# Time to look East again

## John Redwood on why Asian equity and property investment could be the way forward for DB scheme trustees looking to make some headway with their deficits

It's time to contemplate the pensions black hole again. The latest figures do not make good reading. Private sector pension funds are some £250 billion in the red, if you believe one of the latest snapshots.

All this is the result of a couple of bad years for equity and property investment, aided and abetted by our living longer and a touch of inflation. Each one of those things on its own would send the actuary spinning for the red pen. Put them together, and you have a large deficit.

So often however, the biggest part of the problem is that the asset management has gone wrong. Last year many pension funds reported a return of around minus 25 per cent. What can you say? That is bound to make a huge hole in the accounts. What is the excuse for that?

### Poor performing UK equities

Trustees and their advisers would say it was just a bad year for risky assets, but it is still right to own those more volatile assets because in normal years they will outperform. So are they right?

Unfortunately, they are not. Over the last decade, equity investment in the UK has been bad for long-term funds. Indeed, over the ten years to March 2009, you would have lost money by just buying and holding UK equities over the whole of that time period.

If you had bought and held equities in India and China you would have made good money over the last ten years. Equity values should do better when the shares are backed by strong economic growth. Both the Indian and Chinese markets fell sharply last year. So it seems that now is a good time to buy Asian equity on bad days. Asian equities will probably beat European and American over the next decade, as there still seems to be plenty more growth to look for in Asia.

### Other areas

The last decade was good for UK property, but that market reached a very high level during 2007. Now it is in freefall, with values tumbling and rentals under pressure. It may still be wise to avoid UK property as an asset class, as there is a lot of empty space, a lot of new space coming into the market, and rents should fall further.

UK government bonds fared better in 2008, and produced a better return over the whole decade than equities. Those funds which took their actuary's advice and put more into gilts did better than the more conventional equity-oriented strategies. But now is a time for caution. Lending to the UK government at 3.3 per cent for ten years or 4.3 per cent for 20 years does not look like a good proposition. It could be opportune to take some profits on those gilts, while the government is still around as a buyer through quantitative easing.

Corporate bonds are currently very fashionable. That is fine, as long as there are still many more investors who need to buy the latest fashion to drive the prices higher. Locking into a seven per cent plus yield on a portfolio of high-quality corporate bonds could be a good matching asset for a mature pension fund.

The actuaries will approve, and holding more of them could help reduce the black hole as the actuary will favour such investments.

### Nervous

Trustees can often throw up their hands in horror, thinking it is too difficult to make a decision about asset allocation, or worrying that if they make changes they could be vulnerable to criticism under the regulatory system.

In practise, you cannot avoid having an asset allocation policy. You have one every day and every minute of every day. All the time the markets are trading your asset allocation is being tested and altered by market movements. The old rules of thumb – buy UK equities and hold for the long-term, add some gilts into the mix – no longer work well. The modern complex strategies to manage risk often got into difficulties last year, the very year when they should have worked to stop the losses. 'If you don't understand it, don't buy it' is always a good rule.

So what should you do? With suitable advice trustees do need to review and change their asset allocation as circumstances change. The credit crunch was a huge change to markets and economies. The next problem to think about is the large overhang of public sector debt in both the UK and the US and the impact that may have on bond prices and inflation. Cash can be an attractive asset and has been much underrated in recent years when it has performed well. When looking at the future, and thinking of buying assets with rising income to try to beat the increases in the pension liabilities, trustees should look to both Asian equity and Asian property.

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