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<tr><td>MEETING:</td><td colspan="2">AVON PENSION FUND INVESTMENT PANEL</td></tr>
<tr><td>MEETING DATE:</td><td>22 FEBRUARY 2017</td><td>AGENDA ITEM NUMBER</td></tr>
<tr><td>TITLE:</td><td colspan="2">Review Of Investment Performance For Periods Ending 31 December 2016</td></tr>
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<tr><td colspan="3">List of attachments to this report:
Appendix 1 – Fund Valuation
Appendix 2 – Mercer performance monitoring report (Panel version)
Exempt Appendix 3 – RAG Monitoring Summary Report
Exempt Appendix 4 – Liability Risk Management Framework – Appointment Decision</td></tr>
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1 THE ISSUE

1.1 This paper reports on the performance of the Fund's investment managers and seeks to update the Panel on routine aspects of the Fund's investments. The report contains performance statistics for period ending 31 December 2016.

1.2 The report focuses on the performance of the individual investment managers. The full performance report with aggregate investment and funding analysis will be reported to the Committee meeting on 24 March 2017.

1.3 This is the third quarter that performance measurement has been provided by BNY Mellon, the Fund's custodian. The former provider, SSGA (WM Performance Services) withdrew from providing this service to non-custody clients at the end of 1Q16.

2 RECOMMENDATION

That the Investment Panel:

2.1 **Notes the information as set out in the reports.**

2.2 **Identifies any issues to be notified to the Committee.**

3 FINANCIAL IMPLICATIONS

3.1 The returns achieved by the Fund for the three years commencing 1 April 2016 will impact the next triennial valuation which will be calculated as at 31 March 2019. The returns quoted are net of investment management fees.

4 INVESTMENT PERFORMANCE

A – Fund Performance

4.1 The Fund's assets increased by £73m (c. 1.8%) in the quarter ending 31 December 2016 giving a value for the investment Fund of £4,194m. Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and managers.

4.2 Developed market equities were boosted by the US presidential and congressional elections in November. Risk appetite among investors rallied on hopes of increased infrastructure spending, tax reforms and deregulation under a Trump administration. The US Federal Reserve rate increased by 0.25% in December, which led to further USD appreciation against both major and emerging market currencies and contributed to further investor confidence. A hike in the US interest rate coupled with strong equity returns led investors to move out of fixed interest bearing assets, contributing to an increase in sovereign and corporate yields across all maturities. Currency volatility was present throughout the period. Where the EU referendum had sparked a dramatic decline in the value of sterling, the result of the US election and subsequent shift in monetary policy compounded the effect. Sterling extended its losses by c.4.9% against the USD over Q4. It posted marginal gains against the Euro on strong macroeconomic data and rose significantly against the Yen following further extraordinary bond purchases by the Japanese Government. Sterling weakness continues to benefit UK companies who derive their revenues from overseas. Emerging market equities fared less well on fears that Trump would pursue punitive trade protectionism. Brazil underperformed as a result of muted monetary policy and commodity linked countries such as Russia benefitted from an increase in the oil price.

4.3 On a fundamental basis the consensus remains that equities are either fully valued, or close to being fully valued, and therefore represent limited opportunity for capital growth in the medium term. Where equities have benefitted in recent times as a result of accommodative monetary policy, as this starts to normalise and attention shifts back to earnings growth potential the likelihood of a market correction will increase. The outlook for emerging market equities remains neutral and will continue to be partly determined by the level of risk appetite amongst institutional investors. UK government bond returns to 31 December 2016 remain significantly above the long term strategic expectation. As mentioned above, as monetary policy starts to normalise we would expect a commensurate increase in bond yields that would lead to lower returns from fixed income assets moving forward. This sentiment is echoed in the corporate bond market.

4.4 The Fund's overall performance relative to benchmarks is unavailable at the time of publishing. Full performance data will be reported to the Pensions Committee on 24 March 2017.

B – Investment Manager Performance

4.5 A detailed report on the performance of each investment manager has been produced by Mercer – see pages 26 to 46 of Appendix 2.

4.6 All but one equity manager posted positive absolute returns over the quarter, reflective of wider market returns. The exception was Unigestion who achieved -1.3%. Expectedly, RLAM who manage the UK corporate bond portfolio posted negative absolute returns as yields spiked. However their investment approach proved successful as unrated credit and equities generally benefit from the same risk premium. RLAM outperformed their benchmark by 0.8% over the quarter. Pyrford, who allocate a large percentage of their overall holdings to fixed income (c. 60%), posted small positive absolute returns (+0.7%), again as a result of falling bond prices. After a sustained period of negative absolute returns, Standard Life posted a return of +1.8%, which was primarily driven by their short GBP position and US equity strategies.

4.7 Relative returns were less impressive with a number of active managers underperforming their targets, both on a quarterly and a 3 year rolling basis. Jupiter, Schroder Global Equities, TT UK Equities, Unigestion and Pyrford missed their targets and as a result receive an 'Amber' rating. Conversely the enhanced indexation managers outperformed their respective benchmarks on a short- and long-term basis. Invesco benefited from their allocation to financials and State Street Global Advisors were able to generate returns from identification of value stocks in Europe and the Asia-Pacific region. On a 3 year basis RLAM and Genesis underperformed but remain above the threshold as outlined in the RAG framework and therefore retain their 'Green' rating. Schroder Property retain their 'Green' rating based on the fact their performance is assessed on a rolling 5 year basis. Partners retain their 'Green' rating as their performance is based on net IRRs since inception, which continue to meet expectation. Precise detail of underperformance can be found at Exempt Appendix 3.

4.8 Among the managers that are yet to reach the 3 year mark SLI recouped some of the losses suffered in the preceding two quarters but continue to be monitored closely by officers. JP Morgan achieved a quarterly absolute return of +1.9% in USD terms and IFM posted -0.49% since inception, again in local currency terms.

4.9 Exempt Appendix 3 summarises the latest Performance Monitoring Report used internally to monitor manager performance. The summary report highlights the managers that are rated amber or red, detailing the performance and/or organisational issue(s), how they are being monitored and any actions taken by Officers and/or the Panel. Schroder (global equity mandate), Jupiter and TT have retained amber ratings this quarter. Unigestion and Pyrford have been added to the report as they have reached their 3 year since inception date, which is the point where performance is benchmarked.

5 INVESTMENT STRATEGY AND PORTFOLIO REBALANCING

5.1 **Asset Class Returns**: Returns from developed equities, index-linked gilts and corporate bonds remain ahead of their assumed strategic returns on a 3 year basis. Over the same time horizon emerging market equities are now above the assumed strategic return due largely to the depreciation in sterling. Fixed interest securities (index-linked Gilts and corporate bonds) have been significantly above their assumed returns as a result of the collapse in Gilt yields but note that yields have started to increase and so we could see a turnaround in this trend. Hedge funds remain below long-term averages due in part to exceptionally low cash rates. Property and Infrastructure continue to outperform in GBP terms.

5.2 **Infrastructure**: There were no drawdowns during Q4 but IFM have served notice that the final commitment of $105m will fall due in Q117.

5.3 **Currency Hedging**: Since the result of the EU referendum, Sterling has fallen significantly against other major currencies (increasing the local market value of non-sterling assets). This trend has continued throughout Q4 as the US raised interest rates. Therefore, the currency hedge on the non-sterling assets has detracted from local currency returns on property, infrastructure, hedge funds, and to a lesser extent, overseas equities. The Consultant and Officers reaffirmed their position on currency hedging at September 2016 Panel and will further review the efficacy of the hedge at the strategic review in June 2017.

5.4 **Cash Management**: A total of £58m GBP equivalent was sold from BlackRock overseas equity funds in November and December to meet currency hedging cash requirements necessary to maintain a 50% passive hedge level. A further $105m was sold down from North American equities in Q117 to fund the final instalment to IFM.

5.5 **Rebalancing:** As at 1st February the Fund was marginally overweight in developed market equities by 0.14%. Officers did not undertake any rebalancing activity during the quarter in anticipation that the overweight in developed market equities will be used to fund the remaining IFM drawdown at which point the fund will be back within the strategic allocation range for developed market equities.

5.6 **Manager Meetings:** No manager scheduled to present.

6 RISK MANAGEMENT

6.1 The Avon Pension Fund Committee is the formal decision-making body for the Fund. As such it has responsibility to ensure adequate risk management processes are in place. 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 the performance of the investment managers. The 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.

7 EQUALITIES

7.1 An equalities impact assessment is not necessary as the report is primarily for information only.

8 CONSULTATION

8.1 This report is primarily for information and therefore consultation is not necessary.

9 ISSUES TO CONSIDER IN REACHING THE DECISION

9.1 The issues to consider are contained in the report.

10 ADVICE SOUGHT

10.1 The Council's Section 151 Officer (Divisional Director – Business Support) has had the opportunity to input to this report and has cleared it for publication.

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Background papers	Data supplied by BNY Mellon Performance Measurement
Please contact the report author if you need to access this report in an alternative format	