Derbyshire Pension Fund

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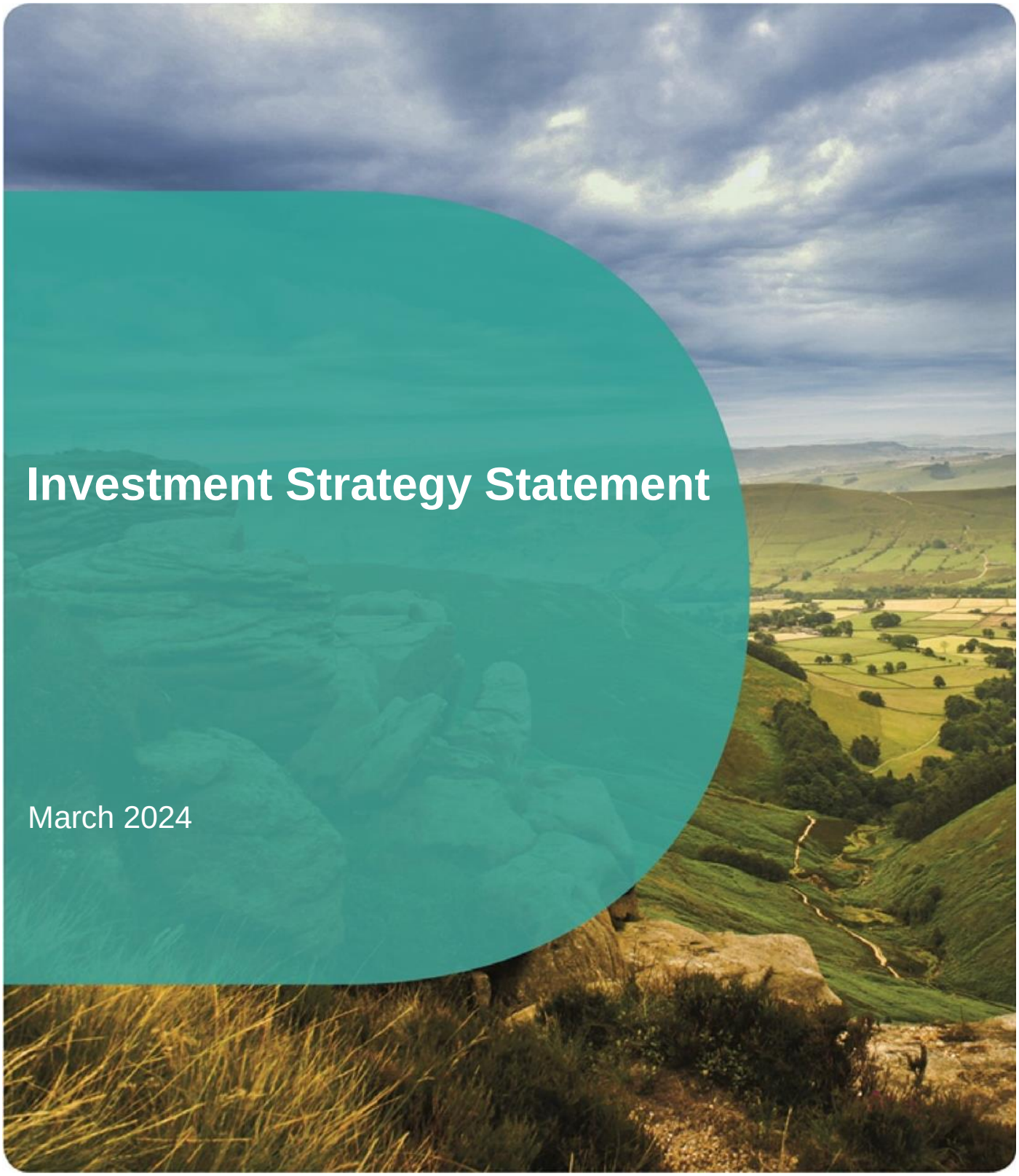
Administered by Derbyshire County Council



Investment Strategy Statement

March 2024

lgps | Local Government Pension Scheme

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1. Introduction

This is the Investment Strategy Statement (the ISS) of Derbyshire Pension Fund (the Fund), which is administered by Derbyshire County Council. The ISS is drawn up in compliance with Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (the Regulations) [and has been prepared following consultation with such persons as Derbyshire County Council considered appropriate].

The ISS will be reviewed following any material change in the factors which are judged to have a bearing on the stated investment policy and at least every three years, as required by the Regulations.

The primary objective of the Fund is to ensure that, over the long term, the Fund will be able to meet all benefit payments as and when they fall due. These payments will be met by contributions resulting from the funding strategy or asset returns and income resulting from the investment strategy. The funding and investment strategies are, therefore, inextricably linked. The Funding Strategy Statement can be found on the Fund's website: www.derbyshirepensionfund.org.uk/fss

2. Fund Governance

Derbyshire County Council is an administering authority for the Local Government Pension Scheme (LGPS) in accordance with LGPS Regulations 2013. The Pensions and Investments Committee (the Committee) is responsible for discharging Derbyshire County Council's statutory function as the administering authority for the Fund.

The Committee is responsible for determining the Fund's investment policy, monitoring performance and overall stewardship of the Fund. Members of the Committee act in a similar manner to trustees and take advice from Anthony Fletcher, the Fund's Independent Adviser and from the Director of Finance & ICT and the Fund's in-house Investment Team.

The Fund's investments are managed by the Fund's in-house Investment Team, either directly, or increasingly through pooled investment products largely managed by either LGPS Central Limited (LGPSC), a company established to manage investments on behalf of eight LGPS pension funds across the Midlands, or Legal & General Investment Management (LGIM).

Derbyshire Pension Board assists the administering authority to ensure the effective and efficient governance and administration of the LGPS.

Full details of the Fund's governance arrangements, including the governance arrangements for the LGPS Central Pool, are contained in the Governance Policy and Compliance Statement which is published on the Fund's website: www.derbyshirepensionfund.org.uk/governanceandcompliance

3. Investment Objectives

The Committee has agreed a long-term investment strategy that aims to maximise the returns from investments within acceptable levels of risk, contributes to the Fund having sufficient assets to cover the accrued benefits, and enables employer contributions to be kept as stable as possible.

The investment strategy takes into account the following beliefs:

- A long-term approach to investment will deliver better returns
- The long-term nature of LGPS liabilities allows for a long-term investment horizon
- Asset allocation is the most important factor in driving long term investment returns
- Liabilities influence the asset structure; funds exist to meet their obligations
- Risk premiums exist for certain investments; taking advantage of these can help to improve investment returns
- Markets can be inefficient, and mispriced for long periods of time; therefore, there is a place for active and passive investment management
- Diversification across investments with low correlation improves the risk/return profile
- Secure and growing income streams underpin the ability to meet future liabilities
- Responsible investment can enhance long term investment performance
- Investment management costs should be minimised where possible but net investment returns after costs are the most important factor

4. Strategic Asset Allocation Benchmark

The Committee aims to balance risk and reward by apportioning the Fund's assets over a range of asset classes to achieve the Fund's goals, to manage risk and to match the investment horizons. The objective is to generate a return that is at least equal to the investment return assumed by the actuary in the actuarial valuation. The assumed investment return is used by the actuary to 'discount' the Fund's liabilities to a present-day value. The actuarial valuation on 31 March 2022 was prepared on the basis of an investment return of 3.8% over the next 20 years, slightly higher than the assumed investment return of 3.6% over the next 20 years reflected in the actuarial valuation on 31 March 2019, albeit with a higher likelihood of success of achieving the stated return.

The Strategic Asset Allocation Benchmark (the Benchmark) for the Fund has been formulated in consultation with Anthony Fletcher, following the completion of the 2022 triannual valuation conducted by Hymans Robertson, the Fund's actuary. The Benchmark takes into account the required level of return and an appropriate balance between generating long term investment returns and exposure to investment risk. The Benchmark includes a wide variety of asset classes, in order to diversify sources of risk and return. It takes into account the future expected returns from the different asset classes, the historic levels of volatility of each asset class and the level of correlation between the asset classes.

The Fund's asset classes are allocated into three categories:

- Growth Assets: largely equities, plus other volatile higher return assets such as private equity
- Income Assets: assets which are designed to deliver an excess return, but with more stable return patterns than Growth Assets because income represents a large proportion of the total return of these assets
- Protection Assets: lower risk government or investment grade bonds, together with cash

The asset allocation of the Fund is reviewed on a quarterly basis, and tactical positions around the Benchmark are agreed by the Committee following advice from the Fund's in-house Investment Team and the Fund's Independent Adviser.

The Fund's Benchmark is set out in the following table:

Asset Category	Intermediate Asset Allocation	Intermediate Permitted Range	Final Asset Allocation	Final Permitted Range	Performance Benchmark
Growth Assets	**52.5%**	**+/- 8%**	**50.0%**	**+/- 8%**	
Total Quoted Equities	*46.5%*	*+/- 8%*	*44.0%*	*+/- 8%*	
-UK Equities	10.0%	+/- 5%	8.0%	+/- 4%	FTSE All Share Total Return
-Japan	2.5%	+/- 2.5%	-	-	FTSE World Japan Total Return
-Emerging Markets	2.5%	+/- 2.5%	-	-	FTSE Emerging Markets Net Return
-Global Sustainable	31.5%	+/- 8%	36.0%	+/- 8%	FTSE All World and/or specific benchmarks for index tracking products
Private Equity	6.0%	+/- 2%	6.0%	+/- 2%	50% FTSE All World + 50% FTSE All Share Total Return + 1% (lagged by 3 months)
Income Assets	**27.5%**	**+/- 6%**	**30.0%**	**+/- 6%**	
Property	9.5%	+/- 3%	10.0%	+/- 3%	IPD UK Quarterly Property Index
Infrastructure	11.5%	+/- 3%	13.0%	+/- 3%	SONIA 3m + 2%
Multi-Asset Credit	6.5%	+/- 2%	7.0%	+/- 2%	40% SONIA 3m + 3% / 30% ICE BofA Global High Yield Index, GBP / 30% S&P & LSTA Leveraged Loan Index, GBP
Protection Assets	**20.0%**	**+/- 5%**	**20.0%**	**+/- 5%**	
Fixed Income	6.0%	+/- 2%	6.0%	+/- 2%	FTSE UK Gov Fixed All Stocks
Index Linked Bonds	6.0%	+/- 2%	6.0%	+/- 2%	FTSE UK I-L All Stocks
Global Non-Government Bonds	6.0%	+/- 2%	6.0%	+/- 2%	50% ICE GBP Non-Gilt Index (ex EM) / 50% ICE Global Corporate Index (ex GBP and EM), hedged to GBP Base
Cash	2.0%	0 - 8%	2.0%	0 - 8%	Sterling 7 Day LIBID
Total	**100.0%**		**100.0%**		

The Intermediate Benchmark is expected to come into effect on 1 April 2024, with the Final Benchmark expected to come into effect on 1 April 2025 at the latest.

5. Asset Classes

All financial instruments are open to consideration by the Committee. The Fund currently invests in quoted and unquoted securities of UK and overseas markets, including equities, government and non-government bonds, multi-asset credit, property, infrastructure, and cash, either directly or via pooled vehicles. Derivatives are used to hedge the currency exposure of the Fund's overseas Income Assets and Protection Assets. The use of derivatives may be extended further in the future for the purpose of efficient portfolio management or to hedge other specific risks. The introduction of any new financial instrument / asset class or any extended use of derivatives will only be considered by the Committee following the receipt of appropriate training and advice from suitably qualified persons.

5.1 Growth assets

- **Equities**
  Equities are classed as growth assets with the potential to provide returns in excess of inflation from growth in both capital values and income. Reinvested income accounts for a large proportion of long-term equity returns. As equity returns are linked to company revenues and profits, investing in equities increases exposure to volatility. Investors expect to be compensated for that volatility by higher returns.

  Over the last 50 years, in the UK, equities have provided a real return (after inflation) of 4.5% p.a., compared with a real return of 2.4% p.a. from long dated government bonds and 0.7% p.a. from cash. Over the last 20 years, the respective real returns were 3.8% p.a., 0.0% p.a. and -1.8% p.a. In the US, the real returns over the last 50 years were 5.8% p.a. from equities, 3.0% p.a. from long dated government bonds and 0.4% p.a. from cash. US respective real returns over 20 years were 6.8% p.a., 1.4% p.a. and -1.3% p.a.[1]. Despite the increasing correlation between the majority of developed equity markets, the Fund believes that a standalone allocation to UK equities is justified because the UK equity market provides portfolio diversification, together with access to sterling denominated assets, which are a natural hedge against the Fund's liabilities.

- **Private equity**
  Private equity investment refers to investment in unquoted, privately owned companies. Investors expect to receive an illiquidity premium for investing in this asset class and target returns above those expected from publicly quoted equities. Returns from private equity primarily come from capital growth, rather than income when investments are exited (realised) following a period of business growth/transformation. Private equity offers access to a broader universe of companies than the publicly quoted space.

5.2 Income assets

- **Property**
  Property investments have traditionally been split between four different sectors: office; retail industrial and alternatives (e.g. hotels and leisure). Increasingly within the asset management industry, exposure to niche sectors such as residential property and exposure to debt secured against property assets is also included within the property asset class. Returns from this asset class come from rental income and the change in market values. Rental income has accounted for a large proportion of total returns over the long term. Given the relative stability

[1] Source: Barclays Equity Gilt Study 2023

of rental income, which gives property bond like characteristics, the returns from property are generally expected to fall between the returns from equities and those from bonds.

Property investment can be carried out directly via the purchase of physical properties or indirectly via the purchase of pooled vehicles or property company shares. The majority of the Fund's property exposure is gained via direct investment; pooled vehicles are used to gain exposure to niche sectors and overseas assets. The Fund's exposure to property debt is currently contained within the allocation to corporate bonds.

- **Infrastructure**
  Infrastructure offers access to long term predictable cash flows, which are often linked to inflation. A low correlation to the business cycle and the other major asset classes provides diversification benefits and long investment horizons. Most the Fund's infrastructure investments are in developed nation core assets (long term assets with regulated and contracted returns), social PFI concessions (typically schools, hospitals and military accommodation) and renewable energy assets (e.g. on-shore & off-shore wind, solar and hydro).

- **Multi Asset Credit**
  Multi-asset credit typically relates to sub-investment grade corporate bonds and includes private credit, high yield debt and asset-backed securities. Multi-Asset Credit offers a predictable income stream and a yield pick-up relative to sovereign bonds and investment grade corporate bonds reflecting the increased risk of default.

5.3 Protection Assets

- **Sovereign and Corporate Bonds**
  Bonds offer predictable streams of income and predictable returns if held to maturity. They are held as stabilising assets to reduce volatility and to provide diversification. As pension funds mature, they can be used to provide liquidity and to match liabilities as they fall due.

  The Fund holds conventional fixed income, index-linked and investment grade corporate bonds. Index linked bonds are regarded as a particularly good match for pension fund liabilities. Most the Fund's government bond holdings are issued by the government of the United Kingdom; the currency exposure of any overseas sovereign bonds holdings is hedged to sterling.

- **Cash**
  Cash management for the Fund comprises cash held in the Fund's cash accounts (i.e. bank and money market funds), loans to UK Local Authorities and cash held in the custodian's bank account in respect of segregated mandates.

  The Fund holds cash to fulfil its daily liquidity requirements, and depending on market conditions, also as a protection asset. The Fund's cash balances are managed by Derbyshire County Council's Treasury Management Team in line with the Fund's annual Treasury Management Strategy.

6. Risk

The overall risk for the Fund is that its assets will be insufficient to meet its liabilities. The Funding Strategy Statement, which is drawn up following the triennial actuarial valuation of the Fund, sets out how any deficit in assets compared with liabilities is to be addressed.

Underlying the overall risk, the Fund is exposed to demographic risks, regulatory risks, governance risks and financial risks (including investment risk). The measures taken by the Fund to control these risks are included in the Funding Strategy Statement and are reviewed periodically by the Committee via the Fund's risk register. The primary investment risk is that the Fund fails to deliver the returns anticipated in the actuarial valuation over the long term. The Committee anticipates expected market returns on a prudent basis to reduce the risk of underperforming expectations.

It is important to note that the Fund is exposed to external, market driven, fluctuations in asset prices which affect the liabilities (liabilities are partially estimated with reference to government bond yields) as well as the valuation of the Fund's assets. Holding a proportion of the assets in government bonds helps to mitigate the effect of falling bond yields on the liabilities to a certain extent. Further measures taken to control/mitigate investment risks are set out in more detail below:

6.1 Concentration

The Committee manages the risk of exposure to a single asset class by holding different categories of investments (e.g. equities, bonds, property, alternatives and cash) and by holding a diversified equity portfolio, spread by both geography and market sectors. Each asset class is managed within an agreed permitted range to ensure that the Fund does not deviate too far away from the Benchmark, which has been designed to meet the required level of return with an appropriate level of exposure to risk, taking into consideration the level of correlation between the asset classes.

6.2 Volatility

The Benchmark contains a high proportion of equities with a commensurate high degree of volatility. The strong covenant of the major employing bodies enables the Committee to take a long-term perspective and to access the forecast inflation plus returns from equities.

6.3 Performance

Investment managers are expected to outperform the individual asset class benchmarks detailed in the overall Strategic Asset Allocation Benchmark. The Fund's performance is measured by an independent provider and reported to the Committee on a quarterly basis. The Committee takes a long-term approach to the evaluation of investment performance but will take steps to address persistent underperformance.

6.4 Liquidity

Close attention is paid to the Fund's projected cash flows; the Fund is currently cash flow positive, in that annually there is an excess of cash paid into the Fund from contributions and investment income after pension benefits are paid out. The Fund expects to be cash flow positive for the short to medium term. Despite the growing proportion of illiquid investments in the Fund, a large proportion of the assets are held in liquid assets and can be realised quickly, in normal circumstances, in order for the Fund to pay its immediate liabilities.

6.5 Currency

The Fund's liabilities are denominated in sterling which means that investing in overseas assets exposes the Fund to a degree of currency risk. The Committee regards the currency exposure associated with investing in overseas equities as part of the return on the overseas equities; the currency exposure in respect of the Fund's Income Assets and Protection Assets is hedged back to sterling.

6.6 Stock Lending

The Fund does not currently participate in any standalone stock-lending arrangements. As part of the LGPS Central Pool, the funds managed by LGPSC do participate in stock-lending arrangements, and LGPSC has put controls in place to protect the security of the Fund's assets.

6.7 Custody

The risk of losing economic rights to the Fund's assets is managed by the use of a global custodian for custody of the assets, regular scrutiny of the Fund's providers, and the maintenance of independent investment accounting records.

7. LGPS Central Pool

The Fund is part of the LGPS Central Pool (the Pool) with the LGPS funds of Cheshire, Leicestershire, Nottinghamshire, Shropshire, Staffordshire, West Midlands, and Worcestershire. The Pool has been established in accordance with Government requirements for pooling the management of LGPS investment assets. Collective investment management offers the potential for substantial savings in investment management fees, increased opportunities for investor engagement and access to a shared pool of knowledge and expertise.

The eight administering authorities of the pension funds within the Pool are equal shareholders in LGPS Central Limited (the Company or LGPSC). LGPSC has been established to manage investments on behalf of the Pool and received authorisation from the Financial Conduct Authority in January 2018. The Company launched its first sub-funds within an Authorised Contractual Scheme collective investment vehicle in April 2018 and has launched several additional sub-funds since that date.

The transition of the Fund's assets into products offered by LGPSC is likely to take several years. Total assets managed by LGPSC on 31 March 2023 totalled £834m (£870m on a committed basis), accounting for 14.2% of the Fund's total investment assets. In addition to the assets managed by LGPSC, the following assets totalling £2,411m on 31 March 2023 were managed through collaboratively procured pooled arrangements:

- Passive equities of £1,776m managed by LGIM in respect of UK Equities; Japanese Equities; Emerging Market Equities and Global Sustainable Equities; and
- Active Global Sustainable Equities of £488m managed by two investment managers; and
- Active Global Infrastructure assets of £147m managed by one manager.

Including the above assets, the percentage of total assets managed through either LGPSC products or other collaboratively procured pooled arrangements increased to 55.1% on 31 March 2023.

Responsibility for determining the Strategic Asset Allocation Benchmark and the tactical quarterly asset allocation positions remains with the Fund.

Robust governance arrangements have been established both within the Company and within the wider Pool to ensure that the Company operates effectively and meets the objectives of the pension funds within the Pool.

A Joint Committee, set up in accordance with provisions of the Local Government Act 1972, provides oversight of the delivery of the objectives of the Pool, the delivery of client service, the delivery against the Pool business case and deals with common investor issues.

A Shareholders' Forum, comprising one shareholder representative from each of the participating administering authorities, oversees the operation and performance of LGPSC and represents the ownership rights and interests of the shareholding councils within the Pool.

To support the Joint Committee and the Shareholders' Forum, a Practitioners' Advisory Forum has been created, consisting of Officers from each of the shareholding councils within the Pool. This forum provides day-to-day oversight of the Operator, scrutinising the delivery of products, investment performance and investment costs, monitoring customer service and the delivery of wider investor services, such as voting and responsible investment.

8. Responsible Investment

The Fund's approach to responsible investment, together with the management of climate-related risks and opportunities, are set out in the Fund's Responsible Investment Framework and Climate Strategy. Copies of the Fund's Responsible Investment Framework and Climate Strategy can be found on the Fund's website:

Responsible Investment Framework: www.derbyshirepensionfund.org.uk/responsibleinvestments

Climate Strategy: www.derbyshirepensionfund.org.uk/climatestrategy