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To: Members of the
PENSIONS INVESTMENT SUB-COMMITTEE

Subject to the Pensions Investment Sub-Committee being reconstituted and Members of the Pensions Investment Sub-Committee being appointed, there will be a meeting of the Pensions Investment Sub-Committee at Bromley Civic Centre on **TUESDAY 19 MAY 2015 AT 7.30 PM**

Glenn Kelly (Non-Voting Staff Representative)

MARK BOWEN
Director of Corporate Services

Copies of the documents referred to below can be obtained from http://cds.bromley.gov.uk/

A G E N D A

1 APOLOGIES FOR ABSENCE AND NOTIFICATION OF SUBSTITUTE MEMBERS

2 DECLARATIONS OF INTEREST

3 CONFIRMATION OF MINUTES OF THE MEETING HELD ON 24TH FEBRUARY 2015, EXCLUDING THOSE CONTAINING EXEMPT INFORMATION (Pages 3 - 10)

4 QUESTIONS BY MEMBERS OF THE PUBLIC ATTENDING THE MEETING

In accordance with the Council's Constitution, questions to this Committee must be received in writing four working days before the date of the meeting. Therefore please ensure that questions are received by the Democratic Services Team by 5pm on Wednesday 13th May 2015.

5 PENSION FUND PERFORMANCE Q4 2014/15 (Pages 11 - 28)

6 PENSION FUND - INVESTMENT REPORT

Printed copies of reports from the Council's Fund Managers are circulated to Sub-Committee Members with this agenda. Representatives of Baillie Gifford and Fidelity will be attending the meeting for this item.

7 REVISED INVESTMENT STRATEGY - PHASE 3 (Pages 29 - 44)

8 IMPACT OF EXCHANGE RATES (Pages 45 - 54)

PENSIONS INVESTMENT SUB-COMMITTEE

Minutes of the meeting held at 7.30 pm on 24 February 2015

Present:

Councillor Simon Fawthrop (Chairman)
Councillor Alan Collins (Vice-Chairman)
Councillors Eric Bosshard, David Livett, Russell Mellor and Neil Reddin FCCA

Also Present:

Councillor Peter Fookes and Alick Stevenson and Patricia O'Loughlin.

24 APOLOGIES FOR ABSENCE AND NOTIFICATION OF SUBSTITUTE MEMBERS

Apologies were received from Councillor Richard Williams.

25 DECLARATIONS OF INTEREST

Councillor Russell Mellor declared a personal interest by virtue of receiving a pension from the Local Government Pension Scheme.

Councillor Eric Bosshard declared a personal interest as a former Member of the Local Government Pension Scheme.

Councillor Simon Fawthrop declared a personal interest as a former Member of the Local Government Pension Scheme

26 CONFIRMATION OF MINUTES OF THE MEETINGS HELD ON 2ND DECEMBER 2014 AND 3RD FEBRUARY 2015 EXCLUDING THOSE CONTAINING EXEMPT INFORMATION

The minutes of the meetings held on 2nd December 2014 and on 3rd February 2015 (excluding exempt information) were agreed.

The Director of Finance gave a brief update on matters concerning the CIV-Collective Investment Vehicle. Three London Boroughs had not yet joined the CIV and this number was expected to reduce to two, including Bromley. The cost of joining the CIV was previously £25k, but now the cost was expected to rise to £75k; negotiation of fees with fund managers was expected to provide compensatory savings.

The concern for LBB in joining the CIV was that LBB may be entering into an agreement with other boroughs that were not as financially stable as LBB, and

that this could be disadvantageous. There were also concerns as to what may happen in the future, subsequent to joining the CIV.

The Director of Finance informed the Committee that plans to join the Local Pension Board had recently been finalised at Full Council.

27 QUESTIONS BY MEMBERS OF THE PUBLIC ATTENDING THE MEETING

There were no questions from members of the public attending the meeting.

28 PENSION FUND PERFORMANCE Q3 2014/15

The report summarised the investment performance of Bromley's Pension Fund in the third quarter of 2014/15. Members heard that the fund ended the December 2014 quarter with a total valuation of £693.9m, but that by the end of January 2015, the valuation had risen to £714.9m. The Sub Committee were pleased to learn that not only had the value of the Fund increased recently, but also that the medium to long term results had been consistently strong over a long period.

The Committee examined a table of rankings (percentiles) with respect to local authority pension schemes. It was noted that LBB's position in the rankings was generally very good. For the three year period 01/01/12--31/12/14, the LBB Pension fund was ranked in the 4th percentile, and for the one year period from 01/01/14 to 31/12/14, the Fund was ranked in the 9th percentile. These rankings were very good.

The Committee noted the section of the report dealing with financial implications, and the fact that for the first three quarters of 2014/15, a net surplus of £2.5m had been achieved. There was a query from a Member concerning what would be done with this, and he was assured that the money would stay within the Pension Fund. The Committee also noted that membership of the Pension Fund had increased by 646 since 1st April 2014.

The Director of Finance provided an update on an interim actuarial valuation for the fund which would be circulated separately to Members of the Sub-Committee. Although there had been a very good performance on investments which exceeded the actuarial previous assumptions, the cost of liabilities had increased by a greater amount, and he referred to low 10 year gilt yields which influenced the calculation of liabilities.

RESOLVED that the Pension Fund Performance report be noted.

29 PENSION FUND - INVESTMENT REPORT

Simon Betteley (Client Director) and Richard Mathieson (Senior Investment Strategist) presented on behalf of Blackrock. Having completed a first year of working for LBB as Pension Fund managers, they came to discuss performance, economic outlook, and prospects.

The Committee were informed that with respect to asset allocation, the value of the equity fund managed by Blackrock as at 31 December 2014 was £139,283,178; however a more recent valuation of the fund as at 9th February 2015, valued the fund at £143,959,425.

The Committee were informed that the equity fund was the "Ascent Life Enhanced Global Equity Fund" and that over the last twelve months the fund had seen a gross increase in value of 14.31%. Blackrock were of the opinion that the equity markets were largely responsive and directed by central bank policy. They felt that the value of the fund had increased dramatically in the year and were very positive. They were however, expecting that a period of volatility would follow any rise in interest rates. Blackrock expected a small rate rise this year.

Blackrock commented on quantitative easing in the Japanese markets, combined with low interest rates. They were of the opinion that the US and UK economies would exhibit tight control by the central banks, but that in Europe and Japan controls would be looser; this they felt would cause a period of volatility. Broadly stated, the Blackrock presentation was divided primarily into three areas, the investment process; performance and research.

The Blackrock presentation emphasised SAE—Scientific Active Equity Global Platform, and Blackrock's links with the IT community in San Francisco where their main HQ was based. The SAE global equity software technology enabled Blackrock to harness the latest technology and internet search data to process 200 different data feeds for over 4,000 stocks in over 40 countries on a daily basis. The main types of stock that Blackrock would invest in were:

- stocks underpinned by attractive fundamentals
- stocks supported by positive sentiment and market activity
- stocks with positive exposure to macro themes

Blackrock referred the Committee to their SAE Global equity strategy performance which had provided consistently good results over the last five years. The Committee were informed that the strategy performance was well above target, and that the three and five year information ratio was ranked as the top percentile relative to peer groups.

Blackrock proceeded to provide some further detail on the fund performance, before looking in more detail at their "Overweight" and "Underweight" positions. Blackrock had high regard for the US semi-conductor markets, US Energy markets, the Japanese domestic market, and markets where companies were involved in exporting to the Eurozone; in these sectors they held "Overweight" positions. Conversely, they held "underweight" positions in the Eurozone Domestic markets, US Consumer Markets and the Global Materials markets.

A Member asked if consideration was given in their financial modelling software to exposure to foreign exchange movements, and how much profits may be affected by movements in the foreign exchange markets. Blackrock responded that risk would be seen in their financial models, and that they expected very little risk from currency fluctuations.

Blackrock elaborated that they adopted a systematic modelling approach that took into consideration:

- Long term growth
- Changing country competitiveness
- Demographics
- Political risk and uncertainty
- Fluctuations in FX markets
- Policy and rates
- Changing growth expectations
- Consumer behaviour

Alick Stevenson (Allenbridge Epic) advised the Committee that he would draft a report on the effect that exchange rates would have on transactions and profits, and that he would have this ready for the Committee at their next meeting.

A Member asked if the financial modelling had forecasting capability. The response to this was yes, by looking backwards with a common sense overview by a fund manager.

The Vice Chairman spoke concerning the matter of investing globally and FX rates and commented that it was obvious that the fund had to invest overseas and that FX was simply part of an inevitable process. Blackrock reassured that trades would only take place when profits outweighed the cost of the trade.

The Chairman thanked Simon Betteley and Richard Mathieson for their interesting and detailed presentation.

A presentation was also given by MFS Investment Management, on the management and performance of the Global Value Equity portfolio that they were managing for the LBB Pension Fund. The presentation was given by Ben Kottler, CFA (Institutional Equity Portfolio Manager), and David J Holding (Director, Relationship Management).

The Committee were referred to the Executive Summary on the presentation, which noted that the total value of the fund as at 31st December 2014 was £139,225,593. The Committee were updated that as at 23rd February 2015, the fund's value had increased to approximately £146.5m.

MFS referred the Committee to the data on the presentation concerning Performance Drivers—these were divided into Sectors and Stocks. The

Committee noted that the main contributors in terms of sectors were Industrials and Financials, and that the main detractors were in Telecommunications Services. As far as specific stocks were concerned, there were three main contributors, and these were the Lockheed Martin Corporation, Cvs Health Corporation and the Kao Corporation. The main detractor in terms of stocks was Apple Inc.

MFS explained to the Committee that stock selection was their main driver, and they felt that they had a competitive edge in this sector. They reaffirmed that their most productive areas of stock selection were in the sectors of Industrials and Financials. In terms of the effect of foreign exchange rates, their view was that this had a short term effect only, and that the impact was slightly negative over the course of the last year. MFS were of the opinion that it was difficult to see how Apple could sustain their recent growth levels. MFS referred the Committee to the fifth highest contributor by stocks, and that was the German company Deutsche Wohen Ag. This was a company that specialised in the German residential property market, and MFS was anticipating a property boom in Germany in the coming year.
MFS expected that the Lockheed Martin Corporation would continue to do well, with a strong US economy, and continued support for the US defence industry.

A Member enquired if the philosophy of MFS was to change stocks frequently, or if they held a longer term view. The response was that MFS held a longer term view of stock holding, and would normally have a holding period of six years—they were focused on longer term strategies, and were paid on the basis of three and five year investment returns.

The Committee noted the region and country weights of exposure, and regional exposures in terms of revenue. In terms of regional/country exposure, 54.8% of the portfolio was held in North America, 19.4% in Europe (excluding the UK), 11.0% was held in Japan and 10.4% in the UK. In terms of exposure by revenue, 42.6% was in North America, 21.6% in developed Europe, 12.6% in Japan and 19.1% in emerging markets.

A Member enquired about the effect of FX rates on transactions. MFS responded that this did not have a significant impact, and that the most important issues were good business sense and good stock picking. It was normally the case that trading outside of the UK was beneficial.

The Director of Finance asked if MFS felt that the current performance of the Fund was sustainable. MFS responded in the affirmative, based on the fact that markets were growing and recovering; MFS felt that in the current climate global equities were good value. It was noted that on the day of the meeting the FTSE was at an all-time high. MFS commented that there had been a lack of volatility in the markets for a while, which was for them a bit of a concern. MFS would have preferred a bit more volatility, as it normally meant that when volatility did occur, it could be drastic. MFS commented that if investment conditions got tough, that would be when their approach to investing would be proved.

A Member asked what was meant by "capture ratio". The answer to this was that the capture ratio was the extent to which MFS captured the market move in any given circumstance.

A Member asked if MFS were "positioning for a downside". MFS responded by stating that they were always in a position to deal with a downside in market forces based on their policy of making sound business decisions and investing in good quality businesses. They felt comfortable and well diversified, with investments currently in 109 companies.

The Chairman enquired as to the voting policy of MFS at the shareholder meetings of companies that they invested in. The Chairman asked why it appeared that MFS always seemed to vote in favour of the proposed remuneration packages of Chief Executives. The Chairman was keen to see value for money. MFS responded that it was not always the case that they supported all the remuneration packages of Chief Executives or CEOs. They highlighted the case of Oracle, where MFS voted against the remuneration package of the Chief Executive Officer.

The Chairman concluded by thanking Ben Kottler and David Holding for attending and for making a very informed and detailed presentation to the Pensions and Investment Sub-Committee.

RESOLVED that:

1. **The Pension Fund Investment Reports from Blackrock and MFS be noted**

2. **Alick Stevenson (Allenbridge Epic) to draft a report on the effect that exchange rates have on transactions and profits, and that this be presented to the Committee at their next meeting**

30 REVISED INVESTMENT STRATEGY - PHASE 3

Alick Stevenson and Patricia O'Loughlin attended on behalf of the Fund's advisers, Allenbridge Epic. Their recommendation was to undertake a gradual move in capital from Fidelity's fixed income holding in the UK Aggregate Bond Fund to the Fixed Income Diversified Alpha (FIDA) Fund.

AllenbridgeEpic had recommended the transfer of funds for various reasons, and these included the fact that they felt that the FIDA Fund was liquid, unconstrained and would mean that LBB would not be tied to just investing in Government Bonds. AllenbridgeEpic advised the Committee that it was not worth investing in Government Bonds at the moment as the returns were too low. AllenbridgeEpic stated that the FIDA Fund was a low volatility fund with a strong capital presentation; the money could be transferred over quickly at no cost.

A Member urged caution on the basis that not enough information was available on risk, and where the existing money in the new Fund had been invested. Alick Stevenson responded that if this information was required, he would have to do some research and bring the answer back to the next Committee meeting. Mr Stevenson then noted some information on the report concerning the FIDA fund, and managed to provide the Committee with some information concerning where the exiting monies had been invested. It seemed to be the case that most of the money in the FIDA Fund was invested in derivatives; the Committee were not happy with this because of the risk of financial loss. The Vice-Chairman recommended that the matter be put on hold, and looked at again at the next meeting, when more detail could be provided. Martin Reeves (Principal Accountant) informed the Committee that Fidelity were due to attend the next meeting of the Pensions and Investment Sub Committee on the 19th May. This being the case, the Committee decided to postpone any decision concerning the FIDA Fund until speaking to Fidelity at the next meeting.

Mr Stevenson was requested to contact Bailey Gifford to see what other products they had in comparison with Fidelity.

RESOLVED

(1) that the Revised Investment Strategy Phase 3 report be noted

(2) that Baillie Gifford continue to manage the fixed income portfolio under their existing aggregate Bond Fund

(3) that Fidelity be invited to the next meeting, where more detail on the FIDA Fund could be provided

(4) that Mr Stevenson from AllenbridgeEpic contacts Bailey Gifford to see what other products they have in comparison with Fidelity.

31 LOCAL GOVERNMENT ACT 1972 AS AMENDED BY THE LOCAL GOVERNMENT (ACCESS TO INFORMATION) (VARIATION) ORDER 2006 AND FREEDOM OF INFORMATION ACT 2000

RESOLVED that the Press and public be excluded during consideration of the items of business referred to below as it is likely in view of the nature of the business to be transacted or the nature of the proceedings that if members of the Press and public were present there would be disclosure to them of exempt information.

The following summaries refer to matters involving exempt information

32 CONFIRMATION OF EXEMPT MINUTES OF THE MEETING HELD ON 2ND DECEMBER 2014

The exempt minutes of the meeting held on December 2nd 2014 were agreed.

Resolved that the exempt minutes for December 2nd 2014 could now be made public.

The Meeting ended at 10.00 pm.

Chairman

Report No.
FSD15028

London Borough of Bromley

PART 1 - PUBLIC

Decision Maker:	**Pensions Investment Sub-Committee**
Date:	**19th May 2015**
Decision Type:	Non-Urgent Non-Executive Non-Key
Title:	**PENSION FUND PERFORMANCE Q4 2014/15**
Contact Officer:	Martin Reeves, Principal Accountant (Technical & Control) Tel: 020 8313 4291 E-mail: martin.reeves@bromley.gov.uk
Chief Officer:	Director of Finance
Ward:	All

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1. Reason for report

This report includes a summary of the investment performance of Bromley's Pension Fund in the 4th quarter of 2014/15. More detail on investment performance is provided in a separate report from the Fund's external advisers, AllenbridgeEpic, which is attached as Appendix 5. Representatives of Baillie Gifford and Fidelity will be present at the meeting, primarily in relation to the separate agenda item on fixed income, but also to discuss performance, economic outlook/prospects and other matters relating to their portfolios. Baillie Gifford has provided a brief commentary on its performance and on its view of the economic outlook and this is attached as Appendix 2. The report also contains information on general financial and membership trends of the Pension Fund and summarised information on early retirements.

RECOMMENDATION(S)

2.1 Note the report and
2.2 Agree the programme for Fund Manager attendance as set out in paragraph 3.9.

Corporate Policy

1. Policy Status: Existing policy. The Council's Pension Fund is a defined benefit scheme operated under the provisions of the Local Government Pension Scheme (LGPS) Regulations 2013, for the purpose of providing pension benefits for its employees. These regulations allow local authorities to use all the established categories of investments, e.g. equities, bonds, property etc, and to appoint external investment managers who are required to use a wide variety of investments and to comply with certain specific limits.
2. BBB Priority: Excellent Council.

Financial

1. Cost of proposal: No cost
2. Ongoing costs: Recurring cost. Total administration costs estimated at £2.5m (includes fund manager/actuary/adviser fees, Liberata charge and officer time)
3. Budget head/performance centre: Pension Fund
4. Total current budget for this head: £35.8m expenditure (pensions, lump sums, etc) - provisional outturn £35.0m; £38.6m income (contributions, investment income, etc) - provisional outturn £40.4m; £744.0m total fund market value at 31st March 2015)
5. Source of funding: Contributions to Pension Fund

Staff

1. Number of staff (current and additional): 0.4 FTE
2. If from existing staff resources, number of staff hours: c 14 hours per week

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Legal

1. Legal Requirement: Statutory requirement. Local Government Pension Scheme (LGPS) Regulations 2013
2. Call-in: Call-in is not applicable.

Customer Impact

1. Estimated number of users/beneficiaries (current and projected): 5,782 current employees; 4,948 pensioners; 5,066 deferred pensioners as at 31st March 2015

Ward Councillor Views

1. Have Ward Councillors been asked for comments? No.
2. Summary of Ward Councillors comments: N/A

3. COMMENTARY

Fund Value

3.1 The market value of the Fund ended the March quarter at £744.0m (£693.7m as at 31st December 2014) but, by the end of April 2015, it had fallen to £731.5m. The comparable value as at 31st March 2014 was £625.5m. Historic data on the value of the Fund are shown in a table and in graph form in Appendix 1.

Performance targets and investment strategy

3.2 Historically, the Fund's investment strategy has been broadly based on a high level 80%/20% split between growth seeking assets (representing the long-term return generating part of the Fund's assets) and protection assets (aimed at providing returns to match the future growth of the Fund's liabilities). Between 1998 and 2012, Baillie Gifford and Fidelity managed balanced mandates along these lines. This strategy was confirmed in 2012, following a comprehensive review of the Fund's investment strategy. This review concluded that the growth element would, in future, comprise a 10% allocation to Diversified Growth Funds (DGF) and a 70% allocation to global equities. The latter eliminated our previous arbitrary regional weightings and provided new managers with greater flexibility to take advantage of investment opportunities in the world's stock markets, thus, in theory at least, improving long-term returns. A 20% protection element would remain in place for investment in corporate bonds and gilts.

3.3 It was agreed that this would be implemented in three separate phases and, following presentations by a short-list of four prospective managers to the meeting in November 2012, Phase 1 was implemented on 6th December 2012 with a transfer of £50m from Fidelity's equity holdings (£25m to each of the two successful companies, Baillie Gifford and Standard Life).

3.4 Following further presentations by four prospective managers to a special meeting in November 2013, Phase 2 was implemented on 20th December 2013, with £200m being allocated to Baillie Gifford (from within their former equities holdings), £120m to MFS International (transferred from Fidelity) and £120m to Blackrock (£70m from Baillie Gifford and £50m from Fidelity). A report elsewhere on the agenda looks further at options for Phase 3 of the revised investment strategy.

Summary of Fund Performance

3.5 Performance data for 2014/15 (short-term)

A detailed report on fund manager performance in the quarter ended 31st March 2015 is provided by the fund's external adviser, AllenbridgeEpic, in Appendix 5. In overall terms, the total fund returned +7.3% (net of fees) in the latest quarter, compared to the overall benchmark return of +6.0% and the local authority average of +5.6%. This followed overall returns of +5.6% in the December quarter (benchmark +4.3%), +3.0% in the September quarter (benchmark also +3.0%) and +1.6% in the June quarter (benchmark +2.3%). With regard to the local authority average, the fund's performance in the March quarter was in the 2nd percentile (the lowest rank being 100%). This follows returns in the 6th percentile in the December quarter, in the 8th percentile in the September quarter and in the 81st percentile in the June quarter. The June quarter was only the second full quarter since some 70% of the total assets of the Fund was moved (in December 2013) from the previous balanced mandates into new global equity mandates and it is probably reasonable to assume that this was, partly at least, due to the new managers "bedding in". In local authority average terms, the performance in the September, December and March quarters was very good.

3.6 Medium and long-term performance data

Since 2006, the WM Company has measured the fund managers' results against their strategic benchmarks, although, at total fund level, it continues to use the local authority indices and averages. Other comparisons with local authority averages may be highlighted from time to time

to demonstrate, for example, whether the benchmark itself is producing good results. The Fund's medium and long-term returns have remained very strong. In spite of both 2012/13 and 2013/14 being years of transition and change, the Fund as a whole achieved overall local authority average rankings in the 29th percentile in 2013/14 and in the 4th percentile in 2012/13. For comparison, the rankings in earlier years were 74% in 2011/12, 22% in 2010/11, 2% in 2009/10 (the second best in the whole local authority universe), 33% in 2008/09, 5% in 2007/08, 100% in 2006/07 (equal worst in the whole local authority universe), 5% in 2005/06, 75% in 2004/05, 52% in 2003/04, 43% in 2002/03 and 12% in 2001/02. The following table shows the Fund's long-term rankings in all financial years back to 2004/05 and shows the medium to long term returns for periods ended on 31st December 2014 (in the 9th percentile for one year, in the 4th percentile for three years, in the 15th percentile for five years and in the 8th percentile for ten years). The medium to long-term results have been very good and have underlined the fact that the Fund's performance has been consistently strong over a long period.

Year	Whole Fund Return	Benchmark Return	Local Authority average	Whole Fund Ranking
	%	%	%	
Figures to 31/03/15				
1 year (1/4/14 to 31/3/15)	18.5	16.4	13.2	7
3 years (1/4/12 to 31/3/15)	14.2	12.1	11.1	5
5 years (1/4/10 to 31/3/15)	10.7	9.2	8.8	11
10 years (1/4/05 to 31/3/15)	10.3	8.7	7.9	8
Financial year figures				
2014/15	18.5	16.4	13.2	7
2013/14	7.6	6.2	6.4	29
2012/13	16.8	14.0	13.8	4
3 year ave to 31/3/15	***14.2***	***12.1***	***11.1***	***5***
2011/12	2.2	2.0	2.6	74
2010/11	9.0	8.0	8.2	22
5 year ave to 31/3/15	***10.7***	***9.2***	***8.8***	***11***
2009/10	48.7	41.0	35.2	2
2008/09	-18.6	-19.1	-19.9	33
2007/08	1.8	-0.6	-2.8	5
2006/07	2.4	5.2	7.0	100
2005/06	27.9	24.9	24.9	5
10 year ave to 31/3/15	***10.3***	***8.7***	***7.9***	***8***

Fund Manager Comments on performance and the financial markets

3.7 Baillie Gifford have provided a brief commentary on recent developments in financial markets, their impact on the Council's Fund and the future outlook. This is attached as Appendix 2.

Early Retirements

3.8 Details of early retirements by employees in Bromley's Pension Fund in the current year and in previous years are shown in Appendix 3.

Fund Manager attendance at meetings

3.9 Meeting dates have been set for 2015/16 and two of the Fund managers, Baillie Gifford and Fidelity, are attending this evening's meeting. It is proposed that managers be invited to attend meetings later in the year as follows, although Members reserve the right to request attendance at any time if any specific issues arise:

Meeting 1st September 2015 – Blackrock (global equities)
Meeting 18th November 2015 – MFS (global equities)
Meeting 17th February 2016 – Fidelity (fixed income) and Standard Life (DGF)
Meeting 19th May 2016 – Baillie Gifford (global equities, fixed income and DGF)

4. POLICY IMPLICATIONS

4.1 The Council's Pension Fund is a defined benefit scheme operated under the provisions of the Local Government Pension Scheme (LGPS) Regulations 2013, for the purpose of providing pension benefits for its employees. These regulations allow local authorities to use all the established categories of investments, e.g. equities, bonds, property, etc, and to appoint external investment managers who are required to use a wide variety of investments and to comply with certain specific limits.

5. FINANCIAL IMPLICATIONS

5.1 Details of the provisional 2014/15 outturn of the 2014/15 Pension Fund Revenue Account are provided in Appendix 4 together with fund membership numbers. A provisional net surplus of £5.4m (including £6.5m investment income) was achieved in 2014/15 (final figures to be reported to the next meeting after the accounts have been finalised) and total membership numbers rose by 861.

6 LEGAL IMPLICATIONS

6.1 The statutory provisions relating to the administration of the Local Government Pension Scheme are contained in the Local Government Pension Scheme (LGPS) Regulations 2013.

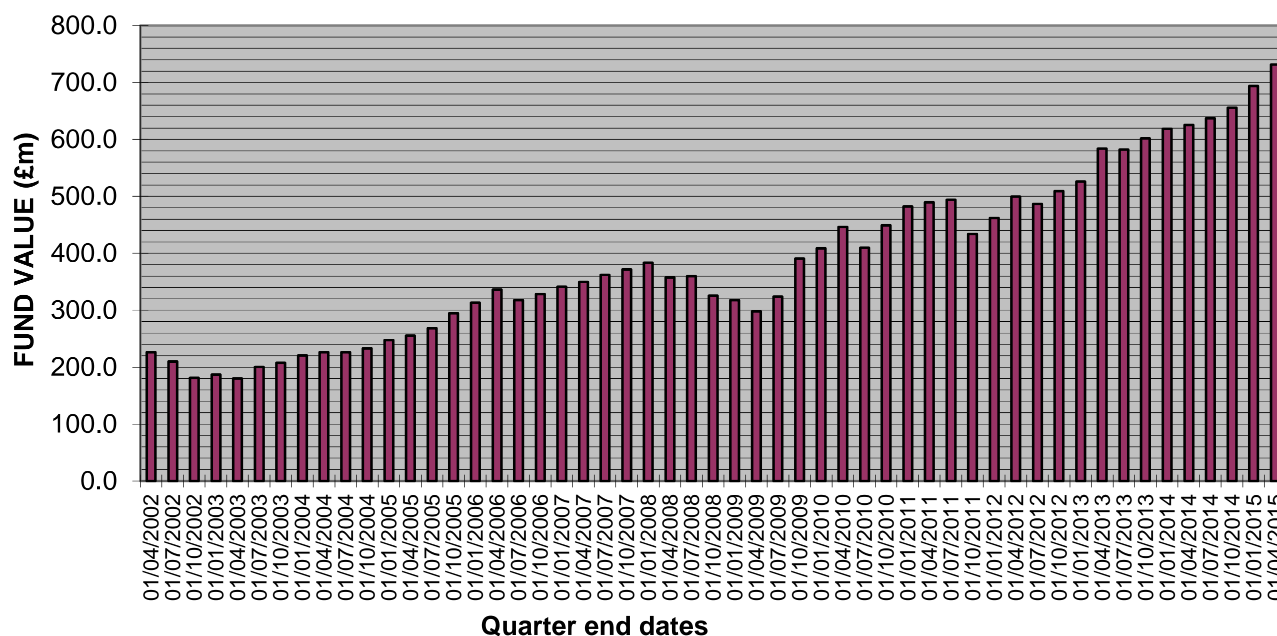
Non-Applicable Sections:	Personnel Implications
Background Documents: (Access via Contact Officer)	Analysis of portfolio returns (provided by WM Company). Monthly and quarterly portfolio reports of Baillie Gifford, Blackrock, Fidelity, MFS and Standard Life. Quarterly Investment Report by AllenbridgeEpic

MOVEMENTS IN PENSION FUND MARKET VALUE SINCE 2002

Date	Baillie Gifford					Fidelity			Blackrock	MFS	Standard Life	CAAM	
	Balanced Mandate	DGF	Fixed Income	Global Equities	Total	Balanced Mandate	Fixed Income	Total	Global Equities	Global Equities	DGF	LDI Investment	GRAND TOTAL
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
31/03/2002	113.3				113.3	112.9		112.9					226.2
31/03/2003	90.2				90.2	90.1		90.1					180.3
31/03/2004	113.1				113.1	112.9		112.9					226.0
31/03/2005	128.5				128.5	126.6		126.6					255.1
31/03/2006	172.2				172.2	164.1		164.1					336.3
31/03/2007	156.0				156.0	150.1		150.1				43.5	349.6
31/03/2008	162.0				162.0	151.3		151.3				44.0	357.3
31/03/2009	154.6				154.6	143.5		143.5					298.1
31/03/2010	235.5				235.5	210.9		210.9					446.4
31/03/2011	262.7				262.7	227.0		227.0					489.7
31/03/2012	269.9				269.9	229.6		229.6					499.5
31/03/2013#	315.6	26.5			342.1	215.7		215.7			26.1		583.9
31/03/2014@	15.1	26.8	45.2	207.8	294.9		58.4	58.4	122.1	123.1	27.0		625.5
30/06/2014		43.0	46.1	208.9	298.0		59.7	59.7	126.5	125.5	27.3		637.0
30/09/2014		43.8	48.1	213.3	305.2		61.5	61.5	131.6	129.5	28.1		655.9
31/12/2014		44.0	50.2	227.7	321.9		64.9	64.9	139.3	139.2	28.4		693.7
31/03/2015		45.5	51.6	248.3	345.4		66.6	66.6	151.0	151.3	29.7		744.0
30/04/2015		45.5	50.4	242.7	338.6		65.7	65.7	149.5	148.2	29.5		731.5

£50m Fidelity equities sold in Dec 2012 to fund Standard Life and Baillie Gifford DGF allocations.

@ Assets sold by Fidelity (£170m) and Baillie Gifford (£70m) in Dec 2013 to fund MFS and Blackrock global equities.



Baillie Gifford Report for the quarter ended 31 March 2015

Global Equities
Performance (net) to 31 March 2015 (%) *

	Fund Net	Benchmark
Five Years (p.a.)	11.3	9.5
Since 31/12/13 (p.a.)	17.0	13.0
One Year (p.a.)	19.4	19.0
Quarter	9.2	7.6

*Balanced mandate prior to investing in Global Alpha wef 31 December 2013

Commentary

The US continues to drive the economic recovery in the western world and this strength came through in the results of a wide range of holdings. We remain enthusiastic about opportunities in the US housing and construction markets taking a new holding in Zillow, an online estate agency, and adding to CRH, the building materials group, which has significant exposure to the US construction market and plans to acquire a range of attractive building assets spun-off from the merger of Holcim and Lafarge.

Lower energy and minerals prices are affecting the economy of big exporters of these commodities. Losers in this respect include the Latin American economies, Russia and the Middle East. This hurt the performance of a few companies in the portfolio, albeit overall exposure to commodities is limited. The weighting in oil, for example, is around 5% and mainly comprises stocks that we think should be able to grow, even in this lower price environment such as EOG Resources, which is optimistic about its organic growth prospects and may acquire cheapened oil assets. In contrast, we sold the small position in Tullow Oil, whose plans are being constrained by lower oil prices.

We have been impressed that the new prime minister of India, Narendra Modi, has adopted sensible pro-growth reforms and that these are supported by the broader population. To date we have only had one holding in India; this quarter we bought HDFC, another finance company to add to the existing holding in ICICI Bank. We think that both are attractive ways for the portfolio to capitalise on the evolving Indian economy.

Also of interest is the sharp rebound in several of our European holdings. This is in contrast to all the negative headlines about Greece. Perhaps the strength is in reaction to the beginning of ‘quantitative easing’ in Europe, which might mark the beginning of the end of the region’s economic difficulties. Holdings that have benefited include Fiat (cars), DIA (Iberian supermarkets), Carlsberg (beer) and Volvo (trucks).

This quarter, most sales have come from stocks which we describe as ‘stalwart’- steadily growing, less-cyclical companies. The reason for their weaker prospects is simply that their share prices have all been strong in recent years and as such now appear fully valued. We have reduced the position in Moody’s (the debt rating agency) and have made complete sales of British American Tobacco (which means you now have no tobacco holdings), Roche (pharmaceuticals) and Bunzl (consumer disposables). Aside from these ‘stalwart’ sales and the commodity sales mentioned above, we have also said goodbye to Teradata, which had been bought with expectations of ‘rapid’ growth but has disappointed with its progress.

Outlook

While there remain some challenges to the portfolio – known and as yet unknown – we expect that a measured approach with a long-term mindset will enable us to navigate them successfully. We remain confident that a well-diversified portfolio of growth stocks can underpin attractive absolute and relative growth for the patient investor.

Diversified Growth
Performance (net) to 31 March 2015 (%)

	Fund	Base Rate +3.5%
Since Inception* (p.a.)	6.4	4.0
One Year	7.9	4.0
Quarter	3.2	1.0

*06 December 2012

Portfolio

In recent changes to asset allocation, we have lowered the equity weighting and reduced the portfolio's exposure to an adverse move in interest rates, particularly in the US.

While these moves are not greatly significant in themselves, they bolster what we believe was already a cautious slant to the portfolio, which remains diversified across many asset classes. The largest exposure is to equities but that accounts for just one-fifth of the portfolio and is half what our asset allocation limits would permit us to own, if we were truly bullish on equities. The next largest allocations are to high yield credit markets and structured finance, but we believe our exposure to rising interest rates in these allocations is limited, either because the bonds held are short-dated or floating-rate instruments, where the coupon payment will rise with market interest rates.

The return on the Fund (net of fees) in the year to 31 March 2015 was +7.9%. Delivered volatility over the past five years was 4.4% per annum. The return on the Fund (net of fees) in the past three months, covering the period since we last reported to you, was 3.2%.

Over the past year, all asset classes contributed positively to performance, with the greatest contributions coming from listed equities, active currency and absolute return.

In the three months to 31 March 2015, the largest contributors to performance were listed equities, active currency, high yield credit and absolute return. Most other asset classes were broadly flat over the quarter.

Bonds

Performance (Net)

Performance to 31 March (%)

	Fund	Benchmark
Since 15/04/14*	12.7	12.4
Since 09/12/13 (p.a.)**	12.3	11.9
Quarter	2.7	2.7

* Transition to Sterling Aggregate Plus Bond Pension Fund.
** Inception date of bond mandate

The ECB finally announced its long-anticipated QE program pushing up prices in almost all bond markets, including sterling. We moved the Fund to a small overweight in corporate bonds versus government bonds, reflecting the support European QE provides for credit assets.

In interest rate positioning, the Fund is positioned to anticipate lower yields across a diverse range of bond markets. We have also taken moderate positive currency positions in faster growing economies such as the US and India. Conversely, we anticipate weakness in currencies with structural growth problems, such as South Africa.

Within corporate bonds, we made an investment in bonds from W.P. Carey, a US real-estate business with a well diversified property and tenant base. We also took a position in Bed, Bath & Beyond, the largest home furnishing retailer in the US. The business is well placed to be competitive both in stores and in the online market and has a strong record of growth. We reduced corporate bond exposure in Brazil, selling part of your holding in Votorantim Cimentos, an investment grade cement company that may struggle should the local economy continue to weaken.

EARLY RETIREMENTS

A summary of early retirements by employees in Bromley's Pension Fund in the current year and in previous years is shown in the table below. With regard to retirements on ill-health grounds, this allows a comparison to be made between their actual cost and the cost assumed by the actuary in the triennial valuation. If the actual cost of ill-health retirements significantly exceeds the assumed cost, the actuary will be required to consider whether the employer's contribution rate should be reviewed in advance of the next full valuation. In the latest valuation of the Fund (as at 31st March 2013), the actuary assumed a figure of £1m p.a from 2014/15, a significant increase over the estimate of £82k p.a. in the 2010 valuation. In 2013/14, there were six ill-health retirements with a long-term cost of £330k and, in 2014/15, there were 7 ill-health retirements with a long-term cost of £452k. Provision has been made in the Council's budget for these costs and contributions have been made to reimburse the Pension Fund, as result of which the level of costs will have no impact on the employer contribution rate.

The actuary does not make any allowance for other (non-ill-health) early retirements, however, because it is the Council's policy to fund these in full by additional voluntary contributions. In 2013/14, there were 26 other retirements with a total long-term cost of £548k and, in 2014/15, there were 19 non ill-health retirements with a long-term cost of £272k. Provision has been made in the Council's budget for severance costs arising from LBB staff redundancies and contributions have been made to the Pension Fund to offset these costs. The costs of non-LBB early retirements have been recovered from the relevant employers.

Long-term cost of early retirements	**Ill-Health**		**Other**	
	No	£000	No	£000
Qtr 4 – Mar 15 - LBB	1	94	1	-
- Other	-	-	-	-
- Total	1	94	1	-
Total 2014/15 – LBB	4	218	15	154
- other	3	234	4	118
- Total	7	452	19	272
Actuary's assumption - 2013 to 2016		1,000 p.a.		N/a
- 2010 to 2013		82 p.a.		N/a
Previous years – 2013/14	6	330	26	548
– 2012/13	2	235	45	980
– 2011/12	6	500	58	1,194
- 2010/11	1	94	23	386

PENSION FUND REVENUE ACCOUNT AND MEMBERSHIP

	Final Outturn 2013/14 £'000's	Estimate 2014/15 £'000's	Provisional Actual to 31/03/15 £'000's
INCOME			
Employee Contributionsl	5,580	5,600	6,100
Employer Contributions	23,967	23,000	24,900
Transfer Values Receivable	5,074	3,000	2,900
Investment Income	10,883	7,000	6,500
Total Income	45,504	38,600	40,400
EXPENDITURE			
Pensions	23,409	24,300	24,500
Lump Sums	5,884	6,000	4,500
Transfer Values Paid	1,559	3,000	3,300
Administration	2,413	2,500	2,600
Refund of Contributions	13	-	100
Total Expenditure	33,278	35,800	35,000
Surplus/Deficit (-)	12,226	2,800	5,400

MEMBERSHIP	**31/03/2014**	**31/03/2015**
Employees	5,254	5,782
Pensioners	4,862	4,948
Deferred Pensioners	4,819	5,066
	14,935	15,796

AllenbridgeEpic
investment advisers

APPENDIX 5

REPORT PREPARED FOR

London Borough of Bromley Pension Fund

19 May 2015

Alick Stevenson
AllenbridgeEpic Investment Advisers Limited (AllenbridgeEpic)

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This quarterly report by your adviser, Alick Stevenson of AllenbridgeEpic Investment Advisers (AllenbridgeEpic), provides a summary of performance and an analysis of the investments of the London Borough of Bromley Pension Fund for the three months ending 31 March 2015.

Market Summary 1Q 2015

"Better a tragic ending, than an endless tragedy"

German proverb

It's becoming a bit of a broken record when the same four economic issues continue to dominate global markets.

- *Global growth, patchy and not yet firmly embedded*
- *Eurozone fears of a Greece exit, and despite the European Central Bank programme of quantitative easing no significant signs of sustainable growth*
- *Central banks versus markets on when interest rates will rise and by how much and*
- *No market perceived "bubbles" in asset prices leading to increased volatility and potential market declines*

Despite the "broken record" concept, the last quarter has been one of strong growth in equity markets, with major markets touching and, in some cases, breaching fifteen year levels.
Six years of quantitative easing and cheap money may have inflated asset values but have had much less success in kick starting economic growth. Equity market levels already owe much of their present levels to central bank actions rather than the everyday realities of economic growth.

Whilst this has led in many instances to aggressive corporate share buy-back programmes, share values have not necessarily been driven by consumer demand and thus corporate profits levels have to a certain extent been created artificially. These comments refer of course to points two, three and four above.

The hesitancy shown by central banks when considering interest rate rises, seems to be justified as any precipitate upward movement could cause a major sell off with all its negative implications and an end to the nascent economic growth. Central bankers around the world seem united in their public pronouncements that there will be no rate increases until they feel the global economic recovery is embedded sufficiently to withstand a rate increase. Point one above.

Markets will no doubt continue to test central bank resolve in the months to come.

The Eurozone side show in which Greece is the "major" player continues. That Greece should never have been allowed to join is apparent to all, however, Brussels and Germany have decreed that an exit is impossible without bringing doom and economic winter down around the collective known as the Eurozone. So further compromise, further meetings and further obfuscation will continue. Meanwhile the rest of the Eurozone stagnates with little or no economic growth.

Closer to home the General Election draws ever closer and a new government of whatever prescription will be formed soon after the results are declared. Whilst opinion polls seem hesitant in calling the result, current voting uncertainties do not appear to derail the strength of the UK equity market.

Executive Summary

- **The fund had a good quarter, rising in value to £744.0m as at 31 March 2015 from £693.7m at 31 December 2014. The corresponding figure for 31 March 2014 was £625.5m.**

- **Investment performance was also good with the fund delivering a strong 7.3% (6.0%) return for the quarter, 18.5% (16.4%) for the rolling twelve months and 14.2%pa (12.1%pa) over the rolling three year period. These figures compare positively to the current actuarial assumption of 5.6%pa. (figures in brackets are the respective benchmarks)**

- **Baillie Gifford reported the closure, (to new business), of their Global Alpha Fund ("GAF"), and also advised that Charles Plowden, one of the portfolio managers on Global Alpha had taken a planned sabbatical for three months and would be returning in the summer. Jenny Davis, already one of the team, will step up as the third "decision maker" The GAF is well supported and I have no reason to express concern.**

Fund Matters

The Third Phase of the investment reorganisation, that of reorganising the fixed income assets continues, Baillie Gifford and Fidelity will be attending the PISC meeting in May to present their alternatives to their current portfolio constructions. Short papers covering the presentations they will make at the May meeting are provided separately..

Fund Value as at 31 March 2015

Manager Name	Asset Class	Value 31-Mar-15 £m	Actual % of Fund	Value 31-Dec-14 £m	Actual % of Fund	Strategic Asset Allocation %
Baillie Gifford	DGF	45.5	6.1	44.0	6.3	
Standard Life	DGF	29.7	4.0	28.4	4.1	
Sub total DGF		75.2	10.1	72.4	10.4	10.0
Baillie Gifford	Global E	248.3	33.4	227.7	32.8	
BlackRock	Global E	151.0	20.3	139.2	20.1	
MFS	Global E	151.3	20.3	139.2	20.1	
Sub total GE		550.6	74.0	506.1	73.0	70.0
Baillie Gifford	Fixed Int	51.6	6.9	50.2	7.2	
Fidelity	Fixed Int	66.6	9.0	64.9	9.4	
Sub total FI		118.2	15.9	115.1	16.6	20.0
Fund Totals		744.0	100.0	693.6	100.0	100.0

source: Baillie Gifford, BlackRock, Fidelity, MFS, Standard Life

The fund moved easily through the £700m level by the end of the quarter, on the back of strong performances from the global equity managers, supported by good performances from DGF and fixed income.
As far as the strategic or long term asset allocations are concerned the fund remains slightly overweight equities and DGF assets and remains underweight fixed income. These over and underweight positions will be closely monitored and may be adjusted following completion of the Phase 3 Fixed Income restructuring.

Fund Performance

Summary

Fund Return	7.3
Benchmark Return	6.0
Relative Performance	1.2
attributable to:	
Asset Allocation	0.1
Stock Selection	1.2

Source: The WM Company

It is clear from the above charts that asset allocation has had a negligible negative impact on overall investment performance whereas stock selection was extremely robust, once again reflecting positively on the active manager structure.

Manager Changes

There was one minor change reported at Baillie Gifford which is highlighted in the Executive Summary. This change should not affect the way in which the portfolio is managed.

No other changes which would affect the running of the various portfolios have been notified by the investment managers.

Fund Governance and Voting

Voting and governance matters are covered in some detail within the various Investment Manager reports provided to the members under separate cover.

INVESTMENT MANAGER REVIEWS

Global Equity Portfolios

Baillie Gifford Global Alpha (segregated)

This portfolio was funded as at 20 December 2013 with a performance objective to outperform the MSCI (“ACWI”) All Country World Index by 2-3% pa (before fees) over rolling five year periods.
(The Fund was closed to prospective investors at the beginning of the year but remains open for additional funding from existing clients).

Fund positioning has changed slightly during the quarter with funding for new stock purchases coming from sales of stocks, described by the manager, as “stalwarts” and recognising that perhaps

their share prices could weaken on the back of uncertain earnings going forward. As a result complete disposals were made in BAT, Roche and Bunzl and from Teradata which had disappointed. New purchases included Zillow, an online US based estate agency, HDFC Bank and MS & AD Insurance. At the end of March 2015 the global equity fund was invested across 24 (24) countries and held 95 (97) different investments. These investments were spread over 8 (8) sectors and encompassed 38 (40) differing industries, thus providing a broadly diversified set of assets. It is worth noting that the active money within this portfolio is continuing to run at 93% (92%). This implies that the fund is not holding benchmark or index weightings relating to stocks making up the index and reflects the active stock picking philosophy of the manager.

For the quarter, the fund returned 8.5% against a benchmark of 7.5%. Since the portfolio reorganisation in December 2013, the fund has returned 17.0%pa against a benchmark of 15.5*%pa. (All returns shown as net of fees.)*

In terms of regional allocations Baillie Gifford remains significantly underweight the MSCI Index in North America (47.5% v 61.2%) and underweight Developed Asia Pacific (11.8% v 13.3%) but is running an overweight to Emerging Markets and a small underweight in the UK.

The “active money” style (stock picking) is clearly demonstrated with the top ten holdings accounting for just over 25% (25%) of the total portfolio. Prudential at 3.5%, Royal Caribbean Cruises at 3.9% and Naspers at 3.8%, retain the top three names whilst TD Ameritrade, AIA Group and Google take the bottom three positions with 2.0%, 1.8% and 1.8% respectively.

BlackRock Ascent Life Enhanced Global Equity Fund (pooled)

This new portfolio was funded as at 20 December 2013 and has a Performance objective: to outperform the MSCI ACWI by 1-2% per annum whilst managing risk relative to the benchmark.

The manager can invest across the whole of the ACW Index and, as a result, held 814 stocks (846) at the end of the quarter and outperformed its benchmark by 0.7% (benchmark 8.3% v 7.6%). Since inception the fund has performed strongly and has a return of 19.9%pa against a benchmark of 16.8%pa. These returns are shown gross of fees. For net returns simply deduct 50bps

In terms of country risk, the manager is slightly overweight Canada and Germany and slightly underweight the US. It remains underweight in the UK and “Other Countries”.
Sectorally, the fund has remained overweight Info Tech, Telecoms and Utilities and continues with its underweight positions in Consumer Discretionary and Consumer Staples. Interestingly, the manager has moved from small underweights to small overweights in Financials and Materials.

Top ten stocks are little changed from last quarter with Apple (back at 2.9%) Verizon (1.5%) and Union Pacific Corp (1.3%) talking the top three positions. However, it should be mentioned that last quarter Apple held the top spot, BlackRock took the view that its valuation was becoming a bit “stretched” and sold the holding down from approx. 2.8%. to just 0.95% of the fund. They have since bought back into Apple following a reappraisal of its “real” value, hence it has regained its number one slot.

MFS Global Equity Fund (segregated)

This portfolio was funded as at 18 December 2013 and has a performance objective to outperform the MSCI world index (net dividends reinvested) over full market cycles.

MFS currently invests in 15 (15) countries and has 108 (109) holdings. This contrasts with the benchmark of 1,633 holdings spread across 24 countries. For the quarter the fund returned 8.5% net against its benchmark of 7.5%.Since inception the fund has returned 19.2%pa (net) against the benchmark of 17.2% pa for a net outperformance of 2.0% pa.

Looking through the country and sector weights shows that the fund is currently underweight North America (53.1% v 61.2%) and Asia Pacific ex Japan (1.2% v 4.7%), and has maintained the overweight positions in Europe ex UK (+2.6%), UK (+2.1%) and Japan (+3.5%). The fund is also running a small +1.2% overweight in emerging markets.

Sectorally, the fund has again maintained its significant overweight position in Consumer Staples (20.2% v 9.8%), with small overweights in Industrials (+3.7%) and Telecommunication Services (+2.0%). These over weights are being "funded" by underweight positions in Information Technology (-2.1%), Consumer Discretionary (-4.4%), Utilities (-3.2%) , Energy (-3.3%) and Materials (-3.3%).

In terms of holdings, KDDI Corporation with 2.6% of the portfolio, Nestle (2.3%) and Johnson & Johnson at 2.2% are the three largest, with JP Morgan (1.8%) % and 3M Company (1.7%) are in ninth and tenth positions.

Global Equity Crossholdings

There are no crossholdings within the aggregated top ten holdings of the three global equity managers.

Diversified Growth Funds

Overall, Baillie Gifford has maintained its much lower allocation to global equities and has increased its exposure to high yield at the expense of a reduction in emerging market bonds. BG has made no major changes to its other investments.

In contrast, Standard Life holds just over 47% of its assets in derivative based investments backed by cash, favouring its relative value and directional investment strategies.

Baillie Gifford

This mandate was funded on 8 December 2012 and has a performance objective to outperform UK base rate by at least 3.5% pa (net of fees) over rolling five year periods and with an annualised volatility of less than 10%.

The fund has performed well since its inception, generating a *net return of 6.4%pa* against the benchmark of 4.0%pa. For the 12 month period it has returned 7.9% against the benchmark of 4.0%. For the quarter the fund had a return of 3.2% versus the benchmark of 1.0%. Annualised volatility continues to well inside the upper limit of 10%.

Most asset classes delivered good returns over the quarter despite a fall in inflation as the effects of the lower oil price worked their way through. This, coupled with the ECB decision to back its rhetoric with real money, saw bond yields fall to record low levels. Almost without exception major sovereign debt issues now trade at a negative rate of return.

There were few major changes to the overall asset allocations over the quarter, the exceptions being increased investment in high yield bonds to 15.1% (11.7%) funded from a reduction in emerging market bond holdings and minor reductions in several other asset classes.

One of the primary directives for the fund, and one closely followed, is to keep volatility within target. At the end of the quarter the current figure was similar to that at the end of the previous quarter 4.4% (4.7%) well within the upper ceiling of +10%.

Standard Life Global Absolute Return Fund

This mandate was funded on 7 December 2012 and has a performance objective to achieve +5% per year (gross) over 6 month LIBOR over rolling three year periods with expected volatility in the range of 4% to 8%
For the quarter the manager delivered a return of 4.4% net of fees against the benchmark of 0.2%, and since inception a strong net return of 7.7%pa. Positive contributions from directional currency investments and global equities were enhanced by good returns on relative value investments. Volatility within GARS was held at just 3.9% for the third consecutive quarter.

Asset allocations at the end of this quarter were almost exactly the same as those at the end of the third and second quarters.

	Baillie Gifford	Baillie Gifford	Standard Life	Standard Life	Total DGF	Total DGF
	%	£m	%	£m	£m	%
Value at 31 March 2015		45.5		29.7	75.2	
Asset Class						
Global equities	21.2	9.6	33.2	9.9	19.5	25.9
Private equity	1.6	0.7			0.7	1.0
Property	3.0	1.4			1.4	1.8
Global REITS						
Commodities	4.9	2.2			2.2	3.0
Bonds						
High yield	15.1	6.9	4.4	1.3	8.2	10.9
Investment grade	6.4	2.9	6.2	1.8	4.8	6.3
Emerging markets	10.0	4.6	8.6	2.6	7.1	9.4
UK corp bonds						
EU corp bonds						
Government		0.0			0.0	0.0
Global index linked						
Structured finance	12.6	5.7			5.7	7.6
Infrastructure	4.3	2.0			2.0	2.6
Absolute return	8.5	3.9			3.9	5.1
Insurance Linked	5.2	2.4			2.4	3.1
Special)pportunities	0.5	0.2			0.2	0.3
Active currency	-0.3	-0.1			-0.1	-0.2
Cash	7.0	3.2			3.2	4.2
Cash and derivatives			47.6	14.1	14.1	18.8
Total	100.0	**45.5**	100.0	**29.7**	**75.2**	100.0

numbers may not add due to roundings

Source: Baillie Gifford and Standard Life

The above table highlights the asset allocation differences between Baillie Gifford and Standard Life in sourcing investment returns

FIXED INCOME PORTFOLIOS

Baillie Gifford Aggregate Plus Portfolio

The transition to the Sterling Aggregate Bond Fund was completed on 15 April 2014. The new mandate has a performance objective to outperform, by 1.5% pa (gross of fees), a benchmark comprising 50% FTSE UL conventional All Stocks index and 50% Bank of America Merrill Lynch Sterling Non Gilt index over rolling three year periods.

The fund had a net return of 2.7% (net of fees) which matched the benchmark.

Portfolio duration is just fractionally longer than the benchmark at 9.7 years versus 9.2 years.

From a credit rating perspective the fund is marginally overweight benchmark with AAA rated bonds, underweight AA (-11.4% to the benchmark) and overweight BBB (+7.0% to the benchmark) with a total of 95% invested in investment grade bonds.

High yield, or below investment grade, has a modest overweight of 4.1% to the index and is comprised largely of bonds rated BB which have lost their “BBB” rating, but in the opinion of the manager have the ability to regain that rating. The manager does not invest in any “C” rated bonds.

In terms of active money, ie. Those positions larger than the benchmark allocation, the manager holds 3.0% of the fund in KFW 2036, 2.1% in Tesco, 2044, 2% in WP Carey 2023 and 1.9% in Network Rail 2035.

Fidelity Global Aggregate Fixed Income Portfolio

This portfolio was originally funded in April 1998 and has a performance objective to outperform by 0.75% pa (gross of fees) a benchmark comprising 100% of (IBoxx Composite (50% Gilts and 50% £ Non Gilts) over rolling three year periods.

The fund outperformed the benchmark during the quarter with a return of 2.9% (gross of fees) just 0.1% over the benchmark. Over the last three years the fund is ahead of the benchmark by 2.3% pa (13.5% pa v 11.2%pa) and since inception (30 April 1998) has outperformed the benchmark by 0.9% pa.

In terms of credit ratings, the fund has slightly over 90% invested in investment grade bonds, albeit underweight the index, especially in AA bonds, and has 21.6% invested in BBB rated bonds. The manager has increased his holdings to 6.3% (2.8%) in high yield bonds and holds the remaining 4% in a mix of cash and unrated investments.

There has been almost no change at all during the quarter to the sectoral allocations with US treasury assets accounting for approximately 37% (43%) of the portfolio. Overweight positions in the Financial Services, Communications and Insurance sectors are offset by underweights in Supranationals and Sovereign Assets and Utilities.

The portfolio is in line with the duration of the benchmark 9.4 years versus 9.5 years and has a running yield of just 3.0%.

Report No.
FSD15029

London Borough of Bromley

PART 1 - PUBLIC

Decision Maker: **Pensions Investment Sub-Committee**

Date: **19th May 2015**

Decision Type: Non-Urgent Non-Executive Non-Key

Title: **REVISED INVESTMENT STRATEGY - PHASE 3**

Contact Officer: Martin Reeves, Principal Accountant (Technical & Control)
Tel: 020 8313 4291 E-mail: martin.reeves@bromley.gov.uk

Chief Officer: Director of Finance

Ward: All

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1. Reason for report

This report provides further information on fixed income assets as part of the 20% “protection” allocation under phase 3 of the investment strategy agreed in 2012. The Sub-Committee is asked to consider the attached report from the Fund’s advisers, AllenbridgeEpic, which recommends a small allocation change within Fidelity’s fixed income holding from the existing UK Aggregate Bond Fund to the Fixed Income Diversified Alpha (FIDA) Fund and a similar change at Baillie Gifford with a small transfer from the Sterling Aggregate Bond Fund to the Global Credit and Emerging Markets Bond Funds.

RECOMMENDATION(S)

The Sub-Committee is asked to:

2.1 Note the report and to:

a) Agree to invest £6m in Fidelity’s FIDA Fund, to be transferred from Fidelity’s existing UK Aggregate Bond Fund.

b) Agree to invest £6m, split equally between Baillie Gifford’s Global Credit and Emerging Market Bond Funds, to be transferred from Baillie Gifford’s Sterling Aggregate Bond Fund.

Corporate Policy

1. Policy Status: Existing policy. The Council's Pension Fund is a defined benefit scheme operated under the provisions of the Local Government Pension Scheme (LGPS) Regulations 2013, for the purpose of providing pension benefits for its employees. These regulations allow local authorities to use all the established categories of investments, e.g. equities, bonds, property etc, and to appoint external investment managers who are required to use a wide variety of investments and to comply with certain specific limits.

2. BBB Priority: Excellent Council.

Financial

1. Cost of proposal: No cost

2. Ongoing costs: N/A.

3. Budget head/performance centre: Pension Fund

4. Total current budget for this head: £35.8m expenditure (pensions, lump sums, etc) - provisional outturn £35.0m; £38.6m income (contributions, investment income, etc) - provisional outturn £40.4m; £744.0m total fund market value at 31st March 2015

5. Source of funding: Contributions to Pension Fund

Staff

1. Number of staff (current and additional): 0.4 fte (current)

2. If from existing staff resources, number of staff hours: c14 hours per week

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Legal

1. Legal Requirement: Statutory requirement. Local Government Pension Scheme (LGPS) Regulations 2013

2. Call-in: Call-in is not applicable.

Customer Impact

1. Estimated number of users/beneficiaries (current and projected): 5,782 current employees; 4,948 pensioners; 5,066 deferred pensioners as at 31st March 2015

Ward Councillor Views

1. Have Ward Councillors been asked for comments? No.

2. Summary of Ward Councillors comments: N/A

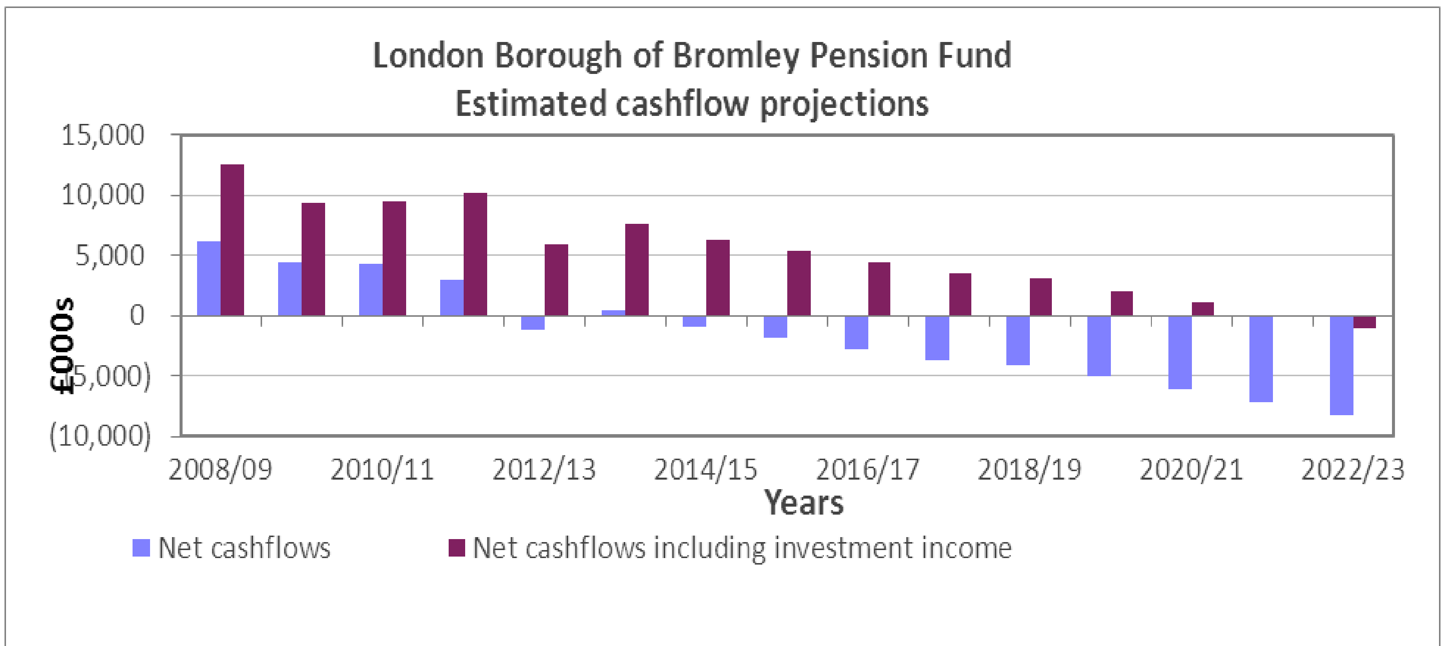
3. COMMENTARY

3.1 In February 2012, the Sub-Committee agreed a future strategy for the Fund, comprising a 10% allocation to Diversified Growth, a 70% allocation to global equities and a 20% allocation to fixed income (corporate bonds/gilts). It was agreed that the revised strategy would be implemented in three separate phases and, following a “beauty parade” in November 2012, Phase 1 was completed on 6th December 2012 with the award of two Diversified Growth Fund mandates of £25m to Baillie Gifford and Standard Life. A further “beauty parade” at the special meeting in October 2013 resulted in the completion of Phase 2 with the award of three global equities mandates to Baillie Gifford (£200m), Blackrock (£120m) and MFS (£120m).

3.2 AllenbridgeEpic have previously been appointed to provide specialist procurement advice for the implementation of the revised strategy and have managed the processes for Phase 1 and Phase 2. At the meeting in November 2013, Members considered an initial update from AllenbridgeEpic on Phase 3 of the revised investment strategy (fixed income). It was agreed that the Fund should enter into arrangements with one or more managers for global fixed income pooled funds (at its meeting in February 2012, the Sub-Committee had originally agreed that two managers be appointed). It was also agreed that the procurement process for Phase 3 be run on the basis that investment would be made in global fixed income pooled funds. Pooled funds fall outside the EU procurement rules because they are considered to be direct investment decisions (there is an exemption for financial instruments). Accordingly, although we would still have to tender for the mandate(s), we would not have to follow the OJEU route, which would shorten the tender process. At that stage, the timetable indicated that Phase 3 should be completed (funded) by 31st March 2014.

3.3 In accordance with the investment strategy agreed in 2012, 20% of the Bromley Fund would be allocated to fixed income, which, based on the current Fund value, would be around £140m. At the November 2013 meeting, however, a Member questioned whether 20% was too high given higher returns he felt could be achieved from other investments. Fixed income assets provide cash for the Fund, but are, over time, likely to generate a return of “only” 3% to 6%, which is considerably less than we would expect from, say, global equities. Members asked for the Scheme Actuary to prepare a cash flow projection for the Fund in order to better identify the length of time potentially remaining before the Fund moves to “cash neutral” and then to “cash negative”. The cashflow forecast would help inform subsequent investment debates and decisions by the Sub-Committee in terms of investing the assets of the fund in income generating assets (fixed income characteristics), rather than growth seeking “risk” assets (equities).

3.4 The actuary prepared a cashflow projection and this was attached as an appendix to a further update report from AllenbridgeEpic that was considered at the Sub-Committee meeting in February 2014. The actuary advised that, based on the numbers in the projections, the Fund was likely to move into a net cashflow negative position (including investment income receipts) in around 2020/21. The Fund is currently cash positive once income from equities being re-invested is taken into account, but, excluding investment returns, became cash-negative in 2012/13 and the actuary expects this position to generally get worse. Put simply, it is possible to say that net dealings with members put the Fund in a cashflow negative position and investment income might be needed each year going forwards from now on to pay benefits due. The actuary’s cashflow projection is shown below.



3.5 At that February meeting, Members agreed to defer a decision on the final allocation to fixed income and requested a report to the next meeting of the Sub-Committee on alternative "protection type" assets as part of the fixed income allocation. The next meeting, originally scheduled in May, was cancelled because of the local elections and the matter was considered again in August 2014, when the Sub-Committee agreed that "a manager search be carried out seeking to appoint one or more managers to invest a total of up to 10% of the fund (c. £60m based on the current fund value) over the longer term in "alternative fixed interest (inflation proofing / illiquid)" assets; and that "the remaining balance of the 20% allocation for fixed income be managed by one (or both) of the existing fixed income managers (Baillie Gifford and Fidelity) on a global basis with an absolute return benchmark (as set out in the Statement of Investment Principles 2014)."

3.6 At the August meeting, there was some discussion around the appropriateness of investing 50% of the 20% "protection" allocation (c. £60m at that time) in fixed income and it was agreed that AllenbridgeEpic should research further into assets matching the criteria contained in the August report. They reported back to the Sub-Committee in December 2014 and the Sub-Committee agreed that, in view of Member concerns over the illiquidity of potential funds highlighted by AllenbridgeEpic, existing conventional fixed income assets be retained. AllenbridgeEpic were asked to continue to search for options at an appropriate level of risk, reporting back to this meeting. An update is attached as Appendix 1.

3.7 At the February 2015 meeting, the Sub-Committee reviewed a new opportunity put forward by AllenbridgeEpic and, whilst agreeing that this (an investment in the Fidelity FIDA Fund) was worth further consideration, felt that further work was needed before Members could make a decision.

3.8 This new paper (attached as Appendix 1) recommends two adjustments to the overall fund allocation to fixed income by minor adjustments to the existing benchmarks used by the two current fixed income investment managers.

- An allocation of £6m (10% of current holding) from the Baillie Gifford fixed income mandate to pooled funds investing in Global Credit and Emerging Market Bonds (£3m each). Baillie

Gifford consider a potential 0.25%pa improvement in return could be achieved without greatly increasing volatility; and.

- An allocation of £6m (10% of current holding) from the existing Fidelity fixed income mandate to their FIDA Fund, which would enable the fund to invest in a wider range of investment opportunities whilst preserving capital values., Fidelity would also expect a modest uplift to investment returns.

4. POLICY IMPLICATIONS

4.1 The Council's Pension Fund is a defined benefit scheme operated under the provisions of the Local Government Pension Scheme (LGPS) Regulations 2013, for the purpose of providing pension benefits for its employees. These regulations allow local authorities to use all the established categories of investments, e.g. equities, bonds, property etc, and to appoint external investment managers who are required to use a wide variety of investments and to comply with certain specific limits.

5. FINANCIAL IMPLICATIONS

5.1 None at this stage.

Non-Applicable Sections:	Legal and Personnel Implications
Background Documents: (Access via Contact Officer)	LGPS (Administration) Regulations 2008 (as amended) and LGPS Regulations 2013. LGPS (Management & Investment of Funds) Regulations 2009.

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APPENDIX 1

REPORT PREPARED FOR

London Borough of Bromley Pension Fund

19 May 2015

Alick Stevenson
AllenbridgeEpic Investment Advisers Limited (AllenbridgeEpic)

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The process of reorganising the investments of the fund began in 2011 and was approved in 2012. The process was managed in three separate phases.

The Committee has already been provided with detailed papers on the completion of Phases 1 and 2, and certain interim papers on Phase 3: Reorganisation of the fixed income assets.

Fixed Income Summary to date

Phase 3 Fixed Income

Whilst this final phase originally considered investing in global bond funds, the manager responses to an initial search in 2013/14 found very few managers with global reach, and found some who focussed on one sub asset class such as "global emerging market" or "global high yield", yet described themselves as "global fixed income". It was agreed in the first quarter of 2014 that the brief should be widened to include fixed income assets which had an "illiquidity premium" such as capital release bonds, infrastructure/renewable energy investments and social housing. At the May 2014 meeting of the PISC, it was agreed that, whilst an illiquidity premium had its attractions, further review was needed.

PISC 2 December 2014

At the meeting on 2 December 2014, Members considered propositions for investment in illiquid assets and expressed concern over the illiquidity aspects. It was agreed that he Committee needed more information before making any firm commitment in either asset class or amount.

It was agreed, however, that AllenbridgeEpic should consider alternative ways in which to improve investment returns whilst *maintaining liquidity* and transparency and present them at the next meeting of the PISC to be held on 24 February 2015.

PISC 24 February 2015

The Sub-Committee received a short presentation from AllenbridgeEpic which highlighted an investment opportunity from Fidelity Investment Management. This opportunity provided for an absolute return strategy, funded from the existing UK Aggregate Bond Fund which focussed on eleven key investment themes primarily using derivative based contracts. From a return perspective the fund sought to generate a target return of 1.5% to 3.0% over cash (one month EURIBOR), gross of fees which would be in the 40/50 bps range.

Whilst not dismissing this product out of hand, the Committee agreed that they would have preferred to measure the FIDA opportunity against another product offering, which perhaps included more physical investments.

Current fixed income Structure

L B Bromley Pension Fund is currently holding £118.2m (15.9%) of the total fund in fixed income assets (31 March 2015), split between Baillie Gifford £51.6m (6.9%) and Fidelity £66.6m (9.0%) in pooled funds, both of which have moderate outperformance targets over their respective benchmarks.
Members should note that the long term strategic allocation to fixed income is 20%. The underweight has primarily been caused, not by poor performance by the managers, but by

central bank actions on interest rates and quantitative easing keeping rates at minimal levels, this, coupled with strong equity performances (also a product of low interest rates), has forced the overall percentage holding in fixed income, at the total fund level, to fall to 15.9% (31 March 2015) from 16.6% as at 31 March 2014.

17 May 2015 Pension Investment sub Committee meeting

In response to the request from the PISC at their last regular meeting on 24 February 2015, Baillie Gifford and Fidelity were asked to consider how they could refine their respective current investment mandates in order to broaden their investment opportunity set, but at the same time retaining liquidity. Recommendations, in the form of short written papers, as to how they would manage this increased flexibility are attached in Appendix A. In addition, both managers will be in attendance at the meeting on 19 May 2015 to present their recommendations and to respond to questions.

Alick Stevenson
AllenbridgeEpic Investment Advisers

APPENDIX A

Baillie Gifford

Potential Amendments to LB of Bromley Bond Mandate

Background

This paper explores the effect of potential changes to the share of London Borough of Bromley's bond portfolio managed by Baillie Gifford.

Current investments

Your existing bond portfolio is invested in the Baillie Gifford Sterling Aggregate Plus Fund. This fund is managed against a benchmark made up of 50% UK government bonds (gilts) and 50% sterling investment grade non-gilts.

This benchmark is quite typical for the bond investments of UK pension funds with similar characteristics and objectives to those of Bromley. The underlying assets are liquid and mainstream and denominated entirely in sterling. Because the non-gilts are all investment grade bonds, they are highly correlated with gilts.

The risk framework of the mandate gives Baillie Gifford the scope to invest opportunistically in attractive bonds outside this narrow benchmark. For example, we have recently benefited from having around 5% in high yield bonds. We believe that there are sufficient degrees of freedom for us to add value relative to the benchmark over the investment cycle of around 1.5% per annum.

However, we have now reached the point at which the yield on the 50:50 aggregate bond index has fallen to close to 2%, driven by lower gilt yields. We can infer from this that future returns from this market are likely to be low, our ability to out-perform our benchmark notwithstanding.

This extreme market situation has led many clients to ask how their bond investments might be improved. In answer, we see scope for potential improvements in three directions:

- Increasing expected returns
- Reducing the volatility of the bond portfolio's returns
- Widening the scope of the manager to add value over the benchmark

In this paper we analyse the effect that two amendments to Bromley's existing portfolio would have on these factors. It should be noted that none of the material in the paper constitutes advice, that actual outcomes may differ significantly from our projections and that the analysis is not specific to your liabilities or other investment factors.

Potential additions

Two new strategies are evaluated: Global Credit and Local Currency Emerging Market Bonds. The assumption is that additions of up to 5% is made in each, funded from the existing bond portfolio.

Global Credit

Credit, or non-government bonds, is already 50% of your bond benchmark. This is a well-established market sector with good liquidity and depth. It is viewed as an attractive part of clients' portfolios because, over time, the extra yield in this type of bond compared to gilts has more than compensated for the higher risk of default.

Global Credit differs from your current investment in credit in two ways. First, it invests in corporate bonds across all developed market currencies rather than predominantly sterling. Secondly, it invests more in bonds with lower credit ratings. These differences are partly a reflection of its benchmark, the Barclays Global Credit index and partly because the strategy has been designed to have fewer investment constraints than your existing strategy.

One important point to make, however, is that our policy in Global Credit is to hedge the currency risk that arises from its global investments back to sterling. Thus no direct currency exposure would arise from investing in this Fund.

The change in overall investment characteristics which these two factors bring your portfolio brings is as follows:

1. More High Yield

Global Credit's benchmark has 18% in sub-investment grade (high yield') bonds. However we concentrate on improving BB-rated bonds at the higher quality end of this spectrum and do not expect to have significant investments at lower ratings i.e. B and, in particular CCC. We believe that these higher quality BB bonds are part of an investment 'sweet spot' where we can find the most attractive bonds on a risk-return basis and so we have given the strategy latitude to take significant over-weights in this area. So, at the end of last month we had a 24% overweight in BB-rated bonds by money weight as opposed to a 4% under-weight in B and CCC.

High yield is, in our view, an attractive asset class over the economic cycle. Investors have been systematically over-compensated for the risk of default over a sustained period. While the market volatility is greater than your existing investments, investors with longer investment horizons can reasonably choose to look through this in the interests of better returns.

Importantly, high yield has historically been only loosely correlated with investment grade bonds. This means that its higher volatility will have less of an effect when twinned with an investment grade portfolio. This helps explain why the Global Credit benchmark has exhibited similar volatility to the purely investment grade all-non gilt index. The reason for its low correlation is that high yield issuers usually benefit from economic upswings because their earnings improve, helping improve their credit status. Conversely, strong economic conditions tend to hurt investment grade bonds because gilt yields rise and this market sector is closely tied to gilts.
Greater international diversity

The other prominent difference in Global Credit is that its issuer base is more international. This, we believe, is beneficial for two reasons. First, it makes the index less prone to domestic economic factors. This makes for better economic diversity. Secondly, it gives our investment team a broader opportunity set with around 13,000 issues in the index. This greater choice is one of the factors behind our decision to target a more ambitious performance target in this strategy.

Taken together, on the basis of past experience, a modest allocation to Global Credit can boost expected returns without greatly increasing volatility.

Emerging Market Bonds

Many of our clients are being advised to add emerging market (EM) bonds to their portfolio mix. The economic case is that the average emerging economy has less debt and better growth than the UK and their bond markets have significantly higher yields. EM bonds have cheapened recently – particularly in sterling terms as currencies weakened - in contrast to the trend in developed market bonds. With a different economic cycle, EM bond returns are less correlated with gilts and sterling corporate bonds than most other bond types.

The asset class is not without its risks and recent events in Russia (a 4.2% weight in the strategy's benchmark index, the JP Morgan GBI-EM Global Diversified) underscore this. Inflation remains higher than in developed markets and so one has to 'aim off' from the high headline yield. Nevertheless, the positive longer term economic fundamentals underpin the case for investment.

We have chosen to invest in so-called 'local currency' bonds in our Fund rather than 'hard' currency (i.e. mainly dollars, as well as sterling, euro and yen to a lesser extent). We did so because we believed that clients would prefer the greater diversification benefit that other currencies bring and also because there is a clear trend towards emerging countries choosing to issue in their own currencies. Hard currency bonds are more akin to corporate bonds and hence less of a diversifier.

This does mean that investing in this strategy brings foreign currency exposure. We manage this investment aspect actively, and often see a currency over-weight as the best means to exploit an improving economic trend or, conversely, under-weight a currency where there is a deterioration in store. Our expectation is that many emerging nations will see their currencies strengthen against sterling in time as they narrow the productivity gap with developed economies. However, this will probably not be a smooth journey and one can reasonably anticipate volatility periodically.

In time, we anticipate that many emerging markets will see their currencies appreciate versus those of developed markets owing to their greater potential improvement in productivity. We have witnessed this in the past in countries like Japan and Korea. In the meantime, there is additional volatility, albeit rewarded with higher interest rates. This is one reason that most advisors suggest relatively low weights in the asset class at this stage.

We believe that emerging market bonds, as a nascent asset class, are quite inefficient. In other words, bond and currency values can fail to reflect economic fundamentals for an extended period. This inefficiency gives us the potential to outperform its benchmark in time as active investors.

Making a modest allocation to EM bonds will add somewhat to overall volatility but is likely to add to expected returns and increase portfolio diversity.

Other considerations

1. Interest rate sensitivity

Making investments in these areas would reduce the sterling interest rate sensitivity of your portfolio. This might be seen as a disadvantage if the Fund took a 'matching' or 'liability-driven' approach which generally involves buying long maturity bonds or proxies for these instruments. However, the recent strategic review did not advise this investment approach at this stage. Instead, it advocated making assets 'work harder' in order to improve returns. This proposal fits well with boosting returns.

Buying more long dated bonds at today's low yields is unlikely to result in good returns.

2. Credit ratings

Many clients have concerns about lower credit quality bonds. We see a marked increase in risk in corporate bonds rated B or below and do not anticipate significant investments in this area. BB and BBB rated bonds are viewed as lying in an investment 'sweet spot' in which there is a balance between value and the potential for us to find improving credits. For this reason, you can anticipate Global Credit having over-weights in this bans rather than very low ratings.

Currently, the benchmark index used by our EM bond fund does not have any bond rated lower than BB and its average credit rating is BBB. While we may make some opportunistic investments in lower rated bonds, this will not be a significant part of the portfolio (currently 2.3%).

Conclusion

Overall, we believe Global Credit and EM bonds could help Bromley to diversify its bond exposure and raise the performance target of its portfolio. In this respect, there are clear parallels with the decision previously made to adopt a global approach to investing in Equities.

While yields in Global Credit have fallen, the inclusion of high yield bonds provides a meaningful cushion over the yield obtainable in the existing portfolio. This is not without risks, but high yield is an asset class that has well established attractive risk-return characteristics.

Emerging countries have superior economic characteristics to the UK in many respects and their bond yields have been less distorted by quantitative easing. Most commentators expect growth to be better than in the West both in the short and long-term. Nevertheless, economic and political institutions are underdeveloped and corruption is a continuing problem. We anticipate EM bonds to be higher returning than gilts over the longer term but to remain more volatile for some time. A modest investment is nonetheless merited.

We see both Global Credit and EM bonds as fruitful areas for active investment. Both areas are, in our opinion, inefficient and lend themselves to fundamental research. Our Funds both have higher performance targets than your existing mandate and we believe this is justified by the potential for active management.

The scale of potential investment, as we understand it, is up to 10% of your existing portfolio into the new strategies. Clearly, this will not be transformational but would boost the overall yield on your bonds by around 0.25% while reducing duration (interest rate sensitivity) by about 0.4 years.

So we see genuine benefits in diversification for Bromley through extending in either of these directions. The additional volatility of the additional strategies should be dampened by diversification effects. While the most obvious benefit will be the boost to yield, we also believe that both fields are attractive arenas for active management, hence our higher performance targets.

We look forward to discussing these potential changes with you in due course.

Baillie Gifford & Co
April 2015

Fidelity Investment Management

London Borough of Bromley: Fixed Income Proposal

The Current Fidelity Mandate

The existing fixed income mandate of £66.6m is managed relative to a market benchmark (the IBOX Composite) which is made up of 50% UK Government and 50% UK Non-Government Fixed Income Securities. Our target is to outperform this benchmark by 0.75% p.a. over rolling 3-year periods.

Fixed income markets have delivered strong returns in recent years against a backdrop of benign inflation and low interest rates, and we have added additional value over and above the market gains. Over the last 3 and 5 years the fund has returned +8.4% pa and +9.0% pa respectively, comfortably beating the benchmark returns of +7.2% pa and +7.8% pa by +1.2% pa over both time frames.

Moving Forward

The key question for the future is what will happen when the current ultra-low interest rate environment ends and interest rates rise to more normal levels. Much will depend on the speed and magnitude of future rate rises, which in turn depend on the strength of economic growth and inflation and it is possible that interest rates will remain lower for longer than many people expect. However, we have looked at various scenarios and it seems clear that if interest rates 'normalise', conventional market based fixed income portfolios are likely to see capital values fall. If interest rates rise only slowly then there will be a lesser negative impact on conventional bond portfolios, but the scope to earn the sort of returns seen in the last few years is much reduced.

We believe that the solution is to start to introduce an absolute return portfolio alongside the traditional long only approach which we have followed to date. This would provide scope to preserve capital value and to exploit a wider set of investment opportunities.

An absolute return strategy would eliminate market exposure and remain broadly market neutral over the full market cycle. In other words, the portfolio would have zero years 'duration' (compared, for example to your existing portfolio duration of 9 years) and so offer downside protection as interest rates rise.

Our Recommendation: Fidelity Fixed Income Diversified Alpha (FIDA) Fund

The Fixed Income Diversified Alpha (FIDA) Fund employs an absolute return strategy unconstrained by traditional, benchmark-bound performance objectives to offer investors returns relative to cash. The strategy blends a global macroeconomic outlook with Fidelity's bottom up approach to investing; optimising a best ideas approach to security selection within a global opportunity set to deliver attractive risk adjusted returns.

We believe that the quality and depth of fundamental research produced by the Fidelity Fixed Income Team allows this philosophy to be successfully implemented to deliver superior risk-adjusted returns compared to a long only, benchmark constrained strategy.

Fidelity FIDA

The FIDA strategy combines diverse sources of alpha, preventing any single position from dominating portfolio risk. Ideas are usually implemented through "pair trades", combining a long and a short position.

Each position is categorised into one of 11 different types of alpha strategy and appropriately sized based upon level of conviction, volatility and correlation criteria.

Key Benefits

Low Volatility & Attractive Risk-Adjusted Returns: The fund aims to deliver cash + 150–300 bps* with a target volatility of 2-5%. FIDA limits the risk of capital losses.

Diversification: Recent years have seen a broad trend towards a more flexible approach to investing, unconstrained by a benchmark. FIDA is broadly market neutral; it may invest in any sector or asset class in Emerging and Developed market debt.

Strong Capital Preservation: The strategy is ideal for investors looking to diversify a growth portfolio with a stabilising vehicle.

A competitive edge: co-management structure

Within our investment teams, we combine home grown talent with experience. Our equity and Fixed Income research teams are two of the largest on the buy-side. Peter Khan and Tim Foster are the portfolio managers and their respective trading and quantitative backgrounds combine to provide the broad base of knowledge and experience necessary for the successful management of the FIDA strategy.

Our process is entirely transparent, integrated and collegiate. Research from the Credit, Quantitative, Trading and Product teams is made available to the entire Fixed Income team, so that every decision is taken with a holistic view.

Conclusion

After a long and successful period for conventional market referenced fixed income investors, there are growing concerns that capital will be at risk as bond yields eventually rise from their historic lows.

We believe that investors should consider moving towards a more broadly based, largely market neutral approach and propose the Fidelity FIDA, initially as a complement to the existing mandate.

We think that a sensible first step might be to consider an allocation of, say, 10% to FIDA to sit alongside the existing portfolio. The initial allocation might then be increased as discussions with your advisors and the economic environment evolve.

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Report No.
FSD15030

London Borough of Bromley

PART 1 - PUBLIC

Decision Maker:	**Pensions Investment Sub-Committee**		
Date:	**19th May 2015**		
Decision Type:	Non-Urgent	Non-Executive	Non-Key
Title:	**IMPACT OF EXCHANGE RATES**		
Contact Officer:	Martin Reeves, Principal Accountant (Technical & Control) Tel: 020 8313 4291 E-mail: martin.reeves@bromley.gov.uk		
Chief Officer:	Director of Finance		
Ward:	All		

---

1. Reason for report

At the last meeting of the Sub-Committee in February, it was agreed that Alick Stevenson (Allenbridge Epic) would submit a report to this meeting on the effect that exchange rates have on transactions and profits. This report is attached at Appendix 1.

RECOMMENDATION(S)

The Sub-Committee is asked to note the report.

Corporate Policy

1. Policy Status: Existing policy. The Council's Pension Fund is a defined benefit scheme operated under the provisions of the Local Government Pension Scheme (LGPS) Regulations 2013, for the purpose of providing pension benefits for its employees. These regulations allow local authorities to use all the established categories of investments, e.g. equities, bonds, property etc, and to appoint external investment managers who are required to use a wide variety of investments and to comply with certain specific limits.

2. BBB Priority: Excellent Council.

Financial

1. Cost of proposal: No cost

2. Ongoing costs: N/A.

3. Budget head/performance centre: Pension Fund

4. Total current budget for this head: £35.8m expenditure (pensions, lump sums, etc) - provisional outturn £35.0m; £38.6m income (contributions, investment income, etc) - provisional outturn £40.4m; £744.0m total fund market value at 31st March 2015

5. Source of funding: Contributions to Pension Fund

Staff

1. Number of staff (current and additional): 0.4 fte (current)

2. If from existing staff resources, number of staff hours: c14 hours per week

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Legal

1. Legal Requirement: Statutory requirement. Local Government Pension Scheme (LGPS) Regulations 2013

2. Call-in: Call-in is not applicable.

Customer Impact

1. Estimated number of users/beneficiaries (current and projected): 5,782 current employees; 4,948 pensioners; 5,066 deferred pensioners as at 31st March 2015

Ward Councillor Views

1. Have Ward Councillors been asked for comments? No.

2. Summary of Ward Councillors comments: N/A

3. COMMENTARY

3.1 In February 2015, the Sub-Committee agreed that a report should be prepared on the potential impact of foreign currency exchange rates on Fund transactions and, therefore, on returns. The Fund's independent advisers, AllenbridgeEpic, have prepared a brief report and this is attached at Appendix 1.

4. POLICY IMPLICATIONS

4.1 The Council's Pension Fund is a defined benefit scheme operated under the provisions of the Local Government Pension Scheme (LGPS) Regulations 2013, for the purpose of providing pension benefits for its employees. These regulations allow local authorities to use all the established categories of investments, e.g. equities, bonds, property etc, and to appoint external investment managers who are required to use a wide variety of investments and to comply with certain specific limits.

5. FINANCIAL IMPLICATIONS

5.1 None at this stage.

Non-Applicable Sections:	Legal and Personnel Implications
Background Documents: (Access via Contact Officer)	LGPS (Administration) Regulations 2008 (as amended) and LGPS Regulations 2013. LGPS (Management & Investment of Funds) Regulations 2009.

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APPENDIX 1

REPORT ON

CURRENCY HEDGING

PREPARED FOR

London Borough of Bromley

19 May 2015

Alick Stevenson

AllenbridgeEpic Investment Advisers Limited (AllenbridgeEpic)

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Currency exposure within a UK Pension Fund

The London Borough of Bromley Pension Fund has exposure to various currencies primarily through its holdings in overseas equities, it also has some exposure in assets held within the smaller fixed income and diversified growth portfolios. Thus, its investment in non-sterling denominated assets can make a positive or negative contribution to overall investment performance as the value of the invested currency fluctuates.

Example:

A manager has a £100 million investment in US equities. The exchange rate is $1.60, which equates to a dollar value of $160 million. If sterling appreciates to $1.70 (and assuming the equity market stays flat), the sterling value of that portfolio now falls to £94.1 million. By hedging the currency exposure, the portfolio would still be worth £100 million, because the sterling loss in value would be offset by a gain on the forward foreign exchange contract.

However, if sterling were to depreciate to $1.50, the sterling value of the holding would increase to £106.7 million. In this case, the currency hedging strategy would make a loss, offsetting the gain in the equity portfolio.

Is there an investment case for currency hedging?

Traditionally, academics used to recommend that pension funds unilaterally hedged around half of their currency exposure on risk diversification grounds. This, they argued, would lead to a more efficient risk adjusted return stream. However, research conducted by Elroy Dimson, Paul Marsh, and Mike Staunton of the London Business School published in 2012 concluded the following:

- Overseas equities perform best after periods of currency weakness. As the example above demonstrates, investors gain when a foreign currency appreciates (and sterling depreciates) and suffer losses when that currency depreciates (and sterling appreciates). Because of this diversifying relationship between equity performance and currency performance, *the authors concluded that un-hedged exposure was most effective at reducing the volatility of the portfolio (my italics)*

For bonds the picture was much less clear. Overseas bond investment added to portfolio risk primarily through currency exposure. Short-term currency hedging was found to be beneficial although these benefits were reduced with longer investment horizons.

There are essentially four mainstream methods by which Pension Funds can hedge currency exposure

1. Passive
2. Dynamic
3. Active currency overlay
4. Tactical currency hedging as part of an underlying portfolio

- **Passive hedging.** In this case, an investment manager, or the pension fund's custodian, routinely hedges a pre-agreed, fixed percentage of the currency exposure in the portfolio, or by hedging the benchmark weights in the index, typically by entering into forward foreign exchange contracts with rolling three-month periods. At the end of each three months, the changes in currency values are cash settled and new currency forward positions are put in place.

As managers are factoring currency into their investment decisions, hedging a fixed amount on a "plain vanilla" 90 day forward contract basis might in fact increase volatility of investment returns.

If sterling appreciates, the cash settlement on the forward currency is positive (this offsets the loss on the underlying portfolio). If sterling depreciates, the forward exchange contract settles at a loss and this is offset by the gain in the value of the underlying portfolio.

Historically, the Fund would be asked to pay across cash at maturity, although this is typically offset by an equivalent book or unrealised gain in the underlying portfolio. In periods of continued sterling depreciation, these cash calls could become significant.

Today's markets, being what they are, most FX counterparties insist on forward contracts being collateralised, and thus any loss/gain on the contract would need to be matched by a cash transfer on a daily basis.

These "real cash" transfers are potentially significant if a Fund is operating within a cash flow neutral or more particularly a cash flow negative environment and may force the fund to liquidate assets if the call is significant.

- **Dynamic hedging.** In this case, the fund manager will vary the amount hedged according to sterling's strength or weakness. The more the foreign currency appreciates, the less the manager hedges, and vice versa. The effect of this strategy is to generate an option-like payoff that captures most of the benefits of foreign currency strength but offers some protection in periods of domestic currency strength.

  Note that this strategy has similar cash payment flows as for a passive hedging approach (although the amounts will differ).

- **Active currency overlay management.** This is where a fund manager uses active skills and judgement to anticipate when currencies are appreciating and when they are weakening. Managers use fundamental and/or quantitative analysis to assess whether currencies are over- or under-valued, and position the portfolio accordingly.

  Arguably this is not a strategic currency hedging approach, as such, yet in the past some funds have argued that this approach offers them the twin benefits of both reducing portfolio risk and increasing potential return (because of the active selection decisions). Unfortunately, the poor performance of many active currency managers during the credit crunch earned active currency overlay management a bad name, and has led to a considerable number of pension funds withdrawing from this approach. This approach also requires the Pension Fund to provide the overlay manager with investment data, at currency level, from the managers, (typically via the custodian). There is an increase in documentation and a continued additional governance element to this method. As the overlay manager is operating in parallel to the main fund there is also the risk of "cash calls" in similar vein to methods 1 and 2 above.

- **Tactical currency hedging as part of the underlying portfolio.** A fourth option is to delegate responsibility for currency hedging to the investment manager responsible for the overseas investments. Typically, managers can be persuaded to take tactical decisions to hedge currencies in the short term, as part of their investment decisions. Bond managers are more

inclined to do this than equity managers. A major advantage of this approach is that the cash settlement on any forward foreign exchange contract must be dealt with by the investment manager as part of their portfolio administration.

According to WM research, only 20% to 25% of LGPS funds hedge currency exposure depending on the nature of their investment mandates. Active currency mandates remain relatively few and far between, and have fallen significantly from around twenty, five years ago to just two at year end 2014.

The Bromley Fund pre transition to global equity mandates

In the latter part of 2012 and before the transition from regional to global mandates in 2013, currency exposures within the Fund were reviewed for the period 30 June 2011 to 30 June 2012.

At that time, ***Fidelity*** was running several regional equity mandates all of which were at or near to their respective benchmarks and as a result had very few "active" money positions. It is important to note that as the indices against which the various mandates were invested were unhedged, the impact on overall investment performance was negligible.

Baillie Gifford however, used their asset class bandwidth to make tactical under and overweight investment decisions, and as a result of these "active" money investments deviated from the unhedged benchmark index, thus creating a currency exposure, ***albeit still small and without significant impact to overall Fund performance.***

The subsequent shift from regional mandates to more active global mandates, adding BlackRock and MFS to Baillie Gifford changed the dynamic somewhat, as each of the three managers, whilst being measured against a global index plus target out performance, have different investment styles.

Investment manager performance attribution for the period 31 December 2013 to 31 December 2014

Manager	Total Return Fund	benchmark	Asset Alloc	Stock select	Currency Effect	Total
Baillie Gifford	12.0	11.2	1.0	-0.4	0.2	0.8
BlackRock	14.8	11.2	1.1	2.3	0.2	3.6
MFS	13.4	12.1	-0.8	2.8	-0.7	1.3

Source: Baillie Gifford, BlackRock, MFS

The above table gives the breakdown of the two main areas of investment performance, asset allocation, stock selection and in this example, also includes currency attribution at manager and portfolio level. *However, when the currency attribution is taken into account at a* ***total fund level***

***and not just for the global equities** then the overall impact on performance was just -0.03% for calendar year 2014.*

Each of the three global equity managers were asked to comment on the way in which they integrate currency matters into the investment decision to buy or sell a particular stock.

Interestingly, whilst they have different investment styles, the decision processes taken to reach buy sell decisions are all very similar, thus there is a remarkable similarity in their responses

Baillie Gifford

“We do not make separate or active currency decisions in our global alpha strategy. Although currency decisions are factored into the overall stock selection process and will contribute in a decision to buy or sell a specific holding”.

Over the period under review currency attribution was 0.2% of the overall investment return of 0.8%.

BlackRock

“We do not explicitly forecast currencies or directly seek to take currency risk in any of our stock selection models. However a number of macro themes which we do trade, seek to position the portfolio towards/away from particular countries/economies. These can therefore provide the portfolio with indirect exposure to FX risk relative to benchmark”.

Over the last twelve months, currency positions accounted for just 0.25% of the investment out performance of 3.6%., a small element of the risk/return equation.

MFS

"The MFS Global Value strategy does not seek to add value by speculating on the direction of currencies and is, therefore, generally unhedged. Whilst a currency hedge may be undertaken in order to protect the value of an underlying holding during times of political, economic or financial crisis, MFS rarely take this step.

While MFS do not typically hedge currency at the portfolio level, it should be noted that their analysts must consider the effect that currency valuations will have on each company's growth projections. When looking at downside risk associated with any company, currency plays a very important role in the stress testing conducted by MFS's analysts. Stress tests, which they run for all companies, examine the potential risk on a company's bottom-line earnings associated with any movement in relevant currencies and the subsequent effect on that stock's performance. In that way, potential currency impacts are built into MFS's valuation process through their fundamental, bottom-up research at the individual stock level."

For the period under review MFS posted a -0.7% currency attribution within the overall return of 1.3%.

Other assets within the overall portfolio

As far as fixed income and diversified growth funds are concerned, both will have some element of currency exposure/risk within them. Some diversified growth funds actively invest in currency pairs (Standard Life GARS) as an asset class. Some fixed income funds will hedge currency back to sterling thus stripping out currency risk from the interest rate on the foreign currency denominated bond. However, given the relative size of these mandates within the Bromley Fund, there is only a very small element of performance attribution.

Summary

Our global equity managers recognise currency as an integral, but small part of their stock selection investment process, but are not driven by it.

The table on page 4 clearly shows the extent to which currency movements impacted the overall investment performance of each manager during the calendar year 2014.

It should also be noted that significant detail on currency hedging, interest rate management and related matters are all contained and explained at length in company Annual Reports

Currency movements, implicit in the global equity portfolios, will have an impact/risk on overall investment performance, however, given the magnitude of that impact over the 12 months to end December 2014 it is recommended that no further action in respect to currency hedging, apart from regular monitoring and reporting, should be taken.

Other issues such as asset allocation, sector weightings and stock concentration risks, implicit within multi portfolios in the same asset class, can have far greater impact on overall investment performance. These are already monitored closely and reported on a quarterly basis.

Alick Stevenson

AllenbridgeEpic Investment Advisers