FTfm Global alternatives survey

In association with Towers Watson

Pension funds press forward on alternative route

Overview

Trend illustrates a growing comfort with the asset class, says **Emma Boyde**

Pension funds, those stalwarts of conservative investment, are continuing to move into alternative assets faster than any other kind of investor, according to data gathered in 2012.

The 2013 Global Alternatives Survey by Towers Watson, the consultancy, in association with FTfm, shows pension fund assets held by the top 100 asset managers that deal with pension funds increased by 8 per cent, from $1.23tn in 2011 to $1.33tn in 2012. This compares with a slight fall of less than 1 per cent from $3.14tn to $3.11tn in alternative assets held by the top 100 managers who deal with all kinds of investors.

Craig Baker, global head of investment research at Towers Watson, says the continued movement by pension funds into alternatives was a continuation of a trend that started many years ago. He points out that in 1995 pension funds allocated only 5 per cent of their assets to alternatives. That figure has now grown to 19 per cent, according to the consultancy's latest global pensions asset study.

As it did in 2011, Towers Watson decided to expand its analysis in 2012 to include data from new types of investor. The survey previously only probed the investment preferences of pension funds.

"We have always asked managers to report total assets under management and, as compared with last year, it has remained relatively stable, with pension funds accounting for about a third of total assets under management," says Luba Nikulina, global head of private markets research.

Last year Towers Watson attempted to fill in some blanks by asking asset managers, for the first time, to reveal data about assets held on behalf of insurance companies, sovereign wealth funds and endowments.

In addition, this year the survey investigated wealth managers, banks and funds of funds for the first time. This yielded a large part that had been missing from the jigsaw. Wealth managers, it transpires, are the second-largest investor type after pension funds, accounting for 19 per cent of assets held by the top 100 managers.

"I wouldn't expect the wealth managers to significantly grow in importance relative to other investor types, because the increase we have seen in allocations from pension funds and other large institutional investors would lead us to believe that wealth managers' share will either remain static or decline," says Ms Nikulina.

Amin Rajan, chief executive of Create Research, a consultancy, agrees. "Wealth managers used to account for more than 50 per cent of global alternatives investment pre-2007," he says, adding that subsequent losses during the time of the financial crisis led to some withdrawals from alternative asset classes. He says he has seen a revival of interest in Asia and the US.

The survey, which reveals an ever more complete picture of investor preferences, yields some data that stand out. For example, most investors have either very little or no exposure to direct commodities funds, but wealth managers allocated 22 per cent of their assets to this class.

"This is a big surprise," says Mr Rajan. "But I suspect the figure is focused on gold held by Asian wealth managers, especially in India."

Considering all types of investors looked after by the top 100 alternative asset managers, direct real estate funds remained the most popular investment, accounting for 34 per cent of assets under management. This was followed by direct private equity funds (23 per cent), direct hedge funds (20 per cent) and private equity funds of funds (10 per cent). Funds of hedge funds accounted for only 6 per cent and direct commodities and infrastructure funds for 4 per cent of assets each.

Despite the continued dominance of investment in direct real estate funds, a theme that emerged in previous surveys, the underlying tale is one of a slight decline in interest in this asset class.

"We see growth everywhere in all asset types, apart from real estate, which is the only one to see a decline in absolute terms, with a decrease of 4 per cent in terms of assets held by the top 100 managers," says Ms Nikulina.

Also notable is the growth of infrastructure assets, particularly those managed on behalf of pension funds. They grew 14 per cent, on a like-for-like basis (when you include only those managers who were present in the ranking on both surveys), during 2012. It was driven largely by allocations to European infrastructure, says Ms Nikulina, adding this indicated that European infrastructure projects were set up more favourably for investors than elsewhere in the world.

For those hoping the survey would reveal more about the behaviour of sovereign wealth funds, the data continue to disclose very little. "If you look at how much they represent in the total universe of managers surveyed, they are at 5 per cent, which intuitively seems low," says Mr Baker. (The total universe of managers this year numbers 578, representing $5.1tn in assets under management, up from 493 managers surveyed last year.)

"Relative to pension funds, sovereign wealth funds don't need to have an enormous book of bonds," says Mr Baker, adding that, anecdotally, he knows more sovereign wealth funds are thinking about diversifying into alternatives than they have been.

Also, although Towers Watson has not included alternative assets held on behalf of banks before, Mr Baker thinks the total and the share of total global alternatives investment is probably smaller than it used to be.

"We're expecting banks' allocations to alternatives to continue to go down unless there's a change in the regulatory environment." Capital ratio requirements stipulated under Basel III mean banks have had to triple the size of capital reserves they must hold against losses. Regulations also specify what kind of assets banks are allowed to hold and how liquid they must be.

> 'This confidence has been shown by the decline in relative popularity of funds of funds'

The research, which this year runs to almost 100 pages, reveals a growing confidence in alternative assets. This has been shown by the decline in relative popularity of funds of funds over the years, particularly funds of hedge funds.

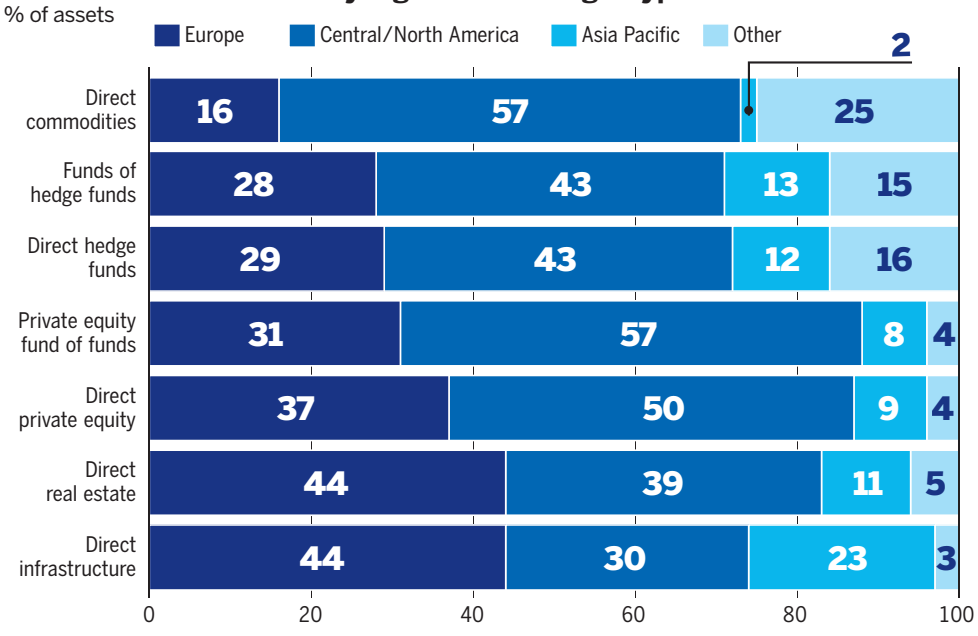
"Anecdotally, we know there's a shift from commingled funds of funds to direct investment in hedge funds and private equity funds," says Mr Baker.

He adds that many investors ask funds of funds to run separate accounts for them, which would still show as a funds of funds choice in this survey. Increasingly, investors are making choices about direct funds themselves, and not just because it is cheaper to do so.

"There is a greater awareness of fees, but also a number of investors are generally getting more comfortable with these asset classes," says Mr Baker.

Pension fund investment by region and manager type

% of assets



Pension assets under management by alternative investment managers

End Dec 2012 ($bn)

Manager type	Pension assets under management	Total assets under management	Pension assets under management (as % of total)
Top 100	**1,328.2**	**2,499.9**	**53.1**
Fund of hedge funds (top 25)	**139.8**	**308.7**	**45.3**
Direct hedge funds (top 25)	**173.8**	**435.4**	**39.9**
Private equity FoF (top 25)	**278.8**	**440.6**	**63.3**
Direct private equity funds (top 25)	**226.3**	**545.7**	**41.5**
Direct real estate funds (top 25)	**475.6**	**837.8**	**56.8**
Direct commodities funds (top 25)	**51.0**	**199.2**	**25.6**
Direct infrastructure funds (top 25)	**163.4**	**251.2**	**65.0**

Source: Towers Watson

Top 20 managers of alternative investments for pension funds

Parent company	Pension AUM ($m)	Total alt AUM ($m)	Pension AUM (as a % of total)
Blackstone Group	**72,811.3**	**152,329.2**	**47.8**
Macquarie Group	**69,185.3**	**110,848.1**	**62.4**
JP Morgan Chase	**52,899.5**	**110,280.8**	**48.0**
Bridgewater Associates	**50,658.0**	**84,042.0**	**60.3**
CBRE Holding	**44,400.0**	**80,000.0**	**55.5**
Carlyle Group	**43,806.1**	**97,367.5**	**45.0**
Credit Suisse Group	**42,748.9**	**110,879.0**	**38.6**
TIAA-CREF	**40,903.7**	**41,680.4**	**98.1**
UBS	**36,646.5**	**112,135.1**	**32.7**
BlackRock	**34,435.7**	**146,388.6**	**23.5**
Prudential	**34,062.2**	**68,493.6**	**49.7**
Deutsche Bank	**33,885.4**	**76,933.0**	**44.0**
Brookfield Asset Management	**29,146.3**	**82,846.9**	**35.2**
LaSalle Investment Management	**26,450.0**	**47,700.0**	**55.5**
Kohlberg Kravis Roberts	**25,970.3**	**56,892.9**	**45.6**
Goldman Sachs	**25,707.0**	**163,893.2**	**15.7**
Morgan Stanley	**25,365.2**	**69,434.3**	**36.5**
Allianz	**24,151.6**	**49,111.3**	**49.2**
Heitman	**23,621.0**	**26,258.0**	**90.0**
BT Pension Scheme Mgmt	**20,692.9**	**23,007.4**	**89.9**

Source: Towers Watson

Figures compiled from individual entries for each asset class so there is scope for misinterpretation or error

Investors build on the diversity of the property market

Real estate

The sector is experiencing a resurgence at the high- and low-risk ends of the market, says **Ed Hammond**

In spite of being maligned for causing the financial crisis, property has once again emerged as the must-have asset class for the world's largest investors as they seek to boost returns in the low interest rate environment that has marked the past year.

Real estate accounted for more than a third of the total assets under management by the world's 100 largest asset managers, according to a survey of the investment industry by Towers Watson, the consultancy.

The figure, down fractionally on a year earlier, suggests the property sector is likely to be as central to the recovery of the financial market as it was to its downfall.

However, far from piling into the safest pockets of the market, investors have spread their spending through a wide spectrum of assets and are increasingly diverse in their tastes. Sub-sectors such as student housing, industrial property and social housing are all enjoying periods of sustained interest.

"One of the key factors behind the heavy allocation that goes into property is the breadth of the market," says Paul Jayasingha, head of real estate research at Towers Watson.

The size of the investable commercial property market was $26.6tn at the end of 2011, according to figures from Prudential Financial. At the same date, the size of the entire equity market was around $27.1tn.

"It goes right the way from the super low-risk stuff that gives bond-like returns of 4-6 per cent, such as ground rents, right the way to high-risk speculative development that generates private equity returns of 20 per cent," Mr Jayasingha says.

He adds that a lot of pension funds have gravitated towards direct ownership of property because it is tangible and lacks some of the complexities of other asset classes.

Perhaps the defining trend in the global property market during the past five years has been a lack of debt capital. The banks, badly hurt by their overexposure to the sector when the markets turned in 2008, have slashed lending secured against property and, even then, are reluctant to finance anything but the lowest-risk investments.

The impact of the retrenchment has been two-fold. First, many property investors, especially those who depended heavily on leverage or those operating at the high-risk end of the sector, have been ruled out of the market.

The second, more recent, consequence has been the entry into the lending market of a host of new sources of capital, ranging from insurers to specialist debt funds and pension funds.

Insurers, as well as pension funds and some long-term debt funds, are predisposed to holding long-dated loans to match their liabilities. In addition, insurers and pension funds are more likely to structure loans with fixed rates of interest and clauses to discourage early repayment.

The shortage of bank lending is likely to worsen further as regulatory changes being swept in under Basel III – the third accord in a sequential improvement of global banking regulation – force banks to hold more capital against loans secured on property.

David Skinner, chief investment officer of real estate at Aviva Investors, says the amount of property debt still held by banks will act as a drag on capital value growth over the medium term. "Some sectors of the UK real estate market will be significantly more impacted than others, however, as banks have more exposure to secondary and tertiary property loans [and more of these loans are troubled]," he adds.

Other large real estate investors argue that money will continue to flow into bricks and mortar as long as volatility and low returns continue to afflict the wider market. Already investors are seeking out esoteric sub-sectors in a bid to further their exposure and, in doing so, are helping to rejuvenate areas of the market that fell foul of the financial crisis, such as warehouses.

"Real estate is popular at the moment because people are looking at the alternatives and seeing a lot of risk and volatility in the equity markets and minimal returns in the fixed income space," says Simon Redman, managing director at Invesco Real Estate.

"However, some new investors are coming into the market and looking at it as a proxy for bonds. It is a mistake to do so. Property is too broad and cannot be boxed into performing like one thing or another; it has some of the characteristics of bonds, but a lot of it also behaves very differently," Mr Redman adds.

Investors are seeking out sub-sectors such as student housing, industrial property, such as warehouses, and social housing Alamy

> 'Many pension funds have gravitated towards direct ownership of property because it is tangible'
>
> **Paul Jayasingha, Towers Watson**

Top 50 real estate fund managers ranked by pension fund assets under management

Management group	Main country of domicile	Pension AUM ($m) 2012	Pension AUM ($m) 2011	% change	Total 2012 AUM ($m)	Pension AUM (as a % of total)
CBRE Global Investors	US	44,400.0	53,800.0	-17.5	80,000.0	55.5
Prudential Real Estate Investors	US	32,516.8	22,916.8	41.9	38,133.0	85.3
TIAA-CREF	US	32,086.3	new	new	32,773.9	97.9
J.P. Morgan Asset Management	US	29,442.0	27,301.5	7.8	34,206.0	86.1
LaSalle Investment Management	US	26,450.0	25,730.0	2.8	47,700.0	55.5
Deutsche Asset & Wealth Management	US	24,929.0	27,140.4	-8.1	48,727.0	51.2
Blackstone Real Estate Partners	US	24,739.1	n/a	new	50,427.1	49.1
Heitman	US	23,621.0	22,910.0	3.1	26,258.0	90
UBS Global Asset Management	UK	23,511.2	20,588.6	14.2	65,036.6	36.2
Principal Global Investors	US	19,554.1	22,806.3	-14.3	36,873.9	53
Brookfield Asset Management	Canada	19,330.0	14,975.9	29.1	65,163.0	29.7
Credit Suisse Asset Management	US	18,352.0	new	new	41,907.8	43.8
Invesco	US	18,129.2	17,672.6	2.6	30,544.7	59.4
Bentall Kennedy	Canada	17,815.0	new	new	18,230.6	97.7
Morgan Stanley	US	15,030.0	22,798.0	-34.1	41,271.0	36.4
AMP Capital Investors	Australia	14,941.9	12,896.6	15.9	22,611.9	66.1
Aberdeen Asset Management	UK	14,661.2	16,654.0	-12	26,443.6	55.4
Clarion Partners	US	13,182.3	new	new	17,188.7	76.7
AEW Capital Management	US	12,154.0	19,407.1	-37.4	34,769.1	35
Henderson Global Investors	UK	9,593.0	9,225.1	4	20,353.0	47.1
Bouwinvest Real Estate Inv Mgmt	The Netherlands	8,924.4	7,387.0	20.8	8,924.4	100
Standard Life Investments	UK	8,720.5	9,350.8	-6.7	16,620.2	52.5
Legal & General Investment Mgmt	UK	8,210.0	9,638.0	-14.8	16,008.3	51.3
Hermes Real Estate Investment Mgmt	UK	7,825.5	7,647.0	2.3	8,190.4	95.5
BlackRockilien	UK	7,504.5	10,664.3	-29.6	9,479.9	79.2
DTZ Investment Management	UK	6,685.0	6,515.6	2.6	11,298.0	59.2
PIMCO	US	6,177.9	new	new	11,373.3	54.3
Lend Lease Group	Australia	5,975.0	5,062.0	18	10,329.0	57.8
QIC	Australia	5,863.5	5,597.3	4.8	8,309.5	70.6
Aviva Investors	UK	5,760.7	5,530.8	4.2	37,303.8	15.4
Cornerstone Real Estate Advisers	US	5,745.2	5,884.2	-2.4	41,016.6	14
Hines	US	5,606.9	6,531.4	-14.2	16,135.1	34.7
Schroders Investment Management	UK	5,484.7	6,168.0	-11.1	11,796.6	46.5
Threadneedle Investments	UK	5,084.3	3,174.0	60.2	8,637.5	58.9
Charter Hall Group	Australia	4,857.0	5,655.7	-14.1	10,075.0	48.2
The Bank of New York Mellon	US	4,754.0	4,519.7	5.2	7,641.2	62.2
Macquarie Group	Australia	4,560.8	4,018.6	13.5	9,162.4	49.8
Partners Group	Switzerland	4,156.0	3,226.0	28.8	5,090.0	81.7
GE Asset Management	US	3,757.6	3,844.4	-2.3	3,875.4	97
Prologis	US	3,719.6	5,862.9	-36.6	9,976.3	37.3
MGPA	Bermuda	3,645.5	5,963.3	-38.9	6,785.0	53.7
M3 Capital Partners	US	3,400.0	2,900.0	17.2	3,400.0	100
Orchard Street Investment Mgmt	UK	3,395.0	2,766.0	22.7	5,001.0	67.9
AXA Real Estate	France	3,309.1	2,973.4	11.3	65,453.5	5.1
EII Capital Management	US	3,308.0	1,812.0	82.6	11,376.0	29.1
SWIP	UK	3,224.5	3,313.5	-2.7	12,129.0	26.6
The GPT Group	Australia	3,159.8	2,720.0	16.2	5,555.4	56.9
Angelo, Gordon & Co.	US	2,660.0	2,555.0	4.1	5,479.0	48.5
AREA Property Partners	US	2,538.5	new	new	6,701.3	37.9
PATRIZIA Immob	Germany	2,300.0	new	new	9,000.0	25.6

Source: Towers Watson

Death of the 'supercycle' exaggerated

Commodities

Interest among many big investors remains healthy, writes **Chris Flood**

An air of gloom appears to have descended on commodity markets. Gold, copper and iron ore prices have tumbled sharply from their post-financial crisis highs while returns to investors have proved disappointing.

The S&P GSCI, the most widely followed commodities benchmark, has delivered a -8.9 per cent total return over the two years to June 30.

Amid concerns about a possible slowdown in demand growth in China, the once popular theory that commodity markets would enjoy a "supercycle" of prolonged growth has been declared dead.

But interest among many institutional investors remains healthy, according to leading commodity managers. "We are seeing tremendous interest in commodities from a wide range of investors that want to enlarge their current holdings or to make new allocations," says Jonathan Berland, managing director at Gresham, a specialist commodities manager with $16bn in assets.

Mr Berland describes predictions of an end to the commodity supercycle as "overdone" as absolute levels of global demand for many commodities have continued to rise.

The recent rise in US bond yields points to an inflection point for interest rates that had implications for all asset markets, says Mr Berland. He adds: "The Fed has not had to sell $1 from its balance sheet and yet bond yields have risen and equities have fallen."

Ahead of that inflection point for yields, sophisticated investors have been looking at commodities as an asset class that offers better value in a world where both equities and bonds looked expensive, says Mr Berland.

The top 10 commodity managers saw a 8.5 per cent increase in pension fund assets under management to $41.7bn in 2012, according to Towers Watson, a professional services company.

BNP Paribas was a notable gainer after wining a mandate increase from one of Europe's largest pension funds.

Alasdair MacDonald, head of investment strategy at Towers Watson, says commodities still have an important role to play in portfolio diversification but disappointing returns in recent years have reduced their attraction as an investable asset class.

Mr MacDonald says that last year's announcement by Calpers, the biggest US pension fund, that it had reduced its allocation to commodities was raising questions among other investors about their own commodity-related investment strategies.

But Bob Greer, real return product manager at Pimco, says talk that institutional investors were withdrawing from commodities were, "like the premature reports of Mark Twain's death, 'greatly exaggerated'".

"We have seen more institutional investors, pension funds in particular, making allocations to commodities over the past six months," says Mr Greer.

Even relatively slow growth in China and other emerging markets would still lead to growing demand for commodities, says Mr Greer.

He points out that mandates are usually awarded only after lengthy evaluations, so institutional investors viewed their commodity investments as strategic long-term commitments.

"The fundamental reasons for investing in commodities: to obtain portfolio diversification and as an inflation hedge are still relevant," says Mr Greer.

He adds that although headline inflation rates might be low, investors were still concerned that inflationary pressures could rise in the future.

Hakan Kaya, portfolio manager at Neuberger Berman, says true long-term investors realised that the slowdown in China is likely to be temporary and that periods of drawdowns (falling prices) for commodities were to be expected.

Mr Macdonald said that institutional investors were paying more attention to implementation issues and showing greater interest in "smarter" approaches that could minimise the drags and costs that had weighed on the widely followed commodity indices.

According to Mr Kaya interest in passive investment strategies had diminished in favour of more nimble active managers who could exploit sectoral shifts and dislocations to generate alpha tactically.

Mr Greer believes that while investors still view the main commodity indices as representing the returns of the asset class, there is growing demand for active strategies that will outperform those benchmarks.

Mr Kaya claims passive investment strategies in commodity markets are increasingly viewed as "counterintuitive, risky and costly". He adds that sophisticated investors want risk-managed diversified strategies that would reduce drawdowns.

Top 10 commodities managers ranked by pension fund

Management group	Pension AUM ($m) 2012	Pension AUM ($m) 2011	Pension AUM (as a % of total)
PIMCO	11,775.7	10,691.3	41.7
Gresham Investment Management	7,597.9	6,738.0	47.6
Schroders Investment Management	4,678.2	4,395.9	51.3
BlackRock	3,330.9	5,200.0	4.5
Diapason Commodities Management	3,235.0	3,485.8	45.2
Credit Suisse Asset Management	2,897.8	2,780.0	26.2
CoreCommodity Management	2,646.0	919.4	56.2
Wellington Management Company	2,273.0	1,769.0	34.7
Investec Asset Management	1,679.7	1,943.1	32.7
THEAM/BNP Paribas Inv Partners	1,579.4	496.9	44.9

Source: Towers Watson

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FTfm – Global alternatives survey

Funds of funds falter in battle for survival

Private equity

Investors are being scared off a once thriving sector by high fees and low returns, writes **Ellen Kelleher**

A wave of consolidation is knocking out the feeblest private equity funds of funds as investors desert them to seek out more rewarding investments.

The survey by Towers Watson, the consultancy, suggests fierce winds are buffeting a number of private equity houses, forcing them to reposition their businesses to survive in an environment Charles Darwin would approve of.

And some analysts report that the fallout from the industry's difficulties on the funds of funds that back promising private equity funds, is more dire still.

Indeed, their fundraising efforts are being met with a lukewarm reception as institutional investors grow even more sceptical about funds of funds than they are about direct private equity funds.

So far this year, private equity funds of funds have raised just $6.1bn, while direct PE funds have brought in $152.6bn, according to the latest figures from Preqin, the research house.

Managers of pension funds still maintain some interest in private equity funds of funds, however. About $261bn of the $1,3tn in pension fund assets managed by the 100 alternative asset managers polled by Towers Watson was stuffed into private equity funds of funds; indeed, private equity funds of funds still ranked as the second most popular alternative asset after real estate funds.

Mark Calnan, global head of private equity with Towers Watson, notes that investors are favouring the brightest stars in the sector as they pare down the number of funds of funds they invest in. They are also looking to put money in customised separate accounts more frequently to reduce their costs.

"The nature of the fundraising market has been tough for the last few years and it's just as challenging for funds of funds as it is for direct funds," notes Mr Calnan.

"It's a very tough market. There has been a clear bifurcation of winners and losers in the market."

Guochuang Kaiyan Fund of Funds, the HarbourVest Partners IX Buyout Fund and Abbott Capital Private Equity Fund VII rank among the largest PE funds of funds on the market. Together, the three vehicles account for 11 per cent of all capital being targeted by private equity funds of funds, according to Preqin.

The study by Towers Watson reveals that Credit Suisse Asset Management, Partners Group, Hamilton Lane Advisors, JPMorgan Asset Management and Pantheon also rank high on the list of houses with the most assets in private equity funds of funds.

Consolidation on the horizon: Groupama, a French insurer, is selling its private equity fund of funds division to ACG Group. It is just one of a number of recent mergers in the sector AP

'It's a very tough market. There has been a clear bifurcation of winners and losers'

It was once the case that the role of funds of funds in the private equity sector was pivotal. As they require less capital upfront, they offer limited partnerships and other investors the chance to offer smaller commitments and still gain exposure to some of the strongest performing funds in the sector. Managers of funds of funds also provide expertise to inexperienced investors keen to expose their portfolios to a range of PE strategies.

However, with investment returns sluggish across most sectors, investors are scared off by the high fees private equity funds of funds carry.

As well as paying the funds "2 and 20" – 2 per cent annual management fee and 20 per cent of profits – the funds of funds take another 5 or 10 per cent profit on top of their own management fee of about 1 per cent.

"Some investors are so intimidated by fees that they are favouring separate accounts as they can be a bit cheaper for slightly larger mandates," adds Mr Calnan. "They also give clients more input into what goes into the portfolio."

For proof that the PE funds of funds sector is in the throes of consolidation, look no further than the recent bevy of merger activities. The start of the year brought news that Groupama, a French insurer, would sell its private equity fund of funds division, Groupama Private Equity, to ACG Group, which would in turn create a new company called ACG Capital. A month later, Aberdeen Asset Management bought a majority stake in SVG Advisers, the PE fund of funds manager, and merged it with its own private equity business to create a fund of funds manager with as much as £5bn.

Lastly, in May, managers with Partners Group, the big Swiss house, revealed they had reached a deal to integrate their operations with Perennius Capital Partners, the Italian private equity fund of funds manager. That same month, Natixis also bolstered its portfolio of private equity fund of fund managers when it took a majority stake in Euro Private Equity, the Swiss fund of funds manager. Equity will remain independent of the other fund of funds managers Natixis owns, which include Caspian Private Equity, Dahlia Partners and Eagle Asia Partners.

The nature of the deals being conducted suggests that investment houses are putting their efforts into achieving scale in the fund of funds business to improve the strength of their offerings. But PE funds of funds remain a difficult sell at a time when investors are cutting down their exposure to private equity, according to their critics, as their returns on average still fail to match those of direct PE funds.

In the 10 years to last December, for example, private equity funds on average provided an annualised return of 17.9 per cent, with buyout funds performing best, at 24.3 per cent. Private equity funds of funds, meanwhile, returned just 8.6 per cent a year, according to Preqin.

Top 25 private equity fund of funds managers ranked by pension fund AUM

Management group	Main country of domicile	Pension AUM ($m) 2012	Pension AUM ($m) 2011	% change	Total 2012 AUM ($m)	Pension AUM (as a % of total)
AlpInvest Partners	The Netherlands	43,806.1	40,797.0	7.4	44,029.5	99.5
HarbourVest Partners	US	20,514.0	21,873.0	-6.2	32,163.0	63.8
Credit Suisse Asset Management	US	18,146.8	21,751.4	-16.6	27,740.8	65.4
Pantheon	UK	17,973.0	18,090.0	-0.6	23,456.0	76.6
Hamilton Lane Advisors	US	16,149.6	14,833.0	8.9	23,814.6	67.8
Adams Street Partners	US	15,455.8	15,776.9	-2.0	17,821.0	86.7
Partners Group	Switzerland	14,753.0	12,294.0	20.0	24,579.0	60.0
J.P. Morgan Asset Management	US	14,562.0	14,238.0	2.3	23,700.0	61.4
LGT Capital Partners	Switzerland	12,662.9	9,385.2	34.9	19,891.2	63.7
Goldman Sachs Asset Management	US	11,857.4	11,662.9	1.7	39,196.7	30.3
Pathway Capital Management	US	10,555.7	9,746.1	8.3	11,336.4	93.1
SL Capital Partners	UK	8,114.1	8,033.9	1.0	8,299.1	97.8
Lexington Partners	US	7,983.1	new	new	12,281.7	65.0
Portfolio Advisors	US	7,941.2	5,099.9	55.7	10,342.8	76.8
Abbott Capital Management	US	6,567.5	6,224.8	5.5	7,732.9	84.9
AXA Private Equity	France	6,396.2	5,379.6	18.9	22,397.8	28.6
Coller Capital	UK	5,797.0	new	new	11,014.0	52.6
Capital Dynamics	Switzerland	5,653.4	1,845.9	206.3	16,286.9	34.7
Siguler Guff & Company	US	5,601.6	5,282.5	6.0	9,125.5	61.4
BlackRock	UK	5,195.0	2,808.0	85.0	14,772.0	35.2
Hermes GPE LLP	UK	5,096.3	new	new	5,945.0	85.7
Morgan Stanley	US	4,898.8	3,977.5	23.2	9,695.0	50.5
Landmark Partners	US	4,640.9	4,109.2	12.9	7,113.9	65.2
Neuberger Berman	US	4,293.1	3,269.3	31.3	13,115.6	32.7
Grove Street Advisors	US	4,232.6	new	new	4,761.4	88.9

Top 25 private equity managers ranked by pension fund AUM

Management group	Main country of domicile	Pension AUM ($m) 2012	Pension AUM ($m) 2011	% change	Total 2012 AUM ($m)	Pension AUM (as a % of total)
Blackstone Capital Parters	US	26,099.0	24,209.0	7.8	57,090.0	45.7
Oaktree Capital Management	US	19,080.9	19,021.1	0.3	41,208.5	46.3
Kohlberg Kravis Roberts	US	19,000.0	18,000.0	5.6	45,200.0	42.0
Apax Partners	UK	16,328.9	16,196.2	0.8	35,497.6	46.0
Advent International	US	14,851.5	10,605.3	40.0	35,062.0	42.4
Riverstone Holdings	US	13,741.9	6,039.4	127.5	34,354.7	40.0
CVC Capital Partners	Luxembourg	12,683.8	14,904.0	-14.9	30,127.4	42.1
Providence Equity Partners	US	11,598.2	9,931.0	16.8	24,813.0	46.7
First Reserve	US	10,904.5	11,359.6	-4.0	15,798.0	69.0
GE Asset Management	US	9,116.4	7,203.8	26.5	9,170.6	99.4
Cinven	UK	8,365.7	new	new	16,672.2	50.2
Warburg Pincus	US	7,633.8	7,000.0	9.1	38,169.0	20.0
Bridgepoint	UK	6,920.0	n/a	new	12,060.0	57.4
Bain Capital	US	6,900.0	6,140.3	12.4	37,250.0	18.5
TIAA-CREF	US	5,996.2	new	new	6,056.8	99.0
BC Partners	UK	5,051.2	4,950.0	2.0	16,837.3	30.0
Welsh, Carson, Anderson & Stowe	US	4,146.4	9,806.0	-57.7	9,453.8	43.9
EQT Private Equity Funds	UK	4,072.0	3,869.9	5.2	20,021.0	20.3
Permira	UK	4,005.6	new	new	11,021.8	36.3
GTCR	US	3,683.9	new	new	6,970.4	52.9
Angelo, Gordon & Co.	US	3,484.0	3,330.0	4.6	8,163.0	42.7
Lion Capital	UK	3,476.2	3,405.5	2.1	5,718.7	60.8
Energy Capital Partners	US	3,351.2	3,115.0	7.6	7,813.9	42.9
Nordic Capital	UK	3,035.1	new	new	10,465.8	29.0
Clayton, Dubilier & Rice	US	2,792.0	2,994.9	-6.8	10,745.0	26.0

Source: Towers Watson

Core projects give challenging asset class more appeal

Infrastructure

Opportunities are increasing but hard regulatory terrain still needs to be negotiated, writes **Madison Marriage**

Institutional investors with long-term liabilities are increasingly looking for infrastructure exposure offering inflation protection and stable yields. However, accessing the sector remains a challenge.

This could change as the asset class matures; cash-strapped governments seeking private funding in public infrastructure to help their faltering economies have increased the number of investment opportunities.

The number of companies providing infrastructure funds is also on the rise: Germany's Allianz Global Investors, BlackRock, the US fund giant, and the European arm of IFM, an Australian infrastructure specialist, are just some of the groups to have established infrastructure debt platforms in the past 12 months.

Historically, however, a large proportion of flows have been funnelled into the world's largest infrastructure managers, creating a winner-takes-all dynamic whereby the big funds get bigger and small funds get wound down or bought out.

About 80 per cent of new infrastructure capital went to the top seven managers globally last year, while a number of managers that struggled to raise funds were squeezed out.

Pension fund assets of the nine largest direct infrastructure funds, meanwhile, increased by around 14 per cent in 2012.

Duncan Hale, senior investment consultant at Towers Watson, the consultancy, adds that many infrastructure funds that raised capital in a more benign environment in 2008 could struggle to do so for a second time, which could prompt some of the larger companies to adopt "orphaned funds".

There is consensus that as infrastructure investment is a relatively young industry compared with private equity and property, there are opportunities for the increasing roster of groups hoping to develop their fledgling infrastructure businesses.

Boe Pahari, head of infrastructure Europe and North America at AMP Capital, an Australian investment house, believes large global fund managers are likely to "keep getting larger", but that there is still room for small managers with niche expertise in areas such as US transportation or renewable energy to grow.

And while historically only large institutions in the US, Australia and Canada pursued infrastructure investment, a range of investors around the world have begun to consider it.

In July the Kuwait sovereign wealth fund announced plans to spend £5bn on infrastructure investment in the UK, while one of the largest Japanese pension funds joined forces with a consortium of investors to buy a $2bn electricity plant in Michigan – the first infrastructure acquisition by a Japanese public pension fund.

Chris Wrenn, co-head of European infrastructure debt at BlackRock, says that as banks no longer want to provide long-term infrastructure financing, institutions, in particular European insurers and pension funds, have started to plug the gap.

Large global fund managers are likely to 'keep getting larger', but that there is still room for small managers with niche expertise in areas such as renewable energy to grow Bloomberg

Funds of funds and endowments are also understood to be gaining awareness of the asset class.

Investors are now warming to the asset class. Until recently, infrastructure exposure mainly involved high-risk investments in, for example, energy companies, Mr Hale says.

Now, however, core infrastructure investments such as regulated utilities or roads are increasingly accessible, broadening the appeal of the asset class.

In addition, the architects of infrastructure projects now approach leverage more cautiously than they did before the financial crisis.

Leverage levels have dropped from about 50 per cent in 2008 to 40 per cent today, Mr Hale says, encouraging more public pension plans to embrace the asset class.

The leverage used to finance large infrastructure projects has also become less complex. "A lot of infrastructure assets used to be funded on five-year bank debt, but now [funds] are going to capital markets for 20- to 30-year bonds and locking in debt over a long period of time," Mr Hale says.

Ian Berry, an infrastructure fund manager at Aviva Investors, acknowledges rising institutional interest in infrastructure, but says many institutions have held back on investing due to concerns about how regulation, such as Solvency II measures for the insurance industry, will affect their investments.

> 'There will be greater institutional investment in infrastructure as it evolves into something that people must do'

He says: "It is widely recognised that regulatory constraints make it more difficult to invest long term. The odd $100m deal makes the headlines, but it shouldn't – there should be multibillion deals or dozens of $100m deals."

BlackRock's Mr Wrenn agrees that "the changing regulatory landscape has been something of an impediment [to infrastructure investment] over the past 24 months". However, he adds that he has recently observed institutions displaying "much more determination to proceed with an [infrastructure] investment strategy" despite these concerns.

Some institutional investors are held back from investing due to their under-developed due diligence resources, Mr Hale says. Despite observing a "great rush" from institutional investors to co-invest in infrastructure projects, he says their corporate governance frameworks are often ill equipped to assess specific assets, causing them to balk at the final stages of the investment process.

However, large institutions are currently in the process of bulking up their internal investment teams with infrastructure specialists.

"This is an inflection point," Mr Hale says. "There will be greater institutional investment in infrastructure as it evolves into something that people must do, not just something that they want to do."

Top 25 direct infrastructure ranked by pension fund AUM

Management group	Main country of domicile	Pension AUM ($m) 2012	Pension AUM ($m) 2011	% change	Total 2012 AUM ($m)	Pension AUM (as a % of total)
Macquarie Group	Australia	**63,076.0**	**59,069.5**	**6.8**	**94,845.7**	**66.5**
Industry Funds Management	Australia	**10,768.0**	**10,151.8**	**6.1**	**12,532.0**	**85.9**
Brookfield Asset Management	Canada	**8,709.6**	**5,662.3**	**53.8**	**14,420.0**	**60.4**
Deutsche Asset & Wealth Mgmt	UK	**8,000.0**	**6,798.8**	**17.7**	**17,073.0**	**46.9**
Alinda Capital Partners	US	**7,307.4**	**6,820.4**	**7.1**	**8,383.8**	**87.2**
Global Infrastructure Partners	US	**7,179.2**	**3,590.5**	**100.0**	**15,707.7**	**45.7**
Goldman Sachs	US	**6,081.0**	**6,080.6**	**0.0**	**10,700.0**	**56.8**
AMP Capital Investors	Australia	**5,335.7**	**5,377.2**	**-0.8**	**6,837.8**	**78.0**
Hastings Funds Management	Australia	**5,325.3**	**3,749.0**	**42.0**	**8,461.5**	**62.9**
JPMorgan Asset Management	US	**4,142.0**	**2,896.0**	**43.0**	**5,428.0**	**76.3**
Hermes GPE	UK	**4,056.0**	**new**	**new**	**4,056.0**	**100.0**
RARE Infrastructure	Australia	**3,969.0**	**1,587.8**	**150.0**	**5,745.4**	**69.1**
Colonial First State Global Asset Mgmt	Australia	**3,671.5**	**2,911.0**	**26.1**	**4,972.6**	**73.8**
Access Capital Advisers	Australia	**3,048.5**	**3,242.4**	**-6.0**	**3,048.5**	**100.0**
QIC	Australia	**3,041.1**	**7,381.8**	**-58.8**	**9,646.4**	**31.5**
SteelRiver Infrastructure Partners	US	**2,562.9**	**2,337.2**	**9.7**	**4,288.7**	**59.8**
Morgan Stanley	US	**2,402.0**	**2,637.0**	**-8.9**	**3,562.0**	**67.4**
Kohlberg Kravis Roberts	US	**2,368.5**	**1,765.5**	**34.2**	**2,759.3**	**85.8**
Innisfree	UK	**2,109.3**	**1,826.0**	**15.5**	**2,777.5**	**75.9**
Partners Group	Switzerland	**2,091.0**	**1,179.0**	**77.4**	**2,490.0**	**84.0**
EQT Infrastructure & EQT Infr II	UK	**2,064.0**	**390.7**	**428.3**	**4,094.0**	**50.4**
Magellan Asset Management	Australia	**1,843.7**	**1,339.0**	**37.7**	**2,190.9**	**84.2**
Arcus Infrastructure Partners	UK	**1,586.6**	**1,512.3**	**4.9**	**1,624.0**	**97.7**
InfraRed Capital Partners	UK	**1,362.0**	**591.0**	**130.5**	**4,255.0**	**32.0**
TIAA-CREF	US	**1,275.0**	**new**	**new**	**1,287.9**	**99.0**

Source: Towers Watson

Funds focus on goal of stability

Hedge funds

Demand for low volatility is the big challenge, writes **Sam Jones**

There is increasing pressure on the hedge fund industry to justify its existence.

With a volatile macroeconomic climate showing no signs of calming – and big, long-term questions pressing over allocations to both equities and bonds – institutional investors have never been in greater need of a diversified, low-volatility compliment to their portfolios.

The challenge for hedge funds, many now equally pressured by the unforgiving investing climate, is to fulfil that mandate.

Post-2008 has hardly been a golden period: according to HFR, the research house, the average hedge fund manager has returned just 34 per cent in the past four years. Much of that is attributable to a 20 per cent return in 2009 as global assets rallied.

While hedge funds could therefore make some claims of value for institutions in the midst of the crisis, when the average manager lost just 20 per cent compared with far steeper drawdowns for long-only managers, their sales pitch is beginning to look stale in the years that have followed.

As the annual Towers Watson/Financial Times Global Alternatives survey shows, allocations from leading institutional investors remain stable, but are showing signs of having slowed – if only, perhaps, temporarily.

"At the current time, directional developed fixed income markets are offering negative real interest rates, and institutional investors, like all investors, need to have a part of their portfolio that generates relatively stable returns in excess of inflation. Hedge funds can do this," says Craig Wallis, head of marketing at GAM, the hedge fund and fund of fund manager.

> 'Assets in hedge funds have been going up and the distribution of those assets has been changing'

Hedge funds remain in third place among alternative asset managers, behind real estate and private equity, according to the survey, with just under $800bn of the $3tn of assets captured by surveyed managers.

The biggest have become bigger. Allocations to funds of funds that appeared in the top 100 managers in 2011 increased by more than 6 per cent, while allocations to single-name hedge fund managers rose by more than 4 per cent.

"Assets in hedge funds have been going up and the distribution of those assets has been changing," says Damian Loveday, global head of hedge fund research at Towers Watson.

For the critical pension fund investors, which account for nearly half of all alternative asset allocations, hedge funds have become less popular. Funds of funds saw their share of allocations dip from 8 per cent to 7 per cent, while single-name hedge funds dropped from 10 per cent to 9 per cent.

But the trend is still upwards, says Mr Loveday. Other institutional investors are now taking up the slack. "Sovereign wealth groups in particular have embraced hedge funds," he says. Like pension funds, they are also switching from funds of funds towards direct investments in managers.

"They, like other institutions, are moving away from one-stop, full-fee solutions that funds of funds used to offer," says Mr Loveday.

Only two individual hedge fund managers, Blackstone and Grosvenor, appear in the top 50 as fund of hedge fund investors Bloomberg

Funds of funds were once the access point of choice for new and experienced investors in the industry. However, they have become derided as an expensive, if not deeply flawed, model for investment. The days of managers acting as high-fee "concierges" – gatekeepers to a secretive and overpriced industry – are long gone.

Individual hedge fund managers now appear among the largest managers of pension fund assets, the survey reveals.

Bridgewater, the world's largest hedge fund group, is also the world's second-largest alternative asset manager of pension fund assets, with $50bn of retirement scheme money. Other individual hedge fund houses making appearances in the top 50 include Europe's BlueCrest Capital and Brevan Howard.

By comparison, only two, Blackstone and Grosvenor, appear in the top 50 as fund of hedge fund investors.

A different breed of fund of fund manager has nevertheless survived. They have adapted to become leaner, with more bespoke operations that target clients' specific investment needs. As with individual managers, the biggest have grown bigger.

Funds of funds still fill an important niche. Many institutional investors do not have the resources to conduct their own due diligence on individual hedge fund managers – a process that can typically require a whole, experienced team.

But wherever institutional investors are making allocations, they are also, increasingly, negotiating on fees. The headline "two and 20" (two per cent of annual assets and 20 per cent of all profits) the industry became noted for has not decreased dramatically, but deals have been cut at the margins.

Some institutions and leading alternative solutions groups have been able to put pressure on hedge fund fees. "In certain cases this has been delivered because the institutional client has been able to agree and accept less liquid terms," says GAM's Mr Wallis.

Long-term allocations, large allocations, or early ones, can all command discounts.

With returns still looking distinctly anaemic, the question now is whether managers can begin, once more, to deliver on their promises.

Top 25 fund of hedge funds managers ranked by pension fund AUM

Management group	Main country of domicile	Pension AUM ($m) 2012	Pension AUM ($m) 2011	% change	Total 2012 AUM ($m)	Pension AUM (as a % of total)
Blackstone Alternative Asset Mgmt	US	**21,973.2**	**19,275.0**	**14.0**	**44,812.1**	**49.0**
Grosvenor Capital Management	US	**11,366.5**	**12,024.7**	**-5.5**	**22,341.9**	**50.9**
Mesirow Advanced Strategies	US	**8,915.2**	**8,546.6**	**4.3**	**13,506.5**	**66.0**
The Permal Group	US	**8,644.9**	**3,900.0**	**121.7**	**24,112.6**	**35.9**
Financial Risk Management	UK	**8,149.0**	**4,957.0**	**64.4**	**16,689.7**	**48.8**
UBS Global Asset Management	UK	**7,870.6**	**7,950.7**	**-1.0**	**27,447.5**	**28.7**
Pacific Alternative Asset Mgmt	US	**6,809.4**	**6,640.5**	**2.5**	**8,557.6**	**79.6**
The Rock Creek Group	US	**6,250.0**	**new**	**new**	**7,500.0**	**83.3**
K2 Advisors	US	**5,552.0**	**6,290.0**	**-11.7**	**8,698.0**	**63.8**
Gottex Fund Management	Switzerland	**5,312.0**	**4,993.0**	**6.4**	**6,773.0**	**78.4**
BlackRock	UK	**4,961.6**	**4,682.5**	**6.0**	**18,094.2**	**27.4**
Goldman Sachs Asset Management	US	**4,678.3**	**4,600.0**	**1.7**	**22,889.2**	**20.4**
EnTrust Capital	US	**4,603.8**	**5,338.8**	**-13.8**	**8,137.3**	**56.6**
Kohlberg Kravis Roberts	US	**4,500.0**	**new**	**new**	**8,500.0**	**52.9**
Fauchier Partners	UK	**4,363.7**	**4,844.7**	**-9.9**	**5,812.7**	**75.1**
J.P. Morgan Asset Management	US	**3,976.5**	**3,448.0**	**15.3**	**9,236.6**	**43.1**
Aurora Investment Management	US	**3,517.0**	**3,223.0**	**9.1**	**9,947.0**	**35.4**
SkyBridge Capital	US	**3,183.0**	**2,927.0**	**8.7**	**7,136.0**	**44.6**
Lyxor Asset Management	France	**2,600.2**	**6,435.8**	**-59.6**	**9,560.2**	**27.2**
Hermes BPK Partners	UK	**2,386.5**	**2,266.0**	**5.3**	**2,507.7**	**95.2**
Morgan Stanley	US	**2,299.0**	**2,394.3**	**-4.0**	**9,659.5**	**23.8**
LGT Capital Partners	Switzerland	**2,250.0**	**1,396.0**	**61.2**	**6,000.0**	**37.5**
Diversified Global Asset Mgmt	Canada	**1,963.1**	**1,983.2**	**-1.0**	**2,136.4**	**91.9**
Crestline Investors	US	**1,835.0**	**975.0**	**88.2**	**5,095.0**	**36.0**
ABS Investment Management	US	**1,804.0**	**1,874.0**	**-3.7**	**3,550.0**	**50.8**

Top 25 hedge fund managers ranked by pension fund AUM

	Main country of domicile	Pension AUM ($m) 2012	Pension AUM ($m) 2011	% change	Total 2012 AUM ($m)	Pension AUM (as a % of total)
Bridgewater Associates	US	**50,658.0**	**47,300.0**	**7.1**	**84,042.0**	**60.3**
BlueCrest Capital Management	UK	**13,332.0**	**8,600.0**	**55.0**	**35,001.0**	**38.1**
Brevan Howard	UK	**12,308.8**	**11,500.0**	**7.0**	**39,915.6**	**30.8**
BlackRock	UK	**12,132.0**	**14,904.0**	**-18.6**	**26,635.2**	**45.5**
GoldenTree Asset Management	US	**6,900.0**	**5,700.0**	**21.1**	**17,000.0**	**40.6**
PIMCO	US	**6,198.0**	**4,240.0**	**46.2**	**9,469.0**	**65.5**
Nephila Capital	Bermuda	**6,018.6**	**4,282.0**	**40.6**	**7,893.5**	**76.2**
D. E. Shaw Group	US	**5,296.0**	**4,319.0**	**22.6**	**19,320.0**	**27.4**
Lyxor Asset Management	France	**5,275.0**	**new**	**new**	**10,742.5**	**49.1**
Beach Point Capital Management	US	**5,139.3**	**4,892.4**	**5.0**	**6,403.6**	**80.3**
Brigade Capital Management	US	**4,908.3**	**new**	**new**	**12,498.0**	**39.3**
Winton Capital Management	UK	**4,428.0**	**4,177.0**	**6.0**	**25,637.0**	**17.3**
Lansdowne Partners	UK	**4,147.0**	**4,049.4**	**2.4**	**11,143.0**	**37.2**
AHL	UK	**3,713.0**	**4,214.0**	**-11.9**	**14,387.0**	**25.8**
Anchorage Capital Group	US	**3,679.2**	**3,020.8**	**21.8**	**10,220.0**	**36.0**
York Capital Management Global Advisors	US	**3,451.7**	**new**	**new**	**14,494.1**	**23.8**
Angelo, Gordon & Co.	US	**3,374.0**	**2,659.0**	**26.9**	**10,919.1**	**30.9**
Credit Suisse Asset Management	US	**3,315.7**	**new**	**new**	**22,116.0**	**15.0**
Cevian	UK	**3,230.0**	**new**	**new**	**8,580.1**	**37.6**
Camden Asset Management	US	**3,153.0**	**new**	**new**	**3,236.0**	**97.4**
Two Sigma Investments	US	**2,753.2**	**new**	**new**	**8,483.5**	**32.5**
Millennium Management	US	**2,700.0**	**new**	**new**	**17,000.0**	**15.9**
GE Asset Management	US	**2,637.9**	**2,475.6**	**6.6**	**2,637.9**	**100.0**
MKP Capital Management	US	**2,632.1**	**new**	**new**	**5,961.0**	**44.2**
CQS	UK	**2,409.4**	**new**	**new**	**11,685.6**	**20.6**

Source: Towers Watson