Analyzing the Impact of Interest Rates

Macroeconomic factors remain a key challenge for institutional investors

Key Takeaway

Disinflation reemerged in 2024 after inflation reached its highest level in four decades in 2023, but still has not reached the Federal Reserve's 2% target.

- **Nearly half (46%) of asset owners surveyed by Cerulli cite inflation as a key challenge**. For most of 2024, interest rates were kept high to combat inflation. The Federal Reserve introduced the first rate cut in the third quarter of 2024. Public plan sponsors particularly feel the pressure of inflation, as plans have cost-of-living adjustments tied to inflation metrics.

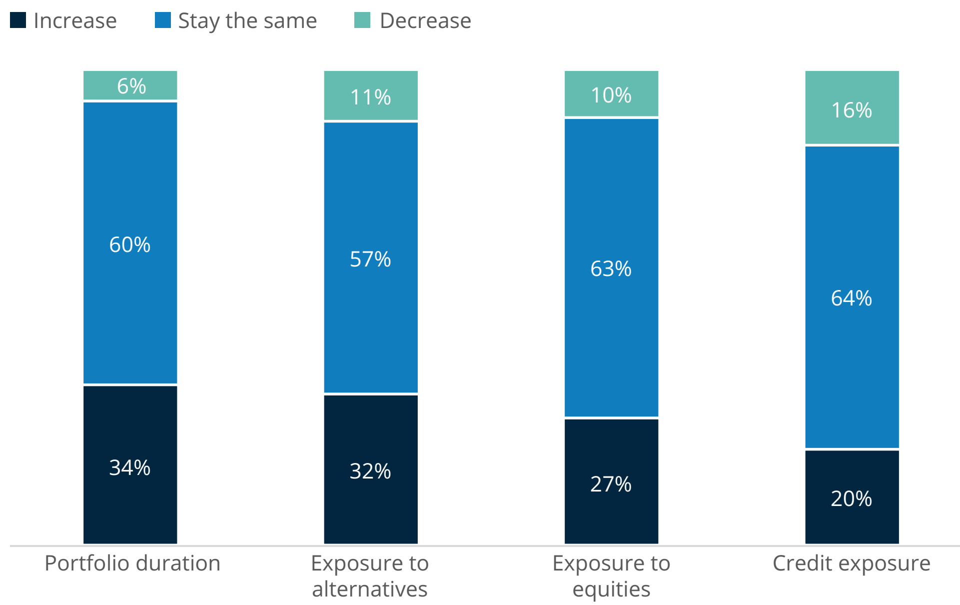
- **Institutional investors' top-two reasons for not incorporating private investments are illiquidity (50%) and high fees (40%)**. Some institutions such as insurance general accounts must constantly tap into their investments; thus, an increase in illiquidity may constrain them from meeting their obligations.

- **Asset owners (34%) cite an increase in U.S. investment-grade fixed income over the next 24 months**, outpacing all other asset classes. Fixed income may provide future stability to pension plan sponsors.

- **A majority of asset owners (64%) that collaborate with investment consultants or OCIOs do so on a total portfolio mandate basis**. Others use intermediaries to advise or manage portfolio sleeves for an asset class or combination of asset classes.

Asset Owners' Response to Rising Interest Rates over the Next 24 Months, 2024

Source: Cerulli Associates



In the first half of 2024, more than one-third (34%) of asset owners expressed plans to increase their portfolio duration. Furthermore, 32% indicated a desire to increase their exposure to alternative investments over the next 24 months.

Asset Growth

Institutional investors' assets bounce back in 2023

Key Takeaway

Across all institutional channels, assets showed a commendable increase, defying the significant losses experienced in 2022. In 2023, overall assets rose by 8.6%, with corporate defined contribution demonstrating the most substantial growth among all channels.

- Institutional channels covered by Cerulli **are projected to increase at a 5.8% compound annual growth rate (CAGR) over the next five years**.
- **Endowment assets totaled $963.2 billion in 2023, the highest level in over a decad**e. Assets are projected to surpass $1 trillion in 2024.
- **In 2023, assets across all channels grew**, unlike in 2022, when only one channel, insurance general accounts, enjoyed positive returns.
- **After a decrease of 8.0% in 2022, total assets bounced back with an increase of 8.6%, totaling $32.4 trillion**. Despite the most recent gain, total institutions' assets shrunk by 0.1% of the 2021 asset total.

U.S. Institutional Markets Year-Over-Year Change in Assets, 2022–2023

Sources: Department of Labor, U.S. Census Bureau, A.M. Best, NACUBO, The Foundation Center, Federal Thrift Savings Plan Annual Reports, ICI, S&P Capital IQ MMD, Cerulli Associates
Analyst Note: See Exhibit 2.01 for details.