

## PENSIONS COMMITTEE

14 December 2021

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| <b>Title:</b> Pension Fund Quarterly Monitoring 2021/22 – 1 July to 30 September 2021  |   |
| <b>Report of the Managing Director</b>   |   |
| <b>Open Report</b>   | <b>For Information</b>  |
| <b>Wards Affected:</b> None  | <b>Key Decision:</b> No   |
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| <b>Accountable Director:</b> Philip Gregory, Chief Financial Officer   |   |
| <b>Accountable Strategic Leadership Director:</b> Claire Symonds, Managing Director  |   |
| <b>Summary</b><br><br>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 2021.<br><br>The report updates the Committee on the Fund’s investment strategy and its investment performance.   |   |
| <b>Recommendation(s)</b><br><br>The Pension Committee is recommended to note:<br><br>(i) the progress on the strategy development within the Fund;<br><br>(ii) the Fund’s assets and liabilities daily value movements outlined in Appendix 1;<br><br>(iii) the purchase of £500k of BlackRock units at 30 November 2021; and<br><br>(iii) the quarterly performance of the fund collectively and the performance of the fund managers individually. |   |
| <b>Reason(s)</b>   |   |

### 1. Introduction and Background

1.1 This report provides information for employers, members of the LBB D Pension Fund (“the Fund”) and other interested parties on how the Fund has performed during the quarter 1 July to 30 September 2021 (“Q3”). The report updates the Committee on the Fund’s investment strategy and 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. A verbal update on the unaudited performance of the Fund for the period to 13 December 2021 will be provided to Members at the Pension Committee.

## **2. Independent Advisors Market Background Q3 2021**

- 2.1 For Q3, world equity markets were flat with the MSCI World Index, in US\$ terms, at (almost exactly) the same level on 30 September as at 30 June. The Quarter however saw equity markets as a whole clearly advancing in both July and August before experiencing a fall of over 4% in September.
- 2.2 There was a clear difference in performance across geographies. The developed US, European, UK and Japanese markets all advanced by around 0.3% to 2.5% (in their own currency terms) while Asia (excluding Japan) and Emerging Markets fell by 8%-9% overall. Positive earnings results and high COVID vaccination levels reassured developed markets. All markets, but particularly Asia and Emerging Markets were negatively impacted by supply chain shortages, the Chinese governments intervention in the Chinese technology and private education sectors, and concerns about the ability of Evergrande, China's second largest property group, to service its debts.
- 2.3 Financial market concerns regarding inflation deepened in the context of supply shortages and energy price rises with an increasing view in financial markets that higher levels of inflation may be more than "transitory." The major central banks, while acknowledging that inflation may be elevated for some time, remained of the view that it would remain "transitory." There were indications from the US Federal Reserve (the Fed) and the Bank of England (BoE) of future, but considered and measured, interest rate rises in the context of judgements regarding achieving the 2% inflation target.
- 2.4 In July and August US equities were supported by strong earnings results and reassurances regarding the timing/circumstances of monetary tightening by the Federal Open Markets Committee (FOMC) of the Fed by Chair Jay Powell at the central bankers annual Jackson Hole summit. The S&P 500 increased to 4,523 on 31 August and reached a (then) all-time closing high of 4,537 on 2 September but closed on 30 September at 4,308, which was 0.2% up for the quarter. September was a poor month due to concerns over a default by Chinese property group Evergrande, concerns whether Congress would increase the debt ceiling to avoid the government defaulting on some of its financial obligations and renewed concerns regarding the future of monetary policy following the FOMC meeting of 21-22 September.
- 2.5 At both its July and September meetings the FOMC of the Fed voted, yet again, to maintain its main interest rate at the range of 0-0.25% and its asset purchase programme at \$120 billion per month. However, there were increasing indications of approaching monetary policy tightening. The press release issued after the July meeting hinted at future reductions in asset purchases referring to "progress towards" achieving the Committee's goals of maximum employment and price stability. The press release issued after the 21-22 September meeting was clear that there could soon be a reduction in monthly asset purchases stating in relation to maximum employment and price stability that "If progress continues broadly as expected, the Committee judges that a moderation in the pace of asset purchases may soon be warranted." Furthermore, the "Summary of Economic Projections" issued after the September meeting indicated an increased expectation of interest rate rises during 2022 compared with the previous projections issued in June.
- 2.6 US inflation as measured by the Core PCE index (the Fed favoured index) remained clearly above the policy target of 2% with July, August and September all registering 3.6%. The FOMC indicated some heightened expectations regarding future inflation

with the Minutes of the September 2021 meeting stating (page 8) “Participants marked up their inflation projections...Some participants expressed concerns that elevated rates of inflation could feed through into longer-term inflation expectations...” The “Summary of Economic Projections” issued after the September meeting suggested Core CPI at 2.3% in 2022 up from the 2.1% issued following the June FOMC meeting. Unemployment continued to fall, to 4.8% in September compared to 5.9% in June.

- 2.7 US economic growth continued but slowed dramatically in the Quarter. On 28 October, the US Bureau of Economic Analysis estimated US GDP increased at an annual rate of 2.0% in the period July to September compared to 6.7% in the previous Quarter. This equates to growth of 0.5% over the July to September period. The University of Michigan survey of consumers saw a major fall, during Q3 in consumer sentiment. The August Final Results release referred to consumers negative reactions citing “the surging Delta variant, higher inflation, slower wage growth, and smaller declines in unemployment” but cautioned this “does not imply an imminent economic downturn...”
- 2.8 Eurozone equities enjoyed a positive July and August supported by positive corporate earnings and high vaccine rates. However, in September Eurozone equities, as with world equities as a whole experienced a clear decline. The MSCI EMU index advanced by 0.3% in Euro terms over the Quarter. On 29 October Eurostat issued “a preliminary flash estimate” of Q3 Eurozone GDP growth of 2.2%. This was compared with the official estimates for the US of 0.5% and China of 0.2% for the same period. The Eurozone, however, remains behind the US and China in terms of its pandemic economic recovery. Euro area inflation as measured by the Harmonised Index of Consumer Prices (HIPC) and reported by Eurostat exceeded the new ECB inflation goal of 2% over the medium term throughout Q3 reaching 3.0% in August and 3.4% in September. At her press conference of 9 September ECB President Christine Lagarde, while referring to improvements in the euro area economy as a whole, increased consumer spending and an improving labour market struck a somewhat cautious note stating that “We see the risks to the economic outlook as finely balanced...”
- 2.09 On 8 July 2021, the ECB published its new Monetary Policy Strategy Statement which was last revised in 2003. The new strategy is modestly but clearly more tolerant of inflation. While the previous target was below but close to 2% the new target is 2%. In addition, the ECB indicated in a commentary also issued on 8 July (entitled “An overview of the ECB’s monetary policy strategy”) that while the old inflation target had led to a perception of aiming not above the target the new inflation target is a “symmetric” one where moderate deviation above and below the target were allowable on a temporary basis. This new Policy Strategy should therefore clearly reduce the chance of premature monetary tightening and make it more likely that the ECB will keep its ultra-loose monetary policy approach for a longer period.
- 2.10 At the July policy setting meeting the ECB retained its previous ultra-supportive monetary policy approach. At the meeting that concluded on 9 September the ECB maintained its ultra-low/negative interest rate policy, forward guidance on interest rate policy, standard asset purchase programme at 20 billion Euros a month, its reinvestment policies and longer-term refinancing operations. There was however a slight tightening of policy with the Press Release issued after the meeting stating “Based on a joint assessment of financing conditions and the inflation outlook, the Governing Council judges that favourable financing conditions can be maintained with a moderately lower pace of net asset purchases under the pandemic emergency purchase programme (PEPP) than in the previous two quarters.” At the press

conference following the meeting Christine Lagarde, however, definitively stated that the ECB was not “tapering” but merely “recalibrating” the PEPP.

- 2.11 Compared with World equities, UK equities enjoyed a successful Q3. Corporate earnings were positive, and merger and acquisition activity also buoyed small and mid-cap equities in particular. Notwithstanding market falls in September the FTSE All Share index ended the Quarter 2% up while the mid cap FTSE 250 advanced by 3%. UK unemployment rate was 4.5% for the Q3 which was only 0.5% above the pre pandemic level. CPI inflation which had been 2.5% in June continued its upward trend recording over 3% in both August and September with further increases expected. The September Monetary Policy Summary issued by the BoE stated “CPI inflation is expected to rise further in the near term, to slightly above 4% in 2021 Q4...”. August and September meetings of the BoE MPC retained Bank Rate at its all-time low of 0.1% and maintained existing policy regarding asset (bond) purchases. The MPC indicated potential future tightening of monetary policy at both the August and September meetings, but this was clearly nuanced. However, given the overall content of the Minutes and Monetary Policy Statement issued after the 23 September meeting market commentators indicated expectations of an increase in interest rates (Bank Rate) by February 2022. Following a speech by Andrew Bailey the Governor of the BoE on 27 September the Financial Times printed an article (28 September 2021, page 2) entitled “Bailey says MPC united behind rate increase this year if needed.”
- 2.12 Japanese equities outperformed world markets with the Nikkei 225 Index advancing by over 2% for Q3. Deflation in Japan (which had persisted since October 2020) continued, but September saw inflation return (just) with the CPI index at +0.2%. Unsurprisingly, in contrast to the Fed and BoE, the Bank of Japan did not at all indicate that it was considering tightening its longstanding ultra-loose approach to monetary policy at either its July or September meetings. Asia (ex Japan) and Emerging Markets (EM) were negatively impacted by the Chinese governments intervention in the Chinese technology and private education sectors, and concerns Evergrande. The MSCI EM index declined by over 8% (in \$) while the MSCI AC Asia (ex Japan) index declined more than 9% (in \$). Chinese economic activity was constrained by energy shortages and government action to control leverage in the property sector. Official Chinese Government statistics indicated China’s GDP grew by 0.2% during the Q3.
- 2.13 The benchmark US 10 Year Treasury weakened slightly from 1.47% to 1.49% and UK 10 Year Gilt weakened from 0.72% to 1.02% over the Quarter. Both weakened clearly (but not dramatically) in late September. This was in the context of increasing financial market inflation concerns, and indications following their September meetings from both the US Fed and in particular the BoE resulting in markets anticipating they could soon tighten their monetary policy approach.
- 2.14 In conclusion, Q3 saw a respite from the overall dramatic upward trend in Equity prices seen since April 2020 but not an overall fall. This ultimately sideward move in markets occurred even in the light of concerns about China, supply side shortages, ST inflation and indications from two of the world’s leading central banks of potential forthcoming monetary policy tightening. While the Fed & BoE gave clear indications of likely future, but limited, monetary tightening this did not result in a “tantrum” in either Equity or Bond markets. It remains, however, a matter of considerable debate as to whether inflation will remain clearly above 2% for a prolonged period or not. This is, of course, a matter of real concern and potential impact upon all of national economies, individuals and financial markets/asset performance going forward.

### 3. Overall Fund Performance

3.1 The Fund's closed Q3 valued at £1,396.9m, an increase of £7.7m from its value of £1,389.2m at 30 June 2021. Cash held by the Fund was £0.48m, giving a total Fund value of £1,397.35m. The gross value includes a prepayment of £30.0m and a short-term loan of £23.7m from the Council. Adjusting for this reduces the Q3 value to £1,342.75m, an increase of £16.07m from the 30 June figure of £1,326.68m.

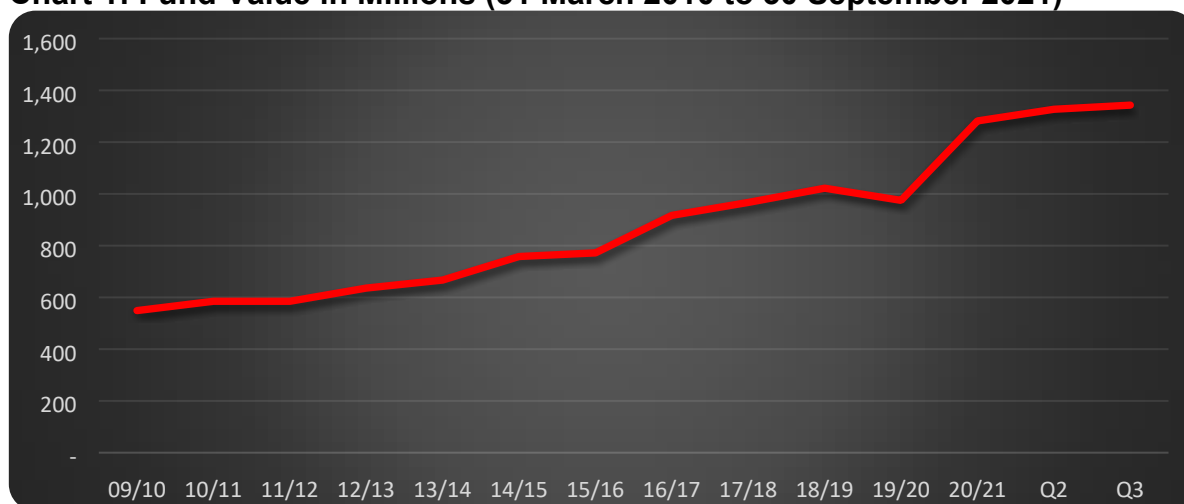
3.2 For Q3 the Fund returned 1.1%, net of fees, underperforming its benchmark by 0.6%. Over one year the Fund outperformed its benchmark by 4.2%, returning 19.8% and underperformed the benchmark by 0.9% over three years, returning 8.6%. The Fund has also underperformed its benchmark over five years by 0.2%, returning 9.6%. Compared to the LGPS universe of Funds, represented below by the PIRC Universe, the Fund has outperformed by 3.4% over one year and by 0.9% over three years. Over five years the Fund has outperformed by 1.1%. The Fund's returns are below:

**Table 1: Fund's 2021, 2020 and 2019 Quarterly and Yearly Returns**

| Year               | 2021  |       |     | 2020 |     |      | 2019   | One Year | Two Years | Three Years | Five Years |       |
|--------------------|-------|-------|-----|------|-----|------|--------|----------|-----------|-------------|------------|-------|
|                    | Q3    | Q2    | Q1  | Q4   | Q3  | Q2   | Q1     |          |           |             |            | Q4    |
| Actual Return      | 1.1   | 4.2   | 3.6 | 8.0  | 2.8 | 12.3 | (11.4) | 2.2      | 19.8      | 11.4        | 8.6        | 9.6   |
| Benchmark          | 1.7   | 4.6   | 2.5 | 5.1  | 2.5 | 9.6  | (7.7)  | 1.7      | 15.6      | 10.0        | 9.5        | 9.8   |
| Difference         | (0.6) | (0.4) | 1.1 | 2.9  | 0.3 | 2.7  | (3.7)  | 0.5      | 4.2       | 1.4         | (0.9)      | (0.2) |
| PIRC Universe      | 1.4   | 5.6   | 2.4 | 5.8  | 1.8 | 11.3 |        |          | 16.4      |             | 7.7        | 8.4   |
| Difference to PIRC | (0.3) | (1.4) | 1.2 | 2.2  | 1.0 | 1.0  |        |          | 3.4       | 11.4        | 0.9        | 1.1   |

3.3 Chart 1 below shows the Fund's value since 31 March 2010 to 30 September 2021.

**Chart 1: Fund Value in Millions (31 March 2010 to 30 September 2021)**



3.4 The fund manager's performance has been scored using a quantitative analysis compared to the benchmark returns, defined below:

|  |   |
|--|---|
|  | <b>RED-</b> Fund underperformed by more than 3% against the benchmark   |
|  | <b>AMBER-</b> Fund underperformed by less than 3% against the benchmark |
|  | <b>GREEN-</b> Fund is achieving the benchmark return or better          |

3.5 Appendix 1 illustrates changes in the market value, the liability value, the Fund's deficit and the funding level from 31 March 2013 to 27 October 2021. Members are asked to note the changes in value and the movements in the Fund's funding level.

### 3.6 Table 2 – Fund Manager Q3 2021 Performance

| Fund Manager    | Actual % | Benchmark % | Variance % | Ranking |
|-----------------|----------|-------------|------------|---------|
| Abrdn           | 4.9      | 1.0         | 3.9        |         |
| Baillie Gifford | (0.6)    | 1.5         | (2.0)      |         |
| BlackRock       | 4.3      | 4.5         | (0.2)      |         |
| Hermes GPE      | 2.2      | 1.4         | 0.7        |         |
| Kempen          | 3.0      | 2.5         | 0.5        |         |
| Newton          | (0.1)    | 1.0         | (1.1)      |         |
| Pyrford         | 0.3      | 2.7         | (2.4)      |         |
| Schroders       | (4.5)    | 4.5         | (9.0)      |         |
| Insight         | 0.0      | 1.0         | (1.0)      |         |
| UBS Bonds       | (1.8)    | (1.8)       | 0.0        |         |
| UBS Equities    | 0.9      | 0.9         | 0.0        |         |

Table 2 highlights the Q3 2021 returns. Abrdn, BlackRock and Kempen provided returns above 3%, with Hermes providing a 2.2% return. Most other funds were flat. Schroders underperformed its benchmark by 4.5% but this is being investigated as this may be an issue caused by the reporting methodology used by the Fund's Custodian. UBS bonds returned -1.8% as bond yields increased during the quarter

### 3.7 Table 3 – Fund Manager Performance Over One Year

| Fund Manager          | Type               | Asset (%)      | Market Value (£000) | Actual | Bench mark | Variance | Ranking |
|-----------------------|--------------------|----------------|---------------------|--------|------------|----------|---------|
| Baillie Gifford       | Equity Active      | 23.80%         | 332,757             | 19.9   | 21.1       | - 1.3    |         |
| Kempen                | Equity Active      | 14.20%         | 198,067             | 31.3   | 21.8       | 9.6      |         |
| UBS Equities          | Equity             | 19.10%         | 266,133             | 25.3   | 25.3       | -        |         |
| Abrdn                 | Alternatives       | 10.00%         | 140,170             | 25.0   | 4.0        | 21.0     |         |
| BlackRock             | UK Property        | 3.70%          | 51,813              | 11.7   | 12.6       | - 0.9    |         |
| Schroders             | UK Property        | 0.80%          | 11,318              | 5.0    | 12.6       | - 7.6    |         |
| Newton                | Diversified Growth | 5.90%          | 82,595              | 9.0    | 4.0        | 5.0      |         |
| Pyrford               | Diversified Growth | 8.00%          | 111,242             | 5.5    | 9.6        | - 4.1    |         |
| Hermes GPE            | Infrastructure     | 6.80%          | 95,586              | 0.3    | 5.8        | - 5.5    |         |
| Mellon Corp.          | Credit             | 4.90%          | 68,339              | 2.3    | 4.0        | - 1.7    |         |
| UBS Bonds             | Bonds              | 2.80%          | 38,706              | - 6.8  | - 6.8      | -        |         |
| LCV                   | Equity             | 0.00%          | 150                 |        |            |          |         |
| Cash                  | Cash               | 0.00%          | 476                 |        |            |          |         |
| <b>Fund Value</b>     |                    | <b>100.00%</b> | 1,396,400           |        |            |          |         |
| ST Loan               | Loan               |                | - 23,650            |        |            |          |         |
| Prepayment            | Prepayment         |                | - 30,000            |        |            |          |         |
| <b>Net Fund Value</b> |                    |                | 1,342,750           | 19.8   | 15.6       | 4.3      |         |

|             |                    |  | Value (£000) | Funding Level |
|-------------|--------------------|--|--------------|---------------|
| Liabilities | Hymans Robertson   |  | 1,352,763    | 99.3%         |
| Liabilities | Barnett Waddingham |  | 1,328,436    | 101.1%        |

Over one-year Kempen has provided a return of 31.3% which was 9.6% above the benchmark, Baillie Gifford has returned 20.0%, underperforming the benchmark by

1.3% and UBS a return of 25.3%. UBS Bonds has returned -6.8% over the 1-year period. Both Blackrock, the funds property manager and Hermes the infrastructure manager underperformed the benchmark by 0.9% & 5.5% respectively. Market value, type of asset and Funding level has been included to provide context.

### 3.8 Table 4 – Fund manager performance over two years

| Fund Manager     | Actual % | Benchmark % | Variance % | Ranking |
|------------------|----------|-------------|------------|---------|
| Abrdn            | 15.0     | 4.4         | 10.6       |         |
| Baillie Gifford  | 23.5     | 15.0        | 8.5        |         |
| BlackRock        | 3.6      | 4.9         | (1.3)      |         |
| Hermes GPE       | 2.4      | 5.8         | (3.4)      |         |
| Kempen           | 9.1      | 15.0        | (5.9)      |         |
| Prudential / M&G | 0.9      | 1.2         | (0.3)      |         |
| Newton           | 6.4      | 4.2         | 2.2        |         |
| Pyrford          | 3.0      | 7.8         | (4.8)      |         |
| Schroders        | 0.2      | 4.9         | (4.7)      |         |
| Insight          | 3.0      | 4.4         | (1.3)      |         |
| UBS Bonds        | (1.5)    | (1.6)       | 0.0        |         |
| UBS Equities     | 18.0     | 18.0        | 0.0        |         |

Over two years, (table 4), all mandates, with the exception of UBS bonds, are positive. Returns ranged from (1.5%) for UBS bonds to 23.5% for Baillie Gifford. Pyrford and Insight (formerly Mellon Corp and Standish) continue to struggle, underperforming their benchmarks but providing positive actual returns overall. Kempen also underperformed the benchmark by 5.9% with a return of 9.1%

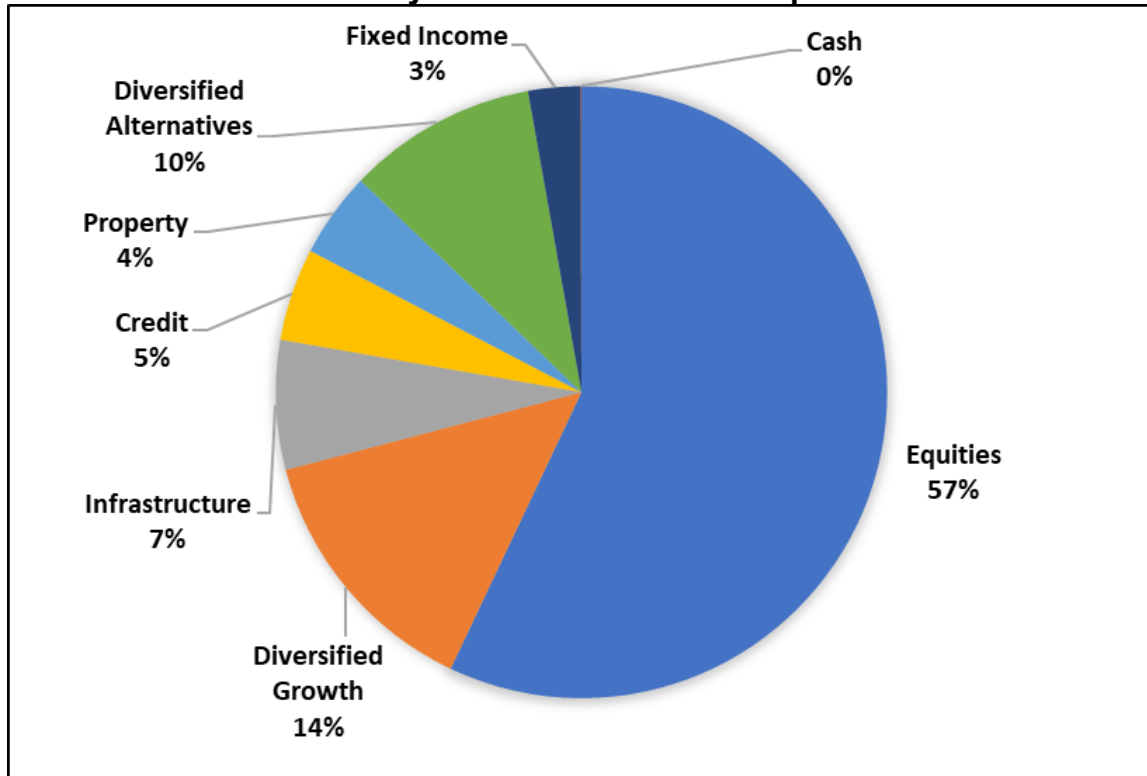
### 4. Asset Allocations and Benchmark: Table 5 outlines the Fund's asset allocation, asset value & benchmark as at 30 September 2021.

#### 4.1 Table 5: Fund Asset Allocation and Benchmarks as at 30 September 2021

| Fund Manager          | Asset (%)     | Market Values (£000) | Benchmark                         |
|-----------------------|---------------|----------------------|-----------------------------------|
| Abrdn                 | 10.0%         | 140,170              | 3 Mth LIBOR + 4% per annum        |
| Baillie Gifford       | 23.8%         | 332,757              | MSCI AC World Index               |
| BlackRock             | 3.7%          | 51,813               | AREF/ IPD All Balanced            |
| Hermes GPE            | 6.8%          | 95,586               | Target yield 5.9% per annum       |
| Kempen                | 14.2%         | 198,067              | MSCI World NDR Index              |
| Newton                | 5.9%          | 82,595               | One-month LIBOR +4% per annum     |
| Pyrford               | 8.0%          | 111,242              | UK RPI +5% per annum              |
| Schroders             | 0.8%          | 11,318               | AREF/ IPD All Balanced            |
| Mellon Corp.          | 4.9%          | 68,339               | 3 Mth LIBOR + 4% per annum        |
| UBS Bonds             | 2.8%          | 38,706               | FTSE UK Gilts All Stocks          |
| UBS Equities          | 19.1%         | 266,133              | FTSE AW Developed (partly hedged) |
| LCIV                  | 0.0%          | 150                  | None                              |
| Cash                  | 0.0%          | 476                  |                                   |
| <b>Fund Value</b>     | <b>100.0%</b> | <b>1,396,400</b>     |                                   |
| ST Loan               |               | (23,650)             | One-month LIBOR                   |
| Prepayment            |               | (30,000)             | 2 year Prepayment - £40m          |
| <b>Net Fund Value</b> |               | <b>1,342,750</b>     |                                   |

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 30 September 2021**



4.3 The strategy is overweight equities, with equities near the top end of the range. Cash excludes the pre-payment and short-term borrowing from the council. The current position, compared to the strategic allocation, is in table 6 below:

**Table 6: Strategic Asset Allocation**

| Asset Class              | Current Position | Strategic Allocation Target | Variance | Range |
|--------------------------|------------------|-----------------------------|----------|-------|
| Equities                 | 57.0%            | 52%                         | 5.0%     | 50-60 |
| Diversified Growth       | 13.9%            | 16%                         | -2.1%    | 14-18 |
| Infrastructure           | 6.8%             | 8%                          | -1.2%    | 7-11  |
| Credit                   | 4.9%             | 8%                          | -3.1%    | 6-10  |
| Property                 | 4.5%             | 5%                          | -0.5%    | 4-7   |
| Diversified Alternatives | 10.0%            | 9%                          | 1.0%     | 7-10  |
| Fixed Income             | 2.8%             | 4%                          | -1.2%    | 3-5   |
| Cash                     | 0.0%             | 0%                          | 0.0%     | 0-1   |
| Total Fund               | 100.00%          | 100.00%                     |          |       |



## 5. Fund Manager Performance

### 5.1 Kempen

| Kempen        | 2021 |       |      | 2020 |       |       |        | 2019 | One Year | Two Years | Since 6/2/13 |
|---------------|------|-------|------|------|-------|-------|--------|------|----------|-----------|--------------|
|               | Q3   | Q2    | Q1   | Q4   | Q3    | Q2    | Q1     | Q4   |          |           |              |
| £198.67m      | %    | %     | %    | %    | %     | %     | %      | %    | %        | %         | %            |
| Actual Return | 3.0  | 2.9   | 10.2 | 15.3 | (3.2) | 16.9  | (27.9) | 1.2  | 31.3     | 9.1       | 8.7          |
| Benchmark     | 2.5  | 7.6   | 4.0  | 7.8  | 3.2   | 19.8  | (15.7) | 1.0  | 21.8     | 15.0      | 13.4         |
| Difference    | 0.5  | (4.7) | 6.2  | 7.5  | (6.4) | (2.9) | (12.2) | 0.2  | 9.6      | (5.9)     | (4.7)        |

#### 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 0.5% for Q3 and has outperformed over one-year by 9.6%. Kempen provided an annual return of 9.1% over two years which was 5.9% below the benchmark. It has also underperformed its benchmark since inception by 4.7% but providing an annualised return of 8.7%.

#### Portfolio Rebalancing

The strategy outperformed both its benchmark and the dividend universe (by 0.9%), driven by stock selection Energy and Financials and in each region. The portfolio has a forward-looking dividend yield of 4.8%, a significant uplift in outlook.

On 1 July Roderick van Zuylen and Reineke Davidsz joined Kempen. Roderick joins from Laaken Asset Management and will cover Energy and Utilities. Reineke joins from APG Asset Management and will cover Consumer Staples and Consumer Discretionary.

Kempen continue to believe that the valuation dispersion in the market provides an attractive opportunity for long-term investors. The portfolio still trades at a discount versus the market and we believe offers exposure to attractively valued companies with good capital discipline and positive cash flow generation. The dividend outlook for the portfolio has improved and Kempen foresee a 15-20% increase in dividends in 2021.

## 5.2 Baillie Gifford

| Baillie Gifford | 2021  |       |       | 2020 |     |      |        | 2019 | One Year | Two Years | Since 6/2/13 |
|-----------------|-------|-------|-------|------|-----|------|--------|------|----------|-----------|--------------|
|                 | Q3    | Q2    | Q1    | Q4   | Q3  | Q2   | Q1     | Q4   |          |           |              |
| £332.76m        | %     | %     | %     | %    | %   | %    | %      | %    | %        | %         | %            |
| Actual Return   | (0.6) | 7.1   | 2.2   | 11.1 | 7.6 | 27.9 | (13.2) | 4.9  | 19.9     | 23.5      | 16.8         |
| Benchmark       | 1.5   | 7.4   | 3.7   | 8.6  | 3.5 | 19.8 | (15.9) | 1.5  | 21.1     | 15.0      | 13.4         |
| Difference      | (2.0) | (0.3) | (1.5) | 2.5  | 4.1 | 8.1  | 2.7    | 3.4  | (1.3)    | 8.5       | 3.4          |

### 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 (0.6%), underperforming its benchmark by 2.0%. BG's one-year return was 19.9%, underperforming its benchmark by 1.3%. Since initial funding, the strategy has returned 16.8% p.a. outperforming its benchmark by 3.4%.

Despite some broader concerns fuelled by uncertainty over the short-term macroeconomic outlook, BG remains optimistic and focused on the long-term growth prospects. BG argue the pandemic has been a catalyst of change in the ways we work, shop and play and have been positioning the Sub-fund to take advantage of these changes.

In their view the current, post-pandemic, period has not only pulled forward some portion of a finite amount of demand but offers glimpses of how the pandemic has accelerated changes in a number of industries and broadened the impact of technology.

These views are expressed most clearly in the 'Rapid Growth' segment of the fund which contains a broad representation of the real economy including entertainment, transportation, real estate, retail and last mile logistics. They advocate that the pandemic has triggered an avalanche of change and there will be structural consequences which are not yet fully appreciated. Importantly, the investment manager believes that innovation is speeding up and spreading out and we are closer to the beginning than the end of that process.

As noted in previous quarterly notes, following the retirement of Charles Plowden, Senior Partner, Helen Xiong was promoted to replace him in the portfolio management team of the Sub-fund. This team now comprises Helen Xiong, Spencer Adair and Malcolm MacColl who concurrently was promoted to Senior Partner.

Despite recent weakness BG continues to deliver good value over the long term. Recent activity has been healthy and well balanced between exiting positions that have not delivered and recycling capital into more promising areas.

### 5.3 UBS Equities

| UBS Equities  | 2021 |     |     | 2020 |     |      |        | 2019 | One Year | Two Years | Since Start<br>31/08/12 |
|---------------|------|-----|-----|------|-----|------|--------|------|----------|-----------|-------------------------|
|               | Q3   | Q2  | Q1  | Q4   | Q3  | Q2   | Q1     | Q4   |          |           |                         |
| £263.85m      | %    | %   | %   | %    | %   | %    | %      | %    | %        | %         | %                       |
| Actual Return | 0.9  | 7.5 | 5.8 | 11.2 | 5.6 | 18.8 | (19.3) | 5.7  | 25.3     | 18.0      | 14.5                    |
| Benchmark     | 0.9  | 7.5 | 5.8 | 11.2 | 5.6 | 18.8 | (19.3) | 5.7  | 25.3     | 18.0      | 14.5                    |
| Difference    | 0.0  | 0.0 | 0.0 | 0.0  | 0.0 | 0.0  | 0.0    | 0.0  | 0.0      | 0.0       | 0.0                     |

#### Reason for appointment

UBS are the Fund's passive equity manager, helping reduce risk from underperforming equity managers and providing a cost-effective way of accessing the full range of developed market equity growth.

#### Performance

The fund returned 0.9% for Q3 and 25.3% over one year. Since funding in August 2012, the strategy has provided an annualised return of 14.5%.

#### Equities

Global stocks were on track for a positive Q3, but after touching an all-time peak in early September, global stocks have trended lower for the month. The magnitude of falls in September overall more than erased gains for the quarter. This reflected a wide array of concerns, from worries over the pace of growth; current valuations; persistent inflationary pressures; to anxiety over a faster-than-expected move towards tightening by central banks against a robust, albeit deteriorating backdrop.

### 5.4 UBS Bonds

| UBS Bonds     | 2021  |     |       | 2020  |       |     |     | 2019  | One Year | Two Years | Since Start<br>5/7/2013 |
|---------------|-------|-----|-------|-------|-------|-----|-----|-------|----------|-----------|-------------------------|
|               | Q3    | Q2  | Q1    | Q4    | Q3    | Q2  | Q1  | Q4    |          |           |                         |
| £39.43m       | %     | %   | %     | %     | %     | %   | %   | %     | %        | %         | %                       |
| Actual Return | (1.8) | 1.7 | (7.2) | 0.6   | (1.2) | 2.5 | 6.3 | (3.9) | (6.8)    | (1.5)     | 3.9                     |
| Benchmark     | (1.8) | 1.7 | (7.2) | 0.6   | (1.2) | 2.5 | 6.3 | (3.9) | (6.8)    | (1.6)     | 3.9                     |
| Difference    | 0.0   | 0.0 | 0.0   | (0.0) | 0.0   | 0.0 | 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 fund returned (1.8%) for Q3, (6.8%) for one year and (1.5%) for two-year return.

The All Stock Gilt index returned -1.84% in sterling in Q3. Two year nominal yields rose by 0.35% to 0.40% and 10 year nominal yields rose by 0.30% to 1.02%. The modified duration of the index is 12.16 years. The BoE MPC decreased the policy rate to 0.1%. The UK Debt Management Office held 15 nominal bond auctions during the quarter across a range of maturities. Activity reflected these changes.

## 5.5 Schroders Indirect Real Estate (SIRE)

| Schroders     | 2021 |     |     | 2020 |     |       |       | 2019 | One Year | Two Years | Since Start<br>6/8/2010 |
|---------------|------|-----|-----|------|-----|-------|-------|------|----------|-----------|-------------------------|
|               | Q3   | Q2  | Q1  | Q4   | Q3  | Q2    | Q1    | Q4   |          |           |                         |
| £18.54m       | %    | %   | %   | %    | %   | %     | %     | %    | %        | %         | %                       |
| Actual Return | tbc  | 3.9 | 2.9 | 2.7  | 0.3 | (2.0) | (3.9) | 1.0  | 9.5      | 2.4       | 5.1                     |
| Benchmark     | 4.5  | 3.8 | 2.2 | 2.1  | 0.2 | (2.0) | (1.3) | 0.3  | 12.6     | 4.9       | 7.1                     |
| Difference    | tbc  | 0.1 | 0.7 | 0.6  | 0.1 | 0.0   | (2.6) | 0.7  | tbc      | tbc       | tbc                     |

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. The strategy is currently being sold down and will cease towards the end of 2021.

### Q2 2021 Performance and Investment Update

The fund generated a return in Q2 of 3.9% with a one-year return of 9.9% and a two-year return of 2.6%. The performance of the UK commercial real estate market accelerated in Q2 2021 with the benchmark delivering its strongest quarterly performance since December 2014.

A number of disinvestments were made in Q3. Further sales are in progress and Schroders anticipate the majority of SIRE's underlying investments will be sold by the end of 2021. As at the end of November 2021 only £2.2m remained of the strategy.

## 5.7 BlackRock

| BlackRock     | 2021 |       |       | 2020 |     |       |       | 2019 | One Year | Two Years | Since Start<br>1/1/2013 |
|---------------|------|-------|-------|------|-----|-------|-------|------|----------|-----------|-------------------------|
|               | Q3   | Q2    | Q1    | Q4   | Q3  | Q2    | Q1    | Q4   |          |           |                         |
| £50.27m       | %    | %     | %     | %    | %   | %     | %     | %    | %        | %         | %                       |
| Actual Return | 4.3  | 2.9   | 2.1   | 2.5  | 0.5 | (2.9) | (2.8) | 0.6  | 11.7     | 3.6       | 1.1                     |
| Benchmark     | 4.5  | 3.8   | 2.2   | 2.1  | 0.2 | (2.0) | (1.3) | 0.3  | 12.6     | 4.9       | 4.2                     |
| Difference    | tbc  | (0.9) | (0.1) | 0.4  | 0.3 | (0.9) | (1.5) | 0.3  | tbc      | tbc       | tbc                     |

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.

### Q2 2021 Performance and Investment Update

BR returned 4.3% for Q3 against a benchmark of 4.5%, returned 11.7% over one year against a benchmark of 12.6%. A further 10,681 units were purchased on 30 November, costing £500k at October NAV prices as part of increasing the allocation to BR. This will increase the BR holding to over £53m, based on current values.

In Q3 there were no acquisitions but five disposals of mostly retail or car showroom totaling £50.67m and were at or above valuation. This concluded the repositioning of the Fund's retail holdings, refining the portfolio of mainly retail warehouses to c.80% in Greater London compared with c.20% for the benchmark. Being 99% leased, BR believe that this residual holding offers robust leasing market dynamics and strong.

## 5.8 Hermes

| Hermes        | 2021 |       |       | 2020  |       |       |     | 2019  | One Year | Two Years | Since 9/11/2012 |
|---------------|------|-------|-------|-------|-------|-------|-----|-------|----------|-----------|-----------------|
|               | Q3   | Q2    | Q1    | Q4    | Q3    | Q2    | Q1  | Q4    |          |           |                 |
| £95.59m       | %    | %     | %     | %     | %     | %     | %   | %     | %        | %         | %               |
| Actual Return | 2.2  | (1.1) | 0.6   | (1.5) | 0.0   | 0.9   | 3.9 | (0.2) | 0.3      | 2.4       | 7.5             |
| Benchmark     | 1.4  | 1.4   | 1.5   | 1.4   | 1.4   | 1.4   | 1.5 | 1.4   | 5.8      | 5.8       | 5.9             |
| Difference    | 0.7  | (2.5) | (0.9) | (2.9) | (1.4) | (0.6) | 2.4 | (1.6) | (5.5)    | (3.4)     | 1.6             |

### Reason for appointment

Hermes were appointed as the Fund's infrastructure manager to diversify the Fund away from index linked fixed income. The investment is in the Hermes Infrastructure Fund I (HIF I) and has a five-year investment period which ended on 30<sup>th</sup> 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 2.2% in Q3 outperforming the benchmark by 0.7%. Over one year the strategy reported a one-year return of 0.3%, underperforming its benchmark by 5.5%. Since inception the strategy has provided a good, annualised return of 7.5%, outperforming its benchmark by 1.6%.

### Portfolio review

Performance over the past 6 months was driven by:

- Cadent (3.6%) primarily due to updated business plan assumptions; and
- ASG I & II (-16.0% and -12.5%) due to the increase in future corporate tax rates.

### Portfolio Performance - Value Added 1

VA reported LTD gross IRR of 9.5% (up from 9.3% at 31 March) and LTD cash yield of 9.8% (down from 10.1% at 31 March). NAV increased by £8.9m (2.3%) since 31 March, principally because the negative valuation impact of the Southern Water re-capitalisation (see below) was more than offset by increased value of:

- Viridor: 4.8% reflecting improved short-term power prices & favourable pricing terms following agreed sale of the collections & recycling business to Biffa plc;
- Eurostar: 4.2% due to the shareholder equity injection as part of refinancing;
- Scandlines: 4.4% due to easing of travel restrictions; and

### Transport Assets

Transport assets benefitted from easing of travel restrictions. In the Core, Iridium continues to show signs of recovery following further easing of restrictions in Spain, with traffic during Q2 performing above budget. Continuing strong volumes and tight cost control at Associated British Ports has contributed to EBITDA performing above budget on a year-to-date basis to June.

In the VA portfolio, the August announcement that quarantining will not be imposed on fully vaccinated passengers travelling between the UK and France led to some recovery in performance for Eurostar during August 2021, ahead of management's planned recovery, which was anticipated to begin in September 2021. The recent announcement of further relaxation of restrictions taking effect from 4 October is also expected to be positive. Reduced restrictions in travel across the EU, along with tight cost control, has also resulted in improved performance for Scandlines, with June 2021 trading above budget on a year-to-date basis.

### Regulatory update

Following Cadent appealing certain aspects of Ofgem's RII0-2 Final Determination to the Competition and Markets Authority ("CMA"), the CMA has now published its Provisional Determination with its Final Determination (and remedies) due by the end of October 2021. At a high level, the CMA upheld three of Cadent's five grounds of appeal and is therefore seen, in the round, as a relatively positive marker. Two of these relate to cost allowances, with the CMA also proposing to remove the 25 bps "outperformance wedge" from the cost of equity. However, it has not made any other changes to cost of equity/allowed returns.

Ofwat published their High-Level Consultation paper on PR24 for the water sector. The overarching theme is that PR24 will be an evolution from the PR19 approach with more emphasis on planning for the longer term, which is seen as positive for both Anglian and Southern Water.

On 9 July 2021, Southern Water was fined £90.0m (plus £2.5m of costs) following its guilty plea to all 51 charges brought by the Environment Agency ("EA") for unlawful discharge of wastewater across 17 sites on the North Kent and Solent coasts, dating back to 2010-2015. Whilst we did not have Board representation at the time or any knowledge of the incidents, we are appalled by the cultural failures at Southern Water which permitted the incidents to occur and the environmental damage that resulted. There is currently another ongoing EA investigation into the manipulation of sampling that occurred over the same period, and for which Ofwat, in 2019, fined Southern Water £3.0m and required it to rebate customers £123.0m. To date, no charges have been brought against Southern Water in relation to this investigation by the EA and consequently no provision for any potential fine has been made by the company.

### Manager update

Perry Noble has been appointed as Head of Infrastructure following Hamish de Run stepping down from his role. Perry, who has been with the business since 2012, has 25 years of infrastructure industry experience and will now chair the Infrastructure Investment Committee. Perry will lead a team of infrastructure professionals including James Wardlaw, Lead Client Partner who joined us from Campbell Lutyens last year; Emma Howell, Head of Asset Management; and Steve Pugh, Head of Origination.

### Outlook

Both the Core and VA portfolios are highly correlated to inflation and would stand to benefit if increasing inflation expectations come to pass in the longer term. In the short term, current year on year CPIH inflation in the UK continues to rise compared to the past couple of years; for the 12 months ending August 2021 it was 3.0%, 2.4% to June 2021, and 1.0% to March 2021.

## 5.9 Abrdn Asset Management

| Abrdn         | 2021 |     |     | 2020 |     |       |       | 2019  | One Year | Two Years | Since Start<br>15/9/2014 |
|---------------|------|-----|-----|------|-----|-------|-------|-------|----------|-----------|--------------------------|
|               | Q3   | Q2  | Q1  | Q4   | Q3  | Q2    | Q1    | Q4    |          |           |                          |
| £133.67m      | %    | %   | %   | %    | %   | %     | %     | %     | %        | %         | %                        |
| Actual Return | 4.9  | 4.4 | 7.4 | 8.3  | 5.1 | (0.6) | 0.7   | (0.2) | 25.0     | 15.0      | 7.2                      |
| Benchmark     | 1.0  | 1.0 | 1.0 | 1.0  | 1.0 | 1.3   | 1.2   | 1.2   | 4.0      | 4.4       | 4.6                      |
| Difference    | 3.9  | 3.4 | 6.4 | 7.3  | 4.1 | (1.9) | (0.5) | (1.4) | 21.0     | 10.6      | 2.6                      |

### Reason for appointment

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

The Portfolio had a strong Q3, posting a gain of around 6.4% over the three months to the end of September. This was largely due to higher June 30 valuations across some of the more seasoned private equity investments (Advent, OEP) which Abrdn were able to reflect in July, but also some excellent performance from some of the more recent co-investments which we've added to the portfolio. For example, Herbivore (a prestige skincare brand offering non-toxic, organic products) was up over 120% and contributed over 1.2% to the quarter's return.

Return for one year is 25.0%, 21.0% above the benchmark of 4.0%. Over two years the strategy is 10.6% above its benchmark of 15.0%.

Abrdn 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. The allocation to private equity (and other less liquid opportunities such as infrastructure, private debt and real assets) will be opportunistic and subject to being able to access opportunities on appropriate terms.

The hedge funds selected for the Portfolio include a blend of:

- i) relative value strategies, intended to profit from price dislocations across fixed income and equity markets;
- ii) macro strategies, which are intended to benefit significantly from global trends, whether these trends are up or down, across asset classes and geographies; and
- iii) iii) tail risk protection which is intended to offer significant returns at times of stress and more muted returns in normal market environments.

## Outlook

For hedge funds, Abrdn are constructive on the outlook for equity hedge overall but the strategy is not without its risks. Market and factor beta have been key drivers of equity hedge performance in what has been a macro-driven equity market environment. The alpha environment has been extremely challenging, and those managers focused on minimizing factor exposures and relying on alpha/idiosyncratic risk to dictate performance have generally found it difficult to produce satisfactory returns. This is unsurprising in a market driven by incremental economic or COVID-related data; stocks and sectors move in tandem based on their characteristics, investors more concerned with owning the 'right' type of stocks as the economic picture shifts rather than necessarily the best companies.

Fundamentals have taken a back seat. But this dynamic won't last forever, and there are reasons to believe that company fundamentals, stock-picking and alpha will become increasingly relevant from here. A market which has been characterized by relative indifference to company fundamentals, by definition, creates a tremendous stock-picking opportunity set from which to generate abnormal levels of alpha thereafter.

Abrdn's outlook for discretionary macro remains positive. Abrdn continue to see a global recovery divergence theme playing out, which is set to continue into 2022. Abrdn see both the regional and country-specific recoveries from this pandemic being attributed to a few key factors including the depth of recession during 2020 (and if it bled into 2021), the speed of vaccination and the ability to avoid new lockdowns. This macro backdrop should allow regional specialists to identify attractive directional and relative value opportunities, particularly in currencies and interest rates.

From a regional perspective, Abrdn expect more emerging markets-tilted managers to generate volatile performance into 2022, as inflation spikes and central bank actions in a number of developing countries continue to surprise market participants this year. Thus, data releases and policy responses remain in focus as global economies unevenly recover from the COVID-19 pandemic. Given the vast opportunity set, Abrdn are closely monitoring certain risks, such as style drift, as managers might want to do too much in this environment, potentially building outsized directional positions or trading in areas where they lack expertise.

Abrdn's outlook for fixed income relative value strategies remains neutral but Abrdn are cautiously optimistic. Abrdn maintain the rating at neutral because the opportunity set for bond basis trading in G3 countries remains moderate, although slightly better than earlier in the year. The recent volatility in developed market rates, though costly at times in terms of mark-to-market P&L, has created larger dislocations between cash bonds and futures that managers hope to be able to capture in the next one to two calendar roll cycles.

In terms of private equity, the market has remained robust, both in terms of fund-raising and deal activity, and deal pricing remains competitive. However, the underlying managers within the LBBB portfolio have continued to deploy capital in a disciplined manner to acquire assets with the potential for future earnings growth.



## 5.10 Pyrford

| Pyrford       | 2021  |       |       | 2020 |       |     |       | 2019  | One Year | Two Years | Since 28/9/2012 |
|---------------|-------|-------|-------|------|-------|-----|-------|-------|----------|-----------|-----------------|
|               | Q3    | Q2    | Q1    | Q4   | Q3    | Q2  | Q1    | Q4    |          |           |                 |
| 111.24m       | %     | %     | %     | %    | %     | %   | %     | %     | %        | %         | %               |
| Actual Return | 0.3   | 1.1   | 0.9   | 3.1  | (1.6) | 6.2 | (4.8) | 0.7   | 5.5      | 3.0       | 3.4             |
| Benchmark     | 2.7   | 3.6   | 1.7   | 1.6  | 1.8   | 1.3 | 1.5   | 1.5   | 9.6      | 7.8       | 7.3             |
| Difference    | (2.4) | (2.5) | (0.8) | 1.6  | (3.4) | 4.9 | (6.3) | (0.8) | (4.1)    | (4.8)     | (3.9)           |

### 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 0.3% in Q3 underperforming its benchmark by 2.4%. Over one year the strategy has returned 3.0%, underperforming its benchmark of 9.6% (which reflects the surge in RPI since the early part of 2021), by 4.8%. Pyrford underperformed its benchmark by 3.9% since inception and has returned 3.4% p.a.

The equity portfolio was the biggest source of profits, with UK stocks providing a small profit, but overseas holdings performed better. Holdings in UK Gilts were a drag on returns, but foreign sovereign bonds made a positive contribution. The impact of rising yields was mitigated in part by the dominance of short maturity bonds: the duration of the bond portfolio is 1.5 years. Part of the positive return earned from non-UK stocks and bonds can be attributed to gains linked to the decline of Sterling against unhedged sources of currency exposure.

### Outlook and Change in Ownership

Pyrford view the current environment as very challenging in the context of a strategy focused on generating positive real returns at low levels of volatility and low risk of capital loss in any 12-month period. At the headline level, they believe that equities are very overvalued, particularly in the United States, bond yields are too low in the context of inflation risk and credit spreads are misaligned to potential default risk.

Pyrford's asset allocation response is defensive as they bide their time until the pricing of assets returns to levels they think are appropriate from a return to risk perspective. They will also seek to tap into diversifying sources of return within asset classes, i.e. investing in property and infrastructure assets within the equity portfolio.

There is a change in ownership as Bank of Montreal (BMO) is selling its European asset management business, including Pyrford, to Columbia Threadneedle (CT). Pyrford operates as a semi-autonomous boutique and will be part of CT's Alternatives unit, where they are expected to continue to operate independently and autonomously, with no changes to the team responsible for managing the fund portfolio or the process used to make decisions.

## 5.11 Newton

| Newton               | 2021         |     |     | 2020 |     |     |        | 2019 | One Year | Two Years | Since 31/8/2012 |
|----------------------|--------------|-----|-----|------|-----|-----|--------|------|----------|-----------|-----------------|
|                      | Q3           | Q2  | Q1  | Q4   | Q3  | Q2  | Q1     | Q4   |          |           |                 |
| £82.60m              | %            | %   | %   | %    | %   | %   | %      | %    | %        | %         | %               |
| <b>Actual Return</b> | <b>(0.1)</b> | 2.4 | 1.1 | 5.6  | 3.5 | 8.0 | (9.2)  | 1.6  | 9.0      | 6.4       | 4.4             |
| <b>Benchmark</b>     | <b>1.0</b>   | 1.0 | 1.0 | 1.0  | 1.0 | 1.1 | 1.2    | 1.2  | 4.0      | 4.2       | 4.4             |
| <b>Difference</b>    | <b>(1.1)</b> | 1.4 | 0.1 | 4.6  | 2.5 | 6.9 | (10.4) | 0.4  | 5.0      | 2.2       | 0.0             |

### 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 -0.1% in Q3, underperforming its benchmark by 1.1%. Over one year the strategy has returned 9.0%, outperforming its benchmark by 5.0%. Newton's performance since inception is 4.4%, which matches its benchmark.

Q3 marked a reversal in the fortunes of Newton after three quarters of performance ahead of the Libor + 4% target. The equity portfolio contributed 0.4% of the loss. The worst performance came from Chinese companies, Alibaba and Tencent specifically, which are exposed to more aggressive scrutiny by regulators and central government. Companies reliant on growth in China, such as the AIA Group, Yum China and LVMH were also weak. The loss of momentum in core holdings, including Alphabet (Google), Amazon and Microsoft, was another headwind.

On the positive side the increased allocation to financial stocks worked well as debt yields increased. Prudential Plc gained almost 6%, reflecting steps taken to demerge its US business and raise equity capital in Hong Kong to fund growth in Asia. Alcon, the eye care products company, reported stronger than expected earnings and the shares gained 17% (in Swiss Franc terms) during the quarter.

The losses on physical holdings in stocks were amplified by losses of 0.3% on derivatives linked to equity indices. Put options on major stock indices are used primarily to guard against large falls in markets so they were of limited value in September. The timing of the expiry of some contracts also worked against Newton.

Fixed income assets contributed 0.3% of the loss. The last sovereign bond holdings were removed from the portfolio in Q1 2021, but Newton retained exposure to US Treasury bonds through futures contracts which have now been sold. Index linked bonds have also been sold. Exposure to emerging markets bonds was cut sharply during the most recent quarter. As a result, fixed income exposure is focused on corporate subinvestment grade bonds which held their value.

The position in gold lost 0.1% and alternative assets, such as renewable power generators, REITs and ETFs providing exposure to energy and metals prices generated a positive return of 0.2%. Currency positioning added 0.1%.

## 5.12 Insight (Mellon Corporation / Standish)

| Insight       | 2021  |       |       | 2020 |     |     |       | 2019  | One Year | Two Years | Since 20/8/2013 |
|---------------|-------|-------|-------|------|-----|-----|-------|-------|----------|-----------|-----------------|
|               | Q3    | Q2    | Q1    | Q4   | Q3  | Q2  | Q1    | Q4    |          |           |                 |
| £68.34m       | %     | %     | %     | %    | %   | %   | %     | %     | %        | %         | %               |
| Actual Return | 0.0   | 0.2   | (0.1) | 2.2  | 1.5 | 4.7 | (2.3) | (0.0) | 2.3      | 3.0       | 1.1             |
| Benchmark     | 1.0   | 1.0   | 1.0   | 1.0  | 1.0 | 1.3 | 1.2   | 1.2   | 4.0      | 4.4       | 5.0             |
| Difference    | (1.0) | (0.8) | (1.1) | 1.2  | 0.5 | 3.4 | (3.5) | (1.2) | (1.7)    | (1.3)     | (4.0)           |

### Reason for appointment

Insight 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

In Q3, the Fund returned 0.0% against a benchmark return of 1.0%. Over one year the strategy has underperformed its benchmark of 4.0% by 1.7%, providing a return of 2.3%. Since funding in August 2013, Mellon Corporation has only provided an annual return of 1.1%. The Fund's asset allocation to corporate credit was the primary contributor to its return.

### Portfolio Composition:

The third quarter saw the fund flat for the quarter with asset allocation and rates positioning making the most notably positively contributions to relative performance. In rates space, the Fund benefitted from underweights in the UK and Canada as strong growth and firming underlying inflation pulled rate hikes forward and pressured yields higher.

Alpha generated in the British and Canadian rates markets was partially offset by underperformance associated with overweight in the Norwegian, Italian and Mexican government bond markets.

From an asset allocation standpoint, the Fund's overweight to corporate debt, specifically high yield corporate debt, made a significant positive contribution to the quarter's outperformance. The overweight to securitized assets provided a similar, albeit more modest tailwind to relative returns.

Positioning in hard currency Emerging Market debt was a source of modest underperformance on the quarter as the sector came under broad based pressure. With the credit curve steepening and EM corporates holding in relatively well, it was single B sovereigns that saw the bulk of the spread widening.

In aggregate, active FX positioning made no material contribution to relative performance in the third quarter. On a more granular level, the small amount of negative alpha associated with positioning in Emerging market Asia and Europe was offset by strong performance from the NZD and EUR.

### **5.13 Currency Hedging**

No new currency hedging positions were placed in Q2 2021.

## **6. Consultation**

- 6.1 Council's 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 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 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 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 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 Q2 2021 Report; and
- Fund Manager Q2 2021 Reports.

**List of appendices:**

**Appendix 1** - Fund Asset and Liability Values 31 March 2013 to 30 June 2021

**Appendix 2** - Definitions

**Appendix 3** - Roles and Responsibilities