AVON PENSION FUND COMMITTEE - INVESTMENT PANEL

Minutes of the Meeting held

Tuesday, 22nd November, 2011, 3.00 pm

Members: Councillor Charles Gerrish (Chair), Councillor Gabriel Batt, Ann Berresford, Councillor Mary Blatchford, Councillor Nicholas Coombes and Andy Riggs (In place of Bill Marshall)
Advisors: Tony Earnshaw (Independent Advisor) and John Finch (JLT Investment Consultancy)
Also in attendance: Tony Bartlett (Head of Business, Finance and Pensions), Liz Feinstein (Investments Manager) and Matthew Betts (Assistant Investments Manager)

9 EMERGENCY EVACUATION PROCEDURE

The Democratic Services Officer read out the procedure.

10 DECLARATIONS OF INTEREST

There were none.

11 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

Apologies were received from Bill Marshall, for whom Andy Riggs substituted.

12 TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

There was none.

13 ITEMS FROM THE PUBLIC - TO RECEIVE DEPUTATIONS, STATEMENTS, PETITIONS OR QUESTIONS

There were none.

14 ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

There were none.

15 MINUTES: 7 SEPTEMBER 2011

These were approved as a correct record and signed by the Chair.

16 REVIEW OF INVESTMENT PERFORMANCE FOR PERIODS ENDING 30 SEPT 2011

The Assistant Investments Manager presented the report. He highlighted three points of note:

1. Man had reduced the number of underlying managers in their portfolio, in line with the recommendations of the review of hedge funds in March 2011. This restructuring had been completed in October.

2. A letter had been received from BlackRock in response to questions about their corporate governance raised at the meeting with them on 7th September. This was attached as Appendix 4 to the report.

3. The active currency hedging programme had been implemented in July and would be fully implemented within a 12-month timeframe. Currency movements favoured the fund during the quarter and therefore the active currency hedge reduced overall return by 0.1%.

Mr Finch commented on the JLT investment report (Appendix 2 to this agenda item.) He said that market volatility had been significant during the period since 30 June 2011. There were no fundamental concerns with any manager. Aggregate manager performance as shown on page 13 of the JLT report demonstrated that diversification across different assets had added value to the Fund during the last 3 months. The second graph on page 13 demonstrated the differences in returns generated by the equity managers over the last 12 months.

Members agreed that the performance of the Fund had been reasonably good in current market conditions.

A Member asked for an update on how cash held internally (paragraph 7.4 of the cover report) had been invested. The Investments Manager replied that the amount of cash held by the Treasury Management Team had been reduced.

Before consideration of Exempt Appendix 3 (TT Peer Group Analysis) and Exempt Appendix 5 (Summaries of Investment panel meetings with Investment Managers) to the report, the Panel **RESOLVED** as follows:

> that having been satisfied that the public interest would be better served by not disclosing relevant information in accordance with the provisions of Section 100(A)(4) of the Local Government Act 1972, the public be excluded from the meeting for these items because of the likely disclosure of exempt information as defined in paragraph 3 of Part 1 of Schedule 12A of the Act as amended.

The Committee returned to open session

Mr Finch tabled a paper setting out the issues of the euro crisis and some strategic options that the Fund might wish to consider. He said that the past 18 months had been the most extraordinary from an investment perspective that he could recall. In 2010 there had been talk of the UK's credit rating being reduced, but now the UK was seen as a safe haven. The change in yields over the period, shown in Chart 1, resulted almost entirely from the Eurozone crisis. Yields had been pushed to unprecedented levels. The last time that bonds were 2.5% was after the war when yields were restricted by legislation. It was noted that the UK has benefitted from the long term structure of its debt when compared with some European countries.

Chart 2 of his paper showed that about 50% of UK exports went to the EU. Admittedly these included exports shipped to Rotterdam whose ultimate destination was outside the EU. The effect of austerity programmes and cascading debt (Italy, for example, owes €309bn to French banks), would depress EU economies and have a significant impact on the UK.

On the positive side, there were UK companies which were major global players, with diverse geographical revenue streams.

In his view speculation was not a major factor in the present crisis in the Eurozone. The fact was that a number of countries had borrowing levels that were completely out of scale with their GDP; even Germany was outside the limits set when the Euro was created. The situation was very different from the credit crisis of 2008 which was a liquidity and banking system crisis. Then corporate bonds yields had risen on credit concerns. This time corporate bond yields had fallen, but gilt yields had gone down even more. Chart 3 showed the spread between government and corporate bonds and how low the yields on UK government bonds are. Chart 4 also illustrated that, unlike in 2008, there had not been much increase in concern about the credit worthiness of companies. The price earnings ratio of equities had fallen, but this had been because of a fall in price, suggesting that there is fear about the current and future level of company earnings. Chart 5 showed the phenomenal increase in the value of long-dated government bonds. As the capital value increases, so the yield decreases and the price of government bonds impacts on the valuation of the Fund as the gilt yield is the reference rate (used in the discount rate) for valuing pension liabilities.

The discussion then addressed the question of what, if anything, should the Fund do? Should it stick with government bonds, or should it realise their capital value and invest in other assets? He recalled that some time ago the Committee agreed a tactical switch between gilts and corporate bonds which could be repeated.

In response to questions, Mr Finch said that the current crisis was very much a political one. It could be traced back to allowing countries with loose fiscal policies to join the Eurozone. He thought that yields on government bonds would continue to be low and that they could fall even further. But companies had strong balance sheets, and if the Fund was looking for an asset that would appreciate or hold value and generate a higher yield in a prolonged period of low growth, corporate bonds would be an attractive option compared to gilts.

The Chair asked about the possibility of B&NES and the other local authorities in the Fund issuing bonds, as some local authorities were planning to do. Mr Finch responded that there might be a problem with the credit rating of some local authorities. The Investments Manager said there might be statutory restrictions on the Fund investing in the bonds of the Fund's administering authority (and possibly other Fund employers). Mr Finch said that government and local authority projects, such as housing schemes, could generate good returns, but there was a shortage of capital for this at present. Corporate debt would be a safer option.

In response to a question about the impact of the government's austerity programme, Mr Finch said that the danger was that, as in Greece, tax revenues declined so that austerity turned into a vicious circle. Home ownership had underpinned a great deal of private borrowing; if people felt that the value of their

homes was decreasing, they restricted their spending, so a stabilisation of house prices would help the economy.

In response to a question about the UK's debt, he said that most was owed to the US andthe UK's biggest debtors were Ireland, Japan and Portugal, followed by Spain.

He advised that if there was to be a switch from gilts into corporate bonds, it would be best to do it fairly quickly ahead of the Christmas break if possible. The Head of Business, Finance and Pensions suggested that the Avon Pension Fund Committee should have the earliest possible opportunity to consider the issues and proposal, and that a report should be presented at the next meeting (9 December 2011). The Panel agreed in principle, given that they did not have a detailed proposal to consider and so could not put forward a substantive recommendation to the Committee.

It was accordingly **RESOLVED:**

1. To invite Officers to prepare a paper on switching from gilts to corporate bonds and to recommend to the Avon Pension Fund Committee to consider it at its meeting on 9 December 2011. In addition, the implementation of any decision to switch should be delegated to Officers.

2. To note the performance report.

17 SSGA POOLED FUNDS

The Investments Manager presented the report.

Members agreed that there was no need for immediate concern that the management of the pooled fund would suffer because of the reduction in the number of investors.

RESOLVED to recommend to the Avon Pension Fund Committee that no further action is required and that Officers will continue to monitor fund size as part of their on-going monitoring.

18 PANEL WORKPLAN

RESOLVED to note the workplan.

The meeting ended at 4.46 pm

Chair(person) ....

Date Confirmed and Signed ....

Prepared by Democratic Services