Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**
MEETING DATE:	**27 FEBRUARY 2024**
TITLE:	**Brunel Global Sustainable Equity Portfolio**
WARD:	ALL
AN OPEN PUBLIC ITEM	
List of attachments to this report: **Exempt Appendix 1 – Brunel Presentation: Global Sustainable Equity Portfolio**	

1. THE ISSUE

1.1. Given the relative underperformance of the Brunel Global Sustainable Equity (GSE) portfolio versus the benchmark on a since inception basis, Panel requested at its last meeting that Brunel attend to explain key performance drivers of the portfolio. Brunel will present Exempt Appendix 1 at the meeting.

1.2. The Fund has a 41.5% strategic allocation to equities; 20.5% to passive Paris-aligned equites, 10.5% to global active and 10.5% to GSE. The Fund seeded the Brunel GSE portfolio in Sept-2020. The Fund's allocation to the GSE portfolio is currently valued at £610.5m (Dec-23). 8 out of 10 underlying Brunel funds have allocations to the portfolio and the aggregate value is c. £3bn.

1.3. The portfolio is benchmarked against a global equity index (MSCI All Country World Index) and contains c. 150 stocks. It seeks to outperform the index by 2% per annum over the medium to longer term (3-5 years).

2. RECOMMENDATION

The Avon Pension Fund Investment Panel is asked to note:

2.1. **The content of the Brunel presentation at Exempt Appendix 1.**

3. FINANCIAL IMPLICATIONS

2.2. 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. PERFORMANCE OF THE BRUNEL GSE PORTFOLIO

4.1. The Performance of the GSE portfolio, net of fees, over the quarter, 1 year, 3 year and since inception can be found below:

Performance	3 month	1 year	3 year (p.a.)	Since inception
Fund	8.0%	9.3%	3.6%	5.6%
Benchmark	6.4%	15.9%	8.7%	10.3%

Excess	1.6%	-6.6%	-5.1%	-4.8%

4.2. Due to the sustainability characteristics of the GSE portfolio it has an inherent 'quality' and 'growth/anti-value' bias. This means the portfolio is underweight to sectors such as energy, banking and traditional healthcare (big pharmaceuticals) sectors and overweight to disruptive technologies and life sciences, which are more aligned to a sustainable strategy.

2.3. These portfolio biases have implications for performance. The GSE portfolio has outperformed in 8 of the 13 quarters since inception. There have been 3 quarters of material underperformance:

Q1 2022: -7.1% driven by the spike in oil prices following Russia's invasion of Ukraine and interest rate hikes, which adversely impact the performance of 'growth' companies whose valuations are largely derived from projected future cashflows.

Q223: -3.3% driven by the exceptional rally (and market concentration) in the 'magnificent 7' stocks (Microsoft, Apple, Amazon, Google, Meta, NVIDIA and Tesla) which the GSE portfolio is underweight to. The sustainable investment case for companies such as Meta do not stack up for several reasons including known poor employment practices, use of personal data and the availability of harmful content on social media platforms.

Q323: -4.8% driven by outperformance of defensive stocks, particularly in the energy, financials and pharmaceutical sectors.

2.4. Over the quarter to Dec-23 the GSE portfolio outperformed the global equity index (MSCI ACWI) by 1.6%, benefiting from the dip in inflation and anticipated interest rate cuts priced by the market.

2.5. Despite the volatility over longer timeframes, applying metrics designed to assess the 'quality' of the underlying companies highlights the fact the GSE portfolio exhibits sound financial underpinnings, which are expected to be rewarded over time. We believe the long-term proposition for sustainable stocks remains intact.

5. APPLICATION OF 'SUSTAINABILITY' IN BRUNEL GSE PORTFOLIO

1.1. The portfolio applies a broad definition of environmental and social sustainability to identify companies and investment themes able to succeed long term through contributing to society. This includes an active approach to corporate governance, and consideration of environmental and social factors, particularly when they represent potential risks to investor capital.

1.2. The GSE portfolio does not automatically screen out companies, however, it should be noted that sustainable equities may implicitly exclude certain areas which are considered incompatible with sustainability (e.g. coal mining), and some sustainable funds may include some explicit screening.

1.3. The portfolio uses active management to achieve the performance target. Although passive ESG approaches are improving, identifying strategic change and underlying ESG risks calls on considerable manager skill. Done well, there is growing evidence that it can enhance risk and return through a robust investment process.

Top 5 Active Overweight Holdings

Company	Weight (%)	Benchmark weight (%)	Sector
Ansys	2.3	0.1	IT
Intuit	2.5	0.3	IT
Mastercard	2.7	0.5	Financials
Adobe	2.1	0.4	IT
Waste Management	1.7	0.1	Enviro/Facilities

Top 5 Active Underweight Holdings

Company	Weight (%)	Benchmark weight (%)	Sector
Apple	0.0	4.5	IT
Microsoft	2.4	4.0	IT
Google	1.0	2.3	Communication Serv
Meta	0.0	1.2	Communication Serv
Tesla	0.0	1.1	Consumer Disc

6. UNDERLYING INVESTMENT MANAGERS IN GSE PORTFOLIO

1.1. The portfolio comprises 5 underlying managers, a short summary of each manager and their respective investment strategy is set out below:

(I) **Ownership Capital (25%)** is a broad sustainable equity manager that focuses on a >10-year time horizon of sustainable investment. They define their target return as 10% absolute annual returns (4% excess above expected equity return) over 10+ years, gross of fees. Their process is built on 8 Investment principles that incorporate traditional financial metrics such as strong revenue growth potential with sustainability criteria, such as a company's environmental and social indicators. This is complemented with an inhouse 75 factor ESG model and comprehensive proprietary risk management tool.

(II) **RBC (20%)** is a broad sustainable equity manager which believes that extra financial assets and liabilities are not reflected in typical financial reporting and therefore the market does not appreciate their impact, these can include effective emissions control, sustainable sourcing practices as well as interactions with customers. These insights are embedded into their valuation models with a continued focus on active engagement once a position has been initiated. The fund aims to outperform the benchmark by 3% (gross of fees) on an annualised basis over a 3 year period.

(III) **Nordea (25%)** are a bottom-up thematic equity manager which aims to invest in companies that derive significant future cashflows from their exposure to climate and environmental solution strategies. Their universe is categorised into three investment clusters; alternative energy, resource efficiency and environmental protection. They then incorporate traditional financial analysis to assess attractiveness and constantly aim to quantify the risk/reward profile of investments, which forms the basis of their construction process. They aim to outperform the MSCI ACWI by +3% (gross) annually with a controlled tracking error of 3%-6%.

(IV) **Mirova (20%)** is a bottom up, fundamental manager that falls into the broad sustainable universe. Their philosophy is focussed on 4 global transitions that will drive economies over the next decade: Environmental, Demographics, Technological and Governance. From these broad transitions they focus on underlying sub-sectors such as Resources and Health. The strategy aims to outperform the MSCI World index by 2% gross p.a. Company engagement is a fundamental part of their process, not only from a strategy level but also from a firmwide level, where they highlight their key engagement themes for the year.

(V) **Jupiter (10%)** is a bottom-up, fundamental manager that looks to provide investors access to high quality companies leading the transition to a more sustainable world. They have an active in-house approach to ESG that gives them the ability to assess strategically material areas. The investment horizon of their strategy is 5 years and that aligns with their target outperformance of 2-3% net of fees p.a. Prior to transition of assets to Brunel, Jupiter managed Avon's SRI mandate.

7. CLIMATE METRICS OF GSE PORTFOLIO

7.1. All Brunel listed equity portfolios are governed by the same net zero target, which requires portfolios to decarbonise by 7% on an annual basis.

7.2. The GSE portfolio exhibits a lower carbon intensity and higher ESG score than its benchmark. However, relative to other Brunel listed equity portfolios the GSE has a relatively high carbon intensity driven by investments in companies who are at the forefront of the energy transition. These companies are leaders in challenging and difficult-to-abate sectors and often have a higher carbon intensity today than companies in other sectors.

7.3. This is reflected in the fact the highest carbon companies in the GSE portfolio are also the largest contributors to 'green revenues' (companies that generate revenues attached to products and services that deliver environmental solutions). The Global Sustainable Equity portfolio has 12.4% exposure to green revenues compared to 7.3% in its benchmark. The majority of green revenues come from energy management and efficiency, followed by waste and pollution control technologies and solutions and transport equipment.

8. RISK MANAGEMENT

8.1. 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.

9. EQUALITIES

9.1. A proportionate equalities impact assessment has been carried out using corporate guidelines and no significant issues have been identified.

10. CLIMATE CHANGE

10.1. 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.

11. OTHER OPTIONS CONSIDERED

11.1. None

12. CONSULTATION

12.1. 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	None
Please contact the report author if you need to access this report in an alternative format	