CITY OF WOLVERHAMPTON COUNCIL	**Pensions Committee** 12 December 2018

Report title	Quarterly Investment Report to 30 September 2018	
Originating service	Pension Services	
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Recommendations for noting:

The Committee is asked to note:

1. The global economic and market update paper prepared by the fund's adviser, Hymans Robertson

2. The update on Investment Pooling

3. Quarterly Performance Reporting for the West Midlands Pension Fund

4. Quarterly Performance Reporting for the West Midlands Integrated Transport Authority

1.0 Purpose

1.1 The quarterly investment report covers the range of investment issues for consideration by the Committee, primarily the economic and investment background, the Fund's responsible investment activities, an update on LGPS Central investment pooling and the quarterly performance of both the West Midlands Pension Fund and the West Midlands Integrated Transport Authority.

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 has a longstanding policy of supporting good corporate governance in the companies in which it invests. The Fund will also challenge companies who do not meet either the standards set by their peers or reasonable expectations as measured by best practice. The Fund's approach is part of its overall investment management arrangements and its active Responsible Investment Framework and Voting Principles. There are three pillars of responsible investment that we focus on: Selection of our assets, Stewardship of our assets and Transparency & Disclosure. Each plays a key role in protecting and enhancing Fund Asset Values

III. The requirement to deliver investment in accordance with the criteria laid down by the Secretary of State led to the creation of LGPS Central, a jointly owned investment management pool established by West Midlands Pension Fund and seven partner Funds to deliver investment pooling. LGPS Central Ltd is the FCA authorised company operator established to help deliver investment pooling through the development and launch of collective investment vehicles designed to assist in delivering higher longer-term risk adjusted returns after costs and meet partner Funds' strategic investment objectives.

IV. The Fund's investment strategy is outlined in the approved Investment Strategy Statement (ISS), 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 returns investment policies will be benchmarked against.

V. 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 was approved by the Committee on 21 March 2018.

3.0 Summary

3.1 Since the start of the financial year the West Midlands Pension Fund's market value increased from £15.4 billion to £16.1 billion and the West Midlands Integrated Transport Authority Funds value increased to £500 million from £492million. Equity markets continued to advance in the third quarter, although have subsequently fallen sharply on concerns of trade wars and slowing global growth. Bond markets were marginally down over the quarter with the UK gilt market being impacted by growing prospects of a disorderly Brexit. Property continued to advance but was dominated by positive gains in industrial property offset by weakening retail demand.

3.2 The Fund continues to demonstrate its commitment to responsible investment and has included a separate paper on this occasion to also cover the work being undertaken to develop a climate change policy.

3.3 LGPS Central Ltd have now finalised details of the global external equity ACS sub-fund with launch on 30 November following the appointment of 3 equity managers for the sub-fund, who presented to Funds at a Product Information Day in September. The Fund is now working closely with LGPSC Ltd and Partner Funds on the arrangements for a transition of holdings to the new sub-fund. Work continues on the development of additional sub-funds including private equity, emerging markets external equity and corporate bonds.

4.0 Economic and Investment Background

4.1 The Fund's Investment Adviser, Hymans Robertson provides a quarterly update on the economic background and market performance over the quarter to 30 September 2018. The report further sets out the outlook for the Fund's key asset classes over the coming months. The report can be found in Appendix A.

4.2 Equity markets continue to build on gains from the second quarter with global equity markets rising 4.8%, although Brexit concerns held the UK market back with a small drift down of 0.8% over the quarter. However, as can be seen from the quarterly update markets post the quarter end had a setback on concerns about global growth and rising tensions over trade. Bond markets were marginally down over the quarter with reflecting some concerns over Brexit and rising yields across the globe. In currency markets, sterling continued to be under pressure and fell against both the US$ and Euro. As noted above property markets continued to strengthen rising 1.8%, although disguising divergence from the sectors within.

4.3 In terms of the outlook, equity market valuations continued to look stretched against a more difficult background and have since come back by over 6% since end of the quarter on concerns over global growth and trade wars. As noted last quarter, private equity markets have seen considerable inflows of capital in recent years and again valuations are also looking stretched with investors chasing multiples higher. Infrastructure and property assets have continued to see demand as investors search for income, with both asset classes offering investors stable income streams at a time when income is scarce

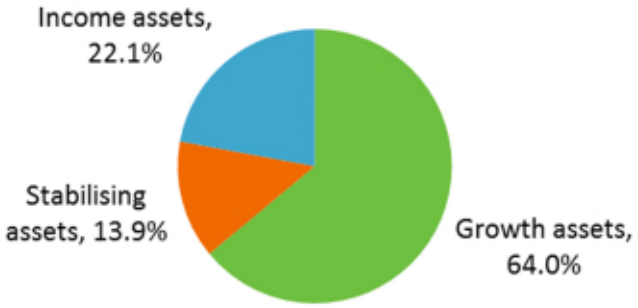
in bond markets, although there are some signs of softening demand for property assets. Monetary policy tightening in the US and the reversal or at least halting of quantitative easing is likely to see pressure increase and bond yields rise further with the most notable impact having been seen in emerging market debt which has sold off further over recent months.

5.0 West Midlands Pension Fund Quarterly Performance

5.1 At the end of the second quarter of the financial year 2018/19, the value of the West Midland Pension Fund had risen to £16.1 billion at the end of September 2018 from £15.4 billion at the end of the year to 31 March 2018. The asset allocation of the portfolio as at the end of the quarter, 30 September, compared to the strategic targets is set out in the table below. This excludes net current assets, hence the difference to the £16.1 total value of the Fund quoted (note the asset allocation contained in the exempt paper provides Committee with an updated asset allocation as at mid-November):

Asset class	Value (£m)	Fund allocation (%)	Policy target (%)	Difference (%)
Quoted equities	8,685	54.6	48.0	6.6
Private equity	1,239	7.8	10.0	-2.2
Special opportunities	227	1.4	2.0	-0.6
Currency Hedge	25	0.2	N/a	0.2
Total growth assets	10,177	63.8	60.0	3.8
UK gilts	164	1.0	2.0	-1.0
Index linked gilts	757	4.8	5.0	-0.2
Cash	594	3.7	2.0	1.7
Corporate bonds	394	2.5	2.0	0.5
Cashflow matching fixed interest	306	1.9	3.0	-1.1
Total stabilising assets	2,215	13.9	14.0	-0.1
Specialist fixed interest	324	2.0	3.5	-1.5
Emerging market debt	602	3.8	3.5	0.3
Property	1,322	8.3	10.0	-1.7
Insurance linked funds	500	3.1	3.0	0.1
Real assets and infrastructure	770	4.8	6.0	-1.2
Total income assets	3,518	22.1	26.0	-3.9
TOTAL	15,909	100.0	100.0	-0.2

The key asset allocation strategies as at 30 September are shown in the chart below:

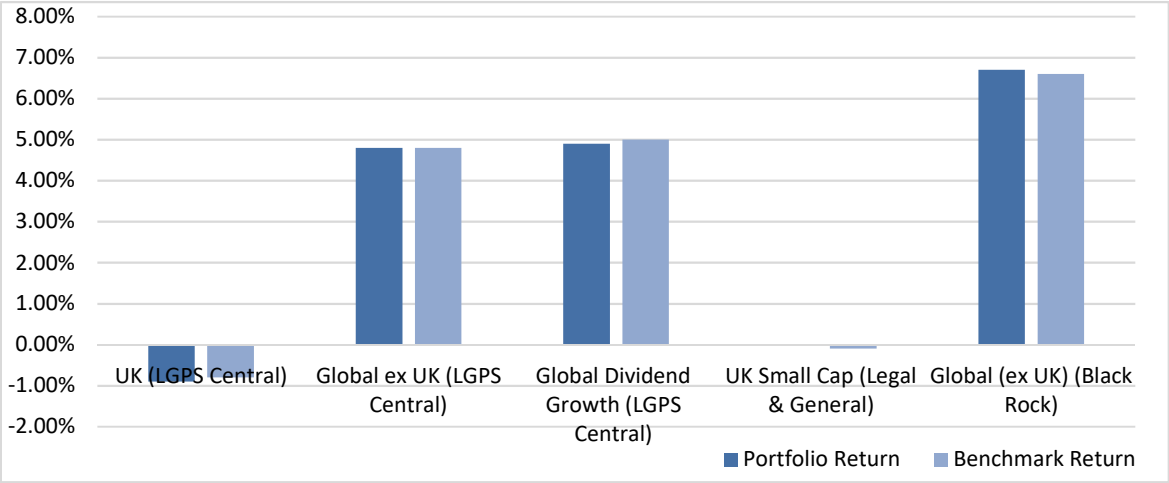


The Fund remained overweight in growth assets at 64%, although subsequent to the quarter end has further reduced exposure to growth assets and is now broadly in line with target. Allocations to income assets, whilst remaining below target have similarly seen an increase towards the target level with new money being invested, rising to 22.1% of assets up from 21% on the previous quarter. Stabilising assets remained relatively neutral compared to benchmark at the end of the quarter with relatively high levels of cash held following some divestment of growth assets and pending investment in income assets.

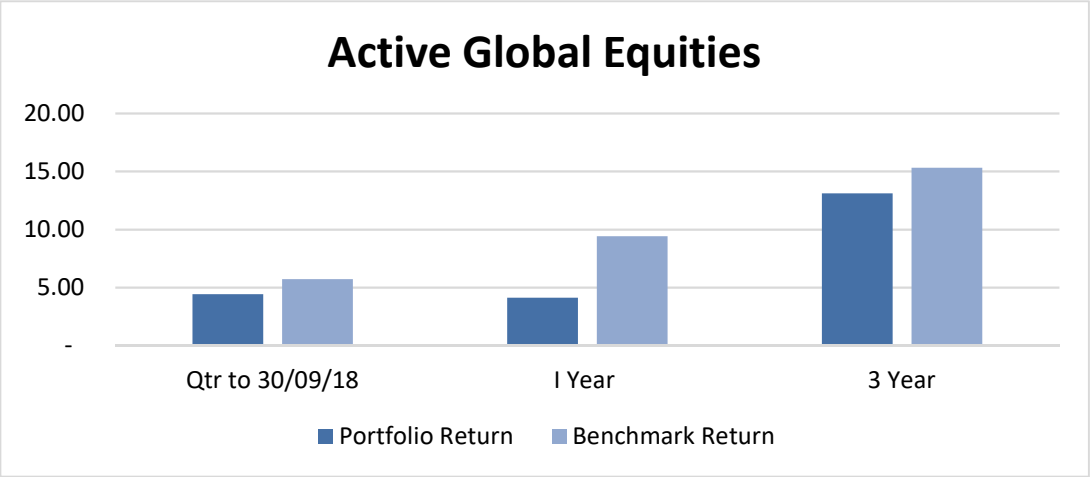
5.2 Performance of the different asset classes is set out below in line with the allocation strategies for the Fund.

Growth Assets

5.3 Passive Equity performance: the passive equity portfolio which transitioned to LGPS Central Ltd at the start of the financial year performed broadly in line with the respective benchmarks during the quarter, although the divided growth fund slightly underperformed its benchmark by 0.2% due to being unable to transition Taiwan stocks (for market reasons) at the outset of the transition and this has continued to have an impact on the performance since inception with LGPSC Ltd. Whilst being aware that this would be an issue it has been exacerbated by the sharp movement over the transition period before new holdings could be purchased.

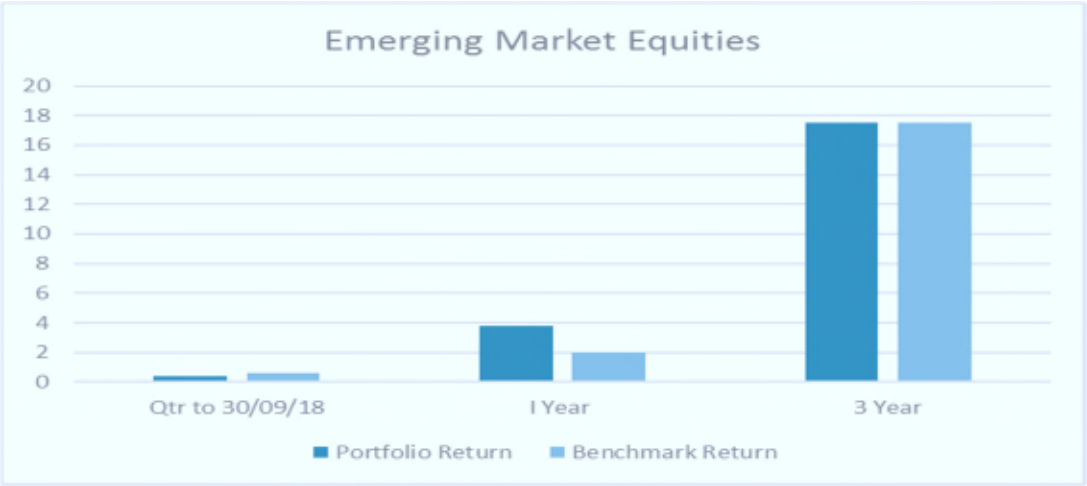


5.4 Global Active Equities performance: This portfolio comprises internal and external portfolios. The combined performance of the global equity fund over the quarter delivered a return of 2.9% compared to the benchmark return of 5.7%, with a return of 5.7% over the year and a benchmark return of 13.4%. Over the 3-year period, the returns for the Fund were 16.9% compared to a benchmark of 19.8%. This portfolio is scheduled to transition to new portfolios through to new managers in the new year

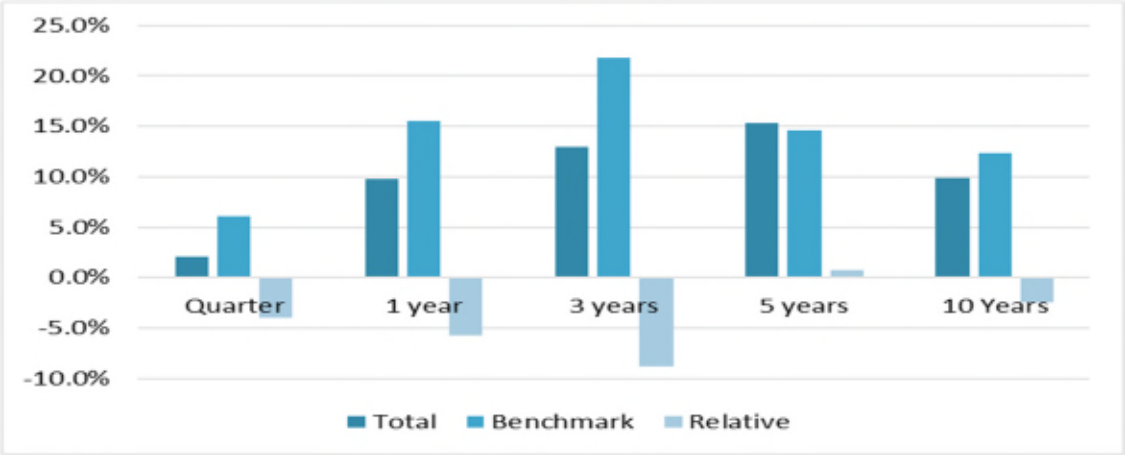


The internal active portfolio has retained a ‘value’ based approach which has continued to be impacted by the market’s preference for growth stocks and in particular highly valued technology companies. This has had a detrimental impact on performance over both the quarter and the year, returning 1.1% and 3.1% against a benchmark return of 5.7% and 13.4% over the quarter and year respectively. The external global active portfolio showed recovery against benchmark over the quarter returning 6.5% versus 5.7%. Over the year, the fund was impacted by an underweight to the high performing technology sector with a return of 11.4% compared to benchmark of 13.4%, however over the longer term the performance was close to the returns on the benchmark at 19.5% compared to 19.8%, outperforming by 4.4% since inception.

5.5 Emerging Market Equities: Emerging market equities having faced a difficult period held relatively stable over the quarter being relatively unchanged. The Fund has three external managers which delivered a combined return of 0.4% slightly underperforming the benchmark where the return was 0.6% over the quarter. Over the year, the portfolio slightly outperformed compared to benchmark with returns of 3.8% and 2.0% respectively, the three-year performance was in line with benchmark at 17.5% as shown in the chart below:

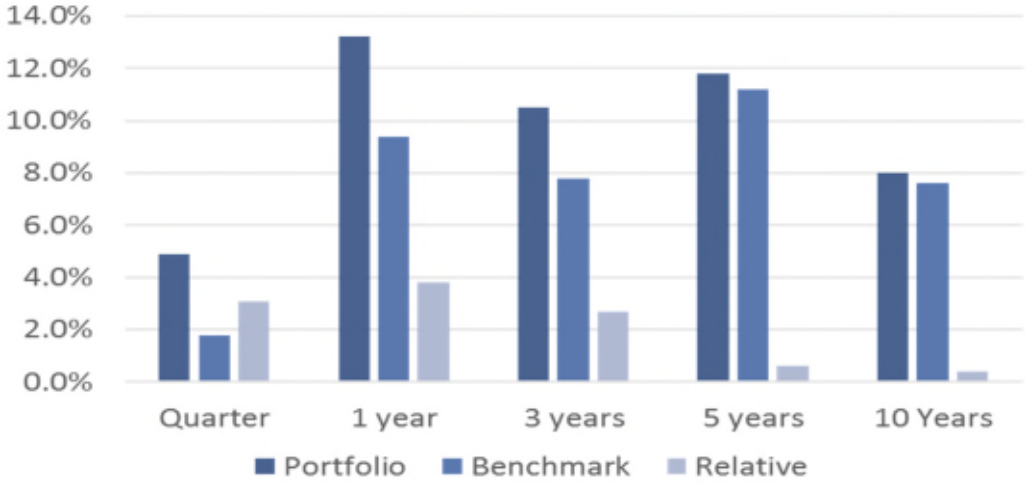


5.6 Private Equity: During the quarter, the Private Equity portfolio had a net cash position of £49 million, made up of aggregate distributions of £83.4 million and total drawdowns of £34.3 million. The portfolio underperformed its benchmark during the quarter with the venture capital sector segment impacting on performance (22% of the Private Equity portfolio) over both the short and medium term. The quarterly, 1 year and longer-term performance of the portfolio is shown in the chart below:

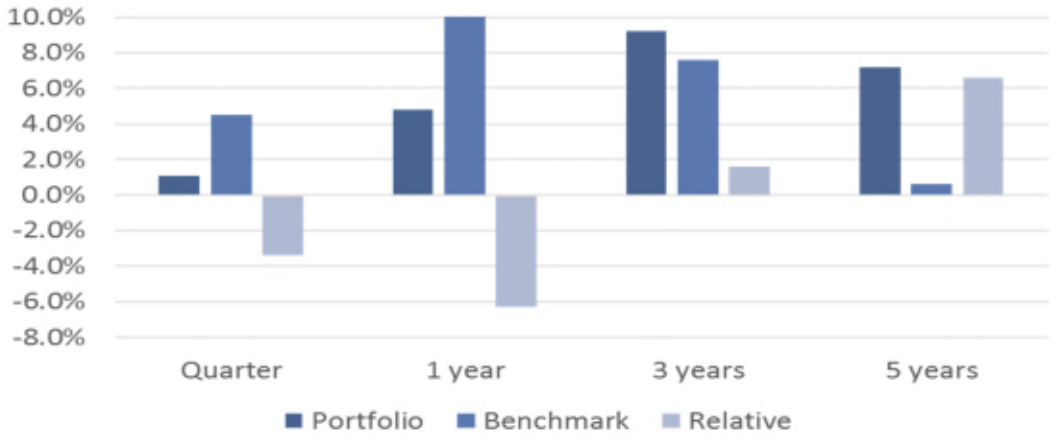


Income Assets

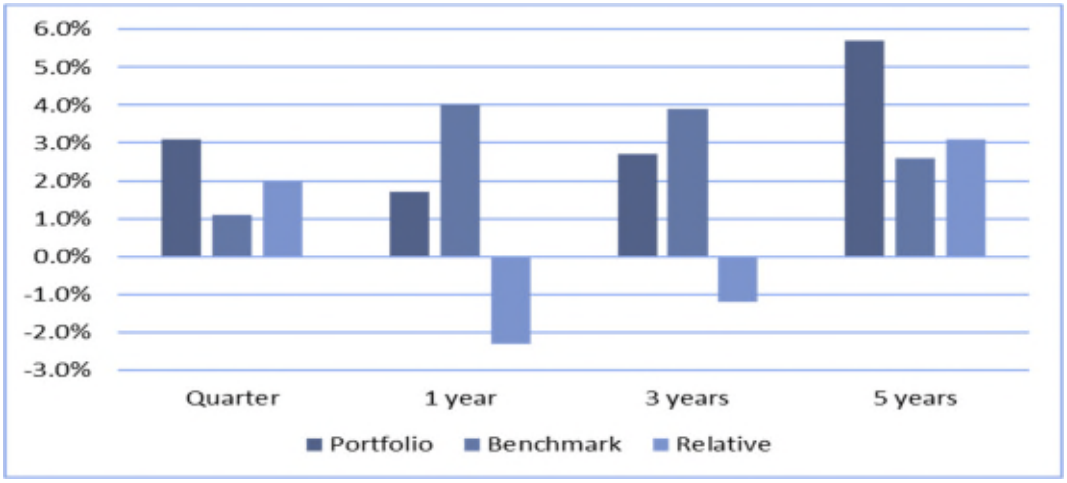
5.7 Property: The Fund made two purchases in the quarter, an office block in Bristol and a retail unit in Ealing. Performance over both the short and long-term has benefited from the Fund's exposure to the industrial sector of the market which has seen strong performance and being underweight in the retail sector which has performed poorly. Performance for the quarter was 4.9% compared to benchmark of 1.8%, with the year's performance of 13.2% for the Fund and 9.4% for the benchmark. The Fund outperformed benchmark over a 3-year period delivering a return of 10.5% compared to a benchmark return of 7.8% as can be seen from the chart below:



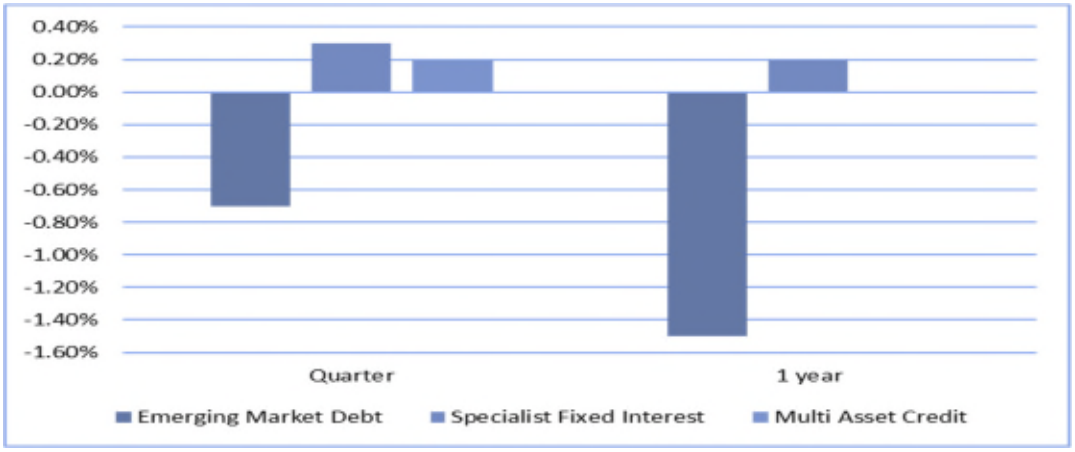
5.8 Infrastructure and Real Assets: There was little activity in this asset class during the quarter although post quarter end, the Fund made a direct investment into a portfolio of motorway service stations. Performance has been impacted within the Project Fleming portfolio by a markdown following the collapse of Carillion to which the Fund had been exposed. This also impacted the 1-year performance returns against benchmark. Over the 3-year period the Fund has delivered outperformance against benchmark as can be seen in the following chart:



5.9 Absolute Return: This covers the insurance linked funds and special opportunity investments. As Members will be aware from previous Committee discussions, the insurance linked sector has been significantly impacted in terms of performance due to the financial impact of the hurricanes and other natural disasters during 2017 but is seeing a rebound in performance for the quarter. However, it is unclear at this stage how the recent Californian wildfires will impact on the performance at this stage and officers are closely monitoring the position for updates. The chart below clearly sets out the impact on the last year from the natural disasters of 2017:

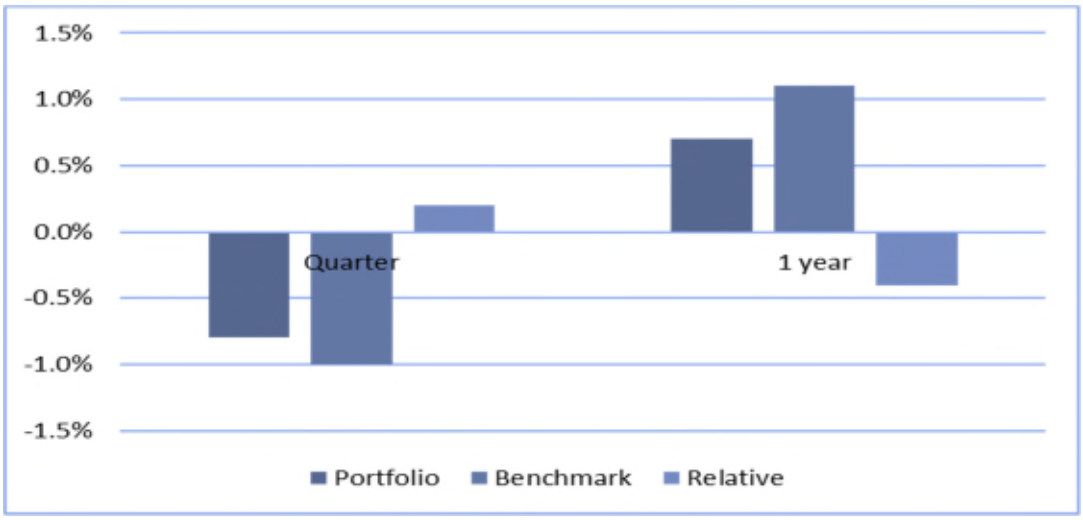


5.10 Fixed Income incorporating emerging market debt and specialist fixed income: During the quarter the Fund added to the fixed income element of the income portfolio with the addition of a holding in a multi-asset credit fund. Emerging market debt has continued to be impacted by US$ strength and volatility in emerging economies, although the Fund benefited from its exposure to specialist fixed income which helped to offset some of the underperformance from emerging market debt. The multi-asset credit fund having only recently been added does not therefore have a longer-term performance. On an individual basis, specialist fixed income outperformed the customised benchmark by 0.3% with the majority of the constituent funds contributing, while emerging market debt underperformed the customised benchmark by 0.7%.



Stabilising Assets

5.11 Stabilising Fixed Income: There was little activity in this portfolio over the quarter and despite yielding a negative return over the quarter, the stabilising component of the fixed income portfolio outperformed over the quarter, although over the longer term has underperformed as shown below:



Currency

5.12 Having benefitted from the weakness of sterling during 2016/17, the Fund entered into a passive currency hedging programme managed by HSBC 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.

The Fund rolled the currency hedge in September 2018 for an additional quarter; in doing so, the Fund realised a loss of £97.6 million, which represented an overall loss to the Fund of 1.5% over the period. This was attributable to the pound's depreciation primarily against the US$ during the third quarter of 2018. However, it should be noted that the loss was offset to a certain extent by the rise in the US equity market, which increased by 8.5% in sterling terms over the period, and corresponding increases in European (+3.1%) and Japanese (+5.0%) equities.

Investment Costs

5.13 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.

6.0 West Midlands Integrated Transport Authority Quarterly Performance

6.1 At the end of the second quarter of the financial year 2018/19, the value of the WMITA Fund had risen to £500 million from £491.9 million at the end of the year to 31 March 2018, due to a combination of cash inflows during the quarter and positive performance from the invested portfolio. The table below sets out the asset allocation of the portfolio at the end of September (excluding the buy-in element of £238.3 million), the policy targets are those that were set at the March Pensions Committee meeting when the updated Investment Strategy Statement was approved and which the Fund is in the process of implementing:

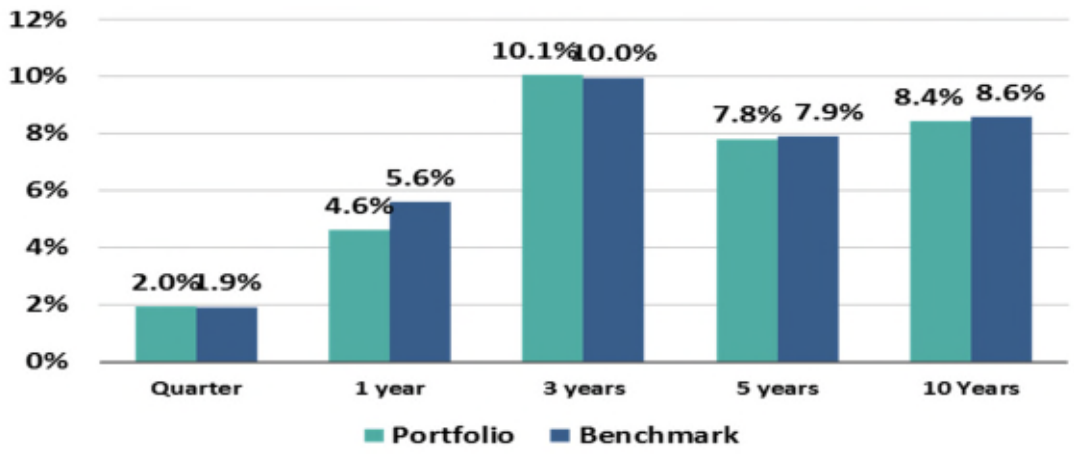
Asset class		Value (£)	Fund allocation	Policy target	Difference
Equities	£	74,704,904	41.1%	38.4%	2.7%
Diversified Growth Funds	£	97,639,942	37.6%	38.6%	-1.0%
Fixed Interest	£	87,819,016	20.7%	22.4%	-1.7%
Cash	£	4,074,856	0.6%	0.6%	0.0%
TOTAL	£	264,238,718	100.0%	100.0%	0.0%

*Excludes Prudential buy-in £238.3 million

** Policy target shows the updated policy targets agreed by Pensions Committee in March 2018

6.2 As noted above, the WMITA's policy allocation was amended at the March Committee meeting following discussions with the main employer in the Fund, West Midlands Travel Limited (trading as National Express Bus) to address concerns about the level of risk within the portfolio given the maturity of the WMITA Fund. The Fund implemented the first part of the strategic changes by switching out of equities and into a multi-asset credit funds. Fund officers are working towards putting the Liability Driven Investment in place and this should then complete the first phase of the restructuring of the portfolio with ongoing discussions on phase 2. Following discussions with WMITA's other employer, additional changes are being put in place to de-risk the overall portfolio further with additional allocations to multi-asset credit and LDI being made.

6.3 In the quarter ended 30 September 2018, the fund achieved a return of 2.0% broadly in line with the benchmark return of 1.9%. Over the 12-month period the fund underperformed the benchmark by 1.0%, this was mainly due to the performance of the diversified growth funds (DGF), impacted by below benchmark returns from one of the managers. The chart below shows the gross 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 September 2018. The passive equity portfolio has performed in line with the benchmark over all periods under review. The diversified growth portfolio is however a mixed performance 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) and an active corporate bond portfolio which has outperformed over the quarter, but in line over the year.

	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	4.1%	9.5%	18.3%	12.3%	0.1%	0.1%	0.0%	0.2%
Diversified Growth Funds	1.1%	1.6%	4.4%	3.9%	0.0%	-2.7%	0.2%	-0.4%
Bonds	-0.2%	0.7%	5.5%	6.4%	0.6%	0.0%	0.0%	0.0%
Total return	2.0%	4.6%	10.1%	7.8%	0.0%	-1.0%	0.1%	-0.1%

7.0 Investment Pooling Update – LGPS Central

7.1 Governance arrangements for LGPS Central Limited include a Shareholder Forum (as the group of “owner” representatives) and the Joint Committee (focused on investment matters and client-side). The Practitioners Advisory Forum, (PAF, Officer group) support both groups and acts as a liaison with the Company. The Shareholder Forum meeting took place on 10 September 2018 along with the company AGM on the same day. This included the adoption of the company’s annual report and accounts and the reappointment of Deloitte as auditor of the company as well as reports from both the Audit, Risk and Compliance Committee and the Remuneration Committee. The Directors were re-elected, although following the resignation of the Chief Executive, Andrew Warwick-Thompson, his was on an interim basis pending the appointment of a new Chief Executive, where a search for a replacement is currently underway. Approval was given

by shareholders to the creation of a subsidiary for a Scottish Limited Partnership for the operation of a private equity sub-fund.

7.2 The Fund's Chair of Pensions Committee also Chairs the Joint Committee and the third meeting of the Joint Committee is scheduled to take place on 14 December. A link to the papers for the Joint Committee when published can be found here: http://www.cheshirepensionfund.org/governance-of-the-cheshire-pension-fund/lgps-central-committee/

7.3 The Practitioners Advisory Forum is working closely with the company to consider the company's budget proposals for 2019/20 in preparation for approval of the budget in February at the next Shareholder Forum.

7.4 The key focus from an investment perspective during the quarter has been the active-external global equity sub-fund and a product information day took place in September, where the 3 selected managers presented to Pension Funds and LGPSC Ltd presented on the process for selection and details of the mandate. Partner Funds looking to participate in the new sub-fund are working closely with LGPSC Ltd and a transition adviser to appoint a transition manager to effect a transfer of assets in the first calendar quarter of 2019.

7.5 The emerging market external active equity sub-fund currently in development phase has seen submissions of shortlisted managers as part of the tender process with responses being evaluated. Further details on the appointments, process and timing for launch of the sub-fund are expected in the new year with a launch expected in the first calendar quarter of 2019.

7.6 As noted above, LGPSC Ltd are establishing a Scottish Limited Partnership to facilitate the introduction of a Private Equity sub-fund using a vintage year approach, the Fund is expected to receive FCA approval in the near future.

7.7 Following liaison with Partner Funds, corporate bonds have been identified as an area where there is likely to be considerable demand and scope for cost savings and the procurement for corporate bond managers is currently underway, and as with the emerging market equity sub-fund, is expected to launch during the first calendar quarter of 2019.

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

14.2 Funding Strategy Statement

15.0 Schedule of appendices

15.1 Appendix A – Economic and Market Update November 2018