

Croydon Council

REPORT TO:	PENSION COMMITTEE 8 July 2014
AGENDA ITEM:	14
SUBJECT:	Progress Report for Quarter Ended 31 March 2014
LEAD OFFICER:	Director of Finance and Assets (Section 151 Officer)
CABINET MEMBER	Councillor Simon Hall Cabinet Member for Finance and Treasury
WARDS:	All
CORPORATE PRIORITY/POLICY CONTEXT: Sound Financial Management: Reviewing and ensuring that the performance of the Council's Pension Fund investments is in line with their benchmark and within the assumptions made by the Actuary.	
FINANCIAL SUMMARY: This report shows that the market value of the Pension Fund (the Fund) investments as at 31 March 2014 was £746.7 million compared to £727.3 million at 31 December 2013, an increase of £19.4 million. Performance data has been provided by WM Company. Independent information and analysis on the fund managers and markets have been provided by the Fund's independent investment advisors AON Hewitt, and Valentine Furniss.	
FORWARD PLAN KEY DECISION REFERENCE NO.: N/A	

1 RECOMMENDATIONS

- 1.1 The Committee are asked to consider and note the contents of this report.

2 EXECUTIVE SUMMARY

- 2.1 This report provides an update on the London Borough of Croydon Pension Fund's (the Fund's) performance for the year and quarter to 31 March 2014. This includes an analysis by asset class and by fund manager. The report comprises two parts: the second part of this report contains material that is considered commercially

sensitive or material that is propriety for advisors to the Fund. Members of the Committee may wish to read this report in conjunction with the Fund Managers' and the WM Company reports, which have been distributed separately. Table 1 below summarises this quarter's market values by asset class.

Table 1: Performance for the Quarter Ended 31 March 2014

Asset Class	Value at Asset class at Quarter End		Performance relative to benchmark (%)		
	Quarter Ended 31/12/2013	Quarter Ended 31/03/2014	Return Made	Benchmark Return	Over/Under Performance
			(a)	(b)	(a-b)
Global Equities	399.3	398.0	-0.3	0.4	-0.7
Global Fixed Interest	161.1	164.4	2.1	1.9	0.2
Fund of Hedge Funds	28.7	29.6	3.4	2.5	0.9
Private Equity ²	26.4	30.6	n/a	4.9	n/a
Property ¹	55.3	67.6	-3 *	3.9	n/a
Infrastructure	26.4	26.7	0.8	2.9	-2.1
Cash ³	30.2	29.6	n/a	0.1	n/a
Fund Total	727.4	746.7			

Source: WM Returns

* Schroders valuation also includes £14 million of additional investment

All figures are rounded to the nearest one decimal place for clarity. Because of roundings figures may not cross-cast. The performance figures and benchmarks are weighted across the entire fund. Source: WM Returns.

Notes:

¹ The performance figure for property has been adjusted to allow for those funds that are considered transitional and will not form part of the long-term investment portfolio.

² Returns for private equity and infrastructure are lagged, that is to say the process by which the assets are valued and performance assessed takes longer than the time required to prepare quarterly valuations. These returns are also quite lumpy – so that one does not observe a steady, smooth growth in the value of the funds, rather they increase in value in steps.

³. Cash figure is cash held in house. The performance figure reflects the use of AAA-rated money market funds to deposit working capital. These instruments are rated as being very risk averse but consequently generate less returns.

2.2 This report also considers officers' review of the Fund Managers over the quarter. This takes into consideration the performance of the Manager against the agreed target, trigger events defined by Croydon that require investigation, and the rating given by AON Hewitt; providers of independent analysis on the fund managers. AON Hewitt's ratings report (Appendix D) has been provided as an appendix to this report.

- 2.3 Financial and market commentaries from the Council's Independent Pension Fund Advisers, Valentine Furniss and AON Hewitt are appended to this report (Appendix F in the closed section of the report). The report from Valentine Furniss (Appendix G) reviews the major world financial markets, whilst a report from AON Hewitt (Appendix E in the closed section of the report) provides a Market Valuation Review of the medium term outlook for returns over three to five years.
- 2.4 The total market value of the Fund as at 31 December 2013 is £15.5 million greater than the figure quoted in the previous Progress Report tabled at this committee on the 4th of March 2014. The difference relates to further investment in AllBlue, a Fund of Hedge Funds, which had mistakenly been omitted from WM Company performance measurement report as at the 31st of December 2013. The report was amended and reissued but unfortunately not in sufficient time to be reported to the 4th of March 2014 committee.

3 DETAIL - PERFORMANCE OF THE PENSION FUND

- 3.1 The WM Company collates valuation and performance data for Croydon's Pension Fund Investment Managers. Reporting on the Fund's performance has been provided below for the period to 31 March 2014. The overall Fund benchmark is a weighted average of the Fund's individual asset benchmarks based on the target allocation to each asset class.

Changes to Fund Structure

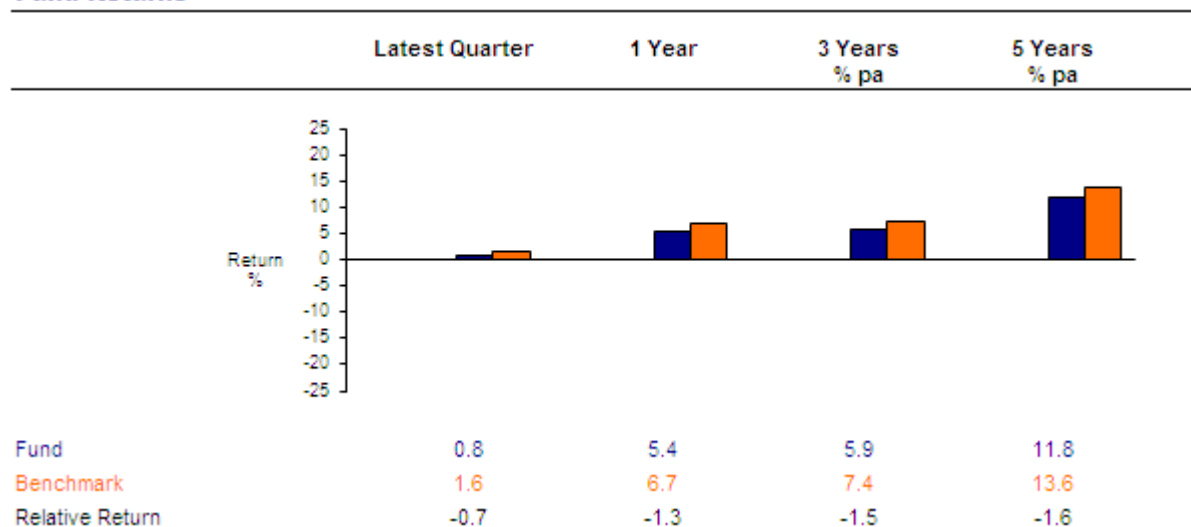
- 3.2 During the quarter ended 31 March 2014 holdings in Sarasin's active global equity portfolio were fully redeemed and reallocated to an L&G passive global equity funds. Cash investments totaling £11.4 million were allocated to the Schroders property portfolio to increase the property allocation towards 10% as per the strategic asset allocation.
- 3.3 The cash balance reported in Table 1 above represents cash held by the in-house treasury team and includes both working capital (i.e. the difference between contributions received and benefits and transfers paid out) and cash liquidated awaiting reinvestment. The cash balance includes two fixed term deposits with Lloyds of £5m and £15m redeemed on the 4th of April and the 7th of April respectively and invested in the Legal and General passive global equity fund. Cash managed in-house is held as working capital and therefore during any given quarter can be reduced by the value of invoices paid out or transfers made. The largest regular charge on this sum relates to the cost of the pensions payroll that is financed by the General Fund of the Council and recharged to the Pension Fund. In keeping with best practice the cash is held and accounted for separately from the general funds of the authority. The balance is invested overnight in a Goldman Sachs Asset Management Money Market Fund. Interest is accrued on a daily basis and paid monthly.

Total Fund Performance

- 3.4 The chart below provides a high level summary of the performance of the fund. The total Fund return for the quarter was 0.8%, and underperformance of 0.7% against the benchmark of 1.6%. The Fund has underperformed the benchmark over the year, 3-year and 5-year periods. The performance gap is steadily falling though, from 1.6% over the 5-year period, 1.5% over 3 years to 1.3% over the year. Further details of performance including underlying asset classes and individual fund managers are provided in section 4 below.

Chart 2: Performance of the Pension Fund

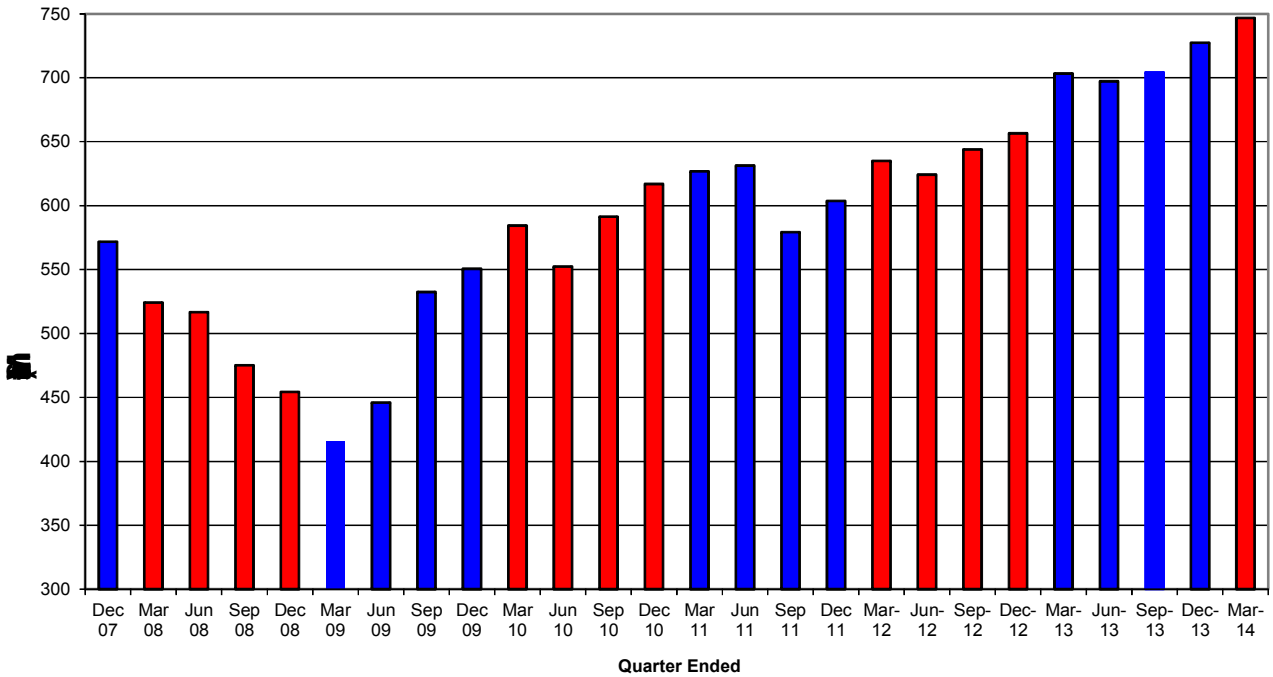
Fund Returns



Source: WM Returns

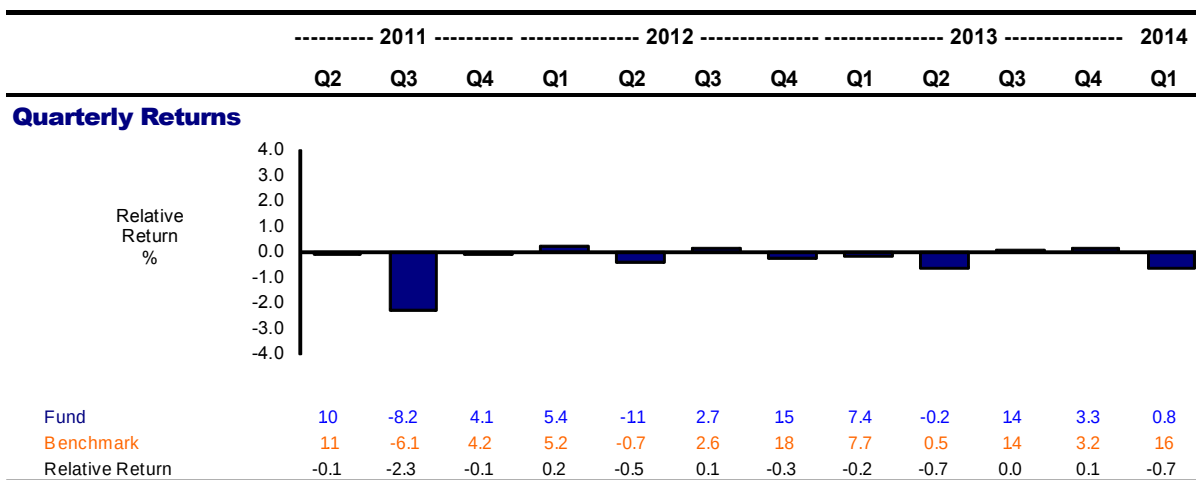
- 3.5 Chart 3 below details the movement in the Market Value of Fund on a quarter by quarter basis, over a 5-year period. The market value of the fund at the end of March 2014 was £746.68m, an increase of £19.4m over the previous quarter's valuation.

Chart 3: Trend in Total Value of Pension Fund in £millions



3.6 Chart 4 below illustrates the Fund's historic relative performance against the benchmark since inception of the revised investment strategy. This benchmark is an aggregate of individual asset class benchmarks weighted by the Fund's target asset allocations.

Chart 4: Trend in Relative Returns of the Pension Fund



Attribution

- 3.7 For the period ending 31 March 2014 the Fund's return of 0.8% underperformed the benchmark return of 1.6%. The summary table below illustrates this point. Fund manager performance including their stock selection decisions dragged heavily on the fund's performance during the quarter. The Fund's asset allocation also detracted from performance albeit to a lesser degree. This is summarised in the table below.

Summary:

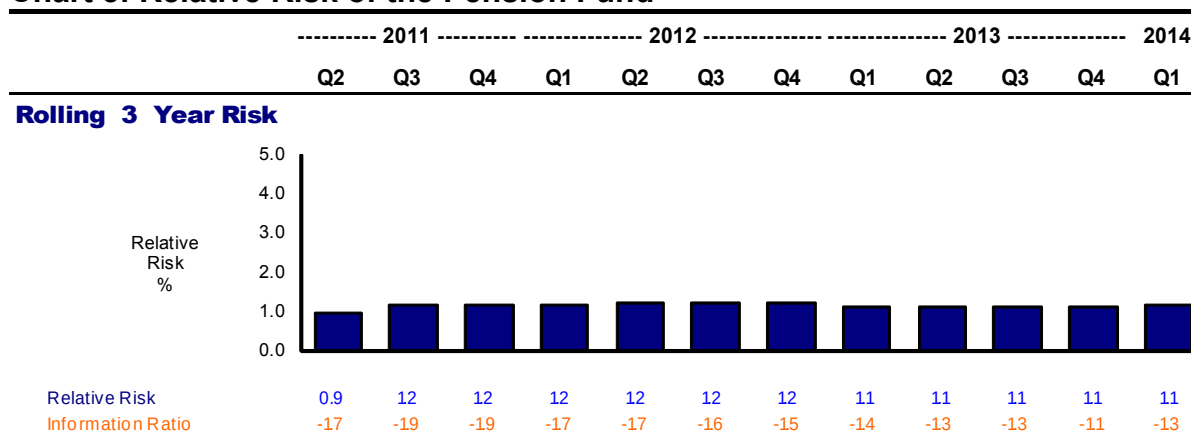
Fund Return	0.8
Benchmark Return	1.6
Relative Performance	-0.7
attributable to:	
Asset Allocation	-0.2
Stock Selection	-0.5

Source: WM Returns

Risk

- 3.8 Chart 5 below illustrates the relative risk of the fund over the past 3 years. Relative risk measures the degree of fund performance deviation from benchmark. This is included with the information ratio, a measure of manager skill in adding value over and above the benchmark.

Chart 5: Relative Risk of the Pension Fund



Source: WM Returns

- 3.9 WM graphs demonstrating the impact of asset allocation and stock selection are attached as Appendix C to this report. The graph shows asset allocation dragged on performance during the quarter this was attributed to cash and property. The stock selection graph, in Appendix C, shows that stock selection by equity managers attributed to the fund's quarterly performance.

3.10 Below is a table of the Top 10 holdings within the portfolio:

Top 10 Holdings Held in Fund	Value (£m)	Weight %
APPLE INC	6.36	0.85%
ROCHE HLDG AG GENUSSSCHEINE NPV	4.65	0.62%
SAMSUNG ELECTR-GDR REGS	3.29	0.44%
VISA INC	3.22	0.43%
SCHLUMBERGER LTD	2.90	0.39%
NOVO-NORDISK AS	2.77	0.37%
US BANCORP	2.74	0.37%
DANAHER CORP	2.74	0.37%
SYNGENTA AG	2.73	0.37%
ORACLE CORP	2.69	0.36%

Source: BNYM Workbench

Note that these equities may be held by more than one of the fund managers.

4 FUND MANAGER PERFORMANCE

Summary

- 4.1 Appendix A details the market value and performance over the quarter and since inception for each fund manager.
- 4.2 Chart 6 below illustrates the performance of each fund manager against their benchmark over the most recent quarter and Chart 7 demonstrates performance for each since inception. Note that the benchmark for private equity does not satisfactorily reflect the potential of immature funds such as Equitix and Knightsbridge.

Chart 6: Fund Manager Quarterly Returns

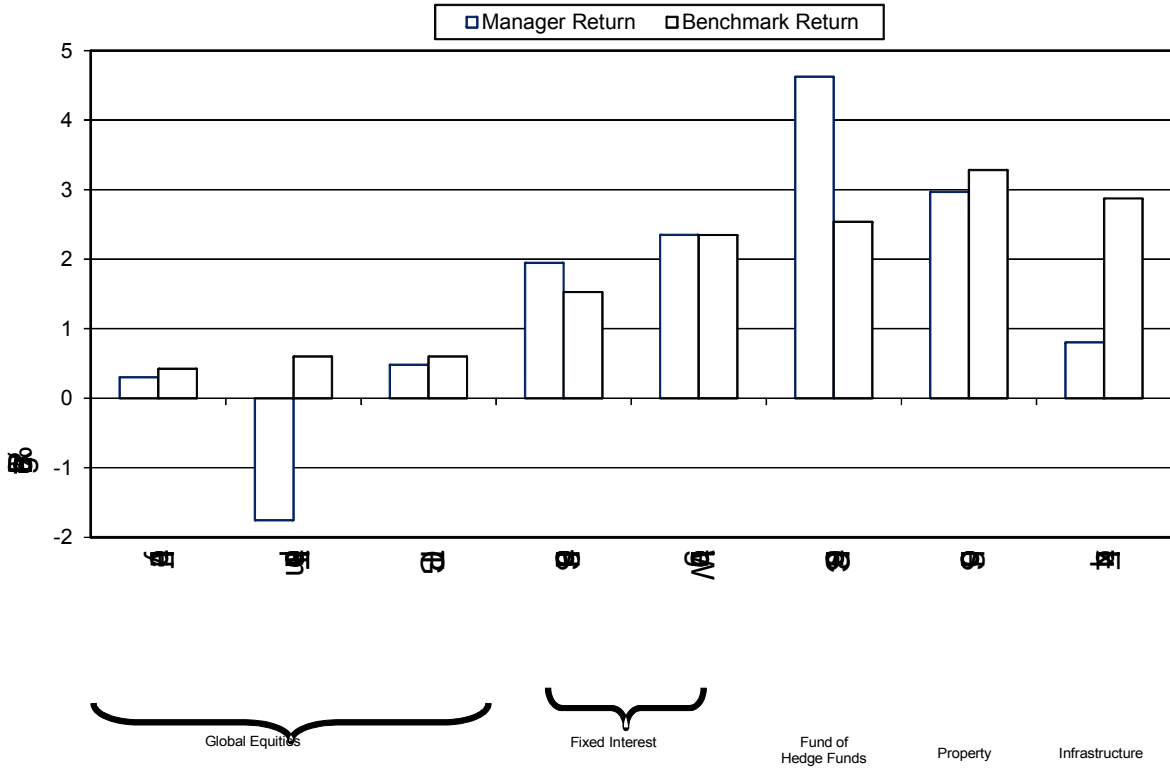
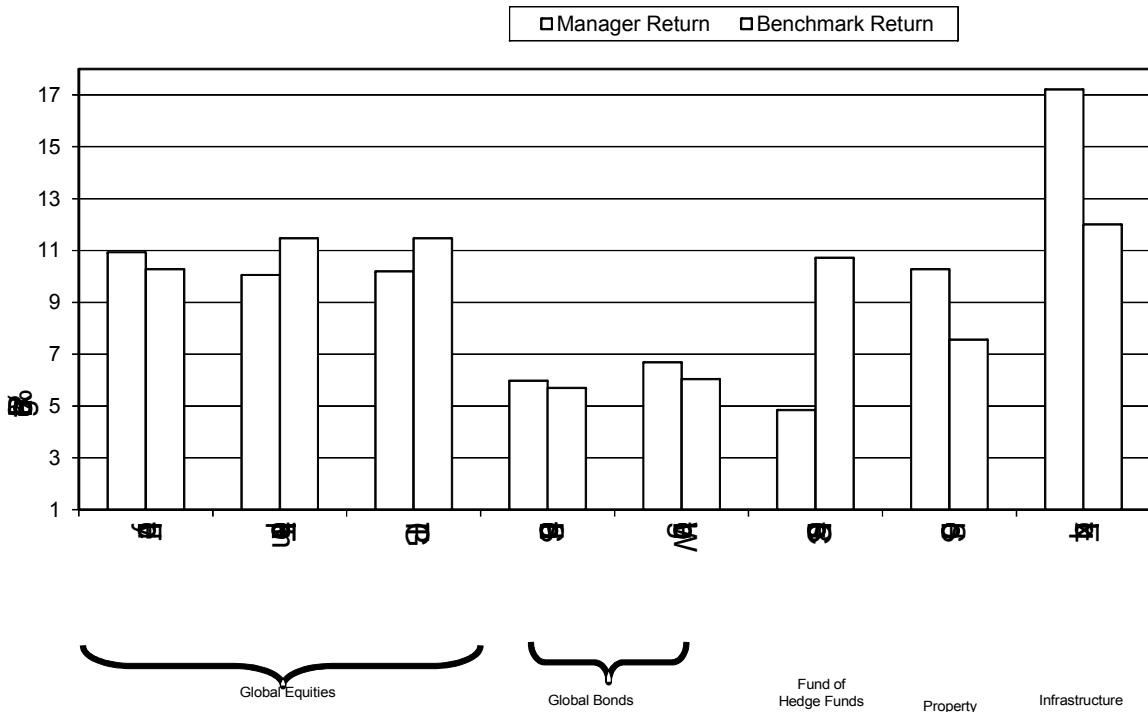


Chart 7: Fund Manager Returns Since Inception



4.3 The MSCI World Index posted a modest gain of 1.2% in the quarter as economic data softened. Economic data from the US was mixed but this is thought to be a result of severe weather rather than underlying weakness in the economy. Announcements by Janet Yellen, the FED's new Chair, signaling the tapering of quantitative easing would remain unchanged at \$10 billion per month and interest rates would remain low for the foreseeable future were positively received by investors as the S&P gained 1.8% over the quarter. Europe was the best performing region during the quarter. Positive macroeconomic data, a change of government in Italy and consistent monetary policy supported returns in the Eurozone despite deflation fears. In contrast UK equities lost value on the back of disappointing earnings. Japan, Asia (ex Japan) and Emerging Markets experienced negative performance over the quarter as concerns over slowing Chinese economy and the Crimea crisis weighted on returns. Chart 6 shows the benefit of having a spread of investment styles within the portfolio. The methodology for assessing the in-year performance of the private equity managers remains problematic especially when the funds are immature, such as is the case for both the Equitix and Knightsbridge funds although their actual performance continues to be encouraging. Please refer to the attribution analysis below under section 5. A detailed review of individual fund manager performance has been undertaken and is reported under the Fund Manager Review section below.

Fund Manager Review

4.4 Officers continuously review the performance of managers and engage with them periodically. A summary table of results is provided below. A tolerance level of 1% below the benchmark has been set for further investigation. Where appropriate, Officers will meet with the manager to discuss performance and consistency of investment themes. Note, where underperformance is consistent across all managers, and attributable to market conditions, - i.e. beta, a review will be considered based on the circumstances at the time. Along with performance data, qualitative information will be considered based on trigger events, news and reviews by the Fund's independent advisors. Members are invited to comment on the outcome of this review process.

Table 2: Summary by Fund Manager

Fund Manager	Is Performance in line with the appropriate index? (allowing for 1% variance)	Has there been no trigger event?	Has there been a visit (or virtual meeting) this quarter?	If in any of these instances the answer is no, what action has been taken?
Fidelity	✓	✓	x	See paragraph 4.6
Franklin Templeton	x	✓	✓	See paragraph 4.9
GTP (DB Advisors)	x	✓	x	See paragraph 4.8
L&G	n/a	n/a	✓	See paragraph 4.7
Standard Life	✓	✓	x	See paragraph 4.11
Wellington	✓	✓	x	See paragraph 4.11
BlueCrest	✓	✓	x	See paragraph 4.14
Pantheon	n/a	✓	✓	See paragraph 4.15
Equitix	n/a	✓	x	See paragraph 4.15
Knightsbridge	n/a	✓	x	See paragraph 4.15
Henderson	x	✓	x	See paragraph 4.12
Schroder	✓	✓	x	See paragraph 4.13

Performance

- 4.5 There was a range of outperformance and underperformance by the managers against their benchmarks over the quarter. For further details please refer to Chart 5 (above) and Appendix A showing the WM performance for each fund manager. Franklin Templeton, GTP, BlueCrest, and Henderson had an underperformance outside the 1% tolerance over the quarter.

Equities

- 4.6 Fidelity underperformed the MSCI AC World NDR by 0.1% over the quarter. A detailed analysis is contained in the closed section of this report.
- 4.7 The Sarasin portfolio was fully redeemed during the quarter and the funds were invested in a Legal and General passive global equity fund. The first full quarter of performance for the Legal and General portfolio will be the quarter ended 30 June 2014.
- 4.8 Global Thematic Partners underperformed the benchmark by 0.1% over the quarter ended 31 March 2014. More detail is provided in the closed part of the report. The manager has underperformed the benchmark by 1.1% since inception.
- 4.9 Franklin Templeton, the Fund's value equity manager, underperformed the MSCI World NDR by 2.3% during the quarter and by 1.3 since inception. The closed section of this report provides a more detailed analysis.

Fixed Interest

- 4.10 Wellington's performance of 2.4% during the quarter was in line with the benchmark. Wellington have outperformed the BAML GBP Broad Market benchmark by 0.6% since inception. Standard Life outperformed the benchmark by 0.4% over the quarter and outperformed the benchmark by 0.3% since inception. Fixed income markets broadly outperformed equity indices over the quarter. However yields in Treasuries, gilts and bunds remained low due to concerns of the crisis in Ukraine and decline in the Chinese economy. High yield and investment grade corporate bonds indices rose by 2.8% and 2.7% during the first quarter.

Property

- 4.11 European property - The Committee agreed to transfer the European property portfolio to Schrodgers to manage on a care and maintenance basis with a view to liquidating the holdings at an opportune time. Hence Schrodgers performance measurements will be net of the European property. The European portfolio, comprises of a Henderson European property fund and Standard Life European property fund. These funds underperformed the benchmark by 1.92% over the quarter and by 9.8% since inception.
- 4.12 Schrodgers – Following the closure of Henderson's property fund of fund business, Schrodgers took over the UK property portfolio (in August 2011) on the understanding they would have require time to transition the assets so that they conformed to their investment strategy. During this period Schrodgers' performance will not be assessed although obviously officers are monitoring performance. The formal measurement of Schrodgers' performance commenced in the quarter starting 1 January 2014. The Schrodgers' UK property portfolio is measured against the IPD All Balanced Weighted Average index. The portfolio underperformed the benchmark by 0.3% during the quarter to 31 March 2014 and has outperformed by 2.8% over the 12 months to 31 March 2014.

Fund of Hedge Funds

- 4.13 BlueCrest have a benchmark of 10% over 3-month LIBOR (London Inter-Bank Offer Rate; the interest rate that banks charge each other for loans). BlueCrest outperformed their benchmark by 2.0 over the quarter but underperformed the benchmark by 5.3 since inception.

Private Equity and Infrastructure

- 4.14 Equitix, Pantheon and Knightsbridge – The design of private equity and infrastructure funds makes meaningful performance management in the initial few years problematic. Both fund managers ask for cash to invest as opportunities arise – in the case of the Knightsbridge fund this will be over a 5 to 7-year period, for Equitix up to 2 years. The value of Knightsbridge's investments will become clear when the invested companies are listed on public exchanges or acquired by other businesses. Consequently there will be a timing gap between investment and crystallising returns. The Fund is investing in the second generation of Pantheon's funds. The first, earlier, generations are in the cash distribution phase. The second generation of funds is in its infancy and looking for investment opportunities. The performance of the asset class is difficult to assess until funds are quite mature. However, by close monitoring of the initial underlying investments and regular

dialogue with fund managers, officers have been able to establish a degree of confidence in the ability of the funds to match performance targets.

Manager Visits

- 4.15 In addition to virtual meetings held during the quarter ended 31 March 2013, officers and/or members attended meetings with the following managers:

Manager	Date of Meeting
Pantheon	13 January 2014
Legal and General	16 January 2014
Sarasin	3 February 2014
Franklin Templeton	25 February 2014
Pantheon	27 March 2014

These meetings represented an opportunity to explore performance issues in detail and for managers to set out their views on the current and future investment landscape.

5 ASSET ALLOCATION

Effect on Performance

- 5.1 Returns of the Fund are due to two factors; the allocation of investments to different assets classes; and how these individual asset classes perform. Table 3 below summarises the asset allocation as at 31 December 2013. The geographical breakdown of asset allocation is provided in the WM Asset Mix and Returns schedule attached as Appendix B.

Table 3: Asset Allocation of the Pension Fund

Asset Class	Percentage of Fund Value	Strategic Allocation	Variance
Equities	53%	50% +/- 3	0.0%
Fixed Income	22.0%	25% +/- 3	0.0%
Property	9.1%	10% +/- 3	0.0%
Private Equity	4.1%	5%	-0.9%
Infrastructure	3.6%	5%	-1.4%
Hedge Funds	3.9%	4%	-0.1%
Cash	4.0%	1%	3.0%

Source: WM Returns

It is clear from this table the Fund had an overweight cash position at the end of the quarter, this included £15m held in fixed term deposits with Lloyds TSB which have since matured and been invested. On the 16th of April officers invested £23M cash in the Fund's passive global equity portfolio. Conversely private equity and infrastructure allocations are underweight against their strategic benchmark. The steps proposed to address these deficiencies are detailed above in the body of this report. Equities are overweight by 1.9% outside of tolerances.

- 5.2 Members will note that market volatility has the potential to drive the weightings of asset allocation out of balance. Asset allocations against the benchmark are reviewed and addressed on a quarterly basis within the agreed tolerances. Adjusting investment levels can be a protracted process involving extensive due diligence and therefore there will typically be a lag between the decision to rebalance and the execution of that decision.

A review of the current market suggests that opportunities to invest in quality infrastructure and private equity investments are not readily available; hence the process of identifying investment opportunities can be time consuming. Cash balances will decrease as the asset classes are populated.

- 5.3 The asset allocation of the portfolio will be monitored internally by officers on a monthly basis. Where needs be the portfolio will be further rebalanced under delegated powers and in consultation of the Chairman.

6 INVESTMENT ADVISOR'S REVIEW

- 6.1 An independent review of the fund managers has been provided by AON Hewitt in the Managing Monitoring Report attached as Appendix D on the closed section of the agenda. AON Hewitt has applied a rating to each fund manager and a traffic light system has been used to highlight where there are issues of concern surrounding each manager.
- 6.2 AON Hewitt have also produced a Market Review paper for the quarter ended 31 March 2014, it is attached at Appendix E in the closed section of this report. This examines the prospects for equities and fixed interest over the forth coming period.

7 INDEPENDENT ADVISOR'S REVIEW

Report by Valentine Furniss

- 7.1 Appendix G is a copy of the financial commentary for the quarter ended 31 March 2014 provided by the Independent Pension Fund Adviser, Valentine Furniss. This is attached to the closed section of this report. The commentary examines the economic data and events on each of the world's major financial markets including the UK, USA, Europe, Japan and finally Asia/ Pacific. In the report a view is given of both the positive and negative influences impacting on each market. The report also includes the index returns for each of the asset classes for the major world markets as at 31 March 2014.

8 CONSULTATION

- 8.1 Officers have fully consulted with the Pension Fund's advisers in preparing this report.

9 FINANCIAL CONSIDERATIONS

- 9.1 This report deals exclusively with the investment of the Council's Pension Fund and

compares the return on investment of the Fund against the benchmark return.

10 COMMENTS OF THE COUNCIL SOLICITOR AND MONITORING OFFICER

10.1 The Council Solicitor comments that there are no specific legal comments arising from this report

(**Approved by:** Gabriel MacGregor, Head of Corporate Law on behalf of the Council solicitor and Monitoring Officer)

11 OTHER CONSIDERATIONS

11.1 There are no Human Resource, Customer Focus, Equalities, Environment and Design, Crime and Disorder or Human Rights considerations arising from this report.

12 FREEDOM OF INFORMATION/DATA PROTECTION CONSIDERATIONS

12.1 This report contains confidential information which could be of a sensitive nature, disclosure of which could prejudice the commercial interest of the companies involved and those of the Council's Pension Fund.

CONTACT OFFICER:

Nigel Cook – Head of Pensions and Treasury
Chief Executive's Department, ext. 62552.

BACKGROUND DOCUMENTS:

Reports from WM Company

Report from Valentine Furniss

Reports from AON Hewitt

Appendix A: Summary of Manager Performance

Appendix B: Asset Mix and Returns

Appendix C: Detailed Analysis of the Latest Quarter Performance

The following appendices are commercially sensitive:

Appendix D: AON Hewitt Manager Monitoring Report

Appendix E: AON Hewitt Market Review: 3 months to March 2014

Appendix F: AON Hewitt Quarterly Investment Outlook

Appendix G: Valentine Independent Advisor Report for March 2014

Appendix H: Letter from Franklin Templeton, 23 May 2014