

CLWYD PENSION FUND COMMITTEE

Date of Meeting	Wednesday, 23 rd November 2022
Report Subject	Investment Strategy, Economic and Market Update and Performance Monitoring Report
Report Author	Head of Clwyd Pension Fund

EXECUTIVE SUMMARY

The purpose of this report is to update the Committee on the Economy and Markets, and the Performance of the Fund's investments. The reports cover periods ending 30 September 2022, and are attached as appendices to this report.

Key points to note:

Economy and Markets

- Equity markets weakened globally as financial conditions tightened, input prices rose and recessionary risks increased - a recovery rally early in the quarter dissipated in August. Global Equities returned 1.4% in sterling terms and -4.8% in local currency terms.
- Over the quarter the Bank of England (BoE) increased the base rate twice, to 2.25%, post quarter end the base rate has risen to 3.0%.
- The UK experienced significant gilts market volatility and sterling weakness post quarter end resulting from announcements contained in the mini-budget. Subsequent intervention from the BOE stabilised market conditions though yields remain elevated.
- The US Federal Reserve (Fed) raised rates over the quarter to 3.25%, post quarter end the rate has risen to 4.0%.
- Both the BoE and Fed are expected to continue to tighten policy throughout the rest of 2022 and 2023 though inflationary pressures appear to be easing - declines in US energy prices from their peaks should lead the headline inflation rate lower in the coming months. Gradual easing of supply side constraints and weaker demand could also slow core inflation.

Performance Monitoring Report

- Over the three months to 30 September 2022, the Fund's total market value decreased by £64.2m to £2,216.0m.
 - Fund Performance over 3 months, 12 months and 3 years; -2.5%, -6.5% and +4.1% p.a. respectively.
 - Fund Performance is ahead of the composite benchmark over all periods.
 - All asset classes are broadly in line with strategic target weight.
- Performance of the Fund is reviewed monthly by the Fund's Officers and advisers.

RECOMMENDATIONS

1	That the performance of the Fund over periods to the end of September 2022 are noted along with the Economic and Market update which effectively sets the scene.
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REPORT DETAILS

1.00	INVESTMENT AND FUNDING RELATED MATTERS
1.01	<p>Economic and Market Update The economic and market update for the quarter from the Fund's Investment Consultant is attached at Appendix 1. The report contains the following key sections:</p> <ul style="list-style-type: none">• Economic and Market Background – an overview of markets in the quarter, including commentary on key economic indicators• Equity Market Review – information on the performance of equity markets during the quarter and key drivers of markets• Bond Market (Fixed Income) Review – provides an update on bond yield movements and interest rates for the period• Currencies, Commodities and Alternatives Review – provides an update on the performance of Sterling against other currencies as well as highlighting movements in major commodity and alternatives asset classes for the period
1.02	<p>Inflation and central bank policy continued to drive markets in the third quarter of 2022. Inflation readings in most major regions remained high and rising. Central banks therefore continued to tighten monetary policy and maintained a hawkish outlook, resulting in elevated market volatility.</p> <p>Risk assets rose in July on the back of hopes of inflation peaking and the hiking cycle ending, but these hopes were quashed later in the quarter. Furthermore, markets priced in the increasing risk of a recession resulting from the monetary tightening. Therefore, most major asset classes ended the quarter with negative returns.</p> <p>The third quarter produced mixed returns though UK investors mitigated some global equity drawdown as a result of the continued weakening of Sterling. Emerging Market Debt was the only asset class to produce positive absolute returns whilst commodity markets saw the biggest fall in value over the quarter.</p> <p>Sterling depreciated against the US Dollar and Euro and the Yen.</p> <p>Post quarter end saw exceptional movements in UK government bond markets and significant further weakening of Sterling – this was as a result of investor reaction to announcements made in the min budget on 23rd September.</p> <p>A verbal update will be provided to Committee on market movements since the writing of this report.</p>
1.03	<p>Performance Monitoring report Over the 3 months to 30 September 2022, the Fund's total market value decreased by £64.2m to £2,216.0m.</p> <p>The Total Fund has decreased in value by £166.7m in 12 months to 30 September 2022.</p>
1.04	<p>It is appropriate to measure performance at a Total Fund level by comparing to a number of different targets:</p>

- The first of these is the assumed return that the Actuary includes within the triennial valuation - **Actuarial Target**. This is the most crucial target as actual performance needs to be ahead of this to ensure that the Fund maintains, or improves its funding level. This currently set at CPI (Consumer Price Index) +1.75% p.a. for past service liabilities and CPI + 2.25% for future service liabilities.
- The second performance measure is the overall assessment of potential return when the Fund reviews and sets its investment strategy – **Strategic Target**. (This is currently CPI +3.4% p.a.)
- The final target is the composite benchmark – **Total Benchmark**. This is a composite of each of the individual manager benchmarks, weighted by strategic target allocation. For most investment managers the benchmark does not include an expectation of outperformance, with the exception of WPP Global Opportunities Equity Fund, WPP Emerging Market Equity Fund and Wellington Emerging Market Equities which have since been disinvested (October 2021) but contribute towards long term performance.

The performance against all benchmarks is shown on Page 6 of the report, and repeated below:

Total	Quarter (%)	1 Year (%)	3 Years (%)
Total Scheme	-2.5	-6.5	4.1
Total Benchmark	-3.6	-7.0	3.6
Strategic Target (CPI +3.4% p.a.)	2.5	13.5	8.0
Actuarial Target – Past Service Liabilities (CPI +1.75% p.a.)	2.1	12.0	6.3
Actuarial Target – Future Service Liabilities (CPI +2.25% p.a.)	2.2	12.6	6.8

1.05 The strongest absolute returns over the quarter came from Private Markets and the BlackRock World ESG Equity portfolio. The Private Markets portfolio returned +6.1% and the BlackRock World ESG Equity portfolio returned +3.5%.

Within Private Markets the strongest returns were seen in Local/Impact and Infrastructure with returns of +11.6% and +11.2%, respectively.

Russell WPP Global Opportunities and Hedge Funds also generated positive returns over the quarter, returning +2.7% and +1.7 respectively.

In the 12 months to 30 September 2022, the best returns came from Private Markets and the Tactical Allocation. Private Markets returning +24.6% whilst the Tactical Allocation portfolio returned +5.8%.

The performance of individual managers is shown in the report and is regularly reviewed by Officers and advisers. At this stage there are no concerns that need addressing, however all positions are being monitored closely.

1.06	<p>All portfolio allocations held sit within the agreed strategic tolerance with the exception of property within Private Markets, which is marginally overweight.</p> <p>Following volatile gilt market movements over Q2 2022, the CRMF portfolio is underweight. This section of the portfolio is monitored closely and has been restructured post quarter end, following the extreme gilt market movements experienced in October and for which further detail has been provided in the Funding and Risk Management reports though further information will also be provided verbally within this agenda item.</p>
2.00	RESOURCE IMPLICATIONS
2.01	None directly as a result of this report.
3.00	CONSULTATIONS REQUIRED / CARRIED OUT
3.01	None directly as a result of this report.
4.00	RISK MANAGEMENT
4.01	<p>The Fund's investment strategy has been designed to provide an appropriate trade-off between risk and return. The Fund faces three key investment risks: Equity risk, Interest Rate Risk and Inflation Risk.</p> <p>Diversification of the Fund's growth assets away from equities seeks to reduce the amount of the equity risk (though it should be recognised that Equities remain an important long term source of expected growth). The implementation of the Fund's De-Risking Framework (Flightpath) has been designed to mitigate the Fund's Interest Rate and Inflation Risks.</p>
4.02	<p>This report addresses some of the risks identified in the Fund's Risk Register. Specifically, this covers the following (either in whole or in part):</p> <ul style="list-style-type: none"> • Governance risk: G2 • Funding and Investment risks: F1 - F6
4.03	<p>The Flightpath Strategy manages/controls the interest rate and inflation rate impact on the liabilities of the Fund to give more stability of funding outcomes and employer contribution rates. The Equity option strategy will provide protection against market falls for the synthetic equity exposure via the Insight mandate only. The collateral waterfall framework is intended to increase the efficiency of the Fund's collateral, and generating additional yield in a low governance manner. Hedging the currency risk of the market value of the synthetic equity portfolio will protect the Fund against a strengthening pound.</p>
5.00	APPENDICES
5.01	<p>Appendix 1 - Economic and Market Update – 30 September 2022 Appendix 2 – Performance Monitoring Report – 30 September 2022</p>

6.00	LIST OF ACCESSIBLE BACKGROUND DOCUMENTS
6.01	<p>Economic and Market Update and Investment Strategy and Manager Summary 30 September 2022.</p> <p>Contact Officer: Philip Latham, Head of Clwyd Pension Fund Telephone: 01352 702264 E-mail: philip.latham@flintshire.gov.uk</p>
7.00	GLOSSARY OF TERMS
7.01	<p>A list of commonly used terms are as follows:</p> <ul style="list-style-type: none"> (a) Absolute Return – The actual return, as opposed to the return relative to a benchmark. (b) Annualised – Figures expressed as applying to 1 year. (c) Duration – The weighted average time to payment of cash flows (in years), calculated by reference to the time and amount of each payment. It is a measure of the sensitivity of price/value to movements in yields. (d) Market Volatility – The impact of the assets producing returns different to those assumed within the actuarial valuation basis, excluding the yield change and inflation impact. (e) Money-Weighted Rate of Return – The rate of return on an investment including the amount and timing of cash flows. (f) Relative Return – The return on a fund compared to the return on index or benchmark. This is defined as: Return on Fund minus Return on Index or Benchmark. (g) Three-Year Return – The total return on the fund over a three year period expressed in percent per annum. (h) Time-Weighted Rate of Return – The rate of return on an investment removing the effect of the amount and timing of cash flows. (i) Yield (Gross Redemption Yield) – The return expected from a bond if held to maturity. It is calculated by finding the rate of return that equates the current market price to the value of future cash flows. <p>A comprehensive list of investment terms can be found via the following link:</p> <p>https://www.schroders.com/en/uk/adviser/tools/glossary/</p>