Pension Committee Investment Sub-Committee

Date: 17 February 2022

Time: 10:00am- 12.55pm

Place: New Shire Hall, Alconbury Weald

Present: County Councillors A Whelan (Chair), C Rae (Vice-Chair), I Gardener and A Sharp; J Walker and L Phanco

Officers: B Barlow (virtual), D Cave, S Heywood (virtual), R McRobbie (virtual), R Perry, T Wardzala (virtual) and M Whitby

Advisers/Consultant: P Gent and C West (Mercer); S Gervaise-Jones (virtual)

18. Apologies and Declarations of Interest

There were no apologies for absence.

John Walker declared a personal interest (i) as a retired member of the Local Government Pension Scheme (LGPS), (ii) his daughter-in-law was a current member of the LGPS and (ii) his son was a deferred member of the LGPS.

19. Action Log

The Action Log was noted.

20. Cambridgeshire County Council Pension Fund Quarterly Performance Report for the period ending 31st December 2021

The Sub-Committee received a report summarising the performance of the Pension Fund for the quarter to 31st December 2021.

There had been an increase in liabilities, largely driven by fall in gilt yields. Assets had increased marginally less, leading to a slight reduction in the funding level from 111% to a still healthy 109%.

Equities were overweight compared to the strategic allocation by 4.4% at the end of the quarter, reflecting the strong sustained, positive performance from that asset class, whilst Alternatives were under weight (-3.7%). The latter was mainly due to the slow draw down for private equity, and it was expected that this would be addressed in the medium term.

Relative returns were 1.9% adverse against benchmark over Q4, reflecting below benchmark returns for all major asset classes. Strong but below benchmark equity returns over the quarter were limited by the impact of equity protection which returned a negative 1.2%. Dodge & Cox, a Value manager, had underperformed, but this was more than offset by JO Hambro's strong performance. Over the year, there had been very strong returns, mainly driven by equities and growth assets, delivering 12.5% returns per annum over three years, but slightly below benchmark.

Q4 had been good for growth assets globally, although Asian and Emerging Markets had lagged. There had been a strong recovery in developed economies post Covid, coupled with the expectation that Central banks would be measured in paring back some of the support they had provided when the pandemic first struck. Q4 also saw the emergence of the Omicron Covid-19 variant, and whilst there had been some reaction in the markets to that initially, the position stabilised as it emerged that Omicron was a milder and less harmful variant.

It was noted that in 2022 Gilt yields started to rise, leading to negative returns for defensive assets. 2022 had also started with higher and stickier inflation, and stronger central bank responses, e.g. increase in BoE interest rates.

Twelve month returns were strong across the board. Gilt returns were slightly negative which was a reflection of gilt yields rising over the year, and also stronger inflation. Members noted the progression of the funding level over time, from 100% at the beginning of 2021 to 109% by the end of the year.

The actual asset allocation showed deviations from the strategic asset allocation. It was anticipated that the overweight equity allocation would reduce by the end of the financial year, which was currently offset by underweight allocations to property and private equity. To date, 2022 had seen a reversal of market conditions indicating that there were likely to be negative returns for global equities.

In terms of manager allocations, JO Hambro had driven active equity performance resulting in the overweight position, with passive equity also overweight due to high returns. Multi Asset Credit was underweight and had become more underweight over Q4, reflective of the lower growth relative to equities due to performance being relatively flat over the quarter, Again, it was likely that position would be reversed by the year end.

Reviewing the Alternatives allocation, it was noted that this was underweight by 3.7%. M&G Shared Ownership was expected to move towards target allocation. Similarly Private Equity allocation was below target, but would be addressed by further commitments coming forward. Infrastructure was overweight (6.5% compared to a 6.0% target), which helped balance the Alternatives portfolio.

There had been strong equity market returns over the short term and also over the 3 year period, but this had been offset by the equity protection which had the expected effect of limiting excessive upside equity performance.

In terms of equity performance, JO Hambro had given strong overperformance over 1 and 3 years, as the markets had favoured their Growth and momentum style approach. Dodge & Cox follow a Value investment style, which performed better in more defensive climates. However, Dodge & Cox had performed in line with expectations over 12 months and outperformed the Value benchmark, but Value as an investment style had underperformed generally.

For Longview, there continued to be some client outflows, but this was offset by strong performance in terms of assets under management. Longview had underperformed in Q4 but were reassuringly above benchmark over 2021.

Turning to Fixed Income, the two MAC managers' performance had been masked since inception. Despite some moderate underperformance in Q4, both Bluebay and M&G got off to a strong start since inception in September 2020, but this was not visible in the 12 month returns reflected in the report.

In the Alternatives portfolio, Schroder Property was a core portfolio (office, retail, industrial) had been modestly behind the benchmark for 3 and 5 year period, but this performance did not cause concern. The M&G residential portfolio had a focus on build to let type properties, and was measured against an absolute return benchmark of 6%pa which was challenging for property assets. It had been a tough period for residential property markets in the pandemic, with delayed lettings leading to uninspiring performance, but still marginally positive. Stronger returns were anticipated as more properties were let.

In terms of Private Equity, for 1 and 3 year figures, there was some mixed performance. Harbourvest and Adam Street showed incredibly strong returns over 1 year, of 62.8% and 74% respectively. Over time this would drift down towards targets as capital paid from the Pension Fund to managers, so this performance would not be sustained in the medium to long-term. Foresight had made a slower start, partly due to early stage expenses and the impact of the pandemic. The mixed performance for Infrastructure managers UBS, IFM and JPM was noted.

It was noted that the Levelling Up White Paper, published on 2nd February, included an ambition for LGPS funds to allocate 5% to local investing. The Fund was already investing locally through the Foresight mandate.

Arising from the presentation:

- In response to a Member question on funding levels, it was confirmed that this had fallen slightly as the increase in liabilities in the quarter was marginally higher than the increase in assets;

- A Member observed that there were quite a few areas of underperformance compared to benchmarks, in equities and also Alternatives. With equities, Mercer advised that the post pandemic recovery had been largely fuelled by the US tech stock sector, which was seen extraordinarily high levels of returns, and this skewed the benchmark. Heavy exposure to that sector was not seen as desirable. Despite this, managers continued to be challenged on underperformance e.g. Dodge & Cox. In terms of Alternatives, there were reasons for underperformance, as returns tended to follow a timeline, with young and mature mandates not achieving benchmark returns. Benchmarking was imperfect in the Alternatives arena, especially given the number of vintages involved, and more attention should be paid to the listed numbers;

- It was noted that Longview had been under review, but performance was in line with other managers. It was likely that there would be a request at the next ACCESS Joint Committee for a new quality manager search, but that process would take time. It was also stressed that although there had been large outflows at Longview, these were not material enough to cause concern;

- Noting the underperformance in residential property over one and three years, a Member observed that there had been strong growth in rental returns and capital values over the period. It was confirmed that underperformance was attributable to the absolute return benchmark used, and issues over the pandemic period, when properties were not fully let.

The Sub-Committee resolved to note the report.

21. Exclusion of Press and Public

The Sub-Committee resolved that the press and public be excluded from the meeting for the following items on the grounds that they contained exempt information under Paragraph 3 of Part 1 of Schedule 12A of the Local Government Act 1972, as amended (information relating to the financial or business affairs of any particular person (including the authority holding that information)) and that it would not be in the public interest for this information to be disclosed as they contained commercially sensitive information.

22. Confidential minutes of the Pension Fund Investment Sub Committee held 25th November 2021

The confidential minutes of the Committee meeting held 25th November 2021 were agreed as a correct record, with one correction: Cllr A Sharp was <u>not</u> present, but had given apologies.

23. Climate Action Plan

The Sub-Committee considered proposals for carbon reduction with appropriate targets, and a Climate Action Plan.

It was resolved to:

1. note the presentation from Mercer;
2. note the proposed Climate Action Plan for 2022, 2023 and beyond;
3. approve the decarbonisation targets to reduce the carbon emissions of listed equities by 23% by 2024 and by 57% by 2030;
4. approve that the Head of Pensions with assistance from Mercer to produce options for implementing climate aware passive equity funds.

24. Structured Equity Protection Update

Members considered an update on Structured Equity Protection.

It was resolved, by a majority, to:

1. note Mercer's report on structured equity protection;

2. approve the continuation of the equity protection strategy after May 2022, with a coverage of 25% of the Fund's equities, to be reviewed after one year;

3. delegate to the Head of Pensions the efficient implementation of the above decisions to cease or extend the equity protection strategy including:

    3.1. The structure of the equity protection contracts;

    3.2. The ability to close out and roll-over the structure in accordance with the agreed triggers.

    3.3. The ability, if a triggering event occurs less than six months from the expiry of the structure to extend the term of protection to the earliest date for which market contracts are available, in consultation with the Chair.

As it was his last meeting, the Chair thanked Richard Perry and wished him well for his retirement.

Chair