

## Bath & North East Somerset Council

MEETING:	Avon Pension Fund Committee	
MEETING DATE:	18 March 2011	AGENDA ITEM NUMBER
TITLE:	Review Of Investment Performance For Quarter Ending 31 December 2010	
WARD:	ALL	
<b>AN OPEN PUBLIC ITEM</b>		
List of attachments to this report: Appendix 1 – Fund Valuation Appendix 2 – JLT performance monitoring report Appendix 3 – Council’s Full Treasury Counterparty Listing		

### **1 THE ISSUE**

- 1.1 This report contains performance statistics for the quarter ending 31 December 2010. The report focuses on the strategic investment policy, the managers’ performance, a funding update, and portfolio rebalancing.
- 1.2 Most of the detail is contained in the appendices. The Fund’s investment consultant, JLT, have prepared a report (Appendix 2) covering the performance of the investment strategy, the performance of the investment managers and the market commentary.

### **2 RECOMMENDATION**

**That the Avon Pension Fund Committee:**

- 2.1 Notes the information as set out in the report.**

### 3 FINANCIAL IMPLICATIONS

3.1 The returns achieved by the Fund for the three years commencing 1 April 2010 will impact the next triennial valuation which will be calculated as at 31 March 2013.

3.2 Section 6 of this report discusses the Fund's liabilities and the funding level.

### 4 INVESTMENT PERFORMANCE

4.1 Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and managers.

4.2 JLT's report in Appendix 2 provides a full commentary on the performance of the strategic benchmark (pages 15 and 16), the investment managers (pages 17 to 42) and a commentary on investment markets (pages 5 to 11). In the section on the Fund (page 12 to 14), three year rolling returns are included to provide a longer term perspective.

4.3 The Fund's investment return and performance relative to benchmarks is summarised in the following table for the periods to 31 December 2010:

	<b>3 months</b>	<b>12 months</b>	<b>3 years (p.a.)</b>
<b>Avon Pension Fund</b>	5.2%	13.4%	3.8%
<b>Strategic benchmark</b> <i>(Fund relative to benchmark)</i>	5.2% (=)	13.1% (+0.3%)	2.6% (+1.2%)
<b>Customised benchmark</b> <i>(Fund relative to benchmark)</i>	4.9% (+0.3%)	12.7% (+0.7%)	4.5% (-0.7%)
<b>WM Local Authority Average</b> <b>Fund</b> <i>(Fund relative to universe)</i>	5.7% (-0.5%)	13.4% (=)	1.3% (+2.5%)

4.4 The Fund's assets rose in value by £134m (+5.2%) in the quarter giving a value for the Fund of £2,626m at 31 December 2010. This investment return was driven mainly by the growth in equity markets offsetting the small negative returns of bonds over the period.

4.5 More importantly over the last twelve months the Fund's assets rose by £330m (+13.4%), driven by positive returns across all asset classes.

4.6 The initial estimate for the Fund's return in January is -0.9%, reflecting the falls in global bond markets. The UK FTSE All Share index fell slightly during the month.

4.7 **Against its strategic benchmark** (60% equities, 20% bonds, 10% property, 10% hedge funds) the Fund outperformed over the year by +0.3%. This is a result of the performance of the Fund's active managers outperforming the benchmark asset returns used in the strategic benchmark.

4.8 **Against its customised benchmark** (which measures the relative performance of the managers), the Fund marginally outperformed in the quarter (+0.3%). This was a result of outperformance by Invesco, Man, Stenham and Lyster Watson

over the quarter. Most of the other managers were in line with, or ahead of, their benchmarks in the quarter, with only Jupiter significantly underperforming their benchmark.

4.9 Over the year the Fund outperformed the customised benchmark (+0.7%) mainly due to the outperformance of Jupiter, Royal London, Genesis and Signet.

4.10 Over the last three years the Fund has generated a return of 3.8% p.a. underperforming the customised benchmark return by -0.7%. This is attributable to manager performance.

4.11 **Compared to the WM Local Authority Fund universe**, the Fund performed in line over the year and outperformed by 2.5% p.a. over 3 years.

4.12 The report by JLT identifies no areas of significant concern regarding the managers, but did note the SRI constraints on Jupiter may be at the cost of continued relative underperformance and significant volatility relative to the benchmark. This will be addressed as part of the forthcoming review of the Fund's SRI policy.

4.13 During the quarter the Investment Panel received presentations from three Fund of Hedge Fund managers, the purpose being to review performance, understand the manager's investment process and operational risk management, review the outlook for their strategies and discuss future investment strategy. This completes the Panel's review of the 5 Fund of Hedge Fund managers, the results of which have been fed into the strategic review of the Funds investments in hedge funds which is addressed in another agenda item.

4.14 The Committee agreed in December 2010 to appoint Schroder to manage the Fund's active global equity mandate. Officers are currently finalising the legal contract and preparing to transition assets.

4.15 In October 2010, Man Group plc completed the acquisition of GLG Partners which created a multi-style alternative asset manager with funds of \$63 billion under management. The impact of this was incorporated into the review of hedge funds elsewhere in the agenda.

4.16 In January 2011, State Street Global Advisors ("SSgA") completed the acquisition of Bank of Ireland Asset Management ("BIAM") for approximately €57 million, which SSgA stated enhances their Global Investment Platform.

## **5 INVESTMENT STRATEGY**

5.1 JLT's report did not highlight any new strategy issues for consideration outside of those already under consideration by the Investment Panel. The report does highlight the risk return profile of the Fund and the impact on risk/return by each of the managers on pages 17 to 20. In particular JLT conclude that the volatility of the various portfolios/funds is in line with expectations and that the Fund has benefited from diversification by asset classes as the Fund volatility is lower than the equity managers and passive BlackRock portfolio despite these making up a large proportion of the Fund's assets.

5.2 The outcome of the Fund's review of its investments in hedge funds is considered elsewhere in the agenda and follows a Committee workshop held on Wednesday 2 March 2010.

**6 ACTUARIAL VALUATION UPDATE**

6.1 The Fund’s actuary will present the outcome to the Fund’s triennial valuation earlier on the agenda. The funding level at 31 December 2010 is estimated to be unchanged from 31 March 2010 at c. 82% adopting consistent assumptions, updated for investment returns, market conditions and cashflows.

6.2 The Actuary estimated assets to have risen by £196m to £2,655m (c. 8% increase) and liabilities have risen £194m to £3,226m. The liabilities have increased due to a fall in real yields of 0.1%.

6.3 The table below shows the change in financial assumptions:

	31 March 2010	31 December 2010
UK Gilt yield	4.5%	4.2%
Real yield	0.7%	0.6%
Implied RPI inflation p.a.	3.8%	3.6%
Inflation adjustment p.a.	0.8%	0.8%
CPI Inflation p.a.	3.0%	2.8%

**7 CASH MANAGEMENT**

7.1 Cash is not included in the strategic benchmark. However, cash is held by the managers at their discretion within their investment guidelines, and internally to meet working requirements. The segregated portfolios, TT, Jupiter and BlackRock utilise money market funds offered by the custodian, BNY Mellon. The cash within the pooled funds is managed internally by the manager. The cash managed by BlackRock in the property portfolio is invested in the BlackRock Sterling Liquidity Fund. 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.

7.2 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 and are invested in line with the Fund's Treasury Management Policy which was approved on 18 December 2009. The Fund adopts the Council’s counterparty list and the latest list approved by the Council in February 2011 is attached as Appendix 3 to this report.

**8 REBALANCING POLICY**

8.1 The rebalancing policy requires rebalancing of the Equity/Bond allocation to occur when the equity portion deviates from 75% by +/- 2%, and the valuation metric, in this case the equity gilt yield ratio, confirms that the relative valuation between equities and bonds is favourable. The implementation of this policy is delegated to officers.

8.2 There was no rebalancing undertaken this quarter. As at 31 January 2011 the Equity:Bond allocation was estimated at 76.4:23.6.

## 9 LAPFF ACTIVITY

9.1 The Fund is a member of the Local Authority Pension Fund Forum (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.

9.2 LAPFF's current activity includes:

- (1) **Positive engagement outcome – Associated British Foods (ABF)** - LAPFF has a history of engagement with ABF on overseas employment standards, its approach to health and nutrition as well as overarching governance concerns. LAPFF has pressed the company to address ESG issues at the group level rather than leaving the management of these issues to its respective brands. In January 2010 the Forum requested and received a commitment by the company to publish a group-wide corporate responsibility report. ABF completed the CR report in advance of its 10 December 2010 AGM. This marks a clear step in the right direction by the company.
- (2) **Current engagement projects:**
  - a) **Engaging over non monetary rewards** – In January LAPFF held its first round of meetings with companies relating to its project on non monetary reward. The idea behind this project is to try and identify the sorts of measures that companies can use to motivate those employed, beyond relying exclusively on financial incentives. The Forum's findings from these meetings will then feed into the design of a survey on non-monetary reward to go to a wider group of UK listed companies.
  - b) **Engaging on Obesity** - LAPFF is currently in the process of conducting a targeted engagement campaign focussing on the risks and opportunities created by obesity with companies in the food and drinks sector.
- (3) **Update on BP engagement following Gulf of Mexico Oil Spill** – A Shareholder coalition have dropped their resolution from the BP AGM in order to facilitate further engagement with the company on the issues identified. The proposed resolution pushed BP to examine its risk assessment and risk management in North America during the wake of the Gulf of Mexico oil spill. Should further engagement not prove productive, the shareholder coalition will reinstate the resolution.

## 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 the return of the strategic benchmark and 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 This report is primarily for information and therefore an equalities impact assessment is not necessary.

## 12 CONSULTATION

12.1 This report is primarily 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 (Council Solicitor) and Section 151 Officer (Divisional Director - Finance) have had the opportunity to input to this report and have cleared it for publication.

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<b>Background papers</b>	LAPPF Member Bulletins Data supplied by The WM Company
<b>Please contact the report author if you need to access this report in an alternative format</b>	