

LOCAL PENSION COMMITTEE – 10th SEPTEMBER 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 30th June 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. Two asset classes show double digit returns over a 20 year time frame, property and high yield; there were three as at last quarter with gold dropping out this quarter with a slightly lower than 10% return over 20 years. Private Equity and Infrastructure have no 20 year source information available. The one year numbers still 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	7.39	39.84	15.08	15.17	10.48	7.42
PRIVATE EQUITY	12.62	41.40	16.57	17.47	13.41	#N/A N/A
PROPERTY	11.97	32.90	12.05	8.14	10.30	10.49
INFRASTRUCTURE	2.26	23.09	5.52	6.17	6.19	#N/A N/A
HIGH YIELD	1.75	12.95	6.33	7.01	8.37	10.37
UK GILTS	1.78	-6.47	3.29	2.16	4.96	5.32
UK INDEX-LINKED	3.58	-3.96	4.97	4.68	7.29	7.03
GOLD	3.28	-10.90	10.49	5.20	3.19	9.97

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 within Appendix B. Central's 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 Asia Pac Equities ▼	GEM Equities ▼ Private Equity ▼ EU Equities ▼	Commodities Japan Equities UK Equities	
INCOME ASSETS		HY Credit ▼	Property	EM Debt ▼ Infrastructure ▼	
STABILISING ASSETS		JP Bonds Index-Linked US Bonds EU Bonds ▲	UK Bonds ▲ IG Bonds ▲	Gold ▲	
INVESTMENT STYLES		Growth Quality/ESG	Low Volatility	Value Size Momentum ▲	
CURRENCIES		US Dollar	Euro	GBP, Yen	

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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 – EU and emerging equity moved down one notch to neutral, Asia Pacific equities moved down one notch to underweight. Central note that the high valuations prevent them from moving growth assets overweight.
- Income assets – Emerging Market debt, infrastructure and high yield credit downgraded, with high yield credit downgraded two notches to underweight.
- Stabilising assets – gold moved to overweight from underweight last quarter. All other classes are either neutral or underweight.
- Investment styles – Size and momentum have been upgraded this quarter to overweight.

Portfolio changes in the quarter (April to June 2021)

- The Fund invested £200m in the LGPS Central Global Active Multi Asset Credit (MAC) fund. This was funded by a combination of sales from the targeted return managers (Pictet and Ruffer), use of excess collateral at Aegon for the currency hedge and cash holdings. 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 awaits a suitable LGPS Central product to transition to.

6. 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.
7. The Fund had a requirement to invest specifically within the private rented sector. 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 private rented sector.
8. The Fund also instructed LaSalle to invest a further £35m to close the gap to the benchmark allocation. LaSalle aim to deploy this additional amount over the rest of 2021 but is dependent on opportunities available and their internal investment approvals process. Whilst an indirect property fund is not available at Central this allocation allows the Fund to close the gap to the target allocation whilst maintaining an interest in a potential Central Fund.

Portfolio changes since the quarter ended

9. At the July Investment Subcommittee two investments were approved. A paper detailing these approvals appears elsewhere on today's agenda. In summary proposals for a £160m investment to private debt and a £70m investment to infrastructure were approved by the Subcommittee. The investments will take time to be called and as such the Fund would not be required to divest assets in order to invest.

Cash at quarter end

10. At quarter end the cash held by the Fund totalled £280m, this includes £71m cash held as collateral with Aegon for the currency hedge. As at the end of June this balance had reduced to £220m. A paper detailing the uses of the cash to the end of 2021 was taken to the July Investment Subcommittee. In summary officers calculate the cash balance should materially reduce by the end of 2021. It is worth noting that the collateral held for the currency hedge moves in accordance to the level of hedging employed by Aegon. When the Pound strengthens versus hedged currencies the amount of collateral will increase.
11. The Fund is cash flow positive as a consequence of paying less in pension benefits 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.
12. Given the volatility in markets over the last 18 months it makes sense to hold some additional cash for the currency hedge in the event currency markets move unexpectedly which may require additional collateral. However, the requirement to hold as much cash as the Fund did has now reduced given the benchmark hedge position is 30% of foreign currency assets. This was as a result of the decision taken in January 2021 to reduce the benchmark hedge from 50% of foreign currency assets, a change which was actioned in mid April 2021.

2021 investment plans

13. 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	

14. Changes to the Fund that officers are considering:

- 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 PE manager, Adam Street Partners. A paper is due to be taken to Investment Subcommittee later in the year for a potential investment in the LGPS Central 2021 PE vintage.
- Targeted return – officers and the investment consultant are working with LGPS Central to build a product alongside one other partner fund. The product is now likely to be available in early 2022.
- Infrastructure – the Fund has an outstanding commitment to an existing manager made in 2020. It is likely to be called by the end of 2021. It also may invest, pending due diligence, within the LGPS Central infrastructure value add/opportunistic fund once manager selection has progressed. Owing to the specialist nature of this area, infrastructure manager selection is deemed to be a more important factor when deciding to invest. The Fund will await further information to see which managers are selected before deciding to commence due diligence.
- Global credit private debt high return sleeve – Central have developed a product that may suit the Fund. The Fund currently has investments in this higher returning space with M&G. The Fund also has an investment in a bank risk transfer investment product that also targets a similar return to the Central product and sits alongside private debt within the income bucket of the overall portfolio. This product is returning money at present and a new vintage of the

product is currently available for investment. Officers propose to bring a paper later in the year that combines the collective products fit with the Fund's strategy.

- e. Property – Central are in process of launching a direct property fund. The Fund is currently underweight within this sector. Whilst the timeline is unclear on a launch date officers have instructed Colliers to continue to 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. LaSalle, the Funds existing indirect investment manager have also been instructed to invest in appropriate funds to help close the gap to target weight.

Overall Investment Performance

15. A comprehensive performance analysis over the quarter, year and three-year period to 31st June 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.
16. Officers requested the movement of the currency hedge be applied to the total portfolio, previously this calculation only applied to the equity portion of the portfolio. This is a more accurate reflection, given that the hedge applies to all unhedged foreign currency positions throughout the portfolio. The Fund now reports the total portfolio including and excluding the effect of the hedge.
17. 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.
18. Summarised returns for the whole Fund versus benchmark is shown below:

	Quarter	1 yr	3 yr	5yr
Total Fund	+4.8%	+17.8%	+7.1%	+7.8%
Vs benchmark	+0.4%	+3.0%	0.0%	+0.7%

- a. The Fund's total value as at the quarter end is £5.4 billion. At 31st March 2019, the triennial valuation date, the Fund had assets valued at £4.3 billion and was 89% funded. The Fund has requested a mid valuation funding position from the Fund's actuary which is included elsewhere on today's agenda. Hymans, the Fund's Actuary, summarise that the mid-valuation exercise is designed as a check for the Fund to assess progress made in reducing the deficit. It also indicates if there is any need to adjust investment and employer contribution plans. The results at the 31 March 2021 indicate there is no corrective action required by the Fund or the employers.
- b. The key assumption relevant to this paper is the investment returns. At the 2019 valuation investment returns of 4.5% were targeted, alongside increased employer contributions, to bring the Fund into a fully funded position. Strong investment returns since March 2019 has increased the likelihood of the Fund's assets achieving this level of return from 70% to 80%. Although the risk remains

that investment returns may not be as favourable by the next valuation date, March 2022.

Asset class performance covering growth, income and protection investments

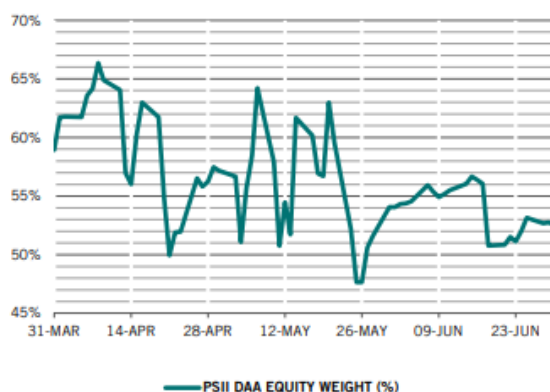
19. There was a +0.4% outperformance in the quarter versus the blended benchmark return of 4.4%. This was largely as a result of the investments within the income portion of the Fund outperforming the market benchmark by +0.5%.
20. Over a longer one year timeframe the total Fund outperformed the market benchmark by +3.0%. This was led by assets within the growth allocation which outperformed by +3.7% with small underperformance to benchmark from the income and protection assets.

Growth assets

21. 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 24.9% and is coming off the low point from one year ago. Over the next few quarters this positive one year performance will become harder to achieve as last year comparatives improve.
22. Global equities made further gains during the second quarter, as economies continued to reopen, monetary policy in most regions remained accommodative and economic data points – in many instances – pointed to a faster-than-expected recovery. Investors spent the quarter weighing such positives against the spread of the more contagious COVID- 19 Delta variant and increasing inflationary pressures.
23. Although the reopening trade, favouring value stocks continued apace, there was more nuance to the winners and losers during the second quarter, as inflation expectations eased. The US Federal Reserve was clear that it expects inflation to be transitory, allowing stocks in the information-technology sector to climb from recent lows as long-term treasury yields became more range bound following large increases in the first quarter. The fund's equity holdings in tech heavy mandates provided a good return as a result in the quarter. The L&G North America passive fund and the Central Climate balanced fund returned 8.7% and 7.5% respectively in the quarter. Together these two funds account for nearly 22% of the total Fund value as at the quarter end and.
24. Being overweight to equity has again helped in the quarter and one year with positive returns on all but one LGIM passive geographic fund and LGPS Central funds. The LGPS Central emerging market fund underperformed the benchmark by 1.7% in the quarter and by 1.0% over the last year. All three Central funds are performing well over longer time frames and in line with the expectations of Central investment directors. At the end of the quarter growth assets are overweight to benchmark allocation by 5.35%. Officers will address this overweight over the next year as a result of the annual strategic allocation review and as cash is required to fund the underweight areas of the portfolio as it is needed by the investment managers.
25. The low cost passive LGIM investments, where the Fund now has c£940m invested across a range of geographies (c17% of Fund assets) has returned 6.6% in the quarter (+3.8% last quarter) and since inception (December 2007)

has returned 8.3% per annum. The Fund pays a low management fee for this mandate with no performance fees. Having divested the two RAFI funds last year this has further reduced the management fee.

26. The three targeted return managers quarterly performance was positive versus a libor + 4% per annum target. Aspect returned +2.2%, Ruffer -0.1% and Pictet +3.1%. Over a longer time frame of 5 years, the annualised returns were +0.5%, +7.4% and +5.2% respectively, which is a combined +4.6% pa return and ahead of the 5 year benchmark return of +4.4%. Overall a reasonable performance as a group versus the target benchmark return.
27. The target weight for this asset class is 7.5%. During the quarter 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.
28. Of note is the performance of both Pictet and Ruffer who over longer time frames of three, five and since inception have produced returns in excess of the benchmark.
29. 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 51% of the total pooled fund (52% last quarter) which although high does not warrant alarm given the very high liquidity. The decrease was due to additional investments from existing investors. This metric will be kept under review.
30. Pictet's investment is based around identification of asset classes that are undervalued and the building of a portfolio that looks to exploit these opportunities in a risk-aware manner. The process leads to variable positions in equities, bonds, currencies, commodities etc. There is evidence of meaningful changes over time and that relatively short-term views are factored in. This is a dynamic product and Pictet do not take a long-term buy-and-hold approach to asset allocation, although this does not preclude exposure to certain assets being held for a considerable length of time. The dynamic nature of their equity holdings is evidenced by their in quarterly equity weighting (see below) which fluctuated during quarter between 60% at 1st April to as low as 47% in late May.



31. The divestment in the quarter attributed to the decrease of the Fund's percentage of the total pooled fund falling to 21% from 25% at the beginning of the quarter. The level of ownership is low and risk is reduced by the broad make up of the investor base.
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 Benchmark
Global Equity	6.9%	30.7%	+5.6%
Global Emerging Equity	3.4%	23.4%	-1.0%
All World Climate Multi Factor	7.5%	22.2%	+0.24%

33. The LGPS Global Equity fund is a multi-manager fund comprising three managers, Harris, Schrodgers 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 returning +2.9% but underperformed the benchmark by 1.1%. Over one year the fund has comfortably beaten the benchmark by +5.6%. Since inception the outperformance is less pronounced at +0.7%. The top 10 holdings are largely unchanged and have a North America bias which represents c60% of fund assets by regional allocation.

Top Ten Holdings	(%)
ALPHABET INC CAPITAL STOCK USD0.001 CL A	3.09
MICROSOFT CORP COM	3.03
AMAZON COM INC COM	2.33
FACEBOOK INC COM USD0.000006 CL 'A'	1.85
BANK OF AMERICA CORP	1.44
DAIMLER AG ORD NPV(REGD)	1.32
TAIWAN SEMICON MAN TWD10	1.27
VISA INC COM CL A STK	1.23
BAYER AG NPV (REGD)	1.20
BERKSHIRE HATHAWAY INC-CL B	1.20

34. The Harris portfolio remains biased towards value and volatility (market beta) and has a high active share meaning that the portfolio is currently weighted materially different to the benchmark and as a result can materially under or overperform the benchmark return. From a risk reward perspective Harris note that the portfolio trades at 67% of intrinsic value as calculated by their in house teams and therefore provides a good risk reward. Harris is well diversified to the other two managers and has delivered a +6.2% return vs a benchmark return of +7.3%.
35. The Schroders portfolio is biased towards quality and growth and away from value and volatility companies and this is evidenced in the overweight position within consumer discretionary stocks (goods and services that are considered non-essential by consumers). Mega cap stocks dominate their portfolio (over 70%) and as such their top 3 stocks are the same as the total funds top three, Alphabet (Google's parent company), Microsoft and Amazon. The quarters performance was in line with the benchmark and is ahead of benchmark from inception to date.
36. The Union portfolio is still biased towards 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. The quarter's performance is slightly below benchmark and in line with benchmark from inception to date.
37. 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.
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 11.4% is USD and is boosted to 13.3% 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. Private Equity (PE) is a long term investment into largely illiquid companies and as such shorter timeframes are less relevant in understanding performance. Underperformance over shorter timeframes to benchmark can be related to timing issues regarding valuations or immature funds with few underlying investments swaying overall valuations. 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, volume of transactions (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 recommitting.

Income Portfolio

41. 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 timberland. 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.

42. Overall the income class saw a return of 2.5% 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.
43. Infrastructure, the blended return from the five managers is +2.2% in the quarter. Given the illiquid nature and valuation cycles 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 -0.2% and +5.6% pa vs a benchmark return of 4.0% and 4.4% pa.
44. The Funds single largest manager within infrastructure is Stafford who manage the timberland funds, the current valuation is £134m or 2.5% of total Fund assets. The Fund has invested in three vintages, the first two are fully drawn and the last 98% drawn at March 2021. 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 11 distributions and returned 10.5% of paid in capital.
45. 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 4.9% and 5.5%. 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.
46. Of the Fund's four other infrastructure managers, the next two largest comprise a combined £196m of the total £384m of infrastructure investments. IFM global infrastructure (IFM) is an open ended fund investing in core infrastructure which is valued at £114m at the quarter end. Fund returns over 1, 3 and 5 years are 7.8%, 10.4% pa and 12.2% pa respectively.
47. JPM infrastructure, the other open ended fund also investing in core global infrastructure is the third largest holding and is valued at £82m. Given the underweight the Fund has in this asset class the Investment Subcommittee approved an investment to this Fund in 2020 whilst Central developed their infrastructure product which the July 2021 Subcommittee approved an £70m investment for. The JPM 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 with to invest into. Fund returns over 1 and 3 years are 10.2% and 7.3%.
48. The Fund employs three property managers, Aegon, Colliers and LaSalle, the blended return from the 3 managers is +3.0% 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 +6.2% and +3.5% pa vs a benchmark return of +9.1% and 3.4% pa.

49. As previously mentioned the Fund is underweight to Property. At the quarter end this amounted to by 2.4% or c£140m and whilst it is awaiting Central to develop a suitable direct and indirect product further investments have been made with LaSalle. 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 was no rush to get back to target allocation whilst the future was uncertain. Since then the market has somewhat stabilised and as such some money has been committed. Central is still in the process of working up their direct property offer which will be considered when available.
50. As part of the annual strategic asset allocation review, officers and the Fund's advisor will look into the best way to manage a multi manager property portfolio with direct and indirect holdings alongside Central.
51. Relatively small holdings individually in the Colliers pooled funds (£23m) and Kames Capital active value (£69m) 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. During the quarter 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. At present the targeted return product is due to be available for investment in early 2022.
52. 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. During 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 given the inception date of April 2021 but at 30th June 2021 the since inception performance was +0.96%. Both underlying managers have built their portfolios from cash transfers of £340m to each manager. The target for the fund is to outperform the benchmark (3 month GBP SONIA) by 4.0% pa net of costs over rolling three year periods.
53. The larger allocation to global credit comes from private debt at 10.5%. The Fund is currently underweight but has made some progress to closing the underweight with a £160m GBP commitment made using both Partners Group and LGPS Central's low return 2021 vintage. This money will take some time to be fully called whilst the original investments made with Partners Group continue to distribute money.
54. Partners Group with whom the Fund has invested in four vintages of their multi asset credit funds (MAC) and soon to be five vintages when MAC 6 makes its first call stretch back to 2014. The fund also has investments with M&G and has invested in three vintages of their distressed opportunities fund (DOF). Both managers work in different areas of the market with higher target returns expected from the M&G offerings to reflect the significantly higher risk incurred.

M&G total 1.3% of the total portfolio whilst Partners total 4.5% of the total portfolio.

55. 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.

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 and retail have fared poorly within DOF 4.

MANAGER	1YR ACTUAL	3YR ACTUAL	5YR ACTUAL	VERSUS BM 3 YR	VERSUS BM 5 YR
PARTNERS GROUP	+7.7%	+3.5%	+4.3%	-0.9%	-0.1%
M&G	+1.1%	-4.3%	+1.8%	-8.7%	-2.6%

56. 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

57. 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 and the short dated investment grade bond fund.
58. The allocations to both IG and IL bonds at the quarter end are 2.5% and 4.5% versus a target of 3.0% and 4.5%. Officers will top up the allocation to liquid investments such as investment grade credit, multi asset credit and emerging market debt in the coming months from existing cash resources to move closer to the target strategic asset allocation.

59. The allocation to the IL bonds is a long standing investment which has returned

Strategy	Q2 2021	YTD	Financial YTD	3 years	5 years
Index Linked	3.43	-3.02	3.43	5.05	4.76
Benchmark /neutral	3.58	-2.99	3.58	4.87	4.92
Geometric relative	-0.15	-0.02	-0.15	0.18	-0.15

in line with the benchmark over longer timeframes, +5.3% pa over 3 years and +5.4% pa over 5 years. Over the quarter the returns were positive due to a number of factors including surprise UK GDP numbers which caused the Bank of England to upgrade their inflation outlook as well as an increase in liability driven investment into a market that was reluctant to sell longer dated bonds.

60. The Fund has employed an active currency hedge with Aegon as the manager since quarter one of 2014. The benchmark hedge position was moved to 30% by the investment manager after consultation between officers and Aegon earlier this year. At quarter end there is £71m of cash collateral.

61. 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%.

Recommendation

62. 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.

Officers to Contact

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