

<b>COMMITTEE:</b> <b>Pensions Committee</b>	<b>DATE:</b> <b>17 November 2011</b>	<b>CLASSIFICATION:</b> <b>Unrestricted</b>	<b>REPORT NO.</b>	<b>AGENDA NO.</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 Ending 30 June 2011.</b>  <b>Ward(s) affected:</b> <b>N/A</b>		

<b>Lead Member</b>	<b>Cllr Alibor Choudhury - Resources</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 30 June 2011.
- 1.2 In the quarter to the end of June 2011 the Fund achieved a return of 1.5% which is 0.5% above the benchmark. The twelve month Fund return of 18.0% is 1.9% ahead of benchmark of 16.1%. For longer periods, performance lags behind the benchmark with three years return at 6.1% only slightly behind benchmark of 6.3% and the five years return of 4.4% underperforming the benchmark return of 4.9% by 0.5%.
- 1.3 The performance of individual managers was mostly positive this quarter. Six 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 content 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

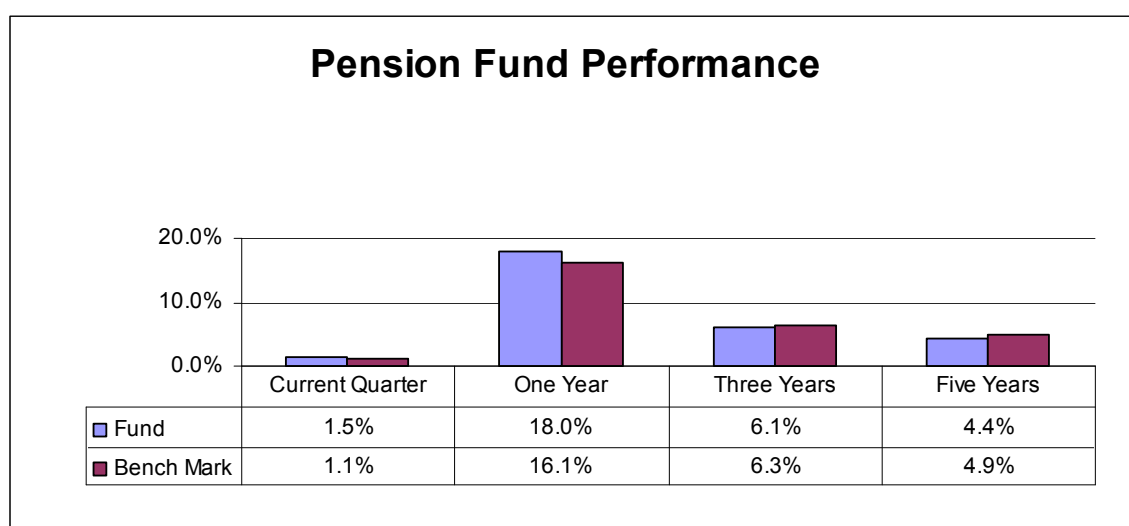
- 4.1 The Pension Fund Regulations requires that the Council establishes arrangements for monitoring the investments of the Pension Fund. No other alternative method of fulfilling this requirement has been identified.

## 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 June 2011.

## 6. INVESTMENT PERFORMANCE

- 6.1 The Fund achieved a return of 1.5% which is 0.4% 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 eight specialist managers with mandates corresponding to the principal asset classes. The managers are as set out in the following table

Table 2: Management Structure

Manager	Mandate	Value £M	Target % of Fund	Actual % of Fund	Difference %	Date Appointed
GMO	Global Equity	208.6	25.0%	25.3%	0.3%	29 Apr 2005
Baillie Gifford	Global Equity	135.9	16.0%	16.5%	0.5%	5 Jul 2007
L & G UK Equity	UK Equity	167.2	20.0%	20.3%	0.3%	2 Aug 2010
Baillie Gifford Diversified Growth	Absolute Return	41.0	5.0%	5.0%	0.0%	22 Feb 2011
Ruffer Total Return Fund	Absolute Return	40.1	5.0%	4.9%	-0.1%	8 Mar 2011
L & G Index Linked-Gilts	UK Equity	39.7	3.0%	4.8%	1.8%	2 Aug 2010
Investec Bonds	Bonds	97.0	14.0%	11.8%	-2.2%	26 Apr 2010
Schroder	Property	93.3	12.0%	11.3%	-0.7%	30 Sep 2004
Cash	Currency	1.1	0.0%	0.1%	0.1%	
<b>Total</b>		<b>823.9</b>	<b>100.0%</b>	<b>100.0%</b>	<b>0.0%</b>	

- 7.2 The fund value of £823.7 million held by the managers has increased by £10.8 million (1.32%) 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	1.10%	1.50%	0.30%	0.00%
Baillie Gifford	0.40%	3.00%	1.80%	2.40%
L & G UK Equity	0.00%	0.10%		
Baillie Gifford Diversified Growth	1.90%	2.20%		
Ruffer Total Return Fund	0.90%	-0.10%		
L & G Index Linked-Gilts	0.00%	0.00%		
Investec Bonds	-1.00%	2.00%	-2.10%	
Schroder	0.30%	-0.40%	-0.90%	0.20%
<b>Total Variance (Relative)</b>	<b>0.80%</b>	<b>-0.90%</b>	<b>-0.70%</b>	<b>-0.70%</b>

- 7.4 **GMO** significantly outperformed over the quarter. They remain overweight in US high quality stocks as they keep to their long held belief that this is the right approach. Some of that belief was repaid this quarter as these stocks outperformed in a nervous market. The portfolio is also overweight European stocks despite weak financials in the Eurozone dominated by sovereign debt issues with Greece and Italy. GMO believe that the markets have priced in much of the threat already, so increased allocation to Europe, but particularly to Spain based on the belief that Spanish banks are among the better quality

and more diversified large banks in the Europe. The portfolio continues to be significantly underweight in Canada and Australia due to a belief that these countries markets are overpriced.

- 7.5 **Baillie Gifford** Performance was significantly ahead of benchmark over the quarter and also over the longer term. Although, the portfolio was some turnover in the portfolio this quarter where market expectations are catching up with Baillie Gifford's view and other holdings that the manager believes have run their course. 'Growth' stocks continue to make significant contributions to returns as long held stocks performed strongly.
- 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)** Schroder outperformed benchmark in the quarter by 0.3%. The drivers of performance this quarter are the overweight positions in the central London office market and improved performance in continental European holdings. Schroder have taken a holding in their Real Income Fund to maintain real income and help protect value in low growth environment.
- 7.9 **Investec (Bonds)** returned -0.9% against a benchmark return of 0.1% underperforming by 1.0% over the quarter. Despite 3 quarters of outperformance, a poor start to the mandate and underperformance in Q2 of 2011 means performance since inception trails the benchmark. The main reasons for underperformance this quarter were interest rate and currency positioning and corporate bond exposure, but exposure to Emerging Markets Debt was a positive contributor.
- 7.10 **Baillie Gifford Diversified Growth Fund (Absolute Return)** significantly outperformed the benchmark returning 2.0% against benchmark of 0.1%. The portfolio continues to have little exposure to equities with higher weightings to cash and more defensive asset classes like insurance linked and absolute return funds.
- 7.11 **Ruffer Total Return Fund (Absolute Return)** outperformed the benchmark returning 1.1% against benchmark of 0.2%. The manager has reduced equity weighting in the portfolio which has assisted performance this quarter.

## 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 – the latest review was carried out in January 2011. 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 30 June 2011 are as set out below:

**Table 4: Asset Allocation**

<b>Mandate</b>	<b>Benchmark 31 Mar 2011</b>	<b>Fund Position</b>	<b>Variance as at 31 Mar 2011</b>	<b>Variance as at 31 Mar 2010</b>
UK Equities	24.0%	24.9%	0.9%	0.8%
Global Equities	37.0%	36.4%	-0.6%	1.9%
<b>Total Equities</b>	<b>61.0%</b>	<b>61.3%</b>	<b>0.3%</b>	<b>2.7%</b>
Property	12.0%	10.8%	-1.2%	-1.3%
Bonds	14.0%	11.8%	-2.2%	-2.0%
UK Index Linked	3.0%	4.8%	1.8%	-0.4%
Alternatives	10.0%	9.8%	-0.2%	0.0%
Cash	0.0%	1.5%	1.5%	1.3%
Currency	0.0%	0.0%	0.0%	-0.3%
<b>Total Equities</b>	<b>100.0%</b>	<b>100.0%</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. The rebalancing exercise that was undertaken in January has corrected the temporary distortion 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 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 2<sup>nd</sup> Quarter Report 2011 – prepared by Hymans Robertson LLP*

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

*Oladapo Shonola Ext. 4733  
Mulberry Place, 4<sup>th</sup> Floor.*