

3 TRENDS IN CLIENT ASSETS AND ALLOCATION

KEY FINDINGS

CLIENT TYPE

- » Institutional clients remain the largest client group accounting for four fifths of assets under management (80%).
- » Pension schemes continue to be the largest institutional client type with 45% of total assets in 2018, increasing total assets by £135 billion in a year when the absolute value of retail and other institutional assets were down.
- » Consistent with previous findings, 56% of assets were managed on a segregated basis and 44% on a pooled basis.

ASSET ALLOCATION

- » Allocation to equities fell from 40% to 36%, possibly reflecting the poor performance in global equity markets in the last quarter of 2018. Both fixed income and 'other' assets increased their share by 1.8% as a result, increasing to 33% and 23% respectively. All other asset classes remained largely unchanged from 2017.
- » Within equities the UK allocation remained unchanged at 30% compared to 47% ten years ago. The fixed income allocation to overseas bonds increased by 7% in 2018 to 49%, up from 34% in 2011 when data was first collected.

GROWTH OF INDEXING MARKET

- » Three quarters (74%) of assets remain managed on an active basis, down from 84% a decade ago.
- » UK listed ETFs reached £240 billion in 2017, a 21-fold increase in value from £11 billion at the end of 2008.

INVESTMENT IN THE UK ECONOMY

- » Despite reduced allocations to UK assets as a proportion of total assets, IA members remain significantly invested in the UK economy holding £1.6 trillion in UK equities, corporate bonds, commercial property and, increasingly in recent years, in infrastructure and direct lending.
- » Three quarters of infrastructure investments are in economic infrastructure with the remaining quarter invested in social infrastructure, such as public schools or hospitals.



This Chapter looks across the entire UK-managed asset base of IA members and documents how these assets are split between different client groups, how they are allocated across asset classes and geographies, and what proportions are actively or passively managed. The distinctions are not always entirely clear, for example the line between retail and institutional is becoming increasingly blurred in the context of the growth in DC pensions. The institutional and retail markets are covered separately and in more detail in Chapters 4 and 5 respectively.¹⁷

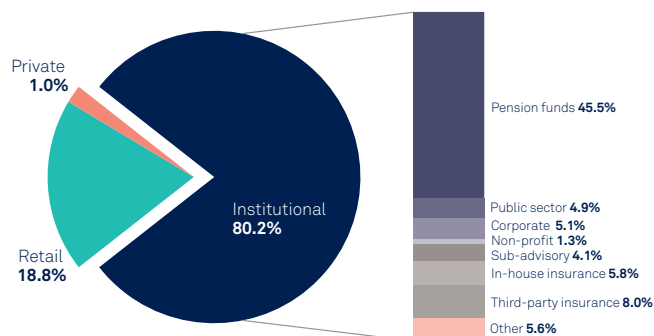
CLIENT TYPES

IA members manage assets on behalf of a range of different clients which can be broadly split into retail and institutional. The client breakdown in 2018 has remained fairly consistent with what we reported last year.

As Chart 8 shows, four-fifths (80%) of IA members' assets were managed on behalf of institutional clients in 2018, a marginal increase on the previous year. Once again pension funds dominate the client breakdown and are approaching half of all assets under management (45%). In a year where the absolute values of both retail and insurance assets were lower than the previous year, pension fund assets increased by £135 billion to £3.5 trillion.

The biggest year on year changes are in the insurance assets. In-house insurance has decreased from 8.3% in 2017 to 5.8% while third party insurance has increased from 6.7% to 8.0%. This decline in in-house insurance assets is a long term trend (see Chart 25) but has accelerated over the last year due to merger and acquisition activity. When we combine the insurance assets we still see an 8.5% reduction in their absolute value in 2018.

CHART 8: ASSETS MANAGED IN THE UK BY CLIENT TYPE 2018



The distinction between the different client types is becoming more challenging giving the blurring of line between different client types (see “Blurring of client types” overleaf for more detail).

¹⁷ Chapter 4 relates to money managed for UK institutional investors by IA members globally. It does not reflect money managed in the UK for all institutional clients.

BLURRING OF CLIENT TYPES

Insurance vs Pension

The definition of pension funds in the IA's data includes all schemes, both defined benefit (DB) and defined contribution (DC) where the scheme has a direct relationship with the investment manager, notably DB schemes and some of the larger DC schemes, including master trusts. However, the direction of travel in the pension provision market, with the ever-increasing importance of DC schemes, is making the distinction between the different client types more challenging.

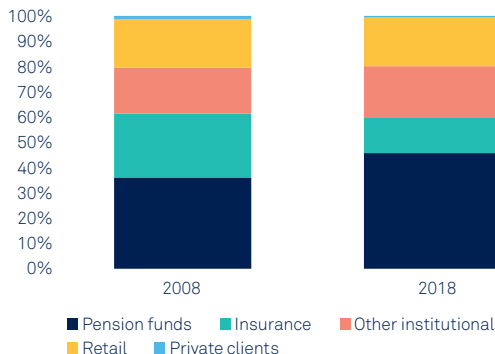
Retail vs Institutional

DC is something of a hybrid between retail and institutional. Pension savers in DC schemes receive an income in retirement that is based on the value of the pension pot they have accrued during their working life. Unlike a DB scheme, where their pension is based on their salary and is ultimately guaranteed by an employer, the value of a DC pension is determined by the contributions an individual makes to their plan and the return on assets they achieve on the investment strategies they select. The ultimate investment risk lies with the individual rather than the employer, and in this regard DC pensions are more akin to retail investments than institutional, albeit they will appear in the IAs data either as Pension fund or Insurance assets.

LONGER-TERM EVOLUTION OF CLIENT BASE

Looking at the long term trend in client types, we see the 80/20 split between institutional and retail clients observed in 2018 has seen little change over the last decade (Chart 9). More significantly, the underlying institutional client types have seen considerable change. The proportion of total assets from insurance clients is close to half the levels observed in 2008, driven by the decline in in-house insurance. The majority of the lost market share has been absorbed by pension funds which have increased their share by a quarter in the last decade from 36% in 2008 to 45% in 2018. Other institutional assets, particularly public sector and corporate client assets have absorbed the rest.

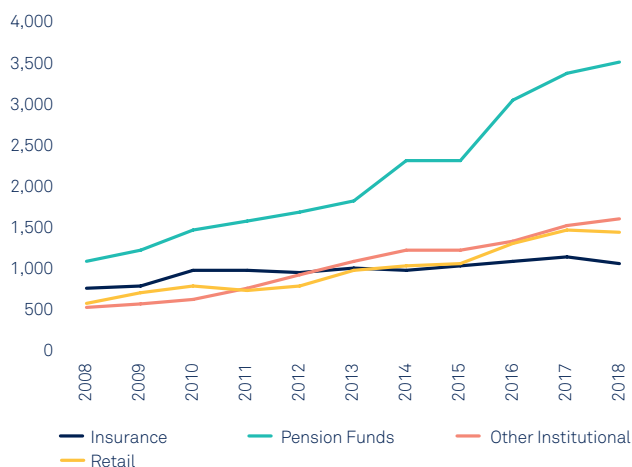
CHART 9: ASSETS MANAGED IN THE UK BY CLIENT TYPE (2008-2018)



As we will see in Chapter 4, liability driven investment (LDI) by DB pension schemes looking to manage the run off of their liabilities is a likely driver behind the growth of pension assets. To a lesser extent it will also reflect the increased pension participation resulting from automatic enrolment, much of which has been invested into master trust arrangements.

Chart 10 shows the growth of assets by client type in billions and shows the scale of pension assets relative to other client categories. The almost ten percentage point increase in pension funds' share of total assets seen in Chart 9 is equivalent to a threefold increase in assets from £1.1 trillion in 2008 to £3.5 trillion in 2018. Until 2013 growth in pension assets was in line, or slightly behind growth in retail and other institutional assets. Since 2013 pension assets have outpaced the growth in retail by a factor of two, almost doubling their assets in a period when retail and other institutional assets grew by 50%.

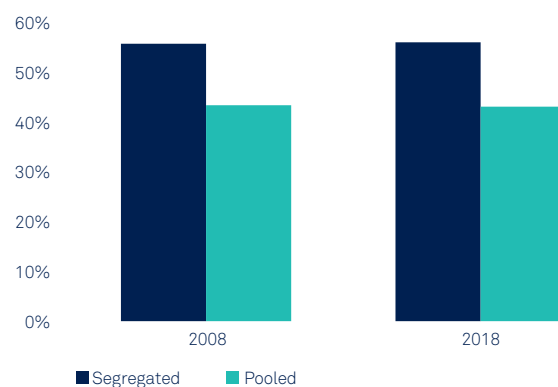
CHART 10: ASSETS MANAGED IN THE UK BY CLIENT TYPE, £BN (2008-2018)



SEGREGATED VS. POOLED

Despite the rise of ETFs alongside more established indexing vehicles such as investment funds and life funds, segregated mandates remain heavily used in the traditional institutional market. The ratio of segregated to pooled assets in 2018 is equal to the ratio reported in 2008, with almost no fluctuation in between (Chart 11). In 2018, 56% of assets were managed on a segregated basis and 44% on a pooled basis.

CHART 11: SEGREGATED VS. POOLED INVESTMENT (2008-2018)



ASSET ALLOCATION

As we discussed in Chapter 1, global equity markets' performance was severely hit in the last quarter of 2018 and although our data does not allow us to distinguish between market performance and flows, we can reasonably conclude that the changes in asset allocation are at least partly due to the market volatility observed in 2018. The most significant changes in asset allocation were seen in equity and 'Other' assets. Allocation to equities decreased from 40% in 2017 to 36% in 2018. Fixed income and 'other' asset classes with both increased as a proportion of total assets by 1.8% to 33% and 23% respectively.

Chart 12 illustrates the structural shift in asset allocation over the last decade. Equity and fixed income remain the two largest asset classes, but allocations outside traditional asset classes have increased significantly. The 'other' category has itself evolved from a focus on commodities, infrastructure and private equity to include LDI and solutions strategies where firms may be using derivatives extensively. It will also include some products where it is not possible to break down the allocation precisely. In 2018, 23% of assets were identified in this broad category, higher than the 21% observed in 2016 and 2017.

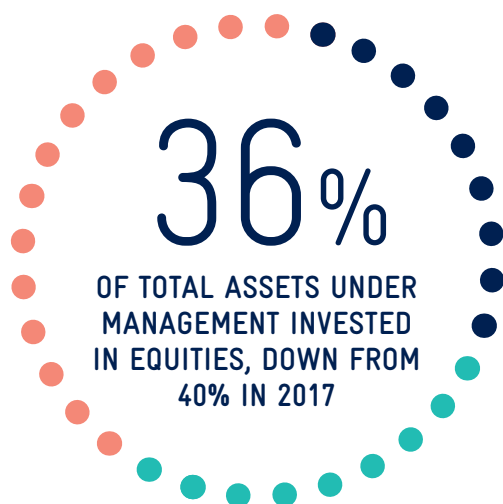


CHART 12: OVERALL ASSET ALLOCATION OF UK-MANAGED ASSETS (2008-2018)

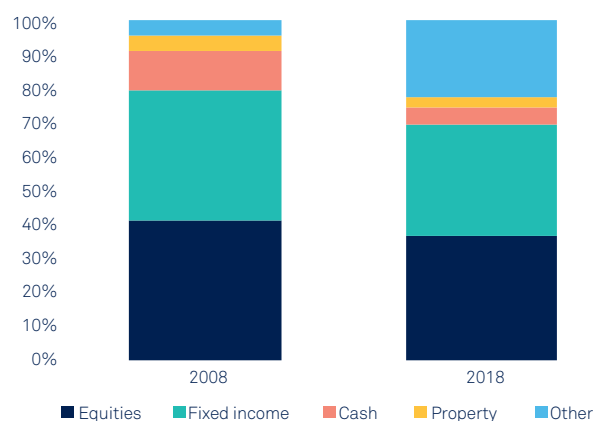


Table 4 shows that almost all members invest in equities with the vast majority also investing in fixed income and cash. The number of firms investing in property and alternative assets is significantly lower.

TABLE 4: PROPORTION OF IA MEMBERS INVESTING BY ASSET CLASS

	Percentage of firms
Equities	96%
Fixed income	85%
Cash	71%
Property	44%
Other	58%

DETAILED ASSET ALLOCATION

Beyond the shifts between asset classes, the IA also monitors the trends within equity and fixed income allocations according to type of exposure and this section considers these changes in more detail.

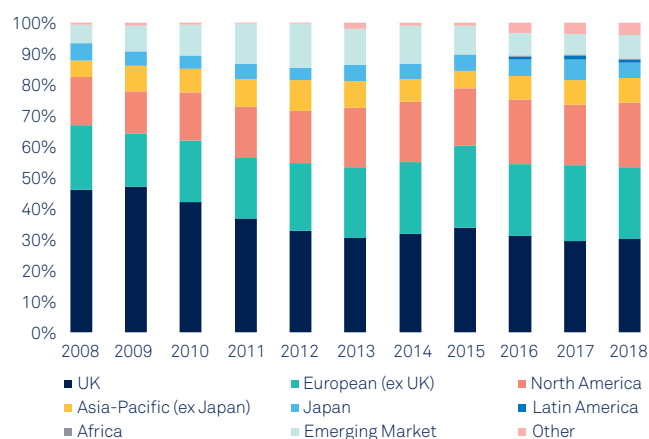
EQUITY BY REGION

Despite the market turbulence discussed in Chapter 1, there were no significant year on year changes in regional equity allocation. Within the last year allocation to UK equities remained unchanged. There was a slight decrease in allocations to Europe ex-UK to 23% as well as a slight increase in the allocation to North America from 19% in 2017 to 21%.

The long term trend in regional equity has been the decreasing allocation to UK equity relative to overseas equity (Chart 13). In 2018, this figure remained unchanged from last year standing at 30% compared to 46% a decade ago. Allocations to UK equity have fluctuated around, but not yet breached, the 30% mark for a number of years suggesting a base level of home bias. North America and European regions have absorbed the majority of this reduced allocation. This decline in UK equity allocation is driven by trends in both the institutional and retail market (see page 63 and page 69). We discuss overall investment in the UK economy in the final section of this chapter.

Emerging market equities' share of total equity allocation grew consistently in the immediate aftermath of the financial crisis but have been falling year on year since 2012. This trend appears to have reversed slightly in 2018 where allocation increased from 6% last year to 7%.

CHART 13: UK-MANAGED EQUITIES BY REGION (2008-2018)



FIXED INCOME BY REGION

While regional allocations in the equity markets have remained largely unchanged in the last few years, the bond market has seen considerable increases in overseas allocation from 42% in 2017 to 49% in 2018 (Chart 14). Half of this loss in UK market share in 2018 comes from the reduced allocation to UK government bonds (non-index linked) from 20% to 16%.

Growth in allocation to overseas bonds has coincided with the UK's decision to exit the European Union, increasing by two-fifths since 2015 from 36% to 49%. The uncertainty around Brexit has meant that firms are looking to reduce their exposure to the UK market. It is also a reflection of pension scheme derisking leading to more much money chasing a limited supply of UK bonds with greater investment opportunities in overseas markets.

Sterling corporate bonds have been the biggest losers since the referendum, with allocations decreasing year on year from 26% in 2015 to 18% in 2018.

CHART 14: ALLOCATION OF UK-MANAGED FIXED INCOME BY TYPE AND REGION (2011-2018)

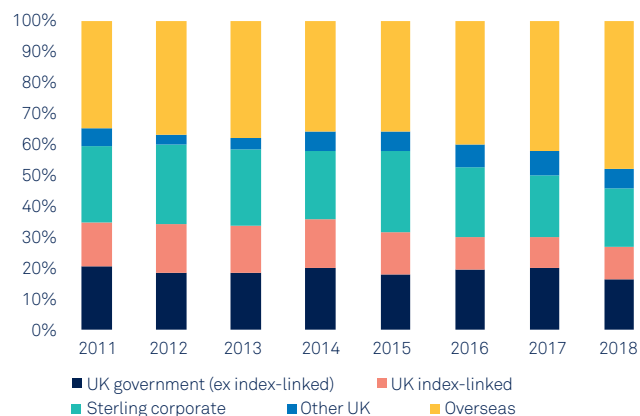
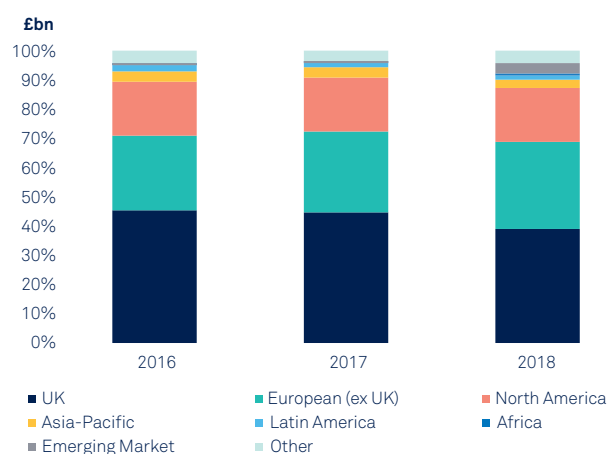


Chart 15 shows that as a proportion of total corporate bond assets, allocation to UK corporate bonds fell in 2018 from 45% to 39%, mirroring what we observed in Chart 14.

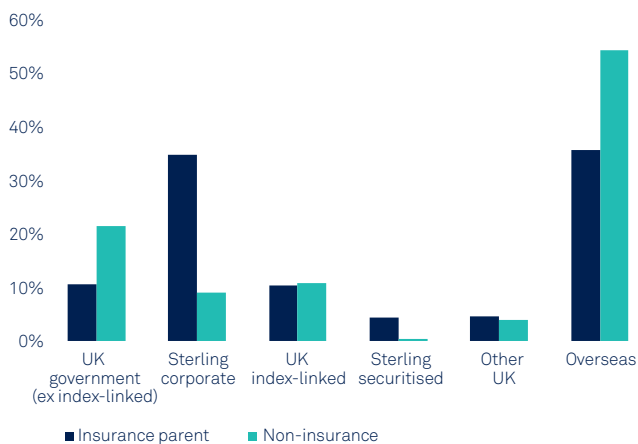
CHART 15: CORPORATE BOND ALLOCATION BY COUNTRY OF ISSUER (2016-2018)



FIXED INCOME BY CLIENT TYPE

Fixed income allocations differ depending on the category of the underlying client. Insurance companies, for example, have very specific requirements, partly driven by the nature of their product set (ie. annuities, protection such as life insurance) and partly driven by prudential regulation. If we look at how the allocation is altered depending on whether the investment manager has an insurance parent or not (see Chart 16) that difference becomes very clear. Insurance-owned groups have a much higher exposure to sterling corporate securities and, to a lesser extent, to index-linked gilts.

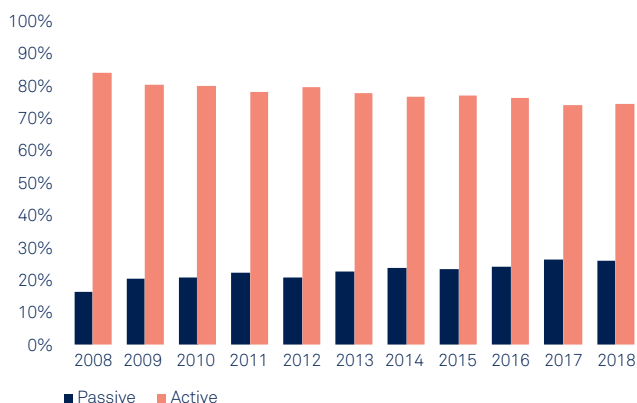
CHART 16: FIXED INCOME OWNERSHIP BY PARENT GROUP (INSURANCE VS. NON-INSURANCE)



GROWTH OF INDEXING MARKET

Chart 17 shows the extent to which UK managed assets are actively managed versus passively (index or 'index plus') managed and how this has evolved over the last decade. The growth in passive assets has increased from 16% in 2008 to 26% in 2018. This growth has been very gradual over the last decade.

CHART 17: ACTIVE AND PASSIVE AS PROPORTION OF TOTAL UK ASSETS UNDER MANAGEMENT (2008-2018)



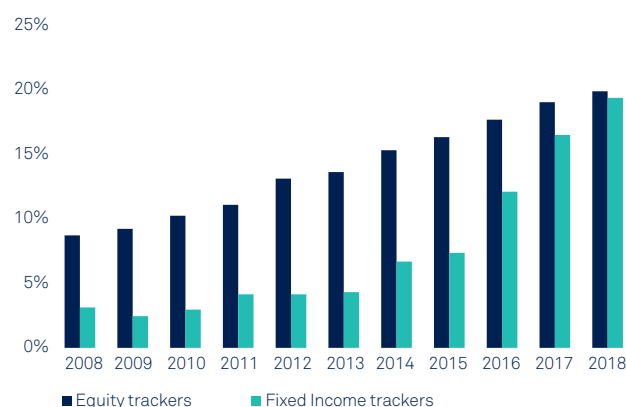
The trend in active and passive reflects two key factors

- Increasing demand for active and passive strategies within each asset class.
- Increasing allocation to strategies such as multi-asset or outcome focused that, by nature, involve more active management.

The IA began to collect the split between active and passive for equity and fixed income assets in 2017. In 2017 we reported that over half of equity assets were managed passively, in 2018 this fell to just over two fifths (42%). This is likely a reflection of the performance of major equity indices in Q4 of last year. The proportion of passive in fixed income also fell slightly from 34% in 2017 to 31%.

In the retail market, data from the IA's monthly fund statistics shows the proportion of funds under management in tracker funds was slightly lower at 15% by the end of 2018, more than double what it was in 2008. At an asset class level, in both equity and fixed income about 20% of fund assets sit in tracker funds (Chart 18). Fixed income in particular has seen remarkable growth in tracker fund assets, increasing by more than six times the proportion of assets reported in 2008.

CHART 18: TRACKER FUNDS AS A PROPORTION OF FUNDS UNDER MANAGEMENT BY ASSET CLASS (2008-2018)



ETF data is not currently included in IA monthly fund statistics, therefore we may not be capturing all retail investment activity. In 2018 we launched a consultation on the inclusion of ETFs in IA sectors, which should be captured in future iterations of the Survey.

THE ETF MARKET

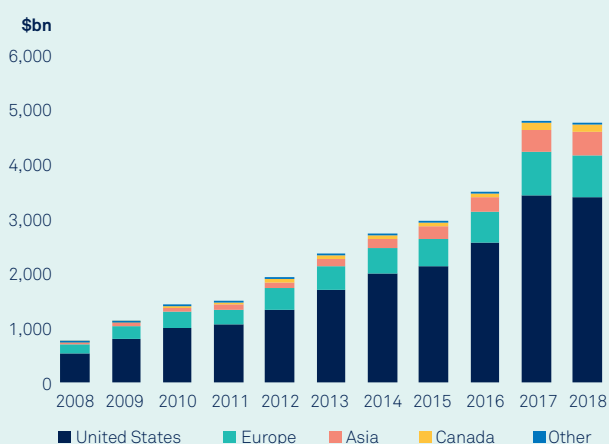
An ETF is an open-ended pooled investment vehicle with shares that, like a 'traditional' fund, will offer investors access to a portfolio of stocks, bonds, and other assets, most commonly aiming to track an index. Unlike a fund, it can be bought or sold throughout the day on a stock exchange which is why ETFs are effectively a hybrid of a tradeable stock and an index-tracking fund.

Over the last decade global ETFs have grown significantly from \$746 billion in 2008 to \$4.7 trillion. This is equivalent to a CAGR of 18% per annum. This global growth has far outpaced the CAGR in both UK AUM and FUM which grew 9% and 11% per annum respectively over the same period.

Chart 19 shows how assets in United States domiciled ETFs dwarfs all other jurisdictions with almost three quarters of total assets (\$3.4 trillion), European-domiciled ETFs stood at \$766 billion and Asian domiciled ETFs had assets under management of \$441 billion. Ireland is the second largest country of domicile behind the United States with \$427 billion held in ETFs.

As noted throughout the report, 2018 was a volatile year for global markets. Although the 0.5% fall is miniscule, it marks the end of a 10-year trend of year on year growth.

CHART 19: ETF ASSETS UNDER MANAGEMENT BY REGION OF DOMICILE

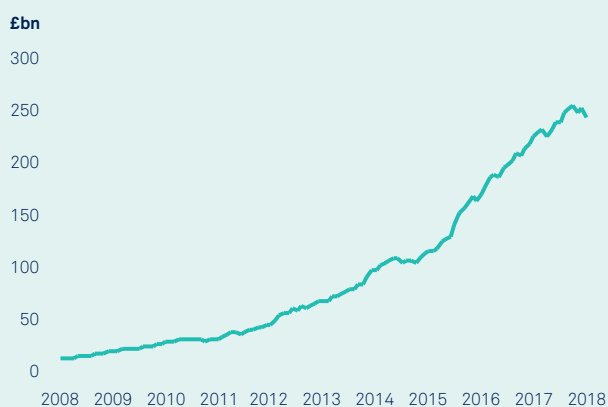


Source: Morningstar

ETFs IN THE UK

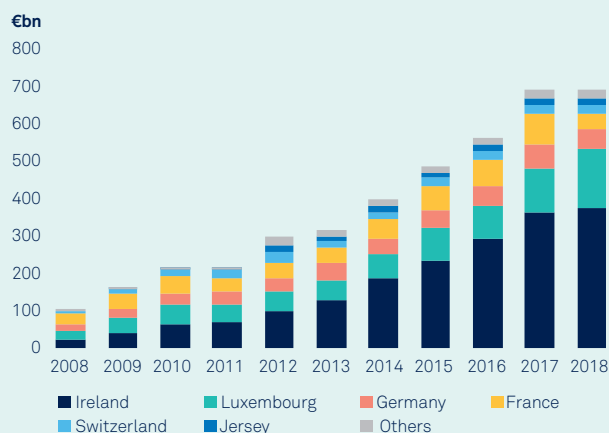
We cannot isolate the UK market for ETFs by domicile or by investor location in the same way we do for UK authorised and recognised funds. There is just one ETF domiciled in the UK. An ETF's domicile is not entirely relevant as it can be bought and sold from around the world making it impossible to know the location of the investor.

We use listing location as a proxy for UK managed ETFs on the basis that most of these assets are managed in the UK by IA members, who also report that almost all assets they manage in ETFs are managed on a passive basis. There are about 1,000 ETFs listed on UK exchanges with assets totalling £240 billion at the end of 2018, UK-listed ETFs have seen a 21x increase in value from £11 billion at the end of 2008 (see Chart 20).

CHART 20: ASSETS MANAGED IN UK LISTED ETFs (2008-2017)

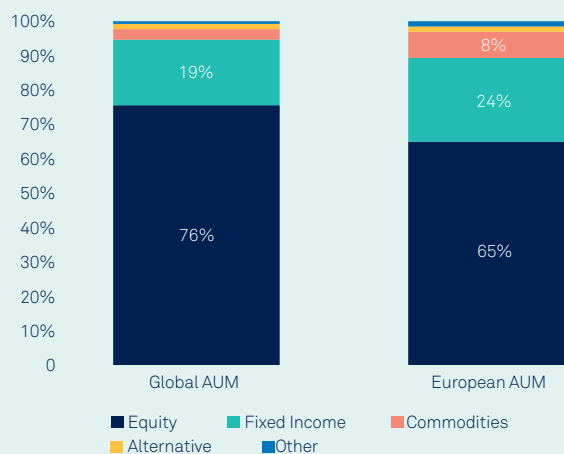
Source: Morningstar

The US ETF market is so large, it can mask some of the strong growth we see in other domiciles. Chart 21 focuses on the long-term trend in European domiciled ETFs which largely mirrors the growth we observed in the global market. As discussed, Ireland is the second largest global domicile for ETFs and dominates in the European market with 54% share (€375 billion) more than double its share of the market a decade ago.

CHART 21: EUROPEAN ETF ASSETS UNDER MANAGEMENT BY COUNTRY OF DOMICILE

Source: Morningstar

Asset allocations have remained fairly consistent over the last decade with equities commanding the largest allocation both globally and in Europe. European domiciled ETFs have a lower proportion of equity ETFs and a higher proportion of fixed income and commodity ETFs relative to global allocations (Chart 22).

CHART 22: PROPORTION OF TOTAL ETF ASSETS UNDER MANAGEMENT BY ASSET CLASS, 2018

Source: Morningstar

INVESTMENT IN THE UK ECONOMY

By channelling savings to capital markets, the investment management industry is a key source of funding for the UK economy, providing financing through a wide range of asset classes. Historically equities, fixed income and property dominated the activity of investment managers in the UK, but increasing use of private markets, including infrastructure, private equity and direct lending reflect the broadening expertise to be found in the UK's investment management industry – see Figure 8.

At the end of 2018, changes in asset allocation shown earlier in Chart 13 meant that the industry had £850 billion invested in UK equities representing 35% of the UK's market capitalisation. The exposure to UK equities as a proportion of holdings over the past twenty years has fallen significantly. This has been driven both by two main factors:

- Erosion of 'home bias', mirrored in other countries, whereby institutional and retail customers are

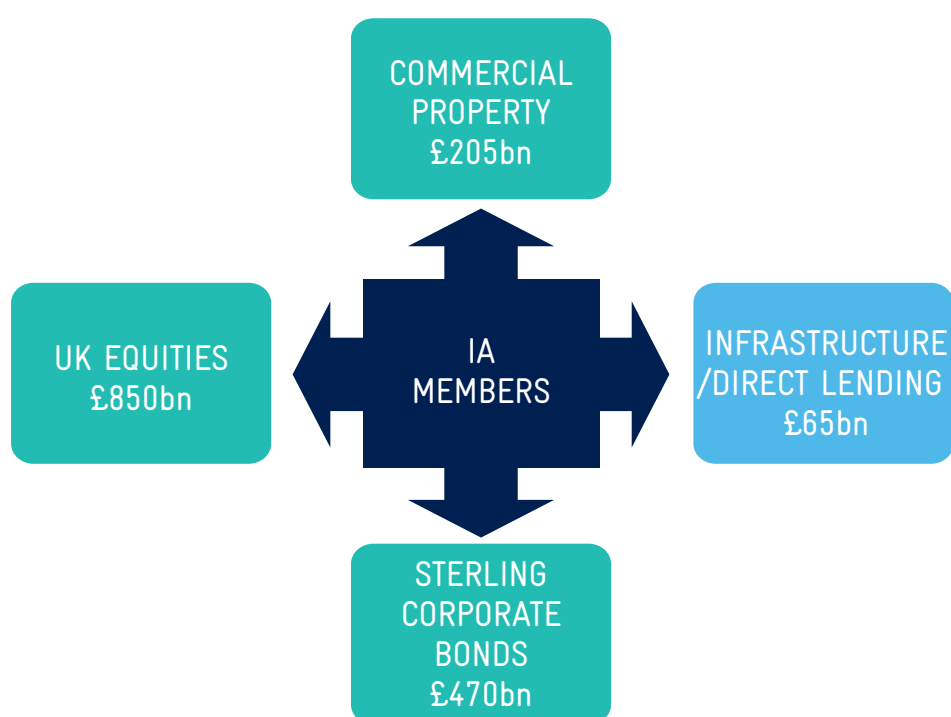
accessing a more international basket of shares (see page 63 and page 68).

- Significant changes in institutional pension allocations which has seen a de-risking, reflecting both regulatory/accounting changes and maturing DB schemes.

The UK's investment management industry continues to play a primary role in corporate debt financing having almost half a trillion invested in sterling corporate bonds. Independent research suggests that investment managers have accounted for purchasing the majority of corporate bond issues in recent years, as companies have turned increasingly to the debt markets to raise capital.¹⁸

Investment is occurring via more diverse asset classes such as infrastructure and direct lending, which are especially attractive to defined benefit pension schemes and insurers looking for liability driven and cash flow driven investment.

FIGURE 8: IA MEMBER HOLDINGS IN UK ASSET CLASSES¹⁹



¹⁸ The contribution of asset management to the UK economy, July 2016, Oxera

¹⁹ The majority of property investment is in commercial property, however a small amount may be allocated to residential accommodation, notably student housing. The majority of infrastructure investment is UK but some may be invested overseas.

INVESTMENT IN UK INFRASTRUCTURE

Total assets reported by UK investment managers into infrastructure was £35 billion in 2018, broadly in line with what was reported last year.

Similar to 2017, most investment in infrastructure by IA members at the end of 2018 (75%) was into economic infrastructure. This includes a variety of projects such as energy generation and metering, transport, utilities and environmental schemes such as flood protection. The remaining quarter was invested in projects which offer a social benefit, particularly social housing and healthcare-related projects such as the construction of hospitals (see Figure 9).

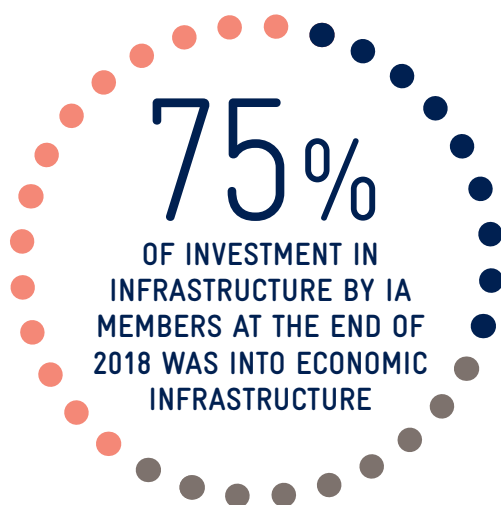
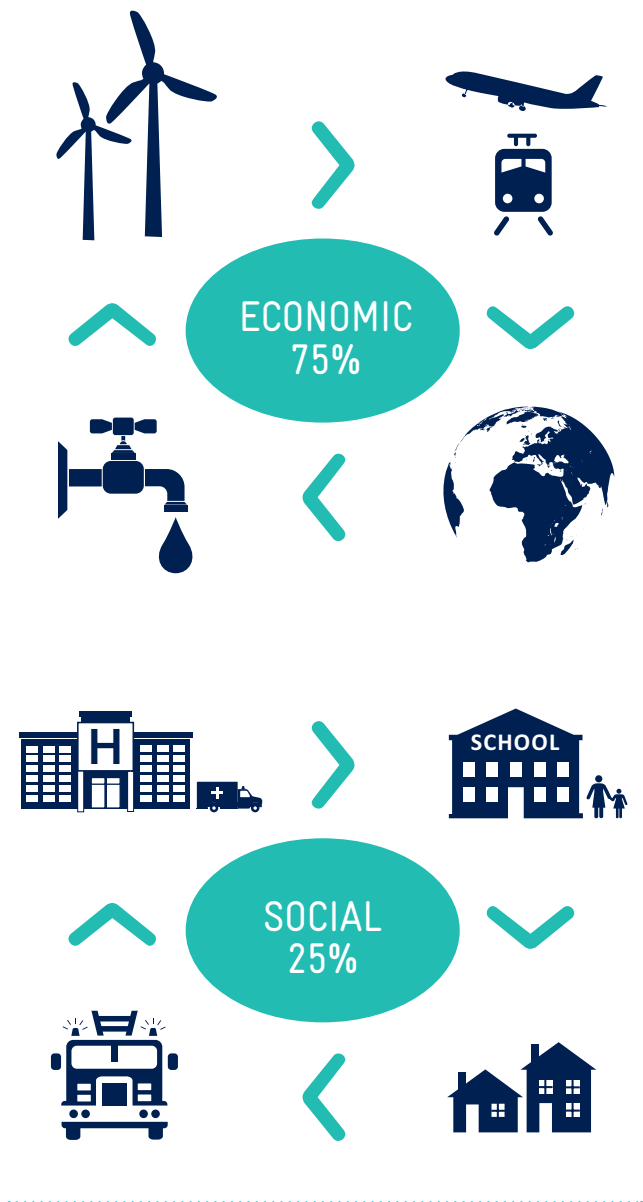


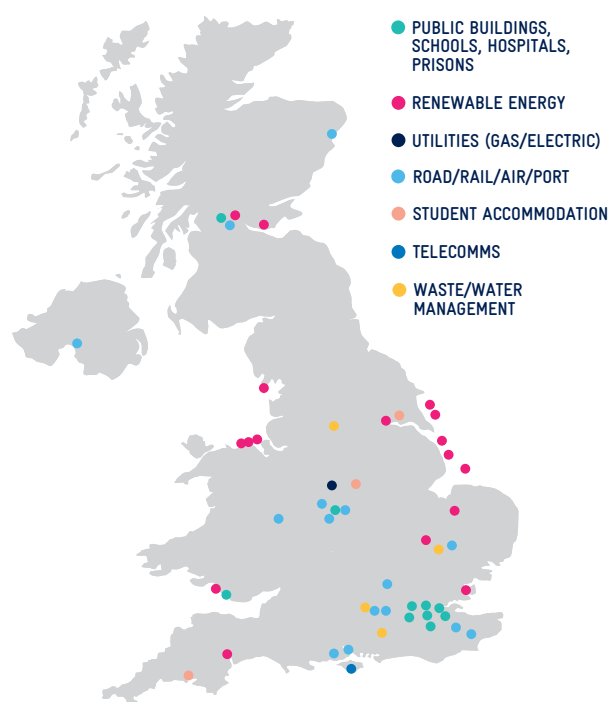
FIGURE 9: INFRASTRUCTURE INVESTMENT BY IA MEMBERS



The majority of this investment is estimated to be in UK infrastructure projects. Most UK investment managers will also consider investing in overseas projects that can meet the strict criteria required by their institutional clients.

The range of projects facilitated by IA members on behalf of their clients is extremely broad and Figure 10 provides a flavour of the projects that have been supported by UK investment managers in recent years. Green energy projects are particularly important, with investment in offshore wind farms.

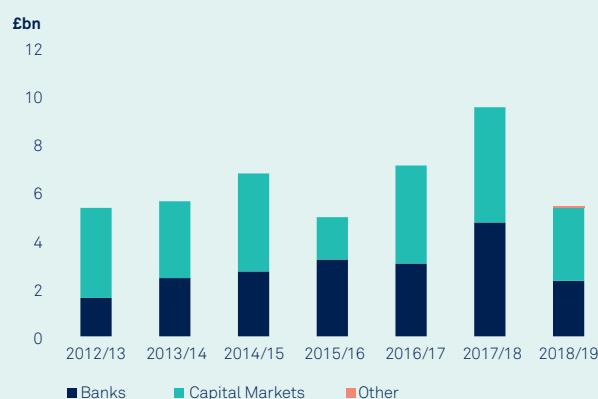
FIGURE 10: SELECTION OF UK INFRASTRUCTURE INVESTMENT FACILITATED BY IA MEMBERS



FINANCING SOCIAL HOUSING IN THE UK

The funding of social housing has undergone a number of step changes over the last 40 years. In the early 1980s housing associations were funded by the Housing Corporation, which provided grant funding. During the 1980s high street lenders entered the market financing housing that would provide them with what was effectively a government guaranteed rental stream, backed by housing benefits. As long-term finance from high-street lenders has become harder to come by housing groups have looked towards the capital markets for funding, via the bond market and private placements.

CHART 23: NEW HOUSING ASSOCIATION FINANCING BY BANKS AND CAPITAL MARKETS²⁰



Source: Homes and Communities Agency

²⁰ Quarterly survey of private registered providers, Homes and Communities Agency.