From:	Chairman Kent Pension Board Corporate Director of Finance
To:	Kent Pension Board – 6 September 2023
Subject:	Fund Position Statement
Classification:	Unrestricted

Summary:

To provide a summary of the Fund’s asset allocation and performance.

Recommendation:

The Board is asked to note the Fund’s asset allocation and performance as of 30 June 2023.

FOR INFORMATION

1. Introduction

1.1 This report provides an update on the Fund’s asset allocation and performance.

1.2 A copy of the Fund Position Statement is at Appendix 1.

2. Fund value and asset allocation

2.1 As of 30 June 2023, the Fund’s value was £7.73bn, a decrease of £95m over the quarter.

2.2 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 Pension Fund Committee is due to conclude the Fund’s investment strategy review at its meeting on 26 September. Therefore, no rebalancing is recommended at this stage. All other asset classes remain within their target allocation ranges.

3. Investment performance quarter to 30 June 2023

3.1 UK Equities were broadly flat over the quarter. High and sticky 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%.

3.2 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% over the quarter.

3.3 Against this backdrop, most of 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 holder, growth manager Baillie Gifford, which benefitted from its concentrated exposure to the technology 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.

3.4 Following the failure of two regional US banks as well as Credit Suisse in Q1, the prospects for a systemic banking crisis subsided somewhat in Q1 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.

3.5 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. Our property managers mainly outperformed the benchmark with the exception of Fidelity which saw negative returns of -0.87% due to its relatively high allocation to the office sector. M&G was the best performer with returns of 1.30% from their residential strategy.

3.6 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.

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

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

4. Longer term performance

4.1 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%.

4.2 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 for performance over the year to date, in relative terms.

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

4.4 Property assets have made the largest negative contribution to performance over the last 12 months, even though 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%.

4.5 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.

4.6 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.

5. Outlook

5.1 The investment outlook remains uncertain although inflation is starting to come down, albeit slowly. Monetary policy remains tight as central banks including the Federal Reserve in the US, the ECB in the Bank of England attempt to bring inflation back to target without engineering a recession. Market sentiment remains cautious but optimistic and is highly sensitive to economic news which introduces. Against this backdrop our managers continue to focus on stock-picking and look for companies with strong balance sheets and good long-term prospects. The Fund aims to limit volatility by diversifying sources of return within the portfolio. The Fund is in the midst of reviewing its investment strategy, which is due to be concluded at the Pension Fund Committee meeting on 26 September.

6. Responsible Investment Update

6.1 The Fund has made progress over the year to date advancing its responsible investment approach. The Pension Fund Committee agreed a responsible investment strategy and workplan in February 2023, which has guided the Responsible Investment Working Group (or "RIWG", a group established by the Committee and tasked with developing and implementing the Fund's responsible investment policy). The strategy and workplan appended to this report structure the Fund's responsible investment activities around three themes: stewardship, climate, and impact. Notable activities over the past six months include the following:

a) **LAPFF Presentation –** The Fund has been a member of the Local Authority Pension Fund Forum (LAPFF), a collaboration of LGPS funds that carries out engagement activities on behalf of its members, since 2022. The RIWG received a presentation from a LAPFF representative in March, which included insights into the forum's recent activities and engagements as well as an update on LAPFF's workplan.

b) **Investor Network Review -** During the first quarter, officers conducted a review of existing investor networks, including reviewing benefits of membership. In addition to this, officers explored potential memberships for the future that align with our RI objectives.

c) **Pensions for Purpose Membership -** As a result of the investor network review, the Committee agreed to join Pensions for Purpose. Pensions for Purpose is a member network that specialises in impact investments and membership will help the Fund to explore both whether impact investing is relevant to the Fund's investment strategy and objectives, and how impact investing can be implemented successfully.

d) **Climate Risk Progress –** As a universal asset owner, the Fund recognises that it is inevitably exposed to climate risks (and opportunities) via its investment activities and accordingly the Committee seeks to manage those risks effectively. Following on from the Fund's carbon footprinting exercise and scenario analysis conducted in 2022, climate has remained a central focus within the RI workplan. The Fund is currently considering the feasibility of establishing a credible net zero strategy. In May and June, the RIWG undertook workshops on net zero with the Investment Consultant (Mercer) and asset manager Ninety-One Asset Management, respectively. These sessions enabled officers and Members to identify and understand that key considerations and steps involved in established a net zero emissions target as an asset owner.

6.2 The RIWG and the Pension Fund Committee has plans to continue progressing its responsible investment activities over the remainder of the year. Key activities anticipated over the autumn include the following:

a) **Net zero target -** the primary focus for the Fund's responsible investment activities over the coming months is in establishing the feasibility of, and ultimately determining, a credible net zero target to apply to the investment strategy, along with interim targets. Work has already been initiated in this area and officers are currently working with Mercer to establish the transition potential of the portfolio which will deliver the Fund to a position where is able to set a net zero target.

b) **Responsible investment policy review –** a review of the responsible investment policy will take account of any developments in the Fund's strategy for managing climate risk (in the event that the Committee does make a net zero commitment) and any other updates to reflect advancements in the Fund's responsible investment approach.

c) **Impact investing and sustainability workshops –** the RIWG will also receive training on both the UN Sustainable Development Goals and impact investing, to take place in September and October, respectively. The sessions will be supported by specialist external experts, with Pensions for Purpose leading the impact investing workshop.

6.3 The Board will receive regular updates on the Fund's responsible investment activities going forward.

Appendices

Appendix 1 – Funding Position Statement (30 June 2023)

Appendix 2 – Responsible Investment Strategy and Workplan 2023-24

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