Isle of Wight Council Pension Scheme

Q3 2020 Investment Monitoring Report

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HYMANS ROBERTSON

Market Returns

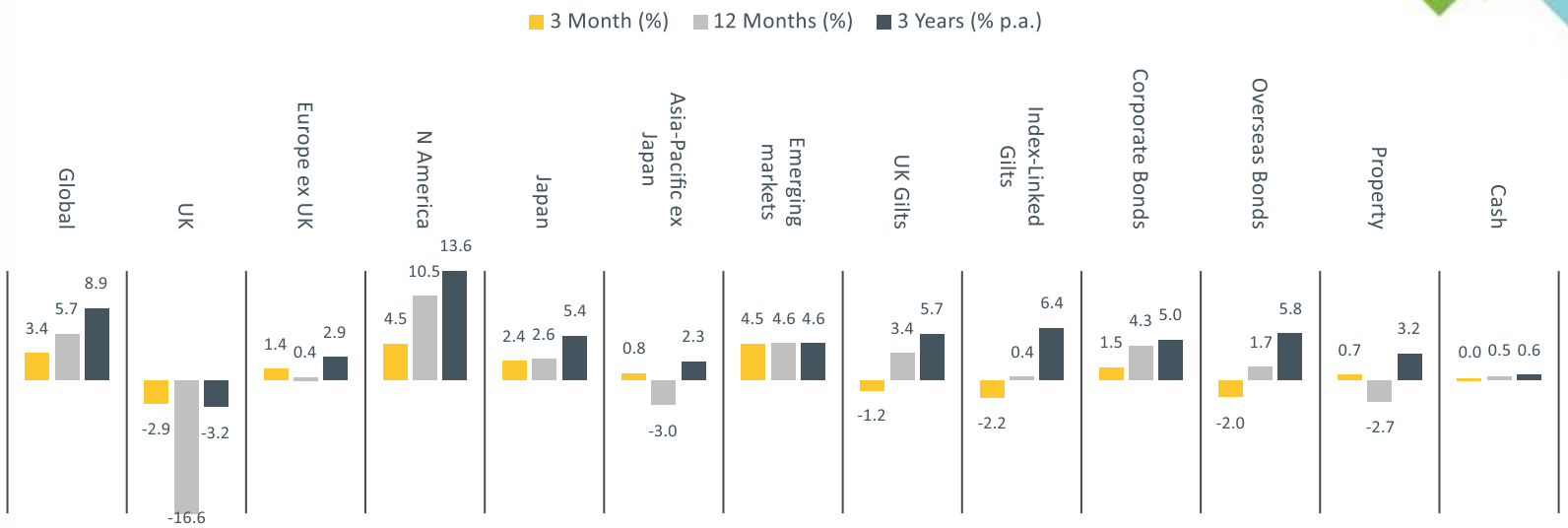
Q3 GDP data will likely reveal record-breaking growth rates for many economies, following Q2's record-breaking declines. Despite signs of a recovery, there is evidence to suggest the pace of improvement in major advanced economies slowed markedly towards the end of Q3. Monthly UK GDP releases show the pattern of growth experienced by the major advanced economies - April marked the nadir of the downturn with the economy returning to month-on month growth in May. Although above longer-term trend growth, the monthly pace of growth slowed from 6.4% in July to 2.1% in August. Purchasing Managers' Indices for both services and manufacturing in the major western economies signalled that the recovery in global activity continued in September.

Sterling partially reversed some of its losses in the first half of 2020, rising 1.7% in trade-weighted terms since the end of June, though weakness returned as trade talks faltered in September. Even allowing for September's gains, the US dollar fell 2.8% in trade-weighted terms in Q3.

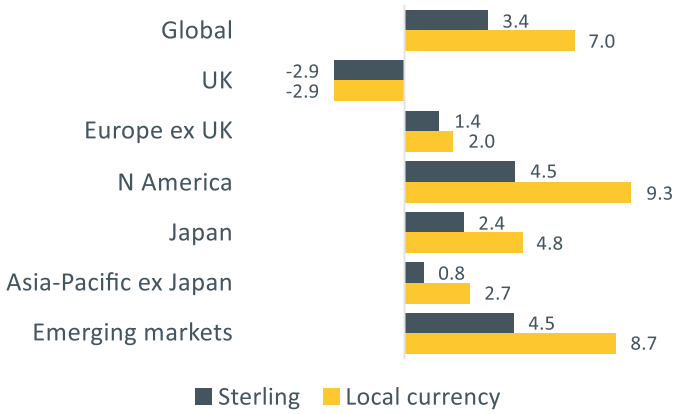
Globally, every major economy has seen its core inflation rate fall since end-2019. Having risen to 1.0% in July, headline UK CPI inflation fell to 0.2% in August, its lowest level since December 2015.

The Fed's shift to "flexible" average inflation targeting over Q3 likely means interest rate rises are even further away than previously envisaged. The Bank of England continues to send mixed messages on the potential use of negative interest rates, but an operational review is ongoing and market pricing, at least, suggests negative interest rates may be introduced in 2021.

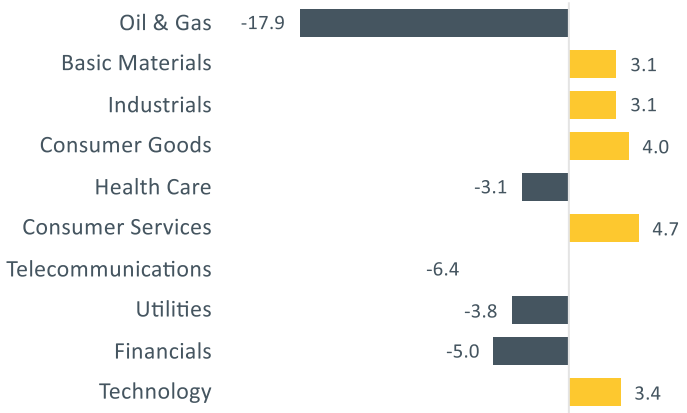
Historic returns for world markets [1]



Regional equity returns



Global equity sector returns (%) [3]



[1]All returns are in Sterling terms. Indices shown (from left to right) are as follows: FTSE All Share, FTSE AW Developed Europe ex-UK, FTSE North America, FTSE Japan, FTSE AW Developed Asia Pacific ex-Japan, S&P/IFCI Composite, FTSE Fixed Gilts All Stocks, FTSE Index-Linked Gilts All Maturities, iBoxx Corporates All Investment Grade All Maturities, JP Morgan GBI Overseas Bonds, MSCI UK Monthly Property Index; UK Interbank 7 Day. [2]FTSE All World Indices. [3]Relative to FTSE All-World Index

Market Returns

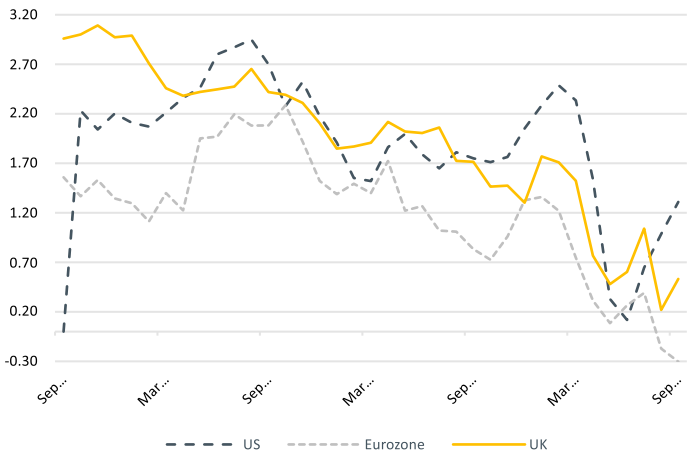
US 10-year treasury yields were little changed, ending the quarter at 0.68% p.a. Equivalent UK yields rose 0.06% p.a. to 0.23% p.a. while German bund yields drifted 0.07% p.a. lower to -0.52% p.a. Equivalent index-linked gilt yields fell, resulting in a rise in 10-year implied inflation to 3.3% p.a.

Despite rising towards the end of Q3, global investment-grade credit spreads fell from 1.6% p.a. to 1.4% p.a. and global speculative-grade spreads fell from 6.4% p.a. to 5.6% p.a. Defaults continued to rise but have been contained in the troubled US energy and retail sectors.

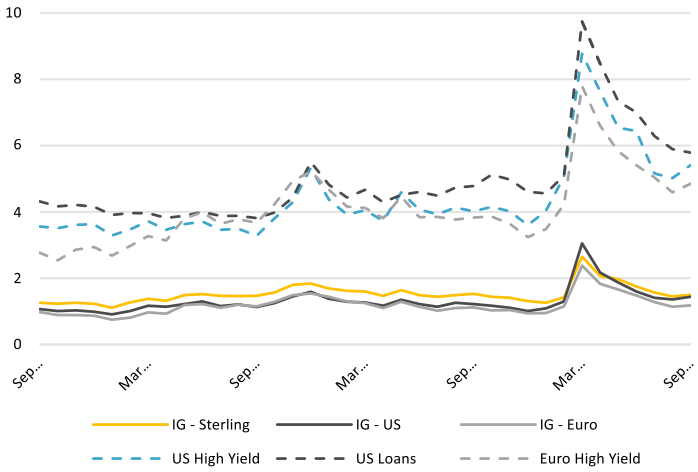
Global equity indices produced a total return of 7% in local currency terms, despite a return of volatility towards the end of Q3. Recent regional trends continued with the US outperforming and the UK underperforming. From a sector perspective technology extended its large year-to-date lead at the top of the performance rankings while oil & gas massively underperformed, cementing its place at the bottom.

The rolling 12-month performance of the MSCI UK Monthly Property Index continues to fall and is now -2.7% to the end of September. Capital values are, in aggregate, 7.8% lower over the same period. This is mainly due to an 18.6% fall in capital values in the retail sector over year, but values in other sectors have also fallen.

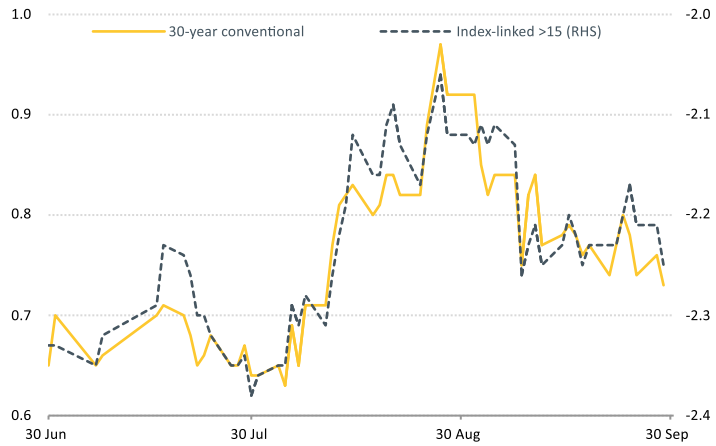
Annual CPI Inflation (% p.a.)



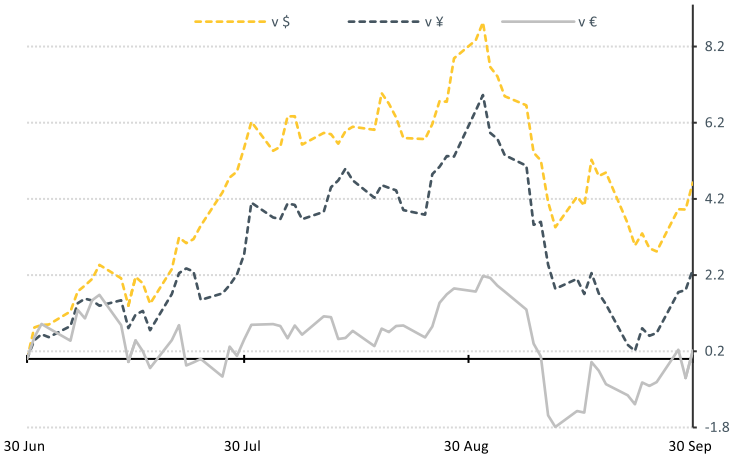
Investment and speculative grade credit spreads (% p.a.)



Gilt yields chart



Sterling trend chart (% change)



Source: Reuters

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

	June 2020	September 2020	Comment
Index-linked gilts	Neutral	Neutral to Cautious	Gilt yields remain near record lows amid slumping forecasts for growth and inflation and ultra-accommodative monetary policy. Yields may remain subdued for some time as major central banks maintain QE programs to provide liquidity to the global financial system, potentially pushing the normalisation of interest rates beyond the horizon of our medium-term views. Implied inflation is no longer significantly cheap versus forecast and target inflation. The ongoing consultation in to RPI as an inflation measure remains a lingering upside risk for real yields. Forecasts for UK growth and inflation in 2020 provide fundamental support for gilt markets.
Conventional gilts	Neutral to Cautious	Neutral to Cautious	
Sterling non-government bonds	Neutral	Neutral to Cautious	Sterling investment grade spreads, on a ratings-consistent basis, have fallen below long-term median levels and the premium on sterling investment-grade corporates relative to equivalent global credit is low relative to history. We remain watchful of spreads given their level relative to history.
Equities	Cautious	Cautious	Global equity markets continued their momentum from Q2 through Q3, boosted by improving investor sentiment as rapid growth was realised following the easing in lockdowns in major economies. While data has improved and analysts' earnings forecasts have stabilised, much uncertainty remains over the recovery and the longer-term trajectory of corporate earnings, particularly in light of the recent return of restrictions in many countries. Valuations are highly disparate by region and sector, but when viewed in aggregate are considered a little stretched and may not be fully reflective of the current downside risks to the outlook.
Cash Strategies	Neutral	Neutral	While interest rates may be as close to zero as they can get, when focused on risk adjusted returns, this feels like a sensible time to hold more cash than usual, that can be deployed into buying opportunities.

Source: Reuters

Asset allocation

The Fund's total assets increased over the quarter by c.£6.7m, totalling £641.9m as at 30 September 2020. This reflects the more muted market activity and more subdued equity increases than Q2 reflecting ongoing uncertainty around COVID-19.

The Fund remains slightly overweight in equities due to market movements. However the transition from the Newton Global Equity Fund to Schroders Fixed Income has remedied some of the underweight to protection assets. The mandate weightings are now all within their acceptable tolerance ranges.

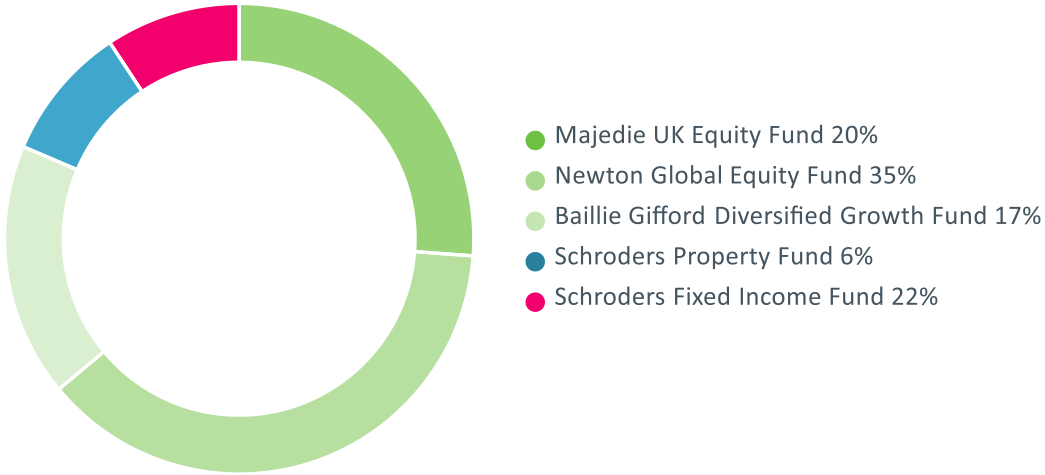
Key Actions

The Fund re-balanced £13m (c2% of assets) out of Newton Global Equity and in to Schroders Fixed Income on 21 September 2020, in order to bring the Fund more in line with strategic target.

Asset Allocation

Manager	Valuation (£m)		Actual Proportion	Benchmark	Relative
	Q2 2020	Q3 2020			
Majedie UK Equity Fund	131.4	129.0	20.1%	22.5%	-2.4%
Newton Global Equity Fund	232.2	225.1	35.1%	32.5%	2.6%
Baillie Gifford Diversified Growth Fund	105.3	108.7	16.9%	15.0%	1.9%
Total Growth	**468.9**	**462.9**	**72.1%**	**70.0%**	**2.1%**
Schroders Property Fund	36.0	36.1	5.6%	8.0%	-2.4%
Total Income	**36.0**	**36.1**	**5.6%**	**8.0%**	**-2.4%**
Schroders Fixed Income Fund	130.3	142.9	22.3%	22.0%	0.3%
Total Protection	**130.3**	**142.9**	**22.3%**	**22.0%**	**0.3%**
Total Scheme	**635.2**	**641.9**	**100.0%**	**100.0%**	

Asset class exposures



Source: Fund performance and valuation data provided by Investment Managers and is net/gross of fees. Benchmark performance provided by Investment Managers and DataStream

Fund performance

Total Fund returns were positive over Q3 2020. The Fund returned 1.7% against its benchmark of 0.6%, giving a relative outperformance of 1.1%.

The Fund is ahead of benchmark over 12 months and 3 years, whilst behind benchmark over the longer term of 5 years.

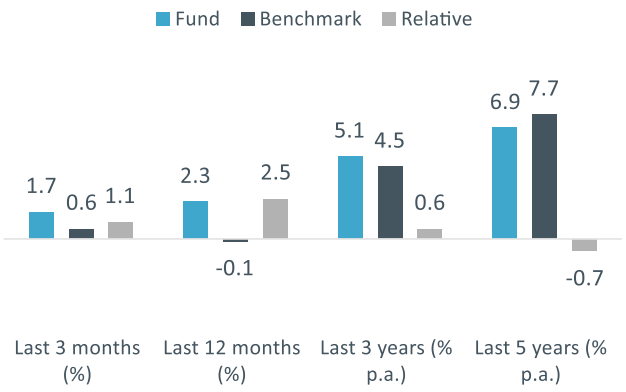
The Fund's managers all outperformed their benchmarks over Q3 against a backdrop of increased uncertainty in global markets surrounding a potential 'second wave' of COVID-19.

The Schroders Property mandate recently lifted the dealing suspension implemented in March.

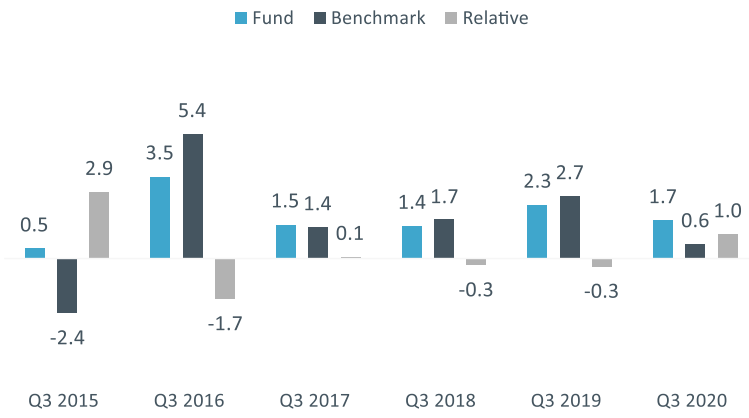
Manager performance

	Last 3 months (%)			Last 12 months (%)			Last 3 years (% p.a.)			Last 5 years (% p.a.)		
	Fund	B'mark	Relative	Fund	B'mark	Relative	Fund	B'mark	Relative	Fund	B'mark	Relative
Growth												
Newton Global Equity Fund	3.6	3.4	**0.3**	8.7	5.3	**3.2**	11.0	8.4	**2.3**	14.0	13.8	**0.1**
Majedie UK Equity Fund	-1.1	-2.9	**1.9**	-13.1	-16.6	**4.1**	-4.2	-3.2	**-1.0**	2.9	3.5	**-0.6**
Baillie Gifford Diversified Growth Fund	3.4	0.9	**2.5**	-1.3	3.9	**-5.0**	1.8	4.1	**-2.2**	4.2	4.0	**0.2**
Income												
Schroders Property Fund	0.4	0.2	**0.2**	-1.3	-2.7	**1.5**	4.0	3.0	**1.0**	5.6	4.3	**1.2**
Protection												
Schroders Fixed Income Fund	0.3	0.1	**0.2**	5.7	4.0	**1.6**	6.2	5.4	**0.8**	6.4	5.4	**0.9**
Total	1.7	0.6	**1.1**	2.3	-0.1	**2.5**	5.1	4.5	**0.6**	6.9	7.7	**-0.7**

Fund performance vs benchmark/target



Historical quarterly performance Summary



Source: Fund performance and valuation data provided by Investment Managers and is net/gross of fees. Benchmark performance provided by Investment Managers and DataStream

Manager Ratings

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. The development of these ratings is still ongoing and thus we do not currently have RI ratings for all the Fund's managers.

Both of these ratings are further explained in the Appendix on page 13.

Manager ratings

Mandate	Hymans Rating	RI
Newton Global Equity Fund	Positive	Good
Majedie UK Equity Fund	Preferred	Adequate
Schroders Fixed Income Fund	Positive	-
Schroders Property Fund	Positive	-
Baillie Gifford Diversified Growth Fund	Preferred	Good

Newton business update

- Newton announced over the quarter that Andrew Downs would become interim CEO of Newton effective at the start of October 2020 and is a result of former CEO Hanneke Smits' promotion to CEO of BNY Mellon Investment Management.
- Andrew has 26 years experience at Newton and is a member of the firm's board and executive management committee. Newton are still searching for a permanent CEO.
- We continue to rate Newton as 'Positive – On Watch' as we monitor developments.

Schroders business update

- It was announced over the quarter that the Schroders UK Real Estate fund has now re-opened following its dealing suspension back in March when the portfolio valuations were subject to material uncertainty clauses from its valuer. These clauses have now been removed from the vast majority of the market and normal dealing has resumed.
- In addition, Schroders has announced that Fund Manager Jessica Berney will go on maternity leave at the end of December. Rob Cosslett, the Deputy Fund Manager, will become Acting Fund Manager while Berney is on maternity leave, supported by Emilia Tiernan, the fund's Investment Manager.
- Finally, Schroders has announced that Duncan Owen, its Global Head of Real Estate, has resigned and will be leaving the firm on 31 December 2020. Owen will remain a Special Advisor to Schroders. Sophie van Oosterom will join the firm in January 2021 as new Global Head of Real Estate and joins from CBRE Global Investors where she was CEO and CIO of its EMEA division.
- In regard to Schroders Fixed Income, Karl Dasher, CEO of North America and Co-Head of Fixed Income, left the firm at the end of the year. Marc Brookman, who joined Schroders last year as Deputy CEO of North America, will take over as CEO of North America. Philippe Lespinard, who has worked with Karl for the past 10 years on the Fixed Income Investment Platform, will continue as Head of Fixed Income, reporting to Charles Prideaux, Global Head of Investment.
- We are comfortable with the changes announced above.
- We continue to rate Schroders as "Positive".

Source: Investment Managers

Majedie UK Equity

The Majedie UK Equity mandate returned -1.1% in absolute terms over Q3 2020, however it outperformed its FTSE All Share benchmark by 1.9% (ahead of performance target). The fund is also ahead of benchmark and target over the 12 month period. Over the longer time periods considered the fund remains behind both benchmark and target

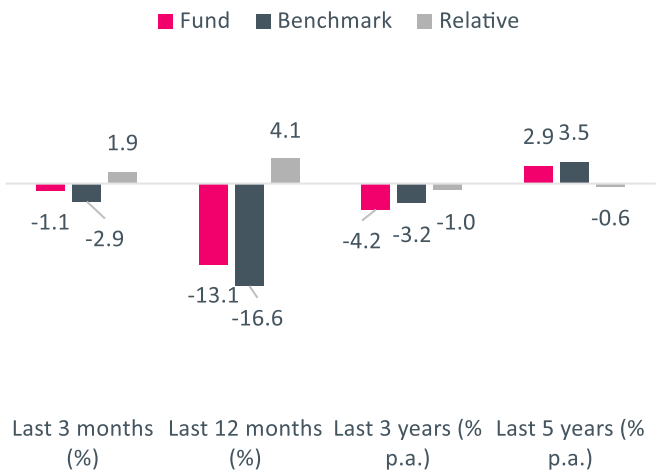
The UK equity market stabilised over the quarter, as governments globally developed frameworks to manage the COVID-19 pandemic, providing some clarity.

Holdings in consumer stocks and industrial metals and mining provided strong returns for the fund. Fever-Tree, Unilever and Mondi all performed well due to strong demand and successful management of demand shifts.

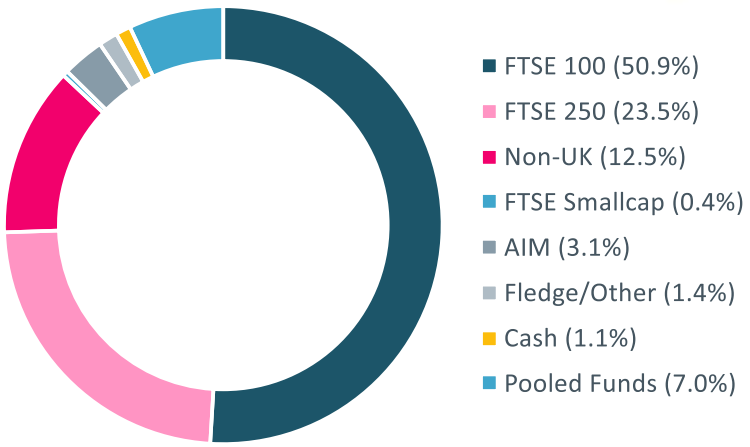
Serco, a public services contractor company, was the main detractor from performance over Q3 2020. This is in part to negative perception in response to the companies involvement in the UK's Track and Trace programme which came under criticism.

The manager established holdings in Diageo, the alcoholic beverages company, and RELX, an information and data analytics company, over the quarter.

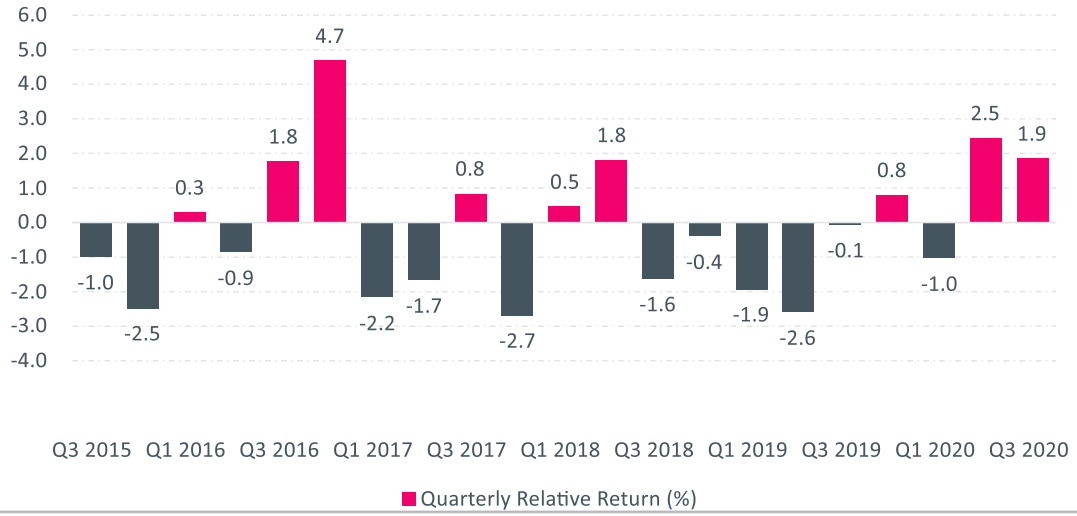
Performance Summary (Gross of Fees)



Asset Allocation



Relative Quarterly Performance



Source: Investment Manager

Newton Global Equity

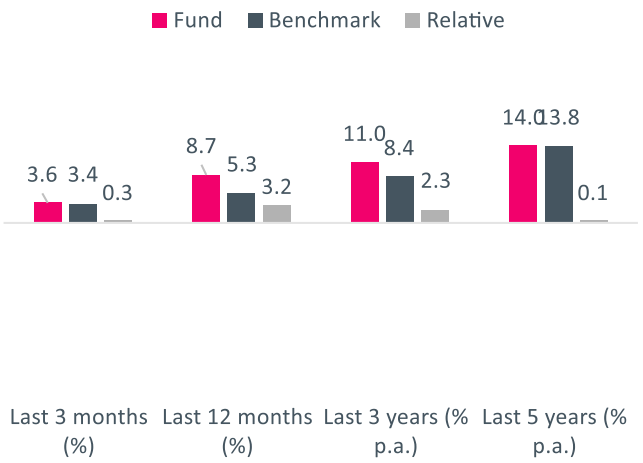
The Newton Global Equity Fund returned 3.6% over the quarter, outperforming its MSCI ACWI benchmark by 0.3%.

The mandate also outperformed its benchmark over the 12 month and 3 year periods, returning 3.2% and 2.3% respectively in relative terms. Global equities continued to recover over Q3 2020 as monetary policy and central bank support continued, though at a slower rate than Q2.

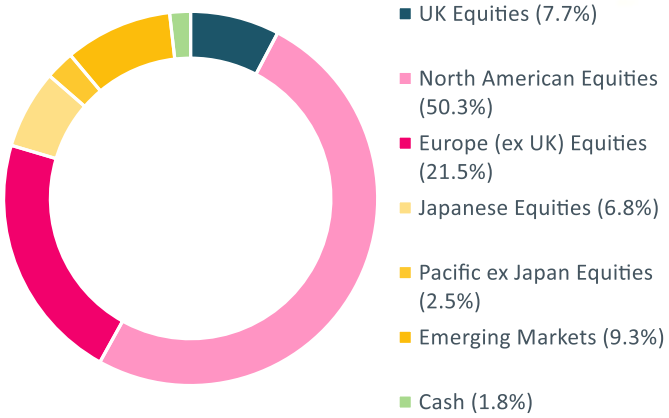
Holdings in consumer products and services, health care and information technology were the main drivers of positive performance over the period. Alibaba provided strong returns as investors confidence grew in their e-commerce service. Holdings in Samsung, Apple and Suzuki also contributed significantly to performance.

The main detractors over the quarter were in the energy, financials and materials sectors. Citigroup struggled amidst a background of low interest rates and detracted from performance. Holdings in Bayer, Cisco Systems and Royal Dutch Shell were among the main detractors to performance. The manager added to positions in information technology and consumer stocks over the quarter, and reduced exposure to energy.

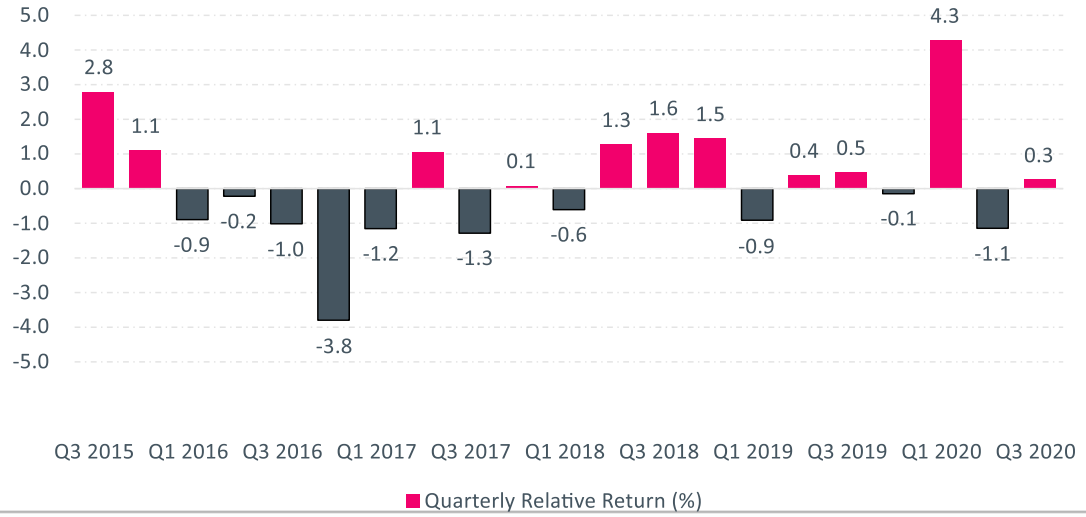
Performance Summary (Gross of Fees)



Asset Allocation



Relative Quarterly Performance



Source: Investment Manager

Baillie Gifford Diversified Growth

The Baillie Gifford Diversified Growth Fund returned 3.4% over the third quarter of 2020, outperforming its benchmark of 0.9% by 2.5%.

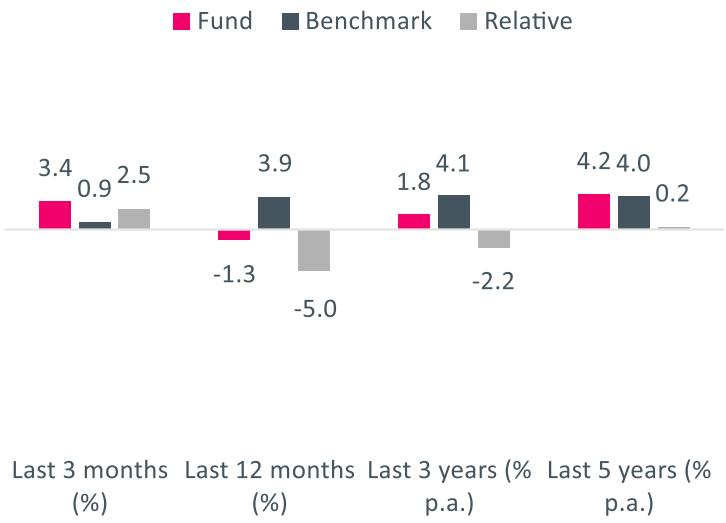
Over the longer term the mandate continues to underperform its target, returning -5.0% and -2.2% p.a. in relative terms over the 12 month and 3 year period respectively.

The mandate again benefitted from its exposure to equities and commodities, with these asset classes providing the bulk of positive performance. Holdings in infrastructure also performed well.

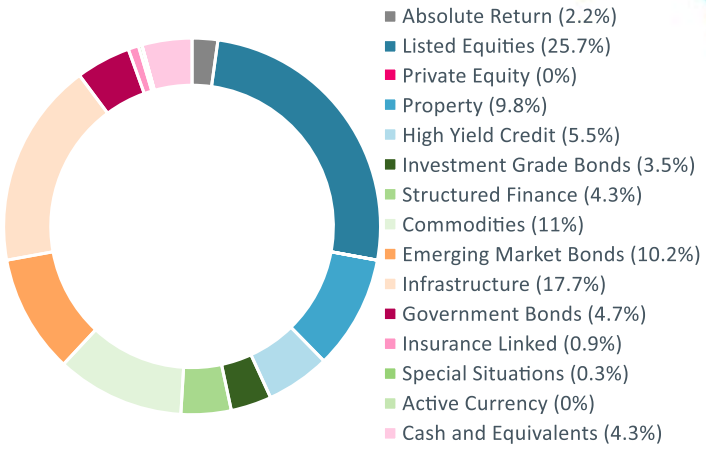
Defensively placed assets such as absolute return strategies detracted from performance, as did property, which has been heavily affected by COVID-19 related restrictions and the move to online shopping.

The manager added to positions in infrastructure, government bonds, and logistics property, and reduced their position to retail property, absolute return positions, and listed equities.

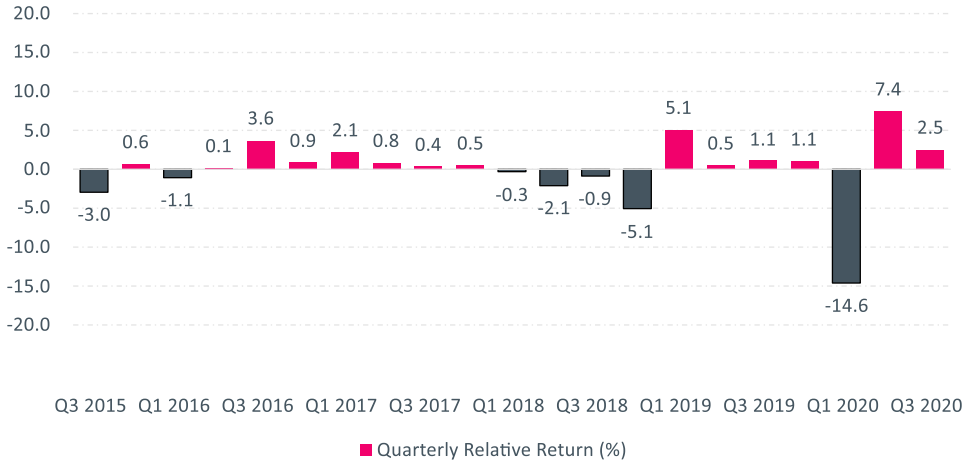
Performance Summary (Gross of Fees)



Asset Allocation



Relative Quarterly Performance



Source: Investment Manager

Schroder Property

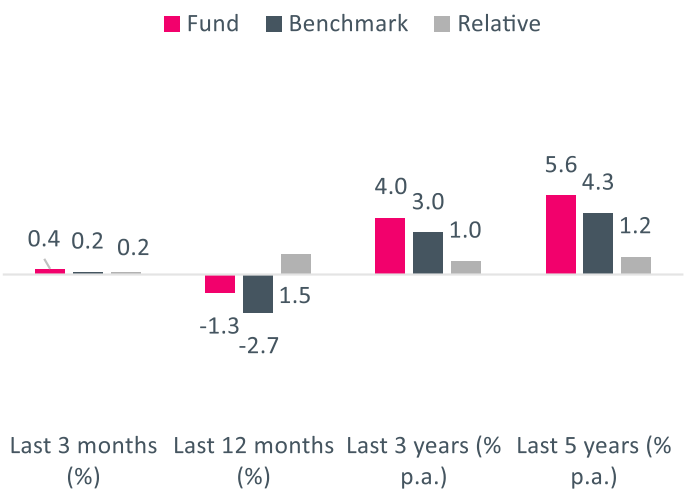
The Schroders UK Real Estate Fund returned 0.4% over the quarter, outperforming its benchmark of 0.2%. Longer term relative returns were also positive, with the fund continuously outperforming its benchmark over the 12 month, 3 year and 5 year periods.

The fund continued to focus on active engagement with tenants, and on long term income office assets. The fund held an underweight position to retail property as a defensive measure.

COVID-19 factors again caused significant issues within the property market. As consumers move in greater numbers towards online retail, retailers which have been slow in adapting have suffered. Greater demand for online retail has resulted in greater demand for warehouses, and as such this sector of the property market grew.

The fund announced a forward commitment to develop a £45m office building in Cambridge. The fund sold Electra Business Park in East London for £133m. 9 new letting and 25 new lease renewals were completed over the quarter, securing £2.9m rental income per annum.

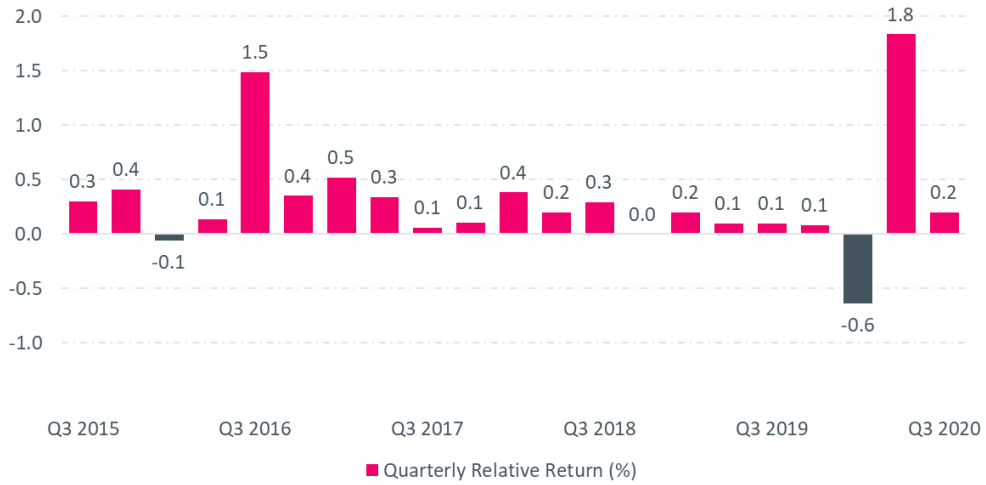
Performance Summary (Gross of Fees)



Key Statistics

Fund size	£2,245.2m
Number of holdings	54
Number of tenants	717
Debt (% of NAV)	0.4%
Top 10 holdings as % of portfolio	45.5

Relative Quarterly and Relative Cumulative Performance



Source: Investment Manager

Schroders Fixed Income

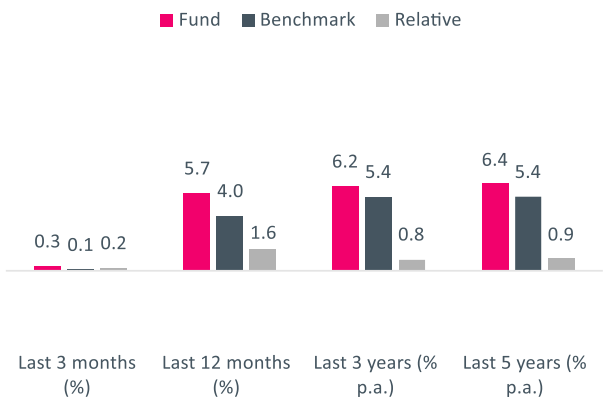
The Schroders Fixed Income portfolio returned 0.3% over the quarter, against its benchmark of 0.1%, giving a relative return of 0.2%. Longer term returns were also positive and ahead of benchmark over all periods.

The fund benefitted from a continuation of relative stability in markets. Monetary policy support kept government bond yields low over the quarter, resulting in marginally positive performance.

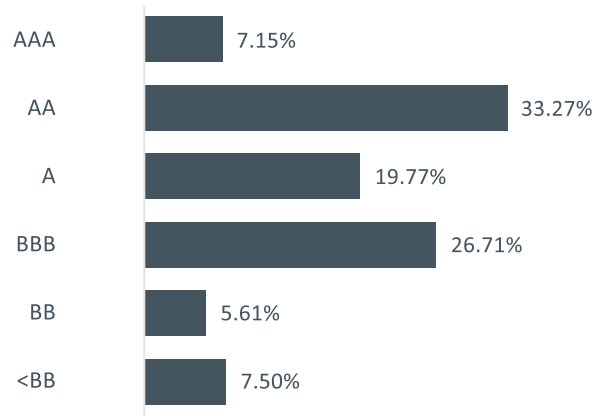
Positive performance was driven by the fund's off benchmark long allocation to Australian interest rates, and preference for government bonds in Europe. European bonds benefitted from the European Union agreeing on a recovery fund to assist weaker members of the union.

The fund maintained its overweight to UK investment grade credit and closed its off benchmark exposure to Chinese rates over Q3 2020. The fund also rotated to an overweight position to UK gilts over the quarter.

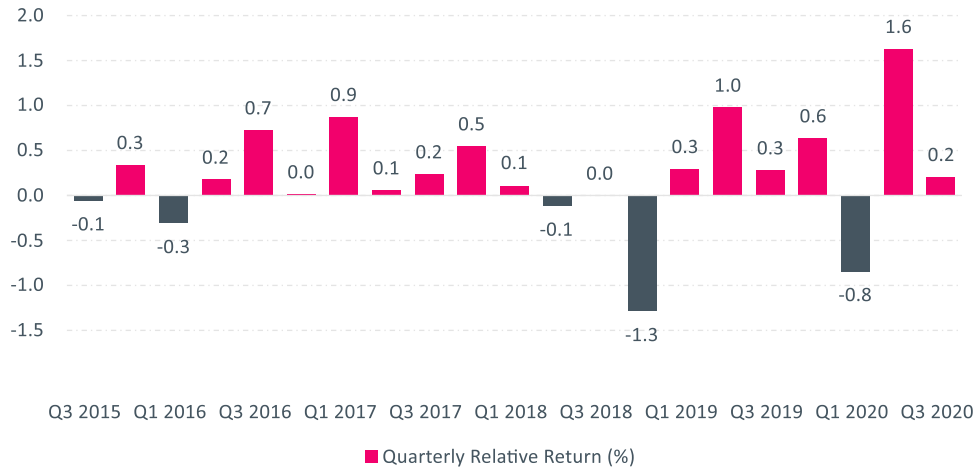
Performance Summary (Gross of Fees)



Relative Credit Allocation



Relative Quarterly and Relative Cumulative Performance



Source: Investment Manager

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
Majedie UK Equity Fund	31/08/2009	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

Source: Investment Managers

Hymans Rating

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.

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.

In some cases, we have commercial business arrangements/agreements with clients within the financial sector where we provide services. These services are entirely separate from any advice that we may provide in recommending products to our advisory clients. Our recommendations are provided as a result of clients' needs and based upon our independent research. Where there is a perceived or potential conflict, alternative recommendations can be made available.

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.