

London Borough of Bromley

Quarterly Report

Q3 2020

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Performance Summary

As I write this, we are still awaiting confirmation of the result of the US Presidential election. It appears that Joe Biden has won the popular vote and enough electoral college votes to become the 46th President of the United States but Donald Trump has yet to concede and has launched several lawsuits suggesting voting irregularities. There is still scope for the outgoing President to cause major social unrest by attempting to undermine US democracy. It does look like the Republicans have retained control of the Senate for the time being. What the election has not done is to consign the Trumpian version of the Republican party to the history books. Donald Trump still won over 70m votes and around 48.5% of the popular vote.

My initial thoughts are as follows:

Joe Biden is an experienced political operator used to building consensus and fashioning compromise. With a Republican controlled Senate and the political climate in the US still deeply riven by the experiences of the last 4 years, he will need all his negotiating skills to make any progress on his agenda. This may mean that those on the left of the Democrat party politically may have less influence than they hoped. Markets will take the constraint of a Republican Controlled Senate on the Democratic President as a positive.

This reduces the likelihood of a major (\$3tn) economic stimulus package being agreed. Any resulting stimulus package is therefore likely to be delayed and smaller in scale and Republicans may quickly revert to championing a lower budget deficit having suspended this belief during the Trump tax cuts.

Internationally, the President elect will have more scope and early moves to bring the US back into the UN Human Rights Council; World Health Organisation and The Paris Accord on climate will be taken as a positive sign of a US wishing to reconnect on the global stage.

Joe Biden's Irish roots will make a Brexit deal that does not create a customs border between Ireland and Northern Ireland more likely. This may increase pressure on the UK government to compromise and find a deal on Brexit, leaving the UK with closer ties to the EU in order to keep trade flowing freely across Europe.

On Covid-19, the US will now have a President who will listen to scientific data and attempt to bring the virus under control. This may mean a form of economic lockdown which would not be popular across swathes of the US and could destabilise global markets, but I suspect his actions will fall short of this.

Outside of the US, the central expectation remains that the Covid-19 pandemic will be brought under control and a vaccine developed in due course, but roll-out is likely to be through 2021 and any full economic recovery not achieved until 2022/3. An eventual recovery should unwind the Covid-19 related pressure on bond yields and should lead to the

yield on UK Government bonds rising back to 1% or slightly above in due course, although inflationary pressure remains muted.

Total Fund Performance

The Fund rose by 3.89% over the quarter, outperforming the benchmark return by 1.62%. The majority of this outperformance was driven by the continued strong performance of the Baillie Gifford Global Equity mandate which returned 7.2%, outperforming its benchmark by 2.7% in the quarter. On a one-year view this mandate has outperformed its benchmark by an incredible 19.9% and by 6.1% per annum over 5 years. This is against their performance target of outperforming by 2-3% per annum over a rolling 5 years. This underlines how exceptional this outperformance has been but also the concentration of risk within the portfolio. It has been slightly offset by the underperformance of MFS in their global equity mandate. MFS are marginally behind their benchmark over 5 years but have underperformed by -5.9% over the last year. The two managers have a different investment philosophy and process and are held in tandem to diversify risk. Compared to a pure 'Value' style manager, MFS has performed well over the short and longer term.

With market returns being low in the third quarter across all asset classes, the performance effect of the Tactical Asset Allocation (overweight global equities and underweight all other asset classes) had a small positive effect. The Fund ended the quarter valued at an all time high of £1.22bn. The long-term performance figures remain very strong with the Fund returning 9% per annum over the last 23 years (since we have records) and outperforming its benchmark over all time periods.

Asset Allocation

During the quarter, £40m was sold from the Baillie Gifford Global Equity mandate, taking advantage of its exceptionally strong performance, and reinvested into the Fidelity Multi-Asset Income Fund. This move reduced the level of investment risk within the Fund marginally, moved the tactical asset allocation of the Fund back towards the Strategic Benchmark and boosted Fund cash-flow at a time when there is pressure on the income generated by all the Fund's portfolios.

Asset class	Asset Allocation as at 31/12/2019	SAA as at 31/12/2019	Position against the existing SAA	Asset Allocation as at 30/9/2020	New SAA going forward	Position against the new SAA
Equities	64.6%	60%	+4.6%	64.4%	57.5%	+6.9%
Fixed Interest	12.7%	15%	-2.3%	12.7%	12.5%	+0.2%
Property	4.2%	5%	-0.8%	3.7%	5%	-1.3%
Multi-Asset Income	18.5%	20%	-1.5%	19.3%	20%	-0.7%
Int'l Property	n/a	n/a	N/a	0%	5%	-5.0%

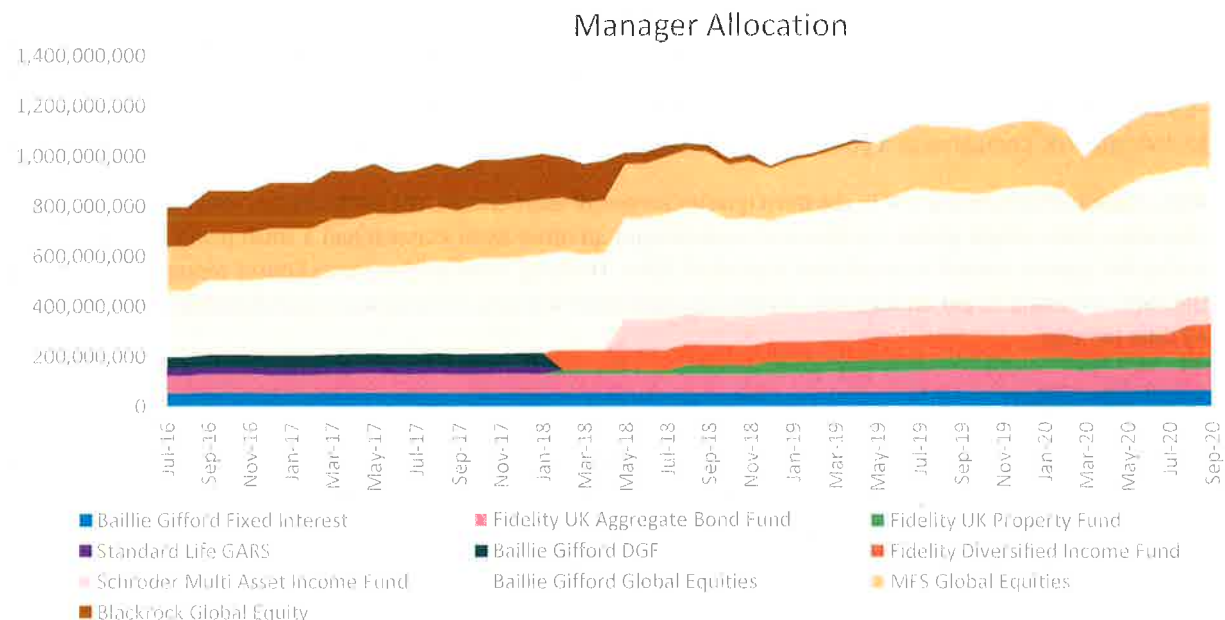
Figures may not add up due to rounding

In addition, the Baillie Gifford Fixed Interest mandate was sold and reinvested with Fidelity. Both these asset movements were made in accordance with the decisions at the last Pensions Committee meeting. Because both the Baillie Gifford and the Fidelity Fixed Interest mandates are held as units in a fund, the transition cost incurred is the difference in the bid/offer spread for the underlying funds. This would have totalled £500k but by transferring approximately 26% of the assets in-specie this cost was kept down to £350k or 0.54% of the £65m asset transfer.

The change of manager within one of the Fund's Fixed Interest mandates does alter the exposure of that specific portfolio slightly but, in my mind, does not increase the risk at the Total Fund level. The Baillie Gifford Fixed Interest mandate has performed in-line with its benchmark since inception but had tended to underperform in down markets. The portfolio was 88% invested in UK Gilts and Investment Grade Corporates and 6% invested in each of High Yield and Emerging Market Bonds. The new Fidelity Fixed Interest Mandate is wholly invested in UK Investment Grade Corporate Bonds.

Going forward, only the Fidelity Sterling Aggregate bond portfolio has exposure to UK Government Gilts within the Fund's benchmark following the decision at the last Pensions Committee meeting not to combine this portfolio with the new Fidelity UK Corporate Bond portfolio, although both of the Fund's Multi-Asset Income portfolios do allow for investment into this asset class if the manager believes this will add value. Government Bonds now account for approximately 5% of the Fund's assets.

The chart below shows the Fund's assets by manager/mandate



Because the investment returns have surpassed the level assumed by the discount rate, the funding level should have improved, all else being equal. Of course, everything else has not stayed constant and the Fund's liabilities will have increased slightly due to the McCloud judgement and a number of other legislative issues. In addition, falling yields on UK Government Gilts may also have affected the actuaries calculation of the discount rate. These calculations are for the Fund as an open, ongoing Defined Benefit Scheme. If the Scheme was to close, less risk could be taken within the investment portfolios and the discount rate would be lower, raising the value of the Fund's future liabilities and hence reducing the lower funding level.

The allocation to the Morgan Stanley International Property fund will be financed by selling down the overweight position in Global Equities. The greater diversification this will provide should lower the investment risk within the Fund marginally.

Cash Flow

Currently, the Fund can cover pension and lump sum payments as well as its manager fees and admin costs from pension contributions and the investment income received. Excess investment income is reinvested within the Global Equity and Fixed Income portfolios and paid out from the Multi-Asset Income and UK Property portfolios. With a number of companies cutting dividends to conserve cashflow, income for the Global Equity portfolios is predicted to fall this year. In addition, rental income from the UK Property portfolio will be reduced and UK Gilt yields have fallen further. Investment income coming into the Fund is, therefore, expected to fall this year and only recover slowly going forward.

Cost Transparency Initiative (CTI)

In 2018, the CTI was tasked by the FCA with designing a standardised cost transparency template for asset managers to report all costs associated with managing an institutional client's money. The CTI is supported by Pensions and

Lifetime Savings Association (PLSA), Investment Association (IA) and Local Government Pension Scheme Advisory Board (LGPS SAB).

The CTI has now launched a standard template for managers to complete which details all costs borne by the investor, including management fees; admin and custody fees and transaction costs. The LGPS SAB has set up an LGPS Cost Transparency Compliance and Validation System with a company called BYHIRAS <https://lgps.byhiras.com/> which can be accessed by LGPS Funds. The Cost Transparency Template is to be completed annually by investment managers but is voluntary.

Of the Fund's four asset managers, Baillie Gifford; MFS; Fidelity and Schroders, only Schroders is not a member of the CTI; however, all four managers complete a Cost Transparency Template which they make available to clients through BYHIRAS. I have reviewed the Cost Transparency templates for all the Fund's mandates and regard them as fit for purpose. The management fees shown are competitive and in line with the agreements that I am aware of and the transaction costs borne by each portfolio are acceptable. The two global equity portfolios, in particular, have low transaction costs compared to the industry average because both managers invest for the long-term and have a low turnover of holdings. Within the less liquid portfolios, the templates are of less value and the reporting of the transaction cost much less detailed. This should improve going forward and the information in these reports should get more standardised next year. Some of the managers have already provided these reports to Bromley, others are happy to do so upon request.

The table below shows the charges borne by the Fund for each mandate for the fiscal year 2019/20 as reported by the managers:

Mandate	AuM (average over period)	Management Fee (Inc VAT)	Transaction Costs	Comment
Baillie Gifford Global Equity	£452m	0.4478% (£2,023,019)	0.0223% (£100,559)	transaction costs do not include full market impact
MFS Global Equity	£251m	0.5083% (£1,278,290)	0.0912% (£229,401)	A more complete estimate of transaction costs
Fidelity Fixed Interest	£83m	0.2512% ¹ (£207,322)	0.1188% (£98,077)	
Baillie Gifford Fixed Interest	£62m	0.3609 (£223,163)	0.3852% (£238,200)	
Fidelity Multi-Asset Income	£90m	0.4275% ² (£383,998)	0.0211% (£18,972)	Pooled fund so the transaction cost not fully included
Schroders Multi-Asset Income	£110m	0.214% (£235,390)	0.250% (£275,299)	Management fee is 0.35%+VAT. 9-month fee holiday post switch to the UK Domiciled fund last year.
Fidelity UK Property	£48m	0.746% (£357,726)	Not recorded	Illiquid asset so difficult to report transaction costs

I would treat these figures with care, there is plenty of scope for managers to interpret the requirements differently particularly around transition costs and the treatment of pooled funds. In particular, with Schroders not signing up to the CTI, their figures are not set out in the same manner and therefore harder to compare. The figures do suggest that moving the Fixed Interest portfolio from Baillie Gifford to Fidelity should have reduced costs.

¹ Includes 40% fee discount for aggregation with Multi-Asset Income Fund

² Includes 33% fee discount for aggregation with Fixed Interest

Key Indicators at a Glance

Market Indicators

Asset Class		Index (Local Currency)	Q3 2020	Quarter-on-Quarter	YTD
Equities					
UK Equities	FTSE 100		5,866.1	-4.0%	-20.1%
UK Equities	FTSE All-Share		3,282.3	-2.9%	-19.8%
US Equities	S&P 500		3,363.0	8.9%	5.6%
European Equities	EURO STOXX 50		3,193.6	-0.7%	-12.6%
Japanese Equities	Nikkei 225		23,185.1	4.6%	1.6%
Emerging Markets Equities	MSCI Emerging Markets		1,082.0	9.7%	-1.0%
Global Equities	MSCI World		2,367.3	8.0%	2.1%
Government Bonds					
UK Govt Bonds	Bloomberg Barclays UK Govt All Bonds TR		430.7	-1.3%	8.2%
UK Govt Bonds Over 15 Years	FTSE Actuaries Govt Securities UK Gilt TR Over 15 Yr		6,575.0	-2.5%	12.6%
UK Govt Index-Linked Bonds Over 5 Years	FTSE Actuaries Govt Securities UK Index Linked TR Over 5 Yr		6,312.8	-2.5%	10.8%
UK Govt Index-Linked Bonds Over 15 Years	FTSE Actuaries Govt Securities UK Index Linked TR Over 15 Yr		8,086.8	-3.5%	12.7%
European Govt Bonds	Bloomberg Barclays EU Govt All Bonds TR		261.3	1.6%	3.7%
US Govt Bonds	Bloomberg Barclays US Treasury TR Unhedged USD		2,580.8	0.2%	8.9%
Bond Indices					
Pan-European Investment Grade	Bloomberg Barclays Pan-European Aggregate Corporate TR Index Value Unhedged		245.3	1.9%	0.3%
Pan-European High Yield	Bloomberg Barclays Pan-European HY TR Index Value Unhedged		398.9	2.6%	-3.4%
US Corporate Investment Grade	Bloomberg Barclays US Corporate Investment Grade TR Index Unhedged		213.8	1.5%	6.6%
US High Yield	Bloomberg Barclays US Corporate High Yield TR Index Value Unhedged		2,196.4	4.6%	0.6%
UK Corporate Investment Grade	S&P UK Investment Grade Corporate Bond Index TR		401.1	1.4%	4.8%
Commodities					
Brent Crude Oil	Generic 1st Crude Oil, Brent, bbl		41.0	-0.5%	-38.0%
Natural Gas	Generic 1st Natural Gas, MMBtu		2.5	44.3%	15.4%
Gold	Generic 1st Gold, 100oz		1,887.5	4.8%	23.9%
Copper	Generic 1st Copper, lb		303.3	11.8%	8.4%
Currencies					
GBP/EUR	GBP/EUR Spot Exchange Rate		1.10	0.0%	-6.9%
GBP/USD	GBP/USD Spot Exchange Rate		1.29	4.3%	-2.6%
EUR/USD	EUR/USD Spot Exchange Rate		1.17	4.3%	4.5%
USD/JPY	USD/JPY Spot Exchange Rate		105.53	-2.1%	-2.8%
Dollar Index	Dollar Index Spot		93.89	-3.6%	-2.6%
AUD/USD	AUD/USD Spot Exchange Rate		0.72	4.1%	2.1%
USD/CAD	USD/CAD Spot Exchange Rate		1.33	-2.2%	2.5%
USD/CNY	USD/CNY Spot Exchange Rate		6.79	-3.9%	-2.5%
USD/CHF	USD/CHF Spot Exchange Rate		0.92	-2.7%	-4.7%
Alternatives					
Infrastructure	S&P Global Infrastructure Index		2,226.3	1.6%	-18.1%
Private Equity	S&P Listed Private Equity Index		138.9	2.9%	-13.7%
Hedge Funds	Hedge Fund Research HFRI Fund-Weighted Composite Index		15,053.3	5.4%	1.8%
Property					
Global Real Estate	FTSE EPRA Nareit Global Index TR GBP		3,148.8	-2.5%	-17.5%
Volatility					
VIX	Chicago Board Options Exchange SPX Volatility Index		26.4	-13.3%	91.4%

* All return figures quoted are Total Return, calculated with gross dividends reinvested Source: Bloomberg

Executive Summary

Following the strong bounce back witnessed across major markets in Q2 and early Q3, markets appeared to run out of steam in September as evidence emerged of a resurgence in European COVID-19 cases and investors anticipated the recessionary effects of the tailing-off of the economic stimulus packages, as well as the uncertainty of a close US presidential election.

While most major economies had reopened by mid-way through the quarter, **forecasts for 2020 global real GDP growth are around -5% (nearer -10% for UK)**. While daily COVID cases were declining in the United States, cases in Europe have been rising rapidly and a second wave is now resulting in renewed economic lockdowns. It is clear that some restrictions are likely to be in place well into next year, and global GDP may not reach pre-COVID-19 levels before 2021/22.

It is worth highlighting the following themes, impacting investment markets:

- **Policy has, and is likely to continue, to support asset markets.** Whilst many governments have pulled back on their fiscal stimulus programmes, the European Union was a notable exception, with the 27-member bloc agreeing to a pandemic recovery package worth €750bn in July. Equally, central banks have continued with their unprecedented levels of monetary support: speculation continues on the possibility of negative interest rates in the UK, while the US Federal Reserve has shifted its mandate to target an average inflation rate of 2% pa rather than a target of 2% to give itself more monetary flexibility. **This has maintained investors' appetite for risk, albeit on somewhat nervous foundations, due to relatively high valuations, notably in US equities.**
- With today's low interest rates, it is hard to see government bonds delivering a good return, especially in real terms. However, they may still provide some (though limited) diversification of equity risk. **The Fund has reduced its exposure to UK Government Gilts with the move of one of the Fixed Interest portfolios from Baillie Gifford to Fidelity with a pure UK Corporate Credit mandate.**
- **Increasing dispersion of returns.** The gap between the winners and losers from COVID-19 restrictions continues to grow, as manufacturing has demonstrated by recovering more quickly than services. Sectors benefitting from the changes have continued to outperform strongly. For example, the global tech sector is up 23% year to date (YTD), while energy is down -40% YTD. This partly explains the continued outperformance of growth-style equities (up +16% YTD) over value-style (down -15% YTD), and also the wide dispersion of regional equity returns (US and emerging markets up nearly 10% in Q3, compared to the UK down -3% and Europe flat). **These extreme dispersions highlight the importance of managing the portfolios' risk in asset allocation and the recent reallocation from Global Equities to Multi-Asset Income has been a part of this risk control.**
- **Warning lights on currency risk.** The extraordinary amount of policy support in addition to the vast debt being accumulated provides fertile ground for investor nervousness, as the weakness in the US dollar over Q3 has shown. A contested US presidential election and, for Sterling-based investors, Brexit, help explain some of the enthusiasm for other currencies, including some emerging markets currencies. Other safe havens, including gold, have also benefitted. **Investors may want to consider hedging some of their currency risk.** This was discussed last quarter and I will continue to keep under review.
- **Inflation.** While further COVID-19 restrictions are clearly deflationary in the short-term, **markets still expect sustained moderate (3% to 4% pa in UK) inflation in the medium term.** However, clearly these expectations are likely to be pushed further out, the longer economic restrictions last.

Many of the geopolitical themes from Q2 have continued into Q3. With the US presidential election fast approaching on 3rd November. Market moves in the immediate aftermath may well prove to be wrong in the longer-term with a contested result the major concern at present.

- Sino-centric tensions have continued, with escalations in the US-China trade war (including a new emphasis on technology firms) as well as renewed tensions with both India and Taiwan.
- Negotiations between the EU and UK on a post-Brexit trade deal have intensified, with political rhetoric and tensions increasing due to the UK Internal Market Bill and the corresponding legal action that the EU has launched to enforce the Withdrawal Agreement. Expectations of a "No-Deal" Brexit have risen, although this is still not regarded as the most likely scenario.

- Shinzo Abe announced his intention to resign as Prime Minister of Japan in August, stepping down on 16th September. Expectations of tighter monetary policy boosted the Yen and put pressure on equities in the aftermath of the news. His former right-hand man, Yoshihide Suga, was elected as his replacement.

After the unprecedented slump to global GDP in Q2, most major economies are poised for record rebounds in Q3 following the lifting of national lockdowns. However, it is becoming apparent that the previous forecasts of a steep “V-shaped” recovery are levelling off towards what economists are referring to as a “reverse-square root sign”. The US economy is forecast to have the highest Q3 GDP growth out of the economies that we track (+20%), followed by the UK (+14%), the Eurozone (+7.5%) and Japan (+3.8%). However, these rebounds need to be considered in the context of the falls in GDP during Q2: the US experienced the greatest slump in GDP (-31.4%), followed by the UK (-19.8%), the Eurozone (-11.8%) and then Japan (-7.8%). More interesting than the bounce back is perhaps the build-up of government debt to finance it. The FY2020 budget deficit in the US alone is projected to reach \$3.3 trillion, with US government debt set to exceed the size of the economy for the first time since the Second World War.

- Current inflation remains well below recent levels among the major economies. In the UK, CPI growth fell from 0.6% in June to an estimated 0.2% in September, while Eurozone CPI fell from 0.3% in June to 0.1% in September. In contrast, US CPI increased from 0.6% in June to an estimated 1.4% in September, with large price increases for second-hand motor vehicles being one factor for this change.

Global equities generally had a strong Q3, although performance diverged as the US, Asia and emerging markets enjoyed gains, while the UK and Europe lagged in comparison. Emerging markets were the frontrunner with a quarterly return of 9.7%, followed by the US, where the S&P 500 saw a return of 8.9%. In contrast, UK equities were the weakest performers with the FTSE 100 returning -4.0%, though this was partially due to the strengthening of Sterling over the quarter. Volatility, as measured by the VIX index, fell from 30.4 on 30 June to 26.4 on 30 September.

- In the US, consumer discretionary and materials companies were boosted as the economy re-opened, while aviation and energy companies have continued to perform poorly. Meanwhile technology, the standout sector during the pandemic, experienced a tough September with significant sell-offs.
- The UK and Europe saw similar trends to the US in terms of consumer discretionary and materials sector performance. However, for the UK in particular, the outsized exposure to stocks in the financial services and oil sectors hampered performance.
- Emerging market equities recorded the strongest returns over Q3 as Asian manufacturing-led economies recovered, helped also by the relative weakness of the dollar. Markets such as China, Taiwan and India performed well, in contrast to the likes of Turkey, Thailand, Russia and Brazil.

On the **fixed income** front, risk appetite remained strong. Defaults have continued at lower than average levels, given fiscal support packages. However, it is likely that they will increase markedly next year as stimulus is withdrawn. As investors continue to hunt for yield in the all-time low interest rate environment, high yield credit performed the best over Q3, followed by investment grade credit. Government bonds yields were generally unchanged over the quarter.

- US high yield credit spreads fell by around 1.1% in Q3. Most of this occurred in July, due to strong investor inflows along with default and downgrade rates slowing in pace. The inability for Democrats and Republicans in the US to agree on refreshed stimulus measures pushed up yields in September.
- US Treasuries and investment grade credit yields were broadly stable over the quarter. The impact on Treasuries of the change in the Federal Reserve’s inflation policy in August was muted. Likewise, high levels of corporate issuance over the quarter has had limited effect on corporate bond yields.
- UK Gilts yields rose slightly over the quarter (prices fell) as renewed fears around a disorderly Brexit transition weighed on investor sentiment, while investors increasingly expect UK interest rates to drop below zero during 2021.
- The positive performance of corporate bonds continues to contrast with credit rating trends. 37% of the companies rated by S&P now have downgrade warnings. Between 70% and 85% of energy, transport, media, and automotive firms have either experienced a credit downgrade, or a downgrade warning since the start of the COVID outbreak.³

Commodities had a strong quarter after the turmoil caused by COVID-19 in the first half of the year.

- Gold continued its strong performance due to the continued economic uncertainty. Prices reached all-time highs in August, breaking the \$2000 per troy ounce barrier for the first time in history. Overall gold posted a 4.8% price increase over the quarter, ending at a price of \$1887 per troy ounce.

³ Reuters, “S&P Global sees U.S., European corporate default rates doubling”, October 2020.

- Oil had made modest gains over the quarter with the price of a barrel reaching a high of \$46 in August. These gains were reversed in September amid fears over the sustainability of the global recovery.
- Natural gas prices rebounded over Q3 from the lows in Q2 (a level which had not been seen since the 1990's) due to a collapse in demand. As suppliers cut production in response to the historically weak prices, prices increased by 44% over the quarter.
- Copper, seen as an indicator of economic activity, continued its rebound in Q3.

Property had a mixed quarter with pricing much dependant on region and sector. Global Listed property delivered negative returns, with the FTSE Global property index down -2.5% in Q3. This index is now down -17.5% since the start of the year. Properties in Asia Pacific performed the strongest over the quarter, followed by Europe, the US, and then the UK.

- Green Street Advisor's US Commercial Property Price Index rose by 1.3% in the first two months of the quarter. The industrial and apartment sectors enjoyed gains over the quarter, while other sectors such as office, retail and self-storage were steady.
- In contrast to the performance of the FTSE UK Property index, the Nationwide UK house price index rose by 4.5% in Q3 due to the temporary suspension of stamp duty, the continuing release of pent-up lockdown demand as well as shifts in housing preferences.

Currencies continued to reflect the risk-on attitude adopted by investors this quarter. The dollar lost further strength and reached a two-year low during Q3, as loose monetary policy in the US continued. The euro and Sterling both gained 4.3% against the Dollar, although Brexit uncertainty pared further gains for Sterling and it ended the quarter flat against the euro.

Global Outlook 2020 Q1

The massive injection of Quantitative Easing (QE) supplied by central banks across the globe has continued to expand in response to a resurgence in the global pandemic which has again forced a number of Governments, particularly across Europe, to shut down their economies to reduce its transmission through lower social contact.

QE creates digital money which the central banks are then using to purchase government and corporate bonds and hence push down yields across the maturity spectrum thereby making borrowing cheaper in the hope that this stimulates a weak economy. By providing a willing buyer for large quantities of government debt, QE has also enabled Governments to increase their borrowing without worrying about investors demanding higher interest rates.

The unanswered questions here are firstly, will QE actually boost the economy and secondly is this money creation inflationary? From a monetarist perspective, whilst Central Banks have increased the amount of money available, it is commercial banks who distribute this into the economy. Since the Global Financial Crisis (GFC) in 2008/9, demand for investment has remained subdued so the flow of the increase in money supply into the economy has been slow. QE seems to have staved off a potential economic collapse post the GFC and again at the onset of Covid-19 but done little more than offset the negative effects of these two events. It has not led to noticeably faster economic growth. What it does appear to have done is to force asset prices higher as the central bank purchasing of low risk bonds has forced other investors further out along the risk curve in the hunt for yield.

From an inflationary perspective the jury is also out, as noted above, the extra money created by QE is not flowing into the economy but rather into assets, raising prices. Because economic activity is not increasing much there is very limited inflationary pressure. However, the sheer scale of money created is a risk and any sign that the global economy is recovering rapidly and investment demand is picking up, may lead to higher inflation (and possibly lower asset prices).

In this environment investors are forced to hold risk assets because cash and government bonds do not provide a yield which matches inflation. This is likely to keep the valuation of risk assets high and introduce increased price volatility as investors are forced to remain invested and collect a yield above inflation whilst they can but will not wish to lose money and will therefore rush for the exit en-masse when this becomes a concern.

This increased volatility and the reduced portfolio protection provided by government bonds makes portfolio diversification more important and I would continue to recommend that the Fund look to acquire real assets over the medium term to help mitigate the inflation risk.

Performance report

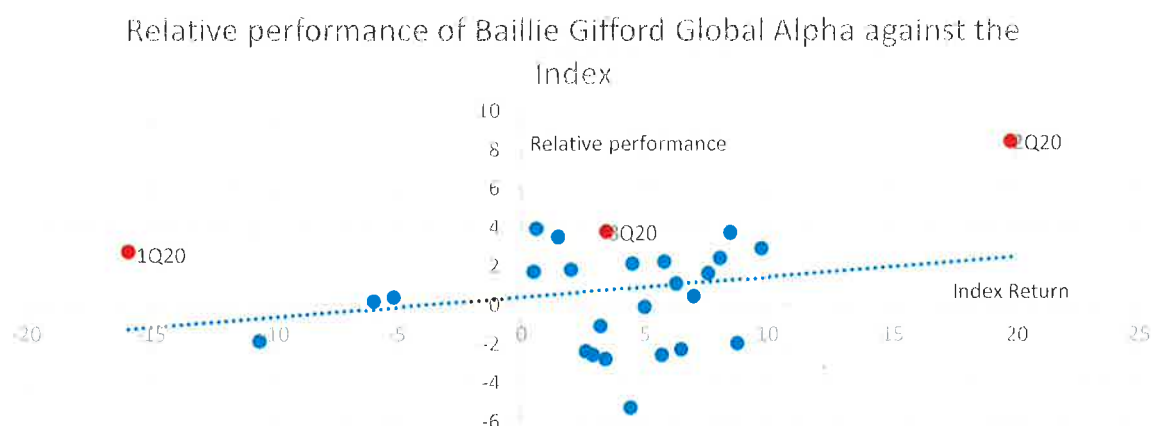
Asset Class/ Manager	Global Equities/ Baillie Gifford
Fund AuM	£525m Segregated Fund; 43% of the Fund
Benchmark/ Target	MSCI All Countries World Index +2-3% p.a over a rolling 5 years
Adviser opinion	Manager continues to exceed their performance target significantly
Last meeting with manager	By phone during the quarter
Fees	0.65% on first £30m; 0.5% on next £30m; 0.35% thereafter

The portfolio rose by 7.2% over the quarter, outperforming the benchmark by 3.5%. The outperformance this year is certainly the strongest quarterly outperformance by this portfolio since the reorganisation on 31/12/13 and probably in the portfolio's 20-year history. The portfolio is up 25.7% over the last 12 months, outperforming its benchmark by a huge 19.9%, it has outperformed its benchmark by 6.1% per annum over 5 years, well in excess of its challenging performance target of benchmark + 2-3% per annum over a rolling 5 years. The portfolio has outperformed its benchmark by 1.7% per annum since inception over twenty years ago. The outperformance of this portfolio alone has added £87m to the value of the Fund over the last 12 months.

I have huge admiration for what Baillie Gifford have achieved over the last ten years and see this not as luck but as the result of the sound application of a well thought through investment philosophy. Over the last 5 years in particular, Baillie Gifford have increased the focus of their portfolio on rapidly growing, asset light, business disrupting companies which are often changing the competitive dynamic in an entire industry. Nonetheless, it is as important to challenge exceptionally good performance as much as exceptionally bad.

The chart below shows the quarterly relative returns of the portfolio against the returns of the index since this portfolio was restructured at the end of 2013. The dotted line is the line of best fit (trend line). The chart shows that the portfolio is outperforming in most market conditions and has a beta of greater than one (the portfolio tends to outperform as markets rise and vice versa).

The dots highlighted in red are for the most recent three quarters. The chart shows how extreme the index return was in the first and second quarter of this year but also the exceptional scale of the outperformance over the last 3 quarters. This raises the question as to whether the portfolio has a higher concentration of risk than in the past and what market conditions could undermine the portfolio.



The Baillie Gifford portfolio has undoubtedly benefitted from the strong performance of 'Growth' as an investment style. It focused on companies which they believe are capable of doubling sales over the next 5 years. This has led to a bias towards asset light companies often using new technology to disrupt existing businesses, an area which has

played out exceptionally well through the economic lockdown as customers have turned to the internet to fulfil more of their consumption of goods and services. I would note that Baillie Gifford have been taking profits in a number of these positions in the last 6 months including Tesla, Amazon and Facebook and purchasing smaller, faster growing companies in the e-commerce space but also a number of cyclical growth companies and companies where the recent disruption has undermined the share price in what they believe are high quality, long-term growth businesses.

Market environments which may prove more challenging for the Baillie Gifford portfolio could include a strong economic recovery as we come out of this Covid-19 era when cyclical, 'Value' stocks may do well; a rising interest rate environment, which I don't forecast happening for few years yet; or if the next virus is a computer based one; but these are just suppositions. The important issue is not to rely on this portfolio continuing to deliver the exceptional outperformance of the past few years. This portfolio is already one of the major determinants of the future performance of the Fund. The recent sale of £40m from this portfolio is important from a risk mitigation standpoint.

Asset Class/ Manager	Global Equities/MFS
Fund AuM	£254m Segregated Fund; 21.6% of the Fund
Benchmark/ Target	MSCI World Index
Adviser opinion	meeting long term performance targets, underperforming short-term
Last meeting with manager	29/10 Elaine Alston/John Arthur
Fees	0.6% on first £25m; 0.45% on next £25m; 0.4% thereafter

The MFS portfolio rose by 1.9% during the quarter, underperforming its benchmark by -1.4%. This poor performance has brought the longer-term performance figures down and the manager is now below the benchmark over 1, 3 and 5 years but has still outperformed their benchmark since inception in 2013 by 0.7% per annum. Given the managers' 'Value' style bias and the pressure this style has been under in performance terms recently, the longer-term outperformance is important.

The MFS philosophy is to invest in quality companies with an above average return on capital but at a below average valuation. This focus means they tend to fall into the 'Value' style category and have seen this approach struggle somewhat, particularly during the rapid market recovery seen in the second quarter which was led by a small number of high growth technology stocks. In addition, during a period of such rapid change in many industries, a number of previously stable and highly regarded businesses now find their operating model under threat. It is noticeable that the turnover within this portfolio has increased as the manager has recognised that some, previously stable, business models are under threat and that the market collapse during March presented an opportunity for the manager to buy a number of favoured holdings at a price they were comfortable with. Whilst MFS remain under-exposed to the kind of high growth business disrupter favoured by Baillie Gifford, they have bought a number of suppliers to the technology sector recently including Intel (semi-conductors) and Quest Diagnostics.

MFS do not hold Apple, Amazon, Alphabet, Google or Tesla, seeing them as expensive. These stocks have benefitted from the switch to the internet by both consumers and businesses, particularly during the recent pandemic. They have been a major contributor to the recovery in the US and Global Equity markets. Not holding just these 5 stocks has contributed 90% of the underperformance year to date by this portfolio.

I continue to believe MFS have a credible investment philosophy and process. Current market conditions have been unfavourable to them but holding this portfolio provides useful diversification and lowers the investment risk across the Total Fund.

MFS have announced a number of personnel changes including their executive chairman as well as the lead manager for this portfolio. I regard these as normal business issues as both are due to the retirement of longstanding employees and the announcements have been made 6 to 12 months prior to the individuals' departure. Their replacements are long standing MFS employees who will understand the culture and investment approach of the company.

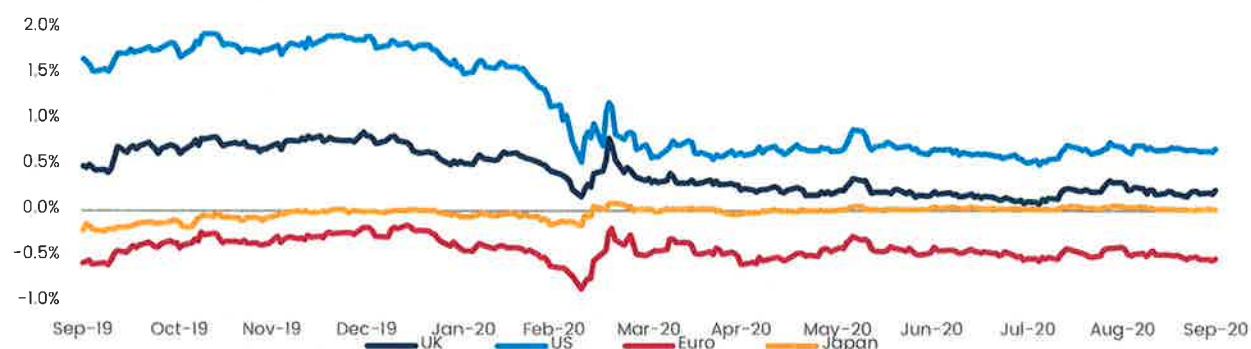
Asset Class/Manager	Fixed Interest/ Fidelity
Fund AuM	£88m Unit Trust; 7.5% of the Fund
Performance target	50% Sterling Gilts; 50% Sterling Non-Gilts; +0.75 p.a rolling 3 year
Adviser opinion	Manager continues to meet long term performance targets
Last meeting with manager	4/8 John Arthur/Paul Harris/Suzy Fredjohn
Fees	0.35% on first £10m; 0.3% on next £10m; 0.21% on next £30m; 0.18% thereafter

The portfolio returned 0.7% over the quarter, ahead of the benchmark return of -0.1%. The portfolio has outperformed over all time periods and is meeting the performance target over the longer term including since inception 22 years ago. This is a strong performance.

UK Gilt prices fell slightly (yields rose) during the third quarter but, with a slight contraction in credit spreads driven by continued central bank buying and investors search for yield, UK Investment Grade Corporate Bonds produced a marginally positive return. It was this credit risk exposure which aided the portfolio performance during the quarter.

The economic slowdown caused by the Covid-19 pandemic and ensuing economic lockdowns has pushed more bonds into a negative yield. As of today, even 5-year Italian Government bonds have a negative yield and for Germany this is the case for bond maturities out to over 30 years.

Chart 4: Government 10-year Bond Yields



Source Bloomberg, 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).

Despite it seeming non-sensical to purchase bonds on a negative yield, the current largescale QE across the developed world is likely to continue and the Bank of England extended its QE program yet further post the end of the third quarter. This will anchor bond yields to low levels for some time yet but I would expect yields to unwind the falls seen in April this year as economies emerge from the Covid-19 related economic lockdowns.

The portfolio is broadly neutral against its benchmark in duration terms and any non-Sterling exposure (currently at 17%) is hedged back to Sterling.

Asset Class/Manager	Fixed Interest/ Baillie Gifford
Fund AuM	£65m consists of holdings in three separate funds; 5.4% of the Fund
Performance target	44% Sterling Gilts; 44% Sterling Non-Gilts; 6% Emerging Market debt; 6% High Yield. Index +0.75 p.a rolling 3 year
Adviser opinion	
Last meeting with manager	By phone during the quarter
Fees	0.35% on first £10m; 0.3% on next £10m; 0.21% on next £30m; 0.18% thereafter

The portfolio returned 0.8% over the quarter, outperforming its benchmark by 0.9%. The portfolio has returned 5.9% per annum since inception on 1/12 13 against a benchmark return of 5.74% but these figures are gross and so before manager fees of 0.4% approx. per annum.

Post quarter end this portfolio was sold on 2/10/20 and the assets reinvested into the Fidelity UK Corporate Bond fund. The expectation is that Fidelity as a manager should be more able to meet the performance target for this portfolio. The Fidelity portfolio is entirely focused on Investment Grade Corporate bonds and whilst there is some leeway for the manager to hold off-benchmark positions it is likely to be credit risk and the direction of credit spreads which will drive the performance of this portfolio.

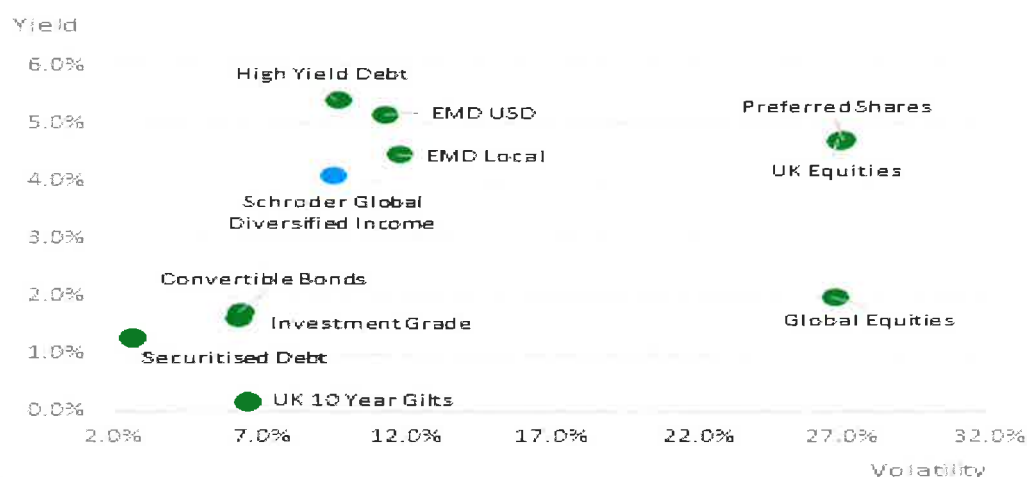
The Fund now holds two quite similar Fidelity bond portfolios, UK Aggregate Bond which is 50/50 UK Government Gilts and UK Investment Grade Credit and the new portfolio which is entirely focused on UK Investment Grade Credit. 10-year return forecasts for UK Government Gilts are close to zero against 1-2% per annum for UK Investment Grade Corporates but the portfolios do provide diversification from the Fund's exposure to Global Equities.

Asset Class/Manager	Multi Asset Income / Schroders
Fund AuM	£107m Pooled Fund; 8.8% of the Fund
Performance target	LIBOR +5% including a yield of 4% per annum
Adviser opinion	Slightly disappointing to date
Last meeting with manager	By phone during the quarter: John Arthur/ Russel Smith/Remi Olu-Pitan
Fees	0.35% of fund value

The Schroders Multi-Asset Income portfolio returned 2.3% over the quarter. This is an acceptable return in a quarter where Global Equities rose 3.4%; UK Gilts fell 1.4% and Investment Grade Credit rose 1.3%. The portfolio is invested approximately 30% in equities with a bias towards quality as a style and a high exposure to Real Estate Investment Trusts (REIT's) for the yield; 50% in Fixed Interest of which approximately half is in low risk Government and Investment Grade Bonds with the other half being invested in EM Debt and High Yield Credit i.e. return seeking but with a high yield and 15% in Preference Shares and Convertible Bonds which are Bond/Equity hybrids. The balance is invested into diversifying yield plays: Catastrophe Insurance and Renewable Infrastructure.

Over twelve months the portfolio is down -3.4% which is a poor return given Global Equities returned 5.5% and UK Gilts 3% over that period. The Portfolio aims to be diversified and the last twelve months has been a continuation of recent history where diversification has failed to add value. The portfolio is currently yielding 4.1% gross and continues to make monthly distributions of income to the Fund.

The chart below compares the yield and price volatility of different asset classes and underlines that a 4% yield is a reasonably challenging target at present.



Schroders

Asset Class/Manager	Multi Asset Income / Fidelity
Fund AuM	£87m Pooled Fund; 7.4% of the Fund
Performance target	LIBOR +4% including a yield of 4% per annum
Adviser opinion	Too early to make any assessment
Last meeting with manager	4/8 John Arthur/ Paul Harris
Fees	0.4% on first £20m; 0.3% on next £30m; 0.25% on next £100m; 0.18% thereafter

The Fidelity Multi-Asset income portfolio returned 0.6% over the quarter, slightly behind the Schroders equivalent. Over a year the portfolio has returned -2.8** against Schroders at -3.4%. Neither portfolio has built-up a 3 year performance history yet. The Fidelity portfolio has a slightly lower return target than the Schroders equivalent and does appear to be more defensively managed.

The chart below shows the asset allocation of the two portfolios, each manager will position differently within individual asset classes, but the Schroders portfolio is more reliant on the performance of equities and appears slightly less diversified. I also see it as slightly faster moving with more frequent adjustments to the asset allocation.

Asset Class	Fidelity Multi-Asset Income	Schroders Multi-Asset Income
Equities	14.9%	29.0%
Preferred Shares/ Convertible Bonds	7.5%	14.0%
High Yield Bonds	18.6%	20.4%
Emerging Market Debt	7.6%	6.8%
Loans/Structured Credit	6.6%	
Infrastructure	4.5%	
Property	2.2%	
Other Alternatives		3.2%
Investment Grade Credit	32.5%	19.5%
Government Bonds	4.0%	5.8%
Cash	1.1%	1.3%
Hedges (risk reducing positions)	-3.5%	-4.1%

Figures may not add up due to rounding

With the combined Multi-Asset income portfolios accounting for 20% of the Fund's investments, they do bring diversification to the Fund. The yield they provide covers the Fund's forecast negative cashflow and through this enables the Fund to carry a higher level of investment risk. Because these portfolios distribute their income to the Fund, their weighting within the total Fund should fall over time especially if equity markets rise. Keeping these two portfolios at 20% of Total Fund assets is good discipline and helps reduce risk within the Fund.

Asset Class/Manager	UK Commercial Property / Fidelity
Fund AuM	£45m Pooled Fund; 3.7% of the Fund
Performance target	IPD UK All Balanced Property Index
Adviser opinion	Has outperformed the peer group during the recent market turbulence
Last meeting with manager	4/8; 29/10 John Arthur/Paul Harris
Fees	0.75% of fund value

The UK Commercial Property portfolio managed by Fidelity fell by -0.1% over the quarter and has fallen -3.2% over the last year. This has been driven by the economic disruption caused by the economic lockdown with the majority of consumer facing businesses being forced to shut down. Valuations declined by -7% for high street retail and -3% for retail warehouses against rising 1% in industrial over the period. The valuation of offices was more mixed depending on the length of the remaining lease and the quality of the tenant.

Rental collection dipped to 90% in the second quarter as the economic lockdown took effect. This reduction has continued with 93% of third quarter rent collected to date. This is above the industry average. The unpaid rent is deferred rather than lost and the majority should be recovered once the economic lockdown ends. In a small number of cases Fidelity have agreed short term rental holidays in exchange for the removal of future break clauses or for agreeing longer lease terms. This has only been done where the manager views the tenant as of sufficient quality.

The portfolio is under-exposed to retail which accounts for only 12% of the portfolio, 7% of the portfolio is in cash with no purchases or sales planned at the current time.

There are three properties undergoing planned refurbishments and then reletting, in addition, one further property is now being refurbished following the exercise of a break clause by the tenant. In all four cases the manager expects to remarket the refurbished property at a premium to the previous rental rate and is progressing well with the refurbishment at the present time despite some delays due to the economic lockdown lengthening supply lines.

The four properties currently undergoing refurbishment are as follows:

- Industrial Units in Wigan – valued at 5% of the portfolio AuM. Refurbishment completed in August 2020 and currently being marketed although this is being delayed due to the current lockdown. The expectation is to achieve a rent above the previous level.
- Office in Cardiff – The client exercised a break clause in the lease enabling them to vacate the property earlier than expected. This property is now being refurbished with completion due end November 2020. The energy efficiency of the property has been improved and the expectation is to achieve a rental level 10%+ above the previous rent.
- Office in Southampton – This was a planned redevelopment due to lease expiry. Planning permission has been granted to add a fourth floor and infill the atrium with completion expected in mid-2021. The manager is targeting an uplift in rent of over 25% upon completion of the refurbishment.
- Barley Wood where the manager is looking for change of use from Office to Industrial.

The current vacancy rate is very high at 21% but over 16% of this relates to the four properties commented on above. Reletting these properties once the refurbishments are completed will drive rental and asset value growth through 2021 and beyond and puts the portfolio in a good position, albeit I am sure the manager would have preferred not to be managing the refurbishments and re-lettings through an economic lockdown. I view the portfolio as well positioned for the next few years but with short term operational risks due to the high vacancy rate at present.

International Real Estate (RE) Manager Selection

Following a review of the terms and conditions for investing in the proposed RE fund, contracts were signed on the 10th November qualifying the Fund for a 25% fee discount for the next four years as an initial investor. In addition the Fund has negotiated an observer seat on the RE funds' advisory panel which is made up of large (\$250m+) investors, had a Most Favoured Nations (MFN) clause included in a side letter to the agreement which ensures that no other investor committing a similar or smaller size of investment will receive more favourable terms and negotiated the consolidation of all LGPS commitments to the RE fund for fee calculations. There are no other LGPS investors in the RE fund at present but if any do invest prior to the final close this could feed through to a lower management fee for the Fund.

Morgan Stanley had raised \$2bn by the first closing date (10/11/20) and are targeting \$3.5bn by final close next year.

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