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REVIEW OF CQS MULTI-SECTOR CREDIT PERFORMANCE TARGET

LONDON BOROUGH OF HARINGEY PENSION FUND (“THE FUND”)

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Review of CQS Multi-Sector Credit Performance Target

The Pensions Committee (“the Committee”) appointed CQS to manage a Multi-Sector Credit mandate in Q3 2014 after a review of the Fund’s investment strategy. This was the result of a manager selection exercise in which CQS presented alongside a number of other highly rated managers on their capabilities in the asset class.

At that time, and based on prevailing market conditions and outlook, it was agreed that the performance target for the mandate should be LIBOR +5-6% p.a. (net of fees) over a full market cycle. Please note that an absolute return target was chosen given the mandate is relatively unconstrained in its ability to invest in different growth fixed income asset classes, and has a *relatively* low sensitivity to changes in credit spreads (i.e. relatively low credit ‘beta’).

We believe that a combination of market conditions and CQS’ naturally cautious investment outlook means that this performance target should now be viewed as overly ambitious. We therefore believe that the performance target merits review by the Committee.

Since inception the mandate has lagged its performance target, due primarily to challenging market conditions; non-investment grade credit spreads have widened since mid-2014 due primarily to the slowdown of the global economy, and there has been significant volatility in global markets (although 2016 YTD has seen a reversal of these trends). This is demonstrated by the chart below.

Source: CQS

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Widening credit spreads (represented by an increase in the chart on the previous page) will result in the asset value of the mandate declining, all else equal, leaving the mandate more reliant on income (i.e. yield) to generate returns.

This widening of credit spreads has impacted the performance of the mandate over the period since inception, which is set out in the table below. As this demonstrates, the mandate has failed to meet its performance target over the one year and since inception periods to 30 June 2016.

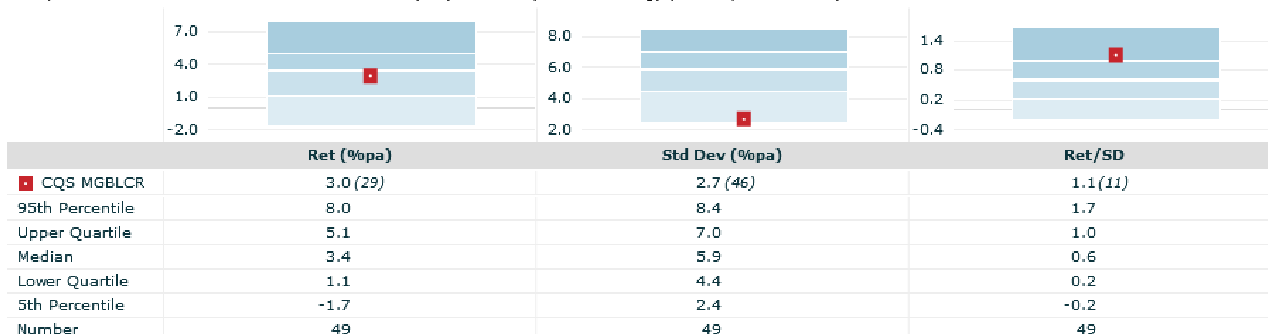
	3 Month (%)	1 Year (%)	Since Inception (% p.a.)
CQS Credit Multi-Asset	2.0	3.1	2.9
Performance Target	1.5	6.1	6.1

Source: CQS, Thomson Reuters Datastream. Inception date taken as 1 September 2014.

We propose that the Commitee alter the performance target of the CQS mandate to LIBOR +4 - 5% p.a. (net of fees). We have spoken with CQS and they have confirmed that they are supportive of this proposal, and feel it is representative of the current market opportunity set.

The first reason for proposing a reduction in the performance target is continuing global macroeconomic and political uncertainty. CQS believe there is reason to be cautious at present, highlighting the UK's decision to leave the EU, the upcoming US Presidential Election, and the Chinese slowdown as three potential headwinds. Mercer continue to believe there is a scarcity of cheap 'beta' in markets, and prospective returns across growth asset classes will be muted by historical standards.

While we retain conviction in CQS' ability to generate returns, we would also remind the Committee that they tend to be relatively defensively positioned compared to other managers in the Multi-Sector Credit universe. This was considered a positive attribute during the manager selection exercise in 2014, where a deliberate decision was taken by the Committee to appoint a manager with a relatively cautious investment style. This defensive positioning has been beneficial to the Fund over recent periods given the aforementioned widening in credit spreads. This has resulted in CQS producing superior risk-adjusted returns compared to the wider Multi-Sector Credit universe over the past two years, as demonstrated by the chart below:



	Ret (%pa)	Std Dev (%pa)	Ret/SD
CQS MGBLCR	3.0 *(29)*	2.7 *(46)*	1.1 *(11)*
95th Percentile	8.0	8.4	1.7
Upper Quartile	5.1	7.0	1.0
Median	3.4	5.9	0.6
Lower Quartile	1.1	4.4	0.2
5th Percentile	-1.7	2.4	-0.2
Number	49	49	49

This focus on downside protection does however mean that CQS are likely to struggle to achieve high single-digit returns over a market cycle, even in a supportive macroeconomic environment (i.e. one very different to the one we are faced with at present). This strengthens the argument for reducing the performance target from the current level to LIBOR +4-5%.

Given the relatively defensive positioning of CQS, the Committee might now be interested in diversifying the manager exposure to include a higher risk (and higher expected return) manager to complement the approach that is taken by CQS. An example of a manager the Committee might wish to consider is Wellington, who were also considered at the time of CQS' appointment in 2014.

Please let us know if you have any questions.

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