Havering
LONDON BOROUGH

PENSIONS COMMITTEE 15 JUNE 2017

Subject Heading:	**PENSION FUND PERFORMANCE MONITORING FOR THE QUARTER ENDED MARCH 2017**
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Policy context:	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 2017

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

Communities making Havering	[]
Places making Havering	[]
Places making Havering	[]
Connections making Havering	X

SUMMARY

This report provides the Committee with an overview of the performance of the Havering Pension Fund investments for the fourth quarter to 31 March 2017. The performance information is taken from the Quarterly Performance Report supplied by each Investment Manager, State Street Global Services Performance Services PLC (formerly known as WM Company) Quarterly Performance Review Report and Hymans Monitoring Report.

The net return on the Fund's investments for the fourth **quarter** to 31 March 2017 was **3.7%.** This represents an outperformance of **1.5%** against the combined tactical benchmark and represents an outperformance of **1.3%** against the strategic benchmark.

The overall net return of the Fund's investments for the financial **year** to 31 March 2017 was **17.1%.** This represents an outperformance of **4.0%** against the combined tactical benchmark and an under performance of **-3.7%** 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 set out in paragraphs 1.2 and 1.3 below.

We measure the individual managers' annual return for the new combined tactical benchmark and these results are shown later in the report.

RECOMMENDATIONS

That the Committee:

1) Notes the summary of the performance of the Pension Fund within this report.
2) Considers Hymans performance monitoring report and presentation (Appendix A).
3) Receive a presentation from the Fund's Multi-Asset Manager (GMO Global Real Return).
4) Considers reviewing the reporting arrangements for the Fund (section 2 refers).
5) Considers the quarterly reports provided by each investment manager.
6) Considers any points arising from officer monitoring meetings (section 4 refers).
7) Notes the analysis of the cash balances (paragraphs 3.2 refers).

REPORT DETAIL

1. Background

1.1 **Strategic Benchmark** - A strategic benchmark has been adopted for the overall Fund of Index Linked Gilts + 1.8% per annum. This is the expected return in excess of the fund's 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. The current shortfall is driven by the historically low level of real interest rates which drive up the value of index linked gilts (and consequently the level of the fund liabilities).

1.2 **Tactical 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.

1.3 The objective of the Fund's investment strategy is to deliver a stable long-term investment return in excess of the expected growth in the Fund's liabilities. Whilst mechanisms such as hedging could have served to protect the fund against falling interest rates in the short-term, such strategies are not commonly employed within the LGPS. The Fund has retained investments with Royal London which have offered some resilience to the fluctuations in interest rates, but given the long term nature of the fund, the Fund's investment advisers believe that the 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, lower realised inflation over recent years means that the actual benefit cash flows expected to be paid from the fund will be lower than previously expected although the fund's liabilities remain subject to changes in future inflation expectations.

1.4 Following the results of the 2016 Valuation and in line with regulations the Committee developed a new Investment Strategy Statement (ISS) which replaced the Statement of Investment Principles (SIP). During the last quarter of 2016/17 some fund rebalancing and short term changes as set out in the ISS was undertaken to bring the asset allocation closer to their benchmark.

1.5 The revised asset allocation targets are shown in the following table and reflect the asset allocation split and targets against their individual fund manager benchmarks:

Table 1: Asset Allocation

Asset Class	Target Asset Allocation (ISS Jan 17)	Investment Manager/ product	Segregated /pooled	Active/ Passive	Benchmark and Target
UK/Global Equity	15.0%	LCIV Baillie Gifford (Global Alpha Fund)	Pooled	Active	MSCI All Countries Index plus 2.5%
	7.5%	State Street Global Asset	Pooled	Passive	FTSE All World Equity Index
	7.5%	State Street Global Asset	Pooled	Passive	FTSE RAFI All World 3000 Index
Multi Asset Strategy	12.5%	LCIV Baillie Gifford (Diversified Growth Fund)	Pooled	Active	Capital growth at lower risk than equity markets
	15.0%	GMO Global Real return (UCITS)	Pooled	Active	OECD CPI g7 plus 3 - 5%

Asset Class	Target Asset Allocation (ISS Jan 17)	Investment Manager/ product	Segregated /pooled	Active/ Passive	Benchmark and Target
Absolute Return	15%	LCIV Ruffer	Pooled	Active	Absolute Return
Property	6%	UBS	Pooled	Active	IPD All balanced (property) Fund's median +
Gilt/Investment Bonds	19%	Royal London	Segregated	Active	• 50% iBoxx £ non- Gilt over 10 years • 16.7% FTSE Actuaries UK gilt over 15 years • 33.3% FTSE Actuaries Index- linked over 5 years. Plus 1.25%*
Infrastructure	2.5%	No allocation			

*0.75% prior to 1 November 2015

1.6 UBS, SSgA and GMO manage the assets on a pooled basis. Royal London manages the assets on a segregated basis. Both the Baillie Gifford mandates and the Ruffer mandates are managed on a pooled basis and operated via the London Collective Investment Vehicle (LCIV). Performance is monitored by reference to the benchmark and out performance target as shown in the above table. Each manager's individual performance is shown later in this report with a summary of any key information relevant to their performance.

1.7 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).

2. Reporting Arrangements

2.1 Current reporting arrangements are that 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, Ruffer and GMO) 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.

2.2 The Department of Communities and Local Government (DCLG) Guidance on Preparing and Maintaining an Investment Strategy Statement (ISS) issued September 2016 relaxed the regulatory framework for scheme investments which also included the relaxation on reviewing investment manager performance.

2.3 In light of the above guidance it is proposed that the Committee consider reviewing the current reporting arrangements. Officers propose that only one fund manager will attend each committee meeting and the Committee meet each manger once in a reporting cycle. The Fund currently has five mangers that they would meet:

GMO
London CIV/Ruffer
Royal London
UBS
SSgA

2.4 Based on the current fund manager numbers and the planned quarterly committee cycle then the Committee would see each manager every 15 months. This will enable the Committee more time to focus on investment strategy development. However if there are any specific matters of concern to the Committee relating to any managers performance, arrangements can be made for additional meetings with those managers.

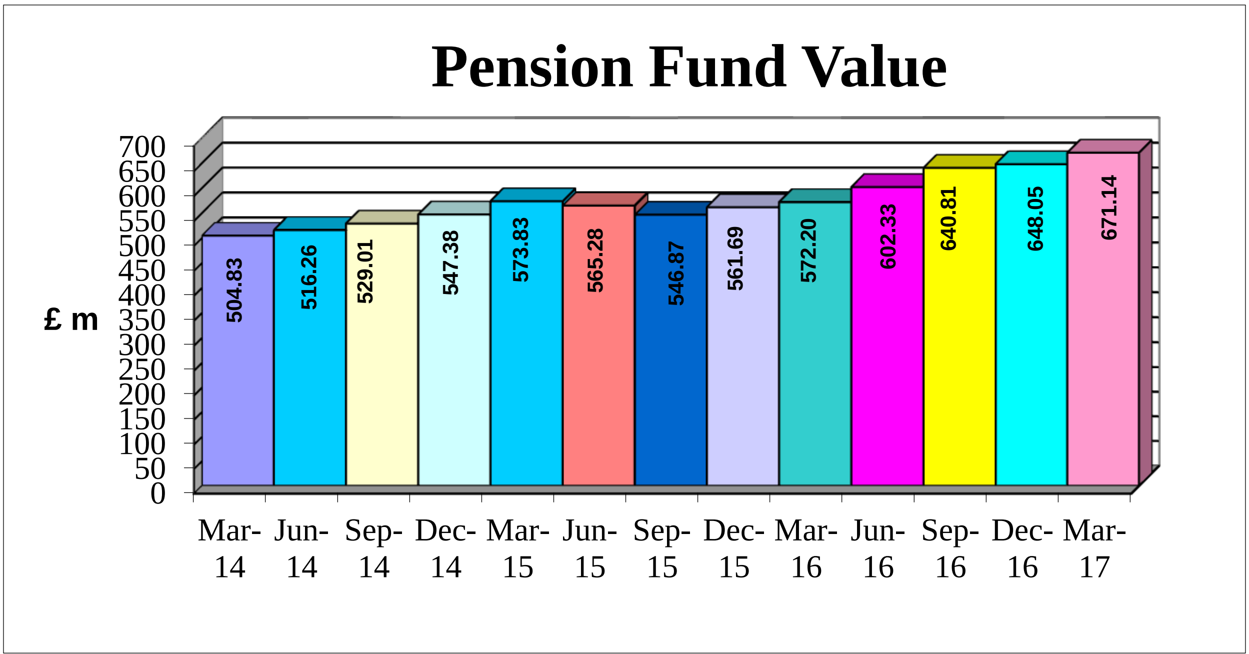
2.5 It is also proposed to cease the officer meeting with fund managers in order to free up time to implement the strategy set by the Committee. However, if there are any specific matters of concern relating to any managers performance, arrangements will be made for additional meetings with those managers.

2.6 Officers have discussed the content of Hymans quarterly reports. Members views and comments are also invited. .

2.7 Hyman’s performance monitoring report is attached at Appendix A.

3 Fund Size

3.1 Based on information supplied by our performance measurers the total combined fund value at the close of business on 31 March 2017 was **£671.14m**. This valuation differs from the basis of valuation used by our Fund Managers and our Investment Advisor in that it excludes accrued income. This compares with a fund value of £648.05m at the 31 December 2016; an **increase** of **£23.09m**. The movement in the fund value is attributable to an increase in assets of £23.46m and a reduction in cash of (£0.37m). The internally managed cash level stands at **£1300m** of which an analysis follows in this report.



Source: WM Company (Performance Measurers)

3.2 An analysis of the internally managed cash balance of **£13m** follows:

Table 2: Cash Analysis

CASH ANALYSIS	**2014/15 31 Mar 15**	**2015/16 31 Mar 16**	**2016/17 31 Mar 17**
	£000's	£000's	£000's
Balance B/F	**-5,661**	**-7,599**	**-12,924**
Benefits Paid	33,568	35,048	36,409
Management costs	1,600	1,754	781
Net Transfer Values	-135	518	2,216
Employee/Employer Contributions	-35,306	-42,884	-39,977
Cash from/to Managers/Other Adj.	-1,618	306	586
Internal Interest	-47	-67	-91
Movement in Year	**-1,938**	**-5,325**	**-76**
Balance C/F	**-7,599**	**-12,924**	**-13,000**

3.3 Members agreed the updated cash management policy at its meeting on the 15 December 2015. The policy sets out that the target cash level should be £5m but not fall below the de-minimus amount of £3m or exceed £6m. This policy includes drawing down income from the bond and property manager when required.

3.4 The cash management policy also incorporates a threshold for the maximum amount of cash that the fund should hold and introduced a discretion that allows the Chief Executive (now the Statutory S151 officer) to exceed the threshold to meet unforeseeable volatile unpredictable payments. The excess above the threshold of £6m is being considered as part of the investment strategy review and awaiting the outcome of the independent review.

4. Performance Figures against Benchmarks

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

Table 3: Quarterly Performance

	Quarter to 31.03.17	**12 Months to 31.03.17**	**3 Years to 31.03.17**	**5 years to 31.03.17**
	%	**%**	**%**	**%**
Fund	3.7	17.1	9.4	9.9
Benchmark	2.2	12.6	8.4	8.5
*Difference in return	1.5	4.0	0.9	1.3

Source: WM Company

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

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

Table 4: Annual Performance

	Quarter to 31.03.17	**12 Months to 31.03.17**	**3 Years to 31.03.17**	**5 years to 31.03.17**
	%	**%**	**%**	**%**
Fund	3.7	17.1	9.4	9.9
Benchmark	2.3	21.7	14.9	10.7
*Difference in return	1.3	-3.7	-4.8	-0.8

Source: WM Company

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

4.3 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.

Table 5: QUARTERLY PERFORMANCE (AS AT 31 MARCH 2017)

Fund Manager	Return (Performance)	Benchmark	Performance vs benchmark	Target	Performance vs Target
	%	%	%	%	%
Royal London	2.85	2.34	**0.50**	2.65	**0.20**
UBS	1.62	2.03	**-0.41**	n/a	**n/a**
GMO	4.19	0.55	**3.64**	n/a	**n/a**
SSgA Global Equity	5.76	5.77	**-0.01**	n/a	**n/a**
SSgA Fundamental Index	4.19	4.23	**-0.04**	n/a	**n/a**
LCIV/Ruffer*	0.00	0.00	**0.00**	n/a	**n/a**
LCIV/Baillie Gifford (DGF)*	2.83	0.00	**2.83**	n/a	**n/a**
LCIV/Baillie Gifford (Global Alpha Fund)	7.60	5.37	**2.23**	n/a	**n/a**

Source: WM Company, Fund Managers and Hymans

- Totals may not sum due to geometric basis of calculation and rounding.
- * Absolute Return and not measured against a benchmark

Table 6; ANNUAL PERFORMANCE (LAST 12 MONTHS)

Fund Manager	Return (Performance)	Benchmark	Performance vs benchmark	Target	Performance vs Target
	%	%	%	%	%
Royal London	16.81	16.28	**0.53**	17.53	**-0.72**
UBS	3.33	3.75	**-0.42**	n/a	**n/a**
GMO	6.54	1.70	**4.84**	n/a	**n/a**
SSgA Global Equity	32.95	33.04	**-0.09**	n/a	**n/a**
SSgA Fundamental Index	36.05	36.21	**-0.16**	n/a	**n/a**
LCIV/Ruffer*	n/a	n/a	**n/a**	n/a	**n/a**
LCIV/Baillie Gifford (DGF)*	10.35	n/a	**n/a**	n/a	**n/a**
LCIV/Baillie Gifford (Global Alpha Fund)	n/a	n/a	**n/a**	n/a	**n/a**

Source: WM Company, Fund Managers and Hymans

- Totals may not sum due to geometric basis of calculation and rounding.
- Ruffer not invested for entire period (inception LCIV 21/06/16)
- Baillie Gifford Global Alpha not invested for entire period (inception LCIV 11/04/16)
- * Absolute Return and not measured against a benchmark

5. Fund Manager Reports

In line with the current reporting cycle, brief overviews are included in this section unless the fund manager met with officers in between committee meetings.

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

a) Officers last met with representatives from Royal London on the 11 May 2017 at which a review of their performance as at 31 March 2017 was discussed.

b) The value of the fund as at 31 March 2017 has reduced by -£10.95m since the December quarter. This was mainly due to a transfer out of £15m in February 2017 from the Royal London mandate to the London CIV Ruffer mandate. This transfer was carried out in accordance with the Committee's decision to rebalance the fund's asset allocation at the Special Pensions Committee on the 23 January 2017.

c) Royal London disinvested in proportion across all the asset classes to stay within the portfolio benchmark.

d) Royal London delivered a net return of 2.85% over the quarter, outperforming the benchmark by 0.50%. The mandate is ahead of the benchmark over the year by 0.53% and 0.57% since inception.

e) The relative fund performance over the quarter was principally a result of asset allocation, holding an underweight position in government debt. Exposure to the Royal London Sterling Extra Yield Bond was also positive to performance. Corporate Bonds and stock selection was also positive for performance.

f) Overall short duration maintained over the quarter had a negative impact on performance.

g) Royal London held a preference for index linked bonds versus conventional government bonds.

h) Beneficial to performance in corporate bonds was holding an overweight position in financials and a bias towards secured and structured sectors and being underweight in consumer sectors and supranationals.

i) Given current yields on sub investment grade bonds Royal London explained when asked about their exposure to the Extra Yield Fund that they are looking to take profit from these holdings and reduced positions in this quarter and will again during the next quarter.

j) Royal London was asked if the decision not to hold a material allocation to overseas bonds (currently 0.2%) was driven by their view on currency movements. Royal London's hedges the currency to avoid the currency risk so this has no impact but do not believe that developed market government bonds to be expensive and expects them to rise over the next 18 months.

5.2. Property (UBS)

a) In accordance with agreed procedures officers will meet with representatives from UBS once in the year with the other meeting to be held with members.

b) Officers last met with representatives from UBS on the 24 August 2016 at which a review of their performance as at 30 June 16 was discussed. UBS made a presentation to the Committee in March 2017 which covered their performance to the quarter ending 31 December 2016. A brief overview of their performance as at 31 March 2017 follows.

k) The value of the fund as at 31 March 2017 increased by £5.59m since the December quarter. This was mainly due to the transfer in of £5m from the SSgA Sterling Liquidity Fund during February 2017. This transfer was carried out in accordance with the Committee's decision to rebalance the fund's asset allocation at the Special Pensions Committee on the 23 January 2017.

c) UBS delivered a net return of 1.62% over the quarter, under performing the benchmark by -0.41%. The mandate is behind the benchmark over the year by -0.42% and behind by 2.15% over 5 years.

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

a) In accordance with agreed procedures officers will meet with representatives from GMO once in the year with the other meeting to be held with members.

b) Officers last met with representatives from GMO on the 3 November 2016, at which a review of their performance as at 30 September 16 was discussed. GMO last met with the members of the Pension Committee on the 13 December 2016 at which they covered the period ending up to 31 October 2016. GMO are now due to present at this committee meeting to discuss their performance to 31 March 2017 so a brief overview of their performance follows.

c) The value of the fund has increased by £4.13m since the December quarter.

d) GMO have outperformed their benchmark over the 3 month and 12 month but have underperformed since inception:

Table 7:GMO performance

	3 Months	12 Months	Since inception (13 Jan 2015)
	%	%	%
Fund	4.19	6.54	0.87
Target CPI +5%	0.55	1.70	1.30
Relative to Target	3.64	4.85	-0.43

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

e) The GMO investment is in a dynamic multi-asset fund, the GMO Global Real Returns UCITS Fund (GRRUF) and targets a return of CPI+5% (net of fees) over a full 7 year cycle. GMO are two years into the 7 year cycle and believes that if current market conditions continue then GMO feel that CPI +2-3% is more achievable.

f) Hymans has improved the ratings of this manager to 'Retain' from the previous rating of 'On Watch' following positive meetings with their investment team.

5.4. Passive Equities Manager (SSgA)

a) In accordance with agreed procedures officers will meet with representatives from SSgA once in the year with the other meeting to be held with members. SSgA last met with the members of the Pension Committee on the 13 December 2016 at which they covered the period ending up to 30 September 2016. Officers met with representatives from SSgA on the 11 May 2017 at which a review of their performance as at 31 March 17 was discussed.

b) The SSgA mandate was split into three components, Sterling Liquidity sub fund, SSgA All World Equity Index sub fund, and the Fundamental Index Global Equity sub fund. The Sterling Liquidity fund was reduced to zero with £5m being transferred to UBS in February 2017 and the balance of £1.2m transferred to London CIV Ruffer account in March 2017. This transfer was carried out in accordance with the Committee's decision to rebalance the fund's asset allocation at the Special Pensions Committee on the 23 January 2017.

c) The value of the two mandates within the fund has reduced by £1.68m in total since the last quarter.

d) As anticipated from an index-tracking mandate SSgA has performed in line with the benchmark over the latest quarter, although there is some underperformance on the Fundamental Index. SSgA explained that the stocks change quarterly so the time lag causes this slight difference

e) SSgA were asked if they had undertaken any work in developing equity strategies that mitigate carbon risk exposure and whether they are looking to adopt low carbon products. SSgA were unable to answer the question at the meeting so they will be sent the question in an email for them to respond. SSgA will also send us a copy of their ESG framework.

f) In response to a question regarding engagement with companies over the last six months SSgA said that they would send us the relevant documents to show what they had done. Although SSgA were unable to identify this at the meeting they do send us quarterly reports on their voting activities

5.5. Multi Asset Manager – London CIV (Ruffer)

a) This mandate transferred to the London CIV on 21 June 2016.

b) Since the transfer the London CIV will oversee the monitoring and review of the performance of this mandate. However Ruffer has stated that they are happy to continue with the existing monitoring arrangements and meet with officers and the Committee to report on its own performance. The London CIV quarterly manager review meetings have largely taken place and the review notes are currently being compiled and will be distributed to members when these are available.

c) Ruffer last met with the members of the Pension Committee on the 20 September 2016 at which they covered the period ending up to 30 June 2016. Officers met with representatives from Ruffer on the 31 January 2017 at which a review of their performance as at 31 December 16 was discussed.

d) The value of the fund as at 31 March 2017 increased by £16.16m on the previous quarter. This was mainly due to a transfer in of £15m from the Royal London mandate in February 2017 and £1.2m from SSgA in March 2017 to the London CIV Ruffer mandate. This transfer was carried out in accordance with the Committee’s decision to rebalance the fund’s asset allocation at the Special Pensions Committee on the 23 January 2017.

e) Since the mandates transfer to the London CIV Ruffer delivered a return in line with the benchmark over the quarter and 11.5% since inception with the London CIV. The mandate is an Absolute Return Fund (measures the gain/loss as percentage of invested capital) and therefore is not measured against a benchmark. Capital preservation is a fundamental philosophy of the Fund.

5.6. UK Equities - London CIV (Baillie Gifford Global Alpha)

a) This mandate transferred to the London CIV on the 11 April 2016.

b) Since the transfer the London CIV will oversee the monitoring and review of the performance of this mandate and representatives from the London CIV met with the Committee on the 13 December 2016. An overview of performance as at 30 September 2016 for mandates within the London CIV was discussed.

c) The London CIV quarterly manager review meetings have largely taken place and the review notes are currently being compiled and will be distributed to members when these are available.

d) The value of the Baillie Gifford Global Equities mandate fund increased by £7.92m over the last quarter.

e) The Global Alpha Fund delivered a return of 7.60% over the quarter, outperforming the benchmark by 2.23%. Since inception with the London CIV the fund returned 35.00% outperforming the benchmark by 2.41%.

5.7. Multi Asset Manager – London CIV (Baillie Gifford Diversified Growth Fund)

a) This mandate was transferred to the London CIV on the 15 February 2016.

b) Since the transfer the London CIV will oversee the monitoring and review of the performance of this mandate and representatives from the London CIV met with the Committee on the 13 December 2016. An overview of performance as at 30 September 2016 for mandates within the London CIV was discussed.

c) The London CIV quarterly manager review meetings have largely taken place and the review notes are currently being compiled and will be distributed to members when these are available.

d) The value of the Baillie Gifford DGF mandate increased by £2.29m over the last quarter.

e) The Diversified Growth mandate delivered a return of 2.83% over the quarter and 14.76% since inception with the London CIV. The Sub-fund's objective is to achieve long term capital growth at lower risk than equity markets and therefore is not measured against a benchmark.

6. 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.

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:

  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

None