From:	Chairman Pension Fund Committee Interim Corporate Director of Finance
To:	Pension Fund Committee – 19 September 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 30 June 2024 while asset allocation is discussed with reference to the Fund's value as at 31 July 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)
b) to delegate authority to the Head of Pensions and Treasury to withdraw sufficient funds from the Insight Liquidity Fund to ensure the Fund's internal cash balances are sufficient to meet ongoing liquidity needs (para 4.6)

FOR DECISION

1. FUND VALUE AND ASSET ALLOCATION

1.1 As of 31 July 2024 (the latest available date), the Fund's value was £8.3bn compared to £8.1bn as at 30 April 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 As previously reported, stage one of the implementation plan for the strategy was completed in May. This brought the allocation at the asset class level broadly in line with the strategic allocation.

Asset Class / Fund Manager	Strategic Asset Allocation	Tolerance Band	Current Asset Allocation		Variance	Status
	(%)	(%)	£m	(%)	(%)	
Equities	**53.0%**	**+/- 10%**	**4,570.5**	**55.1%**	**2.1%**	**In Range**
UK Equities	**10.0%**	**+/- 2.5%**	**906.1**	**10.9%**	**0.9%**	**In Range**
Schroders UK Equity			903.9	10.9%		
Link Fund Solutions			2.2	0.0%		
Global Equities	**38.0%**	**+/- 5%**	**3,273.9**	**39.5%**	**1.5%**	**In Range**
Schroders GAV			474.5	5.7%		
IMPAX Funds			74.0	0.9%		
Baillie Gifford			1,197.8	14.4%		
M&G Global Diversified			621.2	7.5%		
Sarasin			430.7	5.2%		
Insight- Global Synthetic Equity			475.6	5.7%		
Emerging Market Equities	**5.0%**	**+/- 2.5%**	**390.4**	**4.7%**	**-0.3%**	**In Range**
Columbia Threadneedle			200.3	2.4%		
Robeco			190.1	2.3%		
Fixed Income	**22.0%**	**+/- 5%**	**1,751.7**	**21.1%**	**-0.9%**	**In Range**
Credit	**15.0%**	**+/- 5%**	1,244.2	**15.0%**	**0%**	**In Range**
Goldman Sachs			428.0	5.2%		
CQS			266.4	3.2%		
M&G Alpha Opportunities			283.4	3.4%		
Schroders Fixed Income			266.0	3.2%		
Risk Management Framework	**7.0%**	**N/A**	**507.5**	**6.1%**	**-0.9%**	**N/A**
Insight			507.5	6.1%		
Alternatives	**25.0%**	**+/- 10%**	**1,902.5**	**22.9%**	**-2.1%**	**In Range**
Absolute Return	**5.0%**	**N/A**	417.3	**5.0%**	**0%**	**N/A**
Ruffer			181.0	2.2%		
Pyrford			235.7	2.8%		
Infrastructure	**5.0%**	**N/A**	**379.6**	**4.6%**	**-0.4%**	**N/A**
Partners Group			79.6	4.6%		
Private Equity	**5.0%**	**N/A**	**369.6**	**4.5%**	**-0.5%**	**N/A**
YFM			68.9	0.8%		
Harbourvest Intl			300.7	3.6%		
Property	**10.0%**	**N/A**	736.1	**8.9%**	**-1.1%**	**N/A**
DTZ Direct Property			466.0	5.6%		
DTZ Pooled Property			69.8	0.8%		
Fidelity International			138.6	1.7%		
Kames Capital			27.4	0.3%		
M&G Property			34.4	0.4%		
Cash	**0.0%**	**5%**	**68.1**	**0.8%**	**0.8%**	**In Range**
Total	**100.0%**		**8,292.8**	**100.0%**		

1.3 The current asset allocation is aligned with the new strategic asset allocation, allowing for approved tolerance bands. The UK Equities and Global Equities allocations are marginally overweight. As the global equity protection options which form part of the Risk Management Framework move in the opposite direction from the global equities, the Risk Management Framework valuation has fallen and is marginally underweight. Redemption proceeds from two property unit trusts- M&G Built to Rent Fund and Lothbury Fund have reduced the Fund's exposure to property. This is expected to rise in the following quarter as the fund has made a new investment of £35m in the L&G built to Rent property Fund in July and £12m in IPIF Property Unit Trust, which will bring the allocation close to target.

1.4 Given that the current asset allocation remains within range of the Fund's approved tolerance bands, no rebalancing is recommended at the current time.

2. INVESTMENT PERFORMANCE

2.1 The Fund's quarterly and longer-term performance as of 30 June 2024 is summarised below. Further detail is provided in the *Quarterly Fund Performance Report* found at Appendix 1.

Investment performance: quarter to 30 June 2024

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

2.3 ***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, kept pace with the benchmark during the quarter with a return of 3.4%.

2.4 ***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.

2.5 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.

2.6 ***Emerging market equities:*** 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 favourable factors affecting the China, India, and South Africa markets. 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.

2.7 ***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%.

2.8 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. More detailed information on the performance of the Risk Management Framework is included later in today's agenda.

2.9 ***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.

2.10 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%.

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

3. LONGER TERM PERFORMANCE

3.1 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%.

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

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 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.

3.4 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.

3.5 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%.

3.6 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.

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. 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.

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.

4. CASH FLOW

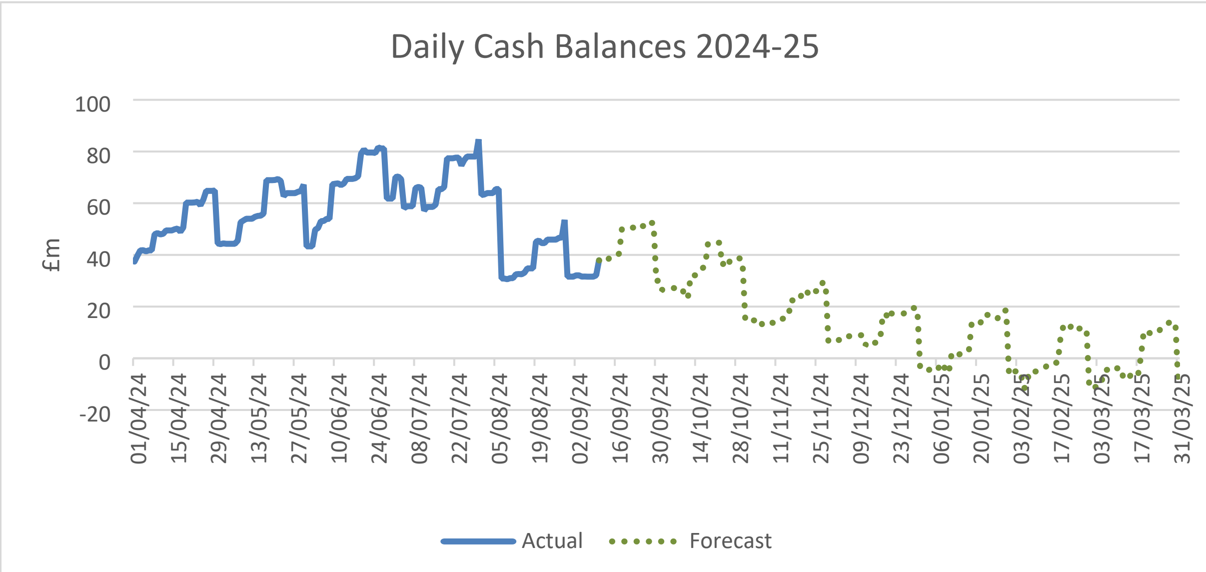
4.1 The cash balance as of 30 June 2024 was £61.8m, up from £24.5m at the end of the previous quarter. This figure excludes £171m of cash currently held with Insight arising from the sale of assets from the Pyrford Total Return Fund under the Committee's strategic asset allocation implementation plan. This additional liquidity source is discussed further in paragraph 4.8 below.

<u>Actual Cash Flow Experience and In Year Forecast (2023-24)</u>

4.2 The chart below shows the Fund's actual cash flow experience from 1 April of to 09 September 2024 (as at the date of writing this report) as well as forecast cash flow to 31 March 2025. 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 pensions payroll payments.

4.3 Actual cash flow experience in the year to date has also been influenced by transaction activity within the property allocation: cash balances have increased with sales from the M&G UK Residential Fund and the Lothbury Property Fund; and have subsequently decreased when these proceeds were reinvested in the L&G Build to Rent Fund and Industrial Property Investments Fund. The transactions were carried out in accordance with DTZ's discretionary mandate.

4.4 The balances are expected to trend down over the remainder of 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, is expected to exceed 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.



4.5 As the graph shows, liquidity pressures are expected to arise in Q1 2025, if no action is taken. The key driver of the projected cash flows is the pace and timing of capital calls and distributions from the Fund's private equity and infrastructure commitments, which are subject to uncertainty. In practice, the Fund has a readily available source of cash via the Insight Liquidity Fund, currently valued at £173m, which it can use to ensure internal cash balances remain sufficient. Officers will use the internally maintained cash flow forecast to anticipate liquidity needs and intend to redeem cash from the Insight Liquidity Fund to ensure that internal cash balances remain at suitable levels. Specifically, officers intend to take action to ensure projected internal cash balances remain at a level of at least £20m on a 30-day forward-looking basis.

4.6 The Committee is asked to delegate authority to the Head of Pensions and Treasury to withdraw sufficient funds from the Insight Liquidity Fund to ensure the Fund's internal cash balances are sufficient to meet ongoing liquidity needs.

Cash Flow Forecast (2024-2027)

4.7 Officers maintain a forecast of the Fund's cash flows over the medium term to ensure that liquidity requirements are identified and managed in an orderly fashion. The 3-year cash flow forecast for the Fund based on existing investment commitments is summarised in the table below.

	2024-25 Q2,3,4 £m	2025-26 Full Year £m	2026-27 Full Year £m
Opening cash balance	**61.8**	**0.0**	**110.7**
Revenue			
Pensions contributions	233.3	324.0	326.0
Property income	13.5	18.0	18.6
Total inflows	**246.7**	**342.0**	**344.6**
Pensions payments	-232.5	-319.0	-328.0
Admin, governance and oversight	-7.1	-7.4	-7.6
Investment management fees	-3.5	-4.8	-5.0
Total outflows	**-243.0**	**-331.2**	**-340.6**
Net revenue cashflow	**3.7**	**10.7**	**4.0**
Investments			
YFM	6.8	23.0	20.0
Partners Group	-30.0	63.0	110.0
Harbourvest	-16.5	14.0	80.0
Property investments net of redemptions	-35.0		
Net investment cashflow	**-74.8**	**100.0**	**210.0**
Closing internal cash balance	**-9.3**	**110.7**	**324.7**
Cash held with Insight	**170.9**	**161.6**	**161.6**
Total cash balances (internal+Insight)	**161.6**	**272.4**	**486.4**

4.8 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.

4.9 The table also shows that investment activity within the alternatives allocation (including real estate) 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 £75m in 2024-25. However, for 2025-26 and 2026-27, net investment cash flows are expected to result in total inflows of circa £100m and £210m, 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).

4.10 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.

4.11 In addition to current and forecast cash levels, the Fund also has £171m 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.

4.12 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.

4.13 Mercer have carried out an initial assessment of the collateral requirements for the Risk Management Framework (RMF) and are satisfied that the current amount of collateral supporting the RMF is sufficient and meets the regulatory requirement.

4.14 The Risk Management Working Group will consider the optimal collateral buffer at its autumn meeting and a Collateral Waterfall Framework will be developed which (if agreed) will provide officers with delegated authority to replenish collateral from pre-approved sources in specific circumstances agreed by the Committee. Following consideration by the RMWG, a proposal will be brought the Committee meeting in December for decision.

Appendices

Appendix 1 – Quarterly Fund Performance Report – Q2 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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