



# Fiduciary Manager Review 2022

Following an extraordinary 2020, for many, and not just those involved with financial markets, the approach to navigating 2021 was one of cautious optimism. Strong equity markets and increasing levels of inflation created a market environment of opportunities for fiduciary managers (FMs) to recover any remaining losses from the pandemic.

This paper presents a holistic analysis of 18 growth portfolios across 14 fiduciary managers (with assets representing more than 90% of the UK FM market) over 2021 to assess where and how the FMs have added value.

## Key findings

- Over 70% of FMs' growth portfolios outperformed the median Diversified Growth Fund ('DGF') returns over the year (p3, Chart 2).
- There was a wide range of returns across the UK FM market over the year with an 8% difference between the highest and lowest returning growth portfolio (p3, Chart 2).
- Portfolio volatility was generally lower than in previous years (p6, Chart 6).
- Typically, FMs taking the most risk delivered higher returns, however some FMs that exhibit lower levels of risk demonstrated higher risk-adjusted returns (p6, Chart 6).
- In the majority of cases, the main contributor to returns was equity exposure, whilst hedge fund-type strategies often did little to add to returns (P8, Chart 9).

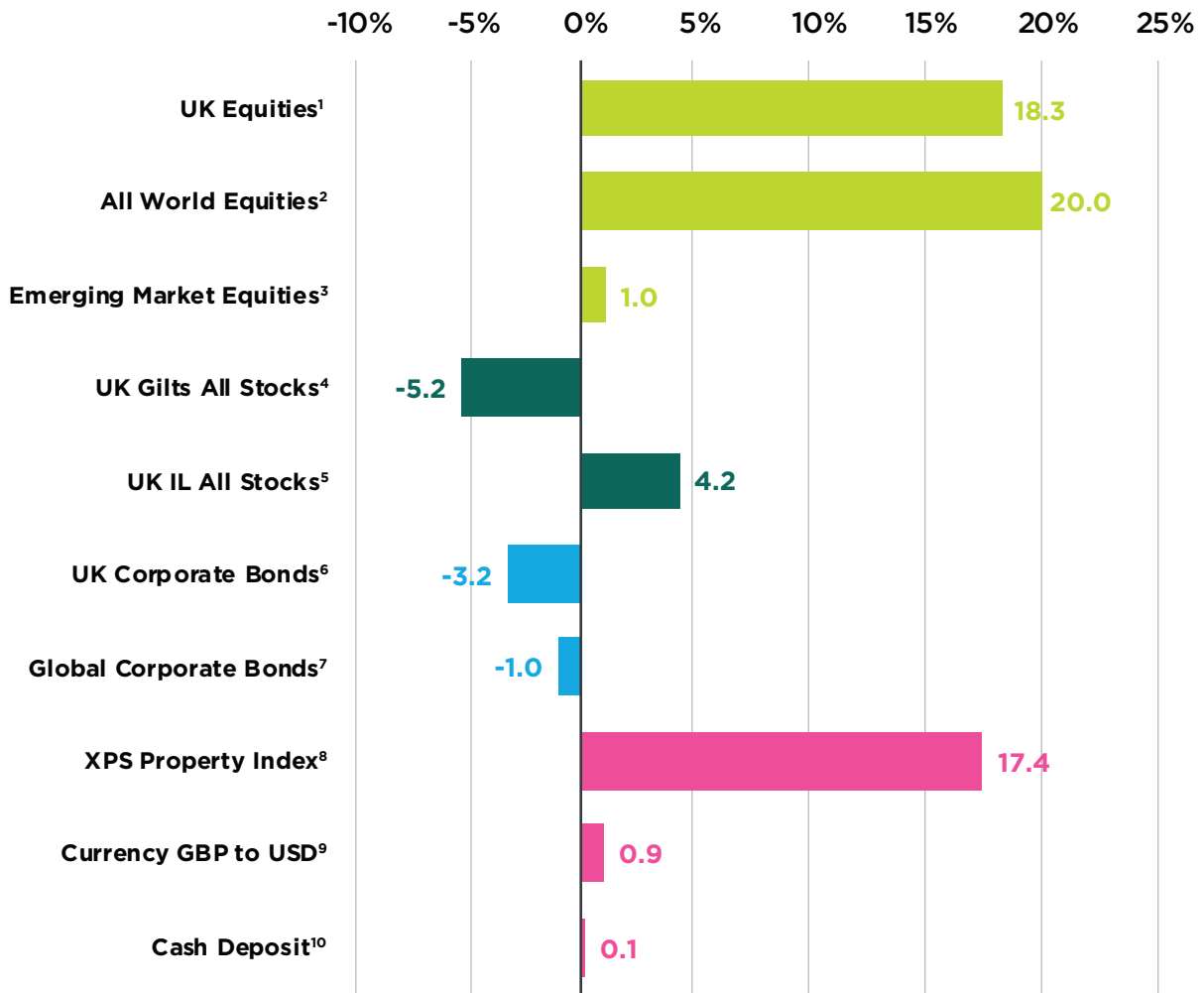
After huge market swings in 2020 that somewhat inevitably led to a large divergence in performance figures across the FM market, it was interesting to see that 2021 also brought about a range of approaches and outcomes which, whilst not as marked, were still significant.

**Guy Plater**  
Partner and Co-head of Fiduciary Management Oversight



# 2021 market backdrop

**Chart 1: 2021 market performance**



**Chart notes:**

Source: Refinitiv, XPS Investment

<sup>1</sup> FTSE All Share Total Return Index

<sup>2</sup> FTSE All World £ Total Return Index

<sup>3</sup> FTSE Emerging £ Total Return Index

<sup>4</sup> FTSE British Government Fixed All Stocks Total Return Index

<sup>5</sup> FTSE British Government Index-Linked All Maturity Total Return Index

<sup>6</sup> iBoxx £ Non-Gilts Total Return Index

<sup>7</sup> ICE BofA Global Corporate Index - Total Return Index Value

<sup>8</sup> XPS Property Index

<sup>9</sup> US(\$ ) to UK(£) (WMR) exchange rate

<sup>10</sup> IBA GBP LIBOR 1 week - Total Return Index

UK and global equities had a very strong year despite the continued impact of COVID-19. Government stimulus measures, vaccine rollouts and easing of social restrictions paved the way for an economic recovery providing high equity returns despite the threat of new virus variants.

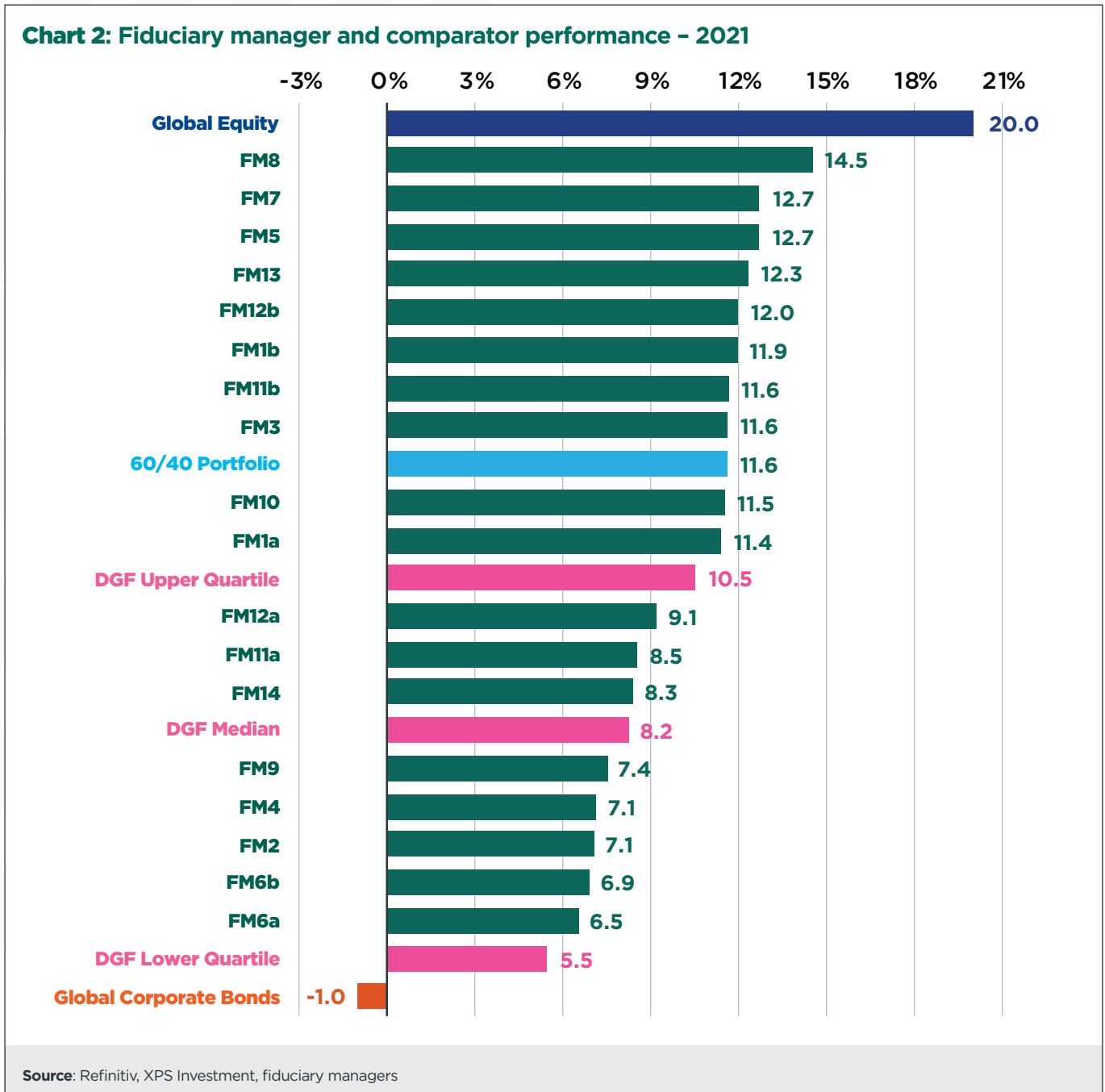
However, increasing consumer demand and supply chain issues resulted in significant inflationary pressures, particularly in food and energy prices. The US Consumer Price Index hit its highest rate in 40 years and central banks were forced to acknowledge that inflation would likely be more ‘persistent’ rather than ‘transitory’.

For most UK pension schemes, despite rising inflation expectations, an increase in fixed interest gilt yields, coupled with strong equity returns, will have proved beneficial for funding levels over the year.

# Fiduciary manager performance comparisons

For fiduciary managers' growth portfolios, those with more exposure to equities, and asset classes providing good levels of inflation protection such as real assets, will have experienced the strongest returns. Our survey collects returns on 'best ideas' growth portfolios that are currently used by DB pension schemes<sup>1</sup>.

Chart 2 shows the 2021 absolute performance for a total of 18 growth portfolios (with four FMs providing data for alternative portfolios designed to cater for clients' differing objectives). The FMs were requested to provide their returns net of all fees, as well as details of the total amount of assets and number of clients invested in each of the portfolios, demonstrating that these are live portfolios.

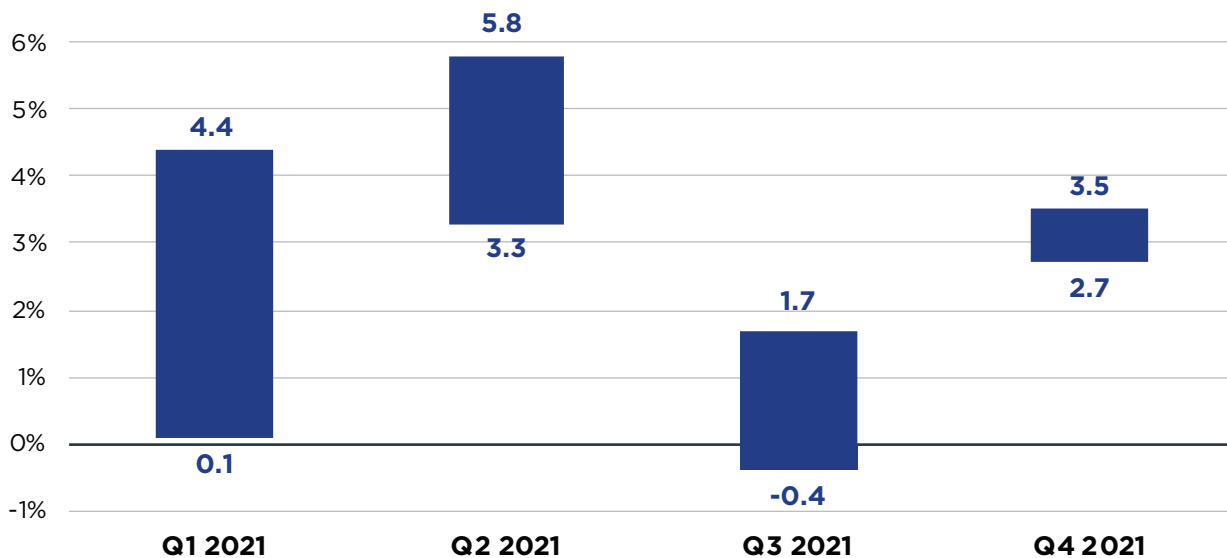


Unsurprisingly all FMs lagged global equity market returns, however, most still provided good absolute (and risk-adjusted) returns. As we would expect, the FM growth portfolios also did well relative to DGFs: over 50% outperformed the DGF upper quartile return and most of those also outperformed a low-cost index tracking '60/40' (60% equity/40% bonds) portfolio. However, nearly 30% of FM portfolios underperformed the median DGF return.

<sup>1</sup> FM5, FM8, FM11a and FM11b represent model portfolios.

As observed in our previous FM Watch reports, there was a significant range (8%) between the highest and lowest returning portfolios for 2021. This significant difference highlights that trustees should continually seek to understand what is driving their FMs' returns and the levels of risk being taken with ongoing oversight. Whilst still significant, this range is notably smaller than in our previous years' FM Watch reviews.

**Chart 3: Range of average returns for the three highest and three lowest returning growth portfolios by quarter**



Source: Fiduciary managers

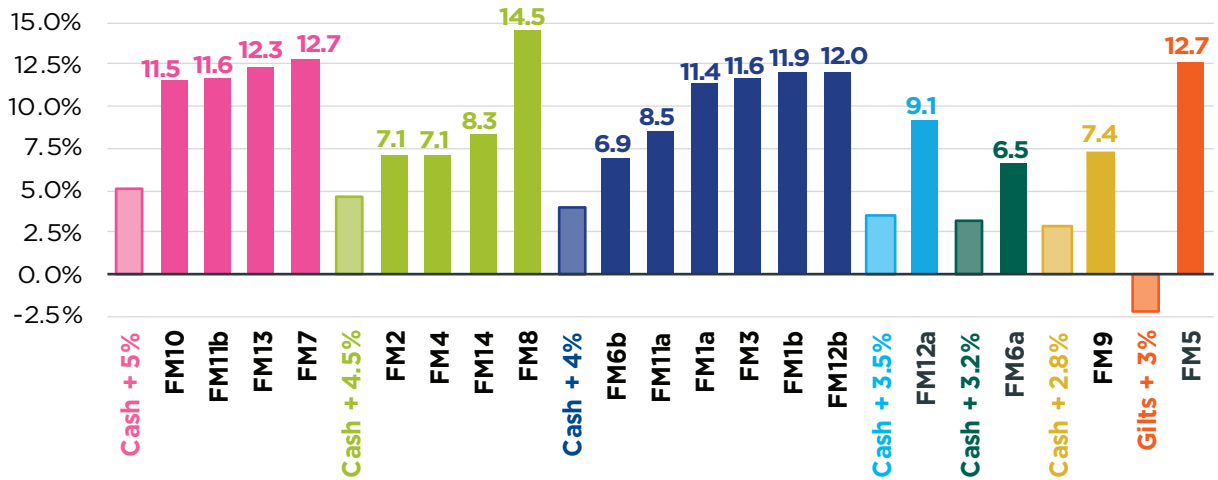
There was also a noticeable trend in the range of returns throughout 2021 by quarter and this perhaps explains why the overall range of portfolio returns was narrower for 2021. Chart 3 shows the average absolute returns for the three highest and three lowest returning growth portfolios for each quarter in 2021. The range of returns progressively reduces during the year - the range of portfolio returns in Q1 2021 (4.3%) was significantly greater than the range of returns in Q4 2021 (0.8%) when the FMs' growth portfolio returns were very similar despite the different approaches. In Q1 2021, mounting inflationary pressures led to a sell off from global government bonds and markets saw a large rise in gilt yields. The FMs' portfolios with more exposure to high yield bonds and investment grade credit struggled to capture positive returns leading to a more varied range of returns across the FM market.



**The range of returns in 2021 was narrower than that seen in 2020 and became progressively so as the year unfolded.**

# FM performance against targets

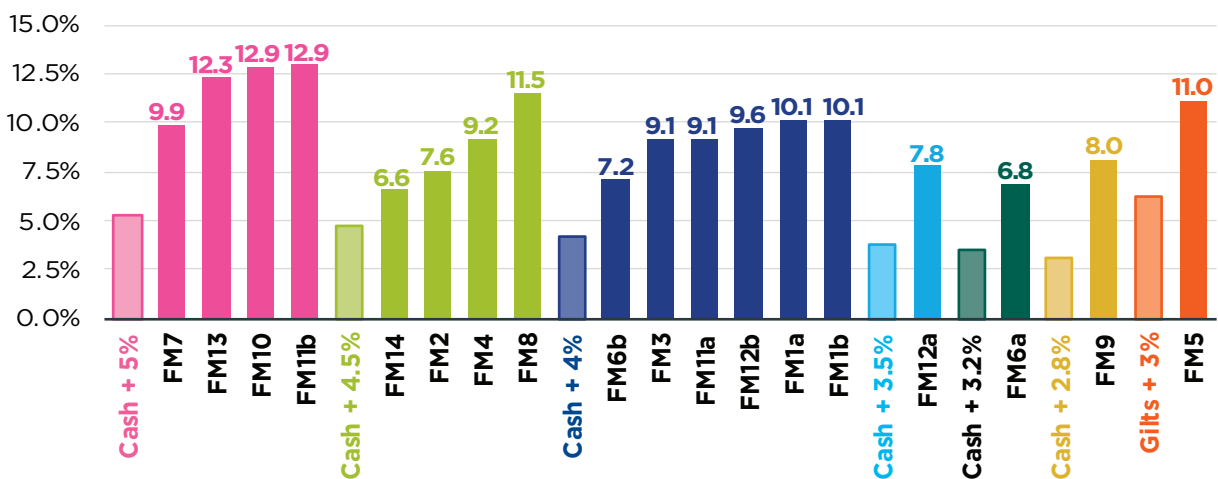
**Chart 4: Fiduciary manager performance vs. target – 1 year to 31 December 2021**



Source: Refinitiv, Fiduciary managers

When assessing returns of a portfolio, our view is that performance should always be considered in the context of the target it is set to achieve. For this year’s FM Watch we asked each FM to provide a performance target for each portfolio. Cash + 5% and 4% p.a. are the most frequently stated return targets, which are similar to that of most DGFs. Just one FM had a gilts based target. Over the one year period to 31 December 2021, all portfolios comfortably outperformed their stated targets which was unsurprising given the strong equity returns over the period. Comparing returns with targets suggests that fiduciary managers are not always effectively adjusting their portfolios to the return target, with half of the cash + 4% p.a. portfolios outperforming the cash + 4.5% p.a. portfolios, and a cash + 5% p.a. portfolio.<sup>2</sup>

**Chart 5: Fiduciary manager performance vs. target – 3 years (p.a.) to 31 December 2021**



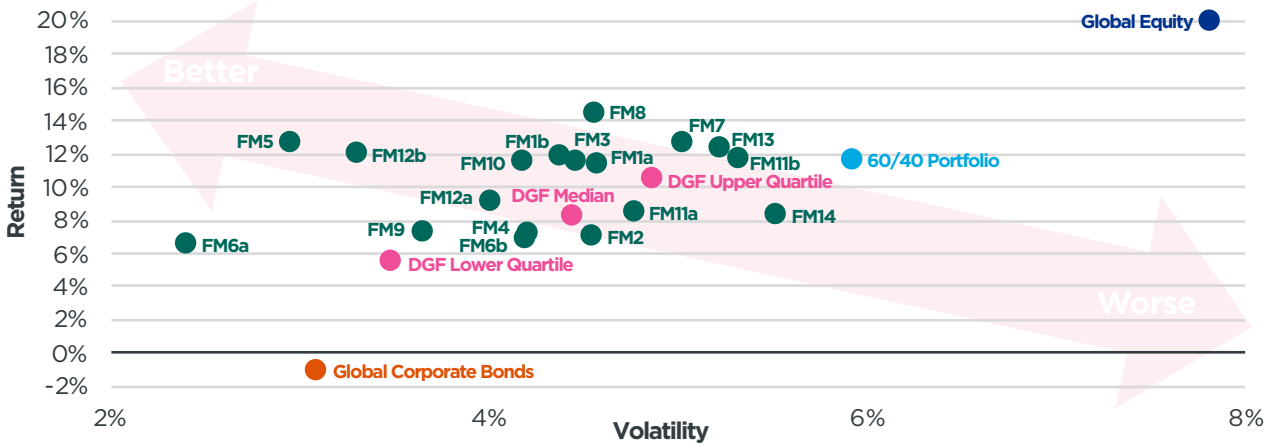
Source: Refinitiv, Fiduciary managers

Similarly, for the 3 year period to 31 December 2021, all FM portfolios have comfortably outperformed their stated performance targets. Despite periods of significant volatility, markets have provided strong absolute returns which has enabled the majority FMs to achieve correspondingly high levels of return from their portfolios. Clients should regularly assess whether FMs are achieving returns through market exposure (Beta) or generating excess returns in addition to the market (Alpha).

<sup>2</sup> Some of the FMs have a ‘SONIA +’ performance target. For purposes of comparison, we have labelled them all as ‘cash +’ targets.

# Volatility-adjusted growth portfolio performance

**Chart 6: Return vs Volatility – 1 year to 31 December 2021**

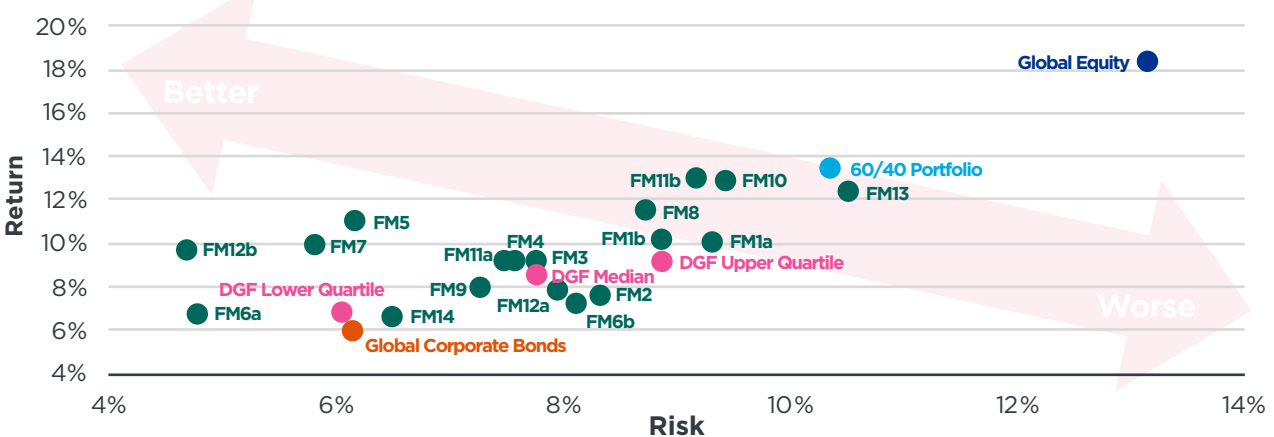


Source: Refinitiv, XPS Investment, fiduciary managers

It is important to consider the returns generated from the growth portfolio against the volatility experienced, as some pension schemes may require a greater emphasis on risk management than return. Chart 6 illustrates FM growth portfolio return against monthly volatility of returns over 2021, based on calculations by XPS, using monthly return data provided by each FM. The portfolios exhibit a much narrower range of volatilities and a less obvious relationship between volatility and return compared with previous FM Watch papers (2019 and 2020). Whilst the volatility of markets in 2020 was exceptional due to the onset of the COVID-19 pandemic, the volatility of global equity markets was considerably higher (by 28%)<sup>3</sup> in 2021 compared to 2019. The narrower range of volatilities is therefore likely to be a result of the cautious positioning of FMs at the beginning of 2021.

10 of the 18 portfolios managed by the FMs performed better on a risk-adjusted basis when compared to a passive 60/40 portfolio, demonstrating added value provided from the FMs. Some of the FMs' portfolios were able to achieve higher returns relative to the level of investment risk taken.

**Chart 7: Return vs Volatility – 3 years to 31 December 2021 (p.a.)**



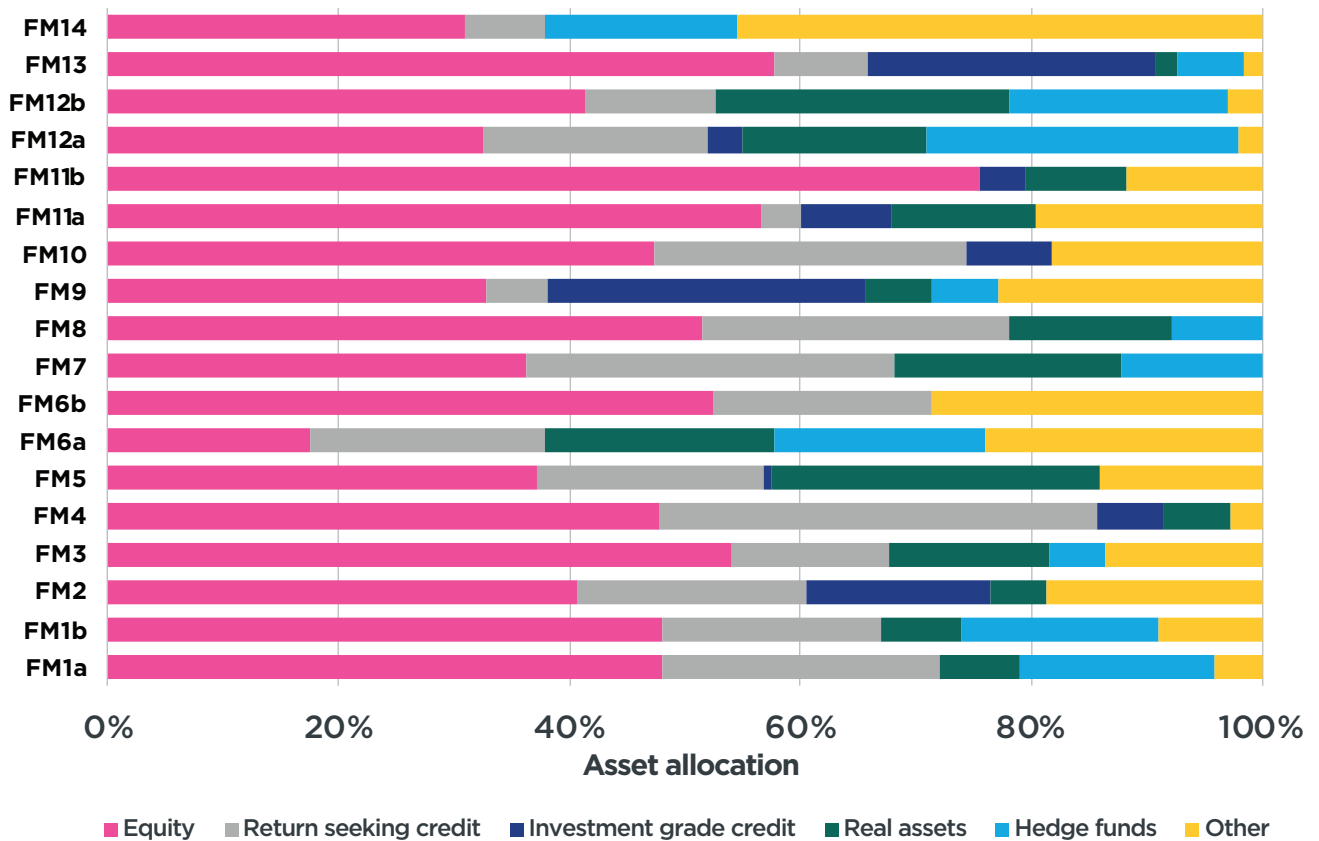
Source: Refinitiv, XPS Investment, fiduciary managers

Chart 7 shows the same data over the last three years to 31 December 2021 and demonstrates a more typical relationship between volatility and return, with FM10, FM13 and FM11b – managers which generally took the most investment risk – being rewarded with the strongest returns. Compared to 2021, the 3 year period shows a much wider spread of volatility of returns, which reflects the higher levels of volatility seen in 2020. The pattern and performance of FMs is very similar for the 5 year period to 31 December 2021.

<sup>3</sup> CBOE Volatility Index

## Investment approach and return contributors

**Chart 8: Average asset allocation – 2021**



Source: Fiduciary managers

The bars in Chart 8 show the FMs' average asset allocations between the major asset classes over 2021.

What is immediately apparent is that most FMs have sizeable allocations to equity within their portfolios and so these are, for many, a key driver of returns. For most, though, these equity allocations were fairly static, with a range of only around 10% between the maximum and minimum equity allocations throughout 2021. There is also a large variation between the FMs in their asset allocations, which demonstrates the significant differences in their approaches.

We have analysed the levels of equity market capture (the proportion of market movements included in returns) of each of the FMs' portfolios and found large differences when markets are rising. Again, this highlights how FMs' approaches can vary

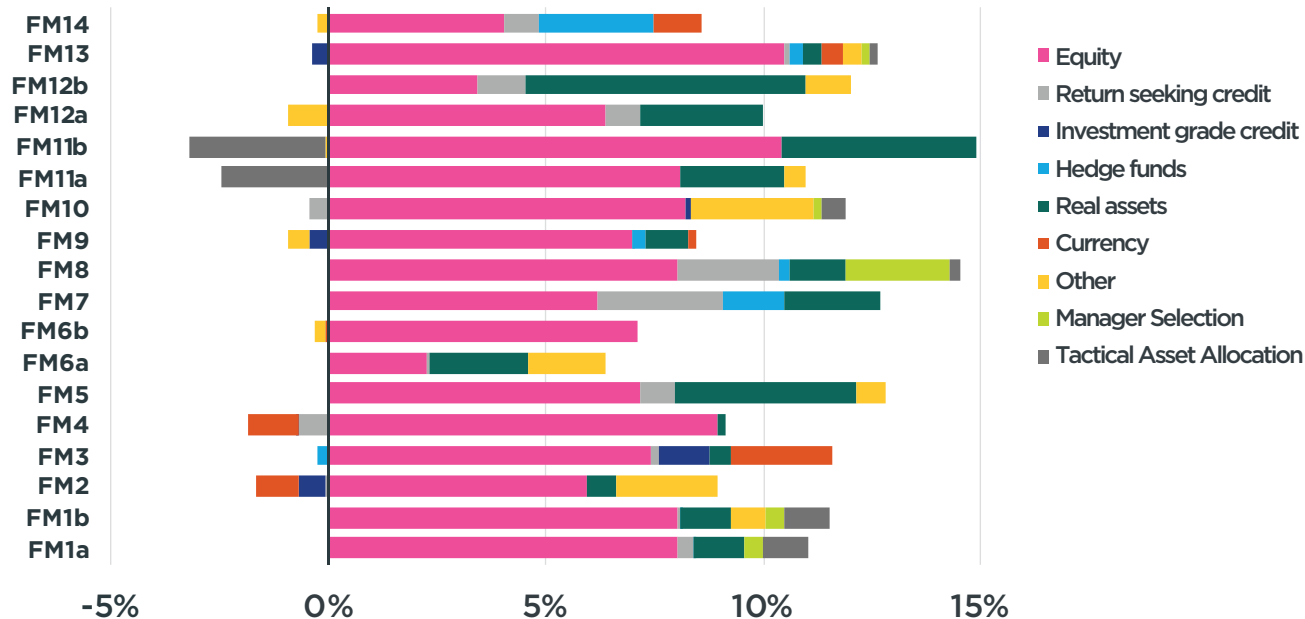
significantly, with some managers preferring more active management than passive with their equity allocations. Conversely, there is less of a difference in downside market capture and we found that the FMs who perform best on downside capture tend to be the lowest returning managers on upside capture (and vice versa). This highlights that it can be difficult for FMs to switch between more aggressive and defensive positions over the shorter term in order to improve returns. There are some FMs which have lower exposures to equity that have been able to achieve greater equity upside capture relative to equity downside capture and this may be due to enhanced diversification compared to peers in the market.

Ultimately, though, trustees need to be familiar with where their FM sits on the risk spectrum and be comfortable with the approach taken.



**Timing switches between aggressive and defensive asset allocations is difficult; most managers were either able to capture significant market upside or protect on the downside, but not both.**

**Chart 9: Contribution to returns - 2021**



Source: Fiduciary managers

Chart 9 illustrates the contributors to the overall returns achieved by each FM in 2021. This shows that strong performing equity markets were the most significant contributor to overall performance. Real assets were also a large contributor due to increased expectations for inflation.

When viewing Chart 8 and Chart 9 together, the majority of FMs that use hedge fund/ absolute return type strategies within their portfolio haven't seen a contribution to return over 2021 from this asset class, albeit the allocation may have reduced portfolio volatility. This is also a trend we have seen over longer time periods. As these are often some of the most complex and costly parts of a portfolio, it is important that trustees are able to challenge their FM on the roles played by different components of the portfolio and how they are adding value.

Where provided by the FMs, we have included their contributions to returns from manager selection and tactical asset allocation decisions.<sup>4</sup> We strongly support this level of analysis given that FM fees will typically incorporate active management, and it is therefore important that trustees can see if FMs are adding value in this way. Trustees should continually assess the approach taken by their appointed FM and analyse which sections of the portfolio are contributing to returns.

Trustees may also wish to evaluate how much latitude FMs should be given over tactical asset allocation, given that such decisions are very difficult to get right consistently. Our analysis suggests that this element may actually detract from some fiduciary managers' performance. Our view is that strategic asset allocation is the main driver of returns and added value from tactical asset allocation is difficult to achieve over the longer term.



**Some fiduciary managers are not always adding significant value in their portfolios through dynamism or complexity. Instead, portfolios are often heavily reliant on market returns. It is important that trustees are in a position to challenge their fiduciary managers on what is driving performance and why.**

**André Kerr**  
Partner and Co-head of Fiduciary Management Oversight



<sup>4</sup> Where not shown explicitly, the contributions by manager selection and tactical asset allocation are wrapped up within the relevant asset class contributions or within 'Other'.



# Conclusions

2021 saw continued strong equity market returns despite periods of concern about the impact of new variants of Covid-19. Inflation grew significantly over the year and central banks started to withdraw stimulus and raise interest rates. Against this backdrop, FMs generally produced strong returns.

## Key observations

- Over half of the FMs outperformed the upper quartile of DGF returns over 2021.
- The dispersion of returns between FMs remains significant, as we have noted in previous years.
- The volatility of FM returns was lower in 2021 than in previous years, largely due to equity markets exhibiting relatively lower levels of volatility.
- Most managers retained fairly stable asset allocations over 2021, possibly due to the relatively stable nature of markets over much of the year.
- Most FMs had a fairly typical link between risk and return, but some managers were able to perform very well whilst taking lower levels of risk.
- The majority of FMs' returns over 2021 were driven by strong performance in equity markets; more complex sub-strategies often did little to add to returns.

## Actions for trustees

If you haven't reviewed your arrangement in the last year or two, now would be a good time to do so. Consider:

- 1 How each part of the portfolio is contributing to returns.
- 2 Whether risk levels and downside protection are as expected.
- 3 Whether all parts of the strategy are delivering value as expected.

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