

REPORT PREPARED FOR

Dyfed Pension Fund
Equity Restructure (Phase III)

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Note : Performance and valuation data is sourced from custodian (Northern Trust) data, wherever possible. This may differ marginally from manager reported returns due to data sources and calculation methodology. Performances over 1 year are annualised geometrically.

Context – Asset Allocation

Asset Allocation refers to the mix of assets which the Fund holds, in order to meet its investment objectives. These objectives clearly require making adequate returns, to allow the Fund to meet its pension payment liabilities, but may also include responsible investment (RI) objectives (eg climate).

The “Strategic Asset Allocation” (SAA) is driven by the *balance* of the investment return required to meet pension liabilities and the desire to minimise employer contributions though taking investment risk when/where the Fund is able, in order to maximise investment returns. It is set every 3 years, at the valuation. The current valuation will be completed early 2023. The table below show the asset allocation at 30 June 2022.

Asset Class	Fund weight (30/06/22)	Target SAA weight	Difference vs. SAA
Equities	70.8%	65%	+5.8%
Fixed Interest	8.8%	10%	- 1.2%
Property	15.7%	15%	+ 0.7%
Alternatives / infrastructure	4.0%	10%	- 6.0%
Cash	0.7%	0%	+0.7%

However, we may adjust the asset allocation (including the sub-asset classes within the asset classes above, eg regional equity allocations) between valuations :-

- To rebalance our portfolio back towards the SAA, taking advantage of market moves
- To meet our RI objectives, notably re: climate-related investment risk, as outlined in the Fund’s RI policy. The Fund currently aims to help drive improved behaviours through active engagement (with consequences), as well as contributing to the transition, through its ambition to reduce the carbon emissions of its investments by 7% per annum over the medium term (compared to a baseline set in Sept 2020.)
- To improve the governance of the Fund. This includes simplifying/improving cost in the manager line-up as well as complying with guidance to Pool assets where practicable (currently 38% of assets are managed by the WPP, rising to c. 80%, including the Blackrock passive assets, managed under Pool-agreed fees).

Background

The Committee agreed previous restructures of the equity portfolio in March and December 2021 (incorporating the BlackRock low-Carbon global equity portfolio, the switch of WPP’s growth sleeve to Baillie Gifford Global Alpha Paris Aligned strategy, and a modest reduction in equity in favour of property / Secure Assets Income Fund). The current proposals represent a third phase of our proposed actions aimed at rationalising the legacy regional equity portfolios, reducing Carbon footprint, and continuing our progress on Pooling.

The table below details some characteristics of the legacy regional equity portfolios, together with those of the WPP sustainable Equity Fund, discussed below :-

Asset Class	Fund weight (30/06/22)	Index Performance (YTD June, %)	Index P/E (June, x)	C-Intensity /sales (scope 1+2 / 3)
UK	17.6	- 0.4	10.6	135 / 894
Emerging Markets	8.5	- 13.1	11.1	328 / 914
Japan (active)	3.4	- 5.1	12.5	94 / 785
Europe	2.5	- 12.0	12.4	122 / 650
WPP Sustainable Equity* (active)	-	- 15.6	14.0	85/na.

*MSCI ACWI index

WPP sustainable equity.

Russell have constructed this portfolio by combining 5 sustainable global equity managers with differing (complementary) investment styles and concentrated portfolios. They combine to offer a performance target of 2% above the MSCI ACWI index, with a 3-5% tracking error (similar return and risk targets to the existing Global Growth portfolio). Fees are expected to be 37bps (WPP GG = 35bps) assuming the strategy raises £500m in total. All 5 managers apply sustainability criteria in their investment decisions, including exclusion of companies involved in thermal coal, oil sands, palm oil tobacco and controversial weapons. In addition, Robeco will manage overall stewardship/engagement and the strategy overall will be Paris-Aligned (ie targeting reducing emissions over time) aiming to reach net-zero emissions by 2040. It is expected to have a Carbon-intensity of c. 85 tCO2/\$m sales, to be c.3% underweight the Energy sector, with a slight bias to Growth, an overweight to Europe and a modest underweight Emerging Markets.

The fund will be launched in November/December 2022, so the Committee needs to decide whether to make an allocation now.

Proposal

Allocate 5% (£160m) to the WPP Sustainable Global Equity strategy, funded by taking 3% from UK (passive) and 2% from Emerging Markets (passive) regional equity allocations.

WPP Sustainable Equity strategy offers an actively managed sustainable portfolio. Active managers will focus not only on currently low carbon emitters, but also on companies which are expected to improve their performance, thereby offering the potential to outperform as well as effecting real change in the carbon outcomes. As such, this Fund will complement the existing allocation to Blackrock's passive low-Carbon Fund, which delivers more exposure to current low emitters.

UK and EM portfolios are not only the highest C-intensity regions, but they are also represent Dyfed's largest regional overweights vs. the global index. In addition, the UK has performed well in the market rotation this year, significantly outperforming the US, making it timely to increase allocations to a global (>50% US) strategy. The 5% allocation is enough to have a material impact on our RI goals, while controlling the risk of investing in a new Fund, and also maintaining a good level of regional diversification within our equity portfolio.

This transition delivers a more diversified regional equity allocation, an estimated 7% reduction in pro-forma 2022 C-intensity of Dyfed's equity portfolio and a 5% increase in WPP-managed assets.

The proposed changes are illustrated in the table below :-

Asset Class (Equities)	Fund weight (30/06/22)	Proposed Change (%)	Resultant weight (pro-forma % 31/3/ 22)
UK (passive)	17.6	-3.0	14.6
Emerging Markets (passive)	8.5	-2.0	6.5
Global – WPP Sustainable Equity (active)	-	+5.0	5.0

Including all the equity portfolios, this would result in Dyfed's equity holdings having the following regional weights as % total equity pro-forma as at June 2022.

Region	Dyfed Actual %	MSCI ACWI %	Proposed % (pro-forma)
N. America	36	64	38
UK	30	4	27
Europe ex UK	12	13	12
Dev. Asia	9	9	10
EM	15	11	13
Total Equity	100	100	100