INVESTMENT STRATEGY and FUND MANAGER PERFORMANCE (Part I)	ITEM 7

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 30 September 2023

HEADLINES

The overall investment return of the Fund was -0.55% over the quarter which was 0.55% lower than the benchmark of 0.0%. Performance over longer-term periods (3 and 5 years) was 3.53% and 2.50% per annum, which are both behind the set benchmark. The 3-year figure is 0.57% below the 4.1% return required in the Funding Strategy Statement, and the 5- year figure 1.60% 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. Whilst equities allocation is 3.11% above the benchmark due to market gains.

RECOMMENDATIONS

It is recommended that Pensions Committee:

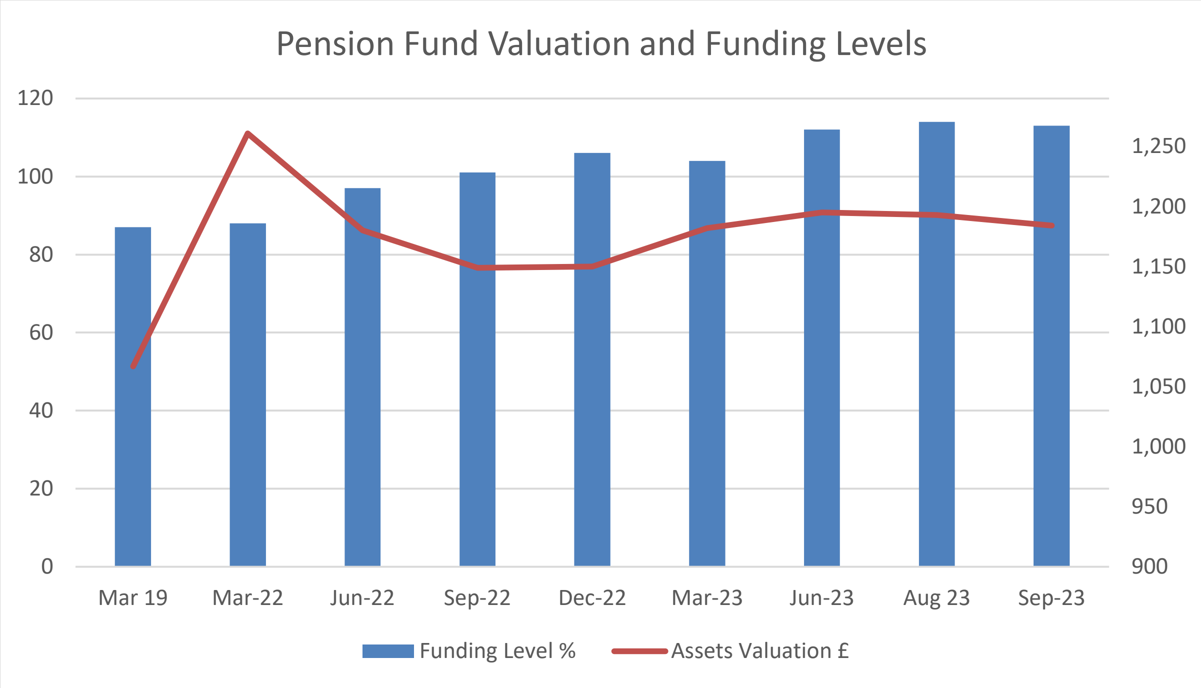
1. **Note the funding and performance update.**

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%.

An interim funding level update was produced by the actuary on 30 September 2023. it showed funds' assets were £1,184m and equated funding level of 113%, a decrease of 1% from the previous quarter. The primary reason for the reduced funding level is a drop in asset value.



2. Fund Performance

Over the last quarter to 30 September 2023, the Fund returned -0.56%, underperforming the benchmark return by 0.55%. The Fund value also decreased over the quarter by £11m, down to £1,184m. Longer term performance is behind the benchmark in all time periods.

Period of measurement	Fund Return %	Benchmark %	Relative Performance
Quarter	-0.56	0.00	-0.55
1 Year	3.37	3.78	-0.39
3 Year	3.53	4.43	-0.86
5 Year	2.50	4.07	-1.51
Since Inception (09/1995)	6.27	6.49	-0.20

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

- Alternative investment managers contributed to performance in the quarter under review, with Adams Street, LGT and Macquarie outperforming their respective benchmarks by 2.63%, 6.31% and 4.50%. Unfortunately, due to the low holding value it had little impact on total fund returns.

- Macquarie again was the standout manager over one and three-year performance measurements, with 20.07% & 18.18% returns above its set benchmark for both periods.

- Notable relative underperformance continues in the LCIV Global Alpha Paris Aligned Growth Fund and the LGIM LPI Income Property Portfolios. Both portfolios underperformed their respective benchmarks overall performance measurement periods of current quarter, one and three year periods.

Fund Performance by Manager Relative to Benchmark as of 30 September 2023

	3 Months		1 Year		3 Years		Since Inception	
	Manager	Benchmark	Manager	Benchmark	Manager	Benchmark	Manager	Benchmark
Adam Street	4.29	1.62	-14.73	*15.23*	8.79	*13.51*	7.54	0
AEW UK	0.81	-0.42	5.96	*-14.31*	5.03	*3.17*	5.85	*5.34*
LCIV Global Alpha Growth Fund Paris Aligned	-4.33	1.23	4.49	*14.68*	N/A	N/A	-7.64	*9.02*
LCIV Infrastructure Fund	0.00	2.03	2.74	*7.39*	5.18	*4.82*	3.98	*4.59*
LCIV Mac Fund	0.99	2.37	3.81	*8.92*	N/A	N/A	2.82	*8.28*
LCIV Private Debt	0.00	1.47	10.27	*6.00*	N/A	N/A	4.98	*6.00*
LCIV Ruffer	-0.75	1.31	-3.82	*4.12*	4.17	*1.63*	4.94	*1.02*
Legal & General World Developed Equity	-0.42	-0.33	14.07	*14.12*	8.70	*8.79*	7.72	*7.84*
Legal & General Index Linked Gilts	-4.69	-4.69	-12.74	-12.75	-13.38	*-13.38*	-3.03	*-2.89*
LGIM - Future World Equity IND	0.07	-0.01	10.82	*10.50*	8.91	8.75	6.96	*6.81*
LGIM LPI Income Property	-2.57	0.53	-19.46	*8.86*	-1.35	*8.74*	-2.15	*7.54*
LGT Capital	8.04	1.62	-5.24	*15.23*	10.46	*13.51*	10.65	0
M&G Investments	-2.38	2.26	-2.99	*8.39*	13.37	*5.82*	5.61	*4.98*
Macquarie	6.62	2.03	28.94	*7.39*	23.87	*4.82*	10.24	*3.98*
Premira Credit	0.96	2.26	6.81	*8.39*	6.17	*5.82*	7.02	*5.09*
UBS Property	-0.16	-0.42	-15.01	*-14.31*	4.18	*3.17*	3.50	*3.41*

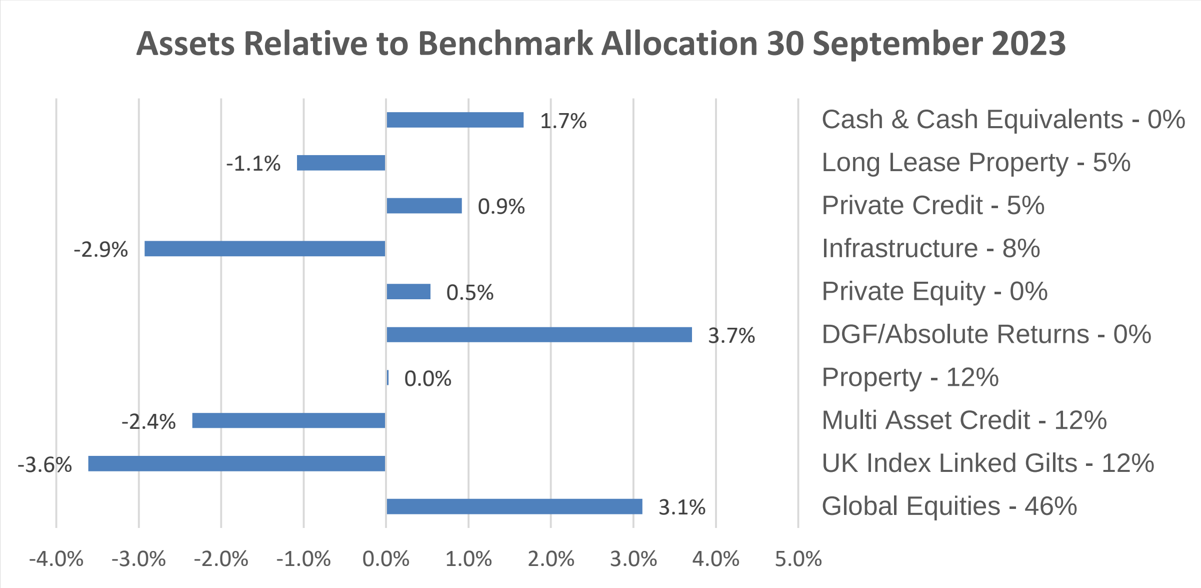
NB: Information from Northern Trust Quarterly performance report

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 Sept 2023	Actual Asset Allocation as of September 2023	Benchmark Allocation	Market Value as of 30 November 2023
	£'000	%	£'000	%	%	£'000
Global Equities	562,149	48	581,441	49.11	46.00	570,318
UK Index Linked Gilts	111,642	9	99,369	8.39	24.00	98,091
Multi Asset Credit	110,959	9	114,195	9.65		113,579
Property	148,291	13	142,407	12.03	12.00	147,354
DGF/Absolute Returns	47,406	4	43,956	3.71	0.00	44,133
Private Equity	6,666	1	6,367	0.54	0.00	5,897
Infrastructure	54,771	5	60,022	5.07	8.00	59,241
Private Credit	75,923	6	70,061	5.92	5.00	70,738
Long Lease Property	47,386	4	46,351	3.92	5.00	46,724
Cash & Cash Equivalents	16,650	1	19,736	1.67	0.00	19,462
Totals	**1,181,843**	**100.00**	**1,183,905**	**100.00**	**100**	**1,175,537**



Highlights of transactions during the quarter under review:

Total gross drawdown of £1m by LCIV Infrastructure Fund in the period under review.

- During the quarter, distributions received totalled £4.0m from Permira Private Debt, $31k & Euro 53k from Private Equity and US$2.2m from Macquarie Infrastructure.

Undrawn commitments on 30 September 2023 are as follows:

- £3.2m (8% of commitment) awaiting drawdown on Private Credit (Permira).
- £14.7m (27% 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 £22.9m (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 Sept 2023**	**Actual Asset Allocation**	**Market Value As of 30 November 2023**
FUND MANAGER	**ASSET CLASS**	**£'000**	**%**	**£'000**
ADAMS STREET	Private Equity	4,340	0.37	3,989
LGT	Private Equity	1,986	0.17	1,908
AEW	Property	68,296	5.77	72,960
LCIV MAC Fund	Multi Asset Credit	114,195	9.65	113,579
LCIV - Baillie Gifford	Global Equities	52,704	4.45	53,964
LCIV - RUFFER	DGF/Absolute Returns	43,956	3.71	44,133

LCIV - STEPSTONE	Infrastructure	44,537	3.76	44,604
LCIV - Private Debt	Private Credit	50,938	4.30	50,938
M&G	Private Credit	666	0.06	655
MACQUARIE	Infrastructure	15,485	1.31	14,637
PERMIRA	Private Credit	18,457	1.56	19,145
LGIM	Global Equities LPI Property Future World UK Index Linked Gilts	307,443 46,351 221,265 99,369	25.97 3.92 18.69 8.39	299,659 46,724 216,666 98,091
UBS EQUITIES	UK Equities Property Private Equity	29 22 41	0.00 0.00 0.00	29 22 0
UBS PROPERTY	Property Cash & Cash Equivalents	74,089 3,277	6.26 0.28	74,372 3,034
Non-Custody	Cash & Cash Equivalents	16,459	1.39	16,428
		1,183,905	**100**	**1,175,537**

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

The tug of war between bond and equity investors continued in the third quarter. Equities were firmly in the ascendancy in July. Consistent with the theme in Q2, leadership was concentrated in a small number of companies perceived to be at the vanguard of the commercialisation of artificial intelligence applications.

China was also an important driver because local stocks benefitted from government measures to stimulate growth, shore up local government finances and accelerate the restructuring of the property sector. This helped propel the MSCI Emerging Markets Index to a gain of almost 5% in July (in Sterling terms), 2.8% more than the MSCI World Index. The positive momentum in emerging markets equities proved to be short-lived. Although the MSCI Emerging Markets Index outperformed the MSCI World Index by a small margin in Q3, emerging markets stocks have underperformed developed markets companies (using the MSCI indices as proxies) by more than 9% in the first nine months of 2023.

Bond markets remained volatile, with yields on government debt moving sharply as expectations changed with the release of updated activity and inflation data. Despite the improvement in the trend rate of inflation, tempered partly by rising oil prices, the prevailing theme was one of risings yields, particularly on long dated debt.

The root cause of the big moves in bond markets in Q3 was a change in thinking on the path of monetary policy. In short, the narrative has shifted away from central banks moving to cut benchmark rates in 2024, to rates staying higher for longer to combat persistent inflation linked to factors such as pressure on wages, the cost of adapting supply chains and the cost of implementing decarbonisation measures.

In the United States, the effects of this shift in expectations were amplified by concerns about the high cost of defying recession, specifically deteriorating budget balances, an explosion of national debt and the risk of more downgrades in credit ratings. The threat of another shutdown of the U.S. federal government also came back into focus.

Rates staying ‘higher for longer’ is not necessarily inconsistent with the soft-landing scenario which has been a focus in recent months. Indeed, consensus expectations for GDP growth in the G8 economies have increased to 1.5% for 2023, up from 1% in our previous update.

The U.S. has shown that it can continue to expand despite the sharp increase in interest rates. However, the slow effects of policy changes have not fully worked their way through the system yet, and evidence is growing that consumers, and companies which are relatively highly exposed to rising input costs, are struggling.
The U.K. and Europe look fragile in the absence of big fiscal programmes and more persistent sensitivity to pressures on input prices and wages, and Asia is weighed down by sluggishness in the Chinese economy.
The realisation that risks to revenue and earnings growth had increased eventually prompted a reversal in sentiment in the equity markets. Post-summer blues set in and by the end of Q3, the gains recorded by the MSCI World Index had been wiped out. The return was positive in Sterling terms (+0.6%) because of the 4% decline in the value of the currency against the U.S. Dollar during the quarter.

The reversal of stock markets was caused primarily by a contraction in valuation multiples. Forecast earnings growth has not changed much, except perhaps in the consumer discretionary and industrial sectors, despite the risks to the outlook for growth.

The response was similar in credit markets. Spreads on corporate debt didn’t change much, and high yield bonds, which are less sensitive to changes in interest rates than investment grade debt, outperformed. Credit investors do not appear to be overly concerned about downside risk, perhaps because valuations are not perceived to be extended. On the other hand, the debate about whether spreads on high yield debt are adequate to compensate for heightened default risk continues.

The moves in Q3 illustrate the effects of regime change: rapid changes in sentiment and capital flows which drive surges in volatility, and at times, anomalies in the valuation of assets. These rapid shifts are challenging for investors, but economies, industries and companies will adapt to the new order at different paces, and different levels of success. This will create opportunities for investors who can take a long-term perspective.

Outlook

The most interesting pockets of value at the time of writing were in government bonds. Real yields have turned positive, and bond and multi-asset investors have more appetite for interest rate risk, whilst being mindful of volatility. Credit spreads are hovering near the mid-point of their long-term valuation ranges, but technical factors are driving anomalies in specific areas, such as in the market for mortgage-backed securities (‘MBS’). Allocations to MBS in the LCIV Global Bond Fund and LCIV MAC Fund have increased.

Equities, and growth stocks especially, don’t offer a premium for risk. However, broad indices are skewed to the relatively high valuations of North American technology and communications stocks, and there are pockets of value in other sectors and regions. Japanese companies are back in focus based on valuations and the view that improvements in corporate governance are having a meaningful impact. Emerging markets stocks also look interesting from a valuation perspective after an extended period of underperformance.

LCIV is disappointed with the performance of most of the equity and multi-asset funds on the London CIV platform this year. LCIV has specific concerns about some of their Sub-funds, but the investment managers employed on our behalf have continued to apply the investment philosophies and processes which have served them well over the long-term. They are also taking care to assess climate and other ESG risks and opportunities when making decisions. LCIV is hopeful that the care taken to select investments for our Sub-funds will be reflected in improved performance in the coming quarters.

Next Step on Investments Consultation Update

Alongside a broad range of pensions proposals included in the Autumn Statement, there were references to the LGPS with key points detailed below:

Pooling

- 2025 stays as the pooling transition deadline for transition of liquid assets to the pool on a comply or explain basis.
- The Government Actuary's Department estimate that the LGPS could reach around £950 billion in assets in 2040, the government is therefore looking towards a smaller number of pools with assets under management averaging £200 billion.
- Revised guidance will include a preferred model of pooling which is expected to be adopted over time based on "characteristics and outcomes" rather than prescribed structures. Inter-pool collaboration encouraged.
- Investment in other pools should only be done via a Fund's existing pool.
- Greater transparency on reporting to be developed in conjunction with the Scheme Advisory Board (SAB).

Levelling Up

- Government keen to maintain a broad definition of levelling up but UK wide.
- Where scale for local investment is an issue funds may wish to continue to invest outside the pool.
- 5% investment in levelling up remains an ambition, but recognises it is not a separate asset class.

Private Equity

- On private equity (PE) the Government remains committed to unlocking capital to support growth businesses. However, "investment in the UK is particularly welcome but it is not proposed to restrict this ambition to investments in private equity in the UK".
- 10% investment in PE remains an ambition and would not be mandated (need to still take into account fiduciary duty). 10% does relate to PE, but funds can also include other investments in private markets outside of this where appropriate on risk / return grounds.
- Pools to be encouraged to strengthen partnerships with British Business Bank (BBB) to support opportunities in venture capital and growth equity.

CMA Objective Setting for Advisers

- LGPS regulations will be amended to require objective setting for all advisers including consultants, pools and independent advisers when providing advice on investments, investment strategy statements, strategic asset allocation and manager selection.

Governance and Other

- Requirement to formally publish a training policy for Pension Committee Members and to report on training undertaken.
- LGPS definition of investments amendment to be made in regulations.
- Guidance to be issued to increase consistency of reporting on asset allocation in annual reports, working with the Scheme Advisory Board.

FINANCIAL IMPLICATIONS

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

LEGAL IMPLICATIONS

There are no legal implications in the report.