

<b>COMMITTEE:</b> <b>Pensions Committee</b>	<b>DATE:</b> <b>16 February 2012</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 September 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 September 2011.
- 1.2 In the quarter to the end of September 2011 the Fund achieved a return of -9.2% which is 0.8% below the benchmark (-8.4%). The twelve month Fund return of -0.9% is in line with benchmark return, also at -0.9%. For longer periods, performance continued to lag behind the benchmark with the three years return at 5.0% only slightly behind benchmark of 5.4% and the five years return of 1.7% underperforming the benchmark return of 2.3% by 0.5%.
- 1.3 The performance of individual managers was mixed in the quarter due mainly to the sharp fall in equities. The absolute return managers seem to have been affected the most by the downturn in equities market, but the negative return was not restricted to this asset class.
- 1.4 Three managers matched or achieved returns above the benchmark whilst five 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.
- 1.5 The fall in the equities market over the quarter means that the Fund is modestly below its long term strategic equity asset allocation. However, the distribution of the Fund amongst the different asset classes is broadly in line with the benchmark.
- 1.6 A separate paper on the agenda proposes a rebalancing strategy that should ensure that actual asset allocation broadly reflects the agreed strategic asset allocation going forward.

## **2. DECISIONS REQUIRED**

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

## **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.

## **ALTERNATIVE OPTIONS**

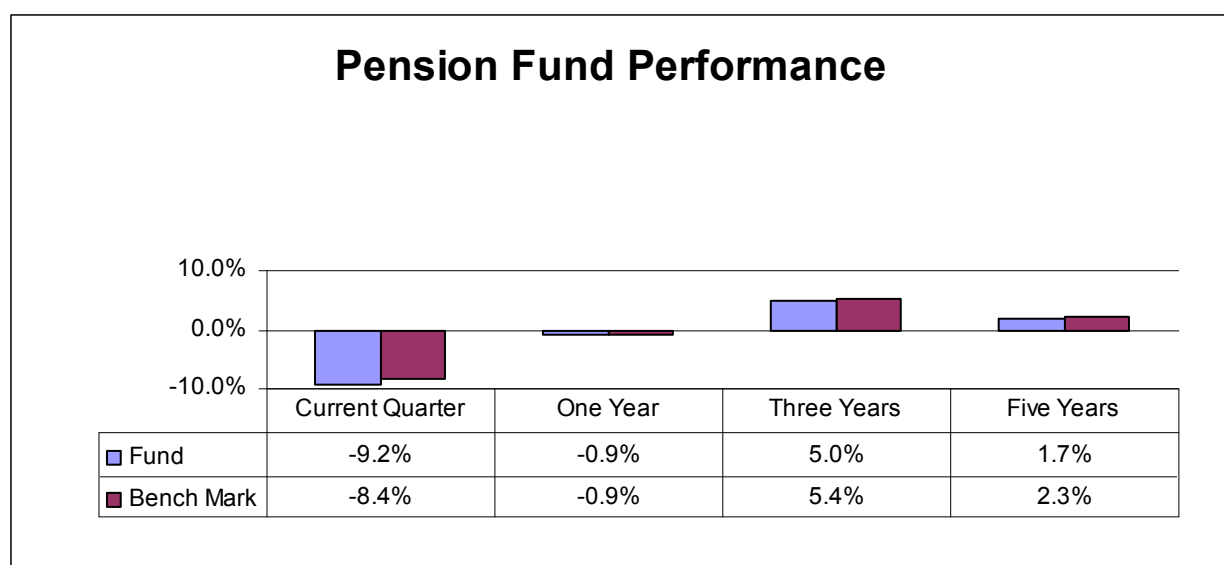
- 4.1 The Pension Fund Regulations requires that the Council establishes arrangements for monitoring the investments of the Pension Fund.

## **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 Investment Adviser, and the Corporate Director of Resources represented by the Service Head Financial Services, Risk and Accountability, one 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 2011.

## **6 INVESTMENT PERFORMANCE**

- 6.1 The Fund achieved a return of -9.2% which is 0.8%% below the benchmark of -8.4%.
- 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	Target % of Fund	Actual % of Fund	Difference %	Date Appointed
GMO	Global Equity	177.9	25.0%	23.4%	-1.6%	29 Apr 2005
Baillie Gifford	Global Equity	115.5	16.0%	15.2%	-0.8%	5 Jul 2007
L & G UK Equity	UK Equity	144.7	20.0%	19.1%	-0.9%	2 Aug 2010
Baillie Gifford Diversified Growth	Absolute Return	39.5	5.0%	5.2%	0.2%	22 Feb 2011
Ruffer Total Return Fund	Absolute Return	39.2	5.0%	5.2%	0.2%	8 Mar 2011
L & G Index Linked-Gilts	Bonds	42.7	3.0%	5.6%	2.6%	2 Aug 2010
Investec Bonds	Bonds	93.1	14.0%	12.3%	-1.7%	26 Apr 2010
Schroder	Property	94.3	12.0%	12.4%	0.4%	30 Sep 2004
Cash	Currency	11.8	0.0%	1.6%	1.6%	
<b>Total</b>		<b>758.7</b>	<b>100.0%</b>	<b>100.0%</b>	<b>0.0%</b>	

- 7.2 The fund value of £758.7 million held by the managers has decreased by £54.2 million (6.7%) 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	0.40%	1.50%	0.10%	0.30%
Baillie Gifford	-0.10%	0.50%	2.70%	2.20%
L & G UK Equity	0.00%	0.10%	N/A	N/A
Baillie Gifford Diversified Growth	-3.90%	-1.80%	N/A	N/A
Ruffer Total Return Fund	-2.30%	-2.40%	N/A	N/A
L & G Index Linked-Gilts	0.00%	0.10%	N/A	N/A
Investec Bonds	-4.10%	-3.60%	-4.50%	N/A
Schroder	-0.60%	-0.60%	-1.30%	-0.10%
<b>Total Variance (Relative)</b>	<b>-0.80%</b>	<b>-0.00%</b>	<b>-0.40%</b>	<b>-0.60%</b>

- 7.4 **GMO** modestly outperformed benchmark over the quarter. Although the Fund returned -14.9% due to its overweight position in European equities which was at the epicentre of the market collapse in this quarter as European equities underperformed global equities by 9%. Despite this loss and continue concerns about Europe, the manager has maintained the overweight position to Eurozone equities based on its belief that Eurozone equities are trading at up to 30% discount to global equities.
- 7.5 **Baillie Gifford** – the Fund performed in line with benchmark over the quarter with positive contributions in some aspects of the Fund being offset by losses in other areas. The make up of the portfolio of holdings remains largely unchanged due to the belief that the growth potential of holdings in the Global Alpha portfolio are largely independent of the macro environment, but more reliant on demand from exposure to geographical sectors such as emerging markets which is seen as robust still.
- 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 underperformed benchmark over the quarter despite returning 1.1%. The European holdings and the impact of currency impact (depreciation of Euro against Sterling) within the Fund continue to adversely impact returns. The portfolio has undergone an intense investment phase over the past 12 months which by itself carries transactions cost – these investments have performed in line with benchmark.
- 7.9 **Investec (Bonds)** Investec had a very poor quarter. The manager admits that they had not envisaged the collapse in investor risk appetite that led to a very sharp sell off in corporate bonds. Although the manager took action to hedge some of the exposure to corporate bonds, and also hedged against currency this was not enough to off-set the impact of their misreading of the market.
- 7.10 **Baillie Gifford Diversified Growth Fund (Absolute Return)** performance this quarter reversed recent gains made by the Fund. The sale of equities significantly impacted performance although some of the negative impact from equities was offset by contributions from other areas such as gold and government bonds.
- 7.11 **Ruffer Total Return Fund (Absolute Return)** although performance was disappointing this quarter, the manager has stuck to its strategy of protecting assets first and seeking value over the longer term and expect that the portfolio's significantly exposure to equities will be rewarded in the long run.

## **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 September 2011 are as set out below:

**Table 4: Asset Allocation**

<b>Mandate</b>	<b>Benchmark 31/09/2011</b>	<b>Fund Position</b>	<b>Variance as at 31/09/2011</b>	<b>Variance as at 31 Mar 2011</b>
UK Equities	20.0%	19.1%	-0.9%	0.9%
Global Equities	41.0%	38.7%	-2.3%	-0.6%
<b>Total Equities</b>	<b>61.0%</b>	<b>57.7%</b>	<b>-3.3%</b>	<b>0.3%</b>
Property	12.0%	12.4%	0.4%	-1.2%
Bonds	14.0%	12.3%	-1.7%	-2.2%
UK Index Linked	3.0%	5.6%	2.6%	1.8%
Alternatives	10.0%	10.4%	0.4%	-0.2%
Cash	0.0%	1.6%	1.6%	1.5%
Currency	0.0%	0.0%	0.0%	0.0%
<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. Given that asset allocation imbalance is a consequence of the relative performance of different asset classes which can be dependent on the prevailing economic conditions at a particular time, it is important that a strategy is in place to periodically rebalance the portfolio to what has been determined to the agreed strategic allocation.
- 8.5 A separate report on the agenda proposes a long term solution to movement in asset allocation caused by relative performance of different asset classes and asks the Committee to agree a rebalancing strategy for the Fund.

## **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.

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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"***

*Review of Investment Managers' Performance for the 3<sup>rd</sup> Quarter Report 2011 – prepared by Hymans Robertson LLP*

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

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