Bath & North East Somerset Council		
MEETING:	**Avon Pension Fund Committee**	
MEETING DATE:	**10 December 2010**	**AGENDA ITEM NUMBER**
TITLE:	**Review Of Investment Performance For Quarter Ending 30 September 2010**	
WARD:	**ALL**	
AN OPEN PUBLIC ITEM		
List of attachments to this report: Appendix 1 – Fund Valuation Appendix 2 – JLT performance monitoring report Appendix 3 – Background information on Manifest		

1 THE ISSUE

1.1 This report contains performance statistics for the quarter ending 30 September 2010. The report focuses on the strategic investment policy, the managers' performance, a funding update, and portfolio rebalancing.

1.2 Most of the detail is contained in the appendices. The Fund's investment consultant, JLT, have prepared a report (Appendix 2) covering the performance of the investment strategy, the performance of the investment managers and the market commentary.

1.3 The Committee agreed in March 2010 to appoint an agent to assist the Fund in monitoring the voting activity that the investment managers undertake on behalf of the Fund. This appointment was delegated to Officers and following a tender process, Manifest has been appointed to provide this service.

2 RECOMMENDATION

That the Avon Pension Fund Committee:

2.1 Notes the information as set out in the report.

2.2 Notes the appointment of Manifest to monitor the Fund's voting activity.

3 FINANCIAL IMPLICATIONS

3.1 The returns achieved by the Fund for the three years commencing 1 April 2010 will impact the next triennial valuation which will be calculated as at 31 March 2013.

3.2 Section 6 of this report discusses the Fund's liabilities and the funding level.

4 INVESTMENT PERFORMANCE

4.1 Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and managers.

4.2 JLT's report in Appendix 2 provides a full commentary on the performance of the strategic benchmark (pages 11-15), the investment managers (pages 16-40) and a commentary on investment markets (pages 4-10). In the section on the Fund (page 13), three year rolling returns are included to provide a longer term perspective.

4.3 The Fund's investment return and performance relative to benchmarks is summarised in the following table for the periods to 30 September 2010:

	3 months	**12 months**	**3 years (p.a.)**
Avon Pension Fund	8.1%	10.8%	*2.6%*
Strategic benchmark *(Fund relative to benchmark)*	7.8% *(+0.3%)*	11.2% *(-0.4%)*	1.0% *(+1.6%)*
Customised benchmark *(Fund relative to benchmark)*	8.3% *(-0.2%)*	10.4% *(+0.4)*	3.4% *(-0.8%)*
WM Local Authority Average Fund *(Fund relative to universe)*	8.2% *(-0.1%)*	11.0% *(-0.2%)*	0.8% *(+1.8%)*

4.4 The Fund's assets rose in value by £187m (8.1%) in the quarter giving a value for the Fund of £2,492m at 30 September 2010. This investment return was driven mainly by the rally in equity markets.

4.5 More importantly over the last twelve months the Fund's assets rose by £260m or 10.8%, driven by positive returns across all asset classes.

4.6 The initial estimate for the Fund's return in October is +1.3%.

4.7 **Against its strategic benchmark** (60% equities, 20% bonds, 10% property, 10% hedge funds) the Fund marginally underperformed over the year. The main reason for this was because the actual returns from property are lower as the Fund is still investing its property portfolio.

4.8 **Against its customised benchmark** (which measures the relative performance of the managers), the Fund marginally underperformed in the quarter. This was a result of underperformance by Jupiter and Invesco. Most of the other managers were in line with, or ahead of, their benchmarks.

4.9 Over the year the Fund marginally outperformed the customised benchmark mainly due to the outperformance of Jupiter, Royal London, Genesis and two of the hedge funds.

4.10 Over the last three years the Fund has generated a return of 2.6% p.a. underperforming the customised benchmark return by -0.8%. This is attributable to manager performance. Asset allocation has been a positive contributor.

4.11 **Compared to the WM Local Authority Fund universe**, the Fund underperformed marginally over the year but outperformed by 1.8% p.a. over 3 years.

4.12 The report by JLT identifies no areas of significant concern regarding the managers, but did note the SRI constraints on Jupiter may be at the cost of continued relative underperformance (notwithstanding the significant outperformance in Q2 2010) and significant volatility relative to the benchmark. This will addressed as part of the forthcoming review of the Fund's SRI policy.

4.13 During the quarter the Investment Panel received presentations from two of the Fund of Hedge Fund managers, the purpose being to review performance, understand the manager's investment process and operational risk management, review the outlook for their strategies and discuss future investment strategy. In January the Panel will meet the remaining three Fund of Hedge Fund managers. From these meetings, the Panel will identify any particular performance or operational issues and draw conclusions about the hedge fund portfolio which will be considered by the Committee at its workshop on the hedge fund portfolio to be held in March 2011.

4.14 Following the merger of MAN Group and GLG in 3Q10, some staff restructuring has occurred within the FoHF division and as a result the portfolio manager responsible for co-ordinating the Fund's portfolio left the company on 10 November 2010. This was discussed at the Panel meeting with MAN Group (on 11/11/10) and assurance was provided by MAN that this should not have an adverse impact on performance, given the team approach to constructing and managing the portfolios. However, the officers will closely monitor the impact of the integration of the two organisations.

4.15 The selection meeting for the new global equity manager was held on the 24 November 2010. This is covered in another agenda item.

5 INVESTMENT STRATEGY

5.1 JLT's report did not highlight any new strategy issues for consideration. The report does highlight the risk return profile of the Fund on pages 17, 18 & 19 and the impact on risk/return by each of the managers. In particular JLT conclude that the volatility of the various portfolios/funds is in line with expectations and that the Fund has benefited from diversification by asset classes as the Fund volatility is lower than the equity managers and passive BlackRock portfolio despite these making up a large proportion of the Fund's assets

5.2 Background work for the Fund's review of its investments in hedge funds is underway and will conclude in Q1 2011 with a Committee workshop on Wednesday 2 March 2010.

6 ACTUARIAL VALUATION UPDATE

6.1 The Fund's triennial valuation is considered in detail in a report earlier in the agenda. Since 31 March 2010 the funding level is estimated to have fallen to around 78% adopting consistent assumptions. The impact of the change in real yields (the main driver for liabilities as demographic assumptions are unchanged) in isolation is to increase liabilities by around £100m which more than offsets the rise in asset values of c. 2.0% over the same period.

6.2 The table below shows the change in financial assumptions:

	31 March 2010	31 September 2010
UK Gilt yield	4.5%	3.9%
Index linked real yield	0.7%	0.5%
Inflation adjustment	0.8%	0.8%
Implied CPI inflation	3.0%	2.6%

7 CASH MANAGEMENT

7.1 Cash is not included in the strategic benchmark. However, cash is held by the managers at their discretion within their investment guidelines, and internally to meet working requirements. The segregated portfolios, TT, Jupiter and BlackRock utilise money market funds offered by the custodian, BNY Mellon. The cash within the pooled funds is managed internally by the manager. The cash managed by BlackRock in the property portfolio is invested in the BlackRock Sterling Liquidity Fund. 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.

7.2 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 are invested in line with the Fund's Treasury Management Policy which was approved on 18 December 2009.

8 REBALANCING POLICY

8.1 The rebalancing policy requires rebalancing of the Equity/Bond allocation to occur when the equity portion deviates from 75% by +/- 2%, and the valuation metric, in this case the equity gilt yield ratio, confirms that the relative valuation between equities and bonds is favourable. The implementation of this policy is delegated to officers.

8.2 There was no rebalancing undertaken this quarter. As at 27 October 2010 the Equity:Bond allocation was estimated at 75.2:24.8.

9 LAPFF ACTIVITY

9.1 The Fund is a member of the Local Authority Pension Fund Forum (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.

9.2 LAPFF's current activity includes:

(1) **BP engagement following Gulf of Mexico Oil Spill** - LAPFF met with the BP chair, Carl-Henric Svanberg, in September. The discussion ranged from the company's business strategy, future plans and approach to developing new frontiers; to health and safety governance and reputation management. These issues have also been addressed by LAPFF at previous meetings with BP dating back to 2006.

(2) **Engaging over labour standards** – LAPFF and a group of investors sought to engage with 10 companies with significant US operations over proposed employment legislation in the US. The legislation intended to make it easier for employees to be represented by a union if they wish to. The legislation has yet to be enacted and changing political fortunes in the US make it appear unlikely to be put into action. However, LAPFF engagement highlighted an issue at one company with alleged anti union practices. LAPFF are seeking to provide support in developing independent monitoring of any alleged breaches of the company's freedom of association policy.

(3) **Progress on Stewardship Code compliance** – In mid-October the Financial Reporting Council (FRC) officially launched the Stewardship Code for institutional investors. LAPFF report that the FRC hoped to have over 50 investors signed up by the official launch, with around three quarters being asset managers. In reality the FRC exceeded their initial expectation, as 50 asset managers complied plus 12 asset owner signatories at launch.

A paper on the FRC Stewardship Code which includes a compliance statement for the Fund is covered elsewhere in the agenda.

10 VOTE MONITORING APPOINTMENT

10.1 Following a recommendation from the Investment Panel, the Committee resolved to appoint a vote monitoring service in their meeting on 26 March 2010. A vote monitoring service will enable the Fund to more closely monitor the voting activity the managers undertake on its behalf and enhance the transparency and reporting of such voting to scheme members. In this way, the service supports the Fund in achieving compliance with the FRC Stewardship Code as discussed elsewhere on the agenda.

10.2 As the contract is to provide operational support to the Fund rather than expert advice the appointment was delegated to officers.

10.3 A tender process in line with the Council's procurement policy was run via the Council's e-procurement platform 'Pro Contract' which provides a full audit trail. Officers identified and invited 7 suppliers to tender. Of these, 5 registered interest and 2 submitted a full tender.

10.4 Following an evaluation of the submissions against the specification and evaluation criteria set out in the tender document, Manifest was appointed as the monitoring agent, subject to legal agreement. Background information on Manifest is included at Appendix 3.

10.5 Manifest will provide the following:

(1) Monitoring the voting activity of the equity managers (for both segregated and pooled equity portfolios, UK and overseas) against benchmark.

(2) A quarterly monitoring report for the Avon Pension Fund Committee, and an additional version of the report in a format suitable for public disclosure (i.e. website).

(3) An annual summary of voting activity and high level review of voting issues for the Avon Pension Fund Committee, which will be in a format suitable for public disclosure (i.e. website).

10.6 An allowance for this service was included in the 2010/11 budget.

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 the return of the strategic benchmark and 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 This report is primarily for information and therefore an equalities impact assessment is not necessary.

13 CONSULTATION

13.1 This report is primarily 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 (Council Solicitor) 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	LAPPF Member Bulletins Data supplied by The WM Company

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