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Decline in earnings-related pension assets levelled off – pension assets EUR 202 billion at the end of March 2019

The investment assets serving as the future buffer for the earnings-related pension system increased during the first quarter of 2019. The assets rose by about EUR 8 billion, totalling EUR 202 billion at the end of March. Especially the favourable trend of equity investments during the first three months of the year had an impact on the increase of assets, but the return on fixed-income investments was also positive. Risk-taking was again favoured on the market in the first quarter, resulting in very good returns, in particular for investments in listed shares.

Analyst Kimmo Koivurinne's analysis of the trend in earnings-related pension assets comprises the following sections:

- Return on investment during the first quarter 5.2 per cent in nominal terms
- Equity markets recovered after the downturn that occurred late last year
- Basic facts about our investment statistics

1. Return on investment during the first quarter 5.2 per cent in nominal terms

- Investment assets of the earnings-related pension system, in total: EUR 202 billion (*)
    - Investment assets in the private sector: EUR 126 billion
    - Investment assets in the public sector: about EUR 76 billion
- Growth in the first quarter about EUR 8 billion
- Investments in equities and equity-like instruments accounted for EUR 112 billion, or 56 per cent of all investment assets
- Fixed-income investments: EUR 72 billion, share 36 per cent
- Real estate investments: EUR 17 billion, share 9 per cent
- Returns on investments for the first quarter of the year: 5.2 per cent in nominal terms and 5.0 per cent in real terms

(*) *Unlike previously, the amount of assets has been reported as a whole number as we have detected inaccuracy in our statistical process for investment assets. We are investigating the cause and, if necessary, will adjust the figures later. Thus, the total amount of assets and their relative shares in the distribution may still be modified.*

Changes in the relative shares of the various asset categories were small during the first quarter. The share of fixed-income investments (36%) diminished by two percentage points. The share of equity and equity-like investments [1] (56%) rose by about two percentage points, while the share of real estate investments (9%) remained almost unchanged. The rise in the relative share of equities is largely due to an increase in the valuation levels of equities.

In the longer term, the relative share of fixed-income investments has decreased. The reason underlying the decrease is the prolonged period of low interest rates, which has made pension insurers seek more profitable investments, for instance, in unquoted shares, real estate, private equity funds and alternative investments. In the light of the returns, this strategy seems to have worked well.

[1] When the analysis refers to investments in equities and equity-like instruments, this means the following categories of investment figures: quoted shares (incl. funds); hedge funds; and other investments in equities, which include, for instance, equity investments and investments in unquoted shares.

The regional distribution of investments changed little during the first three months of the year. The relative share of investments in the euro area decreased by two percentage points and, correspondingly, the share of non-euro area investments rose by two percentage points. There was virtually no change in the share of investments in Finland.

At the end of the first quarter, about a quarter of investment assets (24%) was invested in Finland, about one fifth (18%) elsewhere in the euro area, and more than half (58%) in countries outside the euro area. Changes in the relative shares of investments are affected by net flows — that is, the difference between purchases, sales and maturities.

In the first quarter of 2019, the returns of the six largest operators for each investment category were as follows:

- Average returns on equity investments: 9.6 per cent in nominal terms and 9.4 per cent in real terms;
- Corresponding average returns on fixed-income investments: 2.2 and 2.0 per cent, respectively;
- Average returns on real estate investments: 1.1 and 0.9 per cent, respectively.

The trend of returns on pension investments must be examined over the longer term; changes occurring during one quarter — or even during a year — are not of major importance to the financial sustainability of the pension system. On the other hand, future returns cannot be predicted on the basis of the returns realized. Over the long term, in the end, pension assets put into funds increase in step with economic growth and inflation. It should be noted that the selection of the examination period is also important.

The returns realized look steady in the longer term:

- 2014–Q1/2019 (about 5 years): 5.4 per cent in nominal terms and 4.8 per cent in real terms

- 2009–Q1/2019 (about 10 years): 6.7 per cent in nominal terms and 5.5 per cent in real terms
- 1997–Q1/2019 (about 22 years): 5.8 per cent in nominal terms and 4.2 per cent in real terms

The projected real return used by the Finnish Centre for Pensions for its long-term projections is 2.5 per cent until 2028. Thereafter, the projected real return is 3.5 per cent. The latter projection has been used to examine the pension system all the way until 2085. Then the whole picture depends the most on trends in employment, the birth rate and net immigration.

Pensions are financed not only by pension contributions but also by investment assets placed into funds and the subsequent returns. In addition, since 2014, investment assets have been affected by the fact that the pensions paid out of the funds and their returns have exceeded the sum of pension contributions placed into the funds. For instance in 2018, the entire pension sector collected EUR 2.7 billion of pension contributions into funds, while the sum taken out for pensions paid totalled EUR 4.5 billion. This means that the net sum used for pensions from funds and their returns totalled EUR 1.8 billion.

The solvency of pension insurers continues to be strong despite the weaker investment returns of last year. At the end of March, the solvency ratios of pension insurance companies ranged between 122.4 and 129.4 per cent. Solvency positions ranged between 1.5 and 2.4. Solvency ratios and positions rose slightly during the first three months of the year. Thanks to the buffers meant for rainy days, pension insurers are also able to withstand worse periods on the financial market.

2. Equity markets recovered after the downturn that occurred late last year

The key factor on the financial market in early 2019 was the timeout taken by the US Federal Reserve in pursuing its programme of rising rates. The European Central Bank is in the same boat and, as things look now, will also refrain from raising interest rates. The stable interest rate outlook provided a good basis for stock market recovery. For earnings-related pension providers, the first quarter was one of the best in this millennium, especially for equity investments.

The stock market recovery from the decline late last year was also helped by the momentary easing of the trade war between China and the United States. Aside from equities, bonds also gave a good yield as the general interest level declined during the first quarter.

- The S&P 500 index, describing the stock market performance of the five hundred largest U.S. companies, rose by over thirteen per cent in three months.
- The FTSE index of the 100 largest companies on the London Stock Exchange increased by over eight per cent and the German DAX index by over nine per cent. The London Stock Exchange was overshadowed by uncertainty over Brexit.

- The OMXH25 index, which describes the development of the largest companies on the Helsinki Stock Exchange, went up by a good nine per cent.
- During the same period, the OMXS30 index of the Stockholm Stock Exchange gave an even better yield: an increase of more than ten per cent during the first quarter.
- In the USA, the 10-year interest rate fell by 30 bps, to its lowest level since 2017.
- The interest rate on the German 10-year government bonds turned negative for the first time since October 2016.
- Among corporate bonds, both investment grade and high yield outperformed government bonds.

However, irrespective of the recovery of the equity markets, uncertainties have not disappeared. As the spring went on, concerns for the future were caused, among other things, by investors' recurring mental images of the Chinese–American trade war, the long-drawn-out Brexit talks, and companies' earning capacity from now on. Europe's frozen economic growth is a justified cause for concern. The European economy grew by only 0.2% in the last quarter of 2018, with Germany's economy standing still and Italy slipping into slight recession.

3. Basic facts about our investment statistics

Our member organizations are responsible for investing the statutory earnings-related pension assets. The statistics cover the pension insurance companies, the TyEL funds of industry-wide pension funds and company pension funds, as well as the public-sector earnings-related pension providers: Keva, the State Pension Fund (VER), the pension liability fund for employees of the Social Insurance Institution Kela, the Church Pension Fund (KER) and the Bank of Finland's Pension Fund (SPERA). Also included is the group of specialized pension providers, which comprises the Farmers' Social Insurance Institution (Mela) and the Seafarers' Pension Fund (MEK).

The statistics only cover the statutory earnings-related pension assets put into funds. They do not include the value of the collective supplementary pension funds managed by industry-wide pension funds and company pension funds, which was approximately EUR 4.2 billion at the end of 2018.