

LONG TERM PERFORMANCE AND STRATEGIC REVIEW

Report of the County Treasurer

Please note that the following recommendations are subject to consideration and determination by the Board before taking effect.

Recommendation: That the Committee approves the commissioning of a strategic asset allocation review using the South West investment consultancy framework.

1. Introduction

- 1.1. The Devon Pension Fund's liabilities to meet pension payments stretch many years into the future. As a result the management of investments has to consider the longer term, and the principal aim of the Fund should therefore be to achieve high performance over the longer term.
- 1.2. This report has therefore been brought to the committee to examine the Fund's longer term performance, and in particular to analyse why performance over the last 10 years has been below the average performance achieved by LGPS funds in total. A further briefing on this will be provided by Elaine Packer from WM Performance Services at the training session following the committee meeting.
- 1.3. Further to this, the report proposes the commissioning of a strategic asset allocation review, and outlines the rationale for doing so. Many funds commission a strategic review following the results of an actuarial valuation, and given that the Devon Fund has not commissioned an external strategic review for many years, now would be an opportune time to do so.

2. Performance Analysis

- 2.1. The Devon Pension Fund's performance in comparison to benchmark and the universe of LGPS Funds over the last ten years is summarised in the table below:

Year	Devon Fund Performance	Strategic Benchmark	LGPS Universe Performance	Devon Ranking v. LGPS Universe
2015/16	-0.5%	+1.2%	+0.2%	60
2014/15	+10.0%	+11.0%	+13.2%	95
2013/14	+4.7%	+6.4%	+6.4%	77
Last 3 Years	+4.6%	+6.1%	+6.4%	91
2012/13	+12.3%	+10.4%	+13.8%	82
2011/12	+2.6%	+2.6%	+2.6%	58
Last 5 Years	+5.7%	+6.2%	+7.1%	91

Year	Devon Fund Performance	Strategic Benchmark	LGPS Universe Performance	Devon Ranking v. LGPS Universe
2010/11	+7.6%	+8.3%	+8.3%	67
2009/10	+33.9%	+35.3%	+35.3%	62
2008/09	-19.1%	-20.0%	-20.0%	41
2007/08	-3.5%	-2.8%	-2.8%	55
2006/07	+7.8%	+7.0%	+7.0%	28
Last 10 Years	+4.8%	+5.1%	+5.6%	76

2.2. Until 2012, the Devon Fund used the LGPS Universe average as its strategic benchmark, hence the benchmark and LGPS Universe performance figures are the same up to the 2011/12 financial year. From 2012/13 the Fund changed its benchmark to a bespoke benchmark based on its strategic asset allocation. Therefore from 2012/13 it is possible to see both how the Fund performed against its benchmark and also how both performance and the strategic benchmark compared to the performance of the average LGPS fund. The table shows that the Fund has performed below its benchmark over each of 3, 5 and 10 years, but that even had the Fund performed in line with its strategic benchmark it would still have lagged the LGPS average.

2.3. To analyse this further, a comparison of the Devon fund returns and the LGPS average over three and five years is shown at Appendix 1. The table measures the contribution of each asset class to both the LGPS average return and the Devon Fund return. It then compares the differences between the returns both in terms of strategic asset allocation, i.e. where the Devon Fund has a different weighting to an asset class compared to the LGPS average, and manager performance.

2.4. The three key differences highlighted by the table are as follows:

- The allocation to bonds has cost performance compared to the LGPS average. This is shown under the manager performance heading in appendix 1 because the underperformance is not due to the weighting allocated to bonds within the asset allocation strategy. However, for the most part this is not attributable to the performance of the Fund's bond managers. While they have marginally underperformed their benchmarks, the main reason for the underperformance was the strategic decision made in 2009 to allocate funds to global bonds and reduce the allocation to Gilts. Many LGPS funds will have had specific allocations to Gilts, and the Gilt market has performed more strongly over the last 5 years than both overseas government bonds and corporate bonds. The Fund's strategic benchmark incorporates a global bonds benchmark rather than a Gilts benchmark, which also contributed to the Fund's strategic benchmark being below the LGPS average return over the three and five year periods.
- The Fund's allocation to equities has underperformed. This is the result of the underperformance of the Fund's active equity managers including the Aberdeen global equity mandate, Sarasin to September 2014, and the Specialist Equity Funds. This has impaired performance by 0.8% over three years and 0.5% over five years.
- The main strategic asset allocation decision that has had a negative impact on the Devon Fund is the allocation to diversified growth funds (DGFs). In 2012 the decision was made to allocate 15% of the fund into DGFs, significantly more than the average LGPS fund has allocated. This has cost the fund performance compared with the average at a time when equity markets have been significantly positive.

- 2.5. With hindsight it would appear that the Fund made some incorrect decisions in relation to the allocation to DGFs and global bonds as opposed to Gilts, and in the managers that have been appointed. However, at the time the decisions were made, it would not have been easy to predict the way that the markets have behaved over the intervening period. In relation to manager appointments, Aberdeen, who on their global equity mandate have underperformed the benchmark by 6% per year over the three years to March 2016, had outperformed by 2% per year over the first three years (2009 – 2012) following their appointment. Their performance over the first 6 months of the 2016 calendar year has improved again, and been 6% ahead of benchmark.

3. Strategic Asset Allocation Review

- 3.1. The 2016 Actuarial Valuation of the Fund is currently being undertaken, with provisional results due in the next couple of months. Given that the valuation will assess the Fund's current position in comparing its liabilities with the current value of the assets held, it will give some indication of the investment strategy the fund will need going forward to achieve full funding and meet its liabilities over the longer term. For this reason, the period following completion of the Actuarial Valuation is a good time to review the Fund's strategic asset allocation.
- 3.2. It has been many years since the Fund commissioned an external review of its strategic asset allocation. Recent reviews of the Fund's asset allocation have been conducted internally by Fund officers in liaison with the Fund's independent advisor. Last year Hymans Robertson conducted a review of the Fund's fixed interest allocation producing recommendations which have been implemented in part, with further changes to be phased in as part of the transition to the pooling of investments. However, this addressed less than 20% of the Fund's total asset allocation. Given the recent period of poor relative performance, it is suggested that it would now be appropriate to commission an external review of the overall Fund strategic asset allocation.
- 3.3. An external review would be conducted by consultants with access to significant data on investment markets, and modelling software to analyse the data, neither of which are available to the Devon Fund internally. The consultants would be able to assess the appropriate strategic asset allocation, including the split between "growth" assets and "fixed interest" type assets, geographical allocations and currency hedging issues. This would take into account the structure of the Fund's liabilities and cashflow profile, appropriate risk management, and the setting of appropriate performance targets and benchmarks. The review can also assess whether there are any lessons to be learned from the Fund's underperformance over the last few years. Given the current investment pooling agenda, the review should concentrate on the investment strategy rather than investment manager related activities or functions which will become the responsibility of the Brunel Pension Partnership.
- 3.4. In commissioning the review, the Fund would again be able to make use of the investment consultancy framework set up collaboratively by the South West LGPS Funds. A procurement exercise for investment consultancy was carried out under OJEU (Official Journal of the European Union) regulations and Aon Hewitt, Bfinance, Hymans Robertson, Mercers and JLT (Jardine Lloyd Thompson) were appointed to the framework. Each of them has a strong track record and significant expertise in advising local authority pension funds. It is therefore proposed to use the framework to conduct a mini-competition to appoint one of the companies named to undertake the piece of work required.

4. Conclusion

- 4.1. The Devon Fund's performance in the last few years has been disappointing compared to the LGPS average. However, it will always be a difficult task to forecast the future behaviour of investment markets. Issues such as unprecedentedly low interest rates, the use of quantitative easing, and events such as Brexit, can quickly change the direction of medium term investment returns for different types of assets. These issues may perhaps have had more impact on the Devon Fund's strategic allocation than most. However, the Fund remains well placed to meet the potential challenges of difficult markets ahead, and the Brunel collaboration will also provide opportunities for improved performance.
- 4.2. In consequence of the Actuarial Review currently taking place, the recent history of underperformance and the fact that an external review of strategic asset allocation has not been undertaken for many years, the Committee are asked to approve the commissioning of an external strategic asset allocation review using the South West investment consultancy framework.

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Electoral Divisions: All

Local Government Act 1972

List of Background Papers - Nil

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Comparison between Devon Fund Returns and the LGPS Universe Average for the three years to 31 March 2016

Asset Category	LGPS Universe			Devon Fund			Variance Analysis	
	Weight	Return	Contribution	Weight	Return	Contribution	Strategic Allocation	Manager Performance
	%	%	%	%	%	%	%	%
Equities	62.1	6.5	4.0	59.0	5.1	3.0	0.0	-0.8
Total Bonds	17.0	4.0	0.7	12.2	0.4	0.0	0.1	-0.5
Cash	2.9	1.8	0.0	1.4	0.8	0.0	0.1	0.0
Property	7.7	12.4	1.0	10.1	13.0	1.3	0.1	0.0
Pooled Multi-Asset	2.7	3.5	0.1	14.9	2.8	0.4	-0.4	-0.1
Alternatives	7.6	8.3	0.6	2.4	-0.5	-0.1	-0.1	-0.2
Total	100.0		6.4	100.0		4.6	-0.2	-1.6

Comparison between Devon Fund Returns and the LGPS Universe Average for the five years to 31 March 2016

Asset Category	LGPS Universe			Devon Fund			Variance Analysis	
	Weight	Return	Contribution	Weight	Return	Contribution	Strategic Allocation	Manager Performance
	%	%	%	%	%	%	%	%
Equities	62.3	7.2	4.5	61.7	6.4	4.0	0.0	-0.5
Total Bonds	17.4	7.0	1.2	13.8	3.0	0.4	0.0	-0.6
Cash	3.1	1.8	0.1	2.3	0.3	0.0	0.0	0.0
Property	7.5	9.0	0.7	9.0	9.3	0.8	0.0	0.0
Pooled Multi-Asset	2.1	3.8	0.1	11.3	3.8	0.4	-0.3	0.0
Alternatives	7.6	7.3	0.5	1.9	5.1	0.1	0.0	0.0
Total	100.0		7.1	100.0		5.7	-0.3	-1.1