

REPORT PREPARED FOR
Oxfordshire Pension Fund Committee

9 June 2023

Philip Hebson

MJ Hudson

philip.hebson@mjhudson.com

This document is directed only at the person(s) identified on the front cover of this document on the basis of our investment advisory agreement. No liability is admitted to any other user of this report and if you are not the named recipient you should not seek to rely upon it.

MJ Hudson's Investment Advisory business comprises the following companies: MJ Hudson Investment Advisers Limited (no. 4533331), MJ Hudson Investment Solutions Limited (no. 10796384), MJ Hudson Consulting Limited (no. 13052218) and MJ Hudson Trustee Services Limited (no. 12799619), which are limited companies registered in England & Wales. Registered Office: 1 Frederick's Place, London, EC2R 8AE. MJ Hudson Investment Advisers Limited (FRN 539747) and MJ Hudson Investment Consulting Limited (FRN 541971) are Appointed Representatives of MJ Hudson Advisers Limited (FRN 692447) which is Authorised and Regulated by the Financial Conduct Authority. The information in this email is intended only for the named recipient(s) and may be privileged or confidential. If you are not the intended recipient please delete the email, notify us immediately and do not copy, distribute or take action based on this email. Although emails are routinely screened for viruses, MJ Hudson does not accept responsibility for any damage caused. References to 'MJ Hudson' may mean one or more members of MJ Hudson Group plc and /or any of their affiliated businesses as the context requires. For full details of our legal notices, including when and how we may use your personal data, please visit: <https://www.mjhudson.com/legal-and-regulatory/>.

Summary

The value of the Fund in the quarter rose to £3.15bn, an increase of £95m compared to the end December value of £3.05bn. The Fund produced a return of 3.1% over the quarter, which was -0.4% behind the benchmark. The main reason for this underperformance was the private market elements, which continued to show some catch up in valuations, falling to reflect a more cautious outlook. This was exacerbated by some significant falls in the valuation of the property assets. Over a 12-month period the Fund recorded a negative relative return against the benchmark of -2.9% (-3.7% v.-0.8%). The scale of the recent underperformance has also had an impact on the longer term performance periods, now behind the benchmark over the three and five year periods and in line over the ten year period, details of which can be found in Brunel's report.

The content of the Brunel Performance Report has improved significantly, such that it provides the important information for the Committee to consider in a much clearer format. This includes a concise narrative against each sub Fund within OPF's portfolio. I will continue to highlight particular points of interest, but I will try to avoid unnecessary duplication of content!

The highlights

1. It is encouraging to see another lift in value for the Fund over the final quarter of the 2022-23 financial year. The relative performance is disappointing, but this shows that challenges still remain, economically and politically. The shame is that markets really had been quite buoyant in January and February, but then came the collapse of Silicon Valley Bank and Credit Suisse which unleashed another bout of volatility. Not surprisingly the Financials sector was particularly hit hard.
2. With the exception of UK Active Equity, the equity funds enjoyed both an increase in value and positive relative performance against benchmarks over the quarter. That's the good news, but over the year there remains a significant fall in value with poor performance to recover from.
3. The stand out performance for me is Global High Alpha Equity, which is showing an outperformance over all reported time periods, including 2.2% since inception
4. The Fixed Income portfolio also showed some further recovery in Q1. This includes Multi Asset Credit, which frankly has been very disappointing through the upheavals of 2022.

The lower points

1. The Listed Private Equity portfolio had a very mixed quarter in performance terms; with 3i increasing in value by 25.8% through to ICG Enterprise declining by -15.9%. The FTSE All Share index gained in value by 0.6%. Longer-term performance remains

well in excess of the wider public market. The discounts to NAV continue to be much wider than we have seen in recent times, but the underlying health of the portfolios is substantially better than the discounts imply. As confidence returns, I would expect to see those discounts start to narrow again. I have included some further thoughts in the “Thinker” section.

2. As flagged last time, some of the valuations relating to Infrastructure had started to look rather vulnerable, in comparison to the wider market. Thus in Q1 we have seen some mark downs in valuations, but this is not universal as some types of assets remain in demand.
3. Likewise valuations in the Property sector have in general terms seen another weak quarter, but with some areas performing comparatively well, such as the Private Rental Sector. The UK saw a very sharp fall in values in Q4 2022, so has actually performed relatively well during Q1 as other regions have to some degree been catching up. Valuations are starting to offer some good buying opportunities for long term investors. The same comments apply to Secured Income, being property based.
4. Our Unlisted Private Equity valuations continued to trend downwards during Q1, reflecting growing economic concerns and comparisons to public markets.

Points for consideration

1. The staff recruitment and retention issues at Brunel are clearly a cause for concern at the current time. This is leading to delays in investigating and progressing some of the outcomes from the Strategic Asset Allocation review. Hopefully there will be an early resolution of the issues behind this.
2. My opening comments referred to the recent poor performance relative to benchmark now having an impact on the longer-term performance of the Fund. Along with other Funds, this issue has been raised with Brunel by OPF. While a magic wand isn't available to fix this, Brunel are focusing their attention on attempting to identify weaknesses in their processes with regard to the investment management structure. For me, the flaw lies within the multi manager system, so that has to be made to work better.
3. The revised format of the Brunel report is to be welcomed, particularly the section dealing with Private Markets. It would be good to see the Fund value included over the short, medium and long term periods. The emphasis on assets transitioned to Brunel is not particularly useful, in my opinion.
4. In due course would Brunel consider taking on the elements of Diversified Growth Funds and Multi Asset Credit as stand alone sub funds, so as to give member Funds better flexibility in selecting assets to meet their requirements? It is acknowledged that their current resource constraints are an issue.

Outstanding Action Points and Recommendations

Strategic Asset Allocation review

1. UK Equity exposure. Please refer to the separate paper that considers the realistic options that could be considered to potentially reduce the percentage of total equities listed in the UK and what alternative investments could be considered.
 - a. Scale of reduction. There are many benefits to maintaining a significant discreet exposure to UK equities, which includes holding GBP assets (no currency translation risks) which match the GBP liabilities and also structured correctly would provide “local” economic exposure in UK plc. At the current time I would suggest a reduction to 20% of total equity assets. To keep this simple this would be excluding the UK exposure in the global mandates.
 - b. Options.
 - i. Future UK exposure. While appreciating that Brunel has resource constraints at the current time, it is suggested that further research should be undertaken into the characteristics of companies represented within the FTSE 250 index, looking in particular at the Paris Alignment criteria and their contribution to and from the UK economy. Subject to satisfactory analysis, this would form the future discreet UK equity exposure.
 - ii. Reducing excess UK exposure. Looking at the options available, realistically the two options would be the Paris Aligned Brunel Passive sub-fund or the Sustainable Equities sub-fund. Both have their attractions (and detractions), but in the longer term Sustainable Equities should have the edge in terms of both investment returns and meeting climate change aspirations. However this decision should be taken in conjunction with considerations concerning the Emerging Markets mandate discussed below.
 - iii. Do nothing.
2. Emerging Markets (EM) exposure, ex China. Brunel has informed us that there isn't demand at the current time from other Funds for an Emerging Markets ex China sub Fund.

Options

- a. Continue to seek an ex China EM manager. Realistically this would have to be via Brunel, potentially using one of the existing EM managers. OPF would have to bear all the costs associated with this, at least until other Funds seek this option.
- b. Divest from Emerging Markets. The Fund position is currently sub optimal as it stands, so this isn't as dramatic as it sounds. The proceeds could be reinvested in the Paris Aligned Brunel Passive sub fund (no exposure to EM) or the Sustainable Equities sub fund (which does have EM exposure).

- c. Do nothing.
- 3. Local Investment Proposals. Progress with considering possible options has again been hindered by lack of resource at Brunel. However the Funds are continuing to look at possible local investment opportunities. Consider this to be work in progress.
- 4. Hedging. Having investigated the pros and cons of establishing an occasional use facility to hedge our main currency exposures against adverse movements, it is considered that the potential costs are likely to outweigh the benefits. Events can move so rapidly that attempting to get the timing right moves this more into the world of gambling. A recent example of this was when the Bank of England changed their forecast for the outlook for the UK economy, which has seen GBP strengthen rather than weaken against the USD and Euro. Never say never, but not for now.

Other outstanding action points

- 5. To progress a Brunel led training programme for Fund elected members and others that will provide information about the asset classes that they manage and their processes.

Overview and Outlook thoughts

Global overview

Q1 was a strong quarter for equities and bonds, however the headline numbers obscure some dramatic market events that took place. Macroeconomic data was generally resilient in the quarter, as inflation continued to decline (with the exception of the UK), employment data generally showed tight labour markets and Central Banks continued their rate hikes, albeit at a slower pace. The focus on inflation and Central Bank outlooks took a backseat in early March, as a confidence crisis, which started with US-tech focused Silicon Valley Bank (SVB), spread to other similar US lenders (Signature Bank, First Republic), and then to struggling Swiss bank, Credit Suisse (CS). Central Bank regulators acted swiftly to restore confidence: US Federal Reserve opened swap lines (providing liquidity to banks) and guaranteed depositors in the afflicted banks, while the Swiss National Bank (SNB) organised a rescue bid for CS from rival Swiss bank UBS. While these actions have restored confidence in the short-term, the underlying causes of the stress (mark-to-market losses on balance sheets combined with competition for deposits, both driven by the sharp rise in rates) remain, and are likely to have medium term repercussions.

Despite the banking crisis mentioned, equity markets rose over the quarter and in particular were led by growth-oriented stocks (+14.9% for growth, +0.2% for value). However, the quarterly gain of +7.7% for the MSCI World (c. +6% in GBP terms) was not a smooth ride with the index up sharply in January, before declining in February and early March as the banking crisis unfolded, and then rallying strongly to end the quarter up +7.7%. European and Japanese equities performed particularly strongly (around +12% and +7% in GBP terms respectively). The US Fed providing large amounts of liquidity led to long bond yields falling sharply in March despite a small upward move in short term rates, resulting in performances between +2% and +5% for most fixed income and interest rate-sensitive alternative asset classes (except real estate, which continued to decline -2%). Index-linked gilts and EM debt performed particularly well. Energy prices softened (oil down -7%) and the US dollar continued its weakening trend (-1%).

Quarterly GDP Growth Rate and Monthly CPI

%	GDP		CPI		
	Q4 2022	Q1 2023	Jan	Feb	Mar
UK	0.1	0.2**	10.1	10.4	10.1
US	0.7	0.6**	6.4	6.0	5.6
Eurozone	0.0	-0.2**	8.5	8.5	6.9
Japan	0.0	1.2**	4.3	3.3	3.1

Source: Bloomberg; Trading Economics.

Notes ** Forecasts based on leading indicators

UK: UK CPI EU Harmonised YoY NSA (Ticker: UKRPCJYR Index); US: US CPI Urban Consumer YoY NSA (Ticker: CPI YOY Index); Eurozone: Eurostat Eurozone MUICP All Items YoY Flash Estimate (Ticker: ECCPEST Index); Japan: Japan CPI Nationwide YOY (Ticker: JNCPIYOY Index)

Outlook thoughts

It is worth highlighting the following themes, impacting investment markets:

Tighter credit conditions following the banking crisis makes recession more likely. Keen competition between banks for deposits, together with the reaction to the SNB imposing losses on contingent “AT1” bondholders in the CS rescue, have put significant pressure on bank funding. This has fed quickly through to tighter credit conditions, which, by some measures, are as tight as they were following the 2008 financial crisis. So, while it is important to note that consumption and employment are still relatively strong in most developed economies, they are trending weaker, and the tight credit conditions will make survival tougher for any struggling businesses. This is likely to put pressure on corporate earnings in H2 2023, and increase defaults in credit portfolios.

Inflation – continuing to grind lower, but rates likely to remain elevated for some time. The UK was the outlier in the quarter with annual CPI rising in February to +10.4%, having fallen for the prior 3 months. However, headline UK inflation is expected to decline in the months ahead (current consensus c. +5% in 2023 and +3% in 2024) as energy prices have fallen from their dramatic highs last year. But while labour markets remain relatively tight, Central banks are likely to maintain high short term rates, and there is potential for the energy genie to return later in 2023. So rate cuts still look to be some way off.

Volatility has increased in “stabilising” asset classes (fixed income). Concerns over the path of US rates, and the fallout from the banking crisis has led to increased volatility in bond markets. The MOVE index, which measures the volatility of the US Treasury bond market, ended 2022 at an already elevated level of 122 but spiked in March to 199, well above the Covid-19 March 2020 levels, as bond yields fell dramatically in mid-March 2023. While this volatility has affected the rate-sensitive (long) government bond market in particular, the next phase of tighter credit is likely to see increased volatility in asset-classes exposed to credit risk (corporate bonds, private debt etc)

Equity valuations rise despite earnings risk. While US equities rallied strongly in Q1, analysts have at the same time lowered their forecast earnings for Q1 2023 and for full year earnings 2023. If correct, this will mark consecutive quarters of declining earnings, and for Q1 2023 the expected decline is the largest quarterly decline since the Covid impacted Q2 2020. This combination has led the forward earnings ratio for the S&P 500 to rise to 17.8x, from 16.7x at year end 2022. Companies have generally been guiding that they expect minimal revenue growth for 2023, and slightly contracting profit margins (albeit still at historically elevated levels of c. 11.2%). This appears to leave scope for disappointment.

Equities

Global equities rose sharply in Q1, as investors initially embraced cooling inflation data in the US before strong US economic data (jobs report, ISM survey) reminded investors that the Fed is still in a rate hiking cycle. The VIX declined over the quarter from 22 to 19, although reaching 27 in the midst of the March banking crisis.

In the US, the S&P 500 rose by +7.9% and the NASDAQ soared by +21.6%. Markets rallied despite the turmoil in banks in the US and Europe in March, seemingly driven by support from the US Fed and this potentially signalling a near term end to rate hikes.

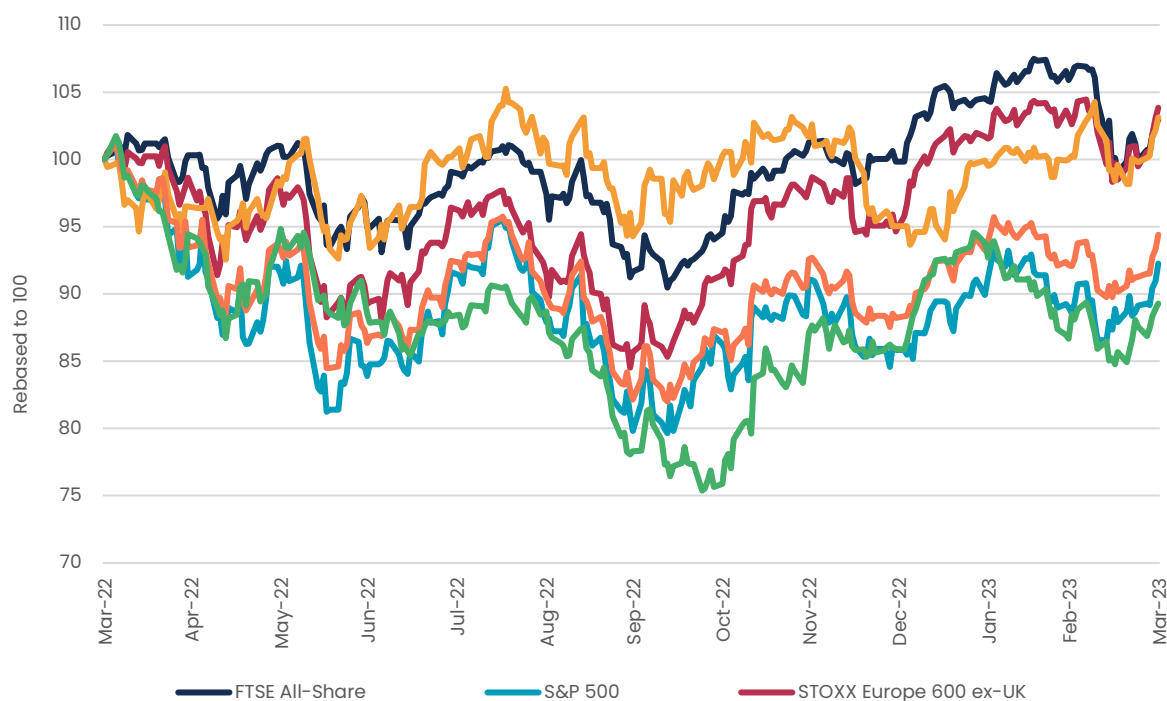
UK equities rose +2.1% in Q1 but underperformed global equities and ending below the February high. Earnings updates from large index constituents in energy and financials drove strong performance. Economic data has also proven more resilient than dire forecasts in late 2022, with a sharp decline in energy prices contributing, and the Bank of England noting that while it still expects a recession in 2023 it now expects a shallower one than previously. The BoE raised the base rate in both February and March, by 50bps and then 25bps, to 4.25%.

The Euro Stoxx 50 rose by 12.4% in Q1, to follow its strong gain last quarter. Economic data was better than expected with falling inflation and a strong PMI index result in February indicating strong business activity. The ECB raised the deposit rate twice by 50bps in the quarter, to 3.5%.

Japanese equities outperformed global equity markets, rising by +10.0% in Q1. Japanese equities appeared to be catching up to global equities after a weak Q4, and were buoyed by comments from the incoming new Bank of Japan Governor that he supported the current easy monetary conditions. Inflation has been rising in recent months but in February declined to +3.3% from +4.3% the month prior. The yen was largely flat vs the USD over the quarter.

Emerging market equities rose +4.0%, lower than global equities due to an -8.9% decline in the relatively expensive Indian equities market.

Global Equity Markets Performance



Source: Bloomberg. All in local currency.
 FTSE All-Share Index (Ticker: ASX Index) S&P 500 Index (Ticker: SPX Index) STOXX Europe 600 (Ticker: SXXP Index)
 Nikkei 225 Index (Ticker: NKY Index) MSCI World Index (Ticker: MXWO Index) MSCI Emerging Markets (Ticker: MXEF Index)

Fixed Income

Medium- and longer-term bond yields fell over the quarter resulting in solid performance for bonds, while very short-term yields rose following various Central Banks rate hikes. The

US yield curve inversion as measured by the 10 year yield –2 year yield ended the quarter at -58bps, close to the 2022 year end -61bps, but much steeper than a peak in March of -107bps. In corporate bonds, high-yield credit and investment grade performed roughly in line as credit spreads for the high yield index tightened slightly over the quarter. Emerging market bonds rose 4.8% in local currency, and 1.9% in hard currency.

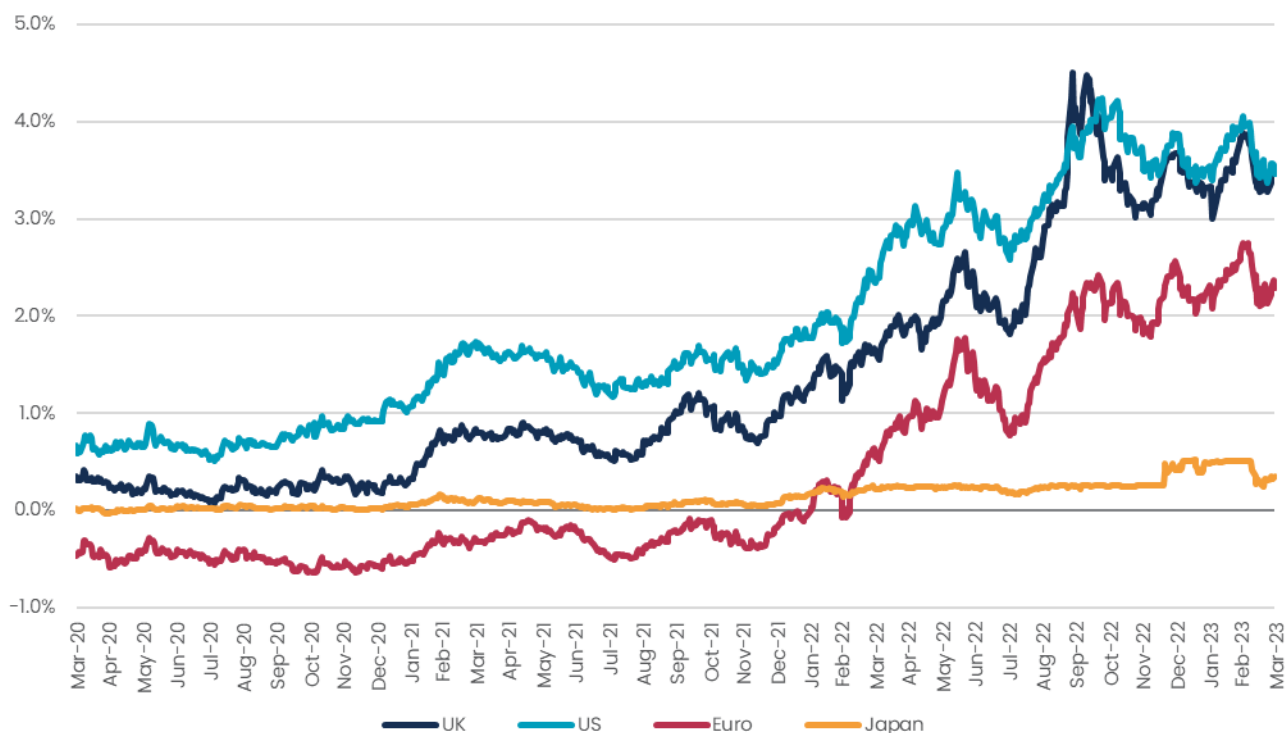
The US 10-year Treasury yield fell in Q1, ending at 3.48% from 3.88%. US rates rose initially until early March, at which point the banking crisis led the Fed to introduce new liquidity provisions. US CPI data prints also declined during Q1 but remain uncomfortably high (6.0% as of February 2023). The Fed raised their policy rate 0.25% twice in the quarter (to 4.75%-5.0%) despite the banking crisis.

The UK 10-year Gilt yield fell from 3.65% to 3.49% and 2-year from 3.60% to 3.44%. Since Q4, UK Gilts have returned to their approximate positioning relative to Bunds (UK approx. +120bps) following the sharp yield spikes due to the September/ October ‘mini budget’. The BoE hiked rates by 75bps in the quarter which led only short term rates to rise, with maturities from 2 years onwards all falling in yield.

European government bonds had a total return of 2.5% in Q1. Yield curves flattened further over Q1, as short end rates rose in response to the ECB raising its policy rate to 3.5% while yields for medium and longer term yields fell. The German 10-year bund yield fell from 2.44% to 2.29%, while Italy’s fell from 4.55% to 4.09%.

US high-yield bonds narrowly outperformed investment grade, returning 3.6% and 3.5% respectively. European high-yield bonds returned 2.9%, outperforming the 2.0% for European investment grade and 2.4% for UK investment grade.

Government Bond Yields



Source Bloomberg, US Generic Govt 10 Year Yield (Ticker: USGG10YR Index); UK Govt Bonds 10 Year Note Generic Bid Yield (Ticker: GUKG10 Index); Euro Generic Govt Bond 10 Year (Ticker: GECU10YR Index).

Currencies

In currencies, sterling strengthened against the US dollar (+2.1%) and the euro (+0.7%) over the quarter, as the ongoing high and uncertain inflation in the UK is viewed as requiring a more lengthy period of tighter monetary policy. The US dollar fell in Q1 (Dollar index -1.0%), continuing to reverse some of the prior 2022 dollar strength.

Commodities

Energy prices fell over Q1 which has supported recent headline inflation figures. Warmer weather over winter in Europe has resulted in a sharp downward repricing in natural gas, while for oil; markets continue to grapple with the trade-off between potential economic slowdown from tighter monetary policies vs a boost in demand from China re-opening and OPEC+ production cuts.

US gas prices fell -50.5% over Q1, reversing the sharp rise that occurred through 2021 and 2022 and are now back to 2020 levels.

Brent crude oil fell -7.1% over Q1, to \$80 per barrel at quarter end, although this was up from the mid-March price of \$73. Prices have continued to be volatile as fears of a recessionary fall in demand fears have clashed with supply side dynamics relating to Russia's invasion of Ukraine, OPEC+ production cuts, and China's reopening from Covid restrictions.

Gold and Copper rose +7.8% and +7.5% respectively over Q1, with gold rising as investors sought a safe haven asset amidst the banking turmoil. Copper rose with a boost from China, a significant copper importer, loosening regulations on its stricken real estate sector which has been hampered since the 2021 property deleveraging policies. Gold and Copper closed Q1 at 1,969 USD/toz and 409 USD/lb, respectively.

Property

Global listed property continued to decline, with the FTSE EPRA Nareit Global Index falling -2.0% in Q1.

The Nationwide House Price Index in the UK has continued its decline, with the price index down -1.8% for the quarter, and down -1.0% for the year. While only a modest decline, this is a considerable deterioration from the 9.5% YoY growth in Q3, and 10.7% in Q2.

European commercial property has also continued to decline in the face of higher interest rates, with the Green Street Commercial Property Price Index down by -2% this quarter and -15% for the past 12 months.

Key Indicators at a Glance

Market Indicators

Index (Local Currency)		Q1 2023	Quarter-on-Quarter	YTD
Equities			Total Return	
UK Large-Cap Equities	FTSE 100	7,632	2.1%	2.1%
UK All-Cap Equities	FTSE All-Share	4,158	1.7%	1.7%
US Equities	S&P 500	4,109	7.9%	7.9%
European Equities	EURO STOXX 50 Price EUR	4,315	12.4%	12.4%
Japanese Equities	Nikkei 225	28,041	10.0%	10.0%
EM Equities	MSCI Emerging Markets	990	4.0%	4.0%
Global Equities	MSCI World	2,791	7.7%	7.7%
Government Bonds				
UK Gilts	FTSE Actuaries UK Gilts TR All Stocks	3,080	2.0%	2.0%
UK Gilts Over 15 Years	FTSE Actuaries UK Gilts Over 15 Yr	3,797	2.8%	2.8%
UK Index-Linked Gilts	FTSE Actuaries UK Index-Linked Gilts TR All Stocks	4,172	4.3%	4.3%
UK Index-Linked Gilts Over 15 Years	FTSE Actuaries UK Index-Linked Gilts TR Over 15 Yr	4,786	4.9%	4.9%
Euro Gov Bonds	Bloomberg EU Govt All Bonds TR	213	2.5%	2.5%
US Gov Bonds	Bloomberg US Treasuries TR Unhedged	2,254	3.0%	3.0%
EM Gov Bonds (Local)	J.P. Morgan Government Bond Index Emerging Markets Core Index	130	4.8%	4.8%
EM Gov Bonds (Hard/USD)	J.P. Morgan Emerging Markets Global Diversified Index	818	1.9%	1.9%
Bond Indices				
UK Corporate Investment Grade	S&P UK Investment Grade Corporate Bond Index TR	338	2.4%	2.4%
European Corporate Investment Grade	Bloomberg Pan-European Aggregate Corporate TR Unhedged	217	2.0%	2.0%
European Corporate High Yield	Bloomberg Pan-European HY TR Unhedged	400	2.9%	2.9%
US Corporate Investment Grade	Bloomberg US Corporate Investment Grade TR Unhedged	3,072	3.5%	3.5%
US Corporate High Yield	Bloomberg US Corporate HY TR Unhedged	2,264	3.6%	3.6%
Commodities				
Brent Crude Oil	Generic 1st Crude Oil, Brent, USD/bbl	80	-7.1%	-7.1%
Natural Gas (US)	Generic 1st Natural Gas, USD/MMBtu	2.2	-50.5%	-50.5%
Gold	Generic 1st Gold, USD/toz	1,969	7.8%	7.8%
Copper	Generic 1st Copper, USD/lb	409	7.5%	7.5%
Currencies				
GBP/EUR	GBPEUR Exchange Rate	1.14	0.7%	0.7%
GBP/USD	GBPUSD Exchange Rate	1.23	2.1%	2.1%
EUR/USD	EURUSD Exchange Rate	1.08	1.3%	1.3%
USD/JPY	USDJPY Exchange Rate	132.86	1.3%	1.3%
Dollar Index	Dollar Index Spot	102.51	-1.0%	-1.0%
USD/CNY	USDCNY Exchange Rate	6.87	-0.4%	-0.4%
Alternatives				
Infrastructure	S&P Global Infrastructure Index	2,741	3.6%	3.6%
Private Equity	S&P Listed Private Equity Index	165	5.3%	5.3%
Hedge Funds	Hedge Fund Research HFRI Fund-Weighted Composite Index	17,820	1.7%	1.7%
Global Real Estate	FTSE EPRA Nareit Global Index TR GBP	3,519	-2.0%	-2.0%
Volatility			Change in Volatility	
VIX	Chicago Board Options Exchange SPX Volatility Index	19	-13.7%	-13.7%

* All return figures quoted are total return, calculated with gross dividends/income reinvested.

Source: Bloomberg

Market thoughts



I am always on the look out for topical and interesting pieces to share with you, hopefully providing some background information around recent events and also some food for thought! At the risk of swamping you, there are two topics this time. Enjoy! (?)

Anatomy of the Banking Crisis

While much has already been written about the banking crisis witnessed to date in 2023, a brief summary is: deposits at US banks rose sharply in 2020 and 2021 following the Covid social security payments, and perhaps due to a decline in spending following Covid restrictions, as well as large amounts of capital raised by venture capital firms which flocked to Silicon Valley Bank (SVB). Interest rates fell to near zero given the extremely loose monetary policy. Banks then needed to use this capital to provide loans, or to invest in securities (commonly US Treasuries). Due to strict risk based capital requirements, many banks invested in Treasuries and engaged in interest rate hedging. SVB was particularly exposed due to: reducing its interest rate hedging ratio on securities leading to large unrealised losses, having an undiversified depositor base largely of VC firms, and having a large proportion of deposits above the \$250k FDIC insured limit. Depositors and investors became alarmed that SVB would not be able to sell its securities to provide cash to depositors if required (essentially a 'bank run'). SVB's depositors then en masse began withdrawing cash, leading SVB to attempt to raise equity capital which proved unsuccessful. Signature Bank also had a very high proportion of uninsured deposits (90%) and was rapidly closed by the FDIC 2 days after SVB. Investors then turned their attention to Credit Suisse (CS), despite very different underlying issues, with CS more troubled by legacy profitability and compliance issues, leading to outflows of assets under management and deposits. With unfortunate timing, in early March CS announced an SEC assessment of issues in its financial reporting in 2021 and 2022 which triggered a share price drop. The following day, large investor Saudi National Bank declared it would 'absolutely not' invest further prompting a collapse in the share price and subsequent forced sale to UBS.

Some further thoughts about the current large discounts to NAV in the listed PE sector

Rather like the buses, sectorial views are turning up all at once from our brokers. For starters here is an interesting alternative take on what lies behind the wide discounts seen during 2022 and into this year, from [Jeffries](#).

Despite PE GPs reporting good Q1 NAV numbers and more evidence of ‘robust’ and ‘solid’ listed PE business models, share prices still seem to be pricing in a calamitous downward revision of asset values. Few market participants believe that this is based on fundamentals. Deep discounts are more a function of the relatively high Total Expense Ratios (TER) of these funds which makes them unattractive to investors obliged to report the KIID costs in their own funds’ ongoing charges figure (OCF). That requirement has driven a flight of capital from the listed private equity sector in the past year and is now deterring new investment from many who would otherwise be taking advantage of the very attractive entry points available today. Another factor has been forced selling by funds which have suffered from redemptions and changes in investment policy. Plus, listed PE funds which are components of FTSE indices have suffered even more because of negative ETF flows – particularly from FTSE 250 - trackers for many years. Index basket trades tend to be executed in haste which can have a devastating share price effect on relatively illiquid investment trusts. The coincidence of these three technical drivers has been particularly acute since last September and that, rather than any real fundamental distress, explains the pricing we see today. But there are signs now that two of the three drivers are becoming less powerful while pools of capital are being raised by closed-end fund specialists to take advantage of the bombed-out share prices. Absent another macroeconomic shock, listed private equity seems set fair for a major rally. Watch for positive fund flows into UK benchmarked ETFs as the likely catalyst. After all, as Citi was forced to concede this week, the UK isn’t quite the basket case many economists thought. Indeed the pick-up in M&A suggests is prompting international investors to realise that the UK stock market is cheap. Hastily executed FTSE 250 “buy” baskets could have an equal and opposite effect on listed private equity share prices soon.

On the same day I received these words of wisdom from [Investec](#), including input from Warren Buffett.

Introduction: We firmly believe that Listed Private Equity has an important role to play in improving portfolio diversification and providing an effective solution to the ongoing de-equitisation of global financial markets. Meanwhile, given the illiquidity of the underlying investments, and at a time when we are beginning to see the launch of the Long-Term Asset Funds, the closed-end structure represents a powerful competitive advantage. In this report, we include 14 companies with total net assets of £17.3bn but an aggregate market capitalisation of just £10.9bn and take a closer look at some of the key topics du jour of this sector.

Excellent long-term track record (NET OF FEES): For those investment companies with a 10-year performance record, this report highlights some impressive NAV total returns, with a simple average NAV total return of 301% compared to MSCI World and FTSE All Share total returns of 187% and 76% respectively. HgCapital Trust and HarbourVest Global stand out

with NAV total returns of 391% and 379% respectively, while even Princess Private Equity, with the lowest NAV total return of 195%, has still outperformed the MSCI World. All companies with a 10-year record are significantly ahead of the FTSE All Share. In an environment where, for many investors the all-in cost is a primary consideration, it is pertinent to highlight that these performance numbers are net of all fees.

But returns have been diluted by discounts, which have become embedded: Sadly, Boards and Managers are seemingly unable, or unwilling, to address the issue. Meanwhile, a flawed cost disclosure regime, and an investor focus on costs rather than value/net returns, have represented a dragging anchor on efforts to widen investor interest. To be candid, for many years, we have been underwhelmed by discount management within Listed Private Equity, which has been very quick to dismiss share buybacks, alleging that they “don’t work”. The approach was best summed up by one manager who told us “No-one else can be bothered, so why should we?” While the NAVs of the traditional private equity companies have proved resilient since the beginning of last year, the average discount has widened from 13% to 37%, while aggregate share buybacks have been just c.0.7% of shares in issue.

Maybe Mr Buffett is on to something here: Against this backdrop, we read with interest Warren Buffett’s latest annual letter to Berkshire Hathaway shareholders which reiterated his support for share buybacks. Mr Buffett said that the *math isn’t complicated....when the share count goes down, your interest in businesses goes up.... adding that, every small bit helps if repurchases are made at value-accretive prices*. Pulling no punches, he slammed critics of buybacks, describing them as economic illiterates. Given the Listed Private Equity discount experience since the global financial crisis, these stark words may strike a chord with investors.