PENSIONS INVESTMENT SUB-COMMITTEE

Minutes of the meeting held at 7.00 pm on 22 May 2018

Present

Councillor Keith Onslow (Chairman)
Councillor Russell Mellor (Vice-Chairman)
Councillors Gareth Allatt, Simon Fawthrop, David Jefferys and Gary Stevens

Also Present

John Arthur, Allenbridge
Alick Stevenson, Allenbridge

34 APOLOGIES FOR ABSENCE AND NOTIFICATION OF SUBSTITUTE MEMBERS

Apologies were received from Cllr Simon Jeal and Cllr Kevin Brooks attended as alternate.

Apologies for attendance were also received from Mr Geoffrey Wright as a Member Representative of the Local Pension Board.

35 DECLARATIONS OF INTEREST

There were no declarations.

36 CONFIRMATION OF MINUTES OF THE MEETING HELD ON 20TH FEBRUARY 2018 EXCLUDING THOSE CONTAINING EXEMPT INFORMATION

The minutes were agreed.

37 QUESTIONS BY MEMBERS OF THE PUBLIC ATTENDING THE MEETING

There were no questions.

38 PENSION FUND PERFORMANCE Q4 2017/18

Report FSD18042

Details were provided of the Fund’s investment performance for the fourth quarter 2017/18 with additional detail provided in an appended report from the Fund’s external advisers, AllenbridgeEpic. Information on general financial and membership trends of the Pension Fund was also outlined along with summarised information on early retirements.

The market value of the Fund ended the March quarter at £970.7m and had increased to £983.6m as at 30th April 2018. The total fund return for the fourth quarter was -2.39% against a benchmark of -2.62%, compared to an average -3.6% across the 61 LGPS funds in PIRC's universe. Overall, medium and long-term returns for the Fund remained particularly strong with returns of 6.7% for 2017/18 and 26.8% for 2016/17 against a benchmark of 3.1% and 24.6% respectively.

Concerning the revised asset allocation strategy and appointments of Schroders (60%) and Fidelity (40%) to manage the Multi Asset Income (MAI) allocations and Fidelity to manage the property fund, initial drawdown for the Fidelity MAI and property fund was completed in February 2018 and the Schroders MAI investment was due to complete on 25th May 2018.

A Q4 summary of manager performance was also appended to Report FSD18042 with the Council using its main custodian, BNY Mellon, for performance measurement information. PIRC currently provided LA universe comparator data with 61 of the 89 LGPS funds signed up to the service, including L B Bromley. Details of the final outturn for the 2016/17 Pension Fund Revenue Account were also appended to the report along with the provisional outturn for 2017/18.

A timetable of Fund Manager attendance at future meetings was also outlined as follows:

24th July 2018 – MFS (global equities)
13th September 2018 - Schroders (multi-asset income)
7th November 2018 – Baillie Gifford (global equities and fixed income)
5th February 2019 – MFS (global equities).

In discussion, Allenbridge summarised the Fund's performance highlighting its very good long term performance and its position as one of the best performing LGPS funds. Background was also provided to the recent asset allocation review and decisions to place funds in the MAI and Property mandates.

Although the Fund's value fell to £970.7m, an outperformance of 0.23% was achieved for the quarter even though global equity markets had been undermined in mid-February. With weak bond markets, strong economic growth, and rising inflation, particularly in the US, an expected rise in interest rates led to the US equity market falling 10% from peak to trough in the following two weeks. All major equity and bond markets were down for the quarter as a whole.

Since Q4, the fund's value had increased and markets were seeing an increased level of stability. Even so, with the substantial Q4 turbulence, Allenbridge suggested (in their report) that 2018 might not be as smooth as 2017. Members were advised that some instability could also remain as central banks continue to remove stimulus to economies such as Quantitative

Easing. Nevertheless, Allenbridge suspected that conditions would be a little better at the end of 2018/19.

Allenbridge also provided a brief summary on the performance of individual fund managers with more detail provided in their report. Although the MFS Global Equity portfolio is ahead of benchmark over five years, it was not reaching its performance target and a close watch was being given to the portfolio.

Highlighting a positive message for the Fund overall, the Chairman indicated that it is more or less 100% funded. In subsequent discussion, various points and observations were made by Members with a number of questions asked.

In regard to fixed Interest, confirmation was sought that this referred to Fixed Income bonds where the capital value was at risk. This was confirmed by Allenbridge. Additionally, it was noted there had been a conscious choice in some cases to invest in sub-investment grade bonds rather than AA rated instruments. Allenbridge indicated that this had been a choice to increase yield on the portfolio and there is a balance to be struck on wanting yield and not wanting risk. Although investments appeared well spread, the inclusion of bonds in relation to economies such as Ghana, South Africa and Egypt did present a greater risk profile. However, fixed interest products were necessary to increase yield for the Fund providing a yield/risk balance. For investment, a close watch was maintained on “junk bonds” thought near to becoming investment grade bonds.

Reference was also made to geo-political considerations, not least Brexit which was posited as inhibiting UK returns, albeit that a view was emphasised of Brexit being an opportunity for growth. In addition, matters such as a new (and uncertain) Italian government, China’s high inflation rate, Middle East instability etc. were matters to note. A need for caution was suggested on MAI funds - should such headwinds come together there could be difficulties.

On property, the yield is attractive and being achieved (but with no excess return); property also increases diversification and spreads risk (helpful in a time of volatility). Investing in a fund rather than direct to property is preferable as risk is spread and income provided.

Concerning the Fund’s cash deficit, the sum amounted to £2.3m in 2016/17 and £5.4m in 2017/18 and, prior to the recent asset allocation review, had been projected to increase to around £20m over the next five years. In this context, the Director of Finance highlighted a seminar on the Fund for all Members set for Monday 5th November 2018 (including attendance by Fund Managers). For new Sub-Committee Members, previous papers of interest would also be circulated for information e.g. those related to the London Collective Investment Vehicle (CIV), the recent asset allocation review, and the Fund’s previous actuarial valuation.

Concerning recent global developments (such as US relations with Iran and a more protectionist US approach to trade), markets can normally cope with political events but major political decisions leading to developments such as a serious trade war can impact economies and lead to higher inflation, interest rate rises, and a slump (in the global) economy.

Should income from the new MAI and Property funds ever be insufficient to meet cash-flow requirements, Members supported the Director (in consultation with the Chairman) instructing Global Equities managers to pay dividend income to the Fund to meet additional cash-flow needs e.g. in the event of a small bulk transfer out of the Fund. Any larger cash-flow need which dividend income alone could not meet would be submitted to the Sub-Committee for agreement on assets to sell for the payment.

On the “shadow pension fund” (Parallel Fund) (value at approximately £2.8m) previously established to mitigate the impact of future actuarial valuations on the Council’s General Fund, the Chairman suggested a discussion on whether the fund should be reviewed and the Director suggested the matter be reviewed by the Executive at the time of the Fund’s next triennial valuation.

RESOLVED that:

(1) the contents of Report FSD18042 be noted; and

(2) authority to retain dividend income from Global Equities mandates to meet any additional cash flow requirements be delegated to the Director of Finance in consultation with the Chairman of the Sub-Committee as detailed at paragraph 5.1.3 of Report FSD18042.

39 PENSION FUND - INVESTMENT REPORT

Quarterly reports from Fund Managers had been circulated to Sub-Committee Members and Members of the Local Pension Board (for information) prior to the meeting.

Representatives from Fidelity attended the meeting to report on the performance of its mandate in Fixed Income (UK Aggregate Bond) Multi-Asset Income (Diversified Income) and Property (UK Real Estate).

<u>Diversified Income</u>

Fidelity’s Diversified Income portfolio for the Fund was launched on 21st February 2018 with an initial mandate size of £80m and a target income of 4% (with no benchmark). A flexible investment approach is taken to navigate changing market environments, balancing income and total return with risk and liquidity.

Income for the portfolio is earned from Growth assets (Equity, Infrastructure, Real Estate, and Catastrophe Bonds), Income assets (Government Bonds, Investment Grade Bonds, Hard Currency EM Debt, Mortgages/ABS, and Cash), and Hybrid assets (Local Currency EM Debt, Loans/CLOs, Hybrid Bonds and High Yield Bonds).

Income assets aimed to deliver steady income with capital preservation characteristics, tending to perform better in recessionary phases when GDP growth is subdued and inflation falling. Hybrid assets deliver an attractive yield with potential for capital growth, tending to outperform in early recovery periods. Growth assets are the most volatile, aiming to deliver capital growth with income, and tending to perform better in phases of robust economic expansion and rising inflation. Investment ranges for the asset groups comprised: Income assets 20-80%; Hybrid assets 0-55%; and Growth assets 5-40%. As at 31st March 2018, Diversified Income comprised: Income assets (yield 2.8%) at 35.5%; Hybrid assets (yield 5.6%) at 32.8%; and Growth assets (yield 4.3%) at 31.7%. Mr Arthur indicated that the Fund could afford to increase diversification at the expense of a reduction in overall returns in view of its good level of funding (approximately 100%).

For standard period returns to 31st March 2018, Diversified Income achieved a one month return of -1.2% and achieved a return since launch of -1.0%. A strong period of economic growth is now plateauing with markets becoming more volatile. As such, Fidelity is looking to have more defensive instruments for the portfolio and low volatility assets. These include instruments such as hedges to dampen volatility and more fixed Income assets going forward. The portfolio was built to withstand a challenging environment and is well diversified across asset classes, regions and capital structure. Fidelity also favoured Alternatives where good yield and diversification opportunities can be found. Emerging market local currency debt, loans and financials are high conviction areas.

Fidelity had increased equity market hedges for the portfolio since the end of March by adding to hedges in the UK equity market and technology sector. They had also trimmed exposure to European high yield bonds and added to US investment grade bond exposure. Additionally, Fidelity had taken a new holding – Chenavari Toro Income Fund Ltd. Fidelity expected to become defensive on equity allocations at an appropriate point in the future.

UK Real Estate

An expected income distribution of 4.5 to 5.0% p.a. was forecast over the next five years for Fidelity's UK Real Estate portfolio. The fund had an Asset GAV at 31st March 2018 (including undrawn commitments and cash) of £597.8m covering 45 high quality assets in the Office sector (46%), Logistics/industrial sector (38%), and Retail sector (18%).

UK Aggregate Bond

Fidelity's presentation showed that since inception, performance against benchmark for their Institutional UK Aggregate Bond fund amounted to 1.3% p.a.

At the end of their presentation Fidelity representatives left the meeting.

The Chairman then took the opportunity of thanking Mr Alick Stevenson (Allenbridge) on his work for the Pension Fund as investment adviser over a number of years. Mr Stevenson would be taking retirement and future investment advice from Allenbridge would be provided by Mr John Arthur.

Mr Stevenson and Mr Arthur both left the meeting on conclusion of the Sub-Committee's Part 1 business.

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

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

The following summaries refer to matters involving exempt information

41 CONFIRMATION OF EXEMPT MINUTES OF THE MEETING HELD ON 20TH FEBRUARY 2018

The exempt minutes were agreed and Members considered two matters referred to in the minutes.

The Meeting ended at 10.11 pm

Chairman