




Report to:	Pension Committee	Date:	19 November 2018
Report title:	Quarterly Investment Performance Report to 30 September 2018		
Report from:	Gerald Almeroth, Strategic Director, Resources		
Ward/Areas affected:	Borough Wide		
Chair of Committee/Lead Member:	Councillor Jill Whitehead		
Author(s)/Contact Number(s):	Paul Audu, Investments, Insurance & Commercial Manager, 0208 770 5016 Lisa Doswell, Senior Finance Lead, Treasury and Pensions, 0208 770 5354		
Corporate Plan Priorities:	<ul style="list-style-type: none"> • Making Informed Choices 		
Open/Exempt:	Part-Exempt: Appendix B is exempt on the basis of Paragraph 3, Schedule 12A of Local Government Act 1972		
Signed:		Date:	8 November 2018

1. Summary

- 1.1 This report shows the performance of the total Fund and individual fund managers for the quarter ending 30 September 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:

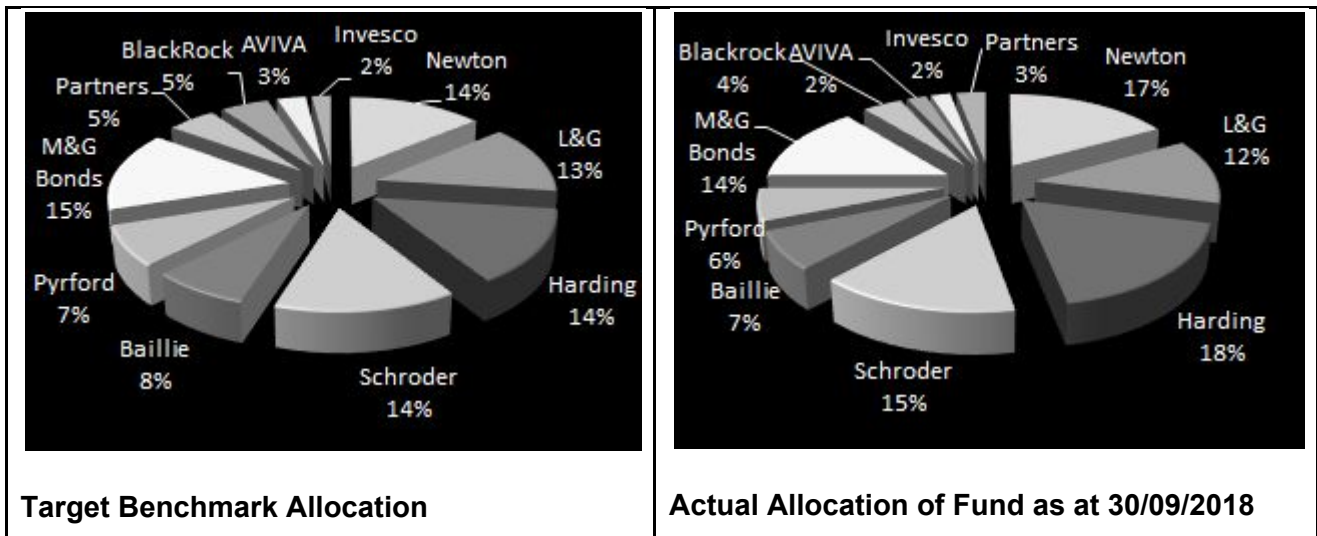
- 2.1 Note the performance of the total Fund, contribution at the fund manager level and detailed attribution of the results.

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 September 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 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 Pymford. 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 allocated to 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 will be addressed in the Investment Strategy Review.

3.4 Performance targets for all fund managers are set by the Council to obtain good investment returns balanced against 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 at paragraph 6 of this report provide comparative analyses of managers’ performance for the quarter, over the last twelve months and since inception (where possible) against the relevant indices in the Council’s benchmark. All figures are shown net of fees. Managers’ remuneration structure and applicable fees for the current and previous quarter are shown in Appendix B (exempt information).

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 30 June 2018 to 30 September 2018

- 4.3 The table below shows the change in the value of holdings with each of the fund managers since the end of the previous quarter in absolute and percentage terms.

Fund Manager	Value at end 30/06/18 £'000	Value at end 30/09/18 £'000	Value change £'000	% Change
Total Equities	402,010	418,625	16,615	4.1
Legal & General	78,975	78,338	-637	-0.8
Newton *	106,003	113,669	7,666	7.2
Harding Loevner	116,458	121,411	4,953	4.3
Schroders	100,574	105,207	4,633	4.6
Bonds	94,548	94,227	-321	-0.3
M&G bonds	94,548	94,227	-321	-0.3
Pooled Multi Asset	88,668	89,023	355	0.4
Baillie Gifford *	46,011	46,044	33	0.1
Pyrford *	42,657	42,979	322	0.8
Property	51,218	51,701	483	0.9
BlackRock	23,626	23,855	229	1.0
Aviva	13,032	13,113	81	0.6
Invesco	14,560	14,733	173	1.2
Alternatives	18,898	21,364	2,466	13.0
Partners Group **	18,471	20,932	2,461	13.3
M&G – Co's Financing Fund	427	432	5	1.2
Cash	10,458	10,314	-144	-1.4
Total Assets	665,800	685,254	19,454	2.9

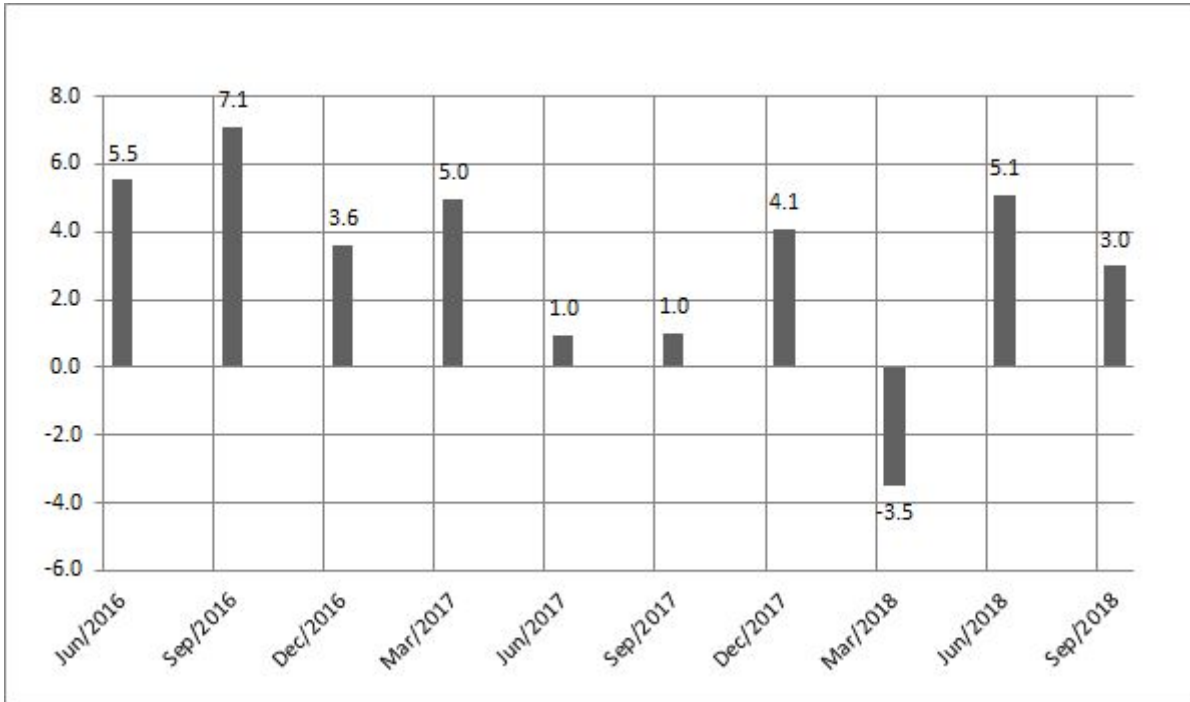
* These managers have transitioned into the London Collective Investment Vehicle (LCIV)

** Partners Group made 3 capital calls in the quarter totalling £1.7m. The remaining increase of £0.8m represents net capital appreciation.



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 69 months to 31/10/12	Fund 69 months to 31/10/12	Variance	Benchmark 69 months to 30/09/18	Fund 69 months to 30/09/18	Variance
%	%	%	%	%	%
4.2	3.2	-1.0	9.6	10.2	0.6

5.1 Prior to the new strategy being implemented, the combined Fund underperformed the benchmark by 1.0% over the previous 69 months (benchmark 4.2%, actual 3.2%). By comparison, in the 69 months post implementation of the new strategy the combined Fund outperformed the benchmark by 0.6% (benchmark 9.6%, actual 10.2%).



Total Fund performance for the latest quarter ended 30 September 2018

TOTAL FUND	Target Allocation	Fund Allocation	Benchmark Return	Fund Return	Relative
	%	%	%	%	%
Equities	55	62	4.1	4.1	0.0
Bonds	15	14	-0.5	-0.3	0.2
Pooled Multi Asset	15	13	1.0	0.4	-0.6
Property	10	8	1.6	0.9	-0.7
Alternatives	5	3	n/a	n/a	n/a
TOTAL ASSETS	100.0	100.0	2.5	3.0	0.5*

* includes Alternatives

- 5.2 At total fund level the combined Fund outperformed the benchmark by 0.5% over the period. Performance of individual asset classes is detailed in paragraph 6 onwards.

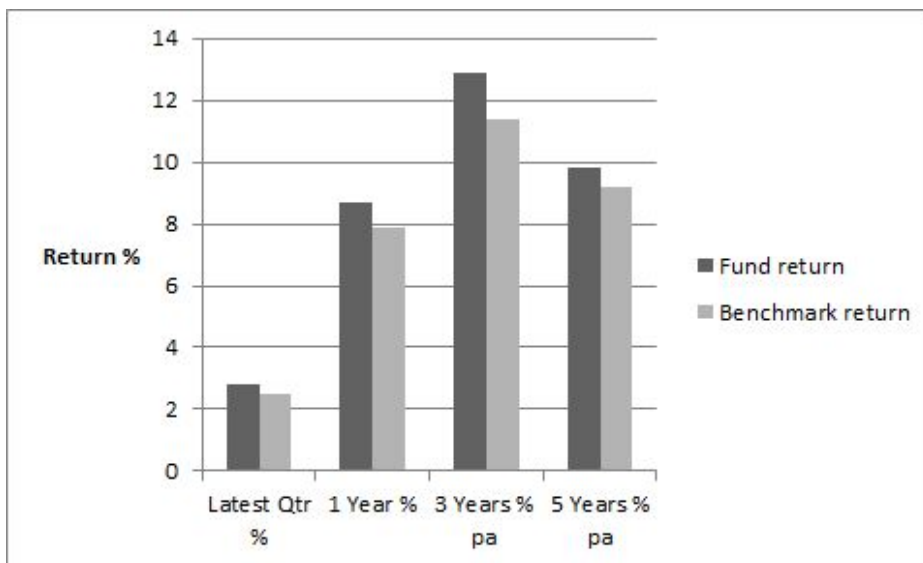
Total Fund performance – longer term

TOTAL FUND	1 Year	3 Years	5 Years
	% pa	% pa	% pa
Fund return	8.7	12.9	9.8
Benchmark return	7.9	11.4	9.2
Relative %	0.8	1.5	0.6

- 5.3 At total fund level, as at September 2018 the combined Fund outperformed the benchmark by 0.8% over the past year, by 1.5% per annum over the rolling three years and 0.6% over the past five years.



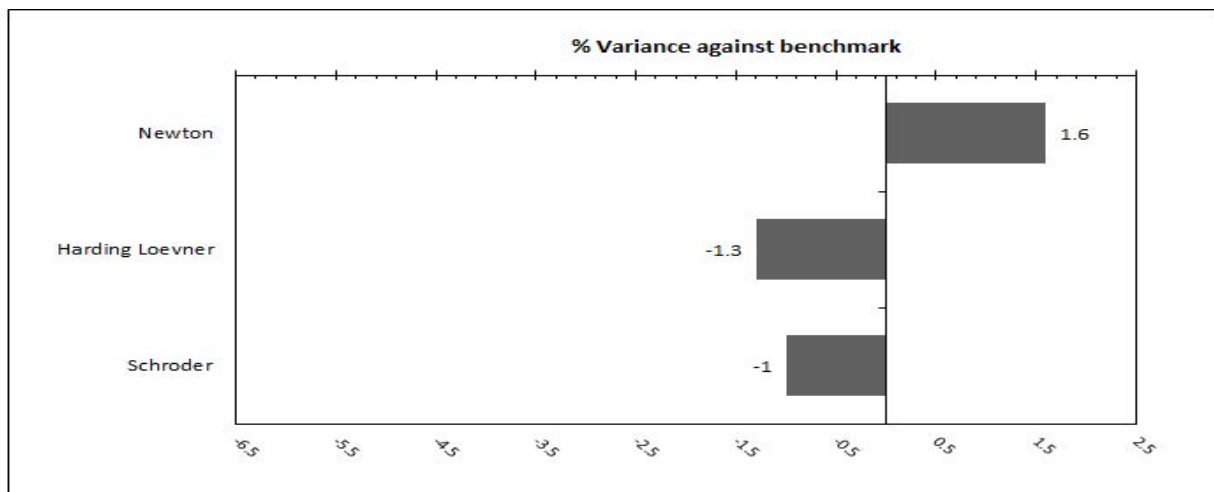
5.4 The bar chart below summarises the overall performance of the Fund over the last year, three year and five year periods:



6. Equity Performance

Equity performance for the latest quarter ended 30 September 2018

Manager	Target Allocation	Fund Allocation	Benchmark Return	Fund Return	Relative
	%	%	%	%	%
L&G	13	12	-0.8	-0.8	0.0
Newton	14	17	5.6	7.2	1.6
Harding Loevner	14	18	5.6	4.3	-1.3
Schroders	14	15	5.6	4.6	-1.0
TOTAL EQUITIES	55	62	4.1	4.1	0.0



- 6.1 Global equity markets continued to make gains during the quarter, largely due to the continuing strength of the US market. The performance of the US versus the rest of the world reached its most extreme level since at least the early 1970s, led by investor confidence in the strong economic growth outlook and record corporate earnings. The Federal Reserve carried out another rate rise in September. Companies in Europe posted positive returns, but the gains were modest compared to US counterparts. In the UK, there was a modest decline in the FTSE All-Share index amid ongoing Brexit concerns and the Bank of England raised interest rates for the first time in ten years by 25 basis points. Sterling continued its downward trajectory. Emerging markets continued to underperform during the quarter, still impacted by US dollar strength and escalating trade tensions. Higher quality, more expensive, growth stocks were again favoured over value, particularly in the US. Some of the best performers were healthcare and telecom stocks. Industrials and information technology performed well, however the information technology market saw some rotation, as companies such as Facebook and Netflix struggled.
- 6.2 Newton outperformed the benchmark. Their overweight position in information technology provided a boost, particularly due to stocks in Apple, Microsoft and Sony and a zero weight position in Facebook. Their holdings in UK equities detracted from performance. Harding Loevner underperformed the benchmark during the quarter, largely due to stock selection in information technology and consumer discretionary. They were underweight in US holdings and correspondingly more heavily weighted in Europe and emerging markets, which also detracted from performance. Schroders underperformed during another quarter in which momentum and growth were the strongest styles. Their positioning in technology sectors and consumer discretionary were detrimental to performance, particularly a lack of exposure to US information technology stocks, such as Apple and Microsoft. Outside of these sectors, holdings in healthcare and energy provided positive gains.



Equity performance – longer term

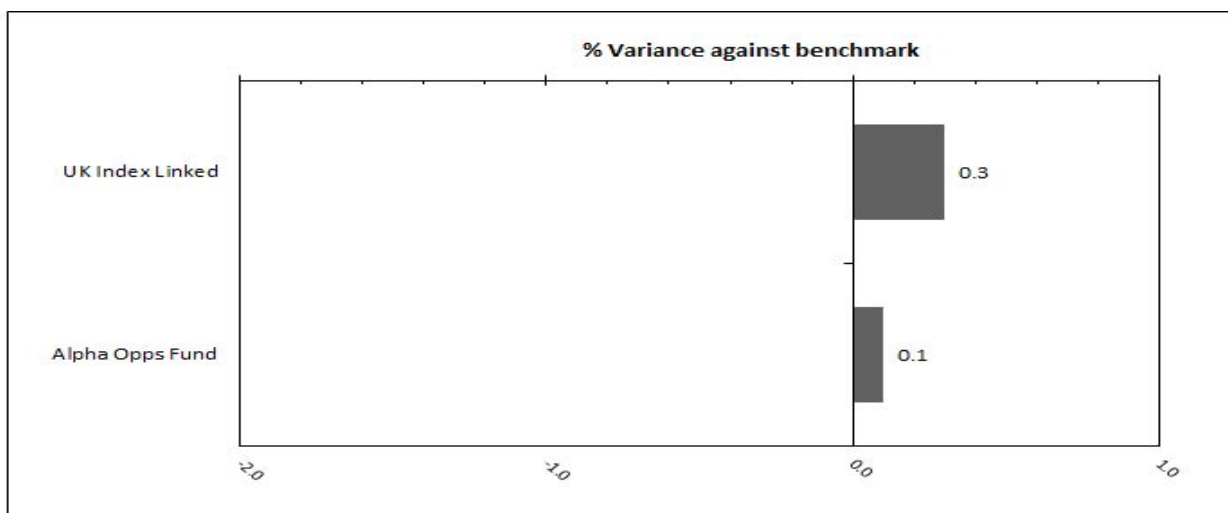
Manager	Benchmark Return 1 Year	Fund Return 1 Year	Relative	Benchmark Return Since Inception	Fund Return Since Inception	Relative
	%	%	%	%	%	%
L&G	5.9	5.9	0.0	7.9	7.9	0.0
Newton	12.9	15.8	2.9	14.3	14.9	0.6
Harding Loevner	12.9	17.0	4.1	14.3	16.3	2.0
Schroders	12.9	10.1	-2.8	14.3	13.2	-1.1

- 6.3 As shown in the table above, over the longer term L&G matched the benchmark during the twelve months ended September 2018, Newton and 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 September 2018

	Target Allocation	Fund Allocation	Benchmark Return	Fund Return	Relative
	%	%	%	%	%
M&G					
UK Index Linked	6	7	-1.4	-1.1	0.3
Alpha Opportunities Fund	9	7	0.2	0.3	0.1
TOTAL (Weighted Average)	15	14	-0.5	-0.3	0.2



- 7.1 Geopolitical events, particularly in Italy and emerging markets drew the attention of fixed income investors throughout the quarter, as currency and bond weakness in some countries increased risk aversion across markets. Developed market government bonds ended the quarter slightly higher. Italian government bonds were the most volatile, however the investment grade corporate bond sectors of Europe, the UK and US performed better than their sovereign counterparts, with the high yield markets continuing to perform well. Most corporate markets experienced further volatility, although at lower than historical levels.
- 7.2 M&G outperformed the benchmark during the quarter. They continue to be defensively positioned, given that credit spreads remain tight compared to longer term historic levels. M&G prefers financial and industrial holdings compared to utility firms and their outperformance in the Alpha Opportunities Fund is primarily attributed to industrial holdings. They took advantage of a number of anomalies in relative value across the index-linked gilt yield curve and maintained exposure to ultra-long index-linked gilts, versus shorter dated gilts.

Bond performance – longer term

Manager	Benchmark Return 1 Year	Fund Return 1 Year	Relative	Benchmark Return Since Inception	Fund Return Since Inception	Relative
M&G	%	%	%	%	%	%
UK Index Linked	1.4	1.7	0.3	9.0	9.4	0.4
Alpha Opportunities Fund	0.5	0.7	0.2	0.9	2.5	1.6

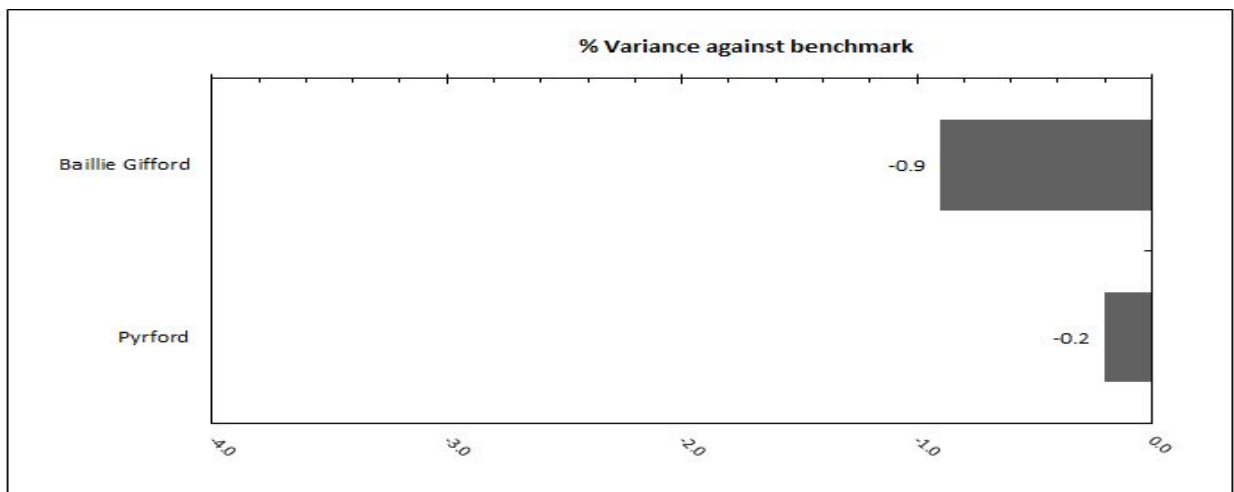
- 7.3 As shown in the table above, over the longer term both M&G portfolios outperformed the benchmark during the twelve months ended September 2018. Both portfolios also outperformed since inception.



8. Pooled Multi-Asset Performance

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

Manager	Target Allocation	Fund Allocation	Benchmark Return	Fund Return	Relative
	%	%	%	%	%
Baillie Gifford	7.5	7	1.0	0.1	-0.9
Pyrford	7.5	6	1.0	0.8	-0.2
TOTAL POOLED MULTI-ASSET	15	13	1.0	0.4	-0.6



8.1 Baillie Gifford underperformed the benchmark for the quarter. Detractors to performance included holdings in commodities, active currency and emerging market bonds. Holdings in infrastructure continued to produce good returns. Pyrford also underperformed during the quarter. Their exposure to UK equities, particularly holdings in National Grid and Vodafone, was one of the largest detractors to performance. However, returns from overseas equity holdings and short duration bonds performed 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	3.7	1.2	-2.5	3.6	4.8	1.2
Pyrford	3.7	1.1	-2.6	3.6	3.6	0.0

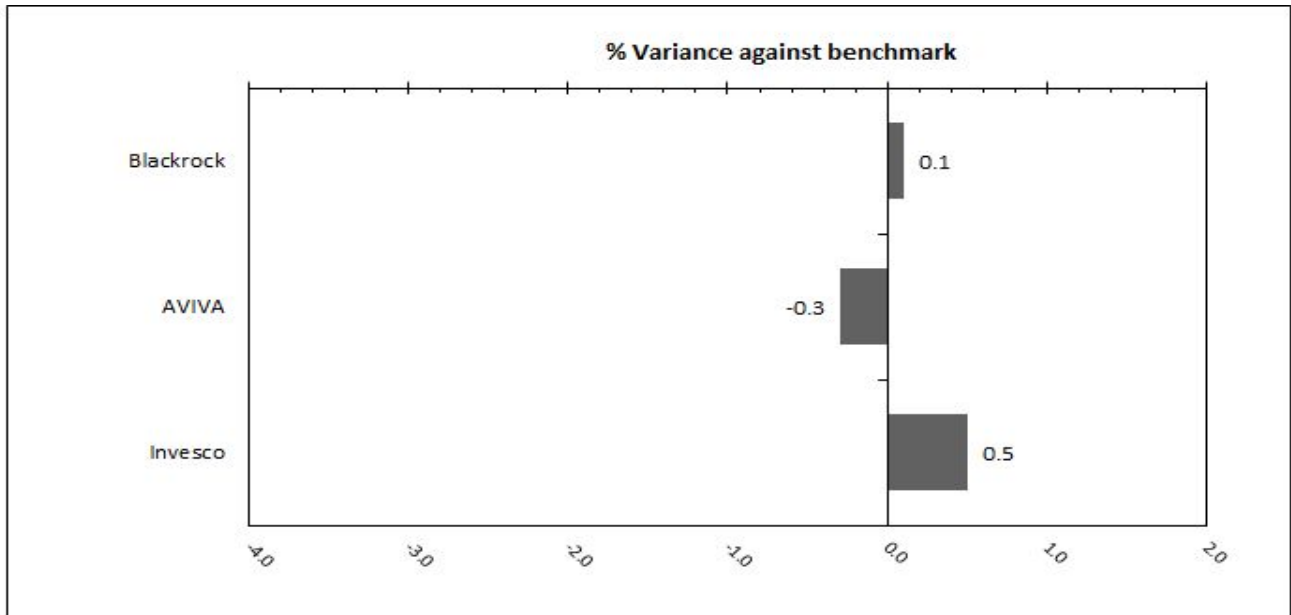
- 8.2 Baillie Gifford and Pyrford both underperformed the benchmark during the twelve months ended September 2018. Baillie Gifford outperformed the benchmark since inception and Pyrford matched the benchmark since inception.

9. Property Performance

Property Performance for the latest quarter ended 30 September 2018

Manager	Target Allocation	Fund Allocation	Benchmark Return	Fund Return Income	Fund Return Capital	Total Fund Return	Relative
	%	%	%	%	%	%	%
BlackRock	5	4	1.6	0.7	1.0	1.7	0.1
Aviva	3	2	1.6	0.7	0.6	1.3	-0.3
Invesco	2	2	1.6	0.9	1.2	2.1	0.5

- 9.1 Since March 2017, the fully committed sum of £15m has been with the Invesco fund. At 30 September 2018 Invesco's asset value still reflects the original commitment and not yet a meaningful performance component.



9.2 Intense demand for yield from income seeking investors has been holding up all of the UK property market. The probability of a severe correction remains low, with yield-driven investor demand for real estate set to persist in the current low interest rate environment. Having been on a slowing trend for much of the prior two years, retail sales growth enjoyed a resurgence which has continued into the current quarter. Office lettings in Central London also performed well. Although the industrial sector is still expanding, there are signs that activity within manufacturing is slowing.

9.3 During the quarter BlackRock outperformed the benchmark. Holdings in industrials and office performed strongly, the former as a result of increasing investor appetite and rental growth and the latter due to active leasing and increasing occupancy in Birmingham Business Park. Aviva underperformed the benchmark. This is attributable to holdings in retail sector funds have hindered performance and offset the outperformance of their other holdings. Standard Life UK Retail Park Trust was a notable underperformer in the quarter. The Industrial Property Investment Fund was the largest positive contributor to performance.

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	8.9	8.7	-0.2	4.7	1.8	-2.9
AVIVA	8.9	6.2	-2.7	8.2	7.6	-0.6



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

10. Alternatives Performance

Alternatives Performance for the latest quarter ended 30 September 2018

Manager	Benchmark Allocation	Fund Allocation	Fund Return
	%	%	%
Partners Group Global 2012	2.8	2.2	4.2
Partners Group Direct 2015	1.1	0.4	4.0
Partners Group Global 2015	1.1	0.5	4.1
M&G – UK Companies Financing Fund	0	0.1	1.2

- 10.1 Partners Group and M&G are not measured as part of the Fund's overall strategic benchmark. It is currently difficult to assess Partners Group's relative performance because the committed capital is still to be drawn down and deployed.
- 10.2 M&G's return of 1.2% for the quarter represents income of £5k earned during the quarter. No income was distributed during this quarter.

Alternatives Performance – longer term

Manager	Fund Return 1 Year	Fund Return Since Inception
	%	%
Partners Group Global 2012	16.9	11.1
Partners Group Direct 2015	7.8	-15.7
Partners Group Global 2015	2.2	-4.3
M&G – UK Companies Financing Fund	4.2	4.3



11. Targets - Annualised Rolling 3 Years to 30 September 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	19.5	21.5	17.7	-1.8	-3.8
<p>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 strong returns. During the third quarter of 2017 sector allocation was a drag on performance. The decline of equity markets in the first quarter of 2018 made it difficult to fully recover their position, however they outperformed in the second and third quarters.</p>					
Harding Loevner	19.2	22.2	23.0	3.8	0.8
<p>Harding Loevner 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 continued to outperform until the second quarter. However, during the third quarter poor stock selection in information technology and consumer discretionary hurt performance, along with an underweight position in US holdings. Good stock selection in other regions had previously compensated for this. These factors caused the manager to underperform during the quarter.</p>					
Schrodgers	19.2	22.2	17.8	-1.4	-4.4
<p>Schrodgers’ value 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. In late 2016 value was the best performing style, due to a significant market rotation following the surprise US election result. However, the start of 2017 saw some unwinding of this strong performance, as investors favoured growth over value by a significant</p>					



margin. In the final months of 2017 the market environment was more suited to Schrodgers' 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 value investing struggled. This position continued during the third quarter.

Baillie Gifford	3.6	6.6	5.3	1.7	-1.3
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During 2014 Baillie Gifford had a relatively strong year, benefitting from positive contributions from listed equities and emerging market bonds. Performance in 2015 was more mixed with exposure to economically sensitive assets, such as high yield and emerging market bonds struggling, balanced to some extent by positives from exposure to listed equities. In 2016 performance was ahead of target with the top 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 source of added value. 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. This continued into the third quarter, along with holdings in commodities and active currency.

Pyrford	3.6	6.6	4.7	1.1	-1.9
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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 outperformed consistently over 12 months, helped by unhedged position in overseas equity and bonds until the second quarter of 2017. The reversal of fortune was linked to the equity portion of their portfolio, having been positioned in high dividend paying defensive sectors perceived as sensitive to rising bond yields. The portfolio's bond holdings also produced negative returns, as government bond yields continued to edge up. Pyrford returned to outperformance during the second quarter of 2018, seeing positive returns from both equities and bonds in the UK and overseas, however they underperformed during the third quarter, largely attributed to exposure to UK equities.

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: 8 November 2018
Consultation with other officers		
Finance	Yes	Paul Audu
Legal	No	N/A
Equality Impact Assessment required?	No	N/A