

3 TRENDS IN CLIENT ASSETS AND ALLOCATION

KEY FINDINGS

ASSETS BY CLIENT AND MANDATE TYPE

- » In 2022, institutional client assets continued to fall as a proportion of total UK assets under management (AUM), down to 74% from 77% in 2021. Retail assets decreased in nominal terms but grew to account for a quarter of AUM, up from 22% in 2021. Unlike previous years when stronger inflows appeared to be driving retail, especially during and immediately after the Covid-19 pandemic, the data this year suggest relative falls in AUM are the main reason for change, as total institutional AUM fell faster than retail.
- » Assets managed on behalf of pension clients, the single largest client group, fell over the year to 34%, which is eleven percentage points lower than in 2018. The sharp reduction in both relative and absolute terms of assets under management for pension schemes between 2021 and 2022 reflects the asset mix, particularly for UK defined benefit (DB) schemes heavily investing in fixed income. As discussed further in Chapter 4, these AUM falls need to be seen in the context of a rapidly improving funding position as discount rates rise.
- » The proportion of assets that sit within segregated mandates versus pooled investment vehicles has evolved over the last five years as pooled vehicles have grown to account for 50% of total AUM (up from 47% a year ago). There are likely to be a range of drivers, but the ongoing rise of both indexing funds and Exchange Traded Funds (ETFs) are central structural drivers over the longer term.

TRENDS IN ASSET ALLOCATION

- » The proportion of the asset base invested in equities (reaching 42%) increased for the fourth year in a row, as the share of fixed income assets fell again through 2022 (down to 28%). Fixed income is now closer as a share of total assets to levels seen before the financial crisis of 2008. In contrast, equity holdings are significantly below headline levels in 2007. On an adjusted basis, however, the relative levels of equities and fixed income look similar to those last seen in 2007.
- » Looking at a regional breakdown of equity holdings, the largest change in 2022 was a rise in the proportion of North American equities, compared to both Europe and the UK. Despite better relative performance against both the US and European markets, the share of UK equities as a proportion of total equities continued to fall, down to 22%. Compared to ten years ago, the relative weights of North American (32% in 2022 from 17% in 2012) and UK equities (22% from 33%) have changed dramatically.
- » We also see ongoing diversification of holdings in the regional fixed income holdings. Some 60% of fixed income assets are now held in overseas bonds, compared to one third of holdings a decade ago. In contrast to the UK equity market experience through 2022, poor UK bond market returns are likely to have been a significant influence on the shift towards overseas fixed income. This might evolve further as the market environment itself evolves.

GROWTH OF THE INDEXING MARKET

- » Indexing funds now account for a third of total UK AUM, up from a little over a fifth a decade ago. Within our sample, AUM for indexing products fell slightly more slowly than for active funds and mandates over the year, leading to a small year-on-year increase to 33% (from 32% a year earlier).
- » A very significant structural factor in this growth of indexing in recent years has been the accelerating importance of Exchange-Traded Funds (ETFs). Nonetheless, during 2022, it was growth in active ETF assets globally that remained positive amidst further momentum in this sector. Overall, ETF AUM fell 11%, mirroring the pull back in the wider markets.

INVESTMENT IN THE UK ECONOMY

- » Total investments in the UK reached £1.4 trillion, amidst greater emphasis from all sides of the UK political spectrum on the need to support future domestic investment, both through public and private markets. This remains closely linked to the climate change agenda and the need for greater capital deployment to help the UK economy adjust to meet emission reduction targets.
- » While economic slowdown and rising rates are having a chilling effect on what has been a strong growth story in private markets in recent years, the emphasis on facilitating greater access to private markets remains strong, especially for DC schemes and retail investors. The first Long-Term Asset Funds are now starting to emerge, but there are wider cultural and delivery infrastructure shifts that will be a pre-requisite for success in this area.

ONGOING FOCUS ON LIQUIDITY MANAGEMENT

- » The March 2020 'dash for cash', the February 2022 Russian invasion of Ukraine and the gilt market turbulence of autumn 2023 have all shone a spotlight on investment fund liquidity management, albeit in very different ways. Amidst some ongoing differences of view and emphasis, industry and regulators are working closely on enhancing the liquidity management toolkit. Within the mainstream investment fund space, this has particular ramifications for pricing and the wider use of tools such as notice periods.

This chapter offers insight into the structure of the UK-managed asset base of Investment Association members. We focus on three key aspects: client type; asset classes and geographies; and asset management styles and approaches.

CLIENT TYPES

The clients that member firms of the Investment Association serve are primarily categorised as either retail clients or institutional clients, although the blurring of the lines between these groups remains a feature of the market (see Box 3). Chart 9 provides a breakdown of assets by client type, and we note the following year-on-year changes:

- As of the end of 2022, the proportion of total assets managed on behalf of **retail** clients grew three percentage points to 25% (from 22% in 2021), with a corresponding fall in assets managed on behalf of institutional clients (74% from 77%). This shift was driven by differential falls in total institutional and retail assets, with the latter more resilient.
- Within the institutional segment, **pension fund** assets saw the biggest change, decreasing six percentage points between 2021 and 2022, down from 40% of total assets to 34%. This is equivalent to a £1.0 trillion fall in assets in nominal terms.

BOX 3: BLURRING OF CLIENT TYPES

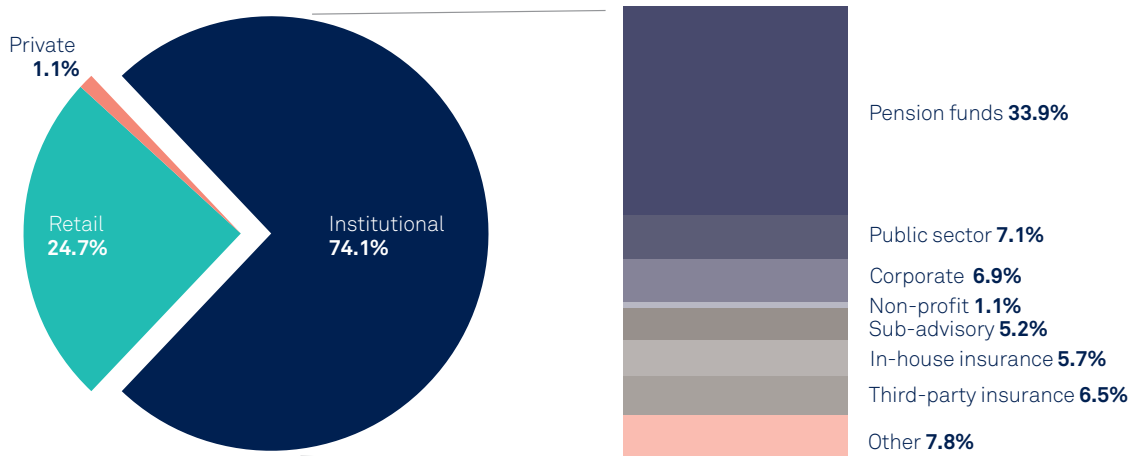
Insurance vs. Pension

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

Retail vs. Institutional

DC pension schemes remain something of a hybrid between retail and institutional. Pension savers in DC schemes receive an income in retirement that is based on the value of the pension pot they have accrued during their working life. Unlike a Defined Benefit (DB) scheme, where their pension is based on their salary, the value of a DC pension is determined by the contributions an individual makes to their plan and the investment return they receive. The ultimate investment risk lies with the individual. In this regard, DC pensions are more akin to retail investments than institutional, albeit they will appear in the IA's data either as pension fund or insurance assets.

CHART 9: ASSETS MANAGED IN THE UK BY CLIENT TYPE 2022



Source: The Investment Association

The data suggest that the fall in pension fund assets was broad-based, driven significantly by a decline in UK bond valuations.

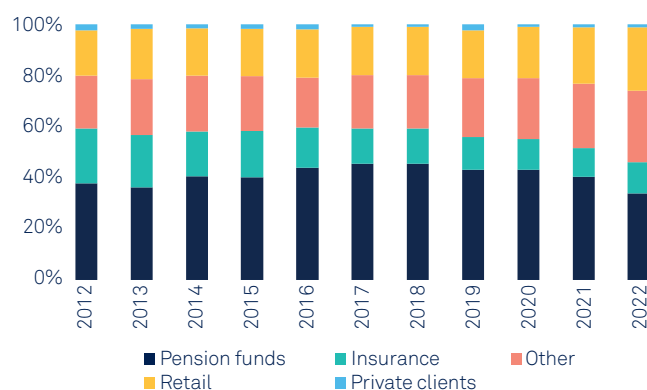
- **Public sector** client assets was the only category to see an increase in nominal terms over 2022. Against a fall in total industry assets, the £80 billion rise in public sector assets meant that the client group now represents 7.1% of AUM, up from 5.5% the previous year.

Chart 10 illustrates the breakdown of UK-managed assets by client type over the last decade. We observe a number of changes over the past ten years:

- From 2014 to 2019, assets managed on behalf of retail clients remained flat at 19%. Since 2020, the proportion of assets managed on behalf of retail clients has been rising each year, reaching 25% in 2022. However, while the increase in retail assets during and after the Covid-19 pandemic appeared to reflect changes in retail market participation, the growth through 2022 appears to be more the result of differential returns, reflecting a heavier bond – especially UK bond – weighting within the institutional asset base.
- Although pension funds continue to be the largest individual client group in terms of AUM, the 34% of total AUM recorded in 2022 is the lowest level in the last decade. The last time pension funds made up this proportion of industry AUM was in 2006.
- The share of assets managed on behalf of insurance clients has fallen by eleven percentage points over the past decade, down from 21% of total UK AUM in 2012 to 12% in 2022. The small relative rise in insurance assets to 12% (from 11% the previous year) is the first increase recorded since 2015. The biggest fall over the last decade has been in the in-house insurance category, which is down from 18% to 6% of total AUM. Third-party insurance assets have fluctuated between 6% and 8% since 2014.

Even with the shifting relative contributions to total AUM, retail clients, pension fund and insurance clients have always been, and remain, the three largest client segments. However, the industry has diversified its client base over the past decade. Within the other institutional client groups, corporate assets have contributed the most to the growth, increasing steadily from 3% in 2012 to 7% 2022. Public sector assets have also seen their contribution to total AUM rise from 5% to 7%.

CHART 10: ASSETS MANAGED IN THE UK BY CLIENT TYPE (2012-2022)



Source: The Investment Association



TRENDS IN ASSET ALLOCATION

Members of the Investment Association are invested across all major asset classes, though to varying degrees given different specialisations. In Table 2, we observe close to all respondents to the Survey are invested in equities (97%) and the majority are also invested in fixed income (80%). Other asset classes, such as cash and alternatives, are more niche, and are primarily managed by larger IA members.

TABLE 2: PROPORTION OF IA MEMBERS INVESTING BY ASSET CLASS IN 2022

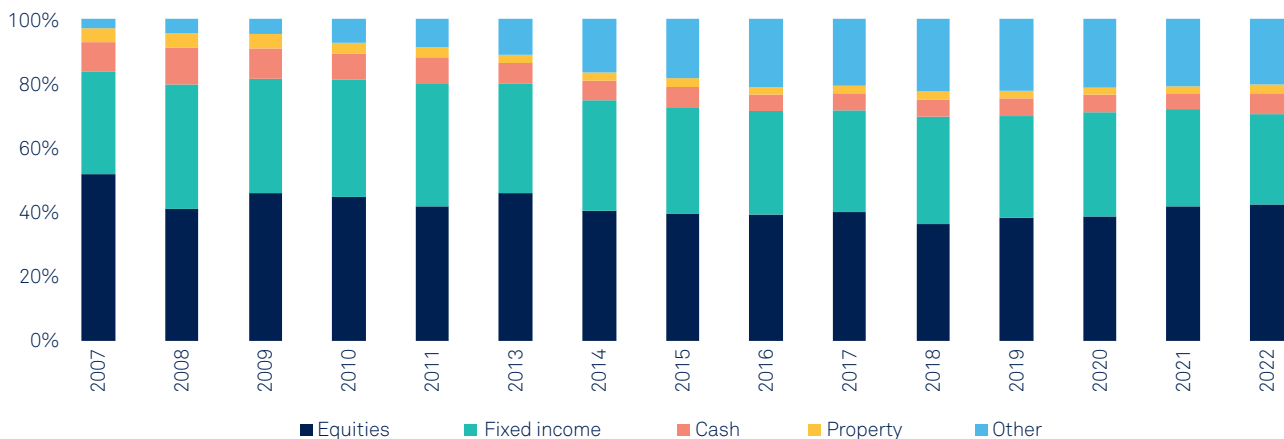
	Share of firms in a given asset class
Equities	97%
Fixed income	80%
Property	41%
Cash	19%
Alternatives (incl. private markets and cryptoassets)	22%

Source: The Investment Association

The evolution in the breakdown of industry AUM by asset class over the last fifteen years is shown in Chart 11. There have been some notable shifts in asset allocation:

- Total assets held in **equities** were marginally higher year-on-year at 42% of total AUM despite a 10% fall in nominal terms. This marks the fourth year in a row where the share of equity assets has increased, though still considerably lower than the 52% recorded in 2007.
- The proportion of **fixed income** assets in 2021 and 2022 were the lowest levels on record at 30% and 28% of total AUM respectively. Rising inflation and the turn in the interest rate cycle hit fixed income values, particularly UK bonds, at the end of 2021 and through 2022. Looking back over fifteen years, this is quite a long way off the 39% peak in 2008.
- Having remained firmly at 5% for the last six years, assets held in **cash** increased to 6% of total AUM in 2022. This was a result of a rise in assets in nominal terms over the year fuelled by a higher risk-free rate of return as well as increased demand for liquidity in a highly volatile market environment.

CHART 11: OVERALL ASSET ALLOCATION OF UK-MANAGED ASSETS (2007-2022)



Source: The Investment Association

- Assets in the ‘Other’ category remained unchanged over 2022 at 21% of total AUM but is substantially higher than the 3% recorded in 2007. Most of the assets in this category sit in solutions type strategies, including liability driven investment assets (LDI) and Multi-Asset strategies, that have experienced strong growth over the last fifteen years. A small proportion sit in alternative assets which includes assets such as infrastructure and cryptoassets.

Given that ‘Other’ assets will include equity, fixed income, cash, property and alternative investments, excluding these assets can shift the balance across asset classes over time. On an adjusted basis, the 2022 balance between equities and fixed income is returning to levels recorded in 2007, when 53% of AUM was in equities and 33% in fixed income.

DETAILED ASSET ALLOCATION

In addition to monitoring the shifts between asset classes, the IA monitors trends within equity and fixed income holdings according to type of exposure. This section considers these changes in more detail.

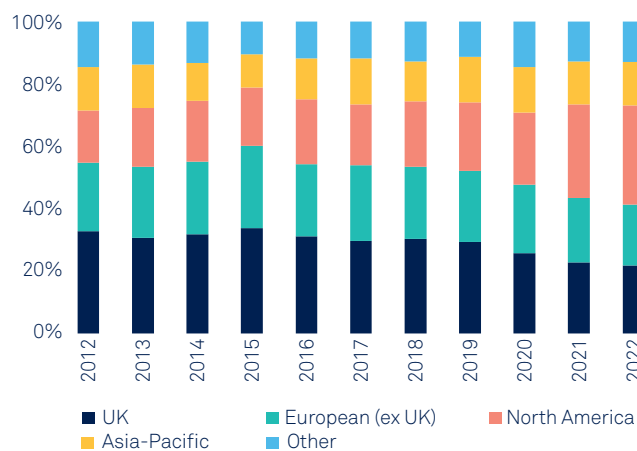
Equities by region

The regional composition of equity holdings over the last ten years is illustrated in Chart 12. Some striking changes can be observed:

- The proportion of total equity assets held in **UK** equities fell for the fourth year in a row to 22%. This is a one percentage point fall year-on-year and eleven percentage points lower than a decade ago. The long term trend towards greater portfolio diversification as well as the relative underperformance of UK equities in recent years, have contributed to the falling allocation to UK equities shown in Chart 12. In 2022, however, the UK was the only major market to record a positive – albeit marginal – return over the year. Even so, AUM in UK equities decreased 13% in nominal terms over the year, suggesting that investor withdrawals are likely to be the main driver of the fall in 2022.

- Buoyed by strong relative performance, the **North American** share of total equity assets has seen the most dramatic change over the last decade, almost doubling to 32% by the end of 2022. This is a two-percentage point increase on the previous year, and the fifth consecutive rise. The rise in 2022 comes despite a particularly challenging performance year for US tech stocks, which made it one of the worst performing equity markets of 2022.¹⁶
- The proportion of equity assets invested in **European** equities was broadly stable at 22-23% for most of the last decade, however the last two years have seen this fall to 21% in 2021 and a further two percentage point fall to 19% in 2022.

CHART 12: ALLOCATION OF UK-MANAGED EQUITIES BY REGION (2012-2022)



Source: The Investment Association

¹⁶ See Box 1 on global capital market performance on page 20 for more information.

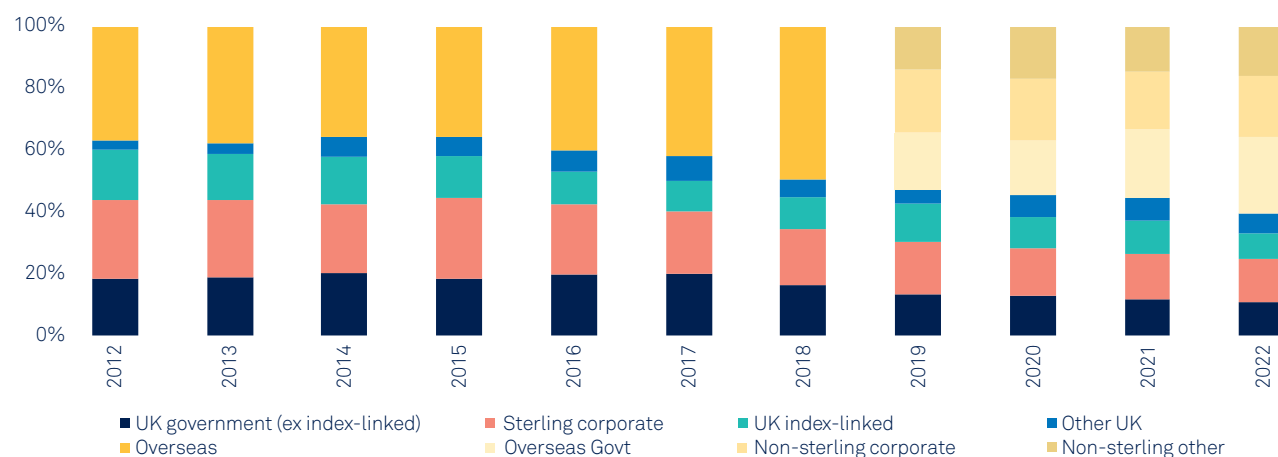
Fixed income assets by region

Fixed income exposure, which was heavily domestically focused a decade ago, has become increasingly diversified. Chart 13 illustrates the changing composition of UK managed fixed income assets over the last decade:

- **Overseas bonds** now account for the majority of fixed income assets reaching 60% in 2022, compared with 35% in 2012. The rise in the proportion of overseas bonds accelerated in 2022, rising five percentage points year-on-year. The shift was driven primarily by poor market returns, particularly UK bond market returns which experienced 18-25% falls over the year.¹⁷
- The long-term trend shown in Chart 13 has been a shift away from **UK government bonds**, which accounted for over a third (35%) of fixed income assets in 2012 but as of 2022 account for less than a fifth (19%) of assets. The shift away from UK government bonds accelerated in 2022, particularly after the Autumn Fiscal Event which resulted in a mass sell-off in the gilt market that saw valuations plummet.¹⁸ **UK index-linked bonds** were particularly affected, falling three percentage points year-on-year to 8%.

- **Sterling Corporate bonds** have also seen substantial falls over the last ten years, and now account for 14% of total assets, almost half the 26% recorded in 2012. Sterling Corporate bonds were also hit heavily in 2022, falling one percentage point, though market performance was marginally better than gilts.
- The rise in the proportion of all of the overseas bond categories was a reflection of the substantially weaker market performance of UK bonds, rather than any increases in nominal terms in the overseas bond market. The biggest increase has been in the proportion of **overseas government bonds** which increased to 25% of total assets, which is up from 22% the previous year.

CHART 13: ALLOCATION OF UK-MANAGED FIXED INCOME ASSETS BY TYPE AND REGION (2012-2022)



Source: The Investment Association

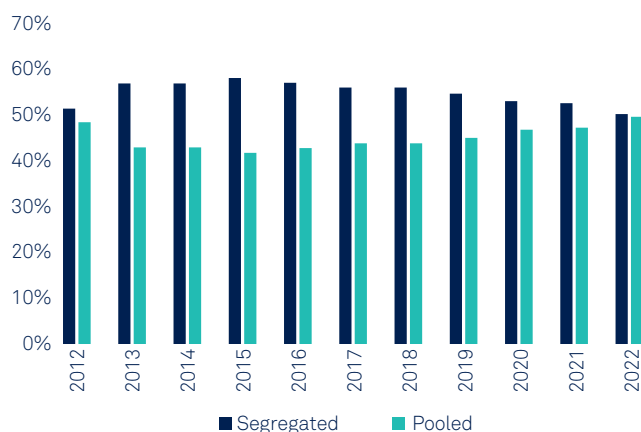
¹⁷ See Box 1 on global capital market performance on page 20 for more information.

¹⁸ See section “The Autumn Gilt Shock” section in Chapter 4 on page 66 for more information.

SEGREGATED VS. POOLED

Chart 14 looks at the evolution of the proportion of assets in segregated mandates versus pooled investments over the past decade. Since 2015 there has been a steady increase in the proportion of assets in pooled investment vehicles rising from 42% of total AUM to 50% of total AUM in 2022. This appears to link directly to wider findings (see Chart 15) on the rise of indexing strategies, especially Exchange Traded Funds (ETFs), which is now reflecting into a shift in the overall balance between segregated and pooled across the total assets base.

CHART 14: SEGREGATED VS. POOLED INVESTMENTS (2012-2022)



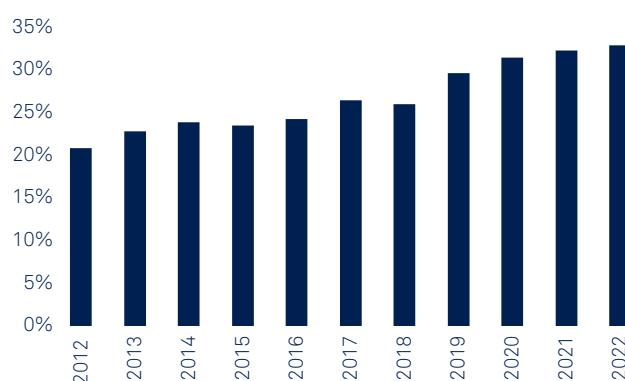
Source: The Investment Association

INDEXING STRATEGIES

Indexing strategies have played an increasingly significant role across UK assets under management over the last decade and now account for one third (33%) of total AUM. The one percentage point increase year-on-year was driven by the slightly slower fall in index tracking strategies relative to that of active strategies. Indexing strategies replicate the performance of the market, so the relative growth in trackers in 2022 may reflect the higher proportion of tracker assets that sit in equities which were not as heavily hit as certain segments of the fixed income market.

Chart 15 illustrates the long-term rise in the proportion of assets tracking an index. Between 2012 and 2022, indexing funds grew to account for 33% of total UK AUM, which represents a twelve-percentage point increase from 21% in 2012. The growth has been gradual and particularly in the last five years, has coincided with the rapid growth in exchange traded funds (ETFs), which are largely index tracking vehicles. For trends in the ETF market, see Box 4.

CHART 15: INDEXING STRATEGIES AS PROPORTION OF TOTAL UK ASSETS UNDER MANAGEMENT (2012-2022)



Source: The Investment Association

BOX 4: EXCHANGE TRADED FUNDS MARKET

An exchange traded fund (ETF) is an open-ended pooled investment vehicle with shares that, like a 'traditional' fund, will offer investors access to a portfolio of stocks, bonds, and other assets, most commonly aiming to track an index. Unlike a fund, it can be bought or sold throughout the day on a stock exchange, which is why ETFs are effectively a hybrid of a tradeable stock and an index-tracking fund. Amongst the IA's membership, less than a fifth of members manufacture ETFs as part of their product offerings.

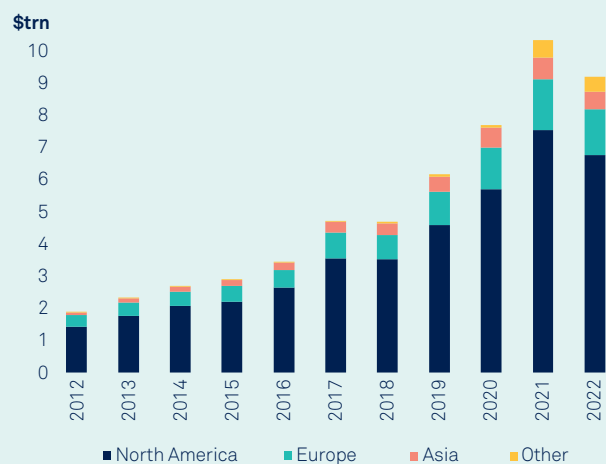
As capital markets posted negative returns in 2022, global assets under management in ETFs took a sharp turn, falling 11% year-on-year to \$9.2 trillion, down from \$10.4 trillion the previous year. Assets were down for funds domiciled across the regions, with Asian domiciled ETFs most heavily affected, falling 14% over the year. Chart 16 shows that the fall in AUM in 2022 comes on the back of a three-year period of significant growth which saw assets more than double globally.

Global flow data suggests that the fall in assets in 2022 was entirely driven by market performance. In contrast to global outflows from mutual funds which reached record levels in the UK (see chapter 5 for more detail), investor appetite for ETFs remained strong through the year recording net inflows of \$750 billion.

Long term trends in ETFs

There have been two standout trends in the ETF market in recent years: the rise in sustainable investment ETFs and the rise in assets within actively managed ETFs.

CHART 16: ETF ASSETS UNDER MANAGEMENT BY REGION OF DOMICILE (2012-2022)



Source: Morningstar

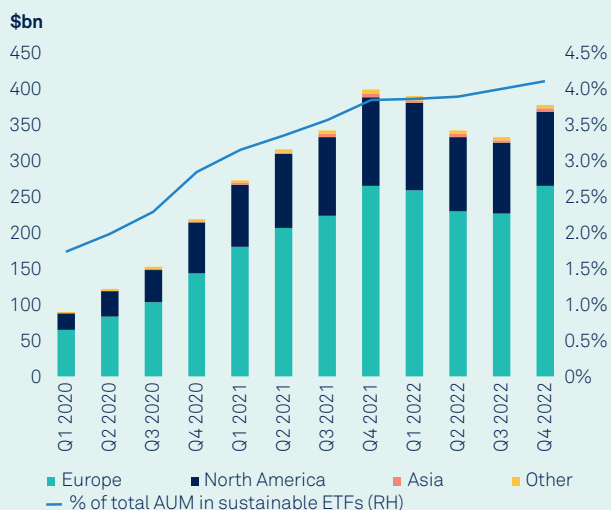
1) Sustainable ETFs

Chart 17 illustrates an almost threefold increase in sustainable ETFs¹⁹ over the last three years, driven largely by the European market, which accounts for over two thirds (70%) of sustainable AUM in ETFs globally:

- Inflows to European sustainable ETFs totalled \$54 billion in 2022, 63% of the net inflow to all European-domiciled ETFs. This is far higher than any other region, where inflows to sustainable ETFs have contributed less than 10% to total net inflows over the last few years.
- As of the end of 2022, assets in sustainable ETFs domiciled in Europe were broadly unchanged year-on-year, in contrast to North America which fell 16%.

¹⁹ According to Morningstar, which categorises a fund as sustainable based on prospectus disclosures.

CHART 17: GROWTH IN SUSTAINABLE ETFs (Q1 2020 - Q4 2022)



Source: Morningstar

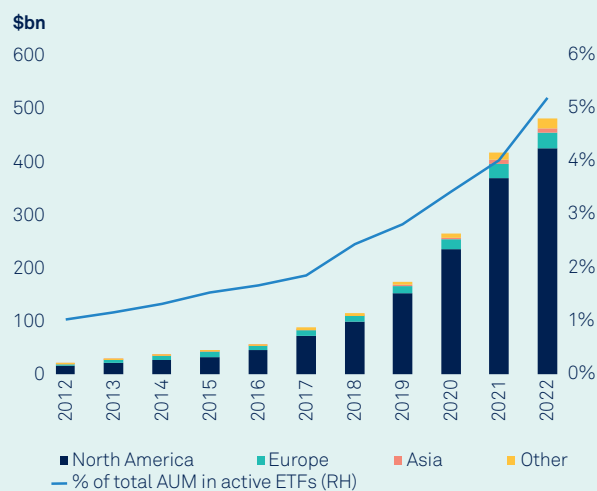
2) Active ETFs

January 2023 marked the 30th anniversary since the launch of the first ETF, an index fund tracking the S&P 500. The first active ETF was launched fifteen years later, by which time total assets in index tracking ETFs had reached approximately \$700 billion. Although still a small part of the industry, Chart 18 illustrates the growth in active ETFs over the last decade:

- Total AUM in active ETFs has risen dramatically over the last decade, increasing from just under \$20 billion to over \$475 billion in 2022. This has outpaced the growth in index-trackers over that period and as such, the proportion of total assets in active ETFs is 5.2%, up from 1.0% at the end of 2012.

- While market performance resulted in a fall in AUM of index tracking ETFs in 2022, assets in active ETFs grew 15% over the year, although this is a considerable slowdown from previous years.
- Europe is lagging behind other regions in terms of the growth of active ETFs. Active ETFs account for just 2.0% of European domiciled funds compared with 6.2% of US-domiciled funds.
- Net flows to active ETFs in 2022 were almost \$120 billion, equivalent to 16% of the total industry inflow.

CHART 18: ACTIVE ETF ASSETS UNDER MANAGEMENT (2012-2022)



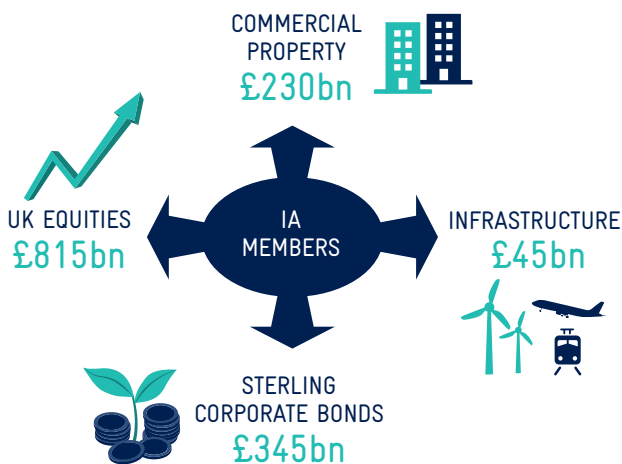
Source: Morningstar

INVESTMENT IN THE UK ECONOMY

The investment management industry plays a significant role in channelling savings to investments in the domestic economy through both public and private markets. This role became more significant with the reduction in bank lending after the global financial crisis and has become a key political focus more recently in the context of financing the UK’s transition to net zero.²⁰

IA members are financing the UK economy through investments in equities, sterling denominated bonds, infrastructure and commercial property (see Figure 7) totalling £1.4 trillion (down from £1.6 trillion in 2021). Of this, £815 billion is invested in UK equities (down from £950 billion) which is equivalent to almost one third (32%) of total UK equity market capitalisation. Sterling corporate bond assets fell almost £100 billion in nominal terms to £340 billion, reflecting very poor UK bond market performance in 2022. Investments in UK social and economic infrastructure projects, which we explore in more detail in the next section, total £45 billion as of the end of 2022.

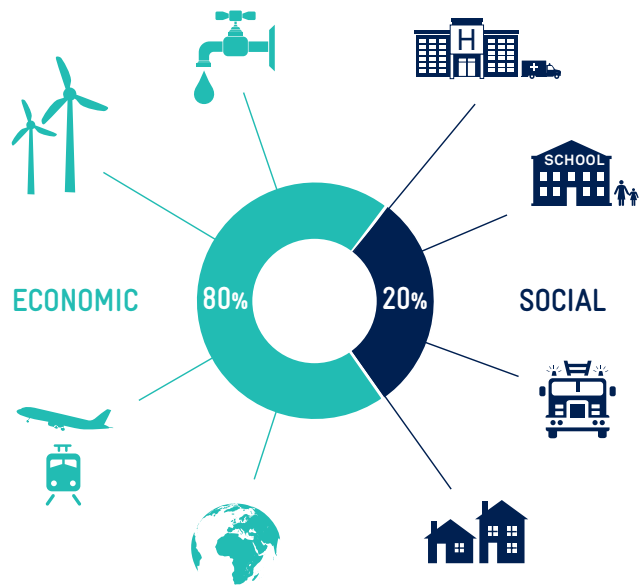
FIGURE 7: IA MEMBER HOLDINGS IN UK ASSET CLASSES IN 2022



Source: The Investment Association

INVESTMENT IN UK INFRASTRUCTURE

FIGURE 8: INFRASTRUCTURE INVESTMENT BY IA MEMBERS IN 2022



Infrastructure investment has garnered increased focus in recent years both as a result of the growing reliance on market-based finance, and the increased focus on the role that investment managers can play to support the UK’s commitment to decarbonisation.

Infrastructure investments can broadly be categorised as economic, which includes investments in renewable energy, utilities, transport and telecommunications, or social, which includes public health, education and building, construction and maintenance. It is estimated that the majority (79%) of infrastructure investments are invested in economic projects and a fifth (21%) in social projects.

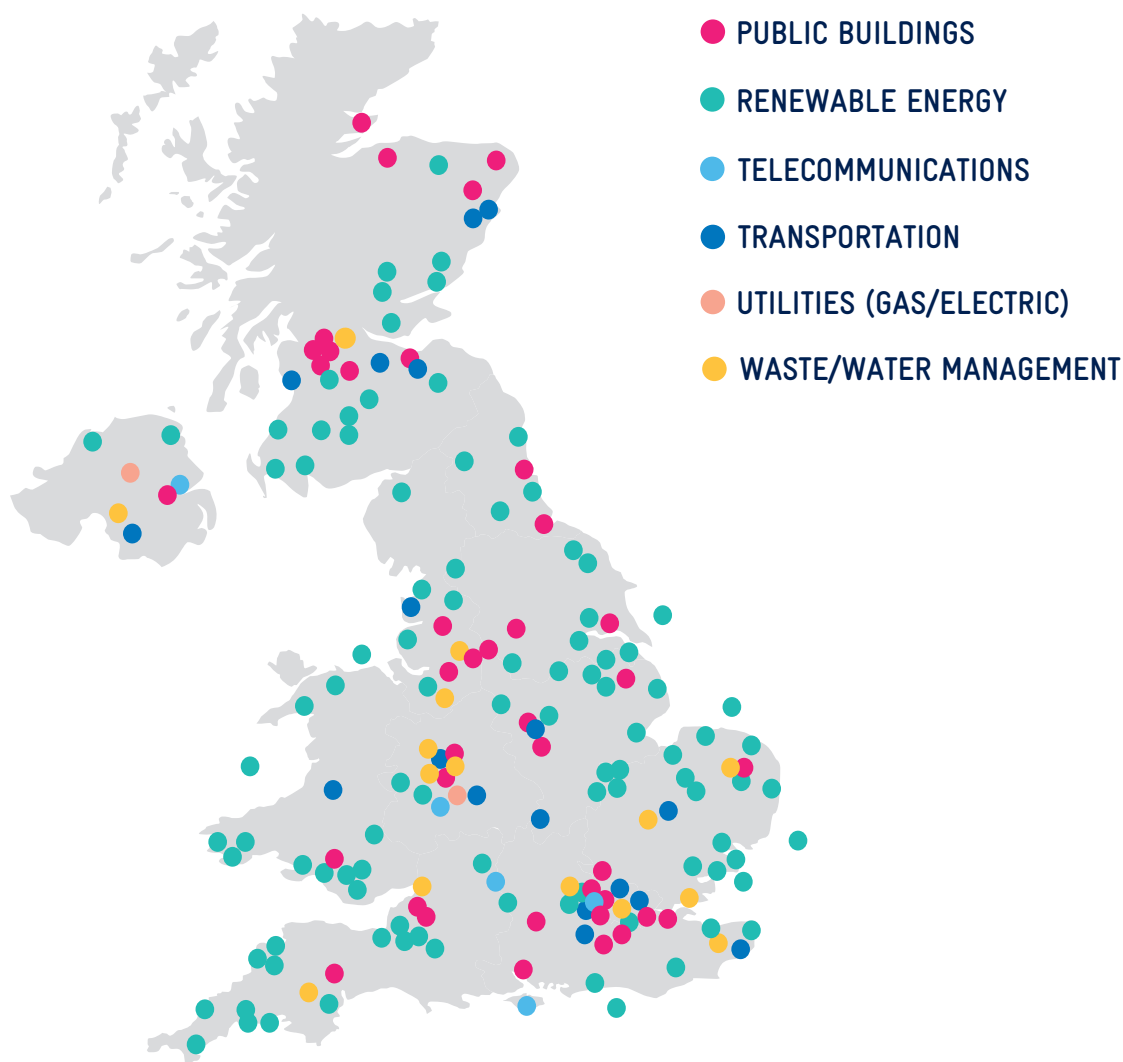
As of December 2022, UK asset managers held an estimated £45 billion in infrastructure projects, slightly higher than the £40 billion reported in the previous two years. This year-on-year increase is likely due to a change in methodology. In 2022, we asked member firms to report investments regardless of the portfolio manager’s domicile.

²⁰ See Box 2 on climate change and the UK’s positioning on page 44.

Though limited to a selection of projects, Figure 9 maps out the types of infrastructure projects facilitated by IA members on behalf of their clients. These investments span across the UK, though notable clusters of investments in public buildings can be seen around major cities.

Renewable energy projects make up a significant proportion of investment in UK infrastructure projects, which mainly consist of offshore and onshore wind farms. Increasingly, members are also investing in nationwide initiatives includes regional waste and water management services, national grids for the provision of fibre broadband and international transportation networks. Because they are nationwide, these projects do not appear on the map.

FIGURE 9: SELECTION OF UK INFRASTRUCTURE INVESTMENT FACILITATED BY IA MEMBERS IN 2021



ONGOING FOCUS ON LIQUIDITY MANAGEMENT

The process of widening access to private markets has coincided with, and partly shaped, the broader discussion in the UK – and internationally – on how better to manage liquidity in open-ended investment funds. A combination of events over the past three years have highlighted the importance of liquidity management in different ways:

- The March 2020 'Dash for Cash' sparked a renewed debate between industry and regulators globally about liquidity measurement and management in the mainstream investment fund universe, especially those assets subject to dynamic (e.g. corporate bonds) or inherent illiquidity (e.g. property).
- The Ukraine crisis – and consequent challenges for assets held in Russia, Ukraine and Belarus – sparked an urgent review of the extent to which investment funds had the necessary tools to separate what had become untradeable assets from the rest of the fund. While some jurisdictions had measures in place to permit side pockets, further work was undertaken by regulators and industry at speed in the UK.
- Following the UK Fiscal Event of late September 2022, an unprecedented spike in gilt yields created a severe challenge for liability driven investment (LDI) strategies – in both segregated and pooled vehicles – in meeting collateral calls against derivative instruments used to hedge liability risk for DB pension schemes (see chapter 4).

While separate issues, requiring distinct approaches to resolution, the 'Dash for Cash' and LDI market turbulence have led to significant central bank concern in the UK about the significance of Non-Bank Financial Institutions (NBFIs) to financial stability. The industry has been closely engaged on ensuring appropriate approaches are put in place to address the challenges arising.

LIQUIDITY MANAGEMENT IN CONVENTIONAL INVESTMENT FUNDS

As we move through 2023, the focus for the UK authorities and others internationally is on the coordinated global regulatory reform agenda being driven by the Financial Stability Board (FSB) and International Organization of Securities Commissions (IOSCO). In December 2022, the FSB published its Assessment of the Effectiveness of the FSB's 2017 Recommendations on Liquidity Mismatch in Open-Ended funds, which set out a clear direction of travel which would require five areas of enhancement of the existing framework:

- A clearer and more specific articulation of the intention outcome of policies to reduce structural liquidity mismatch in OEFs.
- Ensuring investors bear liquidity costs associated with fund subscription and redemption and enhancing use and consistency of use of liquidity management tools (LMTs) by fund managers.
- Requiring clearer fund disclosure with respect to availability and use of LMTs.
- Closing identified data gaps to improve monitoring and management of liquidity mismatch by authorities.
- Further promoting the use of fund and system-level stress testing.

In the summer of 2023, the FSB and IOSCO moved to consult on new recommendations to address identified issues. In the UK, the Bank of England has also launched a new system-wide exploratory scenario exercise to better understanding the behaviours of banks and NBFIs in stressed conditions.

The UK industry is broadly supportive of the objectives of broadening and strengthening the liquidity management toolkit, although still stresses the importance of first mover advantage in the financial markets themselves as the central driver of redemptions during crises, rather than fund structures.

The outcome of these discussions, combined with the ability of the distribution infrastructure to accommodate tools such as notice periods, will shape the evolution in the coming years of the liquidity management toolkit and the way in which access is provided to certain asset classes and strategies in the DC and retail markets.

BOX 5: DEEPENING ACCESS TO PRIVATE MARKETS, AMIDST REFORM TO PUBLIC MARKETS

Previous editions of the Investment Management Survey have reported the significant growth in private market assets globally over the past decade. Although total private markets assets under management continued to increase globally by 16% to \$12 trillion during 2022, fundraising has slowed considerably, falling 11%. A question therefore arises that is similar to the one posed earlier in this chapter with respect to conventional assets under management: to what extent has the strong growth over the past decade been cyclical rather than structural and will a prolonged period of higher interest rates prove a significant and enduring headwind?

The reality is likely to be a mixture of cyclical and structural, with demand-side strength in part driven over the past decade by a hunt from investors for diversified yield in the context of lower yields from conventional sources such as fixed income. On the supply side, lower borrowing costs clearly also contributed to the attractiveness of private funding for corporates and infrastructure projects seeking private finance.

However, there is a recognition that private markets are structurally now a much more significant part of the investing landscape, reflected in the emergence of new vehicles such as the UK Long-Term Asset Fund (LTAF) and the overhauled EU vehicle, the European Long-Term Investment Fund (ELTIF). While private markets are now subject to increasing scrutiny in areas such as valuation, liquidity and fee structures, this likely reflects the transition to a much more mature phase, ahead of a potentially more transformative phase that could be triggered by the impact of tokenisation (see discussion in Chapter 2 of this report).

In the meantime, a significant number of investment managers are further developing their capabilities in the private market space to meet ongoing and emerging funding needs in a number of key areas for the UK, European and global economy. These are likely to include both corporate finance (equity and debt) and, increasingly, infrastructure to drive action in areas such as tackling climate change through decarbonisation and supporting urban and wider public infrastructure renewal.

The shift to greater private market finance requires a range of demand-side and supply-side factors to align in order to be successfully extended. On the demand side, one critical element for broadening the UK customer base will be DC pension scheme participation, which has been constrained historically by a range of factors including:

- A highly cost-focused investment governance process, which does not easily accommodate access to alternative asset classes;
- An incomplete set of fund vehicles for pooled investment;
- Insufficient scale for certain kinds of direct investment; and
- A distribution infrastructure focused predominantly on providing access to daily-dealing investment funds.

“The political zeitgeist is that there will need to be more investment capital in the UK. The asset management industry has a role in helping us to think about how we create those investable opportunities. Figuring out how the asset management industry can help create the structures and opportunities will be an interesting evolution over the next few years.”

Some of these obstacles are now being addressed in the UK, notably:

- The authorisation and launch of the first Long Term Asset Funds (LTAFs) in the UK.
- The publication of rules allowing broader distribution of LTAFs to retail investors, including advised and discretionary managed retail investors.
- The completion of the Productive Finance Working Group's work to facilitate greater access to private markets for DC decision makers.
- Further momentum through the Autumn 2022 Mansion House reform agenda.

However, there remains quite a significant road to travel to engineer the culture and delivery infrastructure shift necessary to embed greater private market investment into DC default strategies. The investment industry will be engaging closely with policymakers and regulators to facilitate further change.

For their part, pension schemes both DB and DC remain cautious – understandably – about the kinds of funding need that they are prepared to support, and sometimes critical of prevailing fee structures. More work will be needed to reduce an ‘expectations mismatch’ between the supply and demand side, especially on public infrastructure where a prevailing theme for a number of years has been a shortage of investible projects rather than a shortage of capital per se.