

**SURREY COUNTY COUNCIL****PENSION FUND COMMITTEE****DATE: 23 SEPTEMBER 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

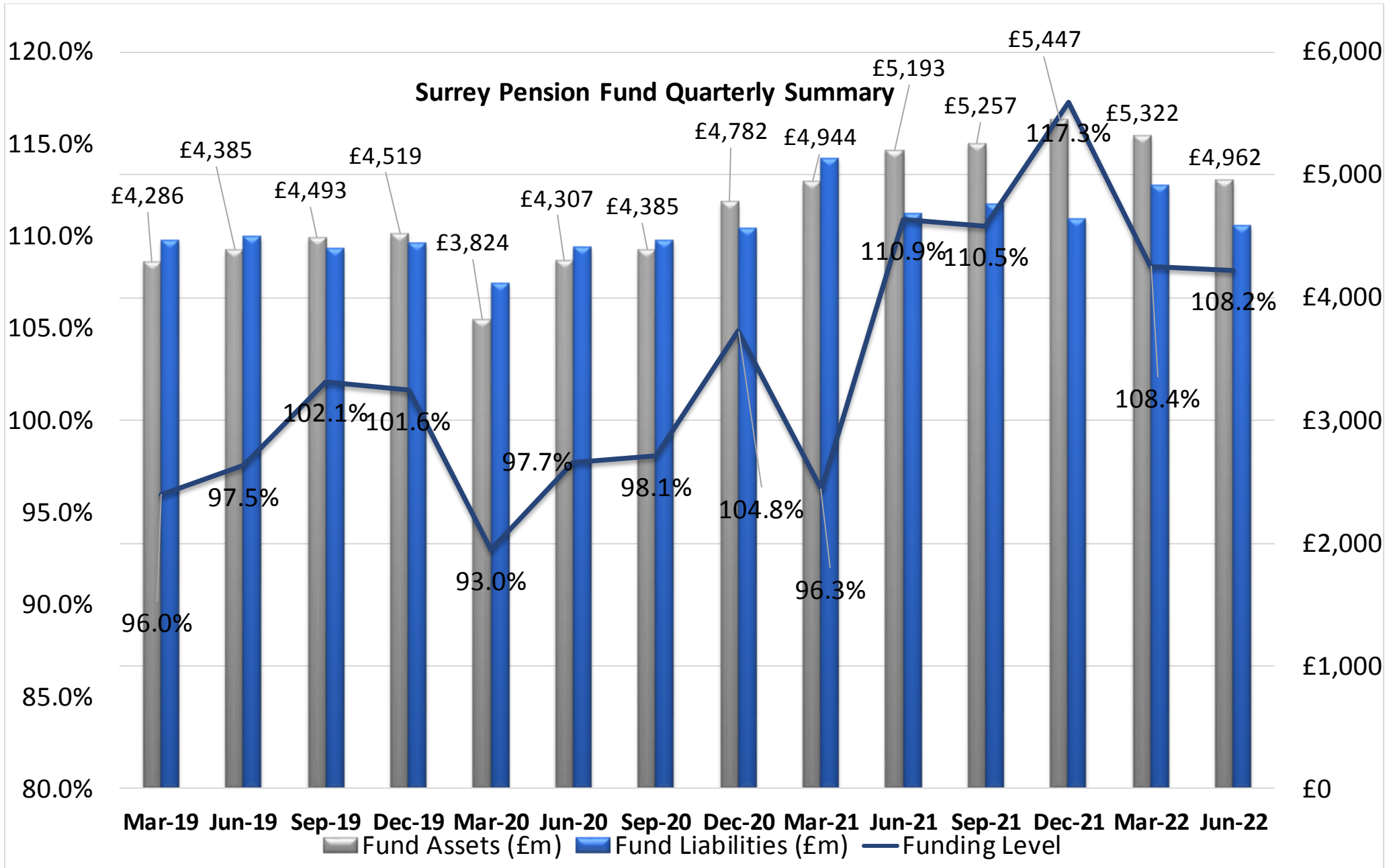
2019, updated for market conditions at 30 June 2022. Based on the data that has been provided, the market value of assets is approximately £4,962bn and the value placed on the liabilities is £4,588bn.

*The assumptions used are as follows: A discount rate of 4.2%, Salary inflation of 3.2%, Pension increases of 2.3%*

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.

### Surrey Pension Fund Quarterly Summary



## Market Review

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6. Global equities fell steeply in the quarter to 30 June 2022, leading to the US equity market having its worst first 6 months of a calendar year for 50 years. Major developed and emerging markets all posted losses, although emerging markets slightly outperformed global equities. This was driven by high levels of inflation, responses from Central Banks and resultant concern over recession.

Despite downward revisions to GDP growth expectations, markets expect further increases in interest rates. In general, economic indicators were depressed, as factory activity slowed and business and consumer confidence fell to lows.

European equity markets performed poorly, with the most significant risk being the tightening of gas supplies from Russia. The high energy prices and disruption to trade have already pushed Germany into its first trade deficit in 30 years. The UK equity market also fell over the quarter, but outperformed other markets, benefitting from its relatively high weighting in energy and commodity companies. Japan's market also held up relatively well due to the Bank of Japan's continued loose monetary policy and the devaluation of the yen, which neared a 24-year low against the US dollar.

Yields on global government bonds rose over the period as inflation readings continued to surprise on the upside. Despite interest rate rises in the US and UK, the European Central Bank left rates unchanged over the quarter but flagged future rises following the end to its asset-purchasing programme. Yields on global credit also rose and spreads widened.

The US dollar rose against sterling, the euro and the Japanese yen in the quarter to 30 June 2022, as rising US interest rates, combined with the dollar's perceived safe-haven status, took hold amid a worsening global economic outlook. Sterling also fell against the euro as the UK's trade performance deteriorated.

Perversely, the Russian rouble is the strongest-performing currency in the world this year, supported by capital controls and interest rates of 20%. Despite the war in Ukraine, international sanctions and foreign investors fleeing the country, the rise in energy prices and Russia's demand that its trading parties pay in roubles has created surprisingly strong demand for the currency.

## Performance Review

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7. Overall, the Fund returned -6.8% in Q1 2022/23, in comparison with the Fund's benchmark of -6.1%. The fall in absolute terms was the result of the factors discussed above, particularly highlighted by the performance of UK Gilts.
8. The relative underperformance was driven by the BCPP UK Equity Alpha Fund and the BCPP Multi-Asset Credit (MAC) Fund. Within the UK Equity fund, Baillie Gifford's growth and long duration stance, discussed last quarter, continued to impact returns, whilst the small cap companies held through Janus Henderson were also a drag on performance. Relative to each individual market benchmark, the underlying funds within MAC underperformed by 0.4%. However, against the overall absolute return benchmark of SONIA +3.5%p.a., the Fund underperformed significantly as yields across the market rose, as discussed above.
9. Offsets to this performance came from the Real Estate exposure, through CBRE, as well as the Private Markets positions. Valuations in both these asset classes tend to be less volatile and, compared to listed equities, tend to adjust more slowly to changing economic conditions. This can benefit relative performance on a short-term basis.

## Fund Performance - Summary of Quarterly Results

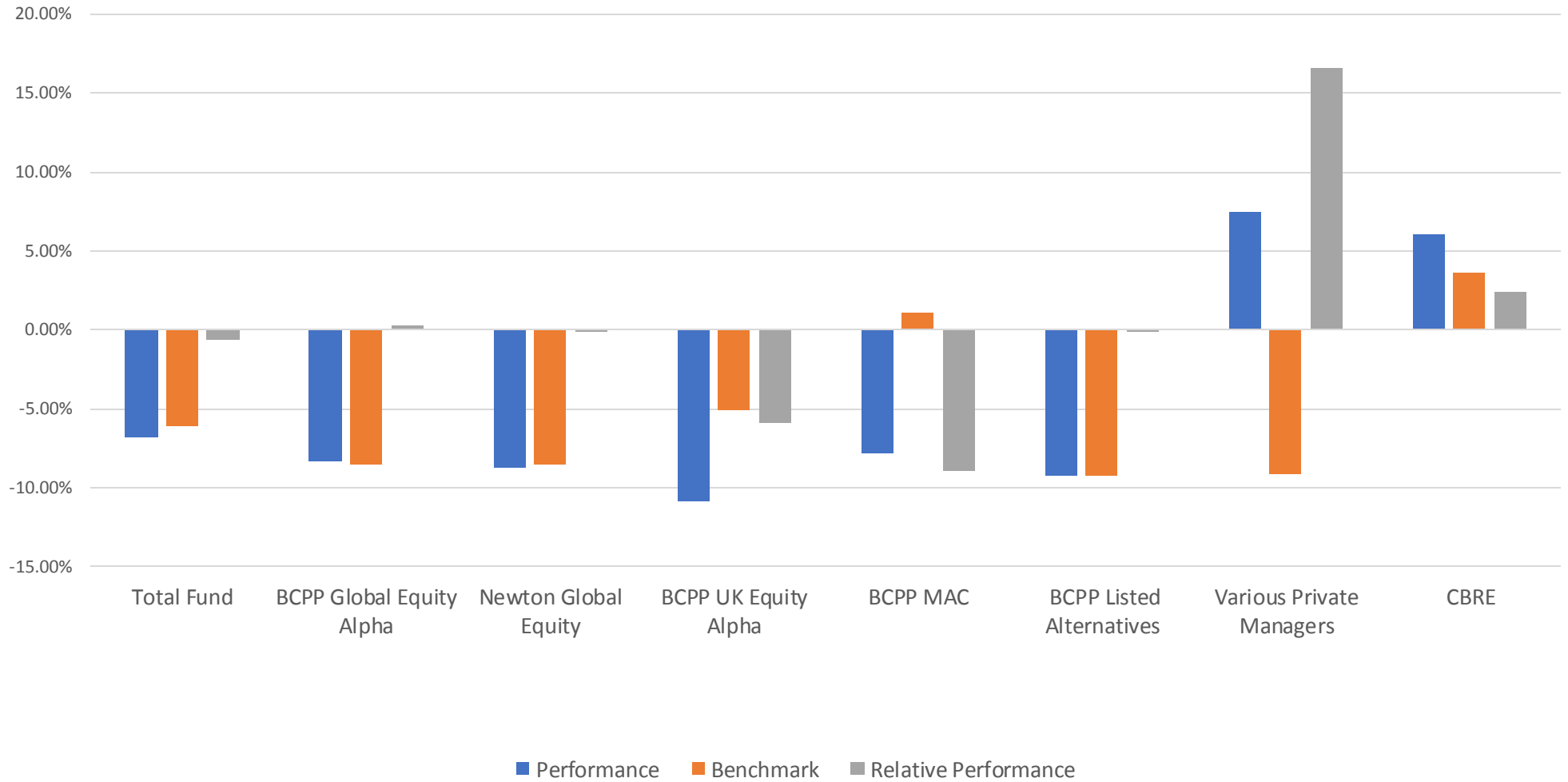
The table below shows manager performance for Q1 2022/23 (net of investment manager fees) against manager specific benchmarks using Northern Trust data.

As at 30 Jun 2022		3M			1Y			3Y		
Asset Class	£m	Performance	Benchmark	Relative Performance	Performance	Benchmark	Relative Performance	Performance	Benchmark	Relative Performance
<b>Total Fund</b>	<b>4,982.3</b>	-6.79%	-6.13%	-0.66%	-5.16%	-2.36%	-2.80%	3.50%	4.12%	-0.62%
<b>Active Global Equity</b>	<b>1,103.6</b>									
BCPP Global Equity Alpha	653.7	-8.30%	-8.56%	0.26%	-7.90%	-4.17%	-3.74%			
Newton Global Equity	449.9	-8.71%	-8.56%	-0.15%	-5.28%	-4.17%	-1.12%	8.12%	7.88%	0.24%
<b>Active Regional Equity</b>	<b>482.3</b>									
BCPP UK Equity Alpha	482.3	-10.89%	-5.04%	-5.85%	-11.43%	1.64%	-13.07%	-0.08%	2.41%	-2.49%
<b>Passive Global Equity</b>	<b>886.8</b>									
LGIM - Future World Global	886.8	-8.42%	-8.31%	-0.11%						
<b>Passive Regional Equity</b>	<b>392.7</b>									
LGIM - Europe Ex-UK	45.0	-8.78%	-9.08%	0.30%	-10.41%	-10.93%	0.51%			
LGIM Emerging Markets	291.2	-2.79%	-2.75%	-0.04%	-10.73%	-10.78%	0.05%			
LGIM - Japan	14.6	-6.69%	-6.79%	0.10%	-8.49%	-8.80%	0.32%			
LGIM - Asia Pacific ex-Japan	41.8	-8.70%	-8.69%	-0.02%	-11.11%	-11.14%	0.03%			
<b>Fixed Income</b>	<b>690.8</b>									
BCPP MAC	537.1	-7.86%	1.09%	-8.95%						
LGIM Gilts*	153.7	-8.61%	-8.61%	0.00%	-14.78%	-14.78%	0.00%	-7.50%	-7.50%	0.00%
<b>Private Markets Proxy</b>	<b>364.9</b>									
BCPP Listed Alternatives	364.9	-9.28%	-9.13%	-0.15%						
<b>Private Markets</b>	<b>615.0</b>									
Various Private Managers	615.0	7.47%	-9.13%	16.60%	22.85%	-2.56%	25.41%	9.57%	8.68%	0.89%
<b>Real Estate</b>	<b>358.9</b>									
CBRE	358.9	6.07%	3.65%	2.42%	22.46%	23.33%	-0.86%	9.59%	9.52%	0.07%
<b>L&amp;G Currency Overlay</b>	<b>- 18.8</b>									
<b>Total Cash &amp; Liquidity**</b>	<b>106.0</b>									

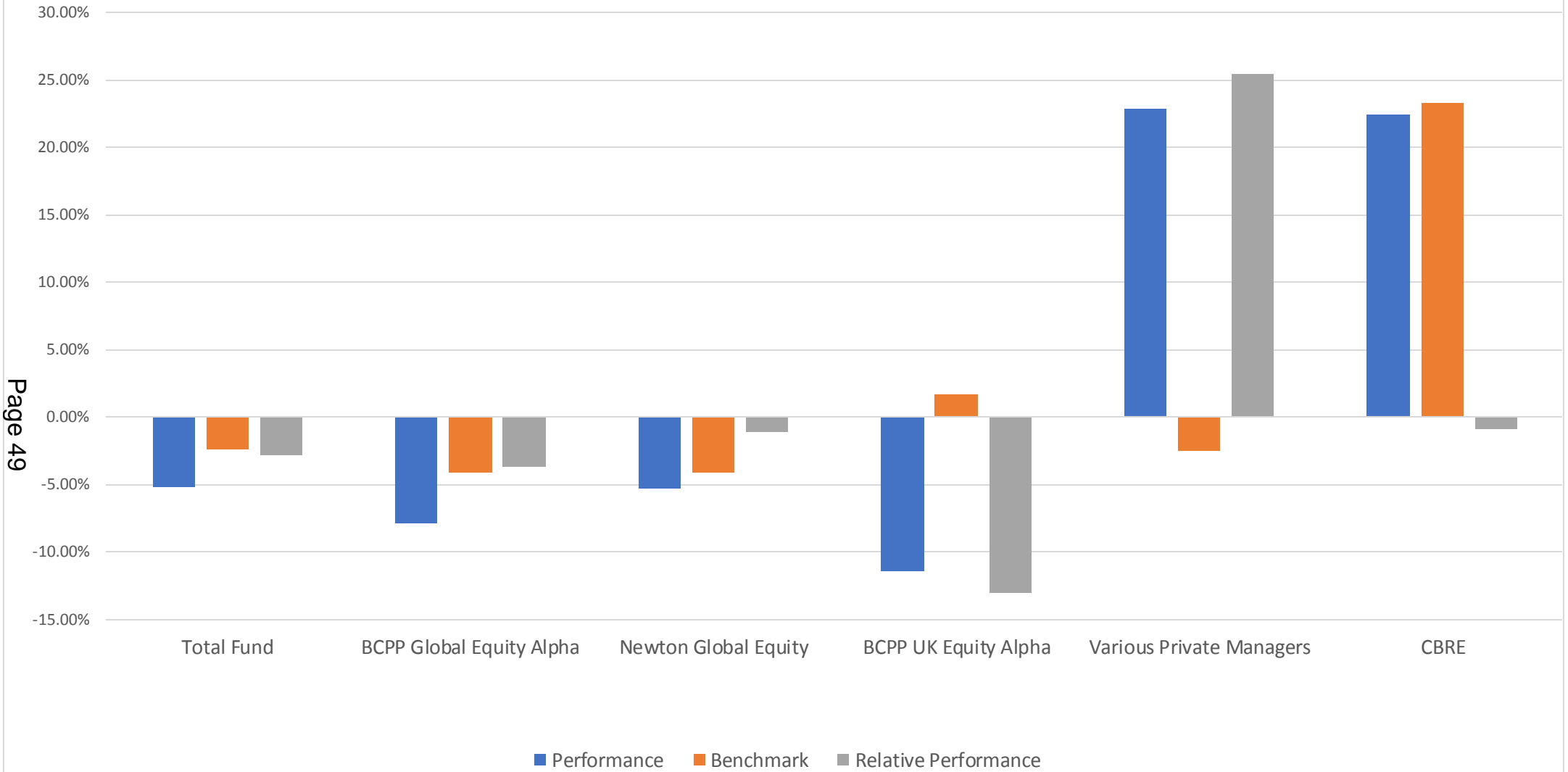
\* Performance figures represent total Bespoke Fund (3M Gilt Return -12.75%, Liquidity Return 0.23%)

\*\* Includes £17.9m of money market funds

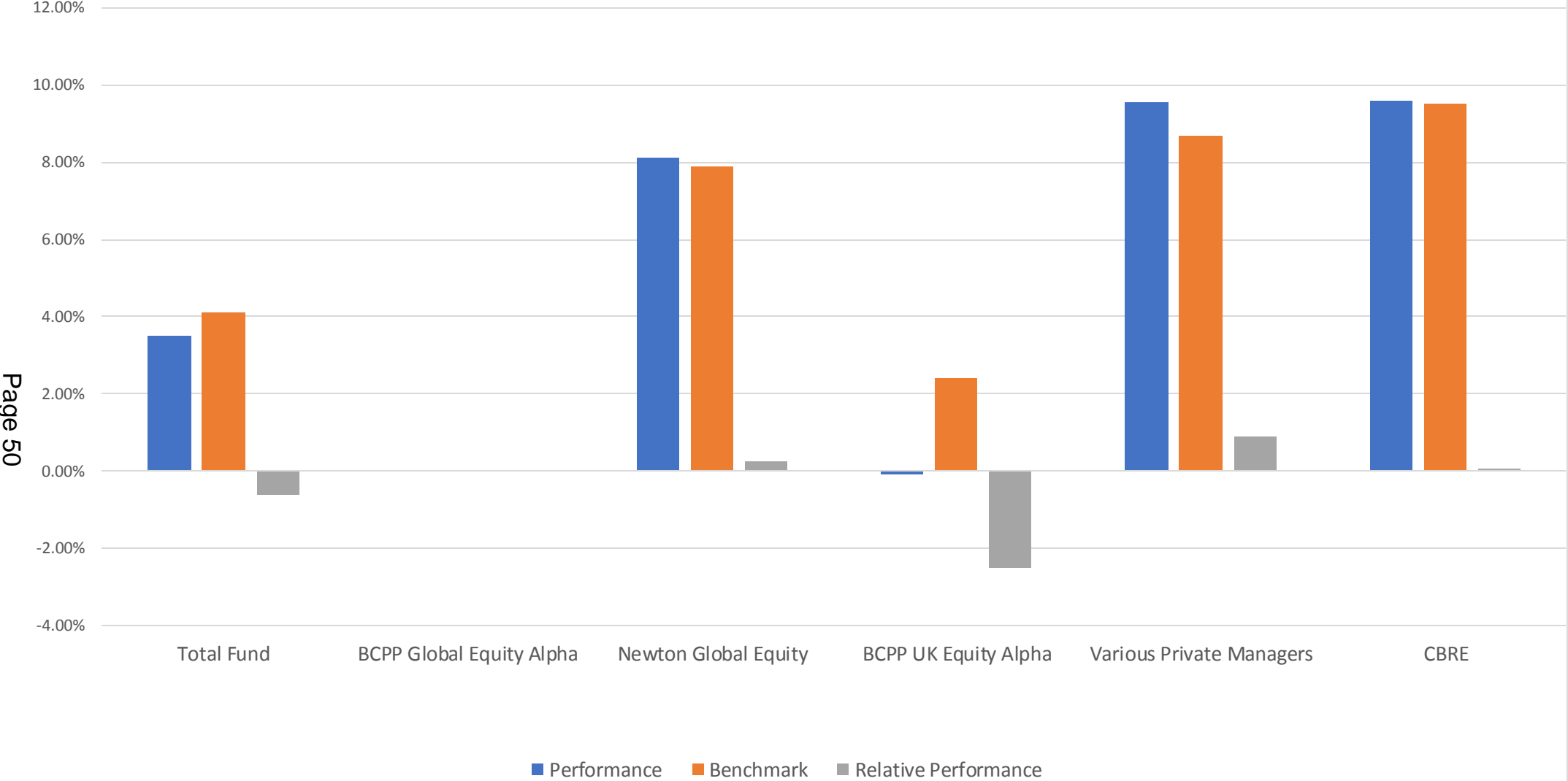
### 3 Months to 30 Jun 2022 Active Manager Performance Relative to Benchmark



# 1 Year to 30 Jun 2022 Active Manager Performance Relative to Benchmark



### 3 Years to 30 Jun 2022 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.

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.

## Stock Lending

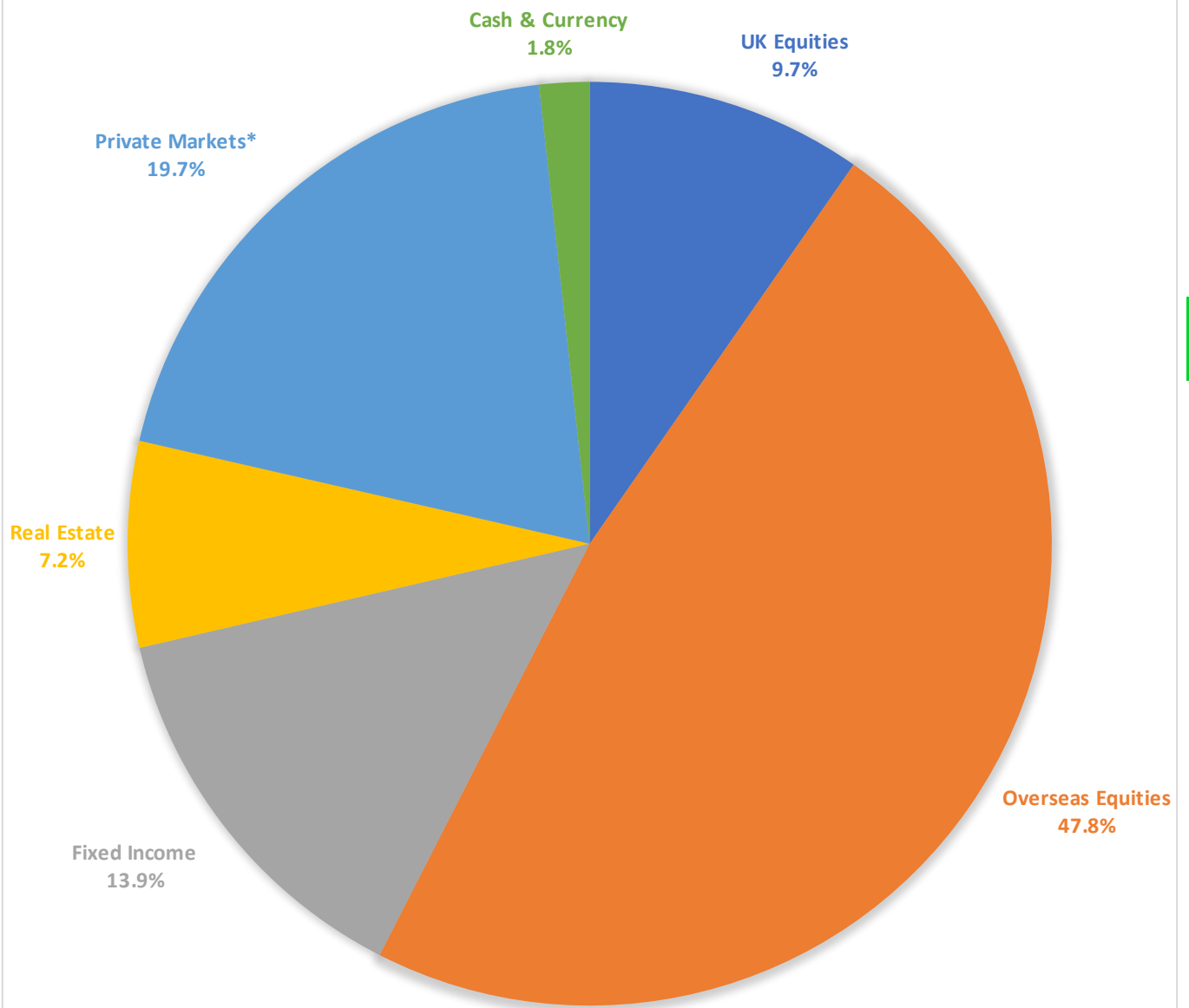
9. In the quarter to 30 June 2022, stock lending earned a net income for the Fund of £8,784 compared with £1,460 for the quarter ended 31 March 2022.

## Asset allocation

10. The table and the graph below show the target and actual asset allocations for the quarter ending 30 June 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>57.5</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	482.3	9.7	12		
Global Market Cap	1,103.6	22.1	13		
Global Regional	101.5	2.0	10		
Emerging Markets	291.2	5.8	3.8		
Global Sustainable	886.8	17.8	16		
<b>Alternatives</b>		<b>26.9</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	615.0	12.3	17	7.0-25.0	
Listed Alternatives	364.9	7.3	3	0.0-6.0	
Real Estate	358.9	7.2	7.6	4.6–10.6	
<b>Multi Asset Credit</b>		<b>10.8</b>	<b>12.1</b>	<b>9.1-15.1</b>	Offer diversified exposure to global credit markets to capture both income and capital appreciation of underlying bonds.
Multi Asset Credit	537.1	10.8	12.1		
<b>Fixed Interest Gilts</b>		<b>3.1</b>	<b>5.5</b>	<b>2.5-8.5</b>	Low risk income stream
Fixed Interest Gilts	153.7	3.1	5.5		
<b>Cash, Liquidity Fund &amp; Currency Overlay</b>		<b>1.8</b>			
Cash, Liquidity Fund & Currency Overlay	87.2	1.8			
<b>Total</b>	<b>4,982.3</b>		<b>100</b>		

## ASSET ALLOCATION AS AT 30 JUN 2022

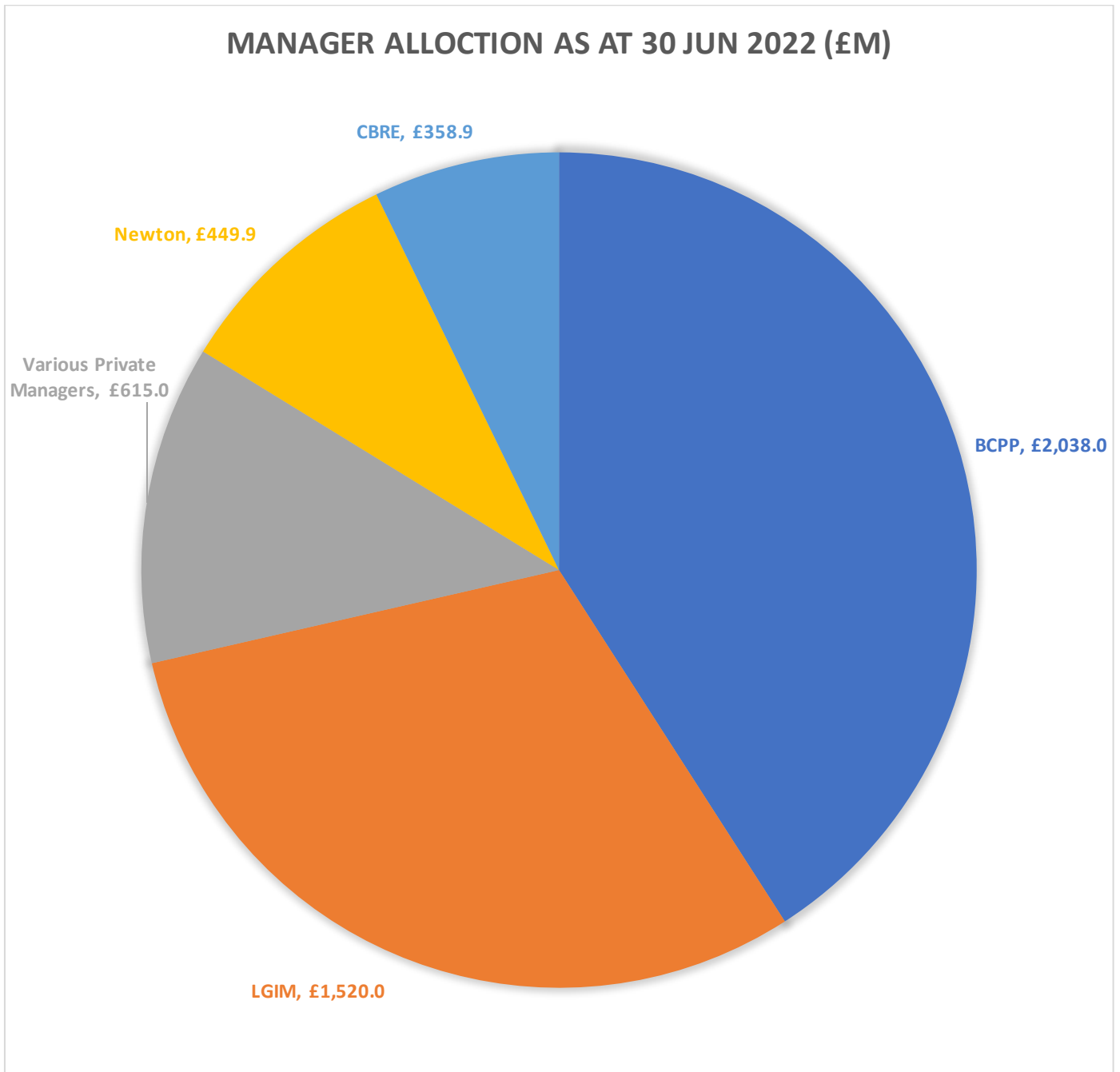


\*Includes Listed Alternatives

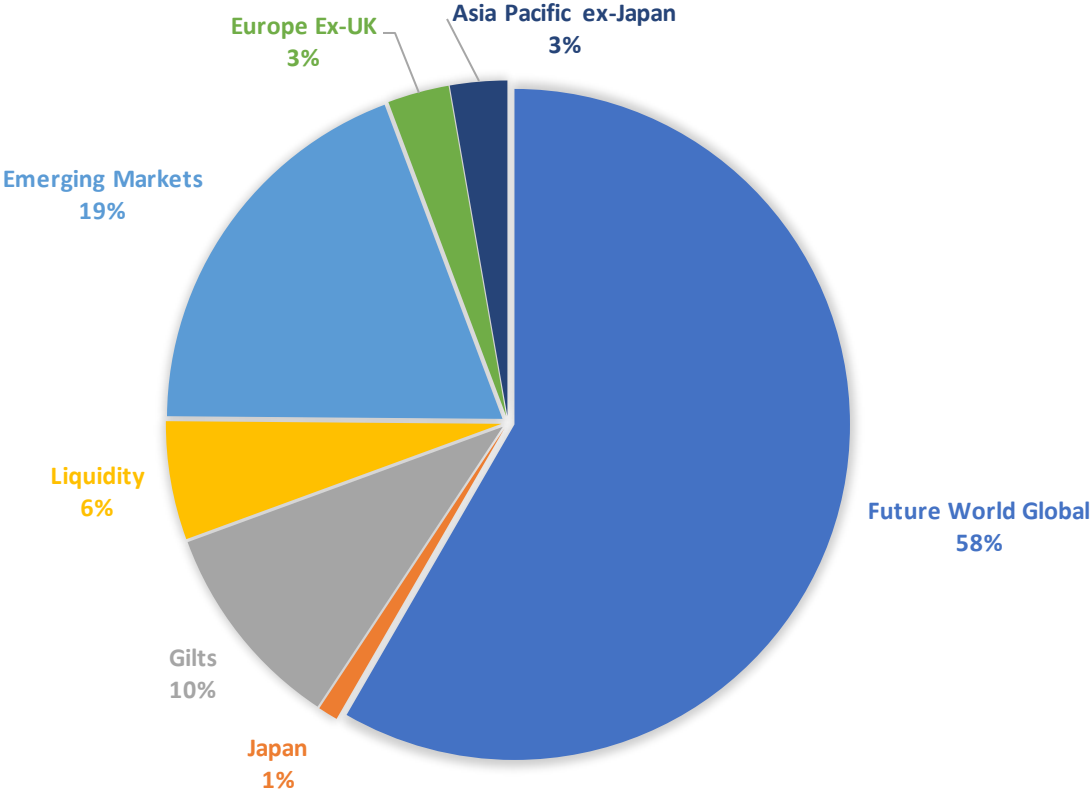
## Manager Allocation

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The graph below shows the manager allocation for the quarter ending 30 June 2022.

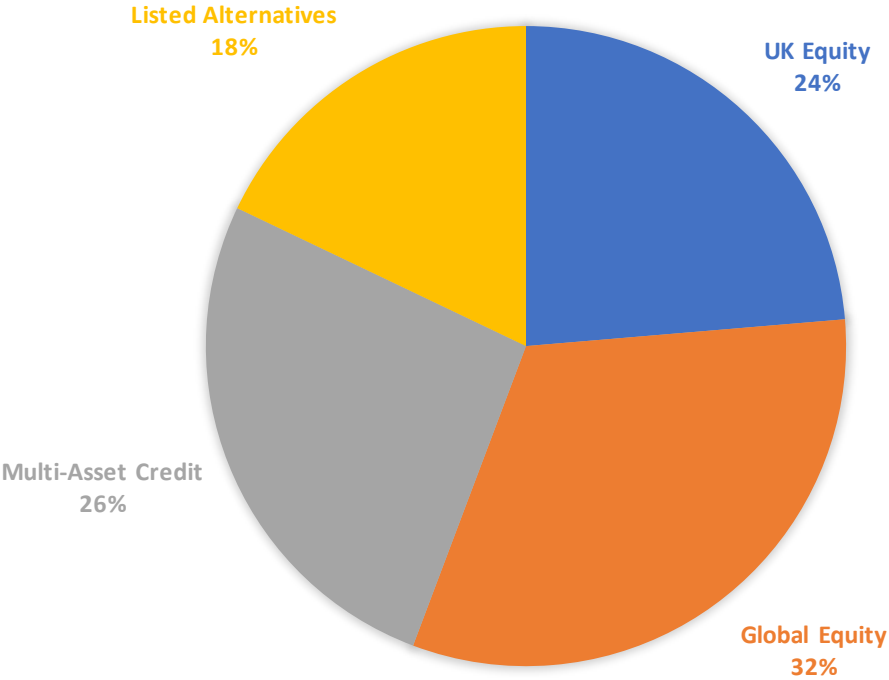


### LGIM ALLOCATION DETAIL AS AT 30 JUNE 2022



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### BORDER TO COAST LISTED ALLOCATION AS AT 30 JUN 2022



## Cashflow

11. Pensions Funds have a positive cash-flow when their contribution inflows exceed pension benefits paid.
12. 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.
13. Any positive cash-flow is invested in accordance with the Fund's cash management plan.
14. We are reviewing cashflow information and in due course will review the prospective cashflow requirements taking account of likely pension increases and the new schedule of employer contributions following the actuarial valuation.

£m Period	Total contributions received	Total pension benefits paid	Net cash-flow
Quarter Four 2021/22  (1 Jan 2022 – 31 Mar 2022)	55.2	49.2	6.0
Quarter One 2022/23  (1 Apr 2022 – 30 Jun 2022)	54.8	51.2	3.6

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

Period	Active members	Deferred members	Pension members	Total members
Quarter Four 2021/22  (1 Jan 2022 – 31 Mar 2022)	35,656	42,776	29,594	108,026
Quarter One 2022/23  (1 Apr 2022 – 30 Jun 2022)	35,394	43,085	29,917	108,396

## 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	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  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

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## **CONSULTATION:**

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

## **RISK MANAGEMENT AND IMPLICATIONS:**

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

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

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

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

19. 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**

20. There are no legal implications or legislative requirements.

## **EQUALITIES AND DIVERSITY**

21. 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**

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

## **WHAT HAPPENS NEXT**

23. 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:**