Bath & North East Somerset Council		
MEETING:	**Avon Pension Fund Investment Panel**	
MEETING DATE:	**22 FEBRUARY 2012**	**AGENDA ITEM NUMBER**
TITLE:	**Review Of Investment Performance For Periods Ending 31 Dec 2011**	
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 Investment Panel on routine strategic areas concerning the Fund's investments.

1.2 This report contains performance statistics for periods ending 31 Dec 2011.

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

Section 4. Investment Performance: A - Fund, B - Investment Managers.

Section 5. Investment Strategy

Section 6. Funding Level Update

2 RECOMMENDATION

That the Investment Panel:

2.1 Notes the information as set out in the report.

2.2 Identifies issues to be notified to the Committee.

3 FINANCIAL IMPLICATIONS

3.1 The returns achieved by the Fund for the three years commencing 1 April 2010 will impact the next triennial valuation which will be calculated as at 31 March 2013. Section 6 of this report discusses the trends in the Fund's liabilities and the funding level.

4 INVESTMENT PERFORMANCE

4.1 JLT's report in Appendix 2 provides a full commentary on the performance of the fund (pages 10 to 15), the investment managers (pages 16 to 36) and a commentary on investment markets (pages 5 to 7). In the section on the Fund (page 10), three year rolling returns are included to provide a longer term perspective.

A – Fund Performance

4.2 The Fund's assets increased by £135m (+5.6%) in the quarter, giving a value for the investment Fund of £2,623m at 31 December 2011. Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and managers.

4.3 The Fund's investment return and performance relative to benchmarks excluding currency hedging is summarised in Table 1.

Table 1: **Fund Investment Performance**
Periods to 31 Dec 2011

	3 months	12 months	3 years (p.a.)
Avon Pension Fund (incl. currency hedging)	5.6%		
Avon Pension Fund (excl. currency hedging)	5.7%	-0.2%	10.0%
Strategic benchmark *(Fund relative to benchmark)*	5.4% *(+0.3%)*	-0.7% ***(+0.5%)***	9.6% *(+0.4%)*
Customised benchmark *(Fund relative to benchmark)*	6.1% *(-0.4%)*	0.7% ***(-0.9%)***	10.3% *(-0.3%)*
Local Authority Average Fund *(Fund relative to benchmark)*	5.2% *(+0.5%)*	-1.5% ***(+1.3%)***	9.6% *(+0.4%)*

4.4 Note that because currency hedging has only been in place for less than 12 months, for consistency all "Fund relative to benchmark" data in the above table excludes currency hedging. The impact of currency hedging is addressed at paragraph 4.9.

4.5 **Avon Pension Fund**: Quarterly return driven by positive returns from all equity markets with the exception of Japan, supported by strong returns from UK bonds and smaller returns from property and hedge funds. The marginally negative annual return was a result of negative returns across all equity markets over the year (with the exception of North America) negating strong returns from the bond portfolio.

4.6 **Versus Strategic Benchmark (which reflects an allocation of 60% equities, 20% bonds, 10% property, 10% hedge funds):** Annual relative outperformance driven by the Fund being overweight UK government bonds (versus the benchmark) which performed strongly over the period and as a result of the emerging markets, hedge fund and property managers outperforming their benchmarks. Over the quarter the Fund benefitted from being underweight Japanese equities and hedge funds and from the outperformance by the property managers. This is despite a small cash holding.

4.7 **Versus Customised Benchmark (which reflects the individual benchmarks of each manager and as such, measures the relative performance of the managers as a whole):** Underperformed the benchmark over the year, with relative underperformance of the Hedge Funds and TT, more than offsetting outperformance by Jupiter, Genesis and the property managers. The other managers performed broadly in line with their benchmarks.

4.8 **Versus Local Authority Average Fund**: Annual relative outperformance driven by Fund's lower than average allocation to equities which performed negatively over the year, and higher than average allocation to bonds which performed well and provided protection from equity losses.

4.9 **Currency Hedging**: The implementation of the active currency hedging programme commenced in July and will be implemented fully within a 12 month timeframe. This quarter movements in currency markets had a mixed impact on the Fund, with Sterling strengthening against the Euro (in December) but weakening against the Dollar and Yen. The hedging programme detracted 0.1% from the overall Fund return for the quarter. The programme provided protection from the currency loss on Euro denominated assets and passed through some of the currency gains from the Dollar and Yen assets.

4.10 Since the beginning of 2012 global equity markets have been more positive with the FTSE All Share index rising by over. 5% (to 8 February). In contrast, the total return for the Over 15-year Gilt index was c. -3% during the same period.

B – Investment Manager Performance

4.11 A detailed report on the performance of each investment manager has been produced by JLT – see pages 16 to 36 of Appendix 2. Their report does not identify any new performance issues with the managers.

4.12 The Investment Panel are receiving a presentation from TT under another agenda item as part of the ongoing review of TT's performance.

4.13 Performance reporting for Partners is lagged by a quarter. However, the latest estimate for the quarter ending 31 December 2011 is -1.1%.

5 INVESTMENT STRATEGY

5.1 JLT's report did not highlight any strategy issues for consideration.

5.2 During the quarter the decision to make a tactical allocation within the bond portfolio was implemented. On 12 December the Fund switched £80m (c.3% of the total Fund assets) from UK Gilts into UK corporate bonds to provide some protection from future rises in gilt yields (which are at historic lows) and in so doing achieve a higher yield from corporate bonds and an opportunity for capital returns should the spread between gilts and corporate bonds narrow. Officers will monitor changes in the relative yields to identify when the spread between gilts and corporate bonds reaches the pre-determined trigger at which point the allocation will be reversed.

6 FUNDING LEVEL UPDATE

6.1 As at 31 Dec 2011 the Actuary has estimated that the funding level has deteriorated to 68%, at 31 March 2010 triennial valuation it was 82%. (Note: The revised funding level takes into account benefit payments and contributions received during the period. However, the actuary uses estimates for asset returns and cashflows so the update is only an indication of the trend in the funding level.)

6.2 Since the 2010 valuation, the value of the assets has increased by £257m (10%) to £2.7bn, and liabilities increased by £985m (32%) to £3.99bn. As a result the deficit has increased from £552m to £1,280m, with much of the deterioration happening in the last six months.

6.3 Table 2 shows the change in financial assumptions:

Table 2: **Change in Financial Assumptions**

	31 March 2010	30 Sept 2011	31 Dec 2011
UK Gilt yield (nominal)	4.50%	3.60%	3.00%
Real yield	0.70%	0.20%	-0.20%
Market Implied RPI p.a.	3.80%	3.40%	3.20%
Inflation adjustment p.a.	0.80%	0.80%	0.80%
CPI Inflation p.a.	3.00%	2.60%	2.40%

6.4 The reduction in the gilt yield from 4.3% at 30 June to 3.0% at end of December is the reason why liabilities have increased so significantly since June (when liabilities were estimated to be £3.3bn). More positively, implied inflation has continued to decline which has helped offset some of the impact from the reduction in gilt yields. The announcement of further “quantitative easing” by the MPC in early February should keep nominal gilts yields at depressed levels for the immediate future. ***It should however be noted that this is just a snapshot of the funding level at a particular point in time.***

7 RISK MANAGEMENT

7.1 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 the return of the strategic benchmark and 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.

8 EQUALITIES

8.1 This report is primarily for information only.

9 CONSULTATION

9.1 This report is primarily for information and therefore consultation is not necessary.

10 ISSUES TO CONSIDER IN REACHING THE DECISION

10.1 The issues to consider are contained in the report.

11 ADVICE SOUGHT

11.1 The Council's Monitoring Officer (Council Solicitor) and Section 151 Officer (Divisional Director - Finance) have had the opportunity to input to this report and have cleared it for publication.

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