PENSIONS COMMITTEE

13 March 2019

Title: Pension Fund Quarterly Monitoring 2018/19 – October to December 2018	
Report of the Chief Operating Officer	
Open 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 Director: Helen Seechurn, Interim Director of Finance	
Accountable Strategic Leadership Director: Claire Symonds, Chief Operating Officer	

Summary

This report provides information for employers, members of London Borough of Barking and Dagenham Pension Fund and other interested parties on how the Fund has performed during the quarter 1 October to 30 December 2018.

The report updates the Committee on the Fund's investment strategy and its investment performance.

Recommendation(s)

The Pension 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 October to 31 December 2018 ("Q4"). The report updates the Committee on the Fund's investment strategy and its investment 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. Appendix 4 is the Independent Advisors quarterly Market background report.

1.2 A verbal update on the unaudited performance of the Fund for the period 1 January to 11 March 2019 will be provided to Members at the Pension Committee.

2. Market Commentary Q4 2018

2.1 Volatility marked Q4 as a broad-based equity sell-off accelerated through to the end of December. Global equities fell over 11%, the worst quarterly return since 2011, as investors sought the safety of more defensive assets amid concerns around US interest rates, trade tensions and downgrades to economic growth forecasts. Emerging markets outperformed developed markets, returning -5.2% but still suffered losses. The UK Index returned -10.2%, reflecting deteriorating international trends and the challenges of Brexit. The energy sector underperformed as oil prices fell, while consumer discretionary stocks were weaker as consumers were reluctant to spend. Defensive stocks such as telecoms and consumer staples outperformed.

2.2 The Bank of England left rates unchanged and cut its growth forecast to 0.2% for Q4 and Q1 2019. Inflation slowed to 2.3% amid declining fuel prices. Brexit dominated the landscape in Europe and the Europe (ex UK) equity Index dropped 10.9% over the quarter. The European Central Bank also kept rates unchanged.

2.3 Having outperformed through 2018, the US stock market lagged in Q4 as the Fed's monetary policy came under scrutiny from the market. The Fed raised interest rates in December as expected and the equity market posted a negative return of -11.4%. The technology stocks that fuelled the market's prior outperformance were among the major decliners, alongside industrials and energy shares. Utilities and consumer staples benefited from investors seeking less economically sensitive earnings.

2.4 The Japanese stocks held up relatively well until it was swept up in the October global sell-off; the Q4 Index return was -12.7% (-17.6% in local currency terms). In the wider Asia-Pacific region returns were negative with the exceptions of India and Indonesia.

2.5 The defensive stance of investors was reflected in positive returns by developed government bonds. UK gilts recovered earlier year losses as heightened uncertainty around Brexit, international trade tensions, tumbling oil prices and economic growth downgrades stoked investor risk aversion. Investment grade credit spreads widened through Q4 as investors sought the safety of sovereigns.

2.6 The GBP Broad Market Index returned 1.4%, UK Gilts Index Linked over 5-year index returned 2.0% and overseas bonds returned 4.6%. Sterling was down 6% against the Japan's yen as the currency benefited from reduced investor risk appetite. The pound also lost 2.4% against the US Dollar and 0.8% against the Euro. Property had a positive quarter, returning 1.1%, bringing the one-year return to 7.5%.

3. Overall Fund Performance

3.1 The Fund's externally managed assets closed Q4 valued at £970.1m, a decrease of £66.3m from its value of £1,036.4m at 30 September 2018. The cash value held by the Council at 31 December 2018 was £19.0m giving a total Fund value of £989.1m.

3.2 For Q4 the Fund returned -6.3%, net of fees, underperforming its benchmark by 1.7%. Over one year the Fund returned -2.1%%, underperforming its benchmark by 3.2%. Over three years the Fund underperformed its benchmark by 0.4%, with a return of 8.2%. The Fund's returns are below:

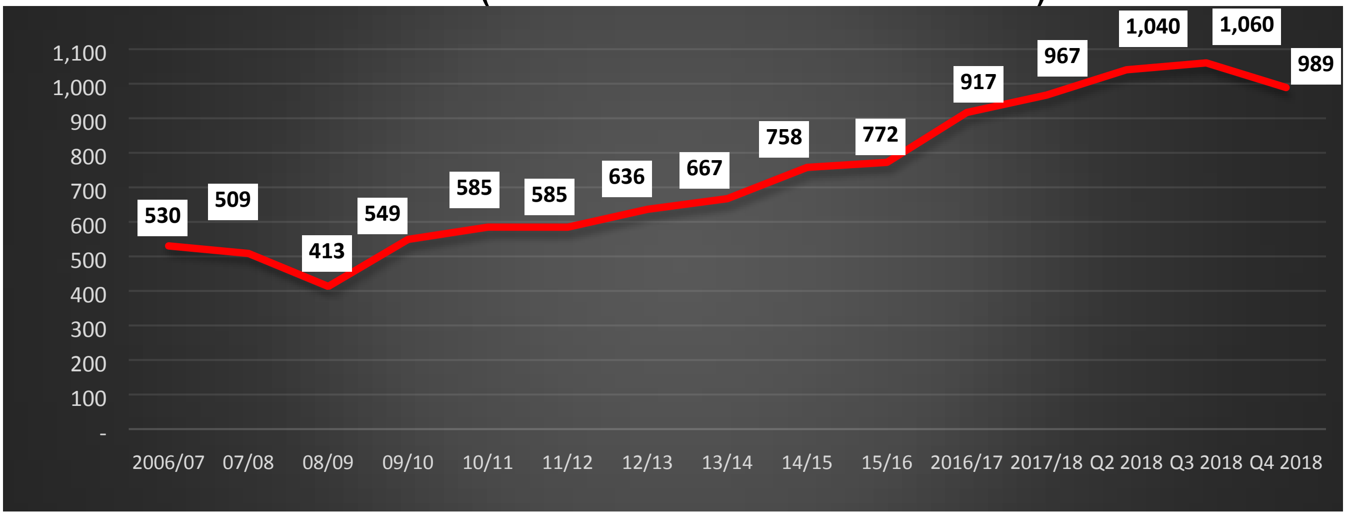
Table 1: Fund's 2018, 2017 Quarterly and Yearly Returns

Year	2018				2017				One Year	Two Years	Three Years	Five Years
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1				
Actual Return	(6.3)	2.3	3.8	(1.9)	3.2	2.2	1.8	3.8	(2.1)	4.5	8.2	7.5
Benchmark	(4.6)	3.3	3.7	(1.3)	3.1	1.8	1.2	3.3	1.1	5.3	8.6	8.1
Difference	(1.7)	(1.0)	0.1	(0.6)	0.1	0.4	0.6	0.5	(3.2)	(0.8)	(0.4)	(0.6)
*PIRC Universe		2.2	4.9	(3.6)	4.0	1.6	0.7		7.8		12.5	9.6

The returns for the latest period are based on the asset allocation of the PIRC Local Authority Universe. The Universe is currently comprised of 60 funds with a value of £162bn.

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 December 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 December 2018)



3.4 Stock selection contributed -0.4%, with asset allocation contributing -1.3% 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 3% against the benchmark
Δ	AMBER- Fund underperformed by less than 3% against the benchmark.
O	GREEN- Fund is achieving the benchmark return or better

3.5 Table 2 highlights the Q4 returns. Equities provided significant actual negative returns for the quarter, with UBS down 12.8% and Baillie Gifford down 12.5%. Kempen performed relatively well outperforming its benchmark by 4.0% but still provided a negative actual return of -7.3%. Newton and Pyrford provided some protection but significantly underperformed their benchmarks. Mellon Corporation (Standish) again provided a negative return for the quarter. Most other manager provided small, but positive returns.

Table 2 – Fund Manager Q4 2018 Performance

Fund Manager	Actual Returns (%)	Benchmark Returns (%)	Variance (%)	Ranking
Aberdeen Standard	(0.8)	1.1	(1.9)	Δ
Baillie Gifford	(12.5)	(10.6)	(1.9)	Δ
BlackRock	1.0	0.9	0.1	O
Hermes GPE	1.1	1.4	(0.3)	Δ
Kempen	(7.3)	(11.3)	4.0	O
Prudential / M&G	1.2	1.2	0.0	O
Newton	(1.7)	1.2	(2.9)	Δ
Pyrford	(2.0)	1.5	(3.5)	
Schroders	0.3	0.9	(0.6)	Δ
Mellon Corporation (Standish)	(2.7)	1.2	(3.9)	
UBS Bonds	1.9	1.9	0.0	O
UBS Equities	(12.8)	(12.9)	0.1	O

3.6 With two significant negative quarters over the past year, equities have provided negative returns of between -3.1% to -6.1%. Mellon Corporation (Standish) has provided a very disappointing return of -6.2%. The best returns for the quarter was from Aberdeen standard which provided a return of 5.1%, Hermes which provided a return of 5.6% and property with returns of 6.4% from BlackRock and 5.7% from Schroders. M&G Prudential and Hermes also provided good returns over the one year period.

Table 3 – Fund Manager Performance Over One Year

Fund Manager	Actual Returns (%)	Benchmark Returns (%)	Variance (%)	Ranking
Aberdeen Standard	5.1	4.6	0.5	O
Baillie Gifford	(3.1)	(2.3)	(0.8)	Δ
BlackRock	6.4	6.3	0.1	O
Hermes GPE	5.6	5.7	(0.1)	Δ
Kempen	(4.6)	(1.7)	(2.9)	Δ
Prudential / M&G	4.6	4.5	0.1	O
Newton	0.2	4.5	(4.4)	
Pyrford	(1.5)	7.5	(9.1)	
Schroders	5.7	6.3	(0.6)	Δ
Mellon Corporation (Standish)	(6.2)	4.6	(10.9)	
UBS Bonds	0.7	0.7	0.0	O
UBS Equities	(6.1)	(5.8)	(0.2)	Δ

3.7 Over two years, (table 4), most mandates are positive. Returns ranged from -1.5% with Mellon Corporation (Standish) to 9.1% with Baillie Gifford. Absolute return and credit continue to struggle, significantly underperforming their benchmarks.

Table 4 – Fund manager performance over two years

Fund Manager	Actual Returns (%)	Benchmark Returns (%)	Variance (%)	Ranking
Aberdeen Standard	8.7	4.5	4.2	O
Baillie Gifford	9.1	5.5	3.5	O
BlackRock	7.5	8.0	(0.5)	Δ
Hermes GPE	5.5	5.7	(0.2)	Δ
Kempen	3.7	4.8	(1.1)	Δ
Prudential / M&G	4.5	4.4	0.1	O
Newton	1.3	4.4	(3.0)	
Pyrford	0.0	8.2	(8.2)	
Schroders	8.6	8.0	0.5	O
Mellon Corporation (Standish)	(1.5)	4.5	(6.0)	
UBS Bonds	1.3	1.2	0.1	O
UBS Equities	5.1	5.1	0.0	O

4. Asset Allocations and Benchmark

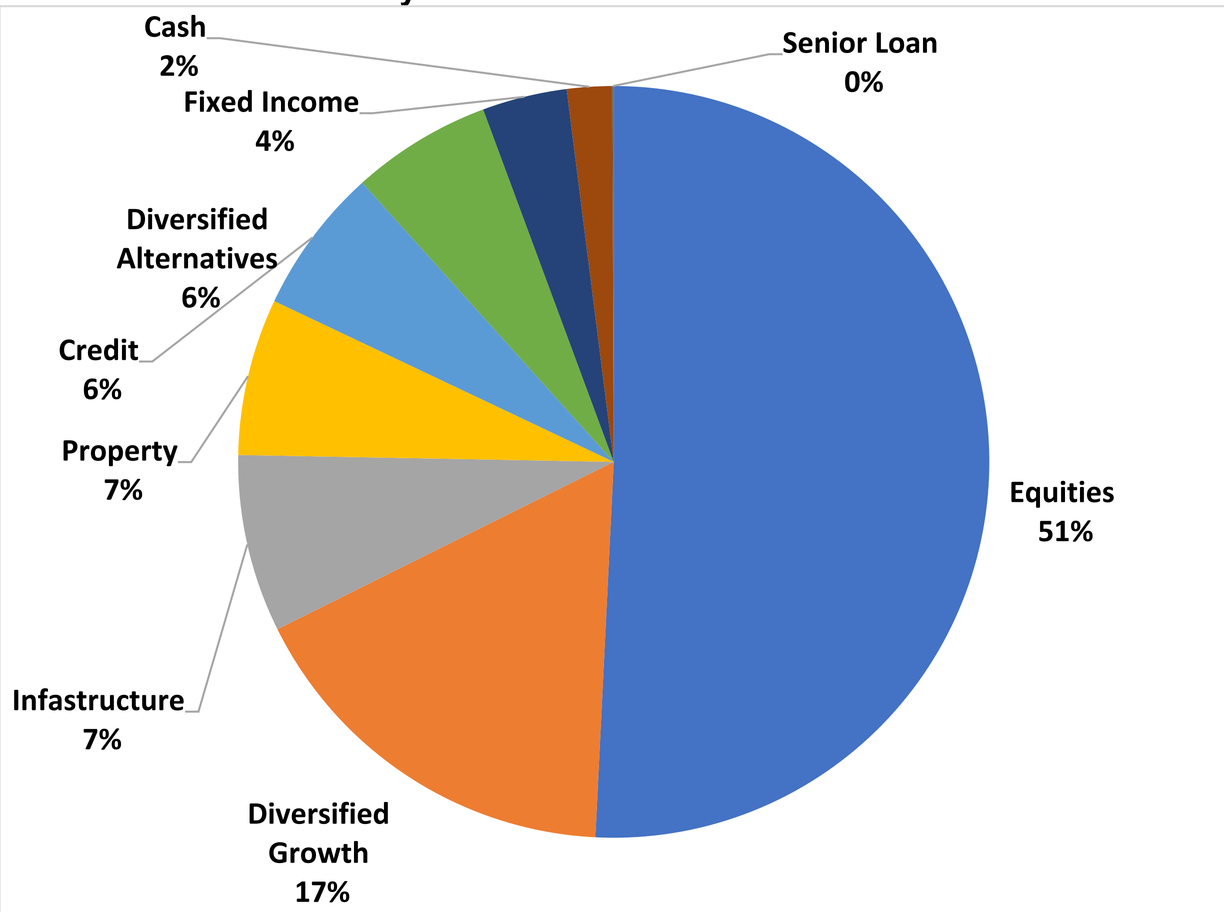
4.1 Table 5 below outlines the Fund's current actual asset allocation, asset value and benchmarks:

Table 5: Fund Asset Allocation and Benchmarks as at 30 September 2018

Fund Manager	Asset (%)	Market Values (£000)	Benchmark
Aberdeen Standard	6.0%	59,598	3 Mth LIBOR + 4% per annum
Baillie Gifford	18.2%	180,176	MSCI AC World Index
BlackRock	4.2%	41,438	AREF/ IPD All Balanced
Hermes GPE	7.6%	75,535	Target yield 5.9% per annum
Kempen	15.9%	157,137	MSCI World NDR Index
Prudential / M&G	0.1%	638	3 Mth LIBOR + 4% per annum
Newton	6.7%	66,442	One-month LIBOR +4% per annum
Pyrford	10.2%	100,476	UK RPI +5% per annum
Schroders	2.6%	25,262	AREF/ IPD All Balanced
Mellon Corporation	6.3%	62,178	3 Mth LIBOR + 4% per annum
UBS Bonds	3.7%	36,104	FTSE UK Gilts All Stocks
UBS Equities	16.7%	164,927	FTSE AW Developed Tracker (partly hedged)
LCIB	0.0%	150	None
Cash	1.9%	19,000	One-month LIBOR
Total Fund	100.0%	989,060	

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 December 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	50.8%	48%	2.8%	*45–53*
Diversified Growth	16.9%	16%	0.9%	*16-20*
Infrastructure	7.6%	9%	-1.4%	*4-11*
Credit	6.7%	8%	-1.3%	*6-10*
Property	6.3%	7%	-0.7%	*6-9*
Diversified Alternatives	6.0%	8%	-2.0%	*6-10*
Fixed Income	3.7%	4%	-0.3%	*3-5*
Cash	1.9%	0%	1.9%	*0-2*
Senior Loan	0.1%	0%	0.1%	*0-1*

5. Fund Manager Performance

5.1 Kempen

	2018				2017				One Year	Two Years	Since Start 6/2/2013
Kempen	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**			
£157.137m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**(7.3)**	2.9	7.2	(7.4)	5.5	3.3	0.1	3.2	(4.6)	3.8	8.8
Benchmark	**(11.3)**	6.3	8.0	(4.7)	4.6	1.5	0.1	5.1	(1.7)	4.8	11.0
Difference	**4.0**	(3.4)	(0.8)	(2.7)	0.9	1.8	0.0	(1.9)	(2.9)	(1.0)	(2.2)

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 4.0% for the quarter but has underperformed its one-year benchmark by 2.9%. Kempen has underperformed its two-year benchmark by 1.1%, providing an annual return of 3.8%. Kempen has underperformed its benchmark since inception by 2.2%, although the return over this period is a good annualised return of 8.8%

Q4 Portfolio Rebalancing

Kempen sold three names: Babcock International, Sun Life and Two Harbors.

Babcock International is encountering the risk of negative revisions of its contracts with the UK government. Two Harbors was sold as the increasingly flat yield curve is not good for the company, which was not yet reflected in the valuation. Sun Life was sold as there is an increased risk of its asset management division to show an eroding profitability.

Six stocks were added: BP, Valeo, easyJet, SKF, Fidelity National and Valero.

BP is an attractively valued major oil & gas company. Valeo’s and easyJet share price had been weak and offered an attractive entry point. Sybank (Danish bank) with an above average dividend yield while a lot of worries are priced into the share price. SKF, a Swedish industrial company that underlying is doing well, but its share price was under pressure. Fidelity National Financial is an US insurance company that provides title insurance. Valero is one of the biggest US refiners and the weak share price offered an attractive opportunity.

The more volatile financial markets of the last months, will give Kempen the opportunity to add companies where valuations have become more attractive.

The Fund now has a forward yield of around 5.6%.

5.2 Baillie Gifford

	2018				2017				One Year	Two Years	Since Start 6/2/13
Baillie Gifford	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**			
£180.176m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**(12.5)**	3.0	7.3	(0.9)	4.9	4.1	4.6	7.6	(3.1)	9.1	13.2
Benchmark	**(10.6)**	5.7	6.9	(4.3)	5.0	2.0	0.6	5.8	(2.3)	5.5	10.8
Difference	**(1.9)**	(2.7)	0.4	3.4	(0.1)	2.1	4.1	1.8	(0.8)	3.6	2.4

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

For Q4 BG returned -12.5%, underperforming its benchmark by 1.9%. BG's one-year return was -3.1%, outperforming its benchmark by 0.8%. Since initial funding the strategy has returned 13.2% p.a., outperforming its benchmark by 2.4%.

BG 's exposure to US, UK and Ireland were among the worst detractors to the portfolio during the quarter as disappointing earnings growth projections caused a mass selloff in the market The largest positive performance contribution included emerging markets such as India and Brazil.

Long duration stocks were particularly affected in the quarter. Both Grubhub And Amazon fall into these categories. In the case of Grubhub, the selloff had far more to do with sentiment then any change in the prospects for the company, as highlighted by the strong quarterly results reported during October.

Also detracting from performance was the portfolios holding in energy related companies including Apache and EOG, in line with the declining oil price.

Offsetting these to some extent, the portfolio's exposure to emerging market companies contributed positively to performance, particularly the portfolios holding in ICICI and Banco Bradesco. Shares in the latter soared by nearly 50% as they announced results which suggested that difficult economic environment which has persistent over the last few years maybe starting to ease. In the case of ICICI, the shares finished the year strongly rebounding from earlier weakness. Headlines about the tension between the central bank and the government obscure the facts of favourable demographics, (66% of India's population is below 35), the rising number of households and a low level of urbanisation, which, with mortgage is at only 10% of GDP, is likely to drive to long term story for ICICI.

5.3 UBS Equities

	2018				2017				One	Two	Since Start
UBS Equities	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Year**	**Years**	**31/8/2012**
£164.927m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**(12.8)**	5.3	4.4	(3.0)	5.7	2.8	2.3	5.5	(6.1)	5.1	12.6
Benchmark	**(12.9)**	5.7	4.4	(3.0)	5.5	2.8	2.2	5.5	(5.8)	5.1	12.6
Difference	**0.1**	(0.3)	0.0	0.0	0.2	0.0	0.1	0.0	(0.2)	0.0	0.0

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 -12.8% for Q4 and -6.1% over one year. Since funding in August 2012, the strategy has provided an annualised return of 12.6%.

Equities

There was no sign of the hoped for 'Santa rally' in equity markets as the year drew to a close. Instead, widespread losses in the fourth quarter meant that markets globally gave up gains from earlier in 2018 and generally finished in negative territory for the year. Uncertainty over the outlook for economic growth, central bank policy and politics more broadly continued to weigh on sentiment and affected demand for economically exposed assets across equity, fixed income and commodity markets. Meanwhile, assets within the fixed income universe considered to be 'safe havens' were in demand.

Equity markets worldwide saw sharp falls in both October and December as 2018 proved to be the worst year since the global financial crisis for many markets. Major developed bourses such as the US and Japan were amongst the biggest fallers for the quarter. Meanwhile, in contrast to the pattern earlier in the year, emerging markets performed relatively well, although Chinese stocks continued to lag.

Q3 2018 reporting provided another season of strong profit-growth for US companies, underpinned by a robust economy, corporate tax cuts and share buybacks. Nevertheless, even this proved to be a source of disquiet for investors as forward guidance from companies regarding mounting cost pressures and the tangible impact of trade tensions led some to fear we've reached the peak in the cycle for US corporate bottom lines. US stocks gave up the gains seen earlier in 2018, with technology stocks particularly affected.

Japanese stocks fared particularly badly over the quarter as fears over the outlook for global trade and economic growth weighed on the country's exporters. The gloomier outlook for the Chinese economy in particular had a detrimental impact. Similarly, the perception of a more negative growth environment hurt European equity markets, although the news of an agreement on the Italian budget provided a relative boost in December.

UK stocks were impacted as Brexit uncertainty increased and there was increased evidence of companies planning for a 'no deal' exit. However, the resulting falls in the value of sterling produced some element of consolation for more overseas focused stocks on the UK market.

After faring badly in October, emerging markets companies saw limited losses later in the quarter relative to their developed counterparts. The cloudier outlook for US interest rate rises and the prospect of further stimulus to boost the Chinese economy helped sentiment, as did the prospect of better relative economic growth as developed economies were seen to be slowing.

The less certain outlook for global growth also weighed on commodity markets. Oil prices continued to fall, despite news of a production cut from the OPEC group of countries. West Texas Intermediate, a key indicator, has seen a price fall of 40% from its most recent peak in October. Other commodities also suffered, while gold - often thought of as a haven in times of market turbulence - regained some of its losses from earlier in the year.

5.4 UBS Bonds

	2018				2017				One	Two	Since Start
UBS Bonds	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Year**	**Years**	**5/7/2013**
£36.104m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**1.9**	(1.7)	0.2	0.3	2.2	(0.5)	(1.3)	1.5	0.7	1.3	4.7
Benchmark	**1.9**	(1.7)	0.2	0.3	2.0	(0.5)	(1.3)	1.5	0.7	1.2	4.6
Difference	**0.0**	0.0	0.0	0.0	0.2	0.0	0.0	0.0	0.0	0.1	0.1

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.

Performance

The return for Q4 was 1.9%, with a one-year return of 0.7% and a two-year return of 1.3%.

It was an eventful quarter within bond markets to end the year. US Treasury yields moved well above 3% at the 10-year point earlier in the quarter, as further rate rises were seen as increasingly likely amidst a hawkish tone from the Fed. However, these moves were more than reversed later in the quarter, with government bond prices rising globally as safe haven assets were in demand. Italian bonds fared well on news of a budget deal with the EU.

The increased economic uncertainty meant rising spreads on most forms of credit assets over the quarter, leading to falls in price. After a strong third quarter, high yield assets were particularly affected. Investment grade credit was somewhat cushioned by the impact of lower government bond yields. Within emerging market debt, it was noticeable that local currency bond yields rallied later in the quarter, relative to their hard currency counterparts, as expectations for a less aggressive US monetary policy increased.

5.5 M&G / Prudential UK

	2018				2017				One	Two	Since Start
M&G / Prudential	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Year**	**Years**	**31/5/2010**
£0.638m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**1.2**	1.2	1.1	1.1	1.1	1.1	1.1	1.1	4.6	4.5	4.5
Benchmark Return	**1.2**	1.1	1.1	1.1	1.1	1.1	1.1	1.1	4.5	4.4	4.4
Difference	**0.0**	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1

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 loans until their maturity.

Performance and Loan Security

The strategy provided a return of 4.6% per year, with a small outperformance against benchmark of 0.1% since inception. The strategies holding has reduced in size to £638k, with most of the loans repaid. The weighted average credit rating is BB+ with an average life of 1.5 years.

5.6 Schroders Indirect Real Estate

	2018				2017				One	Two	Since Start
Schroder	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Year**	**Years**	**6/8/2010**
£25.262m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**0.3**	1.4	2.3	1.7	3.4	2.0	2.8	3.2	5.7	8.6	6.9
Benchmark	**0.9**	1.6	1.9	1.9	3.1	2.4	2.3	2.0	6.3	8.0	8.2
Difference	**(0.6)**	(0.2)	0.4	(0.2)	0.3	(0.4)	0.5	1.2	(0.6)	0.6	(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

The return for Q4 was 0.3%, with a one-year return of 5.7% and a two-year return of 8.6%.

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 15.5%.

5.7 BlackRock

	2018				2017				One	Two	Since Start
BlackRock	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Year**	**Years**	**1/1/2013**
£41.438m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**1.0**	1.9	2.0	1.5	2.9	1.3	2.0	2.5	6.4	7.5	7.4
Benchmark	**0.9**	1.6	1.9	1.9	3.1	2.4	2.3	2.0	6.3	8.0	8.7
Difference	**0.1**	0.3	0.1	(0.4)	(0.2)	(1.1)	(0.3)	0.5	0.1	(0.5)	(1.3)

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 2018 Performance

BR returned 1.0% for the quarter against the benchmark of 0.9%, with a return of 6.4% over one year against its benchmark's return of 6.3%.

Investment Update

During the fourth quarter, transactions have focused on acquisitions that may provide growth to current holdings and disposals where business plans have been completed.

The Fund completed the purchase of Forest Trading Estate, Walthamstow, London for £11 million. This terrace of three industrial units, is positioned adjacent to Uplands Business Park, which is owned by the Fund, and provides a further 1.3 acres of land fronting Walthamstow Reservoirs, which may form part of the wider future redevelopment strategy. The sale of the former dairy site on Station Road, Portsmouth was completed for £6.3m. The 6-acre site was purchased in October 2015 for £2.5m and sold following gaining planning consent for 108 residential units.

Vacancies with a total annual rental value of £2.4m were let during the quarter, including a lease for 80,000 sq. ft. at Heathrow Logistics Park to Pop Air Ltd at a rent of £1.2m p.a.. At The Atrium, Uxbridge, a management agreement was completed with Citibase to provide serviced offices, reusing a high quality fit out left by the previous tenant. Not only does this mitigate an existing void and minimise capital expenditure, but it provides flexibility to existing tenants and will attract new occupiers to the building. At The Lansdowne Building, Croydon, a large tenant occupy over 60% of the offices and have agreed to extend their occupation until 2025; this regear sees their rent increase by 25% to £1.7m p.a.

In Q4 the retail valuation declines continued as increased investment activity started to provide evidence and greater clarity of market pricing. This resulted in an acceleration of retail value declines and a catch up in the negative capital value movement of the benchmark's retail assets. At the end of the year BR's retail assets had fallen by 6.7% vs the benchmark's decline of 5.7% (Q4 was -3.9% decline vs the benchmark 3.3%)1. BR has benefitted from being underweight to retail (24.7% vs the benchmark's 27.7%) and avoided any exposure to the most challenged department store retailers such as House of Fraser and Debenhams. While the early outturn from Christmas trading suggests that the tough environment is persisting, there is a definite nuance which the mainstream media appears to fail to acknowledge.

5.8 Hermes

Hermes	2018				2017				One Year	Two Years	Since Start 9/11/2012
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1			
£75.535m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**1.1**	(2.2)	0.6	6.1	0.8	1.8	0.8	1.9	5.6	5.5	9.2
Benchmark	**1.4**	1.4	1.4	1.4	1.4	1.4	1.4	1.4	5.7	5.7	5.9
Difference	**(0.3)**	(3.6)	(0.8)	4.7	(0.6)	0.4	(0.6)	0.5	(0.1)	(0.2)	3.3

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 31 December 2018, the strategy reported a one-year return of 5.6%, underperforming its benchmark by 0.1%. Since inception the strategy has provided a good annualised return of 9.2%, outperforming its benchmark by 3.3%.

Portfolio review

Over Q4 the portfolio continued to perform well. Associated British Ports, Anglian Water, Cadent Gas, Energy Assets, Eurostar and the wind and solar assets all performed on or above budget and continued to trade positively post quarter end. Southern Water's performance was marginally below budget for the quarter, owing to overspend related to the extreme weather conditions experienced earlier in the year, higher than expected costs to prepare the 2019 business plan and unbudgeted expenses relating to negotiations with the Pensions Regulator. Scandlines performed 5% below budget year to date as a result of lower than budgeted traffic volumes (and associated retail spend) over the summer peak months owing to unseasonably hot weather in Scandinavia and the fall in Swedish Krona.

Investments and divestments

HIFI is a member of the Quad Gas consortium that is party to reciprocal option agreements with National Grid relating to a 14% stake (the "Further Acquisition") in Cadent Gas and the remaining 25% stake ("Remaining Acquisition"). On 8 November 2018 National Grid exercised the options in relation to the Further Acquisition and the Remaining Acquisition, thereby selling its entire remaining 39% stake in Cadent to the consortium. The scheduled closing dates are 27 June 2019 for the Further Acquisition and 28 June 2019 for the Remaining Acquisition. The transactions are expected to be funded in the week prior to closing.

Post-completion, HIFI will own a 3.7% interest in Cadent, equivalent to £204m on an investment cost basis. Hermes Infrastructure will manage a 13.6% ownership interest on behalf of clients on completion, with commensurate governance rights. The combined investment is targeting a post-tax nominal IRR within the HIFI Core strategy range. The Further Acquisition and Remaining Acquisition are expected to be accretive to HIF I's initial acquisition in Cadent.

5.9 Aberdeen Standard Asset Management

	2018				2017				One	Two	Since Start
Aberdeen Standard	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Year**	**Years**	**15/9/2014**
£59.598m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**(0.8)**	2.6	2.4	0.9	1.3	6.1	4.2	0.7	5.1	8.7	4.1
Benchmark	**1.1**	1.1	1.2	1.1	1.1	1.1	1.1	1.1	4.6	4.5	4.5
Difference	**(1.9)**	1.5	1.2	(0.2)	0.2	5.0	3.1	(0.4)	0.5	4.2	(0.4)

Reason for appointment

As part of the Fund's diversification from equities, Members agreed to tender for a Diversified Alternatives Mandate. Aberdeen Standard 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.

Performance

Overall the strategy provided a return of -0.8%, underperforming its benchmark by 1.9%. The Q4 underperformance was predominantly driven by a significant loss from Markel CATCo, a reinsurance manager the mandate is invested in. CATCo's negative return was based on projected losses from the California wildfires and to cover a number of events which took place earlier in the year (Hurricane Michael, Hurricane Florence, and Typhoon Jebi).

Over one year the mandate has outperformed its benchmark, with a return of 5.1% against a benchmark of 4.6%. Since inception in September 2014, the strategy has return 4.1%, underperforming its benchmark by 0.4%.

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.

Aberdeen 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.

5.10 Pyrford

	2018				2017						
Pyrford	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**One Year**	**Two Years**	**Since Start 28/9/2012**
£100.476m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**(2.0)**	0.8	2.0	(2.3)	0.6	(0.9)	0.1	1.7	(1.5)	0.0	3.1
Benchmark	**1.5**	2.3	2.4	1.3	2.2	2.2	2.3	2.1	7.5	8.2	6.9
Difference	**(3.5)**	(1.6)	(0.4)	(3.6)	(1.6)	(3.1)	(2.2)	(0.4)	(9.1)	(8.2)	(3.8)

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

Pyrford generated a negative return of -2.0% in Q4 and underperformed its benchmark by 3.5%. Over one year the strategy has returned -1.5%, underperforming its benchmark by 9.1%. Pyrford's performance since inception is closer to its benchmark but still underperforms by 3.8% with a return of 3.1%.

Outlook and Strategy

The Fund's asset allocation has remained defensive and unaltered since Q3 2016 and this was beneficial during the quarter. The 30% weighting to equity helped the mandate as equities fell significantly. Bonds, with a 67% allocation, and cash with a 3% allocation performed well.

Although the strategy benefited from a lower equity allocation, its stock selection did underperform. The effect of currency management was positive in Q4 as sterling rose. The strategy added US Dollar to the hedged currency list in December, which means that only 13% of the portfolio remains unhedged.

Overall Pyrford remains content with the defensive attribution of the equity holdings and sees capital preservation as key and, to that end, keeping duration low will provide this protection. Pyrford awaits the expected return of fair value with a policy that first seeks to avoid capital loss and then permits long term returns, given the right market access point.

5.11 Newton

	2018				2017				One	Two	Since Start
Newton	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Year**	**Years**	**31/8/2012**
£66.442m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**(1.7)**	2.1	2.4	(2.6)	0.3	(0.8)	1.0	2.0	0.2	1.3	2.8
Benchmark	**1.2**	1.1	1.1	1.1	1.1	1.0	1.0	1.1	4.5	4.4	4.5
Difference	**(2.9)**	0.9	1.3	(3.7)	(0.8)	(1.8)	0.0	0.9	(4.3)	(3.1)	(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

Newton generated a negative return of -1.7% in Q4 and underperformed its benchmark by 2.9%. Over one year the strategy has returned 0.2%, underperforming its benchmark by 4.3%. Newton's performance since inception is 2.8% and underperforms its benchmark by 1.7%.

The main change during Q4 was the reduction in the mandate's return seeking core and an increase in the stabilising and defensive holdings. Equity exposure was reduced in November on a pro-rata basis, just before the December decline but after the initial decline in October. The portfolio's exposure is summarised below:

Portfolio Exposures		
	30 September 2018	31 December 2018
Equity	**48.09**	**32.94**
UK	9.15	5.92
North America	14.00	9.67
Europe	16.93	12.62
Japan	0.77	0.69
Pacific Basin	3.28	1.56
Emerging Markets	3.96	2.48
Fixed Income	**30.11**	**42.03**
Government Bonds	19.47	31.68
Corporate Bonds	5.31	5.63
Index Linked Government	2.40	1.95
Emerging Debt	2.93	2.77
Alternatives	**21.80**	**25.03**
Infrastructure Funds	2.52	7.55
Renewable Energy	2.48	0.00
Precious Metals	3.21	6.53
Derivative Instruments	0.06	0.00
Cash and FX Forwards	13.53	10.95
Total	**100.00**	**100.00**

5.12 Mellon Corporation (Standish)

Mellon Corporation	**2018**				**2017**				**One Year**	**Two Years**	**Since Start 20/8/2013**
	Q4	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**			
£62.178m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**(2.7)**	0.1	(3.9)	0.3	(0.5)	0.7	1.0	2.0	(6.2)	(1.5)	0.0
Benchmark	**1.2**	1.1	1.2	1.1	1.1	1.0	1.0	1.2	4.6	4.5	5.2
Difference	**(3.9)**	(1.1)	(5.1)	(0.8)	(1.6)	(0.3)	0.0	0.8	(10.8)	(6.0)	(5.2)

<u>Reason for appointment</u>

Mellon Corporation 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%.

<u>Performance</u>

The Fund lagged its benchmark over the quarter, returning -2.7% against a benchmark return of 1.2%. Over one year the strategy has underperformed its benchmark of 4.6% by 10.8%, providing a return of -6.2%. Since funding in August 2013, Mellon Corporation has only provided an annual return of 0.0%.

Positive Contributors:

Currency positioning in the Argentine Peso, Japanese Yen, Indonesian Rupiah and the European Euro were the largest drivers of positive performance. Yield Curve Allocation in the US was beneficial to performance for the quarter.

Negative Contributors:

Asset Allocation was a detractor in the 4th quarter. An overweight position to inflation linked bonds in New Zealand, Canada, Europe, the US and Japan all detracted from performance. An overweight position in US investment grade and high yield corporate bonds was also a large detractor.

Foreign Currency positioning detracted from performance. A short position in the US Dollars, along with long positioning in Norwegian Kroner, Australian Dollar and British pound all contributed to under performance.

Portfolio Composition:

Tracking error was increased on a quarter-over-quarter basis and the composition of risk has been modified. The biggest increase in tracking error was through EM spread risk but was slightly offset by a decrease in curve risk. Other risks including yield curve, government spreads and securitised exposure remained flat. Corporate credit positioning remains biased to financials and industrials. Securitised positioning continues to favour Asset Backed Securities.

Strategy Review

Given the consistent underperformance of the strategy both against the benchmark and peer groups, at the September 2018 Pension Committee, Members agreed to formally review Mellon Corporation, with alternative managers through the London CIV considered.

An initial review has been completed by Aon Hewitt, the Fund's independent advisors and officers, with a report included in a separate report.

5.13 Currency Hedging

No new currency hedging positions were placed in Q4 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 Q4 2018 Report; and
- Fund Manager Q4 2018 Reports.

List of appendices:

Appendix 1 - Fund Asset and Liability Values 31 March 2013 to 31 December 2018

Appendix 2 – Definitions

Appendix 3 - Roles and Responsibilities

Appendix 4 – Independent Advisors Market Background Note, Q4 2018