
HYMANS ROBERTSON LLP

Adventurous Lifestyle Option – UK Equities Active Fund Q&A

Important changes to your Fund

You should read this Q&A if your retirement savings are invested the Adventurous Lifestyle Option and you have more than 5 years until your target retirement date, or you have self-selected the UK Equities Active Fund.

Summary

- Previously, the UK Equities Active Fund (which is a constituent of the Adventurous Lifestyle Option) consisted of a single fund, the M&G UK Recovery Fund;
- Recent poor performance and investors' withdrawals from this fund triggered a review. As a result, the Trustees decided that an additional fund should be added and the UK Equities Active Fund now invests in two underlying funds;
- The Baillie Gifford UK Equity Core Fund is the new fund, which now sits alongside the M&G UK Recovery Fund (50% in each);
- Baillie Gifford is one of the UK's leading managers of UK equities;
- Baillie Gifford and M&G have different "styles" of investing - they are likely to perform well at different times in the economic cycle;
- The aim is to achieve less "volatility" of performance compared to the UK equities market as a whole;
- Both funds invest in UK equities and are actively managed;
- Annual management charges will be slightly lower.

More detail

What changes have been made to the UK Equities Active Fund?

The UK Equities Active Fund was previously invested in a single fund - the M&G UK Recovery Fund. It is now a blend of two funds, the M&G UK Recovery Fund (50%) and the Baillie Gifford UK Equity Core Fund (50%).

Why have the Trustees made this change?

The Trustees regularly monitor all of the funds offered to members to ensure they remain appropriate. As part of this, the Trustees have established a number of "triggers" which would cause them to review the continuing appropriateness of any fund (although not necessarily to change a fund). Recently, two of the "triggers" were breached for the M&G UK Recovery Fund (which was the only fund in the UK Equities Active Fund). These triggers were a continuation of the recent poor performance and significant investors' withdrawals from the Fund. As a result, the Trustees undertook a review of the Fund with their Investment Consultants, and it was agreed that another active UK equity fund with a different investment style would be introduced alongside the M&G UK Recovery Fund. The new fund will make up 50% of the UK Equities Active Fund.

The M&G UK Recovery Fund invests mainly in early stage businesses or companies whose problems M&G believe can be resolved by management action. The aim is to buy shares that are relatively cheap and have the potential to increase significantly in value as the company issues are resolved, or as the company grows in size. This Fund has provided strong returns for members who have been invested in it for a long time, but in more recent years it has performed poorly, as its style has not been suited to the current economic climate. The Fund has also held stocks in the oil sector, which have suffered significantly as a result of the sharp fall in the oil price. As a result of the significant underperformance, the M&G Fund has experienced large withdrawals by other investors.

Although it is hoped that the M&G UK Recovery Fund is now well placed to recoup some of the under-performance it has endured over recent years, the Trustees have chosen to balance some of its risks by also investing in a different UK equity fund which will complement the investment style of the M&G UK Recovery Fund.

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Who is Baillie Gifford and why are they considered strong in this area?

Baillie Gifford is an independent, Edinburgh based partnership with a particularly strong reputation for equity investment. Team stability is a hallmark of Baillie Gifford and within the 8 strong UK equity team, the 3 key portfolio managers have worked in the team for over 15 years and have each spent their entire investment careers at the firm. The Core strategy is led by Ian McCombie and the overall Head of UK Equities is Gerald Callahan.

Why have the Trustees chosen the Baillie Gifford UK Equity Core Fund?

Baillie Gifford's managers have a different "style" of investing to M&G and the Trustees believe that the two differing styles will be complementary to each other. Although no equity fund is immune from peaks and troughs in performance, the two funds tend to perform well at different stages of the economic cycle. Historically, Baillie Gifford has outperformed the wider market when the economic climate has been more depressed and uncertain, whilst the M&G Recovery Fund has outperformed during periods of strong market confidence. This should help to 'smooth' the returns generated by the UK Equities Active Fund relative to the equity market as a whole.

Will this change affect the expected returns and volatilities for the Fund?

Both the M&G and Baillie Gifford funds invest in equities and so in the long term their returns are expected to outperform most other asset classes (property, bonds, etc.). However, equities are also one of the most volatile asset classes and so the absolute returns generated by each fund are expected to vary significantly from year to year. The Trustees hope that by introducing Baillie Gifford, overall returns relative to the UK equities market will be less volatile from year to year, but that in the long run there should be no material change to the total expected average annual return.

Do the two funds invest in the same things?

Both funds invest in UK based companies (equities). The aim of the M&G UK Recovery Fund is to hold shares in companies that are believed to be relatively cheap until the potential of the business is fully reflected in the share price. This involves investing at least part of the portfolio in smaller companies that may not be listed on the main stock exchange. The Baillie Gifford UK Equity Core Fund places more of a focus on 'quality' companies that have a sustainable competitive advantage and are expected to grow earnings at an above average rate. Baillie Gifford will typically own shares in larger companies than M&G and will construct a portfolio that contains a greater number of underlying companies.

Does this impact charges for investing in the UK Equities Active Fund?

The overall annual management charge for the Fund will fall as a result of the change. The Total Expense Ratio of the UK Equities Active Fund will reduce from 0.81% p.a. to approximately 0.69%. This is because the management cost of the Baillie Gifford UK Equity Core Fund is lower than the M&G UK Recovery Fund.

Will the blending of the UK Equities Active Fund incur any charges?

Yes, there will be some costs incurred in the selling and purchase of the underlying investments, although the Trustees, their advisers and the investment managers will keep these to a minimum. Final costs will not be fully known until the transaction is completed, but these are expected to be less than 1.0% of members' assets included in the transaction. These charges are unavoidable but should be recouped within four years as a result of the lower charges for the UK Equities Active Fund.

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