PENSIONS COMMITTEE

11 March 2020

Title: Pension Fund Quarterly Monitoring 2019/20 – October to December 2019	
Report of the Chief Operating Officer	
Open Report	**For Information**
Wards Affected: None	**Key Decision:** No
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Accountable Director: Philip Gregory, 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 31 December 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

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

(iv) that the transition to CQS has been put on hold until clarification is obtained from LCIV.

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 2019 ("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.

1.2 A verbal update on the unaudited performance of the Fund for the period 1 January to 10 March 2020 will be provided to Members at the Pension Committee.

2. Independent Advisors Market Background Q4 2019

2.1 The period October to December 2019 was positive for world equity market as a whole. Not only did the MSCI World Index gain over 8% (in $ terms) but both the major developed and other markets experienced a clearly positive quarter. A crucial factor was renewed optimism regarding US-China trade relations progressively developing over the Quarter. The US S&P 500 index gained 9%, while the MSCI EMU Index (which tracks the largest companies in the Eurozone) was up 5% (in Euro terms), the FTSE All Share gained 4% (in £ terms) and the Japanese Nikkei 225 gained approaching 9%. In contrast to the July to September Quarter this Quarter saw significant gains for the MSCI AC Asia (exc Japan) Index and the MSCI Emerging Markets Index which both saw gains (in $ terms) of over 11%. In contrast, the major Government Bond yields rose (and prices consequently fell).

2.2 The S&P 500 advanced from 2,977 at the end of September to close at 3,231 on 31 December 2019. At the end of its 29-30 October 2019 meeting the Federal Open Markets Committee (FOMC) again lowered the federal funds rate (its main interest rate) by 0.25% to 1.5 to 1.75%. At the press conference following the October meeting Chair Jay Powell stated "Today we decided to lower the interest rate for the third time this year, weakness in global growth and trade developments have weighed on the economy and pose ongoing risks. These factors, in conjunction with muted inflation pressures, have led us to lower our assessment of the appropriate level of the federal funds rate. In both July and September, we reduced the target rate for the federal funds rate by ¼%, and we did so again today…" Chair Powell however then went on to indicate that this would likely be the last rate change in this cycle although he did state (as he had at the September press conference) that "Policy is not on a preset course." At the meeting of the FOMC which concluded on 11 December 2019 the committee unanimously voted to retain the federal funds rate at its existing level.

2.3 Trade tensions between the US and China clearly eased during the Quarter. On 11 October President Trump announced a preliminary Phase 1 deal including suspension of threatened tariffs. On 12-13 December both sides announced significant progress on Phase 1 including that new tariffs set to start on 15 December would be indefinitely postponed. The US consumer appeared confident but business less so. Chair Jay Powell at his December Press Conference summarised the US economy as follows – "Household spending has been strong, supported by a healthy job market, rising incomes, and solid consumer confidence. In contrast, business investment and exports remain weak, and manufacturing output has declined over the past year. As has been the case for some time, sluggish growth abroad and trade developments have been weighing on those sectors. Even so, the overall economy has been growing moderately."

2.4 Inflation continued its long trend of running clearly below the Federal Reserve's 2% target. US inflation as measured by the Personal Consumption Expenditures (PCE) Index (the US Federal Reserve's preferred inflation measure) was 1.4% in both October and November, and 1.6% in December. Core PCE which excludes food and energy was 1.6% in October, 1.5% in November and 1.6% in December. US unemployment which had reached another fifty year low in September 2019 of 3.5% remained at the same level at December 2019. The University of Michigan Surveys of Consumers indicated very positive consumer confidence with a clear increase since September and levels above those at the end of June 2019.

2.5 Eurozone equities had a positive Quarter with the MSCI EMU index advancing 5%. This was doubtlessly aided by the positive developments in US-China trade relations as well as greater clarity over the exit of the UK from the EU, together with the implementation of further monetary policy loosening (quantitative easing) and better than expected economic growth reported for the third Quarter of 2019 (July to September).

2.6 The meeting of the Governing Council of the European Central Bank (ECB) on 12 September had, in view of continuing low inflation and to support expansion of the Euro area economy, taken a number of decisions to loosen monetary policy including reducing the deposit interest rate by 0.1% to minus 0.5% and the reintroduction of quantitative easing with effect from 1 November 2019. The two Governing Council meetings held during this Quarter (24 October and 12 December) reaffirmed the policy decisions of 12 September and quantitative easing was restarted on 1 November at the rate of asset purchases of 20 billion Euros per month.

2.7 Eurozone unemployment which had fallen to 7.5% in June 2019 (its lowest level since July 2008) fell further to 7.4% in December. Other economic indicators appear less positive, however. While the headline inflation rate increased from 0.8% in September to 1.3% in December it remains well below the ECB policy objective of below, but close to, 2% over the medium term.

2.9 The FTSE All Share advanced by 4% over the Quarter. While the internationally focussed FTSE 100 was up by approximately 3% the more domestically focussed FTSE 250 advanced by over 10%. Share prices – particularly the FTSE 250 – progressively advanced at the same time that events in British politics resulted in reduced uncertainty about the future relationship between Britain and the EU with the passing of the EU Withdrawal Bill in October and the victory of the Conservative party at the December 2019 General Election. The FTSE 250 advanced by 6% in two (working) days following the General Election. The actual future relationship between the UK and EU is, however, far from settled and 2020 may well see "cliff edge" negotiations and deadlines.

2.10 Unemployment, according to the Office for National Statistics (ONS), fell to 3.8% for the period October to December 2019 its lowest level since 1974. The ONS also reported that "For the first time since March 2008, real regular average weekly earnings exceeded the highest level reached before the economic downturn (2008 to 2009).” Other economic news was not so positive. The ONS reported that Gross Domestic Product was flat during the October to December Quarter with increases in services and construction offset by poor performance from manufacturing. Consumer Price Inflation (CPI) fell from its September level of 1.7% to 1.5% in October and November, and 1.3% in December compared with the Bank of England (BoE) target of 2%.

2.11 The November and December Monetary Policy Committee (MPC) meetings of the Bank of England voted to maintain Bank Rate at 0.75%. At both meetings, however, two external members voted for a reduction to 0.5% citing concerns over the economy and (low) inflation.

2.12 It was a clearly positive Quarter for Japanese equities with the Nikkei 225 advancing by 9%. As not only a major world trading economy, but an economy with close trading links with both the US and China, Japan benefitted from the thaw in US-China relations with a clear upward trend in the Nikkei 225 apparent after the announcement of the preliminary Phase 1 arrangement between the US and China in October 2019.

2.13 At both its 31 October and 19 December 2019 meetings the Bank of Japan again continued its policy of huge monetary policy stimulus. This included maintaining interest rates at minus 0.1%, together with a target of “around zero percent” for 10 year bond yields and major ongoing asset purchase operations. Despite huge monetary stimulus since 2013 Japanese Core CPI inflation has remained well below the 2% target. It did however reach 0.7% in December 2019 up from a 2019 low of 0.3% in September. December 2019 also saw the Japanese Government announce a fiscal stimulus to repair typhoon damage, improve infrastructure and invest in new technology.

2.14 Asia (excluding Japan) and emerging market equity markets enjoyed a positive Quarter. The MSCI AC Asia (exc Japan) Index and the MSCI Emerging Markets Index both saw gains (in $ terms) of over 11%. The positive progress in US-China trade talks was clearly a major positive and a weaker US$ another.

2.15 Chinese growth (as reported by the China National Bureau of Statistics) was an annualised 6% in the October to December Quarter the same rate as for the July to September 2019 Quarter. Chinese growth in 2019 was the lowest since 1990. In November China’s central bank slightly reduced benchmark lending rates. This was seen as a reaction to slowing economic growth.

2.16 The easing of trade tensions which was a major feature of the Quarter resulted in a greater appetite for risk as demonstrated by the clear advances in equity valuations. In contrast major Government bonds suffered as equities and high yield bonds were favoured by investors. The US 10-year Treasury Bond fell in value as its yield increased from 1.66 at the end of September to 1.92 at the end of December. The 10-year Gilt yield – also influenced by less uncertainty around Brexit and the Conservative Election victory – rose from 0.49 to 0.82. The German 10-year Bund yield rose from -0.57 to -0.19.

2.17 In Conclusion the October to December 2019 Quarter was heavily influenced by the clearly positive turn in US-China relations. Again, continued loose monetary policy provided both economic support and support to markets. Equity valuations are however high and the additional tools available to the major central banks to support the economy and markets in a downturn are somewhat limited. Fiscal policy which could provide further economic support has not, however, yet been widely applied.

3. Overall Fund Performance

3.1 The Fund's externally managed assets closed Q4 valued at £1,126.32m, an increase of £15.96m from its value of £1,110.36m at 30 September 2019. The cash value held by the Council at 31 December 2019 was £3.43m, giving a total Fund value of £1,129.75m. The gross value of £1,129.75m includes a prepayment of £25.0m from the Council. The net asset value as at 31 December 2019, after adjusting for the prepayment was therefore £1,104.75m.

3.2 For Q4 the Fund returned 2.2%, net of fees, outperforming its benchmark by 0.5%. Over one year the Fund returned 12.7%, underperforming its benchmark by 0.5%. Over three years the Fund underperformed its benchmark by 0.8%, with a return of 7.2%. The Fund's returns are below:

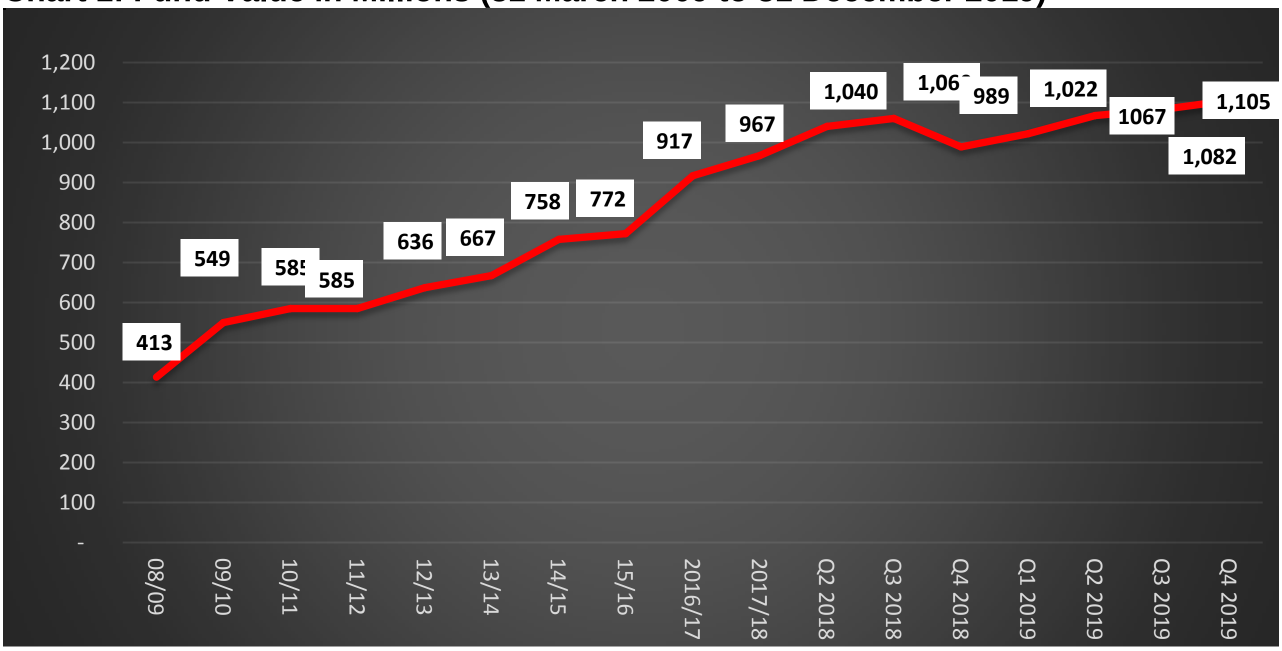
Table 1: Fund's 2019, 2018, 2017 Quarterly and Yearly Returns

Year	2019				2018				One Year	Two Years	Three Years	Five Years
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1				
Actual Return	2.2	1.4	3.3	5.8	(6.3)	2.3	3.8	(1.9)	12.7	5.3	7.2	8.4
Benchmark	1.7	2.4	3.5	5.6	(4.6)	3.3	3.7	(1.3)	13.2	7.1	8.0	9.0
Difference	0.5	(1.0)	(0.2)	0.2	(1.7)	(1.0)	0.1	(0.6)	(0.5)	(1.8)	(0.8)	(0.6)

	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

3.3 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 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 December 2019)



3.4 Stock selection contributed -0.2%, with asset allocation contributing 0.6% for the quarter. The fund manager's performance has been scored using a quantitative analysis compared to the benchmark returns, defined below.

3.5 Table 2 highlights the Q4 2019 returns. The return for Hermes GPE was negative 0.2% which was 1.7% below the benchmark of 1.4%. UBS Bonds, the funds passive strategy also provided a negative return of 3.9% against a benchmark of negative 3.9%. Baillie Gifford provided a good return of 4.9% which was 3.4% above the benchmark of 1.5%. UBS Equities a passive fund provided a return of 5.7% against a 5.7% benchmark. Most other manager provided small, but positive returns.

Table 2 – Fund Manager Q4 2019 Performance

Fund Manager	Actual Returns (%)	Benchmark Returns (%)	Variance (%)	Ranking
Aberdeen Standard	(0.2)	1.2	(1.4)	Δ
Baillie Gifford	4.9	1.5	3.4	O
BlackRock	0.6	0.3	0.3	O
Hermes GPE	(0.2)	1.4	(1.7)	Δ
Kempen	1.2	1.0	0.2	O
Prudential / M&G	0.0	1.2	(1.2)	Δ
Newton	1.6	1.2	0.4	O
Pyrford	0.7	1.5	(0.8)	Δ
Schroders	1.0	0.3	0.7	O
Mellon Corporation (Standish)	0.0	1.2	(1.2)	Δ
UBS Bonds	(3.9)	(3.9)	0.0	O
UBS Equities	5.7	5.7	0.0	O

3.6 Hermes GPE has provided a disappointing return of 0.5% over one year which was 5.2% below the benchmark. Baillie Gifford performed very well over the year with returns of 25.6%. Kempen provided a high return of 13.2% but was still below the benchmark by 8.0%. Newton performed well generating a positive return of 11.8%.

Table 3 – Fund Manager Performance Over One Year

Fund Manager	Actual Returns (%)	Benchmark Returns (%)	Variance (%)	Ranking
Aberdeen Standard	4.5	4.8	(0.3)	Δ
Baillie Gifford	25.6	20.8	4.8	O
BlackRock	2.0	1.6	0.4	O
Hermes GPE	0.5	5.7	(5.2)	
Kempen	13.2	21.2	(8.0)	
Prudential / M&G	2.7	4.6	(1.9)	Δ
Newton	11.8	4.5	7.3	O
Pyrford	5.4	7.1	(1.7)	Δ
Schroders	0.2	1.6	(1.4)	Δ
Mellon Corporation (Standish)	2.8	4.8	(2.0)	Δ
UBS Bonds	7.0	7.0	0.0	O
UBS Equities	23.3	23.4	(0.1)	Δ

3.7 Over two years, (table 4), most mandates are positive. Returns ranged from -1.7% with Mellon Corporation (Standish) to 11.3% 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	4.8	4.7	0.1	O
Baillie Gifford	11.3	9.3	2.0	O
BlackRock	4.2	4.0	0.2	O
Hermes GPE	3.0	5.7	(2.7)	Δ
Kempen	4.3	9.7	(5.4)	
Prudential / M&G	3.7	4.5	(0.9)	Δ
Newton	6.0	4.5	1.5	O
Pyrford	1.9	7.3	(5.4)	
Schroders	3.0	4.0	(1.0)	Δ
Mellon Corporation (Standish)	(1.7)	4.7	(6.4)	
UBS Bonds	3.9	3.9	0.0	O
UBS Equities	8.6	8.8	(0.2)	O

4. Asset Allocations and Benchmark

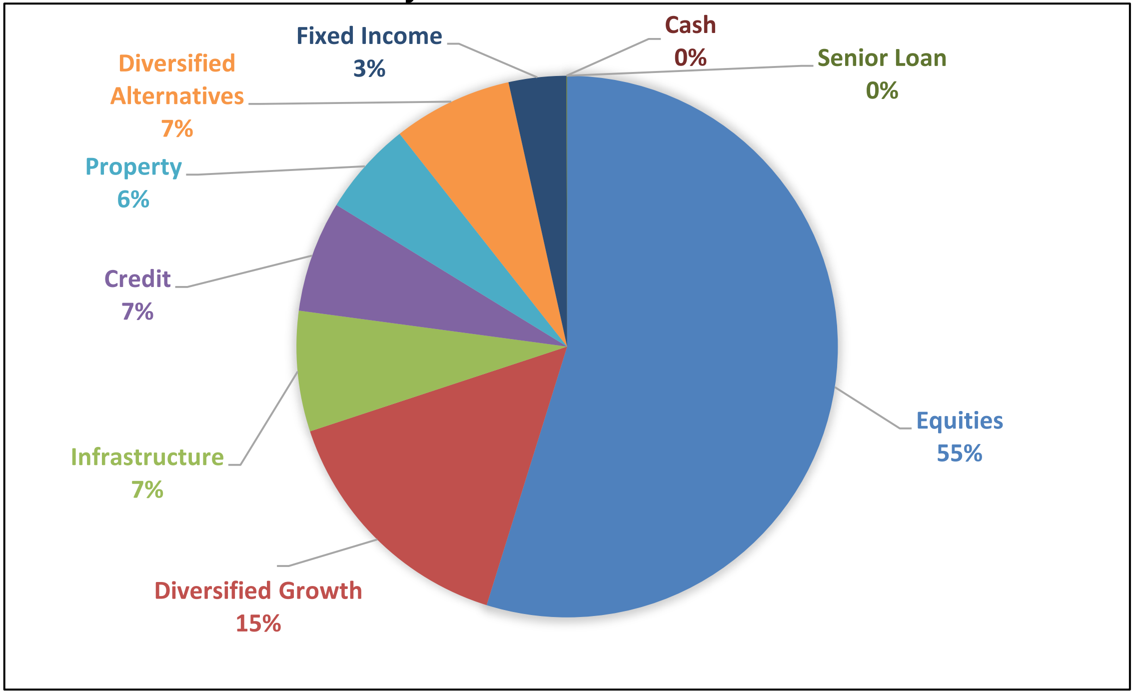
4.1 Table 5 below outlines the Fund's current actual asset allocation, asset value and benchmarks

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

Fund Manager	**Asset (%)**	**Market Values (£000)**	**Benchmark**
Aberdeen Standard	7.1	82,817	3 Mth LIBOR + 4% per annum
Baillie Gifford	20.4	230,232	MSCI AC World Index
BlackRock	3.5	39,371	AREF/ IPD All Balanced
Hermes GPE	7.2	80,784	Target yield 5.9% per annum
Kempen	15.9	179,208	MSCI World NDR Index
Prudential / M&G	0.0	497	3 Mth LIBOR + 4% per annum
Newton	6.6	74,616	One-month LIBOR +4% per annum
Pyrford	9.4	105,959	UK RPI +5% per annum
Schroders	2.1	23,773	AREF/ IPD All Balanced
Mellon Corporation	5.7	63,969	3 Mth LIBOR + 4% per annum
UBS Bonds	3.4	38,595	FTSE UK Gilts All Stocks
UBS Equities	18.3	206,353	FTSE AW Developed Tracker (part hedged)
LCIV	0.0	150	None
Cash	0.3	3,427	One-month LIBOR
Total Fund	**100.0**	**1,129,752**	

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 2019



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 1.8% 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	54.5%	48%	6.5%	*45–53*
Diversified Growth	15.0%	16%	-1.0%	*16-20*
Infrastructure	7.2%	9%	-1.8%	*4-11*
Credit	6.6%	8%	-1.4%	*6-10*
Property	5.6%	7%	-1.4%	*6-9*
Diversified Alternatives	7.3%	8%	-0.7%	*6-10*
Fixed Income	3.4%	4%	-0.6%	*3-5*
Cash	0.3%	0%	0.3%	*0-1*
Senior Loan	0.0%	0%	0.0%	*0-1*

5. Fund Manager Performance

5.1 Kempen

Kempen	2019				2018				One Year	Two Years	Since Start 6/2/13
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1			
£179.21m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**1.2**	1.3	**5.2**	5.5	(7.3)	2.9	7.2	(7.4)	13.2	4.3	9.5
Benchmark	**1.0**	3.8	**6.5**	9.9	(11.3)	6.3	8.0	(4.7)	21.2	9.7	12.8
Difference	**0.2**	(2.5)	(1.3)	(4.4)	4.0	(3.4)	(0.8)	(2.7)	(8.0)	(5.4)	(3.3)

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 0.2% for the quarter but has underperformed its one-year benchmark by 8.0%. Kempen has underperformed its two-year benchmark by 5.4%, providing an annual return of 4.3%. It has also underperformed its benchmark since inception by 3.3%, although the return over this period is a good annualised return of 9.5%.

Portfolio Rebalancing

Kempen sold four names during Q4: Roche, TSMC, Nokia and Limited Brands.

Roche and TSMC were sold after the share prices fell below the 3% dividend threshold after the share prices jumped in 2019. Limited Brands was sold after its Victoria Secret brand continued to perform poorly with again negative like-for-like sales. Nokia was sold due to significant dividend cuts.

Six new stocks were added: Wartsila, Simon Property Group, Public Storage, Simplo Technology, Amada Holdings and MSC Industrial.

Finnish industrial Wartsila has strong market positions in power generation and marine markets, while the valuation is quite attractive. Simon Property (shopping malls) and Public Storage (self-storage facilities) are real estate investments trusts with an attractive valuation. Taiwanese Simplo Technology is a tier 1 battery pack vendor capable of hardware design and software integration. Its most important competitive advantages are product development capabilities and experience. Japanese Amada is a metalworking machine manufacturer with a very strong balance sheet and an attractive valuation.

5.2 Baillie Gifford

Baillie Gifford	2019				2018				One Year	Two Years	Since Start 6/2/13
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1			
£230.23m	%	%	%	%	%	%	%	%	%	%	%
Actual Return	**4.9**	0.7	7.7	12.4	(12.5)	3.0	7.3	(0.9)	25.6	11.3	15.2
Benchmark	**1.5**	3.4	6.2	9.8	(10.6)	5.7	6.9	(4.3)	20.8	9.3	12.6
Difference	**3.4**	(2.7)	1.5	2.6	(1.9)	(2.7)	0.4	3.4	4.8	2.0	2.6

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 4.9%, outperforming its benchmark by 3.4%. BG's one-year return was 25.6%, outperforming its benchmark by 4.8%. Since initial funding, the strategy has returned 15.2% p.a., outperforming its benchmark by 2.6%.

Q4 2019 was a period where market sentiment shifted to more of a positive stance. Signing of the phase 1 US-China trade deal, the Conservative win in the UK and improved corporate earnings results pushed global indices to ever record highs. The regions to most benefit were emerging markets, UK and the rest of the world broadly expanding. IT stocks in the US rallied as investors saw value in the US economy being in the 'goldilocks' zone.

Whilst the manager does not focus on top down analysis for portfolio construction it is important to understand how this impacts the portfolio. The manager focuses on themes that are able to disrupt traditional sectors and facilitate strong growth. One such theme was data usage in healthcare which placed focus on biotechnology stocks. With such a strong growth in the sector, the manager has trimmed its position in healthcare from 15% down to 13.9% by the end of December.

The manager feels the portfolio is well saturated in this space so they have shifted their focus in other areas which includes enterprise IT for the year ahead. These are businesses that have software for business rather than for people. Alibaba is thought of as an enterprise IT stock as the company has 700 million customers on its cloud. Amazon has cloud solutions for smaller businesses and Microsoft for much larger institutions. The manager is also interested in penetration for digital advertising so it increased holdings in Alphabet.

The manager sold out of Persol Holdings in the period which was the second largest staffing company in Japan- behind Recruit. The company is moving into overseas markets where 30% of revenues are sourced form. The manager is not convinced the company is able to compete against other global recruitment firms and following a number of M&A missteps, they decided to sell.

5.3 UBS Equities

UBS Equities	2019				2018				One Year	Two Years	Since Start 31/08/12
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1			
£206.35m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**5.7**	2.1	4.0	11.5	(12.8)	5.3	4.4	(3.0)	23.3	8.6	14.2
Benchmark	**5.7**	2.1	4.1	11.5	(12.9)	5.7	4.4	(3.0)	23.4	8.8	14.3
Difference	**0.0**	0.0	(0.1)	0.0	0.1	(0.4)	0.0	0.0	(0.1)	(0.2)	(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 5.7% for Q4 and 23.3% over one year. Since funding in August 2012, the strategy has provided an annualised return of 14.2%.

Equities

Equity markets enjoyed a strong quarter, finishing a bumper year for many markets on an upbeat note. December was the tenth calendar month of positive returns during 2019, as measured by the MSCI World in local currency. Overall, the index was up over a 25% during the year with most major markets advancing strongly.

Markets seen as most exposed to an improvement in the global growth outlook were amongst those to fare best over the quarter. In contrast to the pattern for much of 2019, emerging markets outperformed their developed counterparts.

Bourses in countries such as Brazil and China were amongst the strongest performers. India, however, lagged, as growth in what was until recently the world's fastest growing large economy continued to slow and credit rating agency Moody's lowered its outlook. In Saudi Arabia, the world's largest oil producer, Aramco, made its stock market debut in December. However, its share offering was primarily focused on domestic and local Gulf investors after overseas investors gave a lukewarm reception to plans for a larger listing.

US equities finished the year on a strong note, with new record highs for the S&P 500 and Nasdaq during December. The latter was up over a third during the year, reflecting the continued positive sentiment towards the technology sector. While corporate profits posted for Q3 were broadly flat, this was ahead of expectations going into the reporting season and hence were positively received overall.

UK equity markets enjoyed a strong December in particular as the Conservative party, seen as more pro-business, triumphed over Labour in the general election. Key Eurozone markets such as France and Germany also fared well and outperformed many other major markets during the year. Commodity markets also saw advances to round off 2019. More economically exposed markets such as copper and oil did best, but even gold, often seen as a hedge in times of uncertainty rose in value despite the more positive mood.

5.4 UBS Bonds

UBS Bonds	2019				2018				One Year	Two Years	Since Start 5/7/2013
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1			
£38.59m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**(3.9)**	6.2	1.4	3.4	1.9	(1.7)	0.2	0.3	7.0	3.9	5.0
Benchmark	**(3.9)**	6.2	1.3	3.4	1.9	(1.7)	0.2	0.3	7.0	3.9	4.9
Difference	**0.0**	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1

<u>Reason for appointment</u>

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.

<u>Performance</u>

The return for Q4 was negative 3.9%, with a one-year return of 7.0% and a two-year return of 3.9%.

Returns to bond investors also continued to follow the pattern seen towards the end of Q3. Yields on government bonds rose further from the historic lows seen over the summer, although these still hovered around or below zero in many large markets. The brighter economic mood also saw an end to the inversion of the US yield curve, which had been widely discussed as a portent of possible economic distress in the third quarter, with 10-year bonds again yielding more than their 2-year counterparts.

The positive attitude towards risk saw credit spreads contract in general, with lower credit quality bonds often seeing strong demand. Investment grade corporate bonds fared less well than areas such as high yield in this environment. Emerging market debt in both hard and local currency shrugged off outbreaks of unrest in a few major economies to deliver a positive return over the quarter.

5.5 M&G / Prudential UK

M&G / Prudential	2019				2018				One Year	Two Years	Since Start 31/5/2010
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1			
£0.50m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**0.0**	1.7	0.0	1.0	1.2	1.2	1.1	1.1	2.7	3.7	4.5
Benchmark	**1.2**	1.2	1.0	1.2	1.2	1.1	1.1	1.1	4.6	4.5	2.9
Difference	**(1.2)**	0.5	(1.0)	(0.2)	0.0	0.1	0.0	0.0	(1.9)	(0.9)	1.6

<u>Reason for appointment</u>

This investment seeks to maximise returns using a prudent investment management approach with a target return of Libor +4% (net of fees).

<u>Performance and Loan Security</u>

The strategy provided a return of 4.5% per year, with an outperformance against the benchmark of 2.9% 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 (SIRE)

Schroders	2019				2018				One Year	Two Years	Since Start 6/8/2010
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1			
£23.77m	%	%	%	%	%	%	%	%	%	%	%
Actual Return	**1.0**	0.3	0.1	(1.1)	0.3	1.4	2.3	1.7	0.2	3.0	6.2
Benchmark	**0.3**	0.4	0.6	0.3	0.9	1.6	1.9	1.9	1.6	4.0	7.4
Difference	**0.7**	(0.1)	(0.5)	(1.4)	(0.6)	(0.2)	0.4	(0.2)	(1.4)	(1.0)	(1.2)

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.

Q4 2019 Performance and Investment Update

The fund generated a positive return in Q4 of 1.0% with a one-year return of 0.2% and a two-year return of 3.0%. In Q4 2019, the two retail warehouse funds, Hercules Unit Trust and Nuveen Real Estate UK Retail Warehouse Fund, generated total returns of -14.2% and -11.0% respectively. These materially detracted from SIRE's total returns. By contrast, the two specialist industrial funds, and those investing in alternative sectors such as student accommodation and leisure, outperformed SIRE's benchmark.

5.7 BlackRock

BlackRock	2019				2018				One Year	Two Years	Since Start 1/1/2013
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1			
£39.37m	%	%	%	%	%	%	%	%	%	%	%
Actual Return	**0.6**	0.7	0.5	0.1	1.0	1.9	2.0	1.5	2.0	4.2	0.8
Benchmark	**0.3**	0.4	0.6	0.3	0.9	1.6	1.9	1.9	1.6	4.0	4.0
Difference	**0.3**	0.3	(0.1)	(0.2)	0.1	0.3	0.1	(0.4)	0.4	0.2	(3.2)

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 2019 Performance and Investment Update

BR returned 0.6% for the quarter against the benchmark of 0.3%, with a return of 2.0% over one year against its benchmark's return of 1.6%.

During Q4, the strategy completed two disposals totalling £41.3 million and did not acquire any new properties. The two sold assets were non-core and were regarded as having limited further value to be added. The outperformance in Q4 was driven primarily through asset management initiatives and the Fund's allocation to the industrial sector, where rental growth and strong leasing activity drove capital values.

5.8 Hermes

Hermes	2019				2018				One Year	Two Years	Since Start 9/11/2012
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1			
£80.78m	%	%	%	%	%	%	%	%	%	%	%
Actual Return	(0.2)	1.2	1.0	(1.5)	1.1	(2.2)	0.6	6.1	0.5	3.0	8.6
Benchmark	1.4	1.5	1.5	1.4	1.4	1.4	1.4	1.4	5.7	5.7	5.9
Difference	(1.6)	(0.3)	(0.5)	(2.9)	(0.3)	(3.6)	(0.8)	4.7	(5.2)	(2.7)	2.7

<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>

Hermes returned negative 0.2% in Q4 underperforming the benchmark by 1.6%. As at 31 December 2019, the strategy reported a one-year positive return of 0.5%, underperforming its benchmark by 5.3%. Since inception the strategy has provided a good annualised return of 8.6%, outperforming its benchmark by 2.7%.

<u>Portfolio review</u>

There was a mixed performance by businesses in the HIF I portfolio over 2019. Cadent, Anglian Water, Fallago Rig, ASG I, ASG II and Energy Assets all performed on or above budget.

Southern Waters performance was negatively impacted by mainly one-off operational costs in Retail and reactive work on the Wastewater network for the 9 months to December 2019. Braes of Doune experienced lower than expected wind resource and power prices, resulting in its quarterly performance also falling below budget. Eurostar's performance was negatively impacted by industrial action by French customs in early 2019 and French trade unions in December 2019.

Southern Water is currently subject to a prosecution from the Environment Agency (EA). The current EA summons relates to the actual and potential environmental impact of the same historical operational issues previously investigated by Ofwat. The outcome of the prosecution is expected to be a significant fine so will have an impact on the fund's performance.

<u>Investments and Divestments</u>

In Q4, HIF I exercised its proprietary, pre-emption right to acquire an additional 3.7% stake in Innisfree PFI Continuation Fund, increasing its stake from 14.3% to 18.0%
HIF I Core entered into an agreement to acquire a 74% interest in Iridium's six Spanish toll roads for approximately £185.5m (Project Everest).

5.9 Aberdeen Standard Asset Management

Aberdeen Standard	2019				2018				One Year	Two Years	Since Start 15/9/2014
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1			
£82.82m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**(0.2)**	1.9	2.3	0.6	(0.8)	2.6	2.4	0.9	4.5	4.8	4.2
Benchmark	**1.2**	1.2	1.2	1.2	1.1	1.1	1.2	1.1	4.8	4.7	4.6
Difference	**(1.4)**	0.7	1.1	(0.6)	(1.9)	1.5	1.2	(0.2)	(0.3)	0.2	(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 negative return of 0.2% in Q4, underperforming its benchmark by 1.4%. The primary commitment to MML led the way in terms of the positive contributors to performance, followed by Field St. In terms of detractors, OEP was the largest. A number of capital calls for payment of management fees also impacted performance.

Over one year the mandate has underperformed its benchmark, with a return of 4.5% against a benchmark of 4.8%. Since inception in September 2014, the strategy has returned 4.2%, 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;

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, and
iv. Reinsurance

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				One Year	Two Years	Since Start 28/9/2012
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1			
£105.96m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**0.7**	0.9	1.1	2.7	(2.0)	0.8	2.0	(2.3)	5.4	1.9	3.5
Benchmark	**1.5**	1.7	2.8	1.1	1.5	2.3	2.4	1.3	7.1	7.3	7.0
Difference	**(0.8)**	(0.8)	(1.7)	1.6	(3.5)	(1.5)	(0.4)	(3.6)	(1.7)	(5.4)	(3.5)

<u>Reason for appointment</u>

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.

<u>Performance</u>

Pyrford generated a positive return of 0.7% in Q4 underperforming its benchmark by 0.8%. Over one year the strategy has returned 5.4%, underperforming its benchmark by 1.7%. Pyrford underperformed its benchmark by 3.5% since inception.

<u>Outlook and Strategy</u>

Both equities and currency hedges were positive contributors for the quarter whereas bonds detracted from the performance. Positive returns within equities were mainly driven by the UK which generally benefited from positive post-election sentiment in the last quarter. Over the year holding defensive equities overall attributed to slight relative outperformance in a cautious UK market. However, in other regions, diminishing trade fears and further central banks' support rose investor confidence resulting in non-defensive equities outperforming their income-based counterparts held in the portfolio. For the quarter, overseas equities detracted, in the main due to lack of organic growth and Sterling's strength. The largest detractor was Telenor that suffered from the Joint Venture with Axiata, which is blocked by regulators and weaker top line growth.

In a reversal to the first three quarters of the year, when bond yields dropped and shorter duration bonds were a detractor for the portfolio, Q4 saw bond yields rise and the managers bias against long duration paid off. Overall, the positive prices continued for the majority of the year but the portfolio did not benefit as its exposure is limited to the very front end of the curve meaning their return profile is more “cash-like”. All hedges (FX shorts) were contributors on the back of Sterling’s strength over the quarter.

5.11 Newton

Newton	2019				2018				One Year	Two Years	Since Start 31/8/2012
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1			
£74.62m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**1.6**	1.7	4.3	4.2	(1.7)	2.1	2.4	(2.6)	11.8	6.0	4.0
Benchmark	**1.2**	1.2	1.0	1.2	1.2	1.1	1.1	1.1	4.5	4.5	4.5
Difference	**0.4**	0.5	3.3	3.0	(2.9)	1.0	1.3	(3.7)	7.3	1.5	(0.5)

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 1.6% in Q4 and outperformed its benchmark by 0.4%. Over one year the strategy has returned 11.8%, outperforming its benchmark by 7.3%. Newton’s performance since inception is 4.0% and underperforms its benchmark by 0.5%.

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		
	30 September 2019	31 December 2019
Equities	**29.50**	**30.76**
UK	7.30	7.42
North America	9.20	9.07
Europe	8.80	9.29
Japan	0.60	0.59
Pacific Basin Ex Japan	1.60	3.20
Emerging Markets	2.00	1.19
Fixed Income	**41.30**	**34.48**
Government Bonds	19.10	9.59
Corporate Bonds	10.00	9.88
Index Linked Government	2.50	2.44
Emerging Debt	9.70	12.57
Alternatives	**29.20**	**34.76**
Infrastructure Funds	6.60	12.48
Renewable Energy	0.20	0.00
Precious Metals	10.50	6.89
Derivative Instruments	10.90	0.79
Cash and FX Forwards	1.00	14.60
Total	**100.00**	**100.00**

5.12 Mellon Corporation (Standish)

Mellon Corporation	**2019**				**2018**				**One Year**	**Two Years**	**Since Start 20/8/2013**
	Q4	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**			
£63.97m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**(0.0)**	0.1	0.8	1.9	(2.7)	0.1	(3.9)	0.3	2.8	(1.7)	0.4
Benchmark	**1.2**	1.2	1.2	1.2	1.2	1.1	1.2	1.1	4.8	4.7	5.2
Difference	**(1.2)**	(1.1)	(0.4)	0.7	(3.9)	(1.0)	(5.1)	(0.8)	(2.0)	(6.4)	(4.8)

<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 returned 0% against a benchmark return of 1.2%. Over one year the strategy has underperformed its benchmark of 4.8% by 2.0%, providing a return of 2.8%. Since funding in August 2013, Mellon Corporation has only provided an annual return of 0.4%.

<u>Positive Contributors:</u>

Asset allocation was the principal contributor to performance during the quarter. Specifically, allocation in emerging market and high yield credit were additive to performance for the period.

Negative Contributors:

Slightly offsetting positive performance was negatives from FX and yield curve allocations.

Portfolio Composition:

Ex-ante annualized tracking error was largely decreased over the quarter as the fund is pending redemption and has significantly de-risked positioning. The fund started the quarter with an annualized tracking error of roughly 115bps and ended the year with tracking error around 50bps. The 50-bps tracking error at year-end had curve, government and EM spreads together representing just under two thirds of the risk budget.

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.

Following manager interviews, the committee agreed to replace BNY Mellon as the fund’s active credit manager and to appoint CQS through the LCIV. Officers were instructed to manage the due diligence on CQS and to manage the transition from BNY Mellon to CQS.

In July, the LCIV informed officers that they have put CQS ‘on watch’ so the transition process to CQS was put on hold until the issues were resolved. On 18 September 2019, LCIV presented to the committee members and after a thorough discussion, members agreed to progress with the transition to CQS. The funding amount was £60million. LCIV confirmed that the trading could only take place at month end so there were further issues around the transition date:

- An initial transition date of 31 October was set. However, due to uncertainties around Brexit, the fund was advised that CQS would not be trading.
- The transition date was then delayed to the of November, however, the fund was advised against this due to the Thanksgiving Day.

On 21 November 2019, LCIV raised the possibility that CQS would be removed from the platform or alternatively, another manager is appointed in addition to CQS as they still have concerns. As a result, the transition to CQS was put on hold until this position could be clarified. LCIV will continue to keep CQS on watch and to closely monitor performance. The position will be reviewed again around the end of the financial year. The transition is still on hold until a full Strategic Asset Allocation Review is carried out in April 2020.

5.13 Currency Hedging

No new currency hedging positions were placed in Q4 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: Philip Gregory, Director of Finance

7.1 The Council’s Pension Fund is a statutory requirement to provide a defined benefit pension to scheme members. Investment decisions are taken based on a long-term investment strategy. The investment performance has a significant impact on the General Fund. Pensions and other benefits are statutorily calculated and are guaranteed. Any shortfall in the assets of the Fund compared to the potential benefits must be met by an employer’s contribution.

7.2 This report updates the 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:

- Northern Trust Quarterly Q4 2019 Report; and
- Fund Manager Q4 2019 Reports.

List of appendices:

Appendix 1 - Fund Asset and Liability Values 31 March 2013 to 31 December 2019
Appendix 2 - Definitions
Appendix 3 - Roles and Responsibilities