

Pension Advisory Panel

Setting an investment strategy



Prepared for: London Borough of Southwark Pensions Advisory Panel

Prepared by: Aon

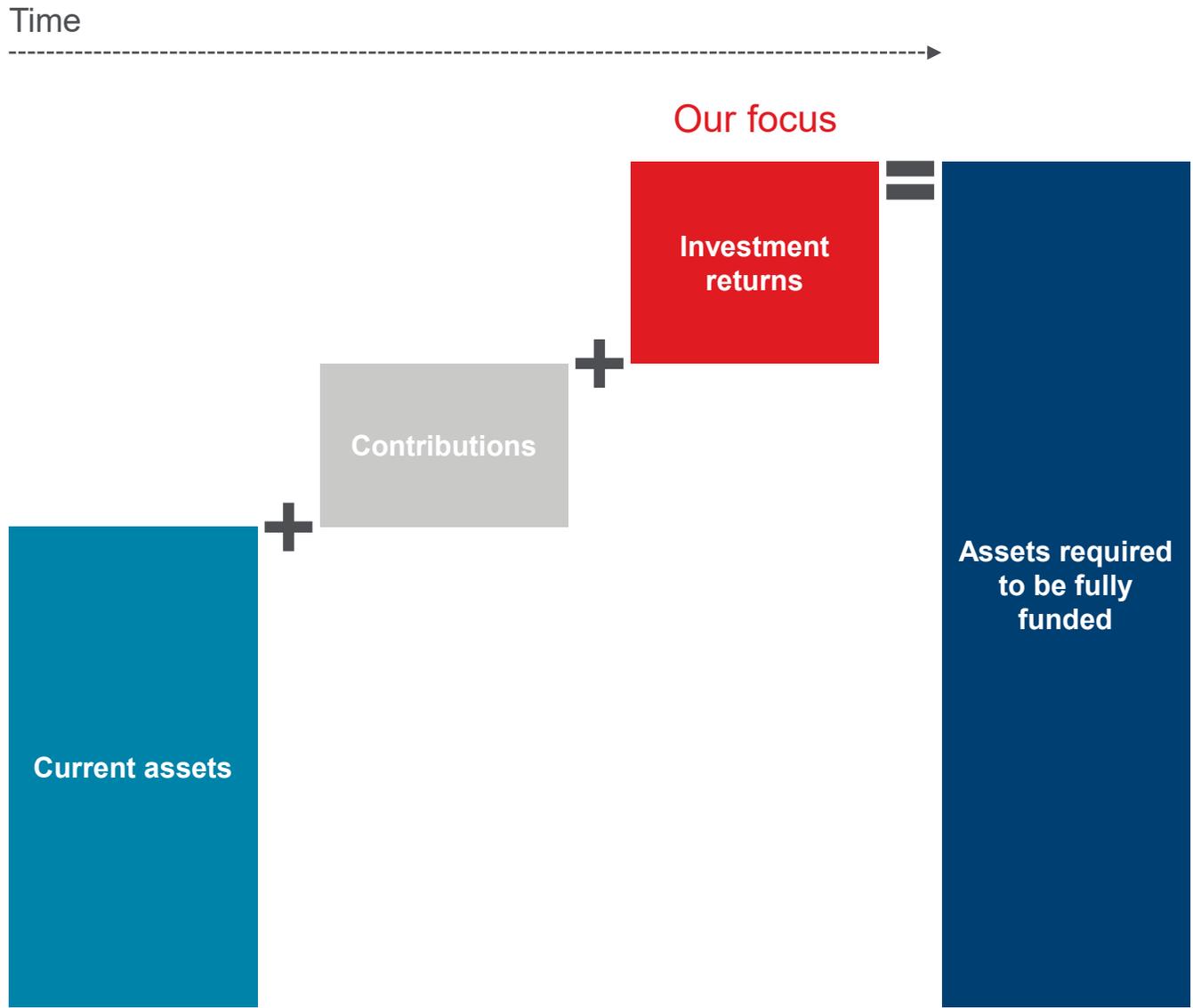
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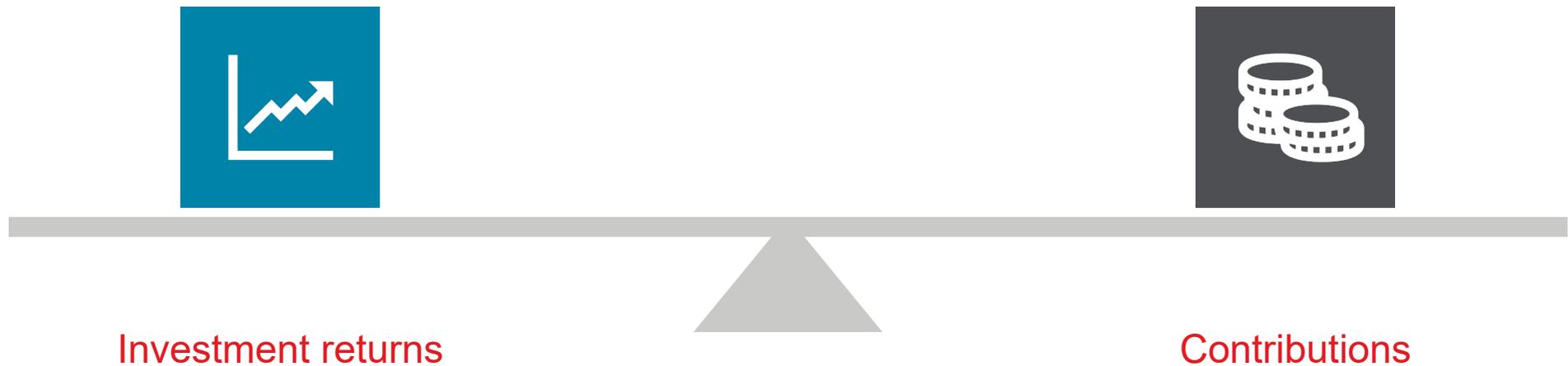
Investment objectives – the big picture



Key objectives

- Ensure that benefits are paid to members
- Ensure suitability of assets
- Optimise the anticipated return consistent with a prudent level of risk

Relationship between strategy and contributions



Key takeaway

Aiming for **higher** investment returns enables you to set **lower** contribution rates today... but means a **higher risk** of not achieving the desired returns in future

What do we mean by risk



What output will we consider?

Establish strategic objectives

- Expected return
- Risk i.e. VaR
- Understand the contributors to risk and return

Define role of parts of the portfolio

- For example what are we trying to achieve from illquids
- This will help us consider opportunities

Decision making framework

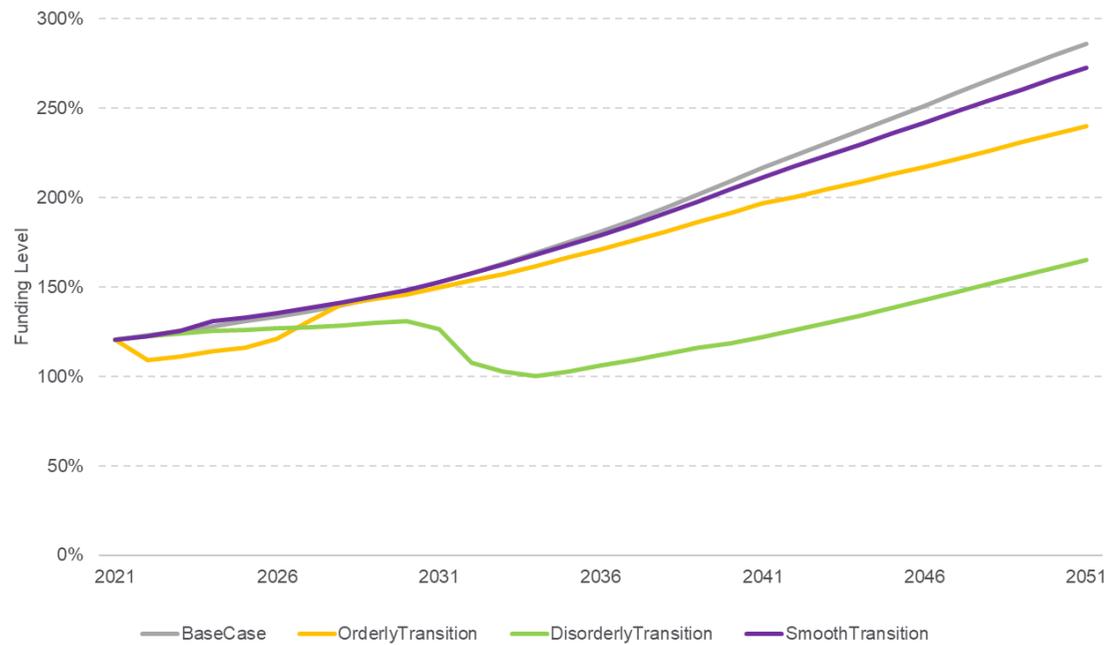
- Putting the above together will create a framework to consider opportunities
- This will help us identify ways to get to net zero



Example output looking at climate scenario risk

Funding level projections under each climate scenario

Funding level projection



Comments

Orderly Transition

Immediate, coordinated global action is taken to aggressively tackle climate change

Disorderly Transition

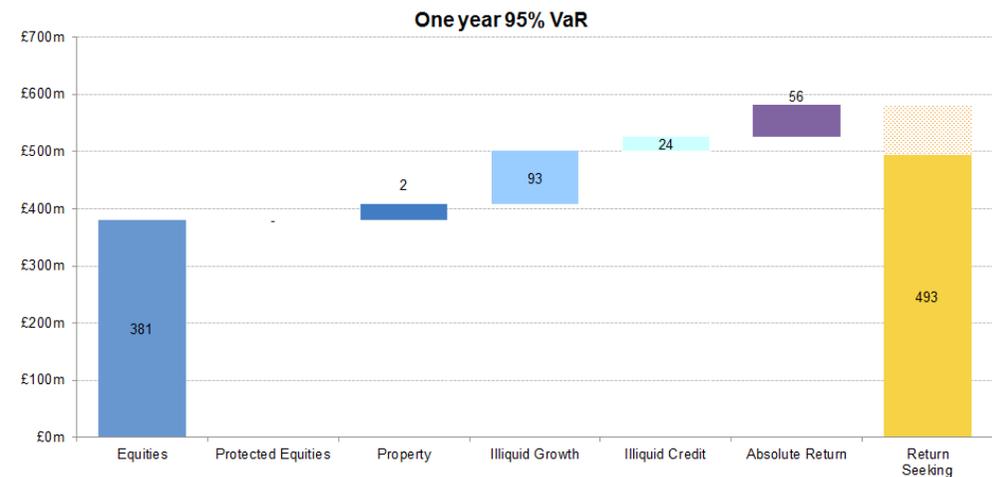
Limited action, insufficient consideration given to sustainable long-term policies to manage global temperatures effectively

Smooth Transition

Rapid advancement of green technology and government action on climate change drives a smooth transition to a low carbon economy

Example Value at Risk distribution

- The chart on the right shows the distribution of risk for a generic local authority client
- Most of the risk will come from the equity holdings as their price is traditionally volatile and most of the assets are held in this asset class
- Additional volatility comes from property and other illiquid holdings
- Different asset classes have different reactions to market events and the diversification of returns due to this is represented by the total risk being lower than adding up the individual risk exposures



Setting a Long Term Investment Strategy



Strategic Asset Allocation

Create an efficient portfolio by setting the allocation across broad asset groups



Strategy Detail

Determine the underlying assets within each asset group



Manager Selection

Meet with and agree to appoint any new investment managers

Strategy review

Implementation

Investment Strategy | London Borough of Southwark Pension Fund Investment Strategy (30 June 2022)

Asset class	Strategic Allocation (%)	Actual Allocation (%)
Active Global Equities	15	49
Passive Low Carbon Global Equities	30	
Total Equities	45	49
Property	20	17
Diversified Growth Funds	10	8.9
Absolute Return Fixed Income	5	6.6
Renewable Energy Infrastructure	5	4.3
Index Linked Gilts	10	7.2
Illiquid Investments*	5	4.8
Liquidity	0	2.2
Total	100	100

Observations

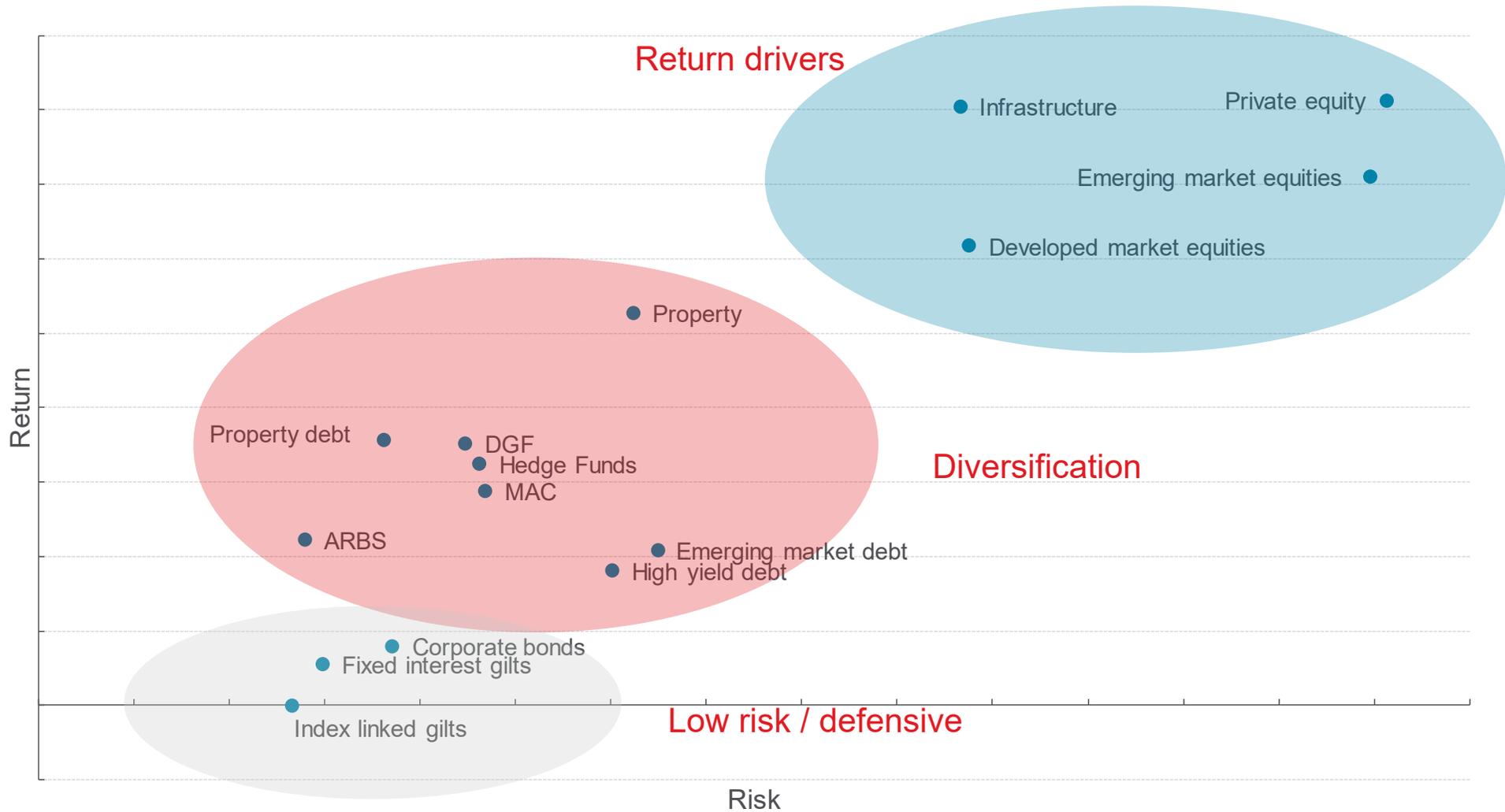
- Equities are the key driver of returns
- Diversification through property, DGFs and infrastructure
- Index linked gilts and, to a lesser extent infrastructure, provide inflation linkage
- ESG incorporated into equity allocation, renewables and illiquid investments

Focus for this session

We want to review the 10% strategic allocation to Diversified Growth Funds

Source: London Borough of Southwark Pension Fund, Investment Strategy Statement

*Illiquid investment asset class includes the recent investments to timberland, bereavement services and private equity strategies



Alternative to DGF

By allocating the assets invested in the DGF to other asset classes, for example equities and index-linked gilts, we can achieve a similar overall risk/return profile

What strategic changes will we consider?

Strategic changes

- Role of DGFs and ARBS
- Illiquid assets
- Moving to net zero

Next steps

- Consider output from Strategy Review in December



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