FOR PUBLICATION

DERBYSHIRE COUNTY COUNCIL

PENSIONS AND INVESTMENTS COMMITTEE

2 March 2022

Report of the Interim Director of Finance & ICT

Investment Report

1. Purpose

1.1 To note the report of the Fund's independent external advisor, to review the Fund's asset allocation, investment activity and long term performance analysis since the last meeting on 8 December 2021 and to seek approval for the investment strategy in the light of recommendations from the Interim Director of Finance & ICT and the Fund's independent external adviser.

2. Information and Analysis

2.1 Report of the External Adviser

A copy of Mr Fletcher's report, incorporating his view on the global economic position, factual information for global market returns, the performance of the Fund and his recommendations on investment strategy and asset allocation, is attached as Appendix 2.

2.2 Asset Allocation and Recommendations Table

The Fund's latest asset allocation as at 31 January 2022 and the recommendations of the Director of Finance & ICT and Mr Fletcher, in relation to the Fund's new final strategic asset allocation benchmark (SAAB), which came into effect on 1 January 2022, are set out on page 3.

The table also shows the recommendations of the Director of Finance & ICT, adjusted to reflect the impact of future investment commitments. These

commitments (existing plus any new commitments recommended in this report) relate to Private Equity, Multi-Asset Credit, Property and Infrastructure and currently total around £330m. Whilst the timing of drawdowns will be lumpy and difficult to predict, the In-house Investment Management Team (IIMT) believes that these are likely to occur over the next 18 to 36 months.

	Benchmark		Fund Allocation	Fund Allocation	Permitted Range	Benchmark Relative Recommendation		Recommendation (1)		Adjusted for Commitments (3)	Benchmark Sterling Return	Benchmark Sterling Return
	Intermediate (1)	Final (1)	31/10/21	31/1/22 (2)	Final (1)	AF 2/3/22	DPF 2/3/22	AF 2/3/22	DPF 2/3/22	DPF 2/3/22	3 Months to 31/12/21	3 Months to 31/1/22
Growth Assets	**56.0%**	**55.0%**	**57.2%**	**55.9%**	**+/- 8%**	**-**	**-**	**55.0%**	**55.0%**	**56.0%**	**n/a**	**n/a**
UK Equities	14.0%	12.0%	14.7%	13.2%	+/- 4%	-	+1.0%	12.0%	13.0%	13.0%	4.2%	2.0%
Overseas Equities:	38.0%	39.0%	38.1%	38.0%	+/- 8%	-	(0.9%)	39.0%	38.0%	38.0%	n/a	n/a
North America	6.0%	-	5.7%	1.6%	-	-	+1.6%	-	1.6%	1.6%	9.5%	(0.6%)
Europe	4.0%	-	3.7%	0.5%	-	-	+0.5%	-	0.5%	0.5%	5.1%	(3.7%)
Japan	5.0%	5.0%	4.8%	5.3%	+/- 2%	-	+0.3%	5.0%	5.3%	5.3%	(4.9%)	(3.7%)
Pacific ex-Japan	2.0%	-	1.9%	0.9%	-	-	+0.5%	-	0.5%	0.5%	(0.7%)	(3.7%)
Emerging Markets	5.0%	5.0%	5.0%	5.1%	+/- 2%	-	+0.1%	5.0%	5.1%	5.1%	(1.4%)	(0.4%)
Global Sustainable	16.0%	29.0%	17.0%	24.6%	+/- 8%	-	(4.0%)	29.0%	25.0%	25.0%	6.6%	(1.3%)
Private Equity	4.0%	4.0%	4.4%	4.7%	+/- 2%	-	-	4.0%	4.0%	5.0%	4.3%	2.4%
Income Assets	**24.0%**	**25.0%**	**20.5%**	**22.2%**	**+/- 6%**	**+2.0%**	**(2.0%)**	**27.0%**	**23.0%**	**27.4%**	**n/a**	**n/a**
Multi-Asset Credit	6.0%	6.0%	6.8%	7.0%	+/- 2%	+2.0%	+1.0%	8.0%	7.0%	8.2%	0.5%	(0.2%)
Infrastructure	9.0%	10.0%	6.3%	7.5%	+/- 3%	-	(2.0%)	10.0%	8.0%	11.1%	0.5%	0.5%
Direct Property (5)	5.0%	6.0%	4.3%	4.6%	+/- 2%	-	(1.1%)	6.0%	4.9%	4.9%	6.1%	6.1% (4)
Indirect Property (5)	4.0%	3.0%	3.1%	3.1%	+/- 2%	-	+0.1%	3.0%	3.1%	3.2%	7.9%	7.9% (4)
Protection Assets	**18.0%**	**18.0%**	**16.7%**	**16.8%**	**+/- 5%**	**(4.0%)**	**(1.0%)**	**14.0%**	**17.0%**	**17.0%**	**n/a**	**n/a**
Conventional Bonds	6.0%	6.0%	4.9%	4.8%	+/- 2%	(2.0%)	(1.0%)	4.0%	5.0%	5.0%	2.4%	(3.6%)
Index-Linked Bonds	6.0%	6.0%	5.5%	5.5%	+/- 2%	-	(0.5%)	6.0%	5.5%	5.5%	4.9%	(2.4%)
Corporate Bonds	6.0%	6.0%	6.3%	6.5%	+/- 2%	(2.0%)	+0.5%	4.0%	6.5%	6.5%	0.3%	(3.0%)
Cash	**2.0%**	**2.0%**	**5.6%**	**5.1%**	**0 – 8%**	**+2.0%**	**+3.0%**	**4.0%**	**5.0%**	**(0.4%)**	**0.0%**	**0.0%**

Investment Assets totaled £6,105m at 31 January 2022.

(1) Intermediate benchmark effective from 1 January 2021 to 31 December 2021. Final benchmark effective from 1 January 2022. Recommendations are relative to the Final benchmark
(2) Adjusted for completed trades in early Feb-22 – North American Equities -1.0%; European Equities -0.7%; Global Sustainable Equities +1.1%; and Cash +0.5%
(3) Adjusted for investment commitments at 31 January 2022, together with commitments placed post period-end. Presumes all commitments funded from cash.
(4) Benchmark Return for the three months to 31 December 2021.
(5) The maximum permitted range in respect of Property is +/- 3%.

The table above shows the intermediate benchmark, together with the new final benchmark approved by Committee in November 2020. The final benchmark came into effect on 1 January 2022. The table above reflects the following three categorisations:

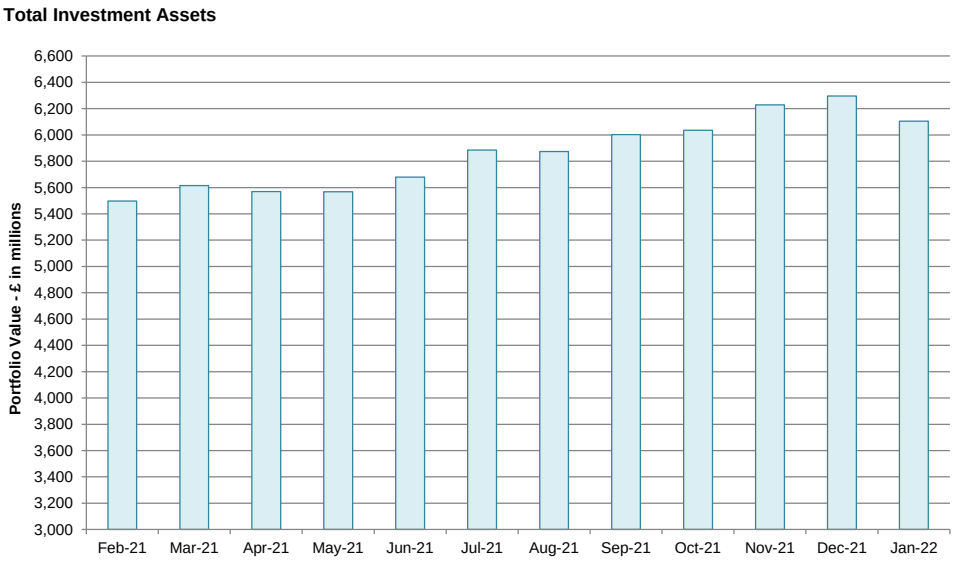
- **Growth Assets**: largely equities plus other volatile higher return assets such as private equity;
- **Income Assets**: assets which are designed to deliver an excess return, but with more stable return patterns than Growth Assets because income represents a large proportion of the total return of these assets; and
- **Protection Assets**: lower risk government or investment grade bonds.

Relative to the final benchmark, the Fund as at 31 January 2022, was overweight Cash and Growth Assets and underweight in Protection Assets and Income Assets. However, should all the IIMT recommendations set out in this report be implemented, together with the expected level of commitment draw-downs, the cash balance would reduce by 5.5% to -0.4%. However, in practice as these commitments are drawn-down, they will be partly offset by new net cash inflows from investment income, distributions from existing investments and changes in the wider asset allocation.

The IIMT recommendations in respect of North American Equities (1.6%), European Equities (0.5%) and Asia Pacific Ex-Japan Equities (0.5%) are outside of the final benchmark's permitted range, reflecting the fact that the investment vehicles required to support a full switch out of North American Equities, European Equities and Asia Pacific Ex-Japan Equities to Global Sustainable Equities are not yet in place. The IIMT estimates that the full transition will be completed in Q2-22. The proposed regional mix of the allocations is designed to broadly match the FTSE All World regional composition.

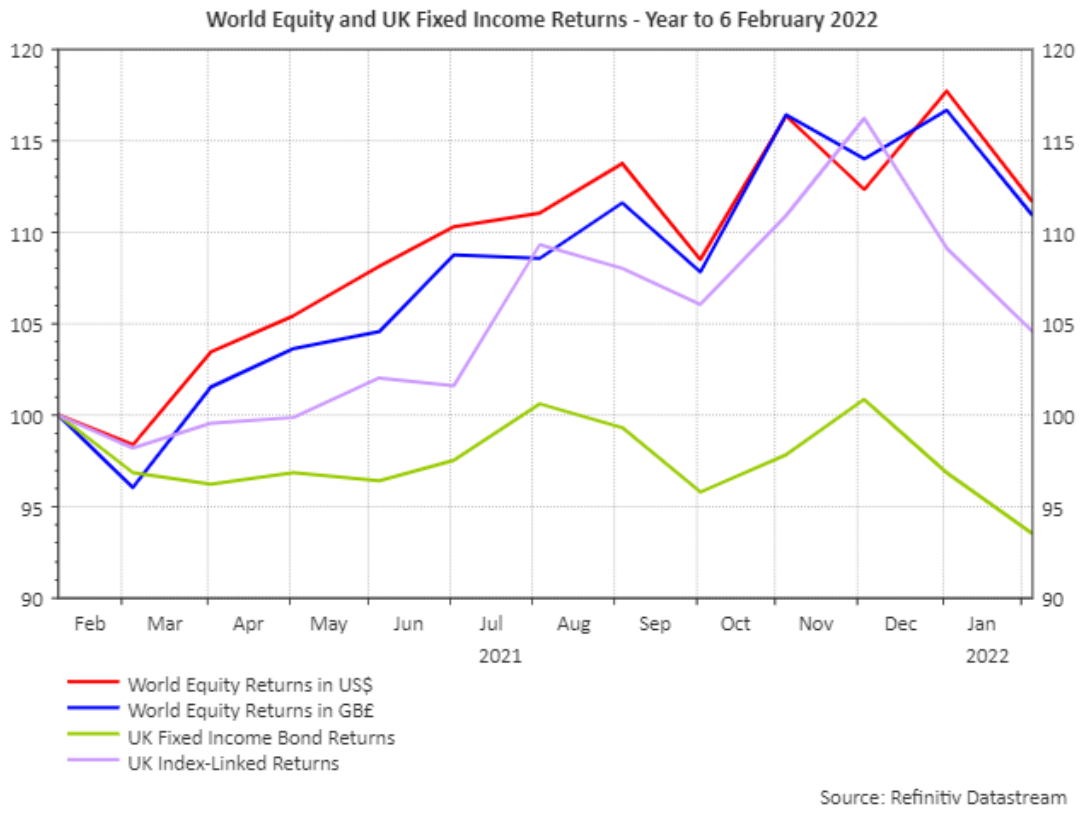
2.3 Total Investment Assets

The value of the Fund's investment assets increased by £70m (+1.2%) between 31 October 2021 and 31 January 2022 to £6.105bn, comprising a non-cash market gain of around £55m and cash inflows from dealing with members and investment income of around £15m. Over the twelve months to 31 January 2022, the value of the Fund's investment assets has increased by £893m (+17.1%), comprising a non-cash market gain of around £803m, and cash inflows from dealing with members & investment income of around £90m.



The Fund's valuation can fluctuate significantly in the short term, reflecting market conditions, and supports the Fund's strategy of focusing on the long term. A copy of the Fund's valuation at 31 January 2022 is attached at Appendix 3.

2.4 Market returns over the last 12 months



The chart above shows market returns for Global Equities in Sterling and the US dollar, UK Fixed Income and UK Index Linked bonds for the twelve months to 6 February 2022.

Over the twelve-month period to 31 December 2021, Global Equities as measured by the FTSE All World Index, returned 21.2% for Sterling investors. In US dollar terms, the returns were slightly lower at 20.1%, as Sterling weakened by 1.0% against the US dollar over the period (from £1:US$1.367 to £1:US$1.353). Market returns in 2021 continued to be driven by the evolution of the Covid-19 pandemic. However, in comparison to the uncertainty which surrounded 2020, the global economy moved into the recovery stage in 2021, supported by high vaccination rates.

During 2020, financial market returns were underpinned by the unprecedented policy decisions by both national governments and central banks in response to the Covid-19 pandemic (i.e. doing whatever it takes to keep the economy and financial markets from collapsing). In return, investors looked through the uncertainty and focused on the assumed future recovery. The development of effective vaccines towards the end of 2020 marked a pivotal moment in the pandemic with investor sentiment moving to cautious optimism. Equity market returns were generally positive in Q1-21 and Q2-21

but were volatile in Q3-21 and Q4-21 (albeit up overall over H2-21) as worries about new variants (e.g. Omicron), supply chain problems, rising inflation and concerns about the Chinese property market weighed on investor confidence.

Equity market returns have fallen YTD-22[1], with the FTSE All-World returning minus 4.5% in Sterling terms. Whilst concerns about the impact of the Omicron variant have eased (as the variant has proved to be more transmissible but with lower hospitalisation rates), inflationary pressures have increased significantly. Markets have responded by pricing-in faster interest rate increases in the UK and US, with 10-year government bond yields rising over 65 and 50 basis points, respectively, since the start of December 2021.

The increase in yields has driven a rotation out of Growth stocks into Value stocks, with investors favouring tangible ('real') assets over intangible assets. On a global basis, Information Technology and Consumer Discretionary stocks have been the hardest hit, falling by -7.5% and -7.4%, respectively, in January 2022. Only two sectors posted positive returns: Energy (+13.9%) and Financials (+2.0%). Energy stocks benefited from the inflation outlook and there was a switch from green energy (i.e. renewables) to brown energy (i.e. fossil fuels); Financial stocks have benefited from the assumed accelerated pace of interest rate increases (i.e. flowing through to a higher net-interest margin).

Geopolitical tensions have also risen in YTD-22, as concerns about a potential Russian invasion of the Ukraine have increased.

Asset class weightings and recommendations are based on values at the end of January 2022. As shown in the charts below, equity markets have now largely recovered most of the March 2020 sell off, albeit this differs by market. For example, the US market is now higher than at any time in the last five years, whereas the recovery in the UK market has been more muted although it is now back close to the level reported immediately before the Covid-19 pandemic.

[1] 1 January 2022 and 6 February 2022

2.5 Longer Term Performance

Figures provided by Portfolio Evaluation Limited show the Fund's performance over 1, 3, 5 and 10 years to 31 December 2021.

Per annum	DPF	Benchmark Index
1 year	11.6%	10.9%
3 years	10.5%	9.8%
5 years	7.9%	7.2%
10 years	9.3%	8.7%

The Fund outperformed the benchmark over all time periods.

The IIMT notes that the one-year return of 11.6% to 31 December 2021 (benchmark 10.9%) reflected a catch-up following a sharp market sell-off in response to the outbreak of the Covid-19 pandemic. This has been supported by unprecedented levels of fiscal and monetary support provided by national governments and central banks. The IIMT does not believe that these levels of returns are sustainable in the long-term and going forward market returns are likely to be much lower. The Fund's Investment Strategy Statement is based on an assumed average market return of 3.6% per annum over the next 20 years.

2.6 Category Recommendations

	Intermediate Benchmark	Final Benchmark	Fund Allocation	Permitted Range	Recommendation (1)		Benchmark Relative Recommendation (1)	
			31 Jan-22		AF	DPF	AF	DPF
Growth Assets	56.0%	55.0%	55.9%	± 8%	55.0%	55.0%	-	-
Income Assets	24.0%	25.0%	22.2%	± 6%	27.0%	23.0%	+2.0%	(2.0%)
Protection Assets	18.0%	18.0%	16.8%	± 5%	14.0%	17.0%	(4.0%)	(1.0%)
Cash	2.0%	2.0%	5.1%	0 – 8%	4.0%	5.0%	+2.0%	+3.0%

(1) Recommendation relative to the Final benchmark effective 1 January 2022

At an overall level, the Fund was overweight Growth Assets and Cash at 31 January 2022, underweight Income Assets and Protection Assets, although if commitments waiting to be drawn down were taken into account, the Fund would move to an overweight position in Growth and Income Assets. The table on page 3 assumes that all new commitments will be funded out of the current cash weighting; in practice as private market commitments are drawn down they are likely to be funded partially out of cash and partially by distributions (income and capital) from existing investments and sales of public market assets. The Fund has progressively reduced its benchmark exposure to Growth Assets into strength over the last three to five years, as equity valuations have become increasingly stretched, and increased the benchmark allocation to Income Assets.

The IIMT recommendations reflected in this report: reduce Growth Assets by 0.9% to 55.0% (neutral) (UK Equities -0.2%; Asia Pacific Ex-Japan Equities -0.4%; Global Sustainable Equities +0.4%; and Private Equity -0.7%); increase Income Assets by 0.8% (Infrastructure +0.5%; and Direct Property +0.3%); increase Protection Assets by 0.2% (Conventional Bonds +0.2%), and reduce cash by 0.1%.

The IIMT notes that the recommendations are subject to market conditions, liquidity, and product availability. The IIMT continues to recommend a defensive cash allocation, reflecting both the general market uncertainty and cash held to fund existing commitment drawdowns.

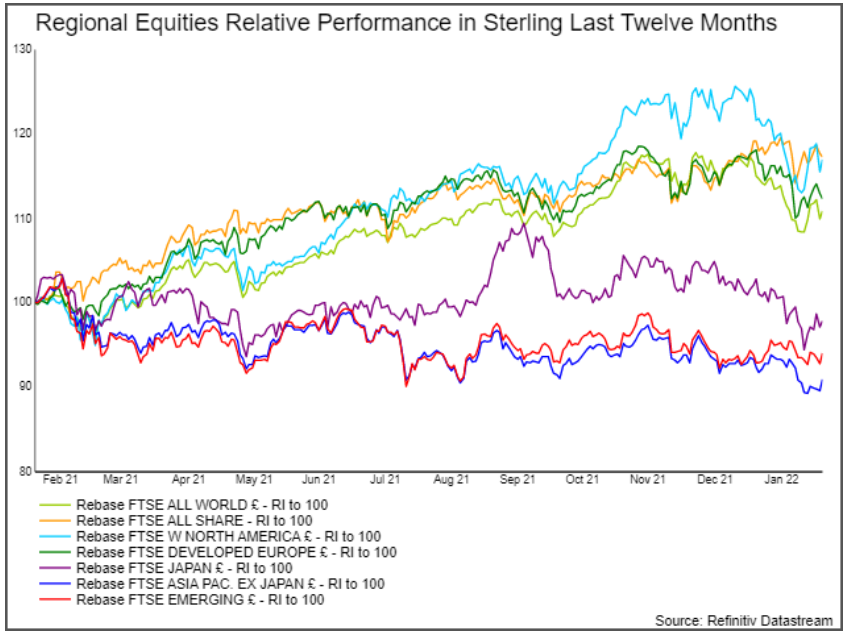
2.7 Growth Assets

At 31 January 2022, the overall Growth Asset weighting was 55.9%, down from 57.2% at 31 October 2021, principally reflecting net divestment of around £130m. During the three months to 31 January 2022, the Fund made significant progress in the transition to the new final SAAB, with £525m invested into Global Sustainable Equities, funded from divestments in respect of UK Equities (£155m); North American Equities (£255m); European Equities (£195m) and Asia Pacific Ex-Japan Equities (£53m). The Fund also increased its allocation to Japanese Equities by £50m, with the remainder being invested into other asset classes, including infrastructure (£64m), Multi-Asset Credit (£19m) and Corporate Bonds (£12m).

The IIMT recommends in this report reduce the weighting to a neutral weighting of 55.0%.

As was the case at the last reporting date, the near-term outlook for equities remains mixed. In December 2021, the accelerating spread of the Omicron variant eroded investor confidence. This concern has gradually eased (whilst more transmissible, the hospitalisation rate has proved to be lower) and the roll out of booster campaigns in the UK, US and Europe have also proven to be successful in increasing the overall protection from developing serious health complications. However, the threat from Covid-19 has not disappeared, and there is an inevitable risk that future mutations could pose a further threat to public health.

Other risk factors that were present at the last reporting date appear to



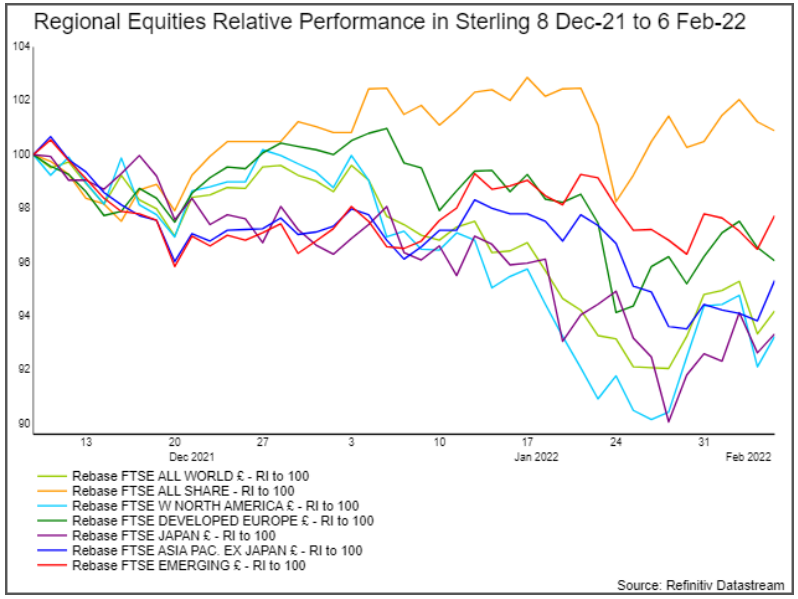
Benchmark Return	Currency	Q4-21(*)	Q3-21	CYTD (*)	1 Year (**)	3 Year (**)	5 Year (**)	Since Last Committee (*)	L3M 31-Jan-22
Sterling Returns									
FTSE All World (***)	GB£	(4.8%)	6.6%	16.6%	21.2%	18.8%	13.1%	(6.0%)	(1.3%)
FTSE UK	GB£	0.1%	4.2%	12.5%	18.3%	8.3%	5.4%	0.9%	2.0%
FTSE North America	GB£	(5.6%)	9.5%	22.2%	28.1%	23.6%	16.2%	(6.8%)	(0.6%)
FTSE Europe	GB£	(5.6%)	5.1%	14.4%	17.3%	15.3%	10.2%	(5.9%)	(3.7%)
FTSE Japan	GB£	(3.1%)	(4.9%)	1.3%	2.5%	9.3%	6.7%	(6.7%)	(3.7%)
FTSE Asia Pacific Ex-Japan	GB£	(2.1%)	(0.7%)	(2.1%)	(0.1%)	10.9%	9.0%	(4.7%)	(3.7%)
FTSE Emerging Markets	GB£	0.5%	(1.4%)	(1.0%)	0.9%	9.4%	7.9%	(2.3%)	(0.4%)
Local Currency Returns									
FTSE All World (***)	US$	(4.9%)	7.1%	14.5%	20.1%	21.4%	15.2%	(3.8%)	(3.4%)
FTSE UK	GB£	0.1%	4.2%	12.5%	18.3%	8.3%	5.4%	0.9%	2.0%
FTSE North America	US$	(5.7%)	10.0%	20.0%	27.0%	26.1%	18.3%	(4.5%)	(2.7%)
FTSE Europe	€	(6.3%)	7.2%	16.4%	25.4%	18.0%	10.7%	(4.6%)	(2.7%)
FTSE Japan	¥	(3.1%)	(1.4%)	3.6%	13.2%	13.4%	8.4%	(3.3%)	(4.8%)
FTSE Asia Pacific Ex-Japan	US$	(2.2%)	(0.3%)	(3.9%)	(1.0%)	13.2%	11.1%	(2.4%)	(5.7%)
FTSE Emerging Markets	US$	0.4%	(1.0%)	(2.7%)	0.1%	11.7%	9.9%	0.1%	(2.5%)

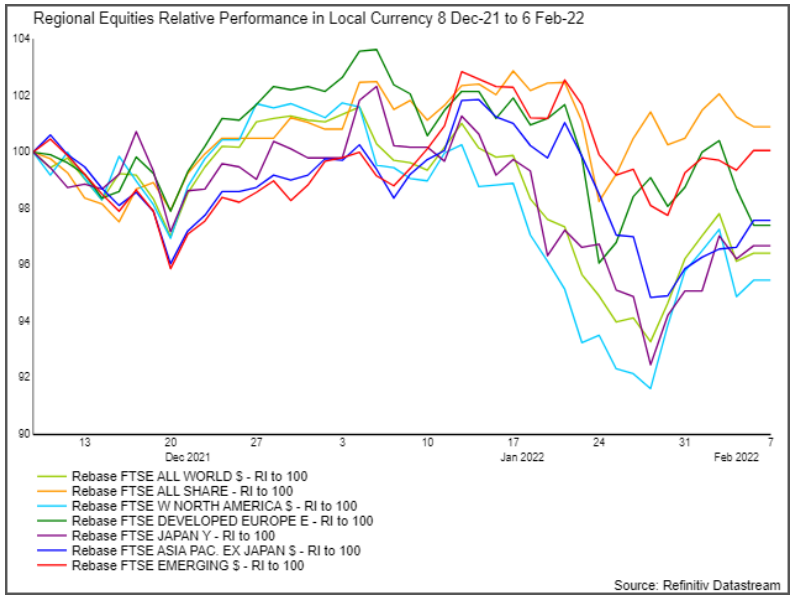
Source: Performance Evaluation Limited & DPF analysis
(*) To 6 Feb-22
(**) To 31 Dec-21
(***) 50% FTSE All World & 50% FTSE Developed
CYTD = Calendar Year To Date

have increased in significance and are now driving market returns, in particular, rising inflation. What was initially viewed as a short-term problem (i.e. transitory price increases) has developed into longer term inflationary concerns. Any expectations that interest rate increases would be slow and steady have faded, as markets have rapidly repriced their expectations for how quickly the Bank of England (BoE) and the US Federal Reserve (FED) will increase interest rates to reduce inflationary pressures.

Notwithstanding the above, there are also some tailwinds which should support positive equity market returns in 2022. The global economic recovery is gathering pace, and GDP growth is forecast to grow at an above trend rate in 2022. As economic activity continues to normalise, the recovery in corporate earnings is also expected to broaden. The recovery in service sector consumption has lagged goods consumption so far, but this trend is expected to reverse as throughout' the year.

Equity market returns have fallen YTD-22, with the FTSE All-World returning minus 4.5% in Sterling terms, reflecting the inflationary pressures noted above. The expected rise in yields has driven a rotation out of Growth stocks into Value stocks, with investors favouring tangible (or 'real') assets over intangible assets.





2.8 United Kingdom Equities

DPF Weightings	
Intermediate Neutral	14.0%
Final Neutral	12.0%
Actual 31.1.22	13.2%
AF Recommendation	12.0%
IIMT Recommendation	13.0%
Benchmark Returns (GB£)	
Q4 21/22 to 6 Feb-22	0.1%
Q3 21/22	4.2%
1 Year to Dec-21	18.3%
3 Years to Dec-21 (pa)	8.3%
5 Years to Dec-21 (pa)	5.4%

The Fund's UK Equity allocation reduced from 14.7% at 31 October 2021 to 13.2% at 31 January 2022 (1.2% overweight), largely reflecting net divestment of £155m as the Fund moved towards the final benchmark.

Mr Fletcher notes that given the ongoing transition to the final benchmark which came into effect on 1 January 2022, and given the quantum of the transition, Mr Fletcher does not recommend making any tactical or temporary changes in the regional equity allocations relative to the new benchmark.

In the three months to 31 January 2022, UK Equities were the only region to achieve positive returns (+2.0%), outperforming the FTSE All World 3.2% in Sterling terms. The UK index has benefited from the shift away from Growth stocks into Value stocks. The FTSE All Share is overweight Energy and Financial stocks and underweight Information Technology and Consumer Discretionary stocks relative to the FTSE All World index. The UK was also one of the first countries to start offering a third Covid-19 booster vaccine, and over 34 million doses had been administered by the end of 2021.g The booster campaign has already had early successes. Whilst Covid-19 hospital admissions rose significantly in the US and Europe in Q4-21, they were relatively flat in the UK, despite new cases reaching all-time highs.

The IIMT continues to believe that UK Equity valuations are attractive on a relative basis. The IIMT recommends a 1.0% overweight allocation of 13.0% relative to the final benchmark, with a modest tilt towards small and mid-cap stocks.

2.9 North American Equities

DPF Weightings	
Intermediate Neutral	6.0%
Final Neutral	-
Actual 31.1.22	1.6%
AF Recommendation	-
IIMT Recommendation	1.6%
Benchmark Returns (GB£)	
Q4 21/22 to 6 Feb-22	(5.6%)
Q3 21/22	9.5%
1 Year to Dec-21	28.1%
3 Years to Dec-21 (pa)	23.6%
5 Years to Dec-21 (pa)	16.2%

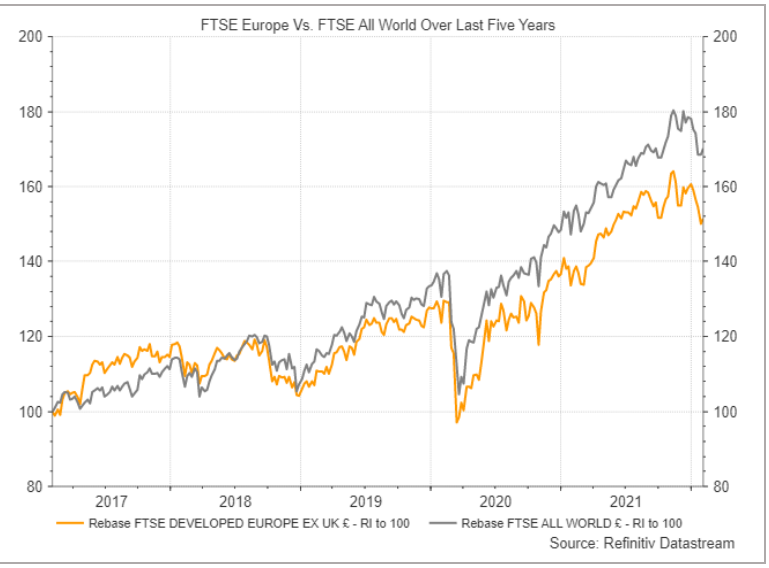
The Fund's North American Equity allocation reduced from 5.7% at 31 October 2021 to 1.6% at 31 January 2022 (1.6% overweight), largely reflecting net divestment of £255m as the Fund moved towards the final benchmark.

Mr Fletcher recommends a neutral weighting relative to the final benchmark across all of the Fund's regional equity allocations; 0% in respect of North American Equities.

The IIMT recommends that the current 1.6% allocation to North American Equities is retained reflecting the fact that the investment vehicles required to support a full switch out of North American Equities are not yet in place. The IIMT estimates that the full transition will be completed in Q2-22.

2.10 European Equities

DPF Weightings	
Intermediate Neutral	4.0%
Final Neutral	-
Actual 31.1.22	0.5%
AF Recommendation	-
IIMT Recommendation	0.5%
Benchmark Returns (GB£)	
Q4 21/22 to 6 Feb-22	(5.6)%
Q3 21/22	5.1%
1 Year to Dec-21	17.3%
3 Years to Dec-21 (pa)	15.3%
5 Years to Dec-21 (pa)	10.2%



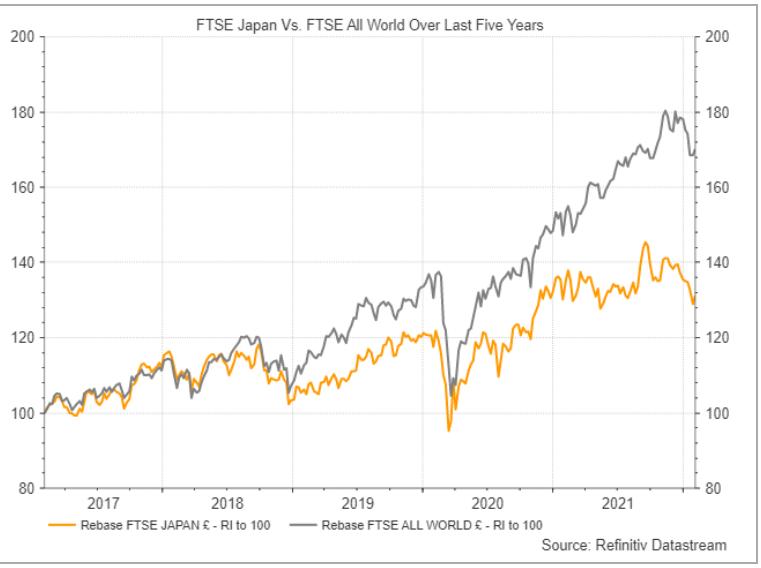
The Fund's European Equity allocation reduced from 3.7% at 31 October 2021 to 0.5% at 31 January 2022 (0.5% overweight), largely reflecting net divestment of £195m as the Fund moved towards the final benchmark.

Mr Fletcher recommends a neutral weighting relative to the final benchmark across all of the Fund's regional equity allocations; 0% in respect of European Equities.

The IIMT recommends that the current 0.5% allocation to European Equities is retained reflecting the fact that the investment vehicles required to support a full switch out of European Equities are not yet in place. The IIMT estimates that the full transition will be completed in Q2-22.

2.11 Japanese Equities

DPF Weightings	
Intermediate Neutral	5.0%
Final Neutral	5.0%
Actual 31.1.22	5.3%
AF Recommendation	5.0%
IIMT Recommendation	5.3%
Benchmark Returns (GB£)	
Q4 21/22 to 6 Feb-22	(3.1%)
Q3 21/22	(4.9%)
1 Year to Dec-21	2.5%
3 Years to Dec-21 (pa)	9.3%
5 Years to Dec-21 (pa)	6.7%



Net investment of £50m, partly offset by relative market weakness, increased the Fund's allocation to Japanese Equities to 5.3% at 31 January 2022 (0.3% overweight).

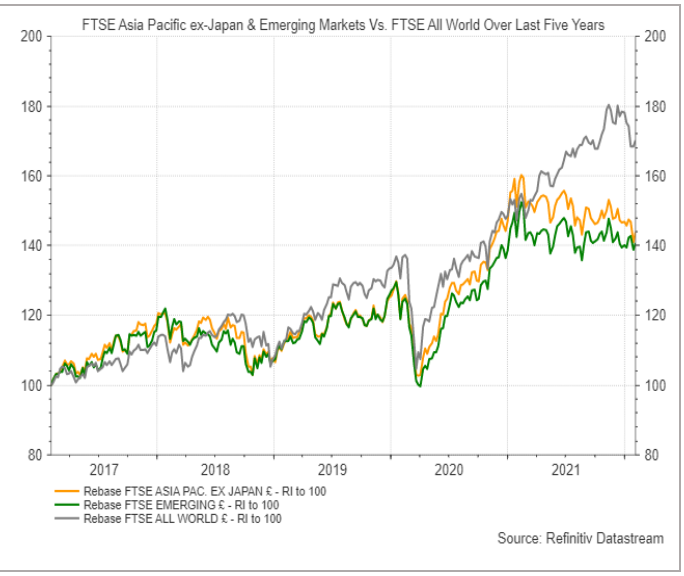
Mr Fletcher recommends a neutral weighting relative to the final benchmark across all of the Fund's regional equity allocations; 5% in respect of Japanese Equities.

Japanese equities underperformed the wider market in 2021, suffering from a slow response to the pandemic, with the domestic vaccination programme starting four months later than most other G7 countries. The economic recovery has been slower than expected, and there has also been political disruption following the Prime Minister Suga resignation in September 2021, which forced the ruling party into a leadership battle and subsequently a national election in October 2021. However, the IIMT believes that the outlook for Japan is now improving. Despite starting late, Japan now leads the G7 in vaccination rates (79% of eligible adults double vaccinated), and after winning a surprise majority in the parliamentary elections, Prime Minister Kishida had unveiled a new $490 billion stimulus package to kick-start growth as the economy recovers from the Covid-19 pandemic.

The IIMT believes that Japanese Equities are attractively valued relative to their global peers and recommends that the Fund's current 0.3% overweight allocation of 5.3% is maintained.

2.12 Asia Pacific Ex-Japan and Emerging Market Equities

DPF Weightings	Asia-Pac	EM
Intermediate Neutral	2.0%	5.0%
Final Neutral	-	5.0%
Actual 31.1.22	0.9%	5.1%
AF Recommendation	-	5.0%
IIMT Recommendation	0.5%	5.1%
Benchmark Returns (GB£)	**Asia-Pac**	**EM**
Q4 21/22 to 6 Feb-22	(2.1%)	0.5%
Q3 21/22	(0.7%)	(1.4%)
1 Year to Dec-21	(0.1%)	0.9%
3 Years to Dec-21 (pa)	10.9%	9.4%
5 Years to Dec-21 (pa)	9.0%	7.9%



The Fund's allocation to Asia Pacific Ex-Japan Equities fell to 0.9% at 31 January 2022 (0.9% overweight), largely reflecting net divestment of £53m as the Fund moved towards the final benchmark. Relative market strength increased the Fund's allocation to Emerging Market Equities from 5.0% at 31 October 2021 to 5.1% at 31 January 2022 (0.1% overweight).

Mr Fletcher recommends a neutral weighting relative to the final benchmark across all of the Fund's regional equity allocations; 0% in the case of Asia Pacific Ex-Japan Equities and 5% in Emerging Market Equities.

The IIMT recommends a 0.5% allocation to Asia Pacific Ex-Japan Equities, reflecting the fact that the investment vehicles required to support a full switch out of Asia Pacific Ex-Japan Equities are not yet in place. The IIMT estimates that the full transition will be completed in Q2-22.

Emerging Market Equities under-performed the wider market in 2021, posting negative returns of -1.0% in Sterling terms versus +21.0% from the FTSE All World. The under-performance largely related to Chinese equities (which make up around 35% of the emerging markets index) which returned -21%, whereas the emerging markets index, excluding China, returned +11%.

Under its 'Common Prosperity' policy, the Chinese government implemented increased regulatory intervention in the private sector, aiming to narrow the widening wealth gap and redistribute economic prosperity. Tough new regulations were imposed on the education, health care, property and

technology sectors. The full extent of regulatory reforms is currently unknown, creating uncertainty which is weighing on investor sentiment.

In addition, the Covid-19 pandemic outlook appears more uncertain in Emerging Markets than Developed Markets. Vaccination rates are lower but are expected to pick up throughout 2022. Many Emerging Market countries, particularly in Asia, have been following a zero Covid-19 policy, which has led to economic disruptions as caseloads have fluctuated. These disruptions should ease as vaccination rates increase through 2022.

The IIMT continues to believe in the long-term growth potential of Emerging Markets, noting that these markets have accounted for well over half of global growth over the last ten years. The IIMT believes that Emerging Market Equities offer value relative to their global peers and recommends that the current 0.1% overweight allocation of 5.1% is maintained.

2.13 Global Sustainable Equities

DPF Weightings	
Intermediate Neutral	16.0%
Final Neutral	29.0%
Actual 31.1.22	24.6%
AF Recommendation	29.0%
IIMT Recommendation	25.0%
Benchmark Returns (GB£)	
Q4 21/22 to 6 Feb-22	(4.8%)
Q3 21/22	6.6%
1 Year to Dec-21	21.2%
3 Years to Dec-21 (pa)	18.8%
5 Years to Dec-21 (pa)	13.1%

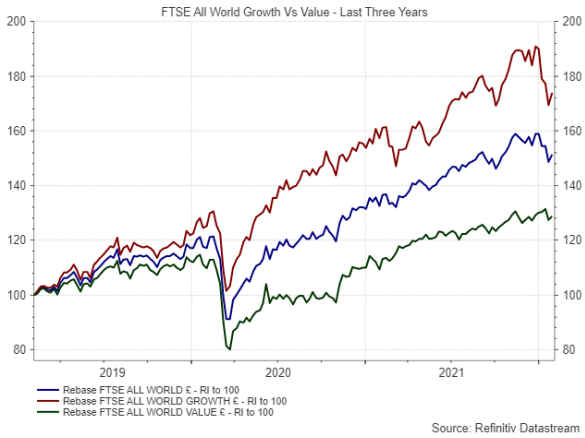
Net investment of £525m in the period increased the Fund's allocation to Global Sustainable Equites from 17.0% at 31 October 2021 to 24.6% at 31 January 2022.

Mr Fletcher recommends a neutral weighting relative to the final benchmark across all of the Fund's regional equity allocations; 29% in respect of Global Sustainable Equities.

The IIMT remains confident about the long-term investment case for the Fund's allocation to Global Sustainable Equities, which typically favour growth

stocks relative to value stocks. A growth stock relates to a company that is forecast to grow at a rate significantly above the average growth rate for the market (e.g. high growth information technology stocks), whereas a value stock relates to a company that appears to trade at a lower price relative to its fundamentals (e.g. pro-cyclical stocks such as industrials).

The charts below shows that growth stocks have significantly out-performed value stocks over the last three years, particularly since the start of the Covid-19 pandemic, as investors favoured quality growth stocks over pro-cyclical stocks, in part supported by low forward interest rate expectations.



However, value stocks have rallied over the last twelve months as both economic activity, and in particular, forward interest rate expectations have increased. This trend has continued into early 2022, with investors favouring tangible (or ‘real’) assets over intangible assets. There has also been a shift from green energy (i.e. renewables) to brown energy (i.e. fossil fuels).

The IIMT notes that value stocks typically out-perform at the start of an economic cycle (as investors position portfolios for the uptick in economic activity) but the period of out-performance tends to be relatively short-lived (generally less than twelve to eighteen months), and investors start to rotate back into growth stocks.

Whilst the IIMT believes that the current value rally may continue for several more months to come (driven by rising forward rate expectations and increased geopolitical tensions), the IIMT remains confident that the Fund’s allocation to Global Sustainable Equities will out-perform over the long-term.

To reduce the performance risk of increasing allocations within a highly correlated asset class, the increase in the Fund’s Global Sustainable Equity allocation in January 2022 (£525m) was invested into highly diversified index products which are designed to significantly reduce the carbon footprint of the

portfolio but also dampen-down performance volatility relative to the wider market.

The IIMT notes that the investment vehicles required to support a full switch out of North American Equities; European Equities and Asia Pacific Ex-Japan Equities to Global Sustainable Equities are not yet in place. As a result, the IIMT recommends a 25.0% allocation to Global Sustainable Equities (4.0% underweight relative to the final benchmark). The IIMT estimates that the full transition will be completed in Q2-22.

2.14 Private Equity

DPF Weighting					
Intermediate Netural	Final Neutral	Actual 31.1.22	Committed 31.1.22	AF Recommendation	IIMT Recommendation
4.0%	4.0%	4.7%	5.0%	4.0%	4.0%
Benchmark Returns (GB£)					
Q4 21/22 to 6 Feb-22	Q3 21/22	1 Year to Dec-21	3 Years to Dec-21 (pa)	5 Years to Dec-21 (pa)	
0.3%	4.3%	19.2%	9.3%	6.4%	

The Private Equity weighting increased from 4.4% at 31 October 2021 to 4.7% at 31 January 2022 (0.7% overweight relative to the final benchmark), reflecting relative market strength.

Mr Fletcher recommends a neutral weighting of 4.0% in Private Equity.

The IIMT notes that the Fund is overweight to Private Equity on a committed basis and is not reviewing further opportunities at this stage. The IIMT believes that the Fund's outstanding private equity commitments of around £60m are well positioned to benefit from any market opportunities resulting from the recovery from the coronavirus outbreak with a strong focus on small and mid-cap deals.

The Fund's listed (i.e. liquid) private equity investments (around 40% of the total private equity portfolio) have performed strongly over the last 12 months, and the IIMT recommends that the Fund 'locks-in' some of these profits and reduces the overall Private Equity allocation by 0.7% to 4.0% (neutral relative to the final benchmark) (5.0% on a committed basis).

2.15 Income Assets

At 31 January 2022, the overall weighting in Income Assets was 22.2%, 1.7% higher than that reported at 31 October 2021, reflecting net investment of £69m, together with relative market strength. The IIMT recommendations below would take the overall Income Asset weighting to 23.0%, and the committed weighting to 27.4%.

2.16 Multi Asset Credit

DPF Weighting				
Intermediate Neutral	Final Neutral	Actual 31.1.22	AF Recommendation	IIMT Recommendation
6.0%	6.0%	7.0%	8.0%	7.0%
Benchmark Returns (GB£)				
Q4 21/22 to 6 Feb-22	Q3 21/22	1 Year to Dec-21	3 Years to Dec-21 (pa)	5 Years to Dec-21 (pa)
(0.1%)	0.5%	4.0%	3.9%	3.7%

The Fund's allocation to Multi-Asset Credit increased from 6.8% at 31 October 2021 to 7.0% at 31 January 2022, largely reflecting net investment of £19m; 1.0% overweight relative to the final benchmark.

Mr Fletcher recommends a 2.0% overweight allocation of 8.0% to Multi-Asset Credit, funded from a 2.0% underweight allocation to investment grade bonds (see Protection Assets). Mr Fletcher notes that whilst credit spreads are low, corporate fundamentals remain strong and default rates are likely to remain low. Furthermore, because many of the securities with a Multi-Asset Credit portfolio have floating rather than fixed interest rates, they are less interest rate sensitive, which is preferable in a rising rate environment.

The IIMT continues to be positive about the long-term attractions of the asset class and favours a strong bias towards defensive forms of credit (e.g. senior secured debt and asset backed securities). The IIMT recommends maintaining the current allocation of 7.0% (1.0% overweight); 8.2% on a committed basis.

2.17 Property

DPF Weighting				
Intermediate Neutral	Final Neutral	Actual 31.1.22	AF Recommendation	IIMT Recommendation
9.0%	9.0%	7.7%	9.0%	8.0%
Benchmark Returns (GB£)				
Q3 21/22 to 6 Feb-22	Q3 21/22	1 Year to Dec-21	3 Years to Dec-21 (pa)	5 Years to Dec-21 (pa)
Not Available	6.7%	17.5%	5.5%	6.5%

The Fund's allocation to Property increased by 0.3% to 7.7% at 31 January 2022, reflecting relative market strength. Direct Property accounted for 4.6% (1.4% underweight against the final benchmark) and Indirect Property accounted for 3.1% (0.1% overweight against the final benchmark).

Mr Fletcher notes that the performance of the Fund's property allocation has proved to be resilient over the last 12 to 18 months despite the impact of the Covid-19 pandemic. Mr Fletcher recommends a neutral overall allocation of 9.0% to property but notes that the Direct Property allocation has outperformed the Indirect Property allocation. Mr Fletcher would like to see the Direct Property allocation increased, funded from realisations out of the Indirect Property allocation, but acknowledges that this should be done with caution as it is a very long-term investment decision, and property transactions tend to be quite expensive.

The Fund's Direct Property Manager notes that in terms of the wider economy, following almost two years of pandemic related economic challenges, the biggest threat now appears to be a resurgence in the inflation rate. This is starting to impact on consumer spending levels and is also likely to result in further rises in interest rates.

Against this backdrop, UK commercial property total returns had a very strong end to 2021. The total return from all UK commercial property as measured by the MSCI Quarterly Index (the Fund's performance benchmark) was +6.1% for the three months to 31 December 2021, comprising an income return of +1.0% plus capital value growth of +5.1%. The total return for the year to 31 December 2021 was +16.3%, comprising an income return of +4.3% combined with capital value growth of +11.5%. In comparison, the Fund's property portfolio returned +5.7% in Q4-21 and +16.6% for the year to 31 December 2021. The focus remains to seek to invest further in the industrial, retail warehouse and alternatives sectors. Investment in the retail

and office sectors remains less likely for the time being, whilst the impact of the Covid-19 pandemic on consumers' shopping habits (on the retail sector) and working from home (on the office sector) is monitored.

The Direct Property Manager has recently agreed Heads of Terms to two properties. The cost of these two purchases (around £30m) will be partly offset by the sale of an existing property for around £7.0m.

The IIMT recommends that the Fund's allocation to Direct Property is increased to 4.9% to reflect the net impact of the purchases noted above (1.1% underweight), whereas the allocation to Indirect Property is maintained at 3.1% (0.1% overweight). It is also recommended that further liquidity of up to £75m is made available to the Direct Property manager to make incremental investments at the right time should suitable investment opportunities be identified.

The IIMT continues to believe that Indirect Property increases the options available to the Fund to deploy capital into a relatively illiquid asset class and increases portfolio diversification, including exposure to overseas assets, private rented accommodation, student accommodation, development capital and medical centres.

2.18 Infrastructure

DPF Weighting					
Intermedidate Neutral	Final Neutral	Actual 31.1.22	Committed 31.1.22	AF Recommendation	IIMT Recommendation
9.0%	10.0%	7.5%	11.1%	10.0%	8.0%
Benchmark Returns (GB£)					
Q4 21/22 to 6 Feb-22	Q3 21/22	1 Year to Dec-21	3 Years to Dec-21 (pa)	5 Years to Dec-21 (pa)	
0.3%	0.5%	2.1%	2.4%	2.5%	

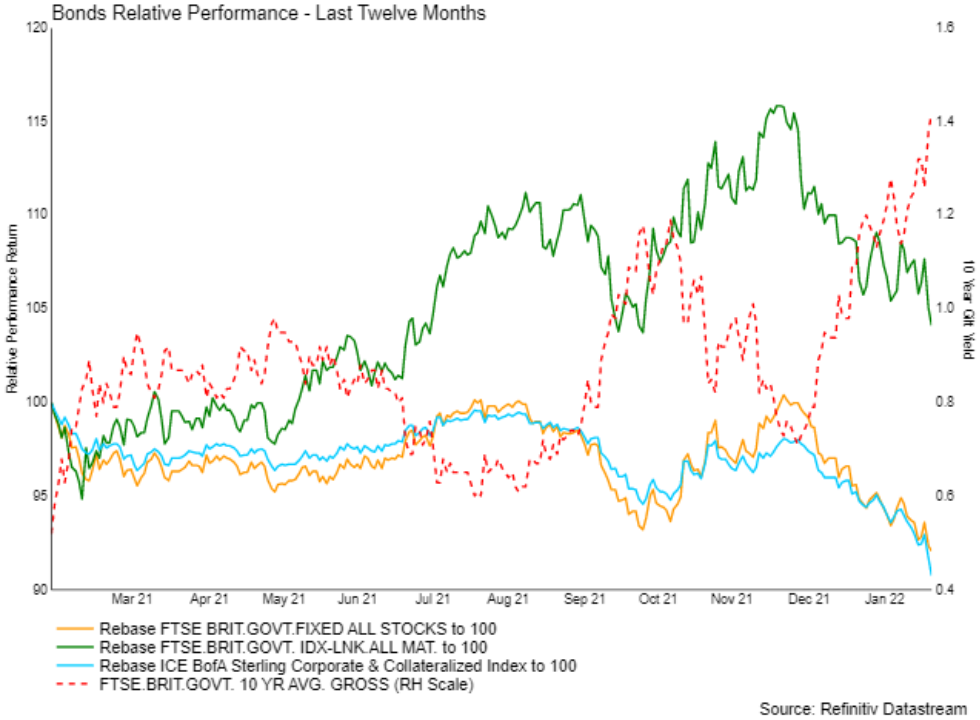
The Fund's allocation to Infrastructure increased from 6.3% at 31 October 2021 to 7.5% at 31 January 2022 principally reflecting net investment of around £64m.

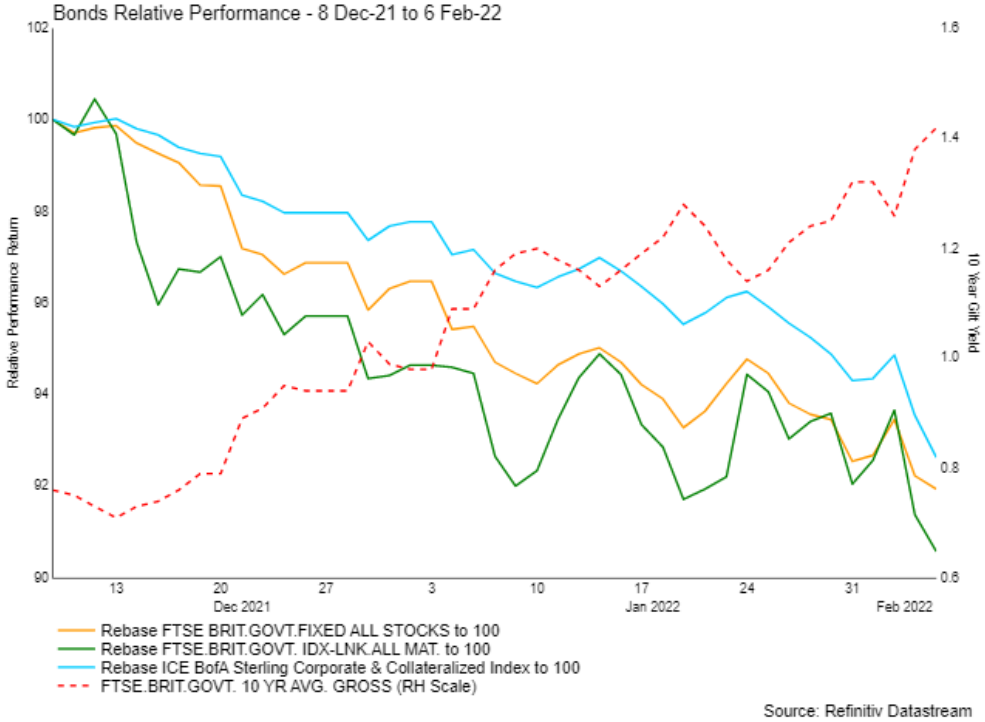
Mr Fletcher recommends a neutral weighting relative to the final benchmark of 10.0% allocation, although Mr Fletcher acknowledges that because of the nature of the infrastructure investment process, it takes time to deploy capital to the asset class.

The IIMT continues to view Infrastructure as an attractive long-term asset class and favours a bias towards core infrastructure assets or renewable energy assets. These assets can offer low volatility; low correlation to equity and fixed income; and reliable long-term cash flows. Notwithstanding the noted favourable long-term characteristics of the asset class, the IIMT continues to believe that infrastructure assets are exposed to increased political and regulatory risk, and this risk is managed through asset type and geographical diversification. It should also be noted that the current market valuation of some infrastructure assets, particularly renewable infrastructure assets, are becoming increasingly stretched driven by strong investor demand.

The IIMT recommends that the invested weighting is increased by 0.5% to 8.0% in the next quarter, reflecting continued investment into listed infrastructure; 11.1% on a committed basis.

2.19 Protection Assets



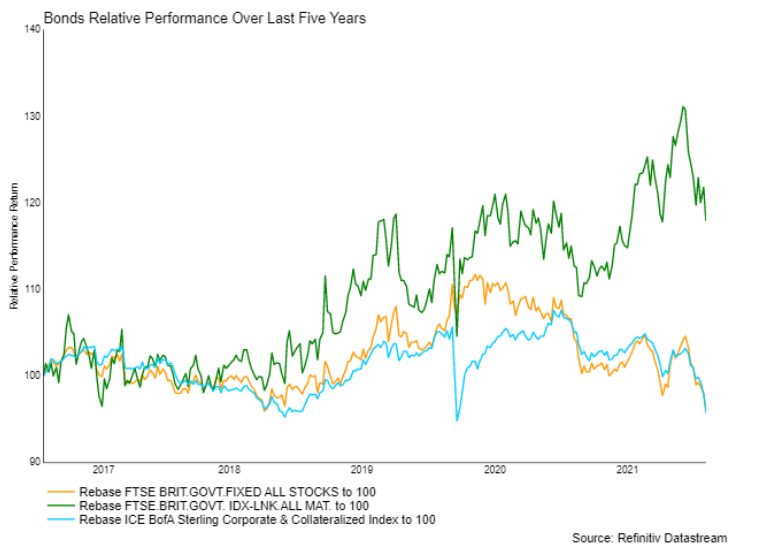


The weighting in Protection Assets at 31 January 2022 was 16.8%, 0.1% higher than that reported at 31 October 2021 reflecting net investment of £12m, partly offset by market weakness. The IIMT recommendations below increase the weighting by 0.2% to 17.0%.

UK Government bond yields have increased since the last Committee meeting (i.e. lower prices), reflecting increasing concerns about the inflation outlook. At the Monetary Policy Committee (MPC) meeting in December 2021, the UK Base Rate was increased from 10 basis points to 25 basis points, and at the meeting in February 2022, it was increased further to 50 basis points, with a number of the MPC members voting for an increase to 75 basis points. Outside of the UK, government yields have also risen and yield curves in the US, Europe and Japan have flattened significantly implying that global bond markets expect the world's major central banks to increase short term interest rates.

2.20 Conventional Bonds

DPF Weightings	
Intermediate Neutral	6.0%
Final Neutral	6.0%
Actual 31.1.22	4.8%
AF Recommendation	4.0%
IIMT Recommendation	5.0%
Benchmark Returns (GB£)	
Q4 21/22 to 6 Feb-22	(4.5%)
Q3 21/22	2.4%
1 Year to Dec-21	(5.2%)
3 Years to Dec-21 (pa)	3.2%
5 Years to Dec-21 (pa)	2.4%



The Fund's allocation to Conventional Bonds reduced by 0.1% to 4.8% between 31 October 2021 and 31 January 2022, reflecting relative market weakness; 1.2% underweight relative to the final benchmark.

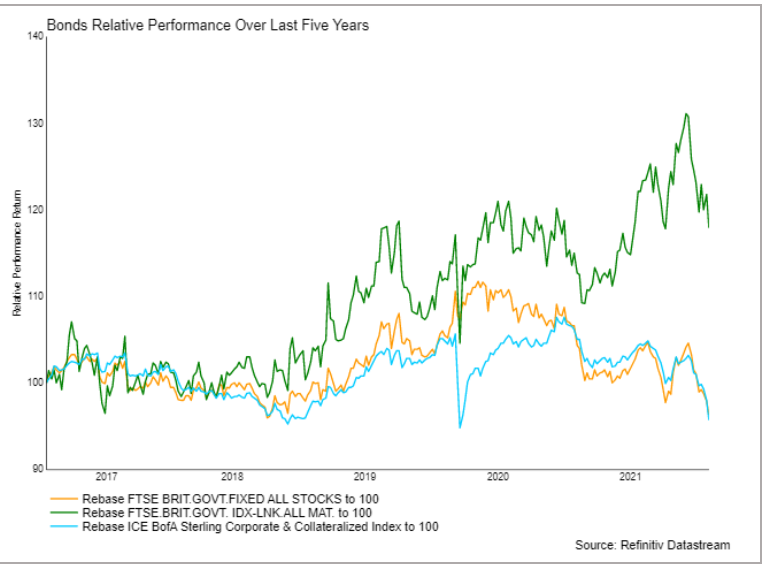
Mr Fletcher has increased his recommended underweight allocation to the asset class from 1.0% to 2.0%, with the 2.0% being allocated to an increase in the Cash weighting.

Mr Fletcher notes that in the short-term inflation is likely to be higher than expected and economic growth while moderating is also likely to remain strong. Central banks are likely to use this opportunity to end super-easy monetary policy and begin the process of normalising interest rates. Mr Fletcher believes that government bond yields are likely to rise further and given their long duration, deliver sizeable negative returns. As a result, Mr Fletcher recommends a 2.0% underweight allocation to Conventional Bonds.

The IIMT continues to believe that whilst conventional sovereign bonds do not appear to offer particularly attractive value at current levels, yields have risen sharply from recent historic lows and sovereign bonds are diversifying assets which continue to afford greater protection than other asset classes in periods of market uncertainty, as evidenced during the Covid-19 pandemic. The IIMT recommends increasing the weighting slightly by 0.2% to 5.0%; 1.0% underweight relative to the final benchmark.

2.21 Index-Linked Bonds

DPF Weightings	
Intermediate Neutral	6.0%
Final Neutral	6.0%
Actual 31.1.22	5.5%
AF Recommendation	6.0%
IIMT Recommendation	5.5%
Benchmark Returns (GB£)	
Q4 21/22 to 6 Feb-22	(4.2%)
Q4 21/22	4.9%
1 Year to Dec-21	4.2%
3 Years to Dec-21 (pa)	7.2%
5 Years to Dec-21 (pa)	4.7%



There were no transactions in the period and the Fund's allocation to Index-Linked Bonds remained flat at 5.5% (0.5% underweight relative to the final benchmark). The Fund's allocation at 31 January 2022 comprised 80% UK Index-Linked Bonds (UK Linkers) and 20% US Treasury Inflation Protected Bonds (US TIPS).

Mr Fletcher has increased his recommended allocation to UK Linkers from 5.0% to 6.0% (neutral). Mr Fletcher notes that whilst he remains uncomfortable with the extremely high duration, negative yield and over-valuation of index-linked gilts, and has consistently recommended an underweight allocation in the past, in the current period of rising inflation, Mr Fletcher now recommends at neutral position.

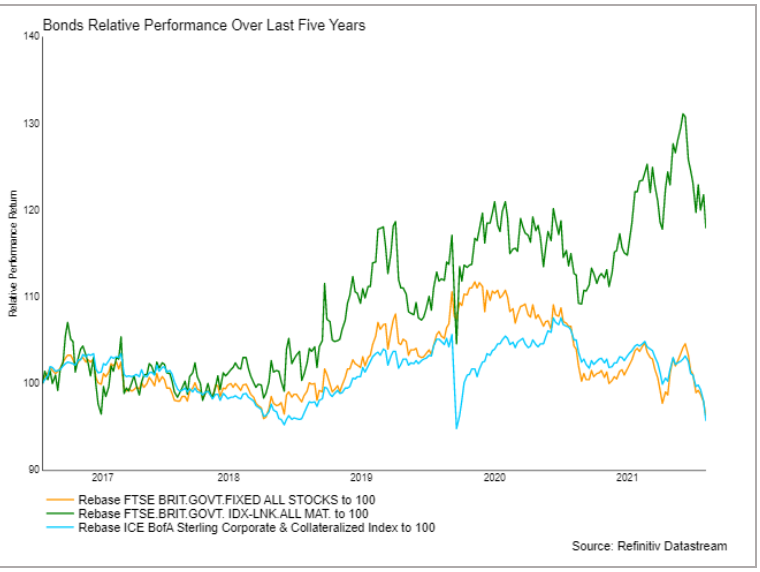
The IIMT notes that markets and the major central banks have become increasingly concerned about higher inflation over the last few months' driven by the 'post Covid-19' economic recovery; supply constraints; high-savings rates (which could reverse and lead to a spending surge), and US policy stimulus. However, it is unclear whether this will be a short-term increase or lead to longer term inflation pressures.

The IIMT believes that the potential for higher inflation, either in the short or longer term, supports the Fund's current Index-Linked bonds allocation, and therefore recommends that the weighting is maintained at 5.5%. The IIMT recommends maintaining the Fund's current exposure to US TIPS, noting that

these offer diversification and protection against rising US inflation expectations.

2.22 Corporate Bonds

DPF Weightings	
Intermediate Neutral	6.0%
Final Neutral	6.0%
Actual 31.1.22	6.5%
AF Recommendation	4.0%
IIMT Recommendation	6.5%
Benchmark Returns (GB£)	
Q4 21/22 to 6 Feb-22	(4.5%)
Q3 21/22	0.3%
1 Year to Dec-21	(2.1%)
3 Years to Dec-21 (pa) (1)	n/a
5 Years to Dec-21 (pa) (1)	n/a



(1) Benchmark returns for the LGPS Central Limited Investment Grade Bonds Sub-Fund only available since the launch of the product in February 2020

Net investment of £12m in January 2022 increased the Fund's allocation to Global Investment Grade bonds from 6.3% at 31 October 2021 to 6.5% at 31 January 2022; 0.5% overweight relative to the final benchmark.

Mr Fletcher has reduced his recommended allocation to Global Investment Grade Bonds from 6.0% (neutral) to 4.0% (2.0% underweight), with the reduction used to fund a 2.0% overweight allocation to Multi-Asset Credit (see Income Assets). Mr Fletcher favours Multi-Asset Credit because of the lower interest rate sensitivity, and the current narrow spread on investment grade bonds. Mr Fletcher notes that while it would seem counter intuitive to make this switch, the reason bond yields are rising is because, interest rates are rising, not because the credit outlook is deteriorating. The fundamentals of improving growth and low default rates remain positive especially for sub-investment grade credits. Furthermore, Multi-Asset Credit managers have the ability to invest in floating rate debt which is a positive in a rising interest rate environment.

The IIMT notes that whilst investment grade bond spreads are low, investment grade bonds are likely to be more defensively positioned relative to risk-on assets (e.g. equities, high yield bonds, etc), should markets experience any

period of weakness. As a result, the IIMT recommends maintaining the current allocation to the asset class at 6.5%; 0.5% overweight.

2.23 Cash

The Cash weighting at 31 January 2022 was 5.1% (3.1% overweight relative to the final benchmark), down from 5.6% at 31 October 2021.

Mr Fletcher has maintained his 4% weighting in Cash (2% overweight) funded from underweight positions in Conventional Bonds, reflecting the 'extremely low yield and high duration risk' currently attached to the asset class. Mr Fletcher notes that given the current valuation of all investment markets, together with the Fund's upcoming contractual commitments, he is not in a hurry to reduce the cash allocation.

The IIMT notes that whilst global markets have recovered strongly following the sharp sell-off in Q1-20, the recovery has been heavily dependent on substantial and unprecedented central bank monetary support and national government fiscal support. The recent change of tone from the central banks, largely in response to higher inflation expectations, has started to erode investor confidence and equity markets have come under increasing pressure since the start of 2022. The recovery from the Covid-19 pandemic is likely to be uneven, and markets appear to be ignoring significant headwinds including considerable uncertainty about the shape of the economic recovery; continuing high levels of coronavirus cases in some countries, the risk of new variants; rising inflationary pressures; tight global supply chains; and rising geopolitical uncertainty.

The IIMT recommends a defensive cash allocation of 5.0% (3.0% overweight relative to the final benchmark) due to the uncertain economic outlook, and the current rich valuations across most asset classes. This will also ensure that the Fund has sufficient operational headroom after adjusting for term-loan maturities (i.e. short-term loans provided by the Fund to other public sector bodies) to cover upcoming investment commitment drawdowns (expected to be in excess of £180m over the course of 2022-23).

3 Implications

3.1 Appendix 1 sets out the relevant implications considered in the preparation of the report.

4 Background Papers

4.1 Papers held in the Investment Section.

5 Appendices

5.1 Appendix 1 – Implications.
5.2 Appendix 2 – Report of independent external adviser.
5.2 Appendix 3 – Portfolio Valuation Report at 31 January 2022.

6 Recommendation(s)

That Committee:

a) note the report of the independent external advisor, Mr Fletcher.
b) note the asset allocations, total assets and long-term performance analysis set out in the report.
c) approve the IIMT recommendations outlined in the report.

7 Reasons for Recommendation(s)

7.1 Both Mr Fletcher's report and the analysis set out in this report in respect of asset allocation, total assets and long-term performance provide an overview of the Fund's investment strategy and performance track-record on which to assess the asset allocation positioning for the Fund for the upcoming quarter.

7.2 The rationale for each of the IIMT asset allocation recommendations included in this report is set out in Section 2.

Report Author: Neil Smith
Investments Manager

Appendix 1

Implications

Financial

1.1 As set out in the above report.

Legal

2.1 None

Human Resources

3.1 None

Information Technology

4.1 None

Equalities Impact

5.1 None

Corporate objectives and priorities for change

6.1 None

Other (for example, Health and Safety, Environmental Sustainability, Property and Asset Management, Risk Management and Safeguarding)

7.1 None