

**London Borough of Merton
Pension Fund Advisory Committee
Date: 07 March 2018**

Subject: Performance of the Pension Fund for the Quarter Ending December 2017

Lead officer: Caroline Holland - Director of Corporate Services

Lead member: Councillor Phillip Jones

Contact officer: Roger Kershaw

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RECOMMENDATION

Members are asked to note the content of this report, in particular, the market values and performance of the total fund and component portfolios for the quarter ending 31 December 2017, attribution of the results and the market environment during the period.

1.0 PURPOSE OF REPORT

- 1.1 To report the investment performance at total fund level, and of the individual fund managers, for the quarter to 31 December 2017.
- 1.2 The report gives the Committee a consistent basis on which to review the performance of the Fund as at 31 December 2017 and provide information to support future actions including periodic rebalancing and review of investment strategy and investment management arrangement.

Reason for Exemption from Disclosure

Information relating to the financial or business affairs of a particular person. (Including the authority holding that information).

2.0 PERFORMANCE REPORT

- 2.1 The attached Fund Analysis & Performance Report (**Appendix 1**) produced by State Street GS Performance Services provides useful analysis and insights of the Pension Fund activity and results for the quarter to 31 December 2017.
- 2.2 The report highlights the performance of the total Fund by asset class compared to the customised benchmark. It also includes comprehensive analysis of the performance of each manager against their specific benchmark and a comparison of performance over longer periods.
- 2.3 At 31 December 2017 the total Fund was valued at £689.1m, up by £27.4m (or 4.2%) since 30 September 2017.

3.0 Market Background/Outlook

- 3.1 Investment markets saw a continued focus on developments within the political sphere globally over the final quarter of 2017, as equities advanced and volatility remained low amidst signs of strong economic growth. Much attention was given to the progress of tax reform through the US Congress in particular, which has been a key priority for the Trump administration. Markets were cheered by clear signs of a legislative package emerging which would have support across the Republican party, and a final deal was passed in December.

Other political events over the quarter received a more mixed response from investors. While there was progress in the ongoing Brexit negotiations between the UK and the Eurozone, talks over the formation of a coalition government broke down in Germany. There was also continuing uncertainty in Catalonia following a disputed referendum over independence from Spain in October. The re-election of Prime Minister Abe in Japan was welcomed by markets however.

A third interest rate increase in 2017 from the US Federal Reserve (Fed) had been widely expected and came as no surprise in December. While the Bank of England (BoE) also moved to increase its base rate in November, further increases are likely to be gradual. In the meantime, other major central banks such as the European Central Bank (ECB) and the Bank of Japan (BoJ) reiterated their commitment to loose monetary policy.

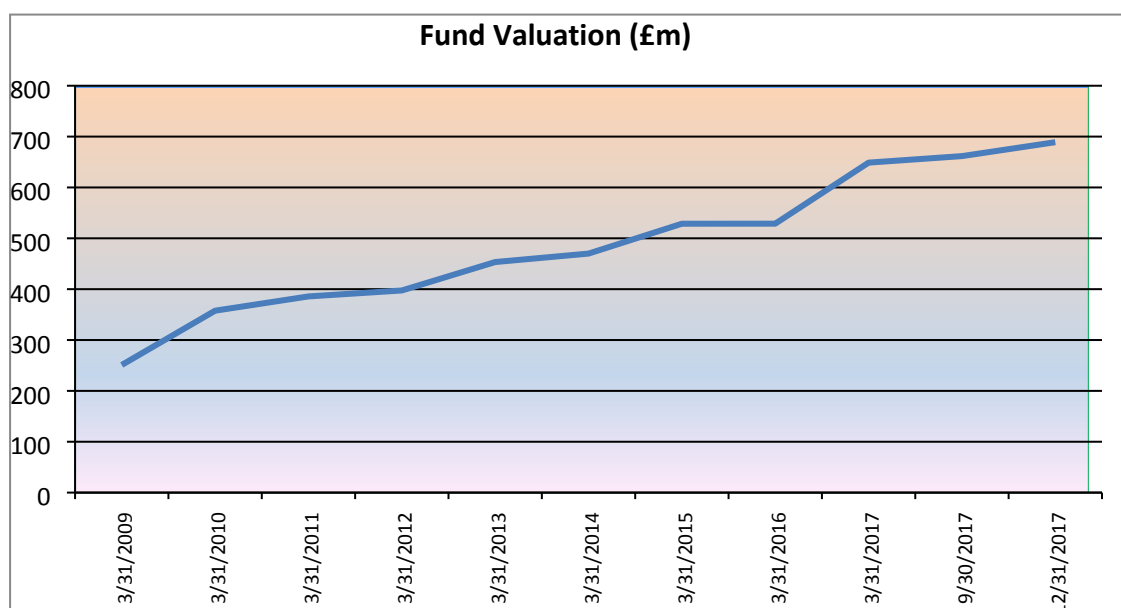
4.0 PERFORMANCE OF THE FUND

- 4.1 The table below shows the Fund's strategic asset allocation as at 31 December 2017 against the asset allocation of the benchmark. The Fund was overweight in Equities and underweight in Bonds and Property compared to the benchmark.

At 31/12/2017	Total Equity %	Total Bonds %	Cash/Alts %	Property %	Total Fund %
Fund Asset Allocation	74.2	22.2	0.3	3.3	100
Fund Benchmark	70.4	24.7	N/A	4.9	100
Difference	3.8	(2.5)	N/A	(1.6)	-

overweight / (underweight)					
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- 4.2 The Fund under performed the benchmark by 0.1% for the quarter ending 31 December 2017. It gained 4.2% compared to the benchmark return of 4.3% for the period.
- 4.3 The 0.1% under performance was due to stock selection. The manager's results are discussed in more detail below in section 5.
- 4.4 The following graph illustrates the Fund's market value trend between 31 March 2009 and 31 December 2017. It shows that the market value of the Fund has appreciated by £438m or 175% over the 8 ¾ yr. periods.



- 4.5 The table below shows the market value of each Portfolio at the start and end of the period. The change in value over the period is a combination of the net money flows into or out of each Portfolio and any gain or loss on the capital value of investments.

<i>Fund</i>	Market Value 30/09/17 £000	Capital Gain/loss £000	Income £000	Market Value 31/12/17 £000	% of Total Fund
UBS Passive Equity	296,517	13,501	704	310,771	46
Aberdeen Fixed Income	149,066	4,380	(115)	153,159	22
Aberdeen Active Equity	125,937	5,010	137	131,102	19
UBS Active Equity	66,950	3,200	222	70,446	10
UBS Property	15,919	305	115	16,125	2
BlackRock Property	7,230	173	41	7,448	1
Total External Fund	661,619	26,569	1,103	689,050	100
Internal Investments	150	-	-	150	-

Total	661,769	26,569	1,103	689,200	100
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4.6 The following table provides detailed analysis of the return on the Fund's investment for the period relative to the benchmark.

Sector	Market Value Sept 17 £000	Market Value Dec 17 £000	Fund Return Dec 2017 %	Benchmark Return Dec 2017 %
UK Equities	287,889	302,864	4.6	5.0
Overseas Equities	199,625	208,263	4.9	4.8
• <i>North America</i>	67,964	72,267	5.6	5.6
• <i>Continental Europe</i>	56,167	56,542	1.6	0.3
• <i>Total Far East</i>	53,802	56,403	7.6	7.7
• <i>Other Intl Equities</i>	21,692	23,051	5.4	6.4
UK Bonds	37,445	38,508	3.4	3.4
Overseas Bonds	36,768	37,388	0.5	0.2
UK Index-Linked	74,713	77,129	3.9	3.9
Cash Alternatives	2,929	2,125	(0.9)	-
Property	22,250	22,773	3.0	3.1
Total	661,619	689,050	4.2	4.3

4.7 The Fund's assets are invested in various sectors and markets globally. During the quarter to 31 December 2017, all asset classes yielded positive returns although not all met the benchmark.

5.0 FUND MANAGER PERFORMANCE

UBS

5.1 UBS manages three portfolios for LB Merton Pension Fund.

(1) UBS Active Global (Equity)

5.2 The market value of the active equity portfolio managed by UBS was £70.4m (£67m in September 2017). During the quarter the manager's performance of 5.1% was in-line with the benchmark.

The table below shows the movement during the period within the portfolio.

<i>UBS Active Equity</i>	30/09/2017		Purchases	Sales	Gain/Loss	Income	31/12/2017	
	£000	%					£000	£000
Total Equities	66,484	99	3,633	3,374	3,200	296	69,943	99
Cash & Cash Alternatives	466	1	7,193	7,157	-	-	503	1
Total	66,950	100	10,826	10,531	3,200	222	70,446	100

The manager's mandate is summarised in the following:

- For the portion of the Active Portfolio invested in UK Equities, the manager shall seek to outperform the benchmark by 1% p.a.
- For the portion of the Active Portfolio invested in Emerging Markets, the manager shall seek to outperform the benchmark by 2.0% p.a.

Performance of the UBS Active Equity over various time periods

<i>Period</i>	<i>Manager</i>	<i>Benchmark</i>	<i>Variance</i>	<i>Comment</i>
	%	%	%	
Last 3 months	5.1	5.1	-	In-line
Last 12 months	12.5	14.2	(1.7)	underperformed
Last 3 years	9.7	10.6	(0.9)	underperformed
Last 5 years	9.6	10.5	(0.9)	underperformed

(2) UBS Global Equity (Passive)

- 5.3 The passive equity portfolio was valued at £310.8m (£296.5m in September 2017). During the quarter the manager's performance of 4.8% underperformed the benchmark of 4.9%.

The table below shows the movement of assets during the quarter.

<i>UBS Passive</i>	Sept 2017		Purchases	Sales	Gain/ Loss	Income	Dec 2017	
	£000	%					£000	£000
UK Equities	163,486	55	3,895	2,583	7,265	741	172,064	55
North America	61,147	21	-	-	3,414	-	64,561	21
Continental Europe	36,681	12	-	-	87	-	36,768	12
Japan	17,592	6	-	250	1,373	-	18,715	6
Total Pacific (ex Japan)	17,812	6	-	250	1,362	-	18,924	6
Cash & Alternatives	(202)	-	3,838	3,895	-	-	(262)	0
Total	296,517	100	7,731	6,978	13,501	704	310,771	100

The manager is to track the Benchmark index over rolling three year periods.

This table shows the performance of the portfolio.

Period	Manager %	Benchmark %	Variance %	Comment
Last 3 months	4.8	4.9	(0.1)	underperformed
Last 12 months	13.6	13.8	(0.2)	underperformed
Last 3 years	12.6	12.7	(0.1)	underperformed
Last 5 years	13.0	13.0	-	In-line

(3) UBS Property Fund

- 5.4 The market value of the property portfolio managed by UBS was £16.1m (£15.9m in September 2017). During the quarter the manager's performance of 2.8% underperformed the benchmark of 3.1%.

The table below shows the movement during the period within the portfolio.

UBS Triton (Property)	30/09/2017		Purchases £000	Sales £000	Gain/Loss £000	Income £000	31/12/2017	
	£000	%					£000	%
Property	15,019	94	1,400	1,400	305	115	15,324	95
Cash & Cash Alternatives	900	6	-	99	-	-	800	5
Total	15,919	100	1,400	1,499	305	115	16,125	100

The manager is to track the Benchmark index over rolling three year periods.

This table shows the performance of the portfolio.

Period	Manager %	Benchmark %	Variance %	Comment
Last 3 months	2.8	3.1	(0.3)	underperformed
Last 12 months	9.5	10.2	(0.7)	underperformed
Last 3 years	8.5	8.4	0.1	outperformed
Last 5 years	8.5	10.3	(1.8)	underperformed

Aberdeen Asset Management

- 5.5 Aberdeen manages two portfolios for the LB Pension Fund.

(1) Aberdeen Active Global Equity

- 5.6 The market value of the active equity portfolio managed by Aberdeen was £131.1m (£125.9m in September 2017). During the quarter the manager's performance of 4.1% underperformed the benchmark of 4.8%.

The following below shows the movement during the period within the portfolio.

Aberdeen Active Equity	30/09/2017		Purchases	Sales	Gain/ Loss	Income	31/12/2017	
	£000	%					£000	£000
UK Equities	67,251	54	5,354	3,891	2,186	261	70,899	54
North America	6,817	5	500	2	391	-	7,706	6
Continental Europe	19,486	16	2,169	2,536	654	11	19,774	15
Japan	10,339	8	550	1,456	811	-	10,244	8
Total Pacific (ex Japan)	8,059	6	-	43	502	-	8,519	6
Other Intl Equities	12,360	10	250	66	465	-	13,009	10
Cash & Alternatives	1,625	1	11,898	12,573	-	1	950	1
Total	125,937	100	20,722	20,567	5,010	137	131,102	100

- 5.7 Although this portfolio is an active mandate, 35% is held in pooled funds. The Manager is required to outperform the benchmark by 1.25% p.a over rolling 3yr periods.

This table shows the performance of the portfolio

Period	Manager %	Benchmark %	Variance %	Comment
Last 3 months	4.1	4.8	(0.7)	underperformed
Last 12 months	14.8	15.9	(1.1)	underperformed
Last 3 years	10.6	12.6	(2.0)	underperformed
Last 5 years	10.0	11.7	(1.7)	underperformed

(2) Aberdeen (Bonds)

- 5.8 The market value of the bonds portfolio was £153.2m (£149.1m in September 2017). During the quarter the manager's performance of 2.9% outperformed the benchmark of 2.8%.

The table below shows the movement during the period within the portfolio.

Aberdeen (Bonds)	30/09/2017		Purchases	Sales	Gain/ Loss	Income	31/12/2017	
	£000	%	£000	£000	£000	£000	£000	%
UK Bonds	37,445	25	1	213	1,274	1	38,508	26
Overseas Bonds	36,768	25	470	20	170	-	37,388	24
UK Index Linked	74,713	50	(1)	519	2,936	(1)	77,129	50
Cash & Alternatives	139	0	752	758	-	-	133	-
Total	149,066	100	1,222	1,509	4,380	(115)	153,159	100

The manager is required to outperform its benchmark by 0.75% p.a. over a rolling three year period.

This table shows the performance of the portfolio.

Period	Manager	Benchmark	Variance	Comment
	%	%	%	
Last 3 months	2.9	2.8	0.1	outperformed
Last 12 months	2.0	1.8	0.2	outperformed
Last 3 years	8.0	8.0	-	In-line
Last 5 Years	7.7	7.9	(0.2)	underperformed

BlackRock (Property)

- 5.9 The market value of the property portfolio managed by Blackrock was £7.5m (£7.2m in September 2017). During the quarter the manager's performance of 3.0% underperformed the benchmark of 3.1%.

The following table below shows the movement in the portfolio during the period.

Blackrock	30/09/2017		Purchases	Sales	Gain/Loss	Income	31/12/2017	
	£000	%	£000	£000	£000	£000	£000	%
Property	7,230	100	45	-	173	60	7,448	100
Cash & Cash Alternatives	-	-	45	45	-	-	-	-
Total	7,230	100	90	45	173	41	7,448	100

The manager is required to outperform the average of similar institutional pooled vehicles by investing in a diversified range of property throughout the UK, principally, but not exclusively, in the retail, office and industrial/warehouse sectors.

This table shows the performance of the portfolio.

Period	Manager	Benchmark	Variance	Comment
	%	%	%	

Last 3 months	3.0	3.1	(0.1)	underperformed
Last 12 months	8.9	10.2	(1.3)	underperformed
Last 3 years	6.3	8.4	(2.1)	underperformed

6. OTHER ISSUES AFFECTING THE FUND

6.1 None

7. FINANCIAL, RESOURCE AND PROPERTY IMPLICATIONS

7.1 All relevant implications are included in the report.

8. LEGAL AND STATUTORY IMPLICATIONS

8.1 All relevant implications are included in the report.

9. HUMAN RIGHTS, EQUALITIES AND COMMUNITY COHESION IMPLICATIONS

9.1 N/A

10. RISK MANAGEMENT AND HEALTH AND SAFETY IMPLICATIONS

10.1 Risk management is an integral part of designing the investment portfolio of the fund particularly in the current volatile economic environment.

11. BACKGROUND PAPERS

11.1 State Street Analytics performance report and individual Fund Managers investment reports.

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