INVESTMENT STRATEGY and FUND MANAGER PERFORMANCE (Part I)

Committee	Pensions Committee
Officer Reporting	Babatunde Adekoya, Finance David O'Hara, KPMG
Papers with this report	Northern Trust Performance Report

HEADLINES

This item will be preceded with a training item from Hymans on The Triennial Valuation.

The total size of the fund was £1,062m at 31 March 2019, an increase of £51m from £1,011m at the end of previous quarter. There was an overall investment return over the quarter of 5.10%, 0.54% less than the benchmark. The estimated funding position at 31 March 2019 is 74.6% (75% as at 31 December 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. **Delegate the implementation of any decisions to the Officer and Advisor - Investment Strategy Group;**
4. **Suspend the UBS Property Fund performance target and change to an advisory mandate.**

SUPPORTING INFORMATION

1. Fund Performance

Over the last quarter to 31 December 2018, the Fund returned 5.10%, underperforming its benchmark return of 5.64% by 54 basis points. The Fund value Increased over the quarter by £51m, to £1,062m compared to the previous quarter.

Period of measurement	Fund Return %	Benchmark %	Arithmetic Excess
Quarter	5.10	5.64	+0.54
1 Year	5.02	6.05	(1.03)
3 Year	8.60	8.66	+0.06
5 Year	7.53	7.53	0
Since Inception (09/1995)	6.95	6.88	+0.07

During the quarter, distributions received from Alternative investments were $1.1m, €0.6m & £0.7m. The cash, along with existing cash balances in the custody account was utilised to fund drawdowns of outstanding commitments in Permira (£3.0m) and Macquarie ($0.1m).

The biggest drag on performance in the quarter under review came mainly from the Private Equity Portfolio, -14.18% behind its benchmarks. Both JP Morgan and London CIV portfolios generated the best outperformance for the fund with 3.36% & 2.84% respectively above benchmark returns.

Relative performance over a one-year rolling period was 0.96% behind the benchmark with the largest detractors being M&G and AEW UK; with a return of -8.47% & -4.96% less than their respective benchmarks, whilst Macquarie and LGT Capital with 10.50% & 2.70% relative excess performances the largest contributors.

2. Asset Allocation

The current asset allocation, the key strategic tool for the Committee, is in the table below. The assets of the Fund are 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

ASSET CLASS	Market Value As at 31 March 2019	Actual Asset Allocation	Benchmark Allocation
	£'000	%	%
UK Equities	128,054	12.05	44.0
Global Equities	361,352	34.01	
UK Index Linked Gilts	96,008	9.04	14.0
Multi Asset Credit	82,707	7.78	
Corporate Bonds (Global)	32,797	3.09	
Property	130,481	12.28	12.0
DGF/Absolute Returns	102,701	9.67	10.0
Private Equity	16,191	1.52	2.0
Infrastructure	27,102	2.55	3.0
Private Credit	73,464	6.92	10.0
Long Lease Property	0	0	5.0
Cash & Cash Equivalents	11,566	1.09	0.0
Totals	**1,062,423**	**100.0**	**100.0**

Current Asset Allocation by Manager

FUND MANAGER	ASSET CLASS	Market Value As at 31 March 2019 £'000	Actual Asset Allocation %
ADAMS STREET	Private Equity	11,462	1.08
LGT	Private Equity	4,688	0.44
AEW	Property	54,186	5.10
JP MORGAN	Multi Asset Credit	82,707	7.78
LCIV - EPOCH	Global Equities	147,156	13.85
LCIV - RUFFER	DGF/Absolute Returns	102,701	9.67
M&G	Private Credit	9,024	0.85
MACQUARIE	Infrastructure	27,102	2.55
PERMIRA	Private Credit	64,440	6.07
LGIM			
	Global Equities	214,196	20.16
	UK Corporate Bonds	32,797	3.09
	UK Index Linked Gilts	96,008	9.04
UBS EQUITIES	UK Equities	128,054	12.05
	Property	22	0
	Private Equity	41	0
	Cash & Cash Equivalents	3,057	0.29
UBS PROPERTY	Property	76,273	7.18
	Cash & Cash Equivalents	421	0.04
Non Custody	Cash & Cash Equivalents	8,088	0.76
		1,062,423	**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.

The fund has £5m awaiting drawdown on Private Credit and £50m awaiting drawdown for the for Long Lease Property which is expected to be drawn-down by the end of Q4 2019, these funds are currently held in passive corporate bonds and other overweight positions.

3. Market and Financial climate overview

UK Equity

UK equities rallied over the period in line with global equities, with almost all areas of the market bouncing back from a very poor Q4 2018. Against an increasingly uncertain outlook for the global economy, equities were perceived to offer superior and defensible earnings growth outperformed. This was reflected in the strong relative performance of the UK's (albeit relatively small) technology sector and select consumer goods companies, including the large-cap tobacco and beverage groups. In addition to these trends, a number of lowly-valued, domestically-focused areas bounced back strongly following the delay to Brexit beyond March 2019. This development fuelled hopes that a disorderly exit from the EU could be avoided.

UK employment growth remained robust. Nominal wages continued to pick up as the UK labour market bucked a wider slowdown in the economy and real wages remained in positive territory as inflation was muted. The UK economy slowed down during the fourth quarter of 2018 when Brexit uncertainty weighed on business investment. The Office for National Statistics revealed that GDP growth decelerated to 0.2% in Q4 from 0.7% in Q3 2018 and confirmed that economy grew at 1.4% in 2018, the lowest rate for several years.

US

US equities rebounded from a weak end to 2018 to post significant gains in Q1,2019. January was especially strong, as the Federal Reserve (Fed) confirmed it would adjust planned interest rate hikes to compensate for deteriorating economic momentum and the US government shutdown ended. The Fed settled further into its dovish stance as the quarter progressed, as a number of indicators reflected slower economic growth. Q4 GDP (quarter-on-quarter, annualised) was adjusted downwards to 2.2% from the initial 2.6% reading. By the end of March, US equities' progress had dropped to a far more cautious pace as investors balanced the Fed's tone with the broader implications for economic growth. As the quarter ended, the Fed lowered its projections for US growth and inflation, and reduced its expectations for interest rates hikes. The adjusted growth outlook caused the Treasury yield curve to invert - a signal historically associated with a pre-recessionary environment.

Eurozone
Eurozone equities enjoyed strong gains in the first quarter, rebounding from weakness at the end of 2018. Stock markets were supported by central banks stepping away from tighter monetary policy. The US Fed said no further interest rate rises were likely this year while the European Central Bank (ECB) said rates would remain at current levels at least until the end of the year. Previously it had said rates would stay on hold until the end of this summer. There was also optimism over global trade as the US suspended planned tariffs hikes on Chinese goods. It was a mixed picture for stock market sectors. Economically-sensitive areas of the market such as industrials and information technology performed well, but the safe haven consumer staples and real estate sectors were also among the top performers. Banks initially drew support from reports of a new ECB programme to support lending; however, the details released in March disappointed some in the market, while ongoing low interest rates may continue to erode net interest margins. Growth worries continued to linger during the quarter. The eurozone economy grew by just 0.2% in the final three months of 2018. Germany saw zero growth while Italy slipped into recession.

Global Equity
Global equity markets regained some ground in the first quarter after the sharp falls at the end of 2018. However, the Japanese equity market return of 7.7% was somewhat muted compared to other developed markets, and the gradual uptrend was punctuated by some significant individual daily declines. The Japanese currency weakened against other major currencies, retracing some of the extraordinary moves seen in late 2018 and the early days of 2019. Several bouts of volatility during the quarter were prompted by a reassessment of interest rate trends after the US yield curve was seen to invert. The perception of a lower global interest rate environment sparked a renewed preference for stable growth, bond-type proxies, within the equity market. Conversely, all financial-related sectors underperformed.

The corporate results season for the quarter ended in mid-February was generally interpreted negatively. However, the balance of real earnings surprises was only slightly skewed to the downside and the individual share price reactions were very muted, suggesting that almost all of the setback had already been discounted in stock prices. Overall, most of the negative surprises were driven by the sharper-than-expected slowdown in the external environment, especially in China. This particularly affected results in the automotive sector while many tech stocks were also impacted by the slowdown in smartphone sales. However, among individual sectors there is some evidence of increased pressure coming from higher labour costs, especially in distribution, food and retail. Corporate earnings revisions for the fiscal year just ended have remained on a negative trend throughout March.

A strong rebound following sharp declines at the end of last year, a dovish shift from central banks and mounting growth concerns combined to allow both riskier assets and government bonds to perform well in Q1. Stocks and high yield corporate bonds each enjoyed their strongest quarter for several years.

Fixed Income
US 10-year Treasury yields fell 30 basis points (bps) over the quarter reaching their lowest level since late-2017. The three-month Treasury bill yield rose higher than

that on 10-year bonds in March. This yield curve inversion underlines the growing caution among investors around economic growth prospects.

In European bond markets, 10-year Bund (German government bond) yields were also more than 30bps lower and fell below zero toward the end of March for the first time since October 2016. European economic data weakened further through the quarter, particularly for the manufacturing sector.

Corporate bonds had a strong quarter, retracing the weakness experienced in Q4 2018. High yield credit outperformed investment grade, with both outperforming government bond markets.

Emerging market (EM) bonds had a positive quarter with US dollar-denominated debt outperforming local currency bonds as certain EM currencies weakened.

4. Strategy Update

At the Pensions Committee in January 2019 it was agreed that the strategic asset allocation of 10% managed by Ruffer via the London CIV should be replaced with a 5% allocation to Infrastructure and 5% to bonds. At the meeting on 22 March the allocation to bonds was agreed to be moved to index linked gilts through the LGIM passive fund. The infrastructure element was deferred while the London CIV infrastructure offering was still to be finalised and accessible for investment, at which time outstanding items such as fees and FCA approval would be agreed to make a more informed decision to invest in the pool offering.

A third of the Ruffer allocation (£34m) has now been divested from the LCIV absolute return fund and invested with LGIM, as passive manager for the LCIV, in the All Stock Index-Linked Gilts on 02 June 2019. The fund’s advisers at a meeting with officers in May agreed a phased reallocation of the Ruffer investments of 3% allocation rather than full 5% due to the current positioning of asset allocation being over weight for IL Gilts. The transition of a third of the Ruffer portfolio brings the bond allocation in line with the revised strategic asset allocation of 19%. Advisers suggested overweighting on IL Gilts would be too expensive based on gilt yield movement in the intervening time from the decision and implementation of transition.

At the Pensions Committee in March 2019 it was agreed to defer the decision to invest in the London CIV Infrastructure sub fund pending resolution of outstanding matters. The LCIV have since resolved a number of commercial items with the manager of this sub fund but FCA approval has been delayed pending valuation methodology. As a result there is no recommendation at this time to progress this decision to invest in the sub fund. FCA submission is expected in Q3 2019, once the fund is able to launch the decision will be brought back to Committee.

5. LCIV update

Currently open on the London CIV are
1 UK Equity sub fund

6 Global equity sub funds
1 Emerging Market Equity sub fund
4 Diversified Growth / Absolute Return funds
1 Multi Asset Credit fund
1 Global Bond Fund

The LCIV have now filed their submission with the FCA for the launch of a new Global Equity Core fund which should be open for investment in July. FCA submission is planned for the end of June for the Ares Private Debt Fund with planned opening date in August, this fund will only accept subscriptions until end of September 2020. Work continues with the infrastructure fund and the CIV are still waiting to submit to the FCA (planned in Q3).

The next phase will look at launching the Liquid Loans, Inflation plus and Equity Value fund.

Following the appointment of Mike O'Donnell as Chief Executive in March, the LCIV have now appointed a permanent Chief Investment Officer, Mark Thompson, who will start in September. In addition to this the LCIV plan to shortly begin recruitment for a Head of Real Assets to oversee the upcoming property and infrastructure funds.

Hillingdon Fund Investment with the London CIV

Since the last committee meeting, engagement with the London CIV has included a meeting in April with the new CEO Mike O'Donnell, Cllr Corthorne as then chair of the committee, Corporate Director of Finance and Head of Pensions, Treasury and Statutory Accounts. The Head of Pensions, Treasury and Statutory Accounts and Clare Scott the fund independent adviser meet with the CIV to discuss governance, ESG and products in development. In addition officers meet with the LCIV for the quarterly review meeting in June.

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 £593m at 31 March 2019, accounting for almost 56% of total assets of the Pension Fund.

FINANCIAL IMPLICATIONS

The financial implications are contained within the body of the report

LEGAL IMPLICATIONS

There are no legal implications in the report.