

London Borough of Merton Pension Fund Advisory Committee

Date: 8 March 2017

Agenda item: **3**

Wards: All

Subject: Performance of the Pension Fund for the Quarter Ending December 2016

Lead officer: Caroline Holland Director of Corporate Services

Lead member: Councillor Imran Uddin

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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 2016, 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 2016.
- 1.2 The report gives the Committee a consistent basis on which to review the performance of the Fund as at 31 December 2016 and provide information to support future actions including periodic rebalancing and review of investment strategy and investment management arrangement.

2.0 PERFORMANCE REPORT

- 2.1 The attached Fund Analysis & Performance Report (**Appendix 1**) produced by State Street Performance Services provides useful analysis and insights on the Pension Fund activity and results for the quarter to 31 December 2016.
- 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 2016 the total Fund was valued at £622.4m, up by £13.2m (or 2.2%) since 30 September 2016.

3.0 Market Background/Outlook

3.1 2016 ended with global equities entering a bull market from the low point seen in February. After an initial fall upon the US election results, developed equity markets quickly recovered and advanced on the anticipation of fiscal stimulus under the new Trump administration. The mood was unbroken by Italian referendum voters rejecting proposed constitutional reform and the decision by the US Federal Reserve to increase interest rates in December. The renewed focus on fiscal rather than monetary stimulus helped drive government bond yields higher from the low levels seen during the third quarter. Positive sentiment was further boosted on news of a global agreement to cut supplies of oil, driving prices sharply higher. The resilience of UK economy post-referendum saw an upward revision to the 2016 Q3 GDP from 0.5% to 0.6% reflecting strong growth in the services sector.

4.0 PERFORMANCE OF THE FUND

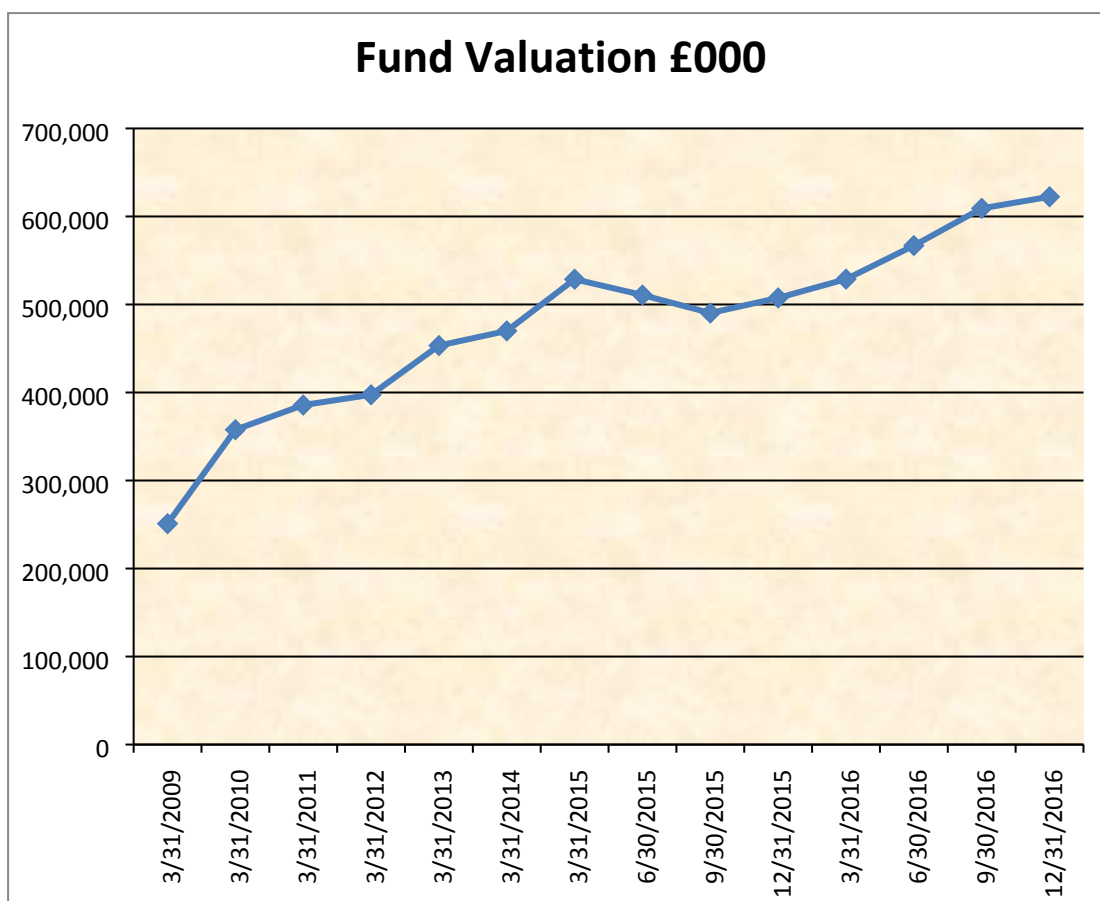
4.1 The table below shows the Fund's strategic asset allocation as at 31 December 2016 against the benchmark allocation. The Fund was overweight in Equities and Bonds and underweight in Property compared to the benchmark.

At 31/12/2016	Total Equity %	Total Bonds %	Cash/Alts %	Property %	Total Fund %
Fund Asset Allocation	72.2	24.2	0.2	3.4	100
Benchmark	71.4	23.6	N/A	5.0	100
Difference overweight / (underweight)	0.8	0.6	N/A	(1.6)	-

4.2 The Fund underperformed the benchmark by 0.3% for the quarter ending 31 December 2016. It gained 2.1% compared to the benchmark return of 2.4% for the period.

4.3 The 0.3% underperformance was due wholly 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 2016. It shows that the market value of the Fund has appreciated by £371m or 148% over the 8 ³/₄ yr. period.



4.5 The table below shows the market value of each portfolio at the start and end of the quarter. 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 30/09/16 £000	Capital Gain/loss £000	Income £000	Market Value 31/12/16 £000	% of Total Fund
UBS Passive Equity	260,290	12,318	556	273,222	44
Aberdeen Fixed Income	155,778	(5,087)	(58)	150,483	24
Aberdeen Active Equity	111,806	2,286	175	114,277	19
UBS Active Equity	59,720	2,285	150	62,328	10
UBS Property	14,917	206	118	15,241	2
BlackRock Property	6,693	68	29	6,807	1
Total External Fund	609,205	12,077	972	622,358	100
Internal Investments	150			150	
Total	609,355			622,508	

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		Fund Return		Benchmark	
	Sept 2016		Dec 2016		Dec 2016	
	£000	£000	%	%		
UK Equities	251,121	264,747	3.7	3.9		
Overseas Equities	178,054	184,413	4.7	5.4		
• <i>North America</i>	61,358	63,627	8.9	9.0		
• <i>Continental Europe</i>	46,736	49,570	3.7	4.8		
• <i>Total Far East</i>	49,830	51,044	2.3	3.0		
• <i>Other Intl Equities</i>	20,130	20,171	0.5	1.4		
UK Bonds	38,175	36,788	(5.4)	(5.6)		
Overseas Bonds	37,307	37,462	(2.4)	(2.3)		
UK Index-Linked	80,271	76,206	(2.6)	(3.0)		
Cash Alternatives	3,347	1,491	(3.8)	-		
Property	20,930	21,251	2.1	2.3		
Total	609,205	622,358				

4.7 The Fund's assets are invested across sectors and markets globally. During the quarter to 31 December 2016, equities and property yielded positive returns albeit below benchmark. Bonds and cash alternatives yielded negative returns.

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 £62.3m (£59.7m in September 2016). During the quarter the manager's return of 4.1% outperformed the benchmark of 3.6%.

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

UBS Active Equity	30/09/2016		Purchases	Sales	Gain/Loss	Income	31/12/2016	
	£000	%					£000	£000
Total Equities	59,143	99	6,927	6,475	2,285	217	61,880	99
Cash & Cash Alternatives	577	1	6,798	6,927	-	0	449	1
Total	59,720	100	13,725	13,402	2,285	150	62,328	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>	Manager %	Benchmark %	Variance %	Comment
Last 3 months	4.1	3.6	0.5	Outperformed
Last 12 months	17.1	19.0	(1.9)	Underperformed
Last 3 years	5.6	6.5	(0.9)	Underperformed
Last 5 years	9.7	10.2	(0.5)	Underperformed

(2) UBS Global Equity (Passive)

- 5.3 The passive equity portfolio was valued at £273.2m (£260.3m in September 2016). During the quarter the manager's performance of 4.9% underperformed the benchmark of 5.0%.

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

<i>UBS Passive</i>	30/09/2016		Purchases	Sales	Gain/ Loss	Income	31/12/2016	
	£000	%	£000	£000	£000	£000	£000	%
UK Equities	143,095	55	7,131	4,429	4,828	583	150,625	55
North America	54,597	21	-	2,000	4,929	-	57,526	21
Continental Europe	30,665	12	-	-	1,491	6	32,156	12
Japan	15,757	6	-	-	814	-	16,571	6
Total Pacific (ex Japan)	16,219	6	-	-	255	-	16,474	6
Cash & Alternatives	(42)	-	7,042	7,131	-	1	(131)	0
Total	260,290	100	14,173	13,560	12,318	556	273,222	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	4.9	5.0	(0.1)	Underperformed
Last 12 months	21.7	21.8	(0.1)	Underperformed
Last 3 years	9.7	9.7	-	In line
Last 5 years	12.7	12.7	-	In line

(3) UBS Property Fund

- 5.4 The market value of the property portfolio managed by UBS was £15.2m (£14.9m in September 2016). During the quarter the manager's performance of 2.2% underperformed the benchmark of 2.3%.

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

UBS Triton (Property)	30/09/2016		Purchases	Sales	Gain/Loss	Income	31/12/2016	
	£000	%	£000	£000	£000	£000	£000	%
Property	14,238	95	-	-	206	118	14,444	95
Cash & Cash Alternatives	680	5	118	-	-	-	797	5
Total	14,917	100	118	-	206	118	15,241	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	2.2	2.3	(0.1)	Underperformed
Last 12 months	2.5	2.8	(0.3)	Underperformed
Last 3 years	11.6	10.7	0.9	outperformed
Last 5 years	6.3	8.2	(1.9)	Underperformed

Aberdeen Asset Management

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

(1) Aberdeen Active Global Equity

- 5.6 The market value of the active equity portfolio managed by Aberdeen was £114.3m (£111.8m in September 2016). During the quarter the manager's performance of 2.2% underperformed the benchmark of 3.8%.

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

<i>Aberdeen Active Equity</i>	30/09/2016		Purchases	Sales	Gain/Loss	Income	31/12/2016	
	£000	%	£000	£000	£000	£000	£000	%
UK Equities	56,327	51	4,583	2,611	1,557	235	59,856	52
North America	6,761	6	-	1,142	482	-	6,101	5
Continental Europe	16,071	14	2,359	1,240	223	29	17,414	15
Japan	9,932	9	1,140	1,041	113	-	10,144	9
Total Pacific (ex Japan)	7,923	7	-	41	(27)	-	7,855	7
Other Intl Equities	12,686	11	-	66	(63)	-	12,558	11
Cash & Alternatives	2,107	2	9,206	10,964	-	1	350	0
Total	111,806	100	17,288	17,103	2,286	175	114,277	100

5.7 Although this portfolio is an active mandate, 36% 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	2.2	3.8	(1.6)	underperformed
Last 12 months	19.6	21.1	(1.5)	underperformed
Last 3 years	6.6	8.3	(1.7)	underperformed
Last 5 years	9.8	11.1	(1.3)	underperformed

(2) Aberdeen (Bonds)

5.8 The market value of the bonds portfolio was £150.5m (£155.8m in September 2016). During the quarter the manager's performance of -3.3% outperformed the benchmark of -3.5%.

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

<i>Aberdeen (Bonds)</i>	30/09/2016		Purchases	Sales	Gain/Loss	Income	31/12/2016	
	£000	%	£000	£000	£000	£000	£000	%
UK Bonds	38,175	25	742	15	(2,113)	36	36,788	24
Overseas Bonds	37,307	24	1,104	20	(928)	-	37,462	25
UK Index Linked	80,271	52	1	2,020	(2,046)	1	76,206	51
Cash & Alternatives	25	0	2,055	2,054	-	-	26	0
Total	155,778	100	3,902	4,110	(5,087)	(58)	150,483	100

The manager is required to outperform its benchmark by 0.60% p.a. over a rolling three year period.

This table shows the performance of the portfolio.

Period	Manager %	Benchmark %	Variance	Comment
Last 3 months	(3.3)	(3.5)	0.2	Outperformed
Last 12 months	23.2	23.5	(0.3)	Underperformed
Last 3 years	13.1	13.4	(0.3)	Underperformed
Last 5 Years	7.8	7.9	(0.1)	Underperformed

BlackRock (Property)

5.9 The market value of the property portfolio managed by BlackRock was £6.8m (£6.7m in September 2016). During the quarter the manager's performance of 1.5% underperformed the benchmark of 2.3%.

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

<i>Blackrock</i>	30/09/2016		Purchases £000	Sales £000	Gain/Loss £000	Income £000	31/12/2016	
	£000	%					£000	%
Property	6,693	100	46	-	68	46	6,807	100
Cash & Cash Alternatives	-	-	46	46	-	-	0	0
Total	6,693	100	93	46	68	29	6,807	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	1.5	2.3	(0.8)	underperformed
Last 12 months	0.8	2.8	(2.0)	underperformed
Last 3 years	8.0	10.7	(2.7)	underperformed

6. OTHER ISSUES AFFECTING THE FUND

6.1 Review of the pension fund investment strategy and investment management arrangements is in progress. This is the subject of a separate report to this meeting.

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 StateStreet Analytics performance report and individual Fund Managers investment reports.

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