Investment approach

Why the investment approach matters

A good investment approach means that members will get the best possible return from their investment and enjoy a better quality of life in retirement.

Over 90 per cent of members stay in the default fund, it's therefore important that this is suitable for the majority of members. It's also vital that it's part of a high-quality, well-run scheme that performs well and delivers value for money for members.

Our expert investment team

At NEST, our members' money is managed by an in-house team of investment experts. They monitor the performance of our fund managers, consider the opportunities available in different asset classes and assess our responsible investment requirements.

The team maintains a comprehensive understanding of what's happening in economies and markets. They use this to make appropriate decisions on the amount of risk members' money should be exposed to, which asset classes to invest in and in what proportion for members.

The investment team is looking to meet our target of growing members' money, well in excess of the cost of living after charges, over the long term. It also aims to avoid undue losses.

The team has a clear risk management framework that helps them position our members' portfolios to achieve the best return for the risk they're taking.

The team also understands what's happening to different types of investment in different economic or market regimes. This means we can reduce exposure to particular assets at certain times and also understand when assets are undervalued and should be bought.

Our unique default option — Retirement Date Funds

At NEST, we have a unique approach to our default strategy. It's made up of around 50 tailored funds known as NEST Retirement Date Funds. These are single year target date funds and correspond to the year that members wish to retire. So, if they intend to retire in 2048, their money would be invested in the 2048 NEST Retirement Fund.

Target date funds are an efficient way to offer a high-quality scheme at a low cost. They allow us to manage the asset allocation of each fund in a way that's sensitive to market and economic conditions. They also mean we can invest in a way that's suitable for how far away members are from retirement. As members get closer to retirement and their risk profile changes, we can alter the assets they're invested in at the fund level. This is straightforward, quick and low cost.

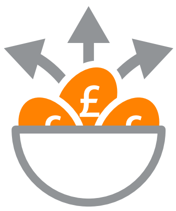
Our method is different from traditional lifestyle models. In these, asset allocations can only be changed at the level of the individual member's account as opposed to a single trade in a single fund. To do so would often mean switching assets on potentially tens of thousands of accounts. This would be costly, difficult and carry significant operational risk.

That's why traditional lifestyle funds tend to have a set asset allocation glide path. This largely remains unchanged through time with a fixed schedule of switches in the run up to retirement. These are not sensitive to market conditions.

The more flexible target date model allows us to manage members' money dynamically and respond to market and regulatory changes quickly on our members' behalf. When the pension freedoms were announced in the 2015 Budget, for example, we adapted the glide path of our consolidation phase funds straight away. Some lifestyle funds still haven't adapted theirs nearly three years later.

In NEST Retirement Date Funds, we always spread members' money over a broad range of global investments. These include shares, bonds and property. Exactly where members' money will be invested depends on how far members are from retirement. We've designed our three-phase investment glide path based on extensive research of what our members need and expect from their savings.

Foundation phase
(approx five years)
Outperform inflation (after charges)
Promote confidence in saving
Minimise impact of investment shocks



Growth phase
(approx 30 years)
Target inflation +3 per cent (after charges)
Maximise diversification | Capture global growth
Reduce impact of investment shocks

Consolidation phase
(approx 10 years)
De-risking to cash or moving to
a less risky set of products
Reduce volatility as retirement approaches

In contrast to other providers, these phases are flexible and can be started slightly earlier or later depending on market conditions.

A range of other fund options

In addition to our NEST Retirement Date Funds, we offer five additional funds. These provide our members with a choice based on their faiths, beliefs and attitudes to risk.

The funds we offer include:

NEST
Higher Risk Fund

for potentially
higher returns

NEST
Lower Growth Fund

for a more conservative
approach to risk

NEST
Ethical Fund

for a more socially
responsible approach

NEST
Pre-retirement Fund

for members close to
retirement

NEST
Sharia Fund

for an investment
compliant with
Islamic law

All our funds are clearly named so that members can understand what they are at a glance and make an informed choice. It's also easy for members to log into their account and change their chosen fund.

We offer five funds because research shows that members are empowered by having a clear but limited set of choices, rather than an endless list of options that they can't distinguish between.

Responsible investing at NEST

Our members save with us over many years. This means we need to think carefully about all the investment factors that could affect their pots over the long term. We consider how companies and markets work and how they treat people and the environment when we make decisions on investing members' money. These issues are likely to affect the performance of the companies and other assets we invest in.

We believe well-run organisations with sound environmental and social practices have a better chance of long-term success and profitability. By focusing on sustainable practices, we're looking to boost and protect our members' pots.

We also want to improve society and the environment our members live and retire in. We apply this approach to all our Retirement Date Funds and fund choices.

Using our influence to invest responsibly

Our work on the UBS Life Climate Aware World Equity Fund is just a part of our responsible investment strategy. We launched it in February 2017, after a year of working closely with our developed global equity partner UBS. The fund now makes up a key building block in our default strategy. It's an important step to prepare members' investments for a lower-carbon global economy. It seeks to mitigate climate related risks and give members access to the opportunities of the transition away from fossil fuels.

We helped design the fund to be flexible and adaptable. It's forward looking and uniquely, we believe, invests in line with internationally agreed targets to reduce global warming. This means our members' pots should be well-positioned as regulation begins to impact global corporations' business models. The fund dials up or dials down investments in companies based on evidence of what they're doing, and planning to do, to mitigate the financial impacts of climate change. As a result, we aim to send a strong signal to businesses we invest in. We're saying that we expect to see measurable progress towards positioning their companies for a future that is no longer reliant on fossil fuels.

Some of our youngest members will be saving with us for the next 40 to 50 years and are most likely to be financially affected by climate related risks and opportunities. We've therefore assigned a larger slice of the equities in our foundation phase, where our youngest members' money is invested, to this fund. As responsible long-term investors on behalf of our members, we can't afford to ignore climate change risks and we've committed to being part of the solution.

We own millions of shares in companies on behalf of our members. So it's our responsibility to help make these companies sustainable and profitable in the long term. We do this by exercising our voting rights at company AGMs, influencing how our fund managers vote and engaging with companies, regulators and standard setters to encourage positive change.

Recommended by industry experts

In its recent report, Defaqto compared our investment approach and our default fund's performance favourably against similar schemes. It found that we had the best risk-adjusted performance against the Consumer Price Index plus three per cent benchmark over three and five years. We also had the best risk-adjusted performance looking at the downside risk, over three and five years. What's more, Defaqto put our fund above average in terms of diversification. It concluded:

'The evidence shows that NEST's Retirement Date Funds can hold their own against their peers and are worthy of consideration alongside other schemes by corporate clients and professional advisers on behalf of their clients, irrespective of the employer's size of scheme.'

Awards and accreditations

At NEST we've been recognised around the world for the way we invest our members' money. Here are some of our recent accolades:

Defaqto 5 Star Rating

Excellence in investment

DC Scheme of the Year

Best ESG programme

Best European pension fund

Best small pension fund

Retirement innovation

Best defined contribution plan

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