Report No.
FSD14076

London Borough of Bromley

PART 1 - PUBLIC

Decision Maker:	**Pensions Investment Sub-Committee**
Date:	**2nd December 2014**
Decision Type:	Non-Urgent Non-Executive Non-Key
Title:	**PENSION FUND PERFORMANCE Q2 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. <u>Reason for report</u>

This report includes details of the investment performance of Bromley's Pension Fund in the 2nd 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 will be present at the meeting to discuss performance, economic outlook/prospects and other matters relating to the three portfolios under their management. They have provided a brief commentary on their performance and on their 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

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: Recurring cost. Total administration costs estimated at £2.5m (includes fund manager/actuary 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); £41.6m income (contributions, investment income, etc); £655.9m total fund market value at 30th September 2014)

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): 5,355 current employees; 4,930 pensioners; 4,931 deferred pensioners as at 30th September 2014

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 rose during the September quarter to £655.9m (£637.0m as at 30th June 2014). The comparable value one year ago (as at 30th September 2013) was £601.8m. At the time of writing this report (19th November 2014), the Fund value had risen further to £688.8m. Historic data on the value of the Fund, together with details of distributions of the revenue fund surplus cash to the fund managers and movements in the value of the FTSE 100 index, are shown in a table and in graph form in Appendix 1. Members will note that the Fund value tracks the movement in the FTSE 100 fairly closely, even though, since 2006, only around 30% of the fund has been invested in the UK equity sector.

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 further review of the Fund's investment strategy. This review concluded, however, that the growth element would, in future, comprise a 10% investment in Diversified Growth Funds (DGF - a completely new mandate) and a 70% allocation to global equities. The latter would involve the elimination of our current arbitrary regional weightings, which would provide 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 (a 10% allocation to Diversified Growth Funds) 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 (a 70% allocation to Global Equities) 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 <u>Performance data for 2014/15 (short-term)</u>

A detailed report on fund manager performance in the quarter ended 30th September 2014 is provided by the fund's external adviser, AllenbridgeEpic, in Appendix 5. In overall terms, the total fund returned +3.0% in the latest quarter, which matched the overall benchmark return of +3.0%. This followed an overall return of +1.6% in the June quarter, which compared to an overall benchmark return of +2.3%. With regard to the local authority average, the fund's performance in the September quarter was in the 7th percentile and, in the June quarter, it was in the 81st percentile. 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, so it is perhaps reasonable to assume that this was, partly at least, due to the new managers "bedding in". In local authority average terms, the September quarter performance was 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 (the lowest rank being 100%). For comparison, the rankings in recent 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 30th September 2014 (in the 34th percentile for one year, in the 3rd percentile for three years, in the 6th percentile for five years and in the 3rd percentile for ten years). The longer term results in particular were very good and 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 30/9/14				
1 year (1/10/13 to 30/9/14)	9.3	9.9	8.5	34
3 years (1/10/11 to 30/9/14)	14.9	13.0	11.7	3
5 years (1/10/09 to 30/9/14)	10.7	9.1	8.9	6
10 years (1/10/04 to 30/9/14)	9.9	8.5	7.8	3
Financial year figures				
2013/14	7.6	6.2	6.4	29
2012/13	16.8	14.0	13.8	4
2011/12	2.2	2.0	2.6	74
3 year ave to 31/3/14	***8.7***	***7.2***	***7.5***	***19***
2010/11	9.0	8.0	8.2	22
2009/10	48.7	41.0	35.2	2
5 year ave to 31/3/14	***15.8***	***13.4***	***12.7***	***3***
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
2004/05	10.6	11.7	11.7	75
10 year ave to 31/3/14	***9.6***	***8.3***	***7.8***	***2***

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 At the last meeting in August, a programme of fund manager attendance was agreed (as set out below) and Baillie Gifford, who currently manage three separate portfolios (global equities, DGF and fixed income) will attend this meeting to discuss performance and other matters. Blackrock and MFS (both global equity managers) will attend the next meeting (on 24th February 2015) and Fidelity (fixed income) and Standard Life (DGF) will attend the meeting on 19th May 2015. By the end of 2014, the global equity managers will all have completed their first year and the Diversified Growth managers will have completed two years and these meetings will provide Members, advisers and officers with opportunities to discuss and ask questions on performance and activities.

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 actual position of the 2014/15 Pension Fund Revenue Account (as at 30th September 2014) are provided in Appendix 4 together with fund membership numbers. A net surplus of £1.5m was achieved in the first half of 2014/15, (lower than expected, mainly due to an unusual excess of transfer values payable over receivable) and total membership numbers rose by 281. The overall proportion of active members has, however, declined in recent years and has fallen from 36.4% at 31st March 2012 to 35.2% at 30th September 2014.

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

Appendix 1

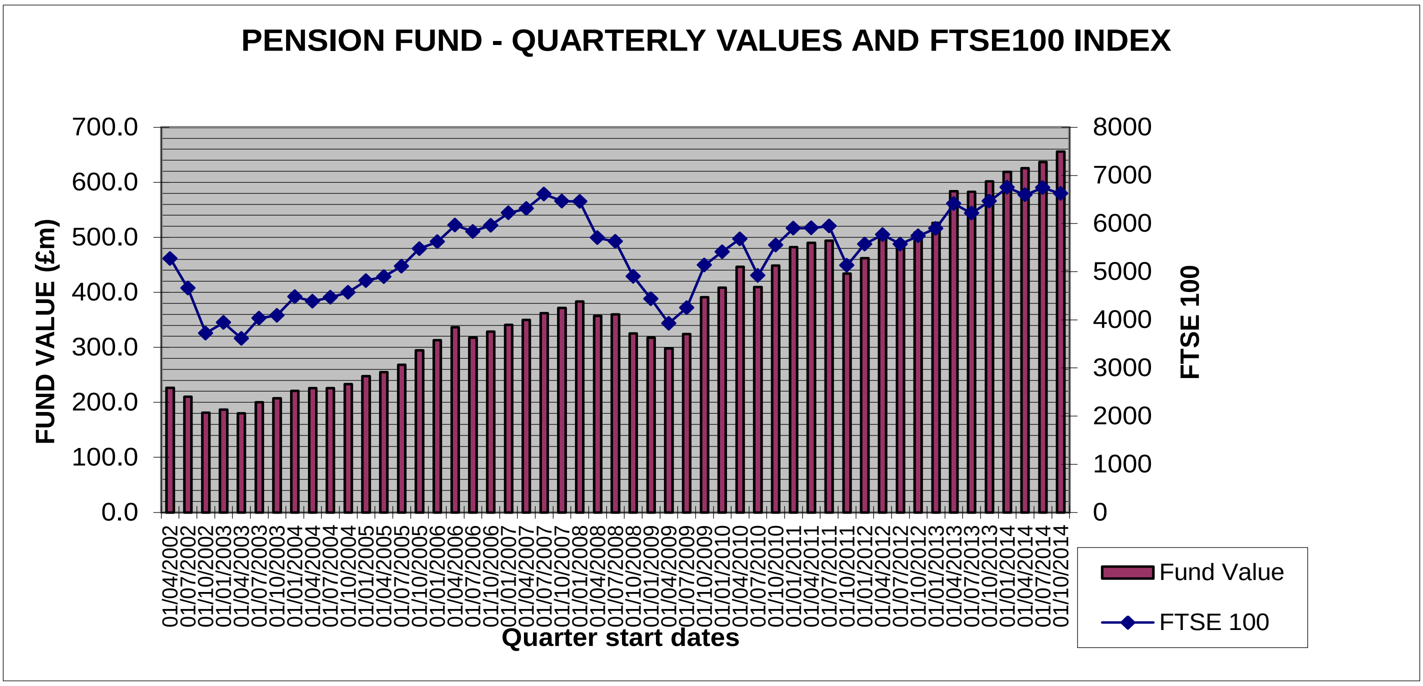
MOVEMENTS IN MARKET VALUE & FTSE100 INDEX

Market Value as at	Fidelity#	Baillie Gifford	CAAM	Black-rock	Standard Life	MFS	Total	Revenue Surplus Distributed to Managers*	FTSE 100 Index
	£m	£m	£m	£m	£m	£m	£m	£m	
31 Mar 2002	112.9	113.3	-	-	-	-	226.2	0.5	5272
31 Mar 2003	90.1	90.2	-	-	-	-	180.3	-	3613
31 Mar 2004	112.9	113.1	-	-	-	-	226.0	3.0	4386
31 Mar 2005	126.6	128.5	-	-	-	-	255.1	5.0	4894
31 Mar 2006	164.1	172.2	-	-	-	-	336.3	9.1	5965
31 Mar 2007	150.1	156.0	43.5	-	-	-	349.6	4.5	6308
31 Mar 2008	151.3	162.0	44.0	-	-	-	357.3	2.0	5702
31 Mar 2009	143.5	154.6	-	-	-	-	298.1	4.0	3926
31 Mar 2010	210.9	235.5	-	-	-	-	446.4	3.0	5680
31 Mar 2011	227.0	262.7	-	-	-	-	489.7	3.0	5909
31 Mar 2012	229.6	269.9	-	-	-	-	499.5	-	5768
31 Mar 2013	215.7	342.1	-	-	26.1	-	583.9	-	6412
30 June 2013	216.5	339.9	-	-	26.0	-	582.4	-	6215
30 Sept 2013	223.5	352.3	-	-	26.0	-	601.8	-	6462
31 Dec 2013@	56.7	290.7	-	121.8	26.9	122.7	618.8	-	6749
31 Mar 2014	58.4	294.9	-	122.1	27.0	123.1	625.5	-	6598
30 June 2014	59.7	298.0	-	126.5	27.3	125.5	637.0	-	6744
30 Sept 2014	61.5	305.2	-	131.6	28.1	129.5	655.9	-	6623
19 Nov 2014	63.0	320.4	-	138.9	28.4	138.1	688.8	-	6697

* Distribution of cumulative surplus during the year.

£50m equity sale 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.



Appendix 2

Baillie Gifford Report for the quarter ended 30 September 2014

Quarterly portfolio information

Summary portfolio valuation and performance			
	30 Jun 2014	**30 Sept 2014**	**3 month Performance to 30 Sept 2014**
Global Alpha (gross)	£208,925,607	£213,321,627	2.1%
MSCI ACWI			*3.2%*
Diversified Growth (net)	£43,044,755*	£43,767,275	1.7%
Base rate +3.5%			*1.0%*
Sterling Aggregate (gross)	£46,133,655	£48,144,437	4.3%
50% FTSE Actuaries UK Conventional Gilts All Stocks Index & 50% BoAML Sterling Non-Gilt Index			3.3%
*Note: *Reflects an additional investment of £15,668,316 into the portfolio*			

Longer Term Performance

Performance to 30 September 2014 (%)

	Fund Gross	Fund Net	Benchmark
Since Inception* (Cumulative)	145.8	137.6	114.6
Since Inception* (p.a.)	6.3	6.0	5.3
Five Years (p.a.)	11.1	10.9	9.1
One Year	7.7	7.3	10.1
Since 31/12/13**	4.8	4.5	6.4
Quarter	2.1	2.1	3.2

*31 December 1999
** Global Alpha performance measurement began on 31 December 2013
Source: StatPro

Baillie Gifford was appointed in 1999 to manage a multi asset portfolio for the London Borough of Bromley. This portfolio was re-organised in December 2013 to the new mandate, Global Alpha, with funds being transferred to separate bond and Diversified Growth portfolios. The longer term performance of the Global Alpha portfolio therefore incorporates the longer term performance of the multi-asset portfolio.

Background

The global equity index rose by 3.2% (in sterling terms) over the quarter. The US economy continued to gather momentum as rising business investment and industrial production offset slack in the labour market. In contrast to a myopically short-term market narrative, we view tapering as a broad positive and have been looking to focus our research efforts on companies that will benefit from a normalisation of monetary policy. In Europe concerns have mounted that a nascent recovery might fall victim to the spectre of both sustained deflation and geopolitical warmongering. However the robust response of the European Central Bank and the developing political consensus away from austerity to more growth-orientated policies gives us reassurance that progress is being made, albeit in a volatile manner.

Emerging market growth has moderated, reined in by the vulnerability of commodity-centric economies (South Africa, Brazil, Russia, and Indonesia) to large current account deficits, structurally inefficient labour markets and inflationary pressures. However the pace of technological change being witnessed in Asia remains hugely exciting. Nowhere is this evolution more evident than in the achievements of Chinese internet companies; a pace of change starkly highlighted by the listing in New York on September 19th of the Chinese ecommerce platform, Alibaba.

Global Alpha Portfolio

We recently produced a progress report on our annual research agenda, highlighting a number of themes where we are focussing our research efforts. We continue to search for opportunities in emerging markets, particularly Asia, our conviction in the economic recovery in America is rising and we are mildly encouraged by early signs of recovery in the European periphery. We are also excited by the transformative power of technology, although our recent focus has been on less glamorous parts of the technology sector, where consolidation of market shares and rising barriers to entry offer the potential for much improved economic performance. Most notably, we hold a range of businesses along the semiconductor supply chain as we are attracted by the combination of the improving supply side dynamics and the 'internet of things' which we believe underpins demand for connected data and devices. Furthermore, this consolidation may alter the pricing power dynamics in favour of the component makers, rather than the producers of the end products.

Wealth creation in emerging Asia generates multiple long-term growth opportunities including savings and insurance. There is a multi-decade opportunity offered by the life insurance industry across Asia, owing to the lack of state social welfare provision and supportive demographics. We are long-term holders of Prudential and added to the recent purchase, AIA, during the quarter. Both companies have leading market shares, deep-rooted distribution, and strong brands having operated throughout South East Asia for decades.

We participated in the Alibaba initial public offering (IPO). Few businesses have as rapidly become entrenched in the national psyche anywhere, as Alibaba has in China. Alibaba handles more than 80% of China's e-commerce business, with nearly US$250 billion passing through its systems in 2013, more than Amazon and eBay combined. Despite its significant size, we are excited by the rapid infiltration of the internet into all aspects of Chinese life and believe there is a significant long-term growth opportunity ahead.

Switching to the developed world, we added to a number of holdings benefiting from consolidating industries, market leading positions and western economic recovery. For example, in the US, we added to Martin Marietta Materials - an aggregates and heavy building materials business which recently merged with Texas Industries, improving its competitive position across most of the largest and fastest-growing parts of North America.

We sold two long-term portfolio holdings, John Deere and Namco Bandai. In both cases, we have gradually come to the conclusion that the continued domestic success of their businesses will not be replicated abroad.

Outlook

Whilst we make few claims to be market timers or top-down macro investors, our broad view is that the world is mending and therefore interest rates and monetary policy will normalise over time. We suspect that the gradual withdrawal of economic stimulus will lead to a decoupling, with a greater divergence between market winners and losers, although overall we remain positive on market direction. Above all, we remain focused on investing in the long-term success of businesses, as we believe the compounding of above market earnings offers us a consistent, repeatable edge in a market that repeatedly fails to look beyond recent 'news'.

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 three year period 2007-2010, the long-term cost of early retirements on ill-health grounds was well below the actuary's assumption in the 2007 valuation of £800k p.a. In the latest valuation of the fund (as at 31st March 2010), the actuary assumed a figure of £82k in 2010/11, rising with inflation in the following two years. In 2012/13, there were two ill-health retirements with a long-term cost of £235k, and, in 2013/14, there were six with a long-term cost of £330k. In the first half of 2014/15, there were three ill-health retirements with a long-term cost of £257k. Provision has been made in the Council's budget for these costs and contributions have been or will be made to reimburse the Pension Fund, as result of which the level of costs had no impact on the employer contribution rate.

The actuary does not make any allowance for other early retirements, however, because it is the Council's policy to fund these in full by additional voluntary contributions. In 2012/13, there were 45 other (non ill-health) retirements with a total long-term cost of £980k and, in 2013/14, there were 26 with a total long-term cost of £548k. In the first half of 2014/15, there were 13 non ill-health retirements with a long-term cost of £133k. Provision has been made in the Council's budget for severance costs arising from LBB staff redundancies and contributions have been or will be made to the Pension Fund in both years 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 2 – Sept 14 - LBB	1	75	8	42
- Other	1	54	3	43
- Total	1	129	11	85
Total 2014/15 – LBB	2	203	10	90
- other	1	54	3	43
- Total	3	257	13	133
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
- 2009/10	5	45	21	1,033
- 2008/09	6	385	4	256

Appendix 4

PENSION FUND REVENUE ACCOUNT AND MEMBERSHIP

	Final Outturn 2013/14 £'000's	Estimate 2014/15 £'000's	Actual to 30/09/14 £'000's
INCOME			
Employee Contributions	5,580	5,600	2,950
Employer Contributions	23,967	23,000	11,590
Transfer Values Receivable	5,074	3,000	740
Investment Income	10,883	10,000	4,600
Total Income	45,504	41,600	19,880
EXPENDITURE			
Pensions	23,409	24,300	12,270
Lump Sums	5,884	6,000	2,150
Transfer Values Paid	1,559	3,000	2,690
Administration	2,413	2,500	1,270
Refund of Contributions	13	-	10
Total Expenditure	33,278	35,800	18,390
Surplus/Deficit (-)	12,226	5,800	1,490

MEMBERSHIP	**31/03/2014**	**30/09/2014**
Employees	5,254	5,355
Pensioners	4,862	4,930
Deferred Pensioners	4,819	4,931
	14,935	15,216