Equity Portfolio Review

Addressee and Purpose

This paper is addressed to the Pensions Committee (the "Committee") of the London Borough of Havering Pension Fund ("the Fund"). The purpose of this paper is to summarise the review of the Fund's equity portfolio undertaken in September 2024 and outline our key recommendations.

Introduction

Following the post-valuation investment strategy review in 2023, it was agreed to consider the Fund's equity portfolio in greater detail to test whether the current allocation remains appropriate. As a reminder, the Fund currently has a 40.0% allocation to listed equity. Of this, 20% is invested in mandates within the London Collective Investment Vehicle ("LCIV") and 20% is invested in mandates managed by LGIM (which are LCIV aligned).

We considered three areas as part of our review of equity allocations:

1. Performance of the mandates relative to respective benchmarks and opportunities for change.

2. Exposures relative to benchmark, including style, geography, sector.

3. Climate characteristics of the current strategy.

Asset Allocation as at 30 June 2024

The table below summarises the Fund's equity holdings as at 30 June 2024,

Mandate		Active vs. Passive	Valuation (£m)	Actual Proportion (%)	Benchmark (%)	Relative (%)
LGIM Global Equity	LCIV Aligned	Passive	42.9	4.4%	5.0%	-0.6%
LGIM Emerging Markets	LCIV Aligned	Passive	40.5	4.1%	5.0%	-0.9%
LGIM Future World Fund	LCIV Aligned	Passive	109.1	11.1%	10.0%	1.1%
LCIV GAGPA	LCIV	Active	159.3	16.2%	15.0%	1.2%
LCIV PEPPA	LCIV	Passive	57.5	5.8%	5.0%	0.8%

Source: Individual valuation figures shown are provided by respective Investment Managers. Actual proportion % figures calculated include valuation figures provided by Northern Trust for the Fund's non-equity allocations.

The Fund's largest allocation to an individual equity mandate is to the LCIV Global Alpha Growth Paris Aligned ("LCIV GAPGA") fund, with a total benchmark allocation of 15% of Fund assets. As at 30 June 2024 the actual allocations of the equity mandates were broadly in line with strategic allocations.

Key conclusions of review

The results of this review have been discussed with Officers, the main conclusions arising from this being as follows:

- The overall equity allocation has provided strong absolute returns over short- and long-term horizons. The main detractor from performance has been the LCIV GAPGA fund which has materially underperformed its benchmark, this being in part due to the growth bias of the underlying strategy. The allocation to the Emerging Markets has also underperformed relative to global equities over the three-year period however has outperformed over the shorter-term horizons.

- From a style perspective, the overall allocation is well balanced, with the 'Growth' style overweight of the LCIV GAPGA fund tempered by the passive allocation (in particular, the Emerging Markets allocation)

- The overall portfolio exhibits an overweight to Emerging Markets and an underweight to North America relative to a global benchmark. We are comfortable with these positions and in particular note that the unweight to North America reduces to some extent the concentration risk associated with the seven largest 'mega-cap' tech stocks which dominate US equity markets, and which have been drivers of recent performance.

- From a sector perspective the allocation is broadly aligned with the global index, with lower exposure to more carbon intensive sectors (such as Energy) resulting from the Fund's allocation to climate-tilted strategies.

- 75% of the Fund's overall equity allocation is held in funds with a climate-related objective. These funds have significantly lower carbon emissions than the broad market benchmark and thus contribute to the overall climate objective of the Fund.

Recommendations

The single biggest allocation in the equity portfolio is the LCIV GAPGA fund (15% strategic allocation, representing 37.5% of total equities). Although recent performance of the fund has been challenging, the Global Alpha Growth fund has delivered strong returns over a longer time horizon (pre-2021). We retain conviction in the strategy overall but believe a modest reduction in allocation to the LCIV GAPGA fund to be an appropriate step to balance the overall equity exposures in the portfolio.

We therefore propose reducing the allocation to the LCIV GAPGA from 15% to 12.5%, with the proceeds invested in the LGIM Future World Fund (thereby increasing the allocation from 10% to 12.5%).

Mandate	Active vs. Passive	Current Benchmark (%)	Proposed Benchmark (%)	Proposed Change (%)
LGIM Global Equity	Passive	5.0%	5.0%	-
LGIM Emerging Markets	Passive	5.0%	5.0%	-
LGIM Future World Fund	Passive	10.0%	12.5%	+2.5%
LCIV GAGPA	Active	15.0%	12.5%	-2.5%
LCIV PEPPA	Passive	5.0%	5.0%	-

Based on the position as at 30 June 2024, this change would:

- Slightly reduce the growth bias within the overall equity allocation.
- Reduce exposure to active management within the overall equity allocation from 15% to 12.5%.
- Marginally change the regional and sectoral distribution of assets, for example, exposure to North American equity falls by 0.3% of equity exposure.
- Increase the Weighted Average Carbon Intensity of the equity portfolio (from 111.2 to 111.8), exposure to companies tied to fossil fuel (5.9% to 6.3%) and climate solutions exposure (19% to 19.1%). It also increases the proportion of assets subject to LGIM's climate impact pledge.
- Slightly reduce total investment management costs (by c0.01%, or £100k p.a., at an overall Fund level).

This change would provide greater balance across the mandate benchmark allocations, whilst retaining a well-diversified aggregate equity allocation across region/sector/style. This is illustrated in the Appendix.

We have also considered the availability of other actively managed equity strategies within the LCIV, particularly for the Emerging Market equity allocation although do not currently believe there is a compelling case for change.

Finally, one area for possible exploration and dialogue with LGIM and/or LCIV relates to investment in the climate transition. Strategies that invest in companies that are both critical to the transition to a lower carbon economy, but which have higher emissions, could be considered as a future investment opportunity to ensure that such companies are supported to change. This would be consistent with the Fund's climate goal of ensuring companies in material sectors are aligned to the climate transition.

Next Steps

We look forward to discussing this paper at the Committee meeting on 10 December 2024. If the Committee is supportive of the proposal, we will work with the Officers to implement the proposed change.

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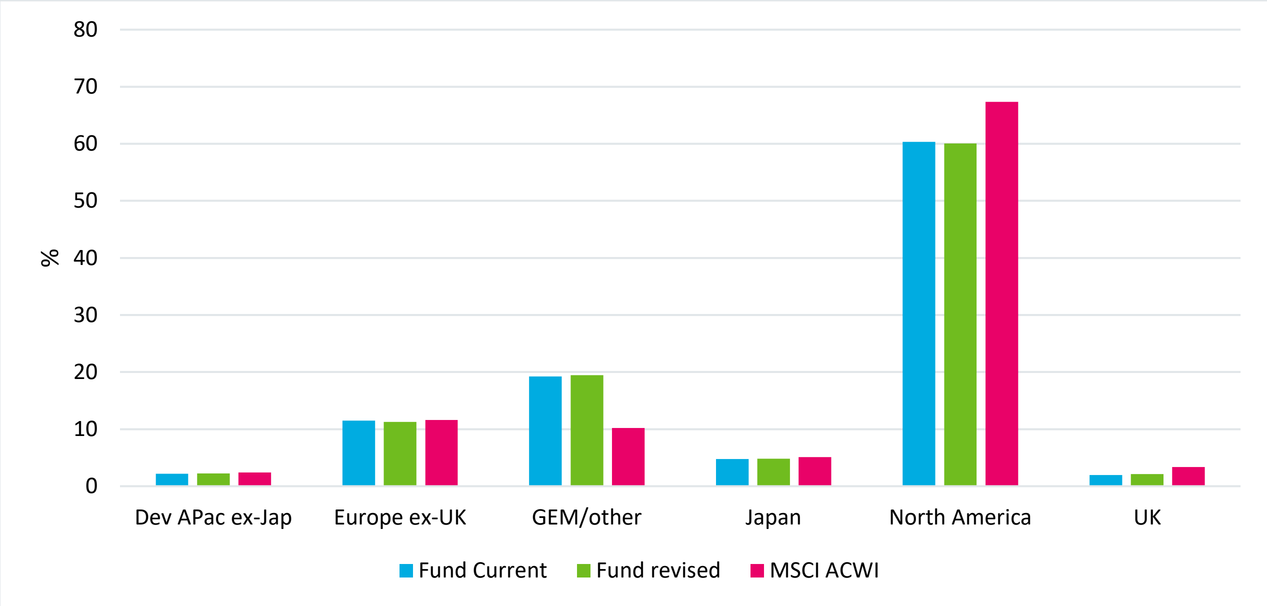
November 2024
For and on behalf of Hymans Robertson LLP

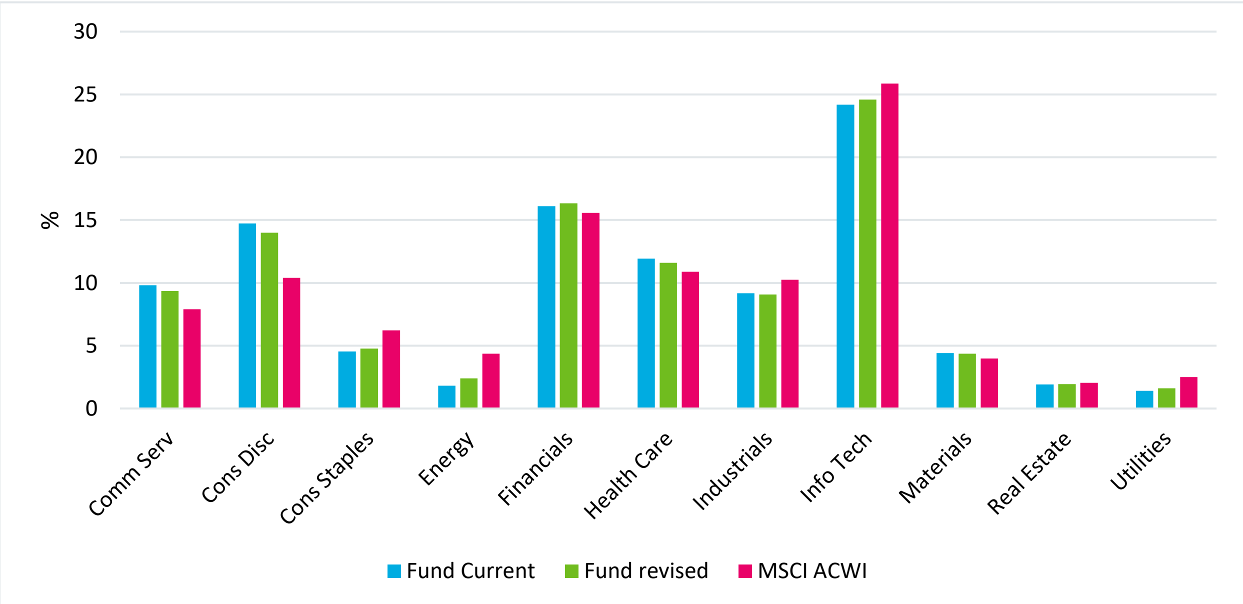
General Risk Warning
Please note the value of investments, and income from them, may fall as well as rise. You should not make any assumptions about the future performance of your investments based on information contained in this document. This includes equities, government or corporate bonds, currency, derivatives, property and other alternative investments, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of an investment. As a result, an investor may not get back the full amount originally invested. Past performance is not necessarily a guide to future performance. As technical actuarial work is not central to any advice contained in this paper, we are not required to ensure that it is TAS100 compliant.

Appendix: Comparators

Regional distribution of current/proposed strategies relative to global equity

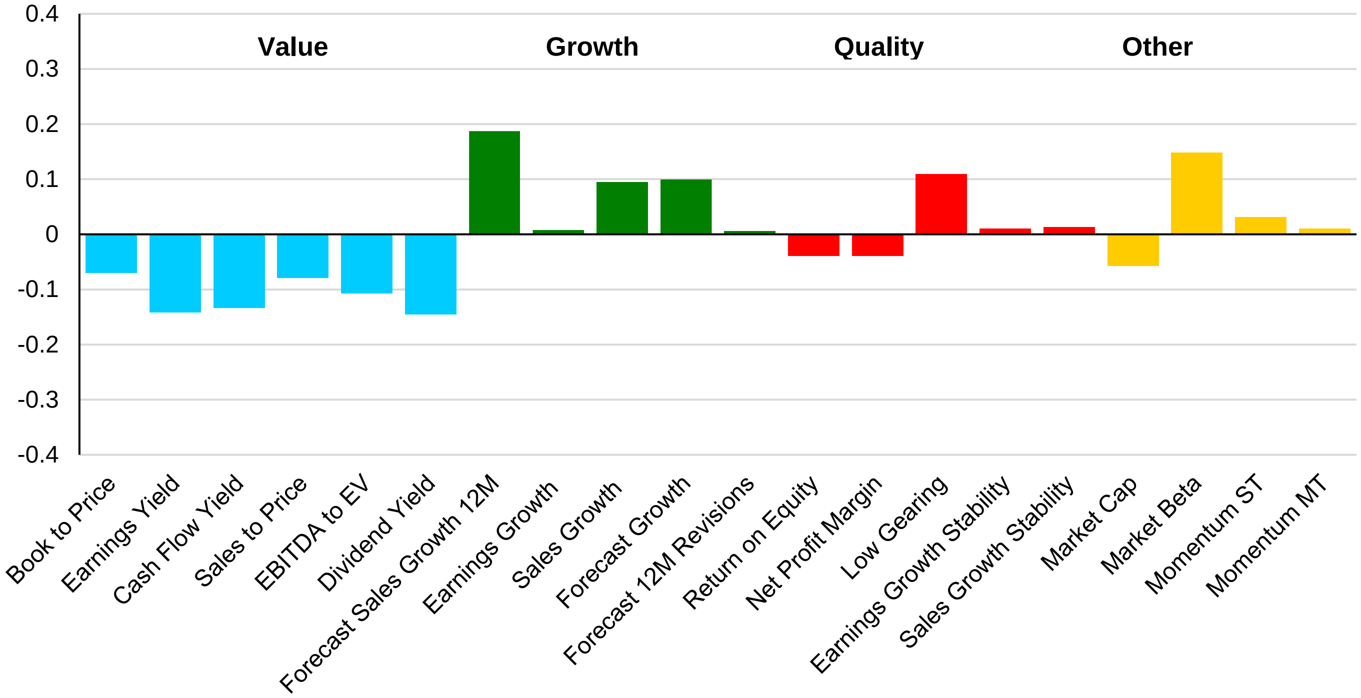


Sector distribution of current/proposed strategies relative to global equity

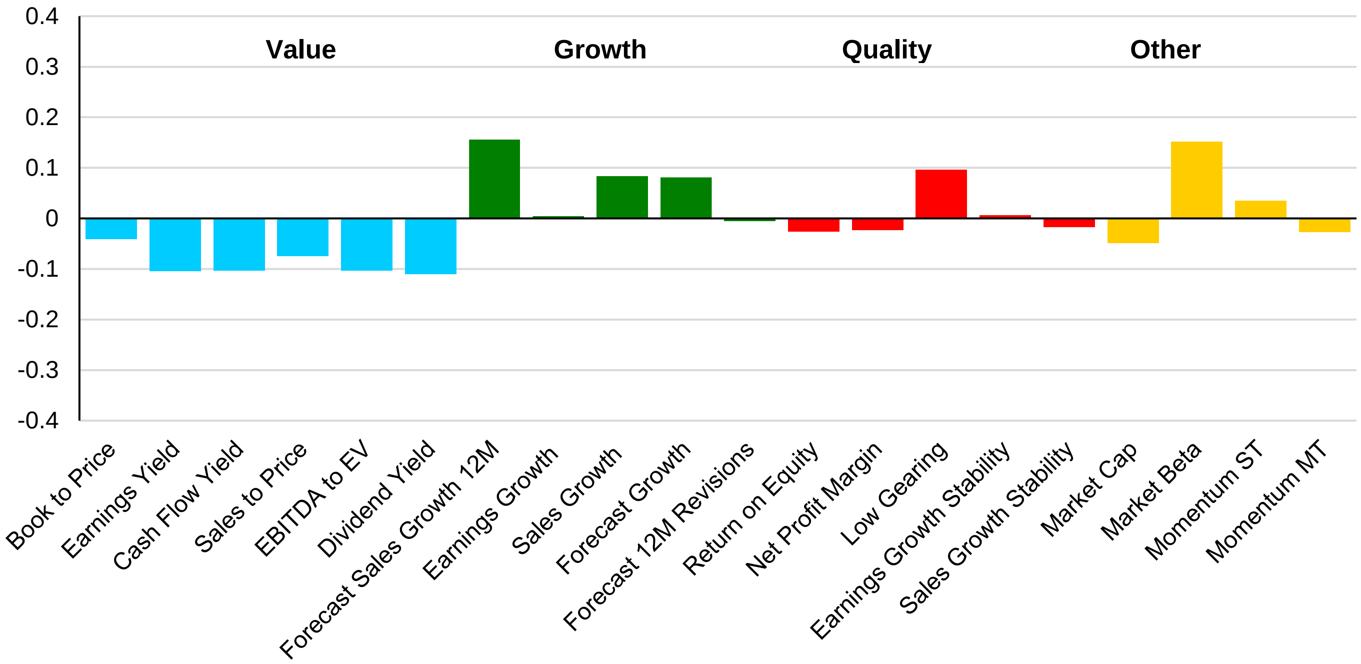


Source: Investment managers, Style Analytics

Style exposure of current strategy



Style exposure of proposed strategy



Source: Investment managers, Style Analytics

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