CLWYD PENSION FUND COMMITTEE	
Date of Meeting	Wednesday 27 November 2024
Report Subject	Funding and Investment Performance
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 over the period ending 30 September 2024, as well as the funding and risk management framework. Separate reports covering these areas are attached as appendices.

Economy and Markets

- Central banks including the US Federal Reserve ("Fed") cut interest rates prompted by the macroeconomic backdrop of cooling inflation, labour markets and slowing wage growth.
- Equity markets performed well in response to rate cuts. There were however temporary periods of volatility caused by uncertainty around the US election, unwinding of the US dollar-Japanese yen carry trade and tensions in the Middle East.
- In the UK, Gilts rose in value as yields fell and inflation fell to 1.7% in September, down from 2.0% in June.

Performance Monitoring Report

- The Fund's total market value increased by £55.0m to £2,505.3m over the three-month period, allowing for net cash outflows of £10.2m.
- Overall absolute performance over 3 months, 12 months, 3 years and 5 years; +2.3%, +14.5%, +2.9% p.a. and +5.6% p.a., respectively.

Funding and Risk Management

- The estimated funding position was 109%, which is ahead of the expected funding level from the 2022 valuation by 5%.
- The total gain since inception of the synthetic equity strategy is c. £210m.
- 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.

REPORT DETAILS

1.00	INVESTMENT PERFORMANCE AND ECONOMIC RELATED MATTERS
1.01	**Economic and Market Update** 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: • **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	**Performance monitoring report** Over the quarter the Fund's total market value increased by £55.0m to £2,505.3m, after allowing for net cash outflows of £10.2m. Movement over the 12-month period saw positive performance from all asset classes, with the exception of private markets property, local/impact, timber/agriculture and private debt. Total Fund performance against its benchmark is shown below:

Total	Quarter (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)
Total Fund	**+2.3**	**+14.5**	**+2.9**	**+5.6**
Total Benchmark	+3.1	+17.3	+5.0	+6.7

	A full performance breakdown of each of the underlying mandates is provided in Appendix 2.
1.03	**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 relative performance as it returned +17.9% against an objective of +22.2% over the 1-year period. Relative performance for Q3 was, however, positive. The Fund's private market holdings also underperformed over the 12-month period, returning -1.1% against a benchmark return of 9.1%. This

	relative performance was driven by weak returns from Property, Timber/Agriculture and Private Debt allocations, as well as relatively 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 and Private Debt investments have returned 12.1% p.a. and 8.2% respectively, so there is no concern from a long-term perspective. 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 WPP Multi Asset Credit allocation and Tactical Asset Allocation portfolio continue to provide strong returns, returning +14.6% and +9.1% respectively and over a 12-month, outperforming their benchmarks by +5.1% and 3.2%, respectively.
1.04	**Performance Highlights** The strongest absolute returns over the quarter came from Risk Management Framework (+6.5 %) and WPP Multi Asset Credit (+5.0%) allocations. Over the 12-month period, WPP Sustainable Active Equity Fund and WPP Infrastructure assets generated the strongest absolute returns, returning +17.9% and +15.9%, respectively. Over the same period, the Risk Management Framework ("RMF") also generated strong returns of +37.2%. The RMF is made up of several components including liability driven investment, equity protection and 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.
1.05	**Asset Allocation** All portfolio allocations are within the agreed strategic tolerance with the exception of the Risk Management Framework and Local/Impact allocation, which are marginally underweight. These tolerances are being addressed as part of ongoing monitoring and commitments, where appropriate. The total credit allocation is close to its upper benchmark range at the end of September 2024. This is as expected given the decision to top up WPP Multi-Asset Credit fund in order to support cashflow needs, through income generated by that fund.
1.06	**Update on Funding and the Flightpath Framework** The estimated funding level was 109% as at 30 September 2024, which is ahead of the expected position when measured relative to the 2022 valuation expected funding plan by 5%. 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. 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 will consider if a new funding level trigger should be adopted and make a recommendation to Committee. The funding level continues to be monitored approximately by Mercer on a daily basis. The 2024 interim review has been completed and details of the high-level outcome is shown in a separate report.
1.07	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. 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.
1.08	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 30 September 2024, meaning it is operating in line within the tolerances monitored by Mercer.
1.09	**Update on Risk Management Framework** **Synthetic equity and equity protection strategy** 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. 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. 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. As at 30 September 2024, the total performance since inception of the custom TRS synthetic equity and equity protection strategy in May 2018 was an increase of c. £209.8m.
1.10	**Currency hedging update** Overall, the action to hedge the Fund's developed equity currency risk has resulted in a loss of £0.4m 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.

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): • Funding and Investment risks: F1 - F6, F8, I1 – I3
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. 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 – Economic and Market Update – 30 September 2024 Appendix 2 – Performance Monitoring Report – 30 September 2024 Appendix 3 – Monthly Monitoring Report – 30 September 2024

6.00	LIST OF ACCESSIBLE BACKGROUND DOCUMENTS
6.01	• Report to Pension Fund Committee – Overview of risk management framework – Previous monthly reports and more detailed quarterly overview. **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) **Actuary -** 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. (b) **Administering Authority or Scheme Manager** – 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. (c) **Absolute Return –** The actual return, as opposed to the return relative to a benchmark. (d) **Annualised –** Figures expressed as applying to 1 year. (e) **Clwyd Pension Fund (the "Fund")** – 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. (f) **Clwyd Pension Fund Committee (the "Committee") -** the Flintshire County Council committee responsible for the majority of decisions relating to the management of the Clwyd Pension Fund. (g) **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.

(h) **FSS – Funding Strategy Statement** – the main document that outlines how we will manage employer's contributions to the Fund

(i) **ISS – Investment Strategy Statement**
The main document that outlines our strategy in relation to the investment of assets in the Clwyd Pension Fund

(j) **LGPS – Local Government Pension Scheme** – the national scheme, which Clwyd Pension Fund is part of

(k) **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.

(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/.