

	Pensions Fund Sub-Committee 6 November 2018
	Report from the Chief Finance Officer
Quarterly monitoring report on fund activity: Quarter to June 2018	

Wards Affected:	All
Key or Non-Key Decision:	Non-Key
Open or Part/Fully Exempt: <small>(If exempt, please highlight relevant paragraph of Part 1, Schedule 12A of 1972 Local Government Act)</small>	Open
No. of Appendices:	One
Background Papers:	<ul style="list-style-type: none"> • Legal & General – June 2018 quarterly report • Northern Trust Performance Report – June 2018 • Websites: https://www.ons.gov.uk
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1. Summary

- 1.1. This report provides a summary of the Fund's activity during the quarter ended 30 June 2018. It examines the economic and market background, and investment performance, as well as commenting on events in the quarter.

The main points arising are:

- During the quarter ending 30 June 2018, the Fund increased in value by 5.4% (£44.6m) from £831.1m to £875.8m; an improvement from the reduction in value of the fund of £23.9m in the last quarter.
- The increase in the value of funds is mainly attributable to the increase in the value of UK and Global Equities; primarily Global Equities with an increase in value of £21.4m.
- The value of cash being held has also increased by £14m since the last quarter.

1.2. Further analysis on the performance of each fund and the cash position is provided in the main body of this report.

2. Recommendations

2.1. Members are asked to note the contents of this report and Independent Financial Adviser's investment report to follow.

3. Quarter ending 30 June 2018 Performance

3.1 Table 1 summarises the change in the Council's asset allocation in the quarter ending June 2018.

Table 1: Asset allocation as at 30 June 2018 compared to the target allocation

ASSET CLASS	31/03/2018 Value (£m)	Net Investment Value (£m)	Appreciation (£m)	31/06/2018 Value (£m)	% of Fund	Allocation Target (%)	Deviation (%)
Fixed Income							
Henderson-Total Return Bond Fund	94.1		-1.7	92.4	10.6	15.0	-4.4
Equities							
UK - L&G	108.4		9.9	118.3	13.5		
UK Smaller Cos - Henderson	31.6	0.1	2.4	34.1	3.9		
Overseas Developed - L&G	274.3		21.4	295.7	33.8		
Equities - Total	414.3	0.1	33.8	448.1	51.2	45.0	6.2
Diversified Growth Fund							
LCIV Baillie Gifford	79.5		-0.9	78.6	9.0		
LCIV Ruffer	48.8		1.1	49.9	5.7		
Total London CIV	128.3	0.0	0.2	128.5	14.7	21.0	-6.3
Property							
UK - AVIVA	0.0		0.0	0.0	0.0		
Europe - AVIVA	2.1		-1.4	0.7	0.1		
Property - Total	2.1	0.0	-1.4	0.7	0.1	0.0	0.1
Private Equity							
Capital Dynamics	64.5	-4.2	5.1	65.4	7.5		
Yorkshire	0.5	-1.9	1.4	0.1	0.0		
Private Equity Total	65.1	-6.1	6.5	65.5	7.5	10.0	-2.5
Infrastructure							
Alinda	24.9	-3.2	-0.3	21.4	2.4		

Capital Dynamics	8.4	0.0	2.1	10.5	1.2		
Infrastructure Total	33.3	-3.2	1.9	31.9	3.6	8.0	-4.4
Cash Deposits							
Other/Northern Trust	93.9	14.4	0.2	108.5	12.4	1.0	11.4
Grand Total	831.1	5.2	39.5	875.8	100.0	100.0	0.0

- 3.2 The total Fund value (including contributions) increased by £44.6m in this quarter, compared to a £23.9m decrease in the previous quarter. The main contributory factor to the increase was the significant improvement in the value of Equities which saw a reduction in value of £22.8m in Q1 with a contrasting increase in value of £33.9m this quarter.
- 3.3 There is a balance of £108.5m in cash deposits which is currently being invested in Money Market Funds and short term loans to other Local Authorities to generate as much interest as possible. Cash is being held for capital commitments in relation to Alinda and Capital Dynamics. Nonetheless, the level of cash balances continue to increase as Capital Dynamics, Alinda II and Avivia distribute investment returns back to the fund. It is expected that as part of the implementation of the new investment strategy, a significant proportion of cash balances will be utilised by the first quarter of 2019. Further explanation on cash balances can be found in section 3.14 below.
- 3.4 The independent custodian, Northern Trust, measures the returns on the Brent Pension Fund as illustrated in the two tables below.
- 3.5 Table 2 sets out returns for the periods to 30 June 2018 compared to the previous quarter.

Table 2: Q2 Investment returns in individual markets compared to benchmark

Investment Category	RETURNS						Benchmark/ Index Description
	Qtr Ending 31/03/18			Qtr Ending 30/06/18			
	Fund %	Benchmark %	Relative Return %	Fund %	Benchmark %	Relative Return %	
Fixed Income Henderson Total Return Bond Fund	0.1	1.0	-0.9	-1.8	1.0	-2.8	Absolute Return 4% pa
Equities UK - Legal & General	-6.9	-6.9	0.0	9.2	9.2	0.0	FTSE All Share
UK - Small Companies Henderson	-6.2	-6.5	0.3	7.7	7.1	0.7	FTSE Small Cap
O'seas Developed - Legal & General	-4.5	-4.5	0.0	7.8	7.8	0.0	FTSE Dev World ex UK
European Property Aviva Investors	-21.7	1.9	-23.6	-64.6	2.0	-66.6	IPD All Properties Index
Private Equity Capital Dynamics	0.54	1.9	-1.4	8.23	1.9	6.3	Absolute Return 8% pa
Yorkshire Fund Managers	0	1.94	-1.9	0	0	0.0	Absolute Return 8% pa
Infrastructure Alinda Capital Partners	-12.4	1.9	-14.3	-0.8	1.9	-2.7	Absolute Return 8% pa
Capital Dynamics	-2.65	1.94	-4.6	25.04	1.9	23.1	

Pooled Multi Asset							
Baillie Gifford	0.5	1.0	0.5	-1.3	1.0	-2.3	Base Rate + 3.5% pa
Ruffer	-2.6	1.0	-3.6	2.3	1.0	1.3	
Cash	0.1	0	0	0.2	0.12	0.05	Base Rate
Average Total	-3.7	-1.9	-1.8	5.3	4.0	1.2	

3.6 Table 3 shows returns over 3 months, 1 year and 3 years for listed investments compared with their benchmarks. Unlisted investments such as Infrastructure and Private Equity are not included as it is difficult to compare alternative investments in this manner.

Table 3: Long Term Returns from Listed Investments

Periods to 30.06.18		3 mnths - Jun18 (%)	1 year (%)	3 years (% p.a.)
Fixed Income	JH Total Return Bond	-1.84	-0.31	2.35
(4% p.a.)	Benchmark	0.99	4.00	4.00
	Relative Return	-2.83	-4.31	-1.65
Equities-UK	LGIM UK	9.21	9.09	9.77
(FTSE All-Share)	Benchmark	9.20	9.02	9.59
	Relative Return	0.01	0.07	0.18
	JH UK Small-Cos	7.73	7.28	6.89
(FTSE Small Cap)	Benchmark	7.05	6.36	9.58
	Relative Return	0.68	0.92	-2.69
Equities-Overseas	LGIM Global ex-UK	7.81	9.93	16.27
(FTSE Dev World ex-UK)	Benchmark	7.84	9.92	16.29
	Relative Return	-0.03	0.01	-0.02
Multi-Asset	Baillie Gifford	-1.3	1.79	4.45
(Base + 3.5%p.a.)	Benchmark	0.99	3.92	3.90
	Relative Return	-2.29	-2.13	0.55
	Ruffer	2.30	1.61	0.00
(Base + 3.5%p.a.)	Benchmark	0.99	3.92	0.00
	Relative Return	1.31	-2.31	0.00

3.7 Fixed Income

The Henderson Bond Fund depreciated by £1.7m in Q2. The main reason for the poor performance has been attributed to exposure to emerging market credit.

Emerging market bonds suffered in an environment of a rising US Dollar, concerns about higher US interest rates and increased global trade tensions between US and China.

The table below shows the value of this asset as at the end of the last 5 quarters.

Table 4: Fixed income performance since Q2 2017

ASSET CLASS	31/06/2017 Value (£m)	30/09/2017 Value (£m)	31/12/2017 Value (£m)	31/03/2018 Value (£m)	31/06/2018 Value (£m)
Fixed Income					
Henderson-Total Return Bond Fund	92.7	93.3	94.1	94.1	92.4

This fund has been experiencing a generally weak performance due to high volatility in the developed market government bond yields which saw a rise in January and a fall in the second quarter of the year as volatility returned to markets.

There remain concerns of low yields and a return of market volatility over the next quarterly cycles. The fund's strategy is to approach the credit markets more cautiously as credit market valuations remain elevated compared to past quarters.

3.8 Equities

Performance has since turned around for the UK and Overseas Legal & General funds with an increase in asset value of £31.3m in Q2 compared to the last quarter which saw a decrease in value of £20.8m and represented the worst performance since March 2016.

These are passive funds which track the overall market, so that the increase in value reflects the positive performance in the equity market indices during the quarter.

Henderson Small Cap also saw an appreciation of £2.4m during the quarter.

Over the three year benchmark which is a normal minimum period over which to consider performance for a long-term investor, equities have performed broadly in line with the benchmark. The exception is the Henderson Small Cap fund, which despite good returns over the last year has performed poorly over the three year benchmark.

Members are advised to note a planned change in management structure by the fund manager, effective from 1 November 2018. The plan is to bring the management of the Janus Henderson UK and Irish Smaller Companies fund in house. This may lead to significant transition costs as assets are liquidated and new ones acquired. Although officers have been advised that this process will be

treated sensitively and the cost of the restructure will be minimised, a proposal to sell the Janus Henderson Small caps UK equities is outlined in the Investment Strategy report to be presented to the Committee along with this report.

3.9 **Property**

The Fund's only remaining Property investment is its holding in AVIVA Europe Real Estate Fund of Funds, which is being liquidated by the managers, with the proceeds being returned to investors. The current asset value is £0.7m and the liquidation process is expected to be completed by the end of 2018.

Accurate measurement of the performance of this fund is complicated by the 3-month delay in updating the official price of its units, which produces an apparent depreciation in value in a quarter when there has been a distribution of capital to investors. As this investment represents less than 1% of the overall Fund at June 2018, the consequent distortion to overall Fund performance is negligible.

3.10 **Private Equity**

Performance of Capital Dynamics investments are not analysed in this manner because they are private equity, as measuring performance against public market indices can be misleading.

It is worth noting that the Fund's holdings in these investments are very mature and approaching the end of the investment period; therefore, more cash is being distributed to investors as assets are sold. This explains the £4.2m distribution in the quarter.

This fund expects further appreciation, as seen with the appreciation of £5.1m this quarter, as underlying portfolio companies exit the fund and managers take advantage of a benign exit environment.

3.11 **Infrastructure**

There are two investments managed by Alinda, namely Alinda II and Alinda III.

There was a distribution of £3.2m in the quarter, mainly from the Alinda II fund which is entering a mature stage in its life and distributing large amounts of cash. This has contributed to the increased amount of cash being held by the Fund.

As a result of the cash distribution, this the asset value has reduced from £24.9m to £21.4m with a slight appreciation of £0.3m from the Alinda III fund.

This quarter has seen an appreciation of £2.1m from investments in Capital Dynamics; compared to the drop in value in the last two quarters.

Members are advised to note that it is normal to expect good and bad investments in this portfolio as it is an unlisted fund. In addition to this Infrastructure investments are by their nature volatile in the short term and it is expected that over the long term the investment will perform better against the benchmark.

3.12 Diversified Growth Fund

Whilst the Baillie Gifford fund realised growth over the past year; primarily due to continued positive performance in investment markets, the fund saw a drop in value of £0.9m in Q2 this quarter.

During the three months to the end of June 2018, the fund delivered a negative return of -1.3%. The fund's performance and volatility are measured over a 5 year period and in the last five years, the fund returned 4.7% per annum (net of fees) and 4.45% in the last three years as can be seen in Table 3 above.

The manager has taken on a strategy to de-risk the fund by reducing equity and credit allocations and increasing hedging positions.

Ruffer joined the Fund in March 2017 and depreciated in value in every quarter except the last quarter of 2017. The fund saw an increase of £1.1m in Q2 and a relative return of 1.31% above benchmark. The main reason for the poor performance of this fund has been linked to higher investments in equities which did not perform as predicted and poor bond yields. As the strategy for this fund remains unchanged, officers remain cautious of the volatility in recent quarters and will continue to liaise with the London CIV to challenge the performance of this particular fund.

- 3.13 LGPS investment regulations state that the Administering Authority shall have regard both to the diversification and the suitability of investments. The Fund has agreed a number of its own restrictions as part of the Investment Strategy Statement and are set out in the table below.

Table 5: Compliance with Investment limits

Type of investment	Maximum investment by the Fund % of assets	Actual exposure at 31 Mar 2018	Compliant Yes / No
Contributions invested in any single partnership	5%	2%	Yes
Contributions invested in partnerships	30%	11%	Yes
Cash deposits	10%	12%	No
Investment with any single manager strategy either directly or via the London CIV (excluding investments in passive index tracking strategies)	15%	11%	Yes
Total investment in illiquid assets	30%	11%	Yes

3.14 Cash deposits have breached the restriction limit. £108.5m of cash is principally being held for the following reasons:

3.14.1 Approximately £31m of this cash is required to fund transfer values in relation to the College of North West London, as it has been agreed by their governing body to merge with the City of Westminster College and transfer their element of the Pension Fund to the London Pension Fund Authority (LPFA). This transfer was originally planned for January 2018 however this has been delayed by the LPFA and is expected to be paid by the end of 2018.

3.14.2 Cash is also being held to honour calls on capital commitments in Private Equity and Infrastructure (See table 5 in section 3.15) and to re-allocate to other future investments following decisions made at the November Sub-Committee meeting on the Investment Strategy.

3.15 The table below illustrates the Fund’s outstanding contractual commitments in Private Equity and Infrastructure investments. These outstanding investment commitments mean that the Fund needs to retain a sizeable cash balance to meet capital call payments as they arise.

Table 6: Outstanding contractual commitments on existing investments

Asset	31 Mar 2018	30 Jun 2018
	£m	£m
Capital Dynamics	13.0	13.8
Alinda	16.5	17.4
Total	29.5	31.2

3.16 Given the sizable amount of cash being held and the need to reduce this to a level which generates more returns to the fund than the current 0.3% interest being generated through investments in Money Market Funds, proposals to utilise some of this cash are set out in the Investment Strategy report which will be presented to the Committee along with this report.

4.0 Financial Implications

4.1 These are no direct financial implications of this report.

5.0 Diversity Implications

5.1 None

6.0 Staffing Implications

6.1 None

7.0 Legal Implications

7.1 None

Report sign off:

CONRAD HALL
Chief Finance Officer

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