

Bath & North East Somerset Council	
MEETING:	AVON PENSION FUND COMMITTEE
MEETING DATE:	13 DECEMBER 2024
TITLE:	INVESTMENT STRATEGY (for periods ending 30 September 2024)
WARD:	ALL
AN OPEN PUBLIC ITEM	
List of attachments to this report: Appendix 1 – Mercer Quarterly Investment Performance Report Appendix 2 – Quarterly LAPFF Engagement Report	

1 THE ISSUE

- 1.1 This paper reports on the investment performance of the Fund and seeks to update the Committee on routine strategic aspects of the Fund's investments and funding level, notable Responsible Investment developments and operational aspects of the Fund.
- 1.2 Investment performance over the quarter and over 1 year to the 30 September 2024 exceeded the benchmark return however over longer timeframes the Fund is behind the benchmark. Return drivers are discussed in further detail in section 4 of this report.
- 1.3 The Mercer Investment Performance Report at Appendix 1 contains performance statistics for periods ending 30 September 2024. Mercer will present their paper at the meeting.
- 1.4 Key discussion points and recommendations arising [from the 26 November 2024 Investment Panel meeting] are summarised in section 5 of this report.

2 RECOMMENDATIONS

The Avon Pension Fund Committee is asked to:

- 2.1 **Note the information set out in the report and appendices.**
- 2.2 **Note the decision made by the Investment Panel to appoint Foresight Group as the Fund's Local Impact SME Funding Manager, subject to further due diligence, suitability, tax and legal advice.**

3 FINANCIAL IMPLICATIONS

- 3.1 The 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 INVESTMENT STRATEGY

A – Funding Level and Investment Performance

- 4.1 The Fund's assets were £6,034m on 30 September 2024 and delivered a net investment return of 3.5% over the quarter which was 2.2% ahead of its strategic benchmark. Whilst there were some positive absolute performances across many of the Brunel listed equity portfolios, outperformance was largely driven by Brunel's Multi Asset Credit and private market portfolios, reflecting the strengthening backdrop for these assets.
- 4.2 Over 1 year the Fund returned 14.8% in absolute terms and +2.7% in relative terms. The Brunel listed equity portfolios were positive over this period, although these returns were in line with or behind their respective benchmarks. Positive contributors to overall returns included the BlackRock LDI strategy, Brunel Multi Asset Credit as well as the Brunel private market portfolios.
- 4.3 The main drivers of underperformance over 3 years included the active equity mandates, the equity protection strategy and Overseas Property and Secured Income.
- 4.4 Manager performance is monitored in detail by the Investment Panel. The Fund's investment return and performance relative to the benchmark is summarised below.

Table 1: Fund Investment Returns (Periods to 30 September 2024)

	3 Months	12 Months	3 Years (p.a)
Avon Pension Fund (incl. currency hedging)	3.5%	14.8%	1.8%
Avon Pension Fund (excl. currency hedging)	2.5%	12.7%	1.7%
Strategic benchmark (no currency hedging)	1.3%	12.1%	5.8%

- 1.1. The estimated funding level stood at 104% at 30 September 2024 (c. £220m surplus).
- 1.2. The 3-year Value-at-Risk (VaR) stood at £1,645m at the end of the quarter. The £41m increase over the period was largely due to the increase in asset values. As a percentage of liabilities, VaR was broadly unchanged at c. 28%.

B – Portfolio Performance

- 4.5 Brunel reports on the performance of the assets they manage on behalf of the Fund. The Brunel quarterly performance reports are presented to the Investment Panel. The Fund's top 10 equity positions and a brief summary of portfolio level performance can be found below. Further detail for both Brunel and legacy portfolio performance can be found in Section 4 of the Mercer report (Appendix 1).

Table 2: Top 10 Equity Holdings

Security Name	Sector	Country	Value of Holding	% of Fund assets
Microsoft	Information Technology	United States	£81.3m	1.4%
Amazon	Consumer	United	£60.4m	1.0%

	Discretionary	States		
Mastercard	Financials	United States	£40.1m	0.7%
NVIDIA	Information Technology	United States	£39.4m	0.7%
Alphabet	Communication Services	United States	£32.4m	0.5%
Taiwan Semiconductor	Information Technology	Taiwan	£31.9m	0.5%
Apple Inc	Information Technology	United States	£29.5m	0.5%
UnitedHealth	Health Care	United States	£27.1m	0.4%
ASML Holdings	Information Technology	Netherlands	£26.9m	0.4%
Tesla Inc	Consumer Discretionary	United States	£23.3m	0.4%
TOTAL	--	--	£392.5m	6.5%

* Table excludes cash and legacy assets. Estimated aggregate position using Brunel Portfolios

4.6 Listed Markets. In Brunel's listed market portfolios, returns were mixed, however these were offset by strong performances from Multi Asset Credit as well as the private market portfolios. The Global High Alpha Equity portfolio returned -0.5% over the quarter, underperforming the benchmark (MSCI World) by 0.9%. This was largely driven by the portfolio's tilt to growth and quality, which significantly underperformed value over the quarter. Stock selection detracted, whilst sector allocation was also marginally negative as the benefit of being underweight energy (the poorest-performing sector) was more than offset by the negative impact of not holding utilities (the best-performing sector). The Global Sustainable Equity portfolio was flat over the quarter, marginally underperforming its benchmark (MSCI ACWI) by 0.6%. The PAB Passive Global Equity portfolio returned 0.4% over the quarter, in line with the market capitalisation parent benchmark. The Diversifying Returns Fund (DRF) returned 1.7% over the third quarter, behind the cash benchmark (SONIA 3+%) of 2.1%. Multi Asset Credit (MAC) had a positive quarter returning 3.9%, comfortably ahead of its primary cash plus benchmark (SONIA +4%) return of 2.3%.

4.7 Private Markets. In private markets, the reduction in interest rates by major central banks across the quarter was generally seen as a positive for infrastructure investments. Many infrastructure assets continue to exhibit strong defensive characteristics and given the diversified nature of the Fund's portfolio (across sectors, geography and business models), performance should be well supported. Global renewables policies also acted as a tailwind, with the new Labour Government committing heavily to increase investment through the newly formed Great British Energy and National Wealth Fund. In private debt, portfolio performance was generally positive. Although M&A activity has been steadily increasing it remains soft for the year as a whole,

resulting in an increase in lending to incumbent borrowers through refinancings.

In Secured Income, the performance of the long lease property sector, which accounts for a large proportion of the portfolio, continues to turn positive after two years of declines. This has largely been driven by sustained rental growth, with distribution yields at historical highs above 5%, and resilient occupational demand, while some sectors are starting to experience capital appreciation. This, coupled with a more benign outlook for inflation and stable borrowing rates provides a positive backdrop for the asset class that should enable continued improvement across sectors.

- 4.8 **Returns versus the strategic assumptions:** Equity and liquid growth assets classes are generally delivering in line or exceeding expected returns based on the 2023 investment strategy review. 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 INVESTMENT PANEL ACTIVITY

- 5.1 The Investment Panel is responsible for addressing investment issues including the investment management arrangements and the performance of the investment managers. The Panel has delegated responsibilities from the Committee and may also make recommendations to Committee.

Local Impact Portfolio – Small- and Medium-sized Enterprise (SME) Funding Manager

- 5.2 The Fund has decided to allocate 3% (c.£175m) to 'local impact'. The majority of the allocation will be split across three core sectors (as set out below), forming part of the overall 32.5% allocation to private markets.

- Renewable Infrastructure – Manager appointed / £50m commitment – completed 4Q23
- Affordable Housing - Manager appointed / £50m commitment – completed 1Q24
- SME Funding – Manager appointment / commitment – pending further due diligence

- 5.3 Minutes of the 26 November Panel meeting will be made available to Committee members in due course. The most substantive item discussed during the meeting was the proposal to appoint Foresight Group as the manager of the Fund's SME funding strategy. SME funding forms the final 'core' element of the Local Impact Portfolio and will leave approximately £30-50m capital to deploy into specialist local investments in due course.

- 5.4 The SME strand of the portfolio will seek to stimulate local economic growth through business innovation and the creation of local jobs. The appointed manager will focus on private equity style investments in local SMEs with established business models and attractive growth potential. 'Local' in respect of this fund is defined as the Brunel catchment area of Avon, Somerset, Wiltshire, Cornwall, Dorset, Devon, Gloucestershire and Oxfordshire. Some 'out-of-county' exposure is expected.

5.5 Mercer rate Foresight Group highly and are supportive of undertaking further due diligence before the final decision to appoint the manager is made by the Head of Pensions under delegated authority.

5.6 Panel voted unanimously in favour of the recommendation to appoint Foresight, citing a number of reasons, including:

- (I) Track record of creating and managing regional SME strategies for institutional investors (including LGPS).
- (II) Regional presence and strong connections to the local business community in the South West.
- (III) A proven ability to add value and help SMEs achieve scale.
- (IV) Strong environmental and social impact characteristics at both the Firm and Fund level.
- (V) A clear origination approach which includes using an established network of corporate advisory firms to generate opportunities.

5.7 The final decision to appoint Foresight and the size of the Fund's commitment will be made by the Head of Pensions in consultation with Mercer once all relevant suitability, tax and legal advice has been procured.

Natural Capital Update

5.8 Natural Capital was identified at the last climate policy review as an area the Fund should explore further given its ambitious Net Zero 2045 target.

5.9 Given the nascency and illiquidity of many natural capital strategies and the non-traditional nature of underlying return drivers, Committee asked the Panel to undertake further research and training before making a recommendation to include natural capital in its investment strategy.

5.10 Mercer have provided the Panel with an overview of the investment case and implementation options for a dedicated Natural Capital allocation. Analysis shared with the Panel indicates an initial 2% of assets (c. £120m) would be a reasonable initial allocation.

5.11 The Panel agreed that any investment in Natural Capital represents an opportunity to show leadership within the LGPS and there is a clear desire to invest in both established forms of natural capital such as sustainable forestry and agriculture as well as more nascent strategies such as wetland and coastal restoration. The Panel acknowledged the importance of ensuring any investment in nature-based assets stands up to scrutiny, particularly where those assets derive the majority of their returns from credits or other forms of offsets.

5.12 The Panel will make a recommendation to the Committee in the first half of 2025 once the Brunel portfolio specification has been finalised. This ensures the views of the Panel are fed directly into the Brunel portfolio development process and Committee can gain assurance that the Brunel portfolio delivers on the Fund's requirements, prior to making a commitment.

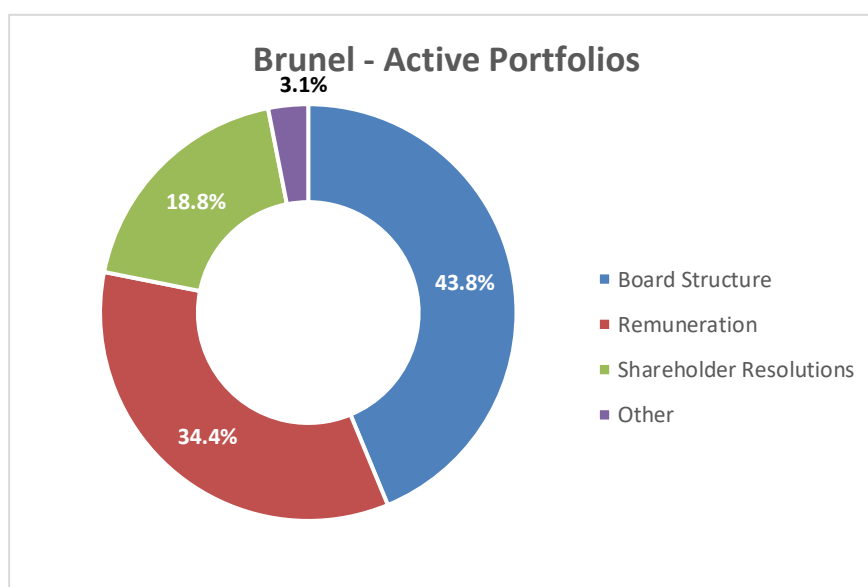
6 QUARTERLY STEWARDSHIP SUMMARY

6.1 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. The voting records of Brunel and LGIM at company meetings held over the last quarter are summarised in the following table:

Manager	Quarter to 30 September 2024		
	Number of Meetings	Number of Resolutions	Votes against management recommendation
Brunel/LGIM - Passive Portfolios	63	887	165
Brunel - Active Portfolios	16	241	32

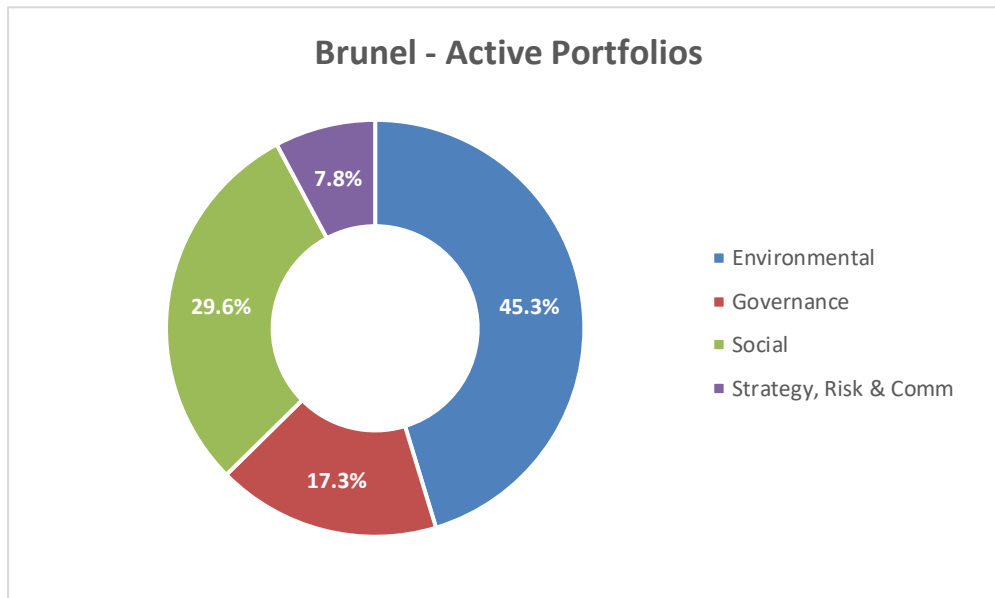
6.2 Brunel and LGIM actively vote the shares held within their funds on behalf of their client funds, including Avon. The votes against management recommendations will reflect matters where there is concern that the company is not addressing the relevant issue and managing it effectively. The Fund would 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:



6.3 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:

	Quarter to 30 September 2024	
	Number of Companies	Number of Issues
Brunel - Active Portfolios	120	371

A breakdown by issues engaged on:



6.4 Further information on Brunel's engagement activity can be found on their website using the following link: [Brunel Website](#)

6.5 Details of LAPFF lead initiatives and engagement work can be found at Appendix 2.

7 RISK MANAGEMENT

7.1 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.

8 EQUALITIES STATEMENT

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

9 CLIMATE CHANGE

9.1 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.

10 OTHER OPTIONS CONSIDERED

10.1 None.

11 CONSULTATION

11.1 The Council's Director of Financial Services, Assurance & 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 & SSBT Performance Services
Please contact the report author if you need to access this report in an alternative format.	