East Sussex Pension Fund

Investment Strategy Recap

Overview of Current Position and Implementation of Changes

February 2022

isio.

Introduction and background

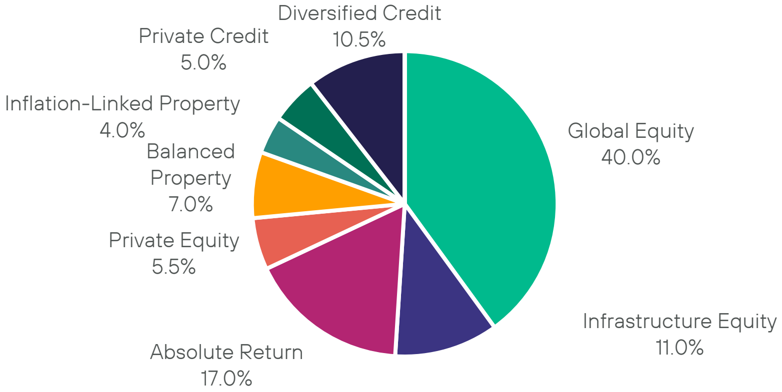
Addressee

- This report is addressed to East Sussex County Council as Administering Authority of the East Sussex Pension Fund ("the Fund").
- This paper summarises the investment strategy changes agreed by the Committee and the investment rationale supporting these, the current position of the investment strategy, the changes that the Fund is looking to implement over the coming year, and the next steps which need to be taken to progress the changes.

Background

- At the July 2021 meeting, the Committee considered an investment strategy review presented by Isio and agreed the following changes to the Fund's strategic asset allocation:
  - Reduced target allocations for diversified growth, balanced property, corporate bonds and index-linked gilts.
  - Increased target allocations for infrastructure equity, inflation-linked property, private credit and diversified credit.

Agreed Strategic Asset Allocation



Mandate	Previous Strategic Allocation (%)	Target Strategic Allocation (%) (relative to previous)	Current Position (%)
Global Equity	40.0%	40.0%	42.9%
Infrastructure Equity	8.0%	11.0% (+3.0%)	4.7%
Private Equity	5.5%	5.5%	7.4%
Absolute Return	20.0%	17.0% (-3.0%)	21.9%
Balanced Property	10.0%	7.0% (-3.0%)	8.3%
Inflation-linked Property	0.0%	4.0% (+4.0%)	0.0%
Private Credit	3.0%	5.0% (+2.0%)	0.8%
Diversified Credit	7.0%	10.5% (+3.5%)	6.1%
Corporate Bonds	3.5%	0.0% (-3.5%)	3.4%
Index-linked Gilts	3.0%	0.0% (-3.0%)	3.0%

Source: Investment managers, Isio calculations.
Notes: Data as at 31 December 2021.

Strategic rationale for investment changes

Background & rationale for the agreed strategic changes

- The strategic changes which were considered and agreed by the Committee in July 2021 were agreed on the basis that they would:
  - Increase exposure to assets with a direct link to inflation.
  - Rising inflation was seen as a key risk to the Fund given the liability structure, and increasing the allocation to assets with direct inflation linkage would help address this risk.
  - Increase exposure to less liquid assets.
  - Given the Fund's long term horizon, and the overall level of liquidity in the asset portfolio, it was agreed there was scope to target less liquid opportunities and earn an excess return for doing so.
  - Increase alignment to the Fund's Responsible Investment Policy
    The Fund has made strong progress incorporating ESG considerations into its investment strategy to date and the assets considered for investment going forward would need to continue this focus.
  - Increase the overall diversification of the Fund's holdings
- The high level rationale at asset class level is outlined below:
  - By increasing the allocation to infrastructure equity, and introducing an inflation-linked property mandate, the Committee was able to increase the Fund's level of direct inflation protection, while also adding yield and diversifying the sources of growth exposure.
  - The increased allocation to private credit is designed to allow the Fund to take advantage of the 'illiquidity premium' offered by private market debt.
  - The switch from low yielding corporate bonds to diversified credit is intended to provide the Fund with a more flexible mandate, designed to be able to achieve a similar (or higher) level of return in a wider range of market conditions.
- From an investment characteristics perspective, the outcome of the agreed strategic changes is to increase the portfolio's expected return slightly (from 5.3% p.a. to 5.5% p.a.), whilst broadly maintaining the previous level of downside risk.
- Given the time lag involved in implementing the investment changes, primarily due to the time involved in the procurement of mandates as well as the private market nature of some of the investments, it is expected that these changes will continue to be implemented in stages over the next 12-18 months.
- The absolute return allocation is currently materially overweight while the property, infrastructure and credit allocations are underweight. These allocations are expected to be brought more closely in line with the agreed target strategic benchmark as the new mandates are agreed and implemented over 2022.

Next steps of implementation

Next steps for the strategy implementation

- The current expectation is that the increases to:
  - Diversified credit will be funded from the sale of corporate bonds
  - Infrastructure equity will be funded from absolute return
  - Private credit allocation will be funded from index-linked gilts
  - Inflation-linked property will be funded from balanced property
- We propose the exact sources of funding are re-assessed at the time of drawdown, given the capital is expected to be implemented in stages over the next 12-18 months. The table to the right provides further information on this.
- The implementation of the new infrastructure equity allocation is at an advanced stage, with the Officers currently considering the suitability of the short-listed managers and funds. Once agreement is reached, the Fund will join a queue for entry to the specific fund, before having capital drawn c. 12 months. after commitment.
- The Officers have provisionally agreed the plan for the implementation of the fixed income mandates. ACCESS are currently onboarding additional managers into the pool, and we expect the complete range of diversified credit products to be available on the ACCESS platform in the first half of 2022. Following this, the fund selection, size of allocation and implementation routes will need to be considered.
- ACCESS are not yet able to provide firm timescales regarding the addition of private credit funds to the platform. Therefore we do not anticipate allocations to this space via the ACCESS platform being a realistic possibility over the short term (in the next 12-18 months). We expect further clarity on this position in Q2 2022 and will look to propose a way forward at this point.
- The implementation of the inflation-linked property allocation will also be considered in due course. ACCESS are not yet able to provide firm timescales regarding the addition of these funds to their platform, so further consideration is needed for this mandate once there is clarity from ACCESS on this.

Mandate	Current Position (%)	Target Strategic Allocation (%)	Increase/ Decrease (%)	Anticipated Primary Funding Source	Anticipated Timescales
Global Equity	42.9%	40.0%			
Infrastructure Equity	4.7%	11.0%	(+6.3%)	Absolute Return	Q1 2023
Private Equity	7.4%	5.5%			
Absolute Return	21.9%	17.0%	(-4.9%)		
Balanced Property	8.3%	7.0%	(-1.3%)		
Inflation-linked Property	0.0%	4.0%	(+4.0%)	Balanced Property	12-18 months
Private Credit	0.8%	5.0%	(+4.2%)	Index-linked Gilts	12-18 months
Diversified Credit	6.1%	10.5%	(+4.4%)	Corporate Bonds	Q2 2022
Corporate Bonds	3.4%	0.0%	(-3.4%)		
Index-linked Gilts	3.0%	0.0%	(-3.0%)		

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Thank you

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