PENSIONS PANEL

15 March 2017

Title: Pension Fund Quarterly Monitoring 2016/17 – September to December 2016	
Report of the Chief Operating Officer	
Public Report	**For Information**
Wards Affected: None	**Key Decision:** No
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Accountable Director: Kathy Freeman, Director of Finance	
Accountable Strategic Director: Claire Symonds, Chief Operating Officer	

Recommendations

The Panel is recommended to note:

(i) the progress on the strategy development within the Pension Fund;

(ii) the daily value movements of the Fund's assets and liabilities outlined in Appendix 1; and

(iii) the quarterly performance of pension funds collectively and the performance of the fund managers individually;

1. Introduction and Background

1.1 This report provides information for employers, members of London Borough of Barking and Dagenham Pension Fund ("the Fund") and other interested parties on how the Fund has performed during the quarter 1 October 2016 to 31 December 2016 ("Q4"). The report updates the Panel on the Fund's investment strategy and its investment performance. Due to the technical nature of this report, Appendix 2 provides a definition of terms used in this report and Appendix 3 sets out roles and responsibilities of the parties referred to throughout this report.

1.2 A verbal update on the unaudited performance of the Fund for the period 1 January to 12 March 2017 will be provided to Members at the Pension Panel.

2. Third Quarter Market Performance

The final quarter of 2016 was dominated by the US presidential election and the surprise victory for Donald Trump, a result which confounded polls, commentators and markets alike. Volatility ensued as investors tried to glean policy cues and implications from a distinctly non-traditional campaign. Overall, equity markets were net winners and bond markets were net losers. The US dollar strengthened, inflation expectations were revised up and additional US federal borrowing was factored in to fund more expansionary fiscal policy.

Equity markets performed strongly albeit with considerable divergence between Developed and Emerging Markets, with the latter struggling in the face of the rising dollar and increasing Treasury yields. While the MSCI World Index advanced 7.2% to a UK investor during the final quarter, the MSCI Emerging Market returned a lesser 0.8%. Within Emerging Markets, indices that did perform well were typically those with a heavy oil influence, brent oil prices rose 15.8% during the quarter to end the year at $56.82.

US equities rallied strongly following the elections and in the final quarter the S&P 500 was up 9%. Financials led the charge with higher interest rates seen as positive for the sector, as was the possibility of a more favourable regulatory landscape. Brexit remained to the fore in the UK with the High Court ruling Parliamentary approval is needed to trigger Article 50. Despite the uncertainty surrounding Brexit, the UK economy performed well: GDP growth was a solid 0.5% and the FTSE All Share Index rose 3.9%. In sterling terms, the FTSE Europe index returned 4.8%; in Japan the Nikkei rose 6.1% (Yen weakness dampened returns for Uk investors) and the FTSE Pacific ex Japan returned 1.7%.

Fixed income markets began the quarter with yields still close to record lows but the surprise US presidential election outcome had a pronounced impact on global bond markets. The JPM Global Index was down 3.6% over the period; within UK markets the BAML Broad UK Index was down 3.4% and UK Index Linked >5 years down 3.0%.

Dollar strength defined the fourth quarter as it advanced versus all the major currencies. Sterling lost about 5% against the US Dollar but gained over 1% against the Euro and nearly 9% against a weak Japanese Yen. Property returned 2% over the quarter.

3. Overall Fund Performance

3.1 The Fund's externally managed assets closed Q4 valued at £869.6, an increase of £25.4m from its value of £844.2m as at 30 September 2016. The cash value held by the Council at 31 December 2016 was £12.7m giving a total Fund value of £882.3m.

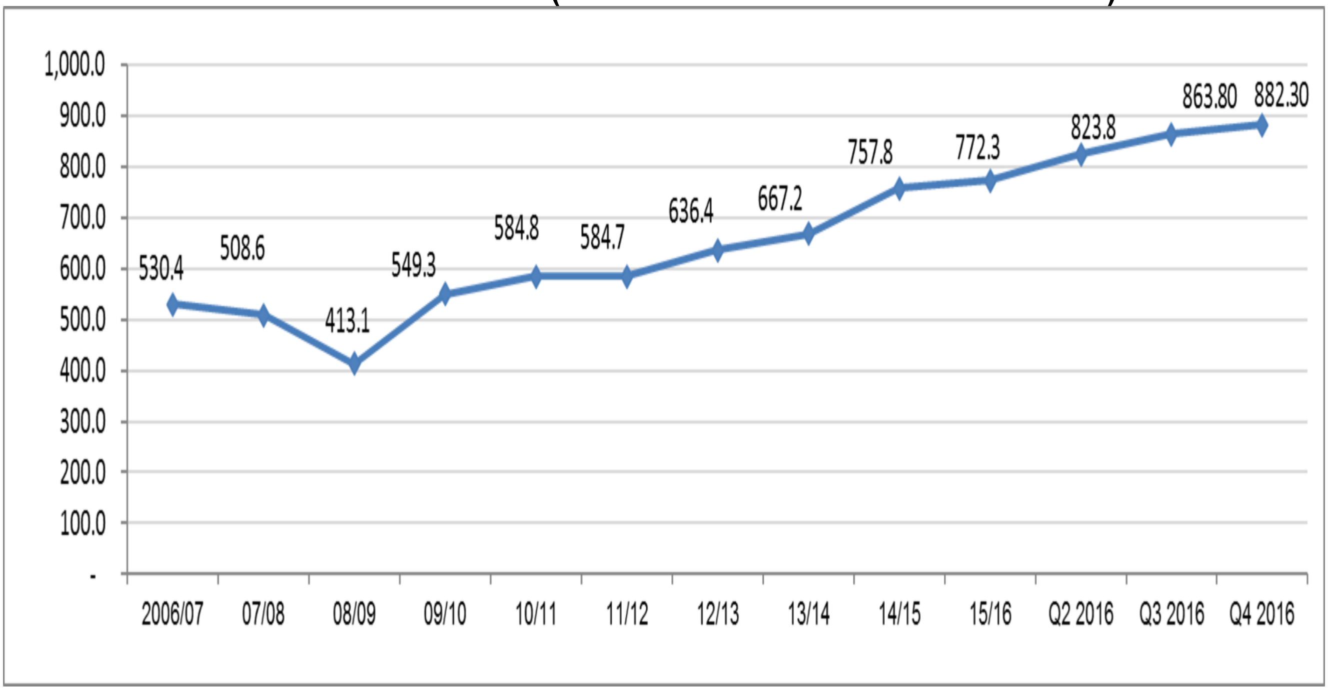
3.2 For Q4 the Fund returned 3.7%, net of manager and custodian fees, outperforming its benchmark by 0.1%. Over one year the Fund returned 16.7%, outperforming its benchmark of by 1.1%. Over three years the Fund trails its benchmark by 0.3%, providing a return of 9.8. The Fund's quarterly and annual returns are provided below:

Table 1: Fund's Q3 2016, 2015 and 2014 Quarterly Returns and yearly returns

Year	2016				2015				1	2	3	5
Period	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1	yr	yrs	yrs	yrs
Actual Return	3.7	5.3	4.2	2.5	4.4	(2.5)	(3.3)	10.0	16.7	12.2	9.8	9.6
Benchmark	3.6	4.4	4.7	2.0	4.5	(1.4)	(1.8)	10.7	15.6	13.3	10.1	10.2
Difference	0.1	0.9	(0.5)	0.5	(0.1)	(1.1)	(1.5)	(0.7)	1.1	(1.1)	(0.3)	(0.6)

3.3 Appendix 1 illustrates changes in the market value, the liability value, the Fund's deficit and the funding level from 31 March 2013 to 25 November 2016. Members are asked to note the significant changes in value and the movements in the Fund's funding level. Chart 1 below shows the Fund's value since 1 July 2007.

Chart 1: Fund value in millions (31 March 2007 to 31 December 2016)



3.4 Stock selection was not a factor in the overall above benchmark, with asset allocation contributing 0.1% for the quarter. The fund manager's performance has been scored using a quantitative analysis compared to the benchmark returns, defined below.

	RED- Fund underperformed by more than 75% below the benchmark
Δ	AMBER- Fund underperformed by less than 75% below the benchmark.
O	GREEN- Fund is achieving the benchmark return or better

3.5 Q4, (table 2 below), highlights the best performers were equities, with most other assets providing positive returns. Newton and UBS bonds provided negative returns, with Newton's return of -5.0% significant. Property showed a small bounce following the negative returns immediately following the referendum results.

Table 2 – Fund manager Q4 performance

Fund Manager	Actual Returns (%)	Benchmark Returns (%)	Variance (%)	Ranking
Aberdeen	0.5	1.1	(0.6)	Δ
Baillie Gifford	3.9	6.5	(2.6)	Δ
BlackRock	1.5	2.3	(0.8)	Δ
Hermes GPE	1.8	1.4	0.4	O
Kempen	10.9	7.1	3.8	O
M&G	0.9	1.1	(0.1)	Δ
Newton	(5.0)	1.0	(6.0)	□
Pyrford	0.6	2.0	(1.4)	Δ
Schroders	2.7	2.3	0.4	O
Standish	0.7	1.1	(0.4)	Δ
UBS Bonds	(3.3)	(3.4)	0.1	O
UBS Equities	6.6	6.4	0.2	O

3.6 Over one year, (table 3 below), equities have provided good returns of between 23.2% and 32.8%, with Kempen's return is particularly welcome. Infrastructure, Pyrford and bonds have also provided near double digit returns. Standish remains behind its benchmark but has met its target over the three quarters.

Table 3 – Fund manager performance over 12 months

Fund Manager	Actual Returns (%)	Benchmark Returns (%)	Variance (%)	Ranking
Aberdeen	1.6	4.4	(2.8)	Δ
Baillie Gifford	23.2	26.7	(3.5)	□
BlackRock	0.5	2.8	(2.3)	Δ
Hermes GPE	11.8	5.6	6.2	O
Kempen	32.8	26.9	5.9	O
M&G	4.4	4.4	0.0	O
Newton	4.8	4.3	0.5	O
Pyrford	9.3	7.3	2.0	O
Schroders	2.0	2.8	(0.8)	Δ
Standish	1.1	4.8	(3.7)	□
UBS Bonds	10.2	10.1	0.0	O
UBS Equities	25.9	25.7	0.2	O

3.9 Over two years, (table 4 below), most mandates are positive, with returns ranging from (0.4%) with Standish to 18.3% with Kempen. Only Standish has significantly underperformed its benchmark, with a negative return of 5.8% over the two-year period. The property correction following the referendum result has had an impact on property but the returns over two years remain positive and are in line with most other asset classes, with the exception of equities.

Table 4 – Fund manager performance over two years

Fund Manager	Actual Returns (%)	Benchmark Returns (%)	Variance (%)	Ranking
Baillie Gifford	16.0	15.7	0.3	O
BlackRock	5.3	7.3	(2.0)	Δ
Hermes GPE	8.1	5.6	2.5	O
Kempen	18.3	16.3	1.9	O
M&G	4.4	4.4	0.0	O
Newton	3.4	4.4	(1.0)	Δ
Pyrford	5.6	6.7	(1.1)	Δ
Schroders	6.4	7.2	(0.8)	Δ
Standish	(0.4)	5.4	(5.8)	□
UBS Bonds	5.5	5.4	0.0	O
UBS Equities	16.1	15.8	0.3	O

4. Asset Allocations and Benchmark

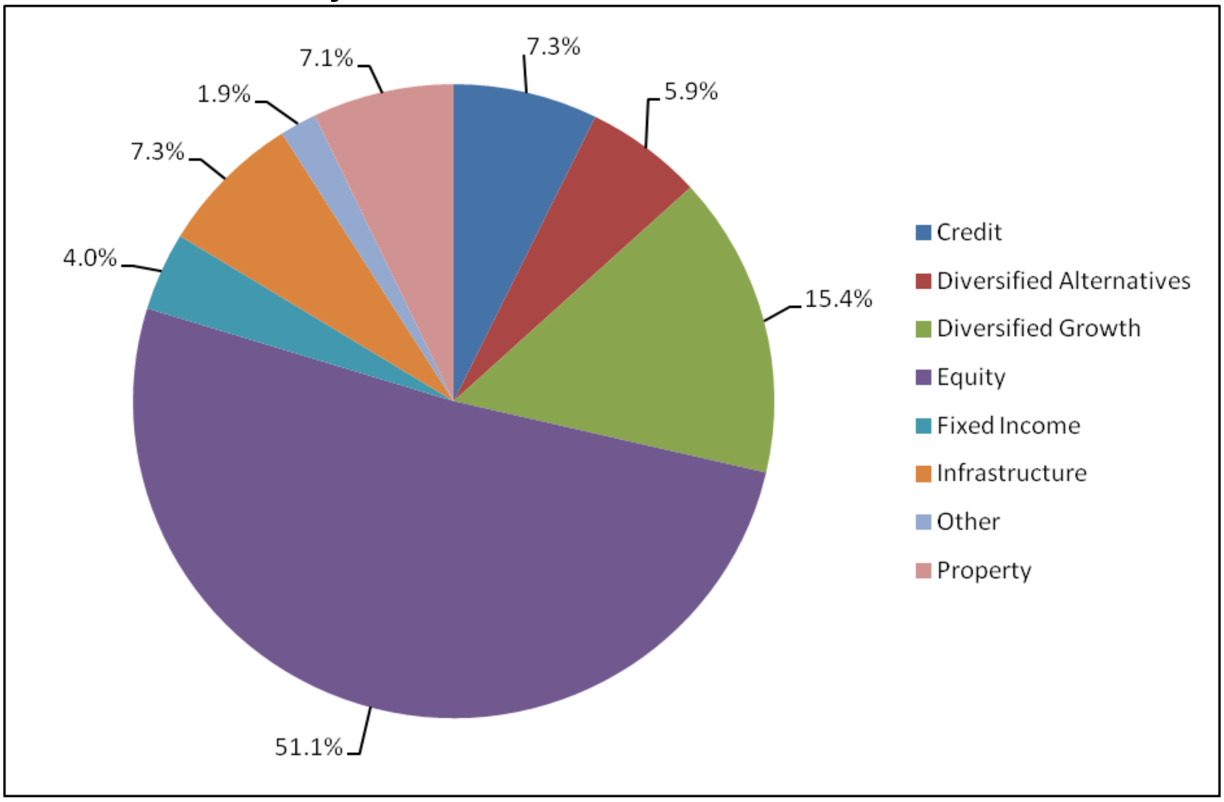
4.1 Table 5 below outlines the Fund's strategic asset allocation, asset value and benchmarks:

Table 5: Fund Asset Allocation and Benchmarks as at 31 December 2016

Fund Manager	Asset (%)	Market Values (£000)	Benchmark
Aberdeen	5.9%	52,362	Libor + 4% (net of fees)
Baillie Gifford	17.3%	153,011	MSCI AC World Index
BlackRock	4.5%	39,840	IPD PPF All Balanced Property Funds
Hermes GPE	7.3%	64,252	Target 5.9% per annum
Kempen	16.6%	146,391	FTSE All World Developed
M&G	0.4%	3,489	None
Newton	6.2%	55,097	Libor + 4% (net of fees)
Pyrford	9.2%	80,950	One month LIBOR plus 4%
Schroders	2.6%	23,039	RPI plus 5%
Standish	7.3%	64,139	IPD PPF All Balanced Property Funds
UBS Bonds	4.0%	35,305	6% Target Return
UBS Equities	17.2%	151,542	FTSE All Stock Gilt Index
Cash & other	1.4%	12,841	One month LIBOR
Total Fund	100.0%	882,258	

4.2 The percentage split between managers is graphically shown in the pie chart below.

Chart 2: Fund Asset by Asset as at 31 December 2016



5. Fund Manager Performance

5.1 Kempen

	2016				2015				One	Two	Since
Kempen	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Year**	**Years**	**Start**
£146,391	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	10.9	10.2	5.8	5.9	7.5	(5.8)	(5.7)	7.7	32.8	18.3	7.6
Benchmark	7.1	7.9	9.7	2.2	8.4	(4.8)	(5.3)	7.5	26.9	16.3	12.1
Difference	**3.8**	**2.3**	**(3.9)**	**3.7**	**(0.9)**	**(1.0)**	**(0.4)**	**0.2**	**5.9**	**1.9**	**(4.5)**

Reason for appointment

Kempen were appointed as one of the Fund's global equity managers, specialising in investing in less risky, high dividend paying companies which will provide the Fund with significant income. Kempen holds approximately 100 stocks of roughly equal weighting, with the portfolio rebalanced on a quarterly basis. During market rallies Kempen are likely to lag the benchmark.

Performance Review

The quarter was very positive for Kempen, with a return of 10.9%, an outperformance against its benchmark of 3.8%. For the one and two-year return Kempen have outperformed their benchmark by 5.9% and 1.9%. Kempen's outperformance over the past year is particularly welcome as Kempen have previously attended the Pension Panel to provide an explanation for their underperformance and Members agreed to maintain the holding with Kempen.

Overall the quarterly rebalancing of the portfolio provided a significant positive return, with sector allocation and stock selection also providing positive returns for the quarter. The strategies sector allocation, mainly relating to emerging market exposure, also provided some of the outperformance, however the strategies underweight exposure to the US did provide a negative attribution for the quarter.

Outlook

Kempen have seen high volatility among their holdings despite there being limited changes the firms intrinsic value. Kempen believe that their rebalancing process continues to add value by taking advantage of this volatility. Overall market multiples remain elevated, but the dispersion both within and between sectors has increased.

Kempen's focus is on finding companies with sustainable dividends that can be bought at a discount to their estimate of intrinsic value. Kempen base their estimate on the Earnings Power Value (EPV) framework of the Columbia Business School. EPV allows us to separate the three valuation components: asset value, earnings power and growth value. This framework improves their ability to analyse what Kempen are paying for, and gives insight into whether a stock is priced with a margin of safety.

The Fund now has a forward yield of around 4.7% compared to the MSCI world average of 2.5%

5.2 Baillie Gifford

	2016				2015				One	Two	Since
Baillie Gifford	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Year**	**Years**	**Start**
£153,011	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	3.9	12.1	6.9	0.3	10.4	(5.8)	(4.9)	9.1	23.2	16.0	13.0
Benchmark	6.5	8.5	8.8	2.9	8.1	(5.9)	(5.1)	7.6	26.7	15.7	11.5
Difference	**(2.6)**	**3.6**	**(1.9)**	**(2.6)**	**2.3**	**0.1**	**0.2**	**1.5**	**(3.5)**	**0.3**	**1.5**

Reason for appointment

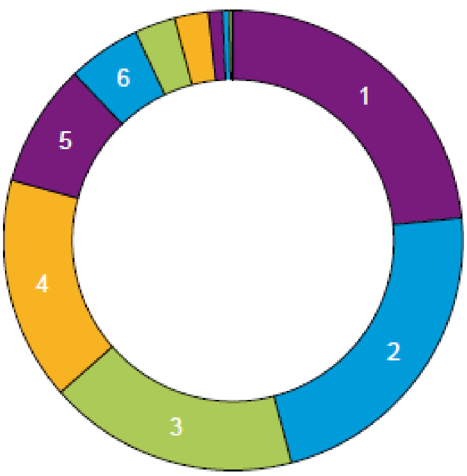
Baillie Gifford (BG) is primarily a bottom-up, active investor, seeking to invest in companies that it believes will enjoy sustainable competitive advantages in their industries and which will grow earnings faster than the market average. The aim of the Global Alpha investment process is to produce above average long term performance by picking the best growth stocks available around the world by combining the specialised knowledge of BG's investment teams with the experience of their most senior investors. BG holds approximately 90-105 stocks.

Performance Review

Over the quarter the Fund underperformed against Benchmark by 2.6%, which whilst disappointing, does cover an extremely volatile period in markets covering the Brexit vote in the UK and the election of Trump in the US and follows a very strong quarter in Q3 of 3.6% against Benchmark. Since inception Fund has outperformed it's benchmark by 1.5% per year.

Whilst the portfolio benefitted from an overweight position in financials during the quarter, underweight positions in energy and consumer staples would have had a negative impact, particularly given the bounce in resource stocks towards the end of the year. Performance was disappointing from the perspective of what the fund didn't hold rather than what it did as oversold cyclical and resource stocks rallied. In terms of the outlook, the fund is positioned to take advantage of continued recovery in the US economy as a result of the US election and the prospects for fiscal stimulus.

The sector breakdown of the portfolio is set out below:



Sector Weights		(%)
1	Financials	23.4
2	Information Technology	22.5
3	Consumer Discretionary	17.6
4	Industrials	15.7
5	Health Care	8.6
6	Materials	5.2
7	Energy	2.9
8	Consumer Staples	2.4
9	Cash	1.0
10	Real Estate	0.5
11	Telecommunication Services	0.2
	Total	100.0

5.3 UBS Equities

	2016				2015				One Year	Two Years	Since Start
UBS Equities	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**			
£151,542	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	6.6	8.2	8.7	2.4	8.6	(4.8)	(5.2)	7.7	25.9	16.1	14.6
Benchmark	6.4	8.2	8.7	2.4	8.6	(5.0)	(5.3)	7.6	25.7	15.8	14.6
Difference	**0.2**	**0.0**	**0.0**	**0.0**	**0.0**	**0.2**	**0.1**	**0.1**	**0.2**	**0.3**	**0.0**

Reason for appointment

UBS were appointed as the Fund's passive equity manager to reduce the risk from underperforming equity managers and provides a cost-effective way of accessing the full range of developed market equity growth. UBS track the developed world market benchmark and there will only be an issue with performance were the manager to vary significantly from the benchmark, either positively or negatively.

Performance

2016 ended with global equities entering a bull market from the low point seen in February. After an initial fall upon the US election results, developed equity markets quickly recovered and advanced on the anticipation of fiscal stimulus under the new administration. The prevailing mood was not broken by Italian referendum voters rejecting proposed constitutional reform or the decision by the US Federal Reserve to increase interest rates in December. The renewed focus on fiscal rather than monetary stimulus helped drive government bond yields higher from the low levels seen during the third quarter.

Equity markets worldwide had another strong quarter, with benchmark indices in the UK and US hitting all-time highs. In local currency terms, the FTSE All-World index returned almost 10% for the year, despite the weakness seen early 2016.

US markets had seen volatility in October due to perceived likelihood of a Trump administration. After the initial shock, US stocks rallied sharply on the prospect of fiscal stimulus, a lighter regulatory regime and reduced corporate taxes. The outlook for US corporate profits has been upgraded for 2017.

However, there was more nervousness around the outlook for emerging markets given the tone of Trump's comments during the campaign and a stronger US dollar. But improving oil prices boosted markets such as Russia and Brazil.

European equities fared well during Q4, despite continued speculation over the health of the Italian banking sector. The ECB's decision to extend its QE programme until at least December 2017, albeit at a gentler pace, was welcomed, with EU stocks enjoying a strong quarter. In the UK, previously unfavoured sectors such as mining and banks strengthened, aided by support from the Prime Minister for an 'implementation phase' to allow Britain to exit the EU smoothly after 2019.

Following weakness earlier in the year, Japan was the best performing major market as 2016 ended. The boost from the continuing recent weakness in the yen was sufficient to offset weak domestic economic data in December.

5.4 UBS Bonds

	2016				2015				One	Two	Since
UBS Bonds	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Year**	**Years**	**Start**
£35,305	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	(3.3)	2.3	6.2	5.0	(1.2)	3.1	(3.4)	2.2	10.2	5.5	8.3
Benchmark	(3.4)	2.3	6.2	5.0	(1.2)	3.1	(3.4)	2.2	10.1	5.4	8.3
Difference	**0.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.1**	**0.1**	**0.0**

Reason for appointment

UBS were appointed as the Fund's passive bond manager to allow the Fund to hold a small allocation (5%) of UK fixed income government bonds.

Market Update

The surprise election of Donald Trump as the 45th President of the United States back in November has had a significant impact on the economic outlook and the financial markets. With the support of a Republican controlled Congress, Trump is likely to enact inflationary and pro-growth policies through tax cuts and infrastructure spending.

In contrast, the decision by the US Federal Reserve's Open Markets Committee (FOMC) to increase the Fed Funds range's target rate by 25bps has been widely discounted by the market. This decision means rising inflation risks, higher employment and, an overall demand growth that has been expanding at a moderate pace since mid-year.

Economic data over the quarter reflected improvements in key economies, raising further doubts about the outlook for monetary policy. Following fears of a slowdown in China at the beginning of 2016, year-end trade data surprised economists as higher export and import flows indicated stronger demand in Chinese products globally.

Performance

The rising trend seen in government bond yields seen towards the end of the third quarter continued into the final three months of the year. The election of a Trump administration was just the most evident of a series of shifts in the discussions on how best to stimulate growth and inflation, with the likelihood of less reliance on monetary policy in isolation in future. The result was increasing doubt on the sustainability of 'lower for longer' policies.

Prices for fixed income securities fell almost across the board. US Treasuries saw the sharpest falls, with the yield on the 10-year bond rising by over 0.8% and inflation expectations spiking higher.

Yields on both fixed and index linked gilts also rose from the record lows seen in August. US high yield was one of the few fixed income asset classes to see a positive return over the quarter, with higher oil prices helping drive prices higher in December.

5.5 BlackRock

	2016				2015				One	Two	Since
BlackRock	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Year**	**Years**	**Start**
£39,840	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	1.5	(3.5)	1.3	1.2	2.5	2.5	2.9	2.2	0.5	5.3	11.3
Benchmark	2.3	(0.7)	0.1	1.1	3.0	3.0	3.1	2.8	2.8	7.3	12.5
Difference	**(0.8)**	**(2.8)**	**1.2**	**0.1**	**(0.5)**	**(0.5)**	**(0.2)**	**(0.6)**	**(2.3)**	**(2.0)**	**(1.2)**

Reason for appointment

In March 2012, a large portion of the Fund's holdings with Rreef were transferred to BlackRock (BR). The transfer to BR provides the Fund with access to a greater, more diversified range of property holdings within the UK.

Summary of Fund Activity

In Q4 liquidity returned to the market and BlackRock took advantage of this by selling a portfolio of 11 smaller, secondary assets. This sorted out most of the remaining non-core holdings in the Fund and removed assets vulnerable in a falling market. Letting activity remained reasonably strong for assets outside the Central London Office sector. A number of key lettings were completed, most notably:

- Tor Maidenhead: Lease agreement signed with Rank Group; and
- Leicester Distribution Park: 20 year pre-let to Samworth Brothers.

The returns for Q4 surprised on the upside with an unexpectedly strong capital value uplift for Central London and South East Offices. BlackRock believe this "bounce" is unlikely to be sustained and this will be proven out over the coming quarters. The Fund's overweight to the defensive Alternatives and underweight Offices held back performance in Q4. BlackRock believe that in line with their forecasts for a decline in capital values for Central London and South East Offices over the next 12 – 24 months, that the Fund's structure is well placed. Alongside a belief in allocations, the portfolio also has numerous asset management opportunities to drive performance.

Following the completion of c. £98m of sales in Q4, BUKPF held an overweight cash position which dragged performance by c. 20bps. Within the BUKPF portfolio there is a pipeline of significant capital projects that this cash is being deployed into, and it will also enable the Fund to take advantage of investment opportunities that emerge from the expected market volatility.

Referendum Result Impact on UK Property

As Article 50 is triggered and negotiations for the UK's exit from the EU begin, there will be times of optimism and pessimism, which creates volatility. As Brexit plays out it will entail challenges for the economy and the financial services sector. With this back drop, BlackRock continues to believe that the Fund's overweight to Industrials and Alternatives, and underweight Retail and Central London Offices mean it is well placed. The countercyclical nature of our favoured sectors and the structural change driving their returns, mean that BlackRock are confident of their performance even in the lower return environment.

5.6 Schroders Indirect Real Estate

	2016				2015				One	Two	Since
Schroder	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Year**	**Years**	**Start**
£23,039	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	2.7	3.7	(5.2)	0.8	2.4	3.0	2.6	2.8	2.0	6.4	6.0
Benchmark	2.3	(0.7)	0.1	1.1	2.8	3.0	3.1	2.8	2.8	7.2	8.5
Difference	**0.4**	**4.4**	**(5.3)**	**(0.3)**	**(0.4)**	**0.0**	**(0.5)**	**0.0**	**(0.8)**	**(0.8)**	**(2.5)**

Reason for appointment

Schroders is a Fund of Fund manager appointed to manage a part of the Fund's property holdings. The mandate provides the Fund with exposure to 210 underlying funds, with a total exposure to 1,500 highly diversified UK commercial properties.

Market summary

Although the UK economy performed better than expected in the six months following the EU referendum, it was dependent on consumer spending. For 2017, consumption is likely to lose momentum, as inflation overtakes annual wage awards. Inflation is forecast to rise to 3% by the end of 2017 partly due to the rebound in oil prices, but mainly because of the 18% fall in sterling's trade weighted index over the last 12 months. While that should help UK exports, history suggests the impact will be limited and the uncertainty over the future terms of trade with the EU may depress investment. Schroders expects GDP growth to slow to around 1.0-1.5% in 2017.

The mixed outlook for the economy is reflected in occupier demand. Brexit has not so far deterred tech companies from taking more office space in central London and the volatility in financial markets has supported demand from hedge funds for offices in Mayfair and St James's. Similarly, there is continued demand for regional offices from professional service firms and the government's plan to consolidate the civil service outside London into 13 hubs will provide further support to office markets in cities such as Birmingham, Bristol, Leeds and Manchester. In addition, the industrial and distribution sectors continue to benefit from the growth of online retail, parcel deliveries.

In the investment market, initial yields rose 0.25% following the EU referendum, as investors downgraded expectations for rental growth and as the authorised open ended retail funds sold assets to meet redemptions. However, Q4 saw a partial return to normality and real estate yields were broadly stable. The key unknown in 2017 is real estate yields. Theory suggests yields should increase, given the upturn in long dated UK and international bond yields since August and the growing prospect of a fall in London office rents and retail rents outside London. In 2017 Schroders' base case is for the all property initial yield to rise 0.25-0.5%, mostly in the secondary property.

Performance

Schroders still remain behind their benchmark over most periods and there is an expectation that they will outperform the market in 2017 as the strategies diversification into alternatives provides support.

5.7 Hermes

	2016				2015				One	Two	Since
Hermes	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Year**	**Years**	**Start**
£64,252	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	1.8	1.6	2.5	5.9	0.3	1.7	1.1	1.3	11.8	8.1	11.6
Benchmark	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	5.6	5.6	5.9
Difference	**0.4**	**0.2**	**1.1**	**4.5**	**(1.1)**	**0.3**	**(0.3)**	**(0.1)**	**6.2**	**2.5**	**5.7**

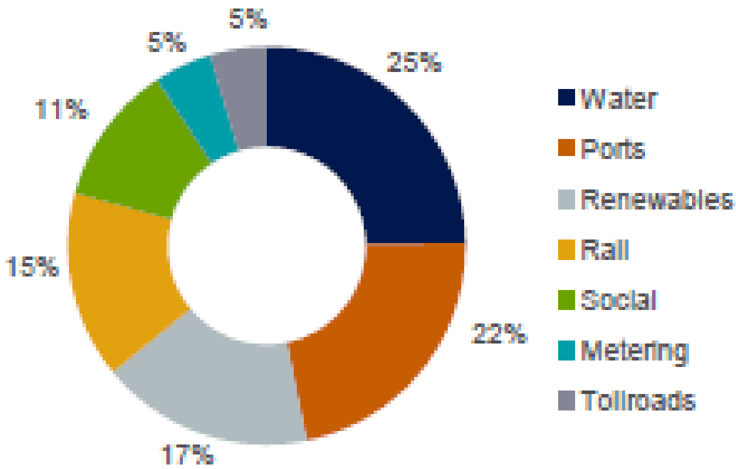
Reason for appointment

Hermes were appointed as the Fund's infrastructure manager to diversify the Fund away from index linked fixed income. The investment is in the Hermes Infrastructure Fund I (HIF I) and has a five-year investment period and a base term of 18 years. At the March 2015 Panel, Members agreed to increase the Fund's allocation to Hermes to 10%. As the investment is illiquid and valuations have to calculated, performance activity and investment activity relates to the end of September 2016 (Q2).

Q2 Key activities: On 19 July 2016 HIF I obtained a 25.6% stake in Energy Assets Group (EAG) as part of a consortium with Alinda Capital Partners. This investment increased the number of direct investments held by HIF I to nine, with two primary investments and two secondary investments. Distributions were received from Anglian Water, Fallago Rig, Braes of Doune, GSIP I and RREEF.

New investments: On 8 December 2016, National Grid plc announced the sale of 61% of National Grid Gas Distribution ('NGGD') to a consortium of UK and international infrastructure investors, including HIF I. The Transaction is subject to regulatory clearance, is expected to be completed in the first quarter of 2017, with a capital call value of £11m. HIF I will hold an 8.5% indirect ownership interest in NGGD, with the Fund acquiring a 2.9% indirect ownership interest.

Holdings at 31/09/2016: The holdings, split by asset type, are provided below:



Renewable Investments:

Audit: KPMG LLP are to replace Deloitte LLP as the Partnership's auditor.

5.8 Aberdeen Asset Management

	2016				2015				One	Two	Since
Aberdeen	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Year**	**Years**	**Start**
£52,362	%	%	%	%	%	%	%	%	%	%	%
Actual Return	0.5	0.3	(1.4)	2.2	(0.1)	0.4	(0.6)	1.4	1.6	1.4	2.1
Benchmark	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	4.4	4.4	3.9
Difference	**(0.6)**	**(0.8)**	**(2.5)**	**1.1**	**(1.2)**	**(0.7)**	**(1.7)**	**0.3**	**(2.8)**	**(3.0)**	**(1.8)**

Reason for appointment

As part of the Fund's diversification away from equities Members agreed to tender for a Diversified Alternatives Mandate. Aberdeen Asset Management (AAM) were appointed to build and maintain a portfolio of Hedge Funds and Private Equity. All positions held within the portfolio are hedged back to Sterling.

Market Update and Performance Summary

Inflation expectations across developed markets rose during the quarter. 10-year US treasury yields rose and the steepening move, combined with a number of better than expected earnings announcements, provided some welcome relief for the banking sector, particularly in Europe.

In the UK, the outlook for the economy in the wake of the referendum is unclear and volatility in UK related assets remains high. Confirmation that the British government would seek to formally initiate the exit procedure from the European Union early next year weighed on sterling during the month. The pound fell more than 5% versus the US dollar in October, and as of month-end is now down more than 15% year-to-date versus both the US dollar and the euro. 10-year gilt yields rose by 50 basis points in October in recognition that there is limited scope for continued monetary easing in the UK given that inflation is likely to accelerate sharply over the coming quarters.

December was for equity markets with the MSCI World Index rising over 2%. European equities experienced a strong relief rally despite Prime Minister Renzi resigning after being defeated in the Italian constitutional referendum. Italian 10 year government bond yields declined by 17 basis points and the Italian FTSE MIB index surged 14%. The broader European Stoxx 600 index also rallied strongly, finishing the month up 6%.

In the United States the Federal Reserve hiked rates by 0.25% as expected. Updated forecasts from the FOMC, however, suggested a more hawkish outlook from the committee for 2017, which led US bond yields to rise relative to other developed markets and the US dollar to strengthen versus the euro, yen, and sterling.

The yield differential between 10-year US treasuries and 10-year German bunds increased to more than 220bps in December, the widest level on record. Emerging markets, however, had mixed performance over the period. A strengthening US dollar and rising bond yields put pressure on Asian markets, with the Shanghai Composite falling close to 5%, while rising oil prices provided support for energy exporters such as Russia (MICEX Index +7%). WTI crude prices rose a further 9% in

December, continuing the positive momentum seen since OPEC reached an agreement to curb production levels.

Heading in to 2017, market expectations are high that the incoming US administration will announce a raft of measures to boost corporate profitability, including cutting taxes and rolling back regulations, but at the same time there are growing concerns that the imposition of trade tariffs may negatively impact larger multi-national companies.

As at the end of December 2016 the portfolio held the following allocation to Hedge Fund's and Private Equity:

Fund	Strategy / Style
Hedge Funds	
Field Street Fund	Fixed Income, Global Macro
Horizon Portfolio Ltd	Market Neutral
Kohinoor Series Three	Tail-risk protection
Obsidian Fund	Fixed Income Relative Value
Pharo Gaia Fund	Discretionary global macro, invests in emerging markets
Alteaus Overseas Fund	Discretionary global macro, focused on FX / commodities
Complus Asia Macro	Discretionary macro fund focused on Asia
Renaissance IDA	Statistical Arbitrage
BlackRock Fixed Income	Relative Value
Private Equity	
PAI Europe VI	Buyout Midcap
MML Capital Partners VI	Lower Mid-Market

5.9 M&G / Prudential UK

	2016				2015				One	Two	Since
M&G / Prudential	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Year**	**Years**	**Start**
£3,489	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.2	4.4	4.5	4.8
Benchmark Return	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	4.4	4.4	4.4
Difference	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.1**	**0.0**	**0.1**	**0.4**

Reason for appointment

This investment seeks to maximise returns using a prudent investment management approach with a target return of Libor +4% (net of fees) and provides diversification from active bond management by holding the loans until their maturity. The strategy continues to meet its objectives and there were no issues in the quarter.

The portfolio maintained its seven senior loan investments with several medium sized institutions, with no changes to their respective credit ratings. The date of the last loan maturity is 2021, after which the investment will be wound up and the final distributions made.

5.10 Pyrford

	2016				2015				One	Two	Since
Pyrford	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Year**	**Years**	**Start**
£80,950	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	0.6	3.1	3.2	2.4	2.2	(0.5)	(2.5)	2.8	9.3	5.6	4.4
Benchmark	2.0	1.9	2.0	1.4	1.6	1.5	1.9	1.1	7.3	6.7	6.0
Difference	**(1.4)**	**1.2**	**1.2**	**1.0**	**0.6**	**(2.0)**	**(4.4)**	**1.7**	**2.0**	**(1.1)**	**(1.6)**

Reason for appointment

Pyrford were appointed as the Fund's absolute return manager (AR) to diversify from equities. The manager's benchmark is a fixed benchmark, which means that the manager is likely to outperform the benchmark significantly during market rallies.

AR managers can be compared to equities, which have a similar return target. When compared to equities, absolute return is likely to underperform when markets increase rapidly and to outperform equities during periods when markets suffer a sharp fall. 2013 and into 2014 could be classified as a significant market rally and therefore, in comparison to equities, Pyrford have underperformed.

Performance

Pyrford generated a return of 0.6% in Q4. The Fund has delivered five positive quarters of return and finished the year with a total return of 9.3%.

Market

In the final quarter, the US election dominated the news. Donal Trump's victory sent the US stock market to a record high whilst depressing bond prices. The potential for substantial spending on infrastructure and a reduction in corporate taxes were the main drivers. The Federal Reserve increased the Fed Funds rate by 25 basis points and indicated that there may be as many as three increases in 2017. European and Asian markets were strong in local currency, with Italy, Greece and Japan leading the way.

The portfolio's allocation to bonds and equities contributed positively to Q4 returns. The portfolio's bonds performed well relative to the market, particularly in a rising yield environment, due to the short duration positioning held.

Pyrford's UK bonds were flat compared to the UK average bond index (5 to 15-year) of -3.6% and the UK long bond Index (over 15 years) of -6.0%. The portfolio's overseas bonds returned +0.9%, compared with the global bond index of -3.6%. Overseas bond returns were increased by sterling weakness against the Canadian dollar as the portfolio holds a portion of unhedged Canadian Government bonds.

Overseas equities performed well, +3.3%, aided by a weaker pound, however Pyrford's UK equities lost ground, -1.8% and underperformed the market, +3.9%. The portfolio, positioned in defensive sectors, suffered as the market reacted to rising yields by rotating out of utilities. Currency management added to returns in the final quarter as sterling strengthened against the Aussie dollar.

5.11 Newton

	2016				2015				One	Two	Since
Newton	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Year**	**Years**	**Start**
£55,097			**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	(5.0)	1.5	4.3	4.0	1.5	(1.3)	(2.7)	4.4	4.8	3.4	4.9
Benchmark	1.0	1.1	1.1	1.1	1.1	1.1	1.1	1.1	4.3	4.4	4.5
Difference	**(6.0)**	**0.4**	**3.2**	**2.9**	**0.4**	**(2.4)**	**(3.8)**	**3.3**	**0.5**	**(1.0)**	**0.4**

Reason for appointment

Newton was appointed as the Fund's absolute return (AR) manager to diversify away from equities. The manager has a fixed benchmark of one month LIBOR plus 4%. AR managers have a similar return compared to equity but are likely to underperform equity when markets increase rapidly and outperform equity when markets suffer a sharp fall. The years 2013 and 2014 could be classified as a significant market rally and therefore, in comparison to equities, Newton has underperformed. The Newton strategy is invested through the London CIV from 16 December 2016.

Performance

2016 proved to be yet another rollercoaster ride in financial markets. Investors started the year in a panic and appeared to end it in euphoria.

Financial Markets, post-US elections, quickly moved to a pro-growth, pro-inflation stance; bond yields have risen sharply and, in equity markets, the rotation out of consumer staples and utilities and into financials and materials that began in the late summer has accelerated significantly.

This does not suit Newton's positioning, which, is cautious and as a result the strategy returned -5.0% compared to a benchmark return of 1.0%. The Q4 underperformance was predominantly due to bond yields rising, stable equities selling off and gold also falling, which was counter to the positions held by this strategy.

A meeting was held with Newton in January 2017 to discuss the underperformance and sufficient assurance was obtained that the strategy remains a good one for the markets and for the Fund, although there would be some repositioning.

Over 2016, the Real Return Fund outperformed its benchmark return by 0.5% and since inception has outperformed its benchmark by 0.4%.

Outlook

Once again, the US-centric consensus is declaring not only that central bank policy appears to have worked for the US economy, but that it has paved the way for an improved global outlook. As a result, risk-asset prices have taken another turn upward, led this time by economically sensitive sectors. Valuations also imply that conditions will remain rosy into 2017, and beyond. Newton suggest that the geopolitical and economic uncertainties ahead do not match this view.

5.12 BNY Standish

	2016				2015				One	Two	Since
Standish	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Year**	**Years**	**Start**
£64,139			**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Actual Return	0.7	1.4	0.9	(1.9)	(1.4)	(2.7)	(1.5)	3.7	1.1	(0.4)	0.4
Benchmark	1.1	1.1	1.1	1.5	1.5	1.5	1.5	1.5	4.8	5.4	5.8
Difference	**(0.4)**	**0.3**	**(0.2)**	**(3.4)**	**(2.9)**	**(4.2)**	**(3.0)**	**2.2**	**(3.7)**	**(5.8)**	**(5.4)**

Reason for appointment

Standish were appointed to achieve a 6% total return from income and capital growth by investing in a globally diversified multi-sector portfolio of transferable fixed income securities including corporate bonds, agency and governments debt.

Performance

US Treasury yields were higher in Q4. Performance across spread sectors was mostly up, except for general underperformance in the asset-backed sector. The US corporate component of the Barclay's US Aggregate (representative of investment-grade credit) was up slightly. US high-yield corporates (specifically the Barclay's US High Yield Index) posted positive performance as well. Emerging-markets hard currency posted a positive total return, as did emerging-market local currency. Conversely, performance in the securitised sector was mostly negative in December, with underperformance in asset-backed securities and commercial mortgage-backed securities and neutral performance in mortgage-backed securities.

Standish is virtually flat against Benchmark for the past 3 quarters (3% against a 3.3% benchmark). Following the significant underperformance in 2015 and Q1 of 2016, Standish still have a significant gap to close and will continue to be monitored. Since inception, Standish have now provided a positive, annualised, real return of 0.4%.

Outlook

While uncertainties about economic policy remain high, we have nudged up the outlook for global economic growth over the next two and a quarter years, mostly on improved performance in the US this year and the promise of additional fiscal impetus in 2017 from the Trump administration.

Few adjustments have been made to growth and inflation forecasts in the major developed economies, except for marking up real GDP growth in Japan. This performance in advanced economies, along with China anchoring the expansion of other emerging-market economies, should support commodity prices. We expect oil prices to trade in a narrow range.

The implications for markets are that long rates rise and the yield curve steepens, and breakevens are still inexpensive, but not as much as before. There will likely be opportunities in high-yield and emerging-market sovereigns. Mortgage-backed securities will likely come under pressure.

5.13 Currency Hedging

No new currency hedging positions were placed in Q4.

6. Consultation

6.1 Council's Pension Fund monitoring arrangements involve continuous dialogue and consultation between finance staff, external fund managers and external advisers. The Strategic Director, Finance & Investment and the Fund's Chair have been informed of the approach, data and commentary in this report.

7. Financial Implications

Implications completed by: Kathy Freeman, Director of Finance

7.1 The Council's Pension Fund is a statutory requirement to provide a defined benefit pension to scheme members. Investment decisions are taken based on a long-term investment strategy. The investment performance has a significant impact on the General Fund. Pensions and other benefits are statutorily calculated and are guaranteed. Any shortfall in the assets of the Fund compared to the potential benefits must be met by an employer's contribution.

7.2 This report updates the Panel on developments within the Investment Strategy and on scheme administration issues and provides an overview of the performance of the Pension Fund during the period.

8. Legal Implications

Implications completed by: Paul Feild, Senior Governance Solicitor

8.1 The Council operates the Local Government Pension Scheme which provides death and retirement benefits for all eligible employees of the Council and organisations which have admitted body status. There is a legal duty fiduciary to administer such funds soundly according to best principles balancing return on investment against risk and creating risk to call on the general fund in the event of deficits. With the returns of investments in Government Stock (Gilts) being very low they cannot be the primary investment. Therefore to ensure an ability to meet the liability to pay beneficiaries the pension fund is actively managed to seek out the best investments. These investments are carried out by fund managers as set out in the report working with the Council's Officers and Members.

8.2 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (SI 2009/3903) ("the 2009 Regulations") are the primary regulations that set out the investment framework for the Pension Fund. These regulations are themselves amended from time to time. The Regulations are made under section 7 of and Schedule 3 to the Superannuation Act 1972. They set out the arrangements which apply to the management and investment of funds arising in relation to a pension fund maintained under the Local Government Pension Scheme.

9. Other Implications

9.1 **Risk Management** - Investment decisions are taken based on a long-term investment strategy. Investments are diversified over several investment vehicles (equities – UK and overseas, bonds, property, infrastructure, global credit and cash) and Fund Managers to spread risk.

Performance is under constant review, with this focused on how the Fund has performed over the past three months, one year and three years.

Background Papers Used in the Preparation of the Report:

- WM Quarterly Q4 2016 Report; and
- Fund Manager Q4 2016 Reports.

List of appendices:

Appendix 1 - Fund Asset and Liability Values 31 March 2013 to 24 February 2017
Appendix 2 - Definitions
Appendix 3 - Roles and Responsibilities