PENSIONS COMMITTEE

12 June 2019

Title: Pension Fund Quarterly Monitoring 2019/20 – January to March 2019	
Report of the Chief Operating Officer	
Open Report	**For Information**
Wards Affected: None	**Key Decision:** No
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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 January to 31 March 2019.

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.

(iv) the independent advisors report on the market background for 2018-19

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 to 31 March 2019 (“Q1”). 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 April to 11 June 2019 will be provided to Members at the Pension Committee.

2. Market Commentary Q1 2019

2.1 Although economic growth downgrades were omnipresent during Q1, the related dovish shift from central banks and easing trade tensions allowed for gains across global stock markets. The World Equity Index achieved a total return of 10% in GBP terms as investors drove markets back up from the lows of Q4. Emerging Markets also had a strong quarter, returning 7.5% in Sterling. Commodities performed strongly helped by signs of stabilisation in China’s economy and easing trade tensions, industrial metals pushed higher. Meanwhile, oil exporters tightened production in response to excess supply, underpinning a 27% rise in Brent crude prices.

2.2 Despite the ongoing uncertainty posed by Brexit, the UK Equites participated in the global equity upswing to achieve a positive return of 9.4% in Q1. However, sterling gains dragged somewhat on companies with overseas revenues. The market was led higher by technology and materials sectors, with the latter benefiting from improving commodity prices. Healthcare and communications services performed poorly.

2.3 The Bank of England kept interest rates unchanged, with predictions on the next move being a cut or hike being dependant on the type of Brexit that unfolds.

2.4 Europe’s stock markets rallied despite worries about Brexit, slowing economic growth and a sharp drop in German manufacturing activity. The Europe ex UK Index returned 8.0% to a GBP investor. The ECB pushed out the prospect of a rate hike to 2020 and said it now expects the eurozone economy to grow by just 1.1% this year, down from a forecast of 1.7% in December. The US stock market also recovered from its worst quarter since 2011, posting a total return of 10.5%.

2.5 Japan’s Equities advanced 4.4%, aided by signs of progress on US-China trade talks. The Bank of Japan remained on hold as annual inflation consistently stayed below 1%. In the wider Asia-Pacific region the Equity market in aggregate returned 9%.

2.6 Fixed income returns were strongly positive as declining interest rates, flatter and inverted yield curves and increased fund flows into fixed income asset classes suggest a worrisome outlook for the global economy. Benchmark 10-year borrowing rates fell across developed markets. With the European Central Bank, indicating rate hikes will be delayed until at least 2020. UK 10-year gilt yields fell 28 basis points to 1.0% amid sustained uncertainty around Brexit. Over the quarter, the GBP Broad Bond Index returned 3.8%; the Index Linked over 5 year Index returned 6.3% and Overseas Bonds had a negative return of -0.8% to a GBP investor.

3. Overall Fund Performance

3.1 The Fund's externally managed assets closed Q1 valued at £1,033.3m, an increase of £63.2m from its value of £970.1m at 31 December 2018. The cash value held by the Council at 31 March 2019 was £8.6m giving a total Fund value of £1,041.7m. The £1,041.7m includes a prepayment of £20.0m from the Council and £200k of net accruals. The net asset value as at 31 March 2019, after adjusting for the prepayment and accruals was £1,021.9m.

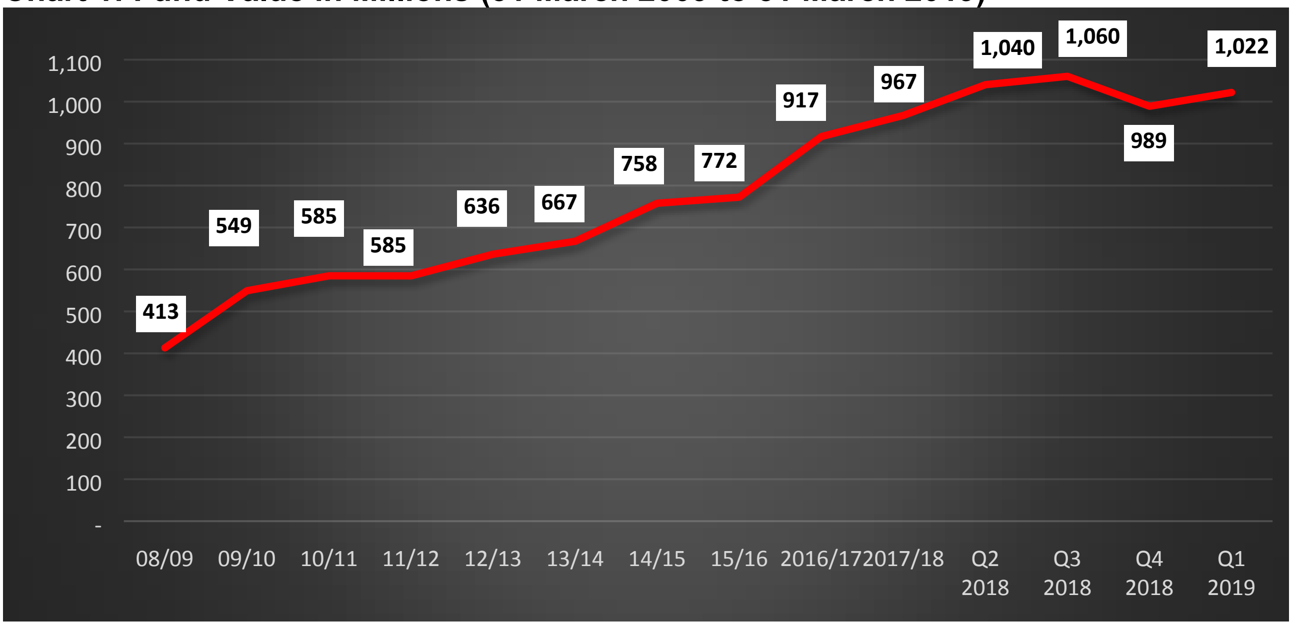
3.2 For Q1 the Fund returned 5.8%, net of fees, outperforming its benchmark by 0.2%. Over one year the Fund returned 5.6%, underperforming its benchmark by 2.4%. Over three years the Fund underperformed its benchmark by 0.5%, with a return of 9.4%. The Fund's returns are below:

Table 1: Fund's 2019, 2018, 2017 Quarterly and Yearly Returns

Year	2019	2018				2017			One	Two	Three	Five
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Year	Years	Years	Years
Actual Return	5.8	(6.3)	2.3	3.8	(1.9)	3.2	2.2	1.8	5.6	5.5	9.4	8.5
Benchmark	5.6	(4.6)	3.3	3.7	(1.3)	3.1	1.8	1.2	8.0	6.4	9.9	9.1
Difference	0.2	(1.7)	(1.0)	0.1	(0.6)	0.1	0.4	0.6	(2.4)	(0.9)	(0.5)	(0.6)

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 2019. 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 2019)



3.4 Stock selection contributed -0.3%, with asset allocation contributing 0.5% 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	**A**MBER- Fund underperformed by less than 3% against the benchmark.
O	**G**REEN- Fund is achieving the benchmark return or better

3.5 Table 2 highlights the Q1 2019 returns. Hermes GPE and Schroders provided actual negative returns for the quarter with Hermes GPE down by 1.5% and Schroders down by 1.1%. Kempen provided a positive return but significantly underperformed this quarter with a return of 5.5%, which was 4.4% below the benchmark. Mellon Corporation (Standish) on the other hand provided a positive return for the quarter and outperformed its benchmark. UBS Equities performed relatively well generating a positive return of 11.5%. Most other manager provided small, but positive returns.

Table 2 – Fund Manager Q1 2019 Performance

Fund Manager	Actual Returns (%)	Benchmark Returns (%)	Variance (%)	Ranking
Aberdeen Standard	0.6	1.2	(0.6)	Δ
Baillie Gifford	12.4	9.8	2.6	O
BlackRock	0.1	0.3	(0.2)	Δ
Hermes GPE	(1.5)	1.4	(2.9)	Δ
Kempen	5.5	9.9	(4.4)	
Prudential / M&G	1.0	1.2	(0.2)	Δ
Newton	4.2	1.2	3.0	O
Pyrford	2.7	1.1	1.6	O
Schroders	(1.1)	0.3	(1.4)	Δ
Mellon Corporation (Standish)	1.9	1.2	0.7	O
UBS Bonds	3.4	3.4	0.0	O
UBS Equities	11.5	11.5	0.0	O

3.6 Mellon Corporation (Standish) has provided a disappointing return of -4.6% over one year. Hermes GPE has also provided a disappointing return of -2% which is 7.6% below the benchmark. The best returns over the one-year period were from equities; Baillie Gifford provided a return of 10.2%, UBS Equities provided a return of 8.4% and Kempen with a return of 8.3%. Newton has also provided a good return over the one-year period of 7.0% against a benchmark of 4.6%.

Table 3 – Fund Manager Performance Over One Year

Fund Manager	Actual Returns (%)	Benchmark Returns (%)	Variance (%)	Ranking
Aberdeen Standard	4.8	4.6	0.2	O
Baillie Gifford	10.2	11.8	(1.6)	Δ
BlackRock	5.0	4.7	0.3	O
Hermes GPE	(2.0)	5.6	(7.6)	
Kempen	8.3	12.9	(4.6)	
Prudential / M&G	4.5	4.6	(0.1)	Δ
Newton	7.0	4.6	2.4	O
Pyrford	3.5	7.3	(3.8)	
Schroders	2.9	4.7	(1.8)	Δ
Mellon Corporation (Standish)	(4.6)	4.7	(9.3)	
UBS Bonds	3.8	3.8	0.0	O
UBS Equities	8.4	8.7	(0.3)	Δ

3.7 Over two years, (table 4), most mandates are positive. Returns ranged from -1.5% with Mellon Corporation (Standish) to 11.4% 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	8.6	4.5	4.1	O
Baillie Gifford	11.4	7.5	3.9	O
BlackRock	6.4	7.2	(0.8)	Δ
Hermes GPE	3.8	5.6	(1.9)	Δ
Kempen	4.9	7.2	(2.3)	Δ
Prudential / M&G	4.4	4.5	(0.1)	Δ
Newton	2.5	4.4	(1.9)	Δ
Pyrford	0.5	7.6	(7.1)	
Schroders	6.4	7.2	(0.8)	Δ
Mellon Corporation (Standish)	(1.5)	4.5	(6.0)	
UBS Bonds	2.2	2.1	0.1	O
UBS Equities	8.1	8.1	(0.0)	O

4. Asset Allocations and Benchmark

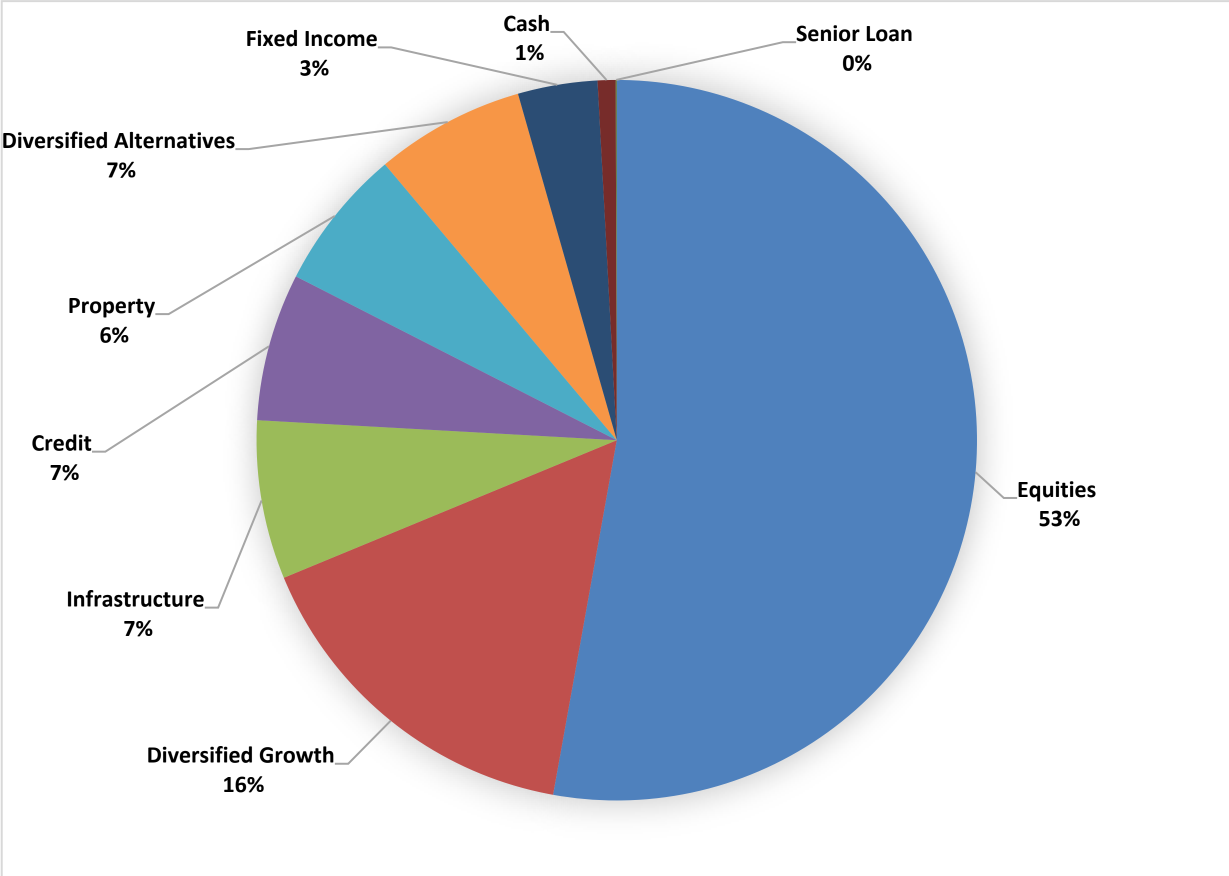
4.1 Table 5 below outlines the Fund's current actual asset allocation, asset value and benchmarks:

Table 5: Fund Asset Allocation and Benchmarks as at 31 March 2019

Fund Manager	Asset (%)	Market Values (£000)	Benchmark
Aberdeen Standard	6.7%	68,555	3 Mth LIBOR + 4% per annum
Baillie Gifford	19.4%	202,492	MSCI AC World Index
BlackRock	4.0%	39,651	AREF/ IPD All Balanced
Hermes GPE	7.1%	74,419	Target yield 5.9% per annum
Kempen	15.9%	165,846	MSCI World NDR Index
Prudential / M&G	0.0%	498	3 Mth LIBOR + 4% per annum
Newton	6.6%	69,267	One-month LIBOR +4% per annum
Pyrford	9.9%	103,188	UK RPI +5% per annum
Schroders	2.4%	24,162	AREF/ IPD All Balanced
Mellon Corporation	6.1%	63,364	3 Mth LIBOR + 4% per annum
UBS Bonds	3.6%	37,324	FTSE UK Gilts All Stocks
UBS Equities	17.6%	183,816	FTSE AW Developed Tracker (partly hedged)
LCIV	0.0%	150	None
Cash	0.8%	8,621	One-month LIBOR
Total Fund	**100.0%**	**1,041,353**	

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 2019



4.2 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 1.9% 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	52.8%	48%	4.8%	*45–53*
Diversified Growth	15.9%	16%	-0.1%	*16-20*
Infrastructure	7.1%	9%	-1.9%	*4-11*
Credit	6.6%	8%	-1.4%	*6-10*
Property	6.4%	7%	-0.6%	*6-9*
Diversified Alternatives	6.7%	8%	-1.3%	*6-10*
Fixed Income	3.6%	4%	-0.4%	*3-5*
Cash	0.8%	0%	0.8%	*0-2*
Senior Loan	0.0%	0%	0.0%	*0-1*

5. Fund Manager Performance

5.1 Kempen

Kempen	2019	2018				2017			One Year	Two Years	Since Start 6/2/13
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2			
£165.8m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**5.5**	(7.3)	2.9	7.2	(7.4)	5.5	3.3	0.1	8.3	4.9	9.4
Benchmark	**9.9**	(11.3)	6.3	8.0	(4.7)	4.6	1.5	0.1	12.9	7.2	12.2
Difference	**(4.4)**	4.0	(3.4)	(0.8)	(2.7)	0.9	1.8	0.0	(4.6)	(2.3)	(2.8)

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 underperformed its benchmark by 4.4% for the quarter and has underperformed its one-year benchmark by 4.6%. Kempen has underperformed its two-year benchmark by 2.3%, providing an annual return of 4.9%. It has also underperformed its benchmark since inception by 2.8%, although the return over this period is a good annualised return of 9.4%.

Q4 Portfolio Rebalancing

Kempen sold five names: Boskalis, Bezeq, Centrica, Nordea Bank and Green King.

Boskalis was sold after it lowered its dividend and the 2019 outlook was disappointing. Bezeq also announced a dividend cut related to Israelian legislation that subscribes companies to cut dividend following a loss over the last 8 quarters. Centrica was sold after it disappointed again with falling customer numbers and an increased risk for future dividends. Nordea Bank was sold after better alternatives were sought in new investment ideas. Green King was sold after the strong share price performance.

Four stocks were added: Schlumberger, Keycorp, Seaspan Corp and Venture Corp.

Schlumberger is a US oil-services company; a market leader in many areas with an attractive valuation. Keycorp is a well-managed US bank. Seaspan Corp operates a fleet of containerships and is attractively values. Lastly, Venture Corp is a Singapore based company which manufactures and designs electronic products for man well-known companies ranging from the healthcare to consumer goods sector.

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 5.2%.

5.2 Baillie Gifford

Baillie Gifford	2019	2018				2017			One Year	Two Years	Since Start 6/2/13
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2			
£202.5m	**%**	%	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**12.4**	(12.5)	3.0	7.3	(0.9)	4.9	4.1	4.6	10.2	11.4	14.8
Benchmark	**9.8**	(10.6)	5.7	6.9	(4.3)	5.0	2.0	0.6	11.8	7.5	12.1
Difference	**2.6**	(1.9)	(2.7)	0.4	3.4	(0.1)	2.1	4.1	(1.6)	3.9	2.7

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 12.4%, outperforming its benchmark by 2.6%. BG's one-year return was 10.2%, underperforming its benchmark by 1.6%. Since initial funding the strategy has returned 14.8% p.a., outperforming its benchmark by 2.7%.

Positive signs from the trade talks between the US and China boosted fund returns. In Q1 the fund rebalanced its best performing positions in Amazon and Banco Bradesco in order to introduce new additions to the portfolio. Amazon remains one of the largest holdings within the funds portfolio and continues to perform strongly with solid growth potential. in case of Banco Bradesco, the bank contributed 0.3% to yearly performance and has been delivering promising growth results despite political challenges affecting the current state of the Brazilian economy.

Several long-term positions have been sold this quarter. These include Rohm, a Japanese semiconductor company and Svenska Handelsbanken, Swedish banking company. As a result of questionable lending practices and the bank's management turnover, the position in Svenska Handelsbanken was sold this quarter. In the case of Rohm, the sale was completed due to the loss of competitive advantage against other peers in Asia as well as a downturn in the traditionally cyclical semiconductor industry which limits future growth opportunities.

The new purchases to the fund's portfolio include Reliance Industries a giant Indian based refining and marketing conglomerate that manufacturers petrochemical, synthetic fibres, fibre intermediaries, textiles, blended yarn and polyester staple fibre. The manager believes that this addition along with telecommunications companies generally will continue to develop revenue generating opportunities in the future The fund increased the portfolio's exposure to Alibaba by 1.2% to 3.2% as a result of a positive partnership structure and future growth potential. The manager believes that the company remains a major player in the economic environment and is building its brand focusing on long term governance.

5.3 UBS Equities

UBS Equities	2019	2018				2017			One Year	Two Years	Since Start 31/08/12
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2			
£183.8m	%	%	%	%	%	%	%	%	%	%	%
Actual Return	**11.5**	(12.8)	5.3	4.4	(3.0)	5.7	2.8	2.3	8.4	8.1	13.9
Benchmark	**11.5**	(12.9)	5.7	4.4	(3.0)	5.5	2.8	2.2	8.7	8.1	14.0
Difference	0.0	0.1	(0.3)	0.0	0.0	0.2	0.0	0.1	(0.3)	0.0	(0.1)

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 11.5% for Q1 and 8.4% over one year. Since funding in August 2012, the strategy has provided an annualised return of 13.9%.

Equities

Equity markets enjoyed a strong quarter with rises across much of the globe as anticipated market volatility fell back to levels seen prior to the turbulence of late last year. Sentiment was boosted by dovish signals from key central banks.

Merger and acquisition activity remained strong, with the proposed tie up between German banking giants Deutsche Bank and Commerzbank being just one example and US ride-hailing company Lyft also came to market in the biggest IPO since 2017. Corporate earnings reported in the US broadly remained ahead of expectations, although they were more mixed in other markets such as the Eurozone and Japan.

US equities were amongst the best regional performers over the three months. Corporate earnings tended to be strong, with tech firms such as Facebook and Apple amongst those reporting good results - although a number of firms warned on a less certain future outlook.

European stocks shared in the good returns over the quarter, despite more gloomy news on economic developments in the Eurozone in particular. While the UK lagged on a relative basis earlier in the quarter as uncertainty over Brexit continued, the perceived increased likelihood of a negotiated agreement saw both stocks and sterling advance later in the quarter.

Japanese stocks also advanced, but fared less well than other key markets during the three months. Sentiment towards emerging markets was positive as the year began and despite a positive return over the three months, concern over the outlook for economic growth tended to limit gains relative to developed markets.

Chinese equities in particular enjoyed a strong quarter, as prospects for reduced trade tensions were seen to increase and the government promised further stimulus. There was further positive news for Chinese stocks in late February, as equity index provider MSCI announced it would quadruple the weighting of onshore Chinese companies in its flagship emerging markets index by November this year.

The more positive market tone also boosted commodities, with oil prices rising sharply from lows seen in the fourth quarter, even if they remained well below the levels seen in 2018.

5.4 UBS Bonds

UBS Bonds	2019	2018			2017				One Year	Two Years	Since Start 5/7/2013
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2			
£37.3m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**3.4**	1.9	(1.7)	0.2	0.3	2.2	(0.5)	(1.3)	3.8	2.2	5.1
Benchmark	**3.4**	1.9	(1.7)	0.2	0.3	2.0	(0.5)	(1.3)	3.8	2.1	5.1
Difference	**0.0**	0.0	0.0	0.0	0.0	0.2	0.0	0.0	0.0	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 (4%) of UK fixed income government bonds.

Performance

The return for Q1 was 3.4%, with a one-year return of 3.8% and a two-year return of 2.2%.

Bond markets also had a positive quarter, as changes in central bank policy meant the likelihood of imminent interest rate rises was judged to fall across a number of major markets. Yields on 10-year German bonds turned negative for the first time since 2016. Meanwhile, the annual yield on similar US bonds fell below 2.4%, having been above 3.0% as recently as late November.

It was also a strong quarter for returns on credit, as both interest rate expectations fell and spreads contracted. In an environment where investors were happy to take on risk, areas such as high yield tended to fare particularly well. Emerging market bonds in local currency also saw good returns over the first three months.

5.5 M&G / Prudential UK

M&G / Prudential	2019	2018				2017			One Year	Two Years	Since Start 31/5/2010
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2			
£0.5m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**1.0**	1.2	1.2	1.1	1.1	1.1	1.1	1.1	4.5	4.4	4.7
Benchmark	**1.2**	1.2	1.1	1.1	1.1	1.1	1.1	1.1	4.6	4.5	2.7
Difference	**(0.3)**	0.0	0.1	0.0	0.0	0.0	0.0	0.0	(0.2)	(0.1)	1.9

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 4.5% per year, with an outperformance against benchmark of 1.9% since inception. The strategies holding has reduced in size to £498k, with most of the loans repaid. The weighted average credit rating is BB+ with an average life of 1.3 years.

5.6 Schroders Indirect Real Estate

Schroders	2019	2018				2017			One Year	Two Years	Since Start 6/8/2010
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2			
£24.2m	%	%	%	%	%	%	%	%	%	%	%
Actual Return	**(1.1)**	0.3	1.4	2.3	1.7	3.4	2.0	2.8	2.9	6.4	6.6
Benchmark	**0.3**	0.9	1.6	1.9	1.9	3.1	2.4	2.3	4.7	7.2	7.9
Difference	**(1.4)**	(0.6)	(0.2)	0.4	(0.2)	0.3	(0.4)	0.5	(1.7)	(0.8)	(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 fund generated a negative return in Q1 of 1.1% with a one-year return of 2.9% and a two-year return of 6.4%.

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 15.4%.

5.7 BlackRock

BlackRock	2019	2018				2017			One Year	Two Years	Since Start 1/1/2013
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2			
£39.7m	%	%	%	%	%	%	%	%	%	%	%
Actual Return	**0.1**	1.0	1.9	2.0	1.5	2.9	1.3	2.0	5.0	6.4	0.7
Benchmark	**0.3**	0.9	1.6	1.9	1.9	3.1	2.4	2.3	4.7	7.2	4.1
Difference	**(0.2)**	0.1	0.3	0.1	(0.4)	(0.2)	(1.1)	(0.3)	0.3	(0.8)	(3.5)

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.

Q1 2019 Performance

BR returned 0.1% for the quarter against the benchmark of 0.3%, with a return of 5.0% over one year against its benchmark's return of 4.7%.

Investment Update

During the first quarter there were no acquisitions and only one small disposition of a parcel of land to a housebuilder at Burcote Road, Towcester for £3.2m. This reflected the fact that the Fund's portfolio is well positioned (overweight Industrials and Alternatives / underweight Retail and Central London Offices) and also the uncertainty created by the political developments around Brexit means that we believe it is better to focus on driving value creation through asset management. This is a challenging environment in which to invest and we will only do so if the opportunity is compelling.

Vacant properties with a total rental value of c. £1.6 million p.a. were let during the quarter. The Fund's void rate decreased from 6.5% to 5.6%; this compares favorably with the benchmark's vacancy rate of 7.1%, as of Q4 2018. Leasing activity was strongest in the rest of UK office sector; however, as explained further in this report, significant lettings were seen across all sectors and geographies.

Given the economic uncertainty created by Brexit and slowing global growth it is unsurprising that UK real estate investment volumes have slowed in Q1 compared with the same time last year. Uncertainty continues to play a role in the weak performance of retailers and retail assets. The consumer environment has not been supportive, with low real wage growth and stagnating wages. However, falling inflation and continued loose fiscal policy could see real wage increases leading to increased retail spending. Nevertheless, retail is still suffering from oversupply of space, compounded by increasing retail sales moving online (to the benefit of logistics demand). Even in the face of this challenging retail environment, occupancy has remained strong with the Fund's retail portfolio being 97% occupied (vs the benchmark at 95%).

5.8 Hermes

Hermes	**2019**	**2018**				**2017**			**One**	**Two**	**Since Start**
	Q1	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Year**	**Years**	**9/11/2012**
£74.4m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**(1.5)**	1.1	(2.2)	0.6	6.1	0.8	1.8	0.8	(2.0)	3.8	8.6
Benchmark	**1.4**	1.4	1.4	1.4	1.4	1.4	1.4	1.4	5.6	5.6	6.0
Difference	**(2.9)**	(0.3)	(3.6)	(0.8)	4.7	(0.6)	0.4	(0.6)	(7.6)	(1.9)	2.6

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 March 2019, the strategy reported a one-year negative return of 2.0%, underperforming its benchmark by 7.6%. Since inception the strategy has provided a good annualised return of 8.6%, outperforming its benchmark by 2.6%.

Portfolio review

Over Q1 the portfolio did not perform as well as the previous quarter. Scandlines performed 5% below budget year to date in Q4 18 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. 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. 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.

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

Aberdeen Standard	2019	2018				2017			One Year	Two Years	Since Start 15/9/2014
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2			
£68.5m	%	%	%	%	%	%	%	%	%	%	%
Actual Return	**0.6**	(0.8)	2.6	2.4	0.9	1.3	6.1	4.2	4.8	8.6	4.0
Benchmark	**1.2**	1.1	1.1	1.2	1.1	1.1	1.1	1.1	4.6	4.5	4.6
Difference	**(0.6)**	(1.9)	1.5	1.2	(0.2)	0.2	5.0	3.1	0.2	4.1	(0.5)

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 0.6%, underperforming its benchmark by 0.6%. The primary commitment to MML VI led the way in terms of the positive contributors to performance. Field Street also did well; Q1 has often proven to be a good period for relative value managers in fixed income as managers tend to deploy capital in the first days of January when banks are willing to expand their balance sheets again and then ride the normalisation in micro relationships in the subsequent months.

Over one year the mandate has outperformed its benchmark, with a return of 4.8% against a benchmark of 4.6%. Since inception in September 2014, the strategy has returned 4.0%, underperforming its benchmark by 0.5%.

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

Pyrford	2019	2018				2017			One Year	Two Years	Since Start 28/9/2012
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2			
£103.2m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**2.7**	(2.0)	0.8	2.0	(2.3)	0.6	(0.9)	0.1	3.5	0.5	3.5
Benchmark	**1.1**	1.5	2.3	2.4	1.3	2.2	2.2	2.3	7.3	7.6	6.9
Difference	**1.6**	(3.5)	(1.6)	(0.4)	(3.6)	(1.6)	(3.1)	(2.2)	(3.8)	(7.1)	(3.4)

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 positive return of 2.7% in Q1 and outperformed its benchmark by 1.6%. Over one year the strategy has returned 3.5%, underperforming its benchmark by 3.8%. Pyrford's performance since inception is closer to its benchmark but still underperforms by 3.4% with a return of 3.5%.

Outlook and Strategy

Performance lagged other multi-asset funds during this quarter; however, the manager has stayed true to its mantra of providing a stable stream of real total returns over the long term with low absolute volatility. With this view in mind, the manager has not made any asset allocation changes in the quarter and maintains its defensive position of 30% equities, 67% bonds and 3% cash.

Performance on the bond portfolio was marginally positive over the first quarter. UK bonds in the portfolio were up 0.31% whereas overseas bonds fell slightly due to the sterling strength over the period. The entire overseas bond portfolio is hedged and therefore the fund was protected against this loss. Equities on the other hand outperformed bonds where UK and Overseas equities bought in 10.88% and 7.36% respectively. The managers holdings in UK equities outperformed the wider FTSE AS index by 1.5%, primarily driven by the allocation to tobacco and utilities.

5.11 Newton

Newton	2019	2018				2017			One Year	Two Years	Since Start 31/8/2012
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2			
£69.267m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**4.2**	(1.7)	2.1	2.4	(2.6)	0.3	(0.8)	1.0	7.0	2.5	3.3
Benchmark	**1.2**	1.2	1.1	1.1	1.1	1.1	1.0	1.0	4.6	4.4	4.5
Difference	**3.0**	(2.9)	0.9	1.3	(3.7)	(0.8)	(1.8)	0.0	2.4	(1.9)	(1.2)

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 positive return of 4.2% in Q1 and outperformed its benchmark by 3.0%. Over one year the strategy has returned 7.0%, outperforming its benchmark by 2.4%. Newton's performance since inception is 3.3% and underperforms its benchmark by 1.2%.

Most of the positive performance was driven by the managers allocation of their return seeking part of the portfolio whereas the defensive stabilising core detracted slightly. The equities portion of the return seeking core was the strongest performer, making up over 80% of the contribution to performance. The portfolios exposure is summarised below:

Portfolio Exposures		
	31 December 2018	31 March 2019
Equity	**32.94**	**54.68**
UK	5.92	8.94
North America	9.67	12.89
Europe	12.62	22.87
Japan	0.69	1.25
Pacific Basin	1.56	8.73
Emerging Markets	2.48	0.00
Fixed Income	**42.03**	**52.39**
Government Bonds	31.68	39.71
Corporate Bonds	5.63	3.12
Index Linked Government	1.95	2.70
Emerging Debt	2.77	6.86
Alternatives	**25.03**	**(7.07)**
Infrastructure Funds	7.55	14.76
Renewable Energy	0.00	0.00
Precious Metals	6.53	9.98
Derivative Instruments	0.00	(12.06)
Cash and FX Forwards	10.95	(19.75)
Total	**100.00**	**100.00**

5.12 Mellon Corporation (Standish)

Mellon Corporation	2019	2018				2017			One Year	Two Years	Since Start 20/8/2013
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2			
£63.364m	%	%	%	%	%	%	%	%	%	%	%
Actual	1.9	(2.7)	0.1	(3.9)	0.3	(0.5)	0.7	1.0	(4.6)	(1.5)	0.3
Benchmark	1.2	1.2	1.1	1.2	1.1	1.1	1.0	1.0	4.7	4.5	5.2
Difference	0.7	(3.9)	(1.1)	(5.1)	(0.8)	(1.6)	(0.3)	0.0	(9.3)	(6.0)	(4.9)

Reason for appointment

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%.

Performance

The Fund performed well this quarter, returning 1.9% against a benchmark return of 1.2%. However, over one year the strategy has underperformed its benchmark of 4.7% by 9.3%, providing a return of -4.6%. Since funding in August 2013, Mellon Corporation has only provided an annual return of 0.3%.

Positive Contributors:

Asset allocation was the main driver of positive performance. Specifically, the overweight allocation to emerging markets debt, industrial and financial corporates and securitized.

Yield Curve Allocation was also a positive contributor, led by the positioning in Argentina.

Negative Contributors:

Currency positioning, as well as local market and asset allocation, contributed to the negative performance on the month. Yield curve positioning was accretive. The position in treasury bonds was also a detractor as the asset class underperformed the broader opportunity set.

Portfolio Composition:

Tracking error was decreased on a quarter-over-quarter basis and the composition of risk has been modified. The biggest decrease in tracking error was through EM spread risk followed by a reduction in credit spread risk. Foreign exchange is now the largest contributor to tracking error for this strategy. Other risks including yield curve, government spreads and securitized exposure remained relatively flat.

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 Q1 2019.

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.

Public Background Papers Used in the Preparation of the Report: None

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