

Decision Maker: Pensions Investment Sub-Committee

Date: 24th February 2015

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

Title: PENSION FUND PERFORMANCE Q3 2014/15

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Chief Officer: Director of Finance

Ward: All

1. Reason for report

This report includes a summary of the investment performance of Bromley's Pension Fund in the 3rd 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 Blackrock and MFS, having now completed their first year as our Pension Fund managers, will be present at the meeting to discuss performance, economic outlook/prospects and other matters relating to their portfolios. One of the other fund managers, 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

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.
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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); £38.6m income (contributions, investment income, etc); £693.7m total fund market value at 31st December 2014)
 5. Source of funding: Contributions to Pension Fund
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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.
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Customer Impact

1. Estimated number of users/beneficiaries (current and projected): 5,637 current employees; 4,937 pensioners; 5,007 deferred pensioners as at 31st December 2014
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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 December quarter at £693.7m (£655.9m as at 30th September 2014) and, by the end of January 2015, it had risen further to £714.9m. The comparable value as at 31st December 2013 was £618.8m. 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 December 2014 is provided by the fund's external adviser, AllenbridgeEpic, in Appendix 5. In overall terms, the total fund returned +5.6% (net of fees) in the latest quarter, compared to the overall benchmark return of +4.3%. This followed overall returns of +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 December quarter was in the 6th percentile (the lowest rank being 100%). In the September quarter, Bromley's Fund was in the 8th 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 and 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 performance in the last two quarters has been 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 31/12/14				
1 year (1/1/14 to 31/12/14)	12.1	10.9	8.1	9
3 years (1/1/12 to 31/12/14)	14.6	12.3	11.0	4
5 years (1/1/10 to 31/12/14)	10.9	9.4	8.9	15
10 years (1/1/05 to 31/12/14)	9.8	8.3	7.5	8
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 August meeting, a programme of fund manager attendance was agreed and Baillie Gifford, who currently manage three separate portfolios (global equities, DGF and fixed income) attended the December meeting to discuss performance and other matters. Blackrock and MFS (global equity managers who have both just completed their first year of management) are attending this meeting and Fidelity (fixed income) and Standard Life (DGF) will attend the meeting on 19th May 2015.

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 31st December 2014) are provided in Appendix 4 together with fund membership numbers. A net surplus of £2.5m (including £5.1m investment income) was achieved in the first three quarters of 2014/15 and total membership numbers rose by 646. The overall proportion of active members has, however, declined in recent years and has fallen slightly from 36.4% at 31st March 2012 to 36.2% at 31st December 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

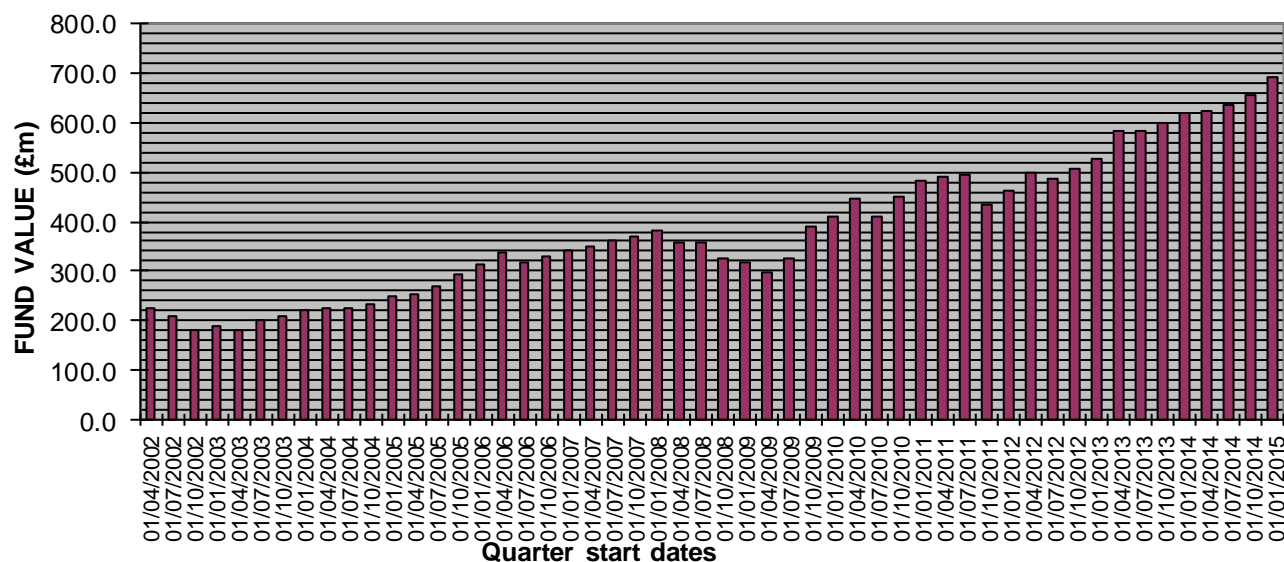
MOVEMENTS IN PENSION FUND MARKET VALUE SINCE 2002

Date	Baillie Gifford				Fidelity			Blackrock	MFS	Standard Life	CAAM	GRAND TOTAL
	Balanced Mandate	DGF	Fixed Income	Global Equities	Balanced Mandate	Fixed Income	Total	Global Equities	Global Equities	DGF	LDI Investment	
	£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
31/01/2015		45.0	52.6	233.5	331.1		67.3	67.3	144.0	143.5	29.0	714.9

£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.

PENSION FUND - QUARTERLY VALUES SINCE 2002



Baillie Gifford Report for the quarter ended 31 December 2014

Quarterly portfolio information

Summary portfolio valuation and performance			
	30 Sept 2014	31 Dec 2014	3 month Performance to 31 Dec 2014
Global Alpha (gross)	£213,321,627	£227,724,878	6.6%
<i>MSCI ACWI</i>			4.5%
Diversified Growth (net)	£43,767,275	£44,039,768	0.6%
<i>Base rate +3.5%</i>			1.0%
Sterling Aggregate (gross)	£48,144,437	£50,152,287	4.17%
<i>50% FTSE Actuaries UK Conventional Gilts All Stocks Index & 50% BoAML Sterling Non-Gilt Index</i>			5.33%

Longer Term Performance

Performance to 31 December 2014 (%)

	Fund Gross	Fund Net	Benchmark
Since Inception* (Cumulative)	162.3	153.3	124.3
Since Inception* (p.a.)	6.6	6.4	5.5
Five Years (p.a.)	11.5	11.3	9.4
One Year	11.8	11.4	11.2
Quarter	6.7	6.6	4.5

*Inception date 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

A violent plunge in the oil price was caused by OPEC's late-November meeting when the cartel of oil producing nations failed to cut production targets. This, and the flood of US shale, led to an imbalance of supply and demand and the oil price lurched sharply downward. Brent finished the year at \$56, a drop of \$39 on the level at the start of October. The negative ramifications are being felt most acutely in Russia, the economy of which remains precariously reliant upon its oleaginous exports. A leap in interest rates to 17% failed to shore up the crumbling ruble; these rates of interest were last seen in 1998, when the Russian government defaulted on its debt. On the positive side, the precipitous fall in the oil price is estimated to represent at least a 0.5% boost to global GDP in 2015. By comparison to the gyrations in the energy market, the stumbling recovery in Europe, another Japanese recession and robust job growth in the US seem mundane. The global index fell sharply early in the quarter, recovered and then stepped back before recovering once more as volatility, as measured by the VIX index, rose to levels last seen in late 2012. The global equity index (MSCI ACWI) rose by 4.5% in sterling terms over the quarter.

Global Alpha Portfolio

Japan is ripe for change and part of our research effort has focused on opportunities that reform may present. The consensus is one of scepticism towards Prime Minister Abe's reform policies. Following two research trips we are inclined to take a different view and we have an increasing belief in the reform agenda which we think will help both traditional Japanese companies and those that are prospering by rejecting the norms of Japanese orthodox corporate culture. As a result of this research, we added two new Japanese companies to your portfolio. CyberAgent is the leading digital

advertising agency in Japan. It combines a strong core franchise and a culture that supports the development of new businesses including a blogging platform and social gaming. In addition, it has a venture capital unit with a portfolio of dynamic early stage technology companies in Japan and other parts of Asia. Insurance company MS&AD should benefit from reform in two ways. It has its own self-help plans – improving underwriting profits through a re-pricing of policies and increasing overseas earnings through organic growth. It can also benefit from reform by proxy through its ownership of Japanese equities within its insurance portfolio as traditional companies sharpen their focus on shareholder value. Elsewhere and maintaining this theme of ‘change’, we have purchased another reforming company in Fiat Chrysler Automobiles which has ambitious plans to grow through leading automotive brands such as Maserati, Jeep, Chrysler and Alfa Romeo. We also bought Monsanto, the global leader in seeds, plant biotechnology and crop protection, the future of which is less dependent on US corn than its past.

We sold three long-term holdings from your portfolio to fund these purchases. The shares of China Mobile have enjoyed a re-rating this year but we think the longer-term prospects are increasingly dull. We have owned Investor since the fund’s inception in 2005. Whilst the guiding hand of the Wallenberg family is still firmly on the tiller of this Swedish holding company, the discount to net asset value has narrowed and we have become increasingly underwhelmed by some of its largest holdings. We also sold New York Community Bank, whose performance has been lacklustre in the past few years. We hoped it would regain market share in its core business of rent-regulated, multi-family housing units in metropolitan New York and that net interest margins would recover. However, neither scenario has played out as we would have hoped and the company’s earnings power has not recovered substantially.

In 2014, Global Alpha’s portfolio turnover has remained low and for the sixth year in a row it will be below the long-term average of 20%.

Outlook

In the early days of the quarter, when markets were once again under stress, we were continuing to find that the majority of the companies we own on your behalf were still reporting strong growth and many were seeing earnings upgrades just as share prices were falling sharply.

Equities are a high volatility asset class, and markets are not always logical so it is reasonable to conclude that, looking forward to 2015, there will be further periods when fundamentals and share prices become disconnected. Short-term or even inconsequential news flow will inevitably be extrapolated and exaggerated by Mr. Market. Guarding against this myopic short-termism, our job is to closely monitor the fundamentals of the businesses we own on your behalf, and keep a check on the progress they are making towards the goals we think they can achieve.

Shortly we will share with you our 2015 Research Agenda. We have used the preceding agendas successfully over the past three years to drive forward our efforts to unearth some exciting new growth ideas. Our optimism can usually be measured by how many new stocks are emerging for consideration, and there has been an uptick in this metric in recent months. The headlines will once again be filled with seemingly important macro-economic news, but we think that long-term corporate value lies in fundamentals. It is our adherence to this philosophy that gives us confidence that we can continue to deliver very worthwhile active equity returns.

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 the first three quarters 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 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 the first three quarters of 2014/15, there were 16 non ill-health retirements with a long-term cost of £196k. 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 3 – Dec 14 - LBB	-	-	3	64
- Other	-	-	-	-
- Total	-	-	3	64
Total 2014/15 – LBB	2	203	13	154
- other	1	54	3	42
- Total	3	257	16	196
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	Actual to 31/12/14 £'000's
INCOME			
Employee Contributions	5,580	5,600	4,450
Employer Contributions	23,967	23,000	17,540
Transfer Values Receivable	5,074	3,000	2,360
Investment Income	10,883	7,000	5,130
Total Income	<u>45,504</u>	<u>38,600</u>	<u>29,480</u>
EXPENDITURE			
Pensions	23,409	24,300	18,290
Lump Sums	5,884	6,000	3,640
Transfer Values Paid	1,559	3,000	3,170
Administration	2,413	2,500	1,870
Refund of Contributions	13	-	60
Total Expenditure	<u>33,278</u>	<u>35,800</u>	<u>27,030</u>
Surplus/Deficit (-)	<u>12,226</u>	<u>2,800</u>	<u>2,450</u>
MEMBERSHIP			
	31/03/2014		31/12/2014
Employees	5,254		5,637
Pensioners	4,862		4,937
Deferred Pensioners	4,819		5,007
	<u>14,935</u>		<u>15,581</u>