A Steady 2017/2018 Financial Year for Local Authority Pension Fund Investment Returns

Over the year to end March 2018 the average Local Authority pension fund, as represented by the PIRC Local Authority Universe, returned 4.5% on its assets.

Property was the best performing asset over the year with a return of 10%, with equities at 4% and bonds at 1%. Lower risk absolute return type investments gave around 2%. In a year where returns were quite tightly grouped. Strategic asset allocation decisions had less of an impact than usual.

A Good Year for Active Equity Managers

The key feature in the year was the performance of active equity managers. Funds that did well tended to have seen strong outperformance by their global equity managers. As a group these managers outperformed their benchmarks by 2% over the year but, as ever, there was a wide range of results.

Although these managers outperformed in the latest year the longer term results are less stellar. Despite this fact the latest year saw a year on year reduction in the level of passive investment for the first time.

Risk Reduction

There was a marked move towards ‘derisking’ with a number of funds moving from equities to less ‘risky’ assets such as diversified growth / absolute return portfolios which target lower than equity returns but at substantially lower than equity volatility. The overall equity exposure fell in year by the largest percentage recorded over many years from 62% to 55% for the average fund.

Such a strategy will inevitably bring with it lower long term returns. However as the key actuarial discount rate assumptions have fallen to relatively modest levels, some funds may now feel comfortable accepting more modest returns and this may be making the decision straightforward.

Longer Term Performance

Long term performance has been excellent. Funds delivered a positive return in 25 of the last 30 years and delivered an annualised performance of 9% p.a. against inflation of 3% p.a.

There have been only five years of negative performance in the last thirty – at the start of the millennium (the bursting of the dot-com bubble) and the global financial crisis of 2008/9. All periods were followed by double-digit returns. The equity 'shocks' that investors are so concerned about mitigating have been infrequent and the reward for holding equities substantial.

Can Long Term Performance Be Maintained?

Long term performance has been extremely strong. It is likely that returns going forward will be lower than those that have been achieved in the past.

Over the last 10 years the best performing funds have held a relatively high level of equities and a relatively low exposure to alternatives. These funds generally experienced more volatility than other funds but over this period the volatility has been rewarded with higher returns. The general move to reduce volatility, whilst necessary as funds mature, will inevitably reduce the overall level of returns.

The best performing funds have had more of their assets managed actively than their peers. There is a possibility that active manager added value could be reduced as funds move to pooling. In some structures a number of active managers will be put together into a multi manager arrangement to reduce risk. This has the possibility of diluting active manager added value and leading to expensive indexation.

The best performing funds have had less complex structures than their peers. There is an ongoing move towards ever more complex fund structures as funds seek to diversify their assets to reduce risk. The benefits of any further diversification needs to be fully understood and quantified. With the average fund now having 13 portfolios the size of many mandates now in place means they are unlikely to have any tangible impact on either overall fund return or on risk reduction.

Funds with higher returns overtime have generally had long term relations with their investment managers. Funds are long term investors – it will be important to ensure that the new pooling arrangements continue to focus on long term results and that manager turnover (a key drag on the long term health of any pension fund) is not increased.

Local Authority Fund Returns to End March 2018

% p.a.	1 Year	3 Yrs	5 Yrs	10Yrs	20 Yrs	30 Yrs
Equity	4.3	9.6	10.1	8.8	6.6	9.4
Bonds	1.4	4.5	4.9	6.7	6.5	7.8
Cash	-0.2	0.7	1.1	1.6	3.2	5.1
Alternatives	5.8	10.1	9.3	6.1	9.0	-
Property	9.8	8.8	10.6	4.7	7.8	7.9
Total Assets	4.5	8.3	8.8	7.7	6.5	8.9

The Local Authority Pension Performance Analytics (LAPPA) Universe has been run by PIRC since 2017 when the State Street / WM withdrew from providing the service. It provides exclusive and unique information to support Local Authority pension funds to view their investment performance within a long-term, peer group context that will enhance governance and improve decision making.

The peer group Universe is the largest and most comprehensive database of local authority pension fund investments. It currently comprises **61 funds with an aggregate value of £177bn**. This represents over two-thirds of local authority pension fund assets. The Universe has thirty plus years of detailed historical data making it unique and increasingly essential for those funds that wish to place their performance in a long-term context.

LAPPA's analysis is completely **independent and objective**, and, being affiliated to neither investment managers nor consultants there are no vested interests.

If you'd like more information about any of the above please get in touch:

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