Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**
MEETING DATE:	**26 February 2025**
TITLE:	**Review of Investment Performance for Periods Ending 31 December 2024**
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 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 £5,899m on 31 December 2024 and delivered a net investment return of -1.8% over the quarter, lagging the 3.0% return for the strategic benchmark. Whilst there were some positive absolute performances across many of the Brunel listed portfolios, these were largely outweighed by the drag from the BlackRock Risk Management Strategies as well a negative return from the Brunel Diversifying Returns strategy. Currency hedging also had a negative impact on overall returns given the strong movements in currencies during the quarter.

4.2. The estimated funding level stood at 105% at 31 December 2024 (c. £284m 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 December update allows for the updated discount rate of 5.65% p.a. (equivalent to a discount rate of CPI+3.05% p.a. at 31 December 2024).

4.4. Over 1 year to the end of December the Fund returned 3.7% in absolute terms and -5.3% in relative terms. On the whole, returns from Brunel's listed portfolios were positive with some notable double-digit performances from Global High Alpha, Global Sustainable Equities and the Passive Developed Equities Paris Aligned portfolios, however relative returns were in line with or behind benchmark. The main detractor on a one year basis was the BlackRock risk management strategies.

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 22-41 of Appendix 2.

4.7. The end of the fourth quarter 2024 capped an extraordinary year for markets, most notably in the US, where continued corporate strength helped equities deliver impressive gains and the performance of US mega cap technology stocks ensured that global growth dominated for a second year in a row. Whilst overall returns were positive in the fourth quarter there was significant divergence among regions. The resounding victory for Donald Trump in the US elections saw equities rally and the dollar strengthen reflecting the view that some of the new administration's policies, such as corporate tax cuts and lighter regulation, could boost domestic growth. However elsewhere other regional markets were more pedestrian. The UK and emerging markets tracked sideways, whilst Continental European markets sold off, weighed down by political turmoil in France and Germany which compounded the region's economic challenges. There was also some weakness in markets at risk of proposed tariffs, including China and Mexico, which fell over the quarter, as well as impacting European car manufacturers.

Fixed income markets experienced considerable volatility in the last quarter of 2024, primarily driven by geopolitical tensions, central bank decisions, and fluctuating inflation rates. Notably the period as marked by a sell-off in major government bonds, with various factors influencing investor sentiment across the globe. UK bond yields moved higher to price in higher future inflation post October's budget, while US yields pushed higher to reflect an increased growth and spending backdrop. Over the quarter, sterling depreciated against the dollar and the Bank of England cut interest rates to 4.75%.

4.8. Brunel's listed market portfolios all recorded positive absolute performances, but in a familiar theme to previous quarters, relative performance was held back due to stock selection and the continued dominance of the US technology stocks. There were also positive performances from Brunel's Multi Asset Credit as well as the private market portfolios.

The Global High Alpha Equity portfolio returned 5.4% over the quarter, which although a solid quarterly return did lag the benchmark (MSCI World) by 1.6%. This relative underperformance was primarily due to stock selection which offset the benefits from sector allocation and the portfolio's growth tilt. The portfolio's underweight position to some of the large-cap technology stocks, such as Tesla and Nvidia, were the biggest detractors from performance. Sector allocation was positive as the overweight in the best-performing consumer discretionary sector benefitted. On a one-year basis, the portfolio returned 16.4%, which was 4.9% behind the benchmark, again primarily due to the portfolio's underweight to the best-performing technology names.

The Global Sustainable Equity portfolio returned 2.6% over the fourth quarter, which was 3.5% behind the benchmark (MSCI ACWI). Over one year the portfolio returned 11.5%, lagging the 20.1% return for the benchmark. The portfolio's large (14%) underweight to the Magnificent-7 stocks was the main drag on performance.

The FTSE Developed Paris Aligned Index (PAB) returned 8.6% over Q4 and 20.8% for 2024 as a whole. The portfolio closely replicated the performance of the benchmark index over these periods. The portfolio benefitted from its high level of exposure to the technology sector, with Tesla, Apple, Nvidia and Alphabet making significant contributions to returns. The top 10 names in the PAB index represent 35% of its overall value. The underweight positioning in the energy sector proved beneficial as the sector underperformed the broader market. However, the portfolios exposure to renewable energy did suffer from some weaker performance following Trump's election victory, although this did not have a material effect on overall performance.

The Diversifying Returns Fund (DRF) returned -1.5% over the fourth quarter of 2024, behind the cash benchmark (SONIA +3%) of 2.0%. Whilst global equity returns were strong and the dollar appreciated, for sterling-hedged investors, global equity returns were more muted and fixed income returns were negative. The Multi Asset Credit (MAC) fund returned 0.7% in Q4, trailing its cash benchmark (SONIA +4%) return of 2.2%. Underperformance was driven by the investment grade credit allocation in the face of continually changing interest rate expectations.

Turning to private markets, private debt fundraising for 2024 as a whole was robust, underscoring the positive attributes of the asset class and the absence of significant stress. Defaults have been minimal, as lenders and sponsors have proactively amended and extended covenant packages to address potential issues before they become problematic. Performance for our two private debt portfolios was mixed (one positive, one negative) over the quarter, however performance across both portfolios was positive on a one-year basis. Infrastructure continued to deliver performance, both in terms of returns as well as societal and environmental sustainability, in line with target and the ambition set at inception. Performance across all three cycles was flat to positive for the quarter and positive for the year.

In Secured Income, the performance of the long lease property sector, the main constituent of the portfolio, experienced a shift in 2024 with returns turning positive over the year as rate cuts facilitated a fall in bond yields. The performance across all cycles was positive during the quarter.

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 p15/16 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.

4.10. **2025 Investment Strategy Review:** The Fund will undertake a full investment strategy review in June. The review will incorporate the initial results of the 2025 actuarial valuation and will ensure the strategic asset allocation supports the long-term return required to maintain the funding position at the assessment date. Invites to strategic review workshops will follow in due course.

4.11. **Local Impact Update**: A verbal update will be provided at the meeting covering deployment of capital and manager appointments relating to the Fund's 3% allocation to local impact.

1.1. **Rebalancing:** During the period the Fund rebalanced its equity overweight down by 5% bringing the overall equity allocation down to c. 45%, which is within the rebalancing range set out in the Investment Strategy Statement. This was implemented via the synthetic equity strategy held in within the QIF. Due to equity market gains post quarter-end the Fund's allocation to equities has drifted above the upper bound of its rebalancing range. Officers will rebalance the portfolio accordingly and update Panel at its next meeting.

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.

4.12. **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 December 2024:

	Quarter to 31 December 2024		
Manager	Number of Meetings	Number of Resolutions	Votes against management recommendation

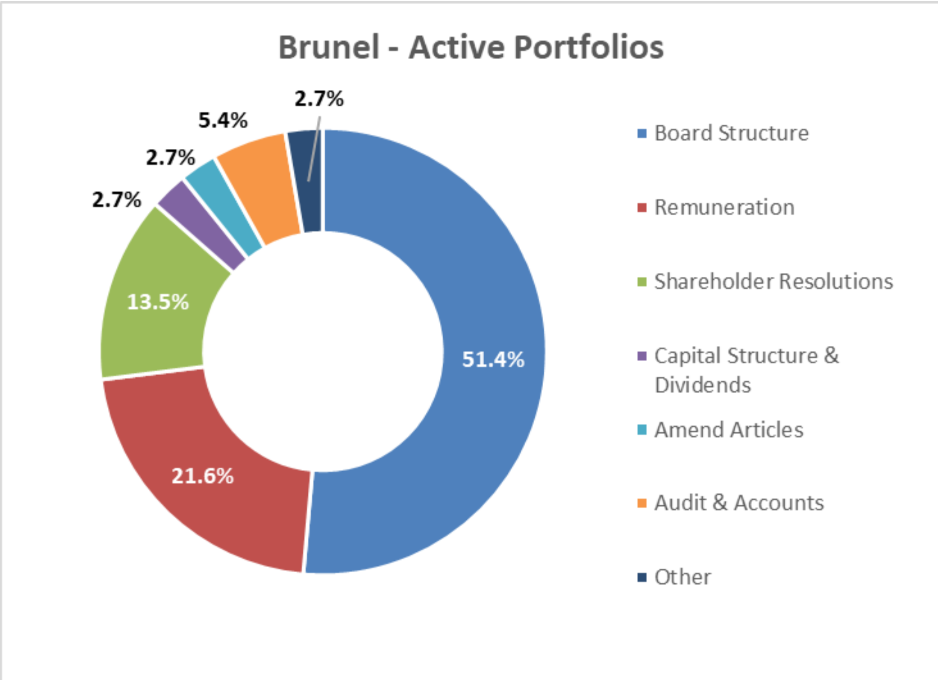
Brunel/LGIM - Passive Portfolios	93	776	204
Brunel - Active Portfolios	27	240	37

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 December 2024

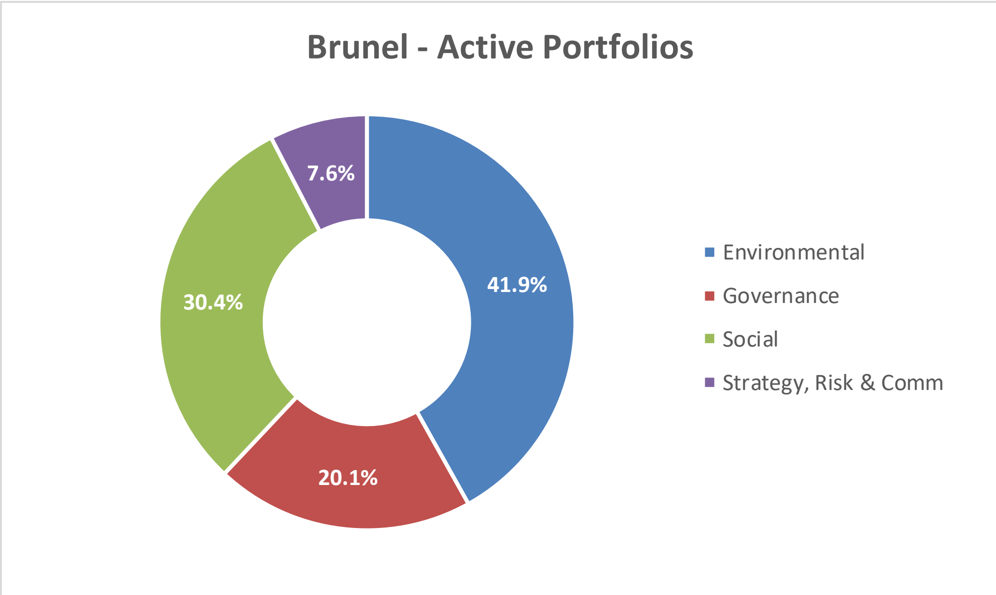


1.1. **Engagement:** Brunel conduct significant engagement with investee companies on behalf of the Fund. A breakdown of the engagement undertaken over the last quarter is summarised as follows:

Company engagement in the quarter to 31 December 2024:

	Quarter to 31 December 2024	
	Number of Companies	Number of Issues
Brunel - Active Portfolios	160	497

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	