

TEESSIDE PENSION FUND

Administered by Middlesbrough Council

AGENDA ITEM 4

PENSION FUND COMMITTEE REPORT

28 JUNE 2018

STRATEGIC DIRECTOR: FINANCE, GOVERNANCE AND SUPPORT, JAMES BROMILEY

FUND MANAGER'S REPORT

1. PURPOSE OF THE REPORT

- 1.1 To inform Members how the Investment Advice recommendations are being implemented.
- 1.2 To provide information with regard to stock selection strategies, including a detailed report on transactions undertaken.

2. RECOMMENDATION

- 2.1 That Members note the report and pass any comments.

3. FINANCIAL IMPLICATIONS

- 3.1 Decisions taken by Members, in light of information contained within this report, will have an impact on the performance of the Fund.

4. IMPLEMENTATION OF INVESTMENT ADVICE FOR THE PERIOD JANUARY – MARCH 2018.

- 4.1 The Fund continues to favour growth assets over protection assets. It is considered that in the long run, Bond yields will rise, but at present and while central bank intervene in the Bond markets, through quantitative easing, yields do not meet the actuarial requirements for the Fund and should continue to be avoided at around these levels unless they are held as a short term alternative to cash.
- 4.2 Cash has built up as divestments from other asset classes have occurred, and is primed to be invested when opportunities allow. It is always preferential for cash to be invested in higher returning assets, but at this time high cash levels can assist in protecting the Fund, as a diversifier, from Equity market downturns. However, at the current level of 13%, cash should not rise too much further in the short term to above the maximum short term level set at the customised benchmark for protection assets (15%). It is accepted that if the value of other asset classes fall, particularly Equities, there is a possibility that the short term cash level will rise over the maximum set below.
- 4.3 Equity markets have been volatile, with additional volatility in currency markets, which have recently been beneficial to the Fund with its high weighting in this asset class. The short

term allocation strategy and range provide flexibility to continue and either increase or decrease investments when market opportunities arise.

- 4.4 Investment in direct property to continue on the same basis as previously presented to the Panel; on an opportunistic basis where the property has a good covenant, yield and lease terms.
- 4.5 Investment in Alternatives, such as general and local infrastructure and private equity, offer the Fund diversification from equities and bonds. They come with additional risks of being illiquid, traditionally they have costly management fees and investment in the type of investment can be a slow process. However, the Fund is considerably underweight its customised benchmark and, providing suitable investment opportunities are available, the Fund should look to increase its allocation to this asset class up to the customised benchmark level.
- 4.6 Summary of Equity Returns in this Period

Asset Class	Percentage Return
UK Equity (FTSE All Share)	-6.9%
US Equity (S&P 500)	-4.3%
Japanese Equity (Topix 500)	-4.5%
Pacific Equity (MSCI Asia X Japan)	-4.0%
European Equity (Stoxx 600)	-4.5%

Source: Portfolio Evaluation Limited

5. TRANSACTION REPORT

- 5.1 It is a requirement that all transactions undertaken are reported to the Investment Panel. Appendix A details transactions from the period 1 January 2018 to 31 March 2018.
- 5.2 There were net sales of approximately £46m in the period, this compares to net purchases of £26m in the previous reporting period. Cash balances increased to £503m from £462m, representing 13% of the Fund's investments.

Our observations by performance driver are as follows:

(i) Bonds

After moves by the MPC finally doubled the Bank of England base rate in November, from its historic low of 0.25% to 0.50%, the market and expectations took a pause to digest what happens next. UK inflation has stayed stubbornly above target, with retail prices peaking above 4%. The evidence is strong that price stability is a low priority with central bank policymakers, at least for now. UK Gilts ended up where they started, with the long run negative real return still intact.

US rates continued to push higher, with long yields reconnecting with 3% yield. Market participants remain concerned that bodes badly for a still fragile debt ecosystem.

(ii) Equity Markets

Equity Markets had a tough start to the year. In January news that the US was set to impose trade tariffs in multiple markets, was difficult news to swallow. Whilst many participants viewed this development as a negotiating ploy or gambit, the degree of uncertainty it presented encouraged investors to take risk off the table.

It was however an unusual 'risk off' scenario, where strength in Oil prices elevated the inflation threat risks. Holding bonds as a risk free asset looked just as precarious. To that end markets were very much a hostage to geopolitics and the actions of the US president.

The Fund continued to reduce exposure to equity at a stock specific level. The bulk of transactions, reflected the transfer of Asian securities into index investments.

(iii) Currency Effects

Sterling returns edged forward both against our primary exposures to US dollar and Euro. As an unhedged portfolio, this weighed against our assets contributing to a decline of 2-3% against the respective currencies.

6. FUND VALUATION

- 6.1 The Fund Valuation details all the investments of the Fund as at 31st March 2018, and is prepared by the Fund's custodian, BNP. The total value of all investments, including cash, is **£3,900 million**. The detailed valuation is available on the Fund's website www.teespen.org.uk. This compares with the last reported valuation, as at 31st December 2017 of **£4,074 million**.
- 6.2 An analysis of the summary valuation shows the Fund's percentage weightings in the various asset classes, compared with the Fund's customised benchmark and the advisors short term asset allocation range.

Asset Allocation Summary

ASSET CLASS	FUND	INVESTMENT ADVISORS' SHORT TERM ASSET ALLOCATION RANGE	CUSTOMISED BENCHMARK	AVERAGE*
PROTECTION ASSETS				
BONDS	0	0 – 7½	12	15
CASH	13	5 – 15	3	2
GROWTH ASSETS				
UK EQUITY	30	27 – 33	30	62
OVERSEAS EQUITY	47	43 – 49	40	
ILLIQUID ASSETS				
PROPERTY	8	7 – 10	10	8
ALTERNATIVES	2	1½ – 5	5	10
DIVERSIFIED GROWTH	0	0	0	3
TOTAL	100		100	100

**Average Local Authority Fund as at the last available date data is available (31 March 2017)*

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