Agenda Item No. 4(a)

DERBYSHIRE COUNTY COUNCIL

PENSIONS AND INVESTMENTS COMMITTEE

11 June 2019

Report of the Director of Finance & ICT

INVESTMENT REPORT

1 Purpose of the Report

To review the Fund's asset allocation, investment activity since the last meeting, long term performance analysis and to seek approval for the investment strategy in the light of recommendations from the Director of Finance & ICT and the Fund's independent adviser.

2 Information and Analysis

(i) Report of the External Adviser

A copy of Mr Fletcher's report, incorporating his view on the global economic position, factual information for global market returns, the performance of the Fund and his recommendations on investment strategy and asset allocation, is attached as Appendix 1.

(ii) Asset Allocation and Recommendations Table

The Fund's latest asset allocation as at 30 April 2019 and the recommendations of the Director of Finance & ICT and Mr Fletcher, in relation to the Fund's new strategic asset allocation benchmark, which became effective on 1 January 2019, are shown in the table overleaf.

The table also shows the recommendations of the Director of Finance & ICT, adjusted to reflect the impact of future investment commitments. These commitments (existing plus any new commitments recommended in this report) relate to Private Equity, Multi-Asset Credit, Property and Infrastructure and total around £356m. Whilst the timing of drawdowns will be lumpy and difficult to predict, the In-house Investment Management Team (IIMT) believe that these are likely to occur over the next 18 to 36 months.

Asset Category	Old Benchmark	New Benchmark	Fund Allocation	Fund Allocation	Permitted Range	Benchmark Relative Recommendation		Recommendation		Adjusted for Commitments (1)	Benchmark Sterling Return	Benchmark Sterling Return
			31/1/19	30/4/19		AF 11/6/19	DPF 11/6/19	AF 11/6/19	DPF 11/6/19	DPF 11/6/19	3 Months to 31/3/19	3 Months to 30/4/19
Growth Assets	**62.0%**	**57.0%**	**57.9%**	**59.0%**	**+/- 8%**	**+2.0%**	**(0.1%)**	**59.0%**	**56.9%**	**58.9%**	**n/a**	**n/a**
UK Equities	25.0%	16.0%	17.9%	18.1%	+/- 4%	-	+1.0%	16.0%	17.0%	17.0%	9.4%	7.8%
Overseas Equities:	33.0%	37.0%	40.0%	38.1%	+/- 6%	+2.0%	+0.1%	39.0%	37.1%	37.1%	n/a	n/a
North America	12.0%	12.0%	10.9%	11.4%	+/- 4%	(2.0%)	(2.0%)	10.0%	10.0%	10.0%	11.3%	10.3%
Europe	9.0%	8.0%	9.8%	10.2%	+/- 3%	-	(0.5%)	8.0%	7.5%	7.5%	8.0%	9.1%
Japan	5.0%	5.0%	6.4%	6.4%	+/- 2%	+1.0%	+1.0%	6.0%	6.0%	6.0%	4.5%	3.0%
Pacific ex-Japan	4.0%	4.0%	5.1%	5.2%	+/- 2%	+1.0%	+1.2%	5.0%	5.2%	5.2%	8.6%	6.5%
Emerging Markets	3.0%	5.0%	5.0%	4.9%	+/- 2%	+2.0%	(0.1%)	7.0%	4.9%	4.9%	7.9%	5.4%
Global Sustainable	-	3.0%	-	-	+/- 2%	-	+0.5%	3.0%	3.5%	3.5%	9.6%	8.6%
Private Equity	4.0%	4.0%	2.8%	2.8%	+/- 2%	-	(1.2%)	4.0%	2.8%	4.8%	9.6%	8.0%
Income Assets	**18.0%**	**23.0%**	**15.9%**	**18.1%**	**+/- 6%**	-	**(3.5%)**	**23.0%**	**19.5%**	**24.0%**	**n/a**	**n/a**
Multi-Asset Credit	4.0%	6.0%	3.7%	4.5%	+/- 2%	-	(0.5%)	6.0%	5.5%	7.5%	1.0%	1.0%
Infrastructure	5.0%	8.0%	4.0%	5.7%	+/- 3%	-	(1.9%)	8.0%	6.1%	8.2%	0.7%	0.7%
Direct Property (3)	5.0%	5.0%	4.8%	4.6%	+/- 2%	+1.0%	(0.4%)	5.0%	4.6%	4.6%	0.3%	0.3% (2)
Indirect Property (3)	4.0%	4.0%	3.4%	3.3%	+/- 2%	(1.0%)	(0.7%)	4.0%	3.3%	3.7%	0.3%	0.3% (2)
Protection Assets	**18.0%**	**18.0%**	**17.5%**	**16.9%**	**+/- 5%**	**(2.0%)**	**(1.1%)**	**16.0%**	**16.9%**	**16.9%**	**n/a**	**n/a**
Conventional Bonds	5.5%	6.0%	5.7%	5.4%	+/- 2%	(1.0%)	(0.6%)	5.0%	5.4%	5.4%	3.4%	0.7%
Index-Linked Bonds	6.5%	6.0%	5.7%	5.6%	+/- 2%	(1.0%)	(0.4%)	5.0%	5.6%	5.6%	5.9%	3.8%
Corporate Bonds	6.0%	6.0%	6.1%	5.9%	+/- 2%	-	(0.1%)	6.0%	5.9%	5.9%	5.0%	2.6%
Cash	**2.0%**	**2.0%**	**8.7%**	**6.0%**	**0 – 8%**	**-**	**+4.7%**	**2.0%**	**6.7%**	**0.2%**	**0.1%**	**0.1%**

(1) Recommendation adjusted for investment commitments at 30 April 2019 and presumes all commitments are funded from cash.
(2) Benchmark Return for the three months to 31 March 2019.
(3) The maximum permitted range in respect of Property is +/- 3%.

The table above reflects the following three categorisations:

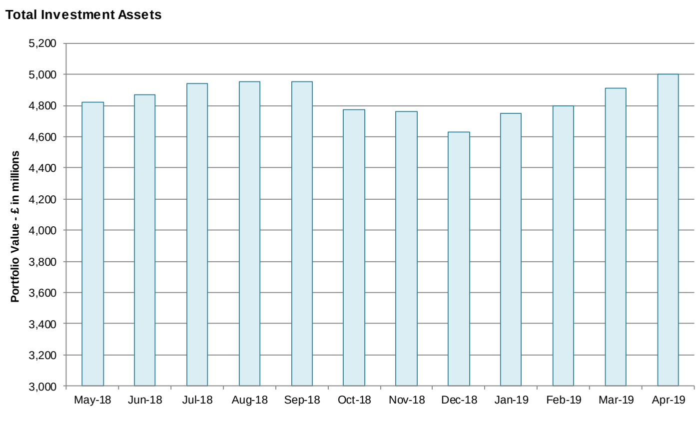
- **Growth Assets**: largely equities plus other volatile higher return assets such as private equity;
- **Income Assets**: assets which are designed to deliver an excess return, but with more stable return patterns than Growth Assets because income represents a large proportion of the total return of these assets; and
- **Protection Assets**: lower risk government or investment grade bonds.

Relative to the new benchmark, the Fund as at 30 April 2019, was overweight in Growth Assets and Cash, and underweight in Income Assets and Protection Assets.

If all of the Fund's commitments (existing plus any new commitments recommended in this report) were drawn-down, the cash balance would reduce by 5.8% to 0.2%. However, in practice as these commitments are drawn-down, they will be partly offset by new net cash inflows from dealing with members, investment income, distributions from existing investments and changes in the wider asset allocation.

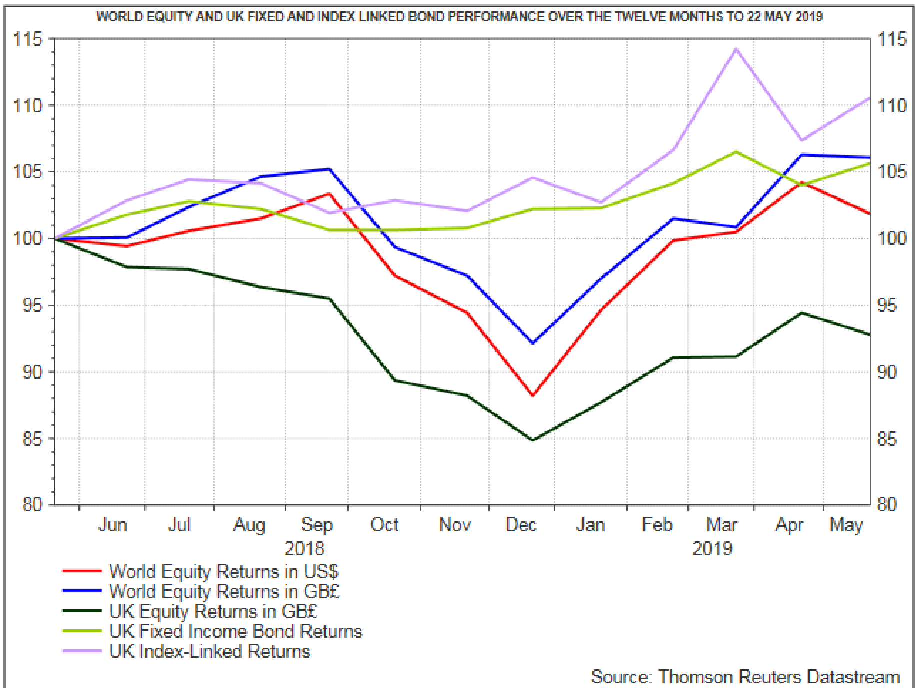
(iii) Total Investment Assets

The value of the Fund's investment assets rose by £253.5m (5.3%) between 31 January 2019 and 30 April 2019 to in excess of £5.0bn for the first time, comprising a non-cash market gain of around £230m, partly offset by cash inflows from dealing with members & investment income of around £20m. Over the twelve months to 30 April 2019, the value of the Fund's investment assets has risen by £249.2m (5.2%), comprising a non-cash market gain of around £135m, an unexpected advanced contribution payment of £25m and cash inflows from dealing with members & investment income of around £90m. A copy of the Fund's valuation is attached at Appendix 2.



The Fund's valuation can fluctuate significantly in the short term, reflecting market conditions and supports the Fund's strategy of focusing on the long term.

(iv) Market returns over the last 12 months



The chart above shows market returns for Global Equities in Sterling and the US dollar, UK Equities, UK Fixed Income and UK Index Linked bonds for the twelve months to 22 May 2019.

Global Equity markets generally rose between May and August 2018, reflecting robust US earnings growth and some easing in the trade tensions between the US and China, with returns for Sterling investors also benefiting from a stronger US$. Global Equity markets then sold-off sharply in Q4 2018, with the quarter recording a 10.5% fall in sterling terms. Investor confidence was impacted by a number of factors, including concerns over the sustainability of US economic growth; an indication from the US Federal Reserve that there was scope for further interest rate rises; worries over a slowdown in China; and fears of a global trade war.

Equity markets subsequently recovered strongly in Q1 2019, with the FTSE All World Equity Index returning +12.2% in US Dollar terms; +9.6% in Sterling terms. Whilst global economic data moderated in the quarter, optimism that trade relations between the US and China might improve, together with a more dovish tone from the US Federal Reserve, lifted equity markets. Although this optimism continued in April 2019 (FTSE World Equity Index up +3.4% in US Dollar terms; +3.4% in Sterling terms), equity market have been weaker in May 2019 (FTSE World Index down 4.4% in US Dollar terms between 1 May and 22 May 2019; down 1.6% in Sterling terms with the local currency impact partly been offset by a weaker GB£) as concerns about US – China trade relations resurfaced.

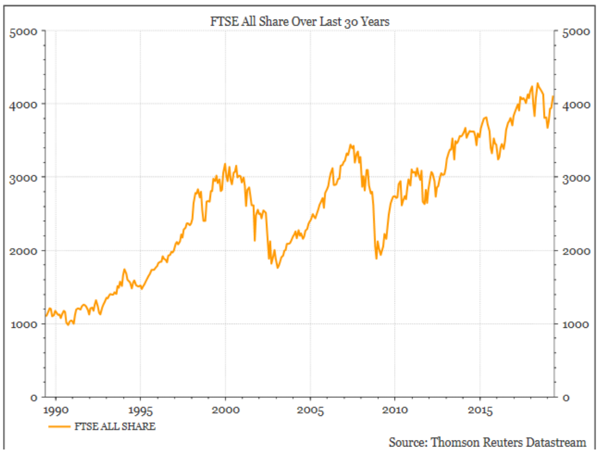
Bonds generally traded sideways between May and September 2018 before yields fell (i.e. prices rose) in Q4 2018, prompted by a general ‘‘risk-off’’ environment. Notwithstanding the recovery in equity markets in Q1 2019, 10 year government bond yields fell further over the quarter (UK -0.28%; US -0.28%; German -0.31%; and Japanese -0.08%) reflecting the impact of moderating economic data, which led central banks (including the US Federal Reserve) to push a more dovish policy stance. The US Federal Reserve removed its signal of interest rate rises for 2019, while the European Central Bank pushed its first forecast interest rate rise from the summer to the end of 2019. Politics also played a significant role, with continued uncertainty around US-China trade developments increasing demand for safe haven bonds. In the UK, government bond yields (gilts and index-linked bonds) also fell sharply in March 2019 in response to the Brexit impasse. UK index-linked bond yields were briefly impacted by uncertainty around the implications of a House of Lords inquiry into the way that the retail price index is calculated and index extensions, but the lack of progress on Brexit and in world trade talks dominated sentiment towards the asset class.

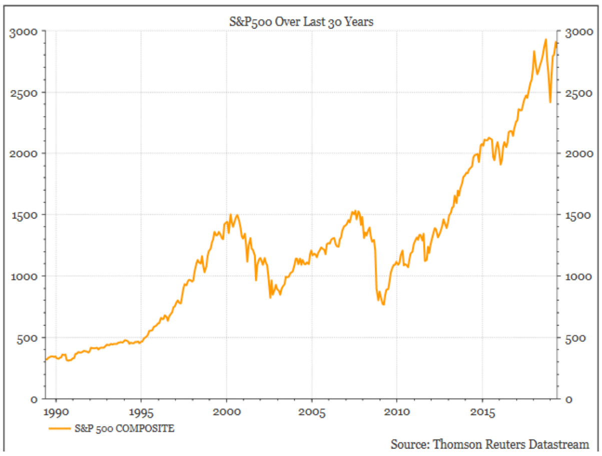
Corporate bond credit spreads narrowed over the quarter, with Sterling investment grade credit outperforming UK government bonds as dovish shifts from central banks contributed to the relative attractiveness of corporate debt relative to sovereign bonds.

UK 10 year government bond yields rose in April 2019 (i.e. prices fell) after the EU agreed to extend the article 50 deadline to 31 October 2019 (reducing the short term probability of a ‘‘no deal’’ exit from the EU), but fell again in May 2019, prompted by a general ‘‘risk-off’’ environment and continued political uncertainty. The announcement that Prime Minister May would be stepping down as leader of the Tory party on 7 June 2019 increased market forecasts of the probability of a “no deal” Brexit.

To put the fall in bond yields since September 2018 into context, the 10 year US Treasury yield has fallen by 74 basis points from 3.06% at 30 September 2018 to 2.32% at 24 May 2019, whereas the 10 year UK gilt yield has fallen by 63 basis points from 1.57% to 0.96% over the comparable period. Furthermore, it should be noted that the US yield curve ‘‘inverted’’ at the end of March 2019; this unusual situation, where short-dated bonds yield more than longer-dated bonds, is often seen as an indicator of a potential recession.

Asset class weightings and recommendations are based on values at the end of April 2019, and are relative to the new strategic asset allocation benchmark which will became effective on 1 January 2019. Many global stock markets are still trading close to all-time highs, despite the recent weakness in May 2019, and it should be noted that recent asset class returns (see charts below which show the long term performance of the FTSE All Share and S&P 500 Composite) remain well in excess of long term averages.





(v) Longer Term Performance

Figures provided by Portfolio Evaluation Limited show the Fund's performance over 1, 3, 5 and 10 years to 31 March 2019.

Per annum	DPF	Benchmark Index
1 year	5.6%	5.6%
3 year	10.1%	9.5%
5 year	8.4%	8.0%
10 year	10.5%	10.4%

The Fund performed in line with the benchmark over the last twelve months, and out-performed the benchmark over all other time periods.

(vi) Category Recommendations

	Old Benchmark	New Benchmark	Fund Allocation	Permitted Range	Recommendation		Benchmark Relative Recommendation	
			30 Apr-19		AF	DPF	AF	DPF
Growth Assets	62.0%	57.0%	59.0%	± 8%	59.0%	56.9%	+2.0%	(0.1%)
Income Assets	18.0%	23.0%	18.1%	± 6%	23.0%	19.5%	-	(3.5%)
Protection Assets	18.0%	18.0%	16.9%	± 5%	16.0%	16.9%	(2.0%)	(1.1%)
Cash	2.0%	2.0%	6.0%	0 – 8%	2.0%	6.7%	-	+4.7%

*Presumes all commitments are funded from cash

The new strategic asset allocation benchmark reflects a re-balancing of the Fund's assets from Growth Assets to Income Assets, and also introduces a new 3% allocation to Global Sustainable Equities.

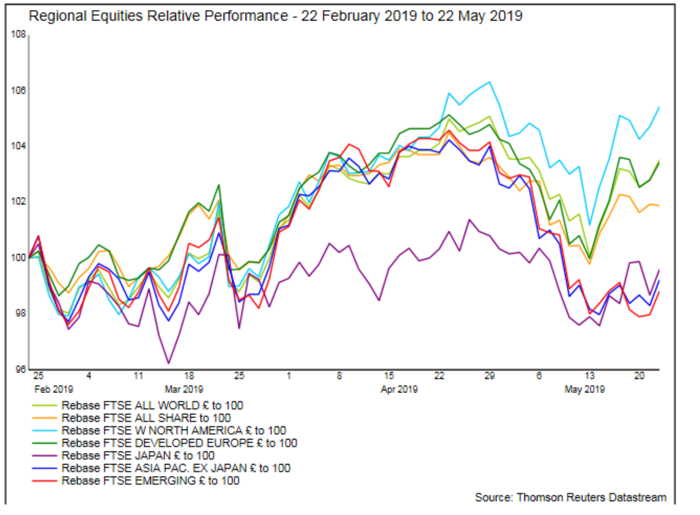
At an overall level, the Fund was overweight in Growth Assets at 30 April 2019, and underweight in Income Assets and Protection Assets, although if commitments waiting to be drawn down were taken into account, the Fund would move to a neutral position in Income Assets. The table on page 2 assumes that all new commitments will be funded out of the current cash weighting; in practice as private market commitments are drawn down they are likely to be funded partially out of cash and partially by distributions (income and capital) from existing investments and sales of public market assets. The Fund has progressively reduced its exposure to Growth Assets over the last two years, as equity valuations have become increasingly stretched, and increased the allocation to Income Assets and Protection Assets.

The IIMT recommendations reflected in this report, continue to build on this trend, with an additional 2.1% reduction in Growth Assets (UK Equities -1.1%; North American Equities -1.4%; European Equities -2.7%; Japanese Equities -0.4%; and Global Sustainable Equities +3.5%), a 1.4% increase in Income Assets (Multi-Asset Credit +1.0% and Infrastructure +0.4%), and a 0.7% increase in cash. The IIMT note that the recommendations are subject to market conditions, which could be significantly impacted in the short term by Brexit uncertainty, and flexibility will be required to respond to the resultant market conditions. Furthermore, a proportion of the equity sales will be dependent on the investment of the proposed new 3.5% allocation to Global Sustainable Equities which is subject to the completion of satisfactory due diligence on several potential investment managers.

The IIMT continues to recommend a defensive cash allocation, believing that public markets continue to trade on rich valuations and appear too sanguine about the level of global political risk which has increased rather than diminished in recent months. Furthermore, as noted above, the cash weighting will be reduced as the Fund’s current commitments are drawn down.

(vii) Growth Assets

At 30 April 2019, the overall Growth Asset weighting was 59.0%, up from 57.9% at 31 January 2019, reflecting relative market strength. Net divestment in the period was minimal.



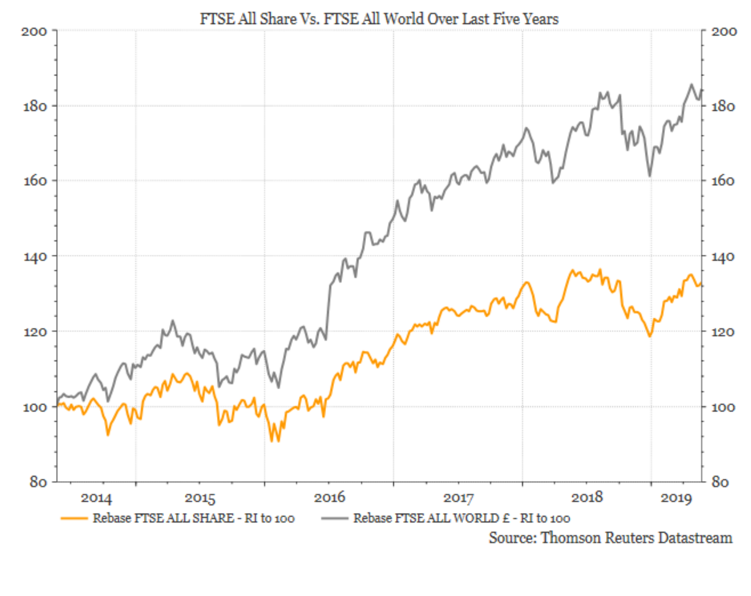
The IIMT recommendations below would reduce the overall Growth Asset weighting by 2.1% to 56.9%, 0.1% underweight relative to the benchmark. The IIMT believe that a small underweight position is warranted due to rich equity valuations, the increasingly late cycle nature of the global economy and the increased levels of market volatility.

The Chart opposite shows the relative regional equity returns since 22 February 2019. Global Equity markets returned +9.6% in Sterling terms in Q1 2019 (12.2% in local currency terms and the best quarter since 2012), and 11.5% in 2019 YTD (10.9% in local currency).

Q1 2019 returns were positive across all regions and reversed a decline of a similar magnitude in Q4 2018. In local currency terms, North American Equities were the best performer, returning 13.9%. Several other regions reported double-digit increases in local currency including European Equities (12.7%), Asia Pacific ex-Japan (11.1%) and Emerging Market Equities (10.4%). The worst performing major market was Japan with a Q1 2019 local currency return of 7.8% reflecting a the impact of a stronger ¥ on exports and weaker corporate earnings. Optimism that US – China trade relations might improve, together with a more dovish tone from the US Federal Reserve, lifted equity markets. Although this optimism continued in April 2019 (FTSE World Equity Index up 3.4% in Sterling terms), global equity market have been weaker in May 2019 (FTSE World Index down 1.6% in sterling terms) as concerns about US – China trade relations resurfaced.

United Kingdom Equities

DPF Weightings	
Old Neutral	25.0%
New Neutral	16.0%
Actual 30.4.19	17.9%
AF Recommendation	16.0%
IIMT Recommendation	17.0%
Benchmark Returns	
Q1 19/20 to date	0.4%
Q4 18/19	9.4%
1 Year	6.4%
3 Years (pa)	9.5%
5 Years (pa)	6.1%



Whilst there were minimal transactions in the period, relative market strength increased the weighting in UK Equities from 17.9% at 31 January 2019 to 18.1% at 30 April 2019; 2.1% overweight relative to the benchmark.

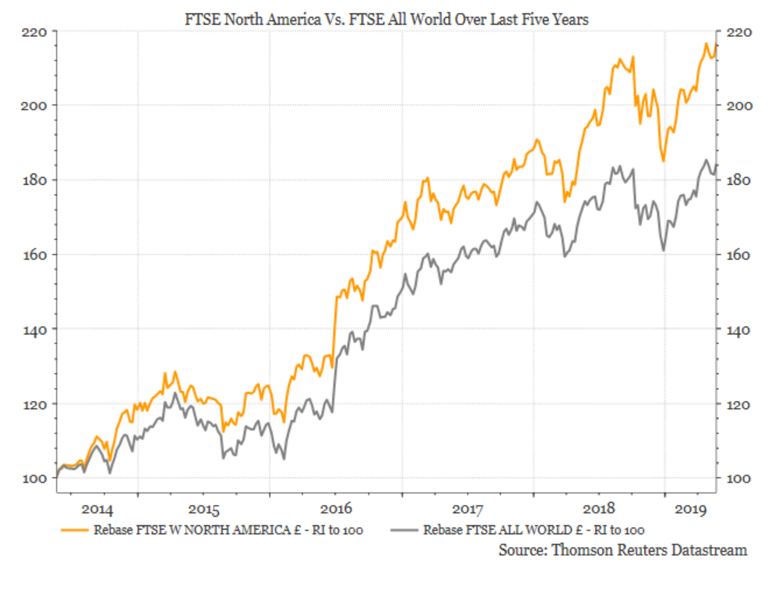
Mr Fletcher recommends a neutral weighting of 16% in UK Equities and notes that whilst progress is being made to bring the UK allocation down, this will take time.

UK GDP growth accelerated to 0.5% in Q1 2019 (1.8% on an annualised basis) from 0.2% in Q4 2018 (1.4% on an annualised basis) and the labour market remains relatively robust. However, political uncertainty has increased with the forthcoming election of a new leader for the Conservative Party further heightening uncertainty about the outcome of the Brexit negotiations. The IIMT believes that the current 2.1% overweight position relative to the new benchmark is difficult to justify against a background of continued Brexit induced market volatility. However, the IIMT recommends a 1.0% overweight position against the new benchmark (a 1.1% reduction of the current allocation) as UK equity valuations and dividend yields are attractive on both an absolute basis and on a relative basis compared to other equity markets.

The IIMT notes that the recommendation is subject to market conditions, which could be heavily impacted in the short term by Brexit developments and flexibility will be required to respond to the resultant market conditions.

North American Equities

DPF Weightings	
New Neutral	12.0%
Old Neutral	12.0%
Actual 30.4.19	11.4%
AF Recommendation	10.0%
IIMT Recommendation	10.0%
Benchmark Returns	
Q1 19/20 to date	2.8%
Q4 18/19	11.3%
1 Year	17.5%
3 Years (pa)	17.1%
5 Years (pa)	15.8%



There were no transactions in the three months to April 2019, but relative market strength increased the weighting to 11.4% at 31 January 2019, 0.6% underweight.

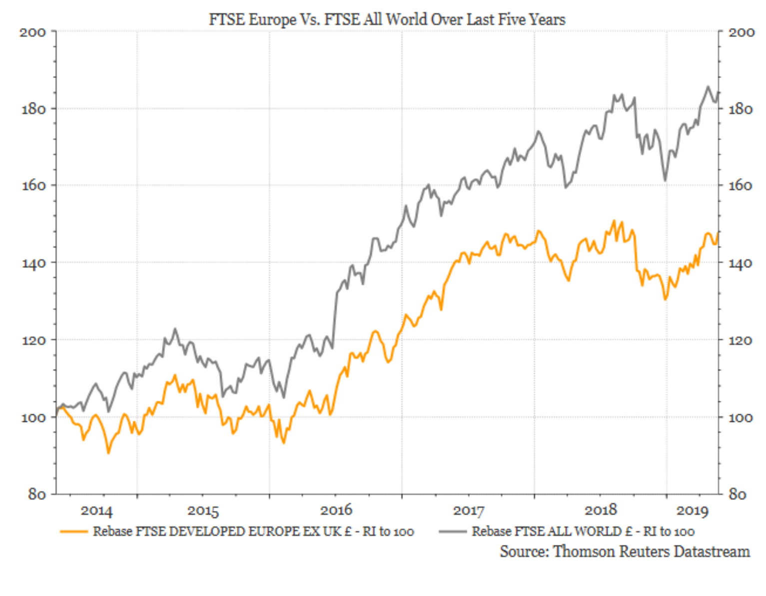
Mr Fletcher notes that because of the past strong performance of the US market on both an absolute and relative basis, and the relatively weaker future prospects, profits should be taken from the region. As a result, Mr Fletcher recommends that the weighting is reduced to 10% (2.0% underweight).

The IIMT concurs with Mr Fletcher and believe that whilst the US continues to show resilient economic (Q4 2019 annualised GDP growth of 3.2%) and employment (non-farm payrolls rose by 263,000 in April 2019) growth, supported by tax cuts, less regulation and the repatriation of cash, the economy is now late cycle and US equity valuations appear increasingly stretched. There is little room for earnings to disappoint on the downside and the increased tension in the on-going US – China trade negotiations has increased the already elevated political uncertainty.

The IIMT believes that the recent sharp rise in the US equity market following the weakness in Q4 2018 (+13.8% YTD in local currency terms, 14.4% in Sterling terms) represents an opportunity to ‘‘lock-in’’ in some profit, and recommends reducing the current weighting by 1.4% to 10.0%, a 2.0% underweight position.

European Equities

DPF Weightings	
Old Neutral	9.0%
New Neutral	8.0%
Actual 30.4.19	10.2%
AF Recommendation	8.0%
IIMT Recommendation	7.5%
Benchmark Returns	
Q1 19/20 to date	2.9%
Q4 18/19	8.0%
1 Year	2.7%
3 Years (pa)	11.0%
5 Years (pa)	7.0%



There were no transactions in the three months to April 2019, but relative market strength increased the weighting to 10.2% at 30 April 2019, 2.2% overweight against the benchmark.

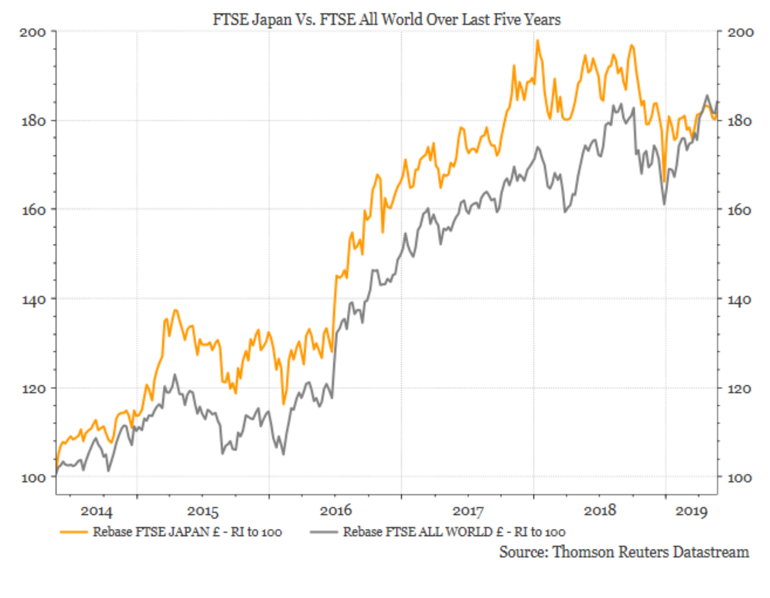
Mr Fletcher recommends a neutral position of 8%., noting that both the German and Italian economies returned to growth in Q1 2019, whereas France saw growth stagnate. Spain also saw its growth rate accelerate, helping to offset the weaker outcome for the Netherlands and Belgium whose economies were impacted by Brexit concerns. Mr Fletcher notes that because of the region’s reliance on exports, it could suffer if the US - China trade negotiations are not resolved amicably.

The IIMT recommends a 0.5% underweight allocation of 7.5% to European Equities. Whilst the European Central Bank continues to support the Eurozone economy via accommodative monetary policy, the Eurozone economy has slowed significantly over the last three quarters (albeit growth did pick-up to 0.4% in Q1 2019). Combined with on-going political uncertainty, demonstrated by the recent European Union parliamentary elections which saw the long-established centre-right and centre-left blocs increasingly lose their combined majorities, and with the potential impact caused by Brexit, these factors are likely to cause periods of heightened uncertainty and volatility.

Furthermore, sluggish inflation and the inability of the European Central Bank to increase interest rates from their current record lows, means that there is little flexibility to lower rates to stimulate growth should economic growth remain subdued.

Japanese Equities

DPF Weightings	
Old Neutral	5.0%
New Neutral	5.0%
Actual 30.4.19	6.4%
AF Recommendation	6.0%
IIMT Recommendation	6.0%
Benchmark Returns	
Q1 19/20 to date	0.6%
Q4 18/19	4.5%
1 Year	(0.9%)
3 Years (pa)	12.3%
5 Years (pa)	11.7%



There were no transactions in the three months to April 2019 and the weighting remained unchanged at 6.4%; 1.4% overweight against the benchmark.

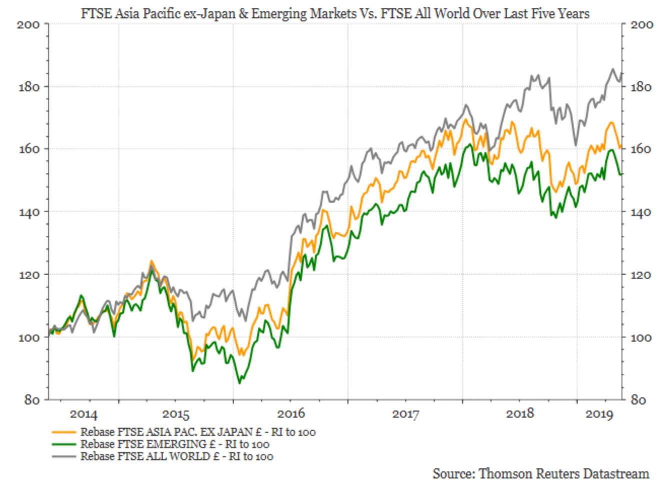
Mr Fletcher notes that whilst the Japanese market continues to disappoint, he likes its defensive characteristics and continues to recommend a 1% overweight allocation of 6%.

The IIMT notes that the Japanese economy continues to remain reasonably resilient (Q1 2019 GDP growth of 0.5%; 2.1% on an annualised basis), and this should allow Prime Minister Abe to press ahead with is on-going political and structural reforms. The IIMT believes that the long term story in Japan remains intact, with structural changes in governance, the labour market and productivity. Furthermore, valuations remain attractive relative both to their historical ranges and other developed markets, and the diversifying and defensive qualities of the Japanese market (e.g. the safe-haven status of the ¥) provide investment support.

However, the IIMT notes that Japanese corporate earnings have weakened and the strength of the Japanese ¥ may adversely impact on exports. Whilst an overweight position remains appropriate, the IIMT recommend that the allocation is reduced by 0.4% to 6.0%; 1.0% overweight overall.

Asia Pacific Ex-Japan and Emerging Market Equities

DPF Weightings	Asia-Pac	EM
Old Neutral	4.0%	3.0%
New Neutral	4.0%	5.0%
Actual 30.4.19	5.2%	4.9%
AF Recommendation	5.0%	7.0%
IIMT Recommendation	5.2%	4.9%
Benchmark Returns	**Asia-Pac**	**EM**
Q1 19/20 to date	(2.5%)	(3.2%)
Q4 18/19	8.6%	7.9%
1 Year	4.0%	1.9%
3 Years (pa)	14.7%	14.5%
5 Years (pa)	9.3%	9.8%



Relative market strength meant that the Fund's allocation to Asia Pacific Ex-Japan Equities increased to 5.2% at 30 April 2019 (1.2% overweight relative to the benchmark), whereas relative market weakness reduced the Emerging Market allocation to 4.9% (0.1% underweight relative to the benchmark).

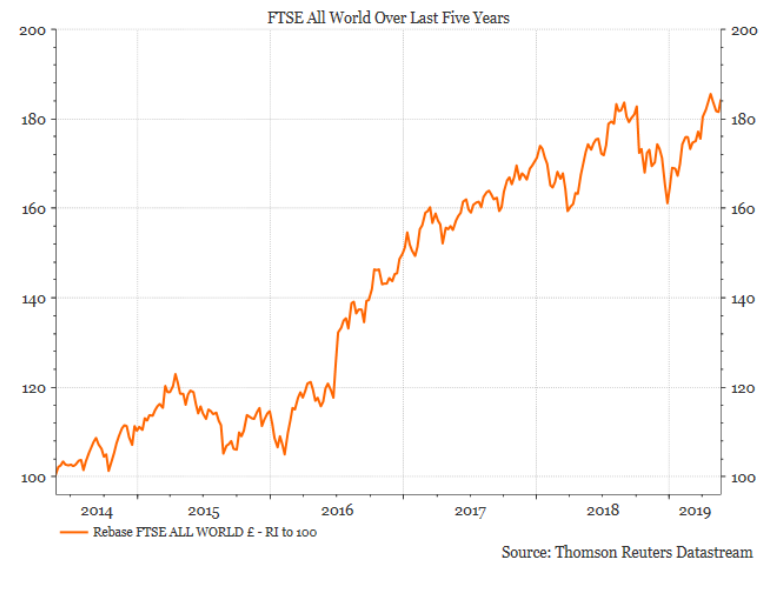
Mr Fletcher notes that the reasons for being overweight in these two markets remain unchanged (i.e. these economies represent a significant proportion of global growth and are growing, on average, roughly twice as fast as developed economies and have positive domestic macro fundamentals), and believes that both markets remain attractive on both a valuation and long term return basis. Mr Fletcher recommends a 1% overweight position in Asia Pacific Ex-Japan, and a 2% overweight position in Emerging Markets (i.e. 3% on a combined basis).

The IIMT continues to believe in the long term growth potential of these regions, but notes that the short-term outlook is less clear, and analysts' earnings forecasts for 2019 have been downgraded. There are signs of an economic slowdown driven by the threat of a global trade war, the strength of the US$ and concerns about a slow-down in the Chinese economy.

As a result, the IIMT recommends that the Fund maintains the Asia Pacific Ex-Japan weighting at 5.2% (1.1% overweight) and the Emerging Market weighting at 4.9% (0.1% underweight); 1.1% overweight on a combined basis.

Global Sustainable Equities

DPF Weightings	
Old Neutral	-
New Neutral	3.0%
Actual 30.4.19	-
AF Recommendation	3.0%
IIMT Recommendation	3.5%
Benchmark Returns	
Q1 19/20 to date	1.7%
Q4 18/19	9.6%
1 Year	10.7%
3 Years (pa)	14.9%
5 Years (pa)	12.5%



The new strategic asset allocation benchmark includes a 3% allocation to Global Sustainable Equities, and Mr Fletcher recommends a 3% neutral allocation. The Pensions and Investments Committee has recently approved the use a non-DCC framework to appoint two or three investment managers to manage the planned allocation on a discretionary basis and the IIMT is currently carrying out due diligence on the potential investment managers. The IIMT is positive about the long term growth prospects for the asset class and recommends a 0.5% overweight allocation of 3.5%, whilst noting that the completion of the necessary due diligence is likely to take several months and some flexibility will be required around the timing of any investment.

Private Equity

DPF Weighting					
Old New	New Neutral	Actual 30.4.19	Committed 30.4.19	AF Recommendation	IIMT Recommendation
4.0%	4.0%	2.8%	4.8%	4.0%	2.8%
Benchmark Returns					
Q1 19/20 to date	Q4 18/19	1 Year	3 Years (pa)	5 Years (pa)	
0.5%	9.6%	7.4%	10.5%	6.8%	

The Private Equity allocation remained unchanged between 31 January 2019 and 30 April 2019 at 2.8%; 4.8% on a committed basis.

Mr Fletcher recommends a neutral weighting of 4% in Private Equity. The IIMT continues to seek out opportunities which offer higher returns than public markets, including co-investment and secondary funds, and recommends that the current invested and committed weightings are maintained while opportunities are assessed.

The IIMT notes that private equity multiples have increased over the last few years, and are now approaching record highs, particularly in respect of large and mega cap deals. The IIMT believes that future commitments should be targeted towards small and mid-cap private equity managers, with a focus on investing in companies with strong secular trends, scalable business models (e.g. operational level and growth through bolt-on acquisitions), robust cash flows, and sustainable capital structures.

(viii) Income Assets

At 30 April 2019, the overall weighting in Income Assets was 18.1%. The IIMT recommendations below would take the overall Income Asset weighting to 19.5%, and the committed weighting to 24.0%.

Multi Asset Credit

DPF Weighting				
Old Neutral	New Neutral	Actual 30.4.19	AF Recommendation	IIMT Recommendation
4.0%	6.0%	4.5%	6.0%	4.5%
Benchmark Returns				
Q1 19/20 to date	Q4 18/19	1 Year	3 Years (pa)	5 Years (pa)
0.6%	1.0%	3.8%	n/a	n/a

Net investment of £47m (£40m in February; £5m in March; and £2m in April 2019) was partly offset by relative market weakness and the Fund’s weighting increased to 4.5% at 30 April 2019; 6.5% on a committed basis versus a neutral weight of 6%.

Mr Fletcher recommends a neutral 6% allocation to Multi-Asset Credit in order to increase the diversified opportunity set going forward. Mr Fletcher believes that investing in shorter duration sub-investment grade high-yield bonds and emerging market debt could protect the Fund from the potential scale of negative returns that gilts could experience should interest rates rise. He also believes that this lower interest rate risk, combined with the recent widening of credit spreads, has made these assets more attractive.

The IIMT continues to remain positive about the long-term attractions of this asset class, but notes that high yield bond yields have rallied strongly in YTD19 following a sharp ‘‘risk-off’’ fall in Q4 2018. The IIMT believes that the scope for further spread compression has reduced, and notes that some parts of the Multi-Asset Credit portfolio are likely to under-perform in a ‘‘risk-off’’ environment. The IIMT continues to prefer a bias towards defensive forms of credit (e.g. senior secured corporate or infrastructure debt with low default rates) with strong covenants, floating rate protection and a yield pick-up, whilst noting that both multiples and leverage are rising and investment needs to be supported by robust due diligence.

The IIMT recommends increasing the invested weighting by a further 1.0% to 5.5% in the upcoming quarter; 7.5% on a committed basis, albeit the IIMT notes that this recommendation should be subject to market conditions at the time. Whilst this implies the pension fund will be 1.5% overweight should all the commitments be drawn-down, in practice it is unlikely that the commitments will be fully drawn, and some of the existing closed-ended investments have now entered their distribution phase (i.e. returning cash to investors).

Property

DPF Weighting				
Old Neutral	New Neutral	Actual 30.4.19	AF Recommendation	IIMT Recommendation
9.0%	9.0%	7.9%	9.0%	7.9%
Benchmark Returns				
Q1 19/20 to date	Q4 18/19	1 Year	3 Years (pa)	5 Years (pa)
Not Available	0.3%	4.3%	6.0%	9.4%

There was no net investment in the period and relative market weakness reduced the weighting to 7.9% at 30 April 2019, with Direct Property accounting for 4.6% (0.4% underweight) and Indirect Property accounting for 3.3% (0.7% underweight). The committed weight was 8.3% at 30 April 2019.

Mr Fletcher notes that the property market continues to provide diversified returns for the Fund and that the Direct Property Manager has outperformed. Mr Fletcher continues to recommend a neutral overall allocation to Property, with a preference for a 1% overweight position in Direct Property and a 1% underweight in Indirect Property. Mr Fletcher recognises that it will take time to build the property allocation to a neutral position.

The IIMT recommends maintaining the current 4.8% allocation to Direct Property while the Property Manager continues to seek out attractive propositions, with a focus on those sectors with the best performance outlook (in particular the industrial sector), strong tenants and rent reviews linked to RPI & CPI. The IIMT continues to assess indirect property opportunities, with a focus on vehicles invested in specialist areas which provide strong covenants and sustainable rental growth. The IIMT recommends maintaining the Indirect Property weighting at 3.3% (3.7% on a committed basis), whilst actively investigating further investment opportunities in this asset class.

Infrastructure

DPF Weighting					
Old Neutral	New Netural	Actual 30.4.19	Committed 30.4.19	AF Recommendation	IIMT Recommendation
5.0%	8.0%	5.7%	8.2%	8.0%	6.1%
Benchmark Returns					
Q1 19/20 to date	Q4 18/19	1 Year	3 Years (pa)	5 Years (pa)	
0.5%	0.7%	2.8%	2.5%	2.0%	

Investment in the three months to April 2019 totalled £89m, and the invested weighting increased to 5.7%. The committed weight totalled 8.2% at 30 April 2019.

Mr Fletcher recommends a neutral weighting of 8% relative to the benchmark, acknowledging that this will take time to achieve.

The IIMT believes that Infrastructure is an attractive asset class, with a bias towards core infrastructure assets which offer favourable risk-adjusted returns, predictable long term cash flows which are often linked to inflation, and low correlation to other major asset classes. The IIMT continues to assess future investment opportunities in line with these objectives, and also recommends that rising levels of political and regulatory risk are managed through increased levels of geographical diversification.

The IIMT recommends increasing the invested weighting by 0.4% to 6.1% in the upcoming quarter, in anticipation of commitment draw-downs.

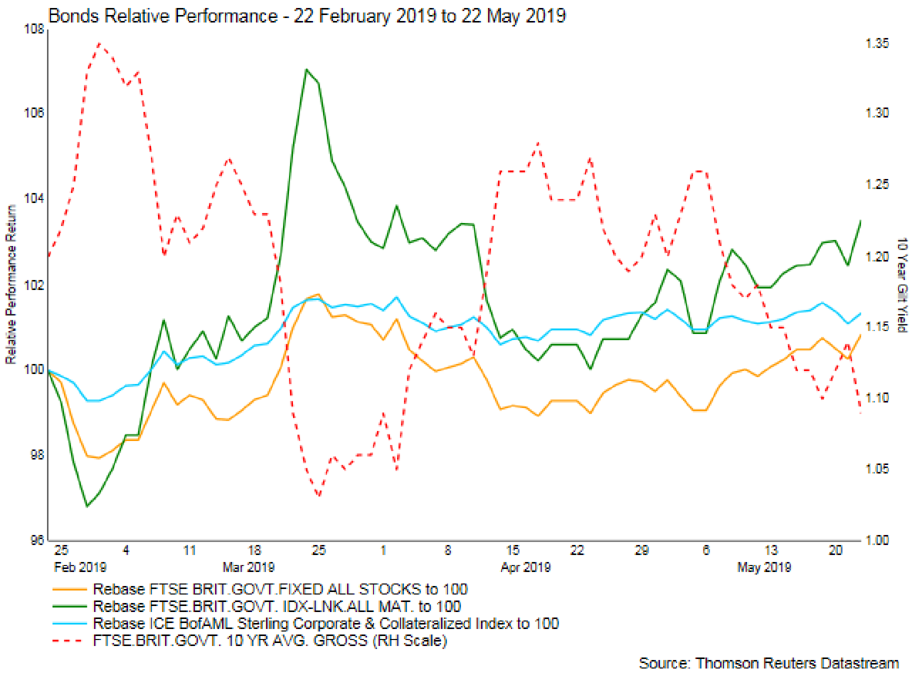
(ix) Protection Assets

The weighting in Protection Assets at 30 April 2019 was 16.9%, down from 17.5% at 31 January 2019, reflecting lower relative (albeit positive) market returns. There were no transactions in the period.

The IIMT recommendations below maintain the weighting at 16.9%.

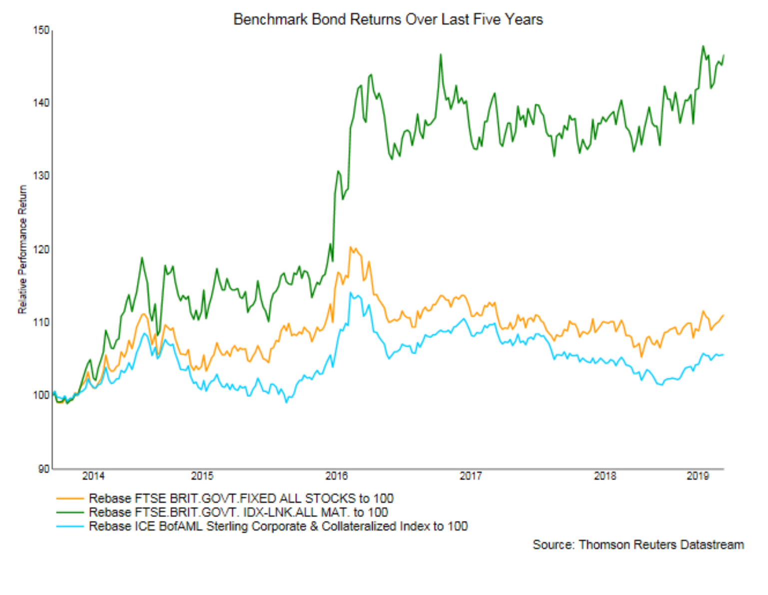
The Chart opposite shows the relative bond returns in respect of UK Conventional Bonds, UK Index-Linked Bonds and UK Corporate between 22 February 2019 and 22 May 2019.

UK 10 year government bond yields fell (i.e. price rose) sharply in March 2019 as uncertainty about the UK's departure from the EU intensified and the UK Government's Withdrawal Agreement failed to gain approval in the House of Commons. Yields subsequently rose in April 2019 after the EU agreed to extend the article 50 deadline to 31 October 2019; reducing the short term probability of a ''no deal'' exit from the EU but fell again in May 2019, prompted by a general ''risk-off'' environment and continued UK political uncertainty.



Conventional Bonds

DPF Weightings	
Old Neutral	5.5%
New Neutral	6.0%
Actual 30.4.19	5.4%
AF Recommendation	5.0%
IIMT Recommendation	5.4%
Benchmark Returns	
Q1 19/20 to date	0.5%
Q4 18/19	3.4%
1 Year	3.7%
3 Years (pa)	3.6%
5 Years (pa)	5.5%



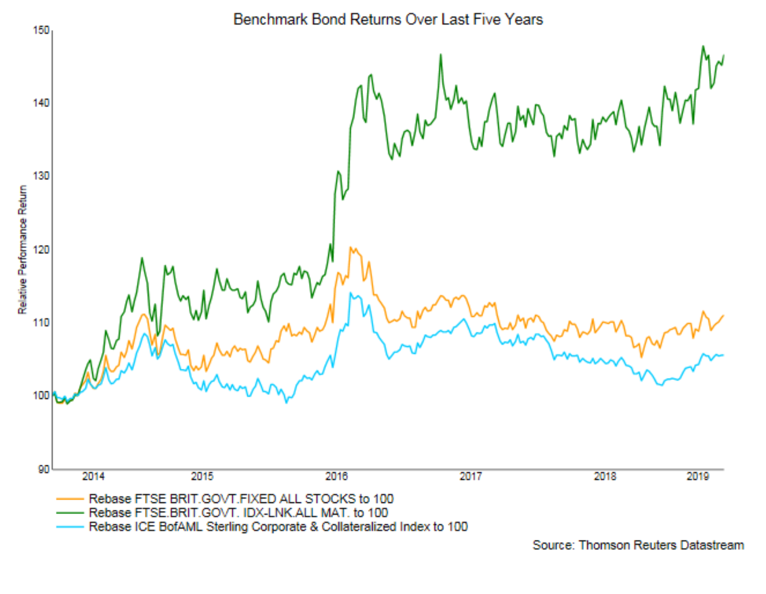
Whilst there were no transactions in the period, relative market weakness reduced the weighting in Conventional Bonds to 5.4% at 30 April 2019.

Mr Fletcher recommends a 1.0% underweight position of 5.0% against the benchmark. Mr Fletcher notes that fundamentally little has changed since the time of the last Committee with respect to this asset class. The global economy continues to grow at a reasonable pace and inflation appears benign. Equity markets have recovered and bond yields have fallen; the fall in bond yields has been helped by the US Federal Reserve deciding to pause monetary tightening and to make Quantitative Tightening data dependent. As a result, Mr Fletcher believes that the best of the news for bond markets is already priced into the current level of yields. Mr Fletcher finds it difficult to believe that government bond yields can fall further below their current levels over the medium term, nor that credit spreads will substantially narrow further. Whilst there is scope for volatility generated by economic data and the US – China trade negotiations, Mr Fletcher believes that by the end of the next twelve months bond yields will have drifted higher (lowering prices).

The IIMT agrees that conventional sovereign bonds do not appear to offer good value at current levels. However, they are diversifying assets and continue to afford greater protection than other asset classes in periods of market uncertainty – as demonstrated in the recent Q4 2018 global equity market sell-off and during periods of heightened Brexit uncertainty. The IIMT recommends maintaining the current weighting of 5.4%, 0.6% underweight relative to the benchmark.

Index-Linked Bonds

DPF Weightings	
Old Neutral	6.5%
New Neutral	6.0%
Actual 30.4.19	5.6%
AF Recommendation	5.0%
IIMT Recommendation	5.6%
Benchmark Returns	
Q1 19/20 to date	1.4%
Q4 18/19	5.9%
1 Year	5.5%
3 Years (pa)	8.3%
5 Years (pa)	8.9%



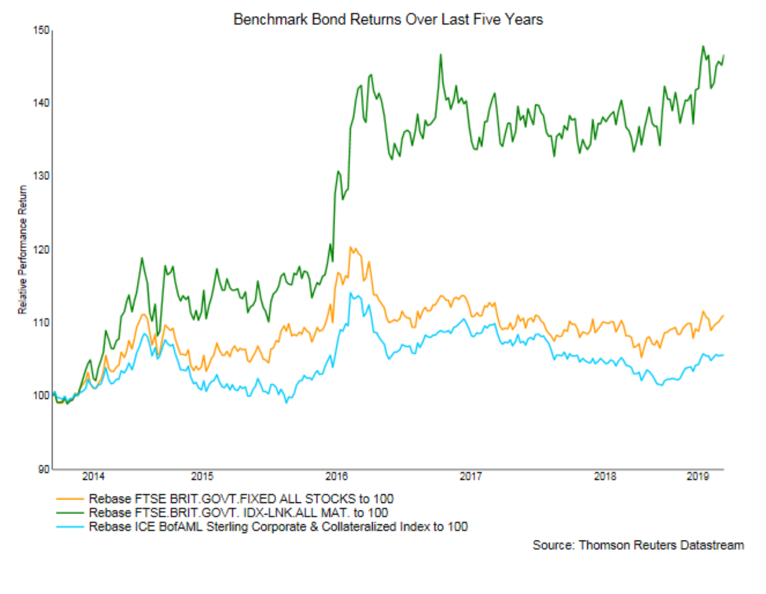
Relative market weakness reduced the weighting in Index Linked Bonds to 5.6% at 30 April 2019. There were no transactions in the period.

Mr Fletcher notes that UK Index-Linked gilts have now become even more expensive, and the long duration of these bonds increases the risk of adverse returns in a rising yield environment. Mr Fletcher believes that it is appropriate to be underweight in this asset class, and recommends a 1.0% underweight position of 5%, and that the Fund should continue to hold some US TIPS (US Index Linked Bonds) as well as UK Index Linked. Although Mr Fletcher notes that the cost of hedging the currency risk needs to be taken into consideration when investing in bonds outside the UK.

The IIMT agrees with Mr Fletcher regarding the current value of UK Index-Linked Bonds and recommends that the current 0.4% underweight position of 5.6% against the benchmark is maintained, with the current exposure to US TIPS (around 20% of the Index-Linked portfolio) being maintained due to the greater potential for price appreciation in US Index Linked Bonds.

Corporate Bonds

DPF Weightings	
Old Neutral	6.0%
New Neutral	6.0%
Actual 30.4.19	5.9%
AF Recommendation	6.0%
IIMT Recommendation	5.9%
Benchmark Returns	
Q1 19/20 to date	0.6%
Q4 18/19	5.0%
1 Year	4.0%
3 Years (pa)	5.5%
5 Years (pa)	6.0%



Whilst there were no transactions in the period, relative market weakness reduced the weighting in Corporate Bonds at 30 April 2019 to 5.9%; 0.1% underweight relative to the benchmark.

Mr Fletcher notes that the current outlook for the investment grade non-government bond market is uncertain. Spreads have narrowed on stronger equity markets and the perceived end of monetary tightening has provided a duration benefit. Mr Fletcher notes that should government bond yields rise, so will investment grade credit yields, albeit the shorter duration of investment grade bonds relative to government bonds, should afford some protection provided defaults are avoided. However, despite these reservations, Mr Fletcher recommends a neutral allocation of 6% to investment grade credit because the ‘‘bigger risk’’ is in longer duration government bonds especially Index-Linked Bonds.

The IIMT believe that the current average credit spread, of around 120 basis points over sovereign bonds, is increasingly insufficient to compensate for the increased default and volatility risk. As a result, the IIMT recommend that the current 0.1% underweight allocation of 5.9% is maintained.

(x) Cash

The cash weighting at 30 April 2019 was 6.0%, 4.0% overweight relative to the benchmark.

Mr Fletcher notes that whilst the high cash balance has helped moderate poor performance at a time of volatility, there is no requirement to carry such a high cash balance. Mr Fletcher acknowledges that much of the cash held is committed to fund managers that have yet to draw-down their allocations for investments, and further draw-downs will reduce the level of cash.

The IIMT notes that markets have experienced several bouts of volatility over the past twelve to eighteen months, and continues to believe that public markets are trading on rich valuations despite increasing levels of global political risk and the increasing maturity of the US economic expansion.

Against this background, the IIMT recommends a defensive cash allocation of 6.7%. The IIMT is actively investigating options for reducing the cash allocation, and notes a continued emphasis on making commitments to more attractively priced illiquid markets. Furthermore, it should be noted that the cash weighting will reduce as private market commitments are drawn down.

3 Other Considerations

In preparing this report the relevance of the following factors has been considered: financial, legal and human rights, human resources, equality and diversity, health, environmental, transport, property and prevention of crime and disorder.

4 Background Papers

Files held by the Investment Section.

5 Officer's Recommendations

5.1 That the report of the external adviser, Mr Fletcher, be noted.

5.2 That the asset allocations, total assets and long term performance analysis in this report be noted.

5.3 That the strategy outlined in the report be approved.

PETER HANDFORD

Director of Finance & ICT