North Yorkshire Pension Fund

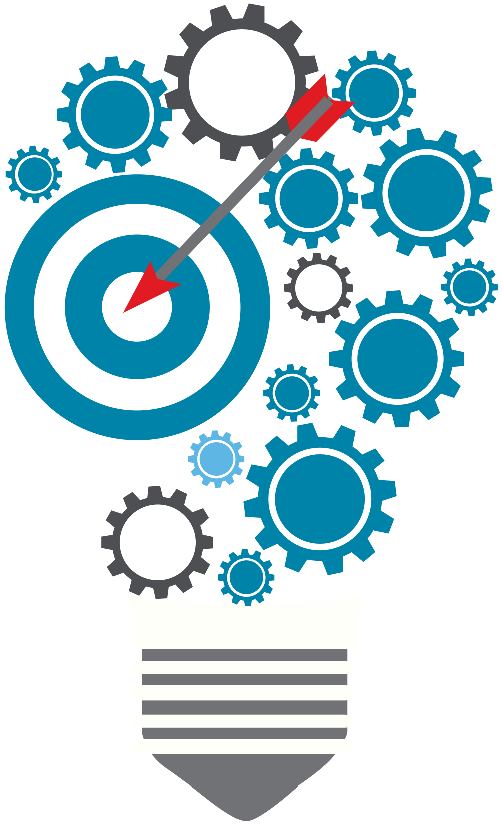
Asset allocation considerations

Prepared for:	NYPF
Prepared by:	Aon
Date:	1 March 2024

Introduction & Executive summary

What is the purpose of today?

- To discuss potential rebalancing and asset allocation considerations, covering;
  - Funding, contributions and investment assumptions (including low risk, index-linked gilts basis)
  - Latest market outlook for main asset classes
  - Introduction to equity protection
  - Current asset allocation considerations

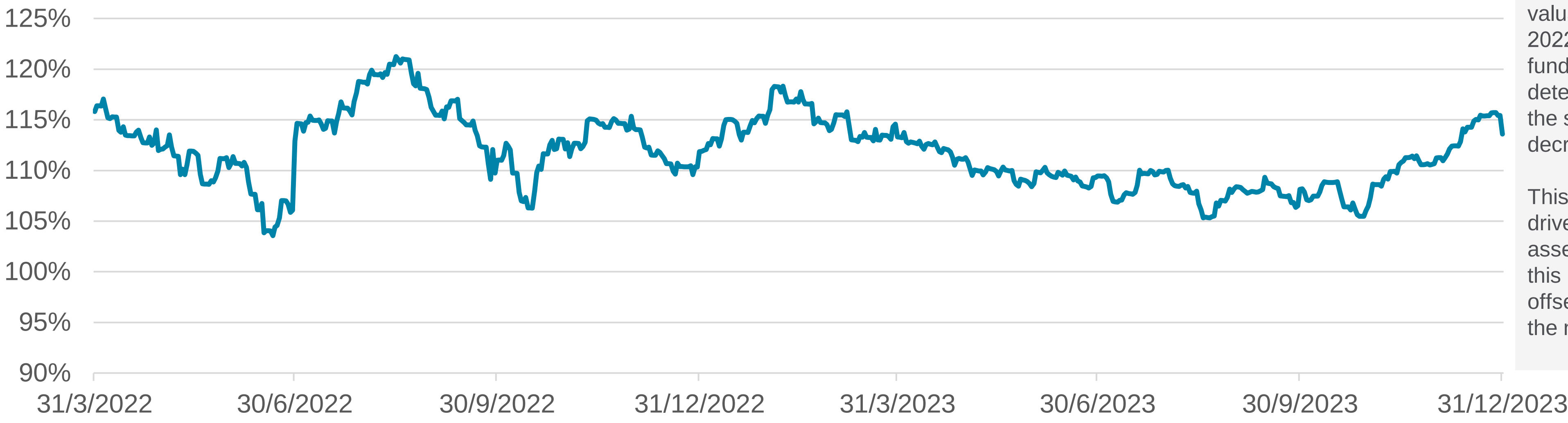


Proposed actions

1. Employers may wish to consider funding objectives and possible de-risking
2. Within equities:
   a) PFC consider impact equity allocation
   b) Officers/advisors discuss impact equity with BCPP
   c) Eliminate UK equity allocation
   d) Reduce BG LTGG allocation
3. Officers/advisors to discuss liquid alternatives with BCPP
4. Officers/advisors meet at least quarterly to discuss cash position and asset allocation

Change in ongoing funding and estimated contributions

Change to funding level since 31 March 2022



Comments

Since the results of the valuation at 31 March 2022 the Fund's ongoing funding level has deteriorated slightly, and the surplus has decreased by £104M.

This has been primarily driven by a reduction in asset values although this has been partially offset by an increase in the net discount rate.

Total employer contribution rate

14.9% ▼

at 31 December 2023

Down from 17.4% at 31 March 2022

Employer cost of accrual

16.7% ▼

at 31 December 2023

Down from 20.1% at 31 March 2022

Comments

The cost of accrual has decreased since 31 March 2022 due to the increase in net discount rate. However, the surplus has decreased which has offset this to an extent. Overall there is a reduction in the total employer contribution rate.

Notes

The total employer contribution rate quoted above is based on the average total employer contribution rates across the Fund. Individual employer contributions can be very different to the average figure across the Fund shown above depending on their own characteristics, membership profile and funding target. The individual employer contributions have been reviewed as part of the triennial valuation at 31 March 2022.

Low risk funding target

Change to funding level since 31 March 2022

Notes

This chart is provided to give an illustration of the change in the funding level based on the low-risk funding target since the 2022 valuation date. It has been produced based on changes in daily gilt yields and market implied inflation assumptions.

Comments

The funding level on the low risk basis has increased since the last valuation due to a rise in gilt yields over the period, leading to a decrease in the liabilities.

Employers should consider funding objectives and possibly de-risking

Deficit

£2,573M

31 Mar 2022

Deficit

£774M

31 December 2023

▼ **£1,799M**
vs 31 Mar 2022

Risk/Return Assumptions

- The table below sets out the asset return assumptions over 10 years. These are based on Aon's Capital Market assumptions as at 31 March 2022, 31 December 2022 and 31 December 2023.

	31 March 2022 (valuation)	31 December 2022 (last strategy review)	31 December 2023 (latest assumptions)	
High level asset class	Expected Return	Expected Return	Expected Return	Expected Volatility
Equities	6.9%	7.6%	6.8%	18.7%
Infrastructure	8.4%	7.8%	7.7%	15.8%
Property	5.3%	5.8%	6.5%	12.6%
Private credit	6.3%	8.0%	7.9%	6.6%
Investment Grade (IG) credit	2.7%	5.5%	4.8%	9.5%
Non-investment grade credit	4.3%	6.5%	6.0%	8.9%
Gilts	0.9%	3.5%	3.2%	9.6%
Cash	1.5%	3.6%	3.5%	1.3%
CPI	2.5%	2.5%	2.5%	2.0%

Source: Aon.
Note: all statistics are 10 year median expected returns/volatility of returns.

Comments

Return assumptions are materially different to those at the valuation.

Employers should consider funding objectives and possibly de-risking

Key Issues in Markets Today

1

Is it plausible for policy rates to be slashed if economic growth can hold up?

Money markets are pricing the former, but equities and credit are pricing the latter.

2

Will rollercoaster swings in bond yields continue?

Yields fell considerably in Q4 but have rebounded so far in Q1. What's next?

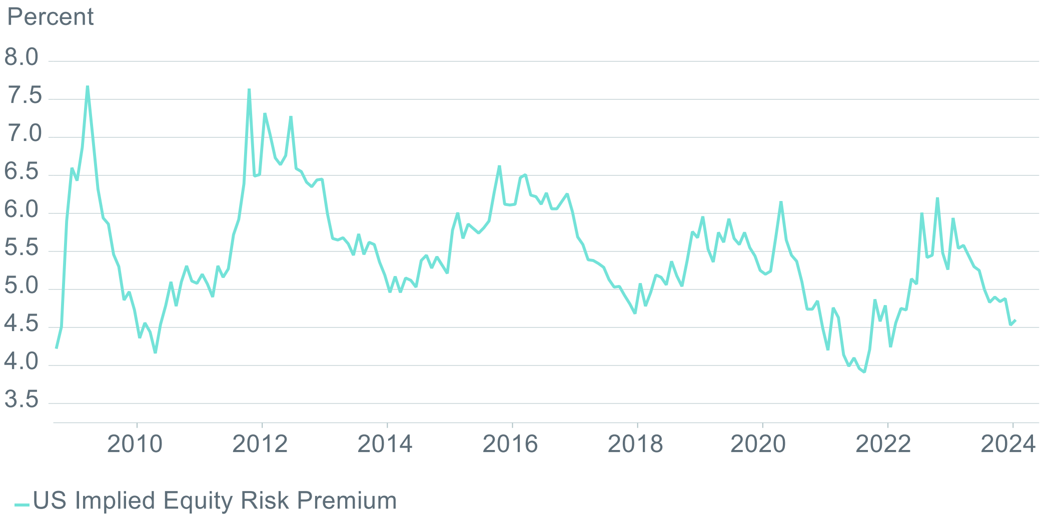
3

Can the 'Magnificent Seven' continue to pull up global equity returns?

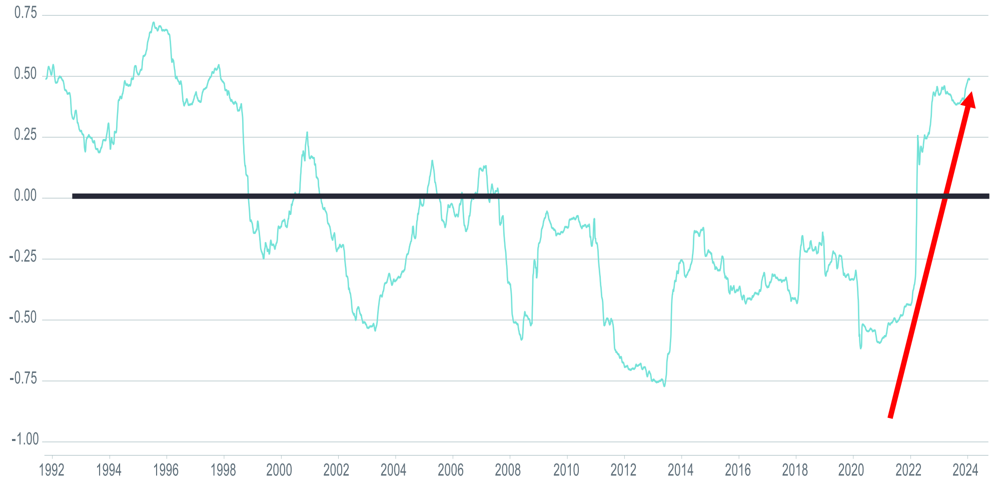
These companies are priced to be an ever-dominant part of the global economy - Is this realistic?

Key Issues in Markets Today

Higher yields will likely persist as an important headwind to equities

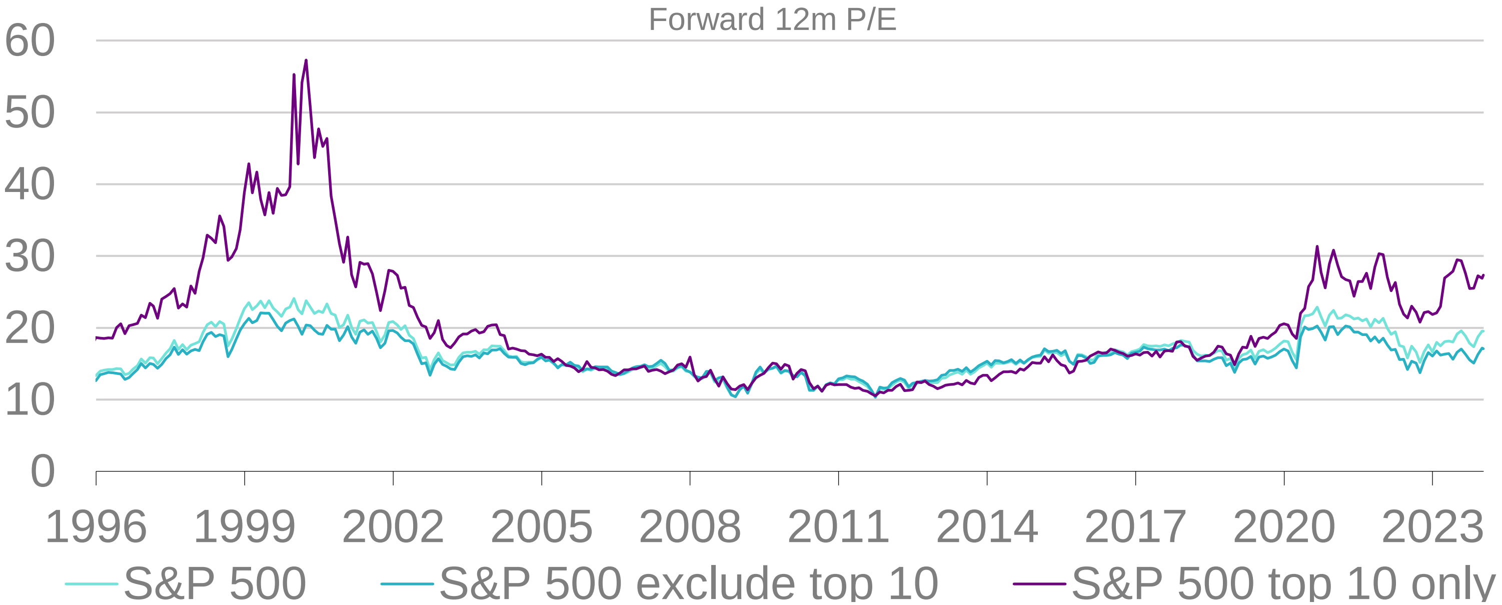


Interest rates driving risk asset performance which makes diversification difficult



Equity- bond correlations (US) 2 year rolling returns

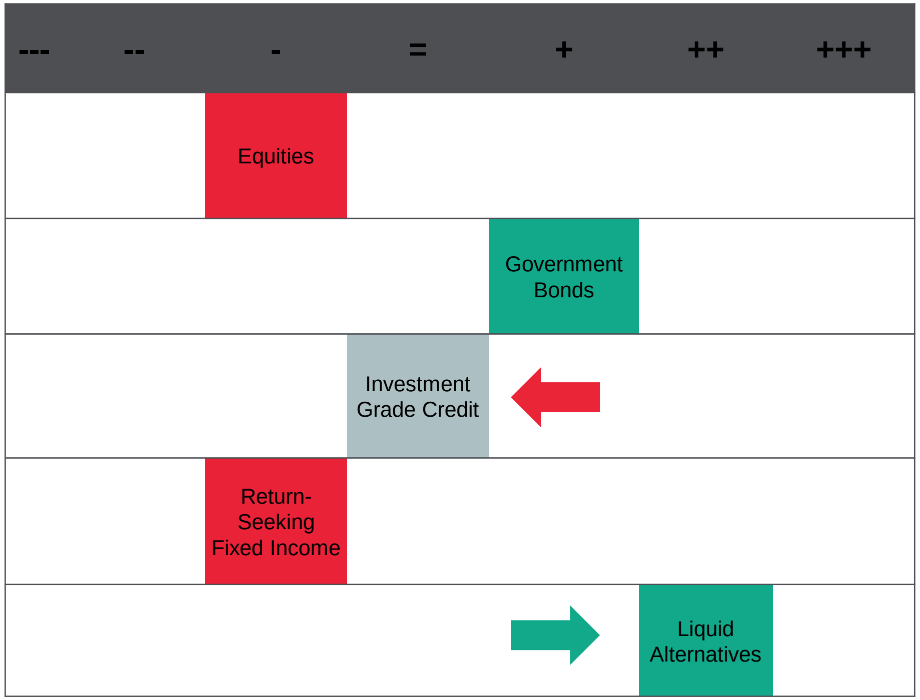
Equities expensive but not bubbly



Comments

We remain cautious on equities overall, based on our view that higher yields and a weaker economic trend, coupled with unattractive valuations will present headwinds.

Cross Asset Views



- We maintain our preference for government bonds/cash over equity and return-seeking fixed income. However, narrower credit spreads have reduced the attractiveness of investment grade relative to government bonds.
- We have upgraded our liquid alternatives view given the risk that the close correlation between equity and bond market performance could continue against the likelihood of increasing geopolitical risk.
- We continue to think that equities will face important headwinds this year, keeping us cautious. The key reasons are the big increase in policy interest rates that have yet to be fully felt by companies and the threat to earnings from weaker economic activity and sticky wages.

Comment

- NYPF consider tactical underweight equities (and MAC) and overweight government bonds (gilts) or cash.
- Or consider equity protection – but complexities and implementation issues are barriers.
- NYPF consider liquid alternatives (e.g. diversifying hedge funds, commodities and insurance linked securities) - but outside of the pool.

Asset allocation – Q4 2023 and potential future allocation

Asset class / manager	Current allocation	Long-term strategy	Q1/Q2 trades	Adjusted allocation for Q1/Q2 trades	Example long-term strategy	Diff. vs adjusted current	Action
Equities	**48.8%**	**50.0%**	-3.5%	**45.3%**	**45.0%**	**+0.3%**	**Reduce strategic allocation (to 45%) & consider further reduction if aligns with funding strategy**
BCPP UK equity	*3.9%*	*4.0%*		*3.9%*		*3.9%*	Eliminate UK equities given strategic preference for global
BCPP Global Equity	*28.4%*	*28.0%*		*28.4%*	*28.0%*	*0.4%*	
Baillie Gifford LTGG	*16.5%*	*18.0%*	*-3.5%*	*13.0%*	*10.0%*	*3.0%*	Reduce given strategic preference to reduce growth and single manager risk
Impact equity (TBC)					*7.0%*	*-7.0%*	PFC to decide whether to pursue; if so discuss with BCPP
Liquid Alternatives	**0.2%**	**0.0%**		**0.2%**	**0.0%**	**+0.2%**	Discuss with BCPP
Bonds & Cash	**28.0%**	**27.5%**	**+4.2%**	**32.2%**	**27.5%**	**+4.7%**	**Temporary increase allocation & consider further increase if aligns with funding strategy**
Non-Investment Grade Credit	5.3%	5.0%		5.3%	5.0%	+0.3%	
Investment Grade Credit	7.2%	7.5%	+0.4%	7.6%	7.5%	+0.1%	
Index-Linked Gilts	13.3%	15.0%		13.3%	15.0%	-1.7%	
Cash (inc in transit)*	2.2%	0.0%	+3.8%	6.0%	0.0%	6.0%	Comfortable with short-term overweight given yields, funding position and market outlook. Review at least quarterly.
Private markets	**23.0%**	**22.5%**	**-0.7%**	**22.3%**	**27.5%**	**-5.2%**	**Increase strategic allocation**
BCPP Listed Alts	*5.9%*			*5.9%*		*+5.9%*	
BCPP Infrastructure	*6.5%*	*10.0%*		*6.5%*	*10.0%*	*-3.5%*	
BCPP Climate Opps	*0.5%*			*0.5%*	*4.0%*	*-3.5%*	New strategic allocation
BCPP UK Opps					1.0%	-1.0%	New strategic allocation
Property	6.1%	7.5%	-0.7%	5.4%	7.5%	-2.1%	Await BCPP funds
Private Credit	4.0%	5.0%		4.0%	5.0%	-1.0%	Consider over allocating or strategic increase

Source: Northern Trust, Aon. Note: Numbers may not sum due to rounding. Q1/Q2 trades include expected trades from BG LTGG and Hermes*.

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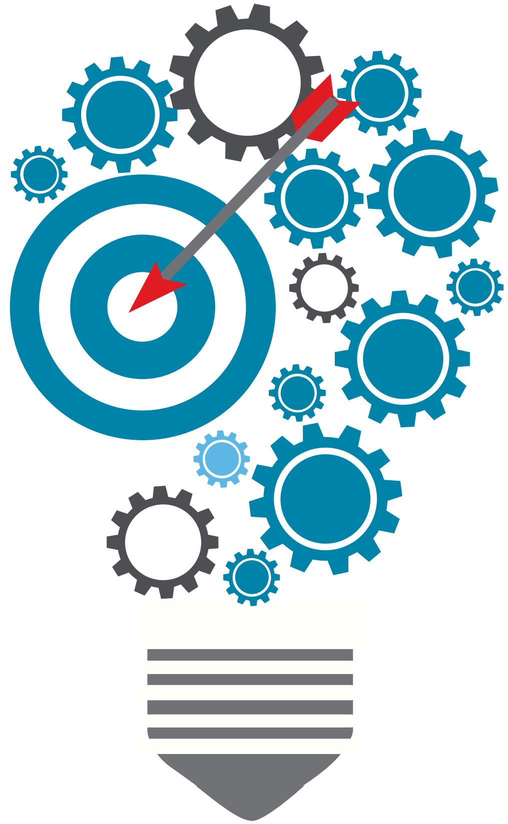


Appendix

Relative Asset Class Views*

*Asset class views are relative to others within the asset class and not relative to other asset types. There should be no read-across from equities to credit, for example.

Equity Regions

---	--	-	=	+	++	+++
			USA			
			Europe ex UK			
			UK			
			Japan			
				Emerging		

UK Gilts

---	--	-	=	+	++	+++
					Long-dated Gilts (20Y)	
			Short-dated Gilts (5Y)			
		Long-dated ILG (20Y)				
				Short-dated ILG (5Y)		

Liquid Alternatives

---	--	-	=	+	++	+++
				Active commodities		
				Alternative Risk Premia		
						Insurance-linked securities
					Diversifying hedge funds	
			Return-seeking hedge funds			

Factors

---	--	-	=	+	++	+++
				Low Vol.		
			Quality			
			Value			
			Growth			

Return-Seeking Fixed Income

---	--	-	=	+	++	+++
			USD EMD			
			Local EMD			
		Bank Loans				
				Selected ABS		
			US High Yield			

Currency views vs GBP

---	--	-	=	+	++	+++
			USD			
				EUR		
					JPY	
				EM		

Comment

- NYPF consider reducing UK equities for global now and consider further reducing growth (Baillie Gifford LTGG) “overweight”
- NYPF consider flexibility around current long-dated ILG holding and options to use short-duration ILGs or fixed gilts or annuities.
- NYPF consider liquid alternatives – noting outside of pool therefore likely low priority

Insurance linked securities

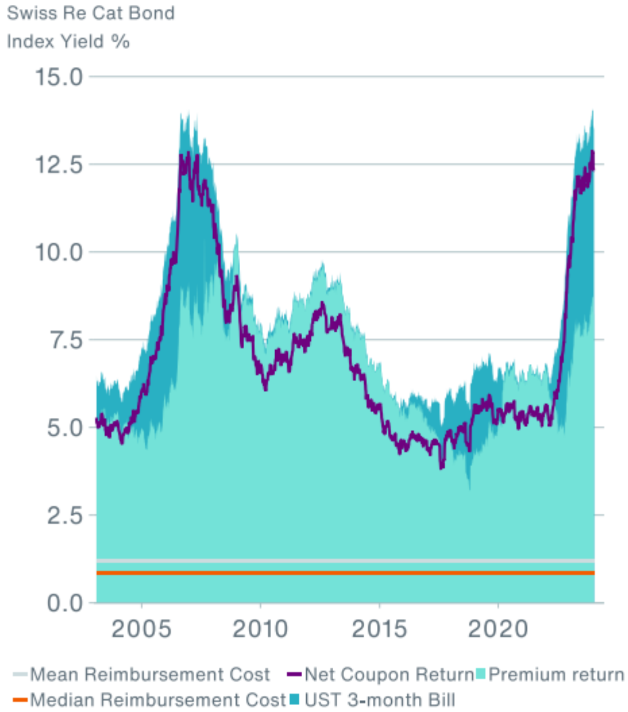
Catastrophe bonds have had a fantastic 2023 but we still expect them to deliver low double digits in 2024

ILS had a great 2023 with a rebound in cat-bond prices from 2022. These had fallen in 2022 (following Hurricane Ian) but losses were less severe than first feared, and interest in ILS made prices rebound. This additional windfall for 2023 is unlikely to be repeated but we still think that low double-digit returns this year are achievable. Spreads at issuance in January 2024 look to be very similar to January 2023,which means that coupon yields are around 13% (c. 8% premium + c. 5% on collateral). We think this is very attractive in a world where spreads on other investments are very compressed.

Climate change has already increased the losses from catastrophes across the world. Aon estimates there were $380 bn in losses in 2023, although insurers only covered $118bn of those losses. Climate change and ever bigger insurer losses might make the case for investing in ILS sound counterintuitive. However, although losses are growing, the cost of insuring those loses has grown even faster.

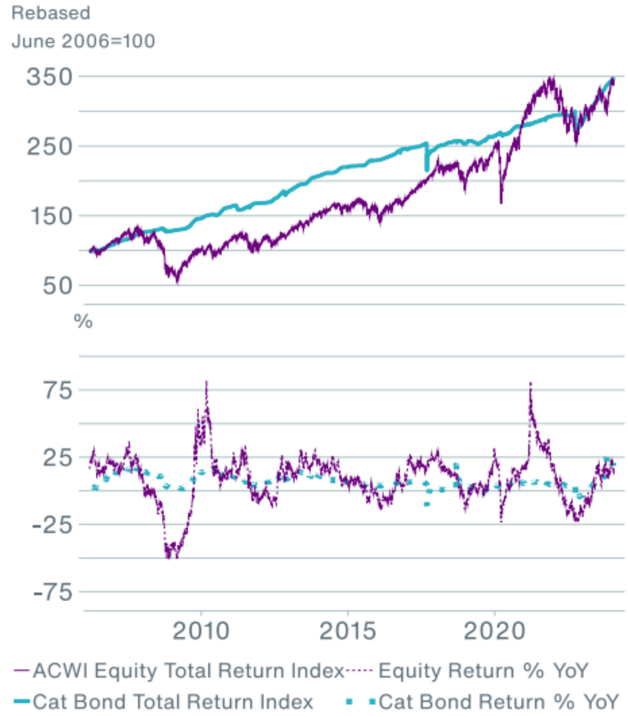
From the end of 2022 we saw the reinsurance markets start to price these risks in a way that investors are now rewarded again for buying cat-bonds and other forms of ILS. Reinsurance contracts are now specified so that insurer losses have to be even higher before reinsurance kicks-in, which means that the effective cost of reinsurance has risen even more than some price indices suggest.

Coupon returns from ILS remain elevated



Source: SwissRe, Bloomberg, Aon. NB series are estimates backed out from data provided by SwissRe. "Reimbursement costs" are an estimate of the long-term headwind to returns coming from reimbursements made to the counterparty/sponsor, calculated by deducting the long-term total return on cat bonds from the long-term coupon return.

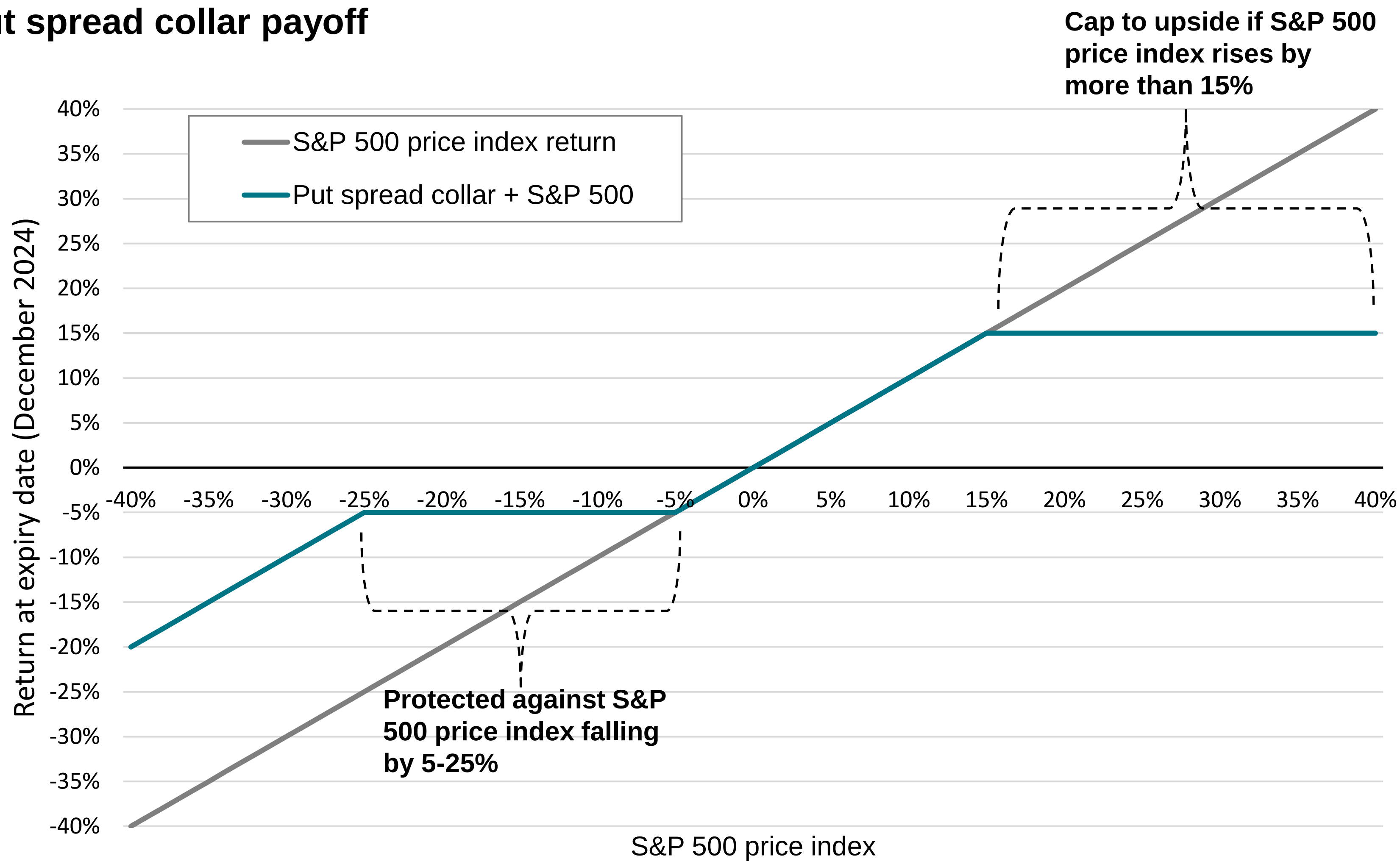
Insurance-Linked Securities: equity like returns but lower volatility



Source: Bloomberg, Macrobond

Introducing options-based equity protection

Put spread collar payoff



Source: Aon.

Comment

- Further training required and relatively complex to implement

Further information

For full detail of methodology, TAS compliance, limitation and disclaimers see report sent to officers dated 22 February