London Borough of Bromley

Quarterly Investment Report

Q2 2023

Contacts

John Arthur

Senior Advisor
+44 20 0000 0000
john.arthur@apexgroup-fs.com

Adrian Brown

Senior Advisor
+44 20 0000 0000
thanos.papasavvas@apexgroup-fs.com

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Key Indicators at a Glance

Index (Local Currency)		Q2 2023	Q2	YTD
Equities			**Total Return**	
UK Large-Cap Equities	FTSE 100	7,608	2.07%	3.82%
UK All-Cap Equities	FTSE All-Share	4,127	1.78%	2.91%
US Equities	S&P 500	4,288	-3.27%	13.51%
European Equities	EURO STOXX 50 Price EUR	4,175	-4.83%	11.51%
Japanese Equities	Nikkei 225	31,858	-3.36%	26.16%
EM Equities	MSCI Emerging Markets	953	-2.85%	2.09%
Global Equities	MSCI World	2,853	-3.36%	11.36%
Government Bonds				
UK Gilts	FTSE Actuaries UK Gilts TR All Stocks	2,895	-0.63%	-4.09%
UK Gilts Over 15 Years	FTSE Actuaries Uk Gilts Over 15 Yr	3,283	-5.69%	-11.13%
UK Index-Linked Gilts	FTSE Actuaries UK Index-Linked Gilts TR All Stocks	3,714	-4.69%	-7.16%
UK Index-Linked Gilts Over 15 Years	FTSE Actuaries UK Index-Linked Gilts TR Over 15 Yr	3,839	-10.67%	-15.87%
Euro Gov Bonds	Bloomberg EU Govt All Bonds TR	208	-2.54%	-0.08%
US Gov Bonds	Bloomberg US Treasuries TR Unhedged	2,155	-3.06%	-1.52%
EM Gov Bonds (Local)	J.P. Morgan Government Bond Index Emerging Markets Core In	128	-3.65%	3.72%
EM Gov Bonds (Hard/USD)	J.P. Morgan Emerging Markets Global Diversified Index	818	-2.23%	1.76%
Bond Indices				
UK Corporate Investment Grade	S&P UK Investment Grade Corporate Bond Index TR	334	-1.01%	1.39%
European Corporate Investment Grade	Bloomberg Pan-European Aggregate Corporate TR Unhedged	219	0.70%	2.69%
European Corporate High Yield	Bloomberg Pan-European HY TR Unhedged	415	3.76%	6.76%
US Corporate Investment Grade	Bloomberg US Corporate Investment Grade TR Unhedged	2,969	-3.37%	0.02%
US Corporate High Yield	Bloomberg US Corporate HY TR Unhedged	2,314	2.21%	5.86%
Commodities				
Brent Crude Oil	Generic 1st Crude Oil, Brent, USD/bbl	95	19.48%	10.94%
Natural Gas (US)	Generic 1st Natural Gas, USD/MMBtu	2.93	32.18%	-34.55%
Gold	Generic 1st Gold, USD/toz	1,848	-6.14%	1.20%
Copper	Generic 1st Copper, USD/lb	374	-8.72%	-1.92%
Currencies				
GBP/EUR	GBPEUR Exchange Rate	1.15	1.44%	2.15%
GBP/USD	GBPUSD Exchange Rate	1.22	-1.12%	0.96%
EUR/USD	EURUSD Exchange Rate	1.06	-2.45%	-1.23%
USD/JPY	USDJPY Exchange Rate	149	12.43%	13.92%
Dollar Index	Dollar Index Spot	106	3.58%	2.56%
USD/CNY	USDCNY Exchange Rate	7.30	6.17%	5.79%
Alternatives				
Infrastructure	S&P Global Infrastructure Index	2,476	-7.27%	-4.04%
Private Equity	S&P Listed Private Equity Index	181	4.75%	18.84%
Hedge Funds	Hedge Fund Research HFRI Fund-Weighted Composite Index	18,215	1.43%	4.27%
Global Real Estate	FTSE EPRA Nareit Global Index TR GBP	3,383	-3.86%	-5.76%
Volatility			**Change in Volatility**	
VIX	Chicago Board Options Exchange SPX Volatility Index	18	-6.31%	-19.15%

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

Performance

The Fund fell by -0.92% in the third quarter of 2023 to a value of £1,268m. As can be seen from the table on the previous page, bonds were noticeably weak during the quarter and the major overseas equity markets also fell in local currency terms. In addition, infrastructure assets fell as the rise in bond yields finally impacted valuations. I would also note the rise in the price of oil and gas over the quarter as this will impact future inflation and was, in part, behind the rise in bond yields (fall in prices). Much of the underperformance against the benchmark was driven by the poor performance of the LCIV Global High Alpha Equity portfolio managed by Baillie Gifford which returned -4.25% over the quarter against a 0.7% rise in the MSCI global equity benchmark.

Over the longer term the Fund is lagging its benchmark over 3-years (by -3.0%) and 5-years (by -0.7%) but with returns of 8.4% per annum over the last 36 years, being above the Fund's actuarial discount rate assumption for future investment returns which will have helped improve the funding ratio.

Asset Allocation changes since quarter end

At the last Pension Committee meeting on 11th September, it was agreed to divest 5% (£65m) of the Fund's total AuM from the Baillie Gifford Global High Alpha Equity portfolio managed via the LCIV and reinvest into UK Short Dated Corporate Bonds via a fund managed by Fidelity. This transaction took place at the beginning of November. Discussions have also continued with Fidelity regarding moving the existing two bond funds Bromley invest in into a segregated account and this work is ongoing. I was also asked at that Committee meeting to provide an update on the Multi-Asset Income Funds and specifically on the portfolio managed by Fidelity and comment on its recent poor performance, an update is included at the end of this report.

Comment

The decision at the last Pensions Committee meeting to shift money out of global equities and into UK short duration corporate bonds was driven by the high yields currently available at the short end of the UK bond market (which exceed the investment return required in the Funds actuarial valuation) and by a belief that interest rates in the UK are nearing a peak and, therefore, investing in this area would be low risk (the bonds could be held to maturity with no interest rate risk). The decision was not to invest into longer dated UK bonds at the current time because these were not offering the same yield but also did not seem to have priced in a higher for longer interest rate environment and that, therefore, there was still scope for longer dated bond yields to rise (prices to fall).

In the last quarterly report I noted that there was '*scope for short-term interest rates to be nearing a peak in the US and UK and soon Europe whilst long-term bond yields may still exhibit some volatility as markets come to realise that inflation is not beaten yet; that interest rates will stay higher for longer; that high government debt levels will lead to higher interest charges with greater government bond issuance and that Quantitative Tightening removes a major buyer from the bond markets as central banks let their existing holdings of bonds bought during Quantitative Easing mature and fall off their balance sheet.*'

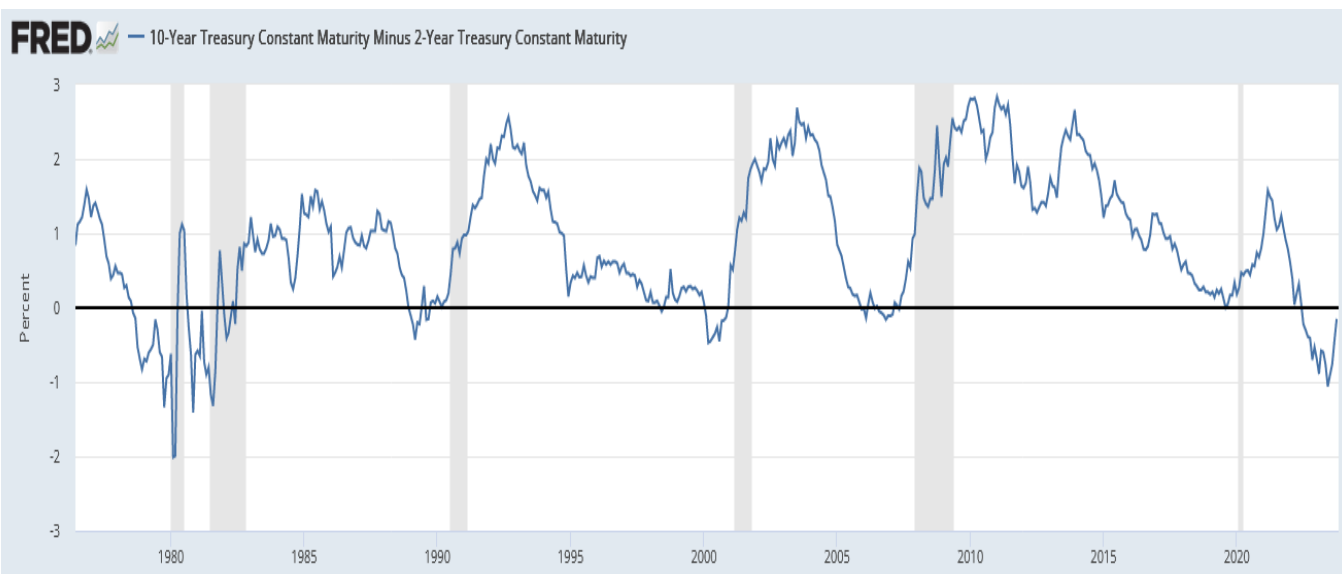
I am not sure which of the factors noted above was the main driver of the rise in longer duration bond yields during the third quarter, but, particularly, in the US, it is the continuing strength of the US consumer and hence the US economy which is concerning markets and this led to a change in the shape of the yield curve undermining market sentiment for risk assets by the end of the quarter.

The situation at the end of the second quarter of 2023 was that both the UK and US had inverted yield curves where short duration bonds were yielding noticeably more than longer duration bonds. This has traditionally been seen as the harbinger of a recession. An inverted yield curve is the market's way of saying that short-term interest rates are peaking because they have risen to an extent that is likely to cause a recession and thereby lead to lower interest rates in the future.

There are two ways a negative yield curve can unwind, either short-term interest rates fall as the economy enters a recession, forcing wages and inflation down and central banks to eventually react to the lower growth profile by cutting interest rates (termed a 'bull flattening' for bond investors) or, for long-term interest rates to rise as markets realise that the economy is not slowing enough to reduce inflation back to target and that rates will therefore either need to rise further or stay higher for longer (a 'bear flattening' for bond investors). Q3 2023 was very much the latter for the US market as the economy has stayed strong despite the sharp rise in interest rates seen over the last 18 months.

The chart below shows the US Treasury 10-year yield minus the 2-year yield. When the line is below zero, 2-year yields are higher than 10-year yields and bond markets are, thereby, predicting a US recession. The shaded areas are actual recessions in the US. As can be seen in the chart, a negative yield curve is a good indicator of a coming recession and this only starts to revert and move into positive territory when markets are confident the US economy is about to enter a recession and that interest rate cuts are firmly on the horizon. During the three most recent occasions when this has occurred (1991, 2001 and 2008) the yield curve normalised (long duration bond yields higher than short ones) through a fall in interest rates expectations pushing the 2-year bond yields down (bond prices up). As can be seen at the right hand side of the chart, during Q3 2023, it looks like this line is again reverting to normality with long-term yields moving towards short-term yields but this time it has been driven by a rise in long-term yields. This is not the market predicting an imminent recession and thereby cuts in interest rates, but is driven by the view that inflation is not completely under control in the US and that either interest rates are likely to rise further or stay elevated for longer or both. The market's view during Q3 2023 is that a US recession is not on the horizon …yet.

Chart 1: US yield curve



Source: Federal Reserve Bank of St Louis

This further rise in long-term bond yields, whilst understandable given the strength of the US economy (and the US consumer in particular) acts as a further piece of monetary tightening as it raises the cost of longer term borrowing and does, therefore, increase the likelihood of a recession in 2024.

The US economy has been far stronger than predicted with annualised economic growth hitting 4.9% in Q3 2023, up from 2.1% in Q2, far above expectations at the start of the year. This has been driven mainly by the consumer although there are now signs of some productivity growth. The US consumer is showing remarkable resilience and like Rasputin seems impossible to kill off at present. Nonetheless, recent data does now show the US consumer with a negative savings rate (spending more than they earn) and this cannot continue indefinitely. I think what we are seeing is the effect of using averages for economic data when we increasingly have a bipolar situation with the well off commanding higher pay and supported by resilient equity markets so continuing to spend but the less well off, with less stable employment, struggling to make ends meet, however, this element is lost within the data averages.

There now look to be three possible outcomes to the economic situation.

1) The US economy now begins to slow as the interest rate rises seen so far take effect. In this scenario the US Federal Reserve (US Fed) holds rates high throughout 2024 only cutting once they are confident inflation will return to the 2% level and stay there.

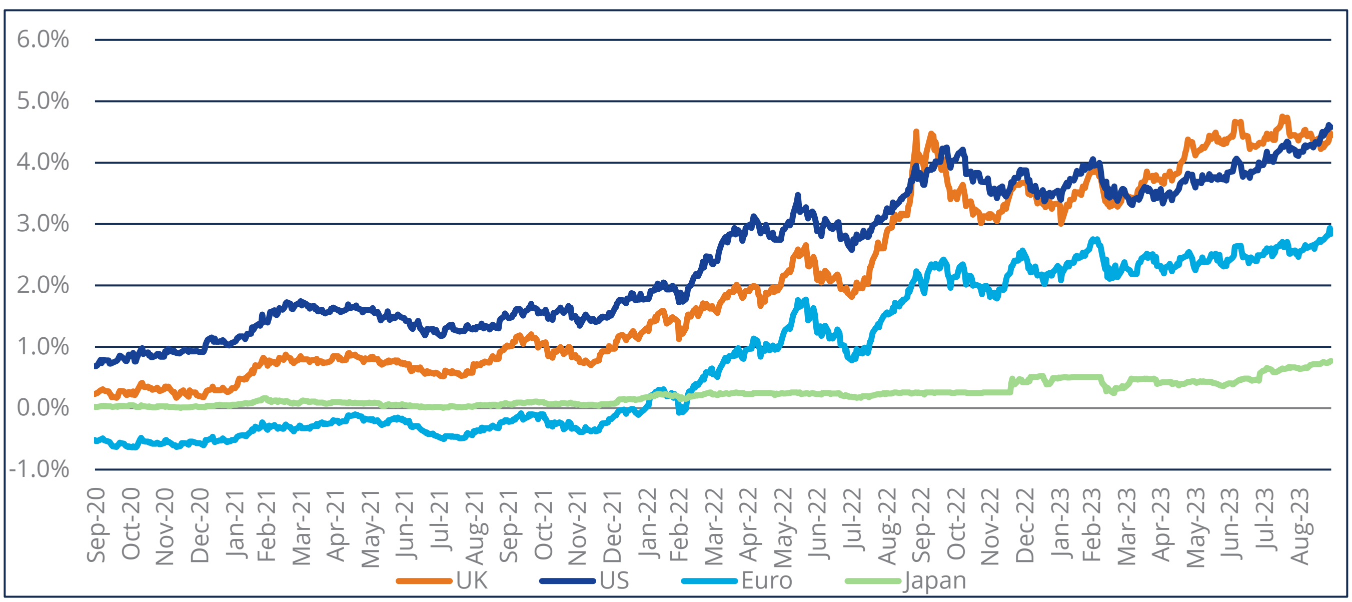
2) Economic growth continues to surprise forcing the US Fed to raise interest rates further. There is then a danger that they are forced into raising rates just as the cumulative effect of the existing interest rate rises hits the economy and forces a sharp slowdown.

3) Something breaks. We saw the effect of the rapid interest rate rises on the regional US banking system in spring of 2022 where a small number of banks holding long-term loans were unable to retain their deposit base as interest rates rose. There will still be other asset owners for whom the rapid rise in interest rates has undermined their investment model. The amount of volatility in long dated bonds is unprecedented. It is quite possible that the US Fed's hand could be forced if markets become particularly stressed. This could be either, by a buyers' strike forcing the US Fed to raise rates to get their bond issuance away or, by a collapse in a specific segment of the market which causes wider collateral damage and forces the US Fed to cut rates to calm markets. Either of these outcomes would be highly destabilising.

Despite the strong GDP growth in the US, it remains my opinion that there will be a US recession during 2024. It will be difficult for the global economy to show much growth in this scenario, particularly with China encountering structural economic change at the same time.

The chart below shows 10-year Government Bond yields. The weakness of the US 10-year bond in particular is noticeable over the last 3 months driven by the strength of the US economy but 10-year Government Bonds have been weak (yields rising, prices falling) across the spectrum of the developed world over the last six months and now sit at decade high yields.

Chart 2: 10-year Government Bond Yields



Source: Bloomberg. Notes: US Govt 10 Year Yield; UK Govt Bonds 10 Year Yield; Euro Govt Bond 10 Year; Japan Govt Bond 10 Year Yield

Outside of the US, in Europe and the UK we are seeing much greater economic weakness and, in the UK's case, more stubborn inflation. Interest rates are having a more obvious effect on consumption in these markets and whilst inflation is falling and may continue to do so in the near term, in the UK in particular, it is unlikely to reach the Bank of England (BoE) target of 2% as an element of the inflation appears more structural.

Markets will be cheered by falling inflation but both core inflation (excluding energy and food) and wage inflation are not consistent with a target for CPI of 2% and whilst interest rates may well have peaked, the market may be too optimistic about the pace at which they will fall from here.

Table 1: Inflation

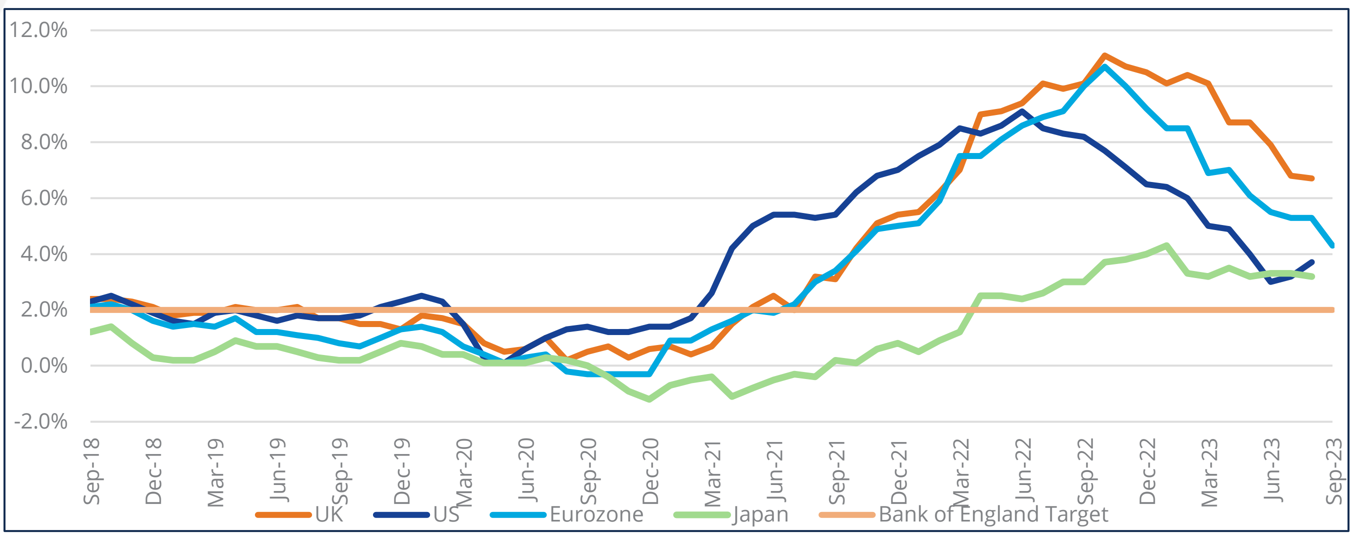
	CPI	Core Inflation	Wage Inflation	Unemployment Rate
US	3.2%	4.1%	4.6%	3.9%
EU	2.9%	5.1%	5.2%	6.0%
UK	4.6%	6.1%	7.9%	4.2%
Japan	3.0%	2.8%	1.2%	2.6%

Source : various

Longer term, it remains my opinion that we are moving into a period of more volatile inflation. The growth rate at which capacity constraints are encountered is lower than was previously thought, this is not helped by an unstable geopolitical situation. The effect of greater volatility in inflation will be felt in interest rates as central banks attempt to fulfil their twin briefs of low inflation and high employment. This is likely to cause shorter business cycles more akin to the 1970's and 1980's than the last two decades.

On a more positive note, long-term returns, particularly from bonds, are becoming more attractive and the opportunity to earn a return higher than inflation is again feasible at a level of risk that is potentially acceptable to well-funded LGPS Funds.

Chart 3: Consumer price inflation (CPI)



Source: Bloomberg

Markets

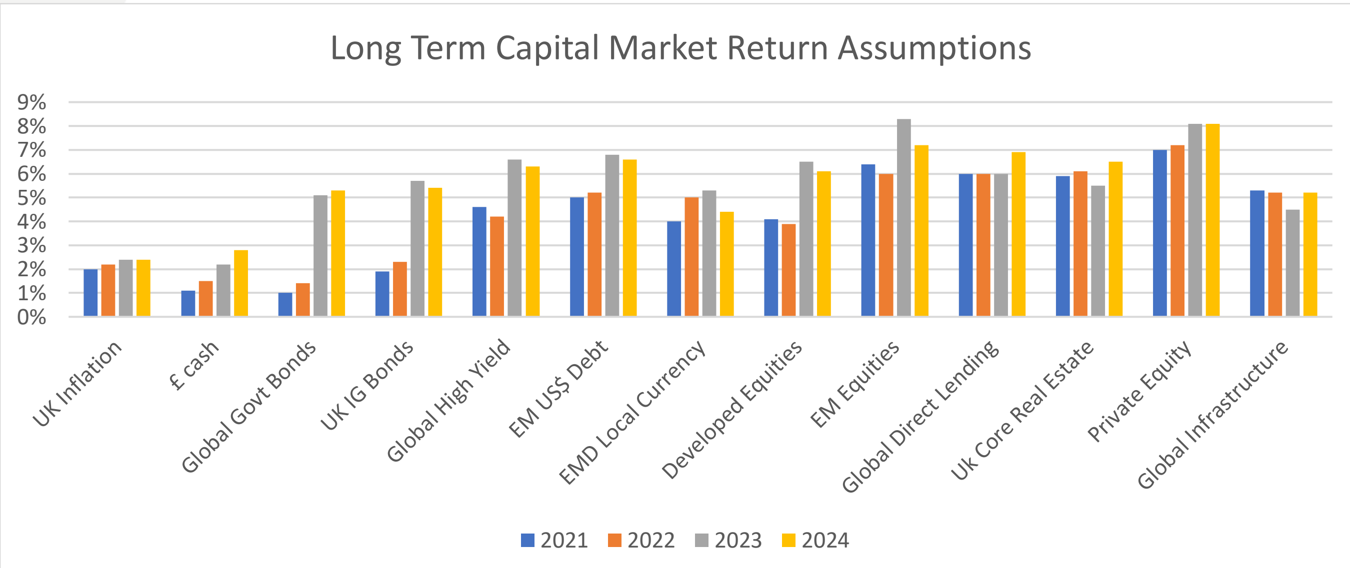
Given the above, my expectation is for interest rates to stay high for the majority of 2024. This continues to make current yields quite attractive, particularly the shorter duration end of the yield curve as short rates are still slightly higher than long rates at present.

In this higher interest rate and slowing economic growth environment I would not expect equities to perform that well, on the one hand they are a partial inflation hedge but when the risks are of a slowing economy and stubborn inflation, the ability to pass costs on to consumers may become constrained. In addition, the higher cost of financing debt will reduce free cash flow and thereby crimp investment.

For Alternatives, it has taken some time to see the effect of interest rate rises on valuations given the illiquid nature of these investments and the opaque nature of pricing but that is now coming through with Infrastructure valuations under some pressure this quarter. I see no rush to increase investments in this area at the current time and remain slightly wary of private equity valuations in particular as the one area where we have yet to see valuations fall but with limited transactions and very little pricing data this gives me little confidence in current valuations. Throughout the last decade an important element of the private equity business model has been the use of cheap debt to leverage up businesses and this will have become more difficult to engineer over the last year.

The chart below shows JP Morgan's Long-term Capital Market Assumptions. These are 10 year return forecasts produced each year with the forecast for 2024 having just been released. We know these forecasts will be wrong but they are built from a single set of assumptions and therefore are comparable with each other and over time. Unsurprisingly, it is the return forecasts for high quality bonds which have seen the largest change over the last 4 years with return expectations for UK Investment Grade Bonds rising from 1.9% p.a. in 2021 to 5.4% in 2024. Return expectations for Equities have also risen but less so.

Chart 4: Forecast returns by asset class, comparing 2024 with earlier forecasts



Source JP Morgan

What this chart does not show is the volatility and correlations estimates of these return assumptions. The volatility of returns should be lower in bonds than equities going forward but correlations between asset classes are likely to be more volatile with periods of positive correlation between equities and bonds similar to the period we have just been through in 2022 when both Equities and Bonds fell.

Asset Allocation

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

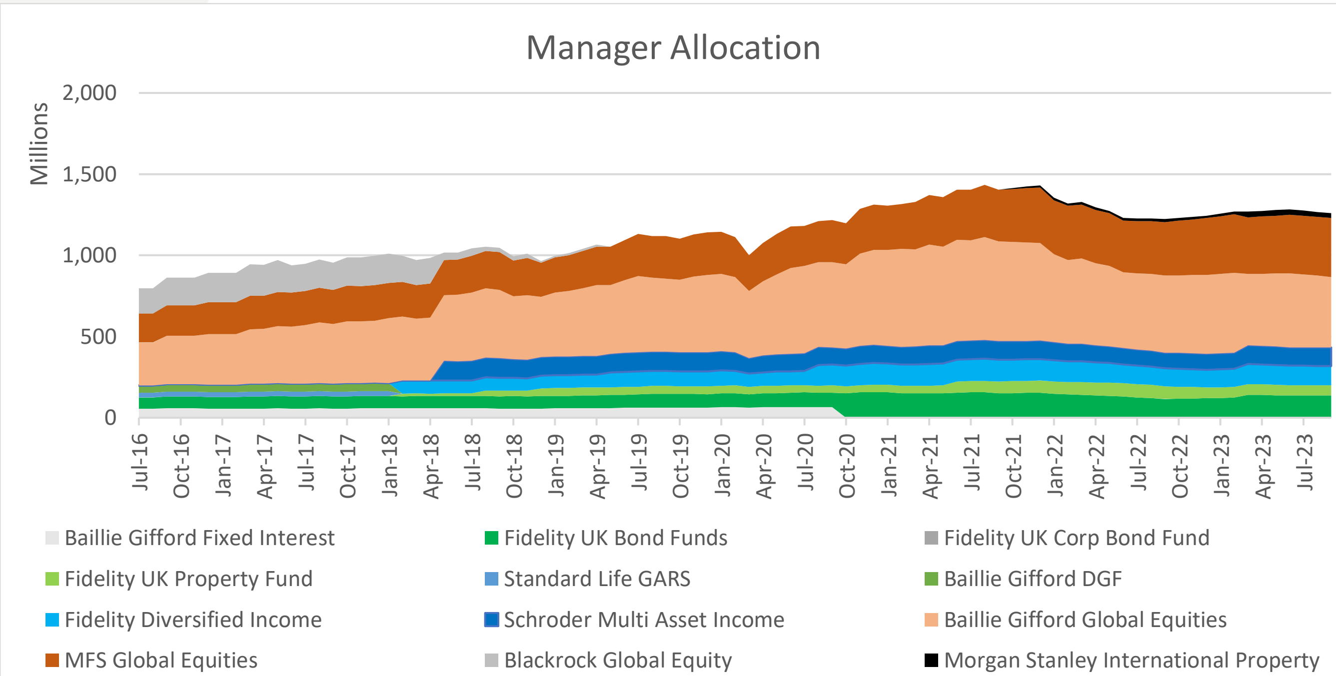
Asset class	Asset Allocation as at 30/9/2023	SAA Benchmark	Position against the benchmark	Cash over/under weight
Global Equities	63.0%	58%	+5.0%	-£63.5m
Fixed Interest	10.7%	13%	-2.3%	+£29.3m
UK Property	5.0%	4%	+1.0%	-£12.7m
Multi-Asset Income	18.3%	20%	-1.7%	£21.6m
Int'l Property +US$ cash	2.9%	5%	-2.1%	£26.7m

Figures may not add up due to rounding

The change in the asset weightings since 30/9/23 does not reflect the move of 5% of the Fund from Global Equities to a short dated bond fund managed by Fidelity. Including this move will bring the Equity weighting down to on-weight against the Strategic Asset Allocation Benchmark and Bonds to slightly overweight.

The column on the right of this table shows the amount pf 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.

Chart 5: Assets by manager/mandate.



Environmental, Social and Governance

Taskforce for Climate Related Financial Disclosure (TCFD)

The Financial Stability Board established the TCFD to develop recommendations for more effective climate-related disclosures that could promote more informed investment, credit and insurance underwriting decisions and, in turn, enable stakeholders to understand better the concentrations of carbon-related assets in the financial sector and the financial system's exposures to climate-related risks. The required reporting disclosure has four core elements:

- Governance: The organization's governance around climate-related risks and opportunities.
- Strategy: The actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy and financial planning.
- Risk Management: The processes used by the organization to identify, assess and manage climate-related risks.
- Metrics and Targets: The metrics and targets used to assess and manage relevant climate-related risks and opportunities.

Each of these sections will require the Committee to think through its current approach to climate change, how this will evolve into the future and what metrics and targets it will monitor to hold itself to account. In essence, it will need to describe and quantify its existing practice and understanding and think through how this might change into the future.

TCFD reporting has already commenced for large, private sector pension schemes with the LGPS sector expected to follow using 2023/4 data. **I feel it is now best practice for LGPS Funds to complete TCFD reporting even if the current Government dos not specifically mandate action on this point.** It may be possible to get assistance from the LCIV with compiling this report but the Committee will need to discuss and agree its approach to climate change and it may make sense to start by creating a Responsible Investment Statement as part of the Fund's governance documents.

Carbon Emissions data

In order to illustrate the carbon intensity of the Fund I have asked each manager to provide the CO2 equivalent (CO2e) of six recognised greenhouse gases covered by the Kyoto protocol (CO2, CH4, N2O, HFC's, PFC's and SF6) and to show these as tonnes of CO2 equivalent per £m of sales (tCO2e/£m) aggregated to the portfolio level. This gives a comparable carbon footprint for each portfolio and their respective index where possible. These figures relate to scope 1 & 2 emissions only. The exception is the property portfolio where the figure is the amount of carbon equivalent emitted (not divided by turnover as this is not appropriate for a property portfolio).

Portfolio	tCo2e/£m	Benchmark equivalent.	Benchmark
Baillie Gifford Global Equity	142.1	154.9	MSCI All Countries World
MFS Global Equity	88.06	118.11	MSCI World (Developed Markets only)
Fidelity Multi-Asset Income	205.91	10% below 2022	
Schroders Multi-Asset Income	131.5		
Fidelity Fixed Interest	187.4		Composite Fixed Interest benchmark
Fidelity UK Property	1,819 tonnes	Data being collected and monitored	Carbon emissions from the portfolio of 36 properties

I believe these figures to be approximately comparable, they are expressed as a carbon equivalent per million pounds of sales at the company level. Where there is a comparable index figure the Fund's assets are managed with a noticeably lower carbon intensity than the index. Because of the multi-asset nature of the Multi-Asset Income portfolios it is not possible to provide a benchmark figure for carbon emissions for these two portfolios. Each manager has also noted a small number of companies where they are currently unable to provide this data, this is mainly for emerging market companies and where the portfolio is invested in third party funds. We, and the industry, continue to push for greater disclosure.

Because these figures are for scope 1 & 2 emissions only and do not include scope 3 emissions the figures should be seen as indicative only at this stage. What is obvious is the scale of the reporting from each manager is improving.

I will continue to discuss with each manager the best way to report this data going forward and suggest it should be reviewed annually with the intention of seeing the carbon intensity of the Fund's portfolios fall over time. This may be hampered in the short-term by filling out the missing data. Personally, I regard carbon reporting as similar to performance reporting for the Fund, the quarterly data is just a point in time and of itself is of limited use, what is more important is the direction of travel and level of volatility within the figures, each of which can lead to further discussion.

Carbon reporting is still developing and for many of the metrics relies on reporting three scopes of emissions:

- Scope 1 covers direct emissions from owned or controlled sources.
- Scope 2 covers indirect emissions from the generation of purchased electricity, steam, heating and cooling consumed by the reporting company.
- Scope 3 includes all other indirect emissions that occur in a company's value chain.

Whilst progress is being made by companies to quantify all three of these scopes, it is the last, covering the whole of the value chain, which is by far the most complex. The majority of carbon reporting available at present covers only scope 1 & 2 emissions.

Market Summary

- Inflation has broadly continued to fall throughout Q3 and whilst the US Fed, European Central Bank (ECB) and BoE all raised interest rates during the quarter, the rate of increase has slowed. With inflation decreasing across the board (with the exception of a slight rebound in the US) it is likely that rates will not increase much further. However, the slow pace of the decline in core inflation, as well as an uptick in the US over the quarter and the risk of renewed energy supply shortages as winter approaches, suggest that rates are likely to remain high for a longer period than previously thought: 10-Year UK rates rose very slightly over Q3 to 4.5%, but US 10-Year rates have risen nearly 1% to 4.6%. Labour markets remain robust, especially in the US (unemployment at 3.8% and job openings up 5.8% Year-on-Year in August) and GDP growth remains slow but largely positive.
- Q3 showed a reversal in the first g=half trend for equities. Global equities (MSCI World) fell -3.4% in local currency terms over the quarter, with Value (-2.5%) proving more resilient than Growth (-5.1%) as a style. Japanese and UK equities were notable exceptions to the downward trend, with Japanese equities returning 2.5% (TOPIX Index) in local currency and UK equities returning 1.8%. Performance in Japanese equities as a whole was largely down to the weakening yen which fell further against the US Dollar, however, large growth stocks were negatively affected by the rising interest rates and yields resulting in a -3.4% performance in the Nikkei 225 Total return. UK equities, due to their energy tilt, benefitted from the rising oil prices caused by Russia and Saudi Arabia's extension of voluntary output cuts. US equities fell (-3.3%) as expectations of near term cuts in rates were disappointed. Bonds continued to face headwinds caused by rising interest rates, with all government bonds performing negatively over the quarter and long dated index-linked down over 10%. Investment grade performed better and spreads over government bond yields remained stable over Q3: European Investment grade indices rose marginally, while the US index fell -3.4%. Tightening spreads and higher carry (coupon) allowed high yield to outperform credit. Interest rate-sensitive alternatives (e.g. Real Estate, Infrastructure) also showed a modest decline.

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

- **Core inflation proving sticky, so interest rates may stay higher for longer.** Inflation fell across the board this quarter (barring the US) with UK annual CPI falling to 6.7% in August, compared to 3.7% for the US and 4.3% for the Eurozone in September (UK data for September is not yet available). Core inflation (excluding energy and food prices) has also been falling, but much more slowly. US and Eurozone core inflation are both above headline inflation at 4.1% and 4.5% respectively. This all suggests the high inflation / high rates environment may last for rather longer than previously thought. This was reinforced by the US Fed which revised median expected rates for 2024 and 2025 up by 0.5%.
- **The US Dollar – tension between reserve currency status and ratings downgrade might cause increased FX volatility.** The US Dollar Index (DXY) steadily increased throughout the first 10 months of 2022 (by around 17.5%) on strong economic data and ongoing geopolitical uncertainty. The net result of this is that the US Dollar is the strongest it has been (barring the 2022 peak) since the early 2000s. At the same time, Fitch became the second major ratings agency to downgrade US Treasuries from an AAA to an AA+ over concerns around the extent of the US government debt and deficit as well as political brinkmanship in the debt limiting process. Whilst the move from AAA to AA+ is unlikely to have major impacts in the short-term, it increases the risk of changes in sentiment toward the USD, causing significant volatility.
- **China's weak Covid recovery and ongoing property crisis remove a key engine of global growth.** Low consumption spending and industrial activity as well as the struggling real estate sector are likely to lead to weak Chinese growth. The composite PMI remains above 50 but is decreasing, with the largest fall seen in services. The property market accounts for a quarter of all Chinese economic activity with real estate employing millions and providing the bulk of most people's savings. As the property prices drop, many people's savings have reduced significantly and so spending has decreased. Local governments rely on land sales to developers, which have dropped and local governments are having to cut back on services as a result. Trust companies that invest heavily in development loans are now seeing significant losses too. In short,

the size and heavily debt-funded nature of the Chinese housing economy has caused it to spill over significantly into the rest of the economy. This has led Chinese growth to dip below US growth, after having been a leader of global growth since the Global Financial Crisis of 2008/9.

- Global equities fell in Q3, following the rally in the first half of the year. The VIX increased over the quarter from 14 to 18, back towards its 2022 level. The sell-off of global bonds has increased yields and put pressure on risk assets.
  - In the US, the S&P 500 fell by -3.3% and the NASDAQ composite also fell by -4%. Optimism over the end of policy tightening proved premature as inflation actually rebounded slightly this quarter and the US Fed indicated median rates would remain higher than expected through 2024.
  - UK equities increased by 1.8%, outperforming global equities. Inflation fell noticeably from 8.7% in May to 6.7% in August. This is the second quarter of significant falls from the highs of around 11% experienced in 2022. Therefore, after the August hike to 5.25%, the BoE kept the rate unchanged during September. The rising oil price contributed strongly to outperformance given the UK's energy tilt.
  - The Euro Stoxx 50 fell by -4.8% in Q3. Inflation continued to move downwards, aided by the ECB's double hike during the quarter. The ECB began to loosen its hawkish rhetoric as a result. The composite Purchasing Managers Index (PMI) has remained in marginal territory at 48.7 (below 50 equating to an economic contraction).
  - Japanese equities continued their strong run in Q3 (TOPIX returned 2.5%), but large growth companies underperformed, hence the Nikkei returned -3.4%. A weakening Yen has boosted exporters, as the BoJ maintains very accommodative monetary policy with core inflation remaining at 2.7%. The Yen fell a further -3.4% against the USD over the quarter. The extent of its weakening is beginning to cause some concern.
  - Emerging market equities fell by -2.9% as concerns over a more extended period of high US interest rates reduced risk appetites. Political uncertainty in Poland and falling Lithium prices in Chile contributed to the negative performance, but the underwhelming Chinese recovery and resurfacing issues with its housing sector were more significant contributors. Turkey notably outperformed following two rate rises, indicative of a more orthodox policy by the Central Bank.
- Medium and longer term bond yields rose over the quarter, as a result of predictions of more persistent high rates. This resulted in negative performance across the main government bond markets. The inversion of the US yield curve, as measured by the 10-year minus 2-year yields, reduced, ending the quarter at around -50bps, as mid and long term yields rose more than shorter bond yields. August saw Fitch downgrade the US's rating from AAA to AA+ leaving Moody's as the only major rating agency keeping US treasury debt at AAA. Fitch cited the increasing debt and deficit as well as 'erosion of governance' and political partisanship in the debt limiting process. In corporate bonds, high-yield credit outperformed as credit spreads tightened over the quarter.
  - The US 10-year Treasury yield rose in Q3, ending at 4.57% from 3.81%, while the 2-year yield rose from 4.90% to 5.05%. US Fed policy rates rose by 25 basis points to 5.25-5.50% in July.
  - The UK 10-year Gilt yield rose from 4.39% to 4.44% while 2-year yields fell from 5.25% to 4.90% due to an increase in demand in shorter-dated Gilts. BoE policy rates rose from 5% to 5.25% in August.
  - European government bonds fell in Q3 as yields rose. Yields rose more in the medium to long-term. German-Italian bond spreads widened as Italian bonds matured and were sold out, Italy's debt continues to grow a considerable amount and the Pandemic Emergency Purchase Program (PEPP) buyback scheme stopped buying new bonds.
  - US high-yield bonds outperformed investment grade, returning +2.2% and -3.4% respectively. European high-yield bonds returned +3.8%, outperforming the +0.7% for European investment grade and -1.0% for UK investment grade.
- Energy prices rose during Q3, as gas prices continued to rebound this quarter, although still sharply down from the pre-winter figures. Oil prices were also a major driver as Russia and Saudi Arabias, extended their voluntary output cuts.
  - US gas prices rose 32% in Q3. Prices remain low compared to their 2021/ 2022 peaks.

- Brent crude oil rose 19.5% over Q3, to $95 per barrel. OPEC production cuts last quarter have now fed through into the price. The US started restocking its Strategic Petroleum Reserve, but slowly. However, it has as little as half of its pre-2022 inventory.
- Gold and Copper fell -6.1% and -8.7% respectively over Q3. Precious metals prices generally fell, while industrial metals went up. Copper is a notable exception partly due to strong links to the Chinese markets. Gold fell given the high yields available on cash alternatives. Gold and Copper closed Q2 at 1,848 USD/toz and 374 USD/lb, respectively.

* Global listed property continued to decline, with the FTSE EPRA Nareit Global Index falling -3.9% in Q3.
    - The Nationwide House Price Index in the UK has declined after its increase last quarter, with the price index down -4.7% for the quarter, but up +4.5% for the last 12 months.
    - European commercial property has also continued to decline in the face of higher interest rates, with the Green Street Commercial Property Price Index down by -1.4% this quarter and -11% over the past 12 months.
* In currencies, the US Dollar strengthened generally throughout the quarter (DXY +3.6%), strengthening against Sterling, the Euro and the Japanese Yen. UK inflation is now in its second quarter of significant decrease. Bitcoin and Ethereum saw strong loses as the US increased regulation, although Ethereum's proof of stake concept has worked well so far since its introduction.

Performance report

Asset Class/ Manager	Global Equities/ Baillie Gifford via the LCIV
Fund AuM	£436m Segregated Fund; 34.5% of the Fund (inc £4m 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 by phone

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 disappointing quarter for Baillie Gifford, underperforming by 5%, having had two more stable quarters recently. This was a difficult quarter with energy stocks again accounting for much of the gain in the index. Baillie Gifford was underweight these stocks in total. However, markets are rarely entirely rational and at present are being buffeted by short-term noise on the macro outlook with many investors trying to pick the peak in US interest rates as a time to invest. I believe Baillie Gifford has worked hard on reappraising its investments to ensure they are fit for a higher interest rate environment and, once markets revert to looking at stock specific fundamentals, we will see this portfolio start to outperform.

Across the developed world, the non-inflationary rate of growth is now lower than in the past due to a number of inflationary trends being nearer the surface. It is quite possible that we are entering a period of medium-term low growth during which I would expect this portfolio, which concentrates on higher growth companies, to outperform driven by earnings growth and some upside in valuations.

Since quarter-end, £65m has been divested from this portfolio as agreed at the last Pension Committee meeting.

Asset Class/ Manager	Global Equities/MFS
Fund AuM	£364m Segregated Fund; 28.7% 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 1.3% over the quarter, outperforming its benchmark by 0.7%. The portfolio has outperformed over the medium and longer term adding 1.4% p.a. over the benchmark since inception in January 2013. MFS retain a 'value' bias within the portfolio and 'value' stocks held better than 'growth' stocks as markets feared higher for longer interest rates given the strength of the US economy.

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	£136m pooled fund; 10.7% 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 hold 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; 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.

During the quarter the combined portfolio fell by -0.15% underperforming the benchmark by 0.9%. These performance figures are taken from the performance report produced by Fund's custodian and differ from the managers report slightly. Any differences are usually due to a different hierarchy of pricing sources and will even out over time but I will query this quarter with the manager. Over the longer term, the portfolio has outperformed, adding 0.7% p.a over the benchmark since inception 25 years ago. I regard this as a highly credible performance.

The third quarter was affected by investors reappraising their interest rate expectations, especially in the US and at the longer duration end of the curve. Longer duration bond yields rose as investors recognised that the US economy continues to grow strongly and that inflation was unlikely to come under control unless US interest rates stayed higher for longer. The Fund's fixed interest portfolio has an average duration of 7.3 years and so was partly affected by this long duration sell off. The current yield of the combined portfolio stands at 6.2% which is usefully above the Fund's actuarial assumed future investment return. This makes current yield attractive and since quarter end the Fund has invested a further £65m into a short duration UK bond fund managed by Fidelity. I would expect to recommend rolling this short duration portfolio into the existing Fixed Interest portfolio, thereby lengthening the duration of the Fund's fixed interest assets, at some stage of over the next 2-5 years as the outlook for consistently lower inflation becomes more believable.

Asset Class/Manager	Mult-Asset Income / Fidelity
Fund AuM	£119m Pooled Fund; 9.4% 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	£113m Pooled Fund; 9.0% 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 was flat whilst the Schroders portfolio rose by 1.4%. Over the last year a noticeable performance gap has opened up between the two portfolios with Fidelity up 0.2% and the Schroders portfolio up 5.0%. This is during a period when the Fund's UK Bond portfolios rose by 0.9% and Global Equities were up over 11% in Sterling terms. Because of this period of poor performance by Fidelity, both when compared to Schroders and to the performance of the major asset classes, I have included a more detailed review of the Multi-Asset Income portfolios at the end of this report.

The divergence in performance is less noticeable over the longer term with the Fidelity portfolio down 0.9% p.a over 5-years against the Schroders portfolio up 0.2% p.a. over the same period which confirms that the performance issue has been only over the last year. This compares to the Funds fixed interest portfolio, also run by Fidelity, down -2.25% p.a. over 5-years and global equity markets (as measured by the MSCI All Countries index) up 8.4% p.a. over 5 years. This 5-year performance does bring to the surface that during the era of ultra-low interest rates, both managers were investing heavily into high yielding fixed interest investments as a way of generating the required yield from their portfolio and have delivered performance which is more heavily influenced by bond returns than equities over the medium term.

The Fidelity portfolio remains the more diverse of the two portfolios with a much lower exposure to global Equities. I would regard it as more defensively positioned at the current time.

Asset Class/Manager	UK Commercial Property / Fidelity
Fund AuM	£63m Pooled Fund; 5.0% 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 3.0% over the quarter, underperforming a flat benchmark. Over the last 5 years the portfolio has returned 1.8% per annum, in line with its benchmark but above the return from the Fund's Fixed Interest portfolio which has fallen by -2.3% p.a. over the 5-year period.

The portfolio is now yielding 4.5%. This yield is paid back to the Fund to help cover pension payments. The portfolio is mainly exposed to the Industrial segment (48.5% of the portfolio) with a number of Distribution facilities. With 42.5% of the portfolio in the Office segment. The manager sold one portfolio during the third quarter raising £12.3m and has sold a further property since quarter end.

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(£57.5M) committed / £22.9m drawn. Limited Partnership; 1.8% of the Fund
Performance target	Absolute return
Adviser opinion	
Last meeting with manager	John Arthur/Gareth Dittmer New Haven AGM 11/11/23

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 $13.7m 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.

Multi-Asset Income

Conclusion

Undoubtedly, markets have changed over the last 18 months and the rise in bond yields has now made them a useful source of income. However, this may not last. My expectation is for more volatile inflation as we are nearer to hitting capacity constraints in a number of areas than was previously assumed. This will mean more volatile interest rates, as central banks attempt to fulfil their twin aims of low inflation and high employment, and the likelihood of shorter economic cycles and more volatility across asset classes. It is quite possible that over the next 5 years we could see interest rates in the UK range between 2%, as the Bank of England (BoE) cuts interest rate in a recession, to 6% as inflation reignites and the BoE raises rates. In the former case of cutting interest rates, yield will again become hard to find.

At the last Strategic Asset Allocation (SAA) review it was calculated that the Fund had a Value at Risk (VaR) of approximately £150m which indicates that once in twenty years the Fund could fall in value by £150m. Given this, I would not recommend raising the risk and hence volatility of the assets within the Fund. In addition, a cash flow analysis of the Fund continues to show a position where pension payments are not covered by pension contributions in the future and therefore some element of investment income is required by the Fund.

I therefore continue to see a Multi-Asset Income portfolio as an appropriate allocation given the Fund's continuing cash flow concerns and the need to secure income from elements of the investment portfolio to cover any shortfall in pension payments in whatever the investment environment in the future.

In the absence of the Multi-Asset income allocation, I would recommend that the Fund hold an income generating asset class that will provide diversification from the predominately equity and bond based current asset allocation of the Fund. Infrastructure could provide a valid alternative with the potential to access the asset class through the secondaries market, a potentially interesting solution at the current time. Alternatives could be Social/Affordable Housing or potentially asking Fidelity to alter their existing Multi-Asset Income portfolio to focus more on Alternative assets (Private Equity, Private Debt and Infrastructure). Because Bromley are the only investors in the specific Multi-Asset Income portfolio managed by Fidelity this latter approach is a feasible option but would require careful consideration as to whether Fidelity are the best managers across these Alternative asset classes. This latter approach would increase the level of diversification within the Fund.

Background

As an open Defined Benefit Pension Fund, the LBBPF has never-ending duration unlike a Scheme which is closed to new members and future accrual. It will not move into run-off whilst it continues to accrue benefits for existing members and new employees of LBB and other admitted bodies are enrolled in the Fund and their pension contributions paid. This gives the Fund a number of significant advantages over other investors. Firstly, it does not invest borrowed money so will never be beholden to an outside party for repayments; secondly, it has infinite longevity and so can invest over the long-term and, lastly, its cash flows, in terms of pension payments offset against pension contributions and income from investments, are broadly predictable. This means that the Fund should be able to plan its investments such that it never has to sell assets into stressed market conditions. With a bit of planning, therefore, the Fund should never require markets to provide it with liquidity to trade as it will never be a forced seller of assets. Instead the Fund becomes a provider of capital to markets and during periods of market stress can demand a premium return for doing this.

Why does LBBPF hold Multi-Asset income Funds?

Following the 2016 Actuarial triannual revaluation, LBBPF conducted a SAA review which made the following comments regarding cash flow:- '*Based on calculations by Officers and the Scheme Actuary, the Pension Fund will move into a negative cash flow situation in fiscal 2017 as total benefit payments and other expenses exceed the total contributions'*: This raised the issue of the Fund needing to take investment income to cover a negative cash flow. To have not acted to provide a stable cash flow from investments at that time would have undermined the ability for the Fund to remain unbeholden to market conditions.

Following this SAA Review, in Q1 2018 10% of the Fund was moved from a Baillie Gifford Multi-Asset portfolio to the Fidelity Mult-Asset Income portfolio and 5% of the Fund was switched from the Standard Life Multi-Asset (GARS) portfolio into the Fidelity UK Commercial Property portfolio. Additionally, in Q2 2018, a further 10% of the Fund was switched from a Blackrock Global Equity portfolio to the Schroders Multi-Asset Income portfolio. The income from the three new portfolios was not reinvested as all income had been in the past but returned to the Fund to cover any cash flow shortfall.

In subsequent Actuarial revaluations the cash flow of the Fund has been reanalysed and whilst the figures have changed, the direction of travel towards a negative cash flow for the Fund with pension contributions no longer covering pension payments has remained.

Should Multi-Asset Income funds perform any better than plain Multi-Asset funds?

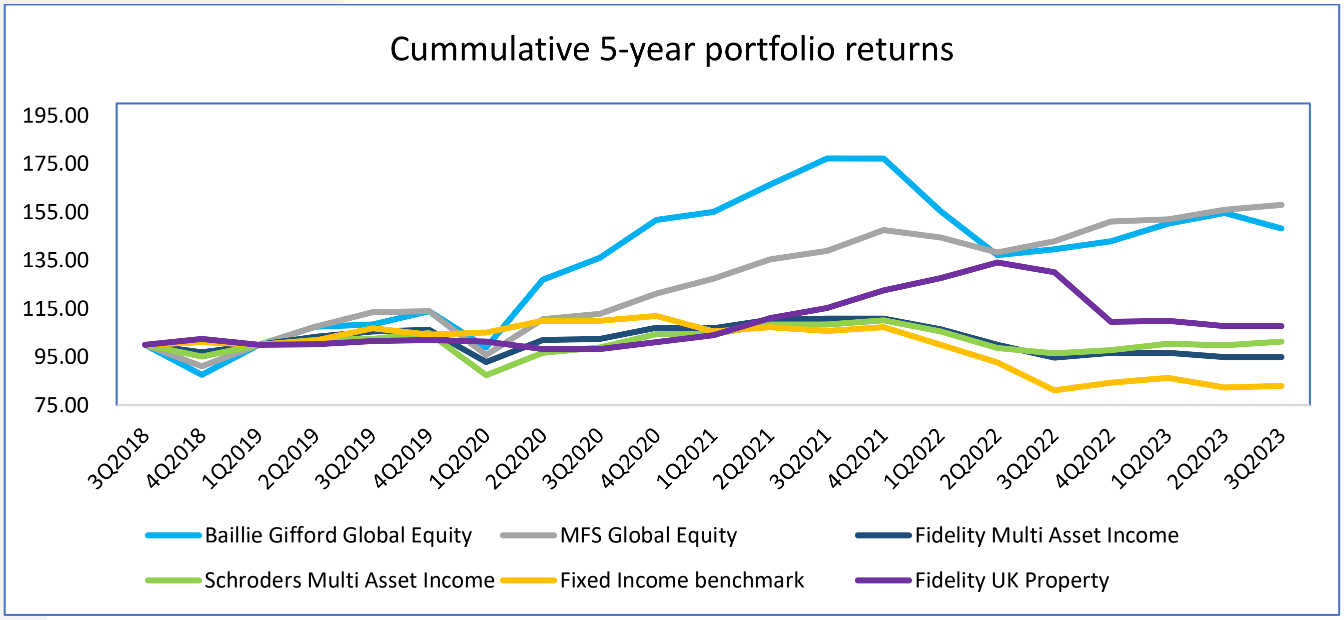
In theory, Multi-Asset Income funds should provide a less volatile return and more stable income than plain Multi-Asset funds. The Focus on income requires the fund manager to concentrate on the balance sheet of any investment and analyse the repeatability of interest or dividend payments. This should lead to a concentration on less risky investments with more secure cash flows. In addition, I personally feel that Multi-Asset funds which target a level of volatility and thereby risk, are at a disadvantage. The opportunity to add value (alpha) from asset allocation decisions is not linear over time. There are occasions when markets are volatile and stressed and asset prices will be out of balance. In these circumstances, an asset allocator can make decisions with high levels of confidence and conviction. In less stressed market conditions asset prices are less likely to be wildly out of line with their fair value and yet an asset manager working from a set risk budget still needs to make decisions and allocate risk despite having a low level of conviction that any assets are mis-priced. This is much less of an issue with Multi-Asset Income funds where the primary focus is on the generation of a repeatable income. These views are supported by the long-term performance of Fidelity's Multi-Asset Income portfolio when compared to the other Multi-Asset portfolios it manages.

Has the allocation to Multi-Asset income Funds worked?

The two Multi-Asset Income portfolios have delivered a yield of approximately 4% throughout the period from initial investment to the present day. Current yields are at 5-6% due to higher bond yields but for much of the time the Fund has been invested in these portfolios income has been hard to come by as Government bond yields approached 1% across much of the developed world.

Whilst the cash flow out of the Fund has not been as negative as initially predicted in the actuarial reviews it has been negative and required an element of investment income to contribute towards the payment of pensions. By receiving income from the two Multi-Asset Income portfolios and the UK Property portfolio the Fund has covered any cash flow shortfall. This has meant that the Fund was not forced to sell assets at any stage over the last 5 years, even during the market turbulence induced by the Covid outbreak. In fact, early on in the Covid outbreak, and again as inflation took off following the Russian invasion of Ukraine, a major focus of the pension officers and myself has been to stress test the cash flow models and forecasts for the Fund to ensure that, even under periods of stress, the Fund did not have to sell assets to meet pension payments.

Chart 1 – Portfolio returns over the last 5 years



As can be seen in the chart above, the two equity portfolios have returned cumulatively around 50% over the last 5 years whilst the Fund's bond portfolio, which is focused on UK Investment Grade Corporate Bonds, has fallen close to 20%, with UK Commercial property up 7% over the last 5 years. The two Mult-Asset Income funds are flat (Schroders) and down 5% (Fidelity).

The Fund remains committed to investing in global equities to provide long-term investment growth and this is stated in the Fund's Investment Strategy Statement (ISS) but to do this I do feel the Fund needs other assets to diversify the equity risk especially as we may be entering a period where there is a positive rather than negative correlation between equities and bonds making true diversification harder to come by..

It is my view that by having an allocation to Multi-Asset Income the Fund is better placed to retain a higher allocation to more volatile asset classes including global equities. The Multi-Asset Income portfolios provide an element of diversification but also the security of cash flow.

How have Multi-Asset Income portfolios performed over the last 5 years?

The answer is mediocre at best. The two Multi-Asset Income portfolios have produced a return roughly equivalent to a portfolio invested 80% in Bonds and 20% in Equities and yet, in reality, their actual allocation is roughly 20% Equities, 60% Bonds including high yield and 20% Alternatives. The disappointing performance is, in part, because the only assets to have added value over the last 5 years have been equity based investments. Anything with a long duration has been hit hard by rising interest rates, this includes Bonds, Property and more recently Infrastructure.

The Chart above shows Fidelity’s asset allocation within their Multi-Asset Income portfolio over time. The allocations do not add up to 100% due to the use of some derivatives, often as hedges. The poor performance of the last year in particular has been driven by the increased allocation to Government Bonds through early 2022 prior to the market sell-off in late 2022. Schroders take slightly more equity risk than Fidelity in their Multi-Asset Income portfolio as they have a return target of cash +5% to Fidelity’s cash +4%. This has aided Schroders performance over the last 5 years as they have held a slightly higher allocation to equities.

The Fidelity Multi-Asset Income portfolio has lagged the similar Schroders product and, to my knowledge, other similar products in the market by 5% over the last year, mainly through a higher allocation to Government Bonds through 2022 but also through an allocation to Chinese government debt which was affected negatively by the problems in the Chinese real estate market.

Because the two Multi-Asset Income portfolios target income there is only a partial overlap with the Fund’s other investment managers. Schroders do use passive index products to gain exposure to equity markets on occasion but both managers also target high yielding stocks which are much less likely to be held directly by either of the Fund’s two Global Equity managers. Both Schroders and Fidelity also invest into Emerging Market debt and High Yield debt which the Fund is not otherwise exposed to. The main overlap with the Fund’s other managers would be in Investment Grade Bonds but neither manager has had a particularly high exposure to this asset class in the past as it has not provided enough yield.

Post the period of poor performance by Fidelity, the lead manager of this portfolio has been changed. I have met with the new manager who is experienced having run similar portfolios at JP Morgan and Jupiter. It makes sense to bring in a new pair of eyes at this stage although the new manager strikes me as more combative and will need to build a good relationship with the existing team. Fidelity have also invested in better monitoring software to look through the holdings within the portfolio to access whole portfolio risk better. I am agnostic regarding the manager change at the current time seeing it as a reaction to a short period of poor performance and a desire to show change.

I have had a number of discussions with the existing manager and the head of Multi-Asset investing at Fidelity about the level of diversification within this portfolio, this stems from my expectation that equities and bonds will be positively rather than negatively correlated going forward and that the level of that correlation will itself be more volatile than in the past. I have encouraged that manager to look for stronger diversification outside of equities and bonds rather than use long duration bonds as a diversifier from equity risk.

Going forward, it is unlikely that global equities remain the only asset class offering a positive return over time. Diversification has not worked over the last 5-10 years but perhaps this is because we have not had a conventional recession over that period.

As noted at the start of this report, it remains my advice that the Fund continues to invest in a Multi-Asset Income portfolio to meet its cash flow requirements. In addition, I remain supportive of both the manager currently used despite the recent poor performance by Fidelity. I see this period of poor performance as being due to one bad tactical allocation to Chinese Government debt and one more fundamental mistake in seeing long duration UK bonds as diversifiers and insurance against a poor equity market environment when in fact the problem was in the long duration bond market when interest rates rose sharply. The manager recognised the issues and has acted to alter the management team and processes to assist in rectifying the issue.

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