

**SURREY COUNTY COUNCIL****SURREY PENSION FUND COMMITTEE****DATE: 8 SEPTEMBER 2023****LEAD OFFICER: ANNA D'ALESSANDRO, DIRECTOR OF FINANCE, CORPORATE AND COMMERCIAL****SUBJECT: INVESTMENT MANAGER PERFORMANCE AND ASSET/LIABILITIES UPDATE****SUMMARY OF ISSUE:**

This report is a summary of manager issues for the attention of the Pension Fund Committee (Committee), as well as an update on investment performance and the values of assets and liabilities.

**RECOMMENDATIONS:**

It is recommended that the Committee:

- 1) Notes the main findings of the report in relation to the Fund's valuation and funding level, performance returns and asset allocation.

**REASON FOR RECOMMENDATIONS:**

To assess and acknowledge performance of the Fund's investment managers against the Fund's target returns, and whether it is meeting its Strategic Investment objective.

**DETAILS:****Funding Level**

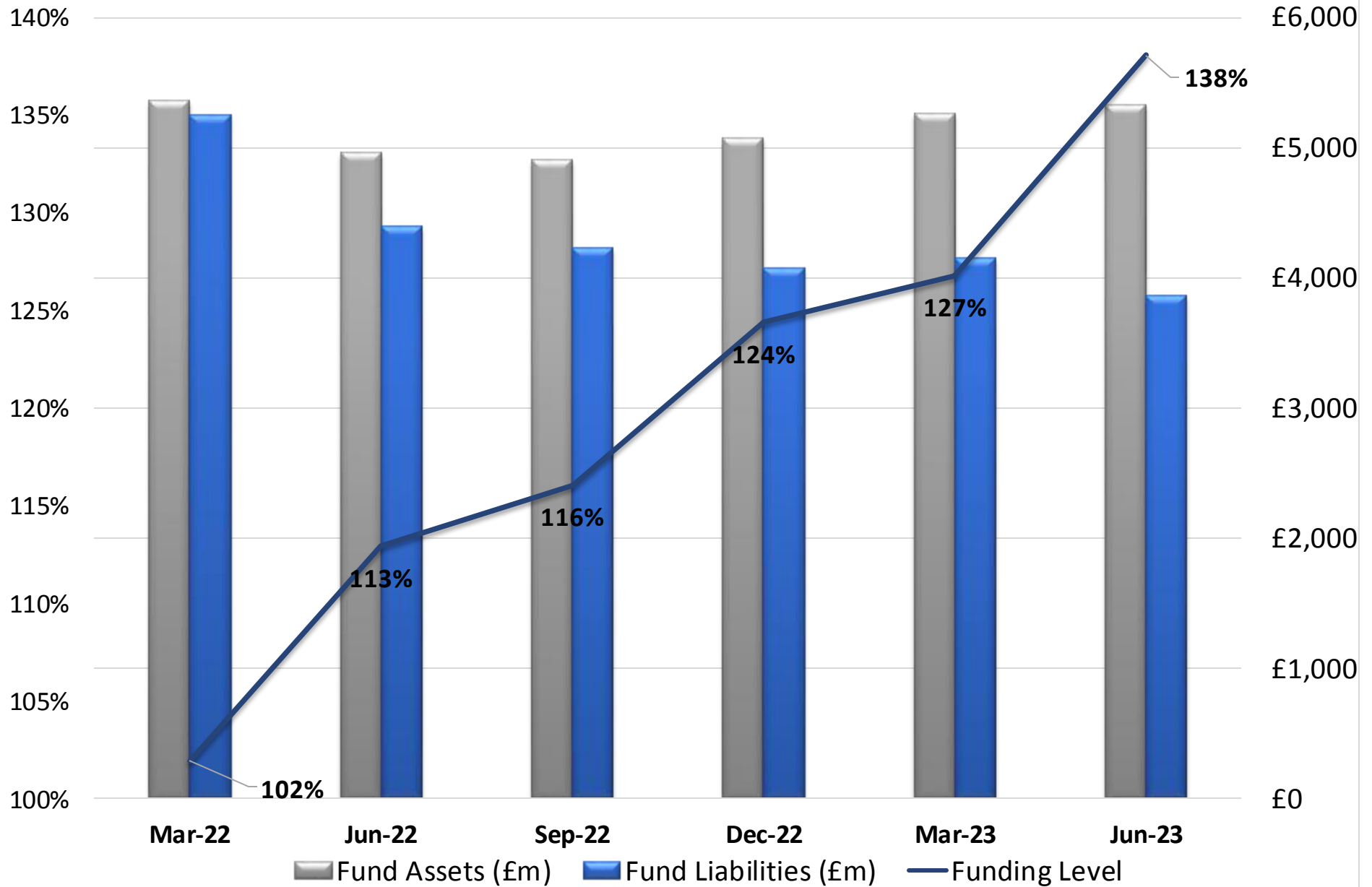
1. The funding level is derived as the ratio of the value of the Fund's assets to the value of its liabilities. The Fund's liabilities are the future benefit payments due to members in respect of their service accrued in the Fund. The Fund's assets are used to pay member benefits accrued to date.
2. For the purpose of providing the quarterly funding updates following the 2022 valuation, it is appropriate (and the Fund Actuary's recommendation) that the 70% level of prudence remains fixed in the determination of the discount rate. This 'dynamic' discount rate each quarter-end would therefore reflect the change in investment return expectations since the 2022 valuation date.
3. Assessing the liabilities using the 'dynamic' discount rate also ensures that the factors leading to a change in asset values are being reflected in liability values. There is not a direct relationship (ie assets and liabilities do not react in the exact same way to changes in market conditions) but measuring the liabilities using the 'dynamic' discount rate means that the assets and liabilities are being measured on a consistent market basis over time.

#### 4. Results and assumptions

|                               | 31 March 2022 | 31 March 2023 | 30 June 2023 |
|-------------------------------|---------------|---------------|--------------|
| Assets (£m)                   | 5,358         | 5,260         | 5,330        |
| Past service liabilities (£m) | 5,257         | 4,150         | 3,860        |
| <b>Surplus (£m)</b>           | <b>101</b>    | <b>1,110</b>  | <b>1,470</b> |
| Funding level                 | 102%          | 127%          | 138%         |
| <b>Assumptions</b>            |               |               |              |
| Discount Rate                 | 4.4%          | 6.0%          | 6.5%         |
| Salary Increases              | 3.7%          | 3.3%          | 3.3%         |
| Pension Increases             | 2.7%          | 2.3%          | 2.3%         |
| Likelihood of success         | 70%           | 70%           | 70%          |

5. The discount rate assumptions at each date are based on the return expected from the Fund's assets with a 70% likelihood, ie based on our asset return expectations as at 30 June 2023, there is a 70% likelihood that the Fund's assets will generate returns over the next 20 years at the level of at least 6.5% per annum.
6. The funding level has increased since that reported at the 2022 valuation. Liability values have fallen since 31 March 2022 by c. 30% due to an increase in the assumed level of future investment returns (the discount rate) which has been driven, in part, by a significant rise in long dated gilts yields over the period from 31 March 2022 to 30 June 2023. The value of the assets at 30 June 2023 is broadly similar to that as at 31 March 2022. The net position has improved from a surplus of £0.1bn at 31 March 2022 to a surplus of £1.5bn at 30 June 2023.
7. The graph below shows that funding level has reached 138% (102% as at 31 March 2022), updated for market conditions at 30 June 2023. The market value of assets is approximately £5.3bn and the value placed on the liabilities is £3.9bn.

### Surrey Pension Fund Quarterly Summary



8. Global equities rose over the quarter to end June 2023, led by the technology sector, amid optimism that US inflation may continue to fall without a significant rise in unemployment.
9. US equities performed strongly, with gains almost entirely driven by mega-cap technology stocks amid enthusiasm over artificial intelligence. Japan was the best-performing major equity market in local currency terms as the yen weakened, which benefited exporters. Returns in Europe were lower, although still positive, as the business surveys fell to contractionary levels. The manufacturing purchasing managers' index looked particularly bleak at 43.4, indicating its sharpest deterioration since May 2020. UK equities were negative over the quarter, as the UK market is heavily weighted towards commodity companies, which performed poorly.
10. US inflation fell to 4.0% in May, helped by lower oil prices over the previous 12 months, whilst GDP grew by 2.0%, well above forecasts, and the labour market remained tight. Against this relatively strong economic backdrop, US Federal Reserve indicated more monetary tightening was to come from the current level of 5.25%. Inflation is tending to be stickier in Europe and in response the European Central Bank increased its main refinancing rate to 4%, whilst the Bank of England took the base rate to 5%.
11. Global government bond yields rose (and so prices fell) over the period. Benchmark 10-year yields in the UK, US, Germany and Japan all ended the quarter higher. Ten-year gilt yields surged a full percentage point, from 3.38% to 4.39%, as UK inflation surprised to the upside, with headline inflation flat at 8.7% in May and core inflation rising to 7.1%. Expectations of higher rates for longer pushed bond yields up. Yield increases for US treasuries and German bunds were more modest. In Japan, the 10-year yield rose from 0.33% to 0.40%. The Bank of Japan kept its key short-term interest rate unchanged at -0.1% and maintained its yield curve control policy to keep government bond yields low, increasing the divergence between rates in Japan and those of other developed markets.
12. Yields on global credit rose over the quarter, reflecting the economic data and market reactions noted above. Credit spreads tightened in the US and UK and widened in the eurozone.
13. Sterling rose against the US dollar, the euro and the Japanese yen as UK inflation surprised to the upside, raising expectations that rates will stay higher for longer and the 75bp hike in rates over the period brought interest rates more into line with those in the US.

14. Overall, the Fund returned 1.55% in Q1 2023/24 (April-June 2023), in comparison with the benchmark of 2.28%.
15. The best absolute performance came from the global equity mandates and in particular Newton, which returned 5.8% on an absolute basis and 2.5% relative to benchmark. Disappointingly, other actively managed equity mandates were behind benchmark, although still nicely ahead over one year, except Listed Alternatives, which continues to perform poorly. The over exposure to investments listed in the UK and the widening of discounts to net asset value for investment trusts negatively impacted returns here.
16. Alternative investments were unable to keep pace with the rallying equity market which was mainly driven by technology companies in the US, and hence underperformed their benchmarks. The BCPP Multi-Asset Credit (MAC) fund also underperformed as the market rallied due to being positioned more defensively and with slightly higher quality than the benchmark average.

## Fund Performance - Summary of Quarterly Results

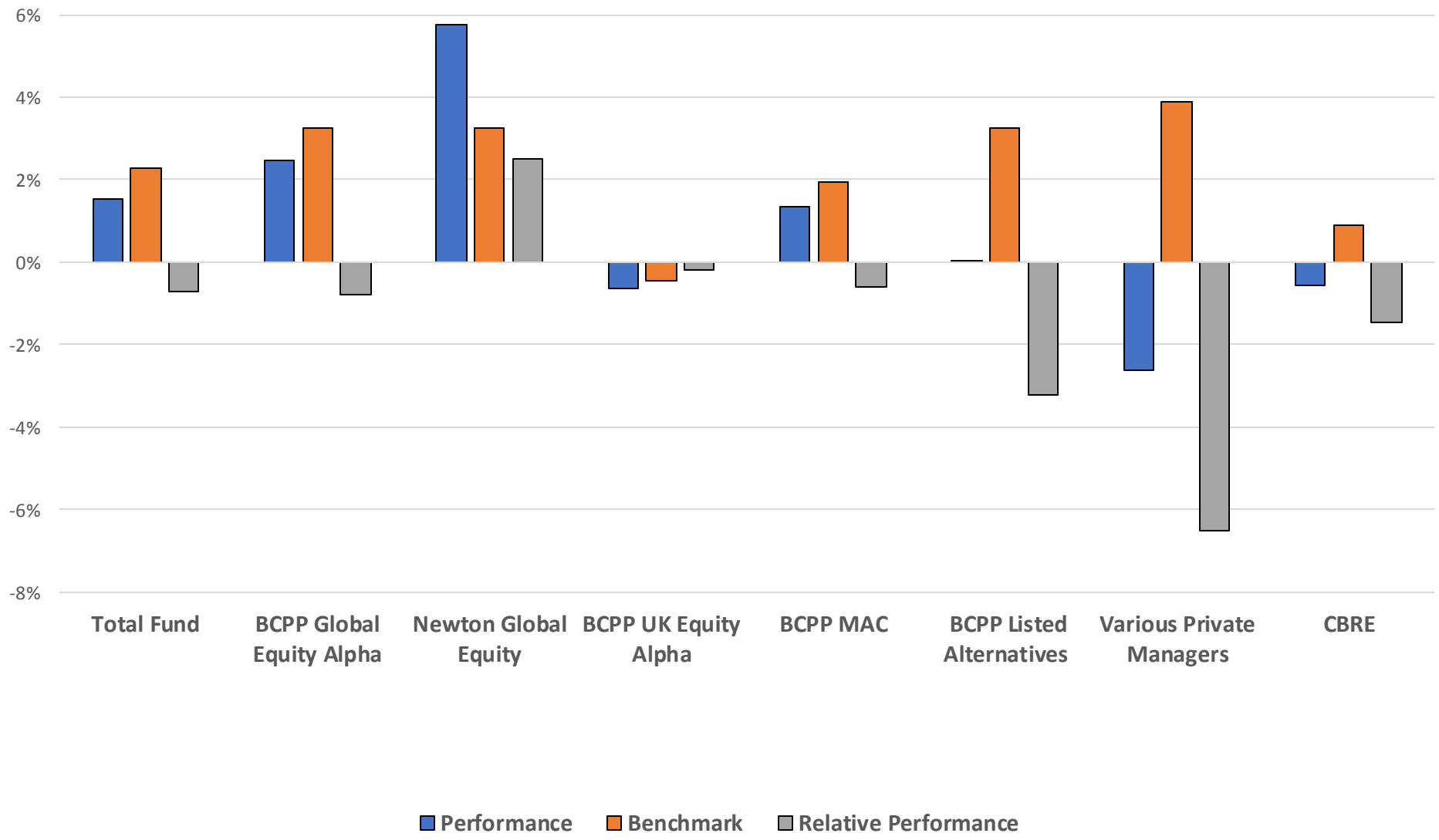
The table below shows manager performance for Q1 2023-24 (March-June 2023), net of investment manager fees, against manager specific benchmarks using Northern Trust data.

| As at 30 Jun2023                      |                | 3M          |           |                      | 1Y          |           |                      | 3Y          |           |                      |
|---------------------------------------|----------------|-------------|-----------|----------------------|-------------|-----------|----------------------|-------------|-----------|----------------------|
| Asset Class                           | £m             | Performance | Benchmark | Relative Performance | Performance | Benchmark | Relative Performance | Performance | Benchmark | Relative Performance |
| <b>Total Fund</b>                     | <b>5,351.3</b> | 1.55%       | 2.28%     | -0.72%               | 6.97%       | 6.94%     | 0.03%                | 6.82%       | 6.81%     | 0.01%                |
| <b>Active Global Equity</b>           | <b>1,277.1</b> |             |           |                      |             |           |                      |             |           |                      |
| BCPP Global Equity Alpha              | 757.8          | 2.47%       | 3.26%     | -0.79%               | 15.92%      | 11.31%    | 4.61%                | 11.77%      | 9.94%     | 1.83%                |
| Newton Global Equity                  | 519.3          | 5.77%       | 3.26%     | 2.51%                | 15.39%      | 11.31%    | 4.08%                | 10.23%      | 9.94%     | 0.29%                |
| <b>Active Regional Equity</b>         | <b>408.9</b>   |             |           |                      |             |           |                      |             |           |                      |
| BCPP UK Equity Alpha                  | 408.9          | -0.65%      | -0.46%    | -0.19%               | 11.46%      | 7.89%     | 3.57%                | 8.94%       | 10.02%    | -1.08%               |
| <b>Passive Global Equity</b>          | <b>1,092.6</b> |             |           |                      |             |           |                      |             |           |                      |
| LGIM - Future World Global            | 1,092.6        | 3.67%       | 3.73%     | -0.06%               | 12.04%      | 12.30%    | -0.26%               |             |           |                      |
| <b>Passive Regional Equity</b>        | <b>382.9</b>   |             |           |                      |             |           |                      |             |           |                      |
| LGIM - Europe Ex-UK                   | 53.2           | 0.32%       | 0.07%     | 0.25%                | 18.91%      | 18.47%    | 0.44%                |             |           |                      |
| LGIM Emerging Markets                 | 270.3          | -1.92%      | -2.08%    | 0.16%                | -3.41%      | -3.62%    | 0.21%                | 2.33%       | 2.19%     | 0.14%                |
| LGIM - Japan                          | 16.4           | 3.01%       | 2.94%     | 0.07%                | 12.57%      | 12.12%    | 0.45%                |             |           |                      |
| LGIM - Asia Pacific ex-Japan          | 43.0           | -2.35%      | -2.35%    | 0.00%                | 2.85%       | 2.80%     | 0.05%                |             |           |                      |
| <b>Fixed Income</b>                   | <b>683.0</b>   |             |           |                      |             |           |                      |             |           |                      |
| BCPP MAC                              | 567.8          | 1.36%       | 1.95%     | -0.59%               | 6.36%       | 6.75%     | -0.39%               |             |           |                      |
| LGIM Gilts *                          | 115.3          | -5.12%      |           |                      | -15.39%     |           |                      | -9.19       |           |                      |
| <b>Private Markets Proxy</b>          | <b>201.4</b>   |             |           |                      |             |           |                      |             |           |                      |
| BCPP Listed Alternatives              | 201.4          | 0.02%       | 3.26%     | -3.24%               | -2.44%      | 11.31%    | -13.76%              |             |           |                      |
| <b>Private Markets</b>                | <b>820.0</b>   |             |           |                      |             |           |                      |             |           |                      |
| Various Private Managers              | 820.0          | -2.61%      | 3.90%     | -6.51%               | 4.06%       | 13.21%    | -9.15%               | 9.09%       | 11.11%    | -2.03%               |
| <b>Real Estate</b>                    | <b>306.0</b>   |             |           |                      |             |           |                      |             |           |                      |
| CBRE                                  | 306.0          | -0.57%      | 0.91%     | -1.48%               | -14.75%     | -17.12%   | 2.37%                | 3.30%       | 3.77%     | -0.47%               |
| <b>L&amp;G Currency Overlay</b>       | <b>21.7</b>    |             |           |                      |             |           |                      |             |           |                      |
| <b>Total Cash &amp; Equivalents**</b> | <b>157.6</b>   |             |           |                      |             |           |                      |             |           |                      |

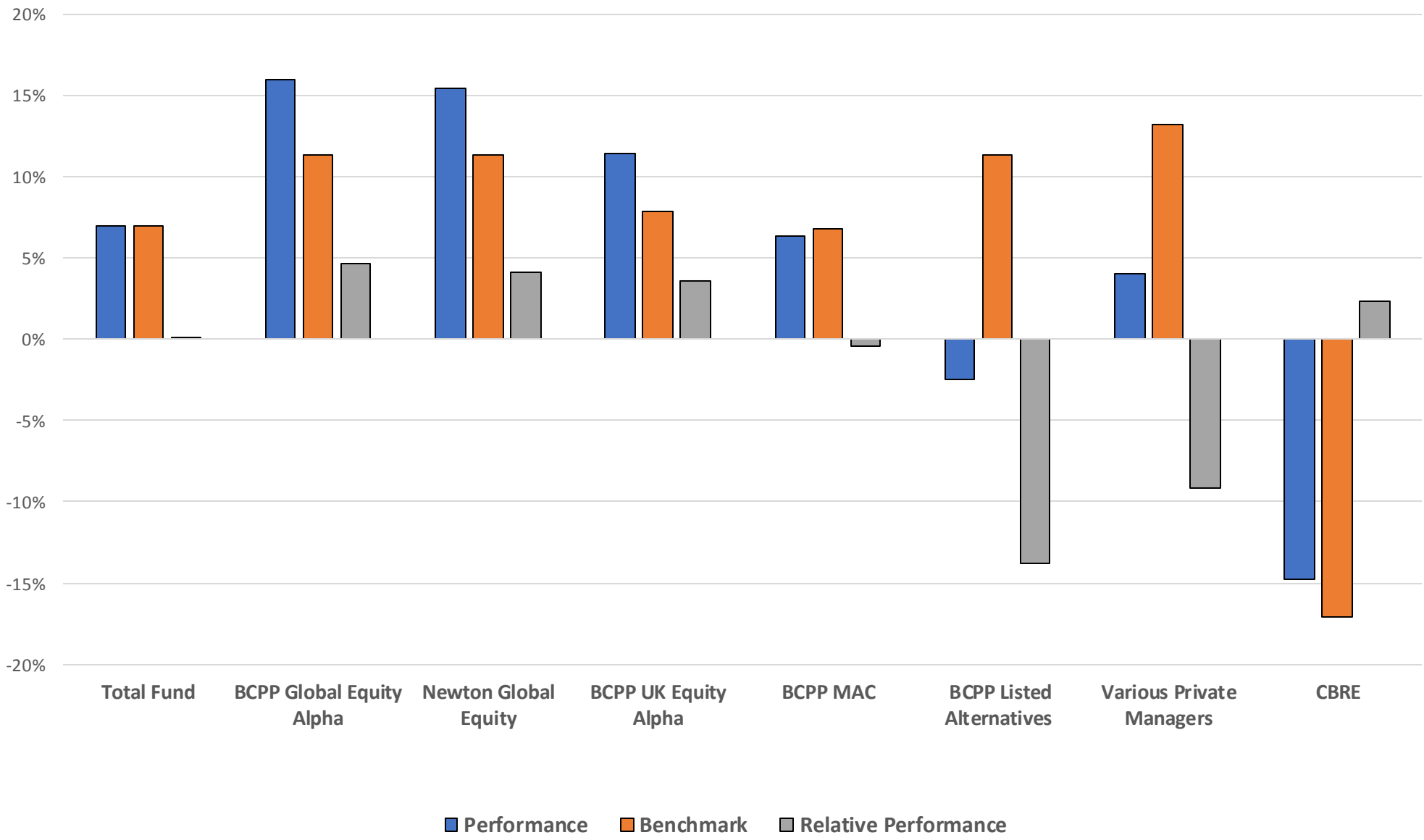
\* Performance figures represent total Bespoke Fund (3M Gilt Return -7.92%, Liquidity Return 1.65%)

\*\* Includes £32.2m of money market funds

### 3 Months to 30 June 2023 Active Manager Performance Relative to Benchmark

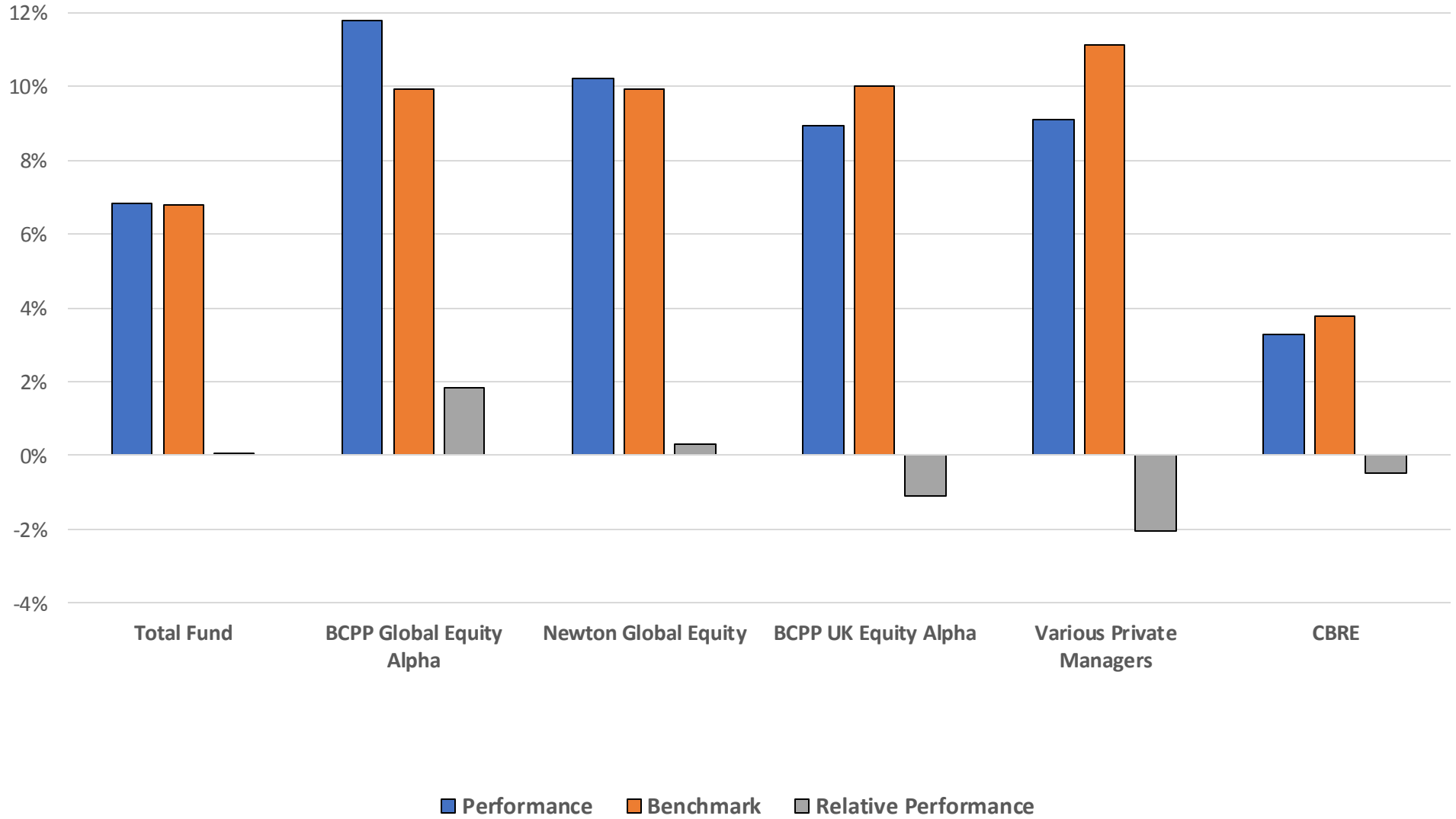


### 1 Year to 30 June 2023 Active Manager Performance Relative to Benchmark





### 3 Years to 30 June 2023 Performance Relative to Benchmark



## Recent Transactions

17. In October 2021 the Fund purchased units in the BCPP Multi-Asset Credit Fund to a value of £613.5m. This was funded from the disposal of units in the Western Multi-Asset Credit Fund and units in the Templeton Global Total Return Fund.
18. In October 2021 the Fund purchased units in the LGIM Future World Global Equity Index Fund to a value of £996m. This was funded from the disposal of units in the LGIM RAFI Multi-Factor Developed Index Fund and units in the LGIM MSCI World Low Carbon Target Index Fund.
19. In February 2022 the Fund purchased units in the BCPP Listed Alternatives Fund to a value of £386.5m. This was funded from the disposal of units in the Baillie Gifford Diversified Growth Fund, units in the Aviva Investors Multi-Strategy Target Return Fund, and units in the Ruffer Absolute Return Fund.
20. From the second half of 2022 the Fund has used BCPP Listed Alternatives, BCPP UK Equity Alpha and LGIM Liquidity Fund as a source of funds for private market capital calls.
21. As part of the new asset allocation agreed in the December 2022 Committee meeting, a series of transactions has taken place during 2023.
22. In April 2023, the Fund invested another £100m into the LGIM Future World Global Equity Index Fund. This was funded by the redemption of £89m from the BCPP UK Equity Alpha Fund and an £11m in specie transfer out of LGIM Future World Emerging Markets Fund, which itself was an in specie transfer from the LGIM Emerging Markets Fund in March 2023.
23. In July 2023, the Fund invested £267m into the BCPP Emerging Markets Equity Alpha Fund. This was funded by the complete redemption of the Fund's remaining holding in the LGIM Emerging Markets Fund.

## Stock Lending

24. In the quarter to 30 June 2023, stock lending earned a net income for the Fund of £10,190 compared with £3,850 for the quarter ended 31 March 2023.

## Mandate Change

25. In Q4 2022/3, the investment management agreement with CBRE was amended. As discussed in the Committee meeting in December 2022, CBRE will now cease to re-invest returns of income and instead pay that income out to the Fund. Given the potential launch and Fund investment in the new BCPP real estate funds, and the potential lack of liquidity of some real estate investments, new investment commitments by CBRE will solely be made to (i) open ended funds, or (ii) funds with at least an annual redemption window.
26. The MAC Income Withdrawal plan has now been initiated with a monthly income of approximately £1.7m being returned to the Fund.

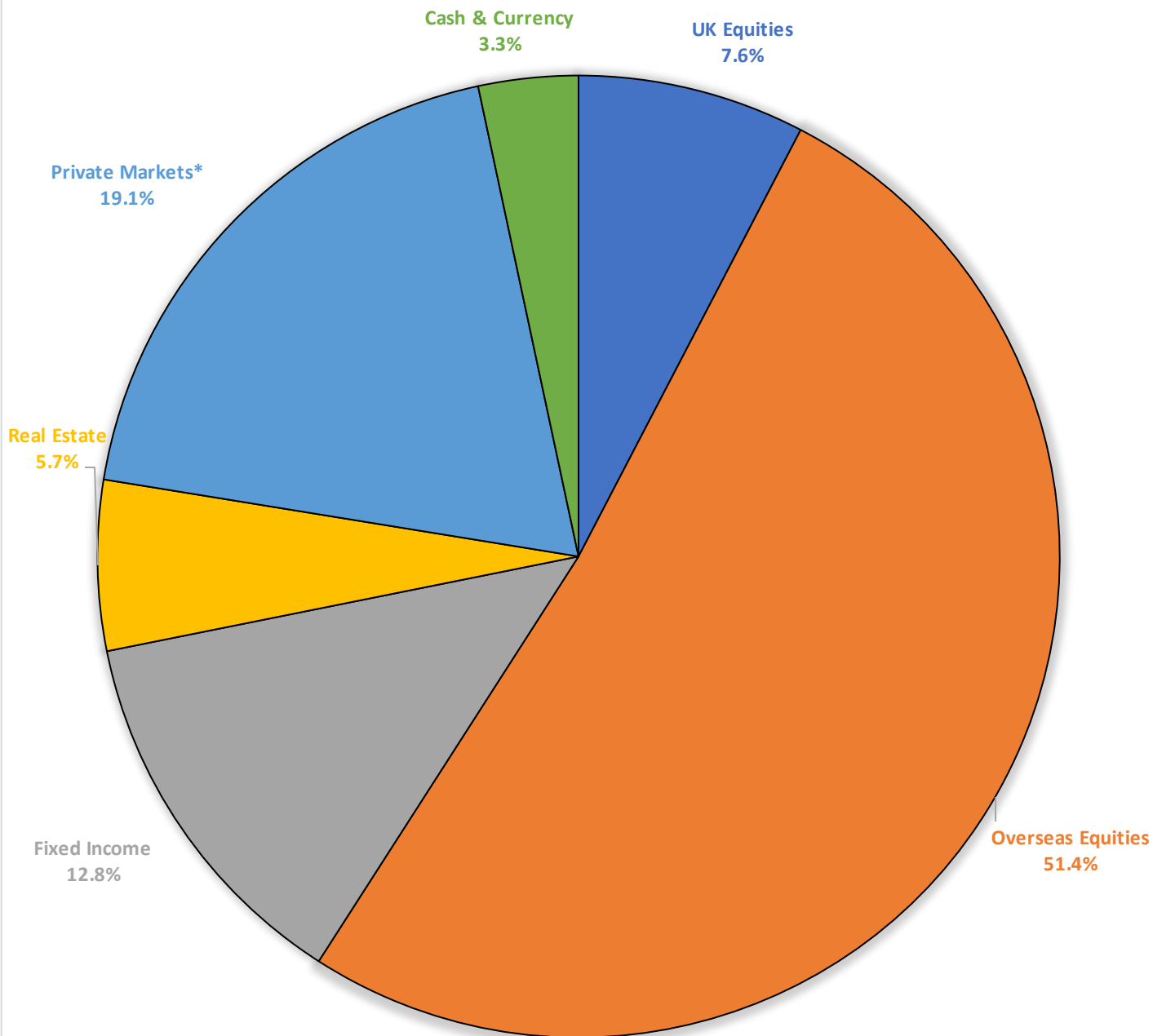
## Asset allocation

27. The table and the graph below show the target and actual asset allocations for the quarter ending 30 June 2023. These allocations were agreed by the Pension Fund Committee in the June 2023 meeting.

|                                    | Total Fund (£M) | Actual (%)   | Target (%)  | Advisory ranges %  | Role(s) within the strategy   |
|------------------------------------|-----------------|--------------|-------------|--------------------|---|
| <b>Listed Equities</b>             |                 | <b>59.1%</b> | <b>55.8</b> | <b>52.8 – 58.8</b> | Generate returns in excess of inflation, through exposure to the shares of domestic and overseas companies.   |
| UK                                 | 408.9           | 7.6%         | 6.7         |                    |   |
| Global Market Cap                  | 1,277.1         | 23.9%        | 21.8        |                    |   |
| Global Regional                    | 112.6           | 2.1%         | 2.2         |                    |   |
| Emerging Markets                   | 270.3           | 5.1%         | 5.6         |                    |   |
| Global Sustainable                 | 1,092.6         | 20.4%        | 19.5        |                    |   |
| <b>Alternatives</b>                |                 | <b>24.8%</b> | <b>27.3</b> | <b>22.3-32.3</b>   | Generate returns in excess of inflation, through exposure to illiquid assets that are not publicly traded, whilst providing some diversification away from listed equities and bonds. |
| Private Equity                     | 263.3           | 4.9%         | 5           | 2.0-8.0            |   |
| Infrastructure                     | 393.4           | 7.4%         | 6           | 3.0-9.0            |   |
| Private Debt                       | 132.3           | 2.5%         | 6           | 2.0-8.0            |   |
| Climate Opportunities              | 31.0            | 0.6%         | 3           | 0.0-6.0            |   |
| Listed Alternatives                | 201.4           | 3.8%         |             |                    |   |
| <b>Real Estate</b>                 | 306.0           | 5.7%         | 7.3         | 4.3–10.3           |   |
| <b>Multi Asset Credit</b>          |                 | <b>10.6%</b> | <b>15.1</b> | <b>12.1-18.1</b>   | Offer diversified exposure to global credit markets to capture both income and capital appreciation of underlying bonds.  |
| Multi Asset Credit                 | 567.8           | 10.6%        | 15.1        | 12.1-18.1          |   |
| <b>Fixed Interest Gilts</b>        |                 |              |             |                    | Low risk income stream  |
| Fixed Interest Gilts               | 115.3           | 2.2%         | 1.8         | 0.0-3.6            |   |
| <b>Cash &amp; Currency Overlay</b> | 179.2           | <b>3.3%</b>  |             |                    |   |
| <b>Total</b>                       | <b>5,351.3</b>  |              | <b>100</b>  |                    |   |

The graph below shows the asset allocation for the quarter ending 30 June 2023.

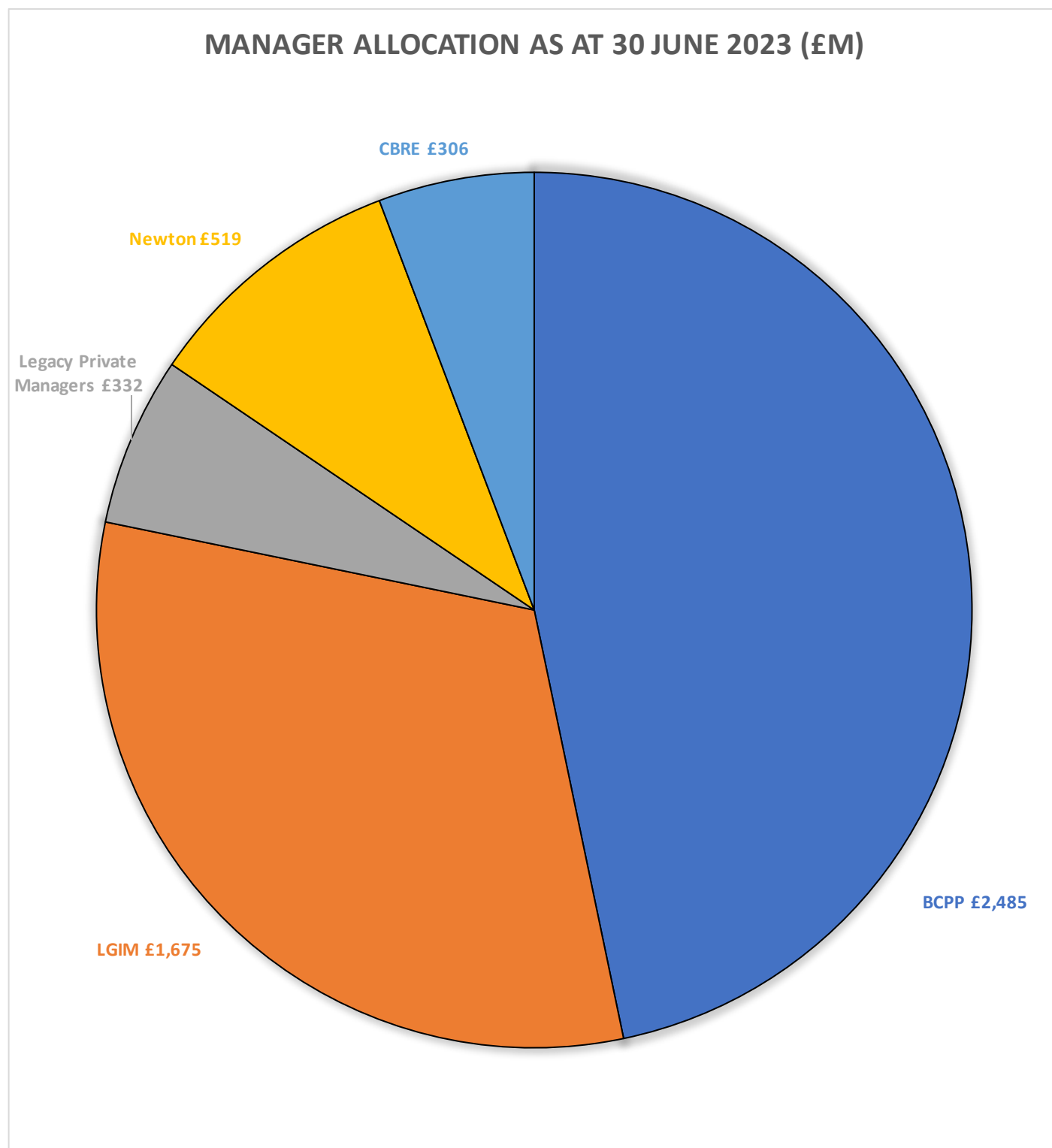
### ASSET ALLOCATION AS AT 30 JUNE 2023 (£M)



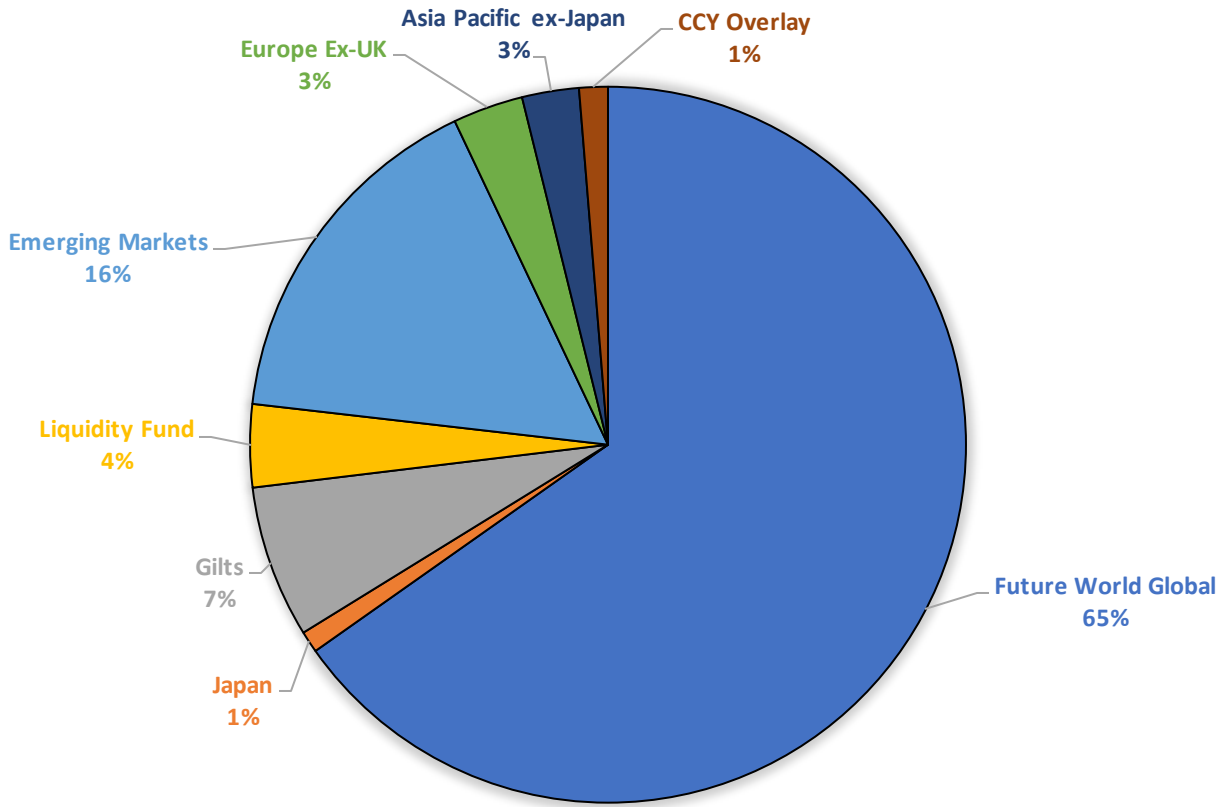
\*Includes Listed Alternatives

## Manager Allocation

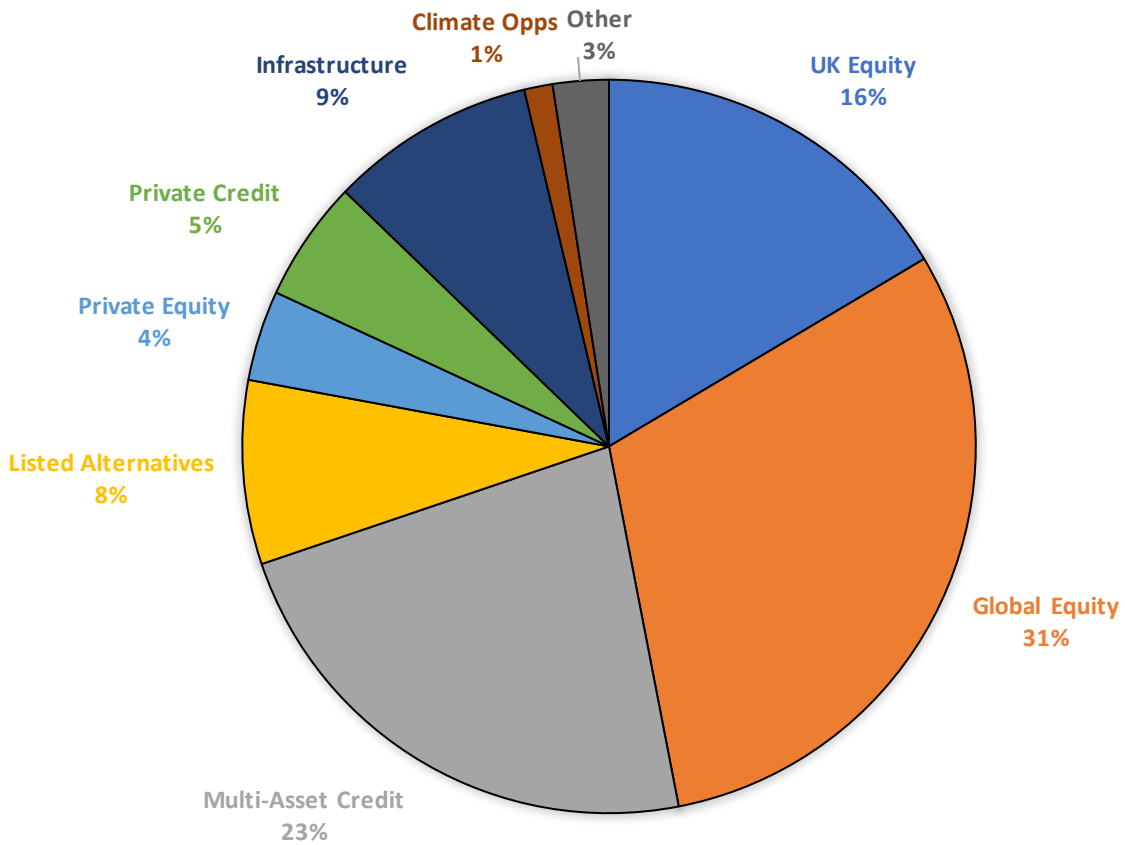
The graph below shows the manager allocation for the quarter ending 30 June 2023.



### LGIM ALLOCATION DETAIL AS AT 30 JUNE 2023



### BORDER TO COAST ALLOCATION AS AT 30 JUNE 2023



## Cashflow

28. Contributions are derived from employers and employees. Pension benefits are derived from pensions and lump sum benefits paid to retired members and benefits paid to employees on leaving the Fund.

| £m<br>Period   | Total<br>contributions<br>received | Total pension<br>benefits paid | Net cash-flow |
|--|------------------------------------|--------------------------------|---------------|
| Quarter Four<br>2022/23<br><br>(1 Jan 2023 –<br>31 Mar 2023) | 61.2                               | 56.4                           | 4.8           |
| Quarter One<br>2023/24<br><br>(1 Apr 2023 – 30<br>Jun 2023)  | 51.7*                              | 37.7*                          | 14*           |

\*Data is estimated for Q1 2023/24 as reporting in the new system Unit4 / MySurrey was not fully functional as at date of this report (25 Aug 2023).

29. An indication of the current membership trends is shown by movements in membership over quarters four and one. Member data listed below.

| Period   | Active<br>members | Deferred<br>members | Pension<br>members | Total<br>members |
|--|-------------------|---------------------|--------------------|------------------|
| Quarter Four<br>2022/23<br><br>(1 Jan 2023 –<br>31 Mar 2023) | 35,531            | 43,203              | 30,742             | 110,476          |
| Quarter One<br>2023/24<br><br>(1 Apr 2023 –<br>30 Jun 2023)  | 35,585            | 44,465              | 30,760             | 110,810          |

## Fund Manager Benchmarks

| Fund                | Portfolio       | Benchmark Index      | Performance Target relative to Benchmark |
|---------------------|-----------------|----------------------|--|
| Surrey Pension Fund | Total Portfolio | Weighted across fund | +1.0%                                    |

| Manager | Portfolio   | Benchmark Index   | Performance Target relative to Benchmark  |
|---------|---|---|---|
| BCPP    | UK Equities Alpha   | FTSE All Share  | +2.0%   |
| BCPP    | Global Equities Alpha   | MSCI ACWI   | +2.50%  |
| BCPP    | MAC   | SONIA   | +3.5%   |
| BCPP    | Listed Alternatives   | MSCI AC World Index (Net)   |   |
| BCPP    | Emerging Markets Equity Alpha   | MSCI Emerging Markets (Net)   | +2.0%   |
| Newton  | Global Equities   | MSCI AC World Index   | +2.0%   |
| Various | Private Equity  | MSCI World Index  | +5.0%   |
| CBRE    | Real Estate   | MSCI/AREF UK QPFI All Balanced Property Fund Index (for UK Assets)<br><br>Global Alpha Fund Absolute Return 9-11%   | +0.5%   |
| LGIM    | Europe ex-UK Equities<br><br>Future World Global Equity Index<br><br>Japan Equity<br><br>Asia Pacific ex-Japan Development Equity<br><br>World Emerging Markets Equity<br><br>Sterling Liquidity Fund<br><br>LGIM Bespoke | FTSE Developed Europe ex-UK Net Tax (UKPN)<br><br>Solactive L&G ESG Global Markets Net<br><br>FTSE Japan NetTax (UKPN)<br><br>FTSE Developed Asia Pacific ex-Japan NetTax (UKPN)<br><br>FTSE Emerging NetTax (UKPN)<br><br>SONIA<br><br>Fund return | To track the performance of the respective indices within a lower level of tracking deviation (gross of fees) over rolling 3-year periods |



## **CONSULTATION:**

30. The Chair of the Pension Fund Committee has been consulted on this report.

## **RISK MANAGEMENT AND IMPLICATIONS:**

31. Risk related issues have been discussed and are contained within the report.

## **FINANCIAL AND VALUE FOR MONEY IMPLICATIONS**

32. Financial and value for money implications are discussed within the report.

## **DIRECTOR CORPORATE FINANCIAL & COMMERCIAL COMMENTARY**

33. The Director Corporate Financial & Commercial is satisfied that all material, financial and business issues and possibility of risks have been considered and addressed.

## **LEGAL IMPLICATIONS – MONITORING OFFICER**

34. There are no legal implications or legislative requirements.

## **EQUALITIES AND DIVERSITY**

35. The approval of the various options will not require an equality analysis, as there is no major policy, project or function being created or changed.

## **OTHER IMPLICATIONS**

36. There are no potential implications for council priorities and policy areas.

## **WHAT HAPPENS NEXT**

37. The following next steps are planned:

- Continue to implement asset allocation restructure as agreed by the Committee in June 2023 and published in the Investment Strategy Statement.
- Continue to monitor performance and asset allocation.

### **Contact Officer:**

Lloyd Whitworth, Head of Investment & Stewardship

### **Consulted:**

Pension Fund Committee Chair

### **Annexes:**

Annexe 1 - Manager Fee Rates (Part 2)

### **Sources/background papers:**

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