PENSIONS INVESTMENT SUB-COMMITTEE

Minutes of the meeting held at 7.00 pm on 7 November 2018

Present

Councillor Keith Onslow (Chairman)
Councillor Russell Mellor (Vice-Chairman)
Councillors Gareth Allatt, Simon Fawthrop, Simon Jeal, David Jefferys and Gary Stevens

Also Present

John Arthur, M J Hudson Allenbridge Investment Advisers

63 APOLOGIES FOR ABSENCE AND NOTIFICATION OF SUBSTITUTE MEMBERS

There were no apologies.

64 DECLARATIONS OF INTEREST

Interests were declared by virtue of deferred membership of the Local Government Pension Scheme as per those previously notified (for the Register of Interests).

65 CONFIRMATION OF MINUTES OF THE MEETING HELD ON 13TH SEPTEMBER 2018 EXCLUDING THOSE CONTAINING EXEMPT INFORMATION

The Minutes were agreed.

In so doing two matters were raised. The first concerned the LCIV receiving any additional permissions under their Phase 3 of development which could lead to investments being managed on behalf of boroughs. The Chairman explained that the LCIV's Financial Plan had been raised in principle at the October Meeting of the LCIV Shareholder's Committee.

The second matter concerned the LCIV's Depositary. With the LCIV Interim CEO previously confirming Northern Trust as the LCIV's Depositary, it was minuted that a check would be necessary on whether a copy of the Depositary's report could be provided. This remained outstanding and it was agreed that the matter should be reflected as a continuing action point for the current minutes **(ACTION: LCIV/Director of Finance)**.

66 QUESTIONS BY MEMBERS OF THE PUBLIC ATTENDING THE MEETING

There were no questions.

67 PENSION FUND PERFORMANCE Q2 2018/19

Report FSD18086

Details were provided of the Fund's investment performance for the second quarter of 2018/19. Additional detail was provided in an appended report from the Fund's external advisers, MJ Hudson Allenbridge.

The market value of the Fund ended the September quarter at £1,045.5m (£1,017.9m at 30th June). The quarter total fund return was +2.84% against the benchmark of +3.36%. Detail on performance by individual fund managers was appended to Report FSD18086.

The Fund's medium and long-term returns remain very strong overall - the Fund ranking third in the PIRC LGPS universe for the year to 31st March 2018, first over three years, second over five years, first over ten years and second over 20 and 30 years. In addition to winning the LGPS Investment Performance of the Year in 2017, the Fund has also recently won the LGPS Fund of the Year (assets under £2.5bn) in 2018, recognising the consistent high performance of the Fund.

Information on general financial and membership trends of the Pension Fund was also outlined along with summarised information on early retirements. Final outturn details for the 2017/18 Pension Fund Revenue Account were included as was the second quarter position for 2018/19 and fund membership numbers. A cash surplus for the Fund of around £3m is expected for the year.

For the Sub-Committee's meeting on 5th March 2019, it was proposed to invite Baillie Gifford (global equities and fixed income) with MFS invited to the Sub-Committee's following meeting (currently set for 23rd May 2019).

John Arthur (M J Hudson Allenbridge) commented on the Fund's performance for the quarter. Reference was made to the Fund's increased value although underperformance from Baillie Gifford's Global Equity portfolio (accounting for over 40% of the Fund's assets) returned at 3.4% over the quarter leading to the Fund underperforming its benchmark by 0.5%. The quarter had not favoured Baillie Gifford's approach to investment growth and they had now underperformed over a couple of quarters. In view of the economic/market outlook, Baillie Gifford could be expected to struggle a little in future (but long term the portfolio had performed very well and continued to hit its long term performance target).

Conversely, MFS outperformed during the quarter on the Fund's other Global Equity portfolio and MFS were now more stable following a period of poor performance (MFS invests in a different manner to Baillie Gifford and was selected because of this diversification of investment philosophy and approach).

On economic outlook, a period of falling growth and rising inflation will be difficult for equities and fixed rate bonds. Events can happen to take the economy into different phases (e.g. Stagflation, Reflation, Deflation, increased productivity) causing uncertainty. In the U.S. The President tended to act specifically for the U.S. and economic growth. Mr Arthur was optimistic of having economic growth; however, recession was further away but when it occurs it could be more extreme.

The Fixed Interest portfolios and their value were discussed. Fixed interest provided diversification and returns will rise in a deflationary cycle when returns from equities reduce. Mr Arthur referred to removing some duration from fixed interest and explained how Fidelity can achieve a higher yield in such a difficult market (involving the purchase of Government debt). Provided a procurement process is not necessary, this was worth exploring, and a meeting could be arranged with Fidelity. Fidelity can then bring a proposal to the Sub-Committee's meeting on 5th March 2019. The Chairman questioned the value of the current Fixed Interest allocation and if Mr Arthur's approach looked possible, he suggested Members consider any better mandate. Although from an actuarial perspective it might not be appropriate to take too much from Fixed Interest, it would be a good area to look at given the market volatility. Supporting the approach, another Member asked to see information on U.S. default rates and securitised debt. It was highlighted that some 6.4% of Schroder's Alternatives portfolio is allocated to Securitised Debt and Mr Arthur indicated that (U.S.) default rates are particularly low.

A Member wanted to see the investment income that is paid to the Council from MAI and property funds to see how the return is spent. The Director advised that a memorandum summary can be produced in future with the quarterly Fund performance report **(ACTION: Director of Finance)**.

Concerning Baillie Gifford's under-performance, Mr Arthur did not expect the portfolio to fall much further and commented on the exceptional run of good performance (over recent years). Noting that Fixed Income is in line with benchmark, a Member suggested that passive is also looked at if Fixed Interest is reviewed. Mr Arthur indicated that he would not naturally put forward a passive investment in Fixed Interest.

RESOLVED that the contents of Report FSD18086 be noted.

68 PENSION FUND - INVESTMENT REPORT

Representatives from Schroders (Multi-Asset Fund Manager and Client Director) attended to present their investment report.

The Schroders ISF Global Multi-Asset Income (MAI) fund sets out to achieve a sustainable, stable investment outcome with an income objective of 4 to 6%

p.a. over a market cycle and an expected volatility of 5 to 7% p.a. The Fund had returned 4% p.a. since inception (GBP hedged).

The previous three months had been challenging for performance. At 30th September 2018, the Year to Date (YTD) contribution to return for Schroders MAI fund provided a 0.3% portfolio return in U S Dollars (Gross of Fees) and a return of -1.0% in GBP (Gross of Fees). Broken down, equity contributed 0.7% return, Fixed Income contributed -0.4%, Alternatives contributed 0.4% and cash and currency contributed -0.3%. Equities had been a driver for the marginal returns but fixed interest is challenging as interest rates are rising. Alternatives behave differently from other classes and are inexpensive, providing good returns in October. For cash and currency, sterling was a little difficult in view of Brexit but the risk had been managed.

Details were provided of current allocation and yield by asset class (allocations at 31st October 2018 and yields at 30 September 2018). Over the next four years, a yield of between 4% and 6% was expected. The presentation also illustrated the current portfolio composition with 26.9% allocated to equities, 49.6% to fixed income, 18.9% to alternatives and 4.5% to cash.

Although asset class returns for 2017 exceeded Schroders expectations, 2018 is proving more difficult. In 2017 only one asset class failed to return above 0% (US dollar) but so far in 2018 seven asset classes are failing to return with just five asset classes doing so i.e. US Tech Equities (9.8%), Oil (8%), US dollar (5.4%), US Equities (3%) and High Yield Debt (0.9%). October in particular had proved negative with only the US dollar asset class (2.1%) and Gold (2%) positively returning.

Concerning Schroder's view of global growth, this was forecast to be 3.3%for 2018 and 3% for 2019. Risk cycle trend data from 1978 to date for both the Business Cycle Indicator (BCI) and a US output gap model also suggested that an expansion stage is currently being experienced (particularly in the U.S.). However, this was not good for fixed income with global inflation gradually rising (and inflation rising faster in the U.S.). Central banks were also starting to raise interest rates slowly and Quantitative Easing had ended. With interest rates rising, Schroder's needed to be more creative (in obtaining returns). The presentation also showed that monetary policy is normalising with details provided on how value is being sought in equities (US equity valuations look extended and assets are inexpensive in the U.S). Buying cheaper assets was thought beneficial. Further details showed how a granular approach is being taken to fixed income (capitalising on market dislocations and inefficiencies).

Information was also provided on: alternative assets; current risk adjusted yield for the Global MAI strategy against other asset classes set against volatility; and a diagrammatic (dynamic) analysis of what can happen to the global economy (stagflationary, reflationary, deflationary and productivity boost) set against certain scenarios. A number of further slides were also appended to the Schroders presentation.

Concerning infrastructure, this had produced wealth but there were now challenges including those around Brexit. Longer term, the Multi-Asset Fund Manager considered infrastructure attractive, particularly in terms of what is available globally, but short term investment in infrastructure (over one to three years) was not considered so attractive.

On income, a 4.5% to 5% return was currently expected for the next 12 months with overachievement expected in the following 12 months (in the order of 5%). Four months previously, income was about 4% and to generate 5% at that point would have meant Schroders taking undue risk.

In regard to Brexit, the Fund Manager had a positive view on sterling, noting that UK data had surprised since the referendum vote. Against the U.S. dollar, sterling was particularly cheap leading to tentative moves back into sterling. The UK equity market was starting to look cheap and apart from infrastructure, UK assets are looking quite attractive.

In October, global equities fell some 7% to 8% and it was thought that this was due to the markets being too optimistic rather than a result of economic weakness. Schroders were ‘parking’ investments into alternative assets where real yield is obtainable; it would then move back into the market when it was more attractive. Reference was also made to dollar exposure to manage risk but more broadly Schroders sought to increase investment in alternatives.

Uncertainty was causing jitters (a Member noted developments concerning a U.S./China trade war, U.S. inflation, concerns over Italy, and the German Chancellor having given notice of leaving office) and the level of panic in markets during October had been considerable. The Fund Manager predicted the start of a negative period (a U.S./China trade war starting and more volatility) and Schroders needed to be more creative and move to other assets. China was worrying; official data indicated that the economy is well managed but non-official reports suggest a fall in electricity demand. The Fund Manager felt that a number of analysts are too optimistic and it is necessary to prepare now for the future.

Noting a 3.3% investment allocation to infrastructure (within a total alternatives allocation of 18.9%), the Director of Finance questioned whether the allocation should be more like 10% rather than 3.3% and whether any increased allocation would be non-U.K (any future nationalisation under a new Government would remove the attraction of U.K. based infrastructure). The Fund Manager considered 3.3% low but access can be difficult with infrastructure investment and an element of liquidity is necessary. She indicated that investment would be non-UK but preferred a 5% allocation to infrastructure rather than an increase to 10%.

A question was asked on how the allocation of assets is decided and whether fees are paid annually or quarterly. Schroders took a diversified approach (on allocation); should one asset not perform, others will perform and the sequence of returns mattered to create a stability (of income return).

Schroders have a qualitative process to focus on the value of assets in the economic cycle. Harnessing an algorithm and human input (for sentiment) combined to make a judgement. The Client Director indicated that fees are 0.35% of the value of an investment with invoices provided quarterly.

Although Schroders manage a £70bn sterling mandate which they had won, along with managing an additional £60bn, the Fund Manager confirmed there would be no disruption to the portfolio (in performance management) and her team would continue to focus on their current mandate for L B Bromley.

Following the discussion, and with the representatives having left the room, all Members agreed that an excellent presentation had been provided and the Chairman asked that the Sub-Committee's feedback be provided to the Schroders representatives **(ACTION: Director of Finance)**.

69 LOCAL PENSION BOARD - ANNUAL REPORT

Report FSD18081

Members noted the Annual Report of the Local Pension Board.

RESOLVED that the contents of the Local Pension Board Annual Report (dated October 2018) appended to Report FSD18081 be noted.

70 LOCAL GOVERNMENT ACT 1972 AS AMENDED BY THE LOCAL GOVERNMENT (ACCESS TO INFORMATION) (VARIATION) ORDER 2006 AND FREEDOM OF INFORMATION ACT 2000

RESOLVED that the Press and public be excluded during consideration of the items of business referred to below as it is likely in view of the nature of the business to be transacted or the nature of the proceedings that if members of the Press and public were present there would be disclosure to them of exempt information.

The following summaries
refer to matters
involving exempt information

71 CONFIRMATION OF EXEMPT MINUTES OF THE MEETING HELD ON 13TH SEPTEMBER 2018

Members received Part 2 minutes of the Sub-Committee's previous meeting and the Chairman requested that future Sub-Committee meetings include "Chairman's Update" as a regular item **(ACTION: Democratic Services).**

The opportunity was also taken at this point to apprise the Sub-Committee on certain matters under Part 2 proceedings of the meeting.

72 LONDON CIV - PENSION RECHARGE AND GUARANTEE AGREEMENTS

The report for this item had been withdrawn. It was considered too soon to look at recommendations for L B Bromley to enter into a Pension Guarantee Agreement (requested by the LCIV and City of London) and Pension Cost Recharge Agreement (requested by the LCIV) related to the pension liability of LCIV employees in the LGPS scheme. Further legal information was necessary and the matter would not be considered at the present time.

The Meeting ended at 9.55 pm

Chairman