Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**
MEETING DATE:	**27 February 2024**
TITLE:	**Review of Investment Performance for Periods Ending 31 December 2023**
WARD:	ALL
AN OPEN PUBLIC ITEM	
List of attachments to this report: **Appendix 1 – Mercer Performance Monitoring Report** **Appendix 2 – Brunel Quarterly Performance 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 2023.

1.2. The Mercer report at Appendix 1 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.

1.3. 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.

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 £5,702m on 31 December 2023 and delivered a net investment return of 8.7% over the quarter. The increase in the value of Fund assets over the quarter was driven mainly by the LDI portfolio and equity assets, which delivered positive absolute and relative returns.

4.2. The liabilities are estimated to have increased by c.5% over the quarter. Taken together with the asset return, the funding level stood at 97% at Dec-31 (c. £170m deficit). The rise in the estimated value of the liabilities was driven by a move to a lower actuarial discount rate basis of CPI +2.5% versus CPI +2.8% at 30-Sept, as well as the impact of observed inflation.

4.3. The discount rate is reviewed each month with a full review each quarter as per the agreed approach at FRMG. The changes each quarter are based on the expected CPI+ return outlook which is based on the Fund's investment strategy and hedging levels. It then takes into account a combination of Mercer's capital market assumptions and real yield changes based on asset class correlations across the portfolio. The discount rate is then sense checked for reasonableness by the Fund actuary taking into account the long-term sustainability of contributions.

4.4. Over 1 year the Fund returned 8.5% in absolute terms and -2.2% in relative terms, where most portfolios underperformed their respective benchmarks. Underperformance was pronounced in the Global Sustainable Equity Portfolio and the Fund's real asset portfolios. The multi-asset credit and high alpha equity portfolio outperformed and matched the benchmark return, respectively. The performance drag created by the Fund's dynamic equity protection strategy compounded underperformance. Panel resolved to reduce the equity protection hedge ratio last year. Officers are in the process of implementing this change (see Item 10). Further details relating to performance attribution can be found on p14/15 of Appendix 1.

B – Investment Manager Performance

4.5. 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 20-41 of Appendix 2.

4.6. Markets finished the year strongly as most risk assets delivered positive returns over the fourth quarter. Improved market sentiment was driven by further declines in inflation towards central bank targets and more robust than expected economic growth in many developed economies. Collectively this supported a consensus among investors that developed economies will successfully achieve a 'soft landing', i.e. a normalisation of inflation without recession.

4.7. Brunel's listed market portfolios delivered strong absolute returns, benefitting from the increased appetite for risk assets and the dip in yields, which acted as a tailwind for credit assets. The Global High Alpha portfolio returned 6.2% during the quarter, underperforming its benchmark by 0.6% where stock selection was the key driver of relative return.

The Global Sustainable Equity portfolio delivered a return of 8.0% over the quarter, outperforming its benchmark by 1.6%. The inherent 'growth' investment style of this portfolio benefitting from the supportive interest rate environment. The Multi Asset Credit (MAC) and Diversified Returns Fund (DRF) both materially outperformed their cash+ benchmarks.

In private markets, deal flow has begun to pick up, thanks to increased certainty in interest rate movements. The Private Debt portfolio has continued to call capital at a healthy pace and has demonstrated positive performance since inception across all cycles on a net IRR basis. Given the nascency of investments performance measures are not yet very meaningful. Deal flow in infrastructure has been more muted and the sector continues to face structural headwinds relating to increased costs in supply chains. That said, Brunel's portfolio is well positioned with high quality assets that should remain resilient to these challenges.

The impact of rising interest rates on property portfolios is well known. Despite headwinds the long-lease property component of the Secured Income portfolio proved resilient to investor redemptions and fundamentals remain strong; rent collection is at pre-pandemic levels, average lease lengths are c. 25 years and funds are registering record high distribution yields and low vacancy rates.

INVESTMENT STRATEGY AND PORTFOLIO REBALANCING

4.8. **Returns versus Strategic Assumptions:** Returns versus the strategic assumptions used during the 2023 investment review can be found on p16/17 of Appendix 1. 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.

4.9. **Rebalancing:** Post period end £35m was drawn into the new local impact portfolio to finance the acquisition of an operational solar portfolio. A further £40m was drawn into the Fund's Secured Income portfolio. To facilitate these large capital calls the Fund used cash and liquidated some of its ETF holdings. Officers are currently in the process of rebalancing the equity portfolio, which is approximately 7% overweight.

4.10. **Responsible Investment (RI) Activity**: A summary of portfolio carbon metrics measured by Brunel over the quarter is included on page 10 of Appendix 2. The Fund undertakes in-depth carbon analysis on an annual basis and publishes the results in its Annual Responsible Investment Report.

4.11. **Voting and Engagement Activity:** Hermes engaged with 190 companies held by Avon in the Brunel active equity portfolios on a range of 698 ESG issues. Environmental topics featured in 37% 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 17% of Governance related engagements most focussed on executive remuneration and board diversity. Over the last quarter Hermes made voting recommendations at 23 meetings (232 resolutions). At 18 meetings they recommended opposing one or more resolutions. Over 70% of the issues Hermes voted against management on comprised board structure and remuneration.

5. RISK MANAGEMENT

5.1. 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.

6. EQUALITIES

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

7. CLIMATE CHANGE

7.1. 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.

8. OTHER OPTIONS CONSIDERED

8.1. None

9. CONSULTATION

9.1. 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	