

ifs Student Investor 2009/10 – Worksheet 9

PENSION FUNDS

Pension funds are financial instruments designed to provide acceptable capital and income for retirement. Individuals make monthly payments into a pension fund over a number of years, hoping that the investment is 'safe' and will grow in value. Pension funds are major investors on the stock market. When the investor retires, they receive a monthly income that is determined by how successful the pension fund has been and the amount contributed by the investor. Investment performance is very important to pension fund managers because it determines the ability to pay the fund's liabilities, which are the pensioner incomes.

Activity 9.1

Karen, a 45-year-old teacher, has been paying into a private pension fund for ten years. Her payments are pooled with many others in the fund, which is managed by fund managers – investment experts. When she took out this pension she had the choice of a high-, medium- or low-risk fund – she chose a medium-risk fund. The company she chose in 1997 has 23 separate funds:

- 10 high risk;
- 7 medium risk;
- 3 low risk.

Here's a table summarising five of the funds between 2003 and 2007:

Fund	Invests in	June 2007	June 2006	June 2005	June 2004	June 2003	Average % growth over 5 years
Emerging markets	Shares in emerging market economies	42%	28.8%	7.3%	-6.4%	1.55	13.3%
Japan	Japanese shares	-3.2%	27.9%	-24.6%	-21.5%	-26.9%	-11.7%
UK capital growth	UK shares excluding FTSE 100	11.7%	24%	-7	-16.8%	-12.4%	-1.3%
Property	Commercial property	11.8%	11%	7.7%	7.8%	4.1%	8.4%
UK capital protected	Bank deposits and FTSE 100	6%	1.7%	0.2%	2.3%	-0.2%	2%

The funds can be classified according to their risk:

- emerging markets – high;
- Japan – high;
- UK capital growth – medium;
- property – medium/low;
- UK capital protected – low.

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Karen was advised in 1997 that her pension fund was expected to grow at a rate of 7% per year. Have any of these funds performed that well? Imagine that Karen has asked your opinion about how well these five pension funds have performed over the last two and five years. What would you say to her?

Activity 9.2

The table below gives the average allocation on asset classes (that is, types of securities) of UK pension funds.

Asset classes	Average allocation
UK shares	37.26%
Overseas shares	25.28%
UK fixed interest	14.09%
Overseas fixed interest	2.98%
Index-linked gilts	7.62%
UK property	5.64%
Overseas property	0.05%
Cash and deposits	2.26%
Other	4.81%

Source: www.thepensionservice.gov.uk

We can see that over 60% of pension fund investments comprise shares in UK and overseas companies. Are you surprised with these statistics? Why do you think this is the case?

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Activity 9.3

Imagine that you are a pension fund manager concerned about being able to pay the retirement pension of your contributors 20 years from now. A stockbroker recommends two American stocks. He advises you to buy 99 Cents Only Stores (NDN) and Bank of America Corporation (BAC).

Click on:

www.ft.com

Now click on 'Companies' and enter 'NDN' and then 'BAC' in the 'Quotes' search function. Based on the business profiles of these two companies, decide which stock you would like to buy. Would it be different if you weren't a pension fund manager concerned with the long term? Why?

Activity 9.4

Click on:

www.usshq.co.uk

The Universities Superannuation Scheme is an occupational pension scheme for academic and related staff. Click on 'USS Investments', then 'Investment Types'. Go to 'Top 100 Investments'. What are the top 15 companies that the USS invests in? What do they have in common?

Tip Check which sector each company belongs to.

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Activity 9.5

Click on:

www.eiris.org

Go to 'For Consumers' and then click on 'Pensions'. What is 'ethical money'? What is the significance of this issue for pension funds? Does this issue interest or concern you?

Activity 9.6

Click on:

www.londonstockexchange.com

Go to 'Private investors' and click on 'Tools and services.' What kind of information is available?

Now click on 'Prices & news'. Type 'Barclays' in the quotes search box and click the 'Go' button. Click on 'Barclays' beside the code 'BARC' in the table. Now explore the information available about Barclays shares from this screen.

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