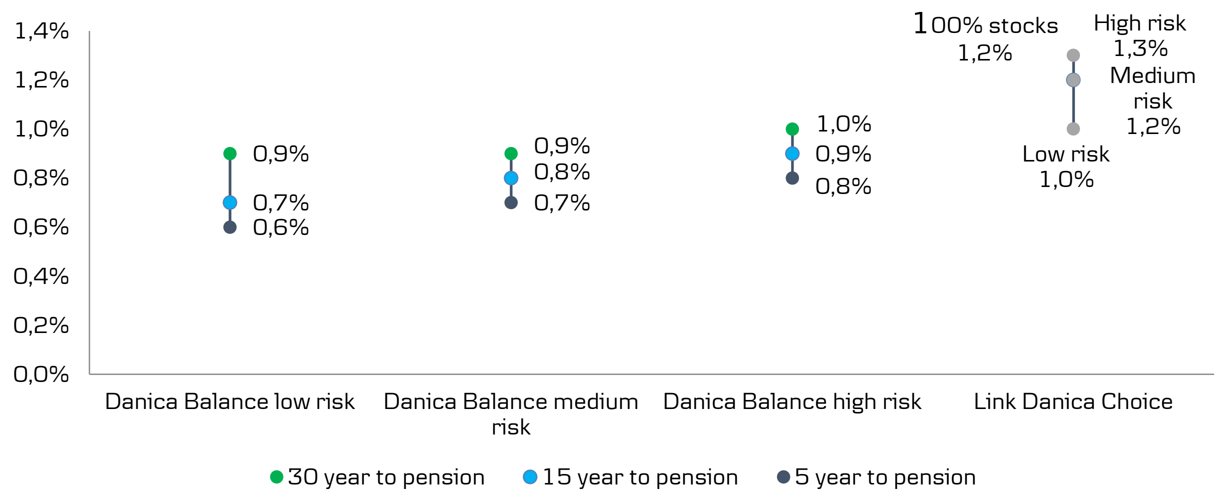
Danica Pension

Markets calm – but more volatility brewing

By Anders Svennesen, CIO

The financial markets trended upward over the summer months, including August, which delivered decent returns for all pension schemes. Equities produced the largest increases of around 1%, while the less risky government and mortgage bonds yielded returns of around 0.3%. Accordingly, customers with high-risk profiles achieved the strongest returns in August, but for 2016 to date, the best returns have been achieved by customers with low to medium-risk profiles.

Figure: Danica Balance Returns in August



CALM AUGUST FOLLOWED BY MORE VOLATILE SEPTEMBER

August was the first calm month in the financial markets following an eventful period surrounding the British EU referendum. The leading US equity index, SP500, saw only minor fluctuations, and the same was true for both US and European bond yields, which moved sideways at very low levels. European equities, however, rose on the realisation that the immediate macroeconomic impact of Brexit proved less severe than initially feared.

We do not expect the calm conditions to continue and, indeed, yields and equity prices are showing some movement again. This is due to uncertainty about what monetary policies the central banks will pursue, as this is the factor that has been underpinning market developments in recent years. At its next policy meeting on 21 September 2016, the US Federal Reserve (Fed) will decide whether to hike interest rates. Also, the ECB surprised the market in early September, postponing a decision on whether or not to continue its bond purchases after March 2017, when the current programme expires. Moreover, a number of political events are coming up in the next few months that could affect the markets. Among these are the US presidential election and a referendum in Italy on constitutional amendments.

GROWTH UNCERTAINTY

Despite the uncertainty, we still expect relatively moderate, but positive, returns for the rest of 2016 and in 2017. Given recent years' large gains in most asset classes, investors will have limited upside potential for assuming risk. The global life expectancy is increasing, there is next to no inflation, and productivity growth, interest rates and investments are at extremely low levels. Finally, US, European and Japanese economic growth rates are disappointingly low. The IMF has termed this the "new mediocre". Whether the low growth is temporary or of a more permanent nature is difficult to say. Even prominent members of the Fed have recently expressed doubt.

If the low economic growth proves to be of a more permanent nature, we expect to see lower long-term returns, and consequently lower returns on pension funds. With lower returns, policyholders will have to increase their pension savings or prolong the period of pension contributions (i.e. retire later) in order to maintain the same level of benefits.

At Danica Pension we strive to make the most of pension savings. We are targeting our investments to ensure the best possible returns relative to investment risk, and we ensure that we take advantage of any price fluctuations to generate higher returns. We are also allocating many resources to pursue our alternative investment strategy, which continues to offer attractive returns and good characteristics for pension schemes. All this helps us ensure the best returns possible in the prevailing economic climate.