

What should an investor buy now to create a solid pension portfolio?

Building for the future

David Burrows

How attractive an option is a self-invested personal pension (Sipp) in the current economic climate? There seem two possible answers.

The woeful performance of some fund managers could have persuaded more investors to take charge of their pension provisions and pick the stocks for their portfolios themselves. Conversely, the market gloom may drive investors into their shells and make them less inclined to take the initiative.

Roger Nightingale, a consultant to Sipp specialists Pointon York, believes so far investors have erred on the side of caution. ‘Psychology is a strange thing,’ he says. ‘It’s true that many pension investors are mightily disappointed with the performance of their fund managers in 2008. But relatively few of them seem inclined to exercise their own judgment in terms of stock picking.

‘Most have opted instead for a more conservative investment strategy: a higher allocation to cash and bonds; a lower one to equities and property.’

However, John Moret, marketing director at Suffolk Life, believes any decline in interest in commercial property has not been as marked as one might think. ‘Normally we would have 250 enquiries in direct commercial property on the go but that has fallen by 10% – so not that dramatic,’ he says.

‘Sipp investors realise that a portfolio is all about diversity over the long term, and commercial property will always be an important ingredient in keeping the asset allocation broad. Even in a bear market like this you do not want to put all your eggs in one basket.’

Diversity is also a theme picked up by Martin Tilly, business development manager and pensions consultant at Dentons Pension

Management. ‘Sipps can be very flexible and help investors diversify risk,’ says Tilly. ‘It is possible to place “alternative” or “non-correlating” assets into a Sipp, such as a short contract for difference (CFD) or hedge fund that can still return gains in a falling market.’

‘It’s all about asset allocation rather than specific investment allocation,’ continues Tilly. ‘Investors can diversify, and consider whether they want to be in equities, bonds or property for example. Being in – or out – of the right asset class at the right time is hugely important, and Sipps provide the flexibility to make these decisions.’

‘experienced and active Sipp investors will have taken advantage of selective buying opportunities’

Evasive action

One could argue a cautious investor with a Sipp might have steered clear of the toxic sectors many fund managers dipped their beaks into too readily. Not just financials, but mining and oils – and we are talking here about some of the so-called ‘cautious managed’ funds here that have posted returns of minus 40% for the year!

Nightingale is not so convinced. ‘Sipp investors certainly had the opportunity to avoid the “bad” sectors but few seemed to do so. Like the professionals, most didn’t notice there was a problem until it was too late.

‘More recently, there have been some instructions to avoid financials (possibly commodities as well), but the sadness is that the weakness of these stocks will have been indelibly embedded into portfolio valuations.’

‘It is true that a number of professional fund managers have

performed shockingly,’ adds Nightingale. ‘How a cautious portfolio can have generated losses of 40% during 2008 is not clear. Perhaps investors should review their legal options. They may have a case for damages arising from mis-selling!’

Mark Allen, a stockbroker with Simple Investments, believes few Sipp investors who dictated the shapes of their portfolios will have avoided much of the carnage that hit pension fund managers.

‘Sipp investors could have benefited if they had put their Sipps entirely into bonds but realistically they would have had to have amazing economic foresight to have done this,’ says Allen.

He adds the benefit of having a fund manager is the investments are diversified. ‘But the trade-off is that it is always “their fund” and therefore it can never entirely satisfy the Sipp investor with regard to its make-up.

‘There is also a danger with a Sipp that you can get into serious hot water trading CFDs, something most fund managers don’t expose investors to.’

Allen argues, however, those Sipp investors who have always been active traders have probably done well as selective stock-pickers in a market that has inevitably thrown up bargains along with the post-credit crunch debris.

‘Experienced and active Sipp investors will have taken advantage of selective buying opportunities as they have always done but the others will have just been sitting tight.’

Where to go?

What offers good value for Sipp investors? People are talking up the corporate bond market and there are opportunities here with spreads widening, but arguably the bargains are at the riskier end rather than in names investors would feel comfortable with.

Even bond fund managers have doubts over some of the bullish statements being made about corporate bonds in the current market.

'We are hearing that corporate bonds are suddenly great value,' says Geoff Lunt, manager of the HSBC Gilt & Fixed Interest fund. 'That may be true but managers need to be very cautious. There is probably a case for saying you could make a lot of money from corporate bonds in the coming years. However, the world is still so uncertain that caution should be very much applied.'

'Credit spreads are wide – but look at the bonds you really want to buy in telecoms, utilities and so on. There aren't many bargains in those areas. Managers are finding it hard to buy. Attractive opportunities are not quite so abundant as some would have you believe.'

Roger Nightingale points out government, not corporate, bonds did best in 2008. The flight to quality led investors to prefer gilts yielding 4.5% to debentures yielding well over 10%. Among long-dated maturities, the former generated returns of around 15%, the latter losses of the same sort of magnitude.'

But he adds, 'I think 2009 will probably be different. Both types of bond look set to fare well – driven by negligible, possibly negative, inflation and the absence of private sector borrowing.'

Lunt agrees gilts are currently a viable option for Sipp investors but warns this is a rare volatile period for them.

'There are two main forces on the gilt market,' he says. 'On the one hand the economy is in very bad shape and I take the view that we won't see a recovery in the next six to 12 months. As a result, interest rates will remain low for a longer period, which is good for the gilts market. But the other side of the equation is the deluge of supply. The two forces are meeting full-on and the gilts market as a consequence is more volatile than I have ever witnessed.'

He concludes, 'We have seen the market trashed one day and the next day it has bounced back. The gilts market is amazingly complex at the moment and very volatile, which is one of the fundamental reasons we are not taking much risk in durations and yield curve.'

Nightingale dismisses any suggestion this volatility in gilts is unprecedented. 'In the 1950s, when it could be argued the economic circumstances were comparable, government bonds were highly volatile, highly priced and low-yielding. It was said by brokers that gilts were for capital gain and equities for income!'

Stock-picker's paradise?

For the brave Sipp investor, there is the opportunity to buy shares at knock-down prices, but picking the winners is not that simple, especially when each day seems to bring news of another established UK brand going to the wall.

John Moret believes experienced Sipp investors may well be keen to take advantage of buying opportunities but he stresses just how treacherous the current climate is. 'There are some Sipp investors who have the security of other pension arrangements behind them so, to a degree they can afford to take a punt on the market,' he says. 'However, a lot of Sipp investors do not have this luxury.'

'For those who do try and outperform the market, if you get the timing right, great, but if not it could be horrendous. Look at how the share price of **Barclays (BARC)** has behaved.'

Nightingale takes a similar line. 'It's paradiso for the stock-picker who gets it right, inferno for the one who doesn't,' he says.

'The news at the moment is grim, but how much is already in the price? At the low point of the market, sentiment turns on a sixpence. The bulls don't need good news, just a reduction in the bad news.'

Nightingale adds it is always sensible to opt for stocks with good balance sheets (low borrowings, most obviously), especially in difficult times. 'Everybody, of course, is looking for the same thing: for stocks with defensive characteristics (with prices that don't go down); with a strong franchise (an

element of monopoly); with barriers to entry

(preferably patrolled by the government).

'The trouble is nobody is certain which stocks provide these virtues. Banks used to be candidates. Then they weren't. Maybe, in the future, they will be again.'

'In the meantime, go for tobacco – the more the government attacks smoking, the stronger the franchise of existing players becomes – and utilities (old fashioned telecoms, for instance). Braver souls might dabble in technology and finance.'

Horses for courses

Billy Mackay, marketing director at Sipp provider AJ Bell, says Sipp investors use a wide range of strategies that vary according to the market conditions and the client's attitude to risk.

'We have many clients adopting a more cautious approach and while it is always difficult to generalise on investment strategies, global fixed interest, fixed interest, UK gilts and exchange-traded funds have been popular choices.'

At the other end of the risk profile, Mackay is seeing days with record buying activity driven by the level of market volatility. 'October 2008 is a very good example of a month where we experienced significant market falls that coincided with huge trading activity as clients looked to identify value opportunities. We also continue to experience healthy activity in collective investments, with absolute return funds and income funds seeing very decent activity.'

As with many investment decisions, the time frame over which the investment is being made is crucial. Clients have to be prepared to accept the potential loss that comes with potential upside – their risk/reward profile, in other words. 'The current market conditions have been challenging and do test this appetite for loss,' says Mackay.