Composition of the Valuation Investment Strategy (VIS)

Introduction

The Valuation Investment Strategy (VIS) is the investment strategy for the Defined Benefit (DB) part of the scheme that was developed for the most recent actuarial valuation. It is adjusted from time to time to retain consistency with the Integrated Risk Management Framework (IRMF) and the trustee's risk appetite.

For a description of the VIS, please refer to our Valuation Investment Strategy (VIS) for the DB part of the scheme.

What is the composition of the VIS?

The high-level composition of the VIS is shown in Table 1, which shows the allocation to the three high-level investment components or building-blocks (which are a combination of portfolio weights and hedge ratios).

Table 1. The composition of the VIS using high-level components.

Components			Portfolio weight[1]
Growth			60%
Credit[2]			20%
Liability hedging[3]			
	Interest rate hedge ratio	*50%*	
	Inflation hedge ratio	*50%*	

[1]Portfolio weights do not add to 100%, because liability hedging is shown as liability hedge ratios.
[2]As per Table 3 below, US TIPS have been re-classified from the credit component to the LDI component. Therefore, a 20% credit allocation in the updated VIS sub-composition is comparable to the 25% credit allocation under the previous VIS sub-composition (published in January 2022).
[3]On a self-sufficiency basis.

We also show the asset allocation breakdowns of the VIS composition in Tables 2 and 3.

Table 2 shows the asset allocation weights only (where we have converted the hedge ratios into LDI asset allocations). Table 3 shows a more detailed breakdown, including sub-asset classes.

Please note, the LDI capital weights in these two tables have been calculated for reference as at 31 March 2023 (the valuation date). However, they will vary over time with market conditions, to retain fixed liability hedge ratios (on a self-sufficiency basis).

Table 2. The composition of the VIS in terms of asset allocation.

Asset class	Allocation
Growth	60%
Credit[1]	20%
LDI[2,3]	37%
Funded LDI 32%	
Levered LDI 5%	
Leverage[3]	-17%
Total	100%

[1]As per Table 3 below, US TIPS have been re-classified from the credit component to the LDI component. Therefore, a 20% credit allocation in the updated VIS sub-composition is comparable to the 25% credit allocation under the previous VIS sub-composition (published in January 2022).
[2]The LDI allocations provide interest rate and inflation hedge ratios (on a self-sufficiency basis) of 50%.
[3]The LDI and leverage allocations vary over time with market conditions, to retain fixed hedge ratios (on a self-sufficiency basis). Please note, we assume -12% of leverage within growth assets.

Table 3. The breakdown of the asset allocation of the VIS.

Asset class	Sub-asset class	Sub-asset class breakdown
Growth	90% Equity	70% Developed market ex UK 20% UK equity 10% Emerging market
	10% Property	100% Property
Credit	100% Other fixed income	40% UK credit 30% Global credit 15% Global high yield 15% Emerging market debt
LDI	98% Index linked gilts 14% US TIPS -12% Nominal gilts	The allocation to US TIPS is kept fixed at 5% (of total assets). The allocation to index-linked and nominal gilts varies over time with market conditions, to retain fixed hedge ratios (on a self-sufficiency basis).

Permitted allocation ranges around the VIS

USSIM has considerable discretion to add value in the investment process by deviating from the VIS. However, USSIM is set risk and return objectives by the trustee in respect of the Implemented Portfolio which pay regard to the level of risk and expected return associated with the VIS.

In practice, this means that there are direct and indirect constraints on the Implemented Portfolio. The main ones are shown in Tables 4 and 5.

The Implemented Portfolio is also constrained in other ways, for example, by virtue of constraints on (i) the level of asset-liability risk (similar to the volatility of the deficit) and (ii) the (very low) probability of running out of collateral and/or cash.

Table 4. Direct constraints on the Implemented Portfolio associated with the VIS.

Component	VIS	Implemented Portfolio range for 'green' status	
		Minimum	Maximum
Growth	60%	52%	72%
Credit	20%	None	None
Liability hedging[2]	50%[1]	40%	60%

[1]These hedge ratios correspond to an LDI allocation in the VIS of 37% as at 31 March 2023 (giving leverage in the VIS of -17%). The level of LDI allocation varies over time with market conditions and the funding level to maintain the same hedge ratios.
[2]On a self-sufficiency basis.

Table 5. Indirect (portfolio-driven) constraints on the Implemented Portfolio associated with the VIS.

Asset class	Indirect constraint
Growth	Constrained by the expected return on the Implemented Portfolio not being less than the expected return on the VIS.
Credit	Constrained by the minimum levels of liability hedging and growth assets.
Liability hedging[1]	Constrained by market capacity and by leverage.
Leverage	Constrained by collateral headroom, which depends inversely on the allocation to growth assets.

[1]On a self-sufficiency basis.