Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**
MEETING DATE:	**1 December 2023**
TITLE:	**Review of Investment Performance for Periods Ending 30 September 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 Exempt Appendix 4 – Mercer Paper: UK Property Fund Market Update	

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 September 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.

1.5. Exempt Appendix 4 serves to update Panel members on the impact of recent market events on the investor profile of UK property funds, and sets out views on the long-term implications for the long lease property component of the Fund's Secured Income allocation. Mercer will present their paper at the meeting. There are no immediate actions arising.

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 2023 will impact the next triennial valuation which will be calculated as at 31 March 2025. The returns quoted are net of investment management fees.

4. INVESTMENTS UPDATE

A – Fund Performance

4.1. The Fund's assets were £5,268m on 30 September 2023 and delivered a net investment return of -2.9% over the quarter. The decline in the value of Fund assets over the quarter was driven mainly by the LDI portfolio and equity assets. Overseas property and secured income portfolios also detracted.

4.2. Over 1 year the Fund returned -2.1% in absolute terms and -6.9% in relative terms, primarily driven by property portfolios whose valuations have been impacted by the higher interest rate environment. Cash benchmarks have made it difficult for these portfolios to outperform on a relative basis too. The performance drag created by the Fund's dynamic equity protection strategy compounded underperformance over 3 years where the Fund delivered a return of 1.5% against a benchmark of 7.0%. Detailed performance attribution can be found on p17/18 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 19-36 of Appendix 2.

4.4. Quarter 3 saw a decided change in tone and outlook. Although interest rates are no longer rising rapidly, the expectation is that they will now remain at higher levels for longer. This weighed on both global equity and bond markets. Brunel's portfolios were mixed during the quarter, with a number rising in absolute terms, whilst others fell. The Global High Alpha portfolio returned -0.6% during the quarter, underperforming the benchmark by 1.2%. The underweight to the energy sector combined with slower than expected revenue growth from stocks in IT, healthcare and financials weighed on performance.

The Global Sustainable Equity portfolio delivered a return of -4.1% over the quarter, underperforming its benchmark by 4.7%. Many sustainable strategies struggled to outperform during the period due to the inherent 'growth' investment style of these funds. Since inception in 2021, this portfolio has underperformed its benchmark by 5.6%. Metrics designed to assess the quality of the underlying companies in the portfolio highlight sound financial underpinnings, which are expected to be rewarded over time. We believe the long-term proposition for sustainable stocks remains intact.

The Multi Asset Credit (MAC) portfolio delivered an absolute return of 1.9%, flat against both its primary (cash + 4%) benchmark and its secondary benchmark, which comprises loans and high yield bonds. Since inception the MAC portfolio has delivered -0.7% in absolute terms, underperforming the cash benchmark by -6.9%. The Diversifying Returns Fund (DRF) generated an absolute return of 2.0% matching its primary (cash + 3%) benchmark. Since inception the DRF fund has generated +2.5%, underperforming its cash benchmark by -2.1%.

In private markets, deal flow has tentatively began to pick up, thanks to increased certainty in interest rate movements. However, raising capital remains difficult with many private equity and debt funds extending fundraising periods. Likewise, global property transactions were down over 50% according to CBRE and property funds continue to be plagued by redemptions. The Fund's core infrastructure delivered an absolute return of 3.3% over the quarter, reflecting increased demand for airport, pipeline and seaport assets. The Brunel infrastructure portfolios are still in build-up but performance data is starting to become more meaningful. A very mild 2023 has negatively impacted many operating renewable businesses as a result of low production rates causing lower than anticipated revenues. Lower production rates have been offset somewhat by higher power prices. Brunel's exposure to renewables is well diversified by geography, technology and revenue profile, however the known risks around supply chains, cost of capital and certain types of subsidy regimes continue to be monitored. Deployment rates can be found at Appendix 1.

Turning to Secured Income, the two long lease property funds held in the portfolio have been impacted by rising rates, resulting in valuation declines. Both long lease property funds received large redemption requests in 2022 and are still in the process of selling assets to raise cash. M&G has paid down approximately 80% of redemption requests and Aberdeen has cleared approximately 40% of its redemption queue. Further asset disposals are expected. 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 13.8%. The Brunel Private Debt portfolio benefits from the defensive, high quality underlying credits that are typically senior in the capital structure and sponsor-backed. This portfolio remains in build-up phase with c.60% 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 p19/20 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:** Post period end £200m was transferred from the Brunel Passive Paris-aligned equity portfolio into the BlackRock Risk Management (RMF) vehicle to facilitate further interest rate hedging. Equity exposure was replicated synthetically so as not to impact the strategic allocation to equities. The offsetting nature of the synthetic equity strategy and the dynamic equity protection strategy continues to benefit the overall collateral position of the RMF.

5.3. **Responsible Investment (RI) Activity**: A summary of portfolio carbon metrics measured by Brunel over the quarter is included on page 10 of Appendix 2.

5.4. **Voting and Engagement Activity:** Hermes engaged with 153 companies held by Avon in the Brunel active equity portfolios on a range of 521 ESG issues. Environmental topics featured in 35% of engagements, 60% of which related directly to climate change. Social topics featured in 31% 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 123 meetings (1,234 resolutions). At 69 meetings they recommended opposing one or more resolutions. 86% 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	