Bath & North East Somerset Council		
MEETING:	**Avon Pension Fund Committee**	
MEETING DATE:	**24 September 2010**	**AGENDA ITEM NUMBER** **13**
TITLE:	**Review Of Investment Performance For Quarter Ending 30 June 2010**	
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 report contains performance statistics for the quarter ending 30 June 2010. The report focuses on the strategic investment policy, the managers' performance to date, a valuation update, portfolio rebalancing and the property portfolio.

1.2 Most of the detail is contained in the appendices. The Fund's investment consultant, JLT, have prepared a report (Appendix 2) covering the performance of the investment strategy, the performance of the investment managers and the market commentary.

2 RECOMMENDATION

That the Avon Pension Fund Committee:

2.1 notes the information as set out in the report.

3 FINANCIAL IMPLICATIONS

3.1 The returns achieved by the Fund for the three years from 1 April 2010 to 31 March 2013 will impact the actuarial valuation which will be struck as at 31 March 2013.

3.2 Section 6 of this report discusses the Fund's liabilities and the funding level.

4 INVESTMENT PERFORMANCE

4.1 Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and managers.

4.2 JLT's report in Appendix 2 provides a full commentary on the performance of the strategic benchmark (pages 12-16), the investment managers (pages 17-40) and a commentary on investment markets (pages 5-11). In the section on the Fund (page 14), three year rolling returns are included to provide a longer term perspective. Qualitative summaries for the property managers are included for the first time.

4.3 The Fund's investment return and performance relative to benchmarks is summarised in the following table for the periods to 30 June 2010:

	3 months	12 months	3 years (p.a.)
Avon Pension Fund	-6.1%	18.6%	0.1%
Strategic benchmark *(Fund relative to benchmark)*	-6.0% *(-0.1%)*	18.7% *(-0.1%)*	n/a
Customised benchmark *(Fund relative to benchmark)*	-6.2% *(+0.1%)*	18.4% *(+0.2%)*	1.0% *(-0.9%)*
WM Local Authority Average Fund *(Fund relative to universe)*	-6.8% *(0.7%)*	18.6% *(0.0%)*	-1.7% *(1.8%)*

4.4 The Fund's assets fell in value by £149m (-6.1%) in the quarter giving a value for the Fund of £2,305m at 30 June 2010. This investment return was driven mainly by the falls in equity markets caused by concerns that the austerity measures in Europe and a slowdown in the pace of economic recovery in the US could lead to a double dip recession. Sterling depreciated against the US$ and Yen but it appreciated against the Euro.

4.5 More importantly over the last twelve months the Fund's assets rose by £377m or 18.6%, driven by positive returns across all asset classes, in particular equities and corporate bonds. Hedge funds lagged the rally in equities but generated positive returns.

4.6 The initial estimate for the Fund's return in July is +2.5%. However equity markets have retreated again in August.

4.7 **Against its strategic benchmark** (60% equities, 20% bonds, 10% property, 10% hedge funds) the Fund marginally underperformed over the year. The high cash balance early in the year detracted value whereas the tactical switch from gilts into corporate bonds added value.

4.8 **Against its customised benchmark** (which measures the relative performance of the managers), the Fund marginally outperformed in the quarter. Jupiter had a strong quarter given its lack of exposure to oil stocks. Most of the other managers added value against their benchmark except TT Int'l and the hedge funds.

4.9 Over the year the Fund marginally outperformed the customised benchmark mainly due to the outperformance of Jupiter, Royal London, Genesis and two of the hedge funds.

4.10 Over the last three years the Fund has generated a return of 0.1% p.a. underperforming the customised benchmark return by -0.9%. This is attributable to manager performance. Asset allocation has been a positive contributor.

4.11 **Compared to the WM Local Authority Fund universe**, the Fund is in line with the average fund over the year. Over three years the Fund's return of 0.1% p.a. is ahead of the average fund return of -1.7% p.a.

4.12 The report by JLT identifies no areas of significant concern regarding the managers, but did note that despite a good quarter the SRI constraints on Jupiter may be at the cost of significant volatility relative to the benchmark. The continued underperformance of MAN, although slight last quarter, should be considered when the fund of hedge fund investments are reviewed in 1Q11.

4.13 The Investment Panel has a workshop on 16 September 2010 to review the property portfolios. The purpose of the workshop is to understand the manager's investment process and how it is applied to our portfolios, review the outlook for the property market and discuss future investment strategy. The Panel will identify any particular performance or operational concerns to raise with the Committee.

4.14 In May MAN announced the acquisition of GLG, a global multi-strategy manager. GLG manages a range of funds and managed accounts across equity and bond markets. GLG investment products will complement and broaden the range of products offered by the enlarged group. GLG will operate as an independent investment unit within MAN Group. GLG do not manage fund of hedge funds and therefore will not directly impact the team that manages our investment. Shareholders will vote on the proposal with the outcome of the vote expected 1 September 2010. The acquisition is expected to complete in September 2010.

4.15 Jupiter became a public company in June following its flotation on the London Stock Exchange. The officers will monitor the company closely especially in relation to key man risk. Until the Fund is satisfied that the full impact from this corporate restructuring is known, no new monies should be allocated to Jupiter.

4.16 The search for the new global equity manager is progressing and submissions are currently being evaluated. The process is on schedule to appoint early in 2011.

5 INVESTMENT STRATEGY

5.1 JLT's report did not highlight any new strategy issues for consideration. The report does highlight the risk return profile of the Fund on pages 18 & 19 and the impact on risk/return by each of the managers. In particular JLT conclude that the volatility of the various portfolios/funds is in line with expectations and that the Fund has benefited from diversification by asset classes as the Fund volatility is lower than the equity managers and passive Blackrock portfolio which comprise c.75% of the total Fund.

6 ACTUARIAL VALUATION UPDATE

6.1 At the 31 March 2007 valuation the funding level was 83% (the assets were sufficient to meet 83% of the projected liabilities at that date given the existing investment and funding strategies).

6.2 The full triennial actuarial valuation is being undertaken as at 31 March 2010 which will set the employer rates for the three years commencing 1 April 2011. **The funding level at 31 March 2010 incorporating the revised assumptions discussed below is estimated to be around 80%.**

6.3 For the 2010 valuation, the Actuary will review the assumptions to be used and will also incorporate the government's recent announcement of changing the inflation rate used to value pension benefits. As part of the valuation process, the Committee will approve the Funding Strategy Statement (FSS) which sets out the parameters for the valuation. The FSS was discussed in depth at the Committee workshop held on 23 July 2010 and is included elsewhere on this agenda.

6.4 The effect of changing the basis of valuing pension benefits from the Retail Price Index (RPI) to the Consumer Price Index (CPI) is to reduce liabilities by between 5-8% (depending on the employer profile) as CPI is normally lower than RPI. (historically CPI has been c. 0.5% lower than the RPI). This difference arises due to the composition of the basket of goods and services used for each index and the method of calculation. The main difference in the underlying baskets is that the CPI does not include housing costs such as mortgage costs or council tax.

6.5 In addition the Actuary is introducing an inflation risk premium (IRP) adjustment to the market derived inflation rate used in the valuation. This adjustment allows for supply/demand distortions in the bond market which is used to derive the implied inflation rate.

6.6 The changes in the Fund's funding level to 31 March 2010 are summarised below:

	Triennial valuation March 2007	Interim valuation March 2008	Interim valuation March 2009	Estimated Mar-10	% change since 2007
Assets (£m)	2,184	2,175	1,819	2,505	15%
Liabilities (£m)	2,643	3,099	3,017	3,126	18%
Deficit (£m)	-459	-924	-1,198	-621	
Funding Level	83%	70%	60%	80%	

6.7 The funding level and increase in the deficit means there is still some pressure on employer contribution rates to rise. However, where possible this will be managed by extending the deficit recovery period beyond the current 15-20 years. Any future reduction in employer costs will first of all be used to reduce this recovery period back to 15-20 years. The Fund's officers have met with outsourcing employers and community admission bodies to discuss their specific situation with regard to the valuation.

6.8 Before the 2010 valuation is completed the government may adopt recommendations from the Independent Commission on Public Service pensions (Hutton Commission). This may result in further changes to the 2010 valuation.

6.9 It is anticipated that the total Fund valuation results will be completed by early October. Individual employer contribution rates will be available late October/early November. Officers will be meeting with employers to discuss the outcome of the valuation.

7 CASH MANAGEMENT

7.1 Cash is not included in the strategic benchmark. However, cash is held by the managers at their discretion within their investment guidelines, and internally to meet working requirements. The segregated portfolios, TT, Jupiter and BlackRock utilise money market funds offered by the custodian, BNY Mellon. The cash within the pooled funds is managed internally by the manager. The cash managed by BlackRock in the property portfolio is invested in the BlackRock Sterling Liquidity Fund. 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 are invested in line with the Fund's Treasury Management Policy which was approved on 18 December 2009.

8 REBALANCING POLICY

8.1 The rebalancing policy requires rebalancing of the Equity/Bond allocation to occur when the equity portion deviates from 75% by +/- 2%, and the valuation metric, in this case the equity gilt yield ratio, confirms that the relative valuation between equities and bonds is favourable. The implementation of this policy is delegated to officers.

8.2 There was no rebalancing undertaken this quarter. As at 4 August 2010 the Equity:Bond allocation was estimated at 74.5:25.6.

9 LAPFF ACTIVITY

9.1 The Fund is a member of the Local Authority Pension Fund Forum (LAPFF), a collaborative body that exists to serve the investment interests of local authority pension funds. In particular, LAPFF seeks to maximise the influence the funds have as shareholders through co-ordinating shareholder activism amongst the pension funds.

9.2 LAPFF's current activity includes:

(1) BP - The Forum will continue to engage with BP, having built a good relationship with the company in the recent past. LAPFF is planning to seek a meeting with the company to learn more about the company's response to the crisis. Forum members will be updated as soon possible.

(2) The Financial Reporting Council (FRC) has published the first Stewardship Code for institutional investors. This Code will replace the Combined Code. The purpose of the Code is to improve the quality of corporate governance through promoting better dialogue between shareholders and company boards, and more transparency about the way in which investors oversee companies they own. The Code includes principles on:-

- The monitoring of investee companies;
- The escalation of activities taken to protect or enhance shareholder value;
- Collective engagement;
- Voting policy;
- Managing conflicts of interest; and
- Public reporting and reporting to clients.

It is intended that a paper on the FRC Stewardship Code will be brought to the December committee meeting. LAPFF will be providing guidance on how funds can apply the Code.

10 RISK MANAGEMENT

10.1 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.

11 EQUALITIES

11.1 This report is primarily for information and therefore an equalities impact assessment is not necessary.

12 CONSULTATION

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

13 ISSUES TO CONSIDER IN REACHING THE DECISION

13.1 The issues to consider are contained in the report.

14 ADVICE SOUGHT

14.1 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	Investment manager reports for quarter ending 31 December 2009 LAPPF Member Bulletins Data supplied by The WM Company
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