Investment Strategy Statement

1. Introduction

Lancashire County Council ("LCC") is the administering authority of the Lancashire County Pension Fund (the "Fund"). This Investment Strategy Statement ("the Statement") has been prepared in accordance with DCLG guidance on Preparing and Maintaining an Investment Strategy Statement (July 2017) and after taking appropriate advice.

As set out in the Regulations, the Pension Fund Committee (the "Committee") will review this Statement from time to time, but at least every three years, and revise it as necessary. Also, in the event of a significant change in relation to any matter contained in this Statement, changes will be reflected within six months of the change occurring.

The Regulations require all Administering Authorities to take "proper advice" when formulating an investment strategy. In preparing this document and the overall investment strategy the Committee has taken advice from the LCPF Investment Panel (the "Panel", a panel of independent advisors appointed by LCC for the purpose of providing advice on pension related matters) and Local Pension Partnership Investment Limited (LPP I) which is a FCA regulated investment manager with specific expertise and regulatory permissions to provide advice on investments.

In 2000, the Government commissioned a 'Review of Institutional Investment in the United Kingdom' by Paul Myners. Following the report the Government issued a set of investment principles which have subsequently been reviewed by HM Treasury. The Fund has considered the principles and considers that it is compliant with them.

2. Investment Objectives

The Fund's primary investment objective is to ensure that over the long term the Fund will have sufficient assets to meet all pension liabilities as they fall due.

In order to meet this overriding objective the Committee maintains an investment policy so as to:

- Maximise the returns from investments whilst keeping risk within acceptable levels and ensuring liquidity requirements are at all times met;
- Contribute towards achieving and maintaining a future funding level of 100%;

The Fund will use its influence as a large institutional investor to encourage responsible long-term behaviour, which includes exercise of voting rights and ownership, delegated to LPP I and overseen by the Committee.

3. Investment Governance

The Committee is responsible for approving and reviewing on a regular basis an overall Investment Strategy and determining asset allocation to such asset classes as the Panel consider appropriate. This includes setting the higher level objectives and risk tolerances of the Fund. The Committee, in conjunction with the scheme's actuary, sets the required rate of return needed to achieve its objectives and the risks it is willing to take. Once these parameters are established, the Committee will determine the strategic asset allocation or policy portfolio that it believes has the highest probability of succeeding.

The Panel will:

• review the Fund's long term investment strategy and where necessary make recommendations to the Committee;

• propose strategic and/or tactical asset allocations, with input from LPP I

• set and monitor the range of asset allocations used by LPP I

• consider appropriate risk management strategies to include the matching of pension liabilities with suitable investments, possibly involving derivatives, and where necessary make recommendations to the Committee;

• consider foreign exchange hedging strategies relating to the equity and/or other asset allocations and where necessary make recommendations to the Committee;

• monitor and review the investment activity; and

• review and report on the performance of the Fund and where necessary make recommendations to the Committee.

The implementation of the asset allocation is delegated to LPP I. LCC is a founding shareholder of LPP I and maintains ongoing corporate governance controls but plays no direct role in investment management activities.

LPP I are responsible for managing 100% of the assets of the Fund. The large majority of the Fund's assets have been transitioned into investment pooling vehicles, also managed by LPP I, as illustrated in the table below. A small minority of assets remain on the balance sheet of the Fund as "legacy assets".

Asset class	**Percentage of total assets in pools**
Public Equity	100%
Fixed Income	100%
Diversifying Strategies	100%
Credit	91%
Infrastructure	84%
Private Equity	98%
Real Estate	64% *
Total	**90%**

**Excluding Legacy Shared Ownership, the percentage of the Fund's Real Estate assets that are pooled is 85%.*

4. Asset Allocation Framework

To pay benefits over time the Fund needs to generate a rate of return that is at least equal to the actuarial discount rate. The starting point for considering asset allocation is a simple portfolio of bonds and equities. However, this basic portfolio does not maximise diversification and therefore risk adjusted return.

In order to prudently diversify sources of risk and return, the Fund allocates capital across a wide variety of different asset classes. To be added to the portfolio, asset classes are first judged for suitability; they have to be well understood by the Committee, consistent with the Fund's risk and return objectives; and they have to make a significant contribution to the portfolio by improving overall return and risk characteristics. In addition, the new asset classes have to be less than perfectly correlated with equities and bonds, so that the Fund benefits from increased diversification. The Fund has identified a total of nine asset classes that, combined, may form the policy portfolio.

The nine asset classes shown in the table below have different exposures to economic factors (GDP growth and inflation) and combine different geographies and currencies. In assessing suitability the Committee has considered the respective return drivers, exposure to economic growth and sensitivity to inflation – each an important consideration, relative to the sensitivities of the Fund's liabilities and managing risk.

Asset Class	Long-Term Return Drivers	Economic Growth *	Inflation *	Geography	Currency
Global Equity	- Economic growth - Dividend income - Earnings growth - Change in company valuation	+	+/ - **	Diversified	Diversified
Private Equity	- Economic growth - Company growth - Earnings growth - Change in company valuation - Availability of finance - Illiquidity premium	+	+/ - **	Diversified	Diversified
Fixed Income	- Yield (minus credit losses) - Valuation increases as bonds approach maturity - Change in yield	-	-	Diversified	Diversified
Credit	- Yield (minus credit losses) - Valuation increases as bonds approach maturity - Change in yield - Illiquidity premium	+	-	Diversified	Diversified
Real Estate	- Rental yield (minus expenses) - Rental growth - Capital growth	+	+/ - **	Predominantly UK	Predominantly GBP
Legacy Shared Ownership	- Rental yield (minus expenses) - Rental growth - Capital growth	+	+/-	UK	GBP

Infrastructure	- Dividend income - Dividend growth - Capital growth	+	+	Predominantly UK	Predominantly GBP
Diversifying Strategies	- Diversified	Low correlation	Low correlation	Diversified	Diversified
Cash	- Yield	+	-	Predominantly UK	Predominantly GBP

**Sensitivities shown are to positive shocks, i.e. if growth and inflation surprise on the upside.*
*** Property, public and private equities expected to provide partial inflation protection.*

The Committee, advised by the Panel, have determined benchmark weights to each asset class which it believes to be best suited to meeting the long term objectives of the Fund. It has also identified tolerance ranges within which shorter term variations would be tolerated and/or actively pursued due to a combination of relative returns and investment opportunity.

The benchmark weight and tolerances are shown in the table below. The weights are to be maintained within the ranges, as long as the Fund can find attractive opportunities that meet its return, risk, and cash flow requirements. In the absence of opportunities investments will not be “forced” and under/over allocations may be made to any asset class whilst also remaining within the tolerance ranges. Should any allocation fall outside of the range the Committee shall seek to bring the allocation back within the range as soon as suitable opportunities are identified.

The Panel review the Strategic Asset Allocations (see below) and recommend any changes to the Committee. This table sets out the Strategic Asset Allocations approved by Committee in September 2020. In addition, the Committee and/or the Panel review any exposures which arise outside these tolerances and advise appropriate action.

Asset Class	Benchmark weight (%)	Range (%)
Global Equities	44.5	40-50
Private Equity	5.0	0-10
Fixed Income	1.5	0-5
Credit	17.0	12.5-22.5
Real Estate	12.5	7.5-17.5
Legacy Shared Ownership	3.0	0-5
Infrastructure	15.0	10-20
Diversifying strategies	0.0	0-5
Cash	1.5	0-5
Total	**100.0**	

Each asset class has its own specific investment objective (benchmark and investment performance target) and within each asset class there are further diversification controls.

Global Equities - The objective is to outperform the MSCI All Country World, net dividends reinvested, GBP Index over the full market cycle which is considered to be at least seven years (the “Benchmark”). Equity investments are made via LPP I, by investing in underlying funds which may be managed by LPP I ("Internal Mandates"), or by external third parties ("External Mandates").

Private Equity - The objective is to outperform the MSCI World SMID, net dividends reinvested, in GBP Index and provide investors with access to attractive private equity opportunities. All new investments will include, but not be limited to the following sectors: Buyout, Venture Capital, Growth Equity, Special Situations/Distressed and Upstream Energy.

Real Estate - The objective is to gain cost effective, diversified exposure to UK and international property assets that meet its investment objectives: to generate a return in excess of UK CPI inflation; earn predictable cash flows; and provide a partial hedge against inflation. The largest exposure of the portfolio will be to traditional sectors of the UK commercial real estate market. A smaller allocation will be made to value-added and opportunistic investments. The benchmark is the MSCI UK Quarterly Property Index.

Legacy Shared Ownership - The objective is to gain cost effective exposure to a specific area of the UK property market. These assets should generate predictable cash flows and provide a partial hedge against inflation.

Infrastructure - The objective is to gain cost effective, diversified exposure to global infrastructure assets located predominantly in the UK or otherwise in OECD nations. These investments seek to generate a satisfactory risk adjusted return; improve diversification; provide predictable cash flows; and indirectly hedge against inflation. The benchmark is the UK CPI + 4% pa net over a 10 year period

Fixed Income - The objective is to outperform the Bloomberg Barclays Global Aggregate (GBP Hedged) Index. The LPPI Pool will pursue this aim by investing in underlying funds which include Internal Mandates and External Mandates.

Credit - The objective is to gain cost effective exposure to diverse sources of return linked to global credit markets and credit instruments. The LPP I pool will pursue this aim primarily by allocating capital to investment vehicles or pooled funds which include External Mandates. The benchmark is an equally-weighted blended composite consisting of the S&P LSTA Leveraged Loans Index (GBP-Hedged) and the Bloomberg Barclays Multiverse Credit Index in GBP.

Diversifying Strategies - The objective is to gain cost effective exposure to diversifying sources of return distinct from global equity beta and bond duration. The LPP I pool will pursue this aim primarily by allocating capital to investment strategies which include External Mandates. The benchmark is the HFRI Fund of Funds Conservative (GBP-Hedged) Index.

Cash - Cash is managed at the Fund level by LCC until needed or drawn by LPP I for investment purposes. The benchmark is 1 month GBP LIBOR.

5. Risk Management

The overriding objective of the Fund in respect of its investments is to maximise return within an acceptable and understood level of risk.

Key risks to the Fund as outlined in the Funding Strategy Statement are:

- Investment markets fail to perform in line with expectations
- Market yields move at variance with assumptions
- Investment Fund Managers fail to achieve performance targets over the longer term especially as there is a large concentration of investments with LPP with the resultant risk of personnel change
- Asset re-allocations in volatile markets may lock in past losses
- Pay and price inflation is significantly higher than anticipated
- Demographic risks
- Regulatory changes
- Changes to national pension requirements and/or Inland Revenue rules

These risks are monitored and managed with diversification being a very important risk management tool. As described in the section on Asset Allocation, the Fund will seek to maintain a diversified exposure to several different asset classes, geographies, and currencies.

The asset class pools described above are also subject to a number of constraints to allow for intra-asset class diversification, including sector, country, manager, and maximum exposure to a single asset.

Operational risk is minimised by having custody of the Fund's financial assets provided by Northern Trust, a regulated, external, third party, professional custodian. Equivalent arrangements are in place where investments are made into pooled vehicles, such as those managed by LPP I.

Performance measurement

Fund performance is measured at a number of different levels. The objective of the Fund is to outperform the actuarial discount rate.

The performance of the pooling arrangements is monitored via regular reporting and through quarterly Panel meetings. Performance for LPP I is measured against the policy portfolio benchmark. LPP I seeks to outperform the policy portfolio on a risk adjusted basis, via active sub-asset class selection, selecting the best stocks/managers for each of the pools and by implementing investments in a low cost manner. Performance for the investment pools is measured against widely used and transparent benchmarks and appropriate targets.

Where performance falls short of expectations the Committee and the Panel will identify the cause of this underperformance and will respond appropriately. In practice, the

Fund would expect to work collaboratively with LPP I to identify and remedy the cause of any underperformance.

6. Environmental Social and Corporate Governance (ESG) Policy, and approach to social investments

The Fund is committed to being a long term responsible investor. It is an integral part of the way the Fund is managed. The Responsible Investment Policy of the Fund is available at this link. Lancashire Fund Information - Lancashire County Council.