Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**
MEETING DATE:	**20 NOVEMBER 2020**
TITLE:	**Review of Investment Performance for Periods Ending 30 September 2020**
WARD:	ALL
AN OPEN PUBLIC ITEM	
List of attachments to this report: Appendix 1 – Fund Valuation Appendix 2 – Mercer Performance Monitoring Report EXEMPT Appendix 3 – Risk Management Framework Quarterly Monitoring Report Appendix 4 – Brunel Quarterly Performance Report EXEMPT Appendix 5 – Mercer Paper: Brexit Scenario Analysis	

1. THE ISSUE

1.1. This paper reports on the performance of the Fund's investment managers and seeks to update the Panel on routine aspects of the Fund's investments. The report contains performance statistics for period ending 30 September 2020.

1.2. The report focuses on the performance of the individual investment managers and the implementation of the investment strategy. The full performance report with aggregate investment and funding analysis will be reported to the Committee meeting on 11 December 2020.

1.3. The report also includes the Risk Monitoring report (exempt appendix 3) produced by Mercer which includes details of the Fund's liability driven investment strategy and equity protection strategy.

1.4. Appendix 4 is the quarterly performance report published by Brunel which focuses on the performance of the Brunel portfolios and responsible investment activity undertaken on the Fund's behalf over the quarter.

1.5. Exempt Appendix 5 is for reference only; it discusses the current Brexit position and risks to various asset classes and the impact these scenarios are likely to have on the Fund's funding level.

2. RECOMMENDATION

2.1. **Notes information as set out in the reports.**

2.2. **Identifies any issues to be notified to the Committee.**

3. FINANCIAL IMPLICATIONS

3.1. The returns achieved by the Fund for the three years commencing 1 April 2019 will impact the next triennial valuation which will be calculated as at 31 March 2022. The returns quoted are net of investment management fees.

4. INVESTMENTS UPDATE

A – Fund Performance

4.1. The Fund's assets increased by £77m in the quarter (c. 1.9% net investment return) ending 30 September 2020 giving a value for the Fund of £5,032m. Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and managers.

4.2. Global equity markets ended the quarter in positive territory. The developed markets were up 6.6% in local currency terms while emerging markets appreciated by 8.8%. US equities were the strongest performer driven mostly by growth technology stocks. The depressed energy sector weighed heavily on UK equities which depreciated over 3% per the FTSE All Share index. 10-year benchmark US and UK yields ended the quarter higher reflective of "risk-on" sentiment and credit spreads narrowed. Sterling appreciated against the US Dollar by 4.6% and by 2.3% against the Japanese Yen and was flat versus the Euro over the quarter. Further information on 3Q asset class performance can be found on page 9 of Appendix 2. Post period-end the US election result and a COVID-19 vaccine breakthrough sparked an equity market rally, pushing prices to all-time highs.

4.3. The Fund's overall performance relative to benchmarks is unavailable at the time of publishing. Full performance data will be reported to the Pensions Committee on 11 December 2020.

B – Investment Manager Performance

4.4. A detailed report on the performance of each investment manager has been produced by Mercer – see pages 22 to 41 of Appendix 2.

4.5. Brunel reports on the performance of the assets they manage on behalf of the Fund. The report for each Brunel portfolio can be found in Appendix 4. Mercer continue to provide quarterly commentary and analysis of all the Fund's mandates and at the strategic total fund level.

4.6. Manager total returns over the quarter were positive for all assets, except for the UK equity mandates. Global and Emerging Market Equities performed strongly. The Fund's Hedge Fund mandate performed well, both in local and Sterling currency terms. Multi-Asset Credit strategies also performed well and the Fund's residual holding in its legacy DGF manager posted modest gains over the quarter. Property returns over the quarter were positive, noting that the Overseas Property mandate is lagged by one quarter. Valuation uncertainty persists in this asset class. Over the year, returns displayed a similar pattern with most asset classes posting positive absolute and relative returns, with the exception of property and core infrastructure. The 1-year relative underperformance in the core infrastructure mandate is partly a result of Sterling appreciating against the US dollar in the final quarter of 2019, before the Fund switched into a GBP share class. The relative underperformance is exacerbated by the managers ‘cash+’ benchmark. Over a 3-year period core infrastructure delivered significant value. Of the other mandates with a 3-year track record returns were mixed. The legacy DGF manager and MAC manager underperformed their cash benchmarks but posted c.3% and c.2% absolute returns, respectively.

C – Risk Management Framework Quarterly Monitoring Report

4.7. A detailed report of the performance of the Fund’s risk management strategies including details of how the Fund’s collateral position has changed over the quarter is presented in Exempt Appendix 3.

4.8. The Fund’s equity protection strategy declined in value over the quarter, as markets rose further from the protection levels in place. All regions of the equity protection strategy posted a positive market value at the end of the period, except for the US as underlying equity markets in this region moved significantly higher. An adjustment to the underlying regional make-up of the options was made during the quarter to ensure minimal mismatch between the protection strategy and the underlying physical equity exposure, where UK equities were exited to facilitate the transition to the Brunel Global Sustainable Equity portfolio.

4.9. The value of the Fund’s LDI portfolio increased slightly, mainly due to a small rise in implied inflation. The Fund’s inflation hedge ratio was increased to 35% of assets in line with the recommendation agreed by Committee at its September meeting. Further work will be undertaken by Officers and Mercer under delegated authority to consider increasing the inflation hedge to the maximum allowable under mandate guidelines following the outcome of the RPI reform consultation, which is due to be released on 25 November.

5. INVESTMENT STRATEGY AND PORTFOLIO REBALANCING

5.1. **Asset Class Returns versus Strategic Assumptions:** Developed market equity returns over the last 3 years were 9.4% p.a., ahead of the assumed strategic return of 6.8% p.a. used during the 2019/20 investment strategy review. The 3-year return from emerging market equities was 4.6%; below the assumed 3-year return of 8.3%. Over the 3-year period index-linked gilts returned 7.0% p.a. versus an assumed return of 1.6%. The 3-year UK property return of 3.2% p.a. lags its assumed return of 5.2%, due to continued recent uncertainty.

5.2. **Rebalancing:** £290m of passive equities were switched into gilts within the BlackRock QIF in order to reduce the Fund’s overweight equity allocation and top up the collateral pool for the risk management strategies.

5.3. **Private Markets Investments:** At 30 September 2020 34% of the Fund’s cycle 1 £115m commitment to Brunel’s renewable infrastructure portfolio had been deployed and 32% of the Fund’s £345m commitment to the secured income portfolio had been deployed. The pace of capital deployment across both asset classes remains slow due to managers deferring acquisitions as a result of the pandemic. The current best estimate suggests further capital will not be called until late 2020 into March 2021 for the long-lease property funds. Capital calls are expected to resume sooner for the infrastructure portfolio as tactical opportunities are explored. The operational infrastructure element of the secured income portfolio has not been affected to the same extent as the long-lease property assets and the Fund’s entire commitment of £94m to the underlying manager has been called following the acquisition of a renewable energy plant.

5.4. **Responsible Investment (RI) Activity:** During the quarter Brunel joined the Workforce Disclosure Initiative. The initiative calls for greater transparency on workforce policies and practices in companies' direct operations and supply chains. Brunel also joined the Good Work Coalition, which engages with companies on the importance of a real living wage and living hours.

5.5. Separately, the Fund pledged its support for an engagement initiative targeting marine microplastic pollution; a priority theme for the Fund as outlined in the Fund's recently published Responsible Investing Annual Report.

5.6. **Voting and Engagement Activity:** Hermes engaged with 211 companies held by Avon in the Brunel segregated portfolios on a range of 606 ESG issues. Environmental topics featured in 28.9% of engagements, 78.9% of which related directly to climate change. Social topics featured in 21.0% of engagements, where human capital, human rights and diversity featured prominently. Of the 29.7% of Governance related engagements most focussed on executive remuneration and board diversity. Over the last quarter Hermes made voting recommendations at 124 meetings (1,397 resolutions). At 57 meetings they recommended opposing one or more resolutions. Over 70% of the issues Hermes voted against management on comprised board structure and remuneration. Aggregate voting data across all the Fund's investment managers will be reported to Committee at their next meeting.

6. RISK MANAGEMENT

6.1. The Avon Pension Fund Committee is the formal decision-making body for the Fund. As such it has responsibility to ensure adequate risk management processes are in place. It discharges this responsibility by ensuring the Fund has an appropriate investment strategy and investment management structure in place that is regularly monitored. The creation of an Investment Panel further strengthens the governance of investment matters and contributes to reduced risk in these areas.

7. EQUALITIES

7.1. A proportionate equalities impact assessment has been carried out using corporate guidelines and no significant issues have been identified.

8. CLIMATE CHANGE

8.1. The Fund is implementing a digital strategy across all its operations and communications with stakeholders to reduce its internal carbon footprint in line with the Council's Climate Strategy. The Fund acknowledges the financial risk to its assets from climate change and is addressing this through its strategic asset allocation to Low Carbon Equities and renewable energy opportunities. The strategy is monitored and reviewed by the Committee.

9. OTHER OPTIONS CONSIDERED

9.1. None

10. CONSULTATION

10.1. The Council's Monitoring Officer and Section 151 Officer have had the opportunity to input to this report and have cleared it for publication.

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Background papers	Data supplied by Mercer, Brunel & State Street Performance Measurement
Please contact the report author if you need to access this report in an alternative format	