REPORT PREPARED FOR

Worcestershire Pension Fund

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Independent Investment Advisor's report for the Pension Committee meeting

28 June 2023

Worcestershire Pension Fund

Quarter to end March 2023

Summary and Market Background

The value of the Fund in the quarter rose to £3.553bn, an increase of £119m compared to the end December value of £3.434bn. The Fund produced a return of 2.7% over the quarter, which was 0.5% behind the benchmark. The main reason for the underperformance was attributed to the Property and Infrastructure mandates. Over a 12-month period the Fund recorded a negative relative return against the benchmark of -0.5% (1.2% v. -1.7%). Performance over three years against the benchmark has dipped to -1.4%. The Fund has performed at or near the benchmark over the five- and ten-year periods, details of which can be found in Portfolio Evaluation Limited's report.

As already reported, the equity protection strategy in its current form has been liquidated. It is important that the capability to implement protection is maintained, given that the asset allocation continues to have a relatively high percentage of the Fund's assets (70%) invested in equities. The equity protection strategy forms part of the overall risk management arrangements, with the objective of continuing to provide some protection to the funding level in the event of future significant falls in equity markets. The initial work to reinstate the ability to implement equity protection as and when required in the future has commenced, although this is unlikely to be in place until Q4.

With the Triennial Actuarial Valuation successfully completed which has not shown anything that is unexpected or that would require major changes in the Fund's investment strategy, attention turned to the Strategic Asset Allocation review. The main items that needed to be considered are ensuring that the mix of assets are appropriate to deal with a) inflation likely to be running at a higher level than we have been accustomed to in recent years and b) a

higher cash flow requirement to accommodate the increase in pension payments resulting from higher inflation. The process of evolution to keep the Fund in good shape should continue, the details of that are contained within the Strategic Asset Allocation review, to ensure that we have sufficient liquidity along with the right mix of investments to diversify risk and to meet the longer-term objectives.

In summary, these are the recommendations contained in the Strategic Asset Allocation review, which was approved by the Pensions Committee on 22nd March.

Exposure to China

To seek that we do not allocate to China within the Nomura Mandate and that this then be left to the Fund Manager to allocate this proportion of the Fund over other areas within the existing mandate.

Performance of LGPSC Emerging Markets

That the Fund awaits the outcome of the 3-year Emerging Markets review being undertaken by LGPSC before deciding what action to take on this mandate.

Passive equity allocation

To increase the Fund's passive market allocation by 5% to the US and reduce the UK allocation by 5%.

Investment in private equity

Allocate up to 5% of the Funds Strategic asset allocation (SAA) to Private Equity (PE), within the alternatives sleeve alongside Property & Infrastructure, and that this be built up steadily over the strategic asset allocation period from equities.

Equity protection

That officers look to procure a segregated Equity Protection strategy mandate so that it is available to the Fund as and when required.

Confirm re-up policy

Although this is normal practice for the Fund, our investment strategy does not explicitly specify this. It should be stressed that this will be on a case-by-case basis, being mindful of allocation size/ scale in relation to the Fund.

Income-generating assets

That the Fund continues to explore opportunities to deploy capital in alternative assets with an income focus to ensure that a continued long term cashflow solution is in place.

Liquidity waterfall

The Fund will establish a collateral waterfall to ensure liquidity requirements are met and only use this liquidity waterfall for one off / very short-term liquidity needs and that this should be undertaken with dynamic monitoring so that income is only released to match current requirements, to prevent a build-up of cash to unnecessarily high levels.

We also need to be cognisant of the constantly rising expectations and requirements relating to ESG and climate change considerations. Considerable progress has already been made in this respect by the Fund and by LGPS Central, but this is an evolving process and consideration needs to be given to the pace of next steps and what they should be.

Performance during Q1 2023 has once again been a bit of a mixed bag, but also has highlighted the value of having a diversified portfolio of asset types. It was pleasing to see a continuing recovery in values for the public market assets, and although on a wider basis property and infrastructure values suffered some falls, our mix of investments fared relatively very well. Although the impact of inflation on the cost of living continues to manifest itself, markets generally seemed to be trying to look through the economic gloom to potentially better times ahead.

In performance terms from our active managers had a good quarter, with Nomura (Pacific) showing an outperformance of 1.1% and LGPS Central (Emerging Markets) outperformed by 1.2%, with all three managers contributing to that (although UBS did not achieve the target return). It is good to see a positive contribution in Q1 from the LGPS Central Global Sustainable Active Funds, with the Targeted strategy outperforming by 3.0% and the Thematic strategy by 1.2%. LGPS Central (Corporate Bonds) slightly underperformed the benchmark, by -0.2%. The total property fund showed an underperformance against our own benchmark of -3.2%, which is a relatively good position given the hiatus seen in property in general during Q1. In the context of the long-term nature of the Fund's investment strategy these times of weakness are not significant detractors from overall performance.

The alternative passive strategies outperformed the passive equities by 0.3% (0.1% v. -0.2%). Active equities also outperformed passive equity, by 1.5% (1.3% v. -0.2%). Out of the passive geographies Europe was again the winner (8.8%), with North America (4.7%) next, with the UK (3.1%) being the laggard this time.