

COMMITTEE: Pensions Committee	DATE: 17 February 2011	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): Oladapo Shonola – Chief Financial Strategy Officer		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 September 2010.
- 1.2 In the quarter to the end of September 2010 the Fund achieved a return of - 8.2% which is 0.9% above the benchmark. The twelve month Fund return of 9.0% slightly underperformed the benchmark return at 10.0%. For longer periods, performance continued to lag behind the benchmark with the three years return of 0.3% underperforming the benchmark return of 1.0% by 0.7% and the five years return of 4.1% underperforming the benchmark return of 4.8% by 0.7%.
- 1.3 The performance of individual managers although varied, was mostly positive this quarter. Five managers matched or achieved returns above the benchmark whilst the remaining two 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 the 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

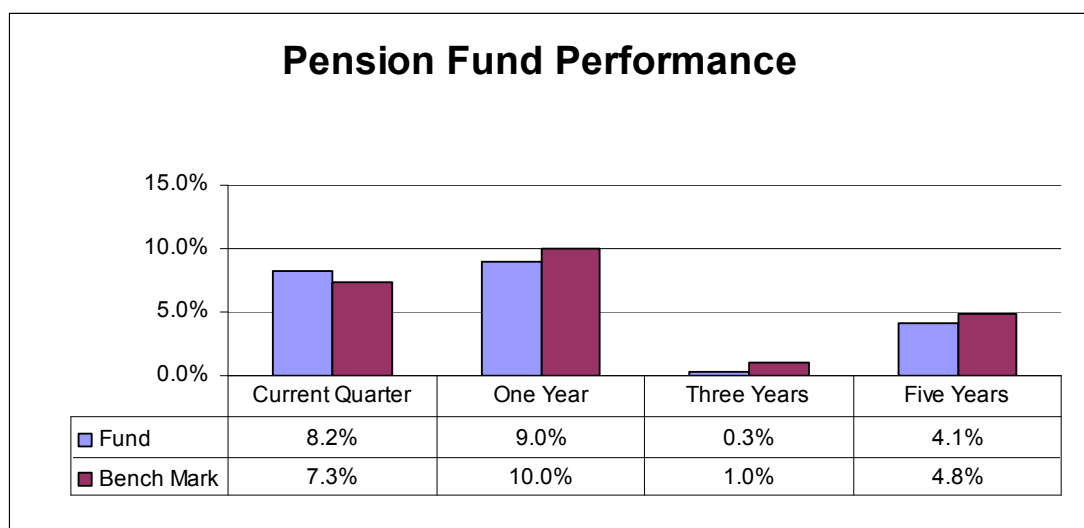
- 4.1 The Pension Fund Regulations requires that the Council establishes arrangements for monitoring the investments of the Pension Fund.

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 September 2010.

6 INVESTMENT PERFORMANCE

- 6.1 The Fund achieved a return of 8.2% which is 0.9% above 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 seven 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	Actual % of Fund	Difference %	Date Appointed
GMO	Global Equity	194.5	25.0%	26.0%	1.0%	29 Apr 2005
Baillie Gifford	Global Equity	133.0	16.0%	17.8%	1.8%	5 Jul 2007
L & G UK Equity	UK Equity	164.8	22.5%	22.0%	-0.5%	02 Aug 2010
L & G Index Linked-Gilts	UK Equity	52.8	7.0%	7.0%	0.0%	02 Aug 2010
Investec Bonds	Bonds	96.0	14.0%	12.8%	-1.2%	26 Apr 2010
Schroder	Property	88.2	12.0%	11.8%	-0.2%	30 Sep 2004
Record	Currency	5.4	1.5%	0.7%	-0.8%	2 Sep 2008
Cash	Currency	14.3	2.0%	1.9%	-0.1%	
Total		749.0	100.0%	100.0%	0.0%	

7.2 The fund value of £749.0 million held by the managers has increased by £69.7 million (10.26%) 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	0.80%	0.20%	0.00%	-0.30%
Baillie Gifford	2.30%	6.10%	3.10%	2.70%
L & G UK Equity	0.00%	N/A	N/A	N/A
L & G Index Linked-Gilts	0.00%	N/A	N/A	N/A
Investec Bonds	1.50%	-3.00%	N/A	N/A
Schroder	-0.40%	-4.30%	-1.10%	0.60%
Record	-3.30%	-31.20%	-25.20%	N/A
Total Variance (Relative)	0.90%	-1.00%	-0.70%	-0.70%

7.4 **GMO's** performance over the quarter was strong in absolute terms as global equity markets posted strong gains. GMO also outperformed their benchmark in relative terms by 0.8%. Country allocation had a mixed effect with gains, particularly from the overweight position to Emerging Markets and also the UK, offset by being overweight Japan and underweight Australia. Stock selection was also positive, with the value-oriented and momentum driven strategies contributing positively.

- 7.5 **Baillie Gifford** Performance continues to be strong, significantly ahead of benchmark over the quarter (2.3%), year and since inception. Baillie Gifford continue to have a strong belief in the theme of emerging markets growth and that structural changes in emerging markets will continue for several years. This exposure continues to be a significant driver of performance. They are optimistic about technological change and scientific progress and have added holdings to capture this such as Roche (new drug technologies), Namco Bandai (new gaming technology).
- 7.6 **L & G (UK Equity)** performance has been in line with the index benchmark (FTSE-All Share) since inception, as expected.
- 7.7 **L & G Index Linked Gilts** performance has been in line with the index benchmark (FTSE-A Index-Linked Over 15 Years Gilts) since inception.
- 7.8 **Schroder (property)** the key drivers of recent underperformance have been costs of acquisitions and the cash holding during the investment phase. The Continental European Fund has also underperformed in comparison to the UK (over the last year but actually outperformed last quarter). The cash balance is now below 5%.
- 7.9 **Investec (Bonds)** recovered in quarter 3 following a disappointing start to the appointment outperforming the benchmark by 1.5%. Exposure to emerging market debt was a positive and currency selection was also beneficial.
- 7.10 **Record** performance for Q3 2010 was disappointing again. Although Record still believes in the strategy for the long-term, it is unable to give any indication as to when we are likely to see a turnaround in performance. Their view is that as developed countries are trying to reduce their deficits through raising taxes and becoming more self-sufficient they are unlikely to allow their currencies to appreciate.

The Panel decided at its last meeting to disinvest funds from Record and use the receipt to fund the newly awarded absolute return mandates. Officers have prepared a transition plan which details transfer assets between managers and how the new mandate will be funded. It is expected that disinvestment from Record will be complete by the end of the month.

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 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 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 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 Sept 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%	27.5%	1.0%	1.1%
Global Equities	37.0%	37.6%	0.6%	1.0%
Total Equities	63.5%	65.1%	1.6%	-2.1%
Property	12.0%	12.4%	0.4%	1.1%
UK Bonds	14.0%	12.8%	-1.2%	-0.7%
Overseas Bonds	0.0%	0.0%	0.0%	-2.0%
UK Index Linked	7.0%	7.0%	0.0%	-1.3%
Cash	2.0%	1.9%	-0.1%	2.8%
Currency	1.5%	0.8%	-0.7%	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. Diversification relates to 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 3rd Quarter Report – prepared by Hymans Robertson LLP

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