From:	Chairman Kent Pension Board Interim Corporate Director - Finance
To:	Kent Pension Board – 03 September 2024
Subject:	Investment Update (30 June 2024)
Classification:	Unrestricted

Summary:

To provide a summary of the Fund's investment strategy, asset allocation, performance, and responsible investment activity.

Recommendation:

The Board is asked to note the report.

FOR INFORMATION

1. Introduction

1.1 This report provides the Board with an update on the Fund's investment activity and performance, as well as on responsible investment developments that have taken place since the Board's last meeting.

2. Investment Strategy update

2.1 As reported to the Board previously, the Pension Fund Committee completed the implementation of the new strategic asset allocation in Q2 2024.

3. Intra Asset Class Review

3.1 Officers have now commenced stage two of the implementation plan which focuses on reviewing portfolio composition on an asset class by asset class basis. The purpose of this review is to ensure the Fund's mandates remain suitably aligned with the investment objectives as well as to identify opportunities to progress asset pooling. As reported at the Board's last meeting, the review will begin with the equity allocation (which dominates the Fund's risk and return profile). This work will be followed by a review of the fixed income mandates and will then conclude with the alternative asset classes.

3.2 At its last meeting, the Committee received a report on the initial findings of the equity allocation review from the Investment Consultant, Mercer, which provided an opportunity for the Committee to provide feedback for developing the final proposals.

3.3. Officers and the Investment Consultant will use the initial findings and the Committee's feedback to finalise recommendations for the future equity portfolio and a final report will be brought to the Committee at its meeting in September, for decision.

4. Infrastructure

4.1 At its meeting in June, the Committee received an update on infrastructure allocation planning. The findings of a commitment analysis carried out by officers together with advice from the Investment Consultant indicated that no additional commitment was required immediately, though this position would be kept under review through routine portfolio monitoring.

5. Property

5.1. The Committee was also informed that the Fund, via its overarching property manager, DTZ, had submitted a request to redeem the Fund's outstanding investment in the Fidelity UK Real Estate Fund following concerns over outflows and the outlook for the strategy. This action was taken to help protect the pension fund from a potential position where it is left with an investment in relatively poor assets after redemption requests from other Fidelity investors are honoured.

5.2. Fidelity has since suspended dealing in the FIREF, an outcome that DTZ and officers had anticipated. Fidelity is now exploring options with investors for the continuation of the fund as well considering how redemption requests can be fulfilled. Fidelity is hopeful that they will be able to meet Kent's redemption request by the end of 2025.

6 Fund value and asset allocation

6.1 As of 30 June 2024 (the latest available data), the Fund's value was £8.25bn compared to £8.07bn as at 30 April 2024, the position previously reported to the Board. The table below sets out the current asset allocation versus the Fund's strategic asset allocation and its rebalancing policy.

Asset Class	Strategic Asset Allocation (%)	Tolerance Band (%)	Current Asset Allocation (%)	Variance	Status
Equities	**53**	**+/- 10**	**55**	**2**	**In range**
UK Equities	10	+/- 2.5	10	0	In range
Global Equities	38	+/- 5	40	2	In range
Emerging Market Equities	5	+/- 2.5	5	0	In range
Fixed Income	**22**	**+/- 5**	**21**	**-1**	**In range**
Credit	15	+/- 5	15	0	In range
RMF (Index Linked Gilts)	7	-	6	-1	N/A
Alternatives	**25**	**+/- 10**	**23**	**-2**	**In range**
Absolute Return	5	-	5	0	N/A
Infrastructure	5	-	4	-1	N/A

Private Equity	5	-	4	-1	N/A
Property	10	-	9	-1	N/A
Cash	**0**	**5**	**1**	**1**	**In range**
Total	**100**		**100**		

6.2 The current asset allocation is broadly aligned with the new strategic asset allocation, allowing for approved tolerance bands. Global equities are marginally overweight and conversely private equity, infrastructure and the risk management framework are slightly underweight. Given the current asset allocation is within tolerance, officers will not be recommending to the Committee that any rebalancing is undertaken at its meeting in September.

7 Investment performance: quarter to 30 June 2024

7.1 The Fund's investments returned 1.4% in the three months to 30 June 2024, compared to the benchmark return of 1.9%.

7.2 ***UK equities*** generated higher returns compared to the global index with the FTSE All Share index gaining 3.4% over the quarter. The Fund's UK equity manager, Schroders, outperformed the benchmark during the quarter with a return of 3.4%.

7.3 ***Global equities*** performance was positive over the quarter, with the MSCI All Countries World Index returning 2.8%. Performance was driven by large cap, US stocks that are regarded as beneficiaries of AI, where the Pension Fund is underweight. Indeed, market breadth was extremely narrow especially in the US where almost three quarters of the index's constituent stocks lagged the index, the highest proportion since the 1990s. European equities declined amidst political uncertainty, but UK stocks rose to an all-time high driven by financials, health care and resources. Emerging markets equities returned 5.8% in sterling terms and outpaced developed markets, reflecting anticipated interest rate cuts in the US (emerging markets are sensitive to changes in the US monetary policy) as well as other favorable factors affecting the China, India and South Africa markets.

7.4 Global equity manager Baillie Gifford's returns of 0.1% were below its fixed weight regional benchmark of 1.5%. Impax, and the Schroders Active Value Fund underperformed the MSCI benchmark of 2.8% this quarter with returns of -4.6% and 0.1%, respectively. Sarasin and M&G outperformed the benchmark with 3.1% and 4.0% returns, respectively. Therefore, collectively, the Fund's global equity mandates delivered a return of 2.0% during the quarter.

7.5 After taking into account the impact of the equity protection programme, this gain was slightly reduced to 1.8%: the increase in the global equity valuations meant that the value of the Fund's equity protection assets decreased by £9.6m during the quarter.

7.6 ***Emerging market equities:*** As the Fund's emerging market equities allocation was only invested in April 2024, quarterly and longer-term returns are not available on these mandates as of 30 June.

7.7 ***Fixed income***. Bonds delivered positive returns following positive news on inflation. The Fund's credit-focused (CQS and M&G) produce higher returns than Schroders and Goldmans Sachs (who additionally use views on the direction of interest rates to drive returns) with CQS outperforming the benchmark of 2.2% with a return of 2.5%. M&G Alpha Opportunities marginally underperformed the same benchmark with a return of 2.0%.

7.8 The newly established index linked gilts portfolio, which is part of the Risk Management Framework (RMF) managed by Insight, detracted with a -4.2% return.

7.9 ***Property*** total returns were 1.2% in this quarter with increased investment activity leading to positive capital returns. On a sectoral basis, retail, hotel and residential sector returns were 2.0% whilst the office sector recorded negative total returns of -0.2%. The direct property portfolio, managed by DTZ, and which comprises the majority of the property allocation, outperformed the benchmark with a return of 2.0% (versus 1.7%) whilst the indirect property mandates each underperformed in the quarter.

7.10 Amongst the two ***absolute return*** mandates, Pyrford and Ruffer achieved absolute returns of 0.6% and 0.1%, respective - underperforming the RPI + 5% benchmark of 1.1%.

7.11 The ***private equity*** and infrastructure managers underperformed the cash benchmark 1.3% over the quarter.

8 Longer term performance

8.1 For the year ended 31 March 2024, the Fund achieved a return of 6.7% against a benchmark return of 10.7%, an underperformance of 4.0%.

8.2 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 13.4% against a benchmark of 9.4%, followed by the M&G Alpha Opportunities fund, which returned 11.8%.

8.3 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 can be attributed to an underweight holding of the “Magnificent-7” tech stocks, which have driven the concentrated rally in global equities recently, (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.

8.4 Relative performance from the absolute return managers against their inflation plus 5% target over the past 12 months has been mixed. Ruffer detracted with a return of 0.5% whilst Pyrford has outperformed the benchmark with 7.3%. Property as an asset class has had a challenging year with benchmark returns being close to zero (0.1%), and the Fund’s property managers have all produced negative returns. The DTZ directly managed portfolio returned 0.3% against a bespoke benchmark of 0.6% over the year. Under the expanded mandate DTZ will have discretion over remodelling the property portfolio over the longer term to improve performance.

8.5 For the three-year period, the Fund achieved a return of 2.0% compared to its strategic benchmark of 5.8%, an underperformance of 3.8%.

8.6 Benchmark equity returns have been strong during the three-year period with UK and Global equity indices returning 7.9%, and 8.6% respectively. Of the equity managers, only M&G, have outperformed the benchmark over the period with an annualised return of 9.9% whilst the Fund’s growth-style manager, Baillie Gifford, significantly detracted with a return of -8.2% against a regional benchmark return of 7.1%. 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.

8.7 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. As part of the investment strategy review the Fund implemented a systematic equity protection programme, which is expected to reduce underperformance in a positive environment for equities. Changes to the Fund’s composition of the Fund’s collateral, including the inception of the index linked gilt portfolio, is expected to improve the returns within the risk management framework.

8.8 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.

9 Responsible Investment Update

9.1 In June the Pension Fund Committee approved the Responsible Investment (RI) Policy which had been reviewed by the Responsible Investment Working Group (RIWG).

9.2 Officers also completed the submission of the PRI survey for 2023. The annual PRI reporting exercise which helps the Fund assess and benchmark the Fund’s RI policies and practices against peers and best practice. Results of the survey will be shared with the Board and Committee when available.

9.3 The Responsible Investment Working Group (RIWG) has met twice since the last Board meeting, on 20 June and 25 July.

9.4 At its June meeting the RIWG received a presentation from the Local Authority Pension Fund Forum (LAPFF). LAPFF is a voluntary association of 87 LGPS funds and 7 LGPS Pools who collectively have assets under management of £350bn.

9.5 Keith Bray from LAPFF gave an overview of the profile and activities of the LAPFF which mainly includes:

- facilitating commissioning of research into and by engagement with investee companies where ESG concerns have been identified.
- issuing occasional voting alerts for members to discuss with their fund managers.

- facilitating collaboration with other institutional investors both nationally and internationally

9.6 The presentation also highlighted the engagements undertaken by the LAPFF which covered topics such as
- Climate change
- Mining
- Human rights of Indigenous communities
- Environmental risks
- Finance and accounting
- Board composition

9.7 Officers informed the RIWG that they have been sharing the voting alerts issued by the LAPFF with the Fund's investment managers to make them aware of the issues to be considered when exercising their voting rights on behalf of the Fund.

9.8 At its meeting on 25 July 2024, the RIWG received a presentation from the IIGCC, an investor network focused on accelerating climate action by facilitating knowledge exchange and providing resources, of which the Kent Pension Fund is a member.

9.9 The IIGCC presented an overview of its tools and resources, most notably the Net Zero Investment Framework which supports both for companies and asset owners in setting of carbon reduction targets with clear action plans and implementing and managing the action plans through portfolio construction engagement with companies and investment solutions.

9.10 The IIGCC also provided an overview of the current regulatory landscape and direction of travel which will affect the reporting by asset managers as well as investors/asset owners.

9.11 Officers will be reviewing how the tools can be utilised to make progress on the implementation of the Fund's net zero target and reporting obligations.

Appendices

Appendix 1 – Quarterly Performance Report (30 June 2024)

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