Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**
MEETING DATE:	**25 FEBRUARY 2022**
TITLE:	**Review of Investment Performance for Periods Ending 31 December 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: Themes and Opportunities 2022	

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 31 December 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. At the time of writing the capital markets data required to calculate the Fund's Value at Risk (VaR) was unavailable. An updated report will be distributed to Members via email ahead of the meeting.

1.3. The performance of the Fund's Risk Management Framework is considered separately under Agenda Item 9 – 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. The table has been compiled using data provided by Brunel as part of their routine reporting process. At the time of writing the Client Group meeting which Fund officers use to scrutinise quarterly performance reporting had not taken place. Any material issues arising from this meeting will be tabled at the meeting.

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 is a Mercer paper that examines several different themes that investors should consider in their decision-making in 2022. It is a discussion document – there are no 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 £185m in the quarter (3.6% net investment return) ending 31 December 2021 giving a value for the Fund of £5,895m. (see Appendix 5 for asset allocation).

4.2. The final quarter of 2021 saw high volatility levels caused by ongoing inflationary pressures and the rise of the Omicron variant in November. However, falls then reversed into December as reports suggested reduced severity in this new variant, leading to positive overall returns for some risk assets. Most equity assets rose in value over the quarter, while commodities were mixed and corporate credit struggled. In the UK, as inflation hit 5.2% in November, its highest rate in a decade, the Bank of England (BoE) became the first developed market to raise interest rates. Despite this rise, the BoE expects inflation to continue its upwards path into 2022 due to a strong labour market. The quarter also saw central bank movements elsewhere as the US Federal Reserve announced a tapering of asset purchases, at double the pace previously communicated, and the European Central Bank considered reducing similar stimulus. Despite geopolitical concerns over the continued build-up of Russian military assets near Ukraine, global developed equities rose by 7% mainly due to strong US performance. However, Emerging Markets performance turned negative, losing 1.7%, due to slowing growth in China and persistent concerns over its indebted property sector. In UK LDI markets, Q4 brought falling gilt prices due to interest rates rises, with December seeing 5-year gilt yields increasing 20bps, 10-year yields increasing 16bps to 0.97% and 30-year yields increasing 26bps to 1.12% versus November. Many investors looked to Infrastructure assets to help protect against inflation, while the quarter saw the $1.2trn US Infrastructure bill pass with new spending on transport and utilities. Renewables saw increased attention following COP26, which added to already high demand from investors. Private Debt saw issuance slow in December, but defaults remained minimal. UK commercial property was the best performing property sector to the end of 2021. Similarly, global real estate remained strong, with a reversal in assets that suffered during lockdown (offices, apartments, retail). Sterling appreciated against the US Dollar by 0.5%, by 2.4% against the Euro and by 3.7% against the Japanese Yen. Further information on 4Q 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 15-42 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 again posted strong performance, achieving a 6.8% absolute return over the quarter, which was 0.5% ahead of its benchmark due to positive sector allocation. The High Alpha portfolio returned 6.3% in absolute terms, underperforming the index by 1.1%. Underperformance in this portfolio was driven by stock selection, which was weakest in IT, and an overweight to China as some Covid winners started to give up their gains. The new Paris Aligned Portfolio posted an absolute return of 3.8% in the two months since its inception on 1st November 2021, in line with its benchmark. The legacy passive Low Carbon portfolio, which is due to be wound down and proceeds re-allocated to the sustainable equity portfolio by the end 1Q22, posted an absolute return of 7.4% for the quarter. Multi Asset Credit (MAC) achieved a 0.4% return vs. the 1% cash benchmark return, having been negatively affected by rising inflation. Core Infrastructure, Renewable Infrastructure, Secured Income and UK Property all saw positive absolute returns despite the uncertainties brought on by Omicron variant and rising inflation. Of those mandates with a 1-year track record the majority earnt positive absolute returns with notable outperformance across the Brunel UK Property and Global Sustainable Equity portfolios. The currency hedge also positively contributed to returns over the quarter as Sterling strengthened.

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 and renewable 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. Brunel Diversifying Return Funds is also marginally behind expectations due to a dampening of performance in the second half of 2021. Other mandates are either still in build-up phase or do not have a sufficient track record to properly compare against strategic return assumptions.

5.2. **Rebalancing:** The quarter saw a number of portfolio changes in line with recommendations from the Equity Review. October saw a £575m sale from Brunel's Low Carbon Passive portfolio into their new Paris Aligned Benchmark (PAB) Fund, while in December the Emerging Markets portfolio was sold (c£275m) with proceeds being fully re-invested in Global High Alpha. The wind down of the JPM hedge fund mandate continues with the first redemption completing in November and the second due to settle in February.

5.3. **Responsible Investment (RI) Activity**: A summary of RI activity undertaken by Brunel is included on page 10 of Appendix 4.

During the quarter the fund sent out a survey to its membership as part of its reporting requirements and in order to canvas member opinions on RI and our activities in this area. The results of this survey have now been collated and analysed, with results to be shared during March's committee meeting.

5.4. **Voting and Engagement Activity:** Hermes engaged with 200 companies held by Avon in the Brunel active portfolios on a range of 660 ESG issues. Environmental topics featured in 34.5% of engagements, 83.3% of which related directly to climate change. Social topics featured in 25.8% of engagements, where conduct and culture, human rights and diversity featured prominently. Of the 23.8% of Governance related engagements most focussed on executive remuneration and board diversity. Over the last quarter Hermes made voting recommendations at 92 meetings (867 resolutions). At 39 meetings they recommended opposing one or more resolutions. 63% 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: 419

Resolutions voted: 3,648

Votes For: 3,124

Votes Against: 468

Abstained: 22

Withheld vote*: 34

***** *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 is addressing this through its strategic asset allocation to Paris Aligned Global Equities, Sustainable 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	