

Bath & North East Somerset Council

MEETING:	AVON PENSION FUND COMMITTEE
MEETING DATE:	13 December 2013
TITLE:	REVIEW OF INVESTMENT PERFORMANCE (for periods ending 30 September 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 30 September 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

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 from 1 April 2013 will affect the next triennial 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 (section 3). This analysis shows the impact of both the assets and liabilities on the (estimated) funding level. ***It should be noted that this is just a snapshot of the funding level at a particular point in time.***

4.2 This quarter the 2013 valuation has been used to update the funding position. The base position is the 2013 outcome which allows for short term pay growth, as declared by the actuary.

4.3 Key points from the analysis are:

- (1) The funding position has risen to 84% (from 78% funding level declared for 31/3/13) and the deficit contracted to £606m (from £876m at 31/3/13).
- (2) Since March the funding position has improved driven by rising real bond yields (nominal bond yields have risen from 3.2% to 3.5%; long term CPI inflation has fallen from 2.6% to 2.5%).
- (3) Investment returns are marginally behind the valuation assumption over the first six months of the year since March (negative returns in the quarter to end June, but positive returns in the quarter to end September). However, this is offset by the positive move in real yields (from the funding perspective).

5 INVESTMENT PERFORMANCE

A – Fund Performance

5.1 The Fund's assets increased by £74m (c. +2.6%) in the quarter, giving a value for the investment Fund of £3,193m at 30 September 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 focuses on strategic performance of the Fund, with a summary of 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 Returns**
Periods to 30 September 2013

	3 months	12 months	3 years (p.a.)
Avon Pension Fund (incl. currency hedging)	2.6%	13.9%	n/a
Avon Pension Fund (excl. currency hedging)	2.2%	13.7%	8.4%
Strategic benchmark (no currency hedging) <i>(Fund incl hedging, relative to benchmark)</i>	1.9% <i>(+0.7%)</i>	11.9% <i>(+2.0%)</i>	8.2% <i>n/a</i>
Local Authority Average Fund <i>(Fund incl hedging, relative to benchmark)</i>	2.6% <i>(=)</i>	14.3% <i>(-0.4%)</i>	8.3% <i>n/a</i>

- 5.2 Fund Investment Return:** Asset class returns were mixed in the quarter with small declines in US and Emerging Market equities. European and UK equity markets performed well over the quarter whilst Gilts and corporate bonds produced modest quarterly gains.
- 5.3** Over the one year period there have been positive returns across all asset classes except fixed interest gilts and overseas fixed interest bonds. Property and hedge funds are showing the weakest returns within the growth portfolio, although both 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.
- 5.4 Fund Performance versus Benchmark: +2.0% over 12 months, attributed to**
- (1) Asset Allocation:** The underweight to fixed income gilts, hedge funds and property (which all performed less well) contributed 0.4% to the outperformance over the twelve month period. The currency hedging programme contributed 0.2% over 1 year.
 - (2) Manager Performance:** In aggregate, manager performance contributed 1.4% of the outperformance over the 12 month period, relative to the strategic benchmark.
- 5.5 Versus Local Authority Average Fund:** Over one year, the Fund underperformed the average fund due to lower than average allocation to equities which experienced a strong year.
- 5.6 Currency Hedging:** This quarter Sterling strengthened against the Dollar, Euro and Yen resulting in the returns from equity assets denominated in these currencies decreasing in Sterling terms. On the c.£929m assets in the programme, the total effect of underlying currency movements had a negative impact of -5.3% over the quarter, with the hedging programme offsetting this by 1.3% resulting in a net currency return on the assets in the programme of -4%. In terms of the Fund's total return, the hedging programme added 0.4% from the Fund's total return in the quarter and 0.2% over the year.

B – Investment Manager Performance

- 5.7** In aggregate over the 3 year period the managers' performance is in line with the benchmark. 10 mandates met or exceeded their 3 year performance benchmark, which offset underperformance by the Hedge Funds and TT. Genesis, RLAM, and Jupiter all continue to significantly outperform their 3 year performance targets.
- 5.8** Following the decision to divest, the vast majority of Man's portfolio has now been redeemed leaving a small amount of more illiquid assets to be realised over the coming months (less than 3% of Man's portfolio).
- 5.9** As part of the 'Meet the Managers' programme, the Panel met with Schroder Global Equity on 15 November 2013. The summary of the Panel's conclusions can be found in Exempt Appendix 3 to the Investment Panel Activity Report.
- 5.10** Under the Red Amber Green (RAG) framework for monitoring manager performance, the Panel consider updates on all managers not currently achieving Green status including progress on action points. Any change in the RAG status of any manager is reported to Committee with an explanation of the change. This quarter there have been no changes to the RAG status of any of the managers. 5

managers are amber rated, 3 of which are showing progress towards achieving a green rating. The only Red rated manager is Man from whom the Fund is in the process of divesting.

6 INVESTMENT STRATEGY

6.1 Changes to the Investment Strategy agreed in March 2013 are in the process of being implemented and progress is as follows:

	Project	Progress
1	DGF Mandates	Completed: Mandates fully invested.
2	Emerging Market Equity Mandate	On track: Tender submissions being evaluated. Due Diligence undertaken w/c 18 November. Appointment decision due w/c 2 December
3	Restructuring passive equity portfolio	On track: Conversion to income distributing funds to coincide with funding of DGF and EM mandates
4	Rebalancing bond portfolio	Completed: Strategic allocation between UK gilts and corporate bonds implemented 16 August
5	Infrastructure	On Track: Background paper for discussion at this meeting.

7 PORTFOLIO REBALANCING AND CASH MANAGEMENT

Portfolio Rebalancing

7.1 The rebalancing policy requires automatic rebalancing between the allocations to Liquid Growth assets (equities and diversified growth funds) and Stabilising assets (Bonds) to occur when the liquid growth 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 consultation with the Investment Advisor, Officers undertook rebalancing in October to reduce the overweight to equities as the allocation was approaching the automatic trigger point for rebalancing. The latest Equity:Bond allocation is 77.8 : 22.2 as at 27 November 2013. This remains within the tactical range for rebalancing. Officers will continue to incorporate any rebalancing considerations as the new strategy is implemented.

Cash Management

7.3 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.

- 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 during the quarter were invested in line with the Fund's Treasury Management Policy. The latest updated version of the Treasury Management Policy was approved on 22 March 2013.
- 7.5 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. Following the March Committee's approval of the revised Treasury Management Policy, the Fund has also been depositing cash with NatWest since the beginning of April.
- 7.6 During the quarter there was a net cash outflow of c. £2.6m 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.

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:	222
Resolutions voted:	2,759
Votes For:	2,693
Votes Against:	68
Abstained:	7
Withheld* vote:	22

** 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 3.

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

11 CONSULTATION

11.1 This report is 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 and Democratic Services) and Section 151 Officer (Divisional Director – Business Support) 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	