Summary:

Investment asset amounts, allocation and returns at the end of 2013

1. A great trend for investments – portfolio exceeding EUR 160 billion

The combined investment portfolio of pension insurance providers was EUR 162.2 billion at the end of 2013. From the end of 2012 the portfolio had grown by EUR 12.6 billion. Expressed in euros, this growth exceeded the annual average – EUR 8.4 billion – for the past ten years (2004–2013).

The growth of the combined portfolio is due to both investment returns and pension contributions. Some of the pension contributions are used to finance pensions currently in payment. The remaining pension contributions are funded and invested so that future pension contributions can be lower than in an alternative where no investments of this type are made. When examined at the level of the entire earnings-related pension system in 2013, about 95 per cent of the portfolio growth of EUR 12.6 billion came from investment returns, while about 5 per cent was derived from pension contributions.

2. More equities, less fixed-income investments and little change for real estate

For the whole sector, the allocation of the overall investment portfolio at the end of 2013 was as follows: investments in equities and equity-like instruments 46.4 per cent (EUR 75.2 billion); fixed-income investments 43.1 per cent (EUR 70.0 billion); and real estate investments 10.5 per cent (EUR 17.0 billion). The most significant change in the weights of the main investment categories during the year was a 3.7 percentage point increase in the allocation of investments in equities and equity-like instruments (EUR 11.4 billion). This change was countered by a reduction in the allocation of fixed-income investments and real estate: -3.4 and -0.3 percentage points respectively.

2.1 Investments in equities and equity-like instruments: a strong market trend and additional purchases

The extensive growth in the whole sector's equity allocation (EUR 11.4 billion) is attributable to a favourable stock market trend (EUR 6.6 billion) and additional purchases that outweighed sales (EUR 4.8 billion). In 2013 equity indices in industrialized countries were typically positive and clearly so, about 20–30 per cent.

The extensive equity allocation includes investments in hedge funds. Increasing this type of investment was an evident trend in 2013. At the end of 2013, investments in hedge funds amounted to EUR 9.2 billion, i.e. 5.7 per cent. Within one year, this investment category increased by 2.5 billion euros, i.e. by 1.2 percentage points. The growth of investments in hedge funds can probably be ascribed, on the one hand, to the investment environment, in which it is difficult to achieve a return on fixed-income investments and, on the other hand, to the need to improve the diversification of the portfolio and to reduce the portfolio's dependence on the development of listed equities.

2.2 Rising interest level curbed investments in bonds

The proportion of fixed-income investments out of the total investment portfolio decreased by 3.4 percentage points. However, when expressed in euros, this investment category grew by EUR 0.4 billion. Investments in bonds rose by EUR 1.6 billion and investments in money markets by EUR 0.2 billion. In contrast, loan portfolios – TyEL relending and investment loans – shrank by a total of EUR 1.4 billion.

New purchases of bonds outweighed sales and matured bonds by EUR 3.6 billion. However, the rise in long-term interest rates burdened the growth of this investment category. In the end, the category grew by EUR 1.6 billion. When interest rates rise, the prices of interest-bearing papers drop. For an investor in fixed-income securities, this fall in prices means a lower market value for the fixed-income portfolio and a reduced fixed-income allocation.

2.3 Continued decrease in loan portfolios

In 2013, pension insurance companies' new investment loans and TyEL relending developed more slowly than in 2011 and 2012. The total amount of new loans was the fourth lowest in the period 2004–2013. The investment loan portfolio of pension insurance companies shrank by EUR 0.5 billion and the TyEL relending portfolio by EUR 0.7 billion. It would seem that the availability of funding is not a major problem for companies at present.

3. The trend of the past few years continued: investments outside the eurozone on the rise

In terms of the regional distribution of investments, the trend of the past few years continued in 2013. Investments outside the eurozone increased (+2.5 percentage points, EUR +9.3 billion) while investments in the eurozone (excl. Finland) decreased (-1.1 percentage points, EUR +1.5 billion). Although the proportion of domestic investments rose in the second and third quarter of the year, the proportion of domestic investments fell at the annual level (-1.4 percentage points, EUR +1.8 billion).

At the end of 2013, investments outside the eurozone totalled EUR 72.5 billion, or 44.7 per cent of all investments. Domestic investments amounted to EUR 49.5 billion, or 30.5 per cent. The rest, or EUR 40.2 billion (24.8 per cent), was invested in other eurozone countries except Finland.

4. Improved investment returns as the year progressed

Earnings-related pension insurers did well in their investments in 2013. The nominal return rate for the sector totalled 8 per cent. Thanks to the strong equity market trend, the best category-specific return rates were achieved from investments in equities and holdings: 15.7 per cent. Apart from the good market trend, some actors were successful in their choices and timing when they managed and increased their equity allocations. The more modest returns of fixed-income investments (+1.2 per cent) were affected by the rise in long-term interest rates on government loans, which took place especially in May–August and again in November–December. A major factor underlying movements on the interest rate markets was the monetary policy pursued by the U.S. Federal Reserve: first the expectations that the Fed would reduce its super-stimulus programme, and later the fulfilment of these expectations. Meanwhile, the returns on real-estate investments continued their steady trend of the past few years, +5.2 per cent, which kept up with inflation well.

The trend in returns improved as the year progressed and the low points of the second quarter were left behind. Good returns are also visible in the long term. The average annual real return for the entire sector is 4.0 per cent when calculated over the past 17 years (1997–2013). The corresponding return rate in the private sector was 4.0 per cent and for the public-sector pension providers 4.3 per cent. The Finnish Centre for Pensions uses 3.5 per cent as the assumption of real return in its long-term projection.

5 Hesitation at the start of the year

The first months of 2014 have been characterized by uncertainty on the financial markets. It can be assumed that the rising interest level will continue to be a hard nut to crack for investors, but in the bigger picture its impact will be small. In a favourable economic environment, the trends followed by various asset categories, such as equities and real estate, are generally positive. The preconditions for positive economic growth have improved; thus, it could be assumed that the favourable development of asset categories will continue in 2014 as well. However, worse news may still come from time to time. Moreover, overly brisk activity on the financial markets in view of the fundamentals of the economy may backfire and corrective actions may need to be taken to calm the situation. This is exactly what has happened during the first months of the current year. Moreover, provision must always be made for surprises, such as greater geopolitical risks. A prime example of this is the ongoing crisis in Ukraine.