Investment Strategy and Fund Manager Performance (Part I)	

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Papers with this report	Northern Trust Performance Report

SUMMARY

This report provides an overview of fund performance and asset allocation as at 30 September 2016 as well as an update on recent investment decisions and progress of the London CIV.

The total size of the fund is £890m at 30 September 2016 an increase from £845m at the end of last quarter.

The overall investment return of the fund in the quarter was 5.96%, giving rise to relative out-performance of the benchmark by 0.77%.

Included with this report is the Northern Trust performance report and in Part II there is an update on each Fund Manager and detailed current market backdrop. These papers all form background reading to inform Committee and to aid discussion.

RECOMMENDATIONS

It is recommended that Pensions Committee:

1. **Discuss the Fund performance update and agree any required decisions in respect of mandates or Fund Managers;**
2. **Delegate the implementation of any decisions to the Officer and Advisor - Investment Strategy Group;**
3. **Note the follow up activity to previous investment decisions and progress in the development of the London CIV.**

INFORMATION

1. **Fund Performance**

Over the last quarter, the Fund returned 5.96% against the fund benchmark of 5.16% resulting in an outperformance for the quarter. The value of the Fund increased by £45m bringing the fund balance to £890m as at 30 September 2016.

Period of measurement	Fund Return %	Benchmark %	Absolute Performance
Quarter	5.96	5.16	+0.80
1 Year	17.19	15.78	+1.41

3 Year	9.00	8.59	+0.41
5 Year	10.22	9.56	+0.66
Since Inception (09/1995)	7.07	6.94	+0.13

The most notable outperformance on investments in the quarter were produced by the LCIV Ruffer DGF fund and UK Value Equities held by UBS, with the biggest underperformance by Newton Global Income Equities.

Outperformance over a one year rolling period of 17.19% compared to the benchmark of 15.78%, is in part from the over performance of Ruffer and Macquarie.

During the quarter £7.6m was withdrawn from Newton to fund the rebalancing of property investments as outlined in the September Committee, increasing the holding in AEW. Income distributions through Private Equity and M&G were used to fund the committed investment in Infrastructure, bringing the total funding of Macquarie to 73% of the total value committed on inception in September 2010.

2. Market and Financial climate overview

The quarter ending September 2016 saw a sharp rebound in UK equities following the initial downward reaction to the Brexit vote. This was partly as a result of the stimulus package announced by the Bank of England, which included reducing the base rate to an historic low of 0.25%, increasing its purchase of gilts by £60bn and introducing and additional £10bn purchase of corporate bonds. Markets also acknowledged the triggering of Article 50, the legal mechanism for withdrawing a member state from the EU, would not take place until March 2017, after which there would be a further two years of negotiations before for the UK would leave the EU.

Despite the negative economic forecasts post Brexit, the economy has performed better than expected. The first estimate Q3 GDP showed the UK economy grew by 0.5% over the quarter and 2.3% year-on-year. The UK labour market has also improved, with the September figures showing the highest employment rate since comparable records began in 1971 and unemployment at its lowest rate since September 2005.

The weakening of sterling was the major contributor in the rise of CPI inflation, with the twelve month figure increasing by 0.4% to 1.0%. Forecasts are for CPI to continue to rise, reaching 2.5% in 2019, however as this will primarily be due to the temporary effect of sterling depreciation, the Monetary Policy Committee are unlikely to increase interest rates.

Overseas, the US economy and its labour market show steady improvement, the market has priced in a high probability of the Federal Reserve increasing interest rates in December 2016. The FTSE World was up 8.3% over the quarter, returning 31.2% for the year. The Eurozone meanwhile has continued to struggle with very low inflation and lack of momentum in growth, and the European Central Bank has left the door open for further quantitative easing.

3. Investment Strategy

Historically, the strategic objectives of the Fund have been contained within the Statement of Investment Principles (SIP). However, the new LGPS Investment Regulations, effective from 1 November 2016, replaces the requirement for the Fund to have a SIP and instead they must develop an Investment Strategy Statement (ISS), by 1 April 2017. Work to develop the ISS is well underway and will be completed over the coming months and a draft brought to Committee for approval in March 2017. As part of the development of the Investment strategy to meet the required return from the 2016 Valuation, a review of the strategic asset allocation will be needed. It is timely therefore to remind Committee of the current asset allocation.

4. Asset Allocation

As Committee are aware, asset allocation is the responsibility of the Pension Committee and will continue to be the key strategic tool for the Committee to manage the fund to obtain the return targets as required in the Funding Strategy Statement.

The assets of the fund are currently invested across 13 different Fund Managers in a range of passive and active mandates including a mix of liquid and illiquid allocations to reflect the funds long term horizon.

Current Asset Allocation by asset class

	Market Value As at 30 Sep 2016	**Allocation**
	£'000	**%**
ASSET CLASS		
UK Equities	191,370	21.5
UK Fixed Interest Gilts	2,705	0.3
UK Corporate Bonds	15,317	1.7
UK Index Linked Gilts	45,861	5.1
Corporate Bonds (Global)	38,823	4.4
Overseas Equities	65,551	7.4
Global Equities	127,020	14.3
Property	104,671	11.8
DGF/Absolute Returns	162,851	18.3
Private Equity	29,631	3.3
Infrastructure	25,001	2.8
Private Credit	65,725	7.4
Cash & Cash Equivalents	15,610	1.7
Totals	**890,135**	**100.0**

Current Asset Allocation by manager

FUND MANAGER	ASSET CLASS	Market Value As at 30 Sep 2016 £'000	Actual Asset Allocation %
ADAMS STREET	Private Equity	19,035	2.1
LGT	Private Equity	10,555	1.2
AEW	Property	39,784	4.5
GMO	DGF/Absolute Returns	61,076	6.8
JP MORGAN	Corporate Bonds (Global)	38,823	4.4
LONDON CIV	DGF/Absolute Returns	101,775	11.4
M&G	Private Credit	37,371	4.2
MACQUARIE	Infrastructure	25,001	2.8
NEWTON	Global Equities	127,020	14.3
PERMIRA	Private Credit	28,354	3.2
SSGA	UK Equities	80,834	9.1
	UK Fixed Interest Gilts	2,705	0.3
	UK Corporate Bonds	15,317	1.7
	UK Index Linked Gilts	45,861	5.2
	Overseas Equities	65,551	7.4
UBS EQUITIES	UK Equities	110,536	12.4
	Property	22	0.0
	Private Equity	41	0.0
	Cash & Cash Equivalents	2,971	0.3
UBS PROPERTY	Property	64,864	7.3
	Cash & Cash Equivalents	4,288	0.5
Non Custody	Cash & Cash Equivalents	8,350	0.9
		890,135	**100.0**

NB: Asset Market Valuation is at BID price, as per accounting requirements, which differs from the NT Performance pack within this report which is measured at MID price.

5. Investment decision updates

At September Pensions Committee it was agreed to transition the passive mandate to Legal and General Investment Managers (LGIM) from Statestreet (SSgA) to benefit from reduced fees as negotiated through the buying power of the LCIV. This transition was completed successfully on 31 October 2016.

Pensions Committee also agreed in September to liquidate the GMO mandate and reinvest in a mix of passive funds. The Investment strategy group have agreed a balance of passive funds in which to move the GMO funds to invest at a lower cost than the premium of investing in the current DGF in the current economic market. Now the LGIM passive mandate has been established the GMO mandate will follow into assets under management by LGIM.

6. LCIV update

The London CIV (LCIV) currently has five sub funds open with assets under management (AUM). These consist of two global equity funds (Allianz and Baillie Gifford) and three Diversified growth Funds (DGF)/Absolute Return funds (Ruffer, Pyrford and Baillie Gifford). The Hillingdon Pension Fund currently invests in Ruffer with current CIV holdings totalling £102m at 30 September 2016. An additional subfund, the London CIV NW Real Return sub-fund managed by Newton, will open in December 2016. The CIV are also working on launching 3 further funds in the new year which will be global equity quality managed by Newton, UK equity managed by Majedie and Global equities managed by Longview.

The LCIV have also carried out intensive work over the past year in looking to bring passive mandates under management within the LCIV, negotiating fees with LGIM and Blackrock on behalf of the funds. However due to legal and technical complications, the passive managers are not coming within the LCIV structure for the time being. The Hillingdon LGIM Passive mandate has put the fund closer to pooling as although the investment will remain outside of the ACS structure, LGIM will provide the LCIV with an overarching report on all of the London Fund holdings that have the negotiated CIV rates. This will ensure we are complaint with the pooling agenda and government requirements at this stage, resulting management and reporting regarding these funds carried out within the pool. Passive holdings across the London Boroughs totals approximately £7.5bn.

Further, the LCIV is working on a number of projects looking at various other assets classes. The first major project has been to carry out a full procurement exercise to appoint a range of Global Equity managers to cover the suite of strategies the London Boroughs want to invest within. Global Equities is the largest asset allocation for LGPS funds with 25% (7.5bn) of assets invested across London in this asset class. As a result the LCIV team along with representatives from boroughs and investment advisers have been reviewing and scoring over 200 submissions and meeting 58 managers through clarification interviews over the past month to recommend managers for each of the strategies for the sub fund mandates. Within Global Equity the Hillingdon Fund currently invests in Global Income Equities as a strategy with £127m under management with Newton as at 30 September 2016. The LCIV will start with launching around 3 sub funds initially within Global Equities due to the resources required to carry out the due diligence, legal, regulatory and operational requirements to open these funds. More sub funds will follow shortly after; as a result the LCIV are looking for guidance from the boroughs over the prioritisation of strategies to focus on the sub funds where assets will come under management funding the mandates.

The next steps for the LCIV are looking at income generation for funds in a low yielding environment to meet the requirements many funds are faced with of negative cashflows and to tie in with funding return requirements resulting from the 2016 triennial valuation. The LCIV are working with the Investment Advisory Committee to consider a range of fixed income and cashflow generating products the funds might want to access later next year.