Investment Strategy Review – Summary of discussions

London Borough of Enfield Pension Fund

Prepared for: Pension Policy & Investment Committee ("PPIC")
Prepared by: Aon
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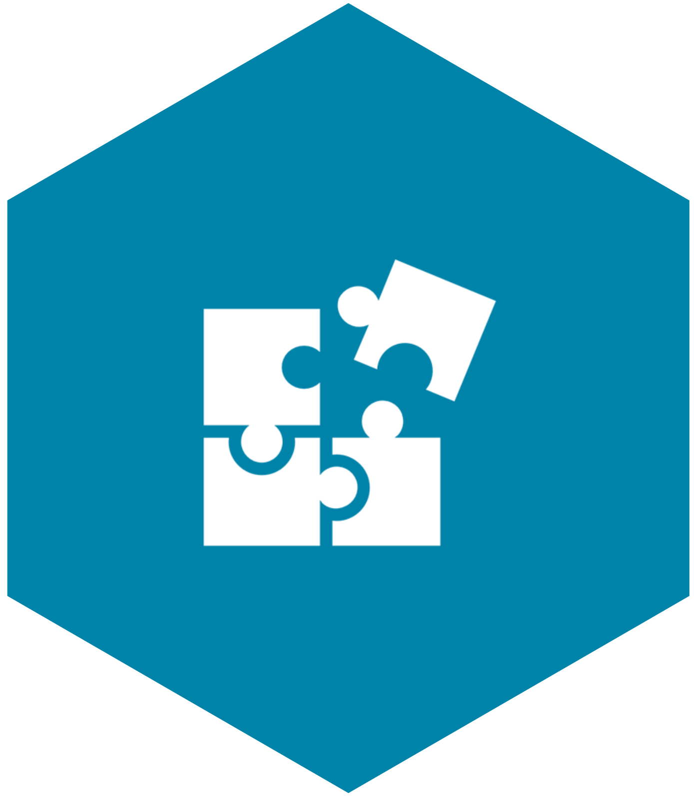
Introduction

Purpose

- The purpose of this slide deck is to consolidate the information provided to the PPIC throughout the investment strategy review exercise undertaken in 2020/21 with Aon.
- The aim is for this slide deck to act as a single point of reference for the PPIC for background on the investment strategies considered as part of the review.
- In addition, it outlines a high-level plan for implementing a revised investment strategy.



Recap: Key statistics

In our analysis we used data from the funding update provided by the Fund Actuary as at 30 September 2020:

Funding position

Discount Rate of **4.0% p.a.**

Fund asset value = £1,295m

Fund liability value = £1,260m

Fund surplus = £35m

Fund was **103% funded** as at 30 September 2020

Investment strategy

10 Year Expected Return of **c.5.8% p.a.** (equivalent to **CPI + 3.6% p.a**.) based on strategic allocation.

1 year Value-at-Risk of c.£269m (e.g. if a 1 in 20 year event were to occur, the value of the assets could decrease by c.£269m)

Key takeaway

The PPIC agreed to target a similar level of return, increasing efficiency within the portfolio if possible, subject to other constraints (e.g. liquidity, governance).

Initial portfolios considered

	Current	Portfolio 1	Portfolio 2	Portfolio 3	Portfolio 4	Portfolio 5
Metrics	Current - Strategic	Equities into alternative Fixed Income	Hedge Funds into Illiquids	Hedge Funds into infrastructure and alternative Fixed Income	Hedge Funds and Property into Infrastructure and alternative Fixed Income	Hedge Funds and Property into Infrastructure, Inflation protection Illiquids and alternative Fixed Income
Expected Return (% p.a.)[1]	3.6	3.0	3.9	3.7	3.9	3.7
Volatility (% p.a.)	10.6	8.8	10.4	10.3	10.6	10.1
1 Yr VaR (95% percentile)[2]	269M	223M	259M	256M	259M	250M
1 Yr VaR Change (%)	-	-17%	-4%	-5%	-4%	-7%
Efficiency Measure[3]	34%	34%	37%	36%	37%	36%
Asset Class Allocations						
Equity	*35%*	*25%*	*35%*	*35%*	*35%*	*35%*
Fixed income	*24%*	*24%*	*24%*	*24%*	*24%*	*24%*
Alternative Fixed Income	-	*10%*	-	*5%*	*5%*	*5%*
Hedge Funds	*10%*	*10%*	*0%*	*0%*	*0%*	*0%*
Private Equity	*5%*	*5%*	*5%*	*5%*	*5%*	*5%*
Property	*10%*	*10%*	*10%*	*10%*	*5%*	*5%*
Infrastructure	*6%*	*6%*	*11%*	*11%*	*16%*	*11%*
Inflation linked illiquids	*10%*	*10%*	*15%*	*10%*	*10%*	*15%*

Portfolio modelling results detailed above are relative to CPI.
[1] 10 year median expected return
[2] EA 1 Yr 95% VaR (£m) is a measure of risk representing an unfavourable outcome. It is calculated as the loss relative to the median expected funding position in 1 year's time that there is a 5% chance of exceeding.
[3] Efficiency Measure calculated as Expected Return/Volatility.

Focussing in on two preferred portfolios

Asset class	Current strategic allocation
Equities	35%
Private Equities	5%
Hedge Funds	10%
Property	10%
PFI & Infrastructure	6%
Bonds	24%
Inflation protection illiquids	10%

Portfolios modelled (preferred strategies highlighted)

1. Equities into alternative Fixed Income
2. Hedge Funds into Illiquids
3. Hedge Funds into Infrastructure and alternative Fixed Income
4. Hedge Funds and Property into Infrastructure and alternative Fixed Income
5. Hedge Funds and Property into Infrastructure, Inflation protection Illiquids and alternative Fixed Income

Characteristics of asset classes & preferred portfolios

	Liquidity	Complexity	ESG Implement	ESG Monitor	Management	Expected Return[2]	Expected Volatility[2]	Current	Alt 1	Alt 2
Equity	*High*	*Low*	*High*	*High*	*Active/ Passive*	*7.0%*	*20%*	*35%*	*35%*	*35%*
Fixed income	*High*	*Low*	*Moderate*	*High*	*Active / Passive*	*1.6%*	*5%*	*24%*	*24%*	*24%*
Alternative Fixed Income[1]	*High*	*Low*	*Moderate*	*High*	*Active*	*0.9%*	*4%*	-	-	*5%*
Hedge Funds	*Low*	*High*	*Low*	*Low*	*Active*	*4.1%*	*12%*	*10%*	*0%*	*0%*
Private Equity	*Low*	*High*	*Low*	*Low*	*Active*	*8.1%*	*28%*	*5%*	*5%*	*5%*
Property	*Moderate*	*Moderate*	*Low*	*Moderate*	*Active*	*5.2%*	*13%*	*10%*	*10%*	*5%*
Infrastructure	*Low*	*Moderate*	*High*	*Moderate*	*Active*	*8.3%*	*19%*	*6%*	*11%*	*16%*
Inflation linked illiquids	*Low*	*Moderate*	*Low*	*Moderate*	*Active*	*4.6%*	*7%*	*10%*	*15%*	*10%*

	Current	Alt 1	Alt 2
Expected Return (% p.a.)[3]	3.6%	3.9%	3.7%
Volatility (% p.a.)	10.6%	10.4%	10.1%
1 Yr VaR (95% percentile)[4]	269M	259M	250M
1 Yr VaR Change (%)	-	-4%	-7%
Efficiency Measure[5]	34%	37%	36%

[1] based on global corporate bonds
[2] 10 year median expected returns and volatility as at 30 September 2020. Asset class expected returns in this table are quoted in absolute terms. Further details in Appendix

Portfolio modelling results detailed to the right are relative to CPI.
[3] 10 year median expected return
[4] EA 1 Yr 95% VaR (£m) is a measure of risk representing an unfavourable outcome. It is calculated as the loss relative to the median expected funding position in 1 year's time that there is a 5% chance of exceeding.
[5] Efficiency Measure calculated as Expected Return/Volatility.

Summary

1 Liquidity

The strategic allocations in both of the alternative portfolios is not expected to change the ability to source cash to meet the Pension Fund's increasing liquidity requirements.

Income generated within the portfolio is expected to be equal or potentially higher than current.

2 Complexity

The removal of a strategic allocation to hedge funds is expected to reduce the complexity within the investment strategy.

The role of each building block within each of the alternative strategies is understood.

3 Risk & Return

By adopting one of the alternatives strategies it is possible to reduce risk in the Fund's investment strategy whilst maintaining a similar level of expected return, thus improving the efficiency of the portfolio.

4 ESG

It is possible to incorporate the PPIC's Responsible Investment beliefs into the alternative portfolios.

In the more traditional asset classes, ESG considerations are easier to implement and monitor. Within property and infrastructure, implementation options are becoming more established (e.g. renewable energy infrastructure).

5 Management Style

All of the building blocks within the strategies have elements of active management within them.

The ability to combine active and passive approaches, will have an impact on the level of fees the Fund pays.

The specifics for each asset class will be further considered at the implementation stage.

6 Asset Pooling

Both of the alternative strategies allow for continued progression towards asset pooling with the London CIV, both within the traditional asset classes and also through some of the more recent offerings available, such as the Renewable Infrastructure Fund.

Aon’s View

Suggested Portfolio

- Taking into account all of the discussions that we have had with the PPIC through the investment strategy review exercise, we believe that portfolio ‘Alternative 2’ best reflects the PPIC’s views on asset classes (notably on Hedge Funds and Property), whilst also resulting in a meaningful increase in allocation to Infrastructure, where there is the ability to implement ESG views (for example by investing in renewables).

Implementation plan

Implementation Plan

Once a revised investment strategy is agreed upon it will take some time to implement. This is in part to allow the identification of appropriate opportunities within each bucket within the revised strategy, but also reflecting the fact that it may take time to redeem from some of the current investments (most notably the hedge fund portfolio).

Phase 1

Equities: Identify opportunities to implement Responsible Investment views (where not already reflected)

Fixed Income: Review options for 'Alternative Fixed Income' allocation (if portfolio Alt 2 is selected).

Identify opportunities to implement Responsible Investment views within Fixed Income.

Hedge Funds: Establish redemption terms and submit requests to redeem with managers

Infrastructure and Illiquids: Begin to identify suitable investment opportunities

Phase 2

Fixed Income: Implement allocation to 'Alternative Fixed Income' (if portfolio Alt 2 is selected). Rebalance liquid assets to fund this allocation.

Hedge Funds: Receive redemption proceeds and re-deploy within portfolio in order to rebalance. Note that this may include a 'temporary' holding position for assets intended to be committed to Infrastructure and Illiquids.

Infrastructure and Illiquids: Commit to suitably identified funds and continue to identify opportunities (if required)

Phase 3

Infrastructure and Illiquids: Assets drawn down over time to fund commitments.

Rebalancing: Ongoing rebalancing of portfolio

Note that the allocations to **Private Equity** (in both alternative portfolios) and **Property** (in portfolio Alt 2) are expected to naturally move towards their strategic allocations.

Appendix

Aon’s Capital Market Assumptions

Aon’s Capital Market Assumptions (‘CMAs’) are Aon's asset class return, volatility and correlation assumptions, calculated quarterly by our Global Asset Allocation team.

Best estimates

Calculated such that we expect there is a 50/50 probability of long-term results being better or worse than expected.

Forward looking and long-term

Long-term (10-year) assumptions that account for historical data but don’t rely on it. Note that they are different to our Medium Term Views, which look at the next 3-5 years.

Market returns

No active management, except for Hedge Funds and Private Equity, where traditional passive investments are not available.

Large data input

Our asset class expectations are based on consensus, rather than extreme subjective views, using wide range of sources.

Capital Market Assumptions

The Capital Market Assumptions used for the current investment strategy are detailed in the table below:

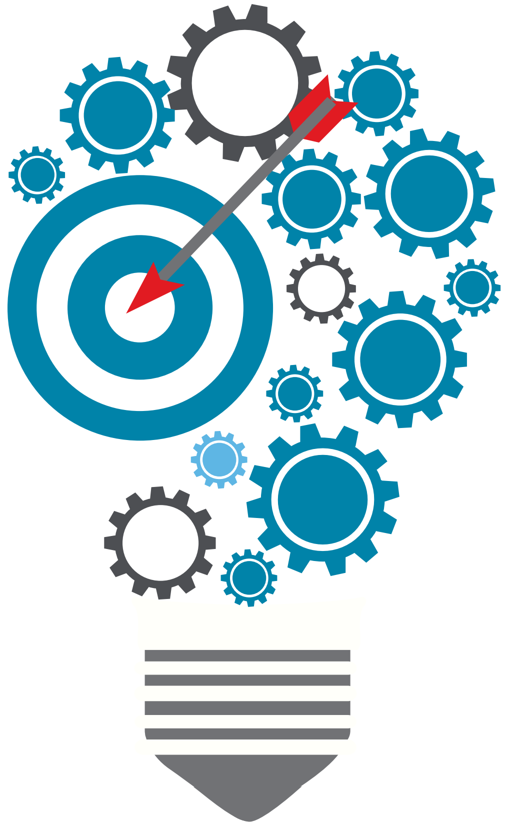
Asset Class	Sub asset class strategy	Expected Return[1]	Expected Volatility
Equities	Global Equities - Active and Passive	7.0%	20%
Private Equity	Private Equity	8.1%	28%
Hedge Funds	A combination of the Fund's respective hedge fund styles	4.1%	12%
Property	Domestic Property	5.2%	13%
PFI & Infrastructure	European Infrastructure	8.3%	19%
Bonds	Fixed Interest & Index-linked gilts, Corporate bonds, Absolute Return Bonds and Multi-asset Credit	1.6%	5%
Inflation protection illiquids	Inflation Opportunities Fund and European Infrastructure	4.6%	7%
Alternative Fixed Income	Global corporate credit	0.9%	4%

Asset class assumptions reflected in the table cover the current investment strategy and are based on Aon's Capital Markets Assumptions as at 30 September 2020.
[1]Expected returns detailed are the median expected annualised return over a 10 year timeframe. Expected returns in this table quoted in absolute terms.

Return Objective Relative to CPI Inflation

Benefits are linked to changes in CPI

- If inflation turns out to be higher than expected then the funding of the Fund would be decreased if the assets did not also perform strongly in that inflationary environment.
- We therefore consider a return objective relative to CPI.
- For an absolute return of 5.8% p.a. the equivalent return objective relative to CPI was: **CPI+3.6% p.a.**
- This was assessed by considering a distribution of possible returns from a specified investment strategy, relative to a distribution of possible year-on-year CPI scenarios.
- The scenarios were generated using Aon's Capital Market Assumptions, the details of which can be found in the Appendix.
- We consider strategies which are expected to broadly:
  - meet the return objective (i.e. median 10 year expected return of c CPI +3.6%);
  - with a suitably low volatility; and
  - a relatively low Value At Risk
- Note that without using assets that explicitly hedge inflation, even a strategy that is expected to perform well relative to CPI may still underperform those expectations in practice in some inflationary outcomes.



Median - A measure of the expected return of a strategy; the middle outcome of the distribution of possible outcomes. I.e. 50% chance of return of at least…

Volatility – A measure of long term risk; the spread of outcomes relative to the median

Value at Risk (VaR) - A measure of short term downside risk; the difference in the Funds surplus/deficit over 1 year between the expected outcome, and a bad outcome with a probability of occurrence of 1-in-20)

CPI – the Consumer Prices Index measure of inflation.

Roles & Views on Strategy Building Blocks

Property

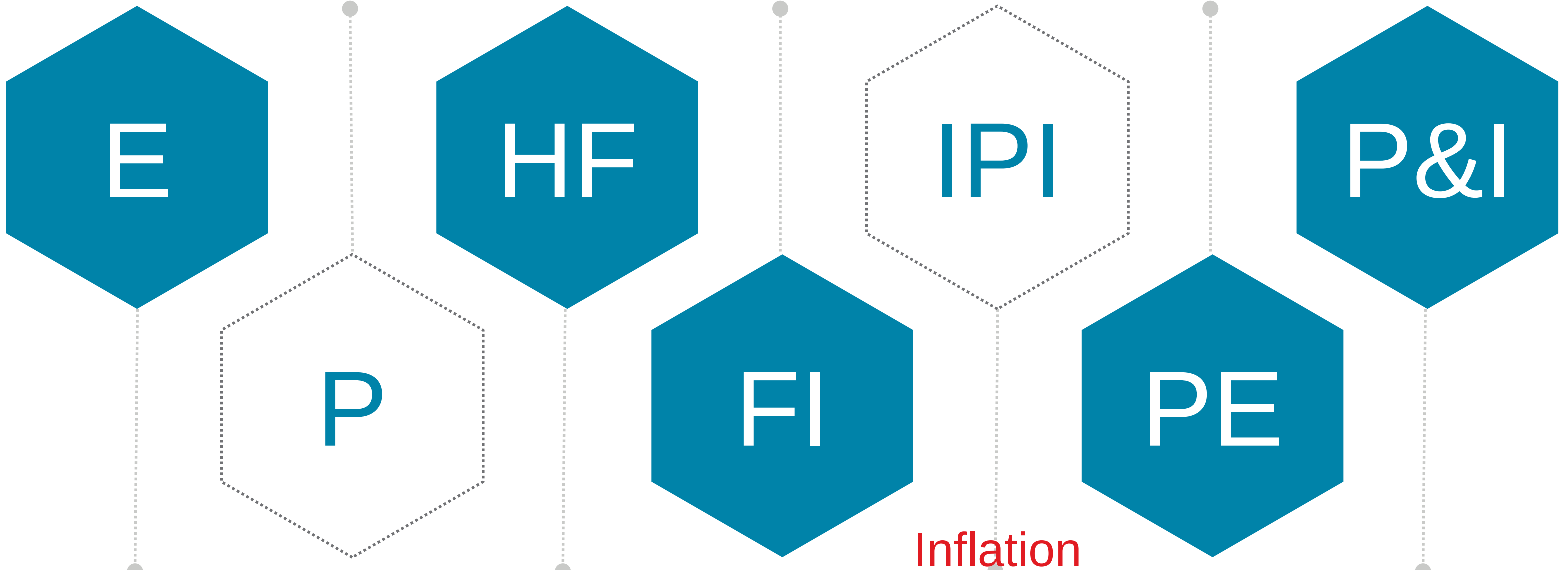
- PPIC view on future market challenges
- No increase from current allocation?

Fixed Income

- Defensive, low volatility asset class
- Consider alternative areas of fixed income universe?

Private Equity

- Illiquid return generator
- Different opportunity set, privately held companies
- Maintain allocation?



Equities

- Long term driver of returns
- Maintain a reasonable allocation
- Rebalance current overweight?

Hedge Funds

- Complex and often expensive
- High degree of manager skill
- Remove allocation?

Inflation Protection Illiquids

- Access ‘’illiquidity premium’
- Provide secure long term inflation protection
- Maintain or increase allocation?

PPI & Infrastructure

- Access ‘illiquidity premium’
- Stable secure cashflows
- Access to renewables
- Increase allocation?

Asset valuations (as at 30 September 2020)

Asset class	Strategy	Market Value (£m)	Percentage (%)	Strategic (%)	Relative (%)
Equities		**553.5**	**42.7**	**35.0**	**7.7**
	BlackRock Passive	196.1	15.1		
	Trilogy Global Unconstrained	0.9	0.1		
	MFS Global Unconstrained	125.6	9.7		
	LCIV Baillie Gifford	102.4	7.9	**32.5**	8.7
	LCIV JP Morgan EM	30.7	2.4		
	LCIV Longview Partners	78.1	6.0		
	Lansdowne Equity L/S[1]	19.8	1.5	**2.5**	**-1.0**
Private equity		**75.9**	**5.9**	**5.0**	**0.9**
	Adams Street	75.9	5.9		
Hedge Funds		**84.1**	**6.5**	**10.0**	**-3.5**
	Lansdowne Equity L/S[1]	19.8	1.5		
	York Distressed Securities	7.7	0.6		
	Davidson Kempner	29.5	2.3		
	CFM Stratus	27.1	2.1		
UK Property		**74.4**	**5.7**	**10.0**	**-4.3**
	BlackRock	35.2	2.7		
	Legal & General	33.1	2.6		
	Brockton	6.1	0.5		
PFI & Infrastructure		**70.9**	**5.5**	**6.0**	**-0.5**
	IPPL Listed PFI	47.7	3.7		
	Antin	23.2	1.8		
Bonds		**281.8**	**21.8**	**24.0**	**-2.2**
	BlackRock fixed and IL gilts	94.1	7.3		
	Western Active Bonds	106.1	8.2		
	Insight Absolute Return Bonds	30.8	2.4		
	LCIV CQS MAC	50.9	3.9		
Inflation protection illiquids		**103.6**	**8.0**	**10.0**	**-2.0**
	M&G Inflation Opportunities	76.7	5.9		
	CBRE	27.0	2.1		
Cash		**51.1**	**3.9**	**-**	**3.9**
Total		**1,295.3**	**100.0**		

Source: Northern Trust, Managers

Note: Numbers may not sum due to rounding.

[1]Due to the equity-like nature of the Lansdowne global equity long / short hedge fund investment, the valuation has been split 50:50 between equities and hedge funds.

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