Agenda Item No. 11

WEST OXFORDSHIRE DISTRICT COUNCIL

FINANCE AND MANAGEMENT OVERVIEW & SCRUTINY COMMITTEE WEDNESDAY 4 FEBRUARY 2015

TREASURY MANAGEMENT ACTIVITY AND PERFORMANCE 2014/15

REPORT OF THE GO SHARED SERVICES HEAD OF FINANCE

(Contact: Paul Stuart, Tel: (01993) 861171)

(The report is for information)

1. PURPOSE

To advise members of treasury management activity and the performance of internal and external fund managers for the period 1 April 2014 – 31st December 2014.

2. RECOMMENDATIONS

That treasury management and the performance of in-house and external Pooled Funds' activity for the period 1 April 2014 – 31 December 2014 are noted.

3. BACKGROUND

Investment Portfolio Background

3.1. The In house investment balance amounted to £14.610m at 1 April 2014 including the long term loan to Hanover Housing Association. However, the average balance of investments for the period to 31st December 2014 has risen to £17.808m excluding outstanding Icelandic deposits.

3.2. Bonds purchased in 2013/14 (at a cost of £4.942m) were valued at £5.081m at 31st March 2014 and are now valued at £5.142m on 31st December 2014.

3.3. The performance of all funds are continually monitored and compared against the 3 month LIBID rate which is 0.43% as at 31 December 2014.

Investment Activity

3.4. The guidance on Local Government Investment in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

3.5. Security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2014/15. New investments were made in line with policy as quoted in the Investment Strategy for 2014/15:

- AAA-rated Money Market Funds;
- Term Deposits with UK Banks and Building Societies systemically important to the UK banking system; and
- Pooled funds (collective investment schemes) meeting the criteria in SI 2004 No 534 and subsequent amendments.

3.6. Counterparty credit quality was assessed and monitored with reference to Credit Ratings (the Council's minimum long-term counterparty rating of A- (or equivalent) across rating agencies Fitch, S&P and Moody's); credit default swaps; GDP of the country in which the institution operates; the country's net debt as a percentage of

GDP; sovereign support mechanisms /potential support from a well-resourced parent institution; share price.

3.7. The cash investments outstanding at 31 December 2014 are detailed in Appendix A.

Investment Performance

3.8. Performance Achieved for the period (excluding outstanding Icelandic investments) is shown below:

Performance of Fund 1 April 2014 to 31 December 2014 (annualised returns)	**Pooled Funds**	**In-House**	**Bonds**
Net Return	0.64%	1.39%	3.78%

3.9. In – house investment achieved a net return of 1.39% which is 0.96% above the 3 month LIBID rate. The outperformance is due to the £5m loan to Hanover Housing Association at a rate of 3.35% and a number of fixed term deposits with Lloyds at the beginning of year with an average rate of 0.94%. However it should be noted in-house investments are largely constrained by cash flow commitments such as precept payments, benefit pay-out as well as the capital programme requirements.

Pooled Funds

Fund Manager	**Original Investment**	**Fund Values for June-December 2014**			**Unrealised Gain/(Loss)**	**% Return Annualised**
		June	**August**	**December**		
	£	**£**	**£**	**£**	**£**	**%**
Insight LPF	2,000,000	2,004,150	2,006,916	2,012,130	12,130	0.81
Payden & Rygel	2,000,000	2,002,259	2,008,961	2,018,844	18,844	1.25
UBS	1,000,000	1,023,698	1,036,947	1,044,970	44,971	6.00
SWIP	4,000,000	3,955,882	3,952,206	3,860,294	-139,706	-4.66
Schroders	1,000,000	1,019,922	1,043,314	1,060,972	60,972	8.13
Threadneedle	1,000,000	1,012,853	1,033,009	1,029,990	29,990	4.00
M&G	1,000,000	1,020,706	1,039,277	1,030,457	30,457	4.06
	12,000,000	12,039,470	12,120,630	**12,057,658**	**57,658**	**0.64**

3.10. **Insight ILF GBP Liquidity Plus Fund** – The Fund aims to preserve capital and provide an investment return in excess of sterling money markets. The fund aims to for a net return equivalent to 0.125% above the 3 month sterling LIBID (currently 0.43%).

3.11. **Payden Sterling Reserve Fund** – The fund invests in a diversified range of sterling-denominated, highly-rated and very liquid government agency securities and corporate fixed – and floating-rate and covered bonds. The Fund has delivered a positive return so far.

3.12. **UBS Multi-Asset Income Fund** – The fund seeks to provide an income, through a diversified portfolio of investments. A very positive return has been generated to date coming from both income and return on capital. The Fund's allocation to high yield debt, both US and European, provided the largest contribution to performance for this year.

3.13. **Aberdeen (SWIP) Absolute Return Bond Fund** – The Fund aims to achieve a positive capital return, regardless of market conditions, over rolling 12 month periods. Emphasis on credit and currency positions is the strategy for fixed income. Arlingclose met with SWIP in January 2015 to discuss their performance and strategy, a summary of that discussion is as follows:

Aberdeen Fund Managers acknowledges that in 2014 the increased short duration position in government bond markets and small shorts in peripheral country debt - based on their view that top quality investment grade government bonds were at extremely high valuation and that yields would rise as a strong US economic rebound and the end of 'tapering' would lead to higher interest rates -proved mistimed as bond markets instead rallied massively and yields fell on the back of Europe's weakness and fears of deflation, slowing Chinese growth and falling oil and the big fall in the oil price. Their duration strategy was the largest contributor to the negative return in 2014.

Their view that credit spreads would widen, forcing investors to sell out of 'carry trades' (borrowing in a low interest rate currency and converting it to or investing in a higher interest rate currency), they concede was also wrong as low rates and expectations of the ECB commencing quantitative easing kept carry trades alive for longer than expected. Their credit strategy also detracted from performance in 2014, but to a lesser extent than the rates strategy.

As bond yields have continued to fall in January, for the month to date performance is, disappointingly, around 0.80% down. Performance attribution, the rationale for the holding and the managers' outlook for the fund's duration/credit/FX strategies are below.

Duration: (-40bp) The fund's negative duration has been cut from -2yrs to -1½yrs. The fund managers' view is that the overall risk vs return for these positions given exceptionally low yields (Japanese 10yr yields are now just 0.2%) warrants them continuing to have an exposure. To give an example of one position in the fund In theory 10yr bonds could get to zero but relative to where they would trade in a normal market the managers have a positive view on the risk/reward trade-off. The rationale is that even when Japan had over 1% deflation, Japanese government bonds traded at 0.4%, and currently Japan has inflation of 1%. Also it is very hard to argue any investor would buy 10yr government bonds with yields below zero, as it would be better to have 'cash under the mattress'.

Currency: (-10bp) A number of risk positions have been cut, the positions they have maintained have had a small negative return on the fund; the managers are confident that these will be profitable although at the moment there has been a small move against the positions in January.

Credit: (-30bp) Spreads have widened somewhat in a number of the fund's positions as their hedges in European credit have not fully offset these losses. They view these positions as offering considerable spread and value, which they believe will soon begin to deliver positive performance.

I fully appreciate that the ARBF's negative performance in the 9 months to December and the further fall in January isn't encouraging given its weighting in West Oxfordshire's pooled fund's portfolio. However, the managers believe that the existing positions, particularly in rates offer considerable value and, in their words, "with very little downside from these levels relative to the upside". The Japanese bond position above is just one such position.

3.14. **Schroder Income Maximiser Fund** – The Fund's investment objective is to provide income with potential for capital growth primarily through investment in equity and equity related securities of UK companies. The fund aims to deliver a target yield of 7% per year.

3.15. **Threadneedle Global Equity Income Fund** – The aim of the Fund is to provide income with the potential to grow the amount invested as well. The fund invests two thirds of its assets in shares of companies worldwide.

3.16. **M&G Global Dividend Fund** – The fund aims to deliver a dividend yield above the market average, by investing mainly in a range of global equities. The fund aims to grow distributions over the long term whilst also maximising total return. The fund will usually hold around 50 stocks, with a long-term investment view and a typical holding period of three to five years.

3.17. In summary the portfolio is performing in line with budget expectations and forecasts, with the exception of the Pooled Funds model. Although the balance of the fund was to allow movement at one end of the market e.g. should bonds be performing poorly, this would be compensated by the alternative investments such as short term cash and equities. This has worked to some degree but the low level of performance at one end is not being fully compensated to create a smoother overall level of performance. Consequently officers will investigate and review with Arlingclose the spread of investments for the on-going position of the portfolio.

3.18. The pooled fund performance also has to be considered alongside other investment performance such as the RSL corporate bonds which have benefited from the bond market position with A2D registering significant capital appreciation to offset the SWIP book position.

Interest Rate Forecast

3.19. The UK economic recovery has continued. Household consumption remains a significant driver, but there are signs that growth is becoming more balanced. The greater contribution from business investment should support continued, albeit slower, expansion of GDP throughout this year.

3.20. Arlingclose as shown in the table below continues to forecast the first rise in official interest rates in Q3 2015; general market sentiment is now close to this forecast. There is momentum in the economy, but inflationary pressure is benign and external risks have increased, reducing the likelihood of immediate monetary tightening.

	Dec-14	Mar-15	Jun -15	Sep-15	Dec-15	Mar-16	Jun -16	Sep-16	Dec-16	Mar-17	Jun -17	Sep -17
Official Bank Rate												
Upside risk	0.25	0.25	0.50	0.25	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75
Central case	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.75
Downside risk					0.25	0.50	0.50	0.75	0.75	1.00	1.00	1.00

4. ALTERNATIVES/OPTIONS

None applicable.

5. FINANCIAL IMPLICATIONS

5.1. The original investment interest budget for 2014/15 was set at £550,000 which was based on an average balance of £32.9 million from all the different type of investments (e.g. fixed term deposits, pooled funds, bonds) achieving an overall average return of 1.67%. The breakdown of the budget and latest forecast to the year-end are as follows:

	Budget 2014/15	Current Forecast 2014/15
Pooled Fund Managers	£120,000	£100,000
In-House Investments	£72,500	£85,000
Hanover Housing Assoc	£167,500	£167,500
Bonds	£190,000	£234,800
Total	£550,000	£587,300

5.2. The continuing fluctuations within the Pooled Fund Investments mean that forecasting an accurate return for the year is quite difficult. However, even if the above forecast is overly optimistic the return should at least be within range of the original budget.

5.3. Officers will be meeting with Arlingclose during February to review the overall investment strategy including the Pool Fund distribution of investments.

6. REASONS

To be recognised as a leading council that provides efficient, value for money services.

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Background Papers
None

Appendix A

SCHEDULE OF CASH INVESTMENTS OUTSTANDING AT 31 December 2014

NAME OF COUNTERPARTY	VALUE DATE	NOMINAL AMOUNT (£)	MATURITY DATE	RATE OF INTEREST	Fitch Credit Rating Fitch Credit Long Term	Short Term	Viability	Support
IN HOUSE MANAGEMENT								
Hannover Housing Association	24.07.13	5,000,000	24.07.18	3.35%	A	F1		
Lloyds Bank	01.04.14	1,900,000	31.03.15	0.95%	A	F1	a-	1
Nationwide BS	11.04.14	2,100,000	25.03.15	0.80%	A	F1	a	1
Barclays Bank	01.07.14	1,500,000	02.02.15	0.65%	A	F1	a	1
Lloyds Bank	04.08.14	1,100,000	04.03.15	0.73%	A	F1	a-	1
Nationwide BS	06.08.14	1,000,000	06.03.15	0.69%	A	F1	a	1
Lloyds Bank	03.09.14	2,000,000	03.03.15	0.70%	A	F1	a	1
Goldman Sachs MMF	31.12.14	1,135,000		0.38%	AAAmmf			
Invesco AIM MMF	31.12.14	4,095,000		0.42%	AAAmmf			
TOTAL IN-HOUSE INVESTMENTS		**19,830,000**						
ICELANDIC BANK DEPOSITS								
GLITNIR	27.06.07	236,166	29.06.09	6.520%				
Kaupthing Singer Friedlander	02.07.07	159,144	02.07.09	6.590%				
GLITNIR (Tradition)	31.08.07	538,041	28.08.09	6.350%				
TOTAL ICELANDIC DEPOSITS		**933,351**						

Appendix B

POOLED FUND & BONDS PORTFOLIO VALUATION AT 31 DECEMBER 2014

POOLED FUNDS & BONDS	MARKET VALUE (£)
Insight ILF GBP Liquidity Plus Fund	2,012,130
Payden Sterling Reserve Fund	2,018,844
UBS Multi-Asset Income Fund	1,044,971
SWIP Absolute Return Bond Fund	3,860,294
Schroder Income Maximiser Fund	1,060,972
Threadneedle Global Dividend Fund	1,029,990
M&G Global Dividend Fund	1,030,457
A2D Bond	2,704,150
Places For People Bond	2,437,563
TOTAL VALUE OF FUNDS & BONDS	**17,199,371**