London Borough of Enfield

PENSION POLICY AND INVESTMENT COMMITTEE

Meeting Date: 23 July 2020

Subject: Quarterly Investment Report for March 2020

Cabinet Member: Cllr Maguire

Executive Director: Fay Hammond

Key Decision: [ ]

Purpose of Report

1. The Pension Fund Regulations require that the Council establishes arrangements for monitoring the investments of the Fund. It considers the activities of the investment managers and ensures that proper advice is obtained on investment issues.

2. Officers and fund advisers meet regularly with investment managers to discuss their strategy and performance and if considered necessary may recommend that investment managers are invited to explain further to the Pension Policy & Investment Committee.

Proposal(s)

3. Pension Policy and Investments Committee are recommended to note the contents of this report.

Reason for Proposal(s)

4. The report informs the Pension Policy and investment Committee of the performance of pension fund managers and the overall performance of the Enfield Pension Fund.

5. **Relevance to the Council's Corporate Plan**

6. Good homes in well-connected neighbourhoods.

7. Build our Economy to create a thriving place.

8. Sustain Strong and healthy Communities.

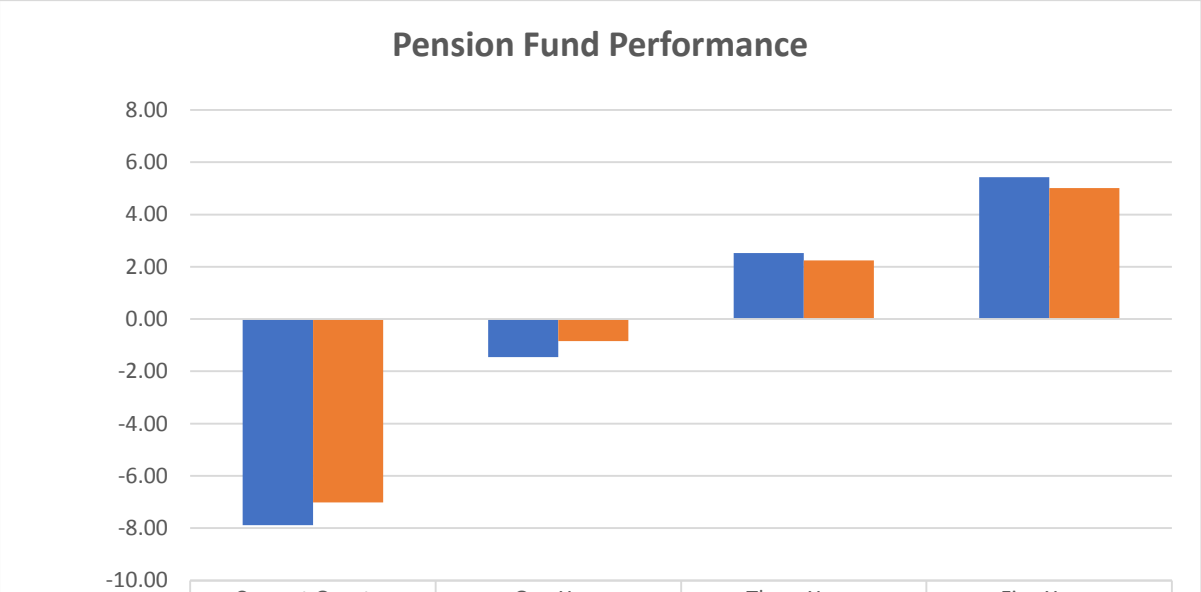
Background

INVESTMENT PERFORMANCE

9. The overall value of the Fund at 31 March 2020 stood at £1,169m which is a significant reduction of £94m from its value of £1,263m as at 31 December 2019. This reduction was because of the Covid-19 outbreak that turned into a global pandemic. And brought about global equities selling off sharply after reaching all-time highs in mid-February.

10. The fund underperformed the benchmark this reporting quarter by posting a return of -7.89% against benchmark return of -7.01%. The twelve-month period sees the fund behind its benchmark by -0.62%.

11. Looking at the longer-term performance, the three years return for the Fund was 2.53%, which was 0.29% per annum ahead its benchmark return. Over the five years, the Fund posted a return of 5.43% outperforming the benchmark return of 5.01% by 0.42% per annum, as shown on the graph below.



	Current Quarter	One Year	Three Years	Five Years
Fund	-7.89	-1.46	2.53	5.43
Benchmark	-7.01	-0.84	2.24	5.01

12. For this reporting quarter, nine out of twenty-one mandates delivered returns, matching or achieving returns above the set benchmark. The nine mandates were Antin, Blackrock Pooled Equity Fund, Brockton, LCIV Henderson, LCIV Baillie Gifford, M & G Inflation, CBRE, Davidson Kempner and Adams Street. The worst performing portfolios for the quarter were LCIV Longview lagging behind its benchmark by -6.85%, York Capital by -14.12%, LCIV CQS behind by -17.22% and Lansdowne by -23.40%.

13. For the 12 months to March 2020, ten out of twenty-one mandates underperformed their respective benchmarks or targets. The mandates that

delivered negative returns or underperformed its benchmark/target were LCIV Henderson, LCIV Longview, LCIV CQS, Western, CFM Stratus, MFS, Blackrock UK Property, Insight Bonds, York Capital and Lansdowne. The following portfolios generated significant amount of unrealised losses one year to 31 March 2020; Insight with -10.09%, LCIV CQS with -15.04%, Lansdowne with -23.16% and York Capital.

INTERNAL CASH MANAGEMENT

14. Cash is held by the managers at their discretion in accordance with limits set in their investment guidelines, and internally by Enfield Council to meet working cashflow requirements, although transfers can be made to Fund managers to top up or rebalance the Fund.

15. The Pension Fund cash balance is invested in accordance with the Council's Treasury Management strategy agreed by Full Council in February 2019, which is delegated to the Executive Director of Resources to manage on a day to day basis within the agreed parameters.

16. The cash balance as at 31 March 2020, was £51.033m in short term deposits and money market funds. £35.868m with Goldman Sachs, £15.165m with Northern Trust.

CURRENCY ANALYSIS

17. The appreciation of sterling versus the US dollar over the quarter decreased the value of dollar denominated holdings.

18. The Fund has exposure to the euro, US dollar, yen and other currencies within its portfolio.

19. At this reporting quarter, the Fund has 5.7% of total assets exposure to the euro, 32.6% to US dollar, 2.2% to yen and 4.2% to other currencies within it. The active equity managers have exposures to various currencies as they are all global mandates, and AON, the Fund Investment Consultant have approximated the currency exposures based on the geographical split of the underlying investments.

20. Adams Street, York Capital and Davidson Kempner are US dollar denominated whilst Antin is euro denominated. The Lansdowne, CFM, BlackRock, CBRE, Western, M&G Inflation Opportunities, Legal & General, Brockton, Insight, LCIV CQS and IPPL mandates are assumed to have no direct exposure to foreign currencies as they are either hedged to sterling or are sterling share classes.

21. US dollar exposure has decreased by 0.9% to 32.6% of the total assets and still representing the largest foreign currency risk for the Fund. For example, a 1% foreign currency appreciation (or depreciation) for the Funds' US dollar denominated assets will increase (or decrease) by £3.8m, and for Euro denominated assets in the Fund, this will effect an increase (or decrease) by

£0.7m and for Yen denominated assets this will effect an increase (or decrease) by £0.3m.

22. It is therefore worth noting that movements in currencies may either contribute to or be caused by factors that move other asset classes. For example, the US dollar may appreciate at times of stress which could coincide with a fall in the value of the Fund's equity holdings.

ASSET ALLOCATION

23. The current strategic weight of asset distribution and the Fund's assets position as at 31 March 2020 are set out below:

Asset Class	Strategic asset allocation as at April 2019 (%)	Fund Position as at 31 Mar 2020 (%)	Variance as at 31 Mar 2020 (%)	Variance as at 31 Mar 2020 (£m)
Equities	35.0	38.2	3.2	37.41
Private Equities	5.0	6.9	1.9	22.21
Total Equities	**40.0**	**45.1**	**5.1**	59.67
Hedge Funds	10.0	7.6	(2.4)	(28.06)
Property	10.0	6.5	(3.5)	(40.92)
Infrastructure	6.0	5.8	(0.3)	(3.5)
Bonds	24.0	22	(2.0)	(23.38)
Inflation protection illiquid	10.0	8.7	(1.3)	(15.20)
Cash	0.0	4.4	4.4	51.44
Total Equities	**100.0**	**100.0**		

24. The Fund has underweight position of 3.5% in Property, 2% underweight position in Bonds and Indexed linked gilts, 1.3% underweight Inflation protection illiquid and 2.4% underweight position in Hedge Funds. with 0.3% underweight position and Infrastructure with 0.6%. There is a need for assets rebalancing to their strategic weights, the consideration for this will be included in the upcoming investment strategy review for the Fund.

25. The Fund triennial valuation result was very favourable with an outcome of 103% funding level. This means as at 31st March 2019 valuation, the Fund is in surplus. The outcome of Enfield Pension Fund of 103% funding level has put the Fund in a favourable position and it is worth noting that the strong 2016-2019 asset performance was due to high exposures to (strongly performing) overseas equities.

26. The next step, is for the Fund Investment Consultant to carry out an investment strategy review, incorporating the Fund's new investment beliefs. Bearing in mind that the high recent asset growth also leads to lower return expectations hence higher primary contribution.

27. Approximately 13.6% of the equity portfolio is being managed passively by BlackRock. The remainder is being managed on an active basis, with the

largest share of 8.8% with MFS, followed by 6.4% with LCIV Baillie Gifford, 5.7% with LCIV Longview and 2% in LCIV EM.

28. As at 31 March 2020, the MSCI All Country World Index had a 12% exposure to Emerging Markets and in aggregate, the Fund's equity portfolio has £23.4m, a reduction in value by £7.5m compared to 31 December 2019 valuation of £30.9m. At this quarter end c.2% of the total assets are invested in Emerging Markets.

29. Asset allocation is determined by several factors including: -

    i) The risk profile - there is a trade off between the returns that can be obtained on investments and the level of risk. Equities have higher potential returns, but this is achieved with higher volatility. However, the Fund remains open to new members and able to tolerate the volatility, allowing it to target higher returns, which in turn reduces the deficit quicker and should eventually lead to lower contribution rates by employers.

    ii) The age profile of the Fund - the younger the members of the Fund, the longer the period before pensions become payable and investments must be realised for this purpose. This enables the Fund to invest in more volatile asset classes because it has the capacity to ride out adverse movements in the investment cycle.

    iii) The deficit recovery term / the surplus amortisation period - Most LGPS funds are fully Funded or almost 100% funded because of great investment returns but being tampered mildly by increasing life expectancy. The actuary determines the period over which the deficit is to be recovered and considers the need to stabilise the employer's contribution rate. For 2019 valuation, the actuary used 16 years as the target of reducing the funding ratio, to illustrate the surplus amortisation.

30. Individual managers have discretion within defined limits to vary the asset distribution. The overweight position in equities has helped the fund's performance in recent months.

KEY DEVELOPMENTS

31. York Capital Management announced in December 2019 the decision to liquidate the York Credit Opportunities Fund held within the portfolio. Following the liquidation announcement, The Fund Investment Consultant research team have downgraded the York fund to a "Sell" rating and have recommended a full redemption from this fund. As background, York made the decision to liquidate the York Credit Opportunities fund after receiving significant redemptions through 2020, which, given the portfolio's high concentration in illiquid post reorganization equity positions, would have put remaining investors at an unfair disadvantage. While investors have been given the option to roll over their redemption proceeds into the York Global Credit Income Fund, this fund has a different investment objective and would not be suitable as a direct replacement.

32. Franklin Templeton, a global leader in asset management, announced that it is purchasing Legg Mason and its affiliates, including Western Asset (WA). WA was an integral part of the discussions leading up to this deal, and Franklin Templeton shares WA commitment to upholding Western Asset's full investment independence and organisational autonomy. WA support the transaction wholeheartedly. There will be no change to our relationship team, our investment team, the Western Asset leadership team nor their investment philosophy or process as a result of this acquisition. The combined company will have an unparalleled global footprint and breadth of investment offerings as one of the world's largest active managers with over $1.5 trillion in assets under management.

33. M&G announced in January that Ben Jones, Head of Long Income at M&G, had left the business at the end of 2019 with immediate effect. The Fund invests in the M&G Inflation Opportunities Fund, which has holdings in another M&G fund where Mr Jones was the co-Fund Manager (the M&G Secured Property Income Fund). M&G has made a number of role changes following Mr. Jones's exit, promoting a number of long serving team members. The Fund Investment Consultant has no concern over the changes and do not recommend any action is taken and there have been no changes to their in-house ratings for the M&G Inflation Opportunities Fund.

34. The London CIV had placed CQS MAC 'On Watch' since July 2019 due to several concerns including, unsatisfactory performance, senior management turnover, increased leverage and investment process issues. In March 2020, the manager was taken off watch as the manager had shown improvements in all areas of concern. However, the LCIV investment team have increased the level of monitoring for the next six months, including monthly manager meetings, to ensure any further concerns are addressed.

35. The London CIV Emerging Market equity fund was previously managed by Janus Henderson. The lead portfolio manager of the Janus Henderson fund, Glen Finnegan, resigned from Janus Henderson, along with a number of his team members. The Fund Investment Consultant downgraded their rating on the strategy to 'Sell' in October 2019 following this news. London CIV have appointed JP Morgan for the Emerging Market Equity fund and the portfolio was transitioned to the new manager on 11 October 2019.

Safeguarding Implications

36. The report provides clear evidence of sound financial management, efficient use of resources, promotion of income generation and adherence to Best Value and good performance management.

Public Health Implications

37. The Enfield Pension Fund indirectly contributes to the delivery of Public Health priorities in the borough.

Equalities Impact of the Proposal

38. The Council is committed to Fairness for All to apply throughout all work and decisions made. The Council serves the whole borough fairly, tackling inequality through the provision of excellent services for all, targeted to meet the needs of each area. The Council will listen to and understand the needs of all its communities.

Environmental and Climate Change Considerations

39. There are no environmental and climate change considerations arising from this report.

Risks that may arise if the proposed decision and related work is not taken

40. Any form of investment inevitably involves a degree of risk.

41. To minimise risk the Pension Policy and Investment Committee attempts to achieve a diversification portfolio. Diversification relates to asset classes and management styles.

42. The monitoring arrangement for the Pension Fund and the work of the Pension Policy & Investment Committee should ensure that the Fund optimises the use of its resources in achieving the best returns for the Council and members of the Fund.

Risks that may arise if the proposed decision is taken and actions that will be taken to manage these risks

43. Not noting the report recommendations and not adhering to the overriding legal requirements could impact on meeting the ongoing objectives of the Enfield Pension Fund.

Financial Implications

44. This is a noting report which fulfils the requirement to report quarterly performance of the Pension Fund investments portfolio to the Pension Policy and Investment Committee. There are no direct financial implications arising from this report, however the long-term performance of the pension fund will impact upon pension contribution rates set by this Committee.

Legal Implications

45. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 govern the way in which administering authorities should manage and make investments for the fund. There are no longer explicit limits on specified types of investment and instead administering authorities should determine the appropriate mix of investments for their funds. However, administering authorities must now adhere to official guidance; broad powers allow the Government to intervene if they do not. Under regulation 8, the Secretary of State can direct the administering authority to make changes to its investment strategy; invest its assets in a particular way; that the investment functions of the authority are exercised by

the Secretary of State and that the authority complies with any instructions issued by the Secretary of State or their nominee.

46. The Council must take proper advice at reasonable intervals about its investments and must consider such advice when taking any steps in relation to its investments.

47. The Council does not have to invest the fund money itself and may appoint one or more investment managers. Where the Council appoints an investment manager, it must keep the manager's performance under review. At least once every three months the Council must review the investments that the manager has made and, periodically, the Council must consider whether or not to retain that manager.

48. One of the functions of the Pension Policy & Investment Committee is to meet the Council's duties in respect of investment matters. It is appropriate, having regard to these matters, for the Committee to receive information about asset allocation and the performance of appointed investment managers. The Committee's consideration of the information in the report contributes towards the achievement of the Council's statutory duties.

49. When reviewing the Pension Fund Investment Performance, the Council must have due regard to the need to eliminate unlawful conduct under the Equality Act 2010, the need to advance equality of opportunity and the need to foster good relations between persons who share a protected characteristic and those who don't (the public sector duty). The Committee may take the view that good, sound investment of the Pension Fund monies will support compliance with the Council's statutory duties in respect of proper management of the Pension Fund.

Workforce Implications

50. The employer's contribution is a significant element of the Council's budget and consequently any improvement in investment performance will allow the Council to meet this obligation easily and could also make resources available for other corporate priorities.

Property Implications

51. None

Other Implications

52. None

Options Considered

53. There are no alternative options in so far as the publication of the Statement of Accounts and Annual Reports is a legislative requirement.

Conclusions

54. The Fund assets reduced by £16.7m over the year. The net asset statement represents the net worth (£1,168.8m) of the Fund. This reduction was because of the Covid-19 outbreak turned into a global pandemic. Whereby, global equities sold off sharply after reaching all time highs in mid-February.

55. The PIRC average universe for Local Authority Pension Fund return in 2019/20 was -4.8%. The Enfield Pension Fund had a return on investment of -1.5% and ranked 10th in the performance league table. Looking at the longer-term performance, the three-year return for the Fund was 2.5% per annum and for over five years, the Fund posted a return of 5.4% p.a. the Fund outperforming the universe average return of 1.9% and 5.2% respectively.

56. At the last formal valuation (31st March 2019) the funding level increased to 103%, with assets of £1,185m and liabilities of some £1,146m, giving rise to a surplus of over £39m. This reduction in funding level gave rise to a deficit position of some £50m.

57. The valuation updates as at 31st March 2020 was received from the Fund actuary 4th May 2020 and this demonstrated the Fund funding level is slightly weakened from the last formal valuation by 7% from 103% to 96% as shown below:

58. Over the quarter to 31 March 2020 the Fund posted a negative return of c.-7.9% all Equity markets delivered positive returns in both local currency and sterling terms. The Fund underperformed its benchmark by -0.88%. Fund value was £1.169bn, reduced by £94m over this reporting quarter end.

59. For this quarter, ten mandates matched or achieved returns above the set benchmark. eleven out of twenty-one mandates underperformed their respective benchmark by producing a return below cash return. The performing portfolios for the period were Antin, Blackrock Pooled Equity Fund, Brockton, LCIV JP Morgan, LCIV Baillie Gifford, M & G Inflation, CBRE, Davidson Kempner and Adams Street.

60. Over the twelve-month period to 31 March 2020, the Fund underperformed its benchmark by 0.6%. For the year to 31 March 2020, the portfolios that outperformed are: LCIV BG, Blackrock Index Linked, Brockton, Antin, CBRE, Adams Street, M & G Inflation and Davidson Kempner

61. Looking at the longer-term performance, the three-year return for the Fund was 0.3% per annum above its benchmark return and for over five years, the Fund posted a strong return of 5.4% outperforming the benchmark return of 5% by 0.4%.

62. The distribution of the Fund's assets amongst the different asset classes is broadly in line with the strategic benchmark weight, albeit there is a need to rebalance the assets and equities is mildly overweight. The overweight position in equities has helped the fund's performance in recent months.

63. Uncertainty around the impact of Coronavirus on the future of the real estate and infrastructure markets has created difficulties in pricing illiquid assets. In

turn, most property fund managers have suspended dealing, to protect investors and avoid having to liquidate assets at potentially highly marked down prices.

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Appendices – To be attached electronically but not in the main printing pack.

Appendix 1 – AON Quarterly Report
Appendix 2 – London CIV Sub-Funds Quarterly Report

Background Papers
None