HYMANS ROBERTSON LLP

# Investment beliefs

## Introduction

This paper is addressed to the Pensions Committee ("the Committee") of the East Sussex Pension Fund ("the Fund"). It discusses investment beliefs and follows on from initial discussions that took place at the Annual Strategy day in July. This paper should not be released or otherwise disclosed to a third party except as required by law or with our prior written consent, in which case it should be released in its entirety. We accept no liability to any third party unless we have expressly accepted such liability in writing.

## Background

### Good governance

A number of studies have been carried out to help define what makes a good pension fund. Many of these studies have cited clarity of objectives, focus on investment strategy and understanding and managing key risks as being core attributes – all of which we agree with. However, one other feature often cited, but often overlooked by decision makers, is having a well-defined set of investment beliefs in place.

### Investment beliefs

Beliefs are, by definition, unique to each pension committee or trustee body. They reflect the way in which committees (explicitly or implicitly) translate a fund's objectives into its actual investment arrangements. For example, you can have two funds, with broadly similar characteristics and objectives, but very different investment arrangements e.g. the extent of their use of diversification, active and passive management, regional equity exposures, approach to environmental, social and governance matters etc. all because the committees' beliefs are very different.

Having a well-defined set of investment beliefs offers a number of advantages, including:

1. **Clarity of why each mandate is held and the role it performs in the Fund's arrangements** – this clarity is of benefit to committees and the underlying members. It also offers a basis for framing external communication on investment strategy which is of particular relevance where decisions are subject to public scrutiny.

2. **Prioritisation** - having identified which investment decisions are most important, advice can be sought and meetings scheduled around these key priorities.

3. **Long-term thinking** - having a set of stated beliefs, committees are better able to avoid being unduly influenced by short-term market noise and "fads".

4. **Consistency, both of advice and decision-making** – meaning all decisions are reached using the same consistent framework.

5. **Continuity of derstanding in decision-making** – having a decision making framework based on a set of beliefs allows decisions to be contextualised which is particularly valuable if there is regular turnover of committee members, i.e. the committee may not "own" the decision on a certain element of the investment strategy, but as they own the framework, they can better understand why the decision was taken.

There is no right answer when it comes to setting beliefs, with each scheme's beliefs being unique, depending on their specific circumstances and their trustees' views. A scheme's beliefs should be revisited on a regular basis to ensure they remain appropriate. It is also important that these beliefs are reflected in the underlying portfolio of assets and in the scheme's ways of working. In the remainder of this paper we discuss what we believe are the Fund's investment beliefs.

## Fund specific

At the July meeting, we introduced the concept of investment beliefs to the Committee. Taking on board some of the initial comments from that meeting, we have prepared a draft set of investment beliefs based on our experience of working with you and the nature of the Fund's underlying investments. These are set out below:

## Draft beliefs

**Belief: Clear and well defined objectives are essential to achieve future success**

The Committee is aware that there is a need to generate a sufficient level of return from the Fund's assets, while at the same time having a clear understanding of the potential risks and ensuring there is sufficient liquidity available to pay members' benefits as they fall due.

**Belief: Strategic asset allocation is a key determinant of risk and return, and thus is typically more important than manager or stock selection**

The Committee understands that having the appropriate strategy in place is a key driver of the Fund's future success. As a result, priority is given to more strategic investment matters.

**Belief: Funding and investment strategy are linked**

The Committee understands that a number of funding related aspects feed into investment strategy decisions, including maturity, sponsor covenant and level of required return. Given this, actuarial and investment matters, most notably setting investment strategy, are looked at in tandem by the Committee.

**Belief: Long term investing provides opportunities for enhancing returns**

The Committee believes that investors with long term time horizons are typically less constrained by liquidity requirements and able to better withstand periods of price volatility. As a long term investor, the Fund may choose to gain additional compensation by investing in assets that are illiquid (e.g. property, infrastructure and private equity) or may be subject to higher levels of volatility (a premium return is required for any such investments). Having this long-term focus also helps the Fund tolerate periods of active manager underperformance when the manager's investment style is out of favour with the market.

**Belief: Equities are expected to generate superior long term returns**

The Committee believes that, over the longer term, equities are expected to outperform other liquid assets, in particular government bonds. The Committee is therefore comfortable that the Fund maintains a significant allocation to equities in order to support the affordability of contributions..

**Belief: Alternative asset class investments provide diversification**

The Committee believes that diversification across asset classes can help reduce the volatility of the Fund's overall asset value and improve its risk-return characteristics. The Committee believes that investing across a range of asset classes (including, but not restricted to, equities, bonds, absolute return funds, infrastructure and property) will provide the Fund with diversification benefits.

**Belief: Fees and costs matter**

The Committee recognises that fees and costs reduce the Fund's investment returns. The Committee considers the fees and costs of its investment arrangements to ensure the Fund is getting value for money and to minimise, as far as possible, any cost leakages from its investment process.

**Beliefs: Rebalancing can add value**

Academic studies show that regular rebalancing can help add value over the long-term. As a result, the Fund has put in place agreed tolerance ranges for their liquid assets, with the intention that assets will be rebalanced, at least towards target, should these ranges be breached.

**Belief: Active management can add value but is not guaranteed**
The Committee recognises that certain asset classes can only be accessed via active management. The Committee also recognises that active managers may be able to generate higher returns for the Fund (net of fees), or similar returns but at lower volatility, than equivalent passive exposure. The Committee will aim to minimise excessive turnover in its active managers. By carefully selecting and monitoring active managers and recognising that periods of underperformance will arise, the Committee seeks to minimise the additional risk from active management, and continue to monitor active managers to ensure their mandates remain appropriate for the Fund.

**Belief: Passive management has a role to play in the Fund's structure**
The Committee recognises that passive management allows the Fund to access certain asset classes (e.g. equities) on a low cost basis and when combined with active management can help reduce the relative volatility of the Fund's performance.

**Belief: Choice of benchmark index matters**
The Committee recognises that, for each asset class, there is a range of benchmark indices that they could use. As a result, the Committee focus on the benchmark's underlying characteristics and consider how they may be appropriate for the Fund.

**Belief: Environmental, social and corporate governance ('ESG') issues can have a material impact on the long term performance of its investments**
The Committee recognises that ESG issues can impact the Fund's returns and reputation. Given this, the Committee aims to be aware of, and monitor, financially material ESG-related risks and issues through the Fund's investment managers. The Committee commits to an ongoing development of its ESG policy to ensure it reflects latest industry developments and regulations.

### Summary

This paper set out our views on your investment beliefs. At your September meeting, we will gather your thoughts on these beliefs. Taking on board your comments and feedback, we will work with the Officers to prepare a finalised set of beliefs that can then be published on the Fund's website.

We look forward to discussing this paper with the Committee at the forthcoming meeting.

William Marshall, Partner
Paul Potter, Partner

For and on behalf of Hymans Robertson LLP

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## Risk Warning

Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of an overseas investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.