

1 Action Log and Investment Workplan

Introduction

This paper is addressed to the Officers and Pensions Committee (“the Committee”) of the East Sussex Pension Fund (“the Fund”). The intention is for this paper to bring together all investment issues relating to the Fund.

This first section will be prepared on a quarterly basis and act as a summary of current investment priorities and proposed work to be carried out. It provides the following:

- A list of actions agreed at Committee meetings; and
- An Investment Workplan detailing areas of work expected over the following 12 months.

It should not be released or otherwise disclosed to any third party except with our prior written consent, in which case it should be released in its entirety. We accept no liability to any other party unless we have accepted such liability in writing.

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

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For and on behalf of Hymans Robertson LLP

General 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.

Action Log

The action log is a reference point of all actions agreed at Pension Committee meetings. Unless otherwise stated, items in the action log are to be considered at the upcoming Committee meeting, or a comment provided explaining why the item is not to be covered at this time.

For this first iteration, we have included actions agreed at the November 2019 Committee meeting. Going forward, we will add agreed actions and remove actions once the Committee are in agreement that they have been completed.

Action	Owner	Current Position	Comments
Evolve the format of the Committee's investment papers into a single larger document covering actions, priorities and supporting papers for decision-making.	Hymans Robertson		Included in meeting pack – agenda item 6
Include '£' amounts for the benchmark fossil fuel exposure in the quarterly report	Hymans Robertson		Included in the meeting pack – agenda item 6
Conduct an asset liability modelling exercise based on 2019 cashflows and present the results at the next Committee meeting	Hymans Robertson		Included in the meeting pack – agenda item 6
Consider the steps required to remain a signatory to the UK Stewardship Code and, if the Committee wish to remain a signatory, agree a timetable for preparing the necessary paperwork	Pension Committee / Officers / Hymans		Included in the meeting pack – agenda item 6
Establish a Working Party tasked with discussing strategic aspects of the Fund and identify two dates for the Working Party to meet	Pension Committee		
Test the current arrangements for implementing agreed strategic changes for the Fund and also test the arrangements with ACCESS when up and running	Officers		
Review the quarterly report provided by Hymans and consider any potential changes	Pension Committee / Officers / Hymans		
Review the manager performance benchmarks and targets paper produced by Hymans in 2018	Pension Committee		
Engage with ACCESS partners to agree measures to mitigate concerns over pool governance	Officers		
Develop an investment risk register to link in to the main risk register	Officers		

Investment Workplan

The Investment Workplan details the areas of work that are anticipated over the next 12 months, with corresponding ownership and estimated timescale for completion.

Item	Comment	Action	Responsibility	Timescale
Strategy				
Strategic Asset Allocation	<ul style="list-style-type: none"> Funds strategic asset allocation needs to be considered following the 2019 actuarial valuation 	<ul style="list-style-type: none"> Complete asset liability modelling exercise Agree strategic asset allocation Implement agreed changes 	<ul style="list-style-type: none"> Hymans Robertson to provide analysis and recommendation Officers to implement agreed changes 	First half 2020
Private market commitments	<ul style="list-style-type: none"> The Committee has agreed to invest amounts equivalent to £235m into infrastructure and £60m into real estate debt 	<ul style="list-style-type: none"> Recommend funds for future commitments Meet capital call requests as they are made 	<ul style="list-style-type: none"> Hymans Robertson Officers 	Ongoing
Structure				
Rebalancing	<ul style="list-style-type: none"> Protection allocation in breach of upper limit Income allocation in breach of lower limit M&G Alpha Opps holding in breach of lower limit 	<ul style="list-style-type: none"> No action proposed at this time due to imminent strategy review and liquidity constraints. Drawdowns into infrastructure and real-estate debt will increase income allocation 	n/a	n/a
Equity Structure	<ul style="list-style-type: none"> Consider the Fund's active allocation and possible integration of an ESG-focused manager 	<ul style="list-style-type: none"> Once strategic asset allocation agreed, recommend equity structure and managers 	<ul style="list-style-type: none"> Hymans Robertson to provide recommendation 	Q2 2020

Managers				
UBS Climate Aware Fund	<ul style="list-style-type: none"> The Committee has previously agreed to commit a further 5% of Fund assets to the UBS Climate Aware Fund 	<ul style="list-style-type: none"> Consider whether to proceed as previously agreed, or drop the intended investment, as part of the equity structure recommendation 	<ul style="list-style-type: none"> Hymans Robertson to provide recommendation 	Q2 2020
ESG				
UK Stewardship Code	<ul style="list-style-type: none"> Consider the Fund becoming a signatory to the revised UK Stewardship Code 	<ul style="list-style-type: none"> Understand the requirements under the UK Stewardship Code with a view to the Fund signing up 	<ul style="list-style-type: none"> Hymans Robertson to advise on requirements 	Q1 2020
UN PRI	<ul style="list-style-type: none"> Consider the Fund becoming a signatory to the UN Principles of Responsible Investment (PRI) 	<ul style="list-style-type: none"> Understand the requirements under the PRI with a view to the Fund signing up 	<ul style="list-style-type: none"> Hymans Robertson to advise on requirements 	Q1 2020
Transition Pathway Analysis	<ul style="list-style-type: none"> Understand the Fund's equity resilience to a transition to a low carbon economy 	<ul style="list-style-type: none"> Conduct the transition pathway analysis on the Fund's active equity holdings with Longview 	<ul style="list-style-type: none"> Hymans Robertson / Officers to conduct 	First half 2020

2 Market Outlook

Core Asset Class Views: Summary

The slowdown in global growth is forecast to abate in 2020, though any potential rebound is expected to be modest, with 2019's slowdown perhaps reflecting a return to a lower long-term trend. While industrial momentum remains weak, labour markets, and hence consumers, have remained relatively resilient. Risks of an escalation in trade tensions between the US and China have eased, but uncertainty is likely to remain high and re-escalation represents a major downside risk to the outlook. Geopolitical risks have also increased as relations between the US and Iran deteriorate.

Valuations in equity and credit markets continue to look more optimistic than this outlook warrants. This is not a new picture and we recognise that risk assets could continue to rise amid globally accommodative monetary policy and a partial easing in trade tensions. However, further evidence of a global industrial recovery might be required to sustain any rise.

Even if the downturn in global growth may soon be over, we retain a degree of caution, holding a little more cash than usual as a result. We continue to prefer equities to property in growth-orientated portfolios and would advocate diversifying credit portfolios, avoiding any overweight and potentially trimming liquid speculative-grade exposures.

Asset Class	Current Quarter View	Previous Quarter View
Equities	Neutral to Cautious	Neutral to Cautious
Sterling Investment Grade Credit	Cautious	Cautious
Liquid Sub-Investment Grade Credit	Cautious to Negative	Cautious to Negative
Private Lending	Neutral to Cautious	Neutral to Cautious
UK Property	Cautious	Cautious
Long Lease Property	Neutral to Cautious	Neutral to Cautious
Gilts	Cautious to Negative	Cautious to Negative
Index-Linked Gilts	Cautious to Negative	Cautious to Negative

Overall ratings: Negative, Cautious, Neutral, Attractive, Positive

The ratings are intended to give a guide to our views on the prospects for markets over a period of around three years; although they are updated quarterly, they are not intended as tactical calls. The ratings reflect our expectations of absolute returns and assume no constraints on investment discretion. In practice, they need to be interpreted in the context of the strategic framework within which individual funds are managed. The property rating ignores purchase transaction costs, i.e. relevant for current holders of property.

The table below provides a high-level overview of our key observations for each asset class.

Asset Class	Comment
Equities	<ul style="list-style-type: none"> Consensus earnings growth forecasts of +9% for global equities look optimistic unless the economic data picks up and the global trade negotiations result in positive action. Global valuations have moved marginally into 'neutral – unattractive' territory but there remains a wide regional disparity, with US valuations expensive by historic companions. Equity sentiment was significantly boosted last year by the shift to more accommodative monetary policies and, although there are currently no signals of this changing, a move back towards a tightening bias would likely impact equity market sentiment.
Sterling Investment Grade Credit	<ul style="list-style-type: none"> Sterling and global corporate spreads are now below long-term median levels and the very low level of underlying yields will likely limit absolute returns from here. The continued search for yield remains a positive technical in the short-term. We continue to prefer floating-rate credit assets, such as Asset Backed Securities, as we think underlying risk-free returns will be better for floating-rate assets than fixed rate.
Liquid Sub-Investment Grade Credit	<ul style="list-style-type: none"> Debt affordability continued to drift lower in 2019 while high yield spreads tightened, touching a level they have rarely ventured below. Continued underperformance of leveraged loans has improved their relative value versus high yield bonds, though loan spreads are also well below their post-crisis median levels. Defaults have picked up in 2019 and downgrades are increasingly outnumbering upgrades.
Private Lending	<ul style="list-style-type: none"> The direct lending market continues to offer an illiquidity premium over the traded market. We also expect private corporate spreads to more closely follow the broadly-syndicated loans market than the high yield market. There has been some deterioration in covenants but, in general, the key maintenance financial test covenants remain in place.
UK Property	<ul style="list-style-type: none"> Property yields remain close to historic lows and appear stretched relative to equities although remain attractive relative to government bonds. With annual rental growth continuing a downward trend and capital growth turning negative during 2019, we expect muted returns from UK commercial property over the short to medium term.
Long Lease Property	<ul style="list-style-type: none"> On an absolute basis, long lease property valuations appear less attractive than wider property market but this market is supported by stronger fundamental and technical drivers.

Infrastructure	<ul style="list-style-type: none">• Evidence from proprietary indicators suggests that valuations remain high.• Technical drivers remain strong and investor demand is high. The uncertain economic outlook is a positive fundamental for long-term infrastructure assets.
Gilts	<ul style="list-style-type: none">• Lower forecasts for UK growth and inflation in 2020 improves the near-term fundamental support for gilts markets, particularly conventional gilts.• Nominal yields remain well below our assessment of neutral levels at all maturities. Without further yield compression, absolute returns are extremely low.
Index-Linked Gilts	<ul style="list-style-type: none">• Index-linked gilt yields remain significantly below equivalent US yields and the BoE's long-term assessment.• Some narrowing of the RPI/CPI wedge is baked into pricing but uncertainty around the future of RPI inflation including the planned government's consultation poses a risk to current valuations of longer-dated index-linked gilts.
Cash Strategies	<ul style="list-style-type: none">• This feels like a sensible time to hold more cash than usual to try and exploit better buying opportunities in the future.