

**SURREY COUNTY COUNCIL****PENSION FUND COMMITTEE****DATE:** 17 JUNE 2022**LEAD OFFICER:** ANNA D'ALESSANDRO, DIRECTOR CORPORATE FINANCIAL & COMMERCIAL**SUBJECT:** INVESTMENT MANAGER PERFORMANCE AND ASSET/LIABILITIES UPDATE**SUMMARY OF ISSUE:**

This report is a summary of all manager issues that need to be brought to the attention of the Pension Fund Committee, as well as an update on investment performance and the values of assets and liabilities.

**RECOMMENDATIONS:**

It is recommended that the Pension Fund 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:**

In order to judge the performance of the Fund's investment managers against the Fund's target returns, and whether it is meeting its Strategic Investment objective in line with its Business Plan.

**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.

**Liabilities**

2. The Fund's liabilities are the future benefit payments due to members in respect of their service accrued in the Fund. Currently, the majority of benefit payments are in respect of pensioner members. However, over time, the benefit payments will transition from being mostly in respect of pensioners to deferred and active members (i.e. the pensioners of the future).

**Assets**

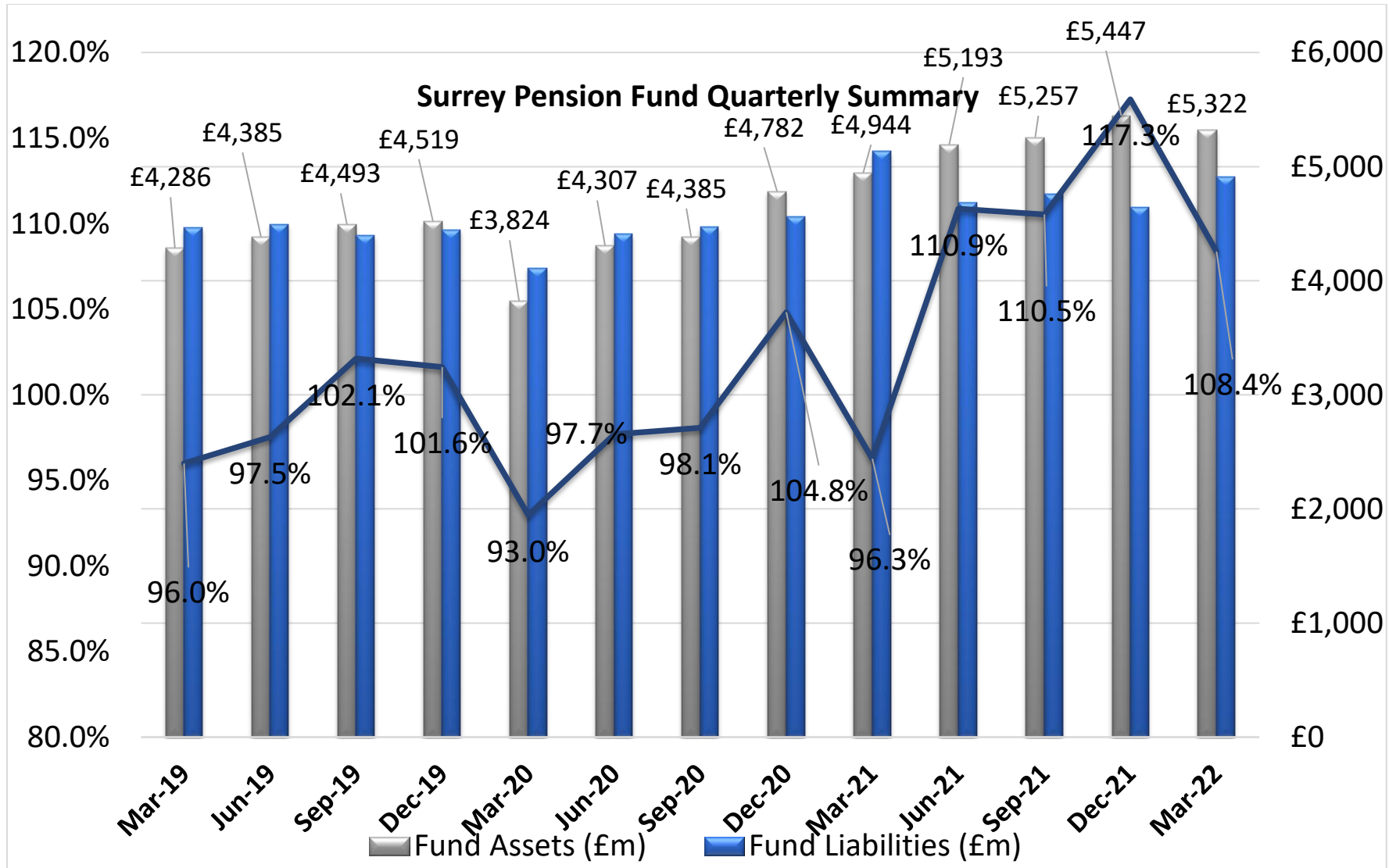
3. The Fund's assets are used to pay member benefits accrued to date. It is estimated that, based on the fund returns 4.2% p.a. the Fund's assets will be sufficient to pay all future benefit payments due.
4. The graph below summaries that funding level has reached 108% (96% as at 31 March 2019) and is based on the formal valuation results as at 31 March

2019, updated for market conditions at 31 March 2022. Based on the data that has been provided, the market value of assets is approximately £5,322bn and the value placed on the liabilities is £4,911bn.

*The assumptions used are as follows: A discount rate of 4.2%, Salary inflation of 3.6%, Pension increases of 2.7%*

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5. The liability figures included in the chart vary each quarter due, primarily to changes in the inflation assumption used to derive the liability value. The discount rate (i.e. the assumed rate of future investment returns) is fixed in this chart at 4.2% per annum, however the inflation assumption (CPI) is set with reference to the market's expectation of future inflation at the date of calculation. As this varies from time to time, this can lead to large changes in the value of the liabilities on a quarterly basis. For example, over the three months to 31 March 2022 long term inflation expectations rose by 0.3% per annum and this led to a c. 5% increase in the value of the liabilities over this short period. If actuarial assumptions remained the same each quarter, and if member and inflation experience was exactly as had been assumed, we would expect the liabilities to rise slightly (by c. 1%) each quarter.

The actuarial assumptions will be reviewed at the 2022 valuation and the final assumptions are likely to differ to those used for the recent update. Any change to the financial and demographic assumptions at the 2022 valuation will lead to a change in the value of the liabilities as at 31 March 2022. Further to this, the 2022 valuation liability calculation will also allow for the effect of member experience since the 2019 valuation and this is also likely to led to a change in the liability value. The Actuary will confirm the effect of assumption changes and member experience when they provide the valuation results later this year.



6. Global equity markets were negative for the first quarter of 2022, despite a strong recovery in the second half of March. Most major markets, developed and emerging alike, posted losses, selling off in January and then again in the last week of February and early March on the shocking news of Russia's invasion of Ukraine.

Rising inflation and a shift in sentiment towards interest rate increases had already been worrying markets, which was amplified after the invasion, as evidenced by the sharp rise in the price of oil. February's US inflation rate came in at 7.9%, the highest since January 1982, and this situation was reflected around the world. In March, the Federal Reserve went ahead with its first 25 basis-point rate rise and indicated further increases are on the horizon. This changed environment negatively impacted long duration sectors and stocks, such as technology. Meanwhile, the FTSE 100 held up relatively well, in part due to its large weighting to energy and materials companies, which benefited from higher oil, gas and other raw materials prices.

Reflecting rising interest rates, yields on global government bonds rose over the quarter. The Bank of England was the first of the major developed market central banks to embark on a tightening cycle, just prior to the start of the year. The UK base rate was back to 0.75% in March, whilst rates in the US are now expected to reach between 2.5% and 3% by the end of 2024. Although the ECB kept interest rates on hold, it announced that the winding down of its bond-buying programme would be accelerated. In response, the yield on German 10-year bunds moved back into positive territory. Corporate bond yields followed the same pattern as government bond yields and rose over the quarter.

Towards the end of the quarter, the yield curve between 2-year and 10-year US treasuries inverted (downward sloping) for the first time since 2019, an event considered to sometimes predict an economic downturn. Slowing economies and persistent inflation has led to a debate about the potential for stagflation going forward.

The US dollar was strong over the quarter, rising against the euro, sterling, and yen.

### **Performance review**

The performance of the Fund, and the individual asset classes, is shown in the table below.

Overall, the Fund returned -3.19% in Q4 2021/22, in comparison with the Fund's benchmark of -1.51%. At the absolute level, this is the result of the factors discussed above, whilst the relative performance reflects a disappointing outturn from the actively managed equity and fixed income allocations.

There are common themes that manifest throughout the various actively managed funds. Namely, the rotation towards value stocks, the valuation pressure on high-valued, long duration stocks, and the performance of the energy and materials sectors over the period.

The Baillie Gifford fund within BCPP UK Equity Alpha was the main driver of the underperformance in the UK asset class, returning -18.2% over the quarter. The fund has a high weighting to companies that are expected to generate significant cashflows in the future, rather than in the present. As discussed, the valuation of these types of company was under pressure during the period.

The BCPP Global Equity Alpha Fund had a strong start to the year, benefitting from its exposure to value managers. However, their gains were eroded after the invasion of Ukraine and meant that the fund underperformed overall in the period. The fund's overweight to Europe and underweight to the Energy sector detracted as the former sold off due to the proximity of the conflict and the source of its energy supplies, and the latter rallied with rising commodity prices.

The Newton Global Equity Fund was also impacted by the same dynamics – the rotation out of higher-multiple stocks and an underweight to Energy. At a stock level, selection in financials was the primary driver of relative performance.

Whilst each of the managers within the BCPP Multi-Asset Credit Fund was within +/- 1.5% of their respective benchmarks, the overall Fund is measured against SONIA (Sterling Overnight Index Average) +3.5% p.a. Therefore, as fixed income markets experienced one of their weakest periods of performance, the relative performance against this benchmark was disappointing.

## Fund Performance - Summary of Quarterly Results

Overall, the Fund returned -3.19% in Q4 2021/22, in comparison with the Fund's customised benchmark of -1.51%. The table below shows manager performance for Q4 2021/2 (net of investment manager fees) against manager specific benchmarks using Northern Trust data.

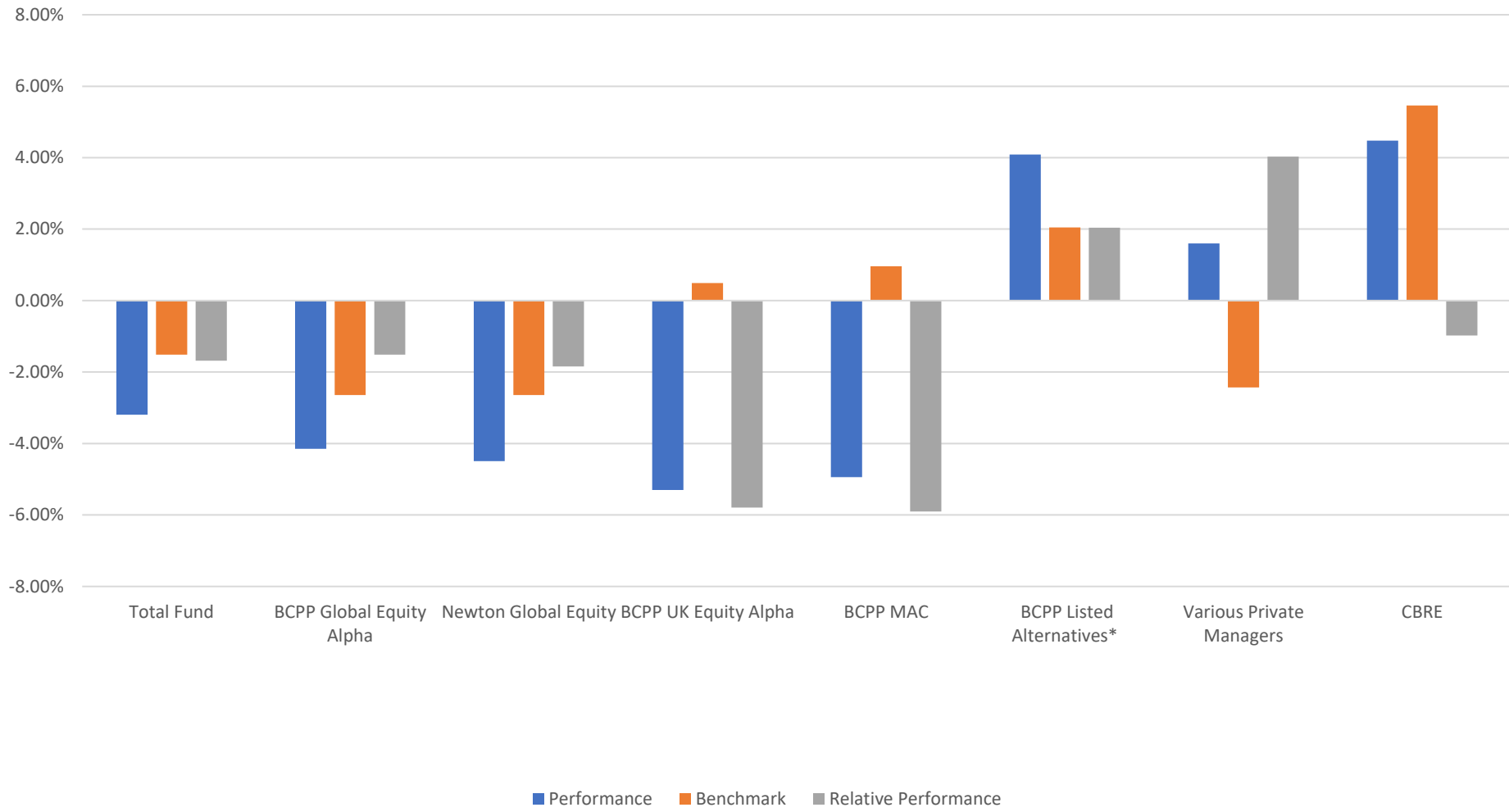
Asset Class	Mid Value £m	3M			1Y			3Y		
		Perf	Benchmark	Relative Perf	Perf	Benchmark	Relative Perf	Perf	Benchmark	Relative Perf
<b>Total Fund</b>	<b>5,310*</b>	-3.19%	-1.51%	-1.68%	6.70%	9.57%	-2.87%	6.73%	7.53%	-0.80%
<b>Active Global Equity</b>										
BCPP Global Equity Alpha	712.9	-4.15%	-2.64%	-1.51%	7.56%	12.42%	-4.85%			
Newton Global Equity	492.8	-4.49%	-2.64%	-1.84%	10.26%	12.42%	-2.15%	13.86%	13.36%	0.50%
<b>Active Regional Equity</b>										
BCPP UK Equity Alpha	541.2	-5.30%	0.49%	-5.79%	3.31%	13.03%	-9.72%	5.25%	5.31%	-0.06%
<b>Passive Global Equity</b>										
LGIM - Future World Global	1,024.7	-3.76%	-3.65%	-0.11%						
<b>Passive Regional Equity</b>										
LGIM - Europe Ex-UK	52.2	-7.22%	-7.32%	0.10%	6.19%	5.70%	0.49%			
LGIM Emerging Markets	299.7	-2.50%	-2.53%	0.03%	-3.56%	-3.64%	0.07%			
LGIM - Japan	16.6	-3.60%	-3.69%	0.09%	-2.43%	-2.67%	0.24%			
LGIM - Asia Pacific ex-Japan	45.8	2.82%	2.79%	0.03%	2.16%	2.09%	0.06%			
<b>Fixed Income</b>										
BCPP MAC	582.9	-4.94%	0.96%	-5.90%						
LGIM Gilts**	177.2	-8.01%	-8.01%	0.00%	-0.26%	-0.26%	0.00%	-5.62%	-5.62%	0.00%
<b>Private Markets Proxy</b>										
BCPP Listed Alternatives***	402.3	4.09%	2.05%	2.04%						
<b>Private Markets</b>										
Various Private Managers	558.1	1.60%	-2.43%	4.03%	16.40%	15.39%	1.01%	8.17%	14.58%	-6.41%
<b>Real Estate</b>										
CBRE	338.4	4.48%	5.46%	-0.98%	19.33%	23.72%	-4.39%	5.50%	8.46%	-2.96%

\* Does not include £15.1m of money market funds

\*\* Performance figures represent total Bespoke Fund (3M Gilt Return -11.44%, Liquidity Return 0.08%) (Liquidity & currency overlay £65.4m)

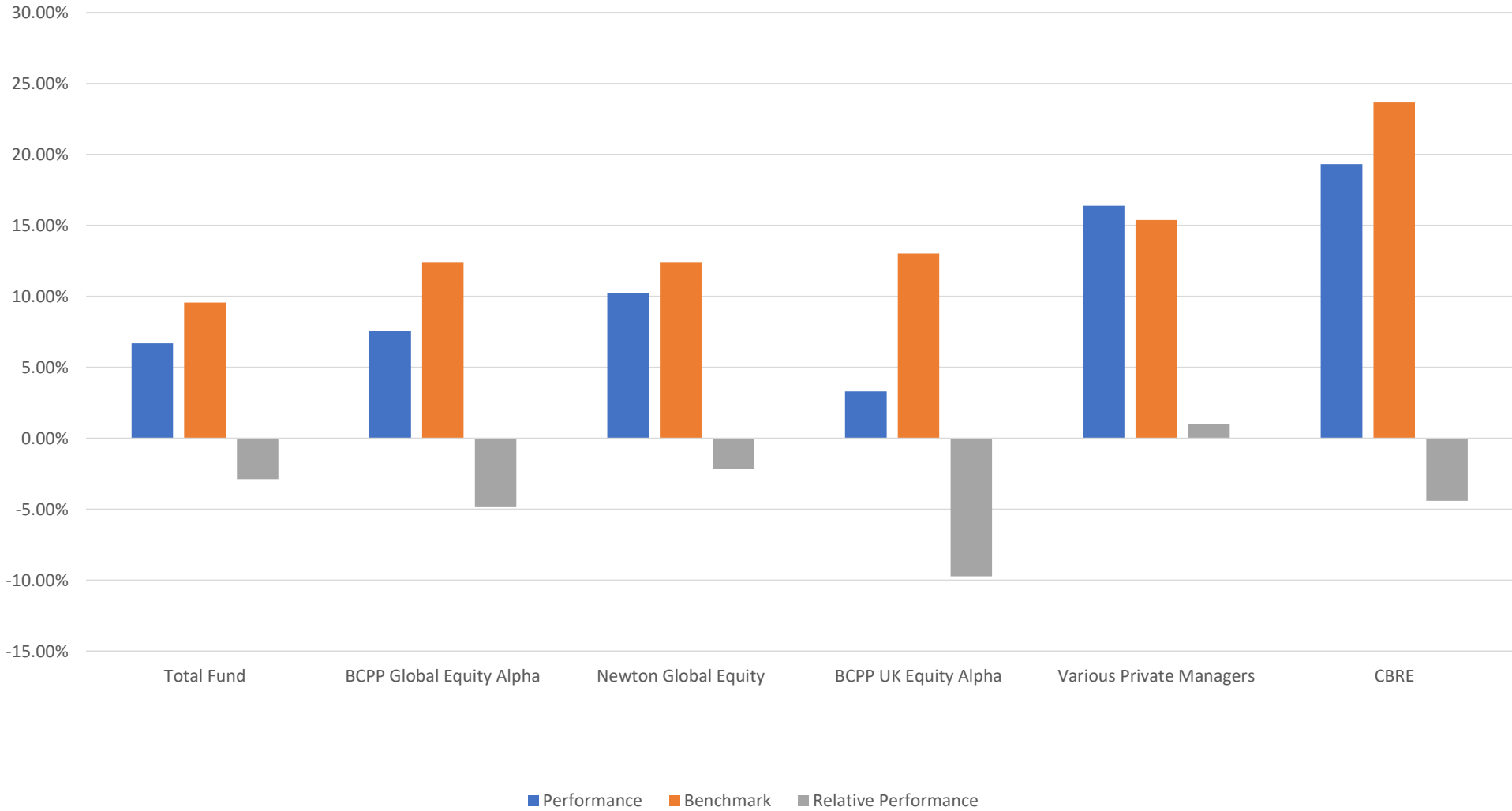
\*\*\* Return period is since inception (2/2/22)

### 3 Month to 31 Mar 2022 Active Manager Performance Relative to Benchmark



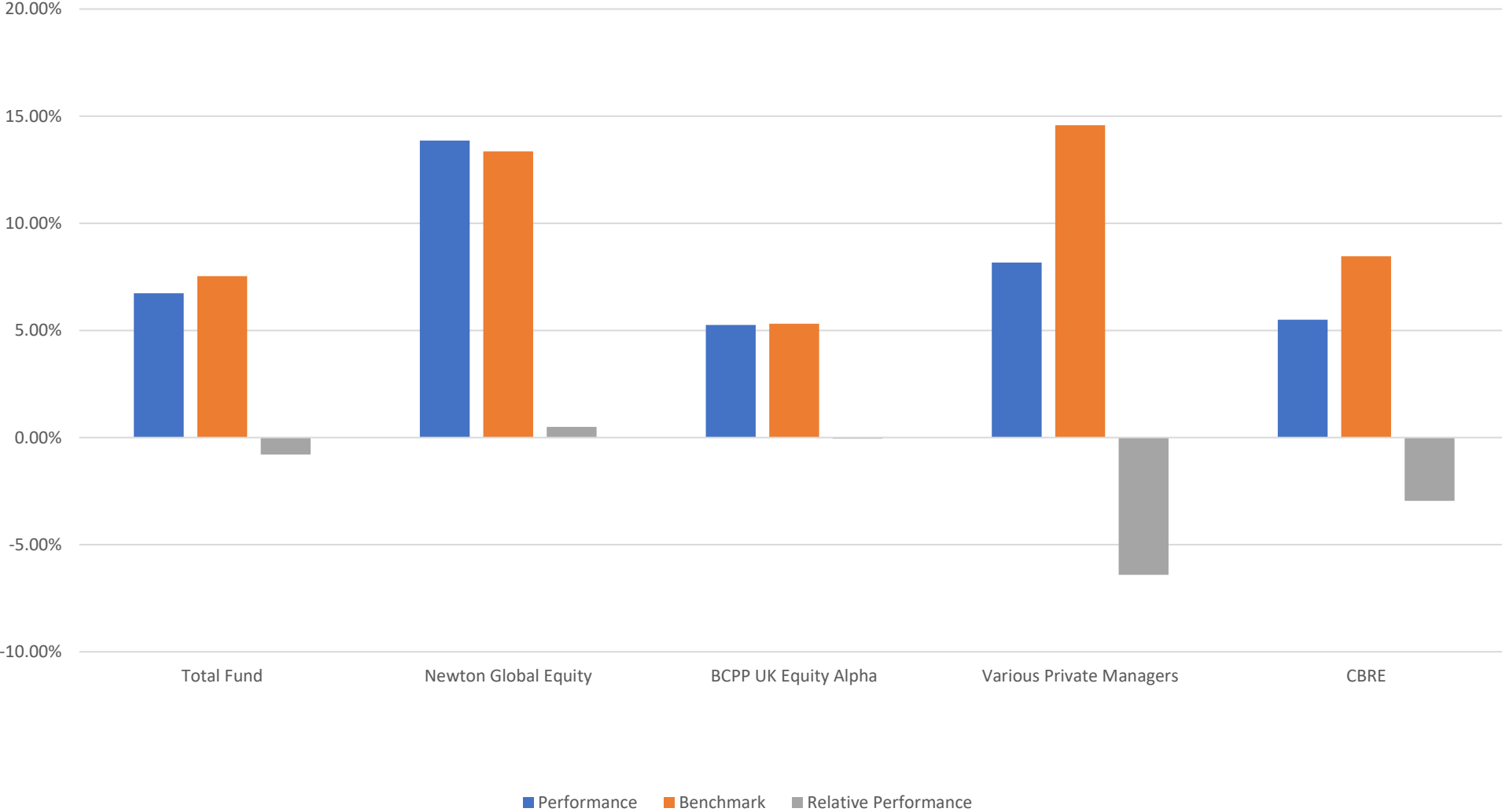
\* Return period is since inception (2/2/22)

### 1 Year to 31 Mar 2022 Active Manager Performance Relative to Benchmark





### 3 Year to 31 Mar 2022 Active Manager Performance Relative to Benchmark



## Recent Transactions

7. 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.
8. 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.
9. 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. The table below shows the performance of funds that were disposed during the quarter.

Performance of funds disposed during the period									
	1M (Jan-22)			1Y			3Y		
	Performance	Benchmark	Relative Performance	Performance	Benchmark	Relative Performance	Performance	Benchmark	Relative Performance
<b>Funds</b>									
Aviva Investors	-1.32%	0.02%	-1.34%	3.23%	0.11%	3.12%	3.70%	0.34%	3.36%
Baillie Gifford	-5.18%	0.02%	-5.20%	3.79%	0.11%	3.68%	4.66%	0.34%	4.23%
Ruffer	0.53%	0.02%	0.51%	10.22%	0.11%	10.11%	8.81%	0.34%	8.47%

## Stock Lending

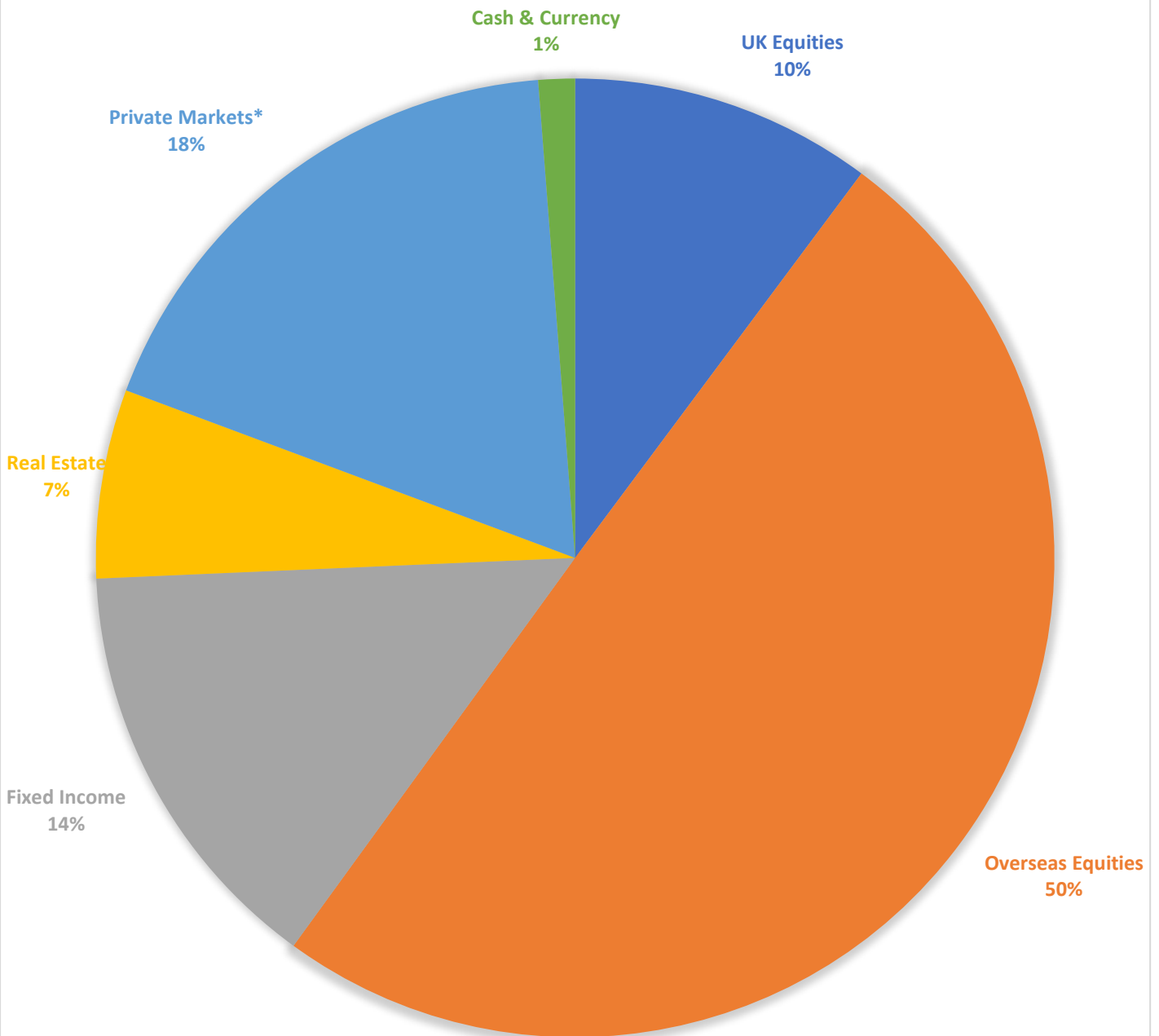
10. In the quarter to 31 March 2022, stock lending earned a net income for the Fund of £1,460. This compares with £1,507 for the quarter ended 31 December 2022.

## Asset allocation

11. The table and the graph below show the target and actual asset allocations for the quarter ending 31 March 2022. These allocations were agreed by the Pension Fund Committee in the December 2021 meeting.

Asset class	Total Fund (£M)	Actual (%)	Target (%)	Advisory ranges %	Role(s) within the strategy
<b>Listed Equities</b>		<b>60.0%</b>	<b>54.8</b>	<b>51.8 – 57.8</b>	Generate returns in excess of inflation, through exposure to the shares of domestic and overseas companies.
UK	541.2	10.2%	12		
Global Market Cap	1,205.7	22.7%	13		
Global Regional	114.6	2.2%	10		
Emerging Markets	299.7	5.6%	3.8		
Global Sustainable	1,024.7	19.3%	16		
<b>Alternatives</b>		<b>24.5%</b>	<b>27.6</b>	<b>22.6-32.6</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 Markets	558.1	10.5%	17	7.0-25.0	
Listed Alternatives	402.3	7.6%	3	0.0-6.0	
Property	338.4	6.4%	7.6	4.6–10.6	
<b>Fixed Income</b>		<b>14.3%</b>	<b>17.6</b>	<b>11.6 – 23.6</b>	
Multi Asset Credit	582.9	11.0%	12.1	9.1-15.1	Offer diversified exposure to global credit markets to capture both income and capital appreciation of underlying bonds.
Fixed Interest Gilts	177.2	3.3%	5.5	2.5-8.5	Low risk income stream
<b>Liquidity &amp; Currency Overlay</b>	65.4	<b>1.2%</b>			
<b>Total</b>	<b>5,310.2</b>				

## ASSET ALLOCATION AS AT 31 MAR 2022

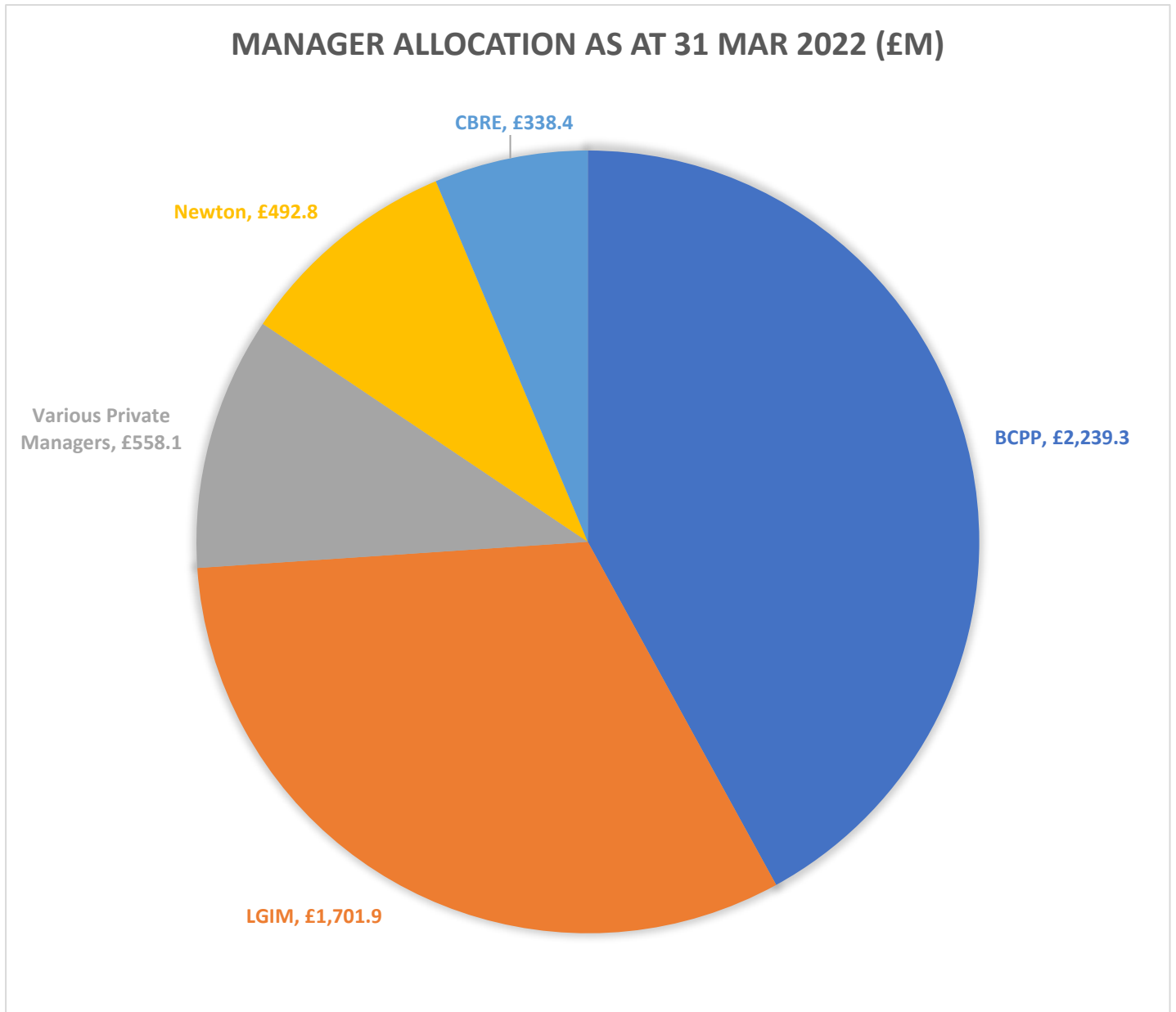


\*Includes Listed Alternatives

## Manager Allocation

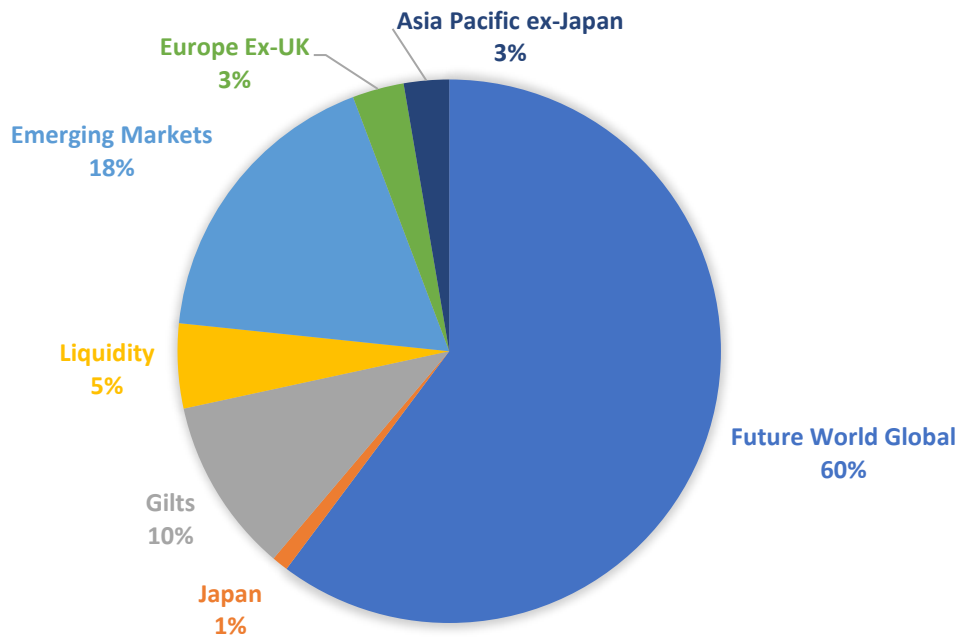
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The graph below shows the manager allocation for the quarter ending 31 March 2022.

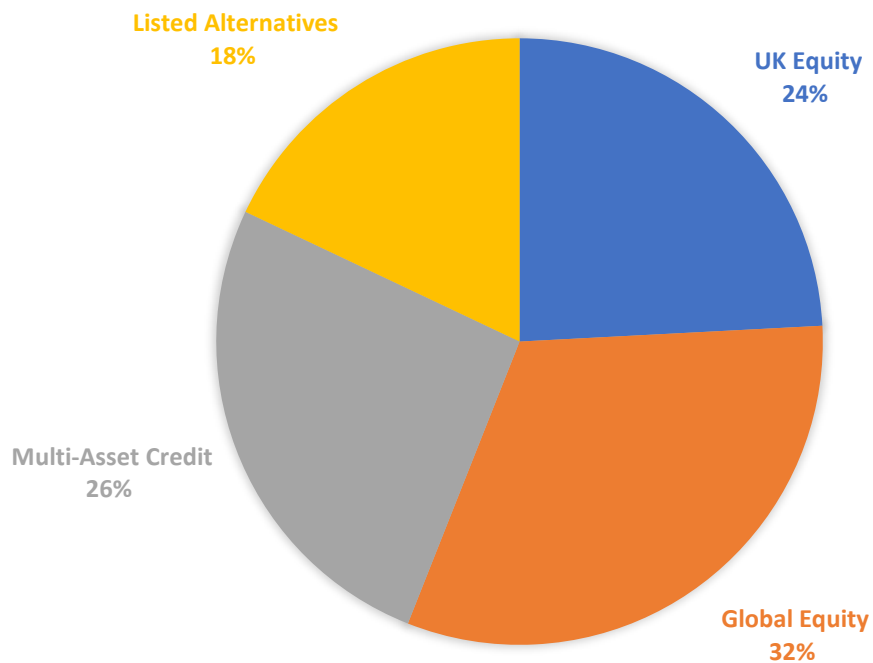


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## LGIM ALLOCATION DETAIL AS AT 31 MAR 2022



## BCPP LISTED ALLOCATION AS AT 31 MAR 2022



## Cashflow Analysis

12. Pensions Funds have a positive cash-flow when their contribution inflows exceed pension benefits paid.
13. 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.
14. Any positive cash-flow is invested in accordance with the Fund's cash management plan.
15. The half-yearly (quarters three-four) cash-flow for the Fund shows positive cash flow of £10,496,236 as shown below.

Quarter	Total contributions received	Total pension benefits paid	Net cash-flow
Three (1 Oct 2021 – 31 Dec 2021)	£51,344,362	£46,854,366	£4,489,996
Four (1 Jan 2022 – 31 Mar 2022)	£55,181,337	£49,175,097	£6,006,240

16. An indication of the current membership trends is shown by movements in membership over quarters three-four. The number of active members has reduced by c3,500 as a result of completing an exercise that identified members who have left the scheme, but no formal notice of termination has been provided by their employers. Work on these member cases is continuing with requests to employers to provide the information required to enable benefit entitlements to be calculated correctly. Member data listed below.

Period	Active members	Deferred members	Pension members	Total members
Quarter Three 2021/22 (1 Oct 2021 – 31 Dec 2021)	39,244	41,719	29,371	110,334
Quarter Four 2021/22 (1 Jan 2022 – 31 Mar 2022)	35,656	42,776	29,594	108,026

## 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 AC World Index	
Newton	Global Equities	MSCI AC World Index	+2.0%
Various*	Private Equity	MSCI World Index	+5.0%
CBRE	Property	MSCI/AREF UK QPFI All Balanced Property Fund Index	+0.5%
LGIM	Europe (ex-UK) Equities  Future World Global Equity Index Japan Equity  Asia Pacific ex Japan Development Equity  World Emerging Markets Equity  LGIM Bespoke & Cash	FTSE Developed Europe Ex-UK Net  Solactive L&G ESG Global Markets Net  FTSE Japan Net  FTSE Developed Asia Pacific Ex-Japan Net  FTSE Emerging Net  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
Internal	Cash	LIBID 7-day rate	LIBID 7-day rate



### **CONSULTATION:**

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

### **RISK MANAGEMENT AND IMPLICATIONS:**

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

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

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

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

20. 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**

21. There are no legal implications or legislative requirements.

### **EQUALITIES AND DIVERSITY**

22. 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**

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

### **WHAT HAPPENS NEXT**

24. The following next steps are planned:

- Continue to transition assets into BCPP and enhance risk adjusted returns

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#### **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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