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 31 December 2023

HEADLINES

The overall investment return of the Fund was 5.52% over the quarter which was 0.89% ahead of the benchmark of 4.63%. Performance over longer-term periods (3 and 5 years) was 3.56% and 4.68% per annum, which are both behind the set benchmark. The 3-year figure is 0.45% below the 4.1% return required in the Funding Strategy Statement, and the 5- year figure 0.58% above this requirement.

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

The Fund's actual asset allocation will require adjustments following the revisions agreed by Committee to the target investment strategy. Differences are also evident in the LCIV Infrastructure and Private Debt Funds which are yet to be fully drawn. There is also a circa 2.5% under-allocation to MAC.

RECOMMENDATIONS

It is recommended that Pensions Committee:

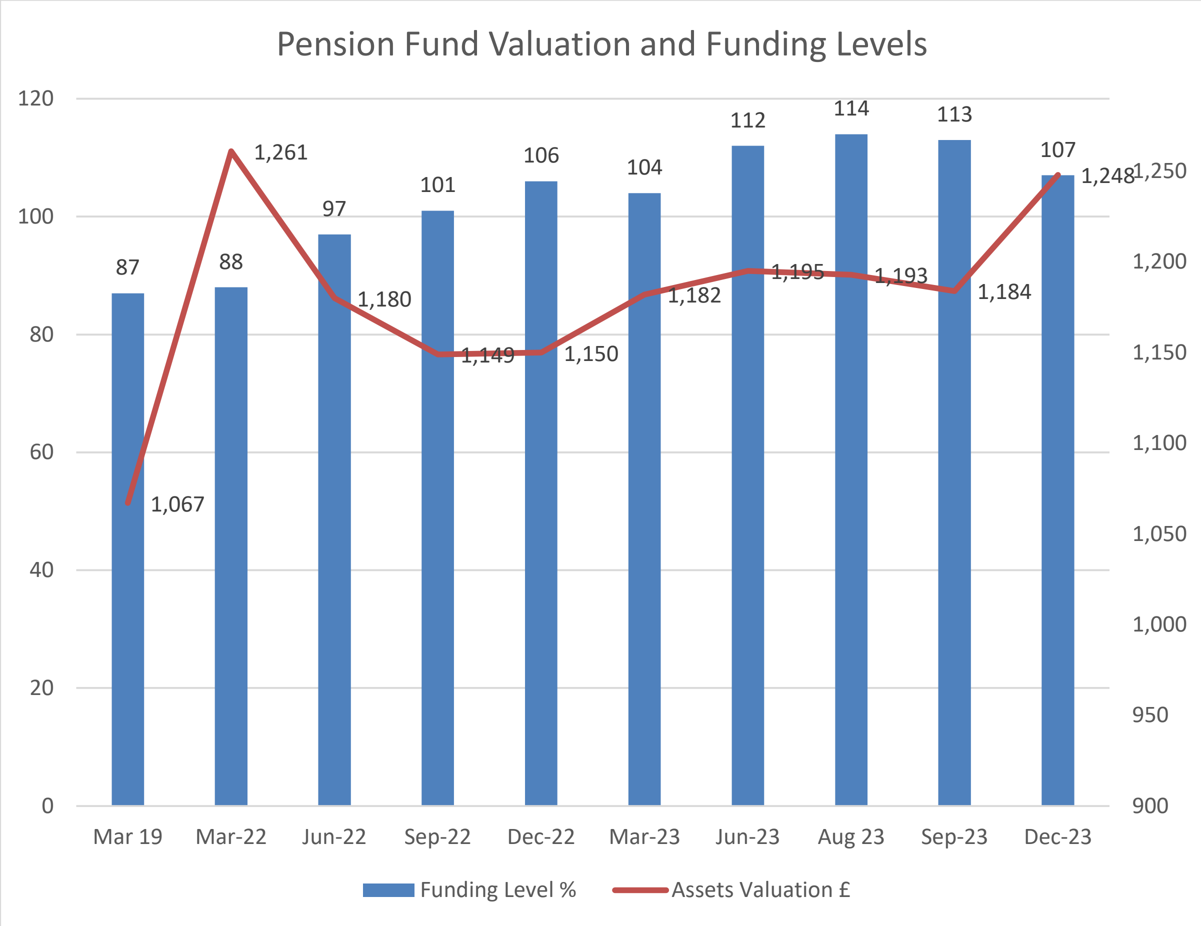
1. **Note the funding and performance update.**

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 31 December 2023. it showed funds' assets were £1.25m and equated funding level of 107%, a decrease of 6% from the previous quarter. The primary reason for the reduced funding level is a decrease in discount rate from 6.4% (September) down to 5.8% (December).



2. Fund Performance

Over the last quarter to 31 December 2023, the Fund returned 5.52%, outperforming the benchmark return by 0.89%. The Fund value also increased over the quarter by £65m, up to £1,248m. Longer term performance is behind the benchmark in all time periods.

Period of measurement	Fund Return %	Benchmark %	Relative Performance
Quarter	5.52	4.63	0.85
1 Year	9.02	9.84	-0.75
3 Year	3.56	4.33	-0.74
5 Year	4.68	6.11	-1.34
Since Inception (09/1995)	6.42	6.60	-0.17

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

- Two portfolios managed by the LCIV were the best performers in the quarter under review. Both LCIV Private Debt and MAC Funds outperformed their respective benchmarks respective benchmarks by 5.81% and 3.51%, with portfolio returns of 7.36% and 5.90% respectively.

- Macquarie again was the standout manager over one and three-year performance measurements, with 18.58% & 17.18% returns above its set benchmark for both periods. The performances are attributable to the maturity profile of the funds in the portfolio, which are being wound up and assets disposed at considerable profits.

- Notable significant relative underperformance continues with both private equity portfolios managed by Adams Street and LGT Capital Partners. It is, however, not surprising as the funds are past their investment cycle and just waiting to be completely wound down. 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 31 December 2023

	3 Months		1 Year		3 Years		Since Inception	
	Manager	**Benchmark**	**Manager**	**Benchmark**	**Manager**	**Benchmark**	**Manager**	**Benchmark**
Adam Street	-6.27	7.15	-11.83	*19.88*	5.12	*12.77*	7.07	0
AEW UK	2.14	-1.16	2.04	*-1.40*	2.16	*2.06*	5.92	*5.07*
LCIV Global Alpha Growth Fund Paris Aligned	8.06	7.22	11.61	*19.81*	0	0	-4.24	*10.98*
LCIV Infrastructure Fund	4.77	1.97	7.64	*7.82*	6.82	*5.24*	4.91	*4.80*
LCIV Mac Fund	5.90	2.31	9.94	*9.32*	0	0	6.10	*8.47*
LCIV Private Debt	7.36	1.47	7.71	*6.00*	0	0	7.93	*5.99*
LCIV Ruffer	2.18	1.33	-6.26	*4.77*	3.41	*2.07*	5.01	*1.09*
Legal & General World Developed Equity	7.32	7.29	17.55	*17.47*	7.70	*7.75*	8.51	*8.61*
Legal & General Index Linked Gilts	8.70	8.72	0.91	0.93	-11.29	*-11.29*	-1.73	*-1.60*
LGIM - Future World Equity IND	7.08	6.96	16.52	*16.15*	8.52	8.32	8.66	*8.48*
LGIM LPI Income Property	-0.71	0.16	-8.13	*5.16*	-2.09	*8.66*	-2.20	*7.07*
LGT Capital	0.36	7.15	-2.24	*19.88*	7.60	*12.77*	10.53	0
M&G Investments	-1.69	2.20	0.26	*8.82*	14.08	*6.24*	5.37	*5.05*
Macquarie	-2.17	1.97	27.85	*7.82*	23.32	*5.24*	9.86	*4.06*
Permira Credit	3.74	2.20	7.54	*8.82*	6.88	*6.24*	7.25	*5.20*
UBS Property	-1.02	-1.16	-4.96	*-1.40*	3.35	*2.06*	3.39	*3.29*

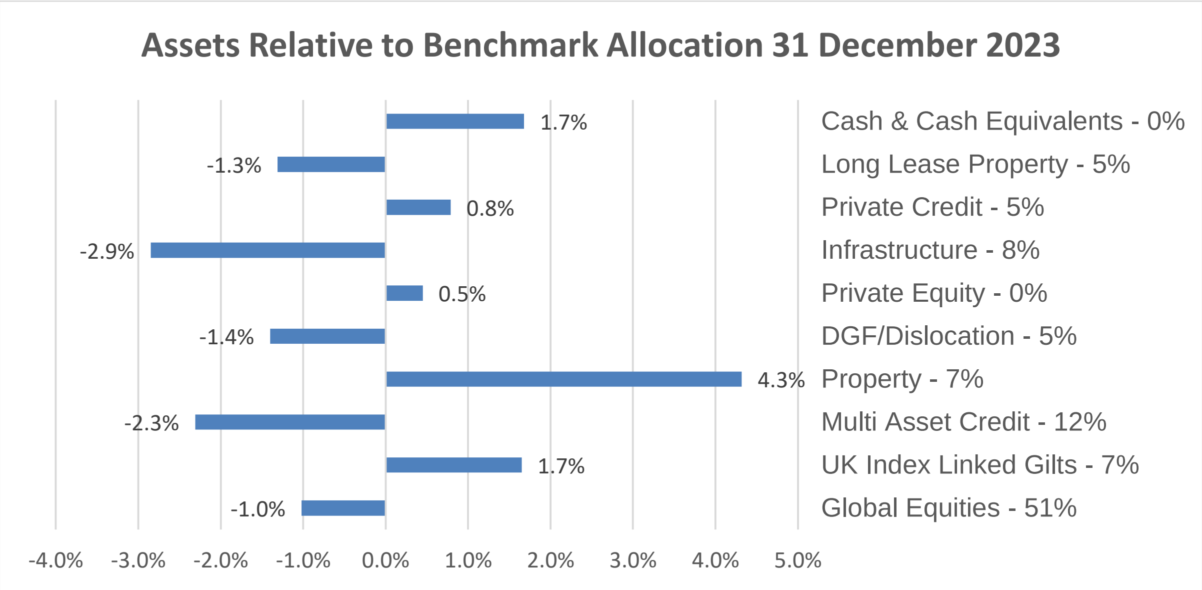
NB: Information from Northern Trust Quarterly performance report

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 31 December 2023	Actual Asset Allocation As of December 2023	Benchmark Allocation	Market Value As of 29 February 2024
	£'000	%	£'000	%	%	£'000
Global Equities	562,149	48	623,808	49.98	51.00	631,867
UK Index Linked Gilts	111,642	9	108,014	8.65	7.00	103,159
Multi Asset Credit	110,959	9	120,935	9.69	12.00	116,695
Property	148,291	13	141,285	11.32	7.00	144,486
DGF/Dislocation	47,406	4	44,914	3.60	5.00	43,814
Private Equity	6,666	1	5,659	0.45	0.00	5,517
Infrastructure	54,771	5	64,258	5.15	8.00	64,165
Private Credit	75,923	6	72,285	5.79	5.00	71,379
Long Lease Property	47,386	4	46,021	3.69	5.00	46,372
Cash & Cash Equivalents	16,650	1	21,000	1.68	0.00	23,667
Totals	**1,181,843**	**100.00**	**1,248,179**	**100.00**	**100**	**1,251,121**



Highlights of transactions during the quarter under review:

Total gross drawdown of £3.3m by LCIV Infrastructure Fund in the period under review.

- During the quarter, distributions received totalled £2.1m from Permira Private Debt, $353k & Euro 104k from Private Equity and US$164k & Euro 396k from Macquarie Infrastructure.

Undrawn commitments on 31 December 2023 are as follows:

- £3.2m (8% of commitment) awaiting drawdown on Private Credit (Permira).
- £11.4m (21% 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 31 December 2023**	**Actual Asset Allocation**	**Market Value As of 29 February 2024**
FUND MANAGER	**ASSET CLASS**	**£'000**	**%**	**£'000**
LGIM	Global Equities	329,951	26.43	332,369
LGIM	Future World	236,905	18.98	239,279
LCIV - BALLIE GIFFORD	Global Equities	56,952	4.56	60,219
LGIM	UK Index Linked Gilts	108,014	8.65	103,159
LCIV MAC Fund	Multi Asset Credit	120,935	9.69	116,695
UBS PROPERTY	Property	75,993	6.09	75,489
AEW	Property	68,694	5.50	72,535
LCIV - RUFFER	DGF/Absolute Returns	44,914	3.60	43,814
ADAMS STREET	Private Equity	3,836	0.31	3,818
LGT	Private Equity	1,864	0.15	1,699
LCIV - STEPSTONE	Infrastructure	49,716	3.98	49,716
MACQUARIE	Infrastructure	14,542	1.17	14,449
M&G	Private Credit	562	0.05	488
LCIV Private Debt	Private Credit	54,689	4.38	54,689
PERMIRA	Private Credit	17,034	1.36	16,202
LGIM	LPI Property	46,021	3.69	46,372
Non-Custody	Cash & Cash Equivalents	17,598	1.41	20,129
		1,248,220	**100**	**1,251,121**

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

The strong returns generated from equity and bond investments mask serious issues: high and persistent inflation, rapid tightening of monetary policy, armed conflict, and geopolitical tensions. We should also recall that it is less than a year since the failure of three regional banks in the U.S. and the forced takeover of Credit Suisse by UBS which raised the spectre of contagion in the financial sector.

The final quarter of 2023 was marked by more big movements in capital markets. This was a consistent theme in 2023. The tone was gloomy in October, when investors were resigned to interest rates staying ‘higher for longer’ to combat persistent inflation. Sentiment then shifted sharply in November when evidence emerged that inflation was decelerating enough to reduce the risk of further tightening of monetary policy.

The positive tone was bolstered on December 13 by comments made by Jerome Powell, the chair of the U.S. Federal Reserve, and data showing that voting members of the Federal Open Markets Committee expect official U.S. interest rates (currently in a target range of 5.25% to 5.5%) to be reduced by about 0.75% over the course of 2024, and continue to decline into 2025.

The Bank of England and European Central Bank left official rates unchanged on December 14th and were more guarded in their comments about the path of monetary policy. Nevertheless, investors in Gilts have priced in reductions in interest rates in 2024, possibly as early as March.

Bond yields fell sharply in Q4 2023. The Bloomberg Global Aggregate Bond Index (hedged to GBP) rose 6.2% in 2023, a good result given the weak and volatile performance of government bonds earlier in the year. Credit indices also performed strongly, with high yield debt being the standout performer. Default rates have increased, but not as much as had been expected, and investors have been attracted by the high single digit/low double digit yields available from sub-investment grade debt.

Equity investors were quick to turn bullish when central bank signalling became less hawkish. The MSCI World Index returned almost 17% in Sterling terms in 2023, despite a 4.4% gain in the value of Sterling against the U.S. Dollar. The surge in enthusiasm for risky assets in 2023 is reflected in the strong outperformance of growth stocks. The MSCI World Growth index was up almost 29% in 2023, whereas the MSCI World Value index returned only 3%.

Despite the surge in 2023, growth stocks have underperformed value stocks by 1% per annum over three years (+7.2% for MSCI World Growth vs. +8.2% for MSCI World Value). As we have seen since the end of the era of exceptionally loose monetary policy, expectations for interest rates, economic growth, and corporate earnings change quickly, and shifts in capital flows have a big impact on the performance of style factors in equity markets.

Based on market action at the end of 2023, we could conclude that central bankers have succeeded in delivering a ‘Goldilocks’ scenario of weak but positive economic growth, stable inflation, and capacity to reduce interest rates as needed to provide stimulus. This is an exceptionally difficult outcome to achieve, particularly in a period of armed conflict, geopolitical tension, tight labour markets, and big adjustments to global supply chains.

Investors have bought into this story – they have been aggressive in pricing in cuts in interest rates. Spreads on credit instruments, a key measure of perceived default and downgrade risk, are at the low end of historic ranges (but above the low points in mid-2021), despite evidence that impairments are increasing in the high yield debt markets.

Outlook

We are concerned that investors have embraced the ‘soft landing’ narrative with too much enthusiasm. In short, there may not be enough fuel left in the tank, in terms of expectations for official interest rates, credit spreads and corporate earnings to push markets much higher in 2024. And as we experienced in 2022 and 2023, negative news will be picked up in asset prices very quickly.

Unfortunately, the prospects for resolution of wars in the Ukraine and Middle East do not look strong. North Korea has become more belligerent again, and the threat of military action by China should not be discounted. China has been an important engine of growth for a long period, and the deceleration of that economy is a significant headwind. Closer to home, the UK economy contracted by 0.1% in the 3rd quarter of 2023 and is expected to grow by only 0.3% in 2024 based on consensus forecasts (source: Bloomberg).

On a positive note, yields on government bonds are positive in real terms. There is a very large amount of cash invested in money market funds and other short term debt instruments which could be redeployed into bond, credit, and equity markets if sentiment remains positive.

‘Reshoring’ and other adjustments to global supply chains present new avenues to growth, particularly for India, other South Asian economies, and Mexico. American companies are also investing around this theme, and fiscal measures to promote spending on infrastructure and renewal energy have supported growth in the U.S. economy, and in the earnings of companies which are positioned to benefit. The latest iteration of the revolution in technology, which has resulted in spectacular gains for leading players in artificial intelligence, may well deliver big gains in productivity and growth potential.

We also note the strong performance of the Nikkei 225 Index in 2023 (+28.2% in local currency terms), suggesting that leading Japanese companies may be able to play a more significant role again (although Japan only accounted for about 6% of the MSCI World Index at the end of 2023).

To sum up, and consistent with our previous updates, we think the outlook for capital markets in 2024 is mixed. We expect more twists and turns as investors respond to geopolitical developments and news flow around central bank action, key economic indicators, and earnings. We encourage Partner Funds to review the sources of returns from their pension funds in 2023, both across and within asset classes (‘growth’ equities for example) and consider opportunities to rebalance the sources of risk in their portfolios.

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

LEGAL IMPLICATIONS
There are no legal implications in the report.