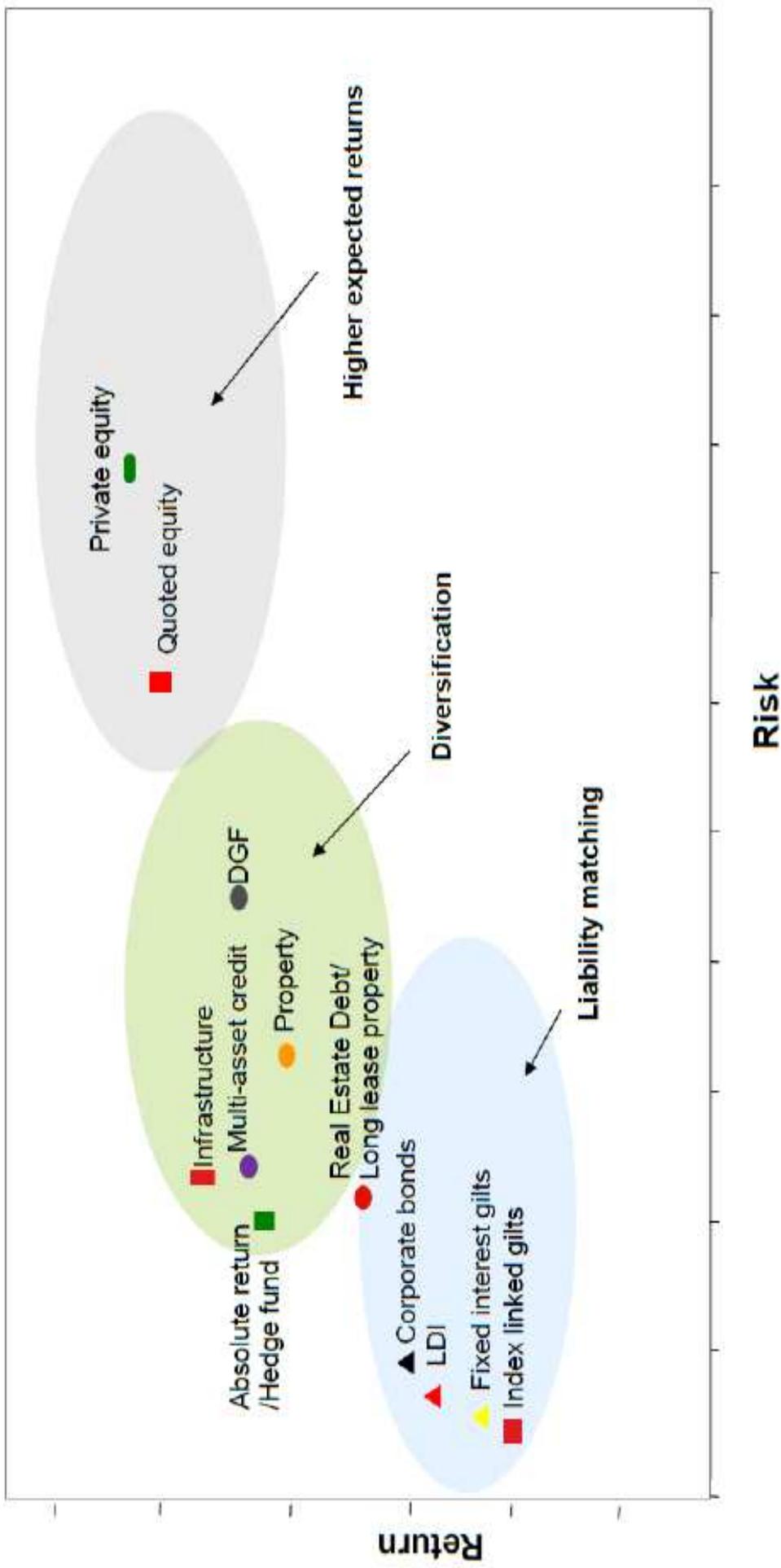


PRESENTATION TO TOWER HAMLETS PENSIONS BOARD  
INVESTMENT STRATEGY AND DIVESTMENT FROM FOSSIL FUELS

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26 NOVEMBER 2018

# Risk and return



Manager	Mandate	Value at 30 <sup>th</sup> September 2018 £m	Strategic Weight of FM AUM*	Actual Weight of FM AUM	Under/(Over) Weight Target	Date Appointed
L&G (Unhedged Global Equity)	Global Equity	85.486	5.00%	5.48%	0.48%	01- Dec-2017
L&G (Hedged GEq)	Global Equity	23.34	1.00%	1.50%	0.50%	01- Dec-2017
L&G (Low Carbon Global Equity)	Global Equity	251.552	15.00%	16.12%	1.12%	01- Dec-2017
LCIV BG (Global Equity)	Global Equity	351.618	20.00%	22.54%	2.54%	05-Jul-07
						22 Apr 2016**
LCIV BG (Diversified Growth)	Absolute Return	135.032	10.00%	8.66%	-1.42%	22-Feb-11
						15 Feb 2016**
LCIV Ruffer (Total Return Fund)	Absolute Return	133.88	10.00%	8.58%	-4.15%	08-Mar-11
						15 Jun 2016**
LCIV CQS (MAC)	Multi Asset Credit	91.26	6.00%	5.85%	-2.70%	31 May 2018
Legacy Mandate	Global Equity	0.078	0.00%	0.00%	0.00%	01- Dec-2017
L & G Index Linked-Gilts	UK Index Linked	0	0.00%	0.00%	0.00%	02-Aug-10
GSAM	Bonds	51.545	3.00%	3.30%	0.30%	04-Apr-16
Insights	Bonds	47.784	3.00%	3.06%	0.06%	01-Jul-16
Schroder	Property	159.324	12.00%	10.21%	-1.79%	30-Sep-04
Schroder	Equity Protection Strategy	214.158	15.00%	13.73%	-1.27%	06 September 2018
Internal cash Management	Cash	15.001	0.00%	0.96%	0.96%	N/A
<b>Total</b>		<b>1,560.059</b>	<b>100.00%</b>	<b>100.00%</b>	<b>0.00%</b>	

Asset Class	Strategic Weight	Actual Weight
	%	%
Equities	50	54.8
Diversified Growth Funds	20	17.2
Absolute Return Funds	12	12.2
Property	12	10.2
Index-linked Gilts	6	4.6
Cash	0	1.0

Weights as at 30 September 2018.

Actual weights for Equities and Index-linked gilts have had to be estimated from Schroders Equity Protection Strategy data.

How sound is the investment strategy?

### **Liability matching**

- How sensitive is the fund to a fall in fixed income gilt yields and a consequent rise in the value of the liabilities?
- Is there sufficient protection against a rise in inflation?

### **Return seeking**

- Is the split between equities and other return seeking assets appropriate?
- How sensitive is this part of the fund to movements in equity prices?
- How diversified is the fund across non-equity asset classes?

### **Other risks**

- How sensitive is the value of the assets to movements in sterling?
- How exposed is the fund to the credit cycle?
- How difficult would it be to sell assets to raise cash if required?

## Divestment from fossil fuels

- The Regulations state that the fund can take environmental factors into consideration provided that pension fund members do not suffer significant financial loss.
- Tower Hamlets has a lower carbon exposure than a benchmark of other pension funds and the fund's equity portfolio also has a lower carbon exposure than that of the MSCI ACWI equity index .
- This is partly attributable to a commitment to the L&G Passive Low Carbon Global Equities fund, as well as to the relatively low carbon exposure of other funds held.
- These other funds do not specifically target low carbon exposure and low exposure will have arisen for a number of reasons, including stock selection and sector allocation for other reasons. For example, the very large tech stocks such as Alphabet (Google) and Facebook have relatively low carbon exposures.
- The stage in the economic cycle will have a major influence on the performance of low carbon or fossil free portfolios. For example, the energy and material sectors are carbon heavy and cyclically sensitive.
- Therefore it will not be easy to establish whether bad performance is caused by an environmental strategy or for other reasons and the time period for measurement will be critical.

## Divestment from fossil fuels

- Performance from an environmental as well as from a financial perspective will need to be measured.
- Is “Fossil Fuel Free” better than “Low Carbon” and what about exclusion of companies rather than engaging with companies to improve the situation?
- From a financial perspective, an active manager should benefit from having the widest universe of stocks from which to choose so the approach to the environment adopted is liable to have financial implications.

Year	Annualised return, %		
	1	3	5
LCIV (BG) GA (USD)	11.61	15.66	11.64
MSCI AC World ND (USD)	10.20	13.14	9.68
MSCI ACWI (USD)	10.35	14.02	9.25
MSCI World Low Carbon Target (USD)	11.44	13.89	9.89
MSCI World Core Infrastructure (USD)	4.49	10.15	7.80
FTSE EO Renewable and Alternative (USD)	-5.00	8.00	4.90
FTSE All-World ex Fossil Fuels (USD)	-0.50	8.20	7.30
FTSE Developed ex Fossil Fuels (USD)	1.00	8.60	7.90
FTSE Global Core Infrastructure (USD)	4.90	10.50	8.40
FTSE Developed Core Infrastructure (USD)	5.90	10.50	8.80

- Crucially, the government has regulated for LGPS funds to invest through Pools which is likely to severely limit the range of acceptable approaches to environmental strategy, as well as whether an active as distinct from a passive investment strategy can be employed.

## Divestment from fossil fuels

### **Other considerations are:**

- The situation will be fluid over the next 5 years and flexibility will be required as regulations and the investment manager products on offer change.
- There is a danger that stocks which tick the environmental boxes become very expensive compared to their fundamental values as investors embrace ESG to an ever greater extent. Timing purchases could become important in avoiding unfavourable short term supply / demand imbalances. The converse is also likely to apply.
- Passive (as distinct from active) fund management is likely to exacerbate this situation and it will be important to consider, for example, active as well as passively managed low carbon funds.
- A transition to “fossil fuel free” from “low carbon” will need to be handled carefully as clearly the scoring system will change. More generally, environmental scoring systems will no doubt become standardised with distortions in the first instance.