Common Good and Trusts Investment Sub-Committee

Committee Room 2, Floor 5, Fife House, North Street, Glenrothes / Remote meeting

Thursday, 30 May, 2024 - 9.15 a.m.

AGENDA

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.

Lindsay Thomson
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23 May, 2024

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Agendas and papers for all Committee meetings can be accessed on www.fife.gov.uk/committees

BLENDED MEETING NOTICE

This is a formal meeting of the Committee and the required standards of behaviour and discussion are the same as in a face to face meeting. Unless otherwise agreed, Standing Orders will apply to the proceedings and the terms of the Councillors' Code of Conduct will apply in the normal way

For those members who have joined the meeting remotely, if they need to leave the meeting for any reason, they should use the Meeting Chat to advise of this. If a member loses their connection during the meeting, they should make every effort to rejoin the meeting but, if this is not possible, the Committee Officer will note their absence for the remainder of the meeting. If a member must leave the meeting due to a declaration of interest, they should remain out of the meeting until invited back in by the Committee Officer.

If a member wishes to ask a question, speak on any item or move a motion or amendment, they should indicate this by raising their hand at the appropriate time and will then be invited to speak. Those joining remotely should use the "Raise hand" function in Teams.

All decisions taken during this meeting, will be done so by means of a Roll Call vote.

Where items are for noting or where there has been no dissent or contrary view expressed during any debate, either verbally or by the member indicating they wish to speak, the Convener will assume the matter has been agreed.

There will be a short break in proceedings after approximately 90 minutes.

Members joining remotely are reminded to have cameras switched on during meetings and mute microphones when not speaking. During any breaks or adjournments please switch cameras off.

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

Committee Room 2, Floor 5, Fife House, North Street, Glenrothes.

23 June 2023 **9.15 am – 9.40 am**

PRESENT: Councillors Dave Dempsey (Convener), Lynn Mowatt, Sarah Neal, Nicola Patrick, Gordon Pryde and Jonny Tepp.

ATTENDING: Eileen Rowand, Executive Director of Finance and Corporate Services; Elaine Muir, Head of Finance; Laura Robertson, Finance Operations Manager; Anne Bence, Accountant, Finance; and Wendy MacGregor, Committee Officer, Legal and Democratic Services.

APOLOGIES FOR ABSENCE: Councillors Colin Davidson and Sean Dillon.

4. DECLARATIONS OF INTEREST

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

5. MINUTE

The Committee considered the minute of the meeting of the Common Good and Trusts Investment Sub-Committee of 13 December 2022.

Decision

The Committee agreed to approve the minute.

6. COMMON GOOD AND TRUST FUNDS

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

Decision

The Committee:-

(1) noted the contents of the report; and

(2) requested to be advised on the appointment of a new fund manager expected appointment by August 2023; and

(3) requested, following consideration of options from Hymans Robertson LLP, to be informed of any changes in investments from UK only equities to investments in Global equities.

30 May 2024

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. The proportions invested in each fund has remained the same.

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 management arrangements and equity allocations, the committee remitted to the Head of Finance to work with the investment adviser, to implement the Investment Strategy and move to a global exposure through a passive market-cap index, preferably with a climate or Environment Social Governance (ESG) tilt.

1.4 The initial process did stall somewhat as all portfolios previously identified were for larger pension funds as opposed to these types of Common Good and Charity funds, in addition those previously identified were only available if the pension fund was invested. However, suitable funds have now been sourced and the transition process is underway.

1.5 The new fund manager is Legal and General Investment Management (LGIM) who offer an appropriate range of pooled funds which facilitates a suitable solution. Funds will be invested collectively in the Future World Climate Change Equity Factors Index Fund and the Global Corporate Bond Fund.

1.6 This is a simple governance solution as there is a relationship with one manager and rebalancing between funds could be undertaken easily. Blended fees are expected to be in the region of 30-40bps.

1.7 The equity fund embeds consideration of ESG factors. ESG factors are considered as part of the management of the bond fund. ESG factors are non-financial factors covering conservation of the natural world, consideration of people and relationships and standards for running a company. Investors such as us are applying these non-financial factors and considering their role in responsible investment when identifying risks and growth opportunities.

1.8 The transition process is being managed in two stages. Stage 1 involves the onboarding and “know your customer”. This involves gathering various documentation such as trust deeds, proof of legal entities, authorised signatories as well as proof of identity documentation for officers. The process has taken longer than hoped given the nature of the documents being sourced and the age of them.

1.9 LGIM are currently undertaking the final review of the documentation submitted to date.

1.10 Stage 2 of the transition involves transferring the assets from the current fund manager to LGIM. A transition manager has been appointed, bank accounts are in place and settlement terms agreed. A trade date will be agreed once the onboarding process is finalised.

2.0 2023-24 Performance

2.1 The current valuations for these funds are shown below: -

	Common Good & Trust Funds	Fife Educational Trust Fund	Total
	£	£	£
Valuation as at 31 March 2023	4,980,401	1,760,120	6,740,521
Increase / (decrease) in year	(37,892)	(14,906)	(52,798)
Valuation as at 31 March 2024	4,942,509	1,745,214	6,687,723

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 2024 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	219,912	79,281	299,193
% of Valuation as at 31 March 2024	4.45	4.54	4.47

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 2024 the Common Good and Trust Funds have made disbursements of £255,883.26 and the Fife Educational Trust made disbursements of £69,539.50.

3.0 Conclusions

3.1 The market values of the Common Good and Trust Funds have deteriorated during the year and have a reduced value at 31 March 2024.

Appendix 1 – Janus Henderson Preference & Bond Fund Commentary

Report Contact
Laura Robertson
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Janus Henderson Fixed Interest Monthly Income: 12 months to 31 March 2024

The fund increased by 4.34% based on Class I income (Net) over the year under review, compared with a rise of 7.27% in the IA Sterling Strategic Bond Sector peer group benchmark.

The period under review was one of two halves. For the first half, the global economic landscape was volatile as central banks – including the US Federal Reserve, European Central Bank and Bank of England – aggressively tightened monetary policy to address surging inflation, sparking concerns over potential recession risks. The tightening led to stresses in regional banking systems, notably in the US, and a significant downturn in manufacturing activity worldwide, although the service sector showed more resilience.

The narrative shifted in October when investors became increasingly optimistic that central banks would implement early interest rate cuts in 2024, as signs of cooling labour markets, global disinflation and slowing growth increased expectations that the global economy would achieve a 'soft landing'. As a result, developed world government bond yields fell sharply during the October to December period. This optimism was tempered somewhat in the new year, as the prospect of early interest rate cuts faded and US inflation remained stronger than anticipated. Elsewhere, the Bank of Japan exited its policy of negative interest rates and raised interest rates for the first time since 2007. Although the move was largely expected, it marked the start of a significant shift in its monetary policy stance.

Despite early economic indicators pointing to a downturn, earnings and labour markets remained resilient through the period. The future economic path hinges on these factors, determining the extent of central bank rate cuts in response to disinflationary trends. The economic outlook for 2024 is cautiously optimistic, with a focus on investing in quality businesses poised to withstand a slowing economic environment.

The fund's performance on a relative basis during the reporting year was in the fourth quartile. The credit book outperformed its benchmark, but the fund's duration positioning detracted from performance. In terms of individual contributors, we saw positive performance from our credit book with few detractors. Positive contributors included Nationwide Building Society and Scottish Widows. The largest individual detractors were our holdings in government bonds, most notably Australian government bonds. Within the credit book, our exposure to pharmaceutical companies Catalent and Organon detracted from returns.

Derivatives were used for three reasons. Firstly, to hedge against any foreign currency risk when buying a bond not denominated in sterling. Secondly, to manage duration through interest rate futures. Thirdly, to manage credit spread risk, via the iTraxx Crossover series.

We are entering the new financial year with spreads relatively tight but all-in yields looking attractive. We remain constructive on good quality credit from both a fundamental as well as technical viewpoint. European high yield spreads tightened by 116 basis points (bps) over the period under review to 358bps, giving an effective yield (yield) of 6.26%. Meanwhile, US high yield spreads tightened by 146bps to 312bps over the year under review, with a yield of 7.8%. European investment grade spreads tightened by 55bps to 113bps, giving a yield of 3.8%, while US investment grade spreads tightened by 52bps to 93bps, giving a yield of 5.7%.

In terms of distress, the 12-month default rate sits at 2.59% for the US high yield market and 2.64% for European high yield. We expect that with tighter financial conditions and headwinds to corporate fundamentals defaults will rise through the year.

Outlook

It is worth mentioning that credit markets have shown notable resilience to the enthusiasm observed in high growth areas of the equity markets such as cryptocurrencies. Spreads are near their historical lows (pricing in very low default rates) while yields remain high, driven by elevated government bond yields.

We have maintained a balanced portfolio between high yield and investment grade, buying high-quality businesses with strong management teams and free cash flow, while our duration positioning acts as downside protection should the economy turn. 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. That said, we remain fully invested in large-cap corporate bonds that have a ‘reason to exist’, as we say, and that we think can withstand softer economic growth. We will continue with our investment philosophy of sensible and sustainable income by looking to invest in companies that have resilient business models and continue to think this is the best strategy for our investors.

Janus Henderson UK Equity Income & Growth 1 Year Commentary to end March 2024

In the year ending March 2024, the fund (as measured by the I Inc share class) rose 3.8%, underperforming its FTSE All-Share benchmark which rose 8.4%. Over the same period its IA UK Equity Income peer group rose 7.7%.

The focus of the market during the year was the pace and magnitude of the fall in inflation and the subsequent pace and timing of any future falls in interest rates. UK inflation came down materially during the period, falling from 10.1% in March ’23 to 3.2% in March ’24. This fall in inflation buoyed equity markets as it cemented the expectation that interest rates have peaked (although the debate remains around when the first interest rate cut is likely to be).

The largest detractor from relative performance during the year was support services firm Ienergizer, which announced it was delisting from AIM, leading to a material fall in the share price on the expectation of a lack of liquidity and transparency following the delisting. The position has since been sold (both during this reporting period and the final sale shortly after). The second largest detractor from relative performance was a lack of holding in engine manufacturer Rolls-Royce, which has benefitted from a recovery in flying hours following Covid as well as positive ‘self help’ (such as cost reductions). The company does not currently pay a dividend and therefore would have been challenging to hold in size within an income fund.

Among the positive contributors to relative performance were firms subject to takeover offers including logistics firm Wincanton, paper and packaging producer DS Smith and broker Numis (there was also a rejected offer for insurer Direct Line). Heightened corporate activity has been an ongoing theme in UK equity markets as a result of the valuation discount of UK equities relative to overseas peers. Until the valuation gap closes this is a trend that we would expect to continue.

During the year new positions were established in companies including food retailer Sainsbury, global underwriter Beazley and medical device company Smith & Nephew. Taking Sainsbury as an example, it has improved its price competitiveness in recent years and this is allowing it to take market share while generating good levels of cash flow (much of which is coming back to shareholders via a dividend and share buyback). These new positions were funded by sales of several companies subject to takeover as well as the sale of the holding in defence company BAE Systems (which was trading on a higher valuation than its historic average).

The UK economy, having fallen into technical recession in the second half of ’23, is now showing tentative signs of recovery with, for example, two months of modest GDP growth and consumer confidence improving from low levels. Meanwhile many of the companies held have reduced costs while maintaining capacity for when demand improves. On a better sales environment it may be that the drop through from sales to earnings surprises positively from often low starting valuations.