Investment Strategy Considerations

February 2018

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Retirement & Investment

Presentation to London Borough of Enfield Pension Fund

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Executive Summary

- Subsequent to the London Borough of Enfield Pension Fund's reduction in equities to 40% the Fund will be holding a material level of cash. The Fund's estimated cash position is discussed in a separate paper.

- There is limited opportunity to deploy capital across the existing investment managers, particularly within liquid assets where the Fund's capital is deployed immediately, as opposed to drawn down over time.

- We are pleased to see that the London CIV is making headway with the fixed income manager selections. We are supportive of both the spectrum of bond opportunities they are looking at and at increasing the Fund's bond allocation.

- There are also opportunities for the Fund to deploy capital outside of the London CIV which we believe are attractive and part of the agreed asset classes.

- The Fund's hedge fund portfolio has drifted away from its original construction and strategic weighting.
  - The current allocation has a higher weighting to strategies which typically exhibit a greater correlation to broader equity markets
  - Following the recent disinvestment from Markham Rae and the decision to redeem from Gruss, the Fund is expected to have c. 8.6% of assets (based on 31 December 2017 values) in liquid alternatives once these redemptions have been accounted for.

Introduction

- In September and November 2017 the Pension Policy and Investment Committee (the “Committee”) considered the results of an investment strategy review undertaken by Aon.
- The results of the investment strategy review showed that the Fund could reduce its equity risk and not materially affect the ability of the Fund to achieve an investment return above the Fund Actuary’s discount rate with a margin for prudence.
- The Committee agreed the long term asset classes or “building blocks” of the investment strategy but the allocation to each was not defined.
- The purpose of this presentation is to provide a follow up to the previous discussions on investment strategy.

Investment strategy building blocks

Equities

- Long term driver of returns
- Maintain a reasonable allocation but may be sensible to reduce reliance on it as a source of return due to high volatility

Property

- Remains attractive
- Consider new property opportunities which are less reliant on capital growth

Liquid Alternative

- Enhance portfolio efficiency by targeting absolute returns in all market conditions
- DGFs provide a diversified portfolio of assets, typically with a higher "beta" or market return
- Hedge Funds provide an "insurance policy" against significant market downturn

Bonds

- Provides diversification from growth assets
- Defensive, low volatility asset class

Inflation Protection Illiquids

- Sacrifice excess liquidity to tap into the "illiquidity premium"
- Provide secure long term inflation protection at a more attractive yield than index-linked gilts

Private Equity

- Benefit from illiquidity premium
- Benefit from a different opportunity set; privately held companies

PFI & Infra

- Low correlation to equities
- Stable, secure cashflows
- Benefit from illiquidity premium

Build a diversified portfolio that meets the required return with lower volatility than equities

Asset allocation following cashflows

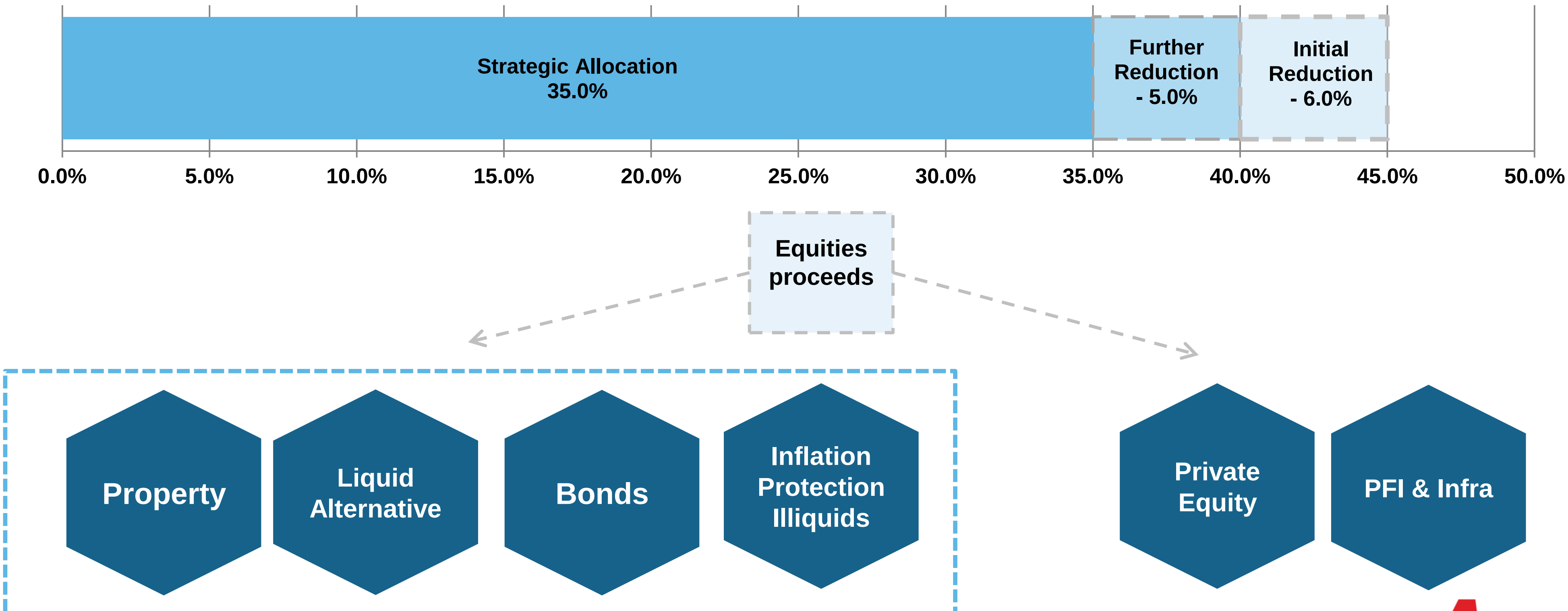
	(£m)	(%)	Current Strategic Allocation
Listed Equity	452.7	40.0	35.0
Private Equity	55.9	4.9	5.0
Hedge Funds	116.7	10.3	15.0
Property	90.2	8.0	10.0
Infrastructure	45.4	4.0	6.0
Bonds	208.1	19.3	24.0
Inflation protection illiquids	42.8	2.9	5.0
Cash	119.9	10.6	-
Total	1,131.8	100.0	

Source: Northern Trust, Managers. Figures shown are as at 31 December 2017.
Note: Numbers may not sum due to rounding.
Due to the equity-like nature of the Lansdowne long / short equity hedge fund investment, the valuation has been split 50:50 between equities and hedge funds..

- The table above shows the Fund's estimated asset allocation position following near term cash movements. This includes the anticipated equity de-risking, funding of the Brockton mandate, receipt of the Markham Rae redemption and the first tranche (25%) of the Gruss redemption proceeds. A separate paper considering the Fund's cashflow in greater detail has been prepared for the Committee.

Where to allocate proceeds?

- Should the Fund reduce its equity weighting by 6% (c. £68m) then consideration should be given to where the assets can be invested.
- As discussed at the September Committee meeting the Fund can consider;
  I. Diversifying across existing assets
  II. Diversifying across new assets
- There is a trade-off between choices with respect to fees, governance and attractiveness of opportunities.
- The London CIV's pipeline should be taken into consideration



Options for investment

	Risk/Return view	Availability on the London CIV	Time to utilise capital	Typical Fees	Governance requirements	Comments
Private equity						Already at strategic weight following recent commitments
Hedge Funds						Attractive investment but low appetite to allocate to asset given political considerations and high fees
UK Commercial Property						Outlook for UK commercial property has weakened given recent strong capital appreciation
Infrastructure						Increased allocation through INPP and Antin – potential for further investment
DGF						Training on suitability of DGF's required
Traditional Bonds						Poor outlook for traditional bond assets High on London CIV priority list
Alternative Credit						Contingent on exact opportunity
Inflation protection illiquids						Scarce investment opportunities

Negative view

Slight concerns

Positive view

Fixed Income Opportunities: London CIV

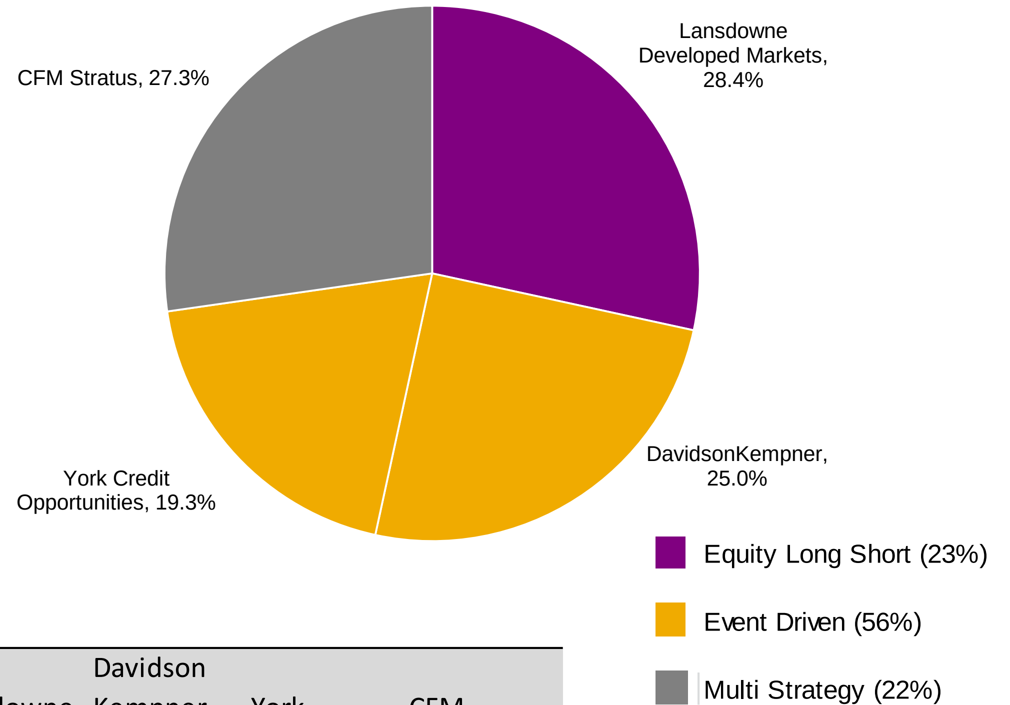
- At the February 2018 Committee meeting, the Committee will receive a presentation from the London CIV on the development of its bond offerings.
- Pending the completion of legal and operational due diligence, these new funds will include:

  LCIV Global Bonds Fund (run by PIMCO)
  LCIV Liquid Loans Fund (run by Ares)
  LCIV Private Debt Fund (run by Ares)
  LCIV Multi Asset Credit Fund – Long Only (run by CQS)
  LCIV Multi Asset Credit Fund – Long/Short (run by MidOcean)

- The discussions at the February 2018 meeting should focus on:
  I. The current strategic allocation to bonds and what the allocation to bonds will be as part of the long term strategy.
  II. The types of bond assets that are appropriate – the funds that the London CIV have chosen represent a different opportunity set relative to what the Fund currently invests in.

The Current Hedge Fund Portfolio

- Current allocation (post all redemptions) is c. £100m, 8.8% of Fund assets. This is significantly below the previously agreed 15% strategic allocation to Hedge Fund strategies.
- Focused portfolio: 4 single strategy hedge fund managers
- Targeting LIBOR +4% p.a. (net of all fees)
- Diversified by manager, but a higher weighting to strategies which typically exhibit a greater correlation to broader equity markets

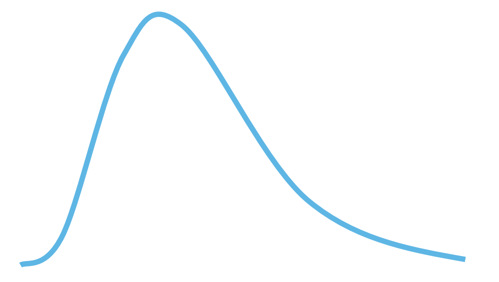
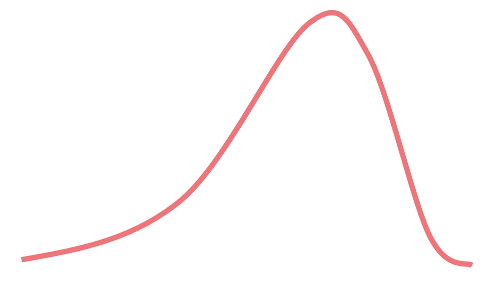


7 year correlation	MSCI ACWI	Barclays Global Agg	Lansdowne	Davidson Kempner	York	CFM
MSCI ACWI	1.00					
Barclays Global Agg	0.39	1.00				
Lansdowne	0.50	0.09	1.00			
Davidson Kempner	0.64	0.22	0.26	1.00		
York	0.67	0.16	0.26	0.86	1.00	
CFM Stratus	0.25	0.32	0.23	0.14	0.10	1.00

Source: Aon Hewitt. As at 31 October 2017

Diversification by Strategy

- Typically a hedge fund portfolio combines these strategies to deliver smoother returns over a range of market conditions

	Divergent Strategies	Divergent/Convergent Strategies	Convergent Strategies
			
Properties	Works best in crisis periods “Cost of carry” in normal market conditions	Works in most market conditions	Works in line with general market movements
Strategies	• Managed Futures • Global Macro	• Multi-Strategy	• Equity Long/Short • Event-Driven

Liquid alternatives portfolio

The discussions at the February 2018 meeting should focus on:

I. The current strategic allocation to liquid alternatives and what the allocation to liquid alternatives could be as part of the long term strategy

II. The types of liquid alternative assets that are appropriate – the Fund currently invests in hedge funds but other asset classes, for example diversified growth funds, could also be considered for this portfolio. At previous meetings the Committee has noted the limitation of DGF's as a substitute for hedge funds given their higher correlation to equities.

Summary

- Should the Fund decide to reduce its equity exposure, consideration should be given as to suitable investment opportunities.

- The Fund can invest across existing and new asset classes, utilising the London CIV where possible.

- The trade-offs between opportunities should be considered with respect to fees, London CIV pooling, governance requirement and liquidity.

- We believe that three key areas that the Committee should consider are:
    1. Agreeing the underlying allocations to the asset classes
    2. Considering the structure of the bond allocation
    3. Considering the structure of the liquid alternatives allocation

Appendix

Strategies considered as part of Strategy review

	September 2017 asset allocation	Current strategy	Diversification across existing assets	Diversification across new assets	Cost reduction and simplification	Reduced equity, Further cost reduction and simplification
Listed Equity	45.0	35.0	35.0	35.0	45.0	35.0
Private Equity	5.0	5.0	7.5	5.0	5.0	5.0
Hedge Funds	12.5	15.0	12.5	12.5	5.0	0.0
Property	10.0	10.0	15.0	12.5	10.0	10.0
Infrastructure	5.0	5.0	7.5	5.0	5.0	5.0
DGF	0.0	0.0	0.0	0.0	7.5	15.0
Bonds	22.5	30.0	22.5	25.0	22.5	30.0
Inflation protection illiquids	0.0	0.0	0.0	5.0	0.0	0.0

Summary of key statistics

	Current allocation	Current strategy	Diversification across existing assets	Diversification across new assets	Cost reduction and simplification	Reduce risk, cost reduction and simplification
Expected Return						
10 year p.a. median return, relative to discount rate	2.3%	1.9%	2.2%	2.2%	2.2%	1.8%
10 year p.a. median vol, relative to discount rate	12.0%	10.4%	11.0%	10.5%	12.0%	10.7%
10 year median absolute return	7.0%	6.5%	6.8%	6.8%	6.8%	6.4%
Risk						
Value at Risk (VaR) over 3 years (£m)	£406m	£350m	£373m	£353m	£403m	£360m
% change from current allocation	-	-14%	-8%	-13%	-1%	-11%
Funding metrics						
Probability of meeting discount rate in 10 years	72%	71%	73%	73%	70%	70%
Median funding level in 10 years	128%	123%	126%	126%	126%	121%
5th percentile funding level in 10 years	66%	70%	69%	71%	65%	68%
Alternative investment lenses						
Approximate Average Manager Fee	0.65%	0.65%	0.70%	0.75%	0.55%	0.55%
% of portfolio that could be held with London CIV	50% -70%	45%-65%	40%-60%	40%-60%	55%-75%	60%-80%
% of portfolio that can be liquidated in a week	55%	50%	45%	45%	65%	65%
Governance requirement (rel. to current strategy)	=	=	↑	↑↑	↓	↓↓

Source: Aon. Modelling results as at 31 March 2017. Liability return is a flat rate of 4.4% p.a.

Considering strategy through different lenses

- When considering an investment strategy, the chosen strategy should meet the required return but also reflect the views and investment beliefs of the Committee, the liquidity requirements of the Fund and the governance structure.
- In this section we consider the strategies through alternative lenses to provide a fuller view of the suitability of each of the strategies. We consider:

  I. **Fees –** the expected base management fee of each of the strategies as a percentage of Fund assets

  II. **Liquidity –** the ability of the Fund to liquidate holdings based on realistic liquidity times

  III. **Governance –** the complexity of an investment into an asset class, including the expected number of asset classes and managers as well as the initial and ongoing time commitment expected for the strategy due to monitoring and manager selections

  IV. **Pooling of assets** – the expected % of the portfolio which is aligned, or is expected to be aligned in the near future, with the London CIV. This accounts for the London CIV's expected pipeline of opportunities over the coming year.

	Current allocation	Current strategy	Diversification across existing assets	Diversification across new assets	Cost reduction and simplification	Reduced equity, cost reduction and simplification
Approximate Average Manager Fee	0.65%	0.65%	0.70%	0.75%	0.55%	0.55%
% of portfolio that could be held with London CIV	50% -70%	45%-65%	40%-60%	40%-60%	55%-75%	60%-80%
% of portfolio that can be liquidated in a week	55%	50%	45%	45%	65%	65%
Governance requirement (rel. to current strategy)	=	=	↑	↑↑	↓	↓↓

Note: The table above has been populated based on our expectation of the London CIV's pipeline of assets and approximate fee schedules

Glossary

- Median expected relative return – this shows the relative expected return per annum over the next 10 years on a 50:50 basis vs the Fund's discount rate (4.4%)
- Median expected relative volatility – this shows the relative expected volatility per annum over the next 10 years on a 50:50 basis vs the Fund's discount rate (4.4%)
- 50th or 5th Percentile funding level – The median funding level can be interpreted as our best estimate funding level over 10 years. In a similar manner to expected return, there is a 50% chance the funding level could be above or below this level. In a one in twenty (5%) event, this is the 10 year funding level we would expect. This figure arises as a result of our projections being stochastic in nature, meaning that there are a range of outcomes depending on different scenarios. The 5th percentile return can be interpreted as a measure of "risk".
- Value at Risk – this shows the worst 5% (i.e. 1 in 20) of outcomes and their impact on the value of the Fund's assets relative to the central scenario. It shows that there is a 1 in 20 chance that the Fund's assets could fall in value by £xm or more, relative to where it is expected to be over a given time frame (typically 1 or 3 years). A strategy with a lower VaR is usually preferable.
- Probability of meeting discount rate – The probability that the Fund's expected return is greater than the Fund's discount rate (4.4%) in 10 years time. It is the probability that the Fund's assets outperform a static discount rate over the period.

Presentation Framework

This presentation has been prepared in accordance with the framework below.

TAS compliant

This presentation, and the work relating to it, complies with 'Technical Actuarial Standard 100: Principles for Technical Actuarial Work' ('TAS 100')

The compliance is on the basis that PP&I Committee of the London Borough of Enfield Pension Fund are the addressees and the only users and that the presentation is only to be used for discussion on the Fund's investment strategy at the February 2018 PP&I Committee meeting.

If you intend to make any other decisions after reviewing this presentation, please let me know and I will consider what further information I need to provide to help you make those decisions.

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Component reports

This presentation should be read in conjunction with our component reports:

- *Investment Strategy review* dated September 2017; and
- *Investment Strategy review – Follow up* dated November 2017.

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