



Glasgow City Council

Strathclyde Pension Fund Committee

Report by Director of Strathclyde Pension Fund

Contact: Jacqueline Gillies Ext: 75186

Item 9

5th June 2019

Investment Advisory Panel – Quarterly Report

Purpose of Report:

To provide the committee with a summary of the Investment Advisory Panel meeting held on Thursday 9th May 2019.

Recommendation:

The Committee is asked to **NOTE** the contents of this report.

Ward No(s):

Citywide: ✓

Local member(s) advised: Yes No consulted: Yes No

PLEASE NOTE THE FOLLOWING:

Any Ordnance Survey mapping included within this Report is provided by Glasgow City Council under licence from the Ordnance Survey in order to fulfil its public function to make available Council-held public domain information. Persons viewing this mapping should contact Ordnance Survey Copyright for advice where they wish to licence Ordnance Survey mapping/map data for their own use. The OS web site can be found at <<http://www.ordnancesurvey.co.uk>> "

If accessing this Report via the Internet, please note that any mapping is for illustrative purposes only and is not true to any marked scale

1 Background

As a key element of its governance arrangements, the Strathclyde Pension Fund (SPF) maintains an Investment Advisory Panel (IAP). The role of the IAP, together with details of membership and meeting arrangements, is summarised in **Schedule 1**.

2 IAP Meeting – Thursday 9th May 2019

Present: Professor Geoffrey Wood, Eric Lambert, Iain Beattie, David Walker (Hymans Robertson), Andy Green (Hymans Robertson, part meeting only), Richard McIndoe, Jacqueline Gillies, Richard Keery, Ian Jamison (part meeting only).

Agenda: Strategy Development Session

- 1) Minutes from last meeting and any matters arising
- 2) Investment Strategy and Structure
- 3) Monitoring
- 4) Allocation
- 5) Governance
- 6) Manager Reviews
- 7) AOCB

2.1 Minutes from Last Meeting & any Matters Arising

The minutes of the previous meeting were agreed to be an accurate record.

At the meeting, the Panel had noted that the Fund continued to hold an emerging markets futures position with Legal and General. The Panel had agreed that the Fund should maintain this exposure to emerging markets, but consider alternative implementation options.

Officers had reviewed the alternative options within the current Fund structure – 2 Genesis funds and a Legal & General fund.

The concluded that, on the basis of cost and accessibility the L&G RAFI Emerging Markets Fund would be the preferred option.

The L&G passive equity portfolio will be re-balanced as implementation of the Alt 2 investment strategy progresses. The Panel agreed that the emerging markets future should be unwound and re-invested in the RAFI emerging markets fund as part of this re-balancing process.

3 Investment Strategy and Structure

The Panel considered 2 papers on implementation of the Alt 2 strategy which had been agreed by the committee in February 2018.

3.1 Implementation: Progress to Date

The first paper reviewed implementation progress to date taking into account the various new allocations agreed by the committee but as yet not fully funded. The position as at 31st March 2019 is summarised in the following table.

Asset Category	Target		Actual	
	Alt 1	Alt 2	NAV	Allocated
Equity	62.5	52.5	58.4	55.0
Hedging/Insurance	1.5	1.5	1.5	1.5
Credit	6.0	6.0	5.7	6.0
S/T Enhanced Yield (STEY)	15.0	20.0	14.8	19.0
L/T Enhanced Yield (LTEY)	15.0	20.0	15.2	18.5
Cash	-	-	4.4	-
	100	100	100	100

Having considered the detail of the report, the Panel's main conclusions were that:

- **Overall** good progress has been made in terms of allocations, but it will take some time before this is reflected in Net Asset Values (NAVs)
 - No action was required in respect of the **Hedging/Insurance** and **Credit** allocations
 - **Equity** was significantly overweight, but within its target range. Around £400m of cash generated by previous sales remained available to fund the new allocations in other asset categories. No further equity reduction was required at present.
 - **LTEY** required a further allocation of **1.5%**. It seemed likely that this could be accommodated in the near future by the Direct Investment Portfolio (DIP). The DIP investment pipeline includes several LTEY proposals with significant investment values. 3 of these would potentially be taken to June committee for approval.
 - **1% of STEY** remained unallocated. This could be allocated across some of the existing STEY mandates. However, there may also be merit in investigating an additional mandate. The Fund looks set to have significant cash flows for the foreseeable future as a result of:
 - the ongoing need to fund recent and new commitments to private debt and DIP
 - the ongoing requirement to manage private equity cash flows (which are currently positive)
 - a potential further sale of equities, and re-investment into other categories and
 - any other mandate changes which may be agreed in future.
- All of this could be managed within the existing structure. But an additional mandate with good liquidity and protection characteristics, and with a return greater than cash, might offer a more efficient solution.
- Hymans Robertson had been asked to review additional mandate options to achieve this.
- Once implementation of Alt 2 is complete, a period of minimal strategic change would be welcome to allow time to fully assess the attributes and performance of the revised structure.

3.2 Additional Mandate Options

Hymans Robertson's paper summarised 2 potential new STEY allocations: Asset Backed Securities and Credit Default Swaps. Key points were as follows.

- **Asset Backed Securities (ABS):**
 - allow banks and finance providers to use capital markets to realise proceeds from lending activities by issuing bonds;
 - are backed by a pool of underlying debt to provide security and cover the interest and redemptions due; and

- different tranches provide different levels of exposure to underlying risk. Investment grade ABS could be used as an enhanced cash option by the Fund, providing greater returns than cash while providing flexibility as private market mandates call and distribute capital.

- **Credit Default Swaps (CDS):**

- are the most highly utilised type of credit derivative;
- indices provide diversified investment grade credit market exposure without having to buy the underlying securities; and
- indices are generally very liquid and require much less capital than bonds for a similar level of credit exposure.

Investment in a CDS fund would provide an opportunity for further diversification within STEY and could be a potential alternative investment within the absolute return allocation should poor performance of the current absolute return bond portfolio persist.

The Panel agreed that both ABS and CDS merited further consideration following more research into the funds available and the practicalities of investment, such as liquidity. Legal and General manage a CDS fund and would be invited to provide some insight into their approach and experience in this area at the Panel's August meeting.

4 Monitoring

4.1 Quarterly Investment Performance Review (Main Fund)

The Panel reviewed the Northern Trust investment performance monitoring report. Recovery in global equity markets meant that the Fund's return for Q1 2019 was positive (+5.6%), but behind benchmark (+5.8%), largely due to underperformance of the Fund's private equity portfolios. Performance for the year to 31 March 2019 was +5.9%, in line with benchmark. Both absolute and relative performance had been positive over the three and five year periods.

4.2 Quarterly Investment Performance Review (No. 3 Fund)

The Panel reviewed the Northern Trust investment performance monitoring report for the No. 3 Fund. The Fund's return for Q1 2019 was above the benchmark return (5.0% vs 4.4%). The No.3 Fund has underperformed over one year, but is ahead of benchmark over three and five years and since inception. Plans to effect the merger of the fund with the North East Scotland Pension Fund were progressing.

4.3 Manager Ratings

Current officer assessments of the Fund's investment managers had been circulated, together with Hymans Robertson's manager update. On a Red, Amber, Green (RAG) analysis: three of the Fund's managers are rated amber, thirteen rated green, and none red.

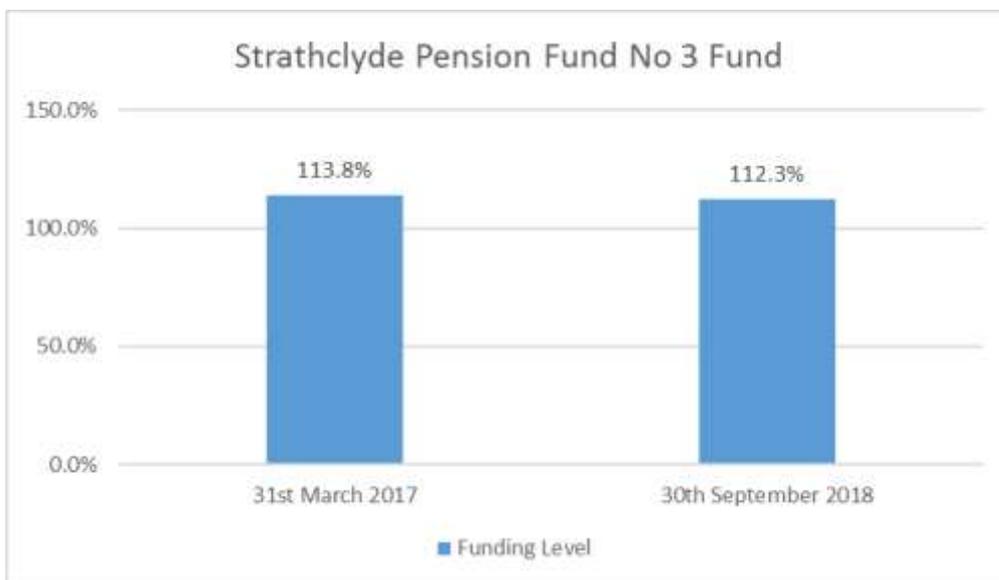
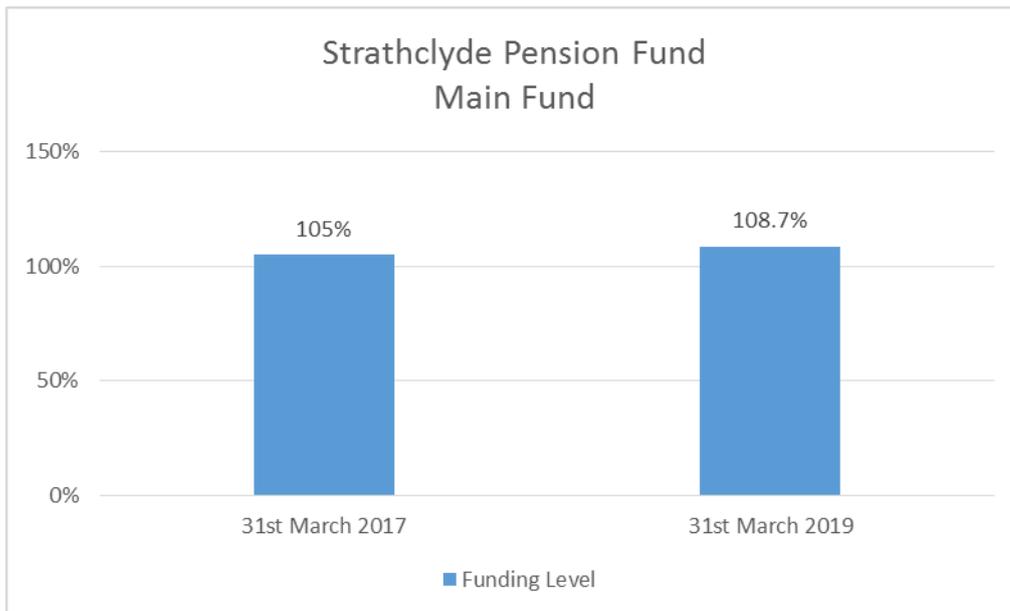
4.4 Direct Investment Portfolio Monitoring Report

The Panel reviewed the quarterly monitoring report for the Direct Investment Portfolio (DIP). The portfolio and most of its investments were progressing well. On a Red, Amber, Green (RAG) analysis: thirty three investments were rated green, four amber, and none red.

4.5 Estimated Funding Levels

Hymans Robertson provided the following estimates of the funding levels as at 31st

March 2019 for the main Fund and No. 3 Fund. The funding level for the Main Fund had increased since the 31st March 2017 actuarial valuation, while the funding level for the No. 3 Fund had decreased slightly.



5 Allocation

5.1 Private Market Allocations

The Panel reviewed a schedule of estimated cash flows for the Fund's private market investment programmes - private equity, global real estate, the Direct Investment Portfolio, and private debt commitments. Totals as at 31st March 2019 were as follows.

	2019 Estimate (£m)	2019 Actual YTD (£m)
Distributions	578	98
Calls	(804)	(109)

Net	(226)	(11)
------------	--------------	-------------

The projected net cash flow to private markets programmes in 2019 is an outflow of **£226m**. The Fund's private debt and Direct Investment portfolios are still building their investment exposure and drawdowns to these investments will make up the majority of the Fund's net cash outflow over the course of the year. The Pantheon private equity and the Partners Group private equity and real estate programmes are mature portfolios and distributions will largely cover the drawdowns required to fund more recent commitments.

The Fund's central cash balance at 31st March 2019 was **£743m**. This had reduced from **£984m** at end December 2018. During Quarter 1 2019, **£200m** had been invested in Ruffer's Absolute Return fund. Cash balances were further reduced as money was transferred to fund benefits cash flow and drawdowns to private market programmes.

5.2 Re-balancing strategy

The Panel reviewed a re-balancing report as at 31st March 2019.

There were a number of breaches of asset category and portfolio allocation ranges but the Panel agreed that no additional action is required as these will be resolved as the implementation phase of the review of investment strategy progresses.

6 Governance

6.1 Strathclyde Pension Fund Committee

The Panel noted the draft agenda for the next committee meeting on Wednesday 5th June 2019.

7 Manager Reviews

The following investment managers attended the Investment Advisory Panel.

- Ashmore
- Veritas
- Henderson
- Barings

Performance of each of the managers was reviewed.

Ashmore

The Ashmore emerging market debt portfolio is currently valued at £499m, or 2.3% of total Fund, versus a target weight of 2.5%. Ashmore provided an update on the performance of the portfolio.

Veritas

The Veritas global equity portfolio is currently valued at £714m or 3.3% of total Fund, versus a target weight of 3.3%. Veritas provided an update on the performance of the portfolio.

Henderson

The Henderson portfolio is currently valued at £251.6m, or 1.1% of total Fund, versus a target weight of 1.0%. Henderson provided an update on the performance of the portfolio and the novation of the mandate to Lombard Odier to whom it is currently sub-contracted as a result of their acquisition of the team and business from Henderson.

Barings (multi-asset credit)

The Barings multi-asset credit portfolio is currently valued at £665.3m, or 3.0% of total Fund, versus a target weight of 2.8%. Barings provided an update on the performance of the portfolio.

8 AOCB

8.1 Review of the Structure of the Scottish Local Government Pension Scheme

Officers of the Fund updated the Panel on the progress of this review. The Pensions Institute had provided a draft report to the Scheme Advisory Board (SAB) on the consultation which had recently taken place. The SAB would now consider the report and make recommendations to Scottish Ministers.

9 Policy and Resource Implications

Resource Implications:

Financial: None

Legal: None

Personnel: None

Procurement: None

Council Strategic Plan: Strathclyde Pension Fund aligns with the theme of a well governed city.

Equality and Socio

Economic Impacts:

Does the proposal support the Council's Equality Outcomes 2017-22 Equalities issues are addressed in the Fund's Responsible Investment strategy.

What are the potential equality impacts as a result of this report? No specific equalities impacts.

Please highlight if the policy/proposal will help address socio economic disadvantage. ESG (Environmental Social and Governance), and local impacts are addressed in the Fund's Responsible Investment strategy.

Sustainability Impacts:

Environmental: ESG (Environmental Social and Governance), and local impacts are addressed in the Fund's Responsible Investment strategy.

<i>Social, including Article 19 opportunities:</i>	ESG (Environmental Social and Governance), and local impacts are addressed in the Fund's Responsible Investment strategy.
<i>Economic:</i>	ESG (Environmental Social and Governance), and local impacts are addressed in the Fund's Responsible Investment strategy.
Privacy and Data Protection impacts:	None.

10 Recommendations

The Committee is asked to **NOTE** the contents of this report.

Strathclyde Pension Fund Investment Advisory Panel Overview

1. Role of Investment Advisory Panel

The role of the IAP, as described in the Fund's Statement of Investment Principles, is to provide support and advice to the Strathclyde Pension Fund Committee and to carry out certain functions on behalf of the Committee.

The functions of the IAP include:

- developing investment strategy
- monitoring investment performance
- assisting in the selection and appointment of investment managers
- setting and reviewing detailed investment mandate terms and guidelines
- implementation of the passive rebalancing strategy
- monitoring cash flows
- implementation of the private markets programmes.

2 Membership

The IAP comprises:

- 3 independent advisors;
- a representative from the Fund's investment and actuarial consultants;
- the Director (SPFO);
- the Chief Investment Officer (SPFO) and
- the Investment Manager (SPFO).

3 Meeting Arrangements

The IAP meets quarterly. Meetings usually comprise a strategy development session and a series of reviews of investment performance with the Fund's investment managers. IAP members also attend Committee meetings and occasional *ad hoc* IAP meetings.