Bath and North East Somerset Council

AVON PENSION FUND COMMITTEE - INVESTMENT PANEL

Minutes of the Meeting held

Wednesday, 24th February, 2016, 2.00 pm

Members: Councillor David Veale, Ann Berresford, Councillor Mary Blatchford and Shirley Marsh
Advisors: Steve Turner (Mercer), James Giles (Mercer) and Tony Earnshaw (Independent Advisor)
Also in attendance: Tony Bartlett (Head of Business, Finance and Pensions) and Matt Betts (Assistant Investments Manager)

22 EMERGENCY EVACUATION PROCEDURE

The Democratic Services Officer read out the procedure.

23 DECLARATIONS OF INTEREST

There were none.

24 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

Apologies were received from Councillor Chris Pearce and Councillor Cherry Beath.

25 TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

There was none.

26 ITEMS FROM THE PUBLIC - TO RECEIVE DEPUTATIONS, STATEMENTS, PETITIONS OR QUESTIONS

There were none.

27 ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

There were none.

28 MINUTES: 18 NOVEMBER 2015

These were approved as a correct record and signed by the Chair.

29 REVIEW OF INVESTMENT PERFORMANCE FOR PERIODS ENDING 31 DEC 2015

The Assistant Investments Manager presented the summary report. He highlighted the following:

- After a fall in the previous quarter, the Fund's assets increased by £104m in the quarter ending 31st December 2015. However since the end of the quarter there had been significant volatility in markets.

- JP Morgan Hedge Fund mandate was now fully funded.

- The agreed changes to the bond portfolio were being implemented and it was hope that this would be completed by the end of the current quarter, subject to market conditions.

- Two managers were rated as amber: Schroder Global Equity, though their relative performance had continued to improve during the quarter and Partners Group. Partner's IRR return was 8.8% p.a., compared to their IRR target of 10%. They were thus within their tolerance for a green rating on the basis of IRR returns. They were rated amber because they were behind the cash + 4% benchmark over 3 years. It was expected that over time that the IRR and cash + 4% performance would converge. The IRR figure was probably a truer measure of performance of this type of mandate.

Members agreed to focus on IRR returns versus IRR target in future reporting of Partners performance.

- Two allocations were outside the normal range under the new rebalancing policy. Developed market equities were overweight pending the drawdown of investments for the infrastructure mandate. Emerging market equities were underweight; because of the recent volatility in emerging markets officers were monitoring the position closely.

- As requested at the previous meeting Mercer had provided the ESG rating for each manager.

- The implementation of MIFID II had been delayed until January 2018.

Mr Turner introduced the Mercer performance report. He said that the performance of equity markets so far this year had probably been the worst ever, though they had rallied recently. Overall they were down about 7%. Developing markets had done a bit better than developed markets. The fall in equities had as usual encouraged a move into gilts. Gilt yields, which had been low, had consequently fallen further. Index-linked gilts were the best proxy for the Fund's liabilities. The result was that the liabilities of the Fund had probably risen about 6%, while the value of its assets had dropped about 5%. This was in the context of the actuarial valuation taking place on 31st March this year. However, the liabilities might not be as great as they appeared on a gilt basis, because of the changes in the way they would be valued.

Mr Giles commented on the performance of managers and asset classes. He said that the majority of managers had outperformed over the longer term and that Schroders were improving. The allocation to JP Morgan Hedge Fund was now fully in place. There were still some illiquid assets with Man Group that needed to be phased out over time. He drew attention to the summary of manager performance on agenda pages 27 and 28.

Members asked about the ESG ratings. Mr Turner explained that 1 was the highest rating, and that an N in the ESG column meant that Mercer had not formally tested that manager. A Member was disappointed to note that Invesco was only rated 4. The Assistant Investments Manager said that Invesco's investment style did not give them scope for achieving high ratings, but that over the past few years Invesco had employed an engagement overlay service to engage with companies through correspondence rather than face-to-face, but it was an improvement on their previous practice.

Members discussed the SRI mandate. Mr Turner replied that Mercer would not positively rate a manager simply because of investment exclusions, e.g. not investing in armaments or nuclear power. Mercer was looking for best practice. A Member suggested that there was a difference between ESG and SRI; ESG was about processes, not about the nature of the assets in which investments were made. The Member, however, agreed with the suggestion that ESG had to be taken account of in assessing SRI. Mr Turner said that the demand for SRI mandates was not high. Jupiter was performing well and it was hard to say whether this was down to skill or their exclusion criteria.

Members and officers discussed how the performance of managers should be taken into account in decisions about pooling. The following points were made:

- Pooling could mean reducing the number of managers currently employed by the participating funds to manage a particular asset class from 10 to 2 or 3. We would not wish to disinvest from managers who were performing well.

- Transaction costs had to be minimised.

- There was no manager so bad that that Members would want to disinvest from them in the next three to six months.

The Head of Business, Finance and Pensions said that pooling would be implemented over a period of years and a series of decisions about investment managers would have to be taken. Other funds in the pool would have to input into these decisions. However, the timetable for pooling was not entirely in the control of funds; the Government expected funds to pool their assets, and at some point would start having conversations with funds which appeared slow in doing so.

There was discussion about opportunities for investment in energy companies and in debt.

Mr Turner distributed a set of slides on current topics in investment and commented on them. The slides reviewed 2015 and identified key themes for 2016. The review of 2015 identified things that worked as:

- diversification
- style factor investing
- property
- equity options

Things that did not work were:

- emerging market debt and equity
- hedge funds
- commodities

Key themes identified for 2016 were;

- reduced market liquidity
- a maturing credit cycle
- tilt from alpha to beta
- need to think long term
- EU referendum and "Brexit"

Mr Turner said that Mercer believed that the impact of a vote for Brexit would be less than that of major market events, e.g. a sharp fall in the markets in China. He did not believe that the Fund should alter its portfolios in anticipation of the outcome of the referendum. The Head of Business, Finance and Pensions said that even if there was a vote for Brexit, the impact would only be felt over the longer term, because of the time it would take to reconfigure the UK's international relationships.

Mr Giles commented on the section of the document dealing with the impact of going cashflow negative. The Head of Business, Finance and Pensions noted that the Fund was facing a "double whammy" with a maturing scheme and a shrinking payroll base. In reply to a comment from a Member the Assistant Investments Manager explained that local government funds would not be pooling their liabilities. The Head of Business, Finance and Pensions said that the exit cap would be a serious deterrent against leaving the Fund early and could lead to an increase in the age profile of members.

RESOLVED

(i) to note the information as set out in the report;

(ii) that there are no issues to be notified to the Committee.

The meeting ended at 3.51 pm

Chair(person) ....

Date Confirmed and Signed ....

Prepared by Democratic Services