AVON PENSION FUND COMMITTEE INVESTMENT PANEL

Minutes of the Meeting held

Friday, 28th May, 2021, 3.00 pm

Members: Councillor Shaun Stephenson-McGall (Chair), Councillor Paul Crossley, Councillor Chris Dando, John Finch, Pauline Gordon and Shirley Marsh-Hughes

Advisors: Steve Turner (Mercer), Joshua Caughey (Mercer) and Hemal Popat (Mercer)

Also in attendance: Tony Bartlett (Head of Business, Finance and Pensions), Liz Woodyard (Group Manager for Funding, Investment & Risk) and Nathan Rollinson (Investments Manager), David Vickers (Brunel) and Chris Crozier (Brunel)

1 WELCOME & INTRODUCTIONS

The Chair welcomed everyone to the meeting.

2 DECLARATIONS OF INTEREST

There were none.

3 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

There were none.

4 TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

There was none.

5 ITEMS FROM THE PUBLIC - TO RECEIVE DEPUTATIONS, STATEMENTS, PETITIONS OR QUESTIONS

There were none.

6 ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

There were none.

7 MINUTES: 26TH FEBRUARY 2021

The Panel noted the minutes of the previous meeting.

8 BRUNEL UPDATE PRESENTATION

David Vickers, Chief Investment Officer, Brunel addressed the Panel and gave them a presentation, a summary of the presentation is set out below.

- PMI – Shows broad measures of economic growth
- Renewed demand for commodities
- Credit spreads are back near pre-Covid levels
- More bankruptcies were experienced in 2019 than in 2020
- A decade of potentially lower returns should be expected
- Value stocks have risen since the Covid vaccination scheme began

Macro outlook

- Economies well on the way to recovery driven by stimulus.

- Global vaccine deployment is allowing markets to “look through lockdowns and outbreaks”
- Pent up demand and high savings rate can spur on the economy.
- High debt levels keep interest rates low
- We are early in the economic cycle, but….

- Equity valuations are not cheap, the boost from lower interest rates is over.
- Credit spreads are at or near all-time lows and companies are more indebted than ever.
- Inflation is picking up (base effect) but the future path of inflation is unclear

Steve Turner, Mercer asked if those outlook points were likely to make it easier or harder to invest in a climate orientated way.

David Vickers replied that while periods of underperformance for certain types strategies should be expected, in the long-term the inherent quality factor of Brunel portfolios should be additive to returns. He commented that in the current environment he had seen the equity market rally broaden out beyond traditional value stocks in the energy and banking sectors. He referred to the recent case of the Dutch Government ruling that Shell’s emissions targets should be accelerated as indicative of the market’s direction of travel.

Other key market trends

Themes for consideration include:

- Unwinding of fiscal stimulus
- Trade tensions
- Political risk e.g. Taiwan
- A change in the global tax system
- A wave of defaults as stimulus and forbearance is withdrawn
- Investing in China – Human Rights issues / Modern Slavery
- Cyber risk
- Climate change – an integral part of how we manage your assets, but a new trend for some!

- A continued and prolonged change in equity leadership from growth to value

Councillor Paul Crossley asked if the speed at which capital was being invested in sustainable and ‘green’ investments could create artificially high valuations, posing a significant risk to ‘green’ investment strategies.

David Vickers replied that there is dispersion among regions as to how far advanced they are in adopting ‘green’ and sustainable investment strategies, with the UK leading the way. Certain markets, including the US, are less well advanced indicating that the market remains robust.

Shirley Marsh-Hughes asked if Brunel would consider all of their portfolios to be sustainable.

David Vickers replied that they all are except for the ones that are passive. He added that all the active portfolios are sustainable with a big ESG input into them.

Pauline Gordon asked if there were any key differences between the developed and emerging markets in terms of the macros highlighted.

David Vickers replied that emerging markets are cheaper on aggregate than developed ones and benefit from a weaker dollar. He added that one thing to be mindful of is that 50% of the emerging market is in China.

The Chair asked if an opinion could be given from a geo-political point of view with regard to Taiwan and the fact that they produce around 80% of the world’s microchips.

David Vickers replied that China were committed to being at the forefront of technology and chip manufacture and had been vocal around elevating their position on the world stage. He added that, critically to investment markets, supply chains had started to consolidate and that increasingly global onshoring will take place.

John Finch asked if he thought inflation would now really take off or are we just witnessing a bounce back from the lows and will it flatten.

David Vickers replied that the general thinking is that this is a bounce back and that it will fade. He added that the problem may occur if markets believe that the rate is going to continue to increase.

The Chair thanked him on behalf of the Panel for his attendance and presentation.

9 GOVERNANCE OF RISK MANAGEMENT STRATEGIES

The Group Manager for Funding, Investment & Risk introduced the report to the Panel and highlighted the following points from it.

The governance has evolved as the strategies have developed and been implemented involving significant and ongoing Investment Panel engagement. The strategies are now at a point where the role of the Committee needs to focus on ongoing delivery of investment objectives and strategic effectiveness rather than broader detailed operational aspects.

The proposed framework therefore addresses the following:

a) The role of the Committee and Panel in terms of strategic oversight of the Risk Management strategies

b) The operational arrangements to agree structures and implementation of the strategies

c) Timeliness of decision making given need to react to market environment

A Funding and Risk Management Group (FRMG) will formalise the decision-making process. It will consist of Officers (including Head of Pensions), Investment & Risk Consultants and the Fund Actuary. This will ensure both the funding and investment aspects of each strategy are holistically considered.

There will be a Terms of Reference (ToR) for the group and minutes of each meeting will be provided to the Investment Panel. FRMG will meet at least quarterly to review in depth the strategies, with the ability to convene more frequent meetings as necessary depending on market conditions or whether action needed to control risk or change the structures (in order to ensure the strategic outcome is delivered). FRMG meetings will cover both strategic and operational matters. All actions and decisions of the FRMG will be reported to the next Panel meeting.

John Finch commented that he felt that it was right to separate the operational and strategic roles.

Shirley Marsh-Hughes said that she felt the formation of the FRMG made good sense, but she was concerned about the timing of the Panel hearing from them only every quarter.

The Group Manager for Funding, Investment & Risk replied that if required an emergency meeting of the Panel could be called and added that the notes of the Group meetings could be shared with the Panel.

The Head of Business Finance & Pensions added that officers will do the best they can to communicate with all parties on decisions taken.

The Panel is supportive of the formation of a FRMG, notes the proposed changes within the report and that proposed changes to the Terms of Reference will be considered at full Committee.

10 LEGACY PORTFOLIOS

The Investments Manager introduced this report to the Panel. He explained that the Fund has several legacy portfolios that need to either be managed down as a result of strategic asset allocation decisions or transitioned to Brunel portfolios.

He said that a number of the legacy portfolios are illiquid or not easily sold, for example hedge funds, infrastructure, and therefore will have to be managed down over time.

He stated that officers will report back to Panel on an annual basis as to the progress made in winding down legacy portfolios.

The Panel noted the report.

11 INVESTMENT PERFORMANCE

The Investments Manager introduced this report to the Panel and highlighted the following areas from within it.

Private Markets Investments: Pace of deployment within the renewable infrastructure portfolio remained steady over the quarter, reflective of the fact the Brunel portfolio focuses on high-quality, essential services. The Secured Income portfolio saw a notable pickup in pace of deployment due to increased acquisition activity of underlying managers.

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 are expected to conclude by the end 2Q 2021.

Steve Turner, Mercer addressed the Panel on their report (Appendix 2) and said that it had been reformatted to focus on forward looking strategic issues and that they would welcome any comments from the Panel.

Joshua Caughey, Mercer highlighted to the Panel some areas from the report.

<u>Market background</u>

Economic data continued to point towards a global recovery but with wide regional dispersions. Markets looked beyond the temporary setbacks created by Covid-19 restrictions. This led to another quarter of positive returns for risk assets and weaker performance for defensive assets, in
particular government bonds.

In terms of market outlook Mercer continues to prefer emerging market equities and to a lesser extent small cap equities. Within growth fixed income, we revised the outlook for loans marginally higher at the expense of high yield following the recent high yield outperformance.

Within defensive fixed income, we continue to like securitised bonds on a relative basis and remain on the underweight side of neutral in UK sovereign bonds and index- linked bonds. We think that government bonds yields will move higher on the back of strong economic growth and a pick-up in inflation. We expect inflation to rise sharply over the next few months as economies reopen , but we expect this will largely be temporary.

<u>Funding level attribution</u>

The Fund's assets returned 2.7% over the quarter, whilst the liabilities are expected to have increased by c. 0.6% due to the rise in inflation. The combined effect of this, also allowing for cashflow over the period, saw the funding level improve from 95% to 97%. The funding level is estimated to have increased by c.13% over the year to 31 March 2021.

Pauline Gordon asked if any further comment could be given on the 3 year Value at Risk (VaR) figures which were now significantly lower than what they were under the static system.

Steve Turner, Mercer replied that they have changed the way they were modelling the equity protection and have assumed that the protection qualities are permanent. He added that they were also reporting a marked reduction of the overall level of the VaR.

<u>Total Fund performance</u>

Fund returns over the quarter were driven by the rise in the value of the LDI portfolio as it protected against inflation increases. The equity portfolio also continued to deliver returns, and the currency hedging policy made a positive contribution as sterling strengthened.

The equity portfolio underperformed relative to the benchmark, however. In particular the Sustainable Equities fund has struggled due to its strong bias away from "value" factors, which have done well over the last few months. The equity protection also detracted from relative performance at the total Fund level. Falls in the MAC and Renewable Infrastructure mandates meant they also underperformed their cash/inflation plus benchmarks.

Relative performance at the mandate level has been stronger over the one year period to 31 March 2021, with the High Alpha Equity, Fund of Hedge Funds and MAC mandates standing out. Underperformance relative to the strategic benchmark over this period is mainly due to the impact of the equity protection strategy, but it is important to note that this has behaved in line with expectations given the increase in the underlying equity markets.

The Panel thanked Steve Turner and Joshua Caughey for attending and noted the report.

12 FORWARD AGENDA

The Group Manager for Funding, Investment & Risk introduced this report to the Panel. She said that the Panel will need to agree meeting dates for 2022 at some point in the near future and added that an Equity Review was planned for September 2021 and this would likely include a workshop prior to the Panel meeting being held.

The Panel noted the report.

The meeting ended at 4.25 pm

Chair(person) ....

Date Confirmed and Signed ....

Prepared by Democratic Services