Common Good and Trusts Investment Sub-Committee

This meeting will be held remotely.

Tuesday, 13th December, 2022 - 9.15 a.m.

AGENDA

		Page Nos.
1.	**APOLOGIES FOR ABSENCE**	
2.	**DECLARATIONS OF INTEREST** – In terms of Section 5 of the Code of Conduct, members of the Committee are asked to declare any interest(s) in particular items on the agenda and the nature of the interest(s) at this stage.	
3.	**MINUTE** – Minute of the meeting of the Common Good and Trusts Investment Sub-Committee of 29th March, 2022.	3 – 4
4.	**TRUST AND COMMON GOOD FUND ANNUAL REPORT 2021-22** – Report by the Head of Finance	5 – 11

Members are reminded that should they have queries on the detail of a report they should, where possible, contact the report authors in advance of the meeting to seek clarification.

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6 December, 2022

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THE FIFE COUNCIL - COMMON GOOD AND TRUSTS INVESTMENT SUB-COMMITTEE – REMOTE MEETING

29th March, 2022 **9.15 a.m. – 9.50 a.m.**

PRESENT:	Councillors Dave Dempsey (Convener), David Barratt, Altany Craik, Colin Davidson, Mino Manekshaw, Alistair Suttie and Jonny Tepp.
ATTENDING:	Elaine Muir, Head of Finance, Laura Robertson, Finance Operations Manager, Anne Bence, Accountant, Eleanor Hodgson, Accountant, Finance Services; and Wendy MacGregor, Committee Officer, Legal and Democratic Services.
ALSO IN ATTENDANCE:	Jordan Irvine, Senior Investment Consultant, Hymans Robertson LLP.
APOLOGY FOR ABSENCE:	Councillor Fiona Grant.

14. DECLARATIONS OF INTEREST

No declarations of interest were submitted in terms of Standing Order No. 7.1.

15. MINUTE

The Sub-Committee considered the minute of the meeting of the Common Good and Trust Investment Sub-Committee of 29th April, 2021.

Decision

The Sub-Committee agreed to approve the minute.

16. COMMON GOOD AND TRUST FUNDS

The Sub-Committee considered a report by the Executive Director, Finance and Corporate Services, updating members on the market value of investments of the Common Good and Trust Funds. The report was provided on an accrual basis and informed the Sub-Committee of the investment performance over the last financial year.

Decision

The Sub-Committee noted the contents of the report.

Councillor David Barratt joined the meeting during consideration of the above item.

17. COMMON GOOD AND TRUST FUNDS INVESTMENT POLICY DOCUMENT

The Sub-Committee considered a report by the Head of Finance providing a Draft Investment Policy Document and setting out the governance arrangements required to be adopted by the Sub-Committee for managing the Funds' assets.

Decision/

Decision

The Sub-Committee:-

(1) considered and endorsed the proposals for inclusion in the Investment Policy Document;

(2) reviewed the Draft Investment Policy Document and agreed to adopt the document for the governance arrangements for the Funds' assets;

(3) agreed to remit to the Head of Finance to collaborate with the adviser to finalise implementation and establish governance arrangements once investments had been restructured;

(4) agreed to delegate to the Head of Finance quarterly reviews and subsequent re-balancing; and

(5) agreed that a further report would be submitted to the relevant Committee in Autumn, 2022 to provide members with an update relating to the appointment of a Fund Manager.

CONVENER'S VALEDICTORY COMMENTS

As this was the last meeting of the Sub-Committee prior to the Local Government Elections in May 2022, the Convener expressed his appreciation of the contributions of members and officers in supporting the work of the Sub-Committee and wished them well for the future.

13 December 2022

Agenda Item No. 4

Common Good and Trust Funds

Report by: Eileen Rowand, Executive Director of Finance and Corporate Services

Wards Affected: All

Purpose

The purpose of this report is to provide an update on the market value of investments of the Common Good and Trust Funds. This report is provided on an accrual basis and is to inform members of the investment performance over the last financial year.

Recommendation

Members are asked to note this report.

Resource Implications

None.

Legal & Risk Implications

None.

Policy & Impact Assessment

An EqIA is not required because the report does not propose a change or revision to existing policies or practices.

Consultation

N/A.

1.0 Background

1.1. Janus Henderson took over the management of the Common Good and Trust Funds investment portfolio in March 2001. As a result, £2.777m of Common Good and Trust funds were invested in the Preference & Bond Fund and the UK Equity Income Fund, with £1.725m in relation to the Fife Educational Trust Fund being invested in a separate portfolio on 8 June 2007.

1.2. The investment strategy for the Fife Educational Trust Fund and Common Good and Trust Funds is the same: to generate income whilst preserving and growing capital.

1.3 Following review of the investment arrangements and equity allocations, the committee remitted to the Head of Finance to work with the investment adviser, to implement the Investment Policy and move to a global equity exposure through a passive market-cap index, preferably with a climate or ESG tilt.

1.4 This process has stalled somewhat. Although advisers have continued to source a suitable investment portfolio to date those identified have been for larger pension funds as opposed to these funds. Further due diligence is ongoing with the adviser to confirm the legal standing of the funds and the relationship with the Council as administering authority. This may impact on the ability to use the existing manager and result in a separate agreement with an investment adviser to continue this work.

1.5 Other Local Authorities have been contacted to establish the nature of their investment arrangements and advisers they may use.

2.0 2021-22 Performance

2.1 The valuations as at 31 March 2022 for these funds are shown below: -

	Common Good & Trust Funds	Fife Educational Trust Fund	Total
	£	£	£
Valuation as at 31 March 2021	5,438,718	1,716,484	7,155,202
Increase / (decrease) in year	4,693	100,740	105,433
Valuation as at 31 March 2022	5,443,411	1,817,224	7,260,635

Janus Henderson has provided some additional commentary on the performance of the fund, which is attached as Appendix 1

2.2 Income earned by Janus Henderson Investors up to 31 March 2022 is also shown, as is the investment Income as a percentage of the market value at the end of the financial year (i.e. the return)

	Common Good & Trust Funds	Fife Educational Trust Fund	Total
	£	£	£
Investment Income earned in year	195,941	75,025	270,966
% of Valuation as at 31 March 2022	3.4%	4.1%	3.7%

2.3 This income is credited to the Common Good and Trust Fund revenue accounts and used to support expenditure in year.

2.4 During the year to end March 2022 the Common Good and Trust Funds have made disbursements of £355,841.67 and the Fife Educational Trust made disbursements of £41,900.67.

2.5 Disbursements are made to individuals and groups in line with the relevant criteria and the purpose of the trusts. Examples include grants to promote arts and sport. Grants are administered by staff in the Communities directorate.

2.6 The major trust administered by the Council is FET whose main purpose is to promote education and reward educational achievement, through providing prizes, bursaries, scholarships, grants and equipment.

2.7 Valuations for the fund as at 30th September are as follows:

	Common Good & Trust Funds	Fife Educational Trust Fund	Total
	£	£	£
Valuation as 30th September 2022	4,595,746	1,584,461	6,180,207

The decreased in value since March 2022 demonstrates the market volatility being experienced by investments.

3.0 Conclusions

3.1 The market value of the Common Good and Trust Funds have improved during the year and have an increased value at 31 March 2022.

Appendix 1 – Janus Henderson Preference & Bond Fund Commentary.

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Fife Educational Trust Scheme 1958 & Fife Common Good Fund

Commentary – 1 year to 31 March 2022

Janus Henderson UK Equity Income & Growth

In the year ending March 2022 the Fund (as measured by the I Inc share class) rose 11.2% on a total return basis, modestly underperforming a 13.0% rise in its FTSE All-Share benchmark. In the same time period there was a 10.8% rise in the Fund's IA UK Equity Income peer group (placing the fund in the second quartile).

This period was defined by inflation consistently surprising to the upside, with UK CPI reaching 7.0% in March '22 and expected to rise further in the coming months. The rise in inflation (both its causes and its effects) can, in our view, explain the majority of sector performance over the course of the year. As the global economy recovered from covid there was an uptick in industrial and consumer demand for commodities such as oil (as, for example, air traffic recovered). This caused upward pressure on a broad spread of commodity prices as rising demand pushed up against relatively constrained supply following several years of subdued investment. The rise in commodity prices benefited the earnings of the basic materials and energy sectors, both of which performed well relative to the FTSE All-Share benchmark. For this Fund, this meant that both sectors moderately detracted from relative returns over the year, as the Fund holds a modest underweight position.

The rise in commodity prices and the subsequent rise in inflation levels meant that inflation began to rise above UK nominal wage growth. This led to a fall in household real disposable income and meant that sectors most exposed to consumer spending (such as consumer discretionary) underperformed. For this Fund this meant that a number of the retailers held (including DFS, Halfords and Kingfisher) were among the largest detractors from performance at the stock level and the consumer discretionary sector as a whole detracted from relative returns. Outside of energy and basic materials the majority of the best performing sectors were defensive (for example utilities and healthcare) as the market began to price in the possibility of 'stagflation'. For this Fund this meant the utilities sector was a positive contributor to returns (helped in particular by retail energy supplier Centrica, which also has direct commodities exposure and therefore benefitted from rising prices).

Dividends recovered well during the year, with dividends for the I Inc share class rising 59% for the 12 months up to an including the quarterly dividend that was paid in February '22 (with the previous 12 months having been highly impacted by dividend cuts during covid). This continued the dividend recovery seen since the peak of the pandemic in Spring 2020 and was boosted by special dividends from holdings including Anglo American and Rio Tinto.

Among the new purchases during the period was consumer healthcare and hygiene company Reckitt Benckiser. Following several years of reinvestment by management, organic growth in recent quarters is showing signs of improvement and the shares trade at a discount to relevant consumer staples peers. Within smaller companies new positions purchased included wealth manager Brooks Macdonald and law firm DWF. Both have gone through periods of restructuring but in our view are showing good progress (in Brook's case net flows have improved, in DWF's case under a new management team there is a greater focus on cost control and cash generation).

Among the largest sales during the period were driven by takeover approaches (specifically aerospace supplier Meggitt and property company St Modwen). Elsewhere Secure Income REIT, Liontrust Asset Management and Vitec were sold having reached what we deemed to be fair value, while the position in housebuilder Bellway was sold on some concerns around housing affordability relative to earnings in the UK.

It is undoubtedly a challenging backdrop for equity markets – higher than expected inflation is causing cost of living pressures, the uncertainty of a European war and rising interest rates all mean that segments of the UK market have substantially de-rated this year and sentiment is broadly cautious. Despite this backdrop we have kept the Fund's modestly cyclical positioning (the two largest absolute sector positions are industrials and financials). This is because in our view there is currently a high price for relative 'certainty', with some defensive sectors (such as utilities) having performed very well and re-rated to above long-term average valuation levels. From a medium term perspective, in our view sectors such as industrials present the opportunity to invest in what are often market leading engineers with structural growth drivers such as industrial automation.

Janus Henderson Fixed Interest Monthly Income

The fund fell -2.6% based on Class I income share class (Net) over the year under review, compared with a fall of -2.4% in the IA Sterling Strategic Bond Sector peer group benchmark.

The year started with optimism following mass COVID-19 vaccinations, large fiscal packages and a reopening of economies, which led to strong economic growth. However, the legacy of the pandemic meant that policy support led to increased demand for goods. This was challenged by fewer, more cautious workers and supply bottlenecks, which stoked inflation. Central banks were, initially, prepared to let inflation move higher, believing it was transitory. However, they turned away from this narrative because the absolute level had become so high (and their forecasts were wrong as a result), while the persistence of these pricing pressures was greater than expected. This prompted a significant hawkish shift from central banks across the developed world, towards much earlier interest rate hikes than previously indicated.

We managed through this post-COVID-19 world using our cyclical process centred on the year-on-year rate of change of economic data over the course of 2021-22 (our process paper was published in November). We argued all year that a linear narrative of rising bond yields was naive/wrong, and the sequencing of bond yield moves was likely to be dictated by the sharp 'handbrake turns' in cyclical momentum that were easily forecastable due to the extreme base effects from 2020. As a result, we added material duration (interest rate risk) into the rise in bond yields in early 2021 and removed it once yields collapsed in July/early August. Using this framework, we positioned the fund for another opportunity to increase duration risk at the beginning of 2022, given the clear base-effect-driven slowdown in the year-on-year rate of change in growth that could emerge from April 2022 onwards. Indeed, come spring 2022 this approach is anticipating a collapse in the year-on-year rate of change of the data in the US, which reflects the exceptional strength of the economy in the prior year (spring 2021 reopening, stimulus and peak reflation narrative), notwithstanding the impact of the conflict in Ukraine.

For 2021, we had been constructive on credit, driven by our belief that it had been sitting in a 'sweet spot' with low realised volatility and tight credit spreads (credit spread is the additional yield available on a corporate bond compared to the equivalent government security). To emphasise this point, at the end of the February 2022, European high-yield defaults hit an all-time low of 0.4%. Towards the end of the year, we began shifting some of the fund's high-yield exposure into longer maturity investment-grade credit, driven by a lack of interesting opportunities at the lower end. The beginning of 2022 proved anything but calm, driven by geopolitical turmoil along with more aggressive central bank interest rate hikes, which negatively impacted investors' attitude to risk. We saw credit underperform during this period and move back into what we considered to be interesting levels.

The top contributors to performance included our duration overlay (using interest rate futures to increase or decrease the interest rate sensitivity in the portfolio), which added meaningfully to returns. Industrial high-yield credit also contributed to performance, although this was offset by the fund's subordinated financial position. In terms of some of the top individual contributors, we held bonds from Lloyds Bank and Barclays, which were called (redeemed by the issuer) during the year, while we also saw a good contribution from some COVID-19 reopening trades, such as Aramark and Boyd Gaming. In addition, the fund benefited from an overweight position in the US, which outperformed European high yield by delivering a 0.8% return versus -2.5% for the latter.

It is worth noting that the portfolio has never had any exposure to Russian or Ukrainian bonds. As many of our investors will be aware, we invest only in developed world bonds.

Outlook

We are entering the new financial year with credit spreads having widened, driven by hawkish central banks and the conflict between Russia and Ukraine. In the year to 31 March, European high-yield spreads widened by 86 basis points (bps) to 400bps, giving a yield of 4.5%, while their US counterparts widened by just 7bps to 343 bps and a yield of 6.1%. European investment-grade spreads rose by 38bps to 129bps, giving a yield of 1.6%, while US investment-grade spreads were up 25bps to 122bps, giving a yield of 3.6%.

We have seen little in terms of distress in lower-rated credit, although that is subject to any economic impact as the Ukraine/Russia conflict progresses. Corporates have spent time repairing their balance sheets and their health is strong. While the ramifications of the conflict remain uncertain, the risk/reward trade-off in spreads has improved. The focus on providing a relatively consistent and attractive income stream to investors means that the fund's investments are naturally skewed to lower-rated and riskier corporate bonds. We will continue with our investment philosophy of sensible and sustainable income by looking to invest in companies with a reason to exist.

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