Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**
MEETING DATE:	**25 November 2022**
TITLE:	**Review of Investment Performance for Periods Ending 30 September 2022**
WARD:	ALL
AN OPEN PUBLIC ITEM	
List of attachments to this report: Appendix 1 - Quarterly Portfolio Monitoring Summary Appendix 2 – Brunel Quarterly Performance Report Appendix 3 – Mercer Performance Monitoring Report	

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 2022.

1.2. Appendix 1 contains a summary table which is designed to flag any concerns from a performance, operational and/or RI perspective.

1.3. Appendix 2 is the quarterly performance report published by Brunel which includes further details on the performance of the Brunel portfolios and responsible investment activity undertaken on the Fund's behalf. This quarter the report is presented in a different format and is designed to be more user-friendly and consolidate public and private markets portfolio information into a single report.

1.4. The Mercer report at Appendix 3 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.

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 £91m in the quarter (-1.2% net investment return) ending September 2022 giving a value for the Fund of £5,365m. The fall in the value of Fund assets over the quarter was driven mainly by the currency hedge as sterling weakened, although this was partially offset by positive returns from overseas exposure. Over 1 year the Fund returned -6.0% driven by negative returns from equities, LDI and currency hedging. The Fund underperformed its strategic benchmark by 6.6% over this time horizon and the main detractors were the active equity portfolios, MAC and DRF. Over 3 years the Fund returned 2.2% p.a., underperforming its benchmark by 4.6%. The main detractors over 3 years include the equity protection strategy and overseas property. Detailed performance attribution can be found on p19/20 of Appendix 3.

B – Investment Manager Performance

4.2. 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 15-28 of Appendix 2.

4.3. Listed equity returns were positive on an absolute basis. The Global High Alpha portfolio returned 1.8%, underperforming its benchmark by 0.4%. Style characteristics were less of a driver of underlying manager returns this quarter with underperformance driven largely by stock selection. Since inception this portfolio has outperformed its benchmark by 1.5%. The Global Sustainable Equity portfolio generated an absolute return of 1.0%, outperforming its benchmark by 0.3%. Overweight positions in more growth-oriented parts of the market and good stock selection in healthcare and tech offset the decline in asset prices that materialised toward the end of the quarter. Since inception this portfolio has underperformed its benchmark by 4.7%. The passive Paris Aligned Benchmark produced positive returns of 1.8% over the quarter.

Multi Asset Credit (MAC) and Diversifying Returns Fund (DRF) both underperformed their respective benchmarks, producing negative absolute returns of -0.9% and -1.0% respectively. MAC's performance was hit by volatile credit spreads and underperformed its cash benchmark by 2.3% and its secondary benchmark, which comprises loans and high yield bonds, by 0.5% over the quarter. DRF benefited from fixed income carry and value exposure but ultimately underperformed its benchmark by 2.2% due to mixed currency returns and falls in commodities and sovereign bonds.

In private markets, Core Infrastructure, UK Property and Secured Income portfolios all produced negative returns over the quarter, but still remain positive for the year to date. One of the biggest detractors was Secured Income, underperforming it benchmark by -5.6% and -4.2% respectively for Cycle 1 and 2 as falls in gilt markets softened capital values. Despite this, the Secured Income portfolios are well positioned for the current environment, with a high-quality tenant base, inflation-linked leases, and no development exposure.

Strong positives over the quarter included Cycle 1 and 2 Renewable Infrastructure (benefiting from decarbonisation and energy tailwinds) and Private Debt, with relative outperformance of 6.4%, 5.1% and 9.1% respectively.

Of those mandates with a 1-year track record the majority of private markets portfolios still generated positive absolute returns in 2022 with notable outperformance from Private Debt and Renewable Infrastructure. Listed market portfolios have produced negative absolute and relative performance figures for the year largely because of their known style and ESG biases.

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 p21/22 of Appendix 3. 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 market 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 fall in gilt prices triggered by the UK government 'mini-budget' meant the Fund needed to top-up its collateral pool to maintain its LDI positions within the Blackrock QIF. To facilitate this, £275m was sold down from the Paris Aligned Benchmark portfolio and a further £75m was drawn from the Blackrock ETF strategy.

£35m was drawn from DRF and used to facilitate the switch of two employers into the low-risk funding strategy. Post quarter end a further £150m was drawn from DRF to bring the allocation in line with the 6% strategic target and top-up the cash holding.

A redemption request was put in with IFM Infrastructure to address an overweight to the asset class. Proceeds will be received by Q1 2023 at the earliest and used to fund private market calls arising from the Brunel portfolios.

5.3. **Responsible Investment (RI) Activity**: A summary of portfolio carbon metrics measured by Brunel over the quarter is included on page 8 of Appendix 2.

Post quarter end, the Fund submitted its FRC UK Stewardship Code statement of compliance for the year ending 31 March 2022. This statement will be assessed by the Financial Reporting Council (FRC) and the result published in Q1 2023.

Further, the Fund was featured in the Institutional Investors Group on Climate Change (IIGCC) inaugural Paris Aligned Asset Owners (PAAO) progress report and nominated for a LAPF award in the category of 'Best Climate Strategy'.

5.4. **Voting and Engagement Activity:** Hermes engaged with 149 companies held by Avon in the Brunel active portfolios on a range of 529 ESG issues. Environmental topics featured in 37% of engagements, 74% of which related directly to climate change. Social topics featured in 30% of engagements, where conduct and culture, human rights and diversity featured prominently. Of the 18% of Governance related engagements most focussed on executive remuneration and board diversity. Over the last quarter Hermes made voting recommendations at 142 meetings (1,498 resolutions). At 69 meetings they recommended opposing one or more resolutions. 78% 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:

Company meetings voted: 327

Resolutions voted: 3,762

Votes For: 3,279

Votes Against: 431

Abstained: 14

Withheld vote*: 38

* *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 Transition Aligned 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 Head of Pensions has reviewed this paper 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	