Schroders

Isle of Wight Council Pension Fund
Schroder Sterling Broad Market Fund

Isle of Wight Council Pension Fund – Fixed Income Portfolio Review

Performance review & Portfolio Activity to September 2020

On a year to date basis, to 30 September 2020, the fund has posted positive returns of 7.64%, outperforming its benchmark which posted returns of 6.46%. The portfolio's rates strategy was the primary contributor to outperformance driven by our off-benchmark allocation to US duration which benefitted both from significant monetary stimulus and safe-haven flows. Our credit strategy has also contributed to performance, initially suffering during the Covid-19 induced market shock in March but has since recovered strongly.

We started the year expecting a near-term cyclical pick-up in growth, particularly across Europe, with our credit strategy primarily expressing this view. On the political front too, we had begun to see some of the headwinds on global growth reversing somewhat, namely with some progress on Brexit. However, the emergence of the coronavirus and with its implications for global growth saw some of these more pro-cyclical (growth sensitive) positions detract from performance. The portfolio was exposed to a sharp widening of credit spreads and this was most apparent from our overweight positioning in sterling-denominated investment grade corporates. However, this was offset somewhat by our rates strategy where we benefitted from an overweight duration stance (sensitivity to interest rates) and an off-benchmark allocation to US duration, which was a notable outperformer.

Following the period of extreme volatility, we have since seen some semblance of stabilisation in financial markets. The fund continued to hold a pro-cyclical bias through our credit strategy, which performed well in the second quarter as markets discounted a more optimistic outlook relative to the severe level of pessimism reached previously, with central banks' increased provision of liquidity helping to normalise market conditions. As the rate of new Covid-19 infections continued to fall and various economies started to reopen, economic data had shown signs of a sharp rebound.

As we moved through the summer period, fixed income markets were relatively muted as monetary policy support kept government bond yields pinned at low levels. As such, in our rates strategy we preferred to express our thematic views through cross-market opportunities which had been created as a result of differing policy responses to the crisis. We initiated a relative value position in various markets (initially Canada, then Germany, and finally Australia) versus UK gilts (underweight gilts) to express our concerns that significant government bond issuance in the UK would likely place upward pressure on yields (yields move inversely to prices) at a time when the Bank of England was considering scaling back its quantitative easing programme. These positions broadly performed well and contributed to the positive outperformance of the fund.

Isle of Wight Council Pension Fund Fixed Income performance to 30 September 2020 (% pa)

	YTD	12 months	3 years	Inception*
Fixed Income Portfolio	7.64	5.66	6.21	6.84
Benchmark	**6.46**	**3.84**	**5.31**	**5.92**

Discrete Annual Performance

	2019	2018	2017	2016	2015
Fixed Income Portfolio	**10.32**	**-1.62**	**4.97**	**11.24**	**1.08**
Benchmark	8.18	-0.51	3.11	10.64	0.47

Schroder Sterling Broad Market Gross Attribution: Year to date 2020

	Alpha	FX	Rates	Credit	Residual
Total	**118**	**-21**	**116**	**32**	**-4**

Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amount originally invested.

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.

*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

More recently, given rising risks surrounding Brexit and considering UK interest rates were continuing to price prospects of a negative Bank of England policy rate, we rotated our underweight position in UK gilts to overweight. This was again positioned on a cross-market basis versus US Treasuries (overweight gilts, short US Treasuries).

Elsewhere, throughout the summer and beyond we have held a positive structural outlook for Europe and expressed this through an allocation to government bonds in the European periphery, held versus Germany. This paid dividends as the EU collectively came together to signal greater integration with the agreement of a Europe-wide recovery fund to assist weaker members of the EU.

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