OUTLOOK 2025

From hands on to hands off

Passive investing will continue to gain traction in 2025 for pension funds, alongside a hands-on approach to private assets. Lynn Strongin Dodds **reports**

Although the year is only a few weeks old, many of 2024's main themes such as geopolitical tensions, shifting economic trends and pension reform are expected to play out in 2025. The ongoing uncertainty has only reinforced the need for a diversified portfolio for all scenarios. Bonds and equities will still feature albeit in different percentages, but increasingly private markets will make a bigger dent.

As JP Morgan Asset Management head of EMEA Institutional ex-UK, Sherene Ban, notes, many European pension funds are adjusting their investment strategies in response to evolving regulations, market volatility, and demographic changes.

Markets have also been rattled by the rapid-fire spate of proclamations from President Trump's second administration. He wasted no time threatening Mexico, Canada and China with tariffs, and many believe it is not too long before the European Union appears on the hit list, which would have a significant impact on the region.

However, many agree with Candriam deputy head of pension and insurance relations, Fabrice Sauzeau, who believes that while Trump's policies and their effect on the markets remain unpredictable, there will

be more continuity than disruption this year.

"The European pensions landscape is diverse in organisation, regulation and investments, but is shaped by common megatrends," he says, adding that one of the most significant is the ongoing replacement of the corporate DB model by multi-employer, sectorial DC or hybrid schemes.

Different paces

Countries are moving at different paces with the Netherlands, the eurozone's largest pension system with over €1.2 trillion in accrued benefits, capturing all the headlines with its sweeping four-year-phased-in reforms. France's transition is also underway with its d'epargne pour la retraite (PER DC framework), which was introduced in 2019 and further enhanced over the years to make pension saving more flexible, simple and standardised. Meanwhile, in Germany, the move to DC was almost complete last year with around 97 per cent of corporates offering that option to its members, up from 93 per cent in 2023.

In terms of asset allocation, strategies will differ depending on a scheme's size and resources, but Janus Henderson head of sales, France Charles Henri Herrmann, highlights a few common approaches. These include a greater portion directed to private credit and alternatives as well as impact investing. "ESG approaches and sustainable finance has to be at the heart of their strategies due to regulation, but we are seeing much more alignment with the United Nations Sustainable Development Goals," he adds. "I also expect to see more interest in digitalisation and AI to help with portfolio optimisation."

An active switch to passive

As in most years, cost is also front and centre, which explains why European pension funds along with the wider investment community have embraced exchange- and commodity-traded funds (ETFs and ETCs). In fact, recent research from BlackRock shows that adoption has accelerated since 2020 not only due to the low-price tag but also the resilience these vehicles demonstrated during the onset of the pandemic when markets panicked.

Invesco head of DC clients, Mary Cahani, expects the trend to continue, due to DC pension funds' low fee budgets. However, innovation to enhance the passive exposure is critical. She adds that over 80 per cent of UK DC fund assets are invested in public assets, and the majority of these investments are passive. ETFs are part of the trend due to their liquidity profile, low cost for access and flexibility to gaining exposure to different markets, commodities, or even illiquid investments.

Figures from Morningstar show that European ETFs and ETCs had a bumper 2024 with a record-breaking €247 billion invested, a significant hike from the previous high of €159 billion set in 2021 and well ahead of the €145.4 billion recorded in 2023. One of the fastest growing segments was active or enhanced ETFs, which tripled their inflows to €19.1 billion, comprising 2.5 per cent of total assets invested in ETFs in Europe, up from 1.8 per cent in 2023.

Their main attraction is they offer the prospect of beating the index because fund managers can pick certain securities and exclude others. Some active ETFs still follow an index very closely, while others deviate more in an attempt to generate higher returns. Pension funds are also becoming spoilt for choice as leading European fund managers have, and are planning, to launch a plethora of equities and fixed-income vehicles.

As Nordea head of wholesale and institutional distribution UK, David Crawford, explains, perceptions have changed about using ETFs. At one time they were the preserve of tactical asset allocation but today they are also being used for strategic asset allocation.

"I think there is also disbelief about the

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capabilities of active managers," he says. "What we are seeing instead is that if investors want to capture a small amount of alpha, they will use enhanced passive strategies."

The death knell though has not been rung for active management and some industry experts think that it could come back into fashion if stock indices repeat January's bumpy ride. As the month came to a close, low cost-effective artificial intelligence (AI) solutions from China's DeepSeek sent the S&P 500 index dropping 1.5 per cent, while the tech-heavy Nasdaq fell 3.1 per cent. Nvidia was the hardest hit, plunging 16.9 per cent and losing roughly USD 600 billion in market value. European and Japanese tech stocks also fell, reminding investors of the vagaries of markets.

"I don't think we will see a wholesale reversal of the move to passive but there has been a slow movement back to active management," says WTW head of manager research, Chris Redmond. "This is due to concerns over the concentration of the stock market, where a small number of stocks – the magnificent seven – dominate US and global equity indices. The volatility over the last three weeks linked to a new AI market entrant have shown the potential impact of the market concentration."

Newton International Management CIO of multi asset, Mitesh Sheth, is also seeing the return of more liquid and transparent hedge fund strategies, such as market neutral and macro directional. "These strategies provide a more flexible and dynamic approach to outperform the index," he adds.

Private assets boost

In addition, European pension funds want a much more hands-on approach to the management of their private assets. They are behind their global counterpart and are planning to boost their exposure by 57 per cent over the next two years, according to Aviva Investors' seventh *Private Markets Study.* This compares to 47 per cent and 44 per cent in North America and in Asia-Pacific, respectively.

L&G institutional deputy head of Europe, Miriam Uebel, says this is the year that European pension funds are placing significant emphasis on building resilience and achieving sustainable, long-term returns. "Infrastructure investment features prominently, with a focus on digital connectivity and renewable energy projects, reflecting a strategic alignment with global decarbonisation goal," she says.

Goldman Sachs Asset Management co-head of the Continental Europe Fiduciary Management team, Céline van Asselt, agrees adding that in this environment, there will be a greater interest in diversifying strategies, with further growth in allocation to private assets. "European pension funds will also continue to pursue opportunities across the risk spectrum in fixed income – especially in investment grade and private credit," she adds.

Emerging market (EM) debt is also firmly on the radar. Ninety-One Co-Head Central & Northern Europe Client Group, Aymeric François, notes that several major European pension funds are aiming to diversify from developed market to EM government bonds because the growth stories are strong given that the central banks acted quickly and in a disciplined fashion to control inflation. However, an active approach is required due to the impact any tariffs would have but also where these countries are in their energy transition journey given the EU requirements.

As the year rolls on, Mercer European head of macro and dynamic asset allocation, Julius Bendikas, recommends pension funds keep a watchful eye on valuations and concentration in equities, assess whether bonds will provide diversification if markets become more volatile and potentially look for opportunities in more niche market segments like frontier markets debt.