

Croydon Council

REPORT TO:	PENSION COMMITTEE 2 December 2014
AGENDA ITEM:	11
SUBJECT:	Progress Report for Quarter Ended 30 September 2014
LEAD OFFICER:	Director of Finance and Assets (Section 151 Officer)
CABINET MEMBER	Councilor 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 30 September 2014 was £769.3 million compared to £753.1 million at 30 June 2014, an increase of £16.2 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 advisor AON Hewitt.	
FORWARD PLAN KEY DECISION REFERENCE NO.: N/A	

1. RECOMMENDATIONS

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

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 30 September 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 so appears in Part B of the agenda. 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 30 September 2014

Asset Class	Value				
	Qua				
	30				

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 exclude funds that are considered transitional and will not form part of the long-term investment portfolio. These are the European property portfolio funds.

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 AON Hewitt are appended to this report (Appendix F in the closed section of the report). 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.

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 30 September 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 At the meeting on 8th July 2014, the Committee approved a move to exclude direct investments in tobacco (Minute B04/14). The Director of Finance and Assets (Section 151 Officer) under previously delegated decision making powers (Minute A03/13) and in consultation with the Chairman has decided to invest in a segregated FTSE4Good tracker fund with Legal and General Investment Management (LGIM). The Investment Management Agreement is currently being reviewed by the council's solicitors. For comparative purposes, performance figures for the FTSE World Index and FTSE4Good Index at 31 October 2014 are outlined below.

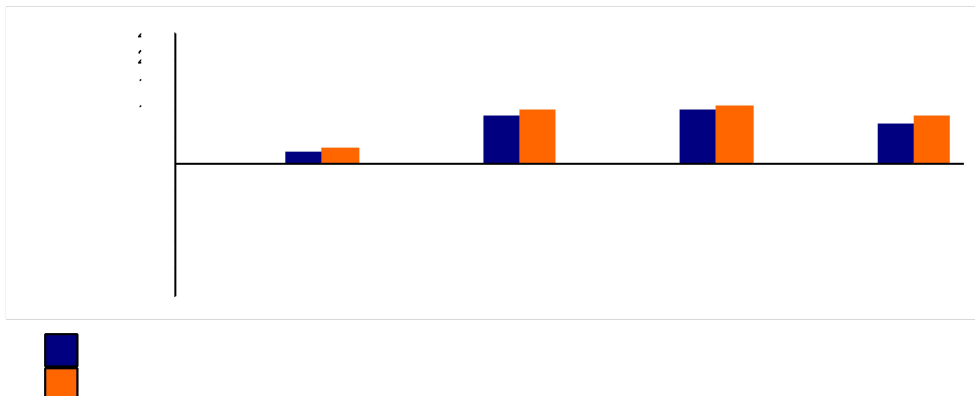
	3 months	12 months	3 years
FTSE World Index	+5.2	+8.8	+14.3 p.a.
FTSE4Good Global Equity Index	+5.3	+9.4	+15.8 p.a.

- 3.3 The Committee also agreed to instigate a review of the asset allocation strategy. It is anticipated a revised strategy will be tabled for approval at the March 2015 Committee meeting.
- 3.4 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. 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

- 3.5 The chart below provides a high level summary of the performance of the fund. The total Fund return for the quarter was 2.4% underperforming the benchmark by 0.6%. 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 to 1.2% over the 3 years. 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

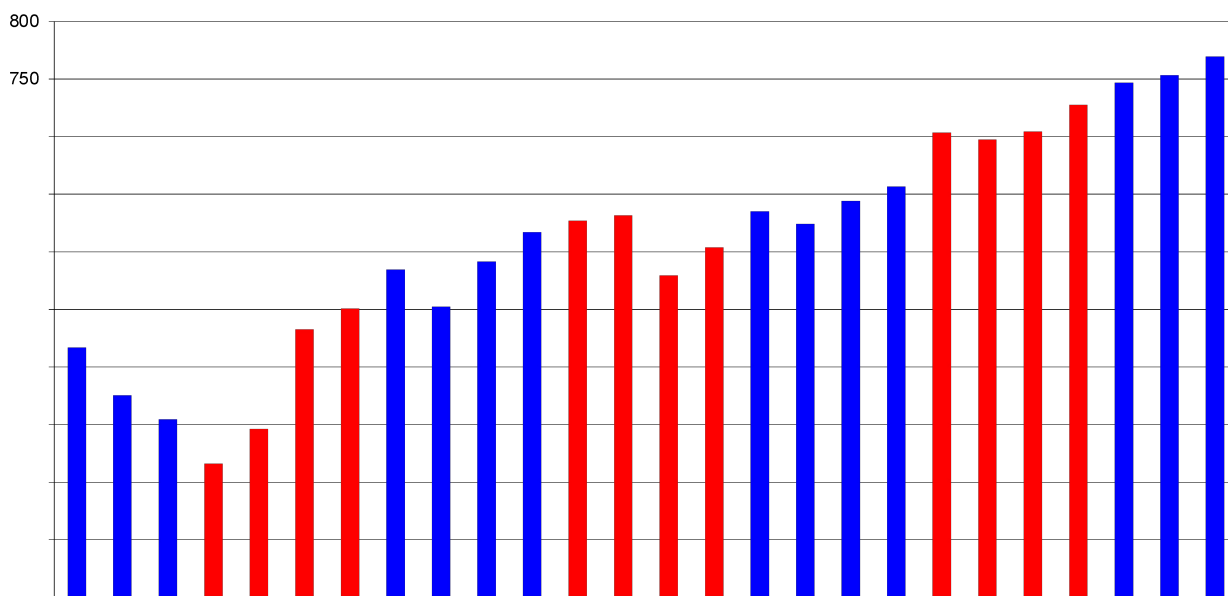


Source

: WM Returns

3.6 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 September 2014 was £769.3m, an increase of £16.2m over the previous quarter's valuation.

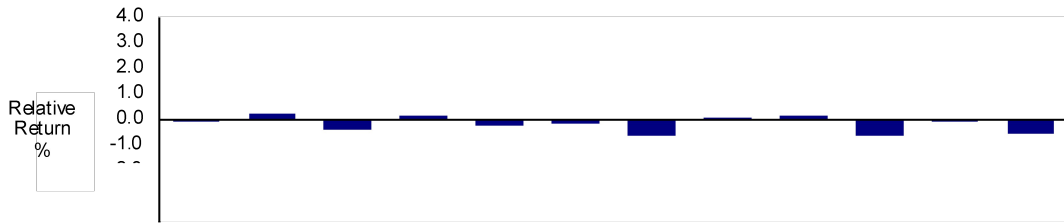
Chart 3: Trend in Total Value of Pension Fund in £millions



3.7 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

Quarterly Returns



Source: WM Returns

Attribution

- 3.8 For the period ending 30 September 2014 the Fund's return of 2.4% was 0.6% under the benchmark return. The summary table below illustrates this point. Stock selection detracted from Fund manager performance during the quarter and asset allocation was in line with the benchmark.

Summary:

Fund Return	2.4%
Benchmark Return	1.8%
Relative Performance	0.6%
Attribution	
Asset Alloc	0.0%
Stock Sele	-0.6%

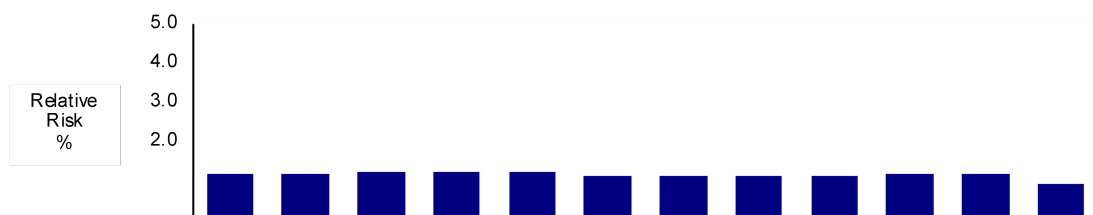
Source: WM Returns

Risk

- 3.9 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

Rolling 3 Year Risk



Source: WM Returns

3.10 WM graphs demonstrating the impact of asset allocation and stock selection are attached as Appendix C to this report.

3.11 Below is a table of the Top 10 holdings within the segregated part of the portfolio:

Top 10 Holdings Held in Fund	Value (£m)	Weight %
ROCHE HLDG	5.38	0.70%
APPLE INC	4.67	0.61%
ADOBE SYSTEMS INC	3.95	0.51%
SYNGENTAAG	3.84	0.50%
DANAHER CORP	3.54	0.46%
CITIGROUP INC	3.36	0.44%
SIGNATURE BANK	3.04	0.40%
ATHENAHEALTH INC	2.84	0.37%
UNITE UK STUDENT ACCOMODATION	2.73	0.35%
SGS SA	2.69	0.35%

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

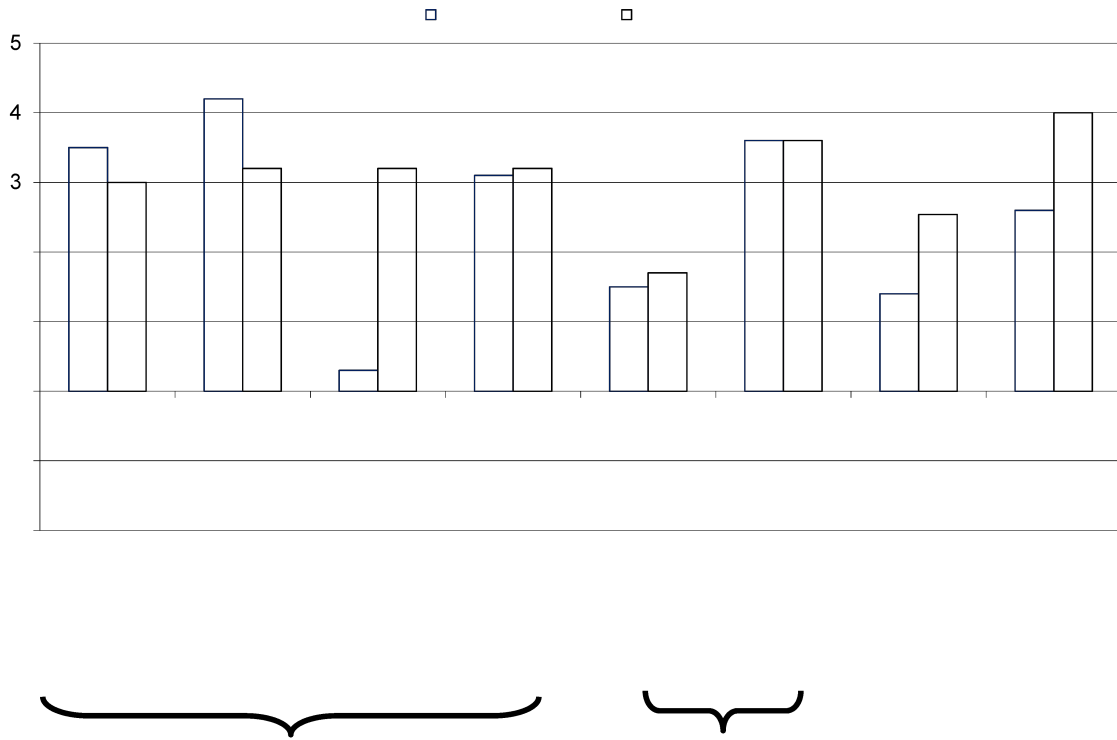
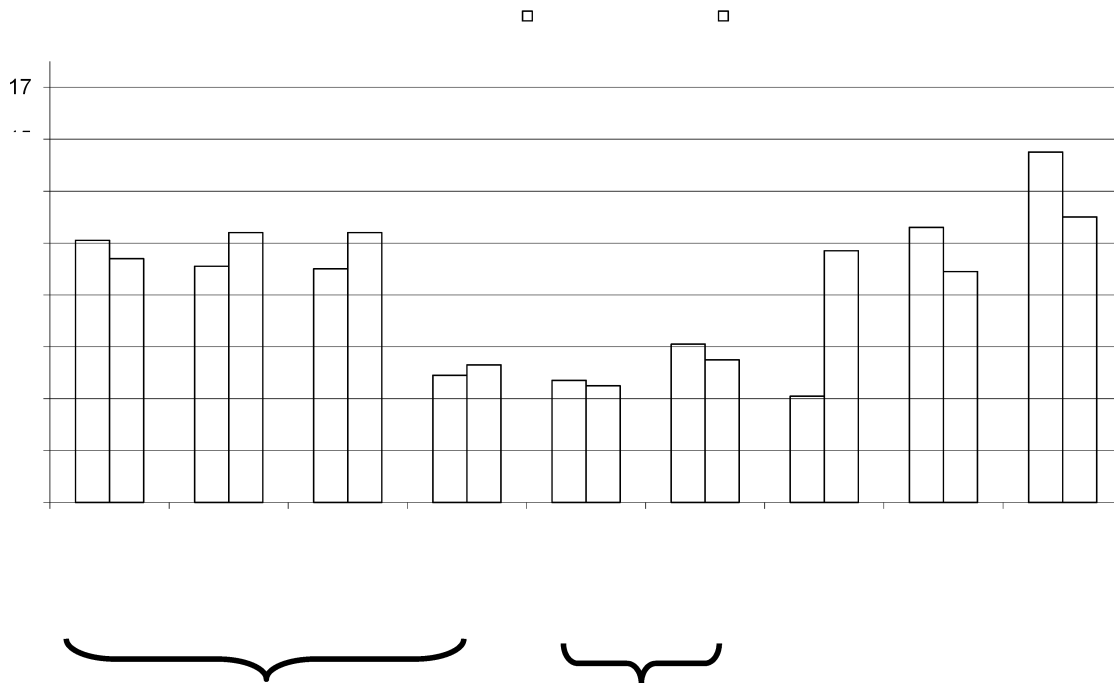


Chart 7: Fund Manager Returns Since Inception



4.3 Disappointing economic data from China and Europe dragged on global equity returns albeit to a lesser extent than tensions Ukraine and the unrest in the Middle East. US equities returned 1.1% over the quarter supported by merger and

acquisition activity within the healthcare and IT sectors. US Energy, utilities and industrials, spooked by the prospect of interest rate hikes and impacted by slowing growth in China, dragged on performance. Eurozone equities posted negative returns over the quarter on the back of disappointing economic data, and the potential impact of sanctions of Russia. The European Central Bank (ECB) took remedial action by cutting interest rates to 0.05% and announcing additional stimulus measures. On a regional basis Italy and Germany were the worst performers while Ireland and Belgium posted the highest returns.

- 4.4 In the UK Mining, oil and gas companies dragged heavily on performance as the result of a slowdown in the Chinese economy and the strengthening US dollar. The pound weakened during the quarter due to uncertainty surrounding the Scottish referendum and disappointing economic data. Although Japanese economic data was mixed, equities performed well as a weaker yen boosted performance across the electrical appliances, machinery and autos sectors. and supportive monetary policy. US equities enjoyed a strong performance in the second quarter as the unemployment rate fell to 6.1%, the housing market improved and inflation moved closed to the Fed's 2% target. Energy was the strongest performing sector boosted by higher oil prices. Despite being the worst performing sector, Financials still produced a positive return. European equities, whilst hammered by disappointing corporate earnings, provided positive returns as expectations that the European Central Bank (ECB) would ease monetary policy gained momentum. The ECB lived up to expectations, cutting the benchmark interest rate to 0.15% (from 0.25%), boosting lending to small businesses by providing cheap four-year loans and introducing a negative deposit rate.
- 4.5 The UK economy continued its upward trend growing by an estimated 0.9% over the quarter driven by household spending and business investment. Both the Oil and Gas and Healthcare sectors performed well, the former benefiting from rising oil prices and the latter from takeover activity. Retailers and house builders had a difficult quarter due to fears of an earlier than expected rise in interest rates. The strength of the pound eroded the profits of UK companies with international exposure. Japanese equity markets were up 5.1% by quarter end and Asia (ex Japan) region produced positive returns boosted by Chinese, Hong Kong and Taiwanese equities. The MSCI Emerging Markets (EM) index underperformed its MSCI World counterpart on the back of weak growth in Latin America, specifically Brazil.
- 4.6 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

- 4.7 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	✓	✓	✓	See paragraph 4.9
Franklin Templeton	✓	✓	x	See paragraph 4.11
GTP (DB Advisors)	x	✓	x	See paragraph 4.10
L&G	✓	✓	✓	N/A
Standard Life	✓	✓	x	See paragraph 4.12
Wellington	✓	✓	x	See paragraph 4.12
BlueCrest	x	✓	✓	See paragraph 4.15
Pantheon	n/a	✓	✓	See paragraph 4.16
Equitix	n/a	✓	✓	See paragraph 4.16
Knightsbridge	n/a	✓	x	See paragraph 4.16
Schroders	n/a	✓	✓	See paragraph 4.14

Performance

4.8 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. GTP and BlueCrest both delivered underperformance outside the 1% tolerance over the quarter.

Equities

4.9 Fidelity returned 3.5%, outperforming the MSCI AC World NDR index return by 0.5% over the quarter and has outperformed the benchmark by 0.6% since inception. A detailed analysis is contained in the closed section of this report.

4.10 Global Thematic Partners underperformed the benchmark by 2.8% over the quarter ended 30 September 2014. Further information is contained in the closed section of this report. The manager has underperformed the benchmark by 1.3% since inception.

4.11 Franklin Templeton, the Fund's value equity manager, outperformed the MSCI World NDR by 0.9% during the quarter. The manager has underperformed

the benchmark by 1.2% since inception. The closed section of this report provides a more detailed analysis.

Fixed Interest

- 4.12 Wellington's performance of 3.6% during the quarter was 0.1% over the benchmark. Wellington has outperformed the BAML GBP Broad Market benchmark by 0.5% since inception. Standard Life underperformed the benchmark by 0.2% over the quarter but outperformed the benchmark by 0.1% since inception.

Property

- 4.13 European property - The Committee agreed to transfer the European property portfolio to Schroders to manage on a care and maintenance basis with a view to liquidating the holdings at an opportune time. Hence Schroders performance measurements will be net of the European property. The Standard Life European Property Growth Fund was sold for £3.89m during the quarter. A redemption notice has been served on the Henderson European property fund, it is anticipated that redemption proceeds will be received in April 2015. The market value of the Croydon share of this fund at 30 September 2014 is £6.87m.
- 4.14 Schroders – Following the closure of Henderson's property fund of fund business, Schroders 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 Schroders' performance would not be assessed although obviously officers monitored performance. The formal measurement of Schroders' performance commenced in the quarter starting 1 January 2014. The Schroders' UK property portfolio is measured against the IPD All Balanced Weighted Average index. The portfolio underperformed the benchmark by 1.3% during the quarter to 30 September 2014 and has outperformed by 1.5% since inception.

Fund of Hedge Funds

- 4.15 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 underperformed their benchmark by 0.8% over the quarter and has underperformed the benchmark by 5.0% since inception. On 26 September 2014, BlueCrest announced its intention to launch an independent firm, Systematica Investments ("Systematica"), which will comprise its systematic investment management business, under the leadership of its current Head of Systematic Trading, Ms. Leda Braga. BlueCrest will maintain a majority economic interest in Systematica, as well as a passive minority equity stake, but the new firm will be managed and controlled by Ms. Leda Braga. Following the announcement, Aon Hewitt reviewed AllBlue, a copy of the review is appended to Part B of this report.

Private Equity and Infrastructure

- 4.16 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

- 4.17 In addition to virtual meetings held during the quarter ended 30 September 2014, officers and/or members attended meetings with the following managers:

Manager	Date of Meeting
Equitix	30 July 2014
Legal and General	11 August 2014
Pantheon	14 August 2014
Equitix	28 August 2014
Fidelity	4 September 2014
Bluecrest	26 September 2014
Schroder	30 September 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 30 September 2014. The geographical breakdown of asset allocation is provided in the WM Asset Mix and Returns schedule attached as Appendix B.

Table 3: Asset Alloca

Asset Class

- 5.2 The Fund held an overweight in equities at the end of the quarter, this reflects the committee decision to use passive equities to hold excess cash positions. Conversely property, private equity and infrastructure allocations are underweight against their strategic benchmark. There is a long-term plan to match these commitments with draw-downs, subject of course to the appropriate investment opportunities presenting themselves.
- 5.3 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.
- 5.4 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.
- 5.5 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 30 September 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 CONSULTATION

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

8 FINANCIAL CONSIDERATIONS

- 8.1 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.

9 COMMENTS OF THE COUNCIL SOLICITOR AND MONITORING OFFICER

- 9.1 The Council Solicitor comments that there are no direct legal implications arising from this report.

(Approved by: Gabriel MacGregor, Head of Corporate Law on behalf of the Council Solicitor & Monitoring Officer).

10 OTHER CONSIDERATIONS

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

11 FREEDOM OF INFORMATION/DATA PROTECTION CONSIDERATIONS

11.1 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

Reports from AON Hewitt

Appendices

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 September 2014

Appendix F: AON Hewitt Quarterly Investment Outlook

Appendix G: AON BlueCrest Flash Report AllBlue

Appendix H: Franklin Templeton Letter re Disclosure Incident