

COMMITTEE: Pensions Committee	DATE: 18 November 2010	CLASSIFICATION: Unrestricted	REPORT NO.	AGENDA NO.
REPORT OF: Corporate Director of Resources		TITLE: Report of Investment Panel for Quarter Ending 30 September 2010.		
ORIGINATING OFFICER(S): Alan Finch – Service Head, Corporate Finance		Ward(s) affected: N/A		

Lead Member	
Community Plan Theme	All
Strategic Priority	One Tower Hamlets

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 30 June 2010.
- 1.2 In the quarter to the end of June 2010 the Fund achieved a return of -7.9% which is 1.3% below the benchmark. The twelve month Fund return of 16.2% slightly underperformed the benchmark return at 18.2%. For longer periods, performance continued to lag behind the benchmark with the three years return of -2.2% underperforming the benchmark return of -1.1% by 1.1% and the five years return of 3.8% underperforming the benchmark return of 4.8% by 0.8%.
- 1.3 The performance of individual managers was variable this quarter. Four managers achieved returns above the benchmark whilst the remaining four 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 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

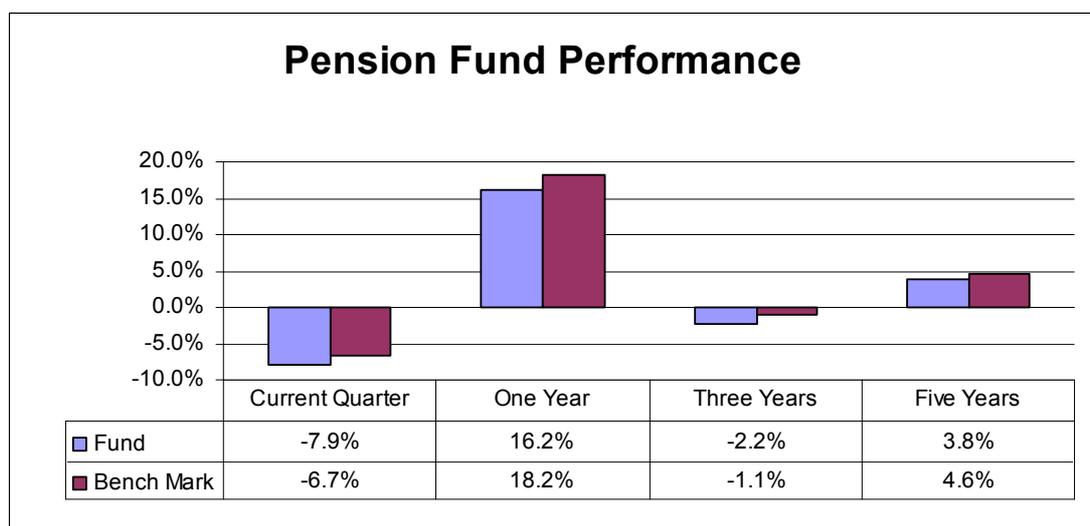
- 4.1 The Pension Fund Regulations requires that the Council establishes arrangements for monitoring the investments of the Pension Fund.

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 June 2010.

6 INVESTMENT PERFORMANCE

- 6.1 The Fund achieved a return of -7.9% which is 1.3% below the benchmark.
- 6.2 The performance of the fund over the longer term is as set out in table 1.



- 6.3 The chart clearly 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 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	Actual % of Fund	Target % of Fund	Difference %	Date Appointed
GMO	Global Equity	177.0	26.0	25.0	1.0	29 Apr 2005
Baillie Gifford	Global Equity	119.7	17.6	16.0	1.6	5 Jul 2007
Martin Currie*	UK Equity	81.0	11.9	12.0	-0.1	17 Jan 2006
Aberdeen (Equities)	UK Equity	63.9	9.4	10.5	-1.1	6 Jul 2007
Aberdeen (Bonds)**	Bonds	50.8	7.5	7.0	0.5	28 Feb 2006
Investec Bonds	Bonds	94.5	13.9	14.0	-0.1	26 Apr 2010
Schroder	Property	87.0	12.8	12.0	0.8	30 Sep 2004
Record	Currency	5.6	0.8	1.5	-0.7	2 Sep 2008
Auriel	Currency	0.0	0.0	2.0	-2.0	2 Sep 2008
Total		679.3	100.0	100.0	0.00	

** Aberdeen assets (excluding index-linked gilts) have been transferred to Investec

* Aberdeen equities and Martin Currie assets to be transferred to Legal & General under a passive mandate

7.2 The fund value of £679.3 million held by the managers has fallen by £69.4 million (9.3%) over the quarter.

7.3 The performance 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	0.30%	-0.80%	-0.30%	-0.40%
Baillie Gifford	1.20%	5.10%	2.20%	
Martin Currie	-3.70%	-4.90%	-2.60%	-3.40%
Aberdeen (Equities)	2.60%	4.60%	-1.30%	
Aberdeen (Bonds)*	-1.40%	0.30%	-0.50%	-0.10%
Investec Bonds	-4.30%			
Schroder	-1.70%	-3.50%	-0.80%	0.40%
Record	-17.60%	-36.90%	-26.80%	
Auriel	2.20%	2.80%	-17.60%	
Total Variance (Relative)	-1.30%	-1.60%	-1.10%	-0.80%

7.4 GMO's performance was ahead of benchmark over the quarter. Exposure to the equity markets of Greece, Portugal and Spain had a detrimental impact on performance. However outperformance came from the portfolio's allocation to high quality US stocks as investors became attracted to these stocks due to reduced appetite for risk. Performance over the longer term remains modestly behind benchmark.

- 7.5 **Baillie Gifford** continues to perform strongly, with the outperformance over the quarter at 1.2%, which puts performance over 12 months 5.1% ahead of benchmark. The fund benefited from a mix of holdings in the quarter. Some of the contributors to outperformance include temporary power supplier Aggreko, the elevator manufacturer Schindler and Richemont who luxury brands such as Cartier and Montblanc.
- 7.6 **Martin Currie** performance continued to disappoint with the portfolio underperforming the FTSE All Share index by 3.7% leaving performance over twelve months, 3 years and since inception all significantly below benchmark. This manager has now been replaced and its asset allocation transferred to Legal & General under the newly awarded passive manager mandate.
- 7.7 **Aberdeen (UK Equities)** outperformed the FTSE All Share index over the quarter by 2.6%. Although 12 month performance is ahead of benchmark, longer term performance remains poor. This manager has now been replaced and its asset allocation transferred to Legal & General under the newly awarded passive manager mandate.
- 7.8 **Aberdeen (Bonds)** Performance was significantly below benchmark. Assets held have now been transitioned to Legal and General.
- 7.9 **Schroder (property)** There has been a drag on overall return from the portfolio on account of the costs associated with transaction volumes. Cash within the fund has been reduced and holdings acquired have been outperforming. As well as the costs of transactions, the holding of cash itself has been detrimental as the property market has recovered and outperformed cash. Of the approximately £20m of cash given to Schroders, 90% has now been invested or committed. Performance over the year has also been impacted by the underperformance of the Continental European Fund (performance has lagged the recovery in the UK) and also by the impact of currency exchange rates.
- 7.10 **Investec (Bonds)** Performance since inception on 26 April has been disappointing, underperformance has been driven by a sharp sell off in corporate bonds. Going forward Investec remain modestly defensively positioned in government bonds.
- 7.11 **Record** performance was disappointing in quarter 2 as high interest rate countries selected by both their strategies underperformed their low interest rate counterparts, particularly in May and June. Losses were mainly due to strengthening Yen versus the Australian dollar and Swiss franc strengthening against Sterling.
- 7.12 **Auriel** The final month of performance was strong relative to the benchmark but the Auriel fund's longer term track record remains disappointing. The Fund has withdrawn all funds that from Auriel.

8 **ASSET ALLOCATION**

8.1 The 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 Investment Panel. Recent reviews have led to the appointment of a passive manager and the Fund is in the process of appointing an absolute manager. 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 is 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 June 2010 are as set out below:

Table 4: Asset Allocation

	Benchmark 30 Sep 2010	Fund Position	Variance as at 30 Sep 2010	Variance as at 31 Mar 2010
	%	%	%	%
UK Equities	26.5%	26.1%	-0.4%	1.1%
Global Equities	37.0%	37.2%	0.2%	1.0%
Total Equities	63.5%	63.3%	-0.2%	-2.1%
Property	12.0%	11.7%	-0.3%	1.1%
UK Bonds	13.6%	13.6%	0.0%	-0.7%
Overseas Bonds	0.0%	0.0%	0.0%	-2.0%
UK Index Linked	7.4%	7.4%	0.0%	-1.3%
Cash	0.0%	3.2%	3.2%	2.8%
Currency	3.5%	0.8%	-2.7%	0.1%
Total Equities	100.0%	100.0%	0.0%	0.0%

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 2009 require 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 policy in relation to its investments and a Statement of Investment Principles. The Council is required to take advice about its investments.
- 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 implication arising from this report.

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.

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

Brief description of "background papers"

Review of Investment Managers' Performance for the 2nd Quarter Report – prepared by Hymans Robertson LLP

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