

Bath & North East Somerset Council

MEETING:	AVON PENSION FUND COMMITTEE
MEETING DATE:	8 December 2017
TITLE:	INVESTMENT PERFORMANCE AND STRATEGY MONITORING (for periods ending 30 September 2017)
WARD:	ALL
AN OPEN PUBLIC ITEM	
<p>List of attachments to this report:</p> <p>Appendix 1 – Fund Valuation</p> <p>Appendix 2 – Mercer Performance Monitoring Report</p> <p>EXEMPT Appendix 3 – Changes in RAG status of Investment Managers</p> <p>Appendix 4 – LAPFF Quarterly Engagement Monitoring Report</p>	

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 September 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

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 decreased by c.1% over the quarter from 99% to 98%.
- (2) The decrease in the funding level over the quarter was driven by the change in the present value of the liabilities outweighing the positive return on assets.

5 INVESTMENT PERFORMANCE

A – Fund Performance

- 5.1 The Fund's assets increased by £89m (2%) over the quarter ending 30 September 2017 giving a value for the investment Fund of £4,573m. 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 September 2017

	3 months	12 months	3 years (p.a.)
Avon Pension Fund (incl. currency hedging)	2.0%	9.3%	8.7%
Avon Pension Fund (excl. currency hedging)	1.5%	8.7%	10.0%
Strategic benchmark (no currency hedging) (Fund incl. hedging, relative to benchmark)	1.4% (+0.6%)	8.5% (+0.8%)	10.4% (-1.7%)

- 5.2 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 equities 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%.

5.3 Fund Performance versus Benchmark: **+0.60% over the quarter, attributed to**

- (1) **Asset Allocation:** Asset allocation detracted -0.08% over the quarter. The currency hedging programme contributed +0.50% over the quarter.
- (2) **Manager Performance:** In aggregate, the contribution of manager performance was +0.18% 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 a relatively small 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 +0.5% to the total Fund return over the quarter and contributed +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 one manager has been downgraded from Amber to Red** (explained in Exempt Appendix 3). Therefore, currently 5 managers are Amber rated and 1 manager is Red rated.

5.6 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% and -0.9, respectively.

6 INVESTMENT STRATEGY

6.1 **Asset Class Returns:** Developed equity returns over the last three years were 15.5% 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 increased to 11.6% p.a. from 11.1% p.a. last quarter and remains well ahead of the assumed strategic return of 8.7%. Index-linked gilts returned 10.8% 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).

6.3 **Collateral Management:** The Panel reviewed the collateral position at their meeting on 13 November. There was sufficient collateral in the QIF (Qualified

Investment Fund managed by Blackrock) to support the LDI (Liability Driven Investing) strategy and the equity protection strategy currently being implemented.

7 MIFID II OPT UP PROGRESS

- 7.1 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 13 managers have resolved to treat the Fund as an 'elective professional' client. The deadline for full compliance is 3 January 2018.

8 PORTFOLIO REBALANCING AND CASH MANAGEMENT

Portfolio Rebalancing

- 8.1 As at 30 September 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.
- 8.2 The asset allocation changes agreed in the strategic review in July 2017 were partially implemented in the quarter, specifically to invest in Multi Asset Credit and increase the allocation to Diversified Growth Funds. These were funded through the divestment from actively managed corporate bonds and reducing the allocation to equities.

Cash Management

- 8.3 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.
- 8.4 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.
- 8.5 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.
- 8.6 During the period there were no breaches of the Fund's Treasury Management Policy (approved March 2017).
- 8.7 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 31 March 2018. Further details are provided in the pension fund budget and cash flow monitoring report to this Committee.

9 CORPORATE GOVERNANCE UPDATE

- 9.1 During the quarter, the Fund's external managers undertook the following voting activity on behalf of the Fund:

Companies Meetings Voted:	213
Resolutions voted:	3,087
Votes For:	2,909

Votes Against:	185
Abstained:	54
Withheld* vote:	6

** 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.*

9.2 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.

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	