

Bath & North East Somerset Council

MEETING:	AVON PENSION FUND COMMITTEE
MEETING DATE:	23 SEPTEMBER 2016
TITLE:	INVESTMENT PERFORMANCE AND STRATEGY MONITORING (for periods ending 30 June 2016)
WARD:	ALL
AN OPEN PUBLIC ITEM	
List of attachments to this report: Appendix 1 – Fund Valuation Appendix 2 – Mercer Performance Monitoring Report EXEMPT Appendix 3 – Changes in RAG status of Investment Managers Appendix 4 – LAPFF Quarterly Engagement Monitoring Report Appendix 5 – Revised Statement of Investment Principles	

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 June 2016.
- 1.2 This is the first quarter that performance measurement has been provided by BNY Mellon, the Fund's custodian. The former provider, State Street WM, withdrew from providing this service to non-custody clients at the end of 1Q16.
- 1.3 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
 - Section 9. Update to Statement of Investment Principles

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 4**
- 2.3 Approve the revised Statement of Investment Principles at Appendix 5**

3 FINANCIAL IMPLICATIONS

3.1 The returns achieved by the Fund from 1 April 2016 will affect the next triennial valuation in 2019. 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.2% over the quarter from 83% to c. 85% and the deficit has fallen from c. £750m to c. £627m (note that this estimate does not take into account the 2016 valuation outcome).
- (2) The improvement over the quarter was due to the return from assets exceeding the increase in liabilities (4.2% vs 1.1% respectively).

5 INVESTMENT PERFORMANCE

A – Fund Performance

5.1 The Fund's assets increased by £160m (c. 4.2%) in the quarter ending 30 June 2016 giving a value for the investment Fund of £3,898m. 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 30 June 2016

	3 months	12 months	3 years (p.a.)
Avon Pension Fund (incl. currency hedging)	4.0%	4.5%	7.5%
Avon Pension Fund (excl. currency hedging)	5.7%	8.7%	8.5%
Strategic benchmark (no currency hedging) <i>(Fund incl hedging, relative to benchmark)</i>	6.0% <i>(-2.0%)</i>	7.6% <i>(-3.1%)</i>	8.7% <i>(-1.2%)</i>

5.2 **Fund Investment Return:** Developed market equities delivered modest positive returns over the quarter on a local currency basis. Japanese equities were the main exception to this trend, falling by more than 7%. European equities (ex-UK) posted small negative returns and in the UK there was a marked difference between domestically focused small- and mid-cap stocks and global large cap stocks, with the FTSE100 returning 6.5% over the quarter. Emerging markets performed well through the quarter. Bond yields fell across all maturities leading to positive returns from Gilts. Corporate bonds benefitted from the decline in government bond yields and contributed a positive performance over the quarter (+4.2%). There was an exceptional level of volatility in financial markets as a result of the EU referendum. On the day of the referendum, 10 year UK gilt yields fell by 0.30%, the largest one day move since the financial crisis.

5.3 Fund Performance versus Benchmark: -2% over the quarter, attributed to

- (1) **Asset Allocation:** The contribution to outperformance from asset allocation was **neutral** over the quarter. The currency hedging programme detracted **-1.7%** over the quarter.
- (2) **Manager Performance:** In aggregate, the contribution of manager performance was **-0.3%** over the quarter, relative to the strategic benchmark, driven by underperformance in UK and overseas equities mandates despite outperformance in hedge funds and infrastructure versus their individual benchmarks.

5.4 **Versus Local Authority Average Fund:** Note that due to the withdrawal of State Street WM from the performance measurement market, there is no longer a local authority average return analysis available.

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 **-1.7%** to the total Fund return over the quarter and **-4.2%** over the year.

B – Investment Manager Performance

5.6 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 3 managers have been downgraded from Green to Amber rating (explained in Exempt Appendix 3).** Therefore, currently 4 managers are amber rated, Schroder (global equity), Invesco, Jupiter and TT.

5.7 Five mandates met or exceeded their three year performance target, which offset underperformance by Schroder (global equity), Invesco, Jupiter and TT. Partners and RLAM were marginally below their performance target but with the tolerance range for a Green RAG rating.

6 INVESTMENT STRATEGY

6.1 **Liability Driven Investing:** Following the delegation by Committee at their June 2016 meeting, Officers and Mercer are in the process of selecting an investment manager and drafting the trigger levels for discussion at the November Investment Panel meeting.

6.2 **Asset Class Returns:** Returns from developed equities, index linked gilts, gilts and property outperformed the strategic assumptions over three years, the latter two were significantly ahead of the assumed return. Corporate bond returns are now also ahead of the strategic assumed return, following a strong Q2. Emerging market equities improved on last quarter due to strong performance throughout Q2 but continue to underperform the 3 year strategic assumption. Hedge funds underperformed significantly.

6.3 **Currency Hedging Policy:** Since the result of the EU referendum, Sterling has fallen significantly against other major currencies (increasing the local market value of non-sterling assets). However, the currency hedge on the non-sterling assets has detracted from local currency returns on the four mandates that are hedged. Mercer

expects currency volatility to continue and have reaffirmed their position on the appropriateness of the current passive currency hedging strategy.

6.4 **Infrastructure:** \$195m of the Fund's \$300m commitment to infrastructure was drawdown in the fund managed by IFM on 1st April.

7 PORTFOLIO REBALANCING AND CASH MANAGEMENT

Portfolio Rebalancing

7.1 No additional rebalancing activity was undertaken during the quarter. As at 31 August there are no allocations outside the rebalancing ranges.

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 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. Deposits with NatWest (the Council / Fund's banker) are kept to the minimum necessary for day to day management.

7.5 During the period there were no breaches of the Fund's Treasury Management Policy (approved March 2016).

7.6 The 2016/17 Service Plan forecast an average cash outflow of c. £1.5m each month during the year to 31 March 2017, making a total outflow of £17.5m for the year to 31st March 2017. This remains the net cash flow forecast for the year. Further details are provided in the pension fund budget and cash flow monitoring report to this Committee.

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:	614
Resolutions voted:	9,724
Votes For:	9,303
Votes Against:	431
Abstained:	29
Withheld* vote:	34

** 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 4.

9 UPDATE TO STATEMENT OF INVESTMENT PRINCIPLES

9.1 The Fund's Statement of Investment Principles (SIP) sets out the Fund's investment strategy and policies and states how the Fund complies with the Myners Principles for Effective Decision Making. The requirement to produce a SIP is set out in the Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 2009. These regulations provide that "the written statement must be revised by the administering authority in accordance with any material change in their policy ... and published".

9.2 The SIP has been updated to reflect the changes made to the bond portfolio to improve matching characteristics versus the liabilities which were fully implemented last quarter. The list of Investment Manager mandates has also been updated to reflect funding of the IFM infrastructure mandate. Note that once the proposed new LGPS Investment Regulations are in place the Fund will produce an Investment Strategy Statement to replace the SIP.

9.3 The Committee is asked to approve the revised SIP in Appendix 5.

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.

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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	