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CITY OF WOLVERHAMPTON COUNCIL	**Pensions Committee** 19 June 2019

Report title	Quarterly Investment Report to 31 March 2019	
Originating service	Pension Services	
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Recommendations for noting:

The Committee is asked to note:

1. The global market and investment update paper prepared by the Fund's adviser, Redington, included at appendix A.

2. Quarterly Asset Allocation and Performance Reporting for the West Midlands Pension Fund

3. Quarterly Asset Allocation and Performance Reporting for the West Midlands Integrated Transport Authority

4. The updated information received in relation to the Fund's investment costs transparency reporting

1.0 Purpose

1.1 The quarterly investment report covers the range of investment issues for consideration by the Committee, primarily the market and investment background and the quarterly performance of both the West Midlands Pension Fund and the West Midlands Integrated Transport Authority. Supporting responsible investment activities are covered in a separate paper.

2.0 Background

2.1 This paper aims to bring together routine investment matters relevant to the management and implementation of the Fund's investment strategy and related policies:

I. The economic and market background environment in which the Fund operates and the outlook for different asset classes;

II. The Fund's investment strategy is outlined in the Investment Strategy Statement (ISS), approved at the March 2019 Pension Committee set in conjunction with the Funding Strategy Statement to target a return over the long term to deliver the asset values required to meet benefit payments due to members. The Strategic Investment Allocation Benchmark (SIAB) forms part of the ISS and includes the target asset allocation and the levels of returns investment policies will be benchmarked against.

III. WMITA Pension Fund's investment strategy is set out in its Investment Strategy Statement, which also contains the Fund's investment beliefs. An updated strategy as at March 2019 was approved by the Committee at its 27 March 2019 meeting.

3.0 Summary

3.1 Over the last financial year to 31 March 2019, the West Midlands Pension Fund's market value increased from £15.4 billion to £15.7 billion and the West Midlands Integrated Transport Authority Funds value decreased from £494 million to £492 million. Following on from the final quarter of 2018 which saw many global stock markets record their worst performance since the 2008 financial crisis, equity markets rebounded strongly in the first quarter of 2019. In the first quarter of 2019, UK gilts delivered solid returns as dovish signals from the world's central banks (inclined against increasing rates), against a backdrop of slowing global growth, helped support demand for traditional safe haven assets. The UK property sector has started to stall after a period of strong performance impacted in part by the poor retail sector outlook.

4.0 Markets and Investment Background

4.1 The Fund's Investment Adviser, Redington provides a quarterly update on the market background and market performance over the quarter. The report for the quarter to 31 March which further sets out the outlook for the Fund's key asset classes over the coming months can be found in Appendix A.

4.2 Equity markets made strong gains in the first quarter of 2019, rebounding from a weak end to 2018 as concerns over the China-US trade dispute eased (although subsequently tensions have risen sharply since quarter end) and major central banks grew more accommodative. Within the equity portfolio, US equities posted the biggest gains over the first quarter of 2019 of 11.3%. This was fuelled mainly by an increasingly softening Federal Reserve commentary on rate increases, apparent progress in US-China trade talks, and the end of the US government shutdown. Within the UK the obsession and lack of resolution with Brexit has continued through the quarter. This continues to lower the economic growth outlook and reduce the willingness of both companies and investment managers to invest in the UK. The 'high street' sector continues to struggle with high costs and lower revenues whilst business is still reviewing how to proceed in the future. Despite posting significant equity market gains, the concerns about the future outlook helps to explain the relatively lack lustre performance of UK stock markets when compared to many others.

4.3 Looking forwards market commentators continue to expect lower global economic growth and corporate earnings growth with the Eurozone looking particularly vulnerable. Many investors seem to expect growth to continue into 2020 and potentially to 2021 as the outlook for a recession gets moved back due partly to positive central bank actions and benign inflation. However, despite this quarter many market commentators are discussing more defensive strategies going forwards, and many are also viewing emerging markets positively.

4.4 In the first quarter of 2019, UK gilts delivered solid returns as dovish signals from the world's central banks, against a backdrop of slowing global growth, helped support demand for traditional safe haven assets. Gilts additionally benefited from ongoing Brexit uncertainty, with 10-year yields briefly dipping below 1% in March. UK corporate bonds also performed well over the period in which they recorded gains of 4.1%, as the general improvement in investor sentiment helped boost returns.

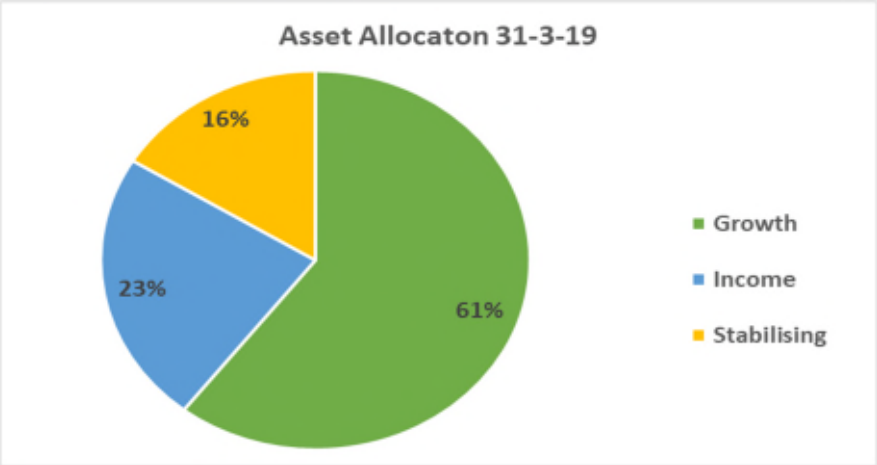
4.5 UK commercial property got off to a subdued start in 2019, a stark contrast to the previous year, when the market recorded a total return of 6.2%. So far this year, capital values have fallen in the Retail sector - reflecting the trend experienced throughout 2018. Conversely, values have continued to rise in the Office and Industrials sectors. But despite weakness in Retail, overall UK property recorded a small positive total return for the first quarter of the year.

5.0 West Midlands Pension Fund Quarterly Performance

5.1 At the end of the fourth quarter of the financial year 2018/19, the value of the West Midland Pension Fund had risen to £15.7 billion at the end of March 2019 from £15.1 billion at 31 December 2018. The asset allocation of the portfolio as at the end of the quarter to 31 March 2019, compared to the strategic targets is set out in the table below. This excludes net current assets, hence the difference to the £15.6 billion total value of the Fund quoted below:

Asset class	Value (£m)	Fund allocation %	Policy target %	Difference %
Growth				
Quoted equities	8,176	52.4	48.0	4.4
Private equity	1,028	6.6	10.0	-3.4
Special opportunities	235	1.5	2.0	-0.5
Currency Hedge	(2)	0.0	N/A	N/A
Total growth assets	**9,437**	**60.5**	**60.0**	**-0.5**
Stabilising				
UK gilts	323	2.1	2.0	0.1
Index linked gilts	817	5.2	5.0	0.2
Cash	511	3.3	2.0	1.3
Corporate bonds	412	2.6	2.0	0.6
Cashflow matching fixed interest	305	2.0	3.0	-1.0
US TIPS	152	1.0	0.0	1.0
Total stabilising assets	**2,520**	**16.2**	**14.0**	**2.2**
Income assets				
Specialist fixed interest	469.5	3.0	3.5	-0.5
Emerging market debt	629	4.0	3.5	0.5
Property	1,323	8.5	10.0	-1.5
Insurance linked funds	361	2.3	3.0	-0.7
Real assets and infrastructure	849	5.4	6.0	-0.6
Total income assets	**3,631**	**23.3**	**26.0**	**-2.7**
TOTAL	**15,588**	**100.0**	**100.0**	**-**

The asset allocation between the core categories of investment strategy as at 31 March 2019 are shown in the chart below:



As at 31 March 2019 the Fund remained slightly overweight in growth and stabilising assets, with an underweight position in income assets. The Fund's asset allocation target

portfolio aims to increase income assets and as a result the Fund continues to look for opportunities to deploy further investment in income assets.

During the quarter, the Fund undertook two equity transitions, the first from external managers to transition to LGPSC Ltd global active equity sub-fund, along with a transition from internal global equities to a basket of equity futures pending transition to global equity sustainable mandates. In addition, the fund invested £50m into a property asset, as well as investments in long dated US Treasury inflation protection securities and medium-term gilt exposure.

The Fund held an overweight allocation to cash, due in part to the need to hold cash as collateral for the Fund's passive currency hedging position.

5.2 Given the level of change within the portfolio over the year and ahead of the next investment strategy review, the Fund is currently working with appointed advisers to review the benchmarks used to assess performance across the range of invested asset classes. Working with the Investment Advisory Panel, the review will ensure the composite benchmarks set for the Fund appropriately reflect the returns expected from the underlying investments. A further report will be provided to the Committee in September. Performance of the different asset classes is set out below in line with the allocation strategies for the Fund.

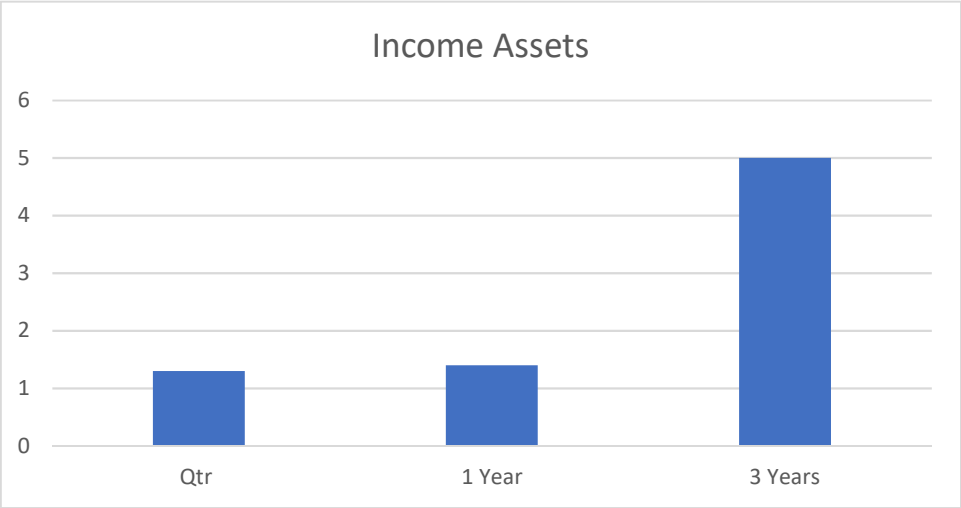
Growth Assets

5.3 This portfolio comprises passive equity, active equity and private equity investments. For the Fund, this has been a year of transition with the Fund's internal passive assets transitioning to LGPS Central Ltd at the start of the year with the active global equity assets transitioning in the fourth quarter of the year, with approximately 50% going into an LGPSC Ltd ACS sub-fund and the remainder to a basket of global equity futures pending the transition to the sustainable equity mandate in the next few months. Over the quarter to 31 March 2019 the growth portfolio grew in aggregate by 7.3% reflecting the turnaround in equity markets following the setback in the quarter to December 2018. Over the year as a whole the growth assets saw an increase on the year of 4.5%, with the 3-year annualised performance of 11.9% over the period, significantly in excess of inflation and the target return of CPI + 4-6% p.a., in what has been a particularly volatile period for equity markets, which has included Brexit concerns, trade wars and geopolitical uncertainty.

5.4 In terms of the individual asset classes within the growth portfolio, the passive element has as might have been expected performed in line with the index over the period. The active equity performance has been mixed with some elements lagging others over the year with corrective action being taken to address the areas that were seeing weaker performance, albeit taking longer than hoped. The private equity portfolio, where performance typically lags that of the broader market due to the illiquid nature of the assets and this has meant that this area has tended to struggle against the broader market in the portfolio. As noted earlier, the Fund is currently reviewing the benchmarks and this will include the performance targets which the Fund has hitherto measured itself against. This is to ensure that the chosen benchmarks are appropriate, transparent and realistic.

Income Assets

5.5 The Fund's income assets comprise a diverse range of individual asset classes which includes emerging market debt, multi-asset credit, property, infrastructure and insurance linked securities. The Performance of these assets is shown below over both the short and longer term:



5.6 Performance has been disappointing over the one-year period with the income portfolio returning just under 1.5% over the year, although on a longer-term view returns have been stronger at 5% annualised over 3 years, within the target return of CPI + 2-4% p.a. over the longer term.

5.7 Within the income asset category, performances have been very diverse, with individual investment categories performing within or above the expected longer term returns for this asset class including property, infrastructure and emerging market debt. The performance for the income group has been significantly impacted by poor performance from the insurance linked sector which has been impacted by a series of severe weather-related events making insurance claims experience much higher over a more extended period. Whilst volatility in this sector is to be expected exposed as it is to catastrophic events, the sector has historically delivered some strong returns to the Fund, which until recently would have compensated for the shorter-term performance drag, investing in this asset class has also offered the portfolio a mechanism for accessing uncorrelated returns i.e. the sector is unlikely to be affected by broader investment market issues. The Committee will be aware that this segment of the portfolio has been problematic for a number of quarters and the Fund is undertaking a fundamental review of the sector with its advisers to determine the extent to which insurance linked will form part of the investment portfolio going forwards and will keep Committee updated of progress.

Stabilising Assets

5.8 The stabilising portfolio comprises the Fund's exposure to government bonds and index linked securities, corporate bonds, cashflow matching and cash. The longer-term target returns from this part of the portfolio are expected to average CPI + 0-2% over the longer term with lower volatility The Chart below shows that the portfolio has exceeded its targeted return over the short and longer term.

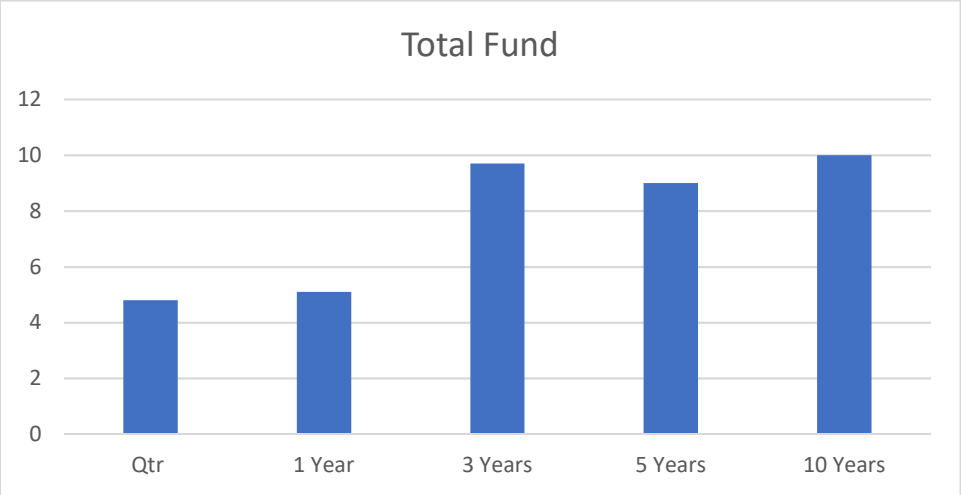
Currency

5.9 Having benefitted from the weakness of sterling during 2016/17, the Fund entered a passive currency hedging programme in September 2017 to protect returns in sterling terms and to reduce currency risk within the investment portfolio. The hedge is applied to the Fund's overseas quoted equity portfolios with a hedge ratio of 50% based on the strategic weights for each region.

During Q1 2019, whilst the hedge acted as a drag on the absolute return of the Fund due to sterling weakness on the back of Brexit concerns, it has been performing in line with expectations.

Total Fund Performance

5.10 The performance of the Fund over the last financial year delivered returns of 5.1% reflecting strong underlying market trends. Over the 3-year period since the last actuarial valuation the Fund has seen returns of 9.7% p.a., a level in excess of the rate required over the long term to support the funding of Scheme benefits.



Investment Costs

5.11 The Fund continues to review its internal and external manager performance and fees to ensure the effective implementation of its investment strategy in line with the Fund's Investment Strategy Statement. Having run the pilot study for the Cost Transparency Initiative, the investment costs being disclosed for the financial year 2018/19 reflect better capture and enhanced transparency, an approach that the Fund has progressively adopted for a number of years. Reported costs for this year are, as a result, higher than envisaged at the start of the year with increases largely driven by an increase in underlying manager reported costs (for example including greater operational and implicit costs) and Fund collection of these, in accordance with the new market-standard templates.

6.0 West Midlands Integrated Transport Authority (WMITA) Quarterly Performance

6.1 At the end of the financial year 2018/19, the value of the WMITA Fund has fallen from £503 million to £492 million at the end of the financial year to 31 March 2019 as global equity markets recovered from the setback in the previous quarter. The table below sets out the asset allocation of the portfolio at the end of March (excluding the buy-in element of £224.5 million, revalued as at 31.03.19), the policy targets are those set in the Investment Strategy Statement, updated following changes agreed with Committee in March 2019.

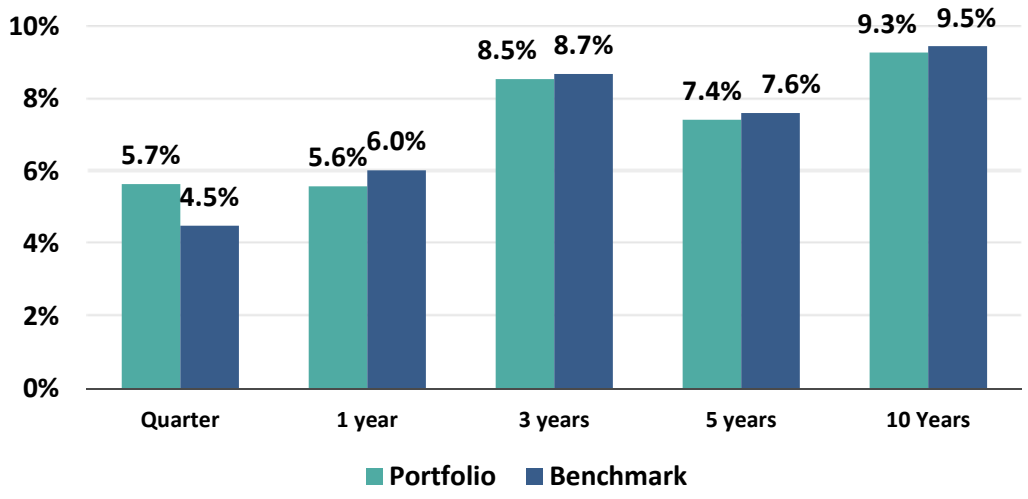
Asset class		Value (£)	Fund allocation	Policy target	Difference
Equities	£	72,359,740	27.0%	27.1%	-0.1%
Diversified Growth Funds	£	95,210,039	35.6%	35.5%	0.1%
Fixed Interest	£	43,381,000	16.2%	0.0%	16.2%
MAC	£	52,577,856	19.6%	20.3%	-0.7%
LDI	£	-	0.0%	17.1%	-17.1%
Cash	£	4,273,382	1.6%	0.0%	1.6%
TOTAL	**£**	**267,802,017**	**100.0%**	**100.0%**	**0.0%**

*Excludes Prudential buy-in £224.5 million

** Policy target shows the updated policy targets agreed by Pensions Committee in March 2019

6.2 The Fund has implemented the first part of the strategic changes by switching out of equities and into a multi-asset credit funds and work to implement the Liability Driven Investment is ongoing.

6.3 In the quarter ended 31 March 2019, the fund achieved a return of 5.7% against the benchmark return of 4.5%. Over the 12-month period the fund marginally underperformed the benchmark by 0.4%, this was mainly due to the underperformance of the DGF's relative to equities and fixed interest portfolios. The chart below shows the gross and relative performance of the portfolio over the last quarter and over the longer term.



6.4 The table below sets out the different components of the performance of the portfolio to periods to end March 2019. The passive equity portfolio has performed in line with the benchmark over all periods under review. The diversified growth portfolio has experienced mixed performances with one of the portfolios impacting on the overall performance of the DGF allocation. The fixed income allocation is split between passive index linked exposure (which has performed in line with benchmark) an active corporate bond portfolio and a multi-asset credit fund.

7.0 Investment Pooling Update – LGPS Central

7.1 Following the launch of the Global Equity Active ACS Sub-Fund in November, the Fund along with four other Partner Funds committed and transitioned over £2bn to this sub-fund during February 2019.

7.2 The Fund made a commitment to the LGPS Central Ltd private equity sub-fund, which started to draw down post quarter end investing in a range of funds and co-investments.

7.3 Work has also taken place alongside input from the Fund and other Partner Funds to develop emerging market equity and corporate bond sub-funds, with the emerging market equity sub-fund being launched and transition arrangements being made. Several other sub-funds remain in development including the low carbon factor based sub-fund and the Committee will be kept updated of other opportunities as they arise.

	Absolute performance				Relative performance			
	Quarter	1 year	3 years p.a.	5 years p.a.	Quarter	1 year	3 years p.a.	5 years p.a.
Equities	8.8%	7.1%	13.8%	10.8%	0.0%	0.0%	0.0%	0.2%
Diversified Growth Funds	5.2%	3.8%	4.0%	10.8%	4.1%	-0.6%	-0.2%	-0.4%
Bonds	4.0%	2.8%	6.0%	6.9%	-1.3%	-2.3%	-0.7%	-0.4%
Total return	**5.7%**	**5.6%**	**8.5%**	**7.4%**	**1.2%**	**-0.4%**	**-0.1%**	**-0.2%**

8.0 Financial implications

8.1 The financial implications are set out throughout the report.

9.0 Legal implications

9.1 This report contains no direct legal implications.

10.0 Equalities implications

10.1 This report contains no equal opportunities implications.

11.0 Environmental implications

11.1 This report contains no environmental implications.

12.0 Human resources implications

12.1 This report contains no direct human resources implications.

13.0 Corporate landlord implications

13.1 This report contains no direct corporate landlord implications.

14.0 Schedule of background papers

14.1 Investment Strategy Statement
http://www.wmpfonline.com/CHttpHandler.ashx?id=17516&p=0

14.2 Funding Strategy Statement

15.0 Schedule of appendices

15.1 Appendix A: Redington Economic and Market Update May 2019