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 <u>Performance data for 2014/15 (short-term)</u>
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 <u>Medium and long-term performance data</u>
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

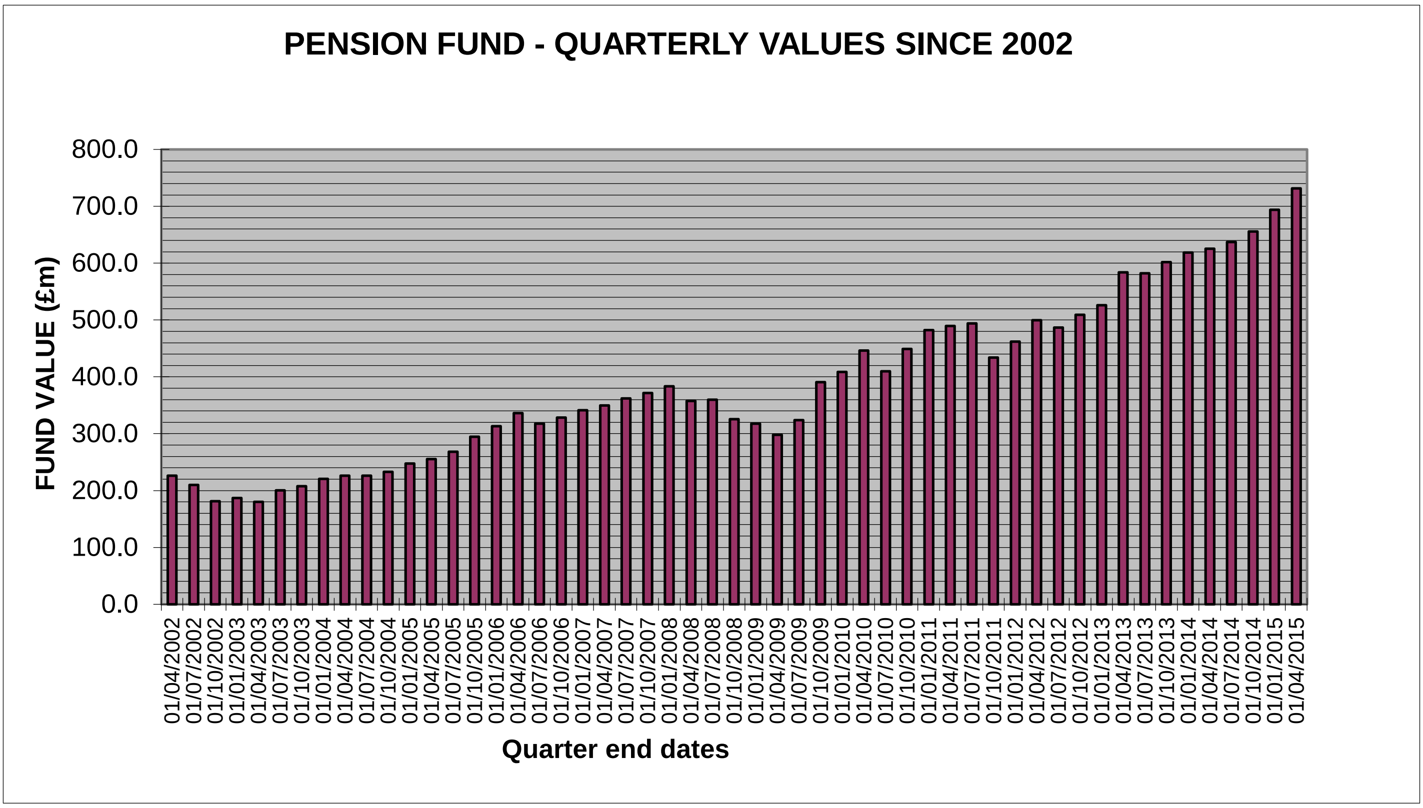
Appendix 1

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.

Appendix 3

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

Appendix 4

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