PENSIONS INVESTMENT COMMITTEE			
REPORT TITLE	**Asset Allocation and Rebalancing Policy**		
KEY DECISION	No	**Item No:**	7
WARD	N/A		
CONTRIBUTORS	Executive Director for Resources & Regeneration		
CLASS	Part 1	**Date:**	9 September 2014

1. SUMMARY

1.1 This report provides members with an analysis of the asset allocation of the Pension Fund and compares the current asset allocation position to the strategic benchmark set in the Pension Fund's Statements of Investment Policy 2014-15.

1.2 The aim of this paper is to:

(i) Set out the new strategic allocation of assets to be included in the 2014-15 Statement of Investment Principles,
(ii) Set out a rebalancing policy,
(iii) and determine whether there has been significant drift from the strategic benchmark, and if so agree the necessary steps to bring the assets back into alignment.

2. RECOMMENDATION

2.1 The Committee is recommended:

1) agree the new strategic allocation for 2014-15

2) to agree a new rebalancing policy as set out in section 5 below

3) to approve delegation to the Executive Director of Resources in consultation with the Chair of Pensions Investment Committee to undertake asset allocation rebalancing when required.

3. BACKGROUND

3.1 Rebalancing is the process of realigning the weightings of the funds assets to its strategic benchmarks. Benchmarks are set in order to ensure that the fund meets optimal return that is consistent with the prudent level of risk.

3.2 Rebalancing ensures that these benchmarks are maintained. The Statement of Investment Principles (SIP) sets out the current benchmark position for each asset class and was originally agreed in 2012.

3.3 As market values move over time, and as managers over and underperform, the proportions actually held in different asset classes will move away from the target allocations Rebalancing of the Fund is currently done on an adhoc basis due to the costs involved and other complications associated with transfer of assets from one manager to another.

3.4 It can be financially beneficial to undertake rebalancing of the portfolios when asset classes move away from the targets set in strategy. The aim of a rebalancing policy is to provide a clear, pragmatic and efficient approach to the distribution of the fund assets.

4. TARGET ASSET ALLOCATION

4.1 The strategic Allocation set out in the SIP 2013 was prior to deciding on where to invest additional cash of £25 million. This was the proceeds from the closure of the Fauchier hedge of hedge funds mandate in 2012. The allocation is shown in table 1 below:

Table 1: 2013 Strategic Allocation

Asset Class	Manager	Benchmark	Benchmark (%)
Equities:			
Private Equity	Habourvest	MSCI All Country World developed Index	3.0
Listed Equity	Blackrock (passive)	Composite	30.0
Listed Equity	UBS (passive)	Composite	30.0
Bonds:			
	Blackrock (passive)	Composite	9.0
	UBS (passive)	Composite	9.0
Sub Total			**81.0**
Property	Schroders	IPD Pooled Property Fund Index	10.0
UK Financing Fund	M&G	LIBOR	1.0
Commodities	Investec	Dow Jones-UBS Commodities Total Return Index	5.0
Temporary Cash Holding			3.0
Total			**100.0**

4.2 The £25 million has now been re-invested in the passive equity mandate (Blackrock £12.5 million, UBS £12.5 million). As a result, the strategic allocation has been revisited, and the benchmarks have been slightly revised. We have consulted with our advisers Hymans Robertson, and the new benchmark is set out in table 2 below:

Table 2: 2014 Strategic Allocation

Asset Class	Manager	Benchmark	New Benchmark (%)
Equities:			
Private Equity	Harbourvest	MSCI All Country World developed Index	3.0
Listed Equity	Blackrock (passive)	Composite	31.2
Listed Equity	UBS (passive)	Composite	31.2
Bonds:			
	Blackrock (passive)	Composite	9.3
	UBS (passive)	Composite	9.3
Sub Total			**84.0**
Property	Schroders	IPD Pooled Property Fund Index	10.0
UK Financing Fund	M&G	LIBOR	1.0
Commodities	Investec	Dow Jones-UBS Commodities Total Return Index	5.0
Cash Holding			0.0
Total			**100.0**

4.3 The last review of the target asset allocation was undertaken during the 2012 transition of the Fund from active to passive management. The following table shows the target allocation versus the actual allocations as at 30 June 2014 using market value (source: Northern Trust).

Table 3: Current fund allocations

Asset Class	Manager	Value as at 30 Jun 14 £'000	Actual (A) Allocation %	Target (T) Allocation %	Variance (A-T) %
Equities:					
Private Equity	Harbourvest	40,708	4.4	3.0	1.4
Listed Equity	Blackrock (passive)	291,676	31.4	31.2	0.2
Listed Equity	UBS (passive)	291,926	31.4	31.2	0.2
Bonds:					
	Blackrock (passive)	86,887	9.3	9.3	0.0
	UBS (passive)	87,392	9.4	9.3	0.1
Equities / Bonds Sub Total			**85.9**	**84.0**	**1.9**
Property	Schroders	81,151	8.7	10.0	-1.3
UK Financing Fund	M&G	14,106	1.5	1.0	0.5
Commodities	Investec	35,239	3.8	5.0	-1.2
Cash Holding		874	0.1	0.0	0.1
Other Sub Total			**14.1**	**16.0**	**-1.9**
Total		**929,959**	**100.0**	**100.0**	**-**

Note: Cash holding includes pending cash for BlackRock and UBS portfolios (as reported by Northern Trust)

4.4 The table above shows that the greatest drift is private equity and property. Private equity is 1.4% above the strategic benchmark, and property is 1.3% less than the strategic benchmark. The rebalancing policy below sets out proposed tolerance levels for the Fund's mandates. If the policy was to be agreed, the portfolio would not need to be rebalanced at this stage.

5. REBALANCING POLICY

5.1 A rebalancing policy is important as it provides a framework for maintaining the Fund's assets within range of its strategic benchmark. A rebalancing policy should be set in such a way as to avoid excessive rebalancing during volatile markets, and should take into account the following factors:

- Tolerance levels – the acceptable % allocation ranges for individual mandates/asset classes,
- Frequency – the frequency of monitoring/rebalancing, and
- Rebalancing target – the point to rebalance to.

In turn, the factors above should take into account characteristics of the individual asset classes, including liquidity (and transaction costs) and volatility.

5.2 Existing rebalancing arrangements are currently in place for the BlackRock and UBS passive multi-asset mandates. Rebalancing operates *within* each mandate, as follows:

Table 4: BlackRock and UBS rebalancing

Mandates	**Policy**
BlackRock	Rebalancing tolerance levels of +/- 2% for the following allocations: - UK Equity (20.5%) - Global Equity (56.5%) - Over 15 Year Gilts (7.6%) - Over 5 Year Gilts (7.7%) - UK Corporate Bonds (7.7%) Monitored on a daily basis, with rebalancing occurring at the next available dealing date if outwith the tolerance range.
UBS	Strategic benchmarking is as follows: - UK Equity (20.5%) - Global Equity (56.5%) - UK fixed interest (7.6%) - UK Index linked (7.7%) - UK Corporate Bonds (7.7%) Monitoring and rebalancing occurs on a quarterly basis, with holdings rebalancing to the benchmark allocation.

5.3 Rebalancing arrangements are proposed for the Fund's mandates, below:

Table 5: Tolerance levels

Mandates	**Deviation from Strategic benchmark**	**Action**
BlackRock (passive multi-asset)	+/- 3%	Monitored on a quarterly basis, with rebalancing to +/- 1.5% at the next available opportunity.
UBS (passive multi-asset)	+/- 3%	Monitored on a quarterly basis, with rebalancing to +/- 1.5% at the next available opportunity.
Schroders Property	+/- 2%	Monitored on a quarterly basis, with rebalancing to +/- 1% at the next available opportunity.
Investec Commodities	+/- 1.5%	Monitored on a quarterly basis, with rebalancing +/- 0.75% at the next available opportunity.
HarbourVest Private Equity	-	Rebalancing is not available for this mandate, given its structure (pre-arranged commitments and buy-and hold).
M&G UK Financing Fund	-	Rebalancing is not available for this mandate, given its buy-and-hold structure.

5.4 In order to avoid excessive rebalancing, the assets will not be brought back to the absolute strategic benchmark, but to a position that is approximately half way between the tolerance level and the target allocation. This also takes into consideration that there is a time lag between reporting a variance, and the rebalancing of the funds.

5.5 Where a mandate is underweight and outwith its tolerance level, the Fund's surplus cash flow will be used to bring assets back to within the tolerable range. If the surplus cash is not sufficient, the rebalancing will be undertaken by selling funds from the mandates that are most overweight, and using the proceeds to purchase assets that are the most underweight.

5.6 Where a mandate is overweight and outwith its tolerance level, assets will be disinvested from the mandate, and the proceeds reinvested in the most underweight mandate. Where multiple mandates qualify as being 'most underweight', the proceeds will be re-invested in relative proportions to bring the respective mandates to a similar level of underweight.

5.7 It has been built into this policy the option for the Executive Director of Resources and Regeneration to exercise discretion to override table 5. This option offers flexibility that takes into account market conditions and other factors that will influence the process of rebalancing.

Costs of rebalancing

5.8 Rebalancing involves portfolio transactions. The cost of selling the assets, and the cost of purchasing the new assets. The costs will depend on market conditions, and the asset classes involved. In general, illiquid assets are more expensive to transact in than liquid assets. Consideration has been given to the potential costs in setting the tolerance levels and rebalancing frequencies in section 5.3 above.

5.9 This policy will be added to the SIP which will be included in the 2013/14 annual report.

6. FINANCIAL IMPLICATIONS

6.1 The Fund's approach to asset allocation links with its investment strategy. The investment strategy is set for the long-term. A significant proportion of the asset allocation is to growth assets because they are expected to achieve a higher rate of return over the long-term. However this strategy carries with it a greater risk of volatility in the short-term and medium-term.

6.2 Rebalancing seeks to add value to the fund over time by:

a) reallocating assets from mandates that have risen beyond their respective tolerance levels (equivalent to selling assets that have done relatively well) or
b) topping up assets to mandates that have fallen below their respective tolerance levels (equivalent to purchasing assets that have become relatively cheaper).

By limiting rebalancing to the mid-point of the difference between the benchmark allocation and relevant boundary of the tolerance range, trading costs are minimised (relative to rebalancing to the target allocation).

7. LEGAL IMPLICATIONS

7.1 The proposed rebalancing policy contained in the Recommendations and the authority delegated to Executive Director for Resources and Regeneration to undertake a rebalancing review and to have the flexibility to make a tactical rebalancing decision are subject to clear limits contained in the proposed rebalancing policy set out in paragraph 5 of this Report, if the Recommendations are accepted by Members. The benefits and risks of adopting the policy are set out in the Report and are for Members to weigh up.

7.2 Any rebalancing must be in accordance with the Authority's statement of investment principles which govern decisions about the investment of Fund money, including amongst other things, the types of investment to be held, the balance between different types of investments, risk, (including the ways in which risks are to be measured and managed) and the expected return on investments.

7.3 Any movement of assets from other parts of the Fund or the use of cash to achieve a rebalancing of particular investment funds must also comply with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (the Regulations) which set out restrictions on types of investments by limiting the proportion of Fund money which may be invested in that type of investment.

7.4 If the delegation is agreed, then the Executive Director must , where necessary, obtain and consider proper independent advice and act prudently in taking any steps in relation to the Fund's investments .

8. CRIME AND DISORDER IMPLICATIONS

8.1 There are no crime and disorder implications directly arising from this report.

9. EQUALITIES IMPLICATIONS

9.1 There are no equalities implications directly arising from this report.

10. ENVIRONMENTAL IMPLICATIONS

10.1 There are no environmental implications directly arising from this report.

FURTHER INFORMATION

If there are any queries on this report or you require further information, please contact:
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