INVESTMENT STRATEGY and FUND MANAGER PERFORMANCE (Part I)

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

HEADLINES

The Actuary's estimate of the funding position as of 31 December 2021 shows an estimated deficit of £159m, equivalent to a funding level of 89% (Sep21 £137m/90%). These metrics still 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 with increased inflation expectations and following the Russian invasion of Ukraine.

The overall investment return of the Fund was +4.53% over the quarter which was 0.33% behind the benchmark. Performance over longer-term periods (3 and 5 years) was 8.81% and 6.40% per annum, showing underperformance of 1.50% and 1.19% per annum compared to the benchmark.

The Fund's asset allocation remains close to the target investment strategy with the exception of Infrastructure which is yet to be drawn and funded by DGF/Absolute Return. There is also a circa 2% under allocation to MAC.

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:

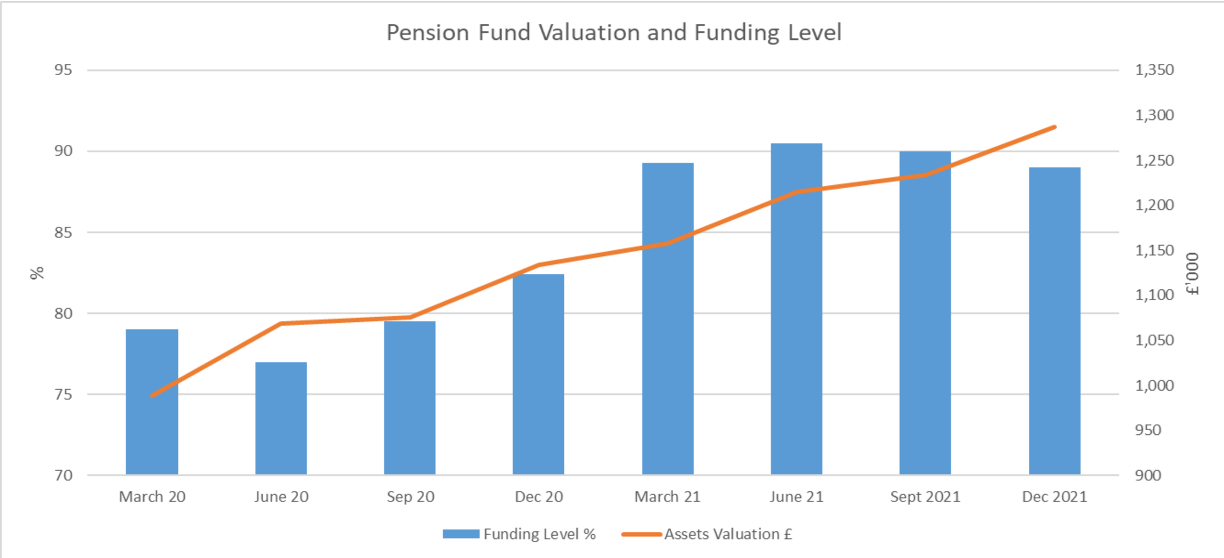
1. **Note the Fund funding and performance update;**
2. **Note the updates on implementation of the investment strategy; and,**
3. **Note exposure to Russia and Ukraine.**

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 31 December 2021. Their report is attached as an appendix to this paper, and it shows an estimated deficit of £159m, equivalent to a funding level of 89%.



Fund returns have been strong since the previous formal valuation, although the outlook for future investment returns has worsened slightly. Combining these key factors, the funding level is estimated to have increased by around 2% 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 31 December 2021, the Fund returned 4.53%, underperforming the benchmark return by 0.33%. The Fund value increased over the quarter by £53m, to £1,287m.

Period of measurement	**Fund Return %**	**Benchmark %**	**Arithmetic Excess**
Quarter	4.53	4.86	-0.33
1 Year	13.84	13.36	0.48
3 Year	8.81	10.31	-1.50
5 Year	6.40	7.58	-1.18
Since Inception (09/1995)	7.02	7.11	-0.09

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

- The AEW UK Property Fund posted a total return of +4.41%, which was marginally behind the IPD UK PPFI AI Balanced Funds Index. Rolling one-year returns continue to see double digit gains, with the mandate returning +20.78% versus +19.17% for the IPD Index. AEW are slightly behind the three-year period returning 6.17% against the benchmark of 6.21%. This translates as -0.04% relative underperformance. Since the fund's inception date of July 2014, the fund return is 9.36%, leading to a relative outperformance of approximately 1.17% when compared to the IPD figure of 8.10%.
- The absolute return strategies employed by London CIV Ruffer translated into a 144-basis point outperformance of the 3-mth Sterling LIBOR target. The investment is now above the benchmark over all longer-term periods. This is seen in a three-year return of 9.87% versus 0.56%, then similarly for the since inception period (May 2010) figures of 5.89% versus 0.76% per annum, which translates as a relative return of over 5%.
- In the latest quarter JP Morgan posted a decrease in assets of -0.01% leading to an underperformance of -0.76% when compared to the 0.75% target for the 3 Month LIBOR +3% p.a. Then with positive results in two of the last four quarters, the one-year return of +1.61% is in positive territory but is behind of the 3.08% target by 1.42%. Over three years they post returns ahead of the benchmark with figures of 5.96% vs 3.56%. Since the mandate was funded, their return of 3.98% is just ahead of the target return of 3.64% on an annualised basis.
- The Permira Credit Fund saw an increase of 1.2% over the fourth quarter of 2021, this was ahead of the 3 Month LIBOR +4% p.a. target of 1.00%. The fund has outperformed in the last six quarters and is ahead of target, leading to an outperformance of 0.84%, created from figures of 4.96% against 4.08%. Since the start of December 2014 when the fund incepted, the fund posts a return of 7.08% against the benchmark of 4.60%,

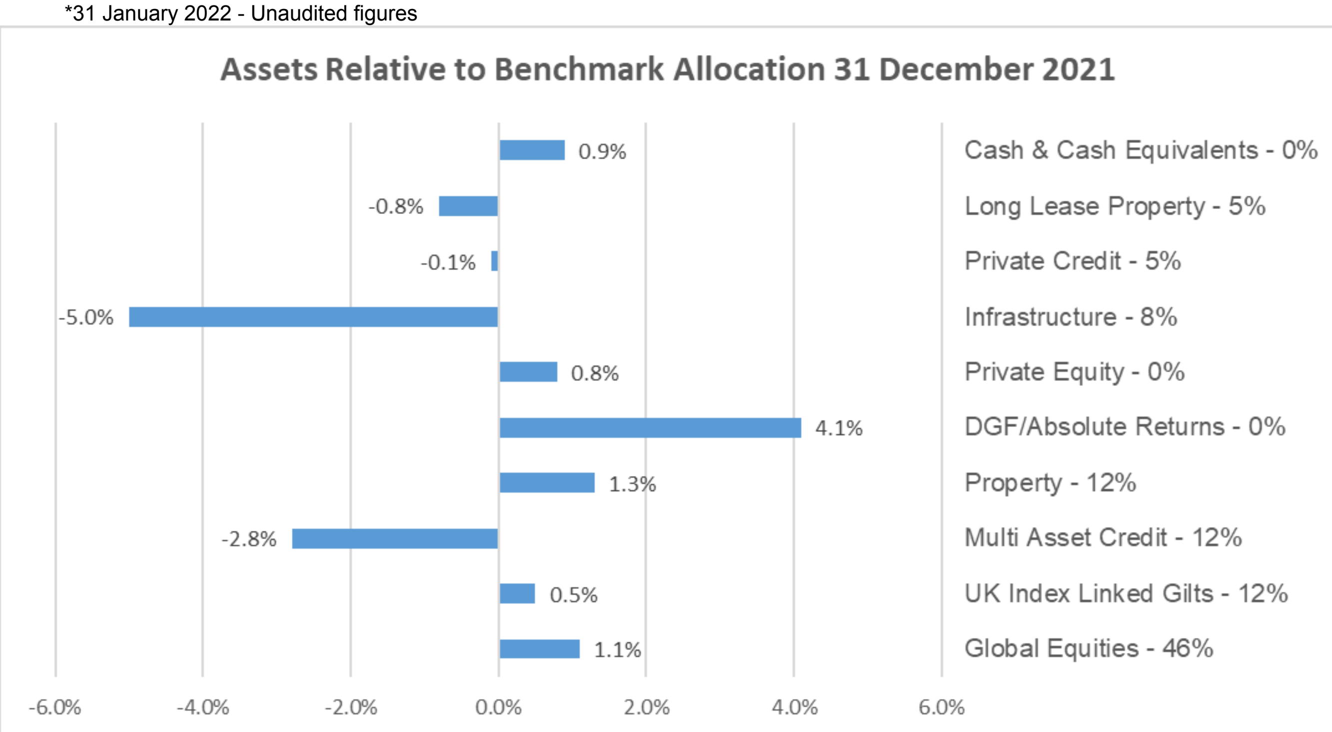
NB: Information from Northern Trust Quarterly performance report

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 at 01 April 2021**	**Actual Asset Allocation As At 01 April 2021**	**Market Value As at 31 December 2021**	**Actual Asset Allocation As at 31 December 2021**	**Benchmark Allocation As at 31 December 2021**	**Market Value As at 28 February 2022**
	£'000	**%**	**£'000**	**%**	**%**	**£'000**
Global Equities	537,066	46	605,509	47	46	558,463
UK Index Linked Gilts	144,920	13	161,179	13	24	156,458
Multi Asset Credit	116,580	10	118,817	9		115,148
Property	139,177	12	170,831	13	12	169,959
DGF/Absolute Returns	50,833	4	52,210	4	0	54,012
Private Equity	12,499	1	9,892	1	0	9,284
Infrastructure	33,403	3	39,124	3	8	45,835
Private Credit	59,208	5	63,211	5	5	60,824
Long Lease Property	49,749	4	54,491	4	5	55,629
Cash & Cash Equivalents	15,254	1	11,466	1	0	12,262
Totals	**1,158,689**	**100.00**	**1,286,730**	**100.00**	**100**	**1,237,874**

*31 January 2022 - Unaudited figures



Highlights of transactions during the quarter under review:

- Total drawdown of £4.3m was called by the London CIV Infrastructure fund and £21.3m by LCIV Private Debt Fund in the period under review.
- During the quarter, distributions received totalled £1.3m from Permira private debt, $4m & Eur264k from Private Equity and $1.2m & Eur583k from Macquarie Infrastructure.

Undrawn commitments on 31 December 2021 are as follows:
- £3.2m (8%) awaiting drawdown on Private Credit.
- £33.9m (62%) 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 £49m.

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 December 2021**	**Actual Asset Allocation**	**Market Value As at 28 February 2022**
FUND MANAGER	**ASSET CLASS**	**£'000**	**%**	**£'000**
LGIM	Global Equities	316,108	24.57	295,709
LGIM	Future World	223,985	17.41	207,301
LCIV - BALLIE GIFFORD	Global Equities	65,416	5.08	55,453
LGIM	UK Index Linked Gilts	161,179	12.53	156,458
JP MORGAN	Multi Asset Credit	118,817	9.23	115,148
UBS PROPERTY	Property	91,435	7.11	92,892
AEW	Property	80,049	6.22	80,897
LCIV - RUFFER	DGF/Absolute Returns	52,210	4.06	54,012
ADAMS STREET	Private Equity	6,386	0.50	6,287
LGT	Private Equity	3,506	0.27	2,997
LCIV - STEPSTONE	Infrastructure	21,459	1.67	27,768
MACQUARIE	Infrastructure	17,665	1.37	18,067
M&G	Private Credit	1,991	0.15	1,851
LCIV	Private Credit	22,475	1.75	22,475
PERMIRA	Private Credit	38,745	3.01	36,498
LGIM	LPI Property	54,491	4.23	55,629
Non-Custody	Cash & Cash Equivalents	10,813	0.84	8,432
		1,286,730	**100**	**1,237,874**

5. Russia & Ukraine Exposure

At the start of the crisis the Fund has an allocation of £803k (0.06%) in Russia and £440k (0.04%) in Ukraine across four managers including LGIM (Equity Index Funds), JP Morgan (MAC Fund), LGT (Private Equity) and LCIV Global Alpha Paris Aligned (Active Equity). All fund managers concerned have confirmed they are monitoring the situation and applying their own risk mitigation and investment protocols. It is understood that the LCIV Global Alpha Paris Aligned managed to sell an element of its Russian holdings before markets closed.

Due to market restrictions no trading activity can currently take place however managers are constantly appraising the situation to ensure they are fully aware and compliant with guidance.

In addition, on the 9 March 2022 the Fund received a communication from the Secretary of State for Levelling Up, Housing and Communities asking it to consider its investments in Russia. To this end each relevant manager was contacted to put on record the Fund's desire for divestment of the Russian holdings where practicable and possible. It was also noted that ultimately it would be the manager's decision, however it was right to make a representation to convey the Fund's thoughts in this matter.

6. Market and Investment/Economic outlook (Dec21 provided by London CIV)

The last 12 months has seen remarkable performance from Equities returning 17.5% after three double digit returning years and up over 70% since the lows of the Covid-19 Outbreak. Emerging Markets (-6.3%) and Japan Equities (+7.5%) were the laggards with U.S. equities (+24.4%) the clear leading market. Bonds have been disappointing seeing a -2.2% return. Broadly private market assets have been recovering and multi-asset funds have seen positive returns in the last 12 months. Listed proxies for property and private equity have outperformed the equity market.

Bond markets have suffered in the recent environment mostly due to rising interest rates and inflation. Credit has managed to outperform government bonds through low default rates and lower duration / interest rate sensitivity. Emerging market equities have suffered from rising rates, strength in the US$ and the specific issues in China which makes up 30% of the MSCI Emerging Market Index. China has seen GDP growth slow to a multiyear low of 4% in Q4 driven by Covid-19 lock downs, the crack down on technology companies and credit problems in the real estate sector. In response to this slowing, China has bucked the global trend and recently cut interest rates.

Style performance trends have reversed in 2021 with value and quality outperforming, growth and momentum underperforming. The Energy sector has done very well recently. Energy was the best performing sector in the MSCI sector indices last year.

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.