

The background of the slide features the coat of arms of the Government of Nunavut. It is a shield divided into four quadrants. The top-left quadrant shows a stylized building. The top-right quadrant shows a caribou head with antlers. The bottom-left quadrant shows a sailing ship on wavy lines representing water. The bottom-right quadrant shows a beaver. Above the shield is a crown with four maple leaves. Below the shield is a banner with the text "ANĖ FOR A'".

## **Agenda Item 10**

# **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: 19 March 2020**

**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 on 13 March 2020 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 December 2019 and;
- (iv) the investment monitoring activity of the Joint Investment Strategy Panel (JISP).

### 3. Market Review and Outlook

- 3.1 The fourth quarter of 2019 saw financial markets maintain positive momentum, with risk assets including equities, commodities and hedge funds among the strongest performing asset classes. In contrast, government bonds delivered negative returns as bond yields rose from historically low levels in Q3 2019. In credit markets, both investment grade and high yield bonds generated positive returns as tighter credit spreads more than offset the rise in bond yields.
- 3.2 Key economic developments during the quarter included the prospect of an initial trade agreement between the US and China, which buoyed global equity markets. In December, the election of a majority Conservative UK government lifted much of the uncertainty around domestically-oriented UK equities, which responded positively.
- 3.3 Markets continued to perform strongly in early 2020, seemingly discounting any major economic impact from the coronavirus (CoVID-19) outbreak in China. However, volatility returned in late February as rising case counts in South Korea, Iran and Italy added to fears that the virus' spread might continue, and that the resulting economic impact, in both China and elsewhere, may be more negative and longer-lasting than first anticipated.

### 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	0%	15%	25%
Gilts	0%	5%	20%
Cash	0%	0%	10%
Total		100%	

- 4.2 The Fund has continued to make investments in areas previously identified by Committee to move towards its strategic allocation. A summary of the Fund's commitments to infrastructure and other private market investments is shown 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**

14 February 2020 £2,662m	Manager	Permitted Range (%)	Strategy Allocation	Actual Allocation	Deviation
<b>EQUITIES (Gilts +3.5%pa)</b>					
Passive Equity (UK 36%/O'seas 64%)	L&G			17.0%	
Fundamental Weighting Global Equity	L&G			4.7%	
Active UK Equity	Schroder			10.8%	
Active Global Equity	Newton			17.9%	
Global Low Volatility (GLOVE mirror)	L&G			10.2%	
<i>Listed Equity Subtotal</i>				60.6%	
Private Equity LPs	Wilshire/SL Capital			1.8%	
<i>Private Equity Subtotal</i>				1.8%	
<b>Total Equities</b>		<b>45 - 65</b>	<b>60%</b>	<b>62.5%</b>	<b>2.5%</b>
<b>REAL ASSETS (Gilts +2.5%pa)</b>					
Property	Various			5.4%	
Property (Affordable Housing)	Hearthstone			0.8%	
Infrastructure FoF	Grosvenor Capital			2.5%	
Infrastructure	Various			6.2%	
<b>Total Real Assets</b>		<b>10 - 25</b>	<b>20%</b>	<b>15.0%</b>	<b>-5.0%</b>
<b>NON-GILT DEBT (Gilts +1%pa)</b>					
Liquid Credit (Corporate Bonds/Loans)	Baillie Gifford/M&G			3.6%	
Illiquid Credit (Private Debt/Loans)	Various			1.6%	
<b>Total Non-Gilt Debt</b>		<b>0 - 25</b>	<b>15%</b>	<b>5.2%</b>	<b>-9.8%</b>
<b>GILTS</b>					
Gilts (60% nominal/40% index-linked)	Baillie Gifford			3.5%	
<b>Total Gilts</b>		<b>0 - 20</b>	<b>5%</b>	<b>3.5%</b>	<b>-1.5%</b>
<b>CASH (7-day LIBID)</b>					
Cash	Various			4.1%	
<b>Total Cash</b>		<b>0 - 10</b>	<b>0%</b>	<b>4.1%</b>	<b>4.1%</b>
<b>OTHER</b>					
Diversified Growth	Baillie Gifford			9.7%	
<b>Total Other</b>			<b>0%</b>	<b>9.7%</b>	<b>9.7%</b>
<b>TOTAL</b>				<b>100%</b>	

Sources: NT/Committee Papers

## 5. Fund Returns

5.1 The Chief Finance Officer and JISP noted the rates of return achieved by the Fund and its managers (for Q3 2019) at the Panel's meeting in December 2019. These returns are measured against pre-determined benchmarks, as calculated by a recently appointed independent provider of performance measurement services, Portfolio Evaluation. Work is ongoing to finalise data migration and reporting processes with the Fund's managers and this work is being finalised. The latest figures provided for Q4 2019 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 0.8% over Q4 2019, ahead of the benchmark return, which declined by 1.0%. Over the 5-year period, the Fund rose 8.9% per annum compared with the benchmark return of 8.2% per annum. Over this 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). UK property assets have also generated strong returns while bond and UK equity assets provided more modest, but still respectable, returns.
- 5.4 Long term return data shows Fund appreciation of 7.8% per annum since September 2001, which is above the benchmark return of 7.3% per annum.
- 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 estimate from the Fund's actuary at 31 March 2019 indicated a funding level of 93.4%, an improvement from the 31 March 2017 valuation position of 92%. Since March, 2019, it was anticipated that funding levels would have improved due to strong asset returns, however, the decline in bond yields and the recent market falls due to coronavirus uncertainty will have trimmed any major improvement in the funding position.

## **6. Investment Manager Monitoring**

- 6.1 The Fund's allocation to Managers within asset classes is typically 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 more defensive assets. The Fund had increased its cash levels as an interim step. This has started to decline – a

trend that is expected to continue - as further changes are implemented over the coming quarters based on the new investment strategy.

- 7.2 The positive return of +0.8% for the Fund during Q4 2019 was ahead of benchmark, and contributes to a return over the 2019 calendar year of +14.2%. Over 5 years, the Fund has achieved an absolute return of +8.9% per annum above its benchmark return of +8.2% per annum.
- 7.3 The JISP monitors the Fund's investment managers and portfolios and advises the Chief Finance Officer quarterly in line with the regulations.

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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**

Portfolio Evaluation – Quarterly Risk and Return Analysis, 31 December 2019

### Rates of Return by Manager with Excess Returns - 31 December 2019

\* Manager returns

Notes:

1. Objectives vary and are set over 3- or 5-year periods highlighted by the boxes for each manager.
2. There are small rounding effects in the table above.
3. The independent performance measurement provider shows a slightly different performance for Baillie Gifford than the manager itself. This is due to intra-day valuation timing differences.
4. Manager return figures have been provided for Baillie Gifford mandates.
5. Private equity returns over 3- and 5-years are being finalised.
5. Private debt total returns are not meaningful until underlying funds are fully invested.



## APPENDIX 2 – PRIVATE MARKET COMMITMENTS

Falkirk Council Pension Fund Limited Partnerships	Market Value 30/09/2019 (£m)	Market Value 31/12/2019 (£m)	% of Fund	Fundings Q4, 2019 (£m)	Distributions Q4, 2019 (£m)	Unfunded Commit (£m)	Unfunded Commit % of Fund	Comment - Q4, 2019
In House Infrastructure	153.2	164.4	6.1%	9.6	2.5	25.5	1.0%	investment in 1 new fund
Global Infrastructure	71.0	65.8	2.5%	3.2	4.0	24.3	0.9%	
Private Equity	54.9	50.3	1.9%	0.7	2.4	14.6	0.5%	
Affordable Housing	21.9	22.1	0.8%	-	-	-	0.0%	
Private Debt	31.3	39.5	1.5%	11.3	2.3	38.8	1.4%	
<b>Total Limited Partnerships</b>	<b>332.3</b>	<b>342.1</b>	<b>12.8%</b>	<b>24.8</b>	<b>11.2</b>	<b>103.2</b>	<b>3.9%</b>	

### APPENDIX 3 – MANDATE BENCHMARKS AND OBJECTIVES

Fund Manager	Benchmark	Objective
<b>Listed Equities Active</b>		
Newton Inv Management	MSCI 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
Legal and General Low Volatility	MSCI All Countries World Index	To achieve a better risk-adjusted return than the benchmark over a full market cycle
<b>Listed Equities Passive</b>		
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
<b>Private Equity/Debt</b>		
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
<b>Property</b>		
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
<b>Multi Assets</b>		
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%
<b>Bonds</b>		
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
<b>Infrastructure</b>		
Grosvenor	RPI	To achieve a net return of 10% over the life cycle of the funds
Internal	RPI	RPI Index +3.5% pa
<b>Social/Affordable Housing</b>		
Hearthstone	RPI	RPI Index +2% pa