

## INVESTMENT STRATEGY and FUND MANAGER PERFORMANCE (Part I)

ITEM 5

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 £1,076m at 30 September 2020, an increase of £7m from £1,069m at the end of previous quarter. There was an overall investment return of 0.67% over the quarter which was -0.85% 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 31 December 2020 was £1,135m, an increase of £59m in valuation compared to end of quarter under review. At the time of writing the report the unaudited Fund value stood at £1.142m. The chart in paragraph 2 shows Fund values from Jan 2019 for comparison and to demonstrate the improvement in value since the start of the COVID pandemic.

## RECOMMENDATIONS

**It is recommended that Pensions Committee:**

- 1. Note the Fund performance update.**

## SUPPORTING INFORMATION

### 1. Fund Performance

Over the last quarter to 30 September 2020, the Fund returned 0.67%, underperforming the benchmark return of 1.52%. The Fund value increased over the quarter by £7m, to £1,076m.

| <b>Period of measurement</b>     | <b>Fund Return %</b> | <b>Benchmark %</b> | <b>Arithmetic Excess</b> |
|----------------------------------|----------------------|--------------------|--------------------------|
| <b>Quarter</b>                   | 0.67                 | 1.52               | -0.85                    |
| <b>1 Year</b>                    | -4.00                | 1.46               | -5.46                    |
| <b>3 Year</b>                    | 2.50                 | 4.63               | -2.13                    |
| <b>5 Year</b>                    | 6.69                 | 7.60               | -0.91                    |
| <b>Since Inception (09/1995)</b> | 6.61                 | 6.74               | -0.13                    |

During the quarter, distributions received from alternative investments were \$391k, €190k & £5.5m.

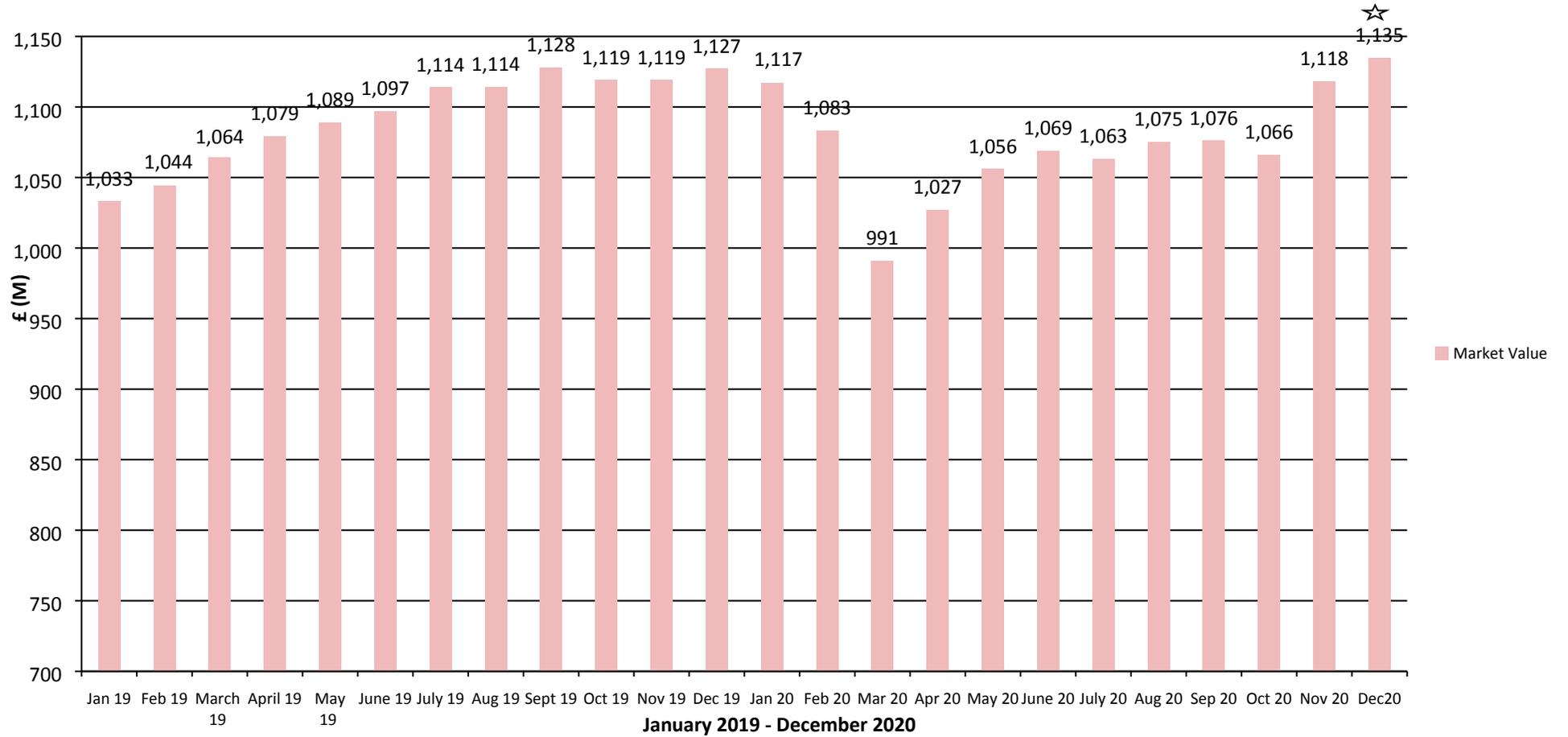
The recovery from effects of COVID-19 continued to be manifested in investment performance for the quarter and this resulted in positive returns by ten of the thirteen portfolios. M&G Investments and LGT Capital with -11.04% & -2.38% behind respective benchmark; however, this is primarily due to the maturity of the funds and it should be noted investment values represent a very small portion within the Fund. Adams Street and UBS Equities were the biggest contributors to performance with 4.58% and 2.16% relative excess returns compared to their respective benchmarks.

Overall portfolio relative performance over a one-year rolling period was arithmetically -5.46% behind the benchmark with the largest detractors being M&G Investments and LCIV-Epoch with returns of -31.03% & -14.54% below benchmarks. LCIV-Ruffer LLP was the largest contributor to performance over one year rolling period with 5.64% outperformance compared to its benchmark.

## **2. Fund Value**

The chart below shows month-end Fund values from January 2019 to December 2020. The fund is currently at its highest level, ahead of both the March 2019 triennial valuation figure and pre-COVID market highs.

# LBH Pension Fund Monthly Market Value Movement



Classification: Public  
Pensions Committee 26 January 2021

### 3. 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.

| <b>Current Asset Allocation by Asset Class</b> |  |                                |                             |  |
|--|--|--------------------------------|-----------------------------|--|
| <b>ASSET CLASS</b>                             | <b>Market Value As at 30 Sept 2020</b> | <b>Actual Asset Allocation</b> | <b>Benchmark Allocation</b> | <b>Market Value As at 31 December 2020</b> |
|  | <b>£'000</b>                           | <b>%</b>                       | <b>%</b>                    | <b>£'000</b>                               |
| Global Equities                                | 473,593                                | 44.90                          | 45                          | 509,810                                    |
| UK Index Linked Gilts                          | 152,914                                | 13.63                          | 24                          | 154,753                                    |
| Multi Asset Credit                             | 96,849                                 | 9.86                           |                             | 111,928                                    |
| Property                                       | 116,995                                | 10.51                          | 12                          | 119,360                                    |
| DGF/Absolute Returns                           | 59,779                                 | 5.09                           | 0                           | 57,787                                     |
| Private Equity                                 | 12,732                                 | 1.02                           | 1                           | 11,593                                     |
| Infrastructure                                 | 29,576                                 | 3.33                           | 8                           | 37,848                                     |
| Private Credit                                 | 61,480                                 | 5.37                           | 5                           | 61,024                                     |
| Long Lease Property                            | 48,285                                 | 4.32                           | 5                           | 49,030                                     |
| Cash & Cash Equivalents                        | 23,385                                 | 1.96                           | 0                           | 22,255                                     |
| <b>Totals</b>                                  | <b>1,075,588</b>                       | <b>100.00</b>                  | <b>100</b>                  | <b>1,135,388</b>                           |

| Current Asset Allocation by Manager |                         | Market Value As at 30 Sept 2020 | Actual Asset Allocation | Market Value As at 31 December 2020 |
|-------------------------------------|-------------------------|---------------------------------|-------------------------|-------------------------------------|
| FUND MANAGER                        | ASSET CLASS             | £'000                           | %                       | £'000                               |
| ADAMS STREET                        | Private Equity          | 9,440                           | 0.88                    | 8,337                               |
| LGT                                 | Private Equity          | 3,251                           | 0.30                    | 3,215                               |
| AEW                                 | Property                | 52,165                          | 4.85                    | 54,208                              |
| JP MORGAN                           | Multi Asset Credit      | 96,849                          | 9.00                    | 111,928                             |
| LCIV - EPOCH                        | Global Equities         | 145,796                         | 13.56                   | 59,842                              |
| LCIV - RUFFER                       | DGF/Absolute Returns    | 59,779                          | 5.56                    | 57,787                              |
| LCIV STEPSTONE                      | Infrastructure          | 3,752                           | 0.35                    | 19,236                              |
| M&G                                 | Private Credit          | 2,146                           | 0.20                    | 1,840                               |
| MACQUARIE                           | Infrastructure          | 25,824                          | 2.40                    | 18,612                              |
| PERMIRA                             | Private Credit          | 59,334                          | 5.52                    | 59,184                              |
| LGIM                                | Global Equities         | 243,404                         | 22.63                   | 268,530                             |
|                                     | LPI Property            | 48,285                          | 4.49                    | 49,030                              |
|                                     | Future World            | 84,351                          | 7.84                    | 181,396                             |
|                                     | UK Index Linked Gilts   | 152,914                         | 14.22                   | 154,753                             |
| UBS EQUITIES                        | Equities                | 42                              | 0.00                    | 42                                  |
|                                     | Property                | 22                              | 0.00                    | 22                                  |
|                                     | Private Equity          | 41                              | 0.00                    | 41                                  |
| UBS PROPERTY                        | Property                | 64,808                          | 6.03                    | 65,130                              |
|                                     | Cash & Cash Equivalents | 811                             | 0.08                    | 348                                 |
| Non-Custody                         | Cash & Cash Equivalents | 22,574                          | 2.14                    | 21,907                              |
|                                     |                         | <b>1,075,588</b>                | <b>100.04</b>           | <b>1,135,388</b>                    |

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 £8.9m has been drawn down at the time of writing this report.

## **4. Market and Financial climate overview**

### **UK Equity**

UK equities lagged other regions during the period – extending their year-to-date underperformance – with the market's significant exposure to poorly performing stocks in the oil and financial sectors proving unhelpful. Renewed fears around a disorderly Brexit also weighed on sentiment, as did worries towards the end of the period around the implications of a second wave in Covid-19 infections. Rising infection rates necessitated the re-imposition of localised restrictions following similar measures taken in continental Europe. Notwithstanding these new measures, the country's economic recovery continued as Covid-19 restrictions were generally eased. The second quarter reporting season underlined increased corporate confidence with many companies resuming guidance on their likely financial performance for the rest of 2020. Where they felt it appropriate, a number of others also resumed the payment of dividends that they had deferred in the spring – many of these payments had been deferred just prior to the AGM season and at a time of peak uncertainty related to the global pandemic.

Several UK focused areas of the market, and mid cap equities, performed poorly over September following the re-imposition of localised restrictions and fears about the impact of these on the UK economy. However, many domestically focused areas performed well over the quarter, as their valuations began to reflect the more encouraging macroeconomic data seen over the summer. In contrast, sterling strength against a weak dollar weighed on large UK companies with exposure to international markets, as a stronger pound makes their products more expensive. There was renewed merger & acquisition interest from overseas firms in UK quoted companies at period end.

### **US**

US equities gained in Q3 despite a decline in September as risk appetites slipped. Overall, the US economy's recuperation continued, and the Federal Reserve's (Fed) messaging remained highly accommodative. The Fed will now use average inflation targeting (AIT) in setting the policy interest rate, allowing for temporary overshoots in inflation. The new policy means the Fed is willing to wait until inflation has gone above 2% until it responds. Furthermore, the latest dot plot – the Fed's own projection of the future path of interest rates - suggests that policymakers see rates at the zero lower bound through to and including 2023.

However, US markets wobbled late in the quarter amid a resurgence in European Covid-19 cases, as well as questions over refreshed fiscal stimulus measures. Adding to these worries was uncertainty over a smooth transition of power if President Trump loses his re-election bid.

Consumer discretionary stocks – particularly restaurants and appliances or apparel retailers - performed well. Distribution companies were stronger and helped to lift the industrials sector, at odds with the performance of several airlines still facing

headwinds from languishing passenger numbers. Energy names – similarly - were broadly weaker on expectations that fuel demand will remain subdued.

### **Eurozone**

Eurozone equities were virtually flat over the quarter. The rate of improvement in economic data slowed over the quarter and worries took hold over sharply rising Covid-19 infections in many European countries. The energy and financials sectors saw the sharpest falls while materials and consumer discretionary advanced, with automotive and luxury goods stocks generally faring well.

In July, the EU approved a €750 billion fund to help member states recover from the pandemic. The fund will be made up of €390 billion of grants and €360 billion of loans to be distributed among EU member states. The money will be borrowed by the European Commission and guaranteed by all EU member states. Covid-19 infections rose rapidly in several countries as the quarter progressed, notably Spain and France, and new restrictions to contain the virus were announced. However, these restrictions tended to be localised, rather than the blanket countrywide measures seen in the first phase of the virus. Various European countries, including Germany, extended their furlough schemes which are designed to support jobs through the crisis.

### **Japan**

The Japanese equity market trended upwards during the quarter and the Topix Index recorded a total return of 5.2%. This was despite a gradual strengthening of the yen against the US dollar over the period. There were some brief periods of style reversal but, across the quarter, the market was led by strong momentum in higher-valuation stocks. Small cap stocks were notable outperformers in September and have now more than recouped the sharp underperformance seen during the market turmoil in the first quarter of the year.

### **Emerging Markets**

Emerging market equities registered a robust return in Q3, aided by optimism towards progress on a Covid-19 vaccine and ongoing economic recovery. US dollar weakness proved supportive. The MSCI Emerging Markets Index increased in value and outperformed the MSCI World.

Taiwan, where strong performance from IT stocks supported gains, and South Korea were among the best-performing index markets. India outperformed the MSCI Emerging Markets Index as monsoon rains remained reasonable and the government made progress with agriculture and labour reforms. This was despite continued increases in the number of new Covid-19 cases as well as tensions with its border with China. China also finished ahead of the index as the economy continued to recover. Q2 GDP growth rebounded to 3.2% year-on-year, after a fall of -6.8% in Q1, and was stronger than expected. Q2 earnings results were also ahead of expectations, notably in the e-commerce sector. However, US-China tensions continued to escalate. These

Classification: Public

Pensions Committee 26 January 2021

included additional measures against Chinese technology companies, and President Trump's executive order to end Hong Kong SAR's special status with the US.

Conversely, Turkey recorded a negative return and was the weakest market in the index, primarily due to lira weakness. This was despite a 200bps interest rate rise from the central bank in September. Thailand and Indonesia underperformed, as did the CE3 markets of Poland, Czechia and Hungary, as new cases of Covid-19 increased. Russia and Brazil also finished behind the index. In Russia, uncertainty over US foreign policy due to the US presidential election and, later in the period, crude oil price weakness, weighed on sentiment. In Brazil, concern over the fiscal outlook was the main headwind.

## **Global Bonds**

The tone was predominantly positive in markets over the quarter, underpinned by policy measures, the gradual reopening of economies and, to some degree, hopes of a Covid-19 vaccine. The Federal Reserve (Fed) announced a change to its inflation targeting regime in August, saying it would target an average 2% inflation rate, allowing periods of overshoot. This was well received by markets.

Government bond yields were mixed. The US 10-year yield finished at 0.68%, three basis points (bps) higher, with the UK 10-year yield six points higher at 0.23%. The UK yield fell in September as Brexit uncertainty resumed and there was further discussion of negative interest rates from the Bank of England.

European government bonds performed well as sentiment toward the region improved markedly after the EU announced a €750 billion pandemic recovery fund. The German 10-year yield fell by 7bps, finishing at -0.52%, while Italy's yield fell by 39bps and Spain's by 22bps. The euro gained over 4% against the US dollar, while the dollar index lost just over 3.5% overall.

Corporate bonds enjoyed a decidedly positive quarter, as riskier assets were broadly buoyant and monetary policy helped anchor yields at low levels. Investment grade returned 1.8%, while high yield debt returned 4%. Sectors worst affected by Covid, such as retail and leisure, partially recovered (source: ICE BofAML). Investment grade bonds are the highest quality bonds as determined by a credit rating agency; high yield bonds are more speculative, with a credit rating below investment grade.

In emerging markets, hard currency government bonds returned 2.3% and corporate bonds returned 2.6%. Hard currency refers to money that is issued by a nation that is seen as politically and economically stable, such as US dollars. Local currency bonds made a modest positive return, while EM currencies were mixed, but slightly negative overall (source: JP Morgan).

Convertible bonds, as measured by the Thomson Reuters Global Focus index, gained 5.5% in US dollar terms, compared to 7.9% for the MSCI World equity index. The asset class delivered well in the quarter's differing market environments, with a strong upside participation in the first two months - when shares gained - and good resilience in the last month when shares came under pressure. With equity markets strongly up over

the quarter, convertible bonds were in demand and the US region became more expensively valued from what had been cheap levels.

### **FINANCIAL IMPLICATIONS**

The financial implications are contained within the body of the report

### **LEGAL IMPLICATIONS**

There are no legal implications in the report.