

WIRRAL COUNCIL

PENSIONS COMMITTEE

19 NOVEMBER 2013

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| SUBJECT: | STRATEGIC ASSET ALLOCATION |
| WARD/S AFFECTED: | ALL |
| REPORT OF: | STRATEGIC DIRECTOR TRANSFORMATION AND RESOURCES |
| KEY DECISION? | NO |

1.0 EXECUTIVE SUMMARY

1.1 This paper outlines proposed changes to the strategic asset allocation following a detailed analysis undertaken by the investment consultant AON Hewitt, and discussions held with the internal investment management team and the independent advisers. This issue was also discussed in detail at an IMWP meeting on 23rd October involving presentations from the Fund's actuary Mercer and Investment Consultant, Aon Hewitt.

2.0 BACKGROUND AND KEY ISSUES

2.1 The Fund last approved a strategic asset allocation at its meeting on 16th November 2010.

2.2 The decision as to how and where the MPF should invest assets, the "strategic asset allocation", is of critical importance in determining the likelihood of the Pension Fund achieving its objectives of optimizing investment returns and meeting its longer term liabilities within acceptable levels of risk.

2.3 The strategic asset allocation is the long-term allocation between the main asset classes and involves the following decisions:

- The balance between equities and bonds
- The allocation between UK and overseas equity investment, and the balance within the overseas equity portfolio between the major regional markets
- The allocation within the bond portfolio between fixed interest and index linked gilts, sovereign and corporate bonds
- The use of alternative investments, such as private equity, hedge funds, infrastructure and property.

2.4 Although the balance between equities and bonds has historically been the most important consideration, the development of more global equity markets and a number of technical factors affecting bond markets causing historically low yield levels has raised the profile of investments in alternative assets to achieve greater diversification and potentially improved risk adjusted returns.

2.5 At an IMWP on 23 October Aon Hewitt presented the preliminary results of their asset liability modelling which looked at the Fund's current strategic allocation, postulated a range of "extreme" investment scenarios and then recommended an optimal strategy to achieve the Fund's long term objectives. These results are set out in appendix 1.

2.6 The current asset allocation is shown in the table below,

| Asset | Benchmark | Benchmark Index |
|--------------------------|------------------|--------------------------------|
| UK Equities | 25 | FTSE ALL SHARE INDEX |
| Overseas Equities | 30 | |
| US Equities | 8 | FTSE AW NORTH AMERICA |
| European Equities | 8 | FTSE WORLD EUROPE EX UK |
| Japan | 4 | FTSE AW JAPAN |
| Pacific | 4 | MSCI DEV ASIA PAC EX JAPAN |
| Emerging Markets | 6 | MSCI EMERGING MARKETS FREE |
| Fixed Interest | 20 | |
| UK Gilts | 4 | FTSE A ALL STOCKS |
| Overseas Gilts | 0 | JPM GLOBAL GOVT EX UK |
| UK Index Linked | 12 | FTSE UK GILTS INDEXED ALL STKS |
| Corporate Bonds | 4 | ML 3 NON GILTS |
| Property | 10 | IPD ALL PROPERTIES INDEX |
| Alternatives | 14 | |
| Private Equity | 4 | GBP 7 DAY LIBID |
| Hedge Funds | 5 | GBP 7 DAY LIBID |
| Opportunities | 3 | GBP 7 DAY LIBID |
| Infrastructure | 2 | GBP 7 DAY LIBID |
| Cash | 1 | GBP 3 MONTH LIBID |

2.7 The proposed changes are

To increase alternatives to 20% of the Fund: 5% for each of Private Equity, Hedge Funds, Opportunities and Infrastructure.

To fund this by making reductions of

- 2% to UK Equities
- 1% to Index Linked Gilts
- 2% to Property
- 1% to Cash (the fund will run minimal cash balances to pay pensions and meet other obligations)

2.8 The rationale for these changes is as follows

- To improve risk adjusted returns
- To minimise transaction costs for the transition
- To have regard to the balance between liquid and illiquid assets

2.9 The new suggested asset allocation is shown in the table below.

| Asset | Benchmark | Benchmark Index |
|--------------------------|------------------|-----------------------------------|
| UK Equities | 23 | FTSE ALL SHARE INDEX |
| Overseas Equities | 30 | |
| US Equities | 8 | FTSE AW NORTH AMERICA |
| European Equities | 8 | FTSE WORLD EUROPE EX UK |
| Japan | 4 | FTSE AW JAPAN |
| Pacific | 4 | MSCI DEV ASIA PAC EX JAPAN |
| Emerging Markets | 6 | MSCI EMERGING MARKETS FREE |
| Fixed Interest | 19 | |
| UK Gilts | 4 | FTSE A ALL STOCKS |
| Overseas Gilts | 0 | JPM GLOBAL GOVT EX UK |
| UK Index Linked | 11 | FTSE UK GILTS INDEXED ALL STKS |
| Corporate Bonds | 4 | ML 3 NON GILTS |
| Property | 8 | IPD ALL PROPERTIES INDEX |
| Alternatives | 20 | |
| Private Equity | 5 | GBP 7 DAY LIBID |
| Hedge Funds | 5 | GBP 7 DAY LIBID |
| Opportunities | 5 | GBP 7 DAY LIBID |
| Infrastructure | 5 | GBP 7 DAY LIBID |
| Cash | 0 | GBP 3 MONTH LIBID |

2.10 As the moves will largely be to illiquid investments it will not be possible to implement the changes with immediate effect. The suggested targets are set out above but officers will move assets gradually toward these targeted allocations as opportunities arise and this will be reflected in incremental changes to the benchmark against which WM monitors the Fund.

3.0 RELEVANT RISKS

3.1 The setting of the investment strategy and the use of diversification to control the overall volatility of Fund returns is the key part of the Fund's risk control strategy. A significant amount of resources and time have been invested in the preparation of the strategy.

4.0 OTHER OPTIONS CONSIDERED

- 4.1 A number of options were considered in the preparation of this report both in meetings between officers and advisers and at a specific IMWP meeting on 23 October 2013

5.0 CONSULTATION

- 5.1 Not relevant for this report, However there has been significant consultation in the preparation of the Funding Strategy Statement which sits alongside this report.

6.0 IMPLICATIONS FOR VOLUNTARY, COMMUNITY AND FAITH GROUPS

- 6.1 There are no implications arising directly from this report.

7.0 RESOURCE IMPLICATIONS: FINANCIAL; IT; STAFFING; AND ASSETS

- 7.1 The costs of compiling the strategy were met from existing budgeted resources. The aim of the strategy is to improve future risk adjusted returns and to minimise the level and volatility of employer contribution rates.
- 7.2 With an increase in the proportion of assets selected and monitored by the in-house team, the appropriateness of the current staffing resources will be kept under review.

8.0 LEGAL IMPLICATIONS

- 8.1 There are no implications arising directly from this report.

9.0 EQUALITIES IMPLICATIONS

- 9.1 Has the potential impact of your proposal(s) been reviewed with regard to equality?

(b) No because there is no relevance to equality.

10.0 CARBON REDUCTION IMPLICATIONS

- 10.1 There are no carbon usage implications, nor any other relevant environmental issues arising from this report.

11.0 PLANNING AND COMMUNITY SAFETY IMPLICATIONS

- 11.1 There are no planning or community safety implications arising from this report.

12.0 RECOMMENDATIONS

- 12.1 That the Pensions Committee approves the revised Strategic Investment Allocation.

13.0 REASONS FOR RECOMMENDATIONS

13.1 The approval of the investment strategy by Pensions Committee forms a key part of setting the strategy and governance arrangements for the Fund's Investments.

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APPENDICES

1. The AON Hewitt report to IMWP on 23rd October is attached as an appendix to this report

REFERENCE MATERIAL

Actuarial Valuation
AON Hewitt Reports

SUBJECT HISTORY (last 3 years)

| Council Meeting | Date |
|---------------------------|-------------------------|
| PENSIONS COMMITTEE | |
| ASSET ALLOCATION | 16 NOVEMBER 2010 |

