



Pensions Committee

24 June 2015

Report Title	Investment policy and performance report 2014/15	
Originating service	Pension Services	
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Recommendations for noting:

The Committee is asked to note:

1. The Fund's investment policy and investment returns for the year to 31 March 2015.

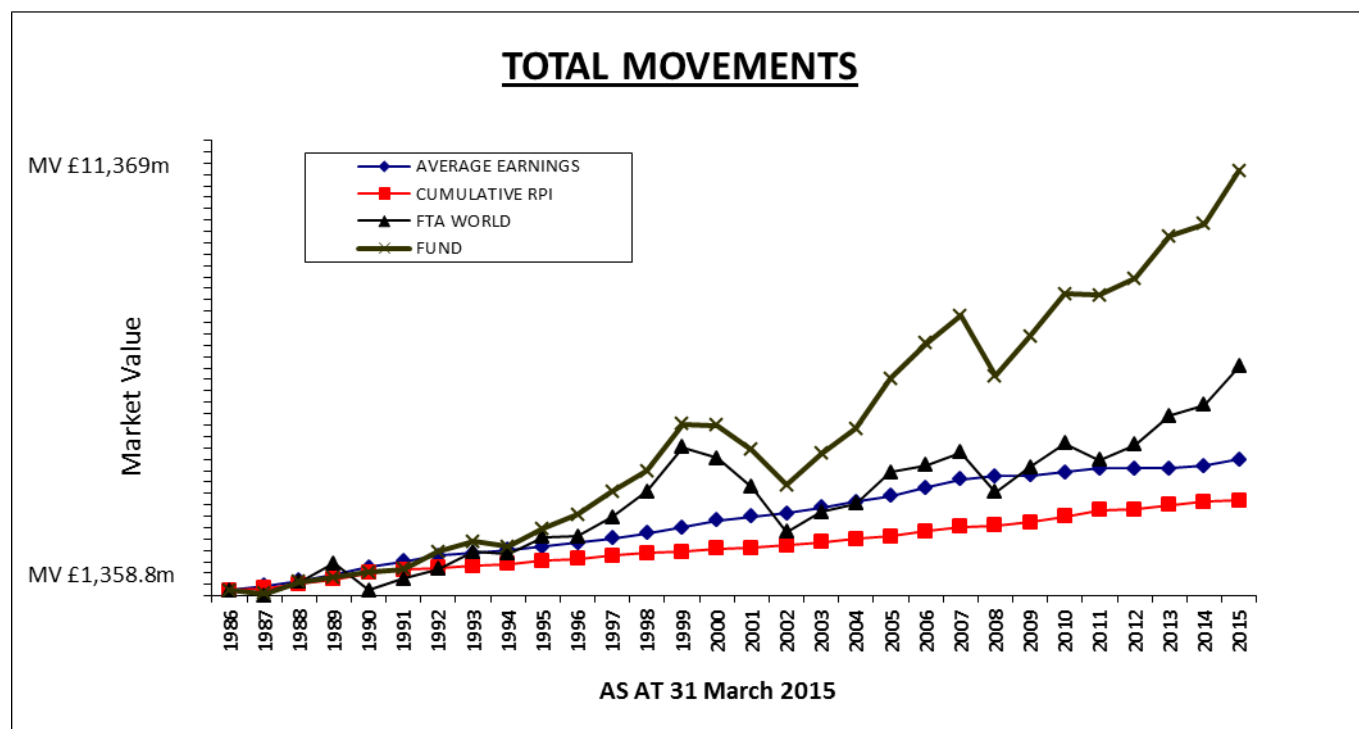
1.0 Purpose

1.1 This report covers the Fund's investment policy and investment returns for the year to 31 March 2015.

2.0 Investment Policy

2.1 Investment policy is reviewed annually with the next Strategic Investment Allocation Benchmark (SIAB) to be presented to the Committee in September 2015. The Fund's focus has been on a long term investment strategy focussing on three principal asset classes – quoted equities, fixed interest and alternative investments. These are combined to provide diversification and reduce volatility. The Fund continues to have a return seeking strategy with a total return target of 6.9% per annum with returns predominantly generated from markets (6.0%) and the balance (0.9%) from active management.

2.2 At the beginning of the period, the Fund's market value was £10.1bn. By the end of March 2015, the value of the Fund was £11.4bn, which reflects net cashflow and appreciation in market value. The graph below illustrates the cumulative movement of the Fund since 1986 resulting from the implementation of investment policies, market movements, unrealised profits and net cash inflows.



2.4 The Fund continues to have positive cash inflows from net contributions and investment income, but during the year there were two exceptional transfers. In April 2014, £184m

was received from employers in respect of deficit advance payments. In the final quarter of 2014, £246m was transferred to Greater Manchester Pension Fund (GMPF) as the responsibility for the management of the local probation trust pension assets was rolled into the National Probation Service pension scheme under the direction of GMPF.

3.0 Asset allocation

3.1 The following table shows a summary of the asset distribution for the year ended 31st March 2014 compared with the Strategic Risk Bands agreed by the Pensions Committee. The Fund's closing market value of £11.4bn reflects a net disinvestment of £97.7m and appreciation of investments during the period.

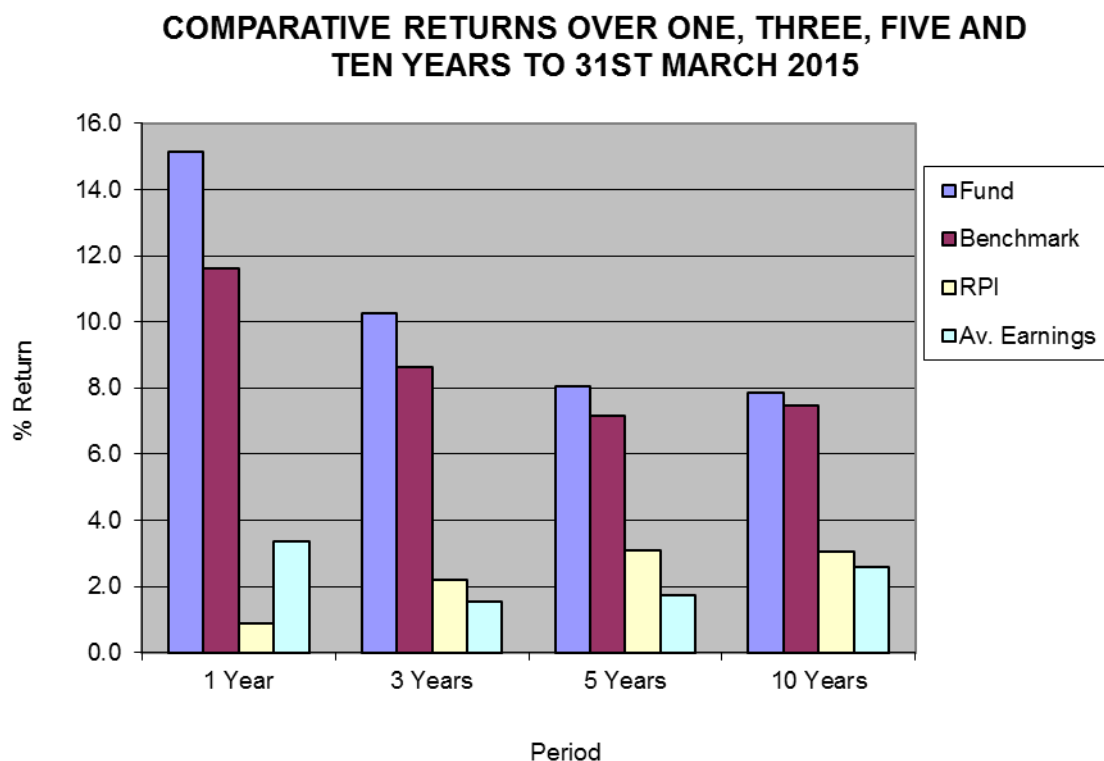
Portfolio	Strategic Risk Bands %	Opening Levels %	Closing Levels %	Closing Market Value £M	Net Investment £M
UK Equities		10.0	9.3	1,060	+26.2
Global Equities		5.2	7.5	856	+219.1
Overseas Equities		30.7	30.7	3,486	-48.6
North America		9.7	7.8	889	-294.2
Continental Europe		6.7	8.0	908	+184.8
Pacific Ex Japan		4.1	3.8	436	-17.4
Japan		1.8	3.8	427	+178.3
Emerging Markets		8.4	7.3	826	-100.1
Private Equity		12.3	11.9	1,351	-174.5
Total Equities	50.0-70.0	58.2	59.4	6,753	+22.2
Stabilising					
UK Gilts		1.9	1.3	151	-61.4
Index Linked Gilts		6.3	6.2	710	-50.0
Cash		2.6	4.8	543	+277.8
Return Seeking					
Specialist Fixed Interest		3.3	3.1	351	-12.9
Corporate Bonds		4.8	4.7	534	0.0
Emerging Market Debt		2.6	2.6	293	-0.0
Total Fixed Interest	15.0-25.0	21.5	22.7	2,582	+153.5
Property		9.2	8.3	944	-89.3
Absolute Return		6.4	6.2	708	-59.9
Real Assets & Infrastructure		4.8	3.4	381	-124.2
Total Alternatives	15.0-25.0	20.3	17.9	2,033	-273.4
Total Non-Equities	30.0-50.0	41.8	40.6	4,615	-119.9
Total	100.0	100.0	100.0	11,368	-97.7

3.2 All main asset classes closed within their wider strategic risk bands.

- 3.3 The investment strategy allocation is determined in accordance with the regulations (LGPS - Management and Investment of Funds - Regulations 2009) and its formulation is set out in the Fund's Statement of Investment Principles. In accordance with the investment management regulations, the schedule of limits on investments has an upper limit of 30% for commitments to partnerships and 15% for investments in unlisted securities of companies. These limits are kept under review and reviewed every time the SIP is reviewed.
- 3.4 The most significant asset allocation changes made during the year were an increase in the allocation to quoted equities (net investment of £196.7m), which was largely offset by record distributions from the private equity portfolio (£174.5m). The allocation to fixed interest was reduced (by £124.3m), the commodities fund portfolio was sold (netting £147.1 million) and there were net property sales (totalling £89.3m). As a result, cash balances increased by £277.8m over the year to reach £541.5m on 31 March 2015.
- 3.5 A major reshaping of the quoted equities portfolio took place in the first quarter of 2015 with a move to fixed weights for the regional overseas equities allocations – 7.5% for each of North America, Europe ex UK, emerging markets and 3.75% for each of the Pacific and Japan. The remaining active equities mandates for the developed overseas equities markets were terminated so that these allocations are managed passively by the in-house team. Active management in quoted equities is now targeted at global and emerging markets equities.
- 3.6 Underlying the changes made to the portfolio during the year was a desire for simpler, lower cost and more cost effective management arrangements. New investments were made very selectively, notably in insurance linked funds, infrastructure and private equity.

5.0 Returns to 31 March 2015

5.1 The Fund's returns over one, three, five and ten years compared to its bespoke benchmark, retail prices index (RPI) and average earnings are illustrated in the chart shown below.



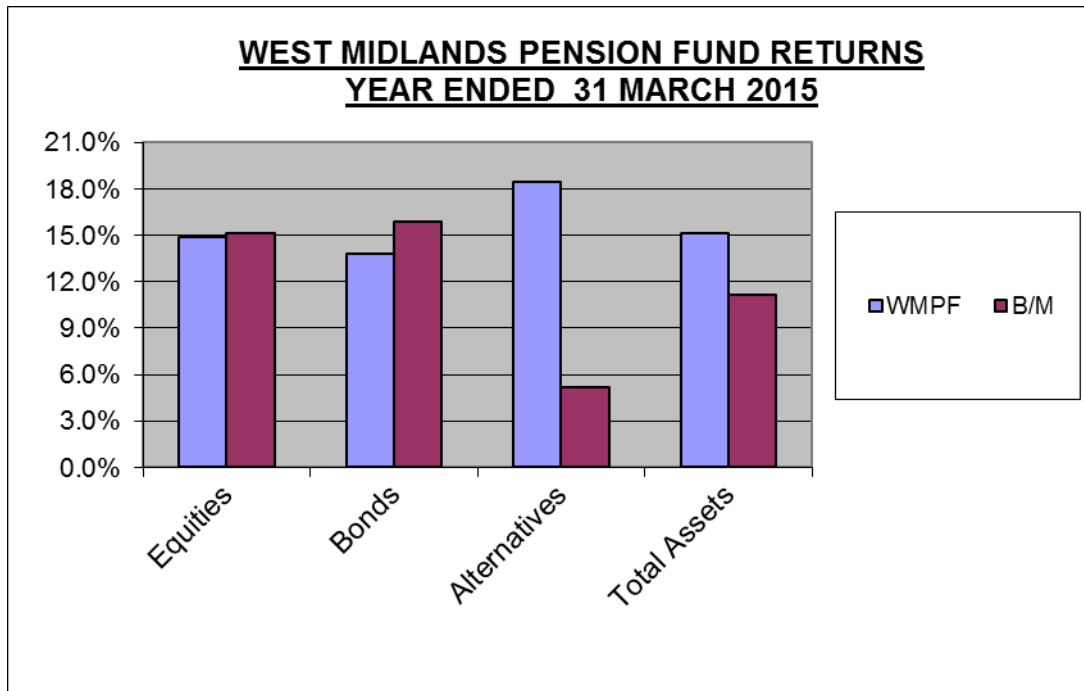
5.2 In the year to 31 March 2015, the Fund delivered a return of 15.1%, well ahead of its bespoke benchmark of 11.6%. The main contributors to the outperformance were good relative performances from the private equity and absolute return portfolios. This was offset in part by underperformance in fixed interest (following a strong 2013/14) and in some parts of the quoted equities portfolio (mainly emerging markets).

5.3 A return of 10.2% per annum was achieved by the Fund in the three years to 31 March 2015, ahead of the bespoke benchmark return of 8.6%. Strong performances from quoted equities and private equity were the key contributors over this time period.

5.4 A return of 8.0% per annum was achieved by the Fund in the five years to 31 March 2015, ahead of the bespoke benchmark return of 7.2%. Good performances from quoted equities and private equity were the key contributors over this time period.

5.5 The Fund's 10 year return of 7.9% per annum was usefully ahead of the benchmark return of 7.5% and well ahead of increases in RPI and Average Earnings.

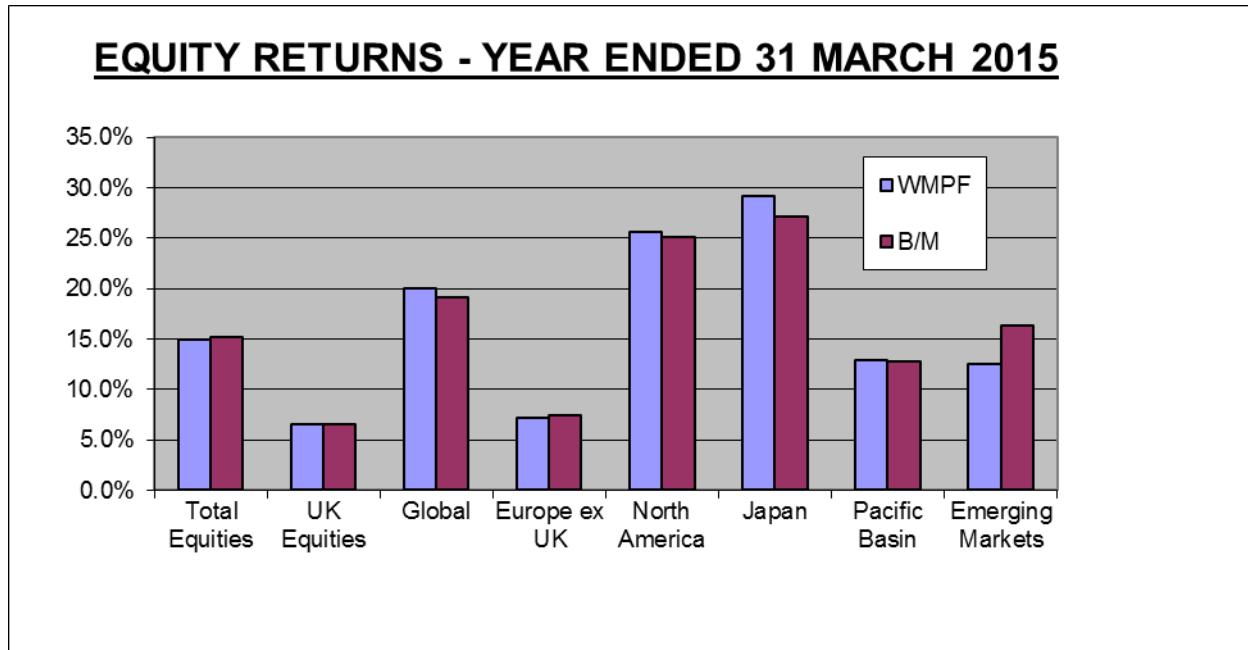
5.5 The graph following illustrates the returns of the Fund's main asset classes for the year ended 31 March 2015 and compares them to the returns from its bespoke benchmark.



Note: the scheme-specific benchmark for individual asset classes are recognised indices, but for the wider asset classes is a combination of weighted indices.

5.6 The Fund's total return was well ahead of its scheme specific benchmark by 3.5%. This outperformance was achieved mainly because of outperformance in private equity and the absolute return portfolios. There was some offsetting underperformance in fixed interest (following a relatively strong 2013/14 performance), notably emerging markets debt. The quoted equities portfolio marginally underperformed, mainly due to the emerging markets equities portfolio lagging in a strong rising market.

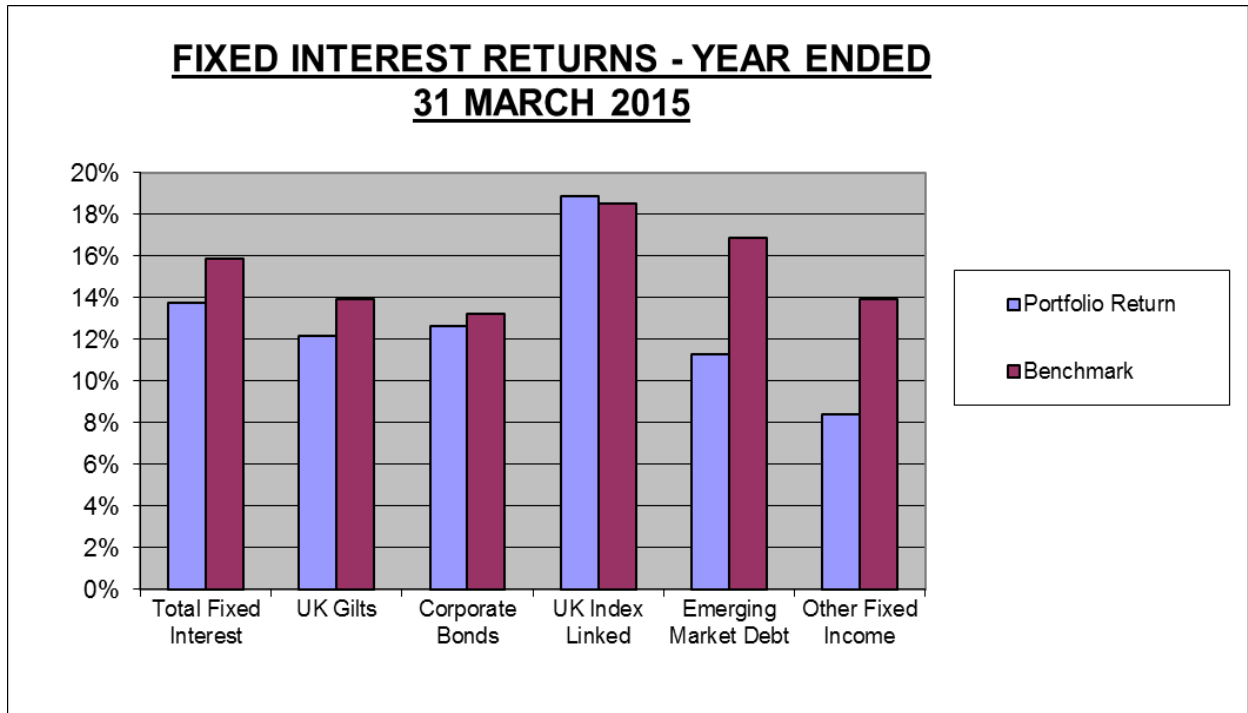
5.7 The graph below illustrates the returns of the different quoted equity markets:



5.8 Developed markets equities posted positive returns, with North America (aided by US Dollar strength) and Japan faring notably well. The UK and Europe posted fairly modest returns.

5.9 The Fund's quoted equities portfolio marginally underperformed, with a return of 14.9% achieved compared with a benchmark return of 15.2%. Most areas performed satisfactorily in relative terms and the emerging markets equities portfolio was the main contributor to underperformance, lagging in a strongly rising market.

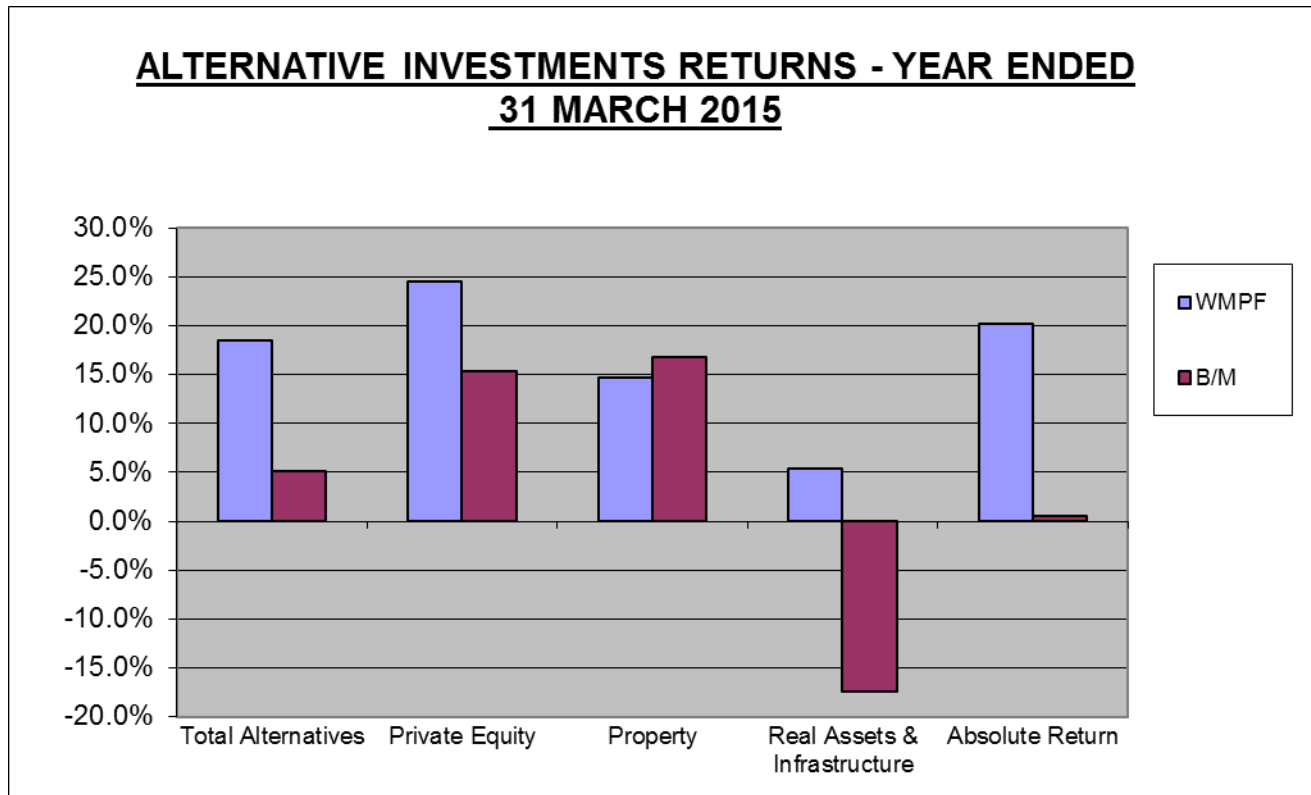
5.10 The graph below illustrates the returns of the different fixed interest markets:



5.11 Fixed interest markets had a strong year (following a difficult 2013/14) with most segments posting double digit returns.

5.12 The Fund's fixed interest portfolio underperformed, posting a return of 13.8% compared with a benchmark return of 15.9%. The emerging market debt allocation was a laggard and the specialist fixed interest funds (which performed well in 2013/14) were largely responsible for the underperformance.

5.13 The graph below shows the returns from the Fund's investments that make up the alternative assets:



5.14 The alternative investments portfolio delivered a strong return in 2014/15 but within the overall picture there were significant variations. The private equity portfolio achieved a return of 24.6%, reflecting profitable distributions in a very favourable market environment. It was another good year for property but the Fund's return from the sector, at 14.7%, lagged its benchmark, mainly due to underperformance from the indirect sector.

5.15 The commodities portfolio was sold in the year, ensuring that the Fund was not unduly exposed to the sharp falls in commodities prices. This part of the portfolio delivered a return of -12.2% compared with the benchmark return of -32.9%. In the absolute return segment, a 20.2% return was delivered with most segments faring well, notably insurance linked funds.

6.0 West Midlands Pension Fund historical returns

6.1 The returns as at 31 March 2015 achieved by the Fund in the main asset classes in which it invests are shown in the table below, as are the three and five year annualised returns where available.

	1 Year %	3 Year %	5 Year %
UK Equities	6.53	10.72	8.54
European Equities	7.14	14.69	7.50
US Equities	25.63	18.49	14.41
Pacific Basin Equities	12.86	7.89	6.17
Japanese Equities	29.21	13.17	7.37
Emerging Markets Equities	12.52	3.08	2.47
Global Equities	20.03	14.69	10.32
Gilts	12.19	4.60	6.67
Index Linked	18.88	8.10	9.72
Corporate Bonds	12.61	9.10	8.14
Emerging Market Debt	11.27	4.58	5.54
Property	14.71	11.21	9.62
Private Equity	24.55	14.59	11.56
Real Assets & Infrastructure	5.42	2.12	1.36
Absolute Return Strategies	20.24	9.83	7.39
Total Fund	15.07	10.23	8.03

6.2 The above table highlights the positive returns achieved by most asset classes over the past year. Three year and five year returns have been strong, reflecting the policy measures taken by the authorities in the wake of the financial crisis of 2008. It is suggested that the double digit returns delivered last year and over three years are rather higher than what the Fund can realistically expect in the coming three years, with single digit annualised returns at best in prospect.

6.3 Following the market turmoil of 2008, a new investment strategy was adopted in 2009, with a reduction in the target allocation to quoted equities (from 60% to 48% currently) and a corresponding increase in the allocation to alternative investments. The increased diversification is designed to protect the portfolio in tougher market conditions.

7.0 Investment management and portfolio construction

- 7.1 The investment policy of the Fund is considered at each quarterly meeting of the Investment Advisory Sub-Committee and implemented by the Investments Division. The Division consists of a number of specialist teams which reflect the asset allocation and functions of the Fund. These teams currently cover quoted equities, alternative investments and fixed interest.
- 7.2 The Division manages approximately 80% of total investments in-house, with the balance managed via external segregated management arrangements.
- 7.3 The Fund recognises that the mainstream quoted equities and fixed interest markets are relatively efficient, thus passive management dominates within these asset classes. Although most use of specialist managers is within alternative assets, the Fund uses active management in mainstream liquid assets where inefficiencies and market opportunities exist, for example in global and emerging market equities.

8.0 Financial implications

- 8.1 This report demonstrates the Fund's return seeking investment strategy through a diversified investment portfolio.

9.0 Legal implications

- 9.1 This report contains no direct legal implications.

10.0 Equalities implications

- 10.1 None identified.

11.0 Environmental implications

- 11.1 None identified.

12.0 Human resources implications

- 12.1 None identified.

13.0 Corporate landlord

- 13.1 None identified.

14.0 Schedule of background papers

- 14.1 There are no background papers except those listed in the report.