Falling behind

Summary
- Many nations' pension assets were found to have decreased overall in 2022 amid global economic uncertainty.
- The UK suffered the largest fall in estimated pension assets of all the countries included in the study.
- Asset allocations have shifted significantly over the past decade, with equity and bond allocations losing ground on alternatives.

Jack Gray reports on the latest *Global Pensions Assets Study* and the findings that make for grim reading for the UK pension market

The most recent *Global Pension Assets Study* by WTW and the Thinking Ahead Institute (TAI) highlighted how difficult 2022 was for pension asset owners. Covering 22 of the world's largest pension markets (P22), the research found they held $47.9trn of assets, as at the end of 2022.

Within the P22, the study included a deeper analysis of seven pension markets (P7), which hold 92 per cent of the assets of all the 22 markets covered. These seven, Australia, Canada, Japan, the Netherlands, Switzerland, the UK and the US, have assets totaling $43.8trn. Outside of the 22 markets in the study, WTW and the TAI estimated that there were an additional $3trn-$5trn of pension assets across 195 pensions markets.

The US was again found to be by far the largest pensions market, with a share of 63.6 per cent of P22 assets, followed by Japan (6.5 per cent) and Canada (6 per cent). However, when assets were measured in relation to GDP, the Netherlands came out on top with a ratio of 165.6 per cent, followed by Switzerland (133 per cent), Canada (130.9 per cent), Australia (123.9 per cent) and the US (121.6 per cent).

Downward trend

Global pension assets took a hit in 2022, with assets in the P22 falling by 16.7 per cent from $57.5trn to $47.9trn. Pension markets such as the US, Japan and Canada saw estimated asset growth rates of -16.8 per cent, -16 per cent and -12.5 per cent respectively during the year.

However, these falls paled in comparison to the loss of asset value in the UK pension market. After

leapfrogging Japan to become the second-largest pension market in 2021, the UK fell two places to fourth in 2022. According to the study, the UK's asset growth rate in US dollar terms was -30.4 per cent last year, the worst rate of any of the countries included in the analysis. Its estimated five-year and 10-year asset growth rates were -3.4 per cent and -1.1 per cent respectively. In British pounds, the UK's asset growth rate was -22.2 per cent last year, as the pound depreciated against the dollar by 10.6 per cent.

Furthermore, it was not only in the past year that the UK experienced pension asset reductions. Pension assets under management in the UK have fallen over the past decade, from $2.88trn in 2012 to $2.57trn in 2022. The only other P7 country to experience negative asset growth during this period was Japan. And while Japan's total pension assets to GDP ratio rose by 22 percentage points over the past 10 years, the UK's ratio fell by 26 percentage points, the largest fall in the P22.

Dominant themes

It will come as no surprise that the wider economic landscape was a key reason for declining global pension assets last year. WTW and the TAI highlighted uncertainty in the investment industry, heightened geopolitical tension and slower economic growth as dominant themes. They also warned that asset owners may find the next period "uncomfortable" and should expect to face the possibility of lower returns for longer. WTW and TAI warned that, in the coming years, the investment industry would face macro uncertainty and systemic risk, a need to reset strategies and to give greater consideration to ESG factors.

Commenting on the report at the time of publication, TAI head, Marisa Hall, suggested that pension organisations will need to adjust their strategies amid the changing landscape, warning that these short-term challenges "cannot be ignored".

She stated: "Last year we experienced, to an extent, a global polycrisis where various risks combined, were amplified as a result, and manifested in significant asset falls.

"It is our view that these systemic risks will increase in future and will emanate predominantly from environmental, societal and geo-political sources.

"While many pension funds are focused on the long term, this situation presents short-term challenges which cannot be ignored.

"The main challenge is that accurate pricing of these risks is near impossible, as they have high uncertainty and low tractability, but their impact is likely to be broad and significant and will test organisational resilience.

"Our work with investors points to transition pathways focused on cleaner energy, fairer societies and greater accountability. As this landscape evolves, pension organisations will need to adjust their strategies and use adaptive capital to navigate these changes and build in future resilience."

Asset allocation

With dramatic changes in the investment landscape, pension organisations have been adapting their asset allocations. A traditional 60/40 equity/bond reference portfolio used for the study returned -17.4 per cent in 2022, highlighting the potential need for change. The average global asset allocation of the P7 was 42 per cent in equities, 32 per cent in bonds, 23 per cent in 'other' and 3 per cent in cash. Between 2002 and 2022, equity allocations have declined from 50 per cent to 42 per cent, while bond allocations decreased from 38 per cent to 32 per cent. Allocations to 'other' assets, such as real estate and other alternatives, rose from 9 per cent to 23 per cent over the same period. Cash remained at around 3 per cent.

According to WTW and TAI, facing lower returns for longer has raised solvency concerns and prompted funds to increase allocations to alternative assets. "With their low correlation to traditional asset classes, alternatives may help asset owners to lessen inflation-induced volatility," the study stated. "As funds attempt to define and access the asset classes of tomorrow, alternatives will play an important role in future portfolios."

DB/DC split

Over the past 10 years, defined contribution (DC) assets have increased by an average of 6.5 per cent a year, while DB assets have seen a slower pace of growth of 2.1 per cent a year over the same period. The pace of growth appears to have slowed, as the rate of growth for DB and DC assets were 7.2 per cent and 4.4 per cent a year, respectively, over the past 20 years.

As at the end of 2022, the Australian and US pension markets were dominated by DC assets, at 87 per cent and 65 per cent respectively, while the UK, Netherlands and Japan were dominated by DB assets, with 81 per cent, 95 per cent and 95 per cent respectively.

However, the UK and Netherlands are likely to see a shift towards DC, as auto-enrolment in the UK continues to bring more people into DC pensions and the upcoming pension reforms in the Netherlands aim to shift focus from DB to DC.

This shift may help pensions become more sustainable, but pension asset owners will have to overcome short-term challenges before feeling the benefits.

Written by Jack Gray