TEESSIDE PENSION FUND

Administered by Middlesbrough Council

AGENDA ITEM 6

TEESSIDE PENSION BOARD REPORT

19 APRIL 2021

DIRECTOR OF FINANCE – IAN WRIGHT

Strategic Asset Allocation Update

1. PURPOSE OF THE REPORT

1.1 To report to Members of the Teesside Pension Board (the Board) on the revision to the Pension Fund's strategic asset allocation agreed at the Pension Fund Committee's 10 March 2021 meeting.

2. RECOMMENDATION

2.1 That Members note this report.

3. FINANCIAL IMPLICATIONS

3.1 There are no specific financial implications arising from this report.

4. BACKGROUND

4.1 The Pension Fund's target strategic asset allocation is set out in its Investment Strategy Statement which was last updated in February 2019. The following table shows the strategic asset allocation alongside the actual allocation of the Pension Fund at the end of the quarter the allocation was published (31 March 2019) and at the end of the last quarter asset information has been published (31 December 2020). This is an update of the table presented to the Board at its 8 February 2021 meeting:

Asset Class	Target Strategic Allocation	Maximum	Minimum	As at 31.03.2019	As at 31.12.2020
GROWTH ASSETS		**98%**	**60%**	**86.7%**	**90.7%**
UK Equities	**22%**	80%	40%	30.2%	28.1%
Global Equities	**28%**			45.3%	48.9%
Property and Property Debt	**15%**	20%	10%	8.6%	7.6%
Alternatives	**15%**	20%	10%	2.6%	7.1%
PROTECTION ASSETS		**40%**	**2%**	**13.3%**	**8.3%**
Bonds	**18%**	40%	2%	0%	0%
Cash	**2%**			13.3%	8.3%
Total Pension Fund value				£4,084m	£4,385m

4.2 As can be seen from this table, and as was reported to the 8 February 2021 Board meeting, the Pension Fund has made slow progress towards its strategic asset allocation, in part for the following reasons:

- An increased allocation to bonds is only realistic if the asset class is appropriately priced, and throughout the period the Fund’s investment advisors have cautioned that bonds do not represent good value;
- Equity valuations, after dropping sharply in March 2021, have been supported by a low inflation environment and a willingness of governments to support their economies while increasing their own indebtedness, this has made it difficult to time an appropriate reduction in equities;
- Investing in unlisted ‘alternative’ assets is usually a lengthy process. There is often a time lag between committing money to a manager and that manager investing the money with the underlying investments. This time lag can mean it takes several years for committed money to be fully invested and by that time some of the earlier underlying investments will be complete and will have started to return money to the investor. There are quicker ways of investing in ‘alternatives’ but these are at times more expensive and can involve more risk concentration.
- Increasing investment in direct property relies on identifying and acquiring suitable assets for the Pension Fund to acquire. This has proved problematic over the last year or so, in part because of the uncertainty around property valuation triggered by initial market inactivity following the pandemic, and partly owing to unique individual factors relating to a number of property assets the Fund has considered acquiring.
- Initial investigations into possible property debt investments were put on hold in March last year while the market was turbulent and unclear. This work has recommenced and the investment team will consider potential property debt investment options.

4.3 However, while the Pension Fund remains heavily invested in equities its assets are subject to significant volatility. While this can be tolerated to a certain extent given the Pension Fund's long investment time horizon, this volatility can cause issues for the Pension Fund's employers if the triennial valuation coincides with a low point in valuations.

4.4 As an indication of this volatility, the graph on the following page shows the actuary's assessment of how the funding level of the Fund has change over the period since the effective date of the last valuation (31 March 2019). There is also a graphic showing how the estimated surplus will have fluctuated. Some of this variation is a consequence of movements in asset values (principally equity values) and some is due to a change in the actuary's views on future long term investment returns (the actuary is now more pessimistic on this). Note, this funding level update is very much an estimate - see the "Method" notes on the page following the graph for more details of the assumptions used.

Change to funding level since the valuation at 31 March 2019

Funding level at 31 Dec 2020	Funding level at 30 Sep 2020	Funding level at 31 Mar 2019
111%	**105%**	**115%**

Surplus at 31 Dec 2020	Surplus at 30 Sep 2020	Surplus at 31 Mar 2019
£430M	**£187.8M**	**£527.3M**

See notes on method overleaf

Method

- This funding update is consistent with the calculations for the formal actuarial valuation as at 31 March 2019. The assumptions used have been modified only insofar as is necessary to maintain consistency with the approach set out in the latest Funding Strategy Statement, reflecting the change in the effective date and in relevant market conditions.
- The funding update is projected from the results of the formal actuarial valuation as at 31 March 2019 and is therefore approximate. Since the update is not based on up-to-date membership data, it becomes more approximate the longer the period of time that has elapsed since the last actuarial valuation.
- The funding update takes account of the following over the period since the last formal actuarial valuation:
  - Cashflows into and out of the Fund estimated based on the 2019 valuation results;
  - Actual price inflation and its impact on benefit increases.
- Demographic experience since the last formal actuarial valuation has been assumed to be in line with the assumptions set out in the 2019 Valuation Report.
- This update is designed to give a broad picture of the direction of funding changes since the actuarial valuation but does not have the same level of reliability as, and therefore does not replace the need for, formal actuarial valuations.
- It does not reflect any changes to assumptions which would be made if a full actuarial valuation were to be carried out to reflect, for example, changes to the investment strategy or economic outlook.
- For the purpose of this funding update, we have used an un-audited value of the assets as at 31 December 2020 provided by the Administering Authority
- The whole of fund total employer contribution rates shown in this funding update allow for the following:
  - a recovery period ending 31 March 2042 when in surplus and 31 March 2040 when in deficit;
  - a target funding level of 105% when in surplus.
- The assumptions used in this funding update are as follows:

	Discount rate	Pay growth	Pension increases
31 March 2019	4.45%	3.1%	2.1%
30 September 2020	4.30%	3.1%	2.1%
31 December 2020	4.30%	3.2%	2.2%

5. ASSET ALLOCATION APPROACH

5.1 The issues set out in paragraph 4.2 above – the unattractiveness of bonds, the necessarily slow increase in investments in private equity, infrastructure and other alternatives, and the difficulty in significantly increasing the direct property portfolio, mean no progress has been made to date in reducing the Pension Fund's equity exposure. This is despite a phased sell-off of £125 million of US equities over the 15 months to 31 December 2020.

6. REVISED ASSET ALLOCATION

6.1 Officers worked with the Pension Fund's investment advisors Peter Moon and William Bourne to review the strategic asset allocation, with a view to setting a long-term and a short / medium term target for asset allocation. The latter target will allow the Committee and Board to judge more quickly whether appropriate progress is being made in reallocating the Pension Fund's assets.

6.2 The revised strategic asset allocation, which was approved by the Pension Fund Committee at its 10 March 2021 meeting includes the following features:

- A significantly lower allocation to UK equities – this partly reflects the fact the UK market is increasingly concentrated on a number of sectors such as consumer staples, financials and commodities, meaning the market's performance is to some extent linked to the performance of those sectors. It also reflects a recognition that future growth may be limited in the UK compared to other global regions.
- A recognition that infrastructure investments can be classed as 'protection' rather than 'growth' assets – this acknowledges the long-term secure nature of the types of infrastructure the Pension Fund invests in.
- Property debt is also reclassified as part of 'other debt' as a 'protection' asset, and so separated from property which remains classified as a 'growth' asset.
- A short / medium term target of 65% equities by 31 March 2022. This may be challenging and will require careful implementation. The longer term equity target increases slightly from 50% to 55%.

6.3 The strategic asset allocation before the change was as follows:

Asset Class	Target Strategic Allocation	Maximum	Minimum
GROWTH ASSETS		**98%**	**60%**
UK Equities	**22%**	80%	40%
Global Equities	**28%**		
Property and Property Debt	**15%**	20%	10%
Alternatives	**15%**	20%	10%
PROTECTION ASSETS		**40%**	**2%**
Bonds	**18%**	40%	2%
Cash	**2%**		

6.4 This revised strategic asset allocation is as follows:

Asset Class	Long Term Target Strategic Asset Allocation	31 March 2022 Target Strategic Asset Allocation
GROWTH ASSETS	**75%**	**78%**
UK Equities	**10%**	**12%**
Overseas Equities	**45%**	**53%**
Property	**10%**	**7%**
Private Equity	**5%**	**3%**
Other Alternatives	**5%**	**3%**
PROTECTION ASSETS	**25%**	**22%**
Bonds / Other debt / Cash	**15%**	**14%**
Infrastructure	**10%**	**8%**

6.5 Following the Committee’s agreement to the revised strategic asset allocation, the following steps are underway:

- The table in paragraph 6.4 is being incorporated into an updated Investment Strategy Statement (ISS) to circulate to Pension Fund employers for comment. Any substantive changes agreed to the revised ISS following the consultation will be brought to the next Committee meeting, but if there are no such changes the ISS will be published in due course.
- Officers will work to implement the revised strategic asset allocation and will report back to future Committee meetings on progress.

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