London Borough of Enfield

Report Title	Changes to Fixed Income Bond Portfolio
Report to	Pension, Policy & Investment Committee (PPIC)
Date of Meeting	31 July 2024
Cabinet Member	Cllr Tim Leaver
Executive Director / Director	Fay Hammond
Report Author	Ravi Lakhani (Head of Pension Investments). Ravi.Lakhani@enfield.gov.uk
Classification	Part 1 Public
Reason for exemption	3 Information relating to the financial or business affairs of any particular person (including the authority holding that information).

Note: No information contained within the report should be deemed investment advice and is for the use of the Enfield Pension Investment Committee only.

Purpose of Report

1. To agree changes to the Fixed Income/Bond Portfolio.

Recommendations

2. The Committee are asked to agree the changes to the fixed income (Bond) portfolio of the Pension Fund ('Fund') as follows:

Manager/Fund	Value at 31 March 2024 £	Current %	Recommended Changes additional/ (reductions)	New allocations	Additional investment(dis) £
Blackrock IL Gilts	117,195,121				
- Up to 5YR UK gilt		4.5%	(4.5%)		(70,317,073)
- All Uk Gilt		3.0%	4.0%	**7.0%**	63,188,859
Western	104,245,533	6.6%	(6.6%)		(104,245,533)
LCIV Global Bond Fund (PIMCO)	82,306,067	5.2%	1.3%	**6.5%**	20,375,828
Aon Diversified Liquid Credit Fund	69,494,876	4.4%	(4.4%)		(69,494,876)
LCIV - CQS & PIMCO MAC	59,726,800	3.8%	(3.8%)		(59,726,800)
Insight	32,973,040	2.1%	(2.1%)		(32,973,040)
LCIV alternative credit fund		0%	6.5%	**6.5%**	102,681,895
Total Value	**465,941,437**	**29%**	**(9.6%)**	**20.0%**	**(150,510,740)**

Background

3. The Local Government Pension Scheme (LGPS) is governed by the Public Service Pensions Act 2013. In managing an LGPS fund, the administering authority (Enfield Council) has both fiduciary duties and public law duties. Fiduciary duties are legal obligations that require the administering authority to act in the best interests of scheme members. The investment powers must be directed to achieving what is the best for the financial position of the fund.

4. The Fund has a paramount duty to seek the best possible return on it’s investment taking into account a properly considered level of risk. A well governed and well-managed pension fund will be rewarded by good investment performance in the long term.

5. Investment returns have a correlation to the funding levels of Pension Funds. Funds that are in a surplus position may be in a position in the future to offer reduced contribution rates for employers in the Fund. Any additional investment returns may result in lower future pension contribution from Employers resulting in those employers (including Enfield Council) having additional funds to spend on front line services.

6. However, this must be considered in the overall context of risk and volatility.

7. The most significant factor in driving investment returns is Asset allocation. In January 2024, PPIC agreed to a new strategic asset allocation as follows:

Asset class	Current Strategic Allocation %	Current Actual Allocation %	Proposed allocation %
Equities	35	40	40
Bonds/Fixed income	29	30	24
Private Equity	5	8	8
Inflation Protection illiquids	10	7	7
UK Property	5	5	5
Infrastructure	16	4	16
Cash	0	6	0
Total	**100**	**100**	**100**

8. Given the current Strategic Allocation to Bond/Fixed Income is overweight, PPIC agreed to carry out a deep dive into the asset class to review which of the managers appointed are still appropriate and meet the objectives of the fund. In addition, the asset class would need to reduce in value to meet the new strategic allocation of 24%.

9. In 2023 the Fund made additional investments into various Fund managers within the asset class as a result of holding a significant amount of cash. The committee made the decision as it felt this was the most optimal use of the cash balance given the high interest rate environment. It was acknowledged that this investment was temporary and that these investments would eventually be reduced once cash is required for infrastructure investment and the asset class has had a 'deep dive' review.

10. The Bond Portfolio is the fixed income, lower risk component of the Fund's investment strategy, offering diversification from equity and other growth assets, a source of income for benefit outgoings, as well as generating additional return for the Fund. Fixed income also has inherent interest rate protection, which may match, to varying levels, the sensitivity of the liabilities, although there is no explicit matching target.

11. Key factors to consider when assessing the current mix of assets within the bond portfolio:
    - Seek to maintain a good exposure across the opportunity set (i.e., government bonds, investment grade credit, high-yield, multi-asset credit etc.), to benefit from the most attractive sub-sectors of the credit market
    - Invest globally, across sectors, issuers and economies, to improve the risk/return profile and enhance value through active management
    - Hold an optimal mix of managers to strike a balance between governance burden, complexity, diversification and efficient portfolio management (ongoing charges and transaction costs)
    - PPIC want reduced complexity and ensure that it is easier to measure and manage performance
    - Consider the Government's reiterated stance on the pooling of LGPS assets, reinforcing the benefits of pursuing options that are managed by the LCIV. Enfield PPIC remain committed to pooling.
    - Net returns on investments is the measure of financial performance.
    - Minimise transition costs through timing of sales.

12. Taking into consideration the above factors, the Committee agreed that a 4% allocation to private debt (as part of the 24% allocated to fixed income) should be included within the asset class given the attractive risk reward opportunities for this type of fund.

13. PPIC met a number of times in the first half of 2024 to review the Bond Portfolio. The review was led by Officers for the Fund and the Fund's investment advisors Aon.

Preferred Option and Reasons For Preferred Option

14. Following the review of the Fixed income/Bond asset class the proposed changes are as follows:

Changes for investment reasons

Changes for Investment reasons	Value at 31 March 2024 £	Current %	Recommended Changes additional (reduction)	New allocations	Additional investment(dis) £
Blackrock IL Gilts	117,195,121				
- Up to 5YR UK gilt		4.5%	(4.5%)		(70,317,073)
- All Uk Gilt		3.0%	4.0%	**7.0%**	63,188,859
Aon Diversified Liquid Credit Fund	69,494,876	4.4%	(4.4%)		(69,494,876)
Insight	32,973,040	2.1%	(2.1%)		(32,973,040)

15. **Blackrock Gilts** – The Fund is currently split 60/40 between short dated gilts (up to 5 years) and longer dated gilts. It is recommended to exit the short dated gilts and increase the weighting on the long dated gilts up to 7%. The rationale behind this is a negative view on short term gilts due to:

- 30-year gilt yields have increased more than shorter maturities recently
- The start of a trend down in policy rates will cause gilt yields to fall over the next two years
- Money market funds are offering similar returns on short dated gilts

16. **Aon Diversified liquid credit fund** – redeem allocation over the medium term to fund Private debt allocation. Although the Fund is suitable for the objectives of investing in asset backed securities and loans, this will be achieved by other managers in the portfolio. Private debt is a risk-efficient way to gain credit exposure that is not publicly traded. Following the 2008 Global Financial Crisis (GFC) banks have stepped back from lending in this sector due to increased regulation.

17. **Insight ARBS Funds** – redeem full allocation. The outlook for investing in absolute return bonds is relatively more unattractive now given the higher yield environment and limited upside potential. In addition, performance against benchmark has been negative over the medium to long term.

Changes for portfolio structure reasons

Changes for Portfolio Structure	Value at 31 March 2024 £	Current %	Recommended Changes additional (reduction)	New allocations	Additional investment(dis) £
LCIV Global Bond Fund (PIMCO)	82,306,067	5.2%	1.3%	**6.5%**	20,375,828
LCIV - CQS & PIMCO MAC	59,726,800	3.8%	(3.8%)		(59,726,800)
LCIV alternative credit fund - CQS		0%	6.5%	**6.5%**	102,681,895

18. The LCIV Global bond Fund (managed by PIMCO) is focussed on global investment grade credit. The fund currently has 5.2% weighting and it is proposed to increase this to 6.5%. Global investment grade provides diversification and exposure to high quality credit. In addition, the increase results in further assets into the LCIV pool.

19. The LCIV MAC fund adopts a broad multi-asset credit strategy, investing across the entire spectrum holding high yield credit, bank loans, and structure credit and investment grade credit. The Fund is split between two managers PIMCO and CQS. Although the duplication in holdings between this fund and the Global bond fund is minimal, the same fund manager for two funds could result in an overlap of research process and ideas. A switch to the alternative credit Fund within LCIV (managed by CQS) that focuses on high yield would be a better fit for the Fund and provide a more transparent split between managers and funds.

20. A new investment of 6.5% of the Fund value in to the LCIV alternative credit fund is proposed for the following reasons:
    - The fund invests predominantly across senior secured loans, high yield credit, asset backed securities and convertible bonds.
    - To achieve a better overall diversification across underlying managers (PIMCO and CQS) and retain greater control over the Fund's exposure to IG credit and MAC

Changes to bring down asset class weighting in line with Strategic allocation.

Manager/Fund	Value at 31 March 2024 £	Current %	Recommended Changes (additional)	New allocations	Additional investment(dis) £
Western	104,245,533	6.6%	(6.6%)		(104,245,533)

21. A full redemption of the Western bond fund is recommended. The Western bond fund is a segregated mandate meaning that instead of investing into a pooled investment, the manager buys individual bonds on behalf of the Fund. The manager is a UK focused manager which results in heavy weights towards real estate and utilities and it is felt globally focussed funds that are invested via

London CIV offer better diversification and greater exposure to a wide range of industries. In addition, redeeming the investment in the Fund will result in reducing the asset class allocation in line with the Strategic Allocation and a greater percentage of assets managed by London CIV.

Summary of impact of changes

22. The remaining manager/funds after the changes have been implemented are:

Manager/Fund	New allocations
Blackrock IL Gilts	
- All Uk Gilt	**7.0%**
LCIV Global Bond Fund (PIMCO)	**6.5%**
LCIV alternative credit fund (CQS)	**6.5%**
Private Debt	**4.0%**

23. The changes outlined above result in the following objectives being achieved:
    - Exposure to Gilts(Blackrock), Investment grade (LCIV -PIMCO), high yield (LCIV- CQS) and Private debt.
    - Simplicity in reducing the number of managers that the committee is required to monitor going forward.
    - All of the Fund's fixed income assets pooled with London CIV as per the Government desired direction of travel and PPIC's objectives
    - A reduction in the weight of the asset class to bring it line with the agreed strategic allocation. (including reversing the temporary cash investments made in 2023)

Additional factors to consider

24. Although there will be no direct costs charged by Fund managers for existing funds there is likely to be a loss of realised values on the sale of bonds in the Western Fund due the spread between the buys and sell price. This spread is likely to be between 0.1%- 0.2% (approx. £80k -£160k). However, officers will work with Western and the investment advisor, on the time and sizing of redemptions, to ensure any loss on spread is minimised.

25. The Committee will monitor Government Policy after the General Election in July 2024 and ensure that it takes all reasonable steps to be consistent with policy and factor in any cost consequences.

Implementation plan

26. PPIC are asked to provide authorisation to officers to implement the recommended changes that will be in the best interest of the fund.

27. As the Fund currently has a large cash holding an immediate redemption is not necessary. Instead, the implementation would approximately be as follows to minimise the loss on spread:

Changes	**Timeline**
Blackrock gilts – less than 5 years to long dated	End of Q3 2024
Redemption of Aon diversified liquid	Redeem once timeline for private debt

credit Fund	investment is understood. Likely end of 2024
Redeem -- Insight ARBS	Look for immediate redemption
Changes to LCIV Funds	Work with London CIV for optimal transition timing.
Redeem Western Fund	Work with investment managers to minimise any spread on sell price. Likely to be carried out in stages. Target by end of Q1 2025.

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Appendices

None