| | |
|---|---|
| From: | Chairman Pension Fund Committee<br>Interim Corporate Director of Finance |
| To: | Pension Fund Committee – 3 December 2024 |
| Subject: | Investment Performance and Asset Allocation Update |
| Classification: | Unrestricted |


**Summary:**

This report provides a summary of the Fund's, asset allocation, performance, and cash flow position.

Section 1 of the report provides an overview of the Fund's current asset allocation compared to the target range. Asset allocation (rebalancing) decisions are based on the latest month-end valuations available and notes that no rebalancing is required at this stage.

The Fund has outperformed its quarterly benchmark and a detailed commentary on the performance by asset class and manager for the quarter as well as longer term is included in sections 2 and 3 of the report. Detailed performance information is provided in the *Quarterly Fund Performance Report* found at Appendix 1.

Finally, the report also includes an overview of the update on the cashflow forecast and cash position to March 27. The cashflow forecast is based on expectations for operational (non-investment) cash flows, current investment commitments of the Fund and does not consider additional commitments to alternative assets which will be required in the future to achieve and maintain the target allocations to these asset classes.


**Recommendation:**

The Committee is asked to:

a) note the report; and
b) to agree that no rebalancing is undertaken (para. 1.4)

**FOR DECISION**

---

## 1. FUND VALUE AND ASSET ALLOCATION

1.1 As of 30 September 2024 (the latest available data), the Fund's value was £8.4bn compared to £8.3bn as at 31 July 2024, the position previously reported to the Committee. The table below sets out the current asset allocation versus the Fund's strategic asset allocation and its rebalancing policy.

| Asset Class / Fund Manager | Strategic Asset Allocation | Tolerance Band | Current Asset Allocation | | Variance | Status |
|---|---|---|---|---|---|---|
| | (%) | (%) | £m | (%) | (%) | |
| **Equities** | **53.0%** | **+/- 10%** | **4,663.1** | **55.6%** | **2.6%** | **In Range** |
| **UK Equities** | **10.0%** | **+/- 2.5%** | 919.2 | **11.0%** | **1.0%** | **In Range** |
| Schroders UK Equity | | | 917.0 | 10.9% | | |
| Link Fund Solutions | | | 2.3 | 0.0% | | |
| **Global Equities** | **38.0%** | **+/- 5%** | 3,334.6 | **39.8%** | **1.8%** | **In Range** |
| Schroders GAV | | | 480.6 | 5.7% | | |
| IMPAX Funds | | | 74.5 | 0.9% | | |
| Baillie Gifford | | | 1,229.9 | 14.7% | | |
| M&G Global Diversified | | | 643.3 | 7.7% | | |
| Sarasin | | | 433.9 | 5.2% | | |
| Insight- Global Synthetic Equity | | | 472.2 | 5.6% | | |
| **Emerging Market Equities** | **5.0%** | **+/- 2.5%** | 409.3 | **4.9%** | **-0.1%** | **In Range** |
| Columbia Threadneedle | | | 206.8 | 2.5% | | |
| Robeco | | | 202.5 | 2.4 % | | |
| **Fixed Income** | **22.0%** | **+/- 5%** | **1,844.6** | **20.8%** | **-1.2%** | **In Range** |
| **Credit** | **15.0%** | **+/- 5%** | 1,266.2 | **15.1%** | **0.1%** | **In Range** |
| Goldman Sachs | | | 434.6 | 5.2% | | |
| CQS | | | 271.2 | 3.2% | | |
| M&G Alpha Opportunities | | | 287.6 | 3.4% | | |
| Schroders Fixed Income | | | 272.7 | 3.3% | | |
| **Risk Management Framework** | **7.0%** | **N/A** | **477.6** | **5.8%** | **-1.2%** | **N/A** |
| Insight | | | 477.6 | 5.8% | | |
| **Alternatives** | **25.0%** | **+/- 10%** | **2,096.2** | **23.3%** | **-1.7%** | **In Range** |
| **Absolute Return** | **5.0%** | **N/A** | 425.3 | **5.1%** | **0.1%** | **N/A** |
| Ruffer | | | 185.8 | 2.2% | | |
| Pyrford | | | 239.5 | 2.9% | | |
| **Infrastructure** | **5.0%** | **N/A** | **384.3** | **4.6%** | **-0.4%** | **N/A** |
| Partners Group | | | 384.3 | 4.6% | | |
| **Private Equity** | **5.0%** | **N/A** | **364.2** | **4.3%** | **-0.7%** | **N/A** |
| YFM | | | 73.7 | 0.9% | | |
| Harbourvest Intl | | | 290.5 | 3.5% | | |
| **Property** | **10.0%** | **N/A** | **776.7** | **9.3%** | **-0.7%** | **N/A** |
| DTZ Direct Property | | | 466.8 | 5.6% | | |
| DTZ Pooled Property | | | 106.0 | 1.3% | | |
| Fidelity International | | | 142.6 | 1.7% | | |
| Kames Capital | | | 26.6 | 0.3% | | |
| M&G Property | | | 34.6 | 0.4% | | |
| **Cash** | **0.0%** | **5%** | **27.2** | **0.3%** | **0.3%** | **In Range** |
| **Total** | **100.0%** | | **8,384.6** | **100.0%** | | |

1.2 The current asset allocation is broadly aligned with the new strategic asset allocation, allowing for approved tolerance bands. Global and UK equities are marginally overweight and conversely private equity, property and the risk management framework are slightly underweight. The Risk Management Framework (RMF) contains £154m of cash that is held to meet liquidity requirements: either for private equity and infrastructure drawdowns or to support any additional collateral requirements for the RMF.

1.3 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 September 2024 is summarised below. Further detail is provided in the *Quarterly Fund Performance Report* found at Appendix 1.

**Investment performance: quarter to 30 September 2024**

2.2 The Fund's investments returned 1.4% in the three months to 30 September 2024, compared to the benchmark return of 1.1%.

2.3 ***UK equities*** continued to generate higher returns compared to the global index with the FTSE All Share index gaining 2.3% over the quarter. Domestically focused mid cap and small cap equities performed better than large cap stocks. The Fund's UK equity manager, Schroders, outperformed the benchmark during the quarter with a return of 3.7%.

2.4 ***Global equities***: geopolitical tensions, economic backdrop was positive, and returns were positive. Global equity markets returned 5.1% in local currency but due to strengthening of the Pound, the MSCI ACWI returns in sterling were a modest 0.5% over the quarter.

2.5 Amongst the Fund's global equity managers, Baillie Gifford's return of 2.1% was above its fixed weight regional benchmark return of 1.0%. Impax, M&G and the Schroders Active Value Fund all outperformed the MSCI benchmark of 0.5% this quarter with returns of 4.5%, 4.1% and 0.9%, respectively. Sarasin underperformed with -1.2% returns over the quarter. Collectively, the Fund's global equity mandates delivered a return of 1.9% during the quarter.

2.6 After considering the impact of the risk management framework, this gain was reduced to 0.7%. The increase in global equity valuations meant that the value of the Fund's equity protection assets decreased.

2.7 ***Emerging market equities:*** This is the first quarter where the Fund has a full quarter's performance for the emerging market equities. Despite some volatility, emerging market equities ended the quarter with strong returns. The MSCI EM index returned 2.5% in sterling. Both Robeco and Columbia Threadneedle (CT) underperformed the benchmark with 2.1% and -1.1% returns, respectively. CT's performance was particularly affected by its underweight position in Chinese stocks which were boosted by the Chinese government's policy initiatives in September as well as its overweight position in technology stocks which detracted in this quarter.

2.8 ***Fixed income***. Rate cutting cycles implemented in major economies, caused government bond yields to decline and boosted valuations. However, the expectations of faster monetary easing by the Fed also led to a weaker dollar against major currencies, including sterling. The Fund's bond mandates collectively achieved 3.1% returns compared to a cash benchmark of 1.3% for the quarter. All credit managers in the Fund outperformed the benchmark with Schroders and GSAM posting returns of 4.1% and 3.3% respectively as their strategies include a view on interest rates which benefitted in a declining rate environment. CQS and M&G Alpha Opportunities also outperformed the benchmark with returns of 2.9 and 2.1%, respectively.

2.9 The Index Linked Gilts portfolio, which is part of the Risk Management Framework (RMF) managed by Insight, returned 1.5%.

2.10 ***Property*** total returns were 1.8% in this quarter against the UK all property benchmarks return of 1.6%. In the market, all sectors delivered positive total returns in Q3, including the office sector which has experienced negative total returns since mid-2022. The best performing sectors this quarter were the industrial, retail and residential sectors. DTZ's legacy portfolio returned 1.5%. Fidelity posted 2.8% but M&G returned 1.1%. Kames which is in winding down stage returned -0.8% against a Balanced Property benchmark of 1.2%.

2.11 Amongst the two ***absolute return*** mandates, Pyrford and Ruffer achieved absolute returns of 3.2% and 3.1%, respectively - outperforming the RPI benchmark of 0.3%.

2.12 Both the large ***private equity*** and ***infrastructure*** managers underperformed the cash benchmark 1.3% over the quarter with Harbourvest returning -4.6% whilst Partners Group returned 0.4%. YFM produced above benchmark returns of 1.5%.

## 3. LONGER TERM PERFORMANCE

3.1 For the year ended 30 September 2024, the Fund achieved a return of 6.5% against a benchmark return of 10.7%, an underperformance of 4.2%.

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 13.6% against a cash +4% benchmark of 8.6%, followed by the M&G Alpha Opportunities fund, which returned 11.1%. Both Schroders and GSAM also performed equally well with 13.0% and 11.1% respectively.

3.3 Equities have also rallied with several major indices reaching record highs and the MSCI ACWI posting an annual return of 19.9%. However, the Fund's active managers have had mixed performance: M&G have delivered the best performance with 23.0%. Baillie Gifford have gained 18.1% and therefore both managers have beaten their respective benchmarks. Sarasin, Schroders GAV and Impax have underperformed with Impax detracting the most with a return of 11%. Given the rally in global equities over the past 12 months, the equity protection programme has detracted from overall Fund returns. With returns of 12.3% Schroders' UK equity portfolio underperformed its UK MSCI benchmark of 13.4%.

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 4.8% whilst Pyrford has outperformed the benchmark with 9.1%. against the benchmark of 5.2%. Overall, the property portfolio returned 1.8% against a benchmark of 2.4%. Although the DTZ direct property portfolio returned 2.6%, performance detracted due to underperformances by Fidelity, Kames and M&G.

3.5 For the three-year period, the Fund achieved a return of 2.1% compared to its strategic benchmark of 5.6%, an underperformance of 3.5%.

3.6 Benchmark equity returns have been strong during the three-year period with UK and Global equity indices returning 7.4%, and 8.3% respectively. Of the equity managers, M&G and Schroders GAV have outperformed the benchmark over the period with an annualised return of 10.2% and 8.5% respectively whilst the Fund’s growth-style manager, Baillie Gifford, significantly detracted with a return of -7.1% against a regional benchmark return of 6.9%.

3.7 The equity protection programme has detracted from performance over this period too, as equities have rallied. As noted above, the programme 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 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

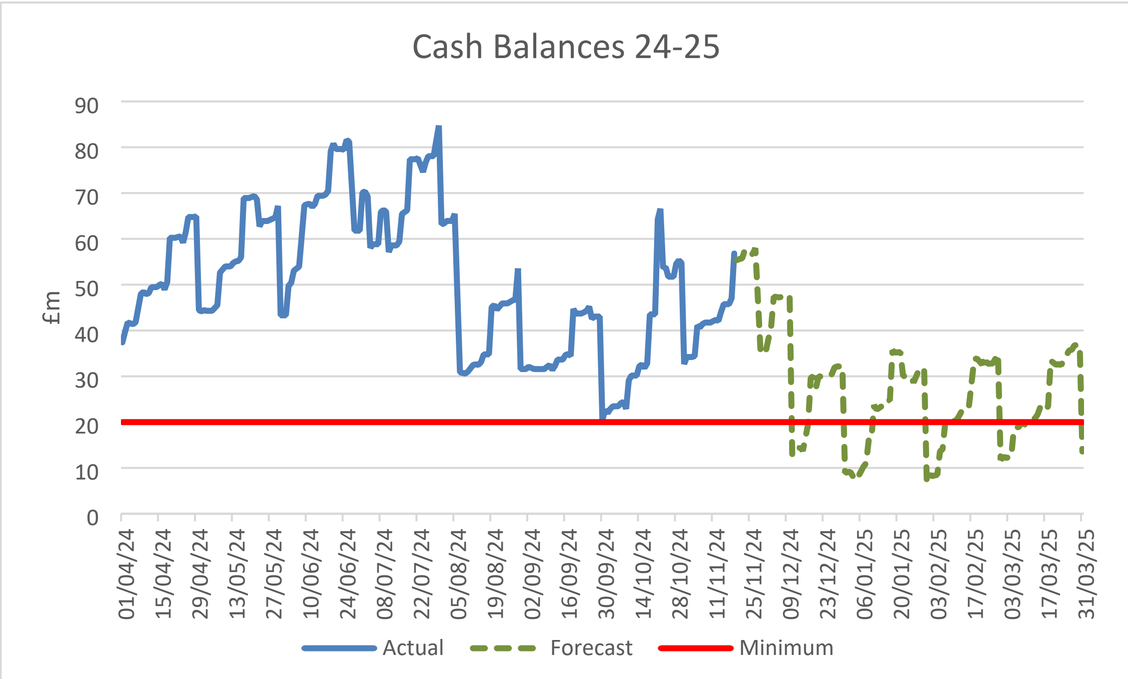
4.1 The cash balance as of 30 September 2024 was £26.1m, up from £61.8m at the end of the previous quarter. This figure excludes £153.8m of cash currently held with Insight arising from the sale of assets from the Pyrford Total Return Fund under the Committee’s strategic asset allocation implementation plan. This additional liquidity source is discussed further in paragraph 4.10 below.

Actual Cash Flow Experience and In-Year Forecast (2024-25)

4.2 The chart below shows the Fund’s actual cash flow experience from 1 April of to 18 November 2024 (the date of writing this report) as well as forecast cash flows 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 the timing of transaction activity within the alternatives allocation, and in particular the property allocation. Overall, as additional investments within these asset classes have exceeded sales and distributions, operational cash balances available to the Fund have declined over the year to date. In October, a redemption of £20m was made from the Insight Liquidity Fund to replenish the balances to a minimum level of £20m. In the previous meeting the Committee delegated the decision to redeem units of the Insight Liquidity Fund to maintain operational cash balances at £20m.

4.4 The balances are expected to trend down over the remainder of the year as further capital is deployed to the alternatives allocation per existing commitments.




4.5 As the graph shows, cash is expected to decline in December 2024 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 as well as property investments, which are subject to uncertainty. In practice, the Fund has a readily available source of cash via the Insight Liquidity Fund, currently valued at £153.8m, 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.

<u>Cash Flow Forecast (2024-2027)</u>

4.6 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 Q3 & 4 £m | 2025-26 Full Year £m | 2026-27 Full Year £m |
|---|---|---|---|
| **Opening cash balance** | **26.1** | **11.2** | **88.8** |
| **Revenue** | | | |
| Pensions contributions | 155.5 | 324.0 | 326.0 |
| Property income | 8.7 | 18.0 | 18.6 |
| **Total inflows** | **164.2** | **342.0** | **344.6** |
| Pensions payments | -155.0 | -319.0 | -328.0 |
| Admin, governance and oversight | -6.9 | -7.4 | -7.6 |
| Investment management fees | -2.3 | -4.8 | -5.0 |
| **Total outflows** | **-164.2** | **-331.2** | **-340.6** |
| **Net revenue cashflow** | **0.0** | **10.7** | **4.0** |
| **Investments** | | | |
| YFM | 10.0 | 13.0 | 26.0 |
| Partners Group | 15.6 | 35.0 | 60.0 |
| Harbourvest | -5.5 | 18.9 | 62.2 |
| Property investments net of redemptions | -35.0 | | |
| **Net investment cashflow** | **-14.9** | **66.9** | **148.2** |
| **Closing internal cash balance** | **11.2** | **88.8** | **241.0** |
| **Cash held with Insight** | **153.8** | **153.8** | **153.8** |
| **Total cash balances (internal+Insight)** | **165.0** | **242.6** | **394.8** |

4.7 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.

4.8 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 £14.9m in the remaining period of financial year 2024-25. However, for 2025-26 and 2026-27, net investment cash flows are expected to result in total inflows of circa £99.5m and £245m, 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).

4.9 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.

4.10 In addition to current and forecast cash levels, the Fund also has £153.8m held in the Insight Liquidity Fund (ILF), 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.

4.11 Given the buffer cash available in the ILF, officers have no concerns over liquidity.

**Appendices**

Appendix 1 – Quarterly Fund Performance Report – Q3 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**


**19 November 2024**

---