CLWYD PENSION FUND COMMITTEE	
Date of Meeting	Wednesday, 21 June 2023
Report Subject	Economic and Market Update and Performance Monitoring Report
Report Author	Head of Clwyd Pension Fund

EXECUTIVE SUMMARY

The purpose of this report is to update the Committee on the Economy and Markets, and the Performance of the Fund's investments. The reports cover periods ending 31 March 2023 and are attached as appendices to this report.

Economy and Markets

- Inflation and central bank policy were once again key market drivers over the quarter, as both the Federal Reserve and the Bank of England raised interest rates.
- Headline inflation continued to slow in major developed economies, except for the UK, but core inflation remained more elevated than expected.
- Resilient growth, receding inflation and expectations of banking distress not becoming systemic for now led to overall positive equity and bond performance over the quarter.
- Global equities posted strong returns over the quarter returning +4.3% (+7.0% local currency terms).

Performance Monitoring Report

- Over the three months to 31 March 2023, the Fund's total market value increased in value by £80.9m to £2,289.2m.
- Fund Performance over 3 months, 12 months and 3 years; +3.7%, -6.4% and +9.5% p.a., respectively.
- Performance over the 12 month period was largely driven by rises in gilt yields.
- Fund Performance is ahead of the composite benchmark for the 3 year period, though behind in relation to the 3 month and 12 month periods.
- Physical equity positions are underweight to target allocations, however an implementation plan is in place to increase the Fund's developed equity exposure towards the recently agreed 15% target. The CRMF remained overweight to its target, however, all positions are within target ranges as at quarter end.

Performance of the Fund is reviewed monthly by the Fund's Officers and advisers.

RECOMMENDATIONS	
1	That the performance of the Fund over periods to the end of March 2023 are noted along with the Economic and Market update.

REPORT DETAILS

1.00	INVESTMENT AND FUNDING RELATED MATTERS
1.01	**Economic and Market Update** The economic and market update for the quarter from the Fund's Investment Consultant is attached at Appendix 1. The report contains the following key sections: • **Economic and Market Background** – an overview of markets in the quarter, including commentary on key economic indicators • **Equity Market Review** – information on the performance of equity markets during the quarter and key drivers of markets • **Bond Market (Fixed Income) Review** – provides an update on bond yield movements and interest rates for the period • **Currencies, Commodities and Alternatives Review** – provides an update on the performance of Sterling against other currencies as well as highlighting movements in major commodity and alternatives asset classes for the period
1.02	Investors welcomed the new year, following the worst year for equity and bond returns for over 150 years. However, the first quarter did not lack headlines. The demise of Silicon Valley Bank (SVB), the second largest US bank failure in history, and UBS's shotgun takeover of Credit Suisse were the major events of the quarter. Developed market central banks continued raising rates through the quarter as overall growth momentum remained robust. Headline inflation continued to slow in major developed economies, except for the UK, but core inflation remained more elevated than expected. Resilient growth, receding inflation and expectations of banking distress not becoming systemic, for now, led to overall positive equity and bond performance over the quarter. US GDP expanded by 2.7% over Q4 2022 quarter-on-quarter (annualised) and a similar figure is expected for Q1 2023. Headline US CPI moderated over the quarter falling to 6.0% in February 2023 from 6.5% at the end of December 2022. Core US inflation has also begun to decline in recent months but at a slowing rate. The Federal Reserve ('Fed') remained steadfast and increased rates by an additional 0.25% over Q1 2023, as it deemed the banking distress to be idiosyncratic and manageable through liquidity provisions. As at quarter end, the Fed economic forecasts show short term rates peaking at 5.125% in 2023, which implies another increase of 0.25% this year. However, the swaps market is pricing a lower peak, as well as cuts later in 2023. Quarter-on-quarter GDP growth was flat for the Eurozone in Q4 2022, strength in net exports were offset by a decline in investment spending. Energy prices in Europe continued their sharp decline which led to a further moderation in inflation during Q1 2023, even if core inflation rose.

	Nevertheless, the European Central Bank erred on the side of caution, raising rates from 2.5% to 3.5% and giving hawkish forward guidance. In the UK, quarter-on-quarter GDP was flat to the end of December 2022 (non-annualised) after declining 0.2% in the previous quarter. Inflation surprised to the upside in February after falling in January. Headline CPI inflation fell to 10.4% (year-on-year) at the end of February 2023, from 10.5% at the end of December 2022. The budget did not contain major surprises and progress was made in trade negotiations with the EU. The Bank of England increased rates from 3.5% to 4.25% but slowed the pace of rate increases from 50bps to 25bps at the March 2023 meeting. A verbal update will be provided to Committee on market movements since the writing of this report.
1.03	**Performance Monitoring report** Over the three months to 31 March 2023, the Fund's total market value increased in value by £80.9m to £2,289.2m. The Total Fund has decreased in value by £167.9m in 12 months to 31 March 2023. Movement over the 12 month period was largely driven by the rising gilt yields, impacting the CRMF portfolio as well as a slight detraction in Emerging Market Equities and Multi-Asset Credit. Since the end of Q4 2022, gilt yields have fallen and the portfolio has returned value. Further information on the CRMF mandate is provided in 1.04 below.
1.04	**Cash and Risk Management Framework (CRMF)** Over the 12 month period to 31 March 2023, performance of the framework has been down -34.8% as interest rates have risen and equity market volatility has increased. Though inflation protection has reduced the funding strain from the increase in actual and expected inflation since early 2022, the rise in gilt yields to date has resulted in a fall in value. This performance is in line with expectations and will have served to reduce volatility in the funding level and reduce risk, since the Fund's liabilities also decreased over the period. As a result of the increase in gilt yields, the Fund's CRMF has enabled the Fund to lock-in to attractive levels of return due to the interest rate trigger framework in place. The framework's equity protection mandate has also served to reduce funding level volatility relative to holding unprotected equities. As equity exposure is achieved synthetically, the addition of this mandate has increased risk-adjusted returns for the Fund (noting that absolute returns added are less than would have been achieved if investing in more volatile vanilla synthetic equity). For further information on the framework please refer to the Funding, Flightpath and Risk Management Framework Update, in particular sections 1.03 and 1.06.

1.05	It is appropriate to measure performance at a Total Fund level by comparing to a number of different targets: • The first of these is the assumed return that the Actuary includes within the triennial valuation - **Actuarial Target.** This is the most crucial target as actual performance needs to be ahead of this to ensure that the Fund maintains or improves its funding level. This is currently set at CPI (Consumer Price Index) +1.75% p.a. for past service liabilities and CPI + 2.25% for future service liabilities. • The second performance measure is the overall assessment of potential return when the Fund reviews and sets its investment strategy – **Strategic Target.** (This is currently CPI +3.4% p.a.) • The final target is the composite benchmark – **Total Benchmark.** This is a composite of each of the individual manager benchmarks, weighted by strategic target allocation. For most investment managers the benchmark does not include an expectation of outperformance. The performance against all benchmarks is shown on Page 11 of the report, and repeated below:

Total	**Quarter (%)**	**1 Year (%)**	**3 Years (%)**
Total Scheme	**+3.7**	**-6.4**	**+9.5**
Total Benchmark	+4.5	-4.6	+7.5
Strategic Target (CPI +3.4% p.a.)	+2.2	+13.8	+9.4
Actuarial Target – Past Service Liabilities (CPI +1.75% p.a.)	+1.8	+12.0	+7.7
Actuarial Target – Future Service Liabilities (CPI +2.25% p.a.)	+1.9	+12.5	+8.2

Note the above targets will change from next quarter to represent the new Actuarial Past and Future Service Liabilities Targets.

1.06	The strongest absolute returns over the quarter came from the Cash and Risk Management Framework (+11.6%), Timber/Agriculture (+6.0%), WPP Emerging Market Equity Fund (+5.7%) and WPP Global Opportunities Fund (+3.4%). The liability hedging portfolio performed positively (+11.6%) over the quarter to 31 March 2023, as real yields fell and equity markets generated positive returns. Local/ Impact and WPP MAC Fund also generated positive returns of +3.3% and +1.9%, respectively. Over the 12 months to 31 March 2023, the Private Market portfolio generated the strongest returns (+10.1%). Within the Private Market portfolio, Timber/Agriculture, Local/ Impact and Infrastructure generated the highest returns of +29.2%, +22.9% and +19.6%, respectively. The performance of individual managers is shown in the report and is

	regularly reviewed by Officers and advisers. At this stage there are no concerns that need addressing, however all positions are being monitored closely.
1.07	All portfolio allocations held sit within the agreed strategic tolerance with the exception of Infrastructure within Private Markets, which is marginally underweight.

2.00	**RESOURCE IMPLICATIONS**
2.01	None directly as a result of this report.

3.00	**CONSULTATIONS REQUIRED / CARRIED OUT**
3.01	None directly as a result of this report.

4.00	**RISK MANAGEMENT**
4.01	The Fund's investment strategy has been designed to provide an appropriate trade-off between risk and return. The Fund faces three key investment risks: Equity Risk, Interest Rate Risk and Inflation Risk. Diversification of the Fund's growth assets away from Equities seeks to reduce the amount of the equity risk (though it should be recognised that Equities remain an important long term source of expected growth). The implementation of the Fund's De-Risking Framework (Flightpath) has been designed to mitigate the Fund's Interest Rate and Inflation Risks.
4.02	This report addresses some of the risks identified in the Fund's Risk Register. Specifically, this covers the following (either in whole or in part): • Governance risk: G2 • Funding and Investment risks: F1 - F6
4.03	The Flightpath Strategy manages/controls the interest rate and inflation rate impact on the liabilities of the Fund to give more stability of funding outcomes and employer contribution rates. The Equity option strategy will provide protection against market falls for the synthetic equity exposure via the Insight mandate only. The collateral waterfall framework is intended to increase the efficiency of the Fund's collateral, and generate additional yield in a low governance manner. Hedging the currency risk of the market value of the synthetic equity portfolio will protect the Fund against a strengthening pound.

5.00	**APPENDICES**
5.01	Appendix 1 – Economic and Market Update – 31 March 2023 Appendix 2 – Performance Monitoring Report – 31 March 2023

6.00	LIST OF ACCESSIBLE BACKGROUND DOCUMENTS
6.01	Economic and Market Update and Performance Monitoring Report 31 December 2022. **Contact Officer:** Philip Latham, Head of Clwyd Pension Fund **Telephone:** 01352 702264 **E-mail:** philip.latham@flintshire.gov.uk

7.00	GLOSSARY OF TERMS
7.01	A list of commonly used terms are as follows: (a) **Absolute Return –** The actual return, as opposed to the return relative to a benchmark. (b) **Annualised –** Figures expressed as applying to 1 year. (c) **Duration –** The weighted average time to payment of cash flows (in years), calculated by reference to the time and amount of each payment. It is a measure of the sensitivity of price/value to movements in yields. (d) **Market Volatility –** The impact of the assets producing returns different to those assumed within the actuarial valuation basis, excluding the yield change and inflation impact. (e) **Money-Weighted Rate of Return –** The rate of return on an investment including the amount and timing of cash flows. (f) **Relative Return –** The return on a fund compared to the return on index or benchmark. This is defined as: Return on Fund minus Return on Index or Benchmark. (g) **Three-Year Return –** The total return on the fund over a three year period expressed in percent per annum. (h) **Time-Weighted Rate of Return –** The rate of return on an investment removing the effect of the amount and timing of cash flows. (i) **Yield (Gross Redemption Yield) –** The return expected from a bond if held to maturity. It is calculated by finding the rate of return that equates the current market price to the value of future cash flows. **A comprehensive list of investment terms can be found via the following link:** https://www.schroders.com/en/uk/adviser/tools/glossary/