

# Croydon Council

<b>REPORT TO:</b>	<b>PENSION COMMITTEE 08 December 2015</b>
<b>AGENDA ITEM:</b>	<b>6</b>
<b>SUBJECT:</b>	<b>Progress Report for Quarter Ended 30 September 2015</b>
<b>LEAD OFFICER:</b>	<b>Richard Simpson, Assistant Chief Executive (Corporate Resources and s.151 Officer)</b>
<b>CABINET MEMBER</b>	<b>Councillor Simon Hall Cabinet Member for Finance and Treasury</b>
<b>WARDS:</b>	<b>All</b>
<b>CORPORATE PRIORITY/POLICY CONTEXT:</b> 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.	
<b>FINANCIAL SUMMARY:</b> This report shows that the market value of the Pension Fund (the Fund) investments as at 30 September 2015 was £810.7m compared to £827.5m at 30 June 2015, a decrease of £16.8m. The performance figures in this report have been provided by State Street Global Services – Performance Services and are quoted net of fees. Independent information and analysis on the fund managers and markets have been provided by the Fund's independent investment advisor AON Hewitt.  Committee are asked to note that global equity markets performed extremely well during October and the Fund was back up to c£840m as at 31 October 2015.	
<b>FORWARD PLAN KEY DECISION REFERENCE NO.: N/A</b>	

## **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 30 September 2015. 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 State Street Global Services – Performance Services reports, which have been distributed separately. Table 1 below summarises this quarter's market values by asset class.

Asset Class	Value at Asset class at Quarter End in £million		Performance relative to benchmark (%)		
	Quarter Ended 30/06/2015	Quarter Ended 30/09/2015	Return Made (a)	Benchmark Return (b)	Over/Under Performance (a-b)
Global Equities – FTSE4 Good	417.9	401.5	-4.6	-4.5	-0.1
Global Equities – World Index	38.8	36.7	-5.4	-5.4	0.0
Global Fixed Interest	174.4	176.1	1.0	1.5	-0.5
Fund of Hedge Funds	31.4	32.2	2.5	2.5	0.0
Private Equity <sup>1</sup>	44.5	46.6	1.0	-5.3	6.3
Property	80.5	85.9	3.5	3.4	0.1
Infrastructure <sup>1</sup>	29.0	29.5	-0.5	2.9	-3.4
Cash <sup>2</sup>	11.0	2.2	0.2	0.1	0.1
<b>Fund Total</b>	<b>827.5</b>	<b>810.7</b>	<b>-1.9</b>	<b>-1.5</b>	<b>-0.4</b>

*Source: State Street Global Services – Performance Services*

All figures are rounded to the nearest one decimal place for clarity. Because of roundings figures may not cross-cast. Source: State Street Global Services – Performance Services.

Notes:

<sup>1</sup> 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.

<sup>2</sup> 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) appears in the closed section of the report.
- 2.3 Financial and market commentaries from the Council's Independent Pension Fund Adviser 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 State Street Global Services – Performance Services 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 2015. 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**

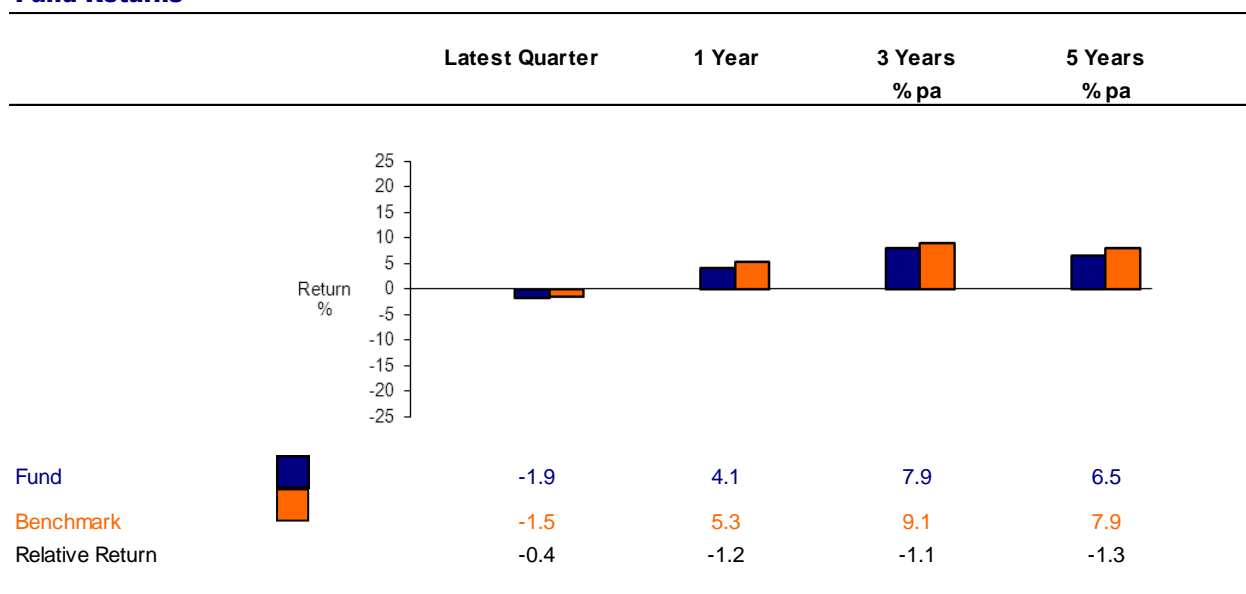
- 3.2 A new asset allocation strategy was approved at the last Committee meeting held on 8 September 2015.
- 3.3 The cash balance reported in Table 1 above represents cash held by the in-house treasury team and includes both working capital (i.e. the difference between contributions received and benefits and transfers paid out) and cash liquidated awaiting reinvestment. 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 -1.9% underperforming the benchmark by -1.5%. The Fund has underperformed the benchmark over the year, 3-year and 5-year periods. 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

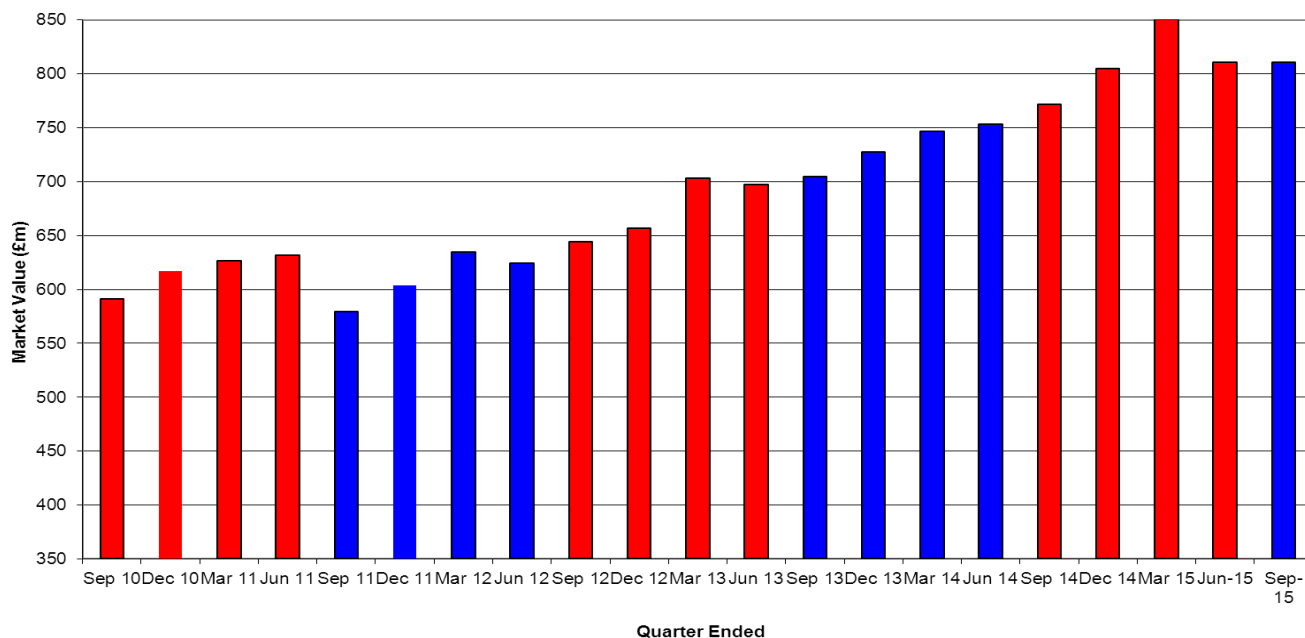


Source: State Street Global Services – Performance Services

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 September 2015 was £810.7m, a decrease of £16.8m over the previous quarter's valuation.

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

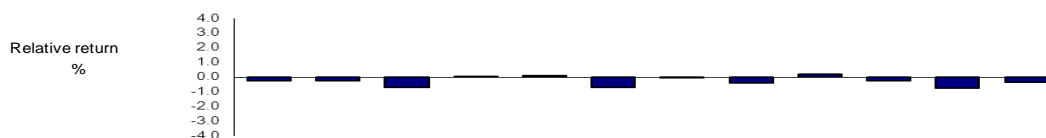
3.6 Chart 4 below illustrates the Fund's historic relative performance against the benchmark since inception of the revised investment strategy. This benchmark is an aggregate of individual asset class benchmarks weighted by the Fund's target asset allocations.



### Chart 4: Trend in Relative Returns of the Pension Fund

	2012		2013				2014				2015		
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	
Values (GBPm's)													
Initial	644.0	653.1	703.4	697.2	704.3	727.4	746.7	753.1	770.3	804.8	852.2	827.5	
Net Investment	0.5	3.0	-2.2	-1.1	0.9	14.5	-8.1	-0.2	3.9	10.1	2.8	14	
Capital Gain/Loss	8.6	47.3	-4.0	8.2	22.1	4.9	14.5	17.4	30.6	37.2	-27.5	-13.2	
Final	653.1	703.4	697.2	704.3	727.4	746.7	753.1	770.3	804.8	852.2	827.5	810.7	
Income	12	13	2.7	14	10	15	2.6	19	17	14	3.5	2.5	
Proportion Of Total Fund (%)	100	100	100	100	100	100	100	100	100	100	100	100	

#### Quarterly Returns



Fund	15	7.4	-0.2	14	3.3	0.8	2.3	2.6	4.2	4.8	-2.8	-19
Benchmark	18	7.7	0.5	14	3.2	1.6	2.3	3.0	4.0	5.0	-2.1	-15
Relative Return	-0.3	-0.2	-0.7	0.0	0.1	-0.7	-0.0	-0.4	0.2	-0.2	-0.8	-0.4

Source: State Street Global Services – Performance Services

## Attribution

- 3.7 For the period ending 30 September 2015 the Fund's return of -1.9% was 0.4% under the benchmark return. The table below shows that asset allocation was the most significant downward pressure on performance. This is in part due to the fact that the portfolio is in transition and assets are not yet aligned with the revised strategy: this causes a drag on performance.

### Summary:

Fund Return	-1.9
Benchmark Return	-1.5
Relative Performance	-0.4
<b>attributable to:</b>	
Asset Allocation	-0.4
Stock Selection	-

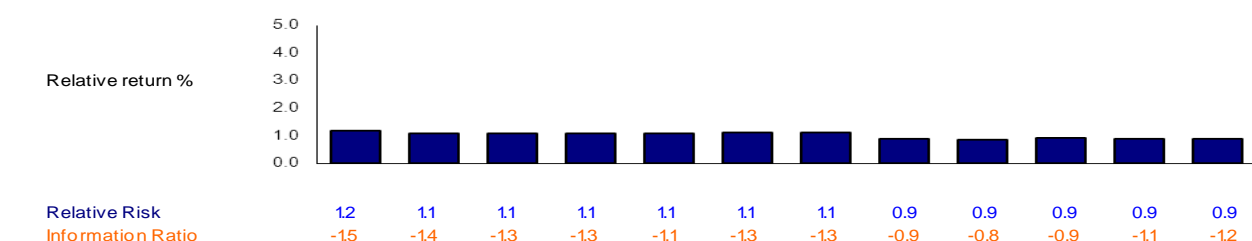
Source: State Street Global Services – Performance Services

## 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 compared with the information ratio, a measure of manager skill in adding value over and above the benchmark. The reduction in relative risk is consistent with the strategy to move away from more rigidly idiosyncratic investment styles.

### Chart 5: Relative Risk of the Pension Fund

#### Rolling 3 Year Risk



Source: State Street Global Services – Performance Services

- 3.9 State Street Global Services – Performance Services graphs demonstrating the impact of asset allocation and stock selection are attached as Appendix C to this report.

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

<b>Top 10 Holdings Held in Fund</b>	<b>Value (£m)</b>	<b>Weight %</b>
APPLE INC	15.35	1.89%
GOOGLE	8.76	1.08%
MICROSOFT CORP	7.76	0.96%
WELLS FARGO & CO	6.47	0.80%
JOHNSON & JOHNSON	6.26	0.77%
NESTLE SA	5.80	0.72%
AT&T INC	4.90	0.60%
PROCTER & GAMBLE	4.80	0.59%
NOVARTIS AG	4.76	0.59%
ROCHE HOLDING AG	4.52	0.56%

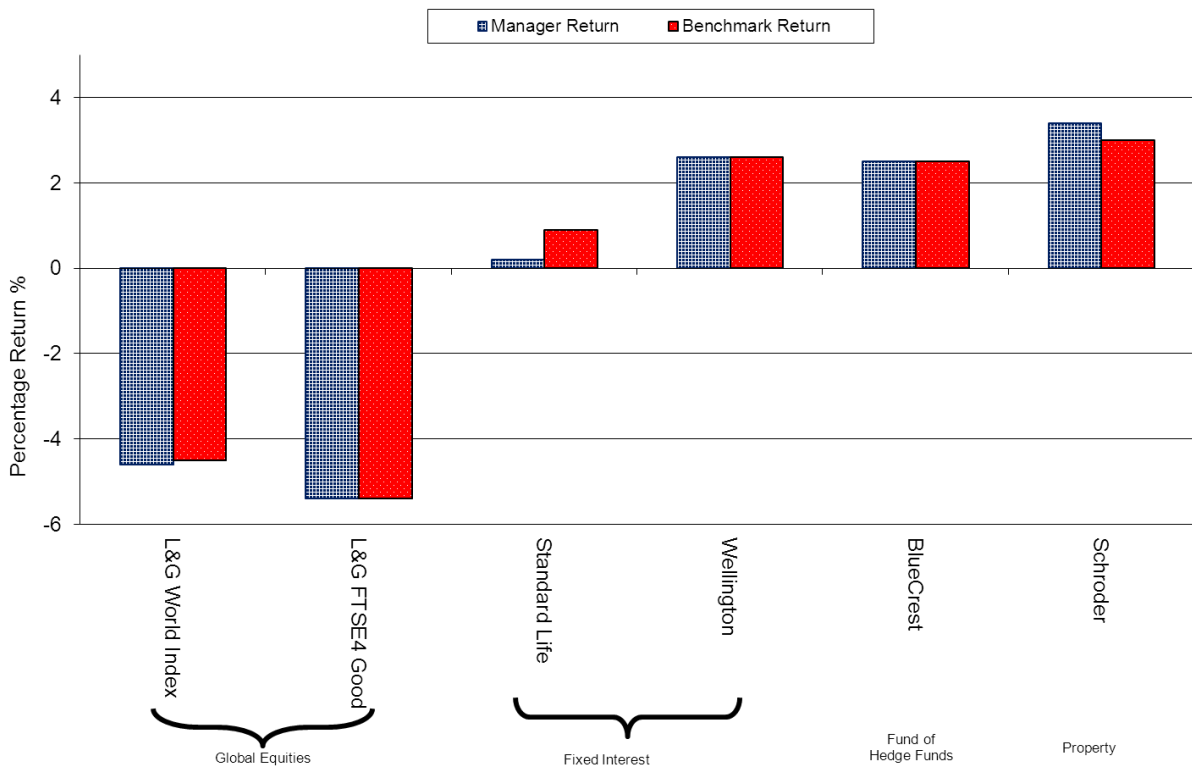
Source: BNYM Workbench

## **4 FUND MANAGER PERFORMANCE**

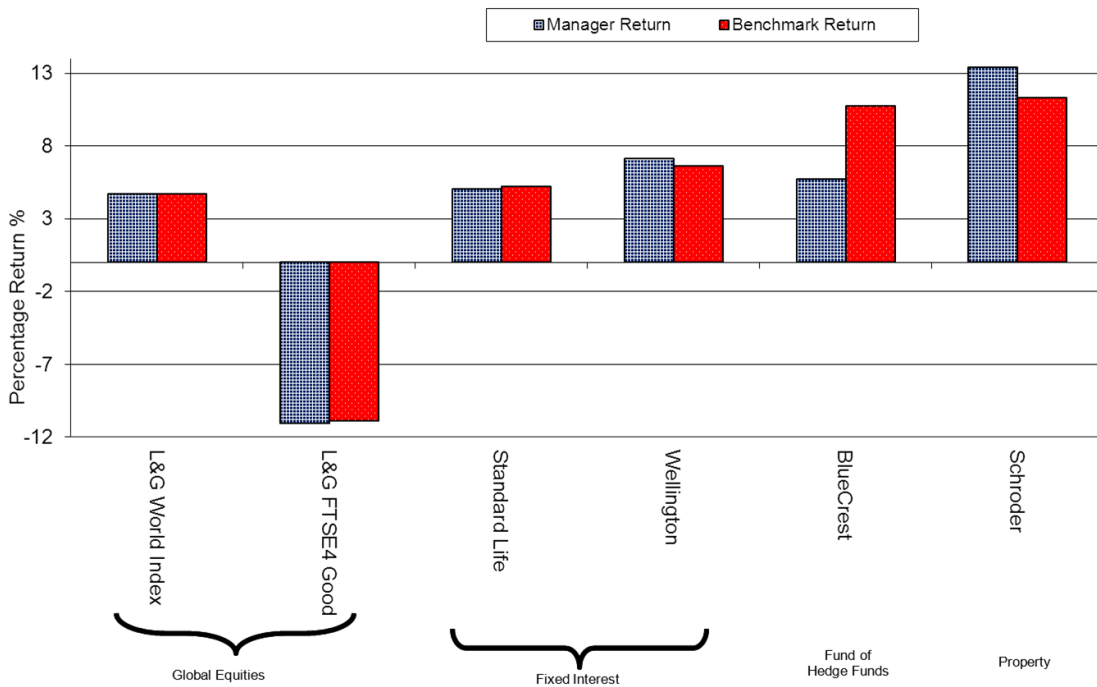
### **Summary**

- 4.1 Appendix A details the market value and performance over the quarter and since inception for each fund manager.
- 4.2 Chart 6 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. Consequently these two charts do not show performance for the quarter and from inception for the private equity and infrastructure funds, that is to say, Equitix, Knightsbridge and Pantheon.

**Chart 6: Fund Manager Quarterly Returns**



**Chart 7: Fund Manager Returns Since Inception**



4.3 Global equities declined amid worries about the economic slowdown in China and



the implications for global growth. The US Federal Reserve's decision not to increase interest rates was a key moment in the quarter and exacerbated the sense of uncertainty in markets. In the Eurozone, the autos sector came under severe pressure after revelations that VW had misled regulators on emissions from diesel vehicles. Japanese equities suffered amid weaker than expected data for Japan's economy. Stocks were further pressured as the yen saw inflows due to its perceived 'safe haven' status. Weak Chinese economic data was a drag on emerging markets while Brazil was also a focus as S&P Ratings downgraded the country's debt to non-investment grade. The third quarter was broadly positive for global bonds, as commodity price weakness and fears over global economic growth led investors to seek out 'safe havens'.

- 4.4 The Pension Committee has, in the past, asked for information about investment in payday lenders. The Fund has a small amount invested in three businesses: Global Analytics in the USA; Kestrel; and Wonga, both in the UK. With effect from January 2015 the Financial Conduct Authority (FCA) introduced a series of measures to limit the costs relating to payday loans, including capping interest rates, fees, default charges and a total cost cap of 100% of the sum borrowed. The current value of these investments is c. £27,000 (or 0.003%) of the Fund: the estimated exit date is 2016, as reported to the Committee last year.

### Fund Manager Review

- 4.5 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?
L&G	✓	✓	X	See paragraph 4.12
Standard Life	✓	✓	X	See paragraph 4.12
Wellington	✓	✓	✓	See paragraph 4.12
BlueCrest	✓	✓	X	Exiting fund manager
Pantheon	n/a	✓	✓	See paragraph 4.12
Equitix	n/a	✓	X	See paragraph 4.12
Knightsbridge	n/a	✓	X	See paragraph 4.12
Schroders	✓	✓	X	See paragraph 4.12

## **Performance**

- 4.6 There was a range of outperformance and underperformance by the managers against their benchmarks over the quarter. For further details please refer to Appendix A showing the State Street Global Services – Performance Services performance for each fund manager.

## **Equities**

- 4.7 The L&G FTSE World tracker mirrored the index returning -5.4% and the L&G segregated equity portfolio (tracking FTSE4 Good Index) slightly under performed the index by -0.1% returning -4.6%. Global equities declined amid continuing worries about the slowdown in China. Over the quarter the MSCI world index returned -8.33% in dollar terms and -4.83% in sterling terms.

## **Fixed Interest**

- 4.8 Wellington's performance of 2.6% during the quarter was in line with the benchmark and continues to outperform the BAML GBP Broad Market benchmark by 0.5% since inception. Standard Life underperformed the benchmark by -0.6% over the quarter and has underperformed the benchmark by 0.2% since inception.

## **Property**

- 4.9 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 outperformed the benchmark by 0.4% during the quarter to 30 September 2015 and has done well for the fund returning 13.4% and outperforming the benchmark by 1.9% since inception.

## **Fund of Hedge Funds**

- 4.10 The investment held with BlueCrest was liquidated and £32.2m was received on 22 October 2015. The fund has produced an annualized return of 5.7%.

## **Private Equity and Infrastructure**

- 4.11 The most appropriate measure to monitor the performance of these type of funds is to use the Internal Rate of Return (IRR) since inception as this explicitly takes the irregular timings of cash flows into account. Although this measure cannot be compared to the time-weighted measure used for standard investments and for immature funds (less than six years old) the results can be misleading. We have calculated the IRR for Pantheon as 11.1%, Equitix 16.7% and Knightsbridge as 13.75%, although Equitix has one immature fund out of three and Knightsbridge has one immature fund out of two. The returns are still seen as being healthy for all three investment managers.

## **Manager Visits**

- 4.12 In addition to virtual meetings held during the quarter ended 30 September 2015, officers and/or members attended meetings with the following managers:

Manager	Date of Meeting
Wellington	17 September 2015
Pantheon	9 September 2015

## 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 2015. Note the strategic asset allocation changed at the last Committee meeting, but we are still reporting on the old basis for this quarter. The geographical breakdown of asset allocation is provided in the State Street Global Services – Performance Services 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	54.1%	50% +/- 3	4.1%
Fixed Income	21.7%	25% +/- 3	-3.3%
Property	10.6%	10% +/- 3	0.6%
Private Equity	5.7%	5%	0.7%
Infrastructure	3.6%	5%	-1.4%
Hedge Funds	4.0%	4%	0.0%
Cash	n/a	n/a	n/a

Source: State Street

- 5.2 The Fund held an overweight position in equities an underweight in fixed income and infrastructure at the end of the quarter. Rebalancing the portfolio has been postponed until the new asset allocation strategy has been achieved. Members should note that the liquidation of the hedge fund investments falls outside the reporting period for this report but all cash has been received.
- 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 When private equity and infrastructure investments are in their infancy, it takes considerable time to draw down the full amount of committed capital. As the investments mature, the investment manager's pay capital distributions to the Fund. To counter balance the incoming cash flow, further investments are made into private equity and infrastructure funds. Hence it is very difficult to keep these assets classes at their strategic allocation.

- 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 Chair.
- 5.6 At its last meeting the Committee was given an indicative timetable for executing this strategy. The exercise comprised three parts: identification of investment opportunities; due diligence; and transfer of cash. Officers have made good progress to date. The progress update is attached in Appendix G.

## **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 2015, 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 legal issues arising from this report.

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

## **10. FREEDOM OF INFORMATION/DATA PROTECTION CONSIDERATIONS**

- 10.1 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.

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**CONTACT OFFICER:**

Nigel Cook – Head of Pensions and Treasury  
Corporate Resources Department, ext. 62552.

**BACKGROUND DOCUMENTS:**

Reports from State Street Global Services – Performance Services

Reports from AON Hewitt

## Appendices

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Appendix A: Summary of Manager Performance

Appendix B: Asset Mix and Returns

Appendix C: Detailed Analysis of the Latest Quarter Performance

Appendix G: Progress towards revised asset allocation

The following appendices are commercially sensitive:

Appendix D: AON Hewitt Manager Monitoring Report

Appendix E: AON Hewitt Market Review: 3 months to 30 September 2015

Appendix F: AON Hewitt Quarterly Investment Outlook