Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**
MEETING DATE:	**8 March 2023**
TITLE:	**Review of Investment Performance for Periods Ending 31 December 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 individual 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 2022.

1.2. Appendix 1 contains a summary table which is designed to flag any concerns from a performance, operational and/or Responsible Investing (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 report now consolidates 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 £134m in the quarter (-2.0% net investment return) ending December 2022 giving a value for the Fund of £5,231m. The fall in the value of Fund assets over the quarter was driven mainly by the UK property portfolio and the long-lease property component of the Fund's Secured Income allocation, with property valuations falling as a result of the Bank of England's rate hikes. The Fund's equity protection strategy also detracted as equity markets, as proxied by the MSCI World index, delivered +2.0% over the quarter. Over 1 year the Fund returned -11.0% in absolute terms and -8.2% in relative terms, driven by negative returns from both equities and credit. Negative absolute performance was compounded by significant headwinds from the Fund's LDI portfolio which detracted value as yields rose. Over 3 years the Fund returned 1.5% p.a., underperforming its benchmark by 5.2%. Detailed performance attribution can be found on p.20/21 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 15-34 of Appendix 2.

4.3. Listed equity returns were positive on an absolute basis. The Global High Alpha portfolio returned 2.7%, outperforming its benchmark by 0.7% as stock selection overcame the headwinds arising from the portfolios tilt toward 'growth' stocks and its underexposure to Energy, the best performing sector. Since inception this portfolio has outperformed its benchmark by 1.6%. The Global Sustainable Equity portfolio generated an absolute return of 2.4%, outperforming its benchmark by 0.5%. Strong stock selection and an underweight to the large-cap technology names offset the decline in asset prices that materialised toward the end of the quarter. Since inception this portfolio has underperformed its benchmark by 4.0%. The passive Paris Aligned Benchmark produced positive returns of 1.9% over the quarter.

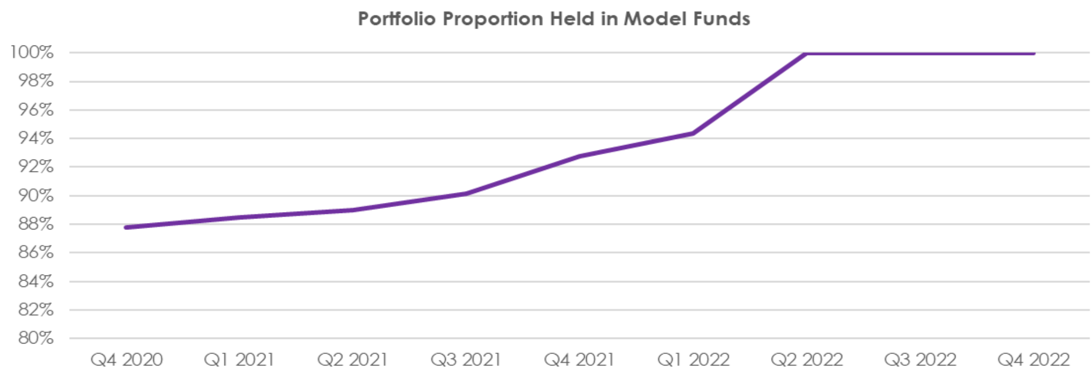
Better than expected corporate earnings, the expectation of more dovish global central bank policy, and a cooling of US inflation in October and November helped the Multi Asset Credit (MAC) portfolio deliver an absolute return of 3.7%, outperforming its primary (cash + 4%) benchmark by 2.0%. Since inception the MAC portfolio has delivered -5.2% in absolute terms, underperforming the cash benchmark by -10.2% but broadly keeping pace with its secondary benchmark, which comprises loans and high yield bonds. The Diversifying Returns Fund (DRF) generated an absolute return of 1.0% underperforming its primary (cash + 3%) benchmark by -0.4% due to mixed currency returns and sovereign bond positions. Since inception the DRF fund has generated +2.0%, underperforming its cash benchmark by -1.7%.

In private markets, UK Property and Secured Income portfolios continued to be affected by capital value declines which began in June in response to rising gilt yields. Negative performance in the Secured Income portfolio was partially offset by continued strong performance from the operational infrastructure component which has benefitted from higher power prices. The shift in yields was most acutely felt by the UK property portfolio and its overweight to the 'Industrials' sector. Valuations in this sector had been at historical highs until recently.

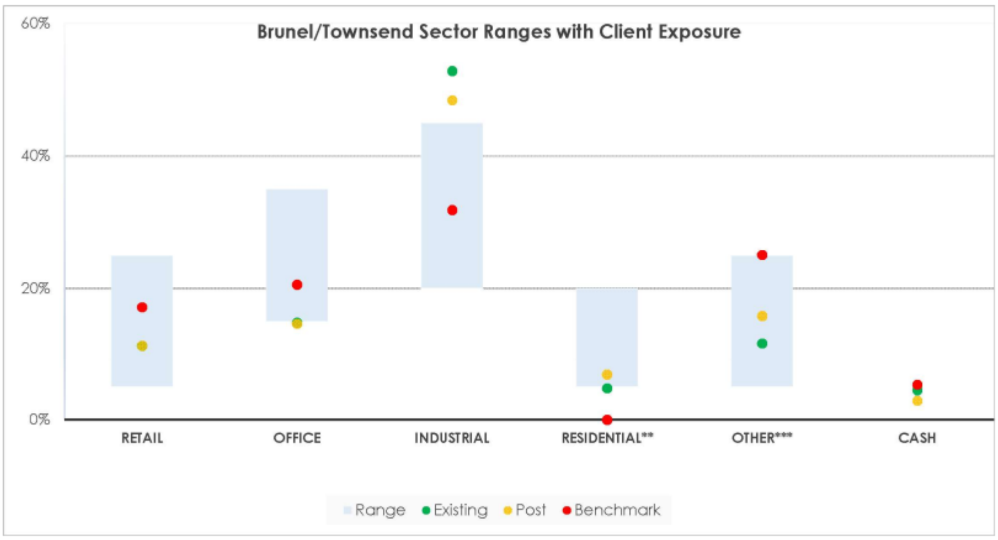
Private debt benefitted from its focus on traditionally resilient sectors such as healthcare, professional services, and established software which helped the portfolio deliver an interim IRR of 10.9%. This portfolio remains in build-up phase with c.40% capital deployed at the end of the quarter. The core infrastructure mandate managed by IFM delivered 5.5% in absolute terms over the quarter, benefitting from strong valuations across toll roads, seaports and renewable energy assets. Similarly, the Brunel Cycle 2 (renewable infrastructure) portfolio benefited from decarbonisation and energy tailwinds. Ongoing challenges for this asset class, particularly around rising rates (and therefore the cost of project delivery), supply chain tensions and the impact of windfall taxes continue to be monitored closely.

5. INVESTMENT STRATEGY AND PORTFOLIO REBALANCING

5.1. **UK Property Portfolio Update:** As can be seen from the chart below the entire portfolio is now invested in Brunel model funds which span diversified core funds and sector specialist funds. The broad spread of sectors, assets and tenants within the diversified funds provide a defensive foundation for the overall UK property portfolio. The sector specialist funds offer complimentary qualities to those within standard UK commercial sectors. Examples include healthcare, the private rented sector and life sciences (laboratory facilities).



Underlying sector positioning as at 31 December 2022 can be seen from the chart below both pre- and post planned trading/cashflows. The portfolio is structually underweight to both retail and office sectors. The largest overweight is to industrials, a position which is actively being rebalanced to fund sector specialist acquisitions. Further information relating to the Fund UK property allocation can be found on p34 of Appendix 2.



5.2. **Returns versus Strategic Assumptions:** Returns versus the strategic assumptions used during the 2019/20 investment review can be found on p22/23 of Appendix 3. Significantly, Global Sustainable and Paris Aligned Equity returns are below expected returns due to portfolio biases and equity market weakness since inception. Multi Asset Credit and DRF are also behind due to negative returns from fixed income markets in 2022. The private market mandates are largely still in build-up phase or do not have a sufficient track record to properly compare against strategic return assumptions.

5.3. **Rebalancing:** At the start of the quarter the Fund topped-up its collateral pool 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.

£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 from IFM Infrastructure for £150m settled post quarter end, addressing the overweight to the asset class. Proceeds were invested in the Fund's liquidity strategy in anticipation of further private market calls arising from the Brunel portfolios.

5.4. **Responsible Investment (RI) Activity**: A summary of portfolio carbon metrics measured by Brunel over the quarter is included on page 9 of Appendix 2.

The Fund successfully retained its FRC UK Stewardship Code signatory status for the year ending 31 March 2022 and published its Responsible Investing Annual Report available to read here.

5.5. **Voting and Engagement Activity:** Hermes engaged with 197 companies held by Avon in the Brunel active portfolios on a range of 695 ESG issues. Environmental topics featured in 39% of engagements, 77% of which related directly to climate change. Social topics featured in 29% of engagements, where conduct and culture, human rights and diversity featured prominently. Of the 21% of Governance related engagements most focussed on executive remuneration and board diversity. Over the last quarter Hermes made voting recommendations at 118 meetings (787 resolutions). At 53 meetings they recommended opposing one or more resolutions. 68% of the issues Hermes voted against management on comprised board structure and remuneration.

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	