


Report to:	Pensions Committee	Date:	12 December 2016
Report title:	Quarterly Investment Performance Report to 30 September 2016		
Report from:	Gerald Almeroth, Strategic Director – Resources		
Ward/Areas affected:	Borough Wide		
Chair of Committee/Lead Member:	Councillor Sunita Gordon		
Author(s)/Contact Number(s):	Lyndsey Gamble, Head of Financial Strategy and Planning, 0208 770 5358 Lisa Doswell, Treasury and Investments Manager, 0208 770 5354		
Corporate Plan Priorities:	<ul style="list-style-type: none"> • A Smart Council 		
Open/Exempt:	Part-Exempt: Appendix B is exempt on the basis of Paragraph 3, Schedule 12A of Local Government Act 1972		
Signed:		Date:	01 December 2016

1. Summary

- 1.1. This report shows the performance of the Pension Fund Investment Managers for the quarter ending 30 September 2016, performance in the last twelve months, annualised rolling three year performance against target benchmark and performance since inception.

2. Recommendation

The Pension Committee is recommended to:

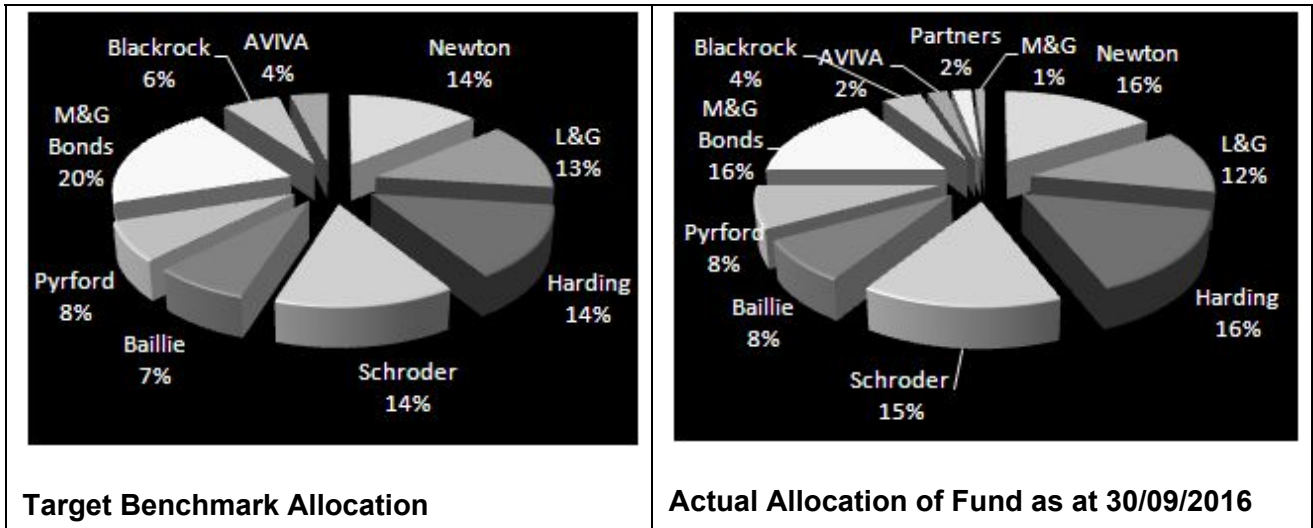
- 2.1. Note the performance of the Pension Fund Investment Managers.

3. Background

- 3.1 Legal & General (L&G), Newton Investment Management (Newton), Harding Loevner, Schroder, Baillie Gifford, Pyrford, M&G, BlackRock and Partner's Group were employed as the Council's investment managers for the year ending 30 September 2016. The Council was also invested in two separate funds; M&G UK Companies Financing Fund and Aviva Investors UK Real Estate Fund of Funds Plan. In December 2015 the Fund agreed a new residential property mandate with Invesco. There has been no investments made into this fund as yet. The first drawdown is expected by the end of quarter three.
- 3.2 Under the Council's current investment strategy a target benchmark allocation of 42% of the total fund value is to be invested in global equities managed in separate, equal sized portfolios by Newton, Harding Loevner and Schroder's. 13% of the fund is to be invested in UK equities by L&G and 15% of the fund is to be split equally in absolute return pooled vehicles managed by



Baillie Gifford and Pyrford. 20% of the fund is currently targeted in bonds by M&G, however there is a long term strategic target to bonds of 15% and 5% to infrastructure, but this will take some time to implement. 10% of the fund is targeted in Property, split between 6% with BlackRock and 4% with AVIVA. This is shown in the chart on the left, against the current actual allocation of the fund on the right.



- 3.3 Actual allocations against the target are monitored on a regular basis. Potential courses of action are discussed with Hymans Robertson if material variations occur.
- 3.4 Performance targets for all fund managers are set by the Council to obtain good investment performance returns, whilst also balancing risk. The targets set are in line with the overall investment strategy agreed by the Members in March 2011.

4. Performance of the Managers

- 4.1 The tables set out within the report show the manager’s performance for the quarter, over the last twelve months and since inception (where possible) and a comparison against the relevant indices in the Council’s strategic asset allocation benchmark. All figures are shown net of fees. Appendix C (exempt information) shows the basis on which fees are calculated by each fund manager and the fees which have been incurred for the current and previous quarter.
- 4.2 The investment performance monitoring service transitioned from WM to Northern Trust (The Fund’s custodian) and this is the seventh quarter in which Northern Trust’s performance data has been used to produce this report.

Movement in Fund Value from 31 March 2016 to 30 September 2016

- 4.3 The table below shows the value of holdings with each of the fund managers as at the end of the latest quarter and the end of the previous quarter.

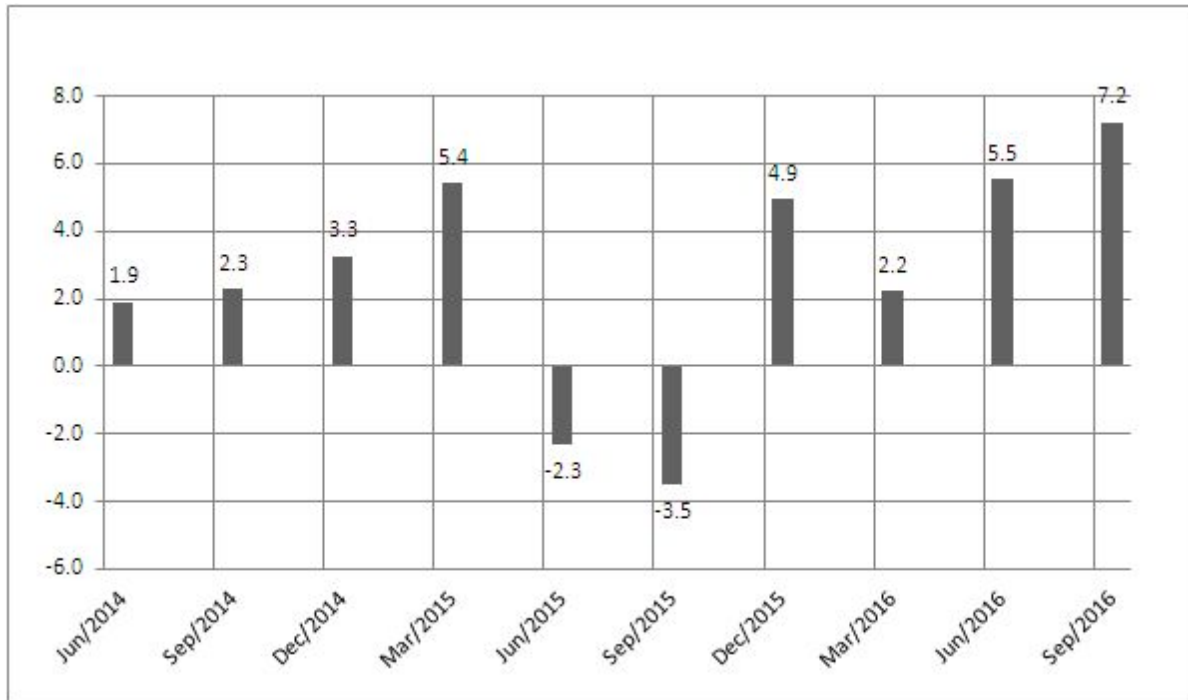
Fund Manager	Value at end 30/06/16 £'000	Value at end 30/09/16 £'000	Value change £'000	% Change
Total Equities	304,986	332,740	27,754	9.1
Legal & General	61,072	65,840	4,768	7.8
Newton	84,192	91,384	7,192	8.5
Harding Loevner	82,310	89,838	7,528	9.1
Schroder	77,412	85,678	8,266	10.6
Bonds	86,361	92,408	6,047	7.0
M&G bonds	86,361	92,408	6,047	7.0
Pooled Multi Asset	80,883	84,254	3,371	4.2
Baillie Gifford	40,458	42,355	1,897	4.7
Pyrford	40,425	41,899	1,474	3.6
Property	34,772	33,891	-881	-2.5
BlackRock	22,530	21,832	-698	-3.1
AVIVA	12,242	12,059	-183	-1.5
Alternatives	14,580	16,511	1,931	13.2
Partner's Group *	10,722	12,779	2,057	19.2
M&G – Co's Financing Fund	3,858	3,732	-126	-3.3
Cash	12,716	11,346	-1,370	-10.8
Total Assets	534,298	571,150	36,852	6.9

* 20th capital call was made to Partners Group in July for EUR 2.5m, approximately £2.1m.



4.4 The chart below shows the percentage change in the total value of the fund each quarter.

Fund Value Movement %



The above table excludes cash.

5. Total Fund Performance

Total fund performance pre and post strategy implementation

Benchmark 45 months to 31/10/12	Fund 45 months to 31/10/12	Variance	Benchmark 45 months to 30/09/16	Fund 45 months to 30/09/16	Variance
%	%	%	%	%	%
12.8	11.0	-1.8	10.2	10.8	0.6

5.1 Prior to the new strategy implementation the combined fund underperformed the benchmark by 1.8% over the previous 45 months (benchmark 12.8%, actual 11.0%). Looking at performance 45 months after the new strategy was implemented the combined fund outperformed the benchmark by 0.6% (benchmark 10.2%, actual 10.8%).

Total fund performance for the latest quarter ended 30 September 2016

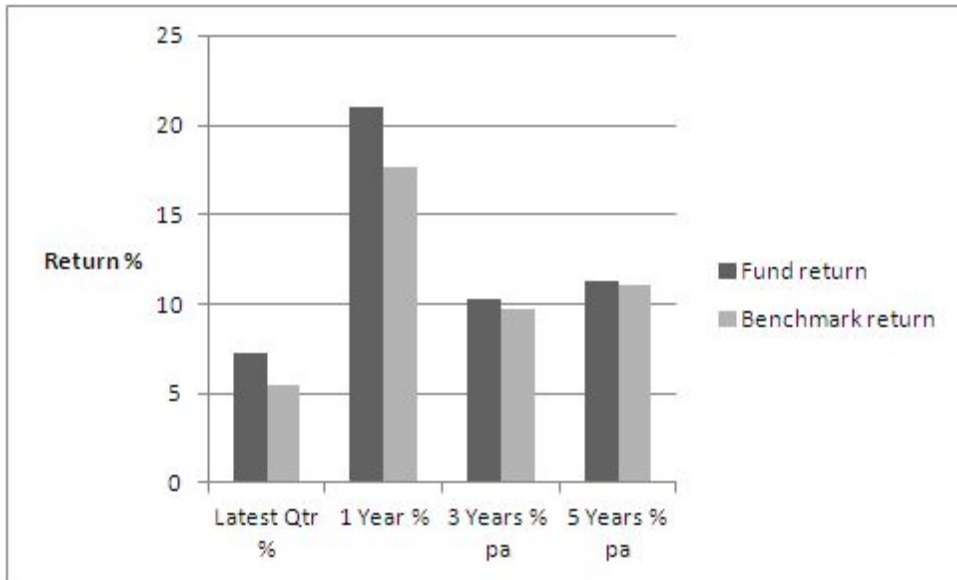
TOTAL FUND	Target Allocation	Fund Allocation	Benchmark Return	Fund Return	Variance
	%	%	%	%	%
Equities	55	59	8.2	9.0	0.8
Bonds	20	16	4.4	7.0	2.6
Pooled Multi Asset	15	16	0.9	4.2	3.3
Property	10	6	-0.7	-1.6	-2.3
Alternatives	0	3	n/a	n/a	n/a
TOTAL ASSETS	100.0	100.0	5.5	7.2	1.7

- 5.2 At total fund level the combined fund performance outperformed the benchmark over the period achieving a return of 7.2% compared to the benchmark return of 5.5%. Performance of individual asset classes is detailed in paragraph 4.9 onwards.

Total fund performance – longer term

TOTAL FUND	1 Year	3 Years	5 Years
	% pa	% pa	% pa
Fund return	21.0	10.3	11.3
Benchmark return	17.7	9.7	11.0
Variance %	3.3	0.6	0.3

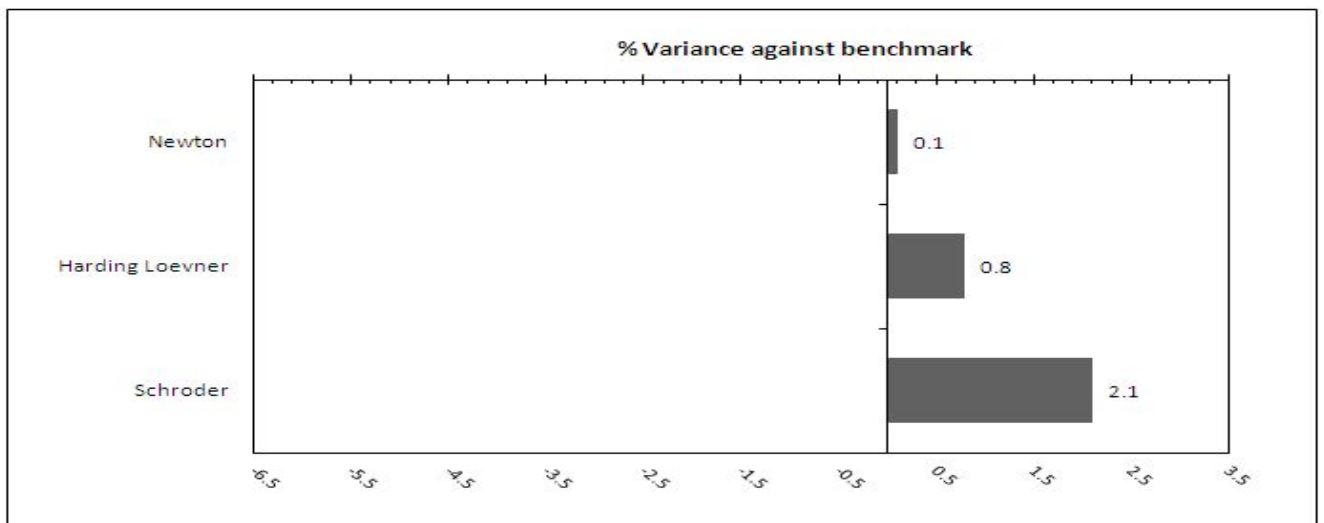
- 5.3 At total fund level, as at September 2016 the combined fund outperformed the benchmark by 3.3% over the past year, by 0.6% per annum over the past three years and 0.3% over the past five years.
- 5.4 The bar chart below summarises the overall performance of the fund over the latest one year, three year and five year positions:



6. Equity Performance

Equity performance for the latest quarter ended 30 September 2016

Manager	Target Allocation	Fund Allocation	Benchmark Return	Fund Return	Variance
	%	%	%	%	%
L&G	13	12	7.8	7.8	0.0
Newton	14	16	8.4	8.5	0.1
Harding Loevner	14	16	8.4	9.2	0.8
Schroders	14	15	8.4	10.5	2.1
TOTAL EQUITIES	55	59	8.2	9.0	0.8



- 6.1 Global equities delivered strong positive returns during the quarter and volatility continued to ease following the initial uncertainty in the aftermath of the UK referendum on membership of the EU. Markets were also boosted by growing confidence that central banks would continue supporting economic activity, while ongoing weakness in sterling boosted returns for UK based investors. However equities did suffer a brief setback in early September amid concerns that the Federal Reserve could push US interest rates higher, but they remained on hold. Global mining and technology firms led the gains with investors favouring commodity and growth-orientated companies. Emerging markets were the standout performers among global equity markets.
- 6.2 As shown in the table below, all managers outperformed the benchmark, but Schroders performed particularly well. Newton benefitted from being overweight in technology and underweight in energy and telecommunications, however their performance was dampened by being overweight in the healthcare sector. Harding Loevner benefitted from good stocks in internet focused businesses in the US and the UK. Schroders' value approach and rebalancing methodology is effective at taking advantage of market volatility and they benefitted from this during the quarter. Their holdings in financials provided their largest contribution to outperformance, as well as their long held positions in Hong Kong real estate companies.

Equity performance – longer term

Manager	Benchmark Return 1 Year	Fund Return 1 Year	Variance	Benchmark Return Since Inception	Fund Return Since Inception	Variance
	%	%	%	%	%	%
L&G	16.8	16.8	0.0	7.5	7.5	0.0
Newton	30.6	28.9	-1.7	14.5	16.2	1.7
Harding Loevner	30.6	34.8	4.2	14.5	15.7	1.2
Schroders	30.6	30.7	0.1	14.5	13.9	-0.6

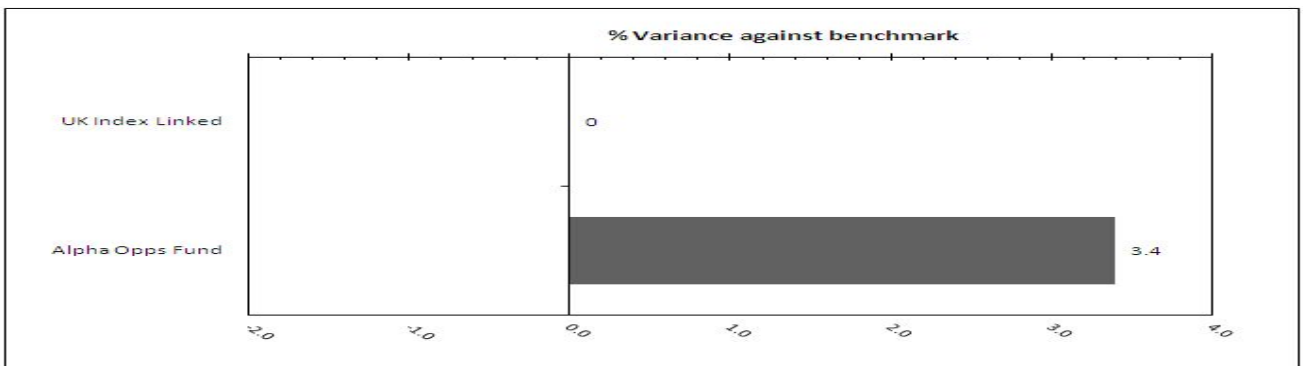
- 6.3 As shown in the table above, over the longer term L&G matched the benchmark during the twelve months ended September 2016, Newton underperformed the benchmark, Harding Loevner showed outperformance and Schroders underperformed. Since inception, L&G matched the benchmark, Newton and Harding Loevner outperformed the benchmark and Schroders underperformed.



7. Bond Performance

Bond performance for the latest quarter ended 30 September 2016 (M&G)

	Target Allocation	Fund Allocation	Benchmark Return	Fund Return	Variance
	%	%	%	%	%
UK Index Linked	8	8	10.9	10.9	0.0
Alpha Opportunities Fund	12	8	0.1	3.5	3.4
TOTAL (Weighted Average)	20	16	4.4	7.0	2.6



- 7.1 During the quarter the Bank of England’s announcement for £10 billion of corporate bond purchases took the market by surprise, resulting in sterling corporate bond markets outperforming both European and US investment grade markets. Bond prices rallied during the quarter and the demand for UK bonds remained robust. This was boosted by the continued positive economic data and the more stable political backdrop.
- 7.2 Bond prices significantly rallied during the quarter, that coupled with M&G’s value approach, which actively reduces credit risk across the fund, provided their strong performance. In reducing risk they sold out of positions in a number of industrial companies after a rally in their prices. They also took this approach to exposure in the financial sector. Using proceeds from the risk reduction they invested in new issues, which included a number of securitised bonds which offered good value. The Index-Linked fund benefitted from positions in gilts maturing in 10 and 50 years. M&G sold gilts maturing in 30 years and switched into 30 year conventional gilts. This position dampened performance as inflation increased.

Bond performance – longer term

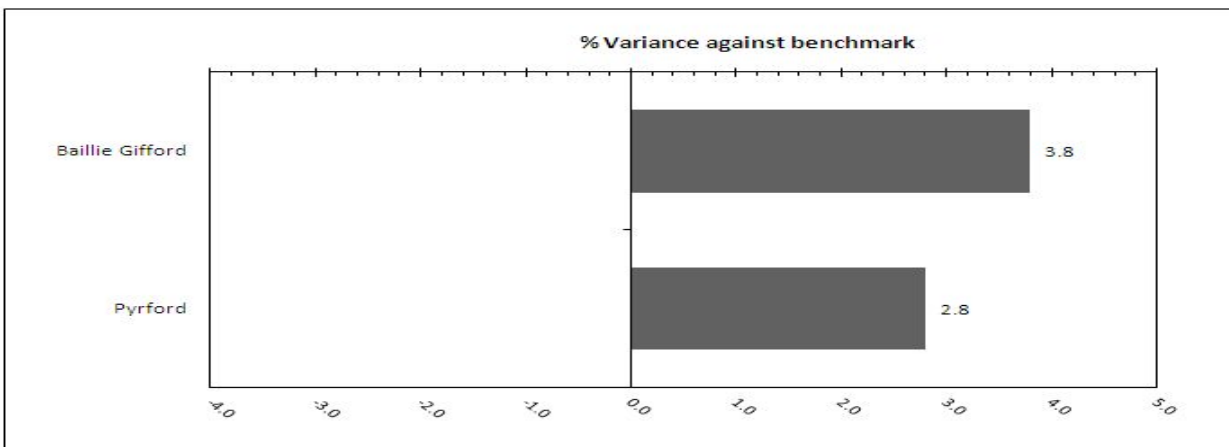
Manager	Benchmark Return 1 Year	Fund Return 1 Year	Variance	Benchmark Return Since Inception	Fund Return Since Inception	Variance
	%	%	%	%	%	%
UK Index Linked	26.9	27.2	0.3	18.7	18.9	0.2
Alpha Opportunities Fund	0.5	5.7	5.2	1.3	2.3	1.0

7.3 As shown in the table above, over the longer term both funds outperformed the benchmark during the twelve months ended September 2016. Both funds also outperformed since inception.

8. Pooled Multi-Asset Performance

Pooled Multi-Asset Performance for the latest quarter ended 30 September 2016

Manager	Target Allocation	Fund Allocation	Benchmark Return	Fund Return	Variance
	%	%	%	%	%
Baillie Gifford	7.5	7.6	0.9	4.7	3.8
Pyrford	7.5	7.5	0.9	3.7	2.8
TOTAL POOLED MULTI-ASSET	15.0	15.1	0.9	4.2	3.3





- 8.1 Baillie Gifford assets were transferred from five underlying boroughs into the London Collective Investment Vehicle (CIV) on 15 February 2016. This was the first such transfer for the London Borough of Sutton towards the pooling of investment assets. Following this, on the 17 June 2016 Pymford became Sutton’s second fund manager to transfer into the CIV.
- 8.2 Over the quarter both Baillie Gifford and Pymford outperformed the benchmark. The biggest contributor to performance for Baillie Gifford came from a strong equities return, in line with recovery in broader equity markets, reversing the negative performance from the previous quarter. High yield credit and structured finance exposures during the quarter also added positively, with only their active currency position detracting marginally from performance. Pymford’s outperformance has also been attributed to equities, particularly overseas holdings, which continued to be boosted by sterling’s weakness. Their holdings in overseas bonds also contributed positively in the quarter.

Pooled Multi-Asset Performance – longer term

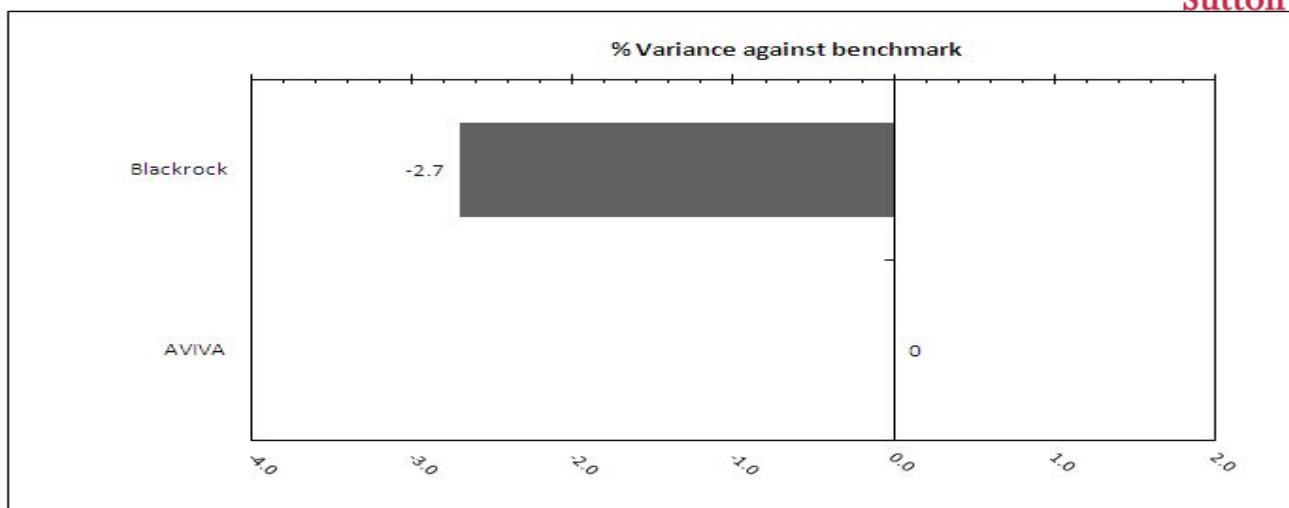
Manager	Benchmark Return 1 Year	Fund Return 1 Year	Variance	Benchmark Return Since Inception	Fund Return Since Inception	Variance
	%	%	%	%	%	%
Baillie Gifford	3.7	7.3	3.6	3.6	5.1	1.5
Pymford	3.7	11.7	8.0	3.6	4.7	1.1

- 8.3 Both managers outperformed the benchmark during the twelve months ended September 2016 and both outperformed since inception.

9. Property Performance

Property Performance for the latest quarter ended 30 September 2016

Manager	Target Allocation	Fund Allocation	Benchmark Return	Fund Return Income	Fund Return Capital	Total Fund Return	Variance
	%	%	%	%	%	%	%
BlackRock	6	4	-0.7	1.1	-3.1	-2.0	-2.7
AVIVA	4	2	-0.7	0.8	-1.5	-0.7	0.0



- 9.1 Capital values fell in the immediate aftermath of the EU referendum vote and a number of open ended property funds suspended redemptions. However, as the quarter progressed the impact on the market moderated and many of the funds resumed trading normally. The industrial sector was the outstanding performer over the quarter, but all three sectors recorded negative returns. City of London offices have been hardest hit.
- 9.2 BlackRock has indicated that the benchmark for the quarter may have been artificially inflated as a result of valuation adjustments made by some fund managers in the previous quarter, which at that time artificially reduced the benchmark. Subsequently, when these adjustments were unwound in the latest quarter the effect on the benchmark was reversed. BlackRock had an active quarter, they completed four sales and one purchase and they made a strategic move to reduce their exposure to Central London offices. AVIVA benefitted from its defensive strategy with reduced exposure to Central London offices, secondary assets and funds with leverage. Their top performing funds in the quarter were UNITE UK Student Accommodation Fund, The Leisure Fund and Savills IM UK Income and Growth Fund.

Property Performance – longer term

Manager	Benchmark Return 1 Year	Fund Return 1 Year	Variance	Benchmark Return Since Inception	Fund Return Since Inception	Variance
	%	%	%	%	%	%
RREEF/Blackrock	3.3	3.1	-0.2	3.9	0.6	-3.3
AVIVA	3.3	3.6	0.3	7.9	7.8	-0.1

- 9.3 As shown in the table above, Blackrock underperformed and AVIVA outperformed the benchmark during the twelve months ending September 2016. Both managers underperformed the benchmark since inception.



10. Alternatives Performance

Alternatives Performance for the latest quarter ended 30 September 2016

Manager	Benchmark Allocation	Fund Allocation	Fund Return
	%	%	%
Partner’s Group – Infrastructure	0	2	8.4
M&G – UK companies financing fund	0	1	3.3

10.1 Partner’s Group and M&G are not measured as part of the fund’s overall strategic benchmark. Due to the way investment is made with Partner’s Group, it is not meaningful to make comparisons with their performance target at this stage.

Alternatives Performance – longer term

Manager	Fund Return 1 Year	Fund Return Since Inception
	%	%
Partner’s Group	28.6	4.5
M&G	3.8	9.1

11. Annualised Rolling 3 Years to 30 September 2016

11.1 The annual performance targets for equities, bonds and pooled multi-asset fund managers are set over a rolling three year period. Since M&G (Bonds) were appointed in May 2014 this assessment will start for the quarter ended 30/06/17.

Manager	3 Yr Benchmark Return	Target 3 Yr Return	3 yr Fund Return	Variance against Benchmark	Variance against Target
	%	%	%	%	%
Newton	13.2	15.2	13.9	0.7	-1.3
Harding Loevner	13.2	16.2	15.8	2.6	-0.4
Schroder	13.2	16.2	11.4	-1.8	-4.8
Baillie Gifford	3.6	6.6	4.9	1.3	-1.7



Pyrford	3.6	6.6	5.0	1.4	-1.6
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11.2 The above table shows that over the three year rolling period all managers except for Schroders have outperformed the benchmark, however all managers have underperformed the target over the same period. The underperformance from Schroders is likely to be due to their value based approach which does not perform well in current market conditions.

12. Options Considered

12.1 Not applicable

13. Impacts and Implications

Financial

13.1 The financial implications are addressed within the report.

Legal

13.2 There are no legal issues arising from this report.

14. Appendices and Background Documents

Appendix letter	Title
A	Current Investment Strategy Benchmarks and Targets
B	Manager Fees - exempt on the basis of Paragraph 3, Schedule 12A of Local Government Act 1972

Background documents
Northern Trust Investment Performance Reports

Audit Trail		
Version	Final	Date: 2 December 2016
Consultation with other officers		
Finance	Yes	Lyndsey Gamble
Legal	No	N/A



Equality Impact Assessment required?	No	N/A
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