

CLWYD PENSION FUND COMMITTEE

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| Date of Meeting | Wednesday, 10 th November 2021 |
| Report Subject | 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 2021, and are attached as appendices to this report.

Key points to note:

Economy and Markets

- The quarter saw low positive returns across major equity markets
- Signs of a Global economic slowdown were seen in the quarter lead by the Chinese economy, with inflation concerns a key threat
- Supply chain constraints were an important driver of both weakening growth and high inflation.
- Central banks indicated that they may look to increase interest rates sooner than previously expected.

Performance Monitoring Report

- Over the three months to 30 September, the Fund's total market value increased by £56.2m to £2,382.6m
- Fund Performance over 3 months, 12 months and 3 years; +2.6%, +19.3% and +8.1% p.a. respectively
- Fund Performance is ahead of Composite benchmark over all periods, and well ahead of the Strategic target and Actuarial targets 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 2021 are noted along with the Economic and Market update which effectively sets the scene.

REPORT DETAILS

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| 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>The quarter was another generally positive one, with most major markets seeing positive returns. That is not to say that there are concerns in a number of areas:</p> <ul style="list-style-type: none">• Pressure on supply chains due to COVID-19 related transport disruption• Inflation concerns in some areas, albeit most commentators felt that this was more due to the COVID-19 effect in the previous year <p>Positive returns (+1.5%) were seen in Global equities over the quarter, with UK equities also performing well; returning +2.2%. In the UK, Government Bond yields rose after falls in the previous quarter, resulting in negative returns of -2.8%.</p> <p>Sterling fell slightly against the US Dollar and the Yen, whilst it was flat against the Euro. Commodities markets continued their strong performance in the quarter, returning 7.8%, resulting in a rise of 51.8% for the year.</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 30 September 2021, the Fund's total market value increased by £56.2m to £2,386.2m.</p> <p>This means that the Total Fund has increased in value by £260.8m in the calendar year 2021.</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 Wellington Emerging Market equities and WPP Global Opportunities equity.

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

| | Quarter (%) | 1 Yr (%) | 3 Yrs (%) |
|---|-------------|-------------|------------|
| Total | 2.6 | 19.3 | 8.1 |
| Total Benchmark | 1.2 | 14.3 | 7.9 |
| Strategic Target (CPI +3.4% p.a.) | 1.3 | 5.5 | 5.5 |
| Actuarial Target – Past Service Liabilities (CPI +1.75% p.a.) | 0.9 | 3.8 | 3.8 |
| Actuarial Target – Future Service Liabilities (CPI +2.25% p.a.) | 1.1 | 4.3 | 4.3 |

The table shows strong outperformance by the Fund against all measures over 3 months, 1 year, and 3 years.

1.05

The strongest absolute returns over the quarter came from the Cash and Risk Management Framework (CRMF) and Private Markets. The CRMF returned +4.1% and Private markets returned +7.4%.

Within Private Markets the strongest returns were seen in the Local/Impact and Infrastructure portfolios with returns of +12.1% and +9.9% respectively.

It is also positive to note the strong performance seen in the BlackRock ESG Equity portfolio in the quarter (+3.9%).

In the 12 months to 30 September 2021 the best returns came from the CRMF, Total Equity and the Tactical Allocation (Best Ideas) portfolio. The CRMF returned +34.2%, with Total Equity and the Tactical Allocation portfolio returning +18.8% and +19.3% respectively.

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

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| 1.06 | The transition of assets in the summer of 2020 brought most asset classes in line with the target strategic weights. Due to strong performance of listed equities in the quarter Global and Emerging Market equity remain marginally overweight. As a result the Private Markets assets are now nearly 4% under target weight, although this is well within the agreed strategic tolerance, and a work plan is in place to bring this in line over the next couple of years. All other asset classes are well within the agreed strategic ranges. |
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| 2.00 | RESOURCE IMPLICATIONS |
| 2.01 | None directly as a result of this report. |

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| 3.00 | CONSULTATIONS REQUIRED / CARRIED OUT |
| 3.01 | None directly as a result of this report. |

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| 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 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. |

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| 5.00 | APPENDICES |
| 5.01 | Appendix 1 - Economic and Market Update – 30 September 2021 Appendix 2 – Performance Monitoring Report – 30 September 2021 |

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| 6.00 | LIST OF ACCESSIBLE BACKGROUND DOCUMENTS |
| 6.01 | <p>Economic and Market Update and Investment Strategy and Manager Summary 30 September 2021.</p> <p>Contact Officer: Philip Latham, Head of Clwyd Pension Fund Telephone: 01352 702264 E-mail: philip.latham@flintshire.gov.uk</p> |

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| 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> <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.</p> <p>(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> <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> |