Master Trusts Unpacked

Default Investment Strategies

April 2024

Welcome

Welcome to the 2024 edition of Master Trusts Unpacked. This report offers a look back at performance throughout 2023, a year predominantly characterised by high inflation and elevated interest rates. We will delve into how these main trends have shaped the investment landscape and, in turn, affected the various master trust default strategies.

For employers and trustees alike, who are reviewing or selecting a master trust, this report aims to shed light on the nuances of default design approaches and their performance in a year when equity and bond markets unexpectedly bounced back despite adverse market conditions.

Similar to last year, we have decided against naming the individual master trusts in our performance breakdown. Our rationale is that while historical performance is an important consideration, it is not the sole factor valued by savers. We wish to ensure that the overall value proposition offered by these master trusts is not overshadowed.

Looking forward to 2024, we anticipate that investment markets will remain volatile, posing challenges for master trusts. The strategies and lessons applied from the experiences of 2023, particularly how they managed high inflation and interest rates, could significantly influence the widening or narrowing of performance gaps between trusts.

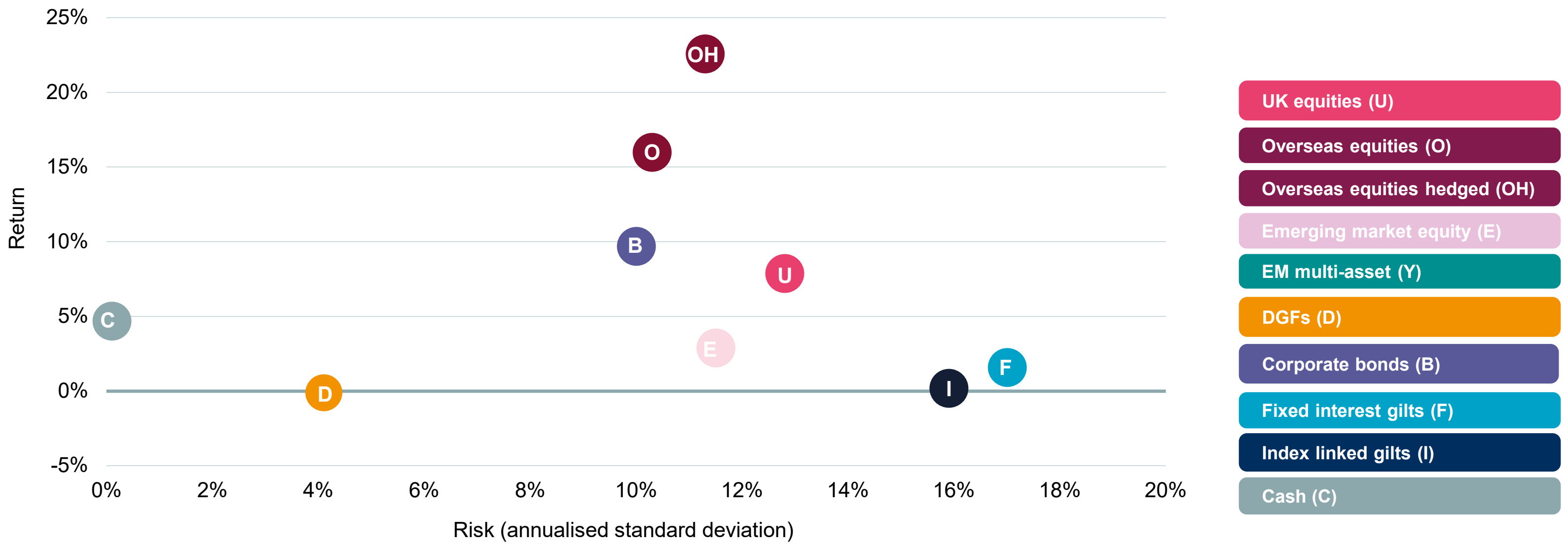
We hope you enjoy reading the report.

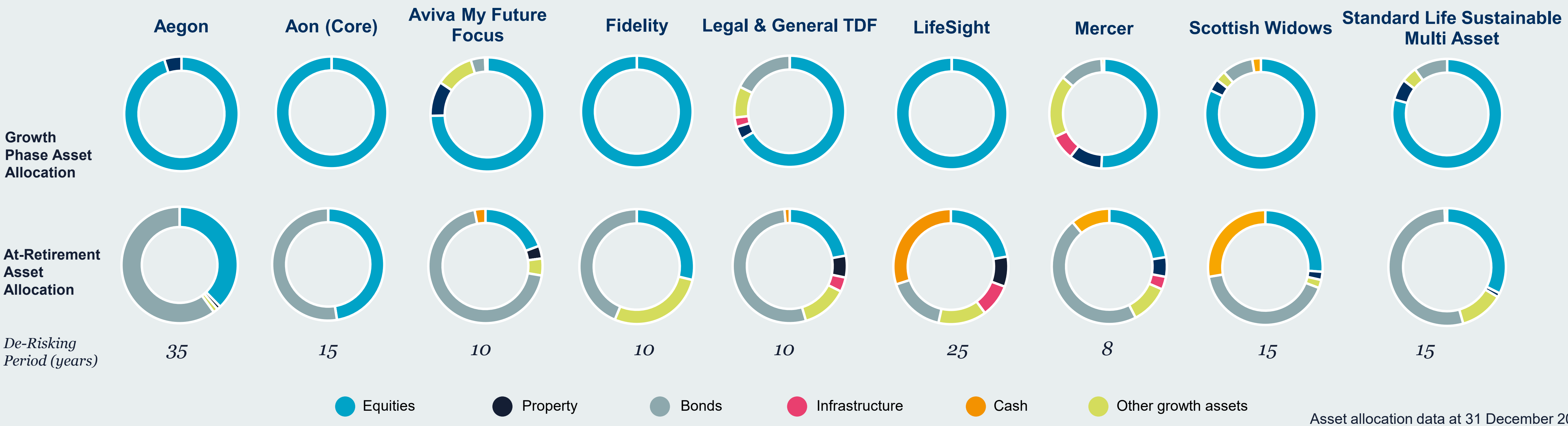
Nigel Dunn
Partner

Magnificent 7 lead equities on charge over 2023

2023 will be remembered as the year that AI fever took hold of global markets and 7 US tech stocks, in particular, benefited from this sentiment. These stocks drove US equities higher, generating a return of 22.6% over the year for Sterling hedged overseas equities. With very low tech exposure and battered by persistently high inflation and interest rates, the UK equity market trailed far behind, with a return of 7.9%. Corporate bonds bounced back after taking losses in 2022 whilst Government bonds continued to deliver high levels of volatility and disappointing returns. Overall, master trusts with high allocations to overseas equities had the best chance of strong performance over the year.

Asset class performance over 1 year to 31 December 2023





Asset allocation data at 31 December 2023

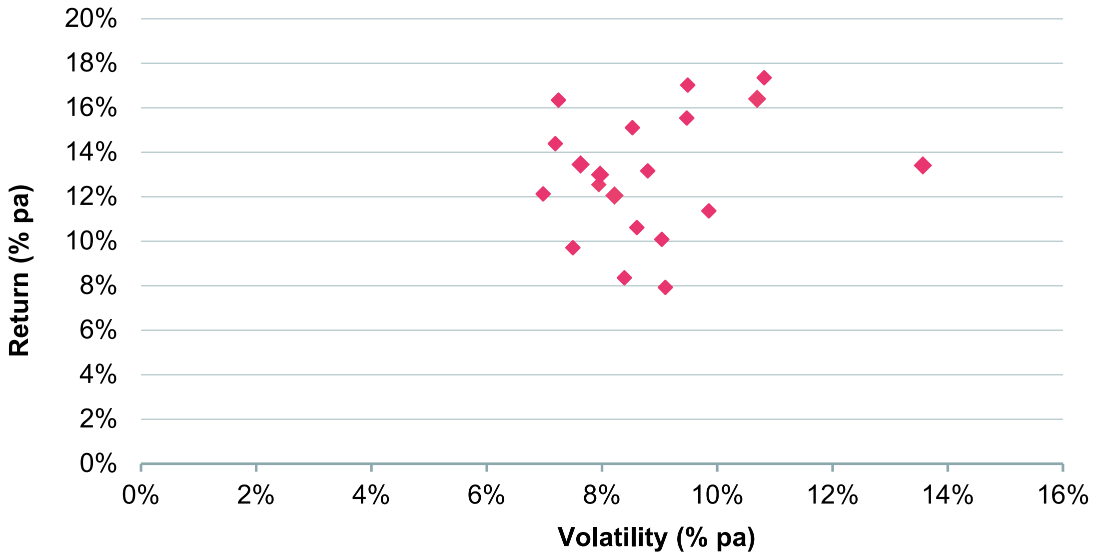
How did master trusts perform over 2023?

Overseas equities provide much needed growth

With overseas equities outstripping all other major asset classes over 2023, it was those master trust strategies that had a high equity allocation that achieved the best performance. As shown on the previous page, many of the leading master trusts have allocated 100% of their growth phase to global equities thus benefiting from the strong performance in this asset class. Master trusts that have taken a more diversified approach saw their performance fall short. The upshot was that the best performing master trust delivered a return of 17.3% vs a return of 7.9% for the worst performer. Government bonds were very volatile over 2023 so master trusts holding these assets for diversification, experienced a bumpy ride.

Strategies with a high allocation to overseas equities performed well, while those diversified into bonds and alternatives lagged the leaders.

Far from retirement - 30+ years to go

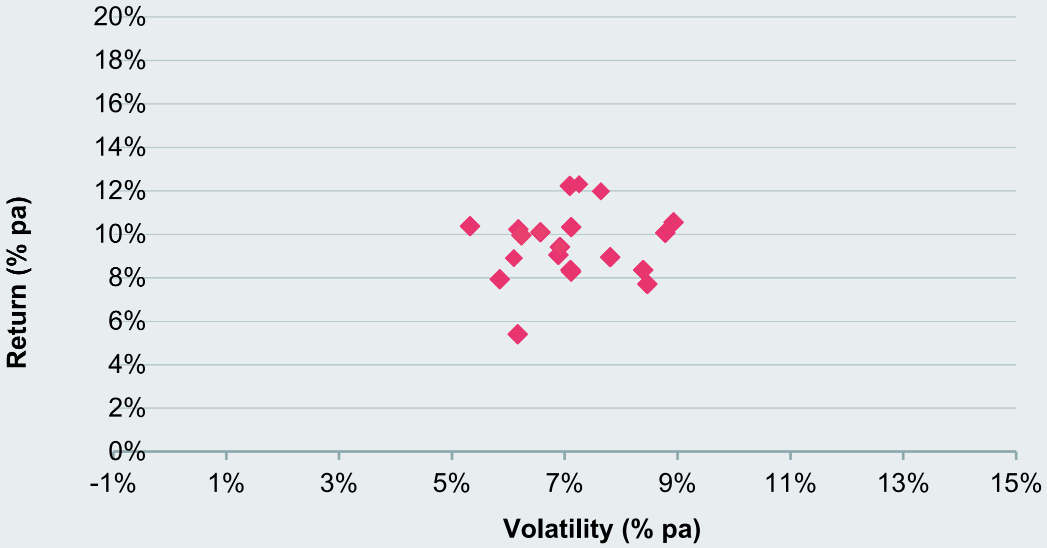


Strong returns but some strategies remain volatile

At 5 years from retirement there is huge potential for capital growth/loss compared to the growth phase as member pot sizes are generally much larger. Performance over this period is critical to member outcomes. Assuming members are cashing out at retirement then poor performance at this stage will not leave members sufficient time to recover their losses. Whilst in 2022 we saw some master trusts experience large losses at this critical juncture, over 2023 performance was much more positive, particularly due to positive returns in the credit market. Returns were tightly bunched as all master trusts use a diversified approach when this close to retirement.

Performance for most schemes was between 8% and 12% for members 5 years from retirement. However, volatility varied between 5% and 10%. Strategies with a high allocation to bonds experienced higher volatility.

Nearing retirement - 5 years to go



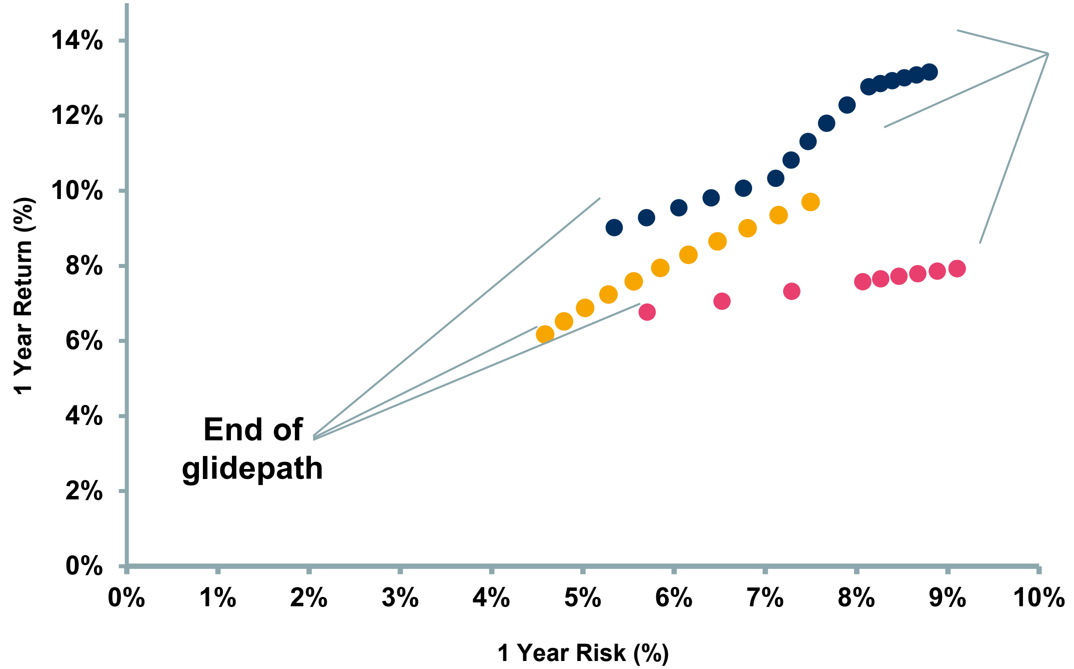
Not all glidepaths are equal

De-risking pace variations expose members to timing risk

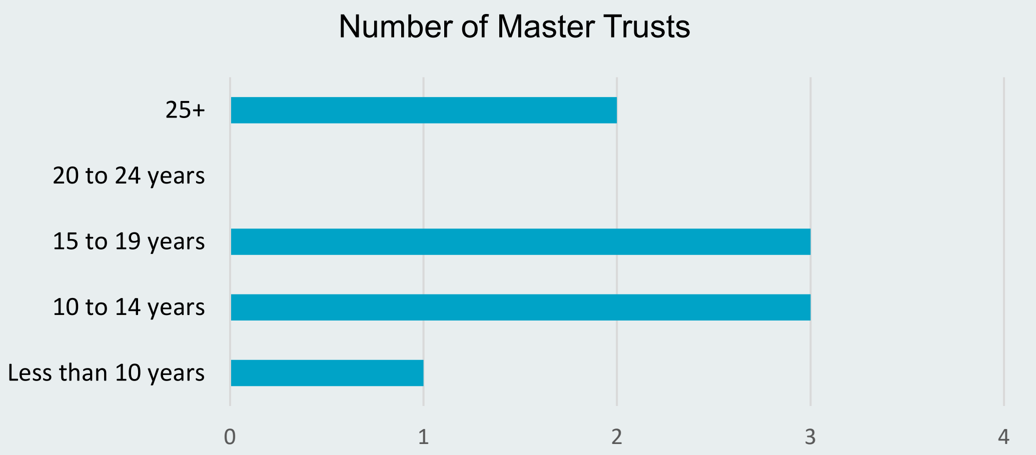
As members approach retirement, they typically move through a glidepath that changes their asset allocation from what is deemed high risk to lower risk assets. The de-risking phase of these glidepaths can be as long as 30 years or as short as 8 years so it's helpful to see how performance varies between these strategies.

Over 2023, long dated government bond returns remained volatile meaning glidepaths using these assets for diversification risk reduction instead experienced higher levels of volatility as shown in the chart. Highly diversified strategies managed these risks better and provided a smoother run in for members.

All glidepaths are not equal and the chart shows how some master trusts delivered a bumpy run in for members whilst others provided a much smoother approach.



Length of glidepath for Master Trust defaults



Equity/bonds strategy
A high allocation to equities in the growth phase produced a strong return but long bonds in the de-risking phase led to a bumpy run in

Diversified with equity focus strategy
This strategy provided a reasonable return in the growth phase and a smooth run in for members as a wide range of assets are used for de-risking

Highly diversified strategy
A high allocation to bonds in the growth phase led to high volatility and low returns. Further diversification in the approach to retirement reduced risk

Which is performing best over longer periods?

Master Trust Quilts - how do they work?

Each coloured section in the quilt represents a different master trust provider's performance over that year (e.g. 2023) or longer term periods (e.g. 5 year pa). Each master trust has been assigned the same colour each year and these are then ranked from best to worst.

Lack of consistency for most master trusts

The quilts demonstrate how performance from some master trusts can vary quite significantly from year to year whilst others have produced more consistent returns. Perhaps what is most striking in both charts is the difference in performance each year of the best and worst performing strategies.

In most years, including 2023, equities have outperformed most other asset classes so those strategies with a high equity allocation both in their growth phase and near retirement have benefited from this exposure. Those with a more diversified approach have seen mixed performance in 2023 and most previous years.

The master trust quilts demonstrate how for some master trusts, relative performance can vary year to year whilst others have produced a more consistent return across the last five years.

Far from retirement - 30+ years to go

2023	2022	2021	2020	2019	3 year pa	5 year pa
17.3%	-3.9%	25.9%	12.9%	23.5%	10.9%	12.8%
17.0%	-6.9%	22.3%	11.9%	23.4%	9.4%	11.7%
16.4%	-7.1%	21.1%	10.1%	23.1%	8.1%	11.3%
16.3%	-7.3%	20.9%	9.9%	22.6%	7.4%	10.8%
15.1%	-7.8%	20.3%	8.4%	20.0%	7.4%	10.7%
14.4%	-7.9%	19.5%	8.3%	19.6%	7.2%	10.0%
13.5%	-8.3%	19.1%	8.2%	19.4%	6.8%	9.9%
13.4%	-8.6%	17.3%	8.1%	19.1%	6.8%	9.5%
13.2%	-9.5%	16.8%	7.5%	18.9%	6.7%	8.7%
13.0%	-9.7%	16.3%	6.0%	18.7%	6.7%	8.1%
12.5%	-9.8%	16.1%	6.0%	18.6%	5.4%	8.0%
12.1%	-10.0%	16.0%	5.5%	18.1%	5.0%	7.3%
12.0%	-10.0%	15.4%	5.2%	17.6%	4.8%	6.9%
11.4%	-10.8%	14.6%	5.0%	17.0%	4.3%	6.8%
10.6%	-11.5%	14.2%	4.2%	17.0%	4.3%	6.7%
10.1%	-11.6%	11.7%	4.1%	16.6%	4.1%	6.6%
9.7%	-11.9%	11.5%	3.2%	16.0%	3.3%	5.5%
8.4%	-12.8%	11.2%	2.3%	15.6%	2.2%	5.3%
7.9%	-19.5%	8.4%			1.8%	

Nearing retirement - 5 years to go

2023	2022	2021	2020	2019	3 year pa	5 year pa
12.3%	-5.0%	19.1%	11.9%	22.6%	7.3%	10.4%
12.3%	-7.0%	18.8%	11.9%	19.2%	6.1%	8.8%
12.0%	-7.0%	15.1%	8.6%	18.9%	5.6%	8.6%
10.5%	-8.5%	12.6%	8.3%	18.6%	4.2%	7.4%
10.4%	-8.5%	12.3%	6.9%	17.9%	4.1%	6.6%
10.3%	-8.6%	11.6%	6.2%	16.9%	3.6%	6.6%
10.2%	-8.7%	11.1%	6.1%	16.3%	3.6%	6.2%
10.1%	-8.9%	10.7%	6.0%	16.2%	3.5%	6.1%
10.1%	-9.2%	10.5%	6.0%	15.8%	3.3%	6.1%
9.9%	-10.0%	10.4%	5.7%	15.8%	3.0%	5.8%
9.4%	-10.3%	10.4%	5.1%	15.6%	2.9%	5.6%
9.1%	-10.4%	10.3%	5.1%	15.1%	2.8%	5.3%
8.9%	-10.6%	9.6%	4.4%	14.1%	2.6%	5.1%
8.9%	-11.1%	9.2%	3.8%	14.1%	1.8%	4.9%
8.4%	-11.1%	8.4%	3.5%	14.0%	1.7%	4.6%
8.4%	-11.5%	8.2%	3.5%	12.8%	1.1%	4.5%
8.3%	-13.1%	6.6%	2.8%	11.7%	0.9%	4.4%
7.9%	-16.8%	6.5%	2.2%	11.3%	0.4%	0.6%
7.7%	-19.4%	1.3%			-3.8%	

Source: Manager data and Bloomberg. Returns are presented gross of charges for all providers except NEST. TPP, and Scottish Widows where returns are net.

The number of master trusts in the quilts increase from 18 to 19 in 2021.

Is the variation in returns reducing?

What do box and whisker charts show?

The box and whisker charts show the median return as an ‘x’ and the 1st and 3rd quartile returns as the box area. The line at the limits of the whiskers show the highest and lowest data points excluding outliers. Outliers are shown outside of this range as shown in 2022 and 2021 in the charts below.

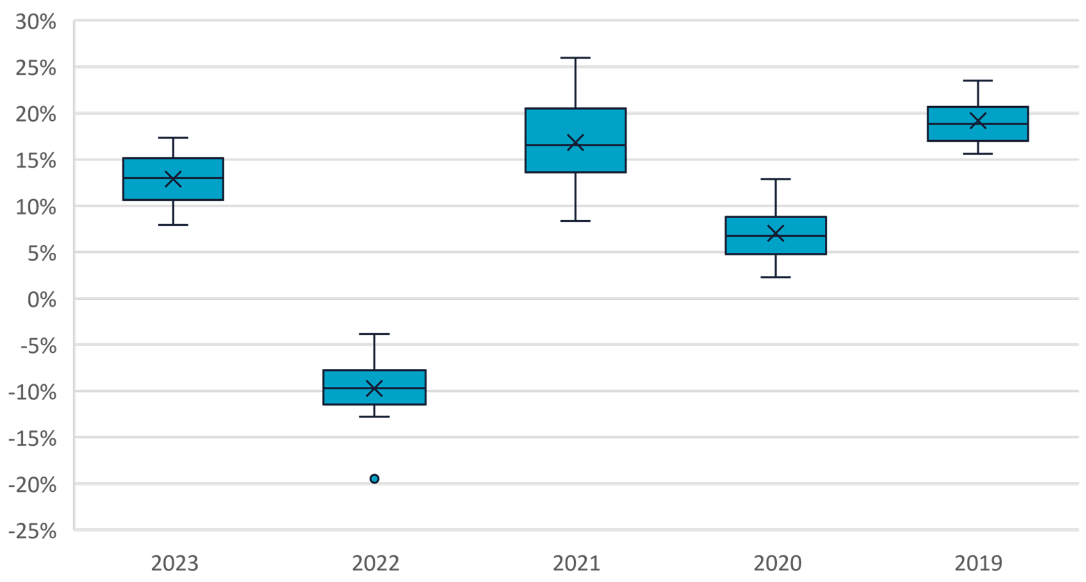
History shows the variation in returns is wider in the growth phase than near retirement as expected. Over 2023, the variation in returns in the growth phase remained in line with historic levels and with no outliers.

Smaller variation between providers near retirement

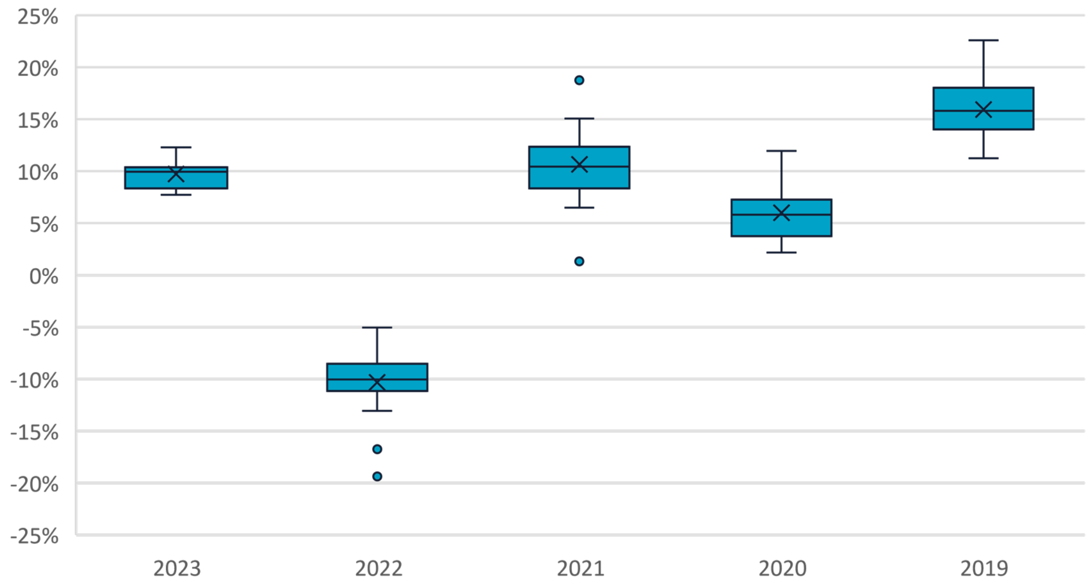
Many providers have reduced allocations to long bonds near retirement after the events in 2022 when bond values fell hard. Over 2023, returns have been much more consistent across the different providers which indicates that providers have adopted similar near retirement investment strategies.

No outliers were recorded in 2023 as most providers reduced allocations to long bonds over 2023, reducing volatility.

Far from retirement - 30+ years to go



Nearing retirement - 5 years to go



Source: Manager data and Bloomberg. Returns are presented gross of charges for all providers except NEST. TPP, and Scottish Widows where returns are net.

What are the key takeaways?

The key takeaways from this year's report are:

- After a volatile 2022, equity markets bounced back in 2023.
- Providers with a high equity allocation in the growth phase produced the best returns.
- Diversification helped some master trusts in 2022 but dragged on performance in 2023 and in some cases increased risk for those master trusts investing long gilts.
- Highly diversified strategies provided the smoothest run in for members approaching retirement.
- Many master trusts have reduced allocations to long government bonds in the de-risking phase which has reduced risk for members approaching retirement.
- Returns near retirement are more consistent between providers, indicating providers are adopting a broadly similar approach to addressing risk in the run up to retirement.

The report has highlighted how important investment design is in delivering good outcomes for members and how analysis like this is required to avoid selecting a master trust with a poor investment strategy.

Looking forward to 2024 and beyond, we expect equity returns to remain key for members in the growth phase with high levels of diversification required in the approach to retirement to cushion members from market shocks.

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