| Non-Executive Report of the:<br><br>**Pensions Committee**<br><br>21 September 2017 |  <br> |
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| **Report of:** Zena Cooke, Corporate Director, Resources | **Classification:**<br>Unrestricted |
| **Update on Market Outlook and the Fund Investment Managers by the Independent Adviser for Quarter Ending 30th June 2017** | |

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| **Originating Officer(s)** | Raymond Haines, Independent Adviser<br>Bola Tobun, Investment & Treasury Manager |
| **Wards affected** | All wards |


**Summary**

This report informs Members the views of the Independent Adviser on the performance of the markets and the Pension Fund investment managers for the first quarter of 2017/18.


**Recommendations:**

Members are recommended to note the contents of this report

## 1. REASONS FOR THE DECISIONS

1.1. The report informs the Pensions Committee the views of the Fund Independent Adviser on markets and the performance of the Fund 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 and to engaged the use of an expert in gaining required knowledge and advice so there is no alternative but to note the views of the Independent Adviser of the Fund to the Pension Committee on a regular basis,

## 3. UPDATE FROM INDEPENDENT ADVISER – Raymond Haines

### Markets and Economics

3.1. Ahead of the last meeting I commented that markets had been remarkably well behaved. If at the start of the year you had forecast the snap election debacle, Brexit making limited progress and much discord, the economy slowing and inflation rising you could be forgiven for feeling cautious. And that is ignoring strained EU / US relations and North Korea lobbing ballistic missiles over Japan. Instead by end June the FTSE All Share was up 3.3% (c.5% total return), the S&P 500 is + 8.2% and gilt yields are below the level at the start of the year.

### Why?

3.2. Fundamentally it has been about liquidity - global quantitative easing, governments creating cash by buying first government bonds then corporate debt. It has led to central bank balance sheets growing exponentially to unprecedented levels. This has driven bond yield to record lows which helped avoid an even deeper recession and fuelled a, albeit tepid recovery. The main beneficiary of the largesse has been capital markets both bond and equity as investors has searched for yields. Equity markets have enjoyed an historically long bull market.

3.3. Now however the choices are limited - government bond yield remain near historic lows and the next moves are likely to be up, sooner in the US than the UK; equities have enjoyed an eight year run and valuations are far from cheap; property is, as LBTH's manager forecasts, likely no better than gilts. Gilt prices move in the opposite direction to yields so if as expected rates rise gilt prices will fall. The extra yield property and corporate debt will provide some protection in terms of total return. Index Linked gilts have been volatile and remain expensive but, as ever in demand by institutional investors. The last issue was over-subscribed with £15bn bids for a £4.5bn issue of 2056 maturity at a real yield of minus 1.4%.

3.4. Equity markets have risen more on the basis of valuation than economic growth. Developed economies have been growing but at low single digit rates. Concerns around China wax and wane; the numbers are OK if pedestrian in an historical context. US is disappointing given the supportive employment data

although profit growth has been good. There are suggestions emanating from the Fed that the next rate rise will not be September after all. However there is increasing attention on how and when central bank balance sheets will be shrunk. Interestingly improving performance in Europe has led to suggestions that ECB bond purchases (QE) might be shrunk or suspended.

3.5. The absence of demonstrable value in bonds investors has been continuing to support equity markets. Valuations are in places stretched, notably technology, but in the absence of a catalyst for change this may continue. Europe and emerging market have arguably better prospects than the US without President Trump's tax changes.

3.6. The UK equity market has a number of conflicting influences: sterling's depreciation is positive for overseas earnings and exporters but negative for domestic companies and importers; Brexit uncertainty is a negative for most quoted equities and rising inflation and falling economic growth is good for none. The effect of Sterling's depreciation is reflected in relative share price performance – overseas earners gaining and importers suffering e.g. over the last 12 months (to 25/8) Next plc is down over 25% and Rio Tinto is up more than 55%. It is hard to be optimistic but this is not new news and to an extent reflected in performances.

3.7. If markets were "well behaved" in Q2, in Q3 they have been largely soporific moving up or down by c.1%. There are two exceptions – FX, principally the Euro and emerging markets. The Euro is benefitting from a better than expected improvement in growth rates and from disillusionment with Trump, or rather his ability to get his promised legislative programme on track.

3.8. Trying to time market movements is always easy in hind sight and near impossible in fore sight; markets often exceed expectations on both the upside and downside. Where markets move from here is dependent on exogenous influences like the Brexit negotiations and President Trump as much as fundamentals, but there are enough concerns both external and fundamental to suggest caution.

## 4. COMMENTS OF THE CHIEF FINANCE OFFICER

4.1. There are no direct immediate financial implications arising as a consequence of this report. The governance role of the Pensions Committee requires that they ensure that they take proper advice at reasonable intervals about its investments and must consider such advice when taking any steps in relation to its investments.

4.2. Understanding and being aware of the financial markets and its economics dynamics will compel the Committee to be able to consider the longer term financial impact of this parameters and make reasonable financial decisions when setting investment and contribution strategies.

4.3. The costs of obtaining the advice are minimal (£20k - £35k per annum) in comparison to the benefits that could be derived from having an appropriate expert advice and views for putting a strategy in place to achieve full funding.

## 5. LEGAL COMMENTS

5.1. In accordance with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016, the Council must take proper advice about its investments and must consider such advice when taking any steps in relation to its investments. 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. 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 the performance of the markets 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.

5.2 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.

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**Linked Reports, Appendices and Background Documents**

**Linked Report**

- [None]

**Appendices**

- [None]

**Local Government Act, 1972 Section 100D (As amended)**
**List of "Background Papers" used in the preparation of this report**

- [None]

**Officer contact details for documents:**

- Bola Tobun Investment &Treasury Manager x4733