Summary
• Global equities have long been a key pillar of pension fund portfolios, offering growth and income.
• Active managers will aim to beat global equity benchmarks while passive funds track indices – both have advantages and disadvantages.
• DB and DC have different requirements and, within the groups, different schemes have varying needs.
• ESG objectives are an integral part of all global equity investment decisions.

Going global

Sandra Haurant explores the current investment landscape for global equities and the impact of worldwide events on their performance

Global equities form one of the mainstays of pension portfolios, offering funds exposure to the successes of enterprises the world over. We take a closer look at how they fit into investment strategies for defined contribution (DC) and defined benefits (DB) schemes.

Core strength

"Global equities should form the cornerstone of any long-term savings portfolio; they offer capital growth and income generation," says SKAGEN Funds lead portfolio manager, Knut Gezelius. "The total return of the MSCI All Country World Index averages around 8 per cent annually since 1994 – as well as inflation protection, diversification and liquidity benefits."

However, Baron Capital vice president, head of EMEA, Stephen Millar, says the focus on growing assets (through the likes of global equity funds) has diminished for a lot of DB schemes, which have either "moved into surplus, and as a result reallocated to fixed income securities, or closed entirely as a result of being bought out by insurance companies".

Millar adds: "Within DC and local authority DB schemes, global equities should continue to play an essential role, given their inherent ability to outperform inflation over the long term, thereby increasing the income available in retirement that is key to alleviating pensioner poverty.

"Arguably, equities should not only form a significant part of a DC pension prior to retirement, but actually should remain a key element of a post-retirement portfolio, given how much life expectancy has increased over the past few years."

Active versus passive

As with all investment, the choice between active management and a passive approach can have an impact on returns. "Both approaches have their merits. The truly passive approach of investing in a market capitalisation weighted portfolio of all eligible stocks should ensure market-like performance before fees. After fees, modest underperformance should be expected," says RBC BlueBay Asset Management global equities senior portfolio manager, Jeremy Richardson. "The passive approach should ensure that the portfolio always owns the stocks that do the best. However, it will also own the stocks that do the worst, as well as those that are expensive or have questionable business models (if truly passive without exclusions)."

Active managers making decisions, such as opting out of badly performing businesses, should (in theory) ensure better returns than those seen in comparable passive funds, although, Richardson adds: "This requires research that comes with a cost, but also enables extra-financial component of the overall return in the form of active engagement with individual companies."

Nonetheless, while actively managed global equities funds can play a bigger part in engaging with companies, the numbers show that, over time, passive investment is able to provide better rewards. According to Trustnet, passive global equity funds more consistently beat their benchmarks than their active fund equivalents over the decade leading to 2023.

No surprises

Investing in companies the world over means exposure to all manner of events and influences. Anything could, and plenty of things will, happen, with each occurrence having the potential to impact on the performance of a global equities fund. So how do the markets cope with uncertainty brought on, for example, by elections?

"For global equities, the US election this year will be the most significant. Our expectation is that whoever wins will likely have to deal with a split congress. In the past, this has suited equity markets as policy is deemed not to interfere too much with earnings growth," says Cardano senior multi-asset strategist, Ross Barr. "The UK election is less relevant for global equities but the UK equity market may benefit from a change in government and renewed ties to the EU – however, this is likely to be a longer-term story."

In all cases, the markets make assumptions based on what they have to go on; if things turn out very differently, it will react. Think Emmanuel Macron's shock decision to call a snap election in France that could open the field for the far right, for example.

"It's a truism to say that 'surprises' move markets," says Barr. "Before any major event, the market will establish a level that reflects the consensus view of what is going to happen. If this consensus expectation is not met, then the market will move to discount the new reality and adjust upwards or downwards accordingly. A recent example of this is the underperformance of the French equity market relative to the broader European market over the past month."

While markets work on consensus views, those views themselves can be wrong. Gezelius says: "It's very hard to forecast elections or other macro variables with any degree of accuracy. It's better to build a portfolio of strong companies that can perform in different economic and geopolitical environments and thereby deliver excess returns in a range of market scenarios."

It may be true that the markets don't like surprises, but they do have a capacity to absorb many of them, at least over time, suggests Polen Capital portfolio manager of international growth strategy, Todd Morris. "Populism has been on the rise globally since 2016, with voters resonating to provocative messages about change. Reactions versus any prior regime are increasing in frequency, as we're seeing in numerous electoral results. Electoral outcomes may change regulatory and policy backdrops, which may alter the growth trajectory of companies." But he adds: "The impacts of such changes are often marginal."

"Few asset classes can match global equities, particularly over a long investment horizon"

Managers, then, must keep their eyes on the prize in uncertain times. "Our focus remains on the long-term earnings growth of businesses," says Morris. "Elections and politicians will come and go, but enduring businesses will serve customer interests regardless of what direction political winds are blowing."

The long and the short of it

One of the strongest arguments in favour of global equities is their long-term performance. Put simply, Gezelius says: "[…] on a risk-adjusted basis, few asset classes can match global equities, particularly over a long investment horizon." But what about DB pension funds reaching the end of their lifecycles?

Barr says: "Generally, as a DB scheme matures, the volatility and drawdown risk associated with equities becomes less desirable. In this sense they are not a 'long game'. It is likely that a maturing scheme's strategic asset allocation will evolve to include more liability-driven and cashflow-driven investments; gilts and corporate bonds rather than equities."

However, there is no one-size-fits-all strategy, and the balance to be struck "depends upon a pension scheme's funding position and the trustees' objectives as to their endgame," Barr says. "This is especially relevant for schemes looking to access the insurance buyout market; careful planning for buyout is essential."

The ESG question

Where does ESG fit into global equities? Barr says: "The landscape for sustainable investing has evolved. Our advice to pension schemes is that they should carefully consider their own ESG beliefs and goals and commit to a sustainable investment policy that is shared with each investment manager that acts on their behalf." And, he adds: "Each investment manager in turn should be able to demonstrate that their own investment choices, stewardship, engagement and voting activities align with the scheme's sustainable investment policy."

Millar agrees that ESG adds: "Within the management of global equities portfolios specifically, ESG factors should be an integral part of the investment process and assessed at the company level to evaluate how these factors impact both risks and opportunities." He goes on: "Material ESG risks are ultimately critical business risks that have the potential to lead to permanent loss of capital. ESG analysis can also illuminate potential opportunities for revenue enhancement, cost reduction, margin improvement, and improved returns on capital."

Pension funds invest in global equities to ensure solid future returns, but those returns will only materialise if the companies behave responsibly. Barr explains it as "the concept of double materiality"; in other words, the idea that: "The financial risk/reward characteristics of an investment are as equally important as the real-world impact of an investment."

Written by Sandra Haurant, a freelance journalist