Bath & North East Somerset Council		
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**	
MEETING DATE:	**27 February 2019**	**AGENDA ITEM NUMBER**
TITLE:	**Review of Investment Performance for Periods Ending 31 December 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 Appendix 5 – Mercer Global Dynamic Asset Allocation Update Appendix 6 – Sample Brunel Quarterly Performance 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 December 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 March 2019.

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 £134m (c.-2.8%) in the quarter ending 31 December 2018 giving a value for the investment Fund of £4,648m. Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and managers.

4.2 Global equity markets declined over the quarter by 12.4%. Developed markets fell by 13.0% while emerging markets were down over 7%. US equities were heavily impacted on continued political uncertainty and trade tensions. The yield on the US 10-year government bond ended December at 2.69%, 0.37% lower than the previous quarter. In the UK, 10-year gilt yields fell 0.31% over the quarter and ended December at 1.27%. The Fed's fourth rate hike in the year came in December against the unusual backdrop of the S&P500 having dropped nearly 10.0% since the previous meeting in November. In the UK, despite a strong labour market the Bank of England left policy unchanged as it pointed to a softening outlook for global growth and intensified Brexit uncertainties. The Fund's currency hedge detracted from Fund performance as sterling depreciated against the US Dollar, Euro and the Yen.

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 March 2019.

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 on the whole negative; with the weakest performance coming from the Fund's overseas developed market equities. Returns from the Fund's diversified growth and hedge fund strategies posted negative returns but did provide protection from the sharp fall in equities, fulfilling their role as portfolio diversifiers. The Fund's infrastructure and property mandates generated positive absolute returns over the quarter, with the infrastructure return enhanced by the depreciation in sterling against the US Dollar. Over the 12 months to 31 December the majority of managers posted negative absolute returns. More information on the mandates 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, added value on an aggregate basis in line with expectations, generating unrealised gains to compensate for the fall in the value of the underlying equity holdings. 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 12.3% p.a., ahead of the assumed strategic return of 8.1% p.a. on the same basis. The 3 year return from emerging market equities was 14.8% in 4Q18; well ahead of the assumed 3 year return of 8.7% but below their long-term historical averages. Over the three-year period index-linked gilts returned 9.2% p.a. versus an assumed return of 2.2%. Similarly, property and infrastructure are ahead of their assumed strategic returns on a 3 year basis. Hedge fund returns are 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. The Fund transitioned its Active UK equity portfolio to Brunel in November and completed the divestment from ASI GARS and proportional redeployment of capital amongst its existing DGF managers.

5.3 **Private Markets Investments:** In the 2017 Strategic review, the Fund allocated 2.5% to Renewable Energy (on a look through basis) and 7.5% to Secured Income assets, with both allocations to be managed within Brunel's private market portfolios. In 4Q18, the first drawdowns of the Fund's committed capital occurred. Of the capital committed to Renewables, EUR13m was drawn down in December and deployed across two pan-European funds. One fund invests solely in renewable energy; the other includes sustainable and social infrastructure such as mass transport (metros) which are typically electric, and social infrastructure such as hospitals and government accommodation as well as renewable energy projects such as renewable energy powered district network heating assets. Shortly after the quarter closed, £16.5m was drawn down in the Secured Income portfolio by one of the selected funds.

5.4 Brunel has begun reporting from 4Q18 on the assets they now manage on behalf of the Fund. The report can be found in Appendix 6. However, Mercer will continue to provide quarterly commentary and analysis of all the Fund's mandates and at the strategic total fund level.

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