CLWYD PENSION FUND COMMITTEE	
Date of Meeting	Wednesday, 30 August 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 30 June 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 remains high but has seen lower increases in the UK, with CPI at 8.7% for the year to May and 7.9% in the year to June.
- Global equities posted strong returns over the quarter returning +3.4%, whilst fixed interest and index-linked gilts detracted -8.3% and -7.8%, respectively.
- Sub investment grade credit markets performed well as high-yield market spreads tightened, helping to drive positive total returns.

Performance Monitoring Report

- Over the three months to 30 June 2023, the Fund's total market value decreased very modestly in value by £2.9m to £2,286.3m.
- Fund performance over 3 months, 12 months, 3 years and 5 years; +0.3%, +1.4% +6.0% p.a. and 4.8% p.a., respectively.
- Fund performance is ahead of the composite benchmark for the 3 year period, though behind in relation to the 3 month, 12 month and 5 year periods.
- The CRMF mandate remains overweight to its target, whilst the physical equity positions remain underweight. The first stage of implementation into the new WPP Sustainable Equity Fund was successful. A plan is now being finalised to increase the Fund's exposure towards the agreed 15% target. All positions are within target ranges as at quarter end.

The Fund's Officers and advisers review performance of the Fund on a monthly basis.

RECOMMENDATIONS	
1	That the performance of the Fund over periods to the end of June 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	The second quarter of 2023 saw the orderly resolution of the second largest bank failure in US history and further distress among US regional banks, ongoing economic resilience, declining inflation, an equity rally led by eight stocks, and increased geopolitical tensions, including an attempted coup in Russia. Developed market central bank actions were mixed over the quarter, with some deciding to pause hiking interest rates, and others continuing to increase the policy rate, but rhetoric remained hawkish. Headline inflation continued to slow and core inflation fell in most regions apart from the UK. Inflation expectations also continued to decline over the quarter. Overall, this led to investor optimism and thus positive performance for risk assets whereas government bond performance was negative because of increasing rates. In the UK, quarter-on-quarter GDP was marginally positive to the end of March 2023, after eking out a similar gain in the previous quarter. Headline inflation in the UK fell to 8.7% in May from 10.1% in March, by far the highest rate among large, developed economies. The Bank of England increased rates from 4.25% to 5%, initially increasing 25bps in May before hastening the pace of increases back to 50bps in June following a stronger than expected inflation print. UK real yields rose across the curve, led by the short end as the Bank of England remained in its hiking cycle. Real yields, for all maturities remain in positive territory. Market based measures of inflation expectations, in the form of breakeven inflation, rose over the quarter. The UK 10-year breakeven rate rose to 3.9%, c. 9 basis points ('bps') higher than at the end of last quarter. However, this masks some of the volatility witnessed in the quarter, as 10yr breakeven rates fell to 3.5% intra quarter. Market based measures of inflation expectations for the US fell over the quarter.

	Global equities returned 3.4% in sterling terms and 6.7% in local currency terms as sterling strengthened against the major currencies. Global equity markets exhibited extremely narrow leadership over the second quarter. Nvidia was the catalyst for a rally in technology stocks. Fewer than 10 stocks made up most of the S&P 500 return through Q2. Equity markets in the US have looked through the regional banking distress during the quarter. Earnings remained resilient, but analyst expectations point to a decline in the coming quarter. US equities returned 5.7% in sterling terms, compared to 8.7% in local currency terms, whilst European (ex-UK) equities returned 0.6% in sterling terms and 3.2% in local terms. Japanese equities returned 3.0% in sterling terms and 15.0% in local currency terms. The yen weakened sharply against sterling over the quarter. Emerging markets ('EM') equities returned -1.9% in sterling terms (1.4% local currency). Weakness in China over its underwhelming recovery following the end of Covid restrictions was offset by stronger returns in Taiwan, Brazil and India. China and the rest of EM have largely offset one another, leading to positive EM returns in absolute terms but still considerable underperformance against developed markets.
1.03	**Performance Monitoring report** Over the three months to 30 June 2023, the Fund's total market value decreased in value by £2.9m to £2,286.3m. The Total Fund has increased in value by £6.1m in 12 months to 30 June 2023, not accounting for net cashflows. Movement over the 12 month period saw positive equity and multi-asset credit performance. Whilst rising gilt yields, impacted the CRMF portfolio, causing a detraction in value. Since the end of Q1 2023, gilt yields have increased. 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 30 June 2023, performance of the framework has been down -12.2% 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 (of assets and liabilities). 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 these market movements. As a result of the increase in gilt yields, the Fund's Flightpath has enabled the Fund to lock-in to attractive levels of return due to the interest rate trigger framework in place. Triggers have been hit in May, June and July 2023, increasing the amount of gilt exposure at each trigger level under favourable market conditions. The interest rate hedge ratio now stands at 67% on the current hedging basis.

	The current hedging basis is based on market conditions as at the 2019 Actuarial Valuation. The FRMG is currently updating the liability benchmark for the 2022 Actuarial Valuation cashflows and as part of this the hedging basis will be revised. Once the hedging basis is updated, the hedge ratios will be re-expressed on the new basis. There will be no change to the gilt exposure gained through the risk management framework as a result. However, given the large increases in real yields since the last time the hedging basis was updated, we expect that the interest rate and inflation hedge ratios will be lower than Insight are currently reporting once the basis is updated. 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. For further information on the framework please refer to funding flightpath and risk management update, in particular section 1.03.
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) +1.5% p.a. for past service liabilities and CPI + 2.0% 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 +2.7% 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. The performance against all benchmarks is shown on Page 8 of the report, and repeated below:

Total	**Quarter (%)**	**1 Year (% p.a.)**	**3 Years (% p.a.)**	**5 Years (% p.a.)**
Total Scheme	**+0.3**	**+1.4**	**+6.0**	**+4.8**
Total Benchmark	+1.7	+3.7	+5.7	+5.2
Strategic Target (CPI +2.7% p.a.)	+2.7	+11.4	+10.1	+7.9
Actuarial Target – Past Service Liabilities (CPI +1.5% p.a.)	+2.4	+9.8	+8.4	+6.2
Actuarial Target – Future Service Liabilities (CPI +2.0% p.a.)	+2.5	+10.3	+8.9	+6.8

In light of the current economic landscape, which has been characterised by high short-term inflation rates, it is evident that the Fund has

	encountered challenges in meeting its strategic target. The surge in short-term inflation has posed formidable challenges for the Fund's performance. The discrepancy between the targets and the prevailing high inflationary conditions has resulted in a discernible gap between the Fund's projected outcomes and the actual performance. It is important to note that the strategic and actuarial targets quoted are based on short-term actual inflation figures, whereas in practise the Fund's liabilities are linked to implied long-term future CPI assumptions. Therefore, whilst short-term inflation is high, the longer term implied inflation figures are much lower. Looking at the performance of the Fund, it has been difficult period for several of the underlying managers to achieve benchmark performance given the recent market environment. For example, the Multi-Asset Credit mandate is targeting SONIA +4.0%, whilst the Best Ideas Portfolio is targeting UK Consumer Price Index +3.0% p.a. Therefore, whilst performance has been positive for both these portfolios, the high hurdles in place have proved a challenge to achieve. Despite the challenging market environment, the Fund has continued to monitor all assets closely and has made several active decisions on strategy. As detailed in 1.04, The Fund has been able to benefit from periods of volatility by locking in at favourable yields, as interest rates have increased. The recent increases in interest rates have increased returns expectations for the Fund's assets, which has in turn increased the Fund's discount rate, leading to a decrease in the value of the Fund's liabilities. Overall, the funding position was estimated to be 107% as at 30 June 2023. This is 2% ahead of the expected position. This is now calculated using the updated assumptions and liabilities in the Actuarial Valuation 2022. The Actuarial Targets set out within the table is based on the real discount rate agreed at the last actuarial valuation effective 31 March 2022. In practice the Actuary's discount rate has changed since the valuation date and this is taken into account in the ongoing monitoring of the funding position.
1.06	The strongest absolute returns over the quarter came from the Local/Impact allocation within the Private Markets portfolio (+2.7%) and Multi Asset Credit (+2.2%). The liability hedging portfolio increased by +0.1% over the quarter to 30 June 2023, despite real yields increasing; performance was supported by the synthetic equity positions as global equity generated positive returns. Over the 12 months to 30 June 2023, holdings within the Private Market portfolio generated the strongest returns. Local/ Impact, Timber/Agriculture, and Infrastructure generated the highest returns of +12.5%, +10.2% and +7.9%, respectively. Total equities also generated

	strong positive returns, returning +5.8% for the period. The performance of individual managers is shown in the report and is regularly reviewed by Officers and advisers.
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 – 30 June 2023 Appendix 2 – Performance Monitoring Report – 30 June 2023

6.00	LIST OF ACCESSIBLE BACKGROUND DOCUMENTS
6.01	None. **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/