

## Bath & North East Somerset Council

MEETING:	<b>AVON PENSION FUND INVESTMENT PANEL</b>
MEETING DATE:	<b>5 June 2024</b>
TITLE:	<b>Review of Investment Performance for Periods Ending 31 March 2024</b>
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 March 2024.
- 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 £5,818m on 31 March 2024 and delivered a net investment return of 2.3% over the quarter which was in line with the benchmark. The increase in the value of Fund assets over the quarter reflected strong equity markets, with Brunel's listed portfolios all positive on an absolute basis, although flat on a relative basis.

- 4.2. The liabilities are estimated to have increased by c.0.6% over the quarter. Taken together with the asset return, the funding level stood at 98% at March-31 (c. £107m deficit).
- 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. The March update allows for the updated discount rate of 5.09% p.a. (equivalent to a discount rate of CPI+2.5% p.a. at 31 March 2024).
- 4.4. Over 1 year the Fund returned 7.8% in absolute terms and -2.0% in relative terms, where most portfolios underperformed their respective benchmarks. Underperformance was most pronounced in the Global Sustainable Equity Portfolio, with Global High Alpha also lagging its benchmark return. The multi-asset credit and diversifying returns portfolios were both ahead of their respective benchmarks.
- 4.5. Further details relating to performance attribution can be found on p14/15 of Appendix 1.

## **B – Investment Manager Performance**

- 4.6. 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 19-40 of Appendix 2.
- 4.7. Risk assets began the year as they finished the last with global equities up close to 10% in sterling terms in the first quarter 2024. The US market was the clear leader, while emerging markets and the FTSE All-Share lagged. Gains across all asset classes could largely be attributed to a resilient US economy, rebounding oil prices, and continued positive sentiment around Artificial Intelligence. Expectations of interest rate cuts also boosted equity markets although the pace of cuts is likely to be slower than the market had hoped at the turn of the year as inflation has once again proved stickier than expected.
- 4.8. In Brunel's listed market portfolios, absolute returns were positive reflecting the strength in global equity markets over the period. Global High Alpha returned 9.9%, just 0.1% below the benchmark (MSCI World). Sector attribution showed allocation and selection were neutral overall. The Global Sustainable Equity portfolio returned 9.2%, also 0.1% behind its benchmark (MSCI ACWI). Market sentiment for sustainable investing continued its positive trend that began in Q4 2023 however, over one year to end March 2024, the portfolio remains significantly behind the benchmark. Stock selection, particularly the underweight to 4 of the 'magnificent 7', was the main driver of relative performance at a sector level.

The Diversifying Returns Fund (DRF) returned 4.3% over the quarter, ahead of the benchmark return of 2.0%. Increasing exposure to equities over the six months to quarter end enabled the portfolio to benefit from recent market performance. Multi Asset Credit (MAC) returned 2.2%, which was slightly behind

the benchmark return. Credit spreads tightened over the quarter reflecting the improvement in the economic outlook and an increase in risk appetite.

In private markets, new deal volumes have been growing from recent lows. In infrastructure, despite continued volatility across the political, economic and investment landscapes, infrastructure as an asset remained broadly resilient, feeding through to the Brunel Infrastructure portfolios. While interest rate cuts, when they arrive, should positively impact asset valuations given the “higher for longer” consensus, short term impacts may be minimal.

In Secured Income despite hopes that the UK had reached the top of the interest rate cycle, further volatility was expected as the market continued to find new pricing levels. Open-ended long lease property funds have suffered heavy redemptions in recent years from liquidity shocks and investors withdrawing from the sector on liquidity concerns. Our underlying property fund managers continue to dispose of assets to fund these redemptions and more sales are expected over 2024. Despite recent outflows, the property portfolio continues to show strong fundamentals such as rent collection at pre-pandemic levels, low vacancy rates and record high distribution yields. Post period end a final £35m capital call was made by Cycle 3 Secured Income. The Fund’s full £705m commitment to Secured Income is now fully invested.

## **INVESTMENT STRATEGY AND PORTFOLIO REBALANCING**

- 4.9. **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.
- 1.1. **Rebalancing:** During the period £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 redeemed £50m from the Brunel Paris-aligned passive equity portfolio to increase cash at hand and reduce the aggregate overweight position to equities. Post period end the Fund received advance deficit payments totalling £30m.
- 1.2. **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, which is cleared by Committee in September.
- 4.10. **Voting and Engagement Activity:** As a responsible investor, we actively endorse collaborative engagement and seek to use our power as a shareholder to encourage corporate change. Voting and engagement are delegated to the Brunel Pension Partnership for the actively managed equity portfolios and to Legal and General Investment Management (LGIM) for the passive portfolios. On significant issues, Brunel may request that their shares held by LGIM are split out and a different vote made. The voting records of Brunel and LGIM at

company meetings held over the last quarter are summarised in the following table:

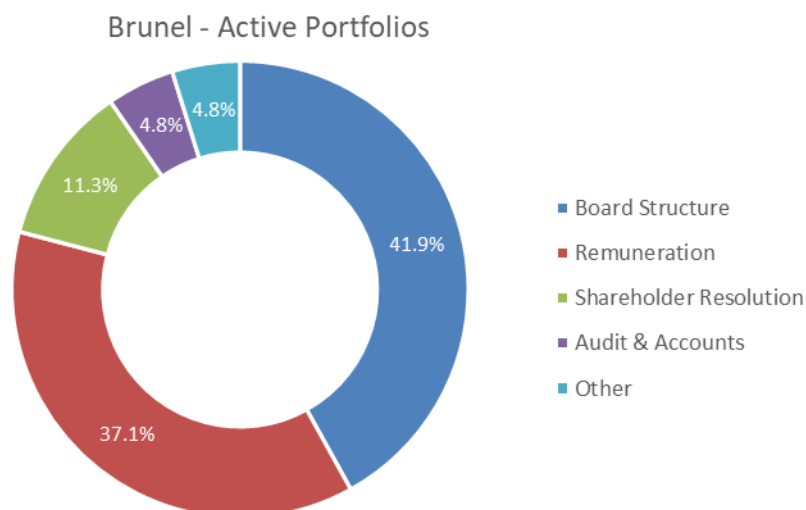
**Votes cast at company meetings in the quarter to 31 March 2024:**

Manager	Quarter to 31 March 2024		
	Number of Meetings	Number of Resolutions	Votes against management recommendation
Brunel/LGIM - Passive Portfolios	128	1805	368
Brunel - Active Portfolios	23	578	62

Points to note:

- a) Brunel and LGIM actively vote the shares held within their funds on behalf of their client funds, including Avon.
- b) The votes against management recommendations will reflect matters where there is concern that the company is not addressing the relevant issue and managing it effectively. The Fund would expect that votes against management should be primarily on the priority areas set out in the Fund’s Investment Strategy Statement. An analysis of the issues where votes have been cast against management recommendations is set out below.

**Votes against management recommendation by issue – Quarter to 31 March 2024**



**Voting Activity Spotlight: Shell Plc Shareholder Resolution**

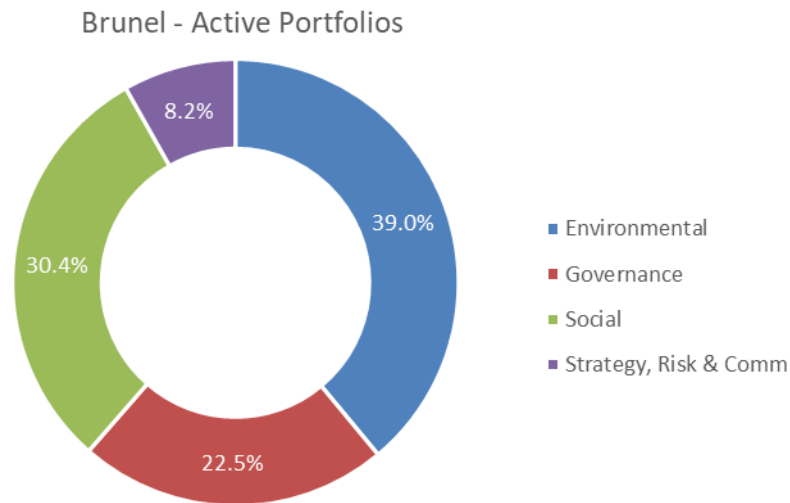
Resolution Details	Management Advice to SH	Brunel Vote	Notes
<p>Shareholder Resolution – Resolution 23</p> <p>Filed by: Follow This</p> <p>Shareholders support the company, by advisory note, to align its medium-term emissions reduction targets covering the GHG emissions of the use of its energy products (Scope 3) with the goal of the Paris Climate Agreement.</p> <p>AGM date 21 May 2024.</p>	<p>Vote AGAINST resolution</p>	<p>Vote FOR resolution</p> <p>Note: not held in LGIM Passive portfolio</p>	<p>Brunel was one of 27 leading investors that backed this resolution alongside Follow This.</p> <p>The resolution was designed to give Shell a shareholder mandate to drive the energy transition.</p> <p>The co-filing demonstrates Brunel’s commitment to tackling the climate crisis at its source.</p> <p>Outcome: the resolution received 18.6% support from shareholders.</p>

1.1. **Engagement:** Brunel conduct significant engagement with investee companies on behalf of the Fund. A breakdown of the engagement undertaken over the last quarter is summarised as follows:

**Company engagement in the quarter to 31 March 2024:**

	Quarter to 31 March 2024	
	Number of Companies	Number of Issues
Brunel - Active Portfolios	220	797

## Breakdown by issues engaged on:



Further information on Brunel's engagement activity can be found on their website using the following link:

<https://www.brunelpensionpartnership.org/library/>

## 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.

<b>Contact person</b>	Rebecca Whelan, Senior Investments Officer (Tel. 01225 395355)
<b>Background papers</b>	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**