

Bath & North East Somerset Council

MEETING:	AVON PENSION FUND COMMITTEE
MEETING DATE:	24 JUNE 2016
TITLE:	Annual Review of Investment Strategy & Performance (for periods ending 31 March 2016)
WARD:	ALL
AN OPEN PUBLIC ITEM	
List of attachments to this report: Appendix 1 – Fund Valuation Appendix 2 – Mercer Annual Investment Review 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 31 March 2016.

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

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, 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.5% over the year to 83% based on the preliminary financial assumptions proposed for the 2016 valuation, with an estimated deficit of £750m. Investment returns contributed negatively to the funding position but this was offset by the reduction in the value of the liabilities.
- (2) For completeness the funding level using the gilts basis fell to 72% on a consistent basis with the 2013 valuation. This reduction has come mainly from the fall in gilt yields which increased the present value of the liabilities over the period, together with the negative return on assets.

5 ANNUAL INVESTMENT REVIEW

- 5.1 This quarter Mercer has provided an annual investment review of the year to 31 March 2016 (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 The purpose of this report is to 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 decreased by £86m (a return of -2.1%) in the year, giving a value for the investment Fund of £3,743m at 31 March 2016. 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 March 2016

	3 months	12 months	3 years (p.a.)
Avon Pension Fund (incl. currency hedging)	0.9%	-2.1%	5.8%
Avon Pension Fund (excl. currency hedging)	1.9%	-0.2%	6.1%
Strategic benchmark (no currency hedging)	3.1%	1.5%	6.3%
<i>(Fund incl hedging, relative to benchmark)</i>	<i>(-2.2%)</i>	<i>(-3.6%)</i>	<i>(-0.5%)</i>
Local Authority Average Fund	1.8%	0.2%	6.4%
<i>(Fund incl hedging, relative to benchmark)</i>	<i>(-0.9%)</i>	<i>(-2.3)</i>	<i>(-0.6%)</i>

6.2 **Fund Investment Return:** Returns from Equity markets were disappointing over the year with only the US achieving a small positive return in sterling terms with all other regions producing negative returns. Property performed well over the year with the bond portfolio also contributing positive returns with gilts outperforming UK corporate bonds.

6.3 Over 3 years all asset classes outperformed their strategic return assumption, with the exception of Emerging Market equities, corporate bonds, and hedge funds.

6.4 **Fund Performance versus Benchmark: -3.6% over 12 months, attributed to**

- (1) **Asset Allocation:** The contribution to outperformance from asset allocation was -**0.6%** over the 12 months. This was due to the underweights to Hedge Funds and Property, and an overweight in developed overseas equities. The currency hedging programme **deducted 1.9%** over 1 year.
- (2) **Manager Performance:** In aggregate, manager performance **deducted 1.0%** of the outperformance over the 12 month period, relative to the strategic benchmark, driven by under performance in overseas equities, property and diversified growth versus their individual benchmarks; this is despite a significant outperformance by UK equity managers.

6.5 **Versus Local Authority Average Fund:** Over one year, the Fund underperformed the average fund. Note that as from next quarter the Local Authority average return will no longer be available due to the provider with-drawing this service.

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 deducted 1% from the total Fund return over the quarter and 1.9% over the year.

B – Investment Manager Performance

6.7 Eight mandates met or exceeded their three year performance benchmark, which offset underperformance by Schroder Equity, Schroder Property and Partners. Jupiter and TT continue to perform particularly well against their three year performance targets.

6.8 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 1 manager is amber rated, Schroder (global equity).

7 INVESTMENT STRATEGY

- 7.1 **Asset Class Returns:** Returns from developed equities, index linked gilts, gilts and property outperformed the strategic assumptions over three years, the latter 2 were significantly ahead of the assumed return. Emerging market equities and hedge funds underperformed significantly whilst the UK corporate bond return is marginally below the three year strategic assumption.
- 7.2 **Infrastructure:** \$195m of the Fund's \$300m commitment to infrastructure was drawdown in the fund managed by IFM on 1st April.
- 7.3 **Bond Portfolio:** Changes to the bond portfolio agreed at the previous meetings have now been fully implemented.

8 PORTFOLIO REBALANCING AND CASH MANAGEMENT

Portfolio Rebalancing

- 8.1 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. Following a large drawdown by the infrastructure manager, the overweight to equities has been reduced to within the rebalancing range. As at 8 June there are no allocations outside the rebalancing ranges.

Cash Management

- 8.2 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.
- 8.3 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.
- 8.4 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.
- 8.5 During the period there were no breaches of the Fund's Treasury Management Policy (approved June 2015).

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:	55
Resolutions voted:	598
Votes For:	421
Votes Against:	9
Abstained:	1
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 3.

10 RISK MANAGEMENT

10.1 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.

11 EQUALITIES

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

12 CONSULTATION

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

13 ISSUES TO CONSIDER IN REACHING THE DECISION

13.1 The issues to consider are contained in the report.

14 ADVICE SOUGHT

14.1 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.

Contact person	Matt Betts, Assistant Investments Manager (Tel: 01225 395420)
Background papers	LAPFF Member Bulletins, Data supplied by The WM Company Mercer report on 2014 Budget flexibilities
Please contact the report author if you need to access this report in an alternative format	