PENSIONS INVESTMENT SUB-COMMITTEE

Minutes of the meeting held at 6.30 pm on 27 January 2021

Present:

Councillor Keith Onslow (Chairman)
Councillor Gareth Allatt (Vice-Chairman)
Councillors Simon Fawthrop, Simon Jeal, David Jefferys, Christopher Marlow and Gary Stevens

Also Present:

John Arthur, MJ Hudson Allenbridge

100 APOLOGIES FOR ABSENCE AND NOTIFICATION OF SUBSTITUTE MEMBERS

There were no apologies for absence.

101 DECLARATIONS OF INTEREST

There were no declarations on interest.

102 QUESTIONS FROM MEMBERS OF THE PUBLIC

No questions had been received.

103 CONFIRMATION OF MINUTES OF THE MEETING HELD ON 1 DECEMBER 2020, EXCLUDING THOSE CONTAINING EXEMPT INFORMATION

RESOLVED that the minutes of the meeting held on 1st December 2020 (excluding exempt information) be confirmed.

104 PENSION FUND PERFORMANCE Q3 2020/21
Report FSD20100

The Sub-Committee received a report providing a summary of the investment performance of Bromley's Pension Fund in the 3rd quarter of 2020/21. Further detail on investment performance was provided in a separate report from the Fund's external adviser, MJ Hudson Allenbridge, at Appendix 5. The report also contained information on general financial and membership trends of the Pension Fund and summarised information on early retirements.

The Chairman invited John Arthur of MJ Hudson Allenbridge to summarise his report. His report had been written before final performance data was available, but it was clear that it had been a good quarter with the Fund outperforming against the benchmark by 2.17% and reaching £1.313bn. The three main factors were the strong performance of the Baillie Gifford Global Alpha Fund (which provided about half of the added performance), being overweight in equities, the best performing asset class, and the straight line increases of the multi asset income funds.

The Fund was 4.6% overweight in equities at the end of 2019 and underweight in other classes. The re-allocation towards added value property had now started and about $70-80m would be drawn down over the next four years, with roughly $5m a quarter going out to Morgan Stanley. It was important that this was managed, and he recommended holding an element of cash, probably $10m, for this purpose. As the Fund would be gently selling equities to finance the move into international property, he proposed, to keep the fund stable, that some profits when equities outperformed were banked into the multi asset income fund. This would control risk while there was a cash outflow from the Fund. He suggested that if multi asset income dropped below 18% of the Fund at quarter end then equity should be moved across.

There had been a steady improvement in the equity portfolios, despite the drop in March 2020. In terms of cash-flow, the Fund remained roughly in balance. He viewed March 2020 as a liquidity crisis, with central banks stepping in with massive quantitative easing which stopped further deterioration. There had then been a hope phase followed by a solvency phase, when the long-term effects of the covid crisis on the economy were being assessed.

The UK had performed poorly over the quarter compared to the US market which was more tech-heavy. In terms of the global outlook, the massive build up in debt (UK Government borrowing had reached £280bn) would lead to inflation and a volatile return on assets over the year. With personal spending across the world depressed by the crisis, as the vaccines were rolled out he expected an urge to spend and a rapid recovery later in the year. The question would be whether this would lead to inflation. In the medium term, he suggested that the recovery would be as transitory as the crisis caused by the pandemic, and high government debt would reduce economic growth.

In terms of the individual fund managers' reports, Baillie Gifford's performance continued to be exceptional. MFS performance was slightly behind the index for the quarter, and they had not caught up since the initial impact of the pandemic in Q2. The Fidelity Fixed Interest portfolios both outperformed their indexes, and the two multi-asset income funds performed well in a rising market. Schroders had a higher target of cash plus five, with more equities, whereas Fidelity were cash plus four. The assumed ten year returns for gilts and index linked gilts were surprisingly poor with relatively high levels of volatility, supporting the Sub-Committee's move away from gilts to investment-grade. The Fidelity Property Fund was going through a number of refurbishments, and Mr Arthur suggested calling in the fund manager to discuss this. The fund could be positioned well, but this depended on their success with renting out these redeveloped properties.

The Sub-Committee discussed Mr Arthur's recommendations. Members supported the idea of holding cash available for the draw-downs for the Morgan Stanley fund, but Cllr Fawthrop argued that this should come from fixed income funds, not from equities. Other members argued that they should not re-visit the decision to reduce equity allocation.

The Chairman asked for an update on the cash-flow position – problems had been anticipated at the last but one revaluation, but this appeared to have been largely overcome. Mr Arthur responded that officers would have a better view on this, but he understood that the multi-asset income fund and the UK commercial property fund were producing enough income to cover the cash outflow, but it would be necessary to top up the multi-asset portfolio periodically.

Asked whether it was realistic that property funds were still expecting to achieve high rental income from office property, Mr Arthur commented that fund managers were surprisingly confident that specific markets and assets in refurbished office space would provide a premium, and he would welcome the opportunity to question their assumptions. The Chairman reported that MFS were due to attend the next meeting, and some Members proposed inviting Fidelity to talk about their UK Property Fund as well. A motion to invite both was defeated, but the Chairman stated that he would consider this with the Vice-Chairman and officers in the light of the overall agenda.

A Member asked about re-investing surplus funds. The Director of Finance reported that there was a surplus of around £6.1m to be re-invested in the current year, and multi-asset income funds had made a positive impact on cash-flow. John Arthur commented that he understood that the Baillie Gifford equity fund, MFS and the two Fidelity fixed interest funds did not pay out income and money was naturally re-invested, but the multi asset income funds and the UK property fund did. This currently covered net outflow on benefit payments with some spare. He expected the Morgan Stanley fund to scoop up any surplus funds over the next few years.

Cllr Fawthrop commented that the Sub-Committee should decide the guiding principles for this, and requested a report to the next meeting.

John Carnegie and Tim Gooding from Baillie Gifford attended the meeting to give a presentation on the Global Alpha fund, which had risen in value to over the £585m shown on the slide. They were continuing to invest in the future by recruiting thirteen graduate trainees, and had opened a Shanghai research office. Charles Plowden, who had been involved in managing Bromley funds since 1999, was due to retire shortly, and would be replaced by Helen Xiong. The target was to outperform by 2-3% per annum over the long term, and they had exceeded this since moving into global equity in 2013. In 2020, the fund had outperformed by about 20%, with a huge acceleration in trends that the fund was exposed to – particularly the success of technology companies and the movement towards online.

Tim Gooding commented on the fund's Tesla holding. The company was continuing to grow its car, autonomous driving software and stationary energy storage businesses and with strong governance now in place was likely to continue to provide exceptional performance. The Fund's holdings in Tesla had been reduced three times to maintain the balance of the Fund, but Baillie Gifford's view was that this remained a technology-led company likely to continue to grow.

In terms of the overall balance of the Fund, with the success of technology stocks there was now a weighting towards Growth Stalwarts and Rapid Growth, and they were looking for opportunities in Cyclical Growth and Latent Growth to re-balance – this was particularly with companies in difficult markets which were poised to exploit the current opportunities. There was a growing taxation and regulatory threat for digital businesses, and Baillie Gifford carried out annual tax audits across the portfolio and was actively engaging with companies that were pursuing inequitable policies aimed at artificially reducing their tax bills – to be sustainable in the longer term these businesses need to have a good relationship with their customers and stakeholders. Although the move online had fuelled enormous growth it was important to distinguish between growth pulled forward from future years, and real long-term potential. Baillie Gifford was now looking for opportunities in sectors such as education and healthcare. Finally, he explained that the Global Alpha Paris-Aligned portfolio had now been launched, partly in response to demand from LGPS clients for an ultra-low carbon scheme.

In response to questions, Mr Gooding explained that they tried to keep abreast of technological changes and opportunities by judging the correct themes and directions, and the potential winners, rather than trying to be too accurate about detail. The focus was on research and talking to experts and academics about long-terms trends, rather than on broker's notes on short term performance.

Asked about SpaceX, Mr Carnegie explained that this was a private company and likely to remain so. In terms of changes in US energy policy, their focus was on longer term trends rather than the political atmosphere. The issues surrounding China's persecution of Uighur people in Xinjiang were difficult to respond to, but he emphasised that there were no blameless companies, and the aim was to support and encourage good practice and progress. Tim Gooding added that the small number of private Chinese companies they invested in tended not to be government owned, and it was companies like these that had driven three quarters of the rapid growth in China over the past forty years. The Chairman suggested that there was a potential contradiction with technology companies so dependent on precious metals for their batteries which allegedly were sometimes mined by slave or child labour. John Carnegie commented that Tesla were trying to develop their own infrastructure to have a greater influence on their supply chain. Paris-aligned funds were intended to reduce carbon emissions, and this was central to Tesla's activities. He added that companies chastened by being involved in difficult issues were more likely to improve their environmental and social policies in future. Members also mentioned Chinese activities in Hong Kong, and investment in the South African company Naspers, although it was explained that Naspers was mainly owned by a Chinese company and its headquarters was in the Netherlands.

Mr Gooding confirmed that in his view AI and accumulation of data would be critical, particularly in fields such as healthcare. Baillie Gifford were seeking to invest in companies that could strip costs from systems and use data effectively. They were also looking at leisure to similarly identify the companies well-placed to profit from long term trends.

Asked whether projections for Tesla's growth in Chinese markets were realistic, and what the implications of the Chinese/American rivalry were, Mr Carnegie agreed that Chinese/American relations were likely to be strained for a long time. The key was to pick winners both inside and outside China, and Tesla was in a good position to exploit Chinese priorities for electric vehicles and exploiting solar energy.

Tim Gooding confirmed that only seven stocks had been excluded from the Paris-aligned Fund; three companies were automatically excluded in view of their role in exploiting fossil fuels, but with other companies the broad issue was whether they were making a positive contribution to the climate issues or were part of the problem. The Paris-aligned Fund had exactly the same target as the core Fund, and as the overlap of funds was high there was not expected to be a material difference in performance between the two models.

Asked about the biggest risk to financial markets at the moment, Mr Carnegie emphasised that Baillie Gifford were looking to find the companies that would be flexible enough to cope with challenges, and well-placed to recover from the current problems. The company felt that its greatest risk was not having the talent to perform its job - this was why the largest number of graduate trainees in the company's history had just been recruited.

The chairman thanked Baillie Gifford for their service to Bromley and John Carnegie and John Gooding for attending the meeting; he also asked them to pass on the Sub-Committee's best wishes to Charles Plowden for his retirement.

RESOLVED

(1) That the report be noted.

(2) That the Fund holds 6 months forecast drawdown into the Morgan Stanley International Property Fund as cash (approximately $10m); to rebalance the Fund from Equities into Multi-Asset Income if the Multi-Asset Income weight in the Fund is more than 2% below the SAA benchmark (i.e. 18%).

(Councillor Simon Fawthrop requested that his contrary vote be recorded.)

105 MEMBER SELF-SERVICE AND I-CONNECT (PART 1)
Report FSD21009

The Sub-Committee received a report providing information about the forthcoming implementation of the Member Self-service portal and i-Connect, the data management portal. It was confirmed that normal communications with scheme members were continuing outside the system, and the proposals in the report were to implement an updated solution from the existing contractor after elements of the system had been turned off at Bromley's request in August 2019 due to security concerns. It was confirmed that the self-service portal would hold scheme documentation and allow scheme members to make inquiries about their entitlements, automating manual processes for maintaining and changing personal information.

Some Councillors questioned whether the costs should exceed the savings from automation, and asked whether there had been a procurement exercise. It was explained that this was an extension of the existing contract so the Council was restricted to using this one solution for the remainder of the contract until 2023, unless it was prepared to re-configure the whole IT system overlay. The proposal would future-proof interactions with scheme members and also assist with the changes to regulations expected in the next few years.

RESOLVED that the proposed changes to the contract for the Pension System with Aquila Heywood, the impact these changes will have on fund administration for the Council and the pricing details included in the part 2 report based on the package of implementing both Member Self-service and i-Connect, be noted and supported.

106 LOCAL GOVERNMENT ACT 1972 AS AMENDED BY THE LOCAL GOVERNMENT (ACCESS TO INFORMATION) (VARIATION) ORDER 2006 AND FREEDOM OF INFORMATION ACT 2000

RESOLVED that the Press and public be excluded during consideration of the items of business referred to below as it is likely in view of the nature of the business to be transacted or the nature of the proceedings that if members of the Press and public were present there would be disclosure to them of exempt information.

**The following summaries
refer to matters
involving exempt information**

107 CONFIRMATION OF EXEMPT MINUTES - 1ST DECEMBER 2020

The exempt minutes of the meeting held on 1st December 2020 were confirmed, subject to a minor correction.

108 MEMBER SELF-SERVICE AND I-CONNECT (PART 2)

See minute 105.

109 UPDATES FROM THE CHAIRMAN/DIRECTOR OF FINANCE/PENSIONS INVESTMENT ADVISOR (PART 2)

The Chairman and Director of Finance updated Members on a number of issues affecting the Pension Fund.

The Meeting ended at 9.30 pm

Chairman