Bath & North East Somerset Council		
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**	
MEETING DATE:	**13 NOVEMBER 2017**	**AGENDA ITEM NUMBER**
TITLE:	**Review Of Investment Performance For Periods Ending 30 September 2017**	
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 – RAG Monitoring Summary Report		

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 30 September 2017.

1.2 The report focuses on the performance of the individual investment managers and the implementation of the investment strategy. The full performance report with aggregate investment and funding analysis will be reported to the Committee meeting on 8 December 2017.

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 £132m (c. 2.9%) in the quarter ending 30 September 2017 giving a value for the investment Fund of £4,616m. Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and managers.

4.2 Global equities delivered a quarter of positive performance on encouraging economic news and a sustained upward trend in corporate earnings. US equities were boosted by strong corporate profits and consumer confidence leading the Federal Reserve to hint at further rate increases in Q4. UK equities, although posting gains, lagged most other major markets. A lack of progress in Brexit talks weighed on performance as did the outlook for the economy, where rising inflation continues to put a strain on real wages. A rate hike from the Bank of England would help curb inflation but compound the strain on household budgets. An indication from the European Central Bank that they would soon look to start reducing the pace of bond purchases under its QE programme lifted European equities. Japanese equites rallied as a result of strong export data and highly supportive monetary policy. Emerging market equities were the strongest performing region, posting gains of 7.6% in local currency terms. Elsewhere, UK gilt prices were negatively impacted by the turnaround in interest rate hike expectations and the Bank of England's commitment to tackle inflation. Over the quarter, sterling appreciated against the Dollar and marginally more so against the Yen (by 3.3% and 3.5% respectively). Sterling depreciated against the Euro over the quarter by 0.3%.

4.3 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 8 December 2017.

B – Investment Manager Performance

4.4 A detailed report on the performance of each investment manager has been produced by Mercer – see pages 25 to 45 of Appendix 2.

4.5 Manager absolute returns over the quarter were largely positive. All but two of the managers posted positive absolute returns over the quarter, reflective of wider market returns. DGF managers Aberdeen Standard (formerly Standard Life) and Pyrford achieved -0.2% (TBC at meeting) and -0.6, respectively.

4.6 Relative returns were disappointing with the majority of managers underperforming their targets, on a 3 year rolling basis. Precise detail of amber rated managers can be found at Exempt Appendix 3.

4.7 Among the managers that are yet to reach the 3 year mark SLI recorded a negative absolute return net of fees of -0.2% (TBC at meeting) over the three-months to 30 September 2017 compared to a target return of 1.4%. JP Morgan achieved a quarterly absolute return of 1.9% in USD terms and IFM posted 13.5% net IRR since inception, again in local currency terms.

4.8 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.

5 INVESTMENT STRATEGY AND PORTFOLIO REBALANCING

5.1 **Asset Class Returns versus Strategic Assumptions**: Developed market equity returns over the last 3 years were 15.5% p.a., materially ahead of the assumed strategic return of 8.05% p.a. on the same basis. The 3 year return from emerging market equities increased from 11.1% last quarter to 11.6% in Q3; again well ahead of the assumed 3 year return of 8.7%. Index Linked Gilts remain considerably above the assumed strategic return as yields remain low relative to historic averages. Similarly, property and infrastructure are significantly ahead of their assumed strategic returns on a 3 year basis. Hedge funds remain below long-term averages due in part to exceptionally low cash rates.

5.2 **Manager Selection Update**: At the 5 July Special Committee Meeting it was resolved to delegate the selection of a new Diversified Growth Fund (DGF) and a Multi Asset Credit Fund (MAC) to Officers in consultation with Mercer to meet the requirements of the recommended changes to the Investment Strategy. As at 30 September 2017 the allocation to the new DGF mandate (Ruffer) had been fully funded and the allocation to the MAC mandate (Loomis) had been partially funded with the remaining commitment settling in early October. The new mandates have been funded from divesting from corporate bonds, reducing emerging market, global and UK equities in line with the revised investment strategy.

5.3 **Currency Hedging**: The impact of the currency hedging overlay on Fund performance will be reported to the Committee on 8 December 2017. From January 2018 currency hedging contracts within the EU will be subject to daily exchange of variation margin under EMIR (European Market Infrastructure Regulation). This will mean that additional collateral needs to be held as part of the currency hedging programme. To avoid missing the deadline and potentially breaching EMIR margining rules the Fund will start posting collateral against its currency positions from 1 November 2017 and has been carrying a larger cash holding in anticipation of this requirement.

5.4 **Rebalancing:** As at 26th October all asset allocations, with the exception of an overweight cash position, remain within the acceptable range requiring no rebalancing action. Officers did not undertake any rebalancing activity during the quarter.

6 MIFID II Opt Up progress

6.1 In July the FCA released details of the revised criteria that LGPS schemes would have to fulfil in order to opt up to ‘professional investor’ status from the default position of ‘retail investor’. To date 7 managers have resolved to treat the Fund as an ‘elective professional’ client. The deadline for full compliance is 3 January 2018. The Fund’s status across all mandates will be reported to the Committee on 8 December 2017.

7 Transfer to New Custodian

7.1 As part of the pooling project, a single administrator and custodian, State Street, has been appointed for the Brunel pool (BPP Ltd and the 10 funds). Once the

Brunel portfolios are established and the assets transferred, the local funds will have minimal custody requirements (limited to cash management and cash instructions, investment accounting and reporting) as most of the operational custody aspects will be managed by BPP Ltd and the investment managers within each portfolio. However, in the interim, we will require the full suite of custody services that we currently have with BNY Mellon.

7.2 As a result the funds are transferring to State Street over the coming months. Avon is planning to transfer December tranche. A fully resourced project plan is in place to support the funds with the transfer, given the operational risks involved. However, as most of our assets are in pooled vehicles the risks are minimised. Please note that from December month end, State Street will be providing our performance measurement reports.

8 RISK MANAGEMENT

8.1 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.

9 EQUALITIES

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

10 CONSULTATION

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

11 ISSUES TO CONSIDER IN REACHING THE DECISION

11.1 The issues to consider are contained in the report.

12 ADVICE SOUGHT

12.1 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	