FOR PUBLICATION

DERBYSHIRE COUNTY COUNCIL

PENSIONS AND INVESTMENTS COMMITTEE

WEDNESDAY, 5 JUNE 2024

Report of the Director of Finance

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 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 2024 and the recommendations of the Director of Finance 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, adjusted to reflect the impact of future investment commitments. These commitments relate to Private Equity, Infrastructure and Multi-Asset Credit and currently total around £368m. 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
	Old	New Inter (1)	New Final (1)	31/1/24	30/4/24	Inter (1)	AF 5/06/24	DPF 5/6/24	AF 5/6/24	DPF 5/6/24	DPF 5/6/24	3 Months to 31/3/24	3 Months to 30/4/24
Growth Assets	**55.0%**	**52.5%**	**50.0%**	**55.9%**	**55.5%**	**+/- 8%**	**(1.0%)**	**(0.3%)**	**51.5%**	**52.2%**	**54.2%**	**n/a**	**n/a**
UK Equities	12.0%	10.0%	8.0%	12.1%	11.8%	+/- 5%	+1.0%	+1.5%	11.0%	11.5%	11.5%	3.6%	7.6%
Overseas Equities:	39.0%	36.5%	36.0%	38.6%	38.6%	+/- 8%	(2.0%)	(0.9%)	34.5%	35.6%	35.6%	n/a	n/a
Japan	5.0%	2.5%	-	5.5%	5.2%	+/- 2.5%	-	+0.5%	2.5%	3.0%	3.0%	11.6%	2.9%
Emerging Markets	5.0%	2.5%	-	4.8%	3.8%	+/- 2.5%	-	+0.5%	2.5%	3.0%	3.0%	3.4%	9.7%
Global Sustainable	29.0%	31.5%	36.0%	28.3%	29.6%	+/- 8%	(2.0%)	(1.9%)	29.5%	29.6%	29.5%	9.3%	5.8%
Private Equity	4.0%	6.0%	6.0%	5.2%	5.1%	+/- 2%	-	(0.9%)	6.0%	5.1%	7.2%	5.0%	8.3%
Income Assets	**25.0%**	**27.5%**	**30.0%**	**25.3%**	**25.4%**	**+/- 6%**	**+1.0%**	**(1.6%)**	**28.5%**	**25.9%**	**29.5%**	**n/a**	**n/a**
Multi-Asset Credit (4)	6.0%	6.5%	7.0%	7.5%	7.7%	+/- 2%	+1.0%	1.2%	7.5%	7.7%	9.6%	2.1%	1.7%
Infrastructure	10.0%	11.5%	13.0%	10.6%	10.7%	+/- 3%	-	(0.8%)	11.5%	10.7%	11.9%	1.8%	1.8%
Property	9.0%	9.5%	10.0%	7.2%	7.0%	+/- 3%	-	(2.0%)	9.5%	7.5%	8.0%	(1.1%)	(1.1%) (3)
Protection Assets	**18.0%**	**18.0%**	**18.0%**	**15.6%**	**16.2%**	**+/- 5%**	**-**	**-**	**18.0%**	**18.0%**	**18.0%**	**n/a**	**n/a**
Conventional Bonds	6.0%	6.0%	6.0%	4.9%	5.0%	+/- 2%	-	-	6.0%	6.0%	6.0%	(1.6%)	(2.3%)
Index-Linked Bonds	6.0%	6.0%	6.0%	4.9%	5.2%	+/- 2%	-	-	6.0%	6.0%	6.0%	(1.8%)	(0.9%)
Corporate Bonds	6.0%	6.0%	6.0%	5.8%	6.0%	+/- 2%	-	-	6.0%	6.0%	6.0%	0.1%	(1.3%)
Cash	**2.0%**	**2.0%**	**2.0%**	**3.2%**	**2.9%**	**0 – 8%**	**-**	**+1.9%**	**2.0%**	**3.9%**	**(1.7%)**	**-**	**-**

Investment Assets totaled £6,414.0m on 30 April 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 30 April 2024 and assumes all commitments are funded from Cash.
(3) Benchmark Return for the three months to 30 April 2024.
(4) Multi-Asset Credit weight on 30 April 2024 adjusted to include 0.5% of pending trades at that date; Cash reduced by -0.5%.

The table above reflects the following three categorisations:

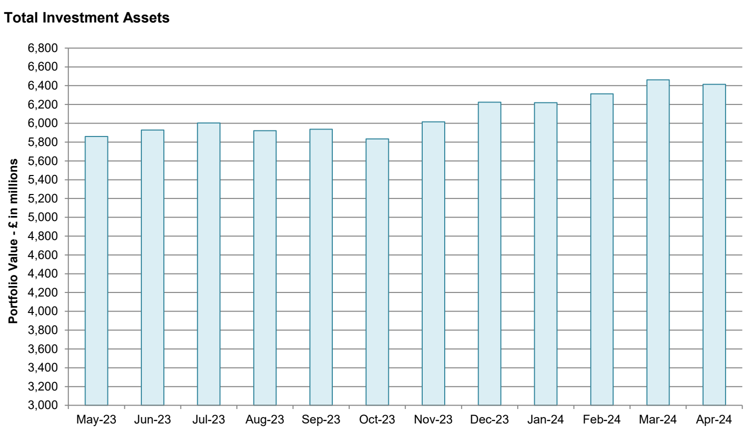
- **Growth Assets**: largely equities plus other volatile higher return assets such as private equity;
- **Income Assets**: assets which are designed to deliver an excess return, but with more stable return patterns than Growth Assets because income represents a large proportion of the total return of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

The table also shows the new Intermediate and Final Benchmarks which were approved by Committee on 6 March 2024, together with the old benchmark. The Intermediate Benchmark become effective on 1 April 2024, and the Final Benchmark will become effective on 1 April 2025 at the latest.

Relative to the current benchmark, the Fund on 30 April 2024, was overweight Growth Assets (3.0%) and Cash (0.9%) and underweight Income Assets (-2.1%) and Protection Assets (-1.8%). 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 -1.7%. 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

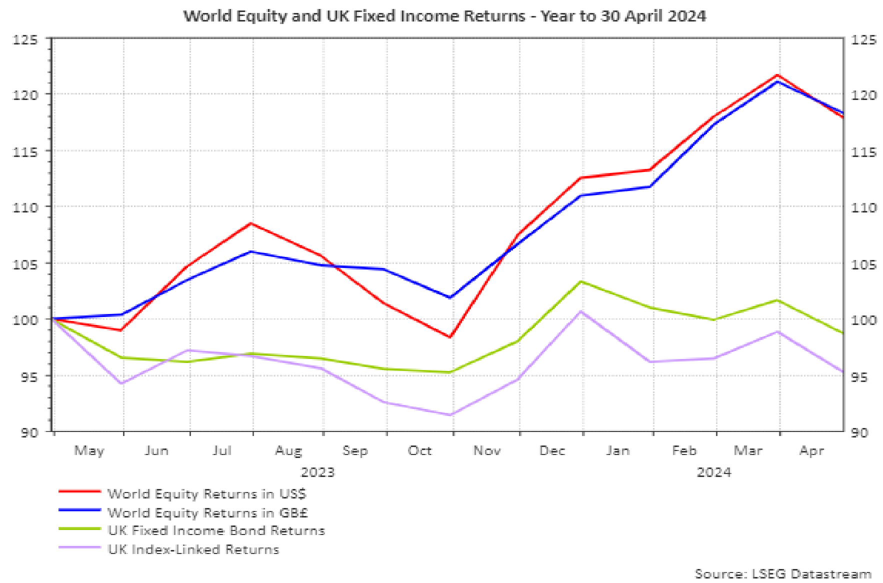
The value of the Fund's investment assets increased by £194m (+3.1%) between 31 January 2024 and 30 April 2024 to £6,414m, comprising a non-cash market gain of around £179m and a cash inflow from dealing with members and investment returns of around £15m. Over the twelve months to 30 April 2024, the value of the Fund's investment assets increased by £486m (+8.2%), comprising a non-cash market gain of around £426m 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 30 April 2024 is attached at Appendix 3.

2.4 Market returns over the last 12 months

The chart below shows market returns for Global Equities in sterling and the US dollar, UK Gilts and UK Index Linked bonds for the twelve months to 30 April 2024. Whilst global equity returns were positive over the 12-month period, returning 18.3% in Sterling terms (17.9% in US dollars), fixed income markets posted moderately negative returns, with losses of -1.3% for Conventional Gilts and -4.7% for Index Linked Gilts.



The Bank of England (BoE) and the US Federal Reserve (US Fed) have both raised interest rates by more than 500 basis points in the current interest rate cycle and they have maintained interest rates at levels slightly exceeding 5.0% for almost 12 months. During that period, inflation has declined materially from its peaks in both the UK and the US and it has started to approach target levels of 2.0%. As a result of this, financial markets and economists have for some time been focused on when developed market central banks will start to ease monetary policy conditions. Consequently, there has been elevated levels of interest rate and bond market volatility (bond prices move inversely to interest rates) as market expectations around the timing of the first interest rate cut and the pace and magnitude of cumulative rate cuts have been in a state of flux.

Over the of course of 2023, consumer price inflation in the US fell from an annual rate of 6.5% to 3.4%, and in the UK from 10.5% to 4.0%. Consequently, during Q4-23 the yield on the 10 Year US Treasury bond declined by 120 basis points from 5.0% to 3.8%, as Treasury bond prices were bid up to reflect the market's expectation for lower future interest rates as inflation started to approach target levels. At the end of 2023, the market was expecting the US Fed to start cutting interest rates in March 2024, forecasting that interest rates would decline by approximately 150 basis points to 175 basis points throughout 2024 (implying an end of year policy rate of between 3.75% to 4.00%). As a result, bond markets rallied quite strongly with Conventional Gilts and Index-Linked Gilts returning 8.1% and 8.7% during the fourth quarter, as the UK market was primarily being driven by US interest rate expectations.

However, subsequent economic data releases between January and April 2024 have indicated that the US economy is still performing robustly despite restrictive monetary policy, and that inflation has been stickier than expected, moving away from target levels. Both data points imply that inflation has not yet been fully brought under control and that the US Fed may be required to hold interest rates at current restrictive levels for a longer period than expected. As a result, market forecasts for interest rates have changed considerably over the first four months of this year. Markets have pushed out their expectations for the first US Fed rate cut from March to September 2024, and interest rates are now expected to decline by only 25 basis points to 50 basis points by the end of 2024 (implying an end of year policy rate of around 5.00%). As a result, the Q4-23 gains in fixed income markets have gradually been unwound in the four months to April 2024. Conventional Gilts have declined in value by -4.5%, with Index-Linked Gilts declining by -5.4%.

Despite elevated volatility within bond markets, equities have generally made steady gains since November 2023, with the FTSE All World returning 16.5% in Sterling terms over the 6-month period to 30 April 2024. Technology stocks continued to be the best performing sector, delivering a return of 23.5% over the same 6-month period (as measured by the FTSE All World Technology Index in Sterling terms), outperforming the FTSE All World by 7 percent. The Technology sector has delivered market leading earnings growth which has surpassed analyst expectations. The sector has also benefited from tailwinds surrounding Artificial Intelligence, which the market expects to be a significant growth area for process and task automation and multi-media content creation.

The continued outperformance of the Technology sector (which has now outperformed the wider index for almost 18 months) is resulting in increased valuation risk. The US Technology sector is currently trading at a forward price-to-earnings ratio of 36 times earnings, which is almost 80% higher than its 20-year average of 20 times earnings. In contrast, the equal weight US index (which controls for the impact of concentration risk and sector biases) is trading in-line with its 20-year average price-to-earnings ratio of 18 times earnings. There is also growing concentration risk, as the Magnificent 7[1] now account for 30% of the US equity index (S&P 500).

Subsequent to the end of April 2024, the BoE voted to maintain interest rates at 5.25%, but it signalled that inflation was moving in the 'right direction' towards the 2% target and that the Bank would consider summer rates cuts as long as the data continues to show further positive progress. In the US, the consumer price index also declined from 3.5% in March to 3.4% in April, reversing consecutive months of rising inflation data which had sparked concern that price pressures were re-emerging. Market expectations for interest rates remain broadly unchanged, as a clearer trend of disinflation over several months is likely required before the US Fed may consider an expedited schedule of interest rate cuts that deviates from its current expected policy path.

Between 1 May 2024 and 20 May 2024, the FTSE All World returned 3.8% in Sterling (rising to 5.4% in US Dollar terms) between 1 May 2024 and 20 May 2024.

On 22 May 2024, Rishi Sunak announced that a general election will take place on 4 July 2024. Economists do not expect the outcome of the election to have a significant impact on the economic outlook for the UK.

Consistent with the previous report, the IIMT continues to recommend a relatively cautious approach to Growth Assets, particularly given the strong rally over the previous six months, which has further stretched already expensive looking valuations within the Technology sector. There is still uncertainty about the future path for interest rates and it is likely that any reduction in rates will be a gradual process, although the risk of a recession appears to have diminished considerably.

[1] Microsoft, Amazon, Google (Alphabet), Tesla, Facebook (Meta), Nvidia and Apple

Asset class weightings and recommendations are based on values on 30 April 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 March 2024.

Per annum	DPF	Benchmark Index
1 year	9.3%	10.0%
3 years	4.5%	4.5%
5 years	5.6%	5.4%
10 years	7.0%	6.7%

The Fund outperformed the benchmark on a five- and ten-year basis and was in line with benchmark on a three-year basis. The Fund underperformed on a one-year basis. Notwithstanding the one-year relative under-performance, the Fund still returned +9.3% on a one-year basis to 31 March 2024.

2.6 Category Recommendations

	Old Benchmark	New Intermediate Benchmark	Benchmark Change	Fund Allocation	Permitted Range	Recommendation		Benchmark Relative Recommendation	
				30 Apr-24		AF	DPF	AF	DPF
Growth Assets	55.0%	52.5%	(2.5%)	55.5%	± 8%	51.5%	52.2%	(1.0%)	(0.3%)
Income Assets	25.0%	27.5%	+2.5%	25.4%	± 6%	28.5%	25.9%	+1.0%	(1.6%)
Protection Assets	18.0%	18.0%	-	16.2%	± 5%	18.0%	18.0%	-	-
Cash	2.0%	2.0%	-	2.9%	0 – 8%	2.0%	3.9%	-	+1.9%

At an overall level, the Fund was overweight Growth Assets and Cash on 30 April 2024, and underweight Income Assets and Protection Assets. As highlighted on page 2, commitments on 30 April 2024 totalled around £368m, potentially increasing Growth Assets by 2.1% and Income Assets by 3.6%. 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 3.3% to 52.2% (0.3% underweight) (UK Equities -0.3%, Japanese Equities -2.2%; Emerging Market Equities -0.8%), increase Income Assets by 0.5% to 25.9% (Property +0.5%); increase Protection Assets by 1.8% (Conventional Bonds +1.0%; and Index-Linked Bonds +0.8%), and increase Cash by +1.0%.

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%.

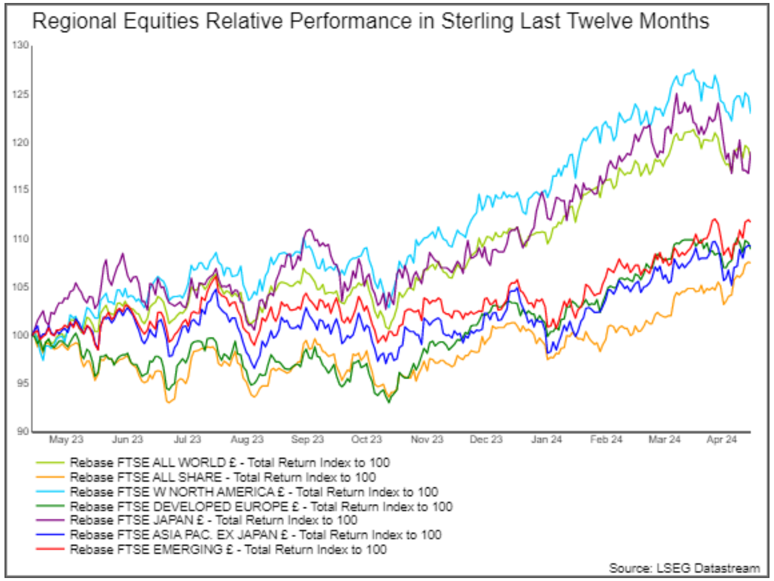
2.7 Growth Assets

On 30 April 2024, the overall Growth Asset weighting was 55.5%, down from 55.9% on 31 January 2024, reflecting net divestment of around £118m, partly offset by relative market strength.

The IIMT recommendations in this report reduce the weighting to 52.2%, largely reflecting the impact of the Fund's new intermediate strategic asset allocation benchmark, which reduced 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 rose over Q1-24 (FTSE All World +9.1% in GBP), driven by resilient US economic data and hopes that major central banks will soon begin to cut interest rates. US equities performed strongly, with the S&P 500 and Nasdaq indices hitting record highs. UK equities were weighed down by weak economic data, falling in January and February before joining the global rally in March and ultimately rising over the period (FTSE All Share up +3.6% over Q1-24). The UK economy entered a technical recession in Q4-23 and inflation remained elevated but fell by more than was expected in February 2024, and fell to 2.3% in April 2024, its lowest level in almost three years.

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.



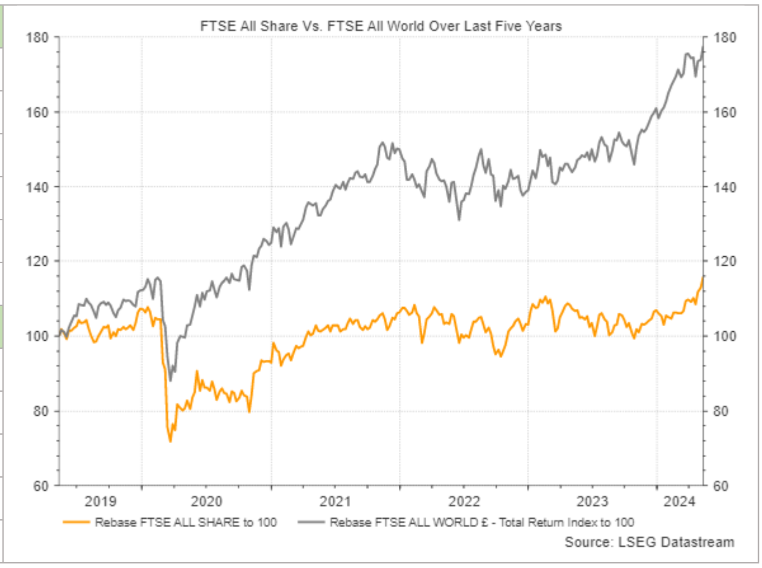
Benchmark Return	Currency	Q1-24 (*)	1 Year (*)	3 Year (*)	5 Year (*)	Since Last Committee (**)	L3M 30-Apr-24	YTD 30-Apr-24	1 Year 30-Apr-24	YTD 12-May-24
Sterling Returns										
FTSE All World	GB£	9.1%	21.0%	10.6%	12.1%	1.0%	5.8%	6.6%	18.3%	10.4%
FTSE UK	GB£	3.6%	8.4%	8.1%	5.4%	6.4%	7.6%	6.1%	7.5%	10.0%
FTSE Japan	GB£	11.6%	22.3%	6.8%	8.5%	(2.1%)	2.9%	7.3%	19.0%	7.7%
FTSE Emerging Markets	GB£	3.4%	6.2%	(0.4%)	3.9%	4.5%	9.7%	5.9%	11.7%	8.5%
Local Currency Returns										
FTSE All World	US$	8.1%	23.6%	7.4%	11.4%	(0.7%)	6.0%	4.7%	17.9%	8.3%
FTSE UK	GB£	3.6%	8.4%	8.1%	5.4%	6.4%	7.6%	6.1%	7.5%	10.0%
FTSE Japan	¥	18.7%	42.1%	15.2%	14.8%	1.3%	8.9%	17.6%	37.0%	16.9%
FTSE Emerging Markets	US$	2.4%	8.5%	(3.3%)	3.2%	2.7%	7.9%	4.0%	11.3%	6.5%

Source: DPF analysis
(*) To 31 Mar-24
(*) To 30 Apr-24

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 further stretched valuations. The MSCI World forward price earnings multiple on 31 March 2024 was 18.9x, 2.6x higher than the long-term average since 1990. The IIMT recommends an overall underweight allocation of 0.3% to Growth Assets, with a tilt to the more diversified and defensive UK and Japanese equity markets.

2.8 United Kingdom Equities

DPF Weightings	
Old Neutral	12.0%
New Intermediate Neutral	10.0%
Actual 30.4.24	11.8%
AF Recommendation	11.0%
IIMT Recommendation	11.5%
Benchmark Returns (GB£)	
Apr-24	2.5%
Q4 23/24	3.6%
1 Year to Mar-24	8.4%
3 Years to Mar-24 (pa)	8.1%
5 Years to Mar-24 (pa)	5.4%



The Fund’s UK Equity allocation fell from 12.1% on 31 January 2024 to 11.8% on 30 April 2024 (1.8% overweight relative to the new intermediate benchmark), largely reflecting net divestment of £30m.

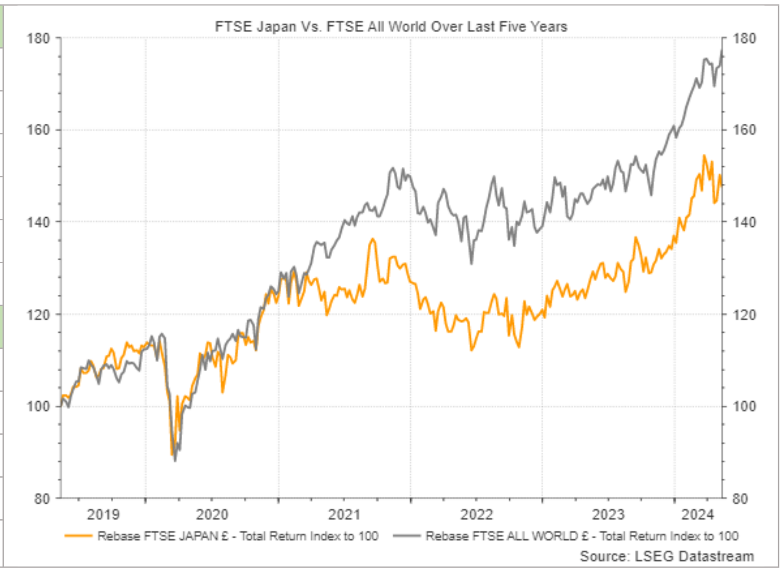
Mr Fletcher recommends a 1.0% overweight allocation to UK Equities, reflecting his assessment of the relative attractiveness of equity valuations in the UK compared to global equity valuations.

UK Equities have significantly under-performed the FTSE All World over the twelve months to 30 April 2024 (7.5% vs. 18.3%) and the forward price earnings multiple on 31 March 2024 was 11.3 times, 2.6 times lower than the long-term average since 1990.

The IIMT recommends a 1.5% overweight allocation to UK Equities due to current UK equity valuations, albeit these have risen of late as the UK market has bounced, leaving them less exposed to material valuation downgrades should the outlook for global growth and/or corporate earnings deteriorate.

2.9 Japanese Equities

DPF Weightings	
Old Neutral	5.0%
New Intermediate Neutral	2.5%
Actual 30.4.24	5.2%
AF Recommendation	2.5%
IIMT Recommendation	3.0%
Benchmark Returns (GB£)	
Apr-24	(3.9%)
Q4 23/24	11.6%
1 Year to Mar-24	22.3%
3 Years to Mar-24 (pa)	6.8%
5 Years to Mar-24 (pa)	8.5%



The Fund's allocation to Japanese Equities fell from 5.5% on 31 January 2024 to 5.2% on 30 April 2024 (2.7% overweight relative to the new intermediate benchmark), principally reflecting net divestment of £30m. Subsequent to 30 April 2024, a further £38m has been divested from Japanese Equities, reducing the weight to closer to 4.8%.

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	
Old Neutral	5.0%
New Intermediate Benchmark	2.5%
Actual 30.4.24	3.8%
AF Recommendation	2.5%
IIMT Recommendation	3.0%
Benchmark Returns (GB£)	
Apr-24	2.5%
Q4 23/24	3.4%
1 Year to Mar-24	6.2%
3 Years to Mar-24 (pa)	(0.4%)
5 Years to Mar-24 (pa)	3.9%

Net divestment of £80m reduced the Fund's allocation to Emerging Market Equities from 4.8% on 31 January 2024 to 3.8% on 30 April 2024 (1.3% overweight relative to the new intermediate benchmark).

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 30 April 2024 (11.7% vs.18.3%) and the forward price earnings multiple on 31 March 2024 of 12.5 times was below the long-term average since 1990 of 14.5 times.

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	
Old Neutral	29.0%
New Intermediate Benchmark	31.5%
Actual 30.4.24	29.6%
AF Recommendation	29.5%
IIMT Recommendation	29.6%
Benchmark Returns (GB£)	
Apr-24	(2.3%)
Q4 23/24	9.3%
1 Year to Mar-24	20.9%
3 Years to Mar-24 (pa)	10.9%
5 Years to Mar-24 (pa)	12.3%

The Fund's allocation to Global Sustainable Equities increased from 28.3% on 31 January 2024 to 29.6% on 30 April 2024 (1.9% underweight relative to the new intermediate benchmark), reflecting net investment of £25m and relative market strength. The net investment related to a subscription to the LGPS Central Global Sustainable Equity Broad Strategy Fund.

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 S&P 500 forward price earnings multiple is around 21.2 times, materially higher than the long-term average since 1990 of 16.3 times.

The IIMT recommends a 29.6% (1.9% underweight relative to the new intermediate benchmark) allocation to Global Sustainable Equities.

2.12 Private Equity

DPF Weighting				
New Intermediate Benchmark	Actual 30.4.24	Committed 30.4.24	AF Recommendation	IIMT Recommendation
6.0%	5.1%	7.2%	6.0%	5.1% Invested 7.2% Committed
Benchmark Returns (GB£)				
Apr-24	Q4 23/24	1 Year to Mar-24	3 Years to Mar-24 (pa)	5 Years to Mar-24 (pa)
(0.1%)	5.0%	12.1%	7.6%	5.6%

The Fund's Private Equity weighting fell slightly from 5.2% on 31 January 2024 to 5.1% on 30 April 2024, (0.9% underweight relative to the new intermediate benchmark), largely reflecting net distributions of around £3m.

The Fund finalised 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) in March 2024.

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

The IIMT recommends maintaining the Fund's Private Equity allocation at 5.1%, noting that on a committed basis, the Fund's weight increases to 7.2%.

Whilst this implies the Fund will be 1.2% overweight relative to the new intermediate benchmark 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 private equity 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.

The Fund's private equity benchmark was changed in Q1-24 from Global Sustainable Equities + 1.0% to 50% FTSE All World + 50% FTSE All Share + 1.00% to better reflect the Fund's underlying tilt towards UK private equity relative to the global market. The change was approved by the Director of Finance.

2.13 Income Assets

On 30 April 2024, the overall weighting in Income Assets was 25.4% (1.9% underweight relative to the new intermediate benchmark, which increased the neutral allocation to Income Assets from 25.0% to 27.5% on 1 April 2024), compared to 25.3% on 31 January 2024. Net investment of around £64m was largely offset by relative market weakness. The IIMT recommendations below increase the weighting to 25.9%; 29.5% on a committed basis.

2.14 Multi Asset Credit

DPF Weighting				
New Intermediate Benchmark	Actual 30.4.24	Committed 30.4.24	AF Recommendation	IIMT Recommendation
6.5%	7.7%	9.6%	7.5%	7.7% Invested 9.6% Committed
Benchmark Returns (GB£)				
Apr-24	Q4 23/24	1 Year to Mar-24	3 Years to Mar-24 (pa)	5 Years to Mar-24 (pa)
0.2%	2.1%	10.7%	5.1%	4.7%

The Fund's allocation to Multi-Asset Credit increased from 7.5% on 31 January 2024 to 7.7% on 30 April 2024 (1.2% overweight relative to the new intermediate benchmark), principally reflecting net investment of around £22m.

Mr Fletcher has maintained his 1.0% overweight allocation to Multi-Asset Credit noting that Multi-Asset Credit remains attractive, 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). 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 7.7% is maintained (1.2% overweight relative to the new intermediate benchmark) and notes the committed weight of 9.6%. Whilst this implies the Fund will be 3.1% 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.

2.15 Property

DPF Weighting				
New Intermeidate Benchmark	Actual 30.4.24	Committed 30.4.24	AF Recommendation	IIMT Recommendation
9.5%	7.0%	7.5%	9.5%	7.5% Invested 8.0% Committed
Benchmark Returns (GB£)				
Apr-24	Q4 23/24	1 Year to Mar-24	3 Years to Mar-24 (pa)	5 Years to Mar-24 (pa)
Not available	(1.1%)	(2.4%)	0.8%	0.8%

The Fund’s allocation to Property reduced from 7.2% on 31 January 2024 to 7.0% on 30 April 2024 (2.5% underweight to the new intermediate benchmark). Net investment of around £7m was offset by relative market weakness. Direct Property accounted for 5.1% and Indirect Property accounted for 1.9%.

The net investment of around £7m in the three months to 30 April 2024 principally reflected the purchase of two adjoining retail warehouse units in Tamworth. The Fund also finalised a £30m commitment to a UK Residential Indirect Property Fund managed by LGPSC in the period, albeit capital deployment in respect of this fund is expected to take up to four years.

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

The Fund’s external discretionary direct property manager notes that a weak economic backdrop and interest rates that have stayed higher for longer have kept commercial property returns low over the past year. Increased geopolitical risks have also not helped investors decision-making to re-enter the market. However, the manager believes that the outlook is now becoming more positive, with the inflation rate well down from its peak and interest rates expected to follow.

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 7.5%, 2.0% underweight relative to the new intermediate benchmark.

2.16 Infrastructure

DPF Weighting				
New Intermediate Benchmark	Actual 30.4.24	Committed 30.4.24	AF Recommendation	IIMT Recommendation
11.5%	10.7%	11.9%	11.5%	10.7% Invested 11.9% Committed
Benchmark Returns (GB£)				
Apr-24	Q4 23/24	1 Year to Mar-24	3 Years to Mar-24 (pa)	5 Years to Mar-24 (pa)
0.6%	1.8%	7.1%	4.5%	3.7%

The Fund’s allocation to Infrastructure increased from 10.6% on 31 January 2024 to 10.7% on 30 April 2024 (0.8% underweight relative to the current strategic asset allocation benchmark), reflecting net investment of around £34m, partly offset by relative market weakness.

The net investment in the period largely related to a top-up commitment to a global diversified core/core plus infrastructure fund, of which around 25% is invested in renewable businesses, and an additional 20% has a direct link to green energy.

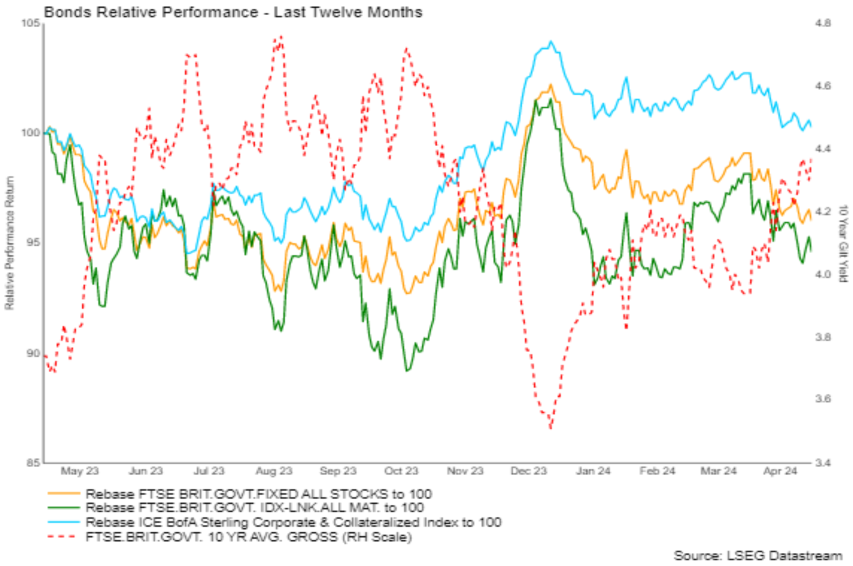
Mr Fletcher recommends a neutral weighting relative to the new intermediate benchmark.

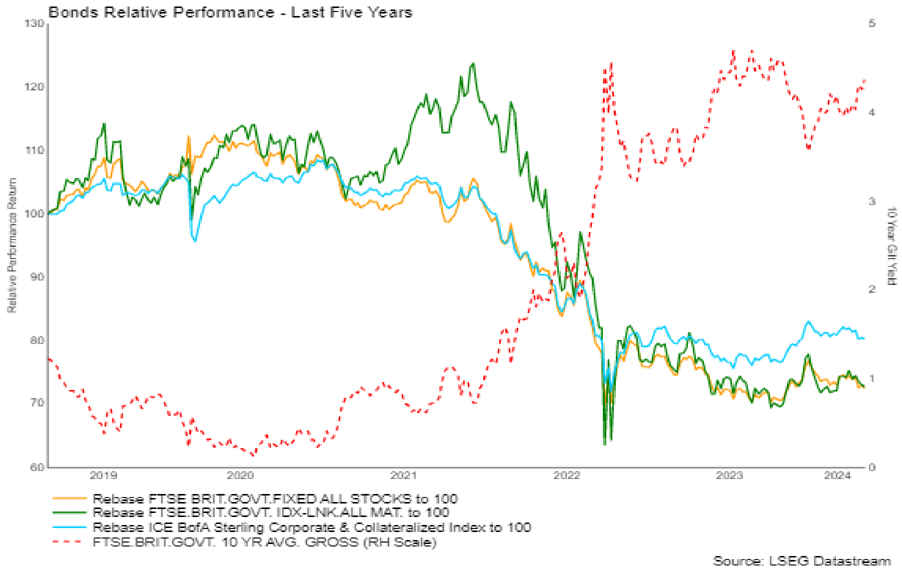
The IIMT continues to view Infrastructure as an attractive long-term asset class and favours a bias towards core infrastructure assets or renewable energy assets. These assets can offer low volatility; low correlation to equity and fixed income markets; and reliable long-term cash flows.

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 maintaining the invested weight at 10.7% (0.8% underweight relative to the new intermediate benchmark); 11.9% on a committed basis.

2.17 Protection Assets





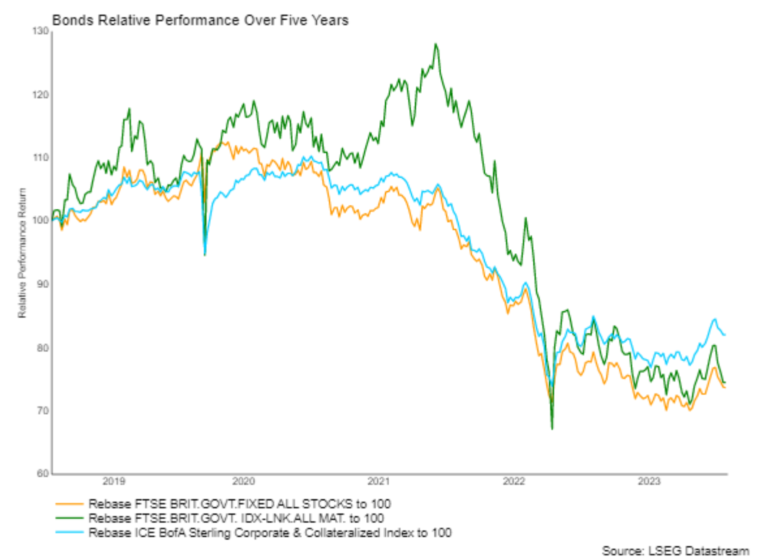
The weighting in Protection Assets on 30 April 2024 16.2%, up from 15.6% on 31 January 2024, reflecting net investment of around £80m, partly offset by market weakness. The IIMT recommendations below increase the weighting by 1.8% to 18.0%, neutral to the new intermediate benchmark.

Fixed income returns were negative over the twelve months to 30 April 2024, with UK Conventional Gilts returning -1.3% and UK Index-Linked Bonds returning -4.7%. Government bond yields rose, and so prices fell, over Q1-24. Benchmark 10-year yields in the US, the UK, Germany and Japan all ended the quarter higher. Yields on the 10-year US treasury rose from 3.87% to 4.21%. Early-year hopes for as many as seven 2024 rate cuts by the US Fed were dashed, with expectations for the first rate cut pushed out. US inflation unexpectedly increased marginally in February, to 3.2% from 3.1% in January. The US jobs market remained strong, with

275,000 non-farm payroll jobs added in February (beating forecasts of 200,000). The composite purchasing managers' index rose over the quarter to 52.2 in March, convincingly in expansionary territory. Business confidence rose to a near two-year high amid signals of a pick-up in the US economy. The US Fed kept the target range for its federal funds rate at a 23-year-high of 5.25-5.5% and indicated a reduction in the number of likely rate cuts in 2024.

2.18 Conventional Bonds

DPF Weightings	
Old Neutral	6.0%
New Intermediate Benchmark	6.0%
Actual 30.4.24	5.0%
AF Recommendation	6.0%
IIMT Recommendation	6.0%
Benchmark Returns (GB£)	
Apr-24	(2.9%)
Q4 23/24	(1.6%)
1 Year to Mar-24	-
3 Years to Mar-24 (pa)	(7.4%)
5 Years to Mar-24 (pa)	(3.8%)



The Fund's allocation to Conventional Bonds increased from 4.9% on 31 January 2024 to 5.0% on 30 April 2024 (1.0% underweight), reflecting net investment of around £22m, partly offset by relative market weakness. The Fund's allocation on 30 April 2024 comprised around 93% UK Conventional Gilts and 7% US Treasuries. Subsequent to 30 April 2024, the Fund has invested a further £35m in UK Conventional Bonds, increasing the weight to closer to 5.5%.

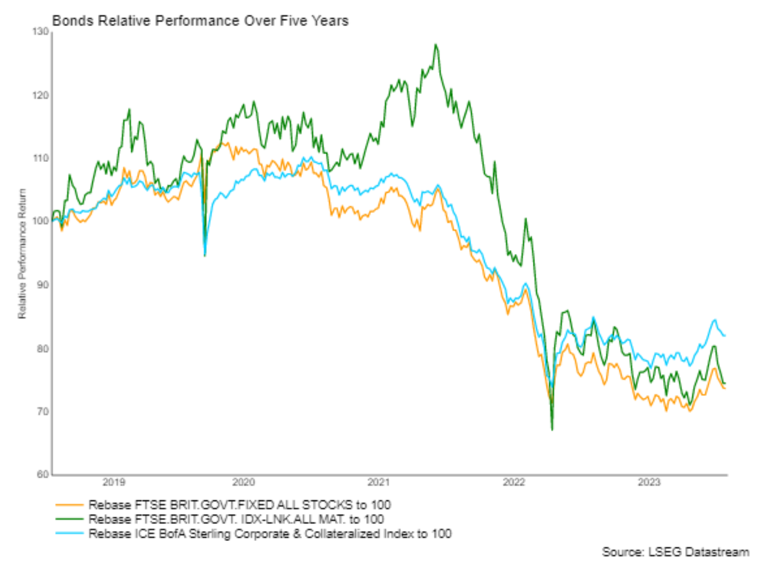
Mr Fletcher has maintained his 6.0% (neutral) recommendation to UK Conventional Bonds.

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 few years (the current yield on a 10-year UK gilt is around 4.121%[2], up from 0.130% in July 2020). As a result, the IIMT recommends a neutral allocation of 6.0%.

[2] On 15 May 2024

2.19 Index-Linked Bonds

DPF Weightings	
Current Neutral	6.0%
New Intermediate Benchmark	6.0%
Actual 30.4.24	5.2%
AF Recommendation	6.0%
IIMT Recommendation	6.0%
Benchmark Returns (GB£)	
Apr-24	(3.6%)
Q4 23/24	(1.8%)
1 Year to Mar-24	(5.0%)
3 Years to Mar-24 (pa)	(9.9%)
5 Years to Mar-24 (pa)	(5.2%)



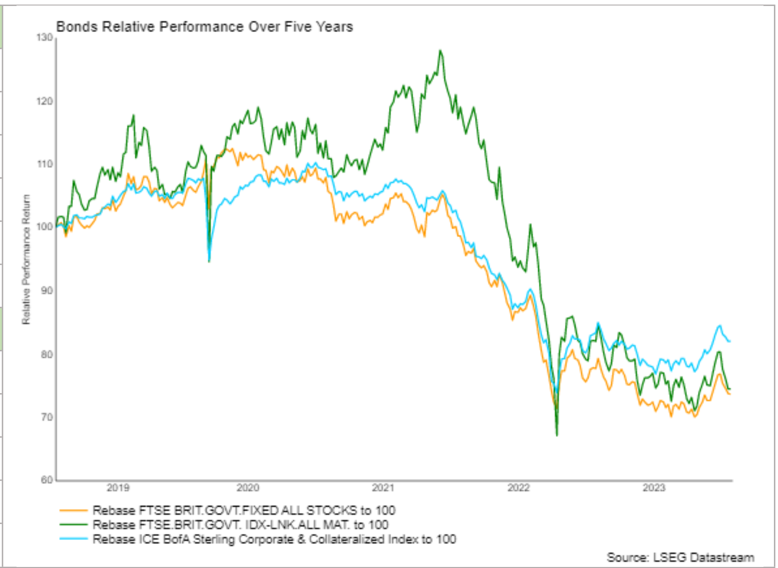
The Fund's allocation to Index-Linked Bonds increased from 4.9% on 31 January 2024 to 5.2% on 30 April 2024 (0.8% underweight relative to the new intermediate benchmark), largely reflecting net investment of around £32m. The Fund's allocation on 30 April 2024 comprised around 80% UK Index-Linked Bonds (UK Linkers) and 20% US Treasury Inflation Protected Bonds (US TIPS). Subsequent to 30 April 2024, the Fund has invested a further £25m in UK Index-Linked Bonds, increasing the weight to closer to 5.5%.

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 30.4.24	6.0%
AF Recommendation	6.0%
IIMT Recommendation	6.0%
Benchmark Returns (GB£)	
Apr-24	(2.0%)
Q4 23/24	0.1%
1 Year to Mar-24	6.3%
3 Years to Mar-24 (pa)	(2.7%)
5 Years to Mar-24 (pa) (1)	n/a



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

Net investment of £25m in the three months to 30 April 2024 increased the Fund's allocation to Corporate Bonds to 6.0% neutral.

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

The spread on investment grade bonds offers relatively good value, albeit tight relative to the average over the last 10 years, 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 that the Fund maintains its current neutral allocation of 6.0% to Corporate Bonds.

2.21 Cash

The Cash weighting on 30 April 2024 was 2.9% (0.9% overweight relative to the new intermediate benchmark), down from 3.2% on 31 January 2024.

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 3.9% (1.9% 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 30 April 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