Isle of Wight Council Pension Fund

Q1 2022 Investment Monitoring Report

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HYMANS ROBERTSON

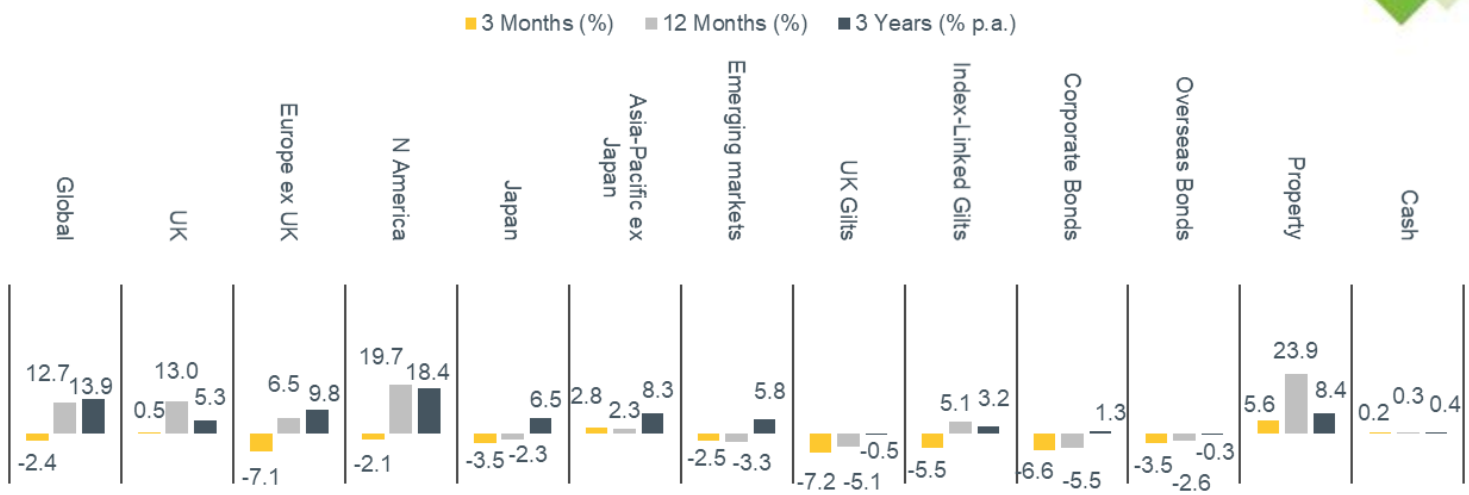
Market Background

Physical disruptions and sanctions caused by the Russia-Ukraine conflict have triggered broad commodity price rises which, alongside existing inflationary pressures, are increasing input costs and weighing on consumer's real incomes. As a result, CPI forecasts have reached new highs while consensus forecasts for global growth have been revised downwards, but still point to a relatively robust pace of growth over 2022 and 2023 by post-Global Financial Crisis standards.

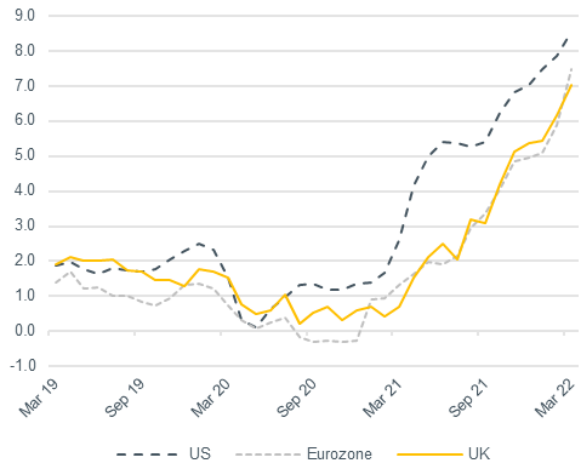
The inflation backdrop has seen central banks turn more hawkish this year, despite the potential downside risks to growth from higher commodity prices. After a first hike in December, the Bank of England raised rates twice in Q1, to 0.75% p.a., and, as expected, the US Federal Reserve raised rates by 0.25% p.a. in March, with the median voting member now expecting seven rate rises in 2022 and four in 2023. The European Central Bank confirmed its asset purchases will end this year, leaving the door open to an interest rate rise, while the Fed noted plans to reduce the size of its balance sheet.

Global sovereign bond yields rose significantly to reflect increased rate rise expectations with UK 10-year gilt yields rising 0.7% p.a., to 1.6.% p.a. UK 10-year implied inflation, as measured by the difference between conventional and inflation-linked bonds of the same maturity, rose 0.5% p.a., to 4.4% p.a., as real yields rose to a lesser extent then their nominal counterparts.

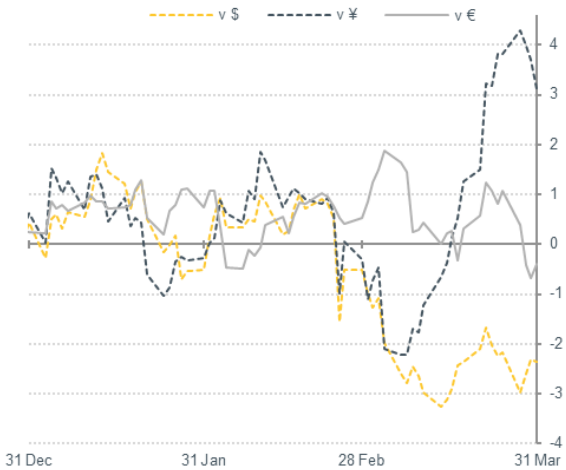
Historic returns for world markets [1]



Annual CPI Inflation (% p.a.)



Sterling trend chart (% change)



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

Market Background

Global investment-grade spreads increased by 0.3% p.a., while US and European speculative-grade spreads increased 0.3% p.a. and 0.7% p.a., respectively. Larger increases in European spreads perhaps allude to the greater exposure of European corporates and consumers to higher energy prices.

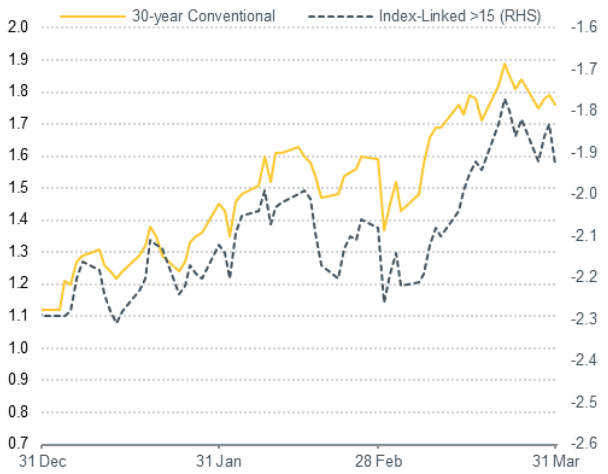
Commodity prices surged to extreme levels and faster than expected monetary tightening in the US contributed to a rally in the dollar, whilst safe-haven appeal drove gold prices higher.

Concerns about central bank tightening, slowing earnings momentum, and the geopolitical situation have all contributed to global equities falling 4.6% this year, despite a bounce back in March. Value stocks notably outperformed growth stocks as rising yields weighed most heavily on the valuations of stocks with earnings growth further in the future, such as those in the technology sector. The consumer discretionary sector also underperformed as markets considered the impact of inflation on real consumer incomes. Surging oil and gas prices sees the energy sector lead the year-to-date performance rankings.

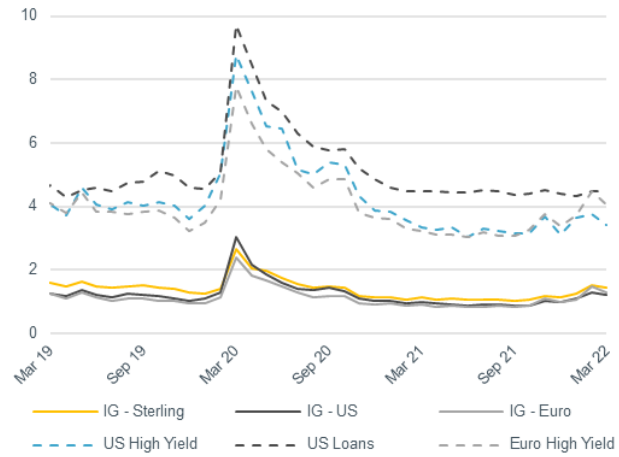
The UK AND Asia – Pacific ex Japan were the only regions to deliver a positive return, benefiting from above-average exposure to energy, metals, and miners. Europe fell to the bottom of the performance rankings, whilst Emerging Markets fell further as new COVID-19 lockdowns and broader geopolitical concerns weighed on Chinese markets.

A 18.0% rise in the MSCI UK AREF capital value index over the 12 months to the end of March is largely attributable to a 36.8% rise in industrial capital values. Return on the All-Property Index, including income, was 23.9% in the 12 months to end-March.

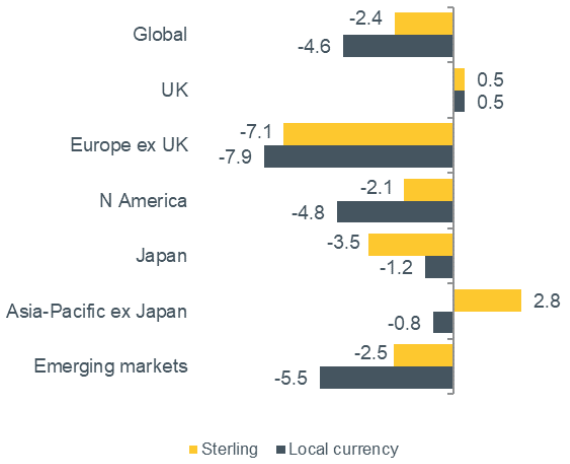
Gilt yields chart (% p.a.)



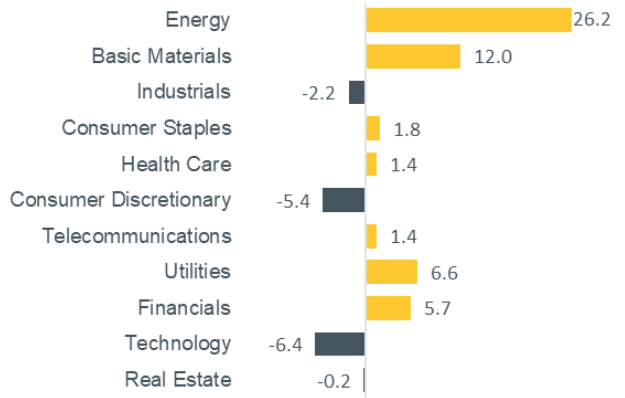
Investment and speculative grade credit spreads (% p.a.)



Regional equity returns [1]



Global equity sector returns (%) [2]



Source: DataStream, Barings, ICE [1] FTSE All World Indices. Commentary compares regional equity returns in local currency. [2] Returns shown in Sterling terms and relative to FTSE All World.

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 2021	March 2022	Comment
Index-linked gilts	Cautious	Cautious	Given elevated inflation forecasts, near-term implied inflation does not look unreasonable relative to fundamentals. From 2030, index-linked gilts will be re-referenced to CPIH, which is typically 1% p.a. lower than RPI. This suggests a substantial inflation risk premium is embedded in the gilt market at longer maturities, especially the 10-20Y part of the curve. Beyond 25 years, inflation pricing doesn't look particularly demanding.
Conventional gilts	Neutral to Cautious	Neutral to Cautious	The path of cash rates currently implied by instantaneous forward nominal yields, rising to 2.25% p.a. over the next 10 to 15 years, does not look unreasonable. Implied cash rates falling beyond 15 years makes us wary of longer-term forward yields.
Sterling non-government bonds	Cautious	Netural to Cautious	Global investment grade spreads have risen considerably since the start of the year and, on a ratings-consistent basis, are now slightly above long-term median levels. Corporate fundamentals are also in decent shape, however high current and forecast inflation, and its corrosive effect on nominal fixed income coupons, sees us retain a degree of caution.
Private Debt	Neutral to Cautious	Neutral to Cautious	Fundamentals have improved post-COVID, but inflation and labour cost impacts are now the prevailing concerns. Valuations have moved to unattractive due to the increase in traded loan spreads. There remains a very high level of activity in the market with most managers achieving high levels of deployment, which is expected to taper as 2022 progresses.
Equities	Neutral	Neutral to Cautious	Equity valuations remain stretched versus historical averages, albeit with wide regional disparities. Earnings growth will inevitably slow sharply from an expected 54% in 2021. However, demand and revenue growth remain strong and there is evidence that businesses expect to be able to pass on most of their higher costs.
Cash Strategies	Neutral	Neutral	We remain supportive of holding modest overweight position to cash and cash plus alternatives (e.g. short duration credit), reflecting our generally cautious outlook on risk assets where current valuations may not fully reflect some of the downside risk.

Source: DataStream

Asset allocation

As at 31 March 2022, the Fund's assets totalled £724.2m decreasing by £40.7m over the quarter.

Investment markets faced a challenging start to 2022 as the Russia/Ukraine crisis exacerbated the ongoing inflationary pressures leading to expectations of tighter monetary policy.

Upwards pressure on inflation has persisted due to ongoing supply chain disruptions, surging energy prices and labour and materials shortages.

Consequently, we also saw a material increase in gilt yields over the quarter. As a result, both equity and bond markets delivered negative returns over the period.

The Fund remains slightly overweight to equities and underweight to income as the new income allocations continue to drawdown capital.

Key Actions

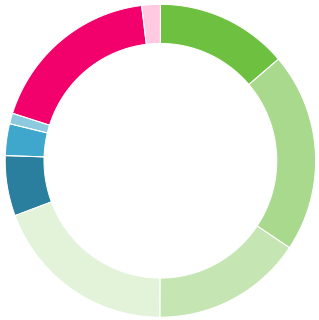
GSAM issued one capital call over the quarter, c.£2.4m on 24 January.

£25m was disinvested from the global equity mandate over Q1 to increase the cash position and repay any outstanding council loans.

Asset Allocation

Manager	Valuation (£m)		Actual Proportion	Benchmark	Relative
	Q4 2021	Q1 2022			
Majedie UK Equity Fund	107.3	99.5	13.7%	12.5%	1.2%
Newton Global Equity Fund	183.5	149.4	20.6%	18.75%	1.9%
Baillie Gifford Diversified Growth Fund	120.9	113.5	15.7%	10.0%	5.7%
UBS Climate Aware World Equity Fund	143.1	139.4	19.2%	18.75%	0.5%
Total Growth	**554.8**	**501.8**	**69.3%**	**60.0%**	**9.3%**
Schroders Property Fund	41.8	45.1	6.2%	8.0%	-1.8%
GSAM Broad Street Loan Partners IV Fund	20.5	23.7	3.3%	5.0%	-1.7%
Partners Infrastructure	6.1	8.0	1.1%	5.0%	-3.9%
Total Income	**68.4**	**76.8**	**10.6%**	**18.0%**	**-7.4%**
Schroders Fixed Income Fund	141.7	131.5	18.2%	22.0%	-3.8%
Total Protection	**141.7**	**131.5**	**18.2%**	**22.0%**	**-3.8%**
Cash	0.0	14.0	1.9%	0.0%	1.9%
Total Scheme	**764.9**	**724.2**	**100.0%**	**100.0%**	

Asset class exposures



- Majedie UK Equity Fund 14%
- Newton Global Equity Fund 21%
- Baillie Gifford Diversified Growth Fund 16%
- UBS Climate Aware World Equity Fund 19%
- Schroders Property Fund 6%
- GSAM Broad Street Loan Partners IV Fund 3%
- Partners Infrastructure 1%
- Schroders Fixed Income Fund 18%
- Cash 2%

Source: Investment Managers. Partners Q4 valuation has now been updated for the 31 December 2021. GSAM provided estimated valuation for Q1 2022.

Fund performance

Over Q1 2022, the Fund's total performance was negative on both absolute and relative terms. The Fund returned -3.9% underperforming its benchmark by 2%.

Over the longer term, the Fund's absolute return remains positive and ahead of its benchmark for the 3-year period. The Fund now falls short of its 12-month benchmark by 0.4%.

All of the mandates delivered negative absolute returns this quarter, with the exception of the property mandate.

The growth mandates suffered following a variety of headwinds including rising inflation and geopolitical uncertainty. The Baillie Gifford and Majedie funds severely underperformed benchmarks this quarter by 7% and 6.7%, respectively.

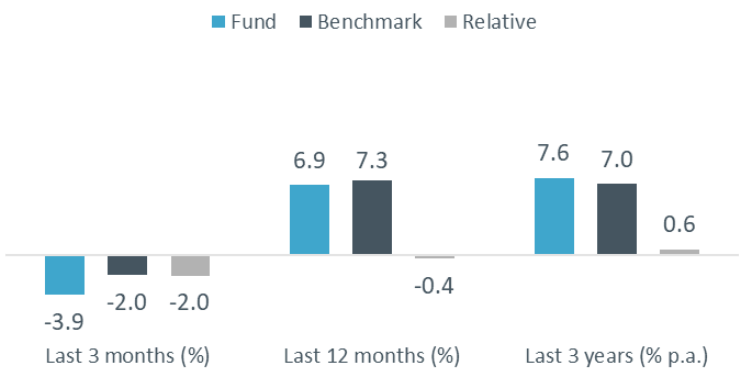
The Schroders fixed income mandate also suffered due to the rise in yields and the expectation of further increases in interest rates.

The Fund's property mandate was the only mandate to outperform its benchmark this quarter. The property market continued to excel and the mandates growth in capital value boosted performance.

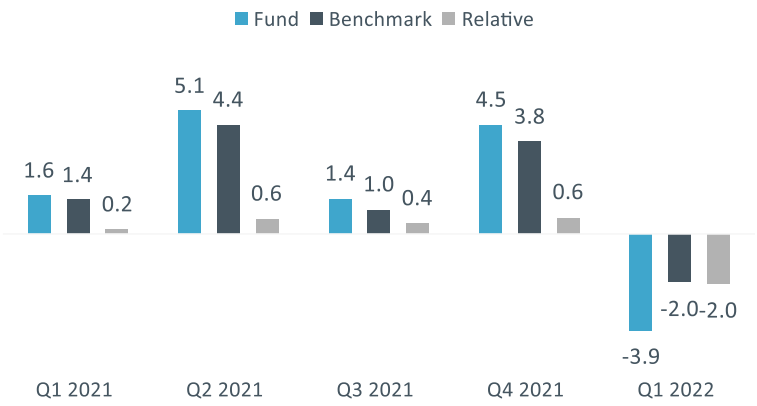
Manager performance (gross of fees)

	Last 3 months (%)			Last 12 months (%)			Last 3 years (% p.a.)		
	Fund	B'mark	Relative	Fund	B'mark	Relative	Fund	B'mark	Relative
Growth									
Newton Global Equity Fund	-4.4	-2.6	**-1.8**	11.1	12.4	**-1.2**	14.1	13.4	**0.7**
Majedie UK Equity Fund	-6.3	0.5	**-6.7**	6.2	13.0	**-6.0**	3.8	5.3	**-1.4**
Baillie Gifford Diversified Growth Fund	-6.1	1.0	**-7.0**	3.8	3.6	**0.1**	3.9	3.8	**0.1**
UBS Climate Aware World Equity Fund	-2.6	-2.4	**-0.2**	-	-	**-**	-	-	**-**
Income									
Schroders Property Fund	5.2	4.0	**1.2**	19.6	19.9	**-0.3**	8.0	7.2	**0.8**
Protection									
Schroders Fixed Income Fund	-7.2	-6.8	**-0.4**	-5.9	-5.2	**-0.7**	1.7	0.4	**1.4**
Total	-3.9	-2.0	**-2.0**	6.9	7.3	**-0.4**	7.6	7.0	**0.6**

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. Performance excludes the impact of any cash held.

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
UBS Climate Aware World Equity Fund	Preferred	Good

UBS business update

- Colm Kelleher is appointed Chairman of UBS AG, replacing Axel Weber
- There were no other significant developments over the quarter to report

Source: Investment Managers

Majedie UK Equity

The Majedie UK Equity fund returned -6.3% over the quarter, falling short of its FTSE All Share benchmark by 6.7%. The fund lags target over the 12-month and 3-year period by 6% and 1.4%, respectively.

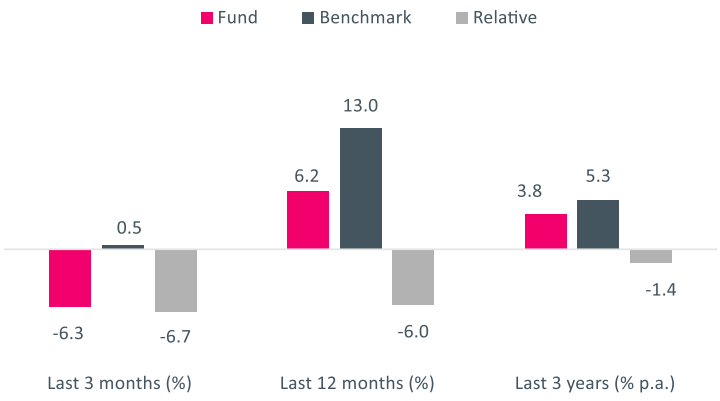
Outbreak of the Russia/Ukraine war led to a sell-off in equity markets in late February / early March. Although, subsequently the markets largely recovered, further headwinds (e.g. the steep rise in inflation) led to an overall reduction in the value of the growth portfolio.

The poor performance this quarter was led by the mandates holdings in consumer discretionary stocks as ongoing inflationary pressures weighed on real consumer incomes. From a stock perspective, Made.com and Dr Martens notably suffered.

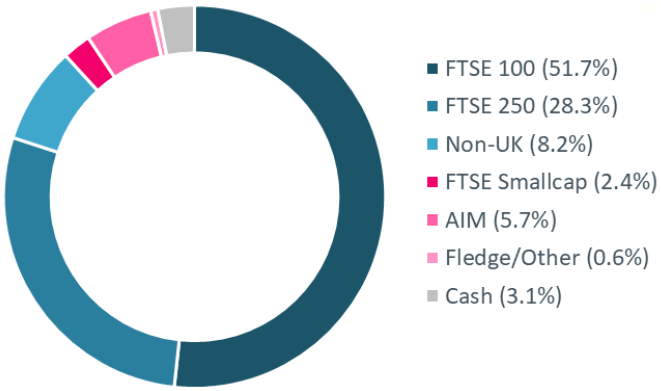
Technology stocks also underperformed as higher yields weighed on valuations. Poor stock selection in financials also detracted (as the rise in rates led to outperformance in the sector).

Leading positive performance this quarter was basic materials. Energy outperformed due to the surge in oil and gas prices. As a result, holdings in Shell were a key contributor to performance.

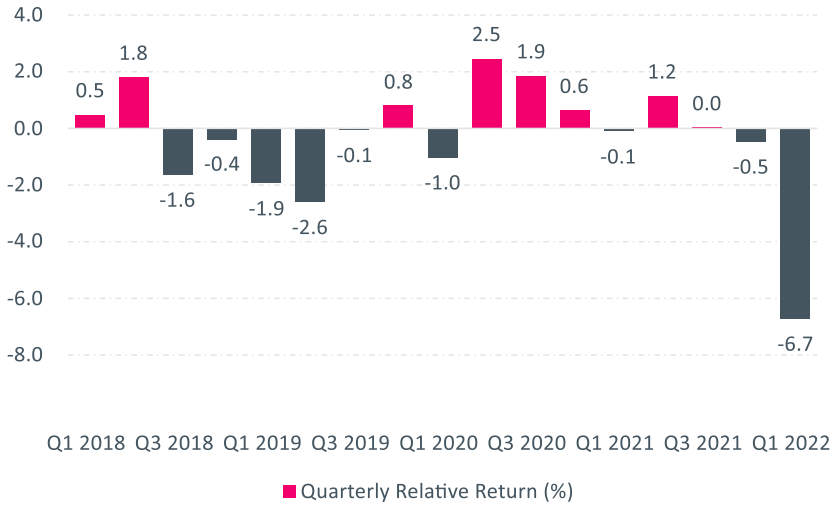
Performance summary



Asset allocation



Performance summary (Gross of Fees)



Source: Data and fund performance provided by Majedie and Link Group and is gross of fees.

Newton Global Equity

The Newton Global Equity Fund underperformed its MSCI ACWI benchmark of -2.6% over Q1 2022, returning -4.4% in absolute terms. The fund now falls short of its 12-month benchmark however continues to outperform over the 3-year period.

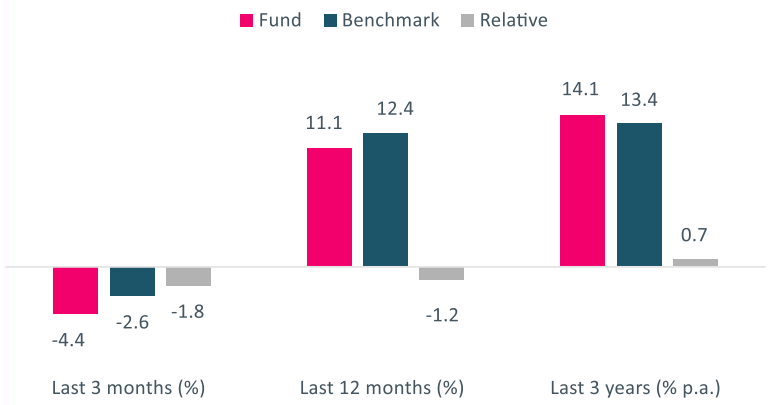
The mandate suffered as market sentiment shifted from growth to value-orientated stocks over the quarter due to rising inflation and hawkish monetary policy shifts. The fund's low allocation to energy also restricted returns as oil prices rocketed.

Stock selection was also a driver to underperformance as holdings in materials, industrials and financials weighed on performance despite generally outperforming in the market. In particular, holdings in industrials such as Deutsche Post and Ferguson Plc detracted.

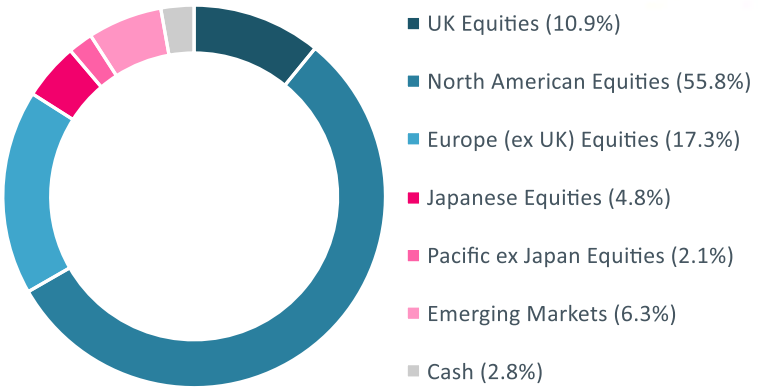
From a regional perspective, Europe fell to the bottom of the rankings due to the reliance on Russian energy imports and stronger trade links. Emerging markets also fell further.

Defensive sectors such as consumer staples and telecoms positively contributed. As a result, holdings in Altria Group and Informa contributed to performance as investors preferred safer areas of the market.

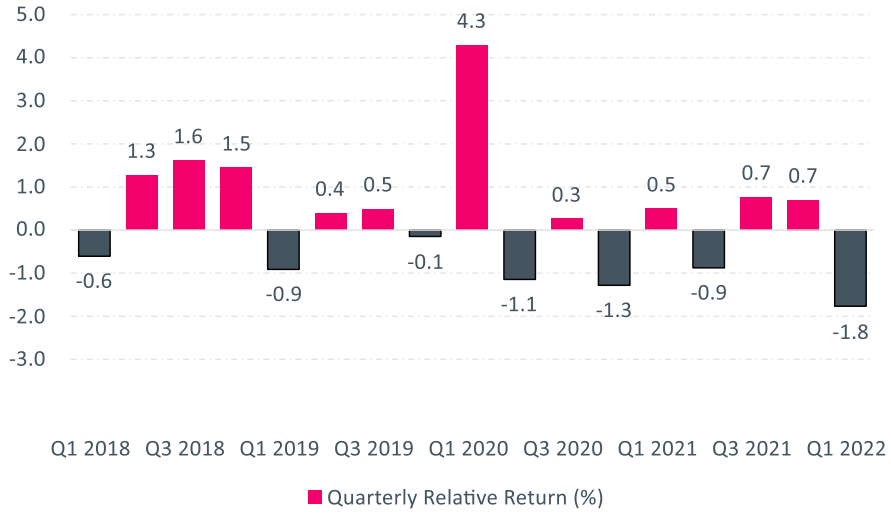
Performance summary



Asset allocation



Quarterly relative performance



Source: Data and fund performance provided by Newton and Link Group and is gross of fees.

Baillie Gifford Diversified Growth

The Baillie Gifford Diversified Growth fund returned -6.1% over Q1, underperforming its benchmark by 7%. The fund remains marginally ahead of its longer term targets.

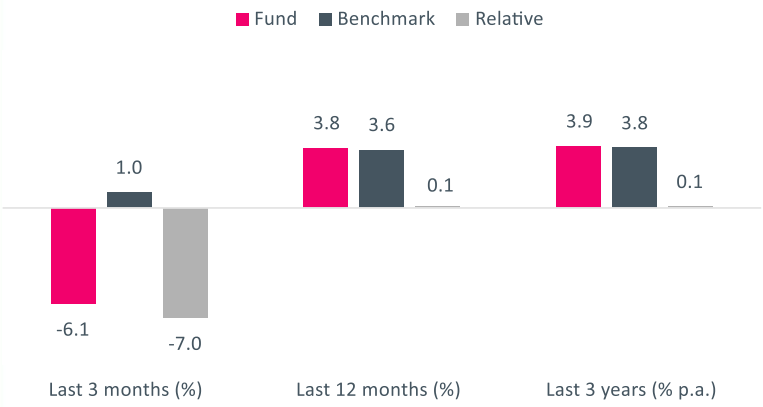
Key detractors to performance this quarter were holdings in equities and absolute return, which suffered amidst the heightened market volatility. Additionally, strategies expected to perform during economic stress failed and Baillie Gifford have since sold these.

High yield bonds also negatively contributed, in particular, Asian high yield bonds purchased last quarter as the newly implemented regulations prolonged the volatility seen in the Chinese property markets. The manager remains focused on the long-term opportunity of these holdings.

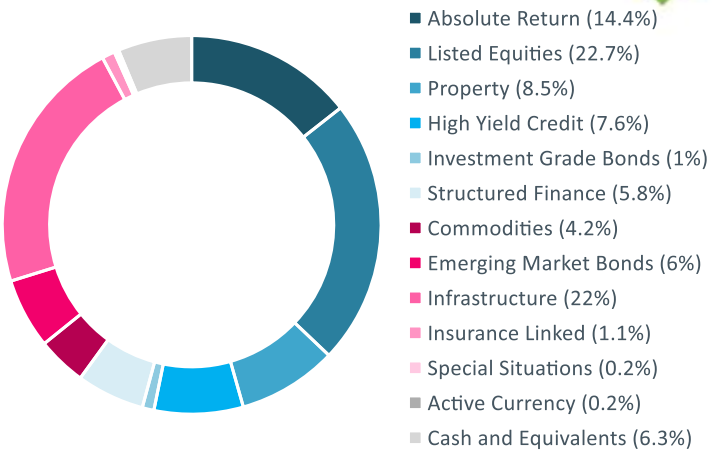
Commodities were the top performer this quarter as prices surged given Russia's position as major energy and commodity producer, albeit the mandate's low exposure restricted returns. Over the 1-year period, infrastructure and property remain top contributors.

Despite poor performance this quarter, Baillie Gifford remains focused on their longer-term trends and stresses the importance of not losing sight of long-term goals amidst the current volatile market.

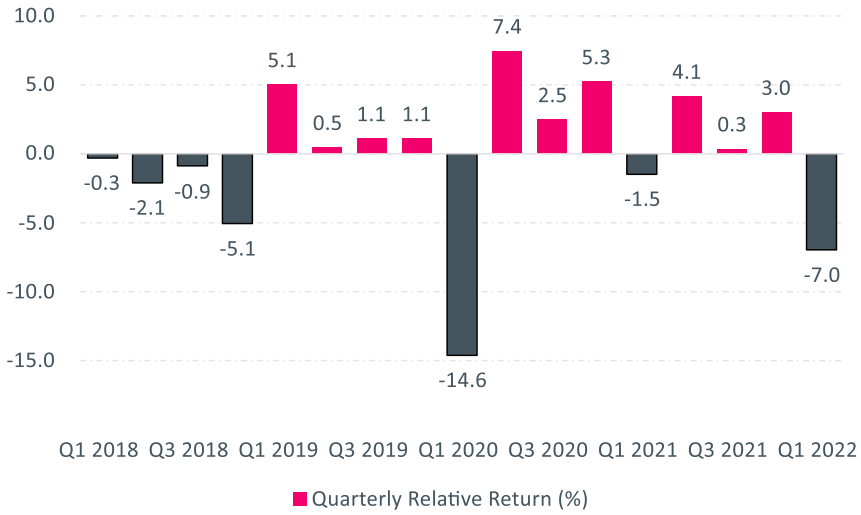
Performance summary



Asset allocation



Quarterly relative performance



Source: Data and fund performance provided by Baillie Gifford and Link Group and is gross of fees.

Schroder Property

The Schroder's property mandate returned 5.2% over Q1 2022, outperforming its benchmark by 1.2%. Relative performance was negative over the last 12-months however remains positive over the 3-year period.

Amidst the environment of rising inflation, rates and yields, the property sector continued to excel over the first quarter of 2022, driven by the buoyant industrial sector. The fund's underweight positions to industrials and retail warehousing restricted performance as a result.

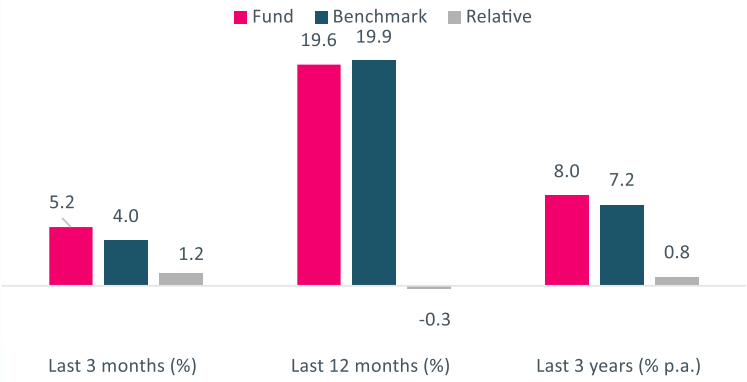
Positive drivers to performance were the growth in capital value (c.£90.2m) and 32 new lettings, lease renewals and rent reviews, creating an increase of c.£1.9m in rent per annum.

8 of the 32 leasing deals were in industrials, as Schroders look to increase their industrial exposure. There were 3 disposals over Q1.

Following completion of the £81m acquisition of Romford (flagged last quarter), the fund faced £4.7m transaction costs, detracting from the overall performance.

Emerging from its pandemic slump, the office sector continued to stabilise albeit remains a laggard compared to industrials and retail. Offices remains the highest allocation within the mandate.

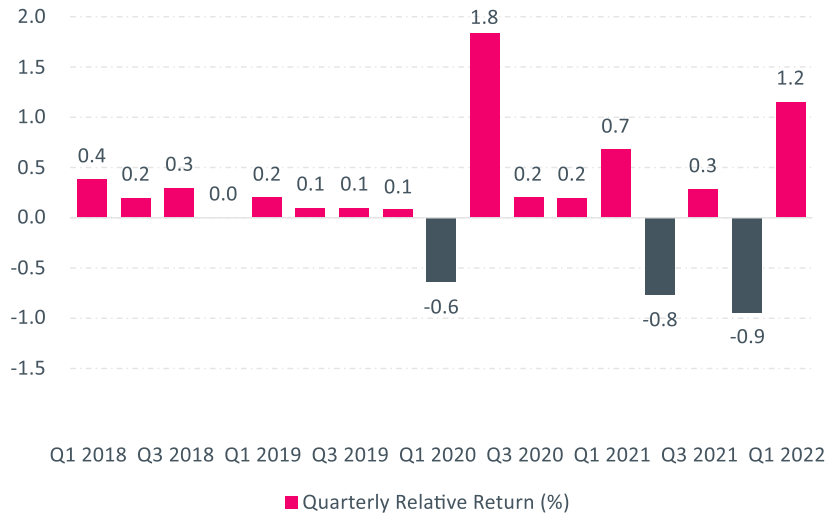
Performance summary



Key statistics

Fund size (gross)	£2,699.7m
Number of holdings	54
Number of tenants	634
Debt (% of NAV)	0.2%
Top 10 holdings as % of portfolio	47.4

Quarterly relative performance



Source: Data and fund performance provided by Schroders and is gross of fees.

Schroders Fixed Income

The Schroders Fixed Income fund underperformed its benchmark by 0.4%, returning -7.2% over Q1 2022. The fund fell short of its 12-month target by 0.7% however remains ahead of its 3-year target.

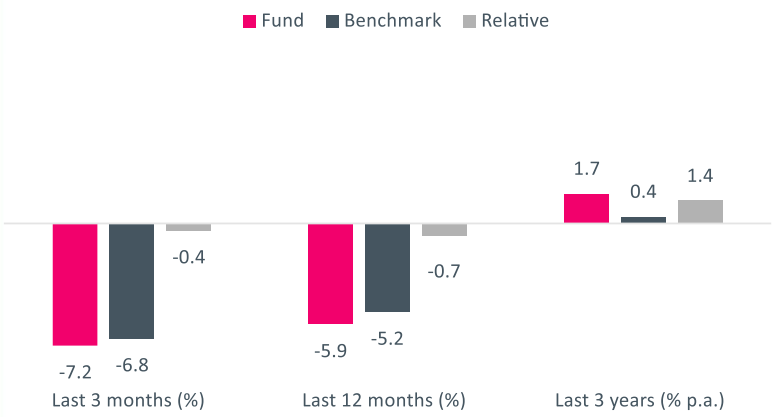
The steep rise in yields as a result of ongoing inflationary concerns and expectations of further rate increases significantly contributed to the fund's underperformance.

The rise in yields was also compounded by spread widening (global investment-grade as well as US and European speculative spreads widened). The mandates underweight position to US credit mitigated some of this however the overweight position to European credit suffered as monetary policy conditions tightened.

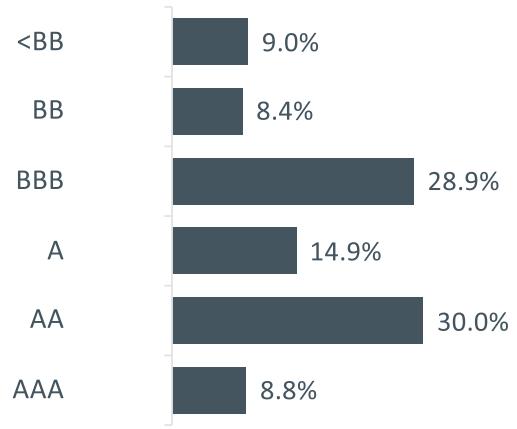
Upwards pressure on inflation has persisted due to ongoing supply chain disruptions, surging energy prices and labour and materials shortages. Underweight position to inflation in Europe detracted from performance – Baillie Gifford has since closed this position.

Overweight position to UK against the US benefitted as the Bank of England raised interest rates. Furthermore, the mandate benefitted from the flattening across the US Treasury bond yield curves due to the sell-off of short-term yields.

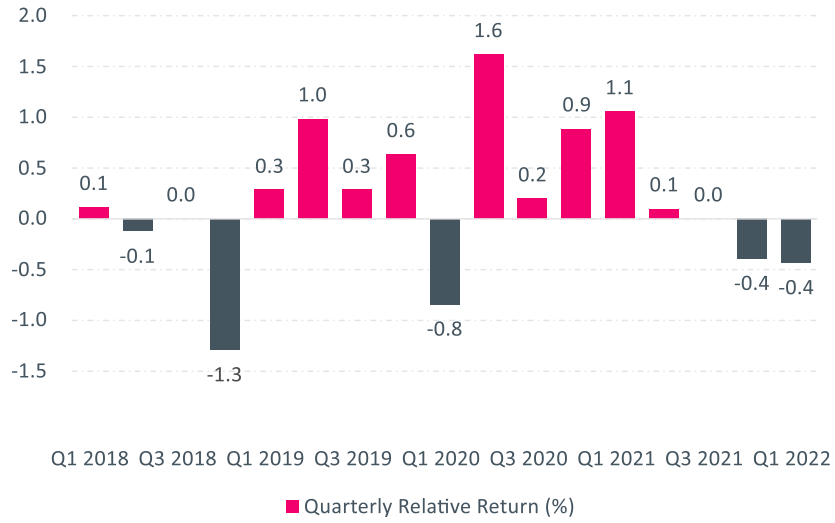
Performance summary



Relative credit allocation



Quarterly relative performance



Source: Data and fund performance 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.

As at 31 March 2022, the estimated capital balance provided by GSAM was c.£23.7m and capital contributions totalled c.£22.8m.

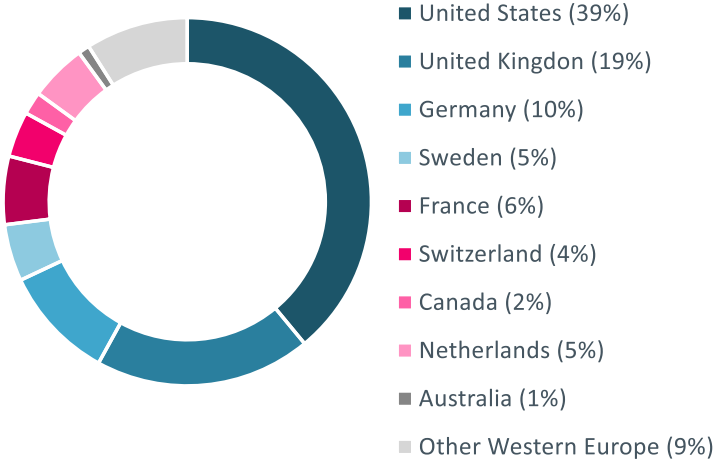
The Fund received one capital call from GSAM over Q1:
- c.£2.4m on 24 January 2022

Following quarter end, there was one distribution notice of c.£490k on 4 May 2022.

First Lien term loans continue to hold the majority weighting, in line with the Fund's target investment profile.

It is too early in the funds lifecycle for performance data however as the Fund's commitment of £29m continues to drawdown, and as the size of the investment increases, performance reporting will develop.

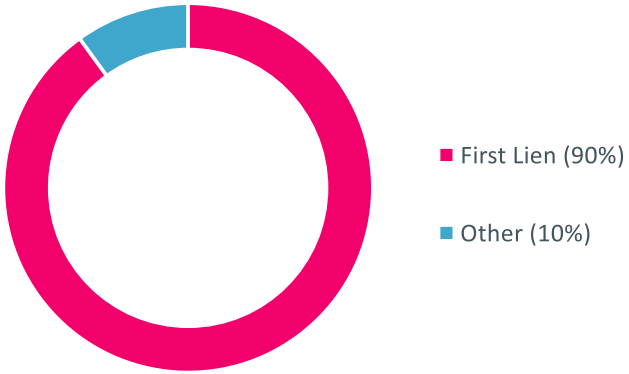
Geography split



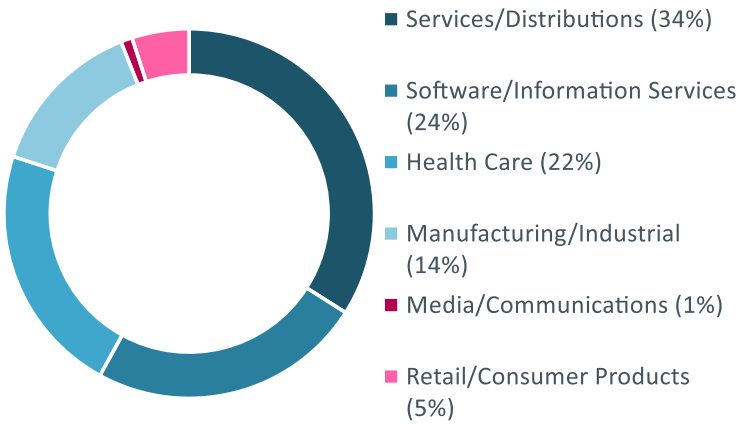
Key statistics (£m)

Commitment	29.0
Capital contributed	22.8
Distributions	0.5
Estimated Capital balance	23.7
Estimated Net Income/Loss	0.3

Security/Loan type



Industry split



Source: Fund data provided by GSAM 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.

The net asset value for the fund was c.£8.0m as at 31 March 2022 (vs. c.£6.1m as at 31 December 2021).

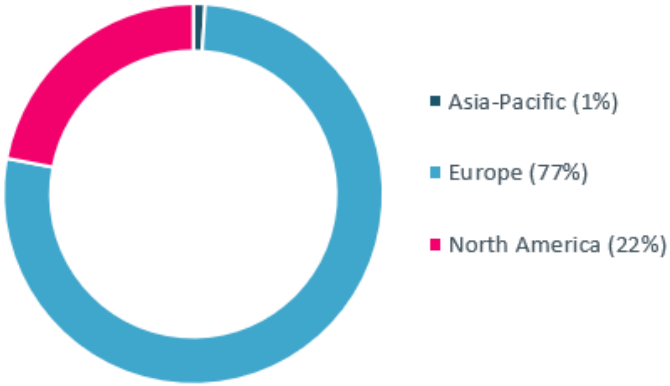
At the end of the quarter, the capital contributions paid to date were c.£7.8m.

Reporting for the fund will evolve over time as the fund establishes.

Key statistics (£m)

Commitment	35.0
Capital contributions	7.8
Distributions	0
Net asset value	8.0
Net multiple	1.05%

Regional allocation



Source: Fund data provided by Partners.

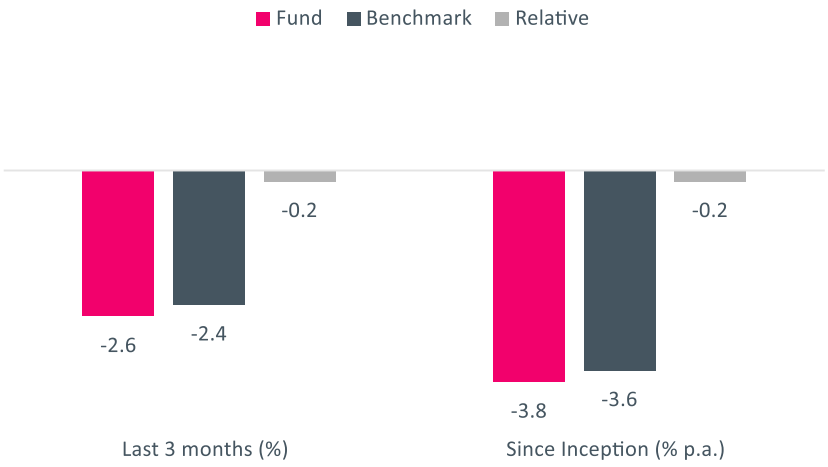
UBS Climate Aware World Equity Fund

Following the equity review in November 2020, the Committee agreed to introduce a passively managed global mandate to provide a more balanced equity investment approach. In December 2021, the new allocation of £145m was invested in the UBS Global Aware mandate.

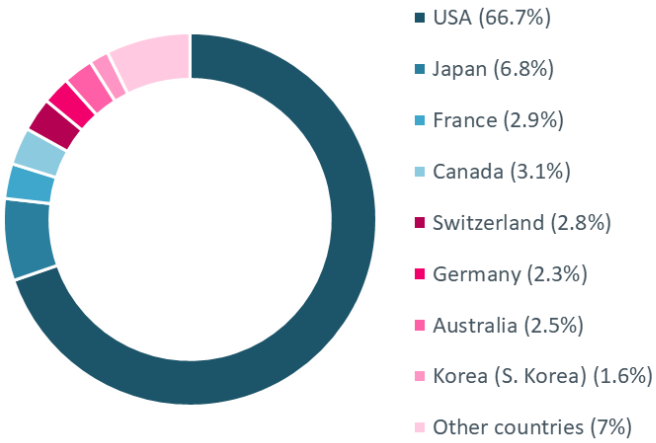
The aim of the mandate is to perform broadly in line with the FTSE AW Developed Index, delivering similar performance to standard global equity indices but with less carbon intensive investments.

Over the first quarter of 2022, the fund returned -2.6%, closely in line with its benchmark of -2.4%.

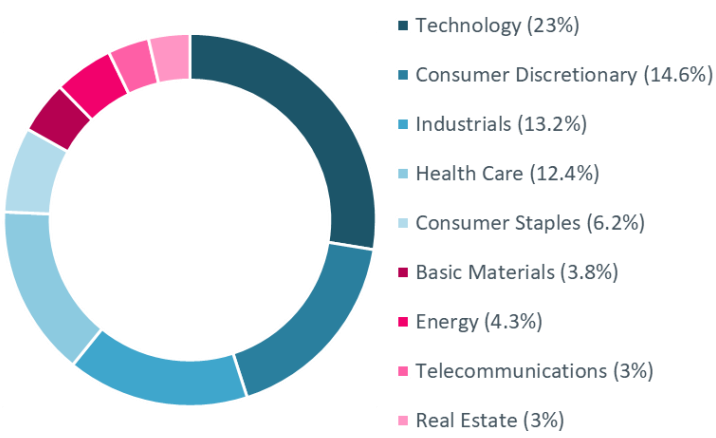
Performance summary



Geographical allocation



Sector allocation



Source: Data and fund performance data provided by UBS 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
UBS Climate Aware World Equity Fund	08/12/2021	FTSE AW Developed Index	-

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.