INVESTMENT STRATEGY and FUND MANAGER PERFORMANCE (Part I)	ITEM 6

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 £1,069m at 30 June 2020, an increase of £80m from £989m at the end of previous quarter. There was an overall investment return of -8.04% over the quarter which was 1.0% 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 September 2020 was £1,080m, an increase of £11m 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 30 June 2020, the Fund returned 8.04%, underperforming the benchmark return of 9.04%. The Fund value increased over the quarter by £80m, to £1,069m.

Period of measurement	Fund Return %	Benchmark %	Arithmetic Excess
Quarter	8.04	9.04	-1.00
1 Year	-1.76	2.29	-4.05
3 Year	2.81	4.66	-1.85
5 Year	6.02	6.82	-0.80
Since Inception (09/1995)	6.65	6.74	-0.09

During the quarter, distributions received from alternative investments were $1.5m, €874k & £628k. £3.2m was paid to the LCIV-Stepstone Infrastructure Fund.

The recovery from effects of COVID-19 was quite visible in investment performance for the quarter and this resulted in positive returns by eight of the thirteen portfolios. M&G Investments, LGT Capital Partners and Adams Street Partners with -15.45%, -22.71% & -27.68% behind respective benchmark returns were the biggest underperformers during the quarter under review. LCIV-Ruffer LLP and JP Morgan were the biggest contributors to performance with 6.06% and 5.45% relative excess returns compared to their respective benchmarks.

Overall portfolio relative performance over a one-year rolling period was arithmetically -4.05% behind the benchmark with the largest detractors being UBS Equities and M&G Investments with returns of -14.91% & -21.73% below benchmarks. LCIV-Ruffer LLP was the largest contributor to performance over one year rolling period with 7.35% outperformance relative to its 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 and 13 portfolios 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 June 2020	**Actual Asset Allocation**	**Benchmark Allocation**	**Market Value As at 30 September 2020**
ASSET CLASS	**£'000**	**%**	**%**	**£'000**
UK Equities	89,662	8.39	45	42
Global Equities	377,163	35.30		474,770
UK Index Linked Gilts	156,330	14.63	24	152,914
Multi Asset Credit	94,971	8.89		96,849
Property	116,383	10.89	12	117,134
DGF/Absolute Returns	59,116	5.53	0	59,779
Private Equity	12,325	1.15	1	12,732
Infrastructure	29,755	2.78	8	29,576
Private Credit	66,069	6.18	5	61,480
Long Lease Property	47,955	4.49	5	48,285
Cash & Cash Equivalents	18,795	1.76	0	26,638
Totals	**1,068,524**	**100.00**	**100**	**1,080,199**

Current Asset Allocation by Manager		Market Value As at 30 June 2020	Actual Asset Allocation	Market Value As at 30 September 2020
FUND MANAGER	**ASSET CLASS**	**£'000**	**%**	**£'000**
ADAMS STREET	Private Equity	8,857	0.83	9,440
LGT	Private Equity	3,427	0.32	3,251
AEW	Property	51,047	4.78	52,317
JP MORGAN	Multi Asset Credit	94,971	8.89	96,849
LCIV - EPOCH	Global Equities	144,688	13.54	145,796
LCIV - RUFFER	DGF/Absolute Returns	59,116	5.53	59,779
LCIV - STEPSTONE	Infrastructure	3,752	0.35	3,752
M&G	Private Credit	2,594	0.24	2,146
MACQUARIE	Infrastructure	26,003	2.43	25,824
PERMIRA	Private Credit	63,475	5.94	59,334
LGIM	Global Equities	232,475	21.76	243,404
	LPI Property	47,955	4.49	48,285
	Future World	0	0.00	85,570
	UK Index Linked Gilts	156,330	14.63	152,914
UBS EQUITIES	UK Equities	89,662	8.39	42
	Property	22	0.00	22
	Private Equity	41	0.00	41
	Cash & Cash Equivalents	2,658	0.25	3,704
UBS PROPERTY	Property	65,314	6.11	64,795
	Cash & Cash Equivalents	339	0.03	361
Non Custody	Cash & Cash Equivalents	15,798	1.48	22,573
		1,068,524	**100**	**1,080,199**

The Fund has £4.5m 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 easing of Covid-19 lockdowns and early signs of economic recovery saw risk appetite return rapidly in Q2, supporting equity and credit markets.

UK Equity

UK equities rose over the period. Having contained the first wave of Covid-19, national lockdown measures were eased. Meanwhile, economic indicators suggested the downturn had past its worst point. A number of economically sensitive areas of the market outperformed amid a general improvement in investor sentiment, largely driven by global considerations. The mining sector, for instance, performed very well, in part due to the ongoing recovery in Chinese economic activity and new stimulus measures. The latest monthly estimates revealed that the UK economy contracted by 20.4% in April (the first full month of the UK national lockdown). However, Google mobility data suggests that the fall in travel to work also bottomed out that month. This supports the view that GDP could have returned to positive growth in May. The government began to ease lockdown measures with people encouraged to return to work where necessary and a phased reopening of schools and various industry sectors confirmed. This occurred as the cost of the government programmes announced in Q1 to cushion the blow from unemployment and the loss of income due to the lockdowns became apparent in borrowing figures released in Q2.

The government confirmed a phased end to the furlough scheme and the Bank of England (BoE) expanded its quantitative easing programme. The BoE's governor told parliamentarians that negative rates were under "active review" while the Debt Management Office reported it had sold negative yielding gilts for the first time. Brexit returned to the agenda as the deadline passed for an extension of the transition period, which expires on 31 December 2020.

US

US equities rebounded in Q2 and outperformed other major equity markets. At the beginning of the quarter, data confirmed the severe economic impact of lockdown measures. However, the subsequent easing of lockdown restrictions, ongoing loose monetary policy from the Federal Reserve (Fed) and early indications of a recovery led to widespread equity market gains. Weekly claims for unemployment insurance slowed substantially and retail sales rebounded strongly from April to May.

However, investor optimism was tempered by a subsequent rise in Covid-19 cases that has prompted some states to rethink or reversing the easing of lockdown measures. US-wide, the trend of new cases accelerated rapidly into the end of June. The states of Texas, Florida, California and Arizona saw notable increases in cases and hospitalisations.

The improvement in retail sales was supportive of consumer discretionary stocks, which outperformed, along with information technology, which has been consistently resilient through the crisis. Energy and materials also made strong gains. Defensive areas such as utilities and consumer staples lagged behind.

Eurozone

Eurozone equities posted strong gains in Q2 as countries began to lift lockdown restrictions. The Baltic countries and Austria were among the first to loosen their lockdowns in April due to their relative success in containing Covid-19. Worse affected countries such as Spain, France and Italy waited until later in the quarter before relaxing measures.

Another source of support for shares was news of the EU's plans for post-Covid-19 recovery. European Commission president Ursula von der Leyen called for the power to borrow €750 billion for a recovery fund to support the worst affected EU regions. This would be in addition to a €540 billion rescue package agreed in April. The European Central Bank also offered support, expanding its pandemic emergency purchase programme to €1.35 trillion.

All sectors posted a positive return in the quarter. Information technology saw some of the strongest gains along with industrials, materials and financials, as news of lockdowns lifting buoyed economically sensitive sectors. The energy sector was the main underperformer.

Japan

After weakness in early April, the Japanese equity market recovered to record a total return of 11.3%. Although there was some short-term currency volatility in June, the yen remained in a stable range throughout the three months.

As the quarter unfolded, investors reacted positively to signs of a peak in virus cases globally, rather than specific news on Japan itself. As a result, economically sensitive and global stocks, together with pharmaceuticals, tended to lead the market recovery. Domestic-focused stocks such as transportation, insurance and utilities typically lagged behind the overall market rise. Airlines continued to weaken as concerns mounted over their inability to restart profitable services in the medium term, even when lockdowns began to ease. Smaller companies were very weak relative to the overall market in first few days of April but gradually recouped this decline and actually outperformed large caps over the quarter as a whole.

Emerging Markets

Emerging market (EM) equities rallied, recording their strongest quarterly return in over a decade, with US dollar weakness amplifying returns. This was despite an acceleration in the number of new daily cases of Covid-19 in some EM countries. The MSCI Emerging Markets Index increased in value but slightly underperformed the MSCI World Index.

EM countries with high foreign financing needs outperformed, notably Argentina, which was the best-performing market in the MSCI EM index, as well as South Africa and Indonesia. The exporter markets of Thailand and Taiwan outperformed on hopes of a recovery in global demand in the second half of 2020. Brazil recorded a strong gain despite a headwind from currency weakness.

By contrast, Egypt and Qatar were the weakest index markets, though both still posted solid gains. Mexico underperformed as the government remained reluctant to provide more meaningful fiscal support. China also underperformed, having outperformed by a wide margin in Q1. Economic activity continued to normalise and additional stimulus was announced at the National People’s Congress in May. However, US-China tensions increased, extending beyond trade and technology issues.

Global Bonds

Broadly, government bond yields saw a degree of divergence over the quarter. The US and Germany’s 10-year yields were little changed, but those more sensitive to risk sentiment declined (meaning prices rose). The US 10-year yield remained in a narrow range, and finished one basis point lower. It sold off in early June following a stronger-than-expected US labour market data release, though the move reversed later in the month.

In Europe, the more noteworthy development was a decline in the Italian 10-year yield of over 22 basis points (bps) to 1.26%. Italian bonds benefited from hopes of moves toward more coordinated support measures in the eurozone.

With Brexit back in focus, the UK 10-year bond yield was 18bps lower at 0.17%. The UK two-year yield dropped below zero for the first time, finishing at -0.08%, as the central bank discussed the possibility of negative interest rates.

Corporate bonds performed strongly, outpacing government bonds, as they benefited from stronger risk appetite. High yield performed particularly well with total returns (local currency) of 11%, led by the European market. Investment grade returned 7.9%. The US energy sector performed well across investment grade and high yield. Investment grade bonds are the highest quality bonds as determined by a credit ratings agency; high yield bonds are more speculative, with a credit rating below investment grade.
Emerging market (EM) bonds also rebounded to produce strong gains. Hard currency government, quasi-sovereign and corporate bonds returned over 11%. Local currency bonds were up nearly 10%.

FINANCIAL IMPLICATIONS

The financial implications are contained within the body of the report

LEGAL IMPLICATIONS

There are no legal implications in the report.