FOR PUBLICATION

DERBYSHIRE COUNTY COUNCIL

PENSIONS AND INVESTMENTS COMMITTEE

WEDNESDAY, 7 JUNE 2023

Report of the Director - Finance and ICT

Investments Report

1. Purpose

1.1 To review the Fund's asset allocation, investment activity since the last meeting, long term performance analysis and to seek approval for the investment strategy in the light of recommendations from the 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 on 30 April 2023 and the recommendations of the Director of Finance & ICT and Mr Fletcher, in relation to the Fund's strategic asset allocation benchmark (SAAB), 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 relate to Private Equity, Infrastructure, Multi-Asset Credit and currently total around £246m. Whilst the timing of drawdowns will be lumpy and difficult to predict, the In-house Investment Management Team (IIMT) believes that the majority of 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 (2)	Benchmark Sterling Return	Benchmark Sterling Return
	Final (1)	31/1/23	30/4/23	Final (1)	AF 7/6/23	DPF 7/6/23	AF 7/6/23	DPF 7/6/23	DPF 7/6/23	3 Months to 31/3/23	3 Months to 30/4/23
Growth Assets	**55.0%**	**56.0%**	**55.5%**	**+/- 8%**	**(1.0%)**	**(0.2%)**	**54.0%**	**54.8%**	**55.4%**	**n/a**	**n/a**
UK Equities	12.0%	14.1%	12.9%	+/- 4%	+1.0%	-	13.0%	12.0%	12.0%	3.1%	1.9%
Global Equities:	39.0%	37.0%	37.7%	+/- 8%	(2.0%)	(1.1%)	37.0%	37.8%	37.8%	n/a	n/a
North America	-	1.0%	-	-	-	-	-	-	-	4.6%	0.2%
Japan	5.0%	5.4%	5.4%	+/- 2%	-	-	5.0%	5.0%	5.0%	3.3%	(1.3%)
Emerging Markets	5.0%	5.7%	5.3%	+/- 2%	-	+0.3%	5.0%	5.3%	5.3%	0.2%	(6.6%)
Global Sustainable	29.0%	24.9%	27.0%	+/- 8%	(2.0%)	(1.5%)	27.0%	27.5%	27.5%	4.2%	0.1%
Private Equity	4.0%	4.9%	4.9%	+/- 2%	-	+1.0%	4.0%	5.0%	5.6%	4.4%	0.3%
Income Assets	**25.0%**	**25.2%**	**25.8%**	**+/- 6%**	**+2.0%**	**+1.0%**	**27.0%**	**26.0%**	**29.1%**	**n/a**	**n/a**
Multi-Asset Credit	6.0%	7.0%	7.1%	+/- 2%	+2.0%	+1.4%	8.0%	7.5%	8.7%	2.0%	1.4%
Infrastructure	10.0%	10.6%	10.9%	+/- 3%	-	+0.9%	10.0%	10.9%	12.8%	1.4%	0.7%
Direct Property (4)	6.0%	5.1%	5.6%	+/- 2%	-	(0.4%)	6.0%	5.6%	5.6%	(1.2%)	(1.2%) (3)
Indirect Property (4)	3.0%	2.5%	2.2%	+/- 2%	-	(0.9%)	3.0%	2.0%	2.0%	(0.2%)	(0.2%) (3)
Protection Assets	**18.0%**	**15.3%**	**15.1%**	**+/- 5%**	**(1.0%)**	**(2.0%)**	**17.0%**	**16.0%**	**16.0%**	**n/a**	**n/a**
Conventional Bonds	6.0%	4.8%	4.7%	+/- 2%	(1.0%)	(1.0%)	5.0%	5.0%	5.0%	2.0%	(2.2%)
Index-Linked Bonds	6.0%	4.8%	4.7%	+/- 2%	-	(1.0%)	6.0%	5.0%	5.0%	4.3%	(2.8%)
Corporate Bonds	6.0%	5.7%	5.7%	+/- 2%	-	-	6.0%	6.0%	6.0%	2.6%	(0.5%)
Cash	**2.0%**	**3.5%**	**3.6%**	**0 – 8%**	**-**	**+1.2%**	**2.0%**	**3.2%**	**(0.5%)**	**0.9%**	**n/a**

Investment Assets totaled £5,928m at 30 Apr-23 adjusted for the following May-23 trades: UK Equities -1.5%; North America Equities -1.1%; +2.0% Global Sustainable Equities; and +0.6% Cash

(1) Final benchmark effective from 1 January 2022.
(2) Adjusted for investment commitments at 30 Apr-23. Presumes all commitments funded from Cash.
(3) Benchmark Return for the three months to 31 Mar-23.
(4) The maximum permitted range in respect of Property is +/- 3%.

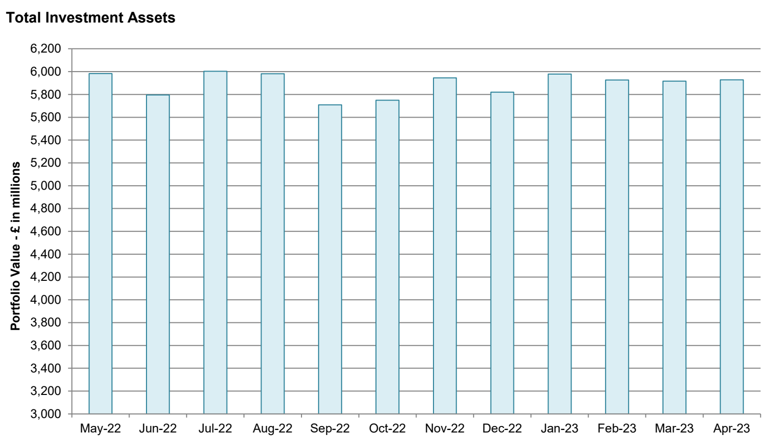
The table above reflects the following three categorisations:

- **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 on 30 April 2023, was overweight Growth Assets (0.5%), Income Assets (0.8%) and Cash (1.6%) and underweight Protection Assets (-2.9%). 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 to -0.5%. 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.

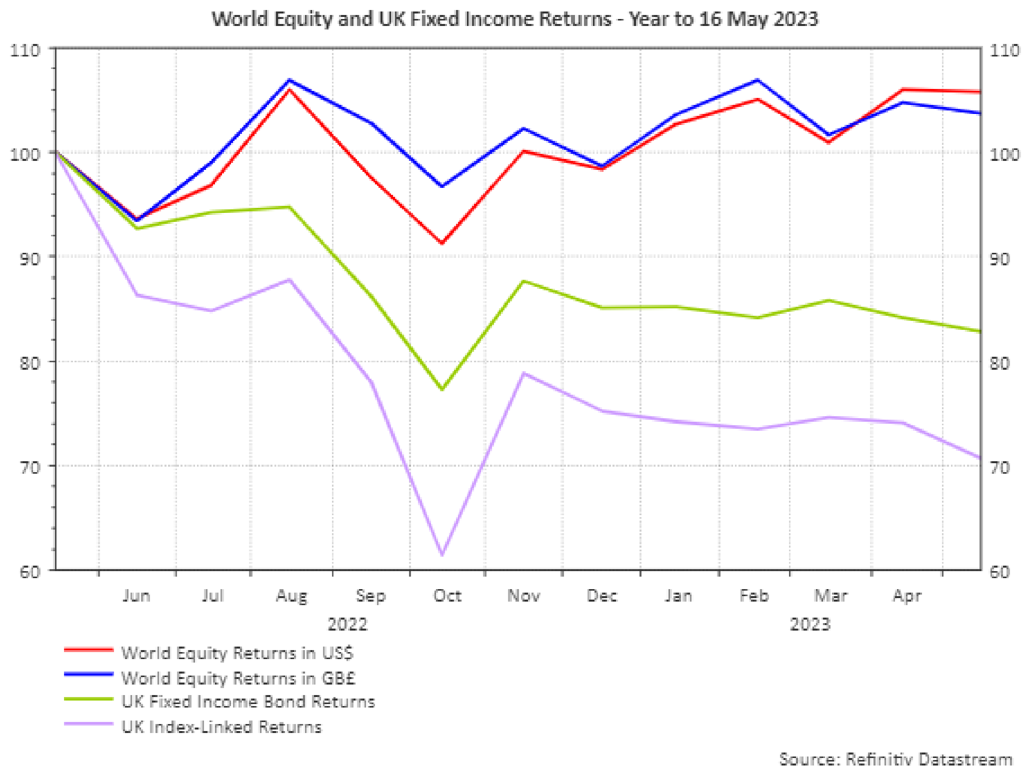
2.3 Total Investment Assets

The value of the Fund's investment assets fell by £51m (-0.8%) between 31 January 2023 and 30 April 2023 to £5.928bn, comprising a non-cash market loss of around £66m, partly offset by cash inflows from dealing with members and investment income of around £15m. Over the twelve months to 30 April 2023, the value of the Fund's investment assets has fallen £102m (-1.7%), comprising a non-cash market loss of around £162m, partly offset by cash inflows from dealing with members & investment income of around £60m.



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 on 30 April 2023 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 Gilts and UK Index Linked bonds for the twelve months to 16 May 2023.

Global Equities (as measured by the FTSE All World) generated a positive return in sterling of 3.7% over the 12-month period to 16 May 2023. However, bond returns were negative. UK Conventional Gilts lost 17% of their value over the 12-month period and UK Index-Linked Bonds fell by 29%. Bond yields rose as markets reacted to higher inflation by pricing in higher interest rates rises to reduce inflationary pressures. A bond's price moves inversely to its yield, so this has resulted in lower capital values.

Year-to-Date 2023[1] performance has been better, with Global Equities returning 4.0%, albeit bonds have generally continued to struggle, with UK Conventional Gilts losing -0.6% and UK Index-Linked Bonds losing -2.9%. After a relatively positive start to the year, markets fell in March 2023 on the back of some US regional bank failures (Silicon Valley Bank and Signature Bank). This was compounded by the collapse of Credit Suisse (and subsequently takeover by UBS) in Europe, which increased investor concern that there was going to be a full-scale banking crisis. Whilst these concerns

[1] 1 January 2023 to 16 May 2023

have subsequently subsided, markets remain volatile and heavily focused on the direction of inflation and interest rates.

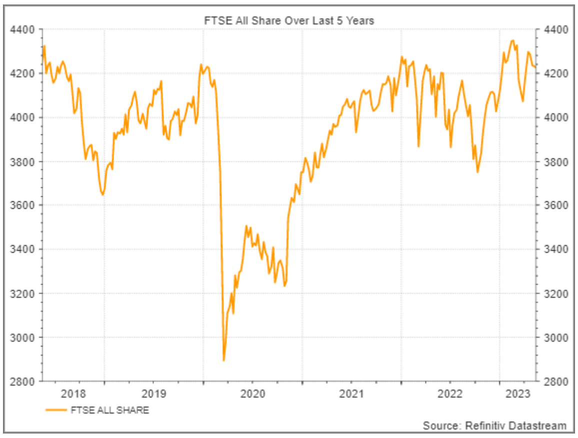
Recent economic data has been relatively resilient. US, UK and Eurozone Purchasing Managers Index (PMI) surveys in April 2023 came in above expectations and reported China's Q1-23 GDP was stronger than expected. Falling energy prices helped to bring down headline inflation down in the US, with the inflation contribution from energy turning negative. The Q1 2023 US earnings reporting season is now largely over, with around 80% of reporting companies beating expectations, with the average beat being around 7%. Whilst a positive, earnings expectations were low, and LGIM notes that blended earnings (i.e. figures including earnings realised for those who have reported, and expected earnings for those not reporting) are down 2% year-on-year. Q1 2023 marked the second consecutive quarter of declining earnings. Furthermore, notwithstanding the resilient economic data, inflation remains very sticky, and it will take time for the impact of the higher interest rates to work through the system. It is also unclear how the tightening of credit conditions, particularly in the US, in response to two regional bank failures in March 2023, will impact on economic activity.

Central banks have continued to raise interest rates, with the US Federal Reserve (the US Fed) increasing rates by 0.25% in February 2023, March 2023 and May 2023, taking the target range to 5.00% - 5.25%, the highest level since October 2007. The US Fed's post-meeting statement for May 2023 omitted a sentence present in the central bank's March 2023 comments saying that 'the Committee anticipates that some additional policy firming may be appropriate' for the Fed to achieve its 2% inflation goal. US Fed Chair, Jerome Powell, noted that 'a decision on a pause was not made today' but markets noted the change in the statement language around future policy firming, and now believe that US interest rates have peaked and will start to fall towards the back end of 2023.

In the UK, the Monetary Policy Committee, increased rates by 0.5% in February 2023 and by a further 0.25% in both March 2023 and May 2023, taking rates to a 14 year high of 4.5%. Notwithstanding the rate rises, UK CPI remained elevated at 10.1% in the twelve months to 31 March 2023.

The IIMT continues to believe that headwinds remain. The global economic outlook remains uncertain, albeit consensus forecasts indicate that any economic slowdown is now likely to be significantly lower than feared twelve months ago. It is also unclear how the on-going cost of living crisis, together with ongoing inflation pressures (whilst inflation may be peaking it remains persistent), higher interest rates and tighter credit conditions will impact economic activity and corporate earnings over the next twelve months.

Asset class weightings and recommendations are based on values at the end of April 2023. As shown in the charts below, both the UK FTSE All Share and US S&P 500 are now trading towards the top end of their 30-year trading range, albeit the US S&P 500 has fallen back over the last two years.



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 March 2023.

Per annum	DPF	Benchmark Index
1 year	(3.1%)	(3.6%)
3 years	8.0%	7.7%
5 years	4.9%	4.5%
10 years	6.6%	6.2%

The Fund outperformed the benchmark over all time periods.

2.6 Category Recommendations

	Benchmark	Fund Allocation	Permitted Range	Recommendation		Benchmark Relative Recommendation	
		30 Apr-23		AF	DPF	AF	DPF
Growth Assets	55.0%	55.5%	± 8%	54.0%	54.8%	(1.0%)	(0.2%)
Income Assets	25.0%	25.8%	± 6%	27.0%	26.0%	+2.0%	+1.0%
Protection Assets	18.0%	15.1%	± 5%	17.0%	16.0%	(1.0%)	(2.0%)
Cash	2.0%	3.6%	0 – 8%	2.0%	3.2%	-	+1.2%

At an overall level, the Fund was overweight Growth Assets, Income Assets and Cash on 30 April 2023, and underweight Protection Assets. As highlighted on page 2, commitments on 30 April 2023 totalled around £246m, potentially increasing Growth Assets by 0.6% and Income Assets by 3.1%. The table on page 3 assumes that these commitments will be funded out of the current cash weighting; in practice as these 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 IIMT recommendations reflected in this report: reduce Growth Assets by 0.7% to 54.8% (0.2% underweight) (UK Equities - 0.9%; Japanese Equities –0.4%; Global Sustainable Equities +0.5%; and Private Equity +0.1%), increase Income Assets by 0.2% to 26.0% (MAC +0.4%; and Indirect Property -0.2%); increase Protection Assets by 0.9% (Conventional Bonds +0.3%; Index-Linked Bonds +0.3% and Corporate Bonds +0.3%), and reduce Cash by 0.4%.

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

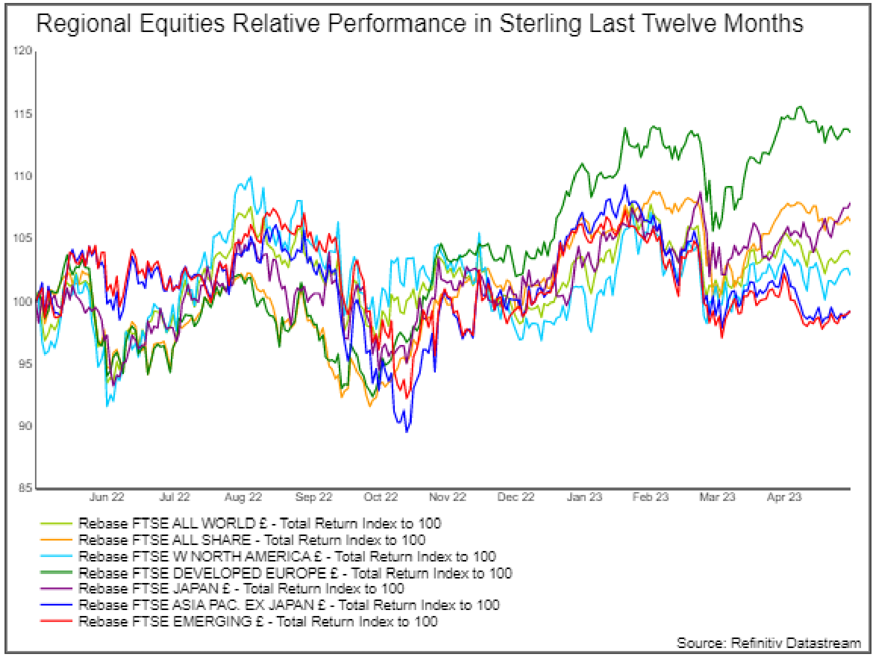
2.7 Growth Assets

On 30 April 2023, the overall Growth Asset weighting was 55.5%, down from 56.0% on 31 January 2023, largely reflecting net divestment of around £30m, including the final unwinding of the Fund's North American Equity allocation.

The IIMT recommendations in this report reduce the weighting to 54.8%, 0.2% underweight, albeit flexibility will be required in response to changing economic and market conditions.

Mr Fletcher recommends an overall 1.0% underweight allocation of 54.0% to Growth Assets. Mr Fletcher notes that he remains cautious on equity markets, especially the more interest rate sensitive growth sectors. Furthermore, future volatility may be higher, suggesting that investors will need to see meaningful 'cheapness' in asset prices before committing new capital to the asset class, especially when bonds appear much better value than they have done in a very long time.

While the IIMT remains optimistic about the long-term potential for Growth Assets, a cautious stance towards this group of assets is currently recommended due to the headwinds for markets noted above. The IIMT believes that some of the recent outperformance from UK and Japanese Equities should be locked in, with a partial switch to Global Sustainable Equities, which should benefit from lower interest rate expectations over the longer-term. The IIMT also recommends that the Fund's allocation to Emerging Market Equities is reduced into line with a neutral position, reflecting the volatility of the asset class and uncertain economic outlook.



Benchmark Return	Currency	Q2-23 (*)	Q1-23	1 Year (**)	3 Year (**)	5 Year (**)	Since Last Committee (*)	L3M 30-Apr-23
Sterling Returns								
FTSE All World	GB£	(0.3%)	4.4%	(0.9%)	16.0%	10.1%	(2.2%)	(0.4%)
FTSE UK	GB£	2.2%	3.1%	2.9%	13.8%	5.0%	(1.4%)	1.9%
FTSE Japan	GB£	2.6%	3.3%	2.0%	7.9%	4.1%	0.0%	(1.3%)
FTSE Emerging Markets	GB£	(1.6%)	0.2%	(4.1%)	9.2%	2.9%	(4.9%)	(6.6%)
Local Currency Returns								
FTSE All World	US$	0.7%	7.3%	(6.9%)	15.9%	7.4%	3.3%	1.7%
FTSE UK	GB£	2.2%	3.1%	2.9%	13.8%	5.0%	(1.4%)	1.9%
FTSE Japan	¥	6.4%	7.0%	5.0%	15.6%	6.1%	5.3%	5.6%
FTSE Emerging Markets	US$	0.5%	3.0%	(9.7%)	9.3%	0.4%	0.4%	(4.7%)

Source: Performance Evaluation Limited & DPF analysis

(*) To 16 May-23

(**) To 31 Mar-23

2.8 United Kingdom Equities

DPF Weightings	
Neutral	12.0%
Actual 30.4.23	12.9%
AF Recommendation	13.0%
IIMT Recommendation	12.0%
Benchmark Returns (GB£)	
Q1 23/24 to 16 May-23	2.2%
Q4 22/23	3.1%
1 Year to Mar-23	2.9%
3 Years to Mar-23 (pa)	13.8%
5 Years to Mar-23 (pa)	5.0%

The Fund’s UK Equity allocation fell from 14.1% on 31 January 2023 to 12.9% on 30 April 2023 (0.9% overweight), largely reflecting net divestment of £90.0m.

Mr Fletcher has maintained his UK Equities recommended weight of 13.0%, 1.0% overweight, reflecting Mr Fletcher’s assessment of the relative value of UK Equities and Global Sustainable Equities.

The IIMT notes that UK Equities have performed strongly over the last twelve months[2], returning 6.4% in GBP versus 4.1% from North American Equities and 5.8% from the FTSE All World in US dollars. The UK index has a structural bias towards Value stocks, in particular the energy sector, which has benefited from higher energy prices over the last twelve months. The UK index has also benefited from a weak pound and the high level of overseas earnings made by the constituents.

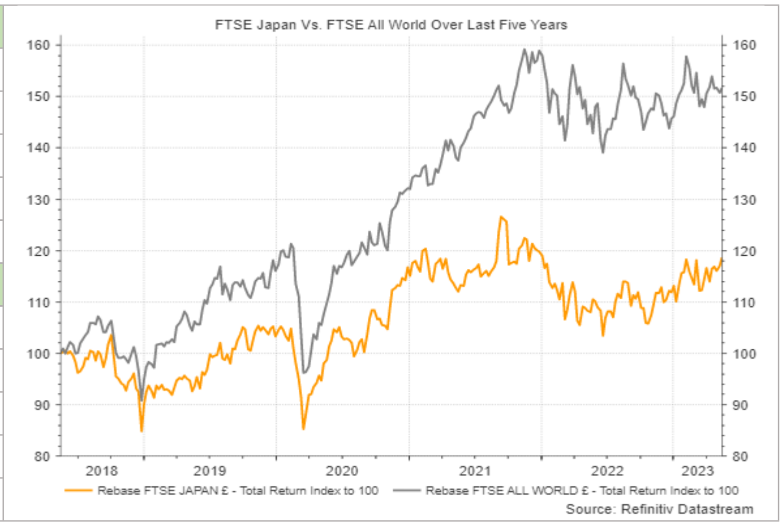
The IIMT believes that it is increasingly likely that interest rates are close to peaking, albeit inflation remains persistent, and it may take some time before interest rates start to fall. This leaves the UK index vulnerably to a Growth rally on a relative basis. As a result, the IIMT recommends that the Fund’s current 12.9% overweight allocation to UK Equities is reduced to a neutral allocation of 12.0% to ‘lock-in’ some of the strong relative performance from UK Equities over the last twelve months.

[2] Year to 16 May 2023

The IIMT is currently reviewing the options to manage around 25% of the Fund's UK Equity allocation through a low carbon vehicle to reduce the portfolio's carbon footprint relative to the FTSE All Share. It is proposed that any allocation to a low carbon vehicle would be benchmarked against the product specific benchmark.

2.9 Japanese Equities

DPF Weightings	
Neutral	5.0%
Actual 30.4.23	5.4%
AF Recommendation	5.0%
IIMT Recommendation	5.0%
Benchmark Returns (GB£)	
Q1 23/24 to 16 May-23	2.6%
Q4 22/23	3.3%
1 Year to Mar-23	2.0%
3 Years to Mar-23 (pa)	7.9%
5 Years to Mar-23 (pa)	4.1%



The Fund's allocation to Japanese Equities remained flat at 5.4% between 31 January 2023 and 30 April 2023; 0.4% overweight.

Mr Fletcher recommends a neutral weighting relative to the benchmark.

The IIMT continues to believe that Japanese Equities offer sector diversification and defensive qualities. Against a backdrop of global economic uncertainty, Japanese Equities have performed strongly over the last twelve months[3], returning 16.5% in Japanese Yen versus 5.8% from the FTSE All World in US$'s.

At this stage in the interest rate cycle, some of the Fund's other equity allocations (e.g. Global Sustainable Equities), now offer better medium term prospects. The IIMT, therefore, recommends that the Fund's allocation to Japanese Equities is reduced by 0.4% to 5.0% neutral to 'lock-in' some of the strong relative performance from Japanese Equities over the last twelve months.

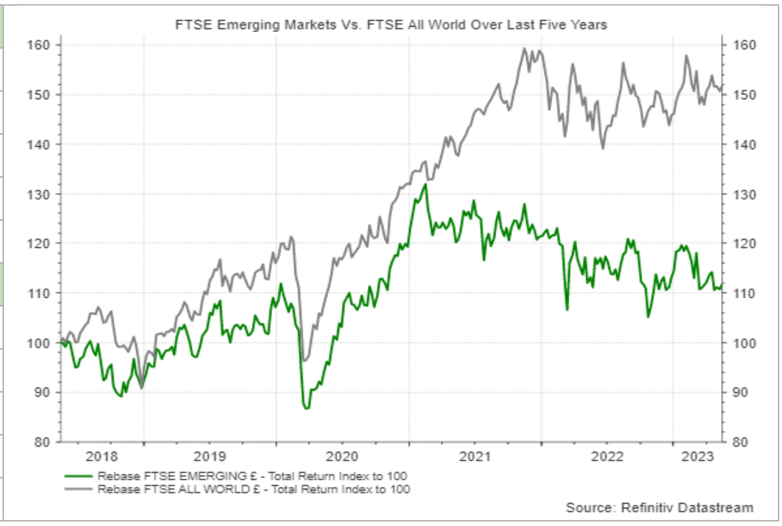
The IIMT is currently reviewing the options to manage around 25% of the Fund's Japanese Equity allocation through a low carbon vehicle to reduce the

[3] Year to 16 May 2023

portfolio's carbon footprint relative to the FTSE Japan Index. It is proposed that any allocation to a low carbon vehicle should be benchmarked against the product specific benchmark.

2.10 Emerging Market Equities

DPF Weightings	
Neutral	5.0%
Actual 30.4.23	5.3%
AF Recommendation	5.0%
IIMT Recommendation	5.3%
Benchmark Returns (GB£)	
Q1 23/24 to 16 May-23	(1.6%)
Q4 22/23	0.2%
1 Year to Mar-23	(4.1%)
3 Years to Mar-23 (pa)	9.2%
5 Years to Mar-23 (pa)	2.9%



Relative market weakness reduced the Fund's allocation to Emerging Market Equities from 5.7% on 31 January 2023 to 5.3% on 30 April 2023 (0.3% overweight).

Mr Fletcher recommends a neutral allocation of 5.0% to Emerging Market Equities.

In US dollar terms, Emerging Market Equities were one of the worst performing regions in 2022, falling by close to 17%. This has continued in YTD-23[4], with Emerging Market Equities returning 2.5% versus 8.1% from the FTSE All World. 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, and recommends a maintained weighting of 5.3%.

[4] 1 January 2023 to 16 May 2023

2.11 Global Sustainable Equities

DPF Weightings	
Neutral	29.0%
Actual 30.4.23	27.0%
AF Recommendation	27.0%
IIMT Recommendation	27.5%
Benchmark Returns (GB£)	
Q1 23/24 to 16 May-23	0.1%
Q4 22/23	4.2%
1 Year to Mar-23	(0.5%)
3 Years to Mar-23 (pa)	16.4%
5 Years to Mar-23 (pa)	10.6%

The Fund’s allocation to Global Sustainable Equities increased from 24.9% on 31 January 2023 to 27.0% on 30 April 2023 (2.0% underweight) reflecting net investment of £120m.

Mr Fletcher continues to recommend a 2.0% underweight allocation of 27.0% to Global Sustainable Equities because of the relatively higher interest rate sensitivity of the asset class

The IIMT notes that the outlook for Global Sustainable Equities is closely linked to the outlook for inflation and interest rates. Global Sustainable Equities typically favour interest rate sensitive growth stocks and tend to outperform when interest rates are falling and underperform when interest rates are rising. Whilst interest rates may be close to peaking, it may take some time before they start to fall. As a result, the IIMT continues to recommend an underweight allocation to Global Sustainable Equities. However, the IIMT recommends that the underweight allocation is reduced by 0.5% to 1.5% to help to position the Fund for any rotation back into growth stocks.

2.12 Private Equity

DPF Weighting				
Netural	Actual 30.04.23	Committed 30.04.23	AF Recommendation	IIMT Recommendation
4.0%	4.9%	5.6%	4.0%	5.0%
Benchmark Returns (GB£)				
Q1 23/24 to 16 May-23	Q4 22/23	1 Year to Mar-23	3 Years to Mar-23 (pa)	5 Years to Mar-23 (pa)
0.3%	4.4%	0.5%	12.3%	4.7%

The Fund’s Private Equity weighting remained flat at 4.9% between 31 January 2023 and 30 April 2023 (0.9% overweight).

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

The IIMT notes that the Fund was 1.6% overweight to Private Equity on a committed basis on 30 April 2023. As a result, the Fund is not considering any further commitments to the asset class at present, albeit this is monitored by the IIMT on an on-going basis.

The IIMT recommends increasing the Fund’s Private Equity allocation by 0.1% to 5.0% (1.0% overweight) (5.6% on a committed basis), reflecting scheduled commitment drawdowns.

2.13 Income Assets

On 30 April 2023, the overall weighting in Income Assets was 25.8% (0.8% overweight), 0.6% higher than that reported on 31 January 2023, largely reflecting net investment of around £30m. The IIMT recommendations below increase the weighting to 26.0%; 29.1% on a committed basis.

2.14 Multi Asset Credit

DPF Weighting				
Netural	Actual 30.04.23	Committed 30.04.23	AF Recommendation	IIMT Recommendation
6.0%	7.1%	8.7%	8.0%	7.5%
Benchmark Returns (GB£)				
Q1 23/24 to 16 May-23	Q4 22/23	1 Year to Mar-23	3 Years to Mar-23 (pa)	5 Years to Mar-23 (pa)
1.0%	2.0%	2.7%	6.4%	3.4%

The Fund's allocation to Multi-Asset Credit increased from 7.0% on 31 January 2023 to 7.1% on 30 April 2023 (1.1% overweight), principally reflecting net investment of £4m.

Mr Fletcher has maintained his 2.0% overweight allocation of 8.0% to Multi-Asset Credit. Mr Fletcher notes that global credit spreads have moved sideways over the last quarter and have experienced some volatility due to the unexpected action of the Swiss regulator with respect to the AT1 bonds (a bond which can be converted into equity if certain conditions are met, for example, such as an issuing bank's capital strength falling below a pre-determined trigger level) of Credit Suisse. However, the overall yield available on sub-investment grade bonds, together with the low duration and floating rate nature of many of the assets included within a Multi-Asset Credit strategy, suggests to Mr Fletcher that Multi-Asset Credit remains attractive relative to longer duration assets in a rising interest 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 believes that the current running yield available from the Multi-Asset Class asset class is attractive, and offers value over the longer term, albeit there could be volatility in the short-term. As a result, the IIMT recommends that the current allocation of 7.1% is increased by 0.4% to 7.5% (1.5% overweight) to reflect scheduled private debt draw-down commitments; 8.7% on a committed basis.

2.15 Property

DPF Weighting				
Netural	Actual 30.04.23	Committed 30.04.23	AF Recommendation	IIMT Recommendation
9.0%	7.8%	8.7%	9.0%	7.6%
Benchmark Returns (GB£)				
Q1 23/24 to 16 May-23	Q4 22/23	1 Year to Mar-23	3 Years to Mar-23 (pa)	5 Years to Mar-23 (pa)
Not available	(0.9%)	(13.2%)	2.2%	2.1%

The Fund's allocation to Property increased by 0.2% to 7.8% on 30 April 2023, principally reflecting net investment of £16m, partly offset by relative market weakness. Direct Property accounted for 5.6% (0.4% underweight) and Indirect Property accounted for 2.2% (0.8% underweight).

Mr Fletcher recommends a neutral overall allocation of 9.0% to property but notes that he would like to see the Direct Property allocation increased in the medium term, funded from realisations out of the Indirect Property allocation. However, Mr Fletcher believes that there may be an opportunity for the Fund to take advantage of distressed selling by other investors by increasing the Fund's exposure to Indirect Property assets.

The Fund's Direct Property manager notes the total return from the Fund's Direct Property portfolio for the year ended 31 March 2023 was -10.0%, compared to the Fund's benchmark return of -12.6%. The portfolio vacancy rate stands at 4.4% versus a benchmark vacancy rate of 8.1%. After a strong run of rising capital values from UK commercial property (+13.8% in total for the four quarters ending September 2022), the political and economic upheavals in the second half of 2022 had a detrimental effect on property values. Property yields followed interest rate movements outwards with all sectors sustaining negative capital value growth. Yields have since stabilised in Q1-23 and whilst economic challenges remain, investors are beginning to re-enter the market. Total return forecasts for the remainder of 2023 remain weak (IPF Consensus Forecast 2023 of -0.6%) but returns are forecast to improve in 2024 (7.2%) and 2025 (8.0%). The industrial and retail warehousing sectors are forecast to provide the strongest total return performance over the medium term; whilst the Fund has good exposure to these sectors, the Fund's discretionary Direct Property manager is actively looking to increase the Fund's holdings further should suitable opportunities arise.

The IIMT recommends that the Fund's allocation to Direct Property is maintained at 5.6%, albeit the IIMT recommends that further liquidity of up to £60m (1.0%) is made available to the Direct Property manager to make incremental investments at the right time should suitable investment opportunities be identified, funded from matching Indirect Property redemptions. The IIMT recommends reducing the Indirect Property weighting by 0.2% to 2.0% (1.0% underweight) to reflect scheduled redemptions.

2.16 Infrastructure

DPF Weighting				
Netural	Actual 30.04.23	Committed 30.04.23	AF Recommendation	IIMT Recommendation
10.0%	10.9%	12.8%	10.0%	10.9%
Benchmark Returns (GB£)				
Q1 23/24 to 16 May-23	Q4 22/23	1 Year to Mar-23	3 Years to Mar-23 (pa)	5 Years to Mar-23 (pa)
0.7%	1.4%	4.3%	2.9%	2.8%

The Fund's allocation to Infrastructure increased from 10.6% at 31 January 2023 to 10.9% at 30 April 2023 (0.9% overweight), largely reflecting net investment of £10m, of which £7m related to renewable energy assets.

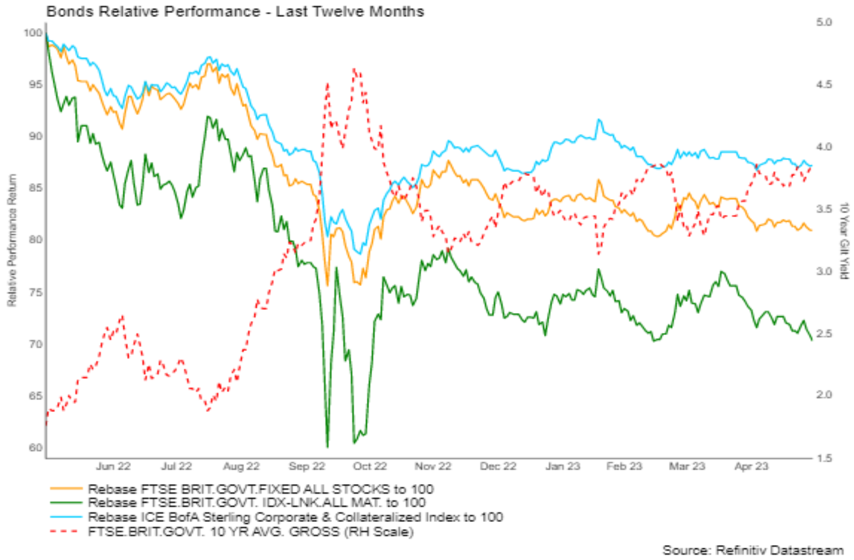
Mr Fletcher recommends a neutral weighting relative the final benchmark.

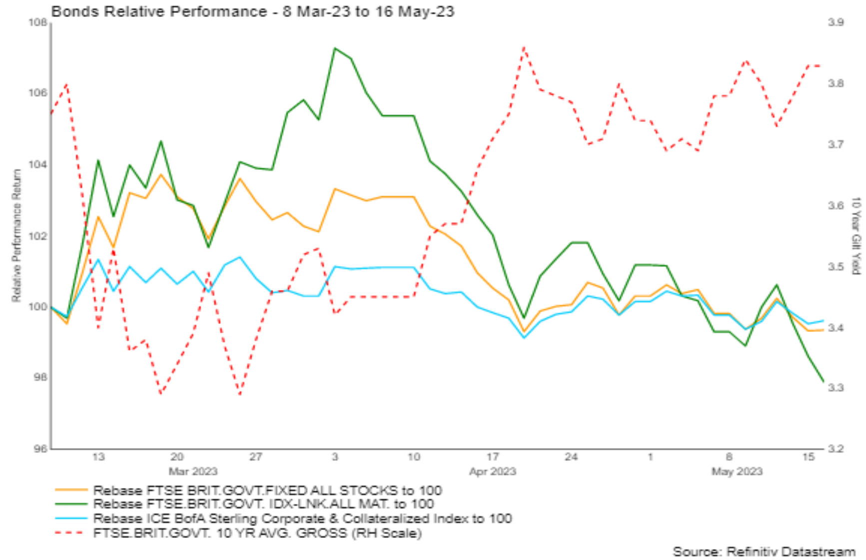
The IIMT continues to view Infrastructure as an attractive long-term asset class and favours a bias towards core infrastructure assets or renewable energy assets. These assets can offer low volatility; low correlation to equity and fixed income markets; and reliable long-term cash flows.

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 best mitigated through asset type and geographical diversification. 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 maintained at 10.9% (0.9% overweight); 12.8% on a committed basis. Given the current committed weight of 12.8%, the IIMT is not reviewing new opportunities at the current time, albeit this is monitored by the IIMT on an on-going basis.

2.17 Protection Assets





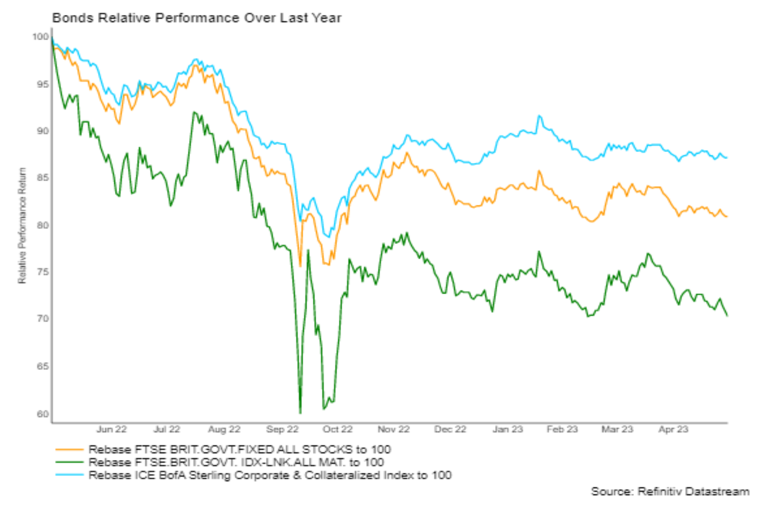
The weighting in Protection Assets on 30 April 2023 was 15.1%, down from 15.3% on 31 January 2023, reflecting relative market weakness. The IIMT recommendations below increase the weighting by 0.9% to 16.0%.

Fixed income returns came under increasing pressure in 2022 as bond yields rose (lowering prices), as markets priced in increasing levels of interest rates in both the US and the UK to tackle rising inflation. UK bond yields were extremely volatile in H2-22, particularly in response to the UK Governments ‘mini-budget’ in September 2022. The ‘mini-budget’ was followed by a sharp sell-off in long-dated gilts (pushing up yields), and the BoE was forced into temporary purchases of government bonds to ensure that the market continued to function properly. The UK bond market subsequently stabilised and prices rose (pushing down yields). Whilst 10-year UK bond yields have been relatively volatile YTD[5] (initially falling in March 2023 in response to some US and Swiss bank failures but recovering thereafter as concerns over a full-scale banking crisis eased and inflation remained elevated pushing up forward rate expectations), over the entire period they have remained relatively flat at around 375 to 385 basis points.

[5] 1 January 2023 to 16 May 2023

2.18 Conventional Bonds

DPF Weightings	
Neutral	6.0%
Actual 30.4.23	4.7%
AF Recommendation	5.0%
IIMT Recommendation	5.0%
Benchmark Returns (GB£)	
Q1 23/24 to 16 May-23	(2.6%)
Q4 23/24	2.0%
1 Year to Mar-23	(16.3%)
3 Years to Mar-23 (pa)	(9.1%)
5 Years to Mar-23 (pa)	(3.1%)



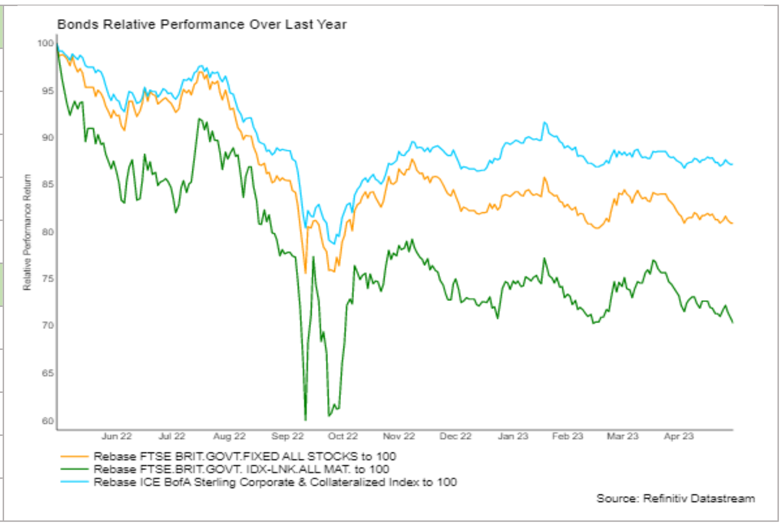
The Fund's allocation to Conventional Bonds reduced from 4.8% on 31 January 2023 to 4.7% on 30 April 2023 (1.3% underweight), reflecting relative market weakness. The Fund's allocation on 30 April 2023 comprised 85% UK Conventional Gilts and 15% US Treasuries.

Mr Fletcher has maintained his 1.0% underweight allocation to Conventional Bonds. Mr Fletcher notes that whilst we are now closer to the end of the tightening cycle, reflecting the passage time, not because inflation has fallen or because economic growth has slowed enough. Growth is actually stronger than expected. Mr Fletcher believes that monetary policy changes will be driven by the rate of inflation, even if this means an economic contraction. Despite the tightening of credit conditions following the recent US and Swiss bank failures, Mr Fletcher believes there is still room for higher bond yields and interest rates. Whilst the pace of increases may slow, Mr Fletcher does not believe that rates will peak until it is clear that inflation is on a path aligned with central bank target rates, especially as economies remain close to full employment.

The IIMT believes that conventional sovereign bonds offer better value now than they have for some time following the substantial rise in yields over the last twelve months. Sovereign bonds are also diversifying assets which should afford greater protection than other asset classes in periods of market uncertainty, as evidenced by the July 2022 fall in bond yields as concerns about the global economy intensified. The IIMT recommends increasing the weighting by 0.3% to 5.0% (1.0% underweight) in line with Mr Fletcher's recommendation.

2.19 Index-Linked Bonds

DPF Weightings	
Neutral	6.0%
Actual 30.4.23	4.7%
AF Recommendation	6.0%
IIMT Recommendation	5.0%
Benchmark Returns (GB£)	
Q1 23/24 to 16 May-23	(6.9%)
Q4 22/23	4.3%
1 Year to Mar-23	(26.7%)
3 Years to Mar-23 (pa)	(7.6%)
5 Years to Mar-23 (pa)	(3.2%)



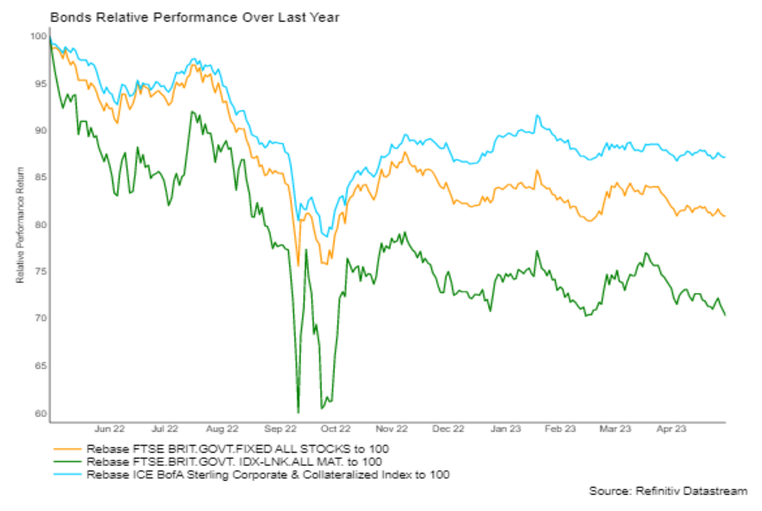
The Fund's allocation to Index-Linked Bonds fell from 4.8% on 31 January 2023 to 4.7% on 30 April 2023 (1.3% underweight), reflecting relative market weakness. The Fund's allocation on 30 April 2023 comprised 80% UK Index-Linked Bonds (UK Linkers) and 20% US Treasury Inflation Protected Bonds (US TIPS).

Mr Fletcher has maintained his 6.0% (neutral) allocation to Index-Linked Bonds.

The IIMT believes that current yields, together with the potential for a longer-term period of elevated inflation, supports a small increase in the Fund's current allocation to Index-Linked Bonds. As a result, the IIMT recommends increasing the weighting to 5.0%; 1% underweight.

2.20 Corporate Bonds

DPF Weightings	
Neutral	6.0%
Actual 30.4.23	5.7%
AF Recommendation	6.0%
IIMT Recommendation	6.0%
Benchmark Returns (GB£)	
Q1 23/24 to 16 May-23	(0.2%)
Q4 22/23	2.6%
1 Year to Mar-23	(9.0%)
3 Years to Mar-23 (pa) (1)	(1.9%)
5 Years to Mar-23 (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

There were no transactions in the period and the Fund's weighting in Global Investment Grade Bonds remained flat at 5.7% on 30 April 2023.

Mr Fletcher has maintained his neutral allocation to Corporate Bonds to 6.0% neutral.

The IIMT believes that the spread on investment grade bonds is now relatively attractive and investment grade bonds are likely to be more defensively positioned relative to risk-on assets (e.g. equities), should markets experience further periods of weakness. However, the challenging economic backdrop increases the risk of a rise in corporate defaults. The IIMT recommends increasing the Corporate Bonds allocation by 0.3% to 6.0% (neutral).

2.21 Cash

The Cash weighting on 30 April 2023 was 3.6% (1.6% overweight), up from 3.5% on 31 January 2023, principally reflecting net divestment across the total portfolio of around £4m over the period.

Mr Fletcher has maintained his recommended weighting in Cash at 2.0% (neutral).

The IIMT notes that global markets are extremely volatile and whilst investor confidence has shown signs of improvement, several significant headwinds remain which could see this reverse, including a slowdown in global activity, continuing inflationary pressures, persistent high interest rates (relative to recent years), energy security concerns, tight global supply chains, the continuing conflict between Russia and Ukraine and potential political gridlock in the US, with the Democrats controlling the Senate and the Republicans controlling the House of Representatives (as evidenced by the current debt ceiling negotiations).

The IIMT recommends a relatively defensive cash allocation of 3.2% (1.2% overweight) due to the uncertain economic and political outlook. 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 £100m over the course of the next twelve months).

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.
5.3 Appendix 3 – Portfolio Valuation Report on 30 April 2023.

6. Recommendation(s)

That Committee:

a) notes the report of the independent external advisor, Mr Fletcher.
b) notes the asset allocations, total assets and long-term performance analysis set out in the report.
c) approves the IIMT recommendations outlined in the report.
d) notes the proposal to benchmark any allocation to UK and Japanese low carbon vehicles to the relevant product specific benchmark.

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 recommendations 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.

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Appendix 1

Implications

Financial

1.1 None

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