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ASSETS FOR A NEW ERA

This could be a year of change. We entered 2023 with inflation at a four-decade high but could leave it with a higher cost of capital.

To cut the cost of goods and services, central banks have warned that interest rates will have to rise. The question is, by how much?

The answer to this question could determine how institutional investors adjust their portfolios to position themselves for a new era. This month's cover story looks at their options (pages 16-19).

We also look at defined contribution, which is being primed to be the future of the British pensions system by the government and employers alike. More than a decade has passed since the introduction of auto-enrolment and the level of assets managed by workplace pensions is catching up with those in the defined benefit market.

As markets are entering a more challenging phase, so must defined contribution pension schemes, which until now have largely been exposed to passive strategies. The level of growth of the assets under management along with new guidance on the way from the regulator concerning value for money, means that the industry is entering a new chapter. Read our take on the issue from page 20.

Elsewhere, ESG has arguably become a mainstream investment strategy as pension schemes seek to use the funds under their stewardship to protect our ecosystem and climate as well as reduce inequality.

Unfortunately, standards of corporate disclosure on their non-financial performance appear to have not kept pace with the demand for such strategies.

The quality of ESG data is inconsistent and sometimes unverified, while the conclusions of independent rating providers rarely appear to agree on how sustainable a particular asset is. Such a lack of data has been named as the biggest barrier to building sustainable portfolios. From page 32 we look at how investors can navigate such inconsistencies.

Despite a strong start to the year, which saw the FTSE100 breach the 8,000 barrier for the first time, equities are predicted to have a difficult 2023.

The S&P500 retreating at the time of writing could be a sign that the good start to the year for major indices is short lived. Yet institutional investors do not appear to be ditching the asset class. *Andrew Holt* finds out why from page 42.

In this edition, we also sit down with the duo hired to oversee the West Yorkshire Pension Fund's investment strategy. Euan Miller and Leandros Kalisperas explain why two heads are better than one from page 12.

Finally, Railpen's Chandra Gopinathan discusses his approach to sustainable ownership. Read the three-page interview from page 28.

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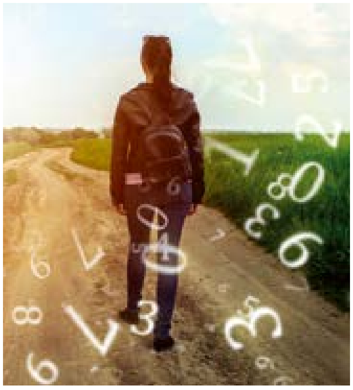


RETURN OF THE SPACS

Does a flurry of special purpose acquisition companies to hit the market mean that spacs are back? *Andrew Holt* takes a look.

There has been a rapid splurge of new special purpose acquisition companies (spacs) listing in the US – which raises questions about whether they are back in vogue as an investment vehicle.

Heading the field has been climate tech startup LanzaTech, which appeals to environmentally conscious investors in that it is a conduit to the energy transition. It listed on Nasdaq in February.

This followed car-sharing company Getaround, which completed its spac offering before Christmas. Then there has been insurance tech firm Roadzen, which is set for a Nasdaq listing via a spac merger, and British IT firm Noventiq heading to New York.

Such activity suggests that a trend is forming. Expectations that the Fed is nearing the end of its rate raising has been cited for a boom in the stock market during January and February, which in turn could also be spurring on the spac splurge.

New York, New York

Two inter-related points stand out: will London ever follow New York in being a leading staging post for spacs? And secondly, how attractive are spacs to investors?

On the first point, in the race to attract more of these investment vehicles, the London Stock Exchange adjusted its rules in 2021 to open the door to such entities.

This was part of then chancellor Rishi Sunak's post Brexit plan to attract capital to the City. But his hopes for a flood of spacs rushing through the exchange's doors has been more of trickle.

It could be that spacs are just a fad, driven primarily by the Silicon Valley trend, as they are usually tech related listings.

But such a view has been questioned by the London Stock Exchange, which believes European investors are just as hungry for data on spacs as their US counterparts.

But reality could bite, based on one interpretation of the numbers. Europe's spac market lost 78% of its value during 2022. Not a good number. But that was a fall from record levels of issuance during 2021, according to financial-focused law firm White & Case.

With issuance for 2022 totaling $1.90bn (£1.5bn), compared to $8.61bn (£7.1bn) in 2021 – these numbers should be put in context, and attributable to negative factors that contributed to the overall market: sustained levels of high inflation, interest rate hikes by central banks and geopolitical pressures.

Europe strikes back

An interesting picture appears when breaking this down by European exchanges. London emerged as the most engaged market for spacs in Europe, with four listings securing issuances totaling $935m (£780m). This marks a significant improvement on the previous year, when only one spac raised $390bn (£325bn) on the UK bourse.

The Netherlands – the leading European exchange for spacs last year – recorded two such IPOs raising a combined $451m (£376.4m). This compares to an impressive 15 listings with proceeds of $4bn (£3.3bn) in Amsterdam during 2021.

Germany ranked third with two spacs raising a total of $363m (£302.9m) in 2022.

In the wider picture, these numbers are pretty decent in what was a pretty tough investor environment.

If such a premise is accepted, it does present a picture in which Europe could challenge the US spac space. Although not yet. But this is the trajectory of travel as European stock exchanges have proven their ability to deliver flexibility and liquidity for spacs. There is no doubt that the awareness of the spac model has increased in Europe in the past two years, with spac structures becoming established as a mainstream route to a listing.

Another factor driving more listings in Europe and London is the US taking a tougher regulatory stance on spacs.

Wheat from the chaff

This shifts the emphasis back to investors, with the key point being: are spacs attractive to investors? Spacs can boast greater speed, flexibility and price certainty when compared to other IPOs.

There is nonetheless a casino investment problem to spacs. Backing the right spac can lead to eye watering returns – the most successful seeing north of 30%. These though are the exception, not the rule.

Finding the wheat amongst the chaff in the spac world can be a perilous business. That said, even liquidated spacs – when returning cash to investors when a deal cannot be made – can return 2%, according to the University of Florida. Not to be sniffed at in a market where returns can be in the negative.

This poses a different question in terms of whether enough spacs, particularly in London, can fulfill investor demand. The situation, as it stands, is most definitely a no.

Which suggests a potential opportunity for spacs to exploit growing investment trends. Here, new spacs focusing on green issues point to a clear slighted future. One in which spacs are not just back, but potentially even better.

That said, it is not all good news. LanzaTech's listing, at least so far, has gone the way of many spacs. In its first weeks the shares plummeted more than 40%. Proving that in the world of spacs, nothing is straightforward.

LONDON CIV SWEATS ON KENSINGTON AND CHELSEA EXIT DECISION

Could the borough refusing to commit to London CIV be a sign of wider discontent within the pooling system? *Andrew Holt* reports.

The pension fund of the Royal Borough of Kensington and Chelsea decided not to push the button on exiting London CIV at its investment committee meeting in February.

This comes after the £800m fund threatened to quit the pooling arrangement, and now raises questions about whether the fund will leave the London's LGPS pool as seemed to be the case a few weeks ago.

On the decision, the fund's chair, councillor Quentin Marshall, said: "We continue to evaluate our position."

Given the timing, the prospect of Kensington and Chelsea leaving London CIV seems slim.

The scheme needs to give notice by the end of March for an official and orderly exit from the London pool, which will take place a year later. This now seems highly unlikely, as the next investment committee meeting for the fund is scheduled for late April – beyond the possible deadline.

A new meeting could be arranged before the March deadline expires, but no such gathering has thus far been placed and confirmed in the investment committee's schedule.

This means that the February meeting was probably the final opportunity for the fund to rubber stamp an exit for an orderly departure next year. The February meeting was seen by many as a *fait accompli* that Kensington and Chelsea would leave.

Three options

That said, what Kensington and Chelsea does next will be vitally important in the wider pooling system – as three options are still open to the fund: a complete exit, staying in London CIV or moving to another pool.

The big source of division between the fund and the pool is that Kensington and Chelsea runs a predominantly passive portfolio while London CIV is actively focused.

Quentin Marshall alluded to this in January, when he said: "Kensington and Chelsea recognises that each LGPS fund has different circumstances and investment strategies and that, for many, the London CIV represents an attractive partner."

A possible alternative therefore does exist within the LGPS pooling system, as Brunel Pension Partnership is passively focused, so would make a more suitable partner for Kensington and Chelsea. Such a move would be allowed under pooling rules.

Government pressure

Some sources close to the situation allege that the government may have leaned on the Kensington and Chelsea pension fund with the potential threat it could be taken over if it quit London CIV, as the government has the power to do so under pooling rules.

This has meant the fund has retreated from quitting the pooling system.

But the terminology used by Marshall on "evaluation" of the situation suggests things may not yet be completely done and dusted from Kensington and Chelsea's perspective.

There is no doubt the government is a key player in all of this, as it has been keen to stress its own position is to focus on cementing pooling as the norm for local authority pension funds while achieving greater scale in the whole system.

In December, the chancellor, Jeremy Hunt, announced plans to consult on the guidance on pooling. What has happened with Kensington and Chelsea has only made this more important and timelier.

Faster pace

One suggestion put forward to *portfolio institutional* is that the government has taken note, and this could mean it increases pressure to pool assets faster.

As an example of the difference in pooling's progress, to date, London CIV's client funds hold £48bn in assets, of which 57% have been pooled.

Interestingly, Kensington and Chelsea has £800m in assets, but has not yet pooled any of them.

If the government insists on a more rapid rate of pooling, it could potentially create a new bout of discontent, or at least a detailed debate about the whole principle of pooling.

Rumblings have emerged that other pension funds are unhappy with the pooling system, but it has been Kensington and Chelsea that has been the first to make this view official.

Whether such funds will come out of the shadows – especially in the face of the government's moves – remains to be seen. But from the perspective of a pool, it is beneficial and needed that pooling progresses at a faster pace: a point that has been made by Chris Rule, chief executive of Local Pensions Partnership Investments, amongst others.

In this way, the Kensington and Chelsea situation could be just a rehearsal of things to come in the push and pull between pools and funds as the pooling process evolves and becomes more defined.

Aside from the pooling itself, one issue that has been a reoccurring theme of criticism from funds within London CIV has been a perceived regular turnover of staff within London's pool.

Something the new chief executive of London CIV, Dean Bowden, will no doubt want to nip in the bud.

PEOPLE MOVES

Robert Waugh has been named as the next trustee chair of the **L&G Mastertrust**.

When he replaces Dermot Courtier in July, Waugh (*pictured*) will bring 35 years of investment and pensions experience to the role, having been chief executive and chief investment officer for the NatWest Group Pension Fund for the past 13 years.

His in-tray at L&G will include diversifying the master trust's assets, especially into private markets, for its 1.8 million members.

Waugh has sat on the board of the PLSA's cost transparency initiative and chaired a defined contribution scheme for The Royal Bank of Scotland.

Master trust **Life Sight** has named **Simon Ellis** as its new trustee chair after Jane Platt stood down at the end of her second term.

Ellis is the chair of Morgan Stanley's UK business and previously held senior roles at HSBC, Legal & General, Fidelity, Axa and Henderson Global Investors.

Claire Bowyer is the new deputy chief executive of **Now Pensions**. She sits on the board but remains a director of the UK arm of Cardano, the defined contribution pension provider's parent company. In her new role, Bowyer (*pictured*) will focus on the commercial, investment and governance aspects of the scheme.

The People's Partnership, which provides The People's Pension to 6 million defined contribution savers, is looking for a new managing director of investment after **Jonathan Cunliffe** (*pictured*) left the not-for-profit.

CALENDAR

Topics for confirmed upcoming *portfolio institutional* roundtables:

March
– Emerging markets

April
– Alternatives

May
– Stewardship

June
– Biodiversity

July
– DC multi asset

July
– Private markets

September
– Defined contribution

October
– Fixed income

November
– Sustainable strategies

NOTICEBOARD

The Royal Mail's £8.8bn defined benefit pension scheme assets are now managed by Blackrock.

The trustees have outsourced the chief investment officer function to benefit from the asset manager's scale and risk management expertise.

The Royal Mail Pension Plan's investment team have moved to Blackrock to continue managing the assets for the scheme's 118,000 members.

Elsewhere, two defined contribution pension schemes collectively managing £26bn could jointly invest in natural capital. **Nest** and **Cushion** have invited fund managers to suggest strategies that could provide a return while making a positive impact on the environment.

Initially, the duo intend to focus on forestry due to its low correlation to equities and bonds, while ecosystem services are not directly linked to market forces.

Cushion already has exposure to natural capital through its default fund, but the potential joint venture, which could be launched depending on interest, is designed to reduce fees.

Defined benefit de-risking specialist **Pension Insurance Corporation** (PIC) has completed the final buy-in of a scheme sponsored by engineer **IMI**.

The £175m deal secures the benefits of more than 1,300 people, 97% of which no longer contribute to the scheme.

PIC has now insured all of IMI's £1bn pension liabilities through six buy-ins since 2016.

Legal & General has completed a £6.5m buy-in with the **Amey Services** section of the **Citrus Pensions Plan**, which is a defined benefit master trust comprising more than 30 sections.

The deal has secured the benefits of 70 retired and current workers of the manufacturing services and engineering group.

Two local government pension schemes have backed an initiative that is working to increase the availability of affordable housing in the UK.

Tyne & Wear Pension Fund and **Scottish Borders Council** have become the latest local authority pension schemes to invest in Affordable Housing Fund, an unlisted fund managed by CBRE Investment Management.

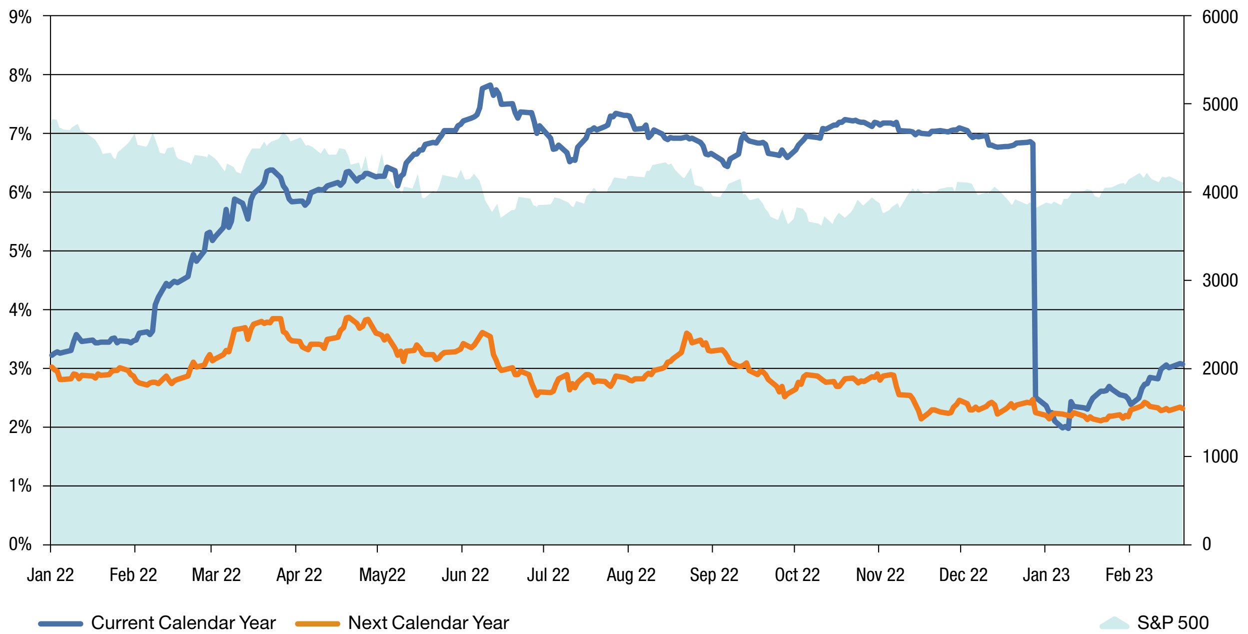
The fund has now secured nine such backers, which have joined 14 other investors in collectively investing more than £500m of equity in increasing the stock of affordable rental and ownership residential properties.

The fund has a pipeline of £400m working in schemes, under development and completed, which could provide almost 2,100 homes, potentially housing more than 5,600 people.

Half of these houses are being built in some of the economically deprived areas of the UK, which the fund managers hope will support the levelling up agenda.

THE BIG PICTURE: LIES, DAMNED LIES AND ECONOMIC FORECASTS

US Dollar Inflation Expectations and S&P500 performance



Source: ICE, S&P Dow Jones Indices

How long can the stock market bull run last, asks *Mona Dohle*.

Stock markets enjoyed a strong start to the year on the back of optimistic inflation forecasts and bets that rate hikes are about to peak, but can the rally continue?

The first quarter was not a good year for cautious investors. If they had bet on a recession in 2023 and sold their equity portfolio, they would have missed out on the rally. The S&P500 rose by nearly 5%, year to date, while in the UK, which months ago was described by Deutsche Bank as a quasi-emerging market, the FTSE100 hit an all-time high of 8,000 in early February.

Despite abysmal fundamentals, stock markets are being driven by a belief that inflation could settle down sooner than expected. This is, after all, what central banks are predicting. The Fed expects inflation to drop to below 3% this year from 8.5% today. Meanwhile, the Bank of England believes that price growth could slow to 4% by the end of this year despite it standing at 10.1% today. This expectation has now been priced into US markets, as the ICE Index suggests. The index, which uses a combination of treasury market data and inflation swaps pricing, showed a sharp surge in inflation expectations in the middle of last year but has since climbed down to below 4%.

Markets appear to have interpreted this to mean that rate hikes might peak sooner than expected and that equities still have some way to go. Europe-domiciled long-term funds reported inflows of €54.1bn (£47.7bn) in January, their best result in two years, with almost half (£22bn) going into equities, according to Morningstar.

But this bet hangs on two crucial factors. First, that central bank forecasts are correct that inflation climbs down. However, over the past year, the Fed, ECB and the Bank of England have persistently missed their inflation forecasts.

The second factor is timing. Historical evidence suggests that it takes at least a year for the effects of rate hikes to feed through to the real economy. This suggests that the real impact of rate hikes on labour, credit and equities remains to be seen. Yet fundamentals are far from promising. Apple, which is a prominent S&P constituent, reported a 5% year-on-year drop revenue, while Microsoft missed its earnings per share targets by almost the same margin.

While equity markets are banking on the short term, central bankers are aware of the medium-term risk of hiking rates as the economy plunges. Stock market bulls may have had a good year so far, the big question is how long this will continue.

Craig Mitchell is an economist at Nest

NEW LANDSCAPE, NEW CHALLENGES

If 2022 taught us anything, it's that "safe" assets may not be quite as safe as we thought.

For many investors, bonds have been the common tool to balance risk in portfolios. And yet, one of the most widely watched bond indices, the Bloomberg Global Aggregate Bond Index, was down 16% by the end of the year.

A negative 16% return in an asset class commonly used to balance portfolios is a tricky position for long-term investors. While we don't think investors should throw out portfolio construction principles, it poses serious questions for those relying on the typically negative correlation between debt and equities.

Inflation has remained persistently high around the world, and central banks have responded by increasing interest rates at a rapid pace and undertaking quantitative tightening.

The impact of higher interest rates and slowing economic growth are giving investors pause for thought. The era of easily available credit, with ultra-low interest rates, appears to be over for now.

Defaults should be the big concern for credit investors. Warren Buffett famously once said: "When the tide goes out you get to see who was swimming naked." Due diligence is key, and investors will find out in the coming year whether they have been thorough.

Suppressed yields on sovereign and highly rated bonds have encouraged investors to explore riskier and higher yielding asset classes to boost returns and try to meet investment targets. These have been enticing options, more so because average default rates have been low by historical standards.

For example, high-yield default rates are around 1% versus a long-term average more like 3.5%. It's a straightforward conclusion to expect default rates will increase given the economic backdrop.

In 2022, companies warned about revenues, saying high inflation will eat into households' budgets and lower sales.

There are ways to mitigate risks in the credit space. For a start, lending through private credit can offer greater reassurance than their public counterparts and historically, has generated excess returns compared with public debt instruments.

Default rates have traditionally been lower in private markets and recovery rates on defaulted debt are typically higher[1]. Currently we are not seeing a significant rise in defaults but that could change.

Lenders in the private space may feel more reassured given the potential for negotiating protections into terms, and the ability to directly interact with companies that may be struggling. Private lenders can also be compensated for taking on illiquidity risk. The illiquidity premium does not always exist though, as public bond spreads react faster to changing conditions. Investors need to be mindful of pricing and whether they are being adequately compensated for the risk.

With borrowing becoming more expensive, liquidity concerns should only push up the premium investors can access. As the yields on government bonds have risen, investors will require a higher interest rate on corporate debt and a sufficient illiquidity premium on top for private corporate debt.

At Nest, some of our members will be investing for 40-plus years. That gives us something we can leverage in helping boost their returns.

What's more, the use of floating rate instruments in direct private credit means investors can receive higher absolute returns as interest rates rise. This is an opportunity to protect the lender when inflation is high. Existing public bonds with fixed rates will be hurt by falling prices as yields rise.

Whilst floating rate notes means that corporates will face these higher costs immediately, if chosen carefully, direct lending offers a lucrative opportunity as companies struggle to find credit elsewhere. It's one of the reasons why private credit, or alternative lending, has expanded so much in the past two decades.

While I've focused on direct lending, investors can also benefit from putting money into other private assets, such as infrastructure and real estate debt. Portfolio diversification is about more than listed equities and bonds.

1) Public versus private debt – what's the difference?
www.abrdn.com/en-us/institutional/insights-thinking-aloud/article-page/public-versus-private-debt-whats-the-difference

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Will Martindale is head of sustainability at Now Pensions

INVESTING RESPONSIBLY IS… INVESTING

At Now Pensions, our approach to sustainability enables us to contribute to our objectives and identify financially material issues in investment decision-making.

We consider a range of sustainability topics in the construction on our investment portfolio and the companies in which we invest, with a particular focus on climate action, living wages and gender equality.

We believe these three issues are financially material to our investments and important to our members.

For example, on gender equality, we believe companies that take steps towards addressing imbalances will:

- Secure a more engaged and diverse workforce, employee retention, and human capital management, leading to better decision-making amongst senior management
- Be less exposed to reputational issues, with increased client and customer loyalty contributing to growth, competitiveness and productive capacity
- Be less exposed to regulatory intervention, such as maternity pay or gender pay gap reporting

To start addressing this, we believe it is crucial to stay invested, using the power we all hold as investors to influence companies and drive change from within.

That said, in the same way we determine some investments as too risky irrespective of performance, investors are becoming increasingly acute at judging the environmental and social impact of their investments in order to ensure they are not having a detrimental real-world impact. This is particularly true in the case of companies where there are systemic issues around climate change or in respect to human rights.

Task Force on Climate-Related Financial Disclosures Report (TCFD)

In 2022, we published our first TCFD report, setting out how we understand climate change-related risks and opportunities. Included in our report is our de-carbonisation target, committing us to net zero greenhouse gas emissions by 2050, with a 50% emission reduction by 2030, based on 2019 levels.

Building on this and to best understand our members' views on sustainability topics, we have also pledged to host focus groups and we'll report the findings of this work in our 2023 TCFD report. This year's reporting will also include an alignment metric, tracking the extent to which our portfolio is aligned with the Paris Climate Agreement.

Our commitment informs our investment activities. We have increased our investments in green, social and sustainable bonds and invested in equity companies which, on average, produce lower greenhouse gas emissions.

As investors, we have a critical role in using our influence to drive change. Investors must play a key role in influencing the companies they invest in through active engagement and dialogue, directly and through investment managers. We routinely engage with companies, governments, stakeholders and third-party asset managers to address sustainability-related risks and opportunities.

Along with our investment manager, Cardano, we have met with companies such as Sainsbury's, Amazon and Tesla to talk proactively about the future direction of sustainability in their businesses.

Across the industry, we are seeing action on sustainability topics. Norway's sovereign wealth fund, one of the world's largest investors, has warned company directors it will vote against their re-election to the board if they did not show a clear enough commitment to tackling the climate crisis, human rights abuses and boardroom diversity.

In the year ahead, we expect sustainability issues to continue to draw attention within the investment community.

The FCA's consultation on sustainability disclosure requirements and the proposals set out by the transition pathways taskforce are a welcome move. It raises minimum standards, levels the playing field and can increase efficiency as we work to coalesce around universal terminology and methodologies. Indeed, as long as capital markets remain unsustainable, further policymaking is inevitable.

Sustainability is at the top of our agenda and must be for the investment community. At Now Pensions we are committed to change, now and long into the future.

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INTERVIEW – EUAN MILLER AND LEANDROS KALISPERAS

"It is an investment heavy job at West Yorkshire, so we have two people replacing one."

Are two heads better than one? *Andrew Holt* sat down with the new recruits at the West Yorkshire Pension Fund – managing director Euan Miller and chief investment officer Leandros Kalisperas – to discuss their ambitions for the local government scheme.

What have been your priorities in the four months since you joined the West Yorkshire Pension Fund, Euan?

Euan Miller: Getting my head around the role. Specifically, how it differs from my experience at the Greater Manchester Pension Fund.

There is a lot to familiarise myself with on the members administration aspects, in particular, because we offer a shared administration service to other LGPS funds. And then it has been getting used to how things work operationally, on human resources and IT provision, for example, because every council operates differently.

I have also been getting to know the West Yorkshire Pension Fund team, while ensuring a smooth transition from my predecessor, Rodney Barton.

Importantly, we have the fund valuation going on, which we need to finish by the end of March. This happens every three years and is a natural moment to consider and reset our strategic allocation. So, the timing of Leandros arriving is good in many ways.

Do you see any big strategic allocation changes, Leandros?

Leandros Kalisperas: Well, through the actuarial valuation we are triangulating where we are in the funding ratio range, with contribution rates and the expected rate of return on our assets. Overall, we look to be in a reasonably healthy position.

It is more of an evolutionary process, than one of significant change. From a strategic asset allocation perspective, it is all about understanding the investment universe and how it is changing.

One of the reasons I have been brought in is to see how the strategic asset allocation might evolve. That may not mean a dramatic shift in risk and return, it may just mean the universe gets filled in a bit more than it has been.

What is the existing portfolio strategy?

Kalisperas: We are an open long-horizon scheme. We therefore have a long-risk bias, which has served the pension fund well for years.

The portfolio is broadly 60% equities, 20% fixed income and 20% alternatives and private markets. One of my initial challenges and opportunities is to work

Euan Miller

Leandros Kalisperas

with our equities, bonds and alternatives teams in making significant allocations across the UK and globally.

From there, it is a case of asking if anything obvious is missing. And are there things we can improve and add to the mix?

Have you come to any conclusions so far?

Kalisperas: No. I have been here six weeks and this pension fund has done well over a number of years without me. So, it is a case of coming in, listening to the team, observing and then seeing what might be required.

Leandros, you have great experience having served as head of credit for USS. What attracted you to the chief investment role at West Yorkshire?

Kalisperas: West Yorkshire Pension Fund is the jewel in the LGPS crown because it has the full toolkit, from strategy to implementation. We have significant partnerships through GLIL Infrastructure and the Northern Private Equity Partnership, as well as additional implementation capabilities. If I compare it to USS, it is quite similar in terms of the range of flexibility and scope.

What are the major differences between the pension funds of Greater Manchester and West Yorkshire?

Miller: The size of the committee is slightly smaller here.

There are five authorities in West Yorkshire – Bradford, Calderdale, Leeds, Kirklees and Wakefield – where Greater Manchester has 10. Having less authorities perhaps allows the non-administering authorities to have a greater role in the governance arrangements.

What attracted you to this role, Euan?

Miller: I had been at Greater Manchester for eight-and-a-half years, so felt it was time for the next challenge. It is an investment heavy job at West Yorkshire, so we have two people replacing one.

In Leandros, we have someone with a great deal of investment experience, while I'm in a more strategic role. Hopefully, it will work well.

So all the investment issues will be left to Leandros?

Miller: Leandros leads the investment team and will drive much of the agenda, and under the scheme of delegation it is the director's responsibility to manage the fund. We are going to be doing a governance review in the next few months and how this operates and whether any improvements can be made will be looked at, but Leandros and I are already working closely together.

The LGPS Scheme Advisory Board has been working on the *Good Governance* review and has handed it to the government who are launching a consultation. I suspect we already meet most of the recommendations, but the two of us coming in could be an opportunity to see how things can be tweaked.

How is the relationship with Northern LGPS?

Miller: Good, I think. My role at Greater Manchester was assistant director for funding and business development. The first part of this was an almost in-house funding actuary role, talking to the employers.

On the business development side, I was interacting with other LGPS funds and related parties in the pensions industry, like the PLSA. I know a lot people in the LGPS through that role, which has been helpful.

How is the pooling process going in light of Kensington and Chelsea wanting to exit?

Miller: The government has been talking for some time about releasing a consultation on the next steps in pooling. I don't know how far that has progressed or if it needs to be rewritten or tweaked to reflect the developments at Kensington and Chelsea.

If and when it comes out, we will have to see what guidance it has on funds leaving pools.

There is a grey area in that you need to be part of a pool but do not have to pool any of your assets, which seems bizarre.

Miller: The guidance suggests the majority of your assets should be invested through a pool. The concept of a pool wasn't really defined in the 2015 guidance, which is one of the difficulties.

It can work with pools interacting and collaborating. To invest with one pool you don't necessarily have to come out of another. GLIL spans two pools. It also has Nest as an outside investor.

Is pooling an effective system?

Miller: Pooling has made people think seriously about collaboration. It has made people ask: is the route into that investment the most efficient way of doing it? If not, how can we make it more efficient.

Even if the government doesn't succeed in getting more assets into pools, it has at least made funds look at what they are doing. There is a tangible benefit to that even if it is difficult to quantify.

Could the Kensington and Chelsea situation result in a two-tier system, where some schemes are in a pool and others are not?

Miller: We are a large fund. Greater Manchester and Merseyside are also large funds. How we do things and the best way for our funds to invest is going to be different to smaller funds. We have always been sceptical about a one-size-fits-all approach to the LGPS for this reason.

It is the fiduciary duty of the fund and committee members to do what is best for their fund. What one London borough thinks is best for their fund might well be different to what we think is best for our fund.

Are you committed to your pool?

Miller: Yes. In the Northern LGPS we have always been efficient in the listed-asset space. We are big funds and have a lot of internal resource.

Alternatives is where we thought cost savings could be achieved. That was where our early concentration was, creating GLIL with Local Pensions Partnership and the collective private equity vehicle we have. They were the obvious cost savings for Northern LGPS.

You mentioned GLIL. The government wants to get more pension funds involved in infrastructure. Is there is a gap between the rhetoric and reality of the situation?

Kalisperas: Supply is always going to be an issue in infrastructure, as it is in many private markets, so I would not exceptionalise infrastructure. Being large, we have already moved into that space.

Are you looking at your wider asset allocations given that we are moving from the great moderation phase to a 'new normal'?

Kalisperas: I start from the position of humility. The pension fund has had a focused, relatively simple asset allocation that has served it well.

Can we think about things differently, as you say towards a 'new normal'?

I would broadly categorise that question simplistically as do 60/40 or 80/20 portfolios need to look more at themes or regimes and effectively consider the allocation in that context? Perhaps.

But you have to go with the tempo, the culture, the resources and spirit of the enterprise. And the spirit of this enterprise is that it is open, it has a long horizon and has done well.

I come from a social science background so I am culturally attuned to the fact you can make things too complex in the investment space. But we have to think about whether an inflationary risk premium is back in the market after a 40-year absence. It has to be considered given that our liabilities are inflation linked.

Will that have a big bearing on any adjustments you make?

Kalisperas: It will. We are an unlevered pension fund and will remain so. Our choices will be somewhat constrained.

We already have inflation-linked income streams in bonds, in parts of property, infrastructure and elsewhere. But do we necessarily classify those things effectively?

To move needles, you need to know where

you are: it is those things that we need to consider first as much as any specific implementation decisions. On the investments themselves, we are diversified: public, private, alternatives. We are pretty much everywhere.

Have you set yourself any particular challenges?

Kalisperas: We are a close to £20bn pension fund with 20-odd people in the investment team. We would like to see a few more people here and I am making that move myself. I am commuting from London for the first six months then re-locating to Yorkshire.

I have, in a small 'p' way, a political view that the country could do with having financial centres of excellence outside London and the southeast. It would be good to see our investment team, as part of the pool, grow.

Recruitment and retention is one of the strategic challenges Euan and I see.

In that sense, do the government's leveling up and northern powerhouse initiatives help?

Miller: The funds in Northern LGPS have probably led the way in the pools to a large extent in these types of investments, especially Greater Manchester, which has a long-established local investment portfolio. So, there does not need to be a big change to what we do.

There is an inverse proportionality in many aspects of managing the LGPS: for example, the employers who employ thousands of LGPS members often have specialist pensions resource and have participated in the scheme for many years, so typically need less help and assistance from their administering fund, but smaller employers may have joined recently and only have one or two administrative staff, so you need to hold their hands to a larger extent.

Similarly for LGPS investments when it comes to local or regional initiatives, a £1bn-plus external passive mandate would likely consume less management time than £10m or £20m invested in a specific local project The investments which may be encouraged by the leveling up agenda could be resource intensive.

So such investments need to fit the bill?

Miller: Yeah, they have to wash their own face and deliver a commercial return for the fund. We are not grant money. That is a misconception people outside the LGPS sometimes have. We are a commercial investor at the end of the day, and have pensions to pay, which need to be funded by employers and scheme members.

How important is ESG to the fund?

Kalisperas: We have an ESG officer who collaborates with Greater Manchester and the Merseyside Pension Fund as part of Northern LGPS. We have signed up for many progressive initiatives.

The E has had a lot of the attention, and rightly so, but, from my own position, I would like to see more balance between the three aspects of the E, the S and the G. The old-fashioned responsible investment pieces – the S and the G – are important. I feel good about the shareholder resolutions we have an opportunity to partake in as part of the pool.

As investors, we see a direct positive link between the S and the G. The E sometimes feels like a more existential question of engagement or even divestment, which makes it more difficult.

What do you aim to achieve in your role?

Kalisperas: I want to see layers of curiosity about the investment puzzle. But our bread and butter remains the same: manage the assets in the context of our triennial-evaluation and try and get to the next one in a healthy state. That has to be the duty: give confidence that we can pay the pensions when they are due.

What do you mean by "layers of curiosity"?

Kalisperas: The investment universe has gone through a significant shift since 2008 and the pension fund has been successful in having a long-term risk appetite. There is the small danger of inertia as we come out of a 15-year run.

The idea that you don't take as much information from the outside because you are doing fine. This can lead to drift in areas.

I would like to see some broader curiosity about the changes in the investment universe that could be implemented for the benefit of the fund: those could be thematic or regime changes, but I see these as evolutions.

What about you, Euan?

Miller: Simply, it's our job to have enough money to pay the right people, the right benefits at the right time at an acceptable level of cost for employers. We have done that for many years. I hope under my watch, we will continue to do so.

LEANDROS KALISPERAS' CV

December 2022 – present
Chief investment officer
West Yorkshire Pension Fund

2018 – 2021
Head of portfolio solutions
Abrdn

2017
Monetary policy advisory roles

2010 – 2016
Head of credit
Universities Superannuation Scheme

EUAN MILLER'S CV

October 2022 – present
Managing director
West Yorkshire Pension Fund

March 2014 – October 2022
Assistant executive director
Greater Manchester Pension Fund

June 2010 – March 2014
Senior actuary and consultant
KPMG

BONDS? ALTERNATIVES?

While financial markets entered the new year with caution, some investors are asking if central bank rate hikes could peak sooner than expected? The answer is set to shape institutional asset allocation, find *Andrew Holt* and *Mona Dohle*.

Investors could be forgiven for entering the New Year with an uneasy feeling. Inflation, although expected to fall, is likely to remain elevated this year and interest rates are on track to rise. These two factors would force investors to adapt their strategic asset allocation to the much-touted term 'the new normal'. This, one would assume, should mean a shift to less riskier assets.

But as this year has progressed, investor caution has been followed by a paradox. While one would have expected investors to sell risk assets, stock markets rose. After an abysmal 2022, the FTSE100 hit a record high in February, while the S&P500 is up 7.6%, year to date.

At the root of this ambivalent investment outlook is uncertainty about inflation. The Bank of England and the Fed have stressed that they expect the cost of goods and services to fall, but that further rate hikes might be required to achieve it.

Markets appear to have swallowed the good news in this message, that inflation could fall, without considering the words of caution about future rate hikes. As recently as January, markets priced in that US Federal Reserve rates could peak in March. This has now been adjusted somewhat, amid a strong job market and news that inflation in February shrank slower than anticipated.

Nevertheless, futures pricing suggests investors believe rate hikes could peak this summer. Are they being too optimistic? For institutional investors having to reposition their asset allocation for the long term, what will happen to inflation and, in turn, to interest rates has now become the all-important gamble.

The inflation issue

Richard Tomlinson, chief investment officer of Local Pensions Partnership Investments (LPPI), confirms that investors must navigate two potentially different outcomes. "The conversa-

tions I have had internally have been on at least two scenarios. One is, are we going back to the great moderation of post 1982: characterised by falling inflation, lower rates, everyone playing nice globally and supply chains that work?"

Then there is the second scenario. "This is where there is inflation, less geopolitical co-operation, shorter supply chains concentrating on security not cost and onshoring. If we go down that road, we will have some serious questions."

At the heart of the uncertainty is the question of whether we are about to enter a 'new normal' of persistently high inflation. Central bank forecasts suggest otherwise. The Bank of England's February monetary policy report predicts that inflation will fall to 4% later this year and settle at 1% in the first quarter of 2025. But there is also a view that the climate crisis and deglobalisation could mean we are entering a period of persistently high inflation.

Dan Mikulskis, a partner at consultancy Lane Clark & Peacock, says the 'new normal' term may be overdone, but it has substance. "Phrases like 'new normal' have become a cliché in investment, and often it is the sort of noise that long-term investors need to look through. That said, some significant things have objectively changed."

Like much of the new normal, there is not an exact consensus on all its component parts. Mikulskis, for example, offers a different take on inflation. "Inflation has obviously been a big driver of the last couple of years, but one interesting feature has been how quickly markets expect it to come back under control," he says. "Market pricing does not anticipate structurally higher inflation being a big medium-term part of the picture."

For us, the new normal is high uncertainty and higher nominal and real bond yields as a starting point.

John Roe, Legal & General Investment Management

A view not shared by John Roe, head of multi-asset funds at Legal & General Investment Management. "For us, the new normal isn't higher inflation," he says. "The initial shock has already peaked and we could even get low inflation in 2023. For us, the new normal is high uncertainty and higher nominal and real bond yields as a starting point."

The right mix

So, how should the asset allocation mix alter for investors? From a macro perspective, if inflation were to fall, now might be the time to lock in relatively attractive rates in fixed income, John Roe says. "We need to be concerned about inflation risks, but equally bonds can provide better returns in a recession where central banks cut interest rates," he adds. "In the next 12 months, we could see anything from a global recession, a rebound in economic growth or another inflation scare."

This could be good news, especially for insurers and defined benefit pension funds looking to match their long-dated liabilities. But the flipside to that is if inflation and rates continue to rise, investors in long-dated debt may have locked themselves into duration risk.

This means investors are increasingly turning to debt with shorter maturities, Mikulskis says. Short-dated, high-quality corporate bonds yielding north of 5% a year set a high hurdle for riskier assets and alternatives to merit inclusion in a portfolio.

"After a decade of scouring the markets for good ideas in private markets and alternatives in a world of zero interest rates, you have a situation where more straightforward assets can do a great job of meeting investors' return targets," he says.

Another area of concern is the increasingly positive correlation between stocks and bonds, which is high on the agenda of Matthew Cox, investment director at the Esmée Fairbairn Foundation, a charity working to improve the quality of life. He reveals that in the past, his team has held little in terms of fixed income due to high valuations. "But, after the corrections in 2022, we are hoping there will be more opportunities in this area. It has been a challenge for a long time now to find attractively priced assets which provide good diversification against equities," he says.

Roe adds that factoring in pricing, fixed income could become more attractive compared to alternatives. "To some degree, these types of assets compete with index-linked government bonds which also offer long-dated real returns only with lower returns and less economic risk. These other assets are riskier than bonds, so should offer a significantly higher return."

For example, in 2022, 20-year real yields on US index-linked bonds climbed by more than 2.25% while in the UK they jumped to more than 3%. This could make inflation-linked debt relatively more attractive than alternative assets that come with higher fees and liquidity risks.

> **We have to plan for the new normal if we want to be standing in 10 years' time.**
>
> Richard Tomlinson, Local Pensions Partnership Investments

But Roe does not dismiss alternatives entirely. "If and when these growth assets re-price, then yes they could be interesting," he adds, "in offering a high initial real yield and some sort of contractual, or at least approximate, inflation hedge to the heightened uncertainty investors face."

The great transition

While fixed income is becoming more attractive, demand for alternatives continues to rise for open schemes such as the LGPS pools and charities. Infrastructure, property, healthcare and higher-income long-term real assets are proving attractive in the current environment. "We are looking at some of these [assets], particularly in relation to the transition to a low carbon economy," Esmée Fairbairn's Matthew Cox says.

The shape of private market assets also appeals to George Graham, fund director at South Yorkshire Pensions Authority. "Certainly, they are a key emphasis in our overall investment strategy and will likely be areas into which cash flows in the coming years, in part because of their strong income characteristics," he says, adding: "The problem, of course, is that this could result in prices being bid up potentially eroding returns in the short term."

This poses a natural dilemma for pensions funds like South Yorkshire's. Graham expects further asset allocation modifications to his fund. "We see some shift into alternatives although we don't make big allocation shifts. Listed equities will have a key role in the portfolio, as we remain an open scheme we need to maintain an exposure to growth assets," he says.

Cyclical headwinds

Illiquid assets also come with risks, especially if the economy takes a turn for the worse. Property could also prove a safe investment option, Mikulskis says. "UK property saw some quite big falls toward the end of last year, but there are some real cyclical headwinds there, such as the decline of the high street and changing use pattern of offices."

Mikulskis recognises that infrastructure has been a popular asset class. "And if anything," he says, "an issue in the UK has been a lack of supply of projects at good return levels." How this can be addressed is still open to question.

He also notes that privately owned infrastructure assets have held their value pretty well over the past year, adding: "That makes them a candidate to rebalance away from where possible, rather than add more due to overall portfolio allocations."

For pension funds there are other considerations beyond what looks good from an investment point of view within a portfolio. Graham says this is the case for local government funds like South Yorkshire. "For LGPS funds we also need to consider the implications of the Edinburgh reforms and the steer from the government in terms of 'levelling up' investment, as well as any changes in the pooling guidance."

Go forth and diversify

The whole debate raises bigger questions about diversification within a portfolio. "A core belief for us is that diversification needs to be much deeper than just equities and bonds," Roe says. "So, including alternatives and also ensuring that within asset classes there isn't too much risk in one region either."

With higher volatility, diversification becomes particularly important – by asset class, regional risk exposure, currency and avoiding too much exposure to one stock or sector. "The main three economic blocks of North America, Europe and China face different challenges and upside opportunities," Roe says.

He, therefore, offers another perspective for investors to consider. "All else equal, investors should aim to be contrarian," Roe says. "This will mean they tend to buy assets after they fall in value and avoid jumping on the bandwagon of assets that have recently done well."

But Tomlinson stresses the limits to diversification. "You cannot have a portfolio for every scenario," he says. Last year LPPI undertook a war game scenario in which the investment committee raised many of these issues. "The conclusion was to be cautious on liquidity," Tomlinson says.

There is a sense in all this that it can become something of a continued argument about an investment portfolio. But keeping the long-term in mind remains crucial, Tomlinson believes. "We have to plan for the new normal if we want to be standing in 10 years' time," he says.

This highlights that investors cannot, and should not, ignore the challenges – and with it opportunities – offered by the new normal.

DC: COMING OF AGE

After receiving the support of policymakers and regulators, it is time for the defined contribution pensions industry to stand on its own two feet. *Mona Dohle* looks at what this means for members.

If the UK's defined contribution (DC) pension market is compared to the lifecycle of a person, then it is no longer a baby and has become a toddler. After a strong start in a buoyant market environment, where investment portfolios could simply be swaddled away in passive index strategies, they have now entered a more challenging phase.

This in part is due to more challenging markets, but also the rapid growth of the assets managed by occupational pension schemes thanks to auto-enrolment and growing consolidation in the industry.

As DC schemes grow, new opportunities arise. The watchful parents, in this case policymakers and regulators, are keeping a close eye on this development, as Department for Work and Pensions (DWP) consultations on broadening investment opportunities and value for money illustrate. These trends mean that such schemes will have to reposition their portfolios to be more active, with inevitable bumps along the way.

Strong start

The birth of auto-enrolment a little over a decade ago could not have come at a better time for occupational pension schemes, which were focused on equity-heavy, low-cost, index strategies. Trustees have been well rewarded for the change in strategy that resulted from the rise in membership.

During the past five years alone, the S&P500 jumped almost 50% to more than 4,000 basis points from 2,700 in 2018. The S&P500's 10-year rolling average stands at 14.5% and the returns recorded by other major stock indices were equally as juicy over the same period.

Such gains are reflected in the performance of the growth-orientated master trust default funds. National Pension Trust, the Aon Mastertrust and SEI Master Trust reported annualised returns north of 8% in the past three years, according to Hymans Robertson.

Other master trusts also produced enviable annualised returns over the same period. The People's Pension's Global Investments fund had a cumulative performance of close to 6%, while Nest's 2040 fund stood at 8.6%.

If their members had moved their retirement savings to a swanky hedge fund office in Mayfair, they might not have received similar returns over the past 10 years (a fact that is indicative of the mixed performance of hedge funds throughout that period).

It is worth adding that the picture is mixed, with some master trusts returning less than 4% during the same period, and one earning less than 2%, according to Hymans Robertson.

Bumps along the road

But last year started to turn sour when stock markets were more volatile. The S&P500 dropped by more than 10% in 2022, which was reflected in the performance of the previously successful DC default strategies. Nest's 2040 default fund

slumped by 9.5% while The People's Pension's Global Investments fund lost more than 9% of its value. Other master trusts who are yet to report their figures for 2022 have acknowledged that it was a challenging year.

Alongside economic turbulence was a gilts sell-off in September, as investors with liability-driven investment strategies sought to firm up their hedges. This especially impacted the retirement stage funds and annuities which paid out late last year.

Inflation has been an additional challenge, says Nest's chief investment officer Mark Fawcett. "2022 was a difficult year for investors. The main drivers for these difficulties were higher inflation, higher interest rates and fears of recessions."

Joanna Sharples, chief investment officer for Aon's DC team, acknowledges that this means schemes are now thinking about what changes they could make to their strategy. "It has been a bit of a shock that last year bonds were quite risky and that you need to think about your maturity.

"Even within the index strategies, there have been better places to be. What you did with your currency made quite a difference and depending on the bond maturity in your indices, you could get a fall of more than 20% or positive returns. There has been a massive dispersion," she adds.

Flexible friends

Another factor driving the trend to re-think investment strategies is the rapid growth of DC assets and the concentration of these assets among an increasingly smaller number of providers. This trend has been accelerated by regulation, such as the rules for master trust authorisation in 2018. Since 2012, the number of DC schemes with more than 11 members has slumped by 67%. While master trusts do not yet hold the majority of the industry's assets, they do have the largest membership, according to The Pensions Regulator (TPR).

In January, the 36 authorised master trusts invested more than £105bn on behalf of 23.7 million workers. Nest's assets alone stand at £26.8bn, which belong to 11.7 million people. This growth in scale means that DC investors now have more flexibility to think beyond conventional assets and index strategies.

A prominent example is Nest launching two private equity mandates last year. For Aon's master trust that means real estate and infrastructure strategies are being considered, Sharples says.

Regulatory drivers

Regulators and policymakers have been keen to accelerate this trend, judging by the two latest DC consultations put forward by the Department for Work and Pensions.

At the end of last year, the department closed a consultation on Broadening Investment Opportunities of Defined Contribution Pension Schemes. In its introduction, then pensions minister Alex Burghardt did not mince his words: "Enabling our occupational schemes to take advantage of long-term illiquid investment is one of this government's key priorities."

While the government changed rather swiftly, the agenda remains the same. The proposals are aimed at accelerating investments in illiquid assets and facilitating greater transparency through so called "disclose and explain" standards, which would require schemes with more than £100m in assets to set out their allocation strategy. This was backed by most of those responding to the consultation.

Another consultation, launched in January and due to close in March, looks specifically at the challenge to address the divergence in member outcomes through a value for money assessment. These proposals mark a significant move from the focus on costs in the early days of auto-enrolment. Instead, the consultation, put forward by the DWP in collaboration with the Financial Conduct Authority and TPR, proposes to assess investment performance alongside costs and charges and quality of service.

In addition, Laura Trott, the new pensions minister, also proposed to widen the scope of exceptions from the charge cap, in another attempt to ease DC investors into illiquid assets. But Aon and Nest have said that the existing charge cap has not been an obstacle to invest in alternatives.

While The People's Pension welcomes the changes to the

> **It has been a bit of a shock that last year bonds were quite risky and that you need to think about your maturity.**
>
> Joanna Sharples, Aon

“

2022 was a difficult year for investors.

Mark Fawcett, Nest

charge cap, it also warns that this now puts the onus on trustees. “There’s nothing intrinsically wrong with performance fees provided there are sufficient protections for members built into investment management contracts. Exempting performance fees from the cap returns member protection responsibilities back to the trustee. It should not be forgotten that trustees have a legal duty to put the interests of savers above everything else,” a spokesperson for the master trust said.

The combination of these potential reforms could accelerate a trend of DC schemes interacting more with asset managers, predicts Henry Tapper, executive chair of pensions consolidator Age Wage. But he also warns that assessing outcomes for DC members would require a much more customised approach and should not be based on the investment performance of defined benefit schemes. “Rather than measuring net performance on a top-down basis, we expect to see performance measured against time-weighted returns measured from the bottom up,” Tapper says.

As the government takes a greater interest in the management and asset allocation of DC default funds, a risk to consider is that this could lead to a growing concentration in some segments of the market.

Sharples warns of the danger of simply developing indices for investment strategy or asset allocation. “To what extent is there a basis for this asset allocation and is there a risk of this being arbitrary?” she asks. “Does that then become the norm? Equally, a default strategy might be right for one size of the population but not for other groups, so there are lot of subtleties and there won’t be a one-size-fits-all approach.”

Re-thinking growth portfolios

The sum of these factors mean that schemes are now considering significant changes to their investment strategies.

Aon is one of the master trusts which is considering investing in alternative assets, Sharples says. “It is about thinking of the assets that will be the right fit at different stages in somebody’s lifetime.”

So, for early stage default funds, private equity would probably be a reasonably good fit. “It also involves thinking about inflation and developing inflation protection where real assets such as infrastructure and property could play quite a nice role,” she adds. “These investments also have potentially quite a strong ESG impact.”

Nest committed £3bn across two private equity mandates last year and is considering other strategic changes. This includes increased exposure to investment-grade bonds, at the extent of high-yield paper, in an attempt to minimise the risks of potential credit losses, Fawcett says.

The master trust has also upgraded the outlook for global real estate investment trusts (REITs), predicting that property prices may not fall as much as expected. In exchange, it predicts that the surge in commodity prices will slow down as European economies show signs of recovery and supply shortages are starting to ease.

Re-thinking decumulation portfolios

But the changes do not stop there. Last year’s bond market troubles have forced investors to re-think their decumulation portfolios, Sharples says. The Aon Mastertrust has been fortunate to have reduced its exposure to long-dated gilts going into 2022. “We have made quite a lot of changes since the end of 2021, thinking about the fact that inflation and interest rates were going to rise,” Sharples says. “This means we have invested quite a lot in shorter maturity bonds and loans which are not commonly used by DC schemes. We had to think about other assets out there and that worked well last year.”

The People’s Pension has also reviewed its fixed income exposure. “Global economic instability, largely caused by the war in Ukraine and the continuing fallout from the pandemic, meant 2022 was a challenging year for investment performance across the board, and we weren’t immune from this,” a spokesperson said.

“During 2022, the main change we made to our asset allocation was reducing the duration and increase diversification of our bond portfolio by selling gilts and sterling corporate bonds and purchasing US treasuries. The gilts and sterling corporate bonds were reduced from 5% to 3% of the portfolio while the US treasury exposure is 4%.”

Overall, the past year has been perhaps the most challenging but also most interesting for the rapidly evolving defined contribution market. While the market is still in its early stages, the changes made now, in terms of policy measures and asset allocation decisions, could potentially shape the UK’s investment landscape in the years to come.

James Fouracre: Director – UK Institutional at Ruffer LLP

THE GREAT REWIRING – CREATING A DC PENSION PORTFOLIO FIT FOR TOMORROW'S WORLD

Annus horribilis

There was nowhere to hide for defined contribution (DC) pensions schemes in 2022 – balanced portfolios were unceremoniously knocked off their perch as equities and bonds fell together.

And the damage wasn't confined to mainstream asset classes. Most others – from credit to infrastructure to property, across public and private markets – also suffered severe losses. The assets that DC investors were relying on to provide offsetting returns became correlated with the rest of the portfolio – diversification did a disappearing act.

Halcyon days

The 40 years following peak inflation in the 1980s were dominated by geopolitical peace, supercharged globalisation and the integration of China's workforce into the world economy – all of which have been key drivers of falling inflation, interest rates and volatility.

These trends have underwritten a golden era for capital, but they are now in reverse. This presents a fundamental challenge to the assumptions which have underpinned the approach of investors for nearly half a century. The world has changed, but have DC portfolios changed too?

A nostalgic view of the future

As inflation falls back this year, you're going to hear a lot of people saying: "So inflation was transitory after all – back to the ways of old." This would be a mistake. Inflation falling sharply this year is consistent with a world in which inflation volatility reigns supreme, not just higher inflation. It's a more complex environment for which to build a portfolio but one which presents opportunities as well as challenges.

History shows that, when inflation averages above 2.5%, most assets are positively correlated with one another – as we saw in 2022. Most notably, conventional bonds which formerly protected clients against falls in equity markets, have had their protective power supressed by ankle-high interest rates.

The challenge in this new environment is that inflation will not only be higher on average, but also volatile. Higher inflation will therefore challenge most DC diversification strategies.

Looking ahead, investment fundamentals and valuation now matter significantly more than they did a year ago, and we expect to see a greater divergence in returns across assets, regions and currencies. Crucially, the old ways may no longer be the best ways. The key question for those responsible for DC investments is clear: what is your plan for this new regime?

Seeking to achieve positive returns in a DC pension scheme portfolio, whatever happens in financial markets, means allocating to a diversified investment strategy with an ability to find and own assets which respond differently to changes in the investment environment – and crucially, owning assets which respond differently to each other.

Member lifecycle

It would be remiss not to highlight the distinctly diverse needs of scheme members across the DC lifecycle in relation to market conditions. Equities are the dominant asset class for most of a DC scheme member's investment lifecycle, given the long-term investment horizon. But bonds are increasingly called into play as members are 'de-risked' as they approach retirement and into the decumulation (post-retirement) phase. Government bonds, or gilts, are (or at least, were) generally regarded as a more cautious and protective source of returns – lower risk, ostensibly, than equities. But as we witnessed last year, owning certain bonds can be speculative too.

Many individuals intending to retire in the near future will have suffered material losses to their capital as a result of the dramatics of late September last year, as the UK gilt market shook many DC pension schemes to the core. Some members simply will not have time to recover that lost ground. The drastically shortened investment time horizons of scheme members in the 'pre-retirement' phase and even more so in the decumulation period, changes the psychology of portfolio construction.

As individuals and organisations inspired by driving better outcomes for DC members, what do we learn from the lessons of late September? Are bonds still the low-risk, low-volatility investment tool they once were? Amidst a regime of higher inflation volatility, we think, perhaps not.

As we saw throughout 2022, the pain is greatest for investors when all assets fall together. Consequently, the call to action across the DC pension industry has been deafening.

There will be times when investors will want exposure to bonds, and the duration that comes with them. But the key is being able to turn the dial on that exposure when necessary – ensuring an allocation to a strategy that boasts the agility that the prevailing market conditions will demand. Furthermore, allocations that use unconventional instruments as a source of uncorrelated returns – think derivatives in credit, equity protections and alternate currency positions.

Investment allocations in the de-risking and decumulation stages in particular will need a relentless focus on the preservation of capital as markets move deeper into uncertain territory. DC schemes and their investors must learn the lessons from the gilt debacle. Because in a world which promises ever more risk and volatility, we must be prepared for the unlikely – not least, history repeating itself.

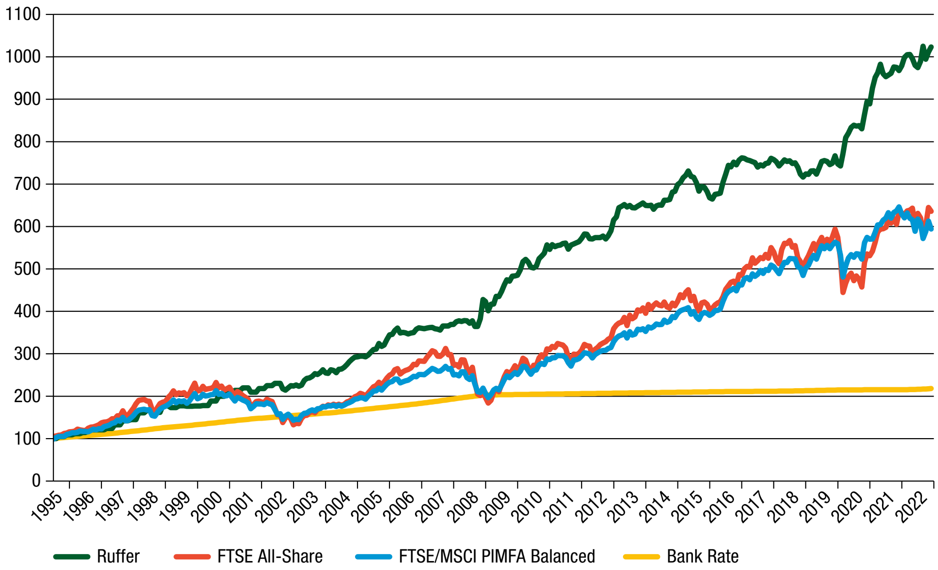
Tomorrow's portfolio, different to today's

It may take time to play out – financial conditions are still incredibly loose – but we know trip wires lie ahead. And inflation is likely to fall sharply again when financial and economic volatility coincide. Unfortunately, political authority is weak in the West, consensus on what the fair distribution of financial outcomes and welfare should be is frayed, and the ideological divide between China and the US is growing. Policymakers could be forced back into monetary financing mode quickly if threatened by recession and asset market distress. These are fertile breeding grounds for inflation.

Inflation volatility will eventually give way to inflation but investing now solely for the inflationary endgame would be a mistake. Peter Drucker, the father of modern management thinking, said: "The greatest danger in times of turbulence is not the turbulence. It is to act with yesterday's logic."

Turbulence lies ahead, that's for sure. The message to DC pension scheme investors: portfolios will need to be steered on this journey, requiring new skills, new ways of constructing portfolios and imaginative thinking. The easy, passive – almost free – ride is coming to an end. It is time to flick the switch off autopilot.

Ruffer – Seeking to provide genuine diversification for DC schemes



To 31 Dec %	96	97	98	99	00	01	02	03	04	05	06	07	08	09	10	11	12	13	14	15	16	17	18	19	20	21	22
Ruffer	10.6	19.8	22.7	-0.2	16.8	5.5	3.0	16.8	11.3	14.1	8.4	2.1	16.0	13.0	15.1	1.3	4.6	11.1	4.2	-0.1	10.9	0.5	-5.8	7.0	16.7	8.2	5.7
FTSE All-Share	16.7	23.6	13.8	24.2	-5.9	-13.3	-22.7	20.9	12.8	22.0	16.8	5.3	-29.9	30.1	14.5	-3.5	12.3	20.8	1.2	1.0	16.8	13.1	-9.5	19.2	-9.8	18.3	0.3
Bank Rate	6.1	6.6	7.4	5.5	6.0	5.3	4.1	3.8	4.4	4.7	4.7	5.6	5.0	0.8	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.3	0.6	0.8	0.3	0.1	1.3
MSCI PIMFA Balanced	11.9	20.7	16.6	18.7	-2.4	-9.6	-16.7	15.8	9.9	18.5	10.0	5.7	-17.4	16.8	12.5	0.2	9.1	14.1	7.2	2.7	17.1	9.9	-4.8	16.2	1.9	12.5	-8.1

pi ESG CLUB

Investors like data. It helps assess risk and monitor progress. But with the quality and frequency of ESG disclosures years behind financial reporting, this month's ESG Club feature looks at removing one of the biggest barriers to sustainable investing.

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Allspring | AON | BNP PARIBAS ASSET MANAGEMENT | JUPITER ASSET MANAGEMENT | LGIM | M&G Investments | Manulife Investment Management | NEWTON Investment Management | PENSIONS AND LIFETIME SAVINGS ASSOCIATION

HOW SUSTAINABLE IS YOUR CHINESE FUND?

For emerging market investors, China is hard to avoid and so, it seems, are its low ESG standards. *Mona Dohle* reports.

At first glance, China appears to offer plenty of green investments. In 2021, it reported record inflows of $46.7bn (£41.1bn) into climate funds, according to Morningstar, a 150% increase year-on-year. While demand for Chinese funds dropped in 2022, investor appetite for China has made a comeback.

For investors replicating an index, China remains hard to ignore. About a third of the MSCI Emerging Market is represented by Chinese firms and the country also dominates emerging market bond indices.

But a series of ESG scandals illustrate that investors might want to approach some Chinese ESG funds with caution. One example is a report that major Chinese firms are benefiting from forced labour of the Uyghurs. This applies to at least 13 firms included in global equity indices such as the MSCI Emerging Market and Morgan Stanley's All World index. Institutional investors with passive exposure to China might therefore be inadvertently complicit in human rights violations.

The E, the S and the G

Another factor to consider is the discrepancy between the stand alone environmental, social and governance (ESG) factors. Some firms perform reasonably well on environmental metrics but less so when it comes to the S and G. This includes Tencent, which has relatively low carbon emissions and accounts for more than a quarter of MSCI's China ESG Leaders index. Another prominent index constituent is micro blogging service Baidu.

But Tencent and Baidu have been downgraded by Morningstar Sustainalytics. As a result, Wisdom Tree has removed them from its China Ex State Owned index, which resulted in an adjustment of 28% of the overall index.

Neither Tencent nor Baidu are state-owned, but in a state capitalist economy, the distinction between state and the private sector is far from straightforward. One decisive factor that motivated the Morningstar downgrade is that Tencent and Baidu have violated UN Global Compact Guidelines.

"While we are primarily known for our ESG risk ratings, which focus on financial and material risk factors, we also have a team which analyses firms based on the UN Global Compact Principles, such as respecting human rights," said Remco Slim, manager of product strategy and development at Morningstar Sustainalytics.

These UN Global Compact assessments are based on reports in the media, including in China, supported by a team of Mandarin speaking researchers. "We noticed that firms like Tencent are increasingly playing a role in the oppression of freedom of speech and their data is also frequently used in court cases against dissidents," Slim said.

Human rights violations are an exclusion criterion for some investors. This includes Capitulum Asset Management, a Berlin-based boutique advising on fixed income strategies. "When it comes to Chinese bonds, the distinction between state and private sector remains almost impossible," said Ernst Theodor Kirschner, a fund manager at the boutique.

"The majority of green bond issuers in China are state-owned banks which are closely connected to the Chinese government," Kirschner added. "This is why we are sceptical of these issuers from a social and governance perspective, even if they have been labelled as green bonds by some of the major rating agencies. We have opted not to invest in local issuers, despite the fact that China's share in bond indices has been growing significantly over the last few years."

Green bonds: Dodgy definitions

Another factor to consider is that up until last year, the Chinese definition of green bonds was less stringent, with up to 50% of the proceeds could be spent on general projects. This included fossil fuel producers and even "clean coal" mining. The Climate Bond Initiative has seen this as a reason to exclude more than 60% of Chinese green bonds from its database.

But green bond standards in China are evolving, said Georg Inderst, who advises pension funds. Indeed, the Chinese Green Bonds Standards Committee published a set of principles in July which obliges issuers to dedicate all of their proceeds to sustainable projects. China has also signed a Common Ground Taxonomy with the EU last year.

While China had "a lot of catching up to do", excluding it entirely means abandoning some significant opportunities, particularly in green technology, Inderst warned.

Another factor to consider is China's growing contribution to global carbon emissions. The People's Republic now generates almost a third of such harmful gases. Tackling climate change without China would be impossible.

Nevertheless, the question remains how investors can gain exposure without being complicit in human rights violations. Some are focusing on firms which operate in China but are not listed there. For fixed income investors, yuan denominated green and social bonds issued by supranationals, such as the European Investment Bank or World Bank, could be an alternative. "These bonds are compliant with global green bond standards and offer AAA rating and greater levels of transparency on the use of proceeds," Kirschner said.

For Inderst, China is too big to ignore. But the gap in ESG standards means investors should approach it with caution.

INTERVIEW – CHANDRA GOPINATHAN

“What we do today should not compromise tomorrow’s outcomes.”

Railpen’s senior investment manager of sustainable ownership tells *Andrew Holt* about what responsible investing means to the scheme and how he is helping to implement it.

Why describe responsible investing as active and universal ownership?

As a pension fund we see ourselves as real asset and universal owners. This means we recognise that through our portfolios we contribute to and own part of the economy as well as a slice of the market: what we do today should not compromise tomorrow’s outcomes.

Actions today should enhance portfolios along with the prospects of the economy and for the market as a whole. That is the starting point when we talk about Railpen’s mission to look at sustainability and universal ownership in the widest economic and market sense.

What does ESG and responsible investing mean for Railpen?

It is incorporating ESG and sustainability considerations into our investment process. It starts with the trustee’s investment beliefs, which completely incorporate ESG and climate considerations.

These are essentially systemic risks across portfolios. Liabilities and governance could be classified by themes like climate change, modern slavery, responsible technologies and sustainable markets. These are themes from a top-down perspective that are incorporated into the investment process.

And we do bespoke analysis by asset class: equities, fixed income, infrastructure and all of the private markets when dealing with and incorporating sustainability.

How long has ESG been part of your overall investment approach?

It has been part of us for at least a decade. It started with being heavily focused on governance – which it still is – and then built out into more granular sustainability themes and then into the investment process.

Railpen aims to cut greenhouse gas emissions in half by 2030 and achieve net zero by 2050: how are these plans progressing?

In 2021 we set out our net-zero analysis with a roadmap of how we are going to get there. We are signatories to the Institutional Investors Group on Climate Change and use the net-zero investment framework to determine how we look at emissions across our portfolio.

The first step is looking at financed emissions. We assess how much, in terms of emissions, we are financing in our public equity and fixed income portfolios. That leads us to look at where the emissions are and where they are coming from. Then we look at the key emitters, which turned out last year to be 42 companies, to help form our net-zero engagement plan.

That means we engage with those companies to see how aligned to net zero they are and understand areas of misalignment according to our Climate Risk Net Zero Assessment Framework, which defines the different pillars for net-zero compliance. We take those areas of misalignment and that goes into our engagement and voting policy, focusing on the climate transition and how well companies are doing in these areas of misalignment.

Another side is looking at transition investments, at climate solutions. We have a real assets portfolio that invests in wind farms and solar farms.

The third part is policymaking. We are collaborative in policy initiatives, on things like climate market assessments.

Are you on track?

We are on track. We are discovering new things and challenges do arise, relating to asset class, data and policy. So, we make sure the process is robust. While it is going well, there is always room to improve.

What challenges are you facing?

There are challenges from an ecological innovation perspective. There are technologies that are untested. While they are offering a lot of promise, there are also questions of scalability. The second set of challenges relates to the asset classes. We have asset class considerations like public equities where you have a say, there is an accountability mechanism. When you look at other asset classes like bonds and private markets, there is not the same mechanism in place. So how do you make sure you have a voice at the table? How do make sure those mechanisms are transferred?

You use a milestone-based approach when assessing a company from an ESG perspective. How does that work?

Climate change offers a good example. It is a set of criteria on which to assess a company on its climate credentials. By setting milestones, you increase the bar as it relates to governance, data capabilities, emissions and disclosures on de-carbonisation, social impact and the just transition.

These are the pillars around which we set milestones for a company. As time goes by, the milestone bar gets higher, as we expect the company to move forward.

As a pension fund we see ourselves as real asset and universal owners.

Has this led you to divest from a company?

We have not reached that point yet. We work through our engagements and give a clear window of time to see how much change can be effectively made by a company.

On divestment as an approach, we use exclusions as a policy across the ESG space. We exclude companies that are extremely negative from climate and ESG perspectives.

That is in some ways a form of divestment, but we believe engaging with a company can lead to better results than divesting.

Why do you believe collaboration is the best way to address change?

It is not the only way to address change, but it is an important part. There is, from an asset-owner perspective, a benefit to collaborating in terms of the universal duties that exist, especially within ESG.

There is more power in collaborative investor engagement with companies. And there is a learning process, where you often need strong scientific brain power to help, and that can be achieved best on a collaborative basis. Working with policymakers helps if you are doing so on an effective collaborative basis.

You have expanded your renewable energy investments. What is the rationale of this within your ESG mission?

This falls within the net-zero plan. This has two pillars: the de-carbonisation policy and climate investment. Within the latter there are significant attractive investment opportunities. They provide good greening opportunities for the economy as a whole, whether they be renewable energy investments or in private companies offering climate solutions.

You chair the new Institutional Investors Group on Climate Change Bondholder Stewardship Working Group. What does it aim to achieve?

Bondholders don't have the right to vote. We can go in and provide a basis on how to improve the governance mechanism. We point to other investors who are engaging with companies and how they can see these engagements being successful.

When we buy bonds from a company, we assess their green credentials. There are other frameworks, like The Green Bond Framework, which is a sustainability bond scheme that helps align green bond standards and the EU taxonomy.

But here investors need the understanding of what is good or bad: which bond issuance is aligned with a company's net-zero strategy. And the group provides a best practice framework for investors to assess what is a good sustainable bond and how to differentiate. This structure will help all asset owners.

What are your priorities throughout the year to address the ESG issues in your portfolios?

> **Actions today should enhance portfolios along with the prospects of the economy and for the market as a whole.**

In terms of climate, we are moving on with the climate transition, determining what is a good transition plan, what is credible.

We are looking at financial disclosures as the Task Force on Climate-related Financial Disclosures kicks in, to use that as a framework in our investment processes. We also have our workforce disclosure project, which is part of the ESG agenda.

What did you make of COP27?

A lot of headlines suggested it was not that successful, and I would agree. It felt like a letdown for a lot of investors, but there was some credibility there. It wasn't about high-level announcements or commitments. It was more a check on how we are doing on the climate front, which for me was real and credible.

It was underwhelming from a financial sector perspective, but more credible from a hands on, 'how are we doing', 'what do we need to do more of' position.

What do you hope for from COP28?

We have a lot of the guidance, frameworks, tools and policies in place. It is now about implementing it all. It may sound mundane, it is hardly headline grabbing, but a 'let's get to work, let's get things done' approach is needed now.

In that context, where is the investment world in terms of dealing with climate change and the other ESG challenges? It is behind where it should be?

Saying we are behind is about expectations. What I would say is, where we are as an ecosystem, between investors, government, policymakers, data providers and NGOs, is that for the first time they are all aligned and engaged in the same mission. That is a huge positive.

Investors need to leverage off this and move forward. There is now a lot of support to address climate change as an issue.

Do you hear much scepticism around climate change within the investment world?

I wouldn't say scepticism to climate change itself. That is a thing of the past. But there is scepticism around certain things, which is more to do with the devil in the detail. Things like questioning if we are doing things right. Are we doing what we are saying we are? Do we understand the technologies?

These detailed discussions are becoming more and more important. It is positive, as it is evidence that we are making progress, but we should maintain those high standards.

What are the biggest challenges you face as a pension fund in addressing the whole range of ESG challenges?

We are fortunate as a pension fund, from trustee and management perspectives, that we believe in co-operation when dealing with systemic risks. It is, though, an educational process. An understanding of what it all means for our portfolios. That isn't an insurmountable challenge. It is more about contextualizing things. So, when we talk about ESG and climate you can contextualise it for all the stakeholders. But it can be challenging.

Alex Parkinson is co-head of responsible investment data integration at Newton Investment Management

MAKING SENSE OF DIVERGENT ESG RATINGS

Third-party environmental, social and governance (ESG) ratings play an important role in asset management, but we believe their application needs to be better understood.

Newton has long held the view that external ESG ratings or scores should not be used in isolation when assessing companies, but as an input into the process. Our consideration of ESG issues more broadly is part of a multi-dimensional research approach that takes account of financial analysis, thematic trends, macro-economics, investigative research and valuation considerations as appropriate.

We believe sustainability is a fundamental part of the mosaic of issues required to fully appreciate the material risks and opportunities influencing the securities and instruments in which we invest on behalf of our clients. External ESG ratings provide an opinion that is independent of the asset manager, and can therefore function as a counterweight to internal views.

ESG rating datasets also offer wide coverage across a universe, which can help in monitoring ESG risks within portfolios, as well as providing a view supporting the screening for new investment ideas.

Nonetheless, it is important to acknowledge that the information on which third-party ESG scores are based is subjective and dependent upon often opaque methodologies. It is based on unaudited data and is proprietary to the data vendor.

We believe that simply taking third-party ESG ratings at face value could result in the mispricing of securities or the inappropriate inclusion of securities in sustainable portfolios. Indeed, the choice of one ESG vendor over another could strongly determine the investment outcome.

With this in mind, we find a paper distributed by the Centre of Endowment Asset Management (CEAM) at Judge Business School, Cambridge University, helpful. The November 2020 paper, *Divergent ESG Ratings*, is authored by Professor Elroy Dimson (CEAM), Professor Paul Marsh and Dr Mike Staunton (London Business School). The authors point to a substantial disparity in the rankings of 878 companies across two leading ESG rating providers.

Inconsistency is further illustrated in an in-depth analysis of the ratings of six companies which diverge significantly across three ESG rating agencies in terms of their overall ratings and even in the pillars that comprise those overall ratings.

An implication of this disparity is that asset managers need to build capacity to manage and interpret the data that they buy. This requires a dedicated ESG data focus and function, supported by a data strategy that aims to plug gaps or weaknesses in available data.

The data that lies behind headline ESG ratings is often the most useful aspect of the datasets that are available. For us, the most effective method is when this underlying data can be integrated from multiple ESG providers in a way that makes the most sense for the asset manager.

Of course, not all the data within an ESG rating will be relevant or aligned with the fundamental view of the asset manager or the interests of its clients, and it is up to asset managers themselves to identify the data points that are most relevant to them. This is a difficult exercise, even when working with the raw data that underpins many ESG ratings.

Data consistency is a challenge here too, since the same data point can vary across providers, owing to different methodologies for data collection and estimation. We have seen considerable variation in carbon-emissions data, for instance, across three providers when comparing data for individual companies.

Newton welcomes the CEAM paper as part of a growing body of literature that shows the disparity in ESG data by highlighting inconsistencies and biases across data providers – in terms of the inputs to the ratings and the divergence of outputs. We believe that this type of research may be increasingly useful for asset managers, companies and ratings agencies as regulators in several jurisdictions – including the EU and India – have been pushing to regulate the ESG ratings market. It is also helpful as asset managers strive for greater transparency in their sustainable investment processes and the data that underpins them, and for enhancements to their investment decision-making.

ESG DATA: FULL DISCLOSURE

While quality has improved, investors are still faced with voluntary disclosures, estimates and a lack of global standards when it comes to data. *Mark Dunne* reports on the long journey to remove one of the biggest barriers to sustainable investing.

Sustainable investing could become a victim of its own success.

Institutional investors are bullish on assets that seek to protect the environment and promote greater equality. Indeed, 65% of inflows into European exchange-traded funds were for sustainable vehicles during 2022, up from 51% a year earlier. This growth came despite the underperformance of such strategies, highlighting pension schemes' long-term view.

Yet this could have been higher. Investor confidence in achieving their sustainable targets appears to be plagued with fears of greenwashing. Almost half (49%) of respondents told a Capital Group survey that a lack of robust ESG data is deterring them from increasing their exposure to such strategies.

But while demand to build sustainable portfolios has grown rapidly on the back of stakeholder concerns, regulation has not moved as fast. The result is a lack of clear standards of what information corporates must disclose to help investors assess and monitor their ESG performance.

There are disclosure frameworks, such as the Sustainability Accounting Standards Board, the Global Reporting Initiative, CDP and the Principles for Responsible Investment, which are all voluntary. Then there are stock exchanges, which require some ESG information to be disclosed, but this information varies between exchanges. "Unfortunately, even to this day, because it is self-disclosed data and is often not audited, it is incomparable. It is not perfect at this point," says Hideki Suzuki, director of sustainable investing for public markets at Manulife Investment Management.

Companies, even those in the same country, are not uniformly reporting on the same aspects of their non-financial performance, if they are disclosing such data at all. And not all of what they do report is audited.

"There is quite a high level of inconsistency in corporate reporting," says Dror Elkayam, global ESG analyst in the investment stewardship team at Legal & General Investment Management (LGIM), who explains that some companies issue specific information one year, but not the next.

The age of data can be another challenge. Companies report at different times, so the latest emission results for one corporate could be a week old, while the same data for another could have been published more than a year ago making a comparison impossible.

Aon, an investment consultancy, helps its clients dive into the detail of individual assets or companies they invest in, and examine the data disclosed across portfolios. "One of the challenges for pension funds and asset owners is getting a handle on the quality and nature of the data that is being aggregated to give you that portfolio view," says Tim Manuel, Aon's head of responsible investment.

An issue made all the more challenging considering the inconsistencies in disclosures when assessing a portfolio. "There is a big challenge in how to fill in the gaps with data in a fair, representative and appropriate way," Manuel says.

A material issue

Yet it appears that despite these issues, the quality of non-financial corporate data has improved, Elkayam says. "Ten years ago, I would have said that standards were concerning or pretty low, but it has improved drastically over the past five to seven years."

He puts this down to more companies committing to improving their ESG profile and wanting better relations with investors. "They are more engaged with data providers," Elkayam says.

Such commitments are ending Europe's dominance in this area, with Elkayam saying that companies in North America are closing the transparency gap. As evidence, he points to the MSCI World, FTSE100 and S&P500. "If you compare some of the more critical ESG indicators, and how they have been reported on between 2017 to 2022, then you will see a gradual improvement in terms of consistency," Elkayam says.

But it is not perfect and, it appears, that non-financial data needs to be given the same level of importance as other disclosures to achieve the change needed. "Ultimately, we want ESG data to be treated as financials by companies," Elkayam says, adding that he sees the need for further progress when comparing the standard of ESG data to financial reports.

"We do not consider ESG to be non-financial," Elkayam says. "ESG is material, so it's good to see that the number of times it's been mentioned in corporate calls has exponentially increased over the last five to six years."

Can we fix it?

One of the issues here is that British pension funds have been mandated to disclose how they are protecting savers from the impact of climate change. They need such data, whereas corporates are yet to receive the same ruling on proving how they are shielding their shareholders from such risks. Reporting on a gender pay gap is one exception for corporates in the UK and shows that such a ruling can be made.

Mandatory reporting of consistent, audited data which is released within a certain timeframe and standardised across all regions is needed to help investors form an accurate picture of the ESG risks they are exposed to.

But achieving this could take time. Manuel points out that there are differences between the EU's green taxonomy and the version due to be launched in the UK.

"Most asset owners invest on a global basis," Manuel says. "It is not, therefore, helpful if they are gathering information on underlying companies and portfolios which have reported across a patchwork of different disclosure frameworks."

Standard setters, like the International Sustainability Standards Board, are trying to set a universal standard in the ESG data space, but would regulators adopt such a benchmark in their jurisdiction?

"It needs a framework for mandatory disclosure," Manuel says. "It needs jurisdictions to work together in bringing some consistency to what they are asking corporates and investors to disclose."

This is not just about reporting data, it's what is reported alongside it that is the issue. When carbon emissions are disclosed, typically, what is released alongside the data is a measure of quality. It is just as important to refer to the quality indicator as it is to refer to the metric itself. "The thing with ESG data, like with any data, is that when you receive it, it's important to also receive information on the quality of it," Manuel says.

The timeliness issue of such reporting also needs to be considered. "A company could disclose fiscal year 2021 data today, as opposed to in 2022. There are no set rules on this," says Hideki Suzuki of Manulife Investment Management.

"[Regulators/standard setting bodies] need to send a clear message on not just what to disclose, such as the gender pay gap, but when to disclose it," Suzuki adds. "It needs to be representing the consolidated group basis data on a fiscal year end basis." Without this, how can such data be comparable?

"There are a lot of regulations around what to disclose, but not much emphasis on how to disclose it," Suzuki says. "Regulators are not sending a clear message. The data released needs to be on par with financial disclosures in that it should be audited and aligned with the fiscal year end."

Beyond carbon

Responsible investing is not just about carbon. Boardroom diversity, water consumption and waste management are other issues that help create an ESG profile.

The performance of an asset's social factors is not as easy to form a picture of compared to measuring climate impact. Reporting how many employees a company has and where they work in the corporate structure is not good enough to assess its social impact. "When investing in a company, a component of what it is delivering in terms of impact is the nature of the jobs it provides," Manuel says, adding that corporate reporting likely does not include anything about the nature or the quality of those jobs. "It doesn't give information on contracts, if they are permanent, temporary or zero hours.

"And there is little reporting around things like the living wage or a safe working environment," Manuel adds.

The reason why carbon emissions come under more scrutiny than other environmental factors, such as water consumption, and the social elements of responsible investing is due to the impact it has on our world.

Harmful gas emissions are also easier to measure than a social impact. "There is a greater standardisation of methodology there, which contributes to the greater focus that carbon data receives," says Jennifer O'Neill, an associate partner at Aon.

She adds that investors are in danger of developing a "carbon tunnel vision". "In other words, investors and interested parties focus on carbon data because of that clarity and greater standardisation," O'Neill says. "But there is a risk of missing

out on significant other forms of data to consider when you are thinking about constructing a sustainable portfolio.

"For instance, biodiversity loss is intrinsically linked to climate change, so focusing solely on carbon emissions doesn't necessarily do anything to address that issue," O'Neill adds.

Another issue on why some issues, such as carbon emissions, have more transparency than other elements is due to their maturity.

"Some datasets can be more challenging, because they are newer, while some are more mature," Elkayam says. "The independence of directors or women on the board, for example, are quite mature datasets, so the quality is fairly high."

This is evident in the S of ESG. "In diversity on the board or at an executive level, we are seeing an evolution in the way diversity is being measured, not just from a gender perspective, but ethnicity, too," Elkayam says.

"This is a relatively new element of disclosure and we expect it to increase in coverage, accuracy and quality" he adds. "But this is one of the most important growing elements in the S, along with paying a living wage and how you onboard employees considering their background and equality in the business."

What's the score?

Data is not just about corporate disclosures. The other side of it are the opinions of third parties on how an asset is performing, commonly known as ESG ratings or ESG scores.

When it comes to sustainability there is more to a company than what it sells. Tesla is an example. One ESG ratings provider points to its positive climate impact because it makes electric-powered cars. Yet another points to the chief executive also being the company's largest shareholder, which is far from ideal from a governance perspective. So it is common for providers to form different conclusions about a company.

"Depending on the methodologies ratings providers use, your opinion could be different," Suzuki says. "You could disagree with one provider but agree with another. It is a matter of being comfortable with the providers we utilise.

"This is why we only use the ratings as a starting point. It is not the end result," he adds. "You have to unpack it because there is no one simple number that explains everything about a company's ESG activities. That is impossible, but it gives you an idea."

ESG scores are also weighted differently depending on sector and the provider's proprietary methodology. "Investors need to be aware of that, understand what it looks like and the rationale for it to determine which provider they wish to use," O'Neill says.

"It's not simple, and it shouldn't be," she adds. "Sometimes simplicity creates pitfalls."

LGIM produces its own ESG ratings. Elkayam is confident that the data LGIM has is of good quality. This is partially due to the asset managers working with policymakers and regulators on certain aspects of ESG disclosure in a bid to improve the quality and breadth of ESG-linked disclosures.

Manulife Investment Management also sets its own ESG ratings, which Suzuki describes as "not easy but doable".

"As long as we have the company disclosed quantitative data, we are able to aggregate that on the portfolio level," he adds. "It becomes challenging when there is not much data for us to work with." He points to gender pay gap, which less than 20% of MSCI World index constituents disclose. "When there is a noticeable data gap, there is a challenge in interpreting the result of aggregated data."

Manulife Investment Management is also active when it comes to making an assessment. The asset manager researches companies beyond just reading a provider's research report by consuming primary sources disclosed by companies and also engaging with those companies, Suzuki says.

No right or wrong

When it comes to data, no matter how much you do or do not have, it is what you do with it that is important. "There is a danger in saying the data is right or wrong," Manuel says. "The data is what the data is. It is what has been collected.

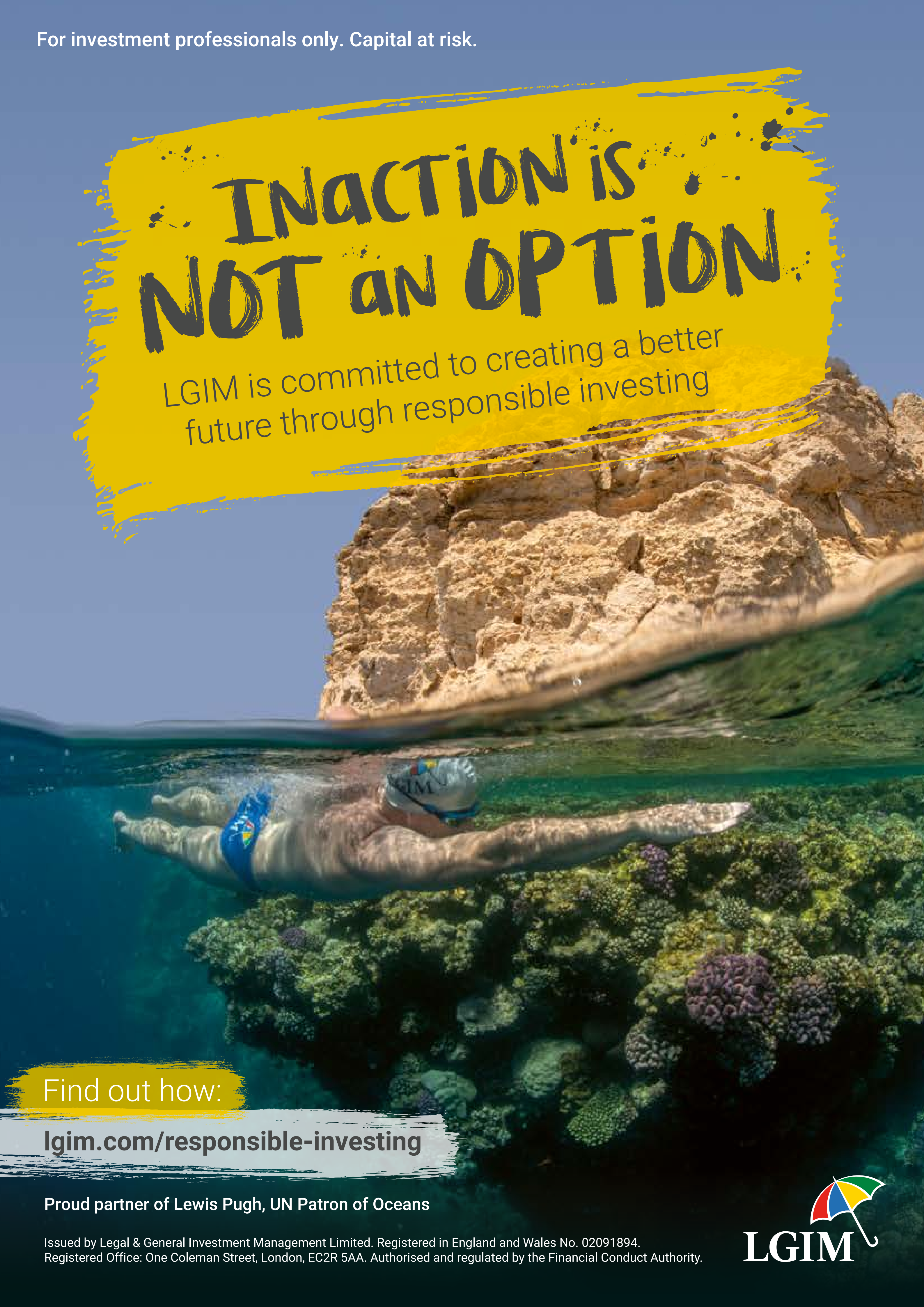
"The challenge is using that data effectively for the decisions we are trying to make," he adds. "How does this piece of data fit into the overall puzzle to support the decisions we are trying to make as a pension fund?

"We are not being driven by the data, we are being informed by it to the extent that we understand the nature and the quality of what is being provided," Manuel says.

It depends on what investors are using ESG data for: Investing? Engagement? Research? It is about what is underpinning the ratings, what goes into it. How has it been calculated? What indicators does the provider use?

"ESG scores or ratings mean different things," Manuel says. "If you are going to use them properly, you need to understand exactly what they are. Too many shortcuts and too many simplifications in how they are applied runs the risk of those ratings or scores being misused. There is no shortcut to digging into what these scores mean."

The rapid growth in the level of capital targeting sustainable assets has made this a mainstream asset class, but when such growth occurs the infrastructure and supporting elements do not always improve at the same pace. Regulation and standardisation of non-financial data needs to improve, but it took decades for a universal financial accounting standard to be agreed. The quality and transparency of ESG data has improved and will continue to do so, but investors will need to be patient.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SUSTAINABILITY – WHAT TO LOOK FOR IN 2023?

Alexander Bernhardt is global head of sustainability research at BNP Paribas AM

Environmental, social and geopolitical crises made 2022 an eventful year, with much of the focus on energy (security) and extreme weather events. We also saw advances on climate spending, biodiversity and sustainable finance regulation. The wider sustainability field will continue to hold investor attention in 2023.

Implications of the energy crisis

While it was uncertain what impact the energy crisis – fuelled by the war in Ukraine and the rapid post-pandemic economic rebound – would have on net-zero commitments, it's clear that it has started to push down carbon emissions.

Carbon Brief has estimated that the European Union's CO_2 emissions from energy use dropped by 5% during August, September and October compared to the same period in 2021. This may be attributed to rising fossil fuel prices that have forced households and industries to reduce electricity and gas use.

The energy crisis is also driving an acceleration in installations of renewable power – the world is now expected to add the same amount of renewable power in the next five years as it did in the previous 20, according to the International Energy Agency (IEA). This build-out would be some 30% higher than the level of growth the IEA forecast in 2021.

Government policies should contribute to this. The EU's REPowerEU plan is to cut reliance on fossil fuels and speed up the energy transition. The US Inflation Reduction Act includes $369bn (£305bn) of incentives to boost clean energy supplies and investment in green technology.

Moreover, countries including Taiwan and India set up carbon pricing schemes in 2022. The scheme with the highest average carbon price remains the EU Emissions Trading System (ETS), where prices hit a high of more than €95 (£84) per tonne in 2022. Longer term, ETS prices are expected to rise, with projects indicating potential for €150 (£133) this year.

Finally, EU negotiators reached a provisional agreement on a Carbon Border Adjustment Mechanism (CBAM) that would impose a carbon price on imports of certain emissions-intense goods. As the implementation of the CBAM gets closer, it is likely other countries will introduce such pricing schemes to avoid the tariff.

Biodiversity

Biodiversity loss has the potential to do unprecedented economic damage. The World Economic Forum estimates $44trn (£36trn) – more than half of the world's GDP – depends on nature.

Encouragingly, 2022 saw a growing focus on biodiversity-related investment in response to investor demand. This trend will likely accelerate, particularly after COP15. The market for biodiversity products is predicted to be worth $93bn (£76.8bn) by 2030, up from $4bn (£3.3bn).

To help plug the financing gap to protect nature, the UN has advocated the use of a new instrument – biodiversity credits.

Last year, the announcement of Nature Action 100, a collaborative initiative similar to Climate Action 100+, focused on investors engaging with companies in sectors driving nature loss.

To help measure exposure to biodiversity risks, the Taskforce on Nature-related Financial Disclosures (TNFD) is developing a framework. This should allow financial institutions to incorporate nature-related risks into strategic planning and asset allocation decisions. The TNFD recommendations are due in September.

Sustainable financial regulation

In 2022, regulators focused on ESG. The US Securities and Exchange Commission proposed new climate-disclosure rules for listed companies. The rules may boost shareholder activism as investors seek more information from firms on their climate-related operations and targets.

Financial regulators are also increasingly clamping down on greenwashing. In Europe, asset managers continue to clarify fund classifications under SFDR.

Additionally, environmental campaigners and individuals are using legal action to force governments and companies to strengthen their climate commitments. The number of climate lawsuits filed globally has more than doubled since 2015, according to the London School of Economics. Furthermore, climate-vulnerable groups, such as indigenous groups, small island communities and youths are likely to play a more active role in climate litigation in 2023.

What we can expect this year:

– Downward pressure on carbon emissions as costs are internalised and scrutiny on net zero commitments intensifies.

– For investors, measurement and management of nature-related dependencies, risks, impacts and opportunities is increasing in importance; biodiversity is catching up with climate.

– Increasing sustainability-related regulation in key jurisdictions will drive closer scrutiny of outcomes driven by sustainable investment strategies.

REAL ESTATE: OVERCOMING THE DECARBONISATION DATA CHALLENGE

Investors are increasingly backing the case for decarbonisation in real estate, but to achieve net zero in the industry, clean and reliable data on emissions and energy consumption is crucial.

A growing number of investors are seeking ways to decarbonise real estate. In 2019, for example, the UK's Better Buildings Partnership launched its climate commitment. It has since amassed 33 signatories, who collectively manage more than £380bn of assets globally, pledging to publish a net-zero pathway for their portfolios, as well as a plan of action.

The case for decarbonisation in real estate is gaining momentum. But to achieve net zero, all stakeholders – from investors to regulators – need to work towards the same goal.

> **Inconsistent carbon data reporting may have important implications on investment decisions.**

This can prove challenging as there is no unified definition of net zero in real estate, nor on operational carbon – which accounts for the bigger share of emissions. The road to net zero in real estate is hindered by a lack of complete data on energy use and associated emissions from building tenants.

Defining carbon in real estate

Building emissions are broadly categorised as either 'operational carbon' or 'embodied carbon'. Being responsible for the larger portion of real estate emissions, operational carbon has gained more attention from regulators and investors alike.

Embodied carbon – the carbon footprint of a building before it becomes operational – accounts for a smaller share of the industry's emissions. To date, it has been less of a focus in regulations and net zero investor frameworks.

The Institutional Investors Group on Climate Change's Net Zero Investment Framework still does not include embodied carbon in its emissions scope for real estate assets.

A lack of definition and inconsistent carbon data reporting may have important implications on investment decisions, particularly regarding where and when to incur refurbishment costs within business plans for real estate assets.

Building emissions data

Despite a growing number of investors making net-zero commitments in real estate, without complete emissions and energy consumption data they will struggle to realise their decarbonisation goals.

A useful tool to aid net zero endeavours is the EU-backed Carbon Risk Real Estate Monitor (CRREM). It helps investors set emissions reduction targets, as well as monitor the performance of their real estate assets while assessing the risk of assets becoming stranded as a result of the transition to a low carbon economy.

Nina Reid, head of sustainability for private and alternative assets at M&G Investments, explains: "Essentially CRREM sets out operational net-zero pathways for different building types in different markets. It's not entirely global, but it's becoming a global tool.

"A number of the green building certifications are starting to look at the use of the CRREM tool as part of the way that they define net zero, so we expect that that will become more integrated and used with operational net zero."

Net zero data limitations

Yet CRREM still has its limitations. Currently, the model is too generic to be applied to all types of assets. Supermarkets, for example, are categorised as retail warehouses but their energy profile is substantially different than a retail warehouse used for fashion.

The CRREM model also only provides pathways for operational carbon and not embodied carbon. The tool's efficacy is reliant on having the necessary data.

"There's a lot of inconsistency around embodied carbon," Reid says. "However, there are some markets where we're seeing regulation coming through. We expect a number of European countries will start to bring in more embodied carbon and/or whole life carbon regulation over time.

"In the interim, while we don't have that regulation, it makes it more challenging to tackle some of the embodied carbon piece in real estate as there isn't that regulatory backstop to drive the market," she adds.

Although enhancing energy efficiency in buildings is necessary to decarbonise, failing to tackle embodied carbon will hinder net-zero goals in the industry due to the impact of emissions created across the construction supply chain.

As buildings become more operationally efficient, embodied carbon will come to represent the larger portion of emissions caused by the built environment.

In the absence of mandatory disclosure, obtaining embodied carbon data from supply chains is challenging. In the meantime, for net zero in real estate to be successful, in our view, the industry needs to take lead, setting its own requirements for emissions standards in real estate to facilitate the decarbonisation journey.

Read more from M&G Investments about decarbonisation in real estate
https://www.mandg.com/investments/institutional/en-gb/insights/2022/q3/decarbonisation

M&G Investments

Despite a strong start to 2023, an historically bad year has been forecast for equities. But, as *Andrew Holt* discovers, investors are not planning to ditch the asset class.

EQUITIES: DON'T PANIC!

Last year was tough for equities. The bad news is that, despite a strong start to the year by the major indices, the outlook for 2023 looks equally bleak. This puts investors in rare territory as records show that two consecutive negative years for equities have only happened four times in the past 100 years.

There are similarities to historical equity downturns. In 1974, the market was stifled by an overbearing inflationary picture. Then in the early 2000s, there was a tech boom and bust: a situation now playing out in slow motion in that it is taking place over a longer period.

An indication of the fall of tech is the demise of the once-favoured investor trend of the FAANG [Facebook, Apple, Amazon, Netflix and Google] giants.

Beyond the historical comparisons, there are other reasons – to misquote singer Ian Dury – not to be cheerful. The most fundamental is that relative to their underlying earnings, shares remain expensive on a historical basis. Even the biggest blockhead could work out that this is far from ideal.

Putting the picture into perspective, Carrie King, global deputy chief investment officer at Blackrock's fundamental equities division, says: "In equities, we believe recession isn't fully reflected in corporate earnings expectations or valuations."

Here the investment environment is reaping what the wider financial world sowed. That is to say, today's valuations are a result of central banks in the US and Europe injecting an abundance of liquidity into the market through quantitative easing. But now these programmes are being reversed, the repercussions are feeding, albeit slowly, through the financial system.

One of the ways this has become evident for investors is the failure of the 60/40 portfolio, which plunged 17% last year. This poses the simple question: why go for equities when you are going to get hammered?

We shall not be moved

Such a picture does not augur well for institutional investors. How then should pension schemes, insurers and charities address this precarious situation?

While corporate defined benefit (DB) schemes have reduced their equity exposure, stocks continue to be a cornerstone of open DB schemes and defined contribution portfolios. Investors who still require income, open DB schemes and DC among others, have taken different positions in response to the equity malaise. The first is to stick it out.

This is the position taken by George Graham, fund director at the South Yorkshire Pensions Authority. "We have a long-term investment horizon, so 'sticking it out' is part of the approach. Although that doesn't mean we ignore underperformance by fund managers or significant secular trends, which might cause us to rebalance between or out of markets," he says.

Nevertheless, there also exists a degree of investment pragmatism in South Yorkshire's approach, which involves shifting to other asset classes. But for Graham it is important for his fund to hold assets that have capital and dividend growth. "We need to maintain exposure to growth assets, and listed equities are a key part of this," he says.

The 'stick it out' approach is also shared by Richard Tomlinson, chief investment officer at Local Pensions Partnership Investments. "It will definitely be a keep calm and carry on approach for us," he says. "We will not be dumping equities. We look at the long-term horizon.

"Within equities," Tomlinson adds, "we have a more effective, quality-type of approach, which means we tend to invest in stuff with a long-horizon, a Buffett-style portfolio: earnings effectively for the long run. We don't try and make regular calls on equities."

This is a typical truism for many open DB schemes: the long term is all. Such an approach is shared by Matthew Cox, investment director at the Esmée Fairbairn Foundation, a charity that aims to improve peoples' quality of life. "We have a long-term time horizon and, as such, keep a high exposure to equity markets. Any adjustments we make are likely to be at the margins and related to rebalancing," he says.

An alternative view

That said, the 'stick it out' approach is not the only stance investors have opted for. Inevitably, given the outlook, there is a view to look at other portfolio options beyond the asset class. Even someone committed to equities like Graham is looking at his portfolio in more detail.

"We will, as part of our strategy review, be looking at the scale of our UK and emerging market exposures, partly given the scale of exposure relative to GDP weighting and in the context of long-term performance in emerging markets," he says.

Will Ballard, head of the equity investment team at Border to Coast, has identified an asset class he considers a solid alternative to equities. "An area we believe offers attractive value in 2023 is the listed alternatives sector," he says. "Average discounts to net asset value across infrastructure, real estate and private equity investment trusts are close to the post-global financial crisis low."

Digging deeper on this, Ballard adds: "The sector's sensitivity to interest rates means that this is likely to shift from being a headwind to a tailwind as expectations for central bank policy begin to moderate.

"The sector offers investors an attractive entry point into long-term secular growth themes, such as renewable energy, and its highly predictable cashflows should provide resilience in the face of any weakness in the global economic environment or more persistent inflationary pressures."

Healthy growth

John Porter, chief investment officer and head of equity at Newton Investment Management, offers advice on other sectors that could benefit investors.

"One area we are particularly excited about is healthcare innovation," he says. "There are many elements of healthcare that we believe could see multiple decades of progress condensed into just the next few years."

Porter cites new forms of healthcare delivery, whether it is telehealth or better primary care, which are expected to become much more "robust".

Secondly, he sees attractions in technology – or at least technology companies that stand apart. "In technology, companies that differentiate and distance themselves through unique intellectual property or business models, and which have assembled impressive innovation and go-to-market engines, are likely to have greater opportunity to achieve important scale in their core businesses, which could enable them to dominate the landscape," Porter says.

Tomlinson admits that as a long-term investor, technology is something he is keeping an eye on. "As I say, we look at the long-term horizon, and here, there is a big question about tech and where tech goes over the next 10 years."

Great transformations

But it is not all about healthcare and technology. "Industrials engaged in the transformation of materials, substances or components into new products are driving innovation around areas such as energy transition, infrastructure, and the move to electric vehicles," Porter says.

Finally, he notes the energy sector also appears attractive as the severe energy supply crisis takes hold of the world. "Many energy companies are employing new business strategies as they focus on capital discipline, returns and returning cash to shareholders," Porter adds. "Energy has also proven to be an under-owned sector despite showing robust performance over the past 12 to 18 months."

A third option for investors is to seek equities that will not be struggling, as they will not all be equally cursed.

Ballard gives some indications of his thinking, highlighting that emerging market equities offer a reversal on recent times – having struggled during the past 12 months and being one of the worst performing equity markets.

"China's growth slowdown exacerbated by structural issues in their property market and their approach to handling Covid

We need to maintain exposure to growth assets, and listed equities are a key part of this.

George Graham, South Yorkshire Pensions Authority has been a near insurmountable headwind," Ballard says. "This has resulted in low expectations for earnings growth combined with cheap equity market valuations."

Great recovery

Putting a more positive spin on the situation, some asset managers have sprinkled a little gold dust on the stock market outlook. JP Morgan has argued that stocks will end 2023 higher than they started, a point echoed by Goldman Sachs, which believes near-term share price falls will recover by the year end. Indeed, market moves have presented a different picture from the pessimistic view that seemed to prevail. January saw what appeared to be a recovery, with the US equity market rising by close to 5%, European equities up 9% and even emerging markets climbing within touching distance of 6%, all offering a clear encouraging jump.

Will Ballard puts these, and other events, into an investor's perspective. "The recent indications that the high levels of inflation experienced globally have started to soften, gives us cause for optimism," he says.

Such a reprieve, Ballard says, would give central bankers greater flexibility on monetary policy, moderating the pace of interest rate increases and perhaps with time, bringing them to an end. "This is supported by the latest IMF global growth forecasts for the coming year, which show an improvement in their expectations for growth across almost all countries other than the UK," he says.

An upbeat view

Looking at other factors that could be playing a positive role, Ballard notes the slow pace of growth expected for the global economy has, to some extent, already been factored into the markets' expectations for corporate profitability.

And with consensus expectations for earnings growth for global equities this year having already dropped to 3%, a significant slowdown from 2022, while global equity valuations themselves are not excessive, being close to their 10-year average, all provide a more positive picture.

All these together contribute to a more upbeat equity outlook, Ballard says. "This combination of reasonable valuations, reasonable expectations and some initial signs that inflation, global growth and monetary policy may not all be such persistent headwinds gives us cause for optimism when it comes to global equities." Dan Mikulskis, a partner at consultancy Lane Clark & Peacock, is also upbeat. "Many 2023 macro outlook forecasts were quite pessimistic, seemingly everyone agreed a recession was coming. But markets have enjoyed a pretty spectacular start to the year up almost 10%, and data such as strong US jobs numbers and warmer European weather are throwing doubt on the recession story," he says.

In equities, we believe recession isn't fully reflected in corporate earnings expectations or valuations.

Carrie King, Blackrock

There are two key issues here though which create difficulties for investors. "One is the question of what is already priced. The market falls during 2022 priced in quite a lot of bad future news, so the news only needs to be a little better than the low expectations to generate a relief rally," Mikulskis says.

Market loops

The second is the confusing feedback loops. "Sometimes markets fall on news that suggests a strong economy – in anticipation of interest rate rises – other times they rise on good news in sympathy with future economic strength," Mikulskis says.

This means investors should be extremely cautious trying to time entry into and exit out of equity markets. "Generally stock investors are rewarded well over the long term and it is a notoriously tricky business trying to finesse the timing any more than that," Mikulskis adds. Thankfully, as a broad rule, many investors – at least asset owners – admit they are sticking to it.

There are other factors that could still have an impact on the equities picture in 2023 and beyond.

Graham sums this up. "Much will depend on Harold Macmillan's old friend, 'events, dear boy, events'. Progress of the war in Ukraine will clearly impact the profitability of traditional energy companies while also attaching a premium to those companies that are key to delivering alternative forms of energy, potentially positively or negatively," he says.

Tomlinson concurs on the impact of a big event, which, from an equities' perspective, could be a game changer. "If something ugly happens this year, say a serious escalation of conflict in Europe, that is likely to lead to equities having a really tough time. At that point, we may need to add to our exposures."

THE FINAL COUNTDOWN

-2.8%

The expected decline in UK headline dividends this year, due to lower special payments, following the 8% rise recorded in 2022.

Source: Link

81%

...of investors expect the assets managed by ESG ETFs in Europe will remain stable or grow in the next 12 months, down from 91% in April.

Source: BNP Paribas AM

68%

The level of institutional investors intending to increase their allocation to private markets, despite rising interest rates. Private equity is the most attractive asset class for 63% of respondents.

Source: State Street

£12.9bn

Inflows into climate change and sustainability themed exchange-traded funds in Europe during 2022.

Source: WisdomTree

2.5%-3%

The expected level of British inflation at the end of this year, which would be a big fall from the 10.1% it stood at in February.

Source: Aegon Asset Management

13%

The rise in defined contribution scheme membership in the UK since the start of 2022 to more than 26 million.

Source: The Pensions Regulator

$65.7bn

The estimated investment in emerging market securities during January.

Source: Institute of International Finance

£2.3bn

The fall in the aggregated surplus of British defined benefit schemes during January to £374.4bn, making them 134.8% funded, down from 136.5% in December.

Source: Pension Protection Fund

64%

The level of professional fund selectors who believe portfolios composed of 60% equities, 20% bonds and 20% alternatives will outperform 60:40 strategies this year.

Source: Natixis Investment Managers

Quote of the Month

"What we do today should not compromise tomorrow's outcomes."

Chandra Gopinathan, Railpen