Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**
MEETING DATE:	**15 September 2023**
TITLE:	**Review of Investment Performance for Periods Ending 30 June 2023**
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 30 June 2023.

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. 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 were £5,455m on 30 June 2023 and delivered a net investment return of -0.1% over the quarter. The marginal decline in the value of

Fund assets over the quarter was driven mainly by the protection assets (LDI and equity protection). The UK property portfolio and the long-lease property component of the Fund's Secured Income allocation also struggled to generate meaningful positive performance with property valuations effected by the high interest rate environment. Positive equity performance served to offset much of the negative performance from real assets. The passive Paris-aligned index outperformed the two active equity mandates.

4.2. Over 1 year the Fund returned -0.3% in absolute terms and -6.7% in relative terms, again driven by the equity protection strategy and property portfolios. Over 3 years the Fund returned 3.2% p.a., underperforming its benchmark by 4.5%. The currency hedge was additive to returns over the quarter and 1 year and neutral over 3 years. Detailed performance attribution can be found on p.20/21 of Appendix 3.

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 17-37 of Appendix 2.

4.4. Listed equity returns were positive on an absolute basis. The Global High Alpha portfolio returned 3.9%, flat against its benchmark. Stock selection was largely positive and offset the impact of being underweight the largest technology stocks including Apple. Since inception this portfolio has outperformed its benchmark by 2.0%. The Global Sustainable Equity portfolio was flat over the quarter, underperforming its benchmark by 3.2%, underweight positions in large technology stocks being the largest detractor. The Panel should note that the top-7 global stocks[1] contributed 65% of total global index returns. Since inception in 2021, this portfolio has underperformed its benchmark by 4.3% though we believe that the long-term proposition for sustainable stocks remains intact. The passive Paris-aligned index outperformed its active counterparts to produce an absolute return of 5.3% over the quarter.

Better than expected corporate earnings, the expectation of more dovish global central bank policy, and a cooling of US inflation helped the Multi Asset Credit (MAC) portfolio deliver an absolute return of 1.8%, flat against its primary (cash + 4%) benchmark. Since inception the MAC portfolio has delivered -1.7% in absolute terms, underperforming the cash benchmark by -7.5% 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 -0.8%. Equity positions within the DRF mandate benefitted while currency returns and sovereign bond positions detracted. Since inception the DRF fund has generated +2.1%, underperforming its cash benchmark by -2.2%.

The fundraising environment for private markets has experienced a significant slowdown in 2023 triggered by higher interest rates which translate into a higher cost of capital. The Fund's core infrastructure delivered an absolute return of 0.5% over the quarter. In local currency terms the return was 2.8%, reflecting increased demand for airport, pipeline and seaport assets. The Brunel infrastructure portfolios are still in build-up so performance is not yet meaningful.

[1] *Apple, Microsoft, Amazon, NVIDIA, Tesla, Alphabet and Meta – dubbed the 'magnificent seven'*

While the pace of deployment has slowed somewhat, it is still largely on track. Deployment rates can be found at Appendix 1. The focus over the coming quarters will shift from deployment to portfolio performance.

UK Property and Secured Income portfolios continue to face a challenging environment of higher interest rates, lower valuations and declines in transactional volume. However, the market is showing signs of improvement with the UK property portfolio returning 0.4% over the quarter. The operational infrastructure component of the Secured Income portfolio, which has benefitted from higher power prices over the past year, continues to offset depressed long lease property valuations.

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 12.4%. This portfolio remains in build-up phase with c.45% capital deployed at the end of the quarter.

5. INVESTMENT STRATEGY AND PORTFOLIO REBALANCING

5.1. **Returns versus Strategic Assumptions:** Returns versus the strategic assumptions used during the 2023 investment review can be found on p22/23 of Appendix 3. It should be noted that actual asset returns relate to a relatively short time period (post investment strategy review) so there are limitations at this stage to making direct comparisons with the longer-term strategic assumptions. Equity and liquid growth assets classes are generally delivering in line or exceeding expected returns. Property is below its modelled return and the other 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.

5.2. **Rebalancing:** A net amount of £125m was drawn down from a combination of cash at hand and the Fund's liquidity management strategy to fund Brunel private market portfolios during the quarter, including the first drawdown to Cycle 3 Secured Income.

There were large transitions within the equity portfolio to achieve the agreed passive/active equity split and the creation of synthetic exposure to the MSCI Paris-aligned index was completed during the period.

A redemption request from IFM Infrastructure for £100m was submitted at the end of the quarter, addressing the overweight to the asset class due to strong returns. Proceeds will be 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 9 of Appendix 2.

5.4. **Voting and Engagement Activity:** Hermes engaged with 352 companies held by Avon in the Brunel active equity portfolios on a range of 1223 ESG issues. Environmental topics featured in 26% of engagements, 68% of which related directly to climate change. Social topics featured in 25% of engagements, where conduct and culture, human rights and diversity featured prominently. Of the 37% of Governance related engagements most focussed on executive remuneration and board diversity. Over the last quarter Hermes made voting recommendations at 454 meetings (6,430 resolutions). At 302 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. An effective governance structure, defining clear responsibilities, and ensuring that the decision-making body has an adequate level of knowledge and access to expert advice, is a key aspect of the risk management process.

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 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.

9. OTHER OPTIONS CONSIDERED

9.1. None

10. CONSULTATION

10.1. The Head of Pensions has had the opportunity to input to this report and has 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	