

Bath & North East Somerset Council

MEETING:	AVON PENSION FUND COMMITTEE
MEETING DATE:	22 September 2017
TITLE:	INVESTMENT PERFORMANCE AND STRATEGY MONITORING (for periods ending 30 June 2017)
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 30 June 2017.
- 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. Corporate Governance and Responsible Investment (RI) Update
 - Section 9. Annual Assurance on Control Environment of 3rd Party Suppliers

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 3**

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.3% over the quarter from 96% to 99%.
- (2) The improvement over the quarter was driven by a positive return on assets outweighing an increase in the present value of the liabilities.

5 INVESTMENT PERFORMANCE

A – Fund Performance

5.1 The Fund's assets increased by £128m (2.9%) over the quarter ending 30 June 2017 giving a value for the investment Fund of £4,485m. 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 30 June 2017

	3 months	12 months	3 years (p.a.)
Avon Pension Fund (incl. currency hedging)	1.0%	13.8%	8.7%
Avon Pension Fund (excl. currency hedging)	0.6%	14.4%	10.2%
Strategic benchmark (no currency hedging) <i>(Fund incl. hedging, relative to benchmark)</i>	0.7% <i>(+0.3%)</i>	14.2% <i>(-0.4%)</i>	10.8% <i>(-2.1%)</i>

5.2 **Fund Investment Return:** Global equity markets advanced in Q2 owing to strong corporate earnings and generally positive economic data, which supported gains. The UK equity market experienced volatility over the quarter, benefitting from strong company fundamentals for much of May and then reversing gains as a hung parliament materialised. US equities posted gains despite political uncertainty over the ability of the US administration to push through its fiscally expansive policies. European equities performed well on improving sentiment following the election of President Macron, but gains were capped as the European Central Bank indicated that they would soon begin to taper quantitative easing. Japanese equities increased on continued accommodative central bank policy. Emerging market equities benefited from the supportive global backdrop,

outperforming developed markets although this performance was not reflected in the Fund's emerging market mandates. Russia was the largest detractor to emerging market gains amid a sharp decline in Brent crude prices. In fixed income, bond yields rose sharply towards the end of June, as perceived 'hawkish' comments from the Bank of England and European Central Bank created expectations that monetary policy tightening might occur sooner than anticipated. Domestic inflation rose to 2.9% while wage growth remained low, placing further pressure on household spending. Over the quarter, sterling appreciated against the Dollar and the Yen but fell in value against the Euro.

5.3 Fund Performance versus Benchmark: +0.3% over the quarter, attributed to

- (1) **Asset Allocation:** Asset allocation detracted -0.1% over the quarter. The currency hedging programme contributed +0.4% over the quarter.
- (2) **Manager Performance:** In aggregate, the contribution of manager performance was neutral 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 **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 contributed +0.4% to the total Fund return over the quarter and detracted -0.6% over the year.

B – Investment Manager Performance

5.5 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 there have been no changes to individual manager RAG ratings.** Currently 6 managers are Amber rated.

5.6 Absolute returns of the managers over the quarter were largely positive. The exception was Invesco, who delivered a return of -0.6%. SSgA European equities and IFM produced the highest returns over the quarter, both delivering over 5%. On a rolling 3 year basis SSgA (Europe and Pacific) was the only manager to outperform its target. Invesco, RLAM and Schroder Property were marginally below their performance targets but within the tolerance range for a Green RAG rating.

6 INVESTMENT STRATEGY

6.1 **Asset Class Returns:** Developed equity returns over the last three years were 16% p.a., materially ahead of the assumed strategic return of 8.05% p.a. from the review undertaken in April 2017. The three year return from emerging market equities decreased to 11.1% p.a. from 12.9% p.a. last quarter but remains well ahead of the assumed strategic return of 8.7%. Index-linked gilts returned 13.2% p.a. versus an assumed return of 2.15% p.a. as yields remain low against historical averages. Corporate bonds, property and infrastructure are also ahead of their respective assumed returns. Hedge Funds lag their assumed return due to exceptionally low cash rates.

6.2 Currency Hedging Policy: The Fund's currency hedging policy was positive for overall Fund performance since the Pound Sterling appreciated against the US Dollar and Japanese Yen over the quarter but fell against the Euro. From January 2018 currency hedging contracts within the EU will be subject to daily exchange of variation margin under EMIR (European Market Infrastructure Regulation).

7 PORTFOLIO REBALANCING AND CASH MANAGEMENT

Portfolio Rebalancing

7.1 As at 30 August 2017 the Fund was within all strategic asset allocation ranges, with the exception of an overweight cash position. Officers did not undertake any rebalancing activity during the quarter.

7.2 In April the Fund received deficit prepayments from some employers. On advice from Mercer this has been placed in cash liquidity funds in the short-term, and will be reviewed on an ongoing basis.

Cash Management

7.3 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.

7.4 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.

7.5 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.

7.6 During the period there were no breaches of the Fund's Treasury Management Policy (approved March 2017).

7.7 The 2017/18 Service Plan forecast an average cash outflow of c. £1.3m each month during the year to 31 March 2018, making a total outflow of £16.4m for the year to 31st March 2018. The current forecast is for a cash out-flow for the year of £18m. 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:	1,386
Resolutions voted:	21,117
Votes For:	19,417
Votes Against:	1,666
Abstained:	1,163
Withheld* vote:	71

** 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 ANNUAL ASSURANCE ON CONTROL ENVIRONMENT OF 3RD PARTY SUPPLIERS

9.1 As part of the risk management process the Fund annually reviews the internal control reports (ICR) of the custodian and investment managers (and their administrators where relevant), and reports the findings to Committee. These reports are often designated SSAE16 or ISAE3402 reports (previously AAF 01/06 and SAS70 reports), that states which set of standards are being reported against.

9.2 ICR reports describe the internal control environment of an organisation. The management of the organisation are responsible for identifying the control procedures which they consider appropriate to enable certain control objectives to be met. External auditors verify that the controls identified are in place and comment on whether the controls will achieve the stated objectives or not.

9.3 For the reports reviewed in 2016/17, in each case the external auditor's report stated that the controls were in place and achieved the control objective and there are no issues to bring to the attention of the Committee. As part of the process, officers discuss the significance of the internal control reports with investment managers and custodian on an on-going basis and follow-up any issues flagged in the reports.

9.4 The ICRs of the pooled funds (and their administrators/custodian) and the Fund's custodian are also audited by the Fund's external auditor as part of the annual audit.

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 (Strategic Director of Resources) 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	