Deloitte.

City of Westminster Pension Fund
Q1 2020 Investment Update

Introduction

This note has been prepared for the City of Westminster Pension Fund Committee ("the Committee") regarding the investments currently held in the City of Westminster Pension Fund ("the Fund") in light of an extremely volatile period for investment markets.

The purpose of this report is to provide an update on market performance over the quarter, alongside an estimated valuation of the Fund's investment portfolio as at 31 March 2020 and an indication of the extent of, and explanations for, the change in valuation over Q1 2020.

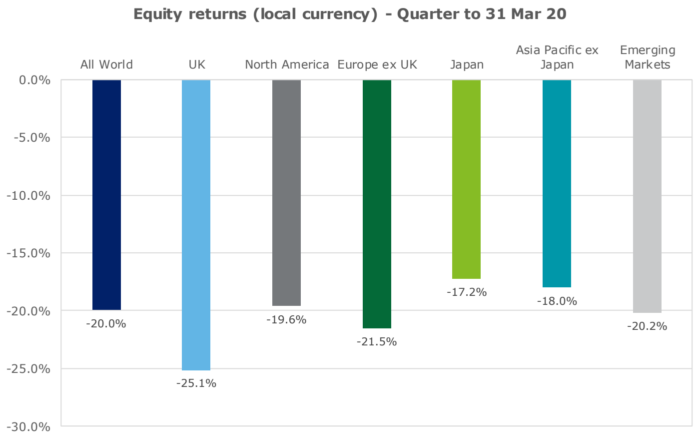
Market Update

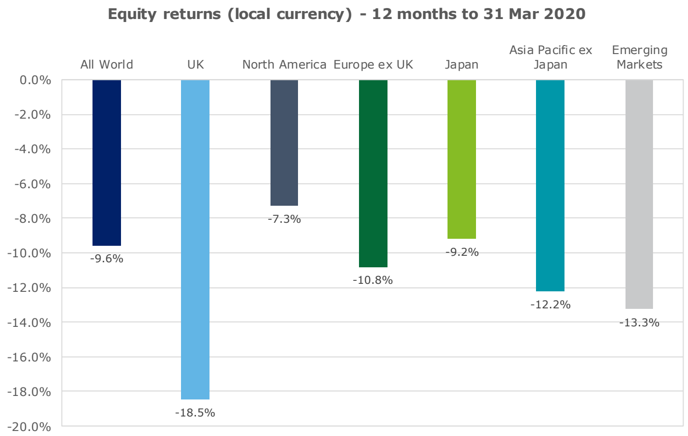
Global equity markets

At the start of the quarter, equity investors were more focused on the generally benign economic outlook and were relatively indifferent to the coronavirus outbreak under an apparent assumption that the virus would remain relatively contained within China and that central banks would offer the requisite monetary stimulus to offset the relatively minor resulting economic weakness.

In the end it proved to be a historically bad quarter for equity markets globally as the Covid 19 virus spread quickly and resulting economic fallout worsened. The 20% fall in global equity markets rivals falls seen during the global financial crisis, however the speed of the falls and the volatility within markets were more extreme. During the second half of February, global equity markets experienced their steepest weekly fall since the 2008 Global Financial Crisis. March was a particularly volatile month. On Monday 16 March for example, the S&P 500 Index registered its largest daily fall since Black Monday in 1987.

The extreme trends in equity prices mirror the severity of the coronavirus outbreak. With the virus proving highly transmittable, containment has been vital to slowing its spread. The restrictions on travel and the severe lockdown measures introduced have had an immediate and extreme impact on economic activity. The outbreak is now truly global and its spread through Europe, and now the US, has proved particularly worrying and is of particular significance to the health of the global economy and the continued stability of financial markets more generally.



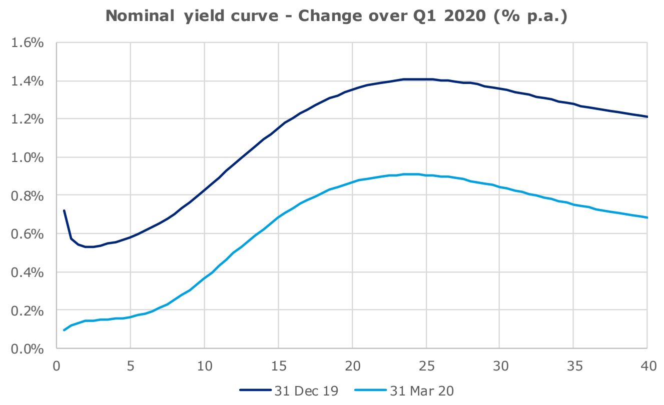


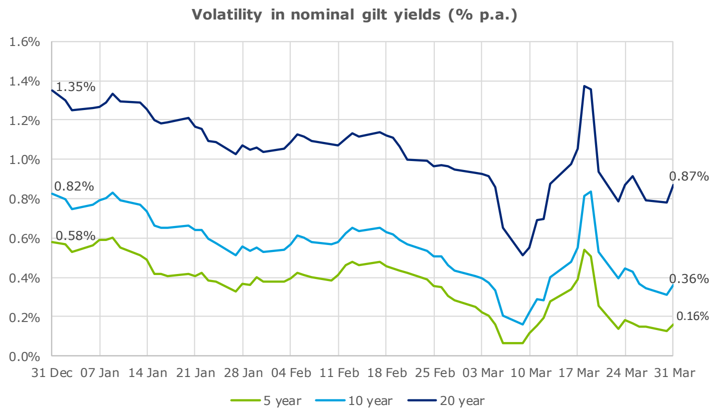
Returns would have been worse still if it hadn't been for a rally in equity markets over the last week of the quarter in response to the sheer weight of stimulus offered by central banks and governments. Time will tell whether the recent recovery is well-founded and that recent falls in equity indices are reflective of the true scale of the economic downturn. It is hoped that volatility from this point on will be less extreme, but like the outbreak itself, the future direction of markets is inherently uncertain.

Gilt yields

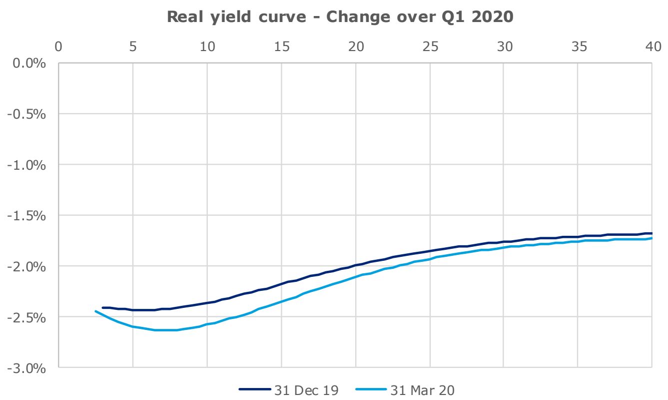
Gilt yields trended lower over the quarter, in line with the deterioration of economic outlook and the Bank of England's subsequent rate cuts and quantitative easing measures.

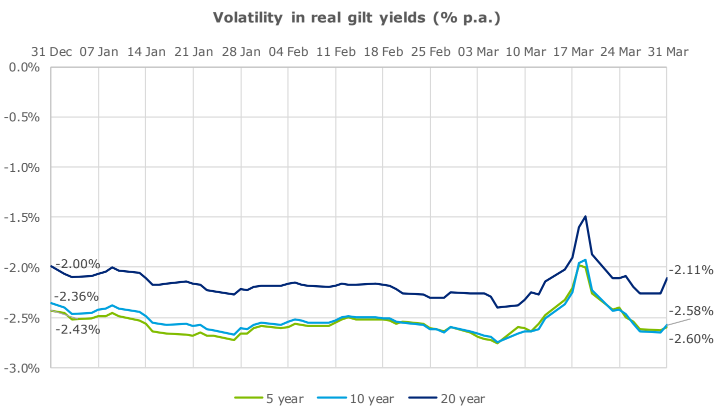
However, like equity markets, gilt yields were also highly volatile over the quarter. At the beginning of March a sharp increase in risk aversion caused yields to plummet. Yields then reversed their downward trend rising sharply as investors sought to raise cash and potentially in anticipation of a future surge in supply to fund the government's stimulus package. By the end of the quarter, gilt yields had trended lower again thanks to a general calming of markets and the expansion of the Bank of England's quantitative easing programme specifically.





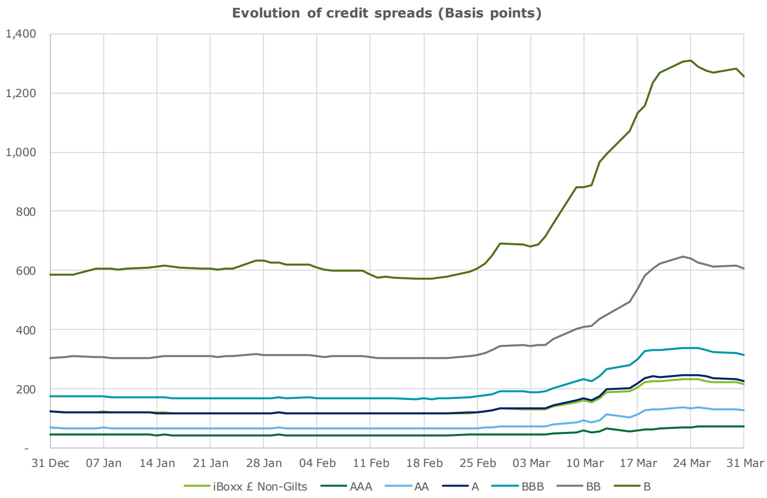
Real yields on index-linked gilts trended lower over the quarter, but to a much lesser extent, with the anticipated decline in economic activity, and a significant decline in oil prices specifically, causing inflation expectation to fall.





Corporate bonds

As risk appetite diminished and default risks become elevated, credit spreads have also increased sharply.



Credit spreads (bps)	31 Dec 2019	31 Mar 2020
iBoxx £ Non-Gilts	122	216
AAA	45	72
AA	68	128
A	122	226
BBB	176	313
BB	304	607
B	586	1,254

As well as the obvious increase in the probability of default, which shouldn't be underestimated given the severity of the economic slowdown, investor demand for liquidity has also contributed to the rise in spreads.

Corporate issuers are finding it more challenging to service their debt obligations given the disruption to cashflow. However, central bank promises to extend quantitative easing programmes to cover investment grade credit and short term commercial paper has helped to stabilise spreads. In fact, preliminary data suggests that there has been spike in corporate debt issuance over March. This suggests that central bank support for the corporate bond market is working, successfully encouraging companies to raise the debt necessary to keep their businesses functioning and their workers employed.

Credit spreads remain high and a sharp rise in issuance will work to keep spreads at elevated levels. Whilst, some investors might be tempted to re-enter the market or increase corporate bond positions, heightened default risks remain and the market has become more illiquid increasing trading costs.

Property and private market assets

Reduced business activity and disruption to corporate cashflow has also affected property markets. Tenants across all sectors are requesting rental deferment, with the hotel, leisure and non-essential retail sectors being the hardest hit. Government contribution to salary overheads is likely to ease some pressure.

The same theme is true across all areas of private markets, with corporate cashflow and the ability to service payments and debt obligations being the key risk. Private debt typically lends to higher levered companies. Average leverage of 4-6x debt-to-earnings are much higher than the 2-3x leverage typical in public investment grade markets, putting sponsors under more pressure. There could also be less refinance capital available in the market, with the influx of central bank money not reaching this market and institutional investors unlikely to commit to illiquid investments for the time being.

Business continuity is essential. Private equity managers are not typically long-term holders of companies. While it is common for PE managers to stress test and implement contingency plans for events such as natural disasters and cyber security, they may not have considered the possibility and implications of widespread quarantine.

Infrastructure assets are generally considered essential for society, however asset usage is key. Assets that are heavily linked to GDP risk are likely to suffer. Even if the asset itself is relatively stable, there could be an impact somewhere along the supply chain. Again, highly geared assets and companies will come under more pressure.

In line with government guidance, construction of assets is likely to be delayed, affecting strategies with development projects. The cashflow impact of operational delays are usually hedged, with construction risk often lying with the developers. However, this protection is likely to be lost in the event of the developer's insolvency.

An issue across all real assets and private markets is valuation. With limited liquidity and fewer transactions in the market, valuations become less reliable. Many UK property managers have therefore applied gating restrictions on their funds, deferring subscriptions and redemptions for the time being, as well as the distribution of income.

Given the illiquid nature of private market assets, the full impact of the Covid 19 outbreak is likely to be felt in the months ahead.

Fund valuation as at 31 March 2020

The table below provides an estimated valuation of the Fund's investment portfolio as at 31 March 2020 based on figures provided by the Fund's investment managers, compared against the corresponding valuations as at 31 December 2019.

Fund	31 December 2019 (£m)	31 March 2020 (£m)	% change in valuation (estimate)*
Legal & General World Equity Index Fund – GBP Currency Hedged	661.0	523.4	-20.8%
LCIV Global Alpha Growth Fund	318.6	276.4	-13.2%
Longview Global Equity Fund	71.6	55.5	-22.5%
Insight Buy and Maintain Fund	231.5	219.1	-5.4%
LCIV Multi Asset Credit Fund	95.0	78.8	-17.0%
Hermes Property Unit Trust Fund	62.9	62.2	-1.1%
Aberdeen Standard Investments Long Lease Property Fund	67.5	68.6	1.6%
Pantheon Global Infrastructure Fund III	18.6	17.8[1]	-7.9%[2]
Cash	18.9	19.0	1.0%
Total[3]	**1,545.4**	**1,320.7**	**-14.6%**

Source: Individual investment managers and have not been independently verified.
Figures may not sum to total due to rounding.
*May not account for all cashflows over the period. Where cashflows have occurred, this has been assumed at the end of the period for the purposes of % change calculation. Excludes residual value held in Majedie.
[1]Pantheon valuation based on 31 March 2020 NAV, converted from USD to GBP, and reduced by 10% based on Pantheon estimation of value as a proportion of NAV.
[2]Percentage change modified to take account of £0.7m capital call for investment over Q1 2020.
[3]Fund cashflows over the quarter are accounted for in the percentage change figure.

Equity allocation

As perhaps would be expected, the largest contribution to the fall in total Fund valuation over the quarter came from the Fund's equity allocation.

The Legal & General World Equity Index Fund – GBP Currency Hedged fell in value by 20.8% in what proved to be a historically bad quarter for global equity markets as a direct result of the Covid 19 pandemic. Global equity markets were previously down by c. 30% over the quarter to 23 March 2020, with a late rally over the last week of the quarter helping to restore parity at least slightly.

The LCIV Global Alpha Growth Fund, managed by Baillie Gifford, fell in value by a considerably modest 13.2% over the first quarter of 2020 as the strategy's large cap exposures in emerging market economies delivered flat to marginally positive returns over the period. The strategy's strategic positions in Financials and Industrials have proved favourable over the quarter.

Longview's global equity strategy also fell in value considerably over the quarter (c. 22.5%). Longview's c. 30% exposure to cyclical businesses, which are highly exposed to economic risks, contributed negatively to performance with US pharmaceutical stocks also badly impacted by the Covid 19 pandemic.

Bonds allocation

The Insight Buy and Maintain Fund held up reasonably well over such a volatile period, decreasing in value by 5.4% with Insight generally viewing the risk of default as a low probability event – there have been no defaults as at 31 March. Insight continues to monitor and stress-test all holdings in the Buy & Maintain Fund to ensure issuers have sufficient liquidity and resilience to a potential recession. The fund is well positioned to withstand the likely increase in credit downgrades of investment grade rated bonds and can hold sub-investment grade bonds, with the primary focus of the fund to buy and hold credit which the manager believes are "money good".

The LCIV Multi Asset Credit Fund, managed by CQS, fell in value by 17.0% over the quarter. CQS' high yield bond exposures have contributed the most to negative performance over the first quarter of 2020 with default risks increasing considerably for those bonds at the lower end of the credit rating spectrum. The strategy's exposure to US oil, gas and consumable fuels companies proved to be the most noticeable detractors to performance within high yield, impacted by the ongoing oil trade war alongside Covid 19 impacts.

Investor demand for liquidity is unlikely to waive, with credit spreads likely to remain elevated. The LCIV Multi Asset Credit Fund may be subject to further volatility and pricing reductions over the coming weeks while Covid 19 continues to impact investment markets.

Property allocation

Both Hermes and Aberdeen Standard's valuations are subject to material uncertainty. The Hermes Trust's valuers have confirmed that they are still able to produce valuations and make professional judgements, however given the market volatility and lack of market evidence available, there is much less certainty than under normal market conditions. The Trust has the ability to defer redemptions for up to three quarters, however, as of yet, dealing has not been suspended.

Aberdeen Standard has taken the decision to defer redemptions, switches and subscriptions in the Long Lease Property Fund. This has been a move driven by a valuation perspective rather than a cash issue, i.e. the property valuers have expressed discomfort at being able to put an appropriate and relevant price on assets at this time. Aberdeen Standard, as per the Terms and Conditions, may delay redemptions for up to 12 months. All redemption requests received from now will be put into a queue and settled when the strategy has been brought out of deferral. In addition, where income options have been selected, Aberdeen Standard has suspended the income facilities on each of the impacted funds, including the Long Lease Property Fund, for the duration of the deferral period.

Hermes is regularly monitoring its position in response to receiving a mixture of requests for deferrals and monthly payments rather than quarterly, together with "rental holidays" requests, which had been previously anticipated to some extent. The Trust recorded quarterly rental collection rates of 56% with retail and leisure sectors recording collection rates below 30%. The industrial and office sectors, usually contributing c. 70% of the total rent demanded, were recording collection rates of approximately 50% and 70% respectively. The Trust continues to hold ongoing conversations with tenants and has taken a pragmatic approach to support tenants for the remainder of this uncertain period.

As at the end of March 2020, none of the Trust's planned sales have been impacted. In February, the Trust completed the sales of two London office investments that had reached business plan completion and were considered to carry some degree of risk with limited future growth potential.

Aberdeen Standard has confirmed that the long lease strategy has received 77% of its Q2 rent, likely rising to 90%, although many tenants have initiated negotiations for deferrals going forward. Hotels, leisure and non-essential retail, representing c. 10%, 5% and 5% of the portfolio respectively have been impacted the most, with supermarkets (19%) and offices (25%) having paid rent in full.

Infrastructure equity allocation

Pantheon typically reports performance quarterly in arrears and uses a cash roll forward to estimate more up to date valuations. Given the current market conditions, this estimation is not a fair representation of the Pantheon Global Infrastructure Fund III's ("PGIF III") current position. Pantheon have suggested a 10% discount to this roll forward valuation is applied although clearly this is a very vague estimate. Pantheon are working on producing a flash valuation on Pantheon's own funds at the end of the month that will provide a more accurate representation of valuations.

Infrastructure assets which are particularly exposed to GDP risk will clearly be at risk to the developments following the Covid 19 outbreak. The extent of any impact will depend wholly on the degree and the lifetime of any potential recession. As of Q3 2019, Pantheon reports that 36% of assets in the PGIF III portfolio have GDP linkages, although this is mitigated through short-to-medium term contracts and diversified sector exposures.

Pantheon expects its transportation assets, such as its large airport exposure, and those GDP-linked assets with a high exposure to volume type risks to be impacted in the short-term by the Covid 19 outbreak. For example Project Gemini, a secondary investment in Gatwick airport, is likely to be materially impacted with numerous regular flights cancelled and countries in "lock down". Project management teams are working on contingency plans to preserve cash and are planning to raise c. £300m from banks.

In addition, the reduction in energy usage and prices, sensitive to the extent and length of any recession, will likely impact the strategy's midstream, energy and power assets over the short to medium term.

Deloitte Total Reward and Benefits Limited
15 April 2020

Risk Warnings

- Past performance is not necessarily a guide to the future.
- The value of investments may fall as well as rise and you may not get back the amount invested.
- Income from investments may fluctuate in value.
- Where charges are deducted from capital, the capital may be eroded or future growth constrained.
- Investors should be aware that changing investment strategy would incur some costs.

Our advice will be specific to your current circumstances and intentions and therefore will not be suitable for use at any other time, in different circumstances or to achieve other aims or for the use of others. Accordingly, you should only use the advice for the intended purpose.

Deloitte.