

<b>Report to:</b>	Pension Committee	<b>Date:</b>	18 December 2017
<b>Report title:</b>	Quarterly Investment Performance Report to 30 September 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>	06 December 2017

## 1. Summary

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

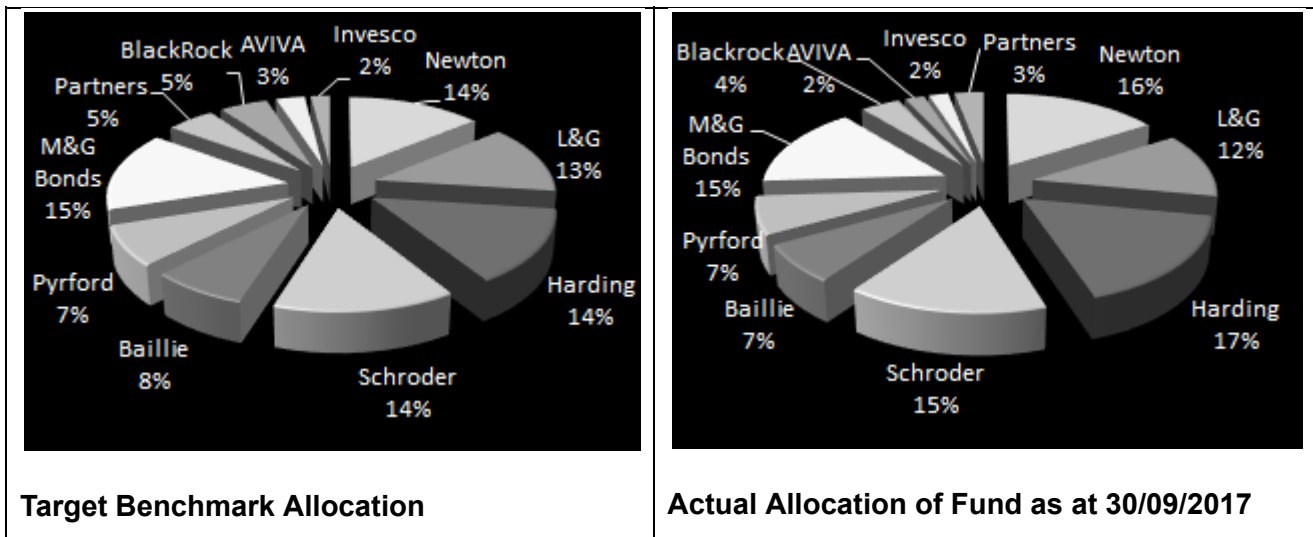
- 2.1. Note the performance of the Pension Fund Investment Managers.

## 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 September 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. The current target allocation of 42% in global equities has been exceeded by 6%. This will be addressed within the action points coming from the review of the Investment Strategy.

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 30 June 2017 to 30 September 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 30/06/17 £'000</b>	<b>Value at end 30/09/17 £'000</b>	<b>Value change £'000</b>	<b>% Change</b>
<b>Total Equities</b>	<b>367,040</b>	<b>371,454</b>	<b>4,414</b>	<b>1.2</b>
Legal & General	72,393	73,978	1,585	2.2
Newton *	97,756	98,169	413	0.4
Harding Loevner	101,509	103,766	2,257	2.2
Schroder	95,382	95,541	159	0.2
<b>Bonds</b>	<b>92,972</b>	<b>93,149</b>	<b>177</b>	<b>0.2</b>
M&G bonds	92,972	93,149	177	0.2
<b>Pooled Multi Asset</b>	<b>88,102</b>	<b>88,021</b>	<b>-81</b>	<b>-0.1</b>
Baillie Gifford *	45,204	45,494	290	0.6
Pyrford *	42,898	42,527	-371	-0.9
<b>Property</b>	<b>49,595</b>	<b>49,981</b>	<b>386</b>	<b>0.8</b>
BlackRock	22,280	22,631	351	1.6
AVIVA	12,418	12,552	134	1.1
Invesco	14,897	14,798	-99	-0.7
<b>Alternatives</b>	<b>16,985</b>	<b>18,277</b>	<b>1,292</b>	<b>7.6</b>
Partner's Group **	16,138	17,612	1,474	9.1
M&G – Co's Financing Fund ***	847	665	-182	-21.5
<b>Cash ****</b>	<b>11,283</b>	<b>13,372</b>	<b>2,089</b>	<b>18.5</b>
<b>Total Assets</b>	<b>625,977</b>	<b>634,254</b>	<b>8,277</b>	<b>1.3</b>

\* These managers have transitioned into the London Collective Investment Vehicle (LCIV)

\*\* Partners Group - a first capital call payment, representing approximately £1.0m was made into the new Direct 2015 fund

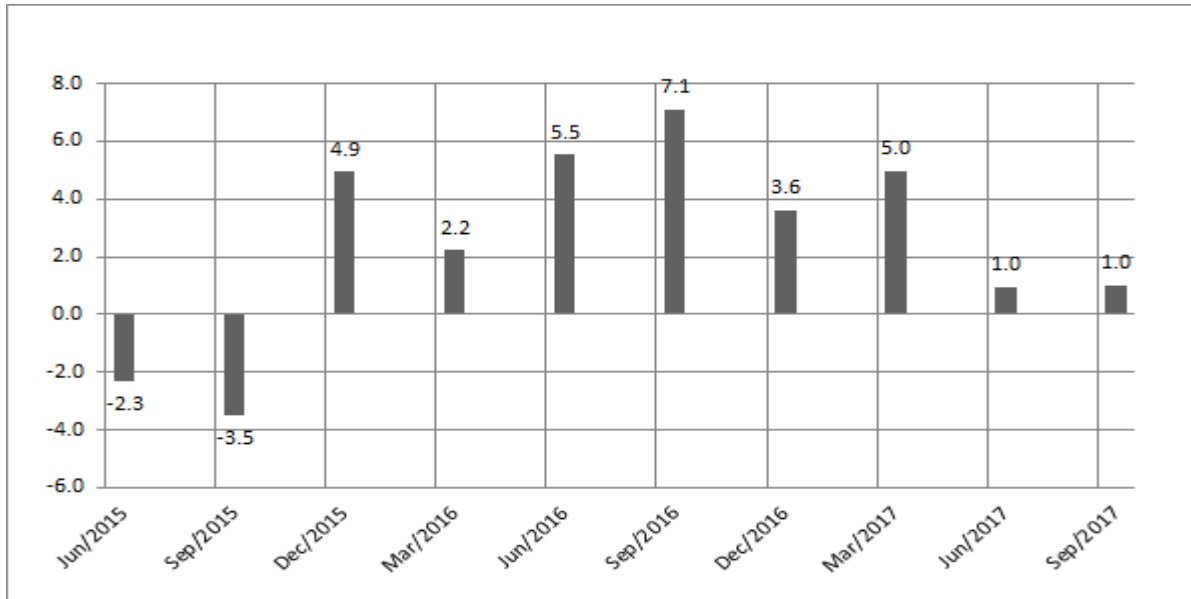
\*\*\* M&G distributed £0.2m from the fund during the quarter reducing the level invested to £0.7m

\*\*\*\* Cash increased by £2.1m during the quarter, which is largely attributable to the receipt of employers deficit contributions of £5.4m, offset by an increase in transfer payments of £3.2m. This largely consisted of Sutton lawyers that transferred to the legal partnership, £2.9m was paid to Merton on 17 August.



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 57 months to 31/10/12</b>	<b>Fund 57 months to 31/10/12</b>	<b>Variance</b>	<b>Benchmark 57 months to 30/09/17</b>	<b>Fund 57 months to 30/09/17</b>	<b>Variance</b>
%	%	%	%	%	%
5.2	3.6	-1.6	9.9	10.5	0.6

5.1 Prior to the new strategy implementation the combined fund underperformed the benchmark by 1.6% over the previous 57 months (benchmark 5.2%, actual 3.6%). Looking at performance 57 months after the new strategy was implemented the combined fund outperformed the benchmark by 0.6% (benchmark 9.9%, actual 10.5%). In overall terms an improvement of 2.2%.

Total fund performance for the latest quarter ended 30 September 2017

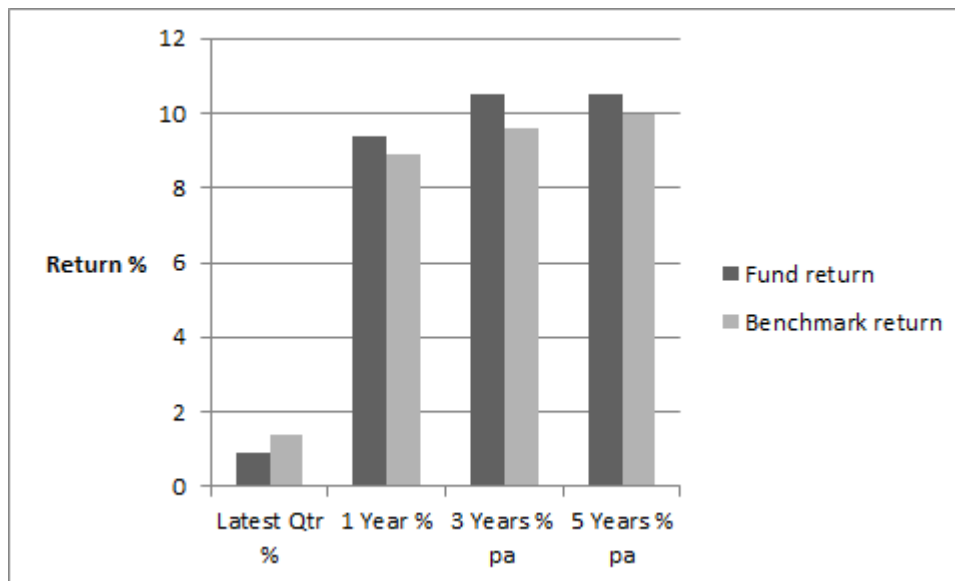
TOTAL FUND	Target Allocation	Fund Allocation	Benchmark Return	Fund Return	Variance
	%	%	%	%	%
Equities	55	60	1.9	1.2	-0.7
Bonds	15	15	-0.2	0.2	1.1
Pooled Multi Asset	15	14	0.8	-0.1	-1.0
Property	10	8	2.3	1.6	-0.7
Alternatives	5	3	n/a	n/a	n/a
<b>TOTAL ASSETS</b>	<b>100.0</b>	<b>100.0</b>	<b>1.4</b>	<b>0.9</b>	<b>-0.5</b>

- 5.2 At total fund level the combined fund performance underperformed the benchmark by 0.5% 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	9.4	10.5	10.5
Benchmark return	8.9	9.6	10.0
<b>Variance %</b>	<b>0.5</b>	<b>0.9</b>	<b>0.5</b>

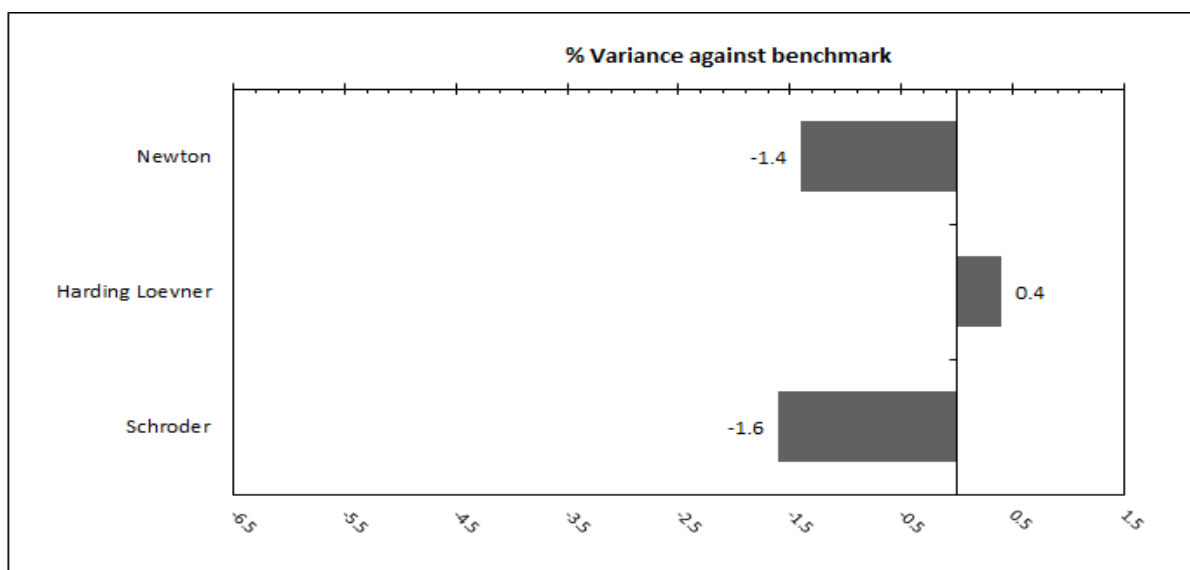
- 5.3 At total fund level, as at September 2017 the combined fund outperformed the benchmark by 0.5% over the past year, by 0.9% per annum over the past three years and 0.5% over the past five years.
- 5.4 The bar chart below summarises the overall performance of the fund over the last year, three year and five year positions:



**6. Equity Performance**

Equity performance for the latest quarter ended 30 September 2017

Manager	Target Allocation	Fund Allocation	Benchmark Return	Fund Return	Variance
	%	%	%	%	%
L&G	13	12	2.1	2.1	0.0
Newton	14	16	1.8	0.4	-1.4
Harding Loevner	14	16	1.8	2.2	0.4
Schroders	14	16	1.8	0.2	-1.6
<b>TOTAL EQUITIES</b>	<b>55</b>	<b>60</b>	<b>1.9</b>	<b>1.2</b>	<b>-0.7</b>



- 6.1 On 22 May, Newton became Sutton's third fund manager to transfer into the London Collective Investment Vehicle (CIV).
- 6.2 Global equities delivered solid gains during the quarter. Global economic growth, positive corporate earnings and enthusiasm for US President Trump's tax-reform proposals were all factors that boosted investor sentiment. The market stayed strong despite geopolitical concerns, such as escalating tensions between North Korea and the US and the deadlock over Brexit negotiations. Emerging markets continued their impressive year-to-date run of performance and US equities reached new highs, despite the Federal Reserve taking further steps to normalise monetary policy. The UK market also rose as more cyclical areas of the market performed well, led by the resources sectors as both industrial metal and crude oil prices recovered. Technology was again one of the best performing sectors and Energy and Materials stocks also performed significantly better than other sectors.
- 6.3 During the quarter Newton underperformed the benchmark. They had good performance from stocks held in Energy and Financials companies, however this was offset by weakness in Healthcare stocks and the positions they held in Information Technology. Harding Loevner's outperformance was boosted by holdings in Information Technology and within the Emerging Markets sector, but holdings in Consumer Discretionary detracted from performance. Again, 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	12.4	12.4	0.0	8.2	8.2	0.0



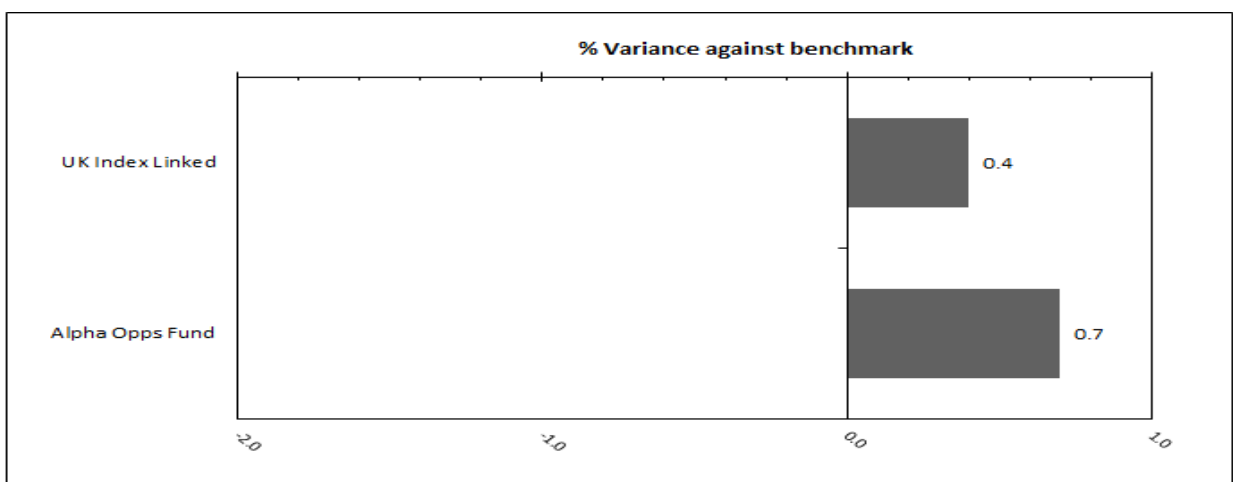
Newton	15.1	9.2	-5.9	14.6	14.7	0.1
Harding Loevner	14.9	17.8	2.9	14.6	16.2	1.6
Schroders	14.9	13.5	-1.4	14.6	13.8	-0.8

6.4 As shown in the table above, over the longer term L&G matched the benchmark during the twelve months ended September 2017, Newton underperformed, Harding Loevner outperformed and Schroders underperformed 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 September 2017

	Target Allocation	Fund Allocation	Benchmark Return	Fund Return	Variance
<b>M&amp;G</b>	%	%	%	%	%
UK Index Linked	6	7	-0.8	-0.4	0.4
Alpha Opportunities Fund	9	8	0.1	0.8	0.7
<b>TOTAL</b> (Weighted Average)	<b>15</b>	<b>15</b>	<b>-0.2</b>	<b>0.2</b>	<b>0.4</b>



7.1 Corporate bonds delivered marginally positive returns, outperforming their government bond counterparts as spreads drifted tighter.



- 7.2 M&G outperformed the benchmark during the quarter. The Alpha Opportunities Fund continued to build the level of defensive assets in the portfolio. Performance was boosted by Industrial and Financial positions. In the UK Index Linked Fund, an overweight position in UK government bonds (gilts) maturing in 50 years against index-linked gilts maturing in 30 years contributed positively to performance.

Bond performance – longer term

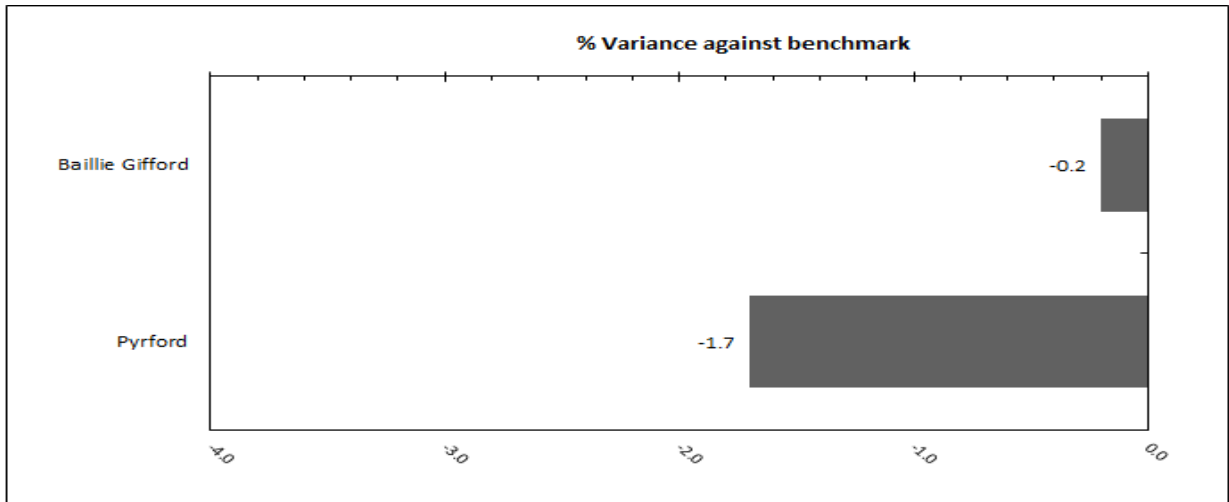
Manager	Benchmark Return 1 Year	Fund Return 1 Year	Variance	Benchmark Return Since Inception	Fund Return Since Inception	Variance
<b>M&amp;G</b>	%	%	%	%	%	%
UK Index Linked	-0.8	-0.4	0.4	11.3	11.8	0.5
Alpha Opportunities Fund	0.3	4.8	4.5	0.9	3.0	2.1

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

**8. Pooled Multi-Asset Performance**

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

Manager	Target Allocation	Fund Allocation	Benchmark Return	Fund Return	Variance
	%	%	%	%	%
Baillie Gifford	7.5	7.3	0.8	0.6	-0.2
Pyrford	7.5	7.0	0.8	-0.9	-1.7
<b>TOTAL POOLED MULTI-ASSET</b>	<b>15.0</b>	<b>14.3</b>	<b>0.8</b>	<b>-0.1</b>	<b>-0.9</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 underperformed the benchmark for the quarter. They gained from positions held in listed equities, emerging market bonds and property, but absolute return, insurance linked securities and active currency were small detractors from performance. Pyrford also underperformed, largely due to holdings in equities in high dividend paying defensive sectors.

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	3.5	7.4	3.9	3.6	5.5	1.9
Pyrford	3.5	1.5	-2.0	3.6	4.1	0.5

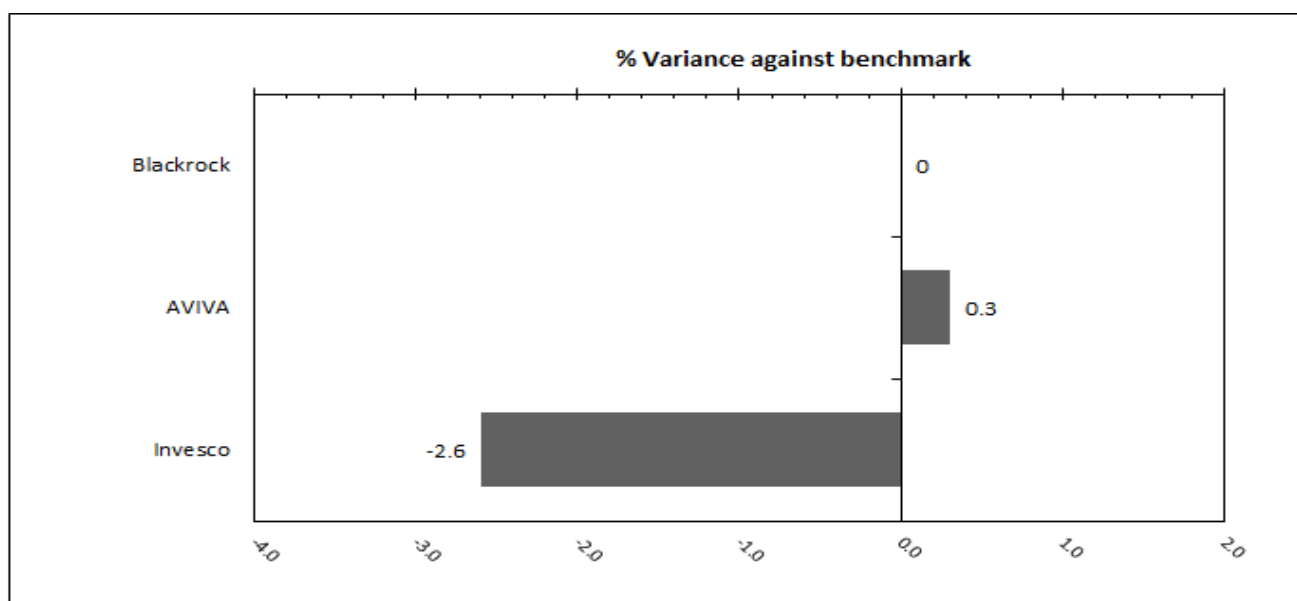
8.3 Both managers outperformed the benchmark during the twelve months ended September 2017 and both outperformed since inception.

## 9. Property Performance

Property Performance for the latest quarter ended 30 September 2017

Manager	Target Allocation	Fund Allocation	Benchmark Return	Fund Return Income	Fund Return Capital	Total Fund Return	Variance
	%	%	%	%	%	%	%
BlackRock	5	4	2.4	0.8	1.6	2.4	0.0
AVIVA	3	2	2.4	1.6	1.1	2.7	0.3
Invesco	2	2	1.9	0.0	-0.7	-0.7	-2.6

- 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 September 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 The UK property market remained resilient during the quarter, as demand for real estate assets, particularly from overseas investors remained robust. Central London shops, Industrials and Alternatives (student accommodation, leisure, healthcare) all recorded significantly higher values, whilst the value of shopping centres and out of town retail remains subdued. Transaction activity across Europe as a whole is down with the focus moving away from the UK, but overseas investors remain active in the Central London office market, accounting for a record share of activity in the quarter.
- 9.3 During the quarter BlackRock matched the benchmark. Their transactions were deliberately very limited during the quarter, as they believe their portfolio is currently well placed and does



not currently require significant re-positioning. AVIVA outperformed the benchmark. The Fund's top performing holdings in the quarter were Industrial Property Investment Fund and AEW South East Office Fund, where performance was driven by capital growth. Other positive contributors to performance were UNITE UK Student Accommodation Fund, The Leisure Fund, THRE UK Property Fund and THRE Central London Office Fund. Invesco's performance is still 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

<b>Manager</b>	<b>Benchmark Return 1 Year</b>	<b>Fund Return 1 Year</b>	<b>Variance</b>	<b>Benchmark Return Since Inception</b>	<b>Fund Return Since Inception</b>	<b>Variance</b>
	%	%	%	%	%	%
RREEF/ BlackRock	9.3	8.8	-0.5	4.4	1.2	-3.2
AVIVA	9.3	8.0	-1.3	8.1	7.8	-0.3

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

#### 10. **Alternatives Performance**

Alternatives Performance for the latest quarter ended 30 September 2017

<b>Manager</b>	<b>Benchmark Allocation</b>	<b>Fund Allocation</b>	<b>Fund Return</b>
	%	%	%
Partner's Group – Infrastructure	5	2.7	9.1
M&G – UK Companies Financing Fund	0	0.2	-21.5

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, when Hymans Robertson undertook a review of Partners Group's performance which was presented to the Committee in March 2017. Their view was 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 capital is still to be drawn down.

- 10.2 M&G's return of -21.5% for the quarter represents a reduction in the value of the fund due to an income distribution of £189k, 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	13.6	9.9
M&G	3.6	4.4

**11. Annualised Rolling 3 Years to 30 September 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	14.5	16.5	13.7	-0.8	-2.8
<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	14.4	17.4	17.7	3.3	0.3
<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	14.4	17.4	12.2	-2.2	-5.2
<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</p>					



<p>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	5.0	1.4	-1.6
<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 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 main detractors.</p>					
Pyrford	3.6	6.6	4.8	1.2	-1.8
<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 and they have yet to return to outperformance.</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

<b>Background documents</b>
Northern Trust Investment Performance Reports

<b>Audit Trail</b>		
Version	Final	Date: 22 November 2017
<b>Consultation with other officers</b>		
Finance	Yes	Lyndsey Gamble
Legal	No	N/A
Equality Impact Assessment?	No	N/A

This page is intentionally left blank