3 TRENDS IN CLIENT ASSETS AND ALLOCATION

KEY FINDINGS

CLIENT AND MANDATE TYPE

- In 2020, institutional clients continued to account for the majority of investment management industry clients, responsible for 79% of assets under management in the UK.
- Pension funds account for some 55% of total institutional assets, the same proportion as in 2019.
- Data from the last decade shows an increase in the proportion of assets managed on behalf of pension funds from 37% in 2010 to 43% in 2020. Over the same period, insurance client assets have fallen in relative terms from 25% to 12%. The ‘other institutional’ client category has increased from 16% to 24% with a notable increase in assets managed on behalf of corporate clients since 2010.
- The balance of assets managed within segregated mandates and pooled vehicles has experienced little change over the past ten years. In 2020, 53% of total assets were managed on a segregated basis and 47% were managed as pooled vehicles.

ASSET ALLOCATION

- In 2020, overall asset allocation remained broadly consistent with the previous year. Equity and fixed income allocations accounted for 39% and 32% of total assets, respectively.
- Long-term data shows an overall decrease in the proportion of assets within equities, which has fallen from 45% of total assets in 2010 to 39% in 2020. The majority of assets invested in equities are held within North America, the UK and Europe, together accounting for 71% of UK-managed equity investments in 2020.
- The share of UK equities has decreased over the past ten years, down from 42% in 2010 to 26% in 2020. This suggests a notable further erosion of the historic home bias towards UK equities. Over the same period, the proportion of European equities has increased from 20% to 22%, and the proportion of North American equities has grown from 15% to 23%.
- On average, the proportion of fixed income assets invested in the domestic bond market stood at 64% between 2011 and 2015 but has fallen consistently over the last five years to 45% in 2020. A variety of factors have contributed to this trend, including the globalisation of the investment process, uncertainty around Brexit and a competitive environment for fixed income assets in the UK.

GROWTH OF INDEXING MARKET

- Actively managed assets account for the majority of investment activity in the UK. However, the use of indexing strategies continued to increase in 2020, growing by one percentage point on the previous year, reaching 31% of total assets.
- The rising popularity of ETFs contributed to the growth of index strategies over the last few years. Global ETF assets under management reached a record $7.9 trillion at the end of 2020, an increase of 25% on the previous year. Almost three quarters (70%) of global assets are in US domiciled ETFs.
- Sustainable investment ETFs saw accelerated growth in 2020, rising to 4.4% of global AUM. The majority (73%) of global assets in sustainable investment ETFs sit within ETFs domiciled in Europe.

INVESTMENT IN THE UK ECONOMY

- Total investments across UK equities, sterling corporate bonds, UK infrastructure and commercial property stood at £1.7 trillion in 2020.
- In 2020, £40 billion was invested in infrastructure projects across the UK, which is unchanged from a revised 2019 figure. This includes investments in economic infrastructure (such as railroads and ports) and social infrastructure (such as public buildings) has remained relatively unchanged from the previous year. Within economic infrastructure, we observe a marked focus on renewable energy projects (mainly solar and wind farms or waste/water management facilities).
This chapter provides insight into the composition of the UK-managed asset base of IA members, with particular focus on three key dynamics: client groups, allocation across asset classes and geographies, and active- vs. indexed-based investment management styles.

It is important to have a strong overview understanding of the investment management industry, but the institutional and retail market are both dynamic spaces that warrant dedicated analysis and understanding, which is provided in chapters 4 and 5, respectively.

**CLIENT TYPES**

The investment management industry serves a wide range of clients that are broadly categorised as either institutional or retail clients. The split between institutional and retail clients has remained consistent over the last decade, with very little fluctuation in between.

Chart 8 shows the split of the £9.4 trillion of assets managed in the UK by client type. Between 2019 and 2020, the proportion of retail clients increased one percentage point to 20%, while the institutional client base remained unchanged at 79%.

- By far the largest client group for the investment management industry is pension funds, accounting for 43% of industry assets and 55% of total institutional assets. This was unchanged year on year.
- Among the other institutional client groups, there has been a significant change in the assets managed on behalf of insurance clients. On a relative basis, total assets have fallen once again and now account for 12% of total assets, a 1% decrease on the previous year.
- Corporate client assets increased for the third year in a row, making up 6.3%, up from 4.6% in 2017.
- Assets managed on behalf of various public sector organisations also increased reaching 5.4% in 2020.

**BLURRING OF CLIENT TYPES**

**Insurance vs Pension**

DC pension assets that are operated via life companies wrapping funds are not included in pension fund assets but are rather reflected in assets managed on behalf of insurance companies. This includes assets managed for personal pension and Group Personal Pensions (GPPs). This blurs the line between pension and insurance assets and means that the allocation to pension funds understates actual pension investment.

**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 IA’s data either as pension fund or insurance assets.
HISTORIC EVOLUTION OF CLIENT TYPES

There has been very little change in the composition of the industry’s client base between 2019 and 2020. However, we can observe some significant shifts when looking at the long-term data. Chart 9 offers a comparison of the distribution of assets managed in the UK by client type over a ten-year period. The most notable trends of the past decade have been:

- An increase in the proportions of assets managed on behalf of pension funds and ‘Other Institutional’ clients.
- A decrease in the share of assets managed on behalf of insurance clients.

The ‘Other institutional’ category has by far outpaced the growth of all other groups, with total assets growing to more than three times the level they were a decade ago in nominal terms. Assets managed on behalf of ‘Other Institutional’ clients now account for 24% of assets managed in the UK, up from 16% in 2010.

- The largest growth within ‘Other’ has been the growth in assets managed on behalf of corporate clients, which have increased from 3% of AUM in 2010 to 6% in 2020.
- Sub-advised client assets and public sector clients have also seen gradual increases over the last decade with each group increasing approximately 1.5% since 2010.

SEGREGATED VS. POOLED

Over the past ten years, the proportion of assets under management within segregated mandates versus the proportion within pooled vehicles has experienced little change. Chart 10 illustrates that between 2010 and 2020, the distribution has changed by merely 1 percentage point (in favour of segregated mandates).

Chart 10 illustrates that the distribution has changed by merely 1 percentage point over the past decade; the proportion of segregated mandates has fallen (from 54% in 2010 to 53% in 2020) but continues to account for the majority of investment strategies.

All client types have experienced some growth over the last decade, however reforms in the pension market as well as changing demographics have increased the need for funded pension provision through retirement. The result of these changes has been that the level of pension assets has increased six percentage points from 37% in 2010 to 43% in 2020 though this growth has flattened off over the last few years.

Insurance client assets have decreased thirteen percentage points over the last decade from 25% to 12% in 2020. The decline has been very consistent each year over the last ten years. In nominal terms, assets have remained flat whilst assets from other client groups have experienced strong growth.
ASSET ALLOCATION

In 2008, the global economic downturn resulted in a shift in the proportion of assets across the asset classes with equities falling and fixed income and cash increasing. There were no significant changes in 2020 with proportions remaining broadly consistent with 2019. Equities increased one percentage point to 39% and assets in ‘Other’ fell by one percentage point to 21%. Fixed income as a proportion of total assets remained unchanged at 32%.

Survey data does not allow us to differentiate between market movements and a genuine reallocation of client assets. We look at the long-term evolution across asset classes over the past ten years in Chart 11, where we see a notable fall in the proportion of assets within equities. Equities fell from 45% of total assets in 2010 to 39% in 2020. Some of this long-term trend will reflect a reallocation of assets but we also observe the impact of market performance, particularly in 2008 and 2018.

Total assets within the ‘Other’ category have seen the most substantial growth, with the proportion more than doubling over the last decade from 8% in 2010 to 21% in 2020. The majority of these assets are in solutions type strategies, such as Liability Driven Investing (LDI) but as we discussed in Chapter 2, a growing proportion are in private markets as IA members look to further diversify sources of returns and tap into higher yielding, but less liquid markets.

Table 5 looks at the proportion of IA members who manage assets within each asset class. Nearly all members invest in equities and over two thirds invest in fixed income assets. Cash is the most niche category with just under a fifth of members investing in the asset class. Over half of respondents (56%) to the Survey are investing across four or five of the asset classes in Table 5. Just over a quarter (26%) of respondents are specialists, investing in only equities or only in bonds.

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Percentage of firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equities</td>
<td>95%</td>
</tr>
<tr>
<td>Fixed income</td>
<td>77%</td>
</tr>
<tr>
<td>Property</td>
<td>39%</td>
</tr>
<tr>
<td>Cash</td>
<td>19%</td>
</tr>
<tr>
<td>Other</td>
<td>56%</td>
</tr>
</tbody>
</table>

Table 11: Overall Asset Allocation of UK-Managed Assets (2006-2020)
DETAILED ASSET ALLOCATION

In addition to monitoring the shifts between asset classes, the IA assesses trends within Equity and Fixed Income allocations according to type of exposure. This section considers these changes in more detail.

EQUITY BY REGION

Chart 12 illustrates the continued fall in the proportion of UK equities and the growth of international equities over the last decade. In 2020 the proportion of assets in UK equities fell three percentage points to 26%, this represents a sixteen percentage point fall since 2010 when UK equities accounted for 42% of total equities.

There are a range of drivers for this decline in UK equity holdings by investors. For domestic private sector DB schemes, changing approaches to risk management in the context of evolving liability structures and regulatory and accounting rules are now a longstanding feature of investment behaviour. This has seen a major disinvestment from equities as an asset class over two decades, which has been characterised by the strong erosion of an earlier ‘home bias’ towards UK equities. The UK retail funds market has also seen a long-term reduction in UK equity holdings as a proportion of total FUM as well as a reduction of total equity (see Chapter 5).

A significant recent driver of the decline in UK equity holdings as a proportion of total equity holdings has been the uncertainty over the future UK relationship with the EU from 2016-2020, resulting in significant under-performance amid reduced allocations by domestic and international investors.

The majority of equity assets are held within North American, UK and European listed equity markets, accounting for 71% of UK-managed equities in 2020. This number has seen some fluctuation over the last decade, averaging at 74%.

The proportion of equity assets within European equities has remained relatively stable over the last decade, and stood at 22% in 2020. Meanwhile, over the past ten years, North American equities have grown to account for 23% of all UK-managed equities in 2020, up from 15% in 2010.

FIXED INCOME ASSETS BY REGION

The majority (41%) of fixed income assets are invested in UK and overseas government bonds. Just over one third (35%) of assets are held within sterling and non-sterling corporate bonds.

We have seen a shift towards overseas bonds over the last five years. Chart 13 shows that between 2011 and 2015, on average, 64% of fixed income assets were in the domestic bond market. Since then, the proportion of assets in UK bonds has fallen each year, reaching a new low of 45% in 2020. This is a nineteen percentage point fall over a period of just five years.

There are a few factors at play that could be driving these trends:

- The first is the increased globalisation of investment processes. We saw the shifts towards increasingly diversified equity holdings in the previous section and Chart 13 is an extension of that trend in the fixed income space.

- The second is a supply side issue. Fixed income holdings have become a core component of many institutional clients’ portfolios. Given the nature of the liabilities, DB pension schemes and insurance clients for example, have become heavily invested in fixed income assets (see Chapter 4 for more detail). The market in the UK is fairly concentrated with 50 issuers accounting for almost half the sterling
As the volume of assets within fixed income has increased, and pension funds balance managing risk through diversification with the hunt for yield, there are not enough investment opportunities in the UK to meet the rising demand.

The third point is related to performance. Corporate bond yields in market such as the US have been higher than in the UK for a number of years.

The final point is regarding the impact of Brexit. The fall in the proportion of assets within domestic bonds coincides with the 2016 Brexit referendum. The uncertainty and political instability over the last few years has meant that investors have been looking to reduce their exposure to the UK market. It could be argued that given points one and two above, Brexit was an accelerant to an inevitable shift.

Global assets in ETFs, which are largely index tracking vehicles, have experienced remarkable growth over the last few years (see overleaf for more detail). The firms with the largest index strategy offerings are also amongst the largest players in the ETF space and this growth is contributing to the trend observed in Chart 14.

Why we see a golden opportunity in UK corporate bonds, Schroders, 2020.
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.

Despite the volatility that has characterised the past eighteen months, global assets under management (AUM) in ETFs reached a record $7.9 trillion at the end of 2020, an increase of 25% on the previous year. This growth rate is slightly lower than the rate recorded in 2019 (30%) but still outpaces the 19% annual growth rate over the last decade.

Growth rates remained strong across domiciles in 2020, but slowed down slightly after a bumper 2019. Chart 15 shows that ETFs domiciled in the United States continue to make up the majority of global AUM, again accounting for 70% – or $5.5 trillion – of total assets.

In 2020, European domiciled ETFs represented 16% of total ETFs, equivalent to $1.3 trillion. This was unchanged year on year. The vast majority (83%) of these assets sit within ETFs domiciled in Ireland and Luxembourg, with assets totalling $800 billion and $280 billion respectively. Assets within Ireland-domiciled ETFs in particular had another year of strong growth, increasing 19% year on year.

Assets in Asian domiciled ETFs reached $813 billion in 2020, a 30% increase year on year. This growth outpaces the growth in other regions, though the proportion of global AUM was still broadly unchanged at 10% of global assets.

ETFs are overwhelmingly index tracking funds with 97% of global ETF assets in trackers. Even though assets in active ETFs are starting from a much lower base, total assets have grown over the last decade from 0.4% of total assets in 2010 to 3.3% in 2020.

Chart 15: ETF ASSETS UNDER MANAGEMENT BY REGION OF DOMICILE (2010-2020)

Source: Morningstar

Chart 16 below shows that this growth has accelerated in 2020, with total assets in active ETFs increasing 65% year on year. Much of this growth comes from US and Canada domiciled funds, which account for 86% of assets in active ETFs. In fact, one quarter (25%) of assets in Canada domiciled ETFs are in active funds.

Chart 16: ACTIVE ETF ASSETS UNDER MANAGEMENT (2010-2020)

Source: Morningstar
ETF PERFORMANCE THROUGH 2020

As news of the spread of Covid-19 began to emerge in early January 2020, Asian markets experienced some volatility. As a result, the first signs of Covid-19 induced stress started emerging among Asian domiciled ETFs in January 2020 as total assets fell 1.1% on the previous month and South Korean domiciled ETFs in particular suffered heavy outflows. In February and March 2020, the volatility had spread across global capital markets and total assets across regions experienced severe declines. Over the first quarter of 2020, total global assets in ETFs had fallen 16%. Chart 17 shows that although the March 2020 downturn was extreme and unprecedented in speed and scale, the bounce back has been equally as remarkable.

CHART 17: ETF AUM BY DOMICILE (2019-2020)

In the equity ETF space, the falls were primarily driven by asset depreciation as most regions recorded net inflows over Q1. The exception was European domiciled equity ETFs, which saw £15 billion in outflows in March. Most of the March redemptions in European domiciled ETFs were from US, Global and Japan Large-Cap equity and Global Emerging Market equity ETFs. In a sign of investor’s home bias during stress periods, European and UK Large Cap equities experienced strong positive inflows in March. By August 2020, as investors began to return to ETFs and markets bounced back, total net assets in European and US domiciled equity funds had fully recovered. Having managed to control the spread of the virus more effectively, AUM in Asian domiciled ETFs recovered more quickly and were back to pre-Covid-19 levels by May 2020.

CHART 18: EQUITY ETF NET FLOWS BY DOMICILE (2020)

Fixed income ETFs had a much more difficult ride as all regions recorded net outflows in March, which is consistent with the trend seen in the wider funds market. In March, US and European domiciled fixed income ETFs reported £20 billion and £15 billion in outflows respectively. Consistent with the broader industry trend, the majority of European domiciled fixed income outflows were from riskier sectors of the fixed income market, namely Global Emerging Market bond ETFs and EUR/USD High Yield bond ETFs. High outflows were also seen from EUR Corporate Bonds.

During the flight to safety in late February, USD Government Bonds domiciled in Europe were the second highest selling ETFs but suffered amongst the heaviest outflows as the demand for dollars increased in March. The recovery in assets and net flows in the fixed income space was quicker than to equity ETFs with total assets returning to pre-crisis levels by May among US domiciled funds and by June among funds domiciled in Europe.
ETFs emerged from the crisis as potential sources of liquidity and price discovery during periods of significant market stress. During the height of the crisis that unfolded across markets in March 2020, ETFs remained resilient despite high levels of trading activity on secondary markets. In the fixed income space, investors relied on ETFs as a price discovery mechanism as their prices were seen as a much clearer indicator of the value of underlying instruments than the Net Asset Value (NAV), which reflected stale valuations at the time.

SUSTAINABLE AND RESPONSIBLE INVESTMENT

Sustainable and responsible investment has seen accelerated growth within the industry in recent years. Member firms have expanded their offerings of products with a responsible investment tilt, including in the ETF space. In early 2019, Morningstar developed a classification framework to identify funds that can be considered “Sustainable Investment” funds. Sustainable investments are then broadly broken down into three main groups: ESG funds, Impact funds and Environmental Sector funds.

Based on this framework, Chart 20 shows that total global assets in sustainable investment ETFs stood at over $340 billion at the end of 2020, more than double the level recorded at the end of 2018. Almost all of these funds are categorised as ESG funds with a smaller proportion with an additional Impact or Environmental flag. The growth has outpaced the growth in ETF assets overall thereby increasing the share of sustainable investments from 2.7% of global assets to 4.4%. The last quarter in 2020 in particular saw this growth accelerate. Environmental sector ETFs have seen the highest growth rates in 2020 with assets in renewable energy ETFs increasing eightfold from $3.9 billion in 2019 to $24.5 billion in 2020.

As we saw in Chart 15, US domiciled ETFs account for 70% of global assets, however amongst sustainable investment funds, US domiciled funds make up just 21% of assets, with the majority (73%) of sustainable investment assets sitting within ETFs domiciled in Europe.
INVESTMENT IN THE UK ECONOMY

The investment management industry is a key source of funding for the UK economy, as it channels savings to capital markets and provides financing through a range of asset classes. The political and economic challenges of the past year – prompted or exacerbated by the pandemic – serve as a reminder of the importance of investment in local economies. In the past, investment managers have invested in the UK economy through the traditional asset classes, namely listed equities and bonds. Increasingly, the reliance on market-based finance since the global financial crisis has seen the investment management industry expand into alternative asset classes within the private markets, which includes investment in infrastructure projects.

Although both UK equities and sterling corporate debt have fallen as a proportion of total assets in 2020, in absolute terms total assets have remained broadly unchanged year on year. As seen in Figure 10, assets managed by IA members in UK equities account for 39% of total market capitalisation in 2020. Total infrastructure assets remained unchanged, though commercial property assets increased 20% in nominal terms to £235 billion. Total assets invested in the UK economy across property, corporate bonds, equities and infrastructure stood at £1.7 trillion in 2020.

FIGURE 10: IA MEMBER HOLDINGS IN UK ASSET CLASSES

- **COMMERICAL PROPERTY** £235bn
- **UK EQUITIES** £950bn
- **INFRASTRUCTURE** £40bn
- **STERLING CORPORATE BONDS** £450bn

20 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-based but there are some investments located overseas.
INVESTMENT IN UK INFRASTRUCTURE

As we emerge from the Covid-19 pandemic, there is an increasing focus on “building back better”. While Covid-19 was economically, politically and socially destabilising, the crisis presents us with a window of opportunity to re-evaluate financial, political and social systems. One of the ways in which investment managers can contribute to this is through investment in infrastructure projects. In 2020, UK investment managers held an estimated £40 billion in infrastructure projects, unchanged from the revised 2019 figure.

Figure 11 presents how we categorise infrastructure investments. There are two broad categories—economic or social. Economic infrastructure includes investments in renewable energy, utilities, transport and telecommunications, and accounts for the majority (70%) of infrastructure projects in the UK. Social infrastructure mainly involves public health, education and building, construction and maintenance. Social infrastructure investments make up 30% of total infrastructure investment in the UK.

Though limited to a selection of projects, Figure 12 illustrates the types of infrastructure projects facilitated by IA members on behalf of their clients. These investments span across the UK, though notable clusters of investments in public buildings can be seen around major cities. Renewable energy projects make up a significant proportion of investment in UK infrastructure projects, which mainly consist of offshore and onshore windfarms.

Increasingly, members are also investing in nationwide initiatives which prohibits their inclusion on this map – this includes regional waste and water management services, national grids for the provision of fibre broadband and international transportation networks.

**Figure 11: Infrastructure Investment by IA Members**

**Figure 12: Selection of UK Infrastructure Investment Facilitated by IA Members**