PENSIONS COMMITTEE

16 December 2020

Title: Pension Fund Quarterly Monitoring 2020/21 – July to September 2020	
Report of the Chief Operating Officer	
Open Report	**For Information**
Wards Affected: None	**Key Decision:** No
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Accountable Director: Philip Gregory, Finance Director	
Accountable Strategic Leadership Director: Claire Symonds, Acting Chief Executive	

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 July to 30 September 2020.

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) the update on the transition to the Multi-Asset Credit Strategy

Reason(s)

1. Introduction and Background

1.1 This report provides information for employers, members of London Borough of Barking and Dagenham Pension Fund ("the Fund") and other interested parties on how the Fund has performed during the quarter 1 July to 30 September 2020 ("Q3"). 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 October to 15 December 2020 will be provided to Members at the Pension Committee.

2. Independent Advisors Market Background Q3 2020

2.1 The Quarter was positive for both Listed Equity and Bond markets. The MSCI World Index was up 8% (in $ terms). Equity markets however saw clear diversification of performance across both geographies and sectors. The United States, Asia (excluding Japan) and Emerging Markets all saw returns around 9%-11% (in $ terms). In contrast European Equities were flat (in Euro terms) and UK equities fell 3% (in £ terms). Growth stocks continued their long trend of outperforming Value stocks. The MSCI World Growth index returned 12% (in $ terms) while the MSCI World Value Index returned 4%. While technology and distribution generally did well (assisted by the COVID-19 restrictions) it was not so positive for financial stocks (held back by potential loan defaults and long term low interest rate expectations) and in particular energy (hampered by lower fuel demand). High Government Bond prices continued while both Investment Grade and High Yield Corporate Credit had a clearly positive Quarter.

2.2 US Equities enjoyed another positive Quarter with the S&P 500 Index increasing by 9% over period June to September. The S&P 500 which had closed at 3,100 on 30 June closed at 3,363 on 30 September an increase of approaching 9%. The actions of the US Federal Reserve (continuing both ultra low interest rates and huge bond buying and announcing a more flexible approach to inflation targeting), some recovery in the US economy and the nature of the US stock market (with around a 25% weighting to just 5 huge technology orientated companies) all contributed to this continued rally.

2.3 The Federal Open Markets Committee (FOMC) of the US Federal Reserve which introduced extraordinary measures to support the economy and financial markets in March 2020 continued and indeed expanded this approach. The ultra low interest rate policy introduced in March was maintained at the July and September meetings when the FOMC maintained "the target range for the federal funds rate at 0 to ¼ percent." On 27 August 2020 the FOMC announced an update to its strategic approach to monetary policy. Significantly the update included both changes that mean the Committee will be more tolerant going forward of inflation above 2% in order to compensate for previous long running low inflation and also that a low unemployment level will no longer be sufficient on its own to result in interest rate rises. These changes clearly indicated that the US interest rates could remain ultra low for a very long time.

2.4 The Press Statement issued after the September FOMC meeting clearly indicated that interest rates will be held at their current ultra low levels for a lengthy period. After referring to inflation "running persistently" below the 2% inflation target it was stated the Committee "expects" to maintain the present target range for the federal funds rate of 0 to ¼% "until labor market conditions have reached levels consistent with the Committee's assessment of maximum employment and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time." Forecasts issued after the September FOMC meeting indicated Federal Reserve policymakers expect no interest rate rises until at least the end of 2023.

2.5 While the July to September Quarter was clearly positive for US Equities volatility was also present. Having risen from 3,100 on 30 June to record closing high of 3,581 on 2 September the market then fell back to 3,237 on 23 September before recovering to 3,363 on 30 September. A particular feature of the performance, and potentially the heightened risks, of US markets is importance of just five stocks. – Apple, Alphabet, Amazon, Facebook and Microsoft. These companies have benefitted significantly in the COVID-19 environment. These companies, which numerically account for 1% of the companies in the Index have grown to account for around a quarter of the total S&P 500 Index by market capitalisation However, as in early September, when they falter, even briefly, their sheer size potentially endangers the US equity market in general.

2.6 While US economic activity and employment were both still well below their levels at the beginning of 2020, they continued to recover somewhat during the July to September Quarter. The "advance" estimate from the US Bureau of Economic Analysis of 29 October 2020, indicated that "Real gross domestic product (GDP) increased at an annual rate of 33.1 percent in the third quarter of 2020.In the second quarter, real GDP decreased 31.4 percent." However, output remained below pre COVID levels.

2.7 Unemployment which had been 3.5% in December 2019 reached 14.7% in April 2020. It had fallen to 10.2% by July and to 7.9% in September. This is however still the highest US unemployment rate since January 2013. Also, these headline unemployment statistics may be categorised as overoptimistic the reason being that some of those who initially lost their jobs in the US have now fallen out of the headline measure due to the Bureau of Labour Statistics labelling them either re-employed in part-time jobs or ineligible for work. Inflation as measured by the Personal Consumption Expenditures (PCE) index (the US Federal Reserve's favoured measure) continued to run clearly below the Federal Reserve's 2% target. The respected University of Michigan Survey of Consumers indicated, for September, the highest level of consumer confidence for 6 months. Notably however the September survey results commentary included the following narrative "the recent gains [in sentiment] are encouraging even though they were largely due to upper income households. Indeed, the data indicate that lower income households face continued income and job losses compared with the modest gains expected by upper income households. Also, lower income households more frequently anticipated real income declines. Without a renewed federal stimulus and enhanced unemployment payments, the income gap will widen."

2.8 Despite a recovery in output in the July to September Quarter Eurozone GDP remained clearly below pre COVID levels. Eurozone equities were flat with, for example, the MSCI EMU Index rising by only 0.2% (in Euro terms). There were signs of clearly rising COVID rates in September. The European Central Bank made no changes to interest rate or bond buying policy at its July and September monetary policy meetings.

2.9 While Eurozone unemployment, aided by furlough schemes, worsened little during the Quarter (it was 7.8% in June and 8.3% in September) the inflation trend became even more worrying with the Eurozone experiencing deflation in both August and September 2020. In 2019 headline Eurozone inflation was well below the ECB policy objective of below, but close to 2% over the medium term. By December 2019 Eurozone headline inflation had climbed to 1.3%. By June 2020 it was however only 0.4% and in August the Eurozone slipped into deflation with headline inflation at minus 0.2%. In September it fell to minus 0.3%. Declines in energy prices and a stronger Euro were amongst the causes.

2.10 In July the European Union agreed to establish a 750 billion Euro Recovery Fund consisting of £390 billion Euros of grants and 360 billion Euros of loans to be allocated amongst European Union states. This amounts to a large fiscal stimulus package. The agreement is also a step towards further European Union integration. The funds will be borrowed by the European Commission and guaranteed by all European Union member states. Italy and Spain are both likely recipients of significant grant aid under this arrangement.

2.11 The UK equity market declined during the Quarter and again clearly lagged world markets in general. The FTSE All Share index was down around 3%. A lack of progress on post Brexit arrangements and increasing COVID cases in September were negative influences on performance. The oil and financial sectors, which account for about 30% of the Index, performed poorly. For example, BP and Shell which comprise about 5% of the entire Index lost approximately 25% of their value during the July to September Quarter.

2.12 While data released by the Office for National Statistics indicated increased GDP over the Quarter monthly GDP was very clearly lower than in February 2020, prior to the full impact of COVID-19. Consumer Price Inflation (CPI), which had been 1.5% in March 2020 remained well below the Bank of England target of 2%. CPI was 1.0% in July, 0.2% in August and 0.5% in September. The Bank of England made no changes to interest rates or its bond buying policy at either its August or September Monetary Policy Committee meetings.

2.13 Japanese Equities (as measured by the Nikkei 225 Index) gained 4% over the Quarter. Japanese Core CPI inflation which despite huge monetary stimulus since 2013 has remained well below the 2% target has, since, the onset of the COVID-19 crisis turned, worryingly, into deflation. Japanese Core CPI which was 0.8% in January 2020 was 0% in July, minus 0.4% in August and minus 0.3% in September. The Bank of Japan maintained its previous ultra accommodative monetary policy stance at its meetings in both July and September 2020. In late August Japan’s longest serving Prime Minister Shinzo Abe announced his resignation due to ill health. This raised concerns regarding the future of Japanese economic policy given his creation of “Abenomics” which sought to revive the Japanese economy through the “three arrows” of ultra loose monetary policy, fiscal policy and structural/industrial reforms. However, his successor Yoshihide Suga quickly announced continuity which allayed investors concerns particularly given it is anticipated that there may be a greater emphasis on structural reform under Mr Suga.

2.14 Despite continuing US – China trade tensions Asia (excluding Japan) and Emerging Market equities enjoyed a clearly positive Quarter during July to September as they had in the previous (April to June) Quarter. Relative US dollar weakness was a positive for Asian/Emerging Markets. China, Singapore, South Korea and China all have strong technology sectors which have benefitted from the COVID-19 environment. The MSCI AC Asia (excluding Japan) returned 11% (in $ terms). The MSCI Emerging Markets Index returned 10% (in $ terms).

2.15 The National Bureau of Statistics of China reported that the Chinese economy grew by 4.9% (year on year) in the third Quarter of 2020. This compared with growth of 3.2% reported for the previous Quarter and a fall of 6.8% for the January to March 2020 Quarter. Alone of the world's major economies China's economy was larger (by about 1%) than a year ago. A number of factors account for this not least relative success in controlling COVID-19 (aided by the commanding/controlling nature of the regime as well as experience), state support for industry and expanding exports including of technology, medical and protective equipment.

2.16 In an environment of Central Bank support and the ongoing COVID-19 crisis the low yields previously associated with the leading Government Bonds – US, UK and Germany continued in this Quarter although both the US and UK 10 Year yields rose slightly (and therefore prices fell slightly). The US 10 Year yield rose from 0.66 to 0.68 while the UK 10 Year Yield rose from 0.17 to 0.23. Corporate credit enjoyed another positive Quarter.

2.17 In conclusion the July to September Quarter was broadly positive for financial markets. Further economic recovery together with huge fiscal and in particular monetary stimulus all provided support to the markets. While continuing market buoyancy is favourable to investors including Pension Funds it should be remembered that the COVID-19 pandemic continued throughout the Quarter. Also, the financial wellbeing of many individuals, particularly the economically less well off, have been significantly adversely affected in the context of the COVID-19 pandemic.

3. Overall Fund Performance

3.1 The Fund's externally managed assets closed Q3 valued at £1,163.27m, an increase of £31.24m from its value of £1,132.03m at 30 June 2020. The cash value held by the Council at 30 September 2020 was 0.44m, giving a total Fund value of £1,163.71m. The gross value of £1,163.71m includes a prepayment of £30.0m from the Council. The net asset value as at 30 September 2020, after adjusting for the prepayment and short term loan from the council was therefore £1,121.60m.

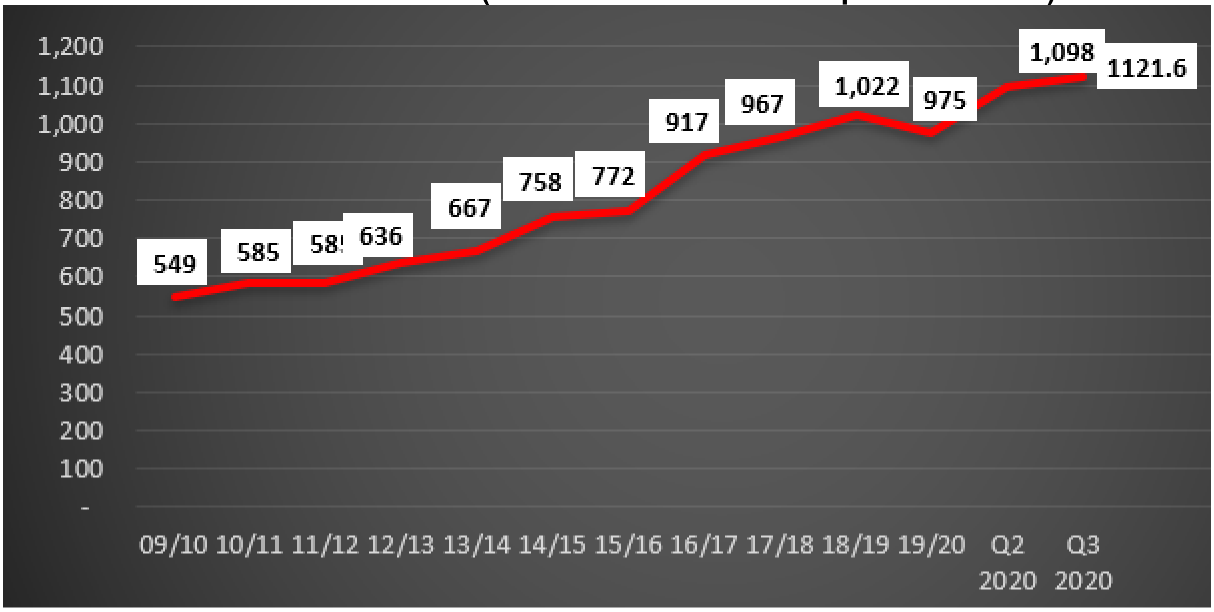
3.2 For Q3 the Fund returned 2.8%, net of fees, outperforming its benchmark by 0.3%. Over one year the Fund returned 5.8%, underperforming its benchmark by 0.3%. Over three years the Fund underperformed its benchmark by 1.8%, with a return of 5.3%. The Fund's returns are below:

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

Year	2020			2019				2018	One	Two	Three	Five
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Year	Years	Years	Years
Actual Return	2.8	12.3	(11.4)	2.2	1.4	3.3	5.8	(6.3)	5.8	5.0	5.3	8.9
Benchmark	2.5	9.6	(7.7)	1.7	2.4	3.5	5.6	(4.6)	6.1	6.5	7.1	9.6
Difference	0.3	2.7	(3.7)	0.5	(1.0)	(0.2)	0.2	(1.7)	(0.3)	(1.5)	(1.8)	(0.7)
PIRC Universe	1.8	11.3							(0.3)		4.4	8.8

3.3 Appendix 1 illustrates changes in the market value, the liability value, the Fund's deficit and the funding level from 31 March 2013 to 30 September 2020. 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 2010.

Chart 1: Fund Value in Millions (31 March 2010 to 30 September 2020)



	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

3.4 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 Q3 2020 returns. Baillie Gifford returned 7.6% which was 4.1% above the benchmark. UBS Equities passive fund provided a return of 5.6% against a 5.6% benchmark. Kempens return was a disappointing -3.2% which was 6.4% below the benchmark of 3.2%. Most managers provided a positive return this quarter except for Kempen, Pyrford and UBS Bonds.

Table 2 – Fund Manager Q3 2020 Performance

Fund Manager	Actual Returns (%)	Benchmark Returns (%)	Variance (%)	Ranking
Aberdeen Standard	5.1	1.0	4.1	O
Baillie Gifford	7.6	3.5	4.1	O
BlackRock	0.5	0.2	0.3	O
Hermes GPE	0.0	1.4	(1.4)	Δ
Kempen	(3.2)	3.2	(6.4)	
Newton	3.5	1.0	2.5	O
Pyrford	(1.6)	1.8	(3.4)	
Schroders	0.3	0.2	0.1	O
Mellon Corporation (Standish)	1.5	1.0	0.5	O

UBS Bonds	(1.2)	(1.2)	0.0	O
UBS Equities	5.6	5.6	0.0	O

3.6 Kempen has provided a disappointing return of -13.1% over one year which was 21.4% below the benchmark. Schroders and Blackrock, the funds property managers also returned -4.6% and -4.5% respectively. On the other hand, Baillie Gifford performed well returning 27.2% which was 18.3% above the benchmark. UBS Equities also performed well returning 10.8%.

Table 3 – Fund Manager Performance Over One Year

Fund Manager	Actual Returns (%)	Benchmark Returns (%)	Variance (%)	Ranking
Aberdeen Standard	5.0	4.7	0.3	O
Baillie Gifford	27.2	8.9	18.3	O
BlackRock	(4.5)	(2.8)	(1.7)	Δ
Hermes GPE	4.6	5.8	(1.2)	Δ
Kempen	(13.1)	8.3	(21.4)	
Prudential / M&G	1.8	4.7	(2.9)	Δ
Newton	3.8	4.4	(0.6)	Δ
Pyrford	0.4	6.0	(5.6)	
Schroders	(4.6)	(2.8)	(1.8)	Δ
Mellon Corporation (Standish)	3.8	4.7	(0.9)	Δ
UBS Bonds	3.7	3.7	0.0	O
UBS Equities	10.8	10.8	0.0	O

3.7 Over two years, (table 4), most mandates are positive. Returns ranged from -4.2% for Kempen to 17.7% for Baillie Gifford. Absolute return and credit continue to struggle, underperforming their benchmarks but providing positive actual returns overall. Kempen also underperformed the benchmark by 12.8% with a return of negative 4.2%

Table 4 – Fund manager performance over two years

Fund Manager	Actual Returns (%)	Benchmark Returns (%)	Variance (%)	Ranking
Aberdeen Standard	4.4	4.7	(0.3)	Δ
Baillie Gifford	17.7	8.8	8.9	O
BlackRock	(1.1)	(0.3)	(0.8)	Δ
Hermes GPE	3.2	5.7	(2.5)	Δ
Kempen	(4.2)	8.6	(12.8)	
Prudential / M&G	2.9	4.7	(1.8)	Δ
Newton	6.1	4.5	1.6	O
Pyrford	1.6	6.6	(5.0)	
Schroders	(2.5)	(0.3)	(2.2)	Δ
Mellon Corporation (Standish)	1.9	4.8	(2.9)	Δ
UBS Bonds	8.2	8.2	0.0	O

UBS Equities	7.8	7.8	0.0	O

4. Asset Allocations and Benchmark

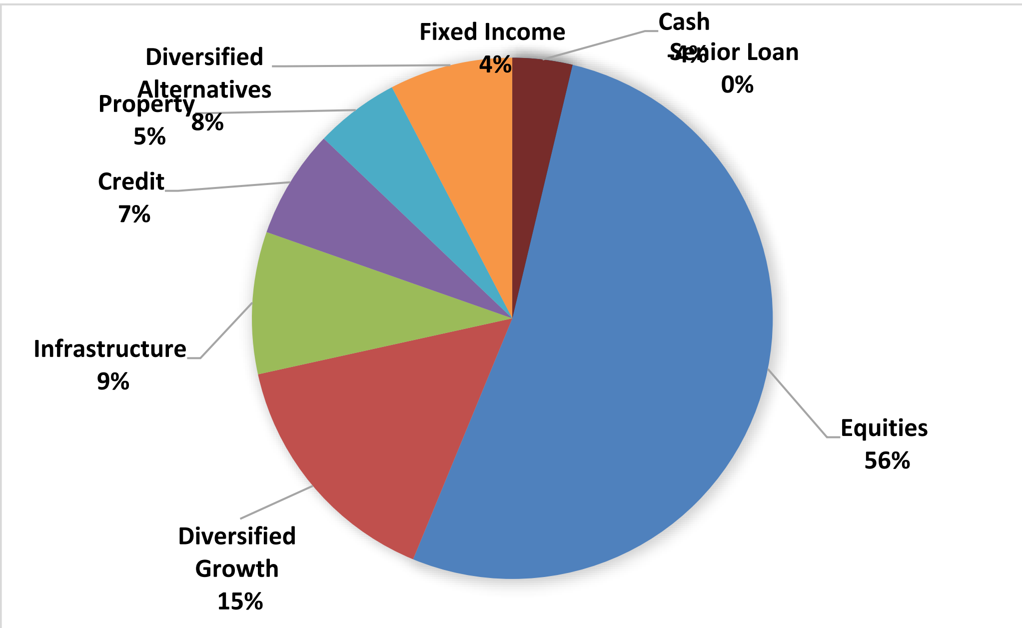
4.1 Table 5 below outlines the Fund's current actual asset allocation, asset value and benchmarks

Table 5: Fund Asset Allocation and Benchmarks as at 30 September 2020

Fund Manager	Asset (%)	Market Values (£000)	Benchmark
Aberdeen Standard	7.7%	85,888,358	3 Mth LIBOR + 4% per annum
Baillie Gifford	24.5%	275,139,453	MSCI AC World Index
BlackRock	3.3%	36,611,132	AREF/ IPD All Balanced
Hermes GPE	8.8%	98,893,410	Target yield 5.9% per annum
Kempen	13.1%	146,539,093	MSCI World NDR Index
Prudential / M&G	0.0%	670	3 Mth LIBOR + 4% per annum
Newton	6.7%	75,671,120	One-month LIBOR +4% per annum
Pyrford	9.4%	105,363,797	UK RPI +5% per annum
Schroders	2.0%	22,087,465	AREF/ IPD All Balanced
Mellon Corporation	5.9%	66,570,732	3 Mth LIBOR + 4% per annum
UBS Bonds	3.7%	41,533,465	FTSE UK Gilts All Stocks
UBS Equities	18.6%	208,820,285	FTSE AW Devel. Tracker (part hedged)
LCIV	0.0%	150,000	None
Cash	-3.7%	(41,658,339)	One-month LIBOR
Total Fund	**100.00%**	**1,121,610,641**	

Chart 2: Fund Allocation by Asset Class as at 30 September 2020

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



4.3 Overall the strategy is overweight equities, with equities at the top end of the range. Cash is underweight due to the pre-payment from the council. 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	56.2%	48%	8.2%	*45–53*
Diversified Growth	15.3%	16%	-0.7%	*16-20*
Infrastructure	8.8%	9%	-0.2%	*4-11*
Credit	6.7%	8%	-1.3%	*6-10*
Property	5.2%	7%	-1.8%	*6-9*
Diversified Alternatives	7.7%	8%	-0.3%	*6-10*
Fixed Income	3.7%	4%	-0.3%	*3-5*
Cash	-3.7%	0%	-3.7%	*0-1*
Senior Loan	0.0%	0%	0.0%	*0-1*

5. Fund Manager Performance

5.1 Kempen

Kempen	2020			2019				2018	One Year	Two Years	Since Start 6/2/13
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4			
£146.54m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**(3.2)**	16.9	(27.9)	1.2	1.3	5.2	5.5	(7.3)	(13.1)	(4.2)	5.7
Benchmark	**3.2**	19.8	(15.7)	1.0	3.8	6.5	9.9	(11.3)	8.3	8.6	12.1
Difference	**(6.4)**	(2.9)	(12.2)	0.2	(2.5)	(1.3)	(4.4)	4.0	(21.4)	(12.8)	(6.4)

Reason for appointment

Kempen were appointed as one of the Fund's global equity managers, specialising in investing in less risky, high dividend paying companies which will provide the Fund with significant income. Kempen holds approximately 100 stocks of roughly equal weighting, with the portfolio rebalanced on a quarterly basis. During market rallies Kempen are likely to lag the benchmark.

Performance Review

The strategy underperformed its benchmark by 6.4% for the quarter and has underperformed its one-year benchmark by 21.4%. Kempen provided an annual return of -4.2% over two years which was 12.8% below the benchmark. It has also underperformed its benchmark since inception by 6.4%, although the return over this period is an annualised return of 5.7%.

Portfolio Rebalancing

Kempen sold two names during Q3: Komatsu and TSMC.

Japanese manufacturer of mining machinery and equipment Komatsu reported disappointing results and reduced its interim dividend. The valuation was no longer attractive so the holding was sold. The shares of Taiwanese technology company TSMC have performed very well this year, however the position was sold as the dividend yield fell below the threshold.

One new stock was added: Sanofi

French pharmaceutical company Sanofi was added as a new position to the portfolio. The shares are attractively valued and offer a growing dividend. The company is a slight beneficiary of the Covid-19 crisis and is working on a vaccine in joint venture with Glaxo (another holding in the portfolio).

5.2 Baillie Gifford

Baillie Gifford	2020			2019				2018	One Year	Two Years	Since Start 6/2/13
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4			
£275.14m	%	%	%	%	%	%	%	%	%	%	%
Actual Return	7.6	27.9	(13.2)	4.9	0.7	7.7	12.4	(12.5)	27.2	17.7	16.3
Benchmark	3.5	19.8	(15.9)	1.5	3.4	6.2	9.8	(10.6)	8.9	8.8	11.9
Difference	4.1	8.1	2.7	3.4	(2.7)	1.5	2.6	(1.9)	18.3	8.9	4.4

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 Q3 BG returned 7.6%, outperforming its benchmark by 4.1%. BG's one-year return was 27.2%, outperforming its benchmark by 18.3%. Since initial funding, the strategy has returned 16.3% p.a., outperforming its benchmark by 4.4%.

Portfolio performance has been driven by strong stock selection within communication services, consumer discretionary and energy. In the managers characterisation of stocks, most of this strong performance was driven by their "Rapid Growth" bucket, with the highest performing names being Tesla, Zillow Group and SEA. The manager had caused headline news in Q3 2020 regarding Tesla as their trimming of the stock down to 2.5% from 3.5% led to a brief panic in the market as other investors began to sell. The stock has now stabilised, and the manager continues to hold high conviction in the business as they believe performance has been underpinned by fundamentals.

Detractors to the portfolio were in industrials, Information technology (IT) and materials. The sub-fund is underweight compared to the benchmark in industrials, but poor stock selection contributed to the underperformance. Kirby group, which belongs in the managers 'Latent Growth' bucket, had a weak quarter as a result of questionable historical capital allocations. In IT, the Sub-fund's lack of exposure to Apple was a large contributor to underperformance.

The manager recognises Tesla as a volatile stock so the trimming of the holding will improve the risk statistics of the portfolio. There were additions to cyclical businesses such as BHP and Ryanair and made a new purchase of Rio Tinto. This ensures that the portfolio remains well diversified across the four different growth buckets. The manager is excited by the prospect of software businesses and have taken new Holdings in Cloudflare, Datadog, Snowflake and Adyen. These additions were made at the minimum holding size of 0.5% and all sit within the manager's

"Rapid Growth" bucket of the sub-fund which has now peaked at 45% of the portfolio.

5.3 UBS Equities

UBS Equities	2020			2019				2018	One Year	Two Years	Since Start 31/08/12
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4			
£208.82m	%	%	%	%	%	%	%	%	%	%	%
Actual Return	5.6	18.8	(19.3)	5.7	2.1	4.0	11.5	(12.8)	10.8	7.8	13.0
Benchmark	5.6	18.8	(19.3)	5.7	2.1	4.1	11.5	(12.9)	10.8	7.8	13.1
Difference	0.0	0.0	0.0	0.0	0.0	(0.1)	0.0	0.1	0.0	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 5.6% for Q3 and 10.8% over one year. Since funding in August 2012, the strategy has provided an annualised return of 13.0%.

Equities

After reaching fresh record highs at the start of September, global equities suffered a correction, with returns on the MSCI AC World index dropping by 3.2% on the month. Switzerland and Japan were the only major markets to post gains. MSCI Emerging markets (-1.6% total return) outperformed MSCI Developed markets (-3.4% total return) in September. After record outperformance of Growth over Value, the trend started to reverse in September.

Technology companies led the market to record highs in early September but has also led the pullback from the peak. The rally in US equities from the March lows has been notable for both its strength and its narrowness, centred on gains for a handful of mega-cap technology names. Supported by lower discount rates and exposure to a less mobile but more connected world, the megacap tech stocks - Facebook, Apple, Amazon, Microsoft, Netflix, and Alphabet, Google's parent company - have rallied by an average of 42% in USD terms this year. At the peak on 2 September, optimism over an earlier than-expected vaccine sparked rotation out of tech, as it suggested potential for a faster economic recovery, prompting flows into more cyclically exposed sectors, such as Value.

5.4 UBS Bonds

UBS Bonds	2020			2019				2018	One Year	Two Years	Since Start 5/7/2013
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4			
£41.53m	%	%	%	%	%	%	%	%	%	%	%
Actual Return	(1.2)	2.5	6.3	(3.9)	6.2	1.4	3.4	1.9	3.7	8.2	5.5
Benchmark	(1.2)	2.5	6.3	(3.9)	6.2	1.3	3.4	1.9	3.7	8.2	5.5
Difference	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	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 Q3 was -1.2%, with a one-year return of 3.7% and a two-year return of 8.2%.

Returns on US and EUR government bonds were both positive in September as yields declined due to rising concerns about a second wave of COVID-19 infections in Europe, US elections and the ongoing negotiations between Democrats and Republicans about a stimulus fiscal package. As volatility rose, credit spreads widened. Spreads for US high yield, USD-denominated emerging market sovereign bonds, and Asia high yields bonds increased by 41, 12 and 51 basis points respectively.

5.5 M&G / Prudential UK

M&G / Prudential	2020			2019				2018	One Year	Two Years	Since Start 31/5/2010
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4			
£0.00m	%	%	%	%	%	%	%	%	%	%	%
Actual Return	0.0	0.0	1.7	0.0	1.7	0.0	1.0	1.2	3.5	4.0	4.5
Benchmark	0.0	0.0	1.2	1.2	1.2	1.0	1.2	1.2	4.6	4.6	2.9
Difference	0.0	0.0	0.5	(1.2)	0.5	(1.0)	(0.2)	0.0	(1.1)	(0.6)	1.6

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).

Performance and Loan Security

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 nil, with all of the loans repaid. The weighted average credit rating is BB+ with an average life of 1.3 years.

This investment completed the sale of its last senior loan and is now closed.

5.6 Schroders Indirect Real Estate (SIRE)

Schroders	2020			2019				2018	One Year	Two Years	Since Start 6/8/2010
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4			
£22.09m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**0.3**	(2.0)	(3.9)	1.0	0.3	0.1	(1.1)	0.3	(4.6)	(2.5)	5.1
Benchmark	**0.2**	(2.0)	(1.3)	0.3	0.4	0.6	0.3	0.9	(2.8)	(0.3)	6.5
Difference	**0.1**	0.0	(2.6)	0.7	(0.1)	(0.5)	(1.4)	(0.6)	(1.8)	(2.2)	(1.4)

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.

Q3 2020 Performance and Investment Update

The fund generated a return in Q3 of 0.3% with a one-year return of negative 4.6% and a two-year return of negative 2.5%.

The best performing sectors continue to be those more resilient to the virus - prime industrials, convenience retail e.g. supermarkets and alternative sectors driven by structural demand and demographic trends.

SIRE's portfolio structure maintains an overweight position relative to its benchmark to the industrial and alternative sectors and an underweight position to the retail sector. SIRE is holding a short-term overweight position to cash reflecting a number of forthcoming redemptions due for payment on the redemption date. The weak economic environment has meant that holding higher than average levels of cash has been accretive to performance over the last 12 months.

No purchases were made in Q3 2020. A sale of £3.9 million was made in Industrial Property Investment Fund at a small discount to the net asset value.

5.7 BlackRock

BlackRock	2020			2019				2018	One Year	Two Years	Since Start 1/1/2013
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4			
£36.61m	%	%	%	%	%	%	%	%	%	%	%
Actual Return	**0.5**	(2.9)	(2.8)	0.6	0.7	0.5	0.1	1.0	(4.5)	(1.1)	0.4
Benchmark	**0.2**	(2.0)	(1.3)	0.3	0.4	0.6	0.3	0.9	(2.8)	(0.3)	3.6
Difference	**0.3**	(0.9)	(1.5)	0.3	0.3	(0.1)	(0.2)	0.1	(1.7)	(0.8)	(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.

Q3 2020 Performance and Investment Update

BR returned 0.5% for the quarter against the benchmark of 0.2%. It returned -4.5% over one year against its benchmark's return of -2.8%.

During the third quarter of the year, the Fund completed two disposals, totalling £46.6 million; there were no acquisitions in Q3 2020. The Fund disposed of Clifton Down Shopping Centre, a supermarket-anchored shopping centre in Bristol. The sale represented a continuation of the strategy to down weight the Fund's retail exposure. The second disposal was of Bowthorpe Industrial Estate, a multi-let industrial estate comprising 66 units in Norwich. It was sold for a net price of £19.4 million. The sale proceeds will be used to invest and drive value in the Fund's existing assets and meet investor redemption requirements.

5.8 Hermes

Hermes	2020			2019				2018	One Year	Two Years	Since Start 9/11/2012
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4			
£98.89m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**0.0**	0.9	3.9	(0.2)	1.2	1.0	(1.5)	1.1	4.6	3.2	8.4
Benchmark	**1.4**	1.4	1.5	1.4	1.5	1.5	1.4	1.4	5.8	5.7	5.9
Difference	**(1.4)**	(0.5)	2.4	(1.6)	(0.3)	(0.5)	(2.9)	(0.3)	(1.2)	(2.5)	2.5

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 which ended on 30th April 2020 and a base term of 18 years. In March 2015 Members agreed to increase the Fund's allocation to Hermes to 10%.

Performance

Hermes returned 0.0% in Q3 underperforming the benchmark by 1.4%. As at 30 September 2020, the strategy reported a one-year positive return of 4.6%, underperforming its benchmark by 1.2%. Since inception the strategy has provided a good, annualised return of 8.4%, outperforming its benchmark by 2.5%.

Portfolio review

In the Value-Added portfolio, Eurostar's volumes were already down significantly following quarantine measures in August and have reduced further following recent lockdowns in England and France. This has accelerated an extensive business review focusing on cash flow management, rightsizing the business to meet expected demand, whilst also reducing fixed costs.

Scandlines has experienced further reductions in leisure and shopping volumes since the emergence of a second wave in Denmark and Germany from mid-September. This trend has accelerated following new restrictions imposed by governments in October. Cargo volumes remain robust, ensuring the business remains profitable, which together with proportionate cost measures being undertaken and a strong rebound in trading over the summer months, should ensure that liquidity and covenant headroom are sufficient in the near term.

In the Core portfolio, Iridium Hermes Roads ('IHR') experienced a strong rebound in traffic volumes over the summer months, trending in line with 2019 levels. However, regional restrictions imposed in Spain in the second half of October have caused traffic volumes to fall by c.25%. Whilst significant, this compares to a c75% reduction in the first lock-down. There remains sufficient liquidity within the business and with only one operating road requiring a covenant waiver in the near term, which is underway.

Associated British Ports continues to trade below budget due to weaker than expected volumes across most sectors. However, the latest lock-down in itself is not expected to further impact ABP in the near term and liquidity and covenant headroom levels remain sufficient for the time being.

5.9 Aberdeen Standard Asset Management

Aberdeen Standard	2020			2019				2018	One Year	Two Years	Since Start 15/9/2014
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4			
£85.89m	%	%	%	%	%	%	%	%	%	%	%
Actual Return	5.1	(0.6)	0.7	(0.2)	1.9	2.3	0.6	(0.8)	5.0	4.4	4.1
Benchmark	1.0	1.3	1.2	1.2	1.2	1.2	1.2	1.1	4.7	4.7	4.7
Difference	4.1	(1.9)	(0.5)	(1.4)	0.7	1.1	(0.6)	(1.9)	0.3	(0.3)	(0.6)

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 5.1% in Q3 2020, outperforming its benchmark by 4.1%. The largest contributors were Advent International GPE VIII & PAI Europe VI. In terms of losers, the largest detractor was RIDA.

Over one year the mandate has outperformed its benchmark, with a return of 5.0% against a benchmark of 4.7%. Since inception in September 2014, the strategy has returned 4.1%, underperforming its benchmark by 0.6%.

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	2020			2019				2018	One Year	Two Years	Since Start 28/9/2012
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4			
£105.36m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**(1.6)**	6.2	(4.8)	0.7	0.9	1.1	2.7	(2.0)	0.4	1.6	3.1
Benchmark	**1.8**	1.3	1.5	1.5	1.7	2.8	1.1	1.5	6.0	6.6	6.9
Difference	**(3.4)**	4.9	(6.3)	(0.8)	(0.8)	(1.7)	1.6	(3.5)	(5.6)	(5.0)	(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 return of -1.6% in Q3 underperforming its benchmark by 3.4%. Over one year the strategy has returned 0.4%, underperforming its benchmark by 5.6%. Pyrford underperformed its benchmark by 3.8% since inception.

Within the portfolio, both equities and bonds detracted during the third quarter, while the currency hedging programme positively contributed to the quarterly performance. The current asset allocation in the portfolio remains mostly the same as last quarter, with 41% in equities, 58% in bonds and 1% allocation to cash. Within fixed income, the manager continues to adopt a very defensive stance by owning short duration securities to protect the capital value of the portfolio from expected rises in yields. The bond duration target was reduced from 2.5 to 1.5 years following further falls in bond yields.

Outlook and Strategy

Equity markets painted a mixed picture over the third quarter. Brexit uncertainty dominates the outlook and with a year end deadline looming for the UK EU trade deal, the current state of negotiations does not inspire confidence in a positive outcome. Finally, the government bonds markets were unremarkable over the quarter although yields did begin to creep up in the markets sub fund currently invests in. With yields remaining at rock bottom, the manager remains comfortable at the short end of yield curve heading into the final quarter of the year.

The equity side of the portfolio has struggled to keep up with the market due to allocations to the Telecommunication and Energy sectors. There were no asset allocation changes to overseas bonds, but this part of the portfolio detracted over the quarter as sterling strengthened significantly against the US and Canadian dollar. The exposure to short duration bonds acts as a capital protection for the portfolio, but the yield remains on the lower end.

5.11 Newton

Newton	2020			2019				2018	One Year	Two Years	Since Start 31/8/2012
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4			
£75.67m	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	**3.5**	8.0	(9.2)	1.6	1.7	4.3	4.2	(1.7)	3.8	6.1	3.8
Benchmark	**1.0**	1.1	1.2	1.2	1.2	1.0	1.2	1.2	4.4	4.5	4.5
Difference	**2.5**	6.9	(10.4)	0.4	0.5	3.3	3.0	(2.9)	(0.6)	1.6	(0.7)

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 return of 3.5% in Q3 and outperformed its benchmark by 2.5%. Over one year the strategy has returned 3.8%, underperforming its benchmark by 0.6%. Newton's performance since inception is 3.8% and underperforms its benchmark by 0.7%.

The portfolio performance was mainly driven by positions in stabilising assets, where increased exposure to gold continues to deliver substantial positive returns during the third quarter. On the return seeking side, equities, corporate bonds, and alternatives also contributed to the performance, while allocation to emerging market debt detracted by quarter end. Allocation to cash was reduced and redistributed to risk assets, which in turn is balanced out with increased exposure to gold.

The portfolios exposure is summarised below:

Portfolio Exposures		
	30 June 2020	30 September 2020
Equities	**37.00**	**41.30**
UK	6.40	6.50
North America	12.20	16.60
Europe	12.70	12.30
Japan	0.40	0.60
Pacific Basin Ex Japan	2.90	2.20
Emerging Markets	2.40	3.10
Fixed Income	**23.30**	**21.70**
Government Bonds	3.90	1.30
Corporate Bonds	13.10	10.50
Index Linked Government	2.80	3.40
Emerging Debt	3.50	6.50
Alternatives	**39.70**	**37.00**
Infrastructure Funds	11.30	12.90
Renewable Energy	0.00	0.00
Precious Metals	15.40	17.80
Derivative Instruments	1.50	1.60
Cash and FX Forwards	11.50	4.70
Total	**100.00**	**100.00**

5.12 Mellon Corporation (Standish)

Mellon Corporation	2020			2019				2018	One Year	Two Years	Since Start 20/8/2013
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4			
£66.57m	%	%	%	%	%	%	%	%	%	%	%
Actual Return	**1.5**	4.7	(2.3)	(0.0)	0.1	0.8	1.9	(2.7)	3.8	1.9	0.9
Benchmark	**1.0**	1.3	1.2	1.2	1.2	1.2	1.2	1.2	4.7	4.8	5.1
Difference	**0.5**	3.4	(3.5)	(1.2)	(1.1)	(0.4)	0.7	(3.9)	(0.9)	(2.9)	(4.2)

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 returned 1.5% against a benchmark return of 1.0%. Over one year the strategy has underperformed its benchmark of 4.7% by 0.9%, providing a return of 3.8%. Since funding in August 2013, Mellon Corporation has only provided an annual return of 0.9%. The Fund's asset allocation to corporate credit was the primary contributor to its return.

Portfolio Composition:

Allocation to corporate credit remained stable throughout the quarter at around 42% split between Investment Grade and High Yield. The allocation to credit was increased from historically low levels held earlier in Q1 2020 to capitalise on the significant dislocation in credit spreads resulting from the COVID 19 pandemic sell off in risk in March. The portfolio maintains a significant allocation to developed market sovereign debt at 47% market value but employs futures to generate an overall negative duration contribution of 3 years to offset the rate duration contribution from corporates.

Strategy Review

Given the consistent underperformance of the strategy both against the benchmark and peer groups, Members agreed to replace BNY Mellon as the fund's active credit manager and to appoint a manager through the LCIV's Multi-Asset Credit (MAC) fund.

In July 2019, the LCIV informed officers that they have put the MAC manager 'on watch' so the transition process 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 the MAC Strategy. 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 2019 was set. However, due to uncertainties around Brexit, the fund was advised that the manager would not be trading.
- The transition date was then delayed to the of November 2019, however, the fund was advised against this due to the Thanksgiving Day.

On 21 November 2019, LCIV raised a number of options for their Multi Asset Credit (MAC) strategy. As a result, the transition to the MAC strategy was put on hold until this position could be clarified. LCIV then announced that the MAC fund is no longer on watch but will be increasing the level of monitoring of the manager.

On 23rd July 2020, officers were informed that the LCIV are looking to add another investment option to the MAC Strategy to provide a more robust performance and better risk profile for investors, without the single manager risk that currently exists. The current MAC manager remains on enhanced monitoring status, so the transition is still on hold.

5.13 Currency Hedging

No new currency hedging positions were placed in Q3 2020.

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, Finance Director

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 Q3 2020 Report; and
- Fund Manager Q3 2020 Reports.

List of appendices:

Appendix 1 - Fund Asset and Liability Values 31 March 2013 to 30 September 2020
Appendix 2 - Definitions
Appendix 3 - Roles and Responsibilities