Isle of Wight Council Pension Scheme

Q4 2020 Investment Monitoring Report

David Walker - Partner
Emma Garrett - Investment Consultant
Eoin Spence - Investment Analyst
Annabel Preston – Investment Analyst

HYMANS ROBERTSON

Market Background

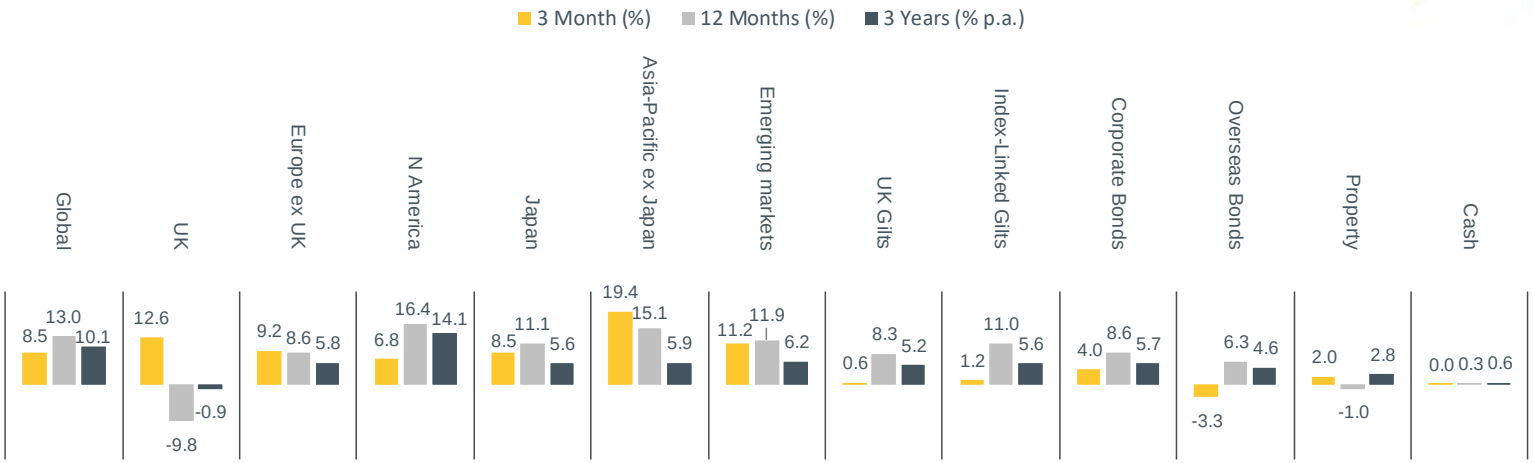
Q3 GDP releases show the initial rebound in activity was sharp as the major advanced economies emerged from lockdown but annualised falls in output have been significant. Composite PMIs suggest the UK and Eurozone economies ended 2020 on a weak note but the global equivalent remains at a level signalling expansion, supported by solid readings in the US, China and elsewhere. Though COVID-19 cases continue to rise at a global level, many advanced economies could potentially vaccinate a large proportion of their most vulnerable citizens in the first half of 2021.

UK headline inflation slowed more than expected falling from 0.7% in October to 0.3% year-on-year in November as restrictions to curb the spread of coronavirus were re-imposed.

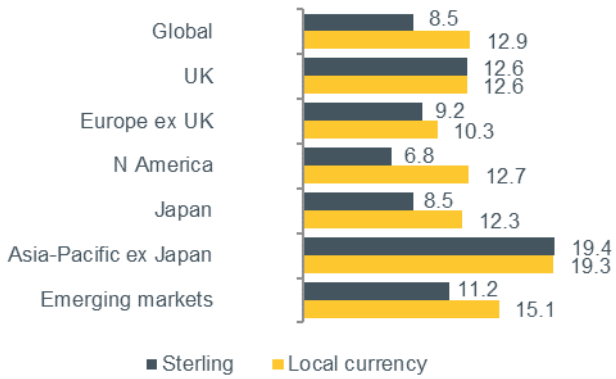
Despite hopes of economic recovery in 2021, government bond yields rose only modestly in the US and fell in the UK and Germany due to near-term economic weakness and central bank intervention. Implied inflation rose at longer terms despite the government's announcement that RPI will be aligned with CPIH from 2030. Global investment grade credit spreads fell from 1.4% p.a. to 1.0% p.a. and global speculative-grade spreads from 5.6% p.a. to 4.1% p.a., as lower rated credit outperformed higher quality.

Sterling was volatile as Brexit talks approached their conclusion, although it ended the period 1.9% higher in trade-weighted terms as the EU and UK reached a trade deal. In comparison, on a trade-weighted basis the US Dollar and Japanese Yen, both typically considered safe-haven currencies, fell 5.3% and 1.4% below end-September levels.

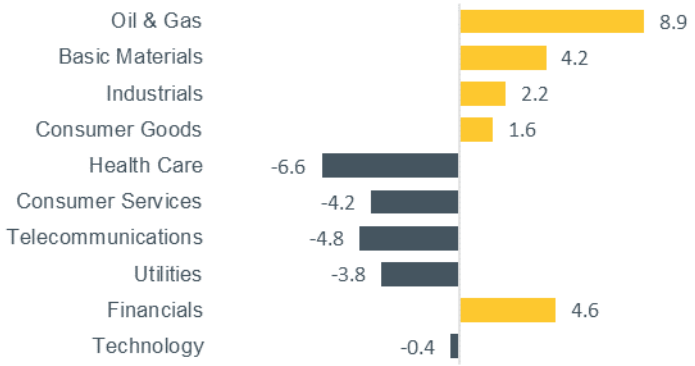
Historic returns for world markets [1]



Regional equity returns [2]



Global equity sector returns (%) [3]



[1] All returns are in Sterling terms. Indices shown (from left to right) are as follows: FTSE All World, FTSE All Share, FTSE AW Developed Europe ex-UK, FTSE North America, FTSE Japan, FTSE AW Developed Asia Pacific ex-Japan, FTSE Emerging, 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 Indices.

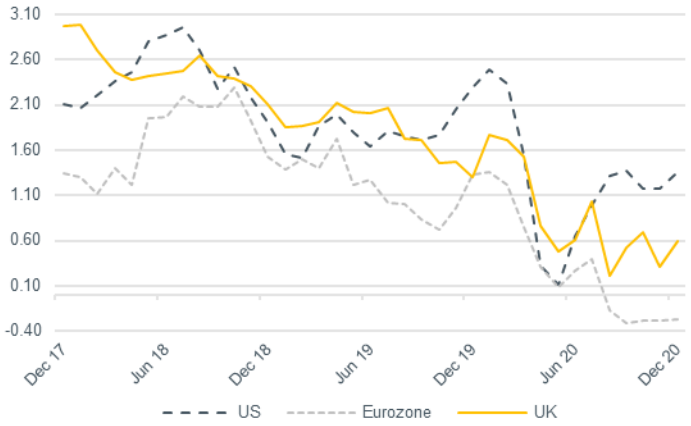
Market Background

After falling in October amid renewed restrictions to curb rapidly rising COVID-19 cases, positive vaccine news propelled equity markets higher, with the FTSE All World returning 12.9% in Q4. This news also caused some moderate rotation within global equities as areas of the market most impacted negatively by the pandemic outperformed. This was evident in the outperformance of cyclical sectors such as oil & gas, financials and materials and interconnectedly, styles such as value and smaller capitalisation stocks. Defensive areas such Healthcare, Utilities and Telecoms all underperformed.

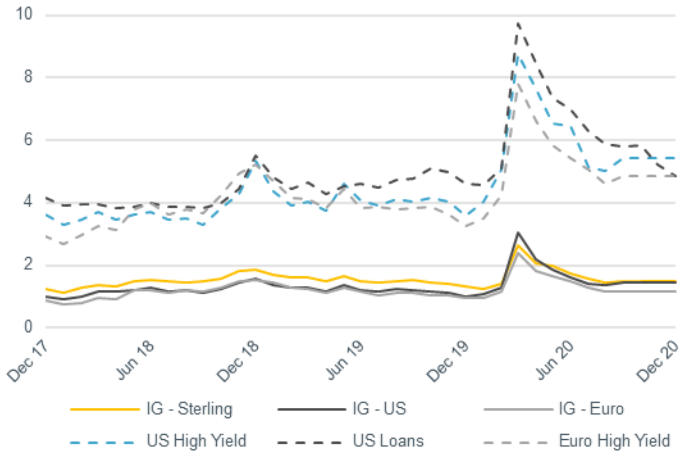
From a regional perspective, Emerging market and Asia ex-Japan equities outperformed, both benefiting from renewed hopes of a cyclical recovery, a falling dollar and increasing global trade activity.

The rolling 12-month total return on the MSCI UK Monthly Property index was -1.9% to the end of November, although monthly total returns have now been positive since July. Capital values, in aggregate, have fallen 7.1% in the year to November, predominantly due to a 17.9% fall in the retail sector, where capital values continue to decline sharply.

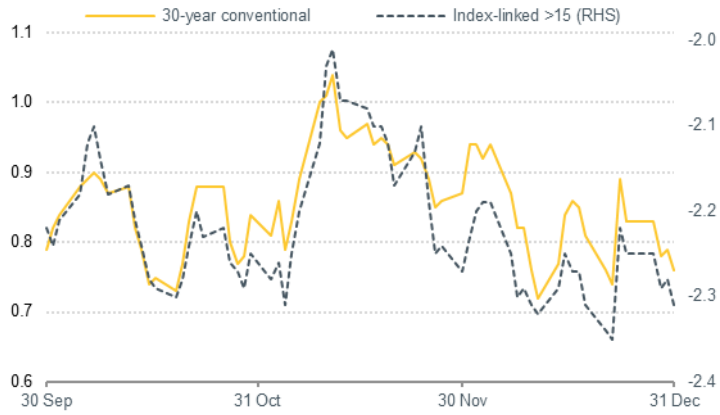
Annual CPI Inflation (% p.a.)



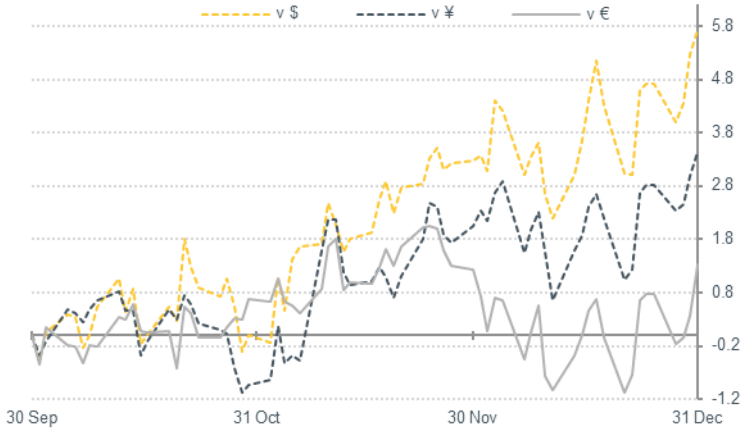
Investment and speculative grade credit spreads (% p.a.)



Gilt yields chart (% p.a.)



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

	September 2020	December 2020	Comment
Index-linked gilts	Neutral to Cautious	Neutral to Cautious	Gilt yields remain well below our assessment of longer-term fair value - 3.0-3.5% p.a. for nominal yields. Economic recovery may drive today's very low yields higher but, while GDP remains below trend and unemployment elevated, 10-year nominal yields may be expected to rise no higher than 1.0-1.5% p.a. Despite the government's announcement that RPI will be aligned with CPIH (c.1% p.a. lower), with no compensation for index-linked gilt holders, implied inflation actually rose at longer terms as gilt yields rose more than index-linked gilt yields. Implied inflation looks expensive at terms up to around 25 years.
Conventional gilts	Neutral to Cautious	Neutral to Cautious	
Sterling non-government bonds	Neutral to Cautious	Cautious	Despite a continued rise in leverage and fall in interest coverage, investment-grade spreads are now well below long-term median levels. Low central bank policy rates and government bond yields will likely provide ongoing technical support and fundamentals should improve as earnings recover in 2021, but very low spreads and yields may pose a headwind to returns going forward. Sterling investment grade spreads, on a ratings-consistent basis, have fallen well below long-term median levels and the premium relative to equivalent global credit is low relative to history.
Private Debt	Neutral to Cautious	Neutral to Cautious	Transaction levels have returned to pre-COVID levels and, while pricing has also returned to pre-COVID levels, loans are typically being written with better lender protections meaning a better risk-adjusted return overall. The illiquidity premium to the loan market remains slightly compressed. More affected outstanding debt in public and private markets may create opportunities for new stressed/distressed and special situations financing strategies.
Infrastructure	Neutral	Neutral to Attractive	The economic impact of the pandemic is having a greater effect on the more GDP-sensitive sectors (airports, shipping, toll roads) of the infrastructure market. Less economically sensitive sectors such as utilities and social infrastructure remain in high demand as they provide essential services. The pandemic has led to significant write-downs of some GDP-sensitive assets which has created some value opportunities, although overall transaction levels are suppressed so far this year.
Equities	Cautious	Neutral to Cautious	Further rises in global equities leaves valuation measures increasingly stretched versus history. However, there remains significant disparity in valuations by region and overall valuations do not look as expensive in the context of very low real yields. Q3 earnings have continued to outperform expectations and estimates for Q4 have risen. The bounce in earnings expected in 2021 would leave full-year earnings in 2021 above end-2019 levels. Given high valuations and near-term economic uncertainty, we retain a degree of caution, despite the fundamental improvement expected in 2021.
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 in Q4 by c.£43.5m, totalling £685.4m as at 31 December 2020.

The Fund's equity holdings were the key drivers for performance over the quarter. After falling sharply in October, positive vaccine developments and the US-election outcome, resulted in strong rallies in equity markets in November and December.

The Fund remains slightly overweight to equities due to the rallies in equities over the quarter. However, this is in acceptable ranges.

Key Actions

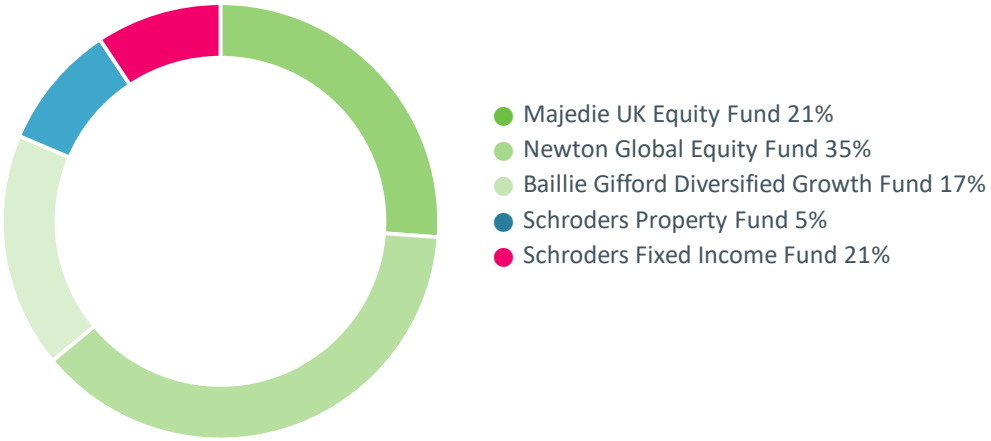
No re-balancing activity is currently required.

The assets held in the Majedie UK Equity Fund were transitioned into the ACCESS pool in-specie on 9 November.

Asset Allocation

Manager	Valuation (£m)		Actual Proportion	Benchmark	Relative
	Q3 2020	Q4 2020			
Majedie UK Equity Fund	129.0	145.6	21.2%	22.5%	-1.3%
Newton Global Equity Fund	225.1	240.9	35.1%	32.5%	2.6%
Baillie Gifford Diversified Growth Fund	108.7	115.4	16.8%	15.0%	1.8%
Total Growth	**462.9**	**501.8**	**73.2%**	**70.0%**	**3.2%**
Schroders Property Fund	36.1	36.8	5.4%	8.0%	-2.6%
Total Income	**36.1**	**36.8**	**5.4%**	**8.0%**	**-2.6%**
Schroders Fixed Income Fund	142.9	146.7	21.4%	22.0%	-0.6%
Total Protection	**142.9**	**146.7**	**21.4%**	**22.0%**	**-0.6%**
Total Scheme	**641.9**	**685.4**	**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 in absolute terms over the quarter. The Fund delivered a return of 6.9% over the 3 month period against its benchmark of 6.3%, resulting in a positive relative return of 0.6%.

The Fund is ahead of benchmark over all time periods considered.

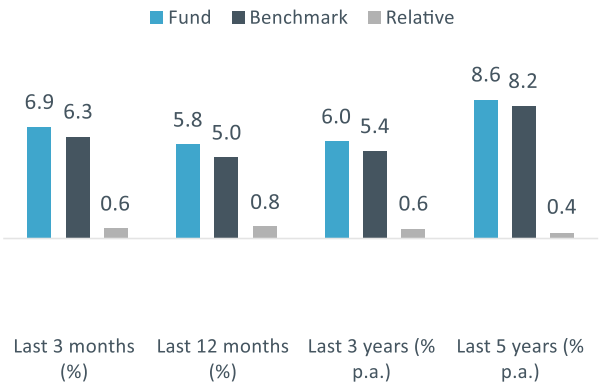
With the exception of Newton Global Equity Fund, all of the Fund's managers outperformed their benchmarks over Q4 2020.

Baillie Gifford in particular provided strong returns with a relative outperformance of 5.3%. Newton struggled over the quarter due to stock selection in the consumer discretionary and healthcare sectors.

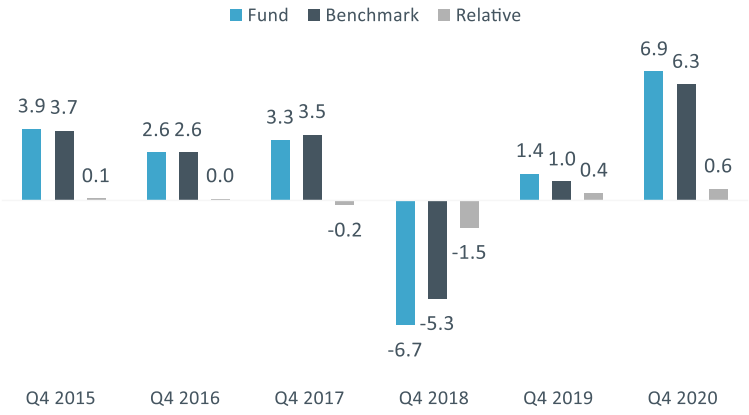
Manager performance (gross of fees)

	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	7.1	8.5	**-1.3**	15.0	12.7	**2.0**	11.7	9.7	**1.9**	13.5	14.0	**-0.4**
Majedie UK Equity Fund	13.3	12.6	**0.6**	-6.2	-9.8	**3.9**	-0.8	-0.9	**0.1**	5.2	5.1	**0.1**
Baillie Gifford Diversified Growth Fund	6.2	0.9	**5.3**	2.6	3.7	**-1.0**	3.4	4.1	**-0.7**	5.1	4.0	**1.1**
Income												
Schroders Property Fund	2.1	1.9	**0.2**	0.4	-1.2	**1.6**	3.6	2.6	**1.0**	5.4	4.2	**1.2**
Protection												
Schroders Fixed Income Fund	2.7	1.8	**0.9**	10.6	8.5	**1.9**	6.3	5.3	**0.9**	7.0	5.9	**1.0**
Total	6.9	6.3	**0.6**	5.8	5.0	**0.8**	6.0	5.4	**0.6**	8.6	8.2	**0.4**

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.

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.

All of the Fund's investment managers have now been rated on both a manager and RI perspective. There have been no changes to the Fund's ratings over the period.

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	Good
Schroders Property Fund	Positive	Good
Baillie Gifford Diversified Growth Fund	Preferred	Good

Newton business update

- Newton announced that Euan Munro will be joining as their new CEO on 23 June 2021. Euan is an experienced leader who has been CEO at Aviva Investors for the past seven years.
- Andrew Downs will continue as interim CEO with the full support of Newton's board and executive team.
- We continue to rate Newton as 'Positive – On Watch' as we monitor developments.

Schroders business update

- John Griffiths, Head of UK and Ireland Institutional Business, has left Schroders to pursue another opportunity. Claire Glennon and Russell Smith have been appointed as Co-Heads of the UK Institutional Business with immediate effect, and Tom Sibler has been appointed Head of Global Consultant Relations.
- Natalie Howard joined Schroders as Head of Real Estate Debt during Q4.
- We continue to rate Schroders as "Positive".

Source: Investment Managers

Majedie UK Equity

The Majedie UK Equity mandate returned 13.3% in absolute terms over the quarter, outperforming its FTSE All Share benchmark by 0.6% (ahead of performance target). The fund is ahead of benchmark over all other time periods considered, but lags it's performance target over 3 and 5 years.

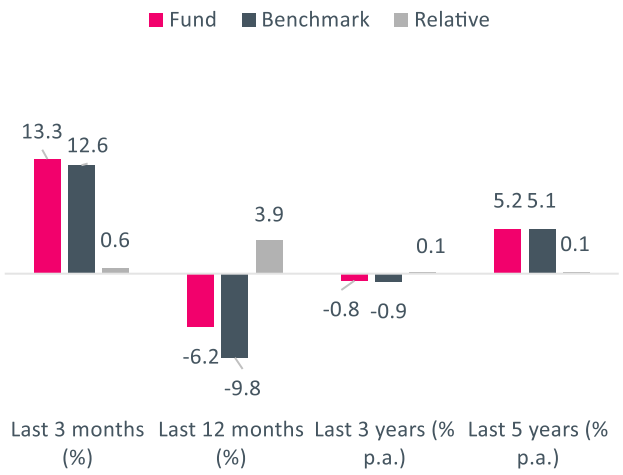
The UK equity market showed strong returns over the quarter, as positive vaccine developments were announced and the UK became the first country to approve a COVID-19 vaccine.

Holdings in industrials, technology and utilities all provided strong returns for the fund. Weir Group, Polypipe and Centrica all performed strongly, with these companies all benefitting from improved optimism from the deployment of COVID-19 vaccines.

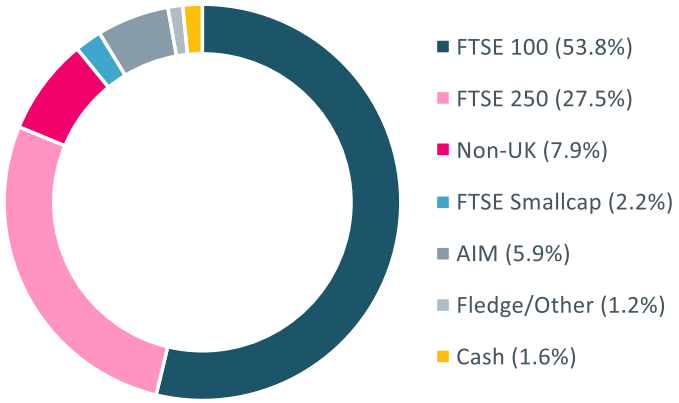
BAE Systems and software provider Aveva were amongst the main detractors to performance. The manager trimmed holdings in UK domestic banks in favour of increasing exposure to businesses with higher growth potential such as Aveva and Next.

On 9 November the Fund's assets with Majedie were transitioned in-specie into the ACCESS pool.

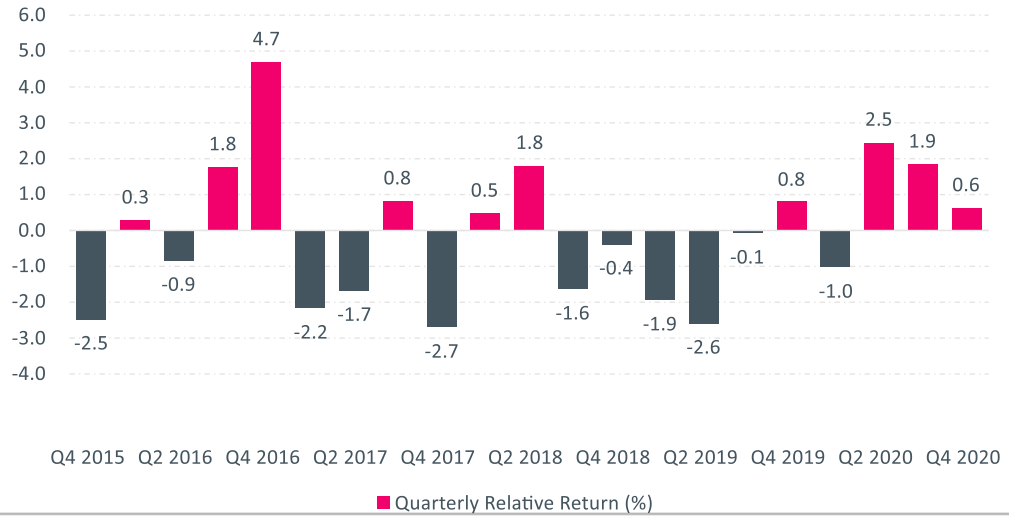
Performance Summary (Gross of Fees)



Asset Allocation



Relative Quarterly Performance



Source: Investment Manager

Newton Global Equity

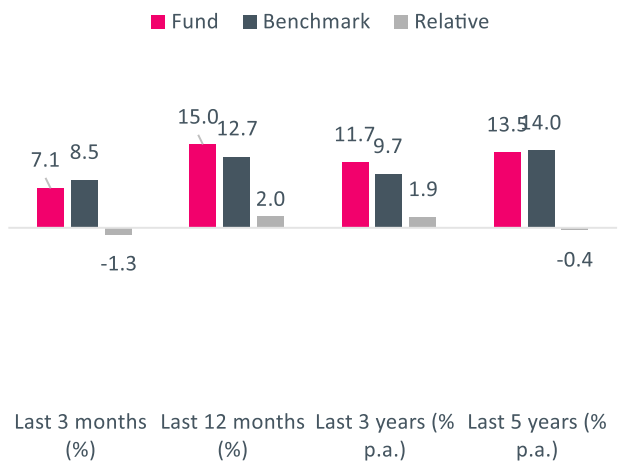
The Newton Global Equity Fund returned 7.1% over the quarter, underperforming its MSCI ACWI benchmark by 1.3%. Performance remains mixed over the longer term.

The mandate outperformed its benchmark over the 12 month and 3 year periods, returning 2.0% and 1.9% respectively in relative terms. Global equities continued to rally after positive news of vaccine developments and the US election. Pacific ex Japan equities in particular performed very strongly.

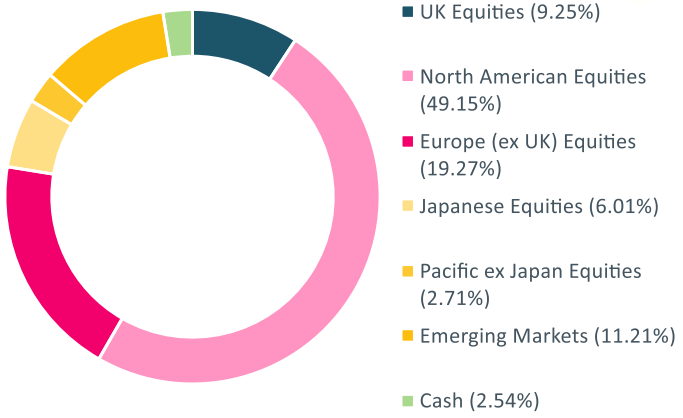
The energy, materials and financial sectors were the main drivers of performance over the period. From a stock perspective, Samsung had the highest positive impact on performance, as increased sales of electric vehicles drove demand for their lithium batteries. Holdings in Apple and Goldman Sachs were also significant contributors.

Holdings in health care and consumer discretionary were the main detractors from performance due to the cyclical nature of these sectors. Alibaba was one of the fund's biggest detractors as share price fell over concerns of increased regulation of 'Big Tech' in China.

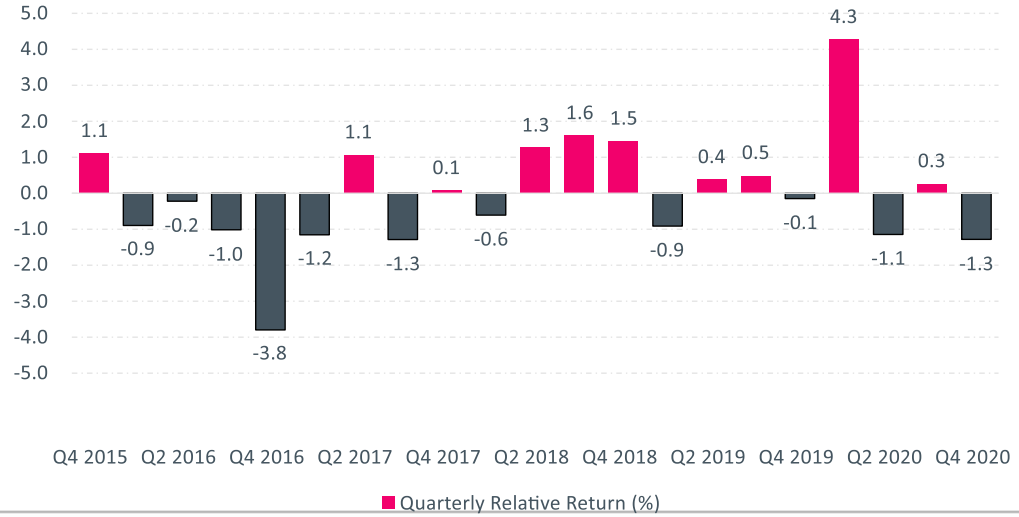
Performance Summary (Gross of Fees)



Asset Allocation



Relative Quarterly Performance



Source: Investment Manager

Baillie Gifford Diversified Growth

Over the last quarter of 2020 the Baillie Gifford diversified growth fund returned 6.2%, outperforming its benchmark (UK Base Rate +3.5%) by 5.3%.

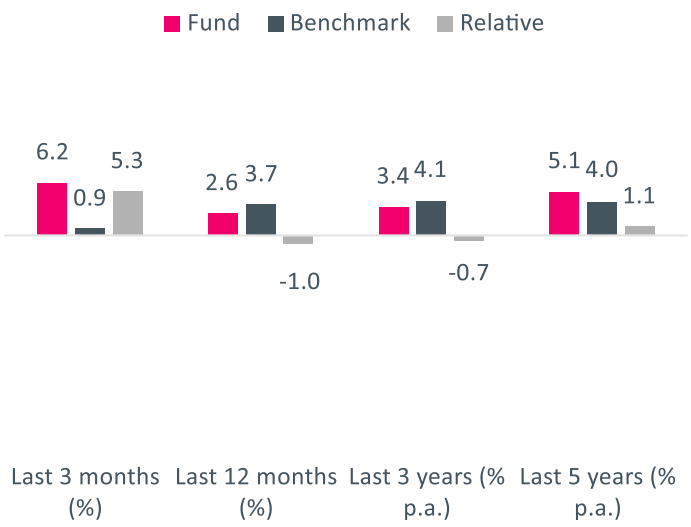
Over the 5 year period the mandate is now ahead of its target, with much reduced underperformance at 12 months and 3 years.

In a period of improved market sentiment the majority of asset classes contributed positively to returns with the allocations to equities and infrastructure providing much of the impetus. The fund also benefitted from its exposure to property. The asset class made somewhat of a recovery within the portfolio in Q4 as several investments rebounded.

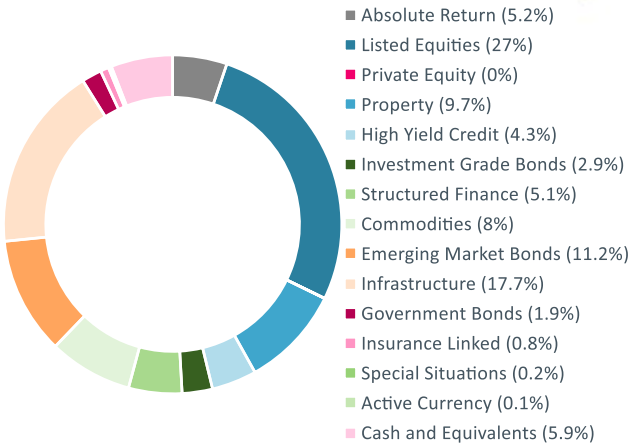
Allocations to absolute returns and active currency marginally detracted from performance.

Over the quarter the manager added risk and rotated the equity holdings into more cyclical stocks. To balance this they have implemented hedges aimed at benefitting from any future market volatility.

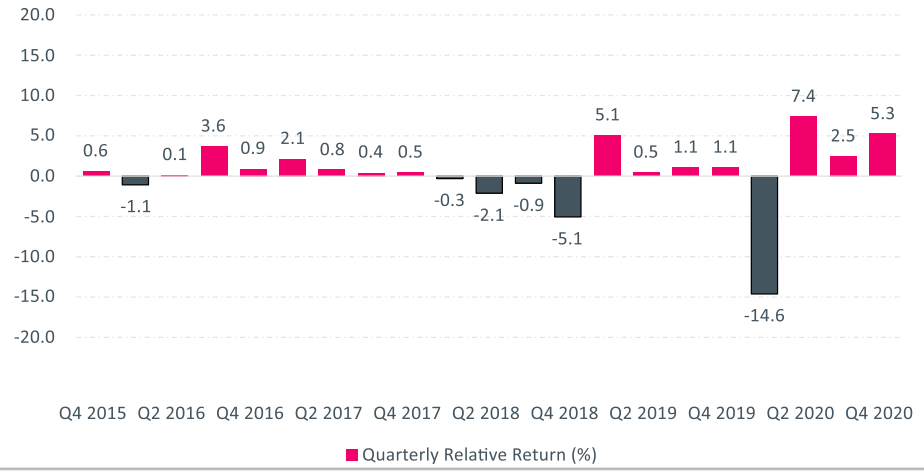
Performance Summary (Gross of Fees)



Asset Allocation



Relative Quarterly Performance



Source: Investment Manager

Schroder Property

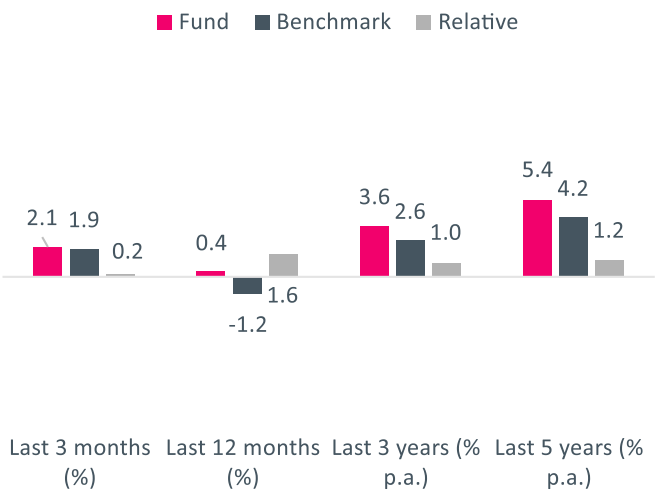
The Schroders UK Real Estate Fund returned 2.1% over the quarter, outperforming its benchmark of 0.2%. Longer term relative returns were also positive, with the fund outperforming its benchmark over the 12 month, 3 year and 5 year periods.

The fund continued to focus on active engagement with tenants, and developing industrial assets on existing sites. The fund continues to hold a defensive underweight position to retail.

Industrials were the key drivers of performance within the property market as COVID-19 has encouraged further growth in online retail, causing greater demand for warehouses and new convenience stores. The retail sector was more mixed, as the insolvency of Debenhams and Arcadia, and the potential end of the furlough scheme, caused uncertainty for shopping centres.

The fund completed the sale of Electra Business Park in East London for £133m, with proceeds recycled into the £45m funding of offices in Cambridge. 20 new lettings and lease renewals were completed over Q4, securing £3.9m rental income per annum, an increase of £1.2m from Q3 2020.

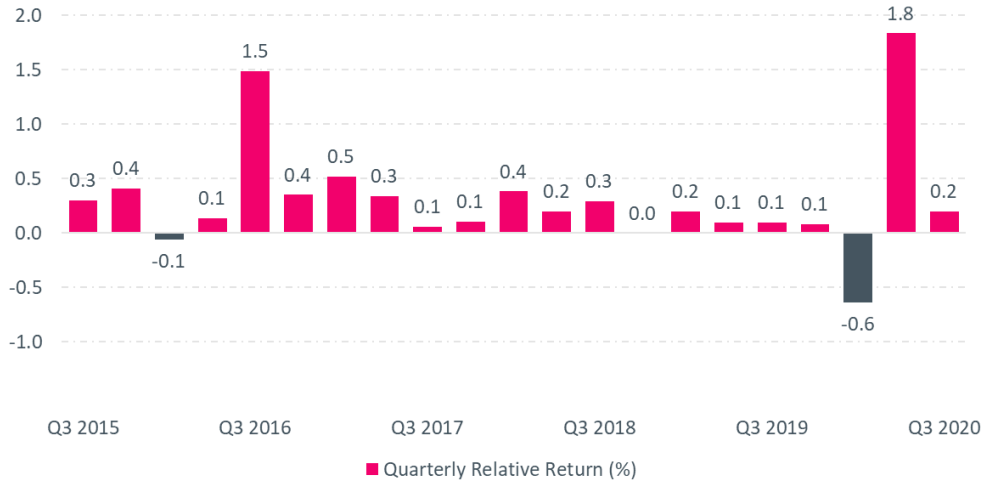
Performance Summary (Gross of Fees)



Key Statistics

Fund size	£2,217.4m
Number of holdings	54
Number of tenants	700
Debt (% of NAV)	0.4%
Top 10 holdings as % of portfolio	45.1

Relative Quarterly and Relative Cumulative Performance



Source: Investment Manager

Schroders Fixed Income

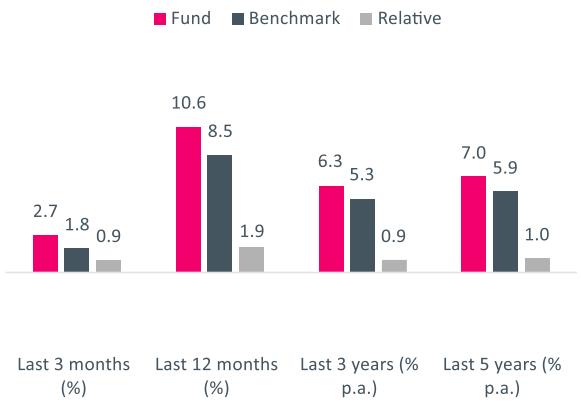
The Schroders Fixed Income portfolio returned 2.7% over Q4 2020, against its benchmark of 1.8%, providing a relative return of 0.9%. Longer term returns were also positive and ahead of benchmark over all time periods.

The fund performed well as developments in COVID-19 vaccines, and the US election resulted in an increase in investor sentiment, which resulted in corporate spreads tightening and prices rising.

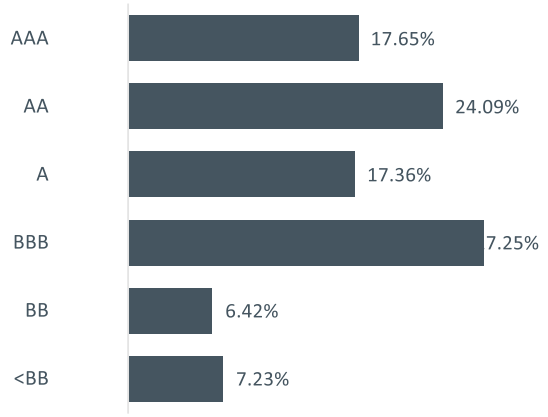
Positive performance was driven by the fund's overweight allocation to UK investment grade credit, as the Bank of England and the UK government continued their monetary and fiscal support which bolstered prices.

The exposure to Australian Gilts detracted from performance, as the fund is positioned to benefit from easing monetary policy amongst subdued economic growth, which was challenged by improved growth expectations following positive vaccine news. The fund sold out of its overweight position in Australian gilts and reduced its overweight UK duration position over the period.

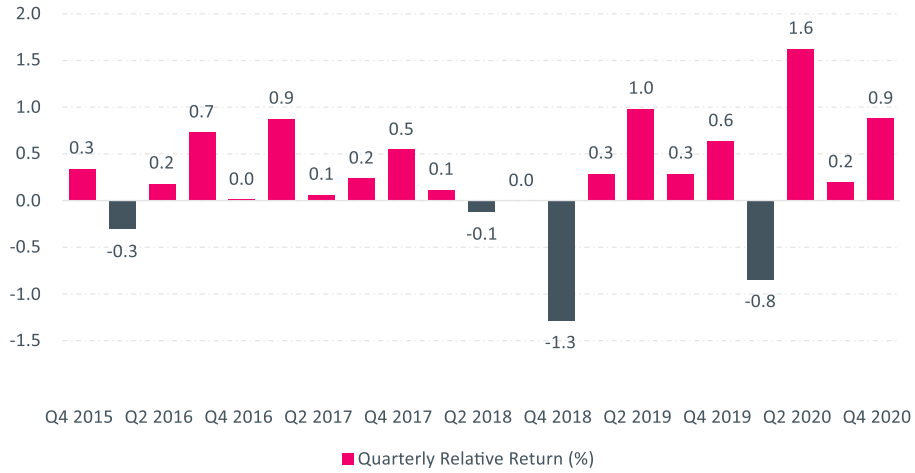
Performance Summary (Gross of Fees)



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.