Isle of Wight Council Pension Fund

Q3 2021 Investment Monitoring Report

David Walker - Partner
Annabel Preston – Investment Analyst

HYMANS ROBERTSON

Market Background

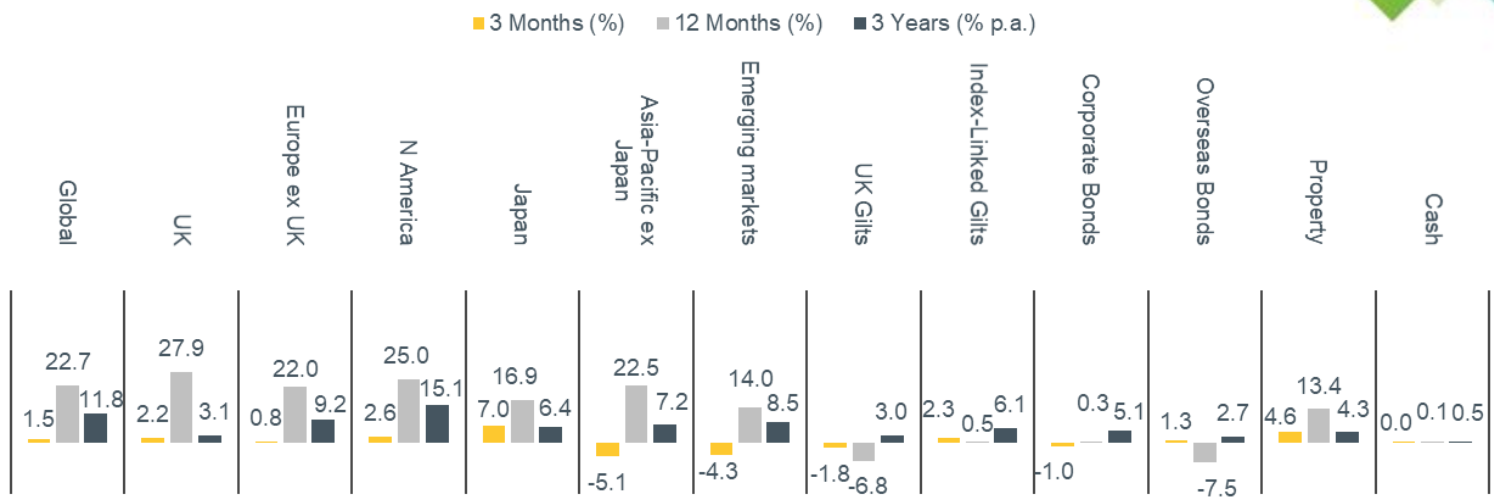
Growth momentum continued to ease as the initial impact of re-opening late last year fades. However, the pace of growth in the major advanced economies is forecast to remain strong over the next couple of years, with consensus forecasts global growth of 5.7% in 2021 and 4.4% in 2022.

Global equities gave up earlier gains as strong earnings growth was offset by easing economic momentum and the prospect of fading monetary support. Strong rises in energy prices lifted the energy sector, while the prospect of higher interest rates buoyed the financial sector. The defensive growth characteristics of the technology and healthcare sectors saw them outperform, while consumer discretionary, basic materials and industrials all underperformed in Q3.

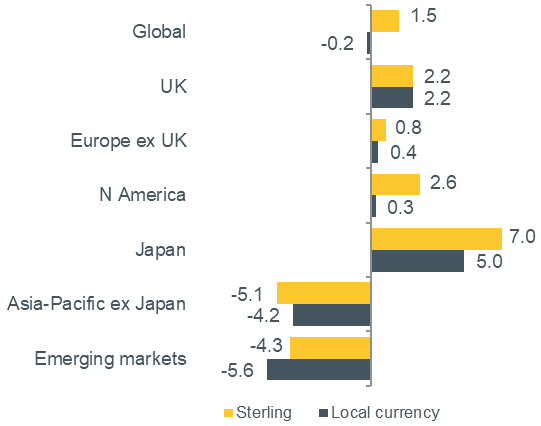
Japanese markets materially outperformed, rallying on expectations of further stimulus and economic reopening as COVID cases declined. UK markets also outperformed, driven primarily by their above average exposure to the energy sector, while emerging markets were pulled lower by weak performance from China, where announcements of tighter regulation have been compounded by a slowdown in the Chinese property and manufacturing sectors, and high energy prices

The total return on the MSCI Monthly Property index was 13.4% in the year to September, which includes a 5.5% income return. A 7.5% rise in capital values over the 12 months to end of September is attributable to buoyant industrial sector where capital values have risen 24%.

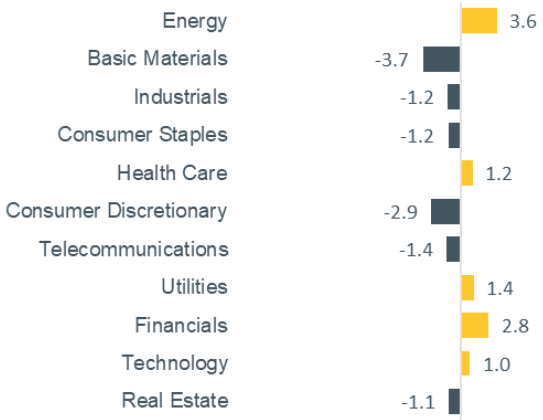
Historic returns for world markets [1]



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 in Sterling terms and relative to FTSE All World. FTSE indices migrated to a new ICB structure in Q1 2021.

Market Background

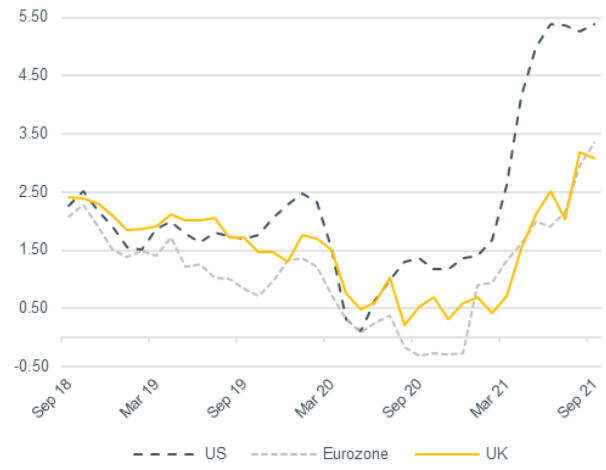
Global investment-grade spreads were little changed in Q3 and global developed market speculative-grade spreads rose 0.3% p.a. Defaults and leverage levels continue to fall, interest coverage is rising, and liquidity remains plentiful. Fears surrounding the potential default of Evergrande, a heavily indebted Chinese property developer, seem to have been contained within Chinese and Asian credit markets for now.

UK 10-year gilt yields rose 0.3% p.a., with steep rises coming in the wake of the Bank of England's September meeting. Having fallen earlier in the quarter, on the back of easing economic momentum, equivalent US and German yields rose back to end-June levels in September.

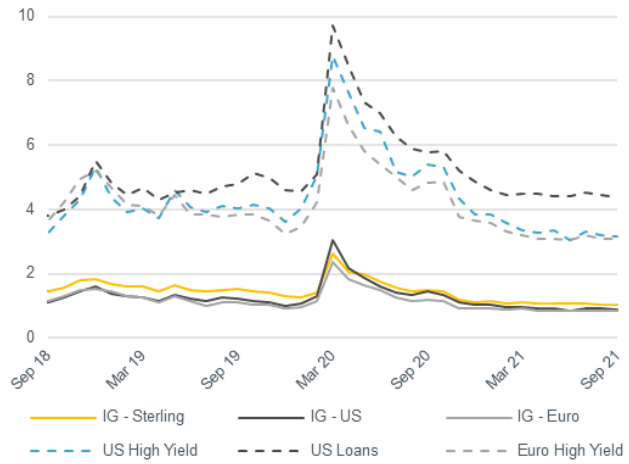
UK 10-year implied inflation, as measured by the difference between conventional and inflation-linked bonds of the same maturity, rose from 3.5% p.a. to 3.9% p.a. as real yields fell and nominal yields rose. 10-year US implied inflation was little changed over Q3.

The trade-weighted dollar has risen around 1.5% while equivalent measures for the sterling and euro eased 0.9% and 0.4% respectively.

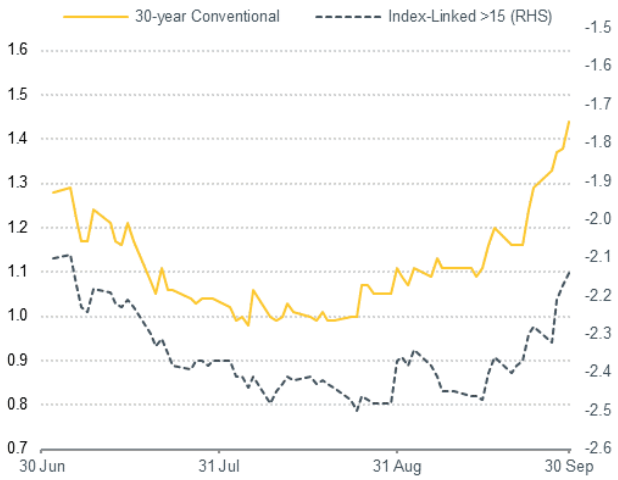
Annual CPI Inflation (% p.a.)



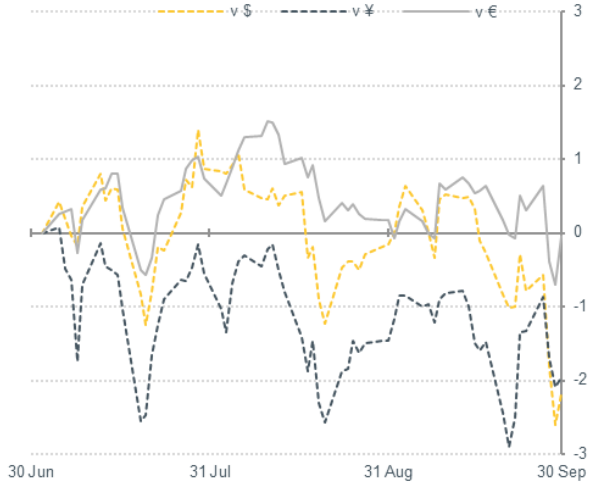
Investment and speculative grade credit spreads (% p.a.)



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

	June 2021	September 2021	Comment
Index-linked gilts	Cautious	Cautious	We see inflation pricing at terms between 10 and 30 years as being the most expensive. In the context of near-term inflation risks, implied inflation up to 10 years is perhaps less expensive than at first glance.
Conventional gilts	Neutral to Cautious	Neutral to Cautious	The pace at which markets now imply interest rates will rise over the next few years does not feel unreasonable. Although the risks still seem skewed to an even faster pace, which would be bad for bond markets. The shorter end of the gilt market looks reasonable, however longer-dated yields remain expensive.
Sterling non-government bonds	Cautious	Cautious	Spreads in investment-grade markets remain well below long-term median levels given strong technical support from central bank purchases, improving fundamentals and robust corporate earnings. Current valuations warrant caution as recent fundamental improvements are already reflected in spreads and future downside risks remain. Long-duration, low spread, investment-grade credit markets are susceptible to potential rate rises, particularly if inflation turn out to be less transitory than thought. We continue to have a preference for ABS which offer an attractive spread premium and provide insulation against interest-rate volatility.
Private Debt	Neutral to Cautious	Neutral to Cautious	A post-Covid rebound in earnings has improved fundamentals with most managers taking assets off watchlists. Valuations remain neutral, relative to traded loan spreads, but given loan spreads are below long-term median levels we retain some caution. There remains a very high level of activity in the market with most managers achieving high levels of deployment over the quarter, which is expected to continue in Q4.
Equities	Neutral	Neutral	The earnings recovery shows little sign of flagging yet, but valuation multiples based on cyclically-adjusted earnings remain stretched versus history. Perhaps the only lens through which global equity valuations do not look exceptional is that of real yields.
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 by c£5.6m over the quarter (£726.3m in Q2 to £731.9m in Q3).

Volatility within equity markets increased after Q2 as economic momentum eased and news of the potential debt shock in China, offsetting the equity returns previously gained. Japanese equities considerably outperformed as the economy reopened whilst Emerging Markets lagged due to tighter regulations in China.

The energy sector led performance rankings following the steep rise in energy prices as demand for oil grew. Financials also outperformed as upside inflationary surprises caused yields to rise in September.

The Fund remains slightly overweight to equities as the new Income allocations continue to drawdown capital over time.

Key Actions

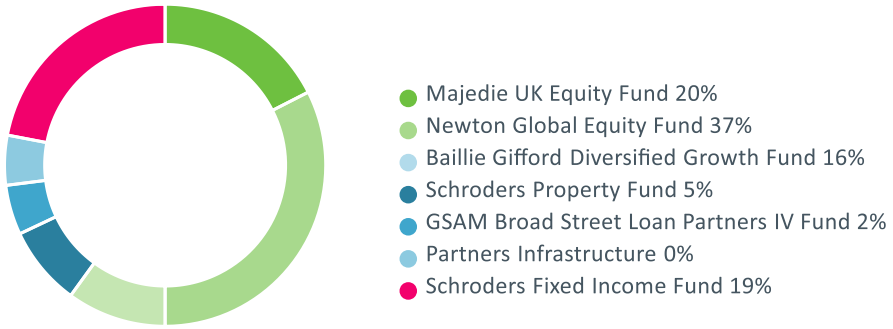
Two capital calls for GSAM took place on 19 July and 7 September. One distribution was made on 19 August.

The first allocation to Partners Infrastructure mandate was made on 10 July.

Asset Allocation

Manager	Valuation (£m)		Actual Proportion	Benchmark	Relative
	Q2 2021	Q3 2021			
Majedie UK Equity Fund	145.8	147.6	20.2%	17.5%	2.7%
Newton Global Equity Fund	264.7	268.3	36.7%	32.5%	4.2%
Baillie Gifford Diversified Growth Fund	120.2	116.5	15.9%	10.0%	5.9%
Total Growth	**530.7**	**532.3**	**72.7%**	**60.0%**	**12.7%**
Schroders Property Fund	39.1	39.7	5.4%	8.0%	-2.6%
GSAM Broad Street Loan Partners IV Fund	14.2	16.1	2.2%	5.0%	-2.8%
Partners Infrastructure	0.0	3.4	0.5%	5.0%	-4.5%
Total Income	**53.2**	**59.2**	**8.1%**	**18.0%**	**-9.9%**
Schroders Fixed Income Fund	142.4	140.4	19.2%	22.0%	-2.8%
Total Protection	**142.4**	**140.4**	**19.2%**	**22.0%**	**-2.8%**
Total Scheme	**726.3**	**731.9**	**100.0%**	**100.0%**	

Asset class exposures



Source: Investment Managers

Fund performance

Total Fund returns were positive in both absolute and relative terms over Q3 2021. The Fund returned 1.4% against its benchmark of 1%, a marginal outperformance of 0.4%.

The Fund remains ahead of its 12-month, 3-year and 5-year benchmarks.

The Newton Global Equity Fund provided the highest relative return, reducing the relative underperformance over the 12-month period from 1.4% in Q2 to 0.9% in Q3. This was driven by holdings in energy and Japanese consumer discretionary companies.

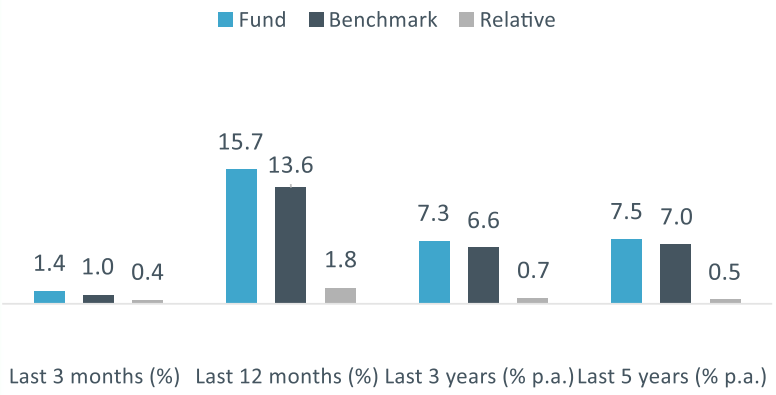
The Schroders Property mandate provided the strongest absolute returns this quarter due to the active management within the industrial portfolio.

The Fund's mandates produced positive relative performance over Q3 2021, with the exception of the Schroders Fixed Income mandate which was in line with its benchmark.

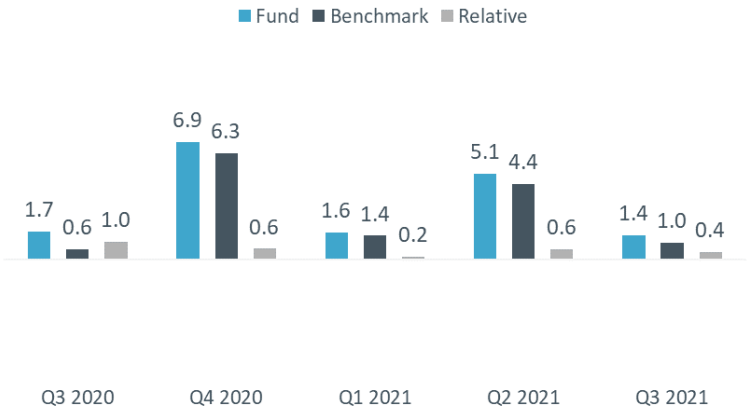
Manager performance (gross of fees)

	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	2.1	1.4	**0.8**	21.1	22.2	**-0.9**	12.7	11.3	**1.2**	12.5	12.3	**0.1**
Majedie UK Equity Fund	2.3	2.2	**0.1**	30.1	27.9	**1.8**	1.7	3.1	**-1.3**	5.4	5.4	**0.0**
Baillie Gifford Diversified Growth Fund	1.2	0.9	**0.3**	12.2	3.6	**8.4**	5.4	3.9	**1.4**	5.1	3.9	**1.1**
Income												
Schroders Property Fund	4.7	4.4	**0.3**	13.5	13.1	**0.4**	4.9	4.2	**0.8**	7.1	6.2	**0.9**
Protection												
Schroders Fixed Income Fund	-1.4	-1.4	**0.0**	-1.8	-3.7	**2.1**	5.3	3.9	**1.3**	3.1	2.0	**1.1**
Total	1.4	1.0	**0.4**	15.7	13.6	**1.8**	7.3	6.6	**0.7**	7.5	7.0	**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.

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.

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

Manager ratings

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

Majedie rating change

The Majedie UK Equity Fund was downgraded from 'Preferred' to 'Suitable' over the quarter. In summary, the rating change was a result of numerous changes within the team and portfolio, as well as concerns surrounding Majedie's multi-manager structure.

Rationale for rating change:

- High level of turnover within the team in recent years following a period of moderated performance and asset declines.
- Portfolio changes have resulted in a reasonable level of style drift and we have questions surrounding Majedie's ability to conduct this style of investing in a diversified portfolio.
- We believe Majedie's multi-manager structure is an unusual and complex way to manage a portfolio, and whilst it has been implemented over the long-term, having a number of different portfolio managers running portfolios creates a number of difficulties. This includes difficulties with transparency around the individual portfolios, managers, performance and the stylistic composition of the total portfolio.
- In addition, the multi-manager structure inevitably means the overall portfolio has a large number of holdings. We prefer strategies that have a high conviction approach which offers the opportunity to deliver outperformance.

Source: Investment Managers

Majedie UK Equity

The Majedie UK Equity fund returned 2.3% over the quarter, marginally outperforming its FTSE All Share benchmark by 0.1% (ahead of performance target). The fund remains ahead of its 12-month benchmark, but now falls short of its 3-year target.

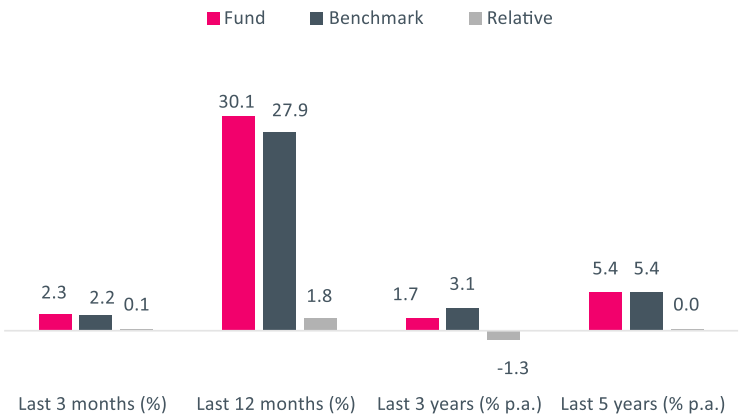
Easing economic momentum, higher inflation, supply chain disruptions and the steep rise in energy prices led to muted equity returns over the quarter.

The energy sector led performance following the surge in energy prices, pressured by rising demand and low energy inventories. The fund's underweight positioning to oil and gas restricted returns as a result. Financials outperformed as yields rose in September.

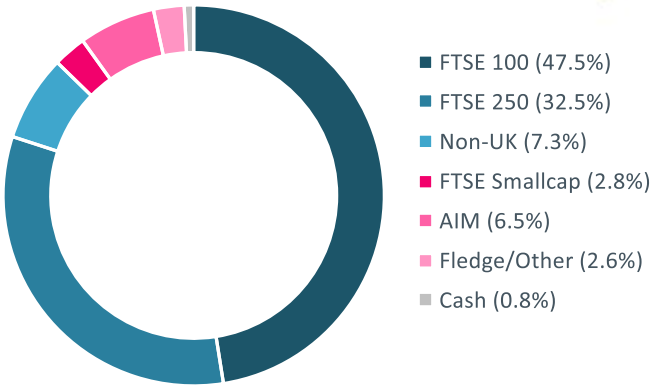
Holdings in basic materials and consumer discretionary were key detractors over the quarter due to ongoing uncertainty surrounding economic recovery. Holdings in Moonpig and Made.com were key detractors.

Consumer staples were amongst the key contributors to performance as Marks and Spencer led from a stock perspective, with Tesco and Morrison's closely following. Marks and Spencer announced its good start to the financial year following its transformation programme with Ocado UK to grow its food division.

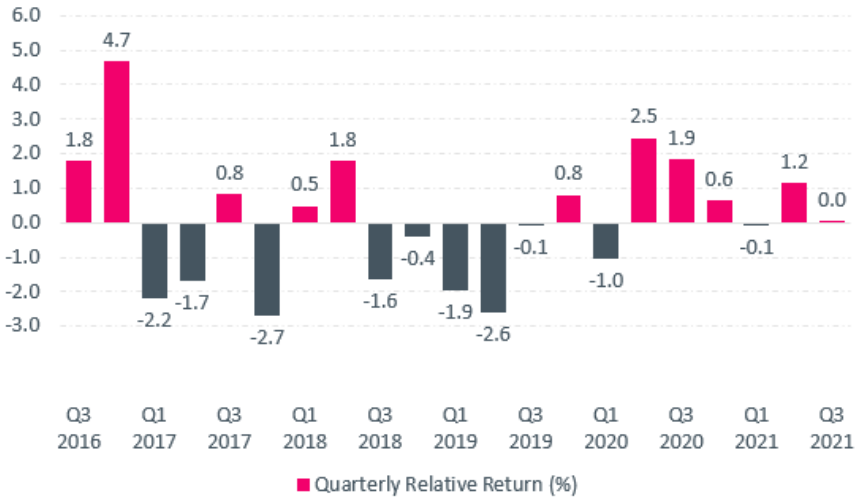
Performance Summary



Asset Allocation



Performance Summary (Gross of Fees)



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

Newton Global Equity

The Newton Global Equity Fund returned 2.1% over the quarter, outperforming its MSCI ACWI benchmark of 1.4% by 0.8%.

The mandate outperformed its benchmarks over the 3-year and 5-year periods, however, it fell short of its 12-month benchmark by 0.9%.

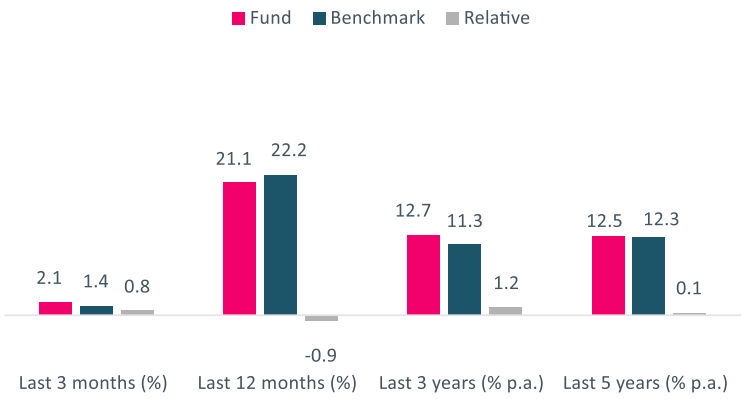
From a regional perspective, Emerging Markets suffered this quarter with the implementation of tighter regulations in China reducing activity in its property and manufacturing sectors and causing economic worry.

On the other hand, Japan provided strong returns as restrictions eased following a decline in Covid-19 cases. Japanese companies including Sony and Suzuki positively contributed to returns.

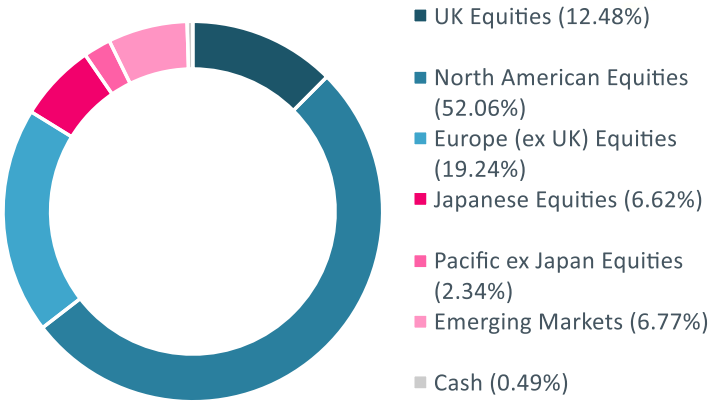
Top performing sectors within the fund were materials, energy and communication services. Despite the fund's underweight position to energy, Shell remained one of the strongest performing stocks within the portfolio.

An underweight position to financials marginally detracted following the rise in yields at the end of the quarter, with holdings in Chinese financial company Ping an Insurance being a key detractor to returns.

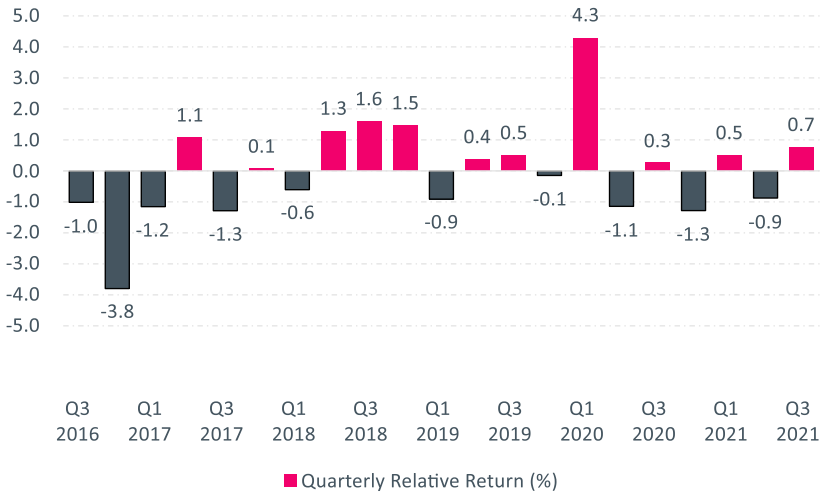
Performance Summary



Asset Allocation



Quarterly Relative Performance



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

Baillie Gifford Diversified Growth

The diversified growth fund marginally outperformed its target of 0.9% - returning 1.2% gross of fees in Q3 2021. The fund remains ahead of its long-term targets.

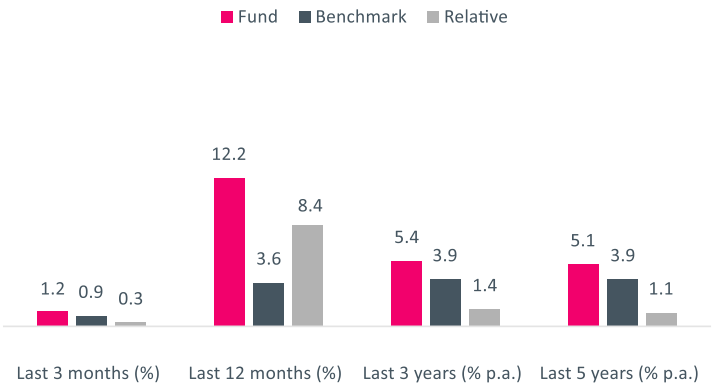
Investment grade bonds were the key contributor to performance over the quarter, with the fund's exposure to property, infrastructure and structured finance also positively contributing.

The crackdown on Chinese regulations hurt key commodity holdings in Q3, with the slowdown in the Chinese property market causing a sharp decline in the prices of metals. The more defensive assets in the portfolio, such as absolute return, also detracted from performance.

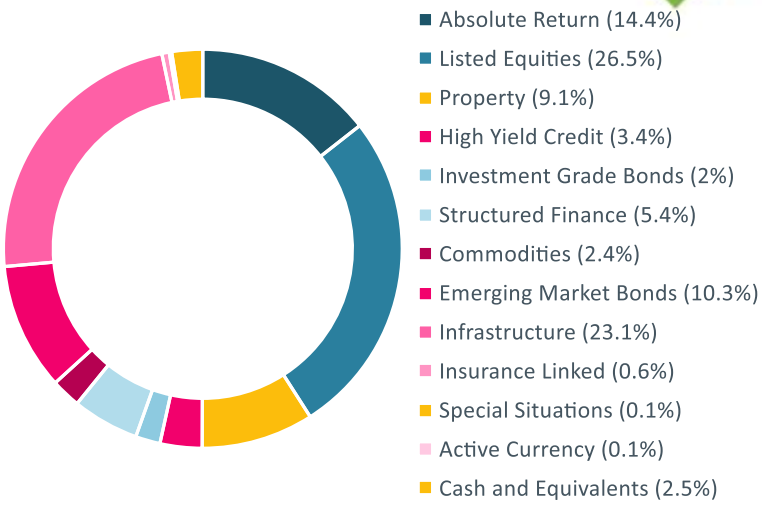
The manager made changes to its absolute return allocation, with a new position in an oil backwardated strategy and a volatility strategy which looks to perform well in spells of low volatility. Allocations to listed equities were reduced to lower the number of cyclical stocks.

Baillie Gifford continues to favour allocations to infrastructure and is in the process of transitioning to a more concentrated allocation, holding larger sizes of fewer holdings. This has been driven by the focus on sustainable power and the investments this will require.

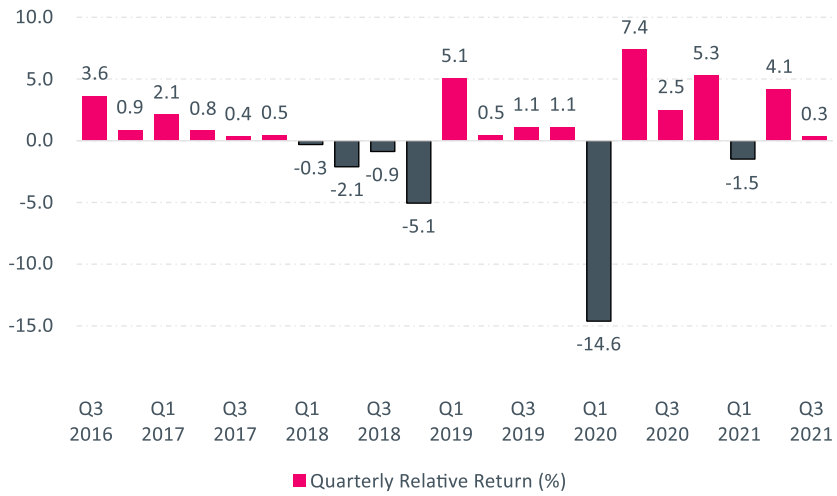
Performance Summary



Asset Allocation



Quarterly Relative Performance



Source: Fund performance data provided by Baillie Gifford and is gross of fees.

Schroder Property

The Schroders UK Real Estate Fund returned 4.7% over the quarter, marginally outperforming its benchmark of 4.4%.

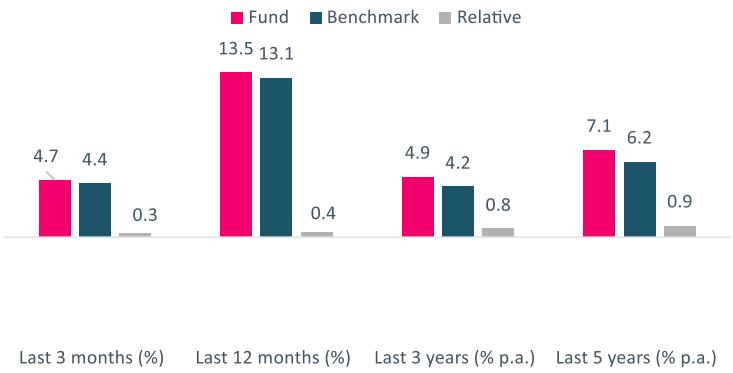
Longer term relative performance was positive across all time periods considered. The fund's underweight position to industrials resulted in muted returns over the 12-month period.

The property market saw its first positive month of annual rental growth since February 2020 and is excepted to improve as the economy strengthens. Schroders are remaining vigilant surrounding the prospect of permanent fuel and material shortages, which could lead to higher interest rates.

Outperformance over the quarter was driven by growth in capital value (c.£104.3m). Active management within the industrial portfolio also contributed, with the fund continuing to obtain resilient and high standard income streams.

Over Q3 2021, 31 new lettings and lease renewals were completed. With the focus on increasing its industrial exposure, the fund successfully obtained planning permission for 4 new industrial units at Revolution Park. A new lease with Jigsaw Research was also agreed, bringing £250,677 income per annum.

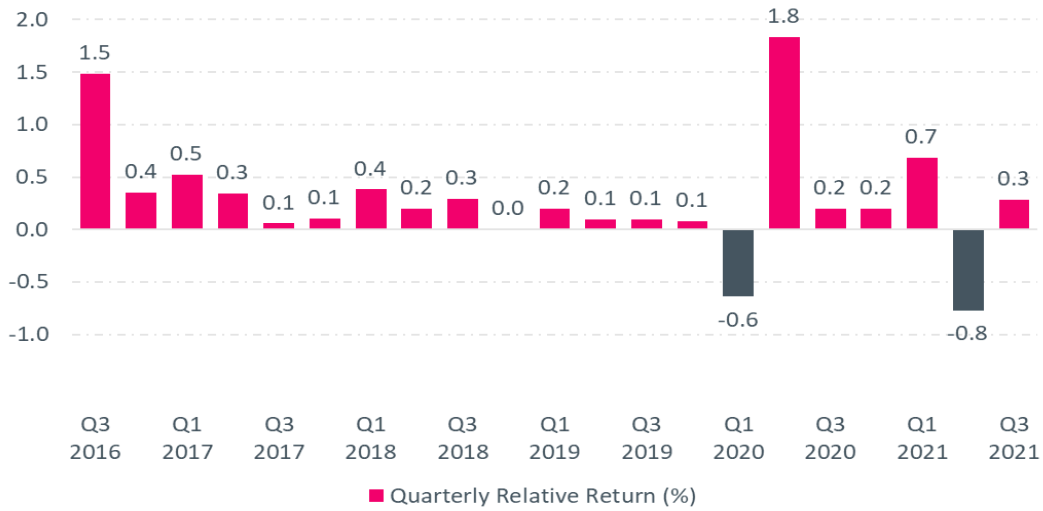
Performance Summary



Key Statistics

Fund size (gross)	£2,410.7m
Number of holdings	48
Number of tenants	621
Debt (% of NAV)	0.3%
Top 10 holdings as % of portfolio	48.2

Quarterly Relative Performance



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

Schroders Fixed Income

The Schroders Fixed Income portfolio returned -1.4% over Q3 2021, in line with benchmark. Relative performance over the longer term remains positive for all periods.

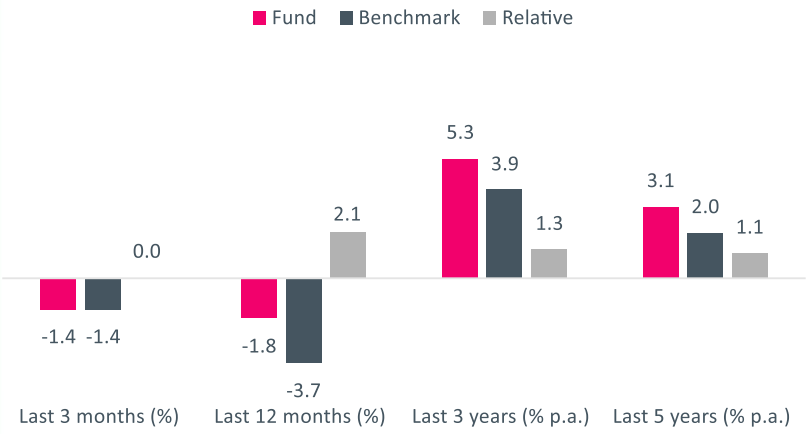
As the prospect of inflationary surprises grew in September, expectations of earlier rate rises led to the sharp increase in bond yields. As a result, this was the key detractor to performance due to the fund's sensitivity to interest rates. UK fixed income markets were also hit from rising oil prices and supply chain disruptions.

The fund's overweight position to investment grade and high yield provided muted returns over the quarter as little change was seen in credit spreads. An overweight position to UK gilts marginally detracted as yields rose.

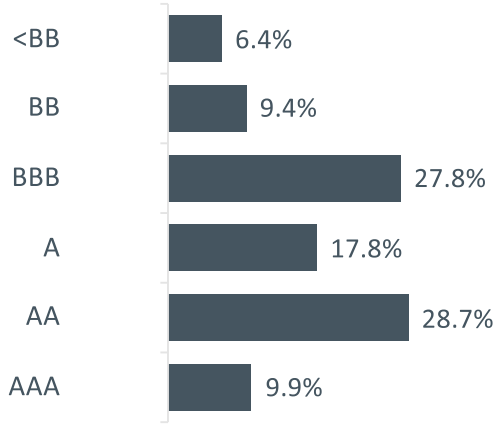
The implementation of tighter restrictions in China resulted in the fund's allocation to Chinese government bonds performing particularly well, as expectations of further monetary support grew.

The fund has increased its durations to the US and UK due to ongoing inflationary concerns.

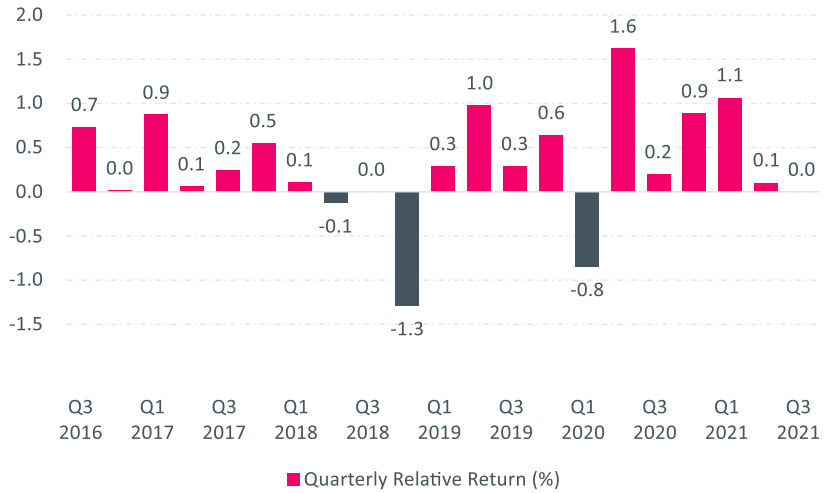
Performance Summary



Relative credit allocation



Quarterly Relative Performance



Source: Fund performance data 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 first allocation to the GSAM Broad Street Loan Partners IV Fund was made on 25 January 2021.

The Fund received two capital calls from GSAM over Q3: These were as follows:

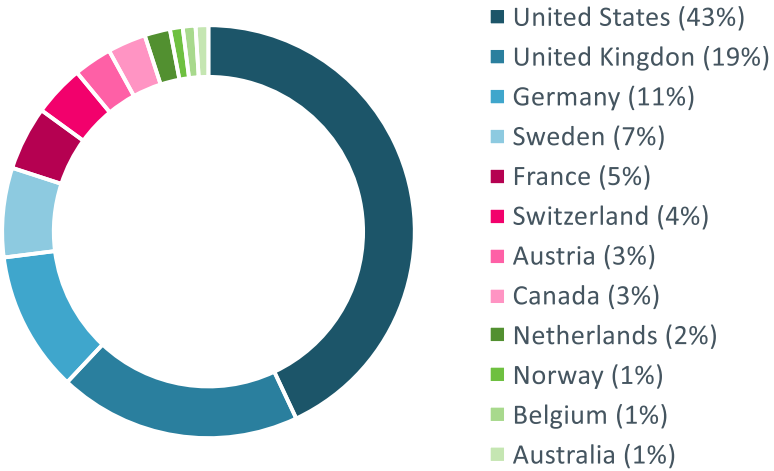
- £1,178,713 on 19 July 2021
- £712,705 on 7 September 2021

After quarter end, a further $1.3m was called on 4 October.

One distribution notice of c.£142k was received from GSAM on 19 August.

Since January 2021, the fund has made two investment exits – Calypso Technology and Agiliti Health, both receiving more than the initial invested cost.

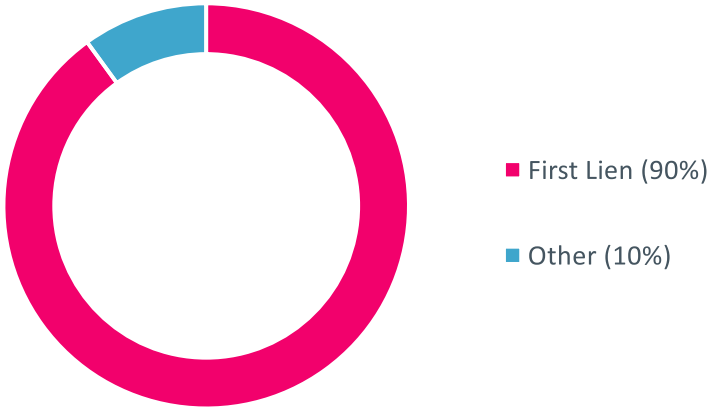
Geography split



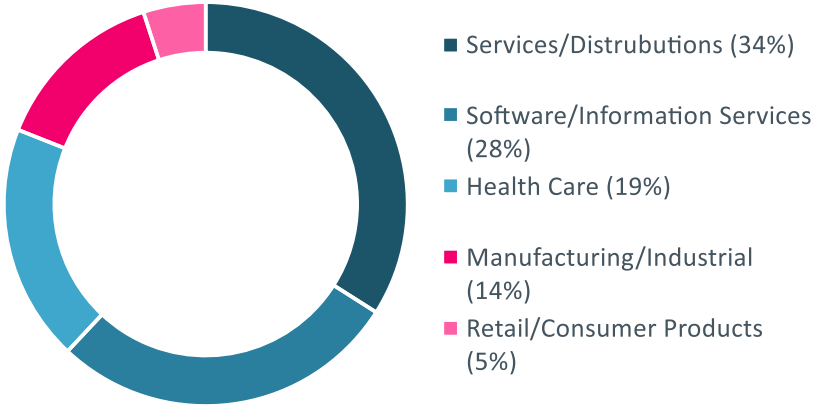
Key Statistics (£m)

Commitment	29.1
Capital calls	1.9
Distributions	0.1
Estimated Capital balance	14.6
Estimated Net Income/Loss	0.1

Security/Loan type



Industry split



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

Partners Direct Infrastructure

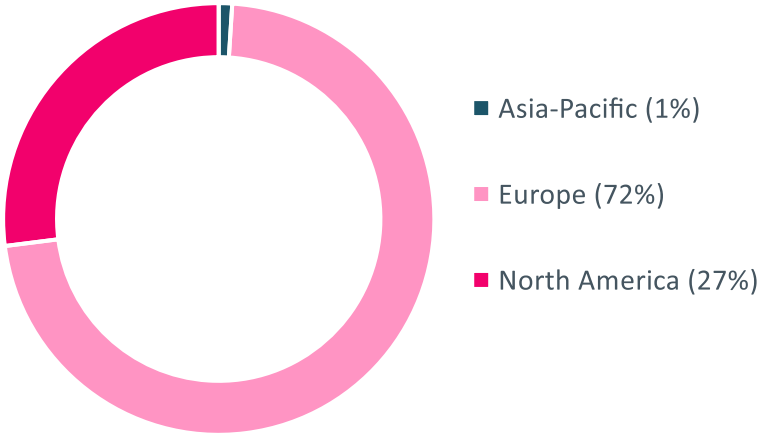
In July 2020, a new 5% allocation to infrastructure was agreed by the Committee which will be drawn down over time. The first allocation to Partners Direct Infrastructure Fund was drawn on 10 July 2021.

As at 30 September 2021, the fund commitments totalled c.£35.2m and capital contributions paid to date were c.£3.9m.

The net asset value at the end of Q3 was c.£3.4m.

Reporting for the fund will evolve as the fund establishes.

Regional Breakdown



Key Statistics (£m)

Commitments	35.2
Capital contributions	3.9
Distributions	0
Net asset value	3.4
Net multiple	too early

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

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
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

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.

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.