

# Croydon Council

<b>REPORT TO:</b>	<b>PENSION COMMITTEE</b> <b>07 June 2016</b>
<b>AGENDA ITEM:</b>	<b>14</b>
<b>SUBJECT:</b>	<b>Progress Report for Quarter Ended 31 March 2016</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</b> <b>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 31 March 2016 was £863.2m compared to £857.4m at 31 December 2015, an increase of £5.8m. 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.	
<b>FORWARD PLAN KEY DECISION REFERENCE NO.: N/A</b>	

<b>1 RECOMMENDATIONS</b>
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 2016. 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 31 March 2016**

Asset Class	Value at Asset class at Quarter		Performance relative to benchmark (%)		
	Quarter Ended 31/12/2015	Quarter Ended 31/03/2016	Return Made	Benchmark Return	Over/Under Performance
			(a)	(b)	(a-b)
Global Equities - FTSE4 Good	432.3	432.8	1.5	1.6	-0.1
Global Equities - World Index	75.5	62.0	3.0	3.0	0.0
Global Fixed Interest	176.8	180.5	2.1	2.9	-0.8
Private Equity <sup>1</sup>	50.6	56.7	5.0	1.1	3.9
Property	94.6	95.7	1.3	1.1	0.2
Infrastructure <sup>1</sup>	29.7	38.7	1.7	1.1	0.6
Cash <sup>2</sup>	-2.1	-3.2	0.1	0.1	0.0
<b>Fund Total</b>	<b>857.4</b>	<b>863.2</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.

<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. The negative cash figure takes into account the March 2016 benefit payments of £5.7m which are paid by the Council and recharged to the pension fund. The actual cash balance was positive.

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 31 March 2016. 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**

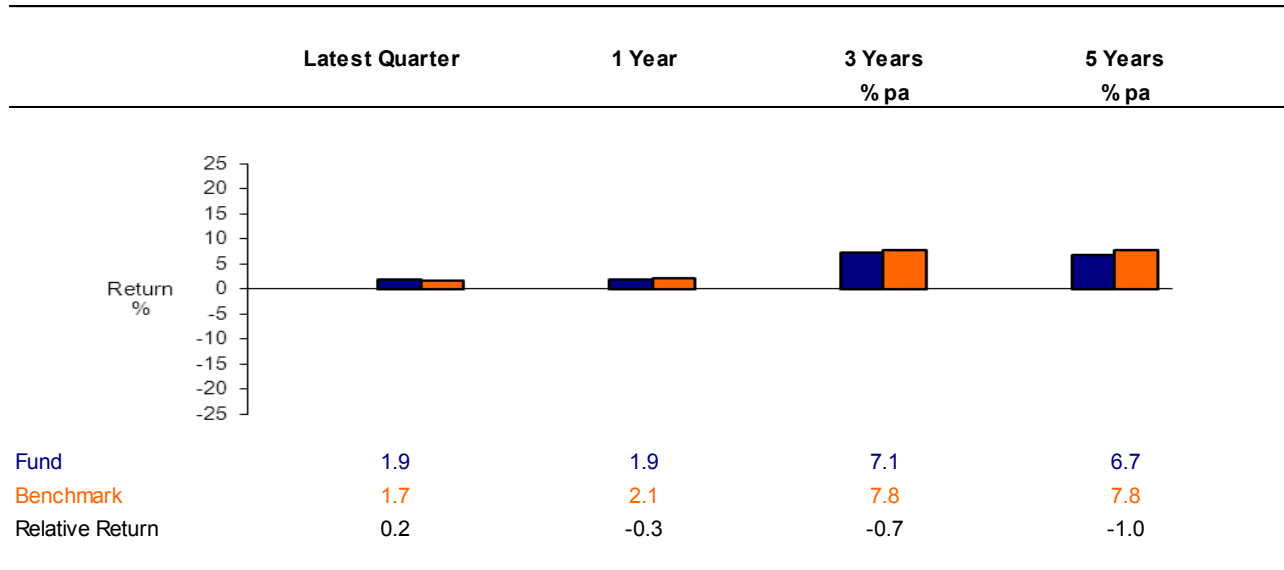
- 3.2 A new asset allocation strategy was approved at the Committee meeting held on 8 September 2015 (Minute .A29/15 refers). During the quarter the fund signed a commitment of €20m to a private equity fund specialising in small cap European buyouts managed by Access Capital Partners and has agreed a commitment of \$25m to a private equity fund managed specialising in Trade Finance managed by Markham Rae. These are all in line with our shift in asset allocation towards a higher weighting in alternatives. Appendix G provides a more detailed narrative on the progress of this project.
- 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 Chart 1 below provides a high level summary of the performance of the fund. The total Fund return for the quarter was 1.9% outperforming the benchmark by 0.2%. 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 1: Performance of the Pension Fund

### Fund Returns



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

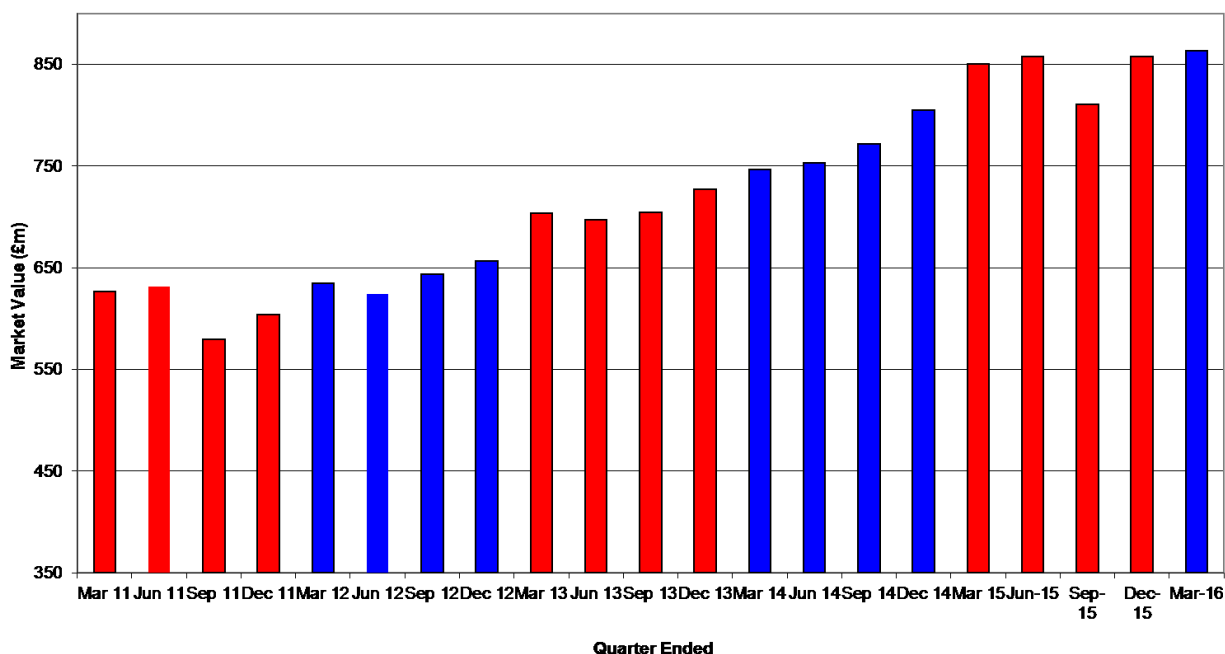
The relative return is the degree by which the Fund has out or underperformed the Benchmark over these periods

# = Data not available for the full period

Source: State Street Global Services – Performance Services

3.5 Chart 2 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 2016 was £863.2m, an increase of £5.8m over the previous quarter's valuation.

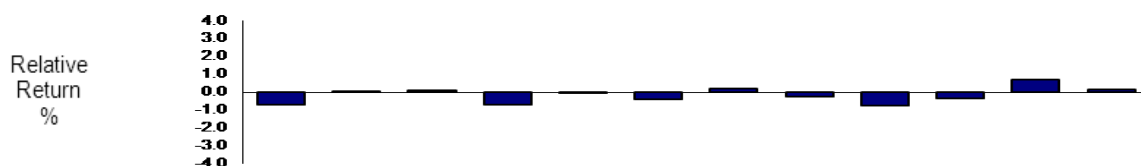
### Chart 2: Trend in Total Value of Pension Fund in £millions



3.6 Chart 3 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.

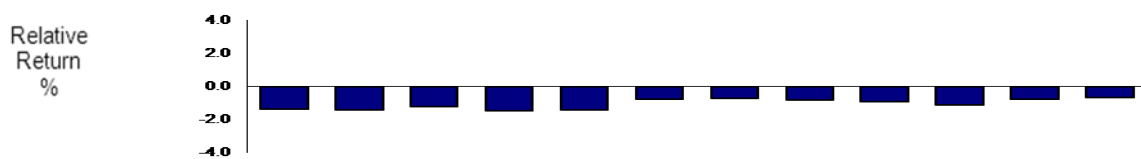
**Chart 3: Trend in Relative Returns of the Pension Fund**

**Quarterly Returns**



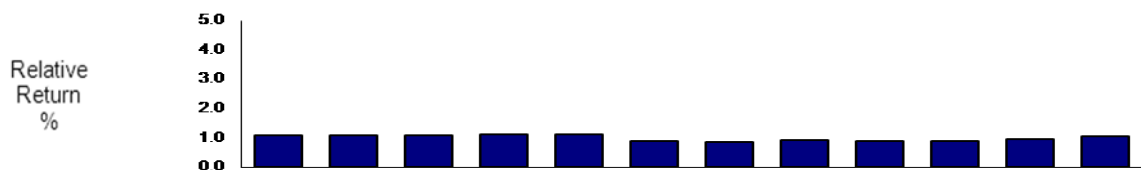
Fund	-0.2	1.4	3.3	0.8	2.3	2.6	4.2	4.8	-2.8	-1.9	4.9	1.9
Benchmark	0.5	1.4	3.2	1.6	2.3	3.0	4.0	5.0	-2.1	-1.5	4.1	1.7
Relative Return	-0.7	0.0	0.1	-0.7	-0.0	-0.4	0.2	-0.2	-0.8	-0.4	0.7	0.2

**Annualised Rolling 3 Year Returns**



Fund	8.2	6.5	6.1	5.9	6.3	10.3	10.4	10.2	9.5	7.9	9.1	7.1
Benchmark	9.7	8.0	7.5	7.4	7.9	11.2	11.2	11.1	10.6	9.1	9.9	7.8
Relative Return	-1.4	-1.4	-1.2	-1.5	-1.4	-0.8	-0.7	-0.8	-0.9	-1.1	-0.8	-0.7

**Rolling 3 Year Risk**



Relative Risk	1.1	1.1	1.1	1.1	1.1	0.9	0.9	0.9	0.9	0.9	0.9	1.0
Information Ratio	-1.3	-1.3	-1.1	-1.3	-1.3	-0.9	-0.8	-0.9	-1.1	-1.2	-0.8	-0.6

The relative return is the degree of out or underperformance of the Benchmark over these periods.

Relative risk measures the degree of fund performance deviation from benchmark. The larger the relative risk number the greater the monthly deviation from benchmark.

Information Ratio is often interpreted as a measure of manager skill in adding value over and above the benchmark.

Source: State Street Global Services – Performance Services

## Attribution

- 3.7 For the period ending 31 March 2016 the Fund's return of 1.9% was 0.2% over the benchmark return. The summary table below shows the attribution of performance to asset allocation and stock selection.

### Summary:

Fund Return	1.9
Benchmark Return	1.7
Relative Performance	0.2
<b>attributable to:</b>	
Asset Allocation	-
Stock Selection	0.1

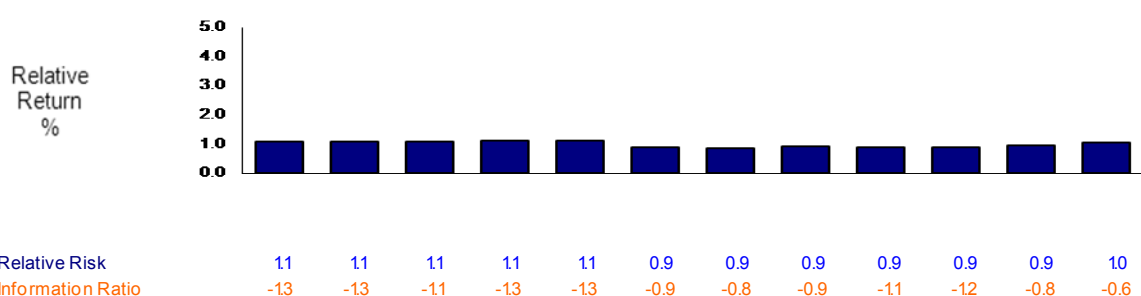
Source: State Street Global Services – Performance Services

## Risk

- 3.8 Chart 4 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 4: 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:

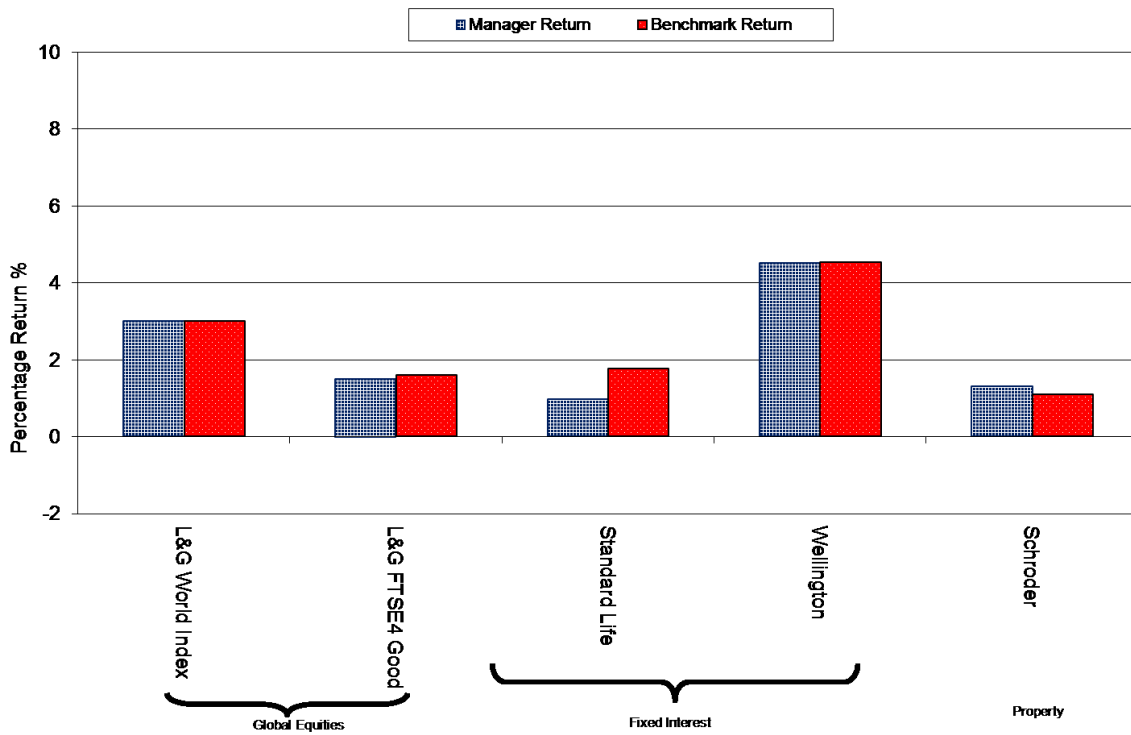
<b>Top 10 Holdings Held in Fund</b>	<b>Value (£m)</b>	<b>Weight %</b>
APPLE INC	15.50	1.80%
ALPHABET INC	11.24	1.30%
MICROSOFT CORP	10.84	1.26%
JOHNSON & JOHNSON	7.63	0.88%
WELLS FARGO & CO	6.34	0.73%
AT&T INC	6.21	0.72%
NESTLE SA	6.00	0.69%
PROCTER & GAMBLE CO/THE	5.67	0.66%
VERIZON COMMUNICATIONS INC	5.66	0.66%
COCA-COLA CO/THE	4.90	0.57%

#### **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 5 illustrates the performance of each fund manager against their benchmark over the most recent quarter and Chart 6 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, Temporis, Access, Knightsbridge and Pantheon.

**Chart 5: Fund Manager Quarterly Returns**



**Chart 6: Fund Manager Returns Since Inception**





## Fund Manager Review

- 4.3 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?
L&G	✓	✓	✓
Standard Life	✓	✓	X
Wellington	✓	✓	X
Pantheon	n/a	✓	X
Equitix	n/a	✓	✓
Knightsbridge	n/a	✓	X
Schroders	✓	✓	✓

## Performance

- 4.4 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

- 4.5 The L&G FTSE World tracker slightly under performed in line with the index returning 3.0% and the L&G segregated equity portfolio (tracking FTSE4 Good Index) underperformed the index by 0.1% returning 1.5%. Global equities were down significantly in the first half the quarter and then recovered to produce positive returns. Our portfolio holds a significant weighting to overseas equities, so was also helped by a sharp fall in sterling due to Brexit fears.

## Fixed Interest

- 4.6 Wellington's performance of 4.5% 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 0.8% over the quarter and has underperformed the benchmark by 0.3% since inception.

### **Property**

- 4.7 The Schroders' UK property portfolio is measured against the IPD All Balanced Weighted Average index. The portfolio outperformed the benchmark by 0.2% during the quarter to 31 March 2016 and has done well for the fund returning 12.7% and outperforming the benchmark by 1.6% since inception.

### **Private Equity and Infrastructure**

- 4.8 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) as the results can be misleading. We have calculated the IRR for Pantheon as 11.4%, Equitix 16.9% and Knightsbridge as 13.3%, 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 extremely good for all three investment managers.

### **Manager Visits**

- 4.9 In addition to virtual meetings held during the quarter ended 31 March 2016, officers and/or members attended meetings with the following managers:

<b>Manager</b>	<b>Date of Meeting</b>
Legal & General	26 January 2016
Equitix	10 February 2016
Schroders	22 February 2016

## **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. The strategic asset allocation changed at the September 2015 Pensions Committee and Table 3 below summarises the actual asset allocation against the target position as at 31 March 2016. 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.

<b>Asset Class</b>	<b>Percentage of Fund Value</b>	<b>Strategic Allocation</b>	<b>Variance</b>
Equities	57.6%	42%+/-5	15.6%
Fixed Income	20.9%	23%+/-5	-2.1%
Property	11.1%	10% +/- 3	1.1%
Private Equity	6.1%	8%	-1.9%
Infrastructure	4.5%	10%	-5.5%
PRS	0.0%	6%	-6.0%
Cash	-0.2%	1%	-1.2%

Source: State Street

5.2 The Fund currently holds an overweight position in equities and this is expected to continue in the short to medium term as progress is made in moving assets towards the new allocation. As well as liquidating equity investments to seed new investments the Fund will be taking dividends as cash to ensure future commitments in other asset classes can be met. Progress towards the new asset allocation needs to be completed in a managed way so as not to expose the fund to liquidity issues. Progress to date is summarised 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 31 March 2016, 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 Solicitor to the Council 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 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 31 March 2016

Appendix F: AON Hewitt Quarterly Investment Outlook