

Bath & North East Somerset Council

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| MEETING: | AVON PENSION FUND INVESTMENT PANEL | |
| MEETING DATE: | 21 FEBRUARY 2018 | AGENDA ITEM NUMBER |
| TITLE: | Review Of Investment Performance For Periods Ending 31 December 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 Exempt Appendix 4 – Risk Management Framework Quarterly Monitoring Report – TO FOLLOW | | |

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 31 December 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 23 March 2018.

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 £86m (c. 1.9%) in the quarter ending 31 December 2017 giving a value for the investment Fund of £4,660m. Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and managers.

4.2 During the quarter bond markets rallied, equity indexes continued to beat records and a weak US Dollar in combination with a strong global economic outlook benefitted commodity prices. Developed and emerging market equities both posted gains in excess of 5%. US and UK equities posted returns of 6.5% and 4.9%, respectively. Japanese equities also continued the momentum from last quarter gaining 8.6%, helped by the landslide victory of Japanese Prime Minister Shinzo Abe in a snap general election held in October. Eurozone equities ended the three months to December 2017 down by 0.5% due to in part to The European Central Bank halving its asset purchases under its quantitative easing program. UK 10-year bond yields fell 0.18% and 30-year yields fell 0.16%. Over the quarter, sterling appreciated against the Dollar and marginally more so against the Yen (by 0.8% and 0.9% respectively). Sterling depreciated against the Euro over the quarter by 0.7%.

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 23 March 2018.

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 all positive, reflective of wider market returns. A weak US Dollar and the increase in commodity prices particularly benefitted the emerging market mandates, which both delivered in excess of 6% p.a. in GBP terms. Over the quarter in relative terms TT, Invesco, Aberdeen Standard and Ruffer outperformed their respective benchmarks.

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

4.7 Among the managers that are yet to reach the 3 year mark Aberdeen Standard recorded a positive absolute return of 1.9% over the three-months to 31 December 2017 compared to a target return of 1.4%. JP Morgan were flat over the quarter in USD terms and IFM posted 14.4% 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.

C - Risk Management Framework Quarterly Monitoring Report

- 4.9 A detailed report of the performance of the Fund's risk management strategies, namely the LDI and equity protection strategies, has been produced by Mercer (see Appendix 4).
- 4.10 During the quarter no further trading activity took place on the Fund's LDI mandate.
- 4.11 The equity protection strategy, designed to guard against a large draw-down in equity markets, was fully implemented in December.
- 4.12 Collateral held in the Qualified Investor Fund (QIF) that is used to capitalise the risk management strategies remained within its prescribed parameters and was sufficient to absorb the stress tests that are routinely carried out to ensure operational efficiency.

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 11.6% last quarter to 13.7% in Q4; 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. Over the three-year period index-linked gilts returned 8.9% p.a. versus an assumed return of 2.15%. 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 **Currency Hedging:** In December the FCA granted an exemption to asset owners, meaning the requirement to post collateral against deliverable FX forward contracts no longer applies. The Fund continues to trade on a credit line basis with its counterparty banks and awaits further information from the regulator.
- 5.3 **Rebalancing:** As at 07 February all asset allocations were within the control ranges for rebalancing based on the revised strategic benchmark agreed at July Special Committee Meeting. 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'.
- 6.2 Following requests from the Fund to opt up in 4Q17, the process has been completed with all managers, advisors and custodians confirming that they will treat the Fund as an 'elective professional' client.

7 Transfer to New Custodian

- 7.1 The Fund instructed its legacy custodian to transfer assets to State Street on 13 December 2017. At time of publishing 91% of assets had successfully settled/re-registered or been redeemed and transferred as cash. The remaining 9% of assets are pooled funds that are out-to-registration with respective transfer agents and expected to be re-registered at the new custodian during 1Q18.

7.2 Due to the timing of the transition and time needed to close the accounting records for the month of December, performance measurement reports were not available at time of writing. This quarter investment manager data has been used to compile returns. It is intended that performance reporting from the new custodian will be in place to present to Pensions Committee on 23 March.

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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| Contact person | Nathan Rollinson, Assistant Investments Manager (Tel: 01225 395357) |
| 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 | |