



**Isle of Wight Council Pension Fund  
Schroder Sterling Broad Market**

## Isle of Wight Pension Fund – Fixed Income Portfolio Review for 2017

### Performance review & Portfolio Activity

Over the year to 31 December 2017, the Fund's investment in the Schroder Sterling Fixed Income Fund produced a return of 4.9%. In comparison, the benchmark, 50% iBoxx GBP Gilts + 50% iBoxx GBP Non-Gilts, generated a total return of 3.1%.

While shorter dated UK yields increased over the year and the UK witnessed its first rate hike in over a decade it was a positive year for sterling bonds as longer dated yields decreased and credit spreads compressed. Off benchmark exposure to US and European credit also offered support to the portfolio, so too active interest rate exposure taking advantage of spreads between UK, US and European bond markets.

The rise of populism and its impact on domestic and global politics has had a direct impact on fixed income markets not only in the UK and US, but has also been a key driver of risk premia in Europe. Market pricing of the impact of Brexit dictated our active risk in the portfolio in terms of holding overweight positions in UK duration. Similarly, political events in France, Germany, Italy and later Spain offered opportunities to be underweight versus the UK. Support for the positive view on UK duration arose from our understanding that the headwind posed by Brexit called for lower UK yields as the BoE sought to retain an accommodative monetary policy. The outperformance of UK yields versus Europe and the US was positive for the strategy overall. However, throughout the course of the year interest rate positioning remained highly active and we took profits on that position in advance of the UK snap election as yields reached their lows.

While central banks had become increasingly worried about their growing market impact causing distortions in asset prices, they were clearly just as worried about their actions to begin to reverse these effects. Consequently, one of the dominant themes in our strategy over the past 12 months has been that central banks would tiptoe towards normalisation of policy. The combination of gradual normalisation and positive global growth generated a fertile environment for credit with investors still eager to gain exposure to assets with a positive spread over government bonds. This supported both prices and spreads for both investment grade and high yield, to the benefit of the strategy overall.

### Isle of Wight Pension Fund fixed income performance to 31 December 2017 (% pa)

	12m	3 years	Inception*
Fixed Income Portfolio	4.9	5.6	7.2
<b>Benchmark</b>	<b>3.1</b>	<b>4.6</b>	<b>6.2</b>

### Schroder Sterling Broad Market Gross Attribution

	Alpha	FX	Rates	Credit	Residual
<b>Total</b>	<b>186</b>	<b>-3</b>	<b>43</b>	<b>157</b>	<b>-10</b>

\*Isle of Wight inception date 31 August 2009. Rates (duration, yield curve, inflation, sovereign, carry and roll sovereign), Credit (Carry & Roll Credit, Credit Sector Allocation, Credit Selection, Credit ABS/MBS), Residual (Volatility, Valuation, Trading)

### Outlook

The narrative for the UK continues to be punctuated by Brexit, with the first round of negotiations complete, but the next round set to prove extremely difficult. The BoE hiked interest rates in November and continues to talk in terms of a (gradual) hiking cycle, but we expect the continued weak domestic growth picture (lack of real wage growth and slowing labour market) and the strong slowdown in inflation to stay their hand for the foreseeable future. Accordingly recorded inflation looks set to fall as the pass through from weaker sterling dissipates, which would be supportive for gilts, negative for short-term market inflation expectations and negative for sterling.

Performance and attribution results are calculated relative to the benchmark using gross performance based on end of day pricing. Returns are calculated internally by Schroders and may differ from the NAV returns. If fees and expenses were reflected, performance figures would be lower. Performance calculations are not adjusted for the effect of taxation and assume reinvestment of dividends and capital gains. Index returns do not incur management fees, transaction costs, or other expenses. Past performance is not indicative of future performance. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost.

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## **Isle of Wight Council Pension Fund Schroder UK Real Estate Fund (SREF)**

## Isle of Wight Pension Fund Real Estate Review for 2017

### Performance and market review

2017 was another strong year for the Schroder Real Estate Fund (SREF). The Fund has outperformed its benchmark over one, three, five and ten years. The Fund's industrial portfolio contributed strongly to return, as high demand and supply constraints have supported rental and value growth. Letting activity in assets located in high growth locations has delivered strong performance. At Jubilee House, E15 and at Palace House, SE1 the completion of new leases has captured significant rental growth as well as de-risking potential void, supporting higher capital values.

### Isle of Wight Pension Fund Real Estate performance to 31 December 2017 (% pa)

	12m	3 years	Inception*
Property Portfolio	11.3	10.3	11.1
<b>Benchmark**</b>	<b>10.6</b>	<b>9.2</b>	<b>10.1</b>

\*Isle of Wight inception date 31 August 2009. \*\*Client Benchmark: AREF/IPD UK Quarterly Property Fund Index All Balanced Fund Median.

Political and economic uncertainties have seen UK GDP growth soften to an estimated 1.5% while a weak GBP Sterling saw inflation rise to 3.1% in November. In spite of this backdrop, pricing of UK real estate has remained resilient, supported by strong demand from Chinese and German investors, attracted by the fall in UK prices in foreign currency terms. The stability of values also reflects the significant gap between real estate and 10 year government bonds. Though the Bank of England raised interest rates to 0.5% in November, this has not affected the relative attractiveness of the asset class to investors.

### Portfolio activity

A portfolio of self-storage assets was purchased in the third quarter for £44.3 million. The five properties are well located in Greater London and around the M25. As part of the transaction, SREF also acquired The Self Storage Company brand and other intellectual property. The acquisition is in line with the fund's strategy of investing in areas of the market that are benefiting from structural and demographic trends. Demand for self-storage reflects the changing nature of millennials' living patterns such as the rise of long-term renting. It is also in demand by start-up businesses.

Eight properties were sold in the year with a total value of £58.7 million. Properties were sold in line with strategy to crystallise gains following the completion of their business plan and to dispose of smaller assets. Recent asset management activity has focused on growing the rent roll of the Fund through lettings and the completion of the developments at Bracknell and Croydon. Their conversion from non-income producing sites into modern, appealing destinations for tenants and consumers has added to SREF's capital and income returns while de-risking the portfolio.

### Outlook

SREF owns a diversified portfolio of good quality properties across the UK which provides a balance of sustainable and growing income with the potential for capital appreciation. In a more uncertain economic environment SREF's portfolio of properties, which are let off affordable rents, offer both growth and defensive characteristics. The transformation of the larger scale developments into core, income producing assets has given the fund a platform for the efficient deployment of capital into the existing portfolio where we have smaller scale asset management plans. Collectively, these are designed to further improve the Fund's income profile and generate additional value over the medium term. In the short term the completion of refurbishment works at Lyric Quarter, Hammersmith, W6, should add value during the course of 2018.

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