



LOCAL PENSION COMMITTEE – 26th NOVEMBER 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 September 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 still show double digit returns over a 20 year time frame, property and high yield; there were three a couple of quarter ago with gold dropping out 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.

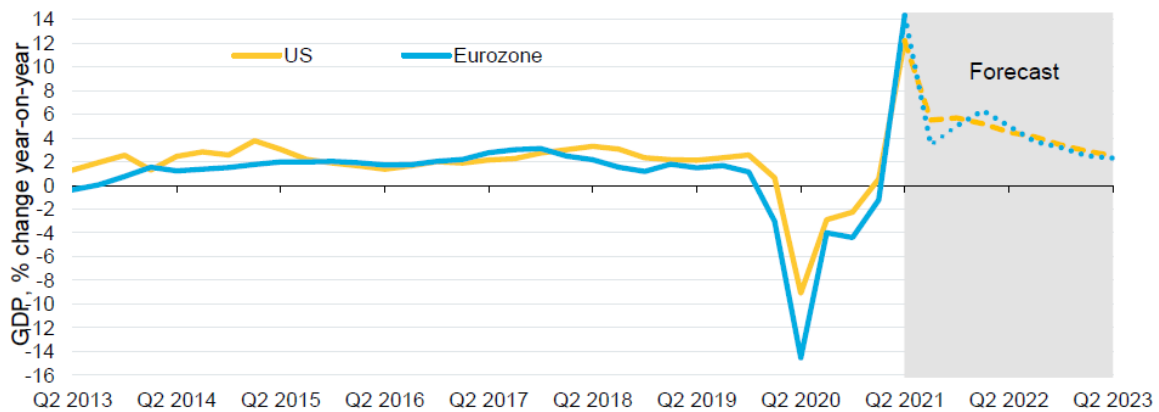
	3 MONTHS*	ONE YEAR	THREE YEARS	FIVE YEARS	TEN YEARS	TWENTY YEARS
GLOBAL EQUITIES	-0.9%	28.0%	13.1%	13.7%	12.5%	8.3%
PRIVATE EQUITY	7.3%	53.3%	16.8%	16.4%	17.3%	N/A
PROPERTY	0.3%	31.6%	11.9%	8.5%	12.1%	10.6%
INFRASTRUCTURE	1.4%	22.9%	6.6%	5.9%	7.8%	N/A
HIGH YIELD	1.0%	11.0%	6.2%	5.9%	9.8%	11.0%
UK GILTS	-1.9%	-7.0%	3.2%	1.3%	3.9%	5.0%
UK INDEX-LINKED	2.3%	0.5%	6.2%	3.2%	6.8%	7.1%
GOLD	1.9%	-10.6%	12.6%	5.2%	2.3%	9.9%

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

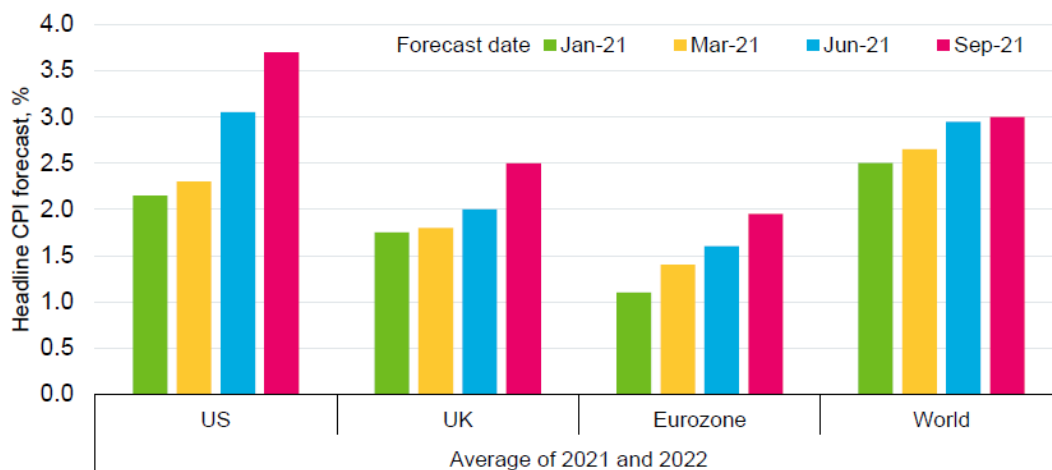
Capital Markets Update – Hymans Autumn 2021

3. A markets update is included for the first time from Hymans Robertson, the Funds Investment Advisor and is included as Appendix B. Some highlights are included below.
4. Growth has been slowing as the positive impact of economies re-opening late last year fades. Global composite purchasing managers' indices (PMI) fell for the fourth consecutive month in September, after a high in May. Consumer sentiment surveys have also weakened in recent months. Manufacturing PMIs remain at a level indicative of expansion, with the new orders component still very strong, but global industrial production has been lacklustre in the first half of 2021, highlighting supply chain and

transportation issues. Hymans see growth as defined by year on year GDP growth slowing but to remain positive in both the US and Eurozone over the next year as illustrated below.



- Hymans refer to the delta variant that may hinder but not derail recovery in the major advanced economies, as rising vaccination rates reduce the likelihood of stringent restrictions. However, new strains or outbreaks of coronavirus in those countries that have lower vaccination rates or adopt zero-tolerance approaches to the spread of infection, are a risk to both global demand and supply. Supply shortages and transport-related bottlenecks are extreme, and many of these issues appear to be deteriorating, highlighting the risk that disruptions are not as transient as forecasters have assumed.
- They also point out inflation continues to exceed expectations, and this year's upward revision of forecasts has been extended (see below). Most forecasters still think that current inflationary pressures will fade, but some have started to question just how temporary current price pressures are. In the UK, where both headline and core CPI inflation rose above 3% in August, anecdotal evidence of labour shortages abounds, vacancies are at all-time highs, payrolls have returned to pre-pandemic levels and the trend in underlying wage growth is increasingly positive. US inflation has recently hit a 30 year high with a 6.2% year on year increase as at October 2021.



- The effect of growth and higher inflation has resulted in indications from Central banks that interest rates may need a little faster than previously thought. Rising interest rates has effects across all asset classes with some (such as growth equities) disproportionately affected as future higher cash flows (common for companies that are expected to make larger profits in the future) are discounted at a higher rates which then equates to lower stock prices all other things being equal.

8. They conclude with, economic momentum may have eased, but the global economy is forecast to grow at a healthy pace. Concerns about coronavirus have diminished, but supply-side risks and China's economic slowdown have intensified. Though central banks are adopting a slightly less accommodative stance, financial conditions are easy and negative real yields are expected to persist for some time. However, even a moderate rise in real yields could pose a challenge, with an obvious potential trigger being interest rate increases in response to persistence in current inflationary pressures.

Portfolio changes in the quarter (July to September 2021)

9. The Fund topped up two LGPS Central investments which were underweight to the Strategic Asset Allocation benchmark approved in January 2021. The Fund invested £20m into the Emerging Market Debt fund and £27m into the Investment Grade corporate bond fund.
10. The Fund also had its first call into the Partners Multi Asset Credit 6 fund. This investment attempts to address the underweight to income asset class. The total commitment is for £60m and is expected to be fully called in the coming months.
11. The Fund instructed LaSalle to invest £35m to close the gap to the benchmark allocation in the April to June quarter. LaSalle aim to deploy this additional amount over the rest of 2021 and the latest estimation suggests they will deploy this into a number of funds pending their internal investment approvals process. Whilst an indirect property fund is not available at Central this commitment 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

12. At the October Investment Subcommittee three investments were approved. A paper detailing these approvals appears elsewhere on today's agenda. In summary proposals for £30m of investment to private equity and £112m into private debt split between two managers 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.
13. Other than rebalancing to already approved investments there are no further planned investments proposals planned for approval in 2022.

Cash at quarter end

14. At quarter end the cash held by the Fund totalled £203m, with an additional £60m cash held as collateral with Aegon for the currency hedge. As at the time of writing the £203m balance has reduced to £186m. Officers calculate the cash balance should materially reduce in the coming months as cash is called by the managers for commitments that have been made.
15. It is worth noting that the collateral held for the currency hedge moves in accordance to the level of hedging and performance by Aegon. When the Pound strengthens versus hedged currencies the amount of collateral will increase and conversely when the pound weakens versus hedged currencies the amount of collateral reduces. The level of change in hedge collateral is impacted by the currencies hedged and level of

hedge, either partial or full. Officers are in regular contact with Aegon to understand the current level of hedge and their rationale for the stated positions.

16. 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.
17. 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

18. 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- <u>inv</u> 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	

19. Outstanding changes to the Fund that officers are considering:

- a. 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. This product has been delayed owing to the due diligence work that is ongoing by Central.
- b. Infrastructure – Pending due diligence the Fund may invest in 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.

Property – Central are in process of launching a direct property fund with an external manager having been selected in the last quarter. The Fund is currently underweight within this sector. Colliers still have instructions to search for direct property opportunities that are a good fit for the existing portfolio given the underweight position. Pricing for the most sought after sectors continues to be expensive as described by Colliers. Money has flowed towards sectors like warehousing and supermarkets where income streams are more secure and have benefited from structural tailwinds.

Overall Investment Performance

20. A comprehensive performance analysis over the quarter, year and three-year period to 30th September 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.
21. This year, 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.
22. 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.
23. Summarised returns for the whole Fund versus benchmark is shown below:

	Quarter	1 yr	3 yr	5yr
Total Fund	+2.4%	+18.4%	+7.8%	+8.3%
vs benchmark	+1.0%	+4.6%	+0.3%	+0.7%

- a. The Fund's total value as at the quarter end is £5.5 billion. At 31st March 2019, the triennial valuation date, the Fund had assets valued at £4.3 billion.
- b. The Fund has experienced strong returns in an absolute sense with positive returns across all time frames alongside favourable returns versus the benchmark. It is important to note that investment returns can be negative and for a protracted period of time. One of the objectives of the annual strategic asset allocation (SAA) exercise is to understand the risks and opportunities to the Fund over a longer period of time and as such the portfolio has a diverse mix of assets including a number of investments within the 'protection' category that should provide a cushion in the event of market shocks.

Asset class performance covering growth, income and protection investments

24. The +1.0% outperformance in the quarter versus the blended benchmark was largely as a result of the investments within the growth and income portions of the Fund outperforming the market benchmark by +1.7% and +0.8% respectively.
25. Over a longer one-year timeframe the total Fund outperformed the market benchmark by +4.6%. This was led by 'growth' assets which outperformed by

+6.1% with small underperformance to benchmark from the protection assets at -0.2% versus their benchmark.

Growth assets

26. 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 25.3% and is coming off low points from about a year ago. Over the next few quarters this positive one-year performance may become harder to achieve as last year comparatives improve.
27. Global equity markets delivered a mixed performance during the third quarter of 2021. Developed markets drifted sideways, with declines in September undoing most of the gains in the previous two months. Emerging markets followed a similar pattern but ended the quarter in negative territory as a result of China weighing on returns. Overall global equities benefited, 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.
28. There were mixed returns in the quarter from the Funds equity investments, with two passive and one active investment returning negative returns in the quarter, namely the LGIM pacific excluding Japan and LGIM emerging markets investments and the LGPS Central active global emerging markets fund. It is to be expected that over short time frames investment returns can vary between funds, sectors and geographies. Both the LGPS Central global equities investment and targeted return investments returned +2.7% and +2.6% respectively which were in excess of the benchmark for the quarter. LGPS Central's active equities investment director will be presenting at today's Committee and will cover performance for both active equity funds alongside responsible investing and wider market commentary.
29. The majority of the outperformance this quarter within growth assets has come from the private equity investments which are measured versus a FTSE all world benchmark. The benchmark returned +1.5% in the quarter, however the holdings at Adam Street Partners, where the majority of the Funds private equity investments reside returned +13.3% in quarter owing to a number of underlying holdings performing well and valuations being revised accordingly. The outperformance of +11.9% to the benchmark returns largely explains the outperformance within the growth asset class.
30. At the end of the quarter growth assets are overweight to benchmark allocation by 5.65%, a similar position to last quarter. Investment returns for growth assets have been positive versus benchmark and other asset classes generally and as such it has benefited the Fund. There are few good options to reduce this position in the short term. The annual strategic asset allocation review will attempt to place upper and lower limits on asset allocations after which reallocation should be performed. This can be a tricky area to address with respect to reallocation given the number of permutations between various asset classes and a mix of public and private investments that have differing liquidity and queuing requirements which need to be taken into account.
31. The low cost passive LGIM investments, where the Fund now has c£950m

invested across a range of geographies (c17% of Fund assets) has returned +1.3% in the quarter (+6.6% last quarter) and since inception (December 2007) has returned 12.3% per annum. The Fund pays a low management fee for this mandate with no performance fees.

32. The three targeted return managers quarterly performance was positive versus a libor + 4% per annum target. Aspect returned +7.2%, Ruffer +0.5% and Pictet +0.2%. Over a longer time frame of 5 years, the annualised returns were +2.2%, +6.4% and +4.2% respectively, which is a combined +4.5% pa return and marginally ahead of the 5 year benchmark return of +4.4%. Overall a reasonable performance as a group versus the target benchmark return.
33. The target weight for this asset class is 7.5%. During the year the Fund divested c£80m combined from the Pictet and Ruffer portfolios to part fund the Central MAC subscription and to reduce the asset class weight closer to the 7.5% SAA target which also reduces the overall overweight position to the growth class and rebalances the three managers with more equal amounts invested.
34. 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	+2.7%	+21.6%	+6.1%
Global Emerging Equity	-4.2%	+13.3%	-0.7%
All World Climate Multi Factor	+2.2%	+19.4%	+0.3%

35. The LGPS Global Equity fund is a multi-manager fund comprising three managers, Harris, Schroders and Union. An exempt manager report is included within the agenda with a summary of the total funds largest holdings shown below. The fund has had a good quarter returning +2.7% and outperformed the benchmark by +1.2%. The top 10 holdings are largely unchanged and have a North America bias which represents c60% of fund assets by regional allocation.

36. 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 12.0% in USD and is boosted to 13.8% when translated into GBP. Recently the Fund has invested into the 2020 ASP global funds vintage (Q4 2020) and the ASP global secondaries fund (Q1 2021). At the last ISC (Oct 2021) a £30m commitment was approved to the LGPS Central 2021 PE vintage.
37. 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 with returns of +10.2% and +5.6% ahead of benchmark respectively.

Income Portfolio

38. This section of the portfolio comprises property, infrastructure and credit (debt) funds. The Fund has a number of investments across each sub sector to get access to various areas and provide diversification. 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.
39. Overall the income class saw a return of +2.7% in the quarter vs a benchmark return of +2.0%. Given the wide range of investments and exposures a summary of the main classes with commentary is included below.
40. Infrastructure, the blended return from the five managers is +4.8% 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 +6.3% and +6.3% pa vs a benchmark return of 3.9% and 4.3% pa.
41. The Funds single largest manager within infrastructure is Stafford who manage the timberland funds, the current valuation is £139m or 2.5% of total Fund assets. The Fund has invested in three vintages, the last fund, Stafford International Timberland (SIT) 8 had its final close in April 2018 and has started distributing and as at June 2021 has made 12 distributions and returned c14% of paid in capital.
- The remaining two funds, SIT 6 and 7, closed in 2012 and 2015 respectively. Given the long term nature of the three funds it is expected that distributions are due to end for SIT 5, 6 and 7 in 2024, 2027 and 2030 respectively based on conversations with the fund managers.
42. Of the Fund's four other infrastructure managers, the next two largest comprise a combined £203m of the total £409m of infrastructure investments. IFM global infrastructure (IFM) is an open ended fund investing in core infrastructure which is valued at £122m at the quarter end. Fund returns over 1, 3 and 5 years are 15.5%, 9.8% pa and 12.6% pa respectively. These returns are ahead of benchmark returns.

43. 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 has now been called in October 2021. Fund returns over 1, 3 and 5 years are 6.8%, 8.1% and 6.9%. These returns are ahead of benchmark returns.
44. The Fund employs three property managers, Aegon, Colliers and LaSalle, the blended return from the 3 managers is +3.4% 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 1, 3 and 5 year timeframe the Fund's investments have returned 9.2%, 4.2% and 6.9% pa. The one and three year returns are below the benchmark returns of 13.7% and 4.4%, with an outperformance over the 5 year benchmark return of 6.6%.
45. As part of the annual strategic asset allocation review, officers and the Fund's advisor, Hymans will look into the best way to manage a multi manager property portfolio with direct and indirect holdings alongside any Central property offering.
46. 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. The Fund is currently underweight by c£200m or 3.6% for Private Debt but has made progress to closing the underweight with a £220m GBP combined commitment made using the Partners Group MAC 6 product as described earlier, LGPS Central's low return 2021 vintage and LGPS Central's high 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.

Protection portfolio

47. The Protection portion of the portfolio contains the most defensive investments, namely, investment grade (IG) credit, short dated investment grade (SDIG) corporate bonds 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 who the Fund employ for IL bond exposure and the SDIG bond fund.
48. The allocations to the protection asset class are in line with benchmark, 7.4% vs a 7.5% target, a small top up to the IG fund was made earlier in the year. Returns over most timeframes are in line with the combined benchmark for this asset class.
49. 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. Officers have regular contact with the manager to understand the level of hedge in place. At quarter end there is £60m of cash collateral.

Recommendation

The Local Pension Committee is asked to note the report.

Appendices

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

Appendix B – Hymans – Capital markets Autumn 2021

Equality and Human Rights Implications

None.

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