INVESTMENT STRATEGY and FUND MANAGER PERFORMANCE (Part I)

Committee	Pensions Committee
Officer Reporting	Babatunde Adekoya, Finance Andrew Singh, KPMG
Papers with this report	Northern Trust Performance Report

HEADLINES

Andrew Singh from KPMG will deliver a training session on Pension Fund Governance ahead of the investment strategy and fund performance update.

The total value of the fund was £1,127m at 30 September 2019, an increase of £31m from £1,096m at the end of previous quarter. There was an overall investment return of +3.02% over the quarter, translating into 0.68% ahead of the benchmark.

A detailed analysis of the performance of each investment manager compiled by the independent investment advisor is included in Part II of this report.

Update

The latest fund value as at 31 December 2019 was £1,122m, a decrease of £5m in valuation compared to end of quarter under review.

RECOMMENDATIONS

It is recommended that Pensions Committee:

1. **Consider and discuss any issues raised in the training item**
2. **Note the Fund performance update.**

SUPPORTING INFORMATION

1. Fund Performance

Over the last quarter to 30 September 2019, the Fund returned 3.02%, outperforming the benchmark return of 2.34% by 68 basis points. The Fund value Increased over the quarter by £31m, to £1,127m.

Period of measurement	Fund Return %	Benchmark %	Arithmetic Excess
Quarter	3.02	2.34	+0.68
1 Year	6.21	5.65	+0.56
3 Year	7.12	7.08	+0.04
5 Year	8.19	7.89	+0.30
Since Inception (09/1995)	7.07	6.96	+0.13

During the quarter, distributions received from alternative investments were $2.5m, €414k & £1.7m. After taking advice from the Fund's investment consultants excess cash of £9.0m, which had built up over time, was invested into the existing LGIM portfolio to secure improved returns. This was actioned under section 151 delegated authority.

Investment performance continues to be supressed by the underperformance of UBS UK Equity portfolio that delivered a return of -1.19% relative compared to the benchmark. LGT Capital private equity portfolio, also underperformed by -3.99% relative to benchmark. Adams Street and Macquarie were the biggest contributors to performance in the quarter under review with relative outperformance of 5.04% and 2.75% above their respective benchmarks.

Relative performance over a one-year rolling period was 0.56% above the benchmark with the largest contributors being Adams Street and Macquarie; with returns of 8.62% & 11.71% above benchmarks, whilst UBS equities was the largest detractor from benchmark over the rolling one year period with an underperformance of -6.10% compared to benchmark.

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.

The asset allocation is currently being reviewed as required by the LGPS regulations following the initial results of the triennial valuation.

Current Asset Allocation by Asset Class

ASSET CLASS	Market Value As at 30 Sept 2019 £'000	Actual Asset Allocation %	Benchmark Allocation %
UK Equities	126,219	11.20	44.0
Global Equities	389,809	34.59	
UK Index Linked Gilts	152,105	13.50	19.0
Multi Asset Credit	94,460	8.38	
Corporate Bonds (Global)	34,648	3.08	
Property	130,263	11.56	12.0
DGF/Absolute Returns	71,607	6.36	0.0
Private Equity	16,116	1.43	2.0
Infrastructure	28,230	2.51	8.0
Private Credit	72,478	6.43	10.0
Long Lease Property	0	0	5.0
Cash & Cash Equivalents	10,784	0.96	0.0
Totals	**1,126,719**	**100.0**	**100.0**

Current Asset Allocation by Manager

FUND MANAGER	ASSET CLASS	Market Value As at 30 Sept 2019 £'000	Actual Asset Allocation %
ADAMS STREET	Private Equity	11,926	1.06
LGT	Private Equity	4,149	0.37
AEW	Property	60,655	5.38
JP MORGAN	Multi Asset Credit	94,460	8.38
LCIV - EPOCH	Global Equities	160,744	14.27
LCIV - RUFFER	DGF/Absolute Returns	71,607	6.36
M&G	Private Credit	6,986	0.62
MACQUARIE	Infrastructure	28,230	2.51
PERMIRA	Private Credit	65,492	5.81
LGIM	Global Equities	229,065	20.33
	UK Corporate Bonds	34,648	3.08
	UK Index Linked Gilts	152,105	13.50
UBS EQUITIES	UK Equities	126,219	11.20
	Property	22	0
	Private Equity	41	0
	Cash & Cash Equivalents	3,158	0.28
UBS PROPERTY	Property	69,586	6.18
	Cash & Cash Equivalents	360	0.03
Non Custody	Cash & Cash Equivalents	7,266	0.64
		1,126,719	**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 £4.0m awaiting drawdown on Private Credit, £50m awaiting drawdown for the Long Lease Property, which is expected to be drawn-down by the end of Q3 2020. £55m was recently committed to LCIV Stepstone Infrastructure Fund; these funds are currently held in passive corporate bonds and other overweight positions with LGIM and the LCIV Ruffer Absolute Return Fund.

3. Market and Financial climate overview

UK Equity

UK equities recorded modest gains in what was a mixed quarter for global stocks. Amid concerns about the world economic outlook, many investors favoured assets perceived to have defensive qualities. These included so-called "quality growth" companies which are characterised by their superior and defensible earnings growth. A strong performance from quality growth stocks, and other defensive sectors, helped the UK stock market achieve positive returns over the period. Merger and acquisition activity was also supportive – trade and private equity buyers took advantage of the relative valuation opportunity of UK equities, sterling weakness and readily available cheap debt financing.

In contrast, many economically sensitive areas of the market performed poorly, including the UK's heavyweight financial and commodity sectors. This contributed to a notable underperformance in the FTSE 100, which rose 1.0%, compared to a 3.6% total return from mid-caps (FTSE 250 ex investment companies). Many of these trends reversed towards the end of the period as expectations rose that policymakers might switch from monetary to fiscal measures to stimulate economic activity and inflation.

US

US equities made modest gains in Q3, despite ongoing growth concerns and uncertainty surrounding US-China trade. The growth concerns were most pronounced in August, when the Federal Reserve's (Fed) conservative messaging around its policy response underwhelmed investors. The Fed acted as expected by cutting rates by 25 basis points both in July and in September, but did not commit verbally to a more extended easing cycle. The US yield curve inverted in the month, a phenomenon which often precedes recession.

US economic data was largely stable, albeit it continued to moderate. Unemployment remains at 3.7% and wage growth in August was stronger (month-on-month) than anticipated. However, new non-farm job additions were lower than expected in August, at 130,000 versus predictions of 158,000. Consumer confidence also weakened; the August Conference Board consumer confidence index fell to 125.1 from 134.2 (the index reflects prevailing business conditions and likely developments for the months ahead, detailing consumer attitudes and buying intentions).

Less economically sensitive areas of the market generally performed more strongly. Utilities, real estate and consumer staples were amongst the quarter's better performers. Energy and materials were weaker areas of the market, given expectations of a more challenging demand environment. Healthcare remains a matter of heated debate in the run-up to the 2020 US presidential election, and the political sensitivity caused the sector to lag the market.

Eurozone

Eurozone shares made gains in the quarter amid ongoing worries over trade wars and global growth, the best-performing sectors included utilities, real estate and consumer staples. Underperformers over the quarter were energy and consumer discretionary. However, the market saw a rotation in September with financials, which had previously been out of favour this year, leading the gains.

Economic data remained lacklustre with confirmation that the eurozone economy expanded just 0.2% in Q2. Annual inflation was 1.0% in August, compared to 2.1% in the same month in 2018. Speculation over the possibility of further stimulus from the central bank dominated the summer. In September, the European Central Bank (ECB) took steps to boost the flagging economy, including restarting quantitative easing and committing to buying assets until its inflation target is reached. Christine Lagarde, head of the International Monetary Fund, was nominated to replace Mario Draghi as president of the ECB when his term ends on 31 October.

Japan

Market weakness in early August was more than reversed in September to produce a total return of 3.4% for the three months. The Japanese currency initially strengthened after the cut in US interest rates, but subsequently weakened to end the quarter little changed. The main domestic political event was the Upper House elections in July, which were won comfortably by Mr Abe's Liberal Democratic Party. However, the party fell just short of the two-thirds majority, which would have facilitated Mr Abe's pursuit of constitutional reform. More importantly for equity investors, the result confirmed continuity of policy for the near future, and effectively removed any uncertainty over the rise in consumption tax in October.

The recent cut in US interest rates again raised expectations for additional easing moves by the Bank of Japan. In the very short term, the counterintuitive weakening of the yen has created some breathing space by easing deflationary pressure. The only real policy development came during September, with a fine-tuning of bond purchases in an attempt to encourage a steeping of the yield curve. The Bank of Japan stepped back from its purchases of exchange-traded funds, after maintaining a very consistent run-rate in the first eight months of the year. Meanwhile, survey data suggests that corporate managements are increasingly viewing their own share prices as attractive, which is one factor behind the near-doubling, year-on-year, in the value of share buybacks announced from April to September. Other interesting developments at the corporate level included several restructurings of long-term strategic shareholdings.

Emerging Markets

Emerging market equities were down as US-China trade tensions escalated and concerns over global growth continued to mount. The MSCI Emerging Markets Index decreased in value and underperformed the MSCI World. Argentina was the weakest index market as surprise primary election results triggered a major sell-off in equities

and the currency. Those markets more sensitive to a stronger US dollar came under pressure, notably South Africa but also Indonesia. Saudi Arabia and Colombia underperformed with crude oil price weakness a headwind.
China underperformed by a more modest margin. The US announced 10% trade tariffs on $300 billion of goods imported from China, some of which took effect in September. Following the announcement, the renminbi weakened beyond the symbolic seven-per-dollar threshold, and in response, the US Treasury labelled the country a currency manipulator. The US also announced plans to increase existing tariffs of $250 billion of Chinese goods from 25% to 30% in October. China responded by announcing tariffs on $75 billion of US goods. By contrast, Turkey registered a robust return, as the central bank cut interest rates by a total of 7.5% over the quarter, more than expected. Taiwan also outperformed, driven by strong performance from technology stocks.

Global Bonds

Government bond yields declined markedly over the quarter due to risk aversion in August when US-China trade tensions escalated. The US announced a marked increase in tariffs and China retaliated with its own measures including allowing a devaluation of the renminbi. September saw the ECB announce a much anticipated new round of stimulus measures which helped sentiment. The Fed cut rates again, but disappointed markets by downplaying the prospect of further easing.
The US 10-year Treasury yield was over 30 basis points (bps) lower, finishing the quarter at 1.67%. The 10-year yield reached below 1.5% in late August, and briefly dipped lower than the two-year yield, a yield curve inversion indicating significant economic pessimism among bond investors. In Europe, the 10-year Bund yield fell 24bps to finish even deeper in negative territory at -0.57%. The Italian 10-year yield saw a substantial move, falling 126bps to 0.82% due to anticipation, and ultimately announcement of new stimulus measures and a calmer political backdrop. The UK saw further escalation in Brexit uncertainty. The 10-year UK yield fell 34bps over the quarter, with most of this occurring in July.
Corporate bonds outperformed government bonds. They benefited from the decline in global yields and more recently an improvement in risk sentiment. Investment grade corporate bonds outperformed the riskier high yield part of the market. The telecoms and utility sectors performed well. Across emerging market bonds, corporate debt and local currency government debt made positive returns, while emerging market currencies broadly weakened against the US dollar.

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 whilst 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.

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
1 Infrastructure Fund

The LCIV launched their Infrastructure fund on 31 October 2019 and Hillingdon Pension Fund committed a total of £55m to this offering. LCIV have received FCA approval for the launch of their new Global Equity Core fund.

The next phase will look at launching Inflation plus, which the LCIV hope to submit the required papers to the FCA for approval in February 2020.

Following the resignation of their newly appointed Chief Investment Officer, Mark Thompson, in September 2019, Kevin Corrigan has been appointed as interim CIO, pending the completion of the search for a permanent appointment.

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 £648m at 30 September 2019, accounting for almost 58% of total assets of the Pension Fund. With a reallocation of £55m recently approved by Committee for investment into the LCIV Stepstone infrastructure fund.

Voting and Engagement

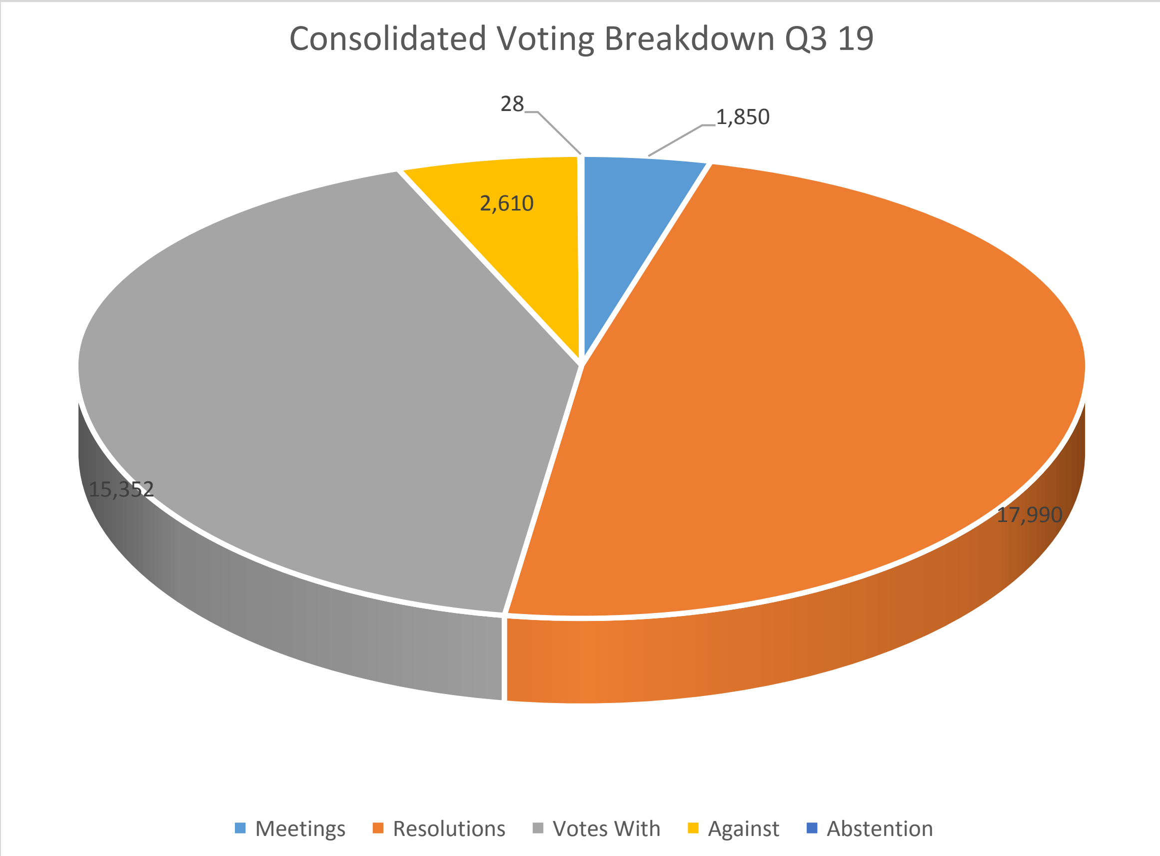
Fund managers carry out proxy voting on the Pension Fund's behalf. Below are a breakdown of voting statistics by UBS Asset Management, LGIM and London CIV (Ruffer and Epoch).

Fund Managers Voting Breakdown Q3, 2019						
UBS		**Meetings**	**Resolutions**	**Votes With**	**Against**	**Abstention**
	Sep-19	1,253	11,857	10,104	1,748	5
		1,253	**11,857**	**10,104**	**1,748**	**5**
	%			**85.22**	**14.74**	**0.04**
LCIV		**Meetings**	**Resolutions**	**Votes With**	**Against**	**Abstention**
	Sep-19					
LCIV - Ruffer		7	102	83	18	1
LCIV - Epoch		5	51	51	0	0
		12	**153**	**134**	**18**	**1**
	%			**87.58**	**11.76**	**0.65**
LGIM		**Meetings**	**Resolutions**	**Votes With**	**Against**	**Abstention**
	Sep-19	585	5,980	5,114	844	22
		585	**5,980**	**5,114**	**844**	**22**
	%			**85.52**	**14.11**	**0.37**

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 14% of voting opportunities and supported resolutions on about 86% of occasions. Both LCIV portfolios combined backed various management resolutions on 88% of voting opportunities and about 12% against the resolutions proposed by company managements.



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.