Schroders
Global Investor Study 2016 – Plan Sponsors

A global study of pension fund investors, with a focus on investment outcomes and environmental, social and governance issues

Gavin Ralston
Head of Official Institutions/Thought Leadership at Schroders

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Aim, context and key findings

The Schroders Global Investor Study seeks to provide insight into how pension fund executives construct their investment views, the issues they rate as priorities and the extent to which environmental, social and governance (ESG) considerations are a factor in their decision-making.

The background to this study is one of significant political turmoil. The rise of populism at a time of already heightened central bank intervention has created an investment environment that demands clear-headed navigation. Investors of all stripes are under pressure to find returns in a climate of lower growth and higher uncertainty.

At the same time, financial markets appear, potentially, to be at a turning point – moving from a widespread expectation of deflation to an environment where inflationary pressures are starting to re-emerge. The need to generate returns in excess of inflation is clearly an increasing weight on the minds of pension fund investors.

Also apparent is the clear focus on generating a long-term real return, with much less concern than retail investors for income or liquidity

In this respect, the era of the relative return would appear to be waning, with investment outcomes now much more of a priority for many investors – and multi-asset and so-called 'smart beta' approaches gaining momentum as preferred ways to go about achieving them. These are not just uncertain times for investors but for the investment management sector also.

This independent study of 712 institutional investors was commissioned by Schroders. Respondents came from the UK, France, Germany, Netherlands, Belgium, Switzerland, China, Japan, Hong Kong, Singapore, Australia, USA, Canada, Brazil and Chile.

Key findings

Investment outcomes

- The average period for which pension fund investors expect to hold their investments is 4.7 years. This is much closer to the widely championed five-year period than private investors, for whom the average expectation is 3.2 years.
- This longer time horizon means considerations such as liquidity and immediate income – which are often high priorities for consumers – are relatively lowly valued by pension fund investors as reasons to choose an investment.
- Pension fund investors are more concerned with the credentials of the investment firm they work with rather than individual portfolio managers. Once a potent force in investment, the cult of the 'star manager' is slowly eroding and most institutional investors like to see a stable team at the helm.
- There is an increasing focus on investment outcomes over and above benchmarked returns. Notably, "getting back the amount invested" ranks third among reasons why pension fund investors choose investment products and is the joint-top concern for both consumers and advisers.
- This growing focus on investment outcome is leading to a significant rise in multi-asset and smart beta approaches to investing.

What do pension fund investors want from an investment?

Pension fund investors surveyed for the study cite long-term potential growth as their principal reason for investing, followed by "good" risk-adjusted returns and capturing a return that beats inflation. Fund manager reputation, fees and liquidity are also cited as considerations but not as frequently as the top three.

The main factor that drives pension fund executives to invest in specific strategies is the expected return on their investment. While this may seem self-evident, the way they assess that return is more nuanced – with a maximum possible score of 5, long-term potential growth averaged a rating of 4.22, with good risk-adjusted returns (4.11) and capital preservation (4.01) close behind.

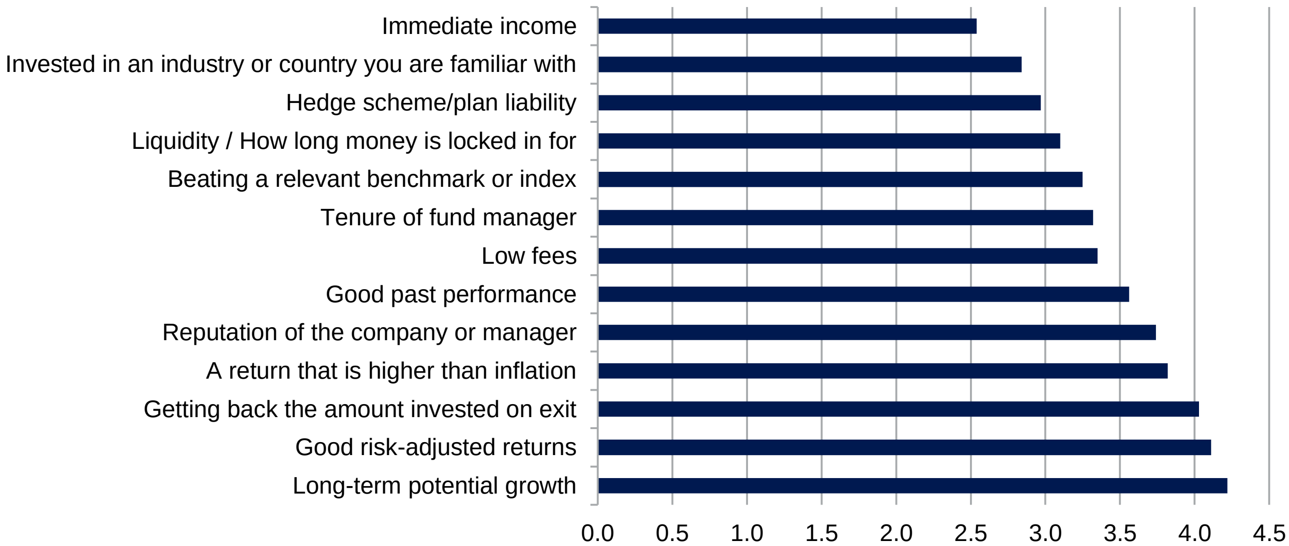
Beating inflation (3.82) looks set to become a higher priority in an environment where economic growth is reigniting while a fund manager's reputation (3.74) and a strategy's track record (3.56) are also relatively highly valued.

At 2.54, however, immediate income, which rates a high priority for many retail investors, is not particularly so for their institutional counterparts. Equally – with teams of analysts at their disposal to carry out due-diligence on new strategies – familiarity with an investment (2.84) is not considered especially significant.

Regional differences also prove marginal, with investors in most locations around the world identifying the same priorities. In the US, for example, the twin priorities of the long-term potential growth of an investment and risk-adjusted returns are more marked – particularly when contrasted with a desire for immediate income.

Capital preservation appears to be particularly important in the US and Canada. And while there is a greater diversity of outcomes in the UK and mainland Europe, and indeed in the Asia-Pacific region, the main priorities are essentially the same.

How important to you are each of the following, when choosing an investment product?
Relative importance rating: (0) Not at all – (10) Critical



Source: Schroders Global Investor Study 2016

Investor timeframe

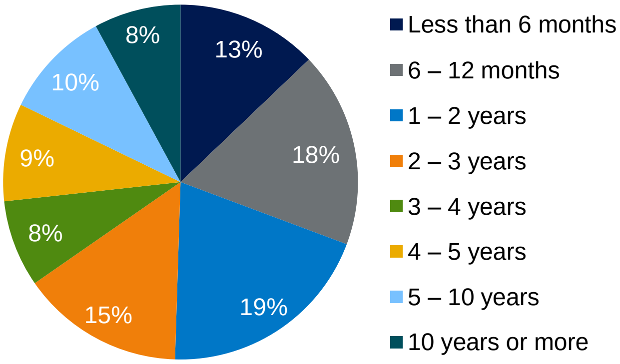
On average, pension fund investors say they stay invested for a little more than four and a half years. This compares favourably with consumers, who on average only expect to hold their investments for 3.2 years, with fewer than a fifth (18%) holding for five years or more. Among institutional investors, 22% have a time horizon of five to 10 years while 8% have a time horizon of just six to 12 months.

A further 20% of pension fund investors admit to taking a more pragmatic approach, saying they have no specific timeframe for holding investments. Arguably this reflects growing support for the view – mirrored in the rise in popularity of multi-asset strategies – that asset class allocations should not be dogmatic and instead more sensitive to movements in price.

At a geographical level, pension fund investors in North America have notably longer outlooks than all other regions covered by the study. Canada is the longest at an average of 6.4 years, with the US next at 5.9 years. In contrast the UK and mainland Europe's average holding period is 4.4 years, with Asia-Pacific the shortest at just 4.1 years.

Consumers

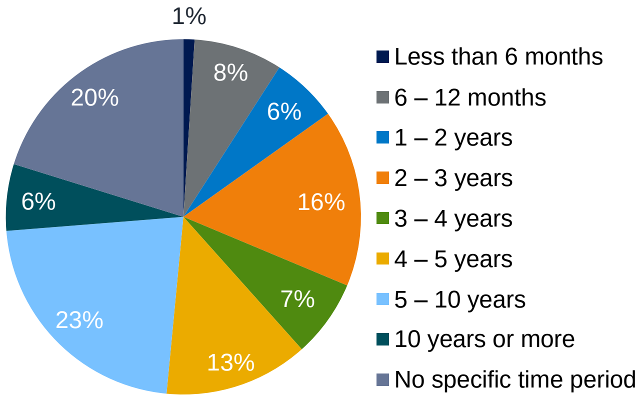
Excluding any pensions or property investments you might have, on average, how long do you hold your investments? By 'hold' we mean the length of time you leave your money invested in the individual investment.



Average: 3.2 years

Institutional investors – Global

When investing in a strategy, how long (on average) does your organisation hold on to it?



Average: 4.7 years

Source: Schroders Global Investor Study 2016

Income expectations

Income is in short supply from traditional sources, with 10 year government bond yields in most countries below 2.5% and broad equity indices yielding between 2 and 3%.

At a geographical level, investors in the US and Europe have higher expectations for income than is available from mainstream equities and bonds, with around four-fifths (81% and 84% respectively) looking for an annual income up to 5%. The proportion holding that view in Asia-Pacific is, at 72%, noticeably lower – although this may simply be a reflection of the higher interest rates available in the region.

By way of comparison, among the Asia members of the G20 grouping of the world's richest nations China, Indonesia and India have respective headline interest rates of 4.35%, 4.75% and 6.25% – albeit with Japan a major outlier at -0.10%. Meanwhile the central bank rates for the US, Canada, the UK and the eurozone are respectively 0.75%, 0.5%, 0.25% and 0%[1].

Of course, a decade ago – in what many investors might consider a more 'normal' interest rate environment – the respective rates for that quartet were 5.25%, 4.25%, 4.5% and 3.5%. This raises the possibility behavioural finance could explain the heightened income hopes of some pension fund investors, with their expectations perhaps 'anchored' to a piece of information of little real relevance.

Investment strategies

To meet their goals, pension fund investors are increasingly turning to smart beta and multi-asset investment strategies. The study finds three-fifths of respondents either already using (29%) or planning to use (31%) smart-beta strategies. Among the latter group, most are planning to do so within the next one to three years.

"31% are using or planning to use smart-beta strategies"

Smart beta is still a relatively new investment approach – particularly for European and Asian-Pacific investors – and assets have only started to build over the last couple of years. According to Morningstar, as of 30 June 2016, there were 1,123 smart beta exchange-traded products (ETPs), with collective assets under management (AUM) of some $550.5bn worldwide[2].

Morningstar also notes that, while ETPs' market share has been increasing in every major region, "they have made greater inroads in large, more mature markets than they have in smaller, less-developed ones". As an example, it points out smart

[1] http://www.cbrates.com/
[2] http://www.ioandc.com/wp-content/uploads/2016/09/7-Smart-Bet-report.pdf

beta ETPs accounted for 21.7% of US ETP assets in June last year, compared with just 3.5% of ETP assets in the Asia-Pacific region.

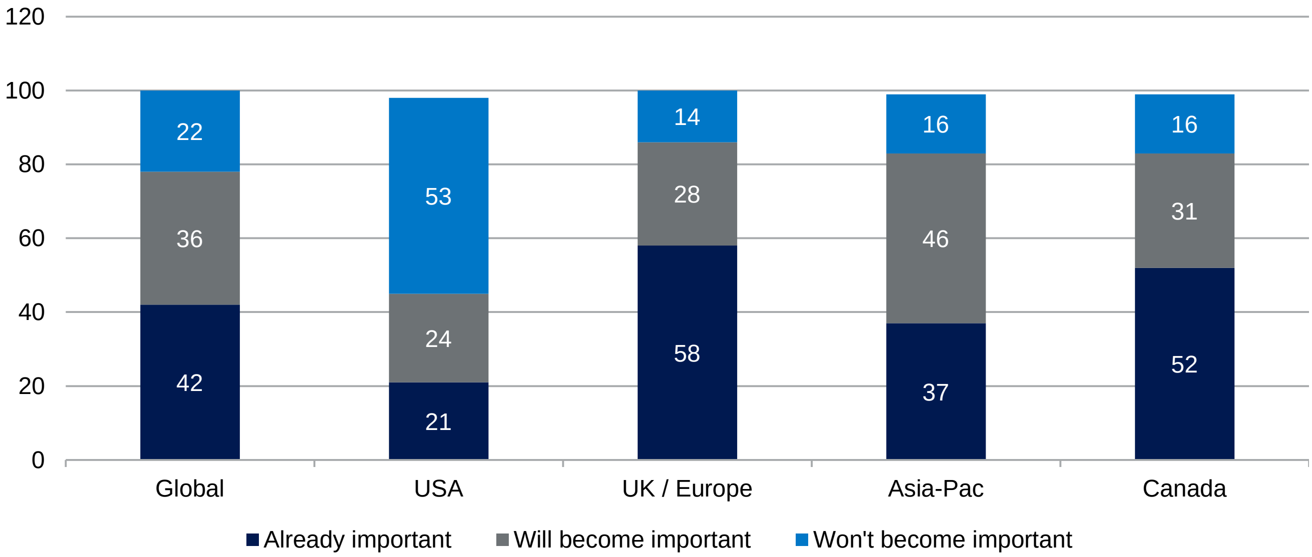
Turning to multi-asset, momentum continues to build. The study finds almost half (47%) of pension fund investors globally now have more exposure to multi-asset strategies than five years ago. One-fifth (20%) say they have less exposure than five years ago while one-third (33%) said they have the same.

Taking the UK as an example, the Pensions and Lifetime Savings Association has described the degree of investor interest in diversified growth funds (DGFs) as “quite remarkable”, quoting statistics from Camradata that show the sector’s AUM growing fourfold from £25bn in 2010 to £111bn in 2015, as well as a forecast from Spence Johnson suggests that the DGF market could reach £200bn in AUM by 2018[3].

ESG

The study finds pension funds attributing greater weight to ESG matters in investment strategies, with more and more institutional investors paying closer attention to their portfolios’ ESG impact and increasingly willing to sell investments – even profitable ones – if they violate certain principles. Good corporate governance continues to be their top ESG consideration.

The study also highlights some significant regional differences. In Europe, for example, 58% of pension fund investors already see ESG as an important consideration while just 14% do not think it will ever be so whereas in the US the percentages are all but reversed. There, only 21% currently incorporate ESG factors into their investment strategy, while the ‘diehard’ group leaps up to 53%.



Source: Schroders Global Investor Study 2016. Note: Responses from Institutional investors. “Will become important” includes “Yes, within the next year/Yes, within the next 1 – 2 years/Yes, within the next 3 – 5 years/Yes, in more than 5 years”. Numbers may not add up to 100% due to rounding.

Still, with 43% of pension fund investors surveyed considering ESG already to be an important component of investment strategy, this of course leaves almost three-fifths (57%) who remain unconvinced. This seems surprising given the ever greater attention this subject is receiving around the world.

To pick out two recent financial examples, the 2015 COP21 Agreement in Paris set out new global standards for climate-related financial disclosures while Morningstar has just started assigning “sustainability ratings” to investment funds[4]. The methodology styles itself as a “new way to evaluate funds based on the sustainability profile of their underlying holdings”.

Even so, ESG remains more of a priority for pension fund investors than it does for financial advisers. According to the adviser element of the 2016 Global Investor Study, ESG considerations are an important element in fund recommendations for around a fifth (22%) of advisers although more than three-fifths (62%) expect them to become so

[3] http://www.plsa.co.uk/PolicyandResearch/DocumentLibrary/~/media/Policy/Documents/0448-DIVERSIFIED-GROWTH-FUNDS-MADE-SIMPLE-v2.pdf
[4] http://www.morningstar.co.uk/uk/news/148119/the-new-morningstar-sustainability-rating-for-funds-and-etfs.aspx

within three years. In contrast, 16% of advisers are unable to envisage a time when they will ever factor ESG issues into their fund recommendations.

Similarly, there is a core of pension fund investors who do not expect ESG to ever become an important part of their strategy. Around a fifth (22%) of those surveyed hold this view while a further 17% do not believe ESG will become a significant factor for at least another three years.

So why would such a significant proportion of pension fund investors ignore what many of their global counterparts now consider to be close to a fiduciary duty? One possible answer is suggested by *Global guide to responsible investment regulation*[5], a report published last year by Principles for Responsible Investment (PRI).

In it, the organisation responsible for framing the United Nations-backed principles noted that all stewardship codes are voluntary and much pension fund regulation operates on a 'disclose if you consider ESG' basis. "This gives the impression that stewardship and ESG integration are optional," it added. "The PRI's previous work shows that these are a requirement of a fund's fiduciary duty[6]."

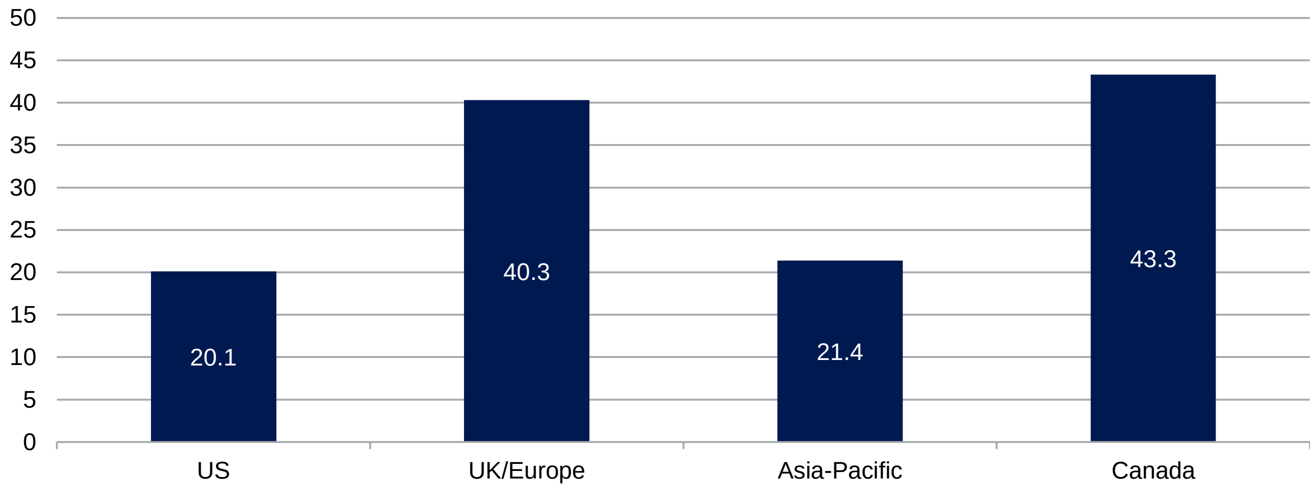
At this point, we would stress the figures in this part of the survey are at odds with Schroders' own experience with pension fund investors, whom we have found to be highly engaged and interested in ESG matters. The conclusion we would draw then is ESG is only going to grow in importance for US pension fund investors until it matches the regard in which it is held by their European and indeed Asia-Pacific counterparts.

"Schroders' own experience is that pension fund investors are highly engaged and interested in ESG matters"

ESG concerns

When asked what proportion of their total portfolio factors in ESG principles, the average among pension fund investors is 30.9%. In keeping with the study's other ESG findings, there is a big disparity between each side of the Atlantic – the average proportion for Europe is double that of the US (40.3% versus 20.1%).

What proportion of your total portfolio factors in ESG principles? (%)



Source: Schroders Global Investor Study 2016

At the same time, almost two-fifths (38%) of European pension fund investors say they operate portfolios that are more than 50% run along ESG lines. In the US, the corresponding figure is 16%. The figures are similarly low for Asia-Pacific (21.4% and 15% respectively) although more pension fund investors in that region say they plan to increase the proportions in future.

With regard to specific ESG considerations, good corporate governance is seen as the highest priority across all regions – scoring 3.98 out of a possible 5 – followed by a good record of social responsibility (3.61). Arguably these two factors have the most obvious and immediate link with a business's share price, suggesting good scores on these measures will enhance investment returns.

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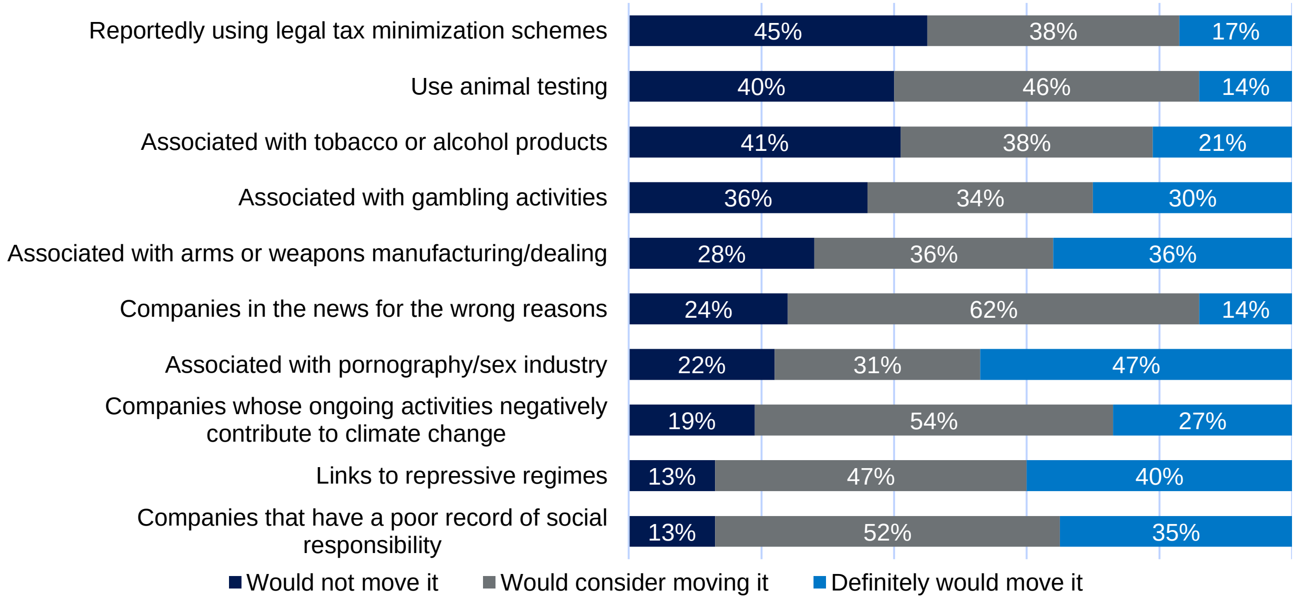
5 https://www.unpri.org/explore/?q=Global+guide+to+responsible+investment+regulation&hd=on&hg=on&he=on&sp=rel&sc=rel&se=rel&ptv=&tv=70%2C

6 http://www.fiduciaryduty21.org/

ESG screening

Turning to the sort of ESG considerations that would lead pension fund investors to move money out of an investment that was performing well, the study finds them keenest to avoid companies with links to pornography or the sex industry (47%) or repressive regimes (40%). Businesses associated with dealing or manufacturing arms or with a poor record of corporate social responsibility would also see disinvestment.

Would you move, or consider moving, money out of an investment that was performing well, if you discovered it was invested in the following types of companies?



Source: Schroders Global Investor Study 2016

This chimes with the findings of the consumer study, which shows investors least disposed towards those companies with links to repressive regimes (40%), to pornography or the sex industry (39%) or to dealing or manufacturing arms (38%).

ESG screening priorities do vary by region. Pornography and repressive regimes are particular concerns for US pension fund investors while in the UK and mainland Europe weapons are a greater issue. In Asia, pornography once again features high among investor dislikes, but it is companies with a poor record of social responsibility that attract the greatest scrutiny from the region's pension fund investors.

In contrast, institutional investors remain relatively unconcerned about tax minimisation schemes. Only 17% would definitely disinvest for this reason globally, with the number dropping to just 6% in the US. This is significant at a time when some of the world's largest companies – most notably the likes of Amazon, Apple and Facebook – are under scrutiny for the way they structure their tax affairs.

Time horizons

It is good news that pension fund investors are, as noted earlier, willing to stick with an investment for an average of a little more than four and a half years. Still, on the basis investments with the potential to have a positive environmental or social impact may take time to perform, the study also asks pension fund investors how much longer than usual they would stay invested in such products.

Although almost a quarter (24%) say they would be prepared to stay invested no longer than usual, the average answer is 3.25 years, which is significantly more than the two years either consumers or financial advisers are willing to wait. Geographically, Canadian pension fund investors are prepared to be the most patient with ESG assets (an extra 4.6 years on average) while, at 3.4 extra years, their US neighbours' average is most out of sync with their professed time horizon for investment in general.

Conclusion

While revolution is a word rarely, if ever, associated with the pensions industry, Schroders' Global Investor Study does identify some signs of surprisingly rapid evolution. This is particularly apparent in the growing willingness of a sector that controls trillions of dollars of the world's wealth to factor ESG considerations into its thinking, a very positive element of the evolution of pension fund thinking.

The Study also presents an encouraging picture of the relatively long term horizon among decision-makers on pension funds, and the clear focus on the delivery of good real returns. This is consistent with the growing use of smart beta as a building block and the use of multi-asset strategies that are designed to target a particular outcome.

The investment industry should welcome these findings and embrace the challenge of helping pension funds achieve these demanding goals

About Schroders

At Schroders, asset management is our business and our goals are completely aligned with those of our clients - the creation of long-term value.

We manage £375.0 billion (€433.5 billion/US$487.1 billion) on behalf of institutional and retail investors, financial institutions and high net worth clients from around the world, invested in a broad range of asset classes across equities, fixed income, multi-asset and alternatives.

We employ over 4000 talented people worldwide operating from 37 offices in 27 different countries across Europe, the Americas, Asia and the Middle East, close to the markets in which we invest and close to our clients.

Schroders has developed under stable ownership for over 200 years and long-term thinking governs our approach to investing, building client relationships and growing our business.

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Source: Schroders, all data as at 30 September 2016.

Notes about the Schroders Global Investor Study 2016

This independent survey was commissioned by Schroders and was conducted between April and October 2016. 712 institutional investors were surveyed across the UK, France, Germany, Netherlands, Belgium, Switzerland, China, Japan, Hong Kong, Singapore, Australia, USA, Canada, Brazil and Chile. Schroders also commissioned a similar independent survey of 20,000 investors (consumers) in 28 countries around the world between 30 March and 25 April 2016, including Australia, Brazil, Canada, China, France, Germany, India, Italy, Japan, the Netherlands, Spain, the UK and the US. This research defined ‘investors’ as those who will be investing at least €10,000 (or the equivalent) in the next 12 months and who have made changes to their investments within the last five years. These individuals represent the views of investors in each country included in the survey. 1,836 independent financial advisers were also surveyed between 7th – 29th April 2016 and these individuals represent the views of advisers in each of the eight countries included in the survey; Australia, Germany, Italy, Hong Kong, South Korea, Singapore, the UK and the US. Please note, where percentages do not add up to 100%, this is due to decimal rounding or a multi-coded question.

Schroder Investment Management (Hong Kong) Limited
Level 33, Two Pacific Place, 88 Queensway, Hong Kong
Telephone +852 2521 1633 Fax +852 2530 9095