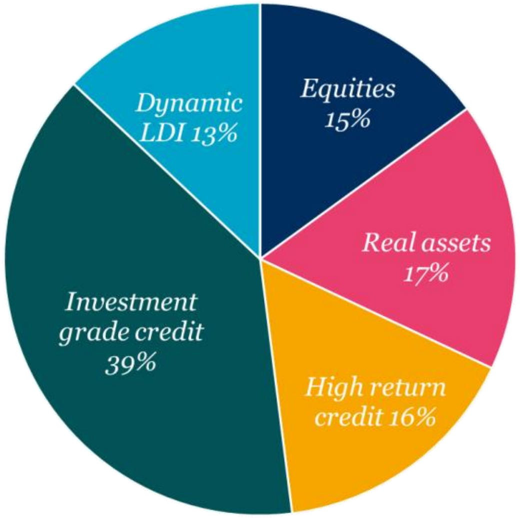
Update on the LCP strategic portfolios

July 2022

Strategic portfolio

Our strategic portfolio highlights the latest ideas from LCP's investment strategy and research teams, and how these ideas can be brought together to construct an efficient asset portfolio.



Expected return:	Gilts + 2.5% pa
Liability hedge ratio:	100% of assets *including future deficit contributions*
Unhedged currency exposure:	25% of assets

Portfolio	%	Change
Investment grade credit	**39**	**+6**
Long dated buy & maintain credit	5	-
Asset-backed securities	12	+2
Short duration credit	10	+2
Synthetic credit overlay	12	+2

Portfolio	%	Change
Equities	**15**	**-**
Synthetic equity protection	8	-
Low carbon global equities	5	-
Emerging market equities	2	-
Real assets	**17**	**-**
Unlisted infrastructure	7	-
Listed infrastructure	1	-
Unlisted global property	4	-
Listed global property	1	-
Long lease property	4	-
High return credit	**16**	**+2**
Opportunistic credit	4	+1
Private credit	2	-
Infrastructure debt	2	-
Emerging market debt	2	-
Multi-asset credit	6	+1
Dynamic LDI	**13**	**-8**

The dynamic LDI portfolio shares an asset pool with the synthetic equity protection portfolio and the synthetic credit overlay, together in a single bespoke fund (totalling 33%).

Expected return based on LCP's latest asset class assumptions, and are available upon request.

Actions we've taken over the quarter

Topped up the Liability Driven Investment (or LDI) portfolio

- The big market impact so far this year has been rising interest rates and gilt yields, in response to the high levels of inflation. In turn, this has meant the LDI portfolio has fallen in value and the LDI portfolio has needed to be replenished to support the liability hedging and overlay exposures.
- As a result, we've decided to partially top up the LDI portfolio by rebalancing the allocations to equities and real assets back to their strategic weights. However, we've opted not to fully top up the LDI portfolio as we view some asset classes as attractive to maintain the overweight positions.
- We are comfortable not rebalancing the LDI portfolio all the way back to the previous strategic weight. We still hold sufficient assets within this portfolio to withstand about a 2% instantaneous rise in long-term interest rates and retain a collateral waterfall structure whereby liquid assets can easily be sold to replenish the LDI assets if market shocks occur.
- The relatively low allocation to LDI is possible in the strategic portfolio because we use synthetic assets (ie some of the equity and credit exposures are accessed through derivatives) to free up cash. Having all these positions brought together into a single bespoke fund maximises the efficiency of the portfolio and reduces the need for any forced selling.

Trimmed the real assets holdings whilst queues to disinvest remain short

- The illiquid allocations have performed well over the quarter compared to other asset classes, which means these have grown as a percentage of total assets and they may start to dominate the investment strategy (reducing the amount of liquid assets available to meet expected and unexpected cashflows).
- As a result, we have taken this opportunity to sell some of the portfolio's illiquid real asset holdings on the secondary trading markets, where pricing remains good.

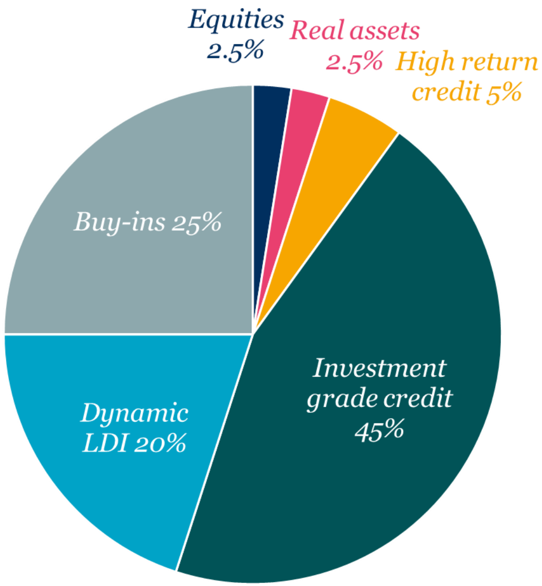
Increased the strategic allocation to credit given the rise in spreads

- In 2021, we held a negative view on credit, with spreads being close to historic low levels. With spreads now having increased towards historical market averages, we have become more positive on credit and see many credit investments as good long-term, contractual investments. For this reason, we have moved to a higher strategic allocation to both investment grade and higher return credit.

Low-dependency strategic portfolio

Our low-dependency portfolio is appropriate for well-funded schemes, which has also been designed to provide flexibility to take advantage of buy-out opportunities.

Portfolio	%	Change
Equities	**2.5**	**-**
Low carbon global equities	2.5	-
Real assets	**2.5**	**-**
Listed infrastructure	2.5	-
High return credit	**5**	**-**
Multi-asset credit	5	-
Investment grade credit	**45**	**+5**
Long dated buy & maintain credit	15	-
Asset-backed securities	13	+2
Short duration credit	11	+2
Synthetic credit overlay	6	+1
Dynamic LDI	**20**	**-5**
The dynamic LDI portfolio shares an asset pool with the synthetic equity protection portfolio and the synthetic credit overlay, together in a single bespoke fund (totalling 26%).		
Buy-ins	**25%**	**-**
Schemes may wish to use a combination of pensioner buy-ins and other insurance solutions such as longevity swaps		



Expected return:	Gilts + 1% pa
Liability hedge ratio:	100% of assets
Minimal unhedged currency exposure	

Actions we've taken over the quarter

Increased the strategic allocation to credit given the rise in spreads

- Similar to the higher-returning strategic portfolio on the previous page, falling yields have caused the Liability Driven Investment (or LDI) portfolio to fall in value and the investment grade credit allocation to increase as a proportion of total assets.
- We have decided not to rebalance the investment grade credit allocation back to the previous strategic weight of 40% in light of the more attractive market levels. We also note a higher credit allocation provides additional hedging against future insurance pricing (eg buy-in/buyout pricing would likely increase if credit prices increase).

Ask your consultant

- What actions should we be taking in response to rising interest rates and inflation?
- What has been the impact of rising yields on the leverage of my LDI portfolio and what plan is in place to reduce the leverage of the portfolio if needed?
- What rebalancing activity should be taken and what opportunities are available to take account of rising credit spreads?

What are pension schemes doing in response to higher interest rates?

In this podcast episode, LCP investment partner Steve Hodder discusses how pension schemes and other investors are reacting to rising interest rates.

LCP's Strategic Journey Planning framework

An effective investment strategy is one component of a successful strategic journey plan. Use our framework to formalise your approach to strategic journey planning: manage risks effectively, capture opportunities, prioritise cost and resource, and ultimately achieve better outcomes for all. Speak to your usual LCP contact about how the framework could apply for you.

LCP Contingent Funding Handbook

Contingent funding solutions for DB pension schemes can be a great way to protect member benefits, as well as other stakeholders of the sponsoring employer. Our report explains how these arrangements are rapidly moving from niche to mainstream due to a raft of regulatory and economic drivers.

Expected return based on LCP's latest asset class assumptions, and are available upon request.

Contact us

For further information please contact our team or your usual LCP contact





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At LCP, our experts provide clear, concise advice focused on your needs. We use innovative technology to give you real time insight & control. Our experts work in pensions, investment, insurance, energy and employee benefits.

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