SOUTH YORKSHIRE
PENSIONS AUTHORITY

QUARTERLY REPORT TO 30 SEPTEMBER 2019

Market background

Global stock markets remained relatively flat this quarter, with the same risks still dominating the investment markets as they did previously. Worldwide growth continues to slow down due to weakening cyclical momentum and softer industrial activity, uncertainties around global trade and geo-political conditions, such as US/China trade tariffs and Brexit. The best performing sectors during the quarter have been the defensive areas in consumer staples, utilities and real estate with global sovereign debt also making strong gains supporting this view. Gold, a proxy for safety, rose 18.5% on the quarter.

Most of the news in the UK has been dominated by Brexit with the new PM, Boris Johnson, assuming office on 24 July. In his first speech to Parliament, the PM underlined that the UK will leave the EU on 31 October 2019 with or without a deal, as mandated by the majority of the British electorate in 2016.

The PM's tenureship has been marred by controversy from removing 17 prominent senior ministers from their roles in the Government, to proroguing Parliament, a decision that was later upheld by the Supreme Court as unlawful. With his proposals fast losing support in both Parliament and in the EU together with time running out, the probability of the UK now leaving on 31 October looks very unlikely, with the possibility of an extension into next year more certain with the Benn-Burt Act taking precedence.

For investors this means more uncertainty, as the country is locked from moving forward. Growth has fallen to -0.2% on a quarter on quarter basis, as companies are running down stock-piles that they had built up in the first quarter of 2019 in the run up to the original 29 March Brexit deadline date. During this period, the sterling/dollar exchange rate ranged from a high of \$1.2696 to a low of \$1.2033, finally ending the quarter end at \$1.2289.

In spite of the doubt surrounding Brexit, employment is high with real wage growth increasing steadily and services output up by 0.1%. Manufacturing output, however, fell by 2.3% as did UK productivity with inflation also declining to 1.7% this quarter, below market expectation due toa slowdown in a cost of transport and a fall in clothing and footwear prices. There was a small increase in retail sales. With this in mind the BOE voted unanimously to hold the base rate at 0.75% with a pledge to a gradual and limited rate rise under the assumption of a smooth Brexit transition and global growth recovery.

Mixed economic signals have been emanating out of the US too, with a solid service and household activity, low unemployment and easy financing conditions but a slow declining trend in industrial activity. This has stemmed from the trade tariffs and subdued inflation data amid heightened concerns about the economic outlook and this still dictates the future monetary policy. Since the last quarter the Fed has lowered rates by a further 50bps to 2%. With US elections set to be in full swing in 2020, the current administration would like to resolve the geo-political issues that are prevalent with a positive momentum as further Fed rate cuts are expected before the year end.

Market background continued

In Europe the slow-down in industrial activity has really impacted the economic growth of the major economies on the continent, notably Germany, with exports and services falling by 1.3% in the quarter (vs 1.8% increase in Q1). However, similar to that seen in the UK and US, unemployment in the Euro-Zone has declined with easy credit conditions and a buoyant housing market being the positive note within the region.

With worries around slowing growth, low inflation, negative economic data and sentiment, the European policy makers are looking to loosen fiscal policy with the aim of improving the overall demand and consumer confidence within the region.

The recent political instability in Italy has now temporarily come to an end with a coalition administration taking charge of the government with Italian BTP bond yields dropping on the expectation of a resolution taking place.

Trade tensions and political unrest in Hong Kong, seems to have had a negative impact on China and its economy, although the latest data coming out of the country shows that the nation grew by 6.2% on a year on year basis; however, this was a fall of 0.2% from the previous quarter, indicating signs of slowness in the region. Total exports growth dropped 0.4% on a year on year basis and domestic demand fell marginally in retail and motor vehicle sales growth from the previous month, with the authorities still engaged in support of the country via fiscal and monetary stimulus as the renminbi is currently trading just off the all-time highs of 7.1789.

The UK property sector offers attractive returns on a relative basis with average yields of around 4.7%%,(seems too high to me)compared to the 10 year Gilts at just under 1%. The key drivers that existed in the previous quarter still currently prevail with investment within the industrial property sector and health care growing while sharp declines in the retail sector continue. E-commerce and logistics sub-sectors offer better opportunities along-side long lease contracts and desirable locations.

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Fund Valuation

as at 30 September 2019

	Jun-19		Quarterly Net	Sep-19		Benchmark	Range
	£m	%	Investment	£m	%	%	%
FIXED INTEREST							
Royal London	411.1	4.7	3.9	428.6	4.8	5	
UK ILGs	1062.4	12.2	-23.7	1140.2	12.8	12	
High Yield Bonds	221.6	2.6	-7.1	216.5	2.4	3	
EM Bonds	233.9	2.7	4.8	238.1	2.7	3	
TOTAL	**1929.0**	**22.2**	**-22.1**	**2023.4**	**22.7**	**23**	**18-28**
UK EQUITIES	**1283.3**	**14.8**	**0.0**	**1298.0**	**14.6**	**15**	**10 _ 20**
INTERNATIONAL EQUITIES							
Developed Market - BCPP	2407.3	27.7	0.0	2473.8	27.8	27.125	
Developed Market - SYPA	141.4	1.6	-29.5	115.2	1.3		
Emerging Market - BCPP	690.9	7.9	0.0	681.0	7.6	7.875	
Emerging Market - SYPA	21.0	0.3	-1.8	18.0	0.2		
TOTAL	**3260.6**	**37.5**	**-31.3**	**3288.0**	**36.9**	**35**	**30-40**
PRIVATE EQUITY							
BCPP	3.1		7.6	7.6			
SYPA	555.4		21.4	613.3			
TOTAL	**558.5**	**6.4**	**29.0**	**620.1**	**7.0**	**7**	**2-12**
PRIVATE DEBT FUNDS	**336.6**	**3.9**	**15.7**	**359.1**	**4.0**	**3.5**	**0-8.5**
INFRASTRUCTURE							
BCPP			1.9	1.9			
SYPA			12.7	366.3			
TOTAL	**338.1**	**3.9**	**14.6**	**368.2**	**4.1**	**5**	**0-10**
PROPERTY	**757.2**	**8.7**	**12.5**	**768.3**	**8.6**	**10**	**7-13**
CASH	**281.2**	**3.2**		**256.4**	**2.9**	**1.5**	**0-10**
EQUITY PROTECTION (EPO)	-50.1	-0.6		-68.5	-0.8		
TOTAL FUND	**8694.4**	**100.0**		**8913.8**	**100.0**	**100**	
COMMITTED FUNDS TO ALTERNATIVE INVESTMENTS	1203.6			**1323.8**			

Asset Allocation Summary

The most significant transactions this quarter were the £23m raised from the index-linked gilt portfolio and the £31m raised from the residual overseas portfolios to fund the £59m net investment across the alternative portfolios.

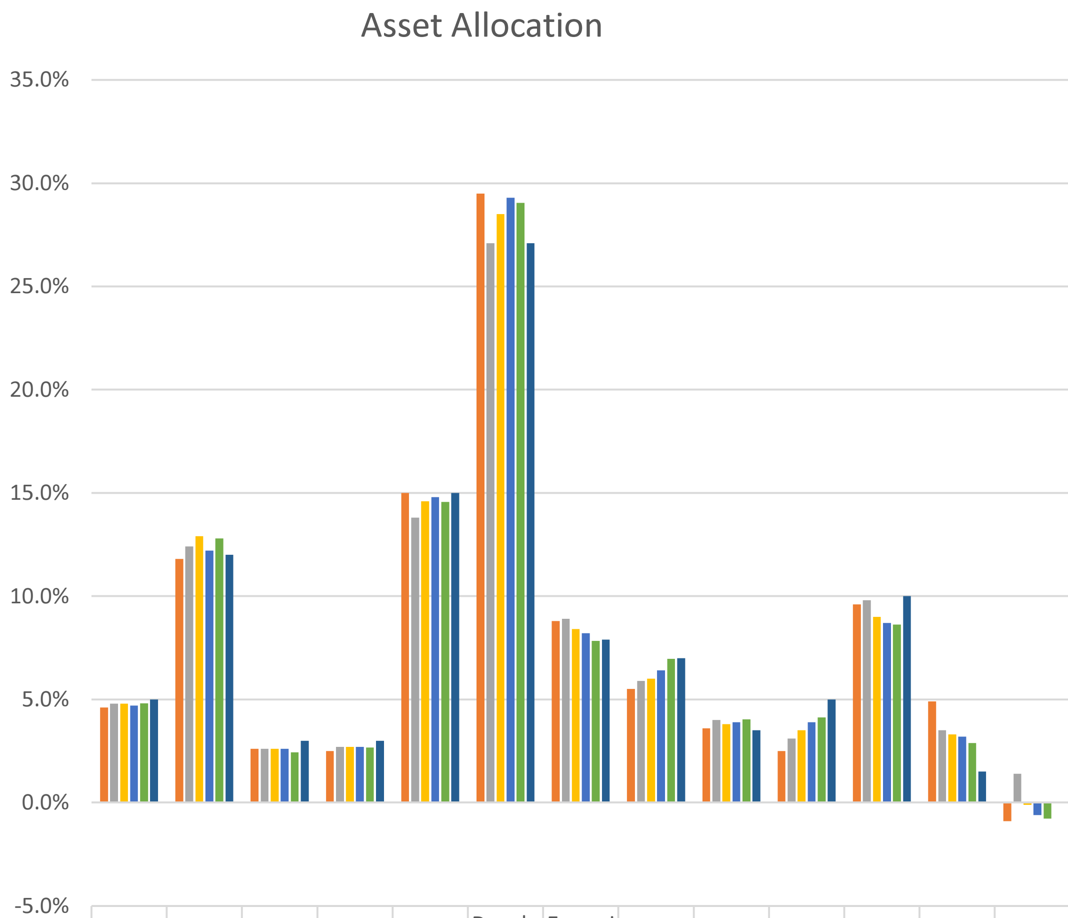
Index-linked gilts are the asset class that the Fund holds for inflation protection and we aim to maintain a neutral weighting. They are not cheap as an asset class and after a period of strong performance we reduced the overweight position that had developed.

We signed up to the Border to Coast Private infrastructure fund with an annual commitment of £100m. They finalised their first investment in September and the first drawdown of £1.9m was paid. We also made an 18 month commitment of £90m to the Private Debt fund in September but the first investment has yet to be made.

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
30/09/18 (%)	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%
30/06/19 (%)	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%
30/09/19 (%)	4.8%	12.8%	2.4%	2.7%	14.6%	29.1%	7.8%	7.0%	4.0%	4.1%	8.6%	2.9%	-0.8%
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%

30/09/18 (%) 31/12/18 (%) 31/03/19 (%) 30/06/19 (%) 30/09/19 (%) Benchmark (%)

Performance Summary

For the quarter to the end of September, the Fund returned 2.8% against the expected benchmark return of 2.8% which gives a year to date return of 6.2% against an expected return of 6.3%

Looking at the Fund ex equity protection we showed an outperformance of the benchmark giving a return of 3.0%. The outperformance was due to stock selection as asset allocation was neutral over the period.

The breakdown of the stock selection is as follows:-

Total equities	-0.2%
Alternative Assets	0.5%

Now looking at the equity protection strategy, the nominal value of the portfolio which was protected rose in value over the quarter by 3.1% and the value of the options detracted by £18.4m from the value of the Fund. This effectively reduced the return to the fund by 0.2%.

The indicative funding level as at 31 June 2019 was 101.5% and by 30 September 2019 was 103.1%.

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

Performance

as at 30 September 2019

	Qtrly Performance		Financial Y.T.D.	
	SYPA	Benchmark	SYPA	Benchmark
	%	%	%	%
FIXED INTEREST				
Royal London	4.2	3.7	6.4	5.7
UK ILGs	9.6	9.8	11.5	11.9
High Yield Bonds	2.2	3.7	4.8	5.7
EM Bonds	1.1	0.9	4.5	4.2
TOTAL	**6.6**	**6.9**	**8.8**	**9.0**
UK EQUITIES	**1.1**	**1.3**	**5.4**	**4.6**
INTERNATIONAL EQUITIES				
Developed Market - BCPP	2.8	2.8	9.9	9.8
Developed Market - SYPA	2.6	2.8	9.0	9.8
Emerging Market - BCPP	-1.4	-0.6	1.6	3.3
Emerging Market - SYPA	-5.9	-0.6	-19.6	3.3
TOTAL	**1.8**	**2.0**	**7.7**	**8.3**
PRIVATE EQUITY	**6.1**	**1.3**	**12.8**	**2.9**
PRIVATE DEBT FUNDS	**2.1**	**1.3**	**5.7**	**2.9**
INFRASTRUCTURE	**4.8**	**1.3**	**6.6**	**2.9**
PROPERTY	**0.7**	**0.7**	**1.0**	**1.4**
CASH	**0.1**	**0.1**	**0.3**	**0.3**
TOTAL FUND excl EPO	**3.0**	**2.8**	**6.9**	**6.3**
EQUITY PROTECTION (EPO)	**-36.7**		**-1146.5**	
TOTAL FUND	**2.8**	**2.8**	**6.2**	**6.3**

Performance attribution

For the quarter, the Fund returned 2.8% in-line with the expected return of the benchmark, with the Fund valuation rising from £8694.4m to £8913.8m.

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

UK Equities
After a period of very strong performance stock selection was negative over the quarter.

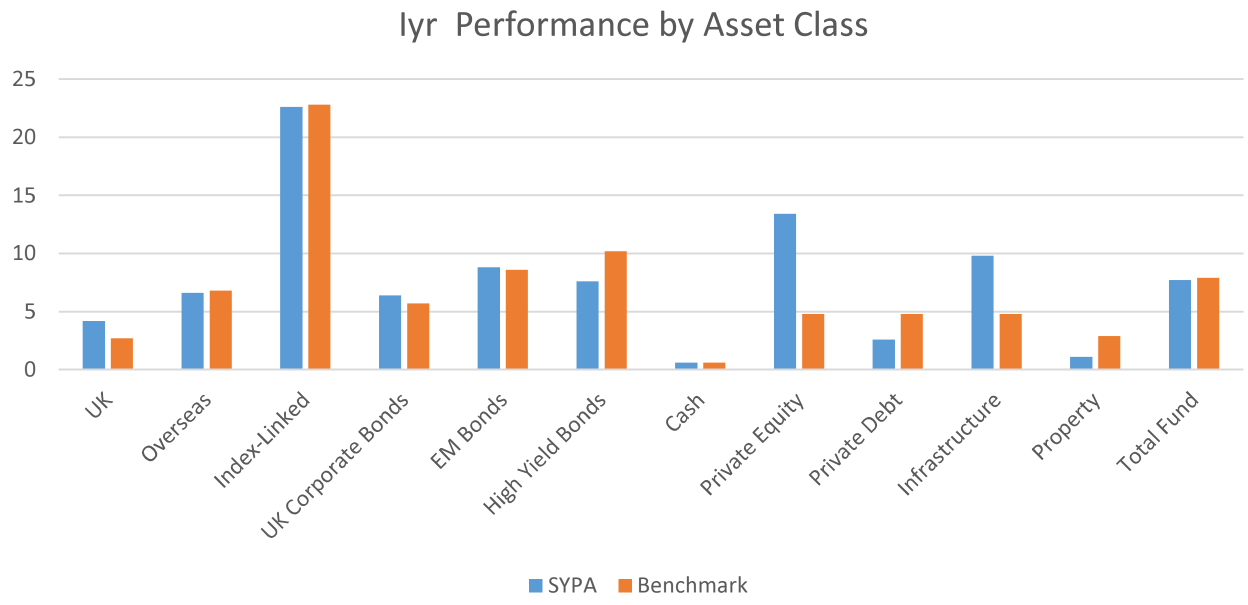
Overseas Equities
Stock selection was in-line across the developed markets but was negative across the emerging market portfolios. The residual portfolios are being sold down and are not expected to perform in-line with the benchmark.

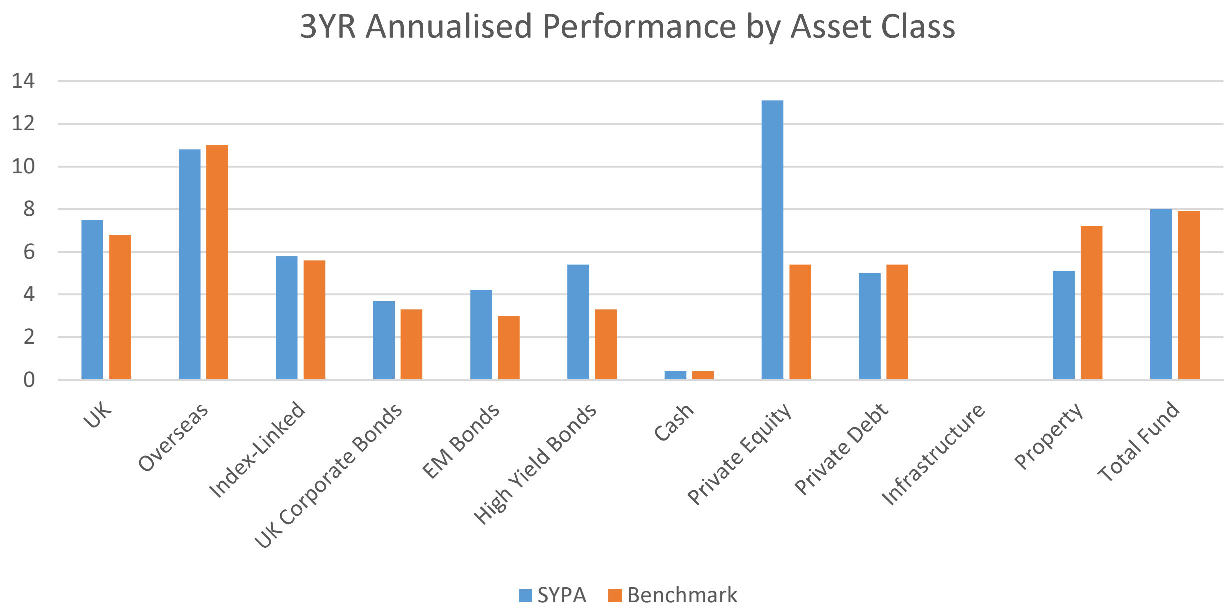
Alternatives
The performance across all the portfolios was positive.

Property
Performance was in-line with the benchmark.

Equity Protection
With the continued improvement in equity markets the equity protection strategy detracted value from the Fund.

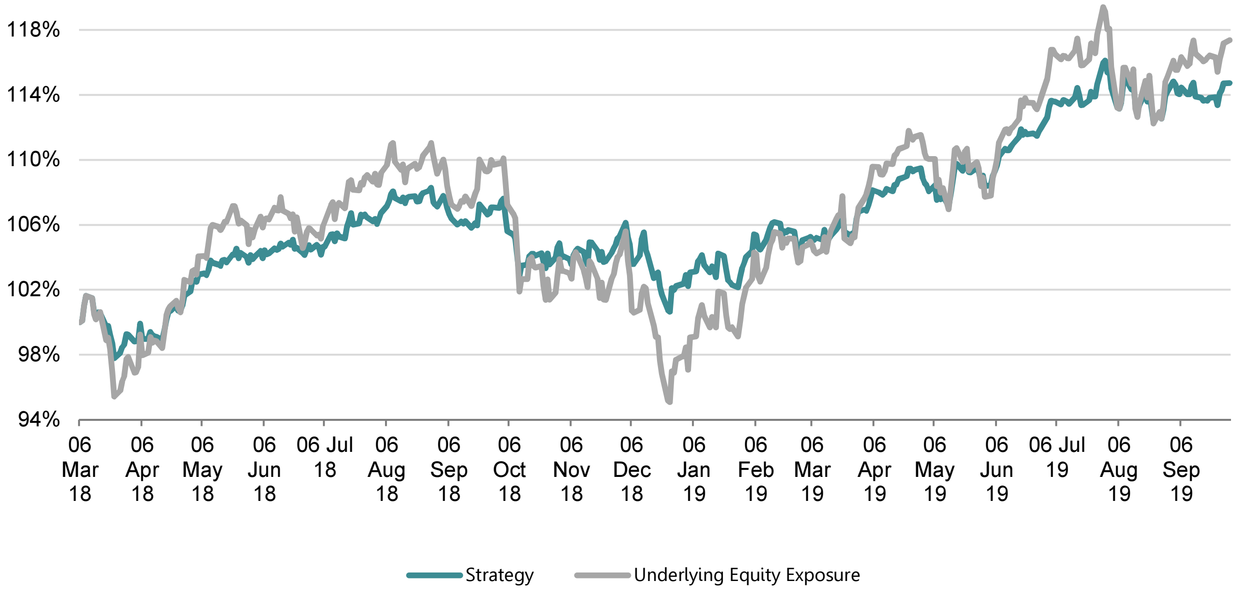
Performance-Medium term





Equity Protection

The equity protection strategy generated a negative return over the quarter given the rise in the financial markets. The strategy impacted the Fund value by £18.4m, which detracted from overall performance by 0.2%.



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 September this negative impact was £68.5m.

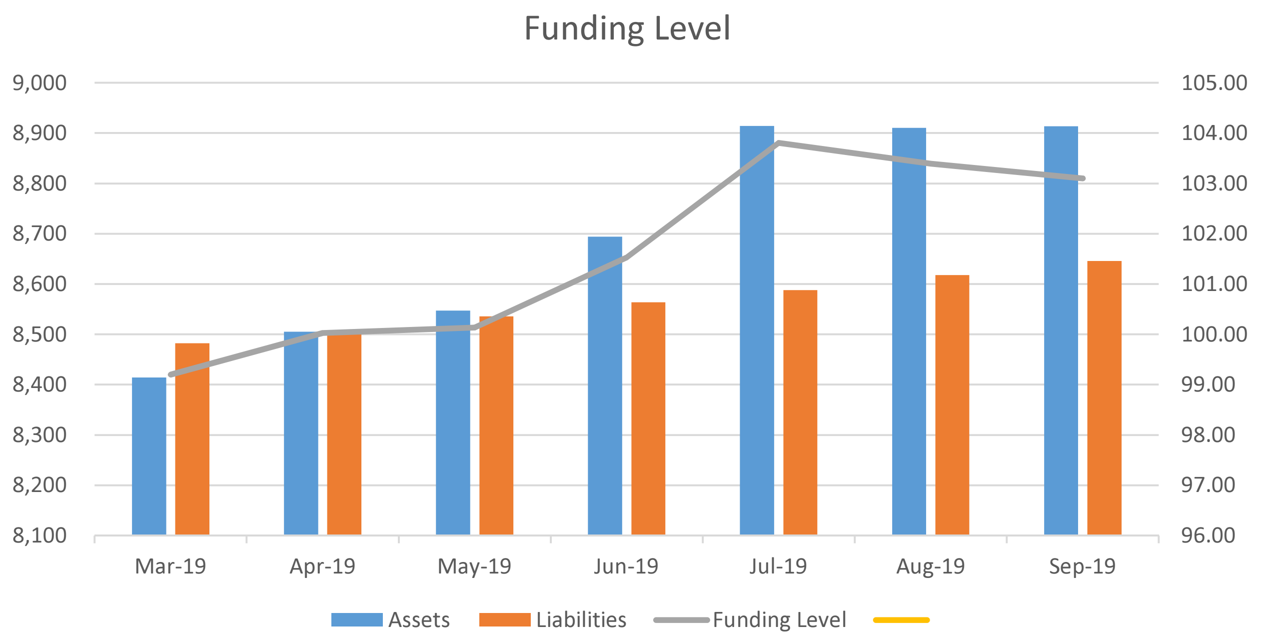
Funding Level

Last quarter we reported that the Funding level was 104% However the liabilities last quarter were calculated using the discount rate from the 2016 Valuation. Since then the discount rate has been adjusted by the Actuary for the 2019 Valuation expectations and the funding level at June would now be 101.5%. The funding level as at 30 September 2019 increased to around 103.1%.

The breakdown is as follows:

Fund's Assets:
As at 30 Sep 2019: £8,913.8m
As at 30 June 2019: £8,694.4m
An increase of £219.4m.

Funds Liabilities:
As at 30 Sep 2019: £8,646m
As at 30 June 2019: £8,564m
An increase of £82m.



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 revised down for all major regions for both 2019 and 2020 and the key concern is that the central banks have insufficient headroom 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 a significant impact.

The Federal Reserve cut rates 25bps in October 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 announced that it will be restarting its quantitative easing programme with €20 billion purchases a month.

UK Equities

Brexit continues to dominate the headlines with a further postponement announced but with the added complication of a general election on the 12th December. 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. Concern remains that further quantitative easing risks merely boosting asset prices. Even though we have high rates of government debt it is now becoming likely that fiscal policy will 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 in most markets. We expect market conditions to remain volatile, with a slowdown in global economic growth punctuated by rising and falling trade tensions and additional monetary and fiscal stimulus. We 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.

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

Bonds

Gilt yields are currently close to the all-time low, following other developed bond markets, although Brexit has undoubtedly been a major factor.

Investment grade spreads widened a little over the quarter but are still seen as vulnerable to economic shocks or upward surprises to gilt yields.

Global high yield spreads widened in August but are still a long way off the highs seen in early 2016. Levels remain low in a longer–term context and given the longevity of the economic cycle, it is difficult to make a case out for going long of high yield risk right now.

Dollar denominated emerging market bonds look relatively attractive in terms of yields and spreads over US Treasuries.

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.

ASI have decreased their anticipated 3 year forecast for property returns from 1.3% to 1% due to their expectations of negative GDP growth in 2020 with the negative consequences for UK property returns. They are expecting negative capital returns in each of the next three 12 month periods. They expect negative total returns in the first 12 month period but forecast that income returns will then keep total return positive thereafter.

Will continue to reduce the Fund's retail weighting and will look to make further acquisitions in the industrial sector or assets with long dated income in one of the alternative sectors.

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.

Cash

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

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PENSIONS AUTHORITY

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