Border to Coast Pensions Partnership Joint Committee

Date of Meeting: 30 September 2021

Report Title: Border to Coast Market Review (for information and read only)

Report Sponsor: Border to Coast CIO – Daniel Booth

1 Executive Summary

1.1 This report provides an overview of the macroeconomic environment as well as high level details on market and fund performance.

1.2 Border to Coast composites (Internal & External Equities & Fixed Income) have 3-5 year performance assessment periods. All are performing above benchmark since inception.

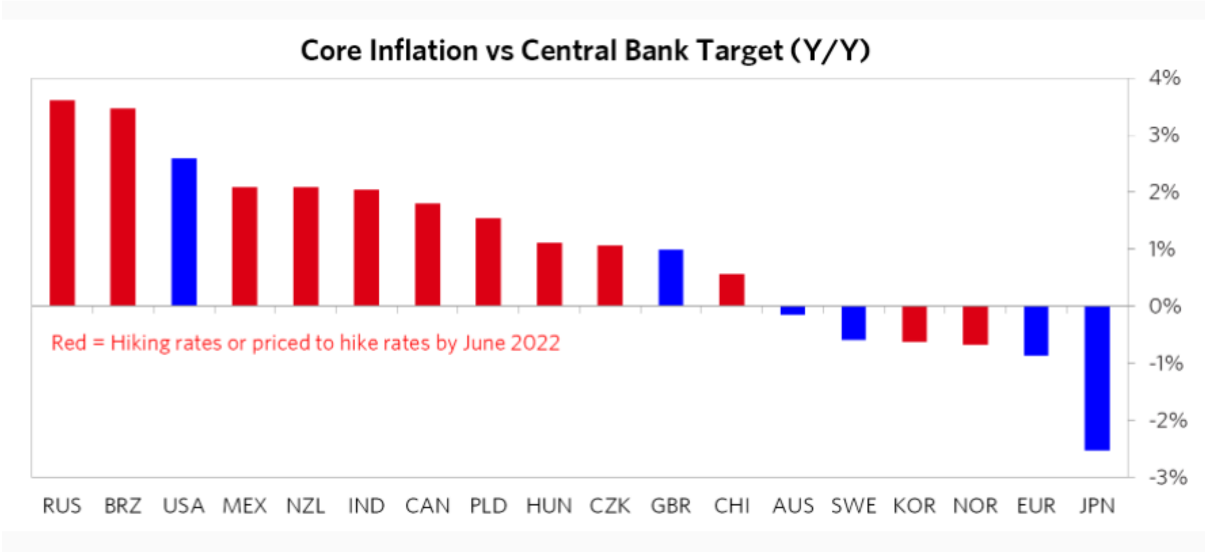
2 Macroeconomic Environment

2.1 Stronger than expected core Inflation and Growth releases across the globe with some central banks proposing higher rates (New Zealand), others reducing quantitative easing 'QE' / asset purchases (UK), whilst the US where seeing some of the strongest inflation and growth readings has only signalled a future tapering of asset purchases toward year-end with interest rates on hold for another year.

	Conditions		Monetary Policy Stance			
	Core Inflation	RGDP vs 2019	QE Ongoing	QE Pace Reduced	Current Policy Rate	Priced Chg Next 12m
USA	4.6%	1.9%	Yes	No	0.1%	0.1%
NOR	1.3%	0.9%	No	-	0.0%	0.7%
EUR	1.1%	-0.3%	Yes	Yes	-0.5%	0.0%
CAN	3.8%	-0.5%	Yes	Yes	0.3%	0.5%
AUS	2.3%	-1.0%	Yes	Yes	0.1%	0.1%
NZL	4.1%	-1.1%	No	Stopped	0.3%	1.2%
JPN	-0.5%	-2.2%	Yes	Yes	-0.1%	0.0%
GBR	3.0%	-2.6%	Yes	Yes	0.1%	0.4%

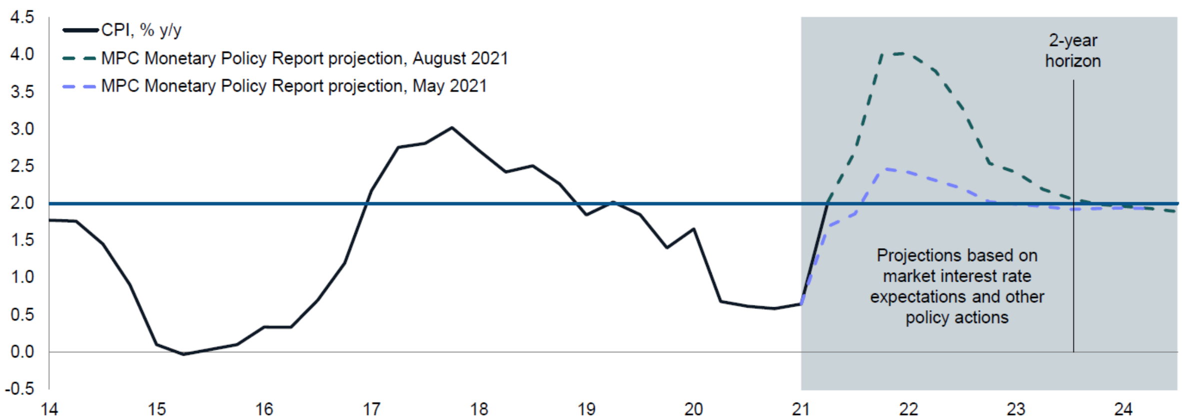
Source: Bridgewater Associates

2.2 Seen elevated 2Q 2021 core inflation rates that were biased upwards by low year-over-year base effects due to the onset of COVID crisis in 2Q 2020. The US stands out as a country with high core inflation rate which is not planning any rate increases by June 2022, with the US Fed deliberately being behind the curve. Supply side shortages will likely keep inflation readings elevated for the remainder of 2021 and into 2022 so it will be key to monitor the reaction function of Central Banks to continued high inflation readings.



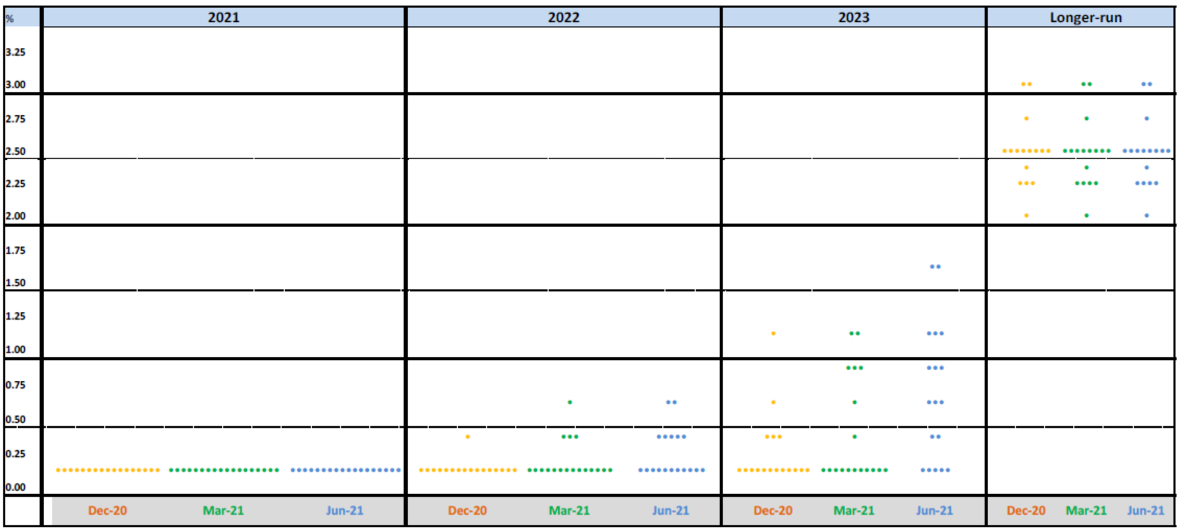
Source: Bridgewater Associates

2.3 In the UK the Bank of England monetary policy projection changed dramatically from the May 2021 to August 2021 meeting to now show a substantial near-term inflation overshoot:



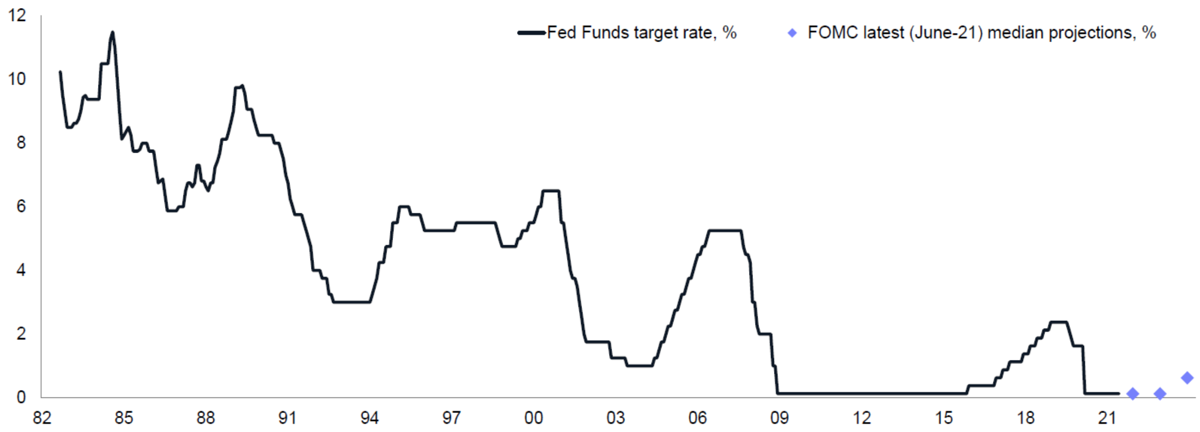
Source: Goldman Sachs

2.4 US interest rate projections increased from the Dec-20 to Mar-21 and Jun-21 meeting with higher interest rates forecasted in 2023:



Source: Goldman Sachs

2.5 Near-term US interest rates still appear accommodative versus a longer-term history and versus current high levels of inflation:



Source: Goldman Sachs

2.6 UK 10-year Gilt yields increased by 60 bps over the last year to a yield of 0.8% but also remain close to historic lows as shown on the chart below:

Source: Bloomberg

2.7 PIMCO view is that "The dramatic and uneven rebound in growth across countries this year is likely to ease to synchronized moderation in 2022, though to a still above-trend pace. From an asset allocation perspective, this means growth-oriented assets, such as equities and credit, may still offer relatively attractive returns. But we expect greater dispersion across sectors and regions. Uncertainty surrounding the uneven recovery from a pandemic-driven recession calls for flexibility and a careful eye toward sector and security selection…"

3 Market Performance

3.1 As of end August 2020, MSCI World (GBP) and MSCI ACWI (GBP) returned 17.1% and 15.1% respectively (the latter including emerging markets). 5 and 10 year equity returns are above long-term expectations whereas 20 year returns are more inline with expectations:

INDEX PERFORMANCE — NET RETURNS (%) (AUG 31, 2021) / **FUNDAMENTALS (AUG 31, 2021)**

					ANNUALIZED							
	1 Mo	3 Mo	1 Yr	YTD	3 Yr	5 Yr	10 Yr	Since Dec 29, 2000	Div Yld (%)	P/E	P/E Fwd	P/BV
MSCI World	3.54	9.36	26.25	17.14	12.79	13.70	14.04	7.09	1.66	23.87	19.54	3.31
MSCI Emerging Markets	3.67	-0.97	17.84	2.15	7.79	9.31	6.63	9.84	2.07	15.98	13.07	2.00
MSCI ACWI	3.55	8.01	25.15	15.12	12.18	13.17	13.16	7.10	1.71	22.54	18.46	3.07

Source: MSCI

4 Fund Performance

4.1 The tables below show our fund absolute and relative performance (versus benchmark) up until the end of June 2021 (in-line with reporting period) and up until end of August 2021 (most up-to-date month-end given we are almost at the end of the quarter):

Period (end June 2021)		**ITD (% p.a.)**	
Fund Name	Fund	Benchmark	Relative
Internal Equity Composite	**6.7%**	**6.0%**	**0.7%**
UK Listed Equity	3.0%	2.0%	1.0%
Overseas Developed Equity	11.7%	10.8%	1.0%
*Emerging Market Equity ***	10.7%	13.0%	-2.2%
External Equity Composite	**15.2%**	**14.0%**	**1.2%**
UK Listed Equity Alpha	10.1%	6.6%	3.5%
Global Listed Equity Alpha	17.3%	17.1%	0.2%
Fixed Income Composite	**8.3%**	**6.8%**	**1.5%**
Sterling Investment Grade Credit	9.2%	7.5%	1.7%
*Sterling Index Linked Bonds **	-1.3%	-1.8%	0.6%

* Less than 1-year (Oct 21 launch) ** Hybird Fund with both internal and external funds

Period (end August 2021)		**ITD (% p.a.)**	
Fund Name	Fund	Benchmark	Relative
Internal Equity Composite	**7.5%**	**6.8%**	**0.7%**
UK Listed Equity	3.8%	3.0%	0.8%
Overseas Developed Equity	12.3%	11.3%	1.0%
*Emerging Market Equity ***	8.3%	10.9%	-2.6%
External Equity Composite	**14.9%**	**14.1%**	**0.8%**
UK Listed Equity Alpha	11.4%	7.4%	4.0%
Global Listed Equity Alpha	17.1%	17.7%	-0.6%
Fixed Income Composite	**10.1%**	**8.7%**	**1.4%**
Sterling Investment Grade Credit	9.0%	7.5%	1.5%
*Sterling Index Linked Bonds **	7.6%	7.0%	0.6%

* Less than 1-year (Oct 21 launch) ** Hybird Fund with both internal and external funds

4.2 Internal Equity composite (asset-weighted) delivered 0.7% outperformance over benchmark (target +1%) since launch, with positive performance from 5 of our 6 internal PMs. This is attributed mainly to stock selection and has been achieved with a low tracking error and a high risk-adjusted return. Our Emerging Market fund has been restructured with China managed externally, which we believe will be accretive for investors, as they benefit from a large, local research teams covering a deep and innovation growth market.

4.3 External Equity composite (asset weighted) delivered 1.2% (end of June) and 0.8% (end Aug) versus target +2%, with strong outperformance from UK Alpha whilst our Global Alpha fund was broadly in-line with benchmark (slight above in June and slightly behind in August due to recent value underperformance). The earlier rebalancing from Growth into Value funds had a positive impact on the UK Alpha fund and neutral on Global Alpha.

4.4 Fixed Income composite was 1.4-1.5% above benchmark with both funds substantially ahead of their targets (+0.65% and +0.2%), as they benefited from the earlier compression in credit spreads.

5 Conclusion

5.1 1H 2021 inflation releases were biased upwards by the low 2020 base impact and 2H 2021 inflation numbers will remain elevated due to supply side constraints. When combine cyclical factors (record monetary and fiscal stimulus and record levels of household and corporate cash balances) with longer-term structural factors (higher taxes, ESG costs and unit labour costs) then remains a risk elevated inflation for longer than expected. The LGPS with long-dated inflation linked liabilities should be mindful of the longer-term inflation risk and potential impact on both their assets and liabilities.

5.2 The remanent of record Fiscal and Monetary stimulus has led to higher than forecasted growth and inflation rates and resulted in a strong liquidity induced rally in risky assets. As we move into the mid-cycle period a diversified pool of risky assets still appears attractive relative to cash (guaranteed negative real returns) but be aware of higher levels of risk and performance dispersion. For public equities the benefit of higher nominal earning will be partly offset by margin compression (from higher input costs) with higher interest rates to come and thereafter potentially lower multiples that investors will pay for future cashflows. How central banks react to elevated levels of inflation in mid-2022 will likely determine the future market outcome.

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22nd September 2021

Important Information