

Bath & North East Somerset Council

MEETING:	AVON PENSION FUND COMMITTEE
MEETING DATE:	9 DECEMBER 2016
TITLE:	INVESTMENT PERFORMANCE AND STRATEGY MONITORING (for periods ending 30 September 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	

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 2016.
- 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. 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 4**

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.4% over the quarter from 85% to c. 89%
- (2) The improvement over the quarter was due to the return from assets exceeding the increase in liabilities (6.2% vs 1.1% respectively).

5 INVESTMENT PERFORMANCE

A – Fund Performance

- 5.1 The Fund's assets increased by £223m (c. 6.2%) in the quarter ending 30 September 2016 giving a value for the investment Fund of £4,121m. 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 September 2016

	3 months	12 months	3 years (p.a.)
Avon Pension Fund (incl. currency hedging)	6.2%	15.2%	8.8%
Avon Pension Fund (excl. currency hedging)	6.8%	19.5%	10.1%
Strategic benchmark (no currency hedging)	6.6%	20.5%	10.4%
(Fund incl hedging, relative to benchmark)	(-0.4%)	(-5.3%)	(-1.6%)

- 5.2 **Fund Investment Return:** Developed market equities delivered positive returns over the quarter largely as a result of accommodative central bank policy in the aftermath of the EU referendum. Positive returns were magnified by Sterling's poor performance where large-cap UK listed names benefitted on repatriation of overseas revenues. Emerging market equities posted equally as impressive returns driven by the prospect of a delayed US interest rate hike and general demand for higher yielding assets. Emerging market economies that derive their value from the price of oil benefitted from a concession by OPEC that crude oil production would likely decrease. Following the announcement of the base rate cut from the Bank of England and increased quantitative easing measures in August, UK Government 10 year bond yields dropped to lows of 0.52%, generating a sharp increase in the value of the Fund's index-linked Gilt holdings. Corporate bonds benefitted from this move to a lesser extent. Both fixed interest

bearing assets remain above the Fund's long-term assumed return. Uncertainty around Brexit may create challenges in the UK property market in future, but for now it continues to outperform the assumed strategic return by 5.6%. Hedge Funds struggle to generate significant absolute returns where yields on cash remain exceptionally low.

5.3 Fund Performance versus Benchmark: **-0.4% 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 **-0.6%** over the quarter.
- (2) **Manager Performance:** In aggregate, the contribution of manager performance was **+0.2%** over the quarter, relative to the strategic benchmark, driven by combined positive returns across all asset classes, with strong returns in particular from global equities.

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 -0.6% to the total Fund return over the quarter and -4.3% 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 1 manager has been upgraded from Amber to Green rating (explained in Exempt Appendix 3).** Therefore, currently 3 managers are amber rated, Schroder (global equity), Jupiter and TT.
- 5.7 All managers with the exception of Schroder Property posted positive absolute returns over the quarter. On a rolling 3 year basis SSgA (Europe and Pacific) was the only manager to outperform their target. Genesis, Invesco, Partners and RLAM were marginally below their performance target but within the tolerance range for a Green RAG rating.

6 INVESTMENT STRATEGY

- 6.1 **Liability Driven Investing:** Progress on the implementation of the Liability Risk Management Framework is set out in the Investment Panel Activity Paper.
- 6.2 **Asset Class Returns:** Returns from developed equities, corporate bonds, index linked gilts and property outperformed the strategic assumptions over three years; the latter two were significantly ahead of the assumed return. Emerging market equities improved on last quarter due to strong performance throughout Q3 and are now only marginally behind their assumed return. Infrastructure is well ahead of expected returns. Hedge Funds lag their assumed return significantly due to exceptionally low cash rates.
- 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). Therefore, the currency hedge on the non-sterling assets has detracted from local currency returns on the four mandates that are hedged. The Consultant and Officers reaffirmed their position on currency hedging at September Panel.

7 PORTFOLIO REBALANCING AND CASH MANAGEMENT

Portfolio Rebalancing

7.1 As at 23 November the Fund was marginally overweight in developed market equities by 0.77%. Officers did not undertake any rebalancing activity in anticipation that the overweight in developed market equities will be used to fund the remaining IFM drawdown.

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 31 March 2017. The current forecast is for a cash out-flow for the year of £20.5m. Further details are provided in the pension fund budget and cash flow monitoring report to this Committee.

8 RESPONSIBLE INVESTMENT UPDATE

8.1 The Fund has published on its website a revised Responsible Investment Policy agreed by Committee on 24 November 2016.

8.2 The Financial Reporting Council (FRC) notified the Fund that the Fund's Statement of Compliance with the FRC's UK Stewardship Code (approved by the Fund in September 2016) achieved a tier 1 rating (the highest rating) assessed as meeting reporting expectations, including clear and meaningful explanations.

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

Companies Meetings Voted:	157
Resolutions voted:	2,120
Votes For:	2,090
Votes Against:	30

Abstained:	11
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.*

8.4 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 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	Data supplied by BNY Performance Services
Please contact the report author if you need to access this report in an alternative format	