INVESTMENT STRATEGY AND FUND MANAGER PERFORMANCE (Part I)

Committee	Pensions Committee
Officer Reporting	James Lake, Finance Babatunde Adekoya, Finance
Papers with this report	Northern Trust Performance Report Hymans Robertson Funding Update

HEADLINES

The Actuary's estimate of the funding position as at 31 March 2021 shows an estimated deficit of £138m, equivalent to a funding level of 89%. These represent are a slight improvement on the 2019 formal actuarial valuation. Investment returns have been slightly above expectations but the outlook for future investment returns is slightly less positive which serves to increase the value placed on the liabilities.

The overall investment return of the Fund was +2.19% over the quarter which was 0.62% ahead of the benchmark. Performance over longer-term periods (3 and 5 years) is in the region of 5 to 7% per annum, showing underperformance of 0.7% to 1.4% per annum compared to the benchmark.

The Fund's asset allocation remains close to the target investment strategy.

More information on implementation of investment strategy and the Fund's investment managers are included in Part II of this report.

RECOMMENDATIONS

It is recommended that Pensions Committee:

1. **Note the Fund funding and performance update; and**
2. **Note the updates on implementation of the investment strategy.**

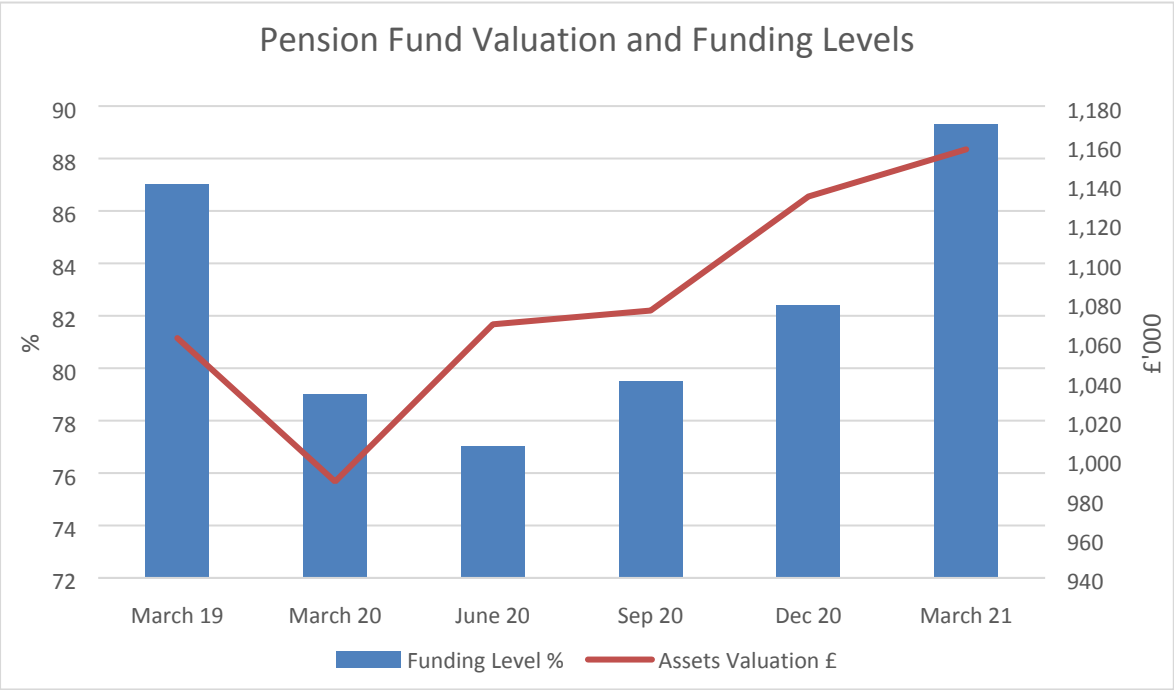
SUPPORTING INFORMATION

1. Funding Update

At the last formal valuation at March 2019, the Fund assets were £1,067m and the liabilities were £1,228m. This represented a deficit of £161m and equated to a funding level of 87%.

Hymans Robertson have carried out an interim funding update to illustrate an estimated funding position at 31 March 2021. Their report is attached as an appendix

to this paper and it shows an estimated deficit of £138m, equivalent to a funding level of 89%, as at 31 March 2021.



Although markets have been severely disrupted by COVID 19 over the last year, in the 24 months since the formal valuation, investment returns have been slightly above expectations. However, the outlook for future investment returns is slightly less positive which serves to increase the value placed on the liabilities.

There is no direct impact of this funding report. During 2022/23, the Actuary will undertake a formal actuarial valuation based on the Fund status at 31 March 2022. Any necessary changes to employer contribution rates will be effective from April 2023.

2. Fund Performance

Over the last quarter to 31 March 2021, the Fund returned 2.19%, outperforming the benchmark return by 0.61%. The Fund value increased over the quarter by £23m, to £1,157m.

Period of measurement	Fund Return %	Benchmark %	Arithmetic Excess
Quarter	2.19	1.57	0.62
1 Year	17.17	17.97	-0.80
3 Year	4.94	6.48	-1.54
5 Year	7.10	7.87	-0.77
Since Inception (09/1995)	6.78	6.87	-0.09

Highlights of the investment managers' relative performance are as follows:

- The London CIV Income Fund outperformed by 2.3% over the quarter but it continued to lag the market over longer-term periods. Relative performance since inception in 2017 is -5.14% per annum.

- Another strong quarter from the London CIV Absolute Return Fund with a return of +7.59%. It has proved resilient during the pandemic.

- The Fund's bond investments (Multi asset Credit managed by JPMorgan and the index-linked gilts managed passively by LGIM) fell in value over the quarter.

- Particularly for illiquid asset classes, interpretation of both absolute and relative performance over short periods should be treated with caution given both the uncertainties and delays in valuations and/or because suitable benchmarks are not necessarily available. This is particularly the case for private equity when the listed markets are volatile.

- Macquarie infrastructure performance has been strong over the quarter (+7.75%), largely due to £6m in distributions.

- M&G Investments and private equity (Adams Street and LGT) are in run off and performance is expected to be volatile. The amounts invested, and hence their contribution to the overall fund performance, are now relatively small.

3. Asset Allocation

The current asset allocation, the key strategic tool for the Committee, is in the table below.

Current Asset Allocation by Asset Class

ASSET CLASS	Market Value As at 01 January 2021	Actual Asset Allocation As At 01 January 2021	Market Value As at 31 March 2021	Actual Asset Allocation As At 31 March 2021	Benchmark Allocation	Market Value As at 30 April 2021
	£'000	%	£'000	%	%	£'000
Global Equities	509,810	45	537,066	46	45	556,401
UK Index Linked Gilts	154,753	14	144,920	13	24	146,307
Multi Asset Credit	111,928	10	116,580	10		117,487
Property	119,360	11	139,177	12	12	139,428
DGF/Absolute Returns	57,787	5	50,833	4	0	51,147
Private Equity	11,593	1	12,499	1	1	12,598
Infrastructure	37,848	3	33,403	3	8	34,105
Private Credit	61,024	5	59,208	5	5	50,357
Long Lease Property	49,030	4	49,749	4	5	49,924
Cash & Cash Equivalents	22,255	2	15,254	1	0	24,154
Totals	**1,135,388**	**100.00**	**1,158,689**	**100.00**	**100**	**1,181,908**

Recent changes to the asset allocation are as follows:

£12.5m was invested over the quarter in the UBS property mandate (for the new investment in the LGIM Industrial Property Investment Fund);

- £5m was invested in the JPMorgan Multi Asset Credit Fund;
- A drawdown of £5m was called by the London CIV Infrastructure fund in the same period;
- £12m was withdrawn from the London CIV Absolute Return Fund to fund new investments;
- During the quarter, distributions received from £6m from Macquarrie Infrastructure and £1m from Permira private debt.

Undrawn commitments at 31 March 2021 are as follows:

- £3.2m (8%) awaiting drawdown on Private Credit.
- £45.8m (83%) to London CIV Infrastructure Fund. These funds are currently held in the LCIV Ruffer Absolute Return Fund.
- £12.5m in for the AEW Urban Renewal property fund.

4. Investment Managers

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 Manager		**Market Value As at 31 March 2021**	**Actual Asset Allocation**	**Market Value As at 30 April 2021**
FUND MANAGER	**ASSET CLASS**	**£'000**	**%**	**£'000**
LGIM – World Developed Equities	Global Equities	281,408	24.29	292,054
LGIM – Future World Equities	Global Equities	192,011	16.57	199,773
LCIV - EPOCH/BALLIE GIFFORD	Global Equities	63,647	5.49	64,574
LGIM	UK Index Linked Gilts	144,920	12.51	146,307
JP MORGAN	Multi Asset Credit	116,580	10.06	117,487
UBS PROPERTY	Property	78,465	6.77	79,475
AEW	Property	60,712	5.24	60,712
LCIV - RUFFER	DGF/Absolute Returns	50,833	4.39	51,147
ADAMS STREET	Private Equity	9,315	0.80	9,297
LGT	Private Equity	3,185	0.27	3,302
LCIV - STEPSTONE	Infrastructure	13,465	1.16	13,980
MACQUARIE	Infrastructure	19,938	1.72	20,125
M&G	Private Credit	1,248	0.11	1,248
PERMIRA	Private Credit	57,960	5.00	49,109
LGIM	LPI Property	49,749	4.29	49,924
Non-Custody	Cash & Cash Equivalents	15,254	1.32	23,395
		1,158,690	**100**	**1,181,909**

In March 2021, Committee endorsed delegated decisions to invest £12.5m in the AEW Urban Renewal Fund and £12.5m in the LGIM Industrial Property Investment Fund.

5. Market and Investment/Economic outlook (provided by London CIV)

Growth assets have continued to perform well in the first quarter of 2021 with global equities returning 5% in dollars and 3.9% in sterling, although global credit markets have turned down though by dropping 4.5% in the same period. This poor performance in stabilising assets has been led by government bonds with long duration (long-term bonds that have greater interest rate sensitivity).

Global economic activity is expected to pick up this year as vaccination programmes progress and the lockdowns ease. Consensus expectations are for a sharp recovery in developed economies with a pick-up in inflation. However there some significant

barriers to future growth because of expanded budget deficits, and the threat of future inflation and rising interest rates. As is often the case, financial markets have been pre-empting the future with growth assets rising (equities +50% in 12 months) and stabilizing assets weakening. The future market direction will be driven by changes in investor expectations, not by historic data.

Investors' expectations for inflation are the highest they have been for 10 years. However, headline inflation levels (excluding oil and food) remain low, especially in Europe. Clearly, we are heading into a time of greater uncertainty on inflation if not entering an inflation cycle. This has implications for asset allocation and pension funds meeting their future liabilities. Rising inflation also tends to lead to higher interest rates and yield curve steepening which will impact fixed income assets, though the economic recovery will likely see stronger returns from higher credit risk assets like high yield and emerging market debt. Bond markets are significantly compromised currently because the Bank of England now owns 33% of the UK Gilts issuance and many G8 governments have been actively buying corporate debt and providing support to distressed companies in the lockdown.

A rising risk for investment returns is how Governments bring their post Covid-19 high debt levels under control. This is more concerning for the developed markets than emerging markets as they have had greater access to such cheap credit. To balance budgets, taxes need to rise, and collection rates need to improve. The U.K. and U.S. proposed measures to raise corporation tax and introduce minimum taxes will seek to address the deficits, but this will have a knock-on effect on investment returns across all asset classes.

So, where do you find returns to meet and beat your liabilities? After the 50% move in equities over the last year, equities' returns must moderate in the future with the risk of decline rising. Stabilising assets (government bonds) will likely remain under pressure from rising inflation and interest rates which leaves income assets (private markets, infrastructure, and credit) as the favoured asset classes, given their inflation protection and income attributes. Property will be a problematic asset class as we find out what a post Covid-19 world looks like. London CIV believe the long-term secular transition to climate stability and responsible investment will continue to offer better risk-adjusted returns over the long term.

FINANCIAL IMPLICATIONS

The financial implications are contained within the body of the report. During 2022/23, the Actuary will undertake a formal actuarial valuation based on the Fund status at 31 March 2022. Any necessary changes to employer contribution rates will be effective from April 2023.

LEGAL IMPLICATIONS

There are no legal implications in the report.