PENSIONS COMMITTEE

20 June 2018

Title: Pension Fund Quarterly Monitoring 2017/18 – January to March 2018	
Report of the Chief Operating Officer	
Public Report	**For Information**
Wards Affected: None	**Key Decision:** No
Report Author: David Dickinson, Investment Fund Manager	**Contact Details:** Tel: 020 8227 2722 E-mail: david.dickinson@lbbd.gov.uk
Accountable Strategic Director: Claire Symonds, Chief Operating Officer	
Recommendations The Committee 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.	

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 January 2018 to 31 March 2018 ("Q1"). The report updates the Committee 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 April to 21 June 2018 will be provided to Members at the Pension Committee.

2. Market Commentary Q1 2018

2.1 The opening months of 2018 proved volatile for global financial markets with equity returns turning negative amid concerns around the potential for accelerating inflation and a trade war, while the Russia diplomatic crisis also caused a stir. The quarter had looked set to follow the trend of 2017 as equities initially maintained the upward trajectory that was a feature of the prior year. However, early-February shook investors from any complacency as strong US jobs and wage inflation data stoked speculation that interest rates could rise more steeply than previously anticipated. Having partially recovered, markets were then rattled by US plans to impose tariffs on selected imports.

2.2 World Equities, posted a return, in sterling, of -4.6%; Emerging Markets outperformed Developed regions, returning -2.1% helped by the weak dollar and higher oil price. In the US the S&P 500 Index lost 4.2% in sterling; while the tech sector fell in March following Facebook's stumble amid claims of misuse of customer data, the sector was still the top performer in the quarter. Consumer discretionary stocks also outperformed, while telecoms and consumer staples lagged the index from a USD perspective.

2.3 UK equities had a difficult quarter as Brexit continued to cast a shadow, even as agreement was reached to allow the UK a 21-month transition period after its March 2019 exit from the EU. That breakthrough helped lift sterling, which in turn seemed to dampen enthusiasm for UK stocks. The FTSE All Share fell 6.9% in the three months.

2.4 European equities were caught up in the volatility driven by the inflation and trade narrative emanating from the US, but the moderation in Eurozone economic growth data likely drove equity underperformance; the FTSE World Europe ex UK returned -4.6%.

2.5 In Japan the market declined 2.6% in sterling terms helped by the strong Yen and the MSCI AC Asia Pacific ex Japan Index was down 4.0%. Returns by country were mixed; China which makes up over a quarter of the Index fell 1.7% and Australia, with around a 17% weighting returned -9.3%.

2.6 Government bond yields for many developed countries spiked higher in January, as bonds were sold off amid strong stock market performance and a healthy economy. As inflation worries eased in March a renewal of market volatility bolstered demand for bonds. The BAML GBP Broad Index returned -0.2% and FTSE UK Gilts Index Linked over 5 year index returned 0.2%.

2.7 Sterling gained 1.2% against the Euro and 3.5% against the US Dollar. Yen had a strong quarter, gaining 2.1% against sterling. The three-month GBP LIBOR rose from 0.5% to 0.7% ahead of an expected rate increase in May. Property had another positive quarter, returning 2.3%, bringing the one-year return to over 11%.

3. Overall Fund Performance

3.1 The Fund's externally managed assets closed Q1 2018 valued at £966.7m, a decrease of £12.4m from its value of £989.1m as at 31 December 2018. The cash value held by the Council at 31 March 2018 was £1.7m giving a total Fund value of £968.4m.

3.2 For Q1 the Fund returned -1.9%, net of all fees, underperforming its benchmark by 0.6% but outperforming the PIRC LGPS Universe (PIRC) by 1.7%. Over one year the Fund has returned 5.3%, outperforming its benchmark by 1.3% and outperforming PIRC by 0.8%. Over three years the Fund has underperformed its benchmark by 0.3%, with a return of 7.9% but has outperformed PIRC by 0.2%. The Fund's returns are provided below:

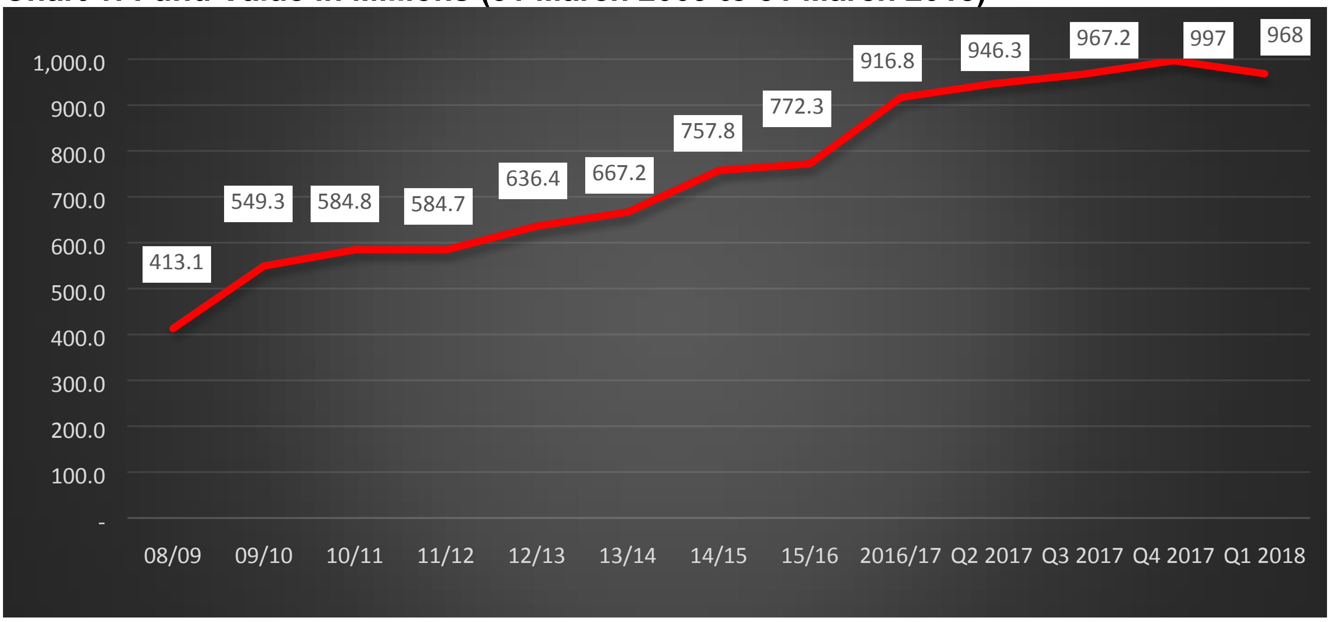
Table 1: Fund's Q1 2018, 2017, 2016 Quarterly and Yearly Returns

Year	2018	2017				2016			One Year	Two Years	Three Years	Five Years
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2				
Actual Return	(1.9)	3.2	2.2	1.8	3.8	3.7	5.3	5.2	5.3	11.7	7.9	8.3
Benchmark	(1.3)	3.1	1.8	1.2	3.3	3.6	4.4	5.7	4.8	10.9	8.2	8.6
Difference	(0.6)	0.1	0.4	0.6	0.5	0.1	0.9	(0.5)	0.5	0.8	(0.3)	(0.3)
***PIRC Universe**	(3.6)	4.0	1.6	0.7					11.8		7.7	8.5

The returns above are based on the asset allocation of the PIRC Local Authority Universe.

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 31 March 2018. 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 31 March 2018)



3.4 Stock selection contributed -0.3%, with asset allocation contributing -0.3% 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	**A**MBER- Fund underperformed by less than 75% below the benchmark.
O	**G**REEN- Fund is achieving the benchmark return or better

3.5 Table 2 highlights the Q1 return. Several funds underperformed their respective benchmarks, with most funds providing a negative return. Hermes, property and Aberdeen provided positive returns.

Table 2 – Fund Manager Q1 2018 Performance

Fund Manager	Actual Returns (%)	Benchmark Returns (%)	Variance (%)	Ranking
ABERDEEN AM	0.9	1.1	(0.2)	Δ
BAILLIE GIFFORD	(0.9)	(4.3)	3.4	O
BLACKROCK	1.5	1.9	(0.4)	Δ
HERMES GPE	6.1	1.4	4.7	O
KEMPEN	(7.4)	(4.7)	(2.7)	Δ
PRUDENTIAL / M&G	1.1	1.1	0.0	O
Newton	(2.6)	1.1	(3.7)	
Pyrford	(2.3)	1.3	(3.6)	
Schroders	1.7	1.9	(0.2)	Δ
BNY Standish	0.3	1.1	(0.8)	Δ
UBS Bonds	0.3	0.3	0.0	O
UBS Equities	(3.0)	(3.0)	0.0	O

3.6 Over one-year, (table 3), most fund provided good returns. Pyrford and Newton continue to struggle, significantly underperforming their benchmarks.

Table 3 – Fund Manager Performance Over One Year

Fund Manager	Actual Returns (%)	Benchmark Returns (%)	Variance (%)	Ranking
ABERDEEN AM	12.5	4.4	8.1	O
BAILLIE GIFFORD	12.7	3.3	9.4	O
BLACKROCK	7.7	9.7	(2.0)	Δ
HERMES GPE	9.5	5.6	3.9	O
KEMPEN	1.5	1.5	0.0	O
PRUDENTIAL / M&G	4.4	4.3	0.1	O
Newton	(2.1)	4.2	(6.3)	
Pyrford	(2.5)	8.0	(10.5)	
Schroders	9.9	9.7	0.2	O
BNY Standish	1.5	4.2	(2.7)	Δ
UBS Bonds	0.7	0.5	0.2	O
UBS Equities	7.8	7.5	0.3	O

3.7 Over two years, (table 4), all mandates are positive, with returns ranging from 0.4% with Newton to 22.5% with Kempen. Newton and Pyrford have significantly underperformed their benchmarks, underperforming by 3.9% and 5.0% respectively. 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	21.6	16.4	5.2	O
BLACKROCK	4.7	6.7	(1.9)	Δ
HERMES GPE	8.7	5.6	3.0	O
KEMPEN	15.8	15.6	0.2	O
PRUDENTIAL / M&G	4.4	4.4	0.0	O
Newton	0.4	4.3	(3.9)	
Pyrford	3.0	8.0	(5.0)	
Schroders	7.1	6.7	0.5	O
BNY Standish	3.2	4.3	(1.1)	Δ
UBS Bonds	3.7	3.5	0.2	O
UBS Equities	18.4	18.2	0.2	O

4. Asset Allocations and Benchmark

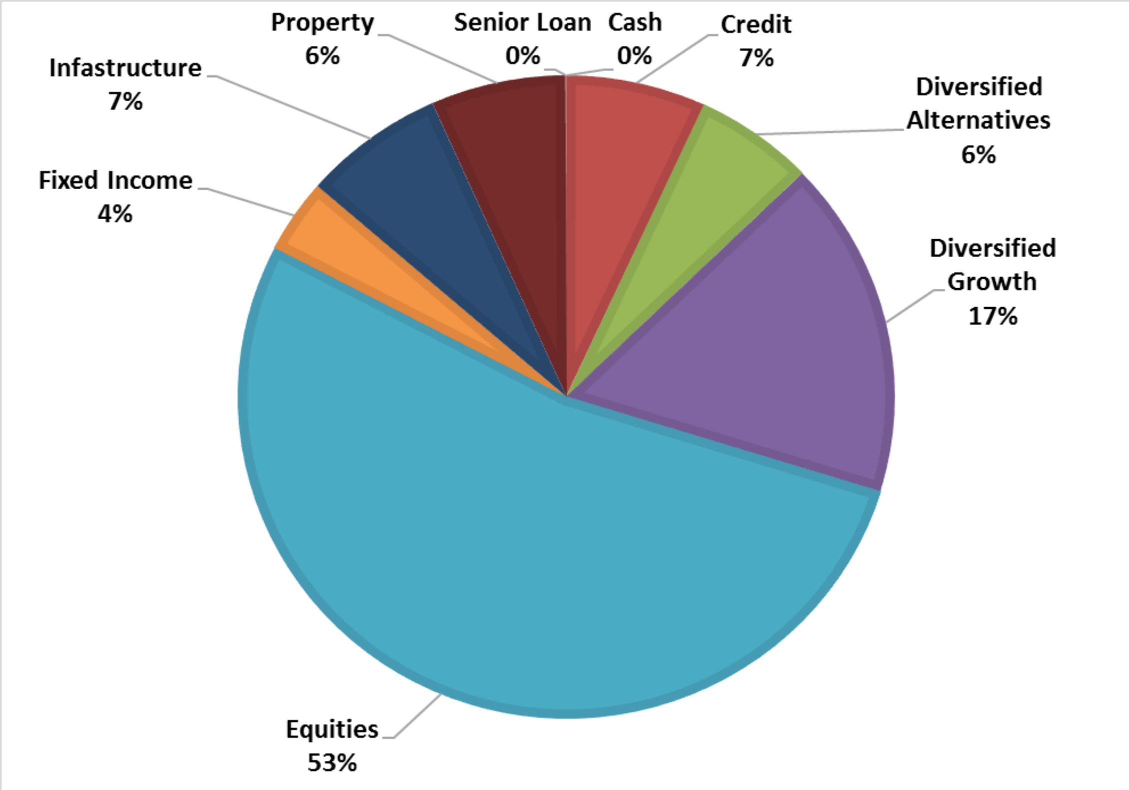
4.1 Table 5 below outlines the Fund's strategic asset allocation, asset value and benchmarks:

Table 5: Fund Asset Allocation and Benchmarks as at 31 March 2018

Fund Manager	Asset (%)	Market Values (£000)	Benchmark
Aberdeen AM	5.9%	56,817	3 Mth LIBOR + 4% per annum
Baillie Gifford	19.2%	186,184	MSCI AC World Index
BlackRock	4.1%	39,452	AREF/ IPD All Balanced
Hermes GPE	6.9%	67,078	Target yield 5.9% per annum
Kempen	15.9%	153,324	MSCI World NDR Index
Prudential / M&G	0.1%	653	3 Mth LIBOR + 4% per annum
Newton	6.7%	64,625	One-month LIBOR +4% per annum
Pyrford	10.3%	99,780	UK RPI +5% per annum
Schroders	2.5%	24,309	AREF/ IPD All Balanced
BNY Standish	6.9%	66,403	3 Mth LIBOR + 4% per annum
UBS Bonds	3.7%	35,990	FTSE UK Gilts All Stocks
UBS Equities	17.8%	171,957	FTSE AW Developed Tracker
Other	0.0%	129	One-month LIBOR
Total Fund	100.0%	966,700	

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 31 March 2018



4.3 Overall the strategy is overweight equities and cash, with equities at the top-end of the range. Most other asset classes are underweight, with infrastructure 2% underweight but this is due to the fact that it is still purchasing assets. The current position compared to the strategic allocation is provided in table 6 below:

Table 6: Strategic Asset Allocation

Asset Class	Current Position	Strategic Allocation Target	Variance	Range
Equities	53%	48%	5%	*45–53*
Diversified Growth	17%	18%	-1%	*16-20*
Infrastructure	7%	9%	-2%	*4-11*
Credit	7%	8%	-1%	*6-10*
Property	6%	7%	-1%	*6-9*
Diversified Alternatives	6%	6%	0%	*6-10*
Fixed Income	4%	4%	0%	*3-5*
Cash	1%	0%	1%	*0-2*
Senior Loan	0%	0%	0%	*0-1*

5. Fund Manager Performance

5.1 Kempen

	2018	2017				2016			One	Two	Since Start
Kempen	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Year**	**Years**	**6/2/2013**
£153,324	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	(7.4)	**5.5**	**3.3**	**0.1**	**3.2**	10.9	10.2	5.8	1.5	15.8	9.9
Benchmark	(4.7)	**4.6**	**1.5**	**0.1**	**5.1**	7.1	7.9	9.7	1.5	15.6	12.3
Difference	**(2.7)**	**0.9**	**1.8**	**0.0**	**(1.9)**	**3.8**	**2.3**	**(3.9)**	**0.0**	**0.2**	**(2.4)**

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

Kempen underperformed its benchmark for the quarter, returning -7.4% against a benchmark of -4.7%. The underperformed reversed a good first three months for Kempen, reducing the annual return to 1.5%, matching the strategies benchmark.

Over two years the fund has slightly outperformed its benchmark, with a good annualised return of 15.8%. Since inception Kempen remains 1.9% behind its benchmark of 13.9%.

In terms of stocks selection two of the biggest contributors were in the utility sector: EDP and National Grid. EDP benefited from improved weather conditions, as increased rain helped the electricity produced by the hydroelectric power stations run by EDP. The share price of National Grid was helped by increased interest in defensively position companies.

Quarterly Rebalance

As a result of our quarterly rebalance Kempen sold 6 companies and added 10 new firms to the portfolio. Kempen sold three names as their crossed the 3% threshold: KKR, Tapestry and Toyota. Three companies were sold as the risk/reward was no longer attractive: Novartis, Seagate and Nutrien.

After a period of muted markets, Kempen welcome increased volatility as this improves their ability to pick individual stocks. The recent decline in equity markets should however be weighed against the strong equity returns in 2017. Kempen believe European and Emerging market stocks offer strong expected returns, but it remains difficult to find ideas that offer attractively valued ideas in the North American Markets.

The Fund now has a forward yield of around 5.2%. Kempen's portfolio trades at a significant discount to market multiples and they remain optimistic on the dividend growth prospects for 2018.

5.2 Baillie Gifford

	2018	2017				2016			One	Two	Since Start
Baillie Gifford	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Year**	**Years**	**6/2/13**
£186,184	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	(0.9)	**4.9**	**4.1**	**4.6**	**7.6**	3.9	12.1	6.9	12.7	21.6	16.0
Benchmark	(4.3)	**5.0**	**2.0**	**0.6**	**5.8**	6.5	8.5	8.8	3.2	16.4	12.3
Difference	**3.4**	**(0.1)**	**2.1**	**4.0**	**1.8**	**(2.6)**	**3.6**	**(1.9)**	**9.4**	**2.2**	**3.7**

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

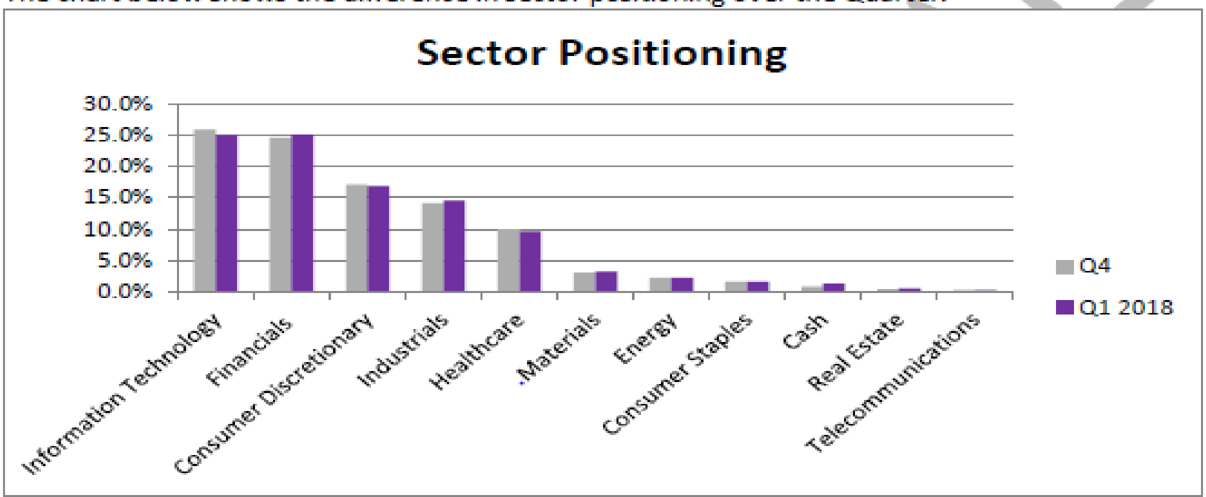
For Q1 BG returned -0.9%, outperforming its benchmark by 3.4%. BG's one-year return was 12.7%, outperforming its benchmark by 9.4%.

Despite posting a negative figure, the fund surprised on the upside in Q1, as it showed unforeseen resilience during the market volatility during the Quarter. Overweight positions to Asia, Emerging Markets and to IT helped the fund, as did stock selection within these areas.

In Q1 BG made a number of changes to the portfolio following the market moves. At the margin, the managers took profits on their more successful names and pivoted into more stable and rapid growth names. Significant transactions:

Purchases: Lending Tree, Genmab, Netflix, Orica and NetEase
Sales: Financial Engines, Japan Exchange Group and Novo Nordisk

The chart below shows the difference in sector positioning over the Quarter.



Source: Baillie Gifford (data as at 31/03/18)

5.3 UBS Equities

	2018	2017				2016			One	Two	Since Start
UBS Equities	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Year**	**Years**	**31/8/2012**
£171,957	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	(3.0)	**5.7**	**2.8**	**2.3**	**5.5**	6.6	8.2	8.7	7.8	18.4	15.2
Benchmark	(3.0)	**5.2**	**2.8**	**2.2**	**5.5**	6.4	8.2	8.7	7.2	18.0	15.2
Difference	**0.0**	**0.5**	**0.0**	**0.1**	**0.0**	**0.2**	**0.0**	**0.0**	**0.6**	**0.4**	**0.0**

<u>Reason for appointment</u>

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.

<u>Performance</u>

The fund returned -3.0% for Q1 and 7.8% over one year. Since funding in August 2012, the strategy has provided an annualised return of 16.7%.

Global equity markets fell over the first three months of 2018. This was the first notable quarterly fall for stocks worldwide in two years. Emerging market equities advanced, while some of the major developed markets saw the biggest falls.

5.4 UBS Bonds

	2018	2017				2016			One	Two	Since Start
UBS Bonds	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Year**	**Years**	**5/7/2013**
£35,990	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	0.3	**2.2**	**(0.5)**	**(1.3)**	**1.5**	(3.3)	2.3	6.2	0.7	3.7	5.3
Benchmark	0.3	**2.0**	**(0.5)**	**(1.3)**	**1.5**	(3.4)	2.3	6.2	0.5	3.5	5.3
Difference	**0.0**	**0.2**	**0.0**	**0.0**	**0.0**	**0.1**	**0.0**	**0.0**	**0.2**	**0.1**	**0.0**

<u>Reason for appointment</u>

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.

<u>Performance</u>
Returns for Q4 were 0.3%, with one year returns of 0.7% and two year returns of 3.7%.

Overall, yields on US and UK government bonds saw the largest increases over the three months while yields on markets such as Italy, Spain and Greece fell in contrast

Other, more credit focused areas of the bond markets fell over the first quarter. High yield, emerging market debt and investment grade credit reversed some of the gains seen in 2017. However, it was striking how the markets for these assets were relatively subdued amidst the increased equity volatility seen in February in particular.

5.5 BlackRock

	2018	2017				2016			One	Two	Since Start
BlackRock	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Year**	**Years**	**1/1/2013**
£39,452	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	1.5	**2.9**	**1.3**	**2.0**	**2.5**	1.5	(3.5)	1.3	7.7	4.7	8.7
Benchmark	1.9	**3.1**	**2.4**	**2.3**	**2.0**	2.3	(0.7)	0.1	9.7	6.7	10.6
Difference	**(0.4)**	**(0.2)**	**(1.1)**	**(0.3)**	**0.5**	**(0.8)**	**(2.8)**	**1.2**	**(2.0)**	**(1.7)**	**(1.9)**

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.

Q4 2017 Performance

BR returned 1.5% for the quarter against the benchmark of 1.9%, with a return of 7.7% over one year against its benchmark's return of 9.7%.

A number of leases and asset management initiatives were completed in the quarter, with the most significant being:

1. London Office leases reduce portfolio vacancy: Vacant properties with a total rental value of £1.9 million per annum were let in Q1. This was offset by new voids totalling £1.5 million per annum, including two office floors in the West End at 51 Great Marlborough Street and 65 Chandos Place. As a result the void rate reduced from 7.3% to 6.9%. The rental value of current vacancies under offer totals in over £1.8 million p.a., which will reduce the void rate to below 5.8%.

2. The most significant lease transaction was at Heathrow Logistics Park, where the first of the four available units was let to James Cargo Services for a term of 10 yrs.

3. South East Offices: The final office floor at TOR, Maidenhead was leased to Lane 4 Management and the penultimate void at Capitol Bracknell was leased to Tektronix.

During the quarter, the Fund limited transactional activity, completing one acquisition and two sales:

1. the Fund acquired 67 acres of land in Manchester, Voltage Park, for £5.95 million which will provide a further c. 1m sf of developable prime logistics to form part of the Fund's "Build to Hold Logistics" strategy.

2. the Fund completed two sales, both in-line with the Fund's strategy to sell smaller assets with tenant credit/property specific risks. Autoplaza, Basingstoke was sold to the current operator and Nene Valley, Oundle was leased to Fairline Yachts.

3. 5 Strand, London WC2 was put on the market following the successful grant of planning permission in Q4 2017, which enhanced the current gross area. Post Q1 BlackRock announced that 5 Strand has been sold ahead of valuation.

5.6 Schroders Indirect Real Estate

	2018	2017				2016			One	Two	Since Start
Schroder	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Year**	**Years**	**6/8/2010**
£24,309	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	1.7	**3.4**	**2.0**	**2.8**	**3.2**	2.7	3.7	(5.2)	9.9	7.1	7.1
Benchmark	1.9	**3.1**	**2.4**	**2.3**	**2.0**	2.3	(0.7)	0.1	9.7	6.7	8.4
Difference	**(0.2)**	**0.3**	**(0.4)**	**0.5**	**1.2**	**0.4**	**4.4**	**(5.3)**	**0.2**	**0.4**	**(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, with outperformance over one year and two years. 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 12.8%. Schroder one-year return is 11.4%, 1.6% above its benchmark.

5.7 M&G / Prudential UK

	2018	2017				2016			One	Two	Since Start
M&G / Prudential	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Year**	**Years**	**31/5/2010**
£653	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
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 Return	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% for the year. The strategies holding has reduced in size to £653k, with most of the loans repaid. The weighted average credit rating is BB with an average life of 1.7 years.

As advised at the December Committee, an issue with one of the loans with Provident Financial ("Provident") has been identified. Subsequently, on 5 Provident announced that its Moneybarn division is being investigated by the Financial Conduct Authority.

5.8 Hermes

	2018	2017				2016			One	Two	Since Start
Hermes	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Year**	**Years**	**9/11/2012**
£67,078	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	6.1	0.8	1.8	0.8	1.9	1.8	1.6	2.5	9.5	8.7	10.5
Benchmark	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	5.6	5.7	6.0
Difference	**4.7**	**(0.6)**	**0.4**	**(0.6)**	**0.5**	**0.4**	**0.2**	**1.1**	**3.9**	**3.0**	**4.5**

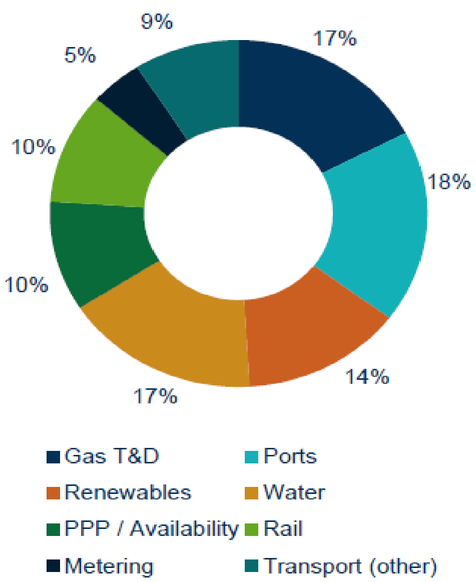
<u>Reason for appointment</u>

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%.

<u>Performance</u>

As at 31 March 2018, the strategy reported a one-year return of 6.1%, outperforming its benchmark by 0.3%. Since inception the strategy has provided a good annualised return of 10.5%, outperforming its benchmark of 6.0% by 4.5%. Overall Hermes has provided a steady return since inception.

The sector allocation below highlights the well diversified nature of the strategy. The second chart outlines the holdings and the percentage that Hermes holds in each investment.



Investment	HIF I ownership
Unrealised portfolio	
Core	
Anglian Water	4.9%
Associated British Ports	3.5%
Cadent	1.6%
Braes of Doune	50.0%
ASG I	100.0%
ASG II	100.0%
Fallago Rig	10.0%
Innisfree PFI Continuation Fund	14.3%
Innisfree M&G PPP	15.6%
Value Added	
Eurostar	6.6%
Southern Water	3.9%
Energy Assets	20.5%

5.9 Aberdeen Asset Management

	2018	2017				2016			One	Two	Since Start
Aberdeen	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Year**	**Years**	**15/9/2014**
£56,817	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	0.9	**1.3**	**6.1**	**4.2**	**0.7**	0.5	0.3	(1.4)	12.5	6.3	3.8
Benchmark	1.1	**1.1**	**1.1**	**1.1**	**1.1**	1.1	1.1	1.1	4.4	4.4	4.5
Difference	**(0.2)**	**0.2**	**5.0**	**3.1**	**(0.4)**	**(0.6)**	**(0.8)**	**(2.5)**	**8.1**	**1.9**	**(0.7)**

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: profit from price dislocations across fixed income and equity;
ii. Global Macro: benefit from global trends across asset classes and geographies; and
iii. Tail Risk protection: protection at times of market stress but more muted returns in normal market environments.

As at the end of 31 March 2018 the portfolio held the following allocations:

Hedge Funds	**Strategy / Style**
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

	2018	2017				2016			One	Two	Since Start
Pyrford	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Year**	**Years**	**28/9/2012**
£99,780	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	(2.3)	**0.6**	**(0.9)**	**0.1**	**1.7**	0.6	3.1	3.2	(2.5)	3.1	3.6
Benchmark	1.3	**2.2**	**2.2**	**2.3**	**2.1**	2.0	1.9	2	8.0	8.0	6.7
Difference	**(3.6)**	**(1.6)**	**(3.1)**	**(2.2)**	**(0.4)**	**(1.4)**	**1.2**	**1.2**	**(10.5)**	**(4.9)**	**(3.1)**

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

Pyrford generated a return of -2.3% for Q1, underperforming its benchmark by 3.6%. Over one year the strategy has returned -2.5%, underperforming its benchmark by 10.5%. Pyrford's performance over two years and since inception is closer to its benchmark but still underperforms by 2.7% and 3.1% respectively.

Strategy and Market Update

The defensive positioning in the equity portion of the fund failed to protect from the return of market volatility, as these were the areas which were hurt the most during the Quarter. However, while bond markets generally weakened as interest rate expectations rose following strong US labour figures, the fund's low duration helped weather these moves.

Overall, the fund remains very defensively positioned, with the majority of the portfolio in short duration government bonds. The performance on the equity buckets is still causing disappointment, underperforming the index for the last 2 years. However, the manager is confident that the positions will come around in what he expects will be a higher volatility environment.

The fund has had a difficult start to 2018, returning -2.1% in Q1. The underperformance of defensive sectors coincided with a rising yield environment – a scenario which was always likely to be detrimental to the strategy.

The manager and team remain dedicated to their investment philosophy of providing downside protection through reliance on the diversification between Government bonds, equities and cash. While this has not occurred during the first Quarter of 2018, over the longer term it is likely to show through.

5.11 Newton

	2018	2017				2016			One	Two	Since Start
Newton	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Year**	**Years**	**31/8/2012**
£64,625	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	(2.6)	**0.3**	**(0.8)**	**1.0**	**2.0**	(5.0)	1.5	4.3	(2.1)	0.4	2.8
Benchmark	1.1	**1.1**	**1.0**	**1.0**	**1.1**	1.0	1.1	1.1	4.2	4.3	4.5
Difference	(3.7)	(0.8)	(1.8)	0.0	0.9	(6.0)	0.4	3.2	(6.3)	(3.9)	(1.7)

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

The Fund delivered a negative return over the quarter of -2.6% and underperformed its benchmark by 3.7%. Over one year and two years the strategy has underperformed its benchmark by 6.3% and 3.9% respectively.

Outlook and Strategy

The Newton strategy comprises a return seeking core with a layer of stabilising assets and hedging positions. Both the return-seeking core and the stabilising assets detracted from performance, which was symptomatic of the market moves during the first 3 months of 2018. The greatest headwinds to performance during the period came from the equities, although this was counteracted partly by the hedging positions.

The managers have continued to position the portfolio with a defensive stance, given a cautious view where the manager believes that markets are not priced for macroeconomic, market and geopolitical risks.

Fund Activities

The cash position has been the main beneficiary of the quarter, increasing from 8.3% to 25.9%. This was primarily a function of the sell-down in the equities position, combined with taking profits from the equity hedges. The net result of this move was a net increase in the equity position from 31% at the end of 2017 to 37% at the end of March.

Newton also trimmed positions to the rest of the stabilising assets including Government Bonds and Gold. The Emerging Market Debt positions are the highest conviction in the portfolio, with Mexico and Indonesia, in particular, impressing the managers.

From a currency perspective, the managers also took risk off the table, increasing the Sterling weight from 80% to 85%. The overall effect of these changes reduced the portfolio’s risk. Newton holds the view that the February moves are symptomatic of what is to come in the future and are waiting for a better entry point.

5.12 BNY Standish

	2018	2017				2016			One	Two	Since Start
Standish	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Year**	**Years**	**20/8/2013**
£66,403	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	0.3	**(0.5)**	**0.7**	**1.0**	**2.0**	0.7	1.4	0.9	1.5	3.2	1.6
Benchmark	1.1	**1.1**	**1.0**	**1.0**	**1.2**	1.1	1.1	1.1	4.2	4.3	5.3
Difference	**(0.8)**	**(1.6)**	**(0.3)**	**0.0**	**0.8**	**(0.4)**	**0.3**	**(0.2)**	**(2.7)**	**(1.1)**	**(3.7)**

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

The Fund lagged its comparative index over the quarter, on a net basis, returning 0.3% against a benchmark return of 1.1%. Over one year the strategy has underperformed its benchmark of 4.2% by 2.7%.

Asset allocation was the main detractor this month. Underperformance was driven by weakness in collateralised mortgage obligations, as well as spread widening in US investment grade and high yield credit. In currency, the long position in the Swedish krona hurt performance. Duration/yield curve positioning contributed to returns as US rates rallied on the month. Currency boosted performance, specifically the Fund’s long positions in the Argentine peso and sterling and the short US dollar position.

Tracking error increased marginally to 246 basis points over the month, with currency and curve positioning remaining the largest allocation within the risk bucket. Government and emerging market spreads, as well as credit default risk, comprised most of the balance.

Outlook

There were no material changes to the global economic outlook, with financial conditions in the US and the UK remaining accommodative. All three economies are enjoying a relatively synchronous upswing in output. Similarly, robust growth in China underpins emerging market economies and commodity prices. Standish believe high-quality emerging market dollar debt looks fairly valued and some frontier markets are attractive for those willing to accept the associated elevated risk and illiquidity.

Standish look to maintain a short duration bias in core developed market sovereign securities but look for opportunities to trim positions as yields move closer to fair value. The overall risk budget remains lean, emphasising quality, and is protected against outsized events, so as to enjoy the flexibility to add selectively to risk when markets temporarily push financial prices too low.

5.13 Currency Hedging

No new currency hedging positions were placed in Q1 2018.

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: Claire Symonds, Chief Operating Officer

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 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 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 Q1 2018 Report; and
- Fund Manager Q1 2018 Reports.

List of appendices:

Appendix 1 - Fund Asset and Liability Values 31 March 2013 to 31 March 2018
Appendix 2 - Definitions
Appendix 3 - Roles and Responsibilities