



Pensions Committee

22 June 2016

Report Title	Investment Performance Report 2015/16	
Originating service	Pension Services	
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Recommendations for noting:

The Committee is asked to note:

1. The Fund's performance for the year to 31 March 2016 and the longer term.

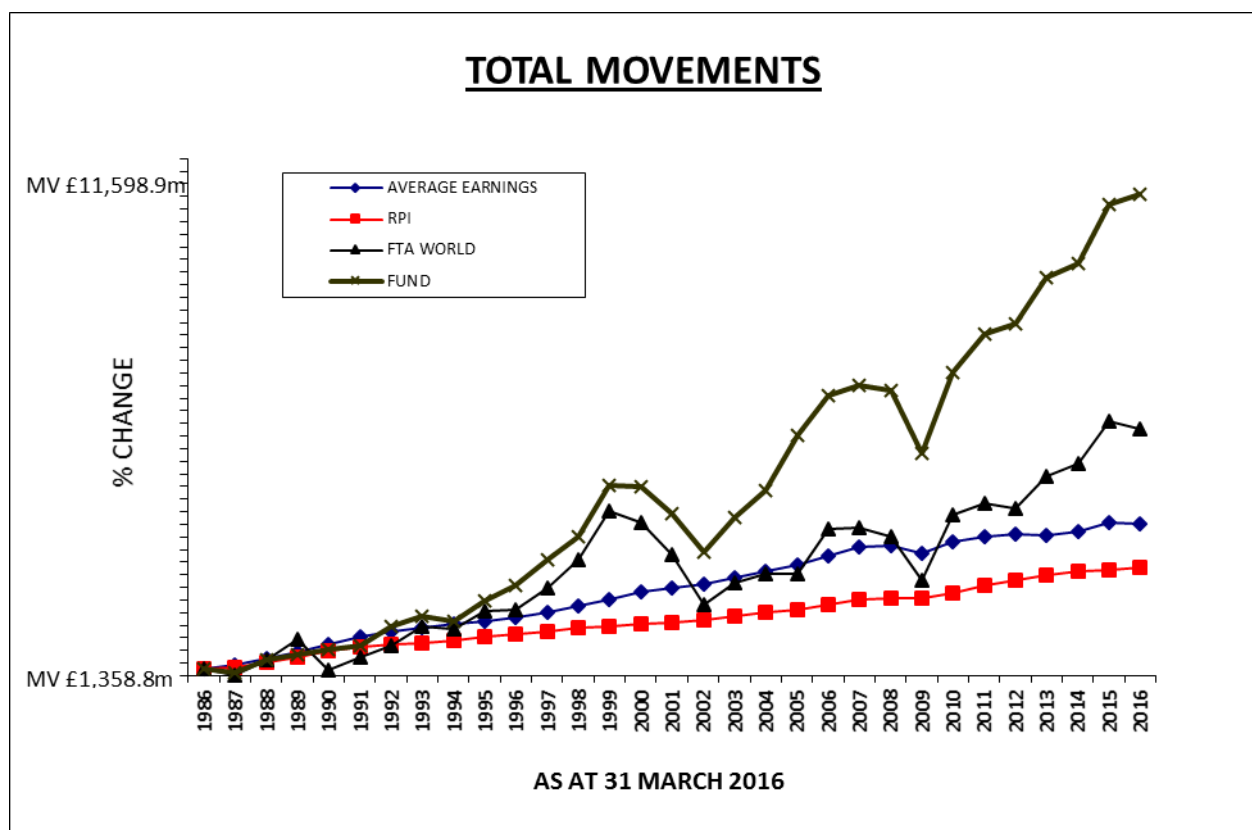
1.0 Purpose

1.1 This report covers the Fund's investment policy and investment returns for the year to 31 March 2016.

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 December 2016. The Fund's focus has been on a long term investment strategy focussing on three principal asset classes – equities, fixed interest and alternative investments. These are combined to provide diversification and reduce volatility. The Fund continues to have a return seeking investment strategy and outperformance of 0.5% per annum over rolling three year periods above the benchmark for the Fund is targeted. At its meeting in September 2015, Committee agreed to revise the benchmarks for individual portfolio segments – the changes were made with effect from 1 October 2015.

2.2 At the beginning of the period, the Fund's market value was £11.4 billion. By the end of March 2016, the value of the Fund was £11.6 billion, 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.



2.3 The Fund continues to have positive cash inflows from net contributions and investment income. Additionally, in April 2015, £220 million was received from employers in respect of deficit advance payments for the year to 2015/16.

3.0 Asset allocation

3.1 The following table shows a summary of the asset distribution for the year ended 31st March 2016 compared with the Strategic Risk Bands agreed by the Pensions Committee. The Fund's closing market value of £11.6 billion reflects a net investment of £161.8 million and appreciation of investments during the period.

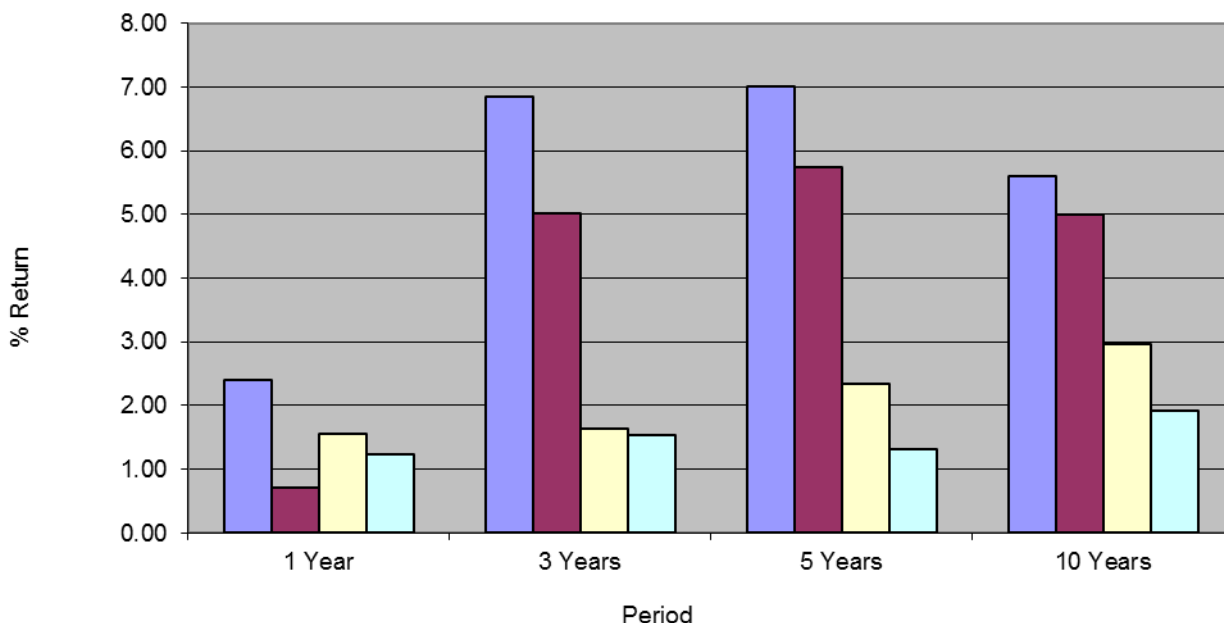
Portfolio	Strategic Risk Bands %	Opening Levels %	Closing Levels %	Closing Market Value £M	Net Investment £M
UK Equities		9.3	7.7	899	-95.7
Global Equities		7.5	11.1	1,290	+466.6
Overseas Equities		30.7	29.8	3,456	+142.3
North America		7.8	7.7	893	-7.7
Continental Europe		8.0	7.4	853	+6.6
Pacific Ex Japan		3.8	3.8	442	+39.3
Japan		3.8	3.5	408	+4.2
Emerging Markets		7.3	7.4	860	+100.0
Private Equity		11.9	11.4	1,319	-223.1
Total Equities	50.0-70.0	59.4	60.0	6,964	+290.2
Stabilising		12.3	12.1	1,407	+6.9
UK Gilts		1.3	1.3	155	+0.0
Index Linked Gilts		6.2	5.5	642	-79.4
Cash		4.8	5.3	610	+86.3
Cashflow Matching		0.0	3.0	351	+340.8
Return Seeking		10.4	8.0	930	-273.6
Specialist Fixed Interest		3.1	2.4	277	-86.3
Corporate Bonds		4.7	3.0	350	-176.6
Emerging Market Debt		2.6	2.6	303	-10.8
Total Fixed Interest	15.0-25.0	22.7	23.1	2,688	+74.0
Property		8.3	8.4	972	-44.1
Absolute Return		6.2	5.3	610	-105.8
Real Assets & Infrastructure		3.4	3.2	365	-52.6
Total Alternatives	15.0-25.0	17.9	16.8	1,947	-202.5
Total	100.0	100.0	100.0	11,599	+161.8

- 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 with a net investment of £513.2m made. £223.1 million was realised in distributions from private equity portfolio. A further £203.5 million was raised from the alternative investments portfolio with the sale of the Fund's remaining hedge funds and distributions from the property and infrastructure portfolios.
- 3.5 During the quarter ending on 30 June 2015, a new internally managed active global equities portfolio was set up with an allocation of £500 million funded from UK equities and cash. As markets in Asia and within the emerging economies fell sharply during the summer due to concerns over slowing economic growth in China, £135 million was allocated to the Fund's emerging markets and Pacific ex Japan portfolios.
- 3.6 On 1 October 2015, a new cashflow matching allocation was set up in order to derisk the fund's orphan liabilities. This allocation was funded from corporate bonds (with a 2% fund allocation) and index linked gilts (1%).
- 3.7 Underlying the changes made remains a desire for simpler, lower cost and more cost effective management arrangements, continuing the progress made in the previous three years.

4.0 Returns to 31 March 2016

4.1 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.

COMPARATIVE RETURNS OVER ONE, THREE, FIVE AND TEN YEARS TO 31 MARCH 2016



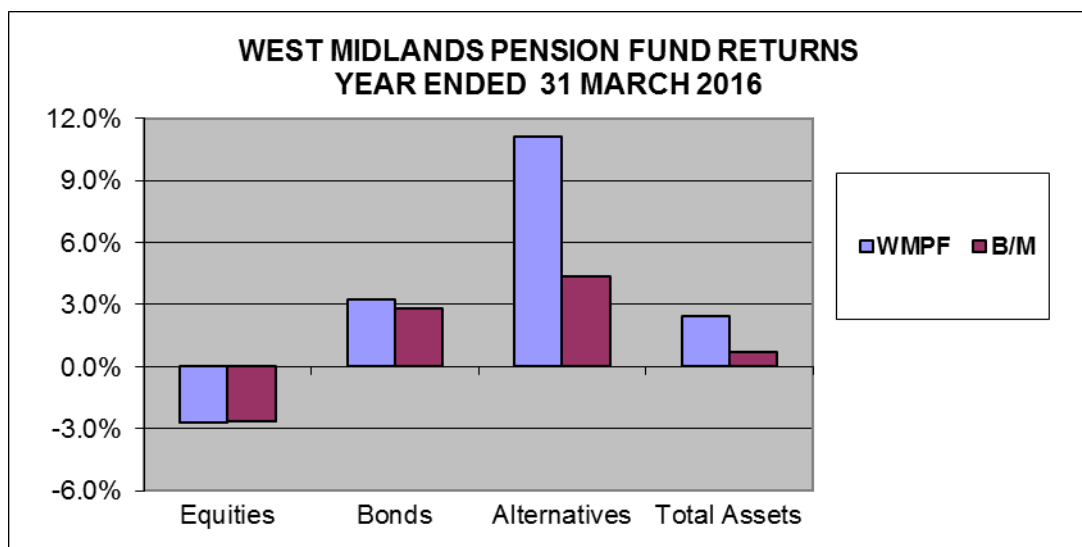
	1 Year %	3 Years %	5 Years %	10 Years %
Fund	+2.41	+6.85	+7.00	+5.60
Benchmark	+0.71	+5.02	+5.73	+5.00
Relative	+1.70	+1.83	+1.27	+0.60
RPI	+1.55	+1.63	+2.34	+2.96
Average Earnings	+1.23	+1.54	+1.31	+1.92

All returns for periods in excess of 1 year are annualised

4.2 Annual returns for the Fund are further illustrated in the table below:

	2015/16 %	2014/15 %	2013/14 %	2012/13 %	2011/12 %	2010/11 %	2009/10 %	2008/09 %	2007/08 %	2006/07 %
Fund	+2.41	+15.16	+3.51	+12.44	+2.26	+7.42	+31.67	-18.51	-1.46	+8.23
Bmk	+0.71	+11.61	+3.05	+11.48	+3.12	+7.78	+33.62	-18.94	-2.04	+7.79
Relative	+1.70	+3.55	+0.46	+0.96	-0.86	-0.36	-1.95	+0.43	+0.58	+0.44

- 4.3 In the year to 31 March 2016, the Fund delivered a return of 2.4%, well ahead of its bespoke benchmark of 0.7%. The key contributors to the outperformance were good relative performances from the private equity and alternative investments portfolios. The quoted equities and fixed interest portfolios delivered performances similar to those of their benchmarks.
- 4.4 A return of 6.9% per annum was achieved by the Fund in the three years to 31 March 2016, ahead of the bespoke benchmark return of 5.0%. Strong performances from private equity and alternative investments were the key contributors over this time period.
- 4.5 A return of 7.0% per annum was achieved by the Fund in the five years to 31 March 2016, ahead of the bespoke benchmark return of 5.7%. Good performances from private equity and alternative investments were the key contributors over this time period.
- 4.6 The Fund's 10 year return of 5.6% per annum was usefully ahead of the benchmark return of 5.0% and well ahead of increases in RPI and Average Earnings.
- 4.7 The following graph illustrates the returns of the Fund's main asset classes for the year ended 31 March 2016 and compares them to the returns from its bespoke benchmark.

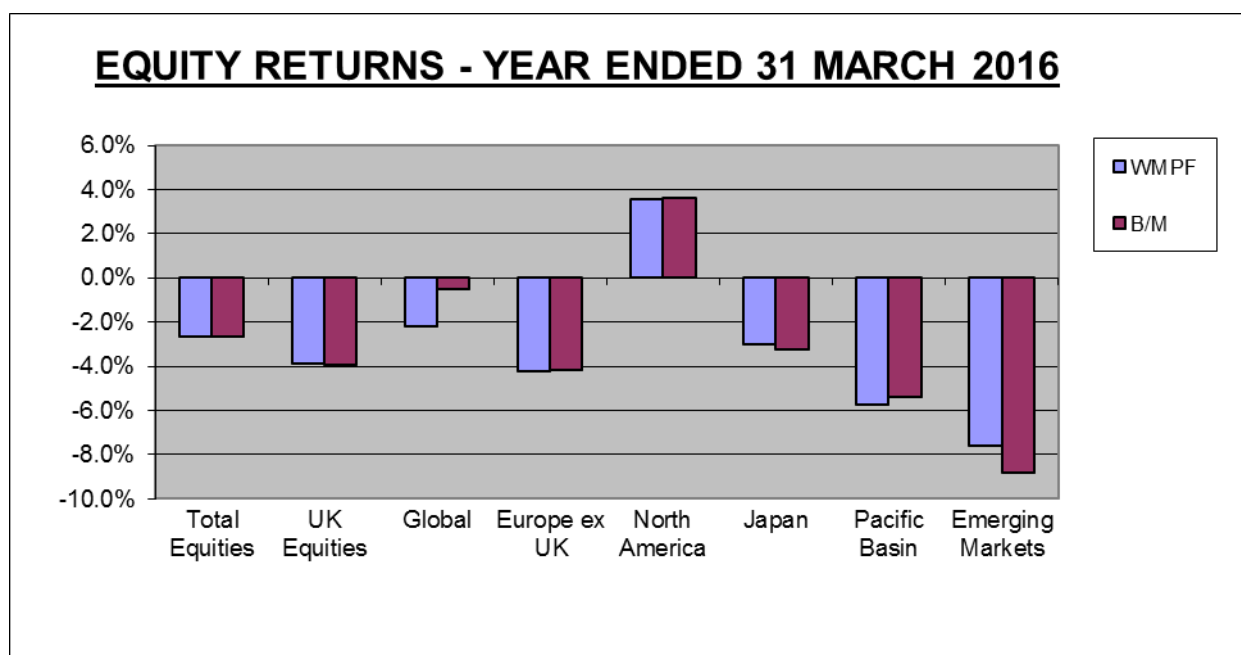


	Equities %	Bonds %	Alternatives %	Total Assets %
Fund	-2.67	+3.25	+11.13	+2.41
Benchmark	-2.65	+2.81	+4.36	+0.71
Relative	-0.02	+0.44	+6.77	+1.70

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

4.8 The Fund's total return was, at 2.41%, usefully ahead of its benchmark return of 0.71%. This was achieved due to strong returns from the alternatives investment portfolios, notably private equity. The returns from quoted equities and fixed interest were similar to those of their respective benchmarks but the fixed interest portfolio helped in the delivery of a positive return for the year, offsetting weak stock markets.

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



	Total Equities %	UK %	Global %	Europe ex UK %	North America %	Japan %	Pacific Basin %	Emerging Markets %
Fund	-2.67	-3.85	-2.21	-4.24	+3.56	-2.99	-5.74	-7.57
Benchmark	-2.65	-3.91	-0.49	-4.15	+3.62	-3.24	-5.38	-8.83
Relative	-0.02	+0.06	-1.72	-0.09	-0.06	+0.25	-0.36	+1.26

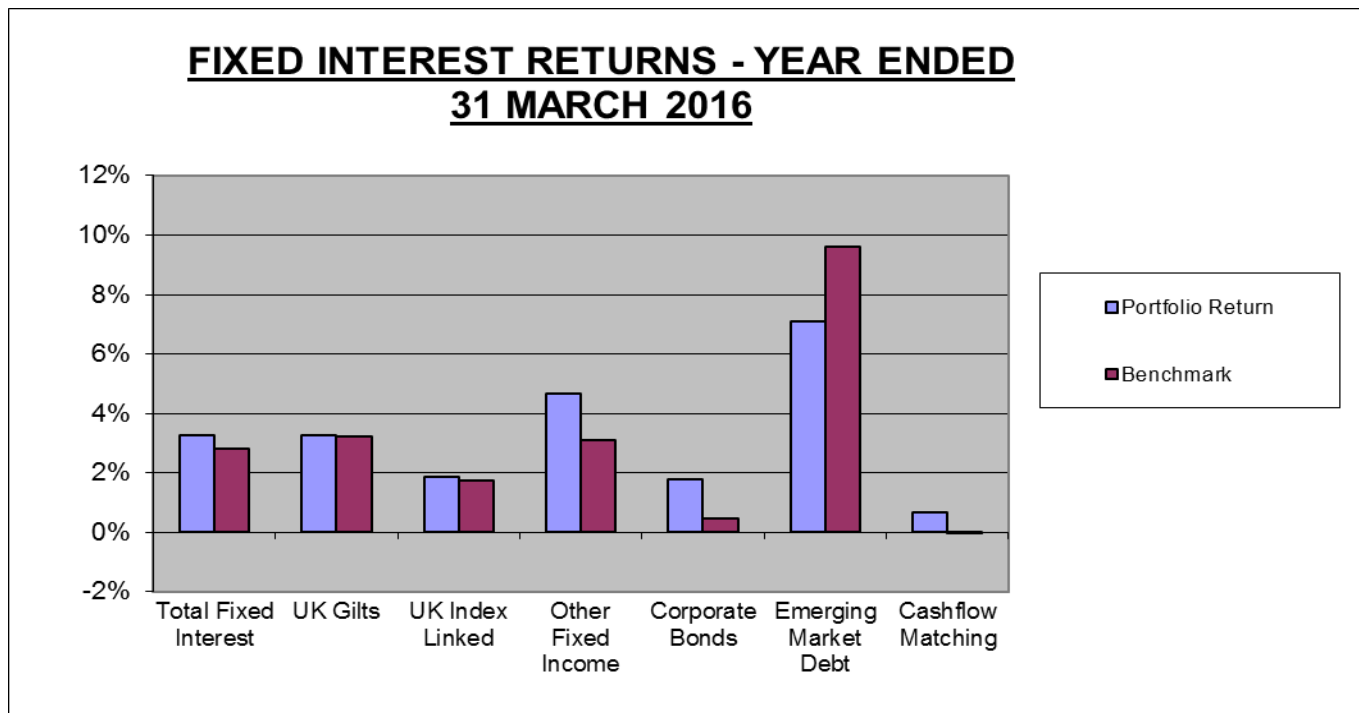
4.10 With the exception of North America, stock markets in the world's regions posted negative returns in 2015/16. Relative returns achieved by the fund were similar to benchmark in developed regional markets (reflecting the passive index tracking arrangements in place). There was some relative outperformance in emerging markets offset by underperformance in global equities. The total return from quoted equities was similar to that of its benchmark in the year.

4.11 A detailed breakdown of the Fund's equity returns over three, five and ten years compared to the respective benchmarks, are illustrated in the tables shown below.

	3 Years			5 Years			10 Years		
	Fund %	Bmk %	Rel %	Fund %	Bmk %	Rel %	Fund %	Bmk %	Rel %
Total Equities	+5.66	+5.30	+0.36	+6.22	+5.80	+0.42	+5.08	+4.82	+0.26
UK	+3.75	+3.67	+0.08	+5.77	+5.69	+0.08	+4.85	+4.70	+0.15
North America	+12.88	+12.67	+0.21	+13.00	+12.76	+0.24	+9.06	+8.79	+0.27
Europe ex UK	+6.90	+6.49	+0.41	+4.86	+4.78	+0.08	+4.89	+4.87	+0.02
Japan	+7.25	+6.59	+0.66	+7.32	+6.92	+0.40	+1.62	+1.70	-0.08
Pacific Basin	-0.51	+0.15	-0.66	+2.54	+2.51	+0.03	+8.05	+7.61	+0.44
Emerging Mkts	-2.65	-1.83	-0.82	-1.46	-1.46	-0.00	+5.51	+6.23	-0.72
Global	+8.15	+8.17	-0.02	+8.65	+8.15	+0.50	+6.26	+6.79	-0.53

All returns for periods in excess of 1 year are annualised

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



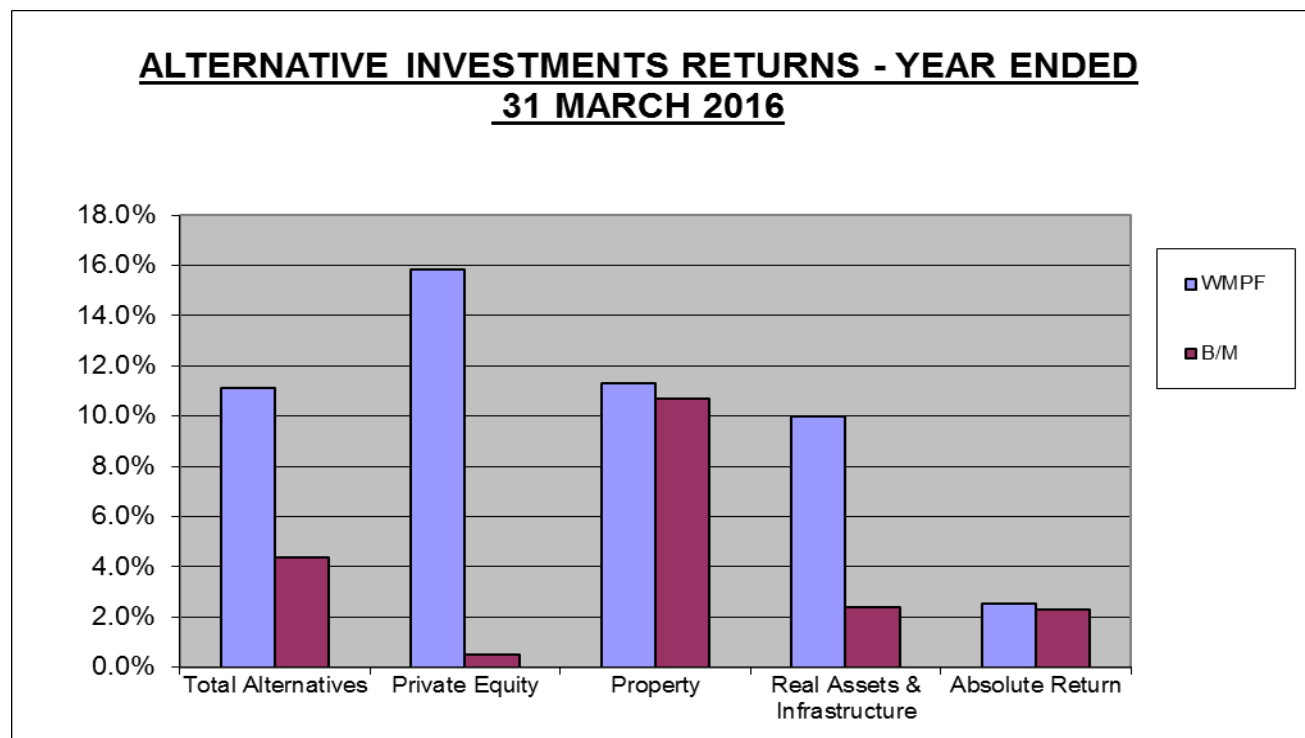
	Total Fixed Interest %	UK Gilts %	UK Index Linked %	Other Fixed Income %	Corporate Bonds %	Emerging Market Debt %	Cashflow Matching %
Fund	+3.25	+3.25	+1.85	+4.66	+1.77	+7.11	+0.66
Benchmark	+2.81	+3.24	+1.74	+3.09	+0.44	+9.61	-0.01
Relative	+0.44	+0.01	+0.11	+1.57	+1.33	-2.50	+0.67

4.13 Fixed interest markets achieved positive returns in 2015/16 and the Fund's portfolio marginally outperformed with a return of 3.3% ahead of the benchmark return of 2.8%. Within the overall picture, there were some notable performances, with emerging markets debt (reorganised in March 2016) underperforming and corporate bonds/other fixed interest outperforming.

4.14 A detailed breakdown of the Fund's fixed interest returns over three, five and ten years compared to the respective benchmarks, are illustrated in the tables shown below.

	3 Years			5 Years			10 Years		
	Fund %	Bmk %	Rel %	Fund %	Bmk %	Rel %	Fund %	Bmk %	Rel %
Total Fixed Interest	+4.86	+4.71	+0.15	+7.24	+7.75	-0.51	+6.45	+6.27	+0.18
UK Gilts	+4.33	+4.65	-0.32	+6.26	+6.66	-0.40	N/A	N/A	N/A
UK Index Linked	+5.24	+5.08	+0.16	+8.75	+8.60	+0.15	N/A	N/A	N/A
Corporate Bonds	+5.86	+4.96	+0.90	+7.31	+7.15	+0.16	N/A	N/A	N/A
Emerging Markets Debt	+2.59	+4.92	-2.33	+5.49	+8.67	-3.18	N/A	N/A	N/A
Other Fixed Income	+5.00	+4.60	+0.40	+4.96	+2.88	+2.08	N/A	N/A	N/A

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



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	Total Alternatives %	Private Equity %	Property %	Real Assets & Infrastructure %	Absolute Return %
Fund	+11.13	+15.84	+11.29	+9.98	+2.55
Benchmark	+4.36	+0.49	10.69	+2.38	+2.29
Relative	+6.77	+15.35	+0.60	+7.60	+0.26

4.16 The alternative investments portfolio posted a strong return in the year and was the key positive contributor to the fund's overall outperformance. Leading the way was a very strong positive return from the private equity portfolio (15.8%), with outperformance also delivered from the property and infrastructure/real assets portfolios.

4.17 A detailed breakdown of the Fund's alternatives portfolios over three, five and ten years compared to the respective benchmarks, are illustrated in the tables shown below.

	3 Years			5 Years			10 Years		
	Fund %	Bmk %	Rel %	Fund %	Bmk %	Rel %	Fund %	Bmk %	Rel %
Total Alternatives	+11.23	+4.91	+6.32	+9.31	+4.41	+4.90	N/A	N/A	N/A
Private Equity	+15.85	+7.66	+8.19	+13.02	+7.55	+5.47	+10.77	+5.88	+4.89
Property	+12.26	+13.74	-1.48	+7.00	+5.73	+1.27	+5.60	+5.00	+0.60
Real Assets & Infrastructure	+2.98	-6.61	+9.59	+1.93	-4.35	+6.28	N/A	N/A	N/A
Absolute Return	+7.30	+1.12	+6.18	+6.78	+0.95	+5.83	N/A	N/A	N/A

5.0 West Midlands Pension Fund historical returns

5.1 The returns as at 31 March 2016 achieved by the Fund in the main asset classes in which it invests are summarised in the table below, as are the three and five year annualised returns where available.

	1 Year %	3 Year %	5 Year %
UK Equities	-3.85	+3.75	+5.77
European Equities	-4.24	+6.90	+4.86
US Equities	+3.56	+12.88	+13.00
Pacific Basin Equities	-5.74	-0.51	+2.54
Japanese Equities	-2.99	+7.25	+7.32
Emerging Markets Equities	-7.57	-2.65	-1.46
Global Equities	-2.21	+8.15	+8.65
Gilts	+3.25	+4.33	+6.26
Index Linked	+1.85	+5.24	+8.75
Corporate Bonds	+1.77	+5.86	+7.31
Emerging Market Debt	+7.11	+2.59	+5.49
Other Fixed Income	+4.66	+5.00	+4.96
Property	+11.29	+12.26	+7.00
Private Equity	+15.84	+15.85	+13.02
Real Assets & Infrastructure	+9.98	+2.98	+1.93
Absolute Return Strategies	+2.55	+7.30	+6.78
Total Fund	+2.41	+0.71	+1.70

5.2 The annualised returns delivered by the fund over three and five years are a reflection of the single digit return environment achieved by mainstream liquid asset classes over the past decade. Future returns are likely to be similar.

5.3 The dull return seen in the year ended 31 March 2016 followed a very strong 2014/15. A year ago, it was suggested that lower returns were in prospect.

5.4 The Fund's portfolio remains well diversified and that should help to smooth the pattern of returns in the future, although with nearly 60% allocated to quoted equities and private equity, there remains a heavy reliance on the fortunes of stock markets.

6.0 Investment management and portfolio construction

6.1 The investment policy of the Fund is considered at each quarterly meeting of the Investment Advisory Sub-Committee and implemented by the Investments Division with advice taken from the Investment Advisory Panel, which was set up in April 2015. 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.

6.2 The Division manages approximately 80% of total investments in-house, with the balance managed via external segregated management arrangements.

6.3 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.

7.0 Financial implications

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

8.0 Legal implications

8.1 This report contains no direct legal implications.

9.0 Equalities implications

9.1 None identified.

10.0 Environmental implications

10.1 None identified.

11.0 Human resources implications

11.1 None identified.

12.0 Corporate landlord

12.1 None identified.

13.0 Schedule of background papers

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