

Bath & North East Somerset Council

MEETING:	AVON PENSION FUND INVESTMENT PANEL
MEETING DATE:	09 September 2022
TITLE:	Review of Investment Performance for Periods Ending 30 June 2022
WARD:	ALL
AN OPEN PUBLIC ITEM	
List of attachments to this report: Appendix 1 - Mercer Performance Monitoring Report Appendix 2 – Brunel Quarterly Performance Report Appendix 3 – Quarterly Portfolio Monitoring Summary	

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 2022.
- 1.2. The Mercer Performance Monitoring Report at Appendix 1 is presented in its revised format and will continue to evolve over time to focus on strategic issues.
- 1.3. Appendix 2 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.
- 1.4. The performance of the Fund's Risk Management Framework is considered separately under Agenda Item 11 – Risk Management Framework Review.
- 1.5. Appendix 3 contains a summary table which is designed to flag any concerns from a performance, operational and/or RI perspective. The table has been compiled using data provided by Brunel as part of their routine reporting process. There are no concerns arising from the Brunel portfolios this 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 decreased by £370m in the quarter (-7.1% net investment return) ending June 2022 giving a value for the Fund of £5,456m.
- 4.2. The second quarter of 2022 saw a continuation of the negative sentiment around risk-assets, primarily driven by multi-decade high inflation, fears of a global recession and further geopolitical tensions. The MSCI All Country World Index was down 9.0% in GBP terms with all but two countries registering negative returns. In terms of equity styles (see below table), the inflationary environment continued to support value stocks and punish growth stocks although the discrepancy between styles started to narrow in June as the market pivoted into defensive names expected to perform strongly in an economic downturn, which in turn led to opportunities to generate alpha.

Equity 'Style'	1Q 2022 Return	2Q 2022 Return	1H 2022 return
MSCI World	-2.32	-9.00	-11.12
MSCI World Growth	-7.01	-14.51	-20.50
MSCI World Value	2.37	-3.95	-1.67
MSCI World Quality	-5.88	-9.90	-15.19
MSCI World Minimum Volatility	-0.29	-2.49	-2.77
MSCI World Large cap	-1.99	-8.84	-10.66
MSCI World small cap	-3.72	-10.08	-13.43

Credit markets fared particularly badly as a result of rising rates and widening credit spreads. In UK LDI markets 10-year gilt yields rose by 62bps. Across Private Markets, Infrastructure opportunities, particularly in the renewables sector, remained in demand. In Private Debt, managers began to move into more defensive sectors with a focus on covenant strength. Property has yet to see a pricing impact from rising inflation and interest rates, with industrial leasing and warehouses remaining buoyant. Demand for offices remained steady with availability falling. The retail sector performed well but this is unlikely to continue as consumer confidence falls. In the long-lease sector rents are typically contracted to rise in line with inflation, but this is often capped at ~5%, which could impact performance as inflation continues to rise. Sterling depreciated against the US Dollar by 7.8%, by 1.8% against the Euro and appreciated by 3.2% against the Japanese Yen. Further information on Q2 asset class performance can be found in the Mercer report at Appendix 1.

B – Investment Manager Performance

- 4.3. The Mercer report at Appendix 1 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.
- 4.4. 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 2.
- 4.5. Overall, the Fund saw a negative return over the quarter. Leading detractors Global High Alpha and Global Sustainable Equities both produced absolute returns of -10.3% (-1.3% and -1.9% respectively on a relative basis). Global High Alpha's relative underperformance was driven by sector selection, suffering from

a large underweight position in the best performing sector (Energy) and a large overweight position in the worst performing (Consumer Discretionary). GSE's underperformance is attributable to its style bias, the overweight to US names and underweight to China. The Passive Paris Aligned Portfolio posted a negative absolute return of -9.1%, with Consumer Staples and Healthcare being the only two positive contributors to returns over the quarter. The MAC portfolio posted a -8.6% return vs. the 1.2% cash benchmark. It performed in line with its proxy credit benchmark. DRF saw negative returns of -3.0% vs its 0.9% cash benchmark. Its relatively low equity beta insulated it from the sharp falls seen in equity markets. Core Infrastructure, Renewable Infrastructure, Private Debt, Secured Income and Property portfolios all produced positive absolute returns over the period. Of those mandates with a 1-year track record the majority of private markets portfolios still earned positive absolute returns, with notable outperformance from the Cycle 2 Brunel Secured Income (which benefits from a larger allocation to renewable infrastructure than Cycle 1) and IFM Infrastructure portfolios. Listed market portfolios have produced negative absolute and relative performance figures for the year largely because of the ESG tilt in these portfolios. The currency hedge detracted 1.2% over the quarter as Sterling weakened against the Euro and US Dollar.

5. INVESTMENT STRATEGY AND PORTFOLIO REBALANCING

5.1. **Returns versus Strategic Assumptions:** Returns versus the strategic assumptions used during the 2019/20 investment review can be found on p22-23 of Appendix 1. Significantly, Global Sustainable Equity returns are below expected returns due to portfolio biases. Multi Asset Credit is also behind due to negative returns from fixed income markets in 2022. Some of the private markets 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 wind-down of the JPM hedge fund mandate continues with the third redemption of \$80m settling in May and the fourth in August.

The Blackrock QIF collateral pool was topped up by £60m during the quarter, funded from the hedge fund wind-down.

5.3. **Responsible Investment (RI) Activity:** A summary of RI activity undertaken by Brunel is included on page 10-11 of Appendix 2.

The Fund has drafted its second Taskforce on Climate Related Financial Disclosures (TCFD) report and is considered under Item 9.

5.4. **Voting and Engagement Activity:** Hermes engaged with 323 companies held by Avon in the Brunel active portfolios on a range of 967 ESG issues. Environmental topics featured in 26% of engagements, 72% of which related directly to climate change. Social topics featured in 18% of engagements, where conduct and culture, human rights and diversity featured prominently. Of the 45% of Governance related engagements most focussed on executive remuneration and board diversity. Over the last quarter Hermes made voting recommendations at 475 meetings (6,832 resolutions). At 311 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: 2.353

Resolutions voted: 35,170

Votes For: 26,642

Votes Against: 7,863

Abstained: 72

Withheld vote*: 593

** 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.

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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	