

15-year investment performance of the MPF System
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Key points

Introduction

1. The Mandatory Provident Fund (MPF) System was launched on 1 December 2000 and has been in operation for 15 years.
2. The rate of return for MPF investments has always been of great concern to members of the public. The Mandatory Provident Fund Schemes Authority (MPFA) recently prepared a report entitled *A 15-year Investment Performance Review of the MPF System*, with the aim of providing members of the public with a better understanding of the MPF System and of the investment performance of different types of funds over this 15-year period.
3. The purpose of this report is to help scheme members see the performance of MPF funds from the right perspective and better manage their MPF investments after understanding the factors that need to be taken into account when making investment decisions.

The role of the MPF System

4. As mentioned in the Commission on Poverty's consultation paper on retirement protection, the MPF System is the second pillar in Hong Kong's multi-pillar retirement protection framework and plays an important role in this framework.
5. The key purpose of the MPF System is to assist employees in accumulating savings for their retirement. It needs to work together with other pillars to provide adequate retirement protection for the working population and the rest.
6. There has been much discussion about retirement protection since the launch of the consultation. Regardless of which option Hong Kong adopts in the end, the MPF System will continue to play a vital role. As the consultation paper noted, when the System matures, its function in providing retirement protection can hardly be taken up by other pillars of the framework.

I. MPF is a long-term investment; its return is characterized by the compounding effect

7. Investing for retirement is a long-term process and the MPF, as a retirement investment, is a long-term investment. It was designed as an employment-based system, and the aim of setting up the System was to assist the working population to save for retirement. The average working life is around 40 years, so it takes this long for a retirement savings system like the MPF to mature.
8. The MPF System is still in the development stage. Only after around 40 years can we see comprehensively the benefits that such a system can produce.
9. The return on MPF investment is characterized by the compounding effect, in which reinvesting earnings, such as dividends, interest and capital gains, over a long time can lead to potentially large increases in value. The power of the compounding effect will be more pronounced as the investment horizon gets longer.
- ✧ For example, if a scheme members contributes \$1,500 each month (i.e. 10% of the median monthly employment earnings of \$15,000), his savings over a number of years will be as follows:

Assumed Rate of Annual Return	20 years	30 years	40 years
2%	\$442,000	\$739,000	\$1,102,000
3%	\$492,000	\$874,000	\$1,389,000
Total Contributions	\$360,000	\$540,000	\$720,000

II. MPF invested in financial instruments in the market, so the System's investment performance is affected by the cycles of the financial market

10. Since MPF scheme members' assets are invested in financial instruments in the market, the investment performance of the MPF System is inevitably affected by the cycles of the financial market and the market can be very volatile at times.
11. Making regular contributions over a long period can even out short-term fluctuations in market prices by averaging out the cost of the fund units. Scheme members should therefore not be overly concerned about short-term volatility.

III. Scheme members should not try to time the market

12. Scheme members should not try to time the market and switch funds based on short-term market performance. Anticipating market rises and falls is impossible, and many market timers actually end up worse off, buying high or selling low.

IV. Scheme members should look at the System's return with care

13. The System's return does not represent what an individual scheme member will make.
14. The System's return is driven by the collective investment choices of all members and reflects the results of their investments across many different asset classes and regions. Therefore, different members will have different returns.
15. The calculation of the System's return takes into account the amount and timing of contributions to, and benefits withdrawn from, the System.
16. It is inappropriate to compare the performance of the MPF System to that of a particular investment product or index, such as the Tracker Fund of Hong Kong or the Hang Seng Index. For one thing, the asset allocation of the Tracker Fund is different from that of the MPF System.

	Tracker Fund	MPF System (as at 30 September 2015)
Asset Class	Equities – 100%	Equities – 65% Debt Securities – 19% Deposits & Cash – 16%
Geographical Region	Hong Kong – 100%	Hong Kong – 62% North America – 14% Europe – 11% Asia – 8% Japan – 5%

Different scheme members have different investment portfolios; when comparing fund performance, should compare like with like

17. Different scheme members have different investment portfolios. They should compare their portfolios' performance with that of the same type of product. For example, if a scheme member has invested all his MPF benefits in an MPF conservative fund, he should compare his investment performance with that of other MPF conservative funds, not the System's average return.

V. Different types of funds have different returns; saving outcome hinges on members' investment decisions

18. Not all scheme members have the same return. Some have had a better return, some not so good, depending primarily on their choice of fund, the timing of their participation and contributions, and the performance of the markets that funds invest in.
19. Different types of funds have different rates of return. Generally, MPF funds achieve returns broadly in line with those of the markets they invest in. For example, the performance of equity funds broadly reflects the trend of the stock markets, with the returns fluctuating from time to time. The performance of MPF conservative funds, on the other hand, broadly reflects the trend of the savings rate of the Hong Kong dollar, which has been at a low level in recent years.
20. The MPF System as a whole has added value to scheme members' retirement savings.

15-year investment performance of the MPF System

VI. MPF has added value to members' retirement savings

21. The figures show that the MPF System has added value to scheme members' retirement savings since its inception. The total assets of the System are generally on the rise. As at the end of November 2015, the System had \$590 billion in assets, of which, one-fifth, or \$114 billion, was investment returns.
22. The 15-year annualized rate of return of the System was 3.1%, exceeding the average inflation rate of 1.8% over the same period.

VII. A high proportion of MPF assets are invested in equities, and thus, the performance of the stock markets has a great impact on the System's performance

23. As a result of scheme members' collective choices, the MPF System is characterized by a relatively high exposure to equities (more than 60% of total MPF assets) and Hong Kong equities in particular (almost 40% of total MPF assets). This percentage is very high by global standards, with the average exposure to equities for private pensions in OECD countries being only 40%.¹
24. In other words, the performance of the equity markets has a great impact on the overall return of the MPF System. For example, the investment return of the MPF System was affected significantly by the substantial fluctuations in the Hong Kong equity market in 2015.
25. The yearly performance of the MPF System, driven by corresponding changes in underlying investment markets, has fluctuated in the past 15 years, ranging from a negative annualized return of 25.9% to a positive annualized return of 30.1%.

Annualized Internal Rate of Return of the MPF System by Period

Period	<i>(HK\$ million)</i>				Annualized Internal Rate of Return
	Net Asset Values		Total Net Contributions during the Period (c)	Net Investment Return during the Period (b)-(a)-(c)	
	Period-Beginning (a)	Period-End (b)			
1.12.2000 – 31.3.2002	-	42,125	43,878	-1,753	-4.9%
1.4.2002 – 31.3.2003	42,125	59,305	23,016	-5,837	-10.7%
1.4.2003 – 31.3.2004	59,305	97,041	22,133	15,604	22.0%
1.4.2004 – 31.3.2005	97,041	124,316	22,205	5,070	4.7%
1.4.2005 – 31.3.2006	124,316	164,613	23,435	16,862	12.3%
1.4.2006 – 31.3.2007	164,613	211,199	24,684	21,901	12.4%
1.4.2007 – 31.3.2008	211,199	248,247	26,844	10,205	4.5%
1.4.2008 – 31.3.2009	248,247	217,741	38,503	-69,010	-25.9%
1.4.2009 – 31.3.2010	217,741	317,310	29,484	70,086	30.1%
1.4.2010 – 31.3.2011	317,310	378,280	31,864	29,106	8.7%
1.4.2011 – 31.3.2012	378,280	390,744	34,687	-22,224	-5.6%
1.4.2012 – 31.3.2013	390,744	455,331	38,321	26,267	6.4%

¹ 2012 data

1.4.2013 – 31.3.2014	455,331	516,192	40,898	19,963	4.2%
1.4.2014 – 31.3.2015	516,192	594,847	44,126	34,529	6.4%
1.4.2015 – 30.11.2015	594,847	589,546	31,118	-36,420	-5.9%
Since the Inception of the MPF System					
1.12.2000 – 30.11.2015	-	589,546	475,196	114,350	3.1%

VIII. Rates of return of different MPF funds differ

26. As different MPF funds invest in different markets and assets, and have different investment strategies, their rates of return differ.

27.	Fund Type	1 December 2000 – 30 November 2015	
		Annualized Return	Cumulative Return
	Equity Funds	4.1%	83.0%
	Mixed Assets Funds	3.9%	77.1%
	Bond Funds	2.8%	52.2%
	Guaranteed Funds	1.3%	20.6%
	MPF Conservative Funds	0.8%	12.9%
	Money Market Funds	0.6%	8.8%

It is important to note, however, that all six types of funds added value to contributions over the 15-year period.

28. But their rates of return varied significantly. For instance, the 15-year cumulative return for equity funds amounted to 83%, while that of the MPF conservative funds, which invest mainly in short-term deposits and short-term bonds, was only 12.9%. In other words, equity funds returned, on average, six times as much as MPF conservative funds.

29. It should be noted that the investment returns of MPF conservative funds (and money market funds) were dampened by the persistently low interest rate environment and were lower than the inflation rate.

30. Scheme members who have invested in guaranteed funds should take into account both the guarantee terms and the guaranteed return. The return figures shown in the above table do not reflect individual member's return on a guaranteed fund.

IX. Return figures vary even for the same type of funds

31. Even for the same type of funds, the performance can vary significantly, depending on their investment strategy and the markets they invest in. For example, Asia equity funds had an annualized return of 6.1% over the 15-year period, but Europe equity funds had only 0.9%. The fund choices made by scheme members (in the types of assets and geographical regions) therefore has an important bearing on their saving outcomes.

X. Funds with higher expected returns come with higher potential risk

32. Return figures have to be understood in the context of the associated risk levels.
33. While equity funds were the top performers, they also had the highest level of risk.

Highest and lowest monthly returns of MPF funds by fund type (1 December 2000 – 30 November 2015)		
Fund type	Highest	Lowest
Equity Funds	15.39%	-20.63%
Mixed Assets Funds	9.10%	-13.70%
Bond Funds	4.31%	-2.76%
Guaranteed Funds	1.58%	-2.24%
MPF Conservative Funds	0.48%	-0.05%
Money Market Funds	0.96%	-0.93%

34. As this table shows, equity funds went up by 15.4% in one month and fell by 20.6% in another, which means that their monthly returns had a range as wide as 36 percentage points over the 15-year period. MPF conservative funds, in contrast, had a range as narrow as 0.53 percentage points.

XI. Diversified portfolios help reduce investment risk

35. Risk can be reduced by developing a diversified portfolio across regions or asset classes. For instance, for equity funds, global equity funds recorded substantially lower volatility than some single market equity funds, such as Hong Kong equity funds and Asia equity

funds, over the 15-year period.

XII. Scheme members should review their MPF investments regularly

36. Scheme members should regularly review their MPF portfolio. They should take into consideration factors such as their investment goals and risk-tolerance level, and consider adjusting their asset allocation approach and the risk return tradeoff if appropriate.

XIII. Historical performance not a good indicator of what will happen in the future

37. Members should also note that the historical performance of a fund is not a good indicator of what will happen in the future.

XIV. Default Investment Strategy to be launched at year end

38. MPF members who find it difficult to make investment decisions may consider using the Default Investment Strategy (DIS) which is expected to be launched at the end of 2016. Even though it does not provide a guaranteed return, the DIS is designed to provide all MPF scheme members with a simplified investment option that is consistent with the overall objectives of retirement savings. The key features of the DIS are:
- ✓ A globally diversified investment strategy;
 - ✓ Automatic de-risking with age increase; and
 - ✓ A fee control of 0.75%.

Conclusion

39. At the System level, scheme members should understand that:
- ✓ The MPF is a long-term investment and its return is characterized by the compounding effect;
 - ✓ MPF funds invest in financial instruments in the market, and a high proportion of the MPF assets are invested in equities, which means the performance of the equity markets has a great impact on the System's performance;
 - ✓ The System's return does not represent what individual scheme members will make; and
 - ✓ The MPF System as a whole has added value to scheme members' retirement savings.
40. At the level of the individual scheme member, they should note:
- ✓ Each scheme member has a different investment portfolio, and his savings outcome hinges on his investment decisions;

- ✓ Different funds have different returns, so comparisons should be made with the same type of funds;
- ✓ Even funds of the same type have different returns; and
- ✓ Past performance is not indicative of future performance.

41. Here are six tips for scheme members:

- ✓ Don't try to time the market or be overly-concerned about short- or even medium-term performance;
- ✓ The higher the expected return, the higher the potential risk;
- ✓ The younger the scheme member, the higher his risk tolerance level. Young scheme members may therefore consider investing in funds with higher expected returns;
- ✓ Diversification can lower investment risk;
- ✓ Regularly review your MPF investment;
- ✓ When choosing funds, you should consider:
 - ⤴ fund fees and charges;
 - ⤴ the quality of the trustees' service (such as the time they take to process a fund switch, and whether they provide sufficient and convenient ways for checking account information);
 - ⤴ the suitability of the funds for your own circumstances (including years to retirement, your personal investment objectives and risk tolerance level).

Tools for managing your MPF

42. The MPFA website has the following information and tools to help scheme members plan their MPF investments:

- ✓ A number of platforms providing information on various schemes and funds, including:
 - ⤴ The Fee Comparative Platform;
<http://cplatform.mpfa.org.hk/MPFA/english/index.jsp>
 - ⤴ The Low Fee Fund List; and
http://cplatform.mpfa.org.hk/MPFA/english/low_fee_fund_list.jsp
 - ⤴ The Trustee Service Comparative Platform.
<http://tscplatform.mpfa.org.hk/scp/eng/index.jsp>
- ✓ Detailed information on MPF investment; and
<http://minisite.mpfa.org.hk/mpfie/en/index.html>
- ✓ Tools to help scheme members calculate their retirement needs.
http://www.mpfa.org.hk/eng/mpf_education/mpf_calculators/index.jsp

The MPFA launched a mobile application recently to help scheme members manage their daily expenses and devise their retirement saving plans.