Your pension and the stock markets

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Inflation. Budget deficits. Oil prices. Recession. Coronavirus. Political turmoil. Currency chaos. Boom and bust. War.

All these events – and more – can unsettle stock markets. And in the short term they can also affect the value of money held in your pension.

Today’s 24-hour cycle of news and information can sometimes make things look worse than they really are. Relax, and read on.

Pensions funds invest in company shares, bonds and property with the aim of helping people like you save for retirement.

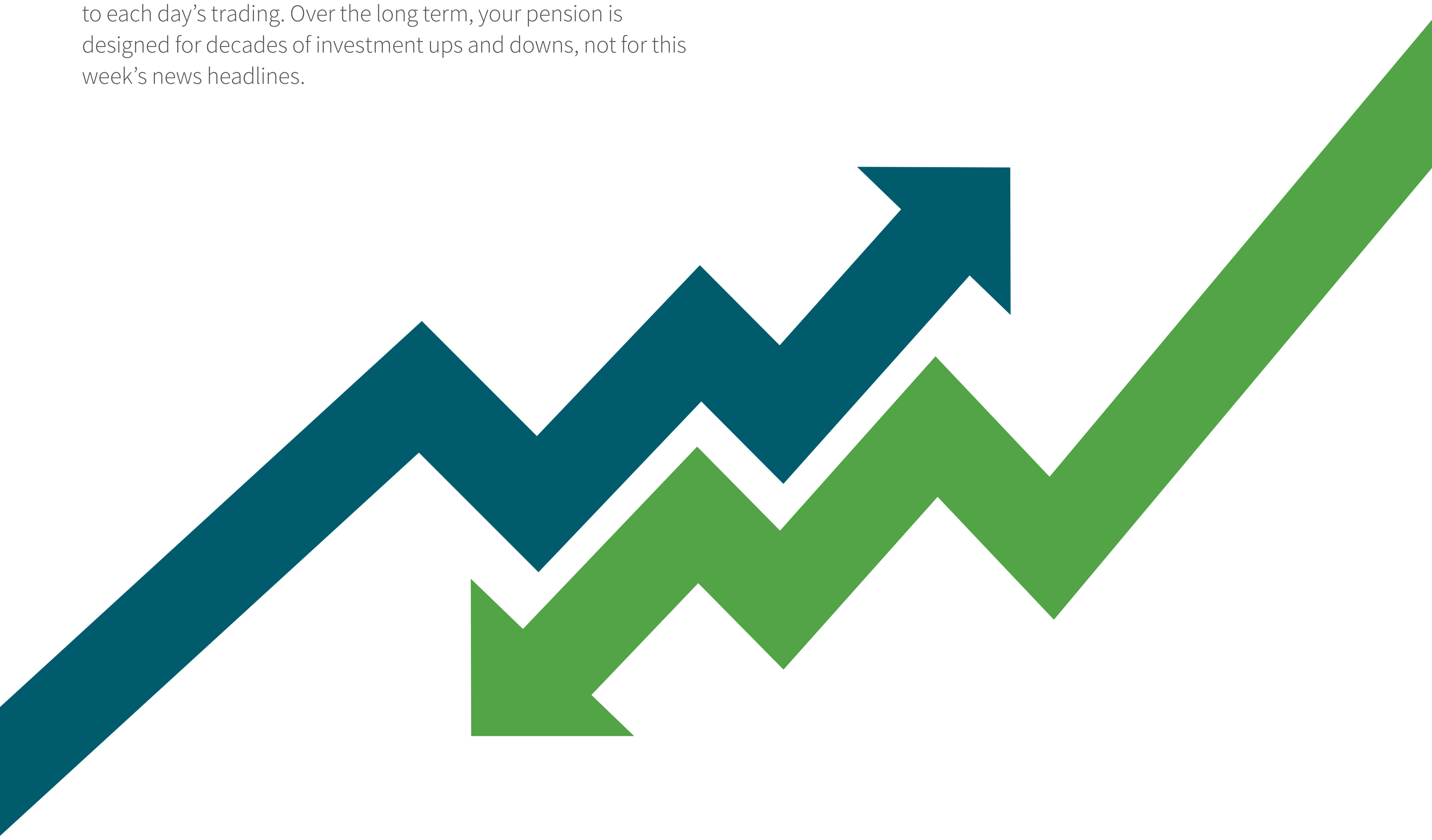
The reason why pension schemes make investments in company shares and bonds, rather than leave your money on deposit is because inflation can – and will – reduce the value of your pension savings over time. That’s why we put your money to work in stock markets and other asset classes, including fixed income, namely government and corporate bonds.

Over the short term, stock markets will rise and fall in response to each day’s trading. Over the long term, your pension is designed for decades of investment ups and downs, not for this week’s news headlines.

Taking the long view, there is one hard truth about investing: nobody knows when stock markets will rise or fall.

We’d all like to find a way around the fact that stock markets and bond markets wobble from time to time, but that goes with the territory.

With investing, the simple fact is that past performance is never a guide to the future and your money is at risk. So, you could get back less than you put in.



Your pension money and investment cycles

Here's the UK's FTSE® 100 stock market index, from 1990 through to the middle of 2020. Often called the 'Footsie®', it's the one you see and hear mentioned on the radio and television and read about in newspapers and on the internet. It measures the latest value of the UK's largest 100 companies (based on their current value), moving up and down from minute to minute, hour to hour on days when people buy and sell shares. Many of these Footsie® companies are household names, such as Unilever and Tesco.

The first thing you'll notice about the FTSE® 100 graph is the shape: it resembles a mountain range with peaks and deep valleys. Steep ravines follow several of the peaks, and then from the valley floor the FTSE® 100 rises to hit new highs. We call these 'investment cycles' and they can be influenced by many different things including good – and bad news – about specific companies; changes in the value of the British pound and other currencies, as well as political uncertainty and unexpected events like the Coronavirus crisis.

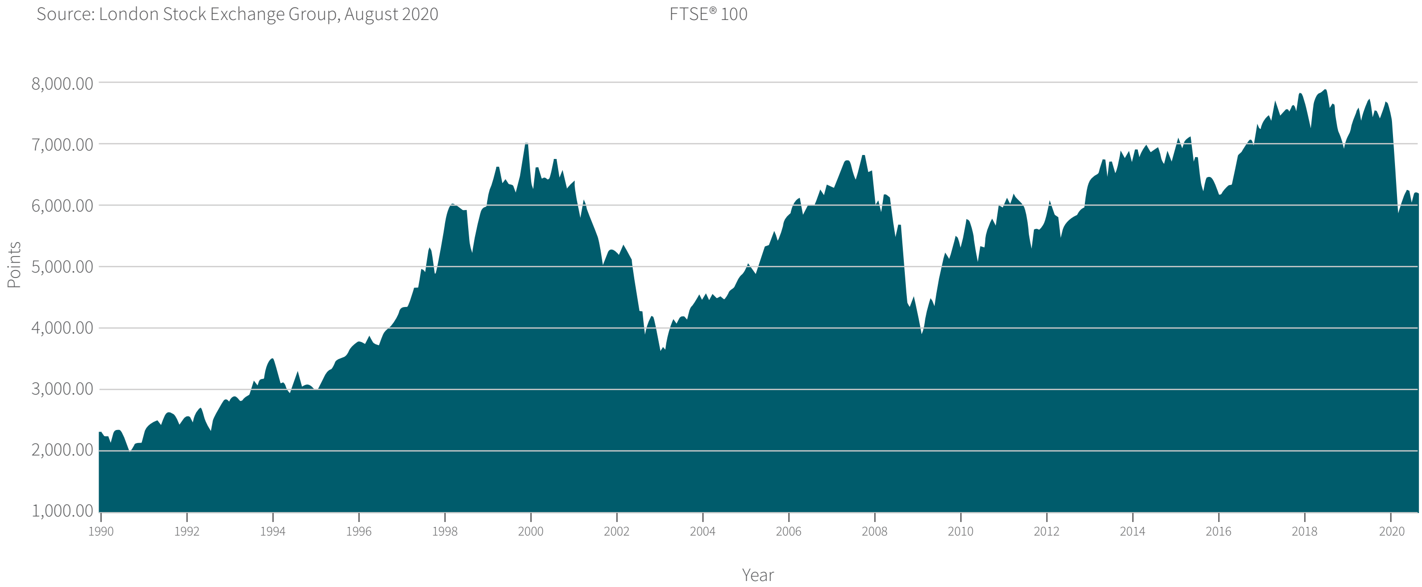
Do people like it when the value of their stake in a company is suddenly smaller than it was the day before?

It's unlikely, but it's all part of investing and this is simply what markets do. The shape you see here is the type of path your pension money takes as it crosses this mountain range from month to month and from year to year as you travel through your journey towards retirement.

If you look closely at the graph, you can see several occasions when the market has fallen and then recovered. But nobody knows exactly when this will happen, and if you had that information in advance, you wouldn't be reading this right now.

One of the advantages of investing in one of these dips is that shares are cheaper than at the peaks. If a company is a successful business and represents good value, this could represent an attractive opportunity for investors and especially stock pickers. In this situation, you simply get more shares for your money than when share prices are higher.

Source: London Stock Exchange Group, August 2020



A reminder about how we manage your money

Governance

Your money is invested in collective investment funds and managed on behalf of Aviva by regulated investment professionals, which the analysts in our in-house governance team have carefully chosen.

Investing always carries a degree of risk and it is impossible to predict and control falls in stock markets. That would be like trying to change the weather. But that's why we have controls in place and only make funds available to you that are managed by investment professionals according to FCA (Financial Conduct Authority) regulations. The analysts in our governance team then review these funds on an ongoing basis.

Our funds can help diversify your pension savings

Basically, we provide a choice of funds that invest in different asset classes to avoid you putting all your eggs in one basket.

As mentioned above, we invest your money in what are known as collective investment funds. As the name suggests, your money is pooled with that of other pension scheme members and the professional fund managers will use it to buy investments such as company shares, bonds and commercial property.

We also offer funds that invest in fixed interest assets. Here's why

There is more to investing your pension money than just investing in company shares. We also invest in fixed interest assets, which tend to be less risky than shares, although they can also rise and fall in value. Fixed interest assets include government and corporate bonds. These are loans issued by the government or a company in the financial markets to boost their finances. Government and corporate bonds pay the holder of the bond regular fixed interest and the full value of the bond when it matures.

Government bonds

Government bonds issued by the UK government are referred to as 'gilts'. If a government or company defaults on the loan, then the interest will not be paid. Gilts are regarded as less risky than corporate bonds as the UK government has a good credit rating. For this reason, it is believed to be in a sound enough financial position to be able to repay the money it has borrowed and honour its debt repayments.

Long-term investment

Pensions are a long-term investment and throughout this journey there will be ups and downs along the way. This applies whether you select the funds you want to be invested in, or you are invested in a default investment solution* for the entirety of your retirement journey. As we've explained, ups and downs in the markets are part and parcel of investing.

For us, taking a long term view is essential. Our pension investment funds provide a wide range of different assets to help manage risk. Investing in diverse assets in different industries in various countries can help provide stability in times of market stress.

*Please note that default investment solutions (where money is automatically invested in funds designed to manage risk throughout the retirement journey on behalf of customers) are only available to those investing in a workplace pension via their employer.

How ‘pound cost averaging’ can help

The coronavirus pandemic has created substantial volatility in financial markets. To demonstrate what can happen to a pension saver’s regular contributions in this situation, ‘pound cost averaging’ can help. Here’s a simple explanation.

What is ‘pound cost averaging’?

In the investment world, regular investing or ‘drip feeding’ is described as ‘pound cost averaging’.

It’s what happens when you invest money at regular intervals, such as your monthly pension contributions. It works by comparing what could happen if you’d invested the same amount of money in your pension in one go. The difference can be significant.

Why is that? It’s the same total amount of money that’s invested.

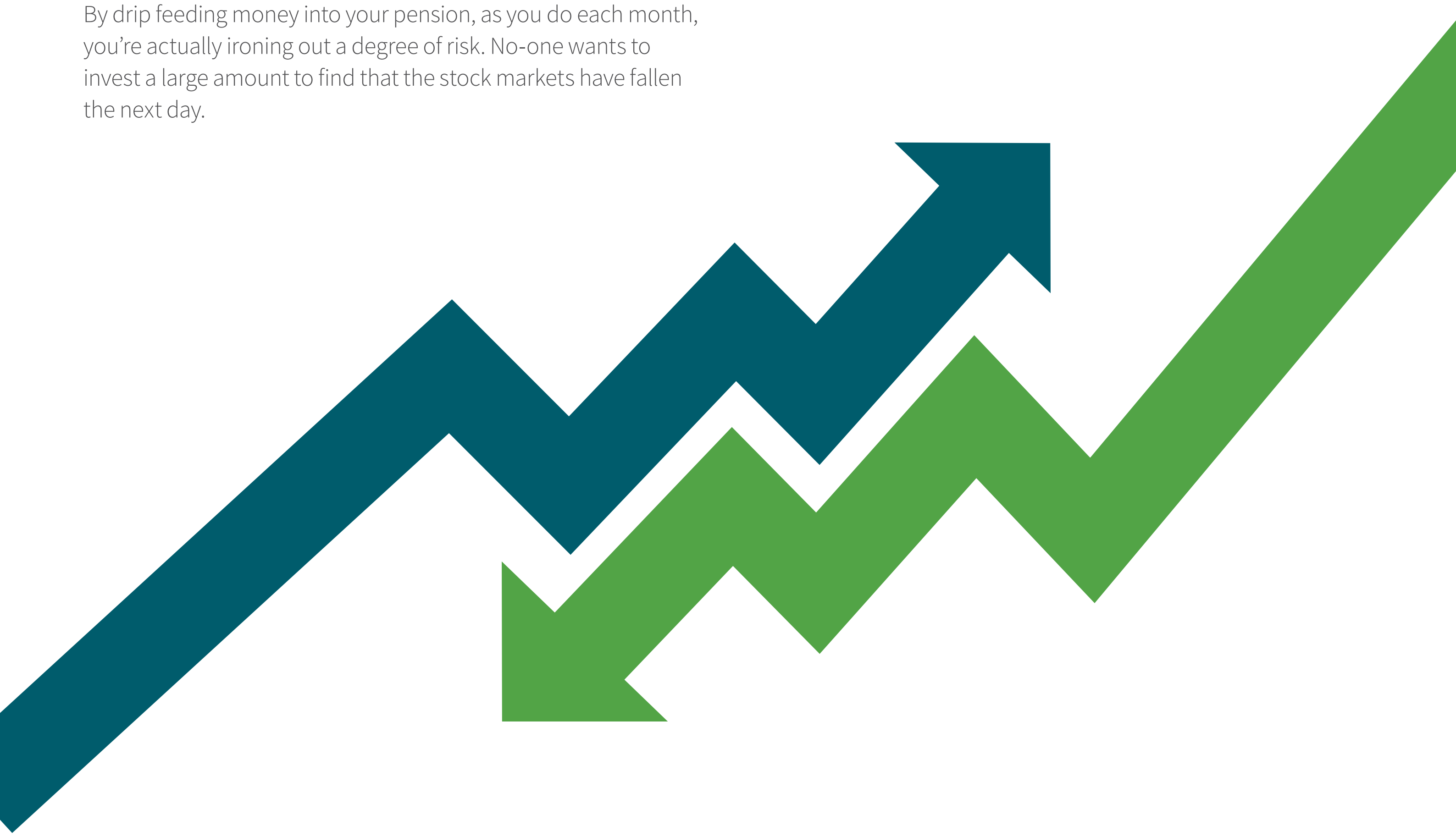
Yes. But the big difference is that the units in pension investment funds move up and down in value. Regular contributions buy more units in a fund when its price is low, and fewer when the price is high. Compare that approach to investing a lump sum. What if your timing is poor and your pension fund has a sharp fall?

By drip feeding money into your pension, as you do each month, you’re actually ironing out a degree of risk. No-one wants to invest a large amount to find that the stock markets have fallen the next day.

But what if I get the timing absolutely right?

Good luck with that. Timing the market is almost impossible. The great thing about investing in your pension each month over the long term is that you don’t have to worry so much about getting your timing absolutely right.

By investing regularly, you average out the price you pay for units, smoothing out the lows and highs. When investment markets are down, your pension contribution buys more units. When markets rise, so should the value of your pension pot.



I'd like a simple example of 'pound cost averaging'. Can you show me some numbers?

Certainly. But bear in mind that what follows is a fictional example. In the table's first three columns, we see what happened to someone investing £1,200 in January. Throughout the year, the unit price rises, falls and rises again. By December, the investor has 1,200 units, worth £1,440.

In the next three columns on the right-hand side of the page, we see our second investor, who has invested the same amount overall, but instead has chosen to do so with 12 monthly payments of £100, instead of all in one go. You'll see that when the unit price dips, more units are purchased. At the end of the year, the regular investor has more units and is ahead with £1,842, so nearly 30% more than the 'one-off' investor. That's the potential benefit of 'pound cost averaging'.

One year	Single investment £1,200			Monthly investment £1,200 (£100 x 12)		
Month	1 - Invested as one contribution			2 - Invested as 12 contributions		
	Amount invested	Fund unit price	Units bought	Amount invested	Fund unit price	Units bought
January	£1,200	£1.00	1,200	£100	£1.00	100
February	0	£1.10	0	£100	£1.10	91
March	0	£0.90	0	£100	£0.90	111
April	0	£0.80	0	£100	£0.80	125
May	0	£0.60	0	£100	£0.60	167
June	0	£0.80	0	£100	£0.80	125
July	0	£1.00	0	£100	£1.00	100
August	0	£0.80	0	£100	£0.80	125
September	0	£0.50	0	£100	£0.50	200
October	0	£0.50	0	£100	£0.50	200
November	0	£0.90	0	£100	£0.90	111
December	0	£1.20	0	£100	£1.20	83
Total	**£1,200**		**1,200**	**£1,200**		**1,538**
Unit value (December)	£1,440 (£1.20 X 1,200 units)			£1,842 (£1.20 x 1,538 units)		

However, **past performance is not a reliable guide to future performance**. Please bear in mind that there would also be charges for managing the fund, which would reduce any potential returns.

Please remember that the value of a pension is not guaranteed. You could get back less than the amount that has been invested.

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