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

**Date:** 18<sup>th</sup> November 2015

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

**Title:** PENSION FUND PERFORMANCE Q2 2015/16

**Contact Officer:** Martin Reeves, Principal Accountant (Technical & Control)  
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**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 2nd quarter of 2015/16. More detail on investment performance is provided in a separate report from the Fund's external advisers, AllenbridgeEpic, which is attached as Appendix 6. Representatives of MFS will be present at the meeting to discuss performance, economic outlook/prospects and other matters relating to their portfolio. Baillie Gifford has provided a commentary on its performance and on its view of the economic outlook and this is attached as Appendix 3. The report also contains information on general financial and membership trends of the Pension Fund and summarised information on early retirements.

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**RECOMMENDATION(S)**

**The Sub-Committee is asked to:**

- 2.1 Note the report;**
- 2.2 Note the position regarding admission agreements for outsourced services as set out in paragraphs 3.11 to 3.14.**

## 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, for the purpose of providing pension benefits for its employees. The investment regulations (The LGPS (Management and Investment of Funds) Regulations 2009) 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 £3.3m (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: £36.6m expenditure (pensions, lump sums, etc); £41.5m income (contributions, investment income, etc); £684.4m total fund market value at 30th September 2015)
  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): 5,985 current employees; 5,026 pensioners; 5,172 deferred pensioners as at 30th September 2015
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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 September quarter at £684.4m (£710.9m as at 30<sup>th</sup> June 2015) but it had recovered to £718.3m by the end of October. The comparable value as at 30<sup>th</sup> September 2014 was £655.9m. Historic data on the value of the Fund are shown in a table and in graph form in Appendix 1 and an analysis of changes in Fund value are shown in Appendix 2.

#### **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. The high-level 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 (Diversified Growth) was implemented on 6<sup>th</sup> 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 (global equities) was implemented on 20<sup>th</sup> 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).
- 3.5 After several reports on Phase 3 (fixed income), the Sub-Committee agreed in May to switch £6m from the Baillie Gifford Sterling Aggregate Plus Fund into that company's Global Bond Fund (£3m) and Emerging Market Bond Fund (£3m). A proposal to switch a further £6m from Fidelity's UK Aggregate Bond Fund into the Fidelity FIDA Fund was not agreed at the meeting. Following the meeting, further advice was received from AllenbridgeEpic, which recommended that no further action be taken. The matter was discussed again at the last meeting in September and it was agreed that no further action be taken.

#### **Summary of Fund Performance**

##### **3.6 Performance data for 2015/16 (short-term)**

A detailed report on fund manager performance in the quarter ended 30<sup>th</sup> September 2015 is provided by the fund's external adviser, AllenbridgeEpic, in Appendix 6. In overall terms, the total fund returned -3.8% (net of fees) in the latest quarter, compared to the benchmark return of -3.6% and the local authority average of -3.5%. This followed an overall return of -4.5% in the June quarter, which compared to an overall benchmark return of -4.2% and a local authority average of -2.5%. With regard to the local authority average, the fund's performance in the September quarter was in the 66<sup>th</sup> percentile (the lowest rank being 100%) and, in the June quarter, it was in the 100th percentile.

### 3.7 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 2014/15, the Fund returned +18.5% compared to the benchmark return of +16.4% and achieved an overall local authority average ranking in the 7<sup>th</sup> percentile. For comparison, the rankings in earlier years were 29% in 2013/14, 4% in 2012/13, 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 30<sup>th</sup> September 2015 (in the 24<sup>th</sup> percentile for one year, in the 14<sup>th</sup> percentile for three years, in the 25<sup>th</sup> percentile for five years and in the 8<sup>th</sup> percentile for ten years). The medium to long-term results have been 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
	%	%	%	
<b>Figures to 30/9/15</b>				
1 year (1/10/14 to 30/9/15)	4.1	2.1	2.5	24
3 years (1/10/12 to 30/9/15)	10.3	8.5	8.3	14
5 years (1/10/10 to 30/9/15)	8.6	7.4	7.2	25
10 years (1/10/05 to 30/9/15)	8.1	6.6	6.0	8
<b>Financial year figures</b>				
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
<b>3 year ave to 31/3/15</b>	<b>14.2</b>	<b>12.1</b>	<b>11.1</b>	<b>5</b>
2011/12	2.2	2.0	2.6	74
2010/11	9.0	8.0	8.2	22
<b>5 year ave to 31/3/15</b>	<b>10.7</b>	<b>9.2</b>	<b>8.8</b>	<b>11</b>
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
<b>10 year ave to 31/3/15</b>	<b>10.3</b>	<b>8.7</b>	<b>7.9</b>	<b>8</b>

### **Fund Manager Comments on performance and the financial markets**

3.8 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 3.

### **Early Retirements**

3.9 Details of early retirements by employees in the Fund are shown in Appendix 4.

### **Fund Manager attendance at meetings**

3.10 Meeting dates have been set for 2015/16 and MFS are attending this evening's meeting. While Members reserve the right to request attendance at any time if any specific issues arise, the timetable for subsequent meetings is as follows:

### **Admission agreements for outsourced services**

- 3.11 On 23<sup>rd</sup> September 2015, the Sub-Committee noted the position regarding admission agreements for outsourced services. Members were informed of the progress of three potential admission body employers, as a result of academies outsourcing either cleaning or catering contracts. Of the three employers, one is being finalised by legal representatives of each party and should be completed very shortly. With respect to the two further employers, officers are continuing dialogue to progress matters. It is likely that we will receive further requests for admitted body status as more schools convert to Academies and as more Academies look to outsource work to external contractors.
- 3.12 At the last meeting in September, the Sub-Committee was informed that both The Landscape Group and Southside Partnership (Certitude) were close to finalising their status as admission body employers. The admission process for each employer is now complete, and both are now admission bodies within the Bromley Fund.
- 3.13 Passenger Transport Services staff are scheduled to transfer to GS Plus on 1<sup>st</sup> December 2015. GS Plus are an entity connected with the Royal Borough of Greenwich (RBG). As such, the transferred staff will cease to be active members within the Bromley Fund and will instead become active members within the RBG Fund. Employees will have a period of one year from the date of transfer in which to make an election not to amalgamate their pension benefits. After the one year period, in the absence of such an election and subject to agreement between actuaries for the two funds, a bulk transfer payment will be made in respect of the relevant employees.
- 3.14 Part 3 of Schedule 2 to the LGPS Regulations 2013 provides that an administering authority must admit to the Scheme eligible employees of a transferee admission body where such body and the scheme employer undertake to meet the requirements of the Regulations. Provided a scheme employer (including an academy) and contractor undertake to meet the requirements of the Regulations, the Council, as administering authority, has no power to refuse admitted status, although we are able to agree the terms of the agreement. Further updates will be provided in quarterly performance reports.

## **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, for the purpose of providing pension benefits for its employees. The investment regulations (The LGPS (Management and Investment of Funds) Regulations 2009) 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 2015/16 Pension Fund Revenue Account (as at 30<sup>th</sup> September 2015) are provided in Appendix 5 together with fund membership numbers. A net surplus of £2.6m was achieved in the first half of 2015/16 (mainly due to investment income of £3.7m) and total membership numbers rose by 387. A net surplus of £5.3m was achieved in 2014/15 (including investment income of £6.9m) and total membership numbers rose in that year 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. The investment regulations (The LGPS (Management and Investment of Funds) Regulations 2009) set out the parameters for the investment of Pension Fund monies.

<b>Non-Applicable Sections:</b>	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

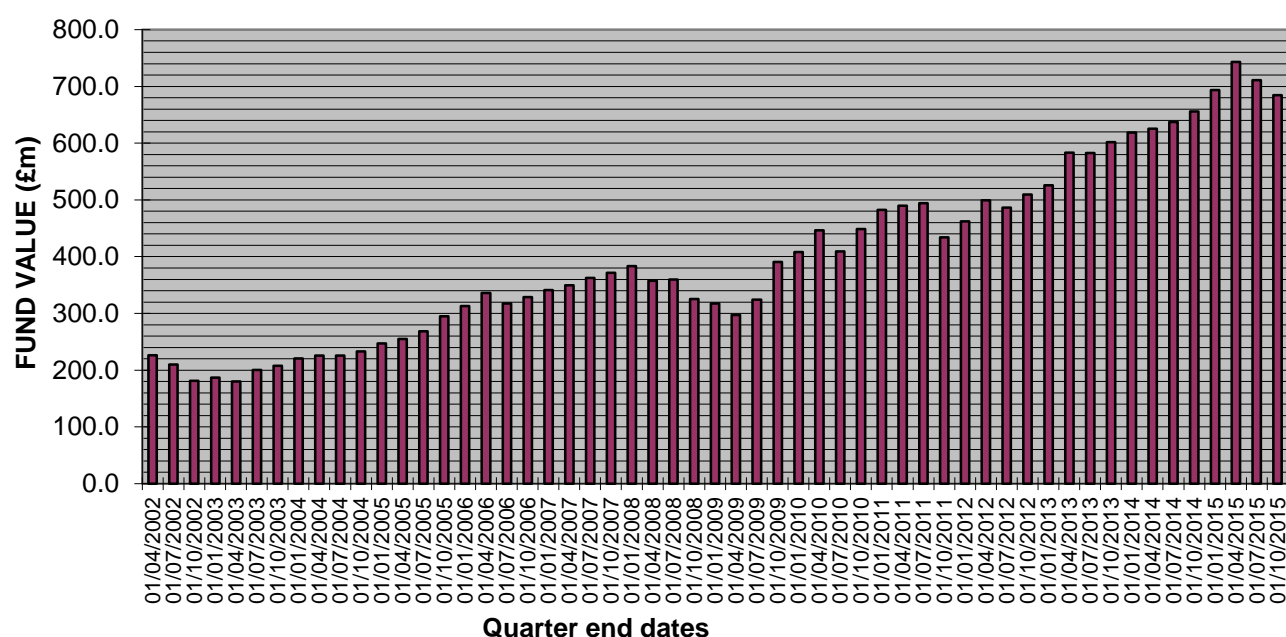
## MOVEMENTS IN PENSION FUND MARKET VALUE SINCE 2002

Date	Standard												GRAND TOTAL
	Baillie Gifford					Fidelity		Blackrock		MFS	Life	CAAM	
	Balanced		Fixed	Global		Balanced	Fixed		Global	Global		LDI	
	Mandate	DGF	Income	Equities	Total	Mandate	Income	Total	Equities	Equities	DGF	Investment	
	£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	126.7		126.7					255.2
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	154.4				154.4	143.0		143.0					297.4
31/03/2010	235.4				235.4	210.9		210.9					446.3
31/03/2011	262.6				262.6	227.0		227.0					489.6
31/03/2012	269.7				269.7	229.6		229.6					499.3
31/03/2013#	315.3	26.5			341.8	215.4		215.4			26.1		583.3
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
31/03/2015		45.5	51.6	248.2	345.3		66.6	66.6	150.5	150.8	29.7		742.9
30/06/2015		45.1	49.6	236.9	331.6		64.4	64.4	143.3	142.3	29.3		710.9
30/09/2015		44.2	50.4	223.6	318.2		65.2	65.2	133.3	138.9	28.8		684.4
31/10/2015		45.2	50.0	238.4	333.6		65.2	65.2	140.2	149.8	29.5		718.3

# £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



## Appendix 2

### Pension Fund - breakdown of changes in Fund Value since 2002

Financial Year	MV b/fwd 1st April £m	Employer & Employee Conts # £m	Benefits @ £m	Payments re leavers \$ £m	Admin costs (inc manager fees) £m	Growth (change in MV) £m	Invest- ment income £m	Other movements £m	MV c/fwd 31st March £m
2002/03	226.2	20.5	-14.8	-3.6	-1.1	-51.5	5.6	-1.0	180.3
2003/04	180.3	22.5	-14.6	-3.5	-1.0	37.6	5.3	-0.6	226.0
2004/05	226.0	24.7	-15.5	-3.2	-1.0	18.8	5.3	0.1	255.2
2005/06	255.2	28.0	-16.0	-3.0	-1.4	66.1	6.3	1.1	336.3
2006/07	336.3	27.4	-18.1	-2.9	-1.2	3.1	5.9	-0.9	349.6
2007/08	349.6	30.8	-20.5	-4.2	-1.3	0.0	5.9	-3.0	357.3
2008/09	357.3	30.1	-21.6	-1.5	-2.3	-75.0	7.8	2.6	297.4
2009/10	297.4	33.6	-24.2	-4.2	-2.9	139.3	7.1	0.2	446.3
2010/11	446.3	33.0	-25.2	-2.8	-3.0	32.1	7.5	1.7	489.6
2011/12	489.6	32.3	-27.0	-1.8	-1.8	2.0	8.5	-2.5	499.3
2012/13	499.3	29.4	-27.5	-2.5	-1.9	77.0	8.4	1.1	583.3
2013/14	583.3	34.6	-29.3	-1.6	-2.4	34.8	7.7	-1.6	625.5
2014/15	625.5	33.9	-28.9	-3.4	-3.2	111.8	6.9	0.3	742.9
<b>TOTAL (13 YEARS)</b>		<b>380.8</b>	<b>-283.2</b>	<b>-38.2</b>	<b>-24.5</b>	<b>396.1</b>	<b>88.2</b>	<b>-2.5</b>	

# Contributions - employee and employer (inc. past deficit) and transfer values receivable

@ Benefits - pensions and lump sums

\$ Payments re leavers - refunds of contributions and transfer values payable



## Baillie Gifford Report for the quarter ended 30 September 2015

### Global Equities

	30 June 2015	30 September 2015
Portfolio Valuation	£236,938,145	£223,619,537

Performance to 30 September (%)

	Fund Gross	Fund Net	Benchmark
Five Years (p.a.)*	8.8	8.6	7.0
Since 31/12/2013 (p.a.)	5.6	5.2	3.9
One Year	4.9	4.6	0.4
Quarter	-5.6	-5.7	-5.9

\*Balanced mandate prior to December 2013

### Investment environment

There is rarely a shortage of geopolitical and economic news flow as we move from one quarter to the next. Recent months have been no different. We left you last quarter with Greece teetering on the brink of exiting the Eurozone. While an €85 billion bailout package was finally agreed between Greece and its creditors, significant question marks remain over the long-term future of the country and its ability to implement reforms. The Greek debt debacle was quickly relegated to the inside cover of newspapers, replaced with headlines reflecting concerns about slowing growth in China, and the drop of the domestic Chinese stock markets. The impact of Chinese developments has been felt globally, as stock markets around the world have fallen and commodity prices have suffered. The impact on Western policy makers was in evidence as speculation mounted as to whether the US Federal Reserve would raise interest rates for the first time since 2006. Ultimately, the decision was to refrain from doing so, owing to concerns about how that would affect global growth.

These concerns gave a strong regional tilt to returns. Emerging Markets fared worst, the index losing 14.6% over the quarter. North America, where the economy continues to recover, was resilient, losing only 3.6%. Similarly, while companies in the Materials sector lost 16.4%, Utilities and Consumer Staples – traditionally defensive sectors – made slight gains. Your portfolio's return over the quarter was close to benchmark. We have not taken a particularly defensive stance, but strong stock-specific returns from stocks like Royal Caribbean Cruises and Ryanair compensated for any short term disadvantage this caused.

In light of recent developments, it would be easy to adopt a gloomy outlook. However, our job is to focus on the long-term growth prospects of the businesses in your portfolio, as well as to identify new opportunities. Over the short term, we often find that share prices can become 'disconnected' from the reality of business fundamentals. We believe that we are seeing many such examples right now.

### Portfolio update

Your portfolio's turnover remains low. In the 12 months to September, this figure was around 14%, implying an average holding period of around seven years for each stock. This is a reflection of our long-term approach to investing, and our preference to look through the short-term ups and downs of the stock market.

One of the recent purchases for your portfolio illustrates our willingness to look beyond the news headlines and broader stock market sentiment. Yandex is Russia's leading internet search business. We believe earnings growth will come from the increasing shift of advertising spending from print to online, and will be supported by rising internet and smartphone penetration levels in Russia. The business generates strong cash flow and reinvests this into its search business, alongside a host of other long-term growth opportunities such as Yandex Market, an e-commerce website. Broader macroeconomic developments in Russia have taken their toll on the share price and provided an attractively priced long-term growth opportunity.

The sell-off in global equity markets has also provided an opportunity to add to some of your existing holdings at attractive valuations. Notably, we added to MS&AD Insurance, Seattle Genetics and Facebook. MS&AD, the Japanese insurer, continues to write increasingly profitable policies. Following a phase of market consolidation, the top three players, of which it is one, now control over 90% of the market. We believe that this oligopolistic industry structure, together with signs of insurance rate rises, will support significant improvement in the profitability of this insurance

business over the coming years (we continue to consider the implications of the company's proposed takeover of Amlin). Seattle Genetics is an early stage biotech company that is developing anticancer drugs. It uses its Antibody Drug Conjugate (ADC) technology to link a poison to an antibody, which then delivers the poison directly to a targeted cancer cell. Following the company gaining approval from the FDA to expand the use of its drug, Adcetris, in treating Hodgkin's Lymphoma, we participated in an equity placing by the company. The company raised US\$480 million which it will invest to commercialise and expand the use of Adcetris further, and will increase spending on R&D to advance its development pipeline. The holding in Facebook was increased from what we refer to as an 'incubator' holding (circa 0.5%) to a mid-sized holding (circa 1%) on account of its established position in the fast moving social media sector, and improving advertising capabilities.

We sold the holding in Arcos Dorados on account of a change to its fundamental growth outlook. Arcos Dorados is the master franchisee for McDonalds across Latin America, but it has failed to achieve the growth we had hoped for, and has been hindered by a growing debt burden. The company has also been hit by the two headwinds of a macroeconomic slowdown in its Latin American markets and a strengthening US dollar.

Dragon Oil has also exited your portfolio. The company had been subject to a number of takeover offers from the Emirates National Oil Company (ENOC) this year. In August we, alongside a quorum of shareholders, accepted an offer of 800 pence per share from ENOC. This represented a 57% premium to the pre-offer share price and we believe fairly reflects the long-term production growth potential of the company's main assets in Turkmenistan.

## Fixed Interest

	30 June 2015	30 September 2015
Portfolio Valuation	£49,632,170	£50,396,297

Performance to 30 September (%)

	Fund	Benchmark
Since Reorganisation*	-0.57	-0.58
Since 09/12/13 (p.a.)**	7.59	6.96
Quarter	1.54	1.37

\*01/06/2015

\*\* Inception date of bond mandate

## Investment environment and performance

Bond markets have spent the past quarter focusing on developments in global economic growth and what they mean for central bank monetary policy. Emerging markets have been an area of particular concern. Having led global growth for more than a decade and having weathered the Global Financial Crisis better than more developed countries, they have been hurt hard by general macro-economic factors, such as waning commodity prices, and more specific issues at a country-by-country level. Corporate bond markets were also weak, seemingly driven by a build-up of negative sentiment due to a number of factors.

Looking more broadly, economic growth has been fairly disappointing. China's slowdown is part of this, but the recovery in the US and Europe – while tangible – remains slow and subject to frequent setbacks. Nevertheless, there has been real progress, particularly in the US. The weakness in commodity prices from wheat through industrial metals to energy is a boost to consumers' spending power and we have seen wages rise while consumer prices stand still.

Absolute performance in the Fund benchmark was positive over both the quarter and the year, helped latterly by market demand for lower risk, less economically sensitive assets. Government bonds were the prime beneficiary of this trend, followed by high credit quality corporate bonds. Higher yielding corporate bonds performed much less well, particularly those with exposure to commodity production. Emerging Markets bonds were the worst performers, and were particularly affected by the market's preference for currencies perceived as lower risk.

Your Fund's performance relative to this benchmark was modestly positive before fees over the quarter. Currency positioning has been the most significant factor. Favouring the US dollar, funded by bearish positions in vulnerable emerging market currencies, has helped this quarter, while we were hurt by the rapid turn in sentiment in commodity exporting countries, such as Brazil, earlier this year. Other factors have been mixed over the year, including stock selection in corporate bonds which has been a strong suit in the Fund over the longer term. Our modest asset allocation position towards corporate bonds meant we largely avoided being caught by the shift in investor sentiment in recent months.

## Outlook

We believe that the increase in consumer spending power should feed through to more investment spending and manufacturing output, boosting developed market growth in the second half of the year. Nevertheless, central banks may err on the side of caution in timing the reversal of the emergency monetary policies still in place in most developed economies. We, and the market, expect a gradual increase in rates, reaching a plateau at a lower rate than historical norms. Heightened investor concerns over emerging markets will persist. China's transition to a more balanced economy should ultimately succeed, but its attempts to regain competitiveness are a challenge to South Asian competitors. While several emerging market bond markets and currencies have priced in too bearish an outcome and should perform well as fundamental factors reassert their influence, others will struggle to regain their composure and could suffer further.

Fundamental cracks are not yet evident in corporate bond markets, and our central expectations are for improving growth and low interest rates to continue supporting the health of most companies. However, the number of recent negative events highlights the uncertainties that persist. The additional yield spread on investment grade corporate bonds has risen close to levels last seen during the 'taper tantrum' of 2013, but remains significantly lower than when the EU faced crises in 2011 and 2012. As discussed earlier, the potential for further shocks in markets means we are wary of taking too much risk in aggregate at this time. Nevertheless, a selective approach in investing in higher yielding corporate and emerging market bonds is now better rewarded and can boost performance from here.

## Diversified Growth Fund

	30 June 2015	30 September 2015
Portfolio Valuation	£45,134,084	£44,182,544

## Performance to 30 September (%)

	Fund Net	Base Rate +3.5%
Since Inception* (p.a.)	4.2	4.0
One Year	0.9	4.0
Quarter	-2.1	1.0

\*Inception of Fund - 6 December 2012

## Investment environment

The investment environment became more challenging over late summer. Equity and commodity markets fell, credit spreads widened and emerging market assets in particular experienced significant price declines. The best returns were recorded by investments traditionally regarded as safe havens such as developed world government bonds. Gold also held up well during the worst of the market falls.

## Outlook

Our central expectations for economic growth and financial market returns are unchanged. Real global growth and inflation are likely to remain at low to moderate levels, giving rise to perhaps 5% or 6% nominal GDP growth in the next few years. Headline inflation will probably rise over the next year as the major part of the oil price decline drops out of the year-on-year calculation (the oil price collapse began at around this time last year), but core rates of inflation (on average, around the globe) are likely to remain low. Valuations across financial markets and the different asset classes in which we invest are generally lower following recent market declines, but it remains the case that most asset classes are trading close to our estimates of fair value. With nominal GDP growth likely to be low relative to history, and few grounds for expecting a sustained and generalised uplift in valuations, investment returns are also likely to be modest.

However, it feels like the spread of possible outcomes has widened (or, perhaps more accurately, our appreciation of what could happen has become clearer). Our judgement is that the drop in valuations should have slightly more influence on the portfolio and our investment decisions than any sense of heightened uncertainty. We have, therefore, made a number of portfolio changes, detailed below, that seek to take advantage of lower prices across financial markets.

## Positioning

Recent transactions have removed some of the defensive tilt to the portfolio. We think this is an appropriate response to the lower valuations across many asset classes but the changes, both at the individual asset class level and in aggregate across the whole portfolio, are relatively small. Overall, the portfolio remains diversified across a wide range of asset classes. We think most asset classes are close to their fair value or to their long-run historical average valuation, and there is no good reason to concentrate the portfolio in any particular asset class.

We increased our equity market exposure, primarily in late August and in response to the significant price falls at that time. Funding for this came from a mix of existing cash and the sale of some of our most highly-rated structured finance holdings. We also bought new holdings, or added to existing ones, in property, infrastructure, high yield credit and commodities.

These transactions leave the broad shape of the portfolio unchanged, in that high yield credit and equities remain the largest asset classes in the portfolio. High yield credit now splits out fairly evenly across euro corporate bonds, dollar corporate bonds and floating rate senior loans. Within equities, the majority of our exposure is achieved through three Baillie Gifford managed global equity funds. The balance is spread across two regional funds, also managed by Baillie Gifford (giving additional exposure to Japanese and Asian equities); European dividend futures; index exposure to the UK and European stock markets through futures; and a number of listed investment funds operating mainly in private equity.

Baillie Gifford & Co  
October 2015

## 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 31<sup>st</sup> 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 2014/15, there were seven ill-health retirements with a long-term cost of £452k and, in the first half of 2015/16, there were four ill-health retirements with a long-term cost of £655k. Provision has been made in the Council's budget for these costs and contributions have been and 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 2014/15, there were 19 other retirements with a total long-term cost of £272k and, in the first half of 2015/16, there were 10 non ill-health retirements with a long-term cost of £398k. Provision has been made in the Council's budget for severance costs arising from LBB staff redundancies and contributions have been and will be 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 2 – Sept 15 - LBB	1	226	6	298
- Other	-	-	1	-
- Total	1	226	7	298
Total 2015/16 – LBB	3	630	9	398
- other	1	25	1	-
- Total	4	655	10	398
Actuary's assumption - 2013 to 2016		1,000 p.a.		N/a
- 2010 to 2013		82 p.a.		N/a
Previous years – 2014/15	7	452	19	272
- 2013/14	6	330	26	548
- 2012/13	2	235	45	980
- 2011/12	6	500	58	1,194

**PENSION FUND REVENUE ACCOUNT AND MEMBERSHIP**

	<b>Final Outturn 2014/15 £'000's</b>	<b>Estimate 2015/16 £'000's</b>	<b>Actual to 30/09/15 £'000's</b>
<b>INCOME</b>			
Employee Contributions	6,106	6,000	2,900
Employer Contributions			
- Normal	18,872	19,500	9,800
- Past-deficit	6,001	6,000	3,000
Transfer Values Receivable	2,896	3,000	500
Investment Income	6,867	7,000	3,700
Total Income	<u>40,742</u>	<u>41,500</u>	<u>19,900</u>
<b>EXPENDITURE</b>			
Pensions	24,470	25,200	12,600
Lump Sums	4,477	5,000	2,600
Transfer Values Paid	3,277	3,000	400
Administration			
- Manager fees	2,495	2,700	1,400
- Other	685	600	300
Refund of Contributions	88	100	-
Total Expenditure	<u>35,492</u>	<u>36,600</u>	<u>17,300</u>
Surplus/Deficit (-)	<u>5,250</u>	<u>4,900</u>	<u>2,600</u>
<b>MEMBERSHIP</b>	<b>31/03/2015</b>	<b>30/09/2015</b>	
Employees	5,782	5,985	
Pensioners	4,948	5,026	
Deferred Pensioners	5,066	5,172	
	<u>15,796</u>	<u>16,183</u>	