

LOCAL PENSION COMMITTEE – 4th JUNE 2021

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 31st March 2021 (Appendix A), together with figures showing the performance of individual managers.

Markets Performance and Outlook

2. A summary of the asset class performance over various time frames as at the quarter ending is shown below. Three asset classes still show double digit returns over a 20 year time frame, property, high yield and gold; the same three as last quarter. Private Equity and Infrastructure have no 20 year source information available. The one year numbers show significant gains in many asset classes given March 2020 contained the low point from the coronavirus markets sell off.

	3 months*	One year	Three years	Five years	Ten years	Twenty years
GLOBAL EQUITIES	4.82	55.38	12.58	13.80	9.74	7.19
PRIVATE EQUITY	10.58	57.95	15.43	16.26	11.64	#N/A N/A
PROPERTY	8.27	34.37	10.88	7.25	9.38	10.45
INFRASTRUCTURE	3.00	37.00	5.65	6.72	6.28	#N/A N/A
HIGH YIELD	1.57	22.89	5.82	6.87	8.21	10.15
UK GILTS	-7.47	-5.72	2.73	3.09	5.05	5.12
UK INDEX-LINKED	-6.36	2.46	3.41	5.99	7.37	6.83
GOLD	-10.83	-5.19	9.43	7.78	3.32	10.08

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

3. 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. These forward looking market views are provided to the committee for information.

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		Stabilising	Growth	Income	
GROWTH ASSET CLASS		US Equities ▲	Private Equity Asia Pac Equities ▼	Commodities GEM Equities Japan Equities UK Equities EU Equities ▲▲	
INCOME ASSETS			Property ▲	HY Credit ▲	EM Debt Infrastructure
STABILISING ASSETS	EU Bonds	UK Bonds JP Bonds Index-Linked ▼ US Bonds ▼ IG Bonds ▼ Gold ▼			
INVESTMENT STYLES		Growth Quality/ESG ▼	Momentum ▲ Low Volatility ▲ Size ▼	Value	
CURRENCIES		US Dollar	Euro	GBP, Yen	

4. Central's major tactical view changes from last quarter are noted below:

- Growth assets – US equities moved up to underweight, Central note that the high valuations prevent them from moving further towards overweight. EU and UK equities moved to overweight from neutral also.
- Income assets – property moved to neutral from significantly underweight, high yield credit added to overweight.
- Stabilising assets – many asset classes downgraded to underweight from neutral and overweight, including index linked, US and investment grade bonds and gold.
- Investment styles – Quality/ESG, low volatility and size have been downgraded to neutral, value continues to sit as overweight.

Portfolio changes in the quarter

- During the quarter in question, January to March 2021, one transaction was completed, and two proposals were taken to the Investment Sub Committee (ISC) for approval, which are included elsewhere on today's agenda.
- The completed transaction was a £25m (0.5% of total fund assets) investment to the Aegon Short Dated bond fund which is in line with the Fund's strategic asset allocation as approved at the January 2021 committee.

Portfolio changes since the quarter ended

- One notable investment post the quarter was a £200m investment into the LGPS Central Multi Asset Credit (MAC) Fund. This proposal was approved at the March ISC. The transaction was completed in April with the two selected fund managers building the target portfolio within two weeks. The transaction enabled the Fund to satisfy an allocation to the area of the strategic allocation (liquid sub investment grade credit), and reduce the weighting to the targeted return asset class which was overweight whilst the Fund awaited a suitable LGPS Central product to transition to.

8. At the same time the Fund divested from the JP Morgan Credit Fund with net proceeds of c£30m being delivered to the Fund in cash. These two transactions mean the Fund has a 4% allocation to the sub investment grade credit per the 2021 strategic allocation.
9. The Fund had a requirement to investment specifically within the private rented sector (PRS). The Fund's property manager LaSalle acquired c£9m of units in the M&G UK residential fund from an institutional seller and have c£5m in the queue to be invested. LaSalle already had an allocation to this fund as their favoured fund in the PRS.

Cash at quarter end

10. At quarter end the cash held by the Fund totalled £293m, this includes £123m cash held as collateral with Aegon for the currency hedge. Since the quarter ended some cash has been utilised to fund the MAC investment alongside some divestments from two targeted returns managers to start bringing the allocation closer to the target weight.
11. The Fund is cash flow positive as a consequence of paying less in pensions than it receives from member and employer contributions. This provides the Fund with flexibility in making investment changes without always having to divest and incur costs but also means regular investments are required. The Fund has taken steps to ensure that the additional liquidity is invested at rates greater than the Treasury function at the Fund can achieve currently.
12. Given the past years' volatility in markets it makes sense to hold some additional cash for the currency hedge in the event currency markets move unexpectedly which may require additional collateral. The requirement to hold as much cash as the Fund did has reduced now the benchmark hedge position is 30% of foreign currency assets. As a result of the decision taken in January 2021 to reduce the benchmark hedge and officer conversations with Aegon, Aegon effected the change in mid April.
13. The Fund's cash is currently earmarked for a number of potential future transactions that coincide with Fund launches from Central and in line with the 2021 strategic allocation. These are described later within this paper.

2021 investment plans

14. The Fund's 2021 strategic asset allocation (SAA) was approved at the January 2021 Pension Committee. A reminder of the 2021 SAA is shown in the table below.

	Proposed target weight (%)	Comments
Growth (55.25%)	55.25	
Listed equity	42.0 (40.0-44.0)	Broad factor based passive allocation implemented December 2020, using LGPS Climate multi-factor sub-fund
Private equity (inc secondaries)	5.75	Increase in strategic target reflecting existing allocations Consider opportunistic investment in Adam Street Secondaries
Targeted return	7.5	Currently higher allocation. Use to fund sub-inv grade credit allocation; Review LGPS sub-fund when details available
Income (36.75%)	36.75	
Infrastructure (inc timberland)	9.75	Review and use LGPS sub-fund
Property	10.0	Consider introducing residential property; Consider LGPS Central proposals
Emerging market debt	2.5	-
Global credit – liquid sub inv grade markets	4.0	Existing JP Morgan fund holding and reduction in Target Return used to fund allocation, subject to due diligence
Global credit - private debt	10.5	Review M&F DOF team mid-year to decide whether to make further allocation to distressed debt
Protection (8%)	8.0	
Inflation-linked bonds	4.5	0.5% reduction in strategic allocation, reflecting recognition of cash held to manage currency hedge
Investment grade credit	3.0	Including up to c.0.5% retained by Aegon to support currency hedge programme
Currency hedge cash	0.5	Recognition of cash held by Aegon for this mandate. Adjust benchmark hedge ratios used by Aegon from 50% to 30%
Total	100.0	

15. Changes to the Fund that officers are considering:

- a. Private equity (PE) – Central are looking to launch a 2021 vintage, mainly focusing on large funds. The Fund invested in LGPS Central's first PE vintage in 2018 with £10m. Officers will review the need to invest further in this class alongside understating the future weight within this class from calls and distributions from the Funds long standing PR manager, Adam Street Partners.
- b. Targeted return – officers and the investment consultant are working with LGPS Central to build a product alongside one other partner fund. The product is likely to be available towards the end of 2021.
- c. Infrastructure – the Fund has an outstanding commitment to existing managers. It also may invest within the LGPS Central infrastructure fund which is now available. Officers have instructed the investment consultant to complete due diligence on the product offering's fit to the Fund's requirements. A proposal will be bought to the July ISC.
- d. Global credit private debt – Central are developing a product that may suit the Fund. The low return sleeve of the product has a similar return profile to the multi asset credit funds offered by the Partners Group that the Fund has invested into since 2013. Hymans are reviewing the product offering from Central. A proposal will be bought to the July ISC.
- e. Global credit private debt (higher return) – the SAA suggested looking further into the Funds existing relationship and products with M&G within this area once the new team at M&G have settled in. Over the last quarter the Fund has been informed of further restructuring within the M&G team and as such Hymans are looking into alternative options for the allocation to higher yielding credit including the high return sleeve being proposed by LGPS Central within the private debt product.
- f. Property – Central are in the early stages of launching a direct property fund. The Fund is currently underweight this sector. Whilst the timeline is unclear on a

launch date officers have instructed Colliers to continue search for direct property opportunities that are a good fit for the existing direct portfolio. Colliers have made one investment in the last year, an industrial warehouse where prospects were good and was available at a reasonable price. Pricing for the most sought after sectors is expensive as described by Colliers as money has flowed towards sectors like warehousing and supermarkets where income streams are more secure and have benefited from structural tailwinds.

Overall Investment Performance

16. A comprehensive performance analysis over the quarter, year and three-year period to 31st March 2021 is provided in Appendix A. Portfolio Evaluation collate information directly from managers and calculate performance, which provides an independent check of valuations and allows greater reporting flexibility. Officers and Portfolio Evaluation have met in the quarter to discuss improvements to the performance tables which should allow for more comprehensive three and five year performance metrics to be included and have updated the format to reflect the changes to target allocations and re classifying of investments into the growth, income and protection buckets.
17. Officers have also requested the movement of the hedge to be applied to the total portfolio, previously this calculation only applied to the equity portion of the portfolio. Given that the hedge applies to all unhedged foreign currency positions throughout the portfolio the Fund now reports total portfolio including and excluding the effect of the hedge.
18. 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.
19. Summarised returns for the whole Fund versus benchmark is shown below:

	Qtr	1 yr	3 yr	5yr	1 yr vs benchmark	3 yr vs benchmark	5yr vs benchmark
Total Fund	+3.3%	+22.1%	+7.1%	+9.5%	+2.4%	-0.2%	+0.9%

20. The Fund's total value as at the quarter end is £5.1 billion. At 31st March 2019, the triennial valuation date, the Fund had assets valued at £4.3 billion. 24 months into the three year cycle, assuming linear asset growth of 3.8% (which Hymans Robertson estimated has a 80% likelihood over the next 20 years and is used in the 2019 valuation for reporting the funding level of the scheme) would equate to a fund valuation of c£4.63 billion. It is worth noting that this only looks at the historic investment return whereas the fullest picture of funding health is only achieved by also considering the future and pension liabilities, which will next be calculated as at 31st March 2022. It is worth noting that yields on government bonds have fallen since the last actuarial valuation. The reduction in this proxy for risk free investment returns is likely to signal that the expectation for future investment returns has declined. This is not unexpected after period of overperformance.

Asset class performance covering growth, income and protection investments

21. There was a +1.3% outperformance in the quarter versus the blended benchmark return of 2.0%. This was largely as a result of the investments within

the growth portion of the Fund outperforming the benchmark by 1.6% with Central's global active equity outperforming in the quarter by +1.9%.

22. Over a longer one year timeframe which covers the 'rebound' from the mid March 2020 low the total Fund outperformed the benchmark by +2.4%. This was led again, broadly by assets within the growth bucket which outperformed by +1.6%. The effect of the Fund's currency hedge which is net long sterling has boosted returns as the values of the unhedged underlying investments have suffered when translated back into sterling. For example, an investment in a USD denominated fund will have suffered translation (to GBP) losses from March 2020 to March 2021 as sterling has appreciated versus the USD. This will have detracted from returns at individual investment level.

Growth assets

23. Over the quarter, the global equity markets were impacted by rising expectations of inflation which led to a significant increase in long-term US treasury yields (ie a drop in price), which lessened the appeal of certain growth stocks in the technology sector, which react to changes in interest rate expectations more than the value sector for example given the impact of rising rates on their future discounted cashflows. These growth stocks were the same that made great progress during the pandemic, capitalising on lockdown-imposed changes in consumer behaviour.
24. Growth assets comprise of passive and active equity managers, private equity and the three targeted return managers the Fund employs. The return over the year was 32.9% again coming off a low base at the end of March 2020.
25. Being overweight to equity has helped in the quarter and one year with positive returns on LGIM passive geographic funds and outperformance on the two out of three LGPS Central funds, the emerging market fund underperformed the benchmark over the quarter by 0.3%. All three Central funds are performing well over longer time frames and in line with the expectations of Central investment directors.
26. The low cost passive LGIM investments, where the Fund has nearly £900m invested has returned 3.8% in the quarter and since inception (December 2007) has returned 7.9% pa. All six geographic funds returned positive returns in the quarter with the North America fund returning 4.9% in the quarter and over 40% in the one year to March 31st 2021 having come off the pandemic induced lows from mid March 2020.
27. The three targeted return managers quarterly performance was positive versus a libor + 4% pa target. Aspect returned +4.7%, Ruffer +6.6% and Pictet +2.5%. Over 5 years, the annualised returns were -1.3%, +8.1% and +5.7% respectively, which is a combined +4.9% pa return. Overall a reasonable performance as a group versus the target return of +4.4% pa.
28. The target weight for this asset class is 7.5%. Post quarter end the Fund divested c£80m combined from the Pictet and Ruffer portfolios to part fund the Central MAC subscription, reduce the asset class weight closer to the 7.5% target which also reduces the overall overweight position to the growth class and rebalances the three managers with more equal amounts invested.

29. Of note is the 6.6% performance in the quarter from Ruffer who build an all weather portfolio with a defensive bias. 4.5% of the return derived from just 40% of the portfolio represented by equities which outperformed the market significantly due to the value/cyclical bias they hold. They have performed well over the longer term comfortably beating the benchmark return over 5 years.
30. Aspect's return is driven by their programmed methodology which makes trading decisions based on market signals their models interpret each day. The Fund now represents 52% of the total pooled fund, which although high doesn't warrant alarm given the very high liquidity. This metric will be kept under review. The returns per Portfolio Evaluation seem to be lower than those reported by the manager and will be clarified between now and the next quarters reporting.
31. Pictet's performance, although ahead of benchmark in the quarter by +1.5% was impacted by their exposure to developed markets government bonds. Their strategy averaged around 25% within fixed income and global government bonds, these markets were down by a combined over 6.5% in the quarter.
32. The Fund is invested in three LGPS Central equity funds, global equity, global emerging markets and the Climate balanced fund. The LGPS Central quarterly investment report which is included within this pack has details of all the Fund's Central investments including performance. The returns for the three funds are shown below including a comparison versus the benchmark over one year. Comparisons to benchmark to shorter timeframes are more volatile. The Fund has a longer term investment horizon and underlying active managers that are selected by Central have longer term benchmark targets to meet which are at least in excess of three years.

Fund	Qtr	1yr	1yr vs BM
Global equity	5.74%	47.89%	+8.31%
Global emerging equity	1.55%	41.07%	+0.29%
All world climate multi factor fund	3.14%	34.69%	+0.24%

33. The LGPS Global Equity fund is a multi-manager fund comprising three managers, Harris, Schroders and Union. Although a manager report is included in the pack a summary of the total fund holdings and styles of each of the managers is shown below. The fund has had a good quarter comfortably beating the benchmark by +1.9%.

Top Ten Holdings	(%)
ALPHABET INC CAPITAL STOCK USD0.001 CL A	2.79
MICROSOFT CORP COM	2.79
AMAZON COM INC COM	2.24
FACEBOOK INC COM USD0.000006 CL 'A'	1.67
JPMORGAN CHASE & CO COM	1.65
APPLE INC COM STK	1.62
TAIWAN SEMICON MAN TWD10	1.53
BANK OF AMERICA CORP	1.44
DAIMLER AG ORD NPV(REGD)	1.40
BAYER AG NPV (REGD)	1.32

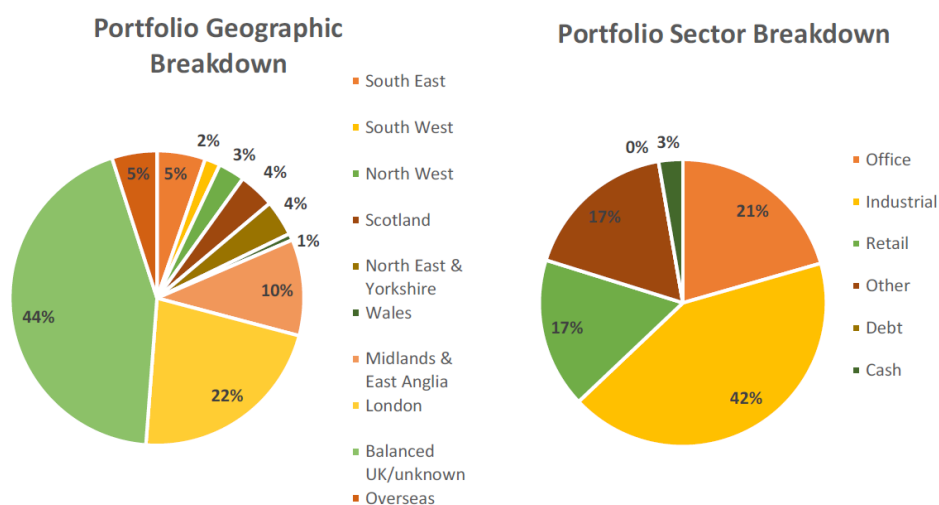
34. The Harris portfolio is biased towards value and volatility (market beta) companies and away from growth and quality styles. It contrasts well with the other two managers and has experienced a good quarter where value has outperformed growth.
35. The Schroders portfolio is biased towards growth and quality companies and away from value and volatility. Mega cap stocks dominate their portfolio and as such their top 3 stocks are the same as the total funds top three, Alphabet (Google's parent company), Microsoft and Amazon.
36. The Union portfolio is biased towards size and momentum factors and away from value, mega cap stocks also dominate their portfolio at just below 70% of total assets. As a result, the top three companies are the same as the Schroders portfolio. All three managers are active, and this is demonstrated by their conviction in companies weights that are different to their underlying benchmarks. Taken together all three managers have differing factor biases which is useful in constructing a portfolio. The similarity in the largest holdings at Schroder and Union is not large at the total level with no single holding representing more than 3% of the fund.
37. LGPS Central continue to meet regularly with the three managers to ensure the actions taken within portfolios are in line with the expectations Central had when the managers were appointed. Each manager had one meeting each in February, March and April of 2021. Central confirm all three managers continue to follow their investment processes and can show decision have been carefully considered.
38. The Fund's private equity investments are largely with Adams Street Partners (ASP) with whom the Fund has invested since 2002 and in over 30 separate funds. The net IRR since inception across all funds is 10.9% is USD and is boosted to 12.8% when translated into GBP. Recently the Fund has invested into the 2020 global funds vintage (Q4 2020) and the global secondaries fund (Q1 2021).
39. The Private Equity (PE) underperformance over shorter timeframes to benchmark is related to timing issues regarding valuations, once volatility has settled variations will become less pronounced. Private equity is a longer term investment into largely illiquid companies that are not traded on recognised exchanges, as such longer term valuations should be looked at alongside shorter term performance. Over three and five years the Fund's PE returns are favourable to the FTSE all world benchmark.
40. Officers have regular calls with ASP to understand the market, deal flow and where risks and opportunities lie in the managers opinion. The Fund currently has a full weighting to private equity but is mindful of the mature nature of the portfolio which translates into regular cash distributions to the Fund which need re committing.
41. With that in mind the Fund officers are keeping track of both, opportunities at LGPS Central and ASP and will bring any relevant proposals to the Pension Committee or ISC when appropriate.

Income Portfolio

42. This section of the portfolio now comprises of property, infrastructure and credit funds. The Fund has a number investments across each sub sector to get access to various areas and provide diversification. Within property, the Fund uses three managers giving access to pooled funds and direct property. Infrastructure has five managers again providing diverse exposure across open and closed funds as well a niche areas of the market including timber. Credit encompasses a wide range of funds including, emerging and developed market government and corporate bonds, private lending to business (private debt) and corporate investment grade debt. Within the credit asset class the Fund currently employs five managers.
43. Overall the income class saw a return of 0.9% in the quarter vs a benchmark return of 0.9%. Given the wide range of investments and exposures a summary of the main classes with commentary is included below.
44. Infrastructure, the blended return from the five managers is 0.4% in the quarter. Given the illiquid nature of many of the investments in this sector it is better to look at returns over a longer period of time. Over a one and three year timeframe the asset class has returned 0.5% and 5.7% pa vs a benchmark return of 4.1% and 4.5% pa.
45. The Funds single largest manager within infrastructure is Stafford who manage the timberland funds, the current valuation is £135m or 2.6% of total Fund assets. The Fund has invested in three vintages, the first two are fully drawn and the last 98% drawn at December 2020. The last fund, Stafford International Timberland (SIT) 8 had its final close in April 2018 and has started distributing and as at December 2020 has made eight distributions and returned 10% of paid in capital. The local currency (USD) net IRR since inception for this fund at December 2020 is 6.7%.
46. The remaining two funds, SIT 6 and 7, closed in 2012 and 2015 respectively. They are both distributing with since inception local currency net IRRs of 4.4% and 5.7%. Given the long term nature of the three funds we expect distributions to end for SIT 5, 6 and 7 in 2024, 2027 and 2030 respectively based on conversations with the fund managers.
47. Of the Fund's four other infrastructure managers, the next two largest comprise a combined £190m of the total £382m of infrastructure investments. IFM global infrastructure (IFM) is an open ended fund investing in core infrastructure which is valued at £107m at the quarter end. Fund returns over 1, 3 and 5 years are 2.8%, 9.6% pa and 12.7% pa respectively.
48. JPM infrastructure, the third largest holding is valued at £84m. This is also an open ended fund investing global core infrastructure. Given the underweight the Fund has in this asset class the ISC approved an investment to this Fund whilst Central developed their product which the Fund would also consider when it was available. That commitment was made in October 2020 but owing to the popularity of the JPM Fund the £25m commitment is yet to be called. Officers estimate that it should be called in the second half of 2021 and is largely dependent on the opportunities the manager is presented. Fund returns over 1 and 3 years are 12.7% and 6.7%.
49. The Fund employs three property managers, Aegon, Colliers and LaSalle, the blended return from the 3 managers is 1.6% in the quarter. Again, given the

illiquid nature of many of the investments in this sector it is better to look at returns over a longer period of time. Over a one and three year timeframe the Fund's investments have returned 1.4% and 1.9% pa vs a benchmark return of 2.7% and 2.8% pa. The longer term returns are under review with the Funds external provider where the Colliers three year return looks low. Officers will resolve this with Portfolio Evaluation by next quarter end.

50. The Fund is underweight to Property by 2.4% or c£120m and whilst it is awaiting Central to develop a suitable direct and indirect product officers have taken the decision to invest into suitable options as presented by Colliers and LaSalle. The most recent Colliers investment was in quarter 4 of 2020, an industrial warehouse at c£9m, LaSalle recently committed £13.5m into the M&G UK residential fund. Colliers are also under instruction to bring forward any relevant direct properties opportunities that may suit the Fund. Property returns were expected to be low in the near term based on discussions with the Fund advisor Hymans when the 2021 strategic allocation was being formulated and as such there is no rush to get back to target allocation whilst the future is uncertain.
51. A total property sector breakdown is provided below. The Fund has a 17% allocation to retail, where capital values will have been revised downwards over the last year. The benchmark position for retail is 22% which will have helped shield the Fund marginally over the last year. The Fund will have been supported by the overall larger industrial weight, 42% versus the MSCI benchmark of 38%.
52. Relatively small holdings individually in the Colliers pooled funds (£23m) and Kames Capital active value (£23m) have performed poorly over the year. The Colliers portfolio includes specific leisure funds that were severely impacted, in addition the Kames portfolio includes properties that are earmarked for active management, this model has been under pressure in a covid environment where restructuring of property is difficult and tenants are cautious when deciding to take on new leases. Post the quarter end the Fund served notice on the advisory agreement with Central regarding property. The advisory agreement for the three targeted return managers remains in place and will be reviewed later in the year as the Central targeted return product progresses towards launch.



53. The Fund also holds global credit within the income part of the portfolio. This is split between private debt and sub investment grade credit, with target weights of 10.5% and 4% respectively. Since the quarter end the Fund made a

commitment to the Central multi asset credit (MAC) fund for £200m (c4% of fund assets) which would satisfy the allocation in total for sub investment grade investments. This allocation was made in cash and the two selected managers built the target portfolios in line with the agreed mandate. It is too early to report on performance but officers have had calls with Central to understand transaction costs to build the two portfolios which has been estimated at 19.5 basis points, lower than the 40 basis points advised during the procurement phase.

54. The larger allocation to global credit comes from private debt at 10.5%. The Fund is currently underweight awaiting the outcome of due diligence on the Central offering as described earlier in this paper. A proposal is planned to be bought to the July ISC.
55. The Fund's managers in this space are Partners Group with whom the Fund has invested in four vintages of their multi asset credit funds (MAC) stretching back to 2014 and M&G who the Fund has invested with in three vintages of their distressed opportunities fund (DOF). Both managers work in different areas of the market with higher target returns and risk expected from the M&G offerings which total 1.4% of the total portfolio whilst Partners total 5.2% of the total portfolio.
56. The overall returns for the two managers are for the 1, 3 and 5 years are shown below alongside the benchmark (BM) return over 3 and 5 years.

Manager	1yr actual	3yr actual	5yr actual	Versus BM 3 yr	Versus BM 5 yr
Partners Group	+7.5%	+2.8%	+3.9%	-1.7%	-0.5%
M&G	-4.5%	-1.8%	+4.7%	-6.3%	+0.3%

The M&G returns as measured by internal rates of return (IRR) show that the two most recent vintages DOF 3 and DOF 4 have poor returns and as such have dragged the performance of the Fund's investment in the overall strategy down. Exposure to a number of sectors especially impacted by the pandemic is still ongoing given the European bias within DOF 3 and 4 funds. A number of sectors within both DOF 3 and DOF 4 have performed poorly, with real estate development, gaming and personal and household investments within DOF 3 having negative IRRs. Similarly, investments in real estate, gaming and retail have fared poorly within DOF 4.

57. The older DOF 2 vintage which has been in the distribution phase since June 2018 has a positive net IRR since inception of 5.3% in the funds base currency euros and is expected to realise the final investments by the middle of 2022. The return is disappointing considering the higher returns the Fund would expect from investing in distressed debt.

Protection portfolio

58. The Protection portion of the portfolio now contains the most defensive investments, namely, investment grade (IG) credit and inflation linked (IL) bonds. The Fund employs two managers for this exposure, Central for IG credit who in turn use two external active managers and Aegon (formally Kames) who the Fund

employ for IL bond exposure.

59. The allocations to both IG and IL bonds at the quarter end are 2.1% and 4.6% versus a target of 3.0% and 4.5%. Overall officers are comfortable with the allocation but may take the opportunity to 'top up' the IG credit allocation over the coming months to bring into line with benchmark.
60. The allocation to the IL bonds is a longer standing investment which has returned in line with the benchmark over longer timeframes, 3.55% pa over 3 years and 6.69% pa over 5 years. Over the quarter the returns were impacted by yields moving higher (and therefore prices moving lower) as economic forecasts surprised, with commentators quoting less slack in the economy and improved vaccine rollout.

Strategy	Q1 2021	YTD	Financial YTD	3 years	5 years
Index Linked	-6.23	-6.23	2.36	3.55	6.69
Benchmark /neutral	-6.35	-6.35	2.29	3.30	6.83
Geometric relative	0.13	0.13	0.08	0.24	-0.14

Performance based on mid-price valuations. Source: AAM UK as at 31 March 2021

61. The Fund has employed an active currency hedge with Aegon as the manager since quarter one of 2014. At quarter end officers were agreeing on the method and timing of moving the hedge from 50% of foreign currency exposure to 30% in line with the SAA agreed in January 2021. Post the quarter end the benchmark position was moved to 30% by the investment manager after consultation between officers and Aegon.
62. Officers meet with the manager on a regular basis to understand the changes made to the active programme and have view of which currencies are hedged differently to the benchmark position of 30%. At the time of writing the hedging programme is about 5% long sterling versus the benchmark position, meaning that Aegon, on balance expect to the Pound to gain in value.

Recommendation

63. 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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