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 2.78% over the quarter which was 0.49% lower than the benchmark of 3.28%. Performance over longer-term periods (3 and 5 years) was 6.28% and 3.44% per annum, which are both behind the set benchmark. The 3-year figure is 2.28% above the 4% return required in the Funding Strategy Statement, but with the 5- year figure 0.56% below this requirement.

Committee should note that the revised return requirement in the FSS commencing 1 Apr 2023 is 4.1%.

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

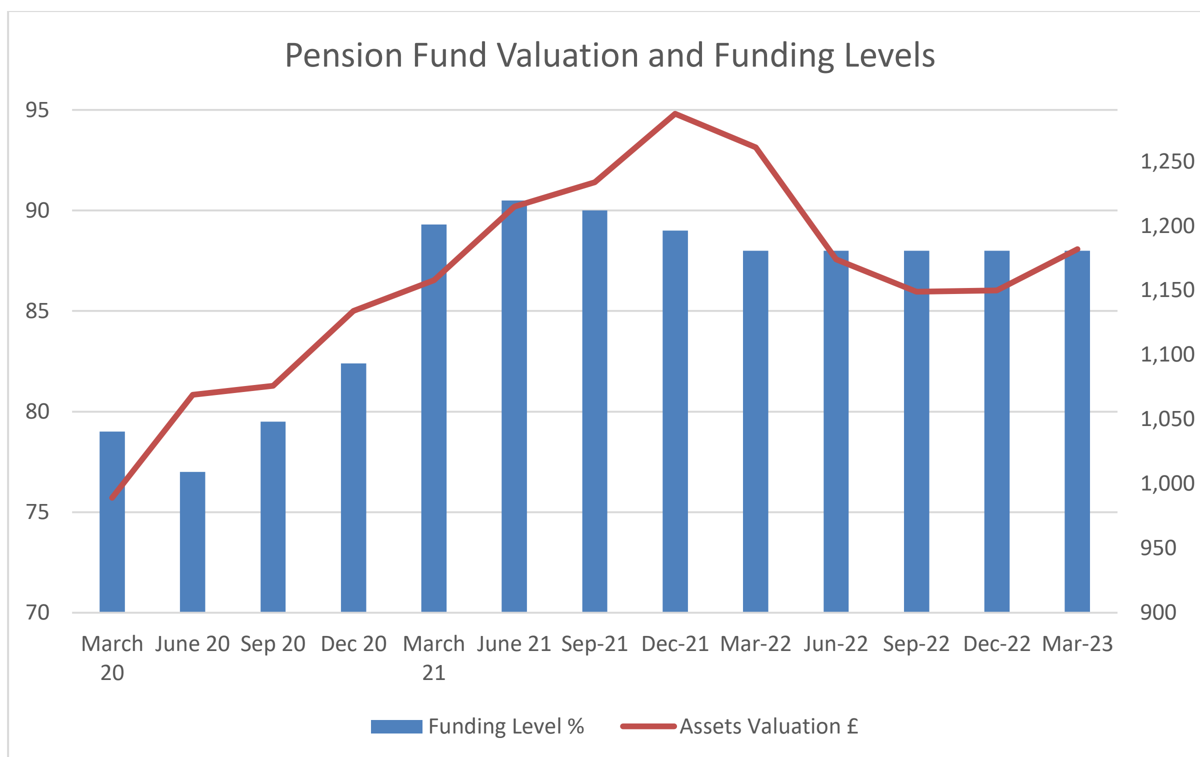
That the Pensions Committee note the funding and performance update.

SUPPORTING INFORMATION

1. Funding Update

At the last formal valuation as of March 2022, the Fund assets were £1,263m and the liabilities were £1,430m. This represented a deficit of £167m and equated to a funding level of 88%.

Regular interim funding levels will be produced by the actuary going forward.



2. Fund Performance

Over the last quarter to 31 March 2023, the Fund returned 2.78%, underperforming the benchmark return by 0.49%. The Fund value however increased over the quarter by £32m to £1,182m. Longer term performance is behind the benchmark in all time periods.

Period of measurement	Fund Return %	Benchmark %	Relative Performance
Quarter	2.78	3.28	-0.49
1 Year	-6.13	-4.97	-1.21
3 Year	6.28	7.44	-1.08
5 Year	3.44	4.89	-1.38
Since Inception (09/1995)	6.37	6.55	-0.17

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

- Alternative investments mostly kept their performance in positive territory. AEW UK, Macquarie and LCIV Infrastructure Funds posted relative returns of 7.02%, 1.24% and 1.23% for the quarter. The three funds were also the best performers with 5.05%, 9.87% & 8.80% for the one-year respectively.
- LGIM LPI Income Property Fund had the largest underperformance in the quarter, 7.15% below the benchmark. One year performance is 25.7% below the benchmark. Valuations of long lease properties continue to fall as a result of rising interest rates and at the same time, the benchmark of inflation has been high.

- 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 -0.86% over the quarter and -7.38% over one year. Confidence in the manager turning around the relative underperformance is still high from the LCIV.

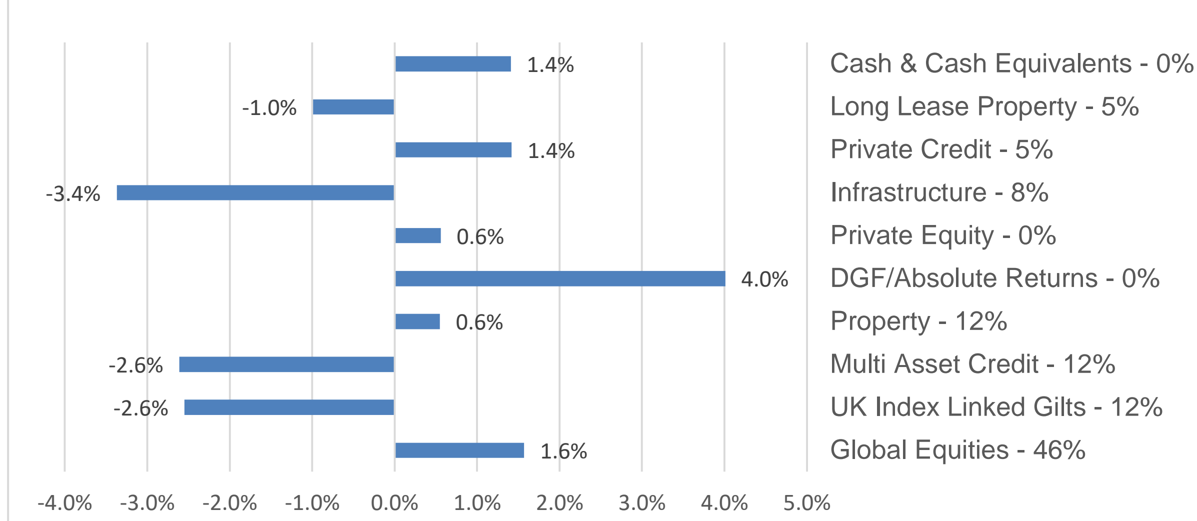
NB: Information from Northern Trust Quarterly performance report

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 March 2023	Actual Asset Allocation As of 31 March 2023	Benchmark Allocation	Market Value As of 30 April 2023
	£'000	%	£'000	%	%	£'000
Global Equities	551,163	45	562,149	47.57	46.00	562,254
UK Index Linked Gilts	142,671	12	111,642	9.45	24.00	107,292
Multi Asset Credit	113,127	9	110,959	9.39		110,959
Property	170,918	14	148,291	12.55	12.00	147,639
DGF/Absolute Returns	54,449	4	47,406	4.01	0.00	46,495
Private Equity	9,257	1	6,666	0.56	0.00	6,429
Infrastructure	41,776	3	54,771	4.63	8.00	55,726
Private Credit	65,928	5	75,923	6.42	5.00	73,098
Long Lease Property	56,836	5	47,386	4.01	5.00	47,132
Cash & Cash Equivalents	12,411	1	16,650	1.41	0.00	19,193
Totals	**1,218,536**	**100.00**	**1,181,843**	**100.00**	**100**	**1,176,217**



Highlights of transactions during the quarter under review:

- Total gross drawdown of £3.2m by LCIV Private Debt Fund in the period under review.
- During the quarter, distributions received totalled £5.5m from Permira private debt, $37k & Euro 112k from Private Equity and $78k from Macquarie Infrastructure.

Undrawn commitments on 31 March 2023 are as follows:

- £3.2m (8% of commitment) awaiting drawdown on Private Credit (Permira).
- £19.2m (35% of commitment) 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 £25.7m (37% of commitment).

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 March 2023	Actual Asset Allocation	Market Value As of 30 April 2023
FUND MANAGER	**ASSET CLASS**	**£'000**	**%**	**£'000**
LGIM	Global Equities	295,450	25.00	296,800
LGIM	Future World	213,304	18.05	213,048
LCIV - BALLIE GIFFORD	Global Equities	53,395	4.52	52,406
LGIM	UK Index Linked Gilts	111,642	9.45	107,292
LCIV MAC Fund	Multi Asset Credit	110,959	9.39	110,959
UBS PROPERTY	Property	77,793	6.58	77,902
AEW	Property	73,067	6.18	73,049
LCIV - RUFFER	DGF/Absolute Returns	47,406	4.01	46,495
ADAMS STREET	Private Equity	4,484	0.38	4,365
LGT	Private Equity	2,182	0.18	2,064
LCIV - STEPSTONE	Infrastructure	40,969	3.47	42,096
MACQUARIE	Infrastructure	13,802	1.17	13,630
M&G	Private Credit	667	0.06	682
LCIV Private Debt	Private Credit	48,763	4.13	48,763
PERMIRA	Private Credit	26,493	2.24	23,653
LGIM	LPI Property	47,386	4.01	47,132
Non-Custody	Cash & Cash Equivalents	14,081	1.19	15,881
		1,181,843	**100**	**1,176,217**

5. Market and Investment/Economic outlook (March 23 provided by London CIV)

2023 started as 2022 ended, with rapid changes in sentiment in the bond and equity markets linked to data on inflation and growth, and expectations for interest rates. Equity markets rallied strongly (MSCI All Country World Total Return Index GBP; +5.2%), led by growth stocks. Bonds also performed well (Bloomberg Global Aggregate Credit Index Hedged to GBP: +3.0%) as yields and spreads on credit instruments declined.

Consistent with the pattern seen in the past 12 to 15 months, this period of calm was short-lived. Most of January's gains in bonds were lost in February, prompted by high core inflation, especially food prices, and strong employment reports. Equities also fell, but more moderately (MSCI All Country World Total Return Index GBP: -1.0%).

These reversals looked mundane in March. Jerome Powell, the Chair of the U.S. Federal Reserve (the ‘Fed’), intervened early in the month to remind investors that the Fed was prepared to step up the pace of interest rate increases to combat inflation. However, warnings about the dangers of complacency were supplanted later the same week when Silicon Valley Bank (‘SVB’) failed, followed in short order by Signature Bank (‘SB’).

Swift action by U.S. state banking regulators, the Federal Reserve, and other institutions to protect the interests of uninsured depositors helped calm the situation. It also became apparent that the problems encountered by SVB and SB, although exacerbated by the pace and magnitude of interest rate increases, were caused by poor management, peculiarities in the sources of funding the banks relied on and ultimately a dangerous mismatch in assets and liabilities which went undetected because the banks were not large enough, under U.S. regulations, to be subject to the full array of stress tests and controls.

Although damage limitation measures helped calm investors, attention shifted to other second tier lenders, such as First Republic Bank (‘FRB’), which were perceived to be exposed to imbalances in their funding models. A rescue deal for FRB was put in place by a consortium of the biggest U.S. banks, but this did not fully resolve the situation. The view at that point was that problems in the U.S. banking system were not representative of issues in Europe. That view was challenged a few days later when the Swiss National Bank (‘SNB’) mandated the sale of Credit Suisse (‘CS’) to UBS. The transaction was imposed without shareholder votes and with an accelerated regulatory approval process.

Under the terms of the deal, UBS assumes responsibility for CS senior and Tier 2 debt, and owners of CS equity receive shares in UBS. However, the holders of additional Tier 1 bonds (‘AT1s’), which is the layer of capital used to supplement the core equity capital ratio of banks, were wiped out completely. CS was the largest issuer of AT1 instruments in Europe, so this could have important ramifications. The SNB opted to be decisive to address the risk that an acceleration of the withdrawal of deposits could precipitate a more damaging crisis.

At the time of writing, the view on European banks was, on the whole, in good health based on capital ratios and sources of funding. One important watching point, for both U.S. and European banks, is exposure to commercial real-estate. Bond and equity markets were jittery before this storm, and predictably, volatility spiked when SVB and SB failed. The movements in yields on U.S. Treasury bonds, particularly bonds maturing in 3 years or less, were exceptional by historic standards. The moves were less extreme in Gilts, but still significant in the short period since the end of 2022. This is linked to speculation about the response of central bankers: would the bank failures prompt a pullback on interest rate increases, or even a ‘pivot’ to rate cuts?

Outlook

The impact of recent events, and interest rate increases already implemented, on the ‘real’ economy is difficult to predict, even for central bankers armed with the best data. Although the risk that excessive tightening of monetary policy precipitates a deep and/or prolonged recession has eased, we are still exposed to the potential for a mild recession or extended period of slow growth, possibly accompanied by higher core inflation for longer than is currently expected. With the rapid disappearance of Credit Suisse and two substantial regional banks in the U.S. we have a stark reminder that big changes in policy regimes will inevitably cause damage, but not always where it is expected.

We are monitoring corporate earnings reports and looking for signs that pressure on consumers and companies is flowing through to default rates. Sentiment could change quickly, resulting in surges in volatility (for both bonds and equities) and possibly, liquidity flight.

The investment managers employed by London CIV are investing as LCIV expect On balance, they are cautious when making forecasts and careful to ensure that the sources of risk and drivers of returns are reasonably diverse at the portfolio level. On a positive note, they are also alert to opportunities to capitalise on volatility and dispersion across and within asset classes to put capital to work at attractive prices.

LCIV suggest investors should stay patient, use the resetting of strategic allocations to diversify the sources of risk in their portfolios, both across and within asset classes, and focus on investment and ESG themes which are expected to drive growth over the long term.

FINANCIAL IMPLICATIONS

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

The triennial valuation based on the Fund status on 31 March 2022 is complete and revised employer contribution have been put in place from April 2023.

LEGAL IMPLICATIONS

There are no legal implications in the report.