From:	Chairman Kent Pension Board Interim Corporate Director - Finance
To:	Kent Pension Board – 21 November 2024
Subject:	Investment Update (30 September 2024)
Classification:	Unrestricted

Executive Summary:

This report provides a summary of the Fund's investment strategy, asset allocation, performance, and responsible investment activity.

The intra asset class review of the Fund which started with Equities is substantively complete and will be tabled at the Committee for decision. Simultaneously the review of the Fixed Income asset class has been commenced to ensure that the timeline for the review is not materially affected.

The suspension in the dealing of the Fidelity Property Fund has now been lifted by the manager and is reported in section 3.

Section 4 of the report provides an overview of the Fund's current asset allocation compared to the target range and notes that no rebalancing is required at this stage.

The Fund has outperformed its quarterly benchmark and a detailed commentary on the performance by asset class and manager for the quarter as well as longer term is included in sections 5 and 6 of the report.

Finally, the report also includes an overview of the update provided to the Responsible Investment Working Group on the Fund's Net Zero commitment as well as on the activity of the ACCESS ESG sub-group.

Recommendation:

The Board is asked to note the report.

FOR INFORMATION

1. Introduction

1.1 This report provides the Board with an update on the Fund's investment activity and performance, as well as on responsible investment developments that have taken place since the Board's last meeting.

2. Intra Asset Class Review

2.1 As the Board is aware, officers had initiated an intra asset class review to ensure that the investments are aligned to achieving the objectives of the investment strategy. The review would start with equities and then cover fixed income and private assets in that order.

2.2 Following the initial report from Mercer on the findings of the equities review and the Committee's feedback in June, the plan was to develop the final proposals and to take recommendations to the September Committee for decision. However, it was felt that further work was required to formulate final recommendations for the Committee, and the decisions would be deferred to the December Committee. It was also agreed that the review of the fixed income asset class would also be commenced to ensure that the review timeline is not materially affected.

2.3 In September the Committee received a progress update on the equity review. It highlighted the work carried out by officers on identifying implementation routes as well as by Mercer who have further developed their proposals having considered options for mitigating unintended underweight bias to the quality style factor and actions for achieving more consistent mandate sizes across the equity allocations.

2.4 Work on the equity allocation review has now been substantively completed by Mercer and the recommendations arising will be tabled at the December Committee meeting for decision, along with initial findings of the fixed income review for the Committee's feedback.

1. Property

1.1. In September we had reported that Fidelity, as the manager of the Fidelity UK Real Estate Fund FIREF had decided to temporarily suspend dealing in the fund. The suspension was implemented after they concluded that redemptions had reached a level whereby a suspension was an appropriate measure intended to protect the interests of all the investors. During the suspension the manager has individually engaged with each investor to provide information about the redemptions pipeline, and to discuss the future and strategic options for the Fund.

1.2. Following the investor engagement Fidelity has lifted the suspension in September. In the meantime, FIREF has been selling properties to meet the queue of existing redemption requests and it is anticipated that they will be able to meet Kent's redemption request by the end of 2025.

4 Fund value and asset allocation

4.1 As of 30 September 2024 (the latest available data), the Fund's value was £8.4bn compared to £8.3bn as at 30 June 2024, the position previously reported to the Board. The table below sets out the current asset allocation versus the Fund's strategic asset allocation and its rebalancing policy.

Asset Class	Strategic Asset Allocation (%)	Tolerance Band (%)	Current Asset Allocation (%)	Variance	Status
Equities	**53**	**+/- 10**	**56**	**3**	**In range**
UK Equities	10	+/- 2.5	11	1	In range
Global Equities	38	+/- 5	40	2	In range
Emerging Market Equities	5	+/- 2.5	5	0	In range
Fixed Income	**22**	**+/- 5**	**21**	**-1**	**In range**
Credit	15	+/- 5	15	0	In range
RMF (Index Linked Gilts)	7	-	6	-1	N/A
Alternatives	**25**	**+/- 10**	**23**	**-2**	**In range**
Absolute Return	5	-	5	0	N/A
Infrastructure	5	-	5	0	N/A
Private Equity	5	-	4	-1	N/A
Property	10	-	9	-1	N/A
Cash	**0**	**5**	**0**	**1**	**In range**
Total	**100**		**100**		

4.2 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 is being held to meet liquidity requirements for private equity and infrastructure drawdowns pending formulation of a liquidity waterfall for approval by the Committee. Given the current asset allocation is within tolerance, officers will not be recommending to the Committee that any rebalancing is undertaken at its meeting in December.

5 Investment performance: quarter to 30 September 2024

5.1 The Fund's investments returned 1.4% in the three months to 30 September 2024, compared to the benchmark return of 1.1%.

5.2 ***UK equities*** continued to generate higher returns compared to the global index with the FTSE All Share index gaining 2.3% over the quarter. Domestically focused mid cap and small cap equities performed better than large cap stocks. The Fund's UK equity manager, Schroders, outperformed the benchmark during the quarter with a return of 3.7%.

5.3 ***Global equities:*** geopolitical tensions, economic backdrop was positive, and returns were positive. Global equity markets returned 5.1% in local currency but due to strengthening of the Pound, the MSCI ACWI returns in sterling were a modest 0.5% over the quarter.

5.4 Amongst the Fund's global equity managers, Baillie Gifford's return of 2.1% was above its fixed weight regional benchmark return of 1.0%. Impax, M&G and the Schroders Active Value Fund all outperformed the MSCI benchmark of 0.5% this quarter with returns of 4.5%, 4.1% and 0.9%, respectively. Sarasin underperformed with -1.2% returns over the quarter. Collectively, the Fund's global equity mandates delivered a return of 1.9% during the quarter.

5.5 After taking into account the impact of the risk management framework, this gain was reduced to 0.7%. The increase in the global equity valuations meant that the value of the Fund's equity protection assets decreased.

5.6 ***Emerging market equities:*** This is the first quarter where the Fund has a full quarter's performance for the emerging market equities. Despite some volatility, emerging market equities ended the quarter with strong returns. The MSCI EM index returned 2.5% in sterling. Both Robeco and Columbia Threadneedle (CT) underperformed the benchmark with 2.1% and -1.1% returns, respectively. CT's performance was particularly affected by its underweight position in Chinese stocks which were boosted by the Chinese government's policy initiatives in September as well as its overweight position in technology stocks which detracted in this quarter.

5.7 ***Fixed income***. Rate cutting cycles implemented in major economies, caused government bond yields to decline and boosted valuations. However, the expectations of faster monetary easing by the Fed also led to a weaker dollar against major currencies, including sterling. The Fund's bond mandates collectively achieved 3.1% returns compared to a cash benchmark of 1.3% for the quarter. All credit managers in the Fund outperformed the benchmark with Schroders and GSAM posting returns of 4.1% and 3.3% respectively as their strategies include a view on interest rates which benefitted in a declining rate environment. CQS and M&G Alpha Opportunities also outperformed the benchmark with returns of 2.9 and 2.1%, respectively.

5.8 The Index Linked Gilts portfolio, which is part of the Risk Management Framework (RMF) managed by Insight, returned 1.5%.

5.9 ***Property*** total returns were 1.8% in this quarter against the UK all property benchmark return of 1.6%. In the market, all sectors delivered positive total returns in Q3, including the office sector which has experienced negative total returns since mid-2022. The best performing sectors this quarter were the industrial, retail and residential sectors. DTZ's legacy portfolio returned 1.5%. Fidelity posted 2.8% but M&G returned 1.1%. Kames which is in winding down stage returned -0.8% against a Balanced Property benchmark of 1.2%.

5.10 Amongst the two ***absolute return*** mandates, Pyrford and Ruffer achieved absolute returns of 3.2% and 3.1%, respectively - outperforming the RPI benchmark of 0.3%.

5.11 Both the large ***private equity*** and ***infrastructure*** managers underperformed the cash benchmark 1.3% over the quarter with Harbourvest returning -4.6% whilst Partners Group returned 0.4%. YFM produced above benchmark returns of 1.5%.

6 Longer term performance

6.1 For the year ended 31 September 2024, the Fund achieved a return of 6.5% against a benchmark return of 10.7%, an underperformance of 4.2%.

6.2 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 were the best performing manager with a return of 13.6% against a cash +4% benchmark of 8.6%, followed by the M&G Alpha Opportunities fund, which returned 11.1%. Both Schroders and GSAM also performed equally well with 13.0% and 11.1% respectively.

6.3 Equities have also rallied with several major indices reaching record highs and the MSCI ACWI posting annual return of 19.9%. However, the Fund's active managers have had mixed performance: M&G have delivered the best performance with 23.0%. Baillie Gifford have gained 18.1% and therefore both managers have beaten their respective benchmarks. Sarasin, Schroders GAV and Impax have underperformed with Impax detracting the most with a return of 11%. Given the rally in global equities over the past 12 months, the equity protection programme has detracted from overall Fund returns. With returns of 12.3% Schroders' UK equity portfolio underperformed its UK MSCI benchmark of 13.4%.

6.4 Relative performance from the absolute return managers against their inflation plus 5% target over the past 12 months has been mixed. Ruffer detracted with a return of 4.8% whilst Pyrford has outperformed the benchmark with 9.1%. against the benchmark of 5.2%. Overall, the property portfolio returned 1.8% against a benchmark of 2.4%. Although the DTZ direct property portfolio returned 2.6%, performance detracted due to underperformances by Fidelity, Kames and M&G.

6.5 For the three-year period, the Fund achieved a return of 2.1% compared to its strategic benchmark of 5.6%, an underperformance of 3.5%.

6.6 Benchmark equity returns have been strong during the three-year period with UK and Global equity indices returning 7.4%, and 8.3% respectively. Of the equity managers, M&G and Schroders GAV have outperformed the benchmark over the period with an annualised return of 10.2% and 8.5% respectively whilst the Fund's growth-style manager, Baillie Gifford, significantly detracted with a return of -7.1% against a regional benchmark return of 6.9%. As noted in section 2 above, a review of the equities portfolio with recommendations to ensure it remains aligned with the Fund's long term investment objectives will be presented to the Committee in December for decision.

6.7 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.

6.8 The private equity allocations have been the best performers in the three-year period while the absolute return managers have struggled against their inflation-linked benchmarks, given elevated levels of inflation over the performance horizon.

7 Responsible Investment Update

Net Zero Update

7.1 In December 2023, the Kent Pension Fund Committee made a net zero commitment for 2050 for listed equity investments of the Fund.

7.2 In October 2024, officers carried out a review of the progress made by the Fund towards decarbonization in the year since June 2023 which was the last point of assessment included in the underlying analysis supporting the Fund's net zero strategy.

7.3 The review was undertaken based on information obtained from investment managers with respect to the following metrics and information:

- Carbon Footprint of the portfolio
- Science Based Targets initiative (SBTi) alignment of underlying portfolio companies
- Rationale for holding high emitters in the portfolio and engagement activity undertaken to support decarbonization

7.4 Although the carbon footprint data used for the analysis was reported by investment managers, they all confirmed that the source of the data was one of the prominent providers of ESG data, mainly MSCI which was also the source of data used in the ACT analysis by Mercer. Officers further validated the data to ensure consistency of basis.

7.5 Overall, the review found:

a. Good progress in decarbonisation of listed equity portfolios being on track to meet the IPCC curve net zero targets. The reduction achieved as of June '24 brought the carbon footprint down to 76% of the 2020 baseline compared to 92% as at June 2023. Coverage of companies reporting carbon metrics ranged from 97%-99% and therefore provided a high level of confidence.

b. The decarbonisation achieved in the fixed income portfolios was even more significant even though the Fund has not made a formal net zero commitment in relation to these portfolios. These portfolios showed a reduction to 39% of the 2020 baseline at June 2024 compared to 60% at June 2023. We recognize that the coverage of companies reporting carbon metrics is still quite low although improving consistently. There is a possibility that the metrics might reflect an increase in carbon footprint in the short run as more companies' data gets included.

c. Number of underlying companies in the listed equity portfolios with SBTi targets also showed an improvement from 37% to 39%. Companies in fixed income portfolios with SBTi targets improved from 23% to 24%. We recognise that as different companies utilise different ESG frameworks to organize their ESG activities it is difficult to measure progress against a single consistent framework.

d. Most managers provided comprehensive details of engagement undertaken by them with the high emitting companies in their portfolio although decarbonization was not the only focus of their engagement.

7.6 Following on from the above analysis, officers will be continuing to further engage with managers to query the methodology of measurement by the managers as well as the effectiveness of the engagement undertaken by them.

ACCESS RI Update

7.7 Officers updated the Responsible Investment Working Group on two recent and significant developments in ACCESS supported by PIRC, (who is the responsible investment consultant for ACCESS) and agreed by the ACCESS Joint Committee (JC):

a. The ACCESS stewardship code submission – this was due to be submitted to the Financial Reporting Council in October 2024.

b. The updated ACCESS Voting Guidelines – this will be shared with the investment managers who will be asked to report on a comply or explain basis (only by exception).

7.8 The JC also approved procurement of a voting and engagement provider for ACCESS whose role will be to provide voting activity for all ACCESS investments in line with the ACCESS voting guidelines and to focus ACCESS engagement activity with underlying companies in line with ACCESS priorities.

7.9 The ACCESS RI sub-group is currently preparing for the procurement of the voting and engagement provider with the support of Hampshire procurement team with an anticipated completion timeframe of March 2025.

Appendices

Appendix 1 – Quarterly Performance Report (30 September 2024)

Sangeeta Surana (Investments, Accounting and Pooling Manager)

T: 03000 416290 / 03000 416738

E: james.graham@kent.gov.uk / sangeeta.surana@kent.gov.uk

30 October 2024