

	Pensions Fund Sub-Committee 20 February 2023
	Report from the Corporate Director, Finance and Resources
Investment Strategy Review	

Wards Affected:	All
Key or Non-Key Decision:	N/A
Open or Part/Fully Exempt: <small>(If exempt, please highlight relevant paragraph of Part 1, Schedule 12A of 1972 Local Government Act)</small>	PART EXEMPT - Appendix 7 to the Investment Strategy Review (Low carbon equities) contains the following category of exempt information as specified in Paragraph 3, Schedule 12A of the Local Government Act 1972, namely: "Information relating to the financial or business affairs of any particular person (including the authority holding that information)"
No. of Appendices:	Two Appendix 1: Investment Strategy Review Appendix 2 Investment Strategy Review – Appendix 7 – Low carbon equities (Exempt from publication)
Background Papers:	<ul style="list-style-type: none"> ▪ N/A
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1.0 Purpose of the Report

- 1.1 This report details the review undertaken by the Fund's investment advisor, Hymans Robertson, of the current investment strategy, following on from the Fund's 2022 valuation. The purpose of the review was to evaluate the current

investment strategy and analyse the ability of alternative strategies to meet the Fund's strategic objectives.

2.0 Recommendation(s)

That the Pensions Fund Sub-Committee:

2.1 Consider and agree the investment strategy review undertaken by the Fund's investment advisors, Hymans Robertson, available in Appendix 1. The following proposals should be taken into consideration:

- Rebalance the equities portfolio by reducing the allocation to global equities by 6% and re-invest in multi-asset credit and gilts;
- Undertakes a market review of low carbon global equity funds to replace the current LGIM global equity mandate;
- The Fund to continue to build its investments in infrastructure (15% target), private debt (5% target) and property (10% target), to move towards the long-term strategic allocation;
- That new investments will be needed to build the infrastructure allocation to the target allocation;
- The broad split between UK commercial, UK housing and Global property for the Fund's property allocation;
- Investigate options to maintain the target allocation to Private Debt;
- Review of the Protection portfolio to identify whether this can be refined to increase expected returns with only a marginal increase in risk.

2.2 Note that the investment strategy review supports the Fund's net zero road map with a market review of the global equities allocation planned for 2023.

3.0 Detail

Current Investment Strategy

3.1 The Fund's current strategic asset allocation was agreed in February 2020 following the 2019 valuation. In summary, a long term target of 50% to equities, 35% to income (including diversified growth funds) and 15% to protection assets was agreed.

3.2 The Fund employs a phased approach to working towards the long-term target allocation, therefore an interim allocation was also agreed. Table 1 below shows the current interim and long term allocation.

Asset Class	Interim Target (%)	Long-term Target (%)	Actual Fund asset allocation (Dec 2022) (%)
Equities	55	50	59
Global ex UK	40	40	46
UK	5	5	6
Emerging Markets	5	5	4
Private Equity	5	0	3
Income	30	35	31
Diversified Growth	20	5	21
Infrastructure	10	15	5
Property	0	10	3
Private Debt	0	5	2
Protection	15	15	10
Multi Credit	5	5	4
Gilts	10	10	5
Cash	0	0	1
TOTAL	100	100	100

3.3 At the time of the last review, the Fund's current strategic asset allocation was expected to generate a return of 5.52% p.a., with a volatility of 9.88% p.a. Over the last 3 years, up to December 2022, the Fund has generated a return of 3.8% which is lower than the long term expected rate but 0.5% higher than its benchmark return of 3.3%.

3.4 The aim of the Fund's investment strategy is to maximise returns over the long term within specified risk tolerances in order to meet the wider strategic goals of the Fund and to close the gap between assets and liabilities. At the 2019 valuation, the Fund was estimated by the actuary to be 78% funded. At the 2022 valuation, the overall funding level has improved by 9% to 87% reflecting higher than expected investment returns and improved data quality.

Strategy Proposals

3.5 The Fund's investment advisors, Hymans Robertson, have completed their Investment Strategy review. The review focuses on the high-level investment strategy with the aim of determining the high-level allocation to Growth, Income and Protection assets, and considers the detailed implementation of these allocations. This review has included carrying out asset liability modelling to test the probability (and associated risks) of the Fund's current investment strategy achieving its long-term objectives. We also tested how the current strategy compares with other investment strategies.

3.6 The remainder of this report provides a short summary of the Investment Strategy Review, the full report is attached in Appendix 1.

3.7 The investment advisor has modelled the existing strategic allocation, the current long term allocation and two alternative de-risked strategies:

- De-risked strategy 1: Reduce the equity allocation by 10%, with an additional 2.5% to income (private debt) and 7.5% to protection (2.5% to multi asset credit and 5% to corporate bonds)
- De-risked strategy 2: Reduce the equity allocation by 10%, with an additional 2.5% to income (private debt) and 7.5% to protection (7.5% to multi asset credit, 10% to corporate bonds less 10% to gilts)

3.8 The table below shows the 20 year expected return and 1 year risk measure (volatility) for these strategies:

	Current strategy (at 31 Dec 2022)	Current long-term strategy	De-risked strategy 1	De-risked strategy 2
20 year expected return	4.56% p.a.	4.61% p.a.	4.56% p.a.	4.75% p.a.
1 year risk measure	12.7%	12.1%	11.4%	11.7%

3.9 The key points to note are:

- This analysis provides support for continuing to move towards the long-term target allocations agreed at the last strategy review, the long-term strategy is expected to provide a marginal increase in expected return with lower risk compared to the current strategy.
- The results for the de-risked strategies give some support to reducing the Fund's exposure to equities.
- the current long-term target allocation can be enhanced by replacing fixed-interest gilts with corporate bonds. The risk and return profile of this strategy is an expected return of 4.81% p.a. with a risk measure of 12.3%.

3.10 It should be noted that the move from the current strategy to the long-term strategy or alternative strategies should take place over time, taking into account the availability of suitable investment opportunities, the scope to access private markets and the current market environment.

Growth

3.11 The current allocation to growth assets is 9% overweight relative to the long-term targets. Around 3% of this position is expected to wind down in the coming years therefore the review recommends to decrease the equity allocation by 6% and re-invested in multi-asset credit and gilts.

3.12 The investment strategy review also recommends undertaking a market review during Q2 2023 to make significant progress towards achieving the Fund's net

zero ambitions and selecting one or two low carbon global equity funds to replace the current LGIM global equity mandate.

Income

- 3.13 The Fund has long held overweight allocation to diversified growth funds as the Fund seeks to build up its infrastructure, private debt and property exposure. The review recommends to continue to move towards the long-term strategic allocation for these asset classes and that new investments to these asset classes are by selling diversified growth funds.
- 3.14 In terms of infrastructure, new investments will need to be identified to build the allocation to infrastructure towards its 15% target. A review of suitable infrastructure funds including funds targeting renewable energy and Forestry/Timberland could be considered as part of a diversified infrastructure portfolio. Such investments would align well with the Fund's net zero ambitions as significant investment is required as part of the transition. Appendix 4 of the full report sets out more information about the Forestry/Timberland asset class including the characteristics and risks.
- 3.15 The review recommends to maintain the 5% allocation over the long term to Private Debt, which is currently in the build up phase. It is recommended to investigate options in this area in terms of follow up commitments to maintain the target allocation.
- 3.16 It is also recommended to maintain the target allocation to Property and that the Fund continues to build its property allocation, creating a diversified portfolio comprising UK commercial property (c. 3.6%), UK housing (c. 2.8%) and global property (c. 3.6%). UK housing can provide additional diversification to the portfolio and tends to have a lower risk/return profile than commercial property, a detailed assessment of the LCIV UK Housing Fund which invests in social, affordable and specialist housing is included as a separate item on this agenda.

Protection

- 3.17 The review considers that current allocations to Protection assets are underweight relative to the long-term targets driven mainly by the sharp decline in the market value of bond assets during 2022 due to the impact of rising interest rates.
- 3.18 As noted in paragraph 3.12 above, it is recommended to decrease the equity allocation by 6% and re-invest the proceeds in multi-asset credit and gilts to increase these towards their target allocations.
- 3.19 The rise in interest rates means that the yields available on bonds (UK government gilts and corporate debt) are more attractive than they have been for some time therefore the committee should consider whether this can be refined to increase expected returns while maintaining risk at or around current levels.

4.0 Financial Implications

4.1 These are discussed throughout the report and included in Appendix 1.

5.0 Legal Implications

5.1 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (the “Investment Regulations”) govern the management of the pension fund and the investment of fund money. According to Regulation 7 of the Investment Regulations an administering authority must formulate an investment strategy which must be in accordance with guidance issued from time to time by the Secretary of State. It must publish a statement of its investment strategy and must review, and if necessary revise, its investment strategy at least every three years.

6.0 Equality Implications

6.1 Not applicable.

7.0 Consultation with Ward Members and Stakeholders

7.1 Not applicable.

8.0 Human Resources

8.1 Not applicable.

Report sign off:

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Resources