Essex County Council

Essex Pension Fund Investment Steering Committee

13:00	**Wednesday, 27 June 2018**	**Committee Room 1, County Hall, Chelmsford, CM1 1QH**

For information about the meeting please ask for:
Kevin McDonald, Director for Essex Pension Fund
Telephone: 01245 431301 (internal ext 21301) or 0333 0138 488
Email: kevin.mcdonald@essex.gov.uk

5	**Arrangement for future meetings**	
	To agree a schedule of meetings for the municipal year 2018/19. The following dates have been proposed: **(1:00pm, unless stated)** 18 July 2018 17 October 2018 28 November 2018 20 February 2019 27 March 2019 NB: these dates may require change during the municipal year. To note the schedule of meetings for the ACCESS Joint Committee: 19 September 2018 10 December 2018	
6	**Minutes of ISC meeting 28 March 2018** To approve as a correct record the Minutes of the Investment Steering Committee meeting held on 28 March 2018.	**11 - 16**
7	**Capital Market Outlook Q1 2018 to date** To note a report by Hymans Robertson	**17 - 34**
8	**Urgent Business** To consider any matter which in the opinion of the Chairman should be considered in public by reason of special circumstances (to be specified) as a matter of urgency.	
9	**Exclusion of Public** To consider whether the public (including the press) should be excluded from the meeting during consideration of an agenda item on the grounds that it involves the likely disclosure of exempt information as specified in Part I of Schedule 12A of the Local Government Act 1972 (exclusion is recommended for the items set out in Part II below)	

Exempt Items

(During consideration of these items the meeting is not likely to be open to the press and public)

To consider whether the press and public should be excluded from the meeting during consideration of an agenda item on the grounds that it involves the likely disclosure of exempt information as specified in Part I of Schedule 12A of the Local Government Act 1972 or it being confidential for the purposes of Section 100A(2) of that Act.

In each case, Members are asked to decide whether, in all the circumstances, the public interest in maintaining the exemption (and discussing the matter in private) outweighs the public interest in disclosing the information.

10 Minutes of ISC meeting 28 March 2018 part 2

- Information relating to the financial or business affairs of any particular person (including the authority holding that information);

11 Investment Tables Quarter ended 31 March 2018

- Information relating to the financial or business affairs of any particular person (including the authority holding that information);

12 Transitions update

To consider a verbal update by Hymans Robertson in consultation with the Independent Investment Adviser and the Director for Essex Pension Fund.

13 Structural Reform of LGPS Pooling

13 13a: Progress Update

To receive a presentation from John Wright, Hymans Robertson

13 **13b: Structural Reform of LGPS pooling quarterly JC update**

- Information relating to the financial or business affairs of any particular person (including the authority holding that information);

13 **13c: Stocklending training**
To receive a presentation from the Fund's Custodian Northern Trust.

13 **13d: Stock lending**

- Information relating to the financial or business affairs of any particular person (including the authority holding that information);

13 **13e: ACS ACCESS Voting Guidelines**

- Information relating to the financial or business affairs of any particular person (including the authority holding that information);

14 **Urgent Exempt Business**
To consider in private any other matter which in the opinion of the Chairman should be considered by reason of special circumstances (to be specified) as a matter of urgency.

15 **Date of Next Meeting**
To note the next Essex Pension Fund Strategy Board is on Wednesday 4 July 2018 at 1pm in Committee Room 2.
To note the next Investment Steering Committee is on Wednesday 18 July 2018 at 1pm in Committee Room 2.

Essex County Council and Committees Information

All Council and Committee Meetings are held in public unless the business is exempt in accordance with the requirements of the Local Government Act 1972. If there is exempted business, it will be clearly marked as an Exempt Item on the agenda and members of the public and any representatives of the media will be asked to leave the meeting room for that item.

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The Council Chamber and Committee Rooms are accessible by lift and are located on the first and second floors of County Hall.

Induction loop facilities are available in most Meeting Rooms. Specialist headsets are available from Reception.

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Should you wish to record the meeting, please contact the officer shown on the agenda front page

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Agenda item 1

Committee: Essex Pension Fund Investment Steering Committee

Enquiries to: Samantha Andrews, Investment Manager

Membership, Apologies, Substitutions and Declarations of Interest

Recommendations:

To note

1. The Committee's membership as agreed at the annual meeting of Essex County Council on 15 May 2018 as detailed below.

2. Apologies and substitutions.

3. Declarations of interest to be made by Members in accordance with the Members' Code of Conduct.

Membership
(Quorum: 4)

5 Conservative Group: 1 Labour Group: 1 Non-aligned Group

Membership	**Representing**
Councillor S Barker	Essex County Council (Chairman)
Councillor A Goggin	Essex County Council
Councillor A Hedley	Essex County Council
Councillor M Platt	Essex County Council
Councillor C Pond	Essex County Council
Councillor L Scordis	Essex County Council
Councillor C Souter	Essex County Council
Observers	
Councillor C Riley	Castle Point District Council
Sandra Child	UNISON

Essex Pension Fund Investment Steering Committee	AGENDA ITEM 4
date: 27 June 2018	

Terms of Reference

Report by Director for Essex Pension Fund

Enquiries to Kevin McDonald on 01245 431301 or 0333 0138 488

1. Purpose of the Report

1.1 To note the Committee's Terms of Reference.

2. Recommendation

2.1 It is recommended that the Terms of Reference, set out overleaf in section 3 of this report, are noted.

3. Terms of Reference (ToR)

3.1 The ToR the Essex Pension Fund Investment Steering Committee, as reflected within the Constitution of Essex County Council are set out below.

Membership: seven members of the Council:

i. to approve and annually review the content of the Investment Strategy Statement;

ii. to monitor compliance of the investment arrangements with the Investment Strategy Statement;

iii. to approve and review the asset allocation benchmark for the Fund;

iv. to assess the risks assumed by the Fund at a global level as well as on a manager by manager basis;

v. to appoint and review investment Managers, Custodian and Advisors;

vi. to set the investment parameters within which the Investment Managers can operate and review these annually;

vii. to assess the quality and performance of each Investment Manager annually in conjunction with investment advisers and the Section 151 Officer;

viii. to approve and to review annually the content of the Pension Fund Treasury Management Strategy; and

ix. to submit quarterly reports on its activities to the Essex Pension Fund Board.

3.2 ***It is recommended*** that these are noted.

Essex Pension Fund
Investment Steering Committee (ISC)

Minutes of a meeting of the Essex Pension Fund Investment Steering Committee held at 13:00pm at County Hall, Chelmsford on 28 March 2018

1 Membership, Apologies and Declaration of Interest

Membership
Present

Cllr S Barker (Chairman)	Essex CC
Cllr A Erskine (Conservative Group Substitute attending on behalf of Cllr S Canning)	Essex CC
Cllr A Goggin	Essex CC
Cllr A Hedley	Essex CC
Cllr M Maddocks (Conservative Group Substitute attending on behalf of Cllr Souter)	Essex CC
Cllr L Scordis*	Essex CC

* Attended the meeting from 1.15pm

Sandra Child (Observer representing scheme employees)	UNISON
Cllr C Riley (Observer representing scheme employers)	Castle Point District Council

The following Advisers were present in support of the meeting;

Mark Stevens	Independent Adviser
Rebecca Craddock Taylor	Hymans Robertson
Matt Woodman	Hymans Robertson

The following Officers were present in support of the meeting;

Kevin McDonald	Director for Essex Pension Fund
Samantha Andrews	Investment Manager

The following Essex Pension Fund Advisory Board (PAB) members were present as observers of the meeting:

Andrew Coburn	UNISON
Paul Hewitt	Deferred Member
Mark Paget	Active Member

Apologies for absence
Apologies were received from Cllr S Canning and Cllr C Souter (ECC Members).

It was noted that Cllr D Blackwell had tendered his resignation forthwith from both the ISC and the Essex Pension Fund Strategy Board.

Declaration of Interest
Cllr Goggin declared that his wife, sister and brother-in-law were in receipt of an Essex LGPS pension. Cllr Barker and Cllr Maddocks confirmed they are also in receipt of an Essex LGPS pension and Cllr Hedley declared he is in receipt of an Aviva Group pension.

2 Minutes
The part one minutes of the meeting of the Committee which took place on 21 February 2018 was approved as a correct record.

3 Arrangements for Future Meetings
The Committee received a schedule of meetings for the municipal year 2018/19.

27 June 2018
18 July 2018
17 October 2018
28 November 2018
20 February 2019
27 March 2019

It was reaffirmed that all meetings will commence at 1pm and that the schedule of dates be noted.

4 Treasury Management Strategy
A report from the Director for Essex Pension Fund was received detailing the Essex Pension Fund Treasury Management Strategy 2018/19.

Kevin McDonald highlighted that the Treasury Management Strategy for the Essex Pension Fund replicates to a large extent the Treasury Management Strategy already approved for Essex County Council, but has been adapted to reflect the limited borrowing requirements, use of global custodian and the separate governance arrangements of the Pension Fund.

The Committee was reminded that at its 21 February meeting it agreed a medium term programme whereby, as opportunities arise, a proportion of the equity strategic allocation be redeployed away from equities towards alternatives. As such it was agreed that up to 1% of the Fund's asset could be held in cash, separate to that the managers may hold for efficient portfolio management in expectation of a drawdown notice or other cashflow requirement for the Fund.

In light of this decision it was confirmed that the draft Treasury Management Strategy cashflow management arrangements have been updated to provide the additional flexibility with the Northern Trust's and BNP Paribas global liquidity fund limits so as to accommodate the gradual move in the strategic allocation.

It was confirmed that the Fund in broad terms remains cashflow neutral.

Following detailed discussions it was **agreed that:**

- the Fund's cash flow situation be kept under review; and
- the Essex Pension Fund Treasury Management Strategy 2018/19 be approved.

5 Market Background and Outlook Q4 2017

Matt Woodman from Hymans Robertson gave a verbal update on the markets since the Committees' last meeting in particular highlighting the short term volatility experienced in the markets over the last few weeks.

Following discussions the update was noted.

6 Urgent Part I Business

There was none.

7 Exclusion of the public

(Press & Public excluded)

Resolved:

That the Public (including the press) be excluded from the meeting during consideration of the following items on the grounds that they involve the likely disclosure of exempt information as specified in Part 1 of Schedule 12A of the Local Government Act 1972:

- ISC 21 February 2018 minutes – Part II
- Investment Tables as at 31 December 2017
- Training Session - Stock Lending
- Stock Lending
- Investment Strategy Review – Implementing the transition from equity to alternatives update
- Structural Reform of the Local Government Pension Scheme (LGPS) Pooling – AJC Quarterly update
- Update on investment managers presenting: ISC Briefing note
- Investment Manager Presentation – Hamilton Lane
- Independent Investment Adviser (IIA) procurement

8 Investment Tables as at 31 December 2017

(Press & public excluded)

The Committee received a report from Kevin McDonald, Director for Essex Pension Fund in consultation with Mark Stevens Independent Investment Adviser, which gave details of the Fund's investment performance for the quarter ended 31 December 2017.

The value of the Fund increased from £6.350bn as at 30 September 2017 to a value of £6.605bn as at 31 December 2017.

The report was noted.

9 Training Session - Stock lending

(Press & public excluded)

The Committee received a training presentation from Matt Woodman from Hymans Robertson whereby an overview of stock lending was provided.

The presentation was noted.

10 Stock Lending
(Press & public excluded)

The Committee received a report on stock lending and initial proposals in relation to whether the Fund should adopt a policy to lend stock as part of the ACCESS pooling arrangements.

After discussions it was **agreed**:
- to give further consideration as to whether Essex is prepared to agree to stock lending on its assets currently held on a segregated basis within the ACCESS pool;
- that additional training be given at a future meeting;
- that a further report be brought to a future meeting detailing ACCESS stock lending proposal; and
- the report be noted.

11 Review of Investment Strategy – Implementing the transition from equity to alternatives
(Press & Public excluded)

The Committee received a verbal update from Matt Woodman from Hymans Robertson outlining an initial timetable in relation to implementing the first phase of the transition from equities to alternatives.

The update was noted**.**

12 Structural Reform of Local Government Pension Scheme (LGPS) – Pooling quarterly Joint Committee (JC) Update
(Press & public excluded)

Kevin McDonald, Director for Essex Pension Fund, gave an update outlining the latest developments in respect of the structural reform of the LGPS.

The progress on the Operator implementation, sub fund construction, ACCESS Governance review, client function and support arrangements workstreams were outlined.

Members were informed that the Operator contract was now live.

It was confirmed that initial negotiations with Baillie Gifford had commenced in respect of the construction of the first sub-fund. It was highlighted that the delay in signing the contract had meant the timing of each sub-fund tranche had resulted in a 4 week slippage to the original timetable first communicated.

It was noted that MUSE had commenced phase two of their governance review and that the JC have agreed the ‘Statement of Purpose’ wording and draft contents of the Governance Manual.

After discussions it was **agreed that:**

- pending a successful conclusion of Link's negotiations with Baillie Gifford the Fund's assets currently managed by Baillie Gifford be transitioned into the sub-fund once launched;
- an assessment be made prior to the sub-fund launch of the Baillie Gifford allocation to be transitioned and a recommendation be brought to a future meeting; and
- the report be noted.

13 Update on Investment Managers presenting – ISC Briefing note Hamilton Lane
(Press & Public excluded)

The Committee received a report from Matt Woodman from Hymans Robertson on Hamilton Lane.

Following discussions the report was noted.

14 Investment Manager Presentation – Hamilton Lane
(Press & Public excluded)

The Committee received a presentation from Jim Strang from Hamilton Lane, the Fund's Private equity manager.

It was **agreed that**:

- a further £50m be committed to new Private Equity opportunities in 2018/19; and
- the presentation be noted.

15 Urgent Exempt Business
(Press & public excluded)

The exempt minutes of the meeting of the Committee which took place on 21 February 2018 was approved as a correct record.

16 Independent Investment Adviser (IIA) procurement
(Press & public excluded)

Kevin McDonald explained that Mark Stevens', the Independent Investment Adviser to the Fund contract is due to expire at the end of July 2018.

It was noted that since the May 2017 County Council elections the membership of the Committee had undergone significant change at a time when the Committee has every increasing demands in respect of the de-risking programme and the pooling agenda. It was therefore felt of the two options considered that there was merit in maintaining the existing arrangements.

After discussions it was **agreed that**:

- an extension to the Fund's existing contract with Mark Stevens on the same commercial terms be made to cover the period 1 August 2018 to 31 July 2020; and
- the report be noted.

17 Date of Next Meeting
(Press & public excluded)

The Committee noted that the date of the next meeting was 27 June 2018.

There being no further business, the meeting closed at 4.05pm

Chairman
27 June 2018

Essex Pension Fund Investment Steering Committee	AGENDA ITEM 7
date: 27 June 2018	

Capital Markets Outlook Q1 2018 & Q2 to date
Report by Hymans Robertson

Enquiries to Kevin McDonald on 0333 0138 488

1. Purpose of Report

1.1 To update the ISC on recent market conditions.

2. Recommendation

2.1 That the Committee should note the content of the report.

Capital Markets Outlook Q1 2018 & Q2 to date

Essex County Council Pension Fund

June 2018

John Dickson, Partner
Rebecca Craddock-Taylor, Investment Consultant

For and on behalf of Hymans Robertson LLP

1.1 Introduction

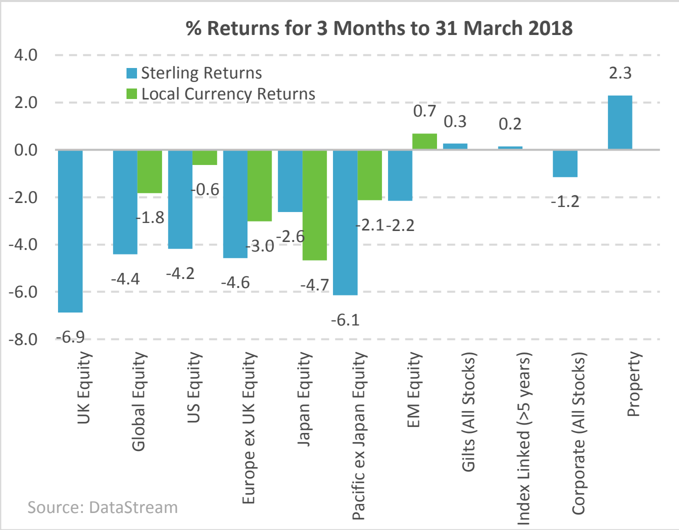
As background to the Investment Tables the majority of this note focuses on Q1 2018 (Section 1.3 onwards). However we have also provided comment on the markets over the year to date in the next section.

1.2 Market Summary to 14 June 2018

Equities	• Global equity indices have struggled to maintain any progress so far in 2018. A strong rise in January as investors focused on the buoyancy of global growth was more than reversed later in Q1 by short-term concerns about inflation and some mixed signals from data releases. • A subsequent rally as economic optimism returned was capped at the end of May by rising political tension in Europe. • Corporate earnings have been strong across all major markets over the past 18 months or so and forecasts are upbeat. However, we are more cautious about the outlook and would argue that earnings already look extended in cyclical terms. • Since the end of the quarter equity markets have recovered and have shown strong performance over the year to date.
Sterling non-government bonds	• Yield spreads narrowed further in January, but subsequently widened, first as concerns grew about tighter monetary policy and rising trade tension, latterly reflecting Eurozone tensions. • Spreads are now above the expensive levels of late 2017, although that partly reflects a deterioration in average credit quality. • Yield spreads on asset-backed securities (ABS) have tightened considerably in 2018 and no longer offer a significant premium over equivalent corporate bonds. ABS are still worth considering as a diversification in low-risk portfolios. • Since the start of the year corporate bonds have returned around negative 1%.
Sub-investment grade debt	• Strong corporate fundamentals, in particular in commodity sectors, are supporting forecasts of lower defaults in 2018 than in 2017, although stress is growing in the retail and US telecom sectors. More generally, if the Fed persists in tightening US monetary policy, default experience could deteriorate. • Even after some widening in response to rising risk aversion in May, spreads remain low by historic standards. • The relative advantage of direct corporate lending still exists, but it is beginning to look less compelling with flows into private corporate lending inevitably leading to lower yields. Sourcing transactions at the right price will prove to be more challenging. We believe there are compelling opportunities elsewhere, for example real estate debt, where an illiquidity premium can be earned. • High yield bonds have returned 0.7% since the start of 2018.
UK property	• Income yields have fallen below 5% p.a., low by historic standards in absolute terms and relative to equity dividend yields, but they continue to provide a reasonable buffer over gilt and corporate bond yields.
Infrastructure	• There is evidence that managers may be finding it more difficult to secure deals. • Our valuation assessment is predicated on managers who are able to secure core infrastructure assets on current income yields of 5-7% p.a. by focussing on deals with a degree of complexity.
Conventional gilts	• Global influences may have dominated this year's moves in gilt yields – rising in the wake of US economic resilience and monetary tightening, falling back in response to Eurozone political risk. • Current valuations and the poor returns they imply for long-term investors remain the main reason for our cautious/negative view of this asset class. • Demand for gilts to hedge pension and insurance liabilities remains strong. • Nominal gilt yields over 2018 have remained relatively flat.

Index-linked gilts	• Inflation protection remains very expensive, particularly in the UK where the demand for index-linked gilts is greater than the supply. • We expect real yields to closely follow nominal yields over 2018, with higher levels of inflation already baked into pricing. • Any increase of cash rates earlier than expected has the potential to impact the short-end of the curve, however, ongoing demand for index-linked gilts by UK institutions should continue to dampen the potential for real yields to rise.
Cash strategies	• With many assets looking stretched on valuation, managers will look to benefit from market corrections. • Active currency and interest rate calls may remain challenging given the lack of political predictability. • Cash provides flexibility to capture more attractive buying opportunities.

2.1 Market Background to 31 March 2018



The global economy ended 2017 in fairly fine fettle despite quarter-on-quarter growth slowing marginally in Q4. The UK, struggling to match the strong showing of 2016, continued to lag. Business conditions, as reflected in PMI manufacturing surveys, have perhaps cooled a little in 2018 without threatening to fall to levels consistent with contraction.

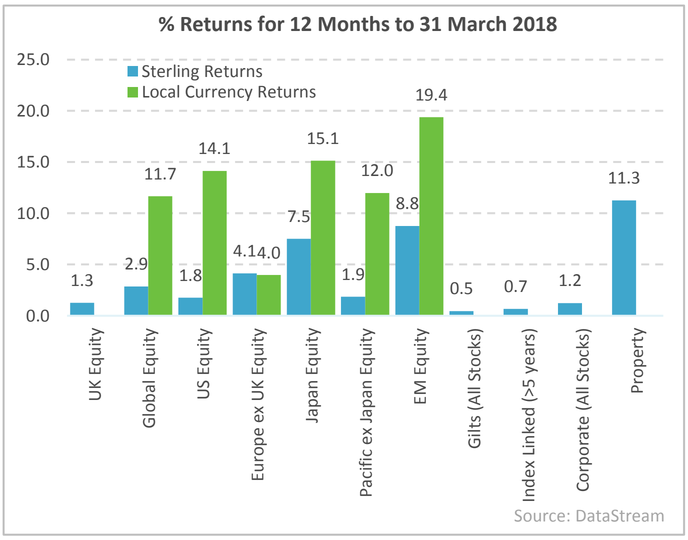
Underlying inflation rates remained relatively stable in the major economies, although investors were briefly unsettled by higher-than-expected US wage growth in January. UK CPI inflation fell from 3% to 2.7% in February. Even so, there is speculation that interest rates may rise in May. The US Federal Reserve, under a new Chairman, continued to tighten policy gradually raising rates by another 0.25%.

Global economic momentum and inflation concerns helped to push government bond yields higher at the start of the year. Inflation concerns receded later, particularly outside the US. Long-dated gilt yields fell over the quarter, although 10-year yields rose.

Oil prices pushed higher – Brent crude reached a three-year high of $70 a barrel. The impact of rising US production was tempered by declines in Venezuela, prospects of renewed US sanctions on Iran and strong demand. In contrast, industrial metals prices fell sharply – relevant indices were down 7%.

Buoyant global growth supported credit markets at the start of the year. Yield spreads narrowed further in January, but ended the quarter higher as concerns grew about tighter monetary policy and rising trade tension.

Similar factors drove equity returns. Global equity indices rose strongly in January, but fell over the quarter as a whole. Sterling's strength further reduced returns to unhedged UK investors. The best regional performance came from Emerging Markets, extending the relative momentum of 2016 and 2017. Sterling's strength contributed to the underperformance of the UK market, because of the significance of foreign earnings.



Technology remained investors' favourite sector, although the current travails of Facebook were putting this position under threat as the quarter closed. Telecommunications was the worst performer – rising US rates may be undermining what is a preferred area for income investors.

The turn of the year brought little change for the UK commercial property market. Capital values and rents nudged higher. Again, this was driven primarily by strong growth in Industrials, although there are some signs that the sector's rental growth may be flagging.

2.2 Key market data

The tables below provide a summary of key financial indicators over recent periods:

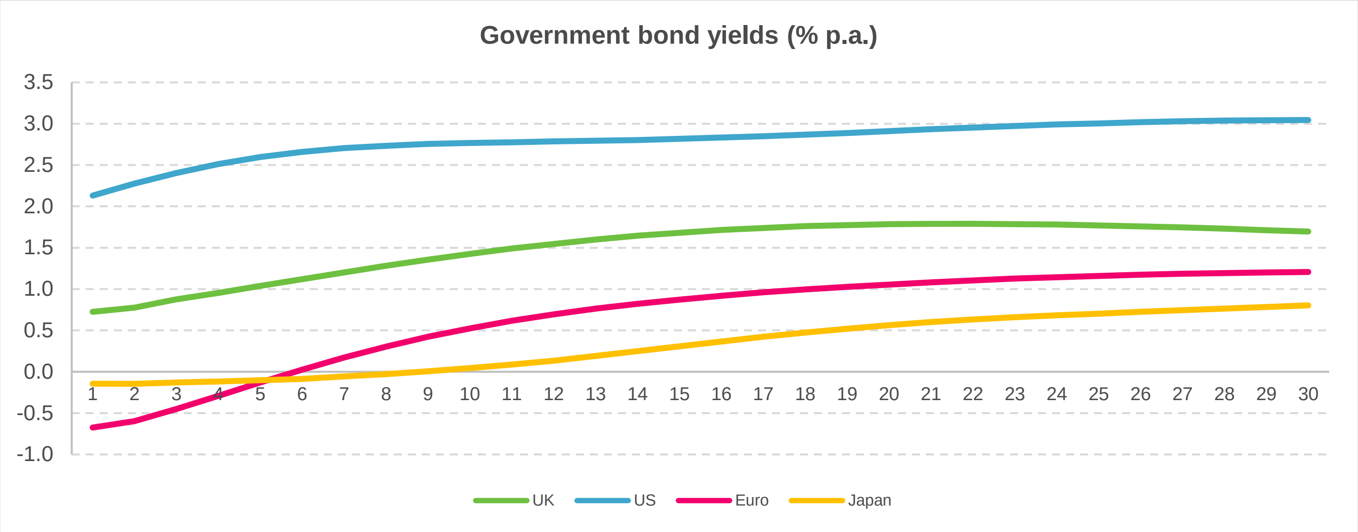
	31.03.17	30.06.17	30.09.17	31.12.17	31.03.18
UK Equity yield	3.5%	3.6%	3.7%	3.6%	3.9%
UK Equity P/E ratio (FTSE)	28.3x	27.5x	24.4x	21.2x	12.8x
Over 15 year gilt yield (p.a.)	1.7%	1.8%	1.8%	1.7%	1.6%
Over 5 year index-linked gilt yield (p.a.)	-1.7%	-1.6%	-1.5%	-1.7%	-1.7%
iBoxx Over 10 year Non-gilt yield (p.a.)	2.8%	2.8%	2.9%	2.8%	2.9%

Source: DataStream

	Year to 31.03.17	Year to 31.03.18	Quarter to 30.06.17	Quarter to 30.09.17	Quarter to 31.12.17	Quarter to 31.03.18
FTSE All Share	21.9%	1.3%	1.4%	2.1%	5.0%	-6.9%
Global Equity	33.1%	2.9%	0.5%	1.9%	5.1%	-4.4%
Over 15 year gilts	12.3%	2.2%	-2.3%	-0.5%	3.7%	1.5%
Over 5 year index linked gilts	22.0%	0.7%	-2.4%	-0.8%	3.9%	0.2%
All Stocks Non-Gilts	9.2%	1.2%	0.5%	0.1%	1.8%	-1.2%
IPD Monthly Index	3.8%	11.3%	2.5%	2.7%	3.4%	2.3%

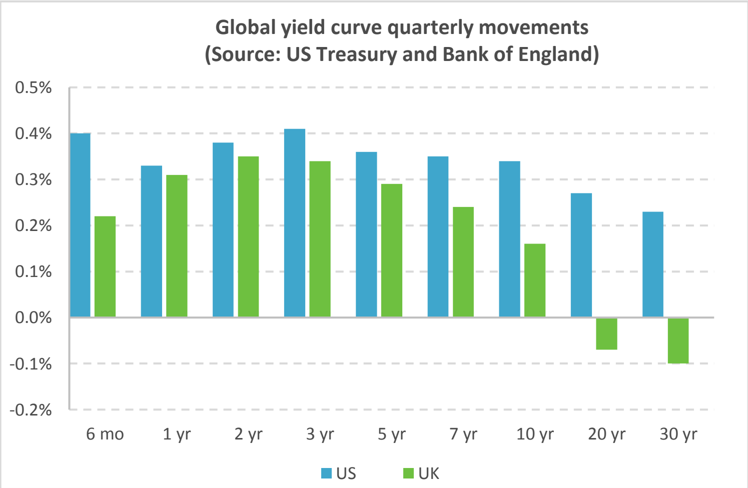
Source: DataStream

3.1 Global Bond Markets



Global economic momentum and inflation concerns helped to push government bond yields higher at the start of the year. US yields led the way with the Federal Reserve raising its benchmark interest rate from 1.5% to 1.75% following strong US wage growth data. In Europe, government bond yields rose sharply at the beginning of the quarter, but retreated in March following dovish comments by the ECB.

In the UK, yields on longer dated gilts fell, as the Bank of England kept interest rates on hold whilst signalling a potential rate rise in May. However, 10-year gilt yields were still up 16bps over the quarter.

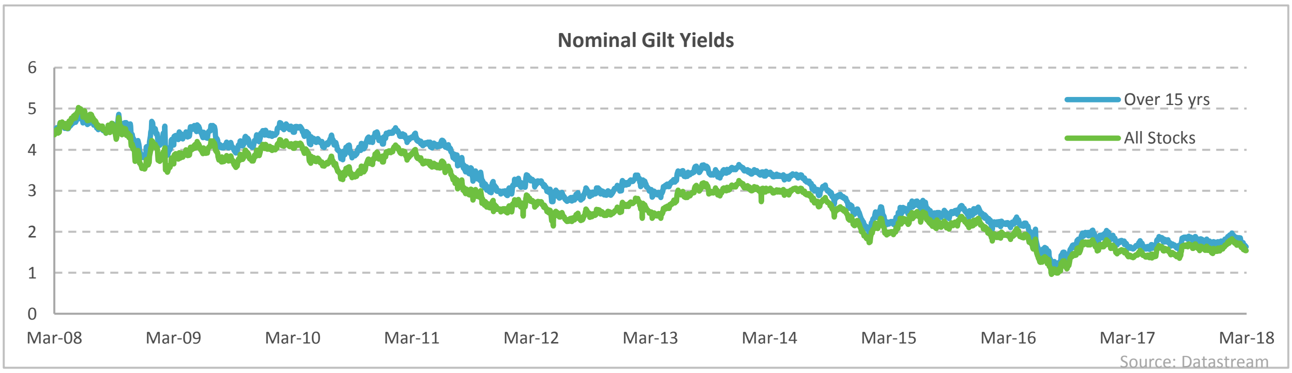


The mixture of solid growth and stable inflation has allowed central banks to stick with their modest tightening bias. The ECB remains on course to finish its QE programme in September; the course of US monetary policy seems little affected by the advent of a new Chair, Jerome Powell – interest rates were raised by another 0.25% p.a. in March. In the UK interest rates remained unchanged in March, although strong labour market data and accelerating wage growth have increased the likelihood of a rate rise in May.

On a relative value basis, UK gilts are yielding more than German and Japanese government bonds, but are more than 1% p.a. lower than US Treasuries at nearly all durations. Higher yields in the US likely reflect a combination of how much further ahead the US is in relation to its interest rate cycle, and of course, the concerns surrounding Brexit and future corporate investment in the UK.

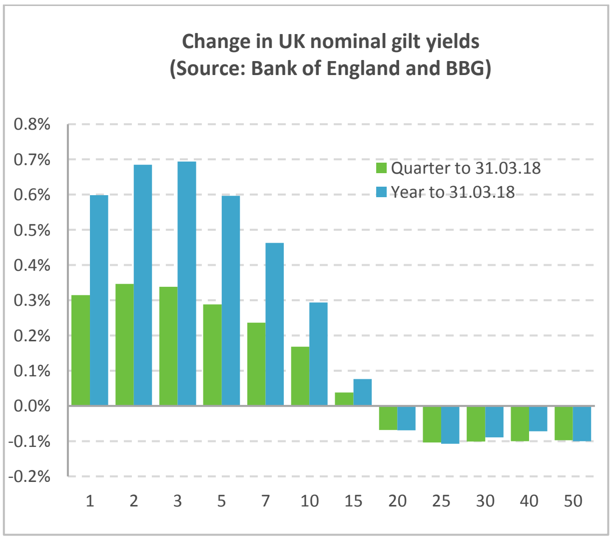
US Treasury rates are now above 2.5% beyond 5 years. Long-term rates are over 3%, suggesting normalisation is now well priced into the US curve. This is very different for the UK market as discussed in the next sub-section.

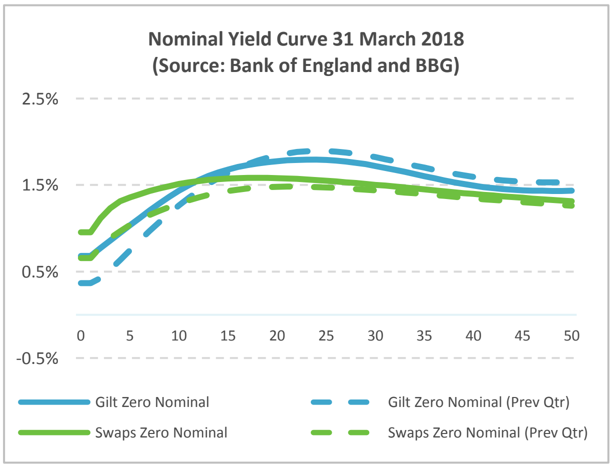
3.2 UK Interest Rates

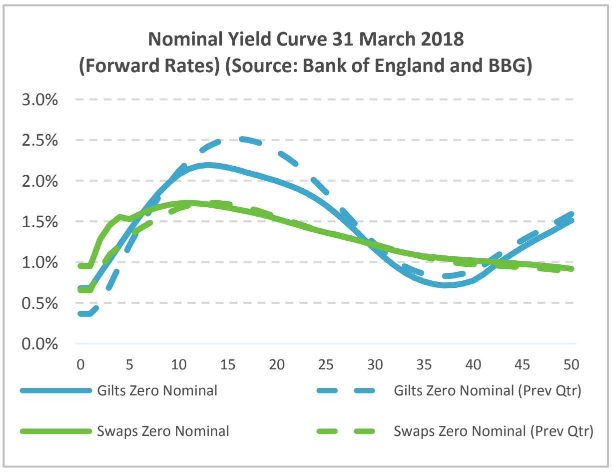


With 10-year yields around 1.4% p.a., we are still reluctant buyers of gilts, albeit a little less reluctant than we were when they were 1.2% p.a. at the end of 2017. This modest rise is consistent with what has been happening in other major markets.

Strong demand for gilts to hedge pension and insurance liabilities from limited supply continues to provide strong technical support. However, we note this demand will peak at some stage. Our latest research paper attempts to work out when that peak will occur and discusses the impact it may have on the market. https://www.hymans.co.uk/news-and-insights/research-and-publications/research/the-age-of-peak-ldi-report/.





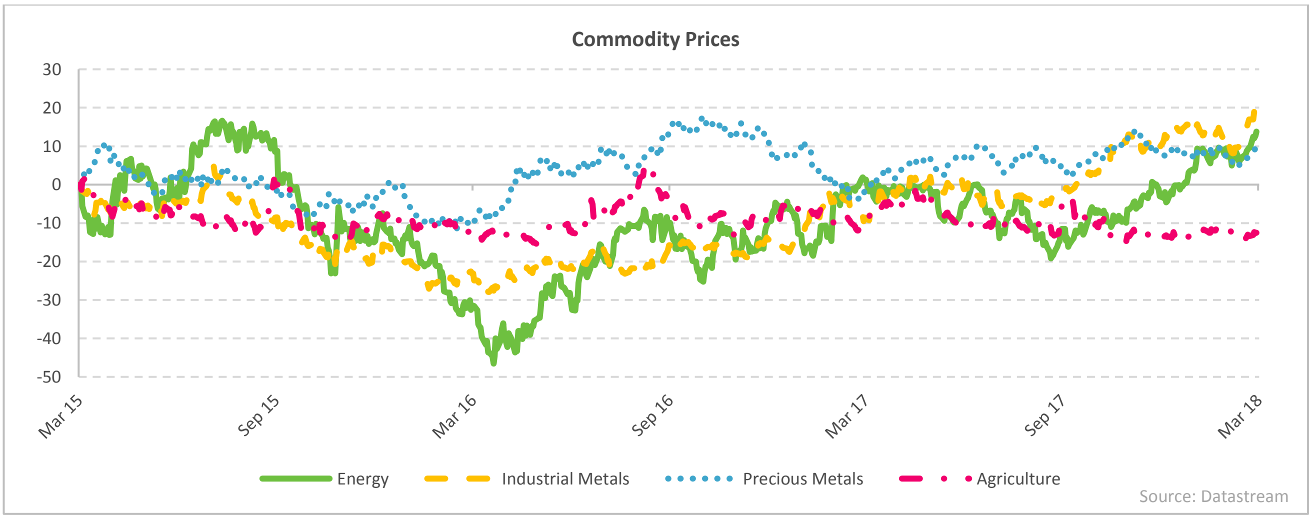


The flattening of the yield curve exacerbates an issue we have highlighted before: the very low level of future interest rates implied by gilt prices – forward gilt yields are below 1.5% p.a. beyond 30 years. Where de-risking involves increase to interest rate hedging programmes, we still recommend adopting a flexible approach.

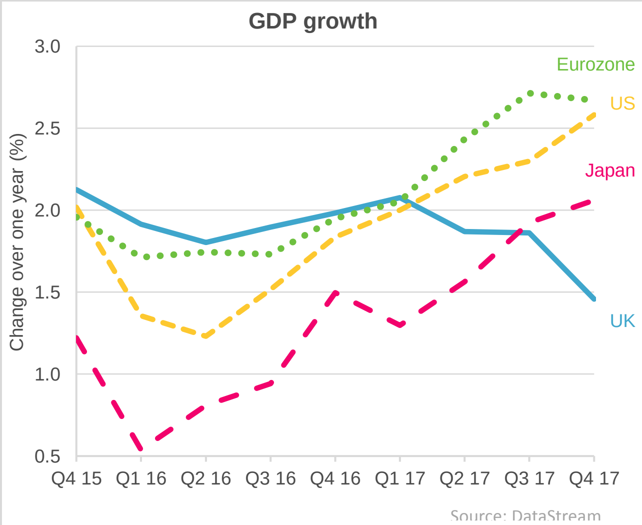
Fundamentals	Valuations	Technicals
Neutral	Unattractive	Neutral to Unattractive

3.3 Inflation and real rates

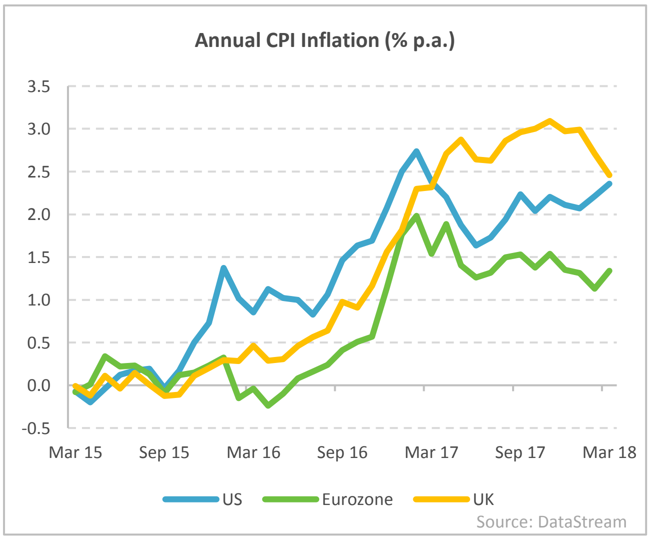
Oil prices pushed higher – Brent crude reached a three-year high of $70 a barrel. The impact of rising US production was tempered by declines in Venezuela, prospects of renewed US sanctions on Iran and strong demand. In contrast, industrial metals prices fell sharply – relevant indices were down 7%.



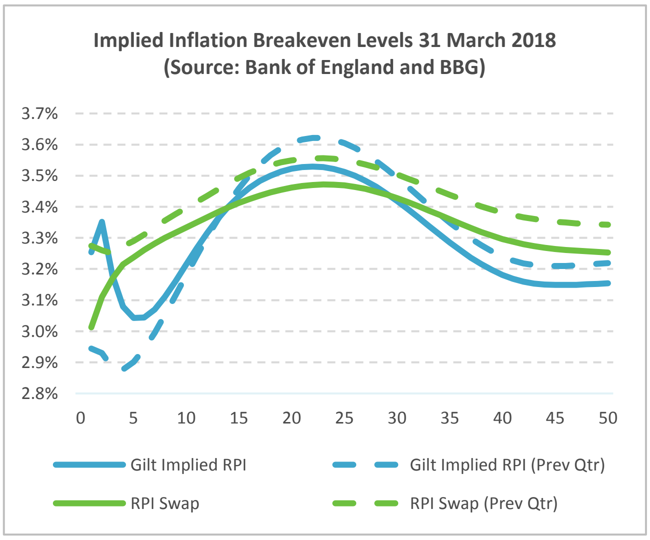
Q4 economic data confirmed that global growth remained buoyant through to the year-end although the UK continues to lag behind its peers - the UK's Q4 growth was the lowest in the G7. UK growth forecasts for 2018 have been revised up 0.1% to 1.6%. Meanwhile US growth forecasts for 2018 and 2019 remain upbeat (2.8% and 2.6%, up 0.3% and 0.4% respectively) and Europe is forecasted to rise at 2.4%, up from 2.1% three months ago.

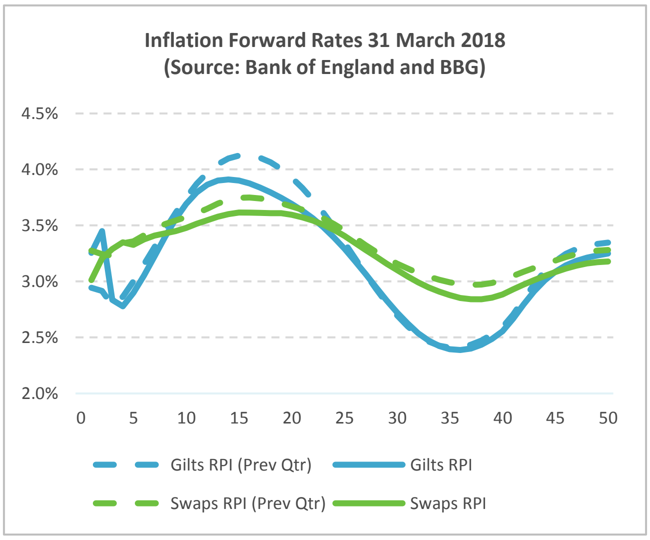


Business conditions, as reflected in PMI manufacturing surveys, have perhaps cooled a little in 2018 without threatening to fall to levels consistent with contraction. There has been nothing this year to match the concern that a US recession might be imminent that marked the start of last year, although rising trade tension between the US and China has clouded the outlook in recent weeks.



A more immediate concern for markets has been the possibility that the longevity of the upturn in growth would stoke inflationary pressure. So far, the evidence is scant. Core inflation in the US and Eurozone has changed little since the middle of 2017 and it has edged above zero in Japan. The UK saw more evidence that the peak in inflation has passed: CPI inflation fell to 2.5% p.a. in March. Even so, there is speculation that interest rates may rise in May.

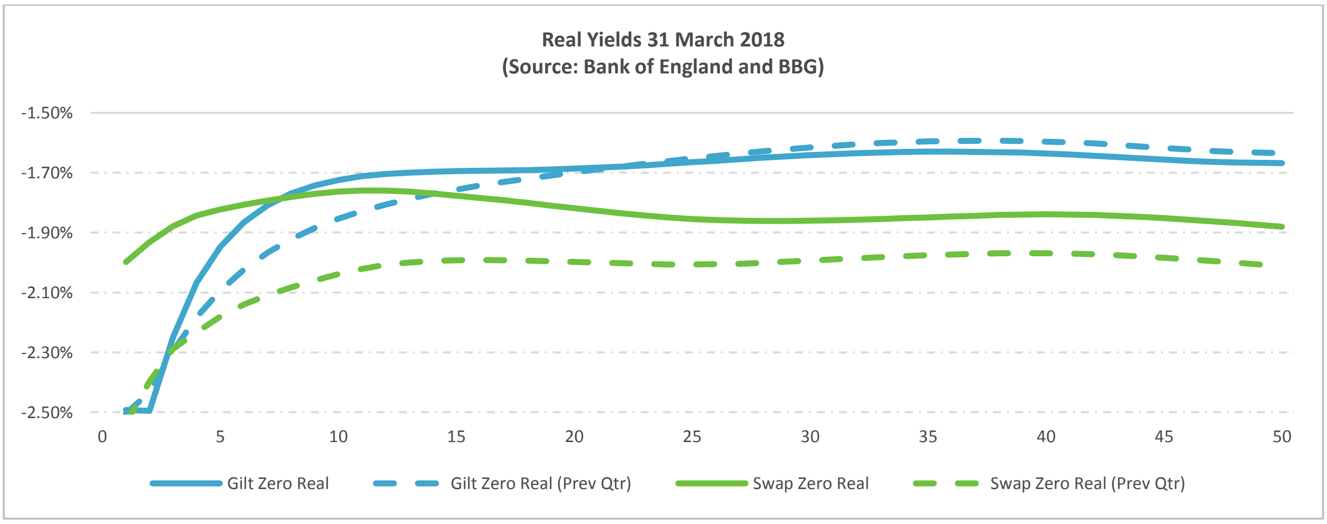




Our view remains largely unchanged from last quarter. With both inflation expectations and nominal yields stabilising towards the end of 2017, real yields on government bonds moved broadly sideways.

The UK remains expensive relative to global inflation linked markets: real yields on ILG (after allowing for RPI assumed to be c.1% pa higher than CPI) are yielding slightly less than their German equivalents, and are more than 1% pa lower than US TIPS. Across the term structure, gilt inflation pricing remains above 3% up to 25 years, with forward inflation falling to 2.5% between 30 and 40 years. However, this is also where forward nominal rates are very low, i.e. real yields remain low across the curve.

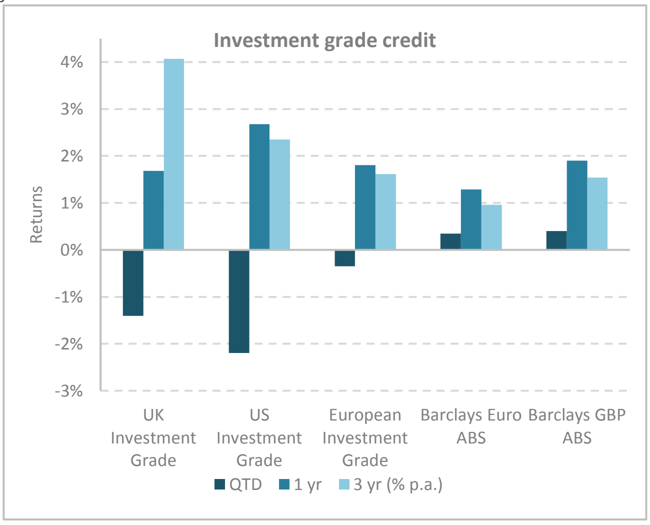
We expect real yields to continue to closely follow nominal yields over 2018, with higher levels of inflation already factored into pricing.

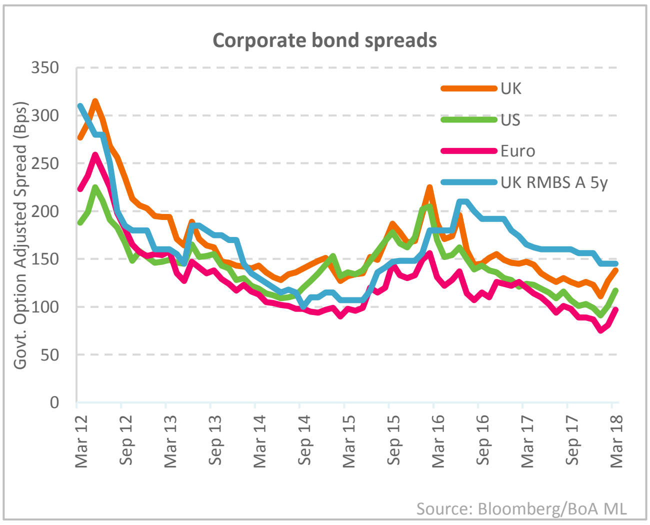


3.4 Investment Grade Credit

ML Non-Gilts Spreads over Gilts (Source: Datastream)	Sterling Non-Gilts (bps)	Sterling Non-Gilts Over 10 Years (bps)	Global Broad Market Corporate (bps)
31 December 2017	101	107	117
31 March 2018	117	126	141
Median spread over last 10 years	152	132	171
Average spreads over last 10 years	169	150	200

Note: Spreads on financials, non-financials and the broad corporate market are calculated using iBoxx indices. All other spreads are calculated using Merrill Lynch indices.





A buoyant global economy has been good for credit markets, helping to minimise default levels. Forecasts suggest that defaults will be lower in 2018, as the effect of the fall in oil prices in 2014 and 2015 on indebted energy companies fades further.

Of course, one consequence of the favourable background has been to drive yield spreads down to historically low levels. Spreads widened in the first quarter: modest tightening at the start of the year as economic optimism mounted was more than unwound as the optimism waned. Despite widening, valuations still remain below long term averages especially for shorter dated maturities and at current levels, room for spread tightening is limited, leaving coupon income as the main source of return.

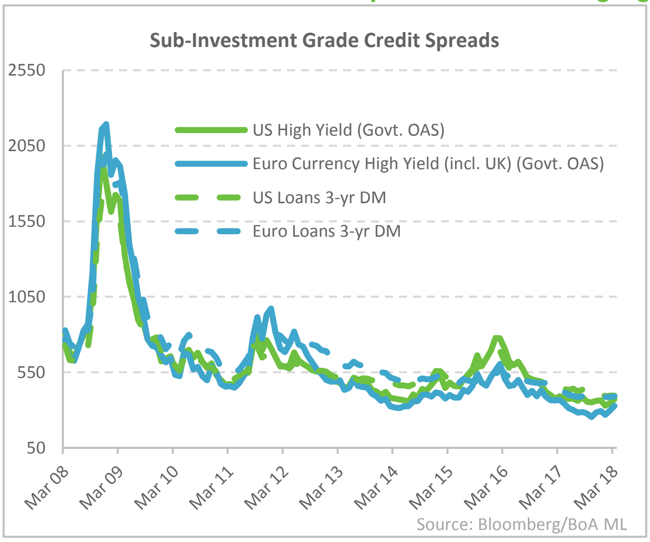
The exception to spread widening is the UK ABS market. Low unemployment rates in UK and Netherlands and falling unemployment rates in Europe are positive for ABS and new issues are heavily oversubscribed despite a healthy pipeline. The end of the UK TFS may ultimately lead to this tightening reversing.

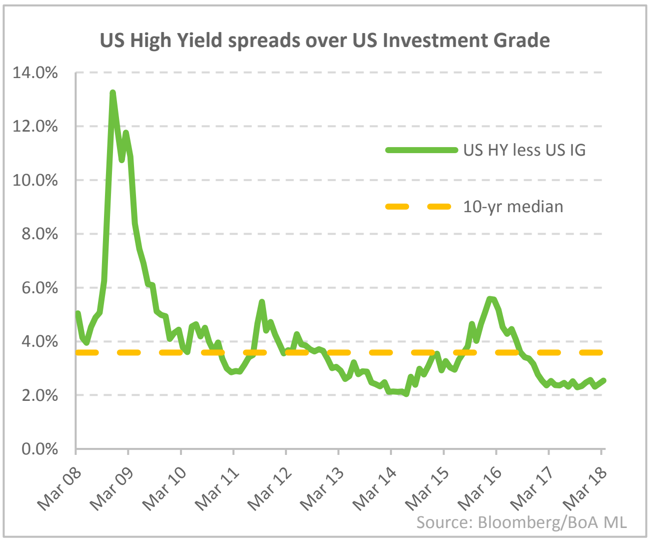
In terms of relative value, UK IG corporate offers spread premium over US and European IG, but it is difficult to see this premium narrowing given Brexit uncertainty. The main risk to future returns from UK IG corporate remains the direction of gilt yields, rather than any expectation of a material widening of credit spreads.

Technicals are currently supportive for IG bonds as the carry trade remains compelling. The ECB's purchase programme will continue until September 2018 and with continued weak inflation numbers looking set to continue for the foreseeable future, it seems unlikely the ECB will withdraw the stimulus quickly.

Fundamentals	Valuations	Technicals
Neutral to attractive	Unattractive	Neutral

3.5 Sub Investment Grade Corporates and Emerging Market Debt

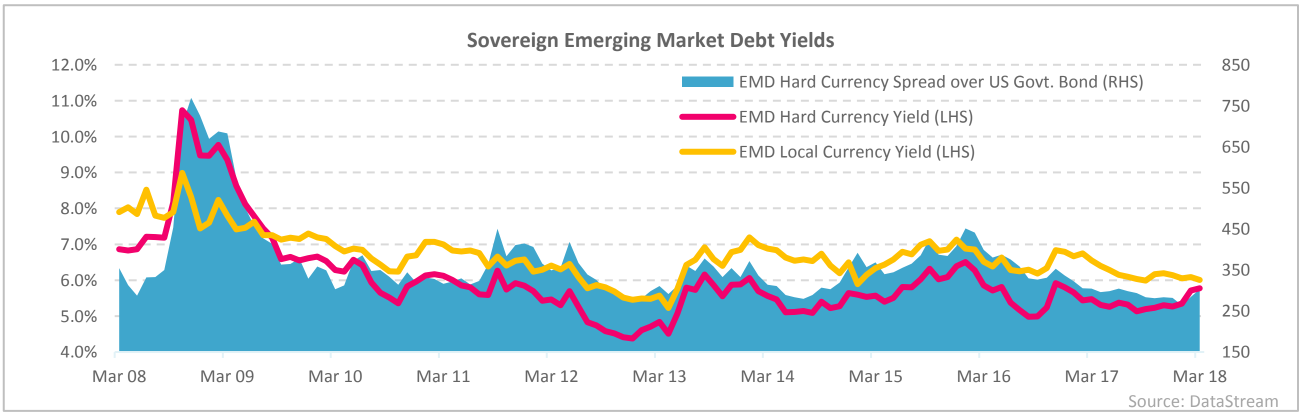




Despite the increased volatility in Q1 2018 causing high yield spreads to widen over the period, valuations for both the high yield and loan markets continue to look expensive on a historic basis. That said, corporate fundamentals remain firm, leverage levels remain stable and interest coverage in general has increased. Furthermore, default levels remain below historic levels in Europe and are improving in the US as conditions in the commodity sector continues to recover.

The relative advantages of direct lending is beginning to look a little less compelling following spread compression and indications that the this market has become more borrower friendly. That said, the level of spread compression has been far less than the traded markets. The direct lending market experienced record capital raised in 2017 ($54bn) up over 40% from the previous high recorded in 2015. Increased competition is likely to put pressure on lending terms and sourcing transactions in 2018. We believe real estate debt can offer both some diversification of underlying risk and the possibility of enhanced returns to an illiquidity premium. Relative to pre-crisis levels, loan margins continue to be higher and LTVs lower.

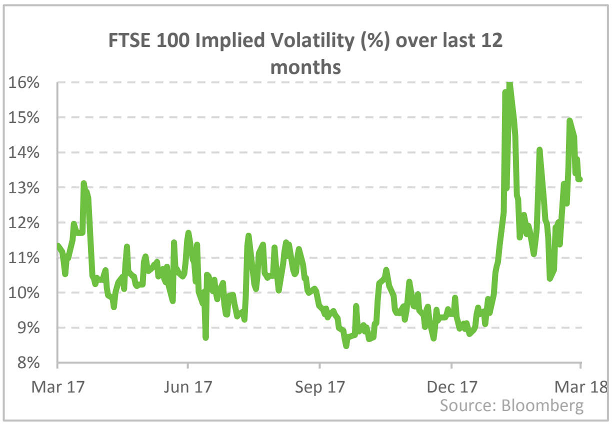
	Fundamentals	Valuations	Technicals
Public markets	Neutral to attractive	Unattractive	Neutral
Private markets	Neutral to attractive	Neutral	Neutral

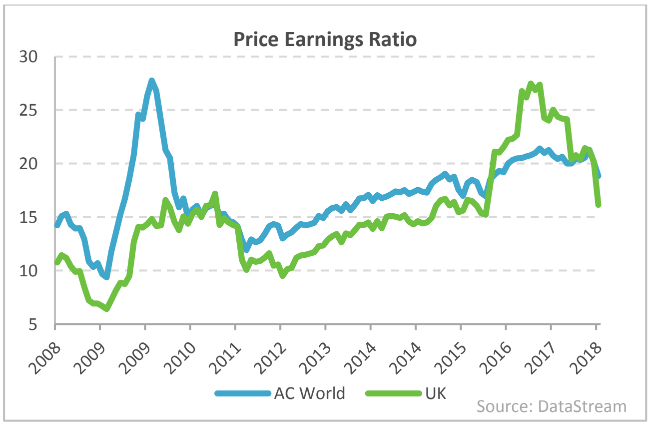


Emerging market debt (EMD) continues to offer attractive spreads relative to developed markets. The macro-economic environment for Emerging Markets continues to be solid, with GDP growth improving and lower inflation across many countries. The risk of protectionism has re-surfaced, with the US government announcing details of a raft of tariffs on Chinese imports.

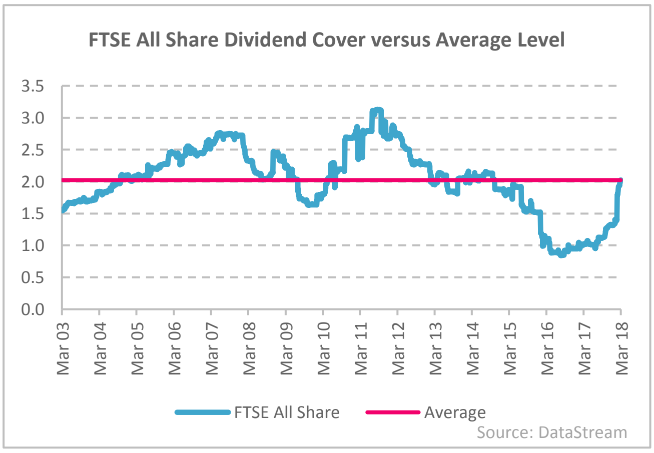
3.6 UK Equity Market

Equity Market Data (Source: Datastream)	31 December 2017	31 March 2018
FTSE All Share Dividend Yield	3.6%	3.9%
Dividend growth over the quarter	1.7%	-1.1%
Dividend growth over the year	12.8%	8.3%
FTSE All Share P/E Ratio	21.2x	12.8x
Total Return during the quarter	5.0%	-6.9%
Total Return over the last 12 months	13.1%	1.3%





The first quarter of 2018 saw a return of volatility in equity markets, with equities recording their first negative quarterly performance since Q3 2015. Equity markets started the quarter strongly and were rising until late January when they sold off following concerns over the course of interest rates. This sell-off lasted nearly two weeks before markets settled and then rebounded. A second sell-off occurred in mid-March following concerns over the potential for a trade war between the US and China.

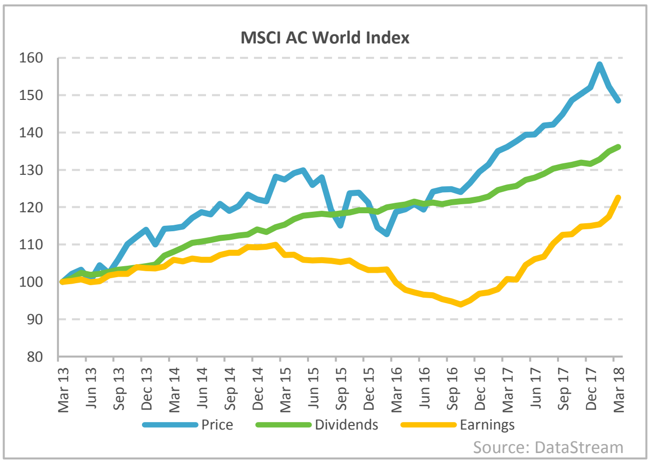


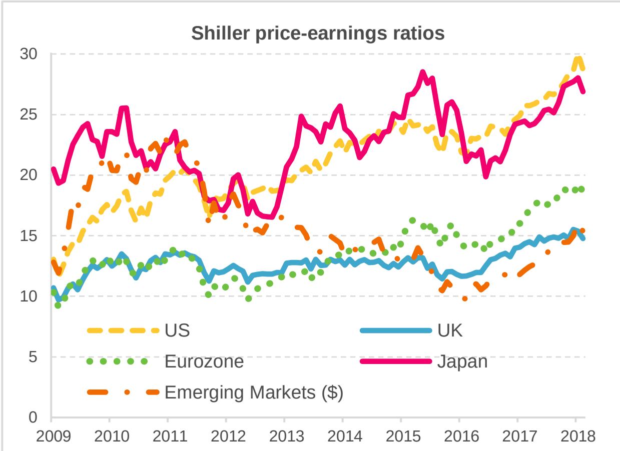
The poor return on UK equities was in part due to the strengthening of sterling over the quarter, providing a headwind for the UK's larger, more globally-focused names, which derive a high proportion of their revenues overseas.

A 10% fall in UK equities from January's peak to March's trough has improved valuations, and dividend cover is back to historic average levels. Relative to historic levels and to global equities, the UK market P/E does not look unreasonable.

3.7 Overseas Equity Markets

Equity Market Data (Source: Datastream)	31 December 2017	31 March 2018
Dividend Yield	2.3%	2.4%
Total Return during the quarter (£)	5.1%	-4.4%
Total Return during the quarter (Local)	5.6%	-1.8%
Total Return over the last 12 months (£)	13.8%	2.9%
Total Return over the last 12 months (Local)	20.3%	11.7%

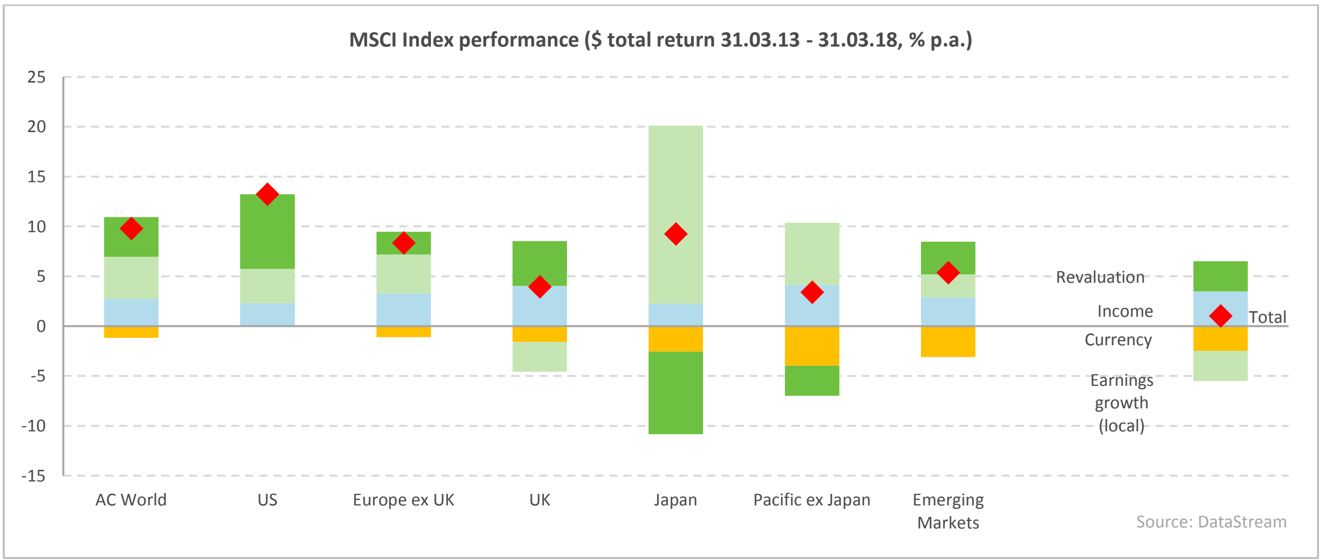




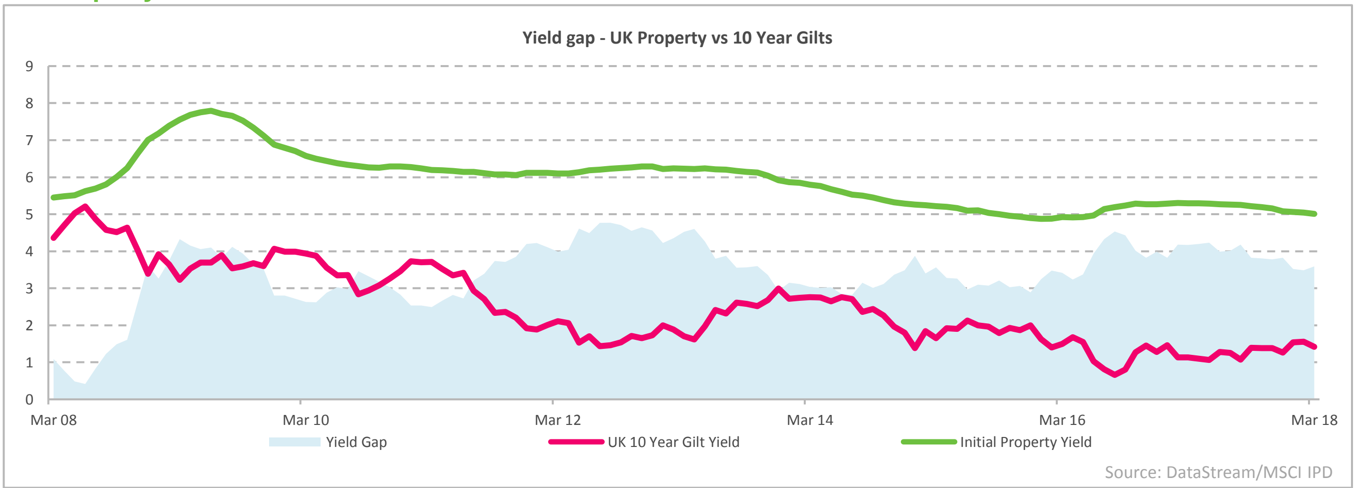
Synchronised global economic growth has supported equity markets over the past 18 months. However, there are questions over the sustainability of current growth rates as the interest rate cycle progresses. The recent US-China trade disputes have added to this uncertainty. Corporate earnings have been strong across all major markets over the past year. However, the short term noise from the US tax reforms has made it more difficult to determine the underlying growth rate for the Q4 reporting season.

The very positive equity sentiment from last year has been hit over the last quarter by concerns over valuation levels (in some areas) and the sustainability in global growth momentum. The “Shiller” price-earnings ratios chart attempts to look through cyclical variations by using the average of the last 10-years’ EPS adjusted for inflation. On this measure, the correction in equity markets has only done a little to improve valuations. The US (accounting for over half of global indices) may be mainly to blame for the level valuation, but valuation in other major developed markets are at or close to post-crisis highs. Emerging markets, despite their relative strength of the last two years, still look less stretched relative to their own recent history.

Fundamentals	Valuations	Technicals
Neutral	Neutral to unattractive	Neutral



3.8 Property



UK Property

In aggregate, capital values and rents continue to edge higher and Industrials continue to drive most of the growth. Anecdotal evidence suggests bargaining power continues to ebb from landlords to tenants in some office and retail markets. Current yields remain low relative to their long term average, but continue to provide a reasonable absolute level of income and a buffer relative to gilts and corporate bonds to absorb rate rises to an extent.

Fundamentals	Valuations	Technicals
Neutral to Unattractive	Neutral to Unattractive	Attractive

Infrastructure

There is building evidence that managers may be finding it tougher to secure deals that will meet return objectives. Annual transactions fell in 2017 for the first time in a decade (Preqin Global Infrastructure reports a drop of 6% drop by number and 8% by value) despite record levels of dry powder. Performance hurdles in some new funds are at lower levels than has been typical in the past.

That said, we continue to see fund managers who are able to secure core infrastructure assets on current income yields of 5%-7% p.a. by focusing on deals with a degree of complexity in implementation or on deals where they have a competitive edge (e.g. through consolidation of fragmented markets). Our valuation assessment is predicated on this type of added-value implementation.

Fundamentals	Valuations	Technicals
Neutral to Attractive	Neutral	Attractive

Notes and Risk Warnings

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, investments in developing or emerging markets may be more volatile and less marketable than in mature markets.

Exchange rates may also affect the value of any investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.

Private equity investments, whether held directly or in pooled fund arrangements carry a higher risk than publicly quoted securities; the nature of private equity pooling vehicles makes them particularly illiquid and investment in private equity should be considered to have a long time horizon.

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