

Bath & North East Somerset Council

MEETING:	AVON PENSION FUND INVESTMENT PANEL
MEETING DATE:	17 SEPTEMBER 2021
TITLE:	Review of Investment Performance for Periods Ending 30 June 2021
WARD:	ALL
AN OPEN PUBLIC ITEM	
List of attachments to this report: Appendix 1 – Fund Valuation Appendix 2 – Mercer Performance Monitoring Report Appendix 3 – Brunel Update & Portfolio Monitoring Summary Appendix 4 – Brunel Quarterly Performance Report	

1. THE ISSUE

- 1.1. This paper reports on the performance of the Brunel and legacy portfolios and seeks to update the Panel on routine aspects of the Fund's investments. The report contains performance statistics for periods ending 30 June 2021.
- 1.2. The Mercer Performance Monitoring Report at Appendix 2 is presented in its revised format and will continue to evolve over time to focus on strategic issues.
- 1.3. The performance of the Fund's Risk Management Framework is considered separately under Agenda Item 10 – Risk Management Framework Review.
- 1.4. The update on Brunel investment activity can be found at Appendix 3. As the transition of our assets to Brunel is drawing to a close the focus for the Panel is now on the ongoing management and performance of the Brunel portfolios. A summary table is included which is designed to flag any concerns from a performance and/or RI perspective. For completeness the legacy portfolios are included.
- 1.5. 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 £270m in the quarter (4.3% net investment return) ending 30 June 2021 giving a value for the Fund of £5,571m. Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class.
- 4.2. Financial market asset prices moved higher in the quarter to 30 June. A significant increase in US inflation initially benefitted 'value' stocks as the market anticipated an interest rate rise to head off inflation. This pattern reversed later in the quarter as the Fed indicated their desire to keep rates 'lower for longer', benefitting 'growth' stocks. The MSCI All Country World Index returned 7.4% in GBP terms over the quarter. The 10-year US treasury yield decreased 0.12% to end the period at 1.47%. In the UK, the 10-year gilt yield ended lower at 0.72%. Commodity prices increased over the period with Oil and Gold posting returns of 3.5% and 7.6%, respectively. The re-emergence of inflation also supported infrastructure asset values which have historically provided a partial hedge in high inflationary environments. Significant lending activity in software, cyber security and healthcare supported private debt assets. Demand for industrial property and grade A office space improved. Sterling appreciated against the US Dollar by 0.1% and by 0.6% against the Japanese Yen. It depreciated against the Euro by 0.8%. Further information on 2Q asset class performance can be found on pages 6-7 of Appendix 2.

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 17-33 of Appendix 4.
- 4.4. The Mercer report at Appendix 2 provides strategic level information including total fund level performance, current funding level and an analysis of how the Fund's mandates are performing against expected strategic returns.
- 4.5. The High Alpha and Sustainable Equity portfolios posted positive relative returns over the quarter, driven mainly by stock selection and inherent 'growth' biases. The mandates measured against cash benchmarks also outperformed with the DRF portfolio exceeding its performance target by 4.5% over the same timeframe. 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 being sold 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 with the exception of the Renewable Infrastructure mandate which is still in its build-up phase. Notable outperformance came from Hedge Funds and Core Infrastructure portfolios. The High Alpha portfolio was the standout performer amongst the Fund's equity mandates, outperforming its benchmark by nearly 6% over the year.

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 manager has delivered significant value on a since inception basis. The currency hedge detracted marginally over the quarter but was additive to returns over 1- and 3-year timeframes as Sterling strengthened over these periods.

5. INVESTMENT STRATEGY AND PORTFOLIO REBALANCING

- 5.1. **Returns versus Strategic Assumptions:** Returns since the last valuation date (March 2019) for all equity mandates and core infrastructure are ahead of the assumed strategic returns used during the 2019/20 investment review. The legacy property portfolio lags assumed returns 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 MAC) to properly compare against strategic return assumptions.
- 5.2. **Rebalancing:** There was no rebalancing activity during the quarter. Further proceeds were received from the wind down of the Schroder UK Property portfolio, some of which has been invested in Brunel's UK Property portfolio post quarter end.
- 5.3. **Responsible Investment (RI) Activity:** A summary of RI activity undertaken by Brunel is included on pages 9 – 10 of Appendix 4.

Separately, the Fund became a signatory to the '2021 Global Investor Statement to Governments on the Climate Crisis'. This Statement, coordinated by the Investor Agenda and signed by over 450 investors representing \$41tn in assets, calls on Governments to strengthen their Nationally Defined Contributions to align with the transition to net-zero emissions by 2050 or sooner, commit to sector-specific decarbonisation roadmaps supported by robust domestic policy, incentivise zero-emissions energy and transport infrastructure investment and support mandated climate risk disclosures.

- 5.4. **Voting and Engagement Activity:** Hermes engaged with 422 companies held by Avon in the Brunel active portfolios on a range of 1,171 ESG issues. Environmental topics featured in 21.4% of engagements, 82.9% of which related directly to climate change. Social topics featured in 18.5% of engagements, where human capital, human rights and diversity featured prominently. Of the 47.5% of Governance related engagements most focussed on executive remuneration and board diversity. Over the last quarter Hermes made voting recommendations at 397 meetings (5,769 resolutions). At 257 meetings they recommended opposing one or more resolutions. 70% of the issues Hermes voted against management on comprised board structure and remuneration. During the quarter, the underlying investment managers undertook the following voting activity on behalf of the Fund:

Companies meetings voted: 2,634

Resolutions voted: 37,338

Votes For: 31,675

Votes Against: 4,839

Abstained: 78

Withheld vote*: 746

** A Withheld vote is essentially the same as a vote to abstain, it reflects a view to vote neither for nor against a resolution. Although the use of 'abstain' or 'withheld' reflects the different terms used in different jurisdictions, a 'withheld' vote can often be interpreted as a more explicit vote against management. Both votes may be counted as votes against management, where a minimum threshold of support is required*

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 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 addresses 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 has 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	