

From:	Chairman Pension Fund Committee Acting Corporate Director of Finance
To:	Pension Fund Committee – 26 March 2024
Subject:	Investment Performance and Asset Allocation Update
Classification:	Unrestricted

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 31 December 2023 while asset allocation is discussed with reference to the Fund's value as at 31 January 2024. Detailed performance information is provided in the *Quarterly Fund Performance Report* found at Appendix 1.

Recommendation:

The Committee is asked to note the report and agree that no rebalancing is undertaken (paragraph 1.3).

FOR DECISION

1. FUND VALUE AND ASSET ALLOCATION

- 1.1 As of 31 January 2024, the Fund's value was £7.84bn (compared to £7.69bn as at the 31 October 2023, the most recent value reported to the Committee). The table overleaf sets out the current asset allocation versus the Fund's new strategic asset allocation and its revised rebalancing policy.
- 1.2 During the reporting period, and in accordance with the implementation plan approved by the Committee at its December meeting, the Fund reduced its allocation to Absolute Return to align with the new (reduced) strategic weight of 5% for the asset class by redeeming £167m from Pырford and investing the proceeds as cash in the risk management framework. The Fund also terminated its synthetic UK equity exposure (as per the implementation plan) reducing the overweight position to UK equity, which now stood at 4.9% as at 31 January 2024. A further update on the progress of the implementation plan is provided in a separate item on today's agenda.
- 1.3 UK Equities and Emerging Market Equities are overweight and underweight, respectively vs the Fund's rebalancing policy. At its last meeting, the Committee approved decisions to bring these positions into line with the new target weights and therefore there is no immediate requirement for any further rebalancing. Accordingly, officers recommend that no routine rebalancing is undertaken.

Asset Class / Fund Manager	Strategic Asset Allocation	Tolerance Band	Current Asset Allocation		Variance	Status
	(%)	(%)	£m	(%)	(%)	
Equities	53.0%	+/- 10%	4,148.7	52.9%	-0.1%	In Range
UK Equities	10.0%	+/- 2.5%	1,171.0	14.9%	4.9%	Overweight
Schroders			1,168.6	14.9%		
Link Fund Solutions			2.4	0.0%		
Global Equities	38.0%	+/- 5%	2,977.7	38.0%	0.0%	In Range
Schroders GAV			432.0	5.5%		
IMPAX Funds			69.2	0.9%		
Baillie Gifford			1,102.1	14.1%		
M&G Global Diversified			555.7	7.1%		
Sarasin			394.2	5.0%		
Insight (Synthetic Equity)			424.6	5.4%		
Emerging Market Equities	5.0%	+/- 2.5%	0.0	0.0%	-5.0%	Underweight
Fixed Income	22.0%	+/- 5%	1,799.4	22.9%	0.9%	In Range
Credit	15.0%	+/- 5%	1,195.7	15.2%	0.2%	In Range
Goldman Sachs			414.8	5.3%		
CQS			252.8	3.2%		
M&G Alpha Opportunities			270.6	3.5%		
Schroders Fixed Income			257.5	3.3%		
Risk Management Framework	7.0%	N/A	603.7	7.7%	0.7%	N/A
Insight			603.7	7.7%		
Alternatives	25.0%	+/- 10%	1,846.2	23.5%	-1.5%	In Range
Absolute Return	5.0%		403.3	5.1%	0.1%	N/A
Ruffer			175.1	2.2%		
Pyrford			228.2	2.9%		
Infrastructure	5.0%	N/A	340.6	4.3%	-0.7%	N/A
Partners Group			340.6	4.3%		
Private Equity	5.0%	N/A	373.2	4.8%	-0.2%	N/A
YFM			85.5	1.1%		
Harbourvest Intl			287.7	3.7%		
Property	10.0%	N/A	729.1	9.3%	-0.7%	N/A
DTZ Direct Property			460.8	5.9%		
DTZ Pooled Property			60.4	0.8%		
Fidelity International			136.6	1.7%		
Kames Capital			28.4	0.4%		
M&G Property			43.0	0.5%		
Cash	0.0%	+5%	48.7	0.6%	0.6%	In Range
Total	100.0%		7,843.0	100.0%		

2. INVESTMENT PERFORMANCE

2.1 The Fund's quarterly and longer-term performance as of 31 December 2023 is summarised below. Further detail is provided in the *Quarterly Fund Performance Report* found at Appendix 1.

Investment performance: quarter to 31 December 2023

2.2 The Fund's investments returned 1.42% in the three months to 31 December 2023, compared to the benchmark return of 3.05%. The relative negative return vs the benchmark is largely attributed to the Fund's equity protection program, which detracted (as expected) during a strong quarter for equities. The program reduces the overall volatility associated with equities by limiting losses and gains vs the benchmark.

2.3 **UK equities** exhibited a relatively poor performance compared to global peers, despite strong showings from the Financials and Consumer Goods sectors. Small caps produced significantly higher returns than large caps, with returns of 6.3% and 2.3% respectively. The Fund's UK equity manager, Schroders, trailed the benchmark marginally during the quarter with a return of 2.12% (versus the benchmark return of 3.14%).

2.4 **Global equities** performance was positive over the quarter, returning 6.3% in sterling terms. This was lower than the local currency returns of 9.3%, due to the appreciation of sterling versus the dollar. The "Magnificent-Seven" continued their rally and played a big role in the strong performance, supported by expectations of interest rate cuts and a soft landing in the US. Emerging markets did not perform as well as developed markets during the quarter, due to the ongoing struggles with China's property sector.

2.5 Following the above, and despite an underweight holding to the "Magnificent-Seven," most of the Fund's active global equity managers outperformed the benchmark returns this quarter. The exceptions to this were the Fund's global active value manager, Schroders, and the global thematic equity manager, Sarasin.

2.6 The increase in the global equity valuations meant that the equity protection program decreased by £195m during the quarter.

2.7 The **Fixed income** managers all outperformed during the quarter to 31 December 2023, amidst shifting market dynamics. All four managers outperformed their benchmarks, with GSAM having the highest outperformance with a return of 6.05% vs the benchmark return of 0.86%. This notable performance occurred against a backdrop of sharp declines in 10-year global government bond yields, which are attributed to the lower-than-expected inflation figures, as well as dovish stances seen from the central banks. UK real yields also experienced declines across the yield curve, again influenced by inflation data as well as the expectation of interest rate cuts. Additionally, spreads on UK investment grade credit tightened over the quarter, which is a factor in the strong performance seen from the Fund's fixed income managers.

2.8 **Property** returns continued to decline during the quarter and the Fund's property managers lagged the benchmark return of -1.35% except for the DTZ- (previously Kames/Aegon) managed Active Value fund which is in wind down stage and managed to release higher than book value on some disposals. The

DTZ Fund achieved a slightly better return than the benchmark of -0.9% vs -1.16%.

- 2.9 Both **absolute return** managers benefitted from the rally in bond and equities and outperformed the RPI linked benchmark of 1.3% during the quarter, with the **private equity** mandate also benefitting from improved valuations this quarter.

Longer term performance

- 2.10 For the year ended December 2023, the Fund achieved a return of 2.98% against a benchmark return of 8.65%, an underperformance of 5.67%.
- 2.11 Against a backdrop of gradual disinflation and renewed expectations of interest rate cuts, bonds have performed well over 2023. 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 12.45% against a benchmark of 4.66%.
- 2.12 Despite strong returns from fixed income managers over the year, performance has lagged on a total Fund level. This has been mainly caused by relative underperformance from each of the Fund's equity managers, with the exception of Baillie Gifford who produced a 1-year return of 14.56% vs the benchmark of 13.26%. Much of this underperformance by the Fund's active managers can be attributed to an underweight holding of the "Magnificent-7" tech stocks, which have mainly driven the rally in the global equities. The equity protection also had a negative impact on the Fund returns.
- 2.13 Moreover, the absolute return mandates largely underperformed versus the benchmark with Ruffer detracting significantly after trailing the benchmark by 16.72%. Property as an asset class has had a challenging year with a benchmark return of -0.51% and Fund's property managers lagged the benchmark, except for DTZ which returned 1.08% over the year.
- 2.14 For the three-year period, the Fund achieved a return of 2.47% compared to its strategic benchmark of 6.12%, an underperformance of 3.65%.
- 2.15 Benchmark equity returns have been strong during the three-year period with UK and Global equity indices returning 9.18% and 8.24% respectively, and value style investments leading the rally. Unsurprisingly during the three-year period, the Fund's value managers Schrodgers and M&G have outperformed the benchmark with 11.09% and 9.37% returns, respectively whilst the Fund's growth manager Baillie Gifford significantly underperformed with -7.48% against a regional benchmark return of 7.19%.
- 2.16 The equity protection programme has detracted from performance over this period too, as equities have rallied. As noted above, the program reduces the overall volatility associated with equities by limiting losses and gains vs the benchmark.
- 2.17 The alternative investment 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 13.66% in this prolonged period of high inflation.

3. CASH FLOW

3.1 The cash balance as of 31 December 2023 was £24.6m, down from £28.6m at the end of the previous quarter.

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

	2023-24	2024-25	2025-26	2026-27
	March Qtr	Full year	Full year	Full year
	£m	£m	£m	£m
Opening cash balance	24.6	8.6	-1.5	139.9
Revenue				
Pensions Contributions	74.8	299.0	311.0	324.0
Property Income	4.0	16.8	17.3	17.9
Total inflows	78.8	315.8	328.3	341.9
Outflows				
Pensions Payments	-76.5	-310.0	-319.0	-328.0
Admin, Governance and Oversight	-0.3	-6.3	-7.1	-7.3
Investment Management Fees	-1.1	-4.6	-4.8	-5.0
Total outflows	-77.9	-320.9	-330.9	-340.3
Net Revenue cashflow	0.9	-5.1	-2.6	1.6
Investments				
YFM	-2.9	9.0	23.0	20.0
Partners Group	-22.0	-40.0	63.0	110.0
Harbourvest	-10.0	-10.0	48.0	100.0
Property redemptions*	18.0	24.0	10.0	10.0
Woodford Receipt		12.0		
Net investment cashflow	-16.9	-5.0	144.0	240.0
Closing Cash balance	8.6	-1.5	139.9	381.5

*Does not include proceeds from future sale of Battersea Park property

3.3 Key observations to note are:

- Higher inflation linked pension payments are causing estimated pension benefit payouts to marginally exceed pension contribution income in the short run. This trend is likely to continue until at least the next valuation period.
- The Fund currently reinvests its investment income although takes some property related income in cash to meet its cashflow requirements.
- The cash flow excludes sale proceeds of £167m, redeemed from Pyrford in January 2024 as part of the implementation of the new strategic asset allocation. The redemption proceeds are being held with Insight in a liquidity fund and are available to meet the Fund's cash flow requirements in addition to in house cash balances at two days' notice.
- The cash flow above does not take into account other rebalancing activities to be undertaken in the new Strategic Asset Allocation (SAA) as these are expected to net to zero.

- However, there will be an implication on cashflows for additional commitments for increased allocations to alternative asset classes per the new SAA. This is discussed further under the Investment Strategy Implementation item elsewhere on the Committee's agenda.
- Cash required for collateral will also be reviewed by Insight after the Systematic Equity Protection is fully implemented.

4. INVESTMENT STRATEGY STATEMENT

- 4.1 Following its approval by the Committee on 12 December 2023, the revised Investment Strategy Statement (ISS) came into force with immediate effect. The updated ISS has been published on the Fund's website and is available at the following address:

<https://www.kentpensionfund.co.uk/local-government/about-us/management-of-the-fund/policies>

Appendices

Appendix 1 – Quarterly Fund Performance Report – Q4 2023

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