INVESTMENT STRATEGY and FUND MANAGER PERFORMANCE (Part I)

Committee	Pensions Committee
Officer Reporting	Babatunde Adekoya, Finance
Papers with this report	NT performance report on shared drive LCIV Performance reporting on shared drive Hymans Interim valuation Report 31 August 2023

HEADLINES

The overall investment return of the Fund was 1.08% over the quarter which was 0.55% lower than the benchmark of 1.64%. Performance over longer-term periods (3 and 5 years) was 3.95% and 2.83% per annum, which are both behind the set benchmark. The 3-year figure is 0.06% below the 4.1% return required in the Funding Strategy Statement, and the 5- year figure 1.18% 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

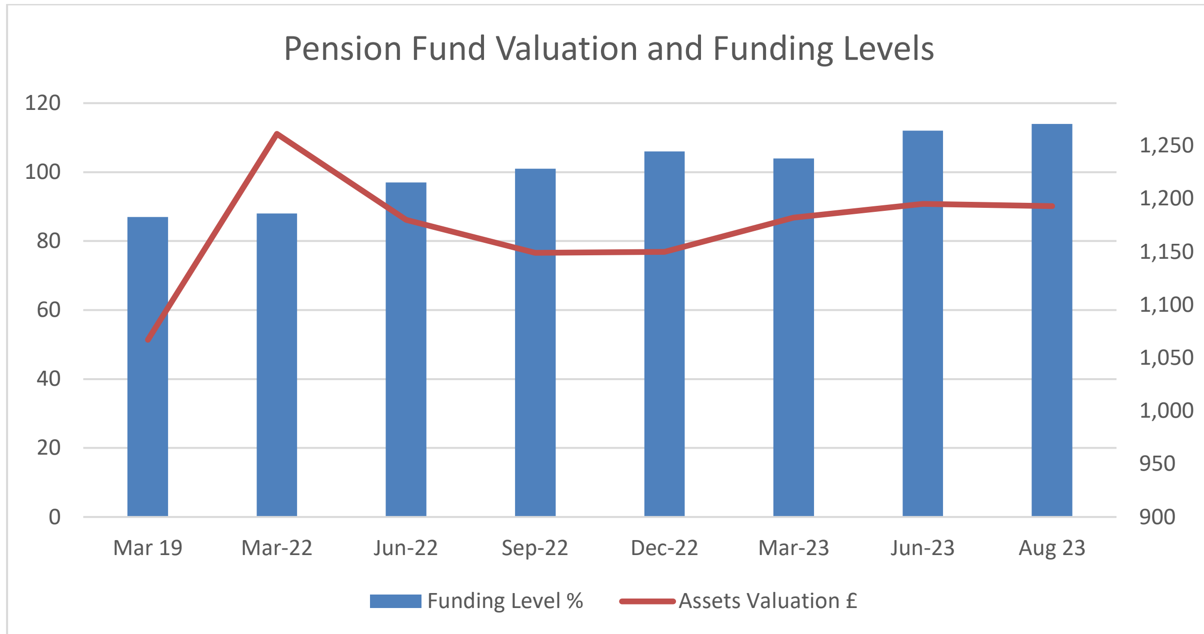
That the Pensions Committee note the funding and performance update.

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%.

The interim funding level update produced by the actuary on 30 June 2023 was 112%. The latest 31 August 2023 showed funds' assets were £1,193m and equated funding level of 114%. The main drivers of the improved funding level were increased discount rate (expected returns on whole fund strategy), 6.3% (4.1% in March 2022) and projected Pension Increases (expected CPI inflation), 2.1% (2.7% in March 2022). Both factors meant the projected liabilities went down. Although outside of the reporting period, fund assets as of 31 August 2023 was £1,193m down on the quarter under review by £2m. This interim funding position is based on a forward projection of the 31 March 2022 valuation and assumptions of financial, membership data and demographic nature.



2. Fund Performance

Over the last quarter to 30 June 2023, the Fund returned 1.08%, underperforming the benchmark return by 0.56%. The Fund value however increased over the quarter by £13m to £1,195m. Longer term performance is behind the benchmark in all time periods.

Period of measurement	Fund Return %	Benchmark %	Relative Performance
Quarter	1.08	1.64	-0.56
1 Year	1.86	2.51	-0.65
3 Year	3.95	4.96	-1.01
5 Year	2.83	4.37	-1.54
Since Inception (09/1995)	6.35	6.55	-0.20

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

- Macquarie, with a relative outperformance of 16.83% was the largest contributor to fund performance in the quarter under review. Whilst AEW, Ruffer and the two Private Equity managers, Adams Street & LGT Capital continued a recent trend of underperformance with relative returns of 7.57%, 7.60%, 7.81% & 8.60% below their respective benchmarks.
- Alternative investments continue to underperform their benchmarks over one- & three-year periods with both Adams Street and LGT Capital the main detractors with returns of 30.02% and 21.57% below their set benchmarks for one year period and 3.55% & 5.41% for three-year period. It should be noted that holdings in Private Equity are however minimal and so have little impact on the overall Fund performance.

- 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 -1.34% over the quarter and -4.76% over one year. Confidence in the manager turning around the relative underperformance is still high from the LCIV.

Fund Performance by Manager Relative to Benchmark as at 30 June 2023

	3 Months		1 Year		3 Years		Since Inception	
	Manager	**Benchmark**	**Manager**	**Benchmark**	**Manager**	**Benchmark**	**Manager**	**Benchmark**
Adam Street	-3.81	4.34	-18.62	*16.29*	10.46	*14.53*	7.40	0
AEW UK	-7.22	0.38	-14.12	*-17.39*	5.50	*3.39*	5.92	*5.54*
LCIV Global Alpha Growth Fund Paris Aligned	3.17	4.58	10.98	*16.53*	N/A	N/A	-6.62	*9.49*
LCIV Infrastructure Fund	-0.24	1.87	14.76	*6.60*	5.18	*4.39*	4.26	*4.34*
LCIV Mac Fund	1.91	2.22	2.79	*8.15*	N/A	N/A	2.55	*7.95*
LCIV Private Debt	-1.16	1.47	10.27	*6.00*	N/A	N/A	5.78	*6.01*
LCIV Ruffer	-6.58	1.11	-1.35	*3.18*	4.82	*1.20*	5.09	*0.93*
Legal & General World Developed Equity	4.52	4.41	12.76	*12.73*	10.53	*10.64*	8.09	*8.20*
Legal & General Index Linked Gilts	-6.61	-6.61	-16.98	-16.98	-12.63	*-12.63*	-2.42	*-2.27*
LGIM - Future World Equity IND	3.67	3.57	12.07	*11.73*	N/A	N/A	7.59	*7.45*
LGIM LPI Income Property	0.40	2.51	-17.94	*10.71*	-0.27	*8.74*	-1.54	*7.96*
LGT Capital	-4.63	4.34	-8.80	*16.29*	8.32	*14.53*	10.35	0
M&G Investments	2.34	2.11	-0.74	*7.61*	10.29	*5.39*	5.92	*4.90*
Macquarie	19.01	1.87	31.72	*6.60*	21.16	*4.39*	9.90	*3.90*
Premira Credit	2.38	2.11	8.17	*7.61*	6.51	*5.39*	7.11	*4.97*
UBS Property	1.36	0.38	-17.07	*-17.39*	4.19	*3.39*	3.57	*3.48*

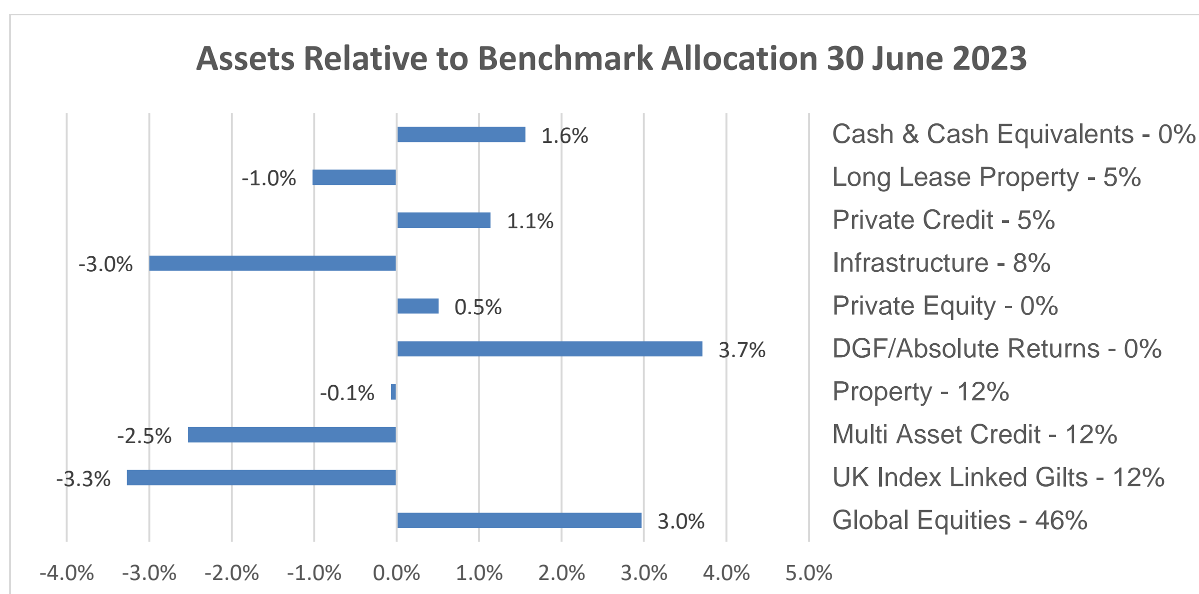
NB: Information from Northern Trust Quarterly performance report

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 2023	Actual Asset Allocation As of 01 April 2023	Market Value As of 30 June 2023	Actual Asset Allocation As of 30 June 2023	Benchmark Allocation	Market Value As of 31 August 2023
	£'000	%	£'000	%	%	£'000
Global Equities	562,149	48	584,985	48.97	46.00	589,393
UK Index Linked Gilts	111,642	9	104,257	8.73	24.00	102,563
Multi Asset Credit	110,959	9	113,074	9.47		110,039
Property	148,291	13	142,551	11.93	12.00	142,945
DGF/Absolute Returns	47,406	4	44,288	3.71	0.00	44,027
Private Equity	6,666	1	6,108	0.51	0.00	6,208
Infrastructure	54,771	5	59,719	5.00	8.00	61,295
Private Credit	75,923	6	73,402	6.14	5.00	71,307
Long Lease Property	47,386	4	47,574	3.98	5.00	46,947
Cash & Cash Equivalents	16,650	1	18,638	1.56	0.00	18,724
Totals	**1,181,843**	**100.00**	**1,194,596**	**100.00**	**100**	**1,193,448**



Highlights of transactions during the quarter under review:

- Total gross drawdown of £2m by LCIV Infrastructure Fund and £2.3m LCIV Private Debt Fund in the period under review.

- During the quarter, distributions received totalled £4.8m from Permira Private Debt, $156k & Euro 195k from Private Equity and Euro187k from Macquarie Infrastructure.

Undrawn commitments on 30 June 2023 are as follows:
- £3.2m (8% of commitment) awaiting drawdown on Private Credit (Permira).
- £16.8m (31% of commitment) to London CIV Infrastructure Fund. These funds are currently held in the LCIV Ruffer Absolute Return Fund.
- £2.8m in for the AEW Urban Renewal property fund.
- LCIV Private Debt £23.4m (33% 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 30 June 2023**	**Actual Asset Allocation**	**Market Value As of 31 August 2023**
FUND MANAGER	**ASSET CLASS**	**£'000**	**%**	**£'000**
LGIM	Global Equities	308,772	25.85	312,308
LGIM	Future World	221,125	18.51	222,929
LCIV - BALLIE GIFFORD	Global Equities	55,088	4.61	54,156
LGIM	UK Index Linked Gilts	104,257	8.73	102,563
LCIV MAC Fund	Multi Asset Credit	113,074	9.47	110,039
UBS PROPERTY	Property	78,210	6.55	78,094
AEW	Property	67,621	5.66	68,215
LCIV - RUFFER	DGF/Absolute Returns	44,288	3.71	44,027
ADAMS STREET	Private Equity	4,214	0.35	4,239
LGT	Private Equity	1,894	0.16	1,969
LCIV - STEPSTONE	Infrastructure	43,506	3.64	44,537
MACQUARIE	Infrastructure	16,213	1.36	16,758
M&G	Private Credit	682	0.06	666
LCIV Private Debt	Private Credit	50,459	4.22	50,938
PERMIRA	Private Credit	22,261	1.86	19,703
LGIM	LPI Property	47,574	3.98	46,947
Non-Custody	Cash & Cash Equivalents	15,358	1.29	15,360
		1,194,596	**100**	**1,193,448**

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

Regime change gives rise to uncertainty and volatility in asset markets. On the other hand, as we have noted in previous updates, it also creates opportunities, particularly when economies and monetary and fiscal policies are not synchronised. The era of low inflation and exceptionally low interest rates is certainly over, and some of the key drivers of that regime, such as the globalisation of supply chains are in flux. However, the pace at which regions adapt to the new economic order will not be uniform, and as a result, the dispersion of returns earned from owning equities, bonds and currencies increases.

This was certainly evident in the second quarter of 2023. The MSCI World Index had a solid quarter, as noted earlier. Looking below the surface though, we observe that equity indices have been dominated by a small number of companies, often referred to in the press as the 'magnificent 7', which are perceived to be at the vanguard of developments in Artificial Intelligence (AI).

The U.S. NASDAQ index, a bellwether for technology stocks, has gained almost 39% in U.S. Dollar terms this year. Conversely, the FTSE 100 Index is up only 1.1%, and most Asian indices have suffered the effects of the Chinese economy running out of steam. Chinese consumers have pulled back on deploying excess savings after a bout of 'revenge spending', and the effects of problems in the property sector have been underestimated. Policy support has not moved the needle yet.

The big exception in Asia is Japan, where the Nikkei 225 Index is up more than 27% in local currency terms, although only 7.3% in Sterling terms because of the poor performance of the Yen. Investors are attracted to valuations in Japan, but it remains to be seen whether Japanese corporates can deliver sustained growth in earnings, for example by redeploying surplus capital at high rates of return.

There is no doubt that AI will have far reaching effects, positive and negative. Investors are correctly focused on the leaders in the fields of semiconductors, cloud computing and application delivery to capitalise on this potential. However, it is too early to form a definitive view on who the winners and losers will be, and how activities will be regulated to limit the use of data and protect personal privacy.

AI theme may turn out to be a pathfinder for a more broadly based rally in equity markets. However, it could also turn out to be another short- lived burst of enthusiasm from investors casting about for the next big thing. Based on the view from bond markets, investors are encouraged to be cautious, particularly if their equity holdings are tilted to growth stocks, including through allocations to passively managed strategies.

The Bloomberg Global Aggregate Credit index {GBP hedged) is up 3% in the year to date, a credible result which reflects the view that interest rates are closer to settling into a range which is aligned to inflation. However, the prevailing view is still that inflation will decline and move towards central bank target rates by early to mid-2024. This optimism is difficult to reconcile to data for core rates of inflation, especially in the

U.K., and to the prevalence of strongly inverted yield curves in major Western economies. U.K. markets are pricing in a peak base rate of 5.75% {as of the 19th of July), compared to the current 5%, by the end of 2023. The differential between yields on Gilts maturing in two years and those maturing in ten years has widened to the highest level in 20 years.

Unfortunately, the U.K. is a laggard in the group of major economies. The economy is expected to expand by only 0.2% this year and by 0.6% and 1.5% in 2024 and 2025 respectively. The persistence of inflation is reflected in the forecast for 2023-year end CPI of 7.5%, although economists then expect a rapid decline in CPI to 3% at the end of 2024 and 2% in 2025. On a positive note, the inflation reading published on July 19th provided the first significant sign that price pressure is easing.

Outlook

This is a challenging time to predict growth, employment, inflation, and corporate earnings. Capital markets are sending mixed signals: the 'not too hot, not too cold’. Goldilocks scenario is the main narrative in equity markets, at least for growth-oriented investors, whereas bond investors are more cautious.

Based on the MSCI World Index, the 12-month forward earnings yield on equities (inverse of the price to earnings ratios) was 5.8% at the end of June, when the yield to maturity of the Bloomberg Barclays Global Aggregate Credit Index (hedged to GBP) was 5.4%. In short, stocks, and growth stocks especially, are not offering much of a premium for risk at a time of uncertainty in the outlook for corporate earnings.

We could argue that a lower risk premium for equities is justified by the very poor performance of bonds in 2021/2022. However, we are closer now to settling at 'normalised' ranges for interest rates, which reduces the likelihood that stocks and bonds will move in tandem, although we accept that sentiment can change quickly, resulting in bursts of volatility, and possibly, illiquidity.

The strong recovery in equity markets makes this an opportune time to review portfolios, and consider assets, such as conventional bonds, which have not offered much in terms of income yield and diversification benefits for the past 15 years or so.

This is also a good time to consider the sources of risk within asset classes, such as tilts to growth stocks in equity holdings, and to riskier borrowers in public and private credit portfolios.

FINANCIAL IMPLICATIONS

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

LEGAL IMPLICATIONS

There are no legal implications in the report.