PENSIONS

THE IMPORTANCE OF
INVESTMENT PERFORMANCE

Interface

Independent Financial Advisers - Financial Life Planners

ISSUE 12 | OCTOBER '18

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Introduction

If you have monies in a pension or are looking to invest further sums in a pension you WILL be subject to a future rate of return.

Whatever you do, there will be a return on your money. This could be a good return, a poor return, it could even be a negative return.

What do we mean by 'a return?'. This is a description of the rate of interest you will get if the money is held in cash or the annual investment return if your money is invested.

You cannot receive income from the investments so the return you get from the money invested, within your pension, will be capital growth combined (if relevant) with a roll up of any income.

If your invested money performs badly this return could be negative, implying a capital loss not capital growth.

This research guide aims to show you how important this factor is – we will outline some basic illustrations of how much future returns can affect the eventual outcome, how much returns have varied from commonly used pension funds and what you can do to give yourself the best chance of getting the best returns possible from whatever strategy you pursue.

MOST PEOPLE USE RISK INVESTMENTS IN THEIR PENSIONS AND THESE WILL GENERATE A RETURN

So just how much difference do future investment returns make?

One aspect of a pension is – more often than not – it represents a long term investment.

More so than just about any other investment most people will make. This is a very good thing, because it means there is plenty of time to (a) deal with the ups and downs in prices and values that inevitably occur with higher risk asset areas (which tend to perform best in the longer term) and (b) to magnify the impact of extra annual returns.

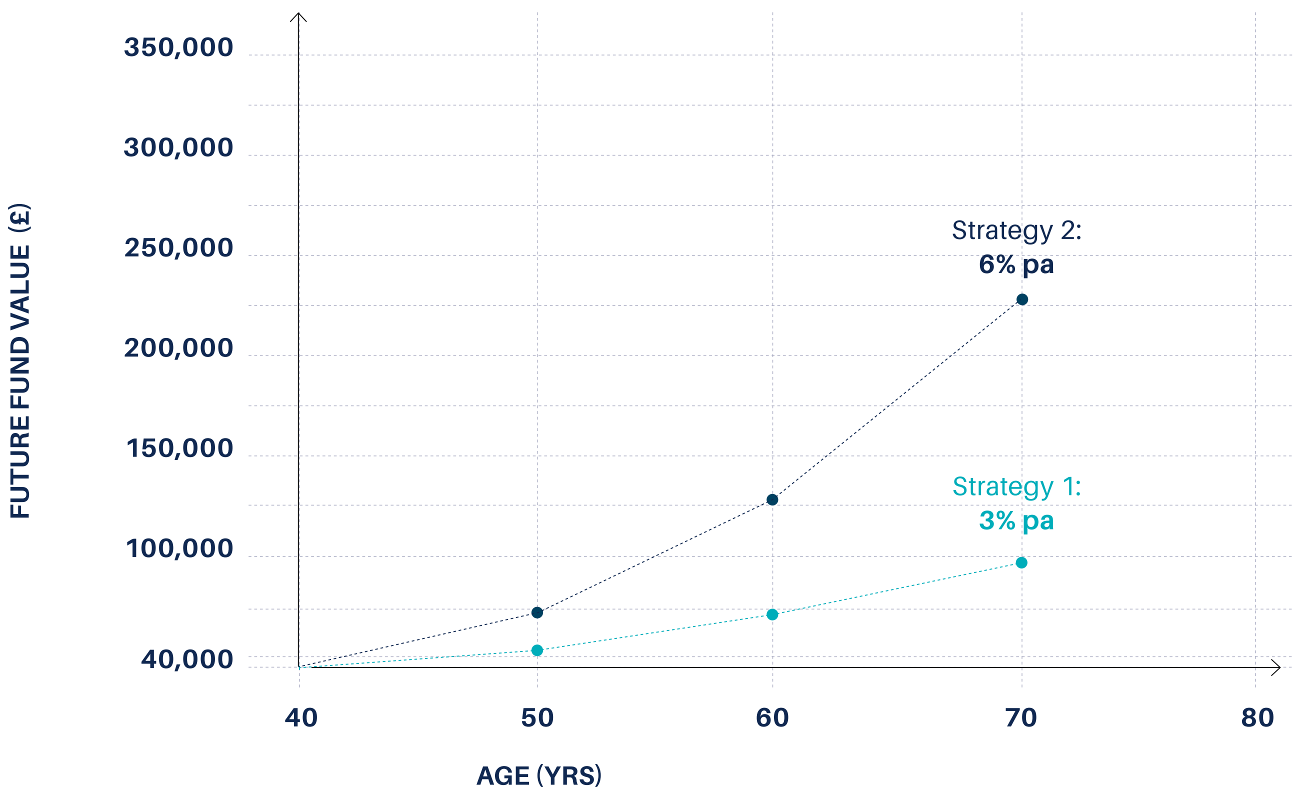
The effect of compounding returns is real and dynamic. Aiming to achieve the best compounding return you can get is a highly desirable objective for any pension investor.

Taking this second point (point b above) on board, this impact can easily be illustrated.

Let us take two 40 Year Old's who have pension funds of exactly the same value today - £40,000. They both have a fresh start with their investment approach starting today.

One invests using a strategy which ultimately produces 3% per year, the other adopts a different strategy and this produces 6% per year. How does this grow their £40,000 fund?

EXAMPLE: PENSION FUND FUTURE INVESTMENT RETURNS



By age 50:
Strategy one investor (getting 3% per year) their fund grows to **£53,756**
Strategy two investor (getting 6% per year) their fund grows to **£71,633**

Now let's look at the difference at 60:
Strategy one investor (getting 3% per year their fund grows to **£72,244**
Strategy two investor (getting 6% per year) their fund grows to **£128,285**

And at age 70:
Strategy one investor (getting 3% per year) – their fund grows to **£97,090**
Strategy two investor (getting 6% per year) – their fund grows to **£229,739**

You will note that the longer time period stretches the difference quite markedly, emphasising the long-term value of the higher return.

We can play with these types of comparison at will. The extra return always produces an ever escalating gap between the two investors' future positions.

Have we illustrated wildly optimistic future returns? No, we have shown the difference between 3% and 6%, both levels which should be considered realistic.

To highlight the trend here even further let us look at the position for a 24 year old saving £100 per month, who will retire at age 67.

At 3% per year their projected future fund will have grown to **£89,700.** At 6% per year their projected future will be **£113,000**

This is all simple mathematics, a demonstration of the differences that can be achieved by obtaining higher rates of growth.

Remember in the real world these differences represent a difference to the future value of a fund of money that is YOURS. The prize for getting better returns is a big prize, one that has direct consequences on the amount of money you will have available in the future.

What makes the biggest difference – time or extra return?

It is interesting to view just how much difference is made in generating returns if we view both time and returns in a separate fashion.

To start with let us look again at 3 investors with £40,000 in their pension funds who have a 10 year time horizon; one of whom gets 3% per year, one gets 6% per year, one gets 9% per year.

Their future pension pot sizes after 10 years:
Investor One (3%) **£53,756**
Investor Two (6%) **£71,634**
Investor Three (9%) **£94,694**

Even over a short period the extra return starts to escalate and compound, however it is time which makes the astonishing differences.

Look at the same investors getting 3% and 6% :

Over 30 years:
Investor One (3%) **£97,090**
Investor Two (6%) **£229,739**

Over 40 years:
Investor One (3%) **£130,481**
Investor Two (6%) **£411,428**

The compounding effect is amazing over time and accentuates the final figures.

Many pension investors will say something along the lines "but I'm 50 and I don't have 30/40 years to invest". This is a fair point, however even a 10 year period delivers a sizeable difference if better returns can be found. PLUS, many pension investors will continue to have their pension pots managed and invested well into their retirement years. The recent changes to how private pensions may be drawn at retirement (the "pension freedoms") mean that many investors will draw on their pension pot slowly, in stages, through retirement, leaving the undrawn part invested. This means a 50 year old may still have an investment approach in place for another 20 years+.

The real world position

How have pension funds performed in the past, what sort of differences in performance have occurred? Can you make a difference?

We can now show you a snapshot picture of how pension funds have performed in different sectors over an historic 10 year period to demonstrate the wild fluctuations that occur and why if you can find good funds with good performance it will make a big difference:

We will show you how much difference this would make to a starting sum of £40,000 ten years ago; investor one achieves top quartile returns, investor two bottom quartile returns.

The conclusions are completely consistent with the exact same comparisons made in 2014 and 2015, plus were re-evaluated in 2018 with the same degree of fluctuation appearing. This shows a pattern which clearly evidences that there are big differences between the top performing funds and the bottom performing funds.

It should be noted that not all funds, even within the same sector, have the same level of risk, an important balancing factor. However adjusting for risk metrics does not change the dynamic, fluctuations in performance are rife, even where the risk rating is considered.

'The following figures are based on bid-bid prices and were assessed on 1st November 2016
Source: *Trustnet.com 2018*

Sector: UK SMALLER COMPANIES

This is a sector which contains funds, where the fund manager invests into smaller companies in the UK.

There are 44 Funds we have tracked with an established ten year performance.

The 10 year average return was 111.4%.

This is 7.6% per year.

However the average of the top quartile (i.e. the best 25%) was 10.3% per year approx.

The average of the bottom quartile (i.e. the worst 25%) was 4.5% per year approx.

You can see therefore that over a relatively short period (10 years) an investor who was in the average of the best funds would have gained around 5.8% more per year than an investor in the average of the worst funds.

Top Quartile Investor £106,614
Bottom Quartile Investor £62,119

On a £40,000 notional starting fund this is around £44,500 more simply for choosing a better fund or funds.

44 FUNDS
111.4% 10 YR AVG

TOP INVESTORS AVG:
£44,500 MORE

Sector: UK INDEX LINKED GILTS

This is a sector which contains funds, where the fund manager invests into UK government index linked gilts.

There are 57 Funds we have tracked with an established ten year performance.

The 10 year average return was 120%.

This is just around 8.2% per year.

However the average of the top quartile (i.e. the best 25%) was 9.3% per year approx.

The average of the bottom quartile (i.e. the worst 25%) was 6.8% per year approx.

You can see therefore that over a relatively short period (10 years) an investor who was in the average of the best funds would have gained around 2.5% more per year than an investor in the average of the worst funds.

Top Quartile Investor **£97,333**
Bottom Quartile Investor **£77,228**

On a £40,000 notional starting fund this is approx. £20,000 more simply for choosing a better fund or funds.

57 FUNDS
120% 10 YR AVG

TOP INVESTORS AVG:
£20,000 MORE

Sector: FLEXIBLE INVESTMENT/MANAGED

This is a sector which contains funds, where the fund manager invests into predominately equities, but with a split to include other assets (e.g. cash and gilts); this is the traditional 'managed fund' that many pension investors use.

There are 77 Funds we have tracked with an established ten year performance.

The 10 year average return was 84.0%.

This is 6.2% per year approx.

However the average of the top quartile (i.e. the best 25%) was 7.6% per year approx.

The average of the bottom quartile (i.e. the worst 25%) was 4.3% per year approx.

You can see therefore that over a relatively short period (10 years) an investor who was in the average of the best funds would have gained around 3.3% more per year than an investor in the average of the worst funds.

Top Quartile Investor **£83,211**
Bottom Quartile Investor **£60,940**

On a £40,000 notional starting fund this is just over £22,000 more simply for choosing a better fund or funds.

77 FUNDS
84% 10 YR AVG

TOP INVESTORS AVG:
£22,000 MORE

THE PRIZE FOR GETTING BETTER RETURNS IS A BIG PRIZE.

Sector: EUROPE EXCLUDING UK

This is a sector which contains funds, where the fund manager invests into companies across Europe but excludes any companies in the UK.

There are 99 Funds we have tracked with an established ten year performance.

The 10 year average return was 83.3%.

This is 6.1% per year.

However the average of the top quartile (i.e. the best 25%) was 7.75% per year approx.

The average of the bottom quartile (i.e. the worst 25%) was 4.54% per year approx.

You can see therefore that over a relatively short period (10 years) an investor who was in the average of the best funds would have gained 3.21% more per year than an investor in the average of the worst funds.

Top Quartile Investor **£84,379**
Bottom Quartile Investor **£62,357**

On a £40,000 notional starting fund this is about £22,000 more simply for choosing a better fund or funds.

97 FUNDS
83.3% 10 YR AVG

TOP INVESTORS AVG:
£22,000 MORE

Sector: UK ALL COMPANIES

This is a sector which contains funds, where the fund manager invests into companies of any size or type in the UK.

There are 135 Funds we have tracked with an established ten year performance.

The 10 year average return was 65.3%.

This is 5.1% per year.

However the average of the top quartile (i.e. the best 25%) was 6.78% per year approx.

The average of the bottom quartile (i.e. the worst 25%) was 3.70% per year approx.

You can see therefore that over a relatively short period (10 years) an investor who was in the average of the best funds would have gained around 3.08% more per year than an investor in the average of the worst funds.

Top Quartile Investor **£77,083**
Bottom Quartile Investor **£57,524**

On a £40,000 notional starting fund this is about £19,500 more simply for choosing a better fund or funds.

135 FUNDS
65.3% 10 YR AVG

TOP INVESTORS AVG:
£19,500 MORE

Sector: UK DIRECT PROPERTY

This is a sector which contains funds, where the fund manager invests into property in the UK.

There are 73 Funds we have tracked with an established ten year performance.

The 10 year average return was 15.0%.

This is around 1.3% per year.

However the average of the top quartile (i.e. the best 25%) was 3.11% per year approx.

The average of the bottom quartile (i.e. the worst 25%) was negative 0.75% per year approx.

You can see therefore that over a relatively short period (10 years) an investor who was in the average of the best funds would have gained around 3.96% more per year than an investor in the average of the worst funds.

Top Quartile Investor **£54,334**
Bottom Quartile Investor **£37,099**

On a £40,000 notional starting fund this is over £17,200 more simply for choosing a better fund or funds.

73 FUNDS
15% 10 YR AVG

TOP INVESTORS AVG:
£17,200 MORE

Sector: ASIA PACIFIC INCL. JAPAN

This is a sector which contains funds, where the fund manager invests into companies across Asia, including Japan.

There are 69 Funds we have tracked with an established ten year performance.

The 10 year average return was 166.6%.

This is 10.4% per year.

However the average of the top quartile (i.e. the best 25%) was 12.9% per year approx.

The average of the bottom quartile (i.e. the worst 25%) was 8.3% per year approx.

You can see therefore that over a relatively short period (10 years) an investor who was in the average of the best funds would have gained around 4.6% more per year than an investor in the average of the worst funds.

Top Quartile Investor **£134,585**
Bottom Quartile Investor **£88,786**

On a £40,000 notional starting fund this is around £45,800 more simply for choosing a better fund or funds.

69 FUNDS
166.6% 10 YR AVG

TOP INVESTORS AVG:
£45,800 MORE

Conclusion

These examples, a sample from the fund market demonstrate that even within sectors there are relatively large variations in performance from the top to the bottom; as described in our opening segment these variations will create sizeable differences in "pot value" over time. An investor who can get the better returns will have a far bigger pot at retirement than investor who gets the lower returns.

Today this is truly significant; because the recent changes in pension rules for private pensions, mean that from April 2015 onwards pensions can be drawn in full (subject to tax) at retirement, they do not have to be turned into an annuity.

Someone arriving at retirement with a pot of £100,000 because they have managed to get a better return than someone else, who has a pot of £70,000, as an example, can enjoy this extra £30,000 as a cash sum (less tax where appropriate).

We have established therefore that returns compound quickly and that even relatively small extra amounts soon start to add up; that differences in returns exist within the fund market – which leads to....

The importance of seeking help and advice

Government changes introduced in April 2015 provide greater freedom for pension investors with a private or personal style pension plan at the point they retire. In brief these changes will allow pensions to be drawn without restriction, at a rate and pace of income to suit that person's requirements.

This is an important change which invigorates pensions, making them incredibly flexible at their most important stage: the stage where they are needed to produce income.

However, this change should not mask what is most important to anyone saving into a pension and looking forward to their retirement: the amount of money that is in the pension will always be the most important factor.

In this respect, this guide has been produced by us to highlight how much difference pension investors can make to their eventual retirement pot and income by focusing on the importance of the return generated year by year.

There is a real, meaningful and discernible "prize" to be gained from concentrating on performance. Most modern pensions are keenly charged – in other words they can be accessed with low or competitive charges – leaving the variation in performance as the likeliest biggest differentiator in how much money will be available in retirement.

Just how does a pension investor get better performance?

The issue that remains therefore is this: it is clear that performance makes a big difference; that there are variations in performance in the fund market and that two investors using similar strategies can and possibly will get very different results.

How can you set out to get the better performance?

Clearly no-one knows what future returns will be from any sector or fund in the market. Likewise there is no guarantee that a good past performance (including out-performance) will be maintained.

This suggests therefore that there is an element of chance around pursuing any mix of fund selection.

This is true, but only to a point. There are ways to focus on better performance and there are steps to improving the prospects of getting superior future returns, naturally these are not guaranteed, but these steps can be employed by anyone. They include:

1. Ensuring that your asset allocation approach is based on your risk profile and tolerance.

2. Using detailed analysis of funds which extends beyond a simple past performance assessment.

3. Ensuring that the funds you use are non-correlated and are diversified.

4. Undertaking a process of regular reviews to monitor and, where appropriate, change any non-performing funds and to keep your approach current to changing fortunes.

5. Having a disciplined and structured approach, and a plan of action which is focused on continually searching out the best funds.

6. Working with appropriate, qualified and quality professionals who will have experience in the selection of funds.

The summary of this is a simple one: improving performance or getting good performance is worth pursuing. It is unlikely to involve any significant increase in costs or charges, however it will inevitably require more time and focus. The outcome if you can achieve this is a higher pension for you to enjoy in your retirement.

History, structure, and expertise

Interface Financial Planning started providing independent financial advice in 1992. From the beginning it had the aim of providing professional advice and quality service to people with modest income and wealth.

Its key value was putting people before profit, and contribution before reward. This mission statement has been our torch to light the path ahead and has been the reason that we have endured for over 24 years.

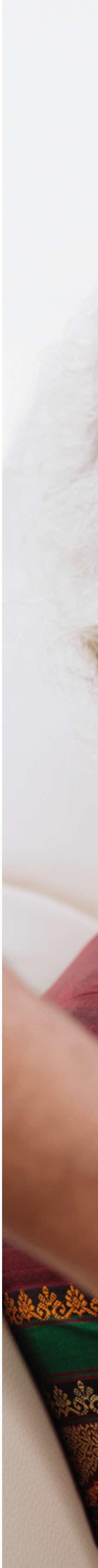
Alan has lead the company with his personal values of: Integrity, Compassion, Respect, & Loyalty, and he is proud that over the years he has worked with clients who share similar values. Like him they want to help others and make the world a little better.

Client care and service is important and he is proud that his first two clients from January 1990 remain his clients today.

We believe that every client should have access to highly qualified advice and expertise.

Technology is used to the full to maximise efficiency and engage expertise from throughout the UK. The business has been paperless for 10 years and for over 5 years has been 'cloud' based. This structure reduces costs and allows support staff to operate anywhere - from Colchester to Honiton to Leicester and elsewhere.

Clients are encouraged to access their online account where they can exchange messages and documents securely. They can view their investments and reports, and they have immediate access to their paper file. Clients love the transparency and openness of being able to view and print paperwork going back for years and many clients use it as a source of reference.



Owner, Director
Interface Financial Planning

Alan Moran is one of the most highly qualified advisers in the UK. He became a Certified Financial Planner in 1995 and he was one of the first Chartered Financial Planners in 2005.

He is a Chartered FCSI, a holder of the IMC certificate and member of CFA UK. His expertise has been called upon by The CII, The IFP, The Kinder Institute, and others, where he has trained and examined other financial advisers.

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Content supplied by: Independent Check Ltd
www.independentcheck.co.uk 2018
Design by: Rae Shirley Photography & Design
Ref: IIP V1 OCT 2018

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