

COMMITTEE: Pensions Committee	DATE: 13th August 2009	CLASSIFICATION: Unrestricted	REPORT NO.	AGENDA NO.
REPORT OF: Corporate Director of Resources		TITLE: Report of Investment Panel for Quarter Ending 31st March 2009.		
ORIGINATING OFFICER(S): Ian Talbot – Interim Chief Financial Strategy Officer		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 March 2009. Since the Panel met the Council has received final year end figures from WM Performance Services, the Council's investment performance measurement advisers. The figures below are those provided by WM which in some cases are different but do not vary significantly from those considered by the Panel.
- 1.2 In the quarter to the end of March 2009 the Fund achieved a return of -8.4% which was below the benchmark return of -8.0%. The twelve months return of -18.9% was marginally below the benchmark return of -18.7%. For longer periods performance continued to lag behind the benchmark with the three years return of -6.0% underperforming the benchmark return of -5.3% and the five years return of 2.6% underperforming the benchmark return of 3.2%.
- 1.3 The performance of individual managers was variable. Three managers achieved returns above the benchmark whilst the remaining five were below. The variability of returns does however partially reflect the management structure of the fund where complementary 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. Consequently there is an overweighting in bonds.
- 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

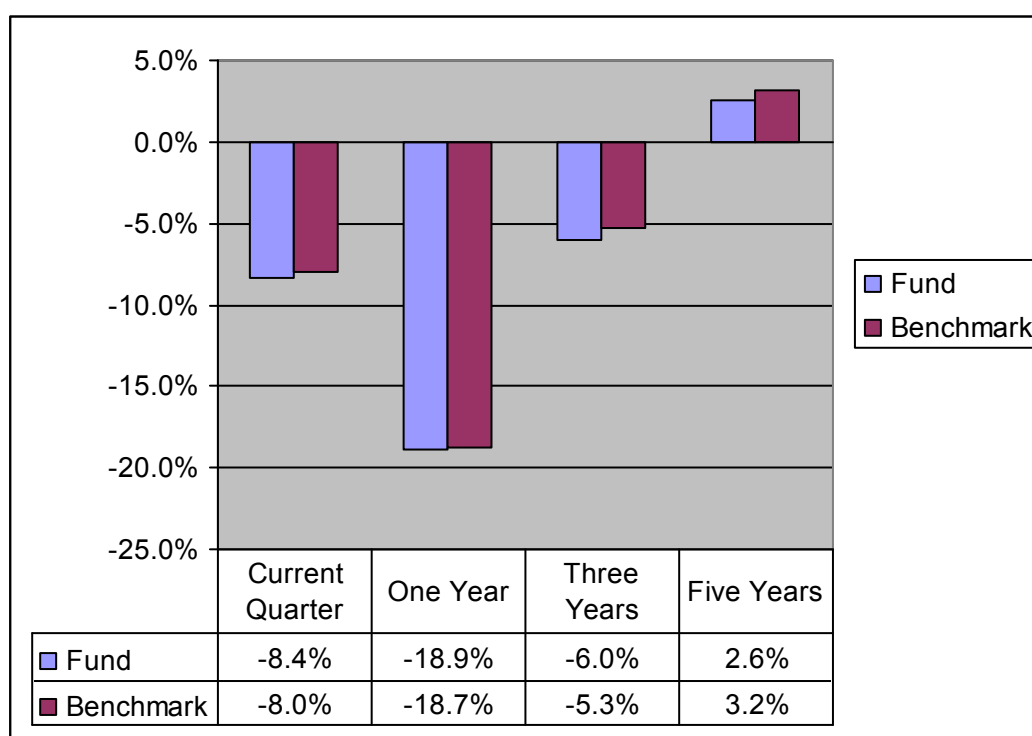
- 2.1 Members are recommended
- 2.1.1 To note the contents of this report.

3. **BACKGROUND**

- 3.1 The Pension Fund Regulations require that the Council establish arrangements for monitoring the investments of the Fund and the activities of the investment managers and ensure 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, two trade union representatives and one representative of the admitted bodies. 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 March 2009.

4 **INVESTMENT PERFORMANCE**

- 4.1 The Fund achieved a return of -8.4% in the quarter compared to the benchmark return of -8.0%.
- 4.2 The performance of the fund over the longer term is as set out in table 1.



- 4.3 The performance of the Fund should however be considered in the context of a major restructuring 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.
- 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 illustrate 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	137,464	25.0%	29 April 2005
Baillie Gifford	Global Equity	85.338	16.0%	5 July 2007
Martin Currie	UK Equity	65.935	12.0%	17 January 2006
Aberdeen (Equities)	UK Equity	45.634	10.5%	6 July 2007
Aberdeen (Bonds)	Bonds	153.159	21.0%	28 February 2006 30 September
Schroder	Property	62.599	12.0%	2004
Record	Currency	6.387	1.5%	2 September 2008
Auriel	Currency	9.820	2.0%	2 September 2008
		<u>566.336</u>		

The fund value held by the managers of £566.3 million has fallen by £52.1 million (8.5%) 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 Benchmark

Manager	Current Quarter	One Year	Three Years	Five Years
GMO	-1.90%	0.70%	-0.30%	
Baillie Gifford	3.30%	-2.30%		
Martin Currie	0.80%	5.60%	-2.80%	
Aberdeen (Equities)	-1.40%	-3.80%	-	
Aberdeen (Bonds)	-0.80%	-2.50%	-1.00%	-0.40%
Schroder	0.20%	4.20%	3.80%	
Record	-5.90%	-23.20%		
Auriel	-11.00%	-31.10%		

- 5.3 **GMO** underperformed the benchmark by 1.9% in the quarter with the underperformance being principally attributable to the currency selections made and the exposure to US high quality stocks.
- 5.4 **Baillie Gifford** put in a strong performance 3.3% above the benchmark due to the significant outperformance of several of their holdings including Petrobras, Amazon, China National Building Materials and Whole Foods.
- 5.5 **Martin Currie** outperformed the benchmark by 0.8% 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 various shortcomings in sector, size and stock selection. Performance for the year and the longer term is significantly below benchmark.
- 5.7 **Aberdeen (Bonds)** performance in the quarter was 0.8% below benchmark which reduced performance in the year to 2.5% below. The poor performance was mainly attributable to the overweight position to parts of the financial sector.
- 5.8 **Schroders** property outperformed the benchmark slightly 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. Aurial performance for the quarter was behind the benchmark principally due to their holding long US dollar and short Sterling positions at various times in the quarter.

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 it can seek 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 March 2009 is as set out below:

Table 4: Asset Allocation

	Benchmark 31 Mar 2009 %	Fund Position %	Variance as at 31 Mar 2009 %	Variance as at 31 Dec 2008 %
UK Equities	26.5%	21.7%	-4.8%	-2.7%
Global Equities	37.0%	36.7%	-0.3%	-1.1%
Total Equities	63.5%	58.4%	-5.1%	-3.8%
Property	12.0%	9.7%	-2.3%	-2.5%
UK Bonds	12.5%	16.6%	4.1%	2.7%
Overseas Bonds	0.0%	1.6%	1.6%	1.5%
UK Index Linked	8.5%	8.7%	0.2%	0.4%
Cash	0.0%	2.0%	2.0%	2.8%
Currency	3.5%	3.0%	-0.5%	-1.1%
	<u>100.0%</u>	<u>100.0%</u>		

- 6.3 Individual managers have discretion within defined limits to vary the asset distribution.
- 6.4 In addition the distribution will vary according to the relative returns of the different asset classes. 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. COMMENTS OF THE CHIEF FINANCIAL OFFICER

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

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

- 8.1 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 require Councils, which administer Pension Funds to invest contributions until such time as they are required to pay pensions.
- 8.2 The Regulations require that when undertaking such investment Councils are required to ensure that such investments are diversified to minimise risk and to obtain and consider proper advice.
- 8.3 The report details how the Council fulfils its obligations in this regard.

9. ONE TOWER HAMLETS CONSIDERATIONS

- 9.1 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.
- 9.2 A viable pension scheme also represents an asset for the recruitment and retention of staff to deliver services to the residents.

10. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

- 10.1 There are no Sustainable Action for A Greener Environment implications.

11. RISK MANAGEMENT IMPLICATIONS

- 11.1 Any form of investment inevitably involves a degree of risk.
- 11.2 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"

Directorate Submissions

***Name and telephone number of holder
And address where open to inspection***

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