DERBYSHIRE County Council

FOR PUBLICATION

DERBYSHIRE COUNTY COUNCIL

PENSIONS AND INVESTMENTS COMMITTEE

WEDNESDAY, 6 DECEMBER 2023

Report of the Director - Finance and ICT

Investment Report

1. Purpose

1.1 To review the Fund's asset allocation, investment activity since the last meeting, and 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 31 October 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 and Multi-Asset Credit and currently total around £270m. 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		Adjusted for Commitments (1)	Benchmark Sterling Return	Benchmark Sterling Return
		31/7/23	31/10/23		AF 6/12/23	DPF 6/12/23	AF 6/12/23	DPF 6/12/23	DPF 6/12/23	3 Months to 30/9/23	3 Months to 31/10/23
Growth Assets	**55.0%**	**56.4%**	**55.0%**	**+/- 8%**	**(1.0%)**	**(0.4%)**	**54.0%**	**54.7%**	**56.4%**	**n/a**	**n/a**
UK Equities	12.0%	12.5%	12.1%	+/- 4%	+1.0%	+0.1%	13.0%	12.1%	12.1%	1.9%	(4.8%)
Global Equities:	39.0%	38.9%	37.7%	+/- 8%	(2.0%)	(1.8%)	37.0%	37.3%	37.3%	n/a	n/a
Japan	5.0%	5.5%	5.3%	+/- 2%	-	-	5.0%	5.0%	5.0%	3.1%	(2.9%)
Emerging Markets	5.0%	5.5%	5.1%	+/- 2%	-	-	5.0%	5.0%	5.0%	2.6%	(5.4%)
Global Sustainable	29.0%	27.9%	27.2%	+/- 8%	(2.0%)	(1.8%)	27.0%	27.3%	27.3%	0.7%	(3.6%)
Private Equity	4.0%	5.0%	5.3%	+/- 2%	-	+1.3%	4.0%	5.3%	7.0%	0.9%	(3.4%)
Income Assets	**25.0%**	**25.8%**	**26.5%**	**+/- 6%**	**+2.0%**	**+1.2%**	**27.0%**	**26.2%**	**29.0%**	**n/a**	**n/a**
Multi-Asset Credit	6.0%	7.4%	7.7%	+/- 2%	+2.0%	+1.7%	8.0%	7.7%	8.9%	2.2%	0.8%
Infrastructure	10.0%	10.7%	11.0%	+/- 3%	-	+1.0%	10.0%	11.0%	12.7%	1.8%	1.8%
Direct Property (3)	6.0%	5.5%	5.6%	+/- 2%	-	(0.4%)	6.0%	5.6%	5.6%	(0.7%)	(0.7%) (2)
Indirect Property (3)	3.0%	2.2%	2.2%	+/- 2%	-	(1.1%)	3.0%	1.9%	1.9%	(0.7%)	(0.7%) (2)
Protection Assets	**18.0%**	**14.6%**	**15.7%**	**+/- 5%**	**(1.0%)**	**(1.6%)**	**17.0%**	**16.4%**	**16.4%**	**n/a**	**n/a**
Conventional Bonds	6.0%	4.5%	5.0%	+/- 2%	(1.0%)	(0.8%)	5.0%	5.2%	5.2%	(0.6%)	(1.7%)
Index-Linked Bonds	6.0%	4.5%	5.0%	+/- 2%	-	(0.8%)	6.0%	5.2%	5.2%	(4.7%)	(5.5%)
Corporate Bonds	6.0%	5.6%	5.7%	+/- 2%	-	-	6.0%	6.0%	6.0%	0.2%	(1.9%)
Cash	**2.0%**	**3.2%**	**2.8%**	**0 – 8%**	**-**	**+0.7%**	**2.0%**	**2.7%**	**(1.9%)**	**1.3%**	**1.2%**

Investment Assets totaled **£5,833.7m** at 31 Oct-23
(1) Adjusted for investment commitments at 31 Oct-23. Presumes all commitments funded from Cash.
(2) Benchmark Return for the three months to 30 Sept-23.
(3) The maximum permitted range in respect of Property is +/- 3%.

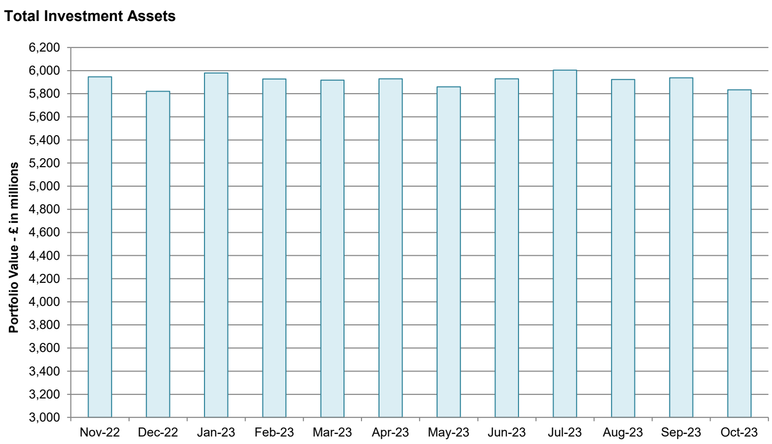
The table above reflects the following three categorisations:

- **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 31 October 2023, was neutral Growth Assets, overweight Income Assets (1.5%) and Cash (0.8%) and underweight Protection Assets (-2.4%). 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 -1.9%. 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

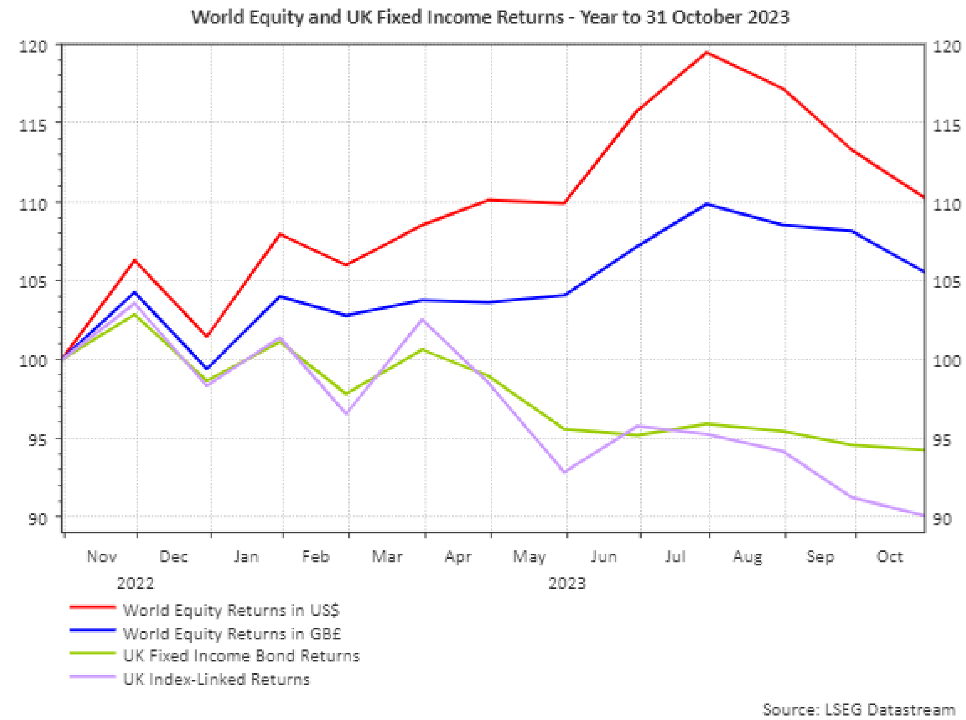
The value of the Fund's investment assets fell by £170m (-2.8%) between 31 July 2023 and 31 October 2023 to £5,833.7m, comprising a non-cash market loss of around £185m, partly offset by a cash inflow from dealing with members and investment returns of around £15m. Over the twelve months to 31 October 2023, the value of the Fund's investment assets increased by £85m (+1.5%), comprising cash inflows from dealing with members & investment income of around £60m and a non-cash market gain of around £25m.



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 31 October 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 31 October 2023.



Global Equities (as measured by the FTSE All World) delivered a positive return of 11.2% in US dollar terms over the 12-month period ending 31 October 2023.

In sterling terms, the return from Global Equities was lower at 5.5% because sterling appreciated against the US dollar from 1.147 to 1.215. In contrast, the returns from the bond markets have been negative over the comparable period. Bond values move inversely to interest rates, so capital values have declined as the major central banks have raised policy rates during the period in a continued effort to tackle persistent inflation. As a result, UK Conventional Gilts decreased in value by 5.8% over the same period, whereas UK Index-Linked Bonds fell in value by 9.9%.

Over the last 18 months, the US Federal Reserve (US Fed) has consistently cautioned that persistent inflation could require interest rates to be held at elevated levels for some time to tame price pressures. However, up until September 2023, markets had generally been dismissive of these warnings as there was an assumption that higher policy rates would quickly feed through into the economy, reducing demand and consumption. In this scenario, it was expected that the upward pressure on prices would be alleviated without significantly affecting economic growth, leading to a sharp decline in inflation which would then afford the Central Banks sufficient headroom to quickly cut interest rates. The expectation of lower future interest rates supported global equity markets, which had climbed 15% in dollar terms in the year-to-date (YTD) period between January and August 2023.

However, the September meeting of the US Fed's Federal Open Market Committee (FOMC) cast doubt on those expectations, when Jerome Powell (US Fed Chair) firmly reiterated his commitment to keeping interest rates higher for longer and reinforced his comments with hawkish projections for the path of future interest rates. Although Powell conceded that US inflation had initially fallen quite rapidly from its peak in June 2022, he warned that core inflation (which strips out volatile items such as food and energy) had been declining at a much slower rate and it had been stubbornly and persistently running above 4% in 2023, more than double the target of 2%.

Furthermore, the US Fed's median projections of US GDP growth for 2023 had increased by more than a full percentage point (ppt) since June to 2.1%, while growth for 2024 had also been revised upwards by 0.4 ppts. Unemployment was also forecasted to be lower than expected, declining by 0.3ppts in 2023 and 0.4 ppts in 2024, indicating further tightness in the labour market at a time when the unemployment rate hovers near a 50-year low.

Powell's message to markets was that persistent core inflation, coupled with strong economic growth and a hot labour market, risked derailing its efforts to tame price rises and it could lead to a situation where inflation becomes resurgent. Consequently, the US Fed's projection of future interest rates differed quite considerably from investors' previous expectations. Whereas the market had been pricing in a full percentage point of cuts in 2024, the US Fed's projection showed no more than 50 basis point of cuts, with more significant rate reductions delayed until 2025.

In response, the US Treasury yield curve (which has been inverted[1] since July 2022) almost entirely dis-inverted over September and October as long-term yields increased relative to short term yields, suggesting that investors had heeded the US Fed's warnings and were, at that time, more accepting of the *'higher for longer'* narrative.

[1] Under normal circumstances, a bond yield curve is expected to be upward sloping, which means that bonds with longer maturities offer higher returns to investors as compensation for locking money away for a longer period of time. When the yield curve inverts, shorter maturity bonds offer higher returns than longer maturity bonds. This indicates that the market believes that future interest rates will revert to lower levels.

The rise in long term bond yields quickly flowed through into equity markets. In dollar terms, the FTSE All World declined by 6.9% between 31 August and 31 October 2023, reducing the year to date (YTD) return from 15.0% to 7.1%. The more growth oriented and interest rate sensitive 'Magnificent Seven'[2] group of stocks declined by almost 10% over the same period, having previously risen almost 100% in the YTD period to 31 August 2023.

Subsequently, equity and bond markets have rallied quite strongly, with the FTSE All World Index up 5% in sterling terms and Conventional Gilts up more than 4% to mid-November. The rally was initially triggered by softer rhetoric from Jerome Powell following the late October/early November FOMC meeting which the market interpreted as the Fed having reached a peak in its interest rate cycle. This interpretation was then strengthened by weaker US employment and inflation data; US inflation fell from 3.7% in September to 3.2% in October, fractionally below the consensus expectation and the first decline in four months.

In the UK, headline inflation has declined substantially from its October 2022 peak of 11.1% to 4.6% in October 2023, largely due to falls in utilities, fuel and food inflation. However, core inflation has proved to be stickier, falling from a peak of 7.1% in March 2023 to 5.7% in October 2023, with a tight labour market and strong wage growth putting pressure on service sector pricing.

The Bank of England's (BOE) Monetary Policy Committee left interest rates at their 15-year high of 5.25% for the second time in a row in November, emphasising again the need to keep policy sufficiently restrictive for a sufficient period of time.

The BOE is facing an increasingly difficult challenge to tame inflation without tipping the UK economy into a recession, against a background of weak GDP growth, rising levels of corporate insolvencies, and depleted levels of consumer savings.

Furthermore, given the significant time delay[3] between an increase in policy rates and its actual impact on the economy, the full consequences of around 500 basis points of tightening in both the US and the UK are yet to fully materialise.

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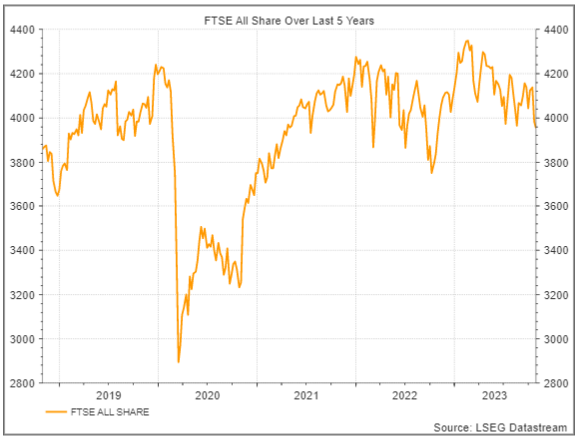
[2] Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, Tesla

[3] The Bank of England expects it to take 18 to 24 months for an increase in interest rates to have its peak effect on economic activity and inflation. Source: Bank of England. Expectations, lags and the transmission of monetary policy (Feb-23). Bank of England. Lags, trade-offs and the challenges facing monetary policy (Dec-21)

The IIMT continues to maintain a relatively cautious stance against a backdrop of sticky core inflation, high interest rates, tight financial conditions and elevated equity markets. The new *‘higher for longer’* interest rate regimes, currently in place to combat inflation, risk tipping economies into recession as consumers and corporates struggle to adapt to a prolonged period of high borrowing costs.

Asset class weightings and recommendations are based on values on 31 October 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.



2.5 Longer Term Performance

The Fund’s externally measured 1-, 3-, 5- and 10-year performance returns to 30 September 2023 are not available as the Fund’s external investment performance measurement provider, Portfolio Evaluation Limited, ceased trading in September 2023. Whilst the Fund has appointed a new external provider, Northern Trust, and the transition of historic performance data is ongoing, this has yet to be completed and the Fund does not expect to receive a Q3-23 performance report until January 2024. An internal estimate of the one-year performance to 30 September 2023, indicates that the Fund returned 4.7% versus a benchmark return of 5.6%. The table below sets out the Fund's externally measured performance over 1, 3, 5 & 10 years to 30 June 2023.

Per annum	**DPF**	**Benchmark Index**
1 year	3.1%	2.8%
3 years	4.8%	4.4%
5 years	4.0%	3.7%
10 years	6.8%	6.4%

2.6 Category Recommendations

	Benchmark	Fund Allocation	Permitted Range	Recommendation		Benchmark Relative Recommendation	
		31 Oct-23		AF	DPF	AF	DPF
Growth Assets	55.0%	55.0%	± 8%	54.0%	54.7%	(1.0%)	(0.3%)
Income Assets	25.0%	26.5%	± 6%	27.0%	26.2%	+2.0%	+1.2%
Protection Assets	18.0%	15.7%	± 5%	17.0%	16.4%	(1.0%)	(1.6%)
Cash	2.0%	2.8%	0 – 8%	2.0%	2.7%	-	+0.7%

At an overall level, the Fund was overweight Income Assets and Cash on 31 October 2023, in line Growth Assets and underweight Protection Assets. As highlighted on page 2, commitments on 31 October 2023 totalled around £270m, potentially increasing Growth Assets by 1.7% and Income Assets by 2.9%. 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 0.3% to 54.7% (0.3% underweight) (Japanese Equities –0.3%; Emerging Market Equities -0.1%; and Global Sustainable Equities +0.1%), reduce Income Assets by 0.3% to 26.2% (Indirect Property -0.3%); increase Protection Assets by 0.7% (Conventional Bonds +0.2%; Index-Linked Bonds +0.2% and Corporate Bonds +0.3%), 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 marginally overweight cash allocation, albeit lower than the recent levels of cash, reflecting both the general market uncertainty and cash held to fund existing commitment drawdowns.

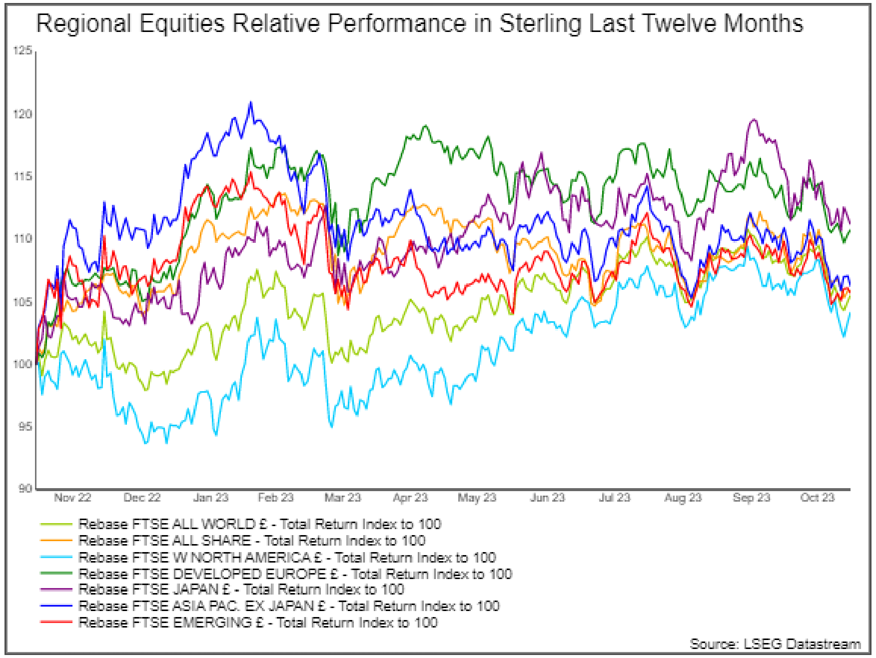
2.7 Growth Assets

On 31 October 2023, the overall Growth Asset weighting was 55.0%, down from 56.4% on 31 July 2023, reflecting net divestment of £30m and relative market weakness.

The IIMT recommendations in this report reduce the weighting to 54.7%, albeit flexibility will be required in response to changing economic and market conditions. Excluding highly illiquid Private Equity (5.3% on 31 October 2023), the recommended listed equity weight is 49.4%, 1.6% underweight.

Mr Fletcher continues to recommend an overall 1.0% underweight allocation of 54.0% to Growth Assets. Mr Fletcher notes that he remains cautious on equity markets, particularly in the US as it is the only major equity market to currently trade at a premium to its long term valuation average. This is primarily due to the YTD performance of Technology stocks, which have rallied significantly.

The IIMT recommends maintaining a relatively cautious stance to Growth Assets. Notwithstanding the recent softening in the guidance from the US Fed, the *'higher for longer'* interest rate policy remains in play and is fundamentally designed to cool economic activity to reduce inflation back towards its 2% target. Markets with attractive valuations relative to historic norms are favoured. Should corporate earnings deteriorate, the companies trading at expensive valuations would be the most vulnerable to repricing and valuation de-ratings.

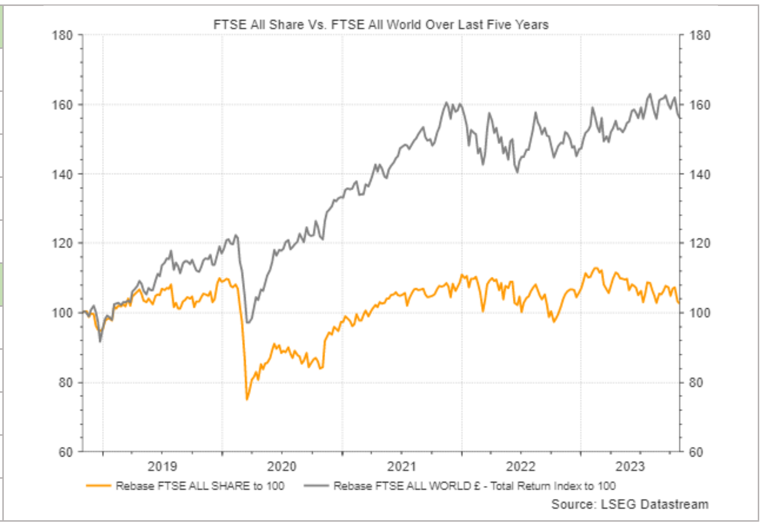


Benchmark Return	Currency	Q3-23 (*)	Q3-23	1 Year (**)	3 Year (**)	5 Year (**)	Since Last Committee (*)	L3M 31-Oct-23	YTD 31-Oct-23	1 Year 31-Oct-23
Sterling Returns										
FTSE All World	GB£	(2.4%)	0.9%	11.2%	9.5%	8.4%	(3.3%)	(3.9%)	6.2%	5.5%
FTSE UK	GB£	(4.1%)	1.9%	13.9%	11.8%	3.7%	(2.1%)	(4.8%)	0.3%	5.9%
FTSE Japan	GB£	(3.9%)	3.1%	15.0%	5.1%	3.6%	(4.8%)	(2.9%)	5.4%	11.2%
FTSE Emerging Markets	GB£	(3.2%)	2.6%	1.6%	2.0%	3.5%	(3.2%)	(5.4%)	(2.4%)	5.7%
Local Currency Returns										
FTSE All World	US$	(3.0%)	(3.2%)	21.6%	7.5%	7.0%	(6.1%)	(9.4%)	7.1%	11.2%
FTSE UK	GB£	(4.1%)	1.9%	13.9%	11.8%	3.7%	(2.1%)	(4.8%)	0.3%	5.9%
FTSE Japan	¥	(3.1%)	2.2%	29.7%	15.7%	8.0%	(5.1%)	(2.4%)	22.0%	19.4%
FTSE Emerging Markets	US$	(3.8%)	(1.5%)	11.1%	0.0%	2.2%	(5.9%)	(10.8%)	(1.6%)	11.4%

Source: Performance Evaluation Limited & DPF analysis
(*) To 31 Oct-23
(**) To 30 Sept-23

2.8 United Kingdom Equities

DPF Weightings	
Neutral	12.0%
Actual 31.10.23	12.1%
AF Recommendation	13.0%
IIMT Recommendation	12.1%
Benchmark Returns (GB£)	
Oct-23	(4.1%)
Q3 23/24	1.9%
1 Year to Jun-23	7.9%
3 Years to Jun-23 (pa)	10.0%
5 Years to Jun-23 (pa)	3.1%



The Fund's UK Equity allocation fell from 12.5% on 31 July 2023 to 12.1% on 31 October 2023 (0.1% overweight), reflecting net divestment of £10m and relative market weakness.

Mr Fletcher has maintained his UK Equities' recommended weight of 13.0%, 1.0% overweight, reflecting his assessment of the relative attractiveness of equity valuations in the UK compared to global equity valuations.

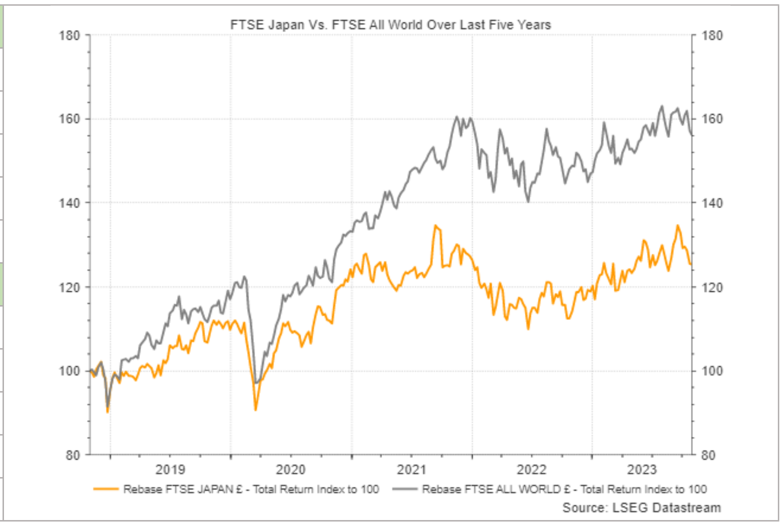
UK Equities offered strong defensive protection as interest rates rose during 2022 due to the exposure of the UK Index to sectors with a value bias and lower interest rate sensitivity such as Energy and Financials. This resulted in relative outperformance of 8.5% in sterling terms in 2022 against the more Technology focussed US S&P 500 index, which has a growth bias with much greater interest rate sensitivity. However, YTD to 31 October almost all of that relative outperformance has been reversed as Technology stocks have been by the far the strongest performing sector, led by the *'Magnificent 7'* group of stocks which have returned almost 80% in sterling against a return of 5.5% for the global index.

The IIMT recommends that the Fund's allocation to UK Equities is maintained at 12.1% (i.e. close to neutral) while Committee considers a potential reduction to the Fund's UK Equity allocation as part of the December 2023 Investment Strategy Statement review.

The relative cheapness of UK equities leaves them less exposed to material valuation downgrades should the outlook for global growth and/or corporate earnings deteriorate.

2.9 Japanese Equities

DPF Weightings	
Neutral	5.0%
Actual 31.10.23	5.3%
AF Recommendation	5.0%
IIMT Recommendation	5.0%
Benchmark Returns (GB£)	
Oct-23	(3.9%)
Q3 23/24	3.1%
1 Year to Jun-23	12.6%
3 Years to Jun-23 (pa)	4.9%
5 Years to Jun-23 (pa)	4.0%



The Fund's allocation to Japanese Equities fell from 5.5% on 31 July 2023 to 5.3% on 31 October 2023 (0.3% overweight), largely reflecting net divestment of £10m.

Mr Fletcher recommends a neutral weighting relative to the benchmark.

The IIMT agrees with the neutral recommendation for Japanese Equities, a reduction of 0.3% to 5.0% while Committee considers the requirement for a standalone Japanese Equity allocation as part of December 2023 Investment Strategy Statement review.

2.10 Emerging Market Equities

DPF Weightings	
Neutral	5.0%
Actual 31.10.23	5.1%
AF Recommendation	5.0%
IIMT Recommendation	5.0%
Benchmark Returns (GB£)	
Oct-23	(3.2%)
Q3 23/24	2.6%
1 Year to Jun-23	(3.4%)
3 Years to Jun-23 (pa)	2.4%
5 Years to Jun-23 (pa)	3.0%

Net divestment of £10m, together with relative market weakness, reduced the Fund's allocation to Emerging Market Equities from 5.5% on 31 July 2023 to 5.1% on 31 October 2023 (0.1% overweight).

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

The IIMT agrees with the neutral recommendation for Emerging Market Equities, a reduction of 0.1% to 5.0% while Committee considers the requirement for a standalone Emerging Market Equity allocation as part of December 2023 Investment Strategy Statement review.

2.11 Global Sustainable Equities

DPF Weightings	
Neutral	29.0%
Actual 31.10.23	27.2%
AF Recommendation	27.0%
IIMT Recommendation	27.3%
Benchmark Returns (GB£)	
Oct-23	(2.3%)
Q3 23/24	0.7%
1 Year to Jun-23	12.0%
3 Years to Jun-23 (pa)	10.8%
5 Years to Jun-23 (pa)	9.8%

The Fund's allocation to Global Sustainable Equities fell from 27.9% on 31 July 2023 to 27.2% on 31 October 2023 (1.8% underweight) reflecting relative market weakness.

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 and the recent increase in valuations for such companies.

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 global interest rates appear to have peaked (noting that this differs by country), it may take some time before they start to consistently fall on a global basis. Furthermore, the valuations in some areas of the Global Sustainable Equity market have become increasingly expensive.

The IIMT recommends a 27.3% (1.7% underweight) allocation to Global Sustainable Equities.

It is noted that that Committee is considering the Fund's strategic allocation to Global Sustainable Equities as part of the December 2023 Investment Strategy Statement review with a recommended increase in the Fund's benchmark weight to 36.0%.

2.12 Private Equity

DPF Weighting				
Netural	Actual 31.10.23	Committed 31.10.23	AF Recommendation	IIMT Recommendation
4.0%	5.3%	7.0%	4.0%	5.3%
Benchmark Returns (GB£)				
Oct-23	Q3 23/24	1 Year to Jun-23	3 Years to Jun-23 (pa)	5 Years to Jun-23 (pa)
(2.1%)	0.9%	13.0%	9.9%	3.5%

The Fund's Private Equity weighting increased from 5.0% on 31 July 2023 to 5.3% on 31 October 2023, reflecting relative market strength and net investment of £4m (1.3% overweight).

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

The IIMT recommends maintaining the Fund's Private Equity allocation at 5.3% (1.3% overweight).

The Fund completed two commitments totalling around £70m in the three months to 31 October 2023, increasing the committed weight to 7.0% on 31 October 2023, with £40m committed to a global fund and £30m committed to a UK focussed fund. The Fund also expects to complete a £30m to £50m allocation to a global private equity fund of fund vehicle managed by LGPS Central Limited in Q1-24.

It is noted that Committee is considering the Fund's strategic allocation to Private Equity as part of the December 2023 Investment Strategy Statement review with a recommended increase in the Fund's benchmark weight to 6.0%.

2.13 Income Assets

On 31 October 2023, the overall weighting in Income Assets was 26.5% (1.5% overweight), compared to 25.8% on 31 July 2023. The IIMT recommendations below reduce the weighting to 26.2% (to reflect planned Indirect Property redemptions); 29.0% on a committed basis.

2.14 Multi Asset Credit

DPF Weighting				
Netural	Actual 31.10.23	Committed 31.10.23	AF Recommendation	IIMT Recommendation
6.0%	7.7%	8.9%	8.0%	7.7%
Benchmark Returns (GB£)				
Oct-23	Q3 23/24	1 Year to Jun-23	3 Years to Jun-23 (pa)	5 Years to Jun-23 (pa)
(0.1%)	2.2%	8.9%	5.0%	3.7%

The Fund's allocation to Multi-Asset Credit increased from 7.4% on 31 July 2023 to 7.7% on 31 October 2023 (1.7% overweight), principally reflecting relative market strength.

Mr Fletcher has maintained his 2.0% overweight allocation of 8.0% to Multi-Asset Credit, noting that global credit spreads have continued to trend sideways over the last quarter, but the overall yield remains attractive. When combined with the low duration and floating rate nature of many of the asset classes it suggests to Mr Fletcher that Multi-Asset Credit remains appealing, relative to longer duration, more interest rate sensitive assets.

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 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. The IIMT recommends that the current allocation of 7.7% is maintained (1.7% overweight) to reflect scheduled private debt draw-down commitments; 8.9% on a committed basis.

It is noted that Committee is considering the Fund's strategic allocation to Mult-Asset Credit as part of the December 2023 Investment Strategy Statement review with a recommended increase in the Fund's benchmark weight to 7.0%.

2.15 Property

DPF Weighting				
Netural	Actual 31.10.23	Committed 31.10.23	AF Recommendation	IIMT Recommendation
9.0%	7.7%	7.7%	9.0%	7.4%
Benchmark Returns (GB£)				
Oct-23	Q3 23/24	1 Year to Jun-23	3 Years to Jun-23 (pa)	5 Years to Jun-23 (pa)
Not available	(0.7%)	(15.0%)	2.5%	1.6%

The Fund’s allocation to Property marginally increased from 7.7% at 31 July 2023 to 7.8% on 31 October 2023. Direct Property accounted for 5.6% (0.4% underweight) and Indirect Property accounted for 2.2% (0.8% underweight).

Mr Fletcher maintains his recommendation for a neutral overall property allocation of 9.0%. He also continues to note 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 to increase its exposure to indirect property funds at a discount to NAV and thereby increase the overall property exposure to neutral.

The Fund’s Discretionary Direct Property Manager notes that UK economic indicators remain weak, with a shallow recession remaining a threat, and notes the expectation that interest rates will remain higher for longer.

The weak economic backdrop continues to negatively impact on the UK commercial property market, more so on investor sentiment than occupational demand, where rental value growth remains positive (albeit largely from continuing strong industrial sector rental growth). Investment transaction levels are significantly below long-term averages.

The total return for all UK commercial property for the Q3-23, as measured by the MSCI Quarterly Index, was -0.7%, comprising an income return of +1.1% and a capital value fall of -1.8%. The total return for the 12-month period to 30 September 2023 was - 12.0%, comprising an income return of +4.5% and a capital value fall of -15.8%. In comparison, the total return for the Fund’s property portfolio was -0.5% for the quarter and -10.5% for the 12 months to 30 September 2023. The current void rate within the portfolio is 5.1%, lower than the MSCI benchmark void rate of 8.3%. The portfolio is currently yielding 4.9%, in line with the MSCI benchmark yield.

The Fund’s property manager continues to focus on assets that provide strong core fundamentals in terms of location, quality of tenant, lease length and ESG (environmental, social and governance) credentials.

Following poor returns over the past 12 months, the manager believes that UK commercial property is nearing the end of the period of re-pricing and is, in certain sectors, well positioned for the next growth cycle. At present, the sectors that look most attractive in relative terms are the retail warehousing and industrial sectors where occupational vacancy rates remain low and, consequently, future rental value growth is most likely. However, care is still required in the retail and office sectors, where structural trends continue to have a negative impact on these markets.

The IIMT recommends that the Fund’s allocation to Direct Property is maintained at 5.5%, 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 0.3% to 1.9% (1.1% underweight) to reflect scheduled redemptions, albeit redemption timing is uncertain.

It is noted that Committee is considering the Fund’s strategic allocation to Property (Direct and Indirect combined) as part of the December 2023 Investment Strategy Statement review with a recommended increase in the Fund’s benchmark weight to 10.0%.

2.16 Infrastructure

DPF Weighting				
Netural	Actual 31.10.23	Committed 31.10.23	AF Recommendation	IIMT Recommendation
10.0%	11.0%	12.7%	10.0%	11.0%
Benchmark Returns (GB£)				
Oct-23	Q3 23/24	1 Year to Jun-23	3 Years to Jun-23 (pa)	5 Years to Jun-23 (pa)
0.6%	1.8%	5.2%	3.2%	3.0%

The Fund’s allocation to Infrastructure increased from 10.7% on 31 July 2023 to 11.0% on 31 October 2023 (1.0% overweight), principally reflecting net investment of £9m, all of which related to renewable energy assets.

Mr Fletcher recommends a neutral weighting relative to the benchmark.

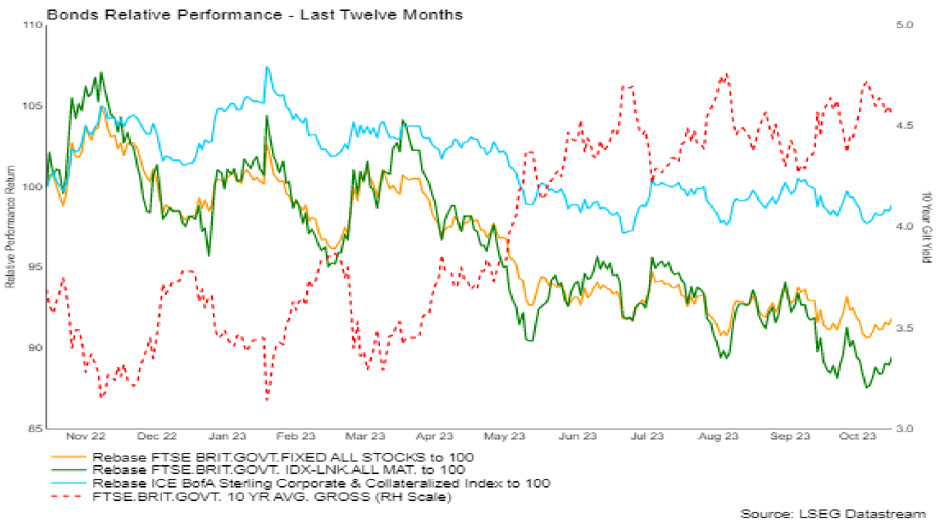
The IIMT continues to view Infrastructure as an attractive long-term asset class and favours a bias towards core infrastructure assets or renewable energy assets. These assets can offer low volatility; low correlation to equity and fixed income markets; and reliable long-term cash flows.

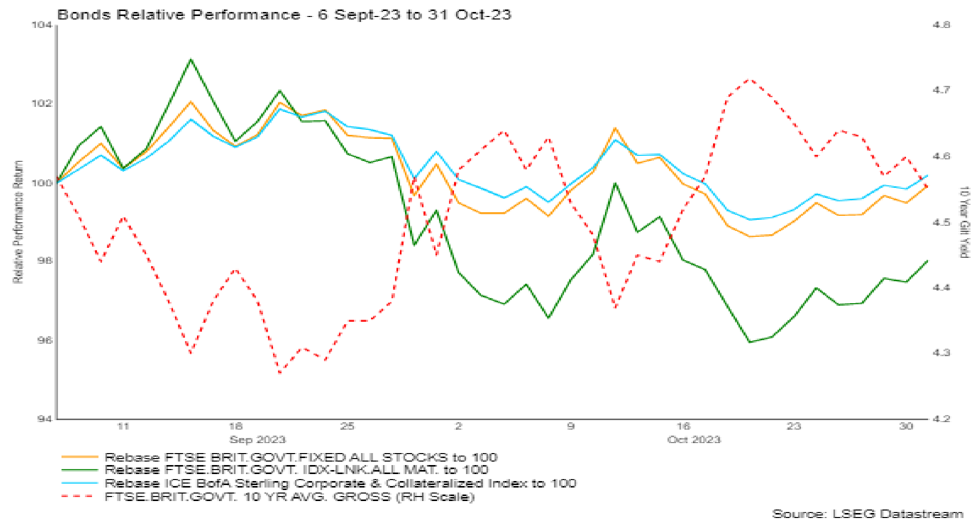
Notwithstanding the noted favourable long-term characteristics of the asset class, infrastructure assets are exposed to increased political and regulatory risk, and this risk is best mitigated through asset type and geographical diversification.

The IIMT recommends maintaining the invested weighting at 11.0% (1.0% overweight); 12.7% on a committed basis. Given the current committed weight of 12.7%, the IIMT is not reviewing new opportunities at the current time, albeit this is monitored on an on-going basis.

It is noted that Committee is considering the Fund’s strategic allocation to Infrastructure as part of the December 2023 Investment Strategy Statement review with a recommended increase in the Fund’s benchmark weight to 13%.

2.17 Protection Assets





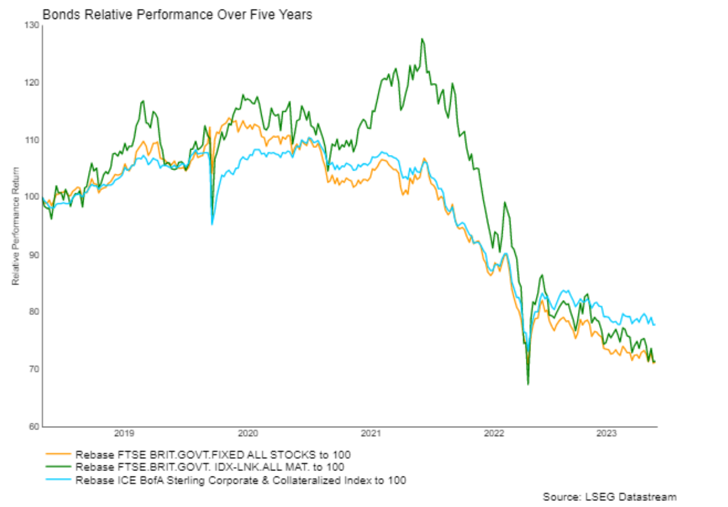
The weighting in Protection Assets on 31 October 2023 was 15.7%, up from 14.6% on 31 July 2023, principally reflecting net investment of £54m. The IIMT recommendations below increase the weighting by 0.7% to 16.4%.

Fixed income returns have been negative over the twelve months to 31 October 2023, with UK Conventional Gilts returning -5.8% and UK Index-Linked Bonds returning -9.9%. This followed significant drawdowns in 2022. On a two-year basis, UK Conventional Bonds have returned -14.6% p.a., with UK Index-Linked Bonds returning -21.9%p.a. Bond yields rose as the market priced interest rates peaking at higher levels and remaining in restrictive territory for a longer period in response to persistent inflation.

Global bond yields have fallen following the softer rhetoric from the US Fed post the late October/ early November FOMC meeting and in reaction to subsequent weaker economic data.

2.18 Conventional Bonds

DPF Weightings	
Neutral	6.0%
Actual 31.10.23	5.0%
AF Recommendation	5.0%
IIMT Recommendation	5.2%
Benchmark Returns (GB£)	
Oct-23	(0.4%)
Q3 23/24	(0.6%)
1 Year to Jun-23	(14.5%)
3 Years to Jun-23 (pa)	(11.5%)
5 Years to Jun-23 (pa)	(4.2%)



The Fund's allocation to Conventional Bonds increased from 4.5% on 31 July 2023 to 5.0% on 31 October 2023 (1.0% underweight), largely reflecting net investment of £28m, partly offset by relative market weakness. The Fund's allocation on 31 October 2023 comprised 93% UK Conventional Gilts and 7% US Treasuries.

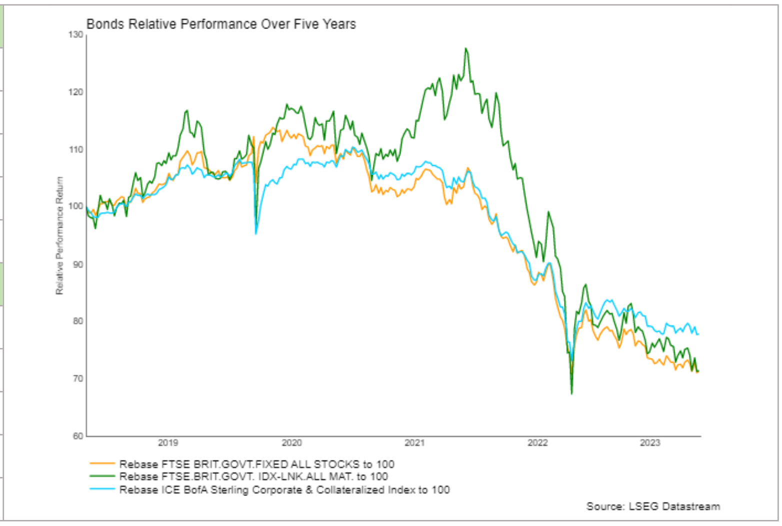
Mr Fletcher notes that, based on market pricing, there is a reasonable chance of the Bank of England implementing one more interest rate increase during the current hiking cycle. He expects Central Banks to maintain rates at their current high levels for some time, before possibly beginning a slow decline in 2025.

Mr Fletcher is also concerned that although long-dated Gilt yields have trended higher during the quarter, this upward trend may have further to run and even relatively small increases in yield can result in meaningful capital losses in the short term. Mr Fletcher has, therefore, maintained his 1.0% underweight allocation to Conventional Bonds.

The IIMT believes that conventional sovereign bonds offer better long-term value now than they have for many years 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. The IIMT recommends increasing the weighting by 0.2% to 5.2% (0.8% underweight), noting that the duration (interest rate sensitivity) of the Fund's Conventional Bonds portfolio has been increased to a neutral position.

2.19 Index-Linked Bonds

DPF Weightings	
Neutral	6.0%
Actual 31.10.23	5.0%
AF Recommendation	6.0%
IIMT Recommendation	5.2%
Benchmark Returns (GB£)	
Oct-23	(1.3%)
Q3 23/24	(4.7%)
1 Year to Jun-23	(17.0%)
3 Years to Jun-23 (pa)	(12.6%)
5 Years to Jun-23 (pa)	(4.3%)



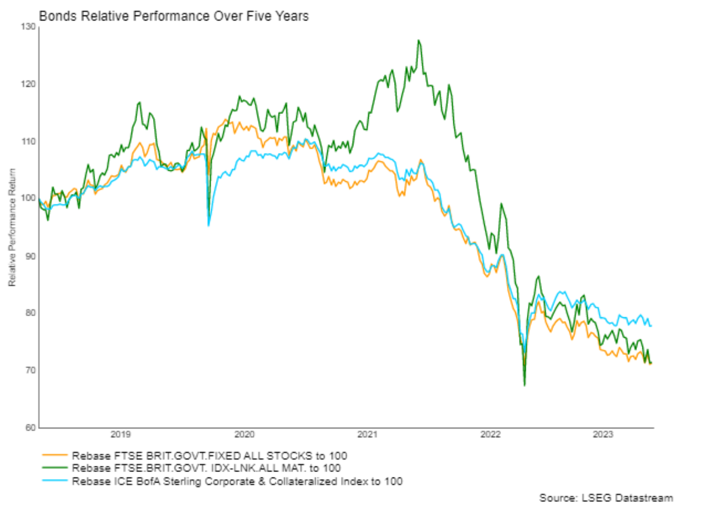
The Fund's allocation to Index-Linked Bonds increased from 4.5% on 31 July 2023 to 5.0% on 31 October 2023 (1.0% underweight), reflecting net investment of £26m, partly offset by relative market weakness. The Fund's allocation on 31 October 2023 comprised 78% UK Index-Linked Bonds (UK Linkers) and 22% US Treasury Inflation Protected Bonds (US TIPS).

Mr Fletcher has maintained his 6.0% (neutral) allocation to Index-Linked Bonds. Mr Fletcher continues to believe that Index-Linked Bonds are expensive in the short term and he is more pessimistic about the longer-term fall in demand and potential increased supply of Index-Linked Bonds, albeit Mr Fletcher notes that Index-Linked Bonds are much cheaper than they were at the beginning of last year, with the 20-year real yield increasing from around -2% 18 months ago to +1.3% currently.

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 5.2%; 0.8% underweight, noting that the duration of the Fund's Index Linked portfolio has been increased to a neutral position.

2.20 Corporate Bonds

DPF Weightings	
Neutral	6.0%
Actual 31.10.23	5.7%
AF Recommendation	6.0%
IIMT Recommendation	6.0%
Benchmark Returns (GB£)	
Oct-23	(0.7%)
Q3 23/24	0.2%
1 Year to Jun-23	(3.3%)
3 Years to Jun-23 (pa) (1)	(5.0%)
5 Years to Jun-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 increased from 5.6% on 31 July 2023 to 5.7% on 31 October 2023 (0.3% underweight), reflecting relative market strength.

Mr Fletcher has maintained his neutral allocation to Corporate Bonds at 6.0%, noting that the extra yield spread available from corporate bonds has recently narrowed slightly but it remains wider than it has been for some years and the total yield remains attractive.

The IIMT believes that the spread on investment grade bonds offers relatively good value and that this asset class is likely to be more defensively positioned relative to risk-on assets (e.g. equities), should markets experience periods of weakness. The IIMT recommends increasing the Corporate Bonds allocation by 0.3% to 6.0% (neutral).

2.21 Cash

The Cash weighting on 31 October 2023 was 2.8% (0.8% overweight), down from 3.2% on 31 July 2023, principally reflecting net investment across the total portfolio of around £35m over the period.

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

The IIMT notes that global markets remain volatile and whilst investors have recently become slightly more positive about the future path of interest rates leading to an improvement in confidence, a number of headwinds remain which could see this reverse, including a slowdown in global activity, continuing core inflationary pressures, persistent high interest rates (relative to recent years), more complex global supply chains and continuing energy security concerns and geopolitical tensions and conflicts.

The IIMT recommends a relatively defensive cash allocation of 2.7% (0.7% 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 31 October 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.

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