Isle of Wight Council Pension Fund

Q3 2022 Investment Monitoring Report

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Market Background

Higher current and forecast inflation, and subsequent expectations of tighter monetary policy, are weighing heavily on consumer and business sentiment, with growth forecasts continuing to see downwards revisions. Recessions are now forecasts in several key European economies and the US economy also expected to slow substantially, increasing global recession risks.

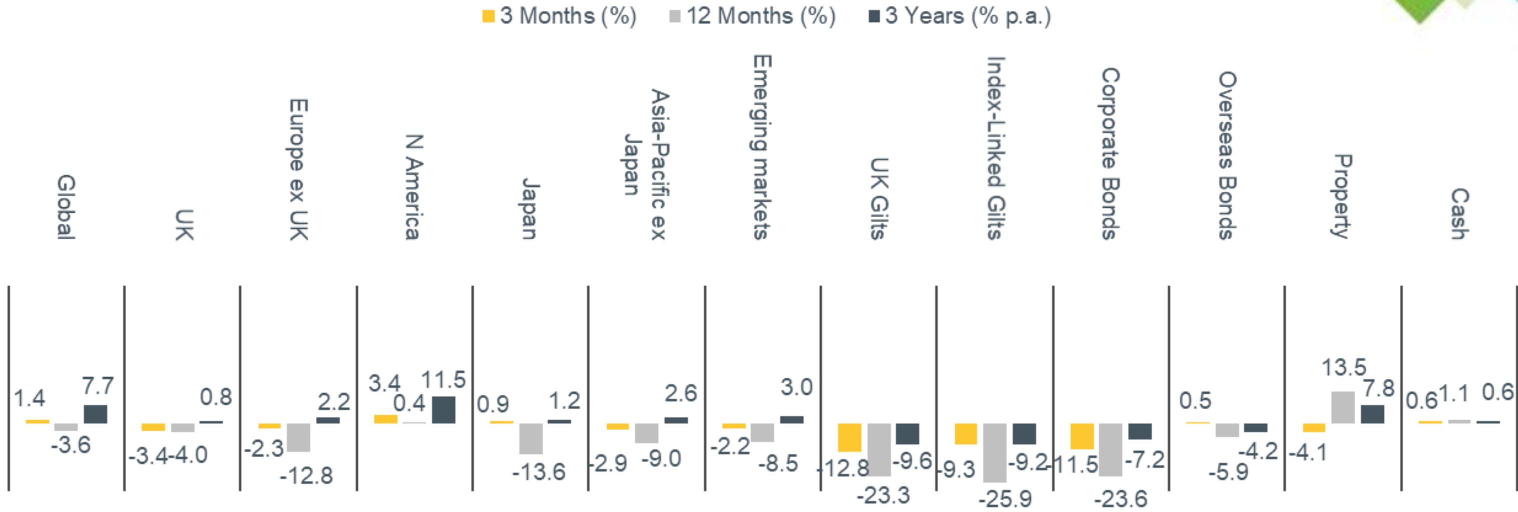
Year-on-year headline CPI inflation is running at 9.9%, 8.3%, and 9.1%, in the UK, eurozone, and US, respectively. Of more concern to central bankers, core inflation, which excludes food and energy prices, is also well above target, at 6.5%, 6.6%, and 4.8% in the UK, US, and eurozone, respectively.

Growing concerns about sustained high inflation were met with more aggressive messaging and action by central banks. The Fed raised interest rates by a cumulative 1.5% p.a. in Q3, while the Bank of England and the ECB raised rates by a total of 1% p.a. and 1.25% p.a., respectively.

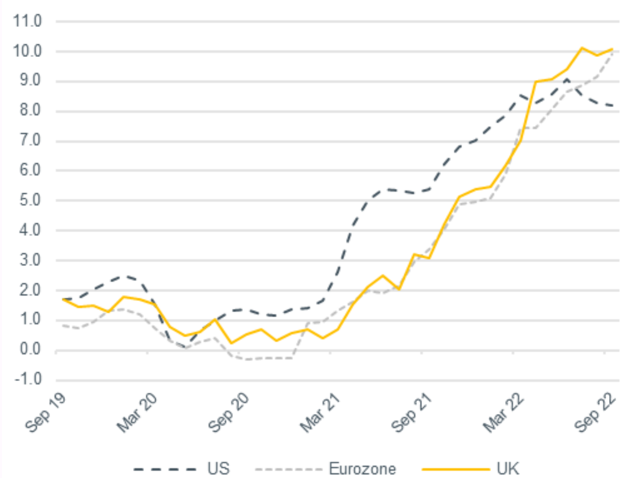
Against a global backdrop of high inflation and rising interest rate expectations, increases in UK government bond yields accelerated as the government unveiled a substantial unfunded fiscal package in late September. 10-year gilt yields ended the quarter at 4.1% p.a., 1.9% p.a. above end-June levels, while equivalent US and German yields both rose 0.8% p.a. over the same period, to 3.8% p.a. and 2.1% p.a., respectively.

UK 10-year implied inflation, as measured by the difference between conventional and inflation-linked bonds of the same maturity, rose 0.4% p.a. to 4.0% p.a. Equivalent US implied inflation fell 0.2% p.a., to 2.2% p.a.

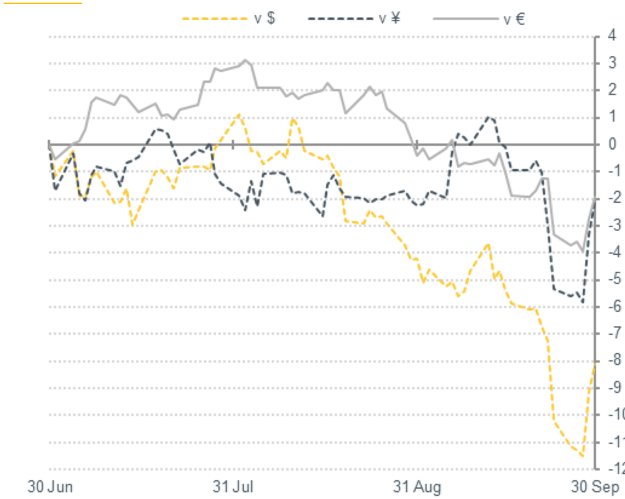
Historic returns for world markets [1]



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, ICE BofA Global Government Index, MSCI UK Monthly Property; UK Interbank 7 Day

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Global investment-grade spreads ended the quarter slightly wider, while UK investment-grade credit spreads rose 0.4% p.a., to 2.4% p.a., as rising government bond yields saw pension schemes liquidate liquid assets to meet collateral calls on their interest-rate hedging programmes. US and European speculative grade credit spreads ended the quarter 0.4% p.a. and 0.2% p.a. below end June levels, at 5.4% p.a. and 6.3% p.a., respectively.

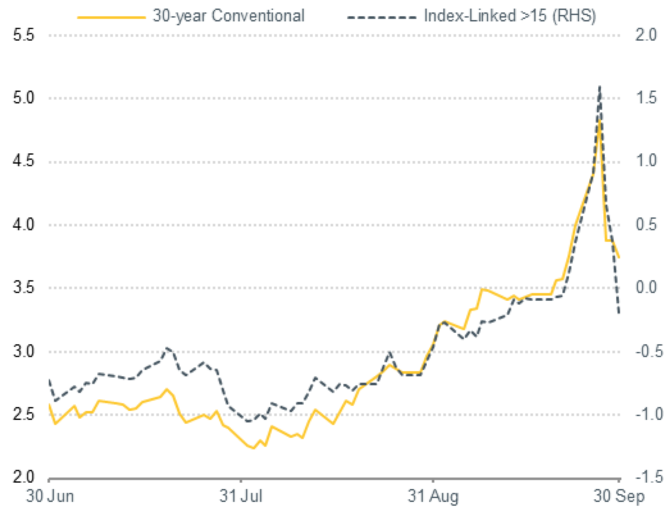
Despite a rally in July, global equities fell sharply in the second half of the quarter as high inflation, and subsequent higher interest rate expectations, weighed on both equity valuations and the fundamental outlook. The FTSE All World Index fell 4.8% (in local terms). Depreciation of sterling over the period resulted in a 1.4% return to unhedged UK investors. Performance was varied between cyclicals and defensives with telecoms, technology, and healthcare underperforming, while the energy and consumer discretionary sectors notably outperformed.

Regionally, Japanese and UK markets outperformed, both supported by currency weakness flattering the international earnings profile of their markets, and the UK also benefitting from an above-average exposure to the energy sector. Emerging and Asian markets once again underperformed.

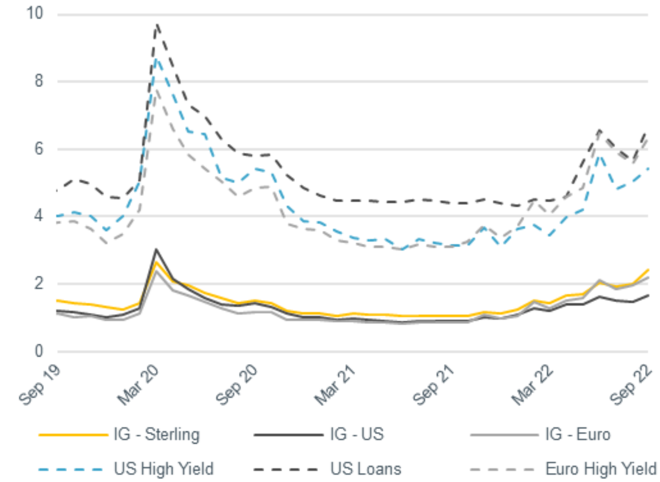
Global growth concerns were reflected in commodity markets, where energy and industrial metals prices led declines.

The MSCI UK Monthly Property Index has returned 13.5% in the 12 months to the end of September, although monthly returns entered negative territory in the third quarter. Capital value declines have been observed across the three main commercial sectors but have been more pronounced in the industrial sector.

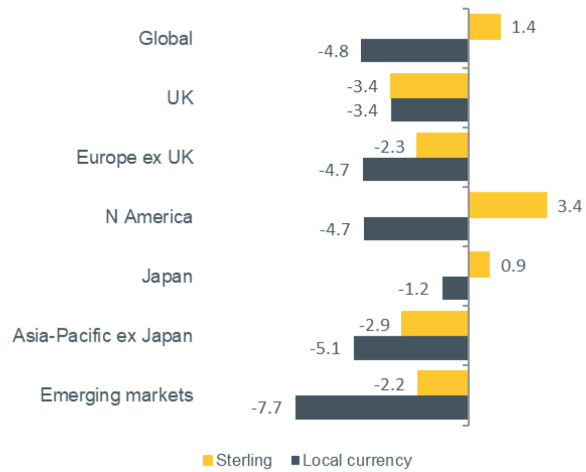
Gilt yields chart (% p.a.)



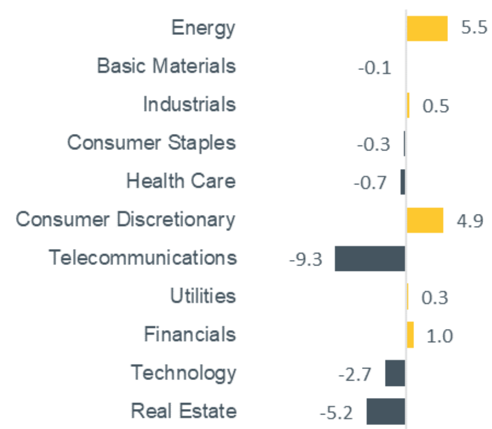
Investment and speculative grade credit spreads (% p.a.)



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

	June 2022	September 2022	Comment
Index-linked gilts	Neutral	Neutral	Even adjusting for the additional inflation protection (typically around 1.0% p.a. over the longer-term) afforded to index-linked gilts until RPI is aligned with CPIH in 2030, and high near-term inflation, long-dated implied inflation still looks a little expensive. The front end of the curve looks to offer better value.
Conventional gilts	Neutral to Cautious	Neutral to Cautious	Valuations have improved materially but near-term fundamental challenges remain and technicals have deteriorated sharply, with gilt market volatility at unprecedented levels in the inflation-targeting era. Nominal yields look reasonably attractive relative to our assessment of longer-term fair value and, considering the path of forward nominal yields which fall sharply beyond 15 years, we retain a preference for the front-end of the curve.
Sterling non-government bonds	Neutral	Neutral	Investment-grade credit spreads have increased, rising well above long-term median levels. Coupled with higher risk-free rates, this makes all-in credit yields far more enticing. While global spreads may move wider in a recessionary environment, they are at reasonably attractive levels on a longer-term view. Corporate balance sheets are in reasonable shape relative to history but will likely come under pressure as the economic outlook deteriorates.
Private Debt	Neutral to Cautious	Neutral to Cautious	Defaults remain low but, as in the public speculative-grade markets, are expected to increase modestly, with risks to growth and earnings skewed to the downside (to the upside for defaults). Overall, we are more cautious on private loan markets versus high yield, as valuations remain relatively unattractive due to significant increases in margin spreads in the public market.
Equities	Neutral	Neutral to Cautious	Equity valuations have continued to fall, with cyclically adjusted price-to-earnings ratios now modestly below long-term median levels. Earnings forecasts for 2022 and 2023 still point to reasonable real earnings growth, but average earnings momentum is poor, and the level of real earnings has started to fall. Although absolute valuations have improved, relative valuations look much less exciting as real yields move closer to long-term fair value.
Cash Strategies	Neutral	Neutral	Although risk asset valuations are improving, we would still hold more cash than strategic requirements dictate due to the deteriorating fundamental outlook.

Source: DataStream

As at 30 September 2022, the Fund's assets totalled £651.0m, decreasing by £20.5m over the quarter.

Key themes from the first half of the year, namely high inflation, global growth concerns and rising interest continued to persist over Q3.

Market sentiment briefly improved in July and early August on expectation of interest rates cuts in 2023. However, persistently high inflation and the central banks' commitment to bringing it down led to a surge in bond yields and sharp sell-off in equity markets in September.

The UK bond market particularly suffered following the mini budget announcement at the end of Q3 which triggered large scale sell-offs in the gilts market.

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

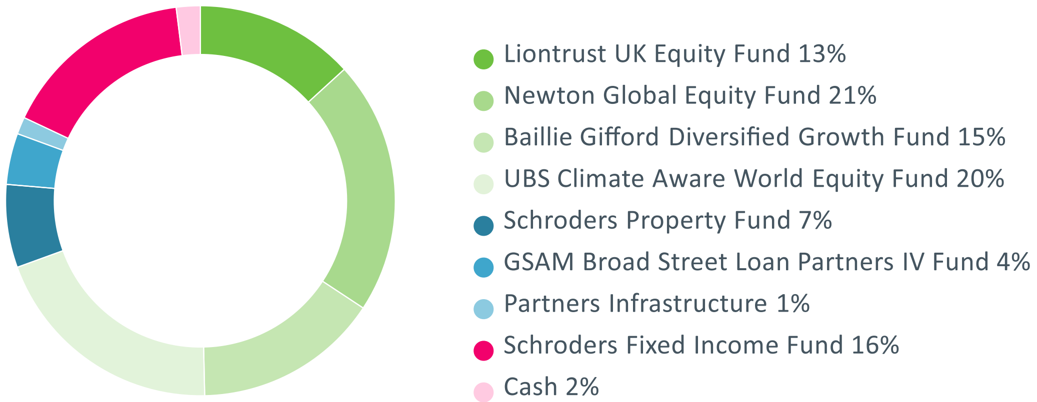
Key Actions

GSAM issued one capital call notice over the quarter, c.£350k on 5 July 2022.

Asset Allocation

Manager	Valuation (£m)		Actual Proportion	Benchmark	Relative
	Q2 2022	Q3 2022			
Liontrust UK Equity Fund	91.0	86.1	13.2%	12.5%	0.7%
Newton Global Equity Fund	136.4	137.0	21.0%	18.75%	2.3%
Baillie Gifford Diversified Growth Fund	103.6	100.1	15.4%	10.0%	5.4%
UBS Climate Aware World Equity Fund	127.0	129.0	19.8%	18.75%	1.1%
Total Growth	**458.0**	**452.2**	**69.5%**	**60.0%**	**9.5%**
Schroders Property Fund	46.2	44.8	6.9%	8.0%	-1.1%
GSAM Broad Street Loan Partners IV Fund	25.1	27.6	4.2%	5.0%	-0.8%
Partners Infrastructure	8.6	9.3	1.4%	5.0%	-3.6%
Total Income	**79.9**	**81.7**	**12.6%**	**18.0%**	**-5.4%**
Schroders Fixed Income Fund	120.3	104.1	16.0%	22.0%	-6.0%
Total Protection	**120.3**	**104.1**	**16.0%**	**22.0%**	**-6.0%**
Cash	13.3	13.0	2.0%	0.0%	2.0%
Total Scheme	**671.5**	**651.0**	**100.0%**	**100.0%**	

Asset class exposures



Source: Investment Managers. GSAM provided estimated valuation for Q3 2022. GSAM Q2 valuation has now been updated to reflect the final valuation statement.

Over the third quarter of 2022, the Fund returned -3.3% against its benchmark of -2.7%, a relative underperformance of 0.6%.

Over the longer term, the Fund fell short of its respective benchmarks over the 12-month and 3-year periods. Absolute performance remains positive over the 3-year, returning 2.0% p.a., whilst 12-month performance is now negative.

The Newton Global Equity and UBS Climate Aware mandates were the only ones to return positively on an absolute basis this quarter.

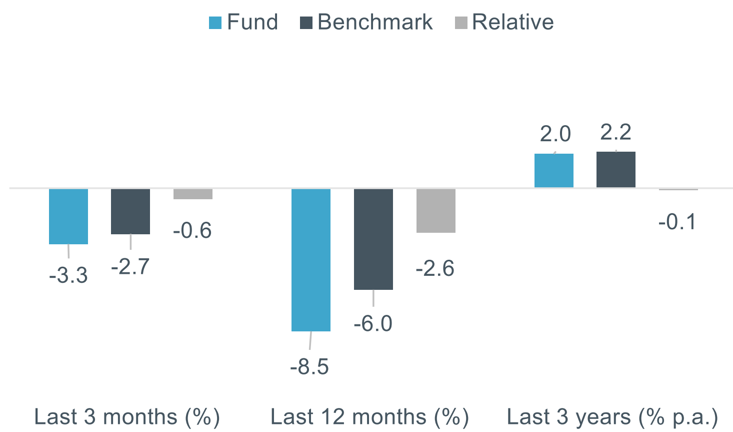
As a result of the steep rise in gilt yields and widening of credit spreads, the Schroders Fixed Income portfolio was the main laggard this quarter as the value of the protection assets fell significantly.

The Fund's property mandate returned negatively on an absolute basis this quarter as rising rates and prospects of a future recession weighed on valuations, albeit marginally outperformed its benchmark.

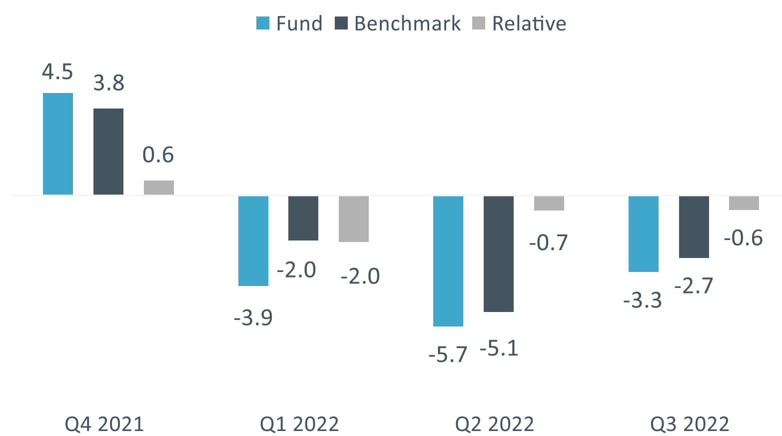
Manager performance (gross of fees)

	Last 3 months (%)			Last 12 months (%)			Last 3 years (% p.a.)		
	Fund	B'mark	Relative	Fund	B'mark	Relative	Fund	B'mark	Relative
Growth									
Liontrust UK Equity Fund	-4.0	-3.5	**-0.5**	-14.5	-4.0	**-10.9**	-1.1	0.8	**-1.9**
Newton Global Equity Fund	1.4	1.4	**0.1**	-5.2	-4.2	**-1.1**	7.6	7.2	**0.4**
Baillie Gifford Diversified Growth Fund	-3.2	1.3	**-4.4**	-13.8	4.3	**-17.3**	-1.5	3.9	**-5.2**
UBS Climate Aware World Equity Fund	1.6	1.9	**-0.3**	-11.0	-10.5	**-0.5**	-	-	**-**
Income									
Schroders Property Fund	-2.8	-3.4	**0.6**	10.4	11.0	**-0.5**	7.3	6.9	**0.4**
Protection									
Schroders Fixed Income Fund	-13.4	-12.5	**-1.0**	-25.7	-23.3	**-3.1**	-8.3	-8.4	**0.2**
Total	-3.3	-2.7	**-0.6**	-8.5	-6.0	**-2.6**	2.0	2.2	**-0.1**

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
Liontrust 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

Partners business update

Partners Group added 5 professionals to its infrastructure team over the last quarter, with a Managing Director covering the Americas, a lead asset manager in Asia and some additional associates in the direct and asset management teams. We view the strengthening of the team positively.

Liontrust UK Equity

Over Q3 2022, the Liontrust UK Equity fund returned -4.0%, marginally falling short of its FTSE All Share benchmark of -3.5%. The fund lags its long term benchmarks, returning -14.5% over the 12-month period and -1.1% p.a. over the 3-year period.

Inflationary concerns, rising interest rate expectations, and low economic growth prospects continued to weigh on equity markets in Q3. Additionally, the market sell-off in September coupled with rising recession fears added to the volatile environment, leading to the negative performance this quarter.

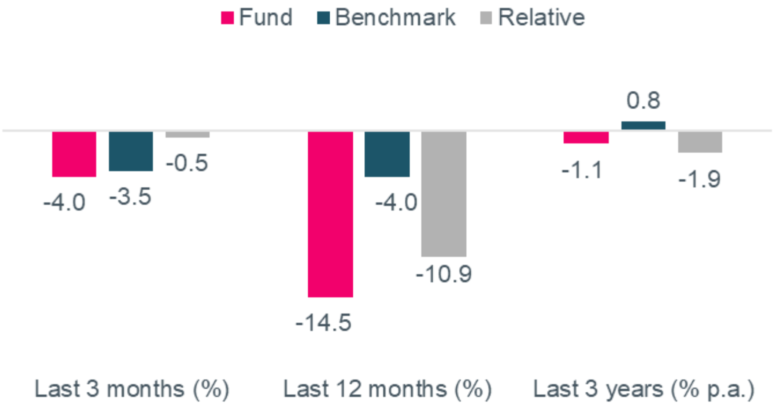
Underweight position to energy detracted as prior rises in oil prices boosted earnings growth releases in Q3.

The fund's discretionary stocks such as Boohoo, Bellway, and Domino's lagged this quarter despite the sector generally performing well in the wider market.

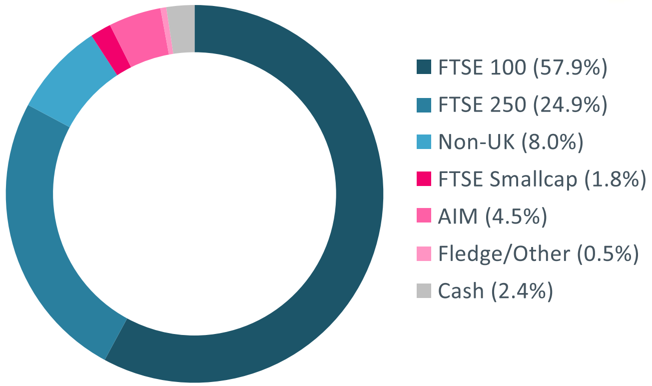
Underweight position to financials positively contributed as the sector returned mutedly as inflationary pressures weighed on valuations.

4Imprint, supplier of customised products, was key positive contributor as the share price rocketed following the company's interim profit results.

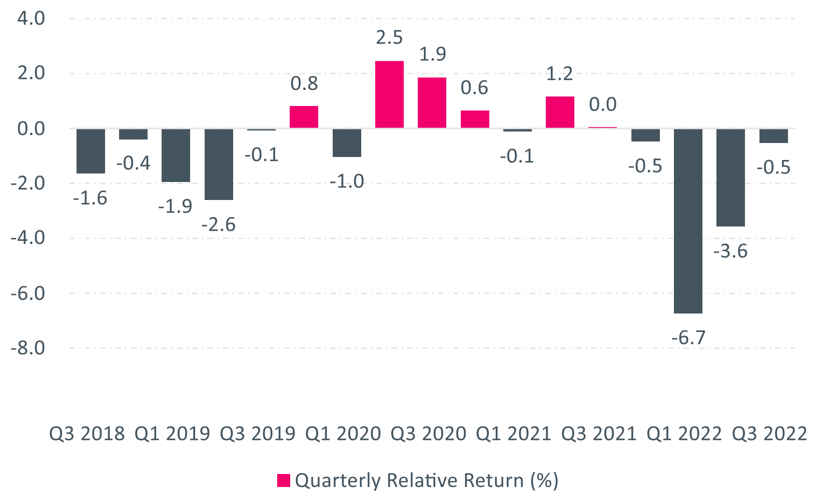
Performance summary



Asset allocation



Quarterly relative performance



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

Newton Global Equity

The Newton Global Equity Fund performed in line with its MSCI ACWI benchmark over Q3 2022, returning 1.4% in absolute terms. The fund continues to fall short of its 12-month benchmark, returning -5.2% and continues to outperform over the 3-year period by 0.4% p.a.

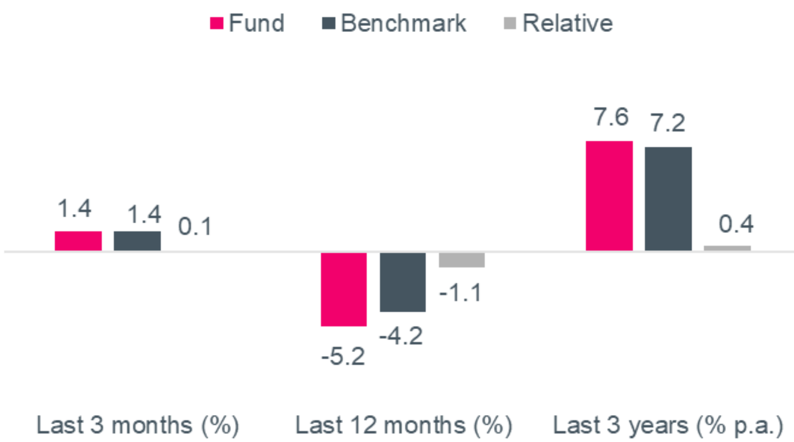
Global equities rallied in July but fell sharply in the second half of the quarter as rising yields, growing macroeconomic uncertainty and the resulting central bank actions continue to weigh on valuations and the fundamental outlook.

Growth stocks marginally outperformed value stocks over the quarter having found some support from earnings resilience early in the quarter.

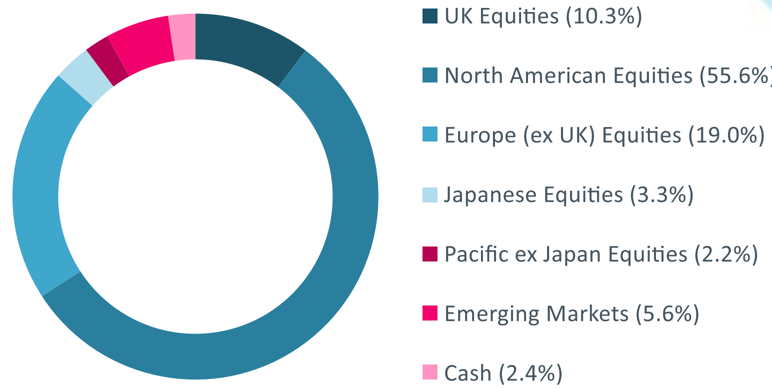
Positive performance was driven by its holdings in materials and industrials, particularly holdings in global chemicals company Albemarle Corp and electrical company Hubbell.

The fund's holdings in Alibaba and Ping An Insurance were key laggards as both experienced share price weakness due to continued lockdown restrictions imposed by China's zero-covid policy. Overall, the fund benefitted from its underweight position to Emerging Markets which notably underperformed.

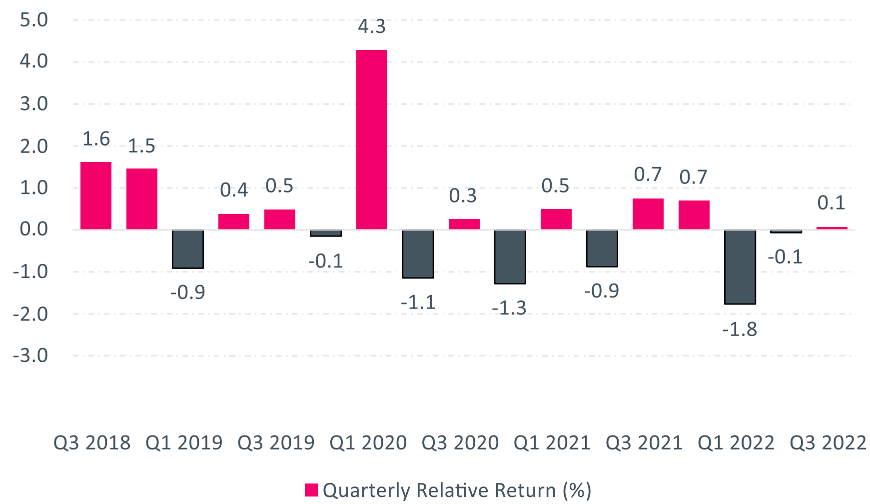
Performance summary



Asset allocation



Quarterly relative performance



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

UBS Climate Aware World Equity Fund

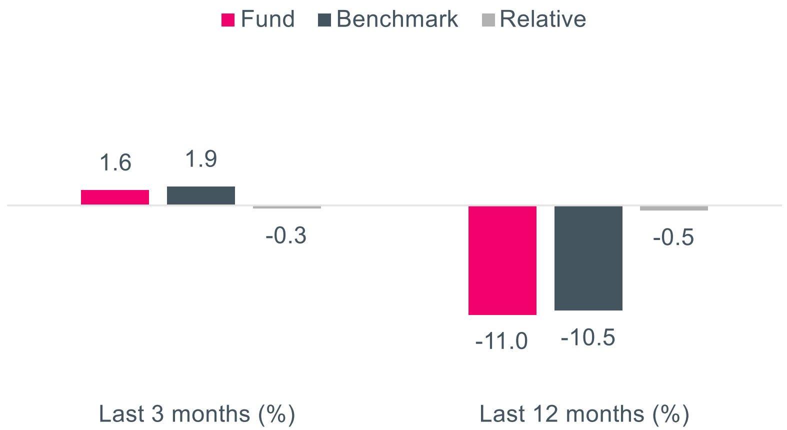
Following the equity review in November 2020, the Committee agreed to introduce a passively managed global mandate to provide a more balanced equity investment approach. In December 2021, the new allocation of £145m was invested in the UBS Global Aware mandate.

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.

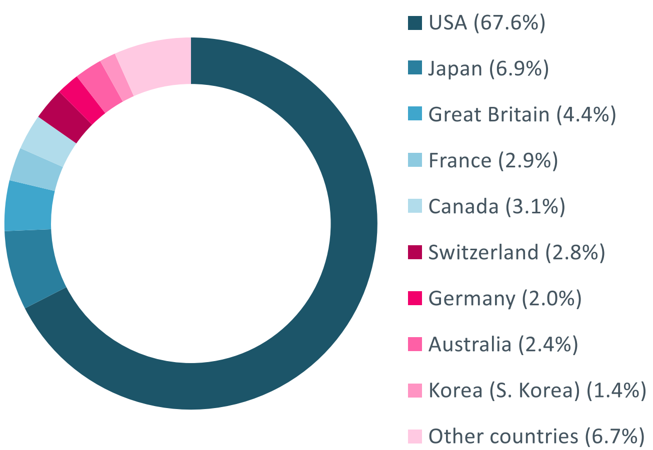
Over the third quarter of 2022, the fund returned 1.6%.

The fund closely tracks its benchmark since inception and has returned -11.0% p.a. vs. benchmark of -10.5% p.a.

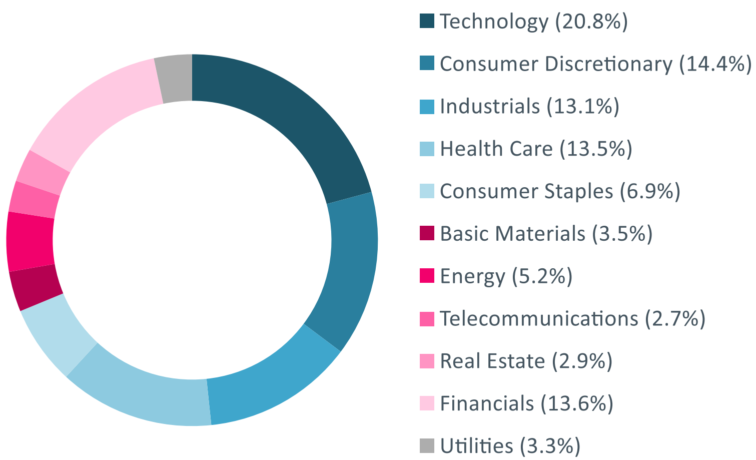
Performance summary



Geographical allocation



Sector allocation



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

Baillie Gifford Diversified Growth

Over Q3 2022, the Diversified Growth fund returned -3.2%, a relative underperformance of 4.4% against its benchmark of 1.3%. The fund fell short of its benchmarks across all time periods considered and the 12-month performance remains the greatest lag against its benchmark by 17.3%.

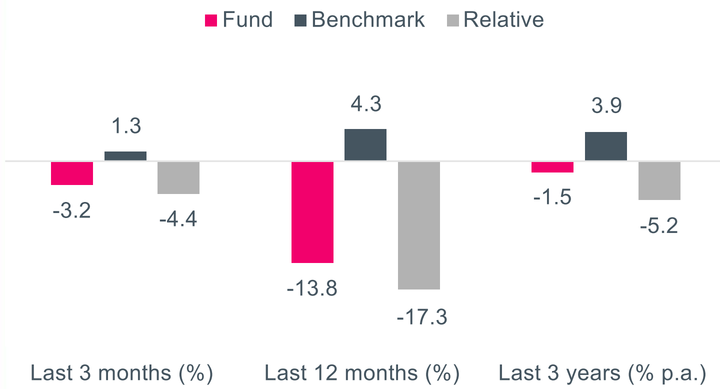
The economic backdrop of high inflation, rising interest rates, and low economic growth prospects were unfavourable for the majority of asset classes within the fund.

The largest detractors were holdings in infrastructure and property (c20% allocation within the fund). The sectors suffered due to the high interest rates and prospects of a recession.

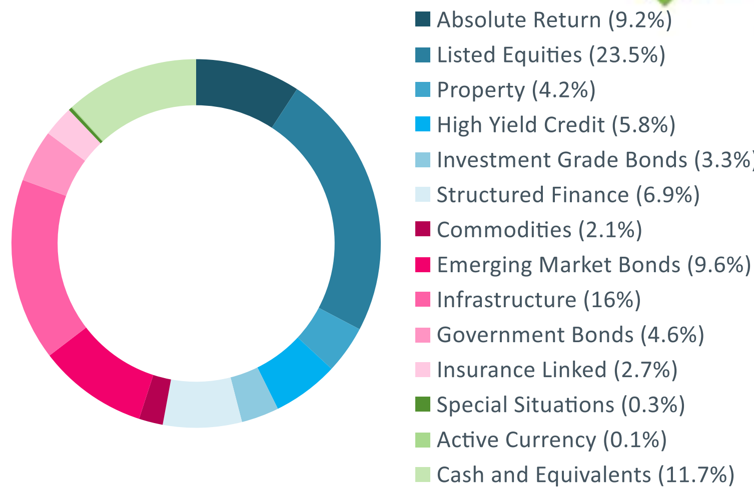
Additionally, the mini budget announced at the end of September saw a sharp sale in infrastructure holdings due to the asset class being more liquid than most other real assets.

Active currency and absolute return were the top positive contributors (total allocation of c9% in the fund). A long position to the dollar benefitted the active currency allocation as rates rose in the US. Absolute return performed well as the weak economic outlook benefitted those investments which excel as commodity prices fall.

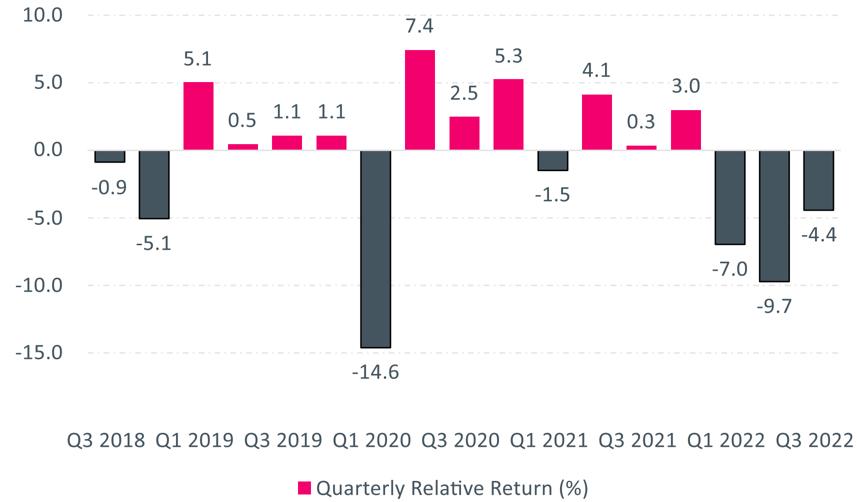
Performance summary



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 -2.8% over Q3 2022 versus its benchmark of -3.4%, an underperformance of 0.6%.

Absolute performance remained positive over the longer term periods however fell short of the 12-month benchmark by 0.5%. The fund remains marginally ahead of benchmark over the 3 year period.

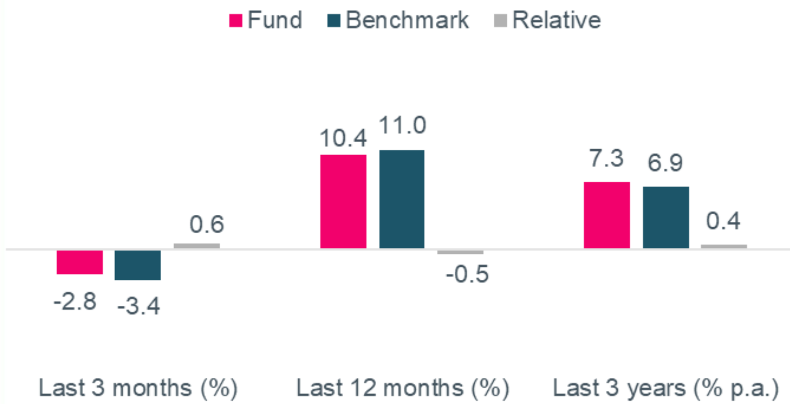
The property sector showed signs of slowing down across the quarter as returns entered negative territory, mostly owing to low market liquidity.

Against this backdrop, capital values have declined since June across the 3 main commercial sectors, with the industrial sector most impacted. The fund's underweight position to industrials benefitted the relative performance.

Looking forward, property markets look vulnerable to further pressure in the short term, given expensive valuations and a rapidly weakening economic outlook.

There were 47 new lettings, lease renewals and rent reviews over the quarter as a result of the active management initiatives, creating £1m rent income per annum.

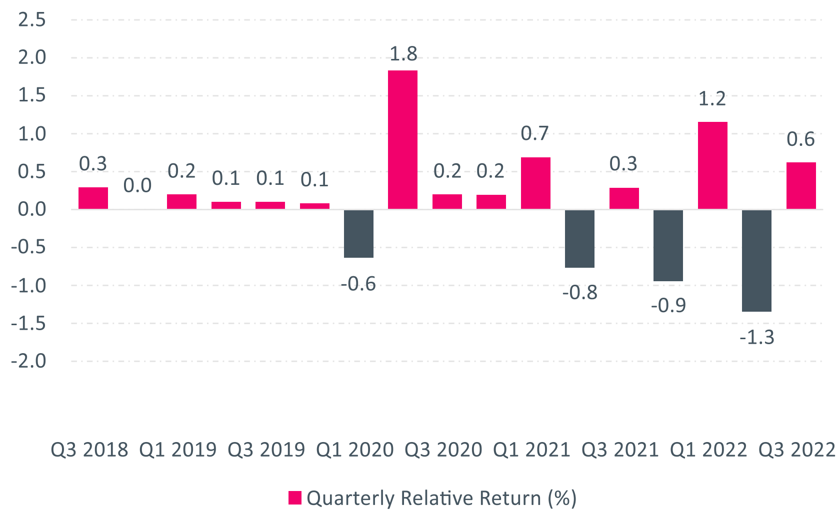
Performance summary



Key statistics

Fund size (gross)	£2,731.1m
Number of holdings	52
Number of tenants	657
Debt (% of NAV)	5.5%
Top 10 holdings as % of portfolio	49.5

Quarterly relative performance



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

Schroders Fixed Income

The Schroders Fixed Income fund returned -13.4% over Q3 20222, marginally short of its benchmark of -12.5%.

The fund's 12-month performance has continued to fall due to the high yields over the year and falls short of its benchmark by 3.1%.

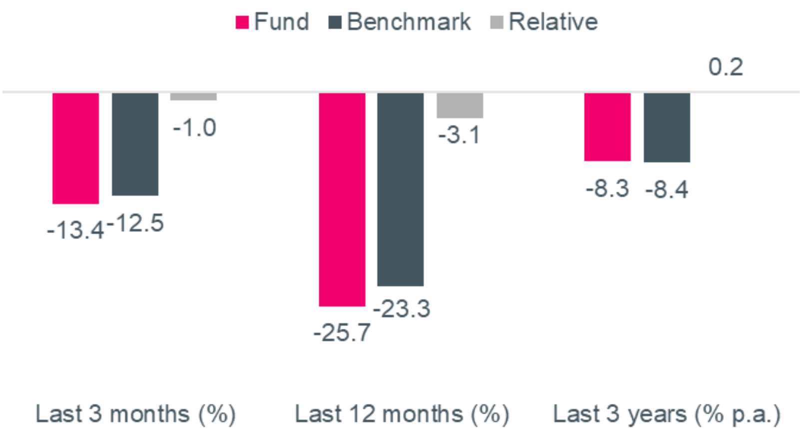
Performance over the 3-year period was also negative albeit marginally outperformed its benchmark by 0.2% p.a.

The fund's negative absolute performance was a result of the steep rise in yields seen in late August and September.

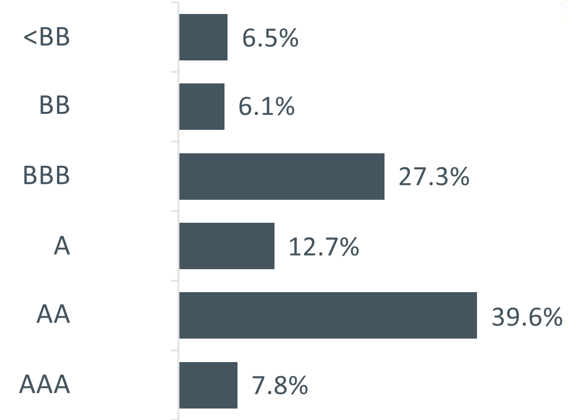
Following a brief spell of stability in early Q3, ongoing inflation pressures and further interest rate rises pressured the further surge in yields.

Credit spreads initially tightened at the start of the quarter however widened in September as global economic outlook weakened, inflationary pressures persisted and rising US Treasury yields.

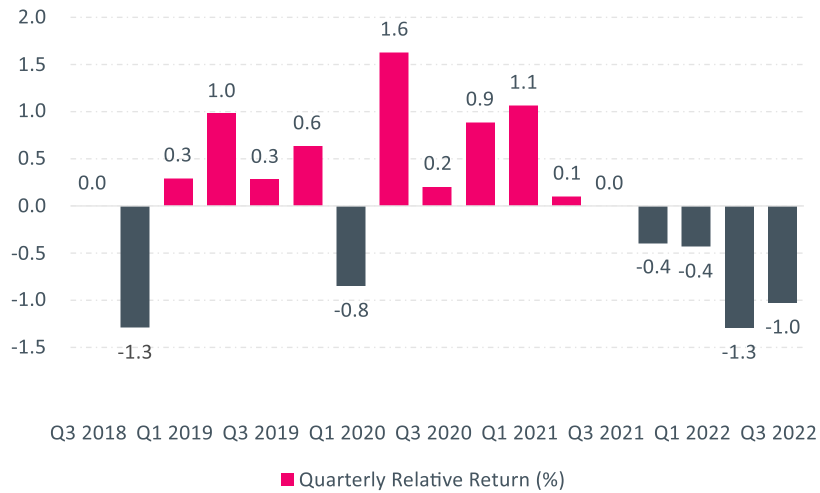
Performance summary



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.

The table to the right reflects the key statistics since inception based on the estimated end of September figures from GSAM.

The estimated capital balance by GSAM as at 30 September 2022 was c.£27.6m and capital contributions were c.£27.3m.

There was one capital call of c.£350k issued by GSAM on 5 July 2022 and distributions totalled c.£880k over the quarter.

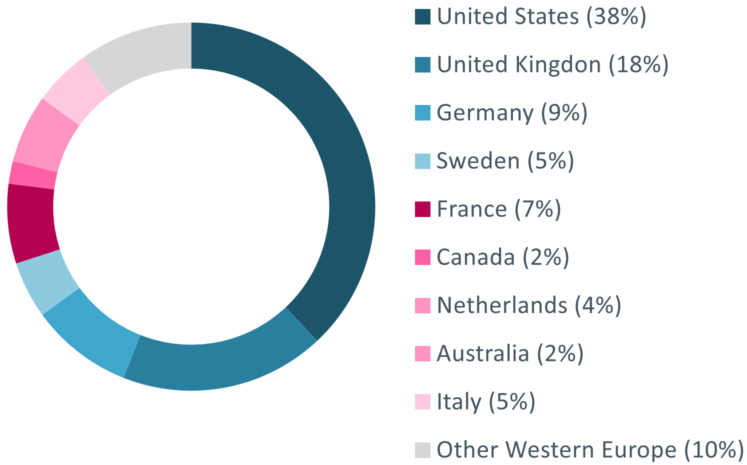
First Lien term loans continue to hold the majority weighting, in line with the Fund's target investment profile.

It is too early in the funds lifecycle for performance data however as the Fund's commitment of £30m continues to drawdown, and as the size of the investment increases, performance reporting will develop.

The charts to the right reflect end of June position as the Q3 report Is still to be released.

*Net income allows for impact of currency movements

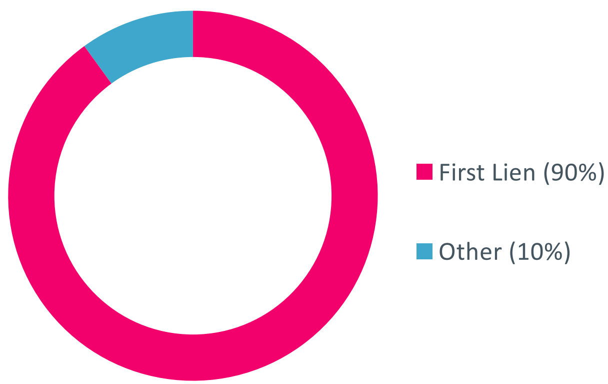
Geography split as at 30 June 2022



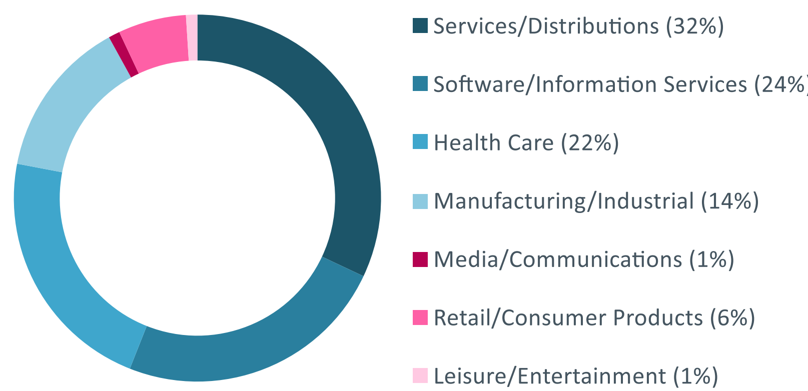
Key statistics since inception (£m)

Commitment	30.0
Capital contributed	27.3
Distributions	2.1
Estimated Capital balance	27.6
Estimated Net Income/Loss*	2.5

Security/Loan type as at 30 June 2022



Industry split as at 30 June 2022



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 as at 30 September 2022 was c.£9.3m (vs. c.£8.6m as at 30 June 2022.

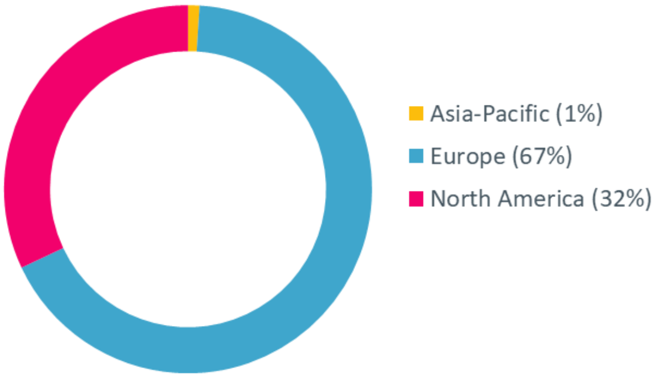
The capital contributions paid to the end of September remained the same as end of June position, c.£8.5m to date.

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

Key statistics (£m)

Commitment	35
Capital contributions	8.5
Distributions	0
Net contributions	8.2
Net asset value	9.3
Net multiple (%)	1.09%

Regional allocation



Source: Fund data provided by Partners.

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
Liontrust 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.

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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.