

COMMITTEE: Pensions Committee	DATE: 21 July 2011	CLASSIFICATION: Unrestricted	REPORT NO PC/003/112	AGENDA NO.
REPORT OF: Corporate Director of Resources		TITLE: Report of Investment Panel for Quarter Ending 31 December 2010.		
ORIGINATING OFFICER(S): Oladapo Shonola – Chief Financial Strategy Officer		Ward(s) affected: N/A		

Lead Member	Cllr Anwar Khan, Chair of Pension Committee
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 31 December 2010.
- 1.2 In the quarter to the end of December 2010 the Fund achieved a return of -6.0% which is 0.1% above the benchmark. The twelve month Fund return of 12.4% slightly underperformed the benchmark return at 12.8%. For longer periods, performance continued to lag behind the benchmark with the three years return of 2.5% underperforming the benchmark return of 2.9% by 0.4% and the five years return of 4.4% underperforming the benchmark return of 5.0% by 0.6%.
- 1.3 The performance of individual managers was mostly positive this quarter. Five managers matched or achieved returns above the benchmark whilst 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

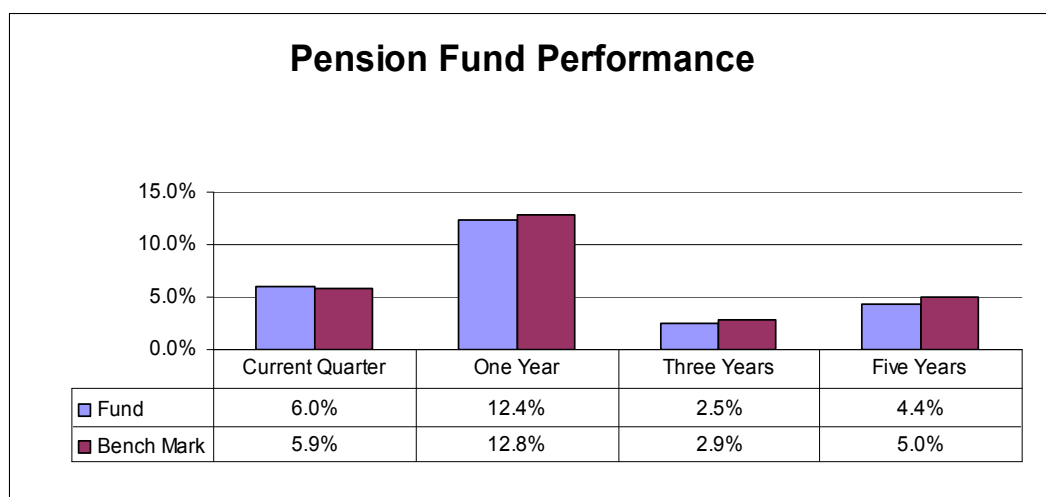
- 4.1 The Pension Fund Regulations requires that the Council establishes arrangements for monitoring the investments of the Pension Fund. Under the constitution of Tower Hamlets Council this is the responsibility of the Pensions Committee.

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 – Finance, Risk and Accountability, 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 31 December 2010.

6 INVESTMENT PERFORMANCE

- 6.1 The Fund achieved a return of 6.0% which is 0.1% 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: (figures are for December 2010)

Table 2: Management Structure

Manager	Mandate	Value £M	Target % of Fund	Actual % of Fund	Difference %	Date Appointed
GMO	Global Equity	210.5	25.0%	26.1%	1.1%	29 Apr 2005
Baillie Gifford	Global Equity	145.9	16.0%	18.1%	2.1%	5 Jul 2007
L & G UK Equity	UK Equity	176.9	22.5%	22.0%	-0.5%	2 Aug 2010
L & G Index Linked-Gilts	UK Equity	53.4	7.0%	6.6%	-0.4%	2 Aug 2010
Investec Bonds	Bonds	97.0	14.0%	12.0%	-2.0%	26 Apr 2010
Schroder	Property	90.0	12.0%	11.2%	-0.8%	30 Sep 2004
Record	Currency	5.0	1.5%	0.6%	-0.9%	2 Sep 2008
Cash	Currency	26.9	2.0%	3.3%	1.3%	
Total		805.7	100.0%	100.0%	0.0%	

- 7.2 The fund value of £805.7 million held by the managers has increased by £56.8 million (7.58%) over the quarter.
- 7.3 Following a decision taken by the Panel, new absolute returns mandates have been awarded (totalling 10% of the Fund's assets) in Q1 2011. These have been awarded to Ruffer LLP (£40m) and Baillie Gifford (£40m), for investment in its Diversified Growth Fund. The new portfolios have been funded by the proceeds of the Record disinvestment, internal cash and transfer of assets from Baillie Gifford, Legal & General and GMO.
- 7.4 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	-0.70%	0.00%	0.30%	-0.20%
Baillie Gifford	0.20%	4.70%	2.80%	2.60%
L & G UK Equity	0.00%	0.00%		
L & G Index Linked-Gilts	0.00%	0.00%		
Investec Bonds	0.90%	-2.00%		
Schroder	0.10%	-3.50%	-1.20%	0.30%
Record	-6.70%	-33.00%	-25.10%	
Total Variance (Relative)	0.20%	-0.40%	-0.40%	-0.60%

- 7.5 **GMO** under-performed in the quarter, trailing the benchmark in relative terms by 0.7%. This is mainly due to the stock selection but some of this was offset by positive contributions from the momentum stock and the newly introduced enhanced currency approach.
- 7.6 **Baillie Gifford** Performance has dropped back in the quarter although continues to be strong and significantly ahead of the benchmark over the year (4.7%), and since inception. The main contributors to performance in the quarter were recovering industrial companies and internet companies whilst Financials became the largest negative contributors. Baillie Gifford believe that emerging market growth will continue to be strong and make a positive contribution to global growth. Baillie Gifford have recently made some partnership changes but this is not expected to affect the management of the portfolio.
- 7.7 **L & G (UK Equity)** performance has been in line with the index benchmark (FTSE-All Share) since inception, as expected.
- 7.8 **L & G Index Linked Gilts** performance has been in line with the index benchmark (FTSE-A Index-Linked Over 15 Years Gilts) since inception.
- 7.9 **Schroder (property)** Schroder out-performed the benchmark in the quarter by 0.10% ending four quarters of relative under performance (3.5%). Performance has improved as the cash holding has been invested and the impact of the European exposure has lessened.
- 7.10 **Investec (Bonds)** Investec continue to return a relative out performance (0.9%), with corporate bonds and interest rate positions being the main positive contributors. They have reduced their exposure to banking and corporate bonds which has proved beneficial.
- 7.11 **Record** Continuing poor performance for Q4 2010. The Long Euro position has detracted from performance over the quarter as the Euro was the weakest currency in the G11 during this period. Following a decision taken by The Panel the funds held by Record were disinvested in Q1 2011 with the proceeds being used to fund the newly awarded absolute return mandates.

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. 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, 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 a twenty 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 31 December 2010 are as set out below:

Table 4: Asset Allocation

Mandate	Benchmark 31 Dec 2010	Fund Position	Variance as at 31 Dec 2010	Variance as at 31 Mar 2010
UK Equities	26.5%	27.3%	0.8%	1.1%
Global Equities	37.0%	38.1%	1.9%	1.0%
Total Equities	63.5%	65.4%	2.7%	2.1%
Property	12.0%	10.7%	-1.3%	1.1%
UK Bonds	14.0%	12.0%	-2.0%	-0.7%
Overseas Bonds	0.0%	0.0%	0.0%	-2.0%
UK Index Linked	7.0%	6.7%	-0.3%	-1.3%
Cash	2.0%	4.6%	2.6%	2.8%
Currency	1.5%	0.6%	-0.9%	0.1%
Total Equities	100.0%	100.0%		

- 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. But superior outperformance by equities over other asset classes means that the portfolio is overweight equities.

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 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"

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

*Review of Investment Managers' Performance for
the 4th Quarter Report – prepared by Hymans
Robertson LLP*

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