INVESTMENT STRATEGY and FUND MANAGER PERFORMANCE (Part I)	ITEM 7

Committee	Pensions Committee
Officer Reporting	James Lake & Babatunde Adekoya, Finance
Papers with this report	Northern Trust Performance Report

HEADLINES

The total value of the fund was £989m at 31 March 2020, a decrease of £137m from £1,126m at the end of previous quarter. There was an overall investment return of -11.77% over the quarter, translating into -2.93% behind 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 30 June 2020 was £1,069m, an increase of £80m in valuation compared to end of quarter under review.

RECOMMENDATIONS

It is recommended that Pensions Committee:

1. **Note the Fund performance update.**

SUPPORTING INFORMATION

1. Fund Performance

Over the last quarter to 31 March 2020, the Fund returned -11.77%, underperforming the benchmark return of -9.10% by 267 basis points. The Fund value decreased over the quarter by £137m, to £989m.

Period of measurement	Fund Return %	Benchmark %	Arithmetic Excess
Quarter	-9.10	-11.77	-2.67
1 Year	-6.10	-3.50	-2.60
3 Year	0.51	2.00	-1.49
5 Year	4.10	4.67	-0.57
Since Inception (09/1995)	6.38	6.44	-0.06

During the quarter, distributions received from alternative investments were $652k, €611k & £1.7m. £856k was paid to the LCIV-Stepstone Infrastructure Fund and Permira Credit solutions as drawdown of investment commitments.

The effects of COVID-19 impacted investment performance for the quarter and this resulted in underperformance by eight of the twelve engaged fund managers. UBS Equities and AEW with -11.69% & -15.56% behind respective benchmark returns were the biggest contributors to underperformance during the quarter under review. Though, the quarter under review was quite disappointing, both Private Equity portfolios of Adams Street and LGT Capital Partners managed to outperform their respective benchmarks with relative returns of +31.85 and 25.31% respectively.

Relative performance over a one-year rolling period was -2.60% behind the benchmark with the largest detractors again being both UBS Equities and Epoch Investments; with returns of -14.17% & -7.10% below benchmarks. Both Private Equity portfolios of Adams Street and LGT Capital Partners were the largest contributors to relative benchmark returns over the rolling one-year period with an outperformance of 26.40% and 15.20%, respectively 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 31 March 2020	Actual Asset Allocation	Benchmark Allocation	Market Value As at 30 June 2020
	£'000	%	%	£'000
UK Equities	84,471	8.54	45	89,662
Global Equities	324,012	32.76		377,163
UK Index Linked Gilts	141,707	14.33	24	156,330
Multi Asset Credit	89,137	9.01		94,971
Property	118,048	11.94	12	116,738

Current Asset Allocation by Manager		Market Value As at 31 March 2020	Actual Asset Weighting	Market Value As at 30 June 2020
FUND MANAGER	ASSET CLASS	£'000	%	£'000
ADAMS STREET	Private Equity	11,203	1.13	8,857
LGT	Private Equity	3,672	0.37	3,427
AEW	Property	50,774	5.13	50,742
JP MORGAN	Multi Asset Credit	89,137	9.01	94,971
LCIV - EPOCH	Global Equities	128,745	13.02	144,688
LCIV - RUFFER	DGF/Absolute Returns	55,573	5.62	59,116
LCIV - STEPSTONE	Infrastructure	567	0.06	3,752
M&G	Private Credit	5,236	0.53	2,594
MACQUARIE	Infrastructure	26,883	2.72	26,003
PERMIRA	Private Credit	65,017	6.57	63,475
LGIM	Global Equities	195,267	19.74	232,475
	LPI Property	47,399	4.79	47,955
	UK Index Linked Gilts	141,707	14.33	156,330
UBS EQUITIES	UK Equities	84,471	8.54	89,662
	Property	22	0.00	22
	Private Equity	41	0.00	41
	Cash & Cash Equivalents	2,817	0.28	2,658
UBS PROPERTY	Property	67,252	6.80	65,974
	Cash & Cash Equivalents	350	0.04	263
Non Custody	Cash & Cash Equivalents	12,901	1.30	15,798
		989,034	**100**	**1,068,803**

DGF/Absolute Returns	55,573	5.62	0	59,116
Private Equity	14,916	1.51	1	12,325
Infrastructure	27,450	2.78	8	29,755
Private Credit	70,253	7.10	5	66,069
Long Lease Property	47,399	4.79	5	47,955
Cash & Cash Equivalents	16,068	1.62	0	18,719
Totals	**989,034**	**100.00**	**100**	**1,068,803**

The Fund has £3.2m awaiting drawdown on Private Credit. £55m is committed to LCIV Stepstone Infrastructure Fund; these funds are currently held in the LCIV Ruffer Absolute Return Fund, of which £3.8m has been drawn-down at the time of writing this report.

3. Market and Financial climate overview

The spread of Covid-19 profoundly affected global markets in the first quarter. Equities suffered steep declines and government bond yields fell (prices rose) as investors favoured their perceived safety.

Shares fell across developed markets as coronavirus spread and countries went into lockdown to try to contain the outbreak. Governments and central banks announced measures to support businesses and households and reduce borrowing costs.

UK Equity

UK equities tumbled as efforts to deal with the coronavirus pandemic hit economic activity indiscriminately and simultaneously. Prior to these events, domestic politics and Brexit had dominated the narrative around UK assets and the economy for much of the quarter. At the height of the market sell-off, all assets (including government bonds) fell amid fears around the stability of the financial system.

Against this backdrop, sterling hit multi-decade lows versus the US dollar as investors sought safety in cash, particularly US dollars. In line with other central banks, the Bank of England materially reduced interest rates, cutting by 65 basis points to 0.10%. This response was co-ordinated with the UK government, which unveiled an unprecedented series of fiscal support measures, in line with initiatives by many other developed nations.

Oil and gas was the worst performing industry groups over the period, selling off on concerns about falling demand in the wake of the virus, as well as the failure of negotiations between OPEC (the Organisation of the Petroleum-Exporting Countries) and Russia to control the global supply of oil. The consumer services sector also performed very poorly as investors sought to calibrate the effect of a sharp fall in consumer demand as the UK and other governments introduced lockdown measures.

US

US equities declined significantly over the quarter as the coronavirus outbreak spread. Confirmed US cases of Covid-19 rose from 150 to over 100,000 between 4 March and 27 March, and the economic impact grew clearer. Jobless claims rocketed by over three million in the last week of March and economic indicators suggest more pain will follow. The Federal Reserve (Fed) cut interest rates twice in March for the first time since the global financial crisis and announced unlimited quantitative easing (buying bonds). US interest rates now stand at 0-0.25%. The US Senate also passed a $2 trillion stimulus package. The proposed package includes $250 billion worth of direct payments to households, $500 billion for loans to distressed companies and $350 billion for small business loans. All sectors saw significant declines. Energy stocks were hit hard, with the addition of the oil price war weighing heavily. Financials and industrials also fell sharply. The information technology and healthcare sectors held up better, albeit with what would be considered steep falls in any other quarter.

Eurozone

Eurozone equities experienced a sharp fall in Q1 due to the spread of coronavirus. Italy and Spain became some of the most severely affected countries. Nations across Europe took steps to restrict the movement of people and shut down parts of the economy in an effort to slow the spread of the virus. Growth in Europe was already fragile - the eurozone economy grew by just 0.1% in Q4 2019, with Germany registering zero growth.

The flash Markit composite purchasing managers' index (PMI) for March fell to a record low of 31.4, compared to 51.6 in February. The PMI survey covers companies in both the services and manufacturing sectors, and an index reading below 50 indicates economic contraction.

All sectors fell over the quarter. Defensive areas of the market such as healthcare and utilities held up best. Financials and industrials were among the worst hit sectors.

Japan

After a relatively stable start to the year, the Japanese market fell steeply in late February and early March before recovering some ground to end the quarter with a total return of -17.5%. Even allowing for the exceptional environment, the yen was extraordinarily volatile through this period but probably remained slightly weaker than one might otherwise expect.

Market dynamics were chaotic, especially during the mid-March rebound, with some days marked by a strong recovery of those stocks and sectors seen as most heavily oversold, while other days seem to represent a more genuine willingness by investors to take on risk in larger cap cyclical sectors (i.e. those that are most sensitive to the economic cycle). Smaller companies have been significantly weaker than the main indices across the quarter, despite some relative recovery in the second half of March. Style influences were also prevalent, as value stocks underperformed across the quarter, with particular weakness in the first half of March. Value stocks are those that tend to trade at a lower price relative to their fundamentals, such as dividends, earnings and sales.

Emerging Markets
Emerging market (EM) equities fell heavily in Q1, negatively impacted by the Covid-19 pandemic. The spread of the virus beyond China led to lockdowns globally and resulted in sharp falls in economic activity. Against this backdrop, a stronger US dollar was a further headwind for EM. The MSCI Emerging Markets Index decreased in value and underperformed the MSCI World Index.
Brazil was the weakest market in the index, with currency weakness amplifying negative returns.
Colombia was another underperformer as it was additionally impacted by the fall in crude oil prices following the failure of talks to limit oil production. Greece, South Africa and Pakistan all underperformed.
By contrast, China recorded a negative return but outperformed the MSCI Emerging Markets Index as the number of Covid-19 cases declined, and economic activity began to resume. The initial response to the virus outbreak led the authorities to effectively quarantine the city of Wuhan, and the wider province of Hubei. These measures only began to be eased at the end of the quarter. A mixture of interest rate cuts and fiscal (tax and spending) measures were also announced during the quarter.

Global Bonds
Government bond yields declined over the quarter, meaning bond prices rose, as higher risk assets such as shares saw heavy declines amid rising fears over the Covid-19 pandemic. Investors favoured the perceived safety of government bonds due to the growing likelihood of a deep global recession. The moves largely occurred in late-February and March as numerous countries went into lockdown in response to the pandemic, seriously depressing economic activity. This resulted in severe declines and extreme daily swings in assets prices on a scale comparable to the crises of 2008 and 2011.
The US 10-year yield dropped from 1.92% to 0.63% over the quarter, while the two-year yield dropped from 1.57% to 0.23%. The German 10-year yield fell from -0.19% to -0.49%, France’s from 0.12% to 0%. The Italian 10-year yield rose from 1.41% to 1.57%. Spain’s increased from 0.47% to 0.71%. The UK 10-year yield fell from 0.82% to 0.32%.
Corporate bonds, and emerging market debt and currencies declined significantly, mainly in March, and underperformed government bonds, with moves exacerbated by a sharp tightening in liquidity. For several days, companies were unable to issue bonds although this improved later in the month.
High yield credit was hit hard given the heightened risk aversion. The sell-off was sharper in more vulnerable sectors related to travel and retailing, as well as in energy as the oil price plummeted.

4. Strategy Update

At the Pensions Committee in January 2020, following the results of the triennial valuation a revised strategic asset allocation was agreed. The resulting updated Investment Strategy Statement (ISS) is brought to Committee in July for approval.

In addition a separate COVID-19 strategy review was commissioned to assess the revised asset allocation and pending ISS to ascertain whether it remained fit for purpose. Further details are included in item 8.

A 5% allocation to Infrastructure is yet to be fully drawn and funds remain with LCIV (Ruffer) until required.

The £50m allocation to Long-Lease Property with LGIM was fully drawn in March 2020.

The index-linked bond allocation was rebalanced to reduce the risk associated with the potential removal of the RPI index as well as aligning the holding with the duration of the Fund’s liabilities.

The Corporate Director of Finance in May 2020 under delegated authority consented to requests from both Permira Credit Solutions II & III for authorisation to proposed recycling arrangements by the funds. The amendments will enable both funds reinvest interest payments received from investee companies in follow-on investments, rather than distribute the money to investors. Thus, provide much needed liquidity for both funds in the current global financial climate.

FINANCIAL IMPLICATIONS

The financial implications are contained within the body of the report

LEGAL IMPLICATIONS

There are no legal implications in the report.