



London Borough of Bromley

Quarterly Investment Report

Q3 2023

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Key Indicators at a Glance

Index (Local Currency)		Q4 2023	Q4	YTD
Equities			Total Return	
UK Large-Cap Equities	FTSE 100	7,733	3.63%	6.22%
UK All-Cap Equities	FTSE All-Share	4,232	4.62%	6.24%
US Equities	S&P 500	4,770	11.67%	26.76%
European Equities	EURO STOXX 50 Price EUR	4,521	9.61%	21.14%
Japanese Equities	Nikkei 225	33,464	5.48%	32.83%
EM Equities	MSCI Emerging Markets	1,024	7.99%	10.14%
Global Equities	MSCI World	3,169	12.10%	24.22%
Government Bonds				
UK Gilts	FTSE Actuaries UK Gilts TR All Stocks	3,129	9.20%	3.69%
UK Gilts Over 15 Years	FTSE Actuaries Uk Gilts Over 15 Yr	3,755	16.67%	1.65%
UK Index-Linked Gilts	FTSE Actuaries UK Index-Linked Gilts TR All Stocks	4,037	10.48%	0.93%
UK Index-Linked Gilts Over 15 Years	FTSE Actuaries UK Index-Linked Gilts TR Over 15 Yr	4,368	16.79%	-4.28%
Euro Gov Bonds	Bloomberg EU Govt All Bonds TR	223	7.72%	7.12%
US Gov Bonds	Bloomberg US Treasuries TR Unhedged	2,277	6.26%	4.05%
EM Gov Bonds (Local)	J.P. Morgan Government Bond Index Emerging Markets Core In	137	7.99%	10.91%
EM Gov Bonds (Hard/USD)	J.P. Morgan Emerging Markets Global Diversified Index	893	9.98%	11.09%
Bond Indices				
UK Corporate Investment Grade	S&P UK Investment Grade Corporate Bond Index TR	362	8.13%	9.63%
European Corporate Investment Grade	Bloomberg Pan-European Aggregate Corporate TR Unhedged	232	5.99%	8.84%
European Corporate High Yield	Bloomberg Pan-European HY TR Unhedged	439	5.63%	12.78%
US Corporate Investment Grade	Bloomberg US Corporate Investment Grade TR Unhedged	3,221	8.50%	8.52%
US Corporate High Yield	Bloomberg US Corporate HY TR Unhedged	2,480	7.16%	13.45%
Commodities				
Brent Crude Oil	Generic 1st Crude Oil, Brent, USD/bbl	77	-19.17%	-10.32%
Natural Gas (US)	Generic 1st Natural Gas, USD/MMBtu	2.51	-14.17%	-43.82%
Gold	Generic 1st Gold, USD/toz	2,072	12.10%	13.45%
Copper	Generic 1st Copper, USD/lb	389	4.09%	2.10%
Currencies				
GBP/EUR	GBPEUR Exchange Rate	1.15	-0.03%	2.12%
GBP/USD	GBPUSD Exchange Rate	1.27	4.36%	5.36%
EUR/USD	EURUSD Exchange Rate	1.10	4.41%	3.12%
USD/JPY	USDJPY Exchange Rate	141	-5.58%	7.57%
Dollar Index	Dollar Index Spot	101	-4.56%	-2.11%
USD/CNY	USDCNY Exchange Rate	7.10	-2.71%	2.92%
Alternatives				
Infrastructure	S&P Global Infrastructure Index	2,724	14.21%	6.46%
Private Equity	S&P Listed Private Equity Index	212	20.57%	40.56%
Hedge Funds	Hedge Fund Research HFRI Fund-Weighted Composite Index	18,783	3.59%	7.21%
Global Real Estate	FTSE EPRA Nareit Global Index TR GBP	3,718	9.92%	3.59%
Volatility			Change in Volatility	
VIX	Chicago Board Options Exchange SPX Volatility Index	12	-28.94%	-42.55%

Source: Bloomberg. All return figures quoted are total return, calculated with gross dividends/income reinvested and in local currency.

Performance

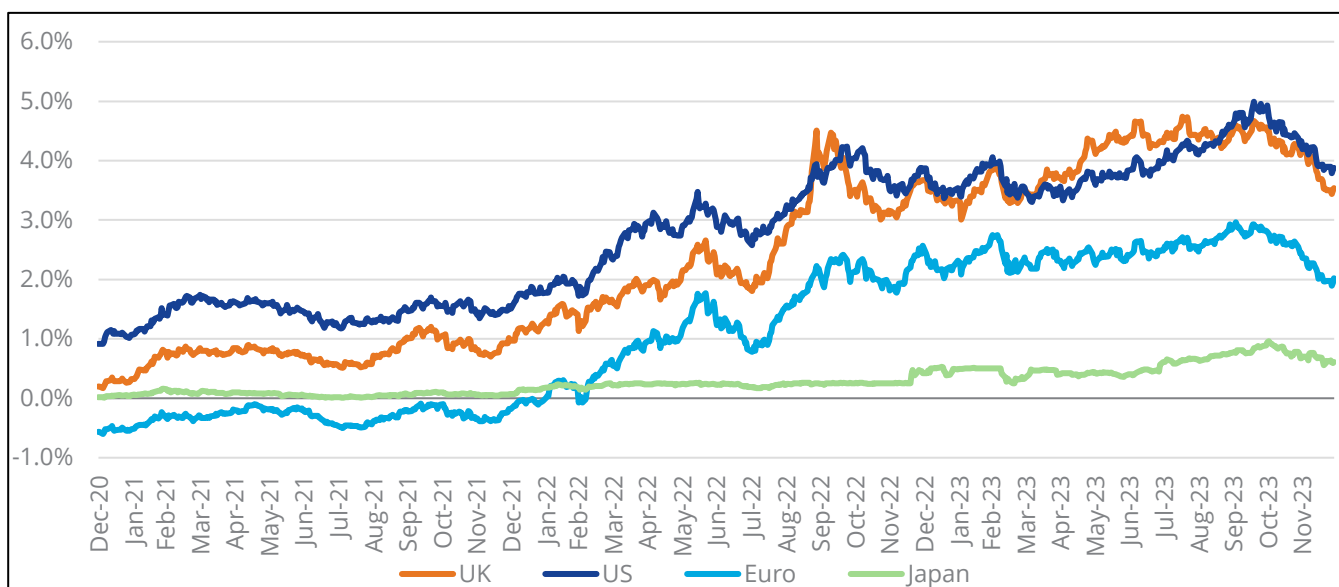
The Fund rose by 5.47% in the fourth quarter of 2023 to a value of £1,333m. This was against a rise in the Fund benchmark of 5.13% over the period. As can be seen from the table on the previous page, during the fourth quarter there was a strong rally across all asset classes led by Fixed Interest markets where an improved outlook on inflation led to forecasts of falling interest rates and hence to a fall in bond yields, this supported all risk assets. The price of oil and gas fell over the quarter, reversing last quarter's gains, which also helped the inflation outlook. The Fund's outperformance of its benchmark was driven by the two Multi-Asset Income portfolios where the benchmark is of a cash + X% style which means the benchmark rises by a fixed amount over the return of cash in any given quarter irrespective of the movement of asset prices. In a quarter where asset prices rise these portfolios will tend to outperform their benchmark (and visa-versa). The Fidelity Multi-Asset Income portfolio rose by 5.8% in the quarter against a rise of 5.3% in the similar Schroders portfolio. In addition the LCIV Baillie Gifford Global High Alpha Equity portfolio outperformed its benchmark by 2.5% over the quarter. Against this, the investment into short-dated corporate bonds through a Fidelity portfolio showed a marginal return with transition costs weighting on returns and the Morgan Stanley International Property Fund showed a negative return driven by the weakness of the US Dollar against Sterling over the quarter as this is a US Dollar based Fund.

The Fund remains noticeably behind its benchmark over 1 and 3 years and marginally behind over 5 years but with returns of 8.5% per annum over the last 36 years being above the Fund's actuarial discount rate assumption for future investment returns investment returns have driven the improvement the funding ratio over the long-term.

Comment

A strong fourth quarter for all asset classes turned 2023 into a year of good returns with the Fund up 8.1% over the course of 2023. This is a far better outcome than was expected at the start of last year when the vast majority of investment strategists (and me!) were predicting a US recession and poor returns. What changed is the strong growth in the US economy, defying rising interest rates, coupled with falling inflation. The rally in the fourth quarter was driven by the US Federal Reserve (US Fed) suggesting that peak interest rates had arrived and that they believed there was scope to cut interest rates during 2024. Bond markets were soon discounting 6 times 0.25% rate cuts during 2024 but have now rowed back from that optimistic scenario.

Chart 1: Government Bond Yields



So what did we learn from markets in 2023 and should there be any changes to the Fund’s asset allocation?

I have spent much time writing about the backdrop for inflation globally over the last few years with a number of long-term factors changing and becoming more supportive of higher inflation. My view on this has not changed. Whilst the consensus at the start of 2023 was for a US recession, the consensus for 2024 is for the year to finish with inflation in the US around 3%. Whilst this is quite possible, it is the strength of that conviction and its almost universal acceptance which is concerning. If we are to end the year with sub 3% inflation in the US that will be on the back of a slower US economy than currently forecast as wage growth needs to slow from here for 3% inflation to be sustainable. The February US unemployment rate reading remained low at 3.7%. It is hard to see wage inflation slowing without unemployment rising.

Chart 2: US inflation and wage inflation



Whilst the issue in the US is of a relatively strong economy keeping inflation high, the economic outlook in Europe and the UK is much weaker. Interest rates are likely to be cut earlier here as economic growth deteriorates. Again wage rises are an issue (UK wage growth was 6% in the year to February 2024) but with unemployment higher and the economy weaker, interest rate cuts should come before those in US.

The other area where I have not changed my view is that inflation will be more volatile going forward. The period of subdued and stable inflation over the past 10 years has ended with inflation now easier to ignite, either by rising economic growth hitting capacity constraints or by geopolitical unrest restricting the supply of important commodities. This will lead to shorter business cycles and more rapidly changing interest rates. Altogether a more complex outlook for the market.

The other issue is politics. Many politicians believe they can impact global markets but this is very rarely the case. Perhaps Mao Zedong is the only one with his drive to open up the Chinese market and compete globally leading to a seismic change in the availability of labour, helping set the scene for 50 years of global deflation. However, we have almost half the world’s population voting in an election this year with votes in over 50 countries. A number of these may be predetermined but the scope for surprises is high and in the US presidential elections, to be held on 5th November this year, the outcome could be disruptive to the current global status quo. Elections to the European parliament could also throw up some disruptive factors with the rise of populism (or short-termism as I see it) a potential outcome. It is possible that elections do not provide the required solutions and, as we are seeing in Pakistan, this could herald a prolonged period of uncertainty.

Against all of this, markets are better value now with returns to be made in Government debt and long-term return expectations increasing across many asset classes although whether this higher absolute return is actually a higher real return after taking inflation into account remains to be seen.

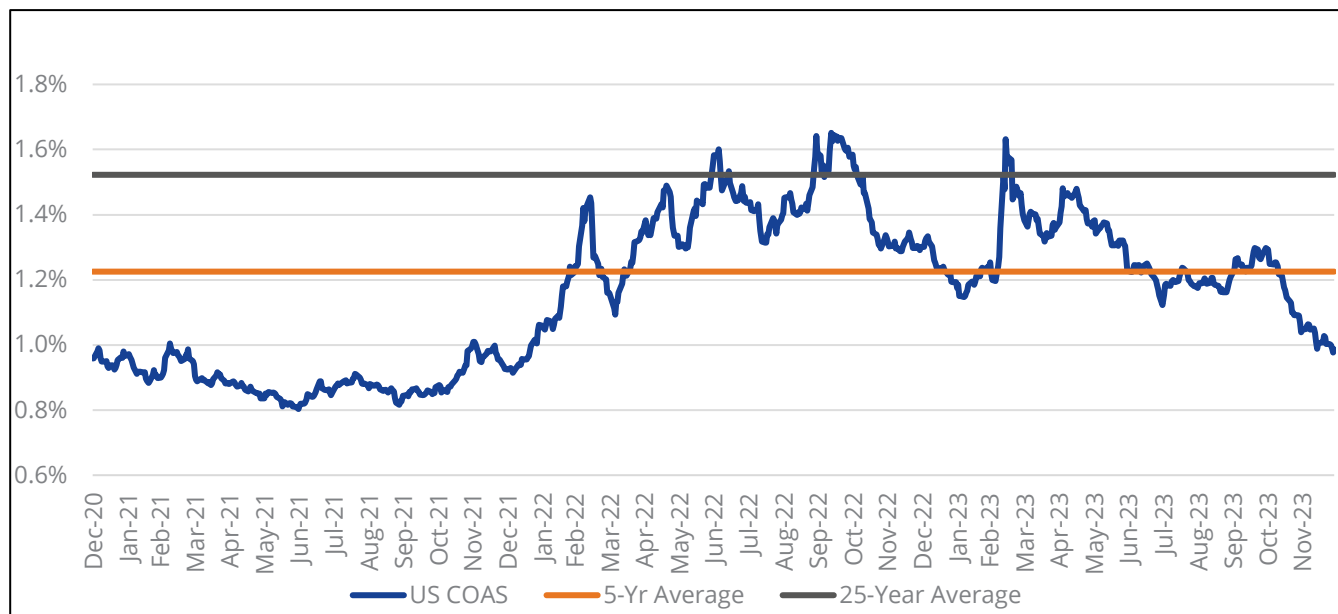
Fund positioning

In an environment of subdued growth with occasional bursts of inflation, companies which can grow quickly, irrespective of the prevailing economic environment should become highly rated, this fits with the LCIV Baillie Gifford Global High Alpha Equity portfolio. In addition, companies with a strong, defensible business model who can pass on prices during bouts of rising inflation also have a place in the Fund, this fits with the MFS Global Equity portfolio.

From a Fixed Interest point of view, because long-term inflation will not be as acquiescent as in the past, long-term inflation expectations may settle higher than current market expectations and so I would favour shorter duration bonds. This is particularly true in the UK where, even with a slowing or recessionary economic environment, long-term interest rates could grind higher if investors are unconvinced by the prevailing government’s drive to tackle its borrowing and debt levels. This fits with the current allocation to a Fidelity short-dated UK corporate bond fund. It would also include direct lending and this remains an area of interest with current yields over 10% for this asset class. With credit spreads already tight, I would have a preference for investment grade bonds and Government bonds over higher yielding credit. Especially as economic growth may slow further from here.

The chart below shows the premium an investment grade corporate borrowing in the US would have to pay over the equivalent US government Treasury with a similar maturity profile.

Chart 3: US Corporate Bond Spreads



Source: Bloomberg

Notes: Bloomberg Barclays US Corporate Option Adjusted Spread (Ticker: LUACSTAT Index); Option-Adjusted Spreads (OAS) represent the difference between the index yield and the yield of a comparable maturity treasury

As noted in the last quarterly report, in my opinion, the two Multi-Asset Income portfolios have a role in the Fund as they generate income. The Fund has a higher risk Strategic Asset Allocation with a high weighting to global equities than the LGPS sector in general and this has benefitted Fund performance over the longer term, but, this only works if there will never be pressure to sell these assets when markets fall. The only way to guarantee this is through ensuring that the Fund will have sufficient cash to pay pensions under all scenarios. The Multi-Asset Income portfolios are an important part of this structure.

I would, however, like to see some changes in their construction to reflect higher bond yields and have challenged the two managers to reflect on the past equity and bond weightings they have held and whether these should change going forward. I have also questioned the level of diversification within the two Funds, wanting less ‘market’ risk and more idiosyncratic risk so that a correlated fall in both Equities and Bonds will not weigh on returns in the same way it did during the last few years. In my view that, now we have decent yields available in most Government Bond markets, the Multi-Asset Income portfolios have a better chance of fulfilling their original brief which was for a good yield with some prospect of capital growth but with strong downside protection.

For the two Property portfolios, returns may remain subdued for the next few years but I do not expect a further market rout and I still believe that the Morgan Stanley Opportunistic International Property Fund will add value over the longer term and would expect to see the rate of investment pick up from here and a faster rate of drawdown into the Fund going forward. **This may require a further allocation of approximately £10m to the US Dollar cash to cover these drawdowns over the next 12 months.**

In the table below are the Long-term Return Assumptions for Alternative Asset classes as forecast by BCA Research, who are one of the world’s leading providers of investment research in this area.

Table 1: Alternative Asset Class return forecasts

Asset Class	Private Equity	Private Debt	Property	Hedge Funds
BCA Research 5-7 year forecast	6.2%	11.8%	3.3%	6.9%
BCA Research 20 year forecast	10.5%	9.2%	9.6%	6.3%

The forecasts above are useful as they show where the revaluation of bond yields will continue to weigh on returns for the next few years (PE and core property) before returning to trend and where they are unaffected (Private Credit) due to this asset class’s variable interest rate exposure meaning the loans have already repriced to reflect current interest rate and bond yield assumptions.

I would rather allocate to Private Debt than Private Equity or Infrastructure at the current time irrespective of what the government is pushing.

Potential Action – To review whether an allocation to Direct Lending would be appropriate.

I regard the risk reward of this asset class as strong at the present time, Direct Lending (also called Private Debt) is lending to small and mid-sized corporates outside of the banking system. Loans are made directly with the lender, often unilaterally or with a small group of lenders acting in concert. The borrowing company is often Private Equity owned. Banks have left this segment of the loan market as changes to capital allocation rules post the global Financial Crisis in 2008/9 has made the lending unattractive. Loans are at variable market rates and so reprice with changes in interest rates. They are priced off money market rates plus a credit spread. In addition, revenue is also generated from arrangement fees. Loans are typically of 4 years but often repaid early giving a fast turnaround on investments. Current returns on these asset class are 10-12% per annum with the downside being credit risk. A fund can have 20-390 loans in it so there is a concentration of credit risk but managers tend to target non-cyclical industries such as healthcare and IT services to reduce the economic sensitivity of the loans.

Is the Committee interested in reviewing this asset class? Any allocation to direct lending would likely be into a closed-end fund and take potentially up to two years to draw down. The Fund would have a 7 year investment life with capital starting to be returned to shareholders after 3-4 years (this is a similar structure to the Morgan Stanley Opportunistic Property fund only drawdown would be faster as the asset class is more liquid).

The LCIV does have a direct lending vehicle and it would be possible to invest via this, the advantage is that this removes the need for a full tender and manager selection exercise saving time and money. The LCIV fund has 8 investors who have committed £615m between them of which £420m has been drawn down and invested so far. The fund was launched on 29/3/21.

Any allocation to Direct lending should be 5% of the Fund to have an impact (£65m) it would add diversification, particularly as it would have very limited sensitivity to bond yields.

Asset Allocation

Table 2: The Funds current asset allocation against the Strategic Benchmark

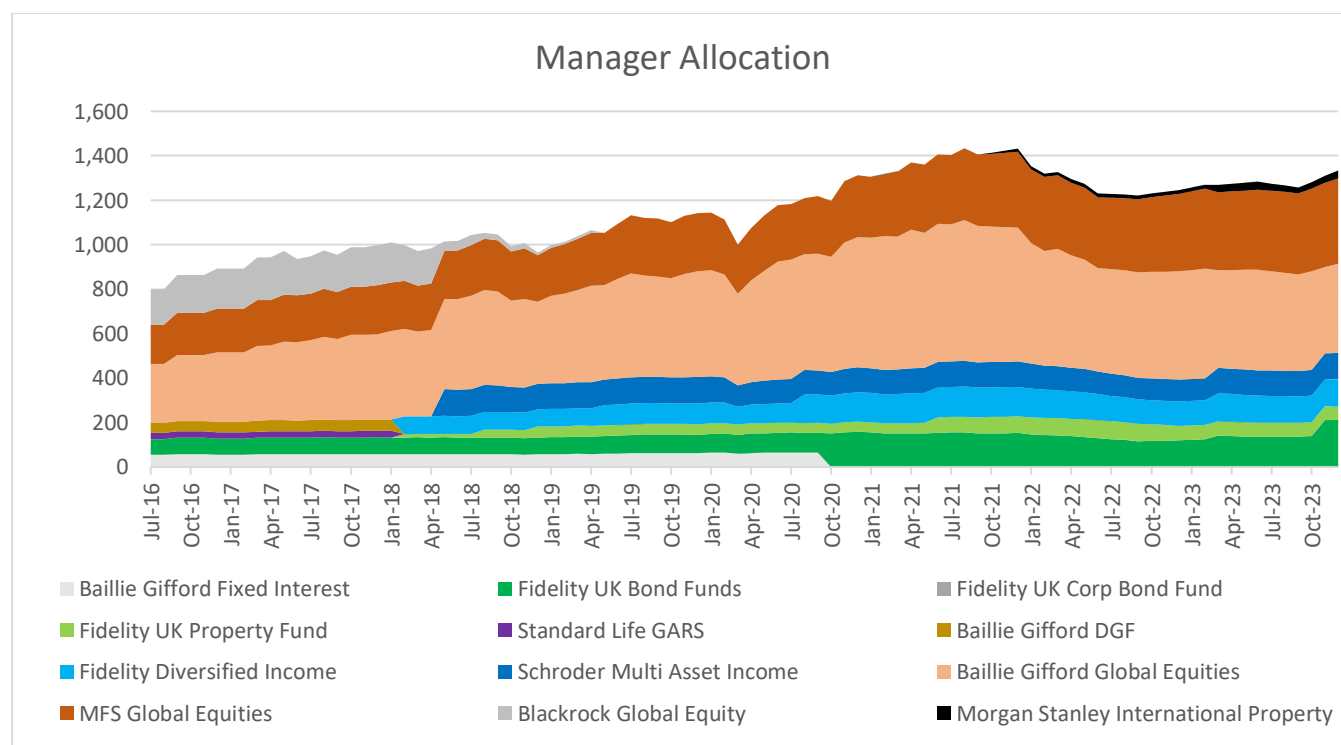
Asset class	Asset Allocation as at 31/12/2023	SAA Benchmark	Position against the benchmark	Cash over/under weight
Global Equities	58.8%	58%	+0.8%	£10.7m
Fixed Interest	15.9%	13%	+2.9%	£38.7m
UK Property	4.5%	4%	+0.5%	£6.7m
Multi-Asset Income	18.1%	20%	-1.9%	£25.3m
Int'l Property +US\$ cash	2.7%	5%	-2.3%	£30.7m

Figures may not add up due to rounding

The asset weightings does now reflect the move of 5% of the Fund from Global Equities to a short-dated bond fund managed by Fidelity.

The column on the right of this table shows the amount of money which would need to be moved from each asset class to bring it to an on-weight position against the Strategic Asset Allocation benchmark. I regard all of these as within acceptable tolerances, particularly as the money awaiting drawdown into the International Property portfolio is now, in essence, held in short-dated UK corporate bonds which will be much less volatile than Global Equities, thereby reducing the risk.

Chart 5: Assets by manager/mandate.



With asset values moving back towards the Fund’s peak valuation from autumn 2021 and bond yields having risen since then, there will have been limited change in the value of the Fund whilst the actuarial valuation of the Fund’s liabilities will have fallen markedly thereby further raising the funding ratio. Given my view of inflation remaining above historic levels going forward, I would expect the actuary to have to alter their long-term inflation expectations at the next triannual valuation.

Market Summary

- Inflation (including core inflation) fell again in Q4 and allayed many market fears over it proving stickier than expected. As a result of this continued fall, central banks have taken a more dovish stance and indicated that rates will be cut sooner in 2024 than previously expected. Lower inflation and peaking rates have shifted the concern more on the side of stagnating growth and recessionary risk, with UK and Europe showing declining GDP growth and China still feeling the effects of the property crisis. The notable exception to this is the US, where resilience in the domestic job market and a healthy consumer market have led to steady GDP growth. Labour markets continue to remain robust, especially in the US (unemployment at 3.7% and job openings up 5.3% YoY in November).
- Q4 delivered a rally in almost all markets, following the Q3 correction, returning to the positive trend of the first half of the year. Global equities (MSCI World) rose sharply by 12.1% in local currency terms over the quarter, with ‘growth’ (+13.2%) rising more sharply than ‘value’ (+8.8%) as an investment style. Japanese and UK equities notably lagged behind other markets, with broad Japanese equities returning 2.0% (TOPIX Index) and 5.5% (Nikkei 225) in local currency and UK equities returning 4.6%. Following a spectacular year, Japanese equities lagged, due to the lesser impact of changes in rate policy combined with Yen appreciation acting as a headwind. UK equities suffered from the drops in oil and gas prices and sterling strength. US equities (+11.7%) rose after the more dovish stance taken by the US Fed allayed fears of ‘higher for longer’ rates. Bonds enjoyed a reprieve in Q4, as markets discounted 1.5-2% cuts in rates during 2024. All government bonds performed strongly over the quarter, with long dated gilts showing the biggest recovery. Investment grade mildly underperformed government bonds, with spreads tightening as refinancing concerns decreased and slightly outperformed high yield, due to a greater sensitivity to rates. Alternatives all showed a strong recovery, with private equity (+20.6%) as measured by the S&P Listed Private Equity Index showing particularly strong performance.

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

- Core inflation is going down but watch for false rallies. Inflation fell across the board through most of the quarter. UK annual CPI fell to 3.9% in November, compared to 3.4% for the US and 2.9% for Eurozone in December (UK estimates for December not yet available). Core inflation (excluding energy and food prices) has now also been falling more significantly, resulting in the US Fed taking a more dovish stance and increasing predicted cuts in 2024. However, tensions in Ukraine and the Middle East illustrate the potential for renewed inflationary shocks (from supply constraints) and sustained inflationary pressure (through “friendshoring”, the onshoring of businesses to friendly nations, and the re-engineering of supply chains). It is likely that as 2024 progresses we will see more pauses/false rallies as central banks’ balance the need to keep the inflation figures falling and the risks of recession.
- AI has now been operational for over a year, what are the next steps? Since ChatGPT’s launch in November 2022, it and other AI platforms have had a significant impact. The scale of its potential can be seen in the way it has materially driven technology investment over the course of the year and in the enormous outperformance of the US tech majors (“Magnificent Seven”). Increasing regulation and concerns over its misuses may lead to a slight slowing of the speed of advancement and investment, but the power of AI to disrupt businesses and, indeed, the political process in the largest electoral year in history, should not be underestimated. It offers huge opportunities, but also creates an increasingly risky investment environment.
- Investment risk is higher and harder to diversify in geopolitically driven or inflationary environments. In inflationary environments, where central banks have to balance taming inflation with causing recessions, equity/bond correlations tend to be positive: raising rates is mathematically bad for bond prices, but also increases recession risk, impacting equities. This means the traditionally stable assets (bonds), as well as being inherently more volatile, are also less likely to offset movements in risk assets (equities). In addition, 2024 will be a year of elections and the Taiwanese elections, in which the DPP (the champions of Taiwan’s separate identity) have been re-elected, illustrates the potential for such events to have global impacts; none more so than the US election at the end of this year, which could impact whole sectors, changing the outlook for global trade and the energy transition. This suggests investors should examine their risk exposures with particular care this year.
- Global equities rose in Q4, returning to the rally of the first half of the year. The VIX decreased over the quarter from 18 to 12.

- In the US, the S&P 500 rose by 11.7% and the NASDAQ composite also rose by 13.8%. The US Fed's more dovish stance and the addition of a third predicted rate cut in 2024, signalled a move from the 'higher for longer' rates predicted last quarter and resulted in a positive market reaction.
- UK equities increased by 4.6%, underperforming global equities. Inflation fell noticeably from 6.7% in August to 3.9% in November, however, sterling strength detracted from returns. Significant falls in oil and natural gas prices contributed strongly to underperformance given the UK stock market's energy sector exposure.
- The Euro Stoxx 50 rose by 9.6% in Q4. Inflation continued to move downwards, with core inflation proving less sticky than feared. The ECB continued to loosen hawkish rhetoric.
- Japanese equities continued their positive run in Q4 but underperformed other equity markets in part due to Yen appreciation. Growth companies outperformed, with the Nikkei returning 5.5% relative to the broader TOPIX index's more muted returns (+2.0%).
- Emerging market equities rose by 8.0% in Q4, whilst Chinese equities fell (-4.8%) over mounting growth concerns. The rest of the emerging markets performed strongly, with MSCI EM LATAM returning 17.8% over the quarter. Poland was another strong performer following Donald Tusk's election as Prime Minister, Taiwan and South Korea benefitted from tech-related performance and overall expectations of more and sooner US rate cuts helped overall emerging market performance.
- Yields generally fell over the quarter, as a result of more dovish stances taken by central banks (mainly the US Fed) and predictions of rate cuts in 2024 which resulted in strongly positive performance across the main government bond markets. The inversion of the US yield curve, as measured by the 10 year–2 year yields, reduced slightly, ending the quarter at around -40bps, as mid and long term yields rose more than shorter bond yields. In corporate bonds, credit spreads tightened as default rates remain low and recessionary fears reduced over the quarter.
- The US 10-year Treasury yield fell in Q4 from 4.57% to 3.88%, while the 2-year yield fell from 5.05% to 4.25%. US Fed policy rates remained the same, but the US Fed took a more dovish stance and indicated there would be more rate cuts and sooner in 2024.
- The UK 10-year Gilt yield fell from 4.44% to 3.53% while 2-year yields fell from 4.90% to 3.95%. The BoE is more divided over its stance but, with the latest inflation measures being lower than expected, the market rallied and yields fell.
- European government bonds rose in Q4, the ECB was also more cautious than the US Fed, but continues to unwind the Pandemic Emergency Purchase Programme (PEPP) support and the market is still pricing in several rate cuts in 2024. Italian – German spreads tightened.
- US high-yield and investment grade credit performed strongly, returning 7.2% and 8.5% respectively. European high-yield and investment grade bonds returned 5.6% and 6.0%, respectively, with UK investment grade returning 8.1%.
- Energy prices declined during Q4, with crude oil falling -19.2% from the highs of Q3 to finish the calendar year -10.3% down. Similarly, natural gas was down -14.2% and ended the year -43.8% down, the largest annual percentage decline since 2006.
- US gas prices fell in Q4 due to record production coupled with abundant inventories and relatively mild winter temperatures.
- OPEC+ supply cuts had little impact on falling crude oil prices as the International Energy Agency forecasted softening global oil demand to continue into 2024. The quarter saw weaker than anticipated demand in Europe, Russia and the Middle East, which was paired with an increase in supply from non-OPEC+ sources.
- Gold and copper rose 12.1% and 4.1% respectively over Q4. Precious metals prices (particularly Gold) generally rose following concerns around geopolitical stability, while industrial metals were more mixed.
- Global listed property rebounded this quarter, with the FTSE EPRA Nareit Global Index rising 9.9% in Q4.
- The Nationwide House Price Index in the UK has increased after its decrease last quarter, with the seasonally adjusted price index up 1.1% for the quarter and down -1.7% for the last 12 months.
- European commercial property has also continued to decline in the face of higher interest rates, with the Green Street Pan European Commercial Property Price Index down by -2.8% this quarter and -10.9% over the past 12 months.
- In currencies, the US dollar weakened generally throughout the quarter (DXY -4.6%), weakening against Sterling, the Euro and the Japanese Yen. Bitcoin and Ethereum saw strong performance in Q4 (57% and 37% respectively) with a main driver being the increasingly likely approval of the US spot bitcoin ETF by the SEC.

Performance report

Asset Class/ Manager	Global Equities/ Baillie Gifford via the LCIV
Fund AuM	£399m Segregated Fund; 30.0% of the Fund (inc £5m still held directly with BG)
Benchmark/ Target	MSCI All Countries World Index +2-3% p.a over a rolling 5 years
Adviser opinion	Short-term performance has been poor, acceptable longer term.
Last meeting with manager	John Arthur/John Carnegie/Tim Golding 25/1/24

This portfolio is now held within the London CIV. It has now underperformed over the last 5 years. I have downgraded the manager to amber given the poor recent performance but remain supportive of their investment approach.

A good return for the quarter with the portfolio returning 8.9% against the benchmark return of 6.4%. Importantly, the holding in the portfolio continues to show strong top line growth and expected growth in earning above the market. In a strong equity market this growth focus was core to the outperformance.

Longer term Baillie Gifford has underperformed over 1 and 3 years but have still added value to the Fund since inception in 1999.

I continue to believe that the investment philosophy and process focusing on high growth businesses should aid performance going forward, especially in a lower growth environment.

Asset Class/ Manager	Global Equities/MFS
Fund AuM	£384m Segregated Fund; 28.8% of the Fund
Benchmark/ Target	MSCI World Index (Developed Markets)
Adviser opinion	This portfolio should outperform in a more inflationary environment
Last meeting with manager	Elaine Alston/Paul Fairbrother/John Arthur 4/12/23

The MFS portfolio returned 5.6% over the quarter, underperforming its benchmark by -0.7%. This brings the 1-year performance to a return of 10.4% which is 4.9% behind the benchmark, a disappointing result. The portfolio has outperformed over the medium and longer term adding 1.3% p.a. over the benchmark since inception in January 2013. MFS retain a 'value' bias within the portfolio focusing on stocks which have a strong and defensible business model and have pricing power which is important in more inflationary times.

MFS remain cautious of the economic outlook at present and are stress testing their investments for the durability of the business franchise as well as concentrating on valuation support. Given that I remain somewhat cautious over the market outlook and expect that we are entering a lower growth, more challenging situation for many corporates, I do think that it is possible that both the Fund's equity managers could outperform over the next few years as both seem to have an investment approach that fits well with current market dynamics.

Asset Class/Manager	UK Aggregate Bond Fund and UK Corporate Bond Fund/ Fidelity
Fund AuM	£212m pooled fund; 15.9% of the Fund
Performance target	28.8% Sterling Gilts; 28.8% Sterling Non-Gilts; 42.5% UK Corporate Bonds +0.75 p.a rolling 3 year;
Adviser opinion	Manager continues to meet long-term performance targets
Last meeting with manager	Tom Jeffery; Jessica Miley/John Arthur 30/8/23

The Fund holds two similar Fidelity Fixed Interest portfolios. The UK Aggregate Bond Fund which has a benchmark that is 50% UK Gilts and 50% UK non-Gilts and the UK Corporate Bond Fund which has a benchmark consisting entirely of UK Investment Grade Corporates and, as such, contains slightly higher credit risk and achieves a slightly higher yield. The manager can invest outside of these benchmarks with a proportion of the portfolio including into overseas investment grade bonds hedged back to Sterling and higher yielding, non-investment grade bonds. These two portfolios are combined for reporting.

In addition the Fund now also holds a third Fidelity bond fund which is focused on the UK short duration investment grade bonds following an allocation to this Fund in October last year.

The two existing bond portfolios returned 7.3% over the quarter against 7.9% for the index and have underperformed over the last year by 1.8%. Over the longer term the portfolio has outperformed, adding 0.7% per annum over the benchmark over the last 25 years.

The fourth quarter saw UK Gilt yields fall across the duration curve as central banks in the US, EU and UK all took a more dovish tone on the outlook for inflation and thereby interest rates. Investors seemed anxious to catch the top of the interest rate cycle and push yields down quickly discounting 6 times 0.25% interest rate cuts by the end of 2024. This optimistic scenario has unwound slightly since the 2023 year end.

With yields falling rapidly across the duration curve, longer duration bonds returned more than short duration bonds because bond returns are a function of yield change multiplied by duration.

The portfolio was slightly short duration against its benchmark which had a negative impact on returns but gained from credit exposure. With credit spreads now tight by historical standards, I will challenge the manager on their credit outlook at my next meeting.

Asset Class/Manager	Multi-Asset Income / Fidelity
Fund AuM	£123m Pooled Fund; 9.2% of the Fund
Performance target	LIBOR +4% including a yield of 4% per annum
Adviser opinion	
Last meeting with manager	Eugene Philalithis; Tom Jeffrey; Jessica Miley/John Arthur 28/9; 24/10; 27/11

Asset Class/Manager	Multi-Asset Income / Schroders
Fund AuM	£118m Pooled Fund; 8.9% of the Fund
Performance target	LIBOR +5% including a yield of 4% per annum
Adviser opinion	
Last meeting with manager	John Arthur/ Russel Smith/Remi Olu-Pitan 31/10/23

These portfolios are designed to provide yield which is paid back to the Fund each quarter. By guaranteeing that the Fund always has enough cash to pay pensions, under any circumstances, the Fund never becomes forced to sell into unfavourable market conditions but can continue to invest for the long-term.

During the quarter the Fidelity portfolio returned 5.8% whilst the Schroders portfolio rose by 5.3%. Over the last year a noticeable performance gap has opened up between the two portfolios with Fidelity up 3.8% and the Schroders portfolio up 9.0%. I detailed the issues behind the poor performance of the Fidelity portfolio in my last report.

As noted earlier in this report, I continue to see these two portfolios as important building blocks in the construction of the Fund as by providing income to the Fund, the Fund's cash flow is supported and the ability to cover pension payments ensured. This allows the Fund to take on more investment risk elsewhere as they will not be forced to sell more volatile, higher risk assets to cover pension payments in difficult market conditions. I will, however, continue to challenge both managers over the structure of their portfolio over the next few months.

Asset Class/Manager	UK Commercial Property / Fidelity
Fund AuM	£60m Pooled Fund 4.5% of the Fund
Performance target	IPD UK All Balanced Property Index
Adviser opinion	
Last meeting with manager	Alison Puhar; Tom Jeffery; Jessica Miley/ John Arthur 24/10/23

The UK property portfolio fell by 4.4% over the quarter, underperforming the benchmarks decline of -1.2%. Over the last 5 years the portfolio has returned 0.4% per annum, against a benchmark return of 1.2% per annum. This remains above the return from the Fund's bond portfolios over the 5-year period. The underperformance in the quarter was driven by a tough valuation by the fund's independent valuer particularly around exposure to the office sector.

With interest rates in the UK likely to fall from here, there should be more support for the property market through 2024.

The portfolio is now yielding 4.7%. This yield is paid back to the Fund to help cover pension payments. The vacancy rate of the portfolio is stable at 16% with half of this being due to refurbishments. There was one small sale during the quarter.

I continue to see this portfolio as well managed and providing an element of diversification from the Fund's heavy global equity exposure.

Given the current state of the UK Commercial property market, the Fund does have a number of investors looking to sell their holdings at the current time. These are predominately corporate defined benefit pension schemes who are looking to move to buyout and therefore need their investments to be liquid and easily valued. I will continue to monitor this going forward to ensure that the manager does not come under undue pressure to realise assets in difficult market conditions.

Asset Class/Manager	International Property / Morgan Stanley
Fund AuM	USD80m (£63.2m) committed / £25.3m drawn. Limited Partnership; 1.9% of the Fund
Performance target	Absolute return
Adviser opinion	
Last meeting with manager	John Arthur/Gareth Dittmer New Haven AGM 11/11/23

Performance measurement for a portfolio undergoing a sustained period of investment is complex. The figures produced by your custodian are chain linked which means that each time period (quarter) is multiplied by the next period to produce longer term figures. This is effective for a portfolio with limited cash inflow or outflow. However, where the value of a portfolio is changing rapidly and, in particular, where a portfolio is going to incur costs at the start of the investment period, this methodology can mislead. Initial negative returns at the start of a fund's life (as costs are incurred) when the fund has limited value, are given the same weight as a period where the fund is fully invested. This produces a somewhat irrelevant figure over time. Because of this, most close-ended investment vehicles show an Internal Rate of Return (IRR) calculation as their primary performance indicator. This gives the money weighted return on investment over the period. They may also show a money multiplier which gives the return as a multiple of the initial sum invested. It should also be remembered that this portfolio is based in US Dollars and therefore the US Dollar/Sterling exchange rate fluctuations will impact performance figures.

The fund has made a number of small property divestments so far, each returning above initial expectations with a gross return of 25-30% and with 1.4 – 1.8 times the initial investment being realised at the time of sale.

At the end of 2023, the fund exchanged contracts for the purchase of a hotel in Paris situated at the base of the Eiffel tower. The Hotel is in the premium budget sector (Accor branded) but is being sold by a distressed seller whose fund is under redemption pressure. This should complete by April resulting in a £3-5m drawdown for Bromley.

When the Pensions Committee decided to invest into International Property it was to provide diversification from the Equity and Bond holdings which made up the majority of the Fund. To achieve this the Committee agreed for the mandate to be opportunistic rather than invest in core international property, selecting a manager in Morgan Stanley/New Haven who would be able to adapt to changing market circumstance and who would work with a total return target rather than a formal property index as its benchmark. Given the disruption caused to property markets globally over the last two years by rising interest rates and higher debt costs, I believe this to have been a good decision.

The capital raising for this fund completed in January 2021 and was due to be completed by December 2024, a four-year investment period. The manager has been relatively slow to commit capital into the property market, particularly during 2022 as interest rates rose substantially undermining many regional property markets. The investment rate is now picking up and the manager has now invested 56% of the committed capital of this fund of which 25% has been in the last year post the rise in interest rates, nonetheless, the manager has asked for a 1-year extension to the investment period to end 2025 as a precaution. This request has been sent to the fund's Advisory Committee. During this 1-year extension to the investment period, the managers fee will be based on invested capital only not committed capital. I regard this as acceptable and prudent given the delay in committing capital to date which will have been advantageous to this fund.

The existing portfolio continues to perform well with only 1 investment of concern, a UK logistics site purchased during the lower interest rate environment. Even here the manager does not expect to lose any capital, but is now forecasting a noticeably lower return on this property. Outside of this the manager is still forecasting an Internal Rate of Return (IRR) for the portfolio already purchased only marginally below the level predicted where interest rates were at 1% in many countries. The current environment for investing is more attractive and I would expect new investments, now being made, to outperform the original expectations for this fund and as such for this fund to reach its original return expectations over its full life.

The Fund held £10.2m as US Dollar cash to cover future draw-downs into this portfolio. I would expect this amount to cover at least the next 6 months of drawdowns but I will continue to monitor this amount.

