INVESTMENT STRATEGY and FUND MANAGER PERFORMANCE (Part I)	ITEM 5

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Papers with this report	Northern Trust Performance Report Funding update

SUMMARY

This item will be preceded with a training and discussion item from KPMG on the fund strategy with options to update the funds strategic asset allocation to align with the funding strategy; to reduce risk and meet planned returns.

This report focuses on the investment of the Fund's assets. The report includes an overview of fund performance as at 31 December 2017, cash flow and expenditure summary for fund activity in the year, progress of the London CIV, regulatory updates and recent voting and engagement.

The total size of the fund was £1,009m at 31 December 2017 an increase £31m from £978m at the end of last quarter, with an overall investment return over the quarter of 3.08%, resulting in a relative under-performance of the benchmark by 0.44%. Included with this report is the Northern Trust performance report.

The funding level has increased from 75.1% at the formal valuation as at 31 March 2016 to 77.9% at the end of December 2017. Included with this report is an update on funding by the fund actuary.

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. **Consider and discuss any issues raised in the training item**
2. **Discuss the Fund performance update and agree any required decisions in respect of mandates or Fund Managers;**
3. **Delegate the implementation of any decisions to the Officer and Advisor - Investment Strategy Group.**

INFORMATION

1. Fund Performance

Over the last quarter to 31 December 2017, the Fund returned 3.08% (1.59% September 2017) an under-performance of 44 basis points relative to the fund benchmark of 3.53% (1.60% September 2017). The value of the Fund increased over the quarter by £31m, to bring the fund balance to £1,008.8m as at 31 December 2017.

Period of measurement	Fund Return %	Benchmark %	Arithmetic Excess
Quarter	3.08	3.53	-0.45
1 Year	8.75	9.53	-0.78
3 Year	10.07	9.43	+0.64
5 Year	10.10	9.50	+0.60
Since Inception (09/1995)	7.24	7.11	+0.13

During the quarter distributions were received from various alternative investment mandates with funds utilised to fund the commitment to Permira. Positive impacts were seen from Macquarie, Permira, LondonCIV and UBS Property negated by negative performances from both private Equity portfolios, AEW, M&G and UBS Equities.

Relative performance over a one year rolling period was 0.72% behind the benchmark with the largest detractors being Adams Street & LGT Capital. Macquarie, Permira, AEW & JP Morgan portfolios significantly outperformed their relative benchmarks during this period.

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 12 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

	Market Value As at 31 Dec 2017	Actual Asset Allocation	Benchmark Allocation
ASSET CLASS	**£'000**	**%**	**%**
UK Equities	227,334	22.5	47.0
Global Equities	255,736	25.3	
UK Index Linked Gilts	66,109	6.6	12.0
Corporate Bonds (Global)	88,625	8.8	
Property	125,834	12.5	12.0
DGF/Absolute Returns	105,970	10.5	12.0
Private Equity	22,016	2.2	4.0
Infrastructure	27,008	2.7	3.0

Private Credit	66,708	6.6	10.0
Cash & Cash Equivalents	23,497	2.3	0.0
Totals	**978,184**	**100.0**	**100.0**

The underweight position in Private Equity is due the maturity profile of the investments with more money now being returned than drawn-down. The underweight position in Private Credit is due to committed funds in Permira yet to be called totalling £20.2m.

The fund will soon be receiving funds from the Harrow and Uxbridge College merger that will be invested in March/April in line with the Strategic asset allocation and to meet liquidity requirements of committed funds.

Current Asset Allocation by Manager

		Market Value As at 31 Dec 2017	**Actual Asset Allocation**
FUND MANAGER	**ASSET CLASS**	**£'000**	**%**
ADAMS STREET	Private Equity	14,382	1.4
LGT	Private Equity	7,593	0.8
AEW	Property	53,073	5.2
JP MORGAN	Corporate Bonds (Global)	56,529	5.6
LCIV - EPOCH	Global Equities	140,384	13.9
LCIV - RUFFER	DGF/Absolute Returns	105,970	10.5
M&G	Private Credit	13,645	1.4
MACQUARIE	Infrastructure	27,008	2.7
PERMIRA	Private Credit	53,063	5.3
LGIM	UK Equities	92,799	9.2
	Global Equities	115,352	11.4
	UK Index Linked Gilts	66,109	6.6
	Corporate Bonds (Global)	31,736	3.2
UBS EQUITIES	UK Equities	134,535	13.3
	Property	22	0
	Private Equity	41	0
	Cash & Cash Equivalents	5,064	0.5
UBS PROPERTY	Property	72,739	7.2
	Cash & Cash Equivalents	1,211	0.1
Non Custody	Cash & Cash Equivalents	17,222	1.7
		1,008,477	**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

In the fourth quarter of 2017, the FTSE All-Share index rose 5.0% over the period amid further evidence of a sustained recovery in the global economy. This was underlined as the International Monetary Fund (IMF) upgraded its global growth forecast for 2017 to 3.6%, from 3.2% reflecting rising hopes for a sustained synchronised recovery. On the domestic front, despite a sluggish economy, the Bank of England's (BoE) monetary policy committee raised interest rates for the first time since November 2007, from a record low of 0.25% back to 0.50%. Annual CPI inflation reached 3.1% in November, breaching the BoE's upper target. The UK Budget did little to dispel the fears around the UK economy as the Office for Budget Responsibility downgraded its GDP growth forecasts. However, hopes rose towards the period end around progress with Brexit negotiations, with an agreement struck to allow talks to proceed to the future of trade arrangements.

In the US, the S&P 500 ended a strong year with a fourth-quarter gain of +6.6%. Two Republican defeats in Senate contests in Alabama and Virginia during the quarter spurred House and Senate Republicans into action. Fearing the defeats are a sign of things to come in next year's mid-term elections, they agreed the long-awaited tax reform bill. Markets rallied on the news, with big permanent cuts for corporations as the centrepiece of the package. US equities were also supported by generally positive macroeconomic data, including better-than-expected third-quarter GDP growth of 3.0% (annualised). Employment data over the period was partly distorted by the effects of the hurricane season. However, non-farm payrolls rose by a stronger-than-expected 228,000 in November although wage growth remained subdued.

Eurozone markets ended 2017 on a negative note with the MSCI EMU index returning -0.5% in the fourth quarter. Profit-taking after this year's gains and a stronger euro were in part to blame for the downward move. The healthcare, telecoms and financials sectors underperformed, while materials was the top gainer. Within healthcare, some corporate updates disappointed the market, including below-consensus Q3 revenues from pharmaceutical firm Sanofi.
Japanese equities gained ground to record a rise of 8.7% for the quarter while the yen ended little changed. After considerable initial uncertainty over the potential outcome of October's snap general election, the likelihood of an LDP victory increased steadily. This enabled equity investors to form a view on the likely continuation of both monetary and fiscal policies. This more stable sentiment was matched by a significant pick-up in net purchases of Japanese equities by foreign investors, helping to maintain upward momentum in the market after Mr Abe's victory was confirmed.

Emerging markets recorded a strong gain in Q4, with political developments supporting gains. The MSCI Emerging Markets index increased in value and outperformed the MSCI World.South Africa was the strongest index market as pro-reform candidate, Cyril Ramaphosa, was elected as leader of the African National Congress. This development increased the prospect for a return to more orthodox policy after elections in 2019.

In the UK, ten-year gilt yields were down from 1.36% to 1.19% with less pronounced decreases for five and two-year maturities. A November rate hike by the BoE was well anticipated and was accompanied by dovish guidance. Economic activity remains subdued and political uncertainty continues. Corporate bonds capped a good year with positive total returns, outperforming government bonds.

4. LCIV update

LCIV currently has 11 sub-funds; two new sub-funds we opened in Q4. Epoch opened with the Hillingdon investment in November transition assets from Newton into the pool.

Sub funds available on the platform currently

Fund Name	Manager	Fund Type
Global Equity		
LONDON LGPS CIV GLOBAL EQUITY ALPHA FUND	Allianz	Global equity
LONDON LGPS CIV GLOBAL ALPHA GROWTH FUND	Baillie Gifford	Global equity
LCIV EP Income Equity Fund	Epoch	Global equity (Income)
LCIV HN Emerging Market Equity Fund	Henderson	Global equity (EM)
LCIV NW GLOBAL EQUITY FUND	Newton	Global equity
LCIV LV GLOBAL EQUITY FUND	Longview	Global equity
UK Equity		
LCIV MJ UK EQUITY FUND	Majedie	UK Equity
Multi assets/Total return		
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

The London CIV is moving forward on its plans to launch a range of fixed income products dependant on soft commitments to the funds.

The LCIV undertook a governance review in 2017 which resulted in a number of areas for suggested improvement. A consultation has taken place for the boroughs to feed into the suggested improvements which include a change to the governance structure, changing the current committee structures and to create a streamlined sub group to make the committee more dynamic. Investment options are also being considered and debated.

Hillingdon Fund Investment with the London CIV

The Hillingdon Pension Fund currently invests in Ruffer and Epoch 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 £552m at 31 December 2017 accounting for 55% of total assets of the Pension Fund.

5. Expenditure and Cash flow

Expenditure during the year to December 2017 on members dealings shows a fluctuating cash flow position from positive to negative month on year; however it is anticipated that the annual position will be a small positive position.

Forecasts on administrative costs are estimated to be lower than 2016/17 due to one off project costs incurred in the 2016/17 on the implementation of the new administration contract. Staffing costs are forecast to be higher in 2017/18 compared to the prior year due to increases to salaries in line with the public sector pay awards, changes in the team structure during the year and the recruitment of an apprentice in 2017/18 to support the internal administration and accounting team.

Oversight and Governance is estimated to be lower than 2016/17 due to the one off software cost involved in the implementation of the new administration contract

Investment Management is estimated to be slightly higher on that incurred in 2016/17 due to the increase in the fund value, as management fees are linked to assets under management; however transparency of these costs will not be clear until the year end accounting process is undertaken.

	Actual 2016/17	YTD Actual 2017/18	Forecast 2017/18
Net Member Income	42,707	33,586	45,923
Net Member Expenditure	(41,597)	(33,840)	(45,222)
Surplus/(Deficit) on member dealings	**1,110**	**(254)**	**701**
Administrative Costs			
Support Services and Staffing	313,614	0	361,802
Admin Contract cost	588,294	237,590	363,000
Oversight & Governance			
Investment & Actuarial advice	721,796	222,517	476,502
Investment Management Expenses	6,760,543	874,056	7,584,000

6. Voting and Engagement

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 and 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.

During the quarter ended 31 December 2017 the Hillingdon investment managers made the following votes

Fund Manager	Meetings Voted	Resolutions	Votes With Management	Votes Against Management	Abstentions
UBS	1,239	8,711	7,830	881	0
Newton	70	229	151	78	0
JP Morgan	142	1,205	1,123	80	2
LGIM	469	4,488	3,803	662	23

Q4 voting reports by the Fund's managers' mirrored the pattern of the last three quarters. UBS were the most active fund manager by attending and voting at 1,239 meetings, with Newton attending 70 shareholder meetings, the least, during the period under review. On average, the four reported managers opposed about 16% of proposals at meetings attended.

7. Other Updates

Responsible Authority

A Cabinet reshuffle took place on 8 January 2018 where the Department of Communities and Local Government (DCLG) changed its name to become the Ministry of Housing, Communities and Local Government (MHCLG). This resulted in a mew minister Rishi Sunak who is now responsible for the LGPS replacing Marcus Jones. Rishi Sunak is currently establishing priorities and building relationships within the industry, there are currently no changes to the approach with the LGPS as a result of this change. The MHCLG are continuing to oversee the progress of pooling with regular progress reports. The deadline for pools to be operational is 1 April 2018, it is expected that all but one of the pools will be operational by this date (due to be operational 1 June 2018) with assets to transition at a later date.

MiFID II

The Fund successfully opted up to all fund managers and other relevant parties before the change in regulations came into effect which moves LGPS pension funds to retail clients as default. As a result the fund has not been affected by reduced access to information or investment products which would impact on the functionality of the fund. MiFID II will continue to be reviewed as the opt up process is affected by changes in circumstances such as member or officer changes.

FINANCIAL IMPLICATIONS

The financial implications are contained within the body of the report

LEGAL IMPLICATIONS

There are no legal implications in the report.