

Bath & North East Somerset Council

MEETING:	AVON PENSION FUND COMMITTEE
MEETING DATE:	24 MARCH 2017
TITLE:	INVESTMENT PERFORMANCE AND STRATEGY MONITORING (for periods ending 31 December 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 31 December 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.1% over the quarter from 93% (recalibrated since Q3 report) to 94%.
- (2) The improvement over the quarter was due to the return from assets exceeding the increase in liabilities (2.0% vs 1.2% respectively).

5 INVESTMENT PERFORMANCE

A – Fund Performance

5.1 The Fund's assets increased by £78m (c. 2.0%) in the quarter ending 31 December 2016 giving a value for the investment Fund of £4,199m. 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 Investment Panel. The Fund's investment return and performance relative to benchmark is summarised below.

Table 1: Fund Investment Returns

Periods to 31 December 2016

	3 months	12 months	3 years (p.a.)
Avon Pension Fund (incl. currency hedging)	2.0%	13.7%	8.0%
Avon Pension Fund (excl. currency hedging)	2.5%	17.9%	9.7%
Strategic benchmark (no currency hedging)	2.5%	19.4%	10.4%
<i>(Fund incl. hedging, relative to benchmark)</i>	<i>(-0.5%)</i>	<i>(-5.7%)</i>	<i>(-2.4%)</i>

5.2 **Fund Investment Return:** 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 generate overseas revenues. 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.

5.3 Fund Performance versus Benchmark: -0.5% 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 **-0.5%** over the quarter. Over 12 months the negative relative performance of the Fund versus the strategic benchmark excluding currency hedging is attributed to underperformance from a number of the Fund's active equity managers and Standard Life GARS.
- (2) **Manager Performance:** In aggregate, the contribution of manager performance was marginal (**+0.02%**) over the quarter, relative to the strategic benchmark. The fact active managers were not able to capture the market preference for 'value' stocks – where many hold portfolios tilted toward 'quality' stocks – led to minimal contribution to returns.

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 -0.5% 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 all manager ratings remain unchanged.** Exempt Appendix 3 details two managers (Pyrford and Unigestion) that reached their 3 year anniversary with the Fund. Both were assigned an amber rating. Therefore, currently 5 managers are amber rated, Schroder (global equity), Jupiter, TT, Pyrford and Unigestion.

5.7 All managers with the exception of Unigestion and RLAM posted positive absolute returns over the quarter. On a rolling 3 year basis SSgA (Europe and Pacific) and Invesco outperformed their targets. Genesis and RLAM were marginally below their performance target but within the tolerance range for a Green RAG rating.

6 INVESTMENT STRATEGY

6.1 **Responsible Investment:** Panel have made a recommendation to Committee on an appropriate low carbon passive indexing approach for future consideration, which is covered in the Investment Panel Activity paper.

6.2 **Liability Driven Investing:** Officers in consultation with Mercer appointed a manager to run the Fund's LDI mandate and the process and due diligence that was undertaken in the selection process was shared with the Panel at the February meeting.

6.3 **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 benefitted from an increase in the oil price and increased risk appetite from investors and are now slightly ahead of their assumed return. Infrastructure is well ahead of expected returns. Hedge Funds lag their assumed return significantly due to exceptionally low cash rates.

6.4 **Currency Hedging Policy:** Continued confusion around plans for a formal exit from the EU and an increase in the US Federal Reserve interest rate led to a further depreciation in GBP against USD. Therefore, the currency hedge on the non-sterling assets has detracted from local currency returns on the four mandates that are hedged. Mercer and Officers reaffirmed their position on currency hedging at September Panel and will reassess the passive hedging program as part of the wider investment strategy review in Q2 2017.

7 PORTFOLIO REBALANCING AND CASH MANAGEMENT

Portfolio Rebalancing

7.1 As at 1 March 2017 the Fund was within all strategic asset allocation ranges. Officers, having taken advice from Mercer, sold \$105m North American equities from the passive portfolio in January to fund the final commitment for the infrastructure mandate (IFM) in February.

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).

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:	103
Resolutions voted:	1,128
Votes For:	1,087
Votes Against:	32
Abstained:	3
Withheld* vote:	7

** 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 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	