

Non-Executive Report of the: Pensions Committee 24 July 2018	 TOWER HAMLETS
Report of: Zena Cooke, Corporate Director, Resources	Classification: Unrestricted
Investment and Fund Managers Performance Review for Quarter Ending 31st March 2018	

Originating Officer(s)	Bola Tobun, Investment & Treasury Manager
Wards affected	All wards

Summary

This report informs Members of the performance of the Pension Fund and its investment managers for the fourth quarter of 2017/18.

Fund outperformed over the quarter.	The Fund marginally outperformed its benchmark return of -1.2% by 0.1% for the quarter. The overall benchmark was negative in the quarter due to falls in global stock markets over the period.
Five mandates matched or achieved benchmark set.	For this quarter end, six mandates matched or achieved returns above the benchmark. The four that did not reach the benchmarks were the mandates with LCIV RF (TR), LCIV BG (DGF), Insight and GSAM bond portfolios.
Fund outperformed over twelve months and three and five year periods.	Fund Valuation £1.485bn, decreased over the quarter by £38m.
Fund is broadly in line with the strategic benchmark weight.	For the twelve months to March 2018, the Fund returned 6% outperforming the benchmark of 4.1%, the Fund is ahead of its benchmark by 1.9%. The Fund valuation increased from £1.130m by £355m for these twelve months.
Five mandates matched or achieved benchmark set.	Four mandates underperformed their respective benchmark. The mandates that underperformed their respective benchmarks were LCIV RF lagged behind by -4.3%, GSAM lagged behind by -5.0% and Insight by -4.3%.
Fund is broadly in line with the strategic benchmark weight.	Looking at the longer term performance, the three year return for the Fund was 8.1%, ahead of its benchmark return by 0.2% for that period. Over the five years, the Fund posted a return of 8.9% outperforming the benchmark return of 8.4% by 0.4%.
	The Fund is still in line with its long term strategic equity asset allocation and the distribution of the Fund's assets amongst the different asset classes is broadly in line with the strategic benchmark weight.

Recommendations:

Members are recommended to note the contents of this report.

1. REASONS FOR THE DECISIONS

- 1.1. The report informs the Pension Committee of the performance of pension fund managers and the overall performance of the Tower Hamlets Pension Fund.

2. ALTERNATIVE OPTIONS

- 2.1. The Pension Fund Regulations require that the Council establishes arrangements for monitoring the investments of the Pension Fund so there is no alternative but to report the performance of the Fund to the Pension Committee on a regular basis,

3. DETAILS OF REPORT

- 3.1. The Pension Fund Regulations require that the Council establishes arrangements for monitoring the investments of the Fund. It considers the activities of the investment managers and ensures that proper advice is obtained on investment issues.
- 3.2. Officers and fund advisers meet regularly with investment managers to discuss their strategy and performance and may recommend that investment managers are invited to explain further to the Pensions Committee.
- 3.3. This report informs Members of the performance of the Fund and its investment managers for the quarter and year ended 31st March 2018.

3.4. SUMMARY OF THE PENSIONS FUND INVESTMENTS

London Common Investment Vehicle (LCIV)

The London CIV was formed as a voluntary collaborative venture by the London Local Authorities in 2014 and has led the way in pooling of investments in the Local Government Pension Scheme (LGPS). The London CIV aims to be the investment vehicle of choice for Local Authority Pension Funds through successful collaboration and delivery of compelling performance. The LCIV was launched in December 2015, as a fully authorised and regulated investment management company. The founding members are the London boroughs and the City of London Corporation. The LCIV has been established as a collective investment vehicle for their Local Government Pension Scheme funds. The current regulatory permission allows the London CIV to operate an Authorised Contractual Scheme Fund (the UK's version of a Tax Transparent Fund).

The London CIV currently manages three investment portfolios of LBTH fund which are listed below:

- a) **The Baillie Gifford diversified growth fund (DGF)** mandate was opened in February 2011 with contract value of £40m. £6.409m was added to this portfolio in the month of June 2015. The performance target for this mandate is to outperform the benchmark (3% p.a. above the 3 month LIBOR) net of fees over rolling 5 years with annual volatility of less than 10%. This mandate was transferred to LCIV on 15 February 2016 at market value of £54.177m and the portfolio is named **LCIV (BG) DGF**. A capital contribution of £70m was paid into this portfolio on 23rd August 2017. The

market value of assets as at 31 March 2018 was £136.444m. For this reporting quarter, the return of this portfolio was 0.5% with relative underperformance of 0.3% below benchmark return of 0.8%. The portfolio outperformed the benchmark for one year to reporting period by 0.7%, also outperformed the benchmark return over 3 years by 0.8% per annum and by 0.9% per annum for 5 years. The portfolio invests in a diversified range of asset classes and the breakdown is shown in the manager's quarterly summary report, attached to this report as Appendix 2a.

- b) **The Baillie Gifford global equity fund** had a value of £118.9m at the start of the mandate in July 2007. The performance target for this mandate is 2% to 3% above the benchmark MSCI AC World Index gross of fees over a rolling 3-5 year period. This mandate was transferred to LCIV on 22 April 2016 at market value of £214.1m and the portfolio is named **LCIV (BG) GA**. The market value of the assets as of 31 March 2018 was £318.033m. The portfolio outperformed the benchmark by delivering a return of -0.9% compared to benchmark return of -4.4% over the quarter. The portfolio also outperformed the benchmark for one year to reporting period substantially by 10.7%, also outperformed the benchmark return for over 3 years considerably by 4.4% per annum and by 4% per annum for 5 years. Further information on this portfolio is attached to this report as Appendix 2b.
- c) **Ruffer LLP** manages an Absolute Return Fund; the value of this contract on the 28 February 2011 was £40m. £6.474m was added to this portfolio on 2nd June 2015. The management of this portfolio was transferred to the LCIV on 20th June 2016 at market value of £54m and the portfolio is named **LCIV Ruffer**. Capital contribution of £70m was added to this portfolio on 23rd August 2017. The performance target for this mandate is to outperform the benchmark (3.5% p.a. above 3 month LIBOR) net of fees over rolling 5 years with annual volatility of less than 10%. The value of assets under management as of 31st March 2018 was £131.297m. The portfolio underperformed the benchmark by delivering a return of -2.5% compared to benchmark return of 0.8% over the quarter. The portfolio also underperformed the benchmark for one year to reporting period substantially by -4.3% and for over 3 years by -1.1% per annum but outperformed its benchmark marginally by 0.1% per annum for 5 years period. Further information on this portfolio is attached to this report as Appendix 2c.

Goldman Sachs Asset Management

On 4th April 2016, the fund invested £75m in Goldman Sachs Strategic Absolute Return Bond II (STAR II). The performance target is to outperform the benchmark (3 Month LIBOR) by 4.0% per annum net of fees over a rolling three year period. The portfolio had a market value of £77.077m at 31st March 2018. The portfolio underperformed the benchmark (3 month LIBOR plus 4%) in the reporting period by posting returns of -0.1% against a benchmark return of 1.1% and underperformed the benchmark significantly for one year to reporting period by -5%. Further information on this portfolio is attached to this report as Appendix 3.

Insight Investment Management

On 1st July 2016, the fund invested £70m with Insight Investment Management in BNY Mellon Global Funds. The portfolio had a market value of £71.779m at

31st March 2018. The performance target is to outperform the benchmark (3 Month LIBOR) by 3-4% per annum net of fees over a rolling three year period. The portfolio underperformed the benchmark (3 month LIBOR plus 4%) in the reporting period by posting returns of 0% against a benchmark return of 1.1%, the portfolio also underperformed its benchmark considerably for one year to reporting period by -4.3%. Further information on this portfolio is attached to this report as Appendix 4.

Legal & General Investment Management

Legal & General was appointed on 2nd August 2010 to manage passively UK Equity and UK Index-Linked Mandates. A decision was made at the September 2017 Committee meeting following the outcome of the Fund investment strategy review to disinvest from passive UK Equity mandate as it is difficult to justify the overweight to the UK market from an investment perspective. The preposition to invest the redemption proceeds of this portfolio along with GMO legacy portfolio in Passive Global Equity and Low Carbon Passive Global Equity Fund was agreed by the Committee and the transition of the assets occurred in December 2017. Hence the revised benchmark for LGIM Equity portfolio is as shown below:

Fund	Allocation (30% of total LBTH Fund)
FTSE All World Equity Index	16.7%
FTSE All World Equity Index GBP Hedged	33.3%
MSCI World Low Carbon Target Index GBP Hedged	50.0%

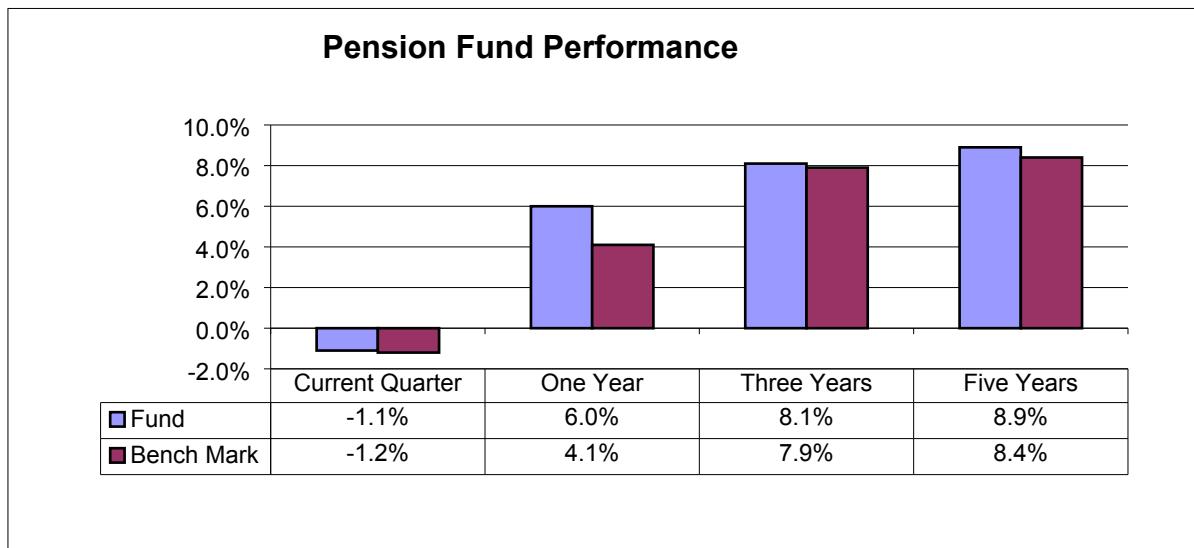
The performance target is to track the FTSE All World Equity Index GBP Hedged for the Hedged Passive Global Equity, FTSE All World Equity Index for the (Unhedged) Passive Global Equity mandate, MSCI World Low Carbon Target Index GBP Hedged for the Low Carbon Passive Global Equity mandate and FTSE A Gov Index-Linked > 5 years benchmark for the UK Index-Linked Mandate. At 31st March 2018, the (Unhedged) Passive Global Equity portfolio had a market value of £67.801m, the Low Carbon Passive Global Equity portfolio had a market value of £233.190m and the Hedged Passive Global Equity portfolio had a value of £167.634m and the UK Index linked portfolio was £68.420m. All the portfolios matched the benchmark returns. Further information on the portfolios being managed by this manager is attached to this report as Appendix 5.

Schroder's Investment Management

Schroder manages a property mandate. The value of this mandate on 20th September 2004 was £90m. The performance target for this mandate is to outperform the IPD UK Pooled Property Fund Indices All Balanced Funds Median by 0.75% net of fees over a rolling three year period. The market value of assets at 31st March 2017 was £155.656m. The portfolio performance is the same as the benchmark return for this reporting quarter. However for twelve months to 31 March 2018, the portfolio posted a return of 10.9%, this was 0.9% above the benchmark. And for longer term, the three years performance was slightly above the benchmark return by 0.3% per annum but for over five years, the portfolio underperformed its benchmark by -0.4% per annum. Further information on the portfolios being managed by this manager is attached to this report as Appendix 6.

INVESTMENT PERFORMANCE

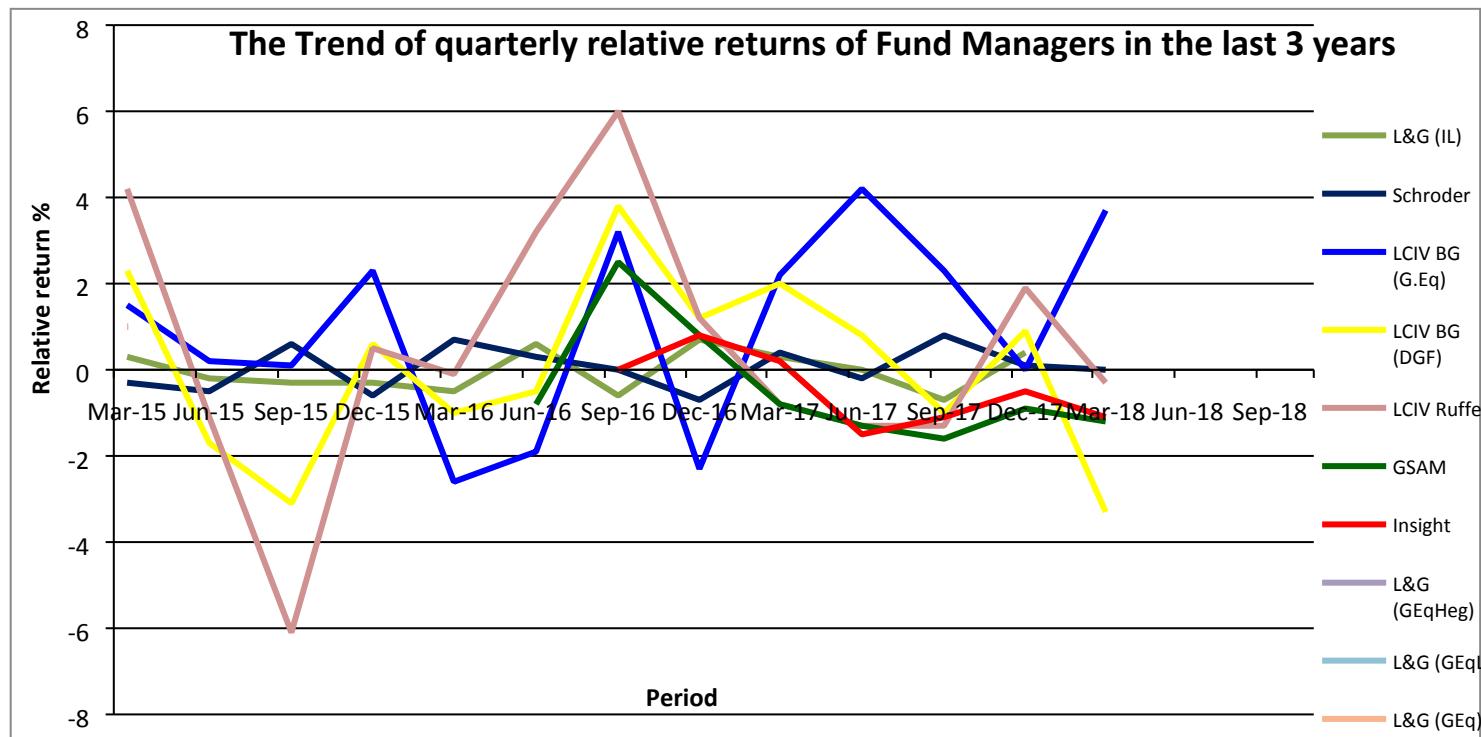
- 3.5. The overall value of the Fund at 31st March 2018 stood at £1,485.328m which is a reduction of £38.149m from its value of £1,523.477m as at 31st December 2017.



- 3.6. The fund slightly outperformed the benchmark this quarter by posting a return of -1.1% against benchmark return of -1.2%. The twelve month period sees the fund ahead of its benchmark by 1.9%, as shown on the graph above.

MANAGER PERFORMANCES

- 3.7. The Fund is being managed by five managers with nine different mandates. LCIV with three mandates managing the Global Equities, diversified growth fund and total return fund on an active basis; UK Index-Linked, Low Carbon Global Equities, Hedged and Unhedged Global Equities are passively managed by LGIM; GSAM and Insight managing absolute return pooled bond funds and Schroders are the property manager.



- 3.8. The graph above demonstrates the volatility and cyclical nature of financial markets relating to the fund's investment holdings. Over the three year period shown in the graph, the outcomes are within the range of expectations used by the Fund actuary in assessing the funding position. The Fund can take a long term perspective on investment issues principally because a high proportion of its pension liabilities are up to sixty years in the future.
- 3.9. The managers, mandate and funds held under management are set out below. The Fund was valued at £1,485.328 million as at 31st March 2018. This includes cash held and being managed internally (LBTH Treasury Management), this stands at 3.1% of the total assets value, this constitutes investment in money market fund (MMF) of £24m and £2.5 working capital of the Fund.

Manager	Mandate	Value at 31 st March 2018 £m	Strategic Weight of FM AUM*	Actual Weight of FM AUM	(Under)/ Over Weight Target	Date Appointed
L&G (Unhedged GEq)	Global Equity	81.614	5.00%	5.50%	0.5%	01- Dec-2017
L&G (Hedged GEq)	Global Equity	164.962	10.00%	11.10%	1.1%	01- Dec-2017
L&G (Low Carbon Eq)	Global Equity	247.536	15.00%	16.70%	1.7%	01- Dec-2017
LCIV BG (Global Equity)	Global Equity	318.033	20.00%	21.40%	1.40%	22 Apr 2016**
LCIV BG (Diversified Growth)	Absolute Return	136.444	10.00%	9.20%	(0.80)%	22-Feb-11 15 Feb 2016**
LCIV Ruffer (Total Return Fund)	Absolute Return	131.297	10.00%	8.80%	(1.20)%	08-Mar-11 15 Jun 2016**
L & G Index Linked-Gilts	UK Index Linked	74.546	6.00%	5.00%	(1.00)%	02-Aug-10
GSAM	Bonds	77.077	6.00%	5.20%	(0.80)%	04-Apr-16
Insights	Bonds	71.779	6.00%	4.80%	(1.20)%	01-Jul-16
Schroder	Property	155.556	12.00%	10.50%	(1.50)%	30-Sep-04
Internal cash Management	Cash	26.484	0.00%	1.80%	1.80%	N/A
Total		1,485.328	100.00%	100.00%	0.00%	

* FM AUM is Fund Asset under Management with a Fund Manager

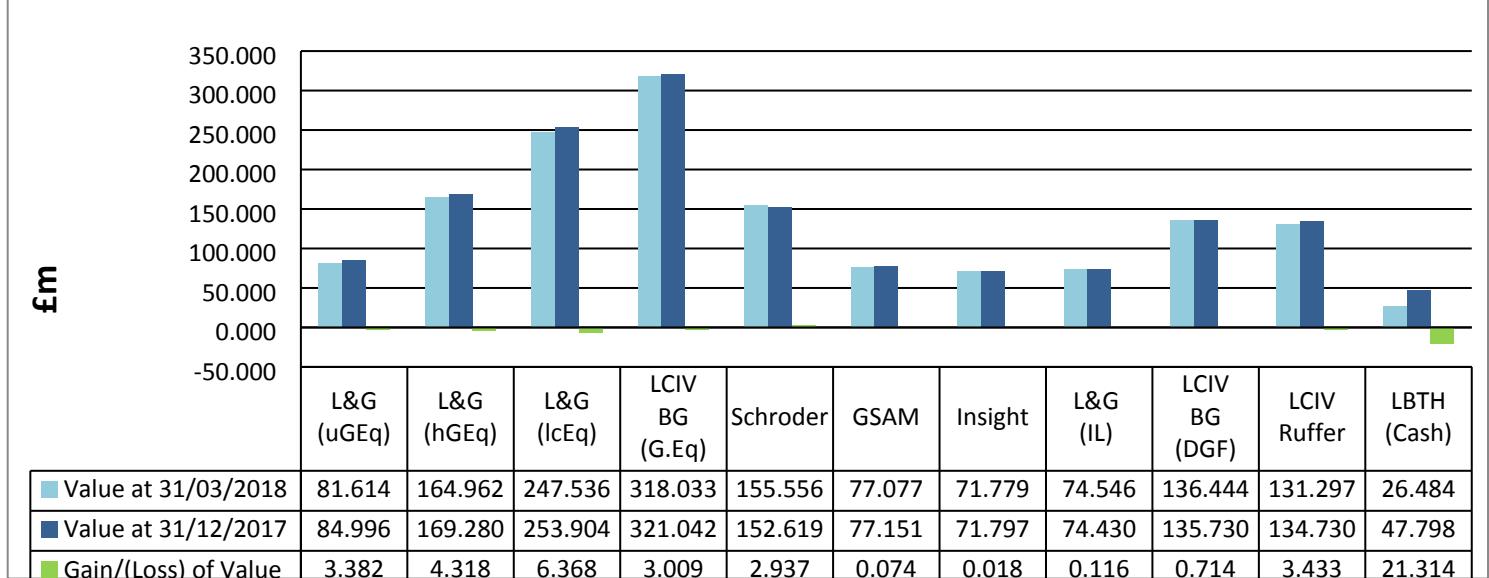
**The date asset ownership was transferred from LBTH Pension Fund to LCIV for management under the pooling arrangements.

- 3.10. Following the outcome of the investment strategy review, the consultant presented and discussed the expected returns from Absolute Return Bonds (ARB) with the Committee at their September 2017 meeting whereby he demonstrated his beliefs that this is very dependent on the skills of individual managers which are difficult to predict and is wholly reliant on the investment managers. The Consultant advocates a reduction of ARB allocation from 12% to 6% and believes that the reduced ARB allocation should be complemented by a 6% allocation to Multi-Asset Credit (MAC), where the returns are likely to be driven by markets rather than just manager skill.
- 3.11. After an in-depth discussion and consideration of this issue at the March 2018 meeting, the Committee agreed to reduce its 12% allocation to ARB to 6% and to allocate 6% to MAC strategy. The Committee approved allocation of 6% of the total Fund assets to CQS multi asset credit (MAC) on London CIV platform and this sub fund to be funded by reducing the Fund allocation with Insight and GSAM to 3% each of the Fund total assets as at 31st March 2018 and

rebalancing of the LGIM equity portfolios. The CQS MAC portfolio was funded on the 29th May 2018 by transferring £90m to London CIV.

- 3.12. The graph below illustrates the portfolio value movement of each mandate for this reporting quarter compared to the last quarter. It shows that all portfolios of the Fund have made gains, albeit in some cases only marginal ones.

Fund Value by Manager as at 31 March 2018 compared to 31 December 2017



- 3.13. The performance, net of fees of the individual managers relative to the appropriate benchmarks over the past five years is as set out in the table below. Each manager provides a report of the performance of their respective mandate and these are summarised as set out in Appendix 1 of this report.

Managers Investment Performance relative to benchmark as at 31st March 2018

		LCIV (BG) Global Equity	LGIM Low Carbon Global Equity	LGIM Hedged Global Equity	LGIM Unhedged Global Equity	Schroder Property	GSAM Absolute Return Bond	Insight Absolute Return Bond	LGIM Index Linked	LCIV (BG) DGF	LCIV (Ruffer) DGF	LBTH Treasury Cash	Total Fund
Quarter %	Fund	(0.9)	2.5	2.4	4.4	1.9	(0.1)	0.0	0.2	0.5	(2.5)	0.0	(1.1)
	Benchmark	(4.4)	2.5	2.5	4.4	1.9	1.1	1.1	0.2	0.8	0.8	0.1	(1.2)
	Relative	3.5	(0.1)	(0.0)	(0.0)	0.0	(1.2)	(1.1)	0.0	(0.3)	(3.3)	(0.1)	0.1
12 month %	Fund	13.1	N/A	N/A	N/A	10.9	(0.7)	0.0	0.7	4.0	(1.0)	0.1	6.0
	Benchmark	2.4	N/A	N/A	N/A	10.0	4.3	4.3	0.7	3.3	3.3	0.3	4.1
	Relative	10.7	N/A	N/A	N/A	0.9	(5.0)	(4.3)	0.0	0.7	(4.3)	(0.2)	1.9
3 years (% p.a)	Fund	14.6	N/A	N/A	N/A	8.4	N/A	N/A	7.7	4.3	2.4	0.8	8.1
	Benchmark	10.2	N/A	N/A	N/A	8.1	N/A	N/A	7.8	3.5	3.5	0.3	7.9
	Relative	4.4	N/A	N/A	N/A	0.3	N/A	N/A	(0.1)	0.8	(1.1)	0.5	0.2
5 years (% p.a)	Fund	14.9	N/A	N/A	N/A	10.1	N/A	N/A	7.7	4.4	3.6	0.8	8.9
	Benchmark	10.9	N/A	N/A	N/A	10.5	N/A	N/A	7.7	3.5	3.5	0.3	8.4
	Relative	4.0	N/A	N/A	N/A	(0.4)	N/A	N/A	0.0	0.9	0.1	0.5	0.5

INTERNAL CASH MANAGEMENT

- 3.14. Cash is held by the managers at their discretion in accordance with limits set in their investment guidelines, and internally by LBTH to meet working cashflow requirements, although transfers can be made to Fund managers to top up or rebalance the Fund.
- 3.15. The Pension Fund cash balance is invested in accordance with the Council's Treasury Management strategy agreed by Full Council in February 2017, which is delegated to the Corporate Director, Resources to manage on a day to day basis within the agreed parameters.
- 3.16. On the 1st December 2017 the Council paid £35.888m, this is a prepayment of deficit contribution for three years 2017/18 to 2019/20 less a quarter payments of £3.75m paid into the Fund early October 2017.
- 3.17. The cash balance as at 31st March 2018, was £47.798m this constitutes investment in money market fund (MMF) of £40m and £7.8m working capital of the Fund.
- 3.18. Members will continue to be updated quarterly of the Pension Fund in house cash investment strategy. Needless to say that the security and liquidity of the Fund's cash remains the overriding priority, ahead of yield.

ASSET ALLOCATION

- 3.19. The revised benchmark of asset distribution and the fund position at 31st March 2018 are set out below:

Asset Class	Benchmark as at 21st September 2017	Fund Position as at 31st March 2018	Variance as at 31st March 2018
Global Equities	50.0%	54.7%	4.7%
Total Equities	50.0%	54.7%	4.7%
Property	12.0%	10.5%	(1.5)%
Bonds	12.0%	10.0%	(2.0)%
UK Index Linked	6.0%	5.0%	(1.0)%
Alternatives	20.0%	18.0%	(2.0)%
Cash	0.0%	1.8%	1.8%
Total Equities	100.0%	100.0%	

- 3.20. Asset allocation is determined by a number of factors including:-
 - i) The risk profile. Generally there is a trade-off between the returns obtainable on investments and the level of risk. Equities have higher potential returns but this is achieved with higher volatility. However, as the Fund remains open to new members and able to tolerate this it can seek long term benefits of the increased returns.
 - ii) The age profile of the Fund. The younger the members of the Fund, the longer the period before pensions become payable and investments have to be realised for this purpose. This enables the Fund to invest in more volatile asset classes because it has the capacity to ride out adverse movements in the investment cycle.
 - iii) The deficit recovery term. Most LGPS funds are in deficit because of falling investment returns and increasing life expectancy. The actuary

determines the period over which the deficit is to be recovered and considers the need to stabilise the employer's contribution rate. The actuary has set a twenty year deficit recovery term for this Council which enables a longer term investment perspective to be taken.

- 3.21. Individual managers have discretion within defined limits to vary the asset distribution. The overweight position in equities has helped the fund's performance in recent months.

4. COMMENTS OF THE CHIEF FINANCE OFFICER

- 4.1. This is a noting report which fulfils the requirement to report performance of the Pension Fund investments portfolio to the Pensions Committee. There are no direct financial implications arising from this report.

5. LEGAL COMMENTS

- 5.1. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 govern the way in which administering authorities should manage and make investments for the fund. There are no longer explicit limits on specified types of investment and instead administering authorities should determine the appropriate mix of investments for their funds. However, administering authorities must now adhere to official guidance; broad powers allow the Government to intervene if they do not. Under regulation 8, the Secretary of State can direct the administering authority to make changes to its investment strategy; invest its assets in a particular way; that the investment functions of the authority are exercised by the Secretary of State and that the authority complies with any instructions issued by the Secretary of State or their nominee.
- 5.2. The Council must take proper advice at reasonable intervals about its investments and must consider such advice when taking any steps in relation to its investments.
- 5.3. The Council does not have to invest the fund money itself and may appoint one or more investment managers. Where the Council appoints an investment manager, it must keep the manager's performance under review. At least once every three months the Council must review the investments that the manager has made and, periodically, the Council must consider whether or not to retain that manager.
- 5.4. One of the functions of the Pensions Committee is to meet the Council's duties in respect of investment matters. It is appropriate, having regard to these matters, for the Committee to receive information about asset allocation and the performance of appointed investment managers. The Committee's consideration of the information in the report contributes towards the achievement of the Council's statutory duties.
- 5.5. When reviewing the Pension Fund Investment Performance, the Council must have due regard to the need to eliminate unlawful conduct under the Equality Act 2010, the need to advance equality of opportunity and the need to foster good relations between persons who share a protected characteristic and those who don't (the public sector duty). The Committee may take the view that good, sound investment of the Pension Fund monies will support compliance with the Council's statutory duties in respect of proper management of the Pension Fund.

6. ONE TOWER HAMLETS CONSIDERATIONS

- 6.1. The employer's contribution is a significant element of the Council's budget and consequently any improvement in investment performance will reduce the contribution and increase the funds available for other corporate priorities.
- 6.2. A viable pension scheme also represents an asset for the recruitment and retention of staff to deliver services to the residents.

7. BEST VALUE (BV) IMPLICATIONS

- 7.1. This report helps in addressing value for money through benchmarking the Council's performance against the WM Local Authority Universe of Funds.

8. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

- 8.1. There is no Sustainable Action for A Greener Environment implication arising from this report.

9. RISK MANAGEMENT IMPLICATIONS

- 9.1. Any form of investment inevitably involves a degree of risk.
- 9.2. To minimise risk the Investment Panel attempts to achieve a diversification portfolio. Diversification relates to asset classes and management styles.

10. CRIME AND DISORDER REDUCTION IMPLICATIONS

- 10.1. There are no crime and disorder reduction implications arising from this report.
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Linked Reports, Appendices and Background Documents

Linked Report

- [None]

Appendices

- Appendix 1 – SSGS Quarterly Performance Review
- Appendix 2a-2c (LCIV Sub-Fund Quarterly Summary)
- Appendix 3 – GSAM Investment Review for the Quarter
- Appendix 4 – Insight Investment Review for the Quarter
- Appendix 5 – LGIM Investment Review for the Quarter
- Appendix 6 – Schroders Property Investment Review for the Quarter

Local Government Act, 1972 Section 100D (As amended)

List of “Background Papers” used in the preparation of this report

Officer contact details for documents:

- Bola Tobun Investment & Treasury Manager x4733