

CLWYD PENSION FUND COMMITTEE

Date of Meeting	Wednesday, 15 February 2023
Report Subject	Economic and Market Update and Investment Strategy and Manager Summary
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 31 December 2022, and are attached as appendices to this report.

Economy and Markets

- Inflation and central bank policy were again key market drivers. Developed market central banks continued tightening monetary policy throughout the quarter but the pace of tightening began to slow in the US, amid an encouraging downwards trend in inflation.
- Global equity markets returns were positive in October and November – sentiment being driven by a tentative slowdown in inflation and resilient economies. December saw equity markets give back some gains following the hawkish messaging from central banks. Overall, global equities returned 7.5% in local currency terms (2.1% in sterling terms).
- In the UK, quarter-on-quarter GDP was -0.3% to the end of September 2022 (non-annualised) after increasing by 0.1% in the previous quarter.

Performance Monitoring Report

- Over the three months to 31 December 2022, the Fund's total market value decreased by £2.5m to £2,213.4m.
- Fund Performance over 3 months, 12 months, and 3 years; 0.0%, -10.6% and +3.9% p.a. respectively.
- Performance over the 12 month period was largely driven by sharp rises in gilt yields and negative performance across global equities.
- Fund Performance is ahead of the composite benchmark for the 3 year period, though behind in relation to the 3 and 12 month periods.
- Emerging markets equity and multi-asset credit positions are underweight to target allocations. The CRMF is overweight to its target (a result of the asset reorganisation in October 2022). All positions are within target ranges as at quarter end.

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 December 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</p> <p>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 final quarter of 2022. Inflation in the US slowed for the fifth straight month in December, to the lowest level since the end of 2021. It also showed tentative signs of peaking in the UK and Eurozone albeit from more elevated levels. Central banks however have continued to tighten monetary policy and maintained a hawkish outlook, resulting in elevated market volatility.</p> <p>The 'Santa' rally in the first two months of the fourth quarter came to a premature end in December as investor optimism over receding inflation was displaced by continued hawkish messages by central banks and more signs of a weakening economy.</p> <p>There are clear signs that the US economy is slowing rapidly as tighter financial conditions are now taking effect. The UK and Eurozone are likely already in a recession.</p> <p>The Ukraine conflict remained in a stalemate, another Chinese company was blacklisted by the US and China responded with air drills around Taiwan after President Biden increased military aid to the island.</p> <p>The US dollar continued to give back some of its gains from earlier in the year, even as risk sentiment faded. Therefore, the US dollar weakened against sterling following hawkish rhetoric from both central banks.</p> <p>Sterling did however depreciate against the Euro and Yen over the quarter.</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</p> <p>Over the 3 months to 31 December 2022, the Fund's total market value decreased by £2.5m to £2,213.4m.</p> <p>The Total Fund has decreased in value by £271.2m in 12 months to 31 December 2022.</p> <p>Total Fund value movement was largely driven by the rising gilt yields, impacting the CRMF portfolio as well as negative equity and credit returns.</p>																								
1.04	<p>It is appropriate to measure performance at a Total Fund level by comparing to a number of different targets:</p> <ul style="list-style-type: none"> • 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. <p>The performance against all benchmarks is shown on Page 8 of the report, and repeated below:</p> <table border="1" data-bbox="304 1375 1369 1823"> <thead> <tr> <th data-bbox="304 1375 831 1451">Total</th> <th data-bbox="831 1375 1007 1451">Quarter (%)</th> <th data-bbox="1007 1375 1182 1451">1 Year (%)</th> <th data-bbox="1182 1375 1369 1451">3 Years (%)</th> </tr> </thead> <tbody> <tr> <td data-bbox="304 1451 831 1518">Total Scheme</td> <td data-bbox="831 1451 1007 1518">0.0</td> <td data-bbox="1007 1451 1182 1518">-10.6</td> <td data-bbox="1182 1451 1369 1518">+3.9</td> </tr> <tr> <td data-bbox="304 1518 831 1585">Total Benchmark</td> <td data-bbox="831 1518 1007 1585">+1.3</td> <td data-bbox="1007 1518 1182 1585">-9.6</td> <td data-bbox="1182 1518 1369 1585">+3.7</td> </tr> <tr> <td data-bbox="304 1585 831 1653">Strategic Target (CPI +3.4% p.a.)</td> <td data-bbox="831 1585 1007 1653">+3.6</td> <td data-bbox="1007 1585 1182 1653">+14.3</td> <td data-bbox="1182 1585 1369 1653">+9.0</td> </tr> <tr> <td data-bbox="304 1653 831 1742">Actuarial Target – Past Service Liabilities (CPI +1.75% p.a.)</td> <td data-bbox="831 1653 1007 1742">+3.2</td> <td data-bbox="1007 1653 1182 1742">+12.4</td> <td data-bbox="1182 1653 1369 1742">+7.3</td> </tr> <tr> <td data-bbox="304 1742 831 1823">Actuarial Target – Future Service Liabilities (CPI +2.25% p.a.)</td> <td data-bbox="831 1742 1007 1823">+3.3</td> <td data-bbox="1007 1742 1182 1823">+13.0</td> <td data-bbox="1182 1742 1369 1823">+7.8</td> </tr> </tbody> </table>	Total	Quarter (%)	1 Year (%)	3 Years (%)	Total Scheme	0.0	-10.6	+3.9	Total Benchmark	+1.3	-9.6	+3.7	Strategic Target (CPI +3.4% p.a.)	+3.6	+14.3	+9.0	Actuarial Target – Past Service Liabilities (CPI +1.75% p.a.)	+3.2	+12.4	+7.3	Actuarial Target – Future Service Liabilities (CPI +2.25% p.a.)	+3.3	+13.0	+7.8
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1.05	<p>The strongest absolute returns over the quarter came from WPP Global Opportunities Fund (+2.1%), WPP Multi-Asset Credit Fund (+4.0%) and the Tactical Allocation portfolio (+1.6%).</p> <p>WPP Emerging Markets Equity and Private Equity also generated positive returns over the quarter, returning +1.5% and +0.8%, respectively.</p>																								

	<p>In the 12 months to 31 December 2022, the best returns came from Private Markets and the Tactical Allocation portfolio. Private Markets returning +15.2%, whilst the Tactical Allocation portfolio returned +3.5%. The Hedge Fund portfolio also generated positive returns over the period of +1.9%.</p> <p>The liability hedging portfolio performed negatively over the quarter to 31 December 2022 as real yields rose, although this was partially offset by the fall in the value of the liabilities.</p> <p>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.</p>
1.06	All portfolio allocations held sit within the agreed strategic tolerance with the exception of property within Private Markets, which is marginally overweight, and Infrastructure, which is marginally underweight.

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	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 generate 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.
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5.00	APPENDICES
5.01	Appendix 1 – Economic and Market Update – 31 December 2022 Appendix 2 – Performance Monitoring Report – 31 December 2022

6.00	LIST OF ACCESSIBLE BACKGROUND DOCUMENTS
6.01	Economic and Market Update and Performance Monitoring Report 31 December 2022. Contact Officer: Philip Latham, Head of Clwyd Pension Fund Telephone: 01352 702264 E-mail: philip.latham@flintshire.gov.uk

7.00	GLOSSARY OF TERMS
7.01	<p>A list of commonly used terms are as follows:</p> <p>(a) Absolute Return – The actual return, as opposed to the return relative to a benchmark.</p> <p>(b) Annualised – Figures expressed as applying to 1 year.</p> <p>(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.</p> <p>(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.</p> <p>(e) Money-Weighted Rate of Return – The rate of return on an investment including the amount and timing of cash flows.</p> <p>(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.</p> <p>(g) Three-Year Return – The total return on the fund over a three year period expressed in percent per annum.</p>

(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.

A comprehensive list of investment terms can be found via the following link:

<https://www.schroders.com/en/uk/adviser/tools/glossary/>