Bath & North East Somerset Council		
MEETING:	**AVON PENSION FUND COMMITTEE**	
MEETING DATE:	**21 SEPTEMBER 2012**	**AGENDA ITEM NUMBER**
TITLE:	**Review Of Investment Performance For Periods Ending 30 June 2012**	
WARD:	**ALL**	
AN OPEN PUBLIC ITEM		
List of attachments to this report: Appendix 1 – Fund Valuation Appendix 2 – JLT performance monitoring report Exempt Appendix 3 – Summaries of Investment Panel meetings with Investment Managers Appendix 4 - LAPFF Quarterly Engagement 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 30 June 2012.

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. Corporate Governance and Responsible Investment (RI) Update

1.3 JLT's report in Appendix 2 provides a full commentary on the performance of the fund (pages 10 to 20), the investment managers (pages 21 to 39) and market background (pages 4 to 6). It also puts the performance into the context of changes to the liabilities and funding level (pages 7 to 9).

1.4 Appendix 4 contains the latest Engagement Report from LAPFF (Local Authority Pension Fund Forum which will keep members aware of the engagement work LAPFF is doing on behalf of its member funds.

2 RECOMMENDATION

That the 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 commencing 1 April 2010 will impact the next triennial valuation which will be calculated as at 31 March 2013. 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 (see pages 7-9). This analysis shows the impact of both the assets and liabilities on the (estimated) funding level. ***It should however 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 at 31 June 2012 fell to 69% from 70% at 31 March 2012.

(2) The largest contributor was the increase in liabilities due to the reduction in the gilt yield (3.1% versus 3.4% at 31 March) which was only partially offset by the fall in inflation expectations

(3) In addition assets returns were lower than the returns assumed in the funding model.

5 INVESTMENT PERFORMANCE

A – Fund Performance

5.1 The Fund's assets decreased by £56m (-1.9%) in the quarter, giving a value for the investment Fund of £2,702m at 30 June 2012. Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and managers.

5.2 The Fund's investment return and performance relative to benchmarks is summarised in Table 1.

Table 1: **Fund Investment Performance**
Periods to 30 Jun 2012

	3 months	12 months	3 years (p.a.)
Avon Pension Fund (incl. currency hedging)	-1.9%		
Avon Pension Fund (excl. currency hedging)	-1.6%	0.5%	11.6%
Strategic benchmark *(Fund relative to benchmark)*	-1.7% *(+0.1%)*	0.0% ***(+0.5%)***	11.4% *(+0.2%)*
Customised benchmark *(Fund relative to benchmark)*	-1.4% *(-0.2%)*	1.1% ***(-0.6%)***	11.8% *(-0.2%)*
Local Authority Average Fund *(Fund relative to benchmark)*	-1.9% *(=)*	-0.9% ***(+1.4%)***	11.5% *(+0.1%)*

Note that because currency hedging has been in place for less than twelve 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 5.8.

5.3 **Avon Pension Fund**: Quarterly return driven by negative returns from equities and hedge funds offsetting positive returns from bonds and property.

5.4 Over three years the Fund has outperformed the return expectations underpinning the investment strategy. This is largely a result of strong three year returns from both equities and bonds. However, the strong equity returns reflect the relatively low valuations of three years ago and returns over the next three years could be significantly lower, particularly if concerns regarding the Eurozone and global growth come to pass. Also, bond yields have fallen to historic lows, and the prospects for similar high returns over the next three years from bonds are low.

5.5 **Versus Strategic Benchmark (which reflects an allocation of 60% equities, 20% bonds, 10% property, 10% hedge funds):** Annual relative outperformance was largely driven by the Fund's hedge fund, property and equity (emerging markets and UK) managers outperforming their respective benchmarks used in the strategic benchmark. The overweight to corporate bonds (which performed strongly) also added to the outperformance over the twelve month period.

5.6 **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 Schroder Equity, more than offsetting outperformance by Jupiter, Genesis, SSGA and Partners over the year. The other managers performed broadly in line with their benchmarks.

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

5.8 **Currency Hedging**: This quarter sterling strengthened against the euro, and weakened against the US dollar and yen, resulting in the returns from euro denominated equity assets reducing in sterling terms and returns from US dollar and yen denominated assets increasing in sterling terms. The underlying currency return on the c£630m assets in the hedging programme had a positive impact of 1.32% over the quarter, with the hedging programme detracting 1.08% from this reducing the net currency return on the assets in the programme to +0.32%. In terms of the Fund's total return, the hedging programme detracted 0.3% from the Fund's total return in the quarter.

5.9 Since the end of the quarter, global equity markets have been positive with the FTSE All Share up over 6% (to 20th August). The total return for the Over 15-year Gilt index was c. +2.2% during the same period. Sterling strengthened against both the dollar (+1%) and Euro (+2.5%) from quarter end to 20th August.

B – Investment Manager Performance

5.10 A detailed report on the performance of each investment manager has been produced by JLT – see pages 17 to 36 of Appendix 2. Other than comments on Man and Schroder (see 5.11 and 5.12 below) their report does not identify any new performance issues with the managers.

5.11 MAN remains under close review as they restructure the portfolio after a period of disappointing performance.

5.12 The Schroder global equity mandate has underperformed over 12 months. Because of the unconstrained nature of the mandate, performance relative to benchmark is expected to be volatile over the short term. Schroder continue to adhere to the approach and philosophy outlined during the tender process. Schroder will be invited to the Panel meeting to be held in first quarter of 2013.

5.13 As part of the 'Meet the Managers' programme, the Panel met with 2 of the Fund's Fund of Hedge Fund managers on 5 Sept 2012. The summary of the Panel's conclusions can be found in Exempt Appendix 3.

6 INVESTMENT STRATEGY

6.1 During the quarter the tactical allocation within the bond portfolio was reversed. In August the spread between gilts and corporate bonds reached the pre-determined trigger point (spread between gilt and corporate bond yields narrows to 120 basis points) for the tactical position to be reversed. Officers subsequently arranged the sale of £80m of corporate bonds to unwind the tactical allocation. Having consulted the Investment Consultant, the proceeds were not re-invested into gilts given that gilt yields were (even) lower than when the tactical position was established and the asset allocation between equities and bonds was nearing the lower band of the rebalancing range. Their advice was to invest the proceeds in global equities (to effect rebalancing policy discussed in section 7). After transaction costs, the tactical allocation benefitted the Fund by £2.4m when compared to the outcome had the monies remained invested in gilts over the period.

6.2 JLT's report did not highlight any strategy issues for consideration. The Fund will be undertaking a full investment strategy review, commencing in Q4 2012.

7 PORTFOLIO REBALANCING AND CASH MANAGEMENT

Portfolio Rebalancing

7.1 The rebalancing policy agreed by the Committee on 22 June 2012 requires rebalancing of the Equity/Bond allocation to occur when the equity portion deviates from 75% by +/- 5%, and allows for tactical rebalancing between deviations of +/- 2 to +/- 5%, on advice from the Investment Consultant. The implementation of this policy is delegated to Officers.

7.2 Rebalancing was undertaken this quarter in conjunction with the reversal of the tactical switch. The Equity:Bond allocation was estimated at 72:28 which was within the tactical decision range. On advice from the Investment Consultant, Officers took the opportunity to rebalance whilst reversing the tactical allocation within the bond portfolio. Gilt values remain very high, so repurchasing gilts at this time was not preferred. JLT advised investing the proceeds from selling the corporate bonds in global equities as equities look better value on a relative basis to gilts. They preferred allocating to an active manager who is better able to take account of current market conditions. The proceeds from the sale of £80m of the RLAM corporate bond fund were allocated to Invesco, Schroder Global Equity and BlackRock with £5m being retained as cash for cashflow management purposes. As a result of the transactions and market movements, the Equity:Bond allocation was estimated at 76:24 (22 August).

Cash Management

7.3 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 Schroder Equity 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 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.

7.4 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 revised Treasury Management Policy which was approved on 16 March 2012.

7.5 The Fund continues to deposit cash on call with Barclays and Bank of Scotland. In line with the Treasury Management Policy the Fund no longer deposits cash with NatWest following the drop in their short term rating to below the minimum required. The Fund has now started to deposit cash with the triple A rated RBS Global Treasury Fund and has another triple A rated fund with Deutsche Bank available for deposits if required. The Fund also has access to the Government's DMO (Debt Management Office); however the interest paid currently may not cover the transfer and administration costs incurred.

7.6 At the June Committee it was agreed that the cash flow position would be included in this quarterly report. During the quarter there was a cash outflow of c. £1m per month due to the level of lump sum payments. In July these payments were lower resulting in an outflow of just under £0.5m. This trend is currently slightly worse than the neutral scenario in the cash flow forecasting model used to monitor cash flow. However, due to the volatility in elements such as lump sums it is too early to determine whether the neutral scenario is too optimistic.

8 CORPORATE GOVERNANCE UPDATE

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

Companies Meetings Voted:	1,105
Resolutions voted:	15,763
Votes For:	14,908
Votes Against:	959
Abstained:	98
Withheld vote:	92

8.2 In 2011 the Fund appointed Manifest to monitor its voting activity. Manifest's annual report on voting activity for 2011 is the subject of another agenda item.

8.3 The Fund is a member of 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. LAPFF's activity in the quarter is summarised in their quarterly engagement report at Appendix 4.

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 This report is primarily for information only.

11 CONSULTATION

11.1 This report is primarily 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 & Democratic Services) 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	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	