SURREY COUNTY COUNCIL

SURREY PENSION FUND COMMITTEE

DATE: **15 DECEMBER 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	30 June 2023	30 September 2023
Assets (£bn)	5.36	5.33	5.29
Past service liabilities (£bn)	5.26	3.86	3.79
Surplus (£bn)	**0.1**	**1.47**	**1.51**
Funding level	102%	138%	140%
Discount Rate	4.4%	6.5%	6.8%
Salary Increases	3.7%	3.3%	3.3%
Pension Increases	2.7%	2.3%	2.3%
Likelihood of success	70%	70%	70%

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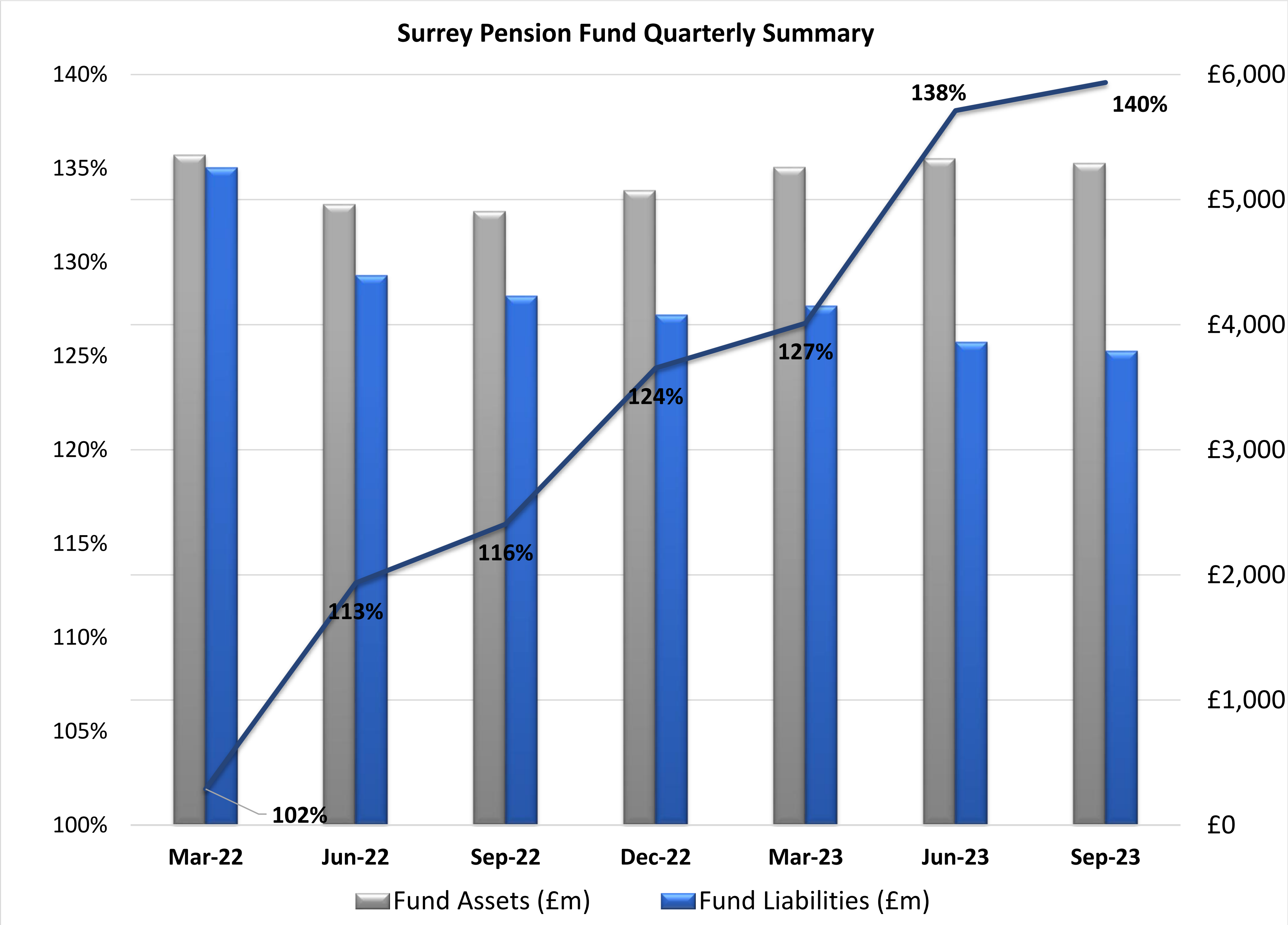
5. The discount rate assumptions at each date are based on the return expected from the Fund's assets with a 70% likelihood, ie based on the actuary's asset return expectations as at 30 September 2023, there is an 70% likelihood that the Fund's assets will generate returns over the next 20 years at the level of at least 6.8% per annum.

6. The liability values in the above table as at 30 June 2023 and 30 September 2023 make allowance for the April 2023 Pension Increase Order of 10.1%. but do not make allowance for the expected April 2024 Pension Increase Order of 6.7%. The Actuary will allow for the expected 2024 Pension Increase Order when they provide their update as at 31 December 2023. In the meantime, the Actuary can confirm that (all else being equal) a 2024 Pension Increase order of 6.7% will reduce the funding level by c. 6%.

7. The funding level has increased slightly over the quarter from 30 June 2023. Liability values have fallen due to a further increase in the assumed level of future investment returns (the discount rate). The value of the assets at 30 September 2023 is slightly lower than that reported as at 30 June 2023, due to negative asset returns over the quarter. The net position has remained broadly unchanged with a surplus of approximately £1.5bn at both the 30 June 2023 and 30 September 2023.

8. The Actuary would express caution in the interpretation of these results. The improvement in the funding level since the 2022 valuation, whilst welcome, is primarily due to an increase in the expected rate of future investment returns, i.e. the discount rate. In the absence of these higher return expectations, it is likely that the funding level would have fallen since the 2022 valuation due to higher than expected inflation experience and lower than expected asset returns. To illustrate this, the required return (the level of returns required to ensure the Fund remains 100% funded) is higher as at 30 September 2023 (4.7%) than it was as at 31 March 2022 (4.3%) i.e. higher asset returns are now required to maintain a funding level of 100%.

9. The graph below shows the development of the funding ratio since the last valuation.


Surrey Pension Fund Quarterly Summary
140%
135%
130%
125%
120%
115%
110%
105%
100%
£6,000
£5,000
£4,000
£3,000
£2,000
£1,000
£0
102%
113%
116%
124%
127%
138%
140%
Mar-22
Jun-22
Sep-22
Dec-22
Mar-23
Jun-23
Sep-23
Fund Assets (£m)
Fund Liabilities (£m)

10. Global equities retreated over the quarter ended 30 September 2023 as market expectations shifted to ‘higher-for-longer’ regarding interest rates around the world, signalling potentially slower growth and tighter credit conditions. US equities declined following a strong run that continued into the end of July. The quarter began with US inflation falling to 3% and an expectation that any further increase in interest rates would be the last. However, higher inflation in July and August, and robust economic data, such as 2.1% GDP growth in the second quarter, suggested that a sustained period of higher rates may be necessary to calm inflation. European equities fell and underperformed global equities. The European Central Bank (ECB) hiked interest rates twice over the quarter, taking the main refinancing rate to a 22-year high of 4.5%. Economic data continued to disappoint, with the manufacturing purchasing managers’ index (PMI) at 43.4 in September, signalling the fifteenth successive month of contraction. UK equities rose over the period. UK inflation continued to fall, down to 6.7% in August, although wage growth advanced to 8.5% in July, stoking concerns that higher inflation may be entrenched. The Bank of England (BoE) raised interest rates by 25 basis points in August, to 5.25%. Rising energy prices, with oil rising from $70 per barrel to over $90, were helpful for UK-listed energy companies, and a weaker pound supported the exporters. However, domestically focused areas of the market were weak. The composite PMI dropped to 46.8 in September, marking the fastest reduction in private sector output since the lockdown period of January 2021, driven by cost-of-living pressures and higher borrowing costs. Emerging markets underperformed global equities, reflecting the sentiment around US interest rates mentioned above and slowing growth and issues in the property sector in China.

11. Global government bond yields rose, and prices fell, over the third quarter of 2023. Benchmark 10-year yields in the US, Germany, UK and Japan all ended the quarter higher. Yields on the 10-year US Treasury rose significantly, from 3.81% to 4.57%, as the higher-for-longer narrative filtered into the market. At the same time, US supply of bonds increased by US$1 trillion in the third quarter to help finance the budget deficit, whilst the Federal Reserve (Fed) continued to let maturing bonds run off its balance sheet, meaning more public buyers are required. In Japan, the 10-year yield rose from 0.39% to 0.76% after the Bank of Japan increased its cap on the 10-year yield from 0.5% to 1.0%. Ten-year gilt yields, after surging in the second quarter, were more settled, rising from 4.38% to 4.44%. The third quarter of 2023 saw yields on global corporate bonds rise in the US and eurozone and decline in the UK. Credit spreads tightened.

12. The US dollar rose against the euro, sterling and yen in the third quarter. Markets priced in the divergence in both the economic outlooks and interest rate expectations between the US and elsewhere. As the ECB and BoE indicated that interest rates may be nearing a peak, US Fed. Chair, Jerome Powell, was more hawkish. Powell stated that the Fed intends to hold policy rates at a restrictive level until inflation is sustainably down. Sterling fell against the US dollar, euro and yen, reflecting a weaker domestic growth outlook.

13. Overall, the Fund returned –0.61% in Q2 2023/24 (July-September 2023), in comparison with the benchmark of 0.51%.

14. Generally during the period, companies with growth and/or quality characteristics underperformed their respective benchmarks. This negatively impacted all the actively managed equity portfolios, particularly Border to Coast Pensions Partnership (BCPP) UK Equity Alpha and Newton. BCPP UK Equity Alpha was also impacted by the exposure to UK smaller companies, which disappointed given economic concerns in the domestic market. However, the outperformance of the value elements within BCPP Global Equity Alpha were enough to generate an overall positive absolute return and relative outperformance for this fund.

15. The other areas of underperformance this quarter were BCPP Multi-Asset Credit (MAC) and BCPP Listed Alternatives. MAC is benchmarked against cash +3.5% p.a., so if market yields rise, and prices fall, over a short period, keeping up with the benchmark can be difficult. Therefore, whilst in absolute terms the fund was slightly up, it underperformed the benchmark. Listed Alternatives continues to be disappointing. Over the period, the fund was impacted by currency shifts as it is underweight dollar exposure and the dollar strengthened. The infrastructure element of the fund was also negatively impacted by its exposure to renewable energy. Valuations within the renewable energy sector have come under intense pressure as debt fuelled capital expansion plans have become less tenable in the current interest rate environment.

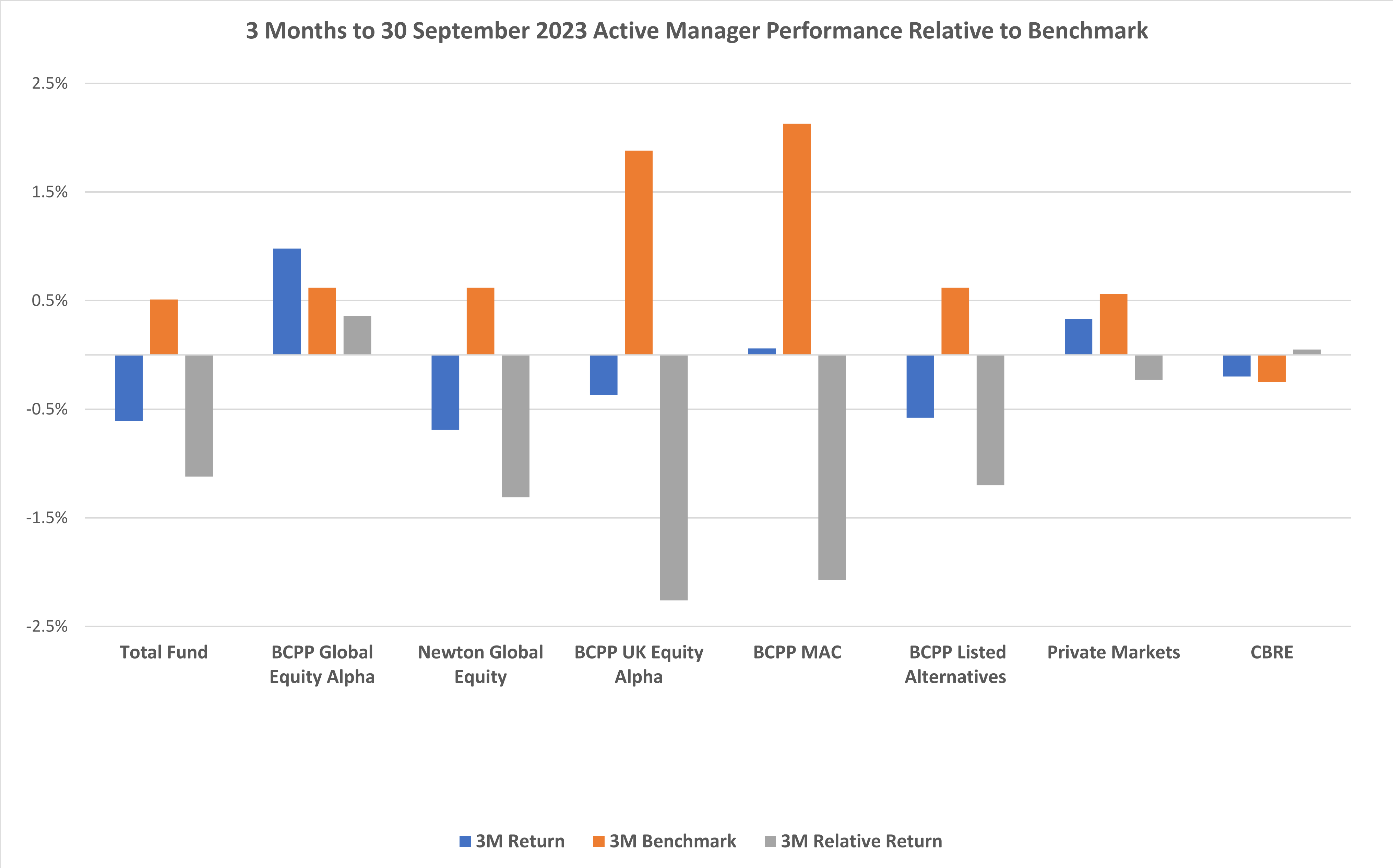
16. There was relative stability in terms of performance for both private markets and real estate. This is particularly welcome for real estate after the falls of the last 12 months in the face of rising interest rates.

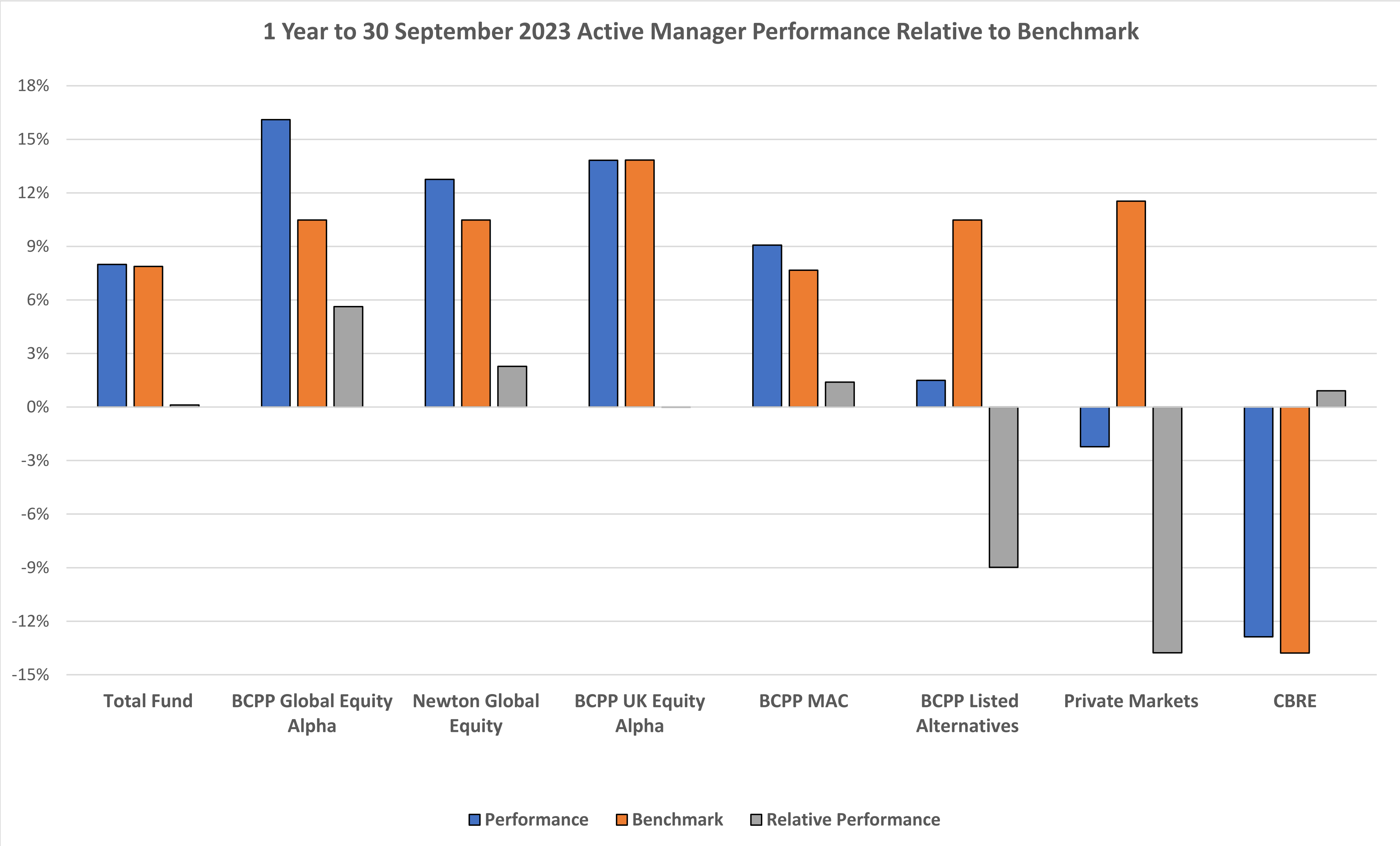
Fund Performance - Summary of Quarterly Results

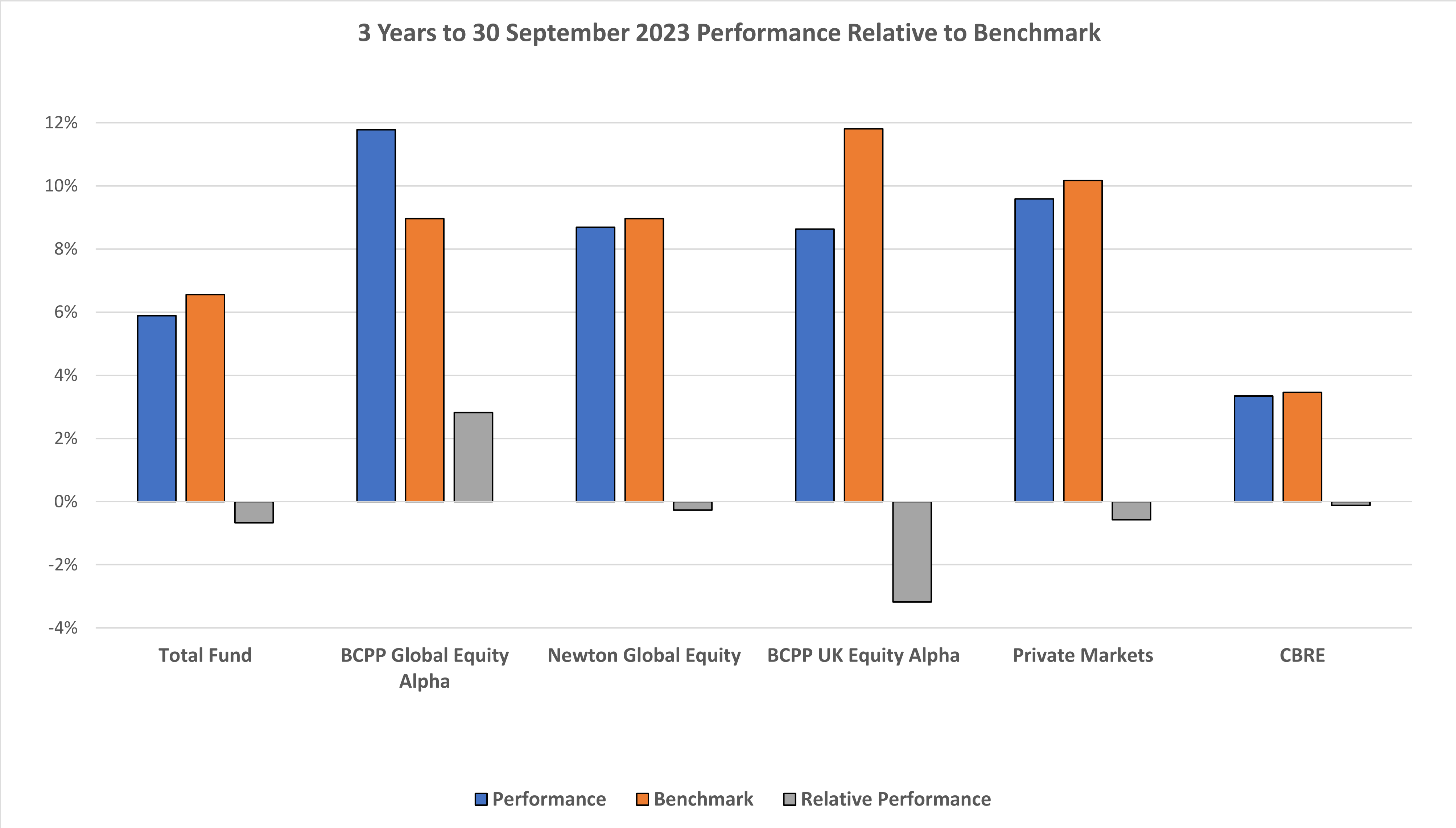
The table below shows manager performance for Q2 2023-24 (June-September 2023), net of investment manager fees, against manager specific benchmarks using Northern Trust data.

As at 30 September 2023	£m	3M Return	3M Benchmark	3M Relative Return	1Y Return	1Y Benchmark	1Y Relative Return	3Y Return	3Y Benchmark	3Y Relative Return
Total Fund	**5,315.33**	-0.61%	0.51%	-1.12%	7.99%	7.88%	0.11%	5.89%	6.56%	-0.67%
Active Global Equity	**1,280.9**	-	-	-	-	-	-	-	-	-
BCPP Global Equity Alpha	765.2	0.98%	0.62%	0.36%	16.10%	10.48%	5.62%	11.78%	8.96%	2.81%
Newton Global Equity	515.8	-0.69%	0.62%	-1.31%	12.76%	10.48%	2.27%	8.69%	8.96%	-0.28%
Active Regional Equity	**614.2**	-	-	-	-	-	-	-	-	-
BCPP UK Equity Alpha	347.0	-0.37%	1.88%	-2.26%	13.83%	13.84%	-0.02%	8.63%	11.81%	-3.18%
BCPP Emerging Markets Alpha	267.3	-	-	-	-	-	-	-	-	-
Passive Global Equity	**1,116.7**	-	-	-	-	-	-	-	-	-
LGIM - Future World Global	1,116.7	0.07%	-0.01%	0.08%	10.82%	10.50%	0.32%	-	-	-
Passive Regional Equity	**113.2**	-	-	-	-	-	-	-	-	-
LGIM - Europe Ex-UK	53.3	-2.02%	-1.94%	-0.08%	19.36%	19.94%*	-0.58%	-	-	-
LGIM - Japan	17.2	3.06%	3.07%	-0.01%	14.93%	14.96%	-0.03%	-	-	-
LGIM - Asia Pacific ex-Japan	42.7	-0.80%	-0.76%	-0.04%	5.15%	5.36%*	-0.21%	-	-	-
Fixed Income	**732.5**	-	-	-	-	-	-	-	-	-
BCPP MAC	622.9	0.06%	2.13%	-2.07%	9.07%	7.67%	1.40%	-	-	-
LGIM Gilts **	109.6	-4.00%	-	-	-9.37%	-	-	-10.99%	-	-
Private Markets Proxy	**121.5**	-	-	-	-	-	-	-	-	-
BCPP Listed Alternatives	121.5	-0.58%	0.62%	-1.20%	1.50%	10.48%	-8.99%	-	-	-
Private Markets	**847.1**	-	-	-	-	-	-	-	-	-
Private Markets	847.1	0.33%	0.56%	-0.23%	-2.23%	11.54%	-13.76%	9.59%	10.17%	-0.58%
Real Estate	**305.4**	-	-	-	-	-	-	-	-	-
CBRE	305.4	-0.20%	-0.25%	0.05%	-12.87%	-13.78%	0.92%	3.34%	3.46%	-0.12%
LGIM Currency Overlay	- 34.6	-	-	-	-	-	-	-	-	-
LGIM Sterling Liquidity Fund	61.3	1.30%	1.31%	-0.01%	-	-	-	-	-	-
Liquidity* **	157.1	-	-	-	-	-	-	-	-	-

* Data under review
** Performance figures represent total Bespoke Fund (3M Gilt Return -4.09%, Liquidity Return 1.26%)
*** Includes £34m of money market funds


3 Months to 30 September 2023 Active Manager Performance Relative to Benchmark
2.5%
1.5%
0.5%
-0.5%
-1.5%
-2.5%
Total Fund
BCPP Global Equity Alpha
Newton Global Equity
BCPP UK Equity Alpha
BCPP MAC
BCPP Listed Alternatives
Private Markets
CBRE
3M Return
3M Benchmark
3M Relative Return


1 Year to 30 September 2023 Active Manager Performance Relative to Benchmark
18%
15%
12%
9%
6%
3%
0%
-3%
-6%
-9%
-12%
-15%
Total Fund
BCPP Global Equity Alpha
Newton Global Equity
BCPP UK Equity Alpha
BCPP MAC
BCPP Listed Alternatives
Private Markets
CBRE
Performance
Benchmark
Relative Performance


3 Years to 30 September 2023 Performance Relative to Benchmark
12%
10%
8%
6%
4%
2%
0%
-2%
-4%
Total Fund
BCPP Global Equity Alpha
Newton Global Equity
BCPP UK Equity Alpha
Private Markets
CBRE
Performance
Benchmark
Relative Performance

Recent Transactions

17. In October 2021 the Fund purchased units in the BCPP MAC 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 Legal and General Investment Management (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.

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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. Also in April 2023, £60m was switched from LGIM Bespoke to the LGIM Sterling Liquidity Fund to reduce fees.

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.

24. Since December 2022, £240m has been redeemed from BCPP Listed Alternatives Fund to fund capital calls in private markets.

25. Following the Committee’s approval of the Investment Strategy Statement in June 2023, the MAC fund exposure was increased. As at 30 September 2023, £60m of BCPP UK Equity Alpha had been sold and £60m of MAC purchased. In October 2023, £60m of Newton Global Equity was sold and £60m of MAC purchased. In November 2023, a further £60m of MAC was purchased.

26. The re-structure of the legacy LGIM Bespoke fund was approved by the Committee in September 2023. In November 2023, in line with that decision, the LGIM Bespoke Fund was liquidated, and a corresponding amount was purchased in the LGIM Over 15Y Gilt fund. The amount of the transaction was £111.4m.

Stock Lending

27. In the quarter to 30 September 2023, stock lending earned a net income for the Fund of £9,152 compared with £10,190 for the quarter ended 30 June 2023.

Mandate Change

28. As agreed at the Committee meeting in September 2023, an active market mechanism was put in place for the allocation to Gilts. If both criteria listed are met, the LGIM Over 15 Year Gilts Index Fund will be switched in its entirety into the All Stocks Index-Linked Gilt Index Fund (OFC). The criteria are 1) The FTA Over 15-year Gilts total return index has outperformed the FTA All Stocks Index-Linked Gilts total return index by 15% since 31 July 2023; plus 2) The Gross Redemption yield on the FTA All Stocks Index-Linked Gilts is in excess of 0%. This will

be monitored by LGIM at no cost to the Fund and will be automatically executed if the above criteria are met.

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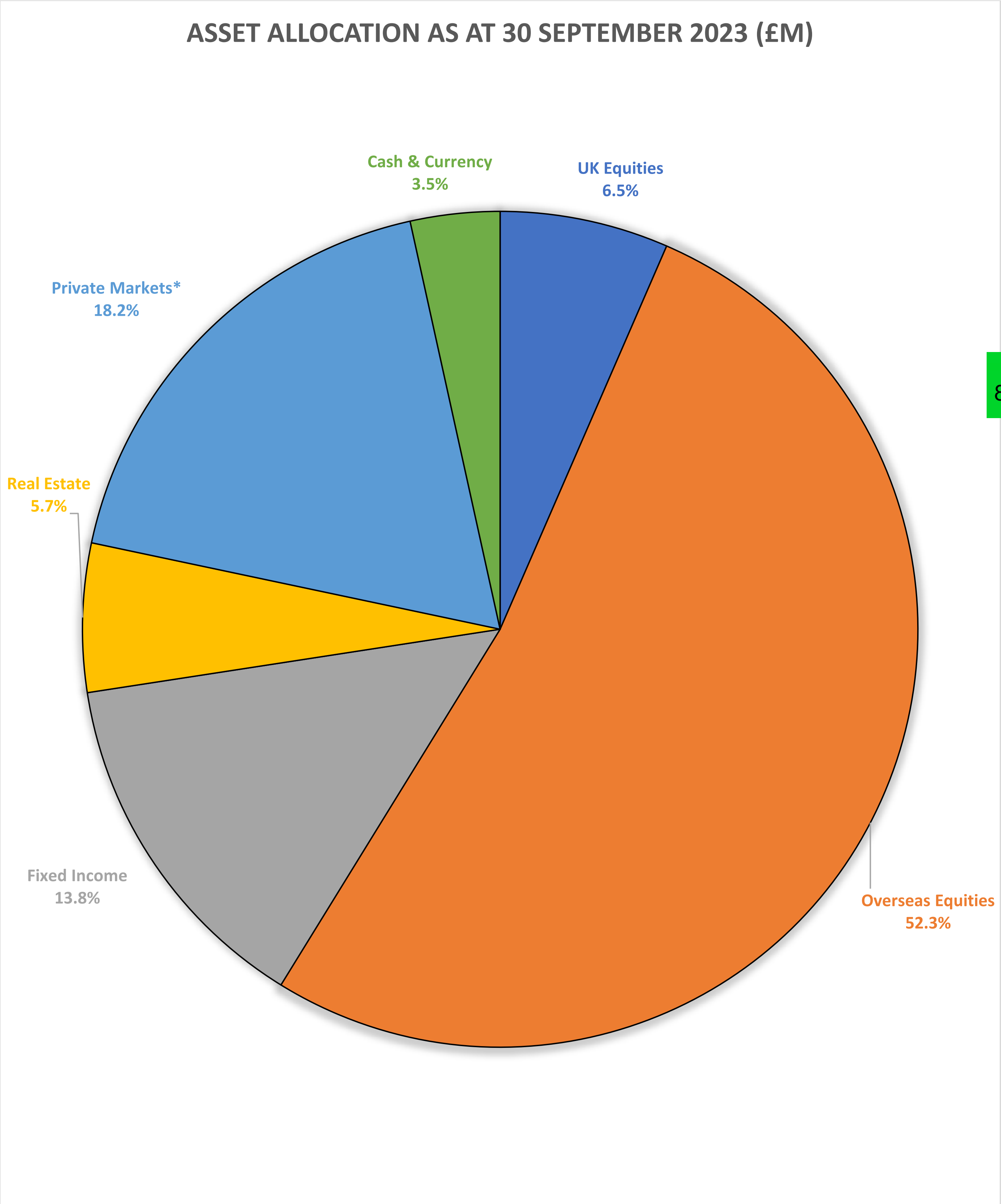
Asset allocation

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

As at 30 Sep 2023	Total Fund (£M)	Actual (%)	Target (%)	Advisory ranges %	Role(s) within the strategy
Listed Equities	**-**	**58.8%**	**55.8**	**52.8 – 58.8**	Generate returns in excess of inflation, through exposure to the shares of domestic and overseas companies.
UK	347.0	6.5%	6.7	-	-
Global Market Cap	1,280.9	24.1%	21.8	-	-
Global Regional	113.2	2.1%	2.2	-	-
Emerging Markets	267.3	5.0%	5.6	-	-
Global Sustainable	1,116.7	21.0%	19.5	-	-
Alternatives	**-**	**24.0%**	**27.3**	**22.3-32.3**	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	271.4	5.1%	5	2.0-8.0	-
Infrastructure	399.0	7.5%	6	3.0-9.0	-
Private Debt	144.5	2.7%	6	2.0-8.0	-
Climate Opportunities	32.2	0.6%	3	0.0-6.0	-
Listed Alternatives	121.5	2.3%			-
Real Estate	305.4	5.7%	7.3	4.3–10.3	-
Credit	**-**	**13.8%**	**16.9**	**12.1-21.7**	Offer diversified exposure to global credit markets to capture both income and capital appreciation of underlying bonds.
Multi Asset Credit	622.9	11.7%	15.1	12.1-18.1	-
Fixed Interest Gilts	109.6	2.1%	1.8	0.0-3.6	-
Cash & Currency Overlay	183.9	**3.5%**	-	-	-
Total	**5,315.3**	-	**100**	-	-

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



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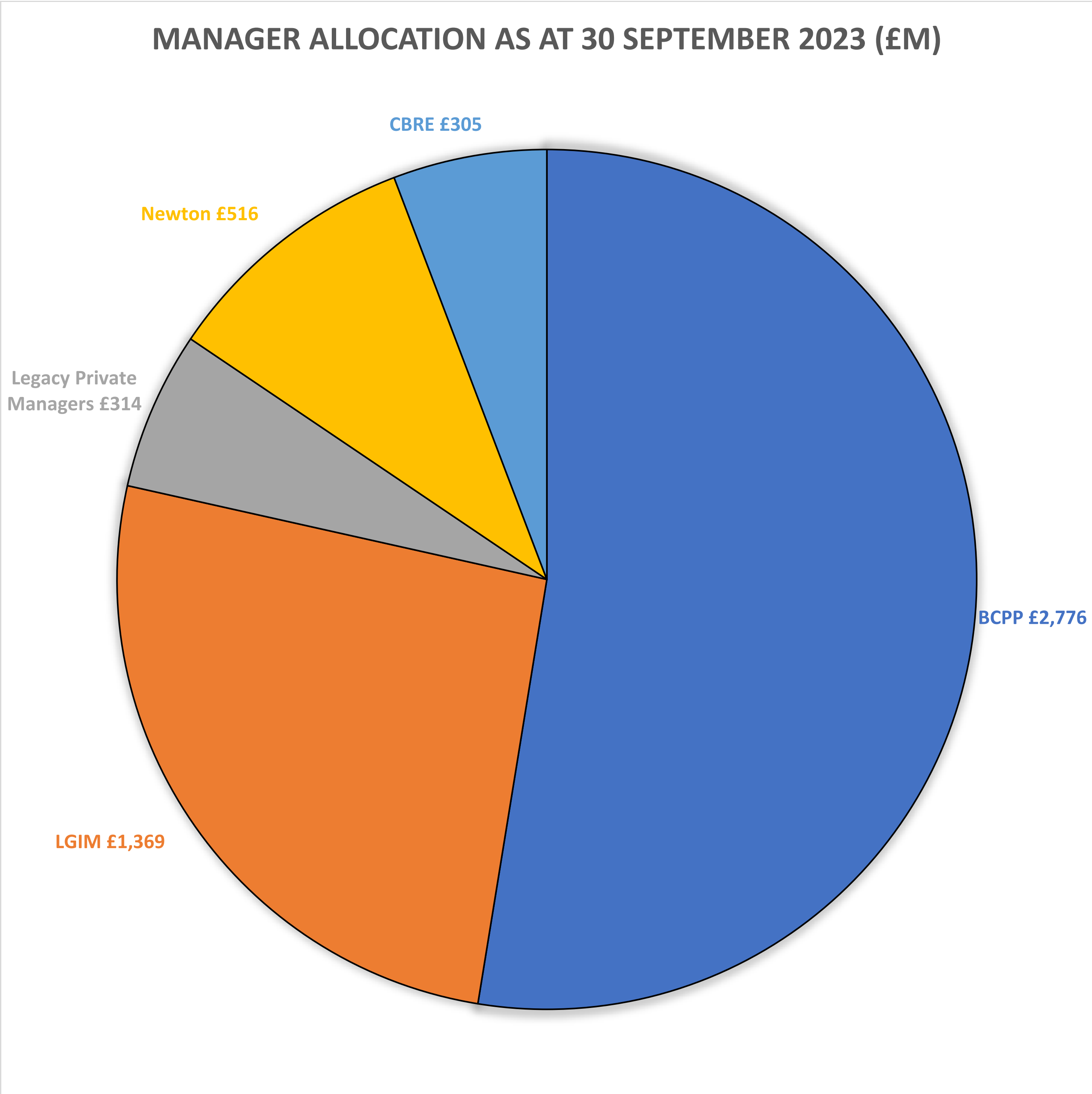
*Includes Listed Alternatives

Manager Allocation

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



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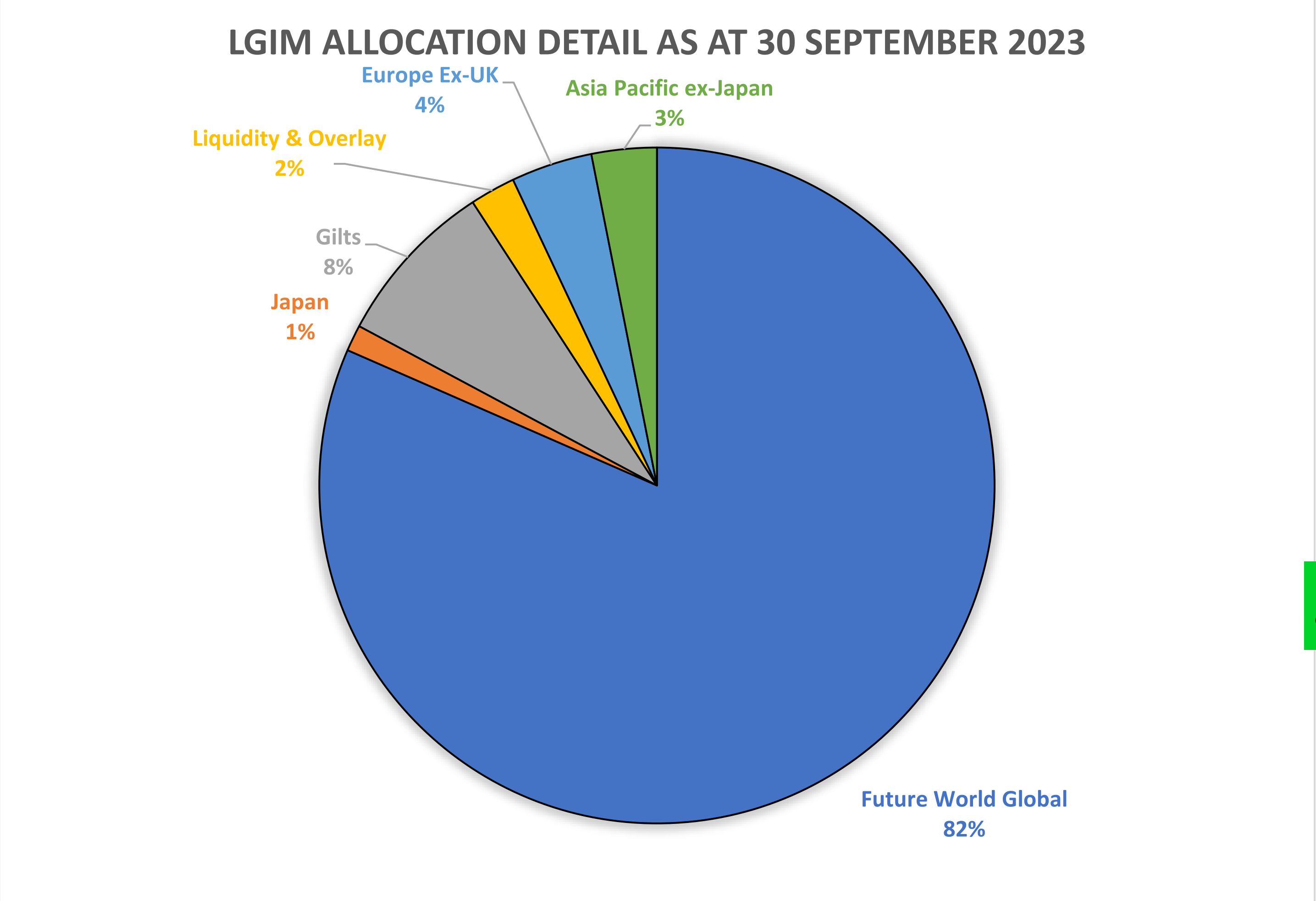
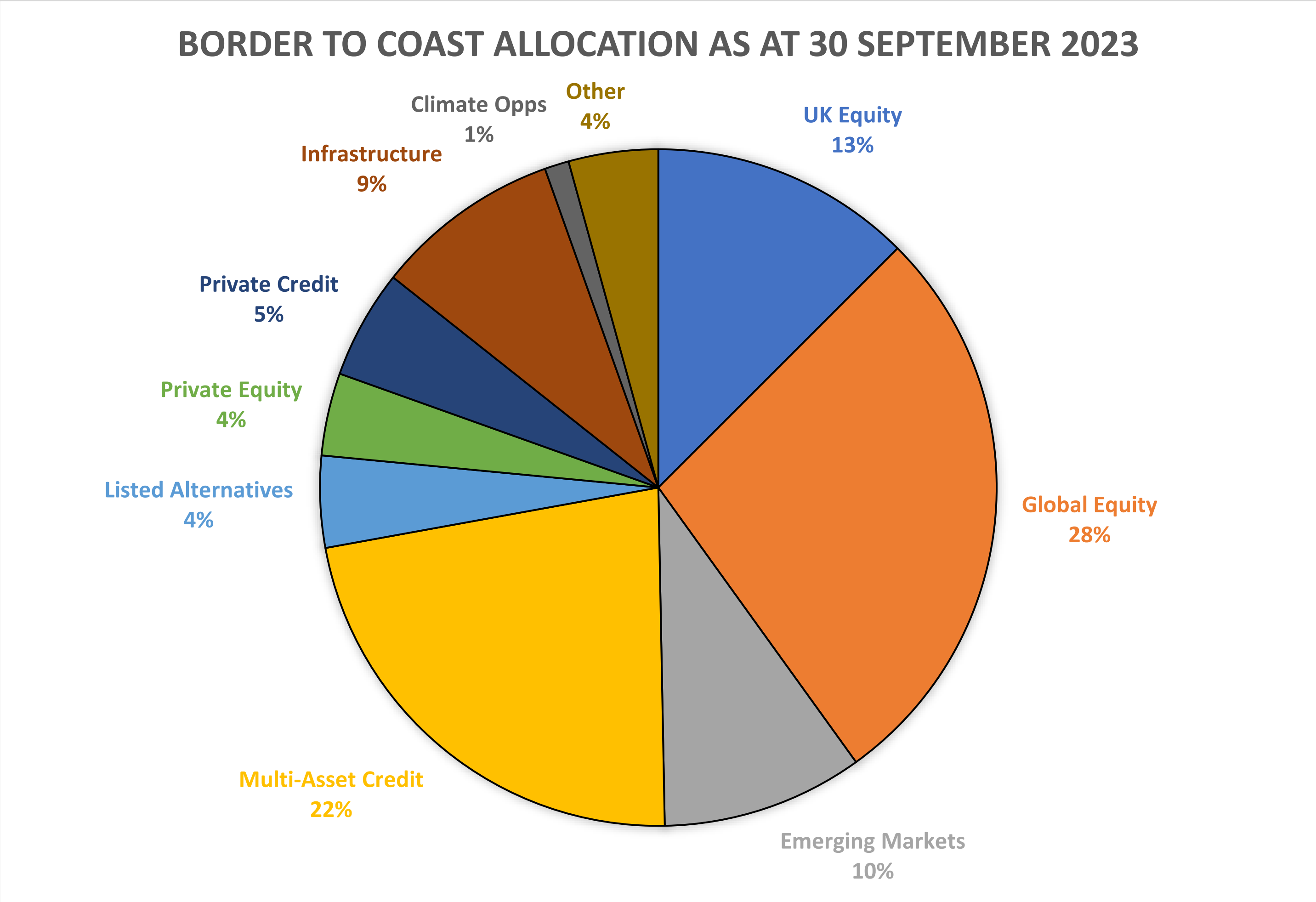

LGIM ALLOCATION DETAIL AS AT 30 SEPTEMBER 2023
Europe Ex-UK 4%
Asia Pacific ex-Japan 3%
Liquidity & Overlay 2%
Gilts 8%
Japan 1%
Future World Global 82%


BORDER TO COAST ALLOCATION AS AT 30 SEPTEMBER 2023
Climate Opps 1%
Other 4%
UK Equity 13%
Infrastructure 9%
Private Credit 5%
Private Equity 4%
Listed Alternatives 4%
Global Equity 28%
Multi-Asset Credit 22%
Emerging Markets 10%

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Cashflow

30. 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.

Period	Total contributions received £m	Total pension benefits paid £m	Net cash-flow £m
Quarter One 2023/24 (1 Apr 2023 – 30 Jun 2023)	51.7	37.7	14
Quarter Two 2023/24 (1 Jul 2023 – 30 Sep 2023)	57.5	66.5	-9

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Quarterly cashflow information has been derived from the new finance system Unit 4/ MySurrey so for the periods shown there may be timing differences due to issues with reporting.

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

Period	Active members	Deferred members	Pension members	Total members
Quarter One 2023/24 (1 Apr 2023 – 30 Jun 2023)	35,585	44,465	30,760	110,810
Quarter Two 2023/24 (1 Jun 2023 – 30 Sep 2023)	34,553*	44,761	30,855	110,169

*The active numbers have slightly decreased since the last quarter. This is most likely due to the fact that no new starters for Surrey County Council (SCC) have been received since June as the Unit 4/ MySurrey i-Connect file is being resolved.

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	+2.0%
BCPP	MAC	SONIA	+3.5%
BCPP	Listed Alternatives	MSCI ACWI	
BCPP	Emerging Markets Equity Alpha	MSCI EM Index	+2.0%
Newton	Global Equities	MSCI ACWI	+2.0%
Various	Private Markets	MSCI World Index	+5.0%
CBRE	Real Estate	MSCI/AREF UK QPFI All Balanced Property Fund Index (for UK Assets) Global Alpha Fund Absolute Return 9-11%	+0.5%
LGIM	Europe ex-UK Equities Future World Global Equity Index Japan Equity Asia Pacific ex-Japan Development Equity Sterling Liquidity Fund LGIM Bespoke	FTSE Developed Europe ex-UK Net Tax (UKPN) Solactive L&G ESG Global Markets Net FTSE Japan NetTax (UKPN) FTSE Developed Asia Pacific ex-Japan NetTax (UKPN) SONIA 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

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CONSULTATION:

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

RISK MANAGEMENT AND IMPLICATIONS:

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

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

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

DIRECTOR CORPORATE FINANCIAL & COMMERCIAL COMMENTARY

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35. 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

36. There are no legal implications or legislative requirements.

EQUALITIES AND DIVERSITY

37. 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

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

WHAT HAPPENS NEXT

39. The following next steps are planned:

- Continue to implement asset allocation shifts as agreed by the Committee.
- 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: