

**Pensions Committee****Friday, 16 June 2017, 10.00 am, County Hall, Worcester****Agenda**

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**PENSIONS COMMITTEE**  
**16 JUNE 2017****ADMINISTERING AUTHORITY – ADMINISTRATION**  
**UPDATE**

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**Recommendation**

1. **The Head of Human Resources and Organisational Development recommends that the general update from the Administering Authority be noted.**

**End of Year Arrangements**

2. The Fund is currently working on End of Year processes and the team have supported employers in providing year end data by the 30 April 2017 deadline.
3. Reminders were sent to a small number of employers extending deadlines and these were copied to the Financial Officers of the Employer advising that where information was not received on time we will not be able to provide annual benefit statements for their members. To-date we have one employer outstanding and we are aware that the employer has been experiencing system problems which have affected their ability to respond. This is scheduled to be received next week.

**Annual Benefit Statements**

4. The team are data cleansing and loading End of Year data for members so that we can ensure that the Annual Benefit Statements can be produced and posted by the statutory deadline of 31 August 2017.
5. As in previous years we are working in partnership with Bedfordshire, Buckinghamshire, Cheshire, Oxfordshire, Shropshire, Staffordshire and Warwickshire funds and Adare (company providing the printing, enveloping and postage service) to deliver our Deferred and Active statements.

**Worcestershire County Council – Change to Payment System**

6. Following the decision of the Council to transfer its Accounts Payable, Accounts Receivable and Payroll services to Liberata UK, in April we saw the implementation of the new payment system. This has led to a few teething problems for the Fund and a small number of pensioners with delays in receiving CARE Pay information and being able to process lump sum payments, transfers in and transfers out. We have been working closely with Liberata (and Finance) to alert them to these issues and to resolve them as quickly as possible.

## Administration Forum

7. Arrangements are continuing for the Administration Forum to take place late June/early July, avoiding school holidays and key network meetings for Academies.

## Guaranteed Minimum Pension (GMP) Reconciliation

8. The HR Service & Commissioning Manager and Pensions Manager attended a GMP Meeting in early May hosted by the National LGPS Frameworks. The Frameworks' was founded by:

- Clwyd Pension Fund
- Environment Agency Pension Fund
- LB Hackney
- LB Tower Hamlets
- Norfolk County Council
- West Midlands Pension Fund

9. In consultation with the Chief Financial Officer we are hoping to use these Frameworks to support our delivery of Phase 2 of the GMP reconciliation which will require us to data cleanse all data received from HMRC to make sure that we only have the relevant liabilities held in the Pension Fund. Any discrepancies need to be reported back to HMRC for further investigation. HMRC will support queries generated by the Scheme Reconciliation Services up to December 2018. HMRC will then issue pension statements to all individuals.

## Contact Points

### County Council Contact Points

County Council: 01905 763763

Worcestershire Hub: 01905 765765

Email: [worcestershirehub@worcestershire.gov.uk](mailto:worcestershirehub@worcestershire.gov.uk)

### Specific Contact Point

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## Background Papers

In the opinion of the proper officer (in this case the Head of Human Resources and Organisational Development) there are no background papers relating to the subject matter of this report.

**PENSIONS COMMITTEE**  
**16 JUNE 2017****PENSION INVESTMENT UPDATE**

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**Recommendation****1. The Chief Financial Officer recommends that:**

- a) the Independent Financial Adviser's fund performance summary and market background be noted; and**
- b) the update on the Investment Managers placed 'on watch' by the Pension Investment Advisory Panel be noted.**

**Background**

- 2. The Committee will receive regular updates on fund performance. The fund's Independent Financial Adviser has provided a fund performance summary and a brief market background update (Appendix 1). The market background update is provided to add context to the relative performance and returns achieved by the fund's investment managers.
- 3. The Committee will also receive regular updates regarding 'on watch' managers and will receive recommendations in relation to manager termination in the event of a loss of confidence in managers by the Advisory Panel (Appendix 1).

**JP Morgan Emerging Markets**

- 4. JP Morgan (Emerging Markets) portfolio outperformed their benchmark over the quarter by 1.3%. Performance for the year ended March 2017 was 3.8% ahead of benchmark and therefore 1.8% ahead of their target outperformance of +2.0% per annum. Over the past three years JP Morgan have underperformed their performance target by 1.1% per annum.
- 5. It is recommended that JP Morgan remain 'on watch' until their three year outperformance is near target.

**JP Morgan Bonds**

- 6. The JP Morgan Bond portfolio outperformed their benchmark by 0.1% in the quarter ended March 2017. Performance for the year ended March 2017 was ahead of benchmark by 0.6% and therefore 0.4% behind their target outperformance. Over the past three years they have underperformed their performance target by 0.6% per annum.

7. It is recommended that JP Morgan (Bonds) remain on watch until their three year performance is tracking further towards target.

## **Contact Points**

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County Council: 01905 763763

Worcestershire Hub: 01905 765765

Email: [worcestershirehub@worcestershire.gov.uk](mailto:worcestershirehub@worcestershire.gov.uk)

### Specific Contact Points for this report

Sean Pearce, Chief Financial Officer

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## **Supporting Information**

- Independent Financial Adviser summary report (Appendix 1)
- Bar Chart of investment managers' performance (Appendix 2)
- Portfolio Evaluation Performance Report (Appendix 3)

## **Background Papers**

In the opinion of the proper officer (in this case the Chief Financial Officer) there are no background papers relating to the subject matter of this report.



REPORT PREPARED FOR  
**Worcestershire County Council Pension Fund**

June 2017

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## Independent Investment Adviser's report

12 June 2017

### **Global overview**

When political historians look back on 2016 and 2017, they will be able to report that politics became exciting again, if not somewhat unnerving! So far this year we have got over some of the more potentially unsettling hurdles, including the fact that Marine Le Pen was NOT elected as the next President of France. However the big surprise, (or is it?) is that we now face a General Election in the UK, the result of which we will know by the time of our meeting. Still to come; the German elections.

In the US, the now not so new President Trump is still being controversial and rather as anticipated he isn't getting everything his own way. The "system" is working. At least some of the rhetoric hasn't been followed through, he seemed to get on well with President Xi, he made the right noises to Muslim leaders in the Middle East, and he appears to be trying to be statesmanlike, when not on Twitter. The implications and detail of his anticipated tax structure changes continue to be worked out, alongside a gently tightening fiscal policy. There are still many "what ifs" about US politics and economic strategy, but to a large degree business continues as normal in the meantime.

The UK government overcame the obstacles to triggering Article 50 and then did so, thus starting the process of leaving the European Union. There will be a lot of bluster during the negotiations, with a lot of uncertainty until that is completed. In the meantime the post period end, post Easter surprise, was the announcement of a General Election. It appears that the Prime Minister is attempting to strengthen her negotiating position by ensuring she has the right "group" in Parliament, backed by a renewed mandate from the UK electorate. Although it hasn't been said as such, there is also clearly some attraction in attempting to sort the "Scottish" issue (aka Nicola Sturgeon) at the same time. Oh, and George Osborne is gone, at least for the time being. Presumably he couldn't do electioneering and start a new job at the same time. Very convenient.

You might recall the comments in the last report about inflation, and how I was flagging that my belief was that the signs were that we would see inflation rise faster and higher than was being forecast at the time. That has happened, so what next? The current consensus seems to be that inflation will peak quite rapidly, and then settle at a slightly higher level than we have seen in recent times, but that there is nothing to worry about. Economic history doesn't really support that benign scenario. Inflation remains a risk, and while currency and commodity pricing threats tend to work out over time, inflation can cause permanent damage to the value of some assets unless appropriate protective action is taken.



Europe is actually treading water quite well at the moment. Economic data looks reasonable, politically the Dutch and French elections have come and gone without major upsets (still trying to work out who President Macron is though!), and the outlook looks reasonable. The ECB is maintaining fiscal stimulus for the time being, but a tailing off is being flagged. Next up, the German elections.....

Another meeting that seemed to go well, after previous negative rhetoric, was that between Prime Minister Abe and President Trump. Mr Abe has also received the backing of the Liberal Democratic Party to continue in office, so apart from a small local scandal, he appears set to remain for a while longer, presumably alongside his economic policies. Corporate results are indicating good earnings prospects, which is encouraging for the wider economy. However for a sustained recovery to be seen, domestic consumption needs to consistently improve.

Asia (ex Japan) and Emerging Markets again had one central driver of sentiment; the US. To a large extent this was a bounce back from the negative sentiment seen in Q4 2016, as fears of a doomsday trade scenario evaporated. As usual on a country by country basis local events impacted on sentiment and consequently markets.

India enjoyed a return to favour, following the demonetisation shock last year, with Prime Minister Modi's party, the BJP, performing well in state elections. This has provided reassurance about the sustainability of his economic strategy.

China also saw an improvement in sentiment, with currency pressures easing. Clearly an easing of trade restriction fears after the meeting between Presidents Trump and Xi has a major part to play. Cynically one could say that President Trump needs President Xi's help to keep the lid on the erratic behaviour of the "Dear Respected Comrade" (Kim Jong Un) before things in North Korea get really out of hand.

Sadly the world continues to be an uncertain place, and the fortunes of many emerging markets are driven by external influences which far outweigh the strengths of their own internal economic performance.

**Summary and Market Background**

The value of the Fund in the quarter rose to £2.45bn, an increase of £133m compared to the end December value of £2.31bn. The Fund produced a return of 5.6% over the quarter, which gave an outperformance against the benchmark of 0.6%. Asset allocation (0.2%) and stock selection (0.4%) both contributed to this positive outcome. The positive asset allocation was as a result of being overweight in equities and underweight in bonds. Over a 12 month period the Fund recorded a positive relative return against the benchmark of 2.0% (26.7% v. 24.7%). The average performance of 60 LGPS Funds for 2016/17, as compiled by PIRC, was a return of 21.4%. It should be noted that the Fund has also outperformed over the three and five year periods as well, details of which can be found in Portfolio Evaluation Limited's report.

As an update to the comments in the last report concerning the improvement in the funding level, this continued increase in value that the Fund has enjoyed over recent months has improved the funding level further to approximately 96%\* (assets as a percentage of liabilities). It should be noted that part of this improvement is as a result of £110m in prepaid deficit contributions being received in April 2017, which is not included in the quarter end Fund value. As a reminder, the 2016 Triennial Valuation showed a funding level of 76%. Given the improvement in the Fund's funding level, further consideration could be given to strategies to protect that position.

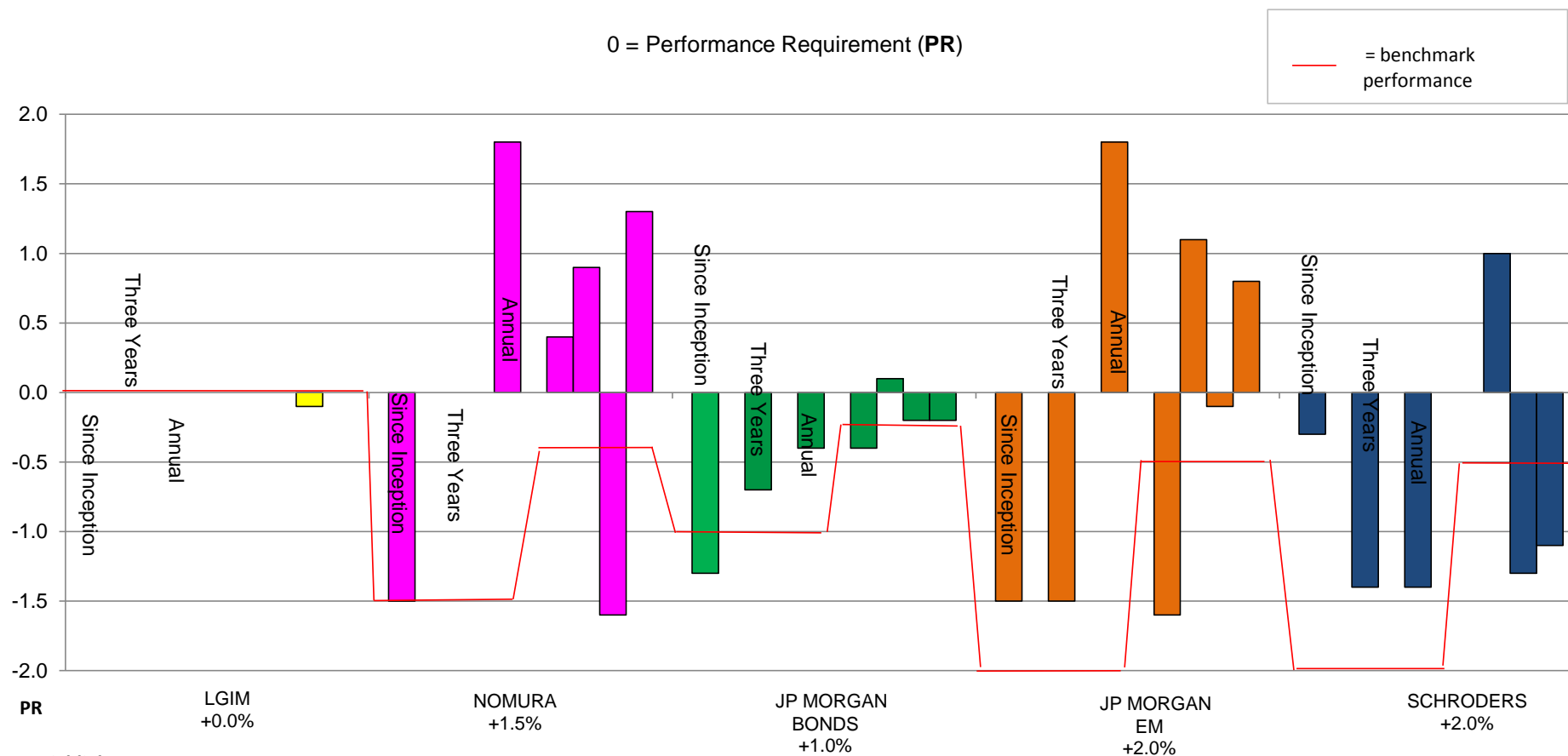
\*This calculation is an estimate, with liabilities based on the assessment date of 31 March 2016, but with assets valued as at 18 May 2017.

The Fund's active managers generally had a positive first quarter of 2017. Nomura (Pacific) was this quarter's star performer, with an outperformance of 1.7%, followed by JP Morgan (Emerging Markets) outperforming by 1.3%. Schroders (Emerging Markets) let the side down, with an underperformance of -0.6%. JP Morgan (Bonds) also outperformed, by 0.1%. The alternative passive strategies performed in line with their total benchmark, but outperformed the traditional passive index benchmark by 0.4% (5.2% v. 4.8%).

World markets once again enjoyed a good quarter, on a sterling adjusted basis. The MSCI World Index showed a rise of 5.8%. In contrast to the previous quarter the strongest returns were seen from Pacific ex Japan at 11.5% and Emerging Markets up 10.2%. Europe ex UK gained a very respectable 7.4%, with the "laggards" being the USA up 5.0%. the UK up 4.0%, and Japan was up just 3.4%.

Bond markets were a bit of a mixed bag in the first quarter. Emerging Market debt was the "stand out" performer; up 5.2% (local currency index). UK long dated conventional gilts enjoyed a good recovery over the last quarter, and Index Linked had a relatively good quarter again. US long dated bonds fell, reflecting the expectation of tighter monetary policy going forwards. Global corporate high yield bonds outperformed investment grade bonds, reflecting an increased risk appetite.

**Worcestershire County Council Pension Fund - Chart showing for each manager: performance since inception, three years, annual performance April 2016 to March 2017 and latest year in quarter ends June 2016 to March 2017, relative to performance requirement**



**Key Highlights**

- The performance trend for Nomura and JP Morgan Bonds on a three year basis compared to since inception is positive. The annual return for Nomura is very strong, whilst JP Morgan Bonds continues only to provide a small outperformance against benchmark each quarter.
- JP Morgan Emerging Markets portfolio had strong performance in quarter 1 of 2017, which increased their one year return to above target, but remain behind target over the past three years and since inception.
- Schroders had a poor Q4 2016 and Q1 2017, which has contributed to a significant one year and three year underperformance against benchmark and target. However, since inception returns are still near target.

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# **Portfolio Evaluation Ltd**

## **Worcestershire County Council Pension Fund**

### **Investment Overview 2016/17**

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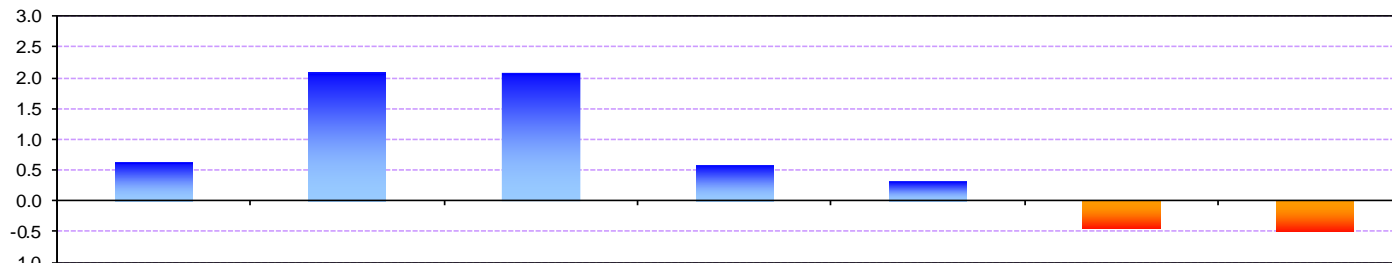
# Overview of Today

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- Market Review
  - Asset class results
  - Themes
  - Market trends and developments
  
- Evaluation of the Worcestershire County Council Pension Fund results
  - Total fund results (short and long term)
  - Attribution of 2016/17 results

# Total Fund Results – Ending March 2017

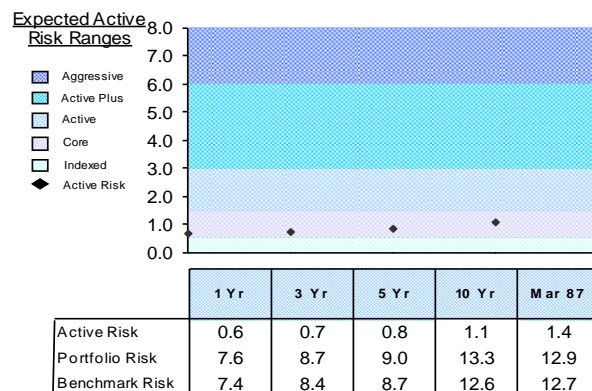
**Excess Return Analysis (%)**



	QTR	YTD	1 Yr	3 Yr	5 Yr	10Yr	Since Mar 87 (p.a.)
Portfolio Return	5.6	26.7	26.7	12.1	11.1	6.7	8.2
Benchmark Return	5.0	24.7	24.7	11.5	10.8	7.2	8.7
Excess Return	0.6	2.1	2.1	0.6	0.3	-0.5	-0.5

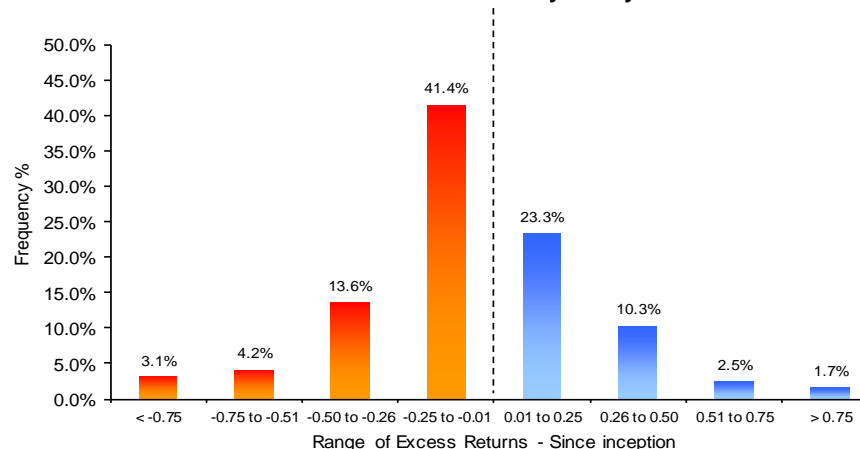
All returns for periods in excess of 1 year are annualised.

**Ex-Post Active Risk Analysis (%)**



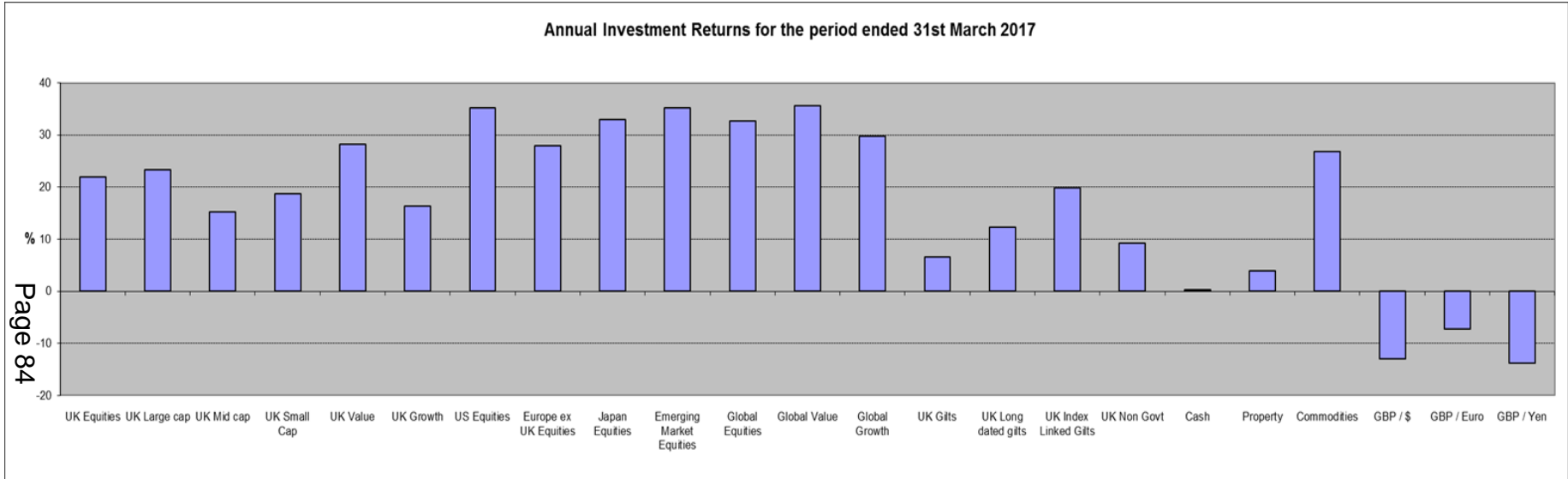
	1 Yr	3 Yr	5 Yr	10 Yr	Mar 87
Active Risk	0.6	0.7	0.8	1.1	1.4
Portfolio Risk	7.6	8.7	9.0	13.3	12.9
Benchmark Risk	7.4	8.4	8.7	12.6	12.7

**Excess Return Consistency Analysis**



- Positive real returns generated by the Fund over all time periods.
- Positive excess over 1 year, 3 years and 5 years.
- Returns in excess of cash and inflation

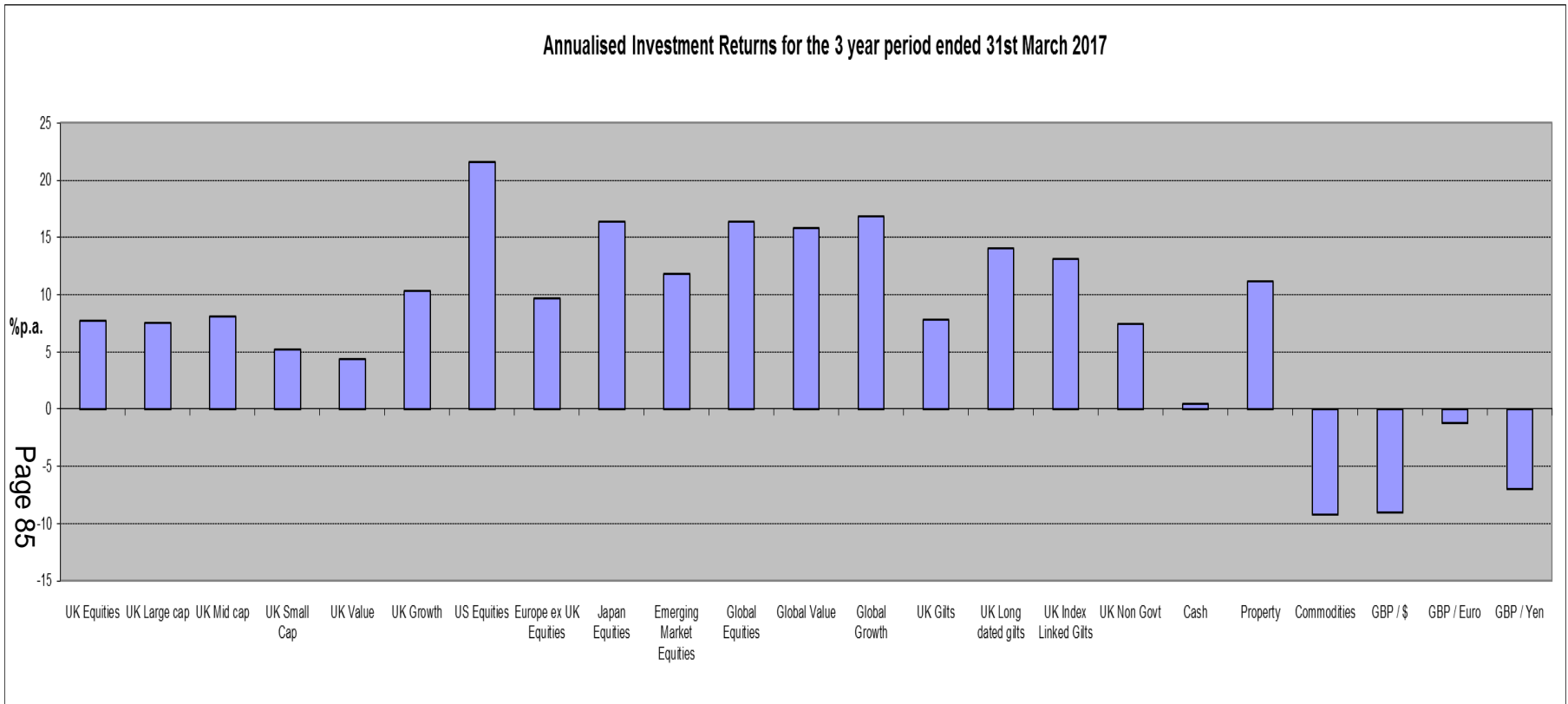
# Market Results – Year Ended March 2017



- High returns due to global economic growth, Brexit and subsequent sterling depreciation
- Loose monetary policy good for markets but bad for savers
- QE beginning to end should result in increasing bond yields.
- Divergent results regionally and between sectors, however increasing signs of convergence
- Market risk increased in 2016 but has plateaued recently



# Market Results - Three Years Ended March 2017



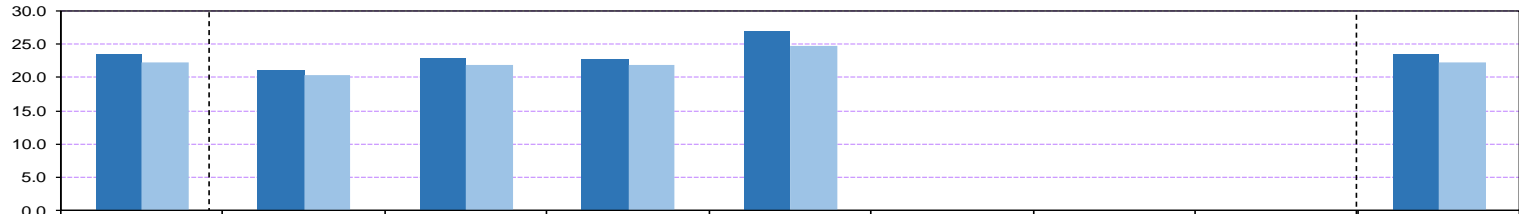
- Strong returns from markets
- Sterling depreciation a significant return generator
- Impact of QE beneficial from a returns perspective

# Client Trends and Developments

- Fund activity;
  - Growth in investments within 'Alternative Asset Classes' including Infrastructure and Private Debt.
  - Property, absolute return funds and private equity funds have performed well and returns are becoming in line with long term targets;
  - Increased exposure to alternative benchmark index strategies such as RAFI
  - Removal of underperforming managers increased partly because of limited time to make up differential because of pooling (these assets typically have been indexed)
  - Investment fees reducing.
- Local Government Pension Scheme Pooling
  - Currently in early stages
  - Transition due in 2018 / 19
  - Impact on investment managers
  - Fee pressures
- WM Company have withdrawn from performance measurement business unless they are your custodian
  - Impact is on many local authorities and charities
  - May lead to opportunities for investment managers as will generate questioning of practises.

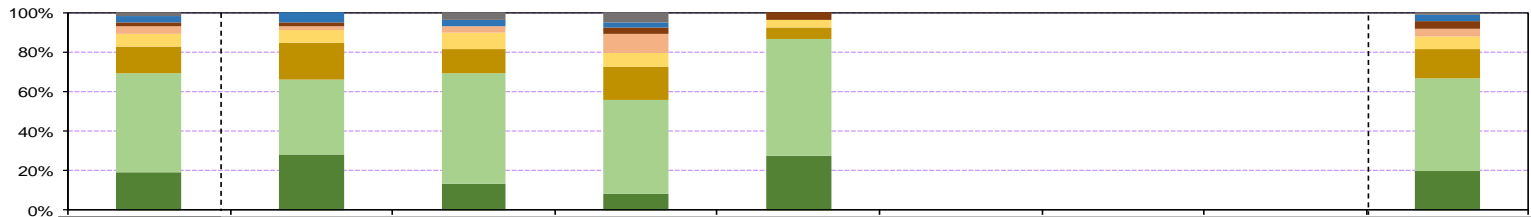
# Universe Performance Midlands Pool for 1 Year Ended 31st March 2017

## RETURN ANALYSIS (%)



RETURN (%)	MIDLANDS POOL	DERBYSHIRE	STAFFORDSHIRE	WEST MIDLANDS	WORCESTERSHIRE	A	B	C	TOTAL LOCAL AUTHORITY POOL
EXCESS	1.2	0.8	0.9	0.8	2.1				1.0
FUND	23.3	21.1	22.9	22.6	26.7				23.4
BENCHMARK	22.2	20.3	21.9	21.8	24.7				22.3

## ASSET ALLOCATION (% WEIGHT)



ASSET ALLOCATION (%)	MIDLANDS POOL	DERBYSHIRE	STAFFORDSHIRE	WEST MIDLANDS	WORCESTERSHIRE	A	B	C	TOTAL LOCAL AUTHORITY POOL
OTHERS	2.2	0.0	3.6	5.1	0.0				1.0
CASH	2.9	5.4	3.6	2.7	0.0				3.4
INFRASTRUCTURE	2.1	1.8	0.0	2.9	3.6				3.6
PRIVATE EQUITY	3.6	1.7	3.1	9.5	0.0				4.1
PROPERTY	6.6	6.3	8.1	7.6	4.2				6.7
FIXED INCOME	13.4	18.8	12.7	16.5	5.6				14.2
OVERSEAS EQ	50.0	38.1	55.3	47.4	59.3				47.0
UK EQUITY	19.3	28.0	13.7	8.3	27.3				20.0

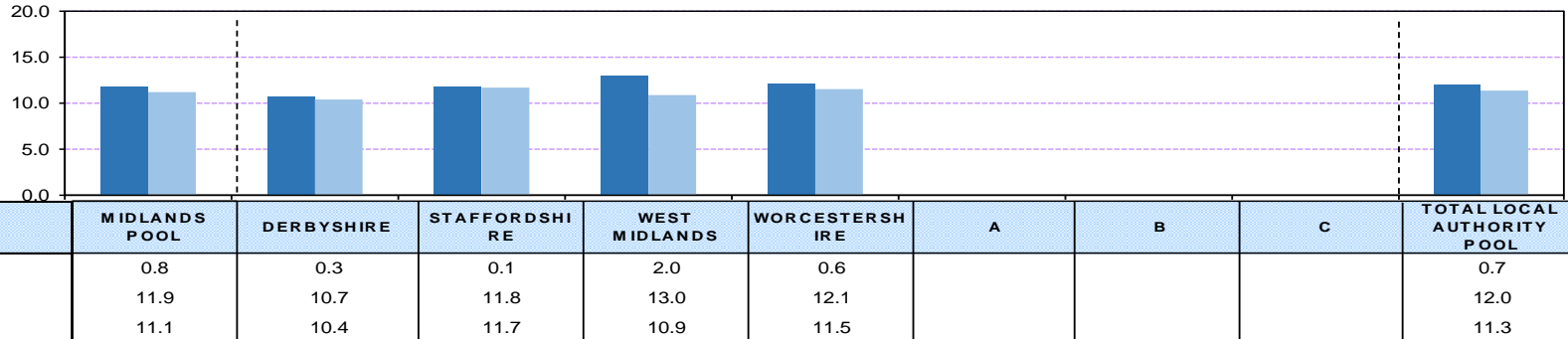
MARKET VALUE (£m)	MIDLANDS POOL	DERBYSHIRE	STAFFORDSHIRE	WEST MIDLANDS	WORCESTERSHIRE	A	B	C	TOTAL LOCAL AUTHORITY POOL
	25,699	4,450	4,584	14,213	2,453				73,906

# Universe Performance

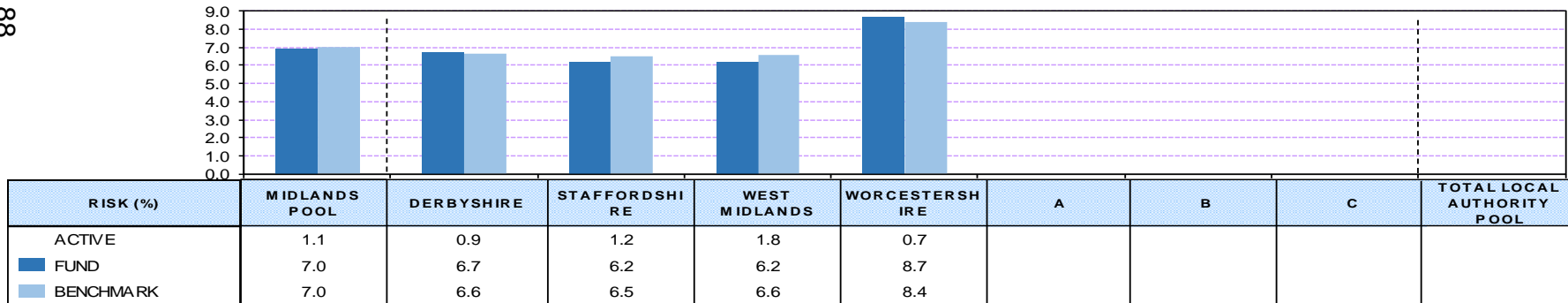
## Midlands Pool

### 3 Year Risk and Return Data

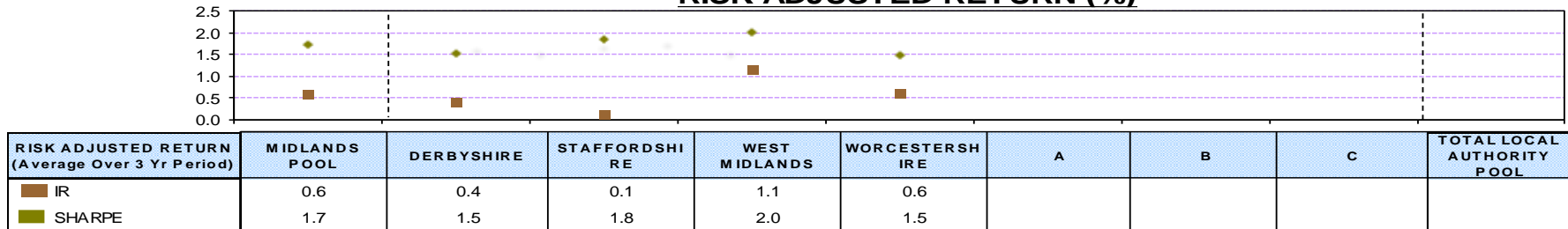
#### RETURN ANALYSIS (%)



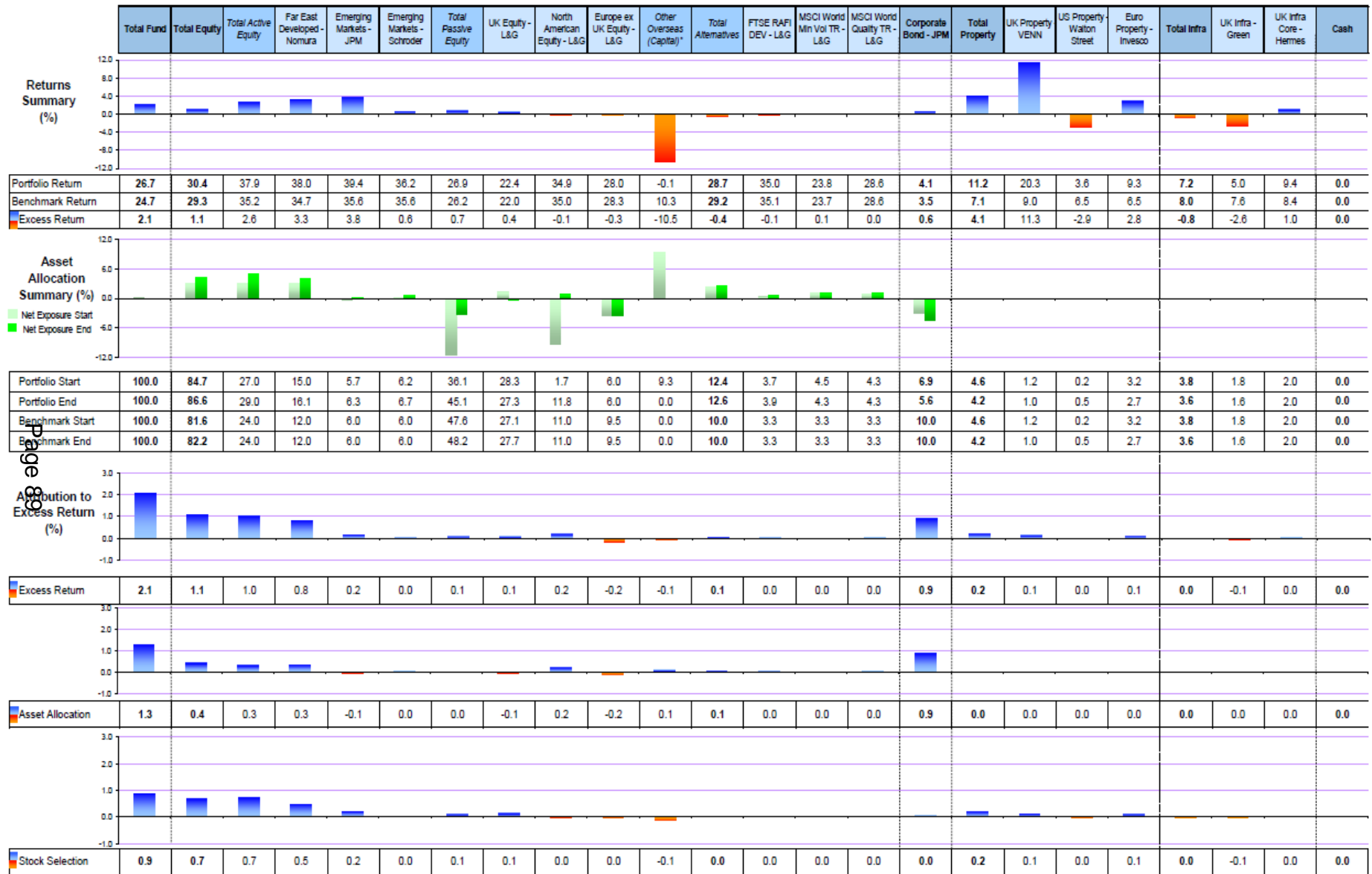
#### RISK ANALYSIS (%) - EX POST



#### RISK ADJUSTED RETURN (%)



# Contribution to Total Fund Excess Return Analysis - Year Ending March 2017



# Fund and Portfolio Summary Page- Year Ending March 2017

	Benchmark	Incep Date	Market Value (£m)	Weight	QTR			Year To Date			1 Year			3 Year			5 Year			10 Year			Since Inception		
					PF	BM	ER	PF	BM	ER	PF	BM	ER	PF	BM	ER	PF	BM	ER	PF	BM	ER	PF	BM	ER
<b>Total Equity Fund</b>	<b>Client Specific Weighted Index</b>	<b>Mar-16</b>	<b>2,124.3</b>	<b>86.6</b>	<b>6.2</b>	<b>5.8</b>	<b>0.4</b>	<b>30.4</b>	<b>29.3</b>	<b>1.1</b>	<b>30.4</b>	<b>29.3</b>	<b>1.1</b>										<b>30.4</b>	<b>29.3</b>	<b>1.1</b>
<i>Total Active Equity Fund</i>	<i>Client Specific Weighted Index</i>	<i>Mar-16</i>	<i>710.7</i>	<i>29.0</i>	<i>8.9</i>	<i>7.9</i>	<i>1.0</i>	<i>37.9</i>	<i>35.2</i>	<i>2.6</i>	<i>37.9</i>	<i>35.2</i>	<i>2.6</i>										<i>37.9</i>	<i>35.2</i>	<i>2.6</i>
Far East Developed Fund - Nomura	FTSE Developed Asia Pacific Index	Feb-03	393.9	16.1	8.6	6.9	1.8	38.0	34.7	3.3	38.0	34.7	3.3	17.1	15.6	1.4	11.7	11.2	0.6	8.1	8.0	0.1	11.3	11.3	0.1
Emerging Markets Fund - JPM	FTSE All World Emerging Market Index	Dec-11	153.4	6.3	10.2	8.9	1.3	39.4	35.6	3.8	39.4	35.6	3.8	13.4	12.9	0.6	7.1	6.6	0.5				8.8	8.3	0.5
Emerging Markets Fund- Schroder	FTSE All World Emerging Market Index	Oct-11	163.4	6.7	8.3	8.9	-0.6	36.2	35.6	0.6	36.2	35.6	0.6	13.5	12.9	0.6	8.2	6.6	1.6				9.0	7.3	1.7
<i>Total Passive Equity Fund</i>	<i>Client Specific Weighted Index</i>	<i>Mar-16</i>	<i>1,105.6</i>	<i>45.1</i>	<i>4.8</i>	<i>4.9</i>	<i>0.0</i>	<i>26.9</i>	<i>26.2</i>	<i>0.7</i>	<i>26.9</i>	<i>26.2</i>	<i>0.7</i>										<i>26.9</i>	<i>26.2</i>	<i>0.7</i>
UK Equity Fund - L&G	FTSE All Share Index	Dec-15	668.9	27.3	4.3	4.0	0.3	22.4	22.0	0.4	22.4	22.0	0.4										19.8	19.4	0.4
North American Equity Fund- L&G	FTSE All World North American Index	Dec-15	289.4	11.8	4.8	4.8	0.0	34.9	35.0	-0.1	34.9	35.0	-0.1										32.3	32.4	-0.1
Europe ex UK Equity Fund- L&G	FTSE Developed Europe Ex. UK Index	Dec-15	147.3	6.0	7.3	7.4	-0.1	28.0	28.3	-0.3	28.0	28.3	-0.3										24.2	24.5	-0.3
<i>Total Alternatives Fund</i>	<i>Client Specific Weighted Index</i>	<i>Mar-16</i>	<i>308.0</i>	<i>12.6</i>	<i>5.2</i>	<i>5.2</i>	<i>0.0</i>	<i>28.7</i>	<i>29.2</i>	<i>-0.4</i>	<i>28.7</i>	<i>29.2</i>	<i>-0.4</i>										<i>28.7</i>	<i>29.2</i>	<i>-0.4</i>
FTSE RAFI DEV Fund - L&G	FTSE RAFI Developed 1000 QSR Net Index	Dec-15	95.1	3.9	3.8	3.8	0.0	35.0	35.1	-0.1	35.0	35.1	-0.1										31.8	31.8	-0.1
MSCI World Min Vol TR Fund - L&G	MSCI World Minimum Volatility Net Index	Dec-15	106.5	4.3	5.0	5.0	0.0	23.8	23.7	0.1	23.8	23.7	0.1										28.8	28.8	0.0
MSCI World Quality TR Fund - L&G	MSCI World Quality Total Return Net Index	Dec-15	106.3	4.3	6.8	6.8	0.0	28.6	28.6	0.0	28.6	28.6	0.0										27.6	27.6	0.0
<b>Corporate Bond Fund- JPM</b>	<b>Bardays Capital Global Aggregate - Ex Treasury, Ex Government Related 100% Hedged to GBP</b>	<b>Mar-03</b>	<b>137.8</b>	<b>5.6</b>	<b>1.1</b>	<b>1.0</b>	<b>0.1</b>	<b>4.1</b>	<b>3.5</b>	<b>0.6</b>	<b>4.1</b>	<b>3.5</b>	<b>0.6</b>	<b>4.3</b>	<b>4.0</b>	<b>0.3</b>	<b>4.2</b>	<b>4.0</b>	<b>0.2</b>	<b>6.0</b>	<b>6.4</b>	<b>-0.4</b>	<b>5.3</b>	<b>5.6</b>	<b>-0.3</b>
<b>Total Property Fund</b>	<b>Client Specific Weighted Index</b>	<b>Mar-16</b>	<b>102.2</b>	<b>4.2</b>	<b>3.2</b>	<b>1.7</b>	<b>1.5</b>	<b>11.2</b>	<b>7.1</b>	<b>4.1</b>	<b>11.2</b>	<b>7.1</b>	<b>4.1</b>										<b>11.2</b>	<b>7.1</b>	<b>4.1</b>
UK Property Fund - VENN	Absolute Return +9%	Jul-15	23.4	1.0	12.7	2.2	10.5	20.3	9.0	11.3	20.3	9.0	11.3										14.1	9.4	4.7
US Property Fund- Walton Street	Absolute Return + 6.5%	Jan-16	12.1	0.5	-1.2	1.6	-2.8	3.6	6.5	-2.9	3.6	6.5	-2.9										4.7	5.6	-0.9
Euro Property Fund- Invesco	Absolute Return + 6.5%	Feb-16	66.7	2.7	0.9	1.6	-0.7	9.3	6.5	2.8	9.3	6.5	2.8										10.9	5.9	5.1
<b>Total Infrastructure Fund</b>	<b>Client Specific Weighted Index</b>	<b>Mar-16</b>	<b>88.3</b>	<b>3.6</b>	<b>1.5</b>	<b>1.9</b>	<b>-0.5</b>	<b>7.2</b>	<b>8.0</b>	<b>-0.8</b>	<b>7.2</b>	<b>8.0</b>	<b>-0.8</b>										<b>7.2</b>	<b>8.0</b>	<b>-0.8</b>
UK Infrastructure Fund - Green	Absolute Return +7.6%	Apr-15	38.9	1.6	0.0	1.8	-1.8	5.0	7.6	-2.6	5.0	7.6	-2.6										2.9	7.6	-4.7
UK Infrastructure Core Fund - Hermes	Absolute Return +8.4%	May-15	49.4	2.0	2.9	2.0	0.9	9.4	8.4	1.0	9.4	8.4	1.0										8.7	8.4	0.4
<b>Worcestershire CC Total Fund</b>		<b>Mar-87</b>	<b>2,452.6</b>	<b>100.0</b>	<b>5.6</b>	<b>5.0</b>	<b>0.6</b>	<b>26.7</b>	<b>24.7</b>	<b>2.1</b>	<b>26.7</b>	<b>24.7</b>	<b>2.1</b>	<b>12.1</b>	<b>11.5</b>	<b>0.6</b>	<b>11.1</b>	<b>10.8</b>	<b>0.3</b>	<b>6.7</b>	<b>7.2</b>	<b>-0.5</b>	<b>8.2</b>	<b>8.7</b>	<b>-0.5</b>

PF = Portfolio Return BM = Benchmark Return ER = Excess Return

# Summary

- The Fund has outperformed its benchmark over the one, three and five year periods.
- Over the one year the Fund has outperformed due to;
  - Asset allocation as it has been overweight equities and underweight bonds (especially Far Eastern equities);
  - Stock selection as all active equity and fixed income and property has outperformed. Only Infrastructure underperformed but its impact on the Total Fund has been negligible to date.
- The Fund has achieved a higher return than the average of the Midlands Pool and the PE Local Authority Universe average. This reflects the high equity content of the Fund. It has also achieved a good information ratio and Sharpe ratio (risk and return ratios).
- Total risk remains low and active risk is at a level that is consistent with the structure of the Fund and its equity bias. Risk has remained stable over the year.
- The Fund has outperformed our average pension fund return with less risk over the three and five year period

# **Appendix 1**

## **Introduction to Performance Measurement**

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# Performance Evaluation – Purpose

- Performance measurement and evaluation should enhance:
  - Reporting and governance procedures
  - Monitoring and decision making function of Funds
  - Dialogue between clients, investment managers and consultants
  - Comply with the CFA Institute guidelines for Effective Investment Reporting
- Key question 1 - Has the Fund and the portfolios met their objectives?
  - What is the expected and realised investment return?
  - How much risk is there?
  - Have I been rewarded for the risk that has been taken?
  - How efficient is the manager?
  - Have I had value for money
- Key question 2 - Is the Fund and its portfolios being managed as expected?
  - What are the sources of my risk and return?
  - Are they consistent with the managers style and process?
  - Is there anything else influencing the portfolio (incidental bets)?
  - What is the cost?
- Key question 3 - Is the mix of managers in the Fund working efficiently ?

# The Pension Fund Management & the Role of Investment Performance Analysis

Pension Fund Investment Review Process		
Process Step	Description	Performance Evaluation role
Actuarial input / requirements	Liability based requirements including required return, risk profile, funding levels etc	Monitor risk and return relative to required return to meet liabilities
Investment objectives	Based on liability inputs and Trustee requirements (risk aversion etc), return, investment restrictions. This determines a long term return / risk profile for the Fund	Ensure the Fund and portfolios meet the required risk and return profile and any constraints / restrictions are met.
Investment strategy	Identifies the asset allocation across asset classes required to meet the investment objectives. This will define a broad market based investment benchmark that will track the investment strategy	Ensure the asset allocation tracks the investment strategy. Measures the risk return profile of the benchmark.
Investment structure	Identifies the type (e.g. pooled / segregated) of mandate, type of management (style / active / passive). Also identifies the amount of assets to be allocated. The sum of this should equal the investment strategy.	Ensures that the investment structure is being tracked and that the portfolios and Fund are being managed as expected.
Investment manager	The selected investment manager and their products required to meet the structure. Each portfolio has a role within the structure	Detailed analysis of portfolios ensures that objectives and constraints are being met and that the portfolios are doing as expected

# Investment Performance Analysis – Key Concepts 1

Investment Performance Analysis – Key Concepts		
Concept	Description	How measured
Benchmark	Provides a framework for both the structure and risk of portfolios and the expected return of Funds and portfolios. Are key as they articulate the investment strategy of the Fund	Typically benchmarks are market indices of a group of securities; these reflect the universe of securities available to a manager. Alternatively they can be based on a broad index such as RPI that reflects the risk return characteristics of an asset class.
Objective	The objective defines the performance, risk and management style of a portfolio / fund	This is measured by evaluating the portfolio and its characteristics relative to those of the benchmark
Return measurement	Primary measurement that identifies the growth in market value. Used to measure the growth in a portfolio or benchmark	We use the time weighted rate of return for portfolio measurement (as opposed to the money weighted return – also known as Internal Rate of Return) as this compensates for the impact of cashflow allowing for comparison with benchmarks. Typically the higher the return the better
Risk measurement	Evaluates the volatility in the market value (cash adjusted) of a portfolio.	This can be calculated on an ex-post basis (uses the observed return series of a portfolio) or an ex-ante basis (which uses the current holdings of a portfolio is calculated using the historic returns and characteristics of securities) and is therefore considered a modelled risk number. These are expressed as an annualised 1 standard deviation number e.g. a portfolio risk of 10% indicates that the portfolio would have a return within 10% of that of cash two thirds of the time over a one year period.

# Investment Performance Analysis – Key Concepts 2

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Investment Performance Analysis – Key Concepts		
Concept	Description	How measured
Excess return	The return that is the difference between the portfolio and that of the benchmark. This can be positive or negative.	Is the return of a portfolio over a period of time minus the return of the benchmark (arithmetic basis) is the most common methodology. It can also be calculated geometrically (i.e. the portfolio return is divided by the benchmark return).
Active risk	This identifies the magnitude of the difference between the composition of a portfolio / fund and that of the benchmark / investment strategy. Typically the larger the active risk the greater the difference in the structure of the portfolio relative to the benchmark e.g. an index fund should have a low active risk.	Can be calculated ex post by measuring the volatility of the excess returns or calculated models. The results are expressed as an annualised standard deviation; for example an active risk of 2% results in our expecting the return of the portfolio to be within 2% of the return of the benchmark two thirds of the time.
Risk adjusted returns	A measure of efficiency as it identifies the return per unit of risk. Two are typically used, namely the Sharpe Ratio and Information Ratio. Typically the higher the ratio the more efficient the management.	The Information Ratio is calculated by dividing the excess return by the active risk and as such measures the efficiency of active management. The Sharpe Ratio is calculated by dividing the portfolio return minus the risk free rate (cash) by the volatility of the portfolio return.
% per annum	Investment returns in excess of one year are typically expressed as % per annum. This permits easier comprehension and comparison.	

# Investment Performance Analysis – Key Concepts 3

Investment Performance Analysis – Key Concepts		
Concept	Description	How measured
Attribution	Permits us to evaluate the sources of a portfolio or fund return. Common sources evaluated are asset allocation (are the right markets / sectors/ styles being selected) and stock selection (does the manager chooses good performing stocks). Used to identify if a portfolio is generating returns from expected sources.	This can be quite complicated but is based on comparing weights allocated and returns from an asset class and comparing them to those of the benchmark.
Diversification	Measures the impact of investing in a range of securities, managers and / or asset classes. This is particularly relevant for analysing the efficiency from a risk perspective of the investment strategy of a Fund or portfolio. Also identifies if a portfolio has too many securities (over diversified).	Typically calculated via risk models
Investment style	Identifies the type of style e.g. index fund, active manager, small or large capitalisation stock bias, value or growth stock bias. Used to identify if a portfolio is generating returns from expected sources.	Calculated from numerous sources.

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**PENSIONS COMMITTEE**  
**16 JUNE 2017****INFRASTRUCTURE AND PROPERTY INVESTMENTS**

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**Recommendation****1. The Chief Financial Officer recommends that:**

- a) the appointments of Invesco, AEW, Stonepeak and First State be approved; and
- b) the following commitments be approved: £75m First State; £75m Stonepeak; £40m Invesco Residential; and £20m AEW.

**Background**

2. In December 2016 the Pension Committee approved recommendations to move to a new strategic asset allocation for the Fund as part of the Fund's strategic asset allocation review. The aim of the asset allocation change is to achieve lower volatility without reducing total returns to enable a closer correlation between the Fund's assets and the longer term liability profile. The new structure is summarised below in table 1:

*Table 1: Summary Changes to the Strategic Asset Allocation*

By Review Year	2013		2016	
Asset Type by %	Allocation	Tolerance	Allocation	Tolerance
Equities	80	75 – 90	75	70 - 85
Bonds	10	5 – 15	10	5 – 15
Infrastructure and Property	10	5 – 10	15	5 – 15

3. In February 2017 BFinance were appointed as a specialist procurement adviser to assist with the tender for property and infrastructure pooled funds. BFinance services included portfolio design of the proposed investments in terms of style, size and geographic exposure along with analysis of proposals from interested managers and preparation of a report in order to select a short list of suitable specialists capable of managing the mandates successfully.

4. As a result of BFinance's analysis and recommendations five pooled Infrastructure and Property Fund managers were interviewed by members of the Pension Investment Advisory Panel on 22nd May 2017.

## **Manager Interviews**

5. Following the interviews, four managers were recommended for appointment by the Pension Investment Advisory Panel: Invesco, AEW, Stonepeak and First State
6. The unsuccessful manager at interview, ISquared, has been notified by BFinance and supplied appropriate feedback.

## **Procurement**

7. The appointment of Stone Peak, a specialist U.S. infrastructure manager, and First State, a specialist European infrastructure manager, would provide good diversification away from the Fund's current UK focused infrastructure investments. Stonepeak and First State have been recommended by BFinance, following an in depth procurement, as the highest rated managers in these regions and are expected to provide returns in line with the Fund's requirements.
8. Given the Fund's current European property investments with Invesco and Property Debt with Venn in the UK and Walton Street in the U.S., a search was undertaken by BFinance for UK property pooled funds and U.S. pooled property funds (excluding debt funds) in order to provide diversification into the portfolio. Given the perceived late stage of the property cycle in the UK and the U.S. the search concentrated on investments that would provide good downside protection in the event of potential capital falls in these property markets. The search identified one possible U.S property pooled fund that met the Fund's requirements, however once the level of leverage, fees and potential tax leakage were taken into account the opportunity was rejected. The two recommended pooled funds for investment. Invesco and AEW, are both UK focused and should provide downside protection and an inflation hedge. Further details on these pooled funds, is set out in Appendix 1 to this report.

## **Pooled fund IRR blend and fees**

9. The inclusion of the four recommended managers within the Fund's current pooled property and infrastructure portfolio increases the expected net IRR from 8.0% to 9.0%.
10. BFinance have negotiated significant fee discounts with all four of the proposed pooled funds. The managers are also willing to treat LGPS in aggregate, so the Fund will benefit from further fee discounts, as other LGPS funds invest with these managers.

## **Commitments**

11. The Pension Committee's decision to increase the allocation to pooled property and infrastructure funds from 10% to 15% of the Fund's market value converts to a Sterling value of an additional commitment of £170m. However due to the analysis undertaken by BFinance modelling the drawdown profile and distribution profile of the Fund's infrastructure and property pooled funds, including the recommended new investments, as set out on slide 5 of the Appendix to the report, an additional £210m is required to meet a peak of 88% deployment in 2018/19. A £250m commitment would be required to ensure 100% deployment, and therefore 15% of the current market value of the Fund is invested at a peak in 2018/ 19.
12. It is however recommended that £210m is committed to the four pooled fund managers to be split: £75m First State; £75m Stonepeak; £40m Invesco Residential and £20m AEW. These commitments would ensure that there is not an over concentration



with the newly proposed managers and allows for further deployment of capital in the next twelve to eighteen months to help increase vintage year diversification and take advantage of any market opportunity as they arise given the changing market environment.

## **Contact Points**

### County Council Contact Points

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Worcestershire Hub: 01905 765765

Email: [worcestershirehub@worcestershire.gov.uk](mailto:worcestershirehub@worcestershire.gov.uk)

### Specific Contact Points for this report

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## **Supporting Information**

- BFinance report (Appendix)

## **Background Papers**

In the opinion of the proper officer (in this case the Chief Financial Officer) the following are the background papers relating to the subject matter of this report:

Agenda papers and Minutes of the meeting held on 7 December 2016

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**PENSIONS COMMITTEE**  
**16 JUNE 2017****ALTERNATIVE INDICES INVESTMENTS**

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**Recommendation**

- 1. The Chief Financial Officer recommends that the blend of alternative indices factors be noted.**

**Background**

2. In December 2016 the Pensions Committee approved recommendations to move to a new strategic asset allocation for the Fund as part of the Fund's strategic asset allocation review. The aim of the asset allocation changes are to achieve lower volatility without reducing total returns to enable a closer correlation between the Fund's assets and the longer term liability profile.

3. One of the recommendations approved by the Committee was to increase the Fund's allocation to alternative indices by 5% from the current strategic allocation of up to 10% of the Fund to 15% equities allocation. The increase was conditional on the Chairman of the Pensions Committee approving the proposed balance of alternative indices which he has agreed to.

**LGIM alternative indices blend analysis**

4. Legal and General Asset Management (LGIM), the Fund's passive equities manager, carried out detailed analysis of the Fund's current alternative indices investments. The key finding was that the current portfolio has a significant negative tilt to 'value' style based on the book-to-price measure. With the addition of the Fund's active equity manager strategies to the alternative indices strategies, the book-to-price negative tilt becomes slightly more pronounced.

5. In 2014 the Fund's passive equity manager at the time, UBS, devised the current alternative indices blend to include a negative tilt to 'value' as the Fund had a number of active equity managers in place with a 'value' style bias e.g. Capital International. The alternative indices blend was therefore underweight to value to provide diversification against the active managers' 'value' style bias.

6. Following the termination of Capital International in 2016 and the ability of the JP Morgan Emerging Markets portfolio to move between 'value' and 'momentum' styles, the need to diversify away from 'value' as a style within the alternatives indices blend has reduced.

## **Revised alternative indices blend**

7. As a result of the LGIM analysis the Chair of the Pension Committee has approved the option to maintain the current factor-based strategies but change the weights allocated to each of the strategies. In order to reduce the underweight to 'value' the alternative indices portfolio can tilt towards the 'value' factor via the FTSE RAFI 1000 index by giving it extra weight. The approved option is to reweight the alternative indices factor blend from equal thirds to 40% Value / 30% Min Vol / 30% Quality.

## **Contact Points**

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## **Background Papers**

In the opinion of the proper officer (in this case the Chief Financial Officer) the following are the background papers relating to the subject matter of this report:

Agenda papers and Minutes of the meeting held on 7 December 2016

By virtue of paragraph(s) 3 of Part 1 of Schedule 12A  
of the Local Government Act 1972.

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