

Mercer SmartPath™

# Helping DC members through turbulent times



welcome to brighter

Global financial markets started the new decade with the worst quarter since the end of 2008, following the unprecedented synchronised shutdown affecting much of the world economy amid the global COVID-19 pandemic. This has lead to significant focus on the performance of DC defaults over the quarter.

Whilst this update addresses the shorter term performance of Mercer SmartPath we also want to use this as an opportunity to remind investors of the long-term nature of pension savings. We remain confident in our SmartPath approach.

The SmartPath design takes into consideration a number of guiding principles as well as incorporating Mercer’s key investment beliefs. For the purposes of this update we want to highlight the following:



Whole of Life Approach



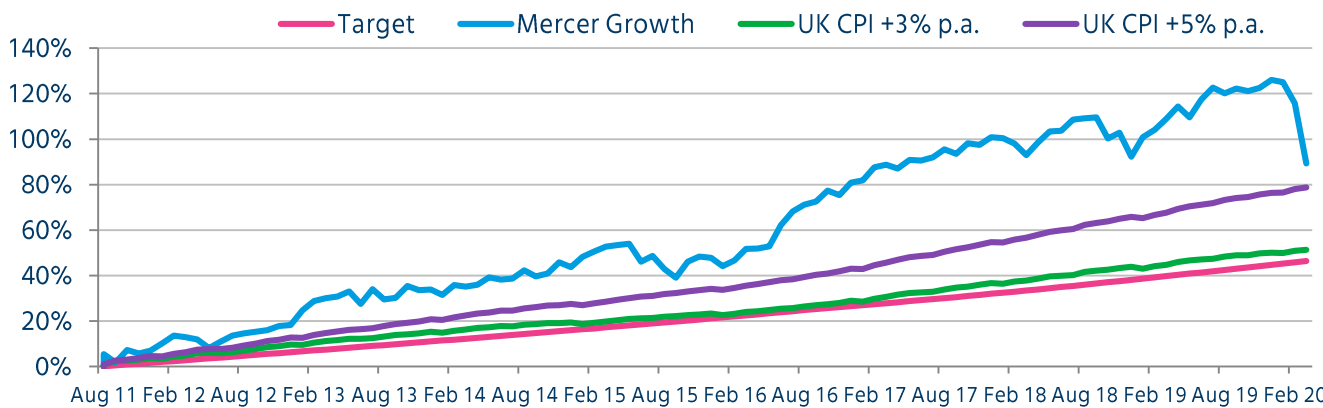
Intelligent Diversification



Dynamic Asset Allocation

## Whole of Life Approach

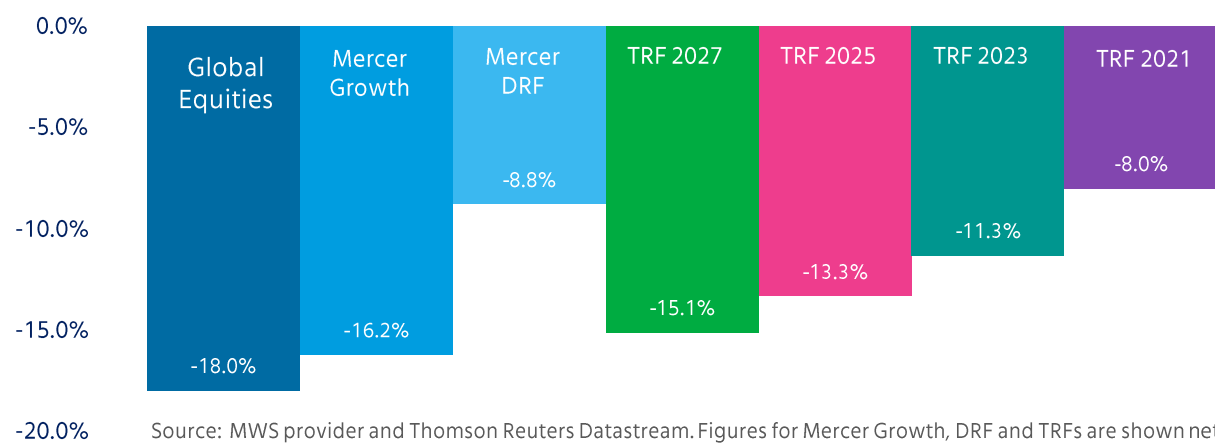
The Mercer Growth Fund is used in the growth phase of all SmartPath solutions. It’s important that during this phase of a member’s life they see an **increase in the purchasing power** of their retirement savings. The chart below shows how the Growth Fund has continued to meet its target and beat inflation over the longer-term, since its inception in August 2011.



Source: Thomson Reuters Datastream and MWS provider. Figures for Mercer Growth are shown net of investment fees. Target taken as FTSE GBP 1 Month Eurodeposit Index + 4% p.a. Performance shown for illustrative purposes only.



As a member approaches retirement and starts drawing an income from their retirement savings it's important to **reduce volatility and risk** in line with member's reduced ability to recover from large market falls. This additional protection is delivered through the Mercer Diversified Retirement Fund (DRF), used throughout Mercer's SmartPath targeting drawdown. The chart below shows how we have protected member value over the quarter, showing performance for Mercer Growth, Mercer DRF and for the target retirement funds for members within 7, 5, 3 and 1 year(s) from retirement. Our target retirement fund aimed at members retiring in 2021 (TRF 2021) experienced less than 40% of the fall seen in global equity values.

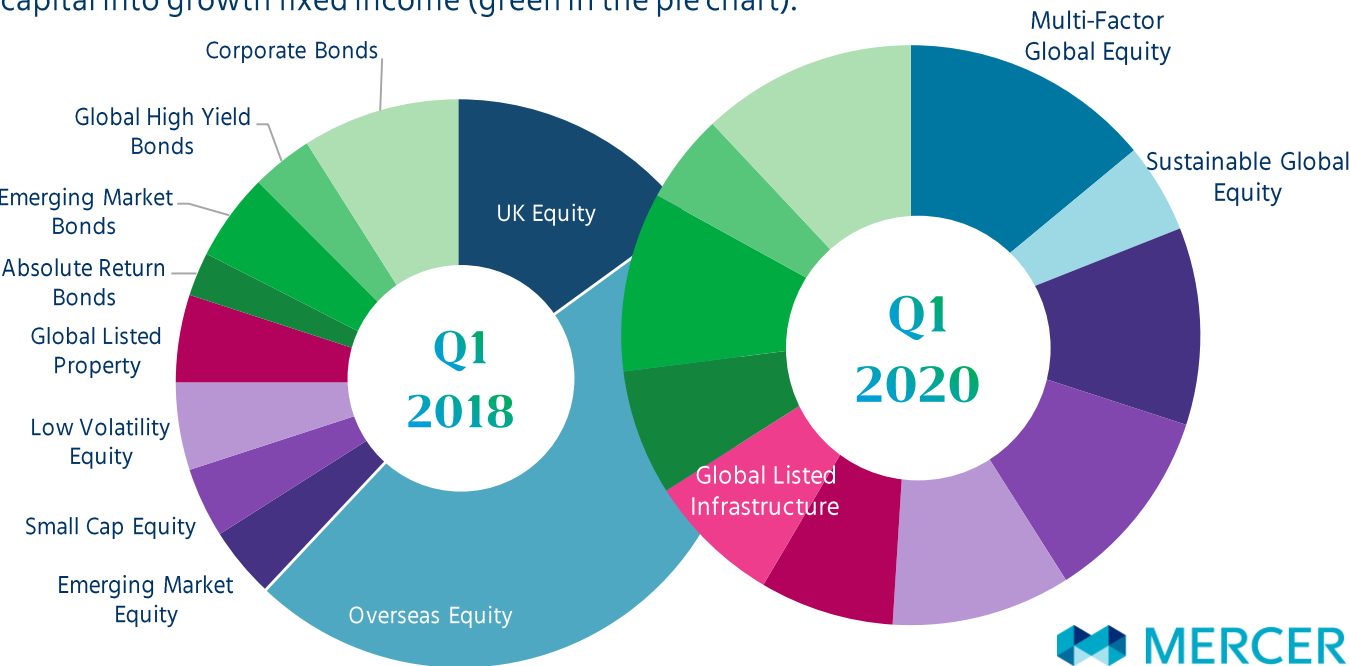


Source: MWS provider and Thomson Reuters Datastream. Figures for Mercer Growth, DRF and TRFs are shown net of standard investment fees. Global equities taken as MSCI All Countries World Index (50% in sterling terms/ 50% local currency terms). Performance shown for illustrative purposes only.

## Intelligent Diversification

**Strategic asset allocation** is the most important decision when designing an investment portfolio and we strongly believe that **genuine diversification is beneficial to investment outcomes**. We are constantly evolving our portfolio, looking for new asset classes and opportunities to diversify.

The charts below show how we have evolved the strategic allocation of the Mercer Growth fund in the last two years. We have **diversified our equity holding** by introducing infrastructure equity, sustainable global equity, and multi-factor global equity allocations and increasing our small cap and emerging market equity exposures whilst reducing our UK equity exposure. We have also **reduced the overall weighting to equities** and redeployed this capital into growth fixed income (green in the pie chart).



# Dynamic asset allocation

Markets can move asset prices away from “fair value” for significant periods of time, medium term **dynamic asset allocation views can add value and mitigate risk.**



## A View from the Portfolio Managers



The first quarter of 2020 was tough for most asset classes, with equities down around c.20%. Markets fared worse in mid to late March, with a significant liquidity squeeze seeing equities, bonds and even gold selling off. As correlations between asset classes tended toward one, diversification benefits in portfolios were muted.

Over the quarter our positions in emerging markets and high yield bonds detracted from our performance. Although our large overweight to emerging market equities detracted from performance versus a neutral position, this was taken via an underweight to other equity classes which also heavily underperformed, somewhat dampening the effect. Whilst we saw some underperformance in our tilts over the quarter, post-quarter end a number of tilts have added value, including some opportunities we tilted towards during the quarter.

With regards to positioning over the quarter, though we remain positive on the narrative of the emerging world, we trimmed our overweight to **emerging market equities** during the quarter amidst our concern that certain countries are ill equipped to deal with the virus. We used the proceeds to buy **developed small cap equity** as it was exhibiting attractive valuations. We also decided to buy **listed infrastructure** as the sharp sell-off had lead to more attractive valuations, and we felt it would likely be a beneficiary from any fiscal reform aimed at restarting economies. Additionally, listed infrastructure companies have inflation linked pricing power, a desirable characteristic in a world where there is a good chance of an inflationary impulse.

The current crisis has led to widening in investment grade credit spreads, and we thought the time was opportune to bring our **investment grade credit** underweight to a neutral level. The high yield market came under intense pressure in the most recent sell off, pricing in a significant number of defaults. We view the pricing as overly pessimistic as we believe governments and central banks will do everything they can to prevent businesses from failing and their credit lines drying up. That, in our view, should limit the extent of defaults and lead to tighter credit spreads. As a result, we increased our overweight to **high yield debt**. We funded the increase to **global high yield** and **investment grade credit** through reductions in **emerging market debt**, **absolute return fixed income**, and a small reduction in **cash**.

Tilts Over  
Q1



Small Cap Equity  
High Yield Debt  
Investment Grade Credit  
Listed Infrastructure



Emerging Market Equity  
Emerging Market Debt  
Absolute Return Bonds  
Cash

# Taking advantage of a recovery

Following a tough first quarter, we have seen a recovery and a more normal relationships return between asset classes. Instead of moving to a completely risk off position in the portfolio during the downturn in March, we were able to position the portfolio to take advantage of this recovery and gain additional value:

High yield bonds had a strong recovery in April, outperforming absolute return bonds, and we expect this position to continue to benefit the portfolio

The position in favour of emerging markets and listed infrastructure is also benefiting performance as we see strong performance in these asset classes

Small cap has had a recovery of almost 12% since the end of March, while market cap equities have returned only 9%, adding to the value gained



**Rupert Watson**  
**Head of Asset Allocation**

Rupert is Head of Asset Allocation for Mercer's investment management business in Europe. He joined Mercer in May 2013 and is responsible for the asset allocation strategy of our discretionary mandates, both in terms of dynamic and strategic allocation.



**Ciara Wyer**  
**Multi Asset Investment Manager**

Ciara is a CFA® Charterholder with over 15 years' experience in investment management. Since joining Mercer's equities portfolio management team in 2011, Ciara has worked across various asset classes and is responsible for the investment strategy and asset allocation of our Multi Asset investments across Europe, Middle East and Africa.

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