From Belief to Benchmark: Framing LGPS Equity Portfolios

Choosing the equity belief and the risk accepted

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This paper aims to support Pension Fund Committees, officers, advisers and Pools in discussing the beliefs that sit beneath listed equity allocation decisions.

We are publishing it now as many LGPS Funds are reviewing their Investment Strategy Statements (ISS) to ensure alignment with the revised requirements. The ISS also guides the respective Pool on the objectives, priorities and preferences of the Fund, enabling effective implementation of its strategy.

This paper argues that a Fund should not start its listed equity discussion with the choice of benchmark or with active versus passive decision. It should first determine what role equities play in meeting the Fund's objective of paying pensions, what kind of equity return driver it believes in, and which form of regret risk it is willing to accept in pursuit of that belief.

Regret risk
Regret risk is the choice between two forms of discomfort: ownership regret where the Fund owns assets it may later regret; and non-ownership regret where the Fund misses returns from assets it does not own. A clear equity belief makes explicit which form of regret risk the Fund is more willing to accept.

A short roadmap for Committee readers

1. Start with the primary objective

The Fund exists to pay all pensions, as they fall due, efficiently and affordably. The listed equity allocation should serve that objective.

2. Decide the positive equity belief

The Fund should ask what it believes is the right driver of long-term equity return. At one end is a belief in broad market exposure. At the other is a belief in deliberate ownership. Many Funds may sit between the two.

3. Recognise the risk accepted

A market exposure belief accepts ownership regret. A deliberate ownership belief accepts non-ownership regret. A balanced view accepts elements of both.

4. Let the benchmark role follow from the belief

The benchmark may be the starting portfolio, a risk anchor or only a reference point. Its role should follow from the equity belief and not determine it.

5. Let implementation express the belief

A Pool serving a Fund with a market exposure belief may start with broad, low-cost exposure. A Pool serving a Fund with a deliberate ownership belief may start with more selective ownership. A balanced view may combine market participation with selected departures.

6. Monitor against the belief

The test is whether the allocation behaves as expected. That may or may not be the same as beating a broad equity benchmark over a period.

7. Be clear about roles

The Pension Fund Committee owns the strategy, and the Pool is responsible for implementation. Clear strategic intent helps the Pool implement the portfolio effectively.

Introduction

Questions about equity allocation are often presented as technical investment debates; should a Fund invest actively or passively? Should it favour broad market exposure or a particular investment style? Should success be judged against a benchmark or against a wider objective? Under the Pension Scheme Act 2026, the supporting 2026 Regulations and published statutory guidance, these questions now sit within a clearer framework for pooling, investment strategy, governance, advice and implementation.

This guide explores the different approaches to investing in listed equity, including broad passive exposure, benchmark-aware active management and more differentiated active approaches. Each can be appropriate where it follows from a Fund's investment objectives, investment beliefs and circumstances.

The choice of approach is important, but it is not the starting point. The starting point is the Fund's positive equity belief: its view on what should drive long-term equity return.

For an LGPS Fund this is a governance question before it is an investment question. The Fund should be clear about its objective, the risks it is most concerned about, and the beliefs that should guide decisions made on its behalf. Different Funds may reasonably reach different conclusions. Good governance makes those answers explicit, deliberate and owned.

For a Pension Fund Committee, the central decision is not the benchmark, the implementation style or the label on the mandate. The central decision is what the Fund believes should drive long-term equity return. The regret risk it accepts should follow from that belief.

Summary equity belief framework

Equity belief spectrum

Broad market exposure → balanced / relative → deliberate ownership

At one end, the Fund seeks broad participation in market returns and accepts **ownership regret**. In the middle, it combines market exposure with selected departures. At the other end, it seeks more deliberate ownership and accepts **non-ownership regret**.

The table below frames the choice as a positive equity belief. In plain terms, what the Fund believes should drive long-term equity return and the regret risk accepted in pursuing it. It is not intended to prescribe an answer. It helps Committees test whether their belief, benchmark role, implementation approach and monitoring framework all point in the same direction.

Decision area	Market exposure belief	Balanced / relative active belief	Deliberate ownership belief
Positive belief	Broad market exposure is the most reliable driver of long-term equity return.	Market participation is important, but selected departures can add value or better reflect Fund beliefs.	Long-term equity return is best sought through businesses or strategies the Fund can understand and justify.
Risk accepted	The Fund accepts **ownership regret:** owning companies, sectors or concentrations it may later wish it had avoided.	The Fund accepts some **ownership regret** and some **non-ownership regret**.	The Fund accepts **non-ownership regret:** missing possible upside from companies, sectors or strategies it does not own.
Benchmark role	The benchmark is close to the portfolio, but the choice of market still matters.	The benchmark is a risk anchor.	The benchmark is a reference point, not the starting point.
Implementation expression	Broad, low-cost exposure, with any departures clearly justified.	Benchmark-aware active, systematic or tilted exposure.	More selective ownership, with clear reasons for holding each exposure.
Monitoring question	Is the Fund capturing the intended market exposure efficiently, and is that exposure still the right one?	Are departures behaving as expected and remaining proportionate?	Does ownership remain explainable and consistent with the belief?
Committee question	Which market do we want to own?	Where is selectivity justified?	What do we want to own, and why?

1.
Start with the primary objective

The Fund exists to pay the pensions its members have been promised, in full and on time, while supporting long-term affordability for employers and taxpayers. Everything else is a means to that objective. The revised statutory framework reinforces rather than replaces that purpose: it defines the framework for advice, pooling, implementation and governance.

The practicalities of investment management often put an intermediate goal in front of this primary objective. The listed equity allocation is often automatically given a benchmark and performance is systematically measured against it.

The distinction between an intermediate measure and the primary objective matters because the two can pull apart. A benchmark can be useful for measuring implementation, but it is not always the same as the Fund's primary objective. A strategy that tracks its benchmark closely can still serve the Fund poorly if the benchmark is not aligned with what the Fund is trying to achieve. A strategy that deviates from the benchmark may feel uncomfortable in relative terms but may still serve the primary objective better. The benchmark may therefore be a reference point, not the goal.

2.
Decide the positive equity belief

Once the primary objective is clear, the Fund can ask a more useful question than "active or passive?" It can ask which positive equity belief it holds or put simply, what it believes should drive long-term equity return.

What kind of equity return does the Fund believe it should seek and what risk is it willing to accept in doing so?

Beliefs are often a spectrum but in this case they could be described with the following bookends:

Market exposure belief

The Fund believes broad market exposure is the most reliable way to earn long-term equity returns. It accepts that this means following the market up and down including owning areas of the market it may not have selected individually.

Deliberate ownership belief

The Fund believes long-term equity returns are best earned by owning businesses or strategies it can understand and justify. It accepts that this may mean missing upside from companies or sectors it does not own.

3.
Recognise the risk accepted

A market exposure belief accepts ownership regret: the possibility that the Fund owns companies, sectors or concentrations it may later wish it had avoided. That risk may be worthwhile because broad exposure can bring diversification, cost discipline and humility about the limits of stock selection.

A deliberate ownership belief accepts non-ownership regret: the possibility that the Fund misses upside from companies, sectors or strategies it does not own. That risk may be worthwhile because the Fund has chosen to own more deliberately and to hold exposures it can understand and justify.

The trade-off is unavoidable. A Fund can reduce one form of regret risk only by accepting more of the other. The governance task is not to eliminate the trade-off, but to decide consciously which form of regret risk the Fund is willing to accept in pursuit of its chosen belief.

4.
Let the benchmark role follow from the belief

The benchmark question should follow, not precede, the Fund's equity belief.

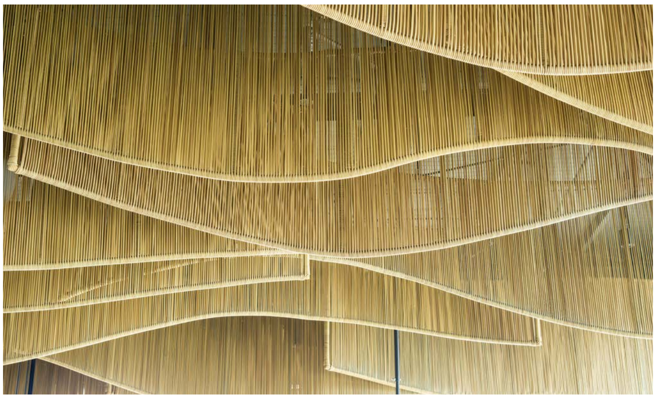
Different beliefs give the benchmark different jobs. For a market exposure belief, the benchmark may sit close to the portfolio. For a balanced approach, it may act as a risk anchor. For a deliberate ownership belief, it may be mainly a reference point for understanding differences. Here there are two recognisable framings, and they are not merely technical. They reflect different views of what the equity allocation is for.

Strategic asset allocation as the organising reference

The conventional framing divides the portfolio into asset classes, each with its own benchmark, set to help meet the Fund's return target at an acceptable level of risk. In that structure, the equity allocation is a block measured against an equity benchmark. This is straightforward to run and to govern. Its weakness is also familiar: the benchmark can often become the thing being managed toward, even when it is only a proxy for the primary objective.

Looking through the benchmark to the underlying exposures

The alternative framing looks beyond the asset-class label to the economic exposures the Fund is actually running. This means the real sources of return and risk in the portfolio: for example, exposure to companies, countries, currencies, sectors or interest rates. Under that lens, the equity benchmark is no longer the starting point. The starting point is the set of risks and return drivers the Fund wants the whole portfolio to carry.



5.
Let implementation express the belief

Market exposure belief: define the market

A Fund with a market exposure belief has a natural starting point: broad, low-cost market exposure. This is not a passive or thoughtless choice. It is a belief that the Fund is best served by capturing market return efficiently, with diversification, cost discipline and humility about stock selection.

The default still has to be specified. This means deciding what "the market" means: which companies are included, how they are weighted, and whether any country, sector or company concentration is capped. In practice, that means choosing a benchmark and understanding its rules.

Whilst this belief is often viewed as "passive" management, few investments labelled as such genuinely are. Whilst the number of "active" decisions is often lower than other forms of implementation they still need to be carefully analysed, diligenced and specified.

Example: making clear choices between a broad global market capitalization weighted index and factor tilted or sustainable indices.

Balanced / relative approach: discipline for departures

A balanced or relative approach sits between broad market exposure and deliberate ownership. It keeps market participation as an anchor but allows selected departures where there is a clear reason, a clear expectation and a clear monitoring test.

A departure might be a tilt toward a type of company, an exclusion, a regional position, a sustainability preference or another implementation style. What matters is that the departure is conscious, proportionate and capable of being explained.

Example: deciding on the departures from the broad benchmark that are expected to align with investment or sustainability beliefs and then designing a mandate around these with risk guidelines (eg. tracking error).

Deliberate ownership belief: what is owned and why

The deliberate ownership belief starts from a different concern. It wants to own businesses or strategies it can understand, justify and hold through difficulty. Owning the whole market may not feel safest because the market includes companies and exposures it may not wish to own on their merits.

This begins with understood ownership. Its concern is not simply to look different from the index but to hold businesses or strategies that can be explained and defended. That is the essence of the appeal: not a style label, but a governance preference for ownership that can be understood well enough to be held through difficulty.

This can be expressed in many ways and may include quality investing, sustainability-led strategies, concentrated fundamental strategies, downside-aware approaches or stewardship-intensive approaches.

Example: benchmark agnostic global approach targeting long-term total-returns through owning companies that are expected to compound earnings over the long-term.

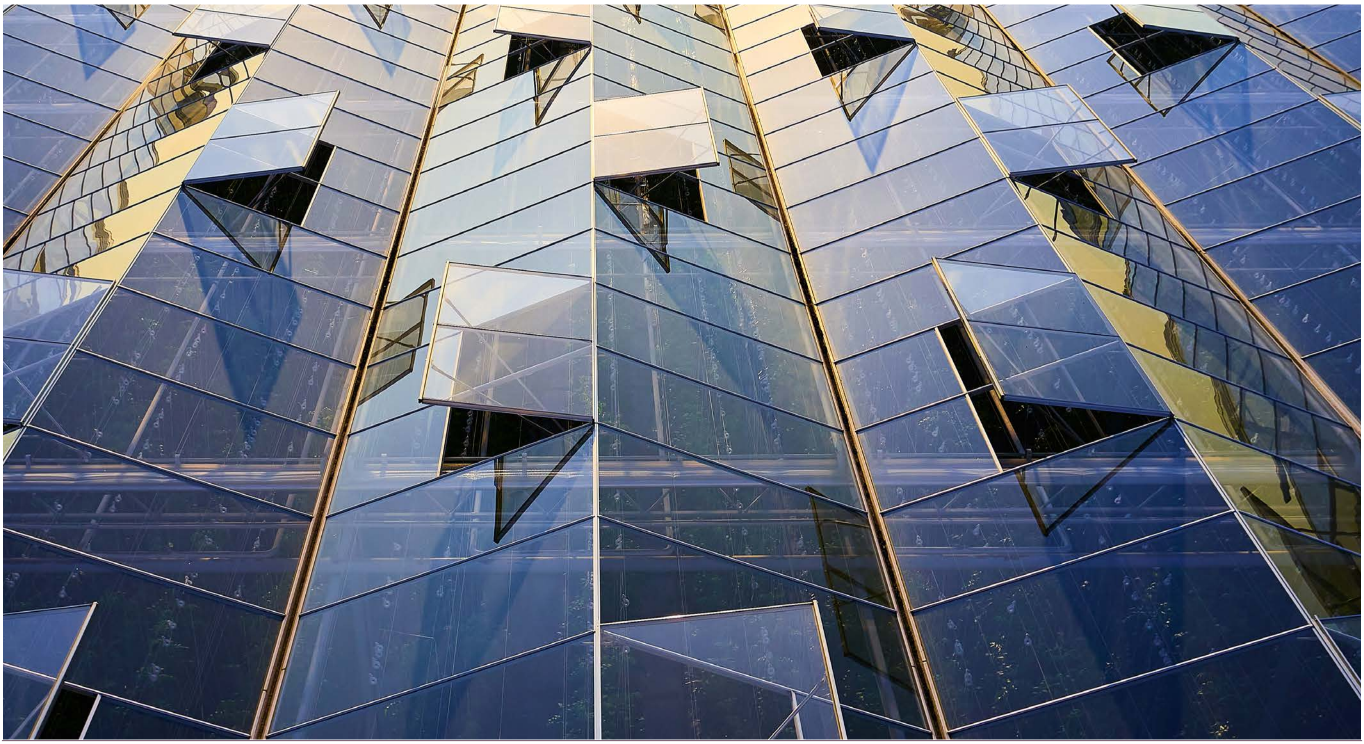
Market concentration and benchmark choice

An index is a rulebook. It turns a market into a portfolio by deciding what is eligible, how companies are weighted, how countries are treated, and whether concentration is capped.

If an index becomes dominated by a few large companies, broad market ownership means owning that concentration. Equal-weighted, market-cap weighted, capped and provider-specific indices can all give different answers. None is automatically right or wrong; each reflects a different rulebook.

Holding the market may still be the right answer but the decision should be conscious and explainable.

This shows why a market exposure belief still requires an active governance decision: the Fund must decide which market exposure it wants to own.



6.

Monitor against the belief

The final stage is how an LGPS Fund knows whether the framework is working. It is also the hardest part to get right.

The right test is whether the allocation is behaving as expected. A belief should create an expectation in advance. Monitoring then asks whether actual experience fits that expectation.

Put simply: the test is not only whether a strategy performs / outperforms / underperforms. It is whether it does so in a way that was expected and understood.

What good monitoring requires

- The belief written down in advance, specifically enough to generate a testable expectation about how the allocation should behave in different environments.
- A regular reconciliation of realised experience against that expectation, distinguishing ordinary variation from genuine change in the world or in the process.
- A pre-agreed understanding between Fund and Pool of what would count as evidence that the belief was wrong, as opposed to evidence that the belief is simply living through an unrewarding period.

This discipline helps the Fund avoid judging the strategy only by its latest outcome. It also helps distinguish a belief that is being tested from one that may need to be reconsidered.

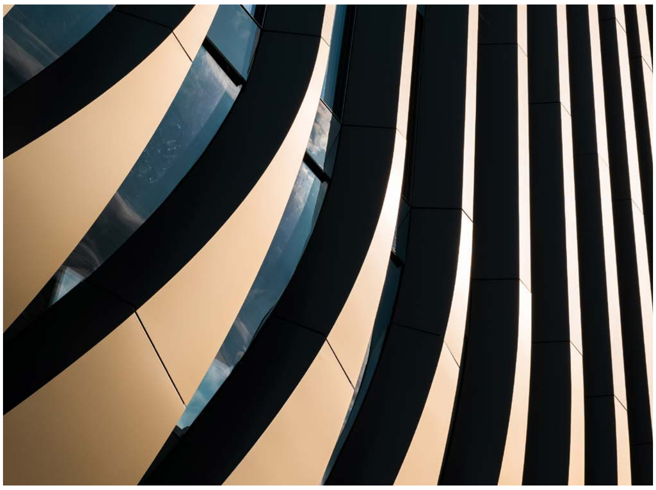
What this means in practice

The framework ultimately comes down to a small number of governance questions that an LGPS Fund may wish to ask of its equity strategy and implementation arrangements.

- What is our equity allocation actually for in terms of the Fund's liabilities and cost, rather than only in terms of an index?
- Have we consciously formed a view on which form of regret risk we are more willing to accept: **ownership regret** or **non-ownership regret?**
- Does the way the Pool has built our equity allocation faithfully express that view?
- When the allocation underperforms an index for a period, do we know in advance how to tell whether that is consistent with the belief or evidence against it?

These are governance questions and not technical ones. Officers, advisers and Pools can support the discussion with evidence, options, advice and implementation insight. The framework does not prescribe the answer; it helps decision-makers understand the belief being expressed and how it will be monitored.

7.
Be clear about roles



The Pension Fund Committee owns the strategy and the equity belief. Officers and advisers support the Committee with evidence, options and advice. The Pool is responsible for understanding the belief and implementation within the agreed strategy and governance framework.

Clear roles make the framework usable for both Funds and Pools alike.

Conclusion

Framing an equity allocation is a chain of reasoning:

1. **start with the objective;**
2. **decide what should drive long-term equity return;**
3. **recognise the form of regret risk accepted: ownership regret, non-ownership regret or a balance of both;**
4. **let the benchmark and implementation follow;**
5. **monitor against the belief.**

Two Funds can follow that chain honestly and still reach different answers.

There is no allocation that is correct in the abstract. The work is to make the belief explicit, consider how an allocation would express it, and monitor it against the expectation that belief generated.

Governance is not there to make every Fund reach the same conclusion. It is there to ensure that the conclusion reached is conscious, recorded, implemented faithfully and reviewed honestly over time.

An equity allocation is therefore more than a collection of investments. It is an expression of the Fund's objectives, governance and investment beliefs. The clearer those beliefs are, the more resilient decision-making is likely to be when markets, performance, regulation and circumstances change.

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