

## Regulatory and Other Committee

### Open Report on behalf of Andrew Crookham, Executive Director - Resources

Report to:	<b>Pensions Committee</b>
Date:	<b>03 October 2019</b>
Subject:	<b>Performance Measurement Annual Report</b>

#### **Summary:**

This report sets out the Pension Fund's longer term investment performance for the period ending 31<sup>st</sup> March 2019.

#### **Recommendation(s):**

That the Committee note the report.

## **Background**

### **1 INTRODUCTION**

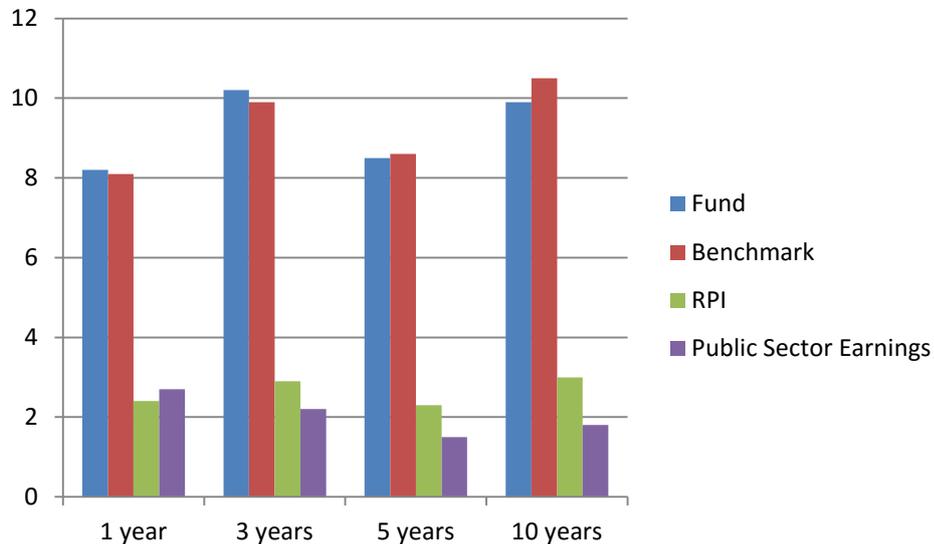
- 1.1 The Pension Fund uses two suppliers for the measurement of the Fund's performance: JPMorgan, the Fund's custodian (to 31 March 2019), calculates the Fund's investment performance and compares it with the returns of the strategic asset allocation benchmark (i.e. the return achieved by the mix of 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 31/3/2019**



	1 year %	3 years annualised %	5 years annualised %	10 years annualised %
Retail Prices Index increases	2.4	2.9	2.3	3.0
Public sector average Earnings increases	2.7	2.2	1.5	1.8
<b>LCC Fund performance</b>	<b>8.2</b>	<b>10.2</b>	<b>8.5</b>	<b>9.9</b>
<b>LCC Benchmark Performance</b>	<b>8.1</b>	<b>9.9</b>	<b>8.6</b>	<b>10.5</b>
<b>Relative Performance</b>	<b>0.1</b>	<b>0.2</b>	<b>(0.2)</b>	<b>(0.5)</b>

**2.3 10 Year Returns**

The Fund's performance over ten years, at 9.9%, is slightly behind the Fund's benchmark return of 10.5%, 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 3.0% and 1.8% p.a. respectively. The biggest impact on performance over this period is from 2010. This was a result of a number of asset allocation changes 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 3.6.

## 2.4 5 Year Returns

Five year returns of 8.5% per annum are ahead of both price and pay inflation. The Fund's actual performance is marginally behind the strategic benchmark return of 8.6%. This reflects the underperforming active managers over the period.

## 2.5 3 Year Returns

Three year returns, at 10.2%, are again ahead of both inflation and average earnings, and also ahead of the strategic benchmark return of 9.9%. This reflects outperformance by the global equity managers .

## 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 poor performance of Invesco in the year ended March 2019 was negated by the out performance of Columbia Threadneedle and Morgan Stanley Global Brands, which led to an overall out performance in stock selection over the year.
- 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 %
<b>2010</b>	29.7	36.7	<b>(5.1)</b>	(3.1)	(2.1)
<b>2011</b>	7.9	7.8	<b>0.1</b>	0.1	0.0
<b>2012</b>	1.5	2.4	<b>(0.8)</b>	(0.2)	(0.6)
<b>2013</b>	12.6	11.3	<b>1.2</b>	0.1	1.1
<b>2014</b>	6.3	6.2	<b>0.1</b>	0.2	(0.1)
<b>2015</b>	12.3	12.4	<b>(0.1)</b>	(0.1)	0.0
<b>2016</b>	0.0	1.4	<b>(1.4)</b>	(0.6)	(0.8)
<b>2017</b>	19.8	19.3	<b>0.3</b>	0.0	0.3
<b>2018</b>	3.3	3.0	<b>0.3</b>	(0.4)	0.7
<b>2019</b>	8.2	8.1	<b>0.1</b>	0.0	0.1

### 4 PIRC LOCAL AUTHORITY UNIVERSE

- 4.1 The PIRC Local Authority (LA) Universe is an aggregation of 64 funds covering £193bn 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 one of the London Pool, and with funds from all other pools except Central.
- 4.2 This was a year of political uncertainty, a burgeoning trade war between the US and China and no resolution to the Brexit issue. Despite this, investment returns, though volatile, were positive and the average Local Authority Fund produced a return of almost 7% for the year. This was slightly below the longer term average of around 8% p.a. but was ahead of inflation and actuarial assumptions.
- 4.3 Asset class returns were tightly grouped with bonds, property and equities returning 4%, 6% and 7% respectively. Private equity was the best performing asset class at 15%, followed by infrastructure at 12%. Absolute return investments all performed relatively poorly, averaging only 1% for the year.
- 4.4 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.
- 4.4 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.

- 4.5 The table below shows how the strategic asset allocation for the Lincolnshire Fund compares with the average Local Authority Pension Fund in 2019 and 2018.

Asset Class	Lincolnshire	LA Average	
		2019	2018
Equities	60.0	55	55
UK	20.0	14	15
Overseas	40.0	41	40
Bonds	13.5	19	18
Property	9.0	9	8
Infrastructure	2.5	3	3
Alternatives	15.0	8	8
Diversified Growth	0.0	3	4
Cash	0.0	3	3

- 4.6 Across the LA Universe, there has been a continuing movement from UK equities to overseas equities, an increase in bonds and a decrease in diversified growth.
- 4.7 The Fund structure is close to the average on equities, property and infrastructure, and the avoidance of diversified growth and the underweight to bonds both had a small positive impact on the relative return. Equity selection was the key element, adding almost 2% to relative return.
- 4.8 The performance of the Fund against the average of those Funds subscribing to the Local Authority universe ranked at the 10<sup>th</sup> percentile over the year.
- 4.9 The table below shows the improving position of the Lincolnshire Fund in the LA Universe over 1, 3, 5 and 10 years.

	1 year %	3 years annualised %	5 years annualised %	10 years annualised %
<b>LCC Fund performance</b>	<b>8.2</b>	<b>10.2</b>	<b>8.5</b>	<b>9.9</b>
<b>Universe Average</b>	<b>6.6</b>	<b>10.5</b>	<b>8.8</b>	<b>10.7</b>
<b>Ranking</b>	<b>10</b>	<b>42</b>	<b>59</b>	<b>82</b>

## **5 Conclusion**

- 5.1 The Pension Fund's investment performance of 9.9% over the 10 year period ended 31<sup>st</sup> March 2019 was slightly behind the strategic benchmark of 10.5%. 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 last year, there was a positive contribution from stock selection in the year ended March 2019, and a neutral contribution from asset allocation, with overall performance was positive, and ranked at the 10<sup>th</sup> percentile of the Local Authority Universe.

## **Consultation**

### **a) Have Risks and Impact Analysis been carried out?**

Yes

### **b) Risks and Impact Analysis**

The Pension Fund has a Risk Register which can be obtained by contacting the author of this report.

## **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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