



Teesside Pension Fund Quarterly Investment Report - Q4 2018

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Note

1) Border to Coast

Executive Summary

Overall Value of Teesside Pension Fund

Value at start of the quarter	£1,238,911,401
Inflows	£100,000,000
Outflows	£0
Net Inflows / Outflows	£100,000,000
Realised / Unrealised gain or loss	£(131,172,760)
Value at end of the quarter	£1,207,738,640

The Teesside Pension Fund made its initial investment of £50m in the Overseas Developed Equity Fund on 17 October 2018. A further investment of £50m was made into this Fund on 7 November.

Over the period to the end of Q4 2018 the return on the Overseas Developed Equity Fund was 0.94% below that of its benchmark. The UK Listed Equity Fund outperformed its benchmark by 0.12% over Q4.

Note

- 1) Source: Northern Trust
- 2) Performance start dates of 26/07/2018 for the UK Listed Equity Fund and 17/10/2018 for the Overseas Developed Equity Fund
- 3) Returns for periods greater than one year are annualised
- 4) Past performance is not an indication of future performance and the value of investments can fall as well as rise.

Portfolio Analysis - Teesside Pension Fund at 31 December 2018

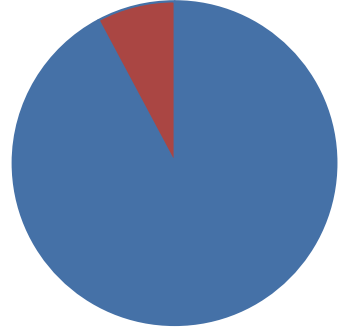
Funds Held

Fund	Market Index	Market Value (£)	Value (%)
Border to Coast UK Listed Equity	FTSE All Share GBP	1,113,549,022.27	92.20
Border to Coast Overseas Developed	40% S&P 500, 30% FTSE Developed Europe Ex UK, 20% FTSE Developed Asia Pacific ex Japan, 10% FTSE Japan	94,189,618.04	7.80

Available Fund Range

Fund
Border to Coast UK Listed Equity
Border to Coast Overseas Developed
Border to Coast Emerging Markets Equity
Border to Coast UK Listed Equity Alpha

Teesside Pension Fund - Fund Breakdown



Note

1) Source: Northern Trust

Portfolio Contribution - Teesside Pension Fund at 31 December 2018

Fund	Portfolio weight (%)	Fund return (net) over the quarter (%)	Benchmark return over the quarter (%)	Excess return (%)	Contribution to performance over the quarter (%)
Border to Coast UK Listed Equity Fund	92.20	(10.12)	(10.25)	0.12	(9.77)
Border to Coast Overseas Dev Markets Equity	7.80	(6.16)	(5.22)	(0.94)	(0.45)
Total	100.00	(10.22)			

The UK Listed Equity Fund returned -10.12% over the quarter, which was 0.12% ahead of the FTSE All Share Index. The Overseas Developed Markets Equity Fund returned -6.16% from Teesside's first investment on 17 October to the quarter end, which was 0.94% below its composite benchmark. Overall, Teesside's investments with Border to Coast returned -10.22% during Q4.

Note

1) Source: Northern Trust & Border to Coast

Valuation Summary at 31 December 2018

Fund	Market value at start of the quarter			Inflows (GBP)	Outflows (GBP)	Realised / unrealised gain or loss	Market value at end of the quarter		
	GBP (mid)	Total weight (%)	Strategy weight (%)				GBP (mid)	Total weight (%)	Strategy weight (%)
Border to Coast Overseas Developed Equity	0.00	0.00		100,000,000.00		(5,810,381.96)	94,189,618.04	7.80	
Border to Coast UK Listed Equity	1,238,911,400.54	100.00				(125,362,378.27)	1,113,549,022.27	92.20	
Total	1,238,911,400.54	100.00		100,000,000.00		(131,172,760.23)	1,207,738,640.31	100.00	

Note

1) Source: Northern Trust

2) Values do not always sum due to rounding

Summary of Performance - Funds (Net of Fees) Teesside Pension Fund at 31 December 2018

Fund	Inception to Date			Quarter to Date			1 Year			3 Years			5 Years		
	Fund	Index	Relative	Fund	Index	Relative	Fund	Index	Relative	Fund	Index	Relative	Fund	Index	Relative
Border to Coast UK Listed Equity Fund	(10.74)	(11.16)	0.42	(10.12)	(10.25)	0.12	--	--	--	--	--	--	--	--	--
Border to Coast Overseas Dev Markets	(9.37)	(8.97)	(0.41)	(11.29)	(10.65)	(0.64)	--	--	--	--	--	--	--	--	--

Note

- 1.) Source: Northern Trust
- 2.) Values do not always sum due to rounding
- 3.) Since inception returns are from the performance inception date of 26/07/2018 up to the end of the quarter.
- 4.) Performance is net of ACS charges such as depository and audit fees. Investment management fees have not been included in the performance
- 5.) Past performance is not an indication of future performance and the value of investments can fall as well as rise.

Summary of Performance - Funds (Gross of Fees) Teesside Pension Fund at 31 December 2018

Fund	Inception to Date			Quarter to Date			1 Year			3 Years			5 Years		
	Fund	Index	Relative	Fund	Index	Relative	Fund	Index	Relative	Fund	Index	Relative	Fund	Index	Relative
Border to Coast UK Listed Equity Fund	(10.73)	(11.16)	0.43	(10.12)	(10.25)	0.13	--	--	--	--	--	--	--	--	--
Border to Coast Overseas Dev Markets	(9.36)	(8.97)	(0.39)	(11.28)	(10.65)	(0.63)	--	--	--	--	--	--	--	--	--

Note

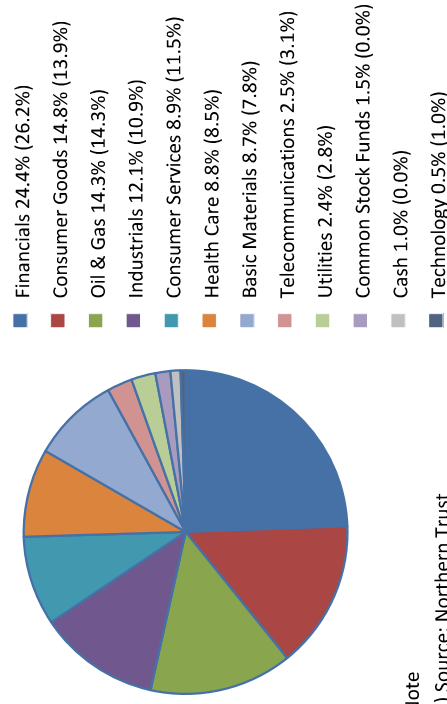
- 1.) Source: Northern Trust
- 2.) Values do not always sum due to rounding
- 3.) Since inception returns are from the performance inception date of 26/07/2018 up to the end of the quarter.
- 4.) The performance shown above does not include the costs of operating the ACS such as the investment management, depositary and audit fees.
- 5.) Past performance is not an indication of future performance and the value of investments can fall as well as rise.

Border To Coast UK Listed Equity Fund at 31 December 2018

Largest Relative Over/Underweight Sector Positions (%)

Common Stock Funds	+1.49
Industrials	+1.26
Basic Materials	+0.91
Consumer Goods	+0.86
Health Care	+0.31
Consumer Services	-2.60
Financials	-1.80
Telecommunications	-0.55
Technology	-0.49
Utilities	-0.36

Sector Portfolio Breakdown



Note

1) Source: Northern Trust

UK Listed Equity Fund

The Border to Coast UK Listed Equity Fund aims to provide a total return (income and capital) which outperforms the total return of the FTSE All Share Index by at least 1% per annum over rolling 3 year periods (before calculation of the management fee).

The majority of the Fund's performance will arise from stock selection decisions.

The Fund generated a total return of -10.12% during the quarter compared to -10.25% for the benchmark, resulting in 0.12% of out-performance.

Sector Weights:

Mutual Funds (+) – exposure to smaller companies and sector-specialist investments via collective vehicles.

Industrials (+) – diversified sector benefiting from increased global investment capital expenditure.

Basic Materials (+) – strong cash generation enabling significant debt reduction, increased shareholder distributions, and capital investment despite recent weakness in commodity prices.

Telecommunications (-) – increased regulatory pressure and significant capital expenditure requirement for full fibre rollout, 5G investment and spectrum costs expected to have a negative impact on returns.

Financials (-) – significant underweight in Banks due to concerns over UK consumer debt and Brexit uncertainty partly offset by overweight positions in Insurers and Wealth Managers as they are expected to benefit from increase in Asian and Emerging Market wealth.

Consumer Services (-) – high street expected to continue to suffer from pressure on UK consumer discretionary spending and high occupancy costs and remains structurally challenged by increased online penetration although online operators are not immune to a more cautious UK consumer.

Border To Coast UK Listed Equity Fund Attribution at 31 December 2018

Positive Stock Level Impacts

Fund	Portfolio weight (%)	Fund return (%)	Benchmark weight (%)	Benchmark return (%)	Contribution to performance (%)
British American Tobacco	2.22	(27.76)	2.72	(27.89)	0.12
BHP Group plc	2.50	(1.24)	1.64	(1.17)	0.09
Fresnillo	0.58	4.83	0.08	4.70	0.07
DS Smith	0.00	0.00	0.18	(36.15)	0.07
BAE Systems	0.35	(25.65)	0.70	(25.90)	0.07

British American Tobacco (underweight) under-performed due to a continued decline in sales of traditional tobacco products and a weak strategy for new generation products.

BHP Group plc (overweight) benefited from strong cash generation despite weaker commodity prices and shareholder returns were boosted by the sale of the US shale assets to BP in July.

Fresnillo (overweight) out-performed following a recovery in silver and gold prices during the quarter as investors sought safe haven assets in a turbulent period.

DS Smith (underweight) impacted by a weaker global packaging market as a result of increased capacity and a slowdown in demand.

BAE Systems (underweight) underperformed due to concerns over slower growth for US defence budgets post 2020 and potential delays to Saudi Eurofighter contract in view of current political issues.

Note

1) Source: Northern Trust & Border to Coast

Border To Coast UK Listed Equity Fund Attribution Continued at 31 December 2018

Negative Stock Level Impacts

Fund	Portfolio weight (%)	Fund return (%)	Benchmark weight (%)	Benchmark return (%)	Contribution to performance (%)
Cairn	0.39	(35.14)	0.04	(35.51)	(0.12)
Biotech Growth Trust	0.64	(23.47)	0.02	(23.55)	(0.11)
Prudential	2.51	(20.30)	1.73	(20.32)	(0.09)
Tullow Oil	0.42	(31.83)	0.12	(31.98)	(0.09)
Wood Group	0.41	(34.10)	0.16	(34.40)	(0.09)

Cairn (overweight) under-performed due to the sharp fall in oil prices during the quarter.

Biotech Growth Trust (overweight) under-performed due to general weakness in technology stocks and heightened political risk of adverse drug price legislation around US mid-term elections.

Prudential (overweight) under-performed due to weakening economic growth in Asia and Emerging Markets and the negative impact of rising US interest rates on Emerging Market fund flows.

Tullow Oil (overweight) and **Wood Group (overweight)** were impacted by the sharp fall in oil prices during the quarter.

Note

1) Source: Northern Trust & Border to Coast

Border To Coast UK Listed Equity Fund at 31 December 2018

Largest Relative Over/Underweight Stock Positions (%)

Intercontinental Hotels	+1.14
Antofagasta	+0.87
BHP Group plc	+0.87
Prudential	+0.78
Schroder UK Smaller	+0.74
Glencore	-1.58
BP	-0.89
Barclays	-0.61
British American Tobacco	-0.50
International Consolidated Airlines Group	-0.47

Top 5 Holdings Relative to Benchmark:

Intercontinental Hotels – operates a return-enhancing capital-light franchise model with significant US exposure and a substantial pipeline of capacity additions, particularly in Asia.

Antofagasta – attractive long term demand for copper despite recent headwinds and operating at the lower end of the cost curve.
BHP Group plc – diversified commodity exposure operating at the lower end of the cost curve with strong cash generation enabling debt reduction.

Prudential – exposure to long term wealth growth trends in Asia and Emerging Markets in addition to significant US exposure.

Schroder UK Smaller Companies Fund – good long-term performance, providing exposure to smaller companies.

Bottom 5 Holdings Relative to Benchmark:

Glencore – higher risk commodity company with significant operations in Democratic Republic of Congo (and risk of Department of Justice sanctions in relation to acquisition of assets) and a poor ESG score relative to peer group.

BP – preference for Royal Dutch Shell with its broader diversification across oil and gas and its exposure to LNG.

Barclays – preference for Asia-focused banks and some concerns regarding unsecured debt growth and ongoing litigation and Serious Fraud Office investigation.

British American Tobacco – traditional tobacco sales under pressure and a weak strategy for new generation products.

International Consolidated Airlines Group – poor record of through cycle returns and preference for short haul low cost carriers to capture long term growth in air travel.

Major transactions during the Quarter

Purchases:

Lloyds Bank (£18.5m) – reducing underweight to UK exposed banks as prospects of a “softer” Brexit increase.

Persimmon (£11.3m) – added following recent share price weakness, clarity on the Help to Buy programme in the long term, and reducing the portfolio underweight to UK domestic exposure.

GSK (£11.5m) – partial reinvestment of sale proceeds from Shire takeover into Pharmaceutical sector.

Sales:

Shire (£60.3m) – sale of holding following the agreed takeover by Takeda as the discount to the acquisition price narrowed.

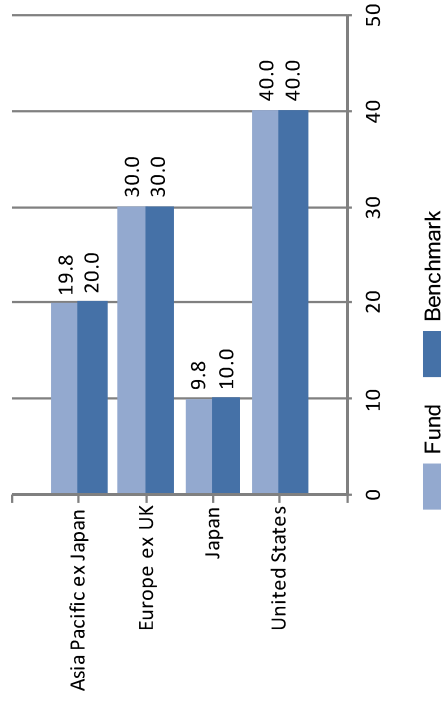
Invesco Perpetual Smaller Companies (£8.8m) – reduction in smaller company exposure through collective vehicles.

Note

1) Source: Northern Trust

Border To Coast Overseas Developed Markets Equity Fund at 31 December 2018

Regional Breakdown



Overseas Developed Markets Fund

The Border to Coast Overseas Developed Equity Fund aims to provide a total return (income and capital) which outperforms the total return of the Benchmark(*) by at least 1% per annum over rolling 3 year periods (before calculation of the management fee).

The Fund will not generally make active regional allocation decisions and the majority of its performance will arise from stock selection.

(*) The Benchmark is a composite of the following indices:

- 40% S&P 500
- 30% FTSE Developed Europe ex UK
- 20% FTSE Developed Asia Pacific ex Japan
- 10% FTSE Japan

The Fund generated a total return of -11.29% during the quarter compared to -10.65% for the composite benchmark resulting in 0.64% of under-performance. Pacific ex-Japan (-7.6%) was the strongest market in relative terms followed by Europe ex-UK (-11.0%), US (-11.5%), and Japan (-12.4%).

Sector Weights:

Mutual Funds (+) – exposure to smaller companies via collective vehicles, specifically in US and Europe.
Technology (+) – long-term structural growth drivers including Internet of Things, Artificial Intelligence, Electric/Autonomous vehicles, new generation memory chips, and change in software business models to long term subscription revenues.

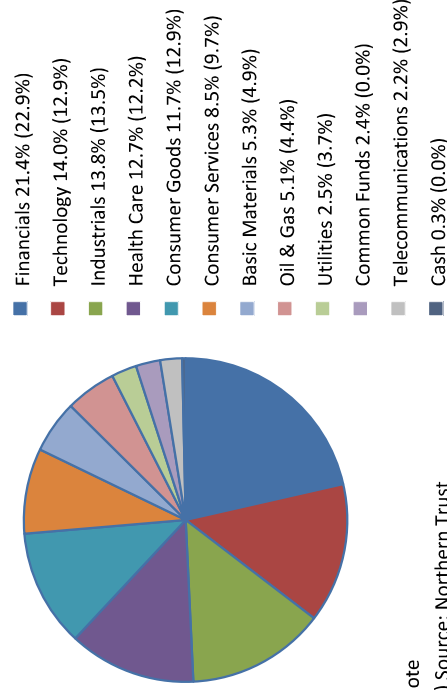
Oil and Gas (+) - despite lower energy prices, lower costs of production should support strong cash generation enabling significant debt reduction, increased shareholder distributions and capital investment.

Utilities (-) – impact of structural shift from coal-fired to renewable generation, increased regulation and capital investment, and government influence (particularly in Europe).

Consumer Services (-) – concerns over consumer spending; continuing structural shift to online retail; disintermediation in media space with digital delivery of content away from cable.

Financials (-) – significant underweight in Banks due to concerns over non-performing loans, legacy litigation issues, and the risk of increased regulation. Partly offset by overweight positions in Insurers and Wealth Managers, as they are expected to benefit from increase in investment wealth.

Sector Portfolio Breakdown



Note

1) Source: Northern Trust

Border To Coast Overseas Developed Markets Equity Fund Attribution at 31 December 2018

Positive Stock Level Impacts

Fund	Portfolio weight (%)	Fund return (%)	Benchmark weight (%)	Benchmark return (%)	Contribution to performance (%)
McDonald's Corp	0.61	9.27	0.26	9.35	0.06
Orange	0.49	5.98	0.16	5.98	0.05
Clorox	0.30	5.56	0.04	5.59	0.05
American Tower	0.33	11.99	0.13	12.07	0.04
Pfizer	0.84	2.14	0.48	2.20	0.04

McDonald's Corp (overweight) benefited from a rotation to defensive stocks and the expected operational benefits from the extensive store refurbishment investment programme.

Orange (overweight) out-performed due to its strong balance sheet, attractive yield, and defensive characteristics.

Clorox (overweight) benefited from a rotation to defensive stocks and has been able to successfully pass on price increases without a detrimental impact on sales volumes, in contrast to other consumer staples stocks.

American Tower (overweight) delivered strong results in the last quarter resulting in an increase in earnings estimates and provides defensive growth with the continued industry infrastructure investment from growth in mobile data and the roll-out of 5G technology.

Pfizer (overweight) benefited from an improved outlook for the product pipeline and reassurance that the company is not looking to engage in major M&A activity.

Note

1) Source: Northern Trust & Border to Coast

Border To Coast Overseas Developed Markets Equity Fund Attribution Continued at 31 December 2018

Negative Stock Level Impacts

Fund	Portfolio weight (%)	Fund return (%)	Benchmark weight (%)	Benchmark return (%)	Contribution to performance (%)
Activision Blizzard	0.24	(42.66)	0.07	(42.68)	(0.10)
Schroder European Smaller Companies Fund	0.38	(20.28)	0.00	0.00	(0.07)
Vanguard US Mid Cap ETF	1.94	(13.45)	0.00	0.00	(0.06)
Hess	0.13	(41.74)	0.02	(41.78)	(0.06)
Wirecard	0.32	(28.32)	0.09	(28.32)	(0.06)

Activision Blizzard (overweight) under-performed due to the rotation away from momentum and growth companies with high valuations into defensive companies with lower valuations, as well as a slowdown in in-game purchases, weaker than expected sales from a new title and a further product delay.

Schroder European Smaller Companies (overweight) significantly under-performed due to the relative weakness of smaller companies in general and technology companies in particular.

Vanguard Mid-Cap ETF (overweight) under-performed due to relative weakness in smaller companies. The portfolio has an overall under-weight position to smaller companies and so benefited from this relative weakness.

Hess (overweight) under-performed due to the sharp fall in oil prices during the quarter.

Wirecard (overweight) under-performed due to the global sell off in technology stocks due to a sharp rotation away from highly valued, high growth momentum stocks.

Note

1) Source: Northern Trust & Border to Coast

Border To Coast Overseas Developed Markets Equity Fund at 31 December 2018

Largest Relative Over/Underweight Stock Positions (%)

Vanguard US Mid Cap ETF	+1.94
Alphabet A	+0.60
Samsung Electronics	+0.44
JP Morgan European Smaller Companies	+0.42
NN Group	+0.41
Alphabet C	-0.61
Mastercard	-0.33
PepsiCo	-0.30
Comcast	-0.29
Walmart	-0.25

Top 5 Holdings Relative to Benchmark:

Vanguard MidCap ETF – provides exposure to the smaller companies in the US index.

Alphabet A share – zero holding in the non-voting C share resulting in broadly neutral net exposure to Alphabet overall.

Samsung Electronics – diversified portfolio, strong balance sheet, potential for increased shareholder returns, and low relative valuation notwithstanding short term issues in the smartphone market and DRAM chip pricing.

JP Morgan European Smaller Companies Fund – provides relatively defensive exposure to smaller companies in Europe with weighting likely to be reduced.

NN Group – synergies being generated from recent acquisition of domestic insurance competitor Delta Lloyd.

Bottom 5 Holdings Relative to Benchmark:

Alphabet C share (non-voting) – exposure in A share resulting in broadly neutral net exposure to Alphabet overall.

Mastercard – preference for Visa, the other global payment network company, due to relative valuation.

PepsiCo – structural risks of consumers moving away from carbonated sugary drinks not reflected in current valuation.

Comcast – sub-scale studio business and growth in traditional broadband service constrained due to already high penetration rates and increased competition in fast fibre and 5G wireless.

Walmart – relatively high valuation, weak trading environment, and risks around growth in online offering.

Note

1) Source: Northern Trust

Market Background at 31 December 2018

Global economic growth prospects continue to be relatively weak and leading indicators suggest that there is unlikely to be a rebound in activity in the short term. Whilst economic growth in the US has weakened somewhat a recession does not look imminent and the Federal Reserve have been quick to signal that interest rate rises may be put on hold in 2019. Market expectations are currently for rates to remain unchanged in 2019, a significant change from just a few months ago when they were expected to rise by around 1%.

Europe has also felt the effects of the trade dispute, as well as the impact of tighter auto emissions standards which had a significant negative impact on industrial activity in Q4. The UK continues to be impacted by the uncertainty around Brexit and the lack of a political solution with only a few weeks before the official leaving date, although this may need to be extended. Developed Asia will always be impacted by its proximity to China but there are also domestic pressures including a housing market slowdown in Australia, unsustainable property prices in Hong Kong and the potential impact of a forthcoming sales tax rise in Japan.

Whilst monetary policy remains relatively loose it is beginning to tighten. Even if the US does not raise interest rates further liquidity is still being removed from the economy. The pace of monetary easing is also being reduced in Europe and Japan, even if monetary conditions remain accommodative. The key concern is that there is insufficient room for central banks to use monetary policy to stimulate economies in the event of a recession as interest rates are not high enough to enable cuts to have an impact and further quantitative easing risks merely boosting asset prices rather than the real economy. Due to high rates of government debt it is unlikely that fiscal policy can be used to stimulate economic growth.

Emerging Markets have stabilised over recent months following significant volatility earlier in 2018. Higher interest rates have stabilised markets in Argentina and Turkey and there appears to be no evidence of contagion to other emerging economies which are performing relatively well. The main imponderable is China which continues to be impacted by the ongoing trade dispute with the US - although recent developments have been more positive - and deleveraging both from consumers and businesses. There are also doubts as to whether the government can stimulate growth to the same extent that it has in the past.

There has been a sharp reduction in risk assets during the quarter with global equity markets (MSCI ACWI) falling by 10.6% as investor sentiment abruptly turned, although there was a marked difference with Emerging Markets (-5.5%) reversing the under-performance of the previous quarter relative to developed markets (-11.3%). The equity market correction has been driven by (unsustainably) high valuations, weaker earnings expectations, a sharp fall in oil prices, and a reduction in risk appetite with a noticeable rotation away from highly valued momentum stocks, particularly in Technology, into more defensive, value-oriented stocks. The correction is perhaps unsurprising given the length of the global economic recovery and the magnitude of the appreciation of risk assets. Typically, at this stage in the market cycle there is likely to be increased volatility as some market participants will consider this to be a buying opportunity, although it could end up being a value trap.

Note

1) Source: Border to Coast

Border to Coast News

Annual Conference:

- The Border to Annual Conference was held on the 8th and 9th of November with over 100 Elected Members, Board members and Officers in attendance. Key topics covered included responsible investment, transition management, future fund launches and the upcoming Actuarial Valuation of the LGPS in March 2019. There was also the opportunity for Partner Funds to collaborate during the conference including a session sharing and exchanging views on future investment strategy.
- The event was well received (88% of attendees providing feedback rated the event as either excellent or very good). Planning is already underway for the 2019 event, any ideas or suggestions for content are welcomed.

People:

- Paul Campbell joined Border to Coast in Q4 as a Property Portfolio Manager. Paul brings extensive experience from his time as Head of Pensions at Teesside. Paul will be working closely with Partner Funds to design and, subject to the usual approvals, launch a solution to the complex question of pooling property.
- We also were delighted to confirm the permanent appointment of Graham Long as our Head of External Investment Management Capabilities. Graham had been operating in an interim capacity during 2018 and his appointment followed a robust process including external candidates.

Investment Funds:

- The UK Listed Equity Alpha Fund launched in November with underlying assets now being managed by Janus Henderson, Baillie Gifford and UBS Asset Management. This was the first Border to Coast ACS sub-fund that makes use of external managers to manage assets. The initial investors in this fund were Surrey, Tyne and Wear and Warwickshire.
- The work towards the launch of the Global Equity Alpha Fund is progressing well. Throughout the quarter there was strong collaboration between Partner Funds and Border to Coast on the design of the ACS sub-fund that will best deliver the required Partner Fund objectives.

- We held a session with over 100 asset managers in December ahead of issuing our Request for Proposals on the investment mandates that will support this sub-fund. Many thanks to those Pensions Committees who have given their indicative support, enabling us to indicate likely mandate sizes to the market. This will help us to deliver value for money as well as continue to build on our collective reputation in the external market for being an LGPS pool which is seen as a substantial and dependable professional investor.
- Significant progress has also been made on the Alternatives structure. The draft shareholder resolution has been submitted to Partner Funds' legal advisors for review and, pending Shareholder and Board approval, is on track for launch in Q2 2019.

Responsible Investment:

- Following engagement with Partner Fund Officers and third-parties, in November the updated Responsible Investment Policy and Corporate Voting Guidelines began their governance journey to approval. These important documents have been updated to reflect global governance trends with key areas including board evaluation, stakeholder engagement, virtual shareholder meetings, shareholder proposals and share blocking. Other amendments were made to reflect global variations in best practice and cover board composition, diversity and remuneration.

Disclosures

Border to Coast Pensions Partnership Ltd is authorised and regulated by the Financial Conduct Authority (FRN 800511). Registered in England (Registration number 10795539) at the office 5th Floor, Toronto Square, Leeds, LS1 2HU

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