Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**
MEETING DATE:	**5 September 2024**
TITLE:	**Review of Investment Performance for Periods Ending 30 June 2024**
WARD:	ALL
AN OPEN PUBLIC ITEM	
List of attachments to this report: **Appendix 1 – Mercer Performance Monitoring Report – to follow** **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 30 June 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.

2. RECOMMENDATION

The Investment Panel:

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 £5,858m on 30 June 2024 and delivered a net investment return of -0.3% over the quarter which lagged the 2.2% rise in the benchmark. The relatively flat nature of returns reflects some positive performances from some of the listed Brunel portfolios, however these were offset by negative returns elsewhere in the portfolio, such as private markets and the risk management strategies.

4.2. The estimated funding level stood at 102% at 30 June (c. £120m surplus).

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 considers a combination of Mercer's capital market assumptions and real yield changes based on asset class correlations across the portfolio. The discount rate is sense checked for reasonableness by the Fund actuary taking into account the long-term sustainability of contributions. The June update allows for the updated discount rate of 5.40% p.a. (equivalent to a discount rate of CPI+2.8% p.a. at 30 June 2024).

4.4. Over 1 year the Fund returned 7.6% in absolute terms and -3.1% in relative terms. Underperformance was most pronounced in the listed portfolios, where both the Global High Alpha and Global Sustainable Equity portfolios underperformed their respective benchmarks. The Multi-Asset Credit and Diversifying Returns portfolios both outperformed their respective benchmarks, while performance of the private markets portfolios was mixed.

4.5. Further details relating to performance attribution can be found in section 4 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 19-39 of Appendix 2.

4.7. Economic and market momentum continued into the second quarter of 2024 with another positive period for equity markets. Strong economic data and sticky inflation resulted in a drop in expectations for interest rate cuts for 2024, with only the ECB enacting a reduction during the period. Global equities rallied, driven by a small group of companies exposed to the artificial intelligence (AI) theme, as market concentration increased even further. Emerging market equities posted the strongest returns while the UK market also advanced with the FTSE 100 hitting an all-time high. Rate sensitive small cap stocks and REITs suffered from confirmation of the higher-for-longer interest rate environment. Conversely, fixed income endured another quarter of negative returns as yields rose, although the benign macro environment was supportive of the riskier segments of the fixed income market.

4.8. In Brunel's listed market portfolios, absolute returns were largely positive however underperformed on a relative basis.

Global High Alpha returned 1.1%, lagging its benchmark (MSCI World) by 1.6%. Attribution data showed that positioning in the IT sector was the biggest detractor of returns, driven largely by underweight positions in Apple and NVIDIA.

The Global Sustainable Equity portfolio fell 0.5% over the quarter, underperforming its benchmark (MSCI ACWI) by 3.5% in a challenging environment for sustainable investing. As with Global High Alpha, narrow market concentration was the main driver for this underperformance, with the portfolio having a 10% underweight position to the five strongest performing names.

The PAB Passive Global Equities portfolio returned 2.8% over the quarter, with the so-called “Magnificent Seven” stocks accounting for the vast majority of the contributions to return.

The Diversifying Returns Fund (DRF) returned -0.5% over the quarter, underperforming the benchmark return by 2.5%. While the fund captured some positive returns from equities and interest earned on cash positions it was a weaker quarter for alternative premia (which seek to generate returns from trends, market volatility and other non-traditional sources of return). Underperformance in currency positioning was pronounced.

Multi-Asset Credit (MAC) returned 1.9%, benefitting from strong appetite for risk assets. The return was slightly behind the cash benchmark (SONIA +4%) where Sterling rates remained elevated. Differences in manager performance were driven by duration positioning, with Neuberger making the lowest return given their higher duration.

In private markets, there was a notable pick-up in M&A activity which is a positive sign for deal flow for lenders and lower rate cut expectations is a tailwind for private debt. However, the high-rate environment remains a challenge for some companies, with ability of companies to meet interest payments on borrowings stretched. The delay in anticipated rate cuts is proving a headwind for the infrastructure portfolios, however these are well diversified and continue to exhibit strong defensive characteristics. Notably, renewable energy generating assets have been, and are expected to continue to be, a key beneficiary of the AI theme, which is responsible for driving exponential demand for green energy.

In Secured Income, both long lease property managers noted markets were more optimistic in the second quarter, with evidence transactions are picking up in areas such as industrial and residential. The occupier market remained resilient, with no rent concerns and near 100% occupancy. But high interest rates and uncertainty persisted, and we could continue to see small valuation write-downs throughout the rest of the year. Over the quarter underlying managers made progress on their redemption queues whilst Schroder Greencoat completed the restructuring and refinancing of the Project Toucan solar portfolio.

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 in line with 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, following the reduction in the equity protection hedge ratio, and to increase the amount of cash held in anticipation of future private markets calls, officers redeemed £50m from the Risk Management portfolio. Aggregate private markets call, excluding the final drawdown from the Secured Income portfolio, totalled £17 million. The Secured Income portfolio is now fully drawn.

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 30 June 2024:

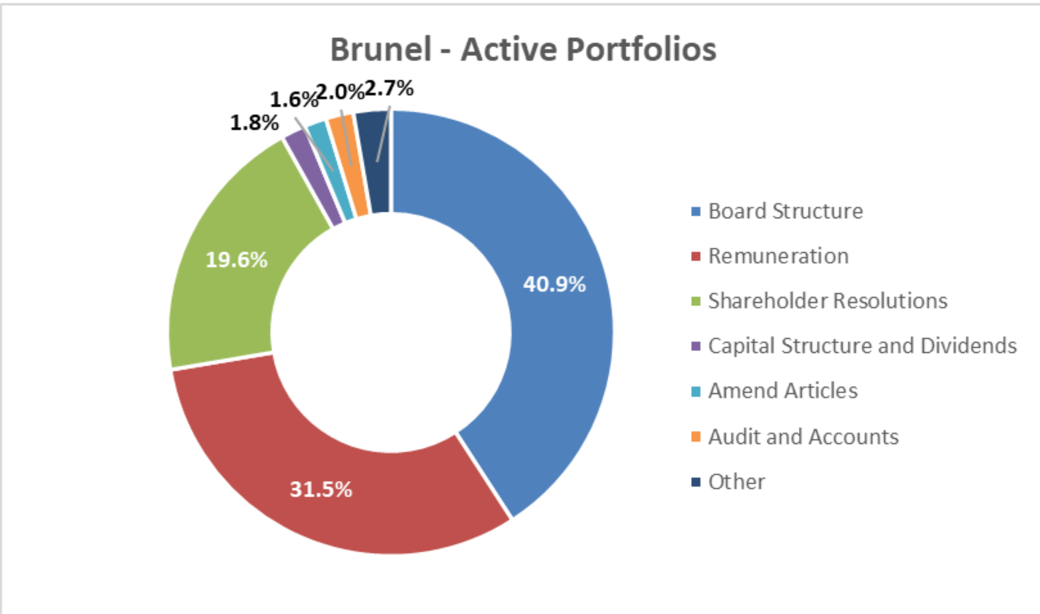
	Quarter to 30 June 2024		
Manager	Number of Meetings	Number of Resolutions	Votes against management recommendation
Brunel/LGIM - Passive Portfolios	766	11,897	2,745
Brunel - Active Portfolios	230	3,447	511

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 30 June 2024

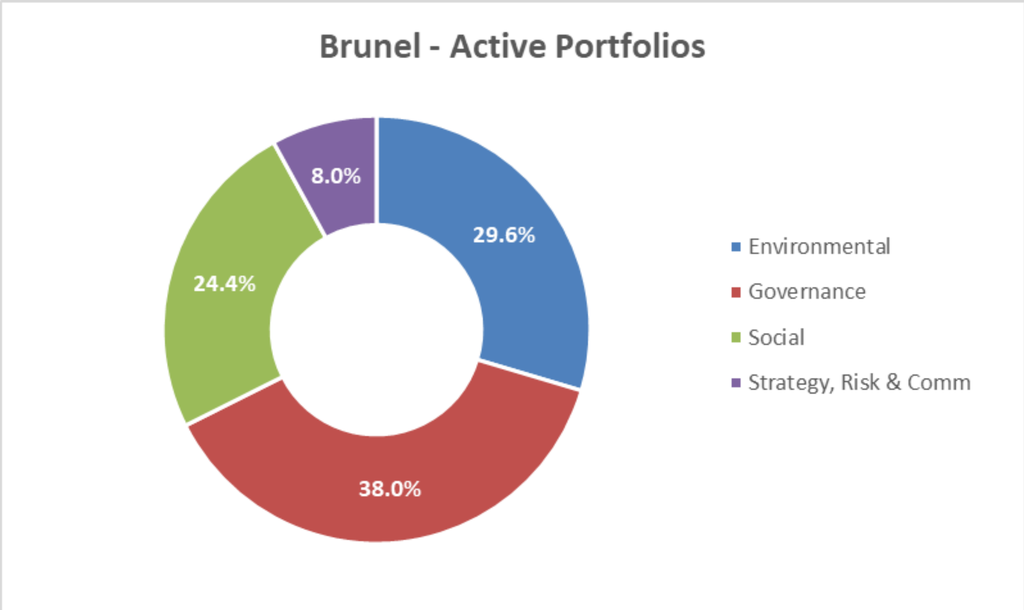


1.1. **Engagement:** Brunel conduct significant engagement with investee companies on behalf of the Fund. A breakdown of the engagement undertaken over the last quarter is summarised as follows:

Company engagement in the quarter to 30 June 2024:

	Quarter to 30 June 2024	
	Number of Companies	Number of Issues
Brunel - Active Portfolios	289	1,004

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.

Contact person	Rebecca Whelan, Senior Investments Officer (Tel. 01225 395355)
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	