Bank of Ireland
Investment Markets

# Why Fund Investors should expect more Modest Returns

**By Andy Ivory-Corr,** Head of Investment Sales, New Ireland Assurance

Mutual fund investors have done well in recent years, largely thanks to Quantitative Easing. Central bank asset purchases in Europe, the US and elsewhere flooded markets with extra cash, which chased equity yields as the same central banks drove deposit rates to negative returns.

Now the punchbowl is being taken away. The US Fed has a head-start over the ECB in Frankfurt, but the trajectory for both is the same: (QE) quantitative easing becomes quantitative tightening (QT). Fund investors who have enjoyed bumper annual returns in recent years will have to get used to more modest returns going forward.

For the funds industry, the challenge is to manage expectations gently downwards so that Investors don't chase returns by pushing too far out the risk spectrum in search of returns.

New Ireland Assurance, which celebrates its centenary this year, manufactures and distributes life and pensions products and has a market share of around 20% of the life and pensions market. The company has relationships with more than 750 brokers and strategic distribution partnerships with FBD and others. The company expects the life and pensions market to grow by an average of 10% per annum from €1.4 billion Annual Premium Equivalent this year to €2 billion by 2021.

Unlike many of its peers, New Ireland doesn't have an in-house Asset Manager but through research of its Investment Markets division sources the best fund managers globally across various fund strategies and asset classes for their life and pensions platform.

Andy Ivory-Corr, Head of Investment Sales, has a view on the likely trajectory for investment fund returns in the coming years, as he explains in the following discussion.

## MUTUAL FUND INVESTORS HAVE GOT USED TO ANNUAL RETURNS OF 8% OR BETTER IN THE PAST FIVE YEARS. WHAT ARE THE PROSPECTS GOING FORWARD?

Markets have been benign for the last few years and investors have done well by being in markets. But they could be in a bit of a comfort zone, and we expect a lot more volatility in the future. The retail investor is a long-term investor with a very short-term focus, and they have to come to terms with is a lower return environment in the next couple of years.

As a result of the Quantitative Easing that has taken place since the financial crisis in the US, the UK, Japan and still in Europe, sovereign bond yields turned negative and deposit rates are as good as zero. Investors were pushed out the risk spectrum in search of elusive yield. Instead of government bonds, they go into corporate bonds, and when they can't get the return from corporates they go into emerging markets.

As QE is unwound, in the next five to seven years the expected return from bonds will be very different, and the same applies with equities. Part of my role is to concentrate minds on two issues. Firstly, don't expect a level of return similar to the last five years. Secondly, don't expect the benign investment journey that you have enjoyed recently. As the QE medication is taken away from markets, we are likely to see increasing bouts of volatility.

## IN THAT SCENARIO, WHAT ADVICE SHOULD FINANCIAL ADVISERS BE GIVING THEIR CLIENTS?

The adviser or broker needs to realistic about the level of return that different funds are likely to generate, and that realism has to be impressed on the client. From the broker's perspective, they have to get a sense for whether or not the client's expectations for growth over the next number of years are realistic. Then it's a case of finding the correct fund to match the client's growth expectation.

For any investors, the three key questions are: what's your objective for the investment, what's your time frame to achieve that objective, and how much risk are you willing and able to take to try and achieve your objective?

Retail investors' risk appetite is still hugely influenced by the financial crash a decade ago. For a large number of people, when they sit down with an adviser they are coming out at a very low end of the risk spectrum. On a 1 to 7 scale, they are coming out 3s and 4s, and mostly in the 3 category.

If you are a risk level 3, you are not comfortable with high levels of volatility. Therefore you require a lower exposure to risk assets and a much higher exposure to monetary assets such as government bonds. The problem now is that the level of return that this investor has received through QE from government bonds since 2012 isn't mathematically possible for the next number of years.

## STOCK MARKETS HAD A BIG DOWNWARD SWING LAST FEBRUARY, AND THERE WAS ANOTHER WOBBLE IN MARCH. WITH FUND INVESTORS SITTING ON BIG GAINS, WAS THERE A DASH TO THE EXIT?

That volatility was short lived. January gave us almost a year's normal return in a month and in February most of January's gains handed back. People should still be invested and diversified but they need to stick to the long-term plan, and our advice is always that the long-term plan is to remain in markets. Quantitative Easing was a little bit like Christmas every day, and from now on there will be more ups and downs.

## WHAT TYPES OF FUNDS ARE POPULAR WITH INVESTORS AT THE MOMENT?

Multi-asset funds still dominate, but then it depends on whether it's life or pension investments that you are looking at. In the pension arena, savers are not as wary of short-terms risks - they are more inclined to take a longer term view.

Within multi-asset funds, there is no doubt that passive is the favoured strategy in the market right now. A lot of the passive portfolios have been simply picking up the beta of the market. If you look at the world equity market at the moment, roughly 57% is US equities, and under the bonnet of that 25% is financial stocks and 20% is IT, with just over 40% of the tech portfolio comprised of the FAANGs – Facebook, Amazon, Apple, Netflix and Google. With such a significant outperformance of these stocks since 2016, clearly the returns have been generated from quite a concentrated area within the market.

The passive funds are picking all of that up. Some active managers who are more conservative or contrarian, or who are less inclined to follow the FAANG hype, can look like they are under-performing relative to their passive peers.

**Warning: The value of your investment can go down as well as up.**

**Warning: These funds may be affected by changes in currency exchange rates.**

**Warning: If you invest in these funds you may lose some or all of the money you invest.**