How to build the perfect pension portfolio

Times may change but some rules of thumb can help your plan stand the test of time. *Dave Baxter* reports

One obvious benefit to running a self-invested personal pension (Sipp) is the control you have over the underlying portfolio. But such freedom invites a good deal of responsibility, given the huge effect performance can have on your circumstances. So while every investor is slightly different, a few rules of thumb are useful when it comes to building a portfolio.

The rulebook for growth investors

Each investor comes with different goals and circumstances. However, some goals are simpler to achieve than others.

One group with a relatively straightforward task is comprised of those who can simply invest, or stay invested, for at least 15 (and ideally 20) years, without needing to crystallise any income or gains. This can be a broad church: younger investors who are a long way from retirement would fit the bill, but so would those individuals who have other pensions, assets or sources of income that mean they have no need to rely on the Sipp alone. A Sipp can be a particularly good way to pass on assets to your family, given that it won't qualify as part of your estate for inheritance tax purposes – and a pot built with such an aim in mind should be constructed for growth. Seeking to grow your pension by as much as possible makes even more sense in light of the lifetime allowance being abolished.

Such investors often have a 100 per cent allocation to so-called 'risk' assets. In many cases, this will simply translate into a portfolio of equities, although underlying allocations can vary significantly. Henry Cobbe, head of research at Elston Consulting, says investors could follow a tried-and-tested formula of the past decade or so by putting all or most of their money into a global equity tracker and sitting tight. That certainly looks appealing in hindsight: to take one example, the **HSBC MSCI World UCITS ETF (HMWO)** delivered a sterling total return of 176.5 per cent over the 10 years to 16 May 2023. To show how it compares with stockpickers, the average fund in the IA Global sector has returned 128.5 per cent while a typical fund in the AIC Global sector has managed 115.2 per cent. However, those active funds that have ridden the right trends have made enormous returns, with the **Lindsell Train Investment Trust (LTI)** sitting on a 300.8 per cent gain, **Scottish Mortgage Investment Trust (SMT)** on 291.6 per cent and **Fundsmith Equity (GB00B4Q5X527)** on 285.8 per cent.

Those picking a global fund should remember the quirks, what with the MSCI World index having a 67.6 per cent allocation to the US market at the end of April and the UK making up just 4.4 per cent. This can have serious effects on performance in the shorter term: the HSBC World index ETF lost 7.8 per cent in 2022 in sterling terms, due to its exposure to a market loaded up with tech and growth stocks and its low allocation to more value-infused markets such as the UK.

There are simple ways to diversify beyond a single global equity product, either by using other funds alongside it or simply using a global fund with a different approach as a complement. Some trackers, such as those in Vanguard's LifeStrategy range, are known for having a decent bias to UK equities, while a handful of global equity funds have tended to go underweight on the US and turn to other regions. Examples include **Lindsell Train Global Equity (IE00B644PG05)** with its big allocations to the UK and Japan, value funds such as **Jupiter Global Value Equity (GB00BF5DS374)** and a good number of global income funds, which often tend to favour higher-yielding markets over the US. **Murray International (MYI)** has tended to look at regions such as Asia rather than fixating predominantly on the US.

INVESTMENT STYLES HAVE PLAYED A BIG PART IN RETURNS OVER THE PAST FEW YEARS

Investment styles have played a big part in returns over the past few years, with portfolios focused on growth stocks dominating for much of the past decade but value investing latterly showing recent signs of resurgence. Passive funds will rebalance their portfolios over time and belatedly capture style shifts, but investors may wish to oversee such changes themselves by holding complementary funds together. While certain regional equity tracker funds can act as a proxy for particular investment styles, active funds can also balance each other out. Our tables show how some funds with different styles have performed versus the relative index at different points in the market cycle, had an investor split their assets evenly between the two.

For those who either enjoy running a portfolio or have concrete ideas about promising stocks of the future, having a very long time horizon does allow you to take risks. Rory McPherson, chief investment officer at fund manager MFDM, notes that investors might want to "tilt to areas that are cheaper or have more potential for upside" – a plan that might include seemingly good value markets such as the UK and Japan but also encompasses thematic investing, with a focus on areas such as clean energy. He has recently favoured **Ninety One Global Environment (GB00BKT89K74)** as a play on clean energy, with funds such as **M&G Japan (GB00B74CQP79)**, **Artemis Income (GB00B2PLJJ36)** and **Fidelity Special Situations (GB00B88V3X40)** used to gain the aforementioned geographic exposures.

Those who want to take more granular bets, be it via thematic funds or individual stock picks, may still wish to exercise some restraint by keeping these holdings as

50/50 PORTFOLIO OF FUNDSMITH EQUITY AND SCHRODER GLOBAL RECOVERY, VS THE GLOBAL MARKET

Period	MSCI World total return (%)	Fund pair total return (%)
H2 2016 (value resurgence)	14.2	15.5
Q4 2018 (broad sell-off)	-11.5	-9.2
09/11/20-07/05/21 (vaccine rally for value stocks)	12.8	16.8
2022 (growth-focused sell-off)	-7.8	-8

50/50 PORTFOLIO OF LIONTRUST SPECIAL SITUATIONS AND SCHRODER RECOVERY, VS THE UK MARKET

Period	FTSE All Share total return (%)	Fund pair total return (%)
H2 2016 (value resurgence)	10.7	14.4
Q4 2018 (broad sell-off)	-10.2	-9.7
09/11/20-07/05/21 (vaccine rally for value stocks)	18.6	24.6
2022 (growth-focused sell-off)	0.3	-7.2

Source: FE

smaller positions alongside an investment in a diversified 'core' fund or set of investments. This core could comprise a global fund or a set of regional funds.

Investors may also consider exposure to some alternative assets as a driver of growth. The likes of the private equity investment trusts have done especially well in the last decade. Public markets are shrinking and there is an argument that promising companies now stay private for longer – although private companies may well have a tougher time amid higher interest rates.

The balancing act

Life is trickier for those who can't afford to simply ride the ups and downs of the market, including those who are at or approaching retirement and rely, or will soon rely, on the portfolio's income or capital gains. For this group, Cobbe believes a useful rule of thumb could be to subtract your age from 100 and have that amount in equities.

More specifically, he argues that investors could split their portfolio into different buckets, each of which is invested according to when an investor might need to access it. "You have a portion of near-term income in something low-risk like a money market fund, you have a portion for the medium term in a cautious portfolio, and the rest that you don't need for eight or 10 years you leave in a growth portfolio," he says. The growth portfolio would be focused on equities while the cautious portfolio would have a mixture of equities and diversifiers.

The big question is what to hold alongside equities. The diversifiers on offer are pretty varied, from bonds to gold, absolute return funds, wealth preservation trusts such as **Ruffer (RICA)** and some alternatives such as infrastructure investment trusts.

Specialists have tended to make the case for holding a range of the above all at once. However, the enormous sell-off that tore through bond markets in 2022 has reset valuations, and moved yields back up to attractive levels. That has two implications: that bond prices have room to rise if investors panic and seek out a 'safe' asset class, and that investors are again getting paid adequately to hold bonds, even if more volatility lies ahead for them.

As such, McPherson is – as it stands – a fan of sticking purely with bonds rather than opting for alternatives in the non-equity segment of a portfolio. Cobbe also argues that bonds have become attractive – but believes investors might want to hold a combination of bonds and alternatives, and shift the balance depending on conditions. For example, the likes of infrastructure trusts arguably looked more attractive than bonds when inflation first emerged and rate rises first seemed like a possibility. Now the opposite may be true.

COBBE BELIEVES A USEFUL RULE OF THUMB COULD BE TO SUBTRACT YOUR AGE FROM 100 AND HAVE THAT AMOUNT IN EQUITIES

Investors piling into fixed income might want to diversify within their bond exposure. High-yield bonds do well when the economy holds up, but struggle in a recession if default rates pick up. Conversely, government bonds are vulnerable to inflation and rising rates but typically do well in recessions, or other scenarios that see investors run for a safe haven.

McPherson has used funds such as **TwentyFour Absolute Return Credit (LU1368730674)** as options that "don't get moved around by interest rate changes". The fund holds short-dated bonds that are less sensitive to interest rate rises as a result. As a source of ballast in the case of an economic slowdown he likes options such as the sterling-hedged share class of the **Invesco US Treasury Bond UCITS ETF (TRGB)**. The team has favoured active portfolios such as **Axa US Short Duration High Yield (GB00B59VLT43)** for exposure to riskier corporate bonds.

Diversification does remain vital. A similar mindset should apply when it comes to income portfolios: it feels as though the investment universe is currently awash with attractive dividend yields, and a good level of equity exposure based on the 100 minus age rule could be one starting point, given that company dividends can often keep up with inflation to some extent. Equally, as mentioned, bonds seem too attractive to dismiss outright at the moment – although it's worth noting that alternative assets continue to prove their worth on the income front.

Infrastructure fund dividends often have a progressive nature or even some inflation linkage, and plenty of trusts more generally are focused on continual dividend growth. Here, the AIC's dividend heroes list, outlining trusts that have increased their dividends for 20 consecutive years or more, and the "next generation" list of those with a record of more than 10 but fewer than 20 years of rising payouts, can be a useful starting point. However some names from these lists, such as Scottish Mortgage, tend to only come with small dividends and wouldn't necessarily suit an income investor. It's also worth checking our recent assessment of newer trusts targeting dividend growth (see IC 3 March, 'Investment trusts promising stellar dividend growth'). ●