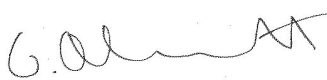


<b>Report to:</b>	Pension Committee	<b>Date:</b>	26 September 2018
<b>Report title:</b>	Quarterly Investment Performance Report to 30 June 2018		
<b>Report from:</b>	Gerald Almeroth, Strategic Director, Resources		
<b>Ward/Areas affected:</b>	Borough Wide		
<b>Chair of Committee/Lead Member:</b>	Councillor Jill Whitehead		
<b>Author(s)/Contact Number(s):</b>	Paul Audu, Investments, Insurance & Commercial Manager, 0208 770 5016 Lisa Doswell, Senior Finance Lead, Treasury and Pensions, 0208 770 5354		
<b>Corporate Plan Priorities:</b>	<ul style="list-style-type: none"> <li>• Making Informed Choices</li> </ul>		
<b>Open/Exempt:</b>	Part-Exempt: Appendix B is exempt on the basis of Paragraph 3, Schedule 12A of Local Government Act 1972		
<b>Signed:</b>		<b>Date:</b>	11 September 2018

## 1. Summary

- 1.1. This report shows the performance of the total Fund and individual fund managers for the quarter ending 30 June 2018, performance in the last twelve months, annualised rolling three year performance against the benchmark and performance since inception.

## 2. Recommendation

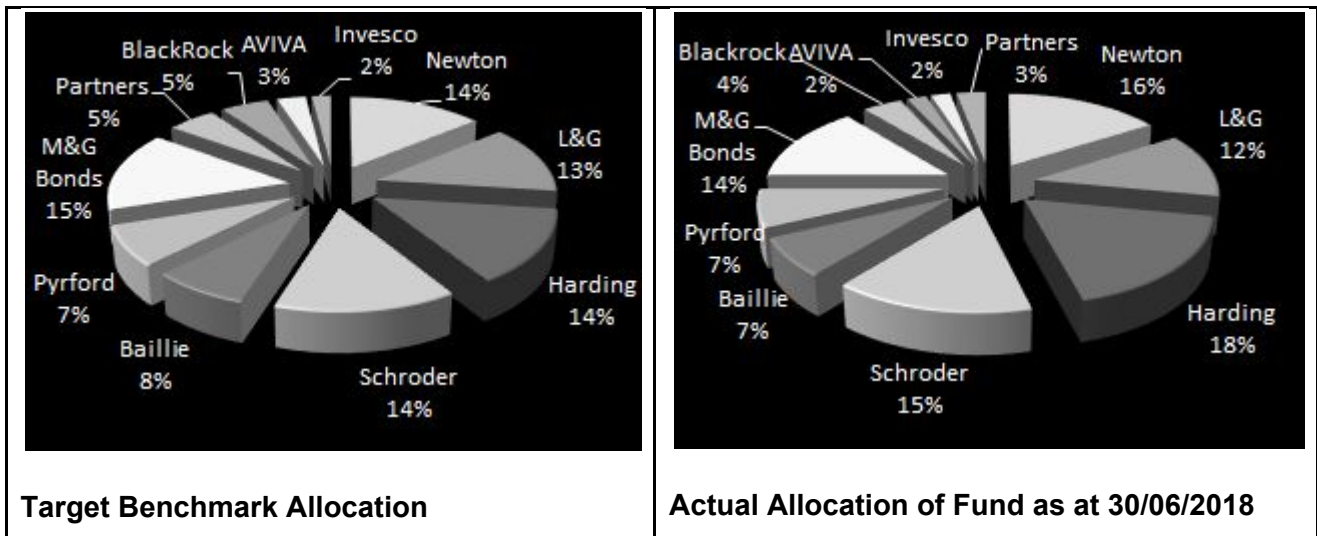
The Pension Committee is recommended to:

- 2.1. Note the performance of the total Fund, contribution at the fund manager level and detailed attribution of the results.

## 3. Background

- 3.1 Legal & General (L&G), Newton Investment Management (Newton), Harding Loevner, Schroder, Baillie Gifford, Pyrford, M&G, BlackRock and Partner's Group were employed as the Council's investment managers for the quarter ending 30 June 2018. The Council was also invested in three separate funds; M&G UK Companies Financing Fund, Aviva Investors UK Real Estate Fund of Funds Plan and Invesco Real Estate UK Residential Fund.

3.2 Under the Council’s current investment strategy a target benchmark allocation of 42% of the total Fund value is to be invested in global equities managed in separate, equal sized portfolios by Newton, Harding Loevner and Schroder’s. 13% of the Fund is to be invested in UK equities by L&G and 15% of the Fund is to be split equally in absolute return pooled vehicles managed by Baillie Gifford and Pyrford. 20% of the Fund is currently targeted in bonds by M&G, however there is a long term strategic target to bonds of 15% and 5% to infrastructure, but this will take some time to implement. 10% of the Fund is targeted in Property. This is shown in the chart on the left, against the current actual allocation of the Fund on the right.



3.3 Actual allocations against the target are monitored on a regular basis. Potential courses of action are discussed with Hymans Robertson if material deviations occur. The current target allocation of 42% in global equities has been exceeded by 7%. This has been addressed within the recent Investment Strategy Review.

3.4 Performance targets for all fund managers are set by the Council to obtain good investment performance returns, whilst also balancing risk. The targets set are in line with the overall investment strategy originally agreed by Members in March 2011.

**4. Performance of the Managers**

4.1 The tables set out within the report show the managers’ performance for the quarter, over the last twelve months and since inception (where possible) and a comparison against the relevant indices in the Council’s strategic asset allocation benchmark. All figures are shown net of fees. Appendix B (exempt information) shows the basis on which fees are calculated by each fund manager and the fees which have been incurred for the current and previous quarter.

4.2 This report is prepared using data provided by Northern Trust, the Fund’s custodian and independent performance measurer, together with reporting from each Fund manager and the London CIV.

Movement in Fund Value from 31 March 2018 to 30 June 2018

4.3 The table below shows the value of holdings with each of the fund managers as at the end of the latest quarter and the end of the previous quarter.

<b>Fund Manager</b>	<b>Value at end 31/03/18 £'000</b>	<b>Value at end 30/06/18 £'000</b>	<b>Value change £'000</b>	<b>% Change</b>
<b>Total Equities</b>	<b>373,400</b>	<b>402,010</b>	<b>28,610</b>	<b>7.7</b>
Legal & General	72,318	78,975	6,657	9.2
Newton *	97,823	106,003	8,180	8.4
Harding Loevner	108,037	116,458	8,421	7.8
Schroders	95,222	100,574	5,352	5.6
<b>Bonds</b>	<b>95,381</b>	<b>94,548</b>	<b>-833</b>	<b>-0.9</b>
M&G bonds	95,381	94,548	-833	-0.9
<b>Pooled Multi Asset</b>	<b>88,346</b>	<b>88,668</b>	<b>322</b>	<b>0.4</b>
Baillie Gifford *	46,525	46,011	-514	-1.1
Pyrford *	41,821	42,657	836	2.0
<b>Property</b>	<b>50,850</b>	<b>51,218</b>	<b>368</b>	<b>0.7</b>
BlackRock	23,378	23,626	248	1.1
Aviva	12,896	13,032	136	1.1
Invesco	14,576	14,560	-16	-0.1
<b>Alternatives</b>	<b>16,164</b>	<b>18,898</b>	<b>2,734</b>	<b>16.9</b>
Partners Group **	15,729	18,471	2,742	17.4
M&G – Co's Financing Fund	435	427	-8	-1.8
<b>Cash ***</b>	<b>15,550</b>	<b>10,458</b>	<b>-5,092</b>	<b>-32.7</b>
<b>Total Assets</b>	<b>639,691</b>	<b>665,800</b>	<b>26,109</b>	<b>4.1</b>

\* These managers have transitioned into the London Collective Investment Vehicle (LCIV)

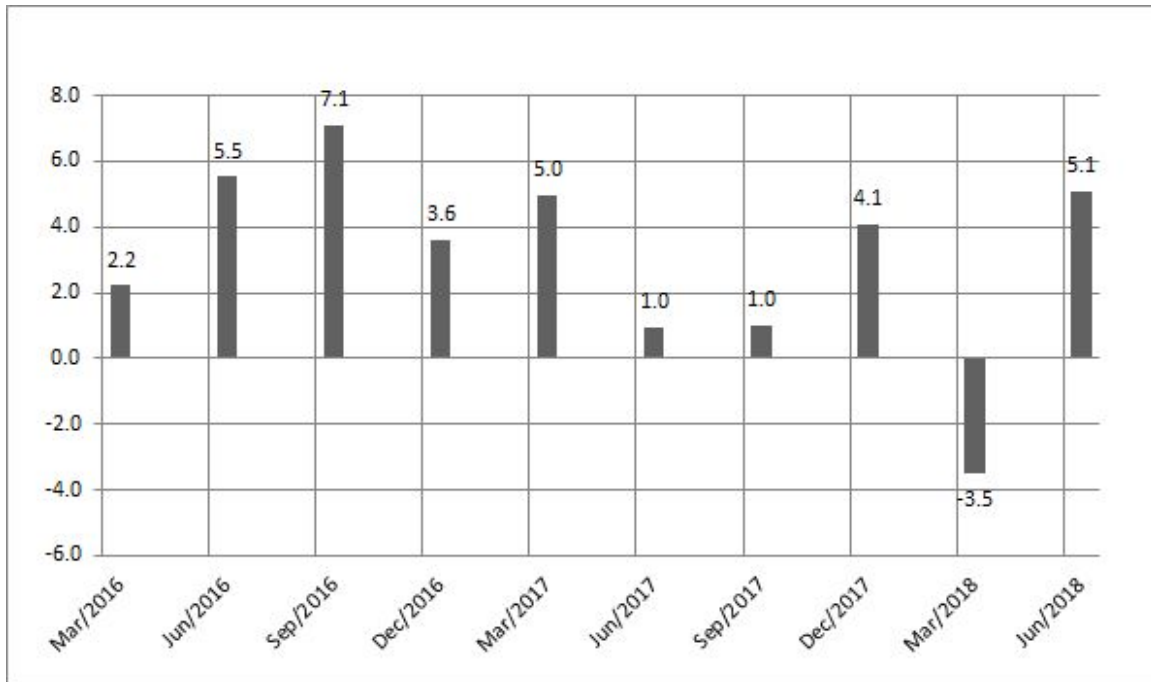


\*\* Partners Group made 5 capital calls in the quarter totalling £2.3m. The remaining increase of £0.4m represents net capital appreciation

\*\*\* Cash decreased by £5.1m during the quarter. £2.3m funded the Partners Group capital calls and the balance of £2.8m largely represents employee and employer contributions received during the quarter, but not yet allocated.

The chart below shows the percentage change in the total value of the Fund each quarter.

**Fund Value Movement %**



The above table excludes cash.

**5. Total Fund Performance**

Total Fund performance pre and post strategy implementation

Benchmark 66 months to 31/10/12	Fund 66 months to 31/10/12	Variance	Benchmark 66 months to 30/06/18	Fund 66 months to 30/06/18	Variance
%	%	%	%	%	%
3.7	2.5	-1.2	9.5	10.2	0.7

5.1 Prior to the new strategy being implemented, the combined Fund underperformed the benchmark by 1.2% over the previous 66 months (benchmark 3.7%, actual 2.5%). By comparison, in the 66 months post implementation of the new strategy the combined Fund outperformed the benchmark by 0.7% (benchmark 9.5%, actual 10.2%).

Total Fund performance for the latest quarter ended 30 June 2018

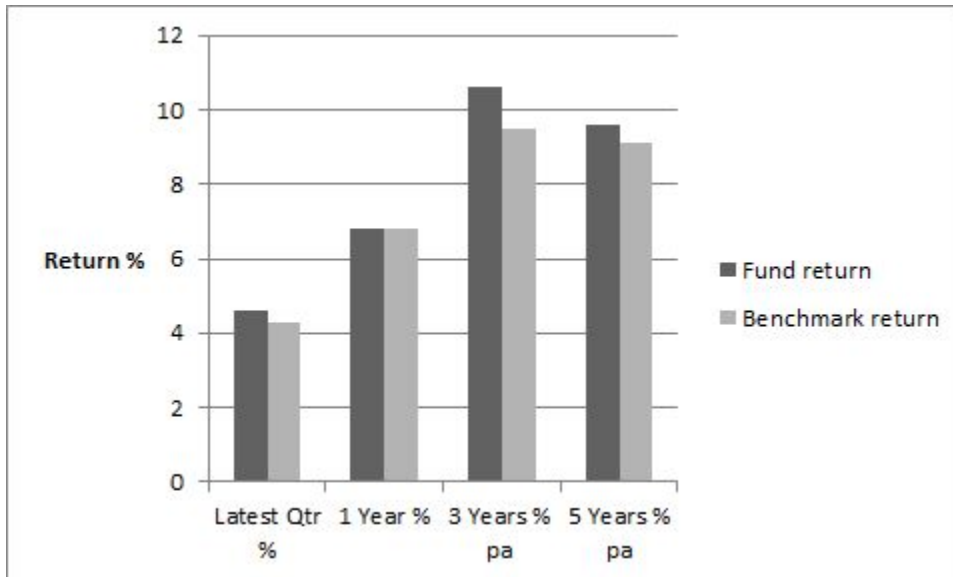
TOTAL FUND	Target Allocation	Fund Allocation	Benchmark Return	Fund Return	Relative
	%	%	%	%	%
Equities	55	61	7.4	7.7	0.3
Bonds	15	14	-0.4	-0.9	-0.5
Pooled Multi Asset	15	14	1.0	0.4	-0.6
Property	10	8	2.0	0.7	-1.3
Alternatives	5	3	n/a	n/a	n/a
<b>TOTAL ASSETS</b>	<b>100.0</b>	<b>100.0</b>	<b>4.3</b>	<b>4.6</b>	<b>0.3</b>

- 5.2 At total fund level the combined Fund outperformed the benchmark by 0.3% over the period. Performance of individual asset classes is detailed in paragraph 6 onwards.

Total Fund performance – longer term

TOTAL FUND	1 Year	3 Years	5 Years
	% pa	% pa	% pa
Fund return	6.8	10.6	9.6
Benchmark return	6.8	9.5	9.1
<b>Relative %</b>	<b>0.0</b>	<b>1.1</b>	<b>0.5</b>

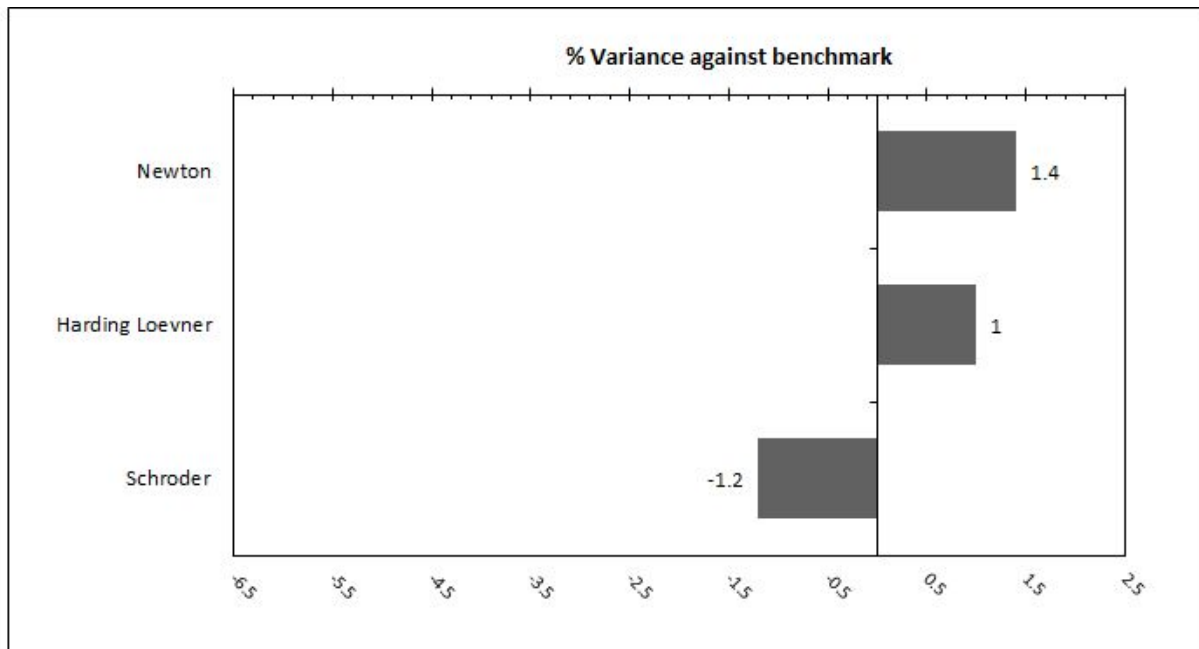
- 5.3 At total fund level, as at June 2018 the combined Fund matched the benchmark over the past year and outperformed the benchmark by 1.1% per annum over the rolling three years and 0.5% over the past five years.
- 5.4 The bar chart below summarises the overall performance of the Fund over the last year, three year and five year periods:



## 6. Equity Performance

Equity performance for the latest quarter ended 30 June 2018

Manager	Target Allocation	Fund Allocation	Benchmark Return	Fund Return	Relative
	%	%	%	%	%
L&G	13	12	9.2	9.2	0.0
Newton	14	16	7.0	8.4	1.4
Harding Loevner	14	18	6.8	7.8	1.0
Schroders	14	15	6.8	5.6	-1.2
<b>TOTAL EQUITIES</b>	<b>55</b>	<b>61</b>	<b>7.4</b>	<b>7.7</b>	<b>0.3</b>



- 6.1 Global equity markets performed strongly during the quarter, despite volatile conditions. Fears mounted over the ongoing trade dispute between the United States (US) and China and the uncertain political outlook in Europe continued. However, equity markets in the major developed economies responded positively to economic and earnings data. Central bank policy remained a focus for investors. The Federal Reserve carried out a rate rise in June, while the European Central Bank announced that it expects to end quantitative easing in December 2018 and that interest rates will remain at current levels for the next year. The decision by the Bank of England to hold rates was a boost to UK equities. The US posted positive returns during the quarter, boosted by strong retail sales growth and a significant fall in unemployment. Emerging markets underperformed during the quarter, impacted by US dollar strength and escalating trade tensions. Energy was the best performing sector, which benefited from further increases in the oil price. Technology and consumer discretionary sectors continued to perform well, while the financials sector was the worst performer.
- 6.2 Newton outperformed the benchmark due to stock selection within financials, information technology and consumer staples, with SAP and Microsoft among the top contributors. Stock selection within healthcare detracted and an overweight position to consumer staples limited outperformance. Harding Loevner's outperformance was particularly boosted by strong stock selection in materials, followed by industrials, consumer discretionary and health care. Holdings in information technology stocks caused a drag on performance. Schroders underperformed during the quarter against a difficult environment for value investing, while momentum and growth were the strongest styles. Schroders' underperformance was driven by a lack of exposure to stocks such as Facebook, Apple, Amazon, Netflix and Google and their positioning within financials. This was offset to an extent from positioning within energy, industrials and pharmaceuticals.

Equity performance – longer term

Manager	Benchmark Return 1 Year	Fund Return 1 Year	Relative	Benchmark Return Since Inception	Fund Return Since Inception	Relative
	%	%	%	%	%	%
L&G	9.0	9.0	0.0	8.3	8.3	0.0
Newton	9.5	8.4	-1.1	14.0	14.2	0.2
Harding Loevner	8.9	14.7	5.8	13.9	16.2	2.3
Schroders	8.9	5.3	-3.6	13.9	12.9	-1.0

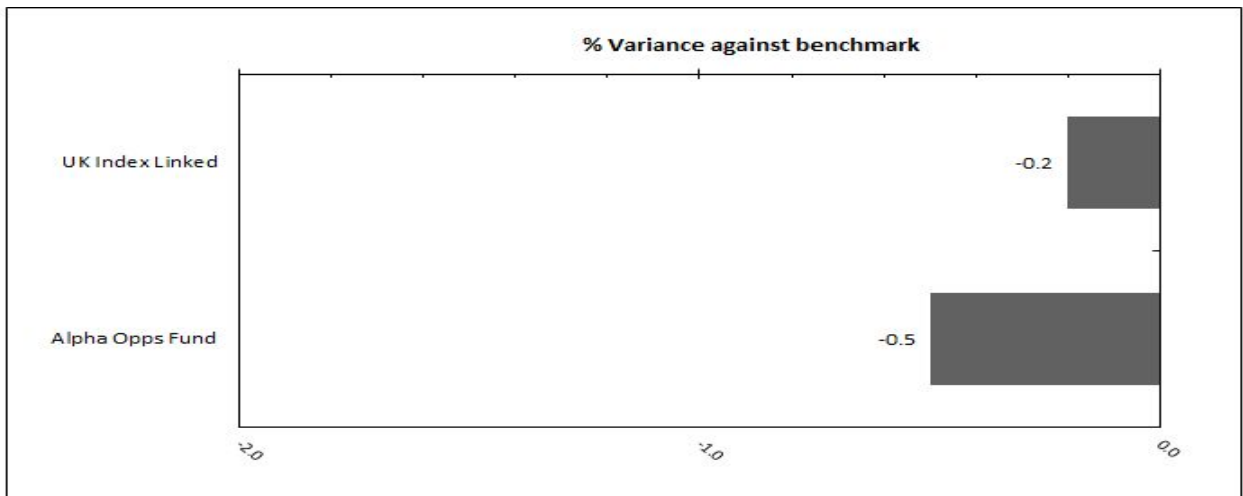
- 6.3 As shown in the table above, over the longer term L&G matched the benchmark during the twelve months ended June 2018, Newton underperformed, Harding Loevner outperformed and Schroders underperformed the benchmark. Since inception, L&G matched the benchmark, Newton and Harding Loevner outperformed the benchmark and Schroders underperformed.

**7. Bond Performance**

Bond performance for the latest quarter ended 30 June 2018

	Target Allocation	Fund Allocation	Benchmark Return	Fund Return	Relative
<b>M&amp;G</b>	%	%	%	%	%
UK Index Linked	6	7	-1.2	-1.4	-0.2
Alpha Opportunities Fund	9	7	0.1	-0.4	-0.5
<b>TOTAL</b> (Weighted Average)	<b>15</b>	<b>14</b>	<b>-0.4</b>	<b>-0.9</b>	<b>-0.5</b>





- 7.1 In a period of market volatility, corporate bond markets underperformed equivalent government bonds. UK government bonds and index-linked gilts were broadly unchanged over the quarter against a backdrop where inflation continued to reduce.
- 7.2 M&G underperformed the benchmark during the quarter. The manager remained defensively positioned, which helped to dampen the impact of negative performance. Individual stock selections, such as Legal and General, UBS, GKN and Tesco performed well. The detractors to performance were widespread given the market volatility, including names such as AT&T. The fund increased its exposure to ultra long index-linked gilts versus gilts maturing in 20 and 30 years.

#### Bond performance – longer term

Manager	Benchmark Return 1 Year	Fund Return 1 Year	Relative	Benchmark Return Since Inception	Fund Return Since Inception	Relative
<b>M&amp;G</b>	%	%	%	%	%	%
UK Index Linked	2.0	2.3	0.3	9.9	10.3	0.4
Alpha Opportunities Fund	0.4	1.2	0.8	0.9	2.6	1.7

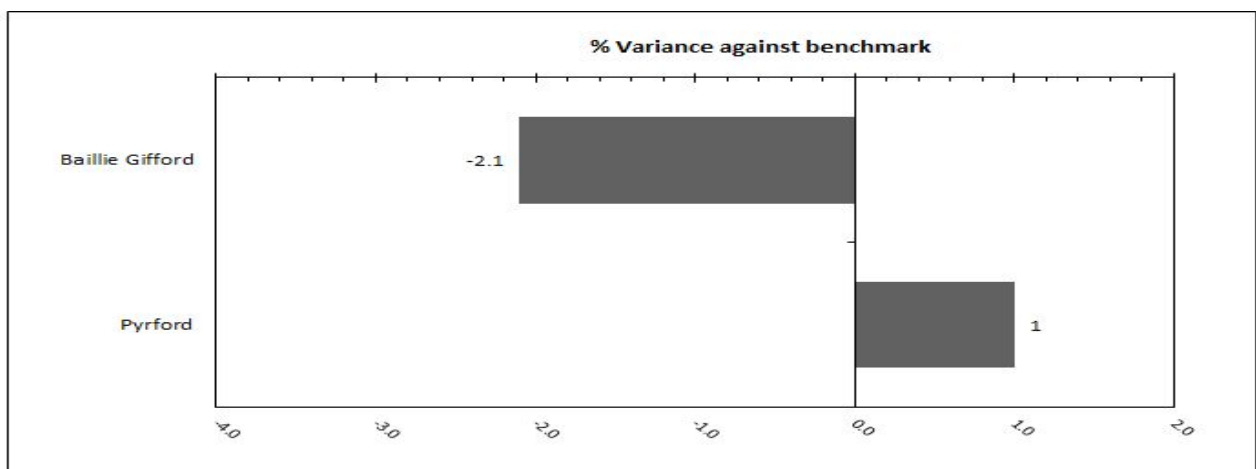
- 7.3 As shown in the table above, over the longer term both M&G portfolios outperformed the benchmark during the twelve months ended June 2018. Both portfolios also outperformed since inception.



**8. Pooled Multi-Asset Performance**

Pooled Multi-Asset Performance for the latest quarter ended 30 June 2018

Manager	Target Allocation	Fund Allocation	Benchmark Return	Fund Return	Relative
	%	%	%	%	%
Baillie Gifford	7.5	7	1.0	-1.1	-2.1
Pyrford	7.5	7	1.0	2.0	1.0
<b>TOTAL POOLED MULTI-ASSET</b>	<b>15</b>	<b>14</b>	<b>1.0</b>	<b>0.4</b>	<b>-0.6</b>



8.1 Baillie Gifford underperformed the benchmark for the quarter, caused primarily by their exposure to emerging market bonds. Holdings in active currency also detracted, but listed equities, property and infrastructure delivered good returns. Pyrford outperformed during the quarter, gaining positive returns in both equities and bonds. Equities provided the biggest contribution to returns with both UK and overseas performing well.

Pooled Multi-Asset Performance – longer term

Manager	Benchmark Return 1 Year	Fund Return 1 Year	Relative	Benchmark Return Since Inception	Fund Return Since Inception	Relative
	%	%	%	%	%	%
Baillie Gifford	3.6	1.8	-1.8	3.6	5.0	1.4
Pyrford	3.6	-0.6	-4.2	3.6	3.6	0.0

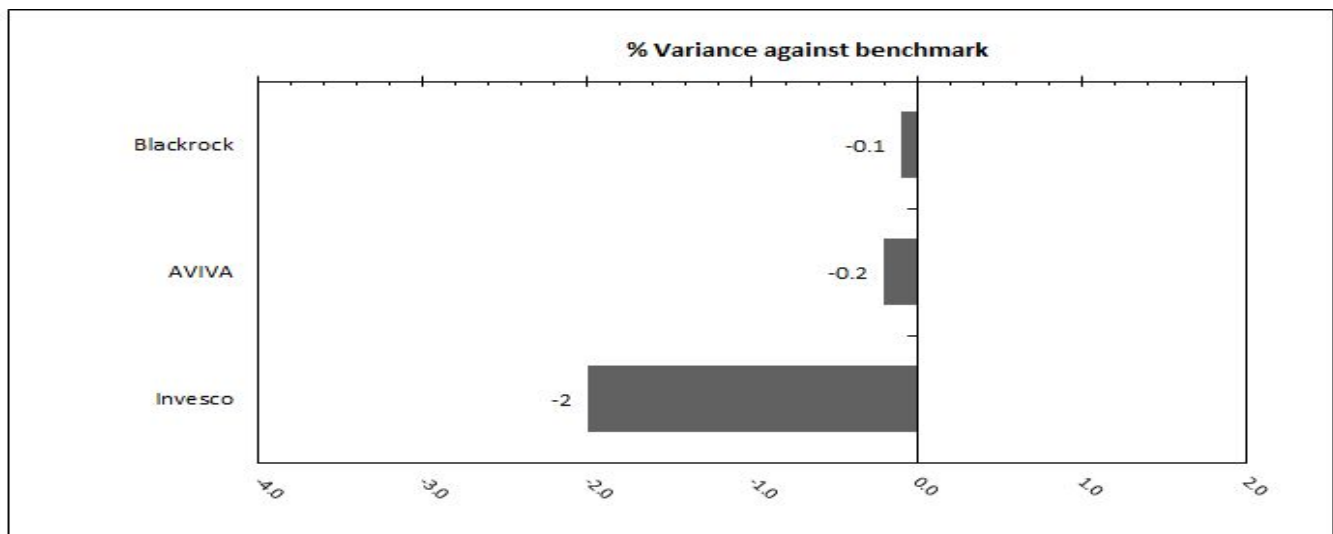
- 8.2 Baillie Gifford and Pyrford both underperformed the benchmark during the twelve months ended June 2018. Baillie Gifford outperformed the benchmark since inception and Pyrford matched the benchmark since inception.

## 9. Property Performance

### Property Performance for the latest quarter ended 30 June 2018

Manager	Target Allocation	Fund Allocation	Benchmark Return	Fund Return Income	Fund Return Capital	Total Fund Return	Relative
	%	%	%	%	%	%	%
BlackRock	5	4	2.0	0.8	1.1	1.9	-0.1
Aviva	3	2	2.0	0.7	1.1	1.8	-0.2
Invesco	2	2	1.9	0.0	-0.1	-0.1	-2.0

- 9.1 Since March 2017, the fully committed sum of £15m has been with the Invesco fund. At 30 June 2018 Invesco's asset value still reflects the level of investment in the fund at that time and not yet a meaningful performance component.



- 9.2 Property values in total held up during the quarter, however a pattern of divergence between the main sectors has emerged. The retail sector saw capital values fall by 1% over the quarter, while office and industrial sectors recorded capital growth of 0.5% and 3.9% respectively. Retail sales growth has been on a slowing trend for the past two years, though the hot weather and the World Cup interrupted this trend during the quarter. It was a strong quarter for office lettings in Central London.
- 9.3 During the quarter BlackRock underperformed the benchmark. BlackRock maintains an underweight position to high street retail and Central London offices and is overweight to



industrials and alternatives. They have not yet benefited from the underweight position in Central London, but believe that this sector will experience weakness resulting from reduced demand from the financial services in the next few years. Aviva also underperformed the benchmark. As in previous quarters, this continues to be primarily attributed to lower performance in their retail specialist funds. Their top performing holdings during the quarter were in industrial property funds. Aviva maintains overweight positions to industrials and alternatives.

9.4 Property Performance – longer term

Manager	Benchmark Return 1 Year	Fund Return 1 Year	Relative	Benchmark Return Since Inception	Fund Return Since Inception	Relative
	%	%	%	%	%	%
RREEF/ BlackRock	9.7	9.5	-0.2	4.7	1.7	-3.0
AVIVA	9.7	7.6	-2.1	8.3	7.7	-0.6

9.5 As shown in the table above, both Blackrock and Aviva underperformed the benchmark during the twelve months ending June 2018 and both managers underperformed the benchmark since inception.

10. **Alternatives Performance**

Alternatives Performance for the latest quarter ended 30 June 2018

Manager	Benchmark Allocation	Fund Allocation	Fund Return
	%	%	%
Partners Group Global 2012	2.8	2.6	3.5
Partners Group Direct 2015	1.1	0.2	-0.5
Partners Group Global 2015	1.1	0.3	-0.3
M&G – UK Companies Financing Fund	0	0.1	-1.8

10.1 Partner’s Group and M&G are not measured as part of the Fund’s overall strategic benchmark. Due to the way investment is made with Partner’s Group it is currently difficult to make meaningful comparisons with their performance target because committed capital is still to be drawn down and deployed.

- 10.2 M&G's return of -1.8% for the quarter represents a reduction in the value of the portfolio due to an income distribution of £13k, which was paid from the portfolio during the quarter, offset by £5k income earned during the quarter.

Alternatives Performance – longer term

Manager	Fund Return 1 Year	Fund Return Since Inception
	%	%
Partners Group Global 2012	18.3	10.8
M&G – UK Companies Financing Fund	3.5	4.4

- 10.3 The Partners Group Direct and Global 2015 vehicles have been invested in for less than one year.

**11. Targets - Annualised Rolling 3 Years to 30 June 2018**

- 11.1 The annual performance targets for equities, bonds and pooled multi-asset fund managers are set over a rolling three year period.
- 11.2 The table below shows that over the three year rolling period Harding Loevner, Baillie Gifford and Pyrford outperformed the benchmark, while Newton and Schrodgers underperformed. With the exception of Harding Loevner, all managers have underperformed the target over the same period.

Manager	3 Yr Benchmark Return	Target 3 Yr Return	3 yr Fund Return	Relative to Benchmark	Relative to Target
	%	%	%	%	%
Newton	14.9	16.9	13.1	-1.8	-3.8

During 2014 and 2015 Newton maintained an outperformance position, which was largely driven by good stock selection in consumer stocks, information technology and the financial sectors. During 2016 Newton's performance deteriorated and this is attributable to sector allocation, being underweight in the better performing sectors and overweight in the less well performing sectors, as well as their defensive stance which damaged relative performance. This underperformance continued into 2017 until the second quarter, when sector allocations, particularly in financials and IT produced outperforming returns. During the third quarter of 2017 they returned to underperformance, due to sector allocation. The decline of equity markets in the first quarter of 2018 made it difficult to fully recover their position, however they achieved outperformance in the second quarter.



Harding Loevner	14.7	17.7	19.3	4.6	1.6
<p>Harding Loevner has maintained a relatively consistent outperformance position over the last three years. This is attributed to good stock selection in the most resilient sectors, particularly in healthcare, information technology and financials. Despite the volatility of equity markets during the first quarter of 2018, they still maintained their outperformance position and this continued during the second quarter.</p>					
Schroders	14.7	17.7	12.8	-1.9	-4.9
<p>Schroders value based investment style (stocks in companies that the market has undervalued) has lagged for several years against the quality growth investment style of the fund's other equity managers. However, by the end of 2016 value had become the best performing style, resulting from a significant market rotation caused by the surprise US election result. The start of 2017 saw some unwinding of this strong performance, as investors favoured growth over value by a significant margin. In the final months of 2017 the market environment was more suited to Schroders' strategy and they finished the quarter ahead of the benchmark. The volatile environment continued to benefit their style during the first quarter of 2018, but they slightly underperformed by the end of that period. During the second quarter the favoured style had returned to growth and value investing struggled.</p>					
Baillie Gifford	3.6	6.6	4.3	0.7	-2.3
<p>During 2014 Baillie Gifford had a relatively strong year, benefitting from positive contribution from listed equities and emerging market bonds. Performance in 2015 was more mixed with exposures to economically sensitive assets, such as high yield and emerging market bonds struggling, balanced to some extent by positives from exposures to listed equities. In 2016 performance was ahead of target with the main positive contributors to performance being economically exposed asset classes such as high yield credit, listed equities and emerging market bonds. Active currency also contributed positively. During 2017, largely the same asset classes continued to be the main contributors to performance. Holdings in absolute return, insurance linked securities and developed market government bonds were the main detractors. In the volatile first quarter of 2018, holdings in absolute return boosted performance, while listed equities and infrastructure detracted. A significant setback to performance came during the second quarter, due to holdings in emerging market bonds.</p>					
Pyrford	3.6	6.6	4.2	0.6	-2.4
<p>Pyrford's positive absolute performance in 2014 was countered by some underperformance in 2015, when the strategy struggled as markets fell sharply in Q2 and Q3. From the last quarter of 2015 onwards Pyrford maintained a consistent outperformance position over 12 months, which is largely attributable to unhedged overseas equity and bond holdings. This position was maintained until the second quarter of 2017 when Pyrford underperformed.</p>					

They continued to struggle with the equity portion of their portfolio, having been positioned in high dividend paying defensive sectors that can be perceived as sensitive to rising bond yields. The portfolio's bond holdings also produced negative returns, as government bond yields continued to edge up. However, Pырford returned to outperformance during the second quarter of 2018, seeing positive returns from both equities and bonds in the UK and overseas.

## 12. Options Considered

12.1 Not applicable.

## 13. Impacts and Implications

### Financial

13.1 The financial implications are addressed within the report.

### Legal

13.2 There are no legal issues arising from this report.

#### 14. Appendices and Background Documents

Appendix letter	Title
A	Current Investment Strategy Benchmarks and Targets
B	Manager Fees - Exempt on the basis of Paragraph 3, Schedule 12A of Local Government Act 1972

Background documents
Northern Trust Investment Performance Reports

Audit Trail		
Version	Final	Date:11 September 2018
Consultation with other officers		
Finance	Yes	Paul Audu
Legal	No	N/A
Equality Impact Assessment required?	No	N/A