

TEESSIDE PENSION FUND

Administered by Middlesbrough Council

AGENDA ITEM 4

TEESSIDE PENSION FUND REPORT

19 SEPTEMBER 2018

STRATEGIC DIRECTOR: FINANCE, GOVERNANCE AND SUPPORT, JAMES BROMILEY

INVESTMENT ACTIVITY 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 APRIL – JUNE 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 to 18% due to divestments from Pacific Equity, the Fund will look to use this cash to move away from its overweight position in equities and invest further in Alternatives. It was agreed at the June Committee that the controlled reduction of equities into cash would continue over the next quarter with an upper target cash level of £800 million (20% of the Fund). It is accepted that if the value of other asset classes fall, particularly Equities, there is a possibility that the short term cash level can 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 Apr 18 – June 18 | Percentage Return July 17 – June 18 |
|------------------------------------|---------------------------------------|--|
| UK Equity (FTSE All Share) | 9.1% | 7.7% |
| US Equity (S&P 500) | 10.4% | 14.9% |
| Japanese Equity (Topix 500) | 3.2% | 6.4% |
| Pacific Equity (MSCI Asia X Japan) | 2.7% | -3.2% |
| European Equity (Stoxx 600) | 3.7% | 3.0% |

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 April 2018 – 30 June 2018.
- 5.2 There were net sales of approximately £199m in the period, this compares to net sales of £46m in the previous reporting period. Cash balances increased to £723m from £503m, representing 18% of the Fund's investments.

Our observations by performance driver are as follows:

(i) Bonds

UK bond rates still remain well below the Retail Price Index, giving negative real returns, without any signs of reversal of this situation. Movements in the quarter show that, apart from predicting the August rate movement, the market is assuming lower rates in the medium term.

The rates in the US picked up in the quarter with the recovering economy. Rates are now above 2½% for 2 year bonds, and longer.

(ii) Equity Markets

Brexit still dominates UK news flow, in May, the House of Commons defeated an attempt to give Parliament a decisive say in the course of events if MPs rejected the deal or the UK/EU could not reach agreement.

In US news, trade tariffs were implemented on steel and aluminium imports from Canada, Mexico and the EU. Those countries targeted immediately responded with retaliatory tariffs of their own leading to short term volatile market moves. Further tariffs, including £200bn aimed at China have been proposed by the US.

The Fund continued to reduce exposure to equity at a stock specific level prior to the transfer of the remaining equity portfolios. The bulk of transactions reflected the sale of Asian equities that could not be transferred directly into passive funds.

(iii) Currency Effects

Due To Brexit uncertainty and UK economic weakness, sterling fell more than 6% in the quarter against the dollar, this was a reversal of all the gains that it had made over the prior 7 months.

6. FUND VALUATION

- 6.1 The Fund Valuation details all the investments of the Fund as at 30th June 2018, and is prepared by the Fund's custodian, BNP. The total value of all investments, including cash, is **£4,096 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 March 2018 of **£3,900 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 | 18 | 5 – 20 | 3 | 2 |
| GROWTH ASSETS | | | | |
| UK EQUITY | 31 | 25 – 32 | 30 | 62 |
| OVERSEAS EQUITY | 42 | 42 – 50 | 40 | |
| ILLIQUID ASSETS | | | | |
| PROPERTY | 8 | 7 – 10 | 10 | 8 |
| ALTERNATIVES | 1 | 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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