

Bath & North East Somerset Council

MEETING:	AVON PENSION FUND COMMITTEE
MEETING DATE:	14 December 2012
TITLE:	REVIEW OF INVESTMENT PERFORMANCE (for periods ending 30 September 2012)
WARD:	ALL
AN OPEN PUBLIC ITEM	
List of attachments to this report: Appendix 1 – Fund Valuation Appendix 2 – JLT performance monitoring report 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 September 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

Section 9. Annual Review of Internal Control Reports

2 RECOMMENDATION

The Avon Pension Fund Committee is asked to agree:

2.1 To note the information 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 8-10). 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 estimated funding level at 30 Sept 2012 increased to 73% from 69% at 30 June 2012.
- (2) The largest contributor to the improved funding level was the increase in asset values over the quarter. The other positive factor was the impact of a fall in implied inflation causing a reduction in the value put on future liabilities.

5 INVESTMENT PERFORMANCE

A – Fund Performance

5.1 The Fund's assets increased by £91m (+3.6%) in the quarter, giving a value for the investment Fund of £2,792m at 30 September 2012. Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and managers. The Fund's investment return and performance relative to benchmarks is summarised in Table 1.

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

	3 months	12 months	3 years (p.a.)
Avon Pension Fund (incl. currency hedging)	3.6%		
Avon Pension Fund (excl. currency hedging)	3.3%	12.6%	7.4%
Strategic benchmark <i>(Fund relative to benchmark)</i>	3.1% <i>(+0.1%)</i>	12.5% <i>(+0.1%)</i>	7.3% <i>(+0.1%)</i>
Customised benchmark <i>(Fund relative to benchmark)</i>	3.1% <i>(+0.2%)</i>	12.8% <i>(-0.2%)</i>	7.4% <i>(=)</i>
Local Authority Average Fund <i>(Fund relative to benchmark)</i>	3.3% <i>(=)</i>	12.6% <i>(=)</i>	7.4% <i>(=)</i>

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 5.4.

5.2 Fund Absolute Return: Quarterly return driven by strong returns from all equity markets (except Japan which fell over the quarter) and UK corporate bonds. 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 prospects for similar high returns from these asset classes over the next 3 years are not as strong in face of concerns over global growth prospects and the historically low bond yields.

5.3 Fund Relative Return:

(1) Versus Strategic Benchmark (which reflects an allocation of 60% equities, 20% bonds, 10% property, 10% hedge funds): Annual relative outperformance was largely driven by several of the Fund's managers outperforming their respective benchmarks used in the strategic benchmark. These included the corporate bond manager, hedge fund managers, property and 3 equity managers (emerging markets and UK). The overweight to corporate bonds (which performed strongly) and underweight to Japan equities (which performed poorly) also added to the outperformance over the twelve month period.

(2) Versus Local Authority Average Fund: Performance in line with the LA average even though the Fund has lower than average allocation to UK equities and private equity, and higher than average allocation to bonds and hedge funds.

5.4 Currency Hedging: This quarter sterling strengthened against the euro, US dollar and yen, resulting in the returns from equity assets denominated in these currencies reducing in sterling terms. The underlying currency return on the c£720m assets in the hedging programme had a negative impact of 2.2% over the quarter, with the hedging programme offsetting 0.9% of this, thereby improving the net currency return on the assets in the programme to -1.3%. In terms of the Fund's total return, the hedging programme added 0.3% to the Fund's total return in the quarter.

B – Investment Manager Performance

5.5 In aggregate over the 3 year period the managers' performance is in line with the benchmark. 8 mandates met or exceeded their 3 year performance target, which offset underperformance by the Hedge Funds and TT. A detailed report on the performance of each investment manager has been produced by JLT – see pages 22 to 39 of Appendix 2. Genesis, RLAM, Invesco and Jupiter have all significantly outperformed their 3 year performance targets. Other than comments on Man and Schroder (see 5.6 and 5.7 below) JLT's report does not identify any new performance issues with the managers.

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

5.7 The global equity mandate managed by Schroder has underperformed over 12 months but has shown a small improvement this quarter. Because of the unconstrained nature of the mandate, performance relative to benchmark is expected to be volatile on a quarterly basis. Schroder continue to adhere to the approach and philosophy outlined during the tender process. Schroder will present to the Panel at the meeting on 22 February 2013.

5.8 As part of the 'Meet the Managers' programme, the Panel met with TT and Partners Group on 14 November 2012. The summary of the Panel's conclusions can be found in Appendix 3.

6 INVESTMENT STRATEGY

6.1 JLT's report did not highlight any strategy issues for consideration. The Fund is currently undertaking a full investment strategy review, concluding in Q1 2013.

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 In August the Equity: Bond allocation (72:28) was rebalanced in conjunction with the reversal of the tactical switch. Following this and subsequent market movements the Equity: Bond allocation is 76:24 as at 31 Oct 2012.

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 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 Treasury Management Policy which was approved on 16 March 2012.

7.5 The Fund continues to deposit internally managed 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 also deposits cash with the AAA rated RBS Global Treasury Fund and has another AAA 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 During the quarter there was a cash outflow of c. £1.1m per month as benefits paid exceeded contributions. In October there was a net inflow of c. £1m as some major deficit funding payments fell due. The overall trend remains slightly worse than the neutral scenario in the cash flow forecasting model used internally to monitor cash flow. However, it is still 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:	237
Resolutions voted:	2,823
Votes For:	2,738
Votes Against:	72
Abstained:	15
Withheld* vote:	14

* 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.

8.2 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 REVIEW OF INTERNAL CONTROL REPORTS

9.1 As part of the risk management process the Fund annually reviews the internal control reports (ICR) of the custodian and investment managers (and their administrators where relevant), and reports the findings to Committee. These reports are often designated SSAE16 or SSAE3402 reports (previously AAF 01/06 and SAS70 reports).

9.2 ICR reports describe the internal control environment of an organisation. The management of the organisation are responsible for identifying the control procedures which they consider appropriate to enable certain control objectives to be met. External auditors verify that the controls identified are in place and comment on whether the controls will achieve the stated objectives or not.

9.3 For the reports reviewed in 2012, in each case the external auditor's report stated that the controls were in place and achieved the control objective and there are no issues to bring to the attention of the Committee.

9.4 The ICRs of the pooled funds (and their administrators/custodian) and the Fund's custodian are also audited by the Fund's external auditor as part of the annual audit.

9.5 As part of the process, officers discuss the significance of the internal control reports with investment managers and custodian on an on-going basis and follow-up any issues flagged in the reports.

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 (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.

11 EQUALITIES

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

12 CONSULTATION

12.1 This report is 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 (Divisional Director – Legal and 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	