

Croydon Council

REPORT TO:	PENSION COMMITTEE 08 September 2015
AGENDA ITEM:	6
SUBJECT:	Progress Report for Quarter Ended 30 June 2015
LEAD OFFICER:	Richard Simpson, Assistant Chief Executive (Corporate Resources and s.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 30 June 2015 was £827.5m compared to £852.3m at 31 March 2015, a decrease of £24.8m. 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.	
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 30 June 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.

Table 1: Performance for Quarter Ended 30 June 2015

Asset Class	Value at Asset class at Quarter End in £million		Performance relative to benchmark (%)		
	Quarter Ended 31/03/2015	Quarter Ended 30/06/2015	Return Made	Benchmark Return	Over/Under Performance
			(a)	(b)	(a-b)
Global Equities	484.1	456.7	-5.2	-5.0	-0.2
Global Fixed Interest	179.1	174.4	-2.6	-2.3	-0.3
Fund of Hedge Funds	32.4	31.4	-3.0	2.5	-5.5
Private Equity ¹	41.2	44.5	1.6	7.5	-5.9
Property	80.3	80.5	3.9	3.6	0.2
Infrastructure ¹	29.0	29.0	9.9	2.9	7.0
Cash ²	6.2	11.0	0.3	0.1	0.2
Fund Total	852.3	827.5	-3.1	-2.1	-1.0

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:

¹ 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.

² 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 June 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

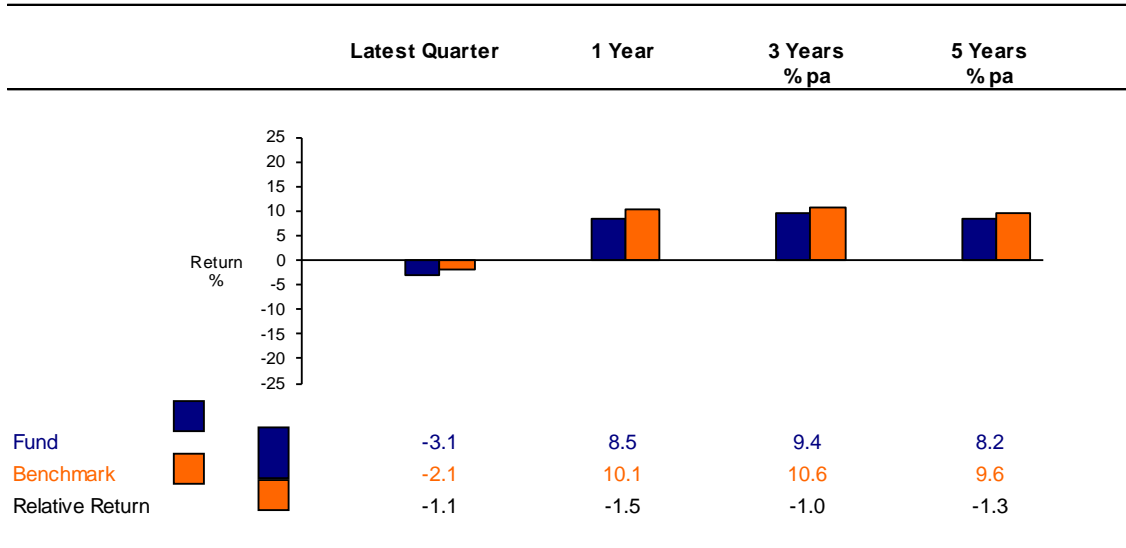
- 3.2 The asset allocation strategy is currently under review and a revised strategy is tabled for approval at this Committee meeting.
- 3.3 The cash balance reported in Table 1 above represents cash held by the in-house treasury team and includes both working capital (i.e. the difference between contributions 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 -3.1% underperforming the benchmark by -1.1%. 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



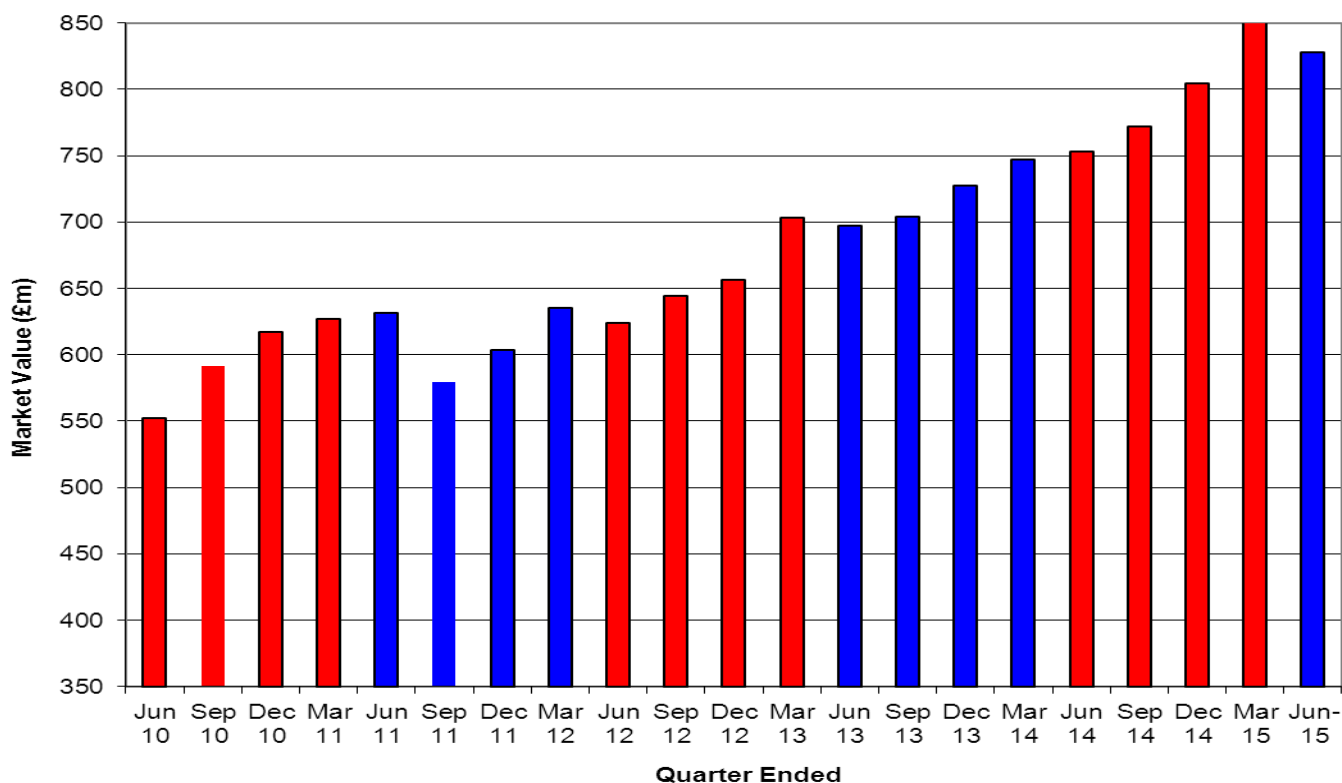
The graphs show the performance of the Fund and Benchmark over the latest period and longer term.

The relative return is the degree by which the Fund has out or underperformed the Benchmark over these periods

Source: State Street Global Services – Performance Services

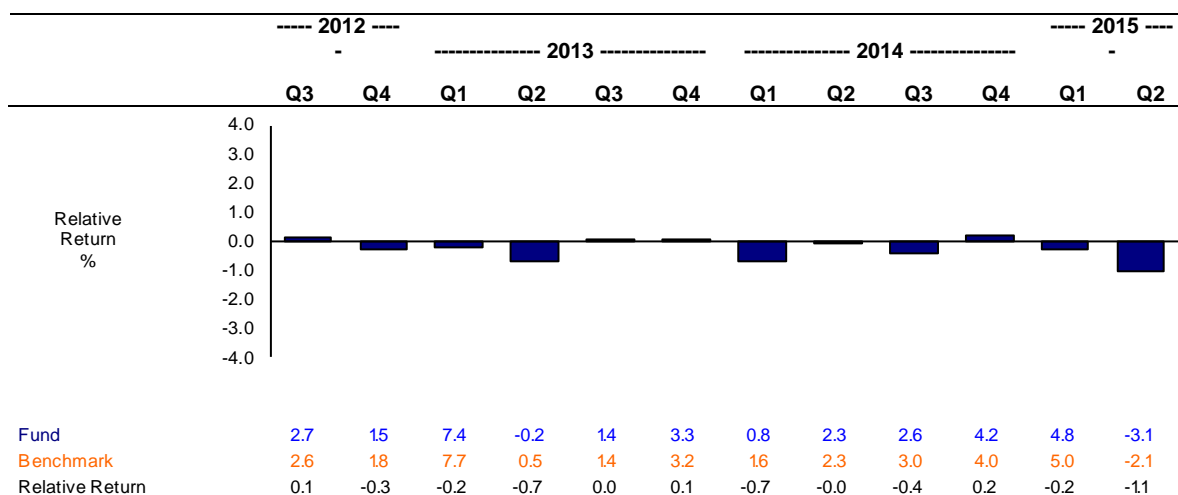
3.5 Chart 3 below details the movement in the Market Value of Fund on a quarter by quarter basis, over a 5-year period. The market value of the fund at the end of March 2015 was £827.5m, a decrease of £24.8m over the previous quarter's valuation.

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



Source: State Street Global Services – Performance Services

Attribution

- 3.7 For the period ending 30 June 2015 the Fund's return of -3.1% was 1.1% under the benchmark return. The table below shows that stock selection was the most significant downward pressure on performance.

Summary:

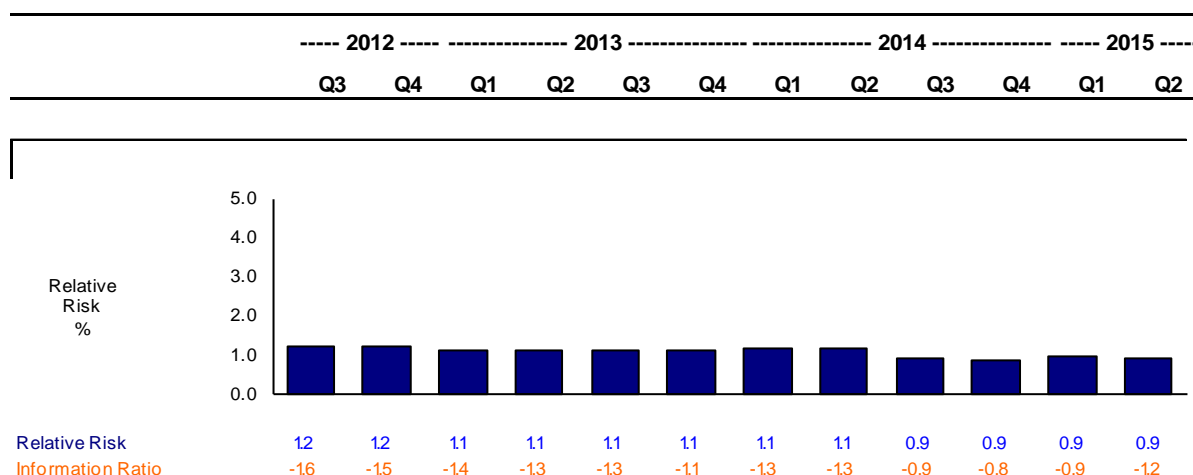
Fund Return	-3.1
Benchmark Return	-2.1
Relative Performance	-1.1
attributable to:	
Asset Allocation	-0.3
Stock Selection	-0.7

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



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:

Top 10 Holdings Held in Fund	Value (£m)	Weight %
APPLE INC	16.67	2.01%
MICROSOFT CORP	7.36	0.89%
WELLS FARGO & CO	6.77	0.82%
JOHNSON & JOHNSON	6.24	0.75%
NESTLE SA	5.39	0.65%
PROCTER & GAMBLE	4.96	0.60%
NOVARTIS AG	4.88	0.59%
ROCHE HOLDING AG	4.64	0.56%
WALT DISNEY	4.51	0.55%
VERIZON COMMUNICATIONS INC	4.44	0.54%

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

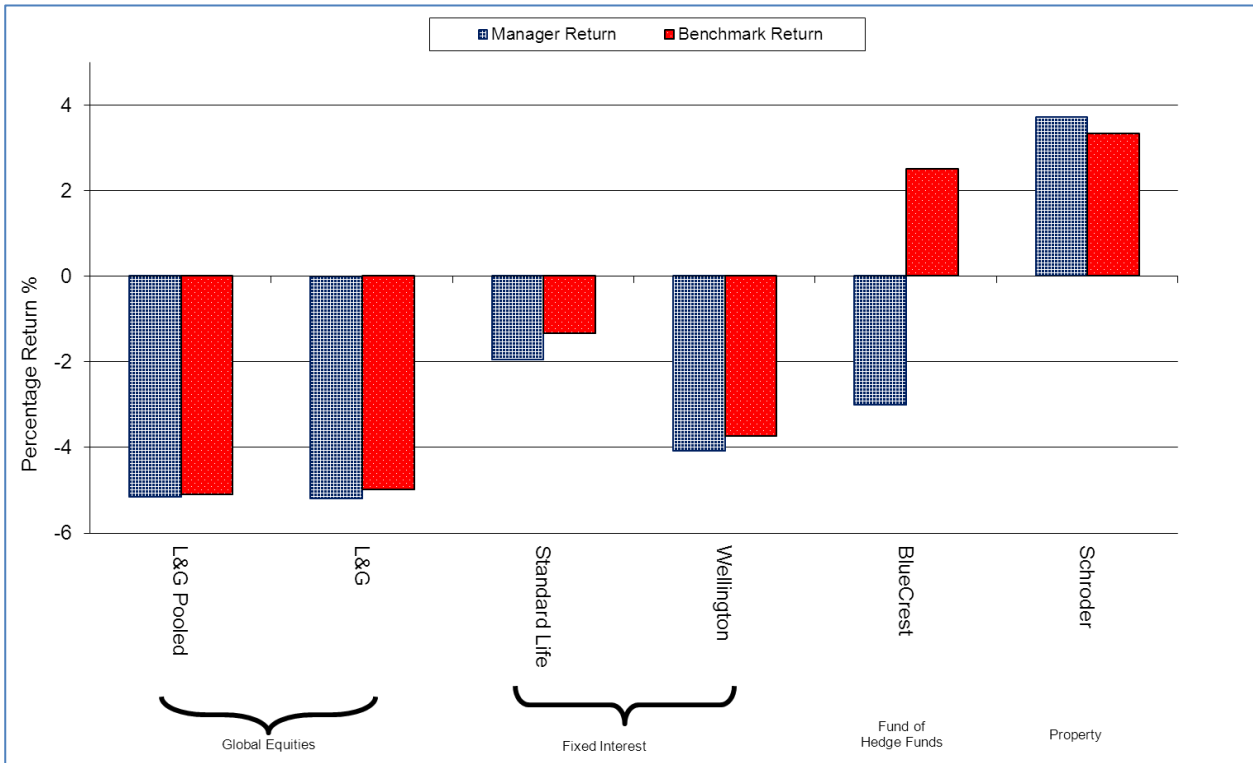
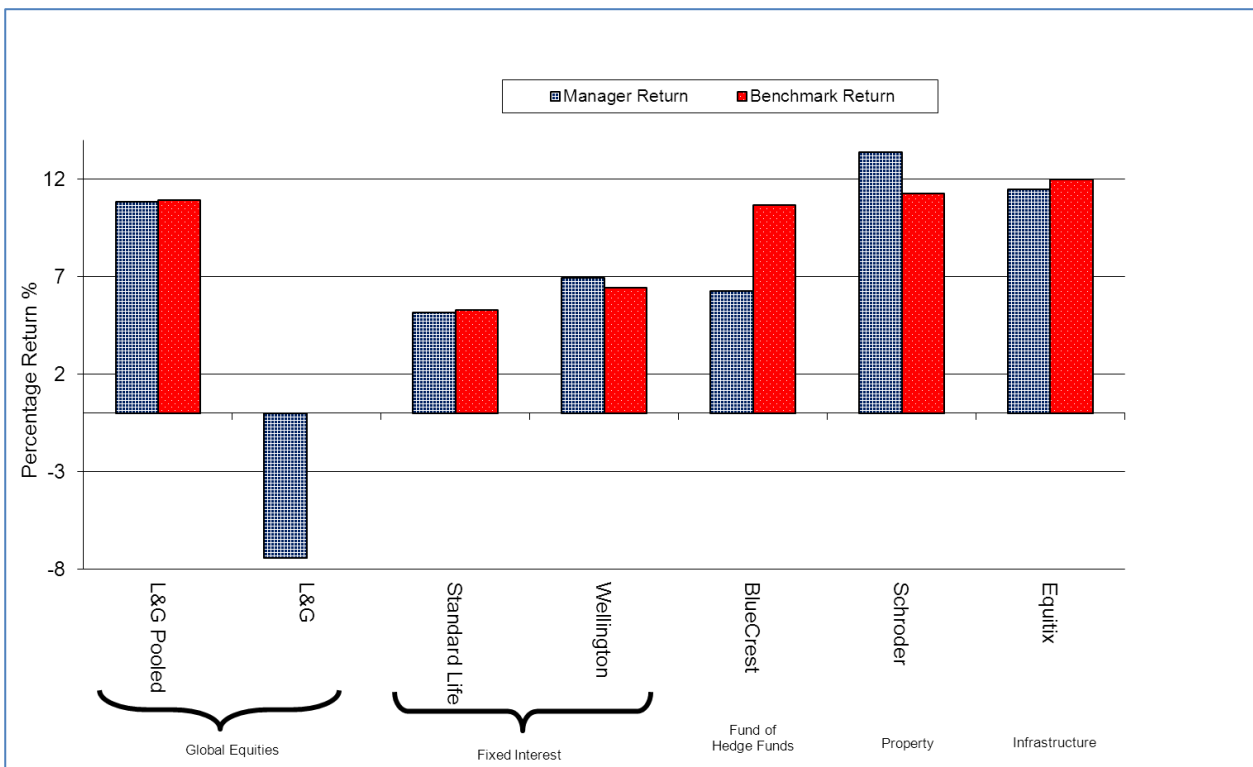


Chart 7: Fund Manager Returns Since Inception



4.3 Global equities registered a small positive return in US dollar terms over the

quarter. Regional performances were mixed with strong gains from Japan while the Eurozone and UK were weak. The S&P 500 reached fresh highs although returns were modest. Economic data was mixed but improved towards the end of the period. Merger & acquisition activity continued. Eurozone and UK equities came under pressure as the Greek debt crisis escalated, leading to concerns over the potential knock-on impact if Greece were to leave the Eurozone. Emerging markets outperformed their developed counterparts. Brazil was strong as the government vetoed measures that would have increased spending on pensions. Chinese equities saw gains after the authorities loosened monetary policy. Bond yields rose across most major markets amid expectations that interest rates could rise in the US and UK this year. Stronger economic data in the Eurozone also sent Bund yields higher over the quarter.

4.4 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. 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

4.5 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	✓	✓	✓	See paragraph 4.12
Standard Life	✓	✓	✓	See paragraph 4.12
Wellington	✓	✓	X	See paragraph 4.12
BlueCrest	X	✓	X	Exiting fund manager
Pantheon	n/a	✓	X	See paragraph 4.12
Equitix	n/a	✓	X	See paragraph 4.12
Knightsbridge	n/a	✓	✓	See paragraph 4.12
Schroders	✓	✓	✓	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 Chart 5 (above) and Appendix A showing the State Street Global Services – Performance Services performance for each fund manager. The Committee has taken a decision to remove Hedge funds from the asset allocation and funds will be redeemed from BlueCrest during October.

Equities

- 4.7 The L&G FTSE World tracker mirrored the index returning -5.1% and the L&G segregated equity portfolio (tracking FTSE4 Good Index) slightly under performed the index by -0.2% returning -5.2%. Global equities were fairly flat over the quarter, but the strengthening pound over the period has contributed to almost all of the negative return.

Fixed Interest

- 4.8 Wellington's performance of -4.1% during the quarter was -0.3% below the benchmark although Wellington has produced a healthy return of 7.0% outperforming the BAML GBP Broad Market benchmark by 0.5% since inception. Standard Life underperformed the benchmark by -0.6% over the quarter and has matched the benchmark from 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 June 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 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 over the quarter and has underperformed against the benchmark by since inception. The Pensions Committee decided to remove Hedge Funds from the asset allocation in June and officers have instructed BlueCrest to redeem all holdings.

Private Equity and Infrastructure

- 4.11 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, since inception, Knightsbridge have returned 7.8% p.a., Pantheon 9.3% and Equitix 11.5%.

Manager Visits

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

Manager	Date of Meeting
Schroders	29 April 2015
LGIM	29 April 2015
Standard Life	2 June 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 June 2015. 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	55.5%	50% +/- 3	5.5%
Fixed Income	21.1%	25% +/- 3	-3.9%
Property	9.8%	10% +/- 3	-0.2%
Private Equity	5.4%	5%	0.4%
Infrastructure	3.5%	5%	-1.5%
Hedge Funds	3.8%	4%	-0.2%
Cash	n/a	n/a	n/a

Source: WM Returns

- 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 agreed.
- 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.

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 June 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 direct legal implications arising from this report.

Approved by Gabriel MacGregor, Head of Corporate Law on behalf of the Council Solicitor & Director of Democratic & Legal Services

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.

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

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 30 June 2015

Appendix F: AON Hewitt Quarterly Investment Outlook