

The background of the slide features a large, light blue outline of the Coat of Arms of the Government of Nunavut. The crest includes a crown at the top with four floral motifs. The shield is divided into four quadrants: top-left shows a stylized building, top-right shows a caribou head with antlers, bottom-left shows a sailing ship on waves, and bottom-right shows an eagle with spread wings. A banner at the bottom contains the motto 'ANE FOR A' in Inuktitut.

Agenda Item 9

Market Review and Fund Manager Performance

Falkirk Council

Subject: Market Review and Fund Manager Performance

Meeting: Joint Meeting of Pensions Committee and Pension Board

Date: 27 June 2019

Submitted by: Director of Corporate and Housing Services

1. Purpose of Report

- 1.1 The Local Government Pension Scheme Regulations require that administering authorities review the investments and performance of their managers at least once every three months.
- 1.2 The Fund's governance structure delegates the implementation of investment strategy to the Chief Finance Officer, who takes advice from the Joint Investment Strategy Panel (JISP) of the Falkirk, Fife and Lothian Pension Funds. An update on the Panel meeting of 10 June 2019 will be given later in this meeting.
- 1.3 This paper updates the Committee and Board on recent investment market developments; the Fund's strategic allocation and performance; and on the monitoring activity of the Fund's investment mandates during the most recently completed quarter.

2. Recommendations

2.1 The Committee and Board are asked to note:

- (i) recent investment market developments;
- (ii) the Fund's strategic allocation;
- (iii) the Fund's performance for the period ending 31 March 2019 and;
- (iv) the investment monitoring activity of the Joint Investment Strategy Panel (JISP).

3. Market Review and Outlook

- 3.1 The first quarter of 2019 saw equity markets rebound from the sell-off in the last quarter of 2018, with global equities rising by almost 10% in sterling terms. Sterling bond markets also performed strongly, with fixed and index-linked gilts returning +3.4% and +5.9% respectively, while investment grade bonds returned +4.1%.

- 3.2 In the US, GDP was higher than expected, at 3.2% year-on-year for the quarter, up from an upwardly revised figure of 3.0% in Q4. The US dollar appreciated back towards its all-time high in 2002 on a trade weighted basis. US equities ended Q1 close to all-time highs.
- 3.3 In the UK, business and consumer confidence survey data shows continuing stagnation. While markets place a diminished probability on the risk of a no deal Brexit, the focus has shifted to the future political state and the ability of Parliament to pass legislation. Post quarter-end, Theresa May's resignation and the emerging prospect of Boris Johnson moving into No. 10 has resulted in Sterling re-testing the lows of December 2018.
- 3.4 The OECD's March 2019 interim economic outlook title changed from November's "Real GDP growth revised down" to "Global growth weakening as some risks materialise". World growth in 2019 was revised down, by an additional 0.2%, to 3.3%.
- 3.5 In Europe, and by implication the UK, growth has been substantially downgraded for 2019. Forecasts were lowered by 0.8% and 0.6% to 1.0% and 0.8%, respectively. The US, in contrast, is downgraded by 0.1% to 2.6% in 2019, and upgraded by 0.1% to 2.2% in 2020. The outlook for China is a little lower than previously forecast.
- 3.6 The outlook for emerging markets is also modestly lower. Brazil and Mexico are expected to have slightly lower growth in 2019, whilst Turkey sees a deeper contraction of -1.8% before rebounding more strongly than previously expected in 2020.
- 3.7 The prospect of looser monetary policy is likely to support risk assets in the short term and although the outlook for global growth is softer than it was, it remains positive overall. However, economic forecasts have been tilting further in a downward direction.

4. Fund Strategy

- 4.1 The Fund's strategic asset allocation was approved by the Pensions Committee in December 2018. It is presented in table 1 with the target weighting for each of the 5 policy groups and ranges around the target strategy within which the Chief Finance Officer is permitted to operate. The policy groups are presented in the order of most to least volatile and highest to lowest expected real return over the long term. The key focus of the Pensions Committee is on investment strategy and oversight, in line with its responsibility for the overall funding and investment arrangements and the level of investment risk within the Fund.

Table 1

Policy Group	Minimum	Strategy	Maximum
Equities	45%	60%	65%
Real Assets	10%	20%	25%
Non-Gilt Debt	5%	15%	25%
Gilts	0%	5%	20%
Cash	0%	0%	10%
Total		100%	

- 4.2 The Fund has continued to gradually make investments in areas previously identified by Committee, including infrastructure and private debt, to move towards its strategic allocation. A summary of the Fund's commitments to infrastructure and other private market investments are presented in Appendix 2.
- 4.3 Table 2 below presents the current policy group allocations along with the investment mandates that populate those groups. The current allocations will evolve gradually to the target allocations as appropriate investments become available.

Table 2

FALKIRK PENSION FUND		Permitted	Strategy	Actual
7 June 2019		Ranges	Allocation	Allocation
Fund size £2,499m	Manager	%	%	%
EQUITIES				
Passive Equity (UK 36%/O'seas 64%)	L&G			16.7
Fundamental Weighting	L&G			4.7
Active UK Equity	Schroder			11.6
Active Global Equity	Newton			16.6
Active Global Equity	Aberdeen			9.6
Listed Equity Subtotal				59.2
Private Equity LPs	Wilshire / SL Cap			2.2
Total Equities		45-65	60	61.4
REAL ASSETS				
Property Multi-Manager	Schroder			5.9
Property (Affordable)	Hearthstone			0.9
Infrastructure FoFs	Grosvenor Capital			2.7
Infrastructure LPs	Internal/LPFI			5.3
Total Real Assets		10-25	20	14.8
NON-GILT DEBT				
Liquid credit	BG/M&G			3.8
Illiquid credit	Internal/LPFI			0.7
Total Non-Gilt Debt		0-25	15	4.5
GILTS				
Index-Linked Gilts and Fixed Gilts	BG			3.8
Total Gilts		0-20	5	3.8
CASH				
Cash	Various			5.8
Total Cash		0-10		5.8
DIVERSIFIED GROWTH				
Diversified Growth	BG			9.7
Total Diversified Growth				9.7
TOTAL				100.0

5. Fund Returns

- 5.1 The Chief Finance Officer and JISP noted the rates of return achieved by the Fund and its managers at the Panel's latest meeting. These returns are measured against pre-determined benchmarks, as calculated by an independent provider of performance measurement services, currently the Fund's Custodian, Northern Trust. They are shown in Appendix 1.

- 5.2 The Chief Finance Officer and JISP review and assess returns and manager implementation in the context of risk taken, mandate constraints and objectives, which depend on the type of mandate awarded. These objectives are shown in Appendix 3, which is an excerpt from the Statement of Investment Principles.
- 5.3 The overall Fund value increased by 6.5% over the quarter, ahead of the benchmark return, which rose by 6.2%. Over the 5-year period, the Fund rose 9.1% per annum compared with the benchmark return of 7.8% per annum. Over the 5-year period, the Fund benefited from its exposure to overseas equities (which performed much better than UK equities partly due to sterling weakness against overseas currencies). Overseas equity and UK property assets generated strong returns while bond and UK equity assets provided more modest, but still respectable, returns. The Baillie Gifford Diversified Growth Fund was the lowest returning allocation within the portfolio over 5 years, returning 4.9% per annum.
- 5.4 Long term return data shows Fund appreciation of 7.7% per annum since September 2001, which is above the benchmark return.
- 5.5 While the above data shows strong growth in assets over mid- and long-term time periods, the funding level is determined by a combination of the growth in assets and changes in liabilities. The latest actuarial valuation at end March 2017, which reassessed a range of financial and demographic assumptions in light of inter-valuation experience, showed that the funding level had improved to 92% (from 85% at end March 2014).

6. Investment Manager Monitoring

- 6.1 The Fund's allocation to Managers within asset classes is a less significant driver of returns and risk than the strategic allocation. The Chief Finance Officer monitors Managers quarterly as per the regulations supported by the JISP and the internal teams at Falkirk and Lothian, who review Managers and portfolios quarterly and hold meetings with managers (in person or by telephone) at least 3 out of 4 quarters in the year. Reporting is conducted using a traffic light system, which highlights issues and concerns across a range of areas, including portfolio activity, portfolio construction, portfolio risk and return as well as business operations.
- 6.2 Full details of each Manager's portfolio activity and any engagement with companies on corporate governance issues are recorded in their individual quarterly investment reports, which have been uploaded to the Sharefile portal.
- 6.3 A separate report provides further details on investment monitoring, including information on the nature of the mandates and the investment approach of the Managers as well as current developments and issues identified through the monitoring process.

7. Conclusion

- 7.1 The most recent change to the Fund's strategic allocation requires a reduction in growth assets and an increase in defensive assets. The Fund has increased

the cash level as an interim step and further changes will be implemented based on the new investment strategy.

- 7.2 The positive return of +6.5% for the Fund during Q1 2019 (which was ahead of benchmark) follows the negative return of -5.7% over the quarter to end December 2018. Over 3- and 5-year timeframes, the Fund has achieved returns above benchmark and, in absolute terms, +10.3% and +9.1% per annum respectively.
- 7.3 The JISP monitors the Fund's investment managers and portfolios and advises the Chief Finance Officer quarterly in line with the regulations.

Director of Corporate & Housing Services

Authors:

Bruce Miller
0131 469 3866 bruce.miller@edinburgh.gov.uk

Albert Chen
0131 469 3079 albert.chen@edinburgh.gov.uk

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Appendices

Appendix 1 – Performance Measurement (Rates of Return)

Appendix 2 – Private Markets Commitments

Appendix 3 – Mandate Benchmarks and Objectives

List of Background Papers

Northern Trust – Investment Risk & Analytical Services, 31 March 2019

PERFORMANCE MEASUREMENT (RATES OF RETURN)

Rates of Return by Manager with Excess Returns - 31 March 2019							
Fund/Portfolio	Market Value £	Weight	Annualized Returns				Inception Date
			3 months	3 year	5 year	Since inception	
Falkirk Council Pension Fund	2,466,323,739	100.0%	6.5%	10.3%	9.1%	7.7%	Sep-01
Benchmark			6.2%	9.0%	7.8%	7.1%	
Excess Return			0.3%	1.2%	1.2%	0.6%	
Aberdeen Portfolio	253,329,907	10.3%	9.2%	12.7%	8.5%	8.9%	May-10
Benchmark			9.8%	15.0%	12.4%	10.8%	
Excess Versus Benchmark			-0.5%	-1.9%	-3.5%	-1.7%	
Excess Versus Objective			-	-4.9%	-6.5%	-4.7%	
Baillie Gifford Bond Portfolio*	184,221,601	7.5%	4.3%	5.7%	6.4%	6.3%	Mar-07
Benchmark			4.4%	5.3%	6.4%	6.4%	
Excess Versus Benchmark			-0.1%	0.3%	0.0%	-0.1%	
Excess Versus Objective			-	-0.6%	-0.9%	-1.0%	
Baillie Gifford Diversified Growth**	240,298,595	9.7%	6.3%	5.6%	4.9%	5.5%	Feb-12
Benchmark			0.2%	0.5%	0.5%	0.5%	
Excess Versus Benchmark			6.1%	5.1%	4.4%	5.0%	
Excess Versus Objective			-	-	0.9%	1.5%	
Hearthstone Social	24,068,386	1.0%	1.2%	-1.2%	-	-0.8%	Nov-14
Benchmark			0.3%	5.0%	-	4.3%	
Excess Versus Benchmark			0.9%	-5.9%	-	-5.0%	
Excess Versus Objective			-	-	-	-	
In-House	323,276,165	13.1%	3.6%	11.2%	12.3%	10.9%	Sep-01
Benchmark			1.7%	0.8%	0.6%	2.2%	
Excess Versus Benchmark			1.9%	10.4%	11.6%	8.6%	
Excess Versus Objective			-	-	-	-	
Legal & General Fundamental Weighting	117,666,686	4.8%	7.8%	-	-	7.1%	Nov-16
Benchmark			7.8%	-	-	7.2%	
Excess Versus Benchmark			0.0%	-	-	0.0%	
Excess Versus Objective			-	-	-	0.0%	
Legal & General Passive	414,559,662	16.8%	9.4%	13.1%	10.4%	12.5%	Jan-09
Benchmark			9.4%	13.0%	10.3%	12.4%	
Excess Versus Benchmark			0.0%	0.1%	0.1%	0.1%	
Excess Versus Objective			0.0%	0.1%	0.1%	0.1%	
Newton	423,589,722	17.2%	9.3%	12.2%	13.2%	10.3%	Jun-06
Benchmark			9.6%	14.4%	12.1%	9.2%	
Excess Versus Benchmark			-0.3%	-1.9%	1.0%	1.0%	
Excess Versus Objective			-	-	-2.0%	-2.0%	
Private Debt	17,018,245	0.7%	-1.8%	-	-	-1.2%	Jul-18
Benchmark			1.3%	-	-	3.6%	
Excess Versus Benchmark			-3.1%	-	-	-4.7%	
Excess Versus Objective			-	-	-	-8.7%	
Schroders UK Equity	310,423,841	12.6%	5.4%	10.6%	6.8%	8.8%	Sep-01
Benchmark			9.4%	9.5%	6.1%	6.8%	
Excess Versus Benchmark			-3.7%	1.0%	0.6%	1.9%	
Excess Versus Objective			-	-0.3%	-0.6%	0.6%	
Schroders Property	157,870,930	6.4%	0.4%	6.0%	8.9%	4.4%	Nov-05
Benchmark			0.3%	6.2%	9.1%	4.4%	
Excess Versus Benchmark			0.1%	-0.2%	-0.2%	0.0%	
Excess Versus Objective			-	-0.9%	-1.0%	-0.8%	

Notes:

- Objectives vary and are set over 3- or 5-year periods highlighted by the boxes for each manager.
- There are small rounding effects in the table above.
- The independent performance measurement provider shows a slightly different performance for Baillie Gifford than the manager itself. This is due to an intra-day valuation timing difference.
- Change in benchmark for In-House portfolio (1 January 2018) from cash to custom benchmark weighted by assets according to benchmarks in SIP (see Appendix 3).
- Private debt total returns are not meaningful until underlying funds are fully invested.

PRIVATE MARKET COMMITMENTS

Falkirk Council Pension Fund Limited Partnerships	Market Value 31/12/2018 (£m)	Market Value 31/03/2019 (£m)	% of Fund	Unfunded Commit (£m)	Unfunded Commit % of Fund	Comment - Q1, 2019
In House Infrastructure	107.4	118.3	4.8%	20.0	0.8%	Net distributions in Q1 were £2.2m. Distributions of £2.6m included proceeds from secondary funds and co-investments.
Global Infrastructure	61.7	66.7	2.7%	27.2	1.1%	Net fundings in Q1 were £3.9m. Gross fundings of £4.6m included a follow-on in Vantage Data Centers. A new primary commitment was made in Asterion Industrial Infra Fund I.
Private Equity	60.4	57.6	2.3%	16.4	0.7%	Net fundings of £0.3m against distributions of £2.8m. With no new commitments being made, we expect distributions will continue to exceed fundings as funds mature and return cash.
Affordable Housing	23.6	24.1	1.0%	3.9	0.2%	Unfunded commitment of £3.9m. The investment period has ended. Balance of undeployed cash to be returned.
Private Debt	13.3	18.4	0.7%	43.0	1.7%	Net fundings in Q1 were £5.9m, with capital calls for each of the commitments to Alcentra, Barings and BlackRock. Distributions of £0.7m were primarily from the residual M&G UK Companies funds.
Total Limited Partnerships	266.3	285.1	11.5%	110.5	4.4%	

Fund value as at 31.03.19 (£m) 2,485.8
(including operational cash held outwith Custodian)

MANDATE BENCHMARKS AND OBJECTIVES

Fund Manager	Benchmark	Objective
Listed Equities Active		
Aberdeen Asset Management	MCSI All Countries World Index	To outperform the benchmark by 3% pa net of fees over rolling 3 year period
Newton Inv Management	MCSI All Countries World Index	To outperform the benchmark by 3% pa net of fees over rolling 5 year period
Schroders UK Equity	FTSE All Share Index	To outperform the benchmark by 1.25% pa net of fees over rolling 3 year period
Listed Equities Passive		
Legal and General	Composite of Regional Indices	To perform in line with the benchmark over all periods
Legal and General Fundamental Weighting	FTSE RAFI All World 3000	To perform in line with the benchmark over all periods
Low Volatility	To be appointed	To be appointed
Private Equity/Debt		
Wilshire Capital	MSCI World Index	To outperform the benchmark by 5% pa net over the life cycle of the fund
Standard Life Capital	MSCI Europe Index	To outperform the benchmark by 5% pa net over the life cycle of the fund
M&G Investments	FT 7 day Sterling LIBID Index	To outperform the benchmark by 5% pa net over the life cycle of the fund
Internal	3 month LIBOR	To outperform the benchmark by 4% pa net over the life cycle of the funds
Property		
Schroders	IPD UK Pooled Property Fund Indices All Balanced Funds Weighted Average	To outperform the benchmark by 0.75% pa net of fees over rolling 3 year period
Multi Assets		
Baillie Gifford Diversified Growth	UK Base Rate	To outperform the benchmark by 3.5% pa net of fees over rolling 5 year period with annual volatility less than 10%
Bonds		
Baillie Gifford	50% Merrill Lynch Stirling Non Gilt 30% FTSE All Stocks Gilts 20% FTSE-A-Index Linked Over 5yr Index	To outperform the benchmark by 0.9% pa net of fees over rolling 3 year period
Infrastructure		
Grosvenor	RPI	To achieve a net return of 10% over the life cycle of the funds
Internal	RPI	RPI Index +3.5% pa
Social/Affordable Housing		
Hearthstone	RPI	RPI Index +2% pa