PENSION FUNDS AND EMERGING MARKETS

Planning for retirement has never been easy, either for the individual who is considering when to stop working, or for governments which deal with the economic and social consequences of an ageing population. While some public sector employees in the UK can still look forward to pensions based on their final salaries, new public sector employees are more likely to receive pensions based on career average wages and private sector workers contribute to money purchase schemes which pay out a lump sum with which they must buy an annuity to see themselves through old age. Against a background of government budget deficits in western economies, and looming recession in Europe, pension funds are struggling to buy assets that can produce the kind of returns they need. Many are looking to emerging markets to plug the gap. In the UK many local council pension funds are increasing their holdings of equity in emerging markets, and in September 2011 the world's largest public pension fund, the Japanese Government Pension Investment Fund announced that it will start investing in equities chosen from the MSCI Emerging Markets Index.

The following table explains this trend. Emerging economies are growing and are projected to grow much faster than developed economies. While Japanese real GDP grew by a creditable 4 per cent during 2010, the IMF believes that growth will be negative during 2011 before rising to 2.3 per cent in 2012. In the UK the growth rate was positive in 2010 and is for projected to remain so, growth but it is slow in contrast to the projections for the economies that are part of the MSCI Emerging Markets Index, especially the BRIC countries.

As discussed in the text, pension funds can bring liquidity to emerging stock markets, and have the potential to become active investors, encouraging improvements in governance at the corporate level, which contributes to a virtuous circle of better reputation, more funding opportunities and economic growth for emerging markets.

Annual growth in real GDP

Country	2010	2011 (e)	2012 (e)
South America			
Brazil	7.5	3.8	3.6
Chile	5.2	6.5	4.7
Colombia	4.3	4.9	4.5
Mexico	5.4	3.8	3.6
Peru	8.8	6.2	5.6
EMEA			
Czech Republic	2.3	2.0	1.8
Egypt	5.1	1.2	1.8
Hungary	1.2	1.8	1.7
Morocco	3.7	4.6	4.6
Poland	3.8	3.8	3.0
Russia	4.0	4.3	4.1
Turkey	8.9	6.6	2.2
Asia			
China	10.3	9.5	9.0
India	10.1	7.8	7.5
Indonesia	6.1	6.4	6.3
Korea	6.2	3.9	4.4
Malaysia	7.2	5.2	5.1
Philippines	7.6	4.7	4.9
Taiwan	10.9	5.2	5.0
Thailand	7.8	3.5	4.8
UK	1.4	1.1	1.6
Japan	4.0	-0.5	2.3

Source: IMF (2011) World Economic Outlook IMF

Note: e denotes an estimated number

1. Would you, as a contributor to a pension fund, be pleased to see your fund investing in emerging markets, or do you see them as riskier than developed markets?

2. Would you, as a contributor to a pension fund, want your fund manager to be an active investor in either or both of developed and emerging markets?
3. Would you, as a fund manager, look for different characteristics in companies in emerging and developed markets, and if so, what would those characteristics be?