Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**
MEETING DATE:	**28 MAY 2021**
TITLE:	**Review of Investment Performance for Periods Ending 31 March 2021**
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 **TO FOLLOW** Appendix 4 – Brunel Quarterly Performance Report Appendix 5 – Brunel Update	

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 March 2021.

1.2. The Mercer Performance Monitoring Report at Appendix 2 has been revised this quarter. Feedback from Panel/Officers will be taken on board and the structure of the report will continue to evolve over time to focus on strategic issues.

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. **TO FOLLOW**

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. The update on Brunel investment activity is now included in this report (see Appendix 5) as the transition of our assets to Brunel is drawing to a close and the focus for the Panel is now the ongoing management and performance of the Brunel portfolios.

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 £132m in the quarter (2.7% net investment return) ending 31 March 2021 giving a value for the Fund of £5,301m. Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and managers.

4.2. Positive risk sentiment drove returns over 1Q21 as upgraded global growth expectations coupled with the passing of the US Administrations stimulus package prompted growth assets to rally and defensive assets - such as government bonds - to sell off. Sterling appreciated against the US Dollar by 0.9%, by 5.1% against the Euro and 8.0% against the Japanese Yen. Further information on 1Q asset class performance can be found on pages 6-7 of Appendix 2 and pages 5 – 8 of Appendix 4.

B – Investment Manager Performance

4.3. Brunel reports on the performance of the assets they manage on behalf of the Fund. The report for each Brunel portfolio can be found on pages 17-34 of Appendix 4.

4.4. The Mercer report provides total fund level performance, current funding level and an analysis of how the Fund's mandates are performing against expected strategic returns (see pages 22-24 of Appendix 2). This report will continue to evolve over time to ensure strategic risks and opportunities are highlighted.

4.5. Manager total returns over the quarter were mixed with equity mandates posting positive absolute returns and fixed income assets adversely impacted by the government bond sell off. On a relative basis the equity mandates underperformed their respective benchmarks due to the inherent quality and growth factor bias. The market rewarded value stocks over the quarter; particularly the financials and energy sectors. The MAC portfolio and Corporate Bond portfolio (held in the QIF for cashflow matching purposes) both posted negative absolute returns largely as a result of yield curve steepening. On a relative basis, the MAC portfolio underperformed its custom benchmark largely as a result of US Dollar strength which negatively impacted its Emerging Market positions. The Brunel DRF also posted a negative absolute return which is attributable to the portfolios underlying growth and quality equity biases and long exposures to sovereign bonds and the Japanese Yen. Elsewhere, the Hedge Fund mandate performed well in local currency terms noting that the Fund no longer has a strategic allocation to this asset class and the allocation is expected to wind down over time. The core infrastructure mandate posted positive absolute returns as revised valuations began to reflect a post-pandemic recovery. The Fund's LDI portfolio provided a tailwind to total fund returns over the quarter as inflation expectations rose and the Fund's inflation positions added value.

Of those mandates with a 1-year track record all posted positive absolute returns (except for the overseas property mandate). Notable outperformance came from the MAC, hedge fund and infrastructure portfolios. The global high alpha was the standout performer amongst the Fund's equity mandates, outperforming its

benchmark by nearly 8%. 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.

C – Risk Management Framework Quarterly Monitoring Report

4.6. 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.

4.7. The Fund's equity protection strategy declined in value over the quarter, as markets rose further from the protection levels in place.

4.8. Post period-end Officers and Mercer concluded the legal review of all documentation attached to the dynamic equity protection strategy and issued instructions to BlackRock to implement the strategy with the appointed counterparty banks. Officers/Mercer will update the Panel at its next meeting once all trading is complete.

4.9. Over the quarter the Fund's LDI portfolio provided a positive return due to changes in inflation expectations. 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. **Returns versus Strategic Assumptions:** Returns since the last valuation date (March 2019) for all equity mandates, the MAC portfolio and core infrastructure are ahead of the assumed strategic returns used during the 2019/20 investment review. The overseas property portfolio lags its assumed return due to the impact of COVID on the property market and the other mandates are either still in build-up phase or do not have a sufficient track record (e.g. Brunel DRF) to properly compare against strategic return assumptions.

5.2. **Rebalancing:** There was no rebalancing activity during the quarter.

5.3. **Private Markets Investments:** At 31 March 2021 39% of the Fund's Cycle 1 (2018-2020) £115m commitment to Brunel's Infrastructure portfolio had been deployed. Pace of deployment remained steady, which is reflective of the fact the Brunel portfolio focuses on high-quality, essential services assets which have been impacted by COVID to a lesser extent than discretionary infrastructure assets. At 31 March 2021 69% of the Fund's £345m commitment to the Secured Income portfolio had been deployed. A notable pickup in pace of deployment largely the result of one underlying manager completing on 4 separate asset purchases. Post period-end a further £58m was drawn down, leaving £48m of undrawn capital for the cycle 1 Secured Income portfolio.

5.4. Over the quarter Cycle 2 (2020-2022) commitments continued drawing down capital. 6% of the £120m renewable infrastructure and 33% of the £120m secured income commitments have been deployed. The Brunel private debt portfolio launched during the period and is expected to start drawing down in May on the Fund's £245m commitment.

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. As at 30 April 2021 the legacy property manager had sold £65m of the funds retained. The remaining balance (c.£45m) is expected to be sold by the end 2Q 2021.

5.5. **Responsible Investment (RI) Activity**: A summary of RI activity undertaken by Brunel is included on pages 9 – 11 of Appendix 4.

5.6. Separately, the Fund published its annual carbon metrics report which showed that the Fund's listed equity portfolio was 30% more carbon efficient than the benchmark (on a Weighted Average Carbon Intensity basis). The relative efficiency was due to a combination of factors including decarbonisation of the underlying portfolios (driven by investment managers allocating capital to less carbon intensive sectors and/or companies) and the Fund's own strategic asset allocation; principally the replacement of the oil & gas heavy UK equity allocation (and reduction in global equities) with the allocation to the Brunel global sustainable equity portfolio, which has a nil exposure to future emissions from reserves. The results of this analysis will inform future strategy around climate change objectives.

5.7. **Voting and Engagement Activity:** Hermes engaged with 338 companies held by Avon in the Brunel segregated portfolios on a range of 1,175 ESG issues. Environmental topics featured in 24% of engagements, 78% of which related directly to climate change. Social topics featured in 22% of engagements, where human capital, human rights and diversity featured prominently. Of the 38% of Governance related engagements most focussed on executive remuneration and board diversity. Over the last quarter Hermes made voting recommendations at 104 meetings (1,036 resolutions). At 36 meetings they recommended opposing one or more resolutions. 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 Section 151 Officer have had the opportunity to input to this report and have cleared it for publication.

Contact person	Nathan Rollinson, Investments Manager (Tel. 01225 395357)
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	