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London Borough of Hammersmith and Fulham
Equity Portfolio Review

Introduction
This note has been prepared for the Pensions Sub-Committee ("the Sub-Committee") of the London Borough of Hammersmith & Fulham Pension Fund ("the Fund"). The purpose of this paper is to provide the Sub-Committee with a review of the Fund's equity holdings and potential points to consider.

Current Equity Allocation
The table below shows the Fund's current allocation versus the strategic benchmark allocation.

Asset Class	31 March 2018	31 March 2018	Benchmark Allocation	Relative Allocation
Majedie	**£159.1m**	**16.0%**	**15.0%**	**1.0%**
UK Equity Fund (LCIV)	*£125.2m*	*12.6%*		
UK Focus Fund	*£19.9m*	*2.0%*		
Tortoise Fund	*£14.0m*	*1.4%*		
LGIM World Equity	**£303.2m**	**30.4%**	**30.0%**	**0.4%**
Total	**£462.3m**	**46.4%**	**45.0%**	**1.4%**

At the start of the year the Sub-Committee carried out an equity rebalancing exercise, disinvesting £60m from Majedie and invested the proceeds with Ruffer, albeit the funds were to be used to fund capital calls for the Partners Group and Aviva infrastructure funds over the longer term. As a result of this, the Fund's strategic benchmark within the equity portfolio changed to 67% LGIM, 33% Majedie (from 50/50).

As at 31 March, the Fund was slightly overweight its equity allocation, however we see the main issues to be addressed as being:

1. The exposure to the UK equity market; and
2. Whether a low carbon alternative would be more suitable than the current passive global equity mandate.

UK Market Exposure
Majedie's UK equity fund and focus fund is benchmarked against the FTSE All-Share Index. Although mostly UK stocks, both funds have flexibility to invest up to 20% in shares listed outside of the UK. As at 31 March, 32.5% of the Fund's total equity allocation was invested in UK stocks, whereas c. 6% of the global equity index is invested in UK stocks.

This analysis excludes the Tortoise Fund which is an equity long/short fund targeting a positive absolute return regardless of how the equity market is performing. In managing the portfolio, Majedie has scope to adjust the extent to which the portfolio retains market directional exposure (beta) and can therefore potentially 'short' the market.

With questions over the outlook for economic growth and the uncertainty around the implications of the UK's exit from the EU, the Sub-Committee should give thought as to whether this overweight exposure to the UK equity market is appropriate going forward.

Exposure to Carbon

In our separate 'Carbon Exposure Report' we discuss the potential risks associated with fossil fuel investments and options to mitigate this risk. One option relating to the passive equity exposure is to select a different index for the fund to track. The MSCI Low Carbon Target Index was developed to address the growing concern from investors about their investment in fossil fuels and the recent trend to reduce their exposure. Two of the largest index tracking fund managers (Legal and General and BlackRock) have products available which track the MSCI Low Carbon Target Index. Further details on each of these funds are given below.

LGIM World Low Carbon Target Index Fund

The Fund aims to track the performance of the MSCI World Low Carbon Target Index to within +/- 1% p.a. for two years out of three. This is an optimized strategy that develops the lowest attainable carbon portfolio within the 0.30% tracking error budget to the parent MSCI World Index.

Fund Launch Date	August 2015
AuM (as at 31 December 2017)	£1,002m
Fees	0.220% per annum of the first £5 million, plus 0.195% per annum of the next £10 million, plus 0.170% per annum of the next £35 million, plus 0.145% per annum of the balance above £50 million The LGPS rate is 7.94% TER flat fee. This is split by AMC of 2.75% and OFC of 5.19% - of which license fee is included.

BlackRock Authorised Contractual Scheme (ACS) World Low Carbon Equity Fund

The Fund aims to track the MSCI World Low Carbon Target Index. The index aims for a tracking error target of 0.30% relative to the MSCI World Index while minimizing the carbon exposure by up to 80%.

Fund Launch Date	December 2017
AuM (as at 31 December 2017)	£168m
Fees	AMC of 0.20%. Admin and custody expenses were 0.02% at the end of February 2018.

LGIM Future World Fund

An alternative strategy that clients could consider is the LGIM Future World Fund, which focusses on wider climate risk as opposed to solely carbon exposure. This Fund aims to capture the transition to a low carbon economy by having a lower exposure to companies with worse than average carbon emissions and fossil fuel assets, and higher exposure to companies that generate revenue from low carbon opportunities.

The objective of the Fund is to replicate the performance of the FTSE All-World ex CW (Controversial Weapons) Climate Balanced Factor Index (which LGIM worked with FTSE-Russell to create) whilst not necessarily holding all of the constituents. The anticipated annual tracking error relative to the Index is +/-0.60% in two years out of three.

As part of LGIM's Climate Impact Pledge, it ranks and analyses c. 90 companies. LGIM actively engages with companies with low scores for a period of one year and if no change is observed the company is added to the list to be disinvested from the Fund. LGIM will publish the list of disinvested companies, as well as the market leaders, on a semi-annual basis. The public nature of these announcements will only improve company engagement.

Conclusion

UK Market Exposure

While we rate Majedie and the portfolio managers responsible for all three products, we would question the Fund's need for such a large (relative) allocation to the UK equity market given current concerns. We would also question the Fund's need for a concentrated active UK Equity portfolio (the Focus Fund), the performance of which is correlated to the larger mandate (the Equity Fund).

Considering both points, we would be supportive of a reduction in the Majedie exposure, taking from the Focus Fund in the first instance. This would be used to increase the Fund's global equity allocation, keeping the total equity exposure the same at 45%. The Sub-Committee may also wish to consider the benefits of the Tortoise mandate, given the other diversifying strategies within the Fund's investment portfolio.

Exposure to Carbon

Recognising the importance of this issue, we would encourage the Sub-Committee to gain a greater understanding of the Fund's overall 'carbon footprint'. The MSCI Low Carbon Target Index would be an appropriate replacement for the FTSE All World, the index the current passive equity mandate tracks, given the reduced exposure to fossil fuels as well as the similarities of performance. It should be noted that there are alternative strategies, such as the Future World Fund, which could also suit the needs of the Fund depending on the overall objective towards fossil fuel and sustainable investment.

Deloitte Total Reward and Benefits Limited
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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 will incur some costs.
- Any recommendation in this report should not be viewed as a guarantee regarding the future performance of the products or strategy.

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.

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