

<b>Bath &amp; North East Somerset Council</b>		
MEETING:	<b>AVON PENSION FUND INVESTMENT PANEL</b>	
MEETING DATE:	<b>10 September 2018</b>	<b>AGENDA ITEM NUMBER</b>
TITLE:	<b>Review of the Role of Diversified Growth Funds</b>	
WARD:	ALL	
<b>AN OPEN PUBLIC ITEM</b>		
List of attachments to this report:		
Exempt Appendix 1 – Review of the Role of Diversified Growth Funds (Mercer)		

## **1 THE ISSUE**

- 1.1 The Funds Diversified Growth Fund (DGF) managers have been appointed to provide diversified and dynamic exposure to varied return sources, with the ability to generate returns in a variety of market environments and with less volatility than equities.
- 1.2 Recent underperformance against absolute return targets specific to DGF mandates prompted a review of the performance and risk characteristics of the Fund's incumbent DGF managers, which can be found at Exempt Appendix 1. The report highlights the strategic role DGFs play within the context of the strategic benchmark, and gives an indication of the potential return prospects of these strategies over the medium-term. It also updates the Panel on manager performance.
- 1.3 The role of DGFs within the strategic asset allocation will be considered in greater detail as part of the 2019 Strategic Investment review.

## **2 RECOMMENDATION**

**That the Panel:**

- 2.1 Notes the information contained at Exempt Appendix 1**
- 2.2 Notes that a detailed review of DGFs will be undertaken as part of the investment strategy review in 2019**

### **3 FINANCIAL IMPLICATIONS**

- 3.1 In general the financial impact of decisions made by the Panel will have been provided for in the budget or separately approved by the Committee when authorising the Panel to make the decision.
- 3.2 There are transactional costs involved in appointing and terminating managers. Where these arise from a strategic review allowance will be made in the budget. Unplanned changes in the investment manager structure may give rise to transition costs which will not be allowed for in the budget.

### **4 CURRENT DIVERSIFIED GROWTH MANAGERS**

- 4.1 The Fund currently employs three DGF managers:
- a) Pyrford allocate c.30% to high quality stocks underpinned by sound fundamentals and the remainder to short duration bonds, cash and currency hedging. They adopt a defensive approach and have a return target of RPI+5% p.a.
  - b) Aberdeen Standard Investments adopt a more idiosyncratic approach and employ the use of derivatives, relative value trades as well as traditional long positions in stocks. They have a return target of Cash+5% p.a.
  - c) Ruffer focuses on capital preservation and allocate dynamically between risk and defensive assets depending on market conditions. They do not have a benchmark but aim to generate an absolute return on 8-10% p.a. over a full market cycle.

### **5 ABSOLUTE RETURN TARGETS AS BENCHMARKS**

- 5.1 An absolute return target means that returns are evaluated relative to a fixed rate and therefore independently of performance of equity markets, debt markets or any other markets. An investment program with an absolute return target seeks positive returns unaffected by market direction.
- 5.2 Managers benchmarked against an absolute return target often face a greater challenge than managers whose performance is benchmarked against a floating index, especially over shorter timeframes.

### **6 CONSIDERATIONS FOR THE ROLE OF DGFS WITHIN THE STRATEGIC BENCHMARK**

- 6.1 Where the Fund seeks to protect against the risk of a fall in equity markets and in the context of a strong funding level, the current 15% allocation to DGFS continues to meet the Fund's strategic objectives.
- 6.2 The 2019 investment strategy review will provide an opportunity to review whether DGFS in general continue to fulfil the Fund's strategic objectives or whether alternative asset classes maybe more appropriate and how the allocation should be implemented across managers.
- 6.3 Any changes to the DGF allocation or managers will need to consider the timing of transitioning the assets to the Brunel DGF portfolio.

### **7 RISK MANAGEMENT**

- 7.1 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. It discharges this responsibility by ensuring the Fund

has an appropriate investment strategy and investment management structure in place that is regularly monitored. The creation of an Investment Panel further strengthens the governance of investment matters and contributes to reduced risk in these areas.

## **8 EQUALITIES**

10.1 An equalities impact assessment is not necessary.

## **9 ISSUES TO CONSIDER IN REACHING THE DECISION**

9.1 Are considered in this report.

## **10 ADVICE SOUGHT**

10.1 The Council's Section 151 Officer has had the opportunity to input to this report and have cleared it for publication.

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<b>Background papers</b>	Mercer paper to Officers August 2018
<b>Please contact the report author if you need to access this report in an alternative format</b>	