



Border to Coast Pensions Partnership Ltd

Border to Coast Emerging Markets Equity Fund ("the Fund")

Report for the Quarter Ended 31 March 2020
(for information and discussion)

Report to the Border to Coast Pensions Partnership Ltd Joint Committee
Date of Meeting: 16 June 2020

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Date: 26 May 2020

Purpose of Report

1. This report summarises the performance and activity of the Border to Coast Emerging Markets Equity Fund over Q1 2020.
2. The Committee is recommended to note this report.

Important Information

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Background

3. Border to Coast launched this internally managed Fund on 22nd October 2018.
4. The Fund has a quality bias with a focus on companies that can generate long term sustainable growth, with a modest value bias which results in a higher exposure to more cyclical stocks, and a focus on larger companies. Border to Coast are long term investors and we expect low portfolio turnover.
5. Most of the Fund's performance is expected to arise from stock selection decisions with more modest contribution from country and sector allocation decisions.

Performance Objective

6. The Fund's objective is to outperform the S&P Emerging Broad Market Index ("the Benchmark") by 1% per annum over three year rolling periods.
7. The Fund aims to provide a benchmark tracking error of 1% to 3% depending on market conditions. This is deemed an appropriate risk profile in view of the performance target.

Market Value

8. The Fund's market value at the quarter end was £611m.

Performance

9. Performance to the quarter end is shown below:

	Since inception 22/10/18 % pa	Year %	Quarter %
Emerging Markets Equity Fund	-4.69	-14.12	-19.06
S&P Emerging BMI	-4.30	-14.32	-19.48
Actual Variance ¹	-0.39	+0.21	+0.42
Target Variance ²	+1.00	+1.00	+0.25
Performance Relative to Target ³	-1.39	-0.79	+0.17

¹ Fund performance minus Benchmark performance

² Based on the Fund's Performance Objective

³ Actual Variance minus Target Variance

Note

1. Source: Northern Trust
2. Values do not always sum due to rounding
3. Performance is net of ACS charges such as depository and audit fees. Investment management fees have not been included in the performance calculations.
4. Past performance is not an indication of future performance and the value of investments can fall as well as rise.
5. Beneficial impact of withholding tax rates was 0.11% over FY2019.

Comments on Performance

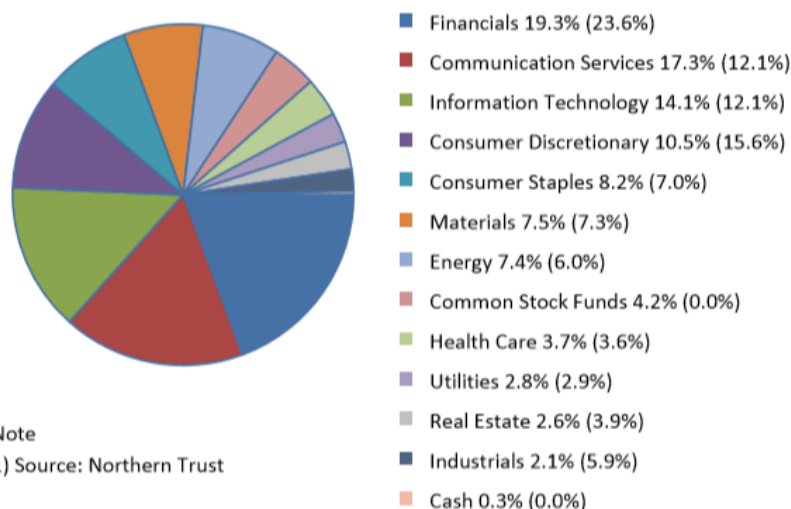
10. Performance was above the Benchmark for Q1 2020 but is below the benchmark and target since inception.
11. The coronavirus crisis caused sharp market falls, which initially significantly impacted China before spreading to Asia, the Middle East, and Latin America.
12. Although the Fund was impacted by the market falls, it benefitted relatively due to:
 - Bias toward quality, resilient companies with strong balance sheets, with a modest tilt to value.
 - Underweight to smaller companies, which can underperform in periods of stress.
 - Underweight to Financials (mainly banks), which significantly under-performed due to economic concerns, increased non-performing loans and asset impairments, and interest rate cuts.
 - Overweight to Communication Services, which is relatively defensive and benefitted from increased demand during lockdowns.
 - Overweight to China (starting to recover economically) and underweight to South Africa (sovereign debt downgrade); partly offset by overweight to Russia (significant energy exposure).
 - Strong stock selection in Utilities, Resources and Financials – offset by weaker selection in the Technology and Consumer sectors, particularly in China.
13. The Fund's risk profile is higher compared to the other internal sub-funds but is still relatively low risk for an active Emerging Markets fund. It is unlikely that there will be any material change to the Fund's construction in the short term.
14. The top and bottom 5 contributors to performance over the quarter were:

Fund	Portfolio weight (%)	Benchmark weight (%)	Contribution to performance (%)	Commentary
Polymetal International (o/w)	1.24	0.07	0.46	Benefits from gold price strength; seen as a safe haven in current environment.
Tencent (o/w)	7.12	5.56	0.45	Computer games and communications services benefited from the lockdown.
Alibaba (o/w)	7.05	6.06	0.26	Chinese online retailer; gained market share from physical retail during lockdown.
China Construction Bank (o/w)	2.70	1.59	0.24	Sentiment improved as China appeared to bring coronavirus under control.
Hengan International (o/w)	0.89	0.10	0.23	Personal hygiene manufacturer had strong results as the crisis increased demand.
iShares South Africa (o/w)	3.13	0.00	-0.77	South Africa underperformed, with economic activity and currency both weak.
Banco Bradesco (o/w)	0.79	0.32	-0.33	Brazilian bank, impacted by current climate and poor foreign investor sentiment.
Petrobras (o/w)	0.50	0.24	-0.29	Brazilian oil company impacted by the sharp fall in oil price and production cuts.
Itau Unibanco (o/w)	0.97	0.43	-0.28	Asset impairment concerns and flattening yield curve affected net interest margins.
Ambev (o/w)	0.91	0.20	-0.26	Appeared defensive, but suffered crisis-led market share losses and closures.

Source: Northern Trust & Border to Coast

Portfolio Structure

15. The sector breakdown of the Fund and Benchmark, at the quarter end, was:



Note: The pie-chart shows the sector allocation of the Fund with the Benchmark sector allocation shown in brackets.

Source: Northern Trust

16. The most significant overweight and underweight allocations at a sector level, relative to the Benchmark, at the quarter end were as follows:

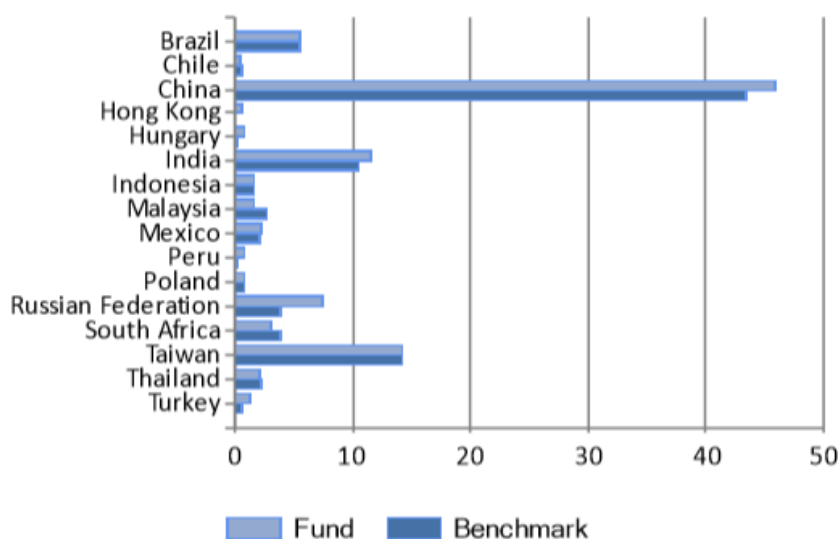
- **Communications Services (o/w)** – A relatively defensive sector with positive long-term growth dynamics, including 5G technology, growth in “the internet of things”, move towards home working, and potentially industry consolidation/co-operation.
- **Common Stock Funds (o/w)** – Provides country exposure via exchange traded funds (ETFs), predominantly South Africa, where it is considered to be more appropriate than investing in underlying companies, due to tax implications or the size of the market.
- **Information Technology (o/w)** – Long-term structural growth drivers including Internet of Things, Artificial Intelligence, Electric/Autonomous Vehicles, and new generation memory chips. Although impacted by coronavirus, there are positive signs of a turnaround from demand for next generation smartphones.
- **Consumer Discretionary (u/w)** – Consumer spending saw a significant short-term impact from lockdowns; high pre-crisis valuations were unconvincing but are now more attractive; demographic trends and rising disposable income remain long-term drivers.
- **Financials (u/w)** – Large underweight driven by an underweight in Banks, due to high valuations in some markets and due to headwinds against profitability, which is partly offset by an overweight to Insurance due to long-term growth prospects.
- **Industrials (u/w)** – the sector tends to be skewed towards mid and small-cap companies of varying quality; finding attractive large-cap investments is challenging.

17. During the quarter, the largest individual transactions were:

- **Reliance Industries (£5.4m)** – Indian industrial conglomerate-built telecoms subsidiary.

- Novatek (£3.5m) – leading Russian energy producer, switching from oil to gas.
- Lukoil (-£6.4m) – relative outperformance resulted in a valuation premium above peers.
- Suzano (-£3.8m) – Brazil’s leading pulp producer, but poor fundamentals and weak balance sheet.

18. The regional breakdown of the Fund and Benchmark, at the end of the quarter, is set out below:



Risk Profile

19. The risk profile of the Fund is monitored on an ex-post and ex-ante basis using data from the fund custodian, Northern Trust, for ex-post, and Bloomberg for ex-ante.

- The ex-post (backward looking) tracking error as of quarter end was 2.46%, inside the risk appetite of 1% - 3%.
- The ex-ante (forward looking) tracking error as of quarter end was 2.83%.

Market Background

20. Coronavirus impacted global economic activity. Reduced activity and earnings could persist through 2020 – uncertainty over shape of the recovery.

21. Russia and Saudi Arabia refused to curtail oil production in line with the Coronavirus-driven lack of consumer demand, causing a 50% collapse in oil price.

22. Fiscal stimulus measures to reduce the virus’ economic impact exceeded \$6tn, and interest rates were cut across markets. Ensuing fiscal deficits will need addressing once the crisis is contained.

23. Unemployment rose sharply in late March, which will affect wage growth and consumer spending.

24. Due to the crisis, investors are risk-averse and prone to selling value and smaller companies as they seek quality and low volatility, intensified by an increase in leverage and algorithmic trading.

25. Bond spreads increased significantly in high yield, with investment grade and government bonds also affected. Total negative yielding debt has halved since last August.

26. Equity markets reversed $\frac{2}{3}$ of all 2019 gains in Q1, ending the 2010s' bull market with the sharpest correction since 1987. Financials, Industrials, Resources and Consumer Goods were most affected.
27. Risk aversion meant developed markets outperformed emerging markets, but the UK was the weakest developed market. In emerging markets, China outperformed as some activity resumed.