Invesco Newsletter

January 2009

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Frequently Asked Questions

With the continuing uncertainty in financial markets, we are receiving queries from concerned members of company pension schemes, in particular from members of defined contribution occupational pension schemes. In order to address some of these concerns we felt it appropriate to put together this Newsletter containing some of the most Frequently Asked Questions.

Q: Is my pension affected by the current turmoil in the financial markets?

A: Probably Yes. Most pension funds are invested to some degree in equities. Equities have fallen significantly in the past 12 months with a direct impact on pension values.

Q: Does this mean I will receive less from my pension scheme?

A: Under a defined contribution pension scheme, the pension you will receive on retiring is related to the value of your retirement account at the date of retirement. Therefore, any drop in the value of your retirement account will have an impact on your ultimate pension benefits. Depending on your investment strategy your projected pension at your normal retirement date may now be less than it was 12 months ago.

Q: How can I make up this loss?

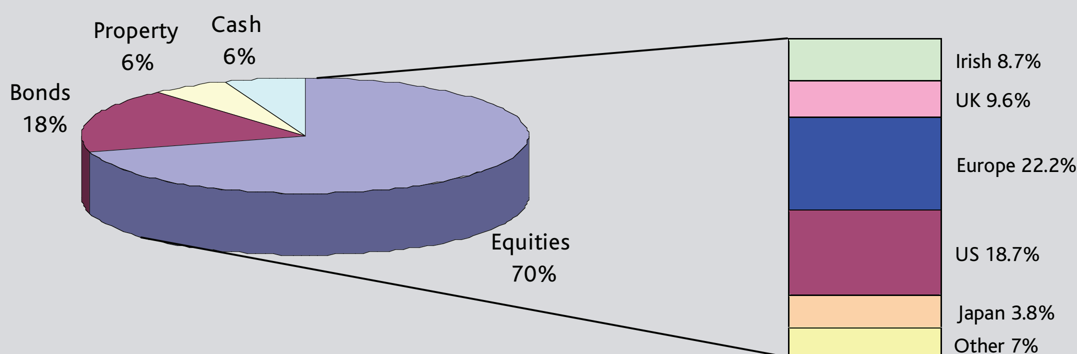
A: If you believe that the projected pension under your company pension scheme is no longer adequate you can increase your retirement account by making Additional Voluntary Contributions (AVCs).

If the investment markets recover and you have remained invested in the markets your retirement account will benefit from the recovery.

Q: What is a Balanced Managed Fund?

A: The vast majority of defined contribution pension members have their funds invested in some form of Balanced Managed Fund. Under the typical Balanced Managed Fund, the investment manager will decide on the split of the fund between the various asset classes. In another words, the manager will decide how much to put into equities, bonds, property and cash.

As at the end of 2008, the typical split was as follows:



As illustrated the average balanced/managed fund is diversified across the various asset classes (Equities, Bonds, Property and Cash) and across the various geographic regions.

Q: What is a Consensus Fund?

A: A Consensus Fund is a Balanced Managed Fund and follows the same strategy as outlined in the earlier question. The difference between a Consensus Fund and a Balanced Managed Fund is the method of picking the actual stocks within the fund. The Consensus Fund tracks a basket of market indices and therefore will hold all the shares within that index whilst the Balanced Managed Fund actually selects shares from the index.

It is important to remember that a Consensus Fund is a Balanced Managed Fund, and will share the same characteristics as all other Balanced Managed Funds, both in terms of the asset allocation and geographic split of equities.

Q: Why does a Balanced Managed Fund invest 70% in Equities?

A: Over the long term, equities tend to outperform most other asset classes. The typical Balanced Managed Fund has a time horizon of 10 years+, and is therefore focused on long term performance as opposed to short term volatility.

To put this into context, we have shown below the returns per annum compound from both the Irish and UK markets over the various asset classes, equities, bonds and cash and compared the returns on these asset classes to the inflation figures over the same period.

(1988-2007)	Ireland		UK	
	Annualised Return	Standard Deviation	Annualised Return	Standard Deviation
Equities	12.5	24.9	10.6	15.6
Bonds	8.3	9.6	8.1	7.5
Property	15.5	11.7	9.6	9.5
Cash	5.8	3.4	7.0	3.5
Inflation	3.0	1.3	3.3	2.1

Source: Goodbody Stockbrokers

As you can see from the table above, equities have outperformed property (with the exception of Ireland) bonds, cash and inflation over the period under review.

However, this out-performance has not been achieved without an element of volatility.

Q: What is Standard Deviation

A: Standard Deviation is a measure often used to compare the volatility of various asset classes. In effect the higher the Standard Deviation the greater the potential for a movement away from the average. So even-though Irish Equities produced the best long term performance figure over the period under review Irish Equities were also the most volatile asset class over the period under review in the table shown.

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Q: How volatile are equities?

A: In the answer to the question above, we highlighted that Irish Equities outperformed Irish Bonds by 4.2% (12.5% less 8.3%) per annum compound over the period from 1988 – 2007. In cumulative terms this is a substantial outperformance. However, it was not achieved on a simple year by year basis.

To illustrate this point we have shown in the table below the actual year on year performance of the ISEQ (index of Irish Shares) over the same period

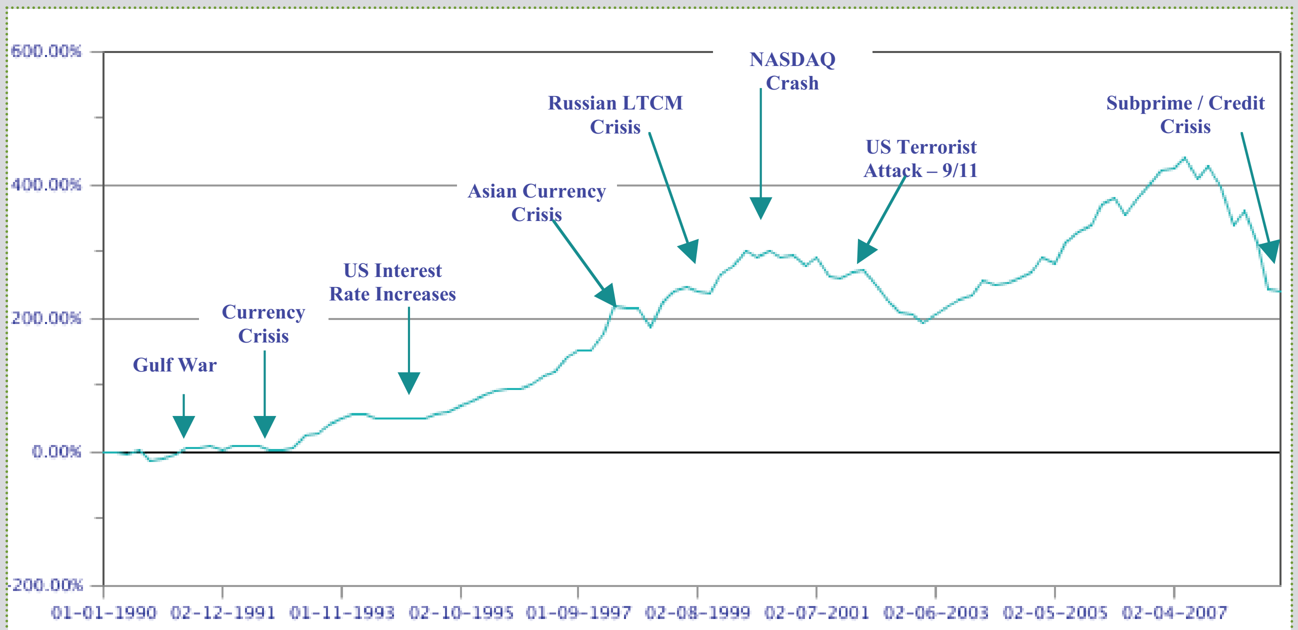
1988	35.3%	1993	53.9%	1998	23.2%	2003	23.2%
1989	27.4%	1994	-2.0%	1999	0.4%	2004	26.0%
1990	-31.5%	1995	20.6%	2000	14.1%	2005	18.8%
1991	14.8%	1996	22.1%	2001	-0.3%	2006	27.8%
1992	-11.1%	1997	48.7%	2002	-30.0%	2007	-26.3%

The average annualized return for the period was 12.5% per annum however during the period the best year was +53.9% and the worst year was -37%.

There are always exceptional events and 2008 has been such an event with the average balanced managed fund (with an allocation of approximately 70% towards equities) producing a negative return of -34% in a 12 month period.

Q: Has this happened before?

A: Yes. Whilst the level of volatility over the past 12 months has been extreme, it is not without precedence. To put this into context we have replicated a chart showing the performance of the average Balanced Managed Fund cover the period 1990 – 2008, and highlighted some of the earlier 'crises' to have impacted on pension funds.



Q: Should I encash all my units now until markets recover?

A: Various studies show that it is very difficult to call the highs and lows in any particular market, and therefore to avoid missing the market highs and lows you are sometimes better off to remain invested in the market. For illustration purposes we have shown the graph below which highlights the returns on the S&P500 from 1988 – 2008.

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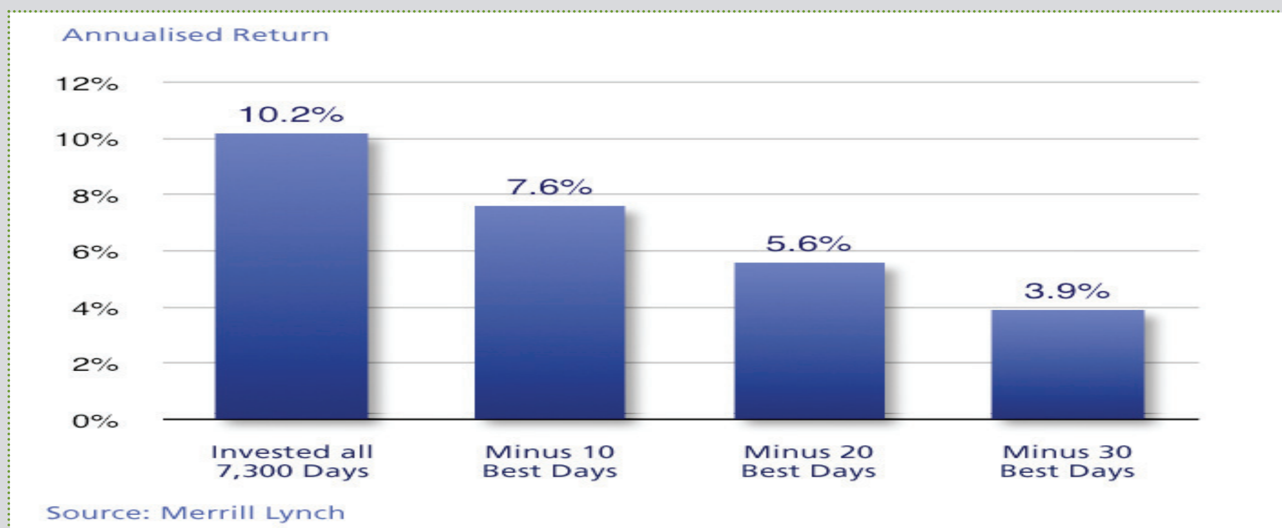

What the graph is showing is that if you remained invested in the market for the full term (7,600 days), you received a return of 10.2 % per annum. However, if you simply missed the 'best 10 days returns' over that same 20 year period, your annual performance figure dropped by 2.6% per annum.

Q: What are my options?

A: In effect you have a number of options.

1. Do nothing and retain your current long term investment strategy
2. Re-direct future contributions to a different fund choice
3. Re-balance your accumulative funds across other fund choices
4. Combination of both 1 and 2 above

Please note that this is not a call to action. We are simply outlining the options open to members. Your personal circumstances (risk tolerance, proximity to retirement, other assets) will dictate which strategy best suits you and we strongly advise members to seek independent financial advice prior to undertaking a strategic review.

Q: Should I be invested in Equities in the period close to retirement?

A: Your personal circumstances should dictate your investment strategy, however, in view of the volatility associated with investment in equities it may be prudent to reduce your exposure to the equity markets as you approach retirement.

Some defined contribution occupational schemes offer a lifestyle option whereby as the member approaches retirement age, the member is automatically moved from an equity based investment strategy towards a cautious investment strategy over a 5 or 10 year period.

We strongly recommend that members within 10 years of retirement should seek advice on the appropriate investment strategy as they near retirement date. An individual's risk profile and personal circumstances will and should dictate an investment strategy.

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