Bath & North East Somerset Council		
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**	
MEETING DATE:	**23 MAY 2018**	**AGENDA ITEM NUMBER**
TITLE:	**Review Of Investment Performance For Periods Ending 31 March 2018**	
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		

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 March 2018.

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 22 June 2018.

1.3 The report also includes the report from Mercer monitoring the Risk Management strategies (Liability Driven Investing and Equity Protection Strategy).

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 decreased by £51m (c. 1.1%) in the quarter ending 31 March 2018 giving a value for the investment Fund of £4,609m. Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and managers.

4.2 The quarter began with a strong tone in January supported by a buoyant global economy. Investor confidence started to wane as the quarter went on as concerns over the possibility of sharper US interest rate rises dented equity returns. US interest rates increased from 1.5% to 1.75% and the new Chair of the Federal Reserve, Jay Powell, signalled two more increases in 2018 and a sharper path of increases thereafter. The sell-off deepened in March on concerns over US trade sanctions on China and slower growth expectations from China and Europe. Global equity declines were led by developed markets.

Emerging markets performed positively over the quarter in local currency terms. US and UK equities ended down by 0.6% and 7.3% respectively. Japanese equities also lost the momentum from the previous quarter losing 4.7% over the period. Likewise, European equities ended down 2.7%. 10 year US and UK government bond yields both ended higher, which created a particularly problematic environment for managers holding both equities and bonds where the diversification effect had little impact. A sharp fall in UK equities was compounded by poor economic data, most notably a decline in construction activity and a particularly poor services sector reading in March.

The VIX index, a measure of equity market volatility, rose through the quarter. This presented a problem for one manager who had opted to unwind equity protection before the full impact of the equity sell-off had materialised. The Fund's equity protection strategy is insulated to an extent to spikes in the volatility index and over the quarter performed in line with expectation, where the UK element delivered greatest value. The spread between the yields on Government bonds and corporate bonds widened which is reflective of a risk-averse investor base. Consequently, credit as an asset class suffered.

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 22 June 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 broadly negative, reflective of market returns. Over the quarter sterling appreciated against the dollar by 3.7%, which dented emerging market returns when expressed in GBP terms. Higher risk assets suffered the greatest declines and managers adopting a 'low beta' defensive approach found that there positive relative returns in February/March were not great enough to offset the losses suffered at the beginning of the quarter.

Of the DGF managers employing equity protection a decision to unwind their hedges before the full extent of the equity market sell off had been realised meant they participated fully in the sell off toward the end of the period. Over the quarter in relative terms TT and Schroder Equity outperformed their respective benchmarks. The most notable underperformance came from the Fund's DGF managers. Over a 1 year period the 'low beta' emerging market manager and DGFs delivered negative relative returns.

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 JP Morgan were up by 0.8% vs their cash benchmark over the quarter in USD terms and IFM posted 23.2% net IRR since inception in local currency terms, noting that the fund is still early in its life. The Fund's Multi Asset Credit mandate was able to deliver positive relative returns due to its allocation to bank loans, which performed well relative to other credit assets given demand in bank loans tends to outstrip other forms of financing in a rising interest rate environment. One of the Fund's DGF manager delivered negative returns relative to a cash benchmark in light of its large allocation to Japanese equities and poor performance of its options strategies.

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 Exempt Appendix 4).

4.10 During the quarter one inflation trigger was breached in the fourth maturity bucket (see page 11 of Exempt Appendix 4).

4.11 The equity protection strategy, designed to guard against a large draw-down in equity markets, added value on an aggregate basis and performed in line with expectations compensating the Fund for losses incurred on its physical equity portfolios. The net impact of the equity protection strategy can be found on page 7 of Exempt Appendix 4.

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.

4.13 During January, as equity markets rallied, the notional value of the equity options rose in line, resulting in an increase in leverage of the QIF. The QIF has a leverage limit set within its prospectus of 6.0x. At its peak in January the leverage moved to 4.8x and closed the period at 4.1x. To increase the collateral within the QIF in order to keep leverage comfortably within the QIF guidelines, the enhanced indexation global equity mandate managed by Invesco was transitioned in-specie to a global passive equity fund managed by BlackRock to be held within the QIF; as a result the leverage falls to c. 3.0x. This transition completed on 20 April 2018.

4.14 Agreement was reached between the Fund's currency overlay manager and BlackRock on the treatment of the currency exposure created by the non-GBP base options contracts (S&P500, Nikkei 225 & Eurostoxx 50). Adjusting the Fund's currency hedge by 50% of the mark-to-market value of the relevant options contracts acts to ensure the 50% aggregate currency hedge on equities is maintained in line with policy. Currency hedging on equity options commences May month end.

5 INVESTMENT STRATEGY AND PORTFOLIO REBALANCING

5.1 **Asset Class Returns versus Strategic Assumptions**: Developed market equity returns over the last 3 years were 10.9% p.a., materially ahead of the assumed strategic return of 8.1% p.a. on the same basis. The 3 year return from emerging market equities decreased from 13.7% last quarter to 10.4% in Q1; 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 7.8% p.a. versus an assumed return of 2.2%. 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 **Rebalancing:** As at 02 May all asset allocations were within the control ranges for rebalancing based on the strategic benchmark. Officers did not undertake any rebalancing activity during the quarter.

5.3 **Transition to Low Carbon Global Equity Index:** Following the cash subscription to the Low Carbon fund in Q417, c. £300m of remaining assets held in regional BlackRock funds were transferred in-specie to the Low Carbon Fund. The transaction completed on 27 February 2018.

5.4 **Global Sustainable Equities investment opportunity:** At the February meeting the Panel resolved to delegate authority to officers to invest £10m in the Jupiter Global Sustainable Equities Fund, subject to a satisfactory assurance statement being provided by Mercer. Mercer has provided the assurance statement and the investment will now proceed.

6 RISK MANAGEMENT

6.1 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.

7 EQUALITIES

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

8 CONSULTATION

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

9 ISSUES TO CONSIDER IN REACHING THE DECISION

9.1 The issues to consider are contained in the report.

10 ADVICE SOUGHT

10.1 The Council's Section 151 Officer 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	