INVESTMENT STRATEGY and FUND MANAGER PERFORMANCE (Part I)	

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Papers with this report	Northern Trust Performance Report DGF Strategic options

SUMMARY

This item will be preceded with a training item from KPMG on Roles and responsibilities of the Pensions Committee.

The total size of the fund was £1,065m at 30 September 2018 an increase £11m from £1,054m at the end of previous quarter. There was an overall investment return over the quarter of 1.08%. The estimated funding position at 30 September 2018 is 80.2% (78.9% as at June 2018).

Part II includes an update on each Fund Manager and the detailed current market backdrop. The 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. **Agree to reduce strategic asset allocation in relation to diversified Growth fund allocation to zero and increase allocation to both index linked bonds and infrastructure by 5%**
4. **Delegate the implementation of any decisions to the Officer and Advisor - Investment Strategy Group.**

INFORMATION

1. Fund Performance

Over the last quarter to 30 September 2018, the Fund returned 1.08%, underperforming its benchmark return of 1.45% by 37 basis points. The Fund value increased over the quarter by £11m, to £1,065m compared to the previous quarter.

Period of measurement	Fund Return %	Benchmark %	Arithmetic Excess
Quarter	1.08	1.45	(0.37)
1 Year	5.63	6.85	(1.22)
3 Year	10.69	10.41	+0.28
5 Year	8.43	8.28	+0.15
Since Inception (09/1995)	7.11	7.02	+0.09

During the quarter, distributions received from Alternative investments were $1.4m, €1.2m & £3.7m. The cash was utilised to fund drawdowns of outstanding commitments in both Permira and Macquarie. The biggest drag on performance in the quarter under review came mainly from the Private Equity portfolios of Adams Street and LGT (-1.46 & -2.68) behind their respective benchmarks. Macquarie with relative outperformance of 2.55 was the biggest contributor to the performance in the quarter under review.

Relative performance over a one-year rolling period was 1.14% behind the benchmark with the largest detractor again being JP Morgan; with a return of -3.63% less than benchmark, whilst Macquarie with 10.49% relative excess performance the largest contributor.

Funding position at 30 September was estimated at 80.2%.

2. Asset Allocation

The current asset allocation, the key strategic tool for the Committee, is in the table below. The assets of the Fund is invested across 11 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 30 September 2018	Actual Asset Allocation	Benchmark Allocation
ASSET CLASS	**£'000**	**%**	**%**
UK Equities	231,644	21.75	44.0
Global Equities	274,862	25.82	
UK Index Linked Gilts	84,744	7.96	14.0
Multi Asset Credit	81,095	7.62	
Corporate Bonds (Global)	31,207	2.93	
Property	133,776	12.56	12.0
DGF/Absolute Returns	105,302	9.89	10.0
Private Equity	18,723	1.76	2.0
Infrastructure	27,935	2.62	3.0
Private Credit	72,570	6.82	10.0
Long Lease Property	0	0	5.0
Cash & Cash Equivalents	2,928	0.27	0.0
Totals	**1,064,786**	**100.0**	**100.0**

The overweight positions in both Equities and Bonds will adjust itself once the cash allocated to Long lease property is drawn-down. A total of 5% fund assets has been allocated for investments in this asset class and in the queue awaiting drawdown.

Current Asset Allocation by Manager

		Market Value As at 30 September 2018	Actual Asset Allocation
FUND MANAGER	**ASSET CLASS**	**£'000**	**%**
ADAMS STREET	Private Equity	13,078	1.23
LGT	Private Equity	5,604	0.53
AEW	Property	57,057	5.36
JP MORGAN	Corporate Bonds (Global)	81,095	7.62
LCIV - EPOCH	Global Equities	144,315	13.55
LCIV - RUFFER	DGF/Absolute Returns	105,302	9.89
M&G	Private Credit	9,587	0.90
MACQUARIE	Infrastructure	27,935	2.62
PERMIRA	Private Credit	62,983	5.92
LGIM	UK Equities	93,574	8.79
	Global Equities	130,547	12.26
	UK Index Linked Gilts	84,744	7.96
	Corporate Bonds (Global)	31,207	2.93
UBS EQUITIES	UK Equities	138,070	12.97
	Property	22	0
	Private Equity	41	0
	Cash & Cash Equivalents	1,617	0.15
UBS PROPERTY	Property	76,697	7.20
	Cash & Cash Equivalents	228	0.02
Non Custody	Cash & Cash Equivalents	1,083	0.10
		1,064,786	**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

The FTSE All-Share fell 0.8% amid Brexit uncertainty and a tempering of the global growth outlook, as a result of the escalating trade war between the US and China. Any slowdown in global growth and trade tends to have an outsized impact on emerging markets (EM). EM-exposed areas of the UK stock market, including financials and miners, performed poorly as a consequence. Closer to home, fears of a “no deal”

Brexit weighed on the share prices of many UK domestic companies, driving a poor relative performance from the mid caps, with the FTSE 250 (ex investment companies) index falling by 2.7%. Fears for UK economy were also clearly reflected in the value of sterling, which resumed its downward trajectory over the period. Notwithstanding this, the near-term outlook for the domestic economy improved, as growth recovered from the slowdown seen in the first quarter, prompting the Bank of England (BoE) to increase interest rates by 25 basis points to 0.75%.

US equities advanced in Q3 to significantly outperform other major regions. Economic growth and earnings data remained robust, and this ultimately overshadowed simmering concerns around the escalating US-China trade war. Stability in growth and employment figures allowed the Federal Reserve (Fed) to enact its widely anticipated increase in the federal funds rate by 25 basis points.

Eurozone equities posted a modest gain in the third quarter with the MSCI EMU index returning 0.4%. Energy and industrials stocks were among the leading gainers. By contrast, real estate, telecommunications and consumer staples were the main laggards. Financials made a positive contribution overall, but banks were weaker. August saw sharp declines for eurozone banks amid concerns over their exposure to emerging markets (notably Turkey) as well as worries over the Italian budget. These concerns eased in September but the last trading day of the month saw Italy propose a deficit of 2.4%. This is within the EU's 3% threshold but higher than some had anticipated.

Emerging markets equities lost value in what was a volatile third quarter, with US dollar strength and the US/China trade dispute weighing on risk appetite. The MSCI Emerging Markets index decreased in value and underperformed the MSCI World. Turkey was the weakest index market amid a sharp sell-off in the lira. The market is vulnerable to global liquidity tightening given the economy's twin deficits, and Q2 GDP growth disappointed, slowing to 0.4% year-on-year. Although trade tensions continued to escalate during the quarter, the Japanese stock market ended September above its recent range to show a total return of 5.9% for the quarter. The Japanese yen weakened against the US dollar during the period, which tended to improve sentiment in the equity market.

Core government bond yields rose over the quarter due to positive economic data, particularly from the US. This outweighed a bout of safe haven demand in August caused by concerns related to emerging market instability, trade tensions and political issues in Europe. US 10-year yields rose from 2.86% to 3.06%, with Bund and UK gilt 10-year yields rising from 0.30% to 0.47% and 1.42% to 1.57% respectively.
Italian 10-year government bond yields rose from 2.68% to 3.15% amid political concerns.

4. Strategy Update

At the Pensions Committee in October it was agreed that the strategic asset allocation of 10% managed by Ruffer via the London CIV should be removed due to high fees and poor performance of the strategy in current markets. Included with this report is a paper by KMPG on recommended options to alternatively invest this allocation and amend the strategic asset allocation. As at 31 December 2018, the Pension Fund assets valuation was £1,014m.

5. LCIV update

Currently open on the London CIV are
1 UK Equity sub fund
7 Global equity sub funds
4 Diversified Growth / Absolute Return funds
1 Multi Asset Credit fund

In the pipeline the London CIV plan to have Infrastructure, Liquid loans and private debt open in the first quarter of 2019, all managers have been appointed for these mandates. In addition, inflation plus and equity core look to be the next sub funds in the later part of Q1 2019. Next in the pipeline the London CIV are working on UK property and an exclusionary sustainable equity portfolio.

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 £590m at 30 September 2018 accounting for 55% of total assets of the Pension Fund. Data from the London CIV suggests the Hillingdon fund has saved £233k through lower fees net of costs through investing via the pool.

6. ESG, Voting and Engagement

As part of the Pension Committees role in making investment decisions it is required to take into account factors that 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, due to 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 30 September 2018 the Hillingdon, investment managers made the following votes:

Fund Manager	Meetings Voted	Resolutions	Votes With Management	Votes Against Management	Abstentions
UBS	1,223	10,274	8,830	1,444	0
LGIM	515	5,527	4,873	726	16

UBS were the most active fund manager by attending and voting at more meetings. On average, the reported managers opposed about 14% of proposals at meetings attended.

ESG and climate change within the pension investments has been prominent, as it has been in other sectors of the media and within parliament in the last quarter. The

Department of Work and Pensions, laid revised regulations before parliament in September 2018, requiring occupational pension schemes to include a policy on how they take account of financially material ESG considerations, including specifically climate change, “over the appropriate time horizon of the investments” in their statement of investment principles (SIP) by October 2019.

FINANCIAL IMPLICATIONS

The financial implications are contained within the body of the report

LEGAL IMPLICATIONS

There are no legal implications in the report.