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 few slides from Clare Scott, Independent adviser on investment governance within the LCIV pool.

The total size of the fund was £1,096m at 30 June 2019, an increase of £34m from £1,062m at the end of previous quarter. There was an overall investment return over the quarter of 3.27%, translating into 0.40% better than the benchmark.

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. **Commit to invest 5% of the portfolio in the London CIV infrastructure sub fund**
4. **Delegate the implementation of any decisions to the Officer and Advisor - Investment Strategy Group.**

SUPPORTING INFORMATION

1. Fund Performance

Over the last quarter to 30 June 2019, the Fund returned 3.27%, outperforming the benchmark return of 2.87% by 40 basis points. The Fund value Increased over the quarter by £34m, to £1,096m.

Period of measurement	Fund Return %	Benchmark %	Arithmetic Excess
Quarter	3.27	2.87	+0.40
1 Year	4.21	4.73	(0.51)
3 Year	8.13	8.05	+0.08
5 Year	7.81	7.71	+0.10
Since Inception (09/1995)	7.02	6.93	+0.09

During the quarter, distributions received from Alternative investments were $1.2m, €1.1m & £3.0m. The cash, along with existing cash balances in the custody account totalling £8.0m was utilised to top up investments in JP Morgan portfolio, due to low returns on cash holdings.

The biggest drag on performance in the quarter under review came mainly from the LCIV Equity income and UBS UK Equity portfolios with returns of 2.39% and 2.07% relative underperformance compared to their benchmarks. AEW, M&G Investments and Macquarie were the biggest contributors to performance in the quarter under review with relative outperformance of 10.48%, 11.46% and 6.29% above their respective benchmarks.

Relative performance over a one-year rolling period was 0.50% behind the benchmark with the largest detractors being UBS UK Equities and LCIV Absolute Return Fund; with returns of -5.76% & -2.25% less than their respective benchmarks, whilst Macquarie and M&G with 11.07% & 3.69% 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 30 June 2019 £'000	Actual Asset Allocation %	Benchmark Allocation %
UK Equities	128,857	11.76	44.0
Global Equities	377,119	34.42	
UK Index Linked Gilts	131,639	12.01	19.0
Multi Asset Credit	93,248	8.51	
Corporate Bonds (Global)	33,416	3.05	
Property	130,128	11.88	12.0
DGF/Absolute Returns	69,559	6.35	0.0
Private Equity	16,465	1.50	2.0
Infrastructure	28,134	2.57	8.0
Private Credit	72,754	6.64	10.0
Long Lease Property	0	0	5.0
Cash & Cash Equivalents	14,376	1.31	0.0
Totals	**1,095,695**	**100.0**	**100.0**

Current Asset Allocation by Manager

FUND MANAGER	ASSET CLASS	Market Value As at 30 June 2019 £'000	Actual Asset Allocation %
ADAMS STREET	Private Equity	11,906	1.09
LGT	Private Equity	4,518	0.41
AEW	Property	60,224	5.50
JP MORGAN	Multi Asset Credit	93,248	8.51
LCIV - EPOCH	Global Equities	152,941	13.96
LCIV - RUFFER	DGF/Absolute Returns	69,559	6.35
M&G	Private Credit	7,978	0.73
MACQUARIE	Infrastructure	28,134	2.57
PERMIRA	Private Credit	64,776	5.91
LGIM	Global Equities	224,178	20.46
	UK Corporate Bonds	33,416	3.05
	UK Index Linked Gilts	131,639	12.01
UBS EQUITIES	UK Equities	128,857	11.76
	Property	22	0
	Private Equity	41	0
	Cash & Cash Equivalents	1,749	0.16
UBS PROPERTY	Property	69,882	6.38
	Cash & Cash Equivalents	362	0.03
Non Custody	Cash & Cash Equivalents	12,265	1.12
		1,095,695	**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 £4.6m 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 Q2 2020, these funds are currently held in passive corporate bonds and other overweight positions.

3. Market and Financial climate overview

UK Equity

UK shares performed well over the quarter, despite ongoing Brexit-related uncertainty and the resignation of Prime Minister Theresa May. Areas of the market perceived to offer superior and defensible earnings growth extended the run of outperformance they have experienced since the beginning of 2019. For example, the technology sector enjoyed another quarter of strong relative performance, as did a number of large consumer goods companies, which are perceived to have dependable growth prospects. Conversely, many of the market's domestically-focused sectors underperformed amid renewed Brexit and political uncertainty.

Meanwhile, the negative impact of the original 31 March Article 50 deadline on the UK manufacturing sector became clearer. While GDP grew by 0.5% in Q1, in line with expectations, the Office for National Statistics (ONS) revealed that the economy shrank by 0.4% in April (by more than forecast) and primarily due to a sharp fall in car production related to Brexit uncertainty.

US

US shares gained in Q2 and the S&P 500 set a new record high. Uncertainty surrounding the US' trade stance caused a mid-quarter market wobble. However, investors were broadly cheered by continued dovishness from the Federal Reserve and indications of progress in trade tensions by the end of June. Comments from President Trump that his administration could impose tariffs on Mexican imports and extend the suite of goods that are taxed on import from China, caused a sharp market sell-off in May. In June, signs emerged of progress in talks with China, with Trump also "indefinitely suspending" the Mexican tariffs. Economic data was mixed. US gross domestic product (GDP), which measures the value of all the goods and services produced by an economy, grew 3.1% revised down from 3.2%, which was as expected. Employment data remained broadly encouraging despite slowing in June. The unemployment rate remained stable at a 49-year low of 3.6% while average hourly earnings climbed 3.1% from a year earlier, below expectation of a 3.2% gain.

Eurozone
Eurozone equities advanced in Q2 with a sharp drop in May but gains in April and June. Top performing sectors included information technology (IT), consumer discretionary and industrials. Sentiment towards trade exposed areas of the market such as semiconductors and car makers ebbed and flowed over the quarter as trade tensions persisted. The lack of any further escalation in the trade wars in June helped the market to recover after May's pull-back. The real estate sector fell after Berlin's city government proposed a five-year freeze on residential property rents from 2020.

Q1 GDP growth for the eurozone was confirmed at 0.4% quarter-on-quarter. Annual inflation for June was stable compared to May at 1.2%. European Central Bank President Mario Draghi hinted that further monetary policy easing, such as new bond purchases, could be on the way if the eurozone inflation outlook fails to improve.
On the political front, Spain held general elections at the end of April. These saw the incumbent Socialist Party (PSOE) emerge as the largest party. Italy's fiscal position was in focus after the European Commission (EC) cut its forecast for 2019 Italian GDP growth to 0.1% from 0.2%. This would mean the budget deficit would exceed the level previously agreed between Italy and the EC.

Japan
Japanese shares performed worse than the other main developed markets in the second quarter. The total return for the three months was -2.4%, primarily as a result of weakness in May. The yen strengthened against other major currencies, driven partly by its perceived safe-haven status at times of geopolitical risk, and partly as a result of changing interest rate expectations for the US.

The main development during the quarter was the continued escalation of trade issues, notably the announcement in May of sharp increases in US tariffs on imports from China. These higher levels would inevitably have a much greater impact on volumes, with repercussions throughout global supply chains. In addition, the US campaign against Huawei is already having an impact on Japanese electronic component suppliers. For most of the quarter, these negative factors exacerbated the reaction to a slowdown in corporate earnings growth, which was evident in the results for the final quarter of the fiscal year. Meanwhile, the direct bilateral trade talks between the US and Japan took a backseat and any substantive announcements seem to have been delayed until August, safely after Japan's Upper House elections in July.

Emerging Markets
Emerging market shares recorded a slight gain in a volatile second quarter. US-China trade tensions were rekindled in May as talks unexpectedly broke down, and both sides implemented new tariffs. However, hopes for a resumption of talks post the G20 summit in June, and rising expectations that the US Fed will cut interest rates, proved supportive later in the period. The MSCI Emerging Markets Index gained but underperformed the MSCI World.

Those markets most sensitive to changes in global liquidity performed well, in particular Argentina where political developments also boosted sentiment. In advance of presidential elections in October, the leading candidates appeared to adopt a more centrist stance. South Africa, Indonesia and Turkey were among the best performers.

Global Bonds
It was a positive quarter for financial markets with both riskier assets and government bonds making gains. Broadly, this reflected expectations that central banks would keep monetary policy loose, including the possibility of US rate cuts. At their meetings in mid-June, comments from the Fed and ECB confirmed the growing dovishness among policymakers, with both clearing the way for further policy measures if needed.

Government bond yields fell markedly as prices rose. The 10-year US Treasury yield was over 40 basis points (bps) lower over the period and the 10-year German Bund yield over 25bps lower at -0.33%. The UK 10-year yield underperformed, falling by about 17bps. The yield rose in April (i.e. bond prices fell) on the announcement of an extension to the Brexit deadline and resilient economic data.

Corporate bond markets delivered positive total returns and outperformed government bonds. EM debt denominated in local currencies performed particularly well as the US dollar weakened in June.

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 at the January and March meeting 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) was invested with All Stock Index-Linked Gilts with LGIM in June to bring the fund to its full allocation of IL gilts.

The LCIV have now finalised the infrastructure sub fund and gained FCA approval so which was one of the outstanding items for the Hillingdon fund to commit. Attached in part II is a paper on the LCIV infrastructure sub fund picking up on outstanding issues with a recommendation to now commit to invest in this fund.

5. LCIV update

Currently open on the London CIV are
1 UK Equity sub fund
5 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 received FCA approval for the launch of their new Global Equity Core fund and the Infrastructure fund.

The next phase will look at launching Inflation plus and Equity Value fund.

Following the appointment of Mike O'Donnell as Chief Executive in March, the LCIV appointed a permanent Chief Investment Officer, Mark Thompson, who started in September but who has since decided to resign for personal and family reasons as he could not fully commit to the pool.

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 £612m at 30 June 2019, accounting for almost 56% of total assets of the Pension Fund. With a further £50m planned for investment through the pool on approval of investment into the infrastructure fund.

The London CIV have advised the fund that they have been able to secure further savings from the Global equities Income sub fund; as a result fees will reduce slightly from October 2019.

Voting and Engagement

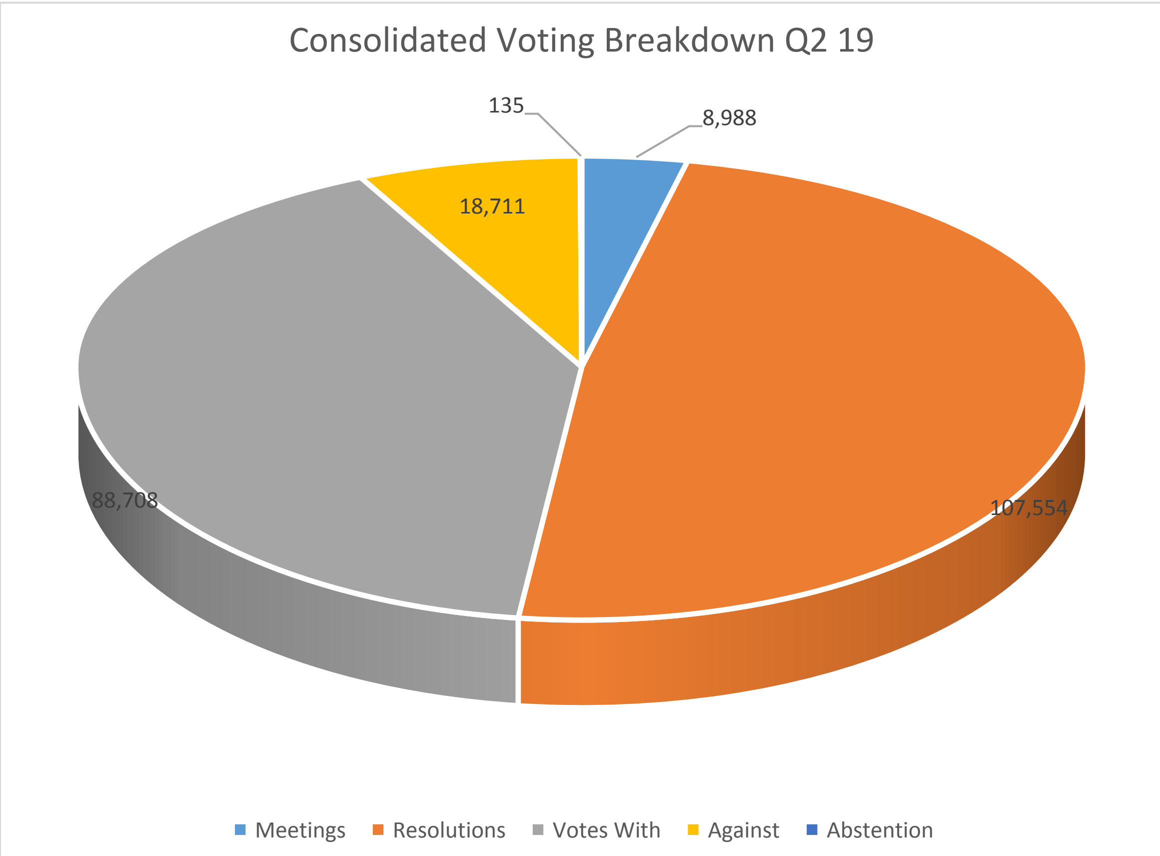
Fund managers carry out proxy voting on the Pension Fund's behalf. Below are a breakdown of voting statistics by UBS Asset Management, LGIM and London CIV (Ruffer and Epoch).

		Fund Managers Voting Breakdown				
UBS		**Meetings**	**Resolutions**	**Votes With**	**Against**	**Abstention**
	Jun-19	6,355	72,268	59,313	12,955	0
		6,355	**72,268**	**59,313**	**12,955**	**0**
	%			**82.07**	**17.93**	**0.00**
LCIV		**Meetings**	**Resolutions**	**Votes With**	**Against**	**Abstention**
	Jun-19					
LCIV - Ruffer		42	682	635	46	1
LCIV - Epoch		83	1,297	1,243	52	2
		125	**1,979**	**1,878**	**98**	**3**
	%			**94.90**	**4.95**	**0.15**
LGIM		**Meetings**	**Resolutions**	**Votes With**	**Against**	**Abstention**
	Jun-19	2,508	33,307	27,517	5,658	132
		2,508	**33,307**	**27,517**	**5,658**	**132**
	%			**82.62**	**16.99**	**0.40**

The UBS figures relate to their Equity fund and not specific shares held by the Hillingdon fund where we are ex tobacco.

The volume of meetings attended and resolutions voted on by all the fund managers shown above encapsulate their commitment to ESG issues and a demonstration of the alignment of their stewardship activities with their own investment beliefs, policies and guidelines. Through this approach, they seek to be active owners on behalf of their clients, by encouraging good governance and a high standard of corporate practices.

The voting breakdown above indicates both UBS and LGIM have voted against proposed management resolutions on 17% of voting opportunities and supported resolutions on about 82% of occasions. Both LCIV portfolios combined backed various management resolutions on 95% of voting opportunities and about 5% against the resolutions proposed by company managements. Full voting reports are included within the part II papers for further information.



The chart above provides a consolidated overview of voting pattern by all fund managers shown in the table above.

FINANCIAL IMPLICATIONS

The financial implications are contained within the body of the report

LEGAL IMPLICATIONS

There are no legal implications in the report.