Leicestershire County Council

LOCAL PENSION COMMITTEE – 19 JUNE 2020

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

LGPS CENTRAL PRODUCT DEVELOPMENT & PERFORMANCE UPDATE

Purpose of the Report

1. The purpose of this report is:

    a. to update the Committee on LGPS Central investment product development.
    b. Receive an update from LGPS Central regarding investment performance for the products our Fund has invested in (Appendix A).

Background

2. LGPS Central (Central), an investment management company jointly owned by eight midlands based Local Government Pension Scheme funds, to deliver investment pooling, successfully went live on 1st April 2018.

3. Pooling will take several years to implement, due to the need to set-up sub-funds by Central and then amalgamate the existing holdings for the eight partner funds. The Leicestershire Pension Fund (the Fund) has currently invested in four Central products, the global active equity fund, global emerging active fund, the 2018 private equity offer and the Investment Grade Corporate Bond Fund most recently. In addition, our Fund has advisory agreements for Property, Targeted Return and Emerging Market Debt.

4. Local management of investments will be required in the medium term for closed-ended funds, whereby an investment manager is appointed to fulfil a specific purpose via a pooled fund which is set up to run for a specified period of time. These investments will be managed locally until the capital is repaid, due to the lack of a natural ability to exit the investment in the event of issues arising.

LGPS Central Update

Global Active Emerging Market Bond Fund

5. The Fund currently has exposure to the Emerging Market Debt (EMD) Fund asset class via Ashmore, the value of the holding at March 2020 is £94 million. During the annual asset allocation review Hymans advised of a 2.5% allocation to be maintained.

6. The Ashmore fund invests in a fixed income EMD investment. The Fund invests in mainly sovereign and corporate bonds denominated in both local currency and US

dollar. Ashmore take large active weight positions and as such volatility versus benchmark returns are to be expected. Active weight refers to the difference in allocation of an individual holding and the benchmark.

7. Central are due launch the Emerging Market Debt Fund in Q3 2020/21 having appointed two managers in April 2020. The Fund has previously advised Central of our interest and have been involved with the discussions in building a suitable product. Any differences to our current mandate have been discussed with Central and include the following:

    a. Change of benchmark to a to a single JPM GBP hedged benchmark from a combined weighted benchmark.
    b. Stocklending will be permitted.
    c. Leverage will not be permitted, Ashmore are currently allowed to borrow up to 10% of their net assets.

8. The overall effect of changes will be minimal from a risk reward perspective.

9. The two managers that Central have appointed are Amundi Asset Management (AM) and M&G. Central's procurement exercise had 79 enquiries, 12 were progressed to RFP (request for proposal) stage with 5 then being interviewed.

10. Officers will consider appropriate due diligence, comparing the Fund's current manager before bringing a paper to Investment Subcommittee later in the year for approval. Two other partner funds have expressed initial interest in the fund.

<u>Targeted Return</u>

11. The Fund currently has exposure to the Targeted Return asset class via three managers, Aspect Capital, Ruffer and Pictet. As part of the annual asset allocation review it was agreed that the Fund would reduce its allocation to 7.5%, which equates to a reduction of c£150 million to the asset class.

12. Central are in the early stages of developing a targeted / absolute return product. The Fund has expressed an interest and is currently working with one other partner fund, LGPS Central and Hymans Robertson to develop a suitable product.

13. The Fund has retained the asset class as it allows investments via active management to take advantage of market opportunities and allows the Fund to be long and short (ie being able to profit whilst market prices are falling) in the market across classes not otherwise accessible. In turn this allows for improved diversification for the Fund. The three managers the Fund currently employs have contrasting approaches, Aspect Capital trades frequently and has low correlation to equity.

14. There is one other partner fund interested in this product at present officers are hopeful of reaching consensus on an outline requirement to be able to go to the market with.

Multi Asset Credit (MAC) Fund

15. Multi asset credit invests across a broad spectrum of credit instruments including, but not limited to investment grade and high yield corporate bonds, emerging market debt, loans, convertible bonds, securitised credit and government bonds.

16. Compared to the recently invested in Investment Grade Corporate Bond product this product is able to invest in a wider pool of securities and therefore has an overall higher risk and expected return.

17. The Fund already has investments in emerging market debt and investment grade corporate bonds. As such this product will be developed with this in mind and will limit exposure as necessary to avoid overlap.

18. The Fund also has limited exposure to this asset class via a minor holding totalling 0.5% of the total Fund's value, through JP Morgan's Global Credit fund (c.£28m).

19. The annual asset allocation review advised that the Fund should increase the allocation to this class from 0.5% to 4.0%. It is deemed to be attractive for a number of reasons:

    a. It provides exposure to multi-asset classes through a single investment strategy.

    b. Managers have the flexibility to move opportunistically between asset sectors, which should allow managers to create excess return by allocating to attractive asset classes. Significant divergence can occur between individual asset class returns and an effective manager will allocate dynamically between asset classes to add value.

    c. MAC strategies can provide yield enhancement compared to traditional fixed income strategies. This is attractive to investors who may need income streams to meet liabilities in a low interest rate environment.

20. Central are developing a product that the Fund has expressed an interest in, and in conjunction with other partner funds will develop a requirement that Central will go to market with.

21. The Fund took the opportunity in May 2020 to review with its advisor the Selection Questionnaire (SQ) and advert including the general fund mandate before it was sent to the market. The review allowed the Fund to address areas that would not meet our objectives. Central have thus undertaken a further review of the documents before progressing.

Direct Property

22. The Fund has a number of property investments totalling £400 million at March 2020 or c10% of the Fund's value. This is split across three managers, Colliers, LaSalle and Kames. Of the total holding £97million is classed at direct holdings

where individual properties are bought and held for the Fund rather than units in a fund that owns property, known as an indirect holding.

23. The current direct holdings are not expected to transfer to Central when the property sub fund is launched, due to taxation and transition cost concerns. As such there is little detriment to the Leicestershire Fund to by adding to its direct holdings.

24. Central have presented a business case to IWG (Investment Working Group) for a UK Direct Property Fund. It has been approved at IWG and by Central's Investment Committee and Executive Committee. Three partner funds including ourselves have expressed a soft commitment to invest at the last IWG. Now that the business case is agreed an appropriate legal structure will be developed with a view to launching a product in late 2020.

25. Central plan to launch additional property funds to focus on other sectors including international property in the future. These are likely to be held on an indirect basis, similar to our current holdings with LaSalle where they hold units in non-UK and other specialised funds which we would otherwise find harder to directly invest in at scale, for example in niche debt funds.

Infrastructure

26. The Fund has a £431 million allocation to Infrastructure; this is managed by IFM, KKR, JP Morgan, Infracapital and Stafford. The KKR and Stafford investments are closed ended with capital not expected to be fully returned until 2027. The IFM and JP Morgan fund are semi open, with matching by the manager of clients seeking to invest / divest providing some liquidity.

27. The Fund has an allocation target of 9.75%, at March 2020 had an allocation of 10.4%. Given the illiquid nature of infrastructure investments and the subsequent rebound in liquid investments classes, officers are comfortable with the slight over-weight position.

28. A two sleeve structure is proposed, a core sleeve (investing in safer more traditional schemes with stable cashflows for example) with a lower return and an opportunistic sleeve with higher risks and returns. Investors will be able to allocate funds to either sleeve in line with their risk and reward profile.

29. Officers have shared the investment case with the Fund's advisors to allow them to comment further on the details and discuss any amendments to the proposal before Central complete a business case that is planned to come to IWG in Q3 of this calendar year.

Other Matters

30. Gordon Ross has been appointed as CIO (Chief investment officer) following resignation of the current post holder who is moving to another Pension Pool. Gordon was the Investment Director for fixed income and deputy CIO prior to being appointed as CIO.

31. The Head of Private Markets position at Central has not yet been filled. This position would oversee both Private Equity and Private Debt investment classes.

With that in mind the Fund may, later in the year propose a further allocation to Private equity or debt that require investment outside the pool.

Recommendation

32. It is recommended that the Local Pension Committee notes the report.

Equality and Human Rights Implications

33. None.

Appendix

Appendix – LGPS Central Presentation

Background Papers

None

Officers to Contact

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