UK With-Profits Funds

Investment performance and strategy

Helping insurers understand the drivers of performance

Analysis as at 31 December 2019

This is the seventh investigation Barnett Waddingham has conducted into the investment strategies of UK with-profits funds. Its purpose is to understand sources of differences in investment returns in the market.

PARTICIPATING FIRMS

We thank the following firms for participating in this survey:

- AEGON
- Chesnara
- Cirencester
- Dentists' Provident
- DG Mutual
- Foresters Financial
- Foresters Friendly
- Healthy Investment
- Kingston Unity
- Legal and General
- Lloyds Banking Group
- LV=
- Metfriendly
- NFU Mutual
- Phoenix
- Police Mutual
- Prudential
- ReAssure
- Royal London
- Scottish Friendly
- Sheffield Mutual
- Shepherds Friendly
- Standard Life
- The Oddfellows
- Utmost
- Wesleyan
- Zurich

Our aim is to stimulate debate with insurers as to whether the approaches others take may be appropriate for them, and whether their asset manager has performed well compared to peers.

The data* our report uses is private information that is not in the public domain. We approached the majority of firms who have with-profits funds in the UK, asking for information on asset allocations and investment returns.

Despite the operational challenges that we have all faced in light of Covid-19, we are delighted that more firms and funds than ever before have chosen to participate. Our analysis covers over £226bn of assets spread over 65 funds from 27 insurers. We have listed the participating firms earlier in this report (page 3).

Executive Summary

2019 was a good year for investing, with the median return being in excess of 10%. However, we still saw a wide range of investment returns achieved by funds.

Most funds have a balanced asset mix, and the average asset mix has remained stable for many years, demonstrating a long-term investment view. Therefore, the cause of the variety of returns is predominantly relative performance within asset classes, rather than differences in asset mixes.

Some firms managed to outperform our benchmarks on a 1-year horizon, but many fewer managed to do so on a 5-year horizon. In general, the larger funds outperformed the smaller funds and this suggests that many smaller funds may be better investing in low cost index trackers rather than using the active managers selected.

Of course, for the consumer, this does not take account of the smoothing, additional profits and guarantees that are benefits of with-profits products, compared to more vanilla investment options.

Additional analysis

This report sets out summary results. We have provided the participating firms with secure online access to a dashboard that allows them to interactively view our more in-depth analysis.

We hope you find the report informative. Please get in touch with any questions and comments you have.

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* We have used the information provided without any independent verification, although we have queried responses where these looked to be outliers.

The data we're reporting on

Grouping of funds

This investigation covers 65 funds across 27 insurers, who provided their asset allocations at 31 December 2019 and their investment performance over 2019 to us privately.

We have split the analysis in this investigation by fund, as different funds within an insurer can have materially different risk characteristics. We have then grouped funds by fund size as set out in Table 1. Funds have been excluded that have less than £5m of assets.

Fund names

We have made the fund names in this report anonymous, as the underlying data is not publicly available.

We present fund names in the format: **'<classification> - <1-year rank>'**.

- **<classification>** is a letter indicating the fund size, as set out in the next table.
- **<1-year rank>** is a number representing overall fund performance in relation to all funds over the last year.

TABLE 1: FUND CLASSIFICATIONS USED IN THIS INVESTIGATION

Classification	Fund size (£m)	Number of funds
XL	> 5,000	10
L	1,000 – 5,000	13
M	250 – 1,000	13
S	75 – 250	15
XS	< 75	14

Investment returns

Table 2 sets out the return achieved by each fund on a 1-year and a 5-year basis. Figure 1 shows the distribution of total 1-year returns by classification. Figure 2 shows the distribution of 5-year returns.

TABLE 2: TABLE OF 1-YEAR AND 5-YEAR INVESTMENT RETURNS

Classification	Fund name	1-year net return	5-year rank	5-year net return
XL	XL - 5	14.30%		
	XL - 11	12.16%		
	XL - 17	11.74%	3	6.51%
	XL - 19	11.34%		
	XL - 22	11.16%		
	XL - 25	10.92%	10	4.94%
	XL - 26	10.87%		
	XL - 30	10.74%		
	XL - 38	10.02%	11	4.68%
	XL - 41	9.60%	6	6.09%
L	L - 1	16.08%		
	L - 3	14.54%		
	L - 4	14.46%	20	1.32%
	L - 9	12.63%		
	L - 12	12.09%	1	7.31%
	L - 13	12.06%		
	L - 18	11.73%		
	L - 21	11.18%		

TABLE 2: TABLE OF 1-YEAR AND 5-YEAR INVESTMENT RETURNS

Classification	Fund name	1-year net return	5-year rank	5-year net return
L	L - 35	10.16%		
	L - 39	9.97%		
	L - 40	9.73%		
	L - 44	9.41%		
	L - 47	9.09%		
M	M - 2	15.12%		
	M - 7	13.10%		
	M - 8	12.82%		
	M - 15	12.00%	4	6.31%
	M - 16	11.97%		
	M - 29	10.79%		
	M - 31	10.54%		
	M - 37	10.15%	2	6.95%
	M - 43	9.47%		
	M - 50	8.16%		
	M - 53	7.84%	13	4.44%
	M - 59	6.35%		
	M - 61	6.28%		
S	S - 6	13.26%		
	S - 14	12.04%	5	6.11%
	S - 23	11.12%		
	S - 24	10.97%		
	S - 27	10.85%	8	5.74%
	S - 32	10.48%	9	5.62%
	S - 33	10.47%		
	S - 34	10.20%	7	5.98%
	S - 48	9.02%		
	S - 51	8.00%		
	S - 52	7.93%		
	S - 54	7.67%		
	S - 58	6.54%	15	3.39%
	S - 63	3.00%	18	2.95%
	S - 64	2.96%	19	2.86%
XS	XS - 10	12.21%		
	XS - 20	11.20%		
	XS - 28	10.83%		
	XS - 36	10.15%		
	XS - 42	9.52%	12	4.53%
	XS - 45	9.25%		
	XS - 46	9.11%		
	XS - 49	8.27%	14	4.24%
	XS - 55	7.10%		
	XS - 56	7.03%	17	3.26%
	XS - 57	6.60%		
	XS - 60	6.30%		
	XS - 62	3.59%		
	XS - 65	2.57%	16	3.27%

FIGURE 1: BOX PLOT OF DISTRIBUTION OF 1-YEAR NET RETURNS BY CLASSIFICATION

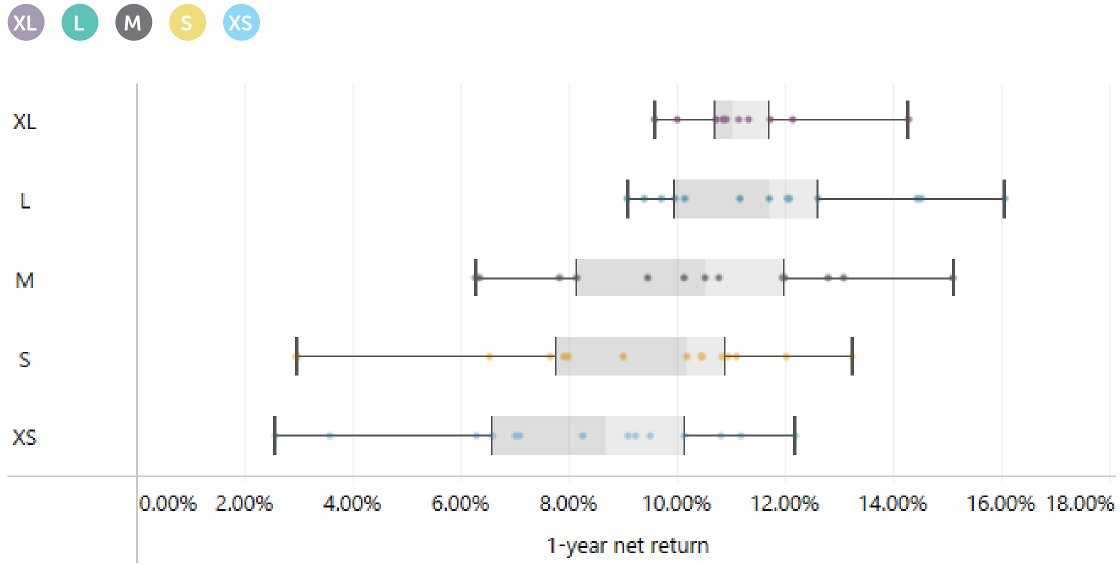
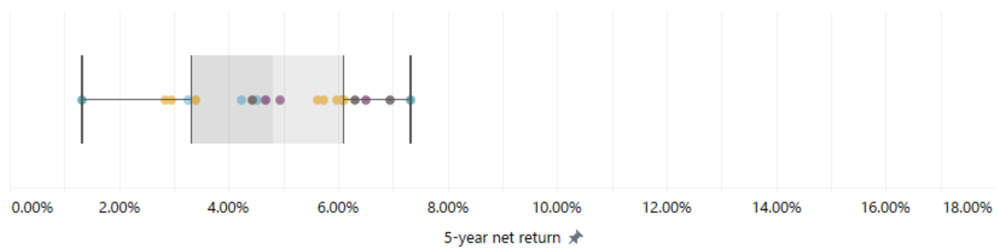


FIGURE 2: BOX PLOT OF DISTRIBUTION OF 5-YEAR NET RETURNS



Notes

- Where a fund has not provided the total fund return, we have estimated it as the weighted average return on each asset class. This applied to funds L – 21, M – 29, M – 50, S – 54, XS – 46 and XS – 55.
- The 5-year returns are only shown for the 20 funds where we have 5 years' worth of data for. The results have been grouped as there is insufficient number of funds to show a box plot by size category.

Our insight

Over 2019 the funds investigated achieved a wide range of investment returns. 2019 has been a good year for all funds, with every fund achieving a positive return, and the median return being in excess of 10%.

Larger funds tended to have a smaller variance in returns. The best performing larger funds tended to perform better than the best performing smaller funds. Similarly the worst performing smaller funds tended to perform worse than the worst performing larger funds. However, there has been some overlap, with some smaller funds outperforming larger funds.

Over 5 years, all funds have achieved a positive return, with larger funds tending to perform better than smaller funds.

Asset allocation

Figure 3 shows a box plot of the asset allocation by asset class. Figure 4 shows how the average fund asset allocation has changed from 2013 year-end to 2019 year-end.

FIGURE 3: BOX PLOT OF DISTRIBUTION OF ASSET ALLOCATION BY ASSET CLASS

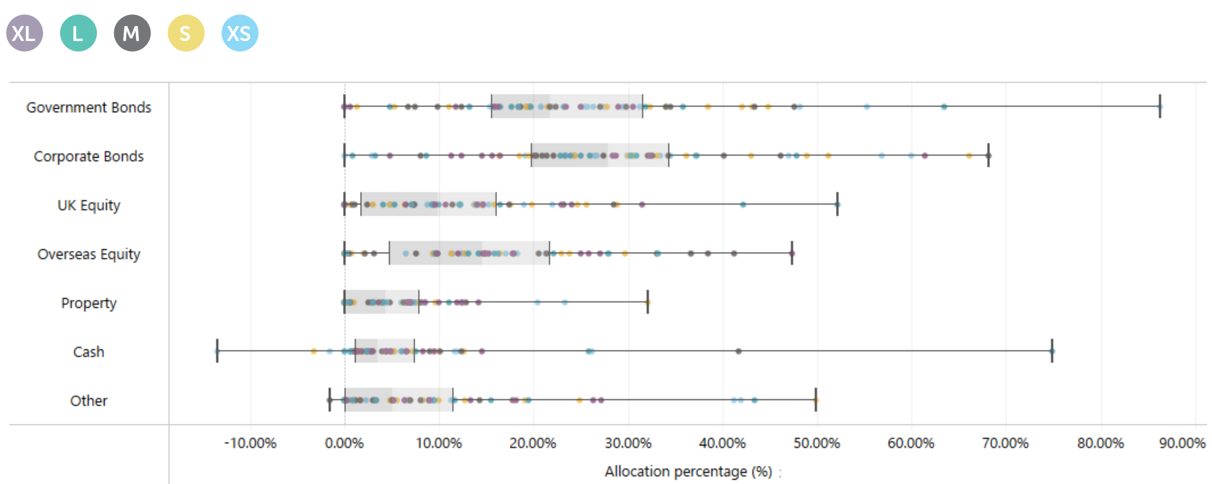
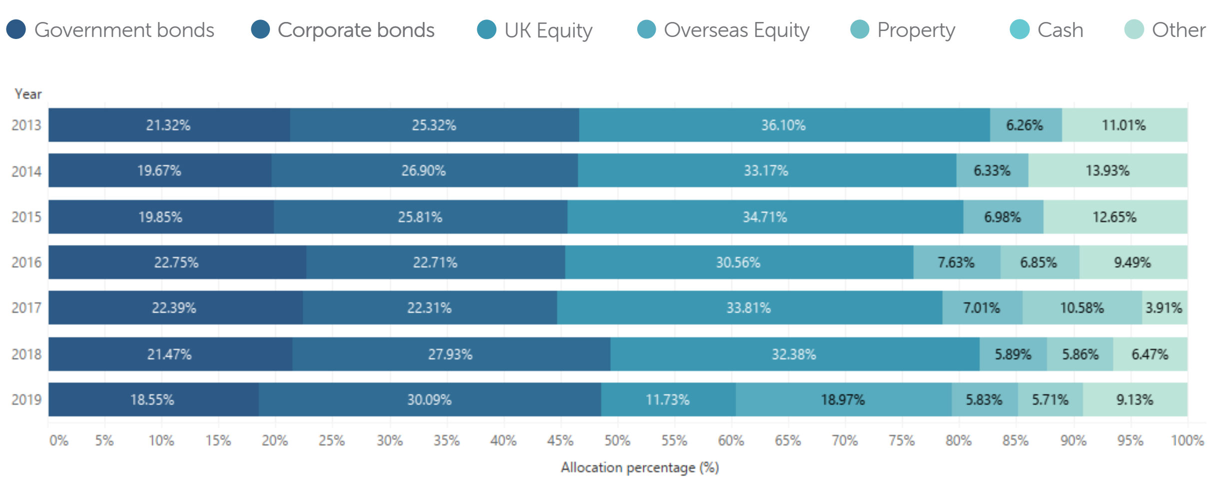


FIGURE 4: BAR CHART OF THE CHANGE IN AVERAGE ALLOCATION PERCENTAGE OF ALL ASSET CLASSES FROM 13YE-19YE



Notes

- Three funds (S – 23, XS – 10 and XS – 62) have a negative 'Cash'. We have queried these and understand that this is due to settlement timings of inter-fund transfers.
- One fund (M – 53) has a negative 'Other' allocation due to only containing derivatives.
- The analysis in Figure 4 only shows the 18 funds across twelve firms for which we have data spanning the entire period.
- Prior to 2016 year-end, cash and other were included as one asset class. Prior to 2019 year-end, equity was not split between UK equity and overseas equity. Hence, although the key says "UK equity", for 2013 year-end to 2018 year-end, this is simply "Equity".

Our insight

There are a range of asset allocations, although most could be described as balanced funds with a mix of all of the major asset classes. On average, larger funds tended to hold more equity and property, whereas smaller funds tended to hold more fixed interest assets.

Despite the market volatility that we observed towards the end of 2018, overall trends in asset allocations are gentle over time, with a slight observable increase in fixed interest at 2018 year-end. Between 2018 year-end and 2019 year-end we can see a shift between government bonds towards corporate bonds, which may be an indication of funds trying to search for yield within fixed interest assets.

Performance within asset class

Figure 5 shows the distribution of 1-year returns by asset class. Figure 6 shows the distribution of 5-year returns by asset class. Table 3 summarises the 1-year and 5-year benchmark returns.

FIGURE 5: BOX PLOT SHOWING DISTRIBUTION OF 1-YEAR NET RETURN BY ASSET CLASS

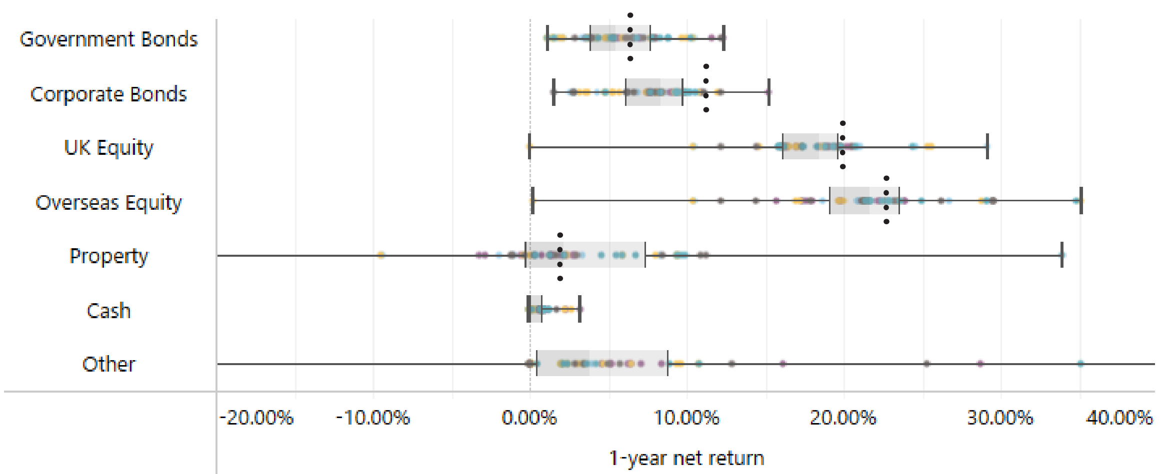


FIGURE 6: BOX PLOT SHOWING DISTRIBUTION OF 5-YEAR NET RETURN BY ASSET CLASS

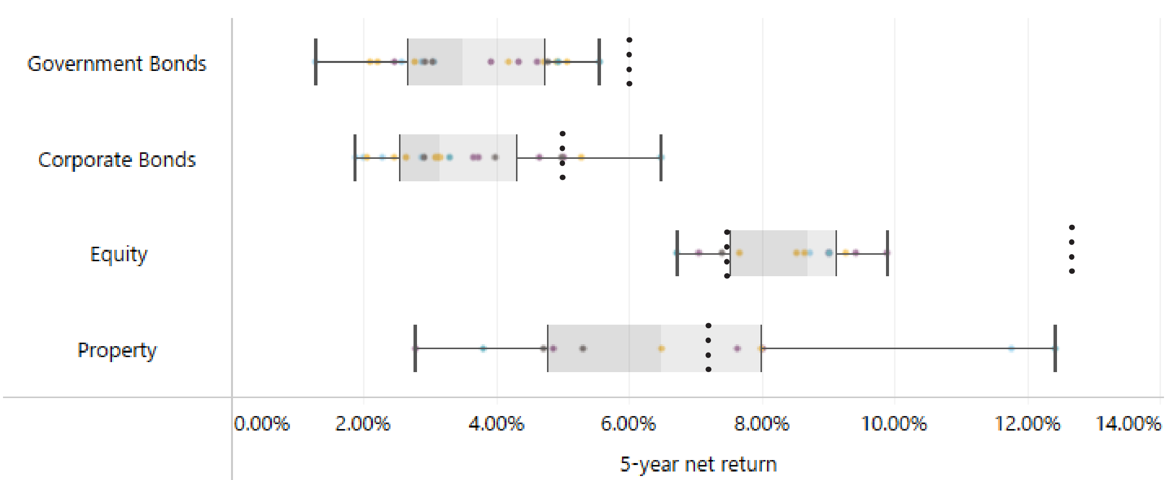


TABLE 3: BENCHMARK RETURNS BY ASSET CLASS

Asset class	1-year benchmark	5-year benchmark	Source
Government Bonds	6.42%	6.01%	FTSE Gilts All stocks Fixed Interest Index
Corporate Bonds	11.03%	5.04%	iBoxx Non-Gilts All Stocks Index
UK Equity	19.17%	7.59%	FTSE All Share Index
Overseas Equity	22.55%	12.75%	FTSE All World (ex UK) Index
Property	2.17%	7.29%	IPD UK All Property Index

Notes

- The dotted black lines show the benchmark returns for each asset class.
- We only started collating separate UK and Overseas equity from 2019 year-end. In prior years, these were shown as just equities. Therefore for the 5-year analysis, we have combined both UK and overseas equities.
- Some funds did not provide the return for some asset classes. Where this is the case, we have estimated the net return for the asset class by applying a goal seek such that the weighted average return on all asset classes equates to the total net return of the fund. This applies to XL – 19, XL - 30, M – 29 and XS – 55.
- Some funds did not provide the total net return. Where this is the case, we have estimated the total net return by calculating the weighted average return. This applies to L – 21, M – 50 and XS – 46.
- Some funds have combined asset classes – they have grouped government bonds and corporate bonds as fixed interest and/or they have grouped UK and Overseas Equities as Equity. In these cases, we have assumed the fund achieved the same return in each component asset class. This applies to L – 21, M – 50, S – 14, S – 24, S – 27, XS – 20 and XS – 36.

Our insight

All funds achieved a positive 1 and 5-year return overall, and only a small number of funds achieved a negative return within an asset class.

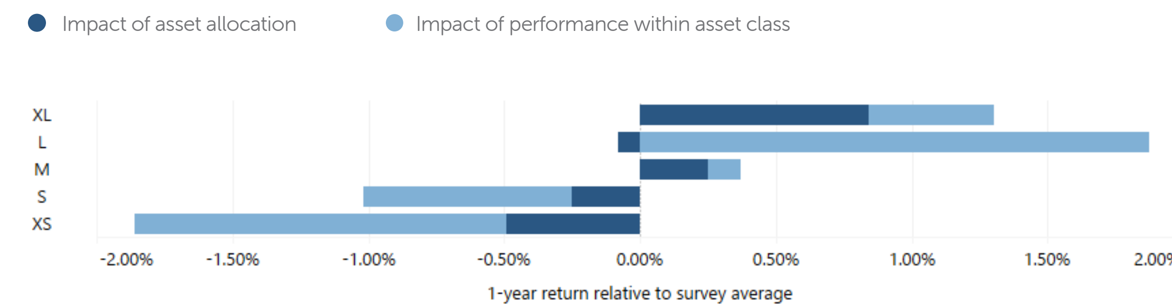
On a 1-year basis, many firms outperformed our chosen benchmarks. However, the median fund in each asset class achieved less than the benchmark. On a 5-year basis most funds lagged against the 5-year benchmarks, and this was disappointing to see. It is worth noting that comparing to our chosen benchmark mark is only an approximate indicator, as most funds will usually have their own internal performance benchmarks which may be different to our own.

Most asset classes had a smaller variance over a 5-year horizon compared to a 1-year horizon.

Performance attribution

Figure 7 shows the impact of performance within asset class and asset allocation on total return by fund size.

FIGURE 7: IMPACT OF PERFORMANCE WITHIN ASSET CLASS AND ASSET ALLOCATION ON TOTAL RETURN



Notes

- We have calculated the impact of asset allocation for each fund on a 1-year horizon as the return each asset class has achieved on average, over the overall total average return, multiplied by the funds' asset allocation to the asset class above the industry average allocation.
- We have calculated the impact of performance within each asset class by finding the difference between return relative to average and the impact of asset allocation.

Our insight

A key determining factor of relative performance has been a fund's equity allocation. The allocation between UK and Overseas has not been a material determinant of relative performance.

The average fund in our analysis can be described as a 'balanced fund', and have a reasonable a sizeable fixed interest holding. A higher ratio of corporates to gilts has contributed towards relative performance.

Funds have achieved a wide spread of returns within most asset classes. This has contributed to performance within asset class being a differentiating factor between funds. On average, performance within asset class has been the driving factor for outperformance of larger funds compared to smaller funds. This trend is less observable when you drill down to an individual fund level.

Barnett Waddingham is proud to be a leading independent UK consultancy at the forefront of insurance, risk, pensions and investment.

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Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively get in touch via the following:

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