

<b>Report to:</b>	Pension Committee	<b>Date:</b>	4 September 2017
<b>Report title:</b>	Quarterly Investment Performance Report to 30 June 2017		
<b>Report from:</b>	Gerald Almeroth, Strategic Director – Resources		
<b>Ward/Areas affected:</b>	Borough Wide		
<b>Chair of Committee/Lead Member:</b>	Councillor Sunita Gordon		
<b>Author(s)/Contact Number(s):</b>	Lyndsey Gamble, Head of Financial Strategy and Planning, 0208 770 5358 Lisa Doswell, Treasury and Investments Manager, 0208 770 5354		
<b>Corporate Plan Priorities:</b>	<ul style="list-style-type: none"> <li>• A Smart Council</li> </ul>		
<b>Open/Exempt:</b>	Part-Exempt: Appendix B is exempt on the basis of Paragraph 3, Schedule 12A of Local Government Act 1972		
<b>Signed:</b>		<b>Date:</b>	21 August 2017

## 1. Summary

- 1.1. This report shows the performance of the Pension Fund Investment Managers for the quarter ending 30 June 2017, 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:

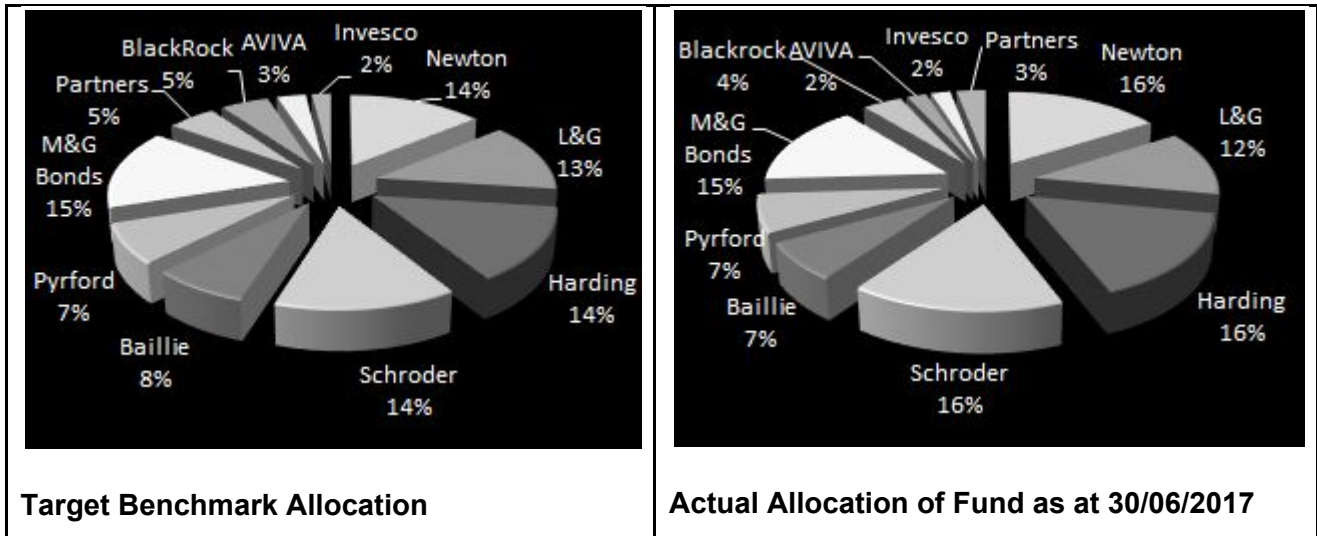
- 2.1. Note the performance of the Pension Fund Investment Managers.

## 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 quarter ending 30 June 2017. The Council was also invested in three separate funds; M&G UK Companies Financing Fund, Aviva Investors UK Real Estate Fund of Funds Plan and Invesco Real Estate UK Residential Fund.

- 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. 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 originally agreed by 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 B (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 and where applicable from the London CIV.

Movement in Fund Value from 31 March 2017 to 30 June 2017

- 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.

<b>Fund Manager</b>	<b>Value at end 31/03/17 £'000</b>	<b>Value at end 30/06/17 £'000</b>	<b>Value change £'000</b>	<b>% Change</b>
<b>Total Equities</b>	<b>362,621</b>	<b>367,040</b>	<b>4,419</b>	<b>1.2</b>
Legal & General	71,366	72,393	1,027	1.4
Newton *	96,650	97,756	1,106	1.1
Harding Loevner	98,105	101,509	3,404	3.5
Schroder	96,500	95,382	-1,118	-1.2
<b>Bonds</b>	<b>93,467</b>	<b>92,972</b>	<b>-495</b>	<b>-0.5</b>
M&G bonds	93,467	92,972	-495	-0.5
<b>Pooled Multi Asset</b>	<b>87,267</b>	<b>88,102</b>	<b>835</b>	<b>1.0</b>
Baillie Gifford	44,426	45,204	778	1.8
Pyrford	42,841	42,898	57	0.1
<b>Property</b>	<b>48,991</b>	<b>49,595</b>	<b>604</b>	<b>1.2</b>
BlackRock	21,983	22,280	297	1.4
AVIVA	12,277	12,418	141	1.1
Invesco	14,731	14,897	166	1.1
<b>Alternatives</b>	<b>16,555</b>	<b>16,985</b>	<b>430</b>	<b>2.6</b>
Partner's Group **	14,917	16,138	1,221	8.2
M&G – Co's Financing Fund ***	1,638	847	-791	-48.3
<b>Cash ****</b>	<b>8,704</b>	<b>11,283</b>	<b>2,579</b>	<b>29.6</b>
<b>Total Assets</b>	<b>617,605</b>	<b>625,977</b>	<b>8,372</b>	<b>1.4</b>

\* Newton transitioned into the CIV during the quarter

\*\* Partners Group - a first capital call payment, representing approximately £1.1m was made into the new Global 2015 fund increasing the total level of investment with Partners Group to £16.1m

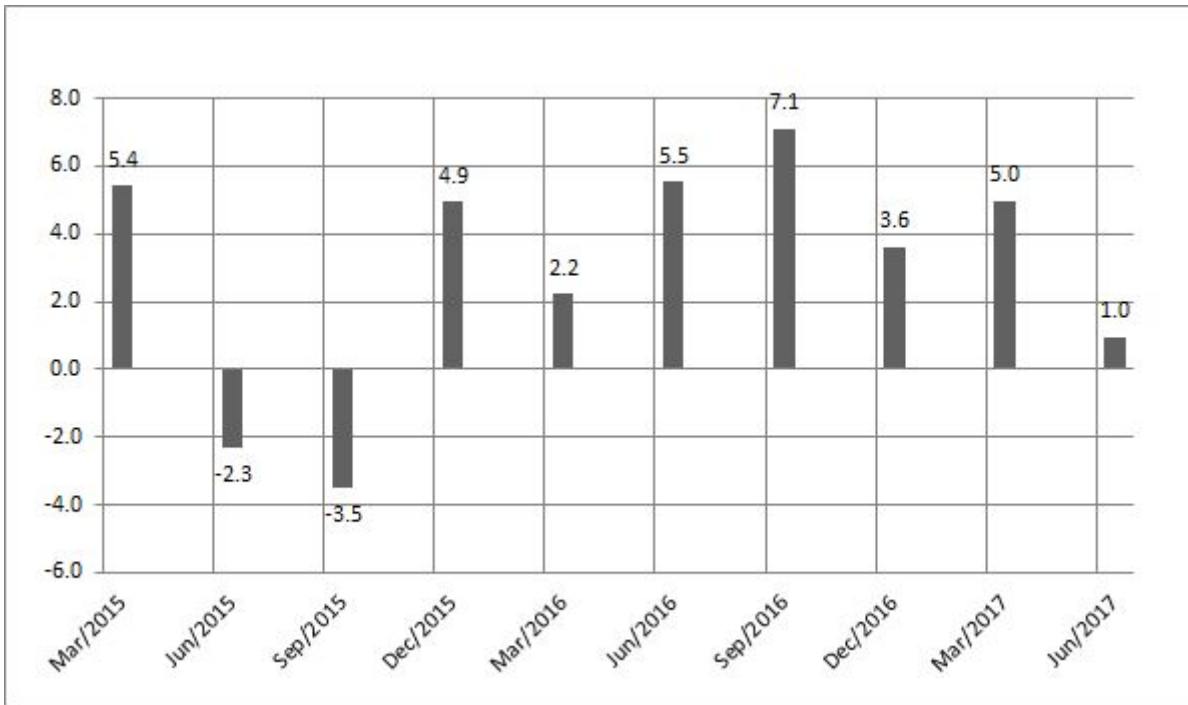
\*\*\* M&G distributed £0.8m from the fund during the quarter reducing the level invested to £0.8m

\*\*\*\* Cash increased during the quarter due to distributions by M&G, BlackRock and Partners Group, which totalled £1.5m and the late receipt of £2m from the disinvestment from Harding Loevner. This cash increase was partially offset by the payment of £1.1m to Partners Group



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

<b>Benchmark 54 months to 31/10/12</b>	<b>Fund 54 months to 31/10/12</b>	<b>Variance</b>	<b>Benchmark 54 months to 30/06/17</b>	<b>Fund 54 months to 30/06/17</b>	<b>Variance</b>
%	%	%	%	%	%
4.7	3.1	-1.6	10.2	10.9	0.7

5.1 Prior to the new strategy implementation the combined fund underperformed the benchmark by 1.6% over the previous 54 months (benchmark 4.7%, actual 3.1%). Looking at performance 54 months after the new strategy was implemented the combined fund outperformed the benchmark by 0.7% (benchmark 10.2%, actual 10.9%). In overall terms an improvement of 2.3%.

Total fund performance for the latest quarter ended 30 June 2017

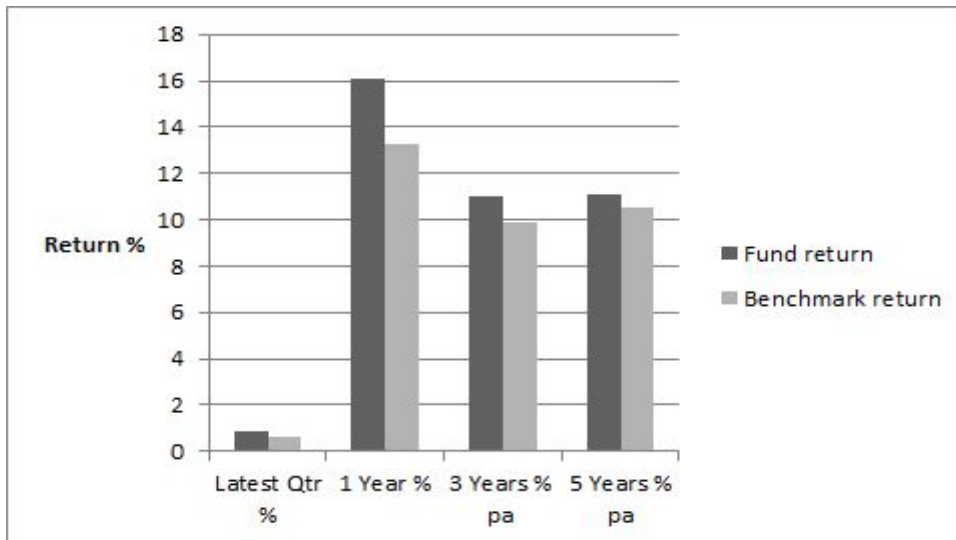
TOTAL FUND	Target Allocation	Fund Allocation	Benchmark Return	Fund Return	Variance
	%	%	%	%	%
Equities	55	60	0.7	1.1	0.4
Bonds	15	15	-0.9	-0.5	0.4
Pooled Multi Asset	15	14	0.9	1.0	0.1
Property	10	8	2.3	1.1	-1.2
Alternatives	5	3	n/a	n/a	n/a
<b>TOTAL ASSETS</b>	<b>100.0</b>	<b>100.0</b>	<b>0.6</b>	<b>0.9</b>	<b>0.3</b>

- 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	16.1	11.0	11.1
Benchmark return	13.3	9.9	10.5
<b>Variance %</b>	<b>2.8</b>	<b>1.1</b>	<b>0.6</b>

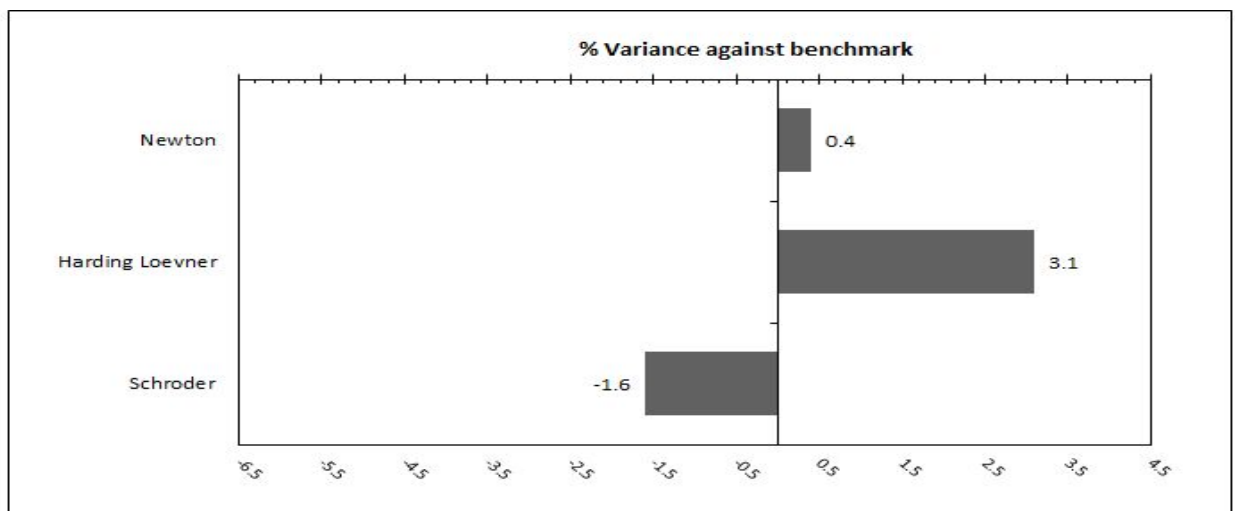
- 5.3 At total fund level, as at June 2017 the combined fund outperformed the benchmark by 2.8% over the past year, by 1.1% per annum over the past three years and 0.6% over the past five years.
- 5.4 The bar chart below summarises the overall performance of the fund over the last year, three year and five year positions:



### 6. Equity Performance

Equity performance for the latest quarter ended 30 June 2017

Manager	Target Allocation	Fund Allocation	Benchmark Return	Fund Return	Variance
	%	%	%	%	%
L&G	13	12	1.4	1.4	0.0
Newton	14	16	0.4	0.8	0.4
Harding Loevner	14	16	0.4	3.5	3.1
Schroders	14	16	0.4	-1.2	-1.6
<b>TOTAL EQUITIES</b>	<b>55</b>	<b>60</b>	<b>0.7</b>	<b>1.1</b>	<b>0.4</b>



- 6.1 The pace of gains eased off during the quarter, but global equity markets continued to move higher overall and volatility remained subdued. Investor sentiment was mainly influenced by earnings releases, central bank activity and political factors. In the US, doubts about President Trump continued, France's presidential election saw a decisive victory and in the UK, June's general election produced a hung parliament. The Dow Jones index reached new all time highs, supported by US dollar weakness. Investors seemed unphased by higher US interest rates, despite the Federal Reserve's decision to raise rates again in June. Despite bouts of volatility, emerging market equities were again the standout performers over the quarter, supported by strength in the Chinese economy and a weaker dollar. Stocks inside the EU were also particularly strong and all sectors, except Energy and Telecom Services produced positive returns in the quarter. The two top performing sectors were healthcare and IT.
- 6.2 On 22 May, Newton became Sutton's third fund manager to transfer into the London Collective Investment Vehicle (CIV). During the quarter, Newton's outperformance is primarily attributed to sector allocations, particularly financials stocks. They were also overweight in information technology stocks, which was beneficial. Similarly, Harding Loevner's outperformance was also produced through sector allocation. They held no telecom services stocks and their holdings in IT and healthcare contributed the most to performance. Schroders' underperformed during the quarter, as investors continued to focus on growth stocks, creating a difficult environment for their value based investment style.

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	18.1	18.1	0.0	8.1	8.1	0.0
Newton	22.3	17.9	-4.4	15.0	15.5	0.5
Harding Loevner	22.3	25.8	3.5	15.0	16.6	1.6
Schroders	22.3	25.4	3.1	15.0	14.6	-0.4

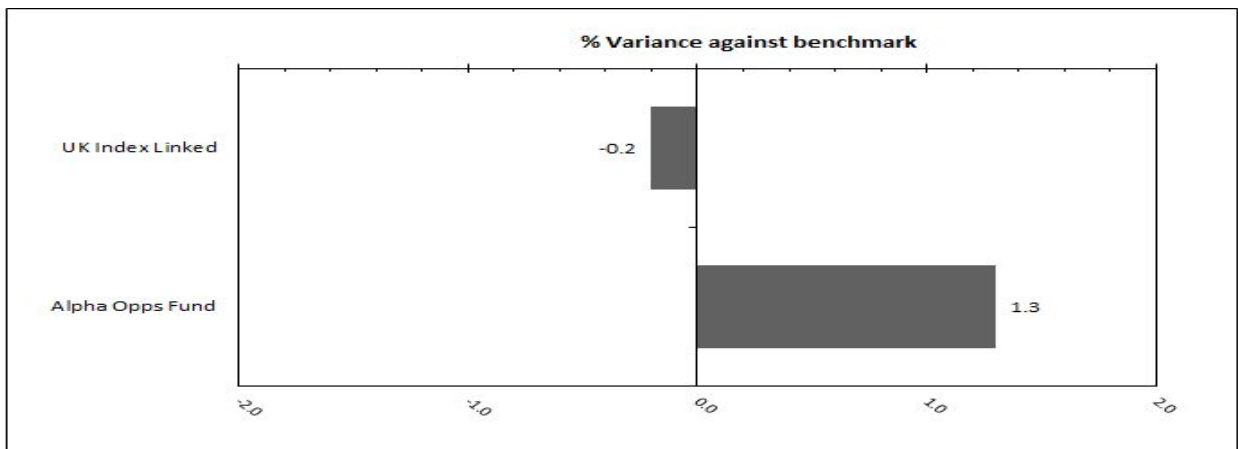
- 6.3 As shown in the table above, over the longer term L&G matched the benchmark during the twelve months ended June 2017, Newton underperformed, while Harding Loevner and Schroders outperformed the benchmark. Since inception, L&G matched the benchmark, Newton and Harding Loevner outperformed the benchmark and Schroders underperformed.



**7. Bond Performance**

Bond performance for the latest quarter ended 30 June 2017

	<b>Target Allocation</b>	<b>Fund Allocation</b>	<b>Benchmark Return</b>	<b>Fund Return</b>	<b>Variance</b>
<b>M&amp;G</b>	%	%	%	%	%
UK Index Linked	6	7	-2.4	-2.6	-0.2
Alpha Opportunities Fund	9	8	0.1	1.4	1.3
<b>TOTAL (Weighted Average)</b>	<b>15</b>	<b>15</b>	<b>-0.9</b>	<b>-0.5</b>	<b>0.4</b>



- 7.1 Global corporate bond markets had a positive quarter against a backdrop of continued improving global economic growth. Credit spreads fell steadily across major developed markets, while government bond yields remained steady.
- 7.2 M&G outperformed the benchmark during the quarter. In the Alpha Opportunities Fund, industrial securitised and financials bond holdings continued to perform well. The fund continues to remain defensively positioned and ready to exploit episodes of volatility. In the UK Index Linked Fund, an above index position in UK government bonds (gilts) maturing in 50 years against index-linked gilts maturing in 30 years detracted from performance.





Bond performance – longer term

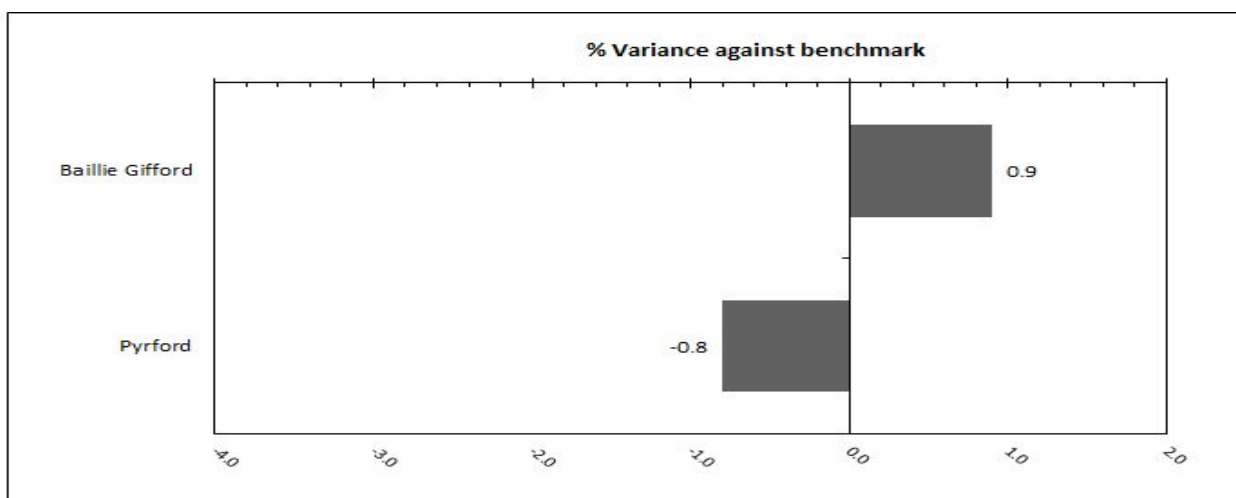
Manager	Benchmark Return 1 Year	Fund Return 1 Year	Variance	Benchmark Return Since Inception	Fund Return Since Inception	Variance
<b>M&amp;G</b>	%	%	%	%	%	%
UK Index Linked	7.1	7.7	0.6	12.6	13.0	0.4
Alpha Opportunities Fund	0.3	7.7	7.4	1.0	3.0	2.0

7.3 As shown in the table above, over the longer term both M&G funds outperformed the benchmark during the twelve months ended June 2017. Both funds also outperformed since inception.

**8. Pooled Multi-Asset Performance**

Pooled Multi-Asset Performance for the latest quarter ended 30 June 2017

Manager	Target Allocation	Fund Allocation	Benchmark Return	Fund Return	Variance
	%	%	%	%	%
Baillie Gifford	7.5	7.3	0.9	1.8	0.9
Pyrford	7.5	7.0	0.9	0.1	-0.8
<b>TOTAL POOLED MULTI-ASSET</b>	<b>15.0</b>	<b>14.3</b>	<b>0.9</b>	<b>1.0</b>	<b>0.1</b>



- 8.1 Baillie Gifford assets were transferred from five underlying boroughs into the 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 their positions in listed equities, property and infrastructure. Pyrford underperformed in the quarter. They continued to benefit from their allocations in equities, particularly overseas holdings, however UK equity holdings underperformed and overseas bonds were weak due to sterling strength over 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	3.6	11.7	8.1	3.6	5.7	2.1
Pyrford	3.6	6.2	2.6	3.6	4.5	0.9

- 8.3 Both managers outperformed the benchmark during the twelve months ended June 2017 and both outperformed since inception.

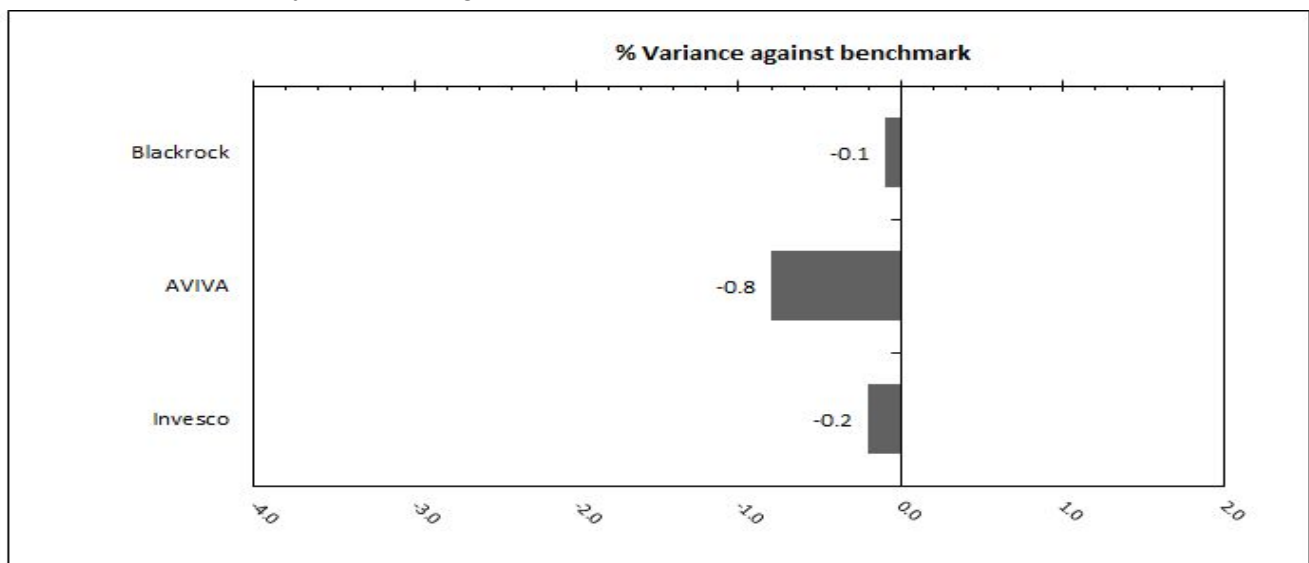
## 9. Property Performance

Property Performance for the latest quarter ended 30 June 2017

Manager	Target Allocation	Fund Allocation	Benchmark Return	Fund Return Income	Fund Return Capital	Total Fund Return	Variance
	%	%	%	%	%	%	%
BlackRock	5	4	2.3	0.8	1.4	2.2	-0.1
AVIVA	3	2	2.3	0.4	1.1	1.5	-0.8
Invesco	2	2	1.3	0.0	1.1	1.1	-0.2

- 9.1 In December 2016 the first drawdown was made into the new residential property mandate with Invesco. A final drawdown was made in March 2017, completing the full commitment of £15m

to this fund. At 30 June 2017 Invesco's asset value reflects the level of investment in the fund at that time and not yet a meaningful performance component.



- 9.2 It was another strong quarter for the UK commercial real estate market. Once again the industrial sector recorded the highest return, driven primarily by sustained growth in e-commerce. The alternative property types (student accommodation, leisure, healthcare) also proved to be resilient, delivering stable returns, underpinned by sustained rental growth. Strong demand for Central London offices from overseas, particularly Chinese investors, has helped to lift the value of this segment, despite weakening tenant demand. In the retail sector, prime shops in larger regional centres have performed better than the broader market, whereas secondary shopping centres have remained out of favour.
- 9.3 During the quarter both BlackRock and AVIVA underperformed the benchmark. BlackRock's performance during the quarter benefitted from their overweight position to industrials and alternatives. AVIVA's performance is understated for the quarter, due to payment of income from a number of holdings being delayed following a change in the administrator and trustee for the fund. Invesco's performance is reflective of the "ramp period" phase of the investment, during which a large proportion of the assets in the fund are still under construction. Returns will be below the benchmark until the fund has stabilised.
- 9.4 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	6.0	4.1	-1.9	4.3	1.0	-3.3
AVIVA	6.0	4.5	-1.5	8.1	7.7	-0.4

9.5 As shown in the table above, Blackrock and AVIVA underperformed the benchmark during the twelve months ending June 2017 and since inception.

## 10. Alternatives Performance

### Alternatives Performance for the latest quarter ended 30 June 2017

<b>Manager</b>	<b>Benchmark Allocation</b>	<b>Fund Allocation</b>	<b>Fund Return</b>
	%	%	%
Partner's Group – Infrastructure	5	2.7	3.8
M&G – UK Companies Financing Fund	0	0.2	-48.3

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 has not been meaningful to make comparisons with their performance target. However, Hymans Robertson recently undertook a review of Partners Group's performance which was presented to the Committee in March 2017. Their view is that the Partners Group fund is progressing well. As at 31 December 2016 they had produced an internal rate of return of 9.3%, compared to the performance objective of 10%. It is still too early to judge the success of the approach since around 40% of capital is still to be drawn down.

10.2 M&G's return of -48.3% for the quarter represents a reduction in the value of the fund due to an income distribution of £804k, which was paid from the fund during the quarter.

### Alternatives Performance – longer term

<b>Manager</b>	<b>Fund Return 1 Year</b>	<b>Fund Return Since Inception</b>
	%	%
Partner's Group	16.6	9.3
M&G	3.6	4.5

## 11. Annualised Rolling 3 Years to 30 June 2017

11.1 The annual performance targets for equities, bonds and pooled multi-asset fund managers are set over a rolling three year period.

11.2 The table below shows that over the three year rolling period all managers except for Newton and Schroders have outperformed the benchmark, however with the exception of Harding Loevner, all managers have underperformed the target over the same period.

<b>Manager</b>	<b>3 Yr Benchmark Return</b>	<b>Target 3 Yr Return</b>	<b>3 yr Fund Return</b>	<b>Variance against Benchmark</b>	<b>Variance against Target</b>
	%	%	%	%	%
Newton	14.9	16.9	14.7	-0.2	-2.2
<p>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 relatively. This underperformance continued into 2017 until the second quarter, when sector allocations, particularly in financials and IT produced outperforming returns.</p>					
Harding Loevner	14.9	17.9	18.6	3.7	0.7
<p>Harding Loevner has maintained a relatively 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.</p>					
Schroder	14.9	17.9	13.0	-1.9	-4.9
<p>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. The start of 2017 saw some unwinding of the strong performance, as investors favoured growth over value again by a significant margin and this position has yet to recover.</p>					
Baillie Gifford	3.6	6.6	5.4	1.8	-1.2
<p>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. During the first half of</p>					



<p>2017, the same asset classes continued to be the main contributors to performance. Holdings in absolute return and developed market government bonds have been the only detractors.</p>					
Pyrford	3.6	6.6	5.4	1.8	-1.2
<p>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. This position was maintained until the second quarter of 2017 when Pyrford underperformed.</p>					

**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**

<b>Appendix letter</b>	<b>Title</b>
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: 23 August 2017
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**Consultation with other officers**

Finance	Yes	Lyndsey Gamble
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Legal	No	N/A
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Equality Impact Assessment?	No	N/A
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