



PENSIONS COMMITTEE

23 June 2015

Subject Heading:

**PENSION FUND PERFORMANCE
MONITORING FOR THE QUARTER
ENDED MARCH 2015
Andrew Blake Herbert**

CMT Lead:

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Policy context:

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Pension Fund Managers' performances are regularly monitored in order to ensure that the investment objectives are being met.

Financial summary:

This report comments upon the performance of the Fund for the period ended 31 March 2015

The subject matter of this report deals with the following Council Objectives

Havering will be clean and its environment will be cared for	<input type="checkbox"/>
People will be safe, in their homes and in the community	<input type="checkbox"/>
Residents will be proud to live in Havering	<input checked="" type="checkbox"/>

SUMMARY

This report provides the Committee with an overview of the performance of the Havering Pension Fund investments for the quarterly period to 31 March 2015. The performance information is taken from the Quarterly Performance Report supplied by each Investment Manager, the WM Company Quarterly Performance Review Report and Hymans Monitoring Report.

The net return on the Fund's investments for the **quarter** to 31 March 2015 was **4.5%**. This represents an out performance of **1.1%** against the tactical benchmark and an under performance of **-0.4%** against the strategic benchmark.

The overall net return of the Fund's investments for the **year** to 31 March 2015 was **13.2%**. This represents an out performance of **1.7%** against the tactical combined benchmark and an under performance of **-12.9%** against the annual strategic benchmark. The annual strategic benchmark is a measure of the fund's performance against a target based upon gilts + 1.8% (the rate which is used in the valuation of the funds liabilities). The implications of this shortfall are discussed further in paragraphs 1.2 and 1.3 below.

It is now possible to measure the individual managers' annual return for the new tactical combined benchmark since they became active on the 14th February 2005. These results are shown later in the report.

RECOMMENDATIONS

That the Committee:

- 1) Considers Hymans performance monitoring report and presentation (Appendix A).
- 2) Receive a presentation from Ballie Gifford for their Diversified Growth Fund and Global Alpha Fund and from the Fund's Multi-Asset Manager (GMO Global Real Return).
- 3) Notes the summary of the performance of the Pension Fund within this report.
- 4) Considers the quarterly reports provided by each investment manager.
- 5) Considers and notes any Corporate Governance issues arising from voting as detailed by each manager.
- 6) Considers any points arising from officer monitoring meetings (section 4 refers).
- 7) Notes the analysis of the cash balances (paragraphs 2.2 and 2.3 refers).

REPORT DETAIL

1. Background

- 1.1 The Fund undertook a full review of the Statement of Investment Principles (SIP) during 2012/13 and following the appointments of the Multi Asset Managers this almost completes the fund's restructuring. The Fund is still considering options for an investment in Local Infrastructure.
- 1.2 A strategic benchmark has been adopted for the overall Fund of Gilts + 1.8% (net of fees) per annum. This is the expected return in excess of the fund's

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liabilities over the longer term. The strategic benchmark measures the extent to which the fund is meeting its longer term objective of reducing the funds deficit. This current shortfall is driven by the historically low level of interest rates which drive up the value of gilts (and consequently the level of the fund liabilities). Whether interest rates will remain at those levels for the longer term and the implications for the Fund's Investment strategy is a matter which will need to be considered at the time of the next actuarial review.

- 1.3 Our Investment Advisors have stated that there are things that could have been done to protect the fund against falling interest rates (e.g. hedging) but they do not believe that this action would have been appropriate. The Fund is already partially protected through its investments with Royal London and given the long term nature of the fund they believe that the fund objective of pursuing a stable investment return remains appropriate. They also note that although the value placed on the liabilities has risen as a result of falling yields, inflations and expectations of future inflation have fallen meaning that the actual benefit cashflows expected to be paid from the fund will be lower.
- 1.4 Individual manager performance and asset allocation will determine the out performance against the strategic benchmark. Each manager has been set a specific (tactical) benchmark as well as an outperformance target against which their performance will be measured. This benchmark is determined according to the type of investments being managed. This is not directly comparable to the strategic benchmark as the majority of the mandate benchmarks are different but contributes to the overall performance.
- 1.5 Changes to the Asset Allocation targets were agreed by members at the Pensions Committee meeting on the 26 March 2013 and 24 July 2013. The long term strategy of the fund adopted at those meetings was to reduce exposure to equities and invest in multi asset strategies.
- 1.6 The following table reflects the asset allocation split following the commencement of trading of the new multi asset managers:

Manager and % of target fund allocation	Mandate	Tactical Benchmark	Out performance Target
State Street Global Assets (SSgA) 8%	UK/Global Equities - passive	UK- FTSE All Share Index Global (Ex UK) – FTSE All World ex UK Index	To track the benchmark
Baillie Gifford 17%	Global Equities - Active	MSCI AC World Index	1.5 – 2.5% over rolling 5 year period
Royal London Asset Management 20%	Investment Grade Bonds	<ul style="list-style-type: none">➤ 50% iBoxx Sterling Non Gilt Over 10 Year Index➤ 16.7% FTSE Actuaries UK Gilt Over 15 Years Index➤ 33.3% FTSE Actuaries Index-	0.75%

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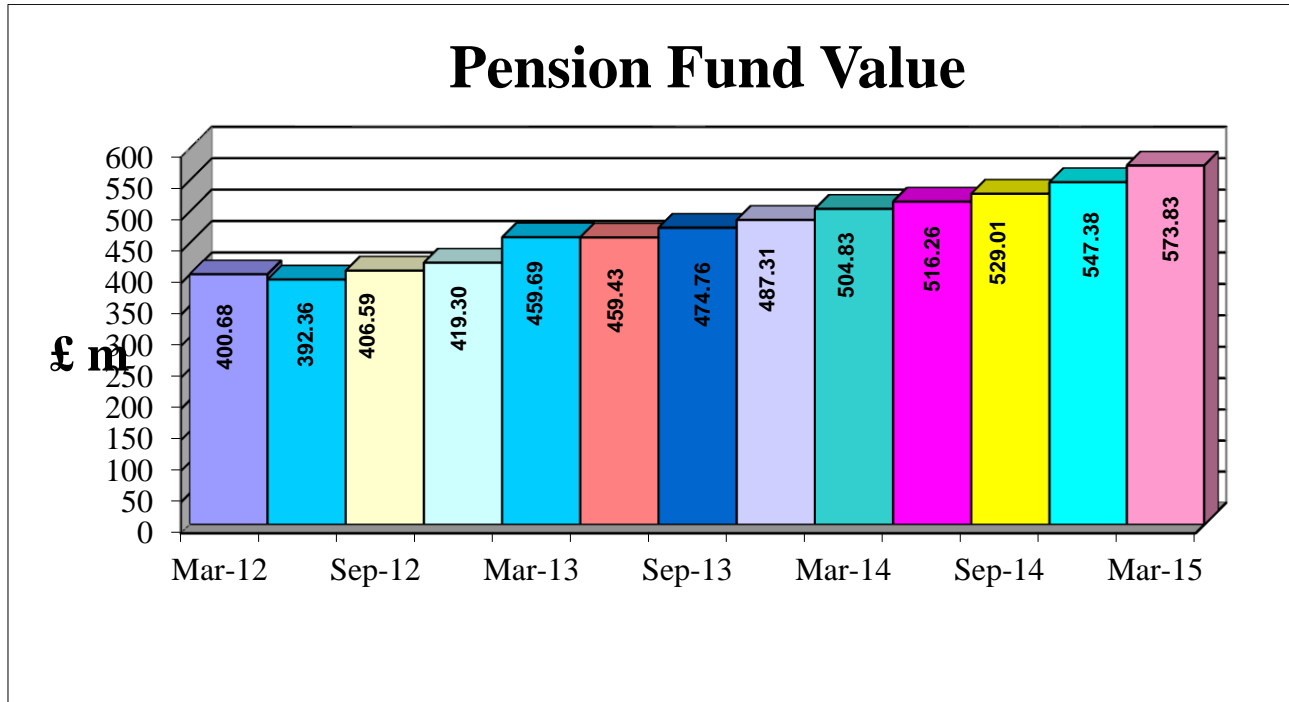
Manager and % of target fund allocation	Mandate	Tactical Benchmark	Out performance Target
		Linked Over 5 Year Index	
UBS 5%	Property	IPD (previously called HSBC/AREF) All Balanced Funds Median Index	To outperform the benchmark
Ruffer 15%	Multi Asset	Not measured against any market index – for illustrative purposes LIBOR (3 months) + 4%.	To outperform the benchmark
GMO Global Real Return (UCITS) 20%	Multi Asset	OECDG7 CPI by +3 to 5% over the medium to long term-	To outperform the benchmark
Baillie Gifford – Diversified Growth Fund 15%	Multi Asset	UK Base Rate +3.5%	To outperform the benchmark

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- 1.7 At a Special meeting of the Pension Committee on the 23 October 2014 members agreed to appoint GMO and invest in their Global Real Return (UCITS) Fund (GRRUF). The GMO (GRRUF) will replace the investment with Barings and will be managed on a pooled basis. During January 2015, the cash was transferred from the SSGA Sterling Liquidity cash account to GMO who have now commenced trading.
- 1.8 UBS, SSgA, GMO and Baillie Gifford manage the assets on a pooled basis. Royal London and Ruffer manage the assets on a segregated basis. Performance is monitored by reference to the benchmark and out performance target. Each manager's individual performance is shown in this report with a summary of any key information relevant to their performance.
- 1.9 Since 2006, to ensure consistency with reports received from our Performance Measurers, Investments Advisors and Fund Managers, the 'relative returns' (under/over performance) calculations has been changed from the previously used arithmetical method to the industry standard geometric method (please note that this will sometimes produce figures that arithmetically do not add up).
- 1.10 Existing Managers are invited to present at the Pensions Committee Meeting every six months. On alternate dates, they meet with officers for a formal monitoring meeting. The exception to this procedure are the pooled Managers (SSgA, UBS, Baillie Gifford and GMO) and Ruffer who will attend two meetings per year, one with Officers and one with the Pensions Committee. However if there are any specific matters of concern to the Committee relating to the Managers performance, arrangements will be made for additional presentations.
- 1.11 Hyman's performance monitoring report is attached at **Appendix A**.

2. Fund Size

- 2.1 Based on information supplied by our performance measurers the total combined fund value at the close of business on 31 Mar 15 was **£573.83m**. This valuation differs from the basis of valuation used by our Fund Managers and our Investment Advisor in that it excludes income. This compares with a fund value of £547.38m at the 31 Dec 14; an **increase of £26.45m**. The movement in the fund value is attributable to an increase in assets of £24.60m and an increase in cash of £1.85m. The internally managed cash level stands at **£7.22m** of which an analysis follows in this report.



Source: WM Company (Performance Measurers)

2.2 An analysis of the internally managed cash balance of **£7.22m** follows:

<u>CASH ANALYSIS</u>	<u>2012/13</u>	<u>2013/14</u>	<u>2014/15</u>
	£000's	Updated £000's	31 Mar 15 £000's
Balance B/F	-1194	-3474	-5661
Benefits Paid	31272	32552	33340
Management costs	1779	2312	1330
Net Transfer Values	-1284	-1131	-78
Employee/Employer Contributions	-30222	-45659	-34470
Cash from/to Managers/Other Adj.	-3780	9825	-1618
Internal Interest	-45	-86	-59
Movement in Year	-2280	-2187	1555
Balance C/F	-3474	-5661	-7216

2.3 As agreed by members on the 27 June 2012 a cash management policy has now been adopted. The policy sets out that should the cash level fall below the de-minimus amount of £2m this should be topped up to £4m. This policy includes drawing down income from the bond and property manager.

3. Performance Figures against Benchmarks

3.1.1 The overall net performance of the Fund against the new **Combined Tactical Benchmark** (the combination of each of the individual manager benchmarks) follows:

	Quarter to 31.03.15	12 Months to 31.03.15	3 Years to 31.03.15	5 years to 31.03.15
Fund	4.5%	13.2%	11.5%	8.9%
Benchmark return	3.3%	11.3%	9.5%	8.4%
*Difference in return	1.1%	1.7%	1.8%	0.5%

Source: WM Company

*Totals may not sum due to geometric basis of calculation and rounding.

3.1.2 The overall net performance of the Fund against the **Strategic Benchmark** (i.e. the strategy adopted of Gilts over 15 years + 1.8% Net of fees) is shown below:

	Quarter to 31.03.15	12 Months to 31.03.15	3 Years to 31.03.15	5 years to 31.03.15
Fund	4.5%	13.2%	11.5%	8.9%
Benchmark return	4.8%	29.9%	13.0%	14.8%
*Difference in return	-0.4%	-12.9%	-1.4%	-5.1%

Source: WM Company

*Totals may not sum due to geometric basis of calculation and rounding.

3.1.3 The following tables compare each manager's performance against their **specific (tactical) benchmark** and their **performance target** (benchmark plus the agreed mandated out performance target) for the current quarter and the last 12 months.

QUARTERLY PERFORMANCE (AS AT 31 MARCH 2015)

Fund Manager	Return (Performance)	Benchmark	Performance vs benchmark	Target	Performance vs Target
Royal London	4.00	4.12	-0.12	4.31	-0.31
UBS	3.34	2.80	0.54	n/a	n/a
Ruffer	4.14	0.10	4.04	n/a	n/a
SSgA	7.63	7.64	-0.01	n/a	n/a
SSgA Sterling Liquidity Fund	0.12	0.09	0.03	n/a	n/a
Baillie Gifford (Global Alpha Fund)	9.20	7.60	1.60	8.23	0.98
Baillie Gifford (DGF)	3.20	1.00	2.20	n/a	n/a
GMO	1.33	0.09	1.24	n/a	n/a

Source: WM Company, Fund Managers and Hymans

- Totals may not sum due to geometric basis of calculation and rounding.
- GMO not invested for entire period

ANNUAL PERFORMANCE (LAST 12 MONTHS)

Fund Manager	Return (Performance)	Benchmark	Performance vs benchmark	Target	Performance vs Target
Royal London	20.39	21.45	-1.06	22.20	-1.81
UBS	19.06	16.64	2.42	n/a	n/a
Ruffer	11.48	0.60	10.88	n/a	n/a
SSgA	19.01	19.08	-0.07	n/a	n/a
SSgA Sterling Liquidity Fund	0.50	0.35	0.15	n/a	n/a
Baillie Gifford (Global Alpha Fund)	19.00	19.00	0.00	21.50	-2.50
Baillie Gifford (DAAF)	7.90	4.00	3.90	n/a	n/a

Source: WM Company, Fund Managers and Hymans

➤ Totals may not sum due to geometric basis of calculation and rounding.

4. Fund Manager Reports

4.1. UK Investment Grade Bonds (Bonds Gilts, UK Corporates, UK Index Linked, UK Other) – (Royal London Asset Management)

- a) In accordance with agreed procedures officers met with representatives from Royal London on the 11 May 2015 at which a review of their performance as at 31 March 15 was discussed.
- b) The value of the fund as at 31st March15 increased by 4.05% on the previous quarter.
- c) The fund achieved a net return of 4% during the quarter and underperformed the benchmark for the quarter by 0.1%. Royal London underperformed the benchmark over the one year period by -1.06% but ahead of benchmark three and five year periods, with relative returns of 0.92% and 1.05% respectively. Since inception they outperformed the benchmark by 0.59% but below the target by -0.16%.
- d) Royal London reported on market events during the quarter:
 - Government Bonds (Gilts) returned 2.2% over the quarter, mainly due to The Bank of England Monetary Policy Committee members being unanimous in maintaining interest rates at current historical low. The majority felt the situation in Europe and low inflation justified no change. Longer dated maturities outperformed. At the end of December 2014, Gross Domestic Product (GDP) was revised from 0.5% to 0.6% resulting in annual GDP growth for 2014 reaching 2.8%, the highest pace of annual growth since 2006.

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- Index linked Market backdrop – Index Linked Gilts returned 2.86% over the quarter, real yields fell over the quarter, with long dated yields reaching a record low near -1%. Real yields were very volatile, trading at a range of 0.5% to -1% at longer maturities. UK Government Index linked Bonds outperformed their US and Canadian counterparts but underperformed European Bonds that were supported by the ECB quantitative easing programme announced in January. UK CPI inflation fall in Feb 2014 and oil prices falling further also contributed to the downturn in returns this quarter.
 - Credit market (corporate bonds) – Sterling Investment grade bonds returned 3.2% this quarter. Sterling Investment grade bonds outperformed Gilts by 1.59%, reversing the underperformance seen in the second half of 2014. Weakness in commodity prices again impacted general industrials, retail consumer bonds improved over the quarter. Bond issuance was at its lowest level since 2000, with issuance down by 43% on the same quarter last year, the main driver for the decline was the fall in non-financial issuances as borrowers looked to the euro market where funding costs were considerably lower.
- e) Asset Allocation within the portfolio was 58.3% in corporate bonds, 29.5% sterling index linked bonds, 11.5% sterling conventional Bonds, 0.2% in overseas Bonds and 0.6% in cash.
- f) The portfolio changes during the quarter, has been to increase allocations in credit conventional and sterling index linked bonds, funded by the sale of the majority of the Overseas Bonds which have declined significantly over the quarter.
- g) Royal London thought that credit bonds would remain attractive over the medium term so maintained underweight exposure to government bonds in favour of corporate bonds during the quarter. The investment grade sterling credit market did outperform both conventional and index linked government bonds so the asset allocation supported fund performance.
- h) They maintained fund duration below that of the benchmark index, yields of short dated UK government bonds rose over the quarter, however the yields of longer term bonds fell. The duration positioning over the quarter was the principle driver of underperformance.
- i) Off-benchmark positions in overseas bonds were a positive factor for relative performance over the period.
- j) Royal London maintained the view that interest rates are likely to rise over the short to medium term so have adopted a short duration position, we asked how they have positioned the portfolio if interest rates stay lower for longer, they said that although there is not a great change in strategy, they will increase allocation to credit which is out performing conventional gilts on a duration-adjusted basis.

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- k) We asked Royal London to explain their approach to taking off bench-mark exposure in the portfolio, they said the off benchmark position in overseas index linked government bonds has been a positive factor over the last quarter, this was tactical positioning to mitigate underperformance in short dated credit, they said that off benchmark medium dated credit underperformed longer maturities.
- l) Royal London were asked about whether they see value in credit markets going forward and will it be necessary to increase risk to maintain current performance, they said to aid risk management they employ the thinkFolio portfolio management system, which allows them to monitor in real time the drivers of performance: asset allocation, interest rate, sector allocation and stock selection. The risk is measured by their Portfolio risk team who have weekly meetings with fund managers, where risk positions are review and relevant actions taken if required.
- m) Reduced liquidity in the market has reduced Royal London's ability to trade in bonds; but their strategy is to have less emphasis on trading with more emphasis on seeking out long term value and lower turnover in portfolios, which is consistent with their long held views regarding managing credit.
- n) The Royal London Investment outlook is that the current global expansion will be sustained into 2015, with loose monetary policy, lower bond yields and lower oil prices acting as key supports. They expect UK CPI inflation to remain below the 2% target for some time, as the effects of the decline in commodity prices continue to feed through. They expect global bond yields to move higher from current levels.
- o) No governance or whistle blowing issues were reported.

4.2. Property (UBS)

- a) To bring UBS in line with the other Pooled managers within the Fund their monitoring meetings have been rescheduled so that officers will only meet with representatives from UBS once in the year with the other meeting to be held with members. Officers last met with representatives from UBS on 05 November 2014 at which a review of their performance as at 30 September 2014 was discussed. The Pensions Committee last met with UBS at the 17 March 2015 meeting at which their performance up to the end of December 14 was discussed. Officers are next due to meet UBS on the 20 August 2015.
- b) The value of the fund as at 31 March 15 increased by 3.3% since the previous quarter.
- c) UBS delivered a return of 3.3% over the quarter, outperforming the benchmark by 0.5%. The Fund is ahead of the benchmark over the year by 2.4%.

4.3. Multi Asset Manager (Ruffer)

- d) In accordance with agreed procedures officers will only meet with representatives from Ruffer once in the year with the other meeting to be held with members. The Pensions Committee last met with Ruffer at the 24 June 2014 meeting at which their performance as at the end of March 14 was discussed. Officers met with representatives from Ruffer on 05 February 2015 at which a review of their performance as at 31 December 2014 was discussed. The Pensions Committee are next due to meet with Ruffer at the September Committee meeting.
- e) Since officers last met with Ruffer in February 2014, the value of the fund has increased by 4.14%.
- f) Ruffer delivered a return of 4.14% (net of fees) over the quarter, outperforming the benchmark by 4.0%. The Fund is ahead of the benchmark over the year by 10.8%.

4.4. Passive Equities Manager (SSgA)

- a) In accordance with agreed procedures officers will only meet with representatives from SSgA once in the year with the other meeting to be held with members. SSgA met with the members of the Pension Committee on the 17 March 2015 at which they covered the period ending up to 31 December 2014. Officers met with representatives from SSgA on the 11 May 2015 at which a review of their performance as at 31 March 15 was discussed.
- b) Pending consideration of options for an investment in Local Infrastructure the £11.5m is still invested in the SSGA Sterling Liquidity Fund.
- c) The SSgA Sterling liquidity fund has outperformed the benchmark by 0.03% over the quarter. Since inception they have outperformed the benchmark by 0.13%
- d) The SSgA passive Equity mandate has underperformed in line with the benchmark. Since inception they have underperformed against the benchmark by -0.02%.
- e) SSgA reported no staff changes
- f) At a previous meeting SSgA mentioned that they are looking at ways of enhancing returns in Index Equity Portfolio management. The opportunities that are available are options for the portfolio to track different indices that may deliver better returns.
- g) We spent some time discussing the various factors within the indices as there are a number of different models that include factors such as value, quality, size and momentum. SSgA said the challenges in tracking non-

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market capitalisation based indices are that these indices are relatively new and are more volatile than the normal market capitalisation. The RAFI Index is closest to a value style which is the model index that as an alternative is being considered.

- h) Hymans was requested to consider the options of switching indices and a separate paper was presented to the Pensions Committee on the 17 March 2015. The decision to switch indices was deferred to the 16 June 2015 meeting so that training can be delivered to assist members in coming to a decision.
- i) No governance issues or whistle blowing was reported.

4.5. Global Equities Manager (Baillie Gifford)

- a) Representatives from Baillie Gifford on the Global Alpha Fund are due to make a presentation at this Committee therefore a brief overview of their performance as at 31 March 2015 follows.
- b) The value of the fund increased by 9.16% over the last quarter.
- c) Baillie Gifford Global Alpha Mandate has outperformed the benchmark over the last quarter by 1.6% (net of fees) and matched the benchmark over the last year.

4.6. Multi Asset Manager (Baillie Gifford Diversified Growth Fund)

- a) Representatives from Baillie Gifford on the Diversified Growth Fund are due to make a presentation at this Committee therefore a brief overview of their performance as at 31 March 2015 follows.
- b) The value of the fund has seen an increase in value of 3.2% over the last quarter.
- c) Baillie Gifford Diversified Growth Mandate has outperformed the benchmark by 2.2% over the last quarter and has outperformed the benchmark over the year by 3.9%.

4.7. Multi Asset Manager (GMO – Global Real Return (UCITS) Fund)

- a) GMO was appointed in October 2014 and £100.75m was invested into the fund during January 2015. This investment was made over two instalments, £50m invested on the 13 January 2015 and £50.75m on the 20 January 2015.
- b) Representatives from GMO on the Diversified Growth Fund are due to make a presentation at this Committee therefore a brief overview of their performance as at 31 March 2015 follows.
- c) The value of the Fund as at the end of March 2015 has increased by 1.13%.

- d) The GMO mandate has outperformed the benchmark by 1.24% over the last quarter.

5. Corporate Governance Issues

The Committee, previously, agreed that it would:

1. Receive quarterly information from each relevant Investment Manager, detailing the voting history of the Investment Managers on contentious issues. This information is included in the Managers' Quarterly Reports, which will be distributed to members electronically.
2. Receive quarterly information from the Investment Managers, detailing new Investments made.
 - Points 1 and 2 are contained in the Managers' reports.
3. Voting – Where the fund does not hold a pooled equity holding, Members should select a sample of the votes cast from the voting list supplied by the managers (currently only Ruffer) which is included within the quarterly report and question the Fund Managers regarding how Corporate Governance issues were considered in arriving at these decisions.

This report is being presented in order that:

- The general position of the Fund is considered plus other matters including any general issues as advised by Hymans.
- Hymans will discuss the managers' performance after which the particular manager will be invited to join the meeting and make their presentation. The manager attending the meeting will be from:

Baillie Gifford (DGF/Global Alpha Fund) and GMO

- Hymans and Officers will discuss with Members any issues arising from the monitoring of the other managers.

IMPLICATIONS AND RISKS

Financial implications and risks:

Pension Fund Managers' performances are regularly monitored in order to ensure that the investment objectives are being met and consequently minimise any cost to the General Fund

Legal implications and risks:

None arising directly

Human Resources implications and risks:

There are no immediate HR implications. However longer term, shortfalls may need to be addressed depending upon performance of the fund.

Equalities implications and risks:

None arising that directly impacts on residents or staff.

BACKGROUND PAPERS

Royal London Quarterly report to 31 Mar 2015
UBS Quarterly report to 31 Mar 2015
Ruffer Quarterly report 31 Mar 2015
State Street Global Assets report to 31 Mar 2015
Baillie Gifford Quarterly Reports 31 Mar 2015
GMO Quarterly Report 31 Mar 2015
The WM Company Performance Review Report to 31 Mar 2015