Isle of Wight Council Pension Scheme

Q1 2021 Investment Monitoring Report

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HYMANS ROBERTSON

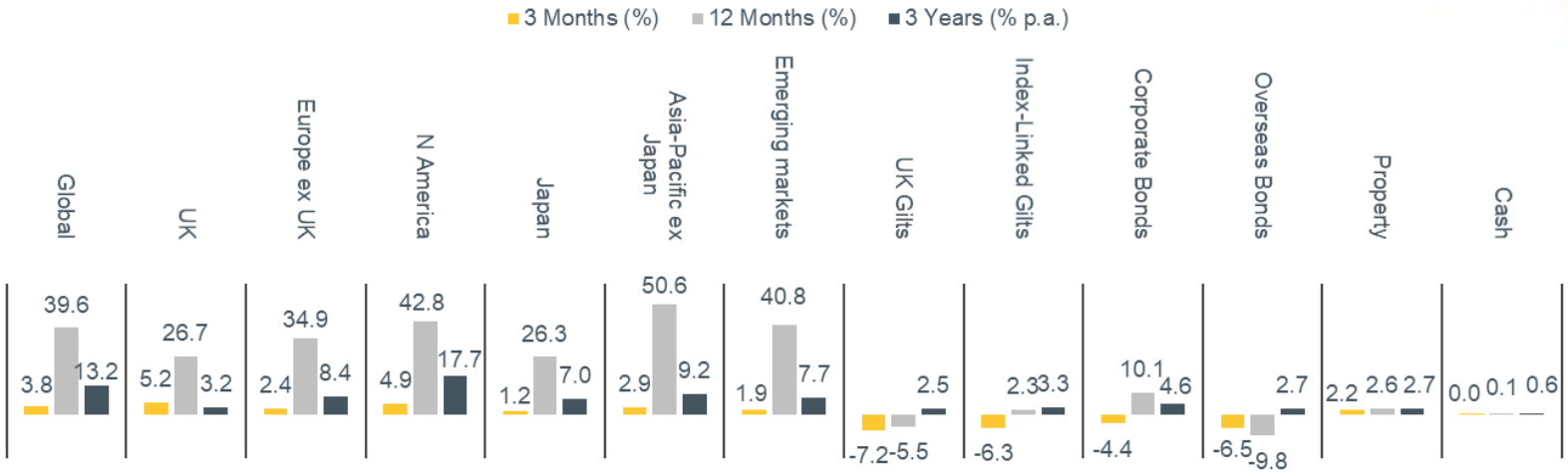
Market Background

Consensus forecasts for global GDP growth have continued to improve, to 5.6% in 2021, following a 3.6% contraction in 2020. Recent data confirms that although the quarterly pace of global growth slowed in Q1 after a robust H2 2020, the hit to activity from tighter restrictions has been less than initially feared. Expectations of a re-acceleration of growth beyond Q2 seem well-founded amid significant progress in vaccine rollouts and massive fiscal support in the US. Indeed, March's global composite PMI rose to its highest level in over 6 years.

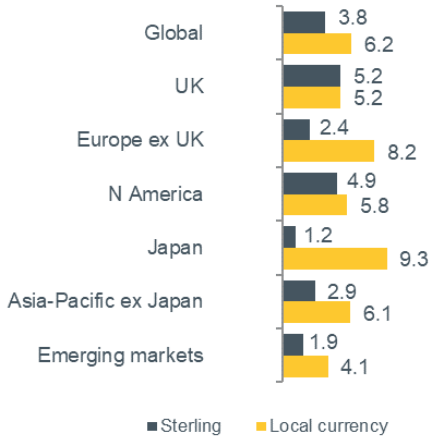
Global equity markets gained 6.2% during the quarter. The improving economic outlook was supportive for more cyclical sectors with energy, financials, basic materials, and industrials the top performing sectors year-to-date, in that order.

Sectoral performance helps explain regional equity performance: Japan and Europe ex-UK, with their above average exposures to industrials, lead the regional performance rankings year-to-date. Emerging markets underperformed markedly, weighed on by a stronger dollar and a Chinese equity market sell-off in February. Despite a higher than average exposure to oil & gas and financials, the UK market underperformed, perhaps weighed down by sterling strength given the high proportion of overseas earnings in the index.

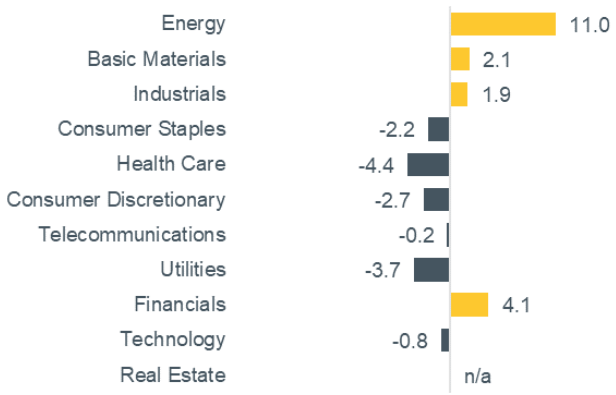
Historic returns for world markets [1]



Regional equity returns [2]



Global equity sector returns (%) [3]



Source: DataStream. [1] Returns shown in Sterling terms. Indices shown (from left to right) are: 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; UK Interbank 7 Day. [2] FTSE All World Indices. Commentary compares regional equity returns in local currency. [3] Returns shown relative to FTSE All World. FTSE indices migrated to a new ICB structure in Q1 2021 – returns for Real Estate will be included when there is a sufficient track record.

Market Background

While realised inflation has remained subdued, UK headline CPI inflation rose to 0.7% year-on-year in March, a resumption of activity and deferred consumption alongside rising oil prices are expected to lead to higher inflation in the short-term.

Reflecting the improvement in economic outlook, government bond yields rose significantly: UK 10-year government bond yields rose 0.7% p.a. to 0.8% p.a. Real yields rose less, with 10-year implied inflation, based on the difference in yield on conventional and index-linked gilts, rising 0.4% p.a. to 3.7% p.a.

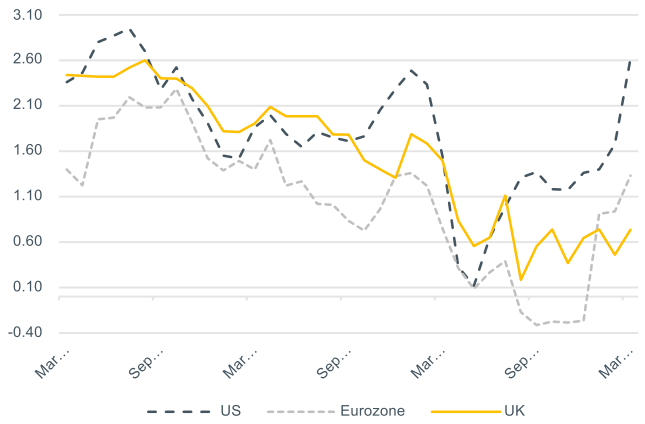
Rising sovereign bond yields weighed on total returns in fixed interest credit markets, which are negative year-to-date for investment-grade markets. Global investment-grade spreads fell 0.1% p.a. to 1.0% p.a. and speculative-grade spreads fell 0.4% p.a. to 3.7% p.a.

Sterling continued to move higher, rising 4.1% in trade-weighted terms. Relative improvement in the economic outlook and increased market-implied odds of rate rises saw the US dollar rise 2.5%, in trade-weighted terms, while the Euro and Japanese Yen fell 1.7% and 4.4%, respectively.

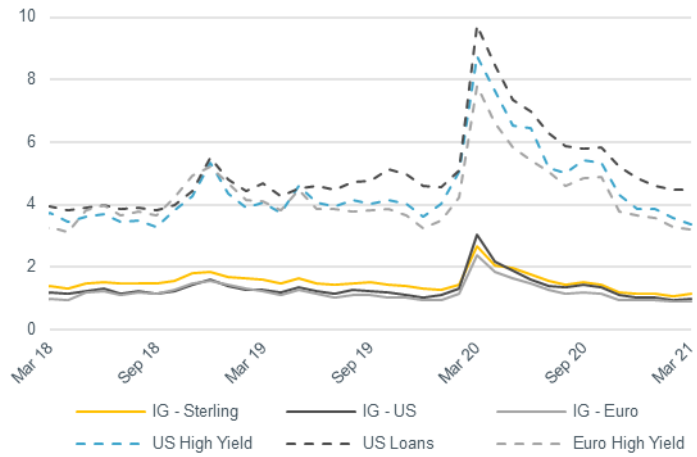
Despite slipping towards the end of the period, oil prices rose 22.4% in the first quarter to $64 per barrel, while the dollar spot price of gold slipped 10.2% as bond yields rose.

The rolling 12-month total return on the MSCI UK Monthly Property Index was 2.6% to the end of March. Capital values, in aggregate, fell 2.9% over the period (driven by a 12.4% decline in retail sector), however aggregate monthly capital value growth has been positive since November.

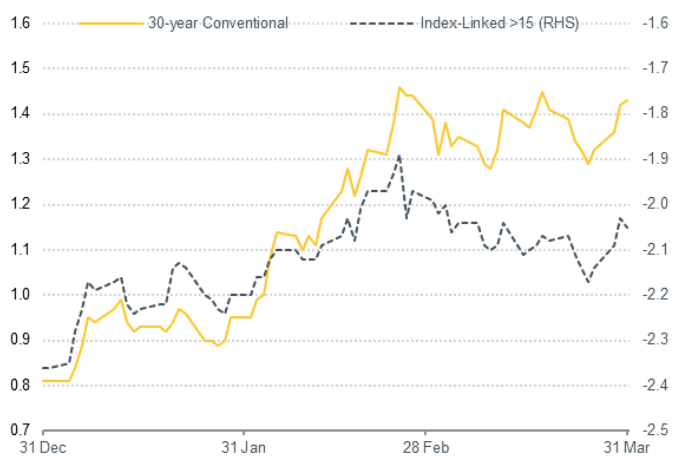
Annual CPI Inflation (% p.a.)



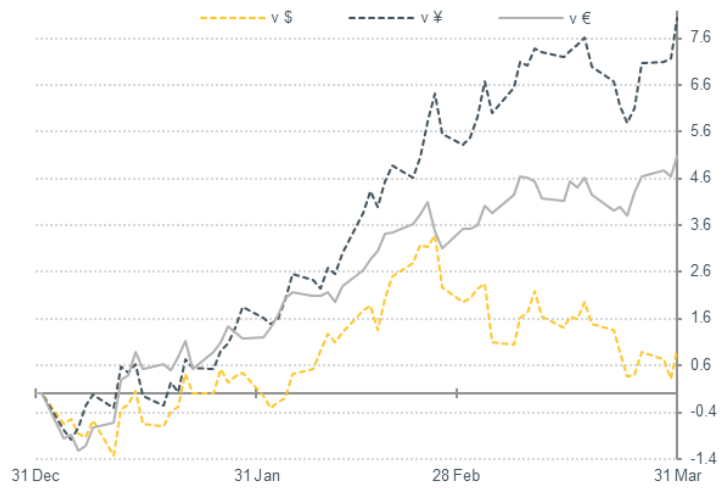
Investment and speculative grade credit spreads (% p.a.)



Gilt yields chart (% p.a.)



Sterling trend chart (% change)



Source: DataStream, Barings and ICE

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

	December 2020	March 2021	Comment
Index-linked gilts	Neutral to Cautious	Cautious	A sharp acceleration in growth and inflation is expected amid a more substantial easing of COVID restrictions in Q2 on the back of a rapid vaccine roll-out and falling case rates, following Q1 weakness. Yields have risen in the first quarter but may face further upwards pressure as economic recovery and reflation continue. Front-end nominal yields are more beginning to look more fairly valued but longer-term nominal yields are far less attractive. Implied inflation looks very expensive at terms up to around 25 years and only slightly less so thereafter.
Conventional gilts	Neutral to Cautious	Neutral to Cautious	
Sterling non-government bonds	Cautious	Cautious	Spreads remain well below long-term median levels, providing little cushion to guard against potential further rises in yields. While leverage remains elevated and interest coverage is low relative to even shorter-term averages, the earnings recovery forecast should be supportive of debt fundamentals going forward.
Private Debt	Neutral to Cautious	Neutral to Cautious	The fundamental backdrop deteriorated in 2020 due to the pandemic and direct lender's hospitality, retail and travel exposures have been particularly impacted. Transaction levels have returned to pre-COVID levels. Pricing has improved slightly although with higher leverage and loan documentation is now back to pre-COVID. The illiquidity premium to the loan market is positive. More affected outstanding debt in public and private markets may create opportunities for new stressed/distressed and special situations financing strategies.
Infrastructure	Neutral to Attractive	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	Neutral to Cautious	Neutral	Modest gains in equity markets year-to-date leave long-term valuation measures similarly stretched as last quarter. However, valuations look less expensive in the context of very low real yields and there remains significant disparity in valuations by region. Earnings momentum is moderately positive and the bounce in earnings now forecast in 2021 would leave full-year earnings in 2021 approximately 7% above end-2019 levels. Given high valuations and near-term economic uncertainty, we hold a neutral position, 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

Over the quarter the Fund's total assets increased marginally by c.£9.3m, valuing £694.7m at the end of Q1 2021.

Global equities performed well over the quarter, led by outperformance in cyclical value in sectors such as industrials and infrastructure.

The positive growth performance was partially offset by holdings in Schroders Fixed Income fund as the mandate was impacted by rising yields.

Equity holdings remain slightly overweight within the Fund, as the new income allocations start to draw down capital over time. The strategic target now allows for the new private debt allocation with infrastructure to be added later this year.

Key Actions

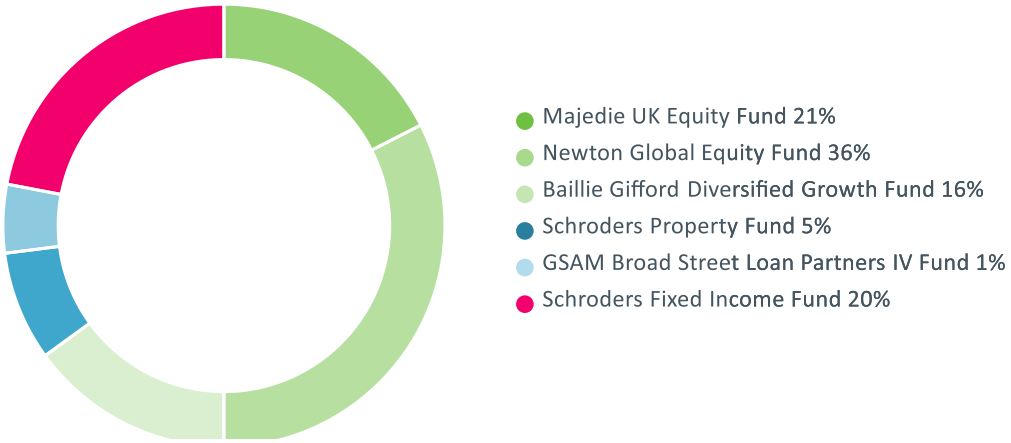
In Q1 two capital calls were paid to GSAM Broad Street Loan Partners IV fund on 25 January and 16 February, funded from the Majedie UK Equity mandate.

Post quarter end further capital calls were made on 5 April and 24 May.

Asset Allocation

Manager	Valuation (£m)		Actual Proportion	Benchmark	Relative
	Q4 2020	Q1 2021			
Majedie UK Equity Fund	145.6	144.1	20.7%	17.5%	3.2%
Newton Global Equity Fund	240.9	249.2	35.9%	32.5%	3.4%
Baillie Gifford Diversified Growth Fund	115.4	114.5	16.5%	15.0%	1.5%
Total Growth	**501.8**	**507.8**	**73.1%**	**65.0%**	**8.1%**
Schroders Property Fund	36.8	37.9	5.5%	8.0%	-2.5%
GSAM Broad Street Loan Partners IV Fund	0.0	9.1	1.3%	5.0%	-3.7%
Total Income	**36.8**	**47.0**	**6.8%**	**13.0%**	**-6.2%**
Schroders Fixed Income Fund	146.7	139.9	20.1%	22.0%	-1.9%
Total Protection	**146.7**	**139.9**	**20.1%**	**22.0%**	**-1.9%**
Total Scheme	**685.4**	**694.7**	**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

Over Q1 2021, the Fund returned 1.6% against its benchmark of 1.4%, providing a positive relative return of 0.2%. That said, returns were more muted following the surge experienced at the end of 2020.

Over the long term, the Fund remains ahead of benchmark for the 12 month, 3 year and 5 year periods with 3.8%, 0.8% p.a. and 0.5% p.a. relative returns, respectively.

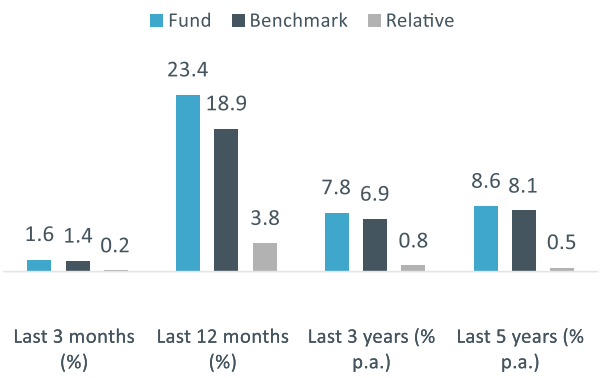
The Fund's equity holdings provided the strongest absolute returns over the quarter, also the Schroders Fixed income mandate, despite giving negative returns, had the strongest relative returns.

Conversely, Baillie Gifford's Diversified Growth Fund experienced a more challenging time as a result of renewed inflationary concerns.

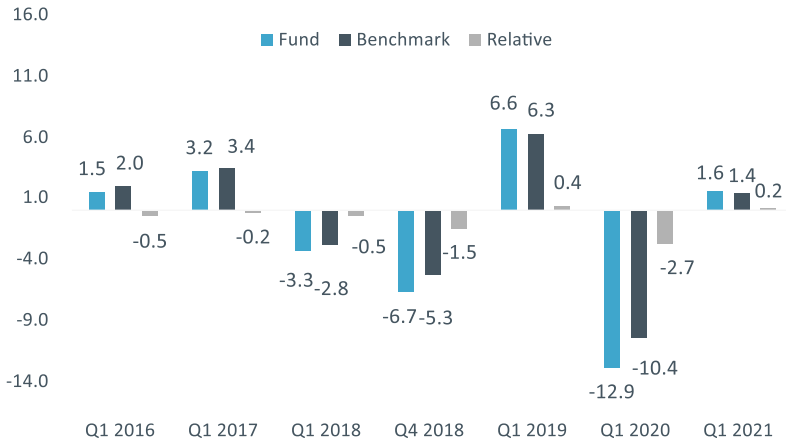
Manager performance (gross of fees)

	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	4.1	3.6	**0.5**	36.6	38.9	**-1.7**	15.2	12.7	**2.2**	14.0	14.1	**-0.1**
Majedie UK Equity Fund	5.1	5.2	**-0.1**	33.0	26.8	**4.9**	3.1	3.2	**-0.1**	6.3	6.3	**-0.0**
Baillie Gifford Diversified Growth Fund	-0.6	0.9	**-1.5**	18.3	3.6	**14.2**	2.9	4.0	**-1.1**	5.0	4.0	**1.0**
Income												
Schroders Property Fund	2.9	2.2	**0.7**	5.3	2.3	**2.9**	3.7	2.6	**1.1**	5.8	4.4	**1.3**
Protection												
Schroders Fixed Income Fund	-4.7	-5.7	**1.1**	4.4	0.6	**3.8**	4.7	3.5	**1.2**	5.2	3.8	**1.3**
Total	1.6	1.4	**0.2**	23.4	18.9	**3.8**	7.8	6.9	**0.8**	8.6	8.1	**0.5**

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

- Schroders have created a new role of Head of Sustainability for Europe as they look to further embed sustainability into client relationships with Nathaële Rebondy appointed to the role.
- We continue to rate Schroders as "Positive".

Baillie Gifford business update

- We rate Baillie Gifford as 'Preferred – On Watch'. There were no significant developments over the quarter.

Source: Investment Managers

Majedie UK Equity

Over the quarter, the Majedie UK Equity mandate returned 5.1% in absolute terms, marginally underperforming its FTSE All Share benchmark of 5.2%. The fund met its benchmark over the longer term, with exception of the 3 year period.

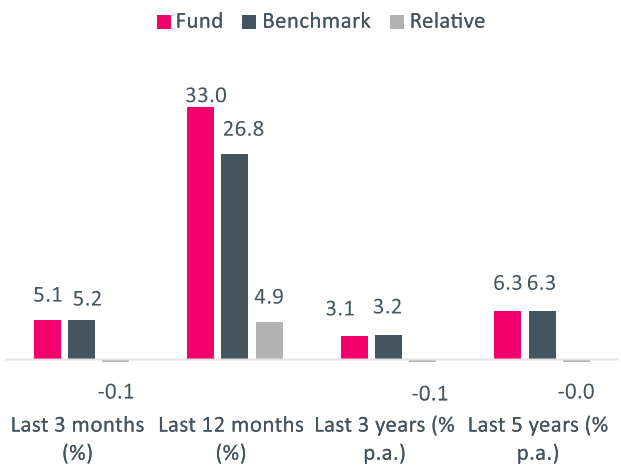
The UK equity market displayed muted returns over the quarter, as ongoing macroeconomic uncertainties surrounding Covid-19 counteracted the positive developments in vaccine rollouts.

Holdings in industrials, utilities and financials provided strong returns for the fund. From a stock perspective, Electrocomponents performed particularly well as value stocks rose.

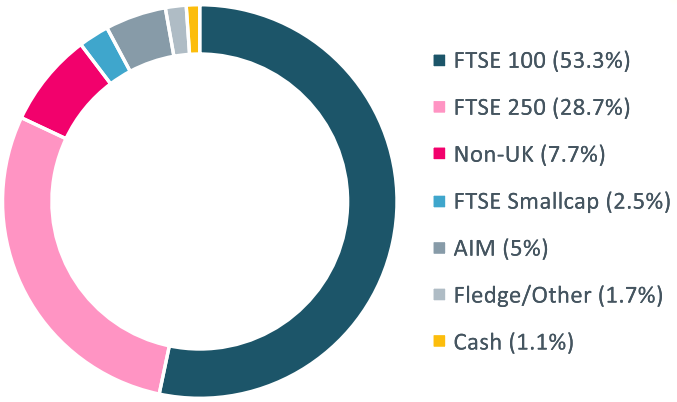
Underweight holdings in oil and gas detracted from relative performance. In particular, an underweight position to BP detracted from performance as the company rallied as a result of sharp price increases. Barrick Gold was also a detractor as rising yields reduced the appeal of gold.

The manager has added to holdings in the housing industry, in particular Taylor Wimpey and Bellway.

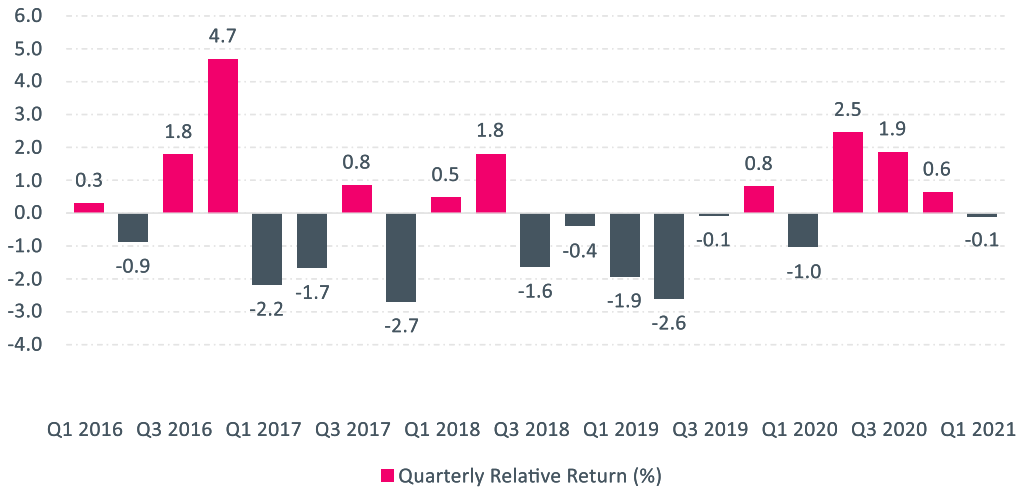
Performance Summary (Gross of Fees)



Asset Allocation



Relative Quarterly Performance



Source: Investment Manager

Newton Global Equity

The Newton Global Equity Fund outperformed its MSCI ACWI benchmark of 3.6% and returned 4.1% over Q1 2021, a relative outperformance of 0.5%.

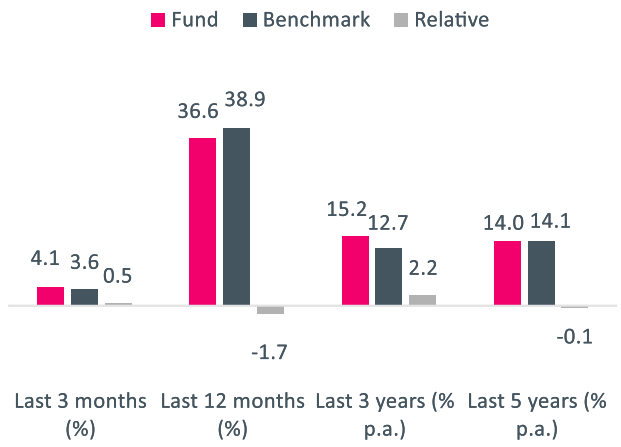
Long term performance remains varied, with 12 month and 5 year periods falling short of target.

Accelerated vaccine rollout and optimistic global recovery drove positive performance over Q1. From a regional perspective, Japanese and North American equities provided strong performance, whilst holdings in European equities slightly detracted from performance.

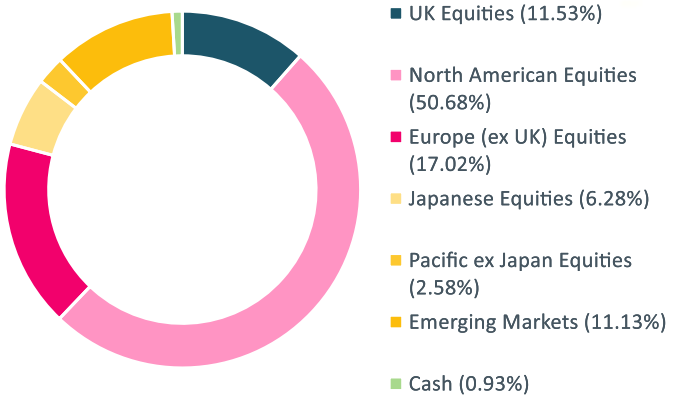
Value stocks benefitted from both rising yields and commodity price recovery, as well as support within cyclical sectors. Holdings in Citigroup and Goldman Sachs were strong contributors to performance as a result. Applied Materials had the most positive impact as demand grew for semiconductors, with further growth expected for 2021.

The mandate's underweight positions to the energy and materials sectors, as well as negative performance from consumer discretionary and healthcare holdings as investors moved into cyclical assets, both detracted from performance over the quarter.

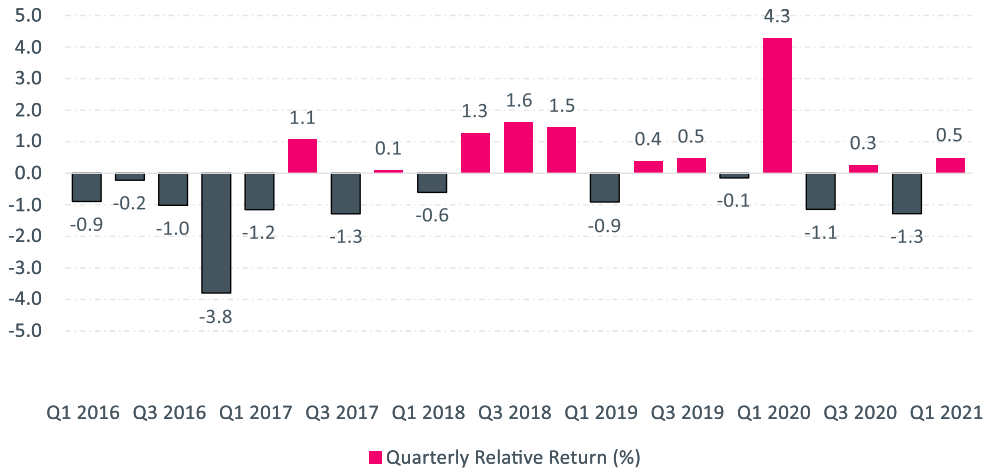
Performance Summary (Gross of Fees)



Asset Allocation



Relative Quarterly Performance



Source: Investment Manager

Baillie Gifford Diversified Growth

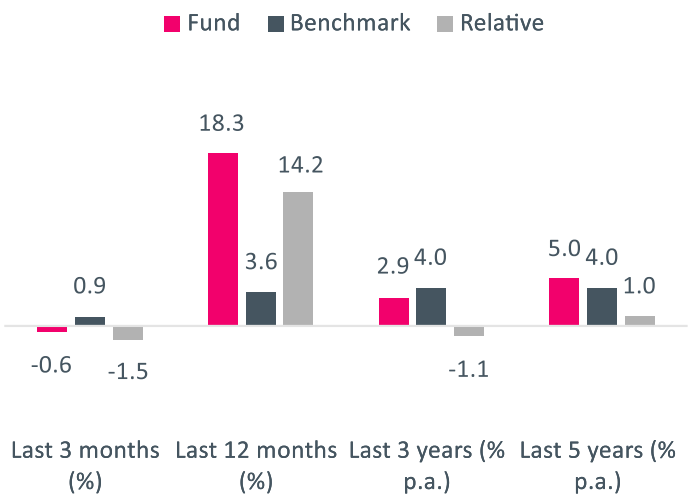
Over Q1 2021, the diversified growth fund underperformed its target of 0.9%, returning -0.6% gross of fees. Performance over the long term remains positive, with the fund outperforming its 12 month and 5 year benchmarks.

Inflation concerns resulted in infrastructure holdings detracting, however, this remains the best performing asset class in the portfolio over the longer term. Commodities were key detractors as higher yields reduced the appeal of gold and nickel was hit by news of wrongful production.

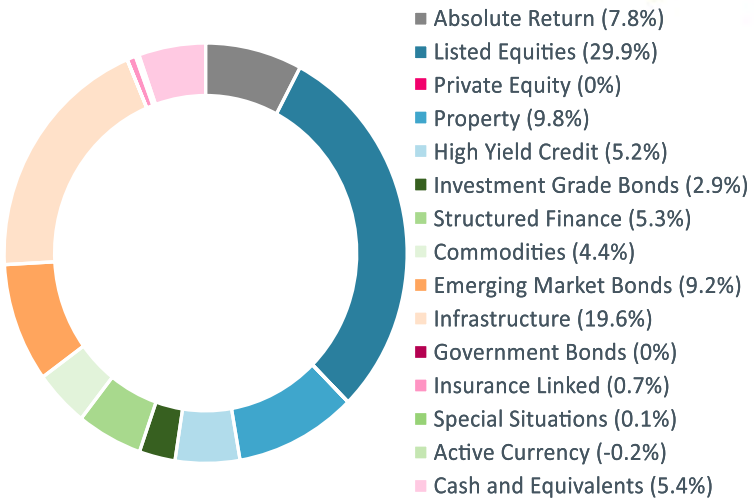
With the focus on cyclical recovery in the portfolio and the reopening of economies, listed equities were the key contributors to performance. The fund's exposure to structured finance and high yield credit also positively contributed.

The manager continued to implement hedging strategies due to further inflation concerns. This aims to minimise downside risk in the event of future volatility within bond markets.

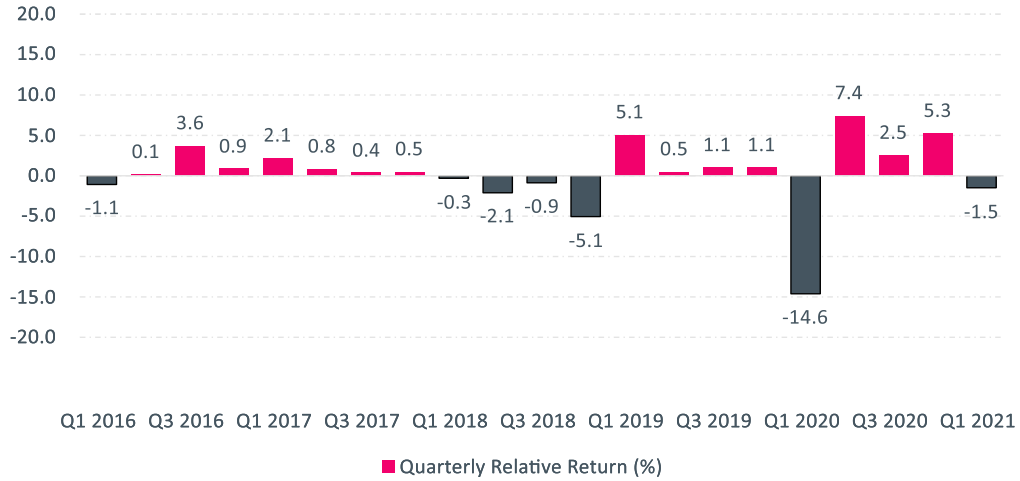
Performance Summary (Gross of Fees)



Asset Allocation



Relative Quarterly Performance



Source: Investment Manager

Schroder Property

The Schroders UK Real Estate Fund returned 2.9% over Q1 2021, remaining ahead of its benchmark of 2.2%. Long term performance remain positive, with the fund outperforming benchmarks over all periods.

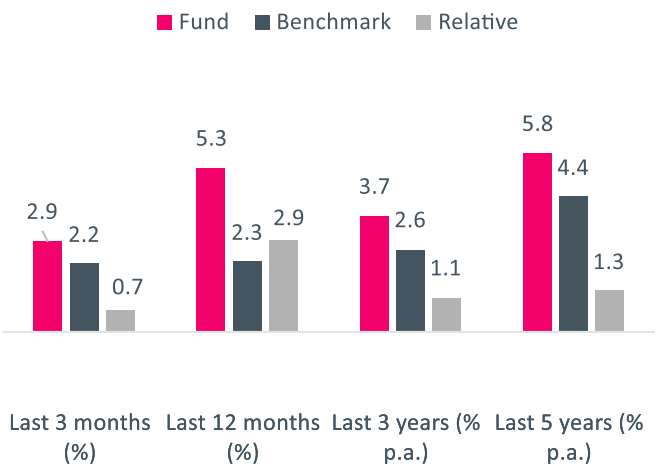
The fund's performance was driven by holdings in the industrial sector. Active management and recent leasing activity also positively contributed to maintaining stable returns and creating future rental growth opportunities.

Underweight holdings in industrial and retail warehouses detracted from performance.

With shopping centre rental values expected to drop a further 20% and the accelerated move to online shopping during the pandemic, the fund continues to hold a underweight position in retail.

The fund adjoined ownership of Hartlebury Trading Estate for £850,000, with an estimate future annual income of £200,000 for the lease of 5 industrial units. Over the quarter, 26 new lettings and lease renewals were completed.

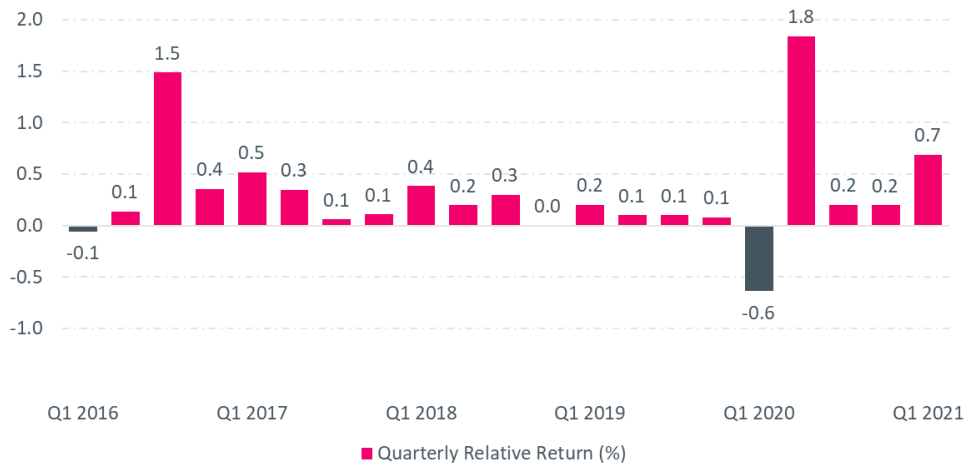
Performance Summary (Gross of Fees)



Key Statistics

Fund size	£2,262.8m
Number of holdings	53
Number of tenants	688
Debt (% of NAV)	0.4%
Top 10 holdings as % of portfolio	46.3

Relative Quarterly and Relative Cumulative Performance



Source: Investment Manager

Schroders Fixed Income

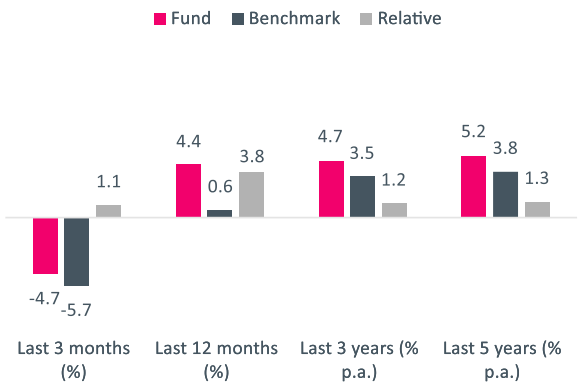
The Schroders Fixed Income portfolio returned -4.7% over the quarter, outperforming its benchmark of -5.7%. Long term performance remains positive and consistently ahead of target for all time periods.

Q1 saw an acceleration in the rise of bond yields as medium-term growth and inflation outlook was boosted by vaccine rollouts and expectations of further fiscal stimulus. Increasing inflation expectations meant that fixed income assets struggled over the quarter.

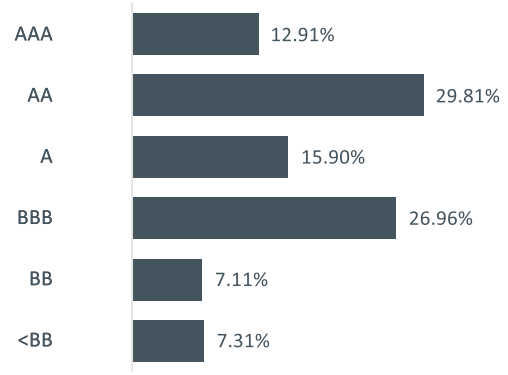
The mandate's overweight to sterling high yield contributed positively to returns. The fund's outperformance was also helped by underweight holdings in UK and US short-term durations, which were impacted by rising yields. Sectors affected by the pandemic performed particularly well, including leisure.

Positive performance was countered by its holdings in UK investment grade credit due to rising bond yields which resulted in low risk-return reward. The manager has since reduced its investment grade allocation.

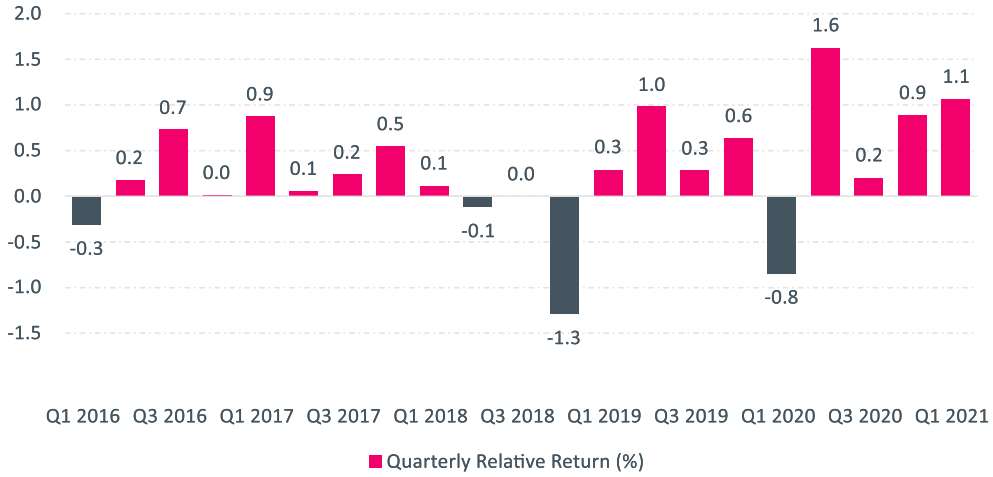
Performance Summary (Gross of Fees)



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.