

# London Borough of Merton Pension Fund **Agenda Item 4**

## **Advisory Committee Date: 8<sup>th</sup> March 2016**

**Subject: Performance of the Pension Fund for the Quarter Ending December 2015**

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 2015, attribution of the results and the market environment during the period.

Members are also asked to note that Aberdeen Asset Management has been invited to attend this meeting to give a presentation to the Committee on their portfolio activity and results. The presentation material is provided under a separate covering report to this meeting and Members will be able to probe the fund manager at the meeting.

### **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 2015.
- 1.2 The purpose of this report is to give the Committee a basis on which to review the performance of the Fund as at 31 December 2015 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 WM Performance Services provides useful analysis and insights of the Pension Fund activity and results for the quarter to 31 December 2015.
- 2.2 The report highlights the performance of the total Fund by asset class against 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 2015 the total Fund was valued at £517.0m (includes internal cash deposits) up by £21.7m (or 4.4%) since 30 September 2015.

### 3.0 Market Background/Outlook

3.1 The final quarter of the calendar year was characterised by volatility exacerbated by crashing commodity prices, falling Chinese market and historically low oil prices. It brought with it much anticipated divergence in monetary policies pursued by the central banks of the major developed markets. In December 2015, the Federal Reserve (Fed) raised interest rates for the first time in almost nine years, increasing the target range for its federal funds rate by 0.25%, to 0.25-0.50%. The move, largely priced in by markets, was taken as a sign of the Fed's confidence in the health of the US economy. Meanwhile, other central banks including the European Central Bank, the Bank of Japan and the Swiss National Bank maintained quantitative easing.

3.2 Concerns about the Chinese economy were more subdued over the three months to the end of December compared with the previous quarter, when the actions of the People's Bank of China to further liberalise its currency and the sharp price movements in the domestic A-share market weighed heavily on sentiment.

3.3 Emerging market economies continued to face challenging headwinds, particularly Brazil and Russia, which endured pressure from commodity price weakness.

### 4.0 PERFORMANCE OF THE FUND

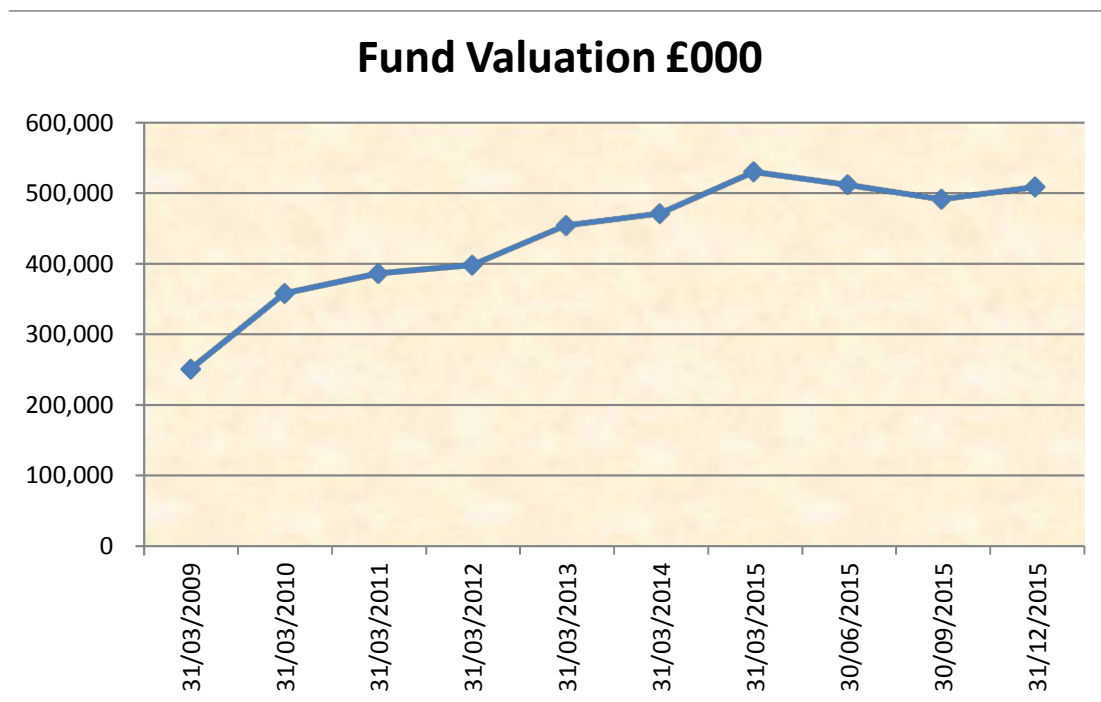
4.1 The table below shows the Fund's strategic asset allocation as at 31 December 2015 against the asset allocation of the benchmark. The Fund was overweight Equity and Bonds and underweight Property compared to the benchmark.

At 31/12/2015	Total Equity %	Total Bonds %	Cash/Alts %	Property %	Total Fund %
<b>Fund Asset Allocation</b>	72.4	24.2	0.2	3.3	100.0
<b>Fund Benchmark</b>	71.3	23.8	N/A	5.0	100.0
<b>Difference overweight / (underweight)</b>	1.1	0.4	N/A	(1.7)	

4.2 The Fund underperformed the benchmark by 0.2% for the quarter ending 31 December 2015. It gained 3.5% compared to the benchmark return of 3.7% for the period. Year-to-date, the Fund underperformed the benchmark by 0.9%. The return for the year was 1.5% and 2.4% for the Fund and benchmark respectively.

4.3 The 0.2% underperformance was wholly due to stock selection decisions in the equities portfolio managed by Aberdeen Asset Management. The manager's results are discussed in more detail below in paragraph 5.6.

4.4 The graph below illustrates the Fund's market value trend between 31 March 2009 and 31 December 2015. It shows that the market value of the Fund has appreciated by £256m or 102.2% over the 7¾ 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 30/09/15 £000</b>	<b>Capital Gain/loss £000</b>	<b>Income £000</b>	<b>Market Value 31/12/15 £000</b>	<b>% of Total Fund</b>
<b>UBS Passive Equity</b>	206,405	12,294	502	219,227	43
<b>Aberdeen Fixed Income</b>	124,352	-2,538	700	122,437	24
<b>Aberdeen Active Equity</b>	91,761	3,527	332	95,614	19
<b>UBS Active Equity</b>	50,856	1,789	191	52,892	10
<b>UBS Property</b>	10,408	217	99	10,620	2
<b>BlackRock Property</b>	6,512	108	26	6,662	1
<b>Total External Fund</b>	<b>490,294</b>	<b>15,397</b>	<b>1,851</b>	<b>507,453</b>	<b>100</b>
<b>Internal Cash from Contributions</b>	5,000			9,580	
<b>Total</b>	<b>495,294</b>			<b>517,033</b>	

4.6 The Fund's assets are invested in various sectors and markets globally. During the quarter to December 2015, equities (in contrast to the previous quarter) made positive gains. On aggregate, fixed income investments yielded negative returns.

4.7 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
	Sept 2015 £000	Dec 2015 £000	Dec 2015 %	Dec 2015 %
<b>UK Equities</b>	210,133	218,026	3.6	4.0
<b>Overseas Equities</b>	138,171	149,150	8.2	8.2
• <i>North America</i>	49,221	52,395	8.8	9.0
• <i>Continental Europe</i>	38,529	40,944	6.8	6.3
• <i>Total Far East</i>	36,916	40,755	10.2	11.0
• <i>Other Intl Equities</i>	13,505	15,055	4.8	3.3
<b>UK Bonds</b>	31,325	30,640	-1.3	-1.5
<b>Overseas Bonds</b>	31,137	31,624	2.1	1.8
<b>UK Index-Linked</b>	61,856	60,163	-3.3	-3.3
<b>Cash Alternatives</b>	1,347	1,157	-1.1	N/A
<b>Property</b>	16,326	16,693	2.9	2.8
<b>Total</b>	<b>490,294</b>	<b>507,453</b>	<b>100</b>	<b>100</b>

## 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 £52.9m (Sept 2015 £50.9m). The portfolio return was 3.9% for the period, marginally ahead of the benchmark return of 3.8%.

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

UBS Active Equity	30/09/2015		Purchases £000	Sales £000	Gain/Loss £000	Income £000	31/12/2015	
	£000	%					£000	%
<b>Total Equities</b>	50,517	99	1,543	1,515	1,789	248	52,334	99
<b>Cash &amp; Cash Alternatives</b>	339	1	1,785	1,565	(1)	0	558	1
<b>Total</b>	<b>50,856</b>	<b>100</b>	<b>3,328</b>	<b>3,081</b>	<b>1,789</b>	<b>191</b>	<b>52,892</b>	<b>100</b>

The manager's mandate is summarised below:

- 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

<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>	3.9	3.8	0.1	outperformed
<b>Last 12 months</b>	0.2	-0.5	0.7	outperformed
<b>Last 3 years</b>	6.3	6.6	-0.3	underperformed
<b>Last 5 years</b>	4.7	5.0	-0.3	underperformed

### (2) UBS Global Equity (Passive)

5.3 The passive equity portfolio was valued at £219.2m (£206.4m Sept 2015). During the quarter the manager's performance of 6.2% was identical to the benchmark.

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

<b>UBS Passive</b>	<b>30/09/2015</b>		<b>Purchases</b>	<b>Sales</b>	<b>Gain/ Loss</b>	<b>Income</b>	<b>31/12/2015</b>	
	<b>£000</b>	<b>%</b>					<b>£000</b>	<b>£000</b>
<b>UK Equities</b>	114,377	55	3,096	1,557	4,060	529	119,977	55
<b>North America</b>	43,487	21	0	1,000	3,930	0	46,417	21
<b>Continental Europe</b>	24,555	12	0	0	1,539	0	26,093	12
<b>Japan</b>	12,481	6	0	0	1,559	0	14,038	6
<b>Total Pacific (ex Japan)</b>	11,678	6	0	0	1,210	0	12,888	6
<b>Cash &amp; Alternatives</b>	-173	0	3,999	4,011	-1	1	-186	0
<b>Total</b>	<b>206,405</b>	<b>100</b>	<b>7,096</b>	<b>6,567</b>	<b>12,294</b>	<b>502</b>	<b>219,227</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>	
Last 3 months	6.2	6.2	0	In line
Last 12 months	3.3	3.3	0	In line
Last 3 years	10.0	9.9	0.1	outperformed
Last 5 years	7.5	7.5	0	In line

### (3) UBS Property Fund

- 5.4 The market value of the property portfolio managed by UBS was £10.6m (£10.4m in Sept 2015). The portfolio return was 3.1% during the quarter, compared to the benchmark return of 2.8%.

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

<i>UBS Triton (Property)</i>	30/09/2015		Purchases	Sales	Gain/Loss	Income	31/12/2015	
	£000	%	£000	£000	£000	£000	£000	%
<b>Property</b>	9,813	94	0	0	217	99	10,031	94
<b>Cash &amp; Cash Alternatives</b>	595	6	79	84	0	0	589	6
<b>Total</b>	<b>10,408</b>	<b>100</b>	<b>79</b>	<b>84</b>	<b>217</b>	<b>99</b>	<b>10,620</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.

Period	Manager %	Benchmark %	Variance %	Comment
<b>Last 3 months</b>	3.1	2.8	0.2	outperformed
<b>Last 12 months</b>	13.7	12.5	1.1	outperformed
<b>Last 3 years</b>	12.8	12.9	-0.01	underperformed
<b>Last 5 years</b>	7.5	9.0	-1.3	underperformed

### Aberdeen Asset Management

- 5.5 Aberdeen manages two portfolios for the LB Pension Fund. The manager has been invited to attend this meeting to present to Members.

#### (1) Aberdeen Active Global Equity

- 5.6 The market value of the active equity portfolio managed by Aberdeen was £95.6m (Sept 2015 £91.8m). The portfolio gained 4.2% during the quarter, significantly underperforming the benchmark of 5.5%. The underperformance was a drag on the total Fund result.

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

<i>Aberdeen Active Equity</i>	30/09/2015		Purchases	Sales	Gain/Loss	Income	31/12/2015	
	£000	%	£000	£000	£000	£000	£000	%
<b>UK Equities</b>	50,492	55	752	855	874	270	51,264	54
<b>North America</b>	5,734	6	200	350	394	2	5,978	6
<b>Continental Europe</b>	13,974	15	695	851	1,033	35	14,851	16
<b>Japan</b>	7,284	8	8,145	8,095	725	27	8,059	8
<b>Total Pacific (ex Japan)</b>	5,473	6	100	0	197	29	5,770	6

<b>Other Intl Equities</b>	8,251	9	950	0	304	43	9,505	10
<b>Cash &amp; Alternatives</b>	552	1	20,147	20,512	-1	1	186	0
<b>Total</b>	<b>91,761</b>	<b>100</b>	<b>30,989</b>	<b>30,663</b>	<b>3,527</b>	<b>332</b>	<b>95,614</b>	<b>100</b>

5.7 Although this portfolio is an active mandate 34% 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	4.2	5.5	-1.2	under Performed
Last 12 months	-1.5	1.8	-3.3	under Performed
Last 3 years	5.4	7.4	-1.9	under Performed
Last 5 years	5.4	5.3	0.2	outperformed

## (2) Aberdeen (Bonds)

5.8 The market value of the bonds portfolio was £122.4m (Sept 2015 £124.4m). The return on the portfolio was -1.5% for the period marginally better than the -1.6% achieved by the benchmark.

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

Aberdeen (Bonds)	30/09/2015		Purchases £000	Sales £000	Gain/ Loss £000	Income £000	31/12/2015	
	£000	%					£000	%
UK Bonds	31,325	25	919	502	-1,102	689	30,640	25
Overseas Bonds	31,137	25	0	151	638	16	31,624	26
UK Index Linked	61,856	50	381	0	-2,074	33	60,163	49
Cash & Alternatives	34	0	1,276	1,300	0	0	9	0
<b>Total</b>	<b>124,352</b>	<b>100</b>	<b>2,576</b>	<b>1,952</b>	<b>-2,538</b>	<b>700</b>	<b>122,437</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	-1.5	-1.6	0.1	outperformed
Last 12 months	0.1	0	0	In line
Last 3 years	4.9	5.1	-0.2	underperformed
Last 5 Years	6.6	7.0	-0.4	underperformed

## BlackRock (Property)

- 5.10 The market value of the property portfolio managed by Blackrock was £6.7m (Sept 2015 £6.5m). The return on the portfolio was 2.1% compared to benchmark return of 2.8%.

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

<b>Blackrock</b>	<b>30/09/2015</b>		<b>Purchases</b>	<b>Sales</b>	<b>Gain/Loss</b>	<b>Income</b>	<b>31/12/2015</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>	6,512	100	42	0	108	42	6,662	100
<b>Cash &amp; Cash Alternatives</b>	0	0	42	42	0	0	0	0
<b>Total</b>	<b>6,512</b>	<b>100</b>	<b>84</b>	<b>42</b>	<b>108</b>	<b>26</b>	<b>6,662</b>	<b>100</b>

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.

<b>Period</b>	<b>Manager %</b>	<b>Benchmark %</b>	<b>Variance %</b>	<b>Comment</b>
<b>Last 3 months</b>	2.1	2.8	-0.8	underperformed
<b>Last 12 months</b>	9.4	12.5	-2.7	underperformed

## 6. OTHER ISSUES AFFECTING THE FUND

- 6.1 Review of the pension fund investment strategy and investment management arrangements is proposed. A draft Pension Fund Business Plan and draft PFAC Work Programme are the subjects of separate reports 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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