

# PENSIONS COMMITTEE

14 September 2022

<b>Title:</b> Pension Fund Quarterly Monitoring 2022/23 – 1 April to 30 June 2022	
<b>Report of the Managing Director</b>	
<b>Open Report</b>	<b>For Information</b>
<b>Wards Affected:</b> None	<b>Key Decision:</b> No
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<b>Accountable Director:</b> Philip Gregory, Chief Financial Officer	
<b>Accountable Strategic Leadership Director:</b> Fiona Taylor, Acting Chief Executive	
<b>Summary</b>  This report provides information for employers, members of London Borough of Barking and Dagenham Pension Fund (“the Fund”) and other interested parties on how the Fund has performed during the quarter 1 April to 30 June 2022.  The report updates the Committee on the Fund’s investment strategy and its investment performance.	
<b>Recommendation(s)</b>  The Pension Committee is recommended to note:  (i) the progress on the strategy development within the Fund;  (ii) the Fund’s assets and liabilities daily value movements outlined in Appendix 1; and  (iii) the quarterly performance of the fund collectively and the performance of the fund managers individually.	

## 1. Introduction and Background

1.1 This report provides information for employers, members of the LBBB Pension Fund (“the Fund”) and other interested parties on how the Fund has performed during the quarter 1 April to 30 June 2022 (“Q2”). The report updates the Committee on the Fund’s investment strategy and performance. Appendix 2 provides a definition of terms used in this report. Appendix 3 sets out roles and responsibilities of the parties referred to in this report. A verbal update on the unaudited performance of the Fund for the period to 13 September 2022 will be provided to Members at the Pension Committee.

## 2. Market Background (Q2 2022)

For the second Quarter in a row World Equity and Bond markets declined. World Equity markets as measured by the MSCI World Index fell by 16% (in \$ terms) in the April to June 2022 Quarter. This compared with a fall of around 5% in World Equity markets in the January to March 2022 Quarter. The April to June Quarter saw not only significant overall falls in Listed Equity markets but also significant volatility as market participants reacted to anticipated or actual monetary policy and economic developments.

As in the previous Quarter concerns regarding interest rate rises (actual and anticipated tightening of monetary policy by the major central banks) and concerns about heightened inflation were major factors adversely affecting markets. The continuing Russian invasion of Ukraine was another negative factor affecting markets worldwide. In this context Jay Powell Chair of the US Federal Reserve stated (on 4 May 2022) that *"In addition to the effects on inflation, the invasion and related events are likely to restrain economic activity abroad and further disrupt supply chains..."* Concerns regarding economic slowdown or even recession increased. In this climate of rising/anticipated rising interest rates and significant inflationary concerns it was no surprise that both Government and Corporate Bonds also weakened during the April to June Quarter.

The United States continued to experience clearly elevated levels of inflation. The headline CPI index which had reached 8.5% in March 2022 reached 9.1% in June 2022 the largest 12 month increase since November 1981. Far more importantly, from a policy perspective, the Core PCE Index, which is closely observed by the Federal Reserve when determining monetary policy remained well above its target of 2% inflation. Core CPE inflation which had been clearly above 2% throughout the period April 2021 to March 2022 continued to remain well above target at 4.9% in April, 4.7% in May and 4.8% in June. Unemployment remained low throughout the Quarter at 3.6%.

During the Quarter, in the context of inflation continuing clearly above target and low unemployment the US Federal Reserve acted decisively to seek to curb inflation with Chair Jay Powell stating, for example, at his 15 June 2022 Press Conference *"From the standpoint of our congressional mandate to promote maximum employment and price stability... The labor market is extremely tight, and inflation is much too high."* At its March 2022 meeting the Federal Open Markets Committee (FOMC) had raised its benchmark interest rate, the Federal Funds rate by 0.25%, the first increase since 2018. At its May meeting the FOMC raised the Federal Funds rate by a further 0.5%. At the June meeting the FOMC increased interest rates by a further 0.75%, the first such increase since 1994. As a result of the June policy decision the target range for the Federal Funds rate was 1.5% to 1.75%. Further increases in interest rates were clearly indicated. The press release issued after the June meeting stated that the FOMC *"anticipates that ongoing increases in the target range will be appropriate."* The Summary of Economic Projections issued after the June 2022 FOMC meeting indicated that Federal Reserve Officials anticipate the Federal Funds rate to rise to 3.4% by the end of 2022 compared to their 1.9% estimate of March 2022.

In the context of the ending of ultra-loose monetary policy which had both supported financial markets and the economy in general and the rapid tightening of monetary policy through two successive rises in the Federal Funds rate of 0.5% and 0.75% with more clearly to follow it was little surprise that US equities suffered a very poor quarter.

Having fallen 5% in the previous Quarter the S&P 500 index fell by over 16% during the April to June Quarter which added to its fall in the January to March 2022 Quarter resulted in the worst first half (calendar) year return since 1970. Sentiment was adversely affected not merely by the likely effects of high inflation and rising interest rates on company earnings in general but concerns about the effects of the Federal Reserve's (new) approach to interest rate policy on the wider economy with some market commentators fearing a resultant clear economic slowdown or even recession.

Eurozone Equities had another poor quarter. Having declined by over 9% (in Euro terms) in the January to March 2022 Quarter the MSCI EMU index declined by over 10% in the April to June Quarter. High inflation continued with the Harmonised Index of Consumer Prices (HICP) which was 7.4% in March and April rising to 8.1% in May and 8.6% in June. The Russian invasion of Ukraine was a further clear Eurozone market detractor with the release issued after the April monetary policy meeting of the European Central Bank including the statement *"The conflict and the associated uncertainty are weighing heavily on the confidence of businesses and consumers. Trade disruptions are leading to new shortages of materials and inputs. Surging energy and commodity prices are reducing demand and holding back production."*

The ECB, again, did not increase interest rates during the Quarter. This was in clear contrast to both the Bank of England and in particular the US Federal Reserve. However, while the "Combined monetary policy decisions and statement" issued after the April ECB policy meeting reiterated previous decisions to conclude its asset purchase programme, the statement issued after the June meeting signalled a clear intention to tighten monetary policy further significantly and to adopt an approach closer to that of the Bank of England and US Federal Reserve. At her press conference on 9 June Christine Lagarde President of the ECB announced, based on the latest ECB assessment, an intended 0.25% increase in interest rates at the July policy meeting, a possible 0.5% increase at the September meeting and further increases at later policy meetings. Christine Lagarde's press conference statement included the following *"High inflation is a major challenge for all of us. The Governing Council will make sure that inflation returns to its 2% target over the medium term. In May inflation again rose significantly...inflation pressures have broadened and intensified...Eurosystem staff have revised their baseline inflation projections up significantly. These projections indicate that inflation will remain undesirably elevated for some time...we undertook a careful review of the conditions which, according to our forward guidance, should be satisfied before we start raising the key ECB interest rates. As a result of this assessment, the Governing Council concluded that those conditions have been satisfied. Accordingly... we intend to raise the key ECB interest rates by 25 basis points at our July monetary policy meeting. Looking further ahead, we expect to raise the key ECB interest rates again in September. The calibration of this rate increase will depend on the updated medium-term inflation outlook. If the medium-term inflation outlook persists or deteriorates, a larger increment will be appropriate at our September meeting. Third, beyond September, based on our current assessment, we anticipate that a gradual but sustained path of further increases in interest rates will be appropriate..."*

However, within a week of its June policy setting meeting the ECB Governing Council felt the need to hold an emergency meeting. This was called in the context of a potential sovereign debt crisis after bond yields of weaker Eurozone countries, including Italy and Spain, increased significantly after the ECB's decision on 9 June not merely

confirming the end of its asset purchase programme but to start raising interest rates from July 2022. The decision to call this emergency meeting indicated that the ECB had quickly become concerned that their objective of tackling Eurozone inflation could result in significant increases in bond yields and a debt crisis in the Eurozone. The “Statement after the ad hoc meeting of the ECB Governing Council” on 15 June indicated that it *would “...accelerate the completion of the design of a new anti-fragmentation instrument...”* an instrument to support the bonds of the weaker eurozone economies. The form of this instrument, subsequently named the transmission protection instrument or TPI was announced on 21 July 2022.

As in the January to March 2022 Quarter UK Listed Equities performed clearly above Global Equities. While in absolute terms the FTSE All Share index performed negatively over the April to June Quarter it lost (only) 5% in £ terms. This relative “success” was, as in the previous Quarter driven by the FTSE 100 index of the largest companies. While the FTSE 100 declined by under 4% the FTSE 250 index declined by 11%.

The Minutes of the June meeting of the Bank of England Monetary Policy Committee included the statement that *“Labour demand indicators had remained strong, alongside evidence of persistently elevated recruitment difficulties...”* The UK Unemployment rate remained low but rose slightly, as reported by the Office for National Statistics, from 3.7% in the January to March 2022 Quarter to 3.8% in the April to June 2022 Quarter. UK CPI which had been 7.0% in March 2022 rose to 9.0% in April 2022, 9.1% in May and 9.4% in June. By June 2022, the Monetary Policy Committee (MPC) of the Bank of England had increased Bank Rate (interest rates) to 1.25% as a result of 0.25% increases at both its May and June 2022 meetings. This approach which resulted in an increase in interest rates of 0.5% during the Quarter was clearly significantly more cautious than that of the US Federal Reserve which increased interest rates by 1.25% during the Quarter and which also clearly indicated significant further future rate increases. The Monetary Policy Summary issued after the May 2022 MPC meeting included the statement *“...given the current tightness of the labour market, continuing signs of robust domestic cost and price pressures, and the risk that those pressures will persist, the Committee voted to increase Bank Rate by 0.25 percentage points at this meeting...”*

The Monetary Policy Summary issued after the June 2022 MPC meeting included the statement *“In view of continuing signs of robust cost and price pressures, including the current tightness of the labour market, and the risk that those pressures become more persistent, the Committee voted to increase Bank Rate by 0.25 percentage points, to 1.25%, at this meeting.”* Six Members of the MPC voted for this 0.25% increase while a minority of three Members considered that circumstances were such to justify a 0.5% increase. The Minutes of the June MPC meeting state *“These [three] members put a higher weight on the prospect of more resilience in demand or shortfalls in supply or both, such that cost and capacity pressures would remain relatively strong over the forecast period... Faster policy tightening now would help to bring inflation back to the target sustainably in the medium term, and reduce the risks of a more extended and costly tightening cycle later.”*

Japanese Equities although posting a negative in absolute terms performed more positively than Global Equities, as in the previous Quarter. The Nikkei 225 Index declined by approximately 5% (in Yen terms) over the April to June Quarter. Japanese inflation finally reached the Bank of Japan’s inflation target rising to slightly over 2%.

The Bank of Japan in stark contrast to other major central banks maintained, however, its ultra-loose monetary policy at both its April and June policy meetings. It maintained commitment to its negative (overnight) interest rate of -0.1% and pledged to continue to intervene in markets (through bond purchases) to maintain the yield on 10-year Japanese Government Bonds at around 0%. The Bank of Japan expressed concerns regarding economic weakness and that inflationary increases may be transitory and therefore considered it needed to continue its ultra-loose monetary policy approach. This clearly divergent approach to monetary policy compared to the United States resulted in significant volatility and weakness in the Yen compared to the US dollar.

Although both Asian and Emerging Market equities as a whole declined during the April to June 2022 Quarter, they performed clearly better than world markets as a whole which was in clear contrast to the previous 12 months. Asian (excluding Japan) and Emerging Markets clearly lagged developed western markets during the year April 2021 to March 2022. During this period, the MSCI World index advanced by 10% (in \$ terms) while the MSCI AC Asia (excluding Japan) fell over 14% (in \$ terms) and the MSCI Emerging Markets index fell over 11% (in \$ terms). During the April to June 2022 Quarter while World Markets fell by 16% (in \$ terms) the MSCI Asia (excluding Japan) index fell by 9% and the MSCI Emerging Markets index by 11.5%. This relative outperformance by Asia and Emerging Markets may partly reflect the past relative performance of these markets against western developed markets. One positive factor, however, for Asia and Developing Markets was the performance in the later part of the Quarter of China in the context of the positive economic effect of the relaxation of COVID lockdown measures and reductions in quarantine requirements and market expectations of further economic stimulus by the Chinese government.

As in the previous Quarter, benchmark Government bonds, experienced a poor Quarter with yields again rising sharply (and prices therefore falling). The 10 Year Treasury yield increased from 2.34% to 3.01%. The 10 Year Gilt yield rose from 1.61% to 2.23% and the 10 Year German Bund from 0.55% to 1.34%. There were also significant increases in the yields (and therefore price falls) in the major 2 Year Government Bonds. High inflation data, central bank policy tightening and consequent interest rate rises/expectations of further rises were, again, negative factors for both government and Corporate Bonds. Overall Corporate Bonds underperformed the major Government Bonds with concerns regarding the future economic outlook perhaps another negative factor for Corporate Bonds in addition to significant inflation and interest rate concerns.

### **3. Overall Fund Performance**

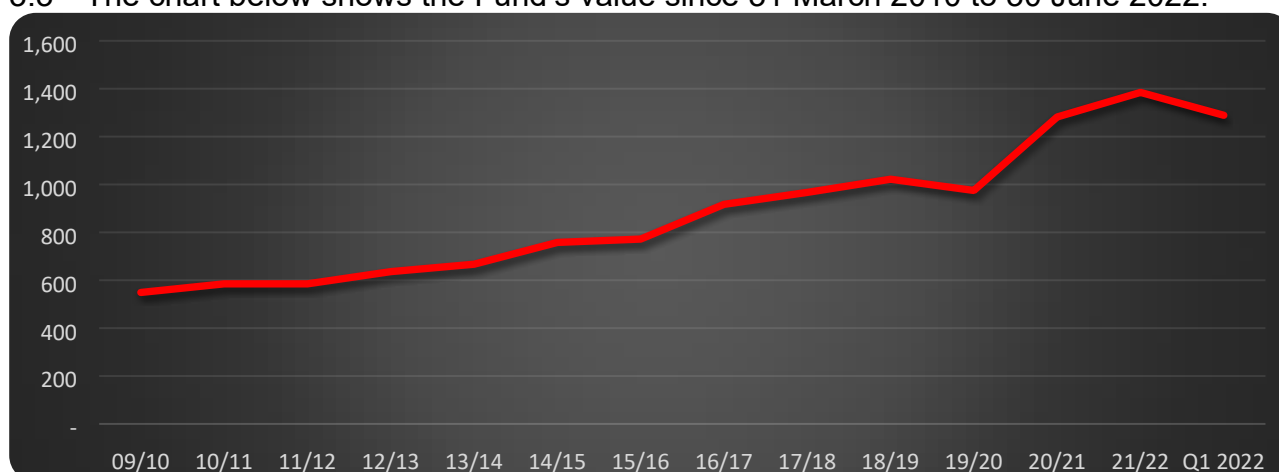
- 3.1 The Fund's closed Q2 valued at £1,289.2m, an decrease of £95.5m from its value of £1,384.7m at 31 March 2022. Cash held by the Fund was £196.8k, giving a total Fund value of £1,289.4m. The gross value includes a prepayment of £35.0m, with the short-term loan from the Council now repaid. Adjusting for this reduces the Q2 value to £1,254.4m, a decrease of £86.3m from the 31 March 2022 figure of £1,340.7m.
- 3.2 For Q2 the Fund returned **-6.3%**, net of fees, underperforming its benchmark of **-4.0%** by **-2.3%**. Over one year the Fund underperformed its benchmark by 7.3%, returning 5.4% and underperformed the benchmark by 1.9% over three years, returning 5.4%. The Fund has also underperformed its benchmark over five years by

1.7%, returning 5.8%. Compared to the LGPS universe of Funds, represented below by the PIRC Universe, the Fund has underperformed by xxx% over one year but outperformed over two years by xxx%. The Fund's returns are below:

**Table 1: Fund's Quarterly and Yearly Returns**

Year	2022		2021				2020		One Yr	Two Yrs	Three Yrs	Five Yrs	Ten Yrs
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3					
Actual Return	(6.3)	(2.8)	2.6	1.1	4.2	3.6	8.0	2.8	(5.4)	6.6	5.4	5.9	7.9
Benchmark	(4.0)	(0.6)	4.8	1.7	4.6	2.5	5.1	2.5	1.9	8.3	7.4	7.5	8.9
Difference	(2.3)	(2.2)	(2.2)	(0.6)	(0.4)	1.1	2.9	0.3	(7.3)	(1.7)	(1.9)	(1.6)	(1.0)
PIRC	(4.8)	(3.2)	4.4	1.4	5.6	2.4	5.8	1.8	(1.4)	6.7	5.3	5.9	8.7
Difference	(1.5)	0.4	(1.8)	(0.3)	(1.4)	1.2	2.2	1.0	(4.0)	(0.1)	0.1	-	(0.8)

3.3 The chart below shows the Fund's value since 31 March 2010 to 30 June 2022.



3.4 The fund manager's performance has been scored using a quantitative analysis compared to the benchmark returns, defined below:

■	<b>RED-</b> Fund underperformed by more than 3% against the benchmark
△	<b>AMBER-</b> Fund underperformed by less than 3% against the benchmark
○	<b>GREEN-</b> Fund is achieving the benchmark return or better

3.5 Appendix 1 illustrates changes in the market value, the liability value, the Fund's deficit and the funding level from 31 March 2013 to 1 August 2022. Members are asked to note the changes in value and the movements in the Fund's funding level.

3.6 Although the Fund's asset performance has had two negative quarters and is down 5.4% for the year, there has been a greater change in the liability levels, resulting from significant increases in yields. As a result the Fund's funding level has fluctuated between 101% and 106% over the quarter (the Fund was 106.4% funded as at 31 August 2022) and between 101% and 121% based on the Hymans Robertson model.

3.7 The Fund's strategy has been set up to be able to positively respond to increasing yields and therefore the current economic environment supports the strategy, even if the return has been negative. Since 1 August the Fund has continued to increase in value, with liabilities largely stabilising, which has resulted in the funding level improving further. The triennial results will likely change the assumptions used in

producing the funding level, although there is the potential for this to improve the position further.

### 3.8 Table 2 – Fund Manager Q1 2022 Performance

Fund Manager	Actual	Benchmark	Variance	Ranking
	Returns (%)	Returns (%)	(%)	
Abrdn	(1.4)	1.6	(3.0)	
Baillie Gifford	(12.1)	(8.4)	(3.7)	
BlackRock	2.9	3.9	(1.0)	Δ
Hermes GPE	(1.0)	1.4	(2.4)	Δ
Kempen	(3.1)	(9.1)	6.0	○
Newton	(2.1)	0.9	(3.0)	
Pyrford	(0.8)	6.3	(7.0)	
Insight	(3.8)	1.0	(4.8)	
UBS Bonds	(7.4)	(7.4)	(0.0)	○
UBS Equities	(12.9)	(12.9)	0.0	○

Table 2 highlights the Q1 2022 returns with a higher than usual number of reds, indicating a number of negative returns. There was a good positive return from BlackRock but large losses from Baillie Gifford and passive equities. Newton's performance was disappointing as it should provide protection in these market conditions. Passive bonds provided large losses for the quarter, reflecting the index linked bond performance for the quarter. Strategies with inflation linkage, such as Kempen, Hermes, and Pyrford performed well considering the market. Pyrford was some way off its benchmark, but the benchmark return was driven by high RPI figures and the protection that Pyrford provided against the performance of GILTS was good.

### 3.9 Table 3 – Fund Manager Performance Over One Year

Fund Manager	Actual	Benchmark	Variance	Ranking
	Returns (%)	Returns (%)	(%)	
Abrdn	8.7	5.1	3.6	○
Baillie Gifford	(24.9)	(3.2)	(21.8)	
BlackRock	20.7	21.5	(0.8)	Δ
Hermes GPE	10.8	5.7	5.1	○
Kempen	2.9	(1.8)	4.7	○
Newton	(2.8)	3.8	(6.6)	
Pyrford	2.3	16.0	(13.7)	
Insight	(7.1)	4.0	(11.1)	
UBS Bonds	(14.0)	(14.0)	(0.0)	○
UBS Equities	(8.5)	(8.5)	0.0	○

Over one-year there are even greater variations between managers, with Baillie Gifford providing a negative return of 24.9% and underperforming its benchmark by 21.8%, while BlackRock provided a positive return of 20.7%. Hermes continues to see significant improvements in asset values as a result of their exposure to inflation linked assets, with a number of these being valued significantly higher.

### 3.10 Table 4 – Fund manager performance over two years

Fund Manager	Actual	Benchmark	Variance	Ranking
	Returns (%)	Returns (%)	(%)	
Abrdn	16.7	5.2	11.4	○

<b>Baillie Gifford</b>	15.5	19.9	(4.4)	
<b>BlackRock</b>	12.9	13.9	(1.0)	Δ
<b>Hermes GPE</b>	4.9	6.5	(1.6)	Δ
<b>Kempen</b>	22.5	20.2	2.2	
<b>Newton</b>	8.8	4.4	4.4	○
<b>Pyrford</b>	6.0	12.9	(6.9)	
<b>Schroders</b>	3.9	3.2	0.8	○
<b>Insight</b>	0.7	4.7	(4.0)	
<b>UBS Bonds</b>	(8.9)	(8.9)	0.0	○
<b>UBS Equities</b>	20.1	20.1	0.0	○

Over two years, (table 4), all mandates apart from passive bonds, are positive. Returns ranged from (8.9%) for UBS bonds to 22.5% for value equities (Kempen). Pyrford and Newton have provided solid returns, with equities, Alternatives and property providing double digit returns. Abrdn continue to performance well as a result of good returns from Private Equity.

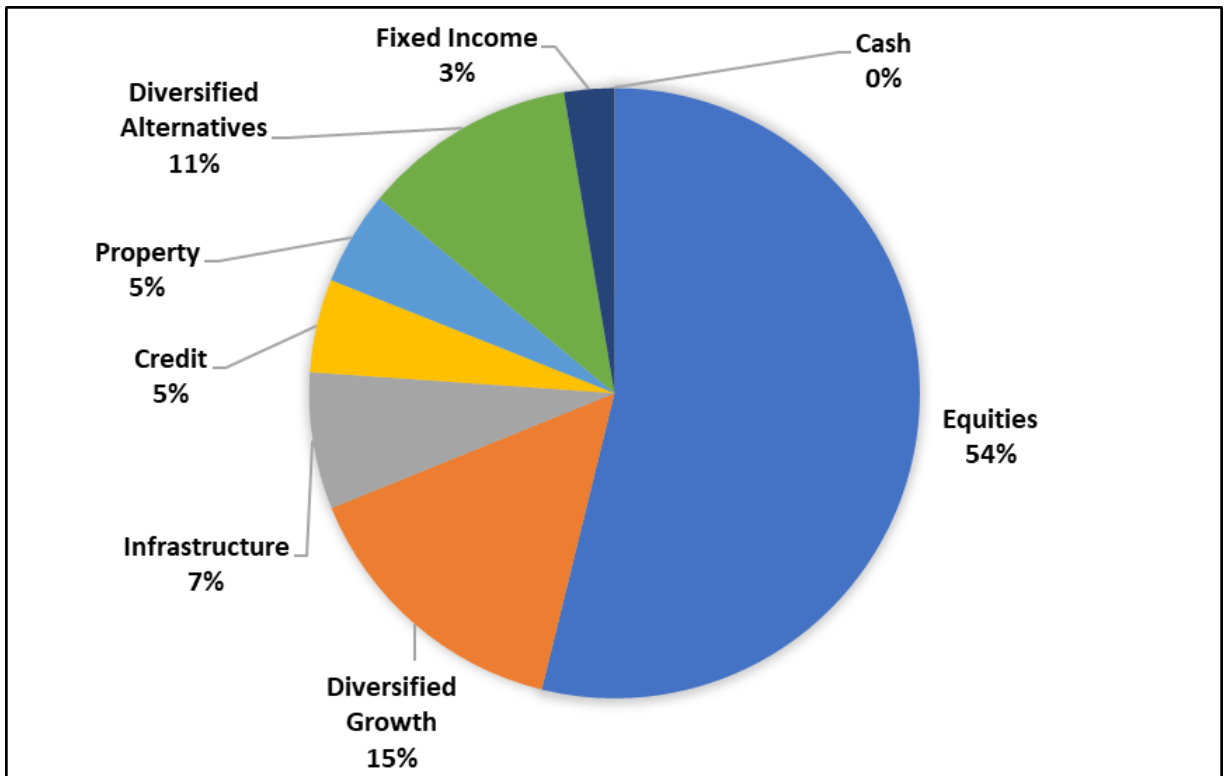
**4. Asset Allocations and Benchmark:** Table 5 outlines the Fund's asset allocation, asset value & benchmark at 30 June 2022.

**4.1 Table 5: Fund Asset Allocation and Benchmarks at 30 June 2022**

<b>Fund Manager</b>	<b>Asset (%)</b>	<b>Market Values (£Ms)</b>	<b>Benchmark</b>
Abrdn	11.3%	146.05	3 Mth LIBOR + 4% per annum
Baillie Gifford	19.9%	256.47	MSCI AC World Index
BlackRock	4.7%	60.83	AREF/ IPD All Balanced
Hermes GPE	7.2%	93.37	Target yield 5.9% per annum
Kempen	15.4%	198.12	MSCI World NDR Index
Newton	6.2%	80.25	One-month LIBOR +4% per annum
Pyrford	8.8%	113.50	UK RPI +5% per annum
Schroders	0.2%	3.17	AREF/ IPD All Balanced
Insight	4.9%	63.77	3 Mth LIBOR + 4% per annum
UBS Bonds	2.6%	34.07	FTSE UK Gilts All Stocks
UBS Equities	18.6%	239.40	FTSE AW Developed Tracker
LCIV	0.0%	0.15	None
Cash	0.0%	0.20	One-month LIBOR
<b>Fund Value</b>	<b>100.0%</b>	<b>1,289.36</b>	
ST Loan		-	
Prepayment		(35.00)	
<b>Net Fund Value</b>		<b>1,254.36</b>	

**4.2** The percentage split by asset class is graphically shown in the pie chart below.





4.3 The strategy is overweight equities, however equities are now nearer the middle of the range at 53.8%. Cash excludes the pre-payment and short-term borrowing from the council and shows that the Fund is fully invested. The Fund is significantly below the exposure to Credit, but this will be reviewed during 2022/23.

The current position, compared to the strategic allocation, is in table 6 below:

**Table 6: Strategic Asset Allocation**

Asset Class	Current Position	Strategic Allocation Target	Variance	Range
Equities	53.8%	52%	1.8%	50-60
Diversified Growth	15.0%	16%	-1.0%	14-18
Infrastructure	7.2%	8%	-0.8%	7-11
Credit	4.9%	6%	-1.1%	6-10
Property	5.0%	5%	0.0%	4-7
Diversified Alternatives	11.3%	9%	2.3%	7-10
Fixed Income	2.6%	3%	-0.4%	3-5
Cash	0.0%	0%	0.0%	0-1

## 5. Fund Manager Performance

### 5.1 Kempen

Kempen	2022		2021				2020		One Year	Two Years	Since Start 6/2/13
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3			
£198.12	%	%	%	%	%	%	%	%	%	%	%
Actual Return	(3.1)	0.1	2.9	3.0	2.9	10.2	15.3	(3.2)	2.9	14.0	7.9
Benchmark	(9.1)	(2.4)	7.3	2.5	7.6	4.0	7.8	3.2	(1.8)	10.3	11.7
Difference	6.0	2.5	-4.4	0.5	(4.7)	6.2	7.5	(6.4)	4.7	3.7	(3.7)

#### Reason for appointment

Kempen were appointed as one of the Fund's global equity managers, specialising in investing in less risky, high dividend paying companies which will provide the Fund with significant income. Kempen holds approximately 100 stocks of roughly equal weighting, with the portfolio rebalanced on a quarterly basis. During market rallies Kempen are likely to lag the benchmark.

#### Performance Review

The strategy outperformed its benchmark by 6.0% for Q2 and has outperformed over one-year by 4.7% and over two years by 3.7%. Kempen has underperformed its benchmark since inception by 3.7% but providing an annualised return of 7.9%. Overall the strategy has provide solid returns over a number of quarters, with a strong outperformance against its benchmark.

#### Strategy Drivers

**INFLATION:** Increasing demand and disrupted supply is pushing price levels up and price inflation is proving persistent and above expectation across the board. Shortage in basic resources is having an impact throughout the supply chain, with the Ukraine conflict creating additional shortages in energy and food supply that has a global impact on prices. Rising prices for consumption goods are putting pressure on the purchasing power of consumers. Strong labour markets give workers bargaining power for higher wages. Companies are mentioning a negative impact on their margins due to rising input costs and wages

**MONETARY TIGHTENING:** Central banks across the world are moving forward their projected path of monetary tightening. Strong labour markets mean central banks can be aggressive with monetary tightening. Interest rates have increased sharply on the back of tighter monetary policy and elevated inflation. Real interest rates remain low due to the high level of inflation. Higher rates are putting pressure on valuation multiples and companies with high leverage

**RECESSION:** Eroding purchasing power of consumers and higher interest rates are slowing down the economy. A wage-price spiral is difficult for central banks to break. Concerns are mounting there may be a recession needed to cool down inflation. If wages manage to keep up with inflation consumer spending should stabilize. Higher input costs and rising wages are a risk to corporate profits. Financial markets appear to already price in a mild recession

## 5.2 Baillie Gifford

Baillie Gifford	2022		2021				2020		One Year	Two Years	Since Start 6/2/13
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3			
£256.47	%	%	%	%	%	%	%	%	%	%	%
Actual Return	(12.1)	(12.4)	0.1	(0.6)	7.1	2.2	11.1	7.6	(24.9)	1.5	12.2
Benchmark	(8.4)	(2.5)	6.3	1.5	7.4	3.7	8.6	3.5	(3.2)	10.0	11.4
Difference	(3.7)	(9.9)	(6.2)	(2.0)	(0.3)	(1.5)	2.6	4.1	(21.8)	(8.5)	0.8

### Reason for appointment

Baillie Gifford (BG) is a bottom-up, active investor, seeking to invest in companies that will enjoy sustainable competitive advantages in their industries and will grow earnings faster than the market average. BG's investment process aims to produce above average long-term performance by picking the best growth global stocks available by combining the specialised knowledge of BG's investment teams with the experience of their most senior investors. BG holds approx. 90-105 stocks.

In July 2022 the Fund transferred from BG's Global Alpha strategy to the BG Paris Aligned Global Alpha fund (BGPA). The transition was completed between 11 and 14 July. The BGPA Fund aims to outperform the MSCI ACWI Index (in Sterling), by at least 2% per annum over rolling five-year periods. In addition, the Fund commits to having a weighted average greenhouse gas intensity lower than that of the MSCI ACWI EU Paris Aligned Requirements Index. BGPA is consistent with the objectives of the Paris Agreement. The portfolio is a variant of the core Global Alpha strategy. It is managed by the same team and with the same investment philosophy and performance objective. However, there is an additional process to screen out carbon intensive companies that do not or will not play a major role in our energy transition.

### Performance Review

For Q2 BG returned -12.1%, underperforming its benchmark by 3.7%. BG's one-year return was -24.9%, underperforming its benchmark by 21.8%. Since initial funding, the strategy has returned 12.2% p.a. outperforming its benchmark by 0.8%.

The first half of this year has been a challenging one for stock markets and more so for growth strategies. Share price weakness has been most acute for high-growth companies, where uncertainty about future rewards is highest, with profits and cash flow weighted to future years. These types of companies are a significant part of the Sub-fund, as would be expected given the investment manager's long-term perspective and focus on identifying companies presenting outstanding potential. However, in the current environment the Sub-fund has been severely penalised by a market increasingly focused on shorter term, safer cashflows and low valuations.

Against this backdrop it was not surprising that the largest detractors at the stock level were companies such as Cloudflare and Shopify which spend heavily now to secure future growth as well as companies like Trade Desk and SEA Limited with strong growth prospects but also high sensitivity to consumer sentiment. Despite recent weakness in these names the investment manager remains confident on their long-term prospects.

Consistent with the prevalent market environment was the list of top performance contributors which mainly included stocks rewarded for short term positive cashflows and stability. Two characteristic examples are Prosus where the company management have decided to sell their long-held share in Tencent and return capital to investors and Elevance Health (nee Anthem) where the company's decision to increase their presence into the 'Medicare' segment of the healthcare services market is seen as increasing the stability of cashflows. Elevance (4.2%) and Prosus (3.4%) were the single largest positions in the Sub-fund in absolute terms at the end of Q2.

### Positioning

As at the end of June 2022, the Sub-fund maintained a significant regional allocation to North American equities at c. 56% followed by an exposure of 19.6% to European equities. At the sector level, the largest exposure was to consumer discretionary with 19.1% followed by financials at 16.7% and health care at 16.3%.

### LCIV Summary

This was the fifth consecutive quarter of negative relative returns for the Subfund with 12-month and 3-year relative performance now firmly into negative territory.

Underperformance of this length and magnitude naturally causes concern about the investment manager's skill and ability to deliver value. The first thing LCIV assess when such concerns arise is the pattern of performance to ensure that it is in line with the investment manager's style and the direction of the market. LCIV also look for changes in trading activity and the structure of the portfolio. Baillie Gifford follows an aggressive growth strategy in the management of the Sub-fund so stylistically the direction of performance was not a surprise and is broadly in line with growth style indices and peers.

However, the magnitude was significantly wider than expected and this triggered extended discussions with the investment manager to understand what drove the level of underperformance.

The conclusion is that the investment manager has remained true to their process through this period. However, there are aspects of the management of the Sub-fund that could have been better. Firstly, the investment manager could have been more aggressive in trimming winners and locking in gains in the early part of 2021. Being more cautious in China, a market where the full intentions of regulators are rarely fully transparent, could have also helped.

Lastly, there were stock specific decisions such as holding Peloton that did not pan out well, but LCIV appreciate that some analytical errors will always happen in an active portfolio.

Going forward LCIV want to see the investment manager sticking to their process and remain fully focused on uncovering those high growth opportunities that have the potential to turn the performance back to positive when the market direction changes. There is evidence this is happening, and LCIV are confident that the portfolio can deliver the growth LCIV expect.

### 5.3 UBS Equities

UBS Equities	2022		2021				2020		One Year	Two Years	Since Start 31/08/12
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3			
<b>£239.40</b>	%	%	%	%	%	%	%	%	%	%	%
<b>Actual Return</b>	(12.9)	(4.0)	7.6	0.9	7.5	5.8	11.2	5.6	(8.5)	10.8	12.1
<b>Benchmark</b>	(12.9)	(4.0)	7.6	0.9	7.5	5.8	11.2	5.6	(8.5)	10.8	12.1
<b>Difference</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

#### Reason for appointment

UBS are the Fund's passive equity manager, helping reduce risk from underperforming equity managers and providing a cost-effective way of accessing the full range of developed market equity growth.

#### Performance

The fund returned -12.9% for Q2 and 11.9% over one year. Since funding in August 2012, the strategy has provided an annualised return of 12.1%.

#### Equities

Global stock markets fell sharply in June, capping a poor second quarter amid the worst first half of a year for the US market since 1970. The MSCI All Country World index lost 8.4% on the month, and 15.7% on the quarter. The slide was led by the US market, where concerns over the pace of monetary tightening and the drag on consumer spending from inflation left the market returning a negative 8.3% for the month and 16.1% on the quarter. Eurozone equities fell 9.2% in June, making it the worst-performing market for the month, amid mounting concerns over the impact of a reduction in gas supplies from Russia. This has been a particular worry for the region's largest economy, Germany, since its heavy industrial base is reliant on gas from Russia.

More defensive markets fared better. The UK market, which is heavily weighted towards value sectors, fell a smaller 5.2% in June. The UK is the only major market to be up year-to-date, though by a relatively modest 1.7%.

The other major outlier has been China, which is overcoming a long stretch of underperformance with a 6.6% rally in June, and a 4.5% gain for the quarter. For the year as a whole, the market is down 10%, outperforming the MSCI All Country Global index by 10 percentage points.

Following the FTSE quarterly review in June, five stocks were added to and five stocks were deleted from the index, along with various changes in the shares in issue of the index constituents. Two-way turnover totalled 1.31%.

Also, during the quarter but outside of the review, WarnerMedia was acquired by Discovery Inc following spin-off from AT&T and was renamed Warner Bros Discovery Inc. Woodside Energy Groups weight in the index increased following merger of Woodside Petroleum with BHPs Petroleum business. Cerner Corp was acquired for cash.

## 5.4 UBS Bonds

UBS Bonds	2022		2021				2020		One Year	Two Years	Since Start 5/7/2013
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3			
£34.07	%	%	%	%	%	%	%	%	%	%	%
Actual Return	(7.4)	(7.2)	2.4	(1.8)	1.7	(7.2)	0.6	(1.2)	(14.0)	(10.1)	2.2
Benchmark	(7.4)	(7.2)	2.4	(1.8)	1.7	(7.2)	0.6	(1.2)	(14.0)	(10.1)	2.1
Difference	(0.0)	0.0	0.0	0.0	0.0	0.0	(0.0)	0.0	(0.0)	0.0	0.1

### Reason for appointment

UBS were appointed as the Fund's passive bond manager to allow the Fund to hold a small allocation (4%) of UK fixed income government bonds. There is a link between the bond price and the Fund's liabilities and therefore the reduction in returns will have helped to reduce the Fund's liabilities.

### Performance

The fund returned -7.4% for Q1, -14.0% for one year and -10.1% for two-year return. Since inception the strategy has returned 2.2%.

### Review

Fixed income markets also had a tough month in June and overall global bond markets have suffered one of the worst starts to the year on record. As of late June, returns across fixed income segments ranged between -20% for emerging market USD sovereign bonds and -4.1% for senior loans.

In June, and for the second quarter overall, US and European government bond yields rose, amid more hawkish signals from both the Fed and the European Central Bank. US government bonds returning -0.9%, for a quarterly loss of 3.8% and a year-to-date loss of 9.1%. EU government bonds fared even worse, returning -2.3% for the month, -5.2% for the second quarter, and -10.9% year-to-date. Riskier parts of the credit market were also affected by a broader risk-off mood in markets, for a 6.8% fall in US high yield bonds for a decline of 14% in the first half of the year.

## 5.5 Schroders Indirect Real Estate (SIRE)

Reason for appointment: Schroders is a Fund of Fund manager appointed to manage a part of the Fund's property holdings. The mandate provides the Fund with exposure to 210 underlying funds, with a total exposure to 1,500 highly diversified UK commercial properties.

The strategy is currently being sold down, although the final sale will be in Q2 2022. The remaining distribution will be approximately 3.1m. This distribution will be used to increase the Fund's cash balance.

## 5.7 BlackRock

BlackRock	2022		2021				2020		One Year	Two Years	Since Start 1/1/2013
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3			
£60.83	%	%	%	%	%	%	%	%	%	%	%
Actual Return	2.9	6.8	6.7	4.3	2.9	2.1	2.5	0.5	20.7	14.3	2.1
Benchmark	3.9	5.6	7.5	4.5	3.8	2.2	2.1	0.2	21.5	14.9	5.0
Difference	(1.0)	1.2	(0.8)	(0.2)	(0.9)	(0.2)	0.4	0.3	(0.8)	(0.6)	(3.0)

Reason for appointment: In December 2012, a sizable portion of the Fund's holdings with Rreef were transferred to BlackRock (BR). The transfer to BR provides the Fund with access to a greater, more diversified range of property holdings within the UK. In 2021 the allocation to BlackRock was increased following the closure of the Schroders SIRE fund.

### Q2 2022 Performance and Investment Update

BR returned 2.9% for Q2 against a benchmark of 3.9%, returned 20.7% over one year against a benchmark of 21.5%. The strong absolute returns have been achieved whilst maintaining a lower-than-average risk profile when considering the low vacancy rate, strong tenant credit and highly diversified tenant and asset profiles. Returns have also been delivered with a low level of volatility with the Fund remaining in the top quartile for risk adjusted returns (standard deviation) over the medium/ long term.

### **Market Conditions**

Inflation at 9.4% in June 2022 has increased the cost of capital, which has had a number of implications for real estate, the most direct being the immediate rise in the cost of debt, increasing 'all in' borrowing rates and affecting the lowest yielding parts of the market in particular. Indirectly, rate increases will impact occupier businesses as well and could lead to reduced demand. As we write this, we are witnessing a rapid reprice in the market as buyers and sellers look to re-establish the trading levels in Q3 as many market players may choose to wait for evidence of market pricing.

However, market fundamentals remain strong: most notable is the absence of oversupply usually associated with a late real estate cycle. This is different to previous cycles, with low vacancy rates across most of the prime markets. The same caution which curtailed development supply during the pandemic will likely see investors dial back risk appetite for construction and hence the occupational market has firm footings. The ability to provide resilient income streams will be a key driver of performance going forwards and it is likely that there will be a widening spread from a tightening definition of prime to secondary.

**Transactions:** In Q2 the Fund completed one acquisition totalling £11.55m; no sales were completed in Q2. The Fund acquired the long leasehold of three units on Riverside Retail Park, Nottingham; the three units total 43,000 sq. ft. across 3.9 acres (25% of the total park). The entirety of the retail park was already held freehold by BUKPF. On acquisition, the three units had been recently refurbished, reconfigured, and let to JD Sports, Iceland Foods and Home Bargains for a weighted average unexpired lease term of 11.5 years to expiry, providing long term income from strong covenants and value accretive opportunities through pod/drive thru development on the existing car parking space. Acquiring the units secures full control of the park.

## 5.8 Hermes

Hermes	2022		2021				2020		One Year	Two Years	Since Start 9/11/2012
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3			
£93.37	%	%	%	%	%	%	%	%	%	%	%
Actual Return	(1.0)	10.5	-0.9	2.2	(1.1)	0.6	(1.5)	0.0	10.8	4.4	7.8
Benchmark	1.4	1.5	1.4	1.4	1.4	1.5	1.4	1.4	5.7	5.8	5.9
Difference	(2.4)	9.0	(2.3)	0.7	(2.5)	(0.8)	(2.9)	(1.4)	5.1	(1.3)	1.8

### Reason for appointment

Hermes were appointed as the Fund's infrastructure manager to diversify the Fund away from index linked fixed income. The investment is in the Hermes Infrastructure Fund I (HIF I) and has a five-year investment period which ended on 30<sup>th</sup> April 2020 and a base term of 18 years. In March 2015 Members agreed to increase the Fund's allocation to Hermes to 10%.

### Performance

Hermes returned -1.0% in Q2 underperforming the benchmark by 2.4%. Over one year the strategy reported a one-year return of 10.8%, outperforming its benchmark by 5.1%. Since inception the strategy has provided a good, annualised return of 7.8%, outperforming its benchmark by 1.8%.

### **Return of capital**

Hermes returned £9.4m of capital to the Fund in April 2022. This distribution, which followed a similar increase in value in Q1 2022, resulted in the Fund receiving a large cash return, with the value of the holding remaining at roughly the same level of £93m.

On 10 August the Fund received a further distribution of £6.2m comprising almost all of the remaining proceeds from the sale of Anglian Water (which was received earlier than expected) and the proceeds of two stake sales in Viridor Energy. A valuation as at 31 July 2022 valued the Fund's holding at £102.1m and therefore there is likely to be another significant increase in return reported for Q3 2022, with the overall return from Hermes since inception nearing 10%.

Based on the valuation of £102.1m but reduced for the sales and distribution of £6.2m, means the holding is valued at approximately £96m, which equates to around 7.5% of the Fund, which is below the target of 8.0%. There is the potential, as further assets are sold, that further investments will be required within infrastructure. Currently officer are in discussions with Hermes to potentially increase the allocation within the current Hermes Strategy, with an increased investment in renewables. Other options are also being discussed with LCIV around the infrastructure they offer. The discussions are focused on the type of infrastructure, the location (Global and within the UK) and governance as it is likely that any initial investment would be fairly small, unless the strategic allocation target were increased.

These options will be discussed with the Fund's advisors and then training and options will be provided to Members towards the end of 2022 / early 2023.



## 5.9 Abrdn Asset Management

Abrdn	2022		2021				2020		One Year	Two Years	Since Start 15/9/2014
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3			
£146.05	%	%	%	%	%	%	%	%	%	%	%
Actual Return	(1.4)	3.7	1.6	4.9	4.4	7.4	8.3	5.1	8.7	17.0	7.8
Benchmark	1.6	1.6	1.0	1.0	1.0	1.0	1.0	1.0	5.1	4.6	4.6
Difference	(3.0)	2.1	0.6	3.9	3.4	6.5	7.3	4.1	3.6	12.4	3.2

### Reason for appointment

As part of the Fund's diversification from equities, Members agreed to tender for a Diversified Alternatives Mandate. Abrdn Asset Management (ASAM) were appointed to build and maintain a portfolio of Hedge Funds (HF) and Private Equity (PE). All positions held within the portfolio are hedged back to Sterling. Since being appointed ASAM have built a portfolio of HFs and PEs, which offer a balanced return not dependent on traditional asset class returns. In the case of PE, the intention is to be able to extract an illiquidity premium over time. The allocation to PE, co-investments, infrastructure, private debt, and real assets will be opportunistic and subject to being able to access opportunities on appropriate terms.

Over a number of years further investments have been made to ASAM, with the focus on increasing the allocation to Private Equity, with the total holding now £146.1m, which is 11.3% of the Fund, significantly higher than the strategic allocation of 9.0%. As part of the strategy review this overweight position will be reviewed with the potential to reduce the allocation, potentially to Hedge Funds, or to increase the strategic allocation level.

### Performance summary

The Portfolio lost around -1.4% (net of fees) over the three months to the end of June. The quarter's loss was primarily driven by lower March 31 valuations for Advent VIII and IX which ASAM were able to reflect in April. Over one year the return of 8.7% outperforms the benchmark return of 5.1% by 3.6%. Since inception the strategy has returned 7.8%, outperforming the benchmark by 3.2%.

ASAM have built a portfolio of hedge funds, private equity funds and co-investments, which can offer a balanced return not wholly dependent on traditional asset class returns. In the case of private equity, the intention is to be able to extract an illiquidity premium over time.

The hedge funds selected for the Portfolio include a blend of:

- i) relative value strategies, intended to profit from price dislocations across fixed income and equity markets;
- ii) macro strategies, which are intended to benefit significantly from global trends, whether these trends are up or down, across asset classes and geographies; and
- iii) tail risk protection which is intended to offer significant returns at times of stress and more muted returns in normal market environments.

## Outlook

ASAM maintain a positive outlook for fixed income relative value strategies. The opportunity set for bond basis trading in G3 countries has become very attractive. Significant volatility in Yen basis in June due to the BoJ buying 7yr cash bonds in an unprecedented move to support Yield Curve Control has re-opened the opportunity set in Japan as well as creating spill-over volatility in EUR and USD basis. There is now notable volatility across fixed income instruments in developed markets, with the Fed/BoE/ECB/RBA hiking rates and engaging in quantitative tightening, high levels of uncertainty on inflation and economic projections, high uncertainty on future monetary policy, diminished flows of gas from Russia to Europe and renewed political tensions in Italy. Therefore, the opportunity set is very attractive for fixed income relative managers not only in basis trading, but in other traditional strategies such as asset swap spreads, yield curve arbitrage (cash bonds vs. cash bonds), macro, inflation and cross-currency trading.

ASAM's outlook for discretionary macro also remains positive. ASAM continue to see inflation rhetoric and central bank thinking around interest rate policy being dominant themes for the remainder of the year. ASAM believe that this backdrop will be supportive and allow specialists to identify attractive directional and relative value opportunities, particularly in interest rates and currencies.

In terms of private equity, ASAM have seen a slight slowing in deal activity in Q2 / Q3 as buyers and sellers interpret the geopolitical challenges, public market volatility, supply chain risks and the changing inflationary environment. Deal activity remains robust for the highest quality companies which can typically demonstrate strong resilience through the COVID-19 period and other recent crises. Value and complex deals are difficult to pull off just now with so much uncertainty and gaps in seller / buyer pricing expectations. The fundraising environment has continued to be strong in H1 2022. Periods of volatility typically present significant opportunity for private equity managers and ASAM think the next 12-24 months will be very interesting vintages for PE investment. ASAM remain pleased with the quality of the existing LBBB PE portfolio.

The underlying managers within the portfolio have continued to deploy capital in a disciplined manner to acquire assets with the potential for future earnings growth. ASAM have remained active in committing to focused strategies and to opportunistic co-investment and secondary deals which ASAM think have compelling risk / return characteristics. Encouragingly ASAM have also continued to see a number of exits announced across the portfolio, typically at meaningful uplifts to holding valuations.

The secondary market in particular should yield interesting opportunities in the coming months, as some investors look to decrease their exposure to the asset class, while on the other hand there are compelling opportunities to back existing owners of assets to hold their highest quality companies for longer. For the reasons outlined ASAM are focusing on quality assets alongside specialist managers with a track record across cycles, while remaining opportunistic on value and complex deals.

## 5.10 Pyrford

Pyrford	2022		2021				2020		One Year	Two Years	Since Start 28/9/2012
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3			
£113.50	%	%	%	%	%	%	%	%	%	%	%
Actual Return	(0.8)	1.5	1.3	0.3	1.1	0.9	3.1	(1.6)	2.3	3.0	3.3
Benchmark	6.3	3.1	4.0	2.7	3.6	1.7	1.6	1.8	16.0	12.3	8.1
Difference	(7.0)	(1.6)	(2.7)	(2.4)	(2.5)	(0.8)	1.6	(3.3)	(13.7)	(9.4)	(4.8)

### Reason for appointment

Pyrford were appointed as the Fund's absolute return manager (AR) to diversify from equities. The manager's benchmark is to RPI, which means that the manager is likely to outperform the benchmark during significant market rallies. AR managers can be compared to equities, which have a similar return target. When compared to equities, absolute return will underperform when markets increase rapidly and tend to outperform equities during periods when markets fall.

### Performance

The equity segment of the Strategy generated a small profit in Q2 on the strength of positioning in defensive industries and Pyrford's preference for inexpensive yield-paying companies, particularly in the UK. Holdings in UK Gilts, which accounted for more than 46% of the portfolio at the beginning of Q2, were a slight drag on returns. Losses on these positions were offset by gains on overseas bonds, particularly those denominated in U.S. and Canadian Dollars, but this ignores the impact of currency hedges, with hedges costing 1% in Q2.

The Strategy is built around four pillars: sovereign bonds, equities, currencies and cash. The key drivers of returns are allocations across the four pillars, duration management and sovereign bond selection and country and stock selection decisions within the equity segment. Derivatives are used only to manage currency risk. Currency exposure arising from bond and equity selection decisions is adjusted based on long-term valuation models.

The asset allocation process is slow moving. In mid-June, Pyrford made their first change to the model portfolio for the Strategy since the first quarter of 2020. The target allocation to equities was increased by 5% to 40% when triggers linked to the projected real rate of return, over a five-year horizon, were hit. The default response is to implement the change in asset allocation based on the prevailing regional, country and stock weights and make any necessary adjustments at the next quarterly forecasting point for growth and inflation. The investment manager is unlikely to make significant changes to the composition of the equity portfolio in the near term.

Pyrford apply their strategy methodically and consistently. The structure and composition of the Strategy are aligned to our expectations. The strategy remains defensively positioned, both in terms of the overall mix of assets, and the constituents of the equity and bond sub-portfolios. However, now that the initial threshold for reallocation of capital to equities has been hit, and trigger points have been reset, the next increase could come more quickly if volatility remains high. Moving decisively to redeploy capital is important in terms of recovering underperformance relative to the target benchmark.

## 5.11 Newton

Newton	2022		2021				2020		One Year	Two Years	Since Start 31/8/2012
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3			
£82.60m	%	%	%	%	%	%	%	%	%	%	
Actual Return	(2.1)	(4.4)	3.7	(0.1)	2.4	1.1	5.6	3.5	(2.8)	4.9	3.8
Benchmark	0.9	0.8	1.0	1.0	1.0	1.0	1.0	1.0	3.8	3.9	4.4
Difference	(3.0)	(5.2)	2.7	(1.1)	1.4	0.1	4.6	2.5	(6.6)	1.0	(0.6)

### Reason for appointment

Newton was appointed to act as a diversifier from equities. The manager has a fixed benchmark of one-month LIBOR plus 4%. AR managers have a similar return compared to equity but are likely to underperform equity when markets increase rapidly and outperform equity when markets suffer a sharp fall.

### Performance

Newton generated a return of -2.1% in Q2, underperforming its benchmark by 0.9%. Over one year the strategy has returned -2.8%, underperforming its benchmark by 6.6%, although the return over two years is 4.9% against a benchmark of 3.9%. Newton's performance since inception is 3.8%.

The allocation to equities had been reduced late in 2021 and in the first half of this year. The stock portfolio had also been repositioned to reduce exposure to relatively highly valued companies, and those perceived to be vulnerable to the effects of higher inflation and/or slower growth. Despite these measures, this segment of the Strategy lost 3.8% in Q2, and an additional 1% through synthetic exposure created through futures and options. Corporate high yield bonds accounted for 4.8% of the portfolio at the beginning of the quarter.

On a positive note, the stabilising layer of the Strategy reversed its poor performance in Q1 and contributed a profit of 1.9% in Q2. This came mainly from derivatives used to protect the Strategy from losses on equity investments. The investment manager increased the use of short futures positions at the expense of the short and long-dated options which usually form the core of this segment, and the addition of contracts linked to the S&P 500 and Nasdaq indices worked well in Q2.

Gains on the equity hedges were partly offset by small losses on government debt and bond derivatives. The investment manager had bought bonds and allowed duration to increase early in 2022 as a hedge against downside risk. This did not work well but the allocation has been increased and repositioned to capture higher yields on short-dated bonds. The increased allocation to gold, implemented mainly as a hedge against inflation and geo-political risk, also detracted in Q2.

Alternative assets, including renewable energy generators, property stocks, risk premia strategies and exchange traded instruments linked to commodities, including oil, have been the best performers in the Strategy over the course of the past 12 months. This segment was flat in Q2, with gains on oil offset by losses on copper and some of the listed real asset positions, including music royalties.

## 5.12 Insight (Mellon Corporation / Standish)

Insight	2022		2021				2020		One Year	Two Years	Since Start 20/8/2013
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3			
£63.77	%	%	%	%	%	%	%	%	%	%	%
Actual Return	(3.8)	(2.6)	-0.7	0.0	0.2	(0.1)	2.2	1.5	(7.1)	(1.7)	0.1
Benchmark	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	4.0	4.0	4.9
Difference	(4.8)	(3.6)	-1.7	(1.0)	(0.8)	(1.1)	1.2	0.4	(11.1)	(5.7)	(4.8)

### Reason for appointment

Insight were appointed to achieve a 6% total return from income and capital growth by investing in a globally diversified multi-sector portfolio of transferable fixed income securities including corporate bonds, agency and governments debt. The return target was later reduced to 4.4%.

### Performance

Q2 saw the BNY Mellon Targeted Return Bond Fund significantly underperform its reference benchmark by 4.8%, providing a negative return of 3.8%. The majority of this underperformance can be attributed to the fund's overweight in developed market duration. Over one year the strategy has returned **-7.1%** and over two years it has returned **-1.7%**, with a flat since inception return.

Although the strategy has underperformed, returns within this asset class have been poor with double digit losses in other strategies. As the strategy has a fixed benchmark the return looks much worse, but the return is still poor given the ability for the manager to use derivatives to protect the strategy in inflationary markets.

As was the case in Q1, the fund benefitted from a significant underweight in US duration as strong realized inflation and an increasingly hawkish Fed pressured US rates higher. Unfortunately, this was more than offset by the negative alpha associated with positioning in the Australian, European, UK and Mexican local government bond markets. In aggregate, rates positioning was a large drag on Q2 relative performance

The fund's overweight to corporate credit and other spread product was a source of additional negative alpha. Risk assets of all types came under heavy pressure in Q2 with the notable underperformance of HY and EUR denominated credit.

At the country level, the fund benefitted from active positioning in the Italian government bond market as spreads widened steadily in the weeks and months preceding the ECB's mid-June emergency meeting. This alpha was largely offset by negative contributions from Colombian and Romanian hard currency debt.

With risk-free rates rising and spreads pushing wider, most fixed income assets saw negative total returns in Q2. For the second consecutive quarter, cash was one of the best performing sectors.

## 5.13 Currency Hedging

No new currency hedging positions were placed in Q2 2022.

## **6. Consultation**

- 6.1 Council's Fund monitoring arrangements involve continuous dialogue and consultation between finance staff, external fund managers and external advisers. The Chief Financial Officer and the Fund's Chair have been informed of the approach, data and commentary in this report.

## **7. Financial Implications**

*Implications completed by: Philip Gregory, Chief Financial Officer*

- 7.1 The Council's Fund is a statutory requirement to provide a defined benefit pension to scheme members. Investment decisions are taken based on a long-term investment strategy. The investment performance has a significant impact on the General Fund. Pensions and other benefits are statutorily calculated and are guaranteed. Any shortfall in the assets of the Fund compared to the potential benefits must be met by an employer's contribution.
- 7.2 This report updates the Committee on developments within the Investment Strategy and on scheme administration issues and provides an overview of the performance of the Fund during the period.

## **8. Legal Implications**

*Implications completed by: Dr. Paul Feild, Senior Governance Solicitor*

- 8.1 The Council operates the Local Government Pension Scheme which provides death and retirement benefits for all eligible employees of the Council and organisations which have admitted body status. There is a legal duty fiduciary to administer such funds soundly according to best principles balancing return on investment against risk and creating risk to call on the general fund in the event of deficits. With the returns of investments in Government Stock (Gilts) being very low they cannot be the primary investment. Therefore, to ensure an ability to meet the liability to pay beneficiaries the Fund is actively managed to seek out the best investments. These investments are carried out by fund managers as set out in the report working with the Council's Officers and Members.
- 8.2 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 are the primary regulations that set out the investment framework for the Fund. These regulations are themselves amended from time to time. The Regulations are made under sections 1(1) and 3(1) to (4) of, and Schedule 3 to, the Public Service Pensions Act 2013. They set out the arrangements which apply to the management and investment of funds arising in relation to a Fund maintained under the Local Government Pension Scheme.

## **9. Other Implications**

- 9.1 **Risk Management** - Investment decisions are taken based on a long-term investment strategy. Investments are diversified over several investment vehicles

(equities – UK and overseas, bonds, property, infrastructure, global credit and cash) and Fund Managers to spread risk.

Performance is under constant review, with this focused on how the Fund has performed over the past three months, one year and three years.

**Background Papers Used in the Preparation of the Report:**

- Northern Trust Quarterly Q2 2022 Report; and
- Fund Manager Q2 2022 Reports.

**List of appendices:**

**Appendix 1** - Fund Asset and Liability Values 31 March 2013 to 1 August 2022

**Appendix 2** - Definitions

**Appendix 3** - Roles and Responsibilities