

Bath & North East Somerset Council

MEETING:	AVON PENSION FUND COMMITTEE
MEETING DATE:	27 JUNE 2014
TITLE:	REVIEW OF INVESTMENT PERFORMANCE (for periods ending 31 March 2014)
WARD:	ALL
AN OPEN PUBLIC ITEM	
List of attachments to this report: Appendix 1 – Fund Valuation Appendix 2 – JLT Annual Investment Review Exempt Appendix 3 – Changes in RAG status of Managers Appendix 4 – LAPFF Quarterly Engagement Monitoring Report Appendix 5 – Revised Statement of Investment Principles	

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 2014.
- 1.2 The main body of the report comprises the following sections:
 - Section 4. Funding Level Update
 - Section 5. Annual Investment Review
 - Section 6. Investment Performance: A - Fund, B - Investment Managers
 - Section 7. Investment Strategy
 - Section 8. Portfolio Rebalancing and Cash Management
 - Section 9. Corporate Governance and Responsible Investment (RI) Update
 - Section 10. Update to Statement of Investment Principles

2 RECOMMENDATION

The Avon Pension Fund Committee is asked to:

- 2.1 **Note the information set out in the report**
- 2.2 **Note LAPFF Quarterly Engagement Report at Appendix 4**
- 2.3 **Agree minor updates to the Statement of Investment Principles as explained in Section 10**

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) The funding level has increased 6% over the year from 78% to c. 84% and the deficit has contracted to c. £636m from £876m.
- (2) The improvement was initially due to a rise in real bond yields used to value the liabilities. However, as the year progressed and bond yields fell back slightly, the improvement has been driven by investment returns exceeding expectations.

5 ANNUAL INVESTMENT REVIEW

5.1 This quarter JLT have provided an annual investment review of the year to 31 March 2014 (see Appendix 2) rather than the normal quarterly performance report. It was agreed as part of the strategic investment review in 2013 to provide an annual report to the Committee following the delegation of some investment decisions to the Investment Panel.

5.2 This purpose of this report is inform the Committee as to how the strategy has performed over the last year, whether the underlying assumptions of the investment strategy remain valid, and whether the investment manager structure is delivering against expectations.

6 INVESTMENT PERFORMANCE

A – Fund Performance

6.1 The Fund's assets increased by £26m (c.0.8%) in the quarter, giving a value for the investment Fund of £3,325m at 31 March 2014. Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and 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 March 2014

	3 months	12 months	3 years (p.a.)
Avon Pension Fund (incl. currency hedging)	0.8%	6.6%	n/a
Avon Pension Fund (excl. currency hedging)	0.9%	5.9%	7.8%
Strategic benchmark (no currency hedging) <i>(Fund incl hedging, relative to benchmark)</i>	1.2% <i>(-0.4%)</i>	4.5% (+2.1%)	6.5% <i>n/a</i>
Local Authority Average Fund <i>(Fund incl hedging, relative to benchmark)</i>	0.8% <i>(=)</i>	6.3% (+0.3%)	7.5% <i>n/a</i>

6.2 **Fund Investment Return:** Equity markets were mixed over the quarter with positive returns led by Europe and the US; Asian markets were marginally positive whilst the UK and Emerging Markets experienced a small fall. Japan was the worst performing equity market in the quarter. Gilts and corporate bonds produced strong positive returns as bond yields fell over the quarter.

6.3 Over the one year period only UK equities and property outperformed their strategic return assumption. Over 3 years only UK equities and UK bonds (gilts, corporates and index-linked) outperformed their strategic return assumption, with Property performing in line, whilst all other asset classes (overseas equities, hedge funds, emerging market equity and hedge funds) underperformed their strategic return assumption.

6.4 **Fund Performance versus Benchmark: +2.1% over 12 months, attributed to**

(1) **Asset Allocation:** The contribution to outperformance from asset allocation was **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 **0.7%** over 1 year.

(2) **Manager Performance:** In aggregate, manager performance contributed **0.3%** of the outperformance over the 12 month period, relative to the strategic benchmark.

6.5 **Versus Local Authority Average Fund:** Over one year, the Fund marginally outperformed the average fund.

6.6 **Currency Hedging:** The hedging programme is in place to manage the volatility arising from overseas currency exposure, in particular to protect the Fund as sterling strengthens and returns from foreign denominated assets reduce in sterling terms. The hedging programme has detracted -0.1% from the total Fund return over the quarter but added 0.8% over the year.

B – Investment Manager Performance

6.7 In aggregate over the three year period the managers' performance is marginally ahead of the benchmark. Eleven mandates met or exceeded their three year performance benchmark, which offset underperformance by Gottex and Signet. Genesis, RLAM, and Jupiter all continue to perform particularly well against their three year performance targets.

- 6.8 As part of the 'Meet the Managers' programme, the Panel met with Stenham and Schroder (UK Property mandate) on 4th June 2014. The summary of the Panel's conclusions can be found in Exempt Appendix 3 to the Investment Panel Activity Report.
- 6.9 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 2 amber rated managers (Stenham and TT) have been upgraded to a Green rating (explained in Exempt Appendix 3).** Currently 3 managers are amber rated.

7 INVESTMENT STRATEGY

- 7.1 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:
2	Emerging Market Equity Mandate	Complete:
3	Restructuring passive equity portfolio	Complete:
4	Rebalancing bond portfolio	Complete:
5	Infrastructure	On Track: Evaluation of tender responses underway. Selection meeting planned for early July.

8 PORTFOLIO REBALANCING AND CASH MANAGEMENT

Portfolio Rebalancing

- 8.1 The rebalancing policy requires automatic rebalancing between the allocations to Liquid Growth (equities and diversified growth funds) and Stabilising (Bonds) assets when the liquid growth portion deviates from 75% by +/- 5%. Tactical rebalancing is allowed between deviations of +/- 2 to +/- 5%, on advice from the Investment Consultant. The implementation of this policy is delegated to Officers.
- 8.2 There was no rebalancing in the quarter. At 21 May 2014 the Equity:Bond allocation was 77.9:22.1. In April/May the Fund received lump sum deficit contribution payments from some employers which was invested to maintain allocation targets, resulting in a small reduction in the Equity:Bond ratio. Monies were invested in the following portfolios: Royal London, Pyrford and Barings. The remainder is held as cash as monthly contributions will be lower as a result of the lump sum payments. Officers will continue to incorporate any rebalancing considerations 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 (latest approved on 28 March 2014).
- 8.5 The Fund continues to deposit internally managed cash on call with NatWest, Barclays and Bank of Scotland. The Fund deposits cash with the Goldman Sachs Asset Management Global Treasury Fund (AAA rated) and another AAA rated fund with Deutsche Bank is available for deposits if required. The Fund also has access to the Government's Debt Management Office; however the interest paid currently may not cover the transfer and administration costs incurred.
- 8.6 During the quarter the net cash flow was neutral with benefits paid and costs incurred approximately equalling contributions and income received. However the overall trend continues to be cash flow negative as costs exceed income. This trend was offset during the quarter by a fall in lump sum payments and unusually high "Strain on the fund" receipts. The Strain receipts related to early retirements at the end of March that resulted in lump sum payments at the start of April. The model forecast an average monthly outflow of c. £0.9m over the year to 31 March 2014, and greater outflows in subsequent years. The outflow of cash during 2013/14 has been very close to this forecast.
- 8.7 In April 2014 the four Unitary Authorities and two Universities paid their deficit recovery payments in advance. This gave the Fund a temporary cash boost that will be offset by lower deficit recovery payments in the next two years. To date there has been no cash flow affect from the 50:50 option of LGPS 2014 or auto enrolment.

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:	143
Resolutions voted:	1,899
Votes For:	1,789
Votes Against:	117
Abstained:	3
Withheld* vote:	0

** 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 4.

10 STATEMENT OF INVESTMENT PRINCIPLES

10.1 The Fund's Statement of Investment Principles sets out the Fund's investment strategy and policies and states how the Fund complies with the

Myners Principles for Effective Decision Making. The requirement to produce a Statement of Investment Principles is set out in the Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 2009. These regulations provide that “the written statement must be revised by the administering authority in accordance with any material change in their policy ... and published”.

10.2 The SIP has been updated to include the new investment managers appointed and the revised allocations between mandates. These changes are highlighted in Appendix 5.

10.3 The Committee is asked to approve the revised SIP in Appendix 5.

11 RISK MANAGEMENT

11.1 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.

12 EQUALITIES

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

13 CONSULTATION

13.1 This report is for information and therefore consultation is not necessary.

14 ISSUES TO CONSIDER IN REACHING THE DECISION

14.1 The issues to consider are contained in the report.

15 ADVICE SOUGHT

15.1 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	