Border to Coast Pensions Partnership Ltd

Border to Coast UK Listed Equity Alpha 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

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Date: 11 September 2020

Purpose of Report

1. This report summarises the performance and activity of the Border to Coast UK Listed Equity Alpha Fund over Q2 2020.

2. The Committee is recommended to note this report.

Background

3. Border to Coast launched this externally managed Fund on 17th December 2018.

4. The Fund invests primarily in listed equities of UK companies included in the index.

5. The Fund combines differentiated strategies based on independent drivers of excess returns that are managed by specialist managers. The allocations to each strategy will reflect the alpha potential in addition to the beta opportunity for each underlying strategy and may change over time.

6. The Fund currently has a mid-cap growth bias with a focus on companies with disruptive models that can sustainably increase their market share.

7. The Fund's performance is expected to arise from both factor and stock selection decisions.

Performance Objective

8. The Fund's objective is to outperform its FTSE All Share Index by at least 2% per annum over three year rolling periods.

9. The Fund aims to provide a benchmark tracking error relative to the Benchmark of between 2% to 5% 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 £1.1bn.

Performance

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

	Since inception 17/12/18	**Year**	**Quarter**
	% p.a.	**%**	**%**
Overall Fund	-1.62	-13.98	14.19
Benchmark	-2.05	-12.99	10.17
Actual Variance[1]	+0.43	-0.99	4.01
Target Variance[2]	+2.00	+2.00	+0.50
Performance Relative to Target[3]	-1.57	-2.99	+3.51

Notes
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. External investment management fees are also included but Border to Coast costs are not reflected.
4. Past performance is not an indication of future performance and the value of investments can fall as well as rise.

[1] Fund performance minus Benchmark performance
[2] Based on the Fund's Performance Objective
[3] Actual Variance minus Target Variance

Comments on Performance

12. The Fund's performance bounced back over Q2. The Fund remains below benchmark over the past year but is back ahead of benchmark since inception.

13. Market performance in Q2 2020 was strong, primarily driven by a normalisation of investor risk sentiment, following extreme market movements in March. The market rally has not been consistent on a sector basis, though, with sectors hit especially hard by COVID-19 - such as physical retail, hotels and airlines - lagging behind the recovery.

14. Against this backdrop, Baillie Gifford and Janus Henderson produced significant positive excess returns during the quarter as smaller companies and those with higher growth expectations outperformed much of the market. This helped the Fund to outperform over the quarter, recouping more than half of relative losses experienced during the market downturn.

15. Following Baillie Gifford's strong outperformance, we rebalanced the Fund in June, investing proceeds in Janus Henderson and UBS to ensure the risk exposure across the Fund remained balanced.

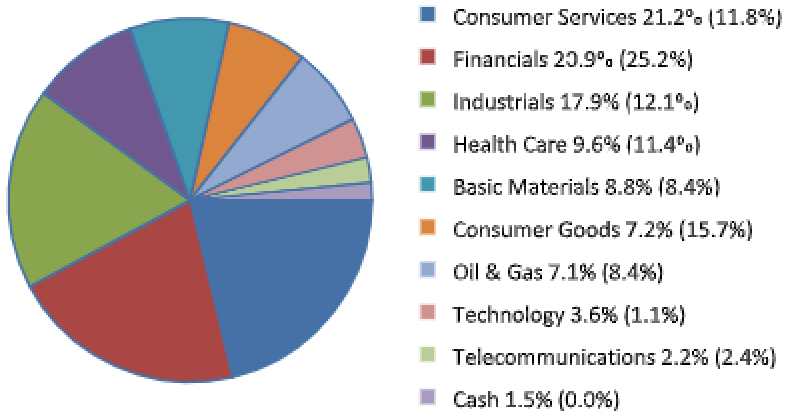
16. The top and bottom 5 contributors to performance over the quarter were:

Fund	Portfolio weight (%)	Benchmark weight (%)	Contribution to performance (%)	Commentary
Ocado (o/w)	2.62	0.31	0.53	Supermarket shares have broadly maintained value as shopping delivery volumes increased due to COVID-19 restrictions.
Royal Dutch Shell A (u/w)	0.35	3.33	0.51	Underperformed the market halting share buybacks and reducing spending by 20% after the breakdown of OPEC supply agreement.
Genus (o/w)	1.12	0.12	0.27	An animal genetics company, which maintained market value over the quarter after announcing revenue growth of 13% due.
Team17 (o/w)	0.42	0.00	0.21	Share price rallied through successful launch of two new games, improving outlook to produce successful franchises in the future.
Abcam (o/w)	1.84	0.00	0.21	Produces and provides a platform for the sale of antibodies. Stock lost value, stabilised by improvement in long term prospects.
Carnival (o/w)	0.62	0.09	-1.13	Global cruise operator. Shares routed during March as the Firm's "Diamond Princess" ship had an outbreak of COVID-19.
AstraZeneca (u/w)	1.37	5.39	-0.89	The firm protected investor value during the quarter as demand for chronic medication remained stable.
Reckitt Benckiser (u/w)	0.00	2.20	-0.56	A producer of health, hygiene and home products. The firm was isolated from COVID-19 impacts on product demand.
SIG (o/w)	0.16	0.01	-0.53	Supplies insulation, roofing and interiors. The CEO and CFO exited in Q1, and the firm announced a further profit warning.
National Grid (u/w)	0.00	1.87	-0.47	Protected value throughout the quarter as revenues remained stable – demand for utilities is largely immune to COVID-19.

Source: Northern Trust & Border to Coast

Portfolio Structure

17. 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

18. Notes:

- Consumer Services (o/w) – overweight position capturing the theme of disruptive, capital-lite businesses attempting to reshape traditional industries.

- Industrials (o/w) – driven by stock selection in high-tech manufacturing, corporate and consumer services with the ability to capitalise on growing industries.

- Technology (o/w) – driven by an overweight position in software and services – targeting innovative, high-growth businesses that are not well represented in the UK benchmark.

- Consumer Goods (u/w) – counterpart to the Consumer Services overweight, large underweight in tobacco given potential ESG concerns and expensive valuations.

- Financials (u/w) – underweight as a result of the sector being dominated by large banks with significant UK economic exposure, for which we are materially underweight. Preference for disruptors and financial services providers (e.g. asset managers).

- Utilities (u/w) – concerns over long term sustainability of businesses and risk of regulatory interference warrants an underweight position.

Risk Profile

19. 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.

20. The ex-post tracking error was 6.10% at quarter end, outside of the 2-5% range, while the ex-ante sat towards the top end of the range, at 4.72%.

21. Ex-post is tracked inception to-date. Sine the fund launched in December 2018 we have seen heightened volatility over this short time period due to Brexit in 2019 and Covid-19 in 2020.

Market Background

22. 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.

23. 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.

24. 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.

25. 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.

26. 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.

27. 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.

28. 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.