

INVESTMENT STRATEGY and FUND MANAGER PERFORMANCE (Part I)

ITEM 7

Committee

Pensions Committee

Officer Reporting

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Papers with this report

Northern Trust Performance Report
Hymans Robertson Funding Update

HEADLINES

The Actuary's estimate of the funding position as at 30 June 2021 shows an estimated deficit of £128m, equivalent to a funding level of 90.5%. These represent 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 +4.94% over the quarter which was 0.34% ahead of the benchmark. Performance over longer-term periods (3 and 5 years) is in the region of 5.22 and 7.16% per annum, showing underperformance of 1.32% and 0.66% 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

That the Pensions Committee:

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

SUPPORTING INFORMATION

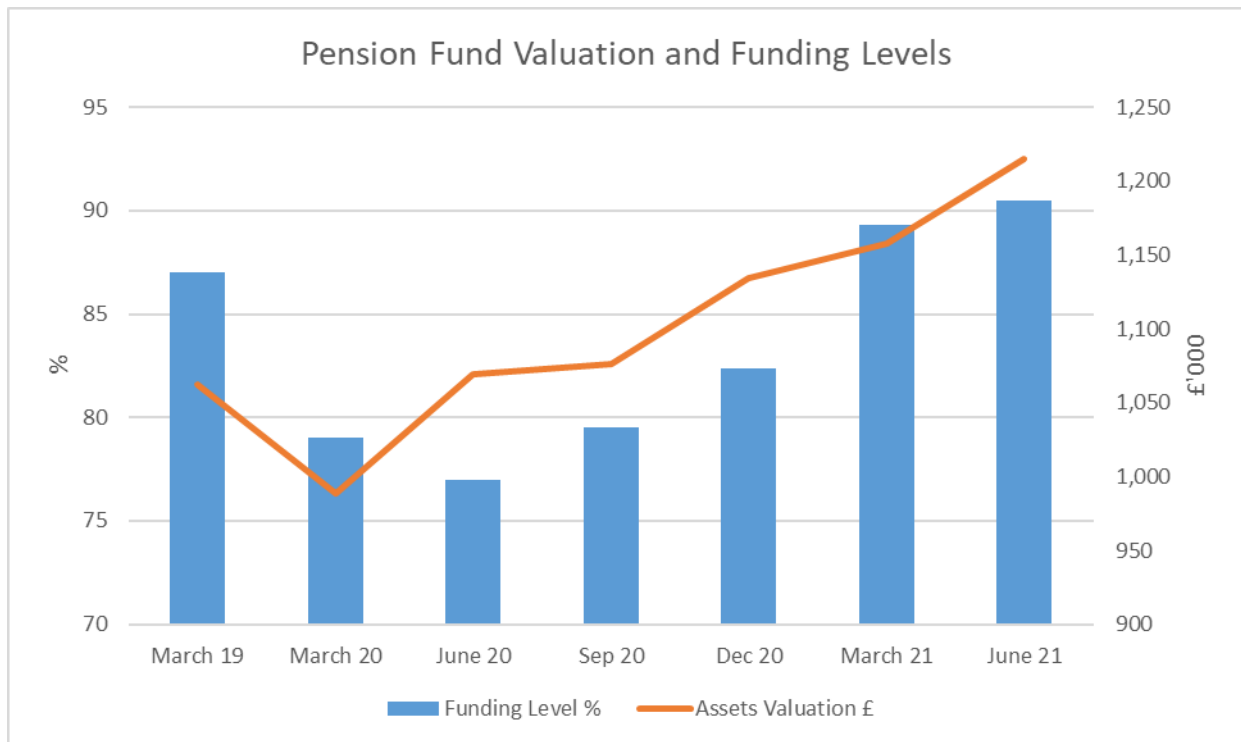
1. Funding Update

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%.

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Hymans Robertson have carried out an interim funding update to illustrate an estimated funding position at 30 June 2021. Their report is attached as an appendix to this paper and it shows an estimated deficit of £128m, equivalent to a funding level of 90.5%, as at 30 June 2021.



Although markets have been severely disrupted by COVID 19 over the last year, in the 27 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 30 June 2021, the Fund returned 4.94%, outperforming the benchmark return by 0.36%. The Fund value increased over the quarter by £23m, to £1,157m.

Period of measurement	Fund Return %	Benchmark %	Arithmetic Excess
Quarter	4.94	4.58	0.36
1 Year	13.80	13.18	0.62
3 Year	5.22	6.63	-1.41
5 Year	7.16	7.87	-0.71
Since Inception (09/1995)	6.91	6.98	-0.07

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

- Macquarie, over the last three months, produced gains of 4.81%, against the 0.78% for the 3 Month LIBOR +3% p.a. this translates as an outperformance of 4.03%. With nine quarters of positive absolute returns and seven positive relative returns, outperformance is seen in all longer periods.
- The private equity assets saw an 8.5% rise in value for Adam Street. LGT also saw an increase of 8.6%. Over the longer periods, the outlook over which private equity investments should be measured, returns remain positive. LGT maintain a run of over 3 years of growth with figures of 11.98% and 15.11% for the three- and five-year periods respectively, while Adam Street posted 17.81% and 15.98% over the same periods.
- In the latest quarter JP Morgan posted an increase in assets of 1.59% leading to an outperformance of 0.81% when compared to the 0.78% target for the 3 Month LIBOR + 3% p.a. Then with positive results in three of the last four quarters, the one-year return of +8.39% is in positive territory and is ahead of the 3.09% target by over 5%.
- The Premira Credit Fund saw an increase of 1.81% over the second quarter of 2021, this was ahead of the 3 Month LIBOR +4% p.a. target of 1.02%. The fund has outperformed in three of the last four quarters and are ahead of target, leading to a relative outperformance of 1.99%, created from figures of 6.16% against 4.09% over the last year.

NB: Information from Northern Trust Quarterly performance report

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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 April 2021	Actual Asset Allocation As At 01 April 2021	Market Value As at 30 June 2021	Actual Asset Allocation As At 30 June 2021	Benchmark Allocation	Market Value As at 31 August 2021*
	£'000	%	£'000	%	%	£'000
Global Equities	537,066	46	574,747	47	45	593,205
UK Index Linked Gilts	144,920	13	150,113	12	24	160,278
Multi Asset Credit	116,580	10	118,434	10		118,919
Property	139,177	12	145,805	12	12	157,456
DGF/Absolute Returns	50,833	4	51,186	4	0	51,146
Private Equity	12,499	1	12,201	1	1	12,193
Infrastructure	33,403	3	35,301	3	8	33,260
Private Credit	59,208	5	44,917	4	5	43,906
Long Lease Property	49,749	4	50,813	4	5	51,564
Cash & Cash Equivalents	15,254	1	31,679	3	0	27,226
Totals	1,158,689	100.00	1,215,196	100.00	100	1,249,153

*Unaudited figures

Highlights of transactions during the quarter under review:

- A drawdown of £1.5m was called by the London CIV Infrastructure fund in the period under review.
- During the quarter, distributions received totalled £17.3m, with £15.3m from Permira private debt, £1.3m from Private Equity and £707k from Macquarie Infrastructure.

Undrawn commitments at 30 June 2021 are as follows:

- £3.2m (8%) awaiting drawdown on Private Credit.
- £39.8m (72%) to London CIV Infrastructure Fund. These funds are currently held in the LCIV Ruffer Absolute Return Fund.
- £3m 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.

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Current Asset Allocation by Manager		Market Value As at 30 June 2021	Actual Asset Allocation	Market Value As at 31 August 2021*
FUND MANAGER	ASSET CLASS	£'000	%	£'000
LGIM	Global Equities	301,491	24.81	311,370
LGIM	Future World	206,680	17.01	215,001
LCIV - BALLIE GIFFORD	Global Equities	66,576	5.48	66,834
LGIM	UK Index Linked Gilts	150,113	12.35	160,278
JP MORGAN	Multi Asset Credit	118,434	9.75	118,919
UBS PROPERTY	Property	81,742	6.73	82,907
AEW	Property	64,668	5.32	75,280
LCIV - RUFFER	DGF/Absolute Returns	51,186	4.21	51,146
ADAMS STREET	Private Equity	8,872	0.73	8,637
LGT	Private Equity	3,329	0.27	3,556
LCIV - STEPSTONE	Infrastructure	14,962	1.23	15,537
MACQUARIE	Infrastructure	20,339	1.67	17,723
M&G	Private Credit	1,249	0.10	1,245
PERMIRA	Private Credit	43,668	3.59	42,661
LGIM	LPI Property	50,813	4.18	51,564
Non Custody	Cash & Cash Equivalents	31,074	2.56	26,495
		1,215,196	100	1,249,153

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

Growth assets have continued to perform well in the second quarter of 2021 with global equities returning 6.6% in sterling. Regionally, performance in all periods has been led by US equities and the UK has been the worst performer, despite the recent strength of sterling global credit markets recovered from a weak first quarter though not in positive territory year-to-date. Alternative markets including Property, Infrastructure, Renewables and Private equity all saw a sharp rise in activity in the first half of the year which has seen positive investment returns.

Global economic activity has picked up this year Covid-19 vaccinations are rolled out and the lockdowns ease. Consensus expectations for growth, inflation, and interest rates have all risen sharply over the last six months for 2021, though long-term economic forecasts have stayed constant. The most concerning economic indicator has been Inflation which has accelerated in the UK (2.5% CPI YOY in June) and US (5.4% CPI YOY in June). Though long-term inflation forecasts remain moderate there is great sensitivity to short term changes. Short term inflation has been driven by energy and food prices, though the pick-up in consumption post lockdown is impacting general pricing. Some credit market yields are now below the prevailing inflation rate raising the fears of negative real yields and the potential for negative real returns.

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There is a rising risk for investment returns connected with how Governments bring their post Covid-19 high debt levels under control. The G8 move to impose a minimum corporation tax on offshore profits is one of the first signs of tax revenue increasing. They will likely target carried interest and the tax benefits from debt financing and indeed pensions savings as we move forward.

So, where do you find returns to meet and beat your liabilities? After the 23% move in equities over the last year, their returns seem likely to moderate in the future with the risk of decline rising. Laggard regional markets including the UK and emerging markets may represent good relative value currently. 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. However residential, warehousing and logistics and industrial property will likely look better. London CIV believe the long-term 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.