INVESTMENT STRATEGY AND FUND MANAGER PERFORMANCE – PART I	ITEM 6

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 of 30 September 2021 shows an estimated deficit of £137m, equivalent to a funding level of 90%. These metrics represent an improvement on the 2019 formal actuarial valuation. Investment returns have been strong since last valuation but the outlook for future investment returns is slightly less positive and inflation expectations have increased.

The overall investment return of the Fund was +1.56% over the quarter which was 0.17% behind the benchmark. Performance over longer-term periods (3 and 5 years) is in the region of 5.39 and 6.26% per annum, showing underperformance of 1.34% and 0.90% 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:

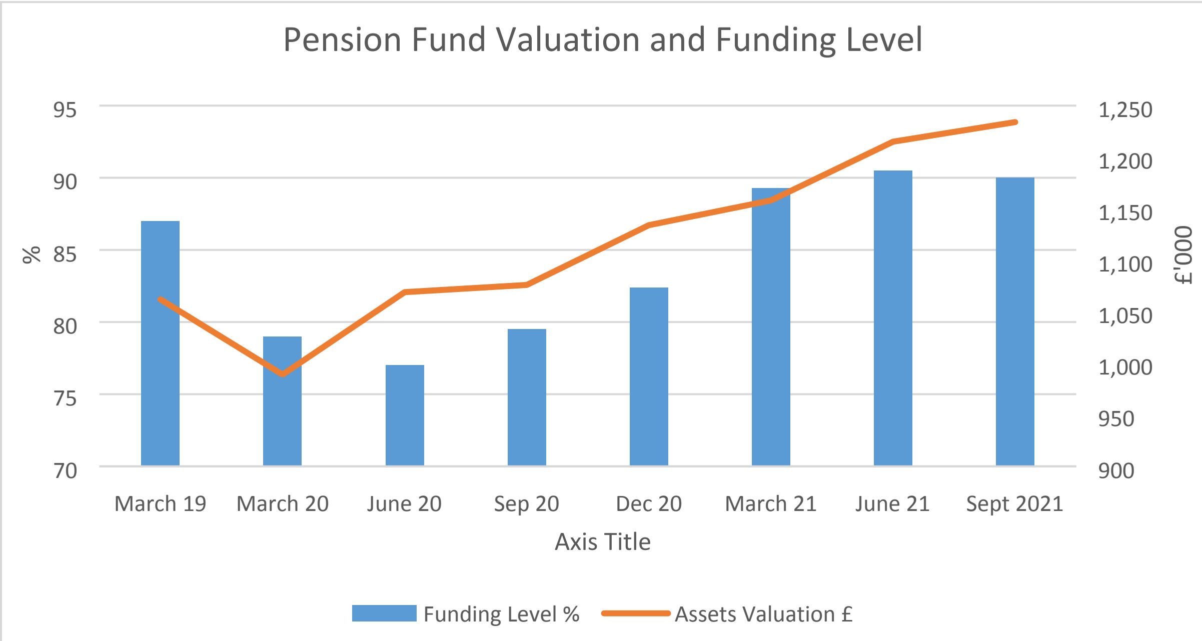
1. **Note the Fund funding and performance update; and**
2. **Note the updates on implementation of the investment strategy.**

SUPPORTING INFORMATION

1. Funding Update

At the last formal valuation as of 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 on 30 September 2021. Their report is attached as an appendix to this paper, and it shows an estimated deficit of £137m, equivalent to a funding level of 90%, as of 30 September 2021.



Fund returns have been strong since the previous formal valuation, although the outlook for future investment returns has worsened slightly and inflation expectations have increased. Combining these key factors, the funding level is estimated to have increased by around 4% compared to 31 March 2019.

During 2022/23, the Actuary will undertake a formal actuarial valuation based on the Fund status on 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 September 2021, the Fund returned 1.56%, underperforming the benchmark return by 0.17%. The Fund value increased over the quarter by £19m, to £1,234m.

Period of measurement	Fund Return %	Benchmark %	Arithmetic Excess
Quarter	1.56	1.73	-0.17
1 Year	14.81	13.43	1.38
3 Year	5.39	6.73	-1.34
5 Year	6.26	7.16	-0.90
Since Inception (09/1995)	6.91	6.99	-0.08

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

- The private equity assets saw an 10.53% rise in value for Adam Street. LGT also saw an increase of 9.61%. 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 14.07% and 15.90% for the three- and five-year periods respectively, while Adam Street posted 19.85% and 16.92% over the same periods.
- Property portfolio managed by AEW, over the last three months, produced gains of 3.56%. Over longer periods, the returns for the fund manager remain positive with 5.49% for three years and 8.22% over five years, both outperforming the benchmark (IPD UK PPFI All Balanced Funds Index) by 1.50% and 2.22% respectively.
- Macquarie, over the last three months, produced gains of 3.42%, against the 0.77% for the 3 Month LIBOR +3% p.a. this translates as an outperformance of 2.65%. With ten quarters of positive absolute returns and eight positive relative returns, outperformance is seen in all longer periods.
- The Permira Credit Fund saw an increase of 1.26% over the third quarter of 2021, this was ahead of the 3 Month LIBOR +4% p.a. target of 1.01%. The fund has outperformed in four of the last five quarters and are ahead of target, leading to a relative outperformance of 1.38%, created from figures of 5.46% against 4.08% over the last year.

NB: Information from Northern Trust Quarterly performance report

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 of 01 April 2021	Actual Asset Allocation As of 01 April 2021	Market Value As of 30 Sept 2021	Actual Asset Allocation As of 30 Sept 2021	Benchmark Allocation	Market Value As of 31 October 2021
	£'000	%	£'000	%	%	£'000
Global Equities	537,066	46	578,711	47	45	581,802
UK Index Linked Gilts	144,920	13	153,597	12	24	153,597
Multi Asset Credit	116,580	10	118,830	10		118,407
Property	139,177	12	161,338	13	12	161,550
DGF/Absolute Returns	50,833	4	51,461	4	0	52,761
Private Equity	12,499	1	13,051	1	1	12,683
Infrastructure	33,403	3	34,562	3	8	37,619
Private Credit	59,208	5	40,800	3	5	40,800
Long Lease Property	49,749	4	52,135	4	5	52,257
Cash & Cash Equivalents	15,254	1	29,492	2	0	26,458
Totals	**1,158,689**	**100.00**	**1,233,977**	**100.00**	**100**	**1,237,934**

*Unaudited figures

Highlights of transactions during the quarter under review:

- Total drawdown of £1.6m was called by the London CIV Infrastructure fund in the period under review.
- During the quarter, distributions received totalled £4.7m from Permira private debt, $478k & Eur30k from Private Equity and $3.6m from Macquarie Infrastructure.

Undrawn commitments on 30 September 2021 are as follows:
- £3.2m (8%) awaiting drawdown on Private Credit.
- £38.2m (69%) 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.
- LCIV Private Debt £70m.

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 of 30 September 2021**	**Actual Asset Allocation**	**Market Value As of 31 October 2021**
FUND MANAGER	**ASSET CLASS**	**£'000**	**%**	**£'000**
LGIM	Global Equities	302,942	24.55	302,931
LGIM	Future World	210,228	17.04	210,228
LCIV - BALLIE GIFFORD	Global Equities	65,541	5.31	68,643
LGIM	UK Index Linked Gilts	153,597	12.45	153,597
JP MORGAN	Multi Asset Credit	118,830	9.63	118,407
UBS PROPERTY	Property	85,334	6.92	85,380
AEW	Property	76,671	6.21	76,671
LCIV - RUFFER	DGF/Absolute Returns	51,461	4.17	52,761
ADAMS STREET	Private Equity	9,429	0.76	9,031
LGT	Private Equity	3,622	0.29	3,652
LCIV - STEPSTONE	Infrastructure	16,628	1.35	20,690
MACQUARIE	Infrastructure	17,934	1.45	16,929
M&G	Private Credit	1,245	0.10	1,245
PERMIRA	Private Credit	39,555	3.21	39,555
LGIM	LPI Property	52,135	4.22	52,257
Non-Custody	Cash & Cash Equivalents	28,825	2.34	25,957
		1,233,977	**100**	**1,237,934**

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

Growth assets have continued to perform well in the third quarter of 2021 with global equities returning 3.2% in sterling terms. Emerging market equities and fixed income returns have been disappointing, but listed proxies for property, infrastructure and private equity have performed very well.

Global economic activity has continued to recover this year, but the real story is the pick-up in inflationary expectations which has led some central banks to start reducing bond buying programmes and even raising interest rates. Consensus expectations for inflation and interest rates have all risen sharply over the last six months for 2021, though long-term economic forecasts have stayed constant. The assumption that inflation is only transitory is beginning to be questioned.

To add to the fears on inflation there is now a credit issue to deal with in China. The largest property company in the world, China Evergrande, has defaulted on its short-term debt and has more than U$300bn of outstanding debt. A large number of Chinese property companies are also understood to be in severe financial difficulties. Based on the stability of credit spreads in September, when interest rate volatility increased, the consensus view is that this problem can be contained in China. Credit markets are not discounting any worsening in defaults at this stage and spreads remain tight.

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 on 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.