

## Suffolk County Council Pension Fund Committee

### Investment strategy and next steps

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- › 5 June 2013

## Members' ultimate funding objective

- › How much money do I need and how should it be invested in order to be able to meet the promised benefits?



## Core objectives

### ➤ Funding objectives

1. Contribution rate is set to achieve full funding
2. Target stabilised contributions

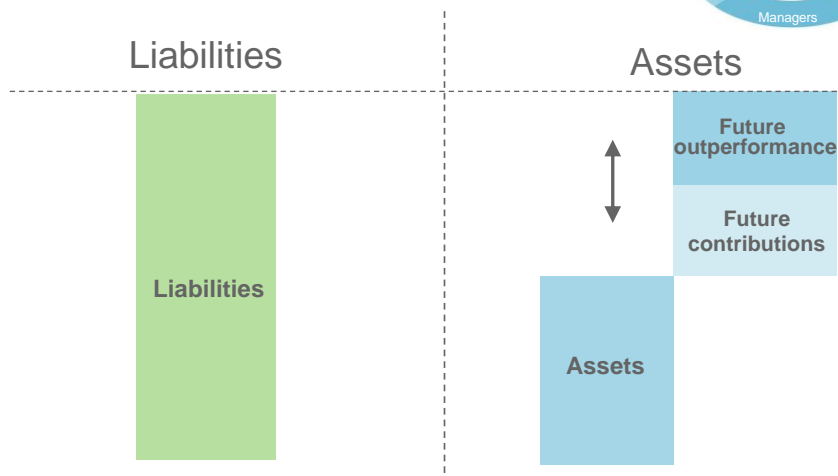
### ➤ Investment strategy

3. Risk consistent with funding objectives
4. Maximise return within acceptable risk

Risk is inevitable – manage it rather than avoid it

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## Achieving the objective

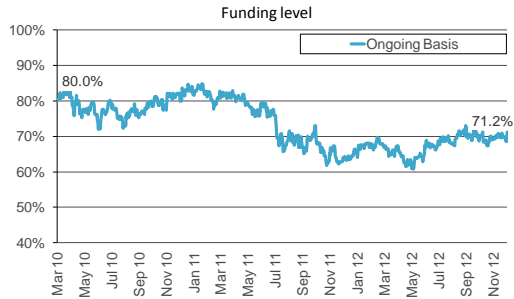


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## Understanding the goal

### Deficit recovery

- All LGPS funds in significant deficit
- Caused mainly by fall in bond yields
- Weak asset returns haven't helped
- Deficit belongs to accrued benefits (Hutton changes won't help repair)
- Likely to require 20 years to repair



### Asset return required (to repair deficit)

- Aim to adopt significant allocation to return seeking assets for foreseeable future
- Need aggregate returns in excess of 3% p.a. real for many years
- But not just about maximising return; need to control risk and retain diversification
- Need to retain flexibility to act in adverse circumstances

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## LGPS – true or false

### Membership

- Membership is maturing
- True
  - Caused by passage of post war baby bulge, outsourcing, move to CARE
  - But Scheme is like a super-tanker
  - Takes decades to affect Scheme materially

### Asset markets

- Asset sales damage UK companies
- False
  - UK equity markets are secondary
  - Facilitate shareholder transfers
  - Do not provide primary funding for companies

### Asset allocation

- Scheme maturity will force Funds to de-risk
- False
  - Council covenants are strong
  - Schemes will remain cash flow positive
  - Should continue return seeking targets
  - No forced selling of assets for many years

### Hutton makes LGPS affordable

- False
- Should contain cost increases due to
  - Improving longevity, by adjusting NRA
  - Inflation by moving to CPI
  - Fast salary progression, by move to CARE

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## Understanding investments

### Why is this important?

*“In those schemes with invested funds, an understanding of financial markets and products is fundamental.”*

*“Investor engagement will be a key consideration in terms of getting value from the fund’s investments ....*

*...An understanding of risk is also fundamental”*

Source: CIPFA Knowledge and Skills Framework

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## Investment beliefs

- Long term approach
  - Largely based on strong covenant
- Risk expected to be rewarded
  - Preference for a significant allocation to equities
- Diversification works
  - Expected to reduce overall volatility of funding level
- Timing and implementation are important
  - Price of entry
  - Benchmarks critical
  - Active versus passive management

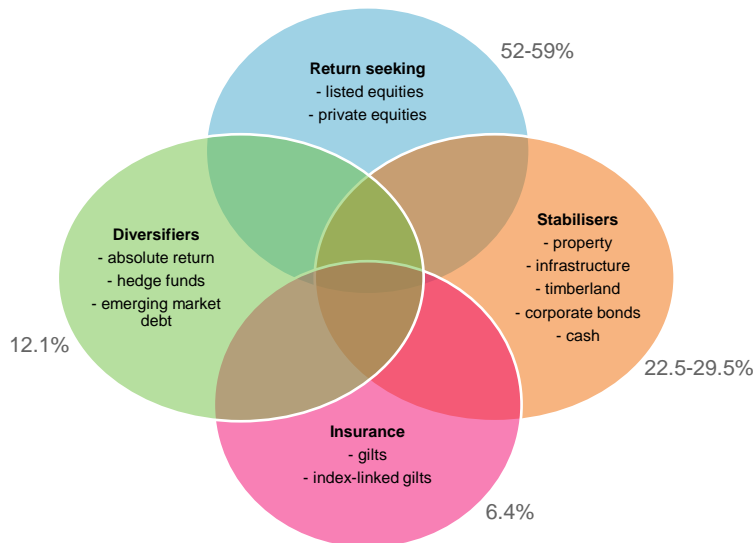
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## Risk framework: setting a long-term course



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## Structural components at target weight



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## Investment strategy and structure

Equities (52-59%)			Inflation Linked (4.3-11.3%)			Alternative (12.1%)		
	Manager	Target %		Manager	Target %		Manager	Target %
UK	Alliance	7.5	Ind-linked	LGIM	4.3	Targeted	Pyrford	6.0
	BlackRock	9.5	Infrastruct.	KKR	0 - 5.0	Hedge funds	BlueCrest	2.0
Regional	LGIM	16.5 - 23.5		Partners		2.0		
Global	Newton	13.5	Timberland	Brookfield	0 - 2.0	EM debt	LGIM	2.1
Private	Pantheon	5.0	<b>Property (10%)</b>			<b>Bonds &amp; cash(14.6%)</b>		
	Wilshire			Manager	Target %		Manager	Target %
			FoFunds	Schroders	10.0	Gilts	LGIM	2.1
						Credit	Credit	12.5
						Cash	TBC	2.0

■ Return seeking  
■ Real assets  
■ Diversifying

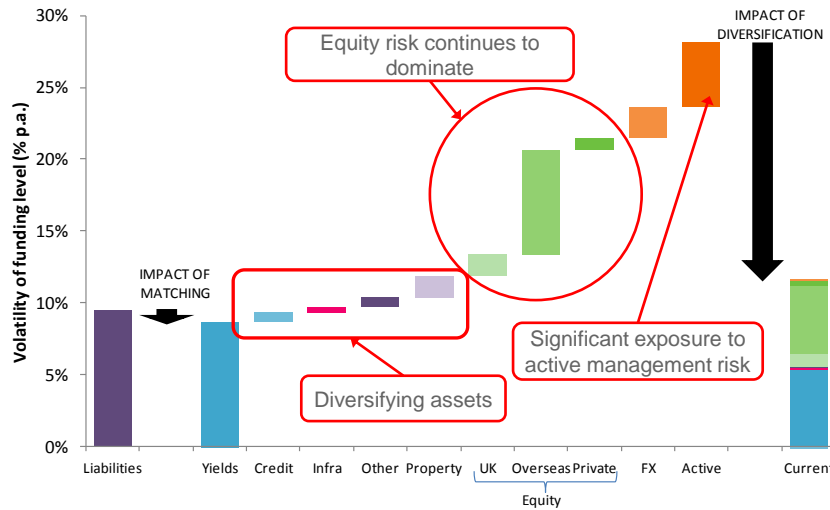
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## Risk factors

<b>Volatility</b> (59% of assets)	<ul style="list-style-type: none"> <li>Listed equities</li> <li>Private equities</li> </ul>
<b>Illiquidity</b> (22% of assets)	<ul style="list-style-type: none"> <li>Property</li> <li>Private equity</li> <li>Infrastructure and timberland</li> </ul>
<b>Transparency</b> (12% of assets)	<ul style="list-style-type: none"> <li>Private equity</li> <li>Infrastructure and timberland</li> </ul>

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## Portfolio tested against beliefs



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## Building blocks for investment strategy

Asset class	Return	Risk	Income	Rationale
Equities	↑↑	↑↑	➔	Key driver of returns
Bonds	➔	↓	➔	Liquidity, insurance asset
Property	↑	↑	➔	Diversification

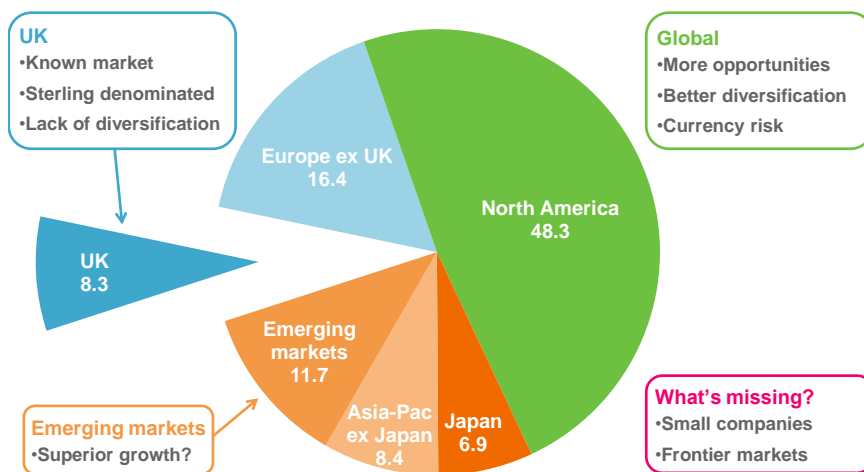
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## What is an equity?

- An owner's "share" of company's profits and assets
  - gives entitlement to dividend, assets on wind-up
- Wide range of opportunities
  - markets: UK, overseas, global emerging, small cap
  - sectors, i.e. industries : Oil & Gas, Utilities, etc.
- Deriving returns from economic activity
  - Participating in long-term growth
- Listed markets offer:
  - Ease of access
  - Liquidity and volatility

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## The global equity market



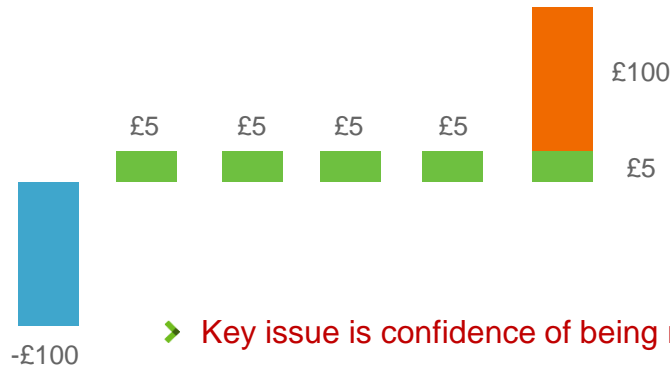
FTSE AW Index 02/01/13. Source: Datastream

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## What is a bond?

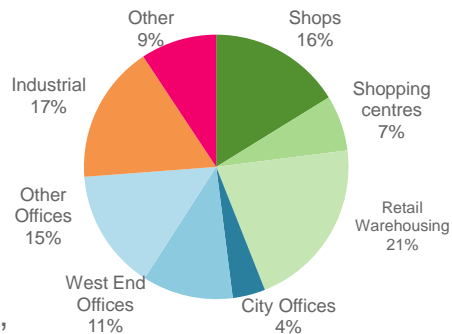
- Simply a loan from one party to another
- Borrower pays interest to lender at agreed rate...
- ...and capital return at maturity



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## UK Commercial property

- Commercial, not residential
- Diversification from equities and bonds
- “Real” asset
- High dealing costs
- Less liquid
- Includes student accommodation, healthcare, car parks
- Excludes forests, bridges, houses, airports



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## Assessing investment opportunities ...

1. Market attributes • What are basic market characteristics
2. Strategic fit • How might asset class fit strategically as investment of the Fund?
3. Market conditions • Current market trends, dynamics and market prices
4. Valuation • View on whether it is currently cheap, fair or expensive
5. Implementation • What is best way to gain exposure?

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## Investment strategy – recent developments

- Equity and bond mandate restructure
  - Make effective use of active and passive strategies
- Appointment of mandates with absolute return focus
  - BlueCrest, Pyrford and Winton appointed in 2012
  - Reduce reliance on equities, diversify risk
- Timberland allocation with Brookfield
  - Attractive asset class with real returns and diversification benefit
- Emerging market debt with L&G
  - Attractive yield relative to UK bonds
- Terminated active currency mandate
  - Market conditions unfavourable for returns

**Agree focus of work for the next year**

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## Equities – current themes include

- Demand for income
  - Is the price paid for income too high?
- Trend to increase overseas over UK continues
  - Currency exposure needs to be addressed
- Mandates either highly active or passive
- Alternative sources of equity market return
  - What index to track and what is the driver to performance

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## Equity asset allocation

Manager	Mandate	Target %	Proposed action
AllianceBernstein	UK equities	7.5	Recently reviewed – scheduled for review again in 2014
BlackRock	UK equities	9.5	Retain
LGIM	Passive Regional	16.5 - 23.5*	Consider alternative approaches for part of mandate
Newton	Global	13.5	Retain
TBC	Cash	2.0	Reinvest in opportunities
Pantheon/Wilshire	Private equity	5.0	Review commitment programme – maintain exposure?

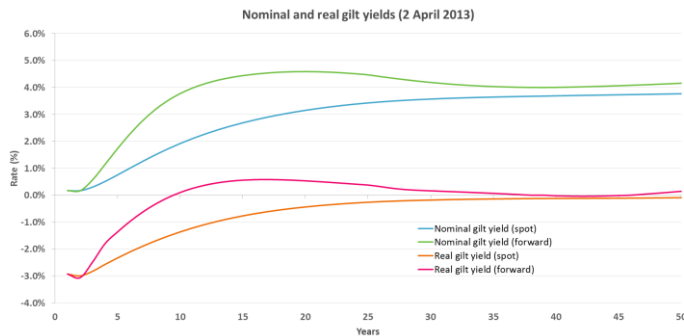
- Consider alternative equity beta approaches
- Focus on specific styles or philosophies
- Table discussions for future work programme

\*Expected reduction of c. 7% of passive regional equities with LGIM to fund infrastructure and timberland

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## Bonds – current themes include

- Considerable debate on role of bonds
- Demand for yield
- Alternative bond mandates?



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## Bond asset allocation

Manager	Mandate	Target %	Proposed action
LGIM	Passive UK index-linked	4.3	Retain as insurance/liquid asset
LGIM	Passive UK gilts	2.1	Retain as insurance/liquid asset
LGIM	Passive UK credit	12.5	Consider alternative approaches
LGIM	Passive emerging market debt	2.1	Retain

- Despite low yields gilts continue to have a role
- Investment grade UK credit offering minimal yield
- Requirement for returns within overall structure
- Allocation to EMD initial step, consider wider credit or debt opportunities as alternative to UK investment grade

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## Property - current themes include

- Concern over capital values, weak tenants and voids
- Income and quality commands a premium
- Number of high profile fund/benchmark issues
- Alternative property investments being considered



## Alternatives - current themes include

- Search for alternative sources of diversified returns continues
- Post-credit crunch opportunities appearing
  - private lending across range of credit classes
  - role of banks as source of finance has diminished
- LGPS regulations have been adapted to provide wider scope



## Alternatives – all recent appointments

Manager	Mandate	Target %	Proposed action
Pyrford	Multi-asset absolute return	6.0	Retain
Bluecrest	Source of credit return	2.0	Retain
Winton	Source of momentum return	2.0	Retain
KKR/Partners	Infrastructure	5.0	Continue to fund draw downs
Brookfield	Timberland	2.0	Continue to fund draw downs

- Significant steps taken in recent years to increase diversification
- Good mix of balancing alternatives with range of sources of return and risk
- Continue to monitor opportunities



**Thank you**

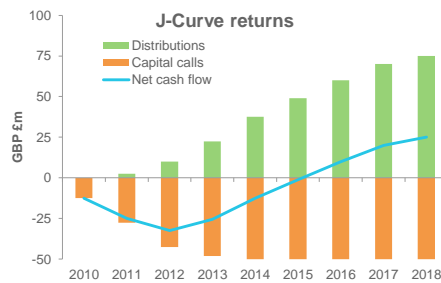
Any questions?

## Private equity

1. **Attributes**  
Equity / debt instruments in unlisted companies
2. **Strategic fit**  
Illiquid, but ultimately equity;  
At odds with de-risking plans
3. **Market conditions**  
US dominated, leverage no longer cheap
4. **Valuation**  
Historically those launched during recessions perform strongly
5. **Implementation**  
Fund of funds for diversification and access to best managers

Financing all stages of corporate development

- > **Venture capital** - start up, early stage, expansion capital
- > **Buy out** - from small cap to multi-billion dollar deals
- > **Special situations** - distressed debt, mezzanine finance



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## Infrastructure

1. **Attributes**  
Essential services, monopolistic characteristics  
Development and operational phases
2. **Strategic fit**  
Often low correlation with equity markets; inflation linked revenue has some attractions for pensions  
Illiquid with long timescales
3. **Market conditions**  
Developed world infrastructure in need of upgrade; developing world in need of building
4. **Valuation**  
More attractive than during debt boom
5. **Implementation**  
Fund of funds for diversification

National infrastructure

- > **Economic infrastructure** – public utilities, transport, communications...
- > **Social infrastructure** – hospitals, prisons, schools...

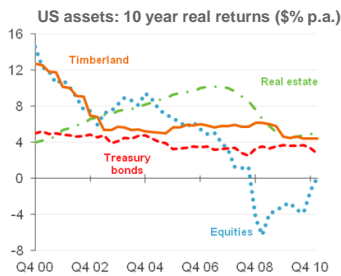
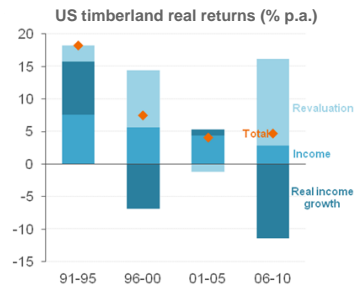
Lower risk, sector specific version of private equity

Sector	Examples
Energy	Power, pipelines
Water	Water & Wastewater networks
Transport	Train lines, Toll roads, Bridges, Ports
Communications	Satellite towers, Cable networks
Social	Schools, Hospitals

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## Timberland

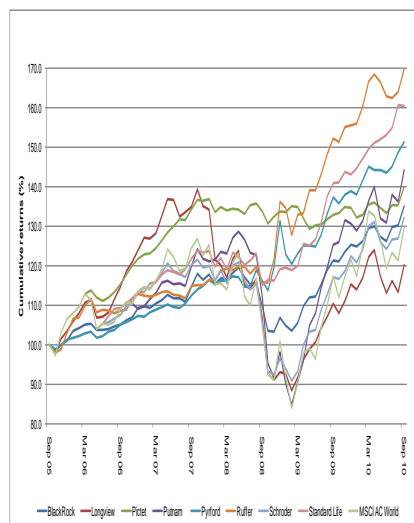
- Attributes**  
 New and existing timber plantations; diverse returns - tree growth, land value, carbon credits, biomass...
- Strategic fit**  
 Low correlation with equities and macro-economic conditions with inflation-linked returns, but illiquid.
- Market conditions**  
 US dominated; increasing demand esp. from Asia.
- Valuation**  
 Strong returns can't be expected to continue, but income growth still valuable
- Implementation**  
 Fund of funds for diversification



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## Multi-asset absolute return

- Attributes**  
 Invest in wide range of assets, traditional and alternative. Aim to preserve capital.
- Strategic fit**  
 By definition diversified, but material equity content. Offers governance to deal with wide range of asset classes.
- Market conditions**  
 Relies of lack of correlation across assets
- Valuation**  
 Decision on relative value across asset classes is taken by manager
- Implementation**  
 Key areas are performance objectives and manager selection



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## Credit opportunities

1. **Attributes**  
Broader universe of bonds – high yield, EMD, loans, convertibles, insurance-linked
2. **Strategic fit**  
Risk profile means it is a diversifier from equity
3. **Market conditions**  
Credit conditions difficult
4. **Valuation**  
Attractive yields available versus prospects on equities
5. **Implementation**  
Wide range of approaches

