

Executive Summary to the Strategy Review

The current portfolio (i.e. the current “tactical” asset allocation) yields an expected annual return of 4.6% with an expected volatility of 9.33%, based on the modelling using our Long-Term Capital Market Assumptions (“LTCMA”). This return is already sufficient to exceed the discount rate assumed by the actuary (i.e. 4.3%) and thus would be expected to improve the funding position of the Fund over time. However, when compared to the Fund’s current strategic asset allocation (“SAA”), the current portfolio has a materially less efficient risk-return characteristic. This suggests that the delays in deployment (as per the SAA) experienced by the Fund has resulted in lower expected returns and higher risk. Rebalancing the Fund back to its existing SAA, increases the expected return and reduces the expected volatility.

Nonetheless, our analysis shows that the investment portfolio can be made more efficient than the current SAA, targeting higher returns for a given level of risk, or reducing the level of risk for similar levels of expected annual return. As such, in order to improve expected returns, reduce downside risk (as measured by Value at Risk (“VaR”) and hence increase probability of being fully funded over the medium to long term, we would propose a number of alterations to the SAA.

We outline three proposed portfolios for consideration below: “Portfolio A – Targeted Return”; “Portfolio B – Higher Return” and “Portfolio C – Lower Risk”. The first two portfolios target higher expected returns with similar levels of expected volatility to the existing SAA and lower than the current portfolio whilst reducing the Fund’s VaR in both cases.

- Portfolio A – (Exp return: 5.2; Exp Volatility 8.9). Re-allocates a portion of equities to private equity and infrastructure, and traditional fixed income assets to multi-asset credit and private debt; diversified growth funds (“DGFs”) have been removed in favour of the aforementioned asset classes.
- Portfolio B – (Exp return: 5.4; Exp Volatility 9.0). Builds on the same theme as Portfolio A and but shifts a greater proportion of assets to these illiquid asset classes, and as such is expected to generate higher long-term returns, but the level of liquidity risk is greater which in the event of an economic downturn would be challenging for the Fund.
- Portfolio C – (Exp return: 5.0; Exp Volatility 8.3). Represents an overall lower risk option with marginally better expected returns than the current SAA. The proposal re-allocates a larger proportion of the equity exposure and some traditional fixed income, to income-generating alternatives, resulting in materially reduced liquidity risk and higher proportions of fixed income assets than either Portfolio A or B.

Overall, we would believe Portfolio A – Targeted Return to be the most attractive in the current environment.

Additionally, we were asked to explore whether the Fund could tilt its portfolio to embrace ESG (“Environmental Social and Governance”) considerations in the investment strategy, based on the investments available through the Brunel Pension Partnership (“Brunel”). We have considered this and included these considerations in the proposals. We have also presented this option in isolation in the Other Scenarios section in the full report, to illustrate the stand-alone impact of the changes.

Lastly, based on the cash flows and expected contributions provided by the Fund’s actuary and our cash-flow analysis, the Fund is expected to become only marginally cashflow negative in the near-term. When considering the current commitments made to illiquid assets (including private equity, infrastructure and secured income), and assumed deployment rates, this results in substantial negative cashflows but these would be funded from any proceeds from asset sales resulting from this portfolio rebalancing exercise. It is important to note that under the current portfolio and all proposed portfolios, the Fund has sufficient liquid investments to meet the near term cashflow obligations should this be required. Nonetheless, our view is that it would be more efficient to re-allocate some of the investments to income-generating assets rather than selling growth assets (such as equities) in future, prematurely at potentially inopportune times in order to raise cash. This is considered in the proposed scenarios and is part of the rationale behind the choice of investments.