Agenda Item 11

Leicestershire County Council

# LOCAL PENSION COMMITTEE – 26th FEBRUARY 2021

# REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

# SUMMARY VALUATION OF PENSION FUND INVESTMENTS AND INVESTMENT PERFORMANCE OF INDIVIDUAL MANAGERS

## Purpose of Report

1. The purpose of this report is to present to the Committee, an update on the investment markets and how individual asset classes are performing, a summary valuation of the Fund's investments at 31st December 2020 (Appendix A), together with figures showing the performance of individual managers.

## Markets Performance and Outlook

2. LGPS Central (Central) provide quarterly a historical asset class performance review covering various time frames. Three asset classes still show double digit returns over a 20 year time frame, property, high yield and gold; the same three as last quarter.

| | 3 months* | One year | Three years | Five years | Ten years | Twenty years |
|---|---|---|---|---|---|---|
| GLOBAL EQUITIES | 14.8% | 16.6% | 10.5% | 12.8% | 9.7% | 6.2% |
| PRIVATE EQUITY | 14.8% | 1.2% | 8.7% | 14.9% | 10.8% | N/A |
| PROPERTY | 8.3% | -4.8% | 5.5% | 6.8% | 9.2% | 10.0% |
| INFRASTRUCTURE | 15.0% | -5.8% | 2.7% | 7.9% | 6.5% | N/A |
| HIGH YIELD | 6.4% | 4.6% | 5.3% | 6.8% | 8.7% | 10.4% |
| UK GILTS | 0.6% | 8.8% | 5.5% | 5.8% | 5.8% | 5.6% |
| UK INDEX-LINKED | 1.2% | 11.2% | 5.7% | 8.6% | 8.1% | 7.0% |
| GOLD | -4.8% | 21.3% | 12.8% | 14.0% | 4.3% | 10.7% |

Source: Bloomberg (NB: assumes dividends were reinvested), Note: Listed proxies have been used for Infrastructure, Property and Private Equity.

3. An update on asset classes and expected market performance is provided by Central within the Tactical Asset Allocation (TAA) report (Appendix B) whose 6 -18 month view is summarised below, arrows indicate movement in weighting since the last quarter. These forward looking market view are provided to the committee for information.

Table1: Weightings ▲ Upgraded, ▼ Downgraded compared to previous quarter

| | Significant Underweight | Underweight | Neutral | Overweight | Significant Overweight |
|---|---|---|---|---|---|
| Estimated Probability | 80-70% | 70-65% | 55-45% | 70-65% | 70-80% |
| BROAD ASSET CLASS | | Stabilising | Growth ▲ | Income | |
| GROWTH ASSET CLASS | US Equities | | UK Equities<br>EU Equities ▲<br>Private Equity ▲ | Commodities<br>GEM Equities ▲<br>Japan Equities<br>Asia Pac Equities ▲ | |
| INCOME ASSETS | Property | | Credit | | EM Debt<br>Infrastructure |
| STABILISING ASSETS | EU Bonds ▼ | UK Bonds<br>JP Bonds ▲ | Index-Linked ▲<br>US Bonds ▲ | Gold<br>IG Bonds | |
| INVESTMENT STYLES | | Growth<br>Momentum ▼ | | Value<br>Size ▲ | Quality/ESG<br>Low Volatility |
| CURRENCIES | | US Dollar | Euro ▼ | GBP, Yen | |

4. Central's major changes from last quarter is noted below:

   a. Growth assets – upgraded four classes to reflect the positive development of the pandemic, with vaccination programmes running since December and the expected opening of the economies as soon as possible thereafter. This changed Central's market risk expectations by shifting the risk expectations from being to the downside to being to the upside.

   b. Income assets - no change from the previous quarter.

   c. Stabilising assets - no major changes, no significant overweight positions noted given central's view of high valuations.

   d. Investment styles – the only major movement has been the movement of size, small companies in particular from significantly underweight to overweight. Central believe that the development of vaccines and the start of the vaccination programmes has significantly reduced the risks for small companies, as the way ahead is much clearer, and that investor sentiment will reflect this and produce a re-rating within markets.

**<u>Portfolio changes Q4 2020</u>**

5. During the last quarter of 2020, the Fund successfully completed two transitions from the 2020 plan. A movement of c£740m from LGIM passive equities to the LGPS Central Climate balanced factor fund and a c£100m transition from the Ashmore emerging market debt (EMD) fund to the LGPS Central multi manager EMD fund.

6. In addition, the Fund also made commitments to infrastructure and private equity with existing managers for £25m and £20m GBP. This was approved at the October Investment Subcommittee. The Fund expects the commitments to be 'called' by the manager during 2021.

**<u>Current cash holdings</u>**

7. The Fund currently holds more cash than for future commitments to investments and the Fund has engaged with a number of options to deploy this in line with the recommendations from the 2021 asset allocation review. At the March 2021 Investment Subcommittee officers hope to bring a number of recommendations for

approval. The agenda today includes a recommendation to utilise a portion of the cash.

8. The cash component is £129m cash with an additional £90m collateral held with Aegon for the currency hedge. Given the past years' volatility in markets it makes sense to hold some additional cash in the event currency markets move unexpectedly which may require additional collateral. The Fund has taken steps to ensure that the additional liquidity is invested at rates greater than the Treasury function at the Fund can achieve currently.

**2021 investment plans**

9. The Fund's 2021 strategic asset allocation (SAA) was approved at the January 2021 Pension Committee. The quarterly independent valuation reports will reflect the new SAA targets from next quarter when the Fund reports on the quarter from January 2021 to March 2021.

10. A reminder of the 2021 SAA is shown in the table below.

| | Proposed target weight (%) | Comments |
|---|---|---|
| **Growth (55.25%)** | **55.25** | |
| Listed equity | 42.0 (40.0-44.0) | Broad factor based passive allocation implemented December 2020, using LGPS Climate multi-factor sub-fund |
| Private equity (inc secondaries) | 5.75 | Increase in strategic target reflecting existing allocations Consider opportunistic investment in Adam Street Secondaries |
| Targeted return | 7.5 | Currently higher allocation. Use to fund sub-inv grade credit allocation; Review LGPS sub-fund when details available |
| **Income (36.75%)** | **36.75** | |
| Infrastructure (inc timberland) | 9.75 | Review and use LGPS sub-fund |
| Property | 10.0 | Consider introducing residential property; Consider LGPS Central proposals |
| Emerging market debt | 2.5 | - |
| Global credit – liquid sub inv grade markets | 4.0 | Existing JP Morgan fund holding and reduction in Target Return used to fund allocation, subject to due diligence |
| Global credit - private debt | 10.5 | Review M&F DOF team mid-year to decide whether to make further allocation to distressed debt |
| **Protection (8%)** | **8.0** | |
| Inflation-linked bonds | 4.5 | 0.5% reduction in strategic allocation, reflecting recognition of cash held to manage currency hedge |
| Investment grade credit | 3.0 | Including up to c.0.5% retained by Aegon to support currency hedge programme |
| Currency hedge cash | 0.5 | Recognition of cash held by Aegon for this mandate. Adjust benchmark hedge ratios used by Aegon from 50% to 30% |
| **Total** | **100.0** | |

11. Changes that officers have commenced work upon:
    a. Private equity – officers have engaged with Adam Street and LGPS Central regarding secondaries investments. This may utilise some cash.
    b. Targeted return – working with LGPS Central to build a product alongside one other partner fund. Likely to be available towards the later end of 2021.
    c. Infrastructure – the Fund has an outstanding commitment to existing managers. It also may invest within the LGPS Central infrastructure fund once it is finalised and due diligence is completed.
    d. Property – the SAA highlighted an investment into the residential sector. The Fund is weighing up investment utilising either existing managers (quicker) or awaiting an LGPS Central indirect property product which could be delivered in the second half of 2021 but has no guarantee of including a residential 'sleeve' if there is not partner fund support.
    e. Global credit sub investment grade – the fund has shown interest in the LGPS Central multi asset credit (MAC) product which will be funded from a reduction in

existing targeted return investments and cash if needed. The Central product is ready and Hymans have been instructed to commence due diligence.

f. Global credit private debt – the SAA suggested looking further into the Funds existing relationship and products with M&G within this area once the new team at M&G have settled in. In addition, officers have been in contact with Central and their plans to launch a private debt offer in 2021.

**<u>Overall Investment Performance</u>**

12. A comprehensive performance analysis over the quarter, year and three-year period to 30th December 2020 is provided in Appendix A. Portfolio Evaluation collate information directly from managers and calculate performance, which provides an independent check of valuations and allows greater reporting flexibility. Officers and Portfolio Evaluation have met in the quarter to discuss improvements to the performance tables which should allow for more comprehensive three and five year performance metrics to be included from March 2021.

13. It is important to note that the valuations produced can be different to those provided by managers or included in the Statement of Accounts. For example, timing differences of use of different accounting methodologies. The differences are not expected to be material in the context of the messages being conveyed by the report.

14. For the quarter ending Dec 2020 the Fund delivered an investment return of +7.2%, +4.4% over the last 12 months and +5.0% pa annualised over the three year period. The one and three year portfolio return is lagging benchmark by returns by 3.0% and 1.0% respectively.

15. The Fund’s total value as at the quarter end is £4.9 billion. At 31st March 2019, the triennial valuation date, the Fund had assets valued at £4.3 billion. 21 months into the three year cycle, assuming linear asset growth of 3.8% (which Hymans Robertson estimated has a 80% likelihood over the next 20 years and is used in the 2019 valuation for reporting the funding level of the scheme) would equate to a fund valuation of c£4.6 billion. It is worth noting that this only looks at the investment return whereas the fullest picture of funding health is only achieved by also considering the liabilities which will next be calculated as at 31st March 2022. It is worth noting that yields on government bonds have fallen since the last actuarial valuation and this would increase the value of the fund’s liabilities, all other things being equal.

**<u>Asset class performance review</u>**

16. There was a +1.8% outperformance in the quarter versus the blended benchmark return of 5.4%. This was largely as a result of the equity positions and alternatives outperforming the benchmark by 2.5% and 3.1% respectively and private equity and real income underperforming by 4.5% and 0.7%.

17. Being overweight to equity has helped in the quarter with virtually good returns on all six passive LGIM geographic funds and outperformance on the two active LGPS Central funds, emerging equity and global equity. The boost of mass vaccination coming on line during the final quarter of 2020 gave many equity markets a shot in the arm with double digit returns common across many indexes. On a one year basis the passive UK equity fund managed by LGIM has posted a negative return even after a 12.9% return in the final quarter of the year. The heavy weight makeup of financial and industrial companies have not fared as well as other indexes such as North America where technology dominates

holdings or Japan where consumer goods and industrials are the largest sectors.

18. It is worth noting that the outperformance of the equity element and the illiquid nature of other areas of the portfolio where valuations are lagged by a quarter or haven't been revalued has pushed the equity weight of the total portfolio to 47.2% and ahead of the 2020 benchmark.

19. The final quarter's overall favourable performance has nudged up the one year and (less so) three year performance numbers to +4.4% and +5.0%, they are both comfortably ahead of the assumption made in the last actuarial valuation but are behind the benchmark returns for both time frames.

20. The Private Equity relative underperformance in the quarter to benchmark is related to timing issues regarding valuations, once volatility has settled variations will become less pronounced. The current valuation available for the bulk of the Fund's private equity investments is as at 30th September 2020 and so it is always worth looking at longer timeframes. Private equity investments are long term in nature with each vintage taking at least 10 years to deploy all commitments and realise distributions. The Fund's long standing manager provides a quarterly statement showing returns on all vintages invested in dating back to 2002 with net internal rate of return (IRR) showing currently at 12.15%. The detail is included within the manager reports section of the pack. Officers have regular calls with the manager to understand the market, deal flow and where risks and opportunities lie in the managers opinion.

21. Property performance in the year to 31st December has been mixed across managers based on the types of assets held. Overall the year has resulted in a flat performance, +0.1% vs a benchmark of -0.9%. With a lot of valuation uncertainty through the year as Covid struck and material uncertainty clauses were activated the true nature of returns couldn't be easily seen. As we enter 2021 and the economy re opens the Fund should start to see the effects in valuations and hopefully some upward movements on some of the most beaten up sectors. For example, the Fund holds two Aegon funds that are more heavily invested in sectors of the market affected by Covid, such as offices and retail. Adding to the fact these funds actively manage to improve and dispose sites the lockdowns will have not helped.

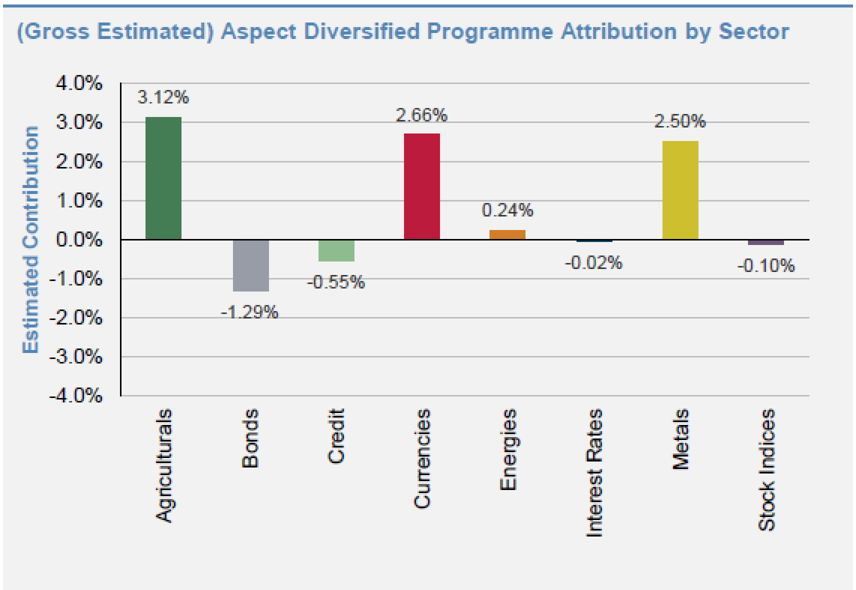
22. The Colliers portfolio consists of three pooled funds with two registering capital losses with the Legal and General leisure fund particularly badly affected. Colliers feel retail and leisure will continue to be badly affected until national lockdowns are eased. Together with their direct property holdings the fund returned -3.6% which includes an income return of 5.0%. Over a longer five year period the Colliers fund has been disciplined in its selection of investments which has resulted in an annualised return of 5.6% and well ahead of the MSCI monthly index benchmark of 4.4% pa.

23. The Fund's largest property manager LaSalle which manages around 3.8% of the total portfolio in open and closed ended funds has had a good year with returns of +0.2% over one year vs their benchmarks return of -0.9%, an outperformance of +1.1%. Their weighting to the retail sector is low, below the benchmark and is planned to be reduced further in early 2021. They are also overweight in sectors that have proved to be resilient during 2020 such as logistics and light industrial assets. The portfolio style adopted is one of holding core investments rather than 'value add' assets which has helped during a pro

longed lockdown where activity in 'value add' has been stunted. The LaSalle fund has also performed well over five years returning 4.9% (gross of fees) and ahead of the benchmark by 1.0%.

24. The Fund employs the three target return managers to meet an overall target of one month (London inter bank offered rate) LIBOR + 4%. All three have dissimilar strategies and show varying success. All three managers had strong positive returns in excess of the benchmark in the final quarter which has been uncommon, with a total return on +6.1%. Over the 12 months in 2020 the portfolio has produced a return of +6.1%, +1.9% to the benchmark, with the standout manager being Ruffer who returned 14.9% in the year. Aspect finished the year at -3.9%, and within a portfolio of three managers chosen for their contrasting styles this return isn't unexpected. Pictet finished 2020 with a total return of +6.0% and ahead of benchmark also.

25. At present the Fund has plans under the 2021 target benchmark to reduce the targeted return weight to 7.5% of Fund assets with the disposal currently planned to be used to fund the MAC fund being launched by LGPS Central pending advisor due diligence and Committee approval. The Fund, may also opt to use the cash resources available but will be mindful of the overweight position within this asset class.

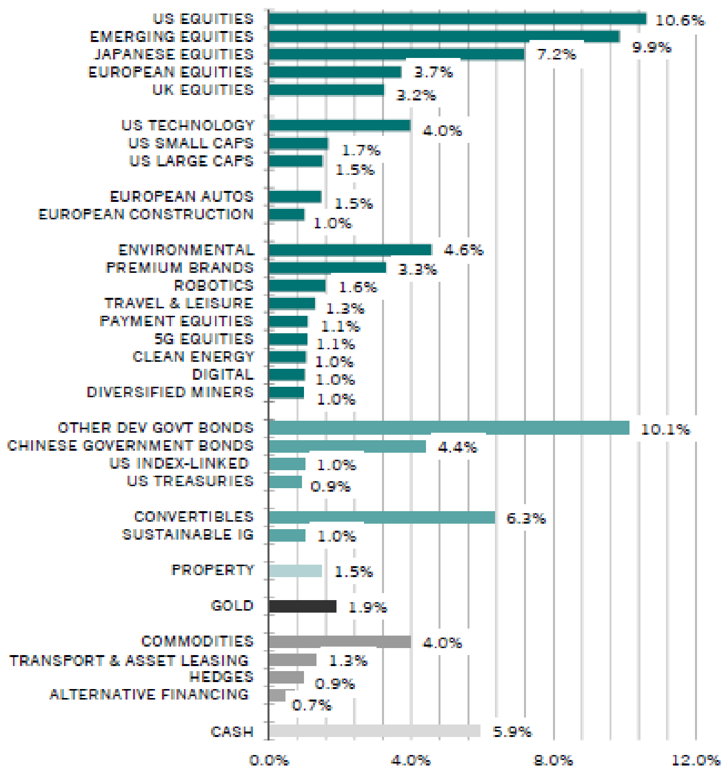



26. Of the three managers Aspect have had a quarter with a return of +5.8% (-5.5% last quarter) with most of that performance coming in December alone. Over the year they were unable to capitalise on the very good flat performance they showed in the first three months when all other asset classes were showing large declines. It is for this reason they are chosen within the overall portfolio, a real diversifier and a strategy that isn't employed elsewhere in the Fund. The middle part of the year showed consistent losses when their strategy couldn't pick on the trends in the markets. During the last quarter the returns by sector show strong returns from agricultural, currencies and metals trading.

27. Pictet posted the best performance of the three managers with a +7.2% return following on from a +3.0% return in previous quarter to finish with the year with a 6.0% after a poor first quarter. Unlike the other two managers Pictet are not able to take 'short' positions to take advantage of market sell offs. They do however

change their investment holdings regularly with a view to control risk and cut they equity exposure to a low of c35% in late October to then finish the year with a c60% equity weighting as they turned increasingly positive on the outlook for equities. The portfolio breakdown below shows their year end positioning with a mix of assets represented. They did reduce the gold allocation during the quarter as prices suffered and reallocated to a broad basket of commodities.

Portfolio breakdown as at 31 December 2020




28. The Ruffer portfolio produced another positive quarter, +5.4% in the quarter and ended 2020 +14.9%. They aim to build an 'all weather' portfolio, one that will make money when risk assets go up but also deliver returns when markets are in crisis. In order to do so they inevitably give up some upside to protect the downside risks.

29. Of note in the quarter was their investment in Bitcoin which amounted to 2.5% their funds value. They 'housed' this within the protection strategies part of the overall fund and felt it provided them with additional protection in light of the increasing supply in paper money which will weaken faith in paper currencies. To fund this meaningful allocation Ruffer sold a portion of their gold holdings which traditionally has served this role. They continue to hold both gold bullion and gold mining shares however. At the time of writing this report the value of the initial 2.5% has increased significantly and Ruffer have chosen to sell the profits to maintain the initial 2.5% allocation. The holding is in effect now 'free', although any negative price movement will affect future performance. A call with Fund officers in December demonstrated their thought process, internal discussions, why they felt it was a good asset to own and the protection they have in place to custody the holding.

30. Similar to Pictet, Ruffer also increased their equity weighting from 30% to 40% in

the quarter whilst the majority of this came from equity outperformance they did not reduce weighting as they felt the companies held are at attractive valuations, with particular attention given to UK and Japan where broad equity valuations are far lower than the main US market indexes. They are sceptical regarding valuations in the market and draw parallels to the dot com bubble in certain areas and are positioning away from those and towards where value exists.

31. The currency hedge has benefited the Fund over the quarter as the main foreign currency the Fund is exposed to, the US Dollar has weakened as Sterling benefited from a Brexit settlement, consequently dollar denominated holdings will have had a drag on performance when translated back to Sterling for reporting purposes. This has also contributed to the Fund's higher cash position as the currency hedges have benefited as Sterling has appreciated.

**Recommendation**

32. The Local Pension Committee is asked to note the report.

**Appendices**

Appendix A - Portfolio Evaluation - Summary Valuation of Funds Performance.

Appendix B - Report of LGPS Central Limited – Tactical Asset Allocation (Market outlook and Performance).

**Equality and Human Rights Implications**

None.

**Officers to Contact**

Mr C Tambini, Director of Corporate Resources
Tel: 0116 305 6199 Email: Chris.Tambini@leics.gov.uk

Mr D Keegan, Assistant Director Strategic Finance and Property
Tel: 0116 305 7668 Email: Declan.Keegan@leics.gov.uk

Mr B Kachra, Senior Finance Analyst - Investments
Tel: 0116 305 1449 Email: Bhulesh.Kachra@leics.gov.uk