

Regulatory and Other Committee

Open Report on behalf of Executive Director of Finance and Public Protection

Report to:	Pensions Committee
Date:	16 July 2015
Subject:	UK Equity Portfolio Annual Report

Summary:

This is the annual report for the year ended 31st March 2015 covering the performance of the UK Equity index-tracking portfolio managed internally. The portfolio is managed within the Pensions and Treasury Section of the Finance and Public Protection Directorate.

Recommendation(s):

That the Committee note the report.

Background

1 UK EQUITY INDEX TRACKING PORTFOLIO - INTRODUCTION

- 1.1 The objective of this portfolio is to deliver the total return of the MSCI UK IMI index +/-0.5% pa. This is to be achieved while maintaining a predicted portfolio tracking error (i.e. risk exposure) within 0.5% of the index.
- 1.2 The portfolio is managed through the Bloomberg system which enables officers to see live valuations during the day and to monitor performance and tracking error. The number of stocks held in this portfolio normally varies between 240 and 260 (358 stocks constituted the MSCI UK IMI index as at 31 March 2015). The number of stocks held is much higher than would conventionally be held in an actively managed portfolio, to ensure limited deviation in performance relative to the total return produced by MSCI UK IMI index.

Table 1: Fund Statistics

All data to 31st March 2014

	Fund	Benchmark
Assets	£348m	-
No. of Stocks	251	358
Turnover	0.1%	-

2 MARKET BACKGROUND

2.1 The 2014/15 financial year was fairly flat for the first six months of the year before more volatile markets resurfaced in the following six months of the year. This resulted in six months producing a positive return and six months of negative returns. The monthly returns ranged from -3% to +3.75% and the index posted a total return (capital and income combined) of +5.6% for the year.

2.2 The main market features over the year were:

- The gradual recovery of the economy continued in the second quarter of 2014, and markets saw a continuation of recent trends; equities and higher-yielding assets continued to grind higher, whilst core bond yields remained low.
- The second quarter saw markets initially fall following concerns about geopolitical tensions. These concerns were quickly shaken off and the market recovered, but succumbed to nervousness about the global economic outlook towards the end of the quarter which saw the market fall 3%.
- The volatility in the markets resurfaced in the second half of the year as the oil price plunged to five year lows.
- The market finished the year strongly with positive news from the Office for National Statistics who revised estimates for economic growth from 2.6% to 2.8%, and estimates for 2015 remain strong.

3 PERFORMANCE

3.1 The market value of this portfolio at 31st March 2015 was £348m, representing 19.9% of the Fund's total investments (the value at 31st March 2013 was £319m). Over the year, the portfolio made purchases of £10.5m and sales of £36.1m. Cash redemptions of £8.2m were made in the year and a further investment of £19.5m was made in January 2015 following a rebalance of the Lincolnshire Pension Fund.

3.2 The performance of the UK Index-tracking portfolio is set out in the table below.

Table 2: Fund Performance & Risk

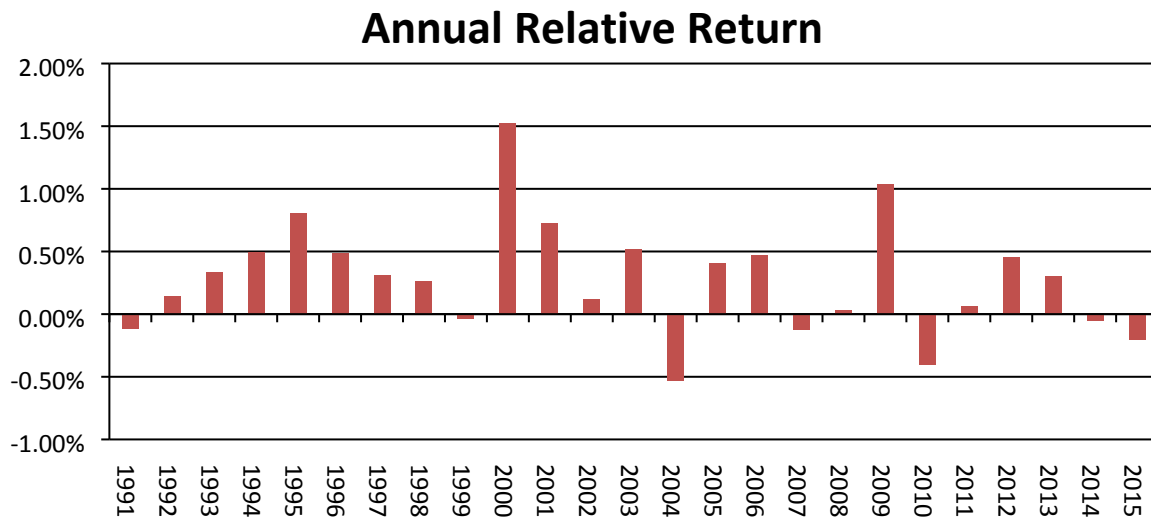
All data to 31st March 2015

Date	Portfolio (%)	Index (%)	Relative (%)
1 Year	5.58	5.79	(0.20)
3 Year *	10.19	10.17	0.02
5 Year *	8.30	8.18	0.11
Since Inception *	8.45	8.15	0.28
Tracking Error	0.17	-	-

*Annualised

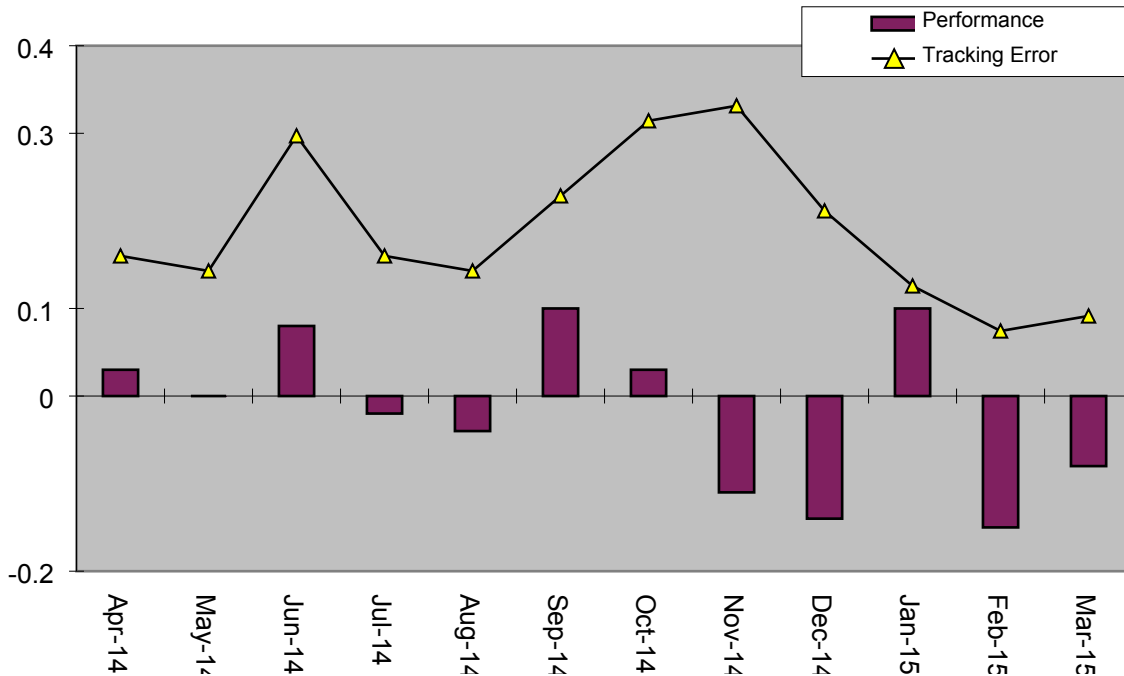
- 3.3 Chart 1 below shows the total return achieved for each year from 31st March 1991 relative to that of the index. In the 25 years since inception, the portfolio has out-performed the benchmark index in 18 years and under performed in 7 years. Performance is shown gross of fees, which equate to approximately 0.02% per annum.

**Chart 1: Returns Relative to the Index on an Annual Basis
31st March 1991 to 31st March 2014**



- 3.4 Over the year, the portfolio performance ranged from -2.9% in September to +3.6% in February and the relative return to the benchmark from -0.15% in February to +0.1% in September and January. The predicted risk (tracking error) of the portfolio was maintained within the permitted range of 0.5% for the whole year. Chart 2, below, shows the monthly forecast tracking error of the portfolio, plotted against the actual monthly performance relative to the benchmark (index). The tracking error is the predicted annual volatility of the actual return compared to the benchmark return. This means that with a forecast tracking error of 0.20%, the return of the portfolio would statistically be expected to be +/-0.20% around the index return, e.g. if the index returned +10%, the portfolio should return between +9.80% and +10.20%. Statistically, this outcome is expected to happen in two years out of three.

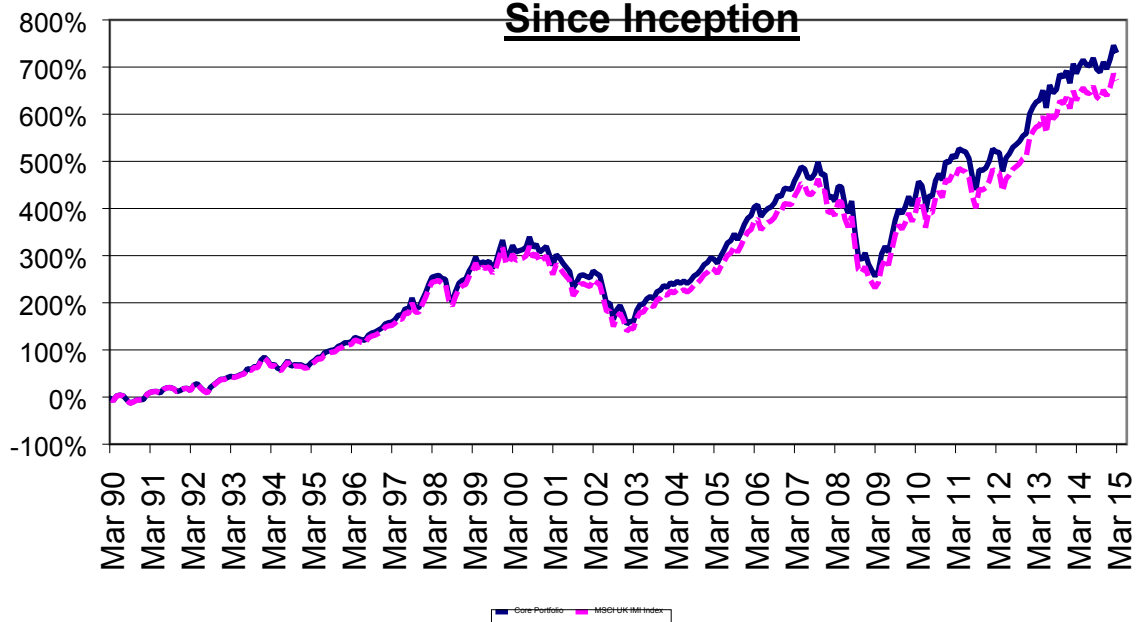
Chart 2: Tracking Error and Monthly Portfolio Performance 2013/14



3.5 Portfolio performance over the year was -0.2%, which is within the target range of +/-0.5%. The performance for the year can be split into three periods. The first five months the index was fairly flat and the fund slightly outperformed the benchmark. September and October saw the index fall nearly -4% whilst the index returned -3.7%, with the overweight position to defensive stocks proving beneficial and being the main contributor to the outperformance in those two months. The final five months, between November and March, were very volatile but the index rallied strongly and returned +5.6% for that period. During this period financials performed well and the funds overweight position was a detractor from performance, as was the funds overweight position to energy which underperformed in the period.

3.6 The chart below shows the portfolio's performance around the relevant index benchmark since inception. On an annualised basis the portfolio has returned gross performance of 0.28% and net performance of 0.26%. The performance return is within the performance target of +/- 0.5%.

UK Equities In House Portfolio Performance Since Inception



Conclusion

4. The UK Equity portfolio underperformed the benchmark over the last 12 months by 0.2% but was still within the target of +/- 0.5%. Since inception the Fund has outperformed the benchmark by 0.28% annualised.

Consultation

a) Policy Proofing Actions Required

n/a

Background Papers

No background papers within Section 100D of the Local Government Act 1972 were used in the preparation of this report.

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