

**London Borough of Merton**  
**Pension Fund Advisory Committee**  
**Date: 1 December 2016**

Agenda item: **3**

Wards: All

**Subject: Performance of the Pension Fund for the Quarter Ending 30<sup>th</sup> September 2016**

Lead officer: Caroline Holland Director of Corporate Services

Lead member: Councillor Imran Uddin

Contact officer: Paul Dale

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## **RECOMMENDATION**

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 30 September 2016, attribution of the results and the market environment during the period.

## **1. PURPOSE OF REPORT**

- 1.1 The purpose of this report is to inform this Committee about the investment performance of LB Merton Pension Fund at total fund level, and of the individual fund managers, for the quarter to 30 September 2016.
- 1.2 The report gives the Committee a consistent basis on which to review the performance of the Fund as at 30 September 2016 and useful background to support future decisions and actions including periodic rebalancing, review of investment strategy and investment management arrangement.

## **2. 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 30 September 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 30 September 2016 the total Fund was valued at £609.2m up by £42.3m (or 7.5%) since 30 June 2016.

### 3. Market Background/Outlook

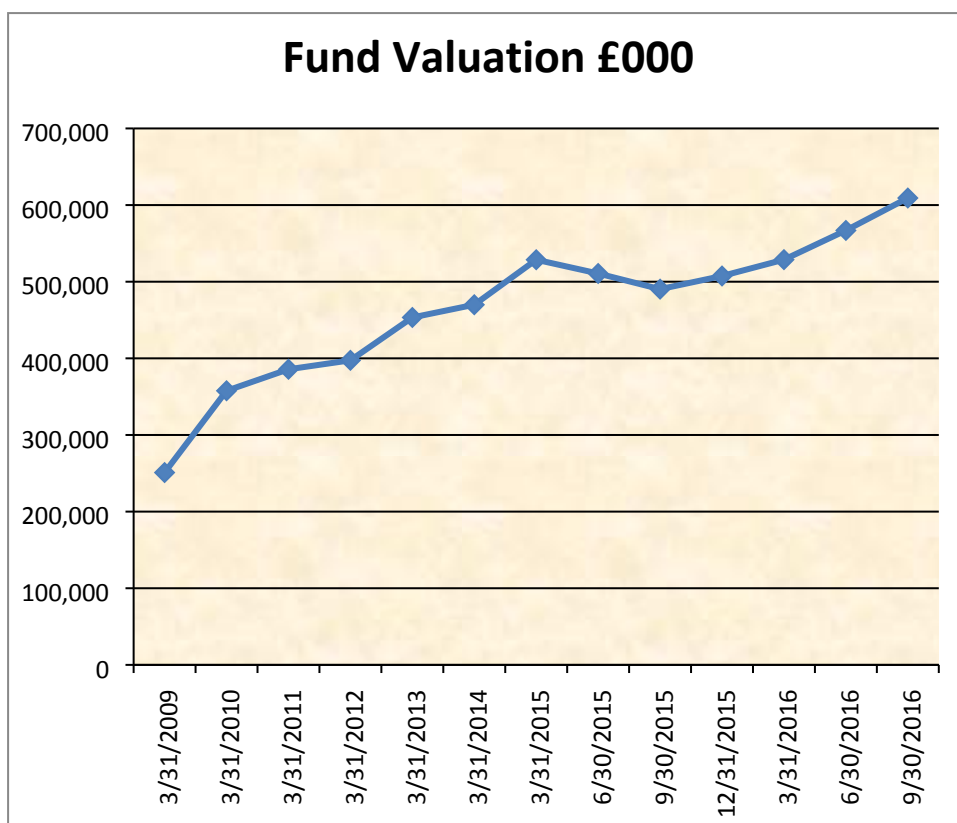
- 3.1 The strong rally in markets for risky assets at the end of June, following the initial falls in the immediate aftermath of UK's decision to leave the European Union, continued for much of the second quarter (1 July – 30 September). Central banks' actions remained in the spotlight over the period. In August, the Bank of England's attempt to mitigate the risks posed by the Brexit vote was well received by equity markets. However, sentiments were mixed on the prospect of a rate rise by the US Federal Reserve (The Fed) in September. In the end the FED decided to leave rates unchanged.
- 3.2 Global equity markets had a good quarter, continuing the strong rebound seen from turbulent period after the vote for Brexit. By contrast, returns on other assets were more subdued, with government bond yields advancing in September after falling earlier in the quarter on the prospect of further central bank support.

### 4.0 PERFORMANCE OF THE FUND

- 4.1 The table below shows the Fund's strategic asset allocation as at 30 September 2016 against the asset allocation of the benchmark. The Fund was in line with Equities, overweight Bonds and underweight Property compared to the benchmark.

At 30/09/2016	Total Equity %	Total Bonds %	Cash/Alts %	Property %	Total Fund %
<b>Fund Asset Allocation</b>	70.4	25.7	0.5	3.4	100
<b>Benchmark</b>	70.4	25.0	N/A	4.6	100
<b>Difference overweight / (underweight)</b>	-	0.6	N/A	(1.2)	-

- 4.2 The Fund underperformed the benchmark by 0.4% for the quarter ending 30 September 2016. It gained 7.5% compared to the benchmark return of 7.9% for the period.
- 4.3 The 0.4% 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 30 September 2016. It shows that the market value of the Fund has appreciated by £358m or 143% over the 8 ½-yr period.



- 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>	<b>Market Value 1/07/16 £000</b>	<b>Capital Gain/loss £000</b>	<b>Income £000</b>	<b>Market Value 30/09/16 £000</b>	<b>% of Total Fund</b>
<b>UBS Passive Equity</b>	240,318	18,998	929	260,290	43
<b>Aberdeen Fixed Income</b>	144,913	10,610	488	155,778	26
<b>Aberdeen Active Equity</b>	104,412	7,002	424	111,806	18
<b>UBS Active Equity</b>	55,208	4,024	424	59,720	10
<b>UBS Property</b>	15,212	(333)	130	14,917	2
<b>BlackRock Property</b>	6,846	(196)	27	6,693	1
<b>Total External Fund</b>	<b>566,908</b>	<b>40,104</b>	<b>2,422</b>	<b>609,205</b>	<b>100</b>
<b>Internal Investments</b>	150			150	
<b>Total</b>	<b>567,058</b>			<b>609,355</b>	

- 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	Market Value	Fund Return	Benchmark
	June 2016 £000	Sept 2016 £000	Sept 2016 %	Sept 2016 %
UK Equities	236,199	251,121	7.2	7.8
Overseas Equities	162,460	178,054	9.2	9.6
• North America	57,330	61,358	7.0	7.1
• Continental Europe	43,709	46,736	9.0	9.1
• Total Far East	44,759	49,830	11.4	12.3
• Other Intl Equities	16,662	20,130	11.3	11.9
UK Bonds	35,952	38,175	5.5	5.8
Overseas Bonds	36,191	37,307	4.0	3.8
UK Index-Linked	72,769	80,271	10.7	11.0
Cash Alternatives	1,922	3,347	(0.2)	-
Property	21,416	20,930	(1.7)	(0.7)
Total	566,908	609,205		

- 4.7 The Fund's assets are diversified across global markets. During the quarter to September 2016, all investments (with the exception of Property) performed well and yielded positive returns.

## 5. 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 £59.7m (£55.2m in June 2016). The portfolio return was 8.0% for the period, being below the benchmark return of 8.3%.

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

UBS Active Equity	30/06/2016		Purchases	Sales	Gain/Loss	Income	30/09/2016	
	£000	%	£000	£000	£000	£000	£000	%
Total Equities	54,824	99	5,473	5,177	4,024	489	59,143	99
Cash & Cash Alternatives	384	1	5,666	5,473	-	-	577	1
Total	55,208	100					59,720	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>	<b>Manager</b> %	<b>Benchmark</b> %	<b>Variance</b> %	<b>Comment</b>
<b>Last 3 months</b>	8.0	8.3	(0.3)	underperformed
<b>Last 12 months</b>	16.9	19.2	(2.3)	underperformed
<b>Last 3 years</b>	5.7	6.8	(1.1)	underperformed
<b>Last 5 years</b>	10.6	10.8	(0.2)	underperformed

## (2) UBS Global Equity (Passive)

- 5.3 The passive equity portfolio was valued at £260.3m (£240.3m in June 2016). During the quarter the manager's performance of 8.3% matched the benchmark return of 8.3%.

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

<b>UBS Passive</b>	<b>30/06/2016</b>		<b>Purchases</b>	<b>Sales</b>	<b>Gain/ Loss</b>	<b>Income</b>	<b>30/09/2016</b>	
	<b>£000</b>	<b>%</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>%</b>
<b>UK Equities</b>	132,127	55	5,707	3,989	9,249	962	143,095	55
<b>North America</b>	50,988	21	-	-	3,609	-	54,597	21
<b>Continental Europe</b>	28,104	12	-	-	2,561	-	30,665	12
<b>Japan</b>	14,423	6	-	400	1,734	-	15,757	6
<b>Total Pacific (ex Japan)</b>	14,975	6	-	600	1,844	-	16,219	6
<b>Cash &amp; Alternatives</b>	(299)	-	5,964	5,707	-	1	(42)	-
<b>Total</b>	<b>240,318</b>	<b>100</b>	<b>11,671</b>	<b>10,696</b>	<b>18,998</b>	<b>929</b>	<b>260,290</b>	<b>100</b>

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

This table shows the performance of the portfolio.

<b>Period</b>	<b>Manager</b> %	<b>Benchmark</b> %	<b>Variance</b> %	<b>Comment</b>
Last 3 months	8.3	8.3	-	In line
Last 12 months	23.1	23.2	(0.1)	underperformed
Last 3 years	9.9	9.9	-	In line
Last 5 years	13.4	13.3	0.1	outperformed

### (3) UBS Property Fund

- 5.4 The market value of the property portfolio managed by UBS was £14.9m (£15.2m in June 2016). The portfolio return was -1.3% during the quarter, compared to the benchmark return of -0.7%.

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

<b>UBS Triton (Property)</b>	<b>30/06/2016</b>		<b>Purchases</b>	<b>Sales</b>	<b>Gain/Loss</b>	<b>Income</b>	<b>30/09/2016</b>	
	<b>£000</b>	<b>%</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>%</b>
<b>Property</b>	14,570	96	-	-	(333)	130	14,238	95
<b>Cash &amp; Cash Alternatives</b>	642	4	38	-	-	-	680	5
<b>Total</b>	<b>15,212</b>	<b>100</b>	<b>38</b>	<b>-</b>	<b>(333)</b>	<b>130</b>	<b>14,917</b>	<b>100</b>

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

This table shows the performance of the portfolio.

<b>Period</b>	<b>Manager</b>	<b>Benchmark</b>	<b>Variance</b>	<b>Comment</b>
	<b>%</b>	<b>%</b>	<b>%</b>	
<b>Last 3 months</b>	(1.3)	(0.7)	(0.6)	underperformed
<b>Last 12 months</b>	3.4	3.4	-	In line
<b>Last 3 years</b>	12.5	11.4	1.1	outperformed
<b>Last 5 years</b>	6.2	7.9	(1.7)	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 £111.8m (£104.4m in June 2016). The portfolio return was 7.1% during the quarter, compared to the benchmark of 9.0%.

The table below shows the portfolio movement during the period.

<b>Aberdeen Active Equity</b>	<b>30/06/2016</b>		<b>Purchases</b>	<b>Sales</b>	<b>Gain/ Loss</b>	<b>Income</b>	<b>30/09/2016</b>	
	<b>£000</b>	<b>%</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>%</b>
<b>UK Equities</b>	55,739	53	2,395	4,488	2,681	474	56,327	51
<b>North America</b>	6,342	6	-	2	420	-	6,761	6
<b>Continental Europe</b>	15,605	15	801	1,646	1,310	36	16,071	14
<b>Japan</b>	8,093	8	1,974	1,010	875	-	9,932	9
<b>Total Pacific (ex Japan)</b>	7,268	7	-	39	694	-	7,923	7
<b>Other Intl Equities</b>	10,172	10	1,553	60	1,022	-	12,686	11
<b>Cash &amp; Alternatives</b>	1,193	1	12,709	11,795	-	1	2,107	2
<b>Total</b>	<b>104,412</b>	<b>100</b>	<b>19,432</b>	<b>19,040</b>	<b>7,002</b>	<b>424</b>	<b>111,806</b>	<b>100</b>

- 5.7 Although this portfolio is an active mandate, 38% 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

<b>Period</b>	<b>Manager %</b>	<b>Benchmark %</b>	<b>Variance %</b>	<b>Comment</b>
<b>Last 3 months</b>	7.1	9.0	(1.8)	underperformed
<b>Last 12 months</b>	21.9	23.0	(1.1)	underperformed
<b>Last 3 years</b>	6.8	8.4	(1.6)	underperformed
<b>Last 5 years</b>	11	11.6	(0.6)	underperformed

## (2) Aberdeen (Bonds)

- 5.8 The market value of the bonds portfolio was £155.8m (£144.9m in June 2016). The portfolio return was 7.7% during the quarter, compared to the benchmark of 7.9%.

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

<b>Aberdeen (Bonds)</b>	<b>30/06/2016</b>		<b>Purchases</b>	<b>Sales</b>	<b>Gain/ Loss</b>	<b>Income</b>	<b>30/09/2016</b>	
	<b>£000</b>	<b>%</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>%</b>
<b>UK Bonds</b>	35,952	25	463	16	1,777	222	38,175	25
<b>Overseas Bonds</b>	36,191	25	-	319	1,435	-	37,307	24
<b>UK Index Linked</b>	72,769	50	291	187	7,398	364	80,271	52
<b>Cash &amp; Alternatives</b>	2	-	820	796	-	-	25	0
<b>Total</b>	<b>144,913</b>	<b>100</b>	<b>1,573</b>	<b>1,318</b>	<b>10,610</b>	<b>488</b>	<b>155,778</b>	<b>100</b>

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	7.7	7.9	(0.2)	underperformed
Last 12 months	25.6	25.9	(0.3)	underperformed
Last 3 years	13.9	14.2	(0.3)	underperformed
Last 5 Years	10.0	10.1	(0.1)	underperformed

### BlackRock (Property)

5.9 The market value of the property portfolio managed by BlackRock was £6.7m (£6.8m in June 2016). The return on the portfolio was -2.5%, compared to benchmark return of -0.7%.

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

<i>Blackrock</i>	30/06/2013 £000 %	Purchases £000	Sales £000	Gain/Loss £000	Income £000	30/09/2016 £000 %
Property	6,846 100	43	-	(196)	43	6,693 100
Cash & Cash Alternatives	- -	43	43	-	-	- -
Total	6,846 100	86	43	(196)	27	6,693 100

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	(2.5)	(0.7)	(1.8)	underperformed
Last 12 months	1.4	3.4	(2.0)	underperformed
Last 3 years	9.1	11.4	(2.3)	underperformed

## 6. OTHER ISSUES AFFECTING THE FUND

6.1 Review of the pension fund investment strategy and investment management arrangement is on-going and 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. APPENDICES**

1. State Street Analytics performance report (1<sup>st</sup> July – 30<sup>th</sup> September 2016)

## **12. BACKGROUND PAPERS**

12.1 State Street Analytics performance report and individual fund managers' investment reports.

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