1 (lunch time talk)

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THE OUTLOOK FOR PENSION FUND INVESTMENT

I am sure that you will all need a brief break before you recommence your deliberations this afternoon, so I will endeavour to be brief and, I hope, to the point.

There are, I suppose, four main contributors to a pension fund. Firstly, the employer, secondly, the employee, thirdly, the State in its allowance of immunity from income tax, capital gains tax and development gains tax, and, fourthly, the investment manager by producing investment income at the highest possible rate.

Until inflation reached its present proportions, it was possible for the investment manager, if he invested wisely, to make a positive contribution to the finances of the fund. But today even the most astute investment manager would find it difficult, in fact, impossible, to invest at a rate of return to combat a rate of inflation of 20% per annum.

So that all he can do is, to invest to get the best possible result, appreciating that the shortfall between what he can achieve and the rate of inflation will have to be made good by additional contributions from the employer, if he can afford it, possibly from the employees (which will no doubt be passed on to the employer in the form of higher wages), or benefits might have to be curtailed or reduced.

The first victim, if a curtailing of benefits is contemplated, would probably be pensions in the course of payment. I do not suggest that such pensions in the course of payment would be reduced, but attempts to increase them annually to keep up with the continuing rise in the cost-of-living, which many funds have achieved up to now out of the resources of the fund, might have to be at a lower rate than the actual increases required to keep the pensions in step with inflation. This warning was very forcibly spelled out last week by Mr. Dunlop of

the Commercial Union, and those of you who may have read the Annual Report of my old Company, the Imperial Group, will have seen that a similar warning is given.

No, our only salvation is for the rate of inflation to be reduced. There are faint signs, I am glad to say, that world inflation is not increasing quite so fast as it was, although we have not yet noticed it much here.

I have good news for you though, because I understand that the message has at last got home to Chancellor Healey that the rate of inflation really is 20% and not the 8½% he was trying to kid us it was at Election time. The incident which brought it home to him occurred when he was walking from the Treasury recently over to the House of Commons, surrounded by his Treasury advisers who were still trying to impress on him the seriousness of the situation. When he turned to them and said: "Nonsense, you are exaggerating", and he pointed to a neighbouring shop window and said: "Where else in the world would you see "Men's suits £7.50, ladies skirts £2, ties £1.20"". "Begging your pardon, Chancellor," they said, "but you are looking at a Dry Cleaners".

But to be serious again, how is the investment manager going to set about achieving the best possible long term result in present conditions, and on this question of achieving the best possible long term result I thought I saw one or two eyebrows raised when I suggested earlier that the investment manager's task was to produce investment income at the highest possible rate. I do not, of course, necessarily mean immediate income, but at the highest possible rate in the long run. He therefore has to exercise considerable judgment as to whether 15% on undated gilts will produce a better long term result than ordinary shares at, say, 6½% immediately, plus an unknown growth rate in the future. I think the approach of some investment managers is highly dangerous; they argue that since it is patently obvious that 15% from undated gilts

is not going to achieve the desired result of offsetting 20% inflation, then the only course is to buy equities and to hope that the growth in profits and dividends will justify their action in due course. I know that there is talk of the 12½% limit on the annual growth of dividends being lifted, but even Mr. Benn is now talking of recession, and higher profits and therefore higher dividends may be increasingly difficult to earn.

What I am even more horrified about is when I read that certain Nationalised industry pension funds are endeavouring to meet the present difficult situation by investing the funds in works of art, gold and other non income producing assets. In my opinion, such investments ignore one of the biggest advantages open to pension fund investors, namely, freedom from income tax on investment income. The book cost of such investment should, theoretically, be written up in the books each year by the 15% free of tax which could be obtained by more traditional investment but, of course, this is not done. They may be an interesting gamble for the private highly taxed individual but I am not attracted to the idea for a pension fund.