

The background of the slide features the coat of arms of the Government of Nunavut. It is a shield divided into four quadrants. The top-left quadrant shows a stylized yellow building with a red roof. The top-right quadrant shows a white caribou head with large antlers. The bottom-left quadrant shows a white sailing ship on blue wavy lines representing water. The bottom-right quadrant shows a white eagle with spread wings. Above the shield is a crown with four red maple leaves. A red banner at the bottom contains the text 'ANE FOR A' in white.

## **Agenda Item 5**

## **Investment Review**

**Falkirk Council**

**Subject: Investment Review**

**Meeting: Joint Meeting of Pensions Committee and Pension Board**

**Date: 01 December 2022**

**Submitted by: Director of Transformation, Communities and Corporate Services**

**1. Purpose of Report**

- 1.1 The Local Government Pension Scheme Regulations require that administering authorities maintain and update a Statement of Investment Principles (SIP) from time to time, and that they review pension fund investments and the performance of their managers at least once every three months.
- 1.2 Implementation of the investment strategy determined by the Pensions Committee is delegated to the Chief Finance Officer, who takes advice from the Joint Investment Strategy Panel (JISP). An update on the Panel meeting on 5 December 2022 will be given at the next meeting.
- 1.3 This paper presents:
  - an update on recent investment market developments
  - an update on the Fund's strategic allocation and performance
  - an update on monitoring activity of the Fund's investment mandates during the most recently completed quarter.

**2. Recommendations**

**2.1 The Committee and Board are asked to note:**

- (i) recent investment market developments
- (ii) the Fund's strategic allocation
- (iii) the Fund's performance for the period ending 30 September 2022
- (iv) the investment monitoring activity of the JISP

### **3. Market Review and Outlook**

- 3.1 Sentiment in asset markets year-to-date has been primarily influenced by the path of inflation and interest rates and, in turn, global economic growth. Against this backdrop, there was little respite for investors in the third quarter of 2022. Inflation figures for most major economies exceeded market estimates in the quarter and central banks reasserted their commitments to do whatever necessary to bring inflation under control. Emboldened by labour market data which remains robust for now, central banks maintained the rapid pace of monetary tightening in order to slow economic activity; corporate earnings reports suggest that this is already underway. Consumer cost-of-living pressures continue to be amplified by the ongoing conflict in Ukraine as well as lingering supply chain disruptions in Asia. Considerable uncertainty remains around the outlook, and while a resolution to the Ukraine-Russia conflict presents a potential positive catalyst for asset prices, there is also scope for things to get worse before they get better.
- 3.2 For the three months to end September 2022, global equity markets rose 1.4% in sterling terms. However, it was only the extreme weakness of the pound that saved equity markets from recording their third straight quarter of declines. In US dollar terms, equities fell 6.8%. While dollar strength has been a persistent feature this year, the UK's political instability and dimmer economic outlook have compounded the pound's relative weakness. Despite a strong start to the third quarter, equities reversed course midway through the period, erasing their earlier gains, with few areas escaping the downdraft.
- 3.3 Bonds offered no shelter from the volatility experienced in equity markets. This was most evident in the UK where gilt yields surged following the Truss government's 'mini-budget', which seemed set to markedly worsen public finances. Some order was restored when the Bank of England intervened in the market, announcing temporary purchases of long-dated bonds "on whatever scale is necessary". Nevertheless, 10-year gilt yields breached 4% for the first time since the 2008 financial crisis, leading to sharply negative returns over the quarter. The UK's chastening experience exemplifies the challenges facing central banks and governments as they negotiate an uncertain and unfamiliar economic environment. The pace and duration of further monetary tightening will play a significant role in the path of asset prices and the broader economy. With the notable exception of Japan, most central banks reiterated their hawkish stances in the quarter, though with recessionary fears coming into focus their resolve to fight inflation may yet be tested.

### **4. Fund Strategy**

- 4.1 Following completion of the 2020 actuarial valuation, the Fund took part in a joint investment strategy review in 2021 alongside Lothian and Fife. The results of the review were presented to the Funds' respective Committees during Q2 2021 and the Falkirk Council Pension Fund Committee agreed its own revised investment strategy in late June 2021.

- 4.2 The Fund's strategic asset allocation is presented in Table 1 (below) with the target weighting for each of the five policy groups and ranges around the target strategy within which the Chief Finance Officer is permitted to operate. The policy groups are presented in the order of most to least volatile and highest to lowest expected real return over the long term. The key focus of the Pensions Committee is on investment strategy and oversight, in line with its responsibility for the overall funding and investment arrangements and the level of investment risk within the Fund.

**Table 1**

<b>Falkirk</b>		
<b>Policy Group</b>	<b>Current Strategy (agreed June 2021)</b>	<b>Permitted Range</b>
Equities	60%	50% - 70%
Real Assets	20%	10% - 30%
Non-Gilt Debt	10%	0% - 20%
LDI (formerly Gilts)	10%	0% - 20%
Cash	0%	0% - 15%
<b>Total</b>	<b>100%</b>	<b>100%</b>

- 4.3 Table 2 below shows the change in asset allocation by Policy Group over 12 months to 30 September 2022. The Fund has continued to make investments in areas previously identified by Committee in order to move towards its strategic allocation. Recent investment activity has increased the Fund's allocations to Real Assets, LDI and Cash while sourcing funds from Equities, and the Other category which is now fully divested.

**Table 2: Quarterly asset allocations – 30 September 2021 to 30 September 2022**

<b>Policy Group</b>	<b>Actual Allocation</b>					<b>Strategy Allocation</b>	<b>Actual less Strategy</b>
	<b>30 Sep 2021</b>	<b>31 Dec 2021</b>	<b>31 Mar 2022</b>	<b>30 Jun 2022</b>	<b>30 Sept 2022</b>	<b>30 Sept 2022</b>	<b>30 Sept 2022</b>
Equities	62.5%	63.1%	63.0%	63.3%	60.8%	60%	0.8%
Real Assets	15.1%	15.6%	17.1%	19.9%	20.9%	20%	0.9%
Non-Gilt Debt	6.3%	6.7%	7.7%	7.5%	7.2%	10%	-2.8%
LDI	4.0%	4.6%	5.9%	5.9%	7.5%	10%	-2.5%
Cash	5.0%	2.9%	2.3%	1.6%	3.6%	0%	3.6%
Other	7.2%	7.1%	3.9%	1.8%	0.0%	0%	0.0%
	100%	100%	100%	100%	100%	100%	-

Source: PE Reporting, Managers

4.4 Table 3 below presents a more recent view of the Fund's policy group allocations.

**Table 3**

**11 November 2022**

<b>£3,088m</b>	<b>Manager</b>	<b>Permitted Range</b>	<b>Strategy</b>	<b>Actual</b>	<b>Actual - Strategy</b>
<b>EQUITIES</b>					
Passive Equity (UK 36%/O'seas 64%)	LGIM			15.3%	
Fundamental Weighting Global Equity	LGIM			5.3%	
UK Value Equity	Schroder			10.9%	
Global Thematic Equity	Newton			12.9%	
Global Environmental Opportunities	Pictet			5.3%	
Global Low Volatility (GLOVE)	LPFI			10.0%	
<i>Listed Equity Subtotal</i>				59.8%	
Private Equity LPs	Wilshire/ASCapital			1.2%	
<i>Private Equity Subtotal</i>				1.2%	
<b>Total Equities</b>		<b>50 - 70%</b>	<b>60%</b>	<b>61.0%</b>	<b>1.0%</b>
<b>REAL ASSETS</b>					
Property	Various			6.0%	
Property (Affordable Housing)	Hearthstone			0.8%	
Infrastructure FoF	Grosvenor Capital			0.5%	
Infrastructure	Various			12.6%	
Timberlands	Various			0.3%	
<b>Total Real Assets</b>		<b>10 - 30%</b>	<b>20%</b>	<b>20.2%</b>	<b>0.2%</b>
<b>NON-GILT DEBT</b>					
Liquid Credit (Corporate Bonds)	Baillie Gifford			2.8%	
Corporate Bonds	LGIM			0.5%	
TIPS	Internal			1.6%	
Illiquid Credit (Private Debt)	Various			2.3%	
<b>Total Non-Gilt Debt</b>		<b>0 - 20%</b>	<b>10%</b>	<b>7.2%</b>	<b>-2.8%</b>
<b>LDI (Formerly Gilts)</b>					
Nominal Gilts	Baillie Gifford			1.1%	
Index-Linked Gilts	In-house			5.9%	
<b>Total LDI</b>		<b>0 - 20%</b>	<b>10%</b>	<b>7.0%</b>	<b>-3.0%</b>
<b>CASH (7-day LIBID)</b>					
Cash	Various			4.6%	
<b>Total Cash</b>		<b>0 - 15%</b>	<b>0%</b>	<b>4.6%</b>	<b>4.6%</b>
<b>TOTAL</b>				<b>100%</b>	

Sources: NT/Committee Papers

## **5. Fund Returns**

- 5.1 The Chief Finance Officer and JISP will be reviewing the rates of return achieved by the Fund and its managers up to end September 2022 at the Panel's next meeting on 5 December 2022. These returns are measured against pre-determined benchmarks, as calculated by its independent provider of performance measurement services, Portfolio Evaluation (PE). The latest figures provided for Q3 2022 are shown in Appendix 1.
- 5.2 The Chief Finance Officer and JISP review and assess returns and manager implementation in the context of risk taken, mandate constraints and objectives, which depend on the type of mandate awarded. These objectives are shown in Appendix 3, which is an excerpt from the Statement of Investment Principles.
- 5.3 The total Fund returned -0.6% over Q3 2022 ahead of the benchmark return of -5.1%. It is important to note that the Fund benchmark is aligned to a long term, not quarterly, objective. In addition, the Fund's private market assets are not valued as frequently as listed assets and benchmarks. Consequently, it is more appropriate to consider long term data for assessment purposes.
- 5.4 Long term return data shows Fund appreciation of 7.4% per annum since September 2001, which is ahead of the benchmark return of 6.4% per annum. Over the 5-year period the Fund rose 5.9% per annum compared with the benchmark gain of 3.2% per annum. Over the 5-year period, the Fund benefited from its exposure to overseas equities (which performed much better than UK equities partly due to sterling weakness against overseas currencies), while UK bonds have generated negative returns.
- 5.5 While the above data shows strong growth in assets over mid- and long-term time periods, the funding level is determined by a combination of the growth in assets and changes in liabilities.
- 5.6 The funding position at 31 March 2020 was assessed by the Fund's actuary, Hymans Robertson, as part of the formal triennial actuarial valuation process in Q1 2021. The 2020 valuation funding level of 94% is an improvement from the previous valuation funding level of 92% (at 31 March 2017). As the Fund's assets have increased in value significantly since 31 March 2020 (from £2.3bn to £3.1bn at 11 November 2022), and interest rates have risen significantly, we estimate that the funding level has improved.

## **6. Investment Manager Monitoring**

- 6.1 The Fund's allocation to Managers within asset classes is typically a less significant driver of returns and risk than the strategic allocation. The Chief Finance Officer monitors Managers quarterly as per the regulations, supported by the JISP and the internal teams at Falkirk and Lothian who review Managers and portfolios quarterly and attends meetings/calls with Managers at least 3 out of 4 quarters in the year. Reporting is conducted using a traffic light system, which highlights issues and concerns across a range of areas, including portfolio activity, portfolio construction, portfolio risk and return as well as business operations.

- 6.2 Full details of each Manager's portfolio activity and any engagement with companies on corporate governance issues are recorded in their individual quarterly investment reports, which have been uploaded to the SharePoint portal.

## **7. Conclusion**

- 7.1 Over the short term, financial markets and risk assets have delivered a marginally negative return with the Fund declining -0.6% during Q3 2022. Over 5 years, the Fund has achieved an absolute return of 5.9% per annum, above its benchmark return of 3.2% per annum.
- 7.2 The JISP monitors the Fund's investment managers and portfolios and advises the Chief Finance Officer quarterly in line with the regulations.

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## **Appendices**

Appendix 1 – Performance Measurement (Rates of Return)  
Appendix 2 – Private Markets Commitments  
Appendix 3 – Mandate Benchmarks and Objectives

## **List of Background Papers**

Portfolio Evaluation – Quarterly Risk and Return Analysis, 30 September 2022

## PERFORMANCE MEASUREMENT (RATES OF RETURN)

Rates of Return by Manager with Excess Returns - 30 September 2022							
			Annualised returns (where > 3 months)				
Fund/Portfolio	Market Value (£m)	Weight	3 months	3 year	5 year	Since inception	Inception Date
<b>Falkirk Council Pension Fund</b>	2,993.2	100%	-0.6%	4.8%	5.9%	7.4%	Sep-01
Benchmark			-5.1%	-0.2%	3.2%	6.4%	
Excess Return			4.5%	5.0%	2.7%	1.1%	
<b>Schroders UK Equity</b>	324.1	10.8%	-7.0%	3.9%	2.8%	6.8%	Sep-01
Benchmark			-3.4%	0.8%	2.2%	4.8%	
Excess Versus Benchmark			-3.6%	3.1%	0.6%	2.0%	
<b>LGIM Global Low Volatility Equity</b>	0.9	0.0%	3.2%	4.4%	-	6.0%	Jul-19
Benchmark			1.4%	7.2%	-	7.7%	
Excess Versus Benchmark			1.8%	-2.9%	-	-1.7%	
<b>LPFI Glove</b>	303.8	10.1%	-0.3%	-	-	3.7%	Jun-22
Benchmark			1.4%	-	-	4.5%	
Excess versus Benchmark			-1.7%	-	-	-0.8%	
<b>Newton Global Thematic</b>	386.5	12.9%	1.4%	6.5%	9.1%	10.0%	Jun-06
Benchmark			1.4%	7.2%	8.4%	9.2%	
Excess Versus Benchmark			0.0%	-0.7%	0.7%	0.8%	
<b>Legal &amp; General Passive</b>	461.3	15.4%	-0.6%	5.1%	6.3%	11.0%	Jan-09
Benchmark			-0.6%	4.9%	6.2%	10.9%	
Excess Versus Benchmark			0.0%	0.1%	0.1%	0.1%	
<b>Pictet Global Environment</b>	148.9	5.0%	5.8%	-	-	3.3%	Mar-21
Benchmark			1.4%	-	-	3.5%	
Excess Versus Benchmark			4.4%	-	-	-0.2%	
<b>Legal &amp; General Fundamental</b>	157.2	5.3%	0.8%	7.2%	7.2%	8.0%	Nov-16
Benchmark			0.7%	7.0%	7.1%	7.9%	
Excess Versus Benchmark			0.1%	0.2%	0.1%	0.1%	
<b>Private Equity Multi-Manager</b>	38.1	1.3%	0.0%	8.1%	-	11.6%	Jun-18
Benchmark			1.5%	7.7%	-	8.4%	
Excess Versus Benchmark			-1.5%	0.4%	-	3.2%	
<b>Infrastructure Multi-Manager</b>	403.9	13.5%	7.2%	17.3%	15.8%	15.8%	Sep-17
Benchmark			-17.8%	-13.0%	-4.9%	-4.9%	
Excess Versus Benchmark			24.9%	30.3%	20.6%	20.6%	
<b>Property Multi-Manager</b>	197.8	6.6%	-4.0%	9.6%	-	9.6%	Oct-19
Benchmark			-4.0%	7.6%	-	7.6%	
Excess Versus Benchmark			0.0%	2.0%	-	2.0%	
<b>Hearthstone Social / Affordable</b>	24.2	0.8%	1.7%	7.2%	4.6%	2.8%	Nov-14
Benchmark			2.7%	8.1%	6.8%	5.9%	
Excess Versus Benchmark			-1.0%	-0.9%	-2.2%	-3.1%	
<b>Baillie Gifford Investment Grade *</b>	32.0	1.1%	-11.1%	-7.0%	-2.2%		Mar-07
Benchmark			-11.6%	-7.0%	-2.3%		
Excess Versus Benchmark			0.5%	0.0%	0.1%		
<b>Baillie Gifford Sterling Aggregate *</b>	91.0	3.0%	-12.3%	-8.2%	-2.9%		Mar-07
Benchmark			-12.2%	-8.2%	-2.8%		
Excess Versus Benchmark			-0.1%	0.0%	-0.1%		
<b>LGIM 6A Corporate Bond Fund</b>	15.7	0.5%	-10.6%	-	-	-11.0%	Sep-20
Benchmark			-10.6%	-	-	-11.0%	
Excess Versus Benchmark			0.0%	-	-	-0.1%	
<b>LPFI Index-Linked Gilts*</b>	177.6	5.9%	-7.5%	-	-	-21.1%	Dec-20
Benchmark			-11.1%	-	-	-22.8%	
Excess Versus Benchmark			3.6%	-	-	1.7%	
<b>Private Debt Multi-Manager</b>	73.8	2.5%	4.6%	8.4%	-	6.9%	Jun-18
Benchmark			1.7%	4.5%	-	4.6%	
Excess Versus Benchmark			3.0%	3.9%	-	2.3%	
<b>Cash Fund</b>	106.7	3.6%	1.0%	-0.1%	0.6%	1.9%	Sep-01
Benchmark			0.4%	0.3%	0.4%	1.8%	
Excess Versus Benchmark			0.6%	-0.5%	0.2%	0.1%	
<b>LPFI US TIPS</b>	50.0	1.7%	-4.1%	-	-	-22.9%	Nov-21
Benchmark			-5.2%	-	-	-21.7%	
Excess Versus Benchmark			1.1%	-	-	-1.2%	

Notes:

1. There are small rounding effects in the table above.
2. The independent performance measurement provider shows a slightly different performance for Baillie Gifford than the manager itself. This is due to intra-day valuation timing differences.
3. Manager return figures have been provided for Baillie Gifford Sterling Aggregate and Corporate Bond mandates (since inception figures not available for Baillie Gifford) and LPFI Index Linked Fund.

**PRIVATE MARKET COMMITMENTS**

<b>Falkirk Council Pension Fund Limited Partnerships</b>	<b>Market Value 30/06/2022 (£m)</b>	<b>Market Value 30/09/2022 (£m)</b>	<b>% of Fund</b>	<b>Fundings Q3, 2022 (£m)</b>	<b>Distributions Q3, 2022 (£m)</b>	<b>Unfunded Commit (£m)</b>	<b>Unfunded Commit % of Fund</b>
In House Infrastructure	299.3	327.0	10.9%	23.7	8.7	25.0	0.8%
Infrastructure FOF	63.0	67.1	2.2%	0.3	2.7	8.2	0.3%
Private Equity	38.6	38.1	1.3%	0.1	3.3	13.8	0.5%
Affordable Housing	24.9	24.3	0.8%	-	0.3	-	0.0%
Private Debt	64.8	72.8	2.4%	6.1	1.3	31.3	1.0%
Timber	9.7	9.7	0.3%	-	-	-	0.0%
<b>Total Limited Partnerships</b>	<b>500.3</b>	<b>539.0</b>	<b>17.9%</b>	<b>30.2</b>	<b>16.3</b>	<b>78.3</b>	<b>2.6%</b>

**MANDATE BENCHMARKS AND OBJECTIVES**

<b>Fund Manager</b>	<b>Benchmark</b>	<b>Objective</b>
<b>Listed Equities Active</b>		
Newton Inv Management	MSCI All Countries World Index	To outperform the benchmark by 3% pa net of fees over rolling 5 year period
Schroders UK Equity	FTSE All Share Index	To outperform the benchmark by 1.25% pa net of fees over rolling 3 year period
LPFI Global Low Volatility	MSCI All Countries World Index	To achieve a better risk-adjusted return than the benchmark over a full market cycle
Pictet Global Env' Opp'ties	MSCI All Countries World Index	To outperform the benchmark by investing in securities with positive environmental impact
<b>Listed Equities Passive</b>		
Legal and General	Composite of Regional Indices	To perform in line with the benchmark over all periods
Legal and General Fundamental	RAFI Global Reduced Carbon Pathway Index	To perform in line with the benchmark over all periods
<b>Private Equity/Debt</b>		
Wilshire Capital	MSCI World Index	To outperform the benchmark by 5% pa net over the life cycle of the fund
abrdn Capital	MSCI Europe Index	To outperform the benchmark by 5% pa net over the life cycle of the fund
Private Debt	3 month SONIA + 4% pa	To perform in line or above the benchmark net of fees over the life cycle of the funds
<b>Property</b>		
LPFI Multi-Manager Property	AREF-MSCI All Balanced Property Index	Over 15 year FTSE Gilts Index + 2.5% pa over the long term
<b>Bonds</b>		
BG Sterling Aggregate	50% FTSE-A UK Gilts All Stocks Index 50% ICE BofA Sterling Non-Gilt Index	To outperform the benchmark by 0.65% pa net of fees over rolling 3 year period
BG Investment Grade	ICE BofA Sterling Non-Gilt Index	To outperform the benchmark by 0.5% pa net of fees over rolling 3 year period
LGIM 6A Corporate Bonds	iBoxx Sterling Non-Gilts ex-BBB Index	To perform in line with the benchmark within +/- 0.5%
LPFI Index-Linked Gilts	FTSE-A Index Linked Over 15yr Index	To perform in line with the benchmark
LPFI US TIPS	ICE US Treasury Inflation Linked Bond 15yr+ Index	To perform in line with the benchmark within +/- 0.5%
<b>Infrastructure</b>		
Grosvenor	RPI	To achieve a net return of 10% over the life cycle of the funds
LPFI Infrastructure	RPI	Over 15 year FTSE Gilts Index + 2.5% pa over the long term
<b>Social/Affordable Housing</b>		
Hearthstone	RPI	RPI Index +2% pa