INVESTMENT STRATEGY and FUND MANAGER PERFORMANCE (Part I)

Committee	Pensions Committee
Officer Reporting	James Lake & Babatunde Adekoya, Finance
Papers with this report	NT performance report on shared drive LCIV Performance reporting on shared drive

HEADLINES

The overall investment return of the Fund was 0.05% over the quarter which was 0.60% above the benchmark of minus 0.55%. Performance over longer-term periods (3 and 5 years) was 1.01% and 2.33% per annum, which are both behind the benchmark and the 4% return required in the Funding Strategy Statement.

The Fund's asset allocation remains close to the target investment strategy except for LCIV Infrastructure and Private Debt Funds which are yet to be fully drawn. There is also a circa 3% under-allocation to MAC.

RECOMMENDATIONS

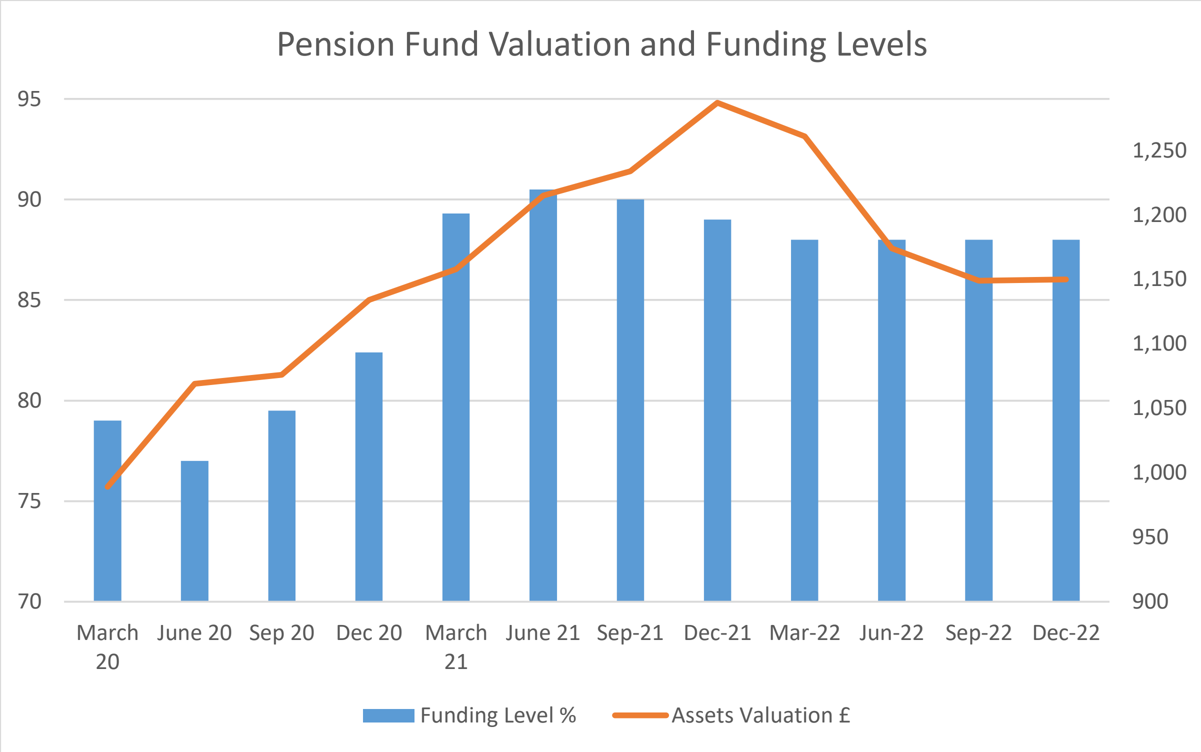
It is recommended that Pensions Committee note the funding and performance update.

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%.

The 2022 valuation results show a funding level of 88%, with assets of £1,263b and liabilities of £1,430b. Changes to employer contribution rates will be effective from April 2023.



2. Fund Performance

Over the last quarter to 31 December 2022, the Fund returned 0.05%, outperforming the benchmark return by 0.60%. The Fund value increased over the quarter by £1m to £1,150m. Longer term performance is behind the benchmark in all time periods.

Period of measurement	Fund Return %	Benchmark %	Relative Performance
Quarter	0.05	-0.55	0.60
1 Year	-10.50	-8.05	-2.66
3 Year	1.01	3.25	-2.17
5 Year	2.33	3.89	-1.50
Since Inception (09/1995)	6.32	6.51	-0.18

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

- Alternative investments mostly kept their performance in positive territory. AEW UK and LCIV Private Debt Fund posted relative returns of 23.48% and 8.32% for the quarter. Whilst Macquarie and LCIV Infrastructure Funds were best performers with 18.75% & 11.87% for the one-year respectively.

- LGIM LPI Income Property Fund and Adams Street Partners were the biggest detractors to performance in the quarter under review with relative underperformance of -16.05% and -11.99%.

- Notable relative underperformance continues in the LCIV Global Alpha Paris Aligned Growth Fund. Since investing the growth style has struggled and the manager has delivered negative relative returns of -1.43% over the quarter and -18.04% over one year. Confidence in the manager turning around the relative underperformance is still high from the LCIV.

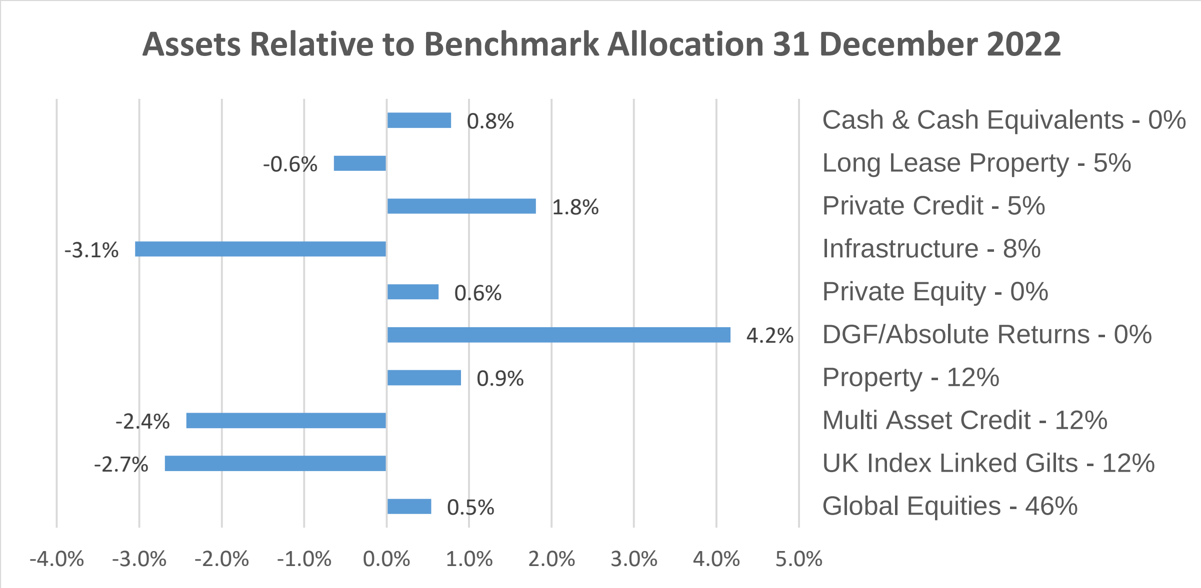
NB: Information from Northern Trust Quarterly performance report

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 2022	Actual Asset Allocation As of 01 April 2022	Market Value As of 31 December 2022	Actual Asset Allocation As of 31 December 2022	Benchmark Allocation	Market Value As of 28 February 2023
	£'000	%	£'000	%	%	£'000
Global Equities	551,163	45	535,178	46.54	46.00	556,198
UK Index Linked Gilts	142,671	12	107,044	9.31	24.00	105,142
Multi Asset Credit	113,127	9	110,000	9.57		110,000
Property	170,918	14	148,355	12.90	12.00	148,708
DGF/Absolute Returns	54,449	4	47,914	4.17	0.00	47,301
Private Equity	9,257	1	7,224	0.63	0.00	7,089
Infrastructure	41,776	3	56,869	4.95	8.00	68,509
Private Credit	65,928	5	78,304	6.81	5.00	72,548
Long Lease Property	56,836	5	50,091	4.36	5.00	48,582
Cash & Cash Equivalents	12,411	1	8,963	0.78	0.00	6,976
Totals	**1,218,536**	**100.00**	**1,149,942**	**100.00**	**100**	**1,171,053**



Highlights of transactions during the quarter under review:

- Total drawdown of £968k was called by the London CIV Infrastructure fund and £3.8m by LCIV Private Debt Fund in the period under review.
- During the quarter, distributions received totalled £1.2m from Permira private debt, $847k & Euro 13k from Private Equity and $1.4m & Euro 187k from Macquarie Infrastructure.

Undrawn commitments on 31 December 2022 are as follows:

- £3.2m (8%) awaiting drawdown on Private Credit (Permira).
- £19.2m (35%) 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 £28.9m (41%).

4. Investment Managers

The assets of the Fund are invested with a number of underlying managers and portfolios and in a range of passive and active mandates, including a mix of liquid and illiquid allocations to reflect the Fund's long-term horizon. The table below provides a breakdown of asset class and manager.

Current Asset Allocation by Manager		**Market Value As of 31 December 2022**	**Actual Asset Allocation**	**Market Value As of 28 February 2023**
FUND MANAGER	**ASSET CLASS**	**£'000**	**%**	**£'000**
LGIM	Global Equities	280,763	24.42	290,945
LGIM	Future World	203,387	17.69	210,817
LCIV - BALLIE GIFFORD	Global Equities	51,028	4.44	54,436
LGIM	UK Index Linked Gilts	107,044	9.31	105,142
LCIV MAC Fund	Multi Asset Credit	110,000	9.57	110,000
UBS PROPERTY	Property	82,691	7.19	77,805
AEW	Property	68,814	5.98	73,329
LCIV - RUFFER	DGF/Absolute Returns	47,914	4.17	47,301
ADAMS STREET	Private Equity	4,796	0.42	4,846
LGT	Private Equity	2,428	0.21	2,243
LCIV - STEPSTONE	Infrastructure	39,036	3.39	48,443
MACQUARIE	Infrastructure	17,833	1.55	20,066
M&G	Private Credit	658	0.06	667
LCIV Private Debt	Private Credit	45,276	3.94	40,515
PERMIRA	Private Credit	32,370	2.81	31,366
LGIM	LPI Property	50,091	4.36	48,582
Non Custody	Cash & Cash Equivalents	5,813	0.51	4,550
		1,149,942	**100**	**1,171,053**

5. Market and Investment/Economic outlook (December 22 provided by London CIV)

The positive tone in capital markets early in the fourth quarter was at odds with data on inflation and economic growth, and in the U.K., disarray in the government and escalating concerns about the effects of industrial action on critical segments of the economy. To start with the positives, GDP growth for 2022 is expected to come in at 2%, slightly higher than expected in the middle of 2022. Unfortunately, inflation also ended the year at higher levels than expected and the forward outlook for growth, unemployment and inflation has continued to deteriorate. G8 group economies are expected to skirt recession in 2023, but only just, and risks to that forecast are high.

The U.K. is the laggard in the group, with the economy expected to contract by 0.9% this year and CPI projected to average 7.1%.

Equity markets were duly brought down to earth in December, when the MSCI World Index lost 5.2% (in Sterling terms). The Index was up 1.9% in Q4 but lost 7.8% in 2022. Volatility was amplified in emerging markets. The MSCI Emerging Markets Index lost 6.1% in October but gained 11% in November, when the outlook for rates improved and the U.S. Dollar levelled off, before dropping again in December, despite the prospect of China loosening its strict lockdown policies.

Bond markets were also disturbed in December. Yields on government bonds rose to bring the curtain down on a year when the yield on the Bloomberg Global Aggregate Total Return Index (hedged to Sterling) increased to 3.73% from 1.31% and the value of the Index dropped by 12.2%. Credit spreads also increased, and the Bloomberg Global Aggregate Credit Total Return Index (hedged to Sterling) lost 15.3% in 2022.

Based on that Index, investment grade credit offered a yield of 5% at the beginning of 2023. Using the Bloomberg Global High Yield Total Return Index as a proxy, sub-investment grade debt yields more than 10%. Companies undoubtedly face a more challenging operating environment now, and although events of default and downgrade have been limited to this point, we expect these events to increase in 2023.

Nevertheless, there is a view that ‘bonds are back’ after a long period when they did not offer value, particularly in risk-adjusted terms. Based on the outlook for yield curves and credit spreads, it has been concluded that this might be an opportune time to consider credit strategies, not just because they are expected to deliver attractive income yields, but also, because they should become useful again in terms diversifying exposure to equity risk.

However, although valuations of stocks have moved closer to historic averages, and yields on debt look attractive at headline levels, risks are high. Short-term surges in volatility are likely to persist as investors adjust to the new environment for growth, inflation, and policy amidst persistent geo-political tensions.

Outlook

The tug of war between inflation and economic momentum will be a big focus in 2023. It is not clear yet how quickly growth will decelerate, and how deep the troughs will be, although the probability of a global recession has increased. There is a risk that policymakers could overcompensate for their slow response to the return of inflation in our Q3 report. That risk has increased, and because the effects of changes in monetary policy feed through with a lag, the outlook remains uncertain, particularly in the U.K. and Europe, where scope to lend support through fiscal channels is constrained and pressure to increase wages has intensified. Fiscal expansion in the UK and the US is constrained in the aftermath of the ‘mini budget’ in the UK and fears that the US will hit its debt ceiling.

FINANCIAL IMPLICATIONS

The financial implications are contained within the body of the report.

The Fund Actuary has undertaken 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.