	Pension Fund Committee **9 September 2019**
Title	**Annual Investment Performance Report to 31 March 2019**
Report of	Director of Finance
Wards	N/A
Status	Public
Urgent	No
Key	No
Enclosures	Appendix A – Investment Performance Comparison Appendix B – Hyman Robertson Comments Appendix C – London Pension Fund Performance Appendix D – PIRC Annual Commentary
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Summary

This report requests that the Pension Fund Committee give consideration of the performance of the Barnet fund compared with other local authorities, including other London Borough's over periods from 1 to 30 years based on analysis undertaken by PIRC.

Officers Recommendations

That the Pension Fund Committee note the performance of the Pension Fund as recorded in the PIRC universe.

1. WHY THIS REPORT IS NEEDED

1.1 Investment returns achieved by each fund are a consequence of the strategy over many years and the selection of fund managers. Each pension fund will have its own requirements that drive strategy and comparison of post event returns overlooks individual scheme requirements. However, as these returns are widely shared it is informative to understand the drivers of relative performance compared with other local authorities.

1.2 Appendix 1 provides a one-page summary of Barnet's returns at asset class level from one to thirty years compared with the local authority average. Hymans Robertson's comments on the relative returns of Barnet are attached (appendix 2).

1.3 The total fund returns at the foot of the table are not encouraging and suggest poor strategy and / or manager selection. Barnet's relatively poor performance is highlighted by page 4 of appendix 2 (London comparison) in which we are the lowest returning fund over 3, 5 and 10 years. However, the picture at the total fund level is very different from that at individual asset class level. Within appendix 1, each asset class for which Barnet has out-performed the universe is highlighted and this includes all the asset classes in which we were invested over five and ten years. Thus, manager selection decisions have been positive for the fund over many years. The one blip at asset class level is total equities over the last year (impacting on the last three years), in which the return of the RAFI portfolio managed by L&G was 1.86% compared with the return on their developed equity (ex UK) portfolio of 12.12%. This is not a manager issue but reflects the relative performance of value equities (stocks that trade at a lower price relative to its fundamentals, such as dividends, earnings, or sales) which are over represented in RAFI compared with the market index. In addition, the currency hedging employed in the RAFI portfolio has tempered returns given the depreciation in sterling that has occurred of recent – this also accounts for some of the RAFI fund underperformance relative to equity market cap index.

1.4 The contradiction between overall fund return and individual asset class returns is due to Barnet's weighting in diversified growth funds and listed equities and the performance of these asset class. DGF's are shown in 1, 3 and 5-year time periods as generating a return below every other asset class; a remarkable achievement given that they comprise allocations to all these asset classes. Barnet's allocation to DGF's is 20% higher than the universe average as at 31 March 2019 and was even greater in previous years. By maintaining a high allocation to DGF's, Barnet has a lower allocation to other higher returning asset classes e.g. listed equity.

1.5 The Committee has already recognised that DGF's have not delivered on their promised returns and are switching the allocation to property, private equity and emerging market equity. Appendix 1 demonstrates a strong performance history for property and private equity (and infrastructure, which is a recent addition to the Barnet portfolio).

1.6 The key points from PIRC's London report (appendix 2) are that a high equity weighting has benefited funds, while low volatility strategies (DGF's) have not. The Annual Report notes that investments returns are well ahead of both inflation and actuarial assumptions. Other comments of note are the flow of money towards Ethical, Green & Environmental investment and the relative poor performance last year of emerging market investments (which may indicate a good time to buy).

2. REASONS FOR RECOMMENDATIONS

2.1 The terms of reference of the Pension Fund Committee require the Committee to review and challenge the fund managers' quarterly investment performance against benchmarks and targets.

3. ALTERNATIVE OPTIONS CONSIDERED AND NOT RECOMMENDED

3.1 None

4. POST DECISION IMPLEMENTATION

4.1 The Chief Financial Officer will carry out any actions considered necessary.

5. IMPLICATIONS OF DECISION

5.1 Corporate Priorities and Performance

5.1.1 To ensure that the Pension Fund is being invested prudently and to the best advantage in order to achieve the required funding level. Effective monitoring of the Pension Fund will ensure that long term investment targeted returns are achieved and will provide support towards the Council's corporate priorities.

5.2 Resources (Finance and Value for Money, Procurement, Staffing, IT, Property, Sustainability)

5.2.1 The Pension Fund appoints external fund managers to maximise Pension Fund assets in accordance with the Fund investment strategy. The Pension Fund is a long-term investor and short-term volatility of investment return is expected. In the longer term, the appointed fund managers are expected to deliver positive returns in accordance with the Fund benchmarks. The global diversification of the Pension Fund portfolio gives some protection against the market volatility. The funding level of the Scheme uses a valuation of the future liabilities discounted using gilt yields. The mismatch between assets held and the method of valuing future liabilities will also result in volatility of funding levels.

5.3 Social Value

5.3.1 Membership of the Pension Fund ensures the long term financial health of contributing employees on retirement.

5.4 **Legal and Constitutional References**

5.4.1 Constitution – Under article 7 one of the responsibilities of the Pension Fund Committee is 'To review and challenge at least quarterly the Pension Fund investment managers' performance against the Statement of Investment Principles [now Investment Strategy Statement] in general and investment performance benchmarks and targets in particular.' One of these meetings to be the annual review, at which the representative from the council's performance management organisation attends to comment on the relative performance of the fund managers'.

5.4.2 Regulation 9 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 provides the power to appoint investment managers. The regulations no longer have a specific reference to monitoring investment managers but state "the authority must reasonably believe that the investment manager's ability in and practical experience of financial matters make that investment manager suitably qualified to make investment decisions for it." Only through periodic monitoring can the Committee achieve this requirement.

5.5 **Risk Management**

5.5.1 A key risk is that of poor investment performance. The performance of the fund managers is monitored by the Pension Fund Committee every quarter with reference to reports from Hymans Robertson, the Pension Fund investment adviser. A fund manager can be replaced if performance is considered inadequate.

5.6 **Equalities and Diversity**

5.6.1 Pursuant to the Equality Act 2010, the Council is under an obligation to have due regard to 1) eliminating unlawful discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Act; 2) advancing equality of opportunity between persons who share a relevant 'protected characteristic' and those who do not share it; and 3) fostering good relations between persons who share a relevant 'protected characteristic' and persons who do not share it. The 'protected characteristics' are: age, disability, gender reassignment, pregnancy, and maternity, race, religion or belief, sex and sexual orientation. The Council also has regard to the additional protected characteristic of marriage and civil partnership even though this does not apply to parts 2) and 3) (above) of the public-sector equality duty.

5.6.2 The rules governing admission to and participation in the Pension Fund are in keeping with the public-sector equality duty. The public sector equality duty requires public authorities in carrying out their functions to have due regard to the need to achieve the objectives set out under s149 of the Equality Act 2010. Good governance arrangements and monitoring of the Pension Fund's managers will benefit everyone who contributes to the fund.

5.7 **Corporate Parenting**

5.7.1 Not applicable in the context of this report.

5.8 **Consultation and Engagement**

5.8.1 Not applicable

5.9 **Insight**

5.8.1 Not applicable

6. BACKGROUND PAPERS

6.1 None

Appendix A – PIRC Performance Summary – As at 31 March 2019

	As at 31 March 2019 [PIRC Definitions]		One year			three years			five years			ten years			thirty years		
	Barnet Allocation %	Universe Allocation	Barnet return %	Universe average return %	Barnet decile ranking %	Barnet return %	Universe average return %	Barnet decile ranking %	Barnet return %	Universe average return %	Barnet decile ranking %	Barnet return %	Universe average return %	Barnet decile ranking %	Barnet return %	Universe average return %	Barnet decile ranking %
Total Equity	39	55	6.1	7.3	87	12.3	13.0	68	10.1	9.9	44	13.4	12.9	28	9.0	8.8	32
Diversified Growth	23	3	3.0	0.3	10	3.6	3.2	56	3.6	3.1	50						
Bonds	31	19	3.4	3.7	46	5.3	5.4	46	5.9	5.8	48	6.9	6.8	59	7.3	7.6	61
Property	0	9		6.1			7.2			9.5			8.7			7.5	
Alternatives (total)			17.0	10.3	11		10.8			10.5			8.1				
Private Equity	0	5		15.3			15.1			14.7			10.2				
Infrastructure	5	3		11.7			11.9			11.0							
Other alt		3															
Cash	2	3															
Total Fund	100	100	5.1	6.6	82	7.9	10.5	97	6.7	8.8	95	8.4	10.7	98	7.6	8.4	98

Appendix B

Hymans Robertson Comments – PIRC Annual Report

We are comfortable with the components of the Fund, particularly considering the plans to evolve them and invest in other asset classes in the near future. With regards to equities, we believe the FTSE RAFI (currency hedged) global equity allocation, which accounts for 50% of the LGIM passive equity (20% of total Fund assets), is largely responsible for 12 months equity underperformance relative to peers. Despite this, we are comfortable with the allocation on a long-term basis, but think it should be discussed to remind the Committee of its purpose in the portfolio. We would not expect any significant differences in performance over the long-term between the RAFI global equity fund and a market-cap global equity fund, however, during the last 12 months RAFI has underperformed market-cap materially (further comments below). Further details below.

- Barnet achieved 5.1% over 12 months to 31 March 2019, ranking in the 82nd percentile among its peers

- Focussing on 12 months total Fund performance the low ranking is due to a number of factors, including:
    - the high allocation to DGFs (third highest among peers), which performed poorly over the 12 months. However, we note the Committee's intention to reduce the allocation significantly over the short term. The Fund's DGFs also performed in the top decile among peers.
    - the high allocation to credit (third highest among peers), which also performed poorly (relative to equity/alts/property) over the 12 months. Despite the poor performance of credit, the Fund's return was above the median for credit and there is strong strategic backing for this allocation, notably its diversifying qualities.
    - nil allocation to property, which contributed to underperformance relative to peers, as the median return for property was greater than the total Fund return.
    - the underperformance of the passive equity allocation with LGIM (87th percentile relative to peers, which may include some actively-managed equity mandates). We believe this to be the primary cause for the Fund's relative underperformance, which is discussed further in the next bullet

- Focussing on Fund equity performance, the LGIM passive equity is split into two parts: 50% in World market-cap indices (currency unhedged) and 50% in RAFI AW 3000 fundamentally-weighted indices (currency hedged).
    - 12 months performance for the World market-cap (currency unhedged) was 10.6%. The underlying components include a c.5% allocation to EM equity, which only returned 1.6% over the period. Despite this, we are comfortable with the allocation to EM equity as a diversifying equity allocation with lots of upside potential over the Long term.
    - 12 months performance for the RAFI (currency hedged) was only 1.9%. This underperformance relative to market-cap is down to two factors: (i) the GBP hedging, which detracted c. 4% from performance, and (ii) the 'value' tilt of the RAFI mandate, which is responsible for c. 4% of underperformance versus a style-agnostic comparable index. Despite the

c. 4% drag on performance, we are comfortable with the currency hedging arrangements as a risk reduction characteristic for the Fund (i.e., reduced volatility relative to our GBP liabilities). We discuss the reasoning for the underperformance of the ‘value’ tilt in the next bullet.

- ‘Value’ equity has underperformed other equity styles over the medium term for a number of reasons, which are listed below. Despite the underperformance, we are comfortable with the allocation as a style-diversifier for the Fund’s equity allocation, as well as having a strong conviction in its ability to outperform over the long term.
    - ‘Value’ tends to outperform when bond yields and interest rate expectations rise, which hasn’t been the case over the last few years
    - ‘Value’ sectors like financials have underperformed in this cycle following the financial crisis. Oil & gas suffered owing to the oil price collapse and shale boom and basic resources from misallocation of capital during the China growth boom. Traditional growth sectors (where RAFI is underweight) have performed well owing to structural factors (e.g. technology)
    - Over the last year, RAFI’s underperformance has also been driven by the underweight allocation to healthcare and technology (the strongest performing sectors), along with the underweight allocation relative to market-cap benchmarks to both the US market and the narrow group of Tech stocks that have led for much of this time.