CLWYD PENSION FUND COMMITTEE	
Date of Meeting	Wednesday, 15 February 2023
Report Subject	Investment Strategy Review
Report Author	Head of Clwyd Pension Fund

EXECUTIVE SUMMARY

The Fund last reviewed its investment strategy in 2019. The Investment Strategy Statement requires that the Fund's asset allocation is reviewed every three or four years. This is to ensure that it continues to achieve the funding and investment objectives.

There are a number of considerations when setting an investment strategy. Some of the key elements are:

- having an appropriate target rate of investment return to ensure assets are available to pay benefits whilst keeping employer contribution rates affordable
- understanding the risks associated with that target investment return
- the economic and market environment
- the Fund's Responsible Investment Policy objectives including the decarbonisation targets
- having regard to the Government's requirements in relation to the pooling of LGPS assets.

The investment consultant has produced modelling analysis both at 31 March 2022 and 30 September 2022. The analysis concluded that the existing investment strategy still broadly achieves the funding and investment objectives. However, a number of minor changes are recommended to continue to achieve these objectives.

If the proposed strategy changes are agreed, officers and advisors will consider an implementation plan, which will feature in the 2023/24 Business Plan

The Fund is required to publish the Investment Strategy Statement which has been updated to reflect the recommended changes and other changes to bring it up to date.

RECOMMENDATIONS	
1.	To agree the changes to the Fund's Strategic Asset Allocation (as shown in paragraph 1.07) of the Fund.
2.	To agree the proposed changes to the Investment Strategy Statement as highlighted in Appendix 2.

REPORT DETAILS

1.00	**REVIEW OF INVESTMENT STRATEGY AND STRATEGIC ASSET ALLOCATION**
1.01	**Background** The Fund last reviewed its investment strategy in 2019. The Investment Strategy Statement requires that the Fund's investment strategy is reviewed every three or four years. This is to ensure that the investment strategy continues to achieve the funding and investment objectives which are: • Achieve and maintain assets equal to 100% of liabilities within the 12-year average timeframe, whilst remaining within reasonable risk parameters • Determine employer contribution requirements, whilst recognising the constraints on affordability and strength of employer covenant, with the aim being to maintain as predictable an employer contribution requirement as possible • Recognising the constraints on affordability for employers, aim for sufficient excess investment returns relative to the growth of liabilities • Strike the appropriate balance between long-term consistent investment performance and the funding objectives • Manage employers' liabilities effectively through the adoption of employer specific funding objectives • Ensure net cash outgoings can be met as/when required • Minimise unrecoverable debt on employer termination • Ensure that its future strategy, investment management actions, governance and reporting procedures take full account of longer-term risks and sustainability • Ensure that the Fund's investments are aligned with the transition to a low carbon economy through a commitment to achieving a net zero carbon dioxide emission's target by 2045 • Promote acceptance of sustainability principles and work together with others to enhance the Fund's effectiveness in implementing these • Aim to use the Wales Pensions Partnership as the first choice for investing the Fund's assets subject to it being able to meet the requirements of the Fund's investment strategy and objectives (including sustainability requirements), within acceptable long-term costs to deliver the expected benefits and subject to ongoing confidence in the governance of the Partnership. These are based on the ultimate objective of ensuring there is sufficient assets to pay the benefits of the current and future beneficiaries of the Fund.
1.02	**2022/23 Review of the Fund's Investment Strategy** As agreed by Committee within the 2022/23 business plan, the Fund's investment strategy was due for review consecutively with the actuarial valuation as at 31 March 2022. As can be seen from the timelines in Appendix 1, this work commenced by the Fund officers and investment consultant in April 2022 and it was originally proposed to take recommendations to Committee in November 2022. However, due to the unexpected market conditions, further work was undertaken to ensure that any proposed changes to the investment strategy remained appropriate.

	The investment strategy review work by officers and investment consultant has now concluded and the proposed changes are being brought to Committee for consideration and approval. Committee members will recall that they received training on the investment strategy on 5 October 2022 which should assist in the understanding of these recommendations.
1.03	**Considerations for an investment strategy** There are a number of considerations when setting an investment strategy. Some of the key considerations are: - having an appropriate target rate of investment return to ensure assets are available to pay benefits whilst keeping employer contribution rates affordable - understanding the risks associated with that target investment return - the economic and market environment - the Fund's Responsible Investment Policy objectives including the decarbonisation targets - having regard to the Government's requirements in relation to the pooling of LGPS assets.
1.04	*Target investment return* When undertaking the actuarial valuation, the Fund Actuary makes a number of key assumptions which were presented to the Committee in November 2022 as proposals within the draft Funding Strategy Statement. These assumptions include a required rate of investment return. Although the valuation date is 31 March 2022, the significant market volatility within the UK government bonds markets in late September/early October 2022 prompted the Fund Actuary to carry out a review of some of their assumptions as at 30 September 2022, to consider their appropriateness particularly when reviewing the Fund's investment strategy. As at 30 September 2022 the Fund Actuary has suggested an assumed future rate of return of inflation (measured by the Consumer Prices Index (CPI)) plus 2.5%. It is therefore crucial that the Fund's investment strategy achieves a return in excess of this future service rate of CPI +2.5% ("target rate of return").
1.05	*Understanding the risks* In addition to the potential for investment return, the Fund's Investment Consultant also assesses the risk of not achieving the target rate of return on investments. Risk is assessed using a Value at Risk (VaR) approach: VaR is a measure of the risk of loss for investments. It estimates how much a set of investments might lose (with a given probability), given normal market conditions, in a set time period such as a day or a year.
1.06	**Analysis and results** When carrying out the review of the Fund's investment strategy, the investment consultant has produced modelling analysis both at 31 March 2022 and 30 September 2022. Further detail of the modelling is contained in Appendix 1. The analysis concluded that the existing investment strategy still broadly

	achieves the funding and investment objectives. In particular: • there is the Cash & Risk Management strategy, which is a significant proportion (23%) of the overall strategy, that on an ongoing basis assists in managing many risks; interest rate, inflation, currency, equity protection, which is subject to regular review. • in addition, there is the Best Ideas (tactical allocation) portfolio, which is 11% of the asset allocation, which is used to alter the risk position of the Fund on an ongoing basis, to attempt to benefit from more near term economic and market opportunities without disturbing the assets managed on a strategic basis. However, a number of minor changes are recommended.
1.07	*Proposed changes* The table below shows the Fund's Strategic Asset Allocation, showing the current target allocations and the proposed changes which relate to four areas of the Fund's asset allocations:

	Current target allocation (%)	Proposed allocation (Alt 1) (%)	Change
Global Equity	10.0	15.0	Increase
Emerging Market Equity	10.0	5.0	Reduce
Best Ideas Portfolio	11.0	11.0	-
Hedge Funds	7.0	5.0	Reduce
Multi-Asset Credit	12.0	12.0	-
Private Markets			
Property	4.0	4.0	-
Private Equity	8.0	8.0	-
Local/ Impact	4.0	6.0	Increase
Infrastructure	8.0	8.0	-
Private Credit	3.0	3.0	-
Stabilising Assets			
CRMF	23.0	23.0	-
Cash	-	-	-
Total	**100.0**	**100.0**	

1.08	The Fund's Investment Consultant has estimated, based on long term market forecasts that the new strategy will deliver a long term (10 year) return of CPI+4.7% per annum, compared to the existing strategy which delivers an estimated CPI+4.8% per annum based on market assumptions as at 30 September 2022. This forecast return of CPI+4.7% p.a. is comfortably ahead of the Fund Actuary's suggested required rate of return of CPI+2.5% p.a. (as at 30 September 2022). For the Clwyd Pension Fund the Investment Consultant has assessed that the target rate of return in the Fund's current investment strategy has a 95% three year VaR of £861m; meaning that there is a 95% confidence level that over a three year period the Fund's assets would not fall by more than £861m. The proposed changes to the investment strategy would result in a marginally lower three year VaR of £855m.
1.09	The overall result of this analysis is that the proposed changes to the

investment strategy would result in a marginally lower potential return than the current strategy (yet still comfortably outperforming the required rate of return assumed by the Fund Actuary) and a lower risk than the current strategy. The Fund's Investment Consultant will cover this in more detail in the presentation.

1.10 **Rational for proposed changes**

The key proposed changes to the Fund's investment strategy are explained in the following paragraphs:

Reduce allocation to Emerging Market Equities and increase allocation to Global Equities

- The Investment Consultant believes that an increased de-globalised world reduces the advantages of having significant overweight exposure to emerging markets, as witnessed in the last couple of decades. The political instability in various segments of emerging markets is leading to lumpy return profiles. This change is linked to this uncertainty in markets especially around Emerging Markets. The proposed reduced allocation to Emerging Market Equities from 10% to 5% allows for an increase in the allocation to Global Equities and an introduction of a new allocation to a Sustainable Active Equity Sub-Fund with WPP, which is being established to meet the Fund's Responsible Investment Policy. It is proposed that all of Fund's allocation to Global Equities be moved to the Sustainable Active Equity Sub-Fund.

Reduce Hedge Fund allocation

- It is proposed to reduce the strategic allocation to Hedge Funds from 7% to 5%. The Fund's investment consultant maintains the view of having an asset allocation that provides diversification from equity and credit risk. Therefore having exposure to a dynamic (i.e. continually changing) strategy will continue to add value in different market environments. Following the restructure of the hedge funds during the 2019 strategy review, the fund has continued to produce returns in excess of its target and therefore it is important to retain an allocation within the strategic portfolio. It is also worth highlighting that the Fund also has the ability to hedge various investment risks within the Cash and Risk Management allocation.

Increase allocation to the Local/Impact Fund

Following the introduction of the Local/Impact Fund following the 2019 investment strategy review, the Fund has continued to allocate to a range of illiquid asset classes within this portfolio. The Local/Impact portfolio plays an important role in the Fund's asset portfolio allowing investments to be made across a range of illiquid asset classes - Private Equity, Private Debt, Infrastructure and Real Estate - as well as being a key part of implementing the Fund's Responsible Investment Policy. The forthcoming DLUHC consultation will, amongst other aspects, focus on the Levelling Up agenda and how the LGPS can play a part in this. The focus will be on LGPS Funds allocating to "local" (Local has been stated to mean UK) investments at a minimum of 5% of total assets. The Fund's investment consultant proposes an increase to the allocation from 4% to 6%, this is to be funded through the reduction in allocation to Hedge Funds.

1.11	**Approval and next steps** Committee members are asked to consider and agree these changes. Officers and advisors will then consider an implementation plan, some of which is driven by the timing of the availability of the WPP Global Equity Sustainable Equity Fund and cash flow requirements. This will feature in the 2023/24 Business Plan.
1.12	**Investment Strategy Statement** The Fund is required to publish an Investment Strategy Statement and there is statutory guidance on its content. The Fund's Investment Strategy Statement has been updated to reflect the recommended changes and other changes to bring it up to date. The changes are highlighted. Committee members are asked to approve the Investment Strategy Statement which will then be published.

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

3.00	**CONSULTATIONS REQUIRED / CARRIED OUT**
3.01	The LGPS Investment regulations require that the Fund "consults with such persons as it considers appropriate as to the proposed contents of its investment strategy". The Fund's usual process for this is to consult with its employers and seek views. However, given the investment strategy review has effectively been "light touch" in nature it is not deemed necessary to consult on this occasion.

4.00	**RISK MANAGEMENT**
4.01	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 and F8
4.02	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 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 Protection 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 generating 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 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.

5.00	**APPENDICES**
5.01	Appendix 1 – Investment Strategy Review presentation Appendix 2 – Proposed Investment Strategy Statement (ISS)

6.00	**LIST OF ACCESSIBLE BACKGROUND DOCUMENTS**
6.01	N/A **Contact Officer:** Philip Latham, Clwyd Pension Fund Manager **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 cashflows (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 cashflows. (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 cashflows. (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. (j) **Value at Risk (VaR)** - a measure of the risk of loss for investments. It estimates how much a set of investments might lose (with a given probability), given normal market conditions, in a set time period such as a day. **A comprehensive list of investment terms can be found via the following link:** https://www.schroders.com/en/uk/adviser/tools/glossary/