

LOCAL PENSION COMMITTEE – 6th SEPTEMBER 2019

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

SUMMARY VALUATION OF PENSION FUND INVESTMENTS AND INVESTMENT PERFORMANCE OF INDIVIDUAL MANAGERS

Purpose of Report

1. The purpose of this report is to present to the Committee, an update on the investment markets and how individual asset classes are performing, a summary valuation of the Fund's investments at 30th June 2019 (attached as Appendix B to this report), together with figures showing the performance of individual managers and a funding position from the fund's actuary.

Market Outlook and Performance

2. An update on asset classes and market performance is provided by LGPS Central in their Tactical Asset Allocation report, in Appendix A. Key indicators for a recession have worsened over the last quarter. Despite this the six months to June 30th have seen Global equity markets rise 16.8% in sterling terms in the strongest six months market move for 21 years. The best equity factors were growth and quality. The likelihood of a recession over the next 12 months is medium. The report also provides a view how the market outlook impacts strategic asset allocations.

Overall Investment Performance

3. A comprehensive performance analysis over the quarter, year and 3-year period to 30th June 2019 is provided in Appendix B. This report is produced by Portfolio Evaluation Limited (PE). PE collate information directly from managers and calculate performance, which will provide an independent check of valuations and allow greater reporting flexibility. Introduction of this reporting will enhance the control and assurance for the Fund. Current performance reporting is limited to three years, but work is ongoing to provide a longer-term history.
4. It is important to note that the valuations produced can be different to those provided by managers or included in the Statement of Accounts. For example, timing differences or use of different accounting methodologies. The differences are not expected to be material in the context of the messages being conveyed by the report.
5. For the period ending 30th June 2019 the Fund delivered an investment return of 3.2% for the quarter, 5.4% over the year and 9.2% over a 3-year period.

6. The Fund's asset allocation compared to the investment strategy is shown in the table below:

	Weighting	Benchmark	Difference
Equities	50.2%	48.0%	2.2%
Real Income Fund	24.7%	26.5%	-1.8%
Alternatives	25.1%	25.5%	-1.1%
Cash	0.7%	0.0%	0.7%
	100.0%	100.0%	0.0%

The Fund's actual allocation varies over time due to differential market movements. However, the allocation remains broadly in-line with the strategy. The marginal overweight positions in equities (+2.2%) are expected to continue for some time, due to the time required to make investments in the underweight positions that are predominately the harder to access private market investments, where managers must source opportunities rather than being able to buy from liquid markets. The main underweight positions are made up of property, infrastructure private debt and the opportunities pool. At the end of June, the Fund had approximately £80m of commitments with managers that are waiting to be called. Further commitments will ideally be made when Central launches relevant products, although the Fund's existing providers will need to be considered if the time to launch is too long. A detailed breakdown of the asset allocation is available in Appendix B.

7. The following table provides the performance of the Fund and the asset classes over short and longer-term periods, compared to their respective benchmarks.

	3 Months %		1 Year %p.a.		3 Years %p.a.	
	Fund	Benchmark	Fund	Benchmark	Fund	Benchmark
Equities	4.4	4.7	6.3	6.6	12.6	12.6
Income Assets	1.5	1.2	7.1	5.5	8.1	6.0
Alternative	3.4	1.7	3.5	5.6	4.7	4.7
TOTAL FUND	3.2	3.1	5.4	6.4	9.2	8.7

8. The investment performance of the individual managers for the quarter to 30th June 2019 is set out in Appendix B. Further information on managers performance can be obtained from the manager reports included in the private part of the agenda. Included for the first time are three reports from LGPS Central providing an update on the performance of the managers under the advisory mandates, namely targeted return, emerging market debt and property. It is worth noting the following performance of certain managers:

Adams Street – Private Equity, 4.8% negative return compared to the benchmark. The benchmark of listed markets can be misleading, in the short-term, due to the less frequent valuations of private equity assets. As a riskier asset class, they have greater potential volatility. The 3-year return is more representative and trails the benchmark by 1.4%. In absolute terms this is still a good performance (12.6% annual return) but is measured against a very strong period for global equities.

IFM - global infrastructure, 10%+ return over benchmark over 1 year. Similarly, to private equity a long-term view needs to be taken, potentially incorporating the initial investment period.

Christofferson Robb & Company –Other Opportunities – 9.3% excess return over benchmark. The other opportunities allocation targets a higher return, at a higher level of risk. The investments in the opportunities area should be looked at as a collective, as not all will perform to target.

Colliers pooled Property fund – 8% excess return over a year. However due to the nature of property performance should be viewed over a longer time frame such as 3 years where it is 0.8% below benchmark. The fund only accounts for 0.7% of the total value of the pension fund so any change has a relatively small impact.

9. Following comments made at the last committee meeting regarding investment in emerging markets the following table has been produced showing equity allocations across different regions:

	Allocation	FTSE	
		All-World	Variance
	%	%	%
Emerging	14.7	10.4	4.3
Developed Asia Pacific ex Japan	6.4	5.6	0.9
North America	38.1	56.9	(18.8)
Japan	6.3	7.7	(1.4)
Europe xUK	16.8	14.1	2.7
United Kingdom	17.5	5.3	12.3
Other	0.2	0.1	0.1
Total	100.0	100.0	0.0

The comparison against the FTSE All-World Index shows the worldwide market capitalisation of various indices. The Fund's allocation is broadly in line with this index although the proportion of the fund invested in emerging markets is 4% higher and the United Kingdom 12% higher, at the expense of North America. The above table represents our passive equity investments and actively managed investments in Global and Emerging Market equities. There will be further equity allocations through the Targeted Return managers, but these managers have freedom to move between asset classes depending upon their outlook.

10. Allocating a higher proportion of the fund to emerging markets also brings with it risks inherent in these markets such as geo-political risk and currency fluctuations. The stock markets in these countries have also historically had higher levels of volatility when compared to developed markets.
11. It is important to note that although emerging market economies are growing, particularly the growing wealth of the middle-class population in those economies, much of the stock market growth associated with this will come from the major equity markets such as the US, UK and Europe. This is due to global nature of many of the companies that reside there meaning that they are likely to be best placed to benefit from this growth.

Currency

12. The movement of currency markets has been prominent in the financial news due to a range of domestic (e.g. Brexit) and global (e.g. trade wars) factors. The Fund

employs Kames to implement a currency hedge to reduce the currency risk. The Fund has set the neutral position of hedging 50% of the currency exposure and Kames have the freedom to vary the exposure depending upon their view of future currency movements.

13. The fund will lose money whenever sterling weakens, as not all of the increase in foreign asset values will be received. Kames have produced a briefing paper on how the currency hedge is utilised and also what may happen in various Brexit scenarios. This is attached as Appendix C.

Recommendation

14. The Local Pension Committee is asked to note the report.

Appendices

Appendix A - Report of LGPS Central Limited Tactical Asset Allocation (Market outlook and Performance).

Appendix B – Portfolio Evaluation Limited – Quarterly Risk and Return Analysis (Summary Valuation of Funds performance)

Appendix C – Kames Capital: Currency Hedging Programme

Equality and Human Rights Implications

None.

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