PENSIONS PANEL

13 December 2017

Title: Pension Fund Quarterly Monitoring 2017/18 – July to September 2017	
Report of the Chief Operating Officer	
Public Report	**For Information**
Wards Affected: None	**Key Decision:** No
Report Author: David Dickinson, Group Manager Pensions and Treasury	**Contact Details:** Tel: 020 8227 2722 E-mail: david.dickinson@lbbd.gov.uk
Accountable Director: Kathy Freeman, Director of Finance	
Accountable Strategic Director: Claire Symonds, Chief Operating Officer	

Recommendations

The Panel is recommended to note:

(i) the progress on the strategy development within the Pension Fund;

(ii) the daily value movements of the Fund's assets and liabilities outlined in Appendix 1; and

(iii) the quarterly performance of pension funds collectively and the performance of the fund managers individually.

The Panel is recommended to agree:

(i) the re-advancement waiver provided by Hermes, which will allow any distributed profits from the sale of GS Global Infrastructure Partners I, LP and Pan-European Infrastructure Fund LP to be reinvested in future Value Added investments. This will increase the Fund's commitment to Hermes from £75m to £80.3m.

1. Introduction and Background

1.1 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 July 2017 to 30 September 2017 ("Q3"). The report updates the Panel on the Fund's investment strategy and its investment performance. Due to the technical nature of this report, Appendix 2 provides a definition of terms used in this report and Appendix 3 sets out roles and responsibilities of the parties referred to throughout this report.

1.2 A verbal update on the unaudited performance of the Fund for the period 1 October to 11 December 2017 will be provided to Members at the Pension Panel.

2. Market Commentary Q3 2017

2.1 Q3 was a broadly positive period for the world's financial markets, with healthy economic data and strong corporate profitability underpinning equity gains. While equity volatility remained remarkably low through much of the quarter, investors were intermittently rattled by tropical hurricanes and the ramping up of tensions between the US and North Korea over the latter's missile tests. As measured by the FTSE World Index, equities achieved a three-month gain of 1.7% to a sterling investor.

2.2 In the UK difficult Brexit negotiations continued along with speculation that the Bank of England would raise the interest rate as early as November; expectations of a near-term rate hike led to a recovery in sterling. The FTSE All-Share Index returned 2.1%.

2.3 Within the US the S&P 500 Index was up 1.1% for the quarter. The most notable central bank action came from the US, where the Federal Reserve announced plans to start 'normalising' its balance sheet from October; the market also placed a higher probability on a 25-basis point rate increase in December, with three similar hikes anticipated to follow in 2018.

2.4 European equities rose 3.6% in Q3. Minimal progress was made on the terms of the UK's exit from the European Union. Politics dominated in Germany where Angela Merkel secured a fourth term as Chancellor however her majority was diminished with unexpected gains by a right-wing party which weighed heavily on sentiment. Other markets in the region generated largely positive returns. The MSCI Asia Pacific Index returned 2.7% in GBP terms.

2.5 Emerging markets equities benefited from the weak dollar in 2017 which, alongside improving economic growth and stronger earnings, helped attract investors. Rising oil and related commodity prices bolstered some market gains. The MSCI Emerging Markets Index returned 4.6% in sterling terms, the best regional performer over the three-month period, outperforming Developed markets

2.6 Overseas Bonds were down -1.7% as measured by the JPM Global x UK Index. UK Bonds returned -0.2% and the short-dated Index Linked Index -0.8%. In currency markets the Euro gained 0.3% on sterling but the USD and the JPY both lost ground against GBP. Property posted another positive return, for the fourth consecutive quarter, bringing the 12 month return to just over 10%.

3. Overall Fund Performance

3.1 The Fund's externally managed assets closed Q3 2017 valued at £966.4, an increase of £20.6m from its value of £945.8m as at 30 June 2017. The cash value held by the Council at 30 September 2017 was £0.8m giving a total Fund value of £967.2m.

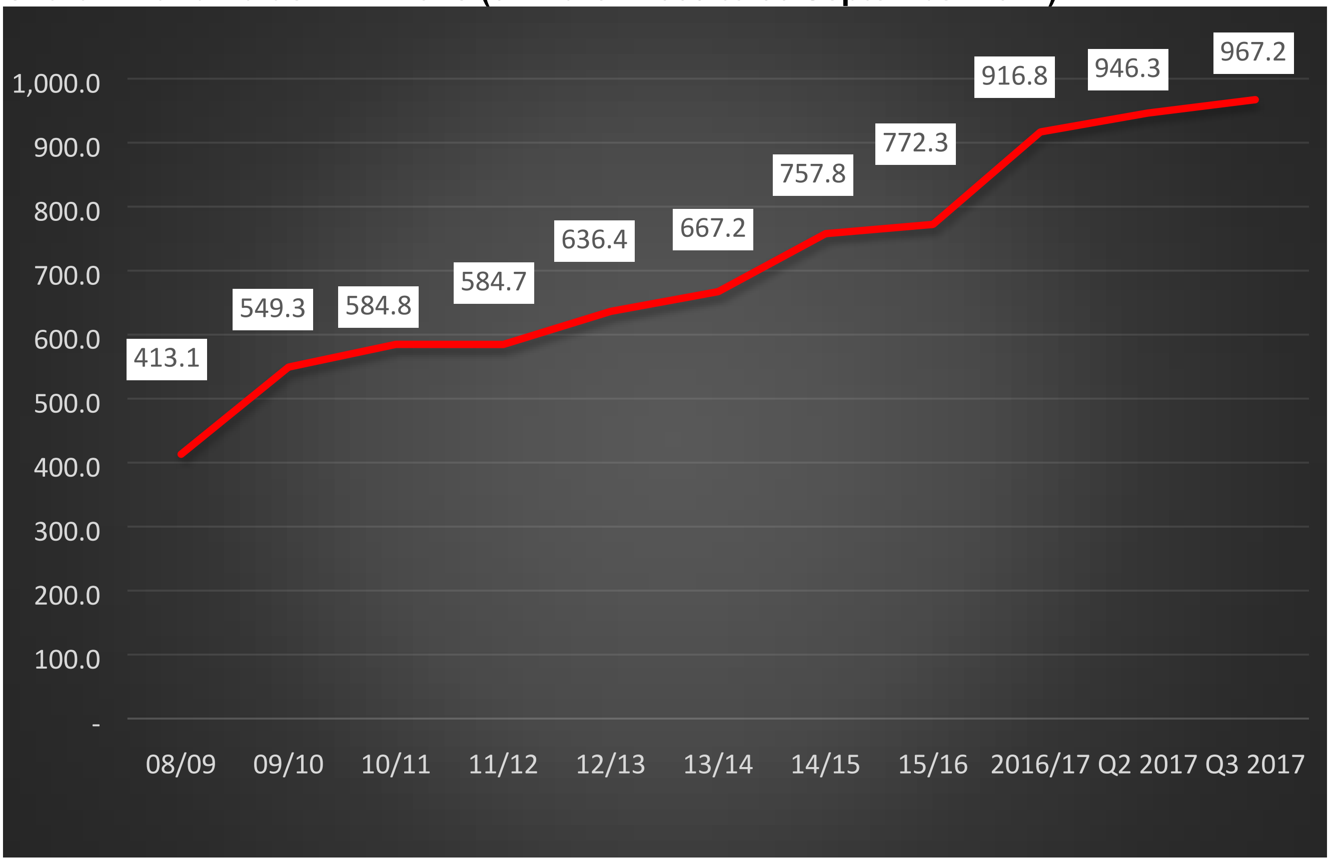
3.2 For Q3 the Fund returned 2.2%, net of all fees, outperforming its benchmark by 0.4% and the PIRC LGPS Universe (PIRC) by 0.6%. Over one year the Fund has returned 11.5%, outperforming its benchmark by 1.6% and PIRC by 2.1%. Over three years the Fund has outperformed its benchmark by 0.2%, with a return of 10.7% and has marginally outperformed PIRC by 0.1%. The Fund's returns are provided below:

Table 1: Fund's Q3 2017, 2016 and 2015 Quarterly and Yearly Returns

Year	2017			2016				2015	One Year	Two Years	Three Years	Five Years
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4				
Actual Return	2.2	1.8	3.8	3.7	5.3	5.2	2.5	4.4	11.5	14.5	10.5	10.2
Benchmark	1.8	1.2	3.3	3.6	4.4	5.7	2.0	4.5	9.9	13.3	10.3	10.2
Difference	0.4	0.6	0.5	0.1	0.9	(0.5)	0.5	(0.1)	1.6	1.2	0.2	-
PIRC Universe	1.6	0.7							9.4		10.4	10.8

3.3 Appendix 1 illustrates changes in the market value, the liability value, the Fund's deficit and the funding level from 31 March 2013 to 30 September 2017. Members are asked to note the significant changes in value and the movements in the Fund's funding level. Chart 1 below shows the Fund's value since 31 March 2009.

Chart 1: Fund Value in Millions (31 March 2009 to 30 September 2017)



3.4 Stock selection contributed 0.2%, with asset allocation contributing 0.2% for the quarter. The fund manager’s performance has been scored using a quantitative analysis compared to the benchmark returns, defined below.

	RED- Fund underperformed by more than 75% below the benchmark
Δ	AMBER- Fund underperformed by less than 75% below the benchmark.
O	GREEN- Fund is achieving the benchmark return or better

3.5 Table 2 highlights the Q3 return. BlackRock, Schroders, Standish. Pyrford and Newton underperformed their respective benchmarks. Aberdeen, Kempen and Baillie Gifford provided good returns of 6.1%, 3.3% and 4.1% respectively.

Table 2 – Fund Manager Q3 2017 Performance

Fund Manager	Actual Returns (%)	Benchmark Returns (%)	Variance (%)	Ranking
ABERDEEN AM	6.1	1.1	5.0	O
BAILLIE GIFFORD	4.1	2.0	2.1	O
BLACKROCK	1.3	2.4	(1.1)	Δ
HERMES GPE	1.8	1.4	0.4	O
KEMPEN	3.3	1.5	0.0	O
PRUDENTIAL / M&G	1.1	1.1	0.0	O
Newton	(0.8)	1.0	(1.8)	Δ
Pyrford	(0.9)	2.2	(3.1)	
Schroders	2.0	2.4	(0.4)	Δ
Standish	0.7	1.0	(0.3)	Δ
UBS Bonds	(0.5)	(0.5)	0.0	O
UBS Equities	2.8	2.8	0.0	O

3.6 Over one-year, (table 3), Aberdeen, Schroders and the equity managers provided good returns. Pyrford and Newton have struggled, significantly underperforming their benchmarks.

Table 3 – Fund Manager Performance Over One Year

Fund Manager	Actual Returns (%)	Benchmark Returns (%)	Variance (%)	Ranking
ABERDEEN AM	11.5	4.4	7.1	O
BAILLIE GIFFORD	20.2	14.9	5.4	O
BLACKROCK	7.3	9.0	(1.7)	Δ
HERMES GPE	6.3	5.7	0.6	O
KEMPEN	17.5	13.8	3.7	O
PRUDENTIAL / M&G	4.4	4.3	0.1	O
Newton	(2.8)	4.1	(6.9)	
Pyrford	1.5	8.6	(7.1)	
Schroders	10.7	9.0	1.7	O
BNY MELLON	4.4	4.3	0.1	O
UBS Bonds	(3.6)	(3.7)	0.1	O
UBS Equities	17.2	16.9	0.3	O

3.7 Over two years, (table 4), all mandates are positive, with returns ranging from 1.7% with Standish to 25.0% with Baillie Gifford. Standish has significantly underperformed its benchmarks, underperforming its benchmark by 3%. The high equity returns are in sharp contrast to the rest of the strategies, where single digit returns are most prevalent.

Table 4 – Fund manager performance over two years

Fund Manager	Actual Returns (%)	Benchmark Returns (%)	Variance (%)	Ranking
ABERDEEN AM	6.3	4.4	1.9	O
BAILLIE GIFFORD	25.0	21.6	3.4	O
BLACKROCK	4.4	6.2	(1.8)	Δ
HERMES GPE	8.3	5.6	2.7	O
KEMPEN	23.5	21.0	2.5	O
PRUDENTIAL / M&G	4.4	4.4	0.0	O
Newton	4.3	4.3	0.0	O
Pyrford	6.2	7.8	(1.6)	Δ
Schroders	6.2	6.1	0.1	O
BNY MELLON	1.7	4.7	(3.0)	
UBS Bonds	4.4	4.3	0.1	O
UBS Equities	22.5	22.4	0.1	O

4. Asset Allocations and Benchmark

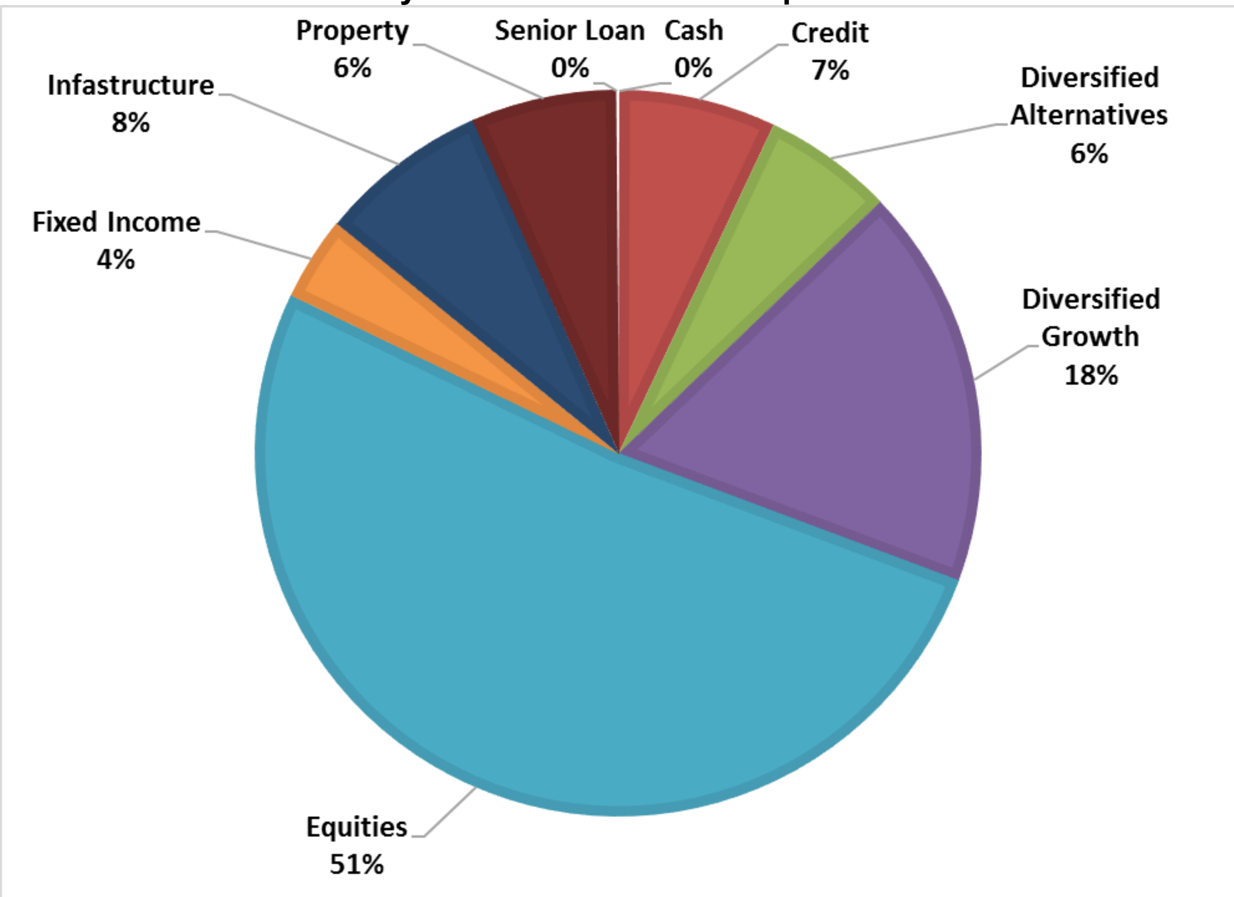
4.1 Table 5 below outlines the Fund's strategic asset allocation, asset value and benchmarks:

Table 5: Fund Asset Allocation and Benchmarks as at 30 September 2017

Fund Manager	Asset (%)	Market Values (£000)	Benchmark
ABERDEEN AM	6.0	57,586	3 Mth LIBOR + 4% per annum
BAILLIE GIFFORD	18.5	179,283	MSCI AC World Index
BLACKROCK	4.0	38,381	AREF/ IPD All Balanced
HERMES GPE	7.5	72,864	Target yield 5.9% per annum
KEMPEN	16.2	156,604	FTSE All World Developed
PRUDENTIAL / M&G	0.1	998	3 Mth LIBOR + 4% per annum
Newton	6.8	66,167	One-month LIBOR +4% per annum
Pyrford	10.5	101,413	UK RPI +5% per annum
Schroders	2.4	23,676	AREF/ IPD All Balanced
BNY Standish	6.9	66,471	3 Mth LIBOR + 4% per annum
UBS Bonds	3.6	35,116	FTSE UK Gilts All Stocks
UBS Equities	17.4	167,850	FTSE All Stock Gilt Index
Cash & Other	0.1	781	One-month LIBOR
Total Fund	**100.0**	**967,189**	

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

Chart 2: Fund Allocation by Asset Class as at 30 September 2017



5. Fund Manager Performance

5.1 Kempen

Kempen	2017			2016				2015	One Year	Two Years	Since Start 6/2/2013
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4			
£156,604	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**3.3**	**0.1**	**3.2**	10.9	10.2	5.8	5.9	7.5	17.5	23.5	11.3
Benchmark	**1.5**	**0.1**	**5.1**	7.1	7.9	9.7	2.2	8.4	13.8	21.0	13.8
Difference	**1.8**	**(0.0)**	**(1.9)**	**3.8**	**2.3**	**(3.9)**	**3.7**	**(0.9)**	**3.7**	**2.5**	**(2.5)**

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 1.8% for the quarter and has outperformed its one-year benchmark by 3.7% over one year and 2.5% over two years. Kempen has underperformed its benchmark since inception by 2.5%, although the return over this period is a good annualised return of 11.3%.

During the quarter Kempen sold seven companies, including Yara, Uniper and Qualicorp due to their dividend yield dropping below the 3% threshold. Pearson was sold due to a large dividend cut, with Camden Property sold due to strong share price performance.

Kempen also bought six companies during the quarter, including WPP, Power Financial Corp, MS&AD Insurance Group, Dixon Carephone Plc, Phasagro and Lite-on Technology.

Outlook

The outlook continues to be promising and has continued to improve over the year. Overall market values are elevated, but there are significant differences in the size of the elevated values, creating more opportunities. Flows into passive strategies have increased valuations in certain sectors while depressing others. Kempen believe this creates the opportunity to invest in areas shunned by the market and it is the expected returns for individual companies that drive the performance of the strategy, and not the flows in and out of sectors.

The strategy now has a forward yield of around 4.8% and Kempen remain optimistic on the dividend growth prospects for 2017.

5.2 Baillie Gifford

	2017			2016				2015			
Baillie Gifford	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**One Year**	**Two Years**	**Since Start 6/2/13**
£179,283	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**4.1**	**4.6**	**7.6**	3.9	12.1	6.9	0.3	10.4	20.2	25.0	16.9
Benchmark	**2.0**	**0.6**	**5.8**	6.5	8.5	8.8	2.9	8.1	14.9	21.6	13.5
Difference	**2.1**	**4.0**	**1.8**	**(2.6)**	**3.6**	**(1.9)**	**(2.6)**	**2.3**	**5.3**	**3.4**	**3.4**

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 approximately 90-105 stocks.

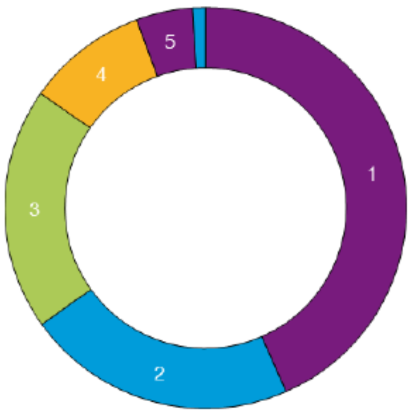
Performance Review and Market Outlook

For Q3, BG provided a return of 4.1%, outperforming its benchmark by 2.1% BG's one-year return is 20.2%, significantly outperforming its benchmark by 5.3%. Since initial funding the strategy has returned 16.9%, outperforming its benchmark by 3.4%.

After a multi-year rally in stock markets, many observers are concerned about irrational exuberance and the withdrawal of unconventional monetary policies which have provided a tailwind for investments. BG acknowledges these concerns but remain optimistic about the companies they have invested in. Where they see share prices ahead of fundamentals, they will trim positions as appropriate.

BG are confident that there remain many exciting growth opportunities to be uncovered. Companies that have many years of growth ahead are very valuable and they are always seeking out opportunities in more unloved segments of the market in the way we have thought about semiconductors in the past few years.

Regional Allocation: The strategies regional weighting is below, highlighting the large allocation to emerging markets and lower than benchmark allocation to the US.



	Regional Weights	(%)
1	North America	43.4
2	Emerging Markets	21.7
3	Europe (ex UK)	19.5
4	Developed Asia Pacific	9.8
5	UK	4.5
6	Cash and Deposits	1.0
	Total	100.0

5.3 UBS Equities

	2017			2016				2015			
UBS Equities	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**One Year**	**Two Years**	**Since Start 31/8/2012**
£167,850	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**2.8**	**2.3**	**5.5**	6.6	8.2	8.7	2.4	8.6	17.2	22.5	16.4
Benchmark	**2.8**	**2.2**	**5.5**	6.4	8.2	8.7	2.4	8.6	16.9	22.4	16.4
Difference	**0.0**	**0.1**	**0.0**	**0.2**	**0.0**	**0.0**	**0.0**	**0.0**	**0.3**	**0.1**	**0.0**

Reason for appointment

UBS were appointed as the Fund's passive equity manager to reduce the risk from underperforming equity managers and provides a cost-effective way of accessing the full range of developed market equity growth. UBS track the developed world market benchmark and there will only be an issue with performance were the manager to vary significantly from the benchmark, either positively or negatively.

Performance

The fund returned 2.8% for the quarter and 17.2% for the financial year. Since initial funding in August 2012, the strategy has provided an annualised return of 16.4%. Equity markets worldwide advanced strongly over the third quarter, for a sixth consecutive quarter of growth. In local currency terms, the MSCI World index delivered a total return of 4.5% over the quarter, and 19% over the last twelve months.

5.4 UBS Bonds

	2017			2016				2015			
UBS Bonds	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**One Year**	**Two Years**	**Since Start 5/7/2013**
£35,116	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**(0.5)**	**(1.3)**	**1.5**	(3.3)	2.3	6.2	5.0	(1.2)	(3.6)	4.4	5.4
Benchmark	**(0.5)**	**(1.3)**	**1.5**	(3.4)	2.3	6.2	5.0	(1.2)	(3.7)	4.3	5.4
Difference	**0.0**	**0.0**	**0.0**	**0.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.1**	**0.1**	**0.0**

Reason for appointment

UBS were appointed as the Fund's passive bond manager to allow the Fund to hold a small allocation (5%) of UK fixed income government bonds.

Market Update

Returns for the quarter were -0.5%, with one year returns -3.6%.

Government bond yields fluctuated over the quarter driven by various news stories, but there were few significant events to provide markets with a clear direction. Demand for safe haven assets rose in August amidst rising tensions on the Korean peninsula, but this was reversed in September as Fed guidance increased market expectations for future rate rises, and news of a new plan for US tax reform broke. The UK gilt market was the major exception, as nominal and real yields rose over the three months.

5.5 BlackRock

	2017			2016				2015			
BlackRock	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**One Year**	**Two Years**	**Since Start 1/1/2013**
£38,381	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**1.3**	**2.0**	**2.5**	1.5	(3.5)	1.3	1.2	2.5	7.3	4.4	9.9
Benchmark	**2.4**	**2.3**	**2.0**	2.3	(0.7)	0.1	1.1	3.0	9.0	6.2	12.3
Difference	**(1.1)**	**(0.3)**	**0.5**	**(0.8)**	**(2.8)**	**1.2**	**0.1**	**(0.5)**	**(1.7)**	**(1.8)**	**(2.4)**

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.

Market Summary

The UK property market remained resilient in Q3 as demand for real estate assets, particularly from overseas investors remained robust. Aggregate values recovered past their pre-Brexit vote peak in the Q2. However, there is considerable dispersion between the various parts of the market with Central London shops, Industrials and Alternatives all recording significantly higher values whilst the value of shopping Centres and out of town retail remains subdued.

Domestic investors remain in the market for Industrial properties and Alternatives such as hotels, student accommodation and healthcare properties. Demand for long leased, indexed linked assets remains particularly strong.

Q3 Performance

The Fund delivered a net return to investors of 1.3% in the third quarter of 2017 and over the last 12 months, the Fund has returned 7.3%. This compares to a benchmark returns of 2.4% and 9.0% respectively.

Purchases

Primary Healthcare: The Fund purchased Rutland Lodge Medical Centre in Leeds for £5.3 million. The asset comprises a self-contained, purpose-built medical centre constructed in 2005 and occupied by a GP practice, NHS Trust and a pharmacy. The scale and services provided are in line with the current NHS strategy for the provision of healthcare to communities.

Sales

During the third quarter, the Fund completed the sale of eight assets totaling £12.9 million. A portfolio of seven medical centres was sold for a total of £11.3 million in August 2017. These assets were identified for sale due their small lots size, property fundamentals or where there are specific concerns over operational performance. The sale of an industrial unit in Corby was completed in September 2017 to an owner occupier for £1.6 million.

5.6 Schroders Indirect Real Estate

	2017			2016				2015			
Schroder	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**One Year**	**Two Years**	**Since Start 6/8/2010**
£23,676	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**2.0**	**2.8**	**3.2**	2.7	3.7	(5.2)	0.8	2.4	10.7	6.2	6.9
Benchmark	**2.4**	**2.3**	**2.0**	2.3	(0.7)	0.1	1.1	2.8	9.0	6.1	8.2
Difference	**(0.4)**	**0.5**	**1.2**	**0.4**	**4.4**	**(5.3)**	**(0.3)**	**(0.4)**	**1.7**	**0.1**	**(1.3)**

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.

Performance

Since the market correction in Q3 2016, the strategy has rebounded strongly. In July 2016, the Fund increased its allocation by £5m due to large discounts available. This helped to rebalance the Fund's underweight property position and provided a good return of 10.5%. Schroder one-year return is 10.7%, 1.7% above its benchmark.

5.7 M&G / Prudential UK

M&G / Prudential	**2017**			**2016**				**2015**	**One Year**	**Two Years**	**Since Start 31/5/2010**
	Q3	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**			
£998	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	4.4	4.4	4.7
Benchmark	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	4.3	4.4	4.4
Difference	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.1**	**0.0**	**0.3**

Reason for appointment

This investment seeks to maximise returns using a prudent investment management approach with a target return of Libor +4% (net of fees) and provides diversification from active bond management by holding the loans until their maturity.

Performance and Loan Security

The strategy provided a return of 4.4% per year, with a small outperformance against benchmark of 0.3% since inception. The strategies holding has reduced in size to £1m, with most of the loans repaid. However, an issue with one of the loans has been identified and this has been passed to M&G's Major Problem Credit Committee for review and monitoring. Liquidity with the company affected remains adequate and covenants have not been breached; there is sufficient liquidity to meet the next contractual amortisation payment in January 2018 on the loan held by the fund. There is no evidence of an impairment at this stage. A verbal update on this will be provided to Members at the Pension Panel.

5.8 Hermes

Hermes	**2017**			**2016**				**2015**	**One Year**	**Two Years**	**Since Start 9/11/2012**
	Q3	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**			
£72,864	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	1.8	0.8	1.9	1.8	1.6	2.5	5.9	0.3	6.3	8.3	10.3
Benchmark	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	5.7	5.6	5.9
Difference	**0.4**	**(0.6)**	**0.5**	**0.4**	**0.2**	**1.1**	**4.5**	**(1.1)**	**0.6**	**2.7**	**4.4**

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 and a base term of 18 years. In March 2015 Members agreed to increase the Fund's allocation to Hermes to 10%.

Performance

As at 30 September 2017, the strategy reported a one-year return of 6.3%, outperforming its benchmark by 0.6%. Since inception the strategy has provided an annualised return of 10.3%, outperforming its benchmark by 4.4%.

Portfolio review

Associated British Ports has continued to perform in line with budget. However, the management team remain cautious on the outlook for the rest of the year considering continued political uncertainty generally and apparent lack of progress in the ongoing negotiations on the terms of the UK's exit from the EU. Eurostar increased passenger numbers and corresponding revenues in comparison with 2016. However, there was a decline in ticket sales following the recent terrorist events in Manchester and London and management are closely monitoring customer reaction to these shocks.

Following the acquisition of an equity interest in Cadent Gas in March 2017, an important milestone in the execution of the work program set out at acquisition was achieved with the appointment of Sir Adrian Montague, as independent chairman, to the board. Sir Adrian brings a wealth of experience in largescale and regulated businesses, has extensive involvement in the infrastructure sector generally and maintains excellent contacts in government. In May 2017, EAG acquired Dragon Infrastructure Solutions, one of the UK's largest Independent Connection Providers, and Utility Distribution Networks, an Independent Distribution Network Operator. The acquisitions are expected to contribute to growth in recurring revenues and accelerate the geographical expansion of EAG's service based business for gas and electricity.

Transaction

Hermes Infrastructure's intention has always been to realise some of the investments that formed part of the strategies original seed investments at an optimum time and value. In Q3 of 2017, Hermes Infrastructure undertook a strategic review of the HIF I Value Added Portfolio's holdings in PEIF and GSIP, which resulted in an investment committee decision that seeking an exit at this point in the market cycle was in the best interests of HIF I.

On 29 and 30 September 2017, Hermes Infrastructure Fund I LP ('HIF I' or the 'Fund') successfully completed a secondary sale of its c0.7% interest in PEIF Pan-European Infrastructure Fund ('PEIF') to Stafford Capital Partners ('Stafford') on behalf of Stafford Infrastructure Secondaries Fund II and IST 3 Investmentstiftung and its c2.3% interest in Goldman Sachs Global Infrastructure Partners I LP ('GSIP') to Pantheon Capital Partners ('Pantheon') on behalf of a number of funds and clients. The total consideration received for PEIF was c£16.8m which delivers a whole of life IRR to the Fund of c11.7%.

The total consideration received for GSIP was £34.2m, delivering an IRR of c17.1%. Typical for transactions of this nature, both fund interests were sold at a discount to the underlying General Partner's valuation with a significant discount for PEIF, compared to GSIP. These successful realisations bring HIF I's total portfolio holdings to 12 investments, comprising ten direct investments and two fund investments.

The sales process for both funds was structured as a competitive auction, which attracted extensive market interest in PEIF and less, but significant, interest in GSIP. Phase 1 of the process resulted in the submission of indicative offers, following which a limited number of parties were asked to submit final binding bids on 15 September 2017. Stafford and Pantheon were selected as preferred bidders in respect of PEIF and GSIP respectively, and the transaction was executed under a tight timeframe.

Commitment Update

A consequence of the sale of GS Global Infrastructure Partners I, LP and Pan-European Infrastructure Fund LP ("Project Solstice") was a significant distribution back to investors of capital and profit. Currently the contract the Fund has with Hermes only allows the capital to be reinvested during the investment period. However, Hermes have provided an option to include the profit (equivalent to £5.3m) to be reinvested should investors agree to a waiver.

The waiver is only on Value Added investments and only covers the two sales outlined above. Effectively by agreeing the waiver the Fund's commitment to Hermes would be £80.3m rather than the £75m currently agreed. Hermes have confirmed that there will be no commitment fees on this amount. Due to the strong equity performance, currently the strategy is underweight infrastructure and by increasing the allocation by £5.3m, the allocation will be better aligned with the strategic allocation. It is likely that, should Members agree to the waiver, that the funds could be invested in early 2018.

Aon Hewitt have provided a detailed paper on the additional investment with Hermes, which is included as appendix 4 of this report. Aon Hewitt recommendation is for the waiver to be signed and the additional c. £5.3m be committed to the Hermes Fund.

Members are recommended to agree the re-advancement waiver provided by Hermes, which will allow any distributed profits from the sale of GS Global Infrastructure Partners I, LP and Pan-European Infrastructure Fund LP to be reinvested in future Value-Added investments. This will increase the Fund's commitment to Hermes from £75m to £80.3m.

5.9 Aberdeen Asset Management

	2017			2016				2015			
Aberdeen	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**One Year**	**Two Years**	**Since Start 15/9/2014**
£57,586	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**6.1**	**4.2**	**0.7**	0.5	0.3	(1.4)	2.2	(0.1)	11.5	6.3	3.7
Benchmark	**1.1**	**1.1**	**1.1**	1.1	1.1	1.1	1.1	1.1	4.4	4.4	4.5
Difference	**5.0**	**3.1**	**(0.4)**	**(0.6)**	**(0.8)**	**(2.5)**	**1.1**	**(1.2)**	**7.1**	**1.9**	**(0.8)**

Reason for appointment

As part of the Fund's diversification away from equities, Members agreed to tender for a Diversified Alternatives Mandate. Aberdeen Asset Management (AAM) 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 AAM have built a portfolio of HFs, PEs and co-investments, 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.

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

i. Relative Value strategies, intended to profit from price dislocations across fixed income and equity markets;
ii. Global 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 in the case of Kohinoor Series Three Fund is intended to offer significant returns at times of stress and more muted returns in normal market environments.

Market Update and Performance Summary

Private Equity and Hedge Funds were both profitable over the quarter (on a currency-hedged basis). PAI Europe VI ("PAI") and Ethypharm Co-Invest ("Ethypharm") led the way in terms of the positive contributors to performance, followed by Pharo Gaia ("Pharo"). Kohinoor Series Three Fund ("Kohinoor") and OEP VI Feeder ("OEP") were the largest detractors although their contributions were small.

Performance

Overall the strategy provided a return of 6.1%, outperforming its benchmark by 5.0%. This good quarterly return helped the strategy to outperform its benchmark over one year, with a return of 11.5% against a benchmark of 4.4%. Since inception in September 2014, the strategy has return 3.7%, underperforming its benchmark by 0.8%.

At the September Pension Panel, Aberdeen presented to Members and there was detailed discussion over the underperformance associated with the initial investment period. It is expected that as the investments in Private Equity mature, that the strategy will begin to outperform its benchmark over the long term.

To be updated when Q3 report provided

As at the end of 30 September 2017 the portfolio held the following allocation to Hedge Fund's and Private Equity:

Fund	**Strategy / Style**
Hedge Funds	
Field Street Fund	Fixed Income, Global Macro
Horizon Portfolio Ltd	Market Neutral
Kohinoor Series Three	Tail-risk protection

Obsidian Fund	Fixed Income Relative Value
Pharo Gaia Fund	Discretionary global macro (Emerging markets)
Complus Asia Macro	Discretionary macro fund focused on Asia
Renaissance IDA	Statistical Arbitrage
BlackRock Fixed Income	Relative Value
Private Equity	
PAI Europe VI	Buyout Midcap
MML Capital Partners VI	Lower Mid-Market
Advent Int GPE VIII-B LP	Sector-focused strategy and operational approach
Cinven Allegro LP	European Fund focused on Financials & Healthcare
Ethypharm Co-Invest FPCI	European generics & specialty pharmaceutical
OEP VI Feeder LP	Merge like-sized businesses with a strategic fit

5.10 Pyrford

	2017			2016				2015			
Pyrford	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**One Year**	**Two Years**	**Since Start 28/9/2012**
£101,413	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**(0.9)**	**0.1**	**1.7**	0.6	3.1	3.2	2.4	2.2	1.5	6.2	4.2
Benchmark	**2.2**	**2.3**	**2.1**	2.0	1.9	2	1.4	1.6	8.6	7.8	6.7
Difference	**(3.1)**	**(2.2)**	**(0.4)**	**(1.4)**	**1.2**	**1.2**	**1.0**	**0.6**	**(7.1)**	**(1.6)**	**(2.5)**

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

After seven quarters of positive absolute returns Pyrford generated a negative return of -0.9%% in Q3, underperforming its benchmark by 3.1%. Over one year the strategy has returned 1.5%, underperforming its benchmark by 7.1%. Pyrford's performance over two years and since inception is closer to its benchmark but still underperforms by 1.6% and 2.5% respectively.

Strategy and Market Update

The biggest detractor over the quarter for the portfolio came from the portfolio's equities as the market reacted to rising rates by rotating out many defensive type companies that offer strong dividend support and moved into more cyclical names.

The Pyrford equity portfolio is positioned in high dividend paying defensive sectors that can be perceived as sensitive to rising bond yields. Pyrford buy companies that have robust businesses are able to grow and pay out attractive dividends. Pyrford retain conviction in this approach despite the recent underperformance. Overseas, the largest detraction came from ComfortDelGro (Singapore).

The portfolio's bonds lost some ground as yields rose sharply towards the end of the quarter. The portfolio's UK bonds outperformed the wider market (longer duration bonds) but still lost some ground as the shorter end of the curve was also hit by the prospect of a rate rise in the UK later in the year.

Cash and currency management added to returns over the quarter as Sterling strengthened against the Swiss Franc by over 4% and the Australian dollar by 1%. The only other currency hedged, the Canadian dollar, rose against the pound by 0.5%.

5.11 Newton

	2017			2016				2015	One Year	Two Years	Since Start 31/8/2012
Newton	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**			
£66,167	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**(0.8)**	**1.0**	**2.0**	(5.0)	1.5	4.3	4.0	1.5	(2.8)	4.3	3.4
Benchmark	**1.0**	**1.0**	**1.1**	1.0	1.1	1.1	1.1	1.1	4.1	4.3	4.5
Difference	**(1.8)**	**0.0**	**0.9**	**(6.0)**	**0.4**	**3.2**	**2.9**	**0.4**	**(6.9)**	**0.0**	**(1.1)**

<u>Reason for appointment</u>

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.

<u>Performance</u>

Disappointingly, the Fund delivered a negative return over the quarter of -0.8%. Derivative protection generated a negative contribution as the primary equity indices used for this protection increased in value over the period. Marginally rising yields and sterling's appreciation negatively affected the contribution from US Treasuries. The equity portfolio was positive, but underperformed broader equity markets which were driven by cyclical sectors. For the year the return is -2.8% but over two years the strategies return is 4.3%, which matches Newton' benchmark.

<u>Activity</u>

In addition to protection implemented through short futures on geographically diverse equity indices, Newton have implemented an option strategy at attractive prices, given low implied volatility. Newton continue to closely manage interest-rate sensitivity through a combination of the sale of physical positions and the implementation of derivative protection. Newton added further to existing positions in Australian and Canadian quasi-government bonds. The gold position was tactically trimmed owing to the precious metal's sensitivity to interest rates.

Outlook and Strategy

The consensus is again warming to the idea of a sustained economic acceleration that will shake the global economy out its post-crisis torpor. Newton remain of the view that economic momentum is likely to have peaked this year, owing to lower nominal GDP growth against a backdrop of intense disruption by new technologies, overcapacity, adverse demography and enormous debt levels. Newton remain focused on maintaining risk at contained levels, and continue to focus on companies with stable growth, characterised by healthy levels of cash generation and high returns on capital.

Management Change

In August, Newton announced the introduction of a new management structure. As part of the changes, Curt Custard was appointed as Chief Investment Officer. Newton also announced that Julian Lyne had taken on the position of Chief Commercial Officer.

5.12 BNY Standish

	2017			2016				2015			
Standish	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**One Year**	**Two Years**	**Since Start 20/8/2013**
£66,471	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**0.7**	**1.0**	**2.0**	0.7	1.4	0.9	(1.9)	(1.4)	4.4	1.7	1.6
Benchmark	**1.0**	**1.0**	**1.2**	1.1	1.1	1.1	1.5	1.5	4.3	4.7	5.4
Difference	**(0.3)**	**0.0**	**0.8**	**(0.4)**	**0.3**	**(0.2)**	**(3.4)**	**(2.9)**	**0.1**	**(3.1)**	**(3.8)**

Reason for appointment

Standish 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.

Performance

Overall the strategy provided a 0.7% return for the quarter, underperforming its benchmark by 0.3%. Over one year the strategy returned 4.4%, which is 0.1% above its benchmark. The two-year return is 1.7%, outperforming its target return of 4.7%. Since funding, the strategy has provided a disappointing annual return of 1.6%, significantly behind its benchmark of 5.4%

Outlook

Standish see global economic expansion continuing, with central banks revisiting unusual policy accommodation. As a result, Standish think that developed market sovereign yields are likely to rise and credit risk spreads are likely to narrow. This presents opportunities to keep duration in developed market yields short and selectively increase credit exposure. However, there is considerable asymmetry in this outlook, as inflation has been slow to materialise in advanced economies, such that the central bank shift is incremental, not monumental.

Valuations are rich with – Standish believe – only limited prospect for them to get significantly richer. By contrast, the scope for a freefall in yields and a widening in spreads remains considerable if growth is derailed. In this environment, Standish prefer to be cautious with our risk budget, targeting selective carry opportunities, being short duration and buying interest rate protection. As more attractive valuations present themselves, Standish believe it makes sense to take advantage of these openings and utilise more of the risk budget.

5.13 Currency Hedging

No new currency hedging positions were placed in Q3 2017.

6. Consultation

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

7. Financial Implications

Implications completed by: Kathy Freeman, Director of Finance

7.1 The Council's Pension 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 Panel on developments within the Investment Strategy and on scheme administration issues and provides an overview of the performance of the Pension Fund during the period.

8. Legal Implications

Implications completed by: 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 pension 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 Pension 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 pension 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:

- WM Quarterly Q3 2017 Report; and
- Fund Manager Q3 2017 Reports.

List of appendices:

Appendix 1 - Fund Asset and Liability Values 31 March 2013 to 31 October 2017
Appendix 2 - Definitions
Appendix 3 - Roles and Responsibilities
Appendix 4 – Aon Hewitt Hermes Infrastructure Note