

Bath & North East Somerset Council

MEETING:	AVON PENSION FUND INVESTMENT PANEL	
MEETING DATE:	12 November 2018	AGENDA ITEM NUMBER
TITLE:	Review Of Investment Performance For Periods Ending 30 September 2018	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
List of attachments to this report: Appendix 1 – Fund Valuation Appendix 2 – Mercer Performance Monitoring Report [TO FOLLOW] Exempt Appendix 3 – RAG Monitoring Summary Report Exempt Appendix 4 – Risk Management Framework Quarterly Monitoring Report [TO FOLLOW] Appendix 5 – Mercer Paper: Is a Bear Market on the Horizon? Appendix 6 – Mercer Paper: Political Risk: “Big Things” Lie Ahead Appendix 7 – Mercer Paper: From QE to QT – Building Robust Portfolios		

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 September 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 7 December 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 £72m (c.1.5%) in the quarter ending 30 September 2018 giving a value for the investment Fund of £4,782m. Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and managers.
- 4.2 During the quarter global equities were largely flat and moved lower late into the quarter, with the exception of US equities which benefited from strong economic growth. The combination of rising US interest rates and a strong US Dollar presented a challenge for many regions, particularly for Emerging Markets where borrowing is often US Dollar denominated. The oil price rose by 6% and notably US bond yields moved higher, with the yield on the 10-year bond breaching 3% for the first time since 2013. This, along with mounting trade tensions between China and the US, provided the impetus late into the quarter to push equity prices down; a trend that continued into 4Q18. For the calendar year to 12th October the MSCI World and Emerging Markets Indices posted losses of 11% and 20% respectively. At time of writing, the US technology sector had been leading declines. The NASDAQ, the index that comprises many US technology companies, is set to post losses of 11% in October, which would make it the worst performing month since 2008. Over the quarter, sterling depreciated against the US Dollar by 1.2% and against the Euro by 0.7% and appreciated against the Japanese Yen by 1.3%.
- 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 7 December 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 total returns over the quarter were mixed; with the strongest performance coming from the Fund's overseas developed market equities. Returns from the Fund's diversified growth strategies were muted. The Fund's infrastructure manager was a standout performer over the quarter, with returns enhanced by the depreciation in sterling against the US Dollar. Over 1 year the majority of managers posted positive absolute returns. More information on those mandates that detracted value on an absolute basis can be found at Appendix 2. Over the 3 year period all mandates with a 3 year track record produced positive absolute returns however a number of funds did underperform their respective benchmarks.
- 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.

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 No triggers relating to the LDI framework were breached during the quarter.
- 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; most notably capping gains on the Fund's physical US equity holdings which was one of the few regions that increased in value through the quarter. 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 specified guidelines, the QIF owns units in a global passive equity fund that the manager has discretion to liquidate when cash is required for collateral purposes.

5 INVESTMENT STRATEGY AND PORTFOLIO REBALANCING

- 5.1 **Asset Class Returns versus Strategic Assumptions:** Developed market equity returns over the last 3 years were 20.1% 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 17.5% in 3Q18; 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 7.2% 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 fund returns picked up this quarter but remain below long-term averages and the strategic return of 5.1% p.a., having been affected by low cash rates.
- 5.2 **Rebalancing:** At quarter end 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.

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	