and arrive in my pensions Tardis at pension freedoms, now allowing greater flexibility and better death benefits than final salary schemes. Many are now heading towards taking their pension as cash to spend on things they wouldn't ordinarily have, or for the lucky ones with enough of a pot, they can consider drawing an income from it. As a result of these changes, the DC market of default funds needs a considerable review and overhaul, given that in many cases one size does not now fit all of the needs of a workforce where circa 95 per cent invest in the default. Also, a high proportion of defaults may still be heading towards a 75/25 mix of bonds and cash, and that just won't cut it. So as the pensions market migrates from DB to DC, and the investment risk shifts from the corporate provider to the member, there are enormous investment implications. And the DB adage of buy-and-hold may not be appropriate in the new DC world where member engagement is increasing and member investment experience is gaining in importance.

At Natixis, we believe that member profiling and member segmentation, which is the establishment of different member cohorts, are of paramount importance. One size rarely fits all of the population within a scheme and although age-based cohorts are a good start, members may more likely be as interested in cohorts built around their attitude to risk, ethical stance, domestic bias etc. And even within age-segmented cohorts there is argument that the younger cohorts may not want to invest in a buy-and-hold strategy at the highest risk level because limiting the risk of loss of capital is very important to them.

We could consider default cohorts based around the generation game; for instance centennials who are going to live forever, millennials the most knowledgeable generation. Also, there are baby boomers, all set pretty fair with DB and property, while Gen X perhaps need careful consideration as they could have either been very lucky, or very unlucky as they may have neither had a DB scheme or took advantage of early undeveloped DC. So as you can see, there are lots and lots to think about.

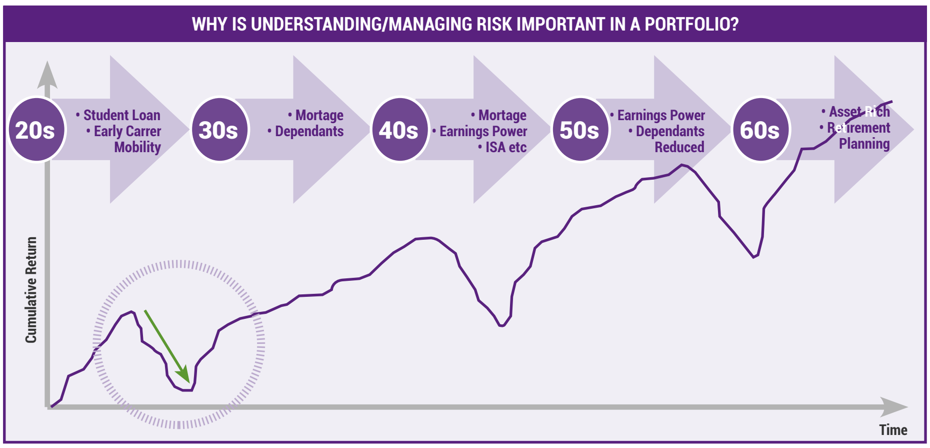
The younger age groups are complicated as they tend to be more mobile and with this mobility, they may be consolidating pension pools and potentially crystallizing or at least seeing the effects of volatility at the wrong time. In some cases a fund might have a third of its value wiped away by a risk event. They may also be more ethically and socially aware than older cohorts. Furthermore, the non-pension investment plans such as LISAs are going to take 'market share' from pension contributions if this cohort isn't correctly engaged and satisfied with their pension investment. In short, we believe that a combination of member profiling and applying a risk-first investment approach to our multi-asset solutions will lead to better member outcomes in both investment experience and return. And why are we suggesting that we turn investment philosophy on its head and put risk first?

Risk is a far more stable indicator of markets. In this instance, we consider the rolling annualised volatility of markets over five- or ten-year periods. When comparing this to the annualised return counterpart, we note that volatility tends to be more stable over time. Applying this logic to specific cohorts we can better manage the risks associated for that group. In particular, we can be better placed to manage future corrections in a way that is more acceptable from a risk perspective for that group. We truly believe that it's not the members that need to be thrown a choice of cautious, moderate and aggressive risk profiles for them to choose, but for the scheme governors to do that choosing for them.

In the chart below, we show how the early years of a member's investment can experience considerable volatility. If this was the start point for a young person starting out on his/her career, entering with piled up student debt and looking for a deposit on a house, they could be easily put off pensions at a critical time because a high-risk strategy was wrongly chosen for this younger cohort. But it could be any cohort.
So we are advocating the use of risk parameters as the main input for asset allocation to manage volatility. For the last decade, the risk profiles of some indexes have been relatively stable – while their returns varied dramatically. Our investment methodology targets a consistent range of risk, rather than a potential range of returns. The result is added predictability and, ultimately, durability in the portfolio. Return, and performance, analysis is important but secondary to risk. Furthermore, the global investor community has migrated from longer term investment horizon to shorter term horizons that tend to have greater emphasis on investment experience, where risk of loss is becoming more prevalent in investment processes.

We believe those responsible for governing employers' schemes have the appropriate knowledge of the schemes' membership (and are better placed) to build an optimum number of risk-first multi-asset default solutions based around specific cohorts that cater better for the needs of a diverse and more demanding workforce. Let's reinvent the wheel!

Written the 18th November 2017



Source: Natixis Portfolio Clarity[SM]

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