SOUTH YORKSHIRE
PENSIONS AUTHORITY

QUARTERLY REPORT TO 30 JUNE 2019

Market background

Global equity markets continued to surge higher this quarter, albeit weaker than the previous one, on the back of low Inflation and positive consumer demand and a possible reduction by the Fed in the base rate. However, geopolitical headwinds still remain at large with the ongoing trade war between China and US not abating, the uncertainty around Brexit and the tense situation between Iran and US still remaining prevalent. With this market volatility, emerging market assets lagged developed market ones, with cyclical and growth stocks performing better than defensive and value over the period.

In the UK, Theresa May announced her resignation as UK Prime Minister and this led to a greater threat of a no deal Brexit, with UK firms stockpiling on the possibility of the lack of availability of inventory after 31 October. With growth shrinking to -0.2% this quarter, with production output dropping to 1.4% and services output growth also slowing to 0.1%, the BOE announced the easing of the monetary policy which led to weakness in sterling and invariably to the strength in UK equities, with relative positive performance of 0.2% in the quarter. Emerging Market debt rose on the back of sterling weakness and the nervousness in the economy saw the value of gilts rise. On a positive note, unemployment stood at 3.8%, with unemployment falling 51,000 to 1.29 million and employment increased by 28,000 to a new all-time high of 32.75 million. Total pay growth picked up to 3.4% with inflation unchanged at 2%, matching market expectation.

With the more dovish stance on monetary policy by most developed nation’s central bankers, bonds climbed higher, with sovereign bonds faring better than corporates due to the perceived muted growth and a weakening economy. This also benefitted gold and yen denominated assets. The yield curve, and particularly the spread between the 10 year and the 3 month treasury, has inverted an early sign of an impending recession. However most commentators have dismissed this although they do agree that the global economy and notably the developed markets are trading in a late cycle phase.

Leading indicators in the US and in particular the housing market and the yield curve, are indicating that the economy has peaked and is now trending downwards, and with inflation being below the current target level of 2%, the signs are that the Fed are concerned and are looking to loosen the current monetary policy with a drop in rates to hopefully kick start the consumer confidence momentum. However employment, corporate earnings and GDP growth rate have remained resilient and strong.

Market background continued

Europe has seen protectionism gain momentum and external demand dwindle, with economic weakness about to set in to the continent, as seen with Germany, a country reliant on exports which are now falling and unemployment now rising, although the service sector is still expanding as evidenced by favorable PMI figures. Just like most of the developed nations, the ECB are also looking to stimulate the economy with rate cuts and quantitative easing (QE), which would imply strength in bonds and the equity markets in Europe.

The Chinese government's expansionary fiscal and monetary polies have supported their economy, with growth now forecast at 6%. As already highlighted, trade tensions looks to impede this figure down, however China is looking to encourage trade by exporting more to other foreign countries especially in and around Asia, to help counter the loss of trade it has with US.

With the fears of a possible economic downturn the commodity index, this quarter, fell just under 6% on an annual basis. Energy based commodities contributed the most to the decline in demand, with gold on the other hand gaining 37% on the back of increased geo-political tensions.

The current political uncertainty in the UK is having a greater impact on the UK property sector than previously assumed, with structural driver's unchanged, weaker economy and sentiment combining to drag the property market down. Areas that remain attractive are within the industrial and healthcare sectors as ecommerce drives sustained demand for industrial and logistics space. Whereas investment in the retail sector still remains low. Business confidence in London and in most regional cities remains high and the office sector has remained resilient.

Fund Valuation

as at 30 June 2019

	Mar 19 £m	%	Quarterly Net Investment	June 19 £m	%	Benchmark %	Range %
FIXED INTEREST							
Royal London	401.7	4.8	4.3	411.1	4.7	5	
UK ILGs	1084.5	12.9	(38.9)	1062.4	12.2	12	
High Yield Bonds	216.5	2.6	2.2	221.6	2.6	3	
EM Bonds	224.0	2.7	5.4	233.9	2.7	3	
TOTAL	**1926.7**	**23.0**	**(27.0)**	**1929.0**	**22.2**	**23**	**18-28**
UK EQUITIES	**1231.5**	**14.6**	**0.0**	**1283.3**	**14.8**	**15**	**10-20**
INTERNATIONAL EQUITIES							
Developed Market - BCPP	2251.6	26.8	0.0	2407.3	27.7	27.125	
Developed Market - SYPA	139.2	1.7	(5.2)	141.4	1.6		
Emerging Markets -BCPP	670.2	8.0	0.0	690.9	7.9	7.875	
Emerging Markets -SYPA	36.8	0.4	(10.8)	21.0	0.3		
TOTAL	**3097.8**	**36.9**	**(16.0)**	**3260.6**	**37.5**	**35**	**30-40**
PRIVATE EQUITY							
Private Equity - BCPP			3.1	3.1			
Private Equity - SYPA	505.3	6.0	17.4	555.4	6.4		
TOTAL	**505.3**	**6.0**	**20.5**	**558.5**	**6.4**	**7**	**2-12**
PRIVATE DEBT FUNDS	**323.8**	**3.8**	**1.7**	**336.6**	**3.9**	**3.5**	**0-8.5**
INFRASTRUCTURE	**292.1**	**3.5**	**41.8**	**338.1**	**3.9**	**5**	**0-10**
PROPERTY	**760.9**	**9.0**	**0.9**	**757.2**	**8.7**	**10**	**7-13**
CASH	**281.8**	**3.3**		**281.2**	**3.2**	**1.5**	**0-10**
EQUITY PROTECTION (EPO)	(5.5)	(0.1)		(50.1)	(0.6)		
TOTAL FUND	**8414.4**	**100.0**		**8694.5**	**100.0**	**100**	
COMMITTED FUNDS TO ALTERNATIVE INVESTMENTS	1009.0			1203.6			

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Asset Allocation Summary

The most significant transactions this quarter were the £39m raised from the index-linked gilt portfolio and the £16m raised from the residual overseas portfolios to fund the £64m net investment across the alternative portfolios.

Index-linked gilts are the asset class that the Fund holds for inflation protection and we aim to maintain a neutral weighting. They are not cheap as an asset class and so we reduced the overweight position that had developed.

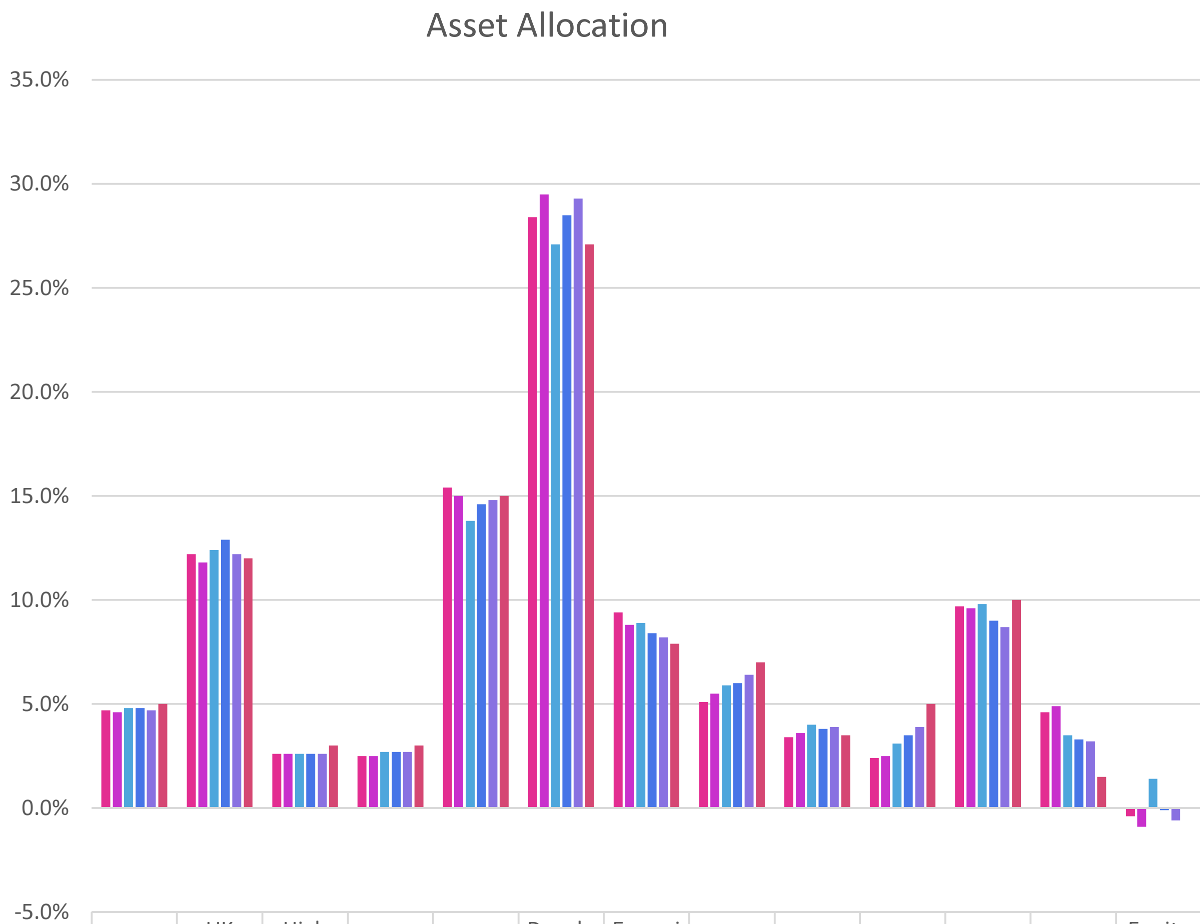
£12m of income and realisations from corporate actions within the other bond portfolios was reinvested over the quarter.

We signed up to the Border to Coast Private equity fund with an annual commitment of £150m. They finalised their first investment at the end of June and the first drawdown of £3.1m was paid. We also made a commitment of £100m to the Infrastructure fund at the beginning of July.

This leaves the Fund with an underweight position to bonds, alternative funds and property, and an overweight position to international equities and cash.

The change in weightings over the last few quarters can be seen in the next chart. The Fund has been very close to its benchmark weightings for most asset classes over this period although it can be seen that it has gradually been increasing its weighting to alternatives at the expense of quoted equities.

Asset Allocation Summary



	Royal London	UK Index Linked	High Yield Bonds	EM Bonds	UK Equities	Developed Market	Emerging Market	Private Equity	Private Debt	Real Assets	Property	Cash	Equity Protection
30/06/18 (%)	4.7%	12.2%	2.6%	2.5%	15.4%	28.4%	9.4%	5.1%	3.4%	2.4%	9.7%	4.6%	-0.4%
30/06/18 (%)	4.6%	11.8%	2.6%	2.5%	15.0%	29.5%	8.8%	5.5%	3.6%	2.5%	9.6%	4.9%	-0.9%
31/12/18 (%)	4.8%	12.4%	2.6%	2.7%	13.8%	27.1%	8.9%	5.9%	4.0%	3.1%	9.8%	3.5%	1.4%
31/03/19 (%)	4.8%	12.9%	2.6%	2.7%	14.6%	28.5%	8.4%	6.0%	3.8%	3.5%	9.0%	3.3%	-0.1%
30/06/18 (%)	4.7%	12.2%	2.6%	2.7%	14.8%	29.3%	8.2%	6.4%	3.9%	3.9%	8.7%	3.2%	-0.6%
Benchmark (%)	5.0%	12.0%	3.0%	3.0%	15.0%	27.1%	7.9%	7.0%	3.5%	5.0%	10.0%	1.5%	0.0%

30/06/18 (%) 30/06/18 (%) 31/12/18 (%) 31/03/19 (%) 30/06/18 (%) Benchmark (%)

Performance Summary

For the quarter to the end of June, the Fund returned 3.3% against the expected benchmark return of 3.5%.

Looking at the Fund ex equity protection we showed an outperformance of the benchmark giving a return of 3.8%. The outperformance was due to stock selection as asset allocation was neutral over the period.

The breakdown of the stock selection is as follows:-

UK Equities	+0.1%
Emerging Market Equities	- 0.1%
Alternative Assets	0.3%

Now looking at the equity protection strategy, the nominal value of the portfolio which was protected rose in value over the quarter by 4.4% and the value of the options detracted by £45m from the value of the Fund. This effectively reduced the return to the fund by 0.5%.

The indicative funding level as at 31 March 2019 was 101.6% and by 30 June 2019 was 104%. This is based on the formal 2016 valuation results, updated for market conditions at 30 June 2019 and actual fund returns to that date.

The performance of the Fund can be seen in detail in the following slides.

Performance

as at 30 June 2019

Return %	Quarter to 30/06/19		Financial Y.T.D.	
	SYPA	Benchmark	SYPA	Benchmark
Fixed Interest				
Royal London	2.2	2.0	2.2	2.0
UK ILG	1.7	1.9	1.7	1.9
High Yield Bonds	2.5	2.0	2.5	2.0
Emerging Market Bonds	3.3	3.3	3.3	3.3
Total	**2.1**	**2.0**	**2.1**	**2.0**
UK Equities	**4.2**	**3.3**	**4.2**	**3.3**
International Equities				
BCPP Overseas Developed Mkts	6.9	6.8	6.9	6.8
SYPA Overseas Developed Mkts	6.3	6.8	6.3	6.8
BCPP Emerging Markets	3.1	3.9	3.1	3.9
SYPA Emerging Markets	(14.5)	3.9	(14.5)	3.9
Total	**5.8**	**6.2**	**5.8**	**6.2**
Private Equity	**6.4**	**1.6**	**6.4**	**1.6**
Private Debt Funds	**3.5**	**1.6**	**3.5**	**1.6**
Infrastructure	**1.7**	**1.6**	**1.7**	**1.6**
Property	0.3	0.7	0.3	0.7
Cash	0.1	0.1	0.1	0.1
Total Fund ex Equity Protection	**3.8**	**3.5**	**3.8**	**3.5**
Equity Protection Options	(811.8)		(811.8)	
Total Fund	3.3	3.5	3.3	3.5

Performance attribution

For the quarter, the Fund returned 3.3% against the expected return of 3.5%, with the Fund valuation rising from £8414.4m to £8694.4m.

Bonds
Stock selection was mixed across the portfolios but overall gave a positive relative performance.

UK Equities
Stock selection was positive over the quarter but being underweight the asset class was negative.

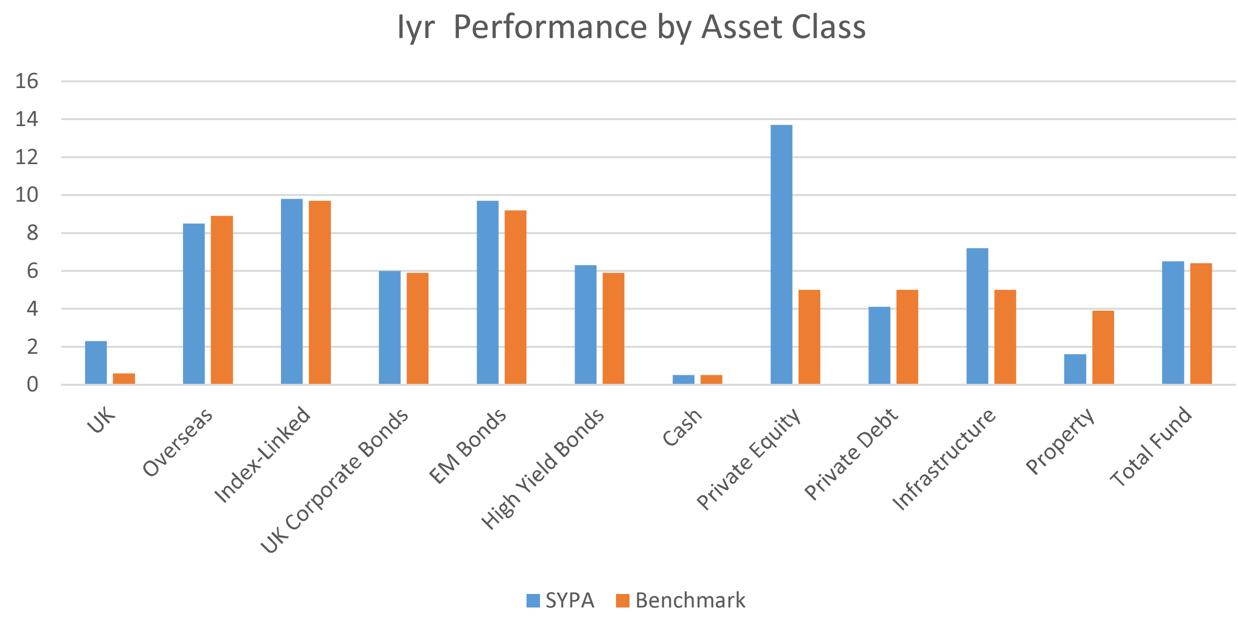
Overseas Equities
Stock selection was positive across the developed markets but was negative across the emerging market portfolios. The residual emerging market fund is only valued at just over £20m. It showed a significant loss due to one of the holdings we have in an African fund which is in liquidation. Its holdings in Zimbabwe were significantly devalued.

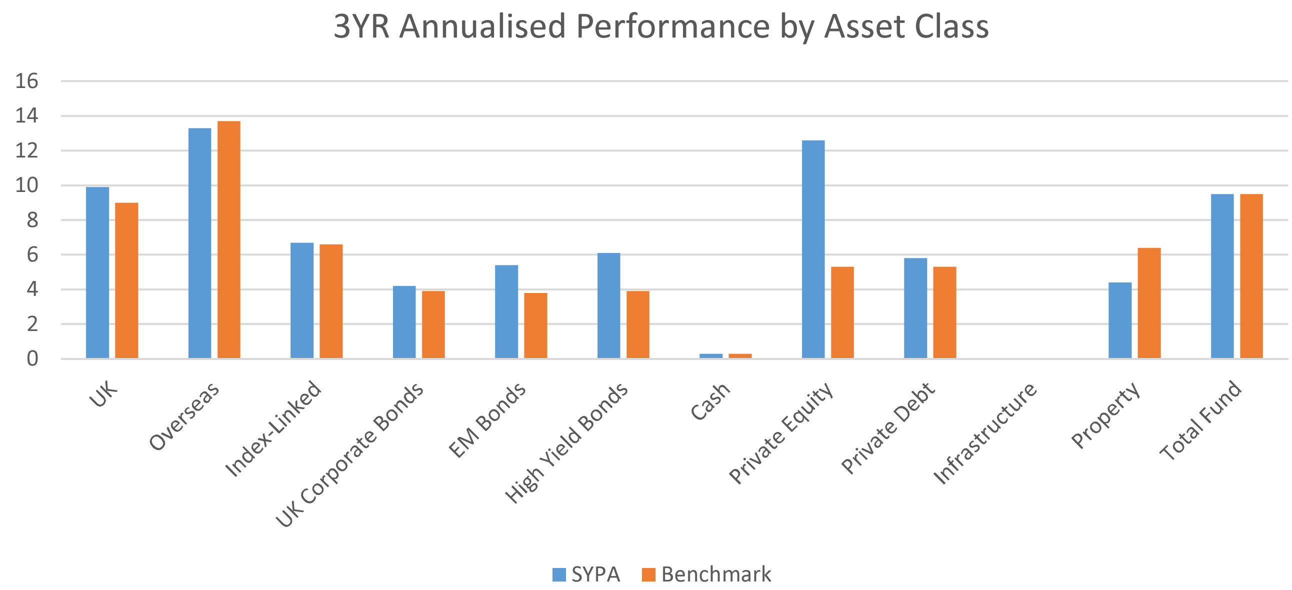
Alternatives
The performance across all the portfolios was positive.

Property
Performance was behind the benchmark.

Equity Protection
With the sharp bounce back in equity markets the equity protection strategy detracted value from the Fund.

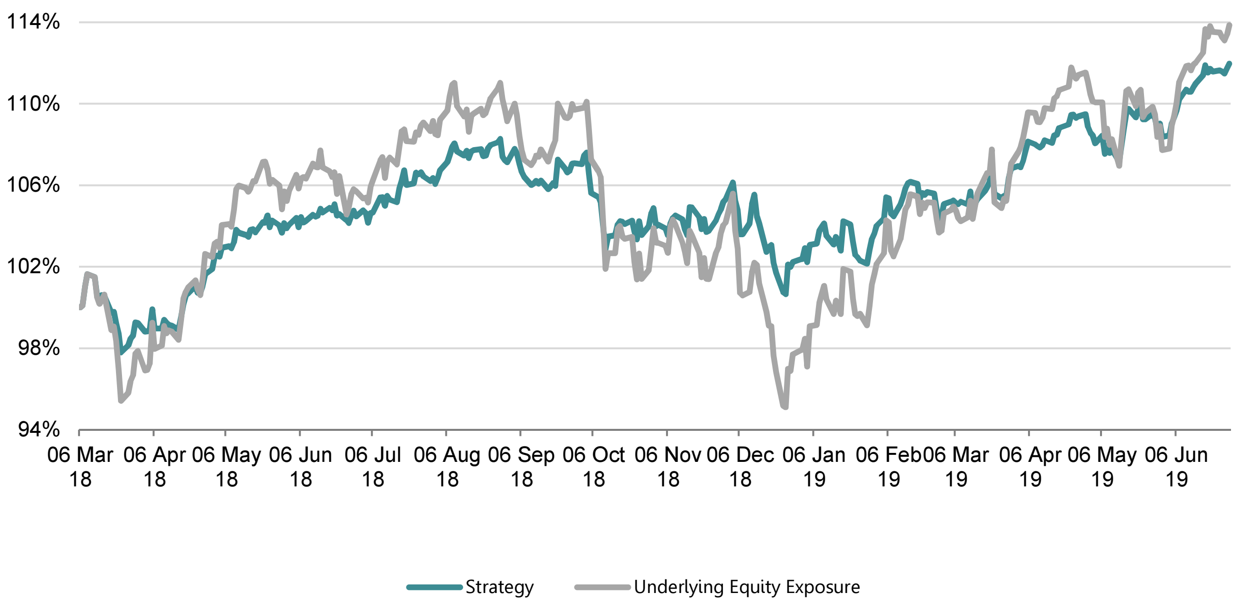
Performance-Medium term





Equity Protection

The equity protection strategy generated a negative return over the quarter given the sharp rise in the financial markets. The strategy impacted the Fund value by £45m, which detracted from overall performance by 0.5%.



The gap in valuation between the equity protection strategy and the underlying equities has varied over the period. When markets fall there has been a positive impact but more recently as markets have risen strongly we can see that there is now a negative impact for the Fund. At the end of June this negative impact was £50m.

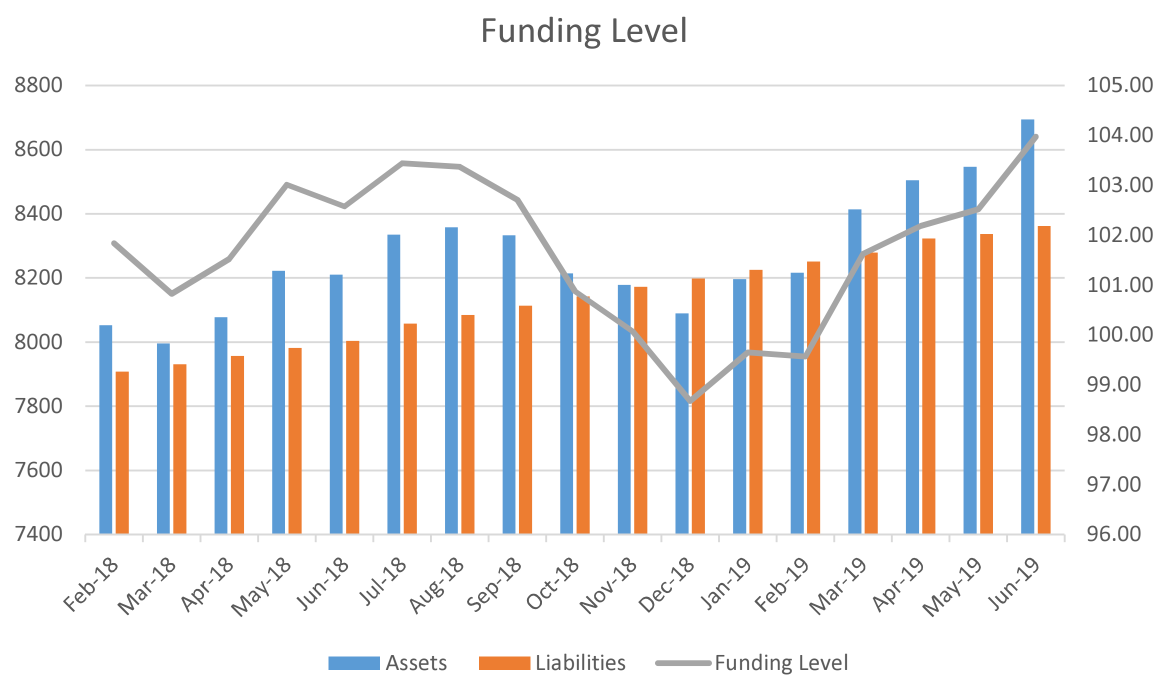
Funding Level

The funding level as at 30 June 2019 was around 104%, an increase from the previous quarter value of 101.6%.

The breakdown is as follows:

Fund's Assets:
As at 30 June 2019: £8,694.4m
As at 31 Mar 2019: £8,414.4m
An increase of £324.6m.
The value of Funds asset's at the last triennial valuation date in March 2016 was £6,270m.

Funds Liabilities:
As at 30 June 2019: £8,362m
As at 31 Mar 2019: £8,279m
An increase of £81m.
The value of Funds liabilities' at the last triennial valuation date in March 2016 was £7,293m.



Outlook

The outlook for global GDP growth has continued to deteriorate on the back of escalating global trade tensions. However, monetary conditions have become more accommodative with increased likelihood of central bank easing and prospects of further Chinese stimulus which would indicate that a global recession can be avoided in 2019/20.

Global growth expectations have been cut to 3.2% from 3.3% for 2019 and to 3.3% from 3.5% for 2020. The Federal Reserve is expected to cut rates 25bps in the second half of 2019 and may signal more cuts to follow. Given the uncertainty regarding the impact of Brexit it is unlikely that the Bank of England will increase interest rates in the short term and the ECB has altered its forward guidance to push the timing of any increase in interest rates into 2020. There is also a chance that it may restart quantitative easing.

While there are undoubtedly short-term challenges facing markets we believe that equities should be favoured over fixed income for the medium term.

UK Equities

Brexit continues to dominate the headlines and will do until the latter part of this year and as such uncertainty will remain and all the risks associated with that. This is having a detrimental impact on investment expenditure. We would still, therefore, expect to remain underweight this asset class.

Overseas equities

Global economic growth continued to soften during the quarter and leading indicators suggest that this weakness may continue in the short term. Global inflation remains relatively benign and despite relatively strong labour markets, wage growth appears contained. Monetary conditions have become more accommodative in recent months, as inflation and interest rate expectations have fallen in response to weaker global economic growth. The key concern remains that there is insufficient room for central banks to use monetary policy to stimulate economies in the event of a recession, as interest rates are not high enough to enable cuts to have an impact and further quantitative easing risks merely boosting asset prices. Due to high rates of government debt it is unlikely that fiscal policy can be used to stimulate growth.

Outlook

Expanding price earnings ratios, as opposed to earnings growth prospects, have driven equity market returns. It is questionable as to whether this is sustainable as multiples are above their long term average. We expect market conditions to remain volatile but remain more weighted to overseas equities than to UK equities.

Within emerging markets valuations appear more attractive than for developed markets but trade tensions will drag on performance and therefore markets with a more domestic bias will be more attractive. China is currently benefiting from fiscal and monetary stimulus and earnings revisions seem to have bottomed. Stronger growth from China should support other emerging markets, although some economies will remain vulnerable due to the slowdown in global growth.

Will be reducing to fund the drawdowns to the alternative assets.

Bonds

Gilts followed the global trend and 10 year yields fell well below 1%, not far off post Brexit vote low with index-linked following suit. They are currently close to the all-time low. Investment grade spreads narrowed in again in June and finished the quarter lower than at the end of March.

The recent bounce has removed much of the attraction in valuation levels in EM and high yield. The global economy has weakened and there seems to be little sign of a rebound in the short term. Markets have been supported by the change in tone by central banks with both the Federal Reserve and the ECB showing a bias towards easing. There is little upside expected from here barring an unexpected extreme event.

Risk free assets are very unappealing and credit spreads in riskier bonds are too low for them to be attractive to long term investors.

Will look to maintain a neutral weighting to index-linked gilts and remain underweight the other bond portfolios.

Outlook

Real Estate

Income is expected to remain the focus for investors and ASI do not expect that there will be any material change to the investment themes that they have been advocating over the past year until there is more clarity on the macroeconomic outlook. Significant weight of capital targeting long secure income is supporting pricing at levels which is out of reach for most balanced funds. The wide dispersion in returns at the sector level is expected to continue in the short term driven by the structural shift into logistics and multi-let industrials to the detriment of retail.

Looking to increase the allocation to property. Have signed the agreement for the first of the property loan investments through CBRE.

Alternatives

The alternative investment market which includes investments within private equity, private debt and infrastructure, generally generates above market returns and with the pension fund currently slightly underweight in this sector, we are looking to add further investments into this asset class.

Going forward new potential investments in the alternative market space will be implemented by Border to Coast Pensions Partnership (BCPP). The existing legacy investments currently are held with the Authority, who will monitor and administer the funds accordingly.

Cash

The deployment of cash to alternatives should see the reduction in cash balances.

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