

Bath & North East Somerset Council		
MEETING:	AVON PENSION FUND INVESTMENT PANEL	
MEETING DATE:	26 FEBRUARY 2014	AGENDA ITEM NUMBER
TITLE:	HEDGE FUND REVIEW - SCOPE	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
List of attachments to this report:		
Nil		

1 THE ISSUE

- 1.1 In response to a mixed performance within the Fund's hedge fund portfolio and to changes within the Fund's fund of hedge fund managers and the hedge fund industry as a whole, the Panel will review the Fund's current allocation to hedge funds and how the required exposure is achieved.
- 1.2 This paper describes the proposed aims and scope of the review, for agreement by the Panel.

2 RECOMMENDATION

That the Panel

- 2.1 Agrees the scope for the Review of Hedge Fund Investments as set out in section 5.**

3 FINANCIAL IMPLICATIONS

3.1 There is provision in the 2014/15 budget for investment advice relating to the review of the Fund’s hedge fund investments.

4 BACKGROUND

4.1 In the strategic review in 2013, the strategic target allocation to hedge funds was cut from 10% to 5%, with a permissible range of 0% to 7.5%

4.2 The pace of change within the Fund of Hedge Fund (FOHF) industry continues unabated. In response to falling Assets under Management and lower margins (as investor behaviour has changed, and fee levels have come under pressure), managers have reacted by consolidating and making changes to the structure of their business models.

4.3 Performance of the Hedge Fund ‘sector’ as a whole has historically underperformed strategic assumptions over the period the Fund has been invested. Individual managers have also underperformed their benchmarks to varying degrees. The review will update expectations for performance as a ‘sector’, and also for each manager we are currently invested with.

4.4 The Fund’s current holding in FoHFs is as follows:

Fund	Holding	% of Total Fund
Gottex	£57m	1.7%
Signet	£66m	2.0%
Stenham	£38m	1.1%
Total	£161m	4.9%

4.5 When the Fund first invested in hedge funds in 2007, it decided to invest via a Fund of Funds structure in order to get real diversification across managers and strategies and to use specialist expertise in the selection and monitoring of funds given that it was a new asset class for the Fund.

5 REVIEW OBJECTIVES AND SCOPE

5.1 The headline objectives of the review are as follows:

- (1) To review the current allocation and determine whether any tactical change from the 5% central target is appropriate within the established strategic range of 0%-7.5% (which will remain unchanged)
- (2) To review how best to get the required exposure (i.e. how the portfolio is structured and the best ‘method of access’)

5.2 The review will be undertaken by JLT, who will produce a report to meet the objectives. The report will include:

- (1) Sector update - A description of how the hedge fund industry has evolved over time, how risks and opportunities have developed and an analysis of

the different options for how hedge fund investments can be accessed (for example through fund of funds, single funds, direct, bespoke funds)

- (2) Performance assumptions – State how returns have compared to strategic assumptions and what implications this has for any changes to the tactical allocation. Compare absolute returns to those of other growth assets (equities mainly). Assess whether there are any significant differences between FoHF, single multi strategy and single strategy in performance and volatility or whether it depends more on the strategy they pursue.
- (3) Performance of APF’s FoHF managers versus benchmarks and strategic assumptions and whether there are any performance concerns with any of the managers
- (4) Options for portfolio – Identify potential options, for example remain in FOHFs (retain some or all of current portfolio and/or select new FoHF manager(s)), go down a single multi strategy manager, or single strategy manager. Outline the different risks and costs involved including manager selection, diversification, and fee levels.
- (5) Implementation considerations

5.3 JLT will make the following recommendations:

- (1) What the target tactical allocation should be (within strategic range of 0%-7.5%)
- (2) How best to structure that exposure.
- (3) Any implications for implementing the recommendations

6 RISK MANAGEMENT

6.1 The Avon Pension Fund Committee is the formal decision-making body for the Fund. As such it has responsibility to ensure adequate risk management processes are in place. It discharges this responsibility by ensuring the Fund has an appropriate investment strategy and investment management structure in place that is regularly monitored. The creation of an Investment Panel further strengthens the governance of investment matters and contributes to reduced risk in these areas.

7 EQUALITIES

7.1 An equalities impact assessment is not necessary as the report contains only recommendations to note.

8 CONSULTATION

8.1 N/a

9 ISSUES TO CONSIDER IN REACHING THE DECISION

9.1 This report is for information only.

10 ADVICE SOUGHT

10.1 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	
Please contact the report author if you need to access this report in an alternative format	