Summary
• Equities, as a whole, have long been vital to pensions, thanks to their growth and income-generating properties.
• While historically pension schemes invested domestically, after the 1990s tax changes, UK equities were no longer more attractive than their global equivalent.
• Over the decades, portfolios have steadily shifted towards global equities so that they now have more overseas than domestic stocks.
• With their differing requirements, DB and DC schemes have adopted different approaches to global equities.
• US stocks dominate the sector, but today's uncertainties, trade wars and policy risks could see Europe taking the centre of the global equities stage.

Global equities: The highs and lows

Sandra Haurant looks at the ever-evolving trends in global equities investment

It is hard to imagine that only a few decades ago, global equities had a vanishingly small role to play in pensions investment. It wasn't until the 1980s that schemes began to branch out of domestic equities and fixed income, dipping their toes in overseas equities. In the 1990s, Gordon Brown removed the tax credit that pension funds had previously been able to reclaim on dividends paid by British companies, in doing so removing an incentive to invest domestically.

Pensions began to look further afield for the returns they needed and, by the middle of the 2000s, pension schemes' portfolios were becoming more heavily invested in global equities than in domestic shares. They had also begun to diversify far more into other asset classes, including real estate and alternatives; a shift that became even more significant after the global financial crisis.

Why global equities?

Equities, in general, have long played a crucial role for pensions, and the benefits they offer as investments have largely remained unchanged. Storebrand Asset Management head of UK, Lauren Juliff, says: "The obvious reasons that pension funds have always invested in global equities are capital growth, income generation, inflation protection, diversification, and liquidity benefits."

One thing that has changed, though, is what pensions need from their investments.

After all, there are significant differences between the requirements of private DB and public DB schemes, and those of DC schemes.

In the private DB sphere, says XPS Investments partner, Alastair Gill, the need for the key benefits that equities offer has diminished. "Because the schemes have matured and will become more legacy schemes and there's not a requirement for future accrual, it's become a much smaller part of the portfolio," he says. "And for many schemes, there are actually no equities left, particularly if they are fully funded."

Isio chief investment officer, Barry Jones, agrees. "The private sector DB has largely moved to bonds – the equity allocations have been drifting down and down; they don't need the returns and they don't need the risk or volatility."

For DC, though, the need for growth – and equities – is still strong. "For DC, global equities are still a fundamental part of the growth phase, and increasingly seen as part of post-retirement drawdown," says Gill. As such, he says: "Portfolios have generally migrated from regional weightings to global (market cap) weightings over the past 10 to 15 years, as regional domiciles became less important in the globalising economy."

Passive and active pursuits

As the name suggests, global equity funds contain an international range of assets, but the lion's share, unsurprisingly, hail from the United States. It's hard to overstate the significance of the key players in that market, the technology behemoths that have become known collectively as the Magnificent Seven. Those companies – Apple, Microsoft, Amazon, Alphabet, Meta, Nvidia, and Tesla – have hogged the headlines as much as they have driven growth in recent years.

The dominance of these players, in fact, has made it difficult for active managers to push for returns beyond the benchmark, according to Jones. "It has been hard to be overweight in the things that were going up, and driving the equity markets," he says. "It's been hard for global equity managers – with global benchmarks – to be overweight in US, as the US makes up 70 per cent of the equity markets. And it is specifically quite hard to be overweight in the Magnificent Seven, because they are simply so big."

Indeed, Gill says: "Active approaches have serially disappointed over the years, hence their declining popularity." In contrast, he adds that passive approaches have gained a huge amount of traction over the years as a great way to deliver market returns at low cost, both in management and turnover cost. While there are, Gill argues, reasons to consider active management, such as a more sustainably focused portfolio, there are many convincing arguments in favour of the passive approach.

In turbulent times

Those seven US tech stocks had been dominating the markets and the conversation, but since the Trump administration came to power in January, there have been plenty of other areas of discussion, and indeed concern. And as a result, some argue that sizeable shifts may be on the way in global equities. Tariffs and unpredictability have had an impact already, and US equity markets were down more than 10 per cent year to date (at time of writing), while German equities have risen by 15 per cent.

"A 25 per cent difference in performance in 10 weeks is noteworthy and already reflects increased pessimism to the US and optimism to Europe," says Royal London Asset Management head of equities, Mike Fox. Indeed, he adds: "Recent weeks have seen a significant dislocation in equity markets from the trends of recent years. This rotation can be thought of as the belief that US exceptionalism and US growth are weakening, at the same time as Europe is awakening from its slumber and China is emerging from a property bust."

But, Fox says: "Most investors are not positioned for a world where Europe and China lead equity returns and, were this to continue, they will need to make significant adjustments. We have begun to see this, with European equities seeing their biggest weekly inflow in 10 years. 'Will this trend continue?' is the question every investor is trying to answer."

WTW multi-asset strategy director, Tessa Mann, agrees: "Since Trump's return to office in January 2025, global equity markets have entered a more volatile and policy-sensitive phase. Initial post-election optimism gave way to a risk-off tone as protectionist rhetoric translated into action. The S&P 500, after peaking in February, has subsequently erased initial gains on Trump optimism. Global indices have been more resilient – the MSCI World is broadly flat, and Eurozone equities have surged, supported by relative political stability." It's a very different picture to that seen in Trump's first term, Mann says. Back then, "equities thrived on tax reform and deregulation", but "markets today are grappling with policy friction, not stimulus".

It's been seen in different ways across different sectors, says Mann. "Technology, initially a leader, has corrected sharply on tariff risks and policy unpredictability. Industrial and consumer sectors exposed to global supply chains have lagged, while defensives – particularly utilities – have offered relative shelter. Energy has held up, supported by the administration's pro-fossil fuel stance, although financials remain under pressure from a flatter yield curve."

What happens next for global equities in pensions?

Markets famously do not like uncertainty, but, Fox says: "Understanding that, in the short term, macroeconomic issues are more important to markets, but that in the long-term micro, company and industry trends are more important, helps." After all, he notes, it is important to understand that very few CEOs adjust their strategies to adapt to short-term news and events – "most concentrate on how they can improve their companies and grow".

And, he says: "Areas such as growth in the digital economy, investment in physical infrastructure, and increasing innovation in healthcare will happen regardless of the events in markets lately. In the end they are likely to be more important than politics and economic data."

Still, with so many turns in such a short time, it's not surprising the effects of the 'rotation' have been dizzying. RBC BlueBay Asset Management senior portfolio manager, global equities team, Jeremy Richardson, says: "It is remarkable how investors' attention has shifted in just a few weeks. At the end of 2024, most were marvelling at US exceptionalism and worrying about levels of market concentration. Today it is the threat of a US recession caused by policy uncertainty that is causing concern and capital to shift to European markets, as governments seek to re-arm." It is, he says "a good reminder of how quickly the market mood can change".

Written by Sandra Haurant, a freelance journalist