

Bath & North East Somerset Council

MEETING:	AVON PENSION FUND COMMITTEE
MEETING DATE:	18 MARCH 2016
TITLE:	INVESTMENT PERFORMANCE AND STRATEGY MONITORING (for periods ending 31 December 2015)
WARD:	ALL
AN OPEN PUBLIC ITEM	
List of attachments to this report: Appendix 1 – Fund Valuation Appendix 2 – Mercer 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 30 September 2015.
- 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**
- 2.2 Note LAPFF Quarterly Engagement Report at Appendix 3**

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, Mercer has analysed the funding position as part of the report at Appendix 2 (section 2). 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 risen c.3% over the quarter from 73% to c. 76% and the deficit has fallen from c. £1.35bn to c. £1.2bn.
- (2) The improvement over the quarter was largely due to positive returns from major asset classes over the quarter and a rise in the discount rate from 4.0% to 4.2% reducing the value of liabilities.

Note: this estimated funding level is based on the 2013 valuation assumptions.

5 INVESTMENT PERFORMANCE

A – Fund Performance

5.1 The Fund's assets increased by £108m (a return of 3.3%) in the quarter, giving a value for the investment Fund of £3,705m at 31 December 2015. 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 benchmark is summarised below.

Table 1: Fund Investment Returns
Periods to 31 December 2015

	3 months	12 months	3 years (p.a.)
Avon Pension Fund (incl. currency hedging)	3.3%	2.3%	8.5%
Avon Pension Fund (excl. currency hedging)	3.9%	3.2%	8.7%
Strategic benchmark (no currency hedging) <i>(Fund incl hedging, relative to benchmark)</i>	3.4% <i>(-0.1%)</i>	2.9% <i>(-0.6%)</i>	8.1% <i>(+0.4%)</i>
Local Authority Average Fund <i>(Fund incl hedging, relative to benchmark)</i>	4.5% <i>(-1.2%)</i>	3.9% <i>(-1.6)</i>	9.1% <i>(-0.6%)</i>

5.2 **Fund Investment Return:** All Equity markets produced positive returns over the quarter in Sterling terms. Emerging Markets was again the worst performing region (+3.1%) whilst the UK All Share Index rose by 4%. Bond yields rose across all maturities over the quarter leading to negative returns from Gilts. Corporate bonds made a small positive performance over the quarter (+0.4%).

5.3 **Fund Performance versus Benchmark: -0.6% over 12 months, attributed to**

- (1) **Asset Allocation:** The contribution to outperformance from asset allocation was - **0.1** over the 12 months. This was largely due to the small underweight to property which performed well over the year. The currency hedging programme detracted - **0.9%** over 1 year.
- (2) **Manager Performance:** In aggregate, the contribution of manager performance was **0.4%** over the 12 month period, relative to the strategic benchmark, driven by strong performance in UK and overseas equities mandates offsetting underperformance in diversified growth and property versus their individual benchmarks.
- 5.4 **Versus Local Authority Average Fund:** Over one and three years, the Fund underperformed the average fund.
- 5.5 **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 detracted -0.6% to the total Fund return over the quarter and -0.9% over the year.

B – Investment Manager Performance

- 5.6 Eight mandates met or exceeded their three year performance target, which offset underperformance by Partners, Schroder Global Equity and Schroder Property. Jupiter, RLAM, and TT all continue to perform particularly well against their three year performance targets.
- 5.7 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 no changes have been made to any managers rating.** Currently 2 managers are amber rated, Schroder (global equity) and Partners. The Panel are monitoring the performance of both mandates.

6 INVESTMENT STRATEGY

- 6.1 **Liability Driven Investing:** The Investment Panel is undertaking a review of the Fund's management of liability risk which will form a significant part of the workplan over the coming months.
- 6.2 **Asset Class Returns:** Returns from developed equities and property significantly outperformed the strategic assumptions over three years, whilst emerging market equities and hedge funds underperformed significantly. The corporate bond return has fallen marginally below the three year strategic assumption this quarter.
- 6.3 **Fund of Hedge Funds:** JPMorgan mandate is now fully funded following drawdown of the final tranche in December, funded from the realisation of the outgoing fund of hedge fund mandates.
- 6.4 **Infrastructure:** The Fund's investments in infrastructure are awaiting drawdown by the manager IFM who anticipate the first tranche of funds being drawn down in the first half of 2016.
- 6.5 **Bond Portfolio:** Changes to the bond portfolio agreed at the previous meeting are in the process of being implemented.
- 6.6 **MIFID II Update:** The implementation of MiFID II has been formally delayed by a year until 3 January 2018 by the European Commission.

7 PORTFOLIO REBALANCING AND CASH MANAGEMENT

Portfolio Rebalancing

7.1 The Fund's new Rebalancing Policy was approved by Committee in December and now looks at the allocations to each asset class rather than just the equity:bond ratio. The following allocations were discussed at the Investment Panel meeting on 24th February:

- (1) Developed market equities were overweight (c.1.9% above maximum neutral range of 42%) - this overweight will remain pending drawdown of investments for the infrastructure mandate.
- (2) Emerging market equities are underweight (c.0.4% below the minimum neutral range of 9%) – yet to rebalance as Mercer outlook is 'neutral' but moving towards 'unattractive'. Given the recent volatility in emerging markets officers are monitoring the position closely.

Cash Management

7.2 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.

7.3 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.

7.4 The Fund continues to deposit internally managed cash on call with NatWest, Bank of Scotland and Svenska Handelsbanken. The Fund also deposits cash with the Goldman Sachs Asset Management Global Treasury Fund (AAA rated). In addition The Fund has access to the Government's Debt Management Office, however the interest paid currently may not cover the transfer and administration costs incurred.

7.5 During the period there were no breaches of the Fund's Treasury Management Policy (approved June 2015).

7.6 The 2015/16 Service Plan forecast an average cash outflow of c. £2m each month during the year to 31 March 2016, making a total outflow of £24m for the year to 31st March 2016. Unbudgeted inflows during the year including the Curo termination payment partly offset by unbudgeted outflows such as Bristol City Council recouping their previous overpayments have led to a revised cash flow forecast for the year to 31st March 2016 of a £16m outflow.

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:	48
Resolutions voted:	397
Votes For:	372
Votes Against:	13
Abstained:	1
Withheld* vote:	11

** 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.

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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	