



PENSIONS COMMITTEE

12 DECEMBER 2017

Subject Heading:

**PENSION FUND PERFORMANCE
MONITORING FOR THE QUARTER
ENDED SEPTEMBER 2017**

CLT Lead:

Julie Oldale

Report Author and contact details:

Debbie Ford
Pension Fund Manager
01708432569

Policy context:

Debbie.ford@onesource.co.uk
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 30 September 2017

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

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

SUMMARY

This report provides the Committee with an overview of the performance of the Havering Pension Fund investments for the first quarter to 30 September 2017. The performance information is taken from the quarterly performance reports 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 first **quarter** to 30 September 2017 was **1.4% (or £11m to £693m)**. This represents an outperformance of **0.5%** against the combined tactical benchmark and outperformance of **1.6%** against the strategic benchmark. The Baillie Gifford (BG) Global Equity Fund was the best performer over the quarter. The BG Diversified Growth Fund (DGF) and GMO Global Real Return Fund both outperformed their respective benchmarks over the quarter whilst the Ruffer

Fund underperformed. The RLAM Fund made a small gain against the benchmark reflecting a fall in the value of bond markets over the quarter.

The overall net return of the Fund's investments for the **year** to 30 September 2017 was **7.9%**. This represents an outperformance of **3.0%** against the combined tactical benchmark and an outperformance of **10.2%** against the annual strategic benchmark - this 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 are set out in paragraphs 1.1 and 1.2 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 - Exempt).
- 3) Receive a presentation from the London CIV for the Funds investment in both Baillie Gifford Global Alpha fund and the Diversified Growth Fund (Appendix B - Exempt).
- 4) Considers the latest quarterly update from the Chair of the Investment Advisory Committee, LCIV (Appendix C - Exempt)
- 5) Considers the quarterly reports provided by each investment manager.
- 6) 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 and should lead to an overall improvement in the funding level. 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). 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 (see paragraph 1.7)	Pooled	Passive	FTSE All World Equity Index
	7.5%	State Street Global Asset (see paragraph 1.7)	Pooled	Passive	FTSE RAFI All World 3000 Index

Pensions Committee, 12 December 2017

Asset Class	Target Asset Allocation (ISS Jan 17)	Investment Manager/ product	Segregated /pooled	Active/ Passive	Benchmark and Target
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% over a complete market cycle
Absolute Return	15%	LCIV Ruffer	Pooled	Active	Absolute Return
Property	6%	UBS	Pooled	Active	AREF/IPD All balanced property Index Weighted Average
Gilt/ Investment Bonds	19%	Royal London	Segregated	Active	<ul style="list-style-type: none"> • 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

- 1.5 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.
- 1.6 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

Pensions Committee, 12 December 2017

used arithmetical method to the industry standard geometric method (please note that this will sometimes produce figures that arithmetically do not add up).

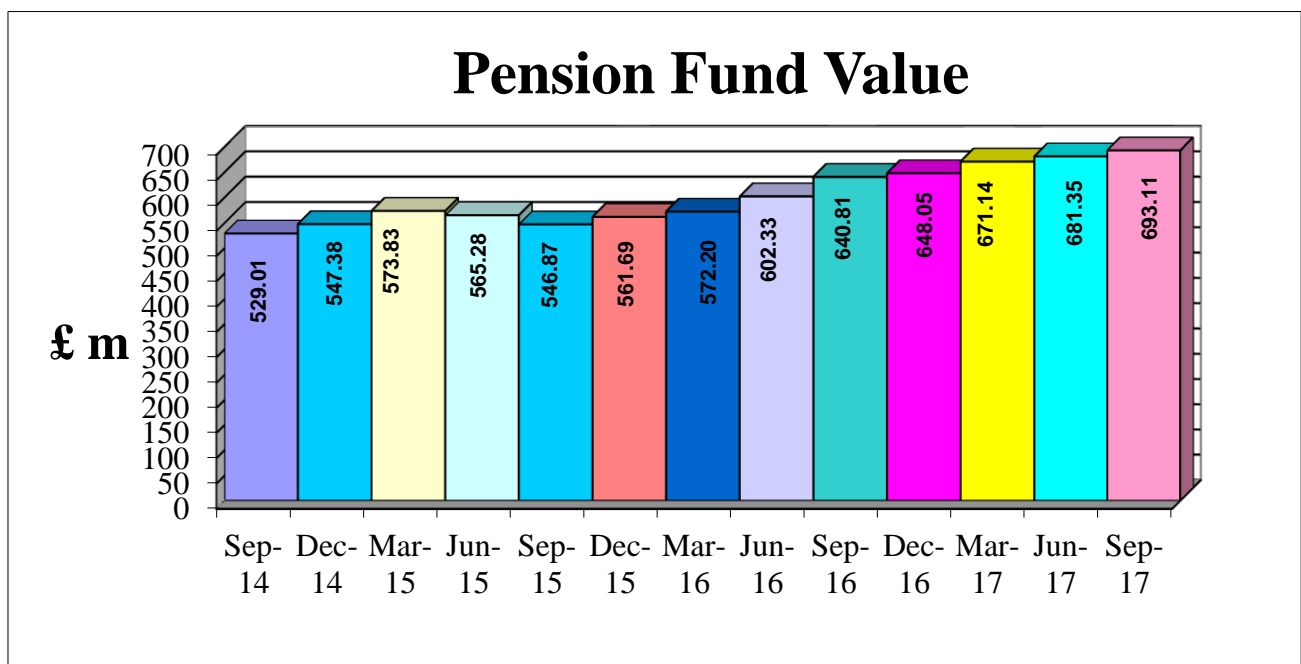
- 1.7 Following a competitive tender exercise, at a Special Pensions Committee meeting held on the 6 September the Committee appointed Legal & General Investment Management (LGIM) as the Fund's new passive equities manager, in order to benefit from reduced fee charges negotiated by the London CIV. Assets will be transitioned across on the 9 November 2017.

2. Reporting Arrangements

- 2.1 After reviewing the current reporting arrangements at the last Pensions Committee held on the 15 June 2017 it was agreed that only one fund manager will attend each committee meeting.
- 2.2 The Fund Manager attending this meeting is the London CIV representing both the Baillie Gifford DGF and Global Alpha Fund mandates.
- 2.3 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 30 September 2017 was **£693.11m**. 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 £681.35m at the 30 June 2017; an **increase of £11.76m**. The movement in the fund value is attributable to an increase in assets of £9.79m and an increase in cash of £1.97m. The internally managed cash level stands at **£16.59m** of which an analysis follows in this report.



Source: WM Company (Performance Measurers)

3.2 An analysis of the internally managed cash balance of **£16.59m** follows:

Table 2: Cash Analysis

<u>CASH ANALYSIS</u>	<u>2015/16</u>	<u>2016/17</u>	<u>2017/18</u>
	<u>31 Mar 16</u>	<u>31 Mar 17</u>	<u>30 Sep 17</u>
	£000's	£000's	£000's
Balance B/F	-7,599	-12,924	-12,770
Benefits Paid	35,048	36,490	18,998
Management costs	1,754	1,358	529
Net Transfer Values	518	2,151	-414
Employee/Employer Contributions	-42,884	-40,337	-24,137
Cash from/to Managers/Other Adj.	306	586	1,256
Internal Interest	-67	-94	-51
Movement in Year	-5,325	154	-3,819
Balance C/F	-12,924	-12,770	-16,589

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.

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 30.09.17	12 Months to 30.09.17	3 Years to 30.09.17	5 years to 30.09.17
	%	%	%	%
Fund	1.4	7.9	8.8	10.1
Benchmark	0.8	4.7	7.3	8.3
*Difference in return	0.5	3.0	1.4	1.7

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 30.09.17	12 Months to 30.09.17	3 Years to 30.09.17	5 years to 30.09.17
	%	%	%	%
Fund	1.4	7.9	8.8	10.1
Benchmark	-0.3	-2.1	11.5	10.5
*Difference in return	1.6	10.2	-2.4	-0.3

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.

4.4 Since January 2017 the Havering Pension Fund uses the performance measurement services of Pensions & Investment Research Consultants Ltd (PIRC) to provide the universe comparisons against other LGPS funds. The PIRC Local Authority Universe comprised of 60 funds as at the end of September 2017 with a value of £162bn. Whilst the Fund does not measure performance against the Local Authority average, the average fund delivered a quarterly return of **1.6%** and an annual return of **9.4%**.

Table 5: QUARTERLY PERFORMANCE (AS AT 30 SEPTEMBER 2017)

Fund Manager	Return (Performance)	Benchmark	Performance vs benchmark	Target	Performance vs Target
	%	%	%	%	%
Royal London	0.21	-0.35	0.56	-0.04	0.25
UBS	2.32	2.25	0.07	n/a	n/a
GMO	1.70	0.25	1.45	n/a	n/a
SSgA Global Equity	1.90	1.89	0.01	n/a	n/a
SSgA Fundamental Index	2.73	2.75	-0.02	n/a	n/a
LCIV/Ruffer*	-0.72	n/a	n/a	n/a	n/a
LCIV/Baillie Gifford (DGF)*	0.65	n/a	n/a	n/a	n/a
LCIV/Baillie Gifford (Global Alpha Fund)	4.12	2.27	1.85	n/a	n/a

Source: WM Company, Fund Managers and Hymans

Pensions Committee, 12 December 2017

- Totals may not sum due to geometric basis of calculation and rounding.
- Performance data reported as per LCIV for those funds under their management.
- *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	-1.33	-3.38	2.05	-2.13	0.80
UBS	9.45	9.04	0.41	n/a	n/a
GMO	6.89	1.55	5.34	n/a	n/a
SSgA Global Equity	15.44	15.45	-0.01	n/a	n/a
SSgA Fundamental Index	16.98	17.08	-0.10	n/a	n/a
LCIV/Ruffer*	0.83	n/a	n/a	n/a	n/a
LCIV/Baillie Gifford (DGF)*	7.43	n/a	n/a	n/a	n/a
LCIV/Baillie Gifford (Global Alpha Fund)	21.80	15.5	6.30	n/a	n/a

Source: WM Company, Fund Managers and Hymans

- Totals may not sum due to geometric basis of calculation and rounding.
- Performance data reported as per LCIV for those funds under their management.
- *Not measured against a benchmark.

5. Fund Manager Reports

In line with the new reporting cycle, the Committee will only see one Fund Manager at each Committee meeting. Fund Managers brief overviews are included in this section. The full detailed versions of the fund managers' report are distributed electronically prior to this meeting.

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

- a) Royal London last met with the Committee on 14 March 2017 which reviewed performance as at 31 December 16 and with officers on the 11 May 2017 which reviewed performance as at 31 March 2017.
- b) The value of the fund as at 30 September 2017 has increased by £0.18m since the June quarter.

Pensions Committee, 12 December 2017

- c) Royal London delivered a net return of 0.21% over the quarter, outperforming the benchmark by 0.56%. The mandate is ahead of the benchmark over the year by 2.05% and 0.63% since inception.
- d) Royal London Asset Allocation:
- | | % |
|----------------------------------|------|
| i. Credit Bonds (corporate) | 52.1 |
| ii. Index Linked Bonds | 28.9 |
| iii. Sterling Government Bonds | 9.8 |
| iv. RL Sterling Extra Yield Bond | 7.3 |
| v. Overseas Bonds | 0.3 |
| vi. Cash | 1.6 |
- e) Main source of outperformance over the quarter was the funds overweight allocation to credit versus government bonds, particularly within financials and secured and structured debt. Asset allocation and a short duration position also had a positive impact upon performance. The exposures to the Royal London Sterling Extra Yield Bond Fund and global index linked bonds were also beneficial.

5.2. Property (UBS)

- a) UBS last met with the Committee on 14 March 2017 which reviewed performance as at 31 December 2016 and with officers on the 17 August 2016 which reviewed performance as at 30 June 2016.
- b) The value of the fund as at 30 September 2017 increased by £0.90m since the June quarter.
- c) UBS delivered a net return of 2.32% over the quarter, just slightly underperforming the benchmark by -0.05%. The mandate is ahead of the benchmark over the year by 0.19% and behind by 1.78% over 5 years. Return comprises of income attributing 0.8% and capital returns 1.5%.
- d) UBS Sector weighting:
- | | % |
|-------------------------------|------|
| i. Industrial | 38.0 |
| ii. Retail warehouse | 22.7 |
| iii. Office | 19.1 |
| iv. Other Commercial Property | 12.5 |
| v. Shopping Centres | 4.1 |
| vi. Unit Shops | 3.6 |
- e) Performance was primarily driven by the Fund's industrial properties with the active leasing programmes across the portfolio also contributing to performance.

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

- a) GMO last met with the Committee on 15 June 2017 which reviewed performance as at 31 March 17 and with officers on the 3 November 2016 which reviewed performance as at 30 September 2016.
- b) The value of the fund has increased by £2.17m since the June quarter.
- c) GMO have outperformed their benchmark over the 3 month, 12 month and since inception as follows:

Table 7:GMO performance

	3 Months	12 Months	Since inception (13 Jan 2015)
	%	%	%
Net Fund Return	1.70	6.89	2.12
Benchmark	0.25	1.55	1.35
Relative to Benchmark	1.49	5.34	0.78

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

- d) GMO asset Allocation:
 - i. Equities 41.3%
 - ii. Alternative strategies 15.7%
 - iii. Fixed Income 16.5%
 - iv. Cash/Cash Plus 26.5%
- e) Top down allocation spread over equities, alternative strategies and bonds added 3.1% to performance whilst stock selection detracted -1.1% from performance .

5.4. Passive Equities Manager (SSgA)

- a) SSgA last met with the Committee on 13 December 2016 which reviewed performance as at 30 September 2016 and with officers on the 11 May 2017 which reviewed performance as at 31 March 2017.
- b) The value of the fund has decreased by £2.24m since the June quarter.
- c) The SSgA mandate is split into two components, SSgA All World Equity Index sub fund, and the Fundamental Index Global Equity sub fund.
- d) As anticipated from an index-tracking mandate SSgA has performed in line with the benchmark over the latest quarter.

Pensions Committee, 12 December 2017

- e) The FTSE RAFI All World 3000 Index (the index) outperformed the FTSE All World Index by +0.57% during the Quarter.
- f) The Index's overweights in Energy and Materials and underweight in Consumer Discretionary were the top contributors. The Index's underweight in Information Technology was the main detractor, followed by its underweight in Health Care and overweight in Telecommunication Services.
- g) The Index's overweights in the UK, Germany, Italy, France and Brazil were the top contributors, while its relative exposures in the China, Korea and Sweden and underweight in the US were the main drags.

5.5. Multi Asset Manager – London CIV (Ruffer)

- a) This mandate transferred to the London CIV on 21 June 2016.
- b) The London CIV will now oversee the monitoring and review of performance for this mandate. However Ruffer has stated that they are happy to continue with the existing monitoring arrangements and meet the Committee to report on its own performance.
- c) Ruffer last met with officers on the 31 January 2017 which reviewed performance as at 31 December 2016 and last met with the Committee on 19 September 2017 which reviewed performance as at 30 June 2017.
- d) The value of the fund has decreased by -£0.68m since the June quarter.
- e) Since inception with the London CIV Ruffer returned -0.72% over the quarter, 0.83% over the year and 10.20% since inception. 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.
- f) Stock selections were factors that helped performance: A rising oil price produced a total return of 10% during the quarter for BP. Further strength in its music business meant a similar gain in Vivendi's share price, while there were helpful gains in the share prices of Sophos (+24%), Tesco (+11%), and Booker (+10%).
- g) Inflation-linked bonds was the main factor that hurt performance: Higher UK inflation readings sharpened the commentary from the Bank of England, driving UK nominal bond yields higher, but leaving inflation breakevens broadly unchanged; inflation-linked bonds therefore lost ground. Volatility hitting new multi-year lows and equity markets grinding higher meant the portfolio's unconventional protections declined in value.

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

- a) This mandate transferred to the London CIV on the 11 April 2016.
- b) The London CIV will oversee the monitoring and review of the performance of this mandate and representatives from the London CIV last met with the Committee on the 13 December 2016 which reviewed performance as at 30 September 2016. Representatives from the London CIV are due to make a presentation at this Committee, and a brief overview of their performance follows.
- c) The value of the Baillie Gifford Global Equities mandate fund increased by £4.83m since the June quarter.
- d) Since inception with the London CIV the Global Alpha Fund delivered a return of 4.12% over the quarter, outperforming the benchmark by 1.85%, delivered a return of 21.80% over the year, outperforming the benchmark by 6.30% and since inception with the London CIV the fund returned 47.05% outperforming the benchmark by 10.49%.

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) The London CIV will oversee the monitoring and review of the performance of this mandate and representatives from the London CIV last met with the Committee on the 13 December 2016 which reviewed performance as at 30 September 2017. Representatives from the London CIV are due to make a presentation at this Committee, and a brief overview of their performance follows.
- c) The value of the Baillie Gifford Global Equities mandate fund increased by £0.55m since the June quarter.
- d) The Diversified Growth mandate delivered a return of 0.65% over the quarter, 7.43% over the last year and 17.53% 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.

5.8 London CIV Update

- a) The latest quarterly update from the Chair of the Investment Advisory Committee, Ian Williams and the work of the Investment Advisory Committee is attached (Appendix C).

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:

London CIV presenting on the Baillie Gifford mandates

- 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