LONDON BOROUGH OF SOUTHWARK - Quarterly Report March 2021

Market Background

The positive momentum in equity markets built up in the December quarter continued into the new quarter. Global markets gained 6% in local terms but near 4% allowing for a stronger Pound. An improving economic outlook, positive news on Covid vaccine efficacy and central banks' willingness to maintain 'accommodative' monetary policies in the short-term all added to the optimism.

This improved market environment was positive for more cyclical 'value' sectors (industrials, oil & gas etc.) helping to explain the broad regional variances in returns. In local currency terms, Japan and Europe performed best due to their particular sectoral biases. Emerging markets lagged as rising levels of Covid infections in developing countries and a stronger US Dollar weighed.

With renewed global growth widely anticipated in the second half of this year and with it, an expectation of higher inflation and tightening monetary policy, government bond yields rose sharply over the quarter. Total returns were negative for both conventional and index linked bonds.

Property returns were modest but positive. There are signs of rental values stabilising after a period of prolonged decline.

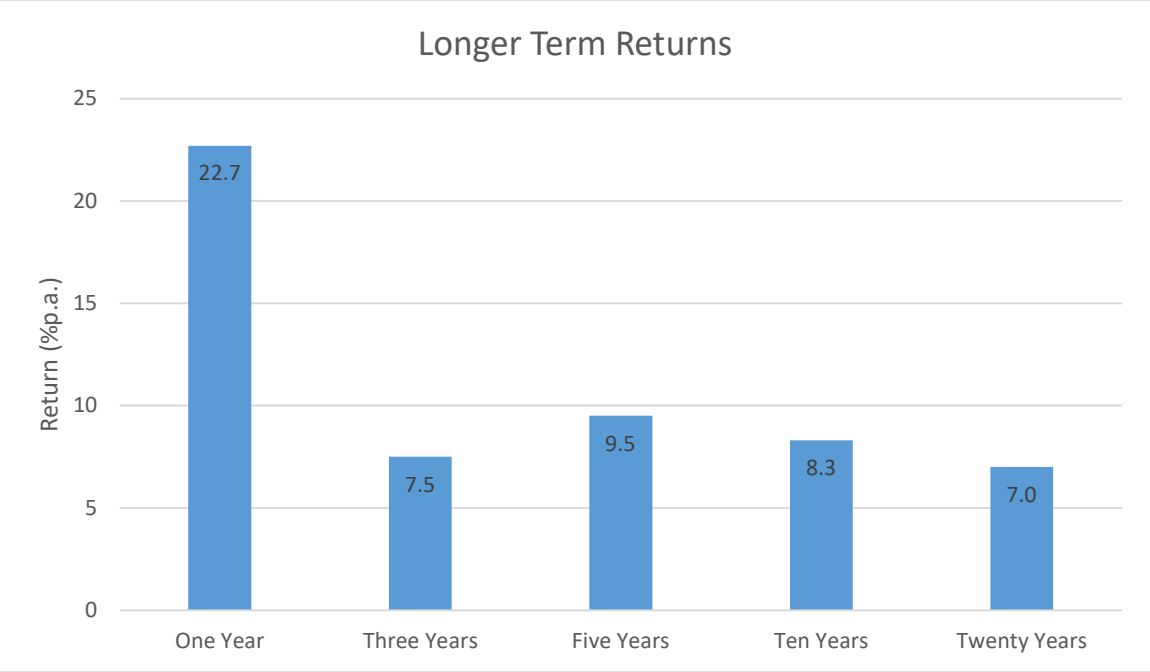
LGPS Funds

The average local authority fund was expected to record a return of just over 2%.

Longer Term

Now that the large market fall at the start of 2020 has dropped from the one-year number, the fiscal year result is estimated to be close to 23%.

The three-year number is back to 7.5% p.a., well ahead of most funds' expectations. Over the medium term the returns remain strong with the ten-year result now above +8% p.a. and the twenty-year return +7% p.a.



Total Fund

The Fund returned around 2% over the quarter, almost exactly in line with the benchmark.

Performance from the Fund's managers was mixed. The analysis below shows the make-up of the returns, absolute and relative.

			Returns			Contributions		
Manager	Brief	Start Value (£m)	Fund	Benchmark	Relative Return	Fund	Benchmark	Relative
BLK	Equity/ILG	512,114	1.7	1.7	-0.0	0.5	0.5	-
LGIM	Equity/ILG	536,078	2.0	1.5	0.5	0.6	0.4	0.1
BLK	Diversified Growth	192,371	0.1	0.8	-0.6	-	0.1	-0.1
BLK	Absolute Return Bond	134,018	1.3	1.0	0.3	0.1	0.1	-
Newton	Equity	229,769	4.3	4.5	-0.2	0.5	0.5	-
Brockton	Property	4,932	10.0	3.6	6.2	-	-	-
Nuveen	Property (Core)	212,414	3.9	2.5	1.4	0.4	0.3	0.2
Invesco	Property	15,136	0.7	1.9	-1.2	-	-	-
M&G	Property	22,366	0.3	1.9	-1.7	-	-	-
Frogmore	Property	8,573	-13.6	3.9	-16.9	-0.1	-	-0.1
Glenmont	Infrastructure	14,660	0.1	2.4	-2.3	-	-	-
Temporis	Infrastructure	24,384	0.0	2.4	-2.3	-	-	-
BLK	Infrastructure	3,399	3.5	2.4	1.1	-	-	-
Cash	Cash	18	0.0			-	-	-
Total		**1,910,231**	**2.0**	**2.0**	**0.0**	**2.0**	**2.0**	

By way of explanation, the third column from the right shows how much the managers have contributed to the overall return e.g. Newton added 0.5% whilst Frogmore detracted 0.1%. The column on the right-hand side shows how much the managers have contributed to the excess return e.g. Nuveen was the biggest contributor adding 0.2%.

The one-year return for the Fund was an extremely healthy 24.4% almost 1.5% above benchmark – an excellent outturn.

Medium-term, the Fund has returned between 9.6%p.a. and 10.4%p.a. over the three and five-year periods. The shorter period return was ahead of benchmark, the longer period marginally behind.

Over the last ten-years, the Fund has delivered a very respectable 9.4%p.a. return but 0.3%p.a. off the target.

Returns have been improving of late and while long-term returns are still sub-benchmark, the margin is reducing. The legacy of poor active equity performance which had the Fund trailing by 2% to 3% p.a. a few years ago is diminishing.

Newton – Active Global Equity

On a gross basis i.e., before the deduction of fees, Newton outperformed the world index by 0.2%. Stock selection within the technology sector and overweighting financials were the positive contributors. *After fees and relative to the stretched (index plus target aspiration) benchmark, the portfolio lagged by 0.2%.*

The portfolio's annual return was strongly positive but significantly behind the benchmark index (moreso the target) for a fourth quarter – fund 36.2%, benchmark (inc. stretch) 43.1%.

Longer-term numbers are very solid in absolute terms but remain some way short of target (particularly nearer-term).

BlackRock - Active

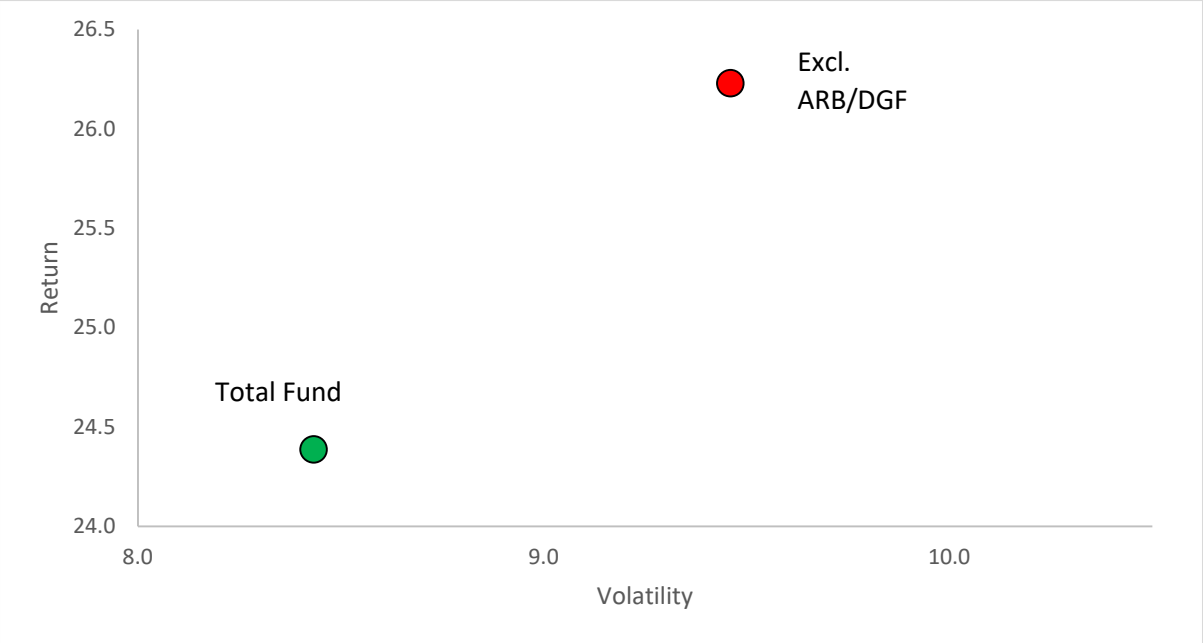
It will come as little surprise that the two active positions continued recent momentum with positive returns outstripping their cash-like benchmarks.

Performance in the ARBF portfolio was broad based and positive (1.3%) against a backdrop of negative returns generally from traditional bonds. The return from the DG portfolio was muted at 0.3% with positive equity returns offset by weakness in bonds.

Since their inception, returns from both strategies have been low digit single figures. In combination, the result has been broadly in line with the 3-4% absolute return sought.

These two portfolios hold traditional assets, but return profiles are designed to deliver results differently. In strong growth environments, returns will appear dampened, but in down markets, returns should be less impacted. Importantly, overall Fund volatility should reduce.

The chart below illustrates the impact over the full year to December. The actual Fund outcome is the green plot, the notional outcome (excl. ARB/DG) is the red plot.



This albeit short-term picture has returned to 'normal' in a return sense as growth assets have re-exerted dominance. What we see here is that the addition of these assets has dampened volatility, as expected, but has had a more pronounced detrimental effect on returns. This is the trade-off!

Nuveen Real Estate – Core Property

The portfolio performance was positive over the quarter, returning 2.3% (Nuveen numbers). Capital appreciation and income contributed in equal measure. The return of positive valuation growth is encouraging, with the portfolio's industrial assets performing well and by a greater margin than the falls in its retail holdings.

The portfolio's direct investments performed better than the indirect holdings, of which there is now only one, the Retail Warehouse Fund which, according to the manager, has reached or is nearing its valuation trough.

Near-term returns are disappointing for the asset class generally, but medium and longer-term numbers stack up very well. The current seven-year number of 6.1%p.a. is behind the 7%p.a. target set by the Panel.

The short-term outlook for the sector remains subdued, but the manager is bullish about the portfolio's direction of travel.

Other Real Estate

Reported returns were typically behind benchmark over the quarter and the full year. Quarterly reporting helps little in understanding investments in this sector.

Southwark's Property Allocation

The core and added value/opportunistic assets continue to perform quite differently, with the former typically outperforming the latter.

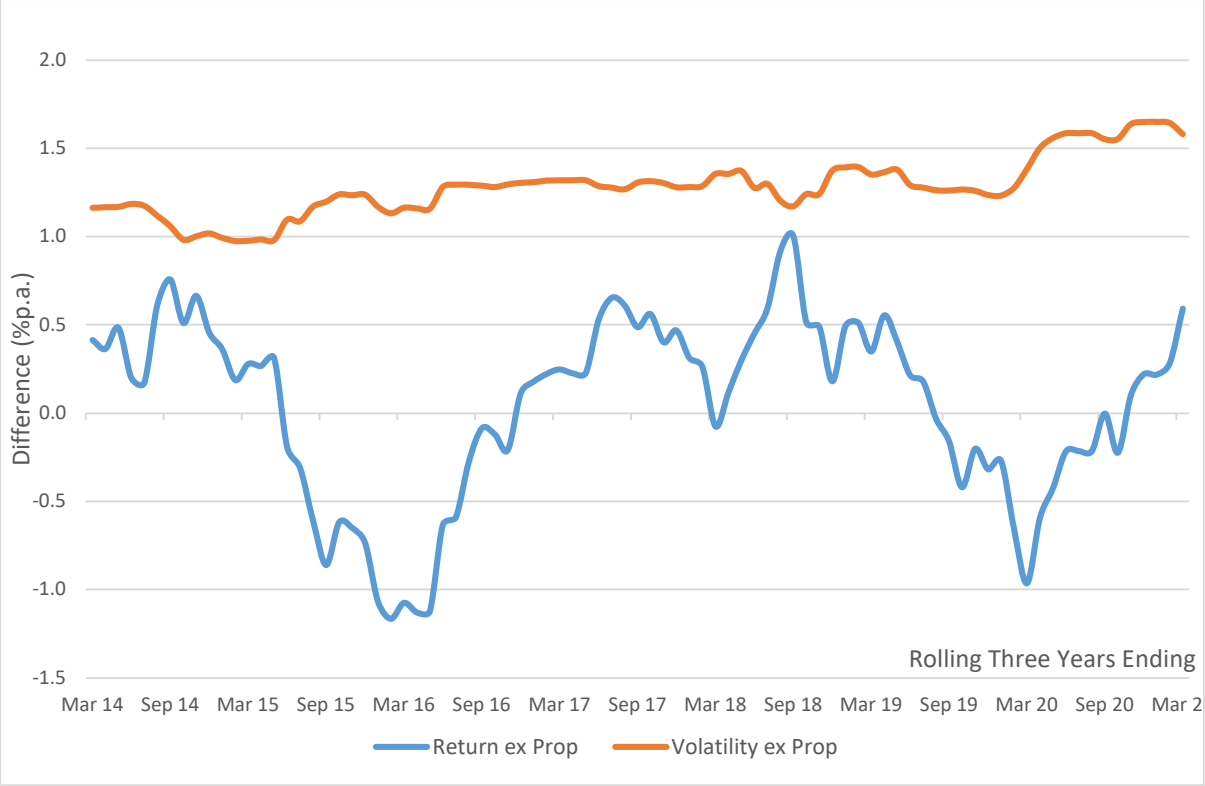
As mentioned previously, the added value/opportunistic portfolios are still early stage so a measure of underperformance against their relatively challenging benchmarks is not unexpected.

The core allocation is just shy of 80%, so this will realistically dictate how the Fund's real estate assets perform.

The Fund's large commitment to the asset class is an important differentiator in its overall strategy.

The chart below shows the impact on risk and return over consecutive rolling three-year periods.

In the latest three-year period, without property the overall return would have been higher (around 0.6%p.a.) but volatility significantly higher (by around 1.6%p.a.). This continues to be a very acceptable trade-off.



Passive Portfolios

The passive mandates have largely tracked the respective benchmarks as we would expect.

Summary

- A quieter quarter for funds following the roller-coaster that was calendar 2020!
- Funds have performed extremely well in general and ours is no different
- Despite recent market turbulence, assets have grown more than actuarial assumptions and so funding levels will have improved
- The moving parts that underly the Fund's performance have generally moved in the right direction.
- Newton has delivered extremely positive returns but continues to struggle against the target aspiration. As our only active equity manager this is disappointing
- Returns from the newer infrastructure and smaller property portfolios appear behind target but we should remind ourselves that these are longer-term investments. Short-term performance measures are often spurious