SURREY PENSION FUND COMMITTEE REPORT

SURREY COUNTY COUNCIL

SURREY PENSION FUND COMMITTEE

DATE: 13 SEPTEMBER 2024

LEAD OFFICER: ANNA D'ALESSANDRO, EXECUTIVE DIRECTOR, FINANCE AND CORPORATE SERVICES

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, as well as an update on investment performance and the values of assets and liabilities.

RECOMMENDATIONS:

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It is recommended that the Pension Fund Committee:

1. Note 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 when using a dynamic discount rate are in the table below.

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Dynamic Discount Rate Table	**31 March 2022**	**31 March 2024**	**30 June 2024**
Assets (£bn)	5.36	5.83	5.98
Past Service Liabilities (£bn)	5.26	4.30	4.19
Surplus (£bn)	0.10	1.52	1.79
Funding Level	102%	135%	143%
Discount Rate	4.4%	6.3%	6.5%
Salary Increases	3.7%	3.4%	3.3%
Pension Increases	2.7%	2.4%	2.3%
Likelihood of success	70%	70%	70%
Required return to be 100% funded	4.3%	4.5%	4.4%

5. The liability values in the above table as at 31 March 2024 and 30 June 2024 make allowances for both the April 2023 Pension Increase Order of 10.1% and the April 2024 Pension Increase Order of 6.7%.

6. The funding level has increased over the quarter from 31 March 2024. Investment performance has been positive (with the Fund achieving a return of 1.84% over the quarter) and liabilities have fallen due to improved assumptions: a higher expected future return (discount rate) and a lower pension increase assumption. Both the impact of higher assets and lower liabilities have improved the funding position.

7. The net position has increased from a surplus of £1.52bn at 31 March 2024 to a surplus of £1.79bn at 30 June 2024.

8. 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. To illustrate this, as noted on page 2 of the funding update report, the required return (the level of returns required to ensure the Fund remains 100% funded) is slightly higher as at 30 June 2024 (4.4%) 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. For comparison, the actuaries have also estimated the updated funding position of the Fund as 30 June 2024 based on the fixed discount rate of 4.4%, which was set at the 31 March 2022 valuation, results of which are shown in the table below.

Static Discount Rate Table	**30 June 2024**
Assets (£bn)	5.98
Past Service Liabilities (£bn)	5.98
Surplus (£bn)	0.0
Funding Level	100%
Discount Rate	4.4%
Salary Increases	3.3%
Pension Increases	2.3%
Likelihood of success	88%

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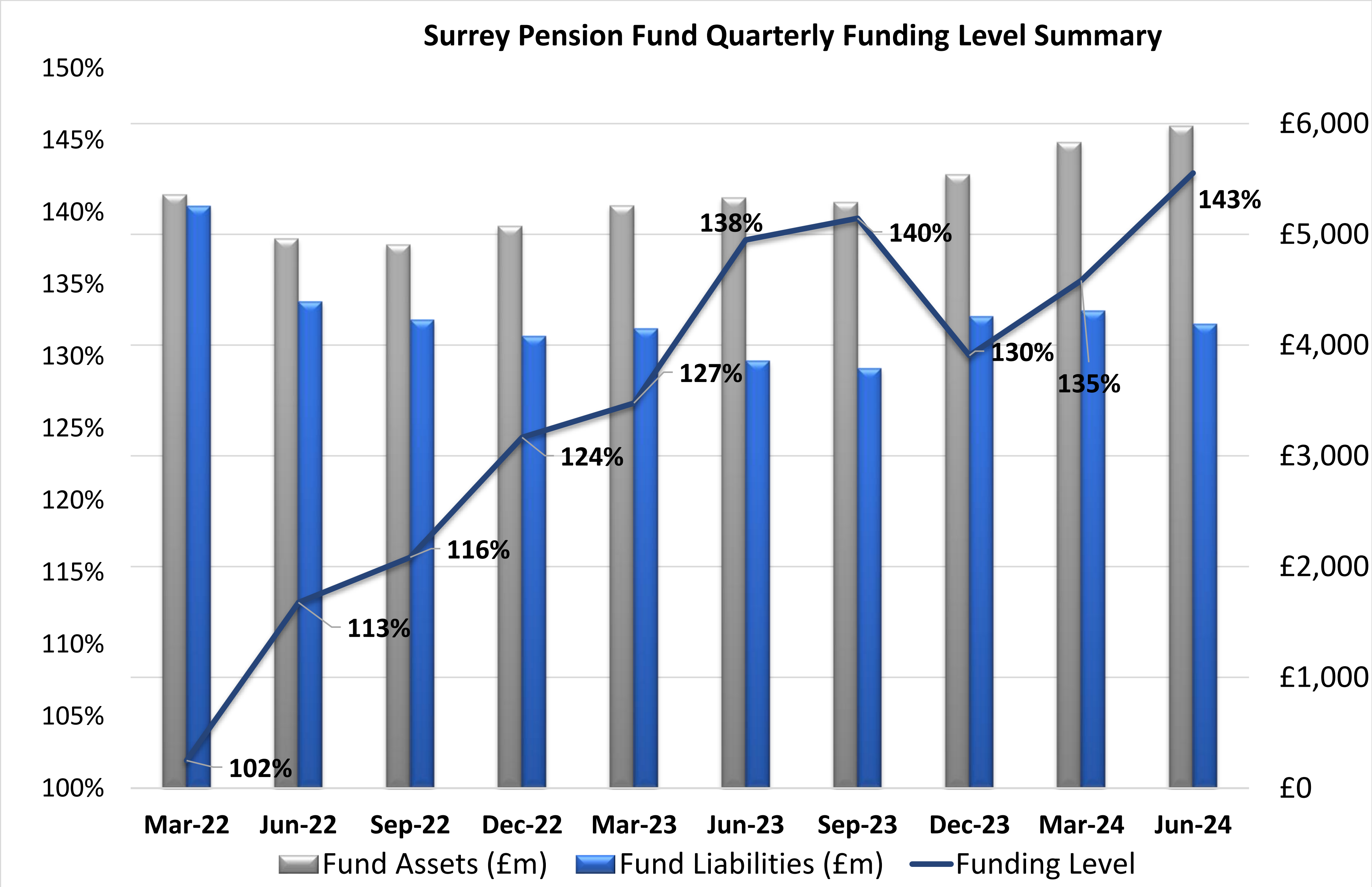
10. The graph below shows the development of the funding ratio since the last valuation.



Market Review

11. Global equity markets rose over the quarter. The key drivers were improving inflation figures, growing hopes over interest rate cuts, and positive corporate earnings momentum, driven by the technology sector. The MSCI World Index and several local indices reached new all-time highs.

12. US equities rose over the quarter and outperformed global equities, with the S&P 500 and Nasdaq trading at new highs. Chipmaker Nvidia* continued to surge, achieving a $3 trillion market cap. Year to date, Nvidia has accounted for 30% of gains recorded by the S&P 500. US inflation slowed to 3.3% in May and there was some mixed data in the labour market

13. European shares were lower over the quarter. France was notably weak in June reflecting on the EU parliamentary elections and President Macron's decision to call an election in France. The European Central Bank (ECB) went ahead with its first rate cut in June, becoming the first of the major central banks to do so.

14. UK equities rose, with the FTSE 100 hitting new all-time highs. The market was supported by inflation declining to 2% in May – the lowest figure since July 2021 – which, crucially, hit the Bank of England's (BoE's) target level. GDP expanded by 0.7% quarter-on-quarter, beating estimates and becoming the strongest figure in more than two years. 11

15. Japanese equities also rose. The yen hit another 38-year low versus the US dollar and inflation accelerated to 2.8% in May. There was increasing talk of intervention and another interest rate hike in July. Investors are becoming concerned about the fragility of the economy as monetary policy changes.

16. Government bond yields rose mildly, and so prices fell, over the quarter to end June 2024. Benchmark 10-year yields in the US, the UK, Germany and Japan all ended the quarter higher. Yields on 10-year US Treasuries rose from 4.21% to 4.37%. Expectations for the magnitude of interest rate cuts by the Federal Reserve (Fed) were reduced once more. By the end of the period, the Fed had kept rates unchanged and guided for only one rate cut this calendar year, while forecasting four interest-rate cuts in 2025.

17. Having been the first of the major central banks to cut interest rates, the ECB warned that it would not automatically cut at its next meeting, and raised inflation forecasts for 2024 and 2025. Inflation in the eurozone rose slightly, to 2.6% in May.

18. Ten-year gilt yields rose from 3.94% to 4.17%. Expectations that the BoE would soon cut rates abounded, but the move was likely delayed by the announcement of a snap UK general election in June. Economic data was mixed, with GDP expansion whilst unemployment picked up to 4.4% in April.

19. In Japan, the 10-year government bond yield rose from 0.72% to 1.03% as the Bank of Japan (BoJ) kept rates unchanged but signalled that it would soon reduce the pace of its monthly bond purchases. Investors began to speculate that the BoJ will increase rates again in July, partly to support the weak yen.

20. The quarter saw yields on global credit rise in the US, the eurozone and the UK. Bond prices consequently fell. Credit spreads widened.

21. The US dollar, euro and sterling were flat against each other over the quarter, but all rose against the Japanese yen.

Performance Review

22. Overall, the Fund returned 1.84% in Q1 2024/25 (April-June 2024), in comparison to the benchmark of 2.66%.

23. BCPP Global Equity Alpha was the single largest contributor to the overall Fund underperformance. Six of the seven underlying managers underperformed, driven by the correlated risk of being underweight the highest capitalised companies, particularly technology companies such as Nvidia and Apple. This continues a series of underperformance and, as agreed at the June 2024 Committee meeting, the Fund's concerns have been escalated to BCPP's Chief Investment Officer to explore understanding and options for change.

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24. Newton Global Equity also underperformed the benchmark but to a much lesser extent and after solid performance over 1 and 3 years. Emerging Market equity was the best performing asset class in absolute terms over the period. BCPP Emerging Markets Alpha returned just over 4%, but underperformed the benchmark by 0.9%. This underperformance was mainly driven by one of the dedicated China managers, Fountain Cap, who were underweight the large banks and technology companies that performed strongly in a volatile market. BCPP UK Equity Alpha had a flat quarter relative to the benchmark.

25. Within the passively managed part of the portfolio, the Fund's largest mandate, LGIM Future World Global, returned 3.32% in absolute terms, outperforming the other global equity mandates.

26. A very disappointing return was reported for the LGIM Europe Ex-UK fund as it underperformed the benchmark by 2.65%. When dividends are paid by overseas companies, the local tax authorities may require the payer to make a deduction on account of tax before making the payment, known as withholding tax. Depending on tax treaties, this withholding tax may subsequently be recoverable. Where withholding tax is likely to be refunded, it is accrued into the net asset value (NAV) of the fund.

27. Within the Future World and Europe Ex-UK funds, accruals have been made for a number of years for the withholding tax from Swiss and Belgian investments. However, LGIM no longer believes that the withholding tax will be recoverable from these countries. Therefore, LGIM has taken the decision to remove the accruals relating to Swiss and Belgian holdings from the NAVs, negatively impacting value.

28. The impact on the LGIM Europe Ex-UK fund was –2.415%. The impact on the LGIM Future World Global fund was –0.014%. This equates to a loss of value for the Fund of over £1.5m, predominantly from the Europe Ex-UK fund.

29. Correspondence from LGIM can be found in Annexe 2, part 2.

30. Within the Alternatives allocation, BCPP Listed Alternatives was impacted by the snap election called in France and Private Markets continues to suffer in comparison to its global listed equity benchmark, previously discussed.

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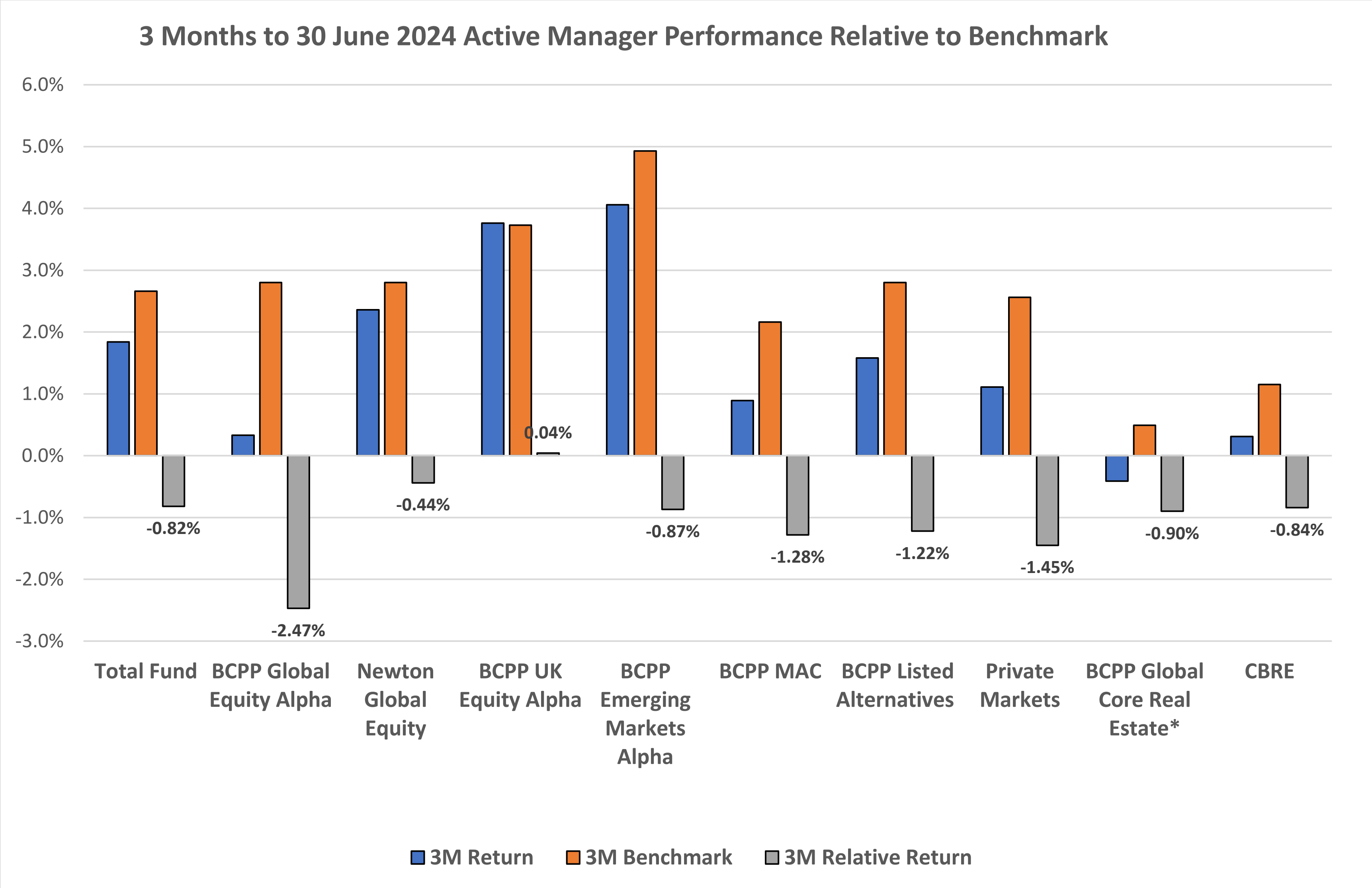
Fund Performance – Summary of Quarterly Results

31. The table below shows manager performance for Q1 2024/25 (April – June 2024), net of investment manager fees, against manager specific benchmarks using Northern Trust data.

As at 30 June 2024	£m	3M Return	3M Benchmark	3M Relative Return	1Y Return	1Y Benchmark	1Y Relative Return	3Y Return	3Y Benchmark	3Y Relative Return
Total Fund	**5,972.81**	1.84%	2.66%	-0.82%	11.61%	15.86%	-4.25%	4.23%	6.52%	-2.30%
Active Global Equity	**1,368.1**	-	-	-	-	-	-	-	-	-
BCPP Global Equity Alpha	878.3	0.33%	2.80%	-2.47%	15.91%	20.06%	-4.15%	7.36%	8.60%	-1.24%
Newton Global Equity	489.8	2.36%	2.80%	-0.44%	21.39%	20.06%	1.33%	9.88%	8.60%	1.28%
Active Regional Equity	**679.2**	-	-	-	-	-	-	-	-	-
BCPP UK Equity Alpha	382.3	3.76%	3.73%	0.04%	9.78%	12.98%	-3.21%	2.72%	7.40%	-4.69%
BCPP Emerging Markets Alpha	296.9	4.06%	4.93%	-0.87%	-	-	-	-	-	-
Passive Global Equity	**1,355.0**	-	-	-	-	-	-	-	-	-
LGIM - Future World Global	1,355.0	3.32%	3.25%	0.07%	21.03%	20.67%	0.35%	-	-	-
Passive Regional Equity	**125.3**	-	-	-	-	-	-	-	-	-
LGIM - Europe Ex-UK	59.8	-2.73%	-0.08%	-2.65%	9.61%	12.84%	-3.23%	5.30%	6.40%	-1.10%
LGIM - Japan	19.0	-4.61%	-4.63%	0.02%	13.32%	13.30%	0.03%	5.29%	5.30%	0.00%
LGIM - Asia Pacific ex-Japan	46.5	0.83%	0.94%	-0.11%	8.02%	8.14%	-0.13%	-0.42%	-0.33%	-0.09%
Fixed Income	**973.0**	-	-	-	-	-	-	-	-	-
BCPP MAC	851.9	0.89%	2.16%	-1.28%	8.86%	8.90%	-0.05%	-	-	-
LGIM - 15 Yr+ Gilts Index Fund	121.1	-2.76%	-2.77%	-0.01%	-	-	-	-	-	-
Private Markets Proxy	**53.9**	-	-	-	-	-	-	-	-	-
BCPP Listed Alternatives	53.9	1.58%	2.80%	-1.22%	12.96%	20.06%	-7.10%	-	-	-
Private Markets	**976.2**	-	-	-	-	-	-	-	-	-
Private Markets	976.2	1.11%	2.56%	-1.45%	1.88%	20.88%	-19.00%	9.21%	10.07%	-0.86%
Real Estate	**294.2**	-	-	-	-	-	-	-	-	-
BCPP Global Core Real Estate	3.0	-	-	-	-	-	-	-	-	-
CBRE	291.2	0.31%	1.15%	-0.84%	-3.15%	0.06%	-3.21%	0.37%	0.64%	-0.27%
LGIM Currency Overlay	0.1	-	-	-	-	-	-	-	-	-
LGIM Sterling Liquidity Fund	43.6	1.31%	1.32%	-0.01%	5.44%	5.39%	0.05%	-	-	-
Liquidity*	104.4	-	-	-	-	-	-	-	-	-

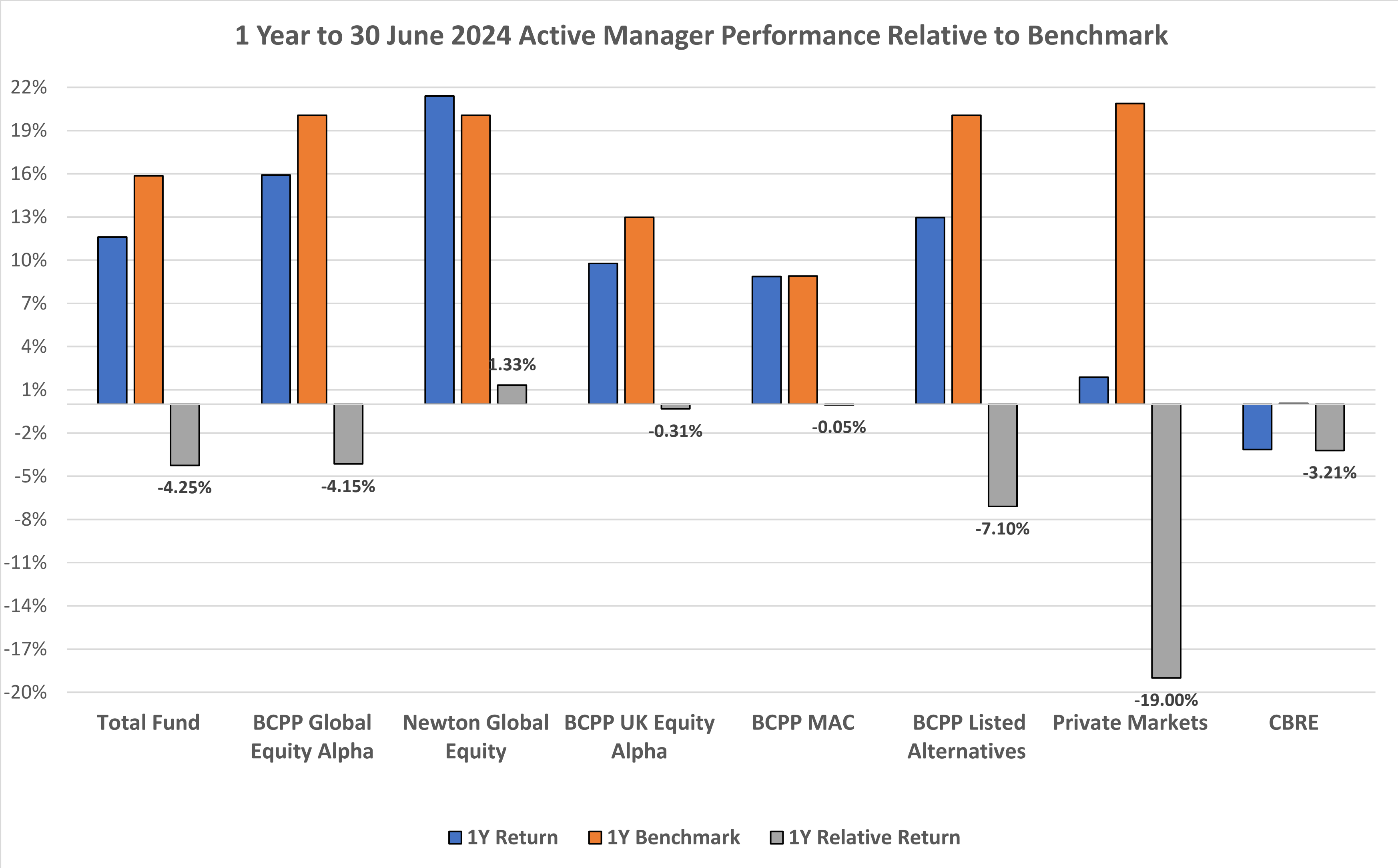
*Includes £69.8m of money market funds

32. The chart below shows the performance, for the latest 3 months to 30 June 2024 for the actively managed portfolios.

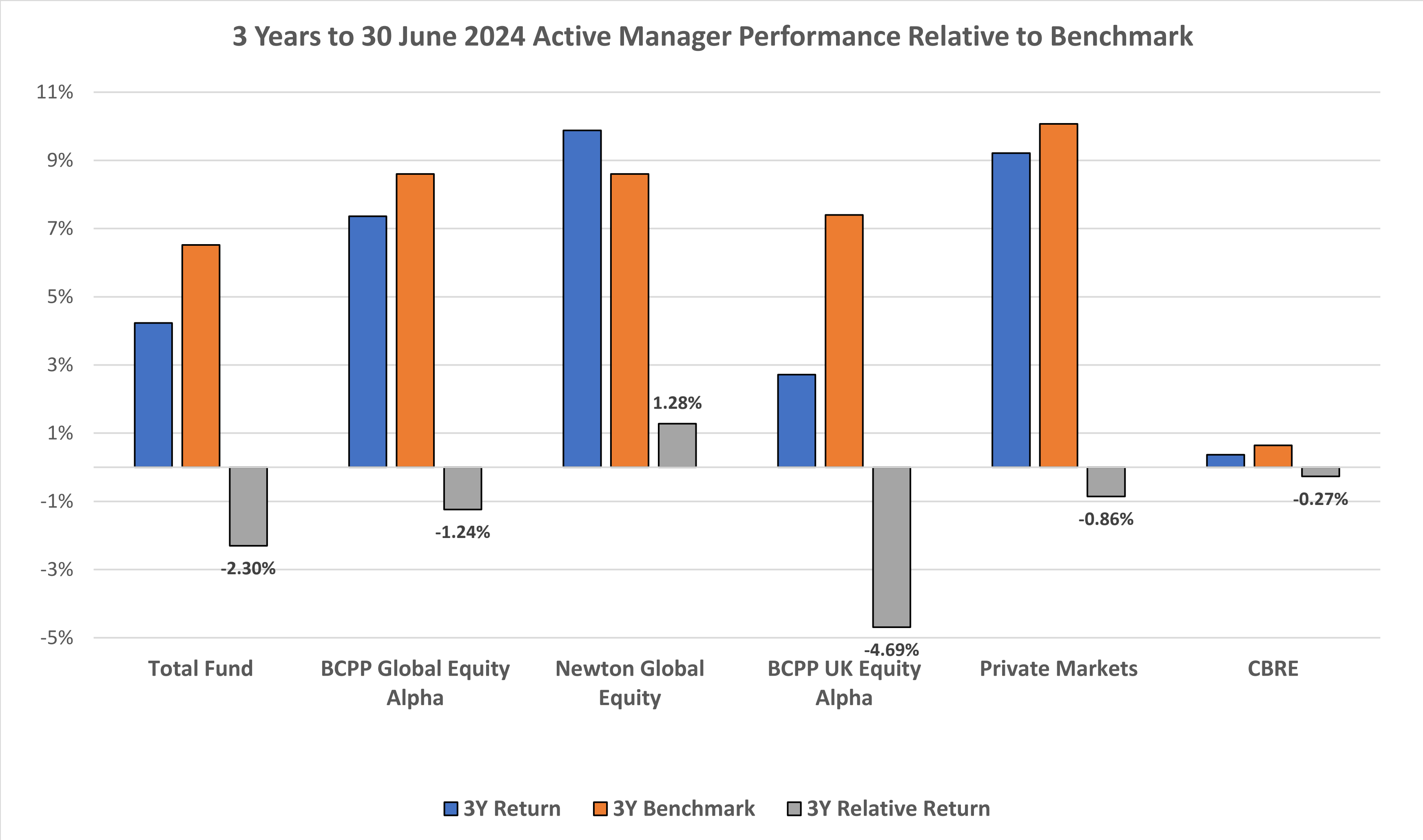


*1 month performance returns

33. The chart below shows the performance for the latest 12 months to 30 June 2024 for the actively managed portfolio



34. The chart below shows the performance for the latest 3 years to 30 June 2024 for the actively managed portfolio.



Recent Transactions

35. 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.

36. The asset allocation agreed in the December 2022 Committee meeting resulted in a series of transactions taking place in 2023.

37. In April 2023, the Fund invested another £100m into the LGIM Future World Global Equity Index Fund, funded by the redemption of £89m from the BCPP UK Equity Alpha Fund and an £11m in specie transfer from LGIM Future World Emerging Markets Fund. Also in April 2023, £60m was switched from LGIM Bespoke to the LGIM Sterling Liquidity Fund, thus reducing fees.

38. In July 2023, the Fund invested £267m into the BCPP Emerging Markets Equity Alpha Fund, which was funded by the full redemption of the Fund's remaining holding in the LGIM Emerging Markets Fund.

39. 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.

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40. 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.

41. To align the exposure to MAC to the Investment Strategy Statement (ISS), the final purchase was completed in January 2024. This amounted to a £60m purchase of MAC and takes the weighting to approximately 15%. There was a corresponding £60m sale of Newton Global Equity.

42. A sale of £20m in Listed Alternatives was completed in January 2024 to help fund ongoing private market capital commitments and drawdowns. Since December 2022, £317m has been redeemed from BCPP Listed Alternatives Fund to fund capital calls in private markets.

43. Capital calls have predominantly been funded by the BCPP Listed Alternatives Fund. Going forward, these calls may increasingly be funded by Newton Global Equity and LGIM Sterling Liquidity Fund assets.

44. The private market commitments to the BCPP programme for April 2024 are £50m to Climate Opportunities, £80 to Private Credit and £90m to UK Opportunities, as agreed at the Committee meeting in March 2024.

45. A sale of £20m in LGIM Sterling Liquidity Fund was completed in April 2024 and a redemption of £27m from Listed Alts in May 2024 to help fund ongoing private market capital commitments and drawdowns.

46. Funding of €2.3m was requested from BCPP for the first transaction in the BCPP Global Real Estate Fund.

47. Looking ahead, due to a build-up of money market funds, the Accounting & Governance team has requested that that regular transfer of income from the MAC and CBRE accounts should stop.

Stock Lending

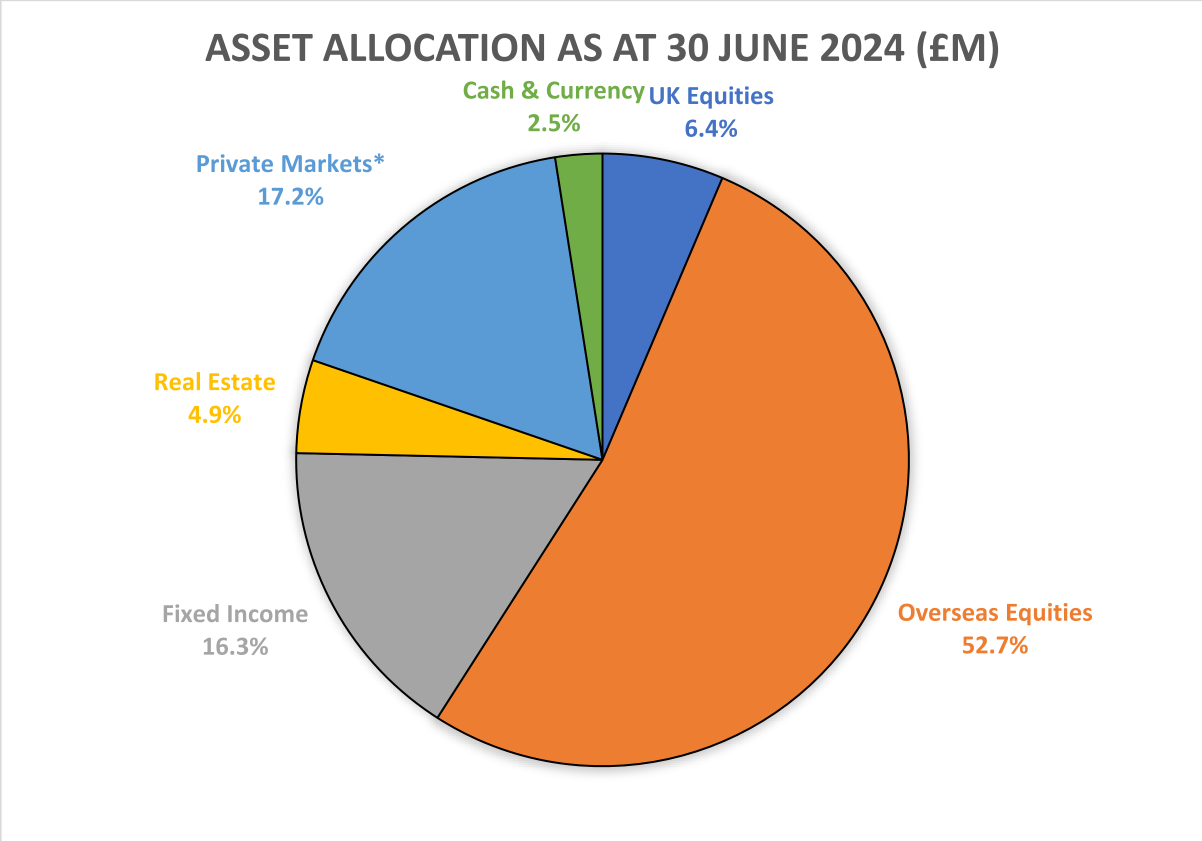
48. In the quarter to 30 June 2024, stock lending earned a net income for the Fund of £14,663 compared with £1,494 for the quarter ended 31 March 2024.

Asset Allocation

49. The table and the graph below show the target and actual asset allocations for the quarter ending 30 June 2024. These allocations were agreed by the Pension Fund Committee in the June 2023 meeting.

As at 30 June 2024	Total Fund (£M)	Actual (%)	Target (%)	Advisory ranges %	Role(s) within the strategy
Listed Equities	**-**	**59.1%**	**55.8**	**52.8 – 58.8**	Generate returns in excess of inflation, through exposure to the shares of domestic and overseas companies.
UK	382.3	6.4%	6.7	-	-
Global Market Cap	1,368.1	22.9%	21.8	-	-
Global Regional	125.3	2.1%	2.2	-	-
Emerging Markets	296.9	5.0%	5.6	-	-
Global Sustainable	1,355.0	22.7%	19.5	-	-
Alternatives	**-**	**22.2%**	**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	331.2	5.5%	5	2.0-8.0	-
Infrastructure	381.0	6.4%	6	3.0-9.0	-
Private Debt	173.5	2.9%	6	2.0-8.0	-
Climate Opportunities	90.4	1.5%	3	0.0-6.0	-
Listed Alternatives	53.9	0.9%			-
Real Estate	294.2	4.9%	7.3	4.3–10.3	-
Credit	**-**	**16.3%**	**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	851.9	14.3%	15.1	12.1-18.1	-
Fixed Interest Gilts	121.1	2.0%	1.8	0.0-3.6	-
Cash & Currency Overlay	148.0	**2.5%**	-	-	-
Total	**5,972.8**	-	**100**	-	-

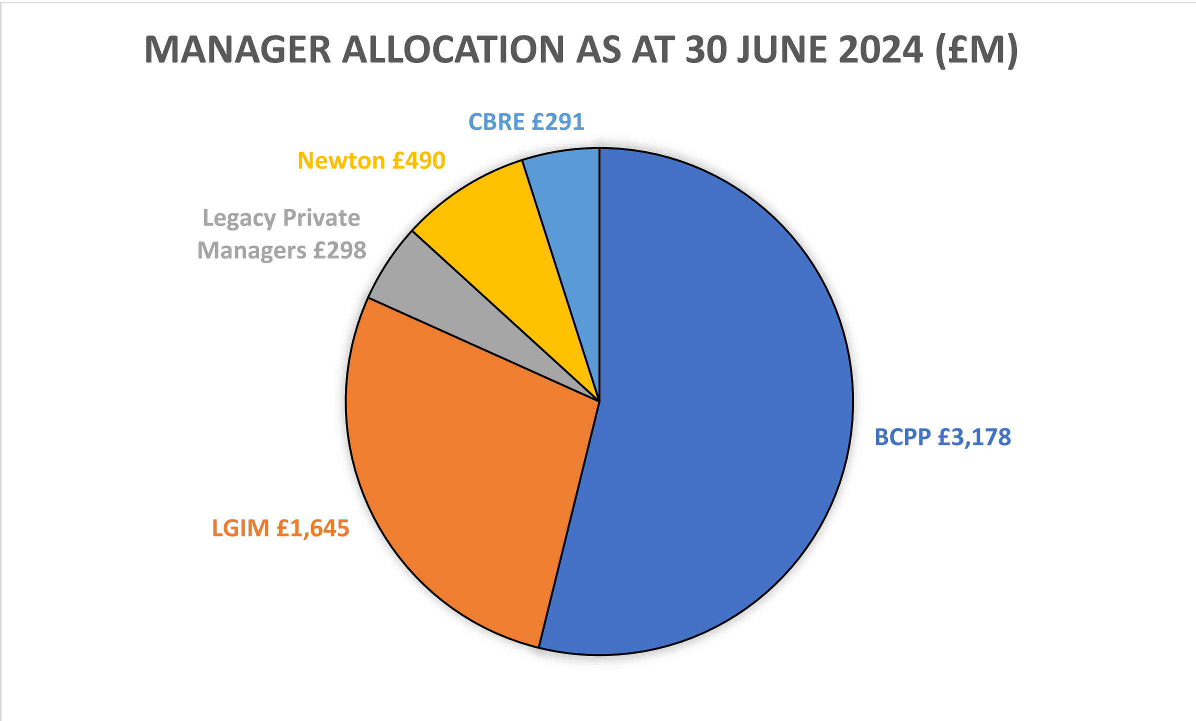
50. The graph below shows the asset allocation for the quarter ending 30 June 2024.



*Private investment in this chart includes Listed Alternatives.

Manager Allocation

51. The graph below shows the manager allocation for the quarter ending 30 June 2024.



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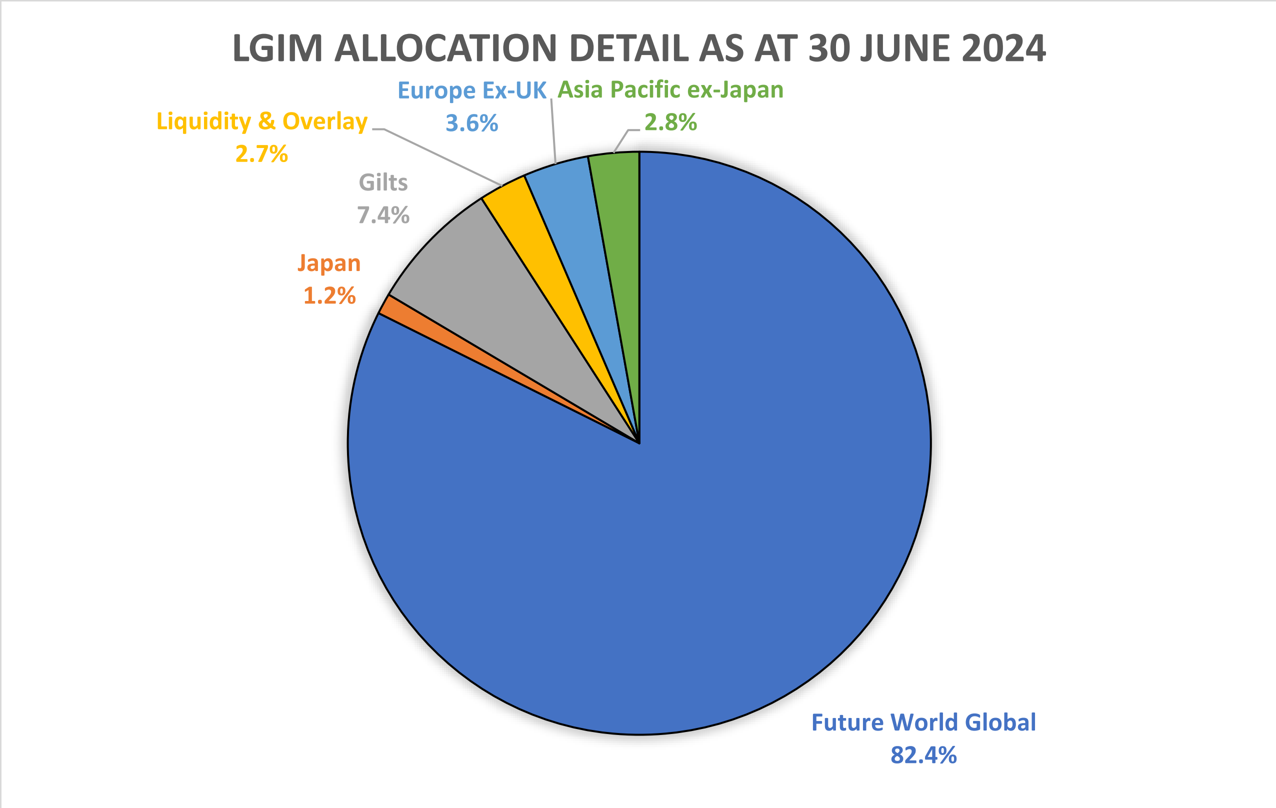
52. The graph below shows the asset allocation within LGIM as at 30 June 2024.



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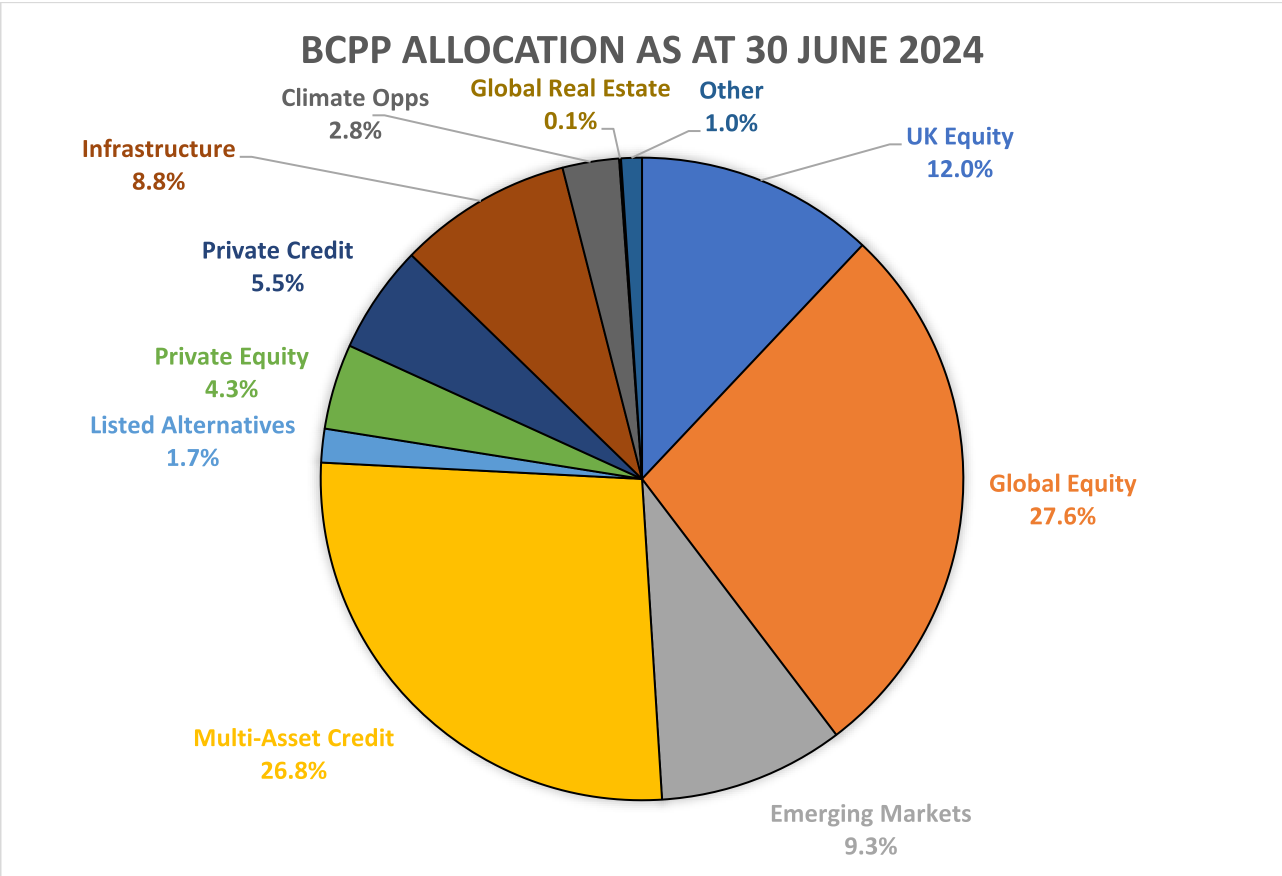
53. The graph below shows the asset allocation withn BCPP as at 30 June 2024.



Cashflow

54. 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. The table below shows the total contributions received, the total pension benefits paid and the net cashflow for the two most recent quarters to 30 June 2024.

Period	Total contributions received £m	Total pension benefits paid £m	Net cashflow £m
Quarter 4 2023/24 (1 Jan 2024 – 31 Mar 2024)	54.9	60.4	-5.5
Quarter 1 2024/25 (1 Apr 2024 – 30 Jun 2024)	55.4	62.9	-7.5

55. Quarterly cashflow information has been provided by the Accounting & Governance Team. 11

Membership Trends

56. An indication of the current membership trends is shown by movements in membership over Q4 and Q1. Member data for the last two quarters to 30 June 2024 as provided by the Accounting & Governance Team is listed below.

Period	Active members	Deferred members	Pension members	Total members
Quarter 4 2023/24 (1 Jan 2024 – 31 Mar 2024)	34,329	46,695	31,688	112,712
Quarter 1 2024/25 (1 Apr 2024 – 30 Jun 2024)	36,770	46,404	31,993	115,167

Benchmark Table

57. The table below shows the fund managers, the mandate, the benchmark and performance target.

Manager	Mandate	Benchmark Index	Performance Target relative to Benchmark
All	Surrey Pension Fund	Weighted across Fund	+1.0
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)	+0.5%
LGIM	Europe ex-UK Equities Index	FTSE Developed Europe ex-UK Net Tax (UKPN)	-
LGIM	Future World Global Equity Index	Solactive L&G ESG Global Markets Net	-
LGIM	Japan Equity Index	FTSE Japan NetTax (UKPN)	-
LGIM	Asia Pacific ex-Japan Development Equity Index	FTSE Developed Asia Pacific ex-Japan NetTax (UKPN)	-
LGIM	Sterling Liquidity	SONIA	-
LGIM	15 Yr+ Gilts Index	FTA Over 15 Yr Total Return	-

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CONSULTATION:

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

RISK MANAGEMENT AND IMPLICATIONS:

59. Any relevant risk related implications have been considered and are contained within the report.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS:

60. Any relevant financial and value for money implications have been considered and are contained within the report.

EXECUTIVE DIRECTOR OF FINANCE & CORPORATE COMMENTARY:

61. The Executive Director of Finance and Corporate Services is satisfied that all material, financial and business issues and possibility of risks have been considered and addressed.

LEGAL IMPLICATIONS – MONITORING OFFICER:

62. There are no legal implications or legislative requirements.

EQUALITIES AND DIVERSITY:

63. There are no equality or diversity issues.

OTHER IMPLICATIONS:

64. There are no other implications.

NEXT STEPS:

65. The following steps are planned:
    a) Continue to implement asset allocation shifts as agreed by the Committee.
    b) Continue to monitor performance and asset allocation.

Contact Officer:

Lloyd Whitworth, Head of Investment & Stewardship

Annexes:

1. Annexe 1 – Manager Fee Rates (Part 2)
2. Annexe 2 – Correspondence from LGIM (Part 2)

Sources/Background papers:

None

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