LONDON BOROUGH OF WALTHAM FOREST

Meeting / Date	Pensions Fund Committee 22 September 2016
Report Title	**Pension Fund Performance and Strategy**
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Wards affected	None Specifically
Public Access	Open Except for Appendices 1-4 which are exempt in accordance with Section 100 (A-H) of the Local Government Act 1972 and Schedule 12A, as amended, on the grounds that the information in it involves the likely disclose of exempt information as defined in Part 1, paragraph 3, as the information relates to the financial or business affairs of any particular person (including the authority holding that information) and the disclosure would not be in the public interest.
Appendices	1 Fund Investments and rebalancing Spreadsheet 2 Investments Following Brexit 3 Independent Advisors Comments 4 Independent Advisors Manager Meeting Notes

1. SUMMARY

1.1 This report presents performance to the quarter ended 30 June 2016. The current sums invested against the various asset classes are also reviewed against the investment strategy and the need for rebalancing considered.

1.2 As at 30 June the Pension Fund investments were valued at £732.8m which is an increase of £1m since the previous quarter. Compared with the aggregate benchmark of 4.4% the fund has under-performed this by 3.5% in the quarter.

2. RECOMMENDATIONS

2.1 Pension Fund Committee is recommended to:

2.1.1 **Note** the report on the overall performance of the Pension Fund as well as that of the individual managers.

2.1.2 **Note** the update on investments following Brexit.

2.1.3 **Agree** that the fund will seek to make direct commercial property investments in the borough and explore the potential to aquire some of the current Council's commercial property portfolio where appropriate.

2.1.4 **Agree** that the Pension Fund will exclude fossil fuels from it strategy over the next five years.

3. REPORT

Overall Performance

In the **quarter** to 30/06/2016 a return of 0.8% was achieved, under-performing the benchmark of 4.4% by -3.5%.

It should be noted that the markets have moved on since the 30 June and our core investments in equities and bonds have made a positive rebound in value since then. As seen in appendix 2 to this report.

	Quarter Ended March 2016			1 Year			Since Inception		
Fund manager	Return	Benchmark	Performance	Return	Benchmark	Performance	Return	Benchmark	Performance
	%	%	%	%	%	%	%	%	%
Axa Framlington	-5.6	4.7	-9.9	-7.1	2.2	-9.1	6.7	4.5	2.2
JO Hambro *	8.4	8.8	-0.4	5.0	13.9	-7.9	13.1	10.6	2.3
Wellington GTR	0.5	1.1	-0.6	1.0	4.4	-3.2	1.7	4.4	-2.6
Wellington MSC	3.3	4.8	-1.4						
BlueCrest	-0.8	2.4	-1.6	-0.2	10.0	-9.0	2.5	10.0	-6.8
Markham Rae	3.2	2.4	0.8	14.9	10.0	4.4	12.9	10.0	2.7
UBS Triton	0.8	1.3	-0.4	7.0	9.1	-2.0	6.8	6.9	-0.1
DTZ	5.9	1.3	4.6	11.1	9.1	1.8	-5.3	4.3	-9.2
Capital Dynamics	7.3	3.6	3.6	14.4	15.0	-0.5	5.3	15.0	-8.4
GIP II	5.5	3.6	1.9	13.6	15.0	-1.2	16.1	15.0	0.9
Darwin Leisure	3.4	1.9	1.5	11.9	8.0	3.6	12.0	8.0	3.7
Impact Ventures UK	-9.7	1.7	-11.2	-16.9	7.0	-22.3	-15.3	7.0	-22.3

Relative return is calculated on a geometric basis and is not fund return less benchmark.

The above figures are taken from the State Street performance report.

There is a difference between the JO Hambro benchmark used by State Street (8.8%) and that used by JO Hambro (6.79%). This difference is explained by the fact that State Street use the close of business benchmark and JO Hambros is adjusting for midday. There were some large market movements in the US on the 30th June which is what is causing this big difference. This will come back into line when the July figures are included.

Manager Commentary

3.2 The main focus for manager performance is the longer term (over a 3-5 year period) and for some illiquid funds such as property, infrastructure or private equity (Impact Ventures UK) there is a much longer time period of 5-10 years or more in some instances. However, monitoring quarterly performance highlights continuous underperformance that is out of line with the manager's fundamental strategies and therefore, will give cause for reviewing these investments. Details for under-performing managers is dealt with below.

3.3 Over the 12 months to 30 June 2016 the fund returned -0.1%, under-performing the benchmark of 6.7% by 6.4%. The main area's of underperformance over the year to date were UK and global equities.

Under performing Managers

3.4 **JO HAMBRO -** The portfolio significantly outperformed (based on JO Hambro's benchmark figure) in a quarter that will linger long in the memory following the UK electorate's unexpected vote to leave the European Union. This was an outcome that blindsided financial markets and created shockwaves across global financial markets. Positive stock selection in Q2: mainly due to positive stock selection in the consumer discretionary sector (owning Cyber Agent and Adidas), the materials sector (owning gold mining stocks Newcrest Mining, Franco-Nevada and Agnico Eagle Mines) and the telecommunications sector (owning NTT Docomo and KDDI). Positive sector allocation in Q2: avoiding European financials and "value trap" banks (prefering stock exchanges) and being underweight the consumer discretionary sector.

'Weeding out the losers' included selling the following companies where either the fundamentals of the business or the technicals of the share price had significantly deteriorated: Allergan (after its merger with Pfizer fell apart) and Valero (after disappointing earnings forecasts). New positions included the following stocks that have positively inflected after several years' of underperformance, both fundamentally and technically: Newmont Mining, an American gold mining company, plus BHP Billiton and Rio Tinto, the Australian mining companies who have embarked on significantly shareholder friendly "shrink to grow" strategies, unlike most banks who still seem to be in denial. As a result, their overweight materials and underweight financials stances are their largest portfolio positions relative to the benchmark. They have not changed their approach in any way in light of the Brexit vote, having found sterling and UK assets unattractive for a while regardless of the referendum. Given the vote for Brexit, sterling will reset at a lower range in the short term, at which point they will look for potential "early Christmas presents" in any UK/European shares that overreact on the downside. In the medium to long term, sterling will probably then start to outperform the euro as other countries/regions within Europe question whether they should stay in the European Union or the euro.

The one year return to June is still showing a negative return against the benchmark of -7.9, but since inception is outperforming the benchmark by 2.3%.

3.5 **AXA -** A difficult quarter with poor absolute return and relative performance. Significant out performance of FTSE 100 versus FTSE 250 and FTSE Small Cap. **Good long term performance** (as seen in the table above on since inception figures). Companies with overseas earnings, particularly with exposure to the resources sector and US Dollar performed well. E.g. Hunting, BTG, Rotork and Weir. Essentra performed poorly after a profit warning. In general, companies exposed to the UK economy, (particularly post Brexit) performed poorly in anticipation of a deteriorating economic outlook – e.g. Paddy Power, Dixons Carphone, ITV and Rightmove. Trading remains robust in each case. Being underweight bank shares and financials was the largest contributor to relative returns. Post Brexit, in particular Consumer Services (i.e. media and retailers) was the worst sector by relative contribution. Also, being underweight consumer goods, deemed to be “defensives”, was a negative. A new holding was taken in Smith & Nephew over the quarter. Stocks added to included Experian, Worldpay and Redx Pharma. The holding in Inmarsat was sold. The sale of the Steris shareholding (received following the takeover of Synergy Healthcare) was completed. Holdings also reduced included B&M, HSBC, Booker and St. James Place.

3.6 **DTZ (European Property)** - This investment is in wind down. It is a closed fund with an end date in 2017. The Pension Fund invested in this in July 2007, which proved to be poor timing to be investing in European property. The fund is a fund of funds investment and has been impacted upon since 2009 by some of the underlying funds problems, including the rescheduling of debt within their portfolios and the fall in value of commercial property prices in southern Europe. The residual capital value was £3.47m as at 30 June 2016. No distributions where made to the fund this quarter.

3.7 **UBS (Triton Property Fund)** – Performance has now stabilised due to the asset management and governance arrangements that the fund now has in place. Due to this confidence and as reported to the previous meetings the fund made an additional allocation to this investment. Following meetings with the Triton fund the officers and advisors to the fund are comfortable with the current performance and the future of our investment to perform to the benchmark target.

3.8 **Capital Dynamics** – This is an infrastructure investment that specialises in clean energy on a relatively small scale. The fund reached final fund raising close in December 2014 and capital is now fully committed over existing investments or exclusive options. Most of the assets in the fund are either in late stage development or are already operational. We should start to see good net distributions from the fund during 2016 The fund has also committed another 2% to Capital Dynamics III fund (as reported at the March meeting) that is a sterling fund invested purely in wind generation in the UK. This fund as at last week has already drawn down 75% of commitments and these will all be operational by March 2017 and generating cash returns.

3.9 **Impact Ventures UK** – This is a social impact fund that has private equity characteristics in terms of fund dynamics. We have now drawn down into this fund as at June 2016 £2.1m out of a £6.2m commitment. The fund is in its early stage we do not expect to make a return in the medium term (3-5 years). The fund is a long term illiquid investment. The fund invests in small companies that have a social impact and need investment to widen their scope.

Managers Under Review

3.10 **Wellington** - The GTR investment has continued to not achieve the targeted return of 4.4%, which remains disappointing. However, the manager's actual benchmark is a cash based against which it is actually outperforming. Their performance against target is still mainly due to the global economic macro environment trends and recent market disruptions arising from the persistent divergences in economic growth and monetary policy.

3.11 **BlueCrest** – Following the committee's agreement on 19 November to divest from BlueCrest- AllBlue Fund, BlueCrest notified all investors on 1 December that it was withdrawing this product from the market and would embark on a programme of returning capital to investors. As at 30 June 2016 the fund has received back approximately 80% of the fund assets in this investment, about £24m, some of this was invested early on in the UBS Triton fund investment and the rest held in cash pending other drawdowns from infrastructure investments.

Investment Issues

3.12 **Residential Property** – This investment is still awaiting drawn-down of this investment. Following a meeting this week drawdowns are expected of approx. 75% by the 4rd quarter 2016. This is earlier than expected as the pipeline of investments has been very strong. This means that income from this investment will come through a bit earlier than the 3-5 years expected.

3.13 **Investments Following Brexit and June quarter**

This is attached in appendix 2 and is an update of the document circulated to members in July.

4. **Hall Farm Curve** – The Director of Finance is raising this with the regeneration team as this has already been part of a discussion of wider regeneration around lea Bridge. It is not felt that this an appropriate investment for the Pension Fund.

5. State Street Analytics

4.1 Detailed analysis of fund performance and statistics on the movements in markets over the quarter, are set out in the quarterly performance monitoring report from WM and the Fund Manager Reports sent separately (Sent by e-mail to Committee members). The WM report that will be sent is over inflated by cash and therefore the attached at appendix 1 is the correct value of the fund.

4.2 Although the Council 's fund performance is formally measured against its own scheme specific benchmark, it is useful to take a look at the pattern of returns in comparison with the universe of Local Authority pension funds, provided by State Street Analytics Performance Services. Included in the second table are the yearly returns and State Street Analytics rankings against other LGPS pension funds.

4.3 Following a decision from State Street to discontinue this service to Local Authority Pension Funds on economic grounds.

4.4 It is hope that another body will take on this long term analysis of the LGPS funds but this is uncertain at this time. In the short term we have asked WM (State Street) to provide us with our pasted data before the end of June when their service will end so that we have this to provide to a potential future provider.

	2010				2011				2012			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Total Fund Return	6.5	-8.0	11.3	6.6	1.1	2.1	-11.4	6.8	7.9	-1.2	3.9	1.5
Ranking in Local Authority Universe	36	85	2	11	63	14	91	11	5	96	22	92

	2013				2014				2015				2016
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Total Fund Return %	9.5	-0.3	4.1	6.0	1.3	0.6	2.7	2.3	7.1	-2.7	-5.0	5.2	-0.9

Ranking in Local Authority Universe	38	30	7	1	21	97	21	87	2	60	93	17	100

4.5 The yearly returns and rankings for the fund from 2007 to 2016.

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Total Fund Return %	7.0	-5.7	-24.1	43.1	10.4	4.3	11.8	11.4	12.5	-3.6
Ranking in Local Authority Universe	50	85	85	6	3	24	86	2	63	98

Figures: State Street Analytics Performance Services

5 Rebalancing Policy

5.1 No rebalancing took place this quarter.

5.2 Attached in appendix 1 Fund Investments and rebalancing Spreadsheet.

6 OPTIONS & ALTERNATIVES CONSIDERED

6.1 Not applicable

7 SUSTAINABLE COMMUNITY STRATEGY PRIORITIES (AND OTHER NATIONAL OR LOCAL POLICIES OR STRATEGIES)

7.1 Not applicable

8 CONSULTATION

8.1 Not applicable

9 IMPLICATIONS

9.1 Finance, Value for Money and Risk

9.1.1 The success of the investment strategy and performance targets is key to the achievement of the funding strategy objectives taken into account in the 2013 triennial valuation. Monitoring and rebalancing asset allocation in line with our policy should achieve a closer alignment of actual asset allocations with the investment strategy agreed by the Committee. Therefore less risk of unplanned outcomes following from differential performance of different asset classes.

9.2 Legal

9.2.1 No specific legal implications.

9.3 Equalities and Diversity

9.3.1 No direct implications

9.4 Sustainability (including climate change, health, crime and disorder)

9.4.1 None arising from this report.

9.5 Council Infrastructure

9.5.1 No direct implications, although, the aim of the fund is to finance employee benefits and minimize the cost of these to the employer, however the performance of the fund does not have an impact on the employees benefits which are guaranteed through legislation.

BACKGROUND INFORMATION