

Top investment actions for institutional investors in 2025

As we look ahead to 2025, investors should focus on actionable strategies to navigate opportunities amid uncertainty, optimize portfolios, and drive long-term success.

In 2024, the global economy experienced a series of changes that significantly affected investment markets.

- Sticky but declining inflation continued to be a central concern. As a result, many central banks worldwide began cutting interest rates while keeping a close eye on factors that could cause a resurgence of inflation.
- Ongoing geopolitical tensions, especially in Eastern Europe and the Middle East, and threats of higher tariffs further complicated trade relations and investor confidence.

In the following sections, we explore specific actions institutional investors should consider to position their portfolios effectively for the year ahead.



1. Incorporate specialist asset managers into your investment line-up

There's a role for "Jack of all trade" managers in your investment portfolio, but specialists should play a major part. They can add differentiated exposures that may help improve the portfolio's overall risk and return.

It's important to find asset managers that specialize in a single investment strategy where their success hinges on executing their strategy.

Portfolio construction is where the benefits of specialization shine. Creating custom investment solutions that include desired exposures and opportunities within an asset class and using multiple specialized managers helps ensure your portfolio reflects the smartest thinking. We believe such an approach separates average from exceptional investment management.



2. Implement a total portfolio approach

When thinking about building a portfolio, we believe that the whole is greater than the sum of the parts. A total portfolio approach (TPA) summarizes and explains this thinking. Portfolios are built from the ground up. Every idea competes for capital, and every investment plays a role in supporting the overall portfolio's objectives.

TPA is in sharp contrast to strategic asset allocation. Traditionally, strategic asset allocation is the core of how assets are allocated in a portfolio, where investments must fit into a particular category. In TPA, every idea should compete for capital, so only the best survive.

A single aspect of an investment opportunity — its risk, return, liquidity or cost — can enable you to expand your portfolio to new opportunities. We have used this approach for over 20 years to build and manage portfolios and understand the role governance plays in its success.



3. Reevaluate your fixed-income allocation

Fixed-income allocations are a mainstay of investors' portfolios. When market volatility rocks the boat in their equity portfolios, fixed income can be a critical ballast. With interest rates not far from their 15-year highs, fixed-income yields are compelling.

But expanding beyond traditional corporate credit is often required to access higher yields and diversify risk. Consider allocations to emerging market debt, bank loans, high-yield and securitized and asset-backed credit, across both private and publicly traded solutions.

Accessing these strategies requires a specialized understanding of the nuances of each market and their relative attractiveness throughout time. Markets evolve through credit and economic cycles. We believe working with specialist asset managers who understand the opportunities in public and private debt markets is critical to effectively manage risk and to overall success.



4. Revisit real assets to seek diversified returns and inflation protection

Rising interest rates and falling occupancy in a post-COVID world hit commercial real estate hard. It dragged down the valuations and liquidity conditions of the overall real assets market. We feel the dust in commercial office space hasn't settled yet, but its effects on other parts of the real estate market are overblown. Consequently, this environment has created incredible opportunities for institutional investors to access very attractively priced assets in the broader real assets market.

The opportunities in real assets are an excellent way for institutional investors to build resilience in their portfolios and improve their exposure to stable, growing and inflation-sensitive assets at attractive valuations.

We favor assets supported by strong, recurring and inflation-linked cash flows that benefit from long-term secular trends. As we look at opportunities, we still focus on niche assets driven by idiosyncratic factors at the individual project level that are likely to benefit from long-term secular trends. We expect demand for single-family homes, industrial technology and healthcare, and renewable energy generation and transmission to continue to grow both in the U.S. and globally.



5. Manage your equity portfolio concentration with active equities

Equity market concentration has grown with the "Magnificent 7" currently representing over 31%¹ of U.S. equity portfolios. Apple, Microsoft and Nvidia are now each larger by market cap than every country in the world MSCI All-Country World Index except the U.S. and Japan.

For most institutional investors, equities are their largest allocation. For many, exposure is increasingly concentrated in a handful of companies. Institutional investors can benefit from rethinking what concentration means for their portfolio.

We believe a better way to build portfolios that reduces concentration requires focusing on conviction. Find eight to 12 active managers with high, but varying conviction. Let them each select 10 to 20 different stocks and build the portfolio from there. The outcome will be a high-conviction, diversified and risk-aware portfolio of 150 to 200 companies. In today's dynamic and uncertain economic and political climate, skilled active managers capable of identifying and capitalizing on emerging trends and evolving markets are critical.

1. Source: FactSet, as of October 31, 2024



6. Add uncorrelated return potential to your portfolio with hedge funds

The value of uncorrelated strategies is always high within an investment portfolio. The ability to generate positive returns regardless of market environment is crucial to helping reduce a portfolio's overall risk in periods of market stress. Hedge funds can serve that role, seeking to generate a meaningful return and serving as an uncorrelated stabilizer to portfolio shocks.

With the increase in interest rates and associated uptick in market volatility, we believe now is the time to consider hedge funds in your portfolio. Hedge funds have historically performed well when market volatility is high, given their unconstrained approach and ability to invest across markets and asset classes.

A portfolio of hedge fund strategies can complement most institutional investors' wider portfolios, adding a differentiated source of risk and return.



7. Unlock liquidity in your private-markets portfolios

Slower distributions of capital have forced a rethinking of traditional liquidity frameworks and semi-liquid alternatives can help.

How you access private markets and alternatives is changing. The growth of semi-liquid alternative strategies has expanded the opportunity for all types of institutional investors. The growth of semi-liquid strategies has enabled more asset owners to access private or what are historically illiquid markets, but in a vehicle that looks and feels much closer to a mutual fund or collective trust.

As an investor, both liquidity and illiquidity have a premium, demanded in times of market stress or as a benefit to investor returns. With cash distributions from traditional private equity funds slowing in the higher interest rate environment, we view growth in semi-liquid alternatives positively.

Semi-liquid funds unlock a larger universe of opportunities for institutional investors. These funds open access to private markets, typically lowering fees, reducing minimums and improving liquidity terms. They create new options for asset owners' portfolios. Semi-liquid alternatives can play a role in helping you achieve your investment goals.



8. Broaden your opportunities in private equity

The explosive growth in private equity over the last 20 years has transformed markets, providing companies with new ways to access capital and institutional investors with new ways to seek returns and transform risk. Commonly, there are many private equity strategies to consider including large buyouts, middle and lower-middle-market, growth equity and venture capital.

However, it is our view that investors are better served by accessing private equity through smaller funds that focus on the lower-middle-market segments. This is driven by strong economic rationale and market dynamics, including

- A larger number of deal opportunities
- Typically, lower pricing
- Broader exit opportunities

Another factor favorable to the lower-middle market, smaller and less mature companies typically have more growth opportunities and are less reliant on leverage.

Also, the opportunity to access these companies via co-investment vehicles and selective secondary transactions is particularly attractive, given the typically favorable fee terms (often no fees) and reduced effects of the infamous "J-curve."



Plan Sponsors



9. Refresh your approach to liability-driven investing (LDI)

With credit spreads at some of the tightest levels in the last 25 years, how you manage your LDI portfolio is critical. Traditional wisdom says that a portfolio of corporate bonds is the best approximation of a liability. Pension funds should consider several ways to meet their objectives and make sure the investments in their LDI portfolios enhance their total portfolio approach.

Interest rates are typically the largest driver of changes to a pension fund's liability and as such, mitigating that risk is a first-order goal. We tend to prefer allocations to U.S. Treasury bonds or STRIPS at various points along the interest rate curve. It helps us target a higher overall hedge ratio but in a more capital-efficient manner.

Likewise, for some clients, the selective use of investment-grade private credit can be helpful, given the typically higher yields and stricter underwriting standards than public credit markets. How to build an LDI portfolio is ultimately a function of your pension plan's goals, risk tolerance and funded status. But it's important to view LDI from a total portfolio approach.

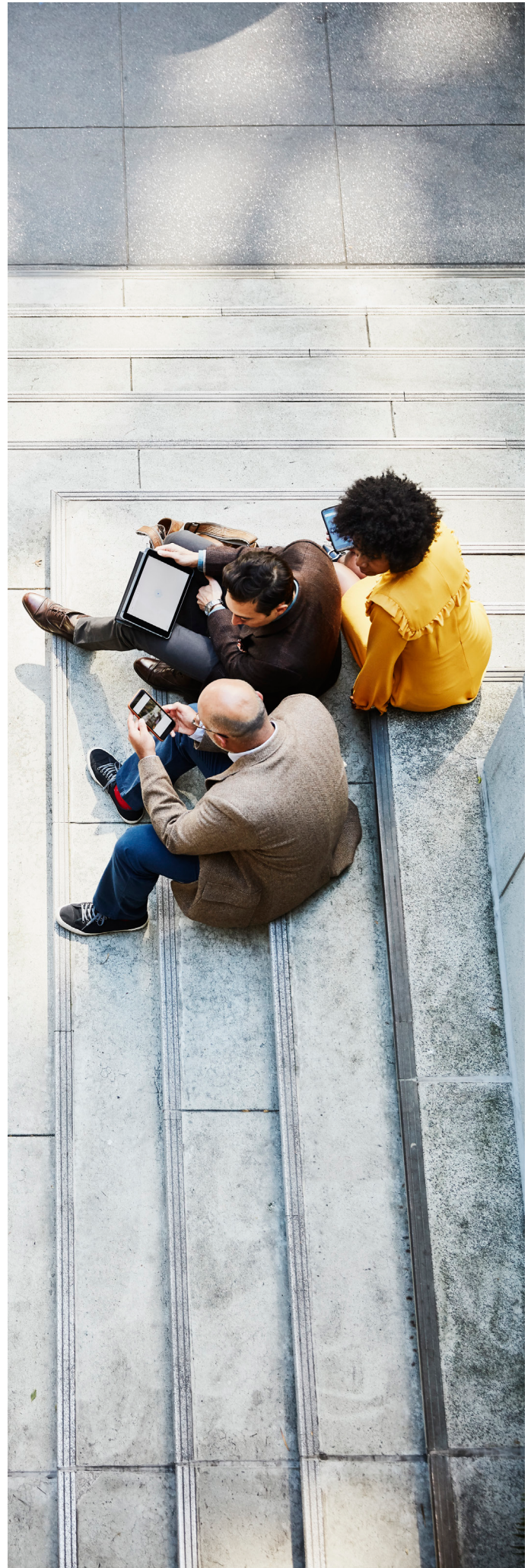


10. Pool your defined contribution (DC) resources with a Pooled Employer Plan

Defined contribution plans are critical to attracting and retaining employees. But for the employer, managing a DC plan can be challenging, both from an investment and ongoing administrative perspective. And SECURE 2.0 has complicated this work, adding regulatory considerations to plan sponsors' responsibilities, as new plan features and rules are rolled out. All this requires more resources to ensure plan sponsors have a clear understanding of their governance obligations and fiduciary duties. There's an alternative for plan sponsors to provide this critical benefit to their employees: a pooled employer plan (PEP).

A PEP is sponsored by a Pooled Plan Provider (PPP), which is the named fiduciary and entity responsible for managing and administering the PEP. Participating employers shift nearly all oversight and governance to the PPP, including fiduciary responsibility for investments and plan administration.

With the success of this model outside of the U.S., we believe over time that many plan sponsors in the U.S. will opt for a pooled employer plan. We expect to see an increased number of adopters across a range of industries and plan sizes over the coming years.



Finally, remain agile in 2025

Looking ahead to 2025, institutional investors must remain agile and responsive to the changing economic and geopolitical landscape. By incorporating specialist asset managers and revisiting strategies in liability-driven investing, investors can better position their portfolios for success. Exploring opportunities in real assets, private equity and hedge funds can provide diversified returns and mitigate risks. Embracing these strategies will help institutional investors navigate the complexities of the market and achieve their long-term investment goals.

How WTW can help institutional investors

We help institutional investors by using our extensive experience and innovative approaches to address complex asset owner challenges. Using our total portfolio approach, we look to understand your investment objectives to develop custom strategies that reduce your critical risks. We emphasize collaboration and diversity of thought, functioning as an integral extension of your investment teams. This approach provides you with a seamless experience.

Our global team will help you navigate asset classes and managers, selecting the best asset managers that align with your specific investment objectives. Our investment approach prioritizes risk management, ensuring that strategies both align with your investment objectives today and are adaptable as objectives evolve.



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