

Pension Fund Committee

26 March 2024

Pension Fund Investments

For Decision

Local Councillor(s): All

Executive Director: A Dunn, Executive Director, Corporate Development

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Report Status: Public

Brief Summary:

The estimated value of the pension fund's assets at 31 December 2023 was £3,728m compared to £3,517m at the start of the financial year, an increase of £211m.

The total return from the pension fund's investments over the quarter to 31 December 2023 was 5.0%, compared to the combined benchmark return of 4.5%. The total return for the 12 months to 31 December 2023 was 9.7% compared to the benchmark return of 8.8%. Annualised returns for three years were 4.5% compared to the benchmark return of 6.0% and for five years were 5.8% compared to the benchmark of 6.4%.

The quarter to 31 December 2023 saw global falls in inflation at a faster pace than expected, which led to expectations that interest rates might start to fall faster than expected and in turn a rally across most asset classes. A key aspect driving markets was the performance of the so-called Magnificent Seven mega-cap stocks - Apple, Amazon, Alphabet, Meta, Nvidia, Microsoft and Tesla.

As at 31 December 2023, approximately 78% of the pension fund's assets were under the management of Brunel Pension Partnership (Brunel), the pension fund's Local Government Pension Scheme (LGPS) investment pooling manager.

The investing environment for Brunel's growth and quality styles was more positive in November/December 2023 as bond yields declined. The future

direction of interest rates is central to the performance of Brunel’s portfolios. Brunel has faced headwinds in this regard in earlier in 2022 and 2023, but a period of stable or falling interest rates should be in Brunel’s favour.

Recommendation:

That the Committee review and comment upon the activity and overall performance of the pension fund’s investments.

Reason for Recommendation:

To ensure that the pension fund has the appropriate management and monitoring arrangements in place, and to ensure that asset allocation in line with agreed strategic targets.

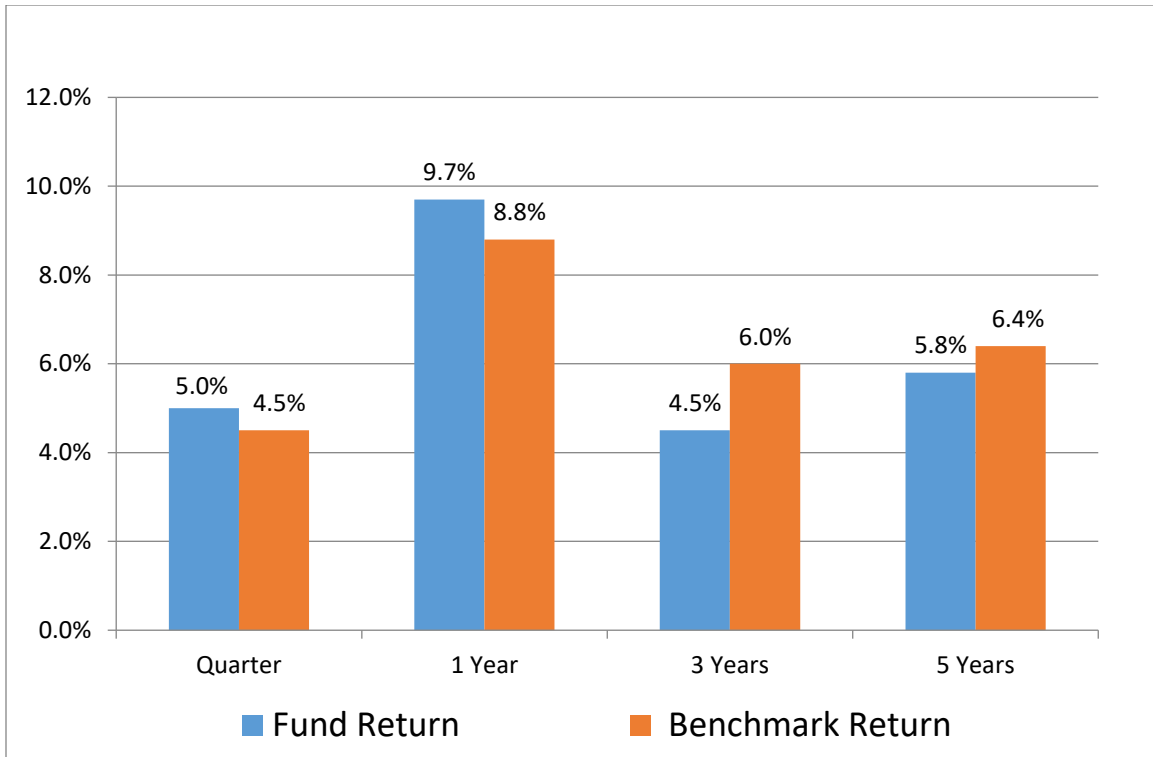
1. Asset Valuation Summary

- 1.1 The table below shows the pension fund’s asset valuation by asset class at the beginning of the financial year and as at 31 December 2023, compared with the target allocation agreed by the Committee June 2023. There were no significant variances between actual and target allocations.

Asset Class	31-Mar-23		31-Dec-23		Target Allocation	
	£M	%	£M	%	£M	%
UK Equities	310.0	8.8%	327.5	8.8%	335.5	9.0%
Global Equities	1,567.5	44.6%	1,680.0	45.1%	1,677.6	45.0%
Emerging Markets Equities	142.2	4.0%	143.8	3.9%	149.1	4.0%
Total Listed Equities	2,019.7	57.4%	2,151.3	57.7%	2,162.2	58.0%
Corporate Bonds	229.1	6.5%	255.5	6.9%	242.3	6.5%
Multi Asset Credit	232.4	6.6%	264.0	7.1%	242.3	6.5%
Diversified Returns	236.5	6.7%	251.5	6.7%	261.0	7.0%
Infrastructure	276.2	7.9%	285.3	7.7%	298.2	8.0%
Private Equity	135.8	3.9%	135.0	3.6%	186.4	5.0%
Property	302.8	8.6%	308.6	8.3%	335.5	9.0%
Liability Driven Investment	19.0	0.5%	0.0	0.0%	-	0.0%
Cash	58.8	1.7%	73.2	2.0%	-	0.0%
F/X Hedging	7.1	0.2%	3.5	0.1%	-	0.0%
Total Asset Valuation	3,517.4	100.0%	3,727.9	100.0%	3,727.9	100.0%

2. Investment Performance Summary

- 2.1 The overall performance of the pension fund’s investments to 31 December 2023 is summarised below (returns for three and five years are annualised figures).



2.2 Appendix 1 summarises by investment manager and investment vehicle the value of Assets Under Management (AUM) as at 31 December 2023 plus each investment's return compared to its benchmark for the quarter, one, three and five years, and 'Since Initial Investment' (SII). All percentages quoted for periods over one year are annualised returns.

3. Economic and Market Background

3.1 The quarter to 31 December 2023 saw global falls in inflation at a faster pace than expected, which lead to expectations that interest rates might start to fall faster than expected and in turn a rally across most asset classes.

3.2 A key aspect driving markets was the performance of the so-called Magnificent Seven mega-cap US technology stocks - Apple, Amazon, Alphabet (Google, YouTube, Android mobile operating system), Meta (Facebook, Instagram, WhatsApp), Nvidia, Microsoft and Tesla. As of January 2024, these seven stocks in total represented nearly 30% of the S&P 500's market capitalisation and were responsible for almost two-thirds of the S&P 500's 24% increase in 2023. These stocks are therefore a major influence on the performance of world benchmarks and market participants.

3.3 Further information relating to the economic and market background relevant to the pension fund's investments can be found in the independent investment adviser's quarterly report (Appendix 2).

4. **Investment Pooling**

4.1 In accordance with the requirements of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016, Dorset participates with nine other LGPS funds to pool investment assets through the Brunel Pension Partnership. Brunel is wholly owned in equal shares by the ten administering authorities that participate in the pool and is authorised by the Financial Conduct Authority (FCA).

4.2 As at 31 December 2023, approximately 78% of the pension fund's assets were under the management of Brunel.

4.3 Brunel's performance report for the quarter ending 31 December 2023 is included as Appendix 3 to this report. This report includes market summaries from Brunel's investment officers and an overall performance summary for the pension fund, together with more detailed information in relation to Dorset's assets under Brunel's management.

4.4 The quarter saw an improved performance for many of the Brunel portfolios with Global Sustainable, UK Active, Emerging Market Equities and Multi Asset Credit were all ahead of their respective benchmarks, with Global High Alpha and Global Small Cap behind benchmark.

4.5 The investment environment for Brunel's general bias towards growth and quality styles was more positive in November/December 2023 as bond yields declined. If interest rates decline, the present value of the future profits of fast growing companies becomes more valuable when a lower discount rate is applied. The view of the future direction of interest rates is therefore key to the performance of Brunel's portfolios. Brunel faced headwinds in this regard in 2022 and 2023, but a period of stable or falling interest rates should be favourable for in Brunel as advised by investment consultants, Mercer, as part of the recent review of equity allocations.

4.6 Another significant factor effecting the relative performance of each of Brunel's portfolios is the exposure to the 'magnificent seven' relative to benchmark.

5. **Private Markets**

- 5.1 The pension fund has private equity investments managed by two external managers, HarbourVest and Abrdn (formerly Aberdeen Standard), and Brunel.
- 5.2 Private Equity is an asset class that takes several years for commitments to be fully invested. The table below summarises the pension fund's commitments, drawdowns, distributions received and closing valuations by manager as at 31 December 2023.

	<u>Commitment</u>	<u>Drawdown</u>		<u>Distributions</u>	<u>Valuation</u>
	<u>£m</u>	<u>£m</u>	<u>%</u>	<u>£m</u>	<u>£m</u>
HarbourVest	109.5	99.1	91%	128.8	64.1
Abrdn	77.7	69.6	90%	98.1	14.6
Brunel	120.0	47.2	39%	3.8	56.3
Total	307.2	216.0	70%	230.7	135.0

- 5.3 The pension fund has two external infrastructure managers, Federated Hermes and IFM. The target for each manager is a 10% absolute annual return and this is used at the benchmark for these investments. In addition to the assets under the management of Federated Hermes and IFM, the pension fund also has holdings in infrastructure funds under the management of Brunel.
- 5.4 The performance of the pension fund's property investments managed by CBRE is detailed in Appendix 4. In addition to the assets under the management of CBRE, the pension fund also has holdings in secured long income property funds under the management of Brunel.

6. Financial Implications

- 6.1 The Local Government Pension Scheme (LGPS) is a national pension scheme administered locally. Dorset Council is the administering authority for the LGPS in Dorset which provides pensions and other benefits for employees of the Council, other councils and a range of other organisations within the county.
- 6.2 The LGPS is a 'defined benefit' scheme which means that benefits for scheme members are calculated based on factors such as age, length of membership and salary. Member benefits are not calculated on the basis of investment performance as they would be in a 'defined contribution' scheme.

- 6.3 Administering authorities are required to maintain a pension fund for the payment of benefits to scheme members funded by contributions from scheme members and their employers, and from the returns on contributions invested prior to benefits becoming payable.
- 6.4 Contribution levels for scheme members are set nationally, and contribution levels for scheme employers are set locally by actuaries engaged by administering authorities. As scheme member rates cannot be changed locally and benefits are defined, the risk of investment underperformance is effectively borne by scheme employers.
- 6.5 The pension fund's actuary, Barnett Waddingham, undertakes a full assessment of the funding position every three years. The results of the latest full assessment as at 31 March 2022 were that the pension fund had a funding level of 96% i.e. assets were estimated to be 96% of the value that they would have needed to be to pay for the expected benefits accrued to that date, based on the assumptions used, compared to 92% at the last valuation as at 31 March 2019.

7. Natural Environment, Climate & Ecology Implications

- 7.1 The pension fund's Investment Strategy Statement requires all external investment managers to consider and manage all financially material risks arising from environmental issues, including those associated with climate change.
- 7.2 At its meeting in September 2020, the Committee agreed to a strategy of decarbonisation meaning a reduction in allocations of investment to companies which are high carbon emitters and looking to influence the demand for fossil fuels and their financing, not just their supply.
- 7.3 Significant decarbonisation has been and will continue to be achieved through the transition of assets to the management of Brunel. Approximately 10% of the pension fund's assets are invested in Brunel's global sustainable equities fund, with all other actively managed Brunel funds are committed to a policy of a 7% year on year reduction in their carbon footprint, and approximately 7% invested in passive equities funds tracking 'Paris Aligned' or 'Climate Transition' benchmarks.
- 7.3 The pension fund no longer has any direct investments in individual companies, including 'fossil fuel' companies, but it does have indirect exposure to such companies through its holdings in pooled investment vehicles. As at 31 March 2023, the value of the pension fund's

investments in companies primarily involved in the exploration, production, mining and/or refining of fossil fuels was estimated at approximately £66M (1.8% of total investment assets).

8. **Well-being and Health Implications**

8.1 None.

9. **Other Implications**

9.1 None.

10. **Risk Assessment**

10.1 The risks associated with the pension fund's investments are assessed in detail and considered as part of the strategic asset allocation. The pension fund's Investment Strategy Statement requires all external investment managers to consider and manage all financially material risks.

11. **Equalities Impact Assessment**

11.1 None.

12. **Appendices**

Appendix 1: Performance summary by investment manager

Appendix 2: Independent Investment Adviser's quarterly report

Appendix 3: Brunel's quarterly report

Appendix 4: CBRE Quarterly Investment Report 31 December 2023

13. **Background Papers**

[Funding Strategy Statement \(dorsetpensionfund.org\)](https://www.dorsetpensionfund.org)

[10-1-investment-strategy-statement-iss-november-2023.pdf](https://www.dorsetpensionfund.org/10-1-investment-strategy-statement-iss-november-2023.pdf)

[\(dorsetpensionfund.org\)](https://www.dorsetpensionfund.org)

Appendix 1

Performance by Investment Manager

The following tables summarise by investment manager and investment vehicle the value of Assets Under Management (AUM) as at 31 December 2023 plus each investment's return compared to its benchmark for the quarter, one, three and five years, and 'Since Initial Investment' (SII). All percentages quoted for periods over one year are annualised returns.

Brunel Pension Partnership

Investment	AUM	Qtr	1 Yr	3 Yr	5 Yr	SII
	£m	%	%	%	%	%
Global Equities:						
Brunel Global Sustainable Equities	360.3	8.0	9.3	3.6	-	4.3
MSCI AC World GBP Index		6.4	15.9	8.7	-	8.4
Excess		1.6	-6.6	-5.1	-	-4.1
Brunel Global High Alpha Equity	296.1	6.2	17.5	7.3	-	12.2
MSCI World TR Index		6.8	17.4	10.3	-	10.9
Excess		-0.6	0.1	-3.0	-	1.3
Brunel Smaller Companies Equities	232.5	5.2	8.2	-	-	1.3
MSCI World Small Cap		7.8	9.8	-	-	3.8
Excess		-2.6	-1.6	-	-	-2.5
Brunel Emerging Market Equity	143.8	3.6	3.5	-4.6	-	0.6
MSCI Emerging Markets		3.3	4.0	-2.5	-	2.5
Excess		0.3	-0.5	-2.1	-	-1.9
LGIM Passive Developed Equities	109.3	6.8	17.2	9.9	-	10.0
FTSE World Developed		6.8	17.2	10.0	-	10.1
Excess		0.0	0.0	-0.1	-	-0.1
LGIM Passive Dev. Equities (Hedged)	111.6	9.7	23.2	8.3	-	9.6
FTSE World Developed Hedged		9.7	23.1	8.4	-	9.7
Excess		0.0	0.1	-0.1	-	-0.1
LGIM Passive Dev. Equities PAB	61.2	6.8	20.3	-	-	14.5
FTSE Developed Paris Aligned Net Index		6.7	20.3	-	-	14.6
Excess		0.1	0.0	-	-	-0.1
LGIM Passive Dev. Equities PAB (Hedged)	62.8	9.7	26.2	-	-	19.7
FTSE Developed Paris Aligned Net Index (hdgd)		9.7	26.2	-	-	19.9
Excess		0.0	0.0	-	-	-0.2

Investment	AUM	Qtr	1 Yr	3 Yr	5 Yr	SII
	£m	%	%	%	%	%
LGIM Passive Dev. Equities CTB	61.3	6.7	20.3	-	-	17.9
FTSE Developed Climate Transition Index		6.6	20.3	-	-	18.1
Excess		0.1	0.0	-	-	-0.2
LGIM Passive Dev. Equities CTB (Hedged)	62.8	9.6	26.1	-	-	19.7
FTSE Developed Climate Transition Index (hdgd)		9.6	26.2	-	-	19.9
Excess		0.0	-0.1	-	-	-0.2
LGIM Passive Smart Beta	160.7	5.3	8.3	9.9	10.5	8.3
SciBeta Multifactor Composite		5.1	7.7	9.4	10.0	8.0
Excess		0.2	0.6	0.5	0.5	0.3
LGIM Passive Smart Beta (Hedged)	161.1	8.2	13.8	8.3	10.1	7.4
SciBeta Multifactor Hedged Composite		8.0	13.2	7.8	9.6	7.1
Excess		0.2	0.6	0.5	0.5	0.3
UK Equities:						
Brunel UK Active Equity	196.5	4.1	8.7	7.3	5.7	4.9
FTSE All Share ex Investment Trusts		2.9	8.1	9.3	6.5	5.7
Excess		1.2	0.6	-2.0	-0.8	-0.8
LGIM Passive UK Equities	131.0	3.2	8.0	8.7	6.7	3.8
FTSE All Share		3.2	7.9	8.6	6.6	3.7
Excess		0.0	0.1	0.1	0.1	0.1
Fixed Income:						
Brunel Multi Asset Credit	264.0	5.4	12.3	-	-	1.5
SONIA + 4%		2.3	8.8	-	-	6.4
Excess		3.1	3.5	-	-	-4.9
Brunel Sterling Corporate Bonds	83.7	7.8	10.5	-	-	7.8
iBoxx Sterling Non Gilts Overall Return		7.4	8.6	-	-	6.7
Excess		0.4	1.9	-	-	1.1
Other:						
Brunel Diversifying Returns Fund	251.5	3.2	6.5	3.1	-	3.3
SONIA + 3%		2.0	7.8	5.1	-	4.8
Excess		1.2	-1.3	-2.0	-	-1.5
Private Markets:						
Brunel Private Equity Cycle 1	54.8	-2.8	1.3	22.0	-	21.3
MSCI AC World Index		6.4	15.9	8.7	-	11.3
Excess		-9.2	-14.6	13.3	-	10.0
Brunel Private Equity Cycle 3	1.5	-28.1	-	-	-	2.1
MSCI AC World Index		6.4	-	-	-	11.0
Excess		-34.5	-	-	-	-8.9
Brunel Secured Income Cycle 1	53.6	-0.3	-4.1	-0.5	-	0.8
CPI		0.2	3.9	6.6	-	4.3
Excess		-0.5	-8.0	-7.1	-	-3.5
Brunel Secured Income Cycle 3	20.5	-1.3	-	-	-	3.8
CPI		0.2	-	-	-	0.7
Excess		-1.5	-	-	-	3.1
Brunel Infrastructure Cycle 3	18.2	0.0	-2.4	-	-	-2.0
CPI		0.2	3.9	-	-	5.5
Excess		-0.2	-6.3	-	-	-7.5

Other Managers

Manager / Investment	AUM	Qtr	1 Yr	3 Yr	5 Yr	SII
	£m	%	%	%	%	%
Royal London / Corporate Bonds	171.8	10.0	10.4	-5.1	1.2	6.1
iBoxx Sterling Non Gilts > 5 Years		10.9	10.5	-7.2	-0.2	5.6
Excess		-0.9	-0.1	2.1	1.4	0.5
CBRE / Property	253.9	-0.2	3.7	2.5	1.4	6.6
MSCI UK All Properties (Quarterly)		-1.1	-1.5	1.5	0.8	6.4
Excess		0.9	5.2	1.0	0.6	0.2
Harbourvest / Private Equity	64.1	-6.0	-6.3	18.8	17.8	13.1
FTSE All Share		3.2	7.9	8.6	6.6	5.5
Excess		-9.2	-14.2	10.2	11.2	7.6
Aberdeen Standard / Private Equity	14.6	-6.1	10.8	14.8	9.8	5.3
FTSE All Share		3.2	7.9	8.6	6.6	5.9
Excess		-9.3	2.9	6.2	3.2	-0.6
Federated Hermes / Infrastructure	86.2	0.4	-10.0	4.5	3.9	5.9
10% Absolute Return		2.4	10.0	10.0	10.0	10.0
Excess		-2.0	-20.0	-5.5	-6.1	-4.1
IFM / Infrastructure	161.4	-0.1	5.6	14.6	10.9	13.4
10% Absolute Return		2.4	10.0	10.0	10.0	10.0
Excess		-2.5	-4.4	4.6	0.9	3.4