Border to Coast Pensions Partnership Ltd

Border to Coast UK Listed 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 UK Listed 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 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 £3.9bn.

Performance

10. Performance to the quarter end is shown below:

	Since inception 26/07/18 % pa	**Year %**	**Quarter %**
UK Listed Equity Fund	-5.09	-11.69	10.16
FTSE UK All Share Index	-6.77	-12.99	10.17
Actual Variance[1]	+1.68	+1.31	-0.01
Target Variance[2]	+1.00	+1.00	+0.25
Performance Relative to Target[3]	+0.68	+0.31	-0.26

[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 broadly in line Benchmark for Q2 2020 but continues to meet the Performance Objective over longer periods.

12. The quarterly performance of the Fund was due to the following factors:

13. A bias toward quality companies with relatively strong balance sheets and resilient business models. This was, however, partly offset by underweight to smaller companies, which rebounded in the recent market bounce, and a modest overweight to high yielding companies which experienced dividend cuts.

14. Exposure to companies with overseas earnings, which have benefited from relative weakness in sterling.

15. Overweight to Materials which benefited from a recovery in commodity prices.

16. Underweight to Financials, where Banks and Insurers underperformed due to lower bond yields and an expected increase in COVID-19 related claims.

17. Strong stock selection in Financials, with a bias towards asset managers who benefited from a recovery in equity markets, offset by weaker selection in Consumer sectors, predominantly due to less exposure to beneficiaries of COVID-19 disruption.

18. Performance dilution from modest cash holdings.

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

Fund	Portfolio weight (%)	Benchmark weight (%)	Contribution to performance (%)	Commentary
HSBC (u/w)	3.61	3.97	0.26	Impact of the deteriorating situation in Hong Kong, as China seeks to impose greater control has weighed heavily on the shares.
Biotech Growth Trust (o/w)	0.72	0.02	0.21	Momentum in the biotech sector has been particularly strong. Development of vaccines for COVID-19 has attracted interest.
BHP Billliton (o/w)	2.66	1.77	0.15	Benefited from higher iron ore and copper prices, driven by stronger demand from China and ongoing supply restrictions.
Herald Investment Trust (o/w)	0.60	0.05	0.12	With a focus on technology and communications, portfolio holdings have benefited significantly from COVID-19 disruption..
Antofagasta (o/w)	1.21	0.17	0.10	Benefited from higher copper prices driven by robust demand from China and COVID-19 related supply restrictions
Glencore (u/w)	0.00	0.95	-0.19	Despite ongoing investigations and a new criminal probe opened by Swiss authorities, has benefited from rebound in commodities.
Ocado (u/w)	0.00	0.48	-0.16	UK online grocery delivery has seen a significant spike in demand during the COVID-19 lockdown.
Scottish Mortgage Inv Trust (u/w)	0.00	0.61	-0.14	Biased towards global large-cap technology companies which have benefited during the COVID-19 lockdown.
Flutter Entertainment (u/w)	0.00	0.65	-0.11	US sports betting continues to grow as states legalise online sports betting - Flutter completed the acquisition of Stars Group.
Just Eat Takeaway (u/w)	0.00	0.51	-0.10	Performed well during the lockdown despite announcing its intention to acquire US operator GrubHub in an all-share deal.

Source: Northern Trust & Border to Coast

Portfolio Structure

20. 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	+1.58
Industrials	+0.83
Basic Materials	+0.80
Oil & Gas	+0.40
Consumer Goods	+0.39
Financials	-3.23
Consumer Services	-2.50
Utilities	-0.36
Technology	-0.24
Health Care	-0.14

Source: Northern Trust

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

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

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

24. Financials (u/w) – underweight in Banks due to concerns over UK consumer debt, rising unemployment, growing impairments linked to COVID-19 lockdown and residual Brexit uncertainty, partly offset by overweight positions in Insurers and Wealth Managers, which are expected to benefit from increase in Asian and Emerging Market wealth.

25. Consumer Services (u/w) – high street and leisure expected to continue to see pressure on discretionary spending from a more cautious UK consumer, slow footfall recovery from COVID-19 shutdowns and high occupancy costs; high street retail remains structurally challenged by increased online penetration.

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

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

- BT (£8.4m) – added on weakness around the dividend cancellation as the longer-term valuation appears attractive.
- British American Tobacco (£7.0m) – reduced underweight position – strong financials and easing of regulatory headwinds.
- HSBC (-£5.1m) – increased underweight position as the situation in Hong Kong deteriorated further.
- Antofagasta (-£3.9m) – trimmed overweight position as the shares benefited from recovery in copper prices.

Risk Profile

28. 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 1.17%, just inside the risk appetite of 1% - 3%.
    - The ex-ante (forward looking) tracking error as of quarter end was 1.15%, just inside 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

29. 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.

30. 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.

31. 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.

32. 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.

33. 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.

34. 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.

35. 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.