

<b>Bath &amp; North East Somerset Council</b>	
MEETING:	<b>AVON PENSION FUND COMMITTEE</b>
MEETING DATE:	<b>24 SEPTEMBER 2021</b>
TITLE:	<b>INVESTMENT PERFORMANCE AND STRATEGY MONITORING (for periods ending 30 June 2021)</b>
WARD:	<b>ALL</b>
<b>AN OPEN PUBLIC ITEM</b>	
<b>List of attachments to this report:</b> Appendix 1 – Fund Valuation Appendix 2 – Mercer Investment Performance Report Appendix 3 – LAPFF Quarterly Engagement Monitoring Report	

## **1 THE ISSUE**

- 1.1 This paper reports on the investment performance of the Fund and seeks to update the Committee on routine strategic aspects of the Fund's investments and funding level; and policy and operational aspects of the Fund.
- 1.2 This report contains performance statistics for periods ending 30 June 2021.

## **2 RECOMMENDATION**

**The Avon Pension Fund Committee is asked to note:**

- 2.1 **The information set out in the report and appendices**

### 3 FINANCIAL IMPLICATIONS

- 3.1 The returns achieved by the Fund from 1 April 2020 will affect the 2022 triennial valuation. Section 4 of this report discusses the trends in the Fund's liabilities and the funding level.

### 4 FUNDING LEVEL

- 4.1 Using information provided by the Actuary, Mercer has analysed the funding position as part of the report at Appendix 2 (section 3). This analysis shows the impact of both the assets and liabilities on the (estimated) funding level. **It should be noted that this is just a snapshot of the funding level at a particular point in time.**
- 4.2 Key points from the analysis are:
- a) The funding level rose from c.97% to c.101% over the quarter to 30 June 2021. The deficit was estimated to have been eliminated over 2Q21 for the Fund to finish the quarter with a surplus of £43m.
  - b) The increase in the funding level was driven by an increase in the value of the assets, which outstripped the growth in the present value of the liabilities.

### 5 INVESTMENT PERFORMANCE

#### A – Fund Performance

- 5.1 The Fund's assets increased by £270m (4.3%%) over the quarter 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 and manager. Manager performance is monitored in detail by the Investment Panel. The Fund's investment return and performance relative to the benchmark is summarised below. The currency hedge detracted 0.1% over the quarter. The main detractor was the Equity Protection Strategy given equity markets continued to rally over the period.

**Table 1: Fund Investment Returns** (Periods to 30 June 2021)

	3 Months	12 Months	3 Years (p.a)
Avon Pension Fund (incl. currency hedging)	4.3%	12.6%	5.6%
Avon Pension Fund (excl. currency hedging)	4.4%	10.3%	5.4%
Strategic benchmark (no currency hedging)	3.9%	14.7%	7.6%
Currency hedge impact	-0.1%	2.3%	0.2%

- 5.2 **Fund Investment Return:** 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 at Appendix 2 (section 2).

- 5.3 Currency Hedging:** The hedging programme is in place to manage the volatility arising from overseas currency exposure, in particular to protect the Fund as sterling strengthens and returns from foreign denominated assets reduce in sterling terms. The hedging programme detracted 0.1% over the quarter.
- 5.4 Risk Management Strategies:** The Fund's LDI portfolio posted a return of 1.2% (based on change in exposure) over the quarter as inflation expectations rose and the Fund's inflation positions added value. The developed market portion of the equity protection strategy posted a return of -2.1% over the quarter, where the proxy benchmark used to represent the underlying equity assets hedged returned 4.8%. Developed market equities therefore returned 2.8% net of protection. Emerging market equities returned 5.1%, noting minimal impact from the equity protection strategy. The collateral position at the end of the quarter was within agreed constraints. Further information relating to the risk management strategies can be found at Item 10.

## **B – Investment Manager Performance**

- 5.5** The Fund's active global equity portfolios posted positive relative returns over the quarter, driven mainly by stock selection and inherent 'growth' biases. The emerging market portfolio was able to offset some of the sharp declines in Chinese holdings through strong stock selection to end the quarter 0.4% behind the benchmark. The mandates measured against cash benchmarks outperformed with the Diversified Returns 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. 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.

### **Overview of Strategic Performance:**

- 5.6 Asset Class Returns:** 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.

- 5.7 **Private Markets Commitments to Brunel Portfolios:** At 30 June 2021 40% 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 30 June 2021 86% of the Fund's £345m commitment to the Secured Income portfolio had been deployed. A notable pickup in pace of deployment in the past two quarters has largely been the result of increased acquisition activity.

- 5.8 Over the quarter Cycle 2 (2020-2022) commitments continued drawing down capital. 11% of the £120m renewable infrastructure and 37% of the £120m secured income commitments have been deployed. The Brunel private debt portfolio also began drawing down on the Fund's £245m commitment post quarter end.

## 6 PORTFOLIO REBALANCING AND CASH MANAGEMENT

### Portfolio Rebalancing

- 6.1 As at 30 June 2021 all asset allocations were within the control ranges for rebalancing based on the strategic benchmark, except for private markets allocations that are still drawing down capital. 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.

### Cash Management

- 6.2 Cash is held by the managers at their discretion within their investment guidelines, and internally to meet working requirements. The officers closely monitor the management of the Fund's cash held by the managers and custodian with a particular emphasis on the security of the cash.
- 6.3 Management of the cash held internally by the Fund to meet working requirements is delegated to the Council's Treasury Management Team. The monies are invested separately from the Council's monies.

## 7 RESPONSIBLE INVESTMENT ACTIVITY

### 7.1 Brunel Responsible Investment Highlights:

- i. **Paris Aligned Benchmarks.** Brunel supported the launch of a new suite of climate benchmarks that will form FTSE Russell's Paris-aligned climate benchmarks for global equity markets. The new index series meets the minimum requirement of the EU's Paris-aligned benchmarks by achieving a 50% reduction in carbon emissions over a ten-year period. It also integrates the Transition Pathway Initiative's analysis of how the largest and most carbon-exposed companies are managing the climate transition.
- ii. **FRC Stewardship Code.** Following the conclusion of the reporting period, Brunel received notification from the Financial Reporting Council that they had been accepted as part of the first wave of asset owners to receive approved signatory status. The FRC stated that it had rejected approximately one third of applicants. The Fund intends to submit its own report to the FRC by the end of the year.

- iii. **Industry Awards.** Recently Brunel has gained industry recognition winning 'Investment Team of the Year – Asset Owner' category at Environmental Finance's IMPACT Awards 2021.

## 7.2 Avon Pension Fund Responsible Investment Highlights:

- i. **Policy Advocacy.** 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.
- ii. **Asset Owner Diversity Charter.** Post quarter end the Fund pledged its support for a new charter developed by the Diversity Project which, on release, gained the support of asset owners representing over £1tn in AUM. The Charter seeks to formalise a set of actions designed to improve diversity, in all forms, across the asset management industry and calls for diversity to be incorporated into manager selection, ongoing manager monitoring and to lead and collaborate with others in the investment industry to identify diversity and inclusion best practice. Brunel have also pledged their support for the initiative.

**7.3 Voting and Engagement Summary:** Over the quarter Hermes (Brunel's appointed voting and engagement provider) 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.

**7.4 Stewardship Update:** During the quarter, the Fund's external 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 or 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.*

**7.5** The Fund is a member of LAPFF, a collaborative body that exists to serve the investment interests of local authority pension funds. In particular, LAPFF

seeks to maximise the influence the funds have as shareholders through co-ordinating shareholder activism amongst the pension funds. LAPFF's activity in the quarter is summarised in their quarterly engagement report at Appendix 3.

## **8 RISK MANAGEMENT**

- 8.1 A key risk to the Fund is that the investments fail to generate the returns required to meet the Fund's future liabilities. This risk is managed via the Asset Liability Study which determines the appropriate risk adjusted return profile (or strategic benchmark) for the Fund and through the selection process followed before managers are appointed. This report monitors (i) the strategic policy and funding level in terms of whether the strategy is on course to fund the pension liabilities as required by the funding plan and (ii) the performance of the investment managers. An Investment Panel has been established to consider in greater detail investment performance and related matters and report back to the committee on a regular basis.

## **9 CLIMATE CHANGE**

- 9.1 The Fund is implementing a digital strategy across all its operations and communications with stakeholders to reduce its internal carbon footprint. The Fund acknowledges the financial risk to its assets from climate change and addresses this through its strategic asset allocation to Low Carbon Equities, Sustainable Equities and renewable energy opportunities. The strategy is monitored and reviewed by the Committee.

## **10 OTHER OPTIONS CONSIDERED**

- 10.1 None.

## **11 CONSULTATION**

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

<b>Contact person</b>	Nathan Rollinson, Investments Manager (Tel: 01225 395357)
<b>Background papers</b>	Data supplied by Mercer & SSBT Performance Services
<b>Please contact the report author if you need to access this report in an alternative format</b>	