

## CLWYD PENSION FUND COMMITTEE

<b>Date of Meeting</b>	Wednesday 11 September 2024
<b>Report Subject</b>	Funding and Investment Performance
<b>Report Author</b>	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, as well as the funding and risk management framework. Separate reports covering these areas for the period ending 30 June 2024 are attached as appendices.

#### **Economy and Markets**

- Inflation rates softened over Q2 2024, leading to a shift towards monetary policy easing in most developed market economies. The European Central Bank (ECB) cut interest rates in June, while the US Federal Reserve (Fed) is expected to reduce interest rates by the end of the year. Headline inflation in the UK fell to 2.0% at the end of June allowing the Bank of England (BoE) Monetary Policy Committee (MPC) to reduce interest rates by 25 bps to 5%.
- Equity markets continued to rally during the second quarter of 2024, whilst UK Gilts fell in value as yields rose.

#### **Performance Monitoring Report**

- The Fund's total market value decreased by £14.8m to £2,460.5m over the three-month period, allowing for net cash outflows of £12.2m.
- Fund absolute performance over 3 months, 12 months, 3 years and 5 years; -0.1%, +9.5%, +3.0% p.a. and +5.5% p.a., respectively.

#### **Funding and Risk Management**

As of 30 June 2024:

- The estimated funding position was 108%, which is ahead of the expected funding level from the 2022 valuation by 4%.
- The total gain since inception of the synthetic equity strategy is c. £193m.
- The hedging collateral is in a healthy position, with the current level of collateral more prudent than that required by the Pensions Regulator. The yield trigger framework is currently suspended.
- Overall, the Fund's currency hedge is performing as expected as a risk-mitigation and diversification strategy.

### **RECOMMENDATIONS**

1	That the Committee note the report and the various actions taken in relation to the funding and risk management framework.
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## REPORT DETAILS

1.00	<b>INVESTMENT PERFORMANCE AND ECONOMIC RELATED MATTERS</b>
1.01	<p><b>Economic and Market Update</b></p> <p>The economic and market update for the quarter from the Fund's Investment Consultant is attached in Appendix 1. The report contains the following key sections:</p> <ul style="list-style-type: none"><li>• <b>Economic and Market Background</b> – an overview of markets in the quarter, including commentary on key economic indicators</li><li>• <b>Equity Market Review</b> – information on the performance of equity markets during the quarter and key drivers of markets</li><li>• <b>Bond Market (Fixed Income) Review</b> – provides an update on bond yield movements and interest rates for the period</li><li>• <b>Currencies, Commodities and Alternatives Review</b> – 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</li></ul>
1.02	<p>The second quarter of 2024 witnessed a softening of inflation rates in most developed market economies, bringing them closer to central banks' targets. This created a favorable environment for a shift towards monetary policy easing. In June, the ECB cut interest rates, while the US Fed is expected to cut rates by the end of the year.</p> <p>Equity markets, except for Japanese equities, continued to rise, with emerging market equities outperforming developed markets. Political volatility remained high, with snap elections in the UK and France.</p> <p>During the quarter gilt yields rose, meaning the value of gilts fell, however post quarter end, the BoE cut interest to 5%, which led to gilt yields falling / prices rising.</p> <p>Equity markets, except for Japanese equities, continued to rally, with emerging market equities outperforming developed markets. Political volatility remained high, with snap elections in the UK and France.</p> <p>Further information on the CRMF mandate is provided in 1.07 below.</p>
1.03	<p><b>Performance monitoring report</b></p> <p>Over the three months to 30 June 2024, the Fund's total market value decreased marginally by £14.8m to £2,460.5m, after allowing for net cash outflows of £12.2m.</p> <p>Movement over the 12-month period saw positive performance from all asset classes, with the exception of property.</p>

Total Fund performance against its benchmark is shown below:

Total	Quarter (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)
Total Fund	-0.1	+9.5	+3.0	+5.5
Total Benchmark	+1.6	+13.1	+4.4	+6.4

A full performance breakdown of each of the underlying mandates is provided in Appendix 2.

1.04

### Performance Commentary

The Fund's 1-year performance was lower than the benchmark. The allocation to the WPP Sustainable Active Equity Fund ("WPP SAE") was a large detractor from performance as it returned +14.0% against a target of +22.4% over the 1-year period.

The Fund has underperformed partly as a result of being underweight notable large-cap stocks such as Nvidia, Meta, Alphabet and Google but also in-line with the experience of sustainability-oriented strategies.

The Fund's private market holdings also underperformed over the 12-month period to 30 June 2024. This relative performance was driven by weak returns from Property and flat returns from the Fund's local/impact allocation. These assets are benchmarked against an absolute return benchmark and a market reference rate with an excess spread target (e.g. SONIA +5.0% p.a.) for performance measurement. Therefore, the performance will appear further weakened against these types of benchmarks during this period. It should also be noted that over the last three years the Fund's local/impact investments have returned c.16% p.a., so there is no undue concern from a short period of flat performance. New private market investments are being made through the WPP pool where possible, whilst Local/Impact investments are being made outside the pool given the pool is not set up to make such investments at this moment in time.

The Fund's Tactical Asset Allocation portfolio continues to provide strong returns, returning +7.8% over 12-month period to 30 June 2024, outperforming its benchmark (+5.9%).

1.05

### Performance Highlights

The strongest absolute returns over the quarter came from WPP Private Equity (+12.2%) and WPP Multi Asset Credit (+1.3%) allocations.

Over the 12-month period, WPP Sustainable Active Equity Fund and WPP Infrastructure assets generated the strongest absolute returns, returning +14.0% and +16.9%, respectively.

Over the same period, the Risk Management Framework ("RMF") also generated strong returns of +17.9%. The RMF is made up of several components including liability driven investment, equity protection and

	<p>synthetic equity. The main purpose of this portfolio to provide stability to the Fund's funding level, hedging off a percentage of the Fund's liabilities to counteract any movement in interest rates and expected inflation.</p>
1.06	<p><b>Asset Allocation</b></p> <p>All portfolio allocations are within the agreed strategic tolerance with the exception of the Local/Impact allocation, which is marginally underweight. These tolerances are being addressed as part of ongoing commitments and transitions.</p> <p>The Strategic Cash and Liquidity ("SCL") allocation was close to its upper benchmark range at the end of June 2024. At the end of Q2 2024, the Fund was transitioning £25m from the SCL into the WPP Sustainable Active Equity Fund to rebalance the mandate closer to its 15% strategic allocation. This transaction was settled post quarter end. Additionally, the SCL is being utilised to support the Fund's ongoing liquidity needs and will fluctuate according to upcoming capital market drawdowns, as well as regular member benefit payments. Furthermore, additional commitments are planned to top up other areas of the portfolio to support the Fund's liquidity needs (increase allocation to income producing assets). When these investments take place the SCL is expected to move further towards its 5% strategic target. Officers and advisors acknowledge that there will be fluctuations within the SCL due to the nature of its positioning and objective in supporting the Fund's ongoing cashflow requirements. The position is being kept under regular review.</p>
1.07	<p><b>Update on Funding and the Flightpath Framework</b></p> <p>The monthly summary report as at 30 June 2024 from Mercer on the funding position and an overview of the risk management framework is attached in Appendix 3.</p>
1.08	<p>The estimated funding level was 108% at 30 June 2024, which is ahead of the expected position when measured relative to the 2022 valuation expected funding plan by 4%. The expected funding level will reduce over time as employers are using part of the valuation surplus in line with the agreed employer contributions commenced from 1 April 2023.</p> <p>As a reminder, the funding level trigger of 110% was breached at the end of February 2024 and prompted de-risking activity as agreed at the March 2024 Committee meeting. Equity exposure was reduced to be broadly equal to 35% of total Fund assets in late March. The FRMG and Committee will consider if a new funding level trigger should be adopted. The funding level continues to be monitored approximately by Mercer on a daily basis.</p>
1.09	<p>The level of liability hedging implemented to date provides access to a lower risk investment strategy by maintaining a sufficiently high real yield/return expectation to achieve the funding and contribution targets. Historically, liability hedging was implemented via a trigger framework, allowing the Fund to lock-in to real yields opportunistically. Given consideration of wider Fund liquidity and collateral requirements, the trigger framework is currently suspended.</p>

	<p>Collateral remains in a healthy position, with the portfolio able to withstand an interest rate rise in excess of 5%, whilst supporting suitable stresses on the other hedging exposures (equity and FX). The level of collateral is stronger than guidance issued by the Pensions Regulator. The Fund has a robust governance framework to regularly monitor collateral levels and take action quickly as needed. Further liquidity can be sourced from liquid assets held outside the Insight mandate at short notice, if required.</p>
1.10	<p>Based on latest data available from Insight, Mercer’s analysis shows that the management of the Insight Liability Hedging mandate is rated as “green” as at 31 March 2024, meaning it is operating in line within the tolerances monitored by Mercer.</p>
1.11	<p><b>Update on Risk Management Framework</b></p> <p><b>Synthetic equity and equity protection strategy</b></p> <p>Within the Risk Management Framework, the Fund gains exposure to equity markets via derivatives and protects this exposure against potential falls in equity markets via the use of an equity protection strategy. This provides further stability (or even a reduction) in employer contributions (all other things equal) in the event of a significant equity market fall, although it is recognised it will not protect the Fund in totality.</p> <p>Importantly, over the longer-term the increased certainty from the equity protection strategy allows the Actuary to include less prudence/buffer in the Actuarial Valuation assumptions; this translates into lower contributions at each valuation (all other things equal), whilst maintaining the equity exposure.</p> <p>The Fund has a bespoke synthetic equity and equity protection strategy, which is implemented through a Total Return Swap (“custom TRS”) contract with JP Morgan, held within the Insight mandate. The TRS contract is for a fixed term of 3 years up to May 2027, having been rolled over in May 2024 with no changes to the equity protection strategy.</p> <p>As at 30 June 2024, the total performance since inception of the custom TRS synthetic equity and equity protection strategy in May 2018 was an increase of c. £193.0m.</p>
1.12	<p><b>Currency hedging update</b></p> <p>Overall, the action to hedge the Fund’s developed equity currency risk has resulted in a loss of £24.4m since inception of the strategies, although this is expected to be fully offset by rises in value of the overseas equity holdings due to these same currency movements.</p>

<b>2.00</b>	<b>RESOURCE IMPLICATIONS</b>
2.01	None directly as a result of this report.

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

<b>4.00</b>	<b>RISK MANAGEMENT</b>
4.01	<p>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.</p> <p>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.</p>
4.02	<p>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):</p> <ul style="list-style-type: none"> <li>Funding and Investment risks: F1 - F6, F8, I1 – I3</li> </ul>
4.03	<p>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. Hedging the currency risk of the market value of the synthetic equity portfolio will protect the Fund against a strengthening pound, which would be detrimental to the Fund's deficit. Hedging the currency risk of the developed market physical equity exposure will mitigate the risk of a strengthening pound.</p>

<b>5.00</b>	<b>APPENDICES</b>
5.01	<p>Appendix 1 – Economic and Market Update – 30 June 2024  Appendix 2 – Performance Monitoring Report – 30 June 2024  Appendix 3 – Monthly Monitoring Report – 30 June 2024</p>

<b>6.00</b>	<b>LIST OF ACCESSIBLE BACKGROUND DOCUMENTS</b>
6.01	<ul style="list-style-type: none"> <li>Report to Pension Fund Committee – Overview of risk management framework – Previous monthly reports and more detailed quarterly overview.</li> </ul>

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7.00	GLOSSARY OF TERMS
7.01	<p>A list of commonly used terms are as follows:</p> <p>(a) <b>Actuary</b> - A professional advisor, specialising in financial risk, who is appointed by Pension Funds to provide advice on financial related matters. In the LGPS, one of the Actuary's primary responsibilities is the setting of contribution rates payable by all participating employers as part of the actuarial valuation exercise.</p> <p>(b) <b>Administering Authority or Scheme Manager</b> – Flintshire County Council is the administering authority and scheme manager for the Clwyd Pension Fund, which means it is responsible for the management and stewardship of the Fund.</p> <p>(c) <b>Absolute Return</b> – The actual return, as opposed to the return relative to a benchmark.</p> <p>(d) <b>Annualised</b> – Figures expressed as applying to 1 year.</p> <p>(e) <b>Clwyd Pension Fund (the “Fund”)</b> – The Pension Fund managed by Flintshire County Council for local authority employees in the region and employees of other employers with links to local government in the region.</p> <p>(f) <b>Clwyd Pension Fund Committee (the “Committee”)</b> - the Flintshire County Council committee responsible for the majority of decisions relating to the management of the Clwyd Pension Fund.</p> <p>(g) <b>Duration</b> – 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.</p> <p>(h) <b>FSS – Funding Strategy Statement</b> – the main document that outlines how we will manage employer's contributions to the Fund</p> <p>(i) <b>ISS – Investment Strategy Statement</b> The main document that outlines our strategy in relation to the investment of assets in the Clwyd Pension Fund</p> <p>(j) <b>LGPS – Local Government Pension Scheme</b> – the national scheme, which Clwyd Pension Fund is part of</p> <p>(k) <b>Market Volatility</b> – The impact of the assets producing returns different to those assumed within the actuarial valuation basis, excluding the yield change and inflation impact.</p>

- (l) **Money-Weighted Rate of Return** – The rate of return on an investment including the amount and timing of cash flows.
- (m) **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.
- (n) **Three-Year Return** – The total return on the fund over a three year period expressed in percent per annum.
- (o) **Time-Weighted Rate of Return** – The rate of return on an investment removing the effect of the amount and timing of cash flows.
- (p) **TPR LDI Guidance** – Guidance issued by the Pensions Regulator in April 2023 covering the use of leveraged liability-driven investment by pension schemes  
(<https://www.thepensionsregulator.gov.uk/en/document-library/scheme-management-detailed-guidance/funding-and-investment-detailed-guidance/liability-driven-investment>)
- (q) **Vanilla/unhedged Synthetic Equity** – Derivative contracts that enable the Fund to gain exposure to broad equity markets with no embedded equity protection. The change in value of vanilla contracts is perfectly correlated to the change in the value of broad equity market indices.
- (r) **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.

Further terms are defined in the Glossary in the report in Appendix 3 and a comprehensive list of investment terms can be found via the following link:  
<https://www.schroders.com/en/global/individual/investment-glossary/>.