DC pensions constitute a large and fast growing pool of global capital

- Investment risks in DC are not static – they change as the member gets older
- There is no risk sharing in DC, which sets it apart from DB
- For DC, non-listed real estate works best in combination with other asset classes

Nobody likes risk. If decent investment returns were available without risk, everyone would take them. But it does not work that way. Risk is the price that investors pay to get returns. In the world of pure DC, investment risk lies with the plan member, not the employer. There is no risk sharing in DC, which sets it apart from DB. To use a simplistic analogy, DC is like savings while defined benefit (DB) is like insurance.

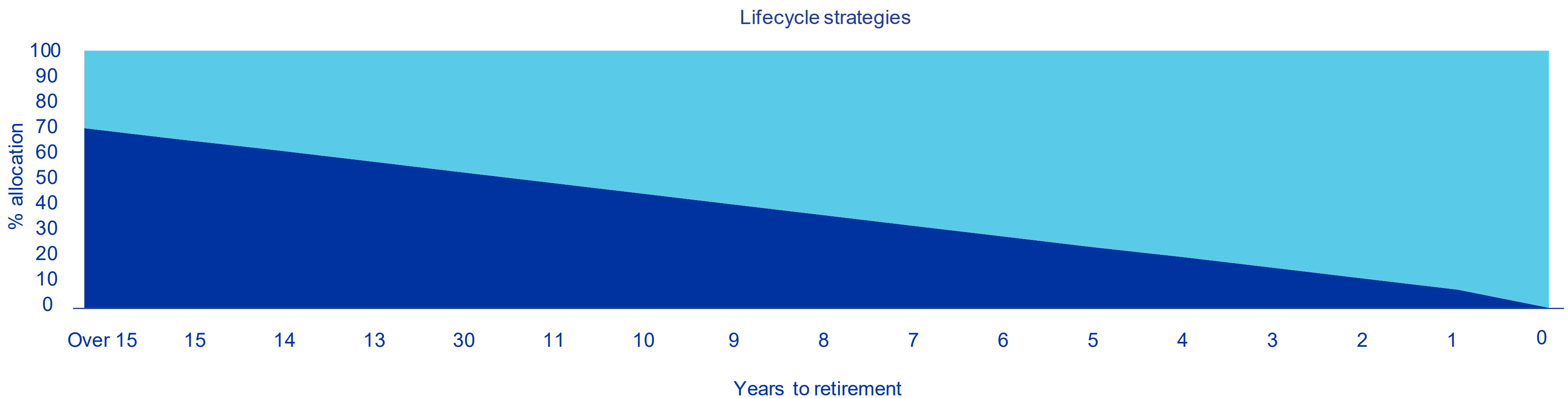
The risks facing DC members evolves over time. This is because DC is built on the lifecycle principle. Lifecycle means that when a person stops working, their human capital (ability to earn) needs to be replaced by financial capital (savings). Financial capital is built up over years. In the early years, the DC nest egg comprises contributions plus a little investment return. In the later years, closer to retirement, the opposite occurs: the nest egg is more dependent on investment returns than cash inflows. As a result, a market downturn in the later years does more damage than in the early years. The nest egg is bigger, and there is less time to recover.

This explains the popularity of lifecycle investment strategies in DC. These strategies adjust in line with the member's age and time left to retirement. There is higher exposure to growth assets in the early and middle years, which reduces in the years leading to retirement. The default strategy in a DC plan is often a lifecycle strategy. Default strategy means the investment strategy that is applied to a member's account unless that member indicates otherwise.

> 'Investment risk evolves as the member gets older.'

Figure 1: Example of typical DC lifecycle investment strategy

Growth asset
Defensive asset



The typical DC investment strategy has two sections: the default strategy and self-select funds, which the members can choose for themselves. Within the self-select section there may be some pre-mixed multi-asset funds, often with risk profiles such as “conservative” or “high risk”. There may also be some building block funds (equity funds, bond funds and so on) which the more confident members can use to blend their own portfolios. Non-listed real estate can add value to most parts of the typical DC line-up of funds.

However, there are sometimes obstacles: liquidity, high cost (actual or perceived) and product availability. All three obstacles can be and have been overcome, often by blending non-listed real estate with other asset classes. Non-listed real estate works best for DC when embedded in a multi-asset strategy, whether that is the plan’s default strategy or a self-select “pre-mixed” strategy. The multi-asset setting makes liquidity management easier. It also leads to lower overall total expense ratios, if some of the other assets are managed on a low-cost passive basis.

> ‘The multi-asset nature of DC default strategies makes liquidity management easier’

Figure 2: Where non-listed real estate fits in DC strategies

Pre-retirement (accumulation) phase of DC		
Default strategy	**Self-select options**	
Multi-asset with automatic derisking	Multi-asset with risk profile	Building blocks
Examples: Target date fund Lifestyle strategy	Examples: Balanced fund Conservative fund	Examples: Passive global equities Long-dated bonds
Within a multi-asset default strategy, non-listed real estate offers: • High growth in early and middle years • Diversification • Low volatility	Within multi-asset risk profile funds, non-listed real estate can add value to all but the most conservative (bond and cash) profiles	1. Non-listed real estate such as a domestic core fund 2. Could also form part of a wider building block fund such as: • Real assets • Private markets • REITs + non-listed