Isle of Wight Pension Fund

Q2 2023 - Investment Monitoring Report

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HYMANS ROBERTSON

Market Background

Consensus forecasts for 2023 global GDP growth saw further upwards revisions in Q2, given unexpected resilience in labour markets and consumer spending. Nonetheless, with higher interest rates likely to weigh on consumer and business activity in the second half of 2023 and into 2024, growth forecasts remain relatively weak.

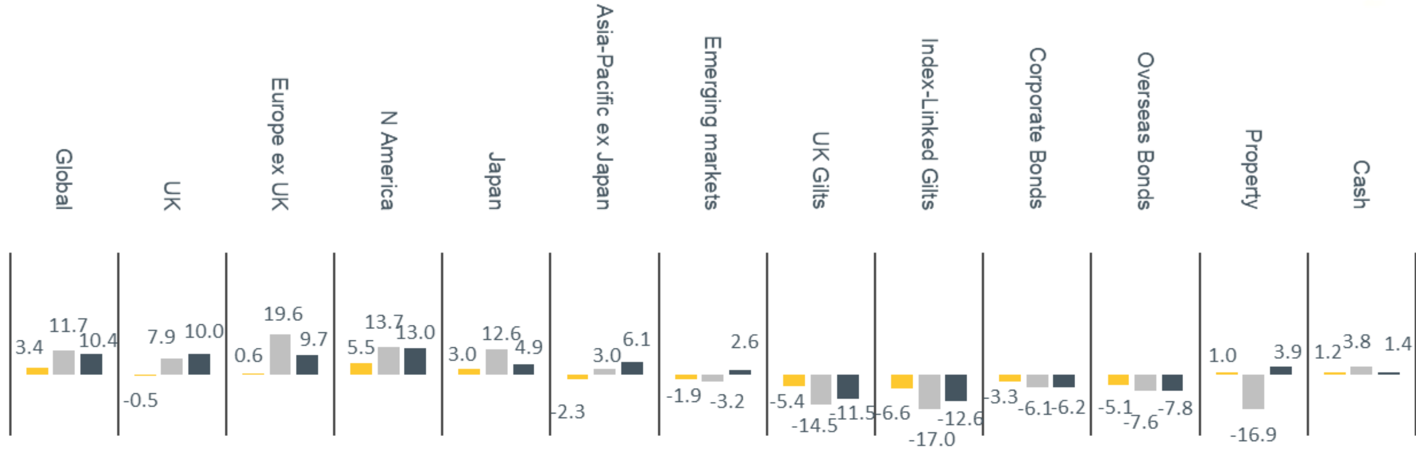
UK inflation data released during Q2 came in higher than forecasters expected. However, June's UK headline CPI inflation figure, released in July, fell more than expected, to 7.9% year-on-year and core inflation slipped back to 6.9% from 7.1%. Equivalent CPI inflation in the US and Eurozone fell to 3.0% and 5.5%, respectively in June. Core inflation eased to 4.8% in the US, but rose to 5.5% in the Eurozone.

Responding to a run of higher than expected inflation, the Bank of England (BoE) raised rates by 0.75% p.a. in Q2, to 5.0% p.a., including a surprise 0.5% p.a. increase in June. The US Federal Reserve raised rates by 0.25% p.a., to 5.25% p.a., in May; pausing in June to evaluate the impact of prior tightening. The European Central Bank increased their deposit rate 3.5% p.a.

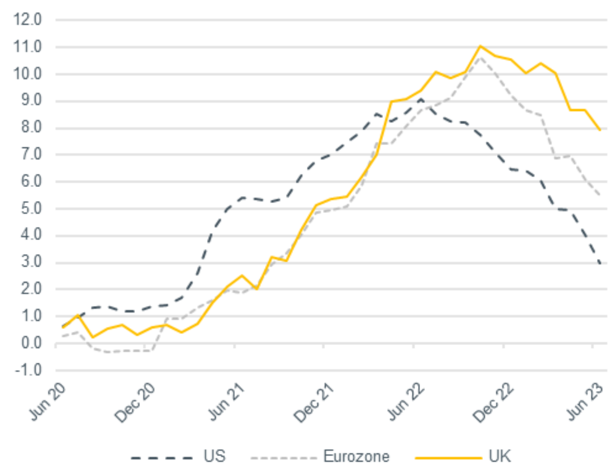
UK 10-year implied inflation, as measured by the difference between conventional and inflation-linked bonds of the same maturity, was unchanged at 3.6% p.a., as real and nominal yields rose by similar amounts.

UK gilt yields surged as disappointing inflation data was compounded by heavy issuance and BoE gilt sales. UK 10-year gilt yields rose sharply by 0.8% p.a. to 4.4% p.a., while US yields rose 0.2% p.a. to 3.8% p.a., and equivalent German yields rose 0.1% p.a., to 2.4% p.a.

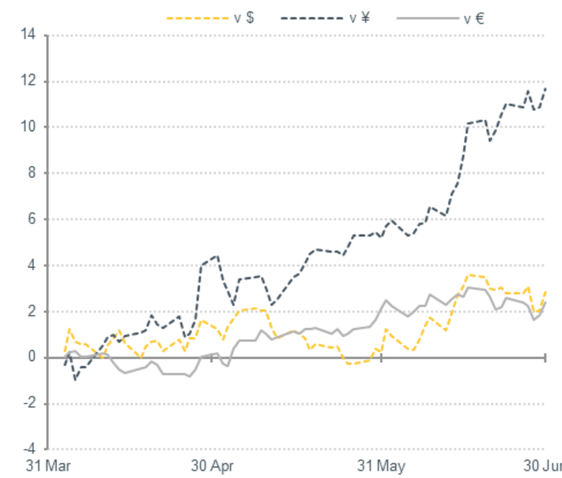
Historic returns for world markets [1]



Annual CPI Inflation (% p.a.)



Sterling trend chart (% change)



Market Background

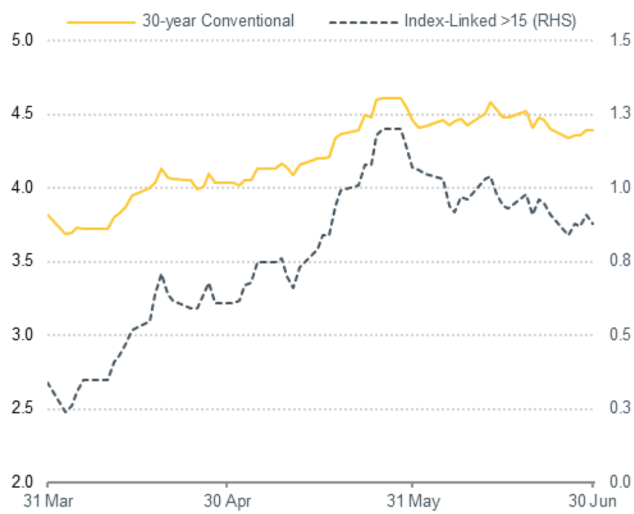
The UK investment-grade credit market recorded negative total returns as the rise in underlying gilt yields more than offset a fall in credit spreads. Global investment-grade credit spreads decreased by 0.1% p.a. to 1.4% p.a., and global speculative-grade credit spreads decreased by 0.5% p.a. to 4.5% p.a.

The FTSE All World Total Return Index rose 6.7%, buoyed by better-than-expected earnings and AI-inspired optimism around the technology sector. Japanese and North American equities outperformed, with the exporter-heavy index of the former benefitting from Yen weakness and the latter benefitting from its disproportionately high exposure to the technology sector. Disappointing Chinese activity data dragged down emerging markets and Asia Pacific ex-Japan. The UK was the worst performing region, as the basic materials and energy sectors underperformed amid commodity price declines and global manufacturing weakness.

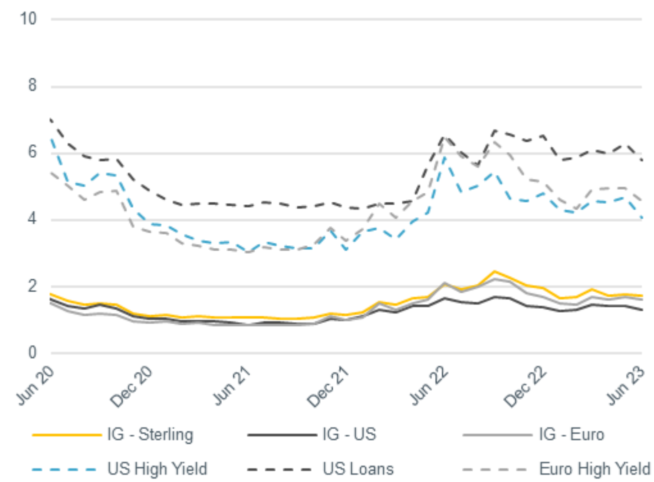
Sterling rose over 4.0% in trade-weighted terms as interest rate expectations soared. Meanwhile, equivalent US and euro measures rose 0.8% and 2.1%, respectively, while the yen measure fell more than 5%. The S&P GSCI Commodity Spot Price Index fell 5.8% in Q2, driven by declines in energy and industrial metal price.

UK commercial property values, as measured by the MSCI UK Property Index, had fallen by over 21% in the 12 months to end-June. Capital values have somewhat stabilised in recent months, though office values continued to decline in June. Alongside income, this led to a modest positive total return from the market over the quarter.

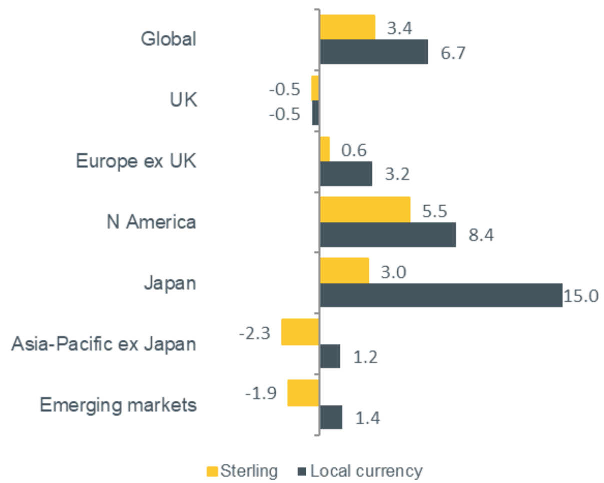
Gilt yields (% p.a.)



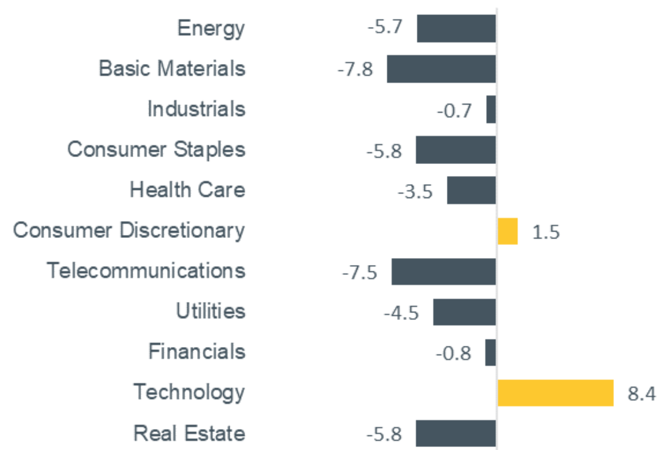
Investment and speculative grade credit spreads (% p.a.)



Regional equity returns [1]



Global equity sector returns (%) [2]



Source: DataStream, Barings, ICE [1] FTSE All World Indices. Commentary compares regional equity returns in local currency. [2] Returns shown in Sterling terms and relative to FTSE All World.

The page summarises our broad views on the outlook for various markets. The ratings used are Positive, Attractive, Neutral, Cautious and Negative.

The ratings are intended to give a guide to our views on the prospects for markets over a period of around three years; although they are updated quarterly, they are not intended as tactical calls. The ratings reflect our expectations of absolute returns and assume no constraints on investment discretion. In practice, they need to be interpreted in the context of the strategic framework within which individual schemes are managed.

Summary of Medium-term Capital Market Views

	March 2023	June 2023	Comment
Index-linked gilts	Attractive	Attractive	Ten-year index-linked gilt yields have also risen to reasonably attractive levels of 1.1% pa. Very weak real growth forecasts and sticky inflation should help keep a lid on real yields. Gilt-implied inflation, as measured by the difference between nominal and index-linked yields of the same maturity, indicates short-dated index-linked gilts offer decent value but suggests a relative preference for nominal gilts at medium-to-longer terms.
Conventional gilts	Neutral	Neutral	Even allowing for elevated near-term inflation, slightly higher inflation over the medium term, and the uncertainty associated with that outlook, 10-year nominal gilt yields of 4.6% pa look attractive versus our assessment of fair value of around 3.5% pa. We see the best value in gilt yields at maturities out to 20 years, given a sharp fall in longer-term forward real and nominal yields beyond. However, quantitative tightening and heavy issuance make for a very fragile technical backdrop.
Sterling non-government bonds	Neutral to Attractive	Neutral to Attractive	Debt affordability metrics are expected to come under pressure, but corporate balance sheets start from a strong position. Though speculative-grade default rates are expected to peak at lower levels than in previous slowdowns, we retain a preference for investment-grade markets, where the deterioration in fundamentals is expected to be less severe and take longer to materialise than in speculative-grade markets.
Private Debt	Neutral to Cautious	Neutral to Cautious	Manager's underwriting has become more conservative as debt affordability is expected to come under pressure from rising borrowing costs and weaker earnings. Leverage levels on new deals has fallen as a result. Defaults are rising but given a greater proportion of non-cyclical origination may peak at lower levels than the traded loan market. Valuations are attractive relative to the new issue traded loan market, which is now functioning again.
Equities	Neutral to Cautious	Neutral to Cautious	Despite consensus global corporate earnings growth expectations for full-year 2023 sitting at a lacklustre 0.7%, they may still be vulnerable to disappointment should economic growth slow as we expect. Recent price performance has taken cyclically adjusted valuations further above long-term averages, leaving limited scope for revaluation to drive equities higher against a challenging fundamental backdrop. Furthermore, recent rises in real yields leave equities looking very expensive relative to risk-free assets.
Cash Strategies	Neutral	Neutral	Higher base rates means investors can now generate positive (although below inflation) returns through cash holdings. The deteriorating economic outlook could provide opportunities further down the line.

Source: DataStream

As at 30 June 2023, the Fund's assets totalled £694.1m, increasing by £7.9m over the quarter.

Global economic growth outperformed prior downbeat expectations in the six months to end-June 2023 on the back of falling energy prices and unexpected resilience in labour markets and consumer spending.

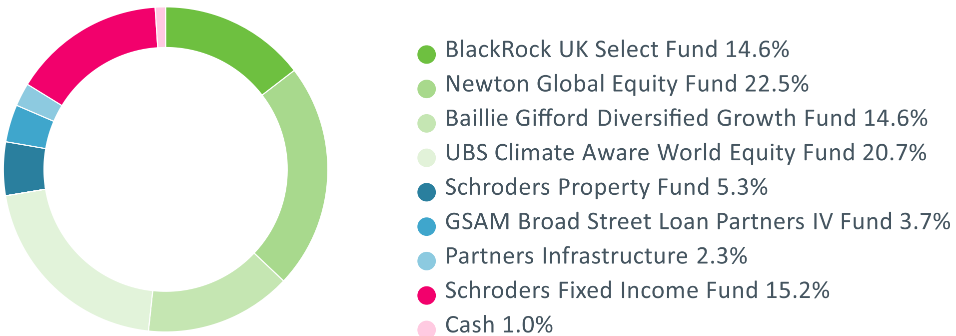
The markets are however pricing in higher interest rates persisting for longer, with little room left for further growth expectations. This is clearly reflected in the increasing gilt yields over the second quarter of 2023. The issue was further compounded by heavy issuance and BoE gilt sales. UK 10-year gilt yields rose sharply by 0.8% p.a. to 4.4% p.a., while US yields rose 0.2% p.a. to 3.8% p.a.

The Fund remains overweight to equities and correspondingly underweight to income and protection assets. The existing income mandates continue to draw down capital and the Scheme is currently in the process of selecting two more funds to top up the allocations. The underweight position in protection assets was accentuated by the negative bond performance over the year to June 2023.

Asset Allocation

Manager	Valuation (£m)		Actual Proportion	Benchmark	Relative
	Q1 2023	Q2 2023			
Newton Global Equity Fund	147.4	155.9	22.5%	18.8%	3.7%
Baillie Gifford Diversified Growth Fund	103.9	101.7	14.6%	10.0%	4.6%
UBS Climate Aware World Equity Fund	138.2	143.8	20.7%	18.8%	2.0%
BlackRock UK Select Fund	98.3	101.2	14.6%	12.5%	2.1%
Total Growth	**487.8**	**502.6**	**72.4%**	**60.0%**	**12.4%**
Schroders Property Fund	37.8	36.9	5.3%	8.0%	-2.7%
GSAM Broad Street Loan Partners IV Fund	26.0	25.9	3.7%	5.0%	-1.3%
Partners Infrastructure	14.3	16.1	2.3%	5.0%	-2.7%
Total Income	**78.0**	**78.9**	**11.4%**	**18.0%**	**-6.6%**
Schroders Fixed Income Fund	111.2	105.5	15.2%	22.0%	-6.8%
Total Protection	**111.2**	**105.5**	**15.2%**	**22.0%**	**-6.8%**
Cash	9.2	7.2	1.0%	0.0%	1.0%
Total Scheme	**686.2**	**694.1**	**100.0%**	**100.0%**	

Asset class exposures



Over Q2, the Fund returned 0.4% against its benchmark of 0.6%, a relative underperformance of 0.2%.

Over the medium term, the Fund fell short of its 12-month benchmark. Over the 3-year period the fund outperformed its benchmark by 0.1% p.a., delivering a 4.2% return per year. The slowdown on the markets is evident over the 12-month period with a much lower, however still positive, absolute return of 1.6%.

The increased AUM of the fund over Q2 was an effect of the majority of the growth mandates returning positive absolute returns, with the notable exception of the Baillie Gifford DGF.

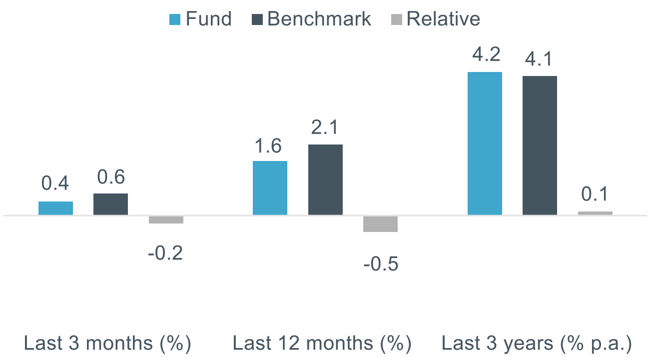
Commercial property capital values showed signs of relative steadiness in recent months. Thus, the Schroders Property fund had a negative return over the quarter against a mildly positive benchmark, mostly due to the mandate's increased exposure to offices, which continued to underperform over the quarter.

With gilt yields increasing in the 3 months to June given the expected persistence of higher interest rates, the Schroders fixed income mandate was a laggard for the Scheme. The mandate delivered a significantly negative return of -5.2%.

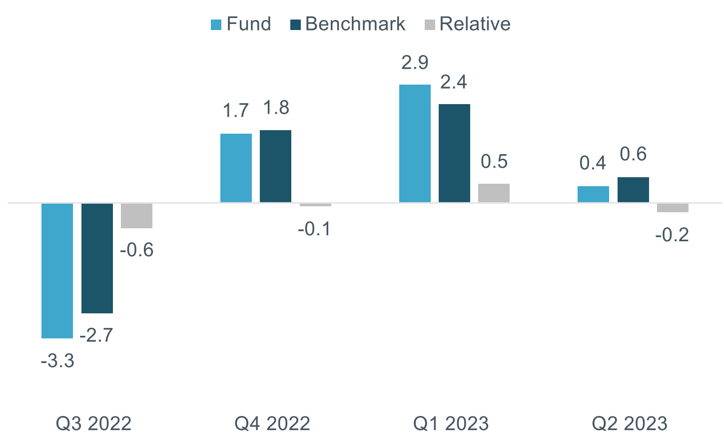
Manager performance (gross of fees)

	Last 3 months (%)			Last 12 months (%)			Last 3 years (% p.a.)		
	Fund	B'mark	Relative	Fund	B'mark	Relative	Fund	B'mark	Relative
Growth									
BlackRock UK Select Fund	2.8	-0.5	**3.3**	0.7	-3.5	**4.4**	-	-	**-**
Newton Global Equity Fund	5.8	3.3	**2.5**	16.3	11.3	**4.5**	10.9	9.9	**0.9**
Baillie Gifford Diversified Growth Fund	-2.0	2.0	**-3.9**	-1.4	6.8	**-7.7**	0.6	4.8	**-3.9**
UBS Climate Aware World Equity Fund	4.0	3.9	**0.1**	13.2	13.5	**-0.3**	-	-	**-**
Income									
Schroders Property Fund	-2.2	0.9	**-3.0**	-19.5	-16.8	**-3.2**	1.4	3.8	**-2.4**
Protection									
Schroders Fixed Income Fund	-5.2	-4.2	**-1.0**	-12.2	-10.8	**-1.7**	-9.5	-9.0	**-0.5**
Total	0.4	0.6	**-0.2**	1.6	2.1	**-0.5**	4.2	4.1	**0.1**

Fund performance vs benchmark/target



Historical quarterly performance summary



Source: Fund performance and valuation data provided by Investment Managers and is gross of fees. Benchmark performance provided by Investment Managers and DataStream. 12-month BlackRock UK Select Fund's performance is since inception.Total Performance excludes the impact of private market allocations and any cash held.

This page includes details of the current investment manager ratings together with any relevant manager business updates.

This page also shows RI ratings for the current investment managers.

Manager ratings

Mandate	Hymans Rating	RI
Newton Global Equity Fund	Suitable	Good
BlackRock UK Select Fund	Preferred	Adequate
Schroders Fixed Income Fund	Positive	Good
Schroders Property Fund	Positive	Good
Baillie Gifford Diversified Growth Fund	Positive	Good
GSAM Broad Street Loan Partners IV Fund	Positive	Adequate
Partners Infrastructure	Preferred	Good
UBS Climate Aware World Equity Fund	Preferred	Good

Source: Investment Managers

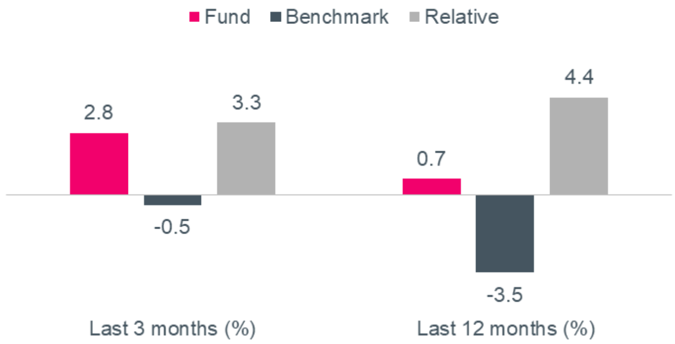
Blackrock UK Equity

The Liontrust UK Equity fund was replaced by the BlackRock UK Select fund as of the 23rd February 2023. The UK Equity allocation remains within the ACCESS LGPS Pool, despite the manager change.

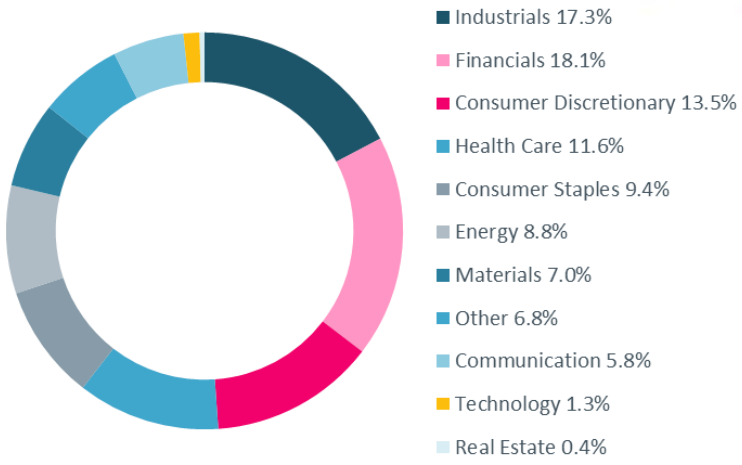
Over Q2 2023 the BlackRock UK Select Fund delivered a total return of 2.8%, outperforming its FTSE All Share benchmark of -0.5%. The fund managed to perform better than its benchmark since the Scheme investment in the first quarter of 2023, with a relative outperformance of 4.4%.

The BlackRock Institutional Equity Fund ('BIEF') – UK Select takes active positions, with significantly overweight allocations to Communication and Industrials. On the other hand, the fund is materially underweighting the UK's Financial and Health Care sectors. This allocation is consistent with the fund's moderate quality/growth bias.

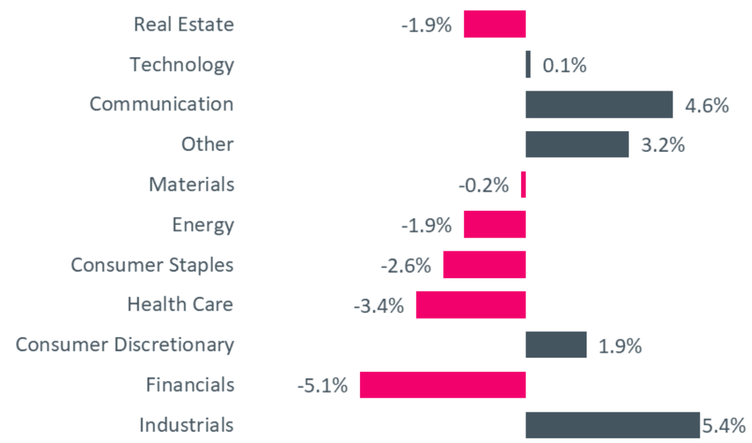
Performance summary*



Sector allocation



Allocation relative to benchmark



Source: Data and fund performance provided by Link Group and is gross of fees.
**12m performance represents the SI figure provided by manager. SI date is 23/02/2023*

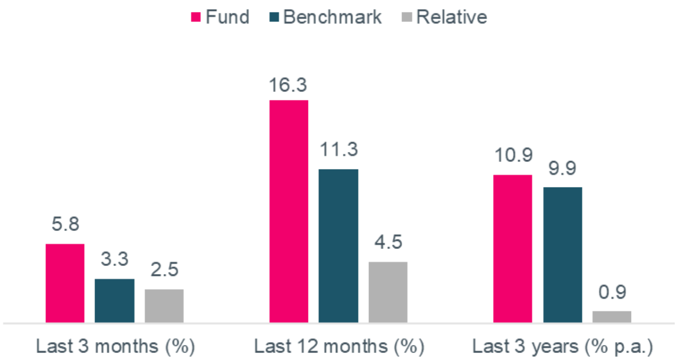
Newton Global Equity

The Newton Global Equity Fund beat its MSCI ACWI benchmark over Q2 2023, returning 5.8% in absolute terms. The fund also outperforms its 12-month and 3-year benchmarks by 4.5% and 0.9% respectively p.a.

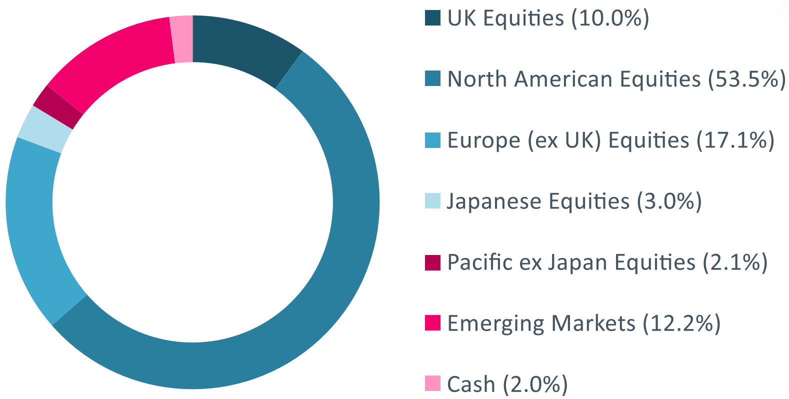
In the 3 months to June the global equity market was characterised by AI optimism and another US debt ceiling crisis being avoided. These events provided a significant boost to equity valuations, particularly in the technology sector. While the US and the UK increased interest rates again in their continued fight against inflation, investors are gaining confidence in the global economy achieving its much-desired soft-landing scenario, avoiding a significant recession in the process.

Outperformance drivers were identified through stock selection in information technology, financials, health care and industrials. The fund overweights the technology sector, benefitting from investors developing an appetite for AI. The materials sector was underweight which also contributed positively to returns given a relatively lacklustre Chinese economy rebound. Performance was negatively impacted by the fund's overweight in health care and poor stock selection in communication services.

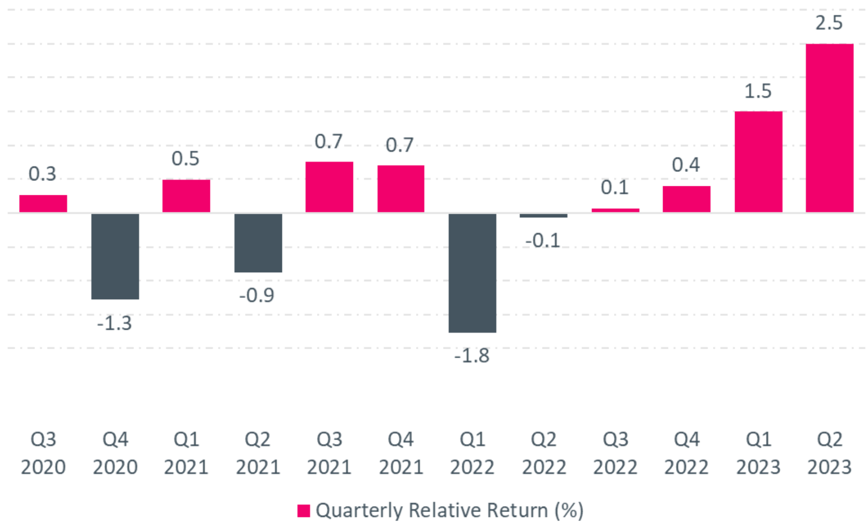
Performance summary



Asset allocation



Quarterly relative performance



Source: Data and fund performance provided by Newton and Link Group and is gross of fees.

UBS Climate Aware World Equity Fund

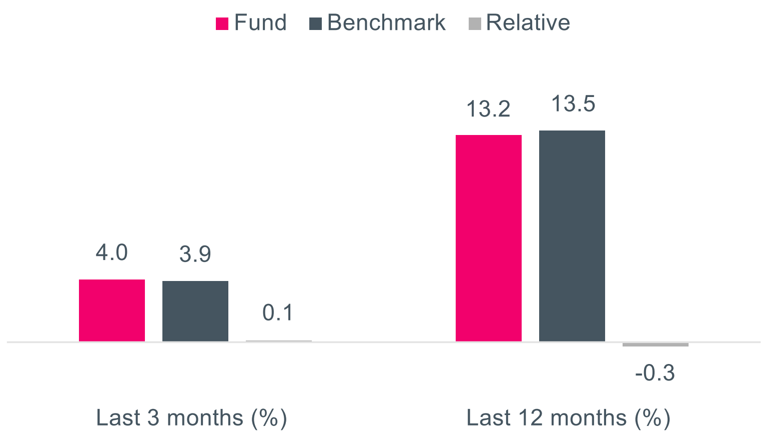
Following the equity review in November 2020, the Committee agreed to introduce a passively managed global mandate to provide a more balanced equity investment approach. In December 2021, the allocation of £145m was invested in the UBS Global Climate Aware mandate.

The aim of the mandate is to perform broadly in line with the FTSE AW Developed Index, delivering similar performance to standard global equity indices but with less carbon intensive investments.

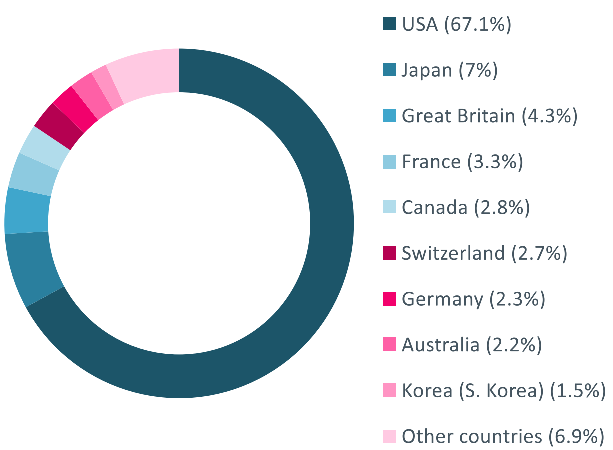
The positive return over the 3 months to June 2023 can be attributed to North American equities outperforming, given their disproportionate exposure to the technology sector, which benefited as optimism grew about the impact of AI adoption on future tech sector earnings. The mandate's exposure to Japanese equities also contributed positively to the return given the close to 0% interest rates maintained in Japan.

The fund is performing broadly in line with the FTSE AW Developed Index over both the shorter and the longer term, some tracking error of +/- 0.5% is expected from this mandate.

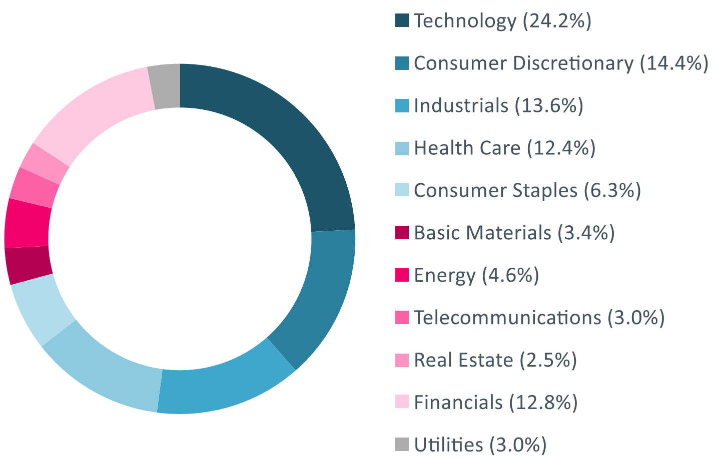
Performance summary



Geographical allocation



Sector allocation*



Source: Data and fund performance data provided by UBS and is gross of fees.
**Due to rounding the allocation total sums to over 100%*

Baillie Gifford Diversified Growth

Over Q2 2023, the Diversified Growth Fund returned -2.3%, underperforming its benchmark, by 3.9%. The fund also fell short of its longer-term benchmarks, with the 12-month relative performance improving from Q1, but remaining the greatest laggard against its benchmark by 7.7%.

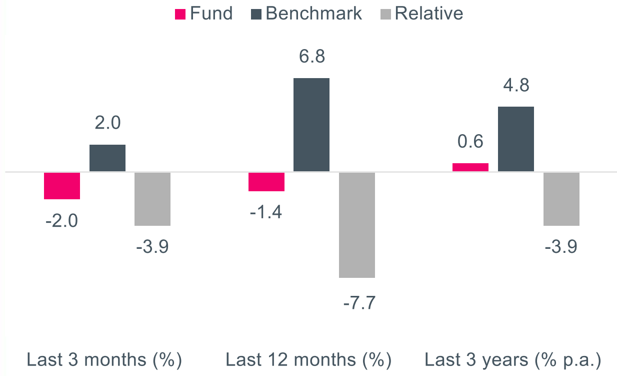
As the wider macroeconomic landscape continues to adapt to increased rates and heightened inflation, a varied performance, both across different asset classes and within the asset classes themselves was evident over the 3 months to June.

As expected, given the rising yields over the quarter the largest detractors were holdings in Government Bonds (14.6% allocation) and High Yield Credit (8.8% allocation). Active currency bets also detracted, contributing c.-1% to the funds return.

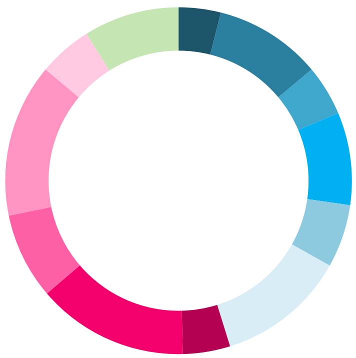
Structured finance, Emerging market bonds, Insurance-linked securities and Absolute return bonds (total allocation of c36%) were the top contributors to Q2 performance.

Baillie Gifford acknowledge the higher than desired allocation to cash and the manager is optimistic with regards upcoming opportunities under the current macroeconomic environment.

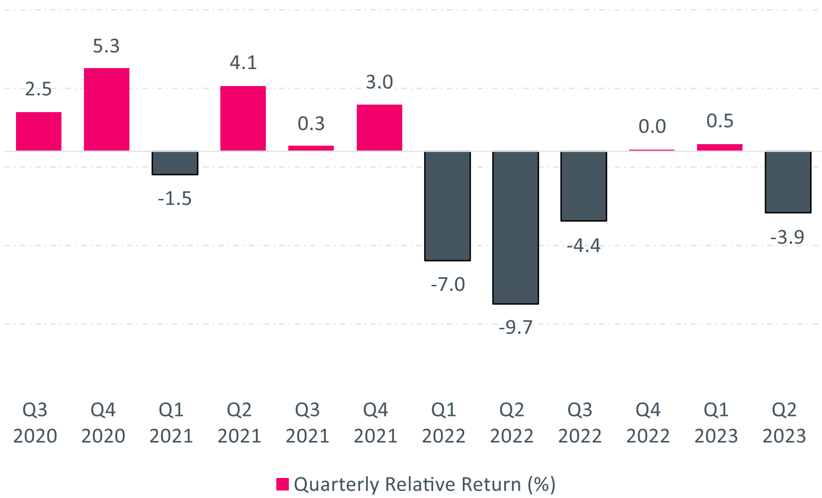
Performance summary



Asset allocation*



Quarterly relative performance



Source: Data and fund performance provided by Baillie Gifford and Link Group and is gross of fees.
**Due to rounding the allocation total sums to over 100%*

Schroders Property

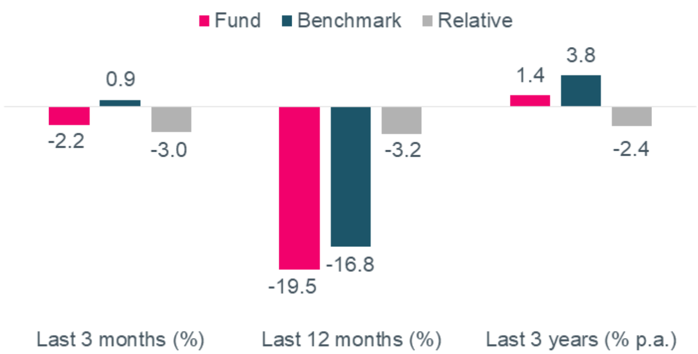
The Schroder's property mandate returned -2.2% over Q2 2023 versus its benchmark of 0.9%, an underperformance of 3.0%.

SCREF's performance during the quarter was derived mainly from capital value declines in the office sector. These falls in valuations are caused by the continued rise in UK bond yields and higher cost of debt. Furthermore, the fund has now transitioned to CBRE as Property Fund Valuer, in line with the latest RICS guidance. The rebasing which forms part of this transition process resulted in notable value declines.

On the positive side, given the numerous rent events over the quarter (i.e. 22 new lettings, 12 lease renewals and 10 rent reviews) the fund's income return is now 0.9% higher than the benchmark income return. Simultaneously to the higher than benchmark income yield, the portfolio is positioned defensively, with high quality assets (i.e. 69.5% London and SE assets and 29.7% of lettings towards government or higher education).

The fund disposed of one of Unit 3C, Hams Hall Distribution Park in Tamworth for £25.0 million, achieving a 10.48% IRR since acquisition. Proceeds were allocated to fulfilling investor redemptions and further improvements to other assets in the portfolio.

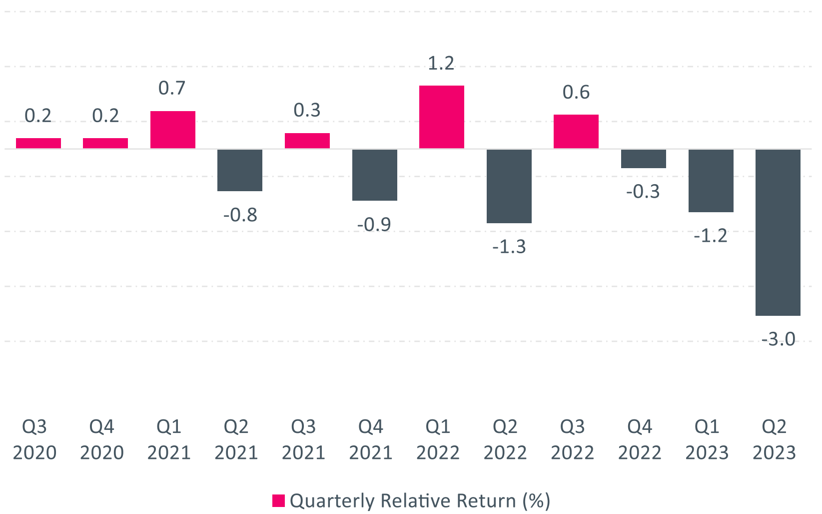
Performance summary



Key statistics

Fund size (gross)	£2,090.15m
Number of holdings	52
Number of tenants	660
Debt (% of NAV)	7.7%
Top 10 holdings as % of portfolio	44.9%

Quarterly relative performance



Source: Data and fund performance provided by Schroders and is gross of fees.

Schroders Fixed Income

The Schroders Fixed Income fund returned -5.2% over Q2 2023, underperforming its benchmark of -4.2%.

The fund also delivered negative returns over the past 12 months due to the dramatic upward shift in yields since September 2022, and falls short of its benchmark by 1.7%.

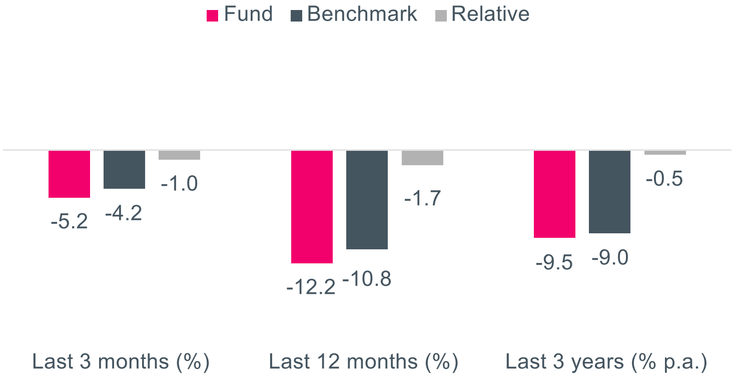
Performance over the 3-year period was also negative however less divergent from its target benchmark return.

The fund's negative return over the quarter is largely attributable to the increasing yields over the quarter. In addition, the manager took a strategic decision to overweight UK gilts, which yielded negative results given the two significant Bank of England rate hikes observed over the past three months.

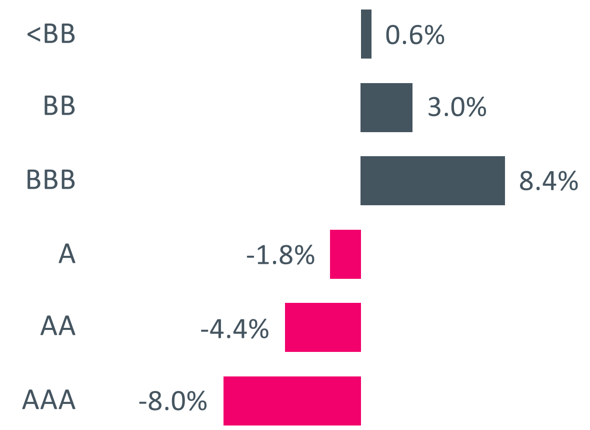
On the bright side, a tactical allocation to German bonds contributed positively, with the contraction in manufacturing activity boosting the performance of eurozone government bonds.

In terms of asset allocation, Schroders is modestly overweight duration. The manager is actively searching for opportunities to exploit divergence in central policy actions across countries.

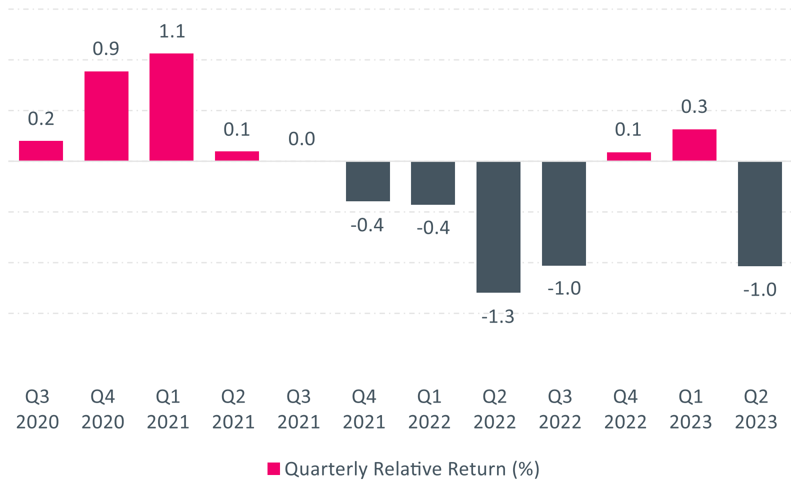
Performance summary



Relative credit allocation



Quarterly relative performance



Source: Data and fund performance provided by Schroders and is gross of fees.

GSAM Broad Street Loan Partners IV Fund

In July 2020, a new 5% allocation to private debt was agreed by the Committee which will be drawn down over time.

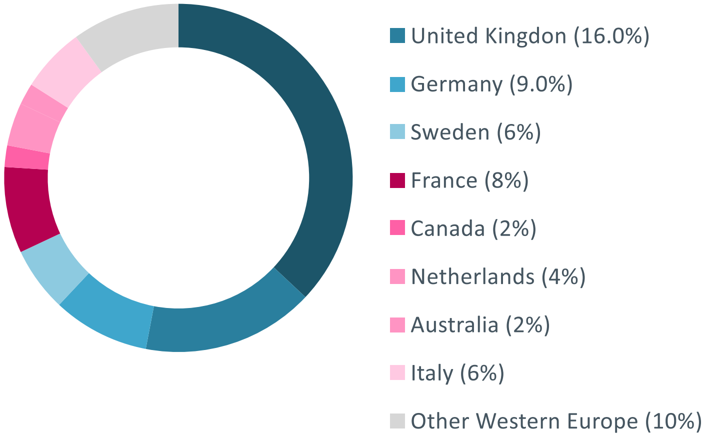
The table to the right reflects the key statistics since inception based on the estimated end of June figures from GSAM.

The estimated capital balance by GSAM as at 30 June 2023 was c.£26m and capital contributions were c.£29.6m (out of which £5.1m were distributed back).

First Lien term loans continue to hold the majority weighting, in line with the Fund's target investment profile.

*Net income allows for impact of currency movements. Over Q2 2023 the dollar depreciated against the pound, negatively impacting returns

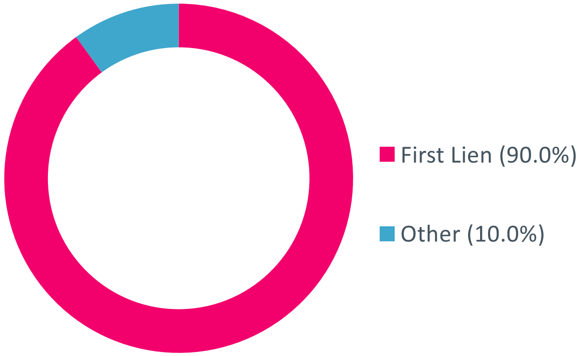
Geography split



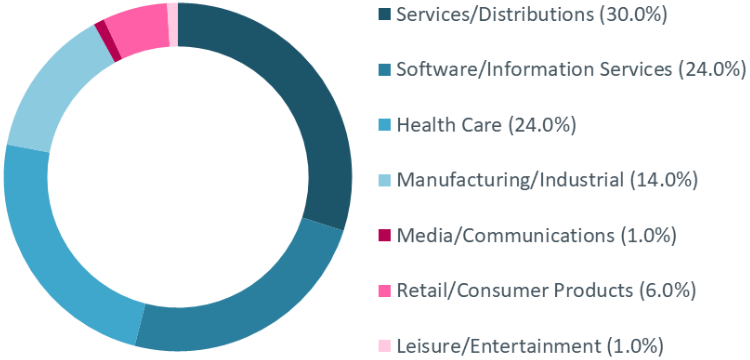
Key statistics since inception (£m)

Commitment	30.0
Capital contributed	29.6
Distributions	5.1
Estimated Capital balance	26.0
Estimated Net Income/Loss*	1.5

Security/Loan type



Industry split



Source: Fund data provided by GSAM and is gross of fees.

Partners Direct Infrastructure

In July 2020, a new 5% allocation to infrastructure was agreed by the Committee which will be drawn down over time. The first allocation to Partners Direct Infrastructure Fund was drawn on 10 July 2021.

The net asset value for the fund as at 30 June 2023 was c.£16.4m (vs. c.£13.7m as at 31 March 2023).

A capital call was issued in June, bringing the net contributions to the fund up to £14.9m (vs £12.8m in March 2023)

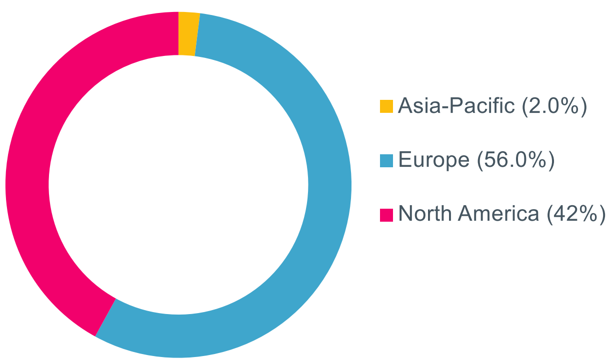
It should be noted that given this is a EUR fund, FX movements will impact the returns. During Q2 2023 the UK Sterling only mildly appreciated against the EUR and thus did not affect the reported NAV meaningfully.

Reporting for the fund will evolve over time as the fund establishes.

Key statistics (£m; as at 30th of June 2023)

Commitment	35
Capital contributions	14.9
Distributions	0.4
Net contributions	14.6
Net asset value	16.4
Net multiple	1.2x

Regional allocation (as at 30th June 2023)



Source: Fund data provided by Partners.

Risk Warning

Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investment in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of an investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.

Hymans Robertson LLP and our group companies have a wide range of clients some of which are fund managers, who may be parties in our recommendations to you in various circumstances including but not limited to manager selection, moving money to or from a manager or supporting retention of or disinvestment from a manager. We have a research team that advises on shortlisting fund managers in manager selection exercises and forming views on managers, which is separate from our client and other relationships with fund managers and therefore we do not believe there will be a conflict that would influence the advice given.

Geometric v Arithmetic Performance

Hymans Robertson are among the investment professionals who calculate relative performance geometrically as follows:

$$\frac{(1 + Fund\ Performance)}{(1 + Benchmark\ Performance)} - 1$$

Some industry practitioners use the simpler arithmetic method as follows:

$$Fund\ Performance - Benchmark\ Performance$$

The geometric return is a better measure of investment performance when compared to the arithmetic return, to account for potential volatility of returns.

The difference between the arithmetic mean return and the geometric mean return increases as the volatility increases.

This page sets out the benchmark, performance targets, and fees of each mandate.

It also provides descriptions of our ratings and the rationale behind our Hymans research and Responsible Investment ratings.

Benchmarks, Targets & Fees

Mandate	Date Appointed	Benchmark Description	Performance Target (% p.a.)
Newton Global Equity Fund	25/08/2009	MSCI AC World	+2% p.a. over rolling 5 years
BlackRock UK Select Fund	23/02/2023	FTSE All Share	+2% p.a. over rolling 5 years
Schroders Fixed Income Fund	31/08/2009	50% iBoxx Gilts and 50% iBoxx Non-Gilts Indices	Outperform benchmark by 1% p.a. (net of fees) over a market cycle before fees
Schroders Property Fund	31/08/2009	AREF/MSCI UK Quarterly Property Fund Index All Balanced Funds Median	Outperform benchmark by 0.5% p.a. (net of fees) over 3 year rolling period
Baillie Gifford Diversified Growth Fund	30/10/2013	UK Base Rate +3.5% p.a.	UK Base Rate +3.5% p.a. (net of fees) over 5 year rolling period
GSAM Broad Street Loan Partners IV Fund	25/01/2021	-	8% gross IRR
Partners Infrastructure	10/07/2021	-	8-12% p.a. net of fees
UBS Climate Aware World Equity Fund	08/12/2021	FTSE AW Developed Index	-

Source: Investment Managers

Hymans Ratings

Preferred	Our highest rated managers in each asset class. These should be the strategies we are willing to put forward for new searches.
Positive	We believe there is a strong chance that the strategy will achieve its objectives, but there is some element that holds us back from providing the product with the highest rating.
Suitable	We believe the strategy is suitable for pension scheme investors. We have done sufficient due diligence to assess its compliance with the requirements of pension scheme investors but do not have a strong view on the investment capability. The strategy would not be put forward for new searches based on investment merits alone.
Negative	The strategy is not suitable for continued or future investment and alternatives should be explored.
Not Rated	Insufficient knowledge or due diligence to be able to form an opinion.

Responsible Investment

Strong	Strong evidence of good RI practices across all criteria and practices are consistently applied.
Good	Reasonable evidence of good RI practices across all criteria and practices are consistently applied.
Adequate	Some evidence of good RI practices but practices may not be evident across all criteria or applied inconsistently.
Weak	Little to no evidence of good RI practices.
Not Rated	Insufficient knowledge to be able to form an opinion on.