From:	Chairman Pension Fund Committee Interim Corporate Director of Finance
To:	Pension Fund Committee – 19 March 2025
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. Detailed performance information is provided in the *Quarterly Fund Performance Report* found at Appendix 1.

Recommendation:

The Committee is asked to:

a) note the report; and
b) to agree that no rebalancing is undertaken (para. 1.3)

FOR DECISION

1. FUND VALUE AND ASSET ALLOCATION

1.1 As of 31 January 2025 (the latest available data), the Fund's value was £8.7bn compared to £8.4bn as at 30 September 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%**	**5,018.0**	**57.4%**	**4.4%**	**In Range**
UK Equities	**10.0%**	**+/- 2.5%**	948.0	**10.8%**	**0.7%**	**In Range**
Schroders UK Equity			945.7	10.8%		
Link Fund Solutions			2.3	0.0%		
Global Equities	**38.0%**	**+/- 5%**	3,648.9	**41.7%**	**3.7%**	**In Range**
Schroders GAV			513.2	5.9%		
IMPAX Funds			73.8	0.8%		
Baillie Gifford			1,108.3	12.7%		
M&G Global Diversified			711.0	8.1%		
Robeco Global Stars			712.7	8.1%		
Insight- Global Synthetic			529.9	6.1%		
Emerging Market Equities	**5.0%**	**+/- 2.5%**	421.2	**4.8%**	**-0.2%**	**In Range**

Columbia Threadneedle			219.1	2.5%		
Robeco			202.1	2.3%		
Fixed Income	**22.0%**	**+/- 5%**	**1,667.6**	**19.1%**	**-2.9%**	**In Range**
Credit	**15.0%**	**+/- 5%**	1,286.3	**14.7%**	**-0.3%**	**In Range**
Goldman Sachs			436.9	5.0%		
CQS			279.9	3.2%		
M&G Alpha Opportunities			296.3	3.4%		
Schroders Fixed Income			273.3	3.1%		
Risk Management Framework	**7.0%**	**N/A**	**381.2**	**4.4%**	**-2.6%**	**N/A**
Insight			381.2	4.4%		
Alternatives	**25.0%**	**+/- 10%**	**1,905.3**	**21.8%**	**-3.2%**	**In Range**
Absolute Return	**5.0%**	**N/A**	425.7	**4.9%**	**-0.1%**	**N/A**
Ruffer			182.8	2.1%		
Pyrford			242.9	2.8%		
Infrastructure	**5.0%**	**N/A**	**395.9**	**4.5%**	**-0.5%**	**N/A**
Partners Group			395.9	4.5%		
Private Equity	**5.0%**	**N/A**	**396.7**	**4.5%**	**-0.5%**	**N/A**
YFM			74.3	0.8%		
Harbourvest Intl			322.4	3.7%		
Property	**10.0%**	**N/A**	**687.0**	**7.9%**	**-2.1%**	**N/A**
DTZ Direct Property			472.5	5.4%		
DTZ Pooled Property			107.6	1.2%		
Fidelity International			45.7	0.5%		
Kames Capital			26.3	0.3%		
M&G Property			34.9	0.4%		
Cash	**0.0%**	**5%**	**158.7**	**1.8%**	**1.8%**	**In Range**
Total	**100.0%**		**8,749.6**	**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. Some excess cash (~£154m) is being held to meet liquidity requirements for private equity and infrastructure drawdowns pending the formulation of a liquidity waterfall.

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

Investment performance: quarter to 31 December 2024

2.2 The Fund's investments returned 1.6% in the three months to 31 December 2024, matching the benchmark return.

2.3 ***UK equities:*** impacted by the UK government's budget, struggled to generate positive returns with the FTSE All Share index detracting by -0.4% over the quarter. Large-cap stocks performed marginally better than small-cap equities with a return of -0.4% compared to -0.5%, respectively. The Fund's only UK equity manager, Schroders, performed in line with its benchmark, posting a return of -0.4%.

2.4 ***Global equities***: US equities made strong gains during the quarter, with positive responses following Donald Trump's re-election early in the quarter – although this had the opposite impact on other global market stocks. As a result, overall, global markets returned 1.3% in local currency; however, due to the strengthening of the USD, returns in Sterling terms were 5.9%. In the US, the rally was led, most notably, by breakthroughs in artificial intelligence and technology stocks.

2.5 Amongst the Fund's global equity managers, Baillie Gifford's return of 3.3% was above its fixed weight regional benchmark return of 1.8%. M&G was the only global equity manager to outperform the MSCI benchmark, making a return of 6.4% this quarter. Sarasin, Impax and Schroders each underperformed the benchmark with returns of 5.4%, -5.0% and 2.7%, respectively. Collectively, the Fund's global equity mandates delivered a return of 4.0% during the quarter.

2.6 After considering the impact of the risk management framework (RMF), this gain was increased slightly to 4.6%. This was helped by strong global returns on the Fund's synthetic equity exposure in the RMF, as well as an increase in exposure following a roll of swaps at higher valuations.

2.7 ***Emerging market equities:*** Despite strong market volatility, mainly due to concerns around the implementation of tariffs, emerging market equities ended the quarter with marginally positive returns in sterling terms, at 0.2% (-3.8% in local currency). Robeco underperformed the benchmark with a return of -3.6%, whilst Columbia Threadneedle performed well, achieving a return of 3.4% during the quarter. CT's performance was largely driven by favourable security selection, with a large overweight position to technology proving beneficial. In addition, CT are underweight to China, which was hit hard by tariff fears and, therefore, contributed positively to performance. Robeco's underperformance was driven mostly by country allocation, with overweight positions to South Korea and South Africa as well as underweight to Taiwan and Saudi Arabia all detracting.

2.8 ***Fixed income***: the fixed income market experienced notable volatility in Q4 2024, influenced by a variety of economic and policy decisions. Despite rate cuts in the US following a softening of the labour market, bond yields rose, and bond prices fell. Economic outlook deteriorated in the UK over concerns around sticky inflation and a lack of rate cuts. During the quarter, the Fund's bond mandates collectively achieved a return of 0.7%, slightly lagging the benchmark of 1.1%. CQS and M&G Alpha Opportunities outperformed the benchmark, both achieving returns of 2.2%. Schroders and GSAM underperformed during the quarter, posting returns of -0.6% and -0.3% respectively.

2.9 The Index Linked Gilts portfolio, which is part of the Risk Management Framework (RMF) managed by Insight, returned -10.5%. This is a buy and hold portfolio and was impacted by inflationary concerns following news on the Chancellor's budget.

2.10 ***Property:*** lagged slightly during the quarter with the Fund's property allocation posting returns of 1.9% against the UK All Property benchmark return of 2.6%. The UK real estate investment market was showing clear signs of improvement with investment volumes up 17% year-on-year and Q4 investment activity up c.25% compared to that of Q4 2023, with the retail sector driving performance whilst the office investment market continued to struggle. DTZ's legacy portfolio returned 1.8%. Fidelity posted 2.8% whilst M&G returned 1.3%. Kames, which is in its winding down stage, returned 0.8% against a Balanced Property benchmark of 2.4%

2.11 Both of the Fund's ***absolute return*** mandates, Pyrford and Ruffer, underperformed the RPI benchmark of 0.9% in the quarter, posting returns of -0.9% and -2.9% respectively.

2.12 In ***private equity,*** HarbourVest managed large outperformance, posting a return of 8.6% relative to the benchmark of 1.2%. YFM, however, was not quite as successful, although still posting returns in line with the benchmark at 1.2%. For ***infrastructure***, Partners Group also performed well, achieving returns of 2.8%.

3. LONGER TERM PERFORMANCE

3.1 For the year ended 31 December 2024, the Fund achieved a return of 6.8% against a benchmark return of 9.1%, an underperformance of 2.3%.

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 remain the best performing manager with a return of 11.4% against a cash +4% benchmark of 7.5%, followed by the M&G Alpha Opportunities fund, which returned 10.2%. Schroders and GSAM also performed well, posting returns of 6.0% and 4.5% respectively.

3.3 Equities have seen exceptional returns with several major indices reaching record highs and the MSCI ACWI posting an annual return of 19.6%. However, the Fund's active managers have had mixed performance: M&G have delivered the best performance with a return of 21.9%. Baillie Gifford also marginally outperformed their regional benchmark, achieving returns of 12.3%. Sarasin, Schroders GAV and Impax have underperformed their benchmarks with Impax detracting the most with a return of -1.9% compared to the benchmark figure of almost 20%. Given the rally in global equities, mostly driven by the technology sector, over the past 12 months the equity protection programme has detracted from overall Fund returns. With returns of 9.5%, Schroders' UK equity portfolio performed in line with the FTSE All Share benchmark.

3.4 Both absolute return managers, Ruffer and Pyrford, were faced with challenges this year resulting in underperformance against the RPI benchmark. Ruffer returned -0.5% in the year against a benchmark of 4.7%, whilst Pyrford performed better with returns of 3.4%. Overall, the property portfolio returned 5.7% against a benchmark of 6.5% Fidelity was the only manager outperforming the benchmark, posting returns of 7.1% in the year to 31 December.

3.5 For the three-year period, the Fund achieved a return of 3.1% compared to its strategic benchmark of 4.8%, an underperformance of 1.7%.

3.6 Benchmark equity returns have been strong during the three-year period with UK and Global equity indices returning 5.8% and 8.2%, respectively. Of the equity managers, M&G and Schroders UK have outperformed the benchmark over the period with an annualised return of 11.5% and 6.1%, respectively, whilst the Fund's growth-style manager, Baillie Gifford, significantly detracted with a return of -4.9% against a regional benchmark return of 6.1%. Impax also detracted from global equities performance with a return of -4.5%.

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 when compared to their relative benchmarks, whilst the absolute return and credit managers have struggled with high inflation, as well as rising rates and significant market volatility.

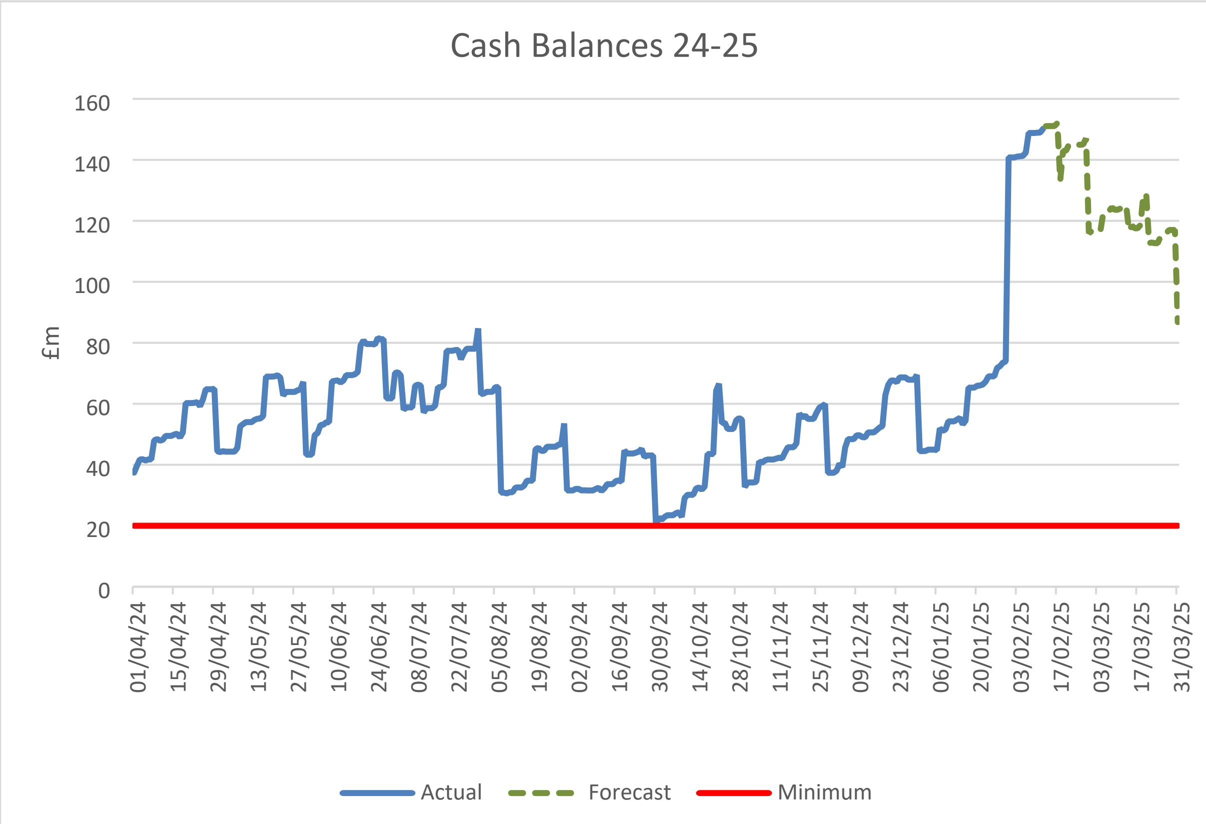
4. CASH FLOW

4.1 The cash balance as of 31 December 2024 was £44.5m, up from £26.1m at the end of the previous quarter. This figure excludes £154.4m 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 available for use to meet investment requirements both for existing commitments, future asset class rebalancing, as well as any additional collateral requirement under the Risk Management Framework.

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 to 14 February 2025 (the date of writing this report) as well as forecast of 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 been largely influenced by the timing of transaction activity within the alternatives allocation, and in particular the property allocation. The recent partial sale of the Fidelity UK Real Estate Fund, in line with DTZ's discretionary mandate, has led to an uplift in cash balances in the final quarter.



4.4 As the graph shows, cash balance rose significantly in January 2025 following the proceeds from sale of units in Fidelity UK Real Estate of £90m. Whilst the intention is to reinvest the redemption proceeds, it is important to note that only *known* commitments are factored into the forecast and, therefore, the forecast is expected to evolve as future drawdowns are communicated and investments are committed.

4.5 Drawdowns usually relate to commitments in private equity / infrastructure funds or from DTZ who manage the Fund's property allocation. At the time of writing the report, the Fund has invested £20m of the proceeds from the Fidelity partial sale into a new investment in the Octopus Healthcare Fund, which was identified by DTZ as part of their discretionary mandate.

4.6 Despite this recent increase in cash, the balances are still expected to trend down until the year-end as a result of investment activity within the alternatives allocation in relation to commitments already made, as well as pensions payments and other fees. This is a trend that is expected to continue to evolve with the market cycle, as well as in accordance to the anticipated life cycle of the Fund's existing and future investments within this asset class.

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

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 Q4 £m	2025-26 Full Year £m	2026-27 Full Year £m
Opening cash balance	**44.5**	**86.5**	**173.8**
Revenue			
Pensions contributions	77.8	324.0	326.0
Property income	4.3	18.0	18.6
Total inflows	**82.1**	**342.0**	**344.6**
Pensions payments	-70.5	-319.0	-328.0
Admin, governance and oversight	-6.6	-7.4	-7.6
Investment management fees	-1.2	-3.9	-4.0
Total outflows	**-78.3**	**-330.3**	**-339.7**
Net revenue cashflow	**3.8**	**11.6**	**5.0**
Investments			
YFM	0.6	13.0	26.0
Partners Group	0.0	45.0	59.0
HarbourVest	-17.4	17.7	64.0
Property investments net of redemptions	55.0		
Net investment cashflow	**38.2**	**75.7**	**149.5**
Closing internal cash balance	**86.5**	**173.8**	**328.3**
Cash held with Insight	**154.4**	**154.4**	**154.4**
Total cash balance (internal + Insight)	**240.9**	**328.2**	**482.7**

4.8 The table shows that the Fund's cashflow from pension contributions and property income is currently sufficient for meeting its ongoing pension liabilities. This situation looks to continue over the medium term with net revenue cashflow remaining positive for both 2025-26 and 2026-27. However, one thing to note is that the triennial valuation exercise will be conducted as at March 2025, the results of which may require changes to contribution rates which will, in turn, impact on cash flow. Officers will continue to monitor progress of the triennial valuation into their forecasts and will update when new contribution rates are known.

4.9 The table also shows that investment activity within the alternatives allocation, specifically real estate, is expected to have a significant impact on projected cash balances, with a net inflow of £38.2m during the remaining quarter, which is mostly as a result of a partial sale of the Fidelity UK Real Estate Fund, as discussed above. In addition, 2025-26 and 2026-27, net investment cash flows are expected to result in total inflows of circa £75.7m and £149.5m, respectively.

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 and given the buffer cash available within the Insight Liquidity Fund, as outlined above, officers have no concerns over liquidity.

Appendices

Appendix 1 – Quarterly Fund Performance Report – Q4 2024

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