Border to Coast Pensions Partnership Ltd

Border to Coast Overseas Developed Equity Fund ("the Fund")

Report for the Quarter Ended 30 June 2020
(for information and discussion)

Report to the Border to Coast Pensions Partnership Ltd Joint Committee
Date of Meeting: 29 September 2020

Author: Jamie Roberts, Border to Coast CRM team
Date: 11 September 2020

Purpose of Report

1. This report summarises the performance and activity of the Border to Coast Overseas Developed Equity Fund over Q2 2020.

2. The Committee is recommended to note this report.

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 £3.0bn.

Performance

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

	Since inception 26/07/18 **% p.a.**	**Year** **%**	**Quarter** **%**
Overall Fund	5.72	5.10	19.75
Benchmark	4.52	3.51	19.37
Actual Variance[1]	+1.20	+1.59	+0.39
Target Variance[2]	+1.00	+1.00	+0.25
Performance Relative to Target[3]	+0.20	+0.59	+0.14

[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 Q2 2020 and is above Benchmark since inception.

13. The performance of the individual regional sleeves of the Fund over Q2 was as follows:
    - US: Fund 21.04% vs Benchmark of 20.81% (+0.23)
    - Japan: Fund 12.62% vs Benchmark of 12.22% (+0.40)
    - Europe ex UK: Fund 18.83% vs Benchmark of 18.44% (+0.39)
    - Asia Pacific ex Japan: Fund 22.79% vs Benchmark of 21.51% (+1.28)

14. The key theme affecting the Fund during the quarter has been the sharp rebound in equity markets due to extensive global monetary and fiscal stimulus and tentative signs of a loosening of COVID-19 restrictions, particularly in Asia and Europe.

15. The Fund has continued to modestly outperform due to the following:

    - Bias towards quality companies with relatively strong balance sheets and resilient business models which have continued to outperform despite the sharp recovery in equity markets, partly offset by an underweight in smaller companies which have rebounded;

    - An overweight position in Technology which has continued to benefit from COVID-19 lockdowns;

    - An underweight position in Utilities which have lagged the broader market recovery;

    - Strong stock selection in Financials, Technology and Consumer broadly offset by weaker selection in Industrials and Healthcare.

16. The Fund has a relatively low risk profile which is driven by low correlations between the four constituent portfolios, whose individual risk profiles are generally in the middle of the targeted range for tracking error of 1 – 3%. It is unlikely that there will be material changes to portfolio positioning in the short term and the Fund will continue to focus on long term fundamentals with a bias towards quality companies with strong balance sheets and earnings and income visibility.

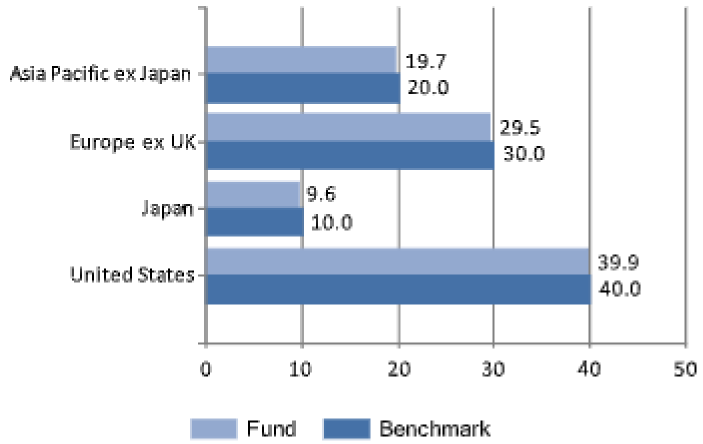
17. The top and bottom 5 contributors to performance over the quarter were:

Fund	Portfolio weight (%)	Benchmark weight (%)	Contribution to performance (%)	Commentary
Vanguard US Mid Cap ETF (o/w)	2.73	0.00	0.13	Rebound in smaller companies following underperformance in the previous quarter.
NVIDIA Corporation (o/w)	0.80	0.36	0.08	Exposure to hyperscale data centre servers, machine learning applications and gaming have lent resilience.
Logitech International (o/w)	0.41	0.04	0.07	The company has experienced an increase in demand due to COVID-19 induced lockdowns and increased working from home.
Xinyi Solar(o/w)	0.25	0.03	0.07	Chinese subsidies higher than expected, leading to increased demand for solar products and positive trading update.
Samsung SDI (o/w)	0.39	0.13	0.06	Continued to benefit from expectations of significant medium-term growth following the announcement of the EU Green Deal.
PayPal (u/w)	0.00	0.32	-0.11	A dominant position within global online payments proving to be a haven amidst a global pandemic.
Adyen (u/w)	0.00	0.18	-0.06	Payments company benefiting from increased online transactions during COVID-19 restrictions.
Afterpay (u/w)	0.00	0.07	-0.05	Australian fintech benefited from the acquisition of a 5% stake by Tencent.
Ageas (o/w)	0.16	0.03	-0.05	Wider under-performance of insurance sector due to concerns that the industry will be inundated with claims in current environment.
Oji Holdings (o/w/)	0.15	0.01	-0.05	Paper and packaging company has experienced a COVID-19 induced reduction in demand for paper for printing.

Source: Northern Trust & Border to Coast

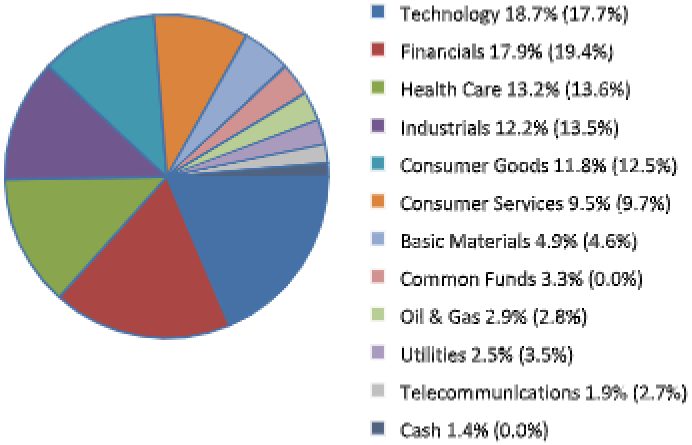
Portfolio Structure

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) – long-term structural growth drivers including Internet of Things, Artificial Intelligence, Electric/Autonomous vehicles, new generation memory chips, the continued transition towards cloud-based

- Basic Materials (o/w) – valuations significantly below the long-term average and strong free cash flow generation, enabling increased shareholder distributions.

- Financials (u/w) – significant underweight in Banks due to concerns over profitability in a persistent low interest rate environment, non-performing loans, legacy litigation issues and the risk of increased regulation. This is partly offset by overweight positions in Insurers and Wealth Managers as they are expected to benefit from long-term increase in investment wealth, although shorter term pressures from the sharp fall in financial markets.

- Industrials (u/w) – short-term disruption from current macroeconomic uncertainty and longer-term concerns regarding capital expenditure with some attractive opportunities in high value-add sectors such as automation.

- Utilities (u/w) – considered to be a relatively defensive sector in current market conditions; however, pressure from increased capital investment, changes in government policy, increased regulatory risk and technological advances in renewable power generation are having an adverse impact on "traditional" power generation companies. In addition, there is long-standing government influence, particularly in Europe, where the sector is considered to be of strategic importance and where interests are not always aligned with shareholders.

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

- KDDI (£5.5m) – new telecoms holding to replace NT&T, due to a slightly better outlook and valuation.

- Roche (£4.7m) – increasing overweight position on positive news relating to cancer drug pipeline, reducing risk of patent expiry on legacy drugs.
- AT&T (-£9.6m) – full disposal due to leveraged balance sheet and the pressure to invest in 5G Infrastructure and acquired media businesses.
- NT&T (-£4.9m) – Switch in to KDDI which has a better outlook and more attractive valuation.

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 0.98% respectively.

Market Background

24. After the global equity market fall of 25% in Q1, stimulus and renewed hope led to a significant rebound in the subsequent three months. Economic data began to rally as lockdowns eased. Activity remains reduced by 20-40%, and in a protracted recovery, retaining Q2 gains may be difficult.

25. The long-term route to withdrawing support is unclear. Fiscal deficits will need addressing through taxation, austerity, or inflation, but only with COVID-19 contained. Further stimulus measures could yet be needed. Inflation is likely to remain low in the short term.

26. Volatility and uncertainty remain high and a second wave or continuance of cases may see reinstated controls. Cases may have peaked in some areas but others are still rising (US, Latin America, India, Africa). Healthcare firms and researchers are working on treatments for COVID-19, with optimism for a 2021 vaccine.

27. Unemployment rose sharply in Q2. Some countries used temporary furlough schemes, but rates will likely rise as these end, affecting wage growth, buyer confidence & spending, and raising cautionary saving.

28. High yield and investment grade bond spreads fell, while government bond yields have been stable. The amount of negative yielding debt increased to $13 trillion in June.

29. Equity markets saw a 20% rebound in Q2. Developed markets modestly outperformed emerging markets. The US (+21%) was the strongest developed market and the UK (+10%) the weakest. South Africa (+28%) was the strongest EM performer while Mexico’s (-12%) rising infection rate saw them perform the worst.

30. Companies with *quality* characteristics and strong balance sheets outperformed, whilst *value* and high-yielding stocks are trading at a discount to the market. The Technology sector outperformed, whilst others such as Consumer Discretionary and Materials rebounded from being adversely impacted during Q1. Financials and Energy have been the worst performing sectors in 2020 so far.