TOWER HAMLETS

Meeting of the

PENSIONS COMMITTEE

Thursday, 23 April 2009 at 6.30 p.m.

SUPPLEMENTAL AGENDA

Please find attached a revised version of the above report for consideration at the 23rd April Pensions Committee.

It contains three tables that were omitted in error from the original report attached to the agenda.

If you require any further information relating to this meeting, would like to request a large print, Braille or audio version of this document, or would like to discuss access arrangements or any other special requirements, please contact:

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COMMITTEE:	DATE:	CLASSIFICATION:	REPORT NO.	AGENDA NO.
Pensions Committee	**23rd April 2009**	**Unrestricted**		
REPORT OF: **Corporate Director of Resources** ORIGINATING OFFICER(S): **Investment Panel**		TITLE: **Report of Investment Panel for Quarter Ending 31st December 2008.** Ward(s) affected: N/A		

1. SUMMARY

1.1 This report informs Members of the activities of the Investment Panel and the performance of the Fund and its investment managers for the period ending 31st December 2008.

1.2 In the quarter the Fund achieved a return of -3.6% which was marginally ahead of the benchmark return of -3.7%. The returns for longer periods continue to lag the benchmark with the one year return of -16.2% being in line with the benchmark return but the three year return of -1.2% underperformed the benchmark return of -0.6%. The improved performance in the shorter term follows the results of the extensive restructuring of the fund.

1.3 The performance of individual managers was variable. Four managers achieved returns above or at the benchmark whilst the remaining four were below. The variability of returns does however partially reflect the management structure of the fund where complimentary investment styles reduce the volatility of returns.

1.4 The distribution of the fund amongst the different asset classes is broadly in line with the benchmark although there is continuing underweighting in equities attributable to declines in world financial markets as a result of the sub prime loan issue.

1.5 The volatility of investment markets has emphasised the need to have the scope to adjust asset allocations in the short term to react to changes. The actuary has recommended a range of asset allocations within which the Corporate Director of Resources has delegated authority subject to the advice of the Chair of the Investment Panel and the approval of the Chair of the Pensions Committee to adjust asset allocations. The exercise of this authority would be reported to subsequent meetings of the Committee.

2. RECOMMENDATIONS

2.1 Members are recommended to

2.1.1 Note the contents of this report.

2.1.2 Authorise the Corporate Director of Resources to reposition the portfolio within the ranges set out in paragraph 7.2 subject to the advice of the Chair of the Investment Panel and consultation with the Chair of the Pensions Committee.

3. BACKGROUND

3.1 The Pension Fund Regulations require that the Council establish arrangements for monitoring the investments of the Fund, the activities of the investment managers and ensuring that proper advice is obtained on investment issues.

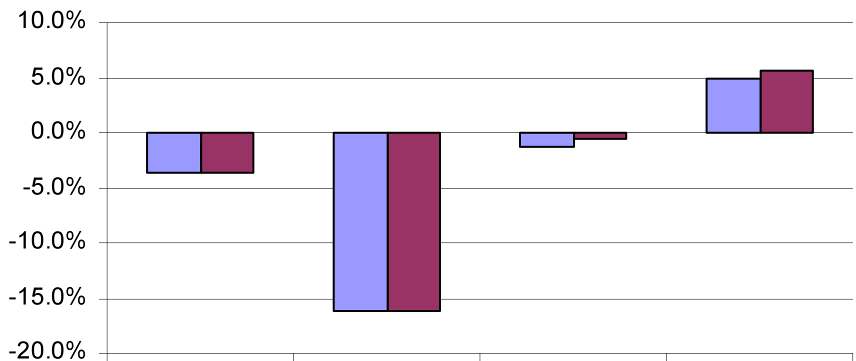
3.2 This Committee has established the Investment Panel, which meets quarterly for this purpose. The Panel's membership comprises all Members of the Pensions Committee, an Investment Professional as Chair, an Independent Financial Adviser, and the Corporate Director of Resources represented by the Service Head Corporate Finance. Trade Union representatives also attend as observers. The Investment Panel is an advisory body which makes recommendations to the Pensions Committee which is the decision making body.

3.3 This report informs Members of the activities of the Investment Panel and performance of the Fund and its investment managers for the period ending 31st December 2008.

4 INVESTMENT PERFORMANCE

4.1 The Fund achieved a return of -3.6% in the quarter which compared to a benchmark of -3.7%. This out-performance of 0.1% marginally improved the long term underperformance of the fund.

4.2 The performance of the fund over the long term is as set out in table 1.



	Current Quarter	One Year	Three Years	Five Years
Fund	-3.6%	-16.2%	-1.2%	5.0%
Bench Mark	-3.7%	-16.2%	-0.6%	5.6%

4.3 The performance of the fund should however be considered in the context of a major restructuring of the fund in the last two years which was undertaken to address the long term performance issues.

4.4 The restructuring has involved the appointment of five managers and a re-distribution of the assets to increase the exposure to equities. Restructuring of this level will inevitably adversely impact on short term performance.

4.5 The long term impact of the restructuring has yet to be fully reflected in performance and it is considered that this can only be assessed when the revised structure has been fully operational for a minimum of two years, and realistically three years

4.6 The negative returns in the one to three year figures illustrates the volatility and cyclical nature of financial markets and are within the range of expectations used by the fund actuary in assessing the funding position. The Fund can take a long term perspective on investment issues principally because a high proportion of its pensions liabilities are up to sixty years in the future. Consequently it can effectively ride out short term volatility in markets.

5. MANAGERS

5.1 The Fund currently employs eight specialist managers with mandates corresponding to the principal asset classes. The managers are as set out below:

Table 2: Management Structure

Manager	Mandate	Value £M	Target % of Fund	Date Appointed
GMO	Global Equity	159.143	25.0%	29 April 2005
Baillee Gifford	Global Equity	92.187	16.0%	5 July 2007
Martin Currie	UK Equity	71.953	12.0%	17 January 2006
Aberdeen	UK Equity	50.844	10.5%	6 July 2007
Aberdeen	Bonds	161.521	21.0%	28 February 2006
Schroder	Property	67.764	12.0%	30 September 2004
Record	Currency	3.626	1.5%	2 September 2008
Auriel	Currency	10.970	2.0%	2 September 2008
		618.008		

The fund value of £618 million has fallen by £25.7 million (3.8%) over the quarter.

5.2 The performance of the individual managers relative to the appropriate benchmarks is as set out in table 3.

Table 3: Manager Investment Performance relative to

Manager	Current Quarter	One Year	Three Years	Five Years
GMO	1.80%	4.90%	1.10%	0.90%
Baillee Gifford	-4.50%	-4.30%	-2.30%	
Martin Currie	1.30%	4.00%	-2.50%	
Aberdeen (Equities)	-1.90%	-3.50%	-4.40%	
Aberdeen (Bonds)	-1.70%	-1.90%	-0.50%	
Schroder	5.00%	4.50%	3.60%	
Record	-14.90%	-1.80%		
Auriel	9.00%	-22.60%		

5.3 **GMO** outperformed the benchmark by 1.8% in the quarter with the out-performance being principally attributable to the currency positions taken, the strategy of concentrating on quality undervalued stocks and the adoption of a defensive position contributed to performance.

5.4 **Baillie Gifford** underperformed the bench mark for the second consecutive quarter by returning a performance which was 4.5% behind the benchmark.

The poor performance is attributable to the exposure to commodity stocks and emerging markets.

5.5 **Martin Currie** outperformed the benchmark by 1.3% over the quarter by adhering to the strategy of concentrating on quality stocks and in particular blue chip companies. Performance since appointment however still lags the long term benchmark return.

5.6 **Aberdeen (UK Equities)** had a disappointing final quarter attributable to the exposure to the oil and gas and consumer goods sectors. Performance for the year and the longer term is significantly below benchmark.

5.7 **Aberdeen (Bonds)** performance in the quarter was 1.7% below benchmark which reduced performance in the year to 1.9% below. The poor performance was attributable to the exposure to the financial sector.

5.8 **Schroders** property outperformed the benchmark significantly over the quarter principally because of the exposure to continental markets and currency movements. This segment of the asset portfolio is however subject to considerable uncertainty in the medium term.

5.9 **Record** is receiving a phased contribution from the Council with an eventual portfolio size of £10M. The mandate has an aggressive performance target of 21% and consequently it is anticipated that performance will be volatile. The current risk adverse investment environment is not conducive to the Record investment approach.

5.10 **Aurial** have an investment portfolio of £14 million. One of the main funds used Lehman Brothers as brokers and funds deposited with them as collateral for derivative trades have been frozen. Recovery action has been taken but as a prudent measure the potential recovery of the Lehman deposits have been excluded from the performance data. The residual Aurial performance for the quarter was ahead of the benchmark principally because of the dollar positioning.

6 ASSET ALLOCATION

6.1 The allocation of investments between the different asset classes was determined in conjunction with the Councils professional advisors in 2004. The asset allocation is determined by a number of factors including:-

6.1.1 The risk profile. Generally there is a trade-off between the returns obtainable on investments and the level of risk. Equities have higher potential returns but this is achieved with higher volatility. However, as the fund remains open to new members and able to tolerate this long term benefits of the increased returns.

6.1.2 The age profile of the Fund. The younger the members of the fund are the longer the period before pensions become payable and investments have to be realised for this purpose. This enables the Fund to invest in more volatile asset classes because it has the capacity to ride out adverse movements in the investment cycle.

6.1.3 The deficit recovery term. All Council funds are in deficit because of falling investment returns and increasing life expectancy. The actuary determines the period over which the deficit is to be recovered and considers the need to stabilise the employer's contribution rate. The actuary has set a eighteen year deficit recovery term for this Council which enables a longer term investment perspective to be taken.

6.2 The benchmark asset distribution and the position at the 31st December 2008 is as set out below:

Table 4: Asset Allocation

	Benchmark 31 Dec 2008 %	Fund Position %	Variance as at 31 Dec 2008 %	Variance as at 30 Sep 2008 %
UK Equities	26.5%	25.6%	-0.9%	-2.7%
Global Equities	37.0%	35.3%	-1.7%	-1.1%
Total Equities	63.5%	60.9%	-2.6%	-3.8%
Property	12.0%	10.7%	-1.3%	-2.5%
UK Bonds	12.5%	14.3%	1.8%	2.7%
Overseas Bonds	0.0%	1.7%	1.7%	1.5%
UK Index Linked	8.5%	8.8%	0.3%	0.4%
Cash	0.0%	1.9%	1.9%	2.8%
Currency	3.5%	1.7%	-1.8%	-1.1%
	100.0%	100.0%		

6.3 Individual managers have discretion within defined limits to vary the asset distribution.

Table 4: Asset Allocation

	Benchmark %	Quarter %	Variance %
UK Equities	30.0%	28.3%	-1.7%
Overseas Equities	37.0%	36.8%	-0.2%
Total Equities	67.0%	65.1%	-1.9%
Property	12.0%	11.4%	-0.6%
UK Bonds	12.5%	12.5%	0.0%
Overseas Bonds		1.8%	1.8%
Index Linked	8.5%	7.9%	-0.6%
Cash		1.3%	1.3%
	100.0%	100.0%	0.0%

6.4 In addition the distribution will vary according to the relative returns of the different asset classes. Global equity markets have seen heavy declines as a result of sub prime loan issues. This has distorted the distribution in the short term. It is considered that the position will correct in the long term and consequently no rebalancing is required at the current time.

7 MARGINAL CHANGES TO ASSET ALLOCATION

7.1 The volatile investment environment has emphasised the necessity to have a mechanism to realign the portfolio to reflect short term movements in the market. The previous balanced mandate management structure provided managers with scope to rebalance the portfolio amongst various asset classes within specified limits. There is no corresponding mechanism within the current specialist mandates.

7.2 To enable the fund to respond to changes in the investment environment the actuary has recommended that there be flexibility to vary the equity exposure within the range 55% to 75% and to vary the proportions of investments within subdivisions of asset classes without obtaining the prior approval of the Pensions Committee.

7.3 It is proposed that the Corporate Director of Resources be delegated authority for effecting the changes subject to advice from the Chair of the Investment Panel and consultation with the Chair of the Pensions

Committee and that all such changes be notified to Members at the next meeting of the Pensions Committee.

8. COMMENTS OF THE CHIEF FINANCIAL OFFICER

8.1. The comments of the Corporate Director Resources have been incorporated into the report.

9. CONCURRENT REPORT OF THE ASSISTANT CHIEF EXECUTIVE (LEGAL)

9.1 The Committee is asked to note the information in the report concerning investment performance and asset allocation and to authorise the Corporate Director Resources to vary asset allocations subject to specified advice and consultation.

9.2 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 require the Council, as administering authority for the Pension Fund, to invest any fund money that is not needed immediately to make payments from the fund. The Council should make investments in accordance with the Council's published statement of investment principles and obtain proper advice at reasonable intervals about the investments. The Council has power to appoint investment managers to invest fund money, as it has done. Having appointed investment managers, the Council is required to keep their performance under review.

9.3 The receipt of the information provided in this report about investment performance and asset allocation is consistent with the Council's obligation to invest fund money, obtain advice about those investments and review the performance of investment managers. This function is delegated to the Pensions Committee under the Council's Constitution.

9.4 The proposed delegation to the Corporate Director Resources to vary asset allocations within specified bounds is permissible, having regard to the identified need to react to volatile market conditions. The Corporate Director Resources should comply with the Council's published statement of investment principles when varying asset allocations.

10. ONE TOWER HAMLETS CONSIDERATIONS

10.1 The employer's contribution is a significant element of the Council's budget and consequently any improvement in investment performance will reduce the contribution and increase the funds available for other corporate priorities.

10.2 A viable pension scheme also represents an asset for the recruitment and retention of staff to deliver services to the residents.

12. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

12.1 There are no Sustainable Action for A Greener Environment implications.

13. RISK MANAGEMENT IMPLICATIONS

13.1 Any form of investment inevitably involves a degree of risk.

13.2 To minimise risk the Investment Panel attempts to achieve a diversified portfolio. This diversification relates to both asset classes and management styles.

LOCAL GOVERNMENT ACT 1972 (AS AMENDED) SECTION 100D
LIST OF "BACKGROUND PAPERS" USED IN THE PREPARATION OF THIS REPORT

Brief description of "background papers"	***Name and telephone number of holder And address where open to inspection***
Directorate Submissions	*Jim Ricketts Ext. 4733* *Mulberry Place, 4th Floor.*

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