Border to Coast Pensions Partnership Ltd

Border to Coast UK Listed 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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Purpose of Report

1. This report summarises the performance and activity of the Border to Coast UK Listed Equity Fund over Q1 2020.

2. The Committee is recommended to note this report.

Important Information

Background

3. Border to Coast launched this internally managed Fund on 26th July 2018.

4. The Fund has a quality bias with a focus on companies that can generate long term sustainable growth and benefit from long term demographic trends. Border to Coast are long term investors and we expect a low portfolio turnover.

5. Cyclical exposure will typically be focused on companies with an identifiable competitive advantage. The Fund seeks to avoid poorer quality cyclical stocks other than when emerging from a deep market correction.

6. The majority of the Fund's performance is expected to arise from stock selection decisions.

Performance Objective

7. The Fund's objective is to outperform the FTSE All-Share Index ("the Benchmark") by 1% per annum over three year rolling periods.

8. 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

9. The Fund's market value at the quarter end was £3.5bn.

Performance

10. Performance to the quarter end is shown below:

	Since inception 26/07/18 % pa	**Year %**	**Quarter %**
UK Listed Equity Fund	-11.07	-16.45	-24.00
FTSE UK All Share Index	-12.89	-18.45	-25.13
Actual Variance[1]	+1.81	+2.00	+1.13
Target Variance[2]	+1.00	+1.00	+0.25
Performance Relative to Target[3]	+0.81	+1.00	+0.88

[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.

Comments on Performance

11. Performance was above the Benchmark for Q1 2020 and continues to meet the Performance Objective over longer periods.

12. There has been a sharp fall in UK markets, caused by a nationwide lockdown resulting from the coronavirus crisis. The market was also significantly affected by the fall in commodity prices, especially the sharp drop in oil prices as 18% of the market consists of Resources stocks.

13. Although the Fund was impacted by the market falls, it benefitted relatively due to:
    - A bias toward quality, resilient companies with strong balance sheets.
    - Underweight to smaller companies, which can underperform in periods of stress.
    - Exposure to companies with overseas earnings, which benefitted from the fall in Sterling.
    - Underweight in discretionary consumer spending, which has suffered from the lockdown.
    - Modest cash holdings.

14. Due to Brexit uncertainty, the Fund has maintained a relatively low-risk profile since launch. This has been beneficial in the current environment; therefore, it is unlikely that there will be any material change to the Fund's composition. There has been some modest rotation into more cyclical, value stocks to take advantage of relative performance, and we have added to favoured companies at lower valuations.

15. The top and bottom 5 contributors to performance over the quarter were:

Fund	Portfolio weight (%)	Benchmark weight (%)	Contribution to performance (%)	Commentary
Glencore (u/w)	0.00	0.76	0.32	Open investigations by the US Dept. of Justice and issues at key growth assets.
International Airlines Group (u/w)	0.00	0.19	0.23	Airline fleets grounded globally due to coronavirus, restricting operations.
Carnival (u/w)	0.00	0.09	0.15	Cruise operations curtailed due to coronavirus, with several high-profile cases.
Royal Bank of Scotland (u/w)	0.00	0.29	0.15	Interest margin pressure, plus rising impairments expected due to lockdown.
National Grid (o/w)	2.42	1.87	0.15	Defensive attributes, with attractive mix of a UK monopoly and US growth.
HSBC (u/w)	4.95	5.24	-0.14	Uptick in Asia activity post-shutdown offset declining interest margin concerns.
Elementis (o/w)	0.12	0.02	-0.14	Cut to earnings forecast due to weak chromium and energy markets.
Next (o/w)	0.70	0.30	-0.12	Stores and online operations closed due to coronavirus containment measures.
William Hill (o/w)	0.16	0.03	-0.12	Outlets closed, online operations severely impacted by cancelled sports events.
Lloyds Banking Group (o/w)	1.51	1.27	-0.12	Net interest margin pressure. Lockdowns, unemployment may raise impairments.

Source: Northern Trust & Border to Coast

Portfolio Structure

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

Common Stock Funds	+1.50
Basic Materials	+1.03
Industrials	+0.97
Consumer Goods	+0.27
Oil & Gas	+0.06
Financials	-3.32
Consumer Services	-1.77
Utilities	-0.27
Technology	-0.14
Telecommunications	-0.13

Source: Northern Trust

17. Common Stock Funds (o/w) – exposure to smaller companies and sector-specialist investments via collective vehicles with long-term track records of outperformance.

18. Basic Materials (o/w) – strong cash generation enabling significant debt reduction, increased shareholder distributions, and increased capital investment over the longer term.

19. Industrials (o/w) – diversified sector benefiting from exposure to longer-term growth in global investment capital expenditure.

20. Financials (u/w) – underweight in Banks due to concerns over UK consumer debt and residual Brexit uncertainty, partly offset by overweight to Insurers and Wealth Managers.

21. Consumer Services (u/w) – high street suffers from pressure on UK consumer discretionary spending and high occupancy costs, as well as online operators.

22. Utilities (u/w) – regulatory and political headwinds alongside increased scrutiny of shareholder returns.

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

- British American Tobacco (£8.1m) – strong cash flows, attractive dividend and easing of regulatory headwinds.
- BHP (£6.2m) – added on recent weakness despite relatively stable iron ore price.
- Hansa Trust (-£5.8m) – reduced legacy holding, as buying interest for this otherwise relatively illiquid holding increased.
- Blackrock Smaller Companies Trust (-£3.7m) – reduced overweight position as shares trading at premium to net asset value (NAV).

Risk Profile

24. 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 1.19%, just inside the risk appetite of 1% - 3%.
    - The ex-ante (forward looking) tracking error as of quarter end was 0.98%, slightly below the risk appetite.
    - The risk profile had already been positioned at the lower end of the target range due to uncertainty regarding Brexit, which has been beneficial as the coronavirus pandemic hit markets. We do not anticipate any material change to the risk profile of the Fund.

Market Background

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

26. 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.

27. 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.

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

29. 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.

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

31. Equity markets reversed $^{2}/_{3}$ 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.

32. 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.