3 TRENDS IN CLIENT ASSETS AND ALLOCATION

KEY FINDINGS

CLIENT TYPE

- Almost four fifths of assets under management (79%) were managed on behalf of institutional investors.
- Pension schemes remained the largest client type although for the first time in over five years pensions failed to increase as a proportion of total assets, remaining almost unchanged from 2016 at 44%.

ASSET ALLOCATION

- There was a small increase in equity allocation from 39% to 40% but the relatively strong returns seen in equity markets compared to other asset classes would actually suggest some outflows from the asset class. All other asset classes remained unchanged from 2016. The allocation to other assets remained stable at 21%.
- Within equities the UK allocation continued to fall and now stands at 30% compared to 51% ten years ago.
- A similar story was seen in the fixed income allocation, which saw the allocation to overseas bonds increase to 42%, up from 34% in 2011 when data were first collected.

ACTIVE VS PASSIVE

- Three quarters of assets are managed on an active basis, down from 83% a decade ago. There has been a gradual growth in the allocation to passive strategies strengthened by the increased use of ETFs, which has seen UK-listed ETFs increase from £11 billion at the end of 2008 to £250 billion in 2017.

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 (see Box 5). The institutional and retail markets are covered separately and in more detail in Chapters 4 and 5 respectively.[26]

CLIENT TYPES

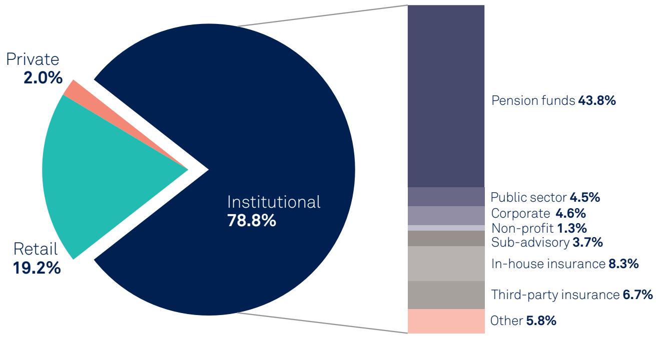
The £7.7 trillion of assets managed in the UK is managed for a broad range of client types. Chart 11 shows the breakdown by client type, reflecting assets managed in the UK for both institutional and retail clients. This includes assets from both domestic and overseas clients.

There was little change in the breakdown of assets under management by client type from last year. Once again, around four fifths of assets managed in the UK were managed on behalf of institutional investors (79%).

Pensions failed to increase as a proportion of clients overall for the first time in over five years. Interestingly, the proportion was almost unchanged from 2016 whilst the absolute value of assets increased from £3 trillion to £3.4 trillion. This would suggest that the slight fall in the relative value of pension assets (from 44% to 43.8%) reflected a difference in the growth rate of client types. The actual value of assets managed for all client types increased in 2017.

The definition of pension funds in the IA's data includes all schemes, both DB and DC where the scheme has a direct relationship with the asset 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 (see Box 5).

CHART 11: ASSETS MANAGED IN THE UK BY CLIENT TYPE



BOX 5: 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 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

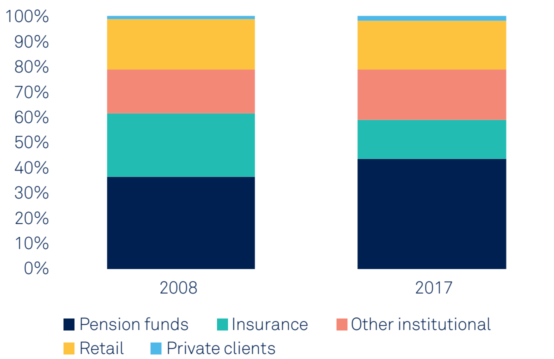
DC is something of a hybrid between retail and institutional. Pension savers in DC schemes receive an income in retirement that is based on the value of the pension pot they have accrued during their working life. Unlike a DB scheme, where their pension is based on their salary and is ultimately guaranteed 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.

[26] 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.

LONGER-TERM EVOLUTION OF CLIENT BASE

Looking at the long term trends, there has been a sustained decline in insurance assets relative to pension funds and other institutional clients (Chart 12). The pace of this fall seems to be slowing, with the proportion of assets managed for insurance clients being almost exactly the same as last year.

CHART 12: ASSETS MANAGED IN THE UK BY CLIENT TYPE (2008-2017)



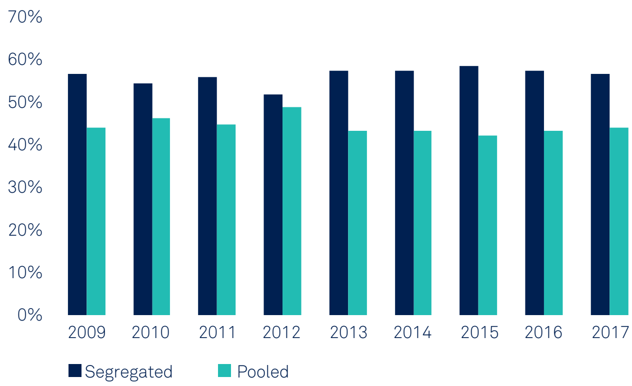
The general trend in recent years has been an increase in the proportion of pension fund assets. This is likely to be attributable to a continued focus on liability driven investment (LDI) by DB pension schemes looking to manage the run off of their liabilities, though this growth may be peaking as the level of hedging in place has now reached very high levels.[27] 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.

The private client figures included in Charts 11 and 12 only relate to the portion of the private client market where members of the IA provide dedicated private client investment services. As can be seen from Figure 3, the actual private client market is significantly larger than this and IA members are estimated to manage around one quarter of this market.

SEGREGATED VS POOLED INVESTMENT

Chart 13 shows the ratio of segregated to pooled assets has remained relatively stable since 2013. In 2017, 56% of assets were managed on a segregated basis. Segregated mandates remain heavily used in the traditional institutional market although there has clearly been a significant evolution in the pooled fund universe in recent years with the rise of ETFs alongside more established indexing vehicles such as investment funds and life funds (see page 52).

CHART 13: SEGREGATED VERSUS POOLED INVESTMENT (2009-2017)



[27] The Age of Peak LDI, Hymans Roberts, Nomura, April 2018

ASSET ALLOCATION

Equity markets posted strong positive returns during 2017.[28] All else being equal, investment returns would have led the proportion of equities to increasing during 2017 and fixed income to decrease. Despite this, there was only a very small increase in equity allocations from 39% to 40%, suggesting that there were some further flows out of equities during the year. This is not consistent with the inflows of £9 billion observed into equity retail funds during 2017 (see page 71), suggesting this is continued institutional market de-risking.[29]

Allocation to all other asset classes remained almost unchanged year on year. For the first time in several years the allocation to other assets remained stable at 21% but given the broad range of investment in this category, it is not possibe to infer whether this is a result of slowing allocations or market movements (see Chart 14).

Nevertheless it is clear that over the last decade there has been a shift towards other assets, which include more solutions-focused strategies (such as liability-driven investment) and alternative asset classes (such as infrastructure and direct lending). In the institutional market this shift has been fuelled by interest from DB pension schemes and insurers in investments that offer ways to more closely match their liabilities and cash flow needs.

CHART 14: OVERALL ASSET ALLOCATION OF UK-MANAGED ASSETS (2008-2017)

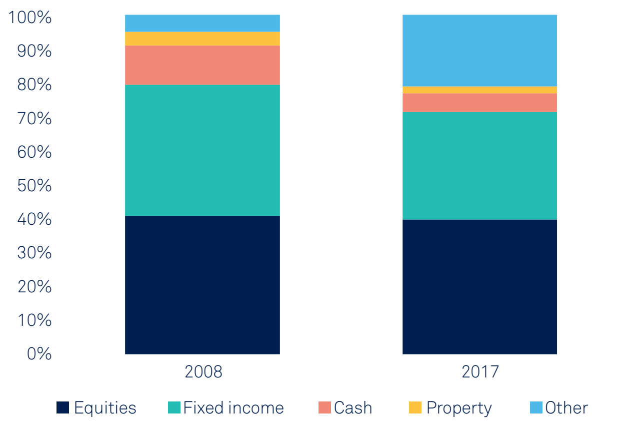


TABLE 1: PROPORTION OF IA MEMBERS INVESTING BY ASSET CLASS

	Percentage of firms
Equities	96%
Fixed income	84%
Cash	71%
Property	47%
Other	65%

[28] Most major equity markets posted at or near double digit returns in sterling terms during 2017, compared to near neutral returns on global bonds in sterling terms.
[29] Net retail sales of Equity Growth funds were £10 billion. There was an outflow of £0.8 billion from Equity Income funds

DETAILED ASSET ALLOCATION

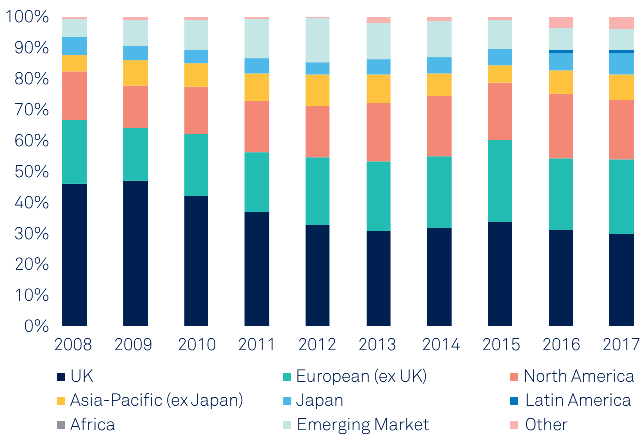
Beyond the shifts between asset classes, the IA also monitors the trends within equity and fixed income allocations according to type of exposure and this section considers these changes in more detail.

EQUITY BY REGION

Chart 15 shows equity allocations on a regional basis. The most striking feature remains the falling allocation to UK equities relative to overseas. This now stands at 30% compared to 70% in overseas equities which is a significant change from a decade ago where the allocation stood at 51% versus 49%. Notably, this decline in UK equity allocation is driven by trends in both the institutional and retail market (see page 63 and page 68). Particularly within the former, a key driver has been the de-risking within DB pension schemes (see page 61 and Chart 26).

Within the last year there was also a slight increase in Europe ex-UK to 24% as well as a slight decrease in the allocation to North America to 19% from 21% in 2016.

CHART 15: UK-MANAGED EQUITIES BY REGION (2008-2017)[30]

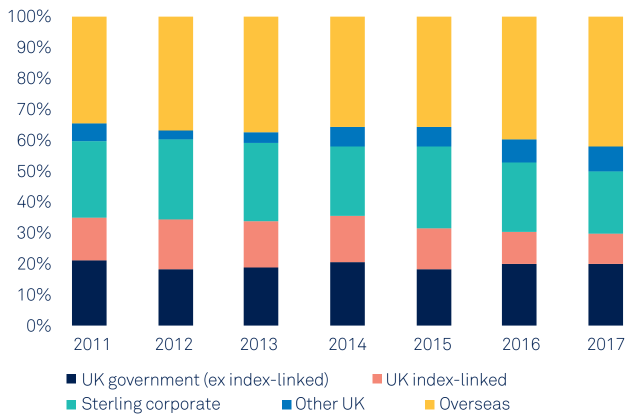


FIXED INCOME BY REGION

Within fixed income, the allocation to overseas bonds continued to increase, largely at the expense of UK corporate bonds (see Chart 16):

- Overseas fixed income finished the year up two percentage points at 42%.
- Sterling corporate bonds fell three percentage points to 20%.

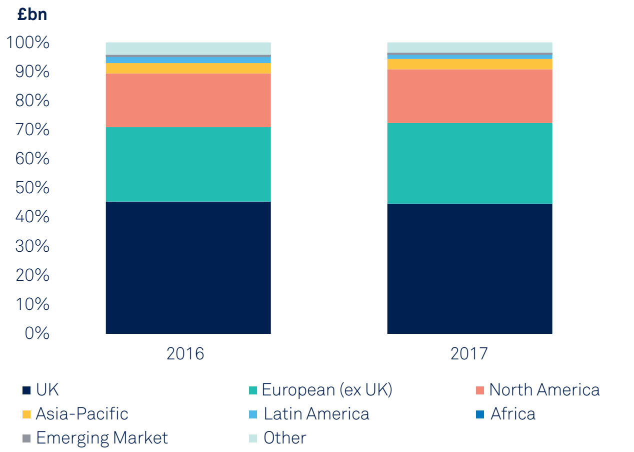
CHART 16: ALLOCATION OF UK-MANAGED FIXED INCOME BY TYPE AND REGION (2011-2017)



[30] The IA is now collecting more granular data on the allocation to Latin America and Africa, and these are detailed separately from 2016 in Chart 15. Although these allocations are small it should be noted that comparisons to the 'Other' country segment will not be directly comparable with previous years.

Within sterling corporate bonds there does not appear to have been any shift towards overseas issuers. The breakdown by issuer country remained almost unchanged from 2016. Bonds issued by UK companies represented 45% of all sterling corporate bonds compared to 46% in 2016 (see Chart 17).

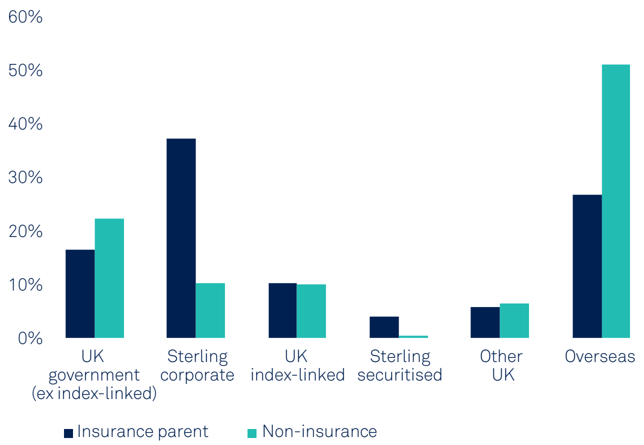
CHART 17: **CORPORATE BOND ALLOCATION BY COUNTRY OF ISSUER (2016-2017)**[31]



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 alters depending on whether the asset manager has an insurance parent or not (see Chart 18) that difference becomes very clear. Insurance-owned groups have a much higher exposure to sterling corporate securities and, a lower exposure to overseas bonds.

CHART 18: **FIXED INCOME OWNERSHIP BY PARENT GROUP (INSURANCE VS. NON-INSURANCE)**

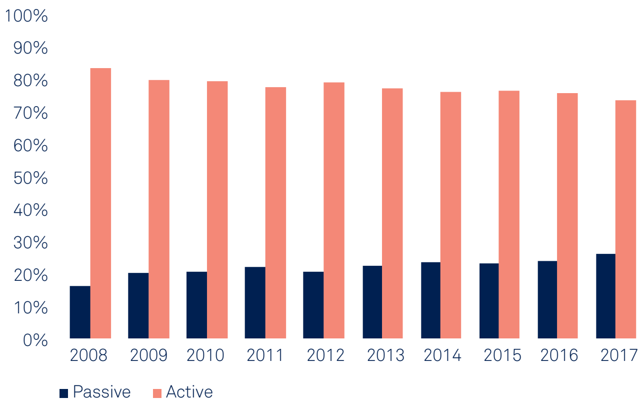


[31] Data collected since 2016

BALANCE BETWEEN ACTIVE AND PASSIVE

Across the overall base of UK-managed assets, almost three quarters of assets are still actively managed (74%). This is down from 83% a decade ago (see Chart 19).

CHART 19: ACTIVE AND PASSIVE AS PROPORTION OF TOTAL UK ASSETS UNDER MANAGEMANT (2008-2017)



The split between active and passive at this macro level reflects a number of factors. First and foremost, it may relate to greater use of either active or passive investment strategies within each asset class, for example, there could be increasing demand for passive products to achieve equity market exposure. Second, but equally important, it may reflect changes in the allocation between asset classes where more money is allocated to strategies that involve by nature more active management, such as multi-asset or outcome-focused.

The trends we observe in Chart 19 above reflect both factors. On the one hand, there has been increasing demand for passive products particularly within equity. For example, Chapter 5 discusses how passive equity FUM have increased by more than 700% since 2008 (see page 67). This would support the upward trend of passive assets under management. On the other hand, this Chapter reports on how the 'other' category has been on the rise given the continued demand for solutions-based investment strategies (see page 47). This would account for what appears to be only a gradual rate of increase in the proportion of passive assets in Chart 19.

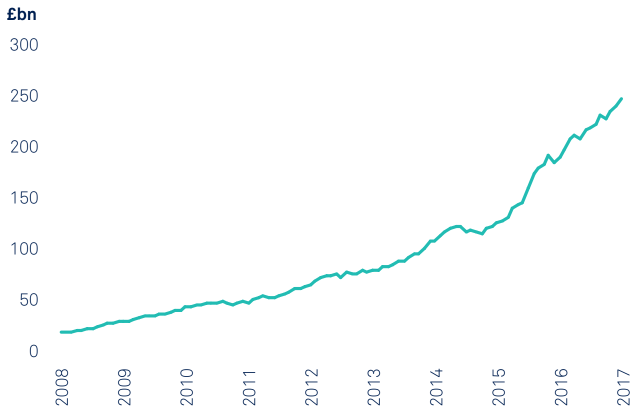
A way to distinguish between the two factors would be to look at the trends in use of passive strategies where these are mostly relevant, which is more the case for equity and fixed income rather than multi-asset and outcome oriented products. In 2017 the IA began to collect the active/passive split separately for equities and fixed income. Passive management was more prevalent among equities than fixed income. More than half of equities were being managed on a passive basis (53%) compared to just over one third of fixed income (34%).

Another way of looking at the long-term trend is therefore to adjust for the wider asset allocation / strategy shifts, and examine the amount of assets managed on a passive basis only as a proportion of total equity and fixed income assets, since these are the asset classes most likely to be passively managed. Doing this indicates that passive is increasing at a slightly faster rate than is indicated in Chart 19, and that passive assets account for more than one third of the total equity and fixed income allocation (36%).

The growth of ETFs in the UK will also influence the prevalence of passive assets. 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.

UK-listed ETFs have increased in value from £11 billion at the end of 2008 to £250 billion in 2017 (see Chart 20). Most of this is managed in the UK by IA members, who report that almost all assets they manage in ETFs are managed on a passive basis. Chart 19 has also been adjusted using data collected in 2017 to reflect those ETFs listed in the UK that are not included in data reported to the IA by its membership as part of this Survey.

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



Source: Morningstar

Data from the IA's monthly fund statistics shows an incomplete picture of the use of passive strategies, capturing conventional investment funds but not ETFs.[32] The proportion of funds under management in passive strategies stood at 13.5% at the end of 2017, a slight increase from 2016 but still more than double what it was in 2008. At the same time, gross retail flows into equity tracker funds have decreased as a proportion of overall sales over the last three years (see Chart 67), suggesting that new money into funds is more likely to be directed towards actively managed strategies than passive ones.

As ETF data is currently not included in IA monthly fund statistics, a proportion of retail investment activity may not be captured within this analysis. That being said, it would seem that the majority of ETFs still lies with the institutional market in the UK. Indeed, it was recently reported that only 10 to 15% of total ETF assets in Europe are held by retail investors.[33] Further detail on the ETF market is available in Box 7.

"ETFS ARE STILL IN THE EARLY STAGES IN EUROPE BUT WITH THE GROWTH OF FEE-BASED ADVISORY, ETFS ARE INCREASINGLY BEING USED BY WEALTH MANAGERS. IN ADDITION INSTITUTIONS ARE USING ETFS TO ALTER THEIR MARKET EXPOSURE, TO FIND LIQUID VEHICLES TO ACCESS LESS LIQUID ASSETS AND USING THEM AS DERIVATIVES. SO WE SEE THE AMOUNT WE MANAGE IN ETFS INCREASING SIGNIFICANTLY IN THE NEXT FIVE YEARS."

3

THE PROPORTION OF RETAIL FUNDS UNDER MANAGEMENT IN PASSIVE STRATEGIES STOOD AT

13.5%

AT THE END OF 2017

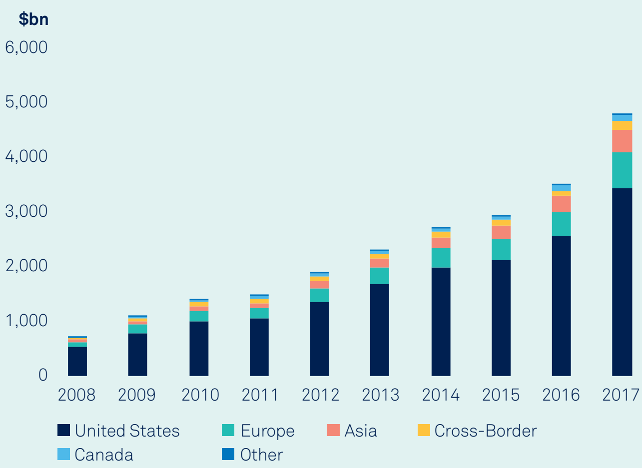
[32] IA monthly data on UK funds does not include investment in exchange traded funds.
[33] European Commission, Distribution systems of retail investment products across the European Union, April 2018.

BOX 7: THE ETF MARKET

ETFs have become a significant investment vehicle in the global market. In the ten years to the end of 2017, global ETF assets under management have grown almost six-fold from $714 billion to $4.8 trillion.

Chart 21 shows the majority of assets reside in the United States, $3.4 trillion in 2017. European-domiciled ETFs stood at $634 billion and Asian domiciled ETFs had assets under management of $411 billion. Canada is the largest single country of domicile outside of the United States with $117 billion held in ETFs.

CHART 21: ETF ASSETS UNDER MANAGEMENT BY REGION OF DOMICILE



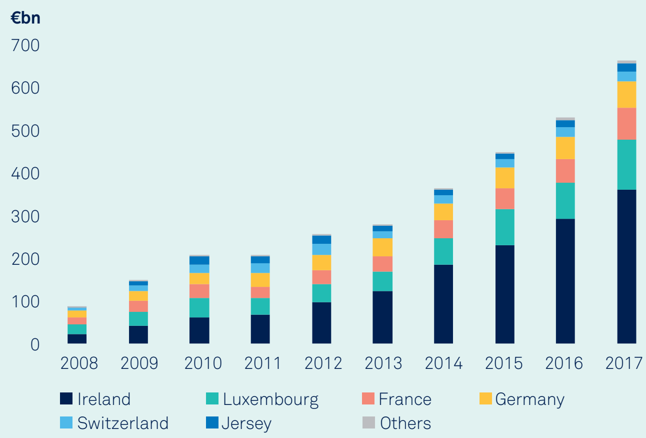
Source: Morningstar

ETFS IN THE UK

It is not possible to isolate the UK market for ETFs as it is for UK authorised and recognised funds – by domicile or by investor location. There are only eight Exchange Traded Products (ETPs) domiciled in the UK, but more than 800 listed on UK exchanges. An ETF's domicile does not determine where it is bought and sold as investors from around the world can access UK equity markets. The location of the investor is therefore unknown and it cannot be assumed that an ETF bought in the UK has been bought by a UK investor

Chart 22 shows where ETFs in Europe are domiciled. Ireland clearly dominates with 55% share (€362 billion) of European ETF assets. Ireland is a popular domicile for ETF issuers due to its regulatory practice, availability of expertise and well developed ETF ecosystem.

CHART 22: EUROPEAN ETFS BY COUNTRY OF DOMICILE



Source: Morningstar

Chart 23 shows the growth in European ETF assets under management broken down by asset class. Equity ETFs represent about two thirds of the market with €444 billion invested at the end of 2017, while fixed income ETFs follow with €151 billion under management.

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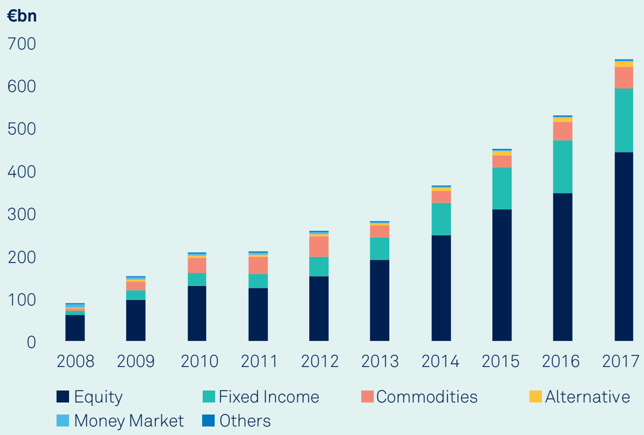
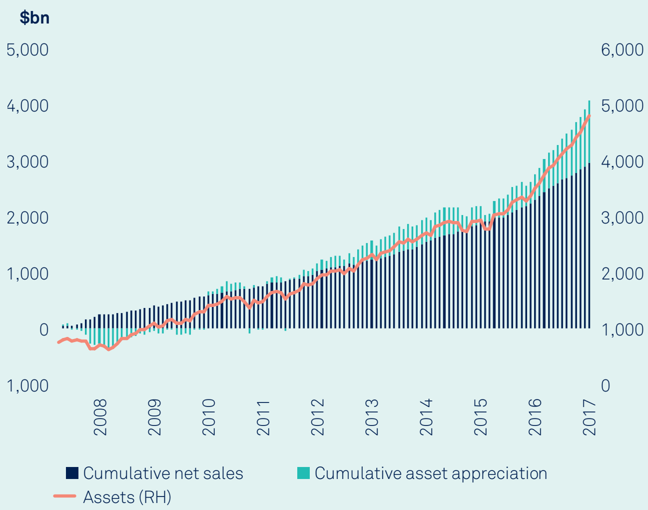
CHART 23: EUROPEAN DOMICILED ETFS BY ASSET CLASS



Source: Morningstar

Chart 24 shows the growth in global ETF assets under management broken down into sales and asset appreciation. Sales make up the dominant part of the growth in ETFs in contrast to traditional funds (see page 68). This may reflect the smaller asset base of the ETF universe. At the end of 2017, sales accounted for 62% of AUM growth within the ETF universe compared to 40% for funds.

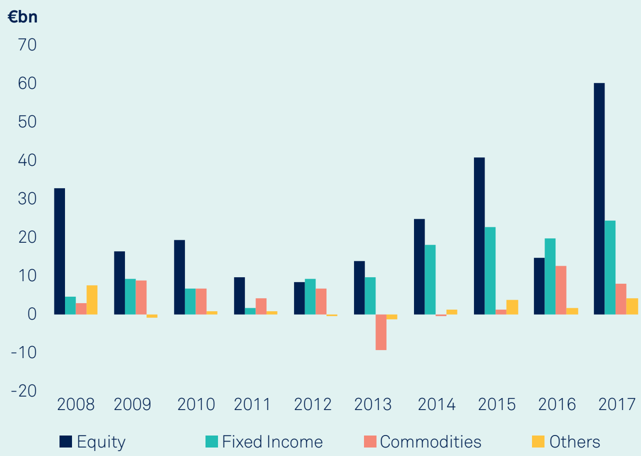
CHART 24: ETF CONTRIBUTION TO ASSET GROWTH



Source: Morningstar

Total net sales into European ETFs were €100 billion in 2017, €60 billion of which went into equity ETFs.[34] Fixed income ETFs gathered €24.4 billion in new investor money through the year and commodity ETFs took in €7.6 billion. It should be noted that this data relates to primary market transactions and reflects the growth in the ETF universe, it does not factor in secondary market transactions.

CHART 25: ETF NET SALES BY ASSET CLASS



Source: Morningstar

[34] Not comparable to sales data in the UK Funds chapter of this report as ETF sales cannot be differentiated between retail and institutional.