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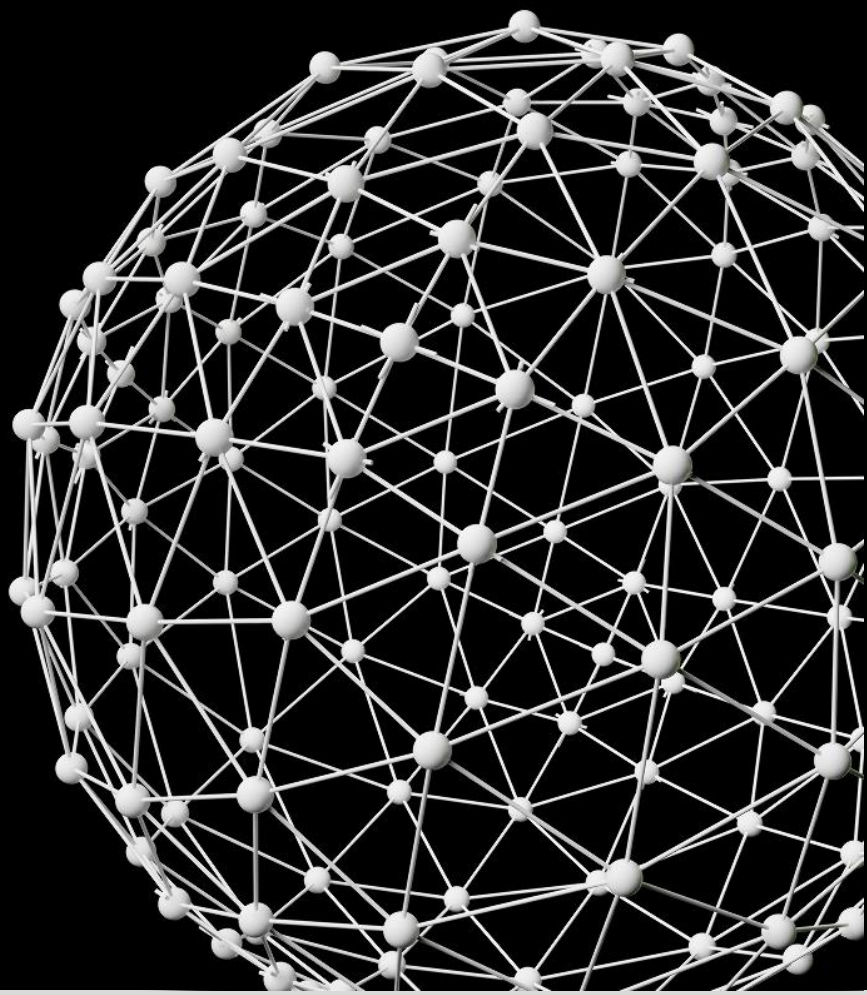
Dealing with market volatility

Key steps trustees can take in these uncertain times

The future direction of investment markets, like the coronavirus pandemic itself, is inherently uncertain. Whilst this presents an obvious challenge for investment decision making, there are key steps trustees can take to ensure they are well-placed to respond to a quickly evolving landscape. By taking a proactive approach, trustees will be better placed to safeguard the benefits of their scheme's members.



Introduction

The coronavirus pandemic has triggered historically significant levels of market volatility whether it be the biggest daily fall in equity markets since Black Monday in 1987, significant swings in gilt yields or the ballooning of credit spreads.

In spite of unprecedented levels of monetary and fiscal stimulus, the economic impact of the outbreak is expected to be both significant and persistent as countries around the world go into lockdown to "flatten the curve" and slow the spread of the virus. As well as the obvious impact on pension scheme asset values and funding positions, these ongoing restrictions have created operational challenges for the average pension scheme trustee.

A lack of clarity over the future spread of the virus makes it difficult to predict what investment markets might do next. In such uncertain times it is particularly difficult to make decisive changes to scheme investment strategies. There are however a series of actions trustees should consider taking to facilitate more timely decisions and ultimately preserve the security of member benefits.

Please note that the list of suggested actions on the following page is in no way exhaustive and we encourage trustees to work closely with their investment advisor to address those items relevant to your scheme.

Key actions

Monitoring

Information is key when taking investment decisions. In such volatile markets, trustees should ensure that they remain informed and ready to take action as required. Consider what information you require and how frequently you would like to receive it. As an example, you could ask your advisor for formal weekly updates which cover an agreed set of key metrics.

Governance

Does your governance structure enable you to take immediate action as required? Consider increasing levels of delegated authority to investment sub-committees and agreeing the clear processes and template documentation required to facilitate the timely implementation of investment decisions.

Cash availability

Ensure that your scheme has sufficient cash to meet the next 3 pensioner payrolls.

Consider whether you could make greater use of income distribution mechanisms to reduce the need for disinvestments.

To preserve cash adequacy, agree how you will deal with new transfer value requests.

LDI – Collateral sufficiency

Where schemes are using leveraged LDI instruments (e.g. gilt repos or swaps), significant volatility in yields has caused large swings in collateral positions. Talk to LDI managers about leverage levels and collateral sufficiency. Understand whether there is an immediate need for more collateral or the market moves required to prompt a collateral call.

Buy & maintain corporate bonds

Buy & maintain corporate bond (or credit) mandates are becoming increasingly popular and fit particularly well in lower risk, cashflow focused investment strategies.

Whilst such funds might exhibit short term volatility, the emphasis is on cashflow security and whether a bond is ultimately "money-good". With credit spreads widening sharply, trustees should contact portfolio managers to better understand current levels of default risk and the extent of transaction activity in what are typically low turnover bond portfolios.

Multi-asset/actively managed funds

Multi-asset investments such as diversified growth funds, and actively managed funds more generally will be responding to current market volatility in different ways to limit falls and maximise return. Keep in close contact with such managers to understand the key decisions being taken and the resulting impact on returns. As ever, trustees should consider whether active managers are successfully adding value, net of fees.

Property funds

Property funds are typically open-ended but have the ability to limit fund liquidity to restrict outflows. With several funds having already implemented these "gating" provisions, reassess your scheme's availability of "liquid" assets. Consider your scheme assets more generally and whether other investments could see their liquidity impaired.

Illiquid assets

Alternative, illiquid assets typically take the form of closed-ended funds. Trustees should understand the impact of market volatility on current investments, future drawdowns/distributions and return expectations. Note that asset pricing will become more challenging in current market conditions and prices may become stale. Other riskier funds, including private equity, may experience write-downs as company valuations become impaired.

Next steps

Please contact your Deloitte advisor or one of our investment specialists below to consider what actions your scheme should be taking to respond to ongoing volatility in investment markets.

Richard Slater
Email: ricslater@deloitte.co.uk
Tel: 0131 535 7602

Yona Chesner
Email: ychesner@deloitte.co.uk
Tel: 0161 455 8791

Kevin Humpherson
Email: khumpherson@deloitte.co.uk
Tel: 0131 535 7287

Fiona Watson
Email: fiowatson@deloitte.co.uk
Tel: 0131 535 7082