Allenbridge
Part of MJ Hudson

REPORT PREPARED FOR

Worcestershire County Council Pension Fund

September 2017

Philip Hebson
Allenbridge

philip.hebson@allenbridge.com www.allenbridge.com

This document is directed only at the person(s) identified above on the basis that they are a professional investor or professional customer. It is issued by Allenbridge. Allenbridge is a trading name of AllenbridgeEpic Investment Advisers Limited and Allenbridge Limited which are all appointed representative of Allenbridge Capital Limited which is Authorised and Regulated by the Financial Conduct Authority (FCA).

We understand that your preference is for your adviser to issue investment advice in the first person. We recognise that this preference is a matter of style only and is not intended to alter the fact that investment advice will be given by AllenbridgeEpic Investment Advisers Limited, an exempt person under FSMA as required by the Pensions Act.

AllenbridgeEpic Investment Advisers Limited is a subsidiary of MJH Group Holdings Ltd.

Independent Investment Adviser's report

Global overview

I think it would be safe to say that the UK General Election did not go the way that the Prime Minister, Mrs May, intended or expected it to go. I'm not sure that I have ever encountered an outcome when both of the main parties can claim victory, but have lost at the same time. We, along with Mrs May, will now have to cope with the consequences, particularly with regard to Brexit.
Still to come, the German general election on 24 September. Angela Merkel seems to have strengthened her position, but we should now know better than to forecast actual outcomes.

I'd guess that I'm not the only one, but I am seriously struggling to understand what is going on in the USA. At a recent conference the BBC's Economic Editor, Kamal Ahmed said, "Trying to navigate around Trump's strategic policy will be nigh on impossible". So I'm not alone. Once again we have to try to separate politics and the "noise" from what is going on in the real world. The US economy had a good Q2, with annualised growth at 3%, helped by strong consumer demand. Not as good as the President would like to see, but realistically that compares well amongst other developed economies, and at that rate it is unlikely to raise fears about underlying inflation accelerating significantly.

Oh Mrs May, what have you done? Instead of strengthening her negotiating position, backed by a large working majority in Parliament, there is now greater uncertainty surrounding the Brexit negotiations with a consequent fall in business confidence.
The rapid rise in the inflation rate was contained by falling commodity prices, specifically oil. Economists remain relaxed about the inflation outlook, but pressure in labour markets for pay increases is gaining ground, likewise an increase in interest rates is inevitable at some stage. The weakness in Sterling has caused an increase in the price of imported goods, but it is clearly good for exports and for tourism, so this particular cloud does have a silver lining for some.

It is hard to know what to think about Europe, and the economic outlook across the region. In general terms economic growth and corporate profitability has certainly improved, and consequently the Euro has strengthened. At the political level much unease remains however. The French elected the least bad option, and popular unrest is not far below the surface in many other countries. My comment this year from my summer holiday originates from Greece, namely that the locals that I spoke to consider that the outlook has not improved, and the comment made by one tour guide basically suggested that their politicians right across the spectrum had run out of ideas. The Eurozone is still a mess and there aren't any painless solutions. Tourism does at least bring some relief.
As mentioned above, we wait on Germany and the outcome of their forthcoming election.

Slowly but surely, Japan seems to be getting there. The Bank of Japan is talking more positively, with corporate profitability generally above expectations. For the first time in a very long time there is talk of capacity constraints. Maybe their stock market doesn't quite know what to make of it, because there isn't any clear pattern to sector performance, which may have presented Nomura with a problem (please see that section of the report). Certainly the increased tension in the region caused by North Korea's missile launches doesn't help sentiment, so it is to be hoped that Kim Jong-Un has now made his point and will calm down.

Asia (ex Japan) and Emerging Markets again enjoyed a good quarter, helped by an encouraging outlook for global growth. Politics as usual played a part in some countries, positively following Presidential elections in South Korea, negatively in Brazil and the Middle East. Given my comments above about Greece, it is pleasing to report that they actually enjoyed the benefit of reaching agreement with Eurogroup creditors, which covered their debt repayments in July. With such a diverse range of countries within these regions, we will always see a game of musical chairs each quarter, but therein lies the opportunity.

Summary and Market Background

The value of the Fund in the quarter rose to £2.49bn, an increase of £38m compared to the end March value of £2.45bn. The Fund produced a return of 1.2% over the quarter, which gave an underperformance against the benchmark of -0.1%. The slightly negative return against the benchmark was due to asset allocation, the Fund being overweight in equities and underweight in bonds. Purely for academic interest, the average performance of 60 LGPS Funds for this quarter, as compiled by PIRC, was a return of 0.7%. Over a 12 month period the Fund recorded a positive relative return against the benchmark of 1.5% (20.1% v. 18.6%). It should be noted that the Fund has also outperformed over the three and five year periods as well, details of which can be found in Portfolio Evaluation Limited's report.

Since the last Pension Investment Advisory Panel and Pension Committee meetings, the Fund officers have been reviewing the means by which the Fund could seek to provide some down-side protection to the funding level, that has increased to c.96% (assets as a percentage of liabilities) since the last actuarial valuation at 31 March 2016. This has been largely driven by a significant rise in equity markets, in which the Fund has a strategic allocation of 75% of total assets. As part of this review, the Fund's actuary has produced a report (in the reports pack) that provides an update on the Fund's funding deficit (reduced from £626m to £184m at 30 June 2017) and some analysis about equity value protection.

In a similar way to the first quarter of 2017, the Fund's active managers generally had a positive second quarter. However this time Schroders (Emerging Markets) was this quarter's star performer, with an outperformance of 2.9%, followed by JP Morgan (Emerging Markets) outperforming by 0.4%. This quarter it was Nomura (Pacific) who let the side down, with an underperformance of -0.2 %. JP Morgan (Bonds) also outperformed, by 0.3%. The alternative passive strategies performed in line with their benchmark, but underperformed the total passive index benchmark by -1.1% (0.2% v. 1.3%).

World markets again enjoyed a good quarter, rather better in US dollar terms than on a sterling adjusted basis. Using the sterling basis, the MSCI World Index showed a rise of 0.3%. The strongest returns came from Europe ex UK, gaining 4.9% against the backdrop of uncertainties elsewhere, Emerging Markets (up 2.4%) and Pacific ex Japan (up 2.3%) continued their rises achieved in Q1, the UK gained 1.4% and Japan 1.3%. The USA was the laggard this time, falling -0.8%.

In general terms bond markets finished down over the quarter having seen some buoyant markets earlier in the period, against the background of anticipated rate increases and scaling back of quantitative easing (QE). The exceptions were Euro Government bonds (up 2.5%) and UK Corporate bonds (up 0.5%). Again in general terms Corporate bonds outperformed Government Bonds, with some corporates gaining in value against the trend of falls seen elsewhere. The Worcestershire bond mandate and related benchmark was probably one of the better performers across all bond markets this quarter.