FOR PUBLICATION

DERBYSHIRE COUNTY COUNCIL

PENSIONS AND INVESTMENTS COMMITTEE

WEDNESDAY, 6 MARCH 2024

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 January 2024 and the recommendations of the Director of Finance & ICT and Mr Fletcher, in relation to the Fund's proposed new strategic asset allocation intermediate benchmark, are set out on page 2.

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 £271m. 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
	Current	Inter (1)	Final (1)	31/10/23	31/1/24	Inter (1)	AF 6/03/24	DPF 6/3/24	AF 6/3/24	DPF 6/3/24	DPF 6/3/24	3 Months to 31/12/23	3 Months to 31/1/24
Growth Assets	**55.0%**	**52.5%**	**50.0%**	**55.0%**	**55.9%**	**+/- 8%**	**(1.0%)**	**(0.7%)**	**51.5%**	**51.8%**	**53.1%**	**n/a**	**n/a**
UK Equities	12.0%	10.0%	8.0%	12.1%	12.1%	+/- 5%	+1.0%	+1.0%	11.0%	11.0%	11.0%	3.2%	6.2%
Overseas Equities:	39.0%	36.5%	36.0%	37.6%	38.6%	+/- 8%	(2.0%)	(1.0%)	34.5%	35.5%	35.5%	n/a	n/a
Japan	5.0%	2.5%	-	5.3%	5.5%	+/- 2.5%	-	+0.5%	2.5%	3.0%	3.0%	3.3%	12.1%
Emerging Markets	5.0%	2.5%	-	5.1%	4.8%	+/- 2.5%	-	+0.5%	2.5%	3.0%	3.0%	2.0%	1.9%
Global Sustainable	29.0%	31.5%	36.0%	27.2%	28.3%	+/- 8%	(2.0%)	(2.0%)	29.5%	29.5%	29.5%	6.4%	10.2%
Private Equity	4.0%	6.0%	6.0%	5.3%	5.2%	+/- 2%	-	(0.7%)	6.0%	5.3%	6.6%	6.7%	10.3%
Income Assets	**25.0%**	**27.5%**	**30.0%**	**26.5%**	**25.3%**	**+/- 6%**	**+1.0%**	**(0.6%)**	**28.5%**	**26.9%**	**29.7%**	**n/a**	**n/a**
Multi-Asset Credit	6.0%	6.5%	7.0%	7.7%	7.5%	+/- 2%	+1.0%	1.5%	7.5%	8.0%	9.5%	3.6%	3.6% (3)
Infrastructure	10.0%	11.5%	13.0%	11.0%	10.6%	+/- 3%	-	(0.3%)	11.5%	11.2%	12.5%	1.8%	1.8%
Property	9.0%	9.5%	10.0%	7.8%	7.2%	+/- 3%	-	(1.8%)	9.5%	7.7%	7.7%	(1.1%)	(1.1%) (3)
Protection Assets	**18.0%**	**18.0%**	**18.0%**	**15.7%**	**15.6%**	**+/- 5%**	**-**	**-**	**18.0%**	**18.0%**	**18.0%**	**n/a**	**n/a**
Conventional Bonds	6.0%	6.0%	6.0%	5.0%	4.9%	+/- 2%	-	-	6.0%	6.0%	6.0%	8.1%	6.1%
Index-Linked Bonds	6.0%	6.0%	6.0%	5.0%	4.9%	+/- 2%	-	-	6.0%	6.0%	6.0%	8.7%	5.2%
Corporate Bonds	6.0%	6.0%	6.0%	5.7%	5.8%	+/- 2%	-	-	6.0%	6.0%	6.0%	7.8%	8.0%
Cash	**2.0%**	**2.0%**	**2.0%**	**2.8%**	**3.2%**	**0 – 8%**	**-**	**+1.3%**	**2.0%**	**3.3%**	**(0.8%)**	**1.3%**	**1.3%**

Investment Assets totaled £6,219.7m on 31 January 2024.
(1) Intermediate benchmark effective 1 April 2024; Final benchmark effective by 1 April 2025 at the latest. Recommendations are relative to the Intermediate benchmark.
(2) Recommendations adjusted for investment commitments on 31 January 2024 and assumes all commitments are funded from Cash.
(3) Benchmark Return for the three months to 31 December 2023.

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.

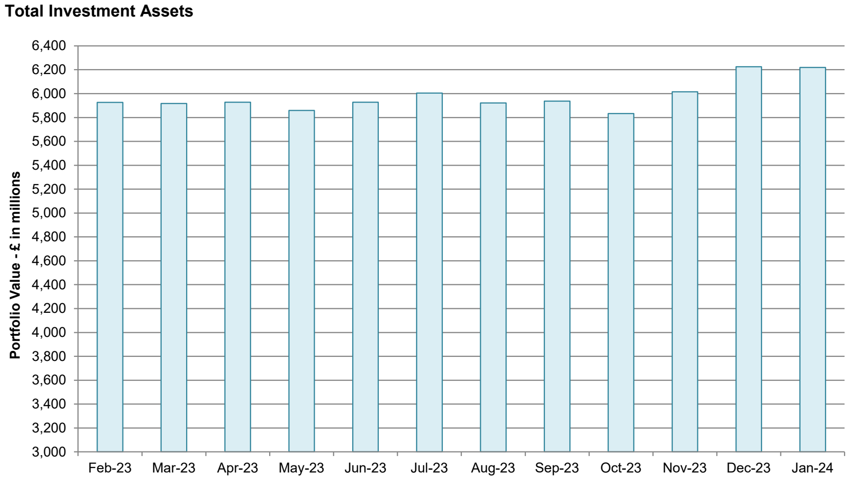
The table also shows the current benchmark, together with the Intermediate and Final Benchmarks which are expected to be approved by Committee on 6 March 2024. The Intermediate Benchmark, if approved, will become effective from 1 April 2024, and the Final Benchmark, if approved, will become effective by 1 April 2025 at the latest.

The Intermediate Benchmark, if approved, reduces Growth Assets by 2.5% (UK Equities -2.0%; Japanese Equities -2.5%; Emerging Market Equities - 2.5%; Global Sustainable Equities +2.5%; and Private Equity +2.0%) and increases Income Assets by 2.5% (Multi-Asset Credit +0.5%; Infrastructure +1.5%; and Property +0.5%). The Fund's allocation to Protection Assets and Cash remain unchanged.

Relative to the current benchmark, the Fund on 31 January 2024, was overweight Growth Assets (0.9%), overweight Income Assets (0.3%) and Cash (1.2%) 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 -0.8%. 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

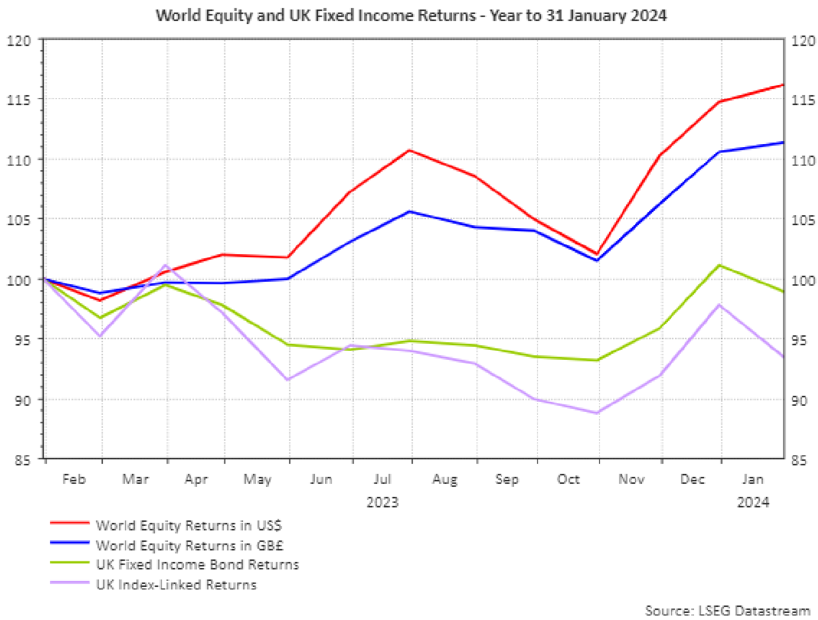
The value of the Fund's investment assets increased by £386m (+6.6%) between 31 October 2023 and 31 January 2024 to £6,220m, comprising a non-cash market gain of around £371m and a cash inflow from dealing with members and investment returns of around £15m. Over the twelve months to 31 January 2024, the value of the Fund's investment assets increased by £241m (+4.0%), comprising a non-cash market gain of around £181m and a cash inflow 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 31 January 2024 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 January 2024.



Global Equities (as measured by the FTSE All World) delivered a positive return of 11.3% in sterling terms over the 12-month period. In US-dollar terms, the return was higher at 15.2%, reflecting the fact that sterling appreciated relative to the US dollar (1.238 to 1.269). However, bond markets delivered negative returns as base interest rates increased over the 12-month period, consistent with Central Banks' attempts to curb higher inflation. Bond values move inversely to interest rates, so capital values declined as UK interest rates increased from 3.50% to 5.25% over the period. As a result, UK conventional Gilts decreased in value by -1.1%, whereas the more interest rate sensitive UK Index-Linked bonds fell by -6.6%.

Over the 12-month period to 31 January 2024, inflation has gradually declined across developed markets. In the US, the Consumer Price Index (CPI) fell from 6.4% to 3.1%; in the United Kingdom, CPI declined from 10.1% to 4.0%, having peaked at 11.1% in October 2022. However, despite the overall declines, inflation still averaged 7.1% in the UK and 4.1% in the US over the 12-month period, considerably above the respective Central Bank targets of 2.0%, which explains why the US Federal Reserve (US Fed) and the Bank of England (BoE) continued to raise interest rates during 2023 despite inflation falling.

The declines in inflation have led to growing market expectations for sizeable rate cuts in 2024, particularly in the US where the number of rate cuts being priced in by markets increased considerably in Q4-23. In September 2023, markets were initially pricing in up to 25 basis points of cuts to occur over the next 12 months (per interest rate swap market pricing), but by the end of December 2023 this had increased significantly to 175 basis points of rate cuts.

However, market expectations for rate cuts were tempered in January 2024 when Jerome Powell, US Fed Chair, moved to cool speculation that the US Fed would begin lowering interest rates as soon as March 2024, insisting that the US Fed required more evidence of sustainable falls in inflation before considering cuts to interest rates. Following his comments, markets lowered their expectations for rate cuts in 2024 to 75 basis points, consistent with the US Fed's median dot-plot projections from the December 2023 Federal Open Market Committee meeting.

Although US inflation has declined significantly from its 2022 peak of 9.1%, it has stubbornly hovered at around 3.0% since June 2023. The US economy has also been remarkably robust, performing well ahead of expectations with strong GDP growth and a persistently tight employment market. As a result, the US economy now looks increasingly on track to achieve a *'soft landing'* in 2024, potentially avoiding earlier forecasts of a mild recession or stagnant economic growth due to restrictive financial conditions caused by higher interest rates.

The US Fed has voiced concerns that over 500 basis points of tightening appears to have had limited impact on curtailing economic growth or in cooling an extremely hot labour market. Jerome Powell, therefore, appears to face a difficult balancing act in returning inflation to the 2.0% target.

Lower interest rates would likely fuel even stronger economic activity, increasing the risk that looser financial conditions may reignite inflation through higher demand. However, maintaining rates at their current restrictive levels for a prolonged period increases the likelihood of a *'hard landing'*, as eventually the economy would be expected to react to the pressure of persistently high interest rates (through a combination of reduced consumer spending, lower business investment and increased corporate bankruptcies). For the time being, Jerome Powell seems to be erring on the side of caution, delaying any discussion of rate cuts until later in the year.

In the UK, the impact of higher interest rates is already having a more direct impact on economic activity. Quarterly GDP growth averaged 0.0% across 2023, and the economy fell into a technical recession in Q4-23 with a contraction of -0.3%, following a -0.1% decline in Q3-23. However, the BoE expects the recession to be mild and short in duration, with growth picking up in 2024.

Markets are now pricing in that the BoE will cut rates by 75 basis points in 2024, which appears broadly in-line with the BoE's February 2024 projections for 200 basis points of cuts over the two-year forecast period. However, the timing of such cuts is uncertain, as Andrew Bailley, the Governor of the BoE, commented that he needed 'more evidence that inflation is set to fall all the way to the two per cent target, and stay there, before we can lower interest rates'. The BoE expects inflation to reach 2.8% by the end of 2024 and remain slightly above target throughout 2025.

In Equity markets, Global Equities were boosted by the strong performance of North American stocks, which returned +26.3% in US dollar-terms (as measured by the S&P 500 Index) in 2023. However, the returns were primarily driven by a small group of technology focussed stocks (the *'Magnificent Seven')* which returned 107.4% in 2023 and now account for over 30% of the US index.

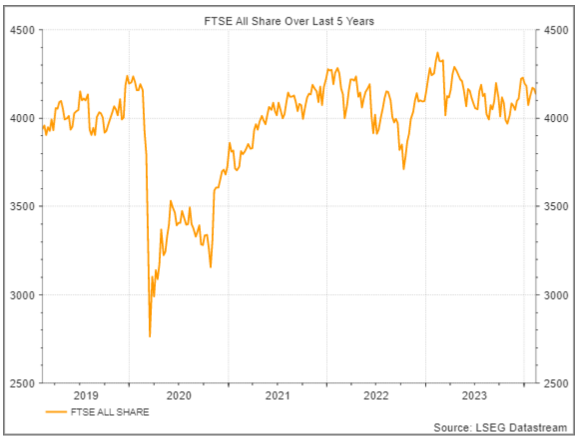
As a result, Global Equities are now trading at relatively expensive levels, with the FTSE All World trading almost 15% above its long term forward price to earnings ratio. Global Equity valuations are being dragged higher by North

American stocks (primarily due to the outperformance of the 'Magnificent Seven'), which are trading at almost 30% above their long-term average forward price to earnings ratio.

Subsequent to the end of January 2024, global equity markets have continued to rise (the FTSE All World returned +5.0% between 1 February 2024 and 22 February 2024) despite a higher-than-expected US CPI reading for January 2024, which reduced market expectations about rate cuts in 2024.

The IIMT recommends maintaining a relatively cautious stance to Growth Assets, particularly given the strong rally over the last few months, which has stretched valuations, especially in respect of the market dominating 'Magnificent Seven'. There is also still uncertainty about the path for future interest rates and whether inflation can be reduced without causing a global recession. The IIMT recommends a small underweight allocation to Growth Assets, with a tilt to the more diversified and defensive UK and Japanese equity markets.

Asset class weightings and recommendations are based on values on 31 January 2024. 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

Figures provided by Northern Trust show the Fund’s performance over 1, 3, 5 and 10 years to 31 December 2023.

Per annum	DPF	Benchmark Index
1 year	7.5%	8.9%
3 years	3.5%	3.6%
5 years	6.0%	5.8%
10 years	6.7%	6.3%

The Fund outperformed the benchmark on a five- and ten-year basis but underperformed on a one-and three-year basis. The Fund’s one year performance was 138 basis points lower than the benchmark, creating a drag to the Fund’s three-year performance numbers, and to a lesser extent the Fund’s five-year performance numbers. Notwithstanding the relative under-performance, it should be noted that the Fund still returned +7.5% on a one-year basis to 31 December 2023.

The one-year relative under-performance largely related to the Fund’s global sustainable equity allocation (c.90 basis points impact), private equity allocation (c.30 basis points impact) and listed infrastructure allocation (c.20 basis points impact).

As noted earlier, global equity market performance in 2023 was concentrated in a narrow range of large mega-cap US companies (often referred to as the ‘Magnificent Seven’), reflecting market enthusiasm for Artificial Intelligence and other sources of technological growth, as well as caution that other market segments may suffer from weaker economic conditions. The Fund’s active global sustainable equity managers were under-weight the ‘Magnificent Seven’ over 2023. Whilst this does not account for all the under-performance of the Fund's active global sustainable equity managers, the underweight to the 'Magnificent Seven', created a sizeable performance drag.

After several years of strong performance, in which private equity outperformed public market equivalents, private equity under-performed public markets in 2023. This reflected valuation downgrades driven by higher interest rates and increased market uncertainty. Notwithstanding the valuation downgrades, which were not unique to the Fund's private equity portfolio, the Fund's private equity portfolio still returned +10.5% in 2023. Whilst this was 520 basis points lower than the FTSE All World, as noted above, the FTSE All World was significantly boosted by the performance of the Magnificent Seven in 2023. To put the one-year performance into context, on a five-year basis to 31 December 2023, the Fund's private equity portfolio has returned +16.7% per annum, 450 basis points per annum higher than the FTSE All World.

The Fund's UK listed infrastructure portfolio significantly under-preformed the Fund's absolute SONIA + 2% benchmark in 2023 (-3.5% versus a benchmark of +6.8%). Despite increased earnings and solid fundamentals, a sharp rise in bond yields put downward pressure on UK listed infrastructure valuations, with many share prices moving from a premium (share price above underlying net assets per share) to sizeable discounts (share price below underlying net assets per share). The IIMT expects UK listed infrastructure valuations to recover once the market starts to anticipate that UK interest rates will start to fall, albeit performance could remain challenging in the short-term should the UK's current level of inflation and higher interest rates remain persistent.

2.6 Category Recommendations

	Current Benchmark	Intermediate Benchmark	Benchmark Change	Fund Allocation	Permitted Range	Recommendation		Benchmark Relative Recommendation	
				31 Jan-24		AF	DPF	AF	DPF
Growth Assets	55.0%	52.5%	(2.5%)	55.9%	± 8%	51.5%	51.8%	(1.0%)	(0.7%)
Income Assets	25.0%	27.5%	+2.5%	25.3%	± 6%	28.5%	26.9%	+1.0%	(0.6%)
Protection Assets	18.0%	18.0%	-	15.6%	± 5%	18.0%	18.0%	-	-
Cash	2.0%	2.0%	-	3.2%	0 – 8%	2.0%	3.3%	-	+1.3%

At an overall level, the Fund was overweight Growth Assets, Income Assets and Cash on 31 January 2024, and underweight Protection Assets. As highlighted on page 2, commitments on 31 January 2024 totalled around £271m, potentially increasing Growth Assets by 1.4% and Income Assets by 3.0%. The table on page 2 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 4.1% to 51.8% (0.7% underweight) (UK Equities -1.1%, Japanese Equities -2.5%; Emerging Market Equities -1.8%; Global Sustainable Equities +1.2%; and Private Equity +0.1%), increase Income Assets by 1.6% to 26.9% (Infrastructure +0.6%; Multi-Asset Credit +0.5%; and Property +0.5%); increase Protection Assets by 2.4% (Conventional Bonds +1.1%; Index-Linked Bonds +1.1% and Corporate Bonds +0.2%), and increase Cash by +0.1%.

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. It should also be noted that the current UK Bank Rate offers an attractive ‘risk-free’ return of 5.25%.

8.18 **Growth Assets**

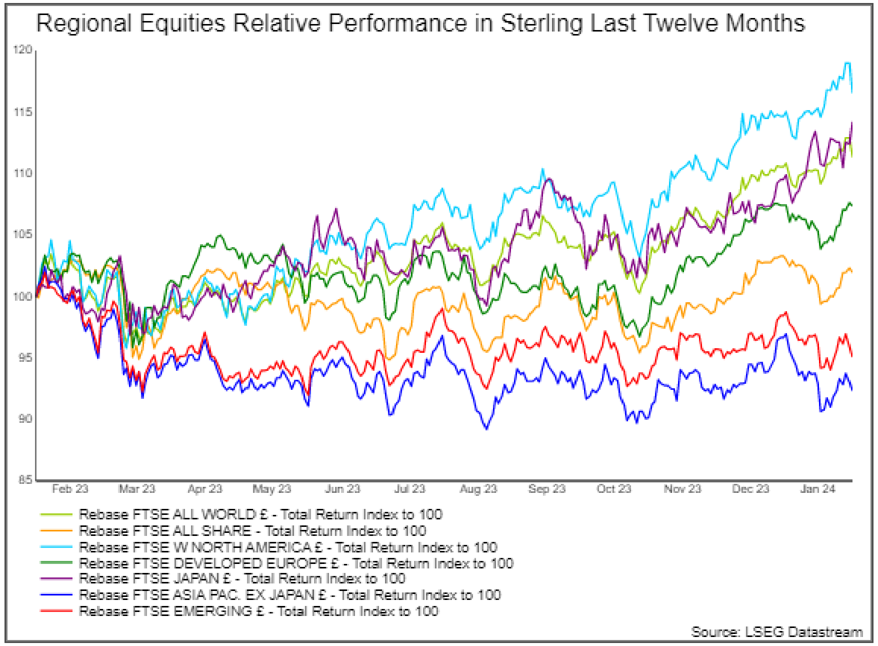
On 31 January 2024, the overall Growth Asset weighting was 55.9%, up from 55.0% on 31 October 2023, reflecting relative market strength.

The IIMT recommendations in this report reduce the weighting to 51.8%, largely reflecting the Fund's new intermediate strategic asset allocation benchmark, which subject to approval, will reduce the Fund's neutral allocation to Growth Assets from 55.0% to 52.5% on 1 April 2024. Flexibility will be required in response to changing economic and market conditions.

Global equities rallied strongly in the three months to 31 January 2024 (FTSE All World +9.7% in GBP, rising to 15.2% in US% terms), boosted by expectations that major central banks could soon cut interest rates. The S&P 500 Index was propelled to record highs as optimism around a 'soft landing' scenario continued the rally in the 'Magnificent Seven' stocks, and several data releases pointed to the ongoing resilience of the US economy.

Mr Fletcher continues to recommend an overall 1.0% underweight allocation of 51.5% to Growth Assets. Mr Fletcher notes that he remains cautious on equity markets, particularly global sustainable equities because of the strategy's higher interest rate sensitivity.

The IIMT also recommends maintaining a relatively cautious stance to Growth Assets, locking in some of the outperformance from the strong rally over the last few months, which has stretched valuations, especially in respect of the market dominating 'Magnificent Seven'. The IIMT recommends an overall



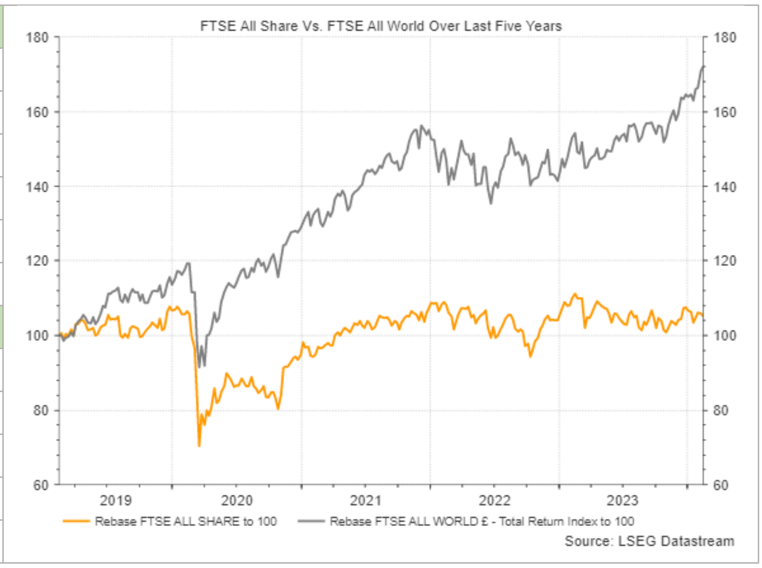
Benchmark Return	Currency	Q4-23 (*)	1 Year (*)	3 Year (*)	5 Year (*)	Since Last Committee (**)	L3M 31-Jan-24	YTD 31-Jan-24	1 Year 31-Jan-24
Sterling Returns									
FTSE All World	GB£	6.3%	15.7%	8.8%	12.2%	4.5%	9.7%	0.7%	11.3%
FTSE UK	GB£	3.2%	7.9%	8.6%	6.6%	2.1%	6.2%	(1.3%)	1.9%
FTSE Japan	GB£	3.3%	13.3%	3.4%	7.1%	6.5%	12.1%	4.3%	14.2%
FTSE Emerging Markets	GB£	2.1%	2.9%	(0.9%)	4.8%	(0.4%)	1.9%	(3.4%)	(4.9%)
Local Currency Returns									
FTSE All World	US$	11.1%	22.6%	6.3%	12.2%	5.6%	15.2%	0.6%	15.2%
FTSE UK	GB£	3.2%	7.9%	8.6%	6.6%	2.1%	6.2%	(1.3%)	1.9%
FTSE Japan	¥	1.9%	28.3%	12.1%	12.6%	7.0%	13.5%	8.0%	32.8%
FTSE Emerging Markets	US$	6.6%	9.1%	(3.2%)	4.8%	0.7%	6.9%	(3.5%)	(1.7%)

Source: DPF analysis
(*) To 31 Dec-23
(*) To 31 Jan-24

underweight allocation of 0.7% to Growth Assets, with a tilt to the more diversified and defensive UK and Japanese equity markets.

8.18 United Kingdom Equities

DPF Weightings	
Current Neutral	12.0%
New Intermediate Neutral	10.0%
Actual 31.1.24	12.1%
AF Recommendation	11.0%
IIMT Recommendation	11.0%
Benchmark Returns (GB£)	
Jan-24	(1.3%)
Q4 23/24	3.2%
1 Year to Dec-23	7.9%
3 Years to Dec-23 (pa)	8.6%
5 Years to Dec-23 (pa)	6.6%



The Fund's UK Equity allocation remained flat at 12.1% between 31 October 2023 to 31 January 2024 (0.1% overweight).

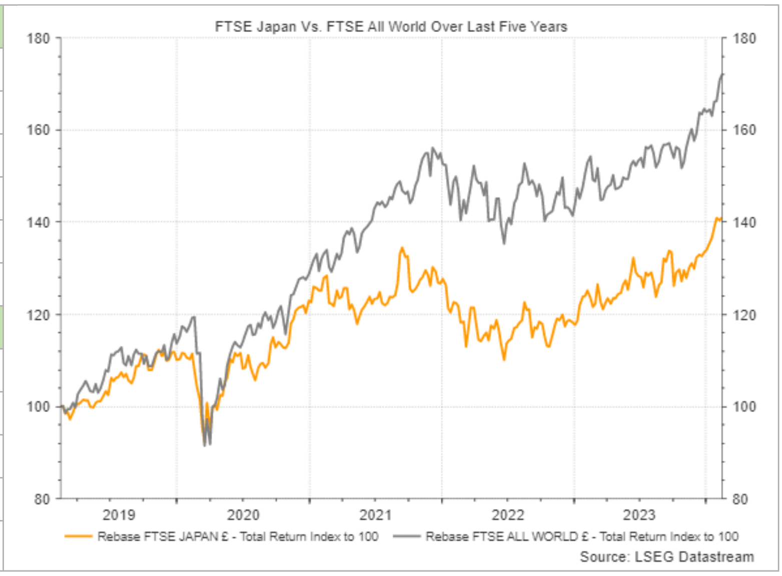
Mr Fletcher recommends a 1.0% overweight allocation to UK Equities, reflecting his assessment of the relative attractiveness of equity valuations in the UK compared to global equity valuations.

UK Equities have significantly under-performed the FTSE All World over the twelve months to 31 January 2024 (1.9% vs. 11.3%) and the forward price earnings multiple on 31 December 2023 was 10.9x, below the long-term average since 1990 of 13.9x.

The IIMT also recommends a 1.0% overweight allocation to UK Equities because current UK equity valuations leave them less exposed to material valuation downgrades should the outlook for global growth and/or corporate earnings deteriorate.

2.9 Japanese Equities

DPF Weightings	
Current Neutral	5.0%
New Intermediate Neutral	2.5%
Actual 31.1.24	5.5%
AF Recommendation	2.5%
IIMT Recommendation	3.0%
Benchmark Returns (GB£)	
Jan-24	4.3%
Q4 23/24	3.3%
1 Year to Dec-23	13.3%
3 Years to Dec-23 (pa)	3.4%
5 Years to Dec-23 (pa)	7.1%



The Fund's allocation to Japanese Equities increased from 5.3% on 31 October 2023 to 5.5% on 31 January 2024 (0.5% overweight), reflecting relative market strength.

Mr Fletcher recommends a neutral weighting relative to the benchmark.

The IIMT recommends a 0.5% overweight allocation of 3.0% to Japanese Equities, noting the asset class's diversification and defensive qualities.

2.10 Emerging Market Equities

DPF Weightings	
Current Neutral	5.0%
New Intermediate Benchmark	2.5%
Actual 31.1.24	4.8%
AF Recommendation	2.5%
IIMT Recommendation	3.0%
Benchmark Returns (GB£)	
Jan-24	(3.4%)
Q4 23/24	2.0%
1 Year to Dec-23	2.9%
3 Years to Dec-23 (pa)	(0.9%)
5 Years to Dec-23 (pa)	4.8%

Relative market weakness reduced the Fund's allocation to Emerging Market Equities from 5.1% on 31 October 2023 to 4.8% on 31 January 2024.

Mr Fletcher recommends a neutral allocation of 2.5% to Emerging Market Equities.

Emerging Market Equities have significantly under-performed the FTSE All World over the twelve months to 31 January 2024 (-4.9% vs.11.3%) and the forward price earnings multiple on 31 December 2023 of 12.5x was below the long-term average since 1990 of 14.5x.

The IIMT recommends a 0.5% overweight allocation of 3.0% to Emerging Market Equities, noting that the asset class's recent poor relative performance makes current valuations attractive relative to other regions. Emerging Market Equities should benefit once US interest rates start to fall (i.e. leading to a weaker US dollar) and on any increased likelihood of a 'soft-landing' for global economic activity.

2.11 Global Sustainable Equities

DPF Weightings	
Current Neutral	29.0%
New Intermediate Benchmark	31.5%
Actual 31.1.24	28.3%
AF Recommendation	29.5%
IIMT Recommendation	29.5%
Benchmark Returns (GB£)	
Jan-24	0.9%
Q4 23/24	6.4%
1 Year to Dec-23	16.1%
3 Years to Dec-23 (pa)	9.3%
5 Years to Dec-23 (pa)	12.5%

The Fund's allocation to Global Sustainable Equities increased from 27.2% on 31 October 2023 to 28.3% on 31 January 2024, (0.7% underweight relative to the current strategic asset allocation benchmark) reflecting relative market strength.

Mr Fletcher continues to recommend a 2.0% underweight allocation of 29.5% to Global Sustainable Equities, relative to the new intermediate benchmark, 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, particularly in the US, have become increasingly expensive. The current SAP 500 forward price earnings multiple is around 24.1x, higher than the long-term average since 1990 of 18.7x.

The IIMT recommends a 29.5% (2.0% underweight) allocation to Global Sustainable Equities.

2.12 Private Equity

DPF Weighting				
New Intermediate Benchmark	Actual 31.1.24	Committed 31.1.24	AF Recommendation	IIMT Recommendation
6.0%	5.2%	6.6%	6.0%	5.3% Invested 6.6% Committed
Benchmark Returns (GB£)				
Jan-24	Q4 23/24	1 Year to Dec-23	8 Years to Dec-23 (pa)	5 Years to Dec-23 (pa)
1.2%	6.7%	16.1%	9.2%	7.4%

The Fund's Private Equity weighting fell from 5.3% on 31 October 2023 to 5.2% on 31 January 2024, reflecting relative market weakness, partly offset by net investment of £2m (1.2% overweight relative to the current strategic asset allocation benchmark).

Mr Fletcher recommends a neutral weighting of 6.0% in Private Equity, relative to the new intermediate benchmark.

The IIMT recommends increasing the Fund's Private Equity allocation to 5.3% (0.7% underweight relative to the new intermediate benchmark), reflecting anticipated commitment drawdowns. On a committed basis, the Private Equity weight increases to 6.6%, 0.6% overweight.

The Fund expects to make a £50m commitment (which will take up to five years to fully deploy capital) to a primary fund-of-fund private equity fund managed by LGPS Central Limited (LGPSC), the Fund's investment pooling operating company, in Q1-24. This will increase the committed weight to

7.4%. Whilst this implies the Fund will be 1.4% overweight should all the commitments be drawn-down, in practice it is unlikely that the commitments will be fully drawn, and some of the existing closed-ended investments have now entered their distribution phase (i.e. returning cash to investors). The Fund can also sell down some of its more liquid listed private equity investments if required.

2.13 Income Assets

On 31 January 2024, the overall weighting in Income Assets was 25.3% (0.3% overweight), compared to 26.5% on 31 October 2023, reflecting relative market weakness. The IIMT recommendations below increase the weighting to 26.9%, largely reflecting the Fund's new intermediate strategic asset allocation benchmark, which subject to approval, will increase the Fund's neutral allocation to Income Assets from 25.0% to 27.5% on 1 April 2024.

2.14 Multi Asset Credit

DPF Weighting				
New Intermediate Benchmark	Actual 31.1.24	Committed 31.1.24	AF Recommendation	IIMT Recommendation
6.5%	7.5%	9.1%	7.5%	8.0% Invested 9.5% Committed
Benchmark Returns (GB£)				
Jan-24	Q4 23/24	1 Year to Dec-23	8 Years to Dec-23 (pa)	5 Years to Dec-23 (pa)
1.8%	3.6%	10.5%	4.9%	4.5%

The Fund's allocation to Multi-Asset Credit fell from 7.7% on 31 October 2023 to 7.5% on 31 January 2024, principally reflecting relative market weakness.

The Fund completed a commitment to a global private credit fund totalling £62.5m in the three months to 31 January 2024, increasing the committed weight to 9.1% on 31 January 2024. Capital deployment will take up to three years. Whilst this implies the Fund will be 2.6% overweight should all the commitments be drawn-down, in practice it is unlikely that the commitments will be fully drawn, and some of the existing closed-ended investments have now entered their distribution phase (i.e. returning cash to investors). The Fund can also sell down some of its more liquid diversified Multi-Asset Credit investments if required.

Mr Fletcher has reduced his 2.0% overweight allocation to Multi-Asset Credit to 1.0% overweight because of the recent strong performance of high yielding 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). Whilst spreads have tightened recently, the current running yield available from the Multi-Asset Class asset class remains attractive (+8.0%), and offers value over the longer term, albeit there could be volatility in the short-term and it is important that manager stock selection minimises the risk of defaults.

The IIMT recommends that the current allocation of 7.5% is increased by 0.5% to 8.0% (1.5% overweight relative to the new intermediate benchmark), reflecting net investment of 0.4% and anticipated comment drawdowns of 0.1%.

2.15 Property

DPF Weighting				
New Intermeidate Benchmark	Actual 31.1.24	Committed 31.1.24	AF Recommendation	IIMT Recommendation
9.5%	7.2%	7.2%	9.5%	7.7% Invested 7.7% Committed
Benchmark Returns (GB£)				
Jan-24	Q4 23/24	1 Year to Dec-23	8 Years to Dec-23 (pa)	5 Years to Dec-23 (pa)
Not available	(1.1%)	(2.2%)	1.8%	1.0%

The Fund's allocation to Property reduced from 7.8% on 31 October 2023 to 7.2% on 31 January 2024 due to the underperformance of the asset class against the Fund's other asset classes. Direct Property accounted for 5.1% and Indirect Property accounted for 2.1%.

Mr Fletcher maintains his recommendation for a neutral overall property allocation of 9.5% relative to the new intermediate benchmark.

The Fund's discretionary direct property manager notes that the economic pressures which caused the UK commercial property investment market such problems in 2023 appear to be easing at the beginning of 2024. The inflation rate has fallen from its peak in October 2022 and interest rates are expected to start falling during 2024. The manager believes that this will undoubtedly assist the property investment market, with investors much more confident that the price correction is over, and that the direction of travel is more positive. Although 2023 recorded historically low investment transaction levels, 2024 is expected to see a marked improvement as investors return to the market, with a greater depth and competition expected to the buyer pool. Notwithstanding the risk of further external geo-political shocks adversely affecting investor confidence, there is pent up demand for good quality property investment opportunities at much more attractive pricing levels.

The total return for all UK commercial property for Q4-23 as measured by the MSCI Quarterly Index was -1.1%, comprising an income return of +1.2% and a capital value fall of -2.3%. The total return for the twelve-month period to 31 December 2023 was -2.8%. In comparison, the total return for the Fund's property portfolio was -0.4% for the three months to 31 December 2023 and -1.2% for the twelve months to 31 December 2023. The current void rate within the portfolio is 6.1% (Q3-23: 5.1%). This compares to the MSCI benchmark void rate of 8.3%.

Property is an illiquid asset class, and it takes time to build the asset class weighting. The IIMT recommends that liquidity of up to £60m (1.0%) is made available to the Fund's Direct Property manager to make incremental investments at the right time should suitable investment opportunities be identified. Of this 1.0% additional liquidity, the Fund's IIMT has reflected 0.5% in the asset class recommendation for the upcoming quarter, taking the overall asset class recommended weight to 7.7%, 1.8% underweight relative to the new intermediate benchmark.

The IIMT is also currently carrying out due diligence on a potential £30m commitment to a UK Residential Indirect Property Fund managed by LGPSC, albeit capital deployment in respect of this fund is expected to take up to four years.

2.16 Infrastructure

DPF Weighting				
New Intermediate Benchmark	Actual 31.1.24	Committed 31.1.24	AF Recommendation	IIMT Recommendation
11.5%	10.6%	12.0%	11.5%	11.2% Invested 12.5% Committed
Benchmark Returns (GB£)				
Jan-24	Q4 23/24	1 Year to Dec-23	8 Years to Dec-23 (pa)	5 Years to Dec-23 (pa)
0.6%	1.8%	6.8%	4.1%	3.5%

The Fund's allocation to Infrastructure fell from 11.0% on 31 October 2023 to 10.6% on 31 January 2024 (0.6% overweight relative to the current strategic asset allocation benchmark), reflecting relative market weakness, partly offset net investment of £5m, of which gross capital investment into renewable energy assets totalled £7.5m.

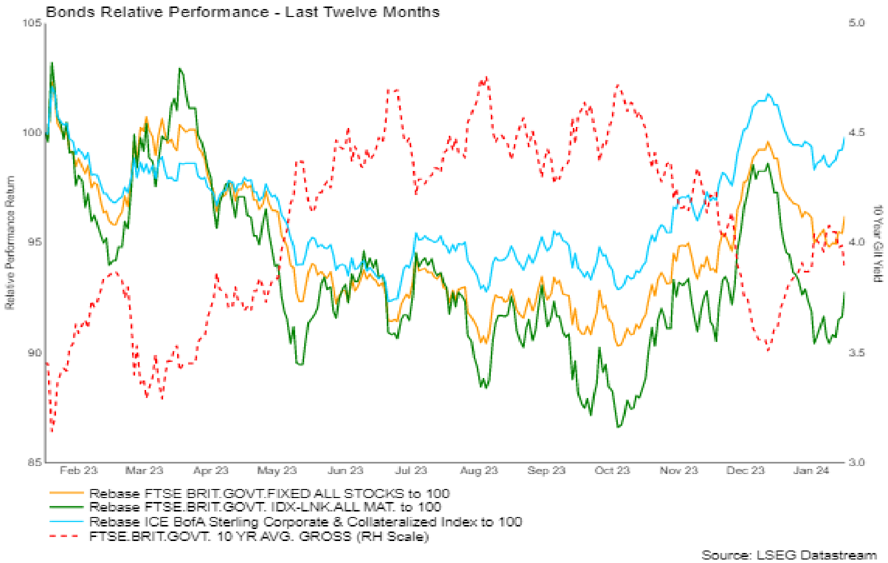
Mr Fletcher recommends a neutral weighting relative to the new intermediate benchmark.

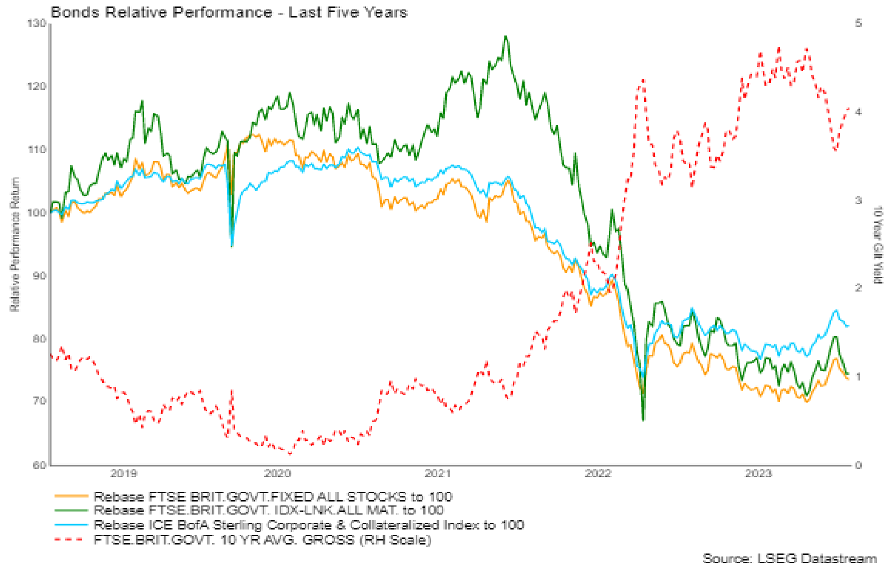
The IIMT continues to view Infrastructure as an attractive long-term asset class and favours a bias towards core infrastructure assets or renewable energy assets. These assets can offer low volatility; low correlation to equity and fixed income markets; and reliable long-term cash flows.

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 increasing the invested weight by 0.6% to 11.2% (0.3% underweight relative to the new intermediate benchmark); 12.5% on a committed basis.

2.17 Protection Assets





The weighting in Protection Assets on 31 January 2024 was 15.6%, marginally down from 15.7% on 31 October 2023. The IIMT recommendations below increase the weighting by 2.4% to 18.0%, neutral to both the current benchmark and the new intermediate benchmark.

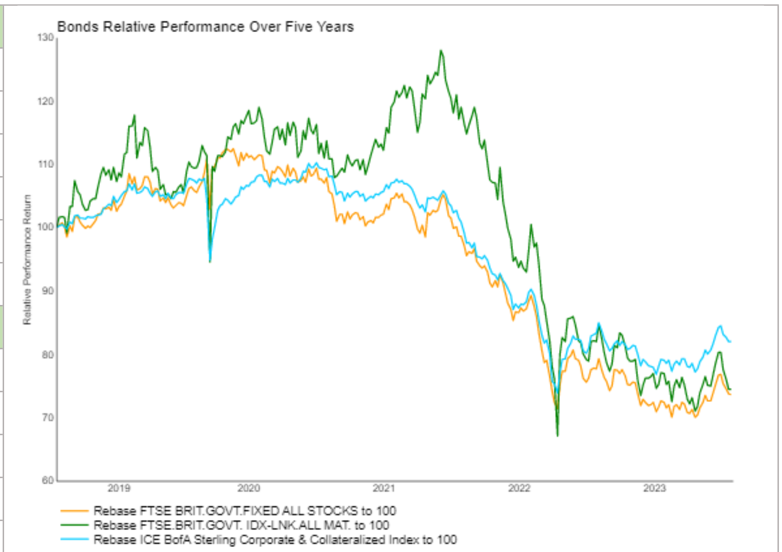
Fixed income returns were positive over the twelve months to 31 January 2024, with UK Conventional Gilts returning +3.7% and UK Index-Linked Bonds returning +0.9%. Government bond yields fell, and so prices rose, in Q4-23. Benchmark 10-year yields in the US, the UK, Germany and Japan all ended the quarter lower. Yields on the 10-year US Treasury fell significantly, from 4.6% to 3.9%. The ‘higher for longer’ interest-rate narrative established over the summer moved into expectations that major central banks would cut rates in 2024. Data suggested that US inflation fell steadily while the labour market slowed. US Inflation fell to 3.1% in November and non-farm payrolls cooled from the averages recorded earlier in the year. The price of crude oil and the value of the

US dollar also fell. The market saw this combination of data as indicative of a US Fed pivot into policy easing. In December, the US Fed signalled that it was prepared to cut rates, potentially even before inflation is brought fully to target, which was seen as justifying the significant fall in bond yields over the previous weeks.

However, whilst stronger than expected economic data in January 2024 added credence to market hopes for a ‘soft landing’, it also made pre-emptive rate cuts in Q1-24 look less likely. Core government bonds reversed some of last year’s gains, as markets scaled back the number of rate cuts priced for 2024.

2.18 Conventional Bonds

DPF Weightings	
Current Neutral	6.0%
New Intermediate Benchmark	6.0%
Actual 31.1.24	4.9%
AF Recommendation	6.0%
IIMT Recommendation	6.0%
Benchmark Returns (GB£)	
Jan-24	(2.2%)
Q4 23/24	8.1%
1 Year to Dec-23	3.7%
3 Years to Dec-23 (pa)	(9.2%)
5 Years to Dec-23 (pa)	(2.3%)



Source: LSEG Datastream

The Fund’s allocation to Conventional Bonds fell from 5.0% on 31 October 2023 to 4.9% on 31 January 2024 (1.1% underweight), reflecting net relative market weakness. The Fund’s allocation on 31 January 2024 comprised around 90% UK Conventional Gilts and 10% US Treasuries.

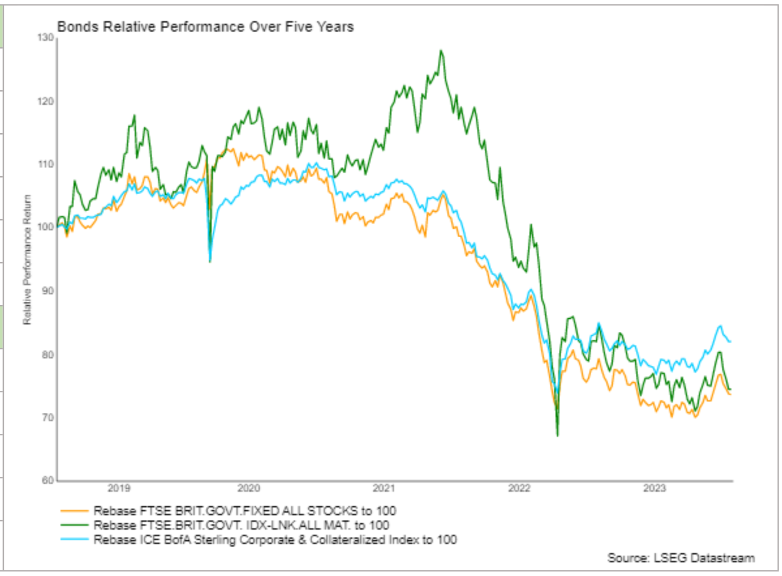
Mr Fletcher has increased his previous 1.0% underweight recommendation to UK Conventional Bonds to neutral.

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 few years (the current yield on a 10-year UK gilt is around

4.107%, up from 0.130% in July 2020). As a result, the IIMT recommends a neutral allocation of 6.0%.

2.19 Index-Linked Bonds

DPF Weightings	
Current Neutral	6.0%
New Intermediate Benchmark	6.0%
Actual 31.1.24	4.9%
AF Recommendation	6.0%
IIMT Recommendation	6.0%
Benchmark Returns (GB£)	
Jan-24	(4.5%)
Q4 23/24	8.7%
1 Year to Dec-23	0.9%
3 Years to Dec-23 (pa)	(11.3%)
5 Years to Dec-23 (pa)	(3.8%)



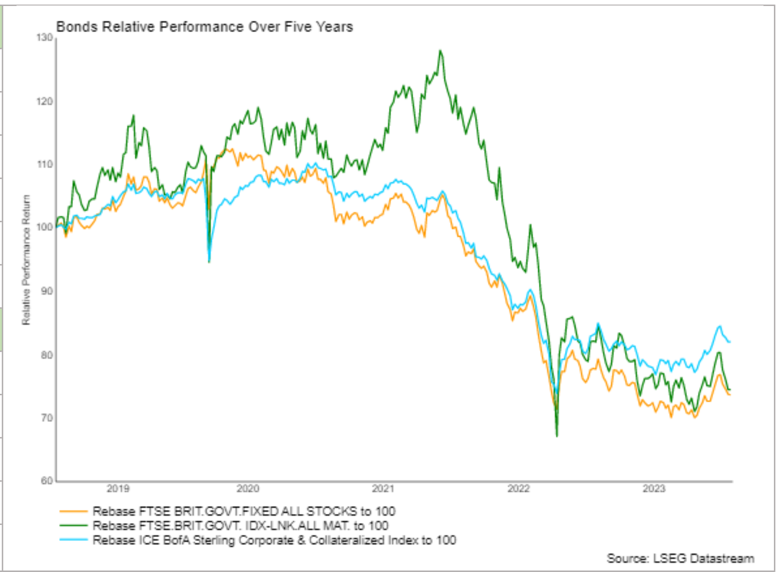
The Fund's allocation to Index-Linked Bonds increased fell from 5.0% on 31 October 2023 to 4.9% on 31 January 2024 (1.1% underweight), reflecting relative market weakness. The Fund's allocation on 31 January 2024 comprised around 80% UK Index-Linked Bonds (UK Linkers) and 20% US Treasury Inflation Protected Bonds (US TIPS).

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

The IIMT believes that index-linked sovereign bonds offer better long-term value now than they have for many years following the substantial rise in yields over the last few years. (As a result, the IIMT recommends a neutral allocation of 6.0%.

2.20 Corporate Bonds

DPF Weightings	
Current Neutral	6.0%
New Intermediate Benchmark	6.0%
Actual 31.1.24	5.8%
AF Recommendation	6.0%
IIMT Recommendation	6.0%
Benchmark Returns (GB£)	
Jan-24	(0.5%)
Q4 23/24	7.8%
1 Year to Dec-23	8.9%
3 Years to Dec-23 (pa)	(4.1%)
5 Years to Dec-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 5.7% on 31 October 2023 to 5.8% on 31 January 2024 (0.2% underweight), reflecting relative market strength.

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

The spread on investment grade bonds offers relatively good value and 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 0.2% to 6.0% (neutral).

2.21 Cash

The Cash weighting on 31 January 2024 was 3.2% (1.2% overweight), up from 2.8% on 31 October 2023.

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

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, stretched equity valuations, a slowdown in global activity (albeit the risk of a global recession appears to have eased over the last six months), continuing core inflationary pressures, persistent high interest rates (relative to recent years), more complex global supply chains, continuing energy security concerns and geopolitical tensions and conflicts.

The IIMT recommends a relatively defensive cash allocation of 3.3% (1.3% 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 more than £100m over the course of the next twelve months). Furthermore, it should also be noted that the current UK Bank Rate offers an attractive 'risk-free' return of 5.25%.

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 by Pension Fund team.

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 January 2024.

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