Rebalancing Recommendation

Addressee

This paper is addressed to the Officers and Pensions Committee ("the Committee") of the London Borough of Hackney Pension Fund ("the Fund"). This paper sets out our recommendation to the Committee to continue the Fund's implementation of its strategic asset allocation to reduce its equity holdings and fund an allocation to private lending. This paper should be considered alongside the January Committee paper entitled "Review of investment strategy - Recommendations"

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Introduction

As part of the Fund's 2018 investment strategy review the Committee agreed to reduce the Fund's equity allocation in order to fund a 10% allocation to two private lending mandates. This was designed to achieve diversification of the Fund's sources of risk and return, and to increase the level of income generated by the Fund's investments.

Due to the nature of how private lending funds are funded, the 10% reallocation from equities to private lending will be gradually drawn down over three years. The funds may be called by the private lending managers with relatively short notice, and so it is important that the funds be held in highly liquid assets whose value will not fluctuate significantly over time. It was therefore agreed that the assets would be gradually sold from equities and held in a short-dated bond fund managed by BlackRock taking a phased approach. An initial 5% was taken from equities and held in the BlackRock Short Bond fund and was used to fund the first calls for the two private lending mandates.

Current Asset Allocation

The table below shows the Fund's asset allocation against current target as at 30 September 2020.

Mandate	Active/ Passive	Actual Proportion	Target benchmark	Relative
London CIV Sustainable World Equity	Active	15.4%	13.0%	2.4%
BlackRock World Equity	Passive	18.4%	13.0%	5.4%
BlackRock Low Carbon	Passive	11.1%	10.0%	1.1%
BlackRock UK Equity	Passive	7.7%	10.0%	-2.3%
RBC Emerging Market	Active	4.8%	4.5%	0.3%
Invesco DGF	Active	3.9%	5.0%	-1.1%
GMO DGF	Active	5.7%	7.5%	-1.8%
Total Growth		67.0%	63.0%	4.0%
Columbia Threadneedle Pension Property	Active	7.5%	7.5%	0.0%
Columbia Threadneedle Low Carbon Property	Active	1.5%	2.5%	-1.0%
Churchill Senior Loans	Active	2.6%	4.0%	-1.4%
Permira Senior Loans	Active	1.8%	6.0%	-4.2%
Total Income		13.4%	20.0%	-6.6%
BMO Bonds	Active	16.3%	17.0%	-0.7%
BlackRock Short Bond	Passive	3.3%	0.0%	3.3%
Total Protection		19.6%	17.0%	2.6%
Total Scheme		100%	100%	

The above table shows the Fund's underlying portfolio split as at the 30 September 2020. Please note that as at the issuance of this note the 30 September valuations were not available for the Churchill and Permira mandates and thus the previous quarter's figures were used.

The most notable relative positions are the following:

- Relative to their strategic allocation of 50.5% of total assets, equities are 6.9% overweight. Combined with the underweight position in the DGFs, this means that the Fund is 4.0% overweight to total Growth assets.
- The Fund is 6.6% underweight to Income assets. This is entirely expected given the early stage of the private lending mandates' lives, meaning they are still drawing down assets. This will be funded over time from the overweight position in equities.
- The Protection assets are 2.6% overweight the strategic benchmark. This is due to the BlackRock Short Bond fund not having a strategic allocation but is used to hold assets for funding the private lending mandates. Like the equity overweight, this will reduce over time as the private lending mandates are funded.

Recommendation

We recommend that the Fund reduces the equity allocation by 3% with proceeds invested in the BlackRock Short Bond fund, pending investment in the private lending strategy. This recommendation is based on the following factors:

- This represents stage 2 of the reduction in equities to fund private lending, with a further 2% to follow prior to completion of the agreed mandate commitments.
- Given equity markets have recovered a significant proportion of their losses from early 2020, in some cases being in positive territory for the year, we consider this to be a suitable time to rebalance the Fund's equity allocation towards target.
- It ensures the Fund is in a comfortable position to meet ongoing cash requirements.

Implementation & Next Steps

We suggest that implementation is carried out such that 3% of total Fund assets are sold from the BlackRock World Equity fund and transitioned into the BlackRock Shorted Dated Bond fund. The cash redeemed from the sale will be used to fund both the Churchill and Permira mandates going forward.

The Committee is asked to consider the Funds current strategic position and whether they consider this to be a suitable time to reduce the equity allocation by 3%.

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General Risk Warning

Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of an overseas investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.