APPENDIX B

MEETING OF LB BROMLEY, MJHUDSON ALLENBRIDGE, MERCER (ACTUARY) AND FUND MANAGERS ON THURSDAY 14TH NOVEMBER 2019

In attendance:
Cllr Onslow, Chairman of Pensions Investment Sub-Committee
Cllr Allatt, Vice Chairman of Pensions Investment Sub-Committee
Peter Turner, Director of Finance, LB Bromley
John Arthur, MJHudson Allenbridge (Council's Investment Adviser)
Joanne Job, MJHudson Allenbridge
Jeremy Dryant, MJ Hudson Allenbridge
Leanne Johnson, Actuary, Mercer
2 Representatives from Fidelity
3 Representatives from Baillie Gifford
2 Representatives from Schroders
2 Representatives from MFS

Introduction and Setting the Scene

Discussion about the value of Bromley working with investment partners and 'picking their brains' in this meeting to contribute to the Pension Fund Asset Allocation Review. This session is not part of the MJHudson Asset Allocation Review and is intended to seek views on the future approach for the Fund. The discussion will be about different opportunities and asset classes and it is not about consideration of fund managers products. We are not seeking a 'house' view at this session, rather an independent view. Words of thanks about helping Bromley achieve top investment performance and we are all keen that it continues.

In 2018/19, income of £10.3m was distributed to the fund and a further £10.3m was reinvested (total income from investments of £20.6m in 2018/19). This compares with a negative cash flow position (arising from a shortfall of current contributions in relation to pension payments but excluding investment income) of an estimated £13m in 2020/21, £14m in 2021/22, £16m in 2022/23 rising to £26m by 2027/28. This highlights that income from investments rather than capital growth will become more critical as the negative cash flow increases. The negative cash flow position provides a greater challenge in balancing investment returns against risk and the need to pay pensions. Bromley's Fund is expected to be fully funded and we need an approach that helps to maintain that position but provides adequate returns for future service and but need to minimise cost to council taxpayers.

The Actuary referred to changes in life expectancy estimates which reduces potential liability costs in the future for the Fund. There remains uncertainty with the impact of the McCloud judgement which adds a cost of around 1% to overall funding level – potential annual cost of £1m per year. This represents a guesstimate at this stage and details of the final outcome are awaited.

Market Conditions – Looking Forward

We are in an environment of low interest rates resulting in low fixed income returns which ultimetaly impacts on overall fund performance. Need to beat inflation to meet liability costs and exceed discount rate set by the actuary to prevent a funding deficit.

In looking at performance in last three years one firm referred to the benefits of Quantitative Easing (QE) which benefitted bonds and gilt yields. There is still QE happening in the world economy and some stock is looking fully valued. Interest rates are expected to move up modestly. Earnings have been reasonable in the last three years but looking flat now.

Another firm referred to markets outperforming economic growth in last three years. With economic growth low, markets have a greater challenge to continue to outpace. QE has become less important and expect lower returns in the future. Need to take higher risk to maintain current investment returns.

Another firm referred to their expectation of lower returns generally but there are still opportunities in the market. Expect some progress between USA and China, Consumer growth worldwide is still strong and if trade wars are resolved market performance will improve. Investors seem less concerned about risk but it remains – pressure to chase yields. Bond markets are pricing low inflation but that could change.

Another firm agreed with the comments so far but referred to different signals being given in the worldwide marketplace but there remains some undervalued stock.

Always a high inflation risk in the future which can't be ruled out.

Actuary Update on Discount Rates

Actuary looking at CPI +1.25% for past service and CPI +2.25% for future service. Final figures yet to be determined but guide at this stage and may change. The overall Fund has members with an average age of 52 years old – the fund is maturing rapidly. Average age of deferred members is 51 years of age. Reflects a reduction in new members in the fund over a period of years.

Fixed Income and Infrastructure

Still awaiting the normalisation of bonds. Recognise lower returns but less volatility and income paid. Discussion about infrastructure and in reality it is difficult to find a good product that gives the timing and cash flow Bromley needs. They are still complex products out there and you can face risk if an overspend on an Infrastructure Product which may require investors to contribute more and have resultant reduction in yield. Potential benefits if gives steady cash flow and is inflation linked – helps deal with a negative cash flow position. Key remains finding the right investment vehicle- price of liquidity can be high volatility. Demand is pushing up price in UK and still limited number of opportunities. Only one of the four firms directly invest in infrastructure. The firms would not view significant infrastructure investment as a positive consideration for the Fund.

Currency

The long term view is that sterling will appreciate. The current approach of the Fund is sensible with a reasonable level of hedging (not excessive) within funds. Currency tends to equalise in the longer term. Have to recognise that there is a cost to hedging currency.

Passive vs Active

Requested information from firms that could be provided following the meeting.

Engagement vs Exclusion

Requested information from firms that could be provided following the meeting

Anticipated Investment Returns in next 10 years.

Achieving excess over inflation is key.
Initial views provided as below but will receive responses after meeting with 'house view'

Equities – between 5.1% and 5.7%
Multi Asset Income Fund – between 3.5% and 4.5%
Private Equity – between 6% and 6.5%
Renewables – between 5% and 5.5%
Infrastructure – around 4.75%
Diversified Growth Fund – 5.5%
Property Fund – between 3% and 4%
Fixed Income – between 1% and 2%
Commodities – broadly match inflation
Multi Asset Credit – rates between fines income and multi asset funds
Unlisted Equities (some illiquidity) – 6% plus
Also need to consider emerging markets and securitised lending (no estimated returns provided)

Discussion that the above figures should not be considered in isolation and have to consider risk, volatility and choosing the right markets.

Asset Allocation Review – MJHudson Allenbridge

Are updating key assumptions at this stage and this asset allocation review recommendation is expected to be less disruptive than previous reviews. Options include taking monies out of equities and move to income products e.g. Multi Asset Income Funds. Also options around moving bonds into higher risk products.

Asset Allocation Review – View from Firms

Appears right balance at moment and selling some equities helps de risk. Less concern about volatility as allocation is well balanced (60/40). Need income related equities to help cash flow position. Could look at inflation protection products but can have a negative impact at present.

Discussion about Council's approach on investment principles and ESG. It was supported and aligns with what fund managers are doing to achieve sustainable investments with good returns. Discussion about the need to retain a fixed income element – although the returns are low (15% of total investments) it helps deal with the impact of a possible scenario of the global economy going wrong. Any de risking does provide less volatility but can reduce the discount rate with a resultant cost to the Council.