From:	Chairman Pension Fund Committee Interim Corporate Director of Finance
To:	Pension Fund Committee – 26 June 2024
Subject:	Investment Performance and Asset Allocation Update
Classification:	Unrestricted

Summary:

This report provides an update on the Fund's asset allocation, performance and cashflow position. Performance reporting is prepared on a quarterly basis while asset allocation (rebalancing) decisions are based on the latest month-end valuations available. Accordingly, performance is reported as at 31 March 2024 while asset allocation is discussed with reference to the Fund's value as at 30 April 2024. Detailed performance information is provided in the *Quarterly Fund Performance Report* found at Appendix 1.

Recommendation:

The Committee is asked to note the report, and:

a) to agree that no rebalancing is undertaken (para. 1.4)

FOR DECISION

1. FUND VALUE AND ASSET ALLOCATION

1.1 As of 30 April 2024 (the latest available data), the Fund's value was £8.07bn compared to £7.84bn as at 31 January 2024, the position previously reported to the Committee. The table below sets out the current asset allocation versus the Fund's new strategic asset allocation and its revised rebalancing policy.

1.2 During the reporting period, and in accordance with the implementation plan approved by the Committee at its December 2023 meeting, officers progressed the investment of the new Emerging Markets Equities allocation. At its March 2024 meeting, the Committee agreed the structure and design of the emerging markets allocation, enabling implementation. The Committee had already agreed in December, to fund the emerging markets allocation by redeeming sufficient assets from the WS ACCESS UK Equity Fund, which would reduce the overweight exposure to UK Equities.

1.3 The Committee delegated authority to manage the transition arrangements to the Head of Pensions and Treasury in consultation with the Chairman. A transition timetable was subsequently devised by officers with trading taking place over April and May 2024. The transition was completed in full on 16 May and a total of £400m of assets was removed from UK Equities and invested in the two Emerging Markets Equities sub-funds (£200m each). A further update on the progress of the implementation plan is provided in a separate item on today's agenda.

Asset Class / Fund Manager	Strategic Asset Allocation	Tolerance Band	Current Asset Allocation		Variance	Status
	(%)	(%)	£m	(%)	(%)	
Equities	**53.0%**	**+/- 10%**	**4,417.4**	**54.8%**	**1.8%**	**In Range**
UK Equities	**10.0%**	**+/- 2.5%**	1,004.4	**12.4%**	**2.4%**	**In Range**
Schroders UK Equity			1,002.1	12.4%		
Link Fund Solutions			2.3	0.0%		
Global Equities	**38.0%**	**+/- 5%**	3,141.3	**38.9%**	**0.9%**	**In Range**
Schroders GAV			468.0	5.8%		
IMPAX Funds			72.2	0.9%		
Baillie Gifford			1,159.4	14.4%		
M&G Global Diversified			586.3	7.3%		
Sarasin			412.9	5.1%		
Insight- Global Synthetic Equity			442.5	5.5%		
Emerging Market Equities	**5.0%**	**+/- 2.5%**	271.7	**3.4%**	**-1.6%**	**In Range**
Columbia Threadneedle			136.0	1.7%		
Robeco			135.7	1.7%		
Fixed Income	**22.0%**	**+/- 5%**	**1707.4**	**21.2%**	**0.8%**	**In Range**
Credit	**15.0%**	**+/- 5%**	1205.4	**14.9%**	**-0.1%**	**In Range**
Goldman Sachs			413.1	5.1%		
CQS			258.5	3.2%		
M&G Alpha Opportunities			277.8	3.4%		
Schroders Fixed Income			256.0	3.2%		
Risk Management Framework	**7.0%**	**N/A**	502.0	**6.2%**	**-0.8%**	**N/A**
Insight			502.0	6.2%		
Alternatives	**25.0%**	**+/- 10%**	**1896.3**	**23.5%**	**1.5%**	**In Range**
Absolute Return	**5.0%**	**N/A**	410.4	**5.1%**	**0.1%**	**N/A**
Ruffer			181.0	2.2%		
Pyrford			229.4	2.8%		
Infrastructure	**5.0%**	**N/A**	364.4	**4.5%**	**-0.5%**	**N/A**
Partners Group			364.4	4.5%		
Private Equity	**5.0%**	**N/A**	387.4	**4.8%**	**-0.2%**	**N/A**
YFM			80.4	1.0%		
Harbourvest Intl			307.0	3.8%		
Property	**10.0%**	**N/A**	734.2	**9.1%**	**-0.9%**	**N/A**
DTZ Direct Property			465.7	5.8%		
DTZ Pooled Property			60.3	0.7%		
Fidelity International			137.6	1.7%		
Kames Capital			27.7	0.3%		
M&G Property			42.9	0.5%		
Cash	**0.0%**	**5%**	**46.7**	**0.6%**	**0.6%**	**In Range**
Total	**100.0%**		**8,067.8**	**100.0%**		

1.4 The current asset allocation is broadly aligned with the new strategic asset allocation, allowing for approved tolerance bands. The UK Equities and Emerging Market Equities allocations are marginally overweight and underweight, respectively. As noted above (para. 1.3), the transition between these two asset classes was not completed until 16 May 2024 (at which point, the allocations achieved their target weightings). Given the current asset allocation is within tolerance, officers do not recommend that any rebalancing is undertaken.

2. INVESTMENT PERFORMANCE

2.1 The Fund's quarterly and longer-term performance as of 31 March 2024 is summarised below. Further detail is provided in the *Quarterly Fund Performance Report* found at Appendix 1.

Investment performance: quarter to 31 March 2024

2.2 The Fund's investments returned 2.0% in the three months to 31 March 2024, compared to the benchmark return of 4.3%. The relative underperformance vs the benchmark is largely attributable to the Fund's equity protection programme, which detracted (as expected) during another strong quarter for global equities. The programme reduces the overall volatility associated with equities by limiting losses and gains versus the benchmark.

2.3 ***UK equities*** generated lower returns than other regions with the FTSE All Share index gaining 3.8% over the quarter. The Fund's UK equity manager, Schroders, trailed the benchmark during the quarter with a return of 2.7% (versus the benchmark return of 3.8%).

2.4 ***Global equities*** performance was positive over the quarter, returning 9.2%. Commodities stocks benefited from renewed optimism in the economic outlook and cyclical assets outperformed during the quarter on expectations that a sharp recession may have been averted. Developed markets continued to outperform emerging markets and the US and Japan indices posted the best returns with 11.3% and 11.6% in sterling terms, respectively. Emerging markets returned a relatively low 3.4% despite a rebound in Chinese stocks as well as good performance in South Korea, Taiwan, and Saudi Arabia stocks.

2.5 Four out of five of the Fund's active global equity managers underperformed their benchmark this quarter. The exception to this was the Fund's global active value manager, Schroders who returned 9.5%.

2.6 The increase in the global equity valuations meant that the value of the Fund's equity protection assets decreased by £168m during the quarter, as expected.

2.7 ***Fixed income***. Bond yields were higher over the quarter (meaning bond values declined) as market expectations of imminent cuts in interest rates faded following higher than expected growth and inflation data. The Fund's fixed income managers all outperformed their benchmarks during the quarter, with M&G Alpha Opportunities having the highest outperformance with a return of 3.5% vs the benchmark return of 2.3%. As part of implementation of the new Strategic Asset Allocation, the newly established index linked gilts portfolio, managed by Insight, contributed £38m to the Risk Management Framework which equates to a gain of 6.6%.

2.8 ***Property*** returns of 0.4% were an improvement from the -1.2% in the previous quarter and were led by the retail and industrial sectors whilst the office sector detracted from performance. The DTZ direct property portfolio, where most of the Fund's property assets are invested, achieved a slightly better return than the benchmark of 0.5%.

2.9 Both ***absolute return*** managers were negatively impacted by the rise in bond yields which was marginally offset by gains from equities. Pyrford returned a positive 0.6% although it underperformed the RPI + 5% benchmark of 2.3%. Ruffer produced a negative performance of -0.7%.

2.10 The ***private equity*** mandate also benefitting from improved valuations this quarter although the ***infrastructure*** mandate detracted.

3. Longer term performance

3.1 For the year ended 31 March 2024, the Fund achieved a return of 3.7% against a benchmark return of 10.4%, an underperformance of 6.9%.

3.2 Against a backdrop of gradual disinflation and renewed expectations of interest rate cuts, bonds have performed well over the last year. All the Fund's bond managers have significantly outperformed the cash benchmark in the 1-year period. CQS were the best performing manager with a return of 13.7% against a benchmark of 9.2%, followed by the M&G Alpha Opportunities fund, which returned 12.4%.

3.3 Equities have also rallied with several major indices reaching record highs. However, the fund's active managers have underperformed the benchmark. Much of this underperformance by the Fund's active managers can be attributed to an underweight holding of the "Magnificent-7" tech stocks, which have driven the concentrated rally in the global equities, although the rally has become broader based in the most recent quarter with commodities benefiting from the improved economic backdrop. Given the rally in global equities over the past 12 months, the equity protection programme has detracted from overall Fund returns.

3.4 Relative performance from the absolute return managers against their inflation plus 5% target over the past 12 months has been negative, which is in part explained by the relatively high level of inflation that has persisted over the period. Ruffer detracted more significantly than Pyrford with a return of -5.9% (Pyrford: 4.9%). Property as an asset class has had a challenging year with benchmark returns being negative, and the Fund's property managers have largely produced negative returns. The DTZ directly managed portfolio returned -0.9% against a bespoke benchmark of -0.3% over the year.

3.5 For the three-year period, the Fund achieved a return of 2.6% compared to its strategic benchmark of 6.6%, an underperformance of 4.0%.

3.6 Benchmark equity returns have been strong during the three-year period with UK and Global equity indices returning 8.6% and 10.1% respectively. The Fund's value-style managers, Schroders and M&G, have outperformed the benchmark with 10.5% and 10.2% returns, respectively whilst the Fund's growth-style manager, Baillie Gifford, significantly underperformed with a return of -5.4% against a regional benchmark return of 8.7%. As noted in section 2 above, officers have commenced a review of the equities portfolio to ensure it remains aligned with the Fund's long term investment objectives.

3.7 The equity protection programme has detracted from performance over this period too, as equities have rallied. As noted above, the program reduces the overall volatility associated with equities by limiting losses and gains vs the benchmark.

3.8 The private equity and investment allocations have been the best performers in the three-year period while the absolute return managers have struggled against their inflation-linked benchmarks, given elevated levels of inflation over the performance horizon as noted above.

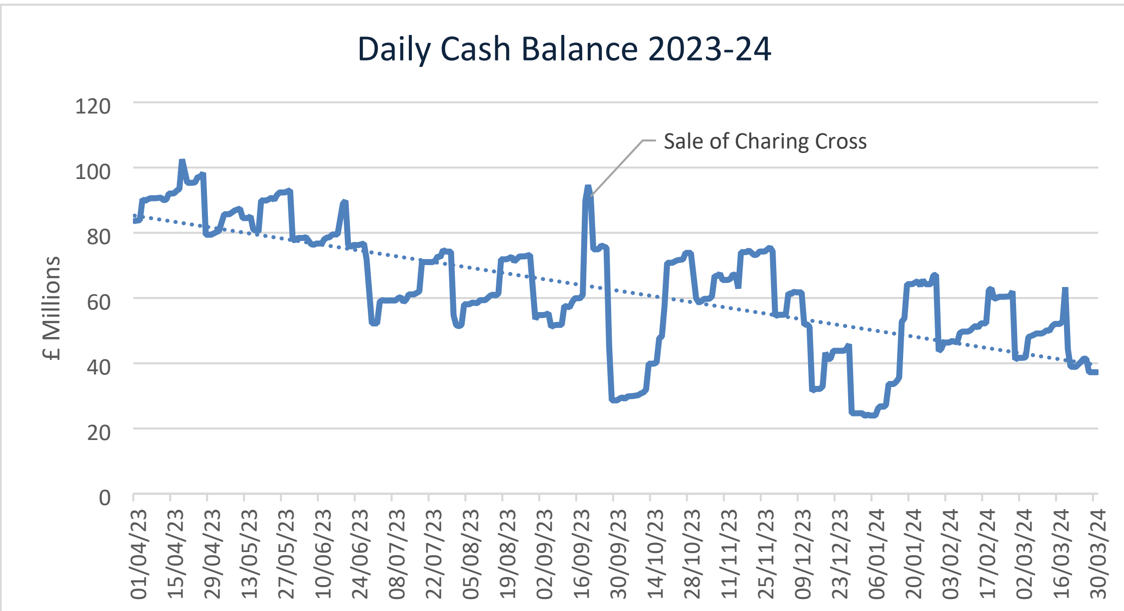
4. CASH FLOW

4.1 The cash balance as of 31 March 2024 was £37.3m, up from £24.6m at the end of the previous quarter. This figure excludes £170m of cash currently held with Insight arising from the sale of assets from the Pyrford Total Return Fund under the Committee's strategic asset allocation implementation plan. This additional liquidity source is discussed further in paragraph 4.8 below.

Actual Cash Flow Experience (2023-24)

4.2 The chart below shows the Fund's actual cash flow experience over the course of 2023-24. The chart shows that operational (non-investment) cash flows occur within a fairly repetitive cycle from one month to the next, which reflects standardised timing for contribution receipts and payroll payments.

4.3 The chart also reveals that cash balances trended down over the course the year. This is due to investment activity within the alternatives allocation and results from the fact that capital drawn down by the alternatives asset managers exceeded capital and income received. This is a trend that is expected to evolve with the market cycle and with the anticipated life cycle of the Fund's existing and future investments to alternative asset classes.



Cash Flow Forecast (2024-2027)

4.4 Officers maintain a forecast of the Fund's cash flows to ensure that there is sufficient liquidity in the Fund to meet its pensions obligations as well as for making investments required to meet its funding objectives. The 3-year cash flow forecast for the Fund based on existing investment commitments is summarised in the table below.

	2024-25 £m	**2025-26 £m**	**2026-27 £m**
Opening cash balance	**37.3**	**0.0**	**101.0**
Revenue			
Pensions contributions	299.0	311.0	324.0
Property income	21.0	21.4	21.9
Total inflows	**320.0**	**332.4**	**345.9**
Pensions payments	-310.0	-319.0	-328.0
Admin, governance and oversight	-7.5	-7.7	-7.8
Investment management fees	-4.6	-4.8	-5.0
Total outflows	**-322.1**	**-331.5**	**-340.8**
Net revenue cashflow	**-2.1**	**1.0**	**5.0**
Investments			
YFM	9.0	23.0	20.0
Partners Group	-40.0	63.0	110.0
Harbourvest	-22.0	14.0	80.0
Property investments net of redemptions	-26.0		
Net investment cashflow	**-79.0**	**100.0**	**210.0**
Closing internal cash balance	**-43.8**	**101.0**	**316.0**
Cash held with Insight	**170.0**	**126.2**	**126.2**
Total cash balances (internal+Insight)	**126.2**	**227.2**	**442.2**

4.5 The table shows that the Fund's cash flow from pension contributions and some investment income (property income) is currently sufficient for meeting its ongoing pension liabilities, and that this situation is expected to persist for the medium term.

4.6 The table also shows that investment activity within the alternatives allocation is expected to have a significant impact on projected cash balances. Specifically, the Fund anticipates that net investment cashflows will result in a total out flow of approximately £60m in 2024-25. However, for 2025-26 and 2026-27, net investment cash flows are expected to result in total inflows of circa £86m and £311m, respectively. Members should note that the table only factors in *existing* commitments and therefore the forecast is expected to evolve as future investments are committed (which is expected to be necessary in order to ensure actual exposure to private equity, property, and infrastructure remains aligned to the Fund's target exposure levels for these asset classes).

4.7 The size and timing of the investment cash flows relating to the alternative investment allocations cannot be precisely predicted, and capital calls can be issued at relatively short notice (two weeks). Therefore, it is important that the Fund has adequate liquidity to manage this inherent uncertainty.

4.8 In addition to current and forecast cash levels, the Fund also has £170m held in the Insight Liquidity Fund, as noted above, which is currently available as a source for additional liquidity to meet investment requirements both for existing commitments, future asset class rebalancing as well as any additional collateral requirement under the Risk Management Framework.

4.9 Given the currently high levels of cash, officers have no concerns over liquidity. Notwithstanding this, officers plan to establish, and introduce into the Fund's investment governance arrangements, a target level of liquidity to ensure both that the Fund has ample liquidity at all times and that it does not hold surplus liquidity, which could act as a drag on investment returns. An assessment of liquidity requirements, taking account of the optimal level of collateral required to support the risk management framework, will be prepared ahead of the Committee's next meeting in September.

Appendices

Appendix 1 – Quarterly Fund Performance Report – Q1 2024

James Graham, CFA (Pension Fund and Treasury Investments Manager)

Sangeeta Surana (Investments, Accounting and Pooling Manager)

T: 03000 416290 / 03000 416738

E: james.graham@kent.gov.uk / sangeeta.surana@kent.gov.uk

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