Investment Strategy and Fund Manager Performance (Part I)

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Papers with this report	Northern Trust Performance Report Ministerial letter on pooling

SUMMARY

This is the main report which focuses on the investment of the Fund's assets. The report includes an overview of fund performance as at 30 June 2017, an update on recent investment decisions, and progress of the London CIV.

The total size of the fund was £965m at 30 June 2017 an increase from £956m at the end of last quarter, with an overall investment return over the quarter was 0.94%, giving rise to relative under-performance of the benchmark by 0.01%. Included with this report is the Northern Trust performance.

Part II includes an update on each Fund Manager and the detailed current market backdrop. These papers all form background reading to inform Committee and to aid discussion.

RECOMMENDATIONS

It is recommended that Pensions Committee, following consideration of the Part II papers:

1. **Discuss the Fund performance update and agree any required decisions in respect of mandates or Fund Managers;**
2. **Delegate the implementation of any decisions to the Officer and Advisor - Investment Strategy Group;**
3. **Note the follow up activity to previous investment decisions and progress in the development of the London CIV.**

INFORMATION

1. Fund Performance

Over the last quarter to 30 June 2017, the Fund returned 0.94% (2.88% March 2017) just 1 basis point below the fund benchmark of 0.95% (3.14% March 2017). The value of the Fund increased over the quarter by £9m, to bring the fund balance to £965.5m as at 30 June 2017.

Period of measurement	Fund Return %	Benchmark %	Arithmetic Excess
Quarter	0.94	0.95	-0.01
1 Year	14.27	12.57	+1.70
3 Year	9.60	8.96	+0.64
5 Year	10.33	9.41	+0.92
Since Inception (09/1995)	7.19	7.03	+0.16

During the quarter distributions were made from various mandates with funds being transferred to fund the commitment to Permira. Positive impacts were seen from Macquarie LGT and AEW negated by negative performance from UBS Property and Ruffer.

Relative outperformance over a one year rolling period was 1.51% ahead of the benchmark with the largest contributions from Macquarie and M&G.

2. Asset Allocation

The current asset allocation, the key strategic tool for the Committee, is outlined in the table below. The assets of the Fund are currently invested across 13 different Fund Managers in a range of passive and active mandates, including a mix of liquid and illiquid allocations to reflect the Fund's long term horizon.

Current Asset Allocation by Asset Class

ASSET CLASS	Market Value As at 30 June 2017	Actual Asset Allocation	Benchmark Allocation
	£'000	%	%
UK Equities	212,661	22.0	47.0
Global Equities	247,245	25.5	
UK Index Linked Gilts	61,501	6.4	12.0
Corporate Bonds (Global)	86,417	9.0	
Property	117,053	12.1	12.0
DGF/Absolute Returns	103,971	10.8	12.0
Private Equity	25,656	2.7	4.0
Infrastructure	27,418	2.8	3.0
Private Credit	56,743	5.9	10.0
Cash & Cash Equivalents	26,814	2.8	0.0
Totals	**965,479**	**100.0**	**100.0**

The underweight in Private Credit is due to a further £30.8 million committed to Permira awaiting drawdown of investment.

Current Asset Allocation by Manager

FUND MANAGER	ASSET CLASS	Market Value As at 30 June 2017 £'000	Actual Asset Allocation %
ADAMS STREET	Private Equity	16,592	1.7
LGT	Private Equity	9,023	0.9
AEW	Property	49,186	5.1
JP MORGAN	Corporate Bonds (Global)	55,302	5.7
LCIV RUFFER	DGF/Absolute Returns	103,971	10.8
M&G	Private Credit	17,883	1.9
MACQUARIE	Infrastructure	27,418	2.8
NEWTON	Global Equities	139,272	14.4
PERMIRA	Private Credit	38,860	4
LGIM	UK Equities	88,195	9.1
	Global Equities	107,973	11.3
	UK Index Linked Gilts	61,501	6.4
	Corporate Bonds (Global)	31,115	3.2
UBS EQUITIES	UK Equities	124,466	12.9
	Property	22	0
	Private Equity	41	0
	Cash & Cash Equivalents	4,946	0.5
UBS PROPERTY	Property	67,845	7
	Cash & Cash Equivalents	1,736	0.2
Non Custody	Cash & Cash Equivalents	20,132	2.1
		965,479	**100**

Note: Asset Market Valuation is at BID price, as per accounting requirements, which differs from the attached Northern Trust Performance report which is measured at MID price.

3. Market and Financial climate overview

During the second quarter of 2017 the French and UK elections dominated the period resulting in volatile European and UK equity markets. However both markets finished the quarter broadly flat. The French election result and strong economic data helped drive confidence within the European area whilst in the UK, a reduced Conservative majority, uncertain Brexit negotiations and weakening economic data dampened the UK outlook. US equities delivered a positive return with the S&P 500 up approximately 2.5% despite a confused message regarding the trajectory of rates. Strong corporate earnings and growing optimism regarding the economy also helped Japan to finish ahead. Taking all regions together, the FTSE World was up 0.5% over the second quarter.

UK inflation ended June at 2.6% and below market expectations. This represented a fall from the May figure of 2.7% and the first reduction since April 2016. The largest detractors came from the Transport sector as a result of a fall in fuel prices when compared to a 2.2% increase in the previous year and Recreational and Cultural Goods & Services which were again down from a year before. However, consumers have started to feel the bite with Food, Household Goods and Restaurants & Hotels all providing upward pressure. Going forward the Monetary Policy Committee expects inflation to increase over the coming months peaking at 3% in October. With this outlook, UK government 10-year gilts yields were up 0.12% on the quarter and the FTSE All Stock Index down by 1.29%.

4. LCIV update

Since last quarter the LCVI have opened one more sub fund and three more are due to open for investment by the end of September. The London CIV are currently ahead of their business plan target for assets under management. The London CIV (LCIV) now have 9 active sub funds open.

Sub funds available on the platform currently

Fund Name	Manager	Fund Type
LONDON LGPS CIV GLOBAL EQUITY ALPHA FUND	Allianz	Global equity
LONDON LGPS CIV GLOBAL ALPHA GROWTH FUND	Baillie Gifford	Global equity
LCIV RF ABSOLUTE RETURN FUND	Ruffer	Diversified growth Fund
LCIV PY GLOBAL TOTAL RETURN FUND	Pyrford	Absolute return
LONDON LGPS CIV DIVERSIFIED GROWTH FUND	Baillie Gifford	Diversified growth Fund
LCIV NW REAL RETURN FUND	Newton	Absolute return
LCIV MJ UK EQUITY FUND	Majedie	UK Equity
LCIV NW GLOBAL EQUITY FUND	Newton	Global equity
LCIV LV Global Equity Fund	Longview	Global equity

The next funds to open for investment in September are Epoch (Income), RBC (Sustainable), Henderson (Emerging markets).

The CIV developing its plans to add fixed income options and are investigating how to enable more illiquid sub funds into the pool as they are not supported on an ACS structure.

Hillingdon Fund Investment with the London CIV

The Hillingdon Pension Fund currently invests in Ruffer on the LCIV platform and LGIM which sits alongside the LCIV Platform accessing the economies of scale created via the LCIV. The Fund has total LCIV holdings of £393m at 31 March 2017 accounting for 41% of total assets.

The Minister for Local Government recently sent a letter to all pools to highlight progress by the pools and the focus of government in this area. A copy of the ministers letter is included as a supporting paper to this report. The minster praises development of the pools and acknowledges resourcing implication on the pools. The letter highlights in some situations they do not have sufficient assurance relation to pools being operational with FCA approval in time. This is not relevant to the LCIV who have FCA approval and assets under management. The minster reiterates its stance on pooling stating that "In order to achieve the maximum savings funds must invest in the pools with minimum exceptions, where there is a value for money case, and they must delegate manager selection to the operator". The minister also goes on to discuss government want to see infrastructure increasing in line with pools ambitions.

The Pensions Committee should consider the offers available, or as they become available, through the LCIV to continue to benefit from the cost savings of the pool where there is a match to strategic asset allocation. In September Epoch will provide the first income Global Equity Income sub fund available to invest in, which is equivalent to the funds current allocation through Newton. Officers are currently discussing and understanding the fee structure of this sub fund, but based on early discussions it looks like there will be a small ongoing saving initially (excluding transition costs) and this saving should increase assuming the LCIV management fees reduce over time with the efficient running of the operator.

The Hillingdon fund are represented on two of the sub fund working groups and Investment Sub Committee as well as the Joint Committee enabling the fund to have insight into the workings

Voting and ESG

As part of the Pension Committees role in making investment decisions it is required to take into account factors which are financially material to the performance of an investment, balancing returns against risks. This includes risks to the long-term sustainability of a company's performance which could arise from a number of factors including poor governance, environmental degradation, or the risks to a company's reputation arising from the way it treats its customers, suppliers or employees.

All the managers in which the Hillingdon Pension Fund invest have Responsible Investing and ESG policies which enable them to promote long term shareholder value and protect the interest of shareholders by only investing in well governed companies.

During the quarter ended 30 June 2017 the Hillingdon Investment managers made the following votes

Fund Manager	Meetings Voted	Resolutions	Votes With Management	Votes Against Management	Abstentions
UBS	6,204	70,789	63,456	7,333	-
Newton	297	507	279	218	10
JP Morgan	1,015	14,276	12,636	1,626	14
LGIM	2,173	31,213	26,884	4,292	37

Overall, Newton Asset Management were quite distinct in their opposition of most management resolutions by voting against 43% of such proposals.

On average, UBS, JP Morgan and LGIM opposed about 10% of proposals at meetings attended. UBS were the most active fund manager by attending and voting at 6,204 meetings, with Newton attending 297 shareholder meetings, the least, during the period under review.

The Pensions Regulator (TPR) received a referral claiming LGPS firms were acting unlawfully by not taking climate risk factors into account when making investment decisions. The Pensions regulator has responded to reiterate their purpose is to how investment policy and decisions are made in the LGPS, and not what decisions were being made, however they have said they recognise come of the concerns raised and that funds should be paying attention to Environmental Social and Governance factors when setting investment strategy. TPR has been in discussion with the Scheme Advisory board over guidance in this area which will be issued in the winter to further guide investment decisions, and a paper will be brought to Pensions Committee once this has been published.

FINANCIAL IMPLICATIONS

The financial implications are contained within the body of the report

LEGAL IMPLICATIONS

There are no legal implications in the report.