

<b>COMMITTEE:</b> <b>Pensions Committee</b>	<b>DATE:</b> <b>17<sup>th</sup> February 2010</b>	<b>CLASSIFICATION:</b> <b>Unrestricted</b>	<b>REPORT NO.</b>	<b>AGENDA NO.</b> <b>4.1</b>
<b>REPORT OF:</b> <b>Corporate Director of Resources</b> <b>ORIGINATING OFFICER(S):</b> <b>Oladapo Shonola –</b> <b>Chief Financial Strategy Officer</b>		<b>TITLE:</b> <b>Report of Investment Panel for Quarter</b> <b>Ending 30th September 2009.</b>  <b>Ward(s) affected:</b> <b>N/A</b>		

<b>Lead Member</b>	<b>Cllr Ohid Ahmed – Resources and Performance</b>
<b>Community Plan Theme</b>	<b>All</b>
<b>Strategic Priority</b>	<b>One Tower Hamlets</b>

## **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 30th September 2009.
- 1.2 In the quarter to the end of September 2009 the Fund achieved a return of 15.3% which was slightly over the benchmark return of 15.2%. The twelve months return of 7.1% was marginally below the benchmark return of 7.3%. For longer periods, performance continued to lag behind the benchmark with the three years return of 0.2% underperforming the benchmark return of 0.9% and the five years return of 6.2% underperforming the benchmark return of 6.7%.
- 1.3 The performance of individual managers was variable. Five managers achieved returns above the benchmark whilst the remaining three 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.

## **2. DECISIONS REQUIRED**

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

## **3. REASONS FOR DECISIONS**

- 3.1 There are no decisions to be made as a result of this report. The report is written to inform panel members of performance of pension fund managers and the overall performance of the Tower Hamlets Pension Fund. The report also updates the Committee on the activities of the Investment Panel.

## 4. ALTERNATIVE OPTIONS

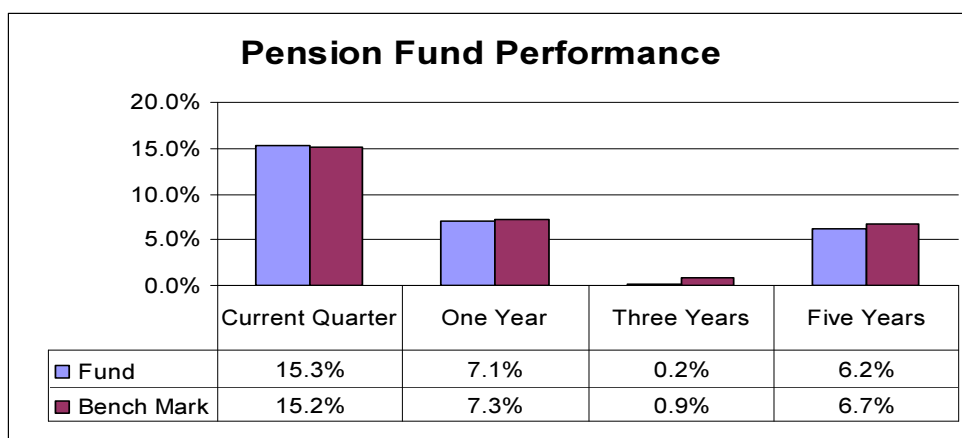
- 4.1 The Pension Fund Regulations requires that the Council establishes arrangements for monitoring the investments of the pension Fund. No alternative method of meeting the Pension Fund Regulations requirement has so far been identified.

## 5. BACKGROUND

- 5.1 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.
- 5.2 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.
- 5.3 This report informs Members of the activities of the Investment Panel and performance of the Fund and its investment managers for the period ending 30<sup>th</sup> September 2009.

## 6 INVESTMENT PERFORMANCE

- 6.1 The Fund achieved a return of 15.3% in the quarter compared to the benchmark return of 15.2%.
- 6.2 The performance of the fund over the longer term is as set out in table 1.



- 6.3 The relatively low returns between 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.

## 7. MANAGERS

- 7.1 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	179.8	25.0%	29 Apr 2005
Baillie Gifford	Global Equity	113.7	16.0%	5 Jul 2007
Martin Currie	UK Equity	85.4	12.0%	17 Jan 2006
Aberdeen (Equities)	UK Equity	62.8	10.5%	6 Jul 2007
Aberdeen (Bonds)*	Bonds	164.8	21.0%	28 Feb 2006
Schroder	Property	59.3	12.0%	30 Sep 2004
Record	Currency	9.6	1.5%	2 Sep 2008
Auriel	Currency	10.7	2.0%	2 Sep 2008
<b>Total</b>		<b>686.1</b>	<b>100.0%</b>	

\*The Pension Funding is in the process of replacing Aberdeen (Bonds) with Investec Asset Management

- 7.2 The fund value of £686.1 million held by the managers has risen by £91.2 million (15.3%) over the quarter.
- 7.3 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	-0.20%	-1.70%	0.00%	0.00%
Baillie Gifford	1.60%	1.80%	1.20%	0.00%
Martin Currie	-1.00%	-2.60%	-4.20%	-3.00%
Aberdeen (Equities)	1.80%	-1.90%	-2.90%	
Aberdeen (Bonds)*	1.10%	-0.30%	0.10%	0.00%
Schroder	0.40%	1.00%	1.50%	1.50%
Record	-11.40%	-17.30%		
Auriel	8.80%	4.70%		
<b>Total Variance</b>	<b>1.10%</b>	<b>-16.30%</b>	<b>-4.30%</b>	<b>-1.50%</b>

- 7.4 **GMO** marginally underperformed the benchmark over the quarter. As with the previous quarter they attribute this to the outperformance of the more “speculative” stocks and their bias to “higher quality” stocks.
- 7.5 **Baillie Gifford** continues to perform strongly, with the outperformance over the quarter sourced particularly from Financial Holdings.
- 7.6 **Martin Currie** underperformed by 0.8% over the quarter. Again they attribute their underperformance to the widespread indiscriminate rally in the market as a whole, outpacing the gains made on their favoured stocks (high quality blue chip). However, Martin Currie’s overall performance since commencement of contract has been disappointing so there are questions to be answered over the reasons for the longer term performance which lags well behind the benchmark return.

- 7.7 **Aberdeen (UK Equities)** outperformed the FTSE All Share index over the quarter. Stock selection contributed most to outperformance while sector selection had an overall positive but much smaller effect. Despite the strong Q3, performance over 12 months now looks disappointing, with Q3 of 2008 dropping out of the calculation (Aberdeen had significant outperformance in that quarter). Longer term performance also remains poor.
- 7.8 **Aberdeen (Bonds)** outperformed over the quarter, the holding of longer dated gilts was beneficial as was the exposure to Financials with corporate bonds. Relative performance over the longer term remains flat. Investec have been appointed to replace Aberdeen for the bonds mandate.
- 7.9 **Schroder** property had its first positive quarter in over 2 years with the benchmark returning 2.1%. Schroder outperformed the benchmark with a strong contribution from their Continental Europe fund. Long term performance is ahead of benchmark too.
- 7.10 **Record** underperformed over quarter 3. Losses were attributable to the strengthening Yen against both Sterling and the Euro in particular. This was the main reason for the underperformance in their "Forward Rate Bias" strategy, whereas in their Range Trading Strategy positions in the Swedish Krona versus Euro hurt.
- 7.11 **Auriel** outperformed their benchmark by 8.9%. Gains resulted predominantly from the short US dollar position versus the New Zealand dollar, Australian dollar and Norwegian Krone. Their sentiment indicators had a strong quarter, along with the short-term technical model. This was a very good quarter for Auriel.

## **8 ASSET ALLOCATION**

- 8.1 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:-
- 8.1.1 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.
- 8.1.2 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.
- 8.1.3 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 an eighteen year deficit recovery term for this Council which enables a longer term investment perspective to be taken.

- 8.2 The benchmark asset distribution and the position at the 30<sup>th</sup> September 2009 are as set out below:

**Table 4: Asset Allocation**

<b>Fund Type</b>	<b>Benchmark 30 Sep 2009</b>	<b>Fund Position</b>	<b>Variance as at 30 Sep 2009</b>	<b>Variance as at 31 Mar 2009</b>
UK Equities	26.5%	26.8%	0.3%	-2.8%
Global Equities	37.0%	36.9%	-0.1%	-2.3%
Total Equities	63.5%	63.7%	0.2%	-5.1%
Property	12.0%	8.2%	-3.8%	-2.4%
UK Bonds	12.5%	14.5%	2.0%	3.9%
Overseas Bonds	0.0%	1.4%	1.4%	1.6%
UK Index Linked	8.5%	7.3%	-1.2%	0.1%
Cash	0.0%	1.9%	1.9%	2.5%
Currency	3.5%	3.0%	-0.5%	-0.6%
<b>Total Equities</b>	<b>100.0%</b>	<b>100.0%</b>	<b>0.00%</b>	<b>0.00%</b>

- 8.3 Individual managers have discretion within defined limits to vary the asset distribution.
- 8.4 In addition the distribution will vary according to the relative returns of the different asset classes. Equity markets have been recovering over the past several months and indexes are now nearing pre-recession levels. This has corrected the temporary distortion in the distribution of assets, so that the actual distribution of assets is similar to targets.

## **9. COMMENTS OF THE CHIEF FINANCIAL OFFICER**

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

## **10. CONCURRENT REPORT OF THE ASSISTANT CHIEF EXECUTIVE (LEGAL)**

- 10.1 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 requires the Council, as an administering authority, to invest fund money that is not needed immediately to make payments from the Pensions Fund. The Council is required to have a Statement of Investment Principles that sets out its investment policy.
- 10.2 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.
- 10.3 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.

## **11. ONE TOWER HAMLETS CONSIDERATIONS**

- 11.1 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.
- 11.2 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 is 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.

## **14. CRIME AND DISORDER REDUCTION IMPLICATIONS**

- 14.1 There are no any crime and disorder reduction implications arising from this report.

## **15. EFFICIENCY STATEMENT**

- 15.1 The monitoring arrangement for the Pension Fund and the work of the Pension Fund Investment Panel should ensure that the Fund optimises the use of its resources in achieving the best returns for members of the Fund.

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### **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***

*Review of Investment Managers' Performance for  
the 3<sup>rd</sup> Quarter Report – prepared by Hymans  
Robertson LLP*

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Mulberry Place, 4<sup>th</sup> Floor.*