Leicestershire County Council

LOCAL PENSION COMMITTEE – 11TH SEPTEMBER 2020

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

RECOMMENDED INVESTMENT INTO LGPS CENTRAL GLOBAL ACTIVE EMERGING MARKET DEBT

Purpose of the Report

1. The purpose of this report is to provide information in respect of a recommended investment into the LGPS Central (“Central”) global active emerging market debt (EMD) multi manager fund.

Background

2. The Fund has a target allocation of 2.5% of total Fund assets to the EMD asset class. EMD sits within the alternatives / credit group of investments. Emerging Market debt is the fixed income debt that is issued by countries within developing economies as well as by corporations within those countries. Emerging markets debt can be issued in local currency (eg Turkish Lira, Thai Bhat etc) or in many cases developing countries can issue debt in US dollars which they repay in US dollars. Both local currency and US dollars carry translation risk for UK Pension funds who need to pay pensions in Sterling.

3. At present the Fund has £109m invested in with Ashmore which represents 2.4% of total fund assets versus a target of 2.5% (An under allocation of 0.1% or c£0.5m). An investment in the Ashmore SICAV EM Total Return Fund has been in place since 31 October 2014, with investments mainly in sovereign, quasi-sovereign and corporate bonds denominated in local currencies as well as US dollar denominated debt.

4. Three partner funds have expressed an interest in the EMD fund with the mandate being formed by collective discussion with Central.

5. The Fund has engaged with LGPS Central whilst they have been developing this product. The selection process was completed in April 2020. Central offered the interested partner funds a virtual meeting with the two managers chosen to operate this mandate, Amundi Asset Management and M&G in May 2020.

6. The Fund has since instructed Hymans Robertson to complete due diligence with respect to the fit the product provides Leicestershire Pension Fund’s investment strategy. The report from Hymans is included within the private section of this meeting’s agenda.

Proposed investment

7. The Global Emerging Markets Debt Active Multi Manager Fund is a sub-fund of the LGPS Central Authorised Contractual Scheme (ACS). LGPS Central Limited is the authorised contractual scheme manager. The ACS structure was selected as it delivers the most efficient vehicle based on costs, flexibility, liquidity and delivering risk adjusted return after costs.

8. M&G is a London-based smaller asset manager with c£340bn in assets under management (AUM). Fixed income assets account for c£170bn and is their largest asset class. The managers manage around c£40bn of assets in various Emerging Market Bond Strategies. The EMD team consist of five dedicated professionals led by a manager, portfolio manager and three dedicated analysts. Although the team is too small to split into different EMD strategies the managers impressed with their separate processes for Hard Currency and Corporates and how they look at the fundamentals in these asset classes in a different way within these asset classes. They also work closely with the other teams within M&G and share the resources of the larger Fixed Income team, in particular the analysts and traders.

9. Amundi is a large European asset manager with c£1.5 trillion in AUM and 37 offices worldwide. Emerging Markets accounts for an AUM of c£40 billion and is an important part of the firm's business. The team that covers this includes 68 professionals, speaking 25 languages and working out of 12 worldwide offices (London, Dublin, Boston, Paris, Vienna, Mumbai, Shanghai, Singapore, Seoul, Taipei, Hong Kong and Kuala Lumpur).

10. The Emerging Market assets are managed through collaboration of the Equity and Fixed Income Emerging Market teams. The EMD team consists of 14 Portfolio Managers who are split between three strategies (Sovereign, Corporate and Aggregate). The team responsible for Central's mandate will be led by the Co-Head of Emerging Markets Fixed income supported by five managers. This team is further supported by a team of career analysts. The managers also have a team dedicated to strategy and portfolio construction.

11. Based on expected investments from the partner funds go forward gross saving c57 bps pa are possible for the Fund compared to our current mandate. There are additional fees attributable to the administration of the Central fund which are split based on the cost saving agreement. Together with the additional fees covering depository and fund accounting, Central calculate the annual savings, on a £100m investment would be c£0.5m pa for our Fund.

12. Central have selected a transition manager to assist in the transition of assets from partner funds into the new fund. The contract will be signed once the Financial Conduct Authority (FCA) have approved the mandate. The Leicestershire Fund will incur costs of transition if the Central Fund is selected. These are estimated by Central to be in the region of 30 bps – 35 bps under normal market conditions, which has largely been the case in the past few months since the market sell offs in Q1 of 2020. Transition costs are dependent upon the exact approach taken to transitioning assets and may therefore be subject to significant variation depending on that approach. Further clarity on transition costs will become available once the approach to transition has been identified, this will be reported to the Partner Funds by the transition managers.

13. It is proposed the investment is split evenly between the two managers. The primary benchmark of the Central Fund will be the JPM EMBI Global Diversified Index GBP Hedged. This benchmark comprises sovereign and quasi sovereign bonds denominated in US dollars. This benchmark was chosen as returns have been better, and less volatile, than returns from the local currency sovereign index (JPM GBI-EM GD) and the hard currency corporate bond index (JPM CEMBI). A summary of the available indexes from JP Morgan is shown below with the chosen benchmark for this mandate shown on the left.

	Hard currency	Local currency	Corporate
Index	JPM EMBI GD	JPM GBI-EM GD	JPM CEMBI BD
Number of securities	780	220	1533
Number of countries	74	18	56
Number of issuers	170	18	690
Currency	USD	Local	USD
Constituents	Sovereign and quasi-sovereign bonds issued in USD	Sovereign bonds issued in their own currency	Debt issued in USD by corporates in EM countries
Average rating	BB+	BBB	BBB-
IG/HY	50%/50%	77%/23%	59%/41%

14. Central's objective is to outperform this benchmark by 1.0% pa measured over a rolling 3 year period. Hymans analysis showed as part of their report that the hard currency benchmark outperformed the other local currency index in 11 out of the last 17 years (2003 to 2019) and outperformed the corporate index in 12 out of the same 17 years.

15. It is worth noting the primary benchmark does not contain local currency bonds or corporate bonds, but the guidelines for the Central Fund allow the managers to hold up to 30% in local currency bonds, and up to 30% in hard currency corporate bonds. Hard currency sovereign and quasi sovereign bond exposure must be at least 50% of the Central Fund.

Hymans Robertson report highlights:

16. A detailed report by Hymans Robertson, the Fund's Investment Consultant, on this investment, which includes exempt information, is included later in today's agenda. A brief overview of the opportunity and why Hymans consider it attractive is given below:

- Hymans Robertson preferred approach to investing in the emerging markets debt asset class is through an actively managed blended portfolio which has the flexibility to invest across the full universe of EMD asset classes and we are of the view that both Amundi and M&G have the capability to offer this. Whilst the Central Fund primary benchmark comprises 100% hard currency bonds (the JPM EMBI GD Index) we are comfortable that both selected managers will take advantage of the flexibility offered in the guidelines to additionally invest in both local currency and corporate bonds.

- The most significant difference between the Fund's existing allocation to EMD with Ashmore, and the proposed Central Fund, is the benchmark used to measure performance. The Ashmore fund uses a blended benchmark reflecting the range of asset classes in which the fund invests. The blended benchmark is comprised 50% JPM EMBI GD, 25% JPM GBI-EM GD, 25% JPM ELMI+*. Essentially split 50% hard currency and 50% local currency.

- The Central Fund is likely to have a lower proportion of local currency bond exposure than the current Ashmore fund, and so offers a less balanced EMD portfolio. This is due to the different benchmark. We do not think this is material as the Central Fund retains the flexibility to take reasonable positions in local currency bonds if the managers believe excess returns are available.

- We also note that the fee schedule looks very attractive relative to LCCPF's existing emerging markets debt strategy with Ashmore. Our initial assessment of the Central Fund is that it is suitable for LCCPF's investment in global emerging markets debt from an investment perspective.

Summary

17. Taking into account development of the Central product in line with the needs of the partner funds and the Hymans Robertson report we propose an investment to the Central product.

Supplementary Information Informing the potential investment

18. An exempt paper from Hymans Robertson which is of a sensitive nature is included on the agenda.

19. The Chief Investment Officer (CIO) from Central will be available to take questions from the committee regarding this proposal.

Recommendation

20. The Local Pension Committee is recommended to consider an investment in the LGPS Central Global Active Emerging Market Debt fund.

Equality and Human Rights Implications

None specific

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