Non-Executive Report of the: **Pensions Committee** 31 July 2017	
Report of: Zena Cooke, Corporate Director, Resources	**Classification:** Unrestricted
Investment Performance Review for Quarter Ending 31 March 2017	

Originating Officer(s)	Bola Tobun, Investment & Treasury Manager
Wards affected	All wards

Summary

This report informs Members of the performance of the Fund and its investment managers for the quarter and year ending 31 March 2017.

The Fund delivered a positive return of 4.4%, by outperforming its benchmark return of 3.6% by 0.8% for this reporting quarter. Also for the twelve months to March 2017, the Fund returned 20.7%, outperforming the benchmark of 19%. However for longer term performance, the three year return for the Fund was 10% which is 0.3% behind the benchmark return of 10.3% for that period. Over the five years, the Fund posted a return of 10% marginally outperforming the benchmark return of 9.8% by 0.2%.

For this quarter end, seven out of the nine mandates matched or achieved returns above the benchmark. LCIV Ruffer and Goldman mandates lagged behind their respective benchmarks. Overall for this reporting quarter the Fund performance was ahead its benchmark.

For 2016/17 financial year end, the Fund is ahead its benchmark by 1.7%. Two out of the nine mandates underperformed their benchmarks; GMO by delivering returns that lagged behind its benchmark by 0.9% and Schroders posting a return that lagged behind its benchmark marginally by 0.1%.

The Fund is still in line with its long term strategic equity asset allocation and the distribution of the Fund's assets amongst the different asset classes is broadly in line with the strategic benchmark weight.

Recommendations:

Members are recommended to:

1) note the contents of this report

1. REASONS FOR THE DECISIONS

1.1 The report informs the Pension Committee of the performance of pension fund managers and the overall performance of the Tower Hamlets Pension Fund.

2. ALTERNATIVE OPTIONS

2.1 The Pension Fund Regulations require that the Council establishes arrangements for monitoring the investments of the Pension Fund so there is no alternative but to report the performance of the Fund to the Pension Committee on a regular basis,

3. DETAILS OF REPORT

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

3.2 Officers and fund advisers meet regularly with investment managers to discuss their strategy and performance and may recommend that investment managers are invited to explain further to the Pensions Committee.

3.3 This report informs Members of the performance of the Fund and its investment managers for the quarter ended 31 March 2017.

3.4 London Common Investment Vehicle (LCIV)

3.4.1 The London CIV was formed as a voluntary collaborative venture by the London Local Authorities in 2014 and has led the way in pooling of investments in the Local Government Pension Scheme (LGPS). London CIV aims to be the investment vehicle of choice for Local Authority Pension Funds through successful collaboration and delivery of compelling performance. LCIV was launched in December 2015, as a fully authorised and regulated investment management company. The founding members are London boroughs and the City of London Corporation. The LCIV has been established as a collective investment vehicle for their Local Government Pension Scheme funds. The current regulatory permission allows the London CIV to operate an Authorised Contractual Scheme Fund (the UK's version of a Tax Transparent Fund).

3.4.2 The London CIV currently manages three investment portfolios of LBTH fund as listed below:

a) **The Baillie Gifford diversified growth fund (DGF)** mandate was opened in February 2011 with contract value of £40m. £6.409m was added to this portfolio in the month of June 2015. The performance target for this mandate is to outperform the benchmark (UK base rate) net of fees over rolling 5 years with annual volatility of less than 10%. This mandate was transferred to LCIV on 15 February 2016 at market value of £54.177m. The market value of assets as at 31 March 2017 was £62.166m. This portfolio is now named ***LCIV (BG) DGF.***

b) **The Baillie Gifford global equity fund** had a value of £118.9m at the start of the mandate in July 2007. The performance target for this mandate is 2% to 3% above the benchmark MSCI AC World Index gross of fees over a

rolling 3-5 year period. This mandate was transferred to LCIV on 22 April 2016 at market value of £214.1m. The market value of the assets as of 31 March 2017 was £281.213m. The portfolio is now named ***LCIV (BG) GA.***

c) **Ruffer LLP** manages an Absolute Return Fund; the value of this contract on the 28 February 2011 was £40m. £6.474m was added to this portfolio on 02 June 2015. Their overall objective is firstly to preserve the capital over rolling 12 month periods and secondly to grow portfolio at a higher rate after fees than could reasonably be expected from the alternative of depositing the cash value of the portfolio in a reputable UK bank. The management of this portfolio was transferred to the LCIV on 20 June 2016 at market value of £54m. The value of assets under management as of 31 March 2017 was £61.835m. The portfolio is now named ***LCIV Ruffer.***

3.5 GMO

3.5.1 GMO manages a Global Equity Mandate, the initial value of assets taken on at the commencement (29 April 2005) of the contract was £201.8m. On 25 November 2014, £20.8m was redeemed from the portfolio; a further £10.674 was redeemed from the portfolio on 29 May 2015 in order to keep the strategic asset allocation weight in line with the investment policy. The portfolio had a market value of £325.278m at 31 March 2017.

3.5.2 The performance target is to outperform a balanced global equity benchmark by 1.5% per annum net of fees over a rolling three year period.

3.6 Goldman Sachs Asset Management

3.6.1 On 4th April 2016, the fund invested £75m in Goldman Sachs Strategic Absolute Return Bond II (STRAT II). The portfolio had a market value of £77.929m at 31 March 2017.

3.6.2 The performance target is to outperform the benchmark (3 Month LIBOR) by 4.0% per annum net of fees over a rolling three year period.

3.7 Insight Investment Management

3.7.1 On 1st July 2016, the fund invested £70m with Insight Investment Management in BNY Mellon Global Funds. The portfolio had a market value of £71.743m at 31 March 2017.

3.7.2 The performance target is to outperform the benchmark (3 Month LIBOR) by 3-4.0% per annum net of fees over a rolling three year period.

3.8 Legal & General Investment Management

3.8.1 Legal & General was appointed (2 August 2010) to manage passively UK Equity and UK Index-Linked Mandates. At 31 March 2017, the UK Equity portfolio had a market value of £266.256m, and the UK Index linked portfolio was £74.030m.

3.8.2 The performance target is to track the FTSE All Share index for the UK Equity mandate and FTSE A Gov Index-Linked > 5 years benchmark for the UK Index-Linked Mandates.

3.9 Schroder's Investment Management

3.9.1 Schroder manages a property mandate. The value of this mandate on 20 September 2004 was £90m. The market value of assets at 31 March 2017 was £140.302m.

3.9.2 The performance target for this mandate is to outperform the IPD UK Pooled Property Fund Indices All Balanced Funds Median by 0.75% net of fees over a rolling three year period.

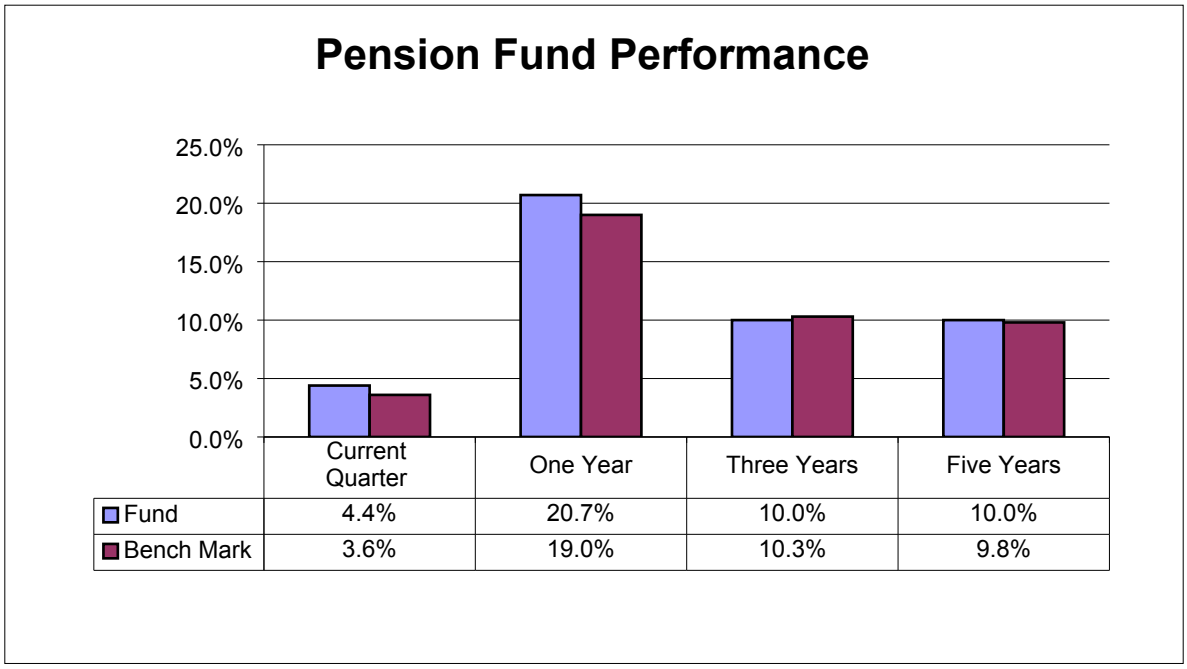
3.10 INVESTMENT PERFORMANCE

I. The Fund's overall value appreciated by £53.992m from £1,312.568m as of 31 December 2016 to £1,379.183m as of 31 March 2017.

II. The fund underperformed the benchmark this quarter by 0.8% with a return of 4.4% compared to its benchmark return of 3.6%. The twelve month period sees the fund ahead of its benchmark by 1.7%, as shown in Table 1

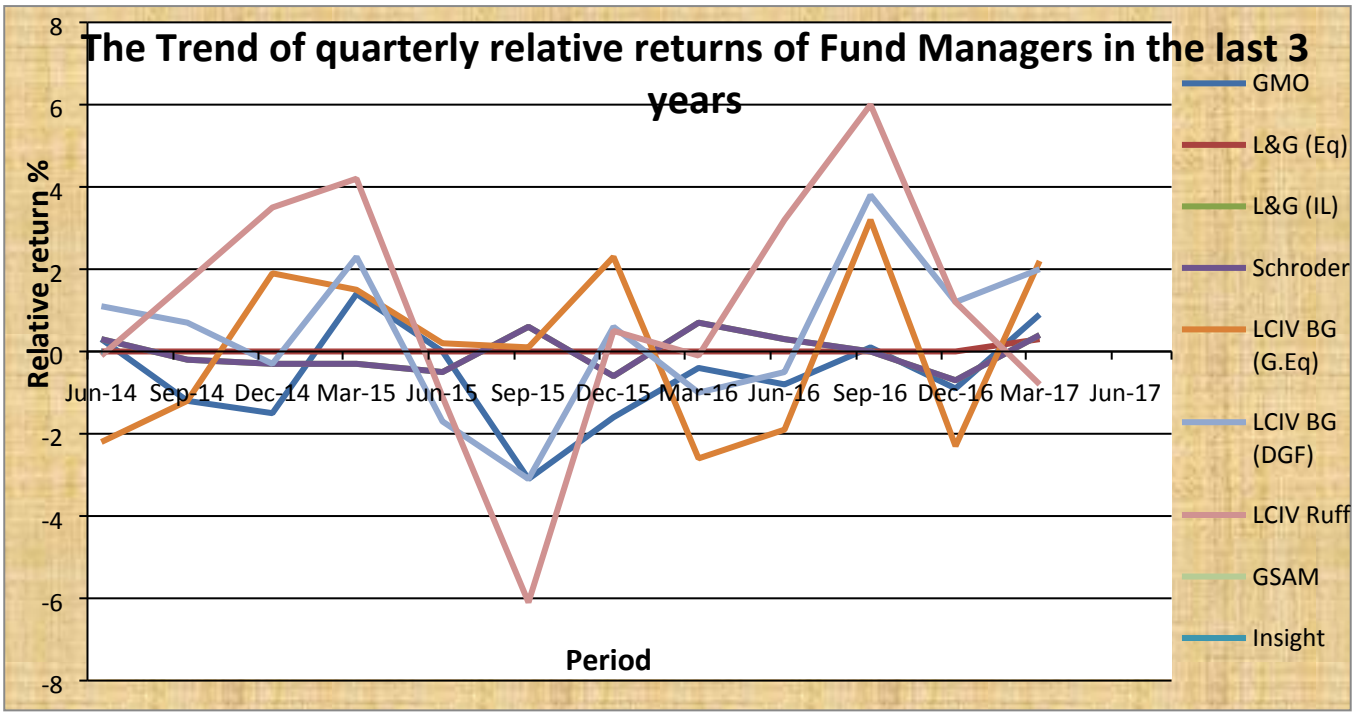
III. The performance of the fund over the longer term is as set out in the chart below.

Table 1 – Pension Fund Performance



	Current Quarter	One Year	Three Years	Five Years
Fund	4.4%	20.7%	10.0%	10.0%
Bench Mark	3.6%	19.0%	10.3%	9.8%

IV. The graph below demonstrates the volatility and cyclical nature of financial markets, but the outcomes 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 pension liabilities are up to sixty years in the future.



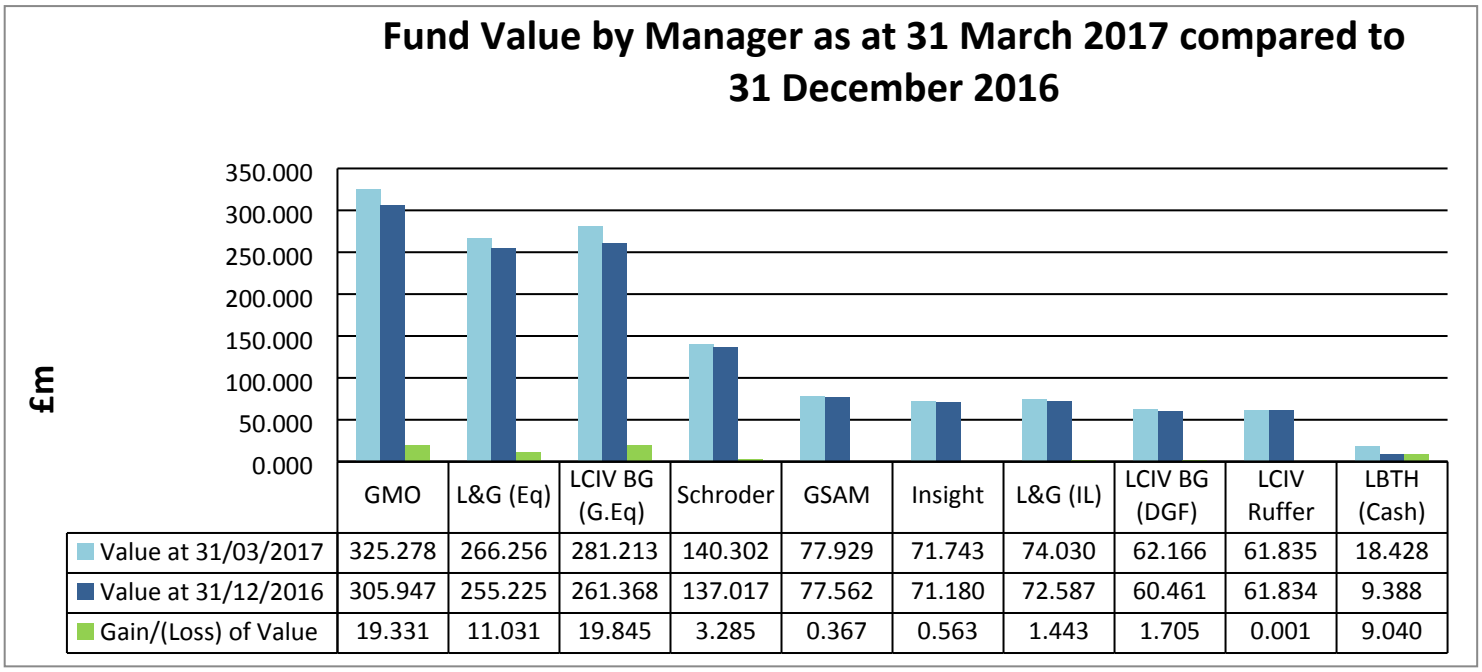
3.11 MANAGERS

I. The Fund is managed on a specialist basis with GMO and LCIV (BG GE) managing the Global Equities on an active basis; UK Equities and UK Index-Linked are passively managed by LGIM; GSAM and Insight managing absolute return pooled bond funds and Schroders are the property manager.

II. The managers, mandate and funds held under management are set out below: The Fund was valued at £1,379.183 million as at 31 March 2017. This includes cash held and being managed internally (LBTH Treasury Management), this stands at 1.34% of the total assets value. This is working capital of the Fund.

Table 2: Management Structure

Manager	Mandate	Value £M	Weight Target of FM AUM %	Actual Weight of FM AUM %	(Under)/Over Weight Target %	Date Appointed
GMO	Global Equity	325.3	22.0%	23.6%	1.6%	29 Apr 2005
LCIV BG (Global Equity)	Global Equity	281.2	18.0%	20.4%	2.4%	5 Jul 2007
L & G UK Equity	UK Equity	266.3	20.0%	19.3%	(0.7)%	2 Aug 2010
LCIV BG (Diversified Growth)	Absolute Return	62.2	5.0%	4.5%	(0.5)%	22 Feb 2011
LCIV Ruffer (Total Return Fund)	Absolute Return	61.8	5.0%	4.5%	(0.5)%	8 Mar 2011
L & G Index Linked-Gilts	UK Index Linked	74.0	6.0%	5.4%	(0.6)%	2 Aug 2010
GSAM	Bonds	77.9	6.0%	5.7%	(0.3)%	4 Apr 2016
Insights	Bonds	71.7	6.0%	5.2%	(0.8)%	1 Jul 2016
Schroder	Property	140.3	12.0%	10.2%	(1.8)%	30 Sep 2004
Internal cash Management	Cash	18.4	0.0%	1.3%	1.3%	
Total		**1,379.183**	**100.0%**	**100.0%**	**0.0%**	



III. The above graph illustrated portfolio value movement of each mandate for this reporting quarter compared to the last quarter. It shows that all portfolios of the Fund have made gains, albeit in some cases only marginal ones.

IV. The performance, gross of fees of the individual managers relative to the appropriate benchmarks over the past five years is as set out in table 3.

Table 3: Manager Investment Performance relative to benchmark

Manager	Current Quarter	One Year	Three Years	Five Years
GMO Global Equities	0.90%	-0.90%	-2.80%	-1.00%
L & G UK Equity	0.30%	0.30%	0.10%	0.10%
LCIV (BG) Global Equities	2.20%	1.70%	0.90%	2.30%
LBTH (Cash Management)	0.10%	0.90%	0.60%	0.60%
Schroder	0.40%	-0.10%	-0.20%	-0.40%
L & G Index Linked-Gilts	0.00%	0.00%	0.00%	0.00%
LCIV (BG) Diversified Growth	2.00%	6.80%	2.10%	2.10%
LCIV (Ruffer) Total Return Fund	-0.80%	9.70%	3.30%	2.40%
Insight (BNY Absolute Return Bond Fund)	0.20%	N/A	N/A	N/A
GSAM (STAR II)	-0.10%	N/A	N/A	N/A
Total Variance (Relative)	**0.80%**	**1.70%**	**-0.30%**	**0.20%**

3.12 **GMO** – The portfolio posted a return of 5.5% over the reporting quarter this was ahead of the benchmark by 0.9%.

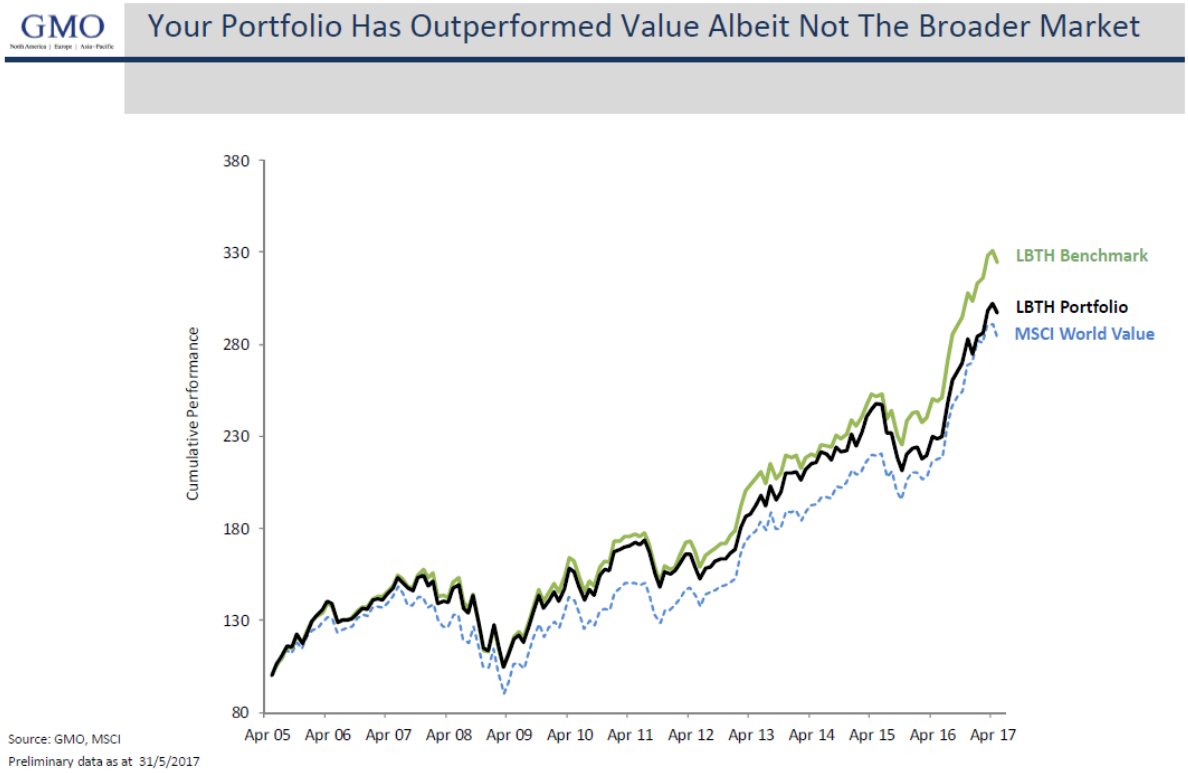
I. Global equities enjoyed a strong quarter as the MSCI All Country World Index gained 6.9%. US equities continued their momentum from the fourth quarter as indices charged to new highs.

II. The Dow eclipsed 20,000 for the first time at the end of January, but there was barely time to schedule the celebration parties before it crashed through 21,000 on March 1. Having risen just shy of 7.5% from year end, the S&P 500 broke 2,400 in intraday trading on March 1. The bullish tone evaporated on March 2 and US equities stumbled to the end of the quarter, with the S&P 500 finishing the period with a total gain of 6.1%. It seemed as if the market just felt that things had "gone too far".

III. GMO long-held top-down view favouring Emerging at the expense of the US has at last begun to deliver the outperformance the manager expect. Although GMO believes this still has a long way to go.

IV. Whilst Value continues to lag Growth, the manager firmly believe that Value wins over time and the best relative returns for investors have typically followed periods of underperformance.

V. This portfolio remains ahead of the MSCI Value index since inception as shown below:



VI. The Manager believes it is important to carefully evolve the investment process adding new enhancements as and when appropriate. They have a number of projects that they are excited about that are coming close to completion.

VII. GMO believes, the portfolio is positioned to benefit should the Emerging/US valuation gap narrow further as they expect and/or there is a return to favour for the Value style. And said now would not be a good time to switch away from Value.

VIII. In the financial year ending 31 March 2017 the portfolio posted a return of 31.6%, lagging behind the benchmark return of 32.5% by 0.9%. The portfolio performance returns over the longer periods are also not encouraging. The portfolio return lagged behind the benchmark by 2.8% for over three years and lagged behind the benchmark by 1.0% for over five years.

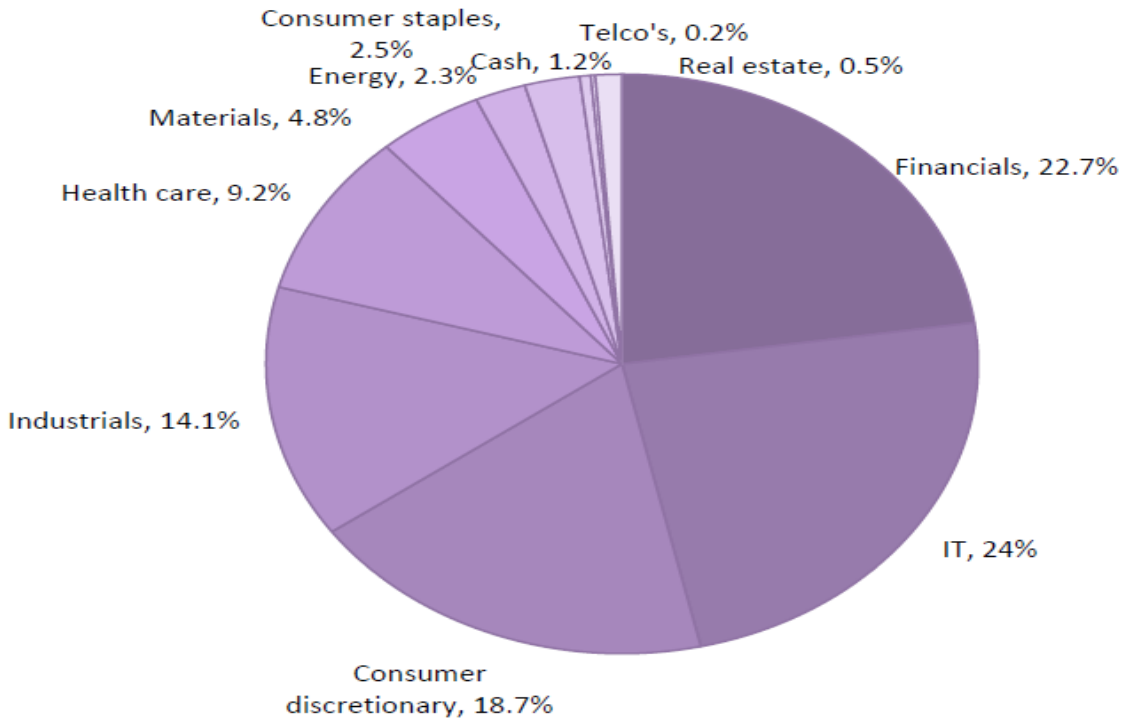
3.13 **LCIV (Baillie Gifford) Global Equities** – the portfolio posted a positive return of 7.80%, outperforming the benchmark by 2.2%. The equity market rose even as wider asset markets remained relatively calm, following the volatility in the previous quarter.

3.14 A moderate outperformance for 12 months to March 2017 with return of 33.9% compared with benchmark return of 32.2%. The portfolio outperformed the benchmark by posting a return of 16.5 % per annum over three years, which is over the benchmark return by 0.9% per annum and also ahead the benchmark return by 2.3% per annum for over five years period.

3.15 The Baillie Gifford team made few changes to the portfolio, with one new purchase during the quarter in the semi-conductor producer Infineon Technologies, as well as the complete sale of Wolseley.

3.16 The strongest contributors to return were Royal Caribbean Cruises (+0.4%) as 2016 earnings rose 26% helped by rising demand in North America and China, and Amazon (+0.3%) which between them make up 8% of the total portfolio.

3.17 Detractors included TD Ameritrade (-0.3%) and Apache (-0.3%), which had a weaker quarter after a strong rally in the last three months of 2017. BG view Apache's strength as an excellent exploratory energy company lying in excellent individuals making up their teams combined with low lifting costs; they remain confident that the company retains good growth prospects over the next three to five years.



3.18 As shown in the chart above, the portfolio remains tilted towards IT and Financials, with neither likely to change as the two highest proportions of the portfolio in the near future. Geographical allocation remains heavily tilted to the US with a 49.1% allocation, with Europe (ex UK) and Emerging Markets both shy of 18% each.

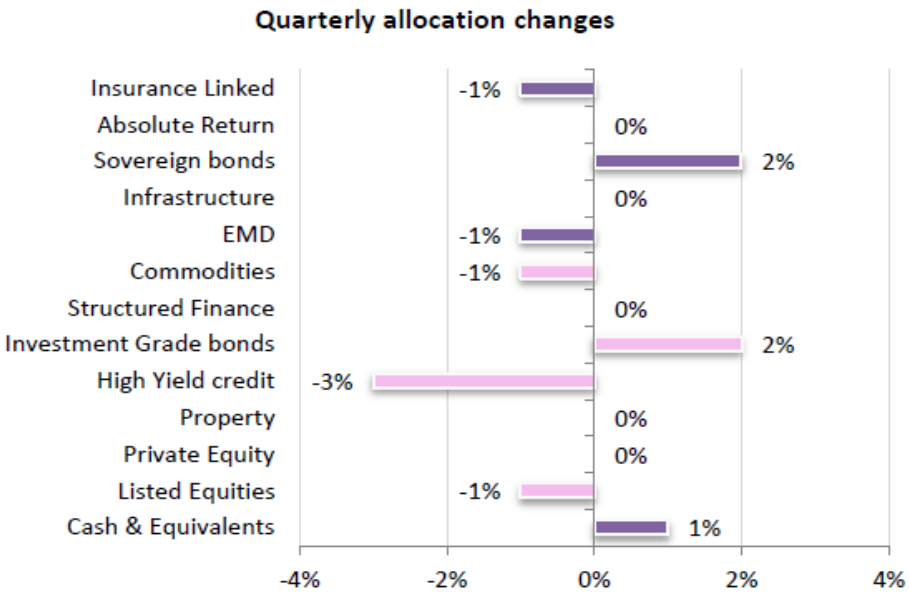
3.19 Finally, with regard to the risk management and scenario testing that are continually undertaken on the portfolio; BG noted that they had begun to introduce more positive scenarios into the mix (such as accelerating global growth expectations) rather than the more common market collapses and viral pandemics. The team agreed this mirrored their increasingly optimistic view of the opportunity set available to the fund.

3.20 **LCIV (Baillie Gifford) Diversified Growth Fund** for this reporting quarter, the portfolio delivered a 2% return against a backdrop of relatively stagnant financial markets in the first quarter, dominated by concerns over reflation and President Trump's ability to implement his much touted financial reforms.

3.21 A strong outperformance for 12 months to March 2017 with return of 10.3% compared with benchmark return of 3.5%. The portfolio outperformed the benchmark by posting a return of 5.6 % per annum over three years, which is over the benchmark return by 2.1% per annum and also ahead the benchmark return by 2.1% per annum for over five years period.

3.22 In the reporting quarter, Baillie Gifford made some small alterations to holdings as markets recalibrated after the volatility of the last quarter of 2016.

Significant transactions:



Government Bonds:

3.23 The team added to their position in US inflation linked government bonds (TIPs) after a similar addition last quarter. They continue to view TIPs as providing a better rate of interest than cash and a continuation in inflation protection as the US began to experience the much heralded pick-up. In addition, the team said that

they remained a preference over UK inflation linked gilts (linkers) and, as a result of having hedged out the TIPs they are purely used for their inflation protection properties.

Emerging Market Bonds:

3.24 The BG team shuffled the holdings as they added to US denominated bonds and reduced local currency bond exposure. The team noted that even with all of the discussion on EM bond valuations that continues to dominate much market discourse, the typical 8.5% return available at the moment is only 0.5% below the long term average and accordingly investors need to keep a watchful eye on yields as the year progresses..

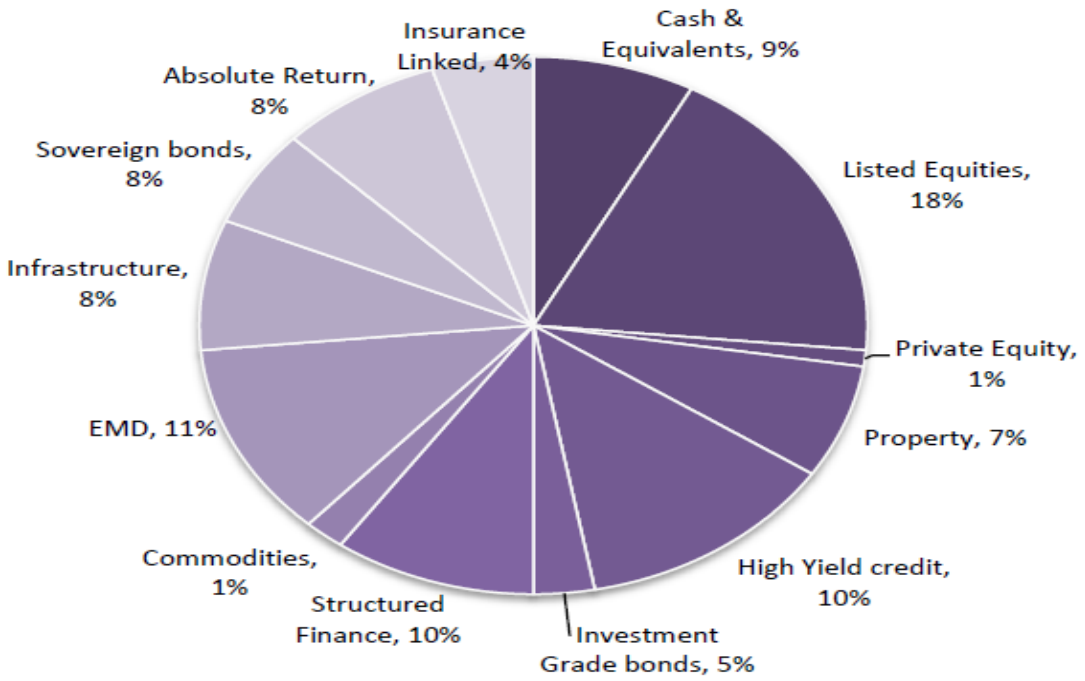
High Yield:

3.25 The high yield allocation of the fund currently sits at 10%, with a historical average of 15-20%, demonstrating that the team continues to see better value elsewhere in the portfolio. During the quarter they trimmed back the High Yield exposure by another 3% as they saw demand continue to push prices upwards (this reduction was split between European and US bonds.) With spreads currently sitting at 400 basis points in the US, they felt this was the opportune time to adjust the holding.

Listed equities:

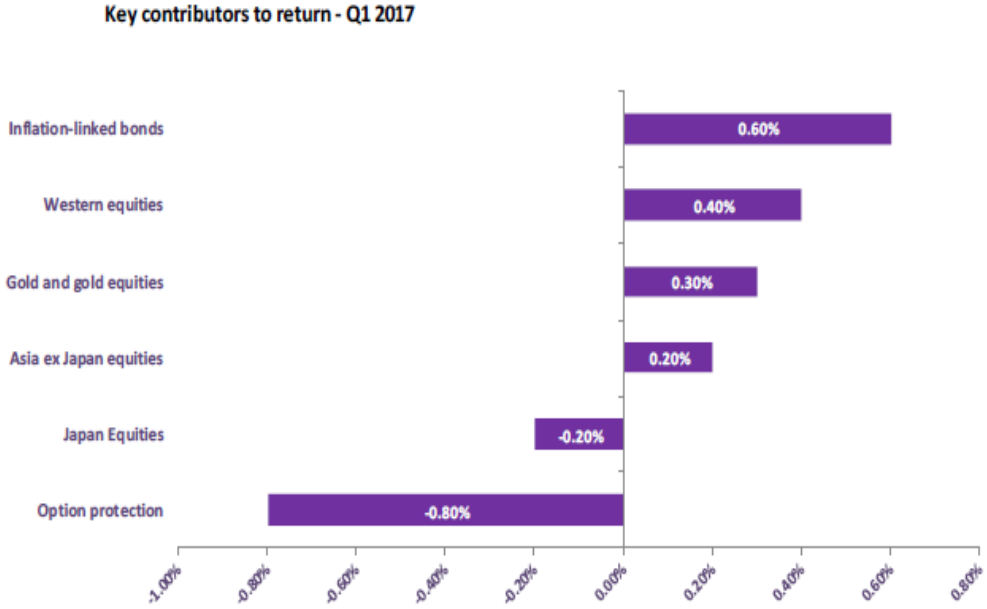
3.26 The team made a small reduction in listed equities in light of rising valuations across developed markets (the reduction was made both to global equities and European dividends.) The Trump effect gave a strong tailwind to cyclical stocks during Q4 2016 and hurt the equity performance of the fund relative to the wider market.

3.27 The fund invests in a diversified range of asset classes and the breakdown is shown below:



3.28 **Ruffer Total Return Fund (Absolute Return)** – The portfolio produced a flat return of 0.0034% during a quarter of lumpy but ultimately rather stagnant market.

As the market was dominated by concerns over reflation and President Trump's ability to implement his much touted financial reforms.



Source: Ruffer, as at 31/03/2017.

3.29 As shown in the above chart, Option protection was the main detractor from performance as markets rose. Ruffer's exposure (including VIX call options and options on rising rates in the UK, EU and Japan) suffered as volatility was subdued during the quarter and bond yields fell back. This fall gave the inflation linked bonds ('linkers' which now make up 40% of the portfolio) a boost leading to a 0.6% rise.

3.30 A softer dollar meant that the fund's gold exposure recovered most of the losses that they incurred at the end of 2016, as well as giving support to the fund's small amount of emerging market equities, which rose 0.2%. Western equities added 0.4% of performance as individual stocks such as Lloyds and ITV had a strong showing, despite some underwhelming performance from the fund's oil equities. However the market move back to 'bond like' stocks (which Ruffer remain wary of on valuation grounds) resulted in a broadly flat performance of the fund as a whole.

3.31 Finally, a strengthening Yen proved too much for the strong performance of individual stocks (such as Sony, which is covered in more detail further on,) with Japanese equities costing the portfolio around -0.2% of performance.

3.32 A strong outperformance for 12 months to March 2017 with return of 13.2% compared with benchmark return of 3.5%. The portfolio outperformed the benchmark by posting a return of 6.8 % per annum over three years, which is over the benchmark return by 3.3% per annum and also ahead the benchmark return by 2.4% per annum for over five years period.

3.33 **Legal & General – L & G (UK Equity)** – The portfolio returned 4.32% ahead of the index return over the quarter by 0.3%.

Global equity markets extended their move higher in the first quarter of 2017. The FTSE 100 index also moved to new all-time highs, briefly rising above 7,400 before ending the quarter near 7300. With bonds yields generally declining over the period, 'bond proxy' sectors such as consumer staples, telecoms and utilities generally fared well, while energy and mining stocks lagged on the back of lower commodity prices. Mid-cap stocks delivered strong returns, with the more domestically orientated FTSE 250 index outperforming the FTSE 100 index following robust UK economic growth data.

3.34 **L & G Index Linked Gilts** – The portfolio returned 1.99% matching the index return over the quarter.

Having risen in late 2016 on the back of higher growth and inflation expectations following President Trump's election victory, global government 10-year bond yields generally treaded water in the first quarter of 2017. However, they still remained significantly above the historic lows witnessed in the immediate aftermath of the UK's EU referendum in the middle of 2016.

A notable feature of global bond markets was a divergence in the performance of short and long-term interest rates. Short-term rates rose, particularly in the United States, with the Federal Reserve opting to hike US rates in March by 0.25%. The Fed took this decision amid continued strong economic and inflation data and the ongoing rise in US stock markets. However, long-term rates actually fell, as investors bet on the tighter monetary policy to moderate longer-term growth.

In the UK, bond market movements mirrored those in the US. Headline UK inflation rose above the Bank of England's 2% target, as sterling's sharp depreciation over the preceding year fed through into higher import costs. Better-than-expected UK economic growth also contributed to rising price levels. However, higher inflation levels had a muted effect on index-linked gilt prices, which moved in line with conventional gilt prices over the quarter.

In Europe, 10-year bond yields rose modesty, diverging from the moves in US and UK yields, with investors pricing in an increase in headline European price levels. In particular, German inflation rose above the European Central Bank's target to its highest level for over four years.

3.35 **Goldman Sachs Asset Management (GSAM) –** The portfolio underperformed the benchmark in the reporting period by posting returns of 0.47% against its benchmark return of 0.6%.

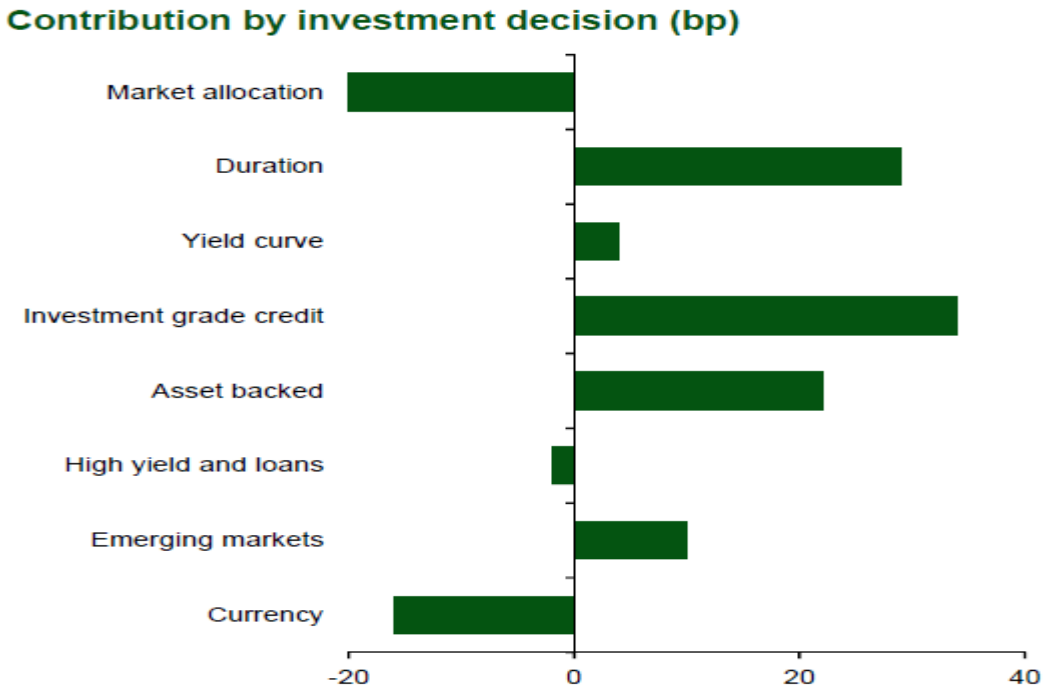
3.36 Within macro strategies, the currency strategy contributed, primarily from the manager longs in the Mexican peso. This was partially offset by losses on short Japanese yen. Within sector strategies, the securitised strategy contributed to performance, from their exposure to Non-Agency mortgages.

3.37 The exposure to Puerto Rico municipals and the short position in China external debt through Credit Default Swaps were the main detractors from performance over the month.

3.38 The Federal Open Markets Committee raised interest rates for the third time since the 2008 global financial crisis, raising the target range for the federal funds rate to 0.75-1.00%. Improving US economic data, including a strengthening labour market, and relatively loose financial conditions supported the case for normalisation of monetary policy. The European Central Bank (ECB) kept policy unchanged at its March meeting, although it acknowledged marginal improvements in the Euro area macroeconomic situation by revising up its growth and inflation forecasts for 2017 and 2018. New polls signalled a strong lead for French presidential candidate Emmanuel Macron, a positive sign for the Eurozone.

3.39 Britain's Prime Minister Theresa May officially triggered Brexit by invoking Article 50. Even though markets weathered the same without much impact, rating agency Fitch has warned that challenges remain ahead, including an unsolidified negotiating agenda, the possible break-up of the United Kingdom, and potential waning of support for independence. Crude oil prices declined over 10% to start the month. Drivers behind the price declines included the increase in headline crude oil inventories for the ninth consecutive week. However, prices made a sharp reversal in the last week of March, rising over 5%. News of a reported pipeline shutdown in Libya, an increased focus on compliance with the agreed upon OPEC cuts and the potential for an extension to those cuts all caused supply concerns to resurface.

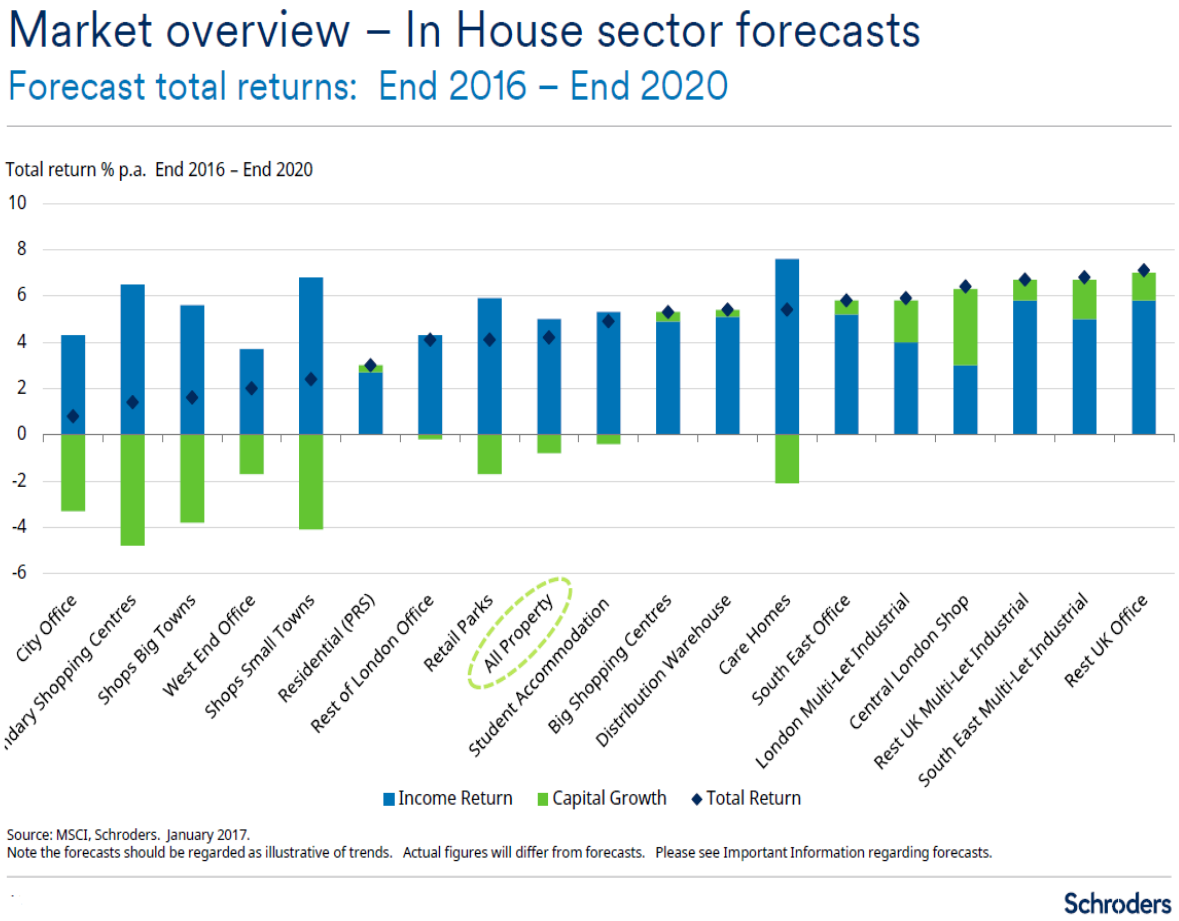
3.40 **Insight Investment** – The portfolio outperformed the benchmark in the reporting period by posting returns of 0.8% against a benchmark return of 0.6%.



3.41 Market allocation was negative, with pair trades into Australia (relative to the US, Germany and the UK) and the manager overweight in France vs Germany detracted from performance.

3.42 Duration was positive, driven primarily by short positions in Germany and the US. The manager took profits in the latter part of the quarter, to return closer to neutral. Investment grade credit and ABS added value as credit spreads tightened. USD denominated debt and European financials continued to outperform, EMD was a positive contributor for performance. EM yields benefitted from a general fall in global bond yields and Currency was a negative contributor, this was primarily driven by a long USD versus short JPY and EUR position held at the beginning of the quarter.

3.43 **Schroder (Property)** – The portfolio performance was above the benchmark over the reporting quarter by 0.4% but behind overall other periods; namely one year to 31 March 2017 marginally by -0.1%, three years by -0.2% and five years by -0.5% per annum.



I. Holdings in continental Europe have been the main detractors from returns over the longer term. The UK portfolio (currently 98% by value) has outperformed the benchmark over all time periods. Holdings in the industrial sector have been the strongest drivers of performance in this reporting quarter, with Industrial Property Investment Fund and Multi-Let Industrial PUT amongst the strongest contributions to returns.

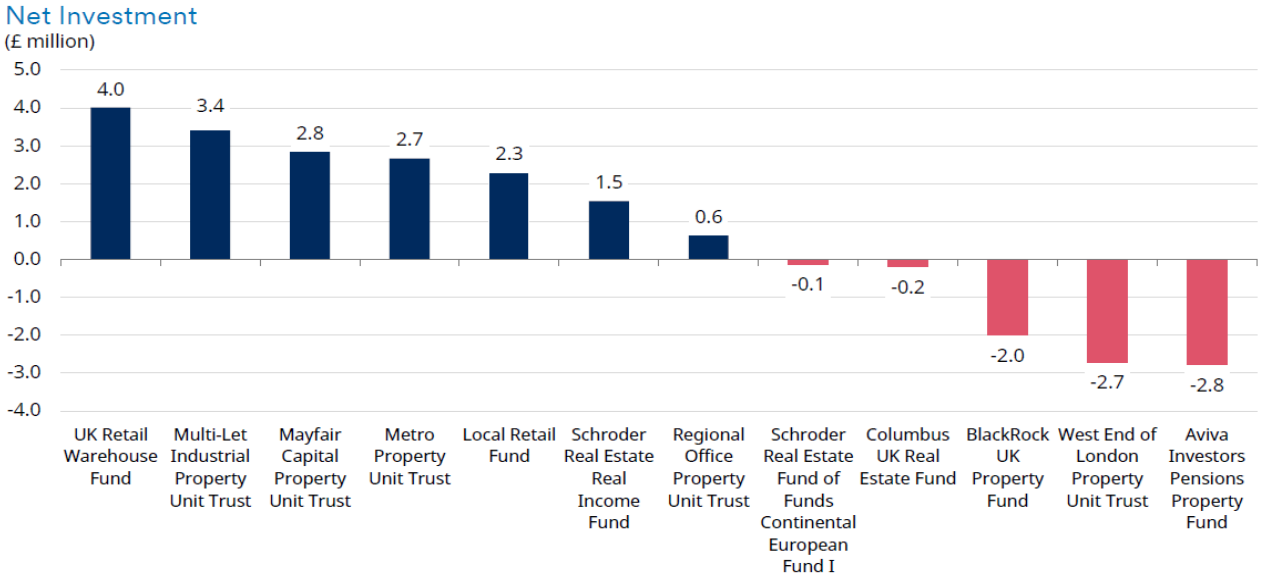
II. UK Retail Warehouse Fund was the strongest contributing fund in this reporting quarter, reflecting the positive impact of transaction costs as units were acquired at a 9% discount to NAV. IPIF and Metro PUT were other notable performers. CEF1 was

the only negative performing fund over the quarter in part due to the timing of a capital distribution.

III. Returns were above benchmark over the quarter, UK core style and value add funds both performed above benchmark. At a sector level, alternatives (i.e. not retail, office and industrial) and industrials have typically performed well, whilst central London offices have generally detracted from returns.

Portfolio

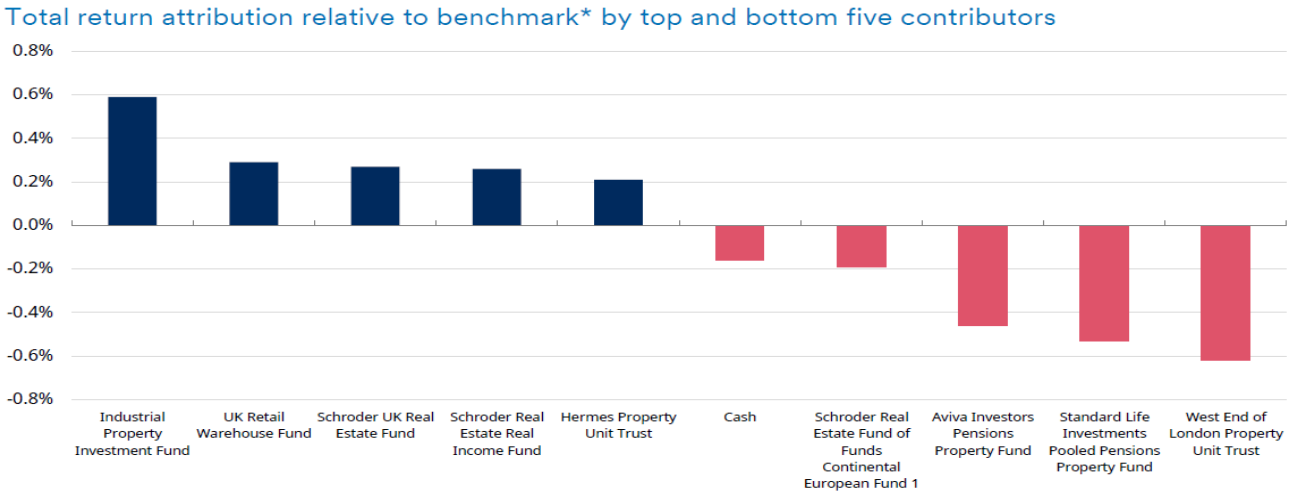
Transactional activity in Q4 2016 and Q1 2017



Source: Schroders, 31 March 2017.

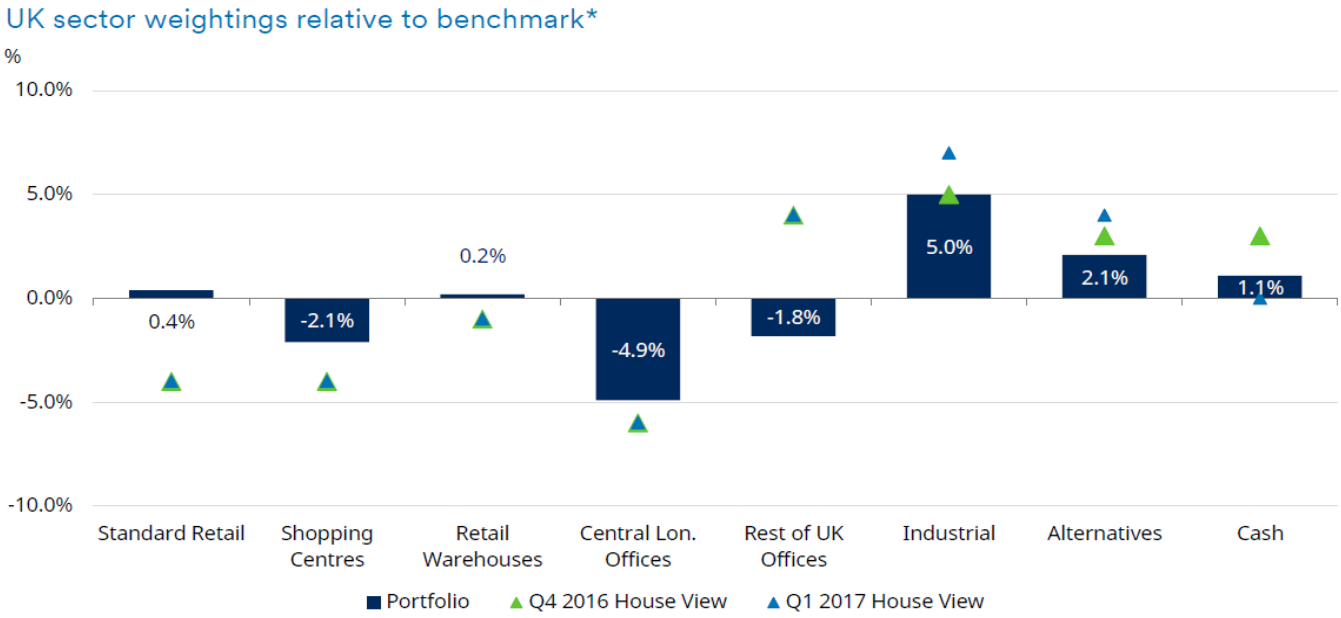
Portfolio

Performance attribution, one year to 31 March 2017



*Benchmark is AREF/IPD UK Quarterly Property Fund Indices All Balanced Funds Weighted Average. Attribution is presented gross of fees.
Source: Schroders and AREF/IPD UK Quarterly Property Fund Indices, 31 March 2017. Past Performance is not a guide to future performance and may not be repeated.
Please refer to the Important Information at the back of this document regarding past performance.

Portfolio sector weightings



Source: Schroders 31 March 2017. *Benchmark AREF / IPD UK Quarterly Property Fund Index – All Balanced Funds Weighted Average. Data subject to rounding.

IV. Costs associated with repositioning the portfolio away from Central London office and towards preferred sectors of the market has driven underperformance over twelve months

V. The strategy is to sell down exposure to central London offices and weaker core funds and invest proceeds into preferred sectors and stronger core funds and to also consider new opportunities.

3.44 **Internal Cash Management**

I. Cash is held by the managers at their discretion in accordance with limits set in their investment guidelines, and internally by LBTH to meet working cashflow requirements, although transfers can be made to Fund managers to top up or rebalance the Fund.

II. The Pension Fund cash balance is invested in accordance with the Council's Treasury Management strategy agreed by Full Council in February 2016, which is delegated to the Corporate Director, Resources to manage on a day to day basis within set parameters.

III. The cash balance as at 31 March 2017, was £18.428m and this is essentially the Fund's working cashflow. Members will continue to be updated quarterly of the Pension Fund in house cash investment strategy. Security and liquidity of the Fund's cash remains the overriding priority, ahead of yield.

3.45 **ASSET ALLOCATION**

I. The revised benchmark of asset distribution and the fund position at 31 March 2017 are set out below:

Table 4: Asset Allocation

Asset Class	Benchmark	Revised Benchmark as at 16 March 2017	Fund Position as at 31 March 2017	Variance as at 31 March 2017
UK Equities	20.0%	20.0%	19.3%	(0.7)%
Global Equities	35.0%	35.0%	38.5%	3.5%
Emerging Markets	5.0%	5.0%	5.5%	0.5%
Total Equities	**60.0%**	**60.0%**	**63.3%**	**3.3%**
Property	12.0%	12.0%	10.2%	(1.8)%
Bonds	15.0%	12.0%	10.6%	(1.4)%
UK Index Linked	3.0%	6.0%	5.7%	(0.3)%
Alternatives	10.0%	10.0%	9.0%	(1.0)%
Cash	0.0%	0.0%	1.3%	1.3%
Total Equities	**100.0%**	**100.0%**	**100.0%**	

II. The original allocation of investments between the different asset classes was determined in conjunction with the Council's professional advisors in 2004 and is subject to periodic review by the Pensions Committee – the latest review was carried out in January 2014 and the index-linked, gilts and corporate bonds strategic weights were revised at Committee meeting 16th March 2017.

Asset allocation is determined by a number of factors including:-

a) 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 it can seek long term benefits of the increased returns.

b) The age profile of the Fund. The younger the members of the Fund, 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.

c) The deficit recovery term. Most LGPS 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 twenty year deficit recovery term for this Council which enables a longer term investment perspective to be taken.

III. Individual managers have discretion within defined limits to vary the asset distribution. The overweight position in equities has helped the fund's performance in recent months.

4. COMMENTS OF THE CHIEF FINANCE OFFICER

4.1 This report fulfils the requirement to report performance of the Pension Fund investments portfolio to the Pension Committee and recommends a change in the asset distribution of the fund to reflect the changes in the market. These changes are line with the investment strategy for the fund.

5. LEGAL COMMENTS

5.1 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 came into force on 1st November 2016. These Regulations represent an update to the LGPS (Management and Investment of Funds) Regulations 2009 and make a number of changes, including dispensing with the current, explicit limits on specified types of investment and instead charging administering authorities with determining the appropriate mix of investments for their funds. However, administering authorities must now adhere to official guidance; broad powers allow the Government to intervene if they do not. Under regulation 8, the Secretary of State can direct the administering authority to make changes to its investment strategy; invest its assets in a particular way; that the investment functions of the authority are exercised by the Secretary of State and that the authority complies with any instructions issued by the Secretary of State or their nominee.

In the case of R on the application of (1) Palestine Solidarity Campaign Ltd (2) Jacqueline Lewis v Secretary of State for Communities and Local Government, the High Court has ruled that, that part of the Secretary of State's ('S of S') guidance relating to pensions policies to pursue boycotts, divestment and sanctions against foreign nations and UK defence industries (paragraph 3 of regulation 7(2)(e) is unlawful as the S of S had exceeded his regulation making powers by using the guidance to protect government foreign policy and UK defence policy which were not policies for "pension purposes". The S of S was ruled to have acted for an unauthorised purpose which made the guidance unlawful. The inference is that this part of the guidance is struck down although this was not made explicit in the judgment. The Committee is recommended to review the Investment Statement Strategy in light of this judgment, in particular section 9 of the ISS which deals with environmental, social and governance issues.

5.2 The Council must take proper advice at reasonable intervals about its investments and must consider such advice when taking any steps in relation to its investments.

5.3 The Council does not have to invest the fund money itself and may appoint one or more investment managers. Where the Council appoints an investment manager, it must keep the manager's performance under review. At least once every three months the Council must review the investments that the manager has made and, periodically, the Council must consider whether or not to retain that manager.

5.4 One of the functions of the Pensions Committee is to meet the Council's duties in respect of investment matters. It is appropriate, having regard to these matters, for the Committee to receive information about asset allocation and the performance of appointed investment managers. The Committee's consideration of the information in the report contributes towards the achievement of the Council's statutory duties.

5.5 When reviewing the Pension Fund Investment Performance, the Council must have due regard to the need to eliminate unlawful conduct under the Equality Act 2010, the need to advance equality of opportunity and the need to foster good relations between persons who share a protected characteristic and those who don't (the public sector duty). The Committee may take the view that good, sound investment of the Pension Fund monies will support compliance with the Council's statutory duties in respect of proper management of the Pension Fund.

6. ONE TOWER HAMLETS CONSIDERATIONS

6.1 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.

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

7. BEST VALUE (BV) IMPLICATIONS

7.1 This report helps in addressing value for money through benchmarking the Council's performance against the WM Local Authority Universe of Funds.

8. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

8.1 There is no Sustainable Action for A Greener Environment implication arising from this report.

9. RISK MANAGEMENT IMPLICATIONS

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

9.2 To minimise risk the Investment Panel attempts to achieve a diversification portfolio. Diversification relates to asset classes and management styles.

10. CRIME AND DISORDER REDUCTION IMPLICATIONS

10.1 There are no crime and disorder reduction implications arising from this report.

Linked Reports, Appendices and Background Documents

Linked Report

- [None]

Appendices

- Appendix 1 – SSGS Quarterly Performance Review

Local Government Act, 1972 Section 100D (As amended)
List of "Background Papers" used in the preparation of this report
Investment Managers Quarterly reports: (Insight, GSAM, GMO, Schroder, LCIV (Baillie Gifford Global Equity and DGF), LGIM and LCIV (Ruffer)) and SSGS Quarterly Performance Review. (To be email if required)

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