LONDON BOROUGH OF HAMMERSMITH & FULHAM

Report to: Pension Fund Committee

Date: 28/02/2023

Subject: Investment Strategy Statement

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Responsible Director: Phil Triggs, Director of Treasury and Pensions

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SUMMARY

As per the Local Government Pension Scheme (LPGS) Management and Investment of Funds Regulations 2016, the Fund is required to publish an Investment Strategy Statement (ISS). Attached is a draft ISS for 2023, which reviews the LBHF Fund's investment strategy in terms of the current asset allocation and funding position and highlights some key areas the Committee should consider for the short- and medium-term outlook of the Fund.

This paper introduces the draft Investment Strategy Statement for the London Borough of Hammersmith and Fulham (LBHF) Pension Fund prepared by the Fund's investment adviser, Deloitte, which is attached as Appendix 1 to this paper.

RECOMMENDATIONS

The Committee is recommended:

a. To comment on the Investment Strategy Statement (ISS) and delegate authority to the Director of Treasury and Pensions in consultation with the Chair to publish the final ISS.

b. To agree a rebalancing of the strategic benchmark asset allocation between two suggested proposals.

c. To consider an alternative investment to replace the Aviva Infrastructure Income mandate.

Wards Affected: None

Our Values	Summary of how this report aligns to

	the H&F Values
Being ruthlessly financially efficient	Part of the Pension Fund’s fiduciary duty should be that its investments assist in making a positive financial contribution to the authority overall. Being an outperforming investor contributes to sharing prosperity and lessening the financial impact on council taxpayers.

Financial Impact

The financial implications of the introduction of this policy will be continually monitored to ensure that members’ pensions are safeguarded.

Legal Implications

None.

DETAILED ANALYSIS

1. Investment Strategy Statement

1.1 The Fund's current benchmark asset allocations are as follows:

- 45% allocation to equities;
- 20% allocation to dynamic asset allocation;
- 20% allocation to secure income;
- 15% allocation to inflation protection.

1.2 In comparison with a funding level of 97% at 31 March 2019, the Fund's overall funding level improved by 8% to 105% at 31 March 2022.

1.3 The Fund's investment portfolio is very well diversified and well placed to withstand the impacts of extreme capital market volatility experienced in recent years. However, given the stronger funding position referenced above, the Fund now has the opportunity to further reduce investment risk within the portfolio.

1.4 The Fund is in a negative cashflow position. To mitigate further levels of negative cashflow, there are opportunities to increase the level of income from the Fund's investment portfolio in the form of cash distributions.

2. Proposed Updates to the Investment Strategy

2.1 As per the attached Deloitte investment strategy review, there is scope to reduce market risk from the investment portfolio.

2.2 There are two variations of proposed strategy outlined in Appendix 1.

2.3 The first would result in a strategic asset allocation of:

- 40.0% allocated to equities
- 25.0% allocated to low-risk growth
- 20.0% allocated to secure income
- 15.0% allocated to total inflation protection

2.4 The second would result in a strategic asset allocation of:

- 42.5% allocated to equities
- 22.5% allocated to low-risk growth
- 20.0% allocated to secure income
- 15.0% allocated to total inflation protection

Equity Allocation

2.5 As at 31 December 2022, the actual allocation to equities is 44.3% (underweight by 0.7%). Of this 44.3%, 14.1% is allocated to the LCIV

Global Equity Core Fund, which is actively managed, and 30.2% is allocated to the LGIM Low Carbon Index Fund, which is passively managed.

2.6 The equity allocation is the largest driver of expected fund returns. Performance has historically been very strong and has been a key driver in the increase of the total value of the fund since the previous actuarial valuation in 2019.

2.7 In order to reduce risk from the investment portfolio, it is recommended that the overall equity allocation is reduced. It is noted that this is expected to reduce expected returns, but still remain sufficient, given the lower target required return.

Dynamic Asset Allocation

2.8 As at 31 December 2022, the allocation to dynamic asset allocation is 25.9% (overweight by 5.9%). Of this 25.9%, 18.9% is allocated to LCIV Absolute Return Fund (Ruffer) and 7% is allocated to the LCIV Global Bond Fund (PIMCO)

2.9 Each of the funds is benchmarked at 10%, leaving PIMCO 3% underweight and Ruffer 8.9% overweight. However, it should be noted the Ruffer allocation includes 2.5% that is to be allocated to Inflation Protection in the future.

2.10 It is suggested in Appendix 1 that the classification of this sub-portfolio “Dynamic Asset Allocation” should be rebranded as “Low Risk Growth Allocation”.

Secure Income Allocation

2.11 As at 31 December 2022, the actual allocation to Secure Income is 18.5% (underweight by 1.5%). Of this 18.5%, the allocation is:

- Partners Group Multi Asset Credit 0.6% (overweight by 0.6%)
- Partners Group Direct Infrastructure 4.3% (underweight by 0.7%)
- Oak Hill Advisors (Diversified Credit) 5.0% (consistent with benchmark)
- Aviva (Infrastructure Income) 2.0% (to be redeemed and placed with a new fund manager)
- Abrdn (Multi Sector Private Credit) 3.8% (underweight by 1.2%)
- Darwin Alternatives (Leisure Development Fund) 2.7% (overweight by 0.2%)

2.12 It is suggested that Aviva should be replaced by an Infrastructure mandate with similar characteristics and an increased allocation to 3.5% considering the impact of recent and anticipated market movements. The benchmark would be adjusted for Abrdn and Darwin Alternatives to stay at 3.8% and 2.7% respectively.

Inflation Protection

2.13 As at 31 December 2022, the actual allocation to inflation protection was 10.5%. Of this, 4.6% was allocated to Abrdn Long Lease Property (underweight by 0.4%), 4.6% was allocated to Alpha Real Capital Ground Rents (underweight by 0.4%) and 1.4% was allocated to Man GPM Affordable Housing (underweight by 1.1%).

2.14 Each of the inflation protection allocation funds invest predominantly in property assets, where the underlying cashflows are linked to inflation. Recognising the importance of inflation protection in today's market, it is recommended that the 2.5% that is currently awaiting permanent reallocation in the LCIV Absolute Return Fund should be invested in Alpha Real Capital Ground Rents, taking that allocation to 7.5%

3. Summary of Proposals

3.1 Depending on which alternative allocation is chosen by the committee, there will be a disinvestment of 5.0% or 2.5% from equities and invested into bonds.

3.2 The Aviva Infrastructure mandate will be replaced by an alternative fund with similar characteristics and to increase the overall infrastructure allocation to 3.5%

3.3 There will be an additional 2.5% invested into ground rents funded from the LCIV Absolute Return Fund (Ruffer).

3.4 The above changes will result in reduced investment risk and increased CPI inflation linkage.

LIST OF APPENDICES

Appendix 1 – LBHF Investment Strategy Review Feb 2023 (EXEMPT)