

<b>From:</b>	Chairman Pension Fund Committee Corporate Director of Finance
<b>To:</b>	Pension Fund Committee – 12 December 2023
<b>Subject:</b>	Investment Performance and Asset Allocation Update
<b>Classification:</b>	Unrestricted

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**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 September 2023 while asset allocation is discussed with reference to the Fund's value as at 31 October 2023. Officers have updated and modernised the Fund's in house performance reporting, which is reflected in the new *Quarterly Fund Performance Report* found at Appendix 1.

The Investment Strategy Statement (ISS) is a central part of the Fund's investment governance architecture, documenting the principles, beliefs and policies by which the administering authority manages the investment assets of the Fund. The ISS has been revised and updated in line with the changes to the investment strategy agreed by the Committee at its last meeting in September. Proposed changes to the updated ISS (found at appendix 2) require the Committee's approval.

**Recommendation:**

The Committee is asked to:

- a) note the report;
- b) agree that no rebalancing is undertaken (para. 1.4); and
- c) agree to adopt the updated Investment Strategy Statement (appendix 2), including the revised rebalancing policy set out within the statement.

**FOR DECISION**

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**1. FUND VALUE AND ASSET ALLOCATION**

1.1 As of 31 October 2023, the Fund's value was £7.69bn, a decrease of £91m since 31 July 2023 (the most recent value reported to the Committee).

1.2 At its meeting in September, the Committee agreed an updated strategic asset allocation. The current asset allocation (as at 31 October) is shown against the new strategic target weights in the table below.

Asset Class / Fund Manager	Current Asset Allocation		Strategic Asset Allocation	
	£m	(%)	£m	(%)
<b>Equities</b>	<b>4,207.3</b>	<b>55%</b>	<b>4,077.4</b>	<b>53%</b>
<b>UK Equities</b>	<b>1,516.0</b>	<b>20%</b>	<b>769.3</b>	<b>10%</b>
Schroders	1,139.0	15%		
Link Fund Solutions	2.4	0%		
Insight (Synthetic Equity)	374.6	5%		
<b>Global Equities</b>	<b>2,691.4</b>	<b>35%</b>	<b>2,923.4</b>	<b>38%</b>
Schroders GAV	405.9	5%		
IMPAX Funds	61.7	1%		
Baillie Gifford	968.8	13%		
M&G Global Diversified	510.5	7%		
Sarasin	364.0	5%		
Insight (Synthetic Equity)	380.4	5%		
<b>Emerging Market Equities</b>	<b>0.0</b>	<b>0%</b>		<b>5%</b>
<b>Fixed Income</b>	<b>1,440.4</b>	<b>19%</b>	<b>1,692.5</b>	<b>22%</b>
<b>Credit</b>	<b>1,128.3</b>	<b>15%</b>	<b>1,154.0</b>	<b>15%</b>
Goldman Sachs	389.6	5%		
CQS	237.6	3%		
M&G Alpha Opportunities	259.2	3%		
Schroders Fixed Income	241.9	3%		
<b>Risk Management Framework<sup>1</sup></b>	<b>312.1</b>	<b>4%</b>	<b>538.5</b>	<b>7%</b>
Insight	312.1	4%		
<b>Alternatives</b>	<b>1,982.3</b>	<b>26%</b>	<b>1,923.3</b>	<b>25%</b>
<b>Absolute Return</b>	<b>552.3</b>	<b>7%</b>	<b>384.7</b>	<b>5%</b>
Ruffer	175.2	2%		
Pyrford	377.1	5%		
<b>Infrastructure</b>	<b>316.1</b>	<b>4%</b>	<b>384.7</b>	<b>5%</b>
Partners Group	316.1	4%		
<b>Private Equity</b>	<b>371.5</b>	<b>5%</b>	<b>384.7</b>	<b>5%</b>
YFM	82.1	1%		
Harbourvest Intl	289.4	4%		
<b>Property</b>	<b>742.4</b>	<b>10%</b>	<b>769.3</b>	<b>10%</b>
DTZ Direct Property	470.1	6%		
DTZ Pooled Property	39.1	1%		
Fidelity International	141.0	2%		
Kames Capital	29.1	0%		
M&G Property	63.0	1%		
<b>Cash</b>	<b>63.2</b>	<b>1%</b>	<b>0.0</b>	<b>0%</b>
<b>Total</b>	<b>7,693.3</b>	<b>100%</b>	<b>7,693.3</b>	<b>100%</b>

1.3 Compared to the strategic target weights for high-level asset classes, the Fund is marginally overweight equities, alternatives and cash, and marginally

<sup>1</sup> The current value of the Risk Management Framework is calculated from the market value of the Fund's derivative instruments, the market value of collateral (itself currently comprised of cash and asset backed securities) and the notional cash exposure from the Fund's synthetic equity positions.

underweight fixed income. However, within these high-level asset classes, deviations are more notable, particularly for UK equities, where the Fund is heavily overweight.

- 1.4 Whilst material deviations would ordinarily trigger rebalancing actions from the Committee, in this instance the differences arise because the Committee has only recently established its new policy portfolio and is yet to implement the required changes to bring the actual portfolio into alignment with its new strategic asset allocation. A separate item on investment strategy implementation appears later on today's agenda. Accordingly, officers recommend that no routine rebalancing is undertaken.

## 2. INVESTMENT PERFORMANCE

- 2.1 Officers have updated and modernised the Fund's in house performance reporting, which is reflected in the new *Quarterly Fund Performance Report* found at Appendix 1. The performance reporting reflects the latest quarterly information (i.e. as at 30 September 2023).

### Investment performance: quarter to 30 September 2023

- 2.2 The Fund's investments returned 1.56% in the three months to 30 September 2023, against a benchmark return of 1.08%, with the performance of the Fund's equity protection programme compensating for negative returns from the Fund's equities allocation.
- 2.3 **UK equities** performed well, in a relative sense, versus global peers due to strong performance in the basic materials and energy sectors. The Fund's UK equity manager, Schroders, trailed the benchmark marginally during the quarter with a return of 0.94% (versus the benchmark return of 2.35%).
- 2.4 **Global equities** fell in local currency but had a positive return in sterling terms as the dollar appreciated versus sterling. Japanese equities were the best performing region and emerging markets generated positive returns. US equities were worst performing followed by European equities with the rally in the so-called "magnificent seven" tech stocks (e.g., Nvidia & Microsoft) having slowed down. Energy sector performance was the exception in all the markets. The MSCI World index in GBP terms returned 0.62% over the quarter.
- 2.5 Against this backdrop, most of the Fund's active global equity managers lagged the benchmark returns this quarter. The exception to this was the Fund's global active value manager Schroder which outperformed the benchmark with quarterly returns of 3.0%.
- 2.6 The fall in the global equities in local currency meant that the equity protection program gained £126m during the quarter.
- 2.7 **Fixed income** markets continued to struggle on account of concerns that interest rates would need to remain higher for longer to address persistent inflation. However, it was a good quarter for high yield and corporate bonds (especially financials) and, accordingly, the Fund's two multi asset credit managers (M&G and CQS) performed well this quarter, beating the cash benchmark of 1.37% with returns of 2.76% and 2.56%, respectively. GSAM and Schroders (who target interest rate risk in addition to credit within their

investment strategies) performed less well and marginally underperformed their benchmarks.

- 2.8 **Property** experienced negative capital returns during the quarter, but positive income yields meant overall returns were broadly flat over the quarter: the total return for the MSCI property index was -0.25% with alternative and industrial sectors providing positive total returns and office and retail sector continuing to suffer losses. The Fund's property managers outperformed the benchmark with the exception of DTZ, where the manager realised losses on two disposals.
- 2.9 Both **absolute return** managers underperformed against the RPI linked benchmark of 1.7% but the **private equity** and **infrastructure** mandates benefitted from improved valuations this quarter.

### Investment performance: longer term

- 2.10 For the year ended September 2023, the Fund achieved a return of 2.67% against a benchmark return of 6.74%, an underperformance of 4.07%.
- 2.11 The performance from the Fund's UK and value style equity managers has been additive, as have strong returns from fixed income managers GSAM, M&G and CQS. Moreover, the property mandates, whilst having produced negative returns, have outperformed the benchmark. However, Baillie Gifford, who manage 13.3% of the Fund's assets have underperformed the benchmark over the year and the equity protection programme has detracted in the past 12 months too. The absolute return managers have also underperformed their inflation plus style benchmarks.
- 2.12 For the three-year period the Fund achieved a return of 4.78% compared to its strategic benchmark of 7.16%, an underperformance of 2.38%
- 2.13 During this period all the Fund's equity managers except M&G have underperformed the benchmark and the alternative investments have generally produced near or above benchmark returns. The fixed income managers have been the best performers in the three-year period and the absolute return managers produced the worst performance against their RPI linked benchmark return of 13.76% in this prolonged period of high inflation.

### 3. CASH FLOW

- 3.1 The cash balance as of 30 September 2023 was £28.6m, down from £55.3m at the end of the previous quarter.
- 3.2 Operational cash flow continues to be positive, with contributions exceeding pension payments. Investment cash flows relate to drawdowns and distribution from alternative asset classes including £30m for purchase of units in the DTZ Co-Liv Fund under the DTZ discretionary property mandate and £19.77m received for sale of Charing Cross property.
- 3.3 Forecast Fund cash flows are summarised in the table below.

	2023-24 2 Qtrs. £m	2024-25 Full year £m	2024-26 Full year £m

<b>Opening cash balance</b>	<b>28.6</b>	<b>48.7</b>	<b>47.0</b>
<b>Operational cashflows</b>			
Pensions Contributions	145.8	300.3	309.3
Property Income	11.1	21.1	22.2
<b>Total inflows</b>	<b>156.9</b>	<b>321.4</b>	<b>331.5</b>
Pensions Payments	-138.4	-294.4	-306.5
Admin, Governance and Investment Managers	-6.5	-9.8	-10.3
<b>Total outflows</b>	<b>-144.9</b>	<b>-304.2</b>	<b>-316.7</b>
<b>Net operational cashflow</b>	<b>12.0</b>	<b>17.3</b>	<b>15.0</b>
<b>Investment cashflows</b>			
YFM	11.7	2.0	2.0
Partners Group	-15.0	-51.7	-22.0
HarbourVest	-5.0	21.7	39.0
Property redemptions	16.4	9.1	9.1
<b>Net investment cashflow</b>	<b>8.1</b>	<b>18.9</b>	<b>28.1</b>
<b>Closing Cash balance</b>	<b>48.7</b>	<b>47.0</b>	<b>90.1</b>

- 3.4 Pension contributions and pension payments are based on Barnet Waddingham's actuarial projections adjusted for actual experience in the current year.
- 3.5 Property redemptions for 2023-24 include: M&G Residential Fund part redemption of £6.8m (already received), the sale of L&G property fund units £7.2mm (already received).
- 3.6 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 into this cashflow forecast but will be updated once officers have undertaken a commitment analysis for the new, increased allocations to private equity and infrastructure.
- 3.7 The cash flow forecast above also does not include short term capital movements required for implementation of the revised investment strategy, as these are expected to broadly net to zero.

#### **4. INVESTMENT STRATEGY STATEMENT**

- 4.1 The Fund is required by the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (the "Regulations") to prepare and publish an Investment Strategy Statement (ISS), which must be in accordance with guidance issued from time to time by the Secretary of State for Levelling Up, Housing and Communities.
- 4.2 The ISS is a central part of the Fund's investment governance architecture, documenting the principles, beliefs and policies by which the administering authority manages the investment assets of the Fund.

- 4.3 The Fund's current ISS was approved by the Committee in September 2021. However, the ISS now needs to be updated to take account of the changes made to the Fund's strategic asset allocation at the Committee's last meeting.
- 4.4 The new strategic asset allocation has also necessitated a review of the Fund's rebalancing policy, which is one of the Committee's key risk management tools as it establishes ranges around the portfolio target weights, beyond which the Committee would ordinarily consider rebalancing activity to bring the actual portfolio into alignment with the approved strategic asset allocation.
- 4.5 The existing rebalancing policy refers to high-level asset classes only and officers have consulted Mercer to establish tolerance thresholds for liquid asset classes within the high-level asset classes too, which is expected to support the Committee's investment governance.
- 4.6 Officers have also taken the opportunity to update other areas of the ISS to aid readability and to better capture the Committee's current investment governance practices.
- 4.7 The updated ISS is found at appendix 2 and additional or revised wording has been highlighted to enable the Committee to easily identify changes.

## **Appendices**

Appendix 1 – Quarterly Fund Performance Report – Q3 2023

Appendix 2 – Kent Pension Fund Investment Strategy Statement (Draft)

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