

<b>Bath &amp; North East Somerset Council</b>	
MEETING:	<b>AVON PENSION FUND COMMITTEE</b>
MEETING DATE:	<b>25 MARCH 2022</b>
TITLE:	<b>INVESTMENT PERFORMANCE AND STRATEGY MONITORING (for periods ending 31 December 2021)</b>
WARD:	<b>ALL</b>
<b>AN OPEN PUBLIC ITEM</b>	
<p><b>List of attachments to this report:</b></p> <p>Exempt Appendix 1 – Quarterly Investment Monitoring Dashboard</p> <p>Appendix 2 – Mercer Quarterly Investment Performance Report</p> <p>Appendix 3 - Mercer Paper: Ukraine and Russia – An Action Checklist</p> <p>Appendix 4 – Responsible Investment Member Survey Results</p>	

## **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 The Mercer Investment Performance Report at Appendix 2 contains performance statistics for periods ending 31 December 2021.
- 1.3 Appendices to this report including the Fund Valuation, Minutes of the Investment Panel and the LAPFF Quarterly Engagement Report are now available in the Modern Gov library.
- 1.4 Mercer have provided a paper (Appendix 3) on key considerations from an investor perspective on the unfolding situation in Ukraine and will provide a further verbal update at the meeting.
- 1.5 Appendix 4 contains the results and key outcomes of the Responsible Investment Member Survey undertaken in 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 improved slightly over the period to 102%. The surplus was estimated to have increased slightly over the quarter from £66m to £107m.
  - 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 £185m (3.6%) over the quarter ending 31 December 2021 giving a value for the Fund of £5,895m. Manager performance is monitored in detail by the Investment Panel. The Fund's investment return and performance relative to the benchmark is summarised below.

**Table 1: Fund Investment Returns** (Periods to 31 December 2021)

	3 Months	12 Months	3 Years (p.a)
Avon Pension Fund (incl. currency hedging)	3.6%	14.2%	8.2%
Avon Pension Fund (excl. currency hedging)	3.3%	14.0%	7.8%
Strategic benchmark (no currency hedging)	3.8%	16.0%	10.3%
Currency hedge impact	0.3%	0.2%	0.4%

#### B – Portfolio Performance

- 5.2 Brunel reports on the performance of the assets they manage on behalf of the Fund. The Brunel quarterly performance reports are available in the Modern Gov library.
- 5.3 The Global Sustainable Equity portfolio 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 Equity 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 the Fund no longer has an allocation to, posted an absolute return of 7.4% for the quarter. The Multi Asset

Credit portfolio 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 portfolios all generated positive absolute returns despite the uncertainties brought on by the Omicron variant and rising inflation. Of those mandates with a 1-year track record, the majority had positive absolute returns with notable outperformance of the UK Property and Global Sustainable Equity portfolios.

## **C - Overview of Strategic Performance:**

- 5.4 The Mercer report in 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.
- 5.5 **Asset Class Returns:** 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 Diversified Return Fund 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.
- 5.6 **Risk Management Framework (RMF):** The Fund's risk management framework seeks to provide greater certainty that the funding plan will be achieved and therefore contribution levels will be stable and minimised. The Committee review the strategic rationale for the RMF on an annual basis.
- 5.7 Over the quarter the mandate has performed as expected and the manager is in compliance with investment guidelines. No interest rate or inflation triggers were breached over the quarter and the equity protection strategy detracted c.-1.1% from the underlying equity return of 11.2%. The currency hedge added 0.3% over the quarter as Sterling strengthened. Collateral remained sufficient to withstand the early warning and collateral top-up tests governing the framework.

## **6 PORTFOLIO REBALANCING AND CASH MANAGEMENT**

### **Portfolio Rebalancing**

- 6.1 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 completed in November and the second in February.

### **Private Markets Commitments to Brunel Portfolios**

- 6.2 The Fund has made commitments to several Brunel private markets portfolios, where those commitments are drawn down over time. The summary in Exempt Appendix 1 shows the pace of capital deployment remains on track. Further details relating to these portfolios can be found in the Brunel Quarterly Private Markets Report available in the Modern Gov library.

## **Cash Management**

- 6.3 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.
- 6.4 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 INVESTMENT PANEL ACTIVITY**

- 7.1 The Investment Panel is responsible for addressing investment issues including the investment management arrangements and the performance of the investment managers. The Panel has delegated responsibilities from the Committee and may also make recommendations to Committee. The Panel's last formal meeting was held on 25 February 2022 in virtual format. There are no decisions to note or recommendations to approve by Committee this quarter. The Panel noted the additional capital being committed to Brunel Cycle 3 private market portfolios in order for to achieve and maintain the strategic allocations already agreed by Committee (in April 2021). The Panel received assurance from Mercer that the Brunel Cycle 3 private markets specifications continued to meet the Fund's investment objectives. The draft minutes of this meeting provide a record of the Panel's discussion and are available in the Modern Gov library.

## **8 RESPONSIBLE INVESTMENT ACTIVITY**

- 8.1 **Voting and Engagement Summary:** Federated Hermes EOS provide voting and engagement services on behalf of the Fund. Summary reports available in the Modern Gov library disclose the number of companies and topics engaged on over the quarter.
- 8.2 **FRC Stewardship Code Result:** Post period-end the Fund was notified of its successful Stewardship Code application, which means it successfully demonstrates application of the Code's 12 principles which focus on the responsible allocation, management and oversight of capital to create long-term value for beneficiaries leading to sustainable benefits for the economy, the environment and society. The Fund will continue to voluntarily submit a report to the FRC on an annual basis.
- 8.3 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 which is also available in the Modern Gov library.

## **9 RESPONSIBLE INVESTMENT MEMBER SURVEY RESULTS**

- 9.1 The Fund undertook an ESG member survey in 2021. An explanation of the process followed, and the results of the survey can be found in Appendix 4. The views of the scheme membership provides useful information to help

Committee members consider the full picture, alongside professional advice, when deliberating changes to the investment strategy. It also provides an opportunity to raise awareness with the members and promote the considerable work that the Committee has, and continues to do, around responsible investment.

- 9.2 Increasingly best practice involves being able to evidence how members views have been gathered and taken account of, specifically in relation to their views on ESG. For instance, the FRC Stewardship Code stipulates: *“Signatories should take account of beneficiary needs and communicate the activities and outcomes of their stewardship and investments to them”*.

### **Avon’s Membership Survey – Results and Key Conclusions**

- 9.3 The total number of members contacted was 41,358 with a completion rate of 9.1% (3,765 respondents).

- 9.4 The responses received were largely supportive of the Fund’s ESG approach which states that; (i) ESG should be integrated in investment decision-making, (ii) climate change presents a long-term financial risk, and (iii) engagement is an effective tool to bring about change. A significant number of free format text responses called on the Fund to go further in respect of its strategy on climate. Key conclusions from the responses received are listed in Appendix 4 and summarised below:

- The majority of respondents agree it is important to take account of RI issues when making investment decisions
- Over half of respondents agree environmental, social and governance factors are of equal importance
- The majority agree climate change presents either a high risk or very high risk to investment returns
- Vast majority agree it is important to use our influence as an investor to bring about better environmental and social outcomes

- 9.5 The Fund will use the results of this survey to feed into the 2022 Brunel climate stocktake, which will consider, among other things, divestment from companies that have been unresponsive to engagement efforts and where significant climate-related financial risk exists.

- 9.6 The results will also be used to build on the Fund’s existing communications strategy by utilising traditional and digital channels e.g., website and social media as key tools to promote recent member-focussed communications.

## **10 RISK MANAGEMENT**

- 10.1 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.

## **11 CLIMATE CHANGE**

11.1 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 Paris Aligned Global Equities, Sustainable Equities and renewable energy opportunities. The strategy is monitored and reviewed by the Committee.

## **12 OTHER OPTIONS CONSIDERED**

12.1 None.

## **13 CONSULTATION**

13.1 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>	