From:	Chairman Pension Fund Committee Corporate Director of Finance
To:	Pension Fund Committee – 26 September 2023
Subject:	Investment Performance and Asset Allocation - 30 June 2023
Classification:	Unrestricted

Summary:

To provide a summary of the Fund's asset allocation, performance, manager activity and cashflow.

Recommendation:

The Committee is asked to note the report; and to:

1. Agree that the Fund's asset allocation should not be changed in accordance with the Fund's rebalancing policy (para. 1.4); and
2. Agree to sell the property referred to as "Plot of Land at Peterborough" through agents at best value for the Fund, and to delegate the disposal after taking proper advice to the Head of Pensions and Treasury in consultation with the Chairman of the Committee (para 3.3).

FOR DECISION

1. ASSET ALLOCATION

1.1 At each meeting, the Committee reviews the Fund's asset allocation based on the agreed rebalancing policy which includes tolerance ranges set sufficiently wide so that a degree of flexibility remains. The rebalancing policy is based on high level asset categories: equities, fixed income, alternatives, and cash.

1.2 In addition, members need to continue to consider the Fund's cashflow requirements in deciding whether to invest and reduce the cash balance.

1.3 The actual allocation compared with the benchmark and agreed tolerance ranges as at the end of July 2023 is shown in the following table. The Committee is asked to consider the Fund's asset allocation based on the position on 31 July 2023.

Fund Position on 31 July 2023	Actual allocation	Actual allocation	Benchmark	Agreed ranges
Asset Class/Fund Manager	**£m**	**%**	**%**	**%**
Equity	**4,618**	**59.3**	**55.5**	**48 - 63**
Schroders GAV	415	5.3		
IMPAX Funds	73	0.9		

Baillie Gifford	1,138	14.6		
M&G Global Diversified	542	7.0		
Sarasin	386	5.0		
Insight- Global Synthetic Equity	401	5.2		
Schroders UK Equity	1,181	15.2		
Woodford Equity	2	0.0		
Insight - UK Synthetic Equity	400	5.1		
Insight - Equity Protection & Collateral	80	1.0		
Fixed Income	**1,127**	**14.5**	**15.0**	**10 - 20**
Goldman Sachs	394	5.1		
CQS	236	3.0		
M&G Alpha Opportunities	255	3.3		
Schroders Fixed Income	242	3.1		
Others	**1,980**	**25.4**	**28.5**	**18.5-38.5**
Ruffer	178	2.3		
Pyrford International	379	4.9		
DTZ	499	6.4		
Fidelity International	142	1.8		
Pvt Equity, Infrastructure & Property Funds	782	10.0		
Cash	**59**	**0.8**	**1.0**	**0 - 5**
Total	**7,784**	**100.0**	**100**	

1.4 Within its equity allocation, the current asset allocation is currently biased towards global equity and underweight UK equity versus the strategic asset allocation. Notwithstanding this, the overall (combined) equity allocation is within the formal tolerance ranges established under the Fund's Investment Strategy Statement. Moreover, the Committee is due to finalise the review of the strategic asset allocation at today's meeting. Therefore, no rebalancing is recommended at this stage. All other asset classes remain within their target allocation ranges.

2. PERFORMANCE

2.1 A copy of the latest Fund Position Statement as at 30 June 2023 is at Appendix 1

2.2 **Investment performance quarter to 30 June 2023**

2.2.1 UK Equities were broadly flat over the quarter. High and persistent inflation as well as rising interest rates have hurt investor sentiment in many sectors such as property and housebuilding although a more resilient UK economy has led to consumer facing stocks perform well. Schroders' UK portfolio performed slightly ahead of the benchmark and returned -0.56% against the MSCI UK index return of -0.72%.

2.2.2 Global equities rose on the back of better-than-expected economic growth although performance has been led by a small group of US technology companies, particularly those benefiting from developments in Generative AI. Apple, Alphabet, Amazon, Meta, Microsoft, NVIDIA, Tesla were responsible for almost all the rally. As a result, US equities were the best performing region although Emerging markets, Japan and Eurozone all delivered modest gains. The MSCI World index returned 3.26% this quarter.

2.2.3 Against this backdrop, the Fund's active global equity managers who do not hold these positions in the same proportion to the index due to their different investment styles, lagged the benchmark returns this quarter, The exception to this was the Fund's largest mandate; growth manager Baillie Gifford, which benefitted from its exposure to growth stocks in the tech sector and returned 1.85%. As the Baillie Gifford portfolio has a customized benchmark to reflect its higher regional allocations, its performance was compared to a lower benchmark return of 1.73%. Sarasin was the top performer with 2.33% return.

2.2.4 Following the failure of two regional US banks as well as Credit Suisse in Q1, the prospects for a systemic banking crisis subsided somewhat over the quarter and credit spreads narrowed. Meanwhile central banks continued to raise interest rates to combat persistent inflation. This environment favoured fixed income managers with a focus on exploiting credit risk premia. Accordingly, the Fund's two multi asset credit managers (M&G and CQS) performed well this quarter, beating the cash benchmark of 1.02% comfortably, whilst GSAM and Schroders (who target interest rate risk in addition to credit within their investment strategies) performed less well and failed to meet the benchmark returns.

2.2.5 The property market remained muted with capital values falling but performance was held up by income. Total return for the MSCI property index was 0.91% with alternative and industrial sectors leading the way with high total returns and office sector suffering losses. The property managers mainly outperformed the benchmark with the exception of Fidelity which saw negative returns of -0.7% due to its relatively high allocation to the office sector. M&G was the best performer with returns of 1.3% from their residential strategy.

2.2.6 The rise in the global equities meant that the equity protection program lost £126m during the quarter, but the fall was offset by the rise in physical equities held by the Fund.

2.2.7 Both the absolute return managers underperformed against the RPI linked benchmark and the private equity and Infrastructure mandates also underperformed over the short term.

2.2.8 Overall, during the quarter, the Fund returned -1.37%, underperforming against its benchmark return of 1.63%.

2.3 Longer term performance

2.3.1 For the year ended June 2023, the Fund achieved a return of 1.95% against a benchmark return of 5.08%, an underperformance of 3.13%.

2.3.2 As noted above, equity returns in 2023 have been concentrated in a handful of technology stocks to a large extent. The Fund has some exposure to these names, particularly within the Baillie Gifford mandate, but overall, the composition of its equity allocation is more diversified, which has had a negative impact for performance over the year to date, in relative terms.

2.3.3 The Fund's fixed income managers have generally performed well over the past twelve months, with all achieving above benchmark returns except for Schroders.

2.3.4 Property assets have made the largest negative contribution to performance over the last 12 months even though all of the Fund's property managers have delivered better results compared to the benchmark return of -17.12%. M&G's residential fund has been the best performer over this time horizon with positive returns of 0.69%.

2.3.5 The Fund operates a diversified asset allocation, across a range of asset classes and styles, together with an equity protection programme, in order to manage risk and meet its investment objectives.

2.3.6 Over three years, the Fund has underperformed its benchmark with an annualised return of 5.65% per annum compared to the benchmark return of 7.57% p.a. As some of the mandates have a benchmark linked to RPI which has been extremely high over the last year, this has contributed to the inflation of the Fund's benchmark for the longer time periods and impacted the Fund's relative performance.

3. MANAGER ACTIVITY

3.1 Fund extensions

3.1.1 During the quarter the Fund received two separate requests from HarbourVest and Partners Group for approval of a short extension to the HIPEP VI (HarbourVest) Fund and the Partners Group 2009 Fund, respectively. Kent's exposure to these funds is £18m and £7.4m respectively.

3.1.2 This is a common occurrence in Private Equity and Infrastructure Funds which are usually closed ended funds and have a finite amount of time to dispose of the assets to return the proceeds to the investors. Often there is a tail end of assets that are harder to dispose of, particularly in time of adverse market conditions, when managers prefer to extend the term of the Fund to avoid a distress sale and achieve a better outcome for investors. This is usually accompanied by a discount or waiver of manager fees during the extended period.

3.1.3 As the dates for voting for or against the proposals were before the committee meeting date, officers utilised the urgent decision process outlined in the Committee's Terms of Reference to obtain approval from the Chair and Director of Finance. In both the cases the recommendation to vote for the extension was supported by the Fund's investment consultant Mercer.

3.2 M&G Residential Fund

3.2.1 The Pension Fund has a direct investment in the M&G UK Residential Property Fund (UKRPF) valued at £69m as at the end of June, which amounts to around 9% of Fund's £784m property allocation at that time.

3.2.2 The liquidity terms of the Fund's property investments are ordinarily heavily constrained, but the M&G prospectus provides for a "liquidity window" every five years, which enables investors to redeem their holdings without being subject to the scale back provisions that normally apply. The fund's second such liquidity window was open and closed on 31 August 2023.

3.2.3 The Fund does not have any fundamental concerns with the M&G UKRPF, which Mercer continue to rate highly, however DTZ recommend partially redeeming the holding to potentially invest the proceeds in the L&G Build to Rent Fund, which is another vehicle within the private residential sector space that DTZ judge to have superior return prospects over the medium term.

3.2.4 Given DTZ's subject matter expertise and proximity to the market, officers were minded investigating the opportunity further with Mercer. Mercer were supportive of the Fund submitting a partial redemption request during the liquidity window (and by 31 August), equivalent to 50% of the current investment value (equating to £34.5m).

3.2.5 Given that the liquidity window expired before the next meeting of the Pension Fund Committee and given that there is a clear governance route for considering the redemption recommendation under urgent decision protocols, officers approached the chair and director of finance who approved the recommendation for partial redemption and submitted the redemption request within the timeframe of the liquidity window.

3.2.6 There is a sequential decision around what to do with the redemption proceeds, and the recommendation is to not immediately create a new investment in the L&G Build To Rent Fund but consider where to allocate the proceeds following a broader review of the property portfolio over the next 12 months. The Committee is asked to agree this recommendation.

3.3 **Plot of land at Peterborough**

3.3.1 The Pension Fund has a small piece of land in Peterborough which was part of agricultural portfolio managed by Cluttons. Although the portfolio was sold a small piece of land remains in the Fund's ownership.

3.3.2 The land is too small to be managed by DTZ and has never formally been part of their portfolio although DTZ have helped us with the maintenance of the land through contractors, which annually costs the fund approximately £500.

3.3.3 DTZ have been approached by the neighbour of the land several times to complain against the lack of maintenance of the property and to request clearing the overgrown vegetation which they cannot clear themselves due to a fence restricting access to the land. The neighbour has also expressed an interest to buy the land as it is adjoining their own property.

3.3.4 In 2021, at the officers' request, DTZ commissioned an independent planning and marketing appraisal and obtained indicative values for the plot of land which were in the range of £160k with and £80k without planning permission for a detached 4-bedroom property. Officers have also requested DTZ to recommend local agents to help with the disposal of the property subject to approval by the Committee.

3.3.5 Given that the land is too small to be managed by the Fund's property managers the Committee is asked to agree to sell the property through agents at best value for the fund and to delegate the disposal after taking proper advice to the Head of Pensions and Treasury in consultation with the Chairman of the Committee.

4. CASH FLOW

4.1 The cash balance as of 30 June 2023 was £55.3m, down from £86.1m at the end of the previous quarter, largely due to net drawdowns from private equity and infrastructure managers of £33.8m.

4.2 Operational cash flow continues to be positive, with contributions exceeding pension payments. Investment cash flows relate to drawdowns and distribution from alternative asset classes.

4.3 Forecast Fund cash flows are summarised in the table below.

	2023-24 3 Qtrs £m	**2024-25 Full year £m**	**2024-26 Full year £m**
Opening cash balance	**55.3**	**100.0**	**116.1**
Operational cashflows			
Pensions Contributions	226.8	315.0	326.0
Property Income	14.4	19.5	20.1
Total inflows	**241.2**	**334.5**	**346.1**
Pensions Payments	-220.8	-318.0	-329.0
Admin, Governance and Investment Managers	-8.9	-10.7	-11.3
Total outflows	**-229.7**	**-328.7**	**-340.3**
Net operational cashflow	**11.5**	**5.7**	**5.8**
Investment cashflows			
YFM	14.6	2.0	2.0
Partners Group	-31.7	-26.8	16.1
HarbourVest	-9.8	25.2	66.8
Property redemptions	60.0	10.0	10.0
Net investment cashflow	33.2	10.4	94.9
Closing Cash balance	**108.4**	**138.8**	**216.9**

4.4 Pension contributions and pension payments are based on Barnet Waddingham's actuarial projections adjusted for actual experience in the current year.

4.5 DTZ collections stabilized around 95% of invoiced rents and improving although there is continued risk of collection in respect of historic arrears.

4.6 Property redemptions for 2023-24 include: M&G Residential Fund part redemption of £32m, and sale of Charing Cross property by DTZ for £18m. A further provision has been made for receipt of sale proceeds from Lothbury Property Unit Trust and Kames Fund of £10m.

4.7 Cash flows for private equity and infrastructure drawdowns and distributions are based on projections provided by managers for existing portfolios. In the revised investment strategy, there is a provision to increase the allocation to these asset classes which will affect the cashflows. These changes have not been factored in this cashflow.

4.8 The cash flow above also does not include short term capital movements required for implementation of the revised investment strategy.

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