Appendix 5

MJ HUDSON Allenbridge

London Borough of Bromley Pension Fund

Quarterly Report

Q4 2018

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Performance Summary

The poor market conditions lead to a fall in the value of the fund in the fourth quarter of 2018 to £960M. The Fund underperformed its Strategic Benchmark quite significantly returning -7.94% over the quarter, slightly more than 2% below the benchmark return of -5.91%. The Fund return now lags the Strategic Benchmark by almost 2% over the year returning -3.01% against the benchmark return of -1.09%. Over the longer term the Fund continues to outperform its benchmark despite this setback.

It is the underperformance in this quarter particularly which has affected the one year performance numbers. It has been caused by three main factors, firstly the Fund entered the quarter overweight in Equities against its Strategic Benchmark with a 65% exposure against the benchmark at 60% and correspondingly underweight Bonds, Multi Asset Income and Property, secondly The Multi Asset Income portfolios have an absolute benchmark related to short term interest rates which generates a positive return for every quarter even if markets fall and thirdly Baillie Gifford which manages the majority of the Funds Global Equities underperformed in the quarter.

Looking at each of these issues in turn:

1. The 5% overweight in equities and corresponding underweights in other asset classes cost the Fund approximately -0.50% in performance terms at the Total Fund level. The outperformance of equity markets over recent quarters had increased the weighting of this asset class in the Fund against the Strategic Benchmark which has static weights.

   It would be worth discussing whether the Fund should have limits on the deviation of its actual weightings against the Strategic Benchmark and thereby to automatically rebalance as the relative performance of individual asset classes moves the Funds asset allocation away from the Strategic Benchmark.

2. Both Multi Asset Income portfolios have an absolute return target set against LIBOR (a measure of short term interest rates). Fidelity target a return of LIBOR +4% and Schroders a return of LIBOR +5% per annum, both over the long term. By having the slightly higher return target you can assume that the Schroders portfolio takes slightly more investment risk to achieve its target than Fidelity.

   The LIBOR based targets reflect the desired return of the portfolios over the longer term but will not reflect the performance of specific asset classes in any individual quarter. With short term interest rates currently set by the Bank of England at 0.75% per annum, both the Fidelity and Schroder return targets will always

be positive irrespective of market returns. In a quarter where the vast majority of assets fell in value it will be almost impossible for either portfolio not to reflect this fall in its quarterly performance and thereby underperform its benchmark for that quarter. It is important, therefore, to look at the performance of these managers against their benchmark only over the longer term. This does not remove the fact that their performance against the benchmark in any specific quarter will affect the performance of the total Fund against its Strategic Benchmark for that quarter. The effect of this on the performance of the total Fund was approximately -1.0%. It is difficult to see an easy solution to this issue but remember it is less relevant over the longer term.

3. The Baillie Gifford global equity portfolio underperformed its benchmark by almost 2.0% in the quarter. This accounted for almost -0.75% of the underperformance at the total Fund level. Baillie Gifford invest with a philosophy which concentrates on a company's long term growth potential rather than any specific valuation criteria. They believe they are better able to analyse the long term growth potential of any business rather than calculate an exact valuation based on a company's short term profit numbers. They back this approach by investing over the long term which provides the time for this growth potential to be realised. They have performed exceptionally well over the long term and even after this set back have outperformed their benchmark by over 2% per annum over 5 years and by over 1% per annum since inception in 1999. This performance has added significant value to the Fund over the long term. The divergence of performance in the quarter is not out of line given the amount of investment risk in the portfolio against its benchmark. I would continue to back this manager to add value over the long term.

In total, these three items account for all of the Fund's underperformance against its benchmark of -2.03% over the quarter and the vast majority of the negative performance against the benchmark over the full year. Against this disappointing performance should be set the major asset allocation changes made by the Pensions Committee over the last 9 months. The Fund had a 75% allocation to equities as recently as 31/3/18. This has been reduced by firstly funding the departure of Bromley College purely with equities and then by allocating 20% of the Fund to Multi Asset income and 5% of the Fund to UK property, both of which performed better than equities in the final quarter of the year and since inception in last year. Because these moves are reflected in the Strategic Benchmark the benefit of these moves is not captured in the Fund's relative performance against its benchmark but have had a beneficial impact on the total value of the Fund and therefore the funding level when the next actuarial revaluation is done starting in March 2019.

Executive Summary

The fourth quarter of 2018 was one of those where the numbers tell the story. Because of that, below is a table of market returns in local currency. It is worth comparing the returns for Q4 with the returns for 2018 as a whole. This shows just how much the markets turned from a relatively stable, albeit low return environment, to one of 'risk off' and run for the cover of Government Bonds. The falls in equity markets in Q4, particularly in December, wiped out any small gain seen in the first 9 months of the year for all risk assets and boosted Government bond returns into positive territory. The fall in equities was exacerbated by light trading volumes over Christmas.

Market Indicators

	Index (Local Currency)	Q4 2018	Q4	2018	2017
Equities					
UK Equities	FTSE 100 Index	6728.13	-9.44%	-8.31%	11.41%
UK Equities	FTSE All-Share Index	3675.06	-10.15%	-9.09%	12.57%
US Equities	S&P 500 Index	2506.85	-13.84%	-5.18%	20.79%
European Equities	EURO STOXX 50 Price EUR	3001.42	-11.77%	-10.99%	9.34%
Japanese Equities	Nikkei 225	20014.77	-17.34%	-13.22%	18.37%
Emerging Markets Equities	MSCI Emerging Markets	965.67	-7.47%	-14.42%	37.85%
Global Equities	MSCI World	1883.90	-13.48%	-8.19%	22.97%
Government Bonds					
UK Govt Bonds	Bloomberg Barclays UK Govt All Bonds TR	371.50	2.18%	0.49%	1.96%
Euro Govt Bonds	Bloomberg Barclays EU Govt All Bonds TR	236.06	1.76%	0.99%	-0.01%
US Govt Bonds	Bloomberg Barclays US Treasury TR Unhedged USD Index	2217.70	2.70%	1.18%	2.35%
Bond Indices					
Pan-European Investment Grade	Bloomberg Barclays Pan-European Aggregate Corporate TR Index Value Unhedged	226.28	-0.69%	-1.40%	2.03%
Pan-European High Yield	Bloomberg Barclays Pan-European HY TR Index Value Unhedged	367.70	-3.85%	-3.71%	5.91%
US Corporate Investment Grade	Bloomberg Barclays US Corporate Investment Grade TR Index Unhedged	175.03	-0.09%	-2.07%	6.37%
US High Yield	Bloomberg Barclays US Corporate High Yield TR Index Value Unhedged	1909.36	-4.72%	-2.18%	7.19%
Commodities					
Brent Crude Oil	Generic 1st Crude Oil, Brent, bbl.	53.80	-34.96%	-19.55%	-15.03%
Natural Gas	Generic 1st Natural Gas, MMBtu	2.94	-2.26%	-0.44%	26.11%
Gold	Generic 1st Gold, 100oz	1281.30	7.54%	-2.14%	-12.04%
Copper	Generic 1st Copper, lb	263.10	-6.20%	-20.28%	-24.09%
Currencies					
GBP/EUR	GBPEUR Spot Exchange Rate	1.11	-0.86%	-1.15%	4.18%
GBP/USD	GBPUSD Spot Exchange Rate	1.27	-2.19%	-5.68%	-8.68%
EUR/USD	EURUSD Spot Exchange Rate	1.15	-1.31%	-4.61%	-12.39%
USD/100JPY	USDJPY Spot Exchange Rate	109.66	-3.55%	-2.69%	3.79%
AUD/USD	AUDUSD Spot Exchange Rate	0.70	-2.51%	-9.81%	-7.70%
Alternatives					
Infrastructure	S&P Global Infrastructure Index	2289.51	-5.22%	-9.83%	19.83%
Private Equity	S&P Listed Private Equity Index	120.16	-17.79%	-12.99%	25.85%
Hedge Funds	Hedge Fund Research HFRI Fund-Weighted Composite Index	13488.92	-5.35%	-4.07%	7.30%
Property					
UK Property	UK House Price Index - Average	230630.00	-0.51%*	2.77%*	5.00%
Volatility					
VIX	Chicago Board Options Exchange SPX Volatility Index	25.42	111.83%	160.18%	-14.09%

*Up to November 2018

So, what was it that changed market sentiment in the fourth quarter?

The global economy continued to slow as the major economies advanced towards the latter stages of the business cycle with only Japan seeing a pick up from a natural disaster impaired Q3. Inflation fell, mainly driven by the fall in Oil prices which were down 35% during the quarter, this reinforced the feeling of a slowing economy.

	GDP		CPI		
	Q3 2018	Q4 2018*	Oct	Nov	Dec
UK	0.60%	0.30%	2.40%	2.30%	2.10%
US	3.40%	2.60%	2.50%	2.20%	1.90%
Eurozone	0.20%	0.30%	2.20%	1.90%	1.60%
Japan	-2.50%	2.10%	1.40%	0.80%	0.30%

What worried markets, I believe, was the initial lack of recognition of the slowdown from the US Federal Reserve which raised interest rates by 0.25% in September and then again in December. US rates now stand at 2.5%. With the new Fed chair, Jay Powell, an unknown quantity and his relationship with Trump already under some stress, market commentators had limited insight over the Fed's likely response to a slowdown and this created uncertainty. China also looked to be slowing, partly due to the effect of trade frictions with the US.

The lesson to take from this period is that, with many assets classes valued above historic levels, Central Banks withdrawing liquidity from markets and high levels of political stress globally, any further uncertainty can lead to a sharp sell-off in risk assets. Equity markets bottomed on the 27th December and following some more 'dovish' noises from the US Fed, suggesting a slower pace of future rate rises, risk assets have shown some recovery. At the time of writing (19/2/19) risk assets have reversed around 50% of the December sell off.

- US equities declined particularly steeply in December with the S&P 500 falling by 13.8% over the quarter; disappointing corporate earnings from tech stocks, particularly Amazon and Alphabet, which missed revenue targets, gave rise to investor concerns over the broader earnings slowdown. European stocks also declined given the backdrop. Continued uncertainties surrounding Brexit and the stability of the UK government continued to act as a drag on the UK market.

- In December, the Federal Reserve increased rates by 25 basis points to a range of 2.25%-2.50%, its fourth rate hike in 2018. The Bank of England kept interest rates at 0.75% - the highest level since 2009.

- US Treasury yields were lower and the yield curve flattened. 10-year UK government yields also fell from 1.59% to 1.28% over the period, as a flight-to-quality increased amidst Brexit and macroeconomic uncertainty.

- US Investment Grade (IG) bond yields did not follow Government yields lower leading to widened credit spreads, bucking the trend of narrowing spreads seen over the last few quarter. Press release research[1] suggested that $90 billion worth of bonds have been downgraded from A to BBB within Investment Grade, the largest amount since Q4 2015.

- Widening credit spreads were also present in the high-yield bond market as interest rate hikes and the high levels of corporate debt raised concerns over corporate creditworthiness.

- The dollar continued to strengthen in Q4, as trade tensions looked to be easing with the meeting of Presidents Trump and Xi at the G20 summit and interest rates were increased. Weakness in Sterling continued as unease over the potential Brexit agreement persisted. Yen strengthened in Q4, as investors looked for a safe haven.

- Gold rose by 7.5% over the quarter reversing the declining trend seen since the start of the year, as volatility in the stock markets and concerns over the global economy left investors seeking a safe haven. Equity markets volatility over the quarter made the VIX (a measure of equity price volatility) jump from 12.1 to 25.4.

[1] https://www.cnbc.com/2018/12/07/bond-markets-flashing-red-and-an-oil-plunge-could-make-things-worse.html

Global Outlook

The fourth quarter of 2018 served as an indicator of choppier waters ahead for investors; however, most market participants are looking forward to 2019 with a certain amount of nervousness that even rougher conditions loom large. While brighter days still punctuate the gloom on the release of strong jobs reports or surprisingly good earnings for some bellwether stocks, market sentiment has currently turned from cautious optimism that the bull market had room to run yet, to an acceptance that all good things come to an end.

The pessimism seems to be derived from three main areas: that the US Technology (FAANG[2]) stocks may have come back down to earth from unsupportable valuations and can no longer drive markets higher on their own; that the economic cycle which seemed to peak in 2018 might be showing signs that it is turning; and that central banks are aggressively draining liquidity from the global system even while inflation seems relatively tame and private sector balance sheets have failed to "repair the roof while the sun was shining" and not deleveraged to an extent which might have lowered borrowing costs and insulated against rising interest rates in the future.

Geopolitical events, from Trump's stalled trade war against China, to the possible denouement of Britain's Brexit saga, also create uncertainty and lend themselves to pessimistic forecasts as we look ahead, although successful trade resolutions are likely to cheer markets substantially.

The loudest prophets of doom, however, have come from those worried about the removal of liquidity from the global market system by central bankers keen to reverse more than a decade of unconventional monetary policy. Stan Druckenmiller's adage that "Earnings don't move markets, It's the Fed" was clearly on his mind as the billionaire investor took to the pages of the Wall Street Journal to warn Jay Powell about further rate rises, while Charles Gave describes the effects of quantitative tightening as signifying a change from there being "more money than fools" to "more fools than money". A possible sympathetic Fed response to these warnings, reneging on planned rate rises, has led some analysts to argue that a recession in 2020 is now more likely than one in 2019.

However, market contrarians do remain, but rather than prophesying doom, these contrarians argue that risk is overblown, that economic fundamentals remain strong and, that worries about the creditworthiness of borrowers has outstripped the reality. While some areas of the globe might not be as robust as they once were, the US and Britain, for example, still have full employment with signs of real wage growth, while the Bank of England released a blog post arguing that household debt fears should be considered overwrought. Far from rotating to more defensive stocks, or allocating more to cash, they argue that the best strategy is to remain fully invested, adding to positions as some valuations drop on market skittishness.

Although markets ended 2018 on a significantly lower note, partly affected by light trading over the Christmas period, these more optimistic voices help support market levels which still price in a relatively optimistic outlook for future corporate earnings. As 2019 proceeds and, more data points either continue to give support for both optimists and pessimists, or a pattern builds that the current valuation levels cannot be sustained, we shall see if those predicting a 2019 recession were right or whether the pain can be delayed for just a little longer.

Economic impact of Brexit

Brexit has proven to be a highly emotional subject and I will attempt to stick to investment and economic issues, nonetheless, these views are my own and not those of MJ Hudson Allenbridge.

Investment markets will be driven by the outlook for global economic growth and geopolitical risk going forward and, as such, the effects of Brexit will have a limited impact on global investment returns in the medium term. From a UK specific viewpoint, however, the impact could be more substantial. Uncertainty over the outcome of Brexit negotiations has already been detrimental to the UK economy with signs of companies delaying capital investment plans until they have a clearer view of the regulatory and trade environment they will be operating in going forward. Higher inflation, caused by the weakness of sterling, has also weakened consumer spending, although

[2] FAANG = Facebook, Amazon, Apple, Netflix and Google.

whether the fall in sterling was as a direct result of the outcome of the referendum or this event just underlined the overvaluation of the currency is a moot point.

Because mainland Europe is the UK's largest trading partner, any disruption to the flow of goods between these two trading partners will have a detrimental impact on both the UK and European economy. As such, Brexit will be negative for the UK economy in the short term whatever form it takes. The softer the Brexit the less this impact will be as the changes to trading regulations and practices will be reduced. A hard Brexit or no agreement could lead to substantial barriers to trade including tariffs and could create a sudden sharp shock to the economy. The question is whether this short term impact will be worth the greater flexibility this gives the UK government in setting future policy. The softer the Brexit the less the short term economic impact but the more the UK will remain bound by EU regulations and the less flexibility this will give the Government to set policy which directly benefits the UK economy, the harder the Brexit the greater the short term impact but the greater the freedom with which future economic policy can be set. The UK is an innovative and entrepreneurial society and I have no doubt it will recover from whatever form of Brexit is finally agreed but this may take some time and, under a no deal Brexit, it may take many years to fully recover from the disruption and higher trading costs incurred, with any savings from not contributing to the EU budget quickly lost in slower GDP growth and any potential recession lowering tax returns.

Performance report

Asset Class/ Manager	**Global Equities/ Baillie Gifford**
Fund AuM	£369m Segregated Fund; 38.5% of the Fund
Benchmark/ Target	MSCI All Countries World Index +2-3% p.a over a rolling 5 years
Adviser opinion	Manager continues to meet their performance target
Last meeting with manager	No meeting this quarter
Fees	0.65% on first £30m; 0.5% on next £30m; 0.35% thereafter

The manager underperformed their benchmark by -2.0% in the fourth quarter and although the portfolio has underperformed over the last year, over the longer term the manager has added significant value and continues to hit their performance target of outperforming the MSCI All Countries index by 2% per annum over a five year period. The manager made efforts to diversify the portfolio during the early part of 2018, introducing a number of new holdings to but always within their long term growth philosophy. Whilst the scale of the underperformance is high it is not out of balance with the level of investment risk taken in this portfolio. When equity markets fall it is often easier to mark down stocks whose valuation discounts future growth than those stocks trading close to their asset values or on a low multiple of annual cash flow and Baillie Gifford's investment approach is likely to make them underperform in rapidly falling markets. In this quarter, this effect was exasperated by the shift in sentiment on a number of high profile technology companies which had, until recently, been the darlings of the stock market and responsible for pushing the index higher. The manager's commitment to research and investment over the long term continues to drive the portfolio and should add value over the longer term.

Asset Class/ Manager	**Global Equities/MFS**
Fund AuM	£210m Segregated Fund; 21.9% of the Fund
Benchmark/ Target	MSCI All Countries World Index
Adviser opinion	
Last meeting with manager	2/10/18 John Arthur / Rob Almeida; David Holding
Fees	0.6% on first £25m; 0.45% on next £25m; 0.4% thereafter

The MFS Global Equity portfolio returned -8.9% in the third quarter, outperforming its benchmark by 1.7%. The manager has underperformed over the last 1 and 3 year periods but has outperformed their benchmark over 5 years by 1.4% which is a creditable performance. MFS have an investment philosophy which concentrates on companies with defendable business models on attractive stock market valuations and this acts as a good balance to the Baillie Gifford, growth orientate, portfolio covered above. It is also an investment style which is likely to outperform in rapidly falling markets as many of the investments in the portfolio have strong valuation support in the form of physical assets/annual cash flow or high dividend yield.

The performance remains within expected tolerances against the benchmark. The speed of technological change is undoubtedly undermining many, previously secure, business models. I have discussed with MFS how they monitor this issue and will pursue this discussion further in due course. I note the London CIV's intention to commence the search for a Global Equity Value manager latter this year and will follow this process with interest as it will provide a data point on what funds are available in this area as well as an insight into the CIV's capabilities in manager selection.

Asset Class/Manager	**Global Equity/ Blackrock**
Fund AuM	£10.4m Pooled Fund; 1.1% of the Fund
Benchmark/ Target	MSCI All Countries World Index
Adviser opinion	A decision needs to be taken with the remaining monies in this portfolio
Last meeting with manager	No meeting this quarter
Fees	0.3% of fund value

Much of this portfolio has now been realised to finance the Fund's investments into Multi Asset Income and UK Property. Action should now be taken with the remaining monies as they are not of a scale to influence the return of the Fund as a whole and add unnecessary complexity through the addition of an additional manager.

Blackrock invests this portfolio by analyses vast quantities of data from foot falls in shopping malls and credit card transitions to investors risk appetite and hedge funds investment flows. Each data point gives insight into the underlying economic situation, investor sentiment or individual company prospects. The manager uses short term changes in the data to act as an early indicator and the portfolio is repositioned automatically to take advantage of these predicted changes. The portfolio seems to outperform over relatively long periods and then suffer a more significant downturn when market change more rapidly and perhaps act more irrationally. The portfolio has performed roughly in-line with its benchmark over the longer term but has underperformed over the last year and 3 months.

Asset Class/Manager	**Fixed Interest/ Baillie Gifford**
Fund AuM	£57m Pooled Fund; 5.9% of the Fund
Benchmark/ Target	Tailored benchmark
Adviser opinion	Benchmark performance over the medium term
Last meeting with manager	No meeting this quarter
Fees	0.3% of fund value

The portfolio has a composite benchmark weighted 44% UK Government Bonds (GILTS) and 44% Non-Government Investment Grade Bonds with a 6% allocation to both Emerging Market Bonds and to High Yield Bonds. The portfolio has an average credit rating of single A, a duration of 8.7 years and is currently yielding 3.7%.

Whilst Government Bond prices rose during the fourth quarter as investors fled risk assets and sought security, all other bonds fell so the cost of credit rose and the lower the quality of that credit the more it rose. This portfolio has achieved below benchmark returns over the last quarter and year and has matched its benchmark over all longer

time periods. Whilst the manager is taking limited investment risk against the benchmark at the current time the portfolio is overweight in both Emerging Market bonds and High Yield bonds against the benchmark both of which detracted from performance in the fourth quarter due to their higher credit risk.

Given the outlook for the UK economy of sluggish growth and flat interest rates, UK Government Gilts are unlikely to provide any return over their yield (sub 2% at present) unless market endure a prolonged period of global uncertainty and potential recession causing a more major reappraisal of risk appetite. However, exposure to Government Gilts does provide diversification in these circumstances and potentially be one of the few asset classes to provide positive returns in this environment.

Asset Class/Manager	**Fixed Interest/ Fidelity**
Fund AuM	£76m Unit Trust; 7.9% of the Fund
Performance target	50% Sterling Gilts; 50% Sterling Non-Gilts; +0.75 p.a rolling 3 year
Adviser opinion	Manager continues to meet long term performance targets
Last meeting with manager	John Arthur/ Pete Turner/Cllr Onslow
Fees	0.35% on first £10m; 0.3% on next £10m; 0.21% on next £30m; 0.18% thereafter

The Fund has a current duration of 9.5 years and a yield of 2.2% both of which are close to the benchmark. The uncertainties around an eventual Brexit deal have caused the manager to move very close to the benchmark in terms of yield, duration and credit quality. The manager remains cautious despite the higher yields now on offer in some areas of the market post the sell-off in the fourth quarter of 2018.

Whilst the portfolio underperformed marginally during the quarter it has performed well over the longer term outperforming its benchmark over 3 and 5 years and since inception in 1998 by close to 1% per annum. Given the low level of yields now available within this mandate and the lacklustre performance of the UK economy I feel it is unlikely that the manager will add such value over the near future.

With this in mind, Pete Turner, Cllr Onslow and I met with the manager in January of this year to discuss possible changes to the mandate. Fidelity manage a number of bond funds which may be suitable for your Fund to invest in, the most promising of which is their Multi Asset Credit fund which invests in a variety of different bond markets globally looking to generate performance through geographic asset allocation and via different credit sectors as well as through the selection of the individual bonds. This fund has a high degree of flexibility to manage investment risk and is less reliant on the performance of the UK Gilt market to generate investment returns. It does, however, take more credit risk and may underperform the existing mandate during a prolonged global downturn.

It is this balance between holding a low yielding asset in Government Bonds as at present or investing in a broader range of Credit Bonds which will provide a higher yield but more volatility and have the potential to correlate with Equities in the event of a major market fall. Ideally you select a manager who has the ability to switch asset allocation to more defensive Government Debt if they predict a market setback but this is hard to get right and few managers show real skill in predicting such an event. I have a further meeting arranged with Fidelity on this issue and will report back in due course.

Asset Class/Manager	**Multi Asset Income/ Fidelity**
Fund AuM	£76m Pooled Fund of Funds; 7.9% of the Fund
Performance target	LIBOR +4% p.a.
Adviser opinion	Too early to make any assessment
Last meeting with manager	No meeting this quarter
Fees	0.4% on first £20m; 0.3% on next £30m; 0.25% on next £100m; 0.18% thereafter

This mandate was funded on 20th February 2018. It invests across multiple asset classes including Alternatives e.g. property, infrastructure, leasing and direct lending, via a Fund of Funds approach. It has a target yield of 4% per annum and is designed to help cover the cash flow requirements of the Fund into the future.

The manager returned -3.2% in Q4, this was significantly below the benchmark return for the quarter. A comment about the benchmark is made earlier in this report. The portfolio is generating the required yield from a diverse set of assets but in a quarter where almost all asset classes fell it proved impossible to generate a positive return.

The Funds allocation to Multi Asset Income provides a source of income to cover pension payments but is also intended to provide some protection from falling markets such that the assets can continue to provide this level of income going forward. Over the fourth quarter global equity markets fell -13.5% and corporate bonds -2%, it is against this environment that the portfolios fall of -3.2% should be set. This seems a credible return given the state of markets and acts as a useful stress test for the asset class and the manager. The true ability of the manager will only be seen over the longer term but so far the diversification of the portfolio has provided some protection from falling markets as intended.

Asset Class/Manager	Multi Asset Income / Schroders
Fund AuM	£112m Pooled Fund; 11.6% of the Fund
Performance target	LIBOR +5%
Adviser opinion	Too early to make any assessment
Last meeting with manager	Manager presented at the last Pension Committee meeting
Fees	0.35% of fund value

£120m was invested into this fund during the second quarter of 2018. The portfolio returned -4.9% during the quarter, significantly below the benchmark return for the period. A comment about the benchmark is made earlier in this report. The most obvious comparison for this portfolio over shorter time period is the performance of the Fidelity Multi Asset income fund which is similar in structure to this one. Schroders portfolio has a slightly higher return target and as such will take slightly more investment risk to achieve this. In a quarter such as this one, where all investment risk failed to pay off, it is unsurprising to see the value of this portfolio fall. The return of -4.9% should be seen against the return of -3.2% achieved by the Fidelity portfolio and is therefore slightly disappointing.

During the quarter the manager reduced exposure to global equities and increased exposure to Government Bonds, Convertibles and Emerging Market Debt. The portfolio remains well diversified and is currently yielding 4.7% per annum.

Currently this portfolio is invested in a dollar fund with the currency risk then hedged back to Sterling for you as a UK based client. The manager has offered to create a Sterling based version of this fund which will reduce the amount of currency hedging and should be marginally positive for performance going forward, especially as US interest rates rise and the hedging the currency becomes more expensive. This is a sensible suggestion and it is pleasing to see the manager offer to do this at their own cost. There would therefore be no transaction costs incurred by the Fund is moving to this new vehicle. The Fund would initially be the only investor in the new vehicle which could hamper disinvestment somewhat if that became an issue. Longer term the manager is making this offer because they value you as a client and what to deliver the best returns possible, but also because they hope the new vehicle will be attractive to other UK based investors which could ease any future divestment by Bromley.

I recommend this be given serious consideration by the committee and if instructed will meet again with the manager to take this forward.

Asset Class/Manager	UK Property/ Fidelity
Fund AuM	£49m Pooled Fund; 5.1% of the Fund
Performance target	IPD UK All Balanced Property Index
Adviser opinion	Too early to make any assessment
Last meeting with manager	
Fees	0.75% of fund value

The portfolio returned 2.4% in the fourth quarter, in line with its benchmark. This made UK Property the best performing asset class during the quarter. A final investment into the fund was made during the quarter and the fund has now reached its intended allocation at 5% of the fund.

The fund now holds 45 properties spread across the UK and across all major property types. It has a 5% exposure to retail assets which is significantly below the index weighting and whilst it is seeing some pressure on lease terms in this area these are within current expectations. The fund has scope for rents to rise as vacancies are filled and rent free periods expire and although their view of the market is becoming more cautious in the shorter term they do still expect the fund to return 7-8% per annum over the longer term despite the potential for near term weakness with scope for short term volatility through the Brexit process.

Global Economy

While global expansion continues, albeit less synchronised than last year and at a slightly reduced pace from the summer, many major economies are now heading towards more advanced stages of the business cycle. The US Fed's less accommodative monetary policy stance, the US-China trade tensions and China's economic slowdown as it shifts towards consumption rather than investment, are putting pressures on the global economy.

Table 1: Quarterly GDP Growth Rate

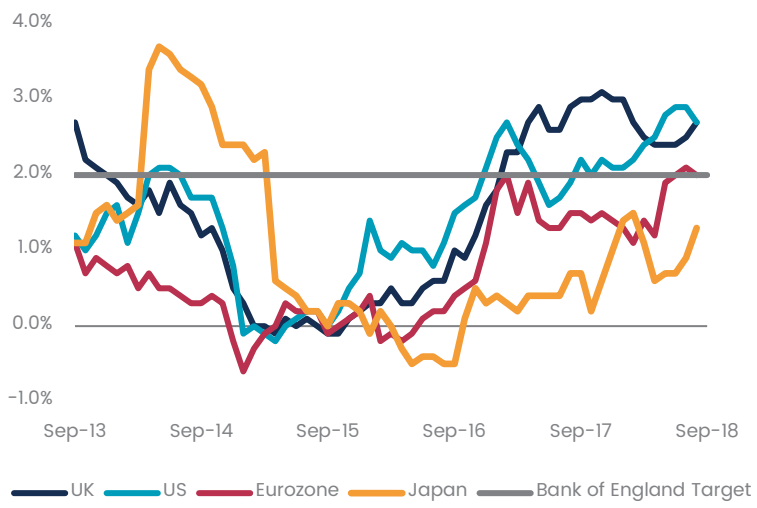
	US GDP	UK GDP	Eurozone GDP	Japan GDP
Q3 2018	3.50%	0.40%*	0.40%*	0.70%*
Q2 2018	4.20%	0.40%	0.40%	3.00%
Q1 2018	2.20%	0.10%	0.40%	-0.90%
Q4 2017	2.30%	0.40%	0.70%	0.90%

Source: Bloomberg. *Forecasts based on leading indicators.
Notes: UK Real GDP (Ticker: UKGRABIQ Index), US Real GDP (Ticker: EHGDUS Index, Eurozone Real GDP (Ticker: EUGNEMUQ Index), Japan Real GDP (Ticker: EHGDJP Index)

GDP: In the US, GDP numbers came in strong at 3.5%, slightly higher than expected as consumer spending underpinned growth, offsetting weak business investment and a drop in exports which widened the US trade deficit. The latter rose to a five-month high in July, as a result of the administration's protectionist trade policy - although towards the end of Q3, the trade deal between the US, Mexico, and Canada had been agreed.

In the UK, GDP figures were revised upwards as the economy grew faster than expected over the summer. However, there was still cause for concern as economic growth flat-lined in August.

Chart 1: 5-year CPI to September 2018



Source: Bloomberg.
Notes: UK: UK CPI EU Harmonised YoY NSA (Ticker: UKRPCJYR Index); US: US CPI Urban Consumer YoY NSA (Ticker: CPI YOY Index); Eurozone: Eurostat Eurozone MUICP All Items YoY Flash Estimate

CPI: US inflation fears calmed in Q3, as consumer prices rose less than expected. Inflation figures reached 2.3%, slowing down from 2.9% in Q2 2018. Slower increases in rental costs and energy prices contributed to the decline. However, low unemployment and wage increases in the US, which helped to boost consumer spending, also contributed to the Fed's decision to tightening its monetary policy stance.

In the UK, inflation generated by the fall in sterling following the EU referendum abated; however, households were squeezed further as CPI inflation unexpectedly rose to 2.7% in August - up from 2.4% in the second quarter. The inflation rate still remained above the Bank of England's 2% target, leading to an increase in interest rates to 0.75% – the second rate rise in 2018.

Central Banks: Central banks took further steps to slow or reverse their monetary stimulus programmes. The Bank of England increased rates due to the strengthening economy, underpinned by low unemployment levels, increasing consumer spending, and wage inflation. The Federal Reserve raised rates again in September by 25 basis points, to a range of 2.0%-2.25%, with a further rate rise expected later this year. In the Eurozone, the ECB is looking to keep rates constant at least through the summer of 2019 as its programme of quantitative easing comes to an end.

Political Headlines: Political turmoil continued to trouble markets as trade tensions between the US and China escalated. The Italian government set next year's budget deficit to 2.4%, which was more than expected by the market. In Mexico, the socialist candidate won the election by a landslide but seemed eager for better relations with the United States and Trump administration regarding NAFTA issues.

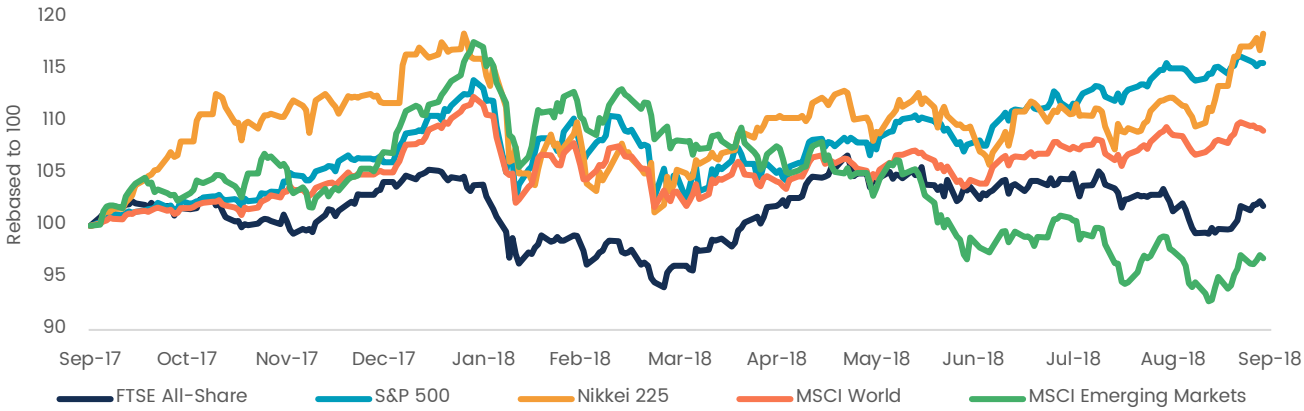
Equities

Global equities registered gains in Q3 partly due to the strength of the US economy; however, political uncertainties and fear of further trade tension escalations still dominated market concerns across the board with emerging markets enduring the most of the volatile conditions. The MSCI World returned 5.6%[3] in Q3, compared to 1.4% in the previous quarter.

UK: In addition to the above, continuing Brexit uncertainty contributed to the negative returns in Q3. UK financial and mining stocks were particularly affected due to their strong exposure to emerging markets. The FTSE 100 fell by -0.7% and FTSE-All share by -0.9%.

US: Performance in US equities remained robust over the period thanks to strong economic growth and corporate earnings. Further trade tariffs were introduced targeting China. Despite this, the US reached the milestone of the longest bull market in history, as the S&P 500 returned 7.7% and the Dow Jones Industrial Index rose by 9.6% over the quarter.

Chart 2: Global Equity Markets Performance



Source: Bloomberg. All in local currency. FTSE All-Share Index (Ticker: ASX Index) S&P 500 Index (Ticker: SPX Index) Nikkei 225 Index (Ticker: NKY Index) MSCI World Index (Ticker: MXWO Index) MSCI Emerging Markets (Ticker: MXEF Index)

Japan: The MSCI Japan Index and the Nikkei both posted positive returns of 6.3% and 8.8%, as the Japanese Yen fell against the US Dollar boosting exports. Economic growth rebounded strongly as corporate earnings continued to improve in line with market expectations.

Emerging Markets: Emerging markets had another volatile quarter, due to the strength of the US dollar, global trade tensions, and an increase in risk aversion. South Africa and Turkey underperformed, the latter suffering the most with the sell-off in the Lira, as geopolitical tensions escalated with the US. However, Mexico outperformed following a decisive Presidential election result and an agreement with the US on the renegotiation of NAFTA. Russian equities benefited from strength in crude oil prices. The MSCI EM Index posted a return of -1.0% over the quarter.

EU: Worries over potential US tariffs on EU goods plagued the markets; this later cooled as an agreement to work towards zero tariffs on non-auto industrial goods materialised, while car tariffs were put on hold. Stock market returns were positive but financial stocks, and in particular Italian banks, weighed on performance, as there were worries over the Italian budget.

China: Further trade tensions with the US caused the MSCI China Index to fall by 7.7%. The US implemented tariffs on Chinese goods and, in September, announced a 10% tariff on $200 billion of Chinese goods, which resulted in the Chinese retaliating by enforcing their own tariffs on US imports. The central bank also introduced measures to try to stabilise the currency (Renminbi).

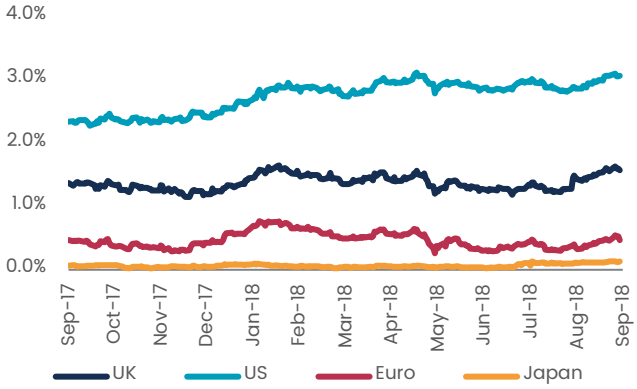
[3] All return figures quoted are Total Return, calculated with gross dividends reinvested. Source: Bloomberg.

Fixed Income

Global bond markets were resilient over Q3: government bond yields rose due to positive macroeconomic data, mainly from the US, and corporate bonds registered positive total returns in local currency. However, the number of geopolitical issues continued to weigh on bond investor sentiment.

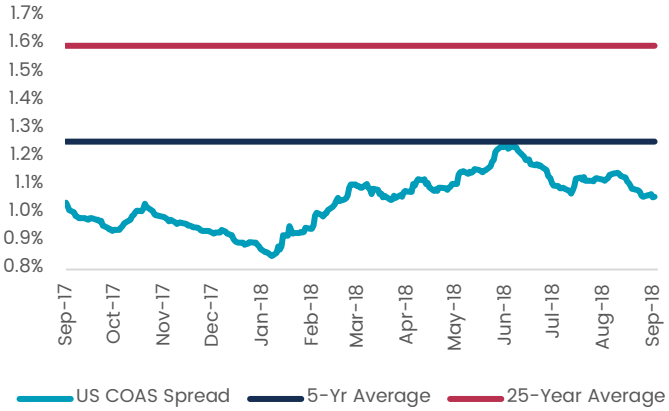
Government Bonds: Government bond yields rose over the quarter: US 10-year yields rose from 2.86% to 3.06%, Bund yields rose from 0.30% to 0.47% and UK Gilt 10-year yields rose from 1.42% to 1.57%. Another rate rise by the US Fed at the end of the year is widely expected while base rates in the UK reached their highest level since 2009. Italian 10-year bond yields rose from 2.68% to 3.06%, as concerns remained with the populist coalition as they announced a target budget deficit higher than market expectations and previous agreements with the EU.

Chart 3: Government Bond Yields



Source: Bloomberg.
Notes: US Generic Govt 10 Year Yield (Ticker: USGG10YR Index)
UK Govt Bonds 10 Year Note Generic Bid Yield (Ticker: GUKG10 Index)
Euro Generic Govt Bond 10 Year (Ticker: GECU10YR Index)

Chart 4: US Corporate Bond Spreads

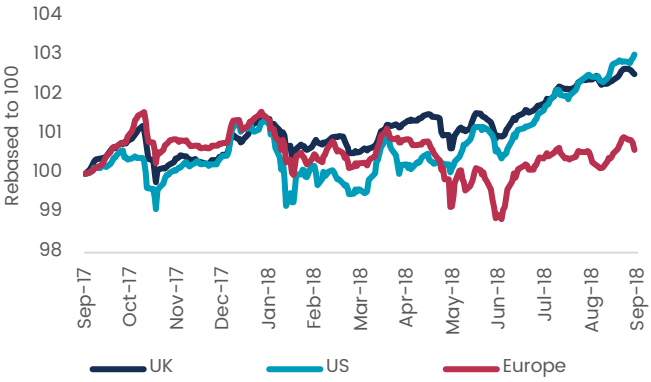


Source: Bloomberg. Notes: Bloomberg Barclays US Corporate Total Return Value Unhedged USD (Ticker: LUACTRUU INDEX)
Option-Adjusted Spreads (OAS) represent the difference between the index yield and the yield of a comparable maturity treasury.

Investment Grade Corporate Bonds: Global Investment Grade (IG) bonds registered positive total returns after two negative quarters, as credit spreads narrowed in response to the improving US macroeconomic data from a strong corporate earnings season. In Q3, the Bloomberg Barclays US Corporate Statistics returned 1.98%, up from -2.15% in Q2. However, the increase in interest rates and the high levels of corporate debt present risks to corporate creditworthiness in the long term.

High Yield Credit: High Yield (HY) credit registered higher positive returns over the quarter outperforming government bonds due to a strong corporate earnings season, rising inflatio, and steady economic growth. In Q3, the Bloomberg Barclays Pan-European High Yield bond index returned 1.56%, up from -2.15% in Q2. High yield bond issuance was low in the quarter which helped returns. The high coupon and relatively short duration gave HY credit opportunities to outperform the market, but volatility could quickly return, particularly with rising interest rates.

Chart 5: High Yield Corporate Bonds



Source: Bloomberg. Notes: Bloomberg Barclays Pan-European High Yield: Sterling Total Return Unhedged GBP (Ticker: I05892GB Index)
Bloomberg Barclays US Corporate High Yield Total Return Index Value Unhedged US (Ticker: LF98TRUU index)
Bloomberg Barclays Pan-European High Yield (Euro) TR Index Value Unhedged EUR (Ticker: LP02TREU Index)

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Currencies

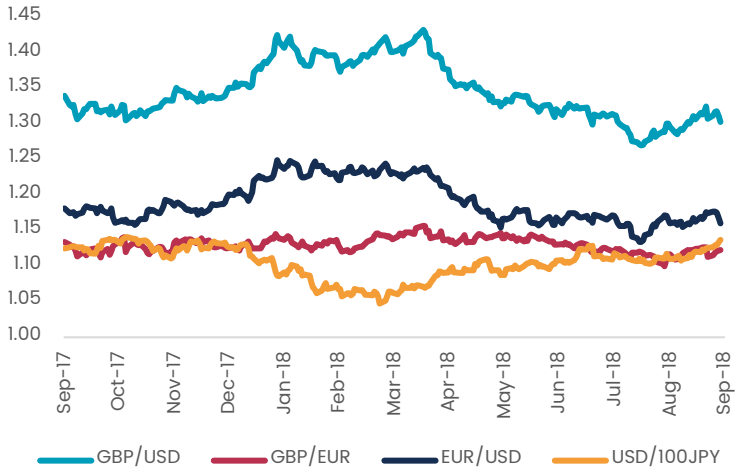
Earlier in the quarter, the dollar strengthened on the back of the strong US economic performance, which exposed frailties in emerging markets (EM), as EM currencies tend to move against the dollar. However, the dollar started to weaken as the Fed raised interest rates, despite ardent criticism from the White House while US trade talks with China did not materialise. Sterling remained volatile as the government continues to negotiate the terms of leaving the European Union and the weaker-than-expected economic data from August remained a concern.

Table 2: Currency Rates as At September 2018

	Quarter-end Value	% Quarter Change
GBP/EUR	1.12	-0.7%
GBP/USD	1.30	-1.3%
EUR/USD	1.16	-0.7%
USD/100JPY	1.14	2.7%

Source: Bloomberg.
Notes:
GBPEUR Spot Exchange Rate (Ticker: GBPEUR Currency)
GBPUSD Spot Exchange Rate (Ticker: GBPUSD Currency)
EURUSD Spot Exchange Rate (Ticker: EURUSD Currency)
USDJPY Spot Exchange Rate (Ticker: USDJPY Currency)

Chart 6: 1-Year Currency Rates of Major Currency Pairs

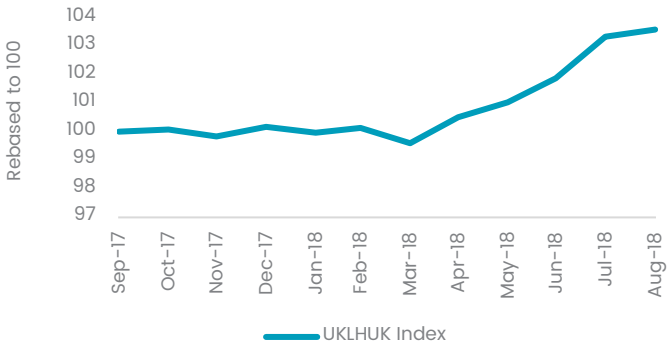


UK Property

Commercial property saw growth of 1.6% in the third quarter but, according to the CBRE, it was the weakest quarterly performance of 2018. Residential property remained flat, with continuing fears over household disposable income and debt servicing if interest rates were to venture higher.

Commercial Property: CBRE reported that UK commercial property values increased by 0.3%, down from the last quarter, with rental growth also lower at 0.1%. CBRE data showed that the industrial sector continued to outperform other sectors with capital values increasing by 0.9% and rental values by 0.4% over the last month of the quarter. The retail sector contracted further in Q3 in terms of both rental values (-0.6%) and capital values (-0.4%).

Chart 7: 1-Year UK House Price Index



Source: Bloomberg.
Notes:
UK House Price Index – Average Price for All Dwellings (Ticker: UKLHUK Index)

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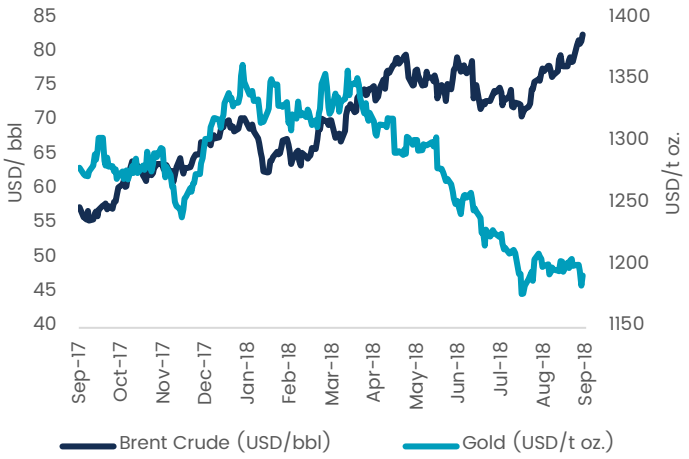
Commodities

Oil: In the second quarter, Brent Crude went above $80 per barrel for the first time since November 2014. Earlier in the quarter, Brent crude prices dipped after the US-China trade war caused volatility in emerging markets. Since then, Brent Crude oil prices have rallied to $82 per barrel due to steady demand and geopolitical tensions. A sharp drop in Venezuelan production, Libyan outages and US sanctions against Iran's oil imports helped to boost crude oil prices.

Gold: The price of gold continued to tumble and declined by 5% in the third quarter. Rising interest rates in the US and the strength of the dollar were the major contributors to the price fall. With the Fed looking to increase interest rates again in 2018 and in 2019, the bearish outlook on gold looks set to continue.

Chart 8: Gold and Brent Crude Oil Prices



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