

European defined benefit pension funds are leaning into fixed income and sustainability in 2024, finds Goldman Sachs Asset Management

Pension fund managers in Europe are cautiously optimistic about the year ahead, according to Goldman Sachs Asset Management's inaugural European Pension Survey

- Investment grade debt and private credit expected to generate the highest risk-adjusted returns in the next year, with nine in 10 survey respondents planning to increase or maintain these allocations
- Seven in 10 respondents believe private credit has the potential for increased returns without a corresponding increase in volatility
- Almost 60% of schemes say the investment climate has improved
- 87% of respondents deem sustainable investing as critical or important in their decision-making, and almost two thirds (63%) allocate more than 10% of their portfolio to this approach
- Seven in 10 respondents plan to outsource some or all of their investment portfolios in the next 12 months

March 18, 2024 – Investment grade debt and private credit are the asset classes pension fund managers expect to generate the highest risk-adjusted returns in the next year, according to Goldman Sachs Asset Management's European Pension Survey: *Finding Opportunity in Uncertain Markets*.

Nine in 10 survey respondents plan to increase or maintain their allocations to these asset classes. For private credit specifically, almost seven in 10 managers (68%) believe it has the potential for increased returns without a corresponding increase in volatility, while two thirds (65%) plan to allocate to this asset class over the next three to five years.

The inaugural survey polls 126 senior defined benefit (DB) pension fund managers and executives based in Europe on the opportunities and challenges schemes face and the outlook for institutional investors in public and private markets. The results reveal cautious optimism about the year ahead, with 59% of respondents saying the investment climate has improved.

Cash is king

Improvement in funding ratios has accelerated over the past two years, with the aggregate funding ratio currently standing at 120% for Europe, and 134% – a record high – for the UK. As a result, pension fund managers are placing a greater focus on liquidity management and risk reduction.

According to the survey, the best-funded schemes are allocating significantly more to cash and less to developed market equities. UK-based funds specifically are a key driver of the move into this asset class, with all respondents based in the market either increasing or maintaining their allocation. In developed market equities, no UK respondents plan to increase their allocation, while 38% plan to decrease.

Geopolitical risks are top of mind

European pension funds say geopolitical risks in general are the biggest risks to their portfolios in the year ahead. More than 70% of pension funds consider geopolitical tensions and political events as the biggest risk to their portfolios. On the regulatory front, disclosure requirements under the Sustainable Finance Disclosure Regulation (58%) and upcoming climate stress-testing requirements (55%) were cited as the most challenging developments for funds to implement. In the Netherlands, the new pensions contract was cited by 86% of respondents as one of the most challenging regulatory developments, highlighting the Dutch pension sector's focus on the transition from defined benefit to defined contribution schemes.

Sustainable investing in focus

The survey findings also reveal the extent to which sustainable investing has become embedded in European pension funds: 87% of respondents incorporate it as a critical or important factor in their decision-making process, and almost two-thirds (63%) allocate more than 10% of their portfolio to sustainable investments. In addition, most respondents (84%) believe integrating ESG criteria into investment decisions can help reduce long-term risks, and more than half say this approach can generate alpha.

When it comes to allocations, developed market equities and investment grade debt top the list of asset classes in which respondents have incorporated sustainable investing strategies.

The sustainability themes most prioritised in investment portfolios span the ESG spectrum: transition risks associated with climate change are the top priority (75%), followed by good governance (61%) and human rights (49%).

Reliance on outsourced investment management

Amid increasingly complex compliance requirements, rising costs and uncertain markets, the outsourcing of investment management is an important tool for pensions funds. With seven in 10 respondents outsourcing some or all of their portfolios, the findings of the survey underscore the reliance of European defined-benefit pension funds on the delegation of asset management.

A specific outsourcing trend relates to ESG. When outsourcing, pension managers look for external managers with strong sustainable investing capabilities and robust stewardship policies. Four in 10 respondents rely on external asset managers to develop their sustainable investing policy.

A pivotal moment for European pensions

Fadi Abuali, CEO of Goldman Sachs Asset Management International, said: *"Our survey captures the views of European defined benefit pension fund managers at a pivotal moment. Many are optimistic about the investment climate, yet the economic outlook is uncertain, with higher-for-longer rates, divergent growth paths around the world and elevated geopolitical risk. Given sharp increases in yields and cooling inflation, managers are leaning into investment grade debt and private credit. We expect to see a continued increase in fixed income allocations across public and private markets, as pension funds trim their exposure to more volatile assets such as equities in favour of more stable income-generating investments."*

Céline van Asselt, Head of Fiduciary Management, Continental Europe, said: *"We expect to see more outsourced asset management. Today, trustees must contend with new regulatory requirements, more vocal stakeholders and rising reputational risks. Pension funds' resources have not increased to match"*

this complexity. The investment climate remains uncertain, with higher-for-longer rates and slower growth expected in most advanced economies, but opportunities abound in public and private markets for investors with a diversified and risk-conscious approach."

ENDS

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