

Bath & North East Somerset Council

MEETING:	AVON PENSION FUND INVESTMENT PANEL
MEETING DATE:	19 NOVEMBER 2021
TITLE:	Review of Investment Performance for Periods Ending 30 September 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 – Quarterly Portfolio Monitoring Summary

Appendix 4 – Brunel Quarterly Performance Report

Appendix 5 – Mercer Paper: Managing Inflation Risk

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 September 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. Exempt Appendix 3 contains a summary table which is designed to flag any concerns from a performance and/or RI perspective.
- 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.
- 1.6. Appendix 5 examines the current inflationary environment and the potential impact on the Fund. It is intended to be a discussion document at this stage – there are no firm recommendations.

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 £139m in the quarter (2.9% net investment return) ending 30 September 2021 giving a value for the Fund of £5,710m. (see appendix 5 for asset allocation).
- 4.2. There was significant volatility in markets towards the end of the quarter, caused by supply chain disruptions and fears of default from Chinese property developer Evergrande. Gains made in July and August were wiped out in September. A lack of reliable alternative energy sources compounded supply chain disruption which drove gas prices higher. Global developed equities returned 2.6% over the quarter while emerging markets fell 5.7% in the same period. Increasing inflationary pressures led to talks of possible interest rate rises in the UK, with the Fed and ECB confirming plans to begin tapering their respective asset purchase programs. The 10-year US treasury yield rose above 1.5% following the September Fed meeting. In the UK, 5- and 10-year gilt yields increased 31bps and 30bps to 0.64% and 1.02%, respectively. In UK LDI markets, Q3 brought the inaugural green gilt, with the 2033 bond bringing record demand and a final issue size of £10bn. While demand for defensive Infrastructure assets, such as water and electric utilities, grew following rising Delta variant numbers, this proved a negative influence on the rest of the sector, which was also hit by supply chain disruptions, gas price volatility and questions around the status of the US infrastructure bill. Issuance of high yield bonds was strong and remain on course for a record-breaking year, with Private Debt markets also holding up despite a seasonal slowdown in August. Rent collection improved in the retail Property sector, with fears of falling valuations in the office sector mitigated by increased overseas demand and lack of high-quality supply. Sterling depreciated against the US Dollar by 2.4%, by 0.1% against the Euro and by 1.9% against the Japanese Yen. Further information on 3Q asset class performance can be found in the Mercer report at 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 15-34 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 Global Sustainable Equity portfolio posted a strong absolute return of 3.6% over the quarter, outperforming the index by over 2%. Stock selection was the main driver of returns. The High Alpha portfolio returned 1.7% in absolute terms, underperforming the index by nearly 1%. Underperformance in this portfolio was driven by stock selection and an overweight to China as fears of default following the Evergrande headlines spread to other sectors in the region. The Emerging Market equity portfolio posted an absolute return of -6.5% and a relative return of -0.8% over the quarter. Rising energy prices resulted in the portfolio overweight to the Energy and Materials sectors detracting from relative performance. The

DRF portfolio posted an absolute return of 0.5%. Core Infrastructure, Renewable Infrastructure and Secured Income all saw strong positive absolute returns despite a slowdown in the pandemic recovery and supply bottlenecks. The Fund's LDI portfolio provided a tailwind to total fund returns as the hedging positions added value as inflation expectations rose. Of those mandates with a 1-year track record the majority earned positive absolute returns with notable outperformance across the Infrastructure mandates and Sustainable Equity. The currency hedge detracted 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. International property is below expectations as the mandate has been impacted by the pandemic. Due to the way this portfolio invests (capital drawn down over time) the focus should be on longer-term performance. 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. The wind down of the Schroder UK Property portfolio completed with the majority of proceeds being used to meet a Secured Income call and further funding for Brunel's UK Property portfolio post quarter end. The wind down of the JPM hedge fund mandate continues and proceeds of the first redemption are due to settle in November.

5.3. **Responsible Investment (RI) Activity:** A summary of RI activity undertaken by Brunel is included on page 9 of Appendix 4.

Separately, the Fund signed up to the 'Asset Owner Diversity Charter'. This charter seeks to formalise a set of actions designed to improve diversity, in all forms, across the asset management industry. In collaboration with Brunel, we will look to follow its three main commitments to incorporate diversity questions into manager selection, incorporate diversity into ongoing manager monitoring and lead and collaborate with others in the investments industry to identify diversity and inclusion best practice. This charter was originally signed by 16 signatories representing £1.08 trillion in assets.

5.4. **Voting and Engagement Activity:** Hermes engaged with 149 companies held by Avon in the Brunel active portfolios on a range of 475 ESG issues. Environmental topics featured in 32% of engagements, 78.9% of which related directly to climate change. Social topics featured in 23.8% of engagements, where human capital, human rights and diversity featured prominently. Of the 26.5% of Governance related engagements most focussed on executive remuneration and board diversity. Over the last quarter Hermes made voting recommendations at 116 meetings (1,228 resolutions). At 41 meetings they recommended opposing one or more resolutions. 64% 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: 702

Resolutions voted: 3,941

Votes For: 3,419
Votes Against: 460
Abstained: 9
Withheld vote*: 53

** 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	