Leicestershire County Council

LOCAL PENSION COMMITTEE – 11th SEPTEMBER 2020

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 2020 (Appendix A), together with figures showing the performance of individual managers.

Market Outlook and Performance

2. An update on asset classes and market performance is provided by LGPS Central's (Central) Tactical Asset Allocation (TAA) report (Appendix B) whose 6 -18 month view is summarised below, arrows indicate movement in weighting since the last quarter.

Table1: Weightings ▲ Upgraded, ▼ Downgraded compared to previous quarter

	Significant Underweight	Underweight	Neutral	Overweight	Significant Overweight
Estimated Probability	80-70%	70-65%	55-45%	70-65%	70-80%
BROAD ASSET CLASS		Income & Growth ▼ Stabilising ▲			
GROWTH ASSET CLASS	US Equities	GEM Equities ▼ EU, UK Equities ▼ Private Equity ▼	Japan Equities ▼	Commodities Asia Pac Equities	
INCOME ASSETS	Property ▼		Infrastructure ▲		Credit, EM Debt
STABILISING ASSETS	JP Bonds	Index-Linked ▲ IG Bonds UK Bonds ▼	EU Bonds ▲	Gold US Bonds	
INVESTMENT STYLES	Value ▼ Size ▼		Momentum ▲	Growth ▲	Quality/ESG ▲ Low Volatility ▲
CURRENCIES		US Dollar		GBP, Yen, Euro	

3. Central's summary with changes from the previous quarter is noted below:

   a. LGPSC increase the allocation to Stabilising Assets from significant underweight to underweight. We decrease the allocation of Growth Assets from significant overweight to underweight, and we also decrease Income Assets from overweight to underweight mainly due to Property. We downgraded Property based on valuations and economics, and also on increased market risk.

   b. Growth Asset valuations are not as attractive as they were at the end of Q1 and our sentiment indicator toward these decreased significantly.

   c. Stabilising Assets we keep at underweight mainly due to their high valuations.

4. A summary of the asset class performance over various time frames covering the 3 months from April to June 2020 and longer time frames is shown below. The rapid rebound in the quarter to June is shown below after similar double digit drops seen in the quarter to March 2020.

	3 months*	One year	Three years	Five years	Ten years	Twenty years
GLOBAL EQUITIES	19.3%	2.0%	6.6%	6.9%	9.8%	4.5%
PRIVATE EQUITY	25.8%	-3.2%	5.4%	11.3%	12.7%	NA
PROPERTY	13.2%	-6.1%	3.6%	6.3%	10.6%	10.1%
INFRASTRUCTURE	13.8%	-14.4%	-0.9%	2.3%	6.9%	NA
HIGH YIELD	10.7%	0.4%	3.0%	5.2%	8.4%	9.8%
UK GILTS	2.6%	11.3%	6.3%	6.4%	6.0%	5.8%
UK INDEX-LINKED	10.5%	9.5%	7.0%	8.7%	8.7%	7.1%
GOLD	13.0%	31.1%	14.7%	14.0%	6.1%	10.7%

Source: Bloomberg (NB: assumes dividends were reinvested), Note: Listed proxies have been used for Infrastructure, Property and Private Equity.

Overall Investment Performance

5. A comprehensive performance analysis over the quarter, year and three-year period to 30th June 2020 is provided in Appendix A. Portfolio Evaluation 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 enhances the control and assurance for the Fund.

6. 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 of use of different accounting methodologies. The differences are not expected to be material in the context of the messages being conveyed by the report.

7. For the period ending 30th June 2020 the Fund delivered an investment return of +7.8% for the quarter, +0.2% over the last 12 months and +4.0% pa annualised over the three year period.

8. The Fund's total value as at 30 June 2020 is £4.5 billion. At 31st March 2019, the triennial valuation date the Fund had assets valued at £4.3 billion. 15 months into the 3 year cycle, assuming linear asset growth would equate to a fund valuation of £4.6 billion. The Fund is behind this but given the Fund's long term view and with many markets recovering officers do not see this as a problem.

Valuation versus benchmark target

9. The Fund's asset allocation compared to the investment strategy at quarter end is shown in the table below together with the last years benchmark and the new benchmark per the revised target asset allocation.

	Current Weighting	2019 benchmark	2019 difference	2020 new Benchmark	2020 New Difference
Equities	49.5%	48.0%	+1.5%	46.75%	+2.75%
Real Income	22.7%	26.5%	-3.8%	24.75%	-2.05%
Alternatives	24.9%	25.5%	-0.6%	27.5%	-2.6%
Cash and hedge collateral	2.9%	0%	+2.9%	1.0%	+1.9%
	100.0%	100.0%	0.0%	100.0%	0.0%

10. The Fund's actual allocation varies over time due to different market movements across the various asset types. This quarter in particular has seen markets move more rapidly. The benchmark allocations have been amended based on the approved strategic asset allocation from the January 2020 meeting. As at quarter end not all of the proposed changes to the Fund to re balance to the new benchmark have been enacted with the exception of the termination of the Funds currency overlay with Millennium and the new £100m investment into Central's Corporate Bond fund.

11. The Fund currently has a larger than 2 percentage point variance to the 3 main benchmark targets, equites, real income and alternatives. At present, officers are not overly concerned given the swings in valuation and the fact some investment managers valuations are lagging, for example private equity where managers don't value each investment every quarter and property where lack of transactions doesn't allow for accurate valuations.

12. The cash that has built up over the quarter is earmarked for use. Given the volatility in markets it is prudent to hold some cash, the 2020 asset allocation has a target of 1% to reflect the fact the Fund will always have cash and collateral with the Funds active currency manager Kames. We currently have instructions with our existing property managers to allow the fund to purchase property that fits the current fund profile, however finding suitable property during the covid related shutdown has proven difficult with suitable stock not on the market.

13. The alternatives part of the Fund's portfolio includes the increase in allocation of +2% from a combination of changes which will be enacted later in the year when Central has launched the Multi asset credit product, due diligence been completed, and committee have approved.

14. The real income part of the portfolio includes the property, infrastructure and index linked bonds. The benchmark includes the changes to reduce the index linked weighting by 2.5% as part of the annual strategic asset allocation review and reinvest in a new Central fund.

15. The process to move a portion of the Fund's passive portfolio to the LGPS Central Climate balanced fund is underway with the selection process of a transition advisor being the first step. A transition manager selection tender will then be conducted. This will not move the variances between asset categories but will address part of the strategic asset allocation change from January 2020.

16. 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 %		3 Years %	
	Fund	Benchmark	Fund	Benchmark	Fund	Benchmark
Equity exc hedge	17.8	18.2	-0.8	-2.3	4.5	6.0
Private Equity	-1.4	19.7	8.1	5.7	10.0	8.4
Real Income	0.0	1.6	1.3	3.0	4.9	4.9
Alternative	3.7	1.8	1.0	4.4	2.6	4.6
TOTAL FUND inc hedge	**7.8**	**9.0**	**0.2**	**3.3**	**4.0**	**5.2**

17. The Private Equity relative underperformance to benchmark of 21% contrasts with the outperformance last quarter of 16% and is related to timing issues regarding valuations.

18. The remainder of this report covers the following asset classes in more detail, equities, property and targeted return.

Equities

19. The Fund ended the quarter with a 49.5% allocation to equities. This includes the allocation to LGPS Central sub funds which total 12.2% of the total fund value. The bulk of the Fund's equity holdings are with Legal and General (LGIM) totalling £1.43 billion, up in line with the benchmark by 17% over the quarter.

LGIM

20. The LGIM portfolio contains a number of passive funds covering the UK, all world and geographic specific funds. The total value of these funds is £1.43 billion with a gain of 17% over the quarter and loss of 1.8% over the last 12 months. The LGIM portfolio performed in line with benchmark returns as expected of a passive fund.

21. Re balancing occurred in the period across the various funds to maintain benchmark targets. During the quarter the Fund initiated a single stock holding in Astra Zeneca as it was due to be divested from the UK core benchmark due to it being weighted at more than 5% of the index. In order to maintain a holding LGIM allow for single stocks within the mandate.

22. Of the LGIM regional investments (exc UK) the highest performance came from the North America index fund at 21.9%, all other regional funds posted double digit percentage increases over the quarter as markets rebounded from the March 2020 lows.

LGPS Central Active Global Equity

23. This fund had a valuation of £372 million at quarter end (£307 million at last quarter) having initially invested in March 2019. The performance since inception has lagged the benchmark by 2.5% and was 3.8% at last quarter end. The target for the fund is to outperform the benchmark by 1.5% per annum net of costs over rolling 5 year periods. Performance in the quarter ended was +4.1% vs a benchmark return of +3.3%.

24. Since inception, both Schroders and Union have outperformed the benchmark by

360 bps and 67 bps respectively. Performance has been impacted by Harris which has underperformed by 1054 bps. Central have assessed that the three managers continue to follow their stated investment process and portfolio constructions are in-line with expectations.

25. During the quarter Central's investment committee approved a recommendation to reduce Harris' target weight within the portfolio to 28.3% and allocate the resulting capital to Schroders bringing their target weight to 37.2%. Union's target position remained unchanged. The transaction was communicated to officers of the relevant funds in advance and a presentation and Q&A was held virtually.

26. This action will reduce the fund's over exposure to 'value' stocks and will go towards reducing the underweight in growth and quality factors within the portfolio.

LGPS Central Emerging Markets Active Equity

27. This fund had a valuation of £180 million at quarter end (£152 million last quarter) having initially invested in July 2019. The performance since inception is marginally ahead of the benchmark by 0.1% having returned -2.9% since inception. The performance in the quarter was +7.3% which was -0.1% vs benchmark. The target for this fund is to outperform the benchmark by 2.0% per annum net of costs over rolling 5 year periods.

28. Central employ three managers, BMO, UBS and Vontobel. Like the Global active equity fund, rebalancing may be carried out if any manager strays by +-2.5% from their target weight. At the last quarter end date all were within +-2.0%.

29. The UBS portfolio showed the strongest performance in the period with BMO and Vontobel both proving to be laggards. The Fund is tilted toward quality and its environmental, social and governance (ESG) factor stance has improved this quarter due to BMO tilting towards a better environmental factor stance.

30. The Central team held meetings every month during the quarter with each fund manager to ensure actions being taken are in line with the expectations of LGPS Central had when the managers were appointed.

31. This fund is overall overweight India versus the benchmark by 4.6% and underweight China by 6.9% at the quarter end. Both variances to the benchmark position adversely affected the performance in the quarter by a combined 40 bps.

Real Income - Property

32. The Fund employs three property managers, Colliers, LaSalle and Kames who hold a combination of direct and indirect property holdings. The total value at the quarter end date is £378m and 8.4% of total fund assets.

33. This is currently 1.6% below the target allocation. Officers are mindful of the illiquid nature of property investment and the need to stay close to the benchmark. The nature of markets where pricing isn't transparent due to low volumes means officers are keeping in contact with managers to understand if and where opportunities are available. The Fund has instructed Colliers earlier in the year to bring to the Fund's attention property that would fit the direct portfolio.

In addition, officers are in discussion with Kames regarding an extension to one of the two funds where it would suit the Fund to take a longer term view to generate higher returns rather than divest during a period where the fund would be forced to sell during a period of low volume. Officers are in discussion with two other Local Authorities who are also investors in the fund.

34. The Central direct property fund is not launched yet and is covered in another part of the agenda. The property investment director at Central, with whom the Fund have an advisory agreement with has provided summaries regarding other property funds in the market that officers may consider if variances to target allocation extend further.

Alternative - Targeted Return

35. The three managers the Fund employs within this category have a target return objective of 1 month LIBOR (London inter bank offered rate) plus 4% pa over rolling 3 year periods. A combined return of +3.7% over the quarter versus a 1.0% target was achieved with varying returns across the managers.

36. The 1 and 3 year returns for targeted return have been behind target by 3.4% and 2.0%. The underperformance being driven by both Pictet and Aspect who are both behind target over both timeframes. Ruffer have beaten the target in both 1 and 3 year timeframes having had a boost from their performance in 2020 to date.

37. Of the three managers Aspect had the worst performance in the quarter with a return of -4.7%, which leaves them virtually flat for the year to June. Aspect are a momentum based manager who trade based on historic correlations between asset classes.

38. Pictet posted the second best performance of the three managers off the back of a poorer March quarter with a 6.7% return. Unlike the other 2 managers Pictet are not able to take ‘short’ positions to take advantage of market sell offs. However the positive strong performance within a number of asset classes allowed them recover a portion of the March quarter losses. They increased their equity holdings from 35% at the start of the quarter to around 50% by the end of the quarter and had strong performance within areas they are invested in such as US technology.

39. Gold remained an asset class with a near 5% weighting for Pictet plus an additional 2% within gold mining companies who generally are a levered play on the gold price. This proved to be a positive over the quarter as the gold price in dollars reached nearly $1,800 dollars at the end of quarter, up more than 10% during the quarter alone.

40. Ruffer produced the best returns of the three managers in the period with a 8.3% return and are now up 12.2% over one year. They aim to build an ‘all weather’ portfolio, one that will make money when risk assets go up but also deliver returns when markets are in crisis. In order to do so they inevitably give up some upside to protect the downside risks.

41. The returns over the first 2 quarters have been a major plus for Ruffere’s alternatives class, where they have produced the best returns of the 3 managers. During the quarter they have sold equities into a rising market and are positioned

defensively which has hurt returns given returns were higher for high growth stocks and in particular mega cap tech stocks. At the end of the quarter the equity weighting was around 25%.

42. Ruffer's long standing view that global fiscal and monetary largesse will result in higher inflation has cost the fund but over the course of 2020 has paid dividends. Their holdings of index linked bonds makes up 15% of their portfolio which will, in their opinion provide greater returns in the future due to investors demanding inflation protection as the effects of global policy filter through. They achieved this return whilst holding a 12% weighting to cash at the end of the quarter.

Recommendation

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

Appendices

Appendix A - Portfolio Evaluation - Summary Valuation of Funds Performance.

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

Equality and Human Rights Implications

None.

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