

Bath & North East Somerset Council		
MEETING:	AVON PENSION FUND COMMITTEE	
MEETING DATE:	9 December 2011	AGENDA ITEM NUMBER
TITLE:	REVIEW OF INVESTMENT STRATEGY	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
List of attachments to this report:		
Appendix 1 – JLT paper on tactical switch from gilts to corporate bonds		
Appendix 2 - JLT brief on Euro Crisis		

## **1 THE ISSUE**

**1.1** At its meeting on 22 November the Investment Panel discussed the impact of the euro crisis on the Fund's investment portfolio. The background paper by JLT for the discussion is found in Appendix 2. In this paper JLT put forward a number of options that the Fund could consider to mitigate risk within the current investment strategy, one of which is to switch between UK gilts and corporate bonds. However, as the Panel was not able to consider this option in detail at the meeting, the Panel agreed that the proposal should be considered fully by the Committee.

**1.2** Appendix 1 sets out the proposal and rationale in detail.

## **2 RECOMMENDATION**

**2.1** Having considered the proposal from JLT, the Committee agrees:

- (i) the recommendation from JLT to tactically switch from UK government bonds (gilts) to sterling corporate bonds
- (ii) the value to be switched is (£80m c.3.2%) of Fund assets
- (iii) the trigger point to reverse the tactical switch is when the corporate bond yield spread over the gilt yield falls to (1.2%).
- (iv) to delegate implementation to the Officers, subject to current conditions prevailing.

### **3 FINANCIAL IMPLICATIONS**

**3.1** Transaction costs of the proposed action have been factored into the analysis.

### **4 BACKGROUND**

**4.1** On November 22 2011, the Investment Panel considered options for protecting the Fund's assets from any adverse impact of the on-going euro crisis.

**4.2** In the short term, the Panel felt there was value in considering a tactical switch from gilts into corporate bonds but required further detailed information on the proposal before making a recommendation for the Committee. Given the speed at which markets are moving it was agreed to bring the proposal directly to the Committee meeting on 9 December 2011. Therefore the Panel asked Officers and JLT to present a detailed proposal to Committee.

**4.3** It should be noted that the Fund undertook a similar tactical switch of £40m from gilts into corporate bonds between July 2009 and January 2010 which generated a £4m return to the Fund.

### **5 PROPOSAL**

**5.1** The proposal from JLT is for a temporary tactical switch of £80m (3.2%) of Fund assets from gilts to corporate bonds. The rationale for this is to seek to provide some protection from future rises in gilt yields (which are at historic lows) and in so doing achieve a higher yield from corporate bonds and an opportunity for capital returns should the spread between gilts and corporate bonds narrow. Selling gilts would also allow the Fund to crystallise profit from the current high price of gilts.

**5.2** Appendix 1 has been prepared by JLT and sets out the proposal in full, the rationale behind it and the inherent associated risks.

**5.3** The Fund's current holding in gilts as at 31October is £188m, 7.3% of assets (managed passively by BlackRock) and corporate bonds is £138m, 5.3% of assets (actively managed by RLAM). The strategic target allocation for gilts is 6% and 5% for corporate bonds.

**5.4** The Fund also has £177m in UK Government index linked bonds and £78m in overseas bonds which will remain unaffected by the proposed change.

**5.5** The switch would be implemented selling down the gilt portfolio managed by BlackRock and investing in the active corporate bond portfolio managed by RLAM. The alternative to investing in the RLAM portfolio is to invest in a passively managed corporate bond fund managed by Blackrock. However, this is not the preferred solution as such funds track the index and are more exposed to the most highly indebted companies which pose greatest credit risk.

**5.6** The Committee is asked to consider the proposal, the amount to be switched and the trigger point for reversal of the switch.

- 5.7** The Committee is asked to delegate responsibility for implementation to the Officers, who will only implement if the current conditions prevail. If conditions alter, the Officers will consult with JLT and the Committee Chair.

## **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. It discharges this responsibility by ensuring the Fund has an appropriate investment strategy and investment management structure in place that is regularly monitored. In addition it monitors the benefits administration, the risk register and compliance with relevant investment, finance and administration regulations. The creation of an Investment Panel further strengthens the governance of investment matters and contributes to reduced risk in these areas.

## **7 EQUALITIES**

- 7.1** An equalities impact assessment is not necessary.

## **8 CONSULTATION**

- 8.1** N/a

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

- 9.1** The issues being considered are contained in the report.

## **10 ADVICE SOUGHT**

- 10.1** The Council's Monitoring Officer and Section 151 Officer (Divisional Director - Finance) have had the opportunity to input to this report and have cleared it for publication.

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<b>Background papers</b>	Investment Panel reports and minutes.