jpespartners

LOOKING BEYOND INVESTMENT RETURNS: ASSET OWNER PRIORITIES IN 2023

CONTENTS

EXECUTIVE SUMMARY

To assess and identify the key trends likely to drive the investment industry in the coming year, JPES Partners has interviewed senior decision-makers at 32 UK pension schemes, charities, investment consultants, fiduciary managers, wealth managers and wholesale platforms who are collectively responsible for more than £800 billion of assets.

Our research assesses asset owners' views across a range of areas including their experiences and satisfaction levels towards the asset managers they employ; future asset allocation plans; and manager selection criteria. The aim is to identify the main trends driving asset owner thinking and what this means for the asset managers providing, or potentially providing, services to these clients.

Having proved very resilient during the COVID-19 pandemic, the last twelve months have been far more challenging for the asset management industry. Greater volatility in markets, rising inflation, increased geopolitical tension, stressed supply chains and policy missteps have created a much more difficult environment for businesses to operate in. The prolonged bull market of the 2010s seems an increasingly distant memory.

In such a context, the expectations of asset owners towards managers are of increasing importance if these businesses are to be successful, and there will be a lot of work required from investment providers if they are to navigate these challenging times.

SURVEY UNIVERSE

Interviews were conducted with 32 UK pension schemes, charities, investment consultants, fiduciary managers, wealth managers and wholesale platforms, including:

- **Babcock International (Rosyth) Pension Scheme**
- **Close Brothers**
- **Church of England Pension Scheme**
- **FE fundinfo**
- **Institutional Adviser**
- **Leverhulme Trust**
- **Local Pensions Partnership**
- **LGPS CIV**
- **National Grid Pension Scheme**
- **Oxford University Staff Pension Scheme**
- **PrudentialPMG**
- **Rathbones**
- **Royal Mail Pension Scheme**
- **Santander (UK) Pension Scheme**
- **SGM**
- **The Mineworkers Pension Scheme**
- **Universities Superannuation Scheme (USS)**
- **TW Pension Scheme**

A further 14 respondents agreed to participate on an anonymous basis. The authors also extend their thanks to Mark Thompson, an independent chair, trustee and adviser, who responded in a personal capacity.

KEY FINDINGS

- The last twelve months have seen a **sharp fall in asset owner confidence in their existing managers**. Just 33% of respondents claimed to be 'confident' or 'very confident' in their existing manager roster, compared to 69% in 2021 – **a decline of 36%**. Of particular concern were the results asset managers have delivered (75%) and the ability of investment strategies to respond to a crisis (41%).
- While managers scored highly on their speed of responsiveness to client requests, **more than a third (41%) were dissatisfied with the quality of information that was provided**. This is potentially a significant issue for investment providers, particularly within the wholesale market, given incoming regulations such as the Financial Conduct Authority's Consumer Duty.
- Inflation and rising interest rates are having a significant impact on asset owner allocation plans, with notable differences between institutional and wholesale audiences. **While institutional investors show a greater propensity towards fixed income, inflation and interest rate hedging assets, wholesale audiences are showing much more interest in equities and real assets/alternatives capabilities** – a feature that may well affect asset managers' distribution strategies. A demand for greater portfolio liquidity is common across all audiences and, if anything, has been heightened by the events following the UK Government's mini-budget at the end of September.
- Underlying audiences are generally satisfied about progress being made on issues relating to ESG, with some additional progress on social and governance issues, though environmental considerations still dominate. **The lack of data and consistency across the investment industry, however, remains a general concern**.
- Investors of all types have felt the reverberations of the Russia-Ukraine conflict, which has also spurred debate on allocations to China in light of its position on the world stage. Responses to this vary significantly, depending on asset owners' particular long-term goals.
- An ability to explain investment strategy, show how investment processes are structured, demonstrate team quality and continuity, and a positive corporate culture, are all key criteria for asset owners when selecting managers. However, these are also perceived as areas of weakness, with **only 8% of asset owners satisfied with the way managers demonstrate their culture**.

IMPROVEMENTS REQUIRED AS SATISFACTION IN MANAGERS FALLS

Asset managers have faced significant challenges over the last twelve months as increased volatility, market selloffs, central bank interventions, policy missteps and a more pessimistic outlook have all taken their toll. In this context, a reduced level of confidence among asset owners towards the managers they employ might be expected. Our analysis, however, finds a much sharper fall in confidence than managers might have anticipated, with just 33% of respondents feeling 'confident' or 'very confident' in their roster of managers. This represents a decline of 36% compared to our 2021 study. Further, almost two-thirds (65%) of respondents indicate they are 'likely' or 'very likely' to make changes to their roster of managers in the next twelve months.

Analysing the reasons for this dissatisfaction (and the potential for changes as a result), the delivery of performance has clearly been a driving factor, with just one-quarter (25%) of respondents 'satisfied' or 'very satisfied' with the delivery of results by their managers versus the objectives that have been set. Active managers came in for particular criticism with several respondents noting that overweight exposures to the technology sector and US markets have been a particular millstone around the necks of managers, leading to underperformance. There is also a general recognition that market conditions have been particularly challenging, with one respondent noting that this has played a significant role in identifying 'weaker' managers.

Digging deeper, our analysis identifies some clear areas where managers were felt to have fallen short, which need to be addressed to both facilitate new business and, just as critically, retain existing clients.

Such a discrepancy is significant, and something that asset managers will need to think carefully about. A case of "more haste, less speed" can be made in terms of managers ensuring that they are not just providing information for the sake of doing so but giving clear and informative insights that can help their clients' long-term planning. This includes clear, concise explanations of investment strategy and its expected performance in different market scenarios.

"There is considerable manager dissatisfaction as most were in Tech and the US, and even ESG managers are overweight in Tech! So, coming to Earth with a bang would be my description…"

PENSION SCHEME TRUSTEE

FIGURE 1: SATISFACTION LEVELS OF ASSET OWNERS TOWARDS THE ASSET MANAGERS THEY EMPLOY OVER THE LAST 12 MONTHS COMPARED TO 2021

(Source: JPES Partners)

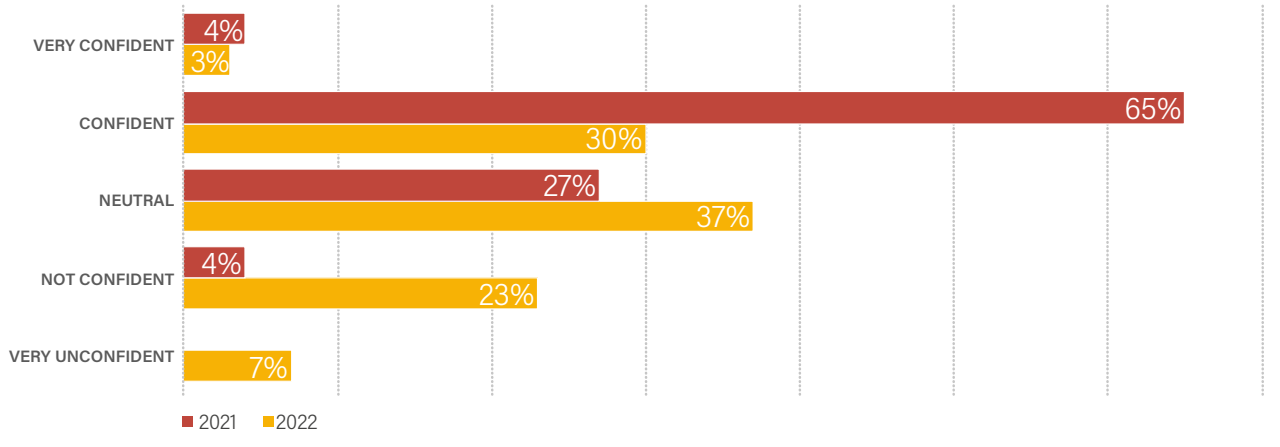
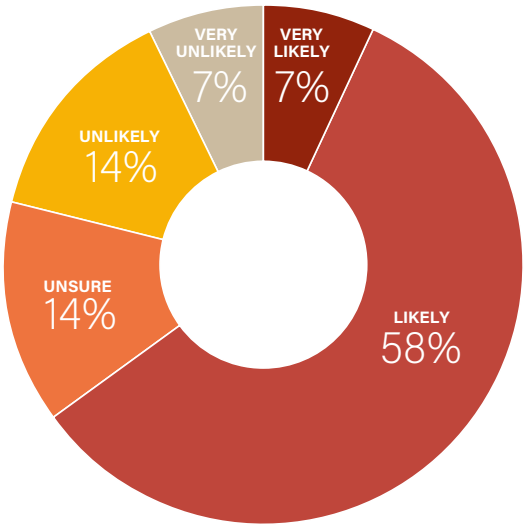


FIGURE 2: LIKELIHOOD OF ASSET OWNERS TO MAKE CHANGES TO THEIR ROSTER OF MANAGERS IN THE NEXT 12 MONTHS

(Source: JPES Partners)



The quality of information is also extremely pertinent when considering the regulatory challenges that asset owners themselves face. In the UK, the FCA's rules on Consumer Duty[1] – an effort to facilitate best practice and improve the experiences of consumers dealing with financial services firms – threatens to have a significant impact, in particular for fund platforms and boards catering for retail investors. There are also reporting challenges posed for asset owners by the incoming Pensions Dashboard while, at a European level, the European Securities and Markets Authority (ESMA) has indicated an ambitious regulatory strategy for the next five years.[2] There has already been significant upheaval arising from the EU's Sustainable Finance Disclosure Regulation (SFDR), with numerous asset managers downgrading funds previously marked as having Article 9 status. Clear, concise and most importantly accurate information will be vital in this future landscape for both asset owners and managers to have a clear grasp on each other's position. Those managers best able to navigate this will undoubtedly find themselves with a distinct competitive advantage.

"Markets have been dismal this year and much worse than during the Covid crisis and as markets have gone down (both equities and bonds) then this has meant that weaker managers have been revealed – and there is a long list of weaker managers suffering from these markets."

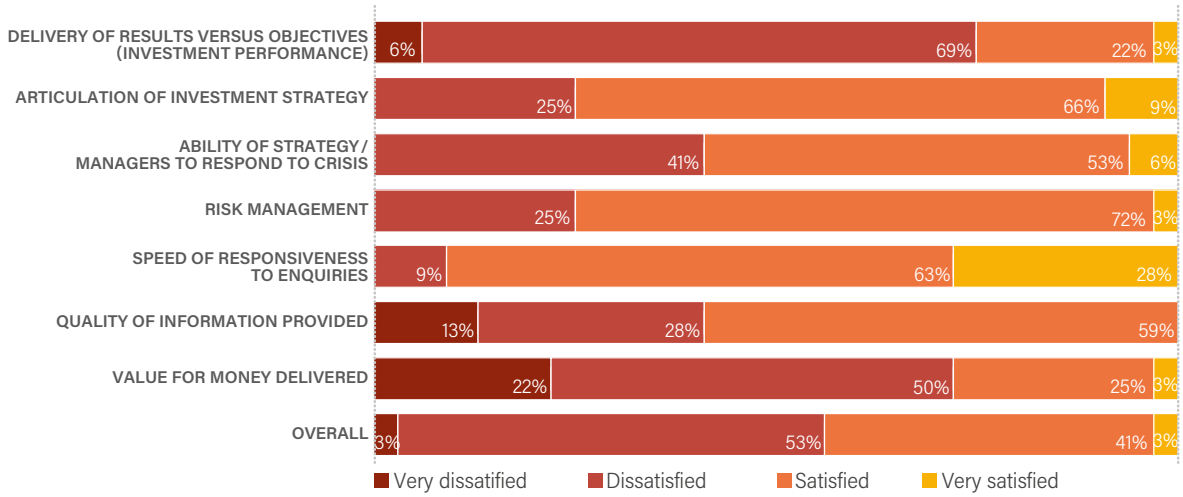
WHOLESALE PLATFORM

"The biggest issue by far is the Consumer Duty Regulation in the UK coming from the FCA. It is TCF on steroids. Fund boards and platforms hosting these funds need to be very aware of the huge amount of work required here. Certainly, this is a juggernaut coming towards fund boards!"

REGULATORY CONSULTANT

FIGURE 3: ASSET OWNER SATISFACTION TOWARDS MANAGERS IN THE LAST TWELVE MONTHS

(Source: JPES Partners)



1. Financial Conduct Authority, A New Consumer Duty – Policy Statement (July 2022)
2. ESMA press release, ESMA announces strategic priorities for the next five years (10 October 2022)

CHANGING ASSET ALLOCATIONS AND THE IMPACT OF INFLATION

Inflation has arguably been the defining story of 2022. A confluence of events – exceptionally tight labour markets, the Russia-Ukraine crisis, supply chain stresses and rising energy prices – have resulted in sharp rises that have been felt by investors, businesses and consumers generally as rising prices significantly impact household budgets. Unsurprisingly, this has become a key consideration for asset owners, with a recent Russell Investments study of UK defined benefit pension schemes identifying this as the most critical issue for pension trustees and sponsors in the next six months.[3]

The impact on asset owners is, however, leading to markedly different approaches and thinking depending on the type of investor – something that is being reflected in future asset allocation plans.

It should be noted that the institutional portion of our study is primarily comprised of defined benefit decision-makers, which is reflected in the asset allocation priorities identified.

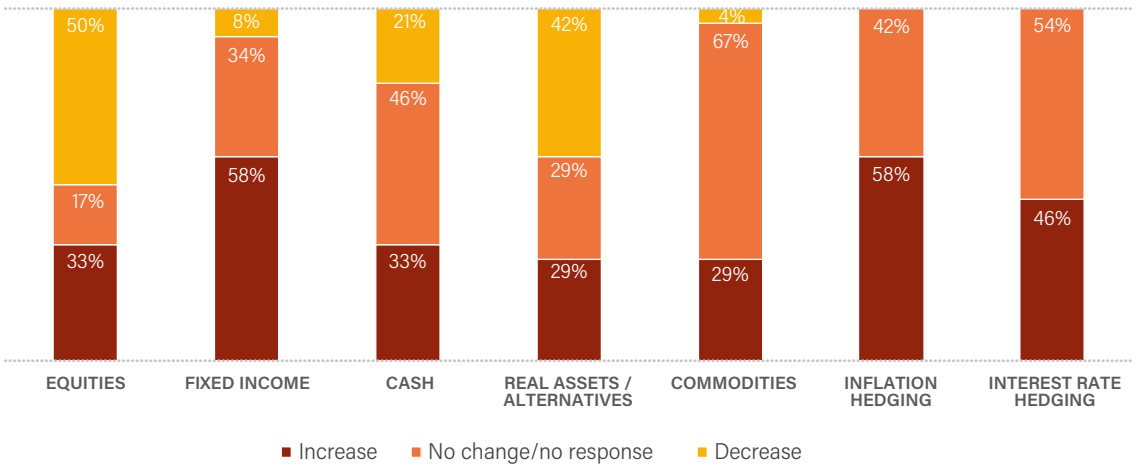
These decision-makers, spurred on by improved funding levels as a result of rising interest rates (an effort by central banks to combat inflation) are increasingly focused on de-risking and, as such, moving away from riskier or more illiquid assets. Particularly notable are the plans among this segment of our survey universe to move away from real assets and alternatives which have previously been in vogue.

"Funding levels have improved substantially so we are closer to neutralising the liabilities. This means that we will have less in the more exotic alternatives because this won't be attractive to potential buyers as valuation is more complex."

DEFINED BENEFIT TRUSTEE

FIGURE 4: INSTITUTIONAL ASSET OWNER ASSET ALLOCATION PLANS IN THE NEXT TWELVE MONTHS

(Source: JPES Partners)



3. Russell Investments, The Changing Ecosystems of Defined Benefit Pensions (November 2022)

In comparison, however, wholesale audiences – specifically wealth managers and platforms – indicate a much stronger appetite for real assets and alternatives, reflecting their different perspectives to defined benefit decision-makers. A much greater appetite for equity market exposure is also evident. We can also apply this thinking to a large degree to the local authority, charity, endowment and foundation markets, which operate with much longer-term perspectives in mind.

This raises an interesting business development proposition for asset managers specialising in these asset classes. Increased demand from wholesale audiences indicates a need, and a business opportunity, to focus sales and marketing efforts more towards these channels than a sizeable portion of the institutional market that now has much more limited appetite for such assets and strategies.

"For us it is all about real assets that can cope with inflationary pressures, and this means property, infrastructure, real assets, commodities and total return solutions. However, I would say that going into some of these securities after periods of very strong performance is galling, so with equities and bonds so weak it is also a time to pick up some of these at good valuations."

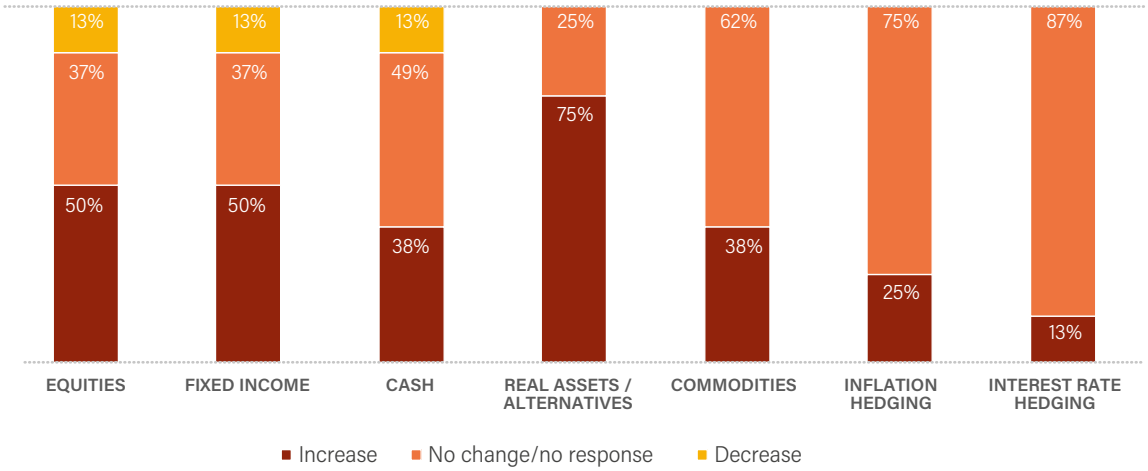
WEALTH MANAGER

"I get it on illiquid alts and the institutional desire to jettison these and this makes for a good opportunity for platforms to pick these up!"

INVESTMENT PLATFORM CIO

FIGURE 5: WHOLESALE ASSET OWNER ASSET ALLOCATION PLANS IN THE NEXT TWELVE MONTHS

(Source: JPES Partners)



THE DATA CHALLENGES OF ESG

The general consensus among asset owners is that issues relating to ESG are being addressed in a largely satisfactory manner. Interestingly, levels of satisfaction are somewhat higher among institutional audiences, with 62% of respondents indicating they are 'satisfied' or 'very satisfied' with the approaches their managers are taking on climate change issues specifically.

Numbers are, however, somewhat lower among wholesale audiences, with wealth managers and investment platforms indicating a lower level of satisfaction on climate-related issues with one quarter of decision-makers either 'dissatisfied' or 'very dissatisfied with the actions of their managers in this area.

Across the board, managers score highly on issues relating to diversity and inclusion (D&I), with audiences noting improvement with respect to areas such as benchmarking, though work in other areas – gender pay gaps, mental health issues – are identified as needing further work. 61% of institutional audiences identified themselves as being 'satisfied' or 'very satisfied' with managers' performance on D&I issues, with wholesale decision-makers scoring even more highly (78%).

Despite these satisfaction levels, notable concerns remain. Questions around greenwashing persist, while there are particular questions around data and reporting, with a view that – at an industry level – much more needs to be done on consistency.

4. Harriet Agnew and Adrienne Klasa, The Financial Times, Asset managers divided by HSBC executive's climate criticism (25 May 2022)
5. Brooke Masters and Patrick Temple-West, The Financial Times, Companies attack Texas over 'politicised' ESG blacklist (29 August 2022)

"The data from managers is not good and also the indices are not correlated. So, a long way to go on this and therefore journeys cannot be mapped properly. This is an industry issue and not a fund-by-fund issue. It falls into the Data, Compliance, Regulation and Reporting box and is a real headache for funds Europe-wide."

WHOLESALE PLATFORM

"Managers do suffer from greenwashing and there is a bit of the bandwagon effect. Also, with the heating and fuel crisis many, particularly in the US, are starting to move against ESG. There is clearly an anti ESG movement commencing and a rational reality check. Stuart Kirk at HSBC was instrumental in this with his criticism of Central Bankers and Policymakers' Climate Change hyperbole."

WHOLESALE PLATFORM

An additional challenge that has particularly come into focus in the last year is the resonance that ESG itself as a concept is having. The comments made by Stuart Kirk at a Financial Times conference have precipitated something of a backlash on ESG . We have also seen significant pushback in the US towards the ESG movement with Texas 'blacklisting' funds and managers it considers hostile towards fossil fuels and, at a social level, the overturning of the Roe v Wade Supreme Court judgement continuing to have reverberations in how asset owners consider US companies and the market as a whole. A recalibration of thinking now appears to be taking place, potentially giving rise to a more granular view of specific aspects within the ESG construct. We have already seen some elements of this with an enhanced focus on climate change and net zero, and an acceleration of this to emphasise individual considerations, rather than ESG as a whole, may now be on the horizon.

FIGURE 6: INSTITUTIONAL SATISFACTION ON CLIMATE CHANGE

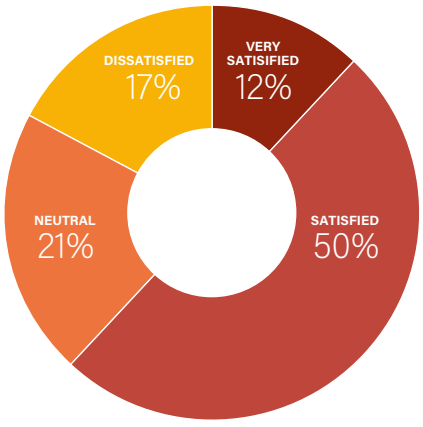
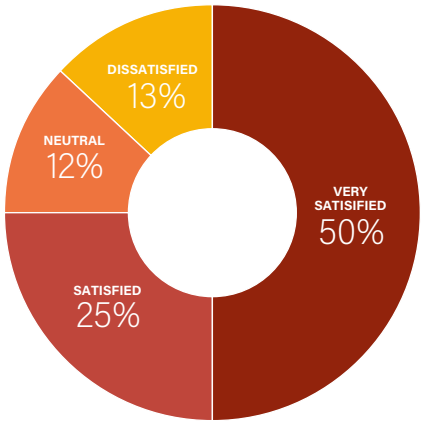


FIGURE 7: WHOLESALE SATISFACTION ON CLIMATE CHANGE

(Source: JPES Partners)



SHIFTING GEOPOLITICAL DYNAMICS RAISE CONCERNS

Russia's invasion of Ukraine has been one of the defining events of 2022. Divestment from Russian assets as a result was inevitable, with outcry over Russia's actions marking it out as a pariah in the international community. The effect on asset owners has also been notable, with 29% of institutional investors and 37% of wholesale respondents noting the conflict has impacted their decision-making to a 'significant extent.'

While the impact of the conflict should in no way be minimised, a notable consequence is the effect it has had in the way that asset owners consider other exposures. Chief among these is China, with asset owners at a minimum beginning to explicitly express concerns about the regime, its practices and its resulting place in portfolios.

FIGURE 8: INSTITUTIONAL CHANGES IN LIGHT OF RUSSIA-UKRAINE CONFLICT

(Source: JPES Partners)

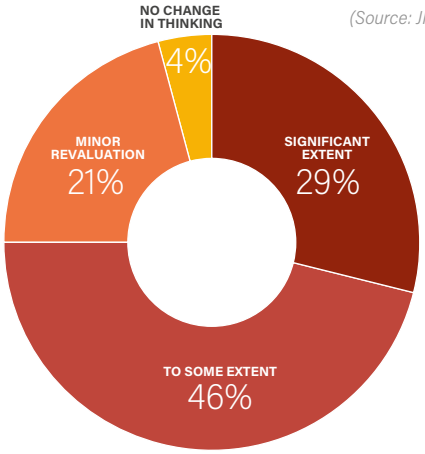
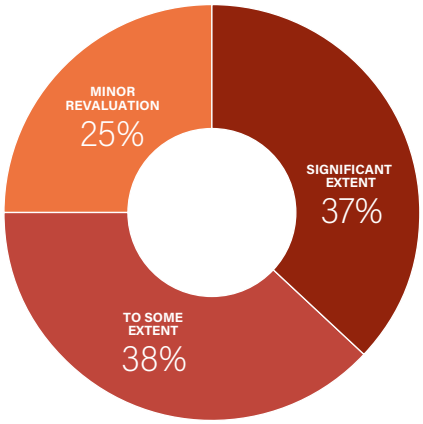


FIGURE 9: WHOLESALE CHANGES IN LIGHT OF RUSSIA-UKRAINE CONFLICT



Attitudes here are extremely mixed – to the extent that it is impossible to draw any firm conclusions as to the thinking of specific groups of asset owners. A clear concern among all audiences, however, is that China is too big to ignore, with an added recognition that improvements in critical areas such as climate change and net zero emissions will be impossible without engagement and the encouragement of better behaviour.

Compounding the problem for investors is that, for many, China cannot be considered in isolation and taking a strong position in having no exposure would mean also re-evaluating other parts of portfolios with exposure to uncomfortable issues – concerning political regimes and practices, poor human rights records and the like. To that end, something of a 'wait and see' sentiment currently pervades. How long this can continue remains to be seen but, as ESG debates continue to evolve, it is increasingly clear that managers will have to clearly articulate and evidence their approach on these types of issues.

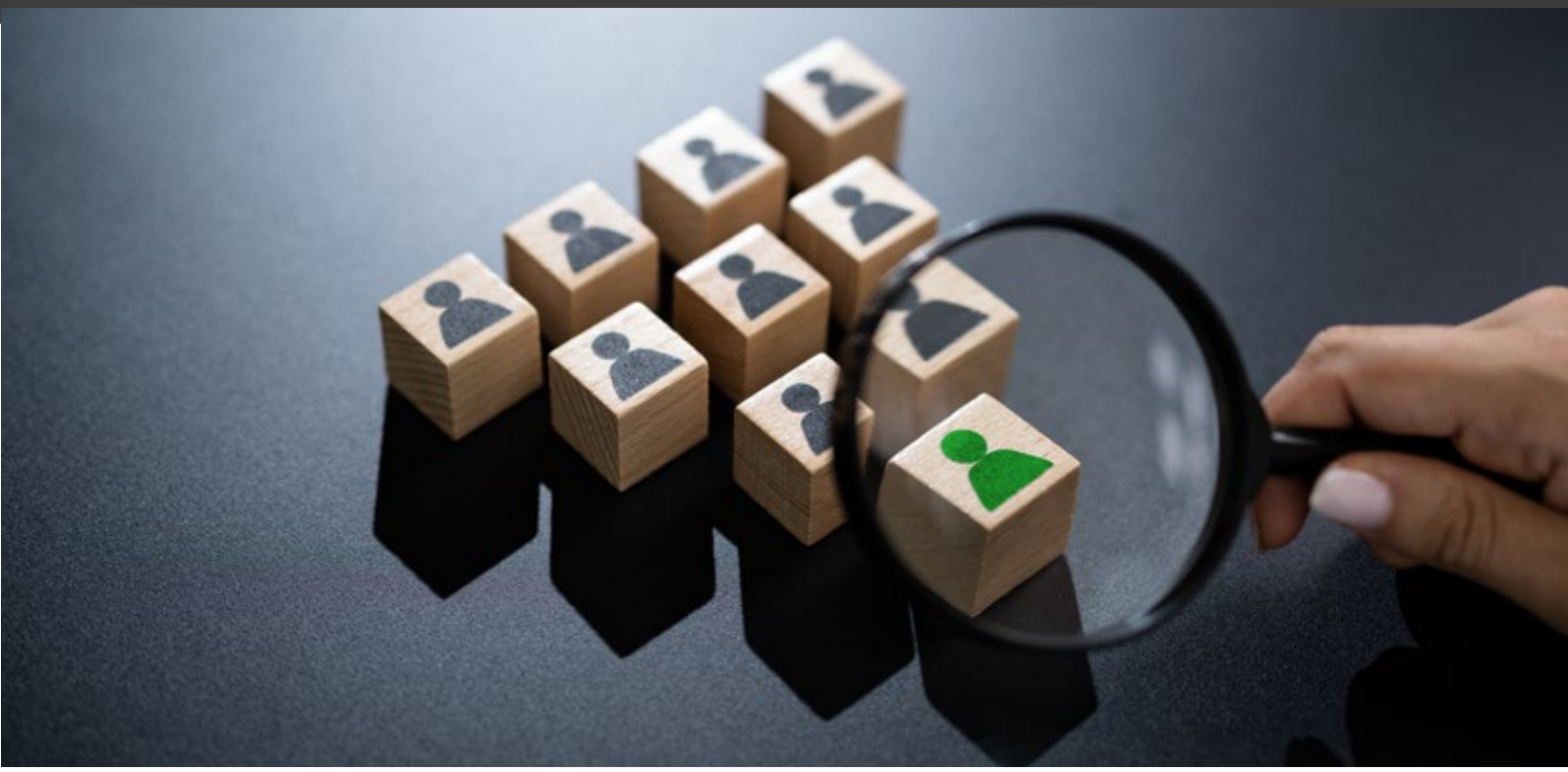
"The view on China is that certainly it is a pariah but clearly without being involved in some way to change behaviour then it is pointless even to pretend there will be a transition globally to Net Zero."

PENSION SCHEME TRUSTEE

"Asset allocation to China is being asked about but currently that is too much in the 'too difficult box.' If we considered China too much, then many other countries would also come up short…we are keeping a watching brief and the Taiwan situation post Ukraine is clearly worrying…"

PENSION FUND TRUSTEE

CULTURE SHOCKS: KEY CONSIDERATIONS WHEN SELECTING MANAGERS



In assessing and selecting managers, it is evident that certain considerations are particularly critical to asset owners. All respondents identified the importance of team quality and continuity in their decision to select a manager, while the ability to explain investment strategy (85%) and how investment processes are structured (96%) also rank extremely highly. Perhaps most notable, however, is the importance that asset owners are placing on the attributes of the investment firms themselves, with 92% of respondents identifying the ability to demonstrate a positive corporate culture as a critical selection criterion.

Unfortunately, responses from our survey universe indicate that many of these priorities are not being met, with just 8% of respondents indicating satisfaction with the culture asset managers demonstrate. Issues relating to team quality and continuity also appear a concern, with 35% of asset owners indicating dissatisfaction in this area.

This raises a number of questions for asset owners to consider and address, be this to secure new mandates or, just as importantly, retain existing clients. Chief among these is how managers engage with their underlying investors to demonstrate the particular attributes of their business, understanding of client needs and ability to meet their requirements. When considered in the context of the current levels of satisfaction towards managers (see Figure 1), investment firms clearly face challenges and will need to take proactive action to alleviate these concerns, at a minimum. This does, however, also present opportunities for those managers who are seen to be making real progress on these issues. They are more likely to experience long-term commercial success.

FIGURE 10: KEY CRITERIA IN ASSET MANAGER SELECTION

(Source: JPES Partners)

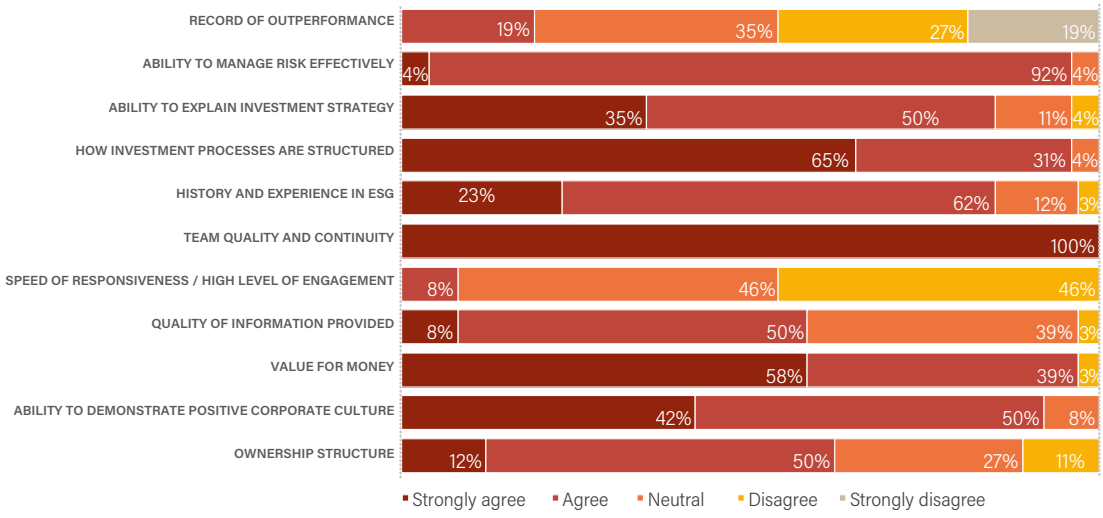
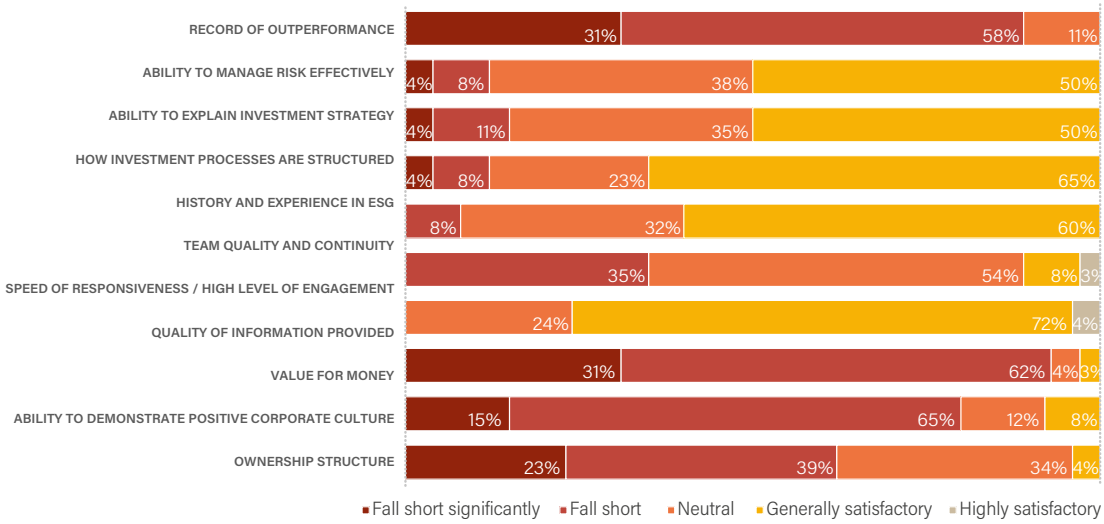


FIGURE 11: PERCEIVED WEAKNESSES OF MANAGERS BY ASSET OWNERS



SUMMARY: ACTIONS AND NEXT STEPS FOR ASSET MANAGERS

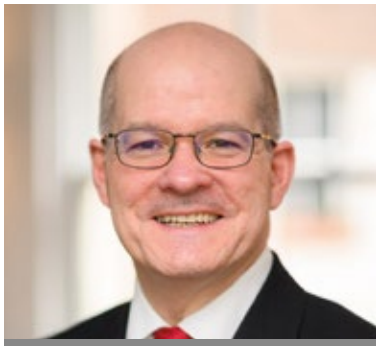
While the challenges of market volatility, geopolitical uncertainty, economic slowdown and increasing regulation can be considered mitigating factors, it is clear there is significant work for asset managers to do.

These changing dynamics mean more scrutiny of the investment industry, its businesses and practices, arguably than ever before. In this context, continuing the approaches employed during the relatively benign environment of the last decade simply will not be sufficient. Specifically, asset managers will need to consider and act on the following areas to enable future business success:

- Reviewing and improving client engagement practices to demonstrate an ability to meet investor needs, as well as the unique characteristics and attributes of individual businesses. This includes the methods, frequency and regularity of engagement, but in particular the provision of information that can help asset owners meet their own regulatory and reporting requirements.
- Reviewing distribution and sales strategies to reflect changes in investor needs and the revised allocation requirements of different facets of the asset owner universe.
- Clearly articulating the merits of investment approaches, their ability to meet investor goals and enable inherent understandings among clients of the different scenarios in which strategies will out – or underperform.
- Demonstrating improvements and insights on ESG approaches to reflect a more granular, nuanced and complex debate that will likely focus on specific issues rather than the ESG construct as a whole.

JPES PARTNERS

REPORT AUTHORS



PHILIP ROBINSON
CONSULTANT AND ADVISER

+44 (0)20 7520 7620
philip.robinson@jpespartners.com

JULIAN SAMWAYS
FOUNDER AND MANAGING DIRECTOR

+44 (0)20 7520 7621
julian.samways@jpespartners.com

MATT ROGERS
CO-HEAD OF INVESTMENT COMMUNICATIONS

+44 (0)20 7520 7624
matt.rogers@jpespartners.com

JPES Partners is a communications consultancy specialising in the investment management and real assets sectors.

We help our clients achieve their business objectives through a combination of strategic marketing and communications disciplines. Our team of consultants draws on a range of professional backgrounds including investment management, journalism, marketing, public relations and law.

For more information, please visit:
jpespartners.com

jpespartners

4 COLDBATH SQUARE
LONDON EC1R 5HL

+44 (0)20 7520 7620
INFO@JPESPARTNERS.COM
JPESPARTNERS.COM