

Pensions Committee

14 December 2022

Report title	Quarterly Investment Report to 30 September 2022	
Originating service	Pension Services	
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Recommendations for action:

The Pensions Committee is asked to note:

1. The global market and investment update paper prepared by the Fund's Investment Consultant, Redington.
2. Asset Allocation and Performance Reporting for the West Midlands Pension Fund (WMPF), Main Fund and Admitted Body Separate Funds.

1.0 Purpose

- 1.1 The investment report covers developments in investment markets, asset allocation and investment performance over the latest quarter in relation to the West Midlands Pension Fund (Main Fund and Admitted Body Separate Funds). Supporting responsible investment activities are covered in a separate paper.

2.0 Background

- 2.1 This paper aims to bring together routine investment matters relevant to the management and implementation of the Fund's investment strategy and related policies:
- I. The economic and market background environment in which the Fund operates and the outlook for different asset classes.
 - II. WMPF's investment strategy is outlined in the Investment Strategy Statement (ISS) and set in conjunction with the Funding Strategy Statement (FSS) to target a return over the long term to deliver the asset values required to meet benefit payments due to members. The Strategic Investment Allocation Benchmark (SIAB) forms part of the ISS and includes the target asset allocation and the levels of returns investment policies will be benchmarked against.
 - III. This report provides separate commentary on the Main Fund and Admitted Body Sub Funds (ABSF), established for former employers of the West Midlands Integrated Transport Authority Pension Fund, West Midlands Travel Limited (WMTL) and Preston Bus (PB).
 - IV. The SIAB policy targets were refreshed as part of the 2020 ISS review as approved by the Pensions Committee in March 2020. Implementation of the ISS changes continues to progress and this report adopts an interim benchmark comprising policy targets that reflect partial transition to the strategic targets outlined in the ISS, designed to better meet the future needs of the WMPF.

3.0 Executive Summary

- 3.1 As at 30 September 2022, the West Midlands Pension Fund's market value was £18.8 billion (incl. WMTL and PB ABSF). Stock markets and fixed income generally fell over the quarter (in local currency terms), although performance varied by region and sector.
- 3.2 The Main Fund decreased by 0.9% over the quarter outperforming its benchmark by 0.4%. Over the 1 bvcbyear the Fund decreased by 4.2% outperforming the benchmark by 0.4%. Performance has trailed the benchmark over longer time periods.
- 3.3 The ABSFs experienced significant negative performance over the quarter and 1 year to 30 September 2022 which has impacted longer-term performance numbers. Negative performance was predominantly driven by the Liability Driven Investment (LDI) and corporate bond allocations. The LDI portfolios are designed to move in a similar fashion

to the expected change in the value of the ABSFs' liabilities in response to changes in interest rates and inflation expectations.

4.0 Markets and Investment Background

4.1 The Fund's Investment Consultant, Redington provides a quarterly update on the market background and market performance over the quarter. The report for the quarter to 30 September 2022, which further sets out the outlook for the Fund's key asset classes over the coming months, can be found in Appendix A.

4.2 Returns for the major asset classes for the period are shown below:

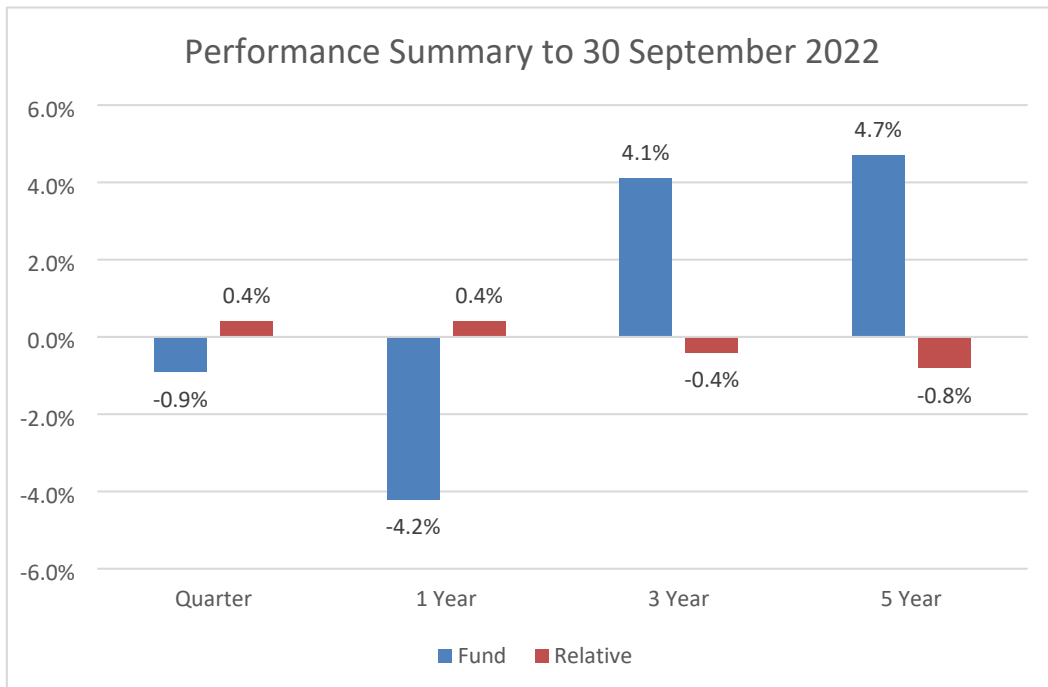
Total Return (£)	<u>Quarter</u>	<u>12 months</u>
Global Equity (MSCI World)	2.1%	-2.9%
US Equity (S&P 500)	3.5%	2.1%
Emerging Markets (MSCI Emerging Markets)	-3.8%	-13.2%
UK Equity (FTSE All Share)	-3.5%	-4.0%
Gilts (GBI UK All Mats)	-13.2%	-24.0%
Corporate Bonds (BofA ML Non-Gilts)	-11.6%	-22.2%
High Yield (BofA ML Global High Yield)	6.0%	-2.8%

4.3 Over the quarter the US Dollar strengthened significantly against GBP. Towards the end of the quarter there was significant volatility experienced in the UK gilt market resulting in a sharp increase in yields and negative returns.

5.0 West Midlands Pension Fund

Main Fund Performance Summary

- 5.1 The Main Fund delivered a return of -0.9% over the quarter outperforming the benchmark return by 0.4%. The Fund's relative returns versus its benchmark over various time periods are shown below.



- 5.2 The Fund outperformed its benchmark over the 12 months to end of September. Private equity was a large contributor to positive relative performance as continued strong performance from the portfolio outperformed the listed equity index to which it is compared.
- 5.3 The Fund's combined global equity portfolio and Infrastructure allocation continue to be negative contributors to relative performance over longer time periods.
- 5.4 The asset allocation of the Main Fund as at the quarter end is set out overleaf. Interim benchmark weights have been introduced to reflect partial transition to the strategic targets outlined in the Fund's ISS. Full adoption of the ISS targets will take some time, especially for illiquid assets such as infrastructure and private debt.
- 5.5 The Fund remained overweight in growth assets versus previous policy targets, as a result of existing equity positions and the strong absolute performance from these asset types over longer time periods.

This report is PUBLIC
NOT PROTECTIVELY MARKED

	Weight @ 30/09/22	Final ISS target	Interim Benchmark
Total Equity	52%	42%	48%
Private Equity	8%	6%	6%
Opportunistic	2%	2%	2%
TOTAL GROWTH	62%	50%	56%
Corporate Bonds	4%	4%	4%
Multi-Asset Credit/Specialist	3%	6%	6%
Emerging Market Debt	4%	5%	5%
Private Debt	2%	6%	1%
Infrastructure	5%	9%	7%
Property	8%	9%	9%
TOTAL INCOME	27%	38%	31%
Gilts	1%	2%	2%
ILG	4%	3%	5%
Low risk strategy (orphan liabilities)	1%	5%	4%
Cash	5%	2%	2%
TOTAL STABILISING (incl. low risk)	11%	12%	13%
TOTAL	100.0%	100.0%	100.0%

- 5.6 The Fund's focus remains on implementing the Strategic Asset Allocation (SAA) changes as agreed as part of the 2020 investment strategy review. Efforts have primarily focused on fixed income and private market assets, with steps being taken to move towards new target weights in multi-asset credit, emerging market debt, private debt and infrastructure in particular, with equity holdings expected to be trimmed over the coming quarters.
- 5.7 The most recent quarter has seen an increase in capital calls in relation to commitments made to Infrastructure and Private Debt Funds and an increase in the cash holding at the quarter end, pending a review of the allocation.

6.0 West Midlands Pension Fund

Detailed Performance Commentary

Growth Assets

- 6.1 The total combined equity fund delivered negative returns during the quarter, 1 year and 3 year periods but has produced positive returns over longer time periods to 30 September 2022.
- 6.2 The Main Fund's passive equity assets are now almost exclusively managed by the investment pool company, LGPS Central Ltd (LGPSC) with a large proportion of these assets held in an LGPSC Global Equity passive fund. All passive funds performed broadly in line with the respective benchmarks during the quarter, however, there was divergence between region and strategy as shown below.

	Quarter	12 months
LGPSC UK (FTSE All Share)	-3.5%	-4.3%
LGPSC Global ex UK	0.1%	-7.7%
LGPSC Dividend Growth (Blended)	-2.4%	-2.2%
LGPSC Climate Multi-Factor	1.2%	-1.3%

- 6.3 Over the quarter the Fund's actively managed global equities comprised the LGPSC Active Equity fund, an allocation to sustainable equity managers and a basket of global equity futures.
- 6.4 The LGPSC Global Active Equity Fund underperformed the benchmark over the quarter and 1 year period, however, has outperformed the benchmark over the 3 year period. The LGPSC Global Active Equity Fund is a blended multi-manager portfolio consisting of 3 underlying portfolios.
- 6.5 Emerging markets performed negatively over the quarter with the Fund's Emerging Market Equity portfolio underperforming its benchmark. The portfolio has lagged its benchmark over longer time periods.
- 6.6 The private equity portfolio outperformed during the quarter and significantly outperformed over 1 year. The benchmark used for this asset class comprises listed equities plus an outperformance target (with a 3 month lag). Over longer time periods the portfolio has met expectations.

	Quarter	1 Year	3 year
Private Equity Portfolio	1.5%	16.1%	20.8%
FTSE All World +1% (3m lagged)	-8.0%	-2.6%	9.4%

Income Assets

- 6.7 The Fund's income segment has underperformed its respective benchmark over the quarter and longer time periods. The aggregate property portfolio provided negative returns over the quarter but has delivered strong absolute returns over the 1 year and longer time periods.
- 6.8 The infrastructure portfolio delivered has delivered strong positive returns over the quarter and 1 year, outperforming its return objective (CPI +4%), however, the portfolio has underperformed against its return objective over longer time periods.

	Quarter		1 Year		3 Year	
	Return	Relative	Return	Relative	Return	Relative
Infrastructure Portfolio	4.1%	1.6%	17.5%	4.7%	4.8%	-3.2%
Property Portfolio	-3.4%	-1.2%	9.6%	-3.4%	7.1%	-1.0%

- 6.9 The Fund's fixed interest holdings produced negative performance as a result of the increasing interest rate environment. Within the Fund's fixed interest holdings, corporate bonds have outperformed the benchmark over the quarter and longer time periods. The emerging market debt and multi asset credit holdings underperformed their respective benchmarks over the quarter, 1 year and 3 year time period.

	Quarter		1 Year		3 Year	
	Return	Relative	Return	Relative	Return	Relative
Corporate Bonds	-8.0%	3.0%	-17.8%	4.1%	-4.1%	2.7%
Multi Asset Credit	-1.9%	-3.6%	-12.0%	-6.6%	-1.6%	-2.7%
Emerging Market Debt	1.2%	-2.6%	-13.6%	-7.2%	-4.2%	-0.2%

Stabilising Assets

- 6.10 The stabilising portfolio comprises the Fund's exposure to government bonds and index linked securities and cash. The stabilising component of the fixed interest portfolio delivered negative returns for the quarter as yields on sovereign debt rose (meaning prices fell).
- 6.11 Over the quarter, 1 and 3 year timeframes the stabilising portfolio has outperformed its benchmark.

7.0 Admitted Body Separate Funds (ABSFs)

7.1 The current allocation for the two ABSFs is shown below.

WMTL asset allocation (excluding buy-in policy):

Asset Class	Value @30/09/2022	Target %	Current %
Total Equities	£ 86,293,937		43%
UK Equities	£ 6,226,292		3%
North America Equity Index	£ 34,963,224		17%
Europe (ex UK) Equity Index	£ 19,693,076		10%
Japan Equity Index	£ 7,085,431		4%
Asia Pac exJap Dev Equ Ind	£ 7,190,164		4%
World Emerging Markets Equ Ind	£ 11,135,751		6%
Newton Real Return	£ 21,239,142		11%
Baillie Gifford DGF	£ 11,074,558		6%
Total Equities & DGF	£ 118,607,637	16%	59%
Corporate Bonds	£ 7,929,146		4%
Multi Asset Credit	£ 47,318,873		24%
Private Debt	£ 13,168,925		7%
LDI	£ 12,626,296		6%
Total Credit & Ldi	£ 81,043,241	84%	41%
Cash	£ 210,595	0%	0%
Total	£ 199,861,472	100%	100%

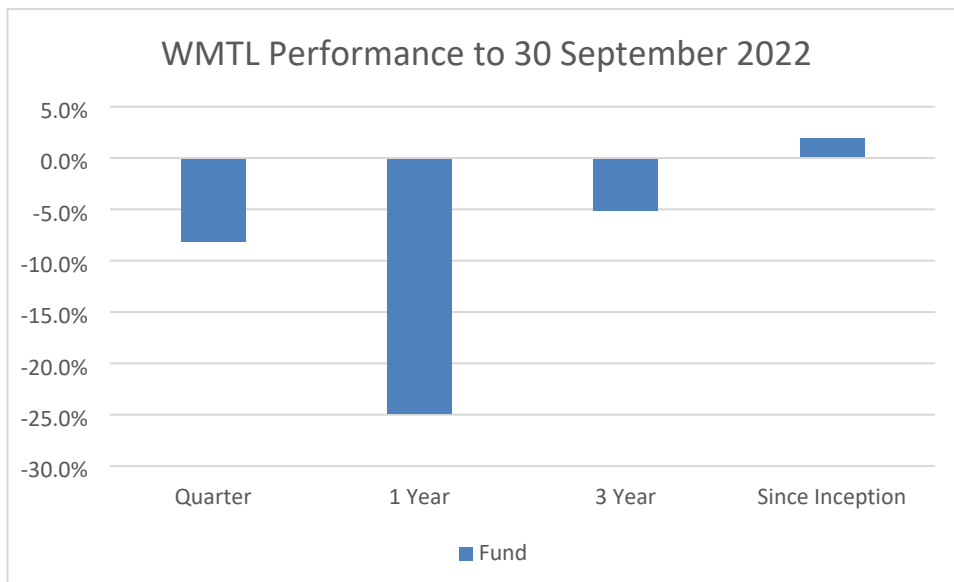
The allocation to private debt is expected to increase over time. Commitments have been made in this area, however, given the private nature of these assets, these commitments will draw down from the growth portfolio over a period of time, moving the allocation towards the target.

PB asset allocation:

Asset Class	Value @30/09/2022	Target %	Current %
Total Equities	£ 2,618,600	15%	20%
UK Equities	£ 217,530		2%
North America Equity Index	£ 1,145,384		9%
Europe (ex UK) Equity Index	£ 347,572		3%
Japan Equity Index	£ 296,253		2%
Asia Pac exJap Dev Equ Ind	£ 202,741		2%
World Emerging Markets Equ Ind	£ 409,120		3%
Multi Asset Credit	£ 3,834,023		29%
Corporate Bonds	£ 2,334,400		18%
LDI	£ 2,051,513		16%
Cash	£ 2,203,638		17%
Total Fixed Interest, LDI & Cash	£ 10,423,574	85%	80%
Total	£ 13,042,173.26		100%

WMTL

- 7.2 The Fund has produced significant negative returns over the quarter and 1 year to 30 September 2022. All assets have contributed to negative performance, however, the Fund's fixed interest holdings have been the most impacted due to the increasing interest rate environment. The diversified growth funds and the multi-asset credit allocation continued to underperform their 'base rate plus' target performance.
- 7.3 Large falls in the value of the Liability Driven Investment (LDI) portfolio were experienced particularly towards the end of the quarter due to sharp increases in UK gilt yields. Whilst this resulted in negative asset returns for the LDI portfolio, the Fund's liabilities are expected to have decreased by a greater extent than the fall in the LDI portfolio.
- 7.4 A review of the Fund's benchmark is currently being undertaken and therefore only absolute Fund returns have been shown below.



Fixed Income

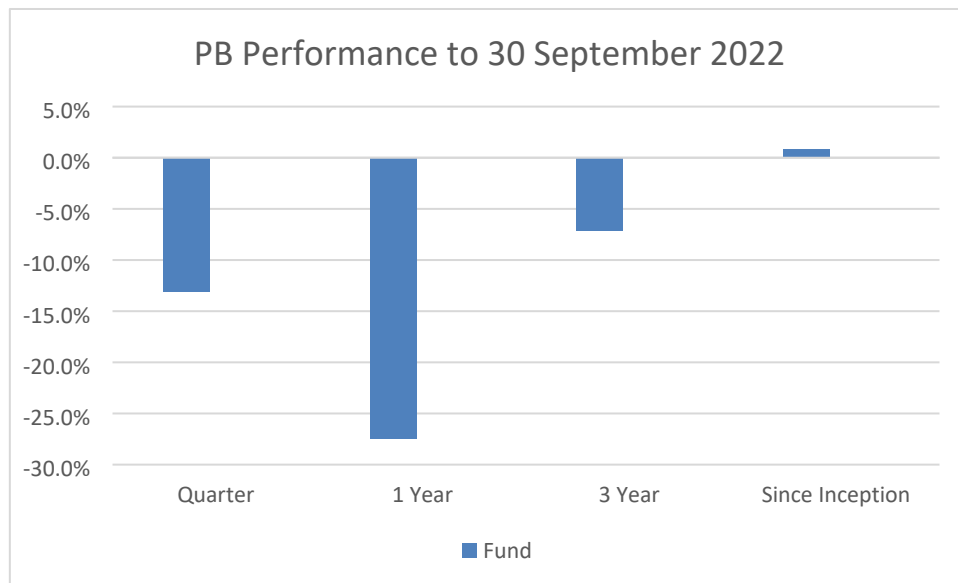
- 7.5 Alongside the multi-asset credit holding in the bond portfolio, the corporate bond mandate underperformed its benchmark over the quarter and 1 year period.

Diversified Growth Funds

- 7.6 Both Diversified Growth Fund holdings delivered negative absolute and relative performance over the quarter and 1 year period.

PB Performance Summary

- 7.7 PB performance is summarised below. Similar to WMTL, the Fund produced significant negative returns over the quarter and 1 year to 30 September 2022 with recent performance impacting longer-term numbers.
- 7.8 The majority of negative performance was driven by the fixed interest holdings, in particular the LDI portfolio given the sharp increase in UK gilt yields experienced over the quarter and 1 year period. The LDI mandate is designed to move in a similar manner to the Fund's liabilities in response to changes in interest rates and inflation expectations.
- 7.9 A review of the Fund's benchmark is currently being undertaken and therefore only absolute Fund returns have been shown below.



8.0 Investment Pooling

- 8.1 The Fund continues to work closely with its investment pool company LGPS Central Ltd (LGPSC) to review the ongoing suitability of investment products and look for opportunities to transition assets to the pool.

9.0 Financial Implications

- 9.1 The financial implications are set out throughout the report.

10.0 Legal Implications

- 10.1 This report contains no direct legal implications.

11.0 Equalities Implications

- 11.1 This report contains no direct equal opportunities implications.

12.0 Other Implications

12.1 There are no other implications.

13.0 Schedule of Background Papers

13.1 None.

14.0 Schedule of Appendices

14.1 Appendix A – Redington Economic and Market Update