



Border to Coast Pensions Partnership Ltd

Border to Coast Overseas Developed 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

Author: Jamie Roberts, Border to Coast CRM team
Date: 26 May 2020

Purpose of Report

1. This report summarises the performance and activity of the Border to Coast Overseas Developed 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 26th July 2018.
4. The Fund invests primarily in listed equities of companies from overseas developed countries which are included in the index.
5. The Fund has a quality and growth bias with a focus on companies that can withstand economic and market volatility. Quality is defined as companies with an identifiable and sustainable competitive advantage, earnings visibility, balance sheet strength and strong management.
6. The Fund will not generally make active regional allocation decisions so most of the Fund's performance will arise from stock selection.
7. The majority of the Fund's performance is expected to arise from stock selection decisions.

Performance Objective

8. The Fund's objective is to outperform its Benchmark by at least 1% per annum over three year rolling periods. The Benchmark is a composite of the following regional indices:
 - 40% S&P 500 (US)
 - 30% FTSE Developed Europe ex UK
 - 20% FTSE Developed Asia Pacific ex Japan
 - 10% FTSE Japan
9. The Fund aims to provide a benchmark tracking error relative to the Benchmark of between 1% to 3% depending on market conditions. This is considered to be an appropriate risk profile in view of the performance target.

Market Value

10. The Fund's market value at the quarter end was £2.5bn.

Performance

11. Performance (net of fees) to the quarter end is shown below:

	Since inception 26/07/18 % p.a.	Year %	Quarter %
Overall Fund	-4.24	-6.20	-15.76
Benchmark	-5.29	-7.59	-16.32
Actual Variance ¹	+1.05	+1.39	+0.55
Target Variance ²	+1.00	+1.00	+0.25
Performance Relative to Target ³	+0.05	+0.39	+0.30

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 0.46% over FY2019.

Comments on Performance

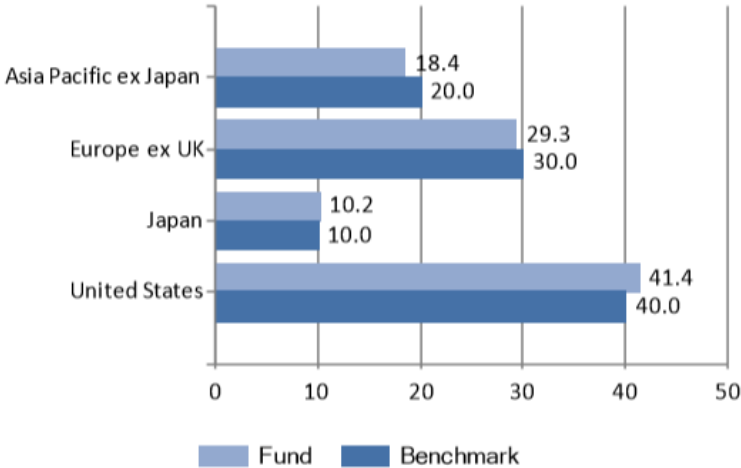
12. Overall Fund performance was above its target over Q1 2020 and is above Benchmark since inception.
13. The performance of the individual regional sleeves of the Fund over Q1 was as follows:
 - US: Fund -8.67% vs Benchmark of -9.76% (+1.09)
 - Japan: Fund -4.41% vs Benchmark of -3.91% (-0.49)
 - Europe ex UK: Fund -11.61% vs Benchmark of -11.41% (-0.20)
 - Asia Pacific ex Japan: Fund -15.45% vs Benchmark of -15.53% (+0.08)
14. The coronavirus crisis caused sharp market falls, which had a particularly negative impact on Pacific ex-Japan – specifically Hong Kong (proximity to China), Australia (significant trading with China), and Korea (restrictive lockdown).
15. 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, who can underperform in periods of stress.
 - Underweight to consumer sectors, which were severely impacted by lockdowns and social distancing measures, as well as rising unemployment.
 - Overweight to Technology, which has been relatively resilient; particularly sectors which benefit from lockdowns, e.g. gaming and media streaming.
 - Strong company selection in most sectors.
16. Due to low correlation between the four portfolios, the Fund has a relatively low risk profile. There is likely to be a modest risk increase due to ongoing rationalisation of the quantity of holdings in the portfolios, which is expected to continue in the short to medium term; however, it is unlikely that there will be any material change to the Fund composition in the short term.
17. The top and bottom 5 contributors to performance over the quarter were:

Fund	Portfolio weight (%)	Benchmark weight (%)	Contribution to performance (%)	Commentary
NVIDIA Corporation (o/w)	0.72	0.30	0.13	Protected by hyperscale data centre growth and machine learning applications.
Novo Nordisk (o/w)	0.96	0.55	0.10	Leading diabetes treatment seen as non-discretionary in current market.
Microsoft (o/w)	2.71	2.25	0.10	Resilient in current climate with cloud platform, online business suite, and X Box.
Dollar General (o/w)	0.44	0.07	0.07	Defensive grocery staples, benefiting from higher Federal food stamp issuance.
Alphabet A (o/w)	1.35	0.65	0.06	Parent of Google; relatively resilient and out-performed the broader market.
Airbus (o/w)	0.50	0.20	-0.23	Grounded global aircraft and increased risk of airline failure causing weakness.
Vanguard US Mid Cap ETF (o/w)	2.69	0.00	-0.14	Significant underperformance from smaller companies in the index over Q1.
Citigroup (o/w)	0.41	0.17	-0.09	As the most global large US bank, Citigroup was heavily impacted by the crisis.
The Cheesecake Factory (o/w)	0.11	0.00	-0.08	Operationally and financially levered, suffering many crisis-driven unit closures.
BNP Paribas (o/w)	0.33	0.18	-0.08	Concerns on rise in non-performing loans and asset valuations due to the crisis.

Source: Northern Trust & Border to Coast

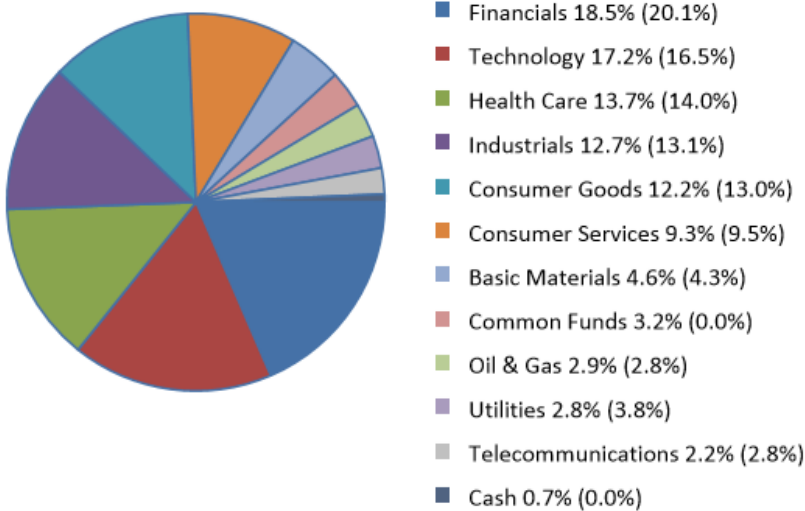
Portfolio Structure

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



Source: Northern Trust

19. 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

20. Notes:

- Common Stock Funds (o/w) – Exposure to smaller companies via collective vehicles, specifically in US, Europe, and Japan.
- Technology (o/w) – Boasts long-term structural growth drivers, including: Internet of Things; Artificial Intelligence; electric/autonomous vehicles; new generation memory chips; rising subscription models; transition to cloud-based services.

- Basic Materials (o/w) – Valuations significantly below long-term average and strong free cash flow generation enable increased shareholder distributions.
- Financials (u/w) – Underweight in Banks due to profitability concerns, non-performing loans, legacy litigation issues and risk of increased regulation. Partly offset by overweight to Insurers and Wealth Managers that may benefit from investment wealth increasing long-term (despite short-term pressures).
- Utilities (u/w) – Considered relatively defensive in current climate, but pressure from increased capital investment, government policy changes and increased regulation are adversely impacting “traditional” power generation companies.
- Consumer Goods (u/w) – High valuations combined with exposure reduction following significant out-performance during the quarter. Larger underweight to Tobacco due to long-term business model concerns. Recent market correction

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

- UBS (£4.7m) – switch from Credit Suisse due to lower valuation and higher dividend yield.
- Wabtec (£4.3m) – fall in valuation following a slow-down in US rail freight and poorly received acquisition activity fails to recognise long-term prospects and a strong recurring revenue stream.
- Clorox (-£8m) – valuation premium relative to the market afforded too much credit for short-term attraction of a defensive product mix and high US domestic exposure.
- Kao Corporation (-£4.9m) – disposal of holding due to rising input prices pressuring margins.

Risk Profile

22. The risk profile of the Fund is monitored on an ex-post (backward looking) and ex-ante (forward looking) basis using data from the fund custodian, Northern Trust, for ex-post, and Bloomberg for ex-ante.

23. Both the ex-post and ex-ante tracking error as of quarter end are below the 1% - 3% target range, standing at 0.65% and 0.73% respectively.

Market Background

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

25. 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.

26. 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.

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

28. 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.
29. Bond spreads increased significantly in high yield, with investment grade and government bonds also affected. Total negative yielding debt has halved since last August.
30. 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.
31. 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.