

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

Report to:	Pensions Committee
Date:	04 October 2018
Subject:	Performance Measurement Annual Report

Summary:

This report sets out the Pension Fund's longer term investment performance, for the period ending 31st March 2018.

Recommendation(s):

That the Committee note the report.

Background

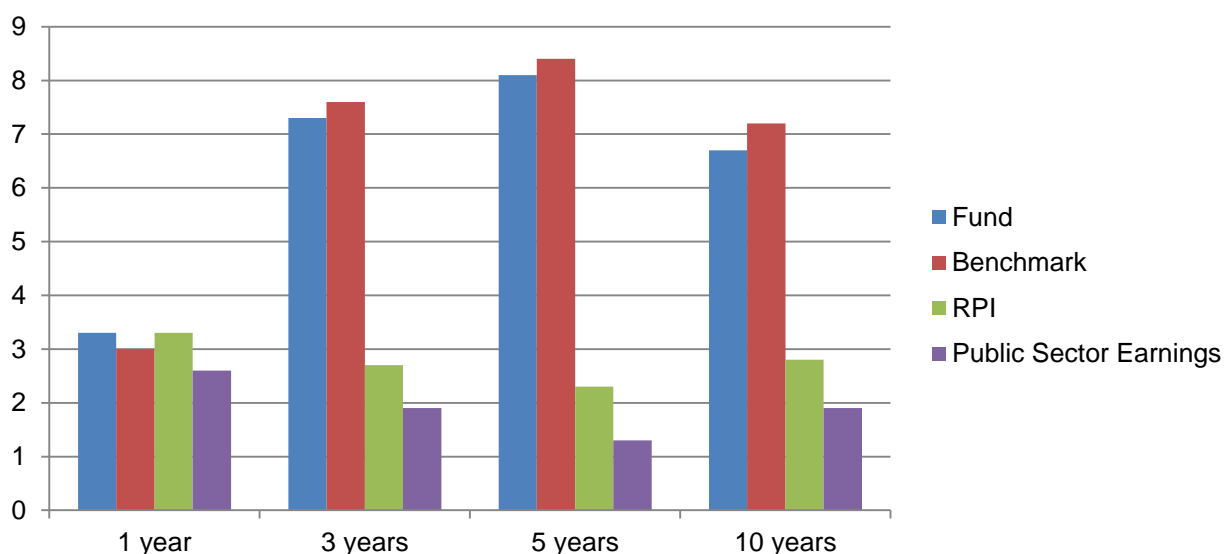
1 INTRODUCTION

- 1.1 The Pension Fund uses two suppliers for the measurement of the Fund's performance: JPMorgan, the Fund's custodian, calculates the Fund's investment performance and compares it with the returns of the strategic asset allocation benchmark (i.e. the return achieved by the mix of assets as recommended by the Actuary) and PIRC compare the Fund's performance against the average Local Authority Pension Fund. The Fund's long term aim is to outperform the strategic benchmark by 0.75% per annum.

2 LONGER TERM PERFORMANCE FOR YEAR ENDED 31 MARCH 2018

- 2.1 The short term performance of the Fund and the performance of its managers are reported in the quarterly Investment Management report. This report focuses on the longer term performance of the Fund overall, compared to its strategic benchmark and the pay and price increases that impact the liabilities of the Fund. At the latest valuation, as at March 2016, the Actuary has calculated the employers contribution strategy based on an assumed annual return of 4.0% over the long term.
- 2.2 The graph and table below shows longer term Fund and Benchmark performance, along with the increases in consumer prices and public sector earnings.

INFLATION INCREASES AND INVESTMENT RETURNS FOR UP TO 10 YEARS ENDED 31/3/2018



	1 year %	3 years annualised %	5 years annualised %	10 years annualised %
Retail Prices Index increases	3.3	2.7	2.3	2.8
Public sector average Earnings increases	2.6	1.9	1.3	1.9
LCC Fund performance	3.3	7.3	8.1	6.7
LCC Benchmark Performance	3.0	7.6	8.4	7.2
Relative Performance	0.3	(0.3)	(0.4)	(0.3)

2.3 10 Year Returns

The Fund's performance over ten years, at 6.7%, is slightly behind the Fund's Benchmark return of 7.2%, with the gap having closed since last year. This return is ahead of both inflation and average earnings over the last ten years, to which the scheme's liabilities are linked, which were 2.8% and 1.9% p.a. respectively. The biggest impact on performance over this period is from 2010. This was a result of a number of asset allocation change made over the year and those changes not reflected in the benchmark until they were all complete. This drift from the benchmark over the year negatively impacted the performance as can be seen in the table at paragraph 3.4.

2.4 5 Year Returns

Five year returns of 8.1% per annum are ahead of both price and pay inflation. The Fund's actual performance is behind the strategic Benchmark return of 8.4%. This reflects the underperforming active managers over the period.

2.5 **3 Year Returns**

Three year returns, at 7.3%, are again ahead of both inflation and average earnings, but behind the strategic Benchmark return of 7.6%. This reflects underperformance by the active global equity manager, Neptune and the absolute return bond manager, BMO, both of whom were terminated in 2016.

3 ATTRIBUTION ANALYSIS

- 3.1 The attribution of the return over any period can be split between asset allocation and stock selection.
- 3.2 The asset allocation contribution reflects the extent to which decisions to deviate from the strategic benchmark, e.g. to be overweight cash and underweight equities, added to or detracted from performance, compared to the benchmark.
- 3.3 The stock selection contribution reflects the extent to which managers have or have not exceeded their benchmark index.
- 3.4 The Fund's annual performance over each of the last ten years compared to the Benchmark is set out in the table below. There is an equal split between stock selection and asset allocation in terms of detractors across the ten year period. This table highlights the impact of the benchmark drift in 2010, mentioned in paragraph 2.3, which resulted in an under performance of over 5%. Since the termination of the two managers in 2016, stock selection (i.e. managers' performance against their benchmark) has been positive.
- 3.5 The underperformance on asset allocation in 2018 is solely attributable to the active currency overlay program. Both managers were terminated in February 2017, however the outstanding currency positions were unwound over the following year, fully closing in February 2018.
- 3.6 Under asset pooling, the Pensions Committee will remain responsible for the asset allocation, however Border to Coast will be accountable for the stock selection element of the Fund's performance.

Long Term Performance Analysis

Year ended March	Fund %	Benchmark %	Relative Performance %	Attributed to Asset allocation %	Attributed to Stock Selection %
2009	(18.6)	(20.0)	1.7	2.1	(0.4)
2010	29.7	36.7	(5.1)	(3.1)	(2.1)
2011	7.9	7.8	0.1	0.1	0.0
2012	1.5	2.4	(0.8)	(0.2)	(0.6)
2013	12.6	11.3	1.2	0.1	1.1
2014	6.3	6.2	0.1	0.2	(0.1)
2015	12.3	12.4	(0.1)	(0.1)	0.0
2016	0.0	1.4	(1.4)	(0.6)	(0.8)
2017	19.8	19.3	0.3	0.0	0.3
2018	3.3	3.0	0.3	(0.4)	0.7

4 PIRC LOCAL AUTHORITY UNIVERSE

- 4.1 The PIRC Local Authority (LA) Universe is an aggregation of 61 funds covering £177bn of assets within the LGPS sector, and is used for peer group comparisons. This represents some two thirds of local authority pension fund assets and includes all of the Welsh and Northern Pools, all bar two of the London Pool, and with funds from all other pools except Central.
- 4.2 Despite a relatively difficult environment for investors the average local authority fund produced a return of 4.5% for the year. This was below the long term average but the return was ahead of inflation and broadly in line with actuarial assumptions, and most funds outperformed their benchmarks by a small margin. Asset returns were tightly grouped with bonds, equities and alternatives returning 1%, 4%, and 6% respectively for the year.
- 4.3 Since the 1990's, Funds have been using specific strategic benchmarks linked to their individual liability profiles, rather than a standard asset allocation. This means that comparison across the Universe can be misleading, as funds are trying to meet their own return requirements rather than compete for the highest return. The asset allocation of the Fund was last formally considered at the January 2017 meeting of this committee following the 2016 triennial valuation results, and the high level growth/low risk asset allocations agreed. This was reconsidered at the training session on 11th September (and detailed in paper 10 on this agenda), in light of the transition of assets across to Border to Coast, as a result of asset pooling.

- 4.4 The table below shows how the strategic asset allocation for the Lincolnshire Fund compares with the average Local Authority Pension Fund in 2018 and 2017.

Asset Class	Lincolnshire	LA Average	
		2018	2017
Equities	60.0	55	62
Bonds	13.5	18	15
Property	9.0	8	8
Infrastructure	2.5	3	2
Alternatives	15.0	8	8
Cash	0.0	3	2

- 4.5 Within the LA Universe, there has been a reduction in equities, a decrease across other asset classes.
- 4.6 Given this move to fund specific strategic benchmarks, the peer group comparison is only a reference point, and not directly comparable. Strategic benchmarks, and the overall return requirement, is linked to the individual liability profiles of each fund, and their funding levels. The most important performance comparison is actual performance against the individual funds strategic benchmark.
- 4.7 The performance of the Fund against the average of those Funds subscribing to the Local Authority universe ranked at the 63rd percentile over three years, moving up slightly from 65th percentile last year.
- 4.8 The table below shows the improving position of the Lincolnshire Fund in the LA Universe over 3, 5 and 10 years.

	3 years annualised %	5 years annualised %	10 years annualised %
LCC Fund performance	7.3	8.1	6.7
Universe Average	8.3	8.8	7.7
Ranking	63	70	84

Conclusion

- 5.1 The Pension Fund's investment performance of 6.7% over the 10 year period ended 31st March 2018 was slightly behind the strategic benchmark of 7.2%. The Fund is seeking to outperform the Benchmark by 0.75% per annum over rolling three year periods. Annualised returns over three, five and ten year periods are ahead of inflation in pay and prices. At an absolute level, the ten year performance is ahead of the current actuarial assumption for return of around 4.0% per annum.

5.2 Looking at the individual years, there was a positive contribution from stock selection in the year ended March 2018, and a negative contribution from asset allocation, however overall performance was positive.

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.

This report was written by Jo Ray, who can be contacted on 01522 553656 or jo.ray@lincolnshire.gov.uk.