

Report to:	Pensions Committee	Date:	20 March 2017
Report title:	Quarterly Investment Performance Report to 31 December 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:	10 March 2017

1. Summary

- 1.1. This report shows the performance of the Pension Fund Investment Managers for the quarter ending 31 December 2016, performance in the last twelve months, annualised rolling three year performance against target benchmark and performance since inception.

2. Recommendation

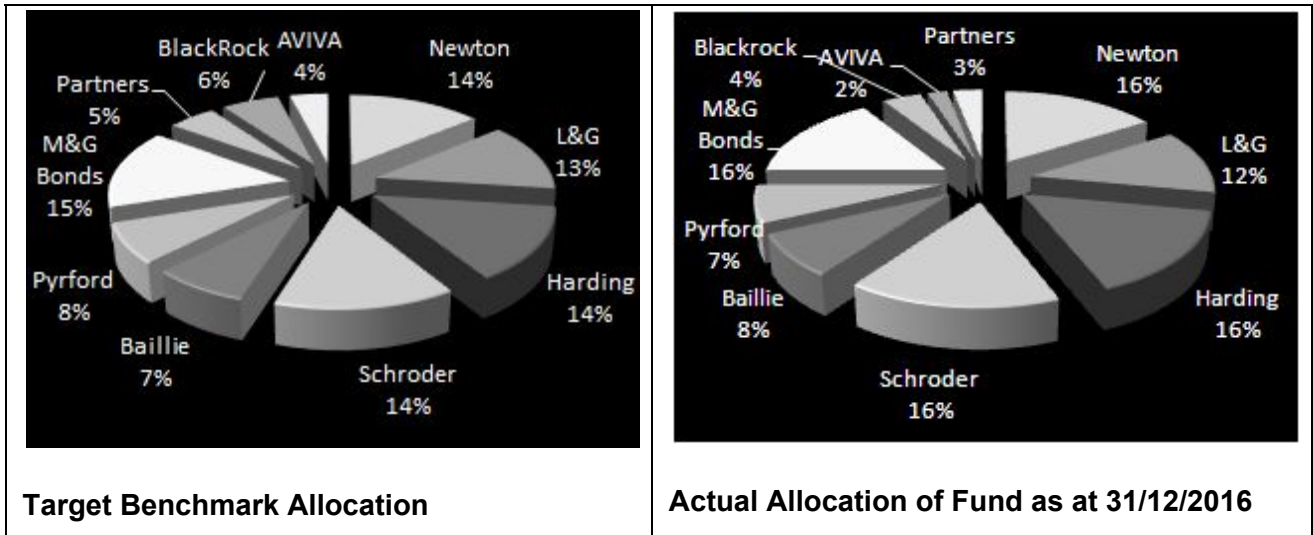
The Pension Committee is recommended to:

- 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 31 December 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 2016 the first drawdown was made into a new residential property mandate with Invesco.
- 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. The actual allocation to global equities is currently 6% above benchmark. Officers are currently discussing rebalancing options for equities with Hymans Robertson as part of the next planned drawdown of funds into the new Invesco residential mandate.
- 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 is provided by Northern Trust (The Fund’s custodian) and their performance data is used to produce this report together with reporting from each Fund manager.

Movement in Fund Value from 30 September 2016 to 31 December 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 30/09/16 £'000	Value at end 31/12/16 £'000	Value change £'000	% Change
Total Equities	332,740	350,026	17,286	5.2
Legal & General	65,840	68,409	2,569	3.9
Newton	91,384	94,671	3,287	3.6
Harding Loevner	89,838	92,953	3,115	3.5
Schroder	85,678	93,993	8,315	9.7
Bonds	92,408	91,916	-492	-0.5
M&G bonds	92,408	91,916	-492	-0.5
Pooled Multi Asset	84,254	85,342	1,088	1.3
Baillie Gifford	42,355	43,207	852	2.0
Pyrford	41,899	42,135	236	0.6
Property	33,557	36,085	2,528	7.5
BlackRock	21,498	21,714	216	1.0
AVIVA	12,059	12,100	41	0.3
Invesco	0	2,271	2,271	0.0
Alternatives	16,511	16,721	210	1.3
Partner's Group *	12,779	14,395	1,616	12.6
M&G – Co's Financing Fund **	3,732	2,326	-1,406	-37.7
Cash	11,346	10,552	-794	-7.0
Total Assets	570,816	590,605	19,789	3.5

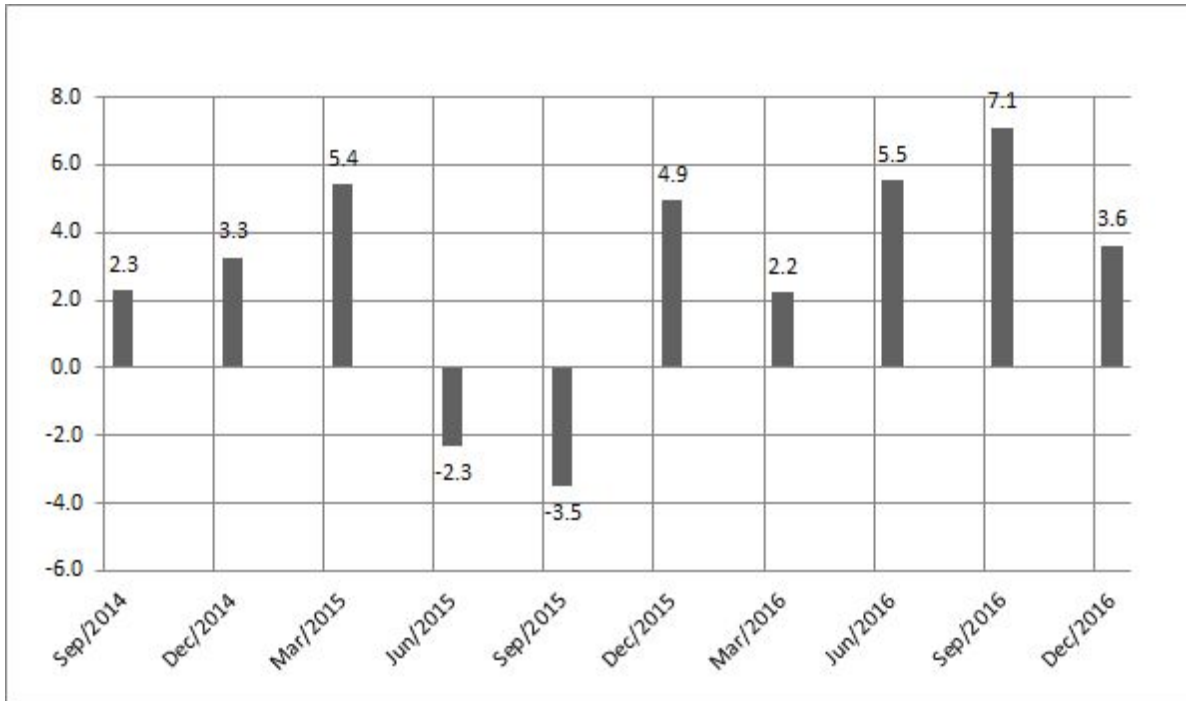
* two capital calls totalling £1.6m were made by Partners Group during the quarter and a distribution of £0.3m also took place

** M&G distributed £1.5m from the fund during the quarter



*** cash was used to fund the first drawdown payment of £2.3m to Invesco
 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 48 months to 31/10/12	Fund 48 months to 31/10/12	Variance	Benchmark 48 months to 31/12/16	Fund 48 months to 31/12/16	Variance
%	%	%	%	%	%
11.6	10.3	-1.3	10.4	11.0	0.6

5.1 Prior to the new strategy implementation the combined fund underperformed the benchmark by 1.3% over the previous 48 months (benchmark 11.6%, actual 10.3%). Looking at performance 48 months after the new strategy was implemented the combined fund outperformed the benchmark by 0.6% (benchmark 10.4%, actual 11.0%).

Total fund performance for the latest quarter ended 31 December 2016

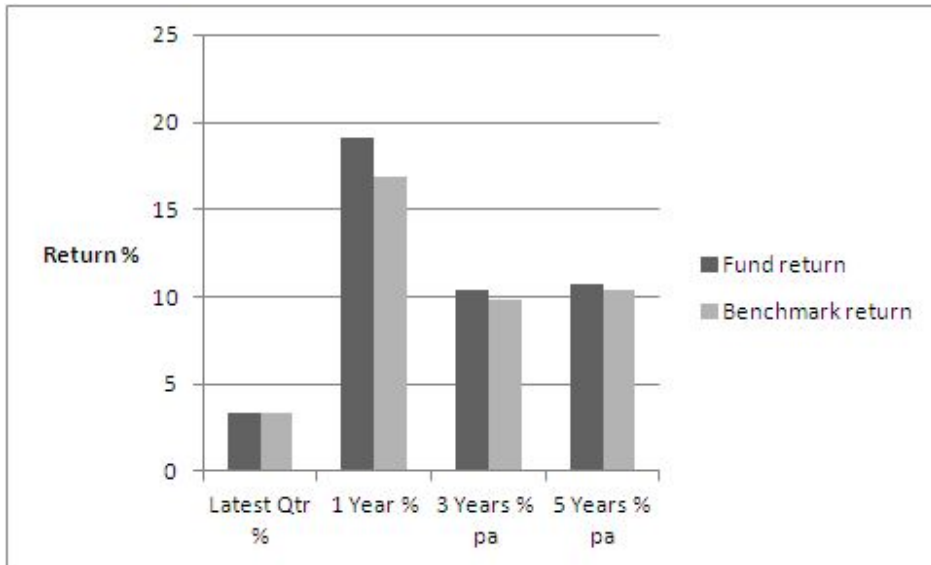
TOTAL FUND	Target Allocation	Fund Allocation	Benchmark Return	Fund Return	Variance
	%	%	%	%	%
Equities	55	60	5.8	5.1	-0.7
Bonds	15	16	-1.1	-0.5	0.6
Pooled Multi Asset	15	15	0.9	1.3	0.4
Property	10	6	2.3	1.5	-0.8
Alternatives	5	3	n/a	n/a	n/a
TOTAL ASSETS	100.0	100.0	3.3	3.3	0.0

- 5.2 At total fund level the combined fund performance matched the benchmark over the period. Performance of individual asset classes is detailed in paragraph 6 onwards.

Total fund performance – longer term

TOTAL FUND	1 Year	3 Years	5 Years
	% pa	% pa	% pa
Fund return	19.1	10.4	10.7
Benchmark return	16.9	9.8	10.4
Variance %	2.2	0.6	0.3

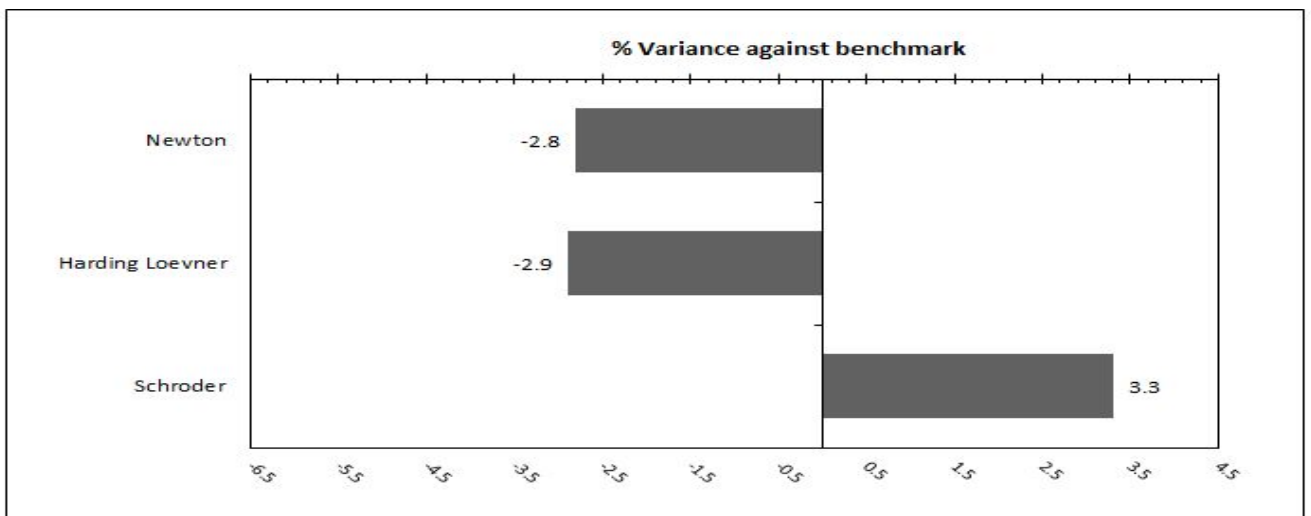
- 5.3 At total fund level, as at December 2016 the combined fund outperformed the benchmark by 2.2% over the past year, by 0.6% per annum over the past three years and 0.3% over the past five years.
- 5.4 The bar chart below summarises the overall performance of the fund over the last year, three year and five year positions:



6. Equity Performance

Equity performance for the latest quarter ended 31 December 2016

Manager	Target Allocation	Fund Allocation	Benchmark Return	Fund Return	Variance
	%	%	%	%	%
L&G	13	12	3.9	3.9	0.0
Newton	14	16	6.4	3.6	-2.8
Harding Loevner	14	16	6.4	3.5	-2.9
Schroders	14	16	6.4	9.7	3.3
TOTAL EQUITIES	55	60	5.8	5.1	-0.7



- 6.1 The November US election outcome caused a rally in global equities. Since the election, financials, especially banks have benefitted from the perception that Trump's victory may mean less regulation, a stronger economy and steeper yield curve. Industrials and materials stocks also rallied in the hope of higher economic growth and infrastructure spending. Expectations for US growth and inflation shifted upward and the US Dollar grew stronger. The Federal Reserve then went on to raise short term interest rates by 0.25% in December and signalled three further rate increases in 2017. All major developed world markets made gains, but UK based investors gained significantly from sterling weakness and US equities generated the greatest gains.
- 6.2 During the quarter a significant market rotation occurred following the US election. After lagging for several years, value was the best performing of the major style indices with most of the outperformance coming in the current quarter. They particularly benefitted from holdings in the resources sectors, such as mining stocks and oil and gas related companies. Also holdings in US industrials, financials and technology boosted performance. Newton and Harding Loevner both underperformed the benchmark. Newton's underperformance is attributed mainly to sector allocation, as they were underweight to financials and overweight in consumer staples. Stock selection was the main issue for Harding Loevner, particularly due to highly priced Japanese company stocks.

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	7.9	7.9	0.0
Newton	28.7	20.7	-8.0	15.3	16.1	0.8
Harding Loevner	28.7	27.0	-1.7	15.3	15.7	0.4
Schroders	28.7	33.9	5.2	15.3	15.5	0.2

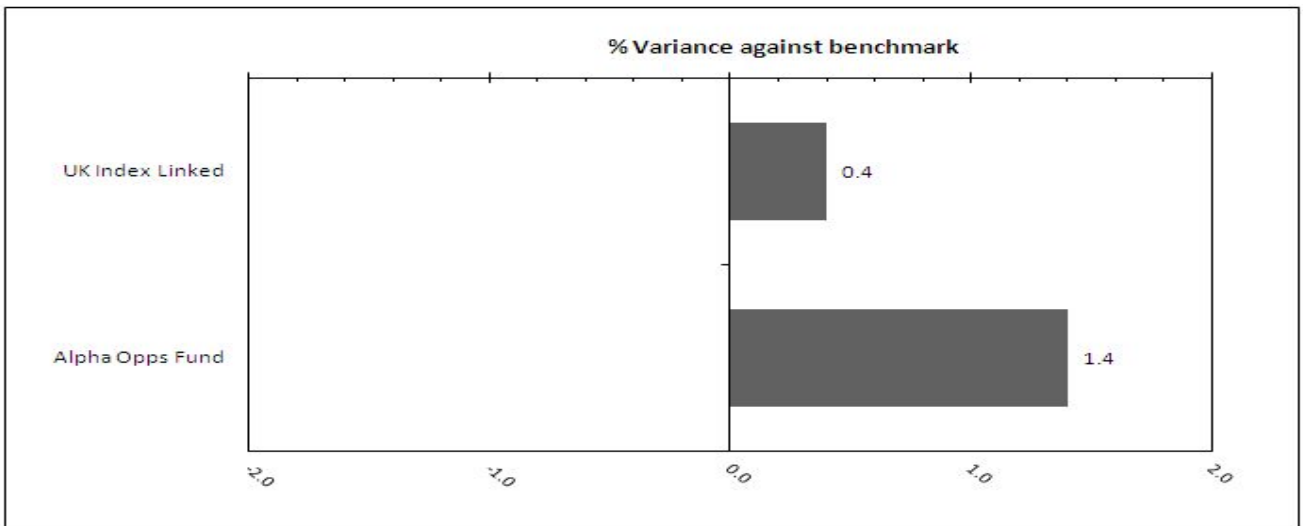
- 6.3 As shown in the table above, over the longer term L&G matched the benchmark during the twelve months ended December 2016, Newton and Harding Loevner underperformed and Schroders outperformed the benchmark. Since inception, L&G matched the benchmark, Newton, Harding Loevner and Schroders all outperformed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



7. Bond Performance

Bond performance for the latest quarter ended 31 December 2016 (M&G)

	Target Allocation	Fund Allocation	Benchmark Return	Fund Return	Variance
	%	%	%	%	%
UK Index Linked	6	8	-3.0	-2.6	0.4
Alpha Opportunities Fund	9	8	0.1	1.5	1.4
TOTAL (Weighted Average)	15	16	-1.1	-0.5	0.6



7.1 The rally in equity markets that followed the US election fed into the bond markets, where government bond yields rose sharply on expectations of an economic and inflationary resurgence. US corporate bond spreads performed well, gaining from the pro-business sentiment from equities and higher available yields from the underlying government bond market.

7.2 M&G outperformed the benchmark during the quarter. In the Alpha Opportunities Fund industrial holdings continued to be the largest contributor to outperformance, with holdings such as Dell (a computer hardware firm), Four Seasons (a health care facilities firm) and Preem (an oil refinery) performing strongly. In the UK Index Linked Fund, M&G closed an overweight position in conventional gilts maturing in 30 years and bought back index linked gilts maturing in

30 years. They also closed an underweight position in index linked gilts in 25 to 40 years relative to gilts maturing in 10 and 50 years. These actions all contributed positively to performance during the quarter.

Bond performance – longer term

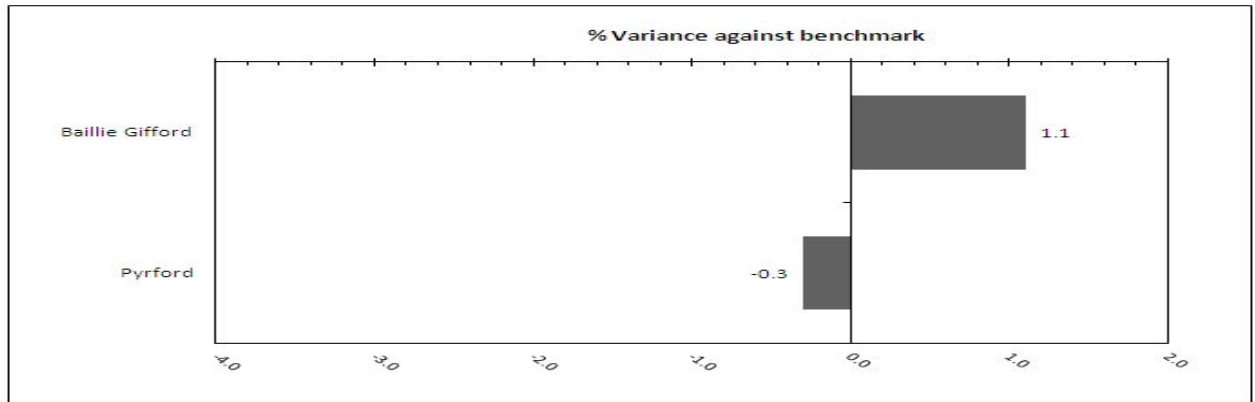
Manager	Benchmark Return 1 Year	Fund Return 1 Year	Variance	Benchmark Return Since Inception	Fund Return Since Inception	Variance
	%	%	%	%	%	%
UK Index Linked	27.4	28.2	0.8	12.2	13.1	0.9
Alpha Opportunities Fund	0.5	6.4	5.9	1.2	2.6	1.4

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

8. Pooled Multi-Asset Performance

Pooled Multi-Asset Performance for the latest quarter ended 31 December 2016

Manager	Target Allocation	Fund Allocation	Benchmark Return	Fund Return	Variance
	%	%	%	%	%
Baillie Gifford	7.5	7.6	0.9	2.0	1.1
Pyrford	7.5	7.5	0.9	0.6	-0.3
TOTAL POOLED MULTI-ASSET	15.0	15.1	0.9	1.3	0.4



- 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 Pyrford became Sutton’s second fund manager to transfer into the CIV.
- 8.2 Baillie Gifford outperformed the benchmark for the quarter. This is mainly attributable to a positive currency return gained from holdings in US dollars. They also benefitted from high yield credit and exposures in equity funds. Pyrford underperformed in the quarter. Whilst they benefitted from outperformance in overseas bonds and overseas equities, their UK equity holdings, (representing a significant portion of their asset allocation) underperformed. These holdings are invested primarily in defensive sectors, such as utilities.

Pooled Multi-Asset Performance – longer term

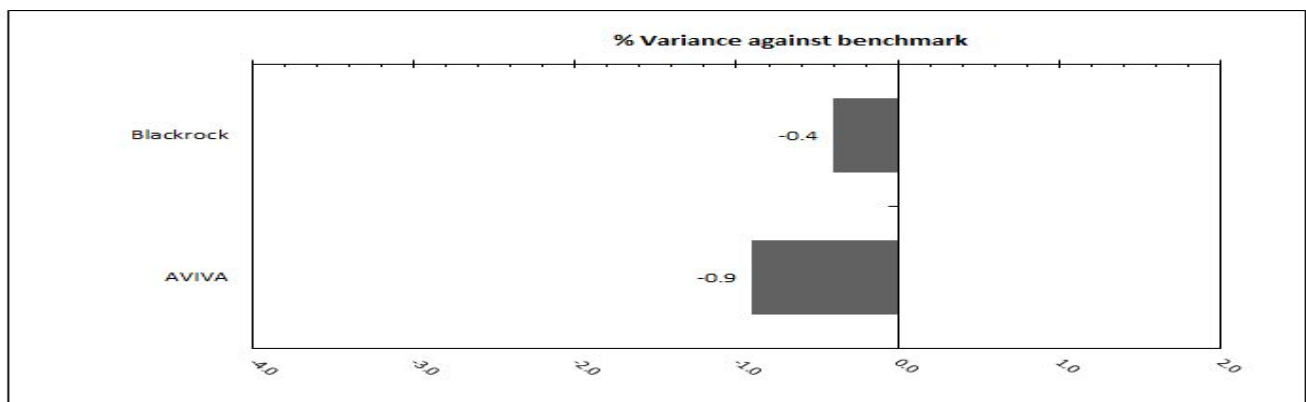
Manager	Benchmark Return 1 Year	Fund Return 1 Year	Variance	Benchmark Return Since Inception	Fund Return Since Inception	Variance
	%	%	%	%	%	%
Baillie Gifford	3.7	7.0	3.3	3.6	5.3	1.7
Pyrford	3.7	9.8	6.1	3.6	4.6	1.0

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

9. Property Performance

Property Performance for the latest quarter ended 31 December 2016

Manager	Target Allocation	Fund Allocation	Benchmark Return	Fund Return Income	Fund Return Capital	Total Fund Return	Variance
	%	%	%	%	%	%	%
BlackRock	6	4	2.3	0.9	1.0	1.9	-0.4
AVIVA	4	2	2.3	1.1	0.3	1.4	-0.9



- 9.1 The UK property market was more resilient than expected during the quarter. This is due to the economy performing better than expected and continued strong investor demand for real estate assets, driven by the relatively attractive yield offered and the decline in sterling attracting international capital. Since the vote to leave the EU, industrial and alternative real estate investments (such as student accommodation, healthcare and hotels) have been more robust than those in the retail and office sectors. In Central London, prime office and retail assets have seen increases in value due to overseas investor demand, however apart from this there are signs the Central London property market is beginning to falter.
- 9.2 During the quarter both BlackRock and AVIVA underperformed the benchmark. BlackRock's performance during the quarter was held back by a position that was overweight in defensive Alternatives and underweight in Offices. They made substantial sales during the quarter, creating an overweight cash position ahead of significant capital spending plans that are in the pipeline. The majority of AVIVA's holdings produced positive returns over the quarter with two exceptions; Standard Life UK Retail Park Trust and West End of London Property Unit Trust. Both of these funds suffered valuation falls.



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	2.8	2.5	-0.3	4.0	0.7	-3.3
AVIVA	2.8	1.7	-1.1	8.0	7.6	-0.4

9.3 As shown in the table above, Blackrock and AVIVA underperformed the benchmark during the twelve months ending December 2016 and since inception.

10. Alternatives Performance

Alternatives Performance for the latest quarter ended 31 December 2016

Manager	Benchmark Allocation	Fund Allocation	Fund Return
	%	%	%
Partner’s Group – Infrastructure	0	2	0.0
M&G – UK companies financing fund	0	1	-37.7

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	27.2	8.6
M&G	3.7	4.6

11. Annualised Rolling 3 Years to 31 December 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.

11.2 The table below 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.

Manager	3 Yr Benchmark Return	Target 3 Yr Return	3 yr Fund Return	Variance against Benchmark	Variance against Target
	%	%	%	%	%
Newton	13.7	15.7	13.9	0.2	-1.8
During 2014 and 2015 Newton maintained an outperformance position, which was largely driven by good stock selection in consumer stocks, information technology and the financial sectors. During 2016 Newton's performance deteriorated and this is attributable to sector allocation, being underweight in the better performing sectors and overweight in the less well performing sectors, as well as their defensive stance which damaged performance.					
Harding Loevner	13.7	16.7	15.2	1.5	-1.5
Apart from the most recent quarter, Harding Loevner has maintained a consistent outperformance position over the last three years. This is attributed to good stock selection in the most resilient sectors, particularly in healthcare and information technology.					
Schroder	13.7	16.7	13.2	-0.5	-3.5
Schroders Value based investment style (stocks in companies that the market has undervalued) has lagged for several years against the quality growth investment style of the Fund's other equity managers. However, by the end of 2016 Value had become the best performing style, resulting from a significant market rotation caused by the surprise US election result.					
Baillie Gifford	3.6	6.6	4.8	1.2	-1.8
During 2014 Baillie Gifford had a relatively strong year benefitting from positive contribution from listed equities and emerging market bonds. Performance in 2015 was more mixed with exposures to economically-sensitive assets such as high yield and emerging market bonds struggling, balanced to some extent by positives from exposures to listed equities. In 2016 performance was ahead of target with the main positive contributors to performance being economically-exposed asset classes such as high yield credit, listed equities and emerging market bonds. Active currency also contributed positively.					
Pyrford	3.6	6.6	5.2	1.6	-1.4



Over the three years Pyrford are ahead of benchmark but behind target. Positive absolute performance in 2014 was countered by some underperformance in 2015 when the strategy struggled as markets fell sharply in Q2 and Q3. From the last quarter of 2015 onwards Pyrford maintained a consistent outperformance position over 12 months, which is largely attributable to unhedged overseas equity and bond holdings.

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: 10 March 2017
Consultation with other officers		
Finance	Yes	Lyndsey Gamble
Legal	No	N/A
Equality Impact Assessment?	No	N/A