Bath & North East Somerset Council		
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**	
MEETING DATE:	**10 SEPTEMBER 2018**	**AGENDA ITEM NUMBER**
TITLE:	**Review Of Investment Performance For Periods Ending 30 June 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 30 June 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 21 September 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 increased by £101m (c. 2.0%) in the quarter ending 30 June 2018 giving a value for the investment Fund of £4,709m. Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and managers.

4.2 Over the quarter European and Emerging Market stocks fell out of favour. European outflows were driven primarily by a quarter of political turbulence and tepid macroeconomic data. Declines in Emerging Markets intensified towards the end of the quarter with political posturing acting as the catalyst in an already challenging environment for Emerging Markets. With US interest rates on the rise and the US Dollar appreciating, a number of regions were faced with higher borrowing costs on already large levels of debt. US equities recovered outflows sustained in 1Q18 as prices were supported by sound fundamentals and positive investor sentiment. UK stocks followed suit, with large-cap stocks outperforming the broader market.

UK Gilt yields started the quarter on an upward trend consistent with an increase in risk appetite. The benchmark 10 year gilt yield rose from 1.35% at the end of March to a high of 1.56% in mid-May. Later in the quarter the political uncertainty in Italy and heightened geopolitical risk in emerging markets drove a flight to quality assets. 10 year gilt yields in turn ended the quarter down 0.07%. Elsewhere, commodities performed well, led by a spike in the oil price from $70 to $80 a barrel – its highest level in over 4 years. Sterling depreciated against the US dollar by 5.9%, against the euro by 0.9% and against the Japanese Yen by 2.0%. The depreciation in sterling enhanced overseas returns.

The price the market assigns to equity option strategies indicated that investors were willing to pay more for downside protection than strategies that allowed participation in upside – a clear sign of caution about market moves. Finally, 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 21 September 2018.

B – Investment Manager Performance

4.4 A detailed report on the performance of each investment manager has been produced by Mercer – see pages 22 to 41 of Appendix 2.

4.5 Manager absolute returns over the quarter were broadly positive, reflective of market returns. Developed market equity mandates delivered the strongest returns. Over the quarter sterling depreciated against the dollar by 5.9%, which enhanced emerging market, hedge fund and infrastructure returns when expressed in GBP terms. As expected the emerging market managers delivered lower absolute returns when expressed in local currency, however the 'low beta'

defensive approach adopted by the Fund's EM managers led to significant outperformance against the benchmark and thus, strong relative returns. Over 1 year TT, Schroder Equity and Genesis outperformed their respective benchmarks. The Fund's infrastructure mandate posted significant outperformance versus its benchmark. Of the Fund's equity managers, the UK SRI mandate posted the weakest relative performance over the year to 30 June 2018 as it was unable to fully participate in the rise in the share prices of the major oil and gas companies.

4.6 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. During the quarter, officers met with Pyrford and Unigestion.

C - Risk Management Framework Quarterly Monitoring Report

4.7 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).

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

4.9 The equity protection strategy, designed to guard against a large draw-down in equity markets, detracted value on an aggregate basis and performed in line with expectations capping gains on its physical equity portfolios. The net impact of the equity protection strategy can be found on page 7 of Exempt Appendix 4.

4.10 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. To allow additional collateral to be raised when required and in order to keep leverage within the QIF guidelines, the enhanced indexation global equity mandate, formerly managed by Invesco, was transitioned in-specie to a global passive equity fund which the QIF subsequently purchased units in. This transition completed on 20 April 2018.

4.11 Since quarter end the 'early warning test', which prepares the Fund for a potential collateral call was breached. On notification of the breach the Fund opted to take no action in light of the fact that the manager of the QIF has discretion to automatically top up collateral by selling down and then 'synthesising' a portion of the passive pooled equities that the QIF now owns units in.

5 INVESTMENT STRATEGY AND PORTFOLIO REBALANCING

5.1 **Asset Class Returns versus Strategic Assumptions**: Developed market equity returns over the last 3 years were 15.8% 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 was 10.9% in 2Q18; 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 8.5% 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 16 August 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 of Low Carbon Global Equity Index to Brunel Passive Portfolio:** A full in-specie transfer of the Fund's low carbon passive fund to the Brunel passive equities portfolio was actioned in July.

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. The investment into the Global Sustainable Equity pooled fund completed on 27 June 2018 and was funded from the Fund's existing mandate with Jupiter.

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 State Street Bank & Trust Performance Measurement
Please contact the report author if you need to access this report in an alternative format	