| Bath & North East Somerset Council | |
|---|---|
| MEETING: | **AVON PENSION FUND COMMITTEE** |
| MEETING DATE: | **28 MARCH 2014** |
| TITLE: | **REVIEW OF INVESTMENT PERFORMANCE (for periods ending 31 December 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 December 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 Key points from the analysis are:

(1) Since 31 March 2013 the funding position has risen to 87% from 78% (and from 84% at 30/9/13) and the deficit has contracted to £515m from £876m (and from £606m at 30/9/13).

(2) The improvement is due to a higher discount rate and better than expected investment returns. Since 31 March 2013 real bond yields have risen by c. 0.4%; nominal bond yields have risen from 3.2% to 3.6% and market implied inflation is unchanged at 3.6%. Investment returns in excess of 5.5% are ahead of the valuation assumption year to date since March.

(3) The funding level improved during the quarter due to investment returns exceeding expectations. Real bond yields were unchanged.

## 5 INVESTMENT PERFORMANCE

### A – Fund Performance

5.1 The Fund's assets increased by £129m (c. 4%) in the quarter, giving a value for the investment Fund of £3,299m at 31 December 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 31 December 2013

| | 3 months | 12 months | 3 years (p.a.) |
|---|---|---|---|
| **Avon Pension Fund** (incl. currency hedging) | 4.1% | 15.2% | n/a |
| **Avon Pension Fund** (excl. currency hedging) | 3.6% | 14.9% | 7.8% |
| **Strategic benchmark** (no currency hedging)<br>*(Fund incl hedging, relative to benchmark)* | 2.6%<br>*(+1.4%)* | 12.2%<br>***(+2.7%)*** | 6.6%<br>*n/a* |
| **Local Authority Average Fund**<br>*(Fund incl hedging, relative to benchmark)* | 3.7%<br>*(+0.4%)* | 15.0%<br>***(+0.2%)*** | 7.7%<br>*n/a* |

5.2 **Fund Investment Return:** Asset class returns were mixed in the quarter with rises in most equity markets and a small decline in Emerging Market equities. Bond markets fell as bond yields rose.

5.3 Over the one year period there have been very positive returns across most equity markets, emerging markets the exception, posting a negative return. Bond markets were flat to down with UK fixed interest gilts and overseas fixed interest bonds declining the most. Property returns have improved whereas hedge funds are still showing the weakest positive returns within the growth portfolio.

5.4 Over three years developed market equities and bond assets have outperformed the strategic assumptions whilst fund of hedge funds and emerging market equities have underperformed assumptions. Longer term bond returns are beginning to tail off as yields begin to rise. Therefore, 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.

5.5 **Fund Performance versus Benchmark: +2.7% over 12 months, attributed to**

**(1) Asset Allocation:** The contribution to outperformance from asset allocation was **1.1%** over the 12 months. This was due to the underweight to fixed income gilts within the bond portfolio; underweight to hedge funds; overweight in developed equities and underweight to emerging markets in final quarter The currency hedging programme contributed **0.3%** over 1 year.

**(2) Manager Performance:** In aggregate, manager performance contributed **1.2%** of the outperformance over the 12 month period, relative to the strategic benchmark.

5.6 **Versus Local Authority Average Fund:** Over one year, the Fund marginally outperformed the average fund due to higher allocations to property and global equities which both performed strongly (this is despite a larger than average allocation to bonds which performed poorly).

5.7 **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.£796m assets in the programme (which has decreased since investing in the two DGF managers), the total effect of underlying currency movements had a negative impact of -2.8% over the quarter, with the hedging programme offsetting this by 1.9% resulting in a net currency return on the assets in the programme of -0.9%. In terms of the Fund's total return, the hedging programme added 0.5% to the Fund's total return in the quarter and 0.3% over the year.

**B – Investment Manager Performance**

5.8 In aggregate over the 3 year period the managers' performance is marginally ahead of the benchmark. 10 mandates met or exceeded their 3 year performance benchmark, which offset underperformance by the Hedge Funds and TT, whose performance has improved significantly. Genesis, RLAM, and Jupiter all continue to perform particularly well against their 3 year performance targets.

5.9 As part of the 'Meet the Managers' programme, the Panel met with Gottex and Signet on 26th February 2014. 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.

## 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 | Complete:<br>Investments made during the quarter. Focus is now on setting up reporting and monitoring. |
| 2 | Emerging Market Equity Mandate | Complete:<br>Selection decision made w/c 2 December 2013. Investments made in January 2014. Focus is now on setting up reporting and monitoring. |
| 3 | Restructuring passive equity portfolio | Complete:<br>Converted to income distributing funds for a number of the passive equity funds managed by BlackRock. |
| 4 | Rebalancing bond portfolio | Complete:<br>Strategic allocation between UK gilts and corporate bonds implemented 16 August |
| 5 | Infrastructure | On Track:<br>Tender process underway. |

## 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 Following the rebalancing undertaken in October 2013 to reduce the overweight to equities (as the allocation was approaching the automatic trigger point for rebalancing), there has been no further rebalancing. The latest Equity:Bond allocation is 78.3 : 21.7 as at 17 February 2014. 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. Your Committee are being recommended to approve the Treasury Management Policy for 2014/15, elsewhere on this meeting's agenda. The Treasury Management policy for 2014/15 is unchanged from the Treasury Management Policy for 2013/14.

7.5 The Fund continues to deposit internally managed cash on call with NatWest, 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.

7.6 During the quarter there was a net cash outflow of c. £0.3m 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. Specific months vary from this average largely due to the varying value of total Lump Sums paid and net Transfers. The model forecasts an average monthly outflow of c. £0.9m over the year to 31 March 2014, and greater outflows in subsequent years. However it is anticipated that c.£17m may be paid up front in April 2014 for three year's deficit recovery payments. This will give the Fund a temporary cash boost that will be offset by lower deficit recovery payments in the following two years. Other factors that will affect the average monthly cash flow are auto enrolment and LGPS 2014. Elsewhere on this meeting's agenda The Service Plan budget includes details of the Fund's three year cash forecast incorporating the anticipated effects of the 2013 Triennial Valuation.

## 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: | 126 |
| Resolutions voted: | 1,309 |
| Votes For: | 1,279 |
| Votes Against: | 20 |
| Abstained: | 0 |
| Withheld* vote: | 10 |

** 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.

| | |
|---|---|
| **Contact person** | Matt Betts, Assistant Investments Manager (Tel: 01225 395420) |
| **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** | |