

 Brent	Pension Fund Sub-Committee 14 th February 2017 Report from the Chief Finance Officer
For Information	Wards Affected: ALL
Quarterly monitoring report on fund activity: Quarter to December 2016	

1.0 SUMMARY

- 1.1 This report provides a summary of the Fund's activity during the quarter ended 31 December 2016. It examines the economic and market background, and investment performance, as well as commenting on events in the quarter. The main points arising are:
- a) The Fund increased in value from by 3.6% £749.7m to £776.9m during the quarter 4 ended 31 December 2016.

2.0 RECOMMENDATIONS

- 2.1 Members are asked to note the investment report.

3.0 DETAIL

- 3.1 Economic growth in the fourth quarter in the UK has been solid. Economic growth has surprised most commentators and investment performance has been greater than expected. However, it is hard to determine how much of that is due to the Bank of England's actions to re-start quantitative easing and the weakened pound; the long-term economic outlook is profoundly unclear. It is important to note that growth was already underway long before Brexit. The lack of clarity around the Government's position and that businesses would be differentially impacted by the different approaches taken has made the future unusually difficult to forecast. It is likely interest rates will cannot go much lower. This has made long-term investment returns more challenging, even as in the short-term there has been significant appreciation, as cheap money pumps up asset prices.
- 3.2 A full market review for the quarter ended 31 December 2016, written by the Independent Financial Adviser, is attached. However, It is important to note in the table below that the majority of growth in the fund has come from appreciation and this quarter has seen more than 3% return solely due to appreciation.

- 3.3 The Fund's position in cash has also risen to the point it now has the cash on-hand to re-allocate to its intended strategic allocation. With Capital Dynamics entering a mature stage in its portfolio and distributing large amounts of cash, this strengthens the Fund's ability to achieve this strategic goal. This is counter-balanced by uncertainty over one of the largest sub-funds, as either £30m approximately will leave Brent Pension Fund or £20m will move to Brent Pension Fund.
- 3.4 UK-AVIVA and YFM have reduced to £5.8m and £0.6m respectively, as the Fund is exiting the former, gradually subject to commercial market conditions and the latter is already being run round down.
- 3.5 The following distributions or capital proceeds took place in Q4 2016:
- £13.7m sales proceeds from the Aviva UK property fund
 - Capital Dynamic private equity distributions in the quarter of £3.5m.
 - £2.1m distributions from Alinda Parallel II Infrastructure.

Table 1: Asset allocation as at 31 December 2016 compared to the benchmark

ASSET CLASS	30/09/2016 Value (£m)	Net Investment Value (£m)	Appreciation (£m)	31/12/2016 Value (£m)	% of Fund	Allocation Target (%)	Deviation (%)
Fixed Income							
Henderson-Total Return Bond Fund	90.6	0	-0.8	89.8	11.6	15.0	-3.4
Equities							
UK - L&G	98.7	0	3.8	102.5	13.2		
UK Smaller Cos - Henderson	27.3	0	0.7	28	3.6		
Overseas Developed - L&G	236.3	0	17.3	253.6	32.6		
Equities - Total	362.3	0	21.8	384.1	49.4	45.0	4.4
Diversified Growth							
Baillie Gifford	72.3	0	1.5	73.8	9.5	21.0	-11.5
Property							
UK - AVIVA	16.7	-13.7	-0.8	2.2	0.2		
Europe - AVIVA	3.7	0	-0.1	3.6	0.5		
Property - Total	20.4	-13.7	-0.9	5.8	0.7	0.0	0.7
Private Equity							
Capital Dynamics	83.3	-3.5	4.6	84.4	10.8		
Yorkshire	0.6	0	0	0.6	0.1		
Private Equity Total	83.9	-3.5	4.6	85	10.9	10.0	0.9
Infrastructure							
Alinda	40.2	-2.1	2.4	40.5	5.2		
Capital Dynamics	11.2	0.1	0.2	11.5	1.5		
Infrastructure Total	51.4	-2	2.6	52	6.7	8.0	-1.3
Cash Deposits							
	68.8	-17.9	35.6	86.5	11.1	1.0	10.1
Grand Total	749.7	-37.1	64.4	777.0	100.0	100.0	0.0

3.6 The independent Custodian Northern Trust measures the returns on the Brent Pension Fund. Table 2 sets out returns for the periods to 31 December 2016.

Table 2: Investment Returns in Individual Markets

Investment Category	31-Dec-16								Benchmark/ Index Description
	RETURNS								
	Qtr Ending 30/09/16				Qtr Ending 31/12/16				
Fund %	Benchmark %	Relative Return %		Fund %	Benchmark %	Relative Return %			
Fixed Income									
Henderson Total Return Bond Fund	3.0	0.1	2.9		-0.7	0.1	-0.8		Absolute Return 6% pa
Equities									
UK - Legal & General	7.8	7.8	0.0		3.9	3.9	0.0		FTSE All Share
UK - Small Companies Henderson	17.1	12.8	4.3		2.6	4.5	-1.9		FTSE Small Cap
O'seas Developed - Legal & General	8.3	8.3	0.0		7.3	7.3	0.0		FTSE Dev World ex UK
Property									
Aviva Investors	-2.4	0.1	-2.5		-4.6	2.3	-6.9		IPD All Properties Index
Private Equity									
Capital Dynamics	*	*	*		*	*	*		Absolute Return 8% pa
Yorkshire Fund Managers	*	*	*		*	*	*		Absolute Return 8% pa
Infrastructure									
Alinda Capital Partners	2.7	1.9	0.8		3.7	1.9	1.8		Absolute Return 8% pa
Capital Dynamics	*	*	*		*	*	*		Absolute Return 8% pa
Pooled Multi Asset									
Baillie Gifford	4.7	1.0	3.7		2.0	0.9	1.1		Base Rate + 3.5% pa
Cash	0	0.1			0	0.1			Base Rate
Total	5.5	5.1	0.4		3.3	3.3	0		

3.7 As you will note above, there have been varying levels of performance. After a surprising performance in Q3, Henderson Bond Fund has returned to underperforming the benchmark. Legal & General have performed at the market rate of return because they are tracker funds. Henderson Small-caps has performed slightly below the benchmark but it is volatile and overall, as a sector, it has performed well, therefore it is not an area of concern. Aviva has underperformed but the Pension Fund is getting out of commercial property. YFM and Capital Dynamics are not compared in this manner because they are private equity. This is planned to be rectified and officers are seeking to find an alternative comparison methodology. Alinda's Infrastructure investment has done very well in large part because it is primarily denominated in American dollars and this has appreciated versus the UK pound. Baillie Gifford had its second strong quarter in a row. Cash has just started being invested via Treasury to enable a return and protect the principal, but returns will inevitably be commensurate with the level of risk tolerated.

3.8 LGPS investment regulations state that the Administering Authority shall have regard both to the diversification and the suitability of investments. The following table notes the compliance record when comparing the Fund's actual investment exposure with the Pension Fund's planned investment levels, as agreed within the FSS. There is a known problem with LGIM as the Council had limited options with regards to investments except for liquidating into cash a year ago. Members were told previously about being over-weight in passive equities in February 2016. There was a clear plan to invest through the CIV and this was anticipated to be a short-term issue at that time.

Table 3: Compliance with Investment limits as noted within the FSS

Investment	Planned Limits	Actual exposure at 31 December 2016	Compliant Yes / No
Any single holding	10%	3%	Yes
Unit trusts managed by any one body	35%	46%	No
Unit trusts under one policy managed by one body	35%	32%	Yes
Lending to any one borrower	10%	3%	Yes
Unlisted securities of companies	15%	Nil	Yes
Any single partnership	5%	3%	Yes
Total investment in partnerships	30%	17%	Yes

3.9 Outstanding contractual commitments:

Table 4: The outstanding contractual commitments on existing investments

	30 June 2016 £'000	30 Sep 2016 £'000	31 Dec 2016 £'000
Capital Dynamics	20,819	21,389	21,729
Alinda	23,540	19,405	21,427
Yorkshire Fund Managers	0	0	0
Total	44,359	40,794	43,156

These outstanding investment commitments mean that the Fund needs to retain a sizeable cash balance to meet capital call payments as they arise.

4. FINANCIAL IMPLICATIONS

4.1 These are no direct financial implications of this report.

5. DIVERSITY IMPLICATIONS

5.1 None.

6. STAFFING IMPLICATIONS

6.1 None.

7. LEGAL IMPLICATIONS

7.1 None.

8. BACKGROUND INFORMATION

- 8.1 Henderson Investors – December 2016 quarterly report
- Legal & General – December 2016 quarterly report
- Northern Trust Performance Report December 2016

9. CONTACT OFFICERS

- 9.1 Persons wishing to discuss the above should contact Gareth Robinson in the Investment and Pensions Section, on 020 8937 6567 at Brent Civic Centre.



QUARTERLY REVIEW PREPARED FOR

Brent Council Pension Fund

Q4 2016

17th January 2017

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BRENT COUNCIL PENSION FUND

Quarterly Review, October – December 2016

Report by the Independent Financial Adviser

Economy

1. The UK economy has held up better than expected, with a growth rate of +0.6% for the third quarter. UK inflation is beginning to rise from abnormally low levels as the effect of a weaker pound becomes apparent.

(In the table below, bracketed figures show the forecasts made in October)

Consensus real growth (%)						Consumer prices latest (%)
	2013	2014	2015	2016E	2017E	
UK	+1.7	+2.8	+2.3	+2.0 (+1.8)	+ 1.2	+1.2(CPI)
USA	+1.9	+2.4	+2.4	+1.6 (+1.5)	+ 2.3	+ 1.7
Eurozone	-0.4	+0.8	+1.5	+1.6 (+1.5)	+ 1.4	+ 1.1
Japan	+1.7	+0.3	+0.6	+0.9 (+0.6)	+1.1	+0.5
China	+7.7	+7.4	+6.9	+6.7 (+6.6)	+6.4	+2.1

[Source of estimates: The Economist, January 14th, 2017]

2. The surprise victory by Donald Trump in the US Presidential Election was initially greeted with sharp falls in equity markets, but these were soon reversed in developed markets as investors concentrated on Trump's plans to cut taxes, deregulate energy, healthcare and financial services, and to offer tax incentives for infrastructure. The dollar strengthened to its highest level in 14 years on a trade weighted basis.
3. In his Autumn Statement on November 23, Philip Hammond confirmed that UK **government borrowing** would be much higher in each of the next 5 years than previously forecast. In total the additional borrowing required over the 5 years amounts to £122bn. This is largely due to slower GDP growth of 2.1% in 2016, 1.4% in 2017, 1.7% in 2018 and 2.1% in next two years, giving a cumulative reduction of 2.4% over the 5-year period. He has replaced George Osborne's target of achieving budget surplus on in 20/21 with an upper limit on the deficit of 2% of GDP (and a forecast level of 0.7%) in 20/21. He hopes to balance the budget as soon as possible after 2020. Debt/GDP will peak at 90% in 2017/8. Among other measures, Hammond announced the government is to spend £23bn on a **National Productivity Investment Fund**, to cover R&D, innovation in housing, rail & road, digital network etc

4. On December 14th, the US Federal Reserve raised the Fed Funds interest rate from 0.5% to 0.75% - the first increase since December 2015. They said they expect to make three more rises during 2017. The European Central Bank announced it would continue its programme of quantitative easing from April to December 2017, but at a reduced rate of €60bn per month, instead of the current €80bn.

5. The Italian Prime Minister, Matteo Renzi, resigned after a heavy defeat in the constitutional referendum on December 4th. His successor is the former Foreign Minister Paolo Gentiloni. In the French Presidential primaries, Francois Fillon gained the nomination of the centre-right party, eliminating ex-President Sarkozy from the race, while President Hollande announced he would not be standing for re-election as the Socialist Party candidate.

Markets

Equities

6. After the result of the US Election, most **equity markets** gained ground – with the exception of Pacific Basin and Emerging Markets which would be disadvantaged by the stronger dollar. Japan was helped by the weakening of the yen.

	Capital return (in £, %) to 31.12.16		
Weight %	Region	3 months	12 months
100.0	FTSE All-World Index	+6.1	+26.2
56.1	FTSE All-World North America	+8.4	+31.2
8.4	FTSE All-World Japan	+5.0	+20.0
11.3	FTSE All-World Asia Pacific ex Japan	+0.3	+24.6
15.3	FTSE All-World Europe (ex-UK)	+5.1	+15.3
6.2	FTSE All-World UK	+3.4	+14.3
8.8	FTSE All-World Emerging Markets	+1.8	+31.4

[Source: FTSE All-World Review, December 2016]

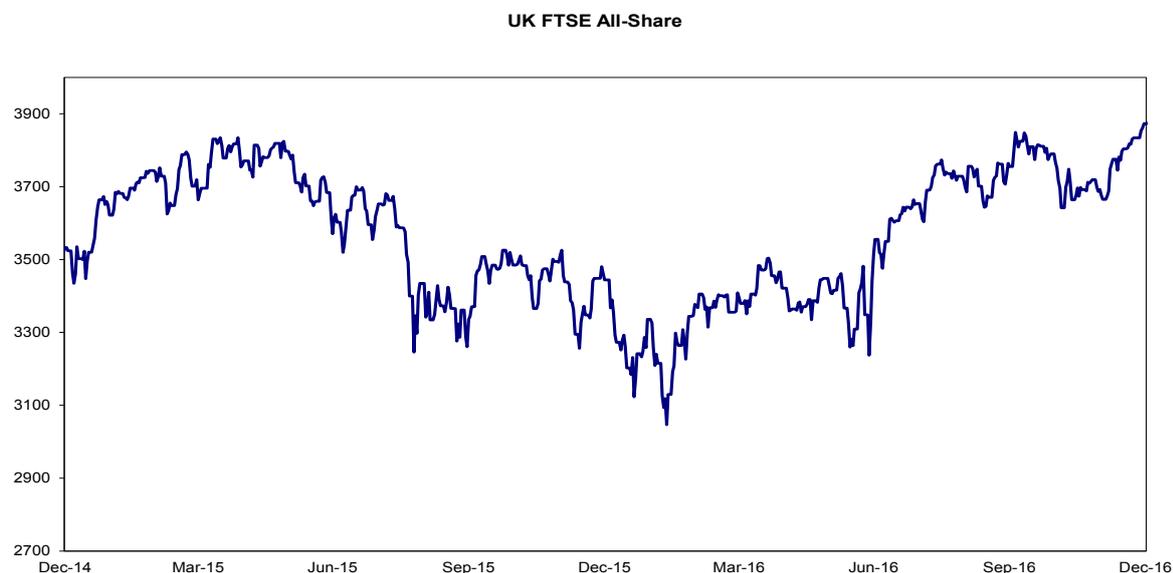
7. Within the UK market the mid-cap section was the weakest in the quarter and – by a wide margin – for the full year. These companies were seen as being more reliant on the domestic economy and not enjoying the boost to foreign earnings from £ weakness which many large-cap companies received.

(Capital only%, to 31.12.16)	3 months	12 months
FTSE 100	+3.5	+14.4
FTSE 250	+1.2	+3.7
FTSE Small Cap	+3.4	+11.0

FTSE All-Share	+3.1	+12.4
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[Source: Financial Times]

The All-Share Index has surpassed its previous high from March 2015



8. The turnaround in energy and resource prices from the early days of 2016 propelled the Oil & Gas and Basic Materials sectors from the two bottom places in 2015 to the top two rungs in 2016. Relative to the All-World Index, Oil & Gas went from -20% to +20%, between 2015 and 2016, while Basic Materials went from -16% to +17%. Conversely, the non-cyclical sectors were the weakest in 2016, having been very buoyant in 2015.

Capital return (in £, %) to 31.12.16		
Industry Group	3 months	12 months
Oil & Gas	+12.2	+46.8
Basic Materials	+ 9.3	+43.3
Technology	+ 4.7	+32.9
Industrials	+ 6.5	+32.1
Financials	+13.8	+26.8

FTSE All-World	+6.1	+26.2
Utilities	+ 1.0	+23.9
Telecommunications	+ 2.3	+22.0
Consumer Services	+ 4.4	+20.7
Consumer Goods	+ 0.7	+19.7
Health Care	-1.1	+10.1

[Source: FTSE All-World Review, December 2016]

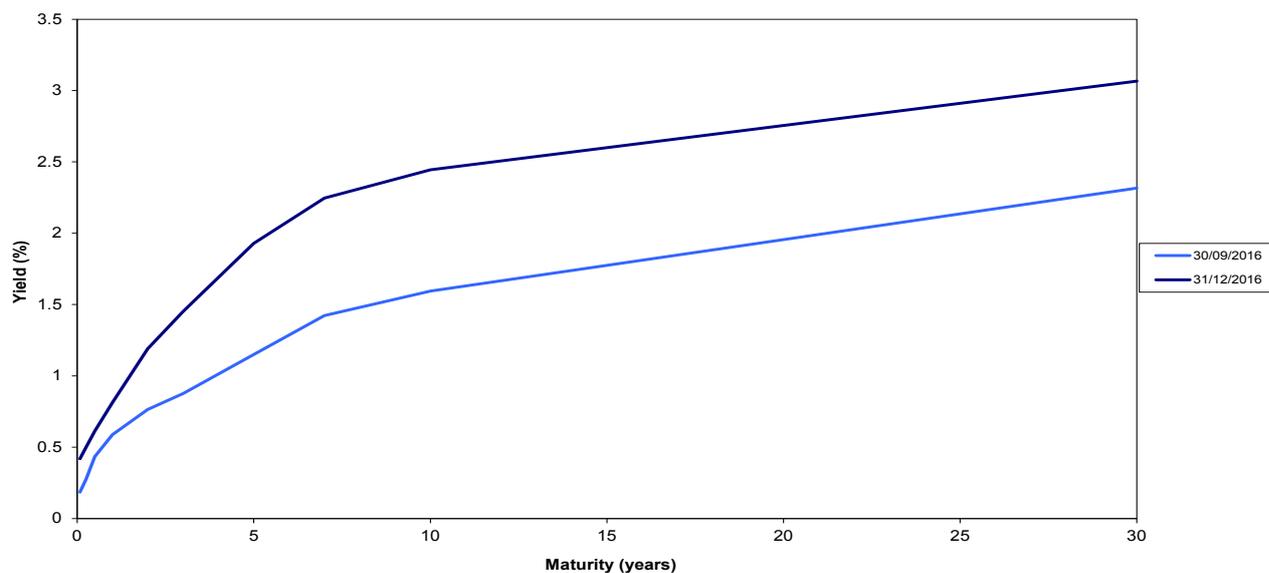
Bonds

9. **Government bond** yields rose sharply during the quarter, as markets began to price in the reflationary impact of Donald Trump's election, and the likely surge in new bond issuance. Apart from US bonds, however, the other three main bond markets all recorded sizeable falls in yield (i.e. gains in price) during the year 2016.

10-year government bond yields (%)					
	Dec 13	Dec 2014	Dec 2015	Sept 2016	Dec 2016
US	3.03	2.17	2.27	1.59	2.46
UK	3.04	1.76	1.96	0.75	1.24
Germany	1.94	0.54	0.63	-0.19	0.11
Japan	0.74	0.33	0.27	-0.08	0.04

US government medium – and long – dated bond yields have risen by almost 1% during the past quarter.

US Yield Curve



Currencies

10. The pound managed some brief rallies – at one stage reaching \$1.27 – but the US Election and the interest rate rise pushed the dollar stronger against all the major currencies.

				£ move (%)	
				3m	12m
	31.12.15	30.9.16	31.12.16		
\$ per £	1.483	1.299	1.236	- 4.8	-16.7
€ per £	1.359	1.156	1.172	+ 1.4	-13.8
¥ per £	178.8	131.5	144.1	+9.6	-19.6

The pound has continued to weaken against the dollar



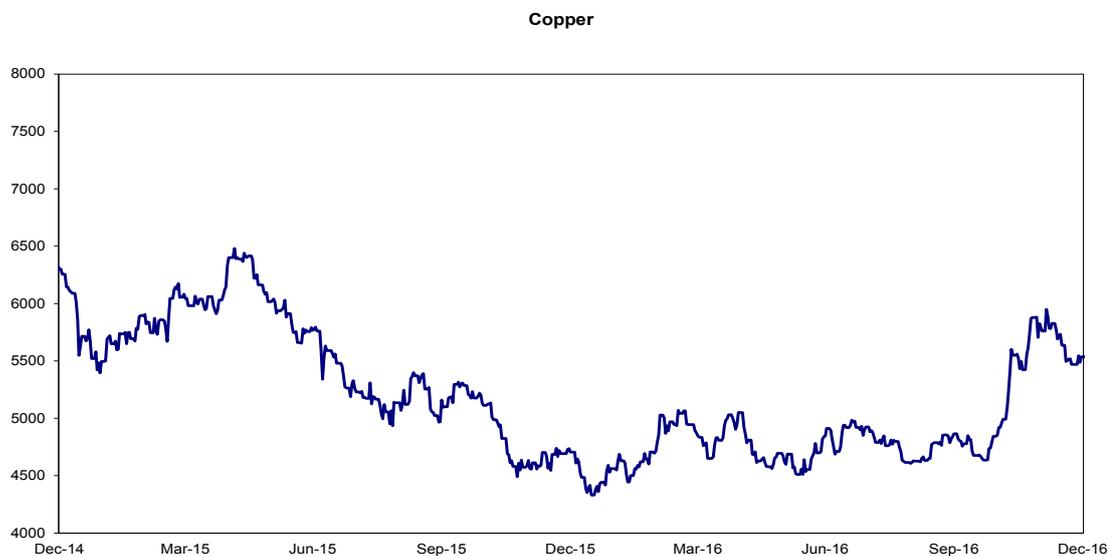
Commodities

11. The price of **Oil** (Brent Crude) rose above \$50 in early December when the OPEC producers confirmed an agreement to cut output by 1.2m barrels/day, to be followed by the news that some non-OPEC countries would cut production by 0.5m b/d. Oil ended the year just below \$57, for a gain of 50% (in dollar terms) during 2016. **Copper** spiked sharply – gaining 20% in the weeks after the US Election, on hopes for increased infrastructure spending in the US and revived demand from China. By contrast **Gold** weakened in response to higher US interest rates and the stronger dollar.

Oil has rallied strongly since early 2016



..... and copper too since the US Presidential Election



Property

12. The December figures are not yet available, but the IPD Monthly Index readings for September show that capital values of UK commercial property fell in the third quarter, amid the fallout from the Brexit vote. The levels of redemption requests from retail investors, combined with uncertainty over the future demand for office space in London, have made valuation more difficult than usual.

	3-month	12-month
All Property	- 2.3%	+ 3.2%
Retail	- 2.4%	+ 1.5%
Office	- 3.5%	+ 2.5%
Industrial	- 0.7%	+ 6.6%

[IPD Monthly Index of total returns, September 2016]

Outlook

13. The reaction of equity markets to Donald Trump's unexpected victory has been equally surprising. The hope that the new president will stimulate the US economy with tax cuts and higher spending has generated gains of up to 5% in Western equities, although Emerging Markets have reacted badly to the stronger dollar. It remains to be seen whether other aspects of Trump's manifesto – such as renouncing trade deals and penalising imports – will provoke a downturn in equities as their impact becomes apparent.
14. The sharp rise in US – and other – government bond yields is more logical, and may well have further to run as inflation begins to return and funding requirements expand to meet the larger US budget deficit.
15. Uncertain times are ahead in Europe: the UK will trigger Article 50 by the end of March, and its negotiating position on withdrawal from the EU will gradually become clearer. Already every hint that the UK will leave the single market triggers a further fall in sterling. With elections coming up in Holland, France and Germany, there is likely to be more upheaval within the European Union if anti-EU parties gain power.
16. With so many potential pitfalls looming, continuing caution on equity and bond markets seems the wisest course to adopt at present.

Peter Davies
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January 17th, 2017

[All graphs supplied by Legal & General Investment Management]