

Bath & North East Somerset Council

MEETING:	AVON PENSION FUND COMMITTEE
MEETING DATE:	12 DECEMBER 2014
TITLE:	REVIEW OF INVESTMENT PERFORMANCE (for periods ending 30 September 2014)
WARD:	ALL
AN OPEN PUBLIC ITEM	
List of attachments to this report: Appendix 1 – Fund Valuation Appendix 2 – JLT Performance Monitoring Report Exempt Appendix 3 – Changes in RAG status of Managers	

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 2014.
- 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. Voting 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) The funding level has fallen from 87% to 83% since June 2014 and compares to 78% at the March 2013 valuation.
- (2) The fall in the funding level was due to an increase in the liabilities. The discount rate has fallen from 5% to 4.7% due to a reduction in the bond yield from 3.4% to 3.1%. This compares to a bond yield of 3.2% at the March 2013 valuation. A fall in implied inflation from 3.5% to 3.4% offset some of the impact from bond yields. Likewise asset returns were marginally ahead of expectations.
- (3) Since the 2013 valuation the discount rate has been broadly neutral on the funding position. The improvement in the funding level has been due to excess investment returns and the advance payment of deficit contributions.

5 INVESTMENT PERFORMANCE

A – Fund Performance

5.1 The Fund's assets increased by £53m (c.1.5%) in the quarter, giving a value for the investment Fund of £3,539m at 30 September 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 30 Sept 2014

	3 months	12 months	3 years (p.a.)
Avon Pension Fund (incl. currency hedging)	1.9%	9.4%	12.0%
Avon Pension Fund (excl. currency hedging)	2.0%	8.9%	11.7%
Strategic benchmark (no currency hedging)	2.4%	8.7%	10.8%
<i>(Fund incl hedging, relative to benchmark)</i>	<i>(-0.5%)</i>	<i>(+0.6%)</i>	<i>(+1.1%)</i>
Local Authority Average Fund	1.8%	8.5%	11.7%
<i>(Fund incl hedging, relative to benchmark)</i>	<i>(+0.1%)</i>	<i>(+0.9%)</i>	<i>(+0.3%)</i>

5.2 **Fund Investment Return:** All Equity markets achieved positive returns over the quarter with the exception of the UK (-1%) and Europe (-2.6%) whilst Frontier markets (+7.1%) and the USA (+6.4%) were the strongest returning markets. Bond yields again fell over the quarter leading to strong positive returns from Gilts (+7.2%) and Corporate Bonds (+5.5%) over the quarter.

5.3 Over the one year period, of the equity markets only North American outperformed the strategic return assumptions. Of the other asset classes, property and UK bonds (gilts corporates and index linked) all outperformed. Over 3 years developed market equities, UK bonds (gilts, corporates and index-linked) and property all outperformed their strategic return assumption, whilst emerging market equities and hedge funds underperformed their strategic return assumption.

5.4 **Fund Performance versus Benchmark: +0.6% over 12 months, attributed to**

(1) **Asset Allocation:** The contribution to outperformance from asset allocation was **0.8%** over the 12 months. This was due to an underweight to emerging markets equities and hedge funds and an overweight in developed market overseas equities. In addition the currency hedging programme contributed **0.5%** over 1 year.

(2) **Manager Performance:** In aggregate, manager performance detracted **-0.7%** over the 12 month period, relative to the strategic benchmark. The main impacts were that the small outperformance by UK and Emerging market equity managers was offset by the underperformance of the global equity manager.

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

5.6 **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 marginally detracted from the Fund's total return over the quarter (-0.1%) but added 0.5% over the year.

B – Investment Manager Performance

5.7 In aggregate over the three year period the managers' performance is marginally ahead of the benchmark (+0.2%). Twelve mandates met or exceeded their three year performance benchmark, which offset underperformance by Schroder Global Equity, and Signet. Genesis, RLAM, TT and Jupiter performed particularly well against their three year performance targets.

5.8 As part of the 'Meet the Managers' programme, the Panel met with TT (UK equity mandate) and Jupiter (UK SRI equity mandate) on 21 November 2014. The summary of the Panel's conclusions can be found in Exempt Appendix 3 to the Investment Panel Activity Report.

5.9 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 (TT and Gottex) have been upgraded to a Green rating (explained in Exempt Appendix 3).** Currently 2 managers are amber rated.

5.10 The reported performance data of the Partners property portfolio was discussed at the Investment Panel meeting. Officers are clarifying with WM (the Fund's independent performance provider) how WM calculate the return of this particular portfolio to ensure they are reflecting the cash flows accurately. Officers will report back to Panel once WM have clarified the situation.

6 INVESTMENT STRATEGY

6.1 During the quarter, progress on implementing the remaining changes to the Investment Strategy agreed in March 2013 was as follows:

(1) Infrastructure investments - Selected IFM to manage the Funds infrastructure allocation, and completed the subscription process. Note that it is expected that funds will be drawn down over a period of up to 2 years.

6.2 Following a review of the Fund of Hedge Funds portfolio, the Fund is currently tendering for a manager to manager a bespoke portfolio of hedge fund investments (as notified in last quarter's Committee meeting).

7 PORTFOLIO REBALANCING AND CASH MANAGEMENT

Portfolio Rebalancing

7.1 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.

7.2 In September the Fund redeemed its holding with Barings realising £232m; the majority of this money (£225m) was placed with the BlackRock passive portfolio on a temporary basis. Approximately 63% of funds were placed in Global Equities, 14% in overseas bonds and the remainder in Gilts. The effect of this change reduced the Equity:Bond ratio and still remains within the tactical range for rebalancing. The latest Equity:Bond allocation is 74.8:25.2 as at 5 Nov 2014. Officers will continue to incorporate any rebalancing considerations as the new infrastructure mandate is funded.

Cash Management

7.1 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.

7.2 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 during the quarter were invested in line with the Fund's Treasury Management Policy (latest approved on 28 March 2014).

7.3 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.

7.4 Following the lump sum deficit recovery payments in April it was forecast that there would be an average cash outflow of c. £3m each month during the year to 31 March 2015. In the quarter ending 30 September the outflow of cash averaged just over £4m. This was due to the advanced payment of deficit recovery payments in previous quarter and the payment of a high level of retirement lump sums. The increase in future service contributions since the commencement of the new rates on 1 April 2014 has in general terms been offset by the increase in pension payments following Bristol City Council's bulk redundancy exercise. To fund the cash flow shortfall £10m of investment income was transferred from the custodian in August. A further £10m of investment income has been transferred from the custodian in October.

8 VOTING UPDATE

8.1 During the quarter, the Fund's external managers undertook the following voting activity on behalf of the Fund:

Companies Meetings Voted:	189
Resolutions voted:	2,658
Votes For:	2,631
Votes Against:	28
Abstained:	5
Withheld* vote:	1

** 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 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	