

FLINTSHIRE COUNTY COUNCIL

REPORT TO: **CLWYD PENSION FUND COMMITTEE**

DATE: **5th NOVEMBER 2014**

REPORT BY: **CHIEF OFFICER (PEOPLE AND RESOURCES)**

SUBJECT: **INVESTMENT STRATEGY REVIEW 2014**

1.00 PURPOSE OF REPORT

1.01 To provide Committee Members with recommendations for changes to the Investment Strategy for the Clwyd Pension Fund.

2.00 BACKGROUND

2.01 The review of the Investment Strategy for the Clwyd Pension Fund was carried out to ensure that the strategy used continued to meet the key objectives of the Fund, which are:

- To aim for a funding level of 100%;
- To aim for long term stability in employers' contribution rates;
- To keep absolute cost at an acceptable and sustainable level;
- To strike an appropriate balance between the strategy most suitable for long-term consistent performance and the funding objectives.

The review was carried out by the Investment Consultant to the Fund (JLT Employee Benefits) in consultation with Officers before being presented, discussed and agreed with the Pension Advisory Panel on 3rd September 2014.

The last fundamental Investment Strategy Review was in 2010, implemented, in the main, from 1st April 2011. A mandate with Insight to provide protection against the volatility of interest rate and inflation rate changes was implemented in March 2014. In addition a funding and risk management "Flightpath" was implemented, embedding longer term objectives relating to the control of the volatility of funding outcomes. The optimisation model used in 2010 to determine the strategic benchmark suggested that the asset mix and the requirement for fund managers to deliver out-performance against market indices should produce a long-term return in the region of gilts + 5% with volatility of around 10%.

3.00 THE CURRENT INVESTMENT STRATEGY

3.01 The current investment strategy resulting from the 2010 review and the introduction of the 'Flightpath' mandate meant that the following Strategic Asset Allocation was established:

SAA (%)	Scenario	Rebalancing Range	CAA Range
	Equity - Alpha Seeking		
6.5	PacRim – High Alpha	+/- 1	
6.5	Emerging Markets – Core	+/- 1	
1.0	Frontier Markets		
5.0	Global – High Alpha	+/- 1	
5.0	Other – High Alpha	+/- 1	
24.0		+/- 2	+/- 10
43.0	TOTAL EQUITY	+/- 3	+/- 15
	Fixed Interest		
15.0	Unconstrained	+/- 2	
0.0	Government Bonds		
0.0	Cash/Other	+/- 5	
15.0		+/- 2	+/- 15
15.0	TOTAL FIXED INTEREST	+/- 2	+/- 15
	Alpha-Seeking Alternatives		
8.0	Private Equity		
5.0	Hedge Fund of Funds		
2.0	Free		
15.0		+/- 3	
	Real Assets		
7.0	Property		
2.0	Infrastructure		
2.0	Timber/Agriculture		
4.0	Commodities		
15.0		+/- 3	
30.0	TOTAL OTHER ASSETS	+/- 5	+/- 5
	Tactical Asset Allocation		
6.0	GTAA	+/- 1	
3.0	DTAA	+/- 1	
3.0	Macro FOF	+/- 1	
12.0		+/- 2	
	TOTAL TAA	+/- 2	+/- 5
	Liability Hedging portfolio		
	Interest rate hedge		
	Inflation rate hedge		
	Collateral portfolio - Bonds/Cash		
	Collateral portfolio – Equity		
19.0	TOTAL HEDGING PORTFOLIO	0-35%	+20%

This structure also allowed the Fund to:

- Aim to reach full funding by 2032, via the Funds' recovery plan;
- Aspire to reach full funding by 2024 to 2026

4.00 FINDINGS FROM THE STRATEGY REVIEW

4.01 The review showed, using JLT Market Forecast Group output for Quarter 2 2014, that the expected market returns over the coming ten year period would mean that the Fund could be expected to generate a return of 7.2% p.a..

- 4.02 The impact of a 1 in 20 market event was also assessed, using a 'Value at Risk' technique and this showed that the Fund deficit could increase by £470.3m if such events were to occur.
- 4.03 The objective of the remainder of the investigations carried out was to focus on identifying amendments to the investment structure that could maintain investment returns as at a suitable level to allow the aim to reach full funding by 2032 but also attain the aspirational goal of full funding by 2024 to 2026.
- 4.04 The conclusions of these investigations were that no radical re-organisation of the current investment structure was required and that the portfolio was well diversified with the introduction of the de-risking framework and Flightpath was well designed and its implementation ahead of the majority of other LGPS funds.
- 4.05 However, there were opportunities to reduce risk without sacrificing return.
- 4.06 These opportunities mean four main areas of change.
1. The current Hedge Fund portfolio be re-structured to incorporate exposure to a Managed Futures account to provide protection against market volatility (particularly on the downside). Also, the overall level of exposure to this area should be reduced;
 2. An increase in the exposure and flexibility of the current Tactical Portfolio and the cessation of the current GTAA portfolio;
 3. Areas (such as Commodities) should be disinvested from, at this time;
 4. Exposure to major economic regions should be managed through the Global Equity exposure.
- 4.07 These changes, based on the recommended allocation for the Tactical portfolio, meant that expected return could be maintained, with the risk being reduced by £18.5m from £470.3m to £451.8m (a reduction of 4%).
- 4.08 In carrying out the assessment, it was recognised that the structure of some of the underlying manager portfolios was hedge fund like and this resulted in an amended current allocation.

4.09 The revised Strategic Asset Allocation and ranges are shown below:

Asset type	Current Allocation	New Allocation	Change	Rebalancing Ranges (%)
Global Equity	5.0%	8.0%	+ 3.0%	5.0 – 10.0
Asia Pacific Equity	6.5%	0.0%	- 6.5%	N/A
Emerging Market Equity	6.5%	6.5%	No Change	5.0 – 7.5
Frontier Market Equity	1.0%	2.5%	+1.5%	1.0 – 4.0
Multi Asset Credit	15.0%	15.0%	No Change	12.5 – 17.50
Tactical Allocation	9.0%	19.0%	+10.0%	15.0 – 25.0
Property	7.0%	7.0%	No Change	5.0 – 10.0
Infrastructure*	4.0%	4.0%	No Change	2.0 – 7.0
Commodities	4.0%	0.0%	- 4.0%	0.0 – 5.0
Private Equity	10.0%	10.0%	No Change	6.0 – 12.0
Managed Account	13.0%	9.0%	- 4.0%	7.0 – 11.0
<i>Hedge Funds</i>	<i>13.0%</i>	<i>3.0%</i>		
<i>Managed Futures</i>	<i>0.0%</i>	<i>6.0%</i>		
Liability Hedging	19.0%	19.0%	No Change	19.0
Cash	0.0%	0.0%	No Change	0.0% - 5.0%

*Infrastructure includes exposure to Agriculture and Timber

4.10 The Rebalancing ranges have been set to allow for reasonable market movement to occur before incurring the costs of changing the asset allocation

4.11 The Tactical portfolio is to be constructed of two elements.

- A Diversified portfolio of Growth assets comprising the existing Pyrford portfolio and a second manager who adds style/portfolio management diversification;
- A flexible short term tactical allocation based on JLTs' suggested 'best ideas'.

4.12 Decisions regarding the 'best ideas' portfolio will be made through discussion between Officers and JLT, carried out on a monthly basis and appropriate targets and monitoring will be developed in relation to this portfolio.

4.13 The revised Conditional Asset Allocations take into account the Total Portfolio positions, excluding the Insight mandate, incorporating the underlying allocations for the Diversified Growth managers, the 'Best ideas' holdings and the Managed Account exposures. The resulting ranges and initial exposure is as follows:

Overall Conditional Asset Allocation ranges

Asset type	Conditional Range (%)	Initial allocation (%)
Developed Equity	0 – 30	11.4
Emerging Market equity	0 – 15	6.8
Frontier Market Equity	0 – 5	2.5
Private Equity	8 – 12	10.0
Corporate Bonds	0 – 30	4.1
Government Bonds	0 – 30	2.1
Overseas Government Bonds	0 – 30	2.2
Emerging Market Debt	0 – 30	10.0
High Yield Debt	0 – 30	10.3
Property	5 – 15	7.0
Infrastructure	2 – 10	4.0
Hedge Funds	0 – 10	3.4
Managed Futures	0 – 15	6.9
Commodities	0 – 10	0.0
Cash	0 - 30	1.2

5.00 RECOMMENDATIONS

5.01 That Committee Members:

- 1) Agree to the recommended and revised Strategic Asset Allocation and Conditional Asset Ranges
- 2) Agree to the amendments (shown in bold) to the Fund's Delegation of Functions to Officers in Appendix 1 as follows:
 - a. the addition of a new delegation of responsibility for decisions relating to the 'best ideas' section of the Tactical portfolio to the Pension Fund Manager, having regard to the advice of JLT with ongoing monitoring by both the Pension Advisory Panel and the Pension Fund Committee, and
 - b. two further clarification amendments.
- 3) Note appropriate objectives and monitoring will be developed in relation to the new 'best ideas' section of the Tactical portfolio.
- 4) Note that the existing Delegation of Functions already provides powers for officers to implement the strategy, including the appointment of suitable investment managers which will be subject to final ratification by the Pension Fund Committee.

6.00 FINANCIAL IMPLICATIONS

6.01 The on-going investment management costs of the Fund are expected to reduce by approximately £650k. This excludes the manager costs incurred within the internal portfolios. As a percentage of the total assets under management excluding those internal assets, the costs would fall from 0.62% to 0.52% per annum.

7.00 ANTIPOVERTY IMPACT

7.01 None directly as a result of this report.

8.00 ENVIRONMENTAL IMPACT

8.01 None directly as a result of this report.

9.00 EQUALITIES IMPACT

9.01 None directly as a result of this report.

10.00 PERSONNEL IMPLICATIONS

10.01 None directly as a result of this report.

11.00 CONSULTATION REQUIRED

11.01 None required

12.00 APPENDICES

12.01 Revised Delegation of Functions to Officers

LOCAL GOVERNMENT (ACCESS TO INFORMATION) ACT 1985

Background Papers: Pension Advisory Panel minutes

Contact Officer: Philip Latham, Clwyd Pension Fund Manager
Tel: 01352 702264
Fax:01352 702279
e-mail: philip.latham@flintshire.gov.uk