Bath & North East Somerset Council

MEETING:	**Avon Pension Fund Committee**	
MEETING DATE:	**9 December 2011**	**AGENDA ITEM NUMBER**
TITLE:	**Review Of Investment Performance For Periods Ending 30 Sept 2011**	
WARD:	**ALL**	
AN OPEN PUBLIC ITEM		

List of attachments to this report:

Appendix 1 – Fund Valuation

Appendix 2 – JLT performance monitoring report

Exempt Appendix 3 – Summaries of Investment Panel meetings with Investment Managers

Appendix 4 - Euro and European Financials exposure

1 THE ISSUE

1.1 This paper reports on the investment performance of the Fund and seeks to update the Committee on routine strategic areas concerning the Fund's investments.

1.2 This report contains performance statistics for periods ending 30 September 2011.

1.3 The main body of the report comprises the following sections:

Section 4. Investment Performance: A - Fund, B - Investment Managers.

Section 5. Investment Strategy

Section 6. Funding Level Update

Section 7. Portfolio Rebalancing and Cash Management

Section 8. Corporate Governance Update

2 RECOMMENDATION

That the Avon Pension Fund Committee:

2.1 Notes the information as set out in the report.

3 FINANCIAL IMPLICATIONS

3.1 The returns achieved by the Fund for the three years commencing 1 April 2010 will impact the next triennial valuation which will be calculated as at 31 March 2013. Section 6 of this report discusses the trends in the Fund's liabilities and the funding level.

4 INVESTMENT PERFORMANCE

4.1 JLT's report in Appendix 2 provides a full commentary on the performance of the fund (pages 10 to 15), the investment managers (pages 16 to 36) and a commentary on investment markets (pages 5 to 7). In the section on the Fund (page 10), three year rolling returns are included to provide a longer term perspective.

A – Fund Performance

4.2 The Fund's assets decreased in value by 0.8% over the previous 12 months and by 7.9% (£213m) in the quarter, giving a value for the investment Fund of £2,488m at 30 Sept 2011. Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and managers.

4.3 The Fund's investment return and performance relative to benchmarks is summarised in Table 1.

Table 1: **Fund Investment Performance, periods to 30 Sept 2011**

	3 months	12 months	3 years (p.a.)
Avon Pension Fund	-7.9%	-0.8%	6.7%
Strategic benchmark *(Fund relative to benchmark)*	-8.5% *(+0.6%)*	-1.3% ***(+0.5%)***	5.6% *(+1.1%)*
Customised benchmark *(Fund relative to benchmark)*	-8.0% *(+0.1%)*	-0.8% ***(=)***	7.2% *(-0.5%)*
Local Authority Average Fund *(Fund relative to benchmark)*	-9.3% *(+1.4%)*	-1.2% ***(+0.4%)***	5.9% *(+0.8%)*

4.4 **Avon Pension Fund**: Quarterly return driven by negative returns from all equity markets, which offset positive returns from bonds and property with hedge funds producing a zero absolute return. Annual return driven by same factors, with the only exception being small positive returns in Japanese and North American equity markets over the year.

4.5 **Versus Strategic Benchmark (which reflects an allocation of 60% equities, 20% bonds, 10% property, 10% hedge funds):** Quarterly relative outperformance driven by Fund benefitting from being overweight bonds (versus the benchmark) and the overseas equity and hedge fund managers outperforming their industry benchmarks. Annual outperformance resulted from being overweight bonds and from the Fund's overseas equity managers outperforming industry benchmark returns over the year.

4.6 **Versus Customised Benchmark (which reflects the individual benchmarks of each manager and as such, measures the relative performance of the managers as a whole):** Underperformed the benchmark over the year, with underperformance of TT, Schroder Equity and 3 hedge fund managers more than offsetting outperformance by Jupiter, Invesco, Genesis and Partners. The other managers performed broadly in line with their benchmarks.

4.7 **Versus Local Authority Average Fund**: Annual relative outperformance driven by Fund's lower than average allocation to equities which performed negatively over the year, and higher than average allocation to hedge funds and property which provided protection from equity losses. A small overweight position in bonds which performed well also added to the outperformance.

4.8 Since the end of September global equity markets have been volatile but have recovered slightly with the FTSE All Share index rising by c. 6% (to 10 November). In contrast, the total return for the Over 15-year Gilt index was c. 7% during the same period. The Fund value is estimated to be c. £2.49bn, marginally higher than at 30 Sept 2011. These market moves impact the funding position and this is discussed in Section 6 below.

B – Investment Manager Performance

4.9 A detailed report on the performance of each investment manager has been produced by JLT – see pages 16 to 36 of Appendix 2. Their report does not identify any additional performance issues with the managers.

4.10 TT performance – to be updated following consideration of report at Investment Panel meeting on 22 November.

4.11 During the quarter Man have commenced a reduction in the number of underlying managers in their portfolio. This is in line with the recommendations following the review of hedge funds in March 2011.

4.12 As part of the on-going "Meet the Managers" programme, the Investment Panel received presentations from RLAM, SSgA and Invesco in a workshop on October 20, and Genesis at the meeting on 22 November. The summaries of these meetings are in Exempt Appendix 3.

4.13 Performance reporting for Partners is lagged by a quarter. However, the latest estimate for the quarter ending September 30 2011 is 0.6% which is 1.1% behind benchmark.

5 INVESTMENT STRATEGY

5.1 JLT's report notes the current market volatility driven by uncertainty over the Eurozone and suggests that it should be considered whether any changes to asset allocation are appropriate. A briefing note addressing this will be circulated ahead of the meeting.

5.2 In addition, the analysis of the Fund's exposure to the Euro and to European financial institutions presented at the last Committee meeting has been updated and can be found at Appendix 4. This summarises the direct exposure the Fund has to the Euro currency and European banks and insurance companies (including those not in the Euro). However, this does not include the indirect exposure of the Fund to other companies and financial institutions that have exposure to the Euro currency or European financial institutions.

5.3 The implementation of the active currency hedging programme commenced in July and will be implemented fully within a 12 month timeframe. This quarter currency markets moved in the Fund's favour and the programme successfully passed through the large majority of these currency returns. The costs of the programme had the effect of marginally reducing overall fund return but as expected these costs were significantly less than a 50% passive hedging approach.

6 FUNDING LEVEL UPDATE

6.1 As at 30 Sept 2011 the Actuary has estimated that the funding level has deteriorated to 69%, at 31 March 2010 triennial valuation it was 82%.

6.2 Since the 2010 valuation, the value of the assets has increased by £72m (3%) to £2.5bn, and liabilities increased by £647m (20%) to £3.65bn. As a result the deficit has increased from £552m to £1,130m, with much of the deterioration happening in the last quarter. Note that the revised funding level takes into account benefit payments and contributions received during the period.

6.3 Table 2 shows the change in financial assumptions:

Table 2: **Change in Financial Assumptions**

	31 March 2010	30 June 2011	30 Sept 2011
UK Gilt yield	4.50%	4.30%	3.60%
Real yield	0.70%	0.60%	0.20%
Implied RPI inflation p.a.	3.80%	3.70%	3.40%
Inflation adjustment p.a.	0.80%	0.80%	0.80%
CPI Inflation p.a.	3.00%	2.90%	2.60%

6.4 The reduction in the gilt yield from 4.3% at 30 June to 3.6% at end of September is the reason why liabilities have increased so significantly since June (when liabilities were estimated to be £3.3bn). More positively, implied inflation has fallen by 0.3% in the quarter which has helped offset some of the impact from the reduction in gilt yields. ***It should however be noted that this is just a snapshot of the funding level at a particular point in time.***

6.5 The interim valuation at the Fund level as at 31 March 2011, rolled forward to 30 September will be discussed at the Committee workshop and meeting on 9 December 2011. The Actuary will also discuss the possible implications of the changes to the scheme as a result of the (expected) Hutton proposals and the changes put forward to achieve savings equivalent to 3.2% of contributions.

7 PORTFOLIO REBALANCING AND CASH MANAGEMENT

Portfolio Rebalancing

7.1 The rebalancing policy requires rebalancing of the Equity/Bond allocation to occur when the equity portion deviates from 75% by +/- 2%, and the valuation metric, in this case the equity gilt yield ratio, confirms that the relative valuation between equities and bonds is favourable. The implementation of this policy is delegated to officers.

7.2 There was no rebalancing undertaken this quarter. As at 31 October 2011 the Equity:Bond allocation was estimated at 72:28. Given the current market volatility and uncertainty over developments in the eurozone, officers have temporarily suspended the rebalancing policy.

Cash Management

7.3 Cash is not included in the strategic benchmark. However, cash is held by the managers at their discretion within their investment guidelines, and internally to meet working requirements. The segregated portfolios, TT, Jupiter, Schroder Equity and BlackRock utilise money market funds offered by the custodian, BNY Mellon. The cash within the pooled funds is managed internally by the manager. The cash managed by BlackRock in the property portfolio is invested in the BlackRock Sterling Liquidity Fund. The officers closely monitor the management of the Fund's cash held by the managers and custodian with a particular emphasis on the security of the cash.

7.4 Management of the cash held internally by the Fund to meet working requirements is delegated to the Council's Treasury Management Team. The monies are invested separately from the Council's monies and are invested in line with the Fund's Treasury Management Policy which was approved on 18 December 2009. The Fund adopts the Council's counterparty list and the latest list approved by the Council in February 2011.

7.5 The Council reduced their limits for a number of banks due to rating downgrades and in line with the Fund's Treasury Management Policy, the Fund's limits to these banks also reduced (from £5m to £3m). However, the Fund has lent up to the previous limits when required due to the lack of other approved counterparties given current market conditions. The Fund's policy has been to maintain the minimum cash balance required for working purposes with the Treasury Management Team. Any cash in excess of working capital requirements is invested via money market funds held with the custodian.

7.6 The Officers are reviewing the Fund's Treasury Management Policy and exploring options for managing the cash more efficiently given current market conditions. Any proposals will be brought to the Committee for approval.

8 CORPORATE GOVERNANCE UPDATE

8.1 During the quarter, the Fund's external managers undertook the following voting activity on behalf of the Fund:

Companies Meetings Voted: 28
Resolutions voted: 495
Votes For: 475 (95.8%)
Votes Against: 20 (4.2%)

8.2 The Fund is a member of the Local Authority Pension Fund Forum (LAPFF), a collaborative body that exists to serve the investment interests of local authority pension funds. In particular, LAPFF seeks to maximise the influence the funds have as shareholders through co-ordinating shareholder activism amongst the pension funds. LAPFF's current activity includes:

(1) **BP Investor update**
One year on from the Macondo oil spill BP updated investors on their risk management strategies, emphasising the changes made to BP's risk management of contractors – investors were reassured by plans for closer and longer term relationships with fewer contractors allowing for deeper due diligence. So far only 2 of the 26 recommendations of the Bly report have been implemented by BP.

(2) **Engagement activity:**

a) News Corp – LAPFF initiated a dialogue with News Corp in June 2010 to address the company's poor governance record. LAPFF has increased its engagement with the company in response to the phone hacking scandal and issued a public statement opposing the re-election of Rupert and James Murdoch. LAPFF will continue engagement and believes News Corp must reform its board.

b) Shell – LAPFF met the Company regarding complaints made by Amnesty International and Friends of the Earth about how Shell manages oil spill risks and engagement in local communities by its business in Nigeria.

c) Premier foods – A meeting was held to discuss improvements in approach to health, nutrition and supply chain matters. Improvements include increased disclosure, better labelling and strategies for reducing salt and fat from products, and the auditing of labour standards at suppliers.

9 RISK MANAGEMENT

9.1 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 return of the strategic benchmark and the performance of the investment managers. An 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.

10 EQUALITIES

10.1 This report is primarily for information only.

11 CONSULTATION

11.1 This report is primarily for information and therefore consultation is not necessary.

12 ISSUES TO CONSIDER IN REACHING THE DECISION

12.1 The issues to consider are contained in the report.

13 ADVICE SOUGHT

13.1 The Council's Monitoring Officer (Council Solicitor) 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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Background papers	LAPPF Member Bulletins, Data supplied by The WM Company
Please contact the report author if you need to access this report in an alternative format	