Appendix B

HYMANS ROBERTSON

Leicestershire County Council Pension Fund

Annual Review of Investment Strategy and Structure

David Walker, Partner

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Background and contents

Addressee and purpose

This paper is addressed to the Pension Fund Committee (the "Committee") of the Leicestershire County Council Pension Fund (the "Fund" or "LCCPF"). The purpose of this paper is to provide an annual review of the Fund's Strategic Asset Allocation (SAA) and structure.

Background and scope

The aim is to assess the effectiveness of the current funding and investment strategy to meet the Fund's objectives and test potential alternative strategies that may enhance the likelihood of achieving long-term investment outcomes.

The review is supported by Asset Liability modelling (ALM) analysis.

The findings will support the Fund's development agenda for the year ahead, informing future strategic discussions and highlighting any areas where additional analysis or action may be required.

Executive summary

1. **Strong funding position:** The Fund's funding level has improved significantly from March 2022 to March 2025, with a surplus rising from approximately £0.28bn to £1.91bn. This improvement is underpinned by a higher discount rate (an increase in the expected returns used to value the liabilities) and robust investment returns. The annual review assesses the effectiveness of the current funding and investment strategy, using Asset Liability Modelling* (ALM) to test alternative strategies and support the Fund's development agenda for the year ahead.
2. **Current Investment Strategy is robust:** The Fund's current strategy is well-diversified. The strategy performs well in meeting the Fund's success and risk criteria but the assessment against these criteria improves under alternative strategies supporting some minor amendments.
3. **Alternative Strategies:** Asset Liability Modelling shows that all tested strategies (including increases to protection or illiquid assets, and shifts from equities to credit or gilts) deliver high probabilities of funding success, with only marginal differences in risk and return.
   - Increasing protection assets can reduce risk of downside funding risks and higher contributions without meaningfully lowering the probability of meeting funding objectives.
   - Analysis suggests funding this increase from equities provides marginally better results, however, given the changes to strategy previously agreed and the Committee's preference to maintain equity exposure we would support the Fund in retaining the current target weight to equities. Funding an increase in protection from MAC also reduces risk and provides a balanced approach to risk and overall Fund liquidity requirements.
   - The current allocation to private markets remain underweight relative to target as private markets continue to call capital, we therefore do not recommend increasing the allocation to illiquid assets at this stage. If increasing allocations to illiquid assets was desired, liquidity constraints and the need for cashflow management is important to consider
4. **Recommendations**:
   - Maintain 41% in listed growth equity assets for liquidity and returns.
   - Increase protection assets from 8% to 10% to further diversify and reduce risk, funded from MAC.
   - Review income portfolio to ensure cashflow needs are met.
   - Engage with pooling requirements and monitor strategic risks
   - We recommend incorporating local within the current private market targets, targeting 1% across private market assets.

*An ALM (Asset-Liability Modelling) exercise uses stochastic modelling to simulate multiple economic scenarios, projecting future funding levels and assessing risk. Factoring in realistic behaviours across asset classes and conditions provides a robust view of the Fund's resilience under a broad range of circumstances.

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Current strategy

Objectives and Funding Position

The fund has two overall objectives:

- ✓ Stable and affordable contributions
- ✓ Sufficient funds to meet benefits as they fall due

The long-term investment strategy is reviewed annually, with the aim to maximise investment returns of the Fund whilst maintaining an acceptable level of risk.

The Committee recognises that:

- Diversification across investment classes with low correlation reduces volatility but over-diversification is both costly and adds little value.
- Environmental, social and governance (ESG) factors can enhance long term investment performance.

The table below shows a summary of how the funding level for the Fund has improved during the period from March 2022 to March 2025, as well as a number of important assumptions that underpin the Fund's investment strategy.

	Mar 2019	Mar 2022	Mar 2025
Funding level %	89	105	140
Surplus / (Deficit)	c.£(0.54bn)	c.£0.28bn	c.£1.91bn
Discount rate p.a.	3.8**	4.4 *	6.1 **

**expected returns over 20yr with 75% likelihood*
*** expected returns over 20yr with 80% likelihood*

Source: Hymans

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Changes in funding environment since 2022

LGPS funds do not operate in isolation from the wider environment. LGPS funding plans are affected by changes in the financial, demographic and political environment. The main changes in the funding environment since the 2022 valuation date are set out below:

Economic

- There has been a large shift in economic environment since the 2022 valuation, characterised by an increase in interest rates from historic lows to rates closer to the long-term average. See the next page for further details.
- There has been higher than expected inflation since 31 March 2022. April 2023 (10.1) and April 2024 (6.7) pension increase orders were slightly higher than that assumed at the 2022 valuation, increasing the value placed on liabilities.
- Increasing budgetary pressure for LGPS employers, and Local Authorities in particular, due to high inflation and higher costs of borrowing.

Demographic

- Despite losing a decade of longevity improvements in 2020 during the pandemic, emerging data from Club Vita suggests that life expectancies have recovered to pre-pandemic levels.
- Whilst LGPS pensioners appear to have been somewhat insulated from some of the population health effects observed in recent years, based on Club Vita's paper, local pockets of COVID-19 infections and deaths led to regional variations in mortality. This could be linked to socio-economic variations.

Political

- In July 2024, the UK Government launched its Pensions Investment Review. As part of this review, the government will focus on developing policy to encourage further pension investment into UK assets.
- Based on information currently available, we do not believe that the Pensions Investment Review will have a material impact on this funding strategy review.
- The Fund is reviewing its investment beliefs within the Investment Strategy Statement (ISS) to support the Pool in managing investments effectively. It should also consider any changes to implementation of investment strategy from government reforms and their potential impact on future returns when assessing this report.

Others

- The Government Actuary's Department (GAD) carry out a review of all LGPS funding plans* following the conclusion of each triennial valuation.
- In their report on the 2022 valuations, GAD set out their intended approach to assessing Long Term Cost Efficiency (LTCE) at the 2025 valuation review in relation to the utilisation of surplus.
- For the 2025 review, GAD will introduce new metrics which aim to identify where LGPS funds are either utilising surpluses too quickly or retaining large surpluses.
- The aim of this analysis is to ensure intergenerational fairness between generations of taxpayers.

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The most material change for the purpose of funding at the 2025 valuation is the change in **economic** environment

* Under Section 13 of the Public Service Pensions Act 2013

Current investment strategy

Asset class	Current Allocation (%)	Current Target (%)
Growth	**54.2**	**53.5**
Listed equity	43.8	41.0
Private equity	5.4	7.5
Targeted return	5.0	5.0
Income	**30.3**	**38.5**
Infrastructure (inc timberland)	10.2	12.5
Property	7.0	7.5
Global credit – public debt (sub-IG)	6.3	9.0
Global credit - private debt (sub-IG)	6.8	9.5
Protection	**14.7**	**8.0**
Inflation-linked bonds	3.0	3.5
Investment grade (IG) credit	3.7	3.75
Currency hedge	0.8	0.75
Cash	7.9	-
Total	**100.0**	**100.0**

Source: Investment managers and "Leicestershire Total Fund Q3 2025 - Manager Summary" quarterly report.

- The current investment strategy is well diversified, with target allocations of approximately 54% allocated to growth assets, 39% to income assets, and 8% to protection assets.
- As of September 30, 2025, the Fund's allocation comprised approximately 54% growth assets, 30% income assets, and 15% protection assets.
- Significant commitments have already been made to private markets. Deviations between current and strategic allocations are expected to diminish as private market mandates draw capital.
- Since the 2022 actuarial valuation, the Fund has implemented minor strategic adjustments, including:
    - Aligning with the government's May 2025 "Fit for the Future" consultation response, aiming to pool assets by the March 31, 2026 deadline.
    - Supporting the Fund's climate and responsible investment objectives.

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Asset Liability Modelling details

Asset Liability Modelling methodology

Asset Liability Modelling allows the Fund to better understand the level of funding risk associated with different funding and investment plans and make a more informed decision.

At a high-level, the methodology for Asset Liability Modelling is:

- Assets and benefits are projected forward from the valuation date under 5,000 different simulations for future market and economic conditions. A summary of the 5,000 simulations is set out in Appendix 2 of this report.
- For each simulation (of which there are 5,000 per funding plan modelled), we calculate the funding position annually throughout the projection period.
- The assumptions underlying the funding position are set out in the 'Data and Inputs' section of this report.
- We rank the 5,000 simulations from best to worst and we plot the outcomes graphically.

We can then compare the range of outcomes and risk metrics with other investment and funding plans modelled.

When comparing plans, we focus on two key risk metrics:

The "likelihood of success" metric shows the percentage of simulations that meet the funding objective at the end of the funding time horizon

The "risk of regret" metric shows the percentage of simulations which result in the funding plan needing to be revised (either through a change in investment strategy or increasing contribution rates) at the 2028 valuation (ie the percentage of simulations for which the likelihood of success in 2028 is no longer above the Fund's threshold of 70%)

Further detail on these metrics are set out on the following pages.

For further technical detail on the Asset Liability Modelling approach please see Appendix.

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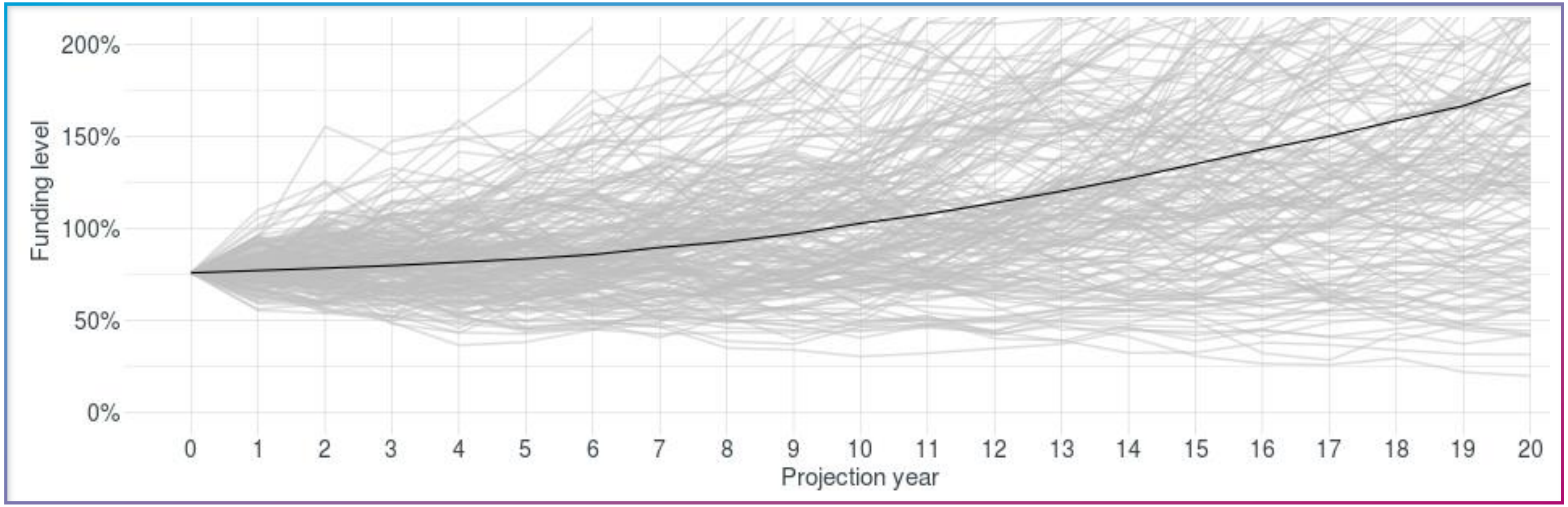
Likelihood of success

The chart below shows a sample of the 5,000 simulations for a certain funding plan tested. Each simulation projects the employers'/fund's assets and liabilities under a potential future outcome for investment returns, inflation and interest rates, allowing us to calculate the funding level over the period. Doing this 5,000 times then provides a range of future funding levels to analyse.



Simulations where the funding objective (of being at least 100 funded) is met

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The likelihood of success is the percentage of the 5,000 simulations that meet the funding objective at the end of the employer's funding time horizon
Under the current funding strategy criteria, the minimum acceptable likelihood of success is 70%

Risk of regret

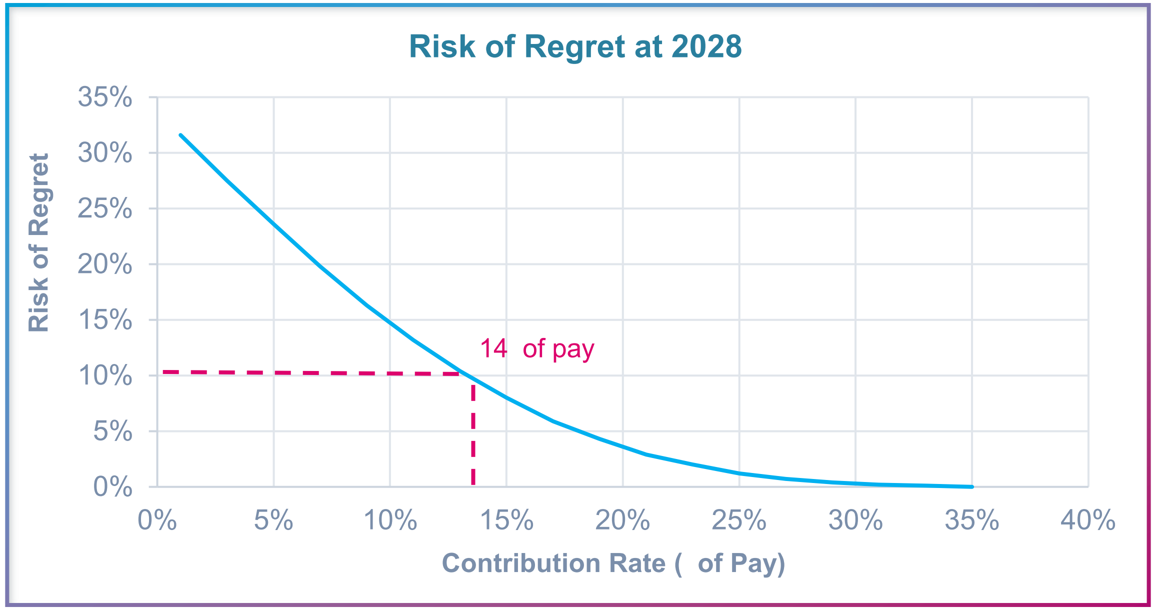
As well as understanding if a funding plan will be successful, it is also important to assess the level of potential downside risk. As the LGPS is an open, long-term scheme, most employers' primary focus will be on contribution rates. Therefore, a key question that needs considered is:

"If the contribution rate is set at a particular level now, what is the likelihood that it will need to increase at the next valuation?"

We refer to this as the "risk of regret". To measure this risk we model a selection of contribution rates (keeping investment strategy the same) which are fixed. We then analyse the model at 31 March 2028 to see how many of the 5,000 simulations do not meet the current funding strategy criteria (of having a 70 likelihood of being 100 funded at the end of a 20 year time horizon). In these simulations, we assume that the funding plan would need adjusted which will typically be done by increasing the contribution rate (but could also be achieved by a change of investment strategy).

So, if a funding plan had a 10 risk of regret, then there is a 10 chance that this plan would have an insufficient likelihood of success of achieving funding strategy criteria at 31 March 2028 and potentially require the contribution rate to be increased (or the investment strategy to be changed)

The chart on the right shows, for a sample fund/employer, how the risk of regret varies by contribution rate paid.



In this example, a contribution rate of 14 of pay has a 10 risk of regret. As the contribution rate increases, the risk of regret decreases (and vice versa).

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The risk of regret measures the risk of having to raise the contribution rate (or change investment strategy) at the next valuation.
Comparing different funding plans on this metric will be helpful for understanding the relative level of downside risk.

Index Linked Gilts

Role of Index Linked Gilts:

- Index-linked gilts (ILGs) provide substantial duration exposure, which helps align assets with long-term pension liabilities and stabilises funding levels.
- ILGs offer direct inflation protection, matching liabilities that are sensitive to inflation and safeguarding the real value of pension payments.
- ILGs act as a hedge against long-term inflation risk, supporting the scheme's ability to meet future inflation-linked benefit promises.

Current Market Views:

- Index-linked gilts are benefiting from a slightly more supportive backdrop, with weaker growth and higher inflation making them more attractive from a fundamental perspective. Ten-year real yields have climbed to around 1.7% pa in Q3, which is attractive relative to our assessed fair value.
- However, the technical environment is becoming more challenging, partly due to the global AI investment boom, which is increasing competition for capital and pushing real yields higher. As a result, the outlook is balanced between nominal and index-linked gilts: nominal gilts offer slightly better valuation, but index-linked gilts have stronger fundamental support.

How does Investment Grade (IG) Credit differ?

Duration & Yield: Provides duration exposure and an additional yield over government bonds.
No Inflation Protection: Does not offer direct inflation linkage, making it less effective for inflation-sensitive liabilities.
Tight Spreads: Current credit spreads are historically tight, limiting the potential for further yield enhancement.

Contrary to IG Credit, Index-linked gilts offer robust inflation protection and liability matching.
IG credit can enhance yield and duration but lacks inflation protection and currently faces tight spreads.

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Fixed Interest Gilts

Role of Fixed Interest Gilts:

- Fixed interest or nominal gits (Gilts) provide substantial duration exposure, which helps align assets with long-term pension liabilities and stabilises funding levels.
- Unlike ILGs they do not offer direct inflation protection, but their fixed nature can provide additional benefits in deflationary environments and add to diversification within a portfolio of protection assets.
- Inflation pricing can also at times be expensive and therefore an allocation to Gilts alongside ILGs can provide relative value opportunities and a lower cost way of reducing risk.

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Current Market Views:

- Ten-year yields fell 0.1% pa in 2025 to close the year at 4.5% pa – still very attractive relative to our fair value, even when allowing for persistence in term premia. Instantaneous forward yields (the gilt market's expectation of cash rates) eased to 5.9% pa at the 10-year point but remain high relative to long-term growth and inflation forecasts.
- Despite above-target near-term inflation, slightly weaker-than-potential real GDP growth means average forecast for nominal GDP growth remains within our neutral band. Interest rate cuts have anchored short-term yields, but longer-dated yields have fallen less amid heavy issuance and waning institutional demand. Ten-year yields remain "very attractive" relative to long-term growth and inflation forecasts – even allowing for some persistence in a positive "term premium".

Investment strategies modelled

We have outlined the alternative strategies considered in this strategy review. These strategies do not entail significant changes to the current investment strategy, instead they consider different factors like local investing and possible ways in which the Fund could reduce risk.

Asset Class	Current Strategy	Alt 1 - top up to illiquids	Alt 2 - equities to IG credit	Alt 3 – equities to ILG	Alt 4 - MAC to FIG
Growth	**53.5**	**51.5**	**48.5**	**48.5**	**53.5**
Global equities	41.0	38.0	36.0	36.0	41.0
Targeted return	5.0	5.0	5.0	5.0	5.0
Private Equity	7.5	8.5	7.5	7.5	7.5
Income	**38.5**	**40.5**	**38.5**	**38.5**	**36.5**
Infrastructure (inc timberland)	12.5	13.5	12.5	12.5	12.5
Property	7.5	8.0	7.5	7.5	7.5
Global credit - private debt (sub-IG)	9.5	10.0	9.5	9.5	9.5
Global credit – public debt (sub-IG)	9.0	9.0	9.0	9.0	7.0
Protection	**8.0**	**8.0**	**13.0**	**13.0**	**10.0**
Investment grade credit	3.75	3.75	8.75	3.75	3.75
Index linked gilt	3.5	3.5	3.5	8.5	3.5
Fixed interest gilt	0.0	0.0	0.0	0.0	2.0
Cash	0.75	0.75	0.75	0.75	0.75
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

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Investment strategies tested

The asset-liability modelling evaluates the Fund's investment strategy from a top-level perspective, helping to determine the optimal allocation among Growth, Income, and Protection assets to meet the Fund's long-term goals. Further analysis will examine the investment strategy's structure and establish the appropriate distribution within each asset category.

We have assessed how the likelihood of success and the risk of regret vary across different investment strategies, and identified asset allocation mixes that can achieve the desired risk-return balance under various market scenarios.

1. Increase in protection assets. Considering the Fund's current funding position, there is an opportunity to raise the allocation to protection assets while still meeting the Fund's overall objectives. We have evaluated how different approaches to increasing protection assets impact the Fund's success probability and regret risk, specifically examining whether to fund this increase solely through equities or income assets. For the equity variations we have tested a 5% shift from equities to protection as a meaningful but manageable shift out of return seeking assets reflecting the need to balance risk with expected returns to support contribution affordability. From the income to protection shift we have tested a 2% move which is broadly in line with resetting the target to the current actual allocation to MAC within income and would address concerns around allocating more capital to this strategy given it is currently under review.

2. Increase in illiquid assets. Since listed equities are a significant contributor to the Fund's returns, we have explored the benefits of further diversifying by adding illiquid income or alternative growth assets to support the Fund's return objectives.

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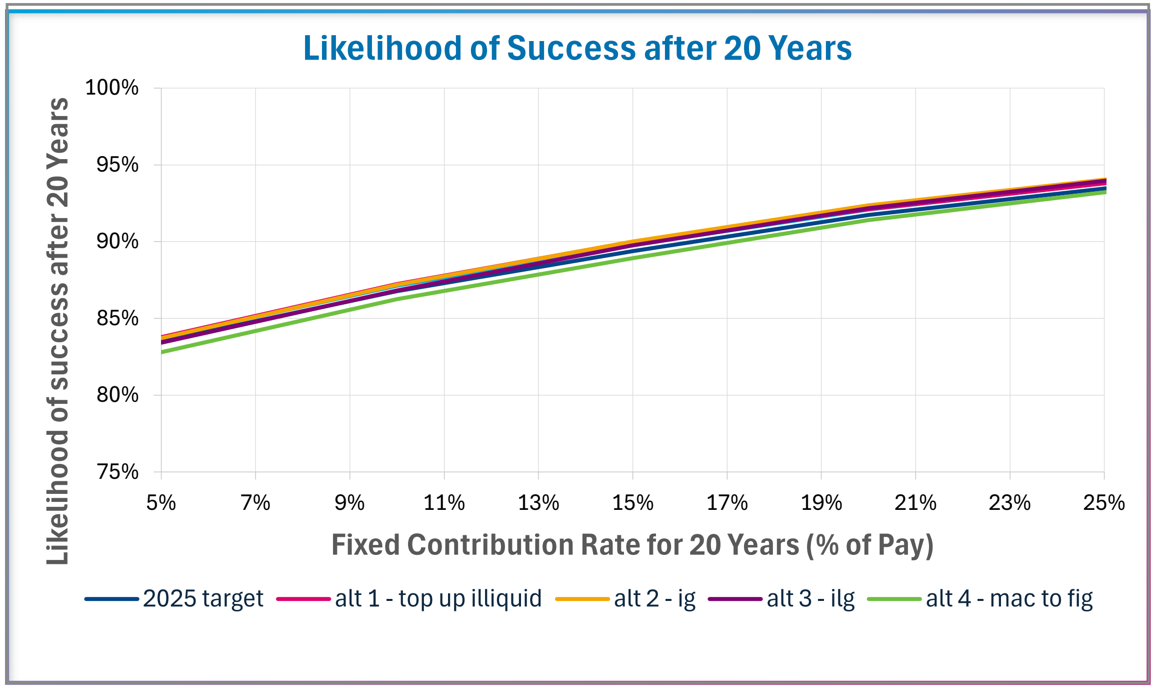
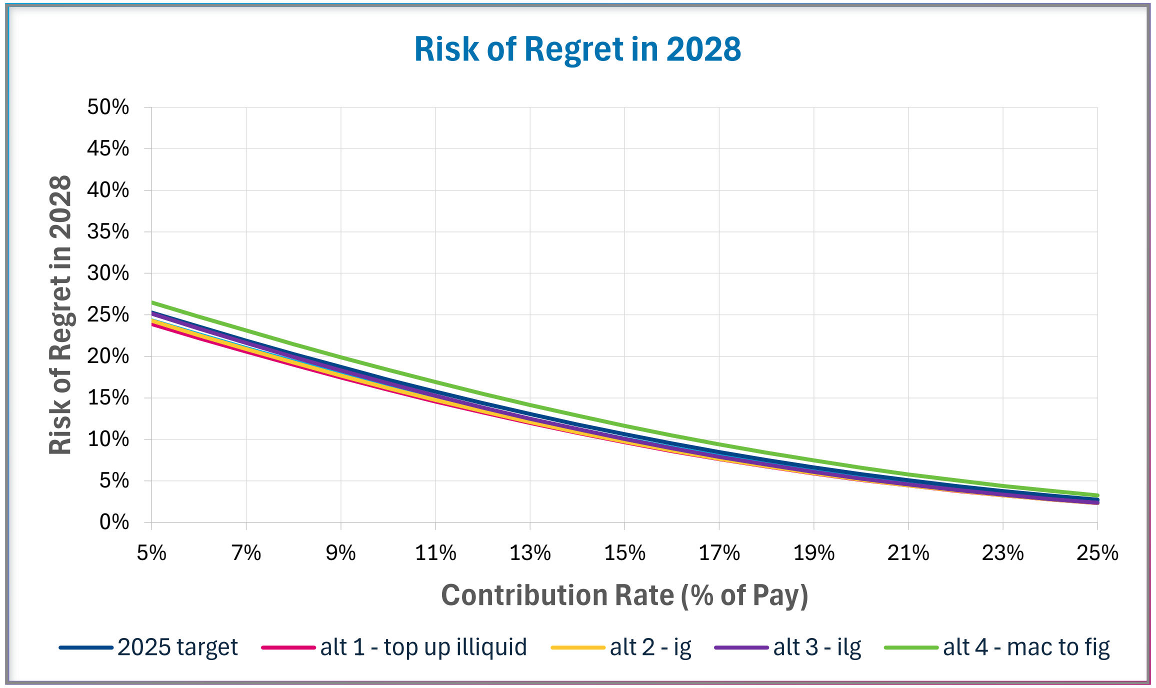
Analysis results

Investment strategy- alternative strategies comparison

Modelling details
Employer: Whole Fund
Contribution strategy: **fixed contribution rate, varied as shown**
Investment strategy: **varied as shown**
Funding strategy criteria: current
Funding assumptions: current
Economic scenario (ESS assumptions): **Core**

Observations: The modelling results show that likelihood of success and risk of regret are similar if the Fund were to adopt any of the alternative investment strategies that have been modelled.





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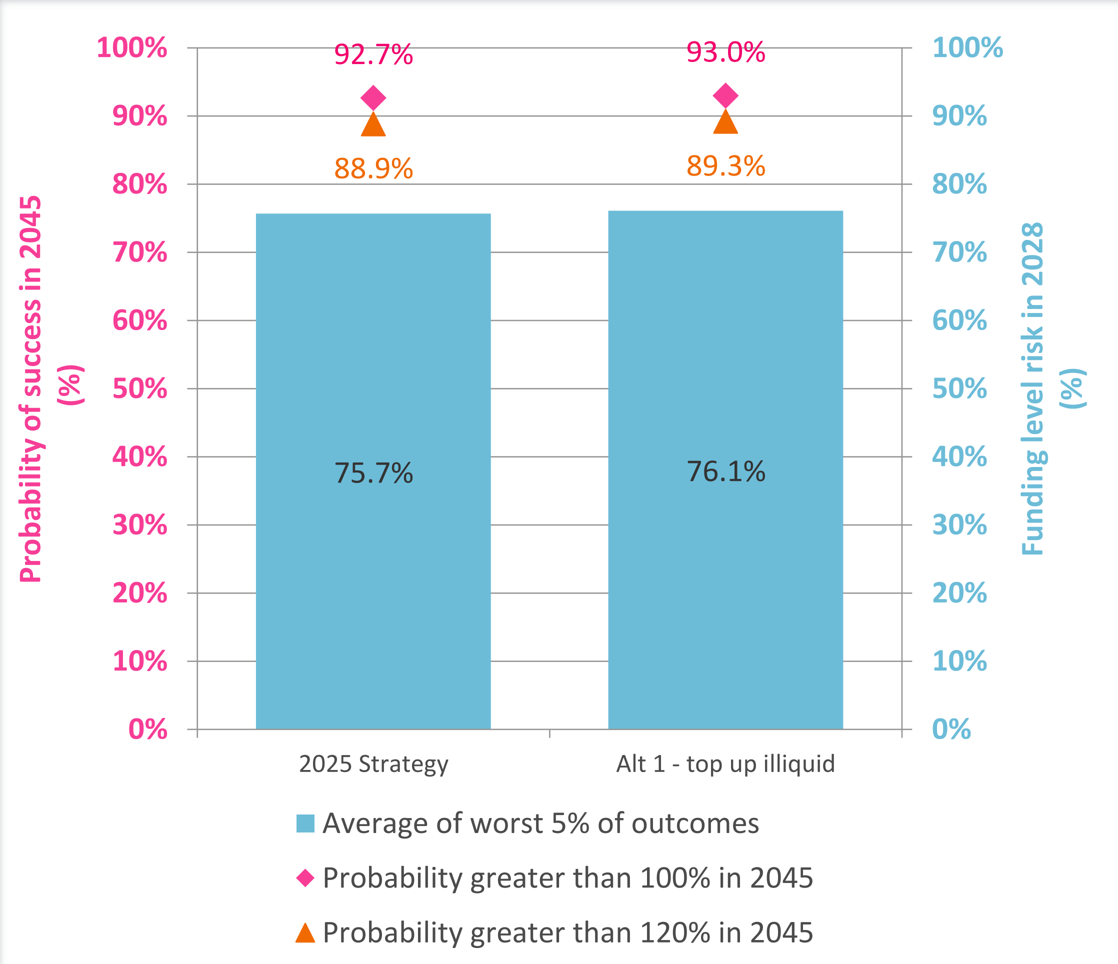
Illiquid alternative strategy

The analysis assumes an average contribution rate of pay at 22% throughout the projection period, though in reality, contributions may fluctuate, impacting funding outcomes accordingly.

The chart on the right illustrates the following:

- Both the current strategy and alt 1 (top up to illiquids) shows a high probability that the funding level will exceed 100% in 20 years under the current investment approach (indicated by the pink diamond on the chart).
- Looking at the more stringent success measure of greater than 120% funded (indicated by the orange triangle in the chart), the probability of success has been minimally impacted.
- Despite the strong funding position, there remains a possibility for the funding level to drop to as low as 76% in the average of the worst 5% of scenarios.
- While the current strategy is well-positioned to achieve the Fund's objectives there are benefits from a success and risk perspective further diversifying the portfolio.
- Alt 1, considers an increase allocation to Local assets (split across private markets). Whilst this strategy doesn't change the dial by too much, liquidity constraints should be considered before implementing such strategies.
- **The current allocation to private markets remain underweight relative to target, we therefore do not recommend increasing the allocation to illiquid assets at this stage.**
- **We recommend incorporating local within the current private market targets.**



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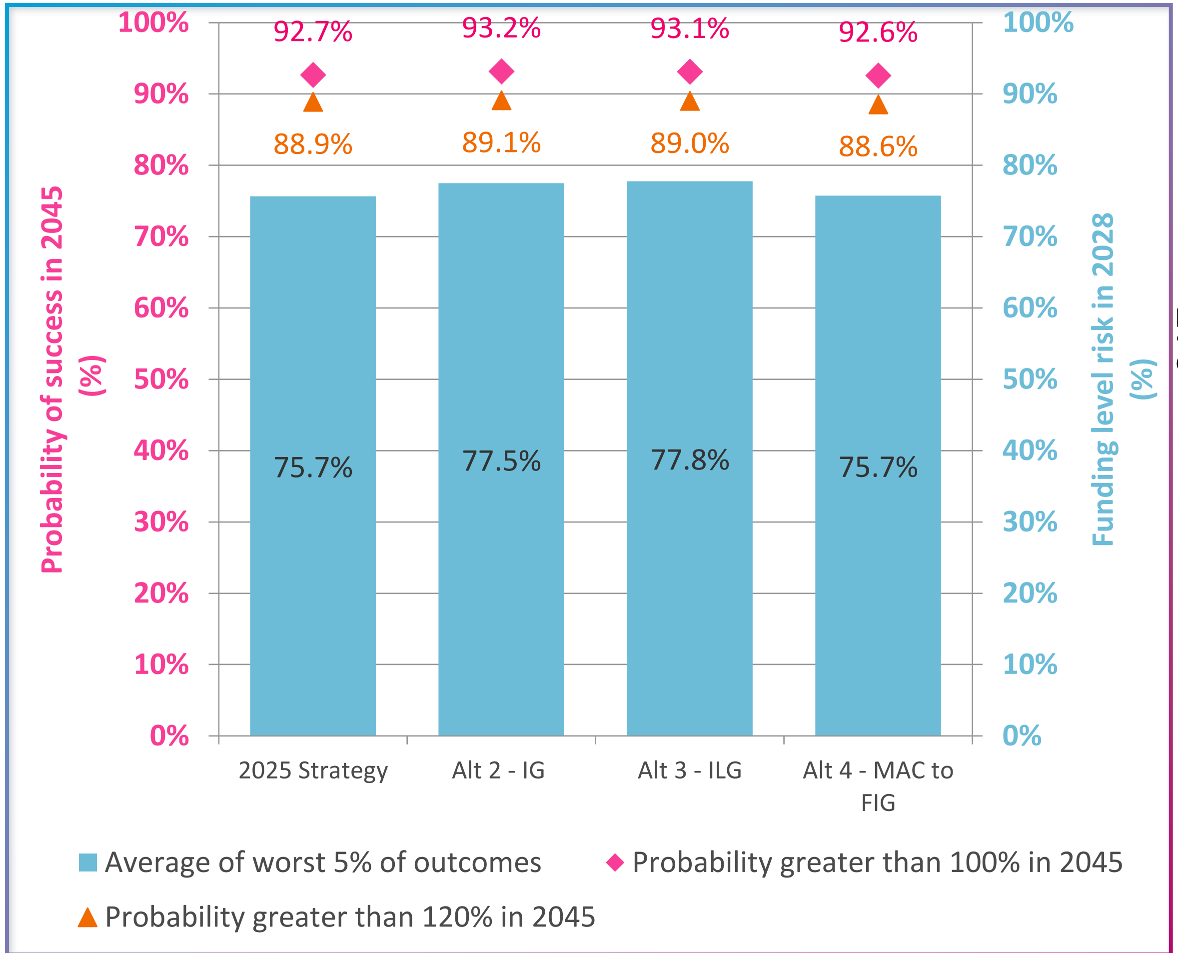
De-risked alternative strategies

- Similarly to the previous slides compared to the current long-term target, a strategy with a greater focus on investments in more liquid credit solutions (alt 2) has a subtle impact on both success and risk characteristics.
- Equally alt 3, moving from equities to index linked gilts, has a slight impact on both success and risk characteristics.
- Alt 4 also has a high probability of success and provides a slight improvement in downside risk and slight reduction in success.
- Looking at the more stringent success measure of greater than 120% funded (indicated by the orange triangle in the chart), the probability of success has been minimally impacted.
- Despite the strong funding position, there remains a possibility for the funding level to drop to as low as 76-78% in the average of the worst 5% of scenarios across the variations tested.
- **The difference in both success and risk metrics from an increased allocation to protection assets are relatively small and all of the options presented are viable strategies. If the current equity allocation were to be maintained an increase to protection assets funded from income (Alt 4) could be implemented without material impact on outcomes.**



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Return vs risk

	Projected 20 year Return, median (% p.a.)	Risk (1 yr volatility)
2025 Strategy	4.1	16.4
Alt 1 - top up to private market assets	4.1	16.3
Alt 2 – Investment Grade credit	4.0	15.3
Alt 3 – Index Linked Gilts	3.9	15.2
Alt 4 - MAC to Fixed Index Gilt	4.0	16.3

Source: Hymans, ESS calibration as at 30 September 2025
** Annualised medium return relative to liabilities (20 years)*

- The current strategy and all the strategies modelled contain relatively high probabilities of success.
- Alternative strategy 1 maintains the current expected return with a slightly lower level of risk. However, liquidity risk, which is factored to the ALM will be higher and further consideration should be taken in order to meet benefit obligations.
- The remaining strategies slightly reduce the expected return for the Fund, which is understandable given the lower allocation to either equity or MAC, into protection. However, they did impact short term volatility to some extent.
- Despite this and given the Fund's strong funding position (i.e. the Fund does not need to seek additional return) we would be supportive of an increase to protection assets.
- The Fund currently holds both IG credit and ILG within the portfolio and we have reviewed IG credit in more detail.
- The index-linked gilts solution used by the Fund is medium dated. **The Fund does not have an explicit target to nominal gilts which we also believe provide attractive protection characteristics, however pooling requirements should be considered before implementing.**

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Strategic risks

We have already discussed some of the economic, demographic and political risks that the Fund is exposed to. There are a several additional strategic risks that the Fund needs to be cognisant of:

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Geopolitical

- **How could this materialise:** Increased physical conflict between regions; cyber attacks and escalation of tariffs / trade wars
- **How would this impact the Fund:** These actions would introduce heightened levels of market volatility and would likely lead to higher levels of inflation and lower economic growth in the short term.
- **How is this mitigated:** Diversification across asset classes and within asset classes (i.e. different styles of equity investing). Allocation to assets that provide inflation protection (property, infrastructure, inflation linked bonds). Low allocation to Emerging markets. Planned increase in protection assets.
- **What else could the Fund consider:** Exploring allocation to gold for its protection characteristics.
- The Fund have explored an allocation to gold over the past few years – no immediate action required

Climate

- **How could this materialise:** increase in natural disasters (physical risk); impact on assets failing to evolve (transition risk) and litigation risk
- **How would this impact the Fund:** Possibility of stranded assets and meaningful loss of value. Lower earnings potential for some sectors. However, clear investment opportunities.
- **How is this mitigated:** Diversification across asset classes and within asset classes. Allocation towards assets that will benefit from transition, i.e. Climate Opportunity Fund, infrastructure and specific equity funds.
- **What else could the Fund consider:** Further increasing allocation to climate-tilted mandates.
- Further details and recommendations on climate are included in the 2026 high-level review

Illiquidity

- **How could this materialise**: Collapse of private markets or meaningful slowdown in exit activity or sell off in listed assets mean portfolio becomes skewed.
- **How would this impact the Fund**: Limited liquid assets available to meet benefit outgo requirements. Possibility to have to sell assets at distressed prices via secondary market.
- **How is this mitigated**: Diversification across private market asset classes and monitoring of current allocation relative to illustrative maximum allocation. Ability to adjust annual commitment amounts.
- **What else could the Fund consider**: Altering annual commitments and types of private markets being targeted.
- This has been incorporated into the Fund’s current process – no action required.

Summary

Implementation considerations - Fit for the future

- The government have outlined nine buckets that all fund's assets should fit into.
- We have made an initial attempt to summarise the current mandates into the 9 buckets in the table below.
- The Fund will need to engage with Central on the requirements and preferences within each of these strategic groupings which would include considerations around regional focus, liquidity and RI alignment.
- The strategy to Local investment would also need to be considered as part of these preferences and requirements.
- **The Fund has bucketed targeted return mandates under "other alternatives" consistent with LGPS Central's approach.**
- **We believe targeted return remains suitable for inclusion in the Fund's portfolio, however consideration is required on implementation with the Pool.**

Asset class	Mandate	Comments
Listed equities	Global equities	Invested across L&G and LGPSC
Private equity	Private Equity	Majority of new commitments with LGPSC. Legacy assets will be need to be transferred to the Pool
Private credit	Private Debt	New commitment made to the latest vintage of the Private debt funds – legacy assets will need to be transferred to the Pool.
Infrastructure	Infrastructure (unlisted)	Top ups have been made to the Core/Core + funds, with a further £100m to be invested. Mandates outside the pool will need to be transferred
Property / real estate	Property	A review of the property mandates was completed in 2025 – a plan is in place regarding the property holding
Other alternatives	Targeted Return	Fund invested across two mandates – engagement with the Pool on Fund's preferences
Credit	Multi Asset Credit	The Fund is invested in LGPSC MAC and has earmarked capital once further due diligence has completed on the new manager
	Investment grade credit	Fund invested across two mandates – engagement with the Pool on Fund's preferences
UK government bonds	Index-Linked/Fixed Gilts	Pool options currently being developed – engagement required
Cash	Cash	*No comment*

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Investment strategy summary

- The Fund's investment strategy has been structured to invest in assets that can generate a positive real return to meet past service and future service costs. The strategy is designed to provide high levels of diversification and offer sufficient liquidity to navigate various market conditions. **Given elevated levels of volatility, this reiterates the importance of maintaining a diversified strategy that offers good levels of liquidity.**
- Cashflow management is becoming increasingly important given the necessity to balance multiple objectives – for example, having liquid assets readily available to meet capital calls from the Fund's private markets program whilst ensuring that pensions can be paid under the new contribution arrangement.
- The modelling shows that altering the investment strategy to increase the protection allocation will not meaningfully impact the success or risk metrics and therefore **all of the options presented are viable strategies.**
- We are proposing some changes that are relatively modest but still represent a meaningful change in allocations and risk exposures which should be considered over time in line with the Fund's long term investment perspective. **We believe a 2% move from MAC to protection assets provides a better balance of risk and return, reflects ongoing liquidity requirements, uncertainty around revisions being made to the LGPSC MAC solution, attractive current market outlook for gilts and can be implemented efficiently given current underweight in actual allocation to MAC.**
- There are various strategic risks that are not captured within the asset liability modelling output. **It is important to monitor climate risk and liquidity risk to ensure that the Fund can achieve its stated long-term objectives.**
- The recent government pooling consultation and the requirement to pool all Fund assets by March 2026 means that engagement and alignment with the Pool is very important. **Understanding how the Fund's legacy private market assets will be transitioned will be a key focus area over the next 12 months.**

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Investment strategy next steps

We recommend:

1) **The Fund maintains a meaningful allocation to listed growth equity assets** to ensure that the Fund retains access to liquid assets that can generate a positive real return. This allocation is complemented by alternative growth assets / illiquid income assets offering diversification as well as positive real return potential.

2) **The Fund incorporates Local investing within the current private market buckets and target 1% local investing across private debt, private equity, infrastructure and property.**

3) **The Fund considers an increase to protection assets from 8% to 10%** to further diversify the strategy and take advantage of attractive yield levels currently available in the market.

    a) Considering practical implementation, this allocation can be funded through MAC allocation, which remains underweight to target and given recent developments within the fund, we are comfortable reducing this allocation broadly inline with the current actual allocation.

    b) The specific assets used to achieve the protection allocation will depend upon market conditions at the point of implementation and discussions with LGPSC on what options will be offered to best meet the Fund's requirements

Asset Class	Current Strategy	Proposed allocation	Tolerance range (+/-%)	Local Investing
Growth	**53.5**	**53.5**	**51.75 - 56.75**	
Listed equities	41.0	41.0		-
Other alternatives (targeted return)	5.0	5.0	+/- 2.5	-
Private equity	7.5	7.5		
Income	**38.5**	**36.5**	**34.5 - 38.5**	
Infrastructure (inc timberland)	12.5	12.5		1%
Property	7.5	7.5		
Private credit	9.5	9.5	+/- 2.0	
Credit liquid MAC	9.0	7.0		-
Protection	**8.0**	**10.0**	**8.0-12.0**	**-**
Credit IG credit	3.75	3.75		-
UK Government Bonds**	3.5	5.5	+/- 2.0	-
Cash*	0.75	0.75		-
Total	**100.0**	**100.0**		

* Currency hedge collateral ** Includes new proposed +2% allocation to fixed interest gilts

Thank you

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Reliances and limitations

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Reliances and limitations

Cashflows

In projecting forward the evolution of the Scheme, we have used estimated cashflows generated using our actuarial valuation system, based on information provided as part of the March 2022 actuarial valuation of the Fund including the LGPS Regulations updated for membership data at March 2024.

Except where stated, we do not allow for any variation in actual experience away from the demographic assumptions underlying the cashflows. Variations in demographic assumptions (and experience relative to those assumptions) can result in significant changes to the funding level and contribution rates. We allow for variations in inflation (RPI or CPI as appropriate), inflation expectations (RPI or CPI as appropriate), interest rates and asset class returns. Cashflows into and out of the Scheme are projected forward in annual increments, are assumed to occur in the middle of each year and do not allow for inflation lags. Investment strategies are assumed to be rebalanced annually.

There are a number of different types of increases applied before and after retirement to benefits payable from the Fund. We have made some assumptions when modelling the various types of increases. In particular the Fund Actuary assumes a fixed CPI assumption based on the ESS in the benefit cashflows provided whereas the ALM assumes an RPI-CPI gap of broadly 1% p.a. before 2030, and 0% p.a. post-2030. All else being equal this will result in the value of the ALM liabilities being slightly different than in the cashflow run.

We have estimated future service benefit cashflows and projected salary roll for new entrants after the valuation date such that the payroll remains constant in real terms (i.e. full replacement). There is a distribution of new entrants introduced at ages between 25 and 65, and the average age of the new entrants is assumed to be 40 years. All new entrants are assumed to join and then leave service at SPA, which is a simplified set of assumptions compared to the modelling of the existing membership. The base mortality table used for the new entrants is an average of mortality across the LGPS and is not client specific, which is another simplification compared to the modelling of existing members. Nonetheless, we believe that these assumptions are reasonable for the purposes of the modelling given the highly significant uncertainty associated with the level of new entrants.

In modelling some of the LGPS benefits, we have assumed:

- Salary growth is assumed to have a floor of 0% and to be modelled in line with inflation plus (or minus) any additions applied.
- S148 salaries / national average earnings is assumed NOT have a floor and is projected in line with our projections of national average earnings and valued in line with inflation plus any additions applied.
- Non-accruing and accruing CARE benefits increase in line with CPI (no floor).

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Reliances and limitations

Investment strategy and contributions

The investment strategies and contributions modelled have been agreed as part of the scoping process and documented above.

The most important assumption for the assets is which asset class to use for each of the assets. We have therefore agreed this during the scoping stage and further details are in the 'What we have modelled' section.

Investment strategy is likely to change with significant changes in funding level, but unless stated otherwise we have not considered the impact of this in order to focus on the high-level investment strategy decision.

The returns that could be achieved by investing in any of the asset classes will depend on the exact timing of any investment/disinvestment, the costs associated with buying or selling these assets and liquidity of the asset classes. The model implicitly assumes that all returns are net of fees and ignores these other factors.

Unless stated otherwise, we have assumed that all contributions are made and not varied throughout the period of projection irrespective of the funding position. In practice the contributions are likely to vary especially if the funding level changes significantly.

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Reliances and limitations

Economic Scenario Service

The distributions of outcomes depend significantly on the Economic Scenario Service (ESS), our (proprietary) stochastic asset model. This type of model is known as an economic scenario generator and uses probability distributions to project a range of possible outcomes for the future behaviour of asset returns and economic variables. Some of the parameters of the model are dependent on the current state of financial markets and are updated each month (for example, the current level of equity market volatility) while other more subjective parameters do not change with different calibrations of the model.

Key assumptions include:

- The average excess equity return over the risk free asset and its volatility which affects growth asset returns
- The level and volatility of yields, credit spreads, inflation and expected (breakeven) inflation, which affect the projected value placed on the liabilities and bond returns.
- The gap between CPI and RPI. The market for CPI-linked instruments is not well developed and this is based on our judgement. Expected long-term RPI and CPI rates are in line with the current Bank of England targets. The RPI-CPI wedge, that is the average difference between projected RPI and CPI rates, is set to 1% p.a. over the short-term ultimately transitioning to zero after early 2030, when the RPI measure will switch to CPIH.
- The output of the model is also affected by other more subtle effects, such as the correlations between economic and financial variables.
- Real interest rates are assumed to (on average) gradually trend towards a long-term rate. This is based on a selection of yield normalisation levels (which can be interpreted as representing low, medium and high economic growth scenarios) reflecting the fundamental uncertainty around long-term average yield levels. Higher long-term yields would mean a lower value placed on liabilities and hence an improvement in the current funding position (and vice versa) unless the Scheme is fully hedged. The Expected Rate of Returns and Volatilities table below details the direction of interest rate movements based on the current calibration of the ESS.

While the model allows for the possibility of scenarios that would be extreme by historical standards, including very significant downturns in equity markets, large systemic and structural dislocations are not captured by the model. Such events are unknowable in effect, magnitude and nature, meaning that the most extreme possibilities are not necessarily captured within the distributions of results.

A summary of economic simulations used is included further on in this document. We would be happy to provide fuller information about the scenario generator, and the sensitivities of the results to some of the parameters, on request.

Expected rates of return and volatilities

The following figures have been calculated using 5,000 simulations of the Hymans Robertson Economic Scenario Service, calibrated using market data as at 31 March 2024. All returns are shown net of fees. Percentiles refer to percentiles of the 5,000 simulations and are the annualised total returns over 5, 10 and 20 years, except for the yields which refer to the (simulated) yields in force at that time horizon.

		Annualised total returns																				
		Cash	Index Linked Gilts (medium)	Index Linked Gilts (long)	Fixed Interest Gilts (short)	Fixed Interest Gilts (medium)	Fixed Interest Gilts (long)	Private Equity	Property	Emerging Market Debt (local currency)	Unlisted Infrastructure Equity	Diversified Growth Fund (low equity beta)	Multi Asset Credit (sub inv grade)	All World Equity GBP Unhedged	Asset Backed Securities (A rated) GBP	Direct Lending (private debt) GBP Hedged	Corporate Bonds (A rated, short duration)	Inflation (RPI)	17 year real yield (RPI)	Inflation (CPI)	17 year real yield (CPI)	17 year yield
5 years	16th %'ile	3.1%	0.9%	0.4%	3.3%	1.6%	0.9%	-2.8%	-0.2%	-1.1%	1.3%	3.0%	2.5%	-0.3%	3.3%	3.0%	3.4%	2.3%	0.4%	1.3%	0.5%	3.7%
5 years	50th %'ile	3.9%	3.8%	3.8%	3.9%	3.7%	3.7%	12.1%	6.4%	5.7%	8.1%	5.3%	5.3%	8.0%	4.6%	7.2%	4.7%	3.9%	1.3%	2.8%	1.4%	4.8%
5 years	84th %'ile	4.7%	7.0%	7.5%	4.4%	5.9%	6.4%	27.1%	13.8%	13.0%	15.4%	7.5%	7.9%	16.2%	5.8%	11.2%	5.6%	5.4%	2.3%	4.4%	2.3%	6.0%
10 years	16th %'ile	2.9%	1.6%	1.5%	3.5%	3.1%	2.6%	0.9%	1.6%	0.9%	2.9%	3.6%	4.0%	1.9%	3.4%	4.7%	3.8%	1.5%	0.2%	1.0%	0.2%	3.2%
10 years	50th %'ile	3.9%	3.6%	3.8%	4.1%	4.3%	4.4%	11.8%	6.6%	5.9%	8.1%	5.4%	5.9%	8.0%	4.7%	7.5%	4.9%	3.2%	1.5%	2.6%	1.4%	4.6%
10 years	84th %'ile	5.1%	5.9%	6.3%	4.7%	5.5%	6.0%	22.7%	11.9%	11.3%	13.6%	7.3%	7.7%	14.0%	6.2%	10.1%	5.8%	4.9%	2.7%	4.2%	2.7%	6.3%
20 years	16th %'ile	2.6%	1.9%	2.0%	3.3%	4.0%	3.9%	4.0%	3.0%	2.5%	4.2%	3.8%	4.8%	3.5%	3.3%	5.9%	3.9%	1.1%	-0.5%	0.8%	-0.5%	1.6%
20 years	50th %'ile	4.0%	3.6%	3.7%	4.2%	4.8%	4.9%	11.7%	6.7%	6.3%	8.2%	5.5%	6.4%	8.0%	4.9%	7.9%	5.1%	2.7%	1.2%	2.37%	1.2%	3.5%
20 years	84th %'ile	5.7%	5.4%	5.5%	5.5%	5.5%	6.0%	19.5%	10.7%	10.3%	12.3%	7.5%	8.0%	12.8%	6.7%	10.0%	6.5%	4.3%	2.9%	4.0%	2.9%	6.1%
	Volatility (Disp) (1 yr)	0%	7%	8%	2%	6%	7%	31%	16%	14%	14%	5%	7%	16%	3%	11%	3%	1%		1%		

The current calibration of the model indicates that a period of inward nominal yield movement is expected. For e.g., over the next 20 years our model expects the 17-year maturity annualised nominal interest rate to fall from 4.43% to 3.54%.

The corresponding market implied forward rate is 4.25% over 20 years.

The current calibration of the model indicates that a period of outward real yield movement is expected. For e.g., over the next 20 years our model expects the 17-year maturity annualised real interest rate to rise from 0.82% to 1.17%.

The corresponding market implied forward rate is 1.27% over 20 years.

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