Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND COMMITTEE**
MEETING DATE:	**27 MARCH 2015**
TITLE:	**REVIEW OF INVESTMENT PERFORMANCE (for periods ending 31 December 2014)**
WARD:	**ALL**
AN OPEN PUBLIC ITEM	
List of attachments to this report: Appendix 1 – Fund Valuation Appendix 2 – JLT Performance Monitoring Report	

1 THE ISSUE

1.1 This paper reports on the investment performance of the Fund and seeks to update the Committee on routine strategic aspects of the Fund's investments and funding level. This report contains performance statistics for periods ending 31 December 2014.

1.2 The main body of the report comprises the following sections:

Section 4. Funding Level Update

Section 5. Investment Performance: A - Fund, B - Investment Managers

Section 6. Investment Strategy

Section 7. Portfolio Rebalancing and Cash Management

Section 8. Voting Update

2 RECOMMENDATION

The Avon Pension Fund Committee is asked to:

2.1 **Note the information set out in the report**

3 FINANCIAL IMPLICATIONS

3.1 The returns achieved by the Fund from 1 April 2013 will affect the next triennial valuation in 2016. Section 4 of this report discusses the trends in the Fund's liabilities and the funding level.

4 FUNDING LEVEL

4.1 Using information provided by the Actuary, JLT has analysed the funding position as part of the quarterly report at Appendix 2 (section 3). This analysis shows the impact of both the assets and liabilities on the (estimated) funding level. ***It should be noted that this is just a snapshot of the funding level at a particular point in time.***

4.2 Key points from the analysis are:

(1) The funding level has fallen 6% to 77% during the quarter and compares to 78% at the March 2013 valuation.

(2) Asset returns were positive over the quarter but they could not offset the fall in the discount rate from 4.7% to 4.1%. Gilt yields fell to 2.5% from 3.1% the previous quarter end. This compares to a bond yield of 3.2% at the March 2013 valuation. A slight fall in the long term CPI from 2.4% to 2.3% was a small positive but there was still a significant increase in the value of the liabilities.

(3) Since the 2013 valuation the discount rate has negatively affected the funding position which has only been partially offset by investment returns exceeding expectations.

5 INVESTMENT PERFORMANCE

A – Fund Performance

5.1 The Fund's assets increased by £102m (a return of 3.1%) in the quarter, giving a value for the investment Fund of £3,642m at 31 December 2014. Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and managers. Manager performance is monitored in detail by the Panel. The Fund's investment return and performance relative to benchmarks is summarised in Table 1.

Table 1: Fund Investment Returns
Periods to 31 Dec 2014

	3 months	12 months	3 years (p.a.)
Avon Pension Fund (incl. currency hedging)	3.1%	8.4%	11.1%
Avon Pension Fund (excl. currency hedging)	3.1%	8.4%	10.8%
Strategic benchmark (no currency hedging) *(Fund incl hedging, relative to benchmark)*	3.4% *(-0.3%)*	9.5% ***(-1.0%)***	10.1% *(+0.9%)*
Local Authority Average Fund *(Fund incl hedging, relative to benchmark)*	3.1% *(=)*	8.1% ***(+0.3)***	11.1% *(=)*

5.2 **Fund Investment Return:** All Equity markets achieved positive returns over the quarter with the exception of the Europe (-1.4%) and Frontier markets (-9.0%) whilst the USA (+8.9%) was the strongest returning market. Bond yields again fell over the quarter leading to strong positive returns from Gilts (+11.2%) and Corporate Bonds (+6.7%) over the quarter.

5.3 Over the one year period, of the equity markets only North America and Asia Pacific outperformed the strategic return assumptions. Of the other asset classes, property and UK bonds (gilts corporates and index linked) all outperformed. Over 3 years developed market equities, UK bonds (gilts, corporates and index-linked) and property all outperformed their strategic return assumption, whilst emerging market equities and hedge funds underperformed their strategic return assumption.

5.4 **Fund Performance versus Benchmark: -1.0% over 12 months, attributed to**

(1) **Asset Allocation:** The contribution to outperformance from asset allocation was **0.3%** over the 12 months. This was due to an underweight to emerging markets equities and hedge funds and an overweight in developed market overseas equities. The currency hedging programme did impact performance over the 1 year period.

(2) **Manager Performance:** In aggregate, manager performance detracted **–1.3%** over the 12 month period, relative to the strategic benchmark. The main impacts were that the small outperformance by UK corporate bond manager was offset by the underperformance of the global equity manager and property managers.

5.5 **Versus Local Authority Average Fund:** Over one year, the Fund outperformed the average fund, and over three years performance is in line with the average local authority fund.

5.6 **Currency Hedging:** The hedging programme is in place to manage the volatility arising from overseas currency exposure, in particular to protect the Fund as sterling strengthens and returns from foreign denominated assets reduce in sterling terms. The hedging programme has had marginal impact on the Fund's total return over the quarter and year, but added 0.3% over the 3 year period.

B – Investment Manager Performance

5.7 In aggregate over the three year period the managers' performance is marginally ahead of the benchmark (+0.2%). Twelve mandates met or exceeded their three year performance benchmark, which offset underperformance by Schroder Global Equity, Signet and Partners Group. RLAM, Jupiter and Stenham performed particularly well against their three year performance targets.

5.8 As part of the 'Meet the Managers' programme, the Panel met with Schroder (Global equity mandate) and Partners Group (Global property mandate) on 4 March 2015. The summary of the Panel's conclusions can be found in Exempt Appendix 3 to the Investment Panel Activity Report.

5.9 Under the Red Amber Green (RAG) framework for monitoring manager performance, the Panel consider updates on all managers not currently achieving Green status including progress on action points. Any change in the RAG status of any manager is reported to Committee with an explanation of the change. **This quarter there has been no change to the rating of any managers and 2 managers remain amber rated.**

5.10 The reported performance data of the Partners property portfolio by WM and Partners was discussed at the Investment Panel meeting and the workshop meeting with Partners. Officers have also investigated the issue with both Partners and WM. The performance data reported by both parties is an accurate reflection of performance but they use different methodology. Partners use money weighted returns which is the most appropriate calculation given the way the money is invested. WM use time weighted returns which is consistent with the way they measure performance of the Fund as a whole. As the portfolio matures, the differences in returns calculated by the two approaches should reduce. Officers will continue to reconcile the two returns and will also explore whether there is a more appropriate way to include Partners' performance within the WM returns.

6 INVESTMENT STRATEGY

6.1 Diversified Growth Mandate: Standard Life GARS fund was selected to manage the Fund's second diversified growth mandate, replacing Barings. The funds were invested with Standard Life in early February.

6.2 Fund of Hedge Funds: Following a review of the Fund of Hedge Funds portfolio, the Fund is currently tendering for a manager to manage a bespoke portfolio of hedge fund investments (as notified in last quarter's Committee meeting).

6.3 Infrastructure: The Fund's investments in infrastructure are awaiting drawdown by the selected manager IFM who anticipate the funds being drawn down over the next 18 months to 2 years.

7 PORTFOLIO REBALANCING AND CASH MANAGEMENT

Portfolio Rebalancing

7.1 The rebalancing policy requires automatic rebalancing between the allocations to Liquid Growth (equities and diversified growth funds) and Stabilising (Bonds) assets when the liquid growth portion deviates from 75% by +/- 5%. Tactical rebalancing is allowed between deviations of +/- 2 to +/- 5%, on advice from the Investment Consultant. The implementation of this policy is delegated to Officers.

7.2 Following the investments in Standard Life, the Equity:Bond allocation is estimated to be 76.4: 23.6 at the end of February. This remains within the tactical range for rebalancing.

Cash Management

7.1 Cash is held by the managers at their discretion within their investment guidelines, and internally to meet working requirements. The officers closely monitor the management of the Fund's cash held by the managers and custodian with a particular emphasis on the security of the cash.

7.2 Management of the cash held internally by the Fund to meet working requirements is delegated to the Council's Treasury Management Team. The monies are invested separately from the Council's monies and during the quarter were invested in line with the Fund's Treasury Management Policy (latest approved on 28 March 2014).

7.3 The Fund continues to deposit internally managed cash on call with NatWest, Barclays and Bank of Scotland. The Fund deposits cash with the Goldman Sachs Asset Management Global Treasury Fund (AAA rated) and another AAA rated fund with Deutsche Bank is available for deposits if required. The Fund also has access to the Government's Debt Management Office, however the interest paid currently may not cover the transfer and administration costs incurred.

7.4 Following the lump sum deficit recovery payments in April it was forecast that there would be an average cash outflow of c. £3m each month during the year to

31 March 2015. In the quarter ending 31 December the cash outflow averaged just under £4.5m. This was a greater outflow than originally forecast due to the absence of the major deficit recovery payments and the £2.5m payment to Gloucestershire Pension Fund relating to the transfer of Prospects Services. Excluding this transfer the average monthly out-flow is just over £3.6m. To fund the cash flow shortfall £15m of cash was transferred back from the custodian during the quarter. The increase in future service contributions since the commencement of the new rates on 1 April has been offset by the increase in pension payments following Bristol City Council's bulk redundancy exercise.

8 VOTING UPDATE

8.1 During the quarter, the Fund's external managers undertook the following voting activity on behalf of the Fund:

Companies Meetings Voted:	130
Resolutions voted:	1,374
Votes For:	1,322
Votes Against:	40
Abstained:	8
Withheld* vote:	9

** A withheld vote is essentially the same as a vote to abstain, it reflects a view to vote neither for or against a resolution. Although the use of 'abstain' or 'withheld' reflects the different terms used in different jurisdictions, a 'withheld' vote can often be interpreted as a more explicit vote against management. Both votes may be counted as votes against management, where a minimum threshold of support is required.*

9 RISK MANAGEMENT

9.1 A key risk to the Fund is that the investments fail to generate the returns required to meet the Fund's future liabilities. This risk is managed via the Asset Liability Study which determines the appropriate risk adjusted return profile (or strategic benchmark) for the Fund and through the selection process followed before managers are appointed. This report monitors (i) the strategic policy and funding level in terms of whether the strategy is on course to fund the pension liabilities as required by the funding plan and (ii) the performance of the investment managers. An Investment Panel has been established to consider in greater detail investment performance and related matters and report back to the committee on a regular basis.

10 EQUALITIES

10.1 An Equality Impact Assessment has not been completed as this report is for information only.

11 CONSULTATION

11.1 This report is for information and therefore consultation is not necessary.

12 ISSUES TO CONSIDER IN REACHING THE DECISION

12.1 The issues to consider are contained in the report.

13 ADVICE SOUGHT

13.1 The Council's Monitoring Officer (Divisional Director – Legal and Democratic Services) and Section 151 Officer (Divisional Director – Business Support) have had the opportunity to input to this report and have cleared it for publication.

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Background papers	LAPPF Member Bulletins, Data supplied by The WM Company
Please contact the report author if you need to access this report in an alternative format	