

Bath & North East Somerset Council

MEETING:	AVON PENSION FUND COMMITTEE
MEETING DATE:	21 June 2013
TITLE:	REVIEW OF INVESTMENT PERFORMANCE (for periods ending 31 March 2013)
WARD:	ALL
AN OPEN PUBLIC ITEM	
List of attachments to this report: Appendix 1 – Fund Valuation Appendix 2 – JLT performance monitoring report Appendix 3 - 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 March 2013.
- 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 As agreed as part of the Investment Strategy Review, the structure of JLT's report at Appendix 2 has been revised to provide greater focus on the strategic nature of investment performance and a shorter summary performance analysis on the investment managers. Detailed performance analysis on each individual investment manager is routinely considered by the Investment Panel and any issues identified by the Panel on any individual investment manager are reported to Committee.

2 RECOMMENDATION

The Avon Pension Fund Committee is asked to:

- 2.1 Note the information set out in the report

3 FINANCIAL IMPLICATIONS

3.1 The returns achieved by the Fund for the three years commencing ending 31 March 2013 will impact the triennial valuation which is being calculated as at 31 March 2013. Investment returns from 1 April 2013 will affect the next valuation in 2016. 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 at Appendix 2 (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.*** (Please note, the Actuary is currently undertaking the triennial valuation which will calculate the funding position more accurately using membership data at March 2013).

4.2 Key points from the analysis are:

- (1) The estimated funding level at 31 March 2013 decreased to 69% from 71% at 31 December 2012.
- (2) The largest contributor to the reduction in the funding level was once again the rise in the inflation assumption used to value the liabilities (same as last quarter), which increased the value of future inflation linked payments (liabilities). The overall 2% reduction in the funding level was in spite of a return on assets in excess of the assumed return.

5 INVESTMENT PERFORMANCE

A – Fund Performance

5.1 The Fund's assets increased by £262m (+8.9%) in the quarter, giving a value for the investment Fund of £3,135m at 31 March 2013. Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and managers. JLT's quarterly performance report is at Appendix 2. This report now focuses on strategic performance of the Fund and summarises the performance of the managers. Manager performance is monitored in detail by the Panel. The Fund's investment return and performance relative to benchmarks is summarised in Table 1.

Table 1: **Fund Investment Performance**

Periods to 31 March 2013

	3 months	12 months	3 years (p.a.)
Avon Pension Fund (incl. currency hedging)	8.9%	13.8%	n/a
Avon Pension Fund (excl. currency hedging)	9.4%	14.1%	8.4%
Strategic benchmark (no currency hedging) <i>(Fund incl hedging, relative to benchmark)</i>	8.6% <i>(+0.3%)</i>	12.4% <i>(+1.4%)</i>	7.7% <i>n/a</i>
Local Authority Average Fund <i>(Fund incl hedging, relative to benchmark)</i>	9.1% <i>(-0.2%)</i>	13.8% <i>(=)</i>	8.1% <i>n/a</i>

5.2 Fund Absolute Return: Quarterly return driven by positive returns across all asset classes with equity markets and UK index linked gilts the strongest performers. The story is similar over the one year period with positive returns across all asset classes. Property is showing the weakest returns within the growth portfolio, although still positive over the year. 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 bonds and equities. 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 original Strategic Benchmark (which reflects an allocation of 60% equities, 20% bonds, 10% property, 10% hedge funds – note that relative performance will be reported against this benchmark until the investment in DGFs marks the first move towards the new benchmark and from then on that will be used): Annual relative outperformance was largely driven by the majority of the Fund's active managers outperforming their respective benchmarks used in the strategic benchmark (particularly the equity and bond managers). The overweight to equities and UK corporate bonds (which performed strongly) and underweight to hedge funds and property (which both performed less well) also contributed to the outperformance over the twelve month period.

(2) Versus Local Authority Average Fund: Over the quarter the Fund underperformed the average fund slightly due to lower than average allocation to equities which experienced a strong quarter. Over one year the Fund performed in line with the average fund.

5.4 Currency Hedging: This quarter Sterling weakened against both the Dollar and Euro, resulting in the returns from equity assets denominated in these currencies increasing in Sterling terms. This currency gain was partially offset by sterling strengthening versus the Yen as the Yen continued to show weakness against most major currencies, resulting in returns from Yen denominated assets reducing in Sterling terms. On the c.£872m assets in the programme, the total effect of underlying currency movements had a positive impact of 5.13% over the quarter, with the hedging programme detracting 1.67% from this, resulting in a net currency return on the assets in the programme to +3.42%. In terms of the Fund's total return, the hedging programme detracted 0.5% from 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. 11 mandates met or exceeded their 3 year performance benchmark, which offset underperformance by the Hedge Funds. Genesis, RLAM, and Jupiter all continue to significantly outperform their 3 year performance targets.

5.6 Man remains under close review by officers as they restructure the portfolio after a period of disappointing performance. Man's mandate was considered at the Investment Panel meeting on 4 June 2013 and the outcome is reported in the Investment Panel Activity Report item on this agenda.

5.7 TT's performance continues to improve since changes were made to address performance and whilst still short of their three year performance target, this

performance measure is positive and improving. One year performance is ahead of target.

6 INVESTMENT STRATEGY

- 6.1 Returns within the fixed income portfolio are significantly ahead of the assumed strategic return over 3 years, except for overseas fixed interest (which forms a small part of the portfolio). Equity returns are in line with the return assumptions over 3 years, with property and hedge funds underperforming the strategic assumptions.

7 IMPLEMENTATION OF NEW INVESTMENT STRATEGY - UPDATE

- 7.1 Changes to the Investment Strategy agreed at the Special Meeting in March 2013 will be implemented over the coming months. Plans for Stage 1 of the implementation plan (changes to the liquid growth portfolio, equities and diversified growth funds) were considered by the Investment Panel at their meeting on 4 June 2013 a summary of which is included in another agenda item. In addition, the Panel agreed the brief for the Diversified growth fund mandates, the tender process for which commenced in June. The Committee will be kept up to date with progress on the implementation of the new strategy in this report and through the Investment Panel Activity report.

8 PORTFOLIO REBALANCING AND CASH MANAGEMENT

Portfolio Rebalancing

- 8.1 The rebalancing policy 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. Revisions to this policy are being considered in another item on this Committee agenda.
- 8.2 There was no rebalancing activity undertaken during the quarter. Market movements have resulted in an Equity:Bond allocation of 77.9:22.1 as at 1 May 2013. This is within the tactical range for rebalancing. Officers will incorporate rebalancing as part of the changes to the Fund's asset allocation as the new strategy is implemented.

Cash Management

- 8.3 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.
- 8.4 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 during the quarter were invested in line with the Fund's Treasury Management Policy which was approved on 16 March 2012. A revised Treasury Management Policy was approved on 22 March 2013.
- 8.5 The Fund continues to deposit internally managed cash on call with Barclays and Bank of Scotland. 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. In line with the Treasury Management Policy the Fund did not deposit cash with NatWest during the quarter. However following the March Committee's approval of a revised Treasury Management Policy, depositing cash with NatWest was resumed at the beginning of April.

- 8.6 During the quarter there was a net cash outflow of c. £1.5m as benefits paid and costs incurred exceeded contributions and income received. This is largely in line with the overall trend of 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 over the year to 31 March 2014, and greater outflows in subsequent years. However this could change as the effects of the 2013 valuation, auto enrolment and LGPS 2014 become clearer.

9 CORPORATE GOVERNANCE UPDATE

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

Companies Meetings Voted:	226
Resolutions voted:	2,671
Votes For:	2,529
Votes Against:	145
Abstained:	11
Withheld* vote:	1

** 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.*

- 9.2 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 3.

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	