Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND COMMITTEE**
MEETING DATE:	**22 March 2013**
TITLE:	**REVIEW OF INVESTMENT PERFORMANCE (for periods ending 31 December 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 31 December 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. Change to Investment Regulations

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 31 Dec 2012 decreased to 71% from 73% at 30 Sept 2012.

(2) The largest contributor to the reduction in the funding level was a rise in the inflation assumption used to value the liabilities, which increased the value of future inflation linked payments (liabilities). The overall 2% reduction in the funding level was in spite of a positive return on assets.

5 INVESTMENT PERFORMANCE

A – Fund Performance

5.1 The Fund's assets increased by £80m (+2.8%) in the quarter, giving a value for the investment Fund of £2,873m at 31 December 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 31 Dec 2012

	3 months	12 months	3 years (p.a.)
Avon Pension Fund (incl. currency hedging)	2.8%	9.7%	n/a
Avon Pension Fund (excl. currency hedging)	2.6%	9.3%	7.3%
Strategic benchmark *(Fund incl hedging, relative to benchmark)*	2.3% *(+0.5%)*	8.6% ***(+1.1%)***	6.8% *n/a*
Customised benchmark *(Fund excl hedging, relative to benchmark)*	2.6% *(=)*	9.1% ***(+0.2%)***	7.4% *(-0.1%)*
Local Authority Average Fund *(Fund incl hedging, relative to benchmark)*	3.0% *(-0.2%)*	10.2% ***(-0.5%)***	7.2% *n/a*

Note that "*Fund relative to benchmark*" data in the above table includes currency hedging except when in comparison with the customised benchmark which seeks to assess manager performance and therefore doesn't include the impact of hedging.

5.2 **Fund Absolute Return:** Quarterly return driven by positive returns from all equity markets (except US which fell over the quarter), index linked gilts and to a lesser extent 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 both active UK equity managers and the corporate bond manager. The overweight to corporate bonds (which performed strongly) and underweight to hedge funds and Japan equities (which both performed poorly) also added to the outperformance over the twelve month period. Currency hedging added 0.2% to the Fund return during the quarter (see 5.4 below for details).

(2) **Versus Local Authority Average Fund:** Performance behind the LA average over 12 months due to the Fund's lower than average allocation to UK equities, and higher than average allocation to bonds and hedge funds which underperformed the returns of the equity markets over 12 months.

5.4 **Currency Hedging:** This quarter Sterling strengthened against the US dollar and Yen, resulting in the returns from equity assets denominated in these currencies reducing in Sterling terms. The opposite can be said for assets denominated in Euro's as Sterling weakened versus the Euro. On the c.£764m assets in the programme, underlying currency return had an impact of -1.6% over the quarter, with the hedging programme offsetting this by 0.9% by generating a value of c.£7.1m, thereby improving the net currency return on the assets in the programme to -0.7%. In terms of the Fund's total return, the hedging programme added 0.2% 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 marginally behind the benchmark. 10 mandates met or exceeded their 3 year performance benchmark, which offset underperformance by the Hedge Funds. 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, and Jupiter have all significantly outperformed their 3 year performance targets. Other than comments on Man, Stenham, Schroder and SSgA (see 5.6 to 5.9 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 Close monitoring of Stenham's mandate will be undertaken in light of the changing focus of their business strategy away from growing their institutional client base to focus on existing investors.

5.8 After an increase in size, the funds managed by SSgA that the Fund invests in have again reduced in size to the level they were when the issue was raised in Dec 2011. At that time the Panel were satisfied that the funds were sustainable at this size, that no additional costs were being borne by remaining investors and that there was no impact on the efficiency of the models used to generate returns.

5.9 The global equity mandate managed by Schroder has underperformed over 12 months but the rolling 12 month relative return is improving. 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. Closer monitoring of this mandate will continue.

5.10 As part of the 'Meet the Managers' programme, the Panel met with Man and Schroder (Global Equity) on 22 February 2013. The summary of the Panel's conclusions can be found in Exempt Appendix 3.

6 INVESTMENT STRATEGY

6.1 The Fund has recently undertaken a full strategic investments review which reported to the Special Committee Meeting on 6 March 2013. JLT's performance report at Appendix 2 did not highlight any additional strategy issues for consideration.

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 There was no rebalancing activity undertaken during the quarter. Market movements have resulted in an Equity:Bond allocation of 78:22 as at 22 Feb 2013. This is within the tactical range for rebalancing. Given the Fund's asset allocation is subject to change following the recent strategy review, Officers decided not to undertake any rebalancing at this time.

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 has not deposited cash with NatWest during the quarter. This issue is being considered elsewhere on the agenda. 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 net cash inflow of c. £0.5m as some major deficit funding payments fell due. However the overall trend is close to the neutral scenario in the cash flow forecasting model used internally to monitor cash flow. This forecasts an average monthly outflow of C£0.9m but this could change as the effects of the 2013 valuation, Auto enrolment and LGPS 2014 become clearer.

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:	204
Resolutions voted:	1,925
Votes For:	1,853
Votes Against:	59
Abstained:	13
Withheld* vote:	12

* 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 CHANGE TO INVESTMENT REGULATIONS

9.1 On 28 February 2013 following a consultation exercise, DCLG has issued a revision to the LGPS Investment Regulations, increasing the maximum proportion that LGPS funds can invest in partnerships from 15% to 30% of assets in total, effective from 1 April 2013. Currently, to invest more than 5% in partnerships the Fund's Committee has to resolve to increase the limit up to 15%, the option to increase the limit by Committee resolution will be available up to 30% as of 1 April. The limit on investments in any single partnership remains at 5%. At this stage there is no need to increase the partnerships limit to 30%.

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	