

Index-Linked Portfolio

Leicestershire County Council Pension Fund

James Lynch, Investment Manager

Jordan Irvine, Client Director

26 July 2023



*Beyond
borders™*

Overview of our relationship

Mandate	AUM	Objective
Index-linked gilts	£223.8m	<ul style="list-style-type: none">• Provide modest outperformance relative to FTSE UK Index-Linked All Stocks index• A segregated solution
Short-dated credit	£57.0m	<ul style="list-style-type: none">• Investment in global short-dated investment grade bonds• Generate steady cash stream due to high frequency of maturing bonds• Climate transition overlay supports journey to net zero
FX overlay*	On £1.9bn of overseas equity exposure	<ul style="list-style-type: none">• Overarching aim is to protect capital and generate an excess return• Strategic target is to hedge 30% of the overseas equity exposure• Responsible for all aspects of implementation including execution and collateral management

As at 31 May 2023. *As at 30 November 2022.

Responsible investment at a glance

£96 billion invested in responsible investment solutions

Responsible investment approach

- **ESG integration** into bottom-up credit, equities, sovereign and structured research
- **Active ownership** to generate long-term economic value
- **Solutions** focused on responsible investment and ESG criteria



30+ years of responsible investing history¹



397 engagements conducted by the RI team during 2022



20 professionals in a dedicated RI team



10+ year commitment PRI signatory since 2011

As at 31 March 2023. This is a general description of the firm's ESG process. It may not be applied to every holding in a given strategy. Assets under management/advisement excludes joint ventures. Personnel may be employed by any of the Aegon AM affiliates. ¹Aegon AM UK launched first ethical strategy in 1989. ²Exclusions and ethical include assets primarily managed for Aegon AM affiliates subject to a global exclusion list. The impact of the exclusion list will vary depending on the asset class and may not materially affect the implementation of every strategy. Products vary regionally.

Overview of Index-Linked Gilt Mandate

Portfolio managers	James Lynch and Nick Chatters
Benchmark	FTSE UK Index-Linked All Stocks Index
Performance aim	The Fund aims to outperform the FTSE UK Index-Linked All Stocks index by 0.3% p.a. (gross of asset management fees) over rolling three-year periods.
Inception	31 December 2013
Fund size	£224m



James Lynch
Co-manager



Nick Chatters
Co-manager

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What is the Index-Linked mandate?

- The UK government issue 2 types of debt for borrowing
 - Nominal bonds – fixed rate of interest
 - Inflation-linked bonds – issue debt that pays inflation (RPI) return, from when a bond is issued to maturity. Also referred to as 'linkers'
- There are 33 linkers in the benchmark
- The total returns of these 'linkers' make up the benchmark of the fund
- The purpose of the fund is to match the return of the benchmark plus an outperformance

Mandate Parameters

- Benchmark is FTSE Govt Securities UK Index Linked TR All Stocks (FTRFILA)
- Fund aims to outperform benchmark by 0.3% p.a gross fees over rolling 3y period
- The mandate is run in line with the following parameters

Parameters	
Duration Limit	+ /- 2 years
Cash Limit	<5%
Overseas Holdings	<20%
Unhedged Currency Risk	<1%

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Fund performance

	1 year %	3 years % p.a.	5 years % p.a.
UK Index Linked Fund	-22.8	-13.3	-4.9
FTSE UK Index-linked All Stocks	-23.2	-13.4	-5.1
Relative return	0.4	0.1	0.1

Cumulative returns since inception (bps)



As at 31 May 2023. All returns are gross. Relative performance is geometric. Periods over one year are annualised. Benchmark is FTSE UK Index-linked All Stocks.

2022 performance of index-linked bonds

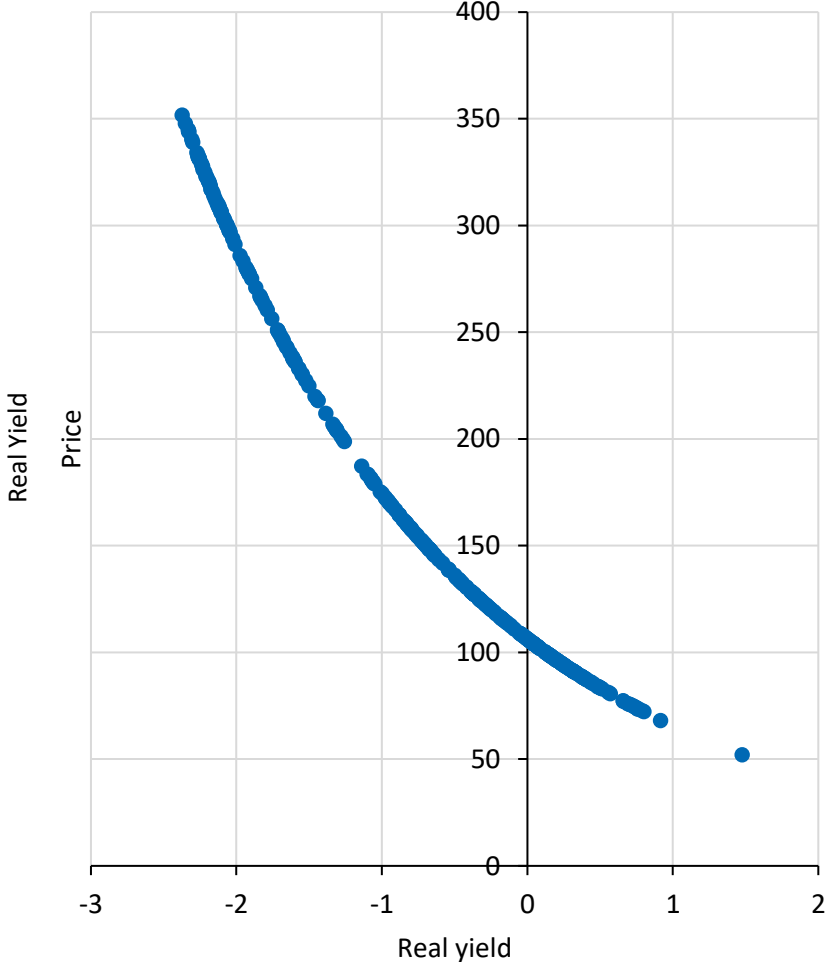
- The macro environment changed in 2022, higher inflation with low unemployment and a fiscal tailwind meant central banks globally significantly increased interest rates
- UK policy rate moved from 0.25% to 3.5%
- Higher inflation made fixed income less attractive
- Bonds had a very expensive starting point in 2022 given the low interest rates and previous quantitative easing (QE)
- 'Linkers' are very long in duration. They are long maturity dates with large end payments
- Average duration in the portfolio is 16 years. For every 1% move in interest rates the total return of the portfolio will move by 16%
- The market in 2022 did not expect that inflation would continue to be high for any material length of time
- This has significant effect on value of index-linked bonds when nominal interest rates are rising
- The mini-budget in September/October 2022 triggered the LDI crisis and resulted in BoE intervention, which did not help the linker market

Price versus yield

Price v Yield 2022/23



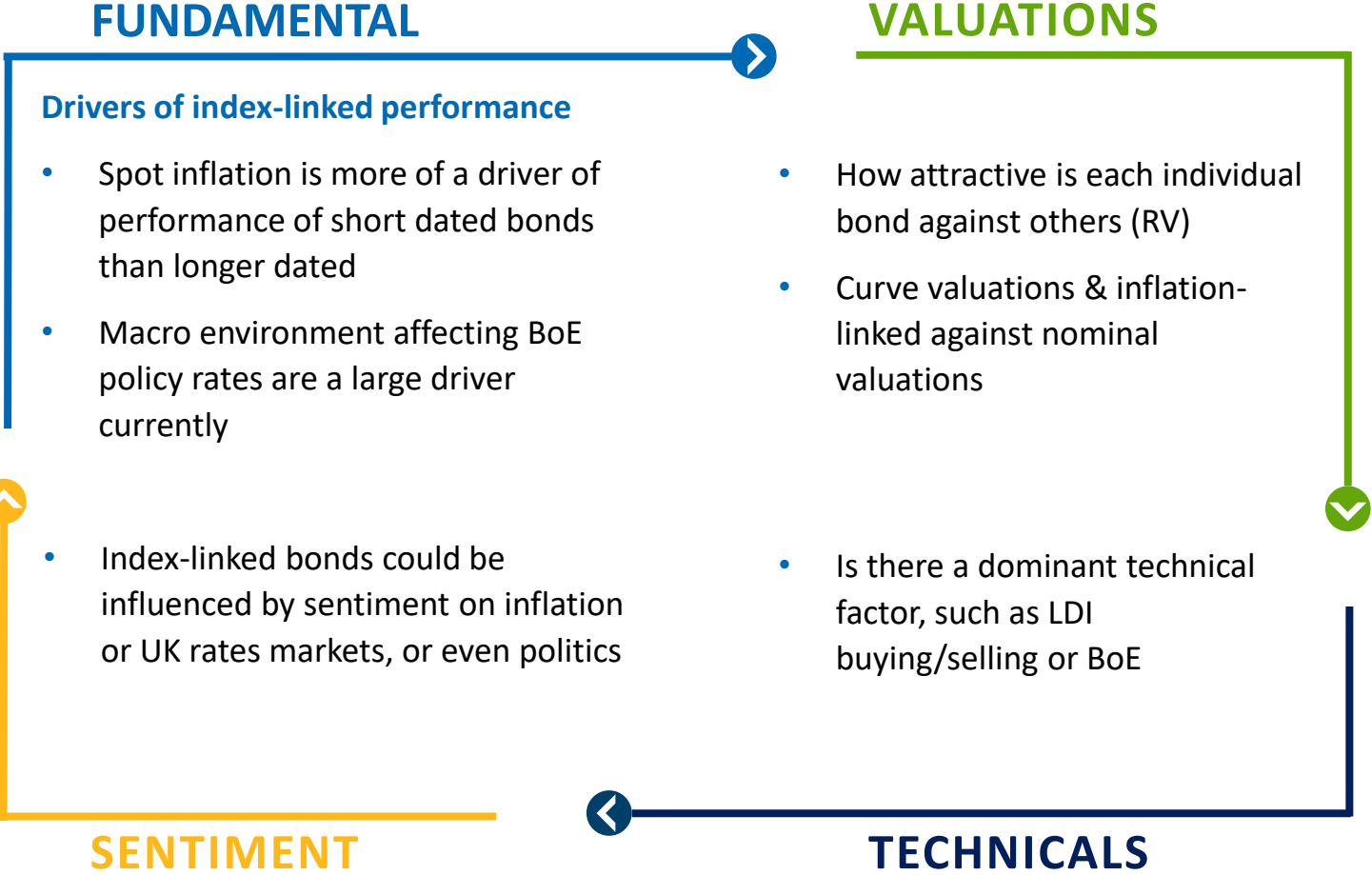
Convexity in action



Source: Bloomberg as at 10 July 2023. Based on the 2073 index-linked bond

Opportunities in Index – Linked

Index-Linked Fund Investment Process



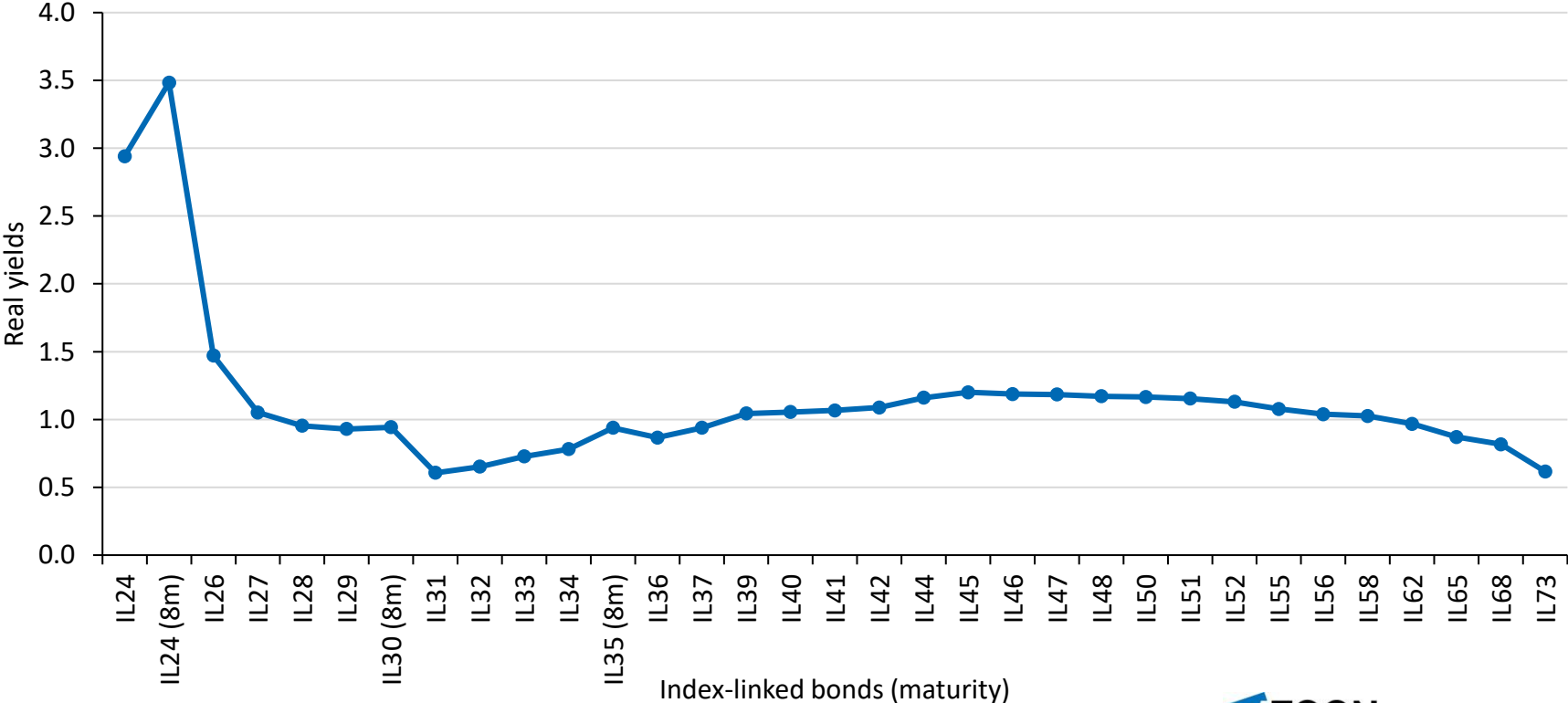
Alpha opportunities for active managers in Index-Linked

- Adjust fund duration – ability to go overweight / underweight the benchmark
- Ability to buy nominal UK Gilts (either breakeven, or outright, not allowed to be short)
- Active curve positions – flatteners and steepeners
- Relative Value stock selection – overweight/underweight individual bonds against each other

UK Government Index-Linked Bonds

- Below is the real yield of each linker across the maturity spectrum to give ‘the curve’
- Flexibility in mandate to construct portfolio to be underweight / overweight these bonds versus benchmark

Index-Linked bonds and real yields



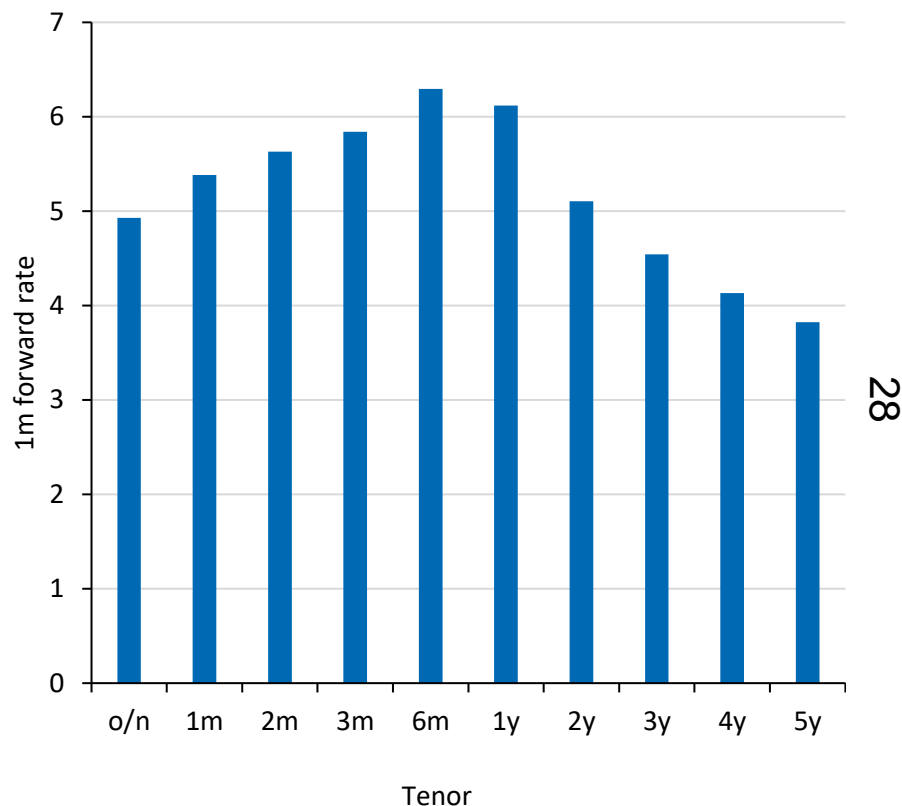
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Source: Bloomberg as at 13 July 2023

Market Outlook

- We see fixed income as very attractive proposition currently
- Market expectations of increases in interest rates are more than fully valued
- If BoE do not reach 6.25% the market will be disappointed
- We expect current valuations to be attractive for de-risking flow and macro investors
- Index-linked bonds are not expensive on an outright basis, and versus nominal bonds are middle of the past 1y range
- Supply is not as aggressive in index-linked bonds versus nominal bonds

Bank of England expectations



Appendix

Fixed income investment team

Experienced professionals, deep global resources

Stephen Jones, CIO Fixed Income, Equities and Multi-Asset & Solutions

Core Fixed Income

Adrian Hull

Multi Sector/Investment Grade

13 portfolio managers | 22 years' experience

*See Credit Research for analyst information

Emerging Markets Debt

1 portfolio managers | 29 years' experience

7 research analysts | 17 years' experience

Sovereign Credit, Rates & Currency

13 portfolio managers | 21 years' experience

Customized Solutions & Insurance

Asset Management

5 portfolio managers | 13 years' experience

Leveraged Finance

Jim Schaeffer

High Yield

6 portfolio managers | 22 years' experience

*See Credit Research for analyst information

Leveraged Loans

2 portfolio managers | 16 years' experience

3 research analysts | 12 years' experience

Special Situations and Distressed Credit¹

2 portfolio managers | 18 years' experience

1 research analysts | 8 years' experience

Impact Venture Debt

3 professionals | 15 years' experience

Alternative/Structured Finance

Frank Meijer, PhD

EU ABS/Mortgages/Government Guaranteed Loans

12 investment managers | 11 years' experience

US Structured Finance

8 investment managers | 21 years' experience

Private Placements

4 professionals | 31 years' experience

Insured Credit & Trade Finance

6 professionals | 15 years' experience

EU SME & Midcap Lending

5 professionals | 18 years' experience

Credit Research²

Jennifer Moore, CFA

Investment Grade

17 research analysts

18 years' experience

High Yield

13 research analysts

12 years' experience

Additional resources

Macro Strategy¹

6 professionals

19 years' experience

Portfolio Analysts

9 professionals

16 years' experience

Quantitative Solutions

9 professionals

13 years' experience

Trading

14 professionals

21 years' experience

Responsible Investment

20 professionals

12 years' experience

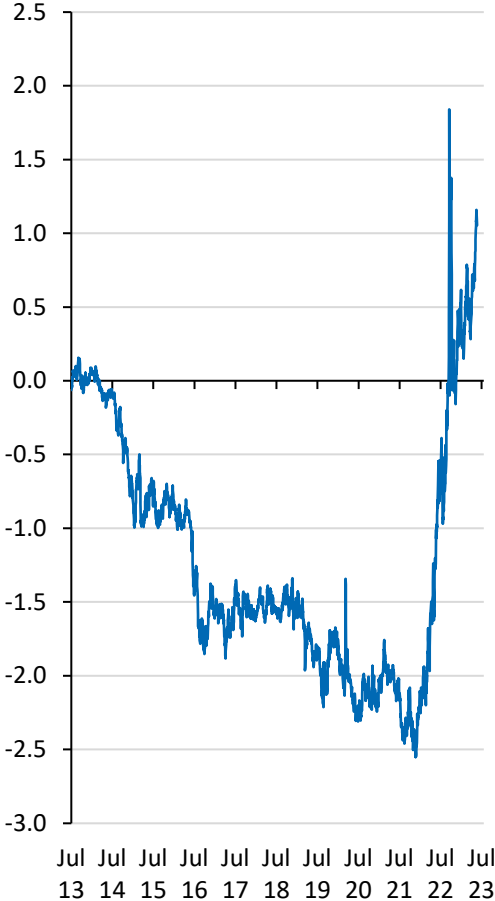
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Index-linked bond - return explanation

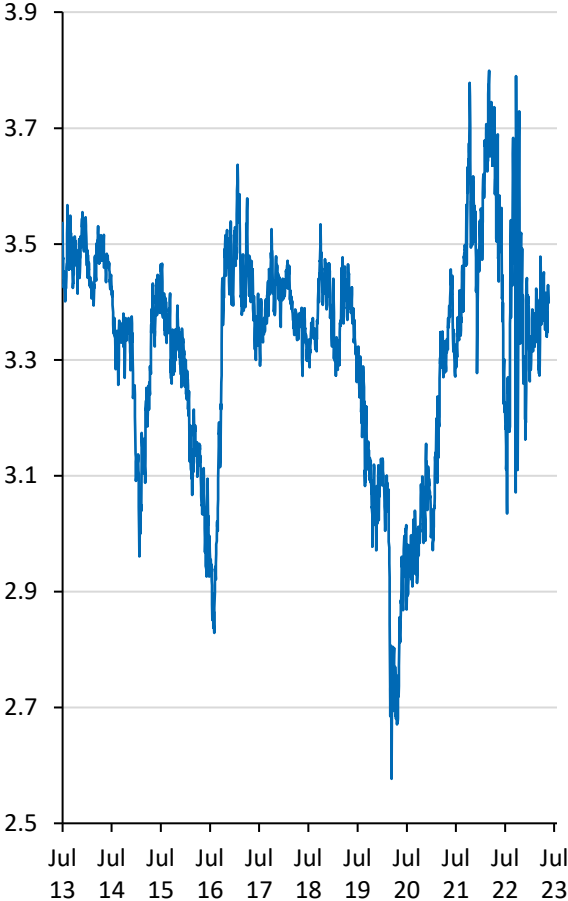
- The total return of an index-linked bond is the real yield the bond was bought at plus inflation
- At 0% the real yield for a 30y index-linked bond plus inflation expectation (breakeven) at 3.5% means a total return expected (but not guaranteed) of 3.5% nominal. If inflation over the 30y is 2%, the total return would be 2% etc.
- The final RPI fixing before a bond matures is the most sensitive point for total return. Bonds that mature in the next year for example are more sensitive to current inflation than those that mature in 30 years' time

Price versus yield

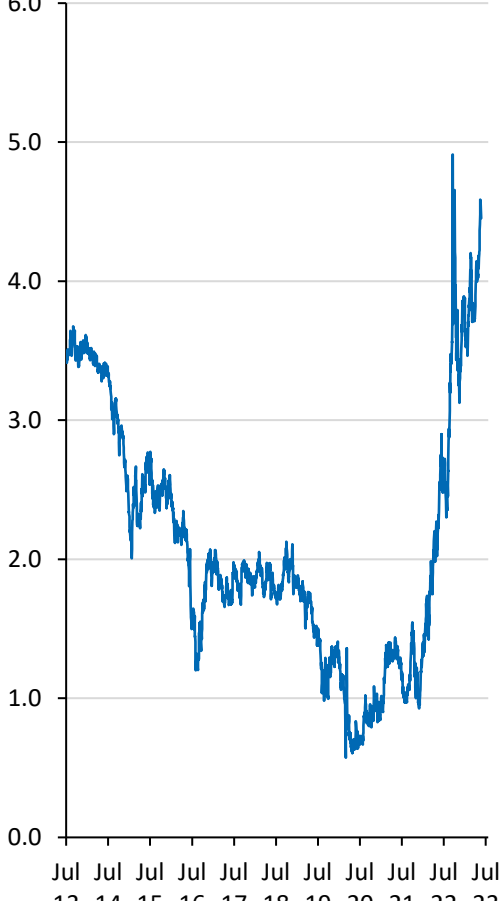
UKTI 2055 yield



30y inflation expectations



Theoretical nominal yield



Source: Bloomberg as at 10 July 2023

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