Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**
MEETING DATE:	**26 FEBRUARY 2021**
TITLE:	**Review of Investment Performance for Periods Ending 31 December 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	

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 31 December 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 26 March 2021.

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.

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 £138m in the quarter (3.2% net investment return) ending 31 December 2020 giving a value for the Fund of £5,169m. Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and managers.

4.2. The prospect of vaccine rollouts and supportive geopolitical events drove growth assets higher across the board. Global equities returned 8.5% in sterling terms. The US lagged other developed regions returning just over 6%, while UK equities rallied over 12%. Over the year US equities generated the strongest returns into the high double digits benefitting from rapid growth in technology stocks, while the UK lagged due to its oil & gas and financials sectoral bias. Yields remained suppressed due to COVID-related central bank stimulus and credit spreads narrowed, indicative of the risk-on sentiment. Sterling appreciated against the US Dollar by 5.7%, by 1.3% against the Euro and 3.4% against the Japanese Yen. Further information on 4Q asset class performance can be found on page 9 of Appendix 2 and pages 5 – 9 of Appendix 4.

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 26 March 2021.

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. We are reviewing the quarterly reporting given that most of the assets are now managed by Brunel; Mercer's will continue to provide assurance but focus will be more strategic.

4.6. Manager total returns over the quarter were positive for all assets except for the overseas property mandate, noting that performance for this mandate is lagged by one quarter. The Fund's active equity portfolios marginally outperformed their respective benchmarks. The Hedge Fund mandate performed well in local currency terms as did the Multi-Asset Credit and Diversified Return strategies. Over the year, the Global High Alpha portfolio delivered significant outperformance, largely as a result of one underlying manager with a significant growth stock bias. The Emerging Market portfolio fared less well, underperforming the benchmark by 1%. There have been significant downward revisions to the values of some underlying overseas property assets over the year, however it is worth noting that the manger has delivered significant value on a since inception basis. Further, a number of the underlying funds have several years to maturity and remain in the 'value creation' phase of their respective lifecycles. Both the core infrastructure and overseas property mandates are affected by static benchmarks, which can magnify underperformance. Over a 3-

year period core infrastructure and hedge funds delivered significant value, outperforming their respective benchmarks. The MAC manager underperformed its cash benchmark but posted over 4% in absolute terms.

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. Officers, acting on advice from Mercer, considered a tactical opportunity to restrike the protection levels given the significant increase in the underlying equity markets, which would allow further upside participation. Due to unattractive pricing and the potential losses incurred under a downside scenario, Officers agreed to take no action but to keep the prospect of closing out the structure ahead of time - and moving to a dynamic approach sooner - under review.

4.9. Post period-end Officers and Mercer reviewed counterparty banks shortlisted for the implementation of the dynamic equity protection strategy. Having assessed the banks across a broad set of criteria including cost, operational capability and client servicing, Officers and Mercer, under delegated authority, agreed to appoint three banks to minimise concentration risk. The final appointment of each bank will be subject to an independent legal review of key trade terms and documentation. Details of the counterparty banks selected can be found on p.13 of Exempt Appendix 3.

4.10. Over the quarter the Fund's LDI portfolio provided a marginally positive return due to changes in inflation expectations. Post period-end the Fund's inflation hedge ratio was increased to c.45% of assets, following the outcome of the RPI reform consultation. This means that no further inflation hedging will be implemented even if inflation triggers are hit as the hedge ratio is now at the maximum allowable under mandate guidelines. The suitability of the current mandate guidelines will be factored into the annual review of the risk management framework, which is reported to Panel and Committee in September.

5. INVESTMENT STRATEGY AND PORTFOLIO REBALANCING

5.1. **Asset Class Returns versus Strategic Assumptions:** Developed market equity returns over the last 3 years were 10.5% 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 6.2%; below the assumed 3-year return of 8.3%. Over the 3-year period index-linked gilts returned 6.1% p.a. versus an assumed return of 1.6%. The 3-year UK property return of 2.8% p.a. lags its assumed return of 5.2%, due to continued uncertainty in the sector.

5.2. **Rebalancing:** The residual holding in the Ruffer DGF (c. £160m) was sold in December in anticipation of private markets drawdowns and to align the portfolio with the 10% strategic allocation. Cash proceeds of the sale were subsequently invested in the Fund's liquidity strategy, managed by BlackRock.

5.3. **Private Markets Investments:** At 31 December 2020 37% of the Fund's Cycle 1 (2018-2020) £115m commitment to Brunel's renewable infrastructure portfolio had been deployed and 37% of the Fund's £345m commitment to the secured income portfolio had been deployed. The pace of capital deployment across both

portfolios is expected to increase in the coming quarters as the pipeline for new build and operational renewable energy assets remains strong and acquisition activity is starting to pick-up in the long lease sector. Current best estimates suggest a significant amount of capital will be called by the end of 1Q 2021 as underlying managers near completion on two sizeable assets. Over the quarter Cycle 2 (2020-2022) commitments also began drawing down capital. Of the scaled back commitments made to Cycle 2 in March 2020, 12% of the renewable infrastructure and 7% of the secured income commitments have been deployed. The Brunel private debt portfolio for Cycle 2 is launching in 1Q 2021 and is expected to start drawing down on the Fund's £45m commitment early in 2Q 2021. The Fund has the option to top-up Cycle 2 commitments in March. This is discussed further in Appendix 1 to Item 8.

The re-registration of the Fund's UK property assets (to be managed by Brunel) commenced in January. As part of the transition the Fund committed £10m to an affordable housing fund, which works with regional house builders to develop new-build housing for the underserved affordable rental sector. Redemptions in non-transferable funds held by the legacy UK property manager continued to progress as the Fund seeks to rebalance its allocation to the 3.75% strategic allocation. Post period-end c.£15m was redeemed from one of the legacy funds. A further c.£32m is expected to be redeemed in 2Q21, leaving c.£60m of holdings to wind down.

5.4. **Responsible Investment (RI) Activity**: A summary of RI activity undertaken by Brunel is included on pages 10 – 12 of Appendix 4. As part of the ongoing work around climate governance and fossil fuel financing in the banking sector, Brunel co-filed a shareholder resolution at HSBC, calling for the bank to publish a strategy and targets in order to reduce its exposure to fossil fuel assets. Engagement with the bank is ongoing in the lead up to its April AGM.

5.5. Separately, the Fund will sign an IIGCC initiative which calls on asset owners to make a series of commitments to help deliver the goals of the Paris Agreement. Details will follow on the specifics of this initiative once released publicly by IIGCC. Further, the Fund is currently undertaking an analysis of its current disclosures to better understand what is required under the new FRC Stewardship Code and the TCFD reporting requirements in order to meet compliance for the 2020/21 financial year.

5.6. **Voting and Engagement Activity:** Hermes engaged with 297 companies held by Avon in the Brunel segregated portfolios on a range of 878 ESG issues. Environmental topics featured in 26% of engagements, 77% of which related directly to climate change. Social topics featured in 22% of engagements, where business conduct, human rights and diversity featured prominently. Of the 31% of Governance related engagements most focussed on executive remuneration and board diversity. Over the last quarter Hermes made voting recommendations at 108 meetings (749 resolutions). At 43 meetings they recommended opposing one or more resolutions. 65% 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 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	