

COMMITTEE: Pensions Committee	DATE: 14 June 2012	CLASSIFICATION: Unrestricted	REPORT NO.	AGENDA NO. 6.2
REPORT OF: Corporate Director of Resources		TITLE: Report of Investment Panel for Quarter Ending 31 March 2012.		
ORIGINATING OFFICER(S): Oladapo Shonola – Chief Financial Strategy Officer		Ward(s) affected: N/A		

Lead Member	Cllr Alibor Choudhury - Resources
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 March 2012.
- 1.2 In the quarter to the end of March 2012 the Fund achieved a return of 4.8% which is 0.2% below the benchmark 5.0%. The twelve month Fund return of 1.6% is also slightly below benchmark at 1.8%. For longer periods, performance continued to lag the benchmark with the three year return at 12.9%, which is 0.4% behind benchmark of 13.4% and the five year return of 2.6% underperforming the benchmark by 0.4% at 3.0%.
- 1.3 The performance of individual managers was mixed in the quarter resulting in an overall portfolio performance that was moderately behind benchmark. Absolute return managers continue to make positive contributions, which is a reflection of the rally in global equity markets. As is often the case, the rising equities market had a negative effect on the relative performance of GMO, who were the biggest contributor to negative performance in the quarter.
- 1.4 Five managers matched or achieved returns above the benchmark whilst three were below. The variability of returns does however partially reflect the management structure of the fund where complementary investment styles reduce the volatility of overall portfolio returns.
- 1.5 The rise in most asset classes over the quarter means that the Fund is now essentially back in line with its long term strategic equity asset allocation and the distribution of the Fund amongst the different asset classes is broadly in line with benchmark.
- 1.6 A separate paper on the agenda proposes a rebalancing strategy that should ensure that actual asset allocation remains broadly in line with agreed strategic asset allocation going forward.

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 committee members of the performance of pension fund managers and the overall performance of the Tower Hamlets Pension Fund.

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.

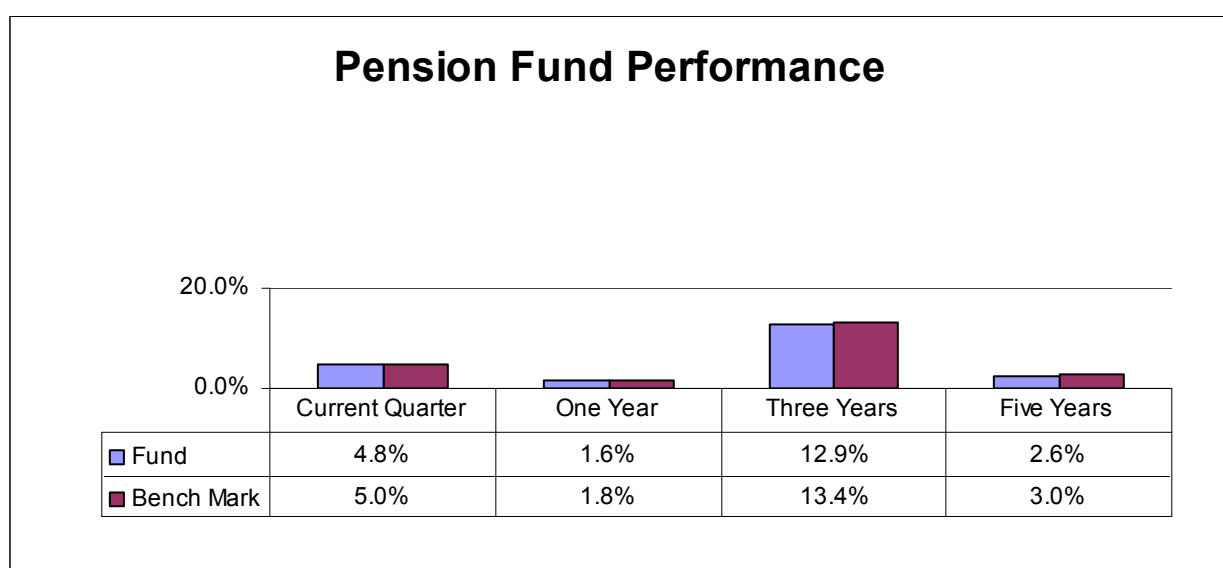
5.2 This Committee has established the Investment Panel, which meets quarterly for this purpose. The Panel's membership comprises all Members of the Pensions Committee, an Investment Professional as Chair, an Independent Investment Adviser, and the Corporate Director of Resources represented by the Service 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 31 March 2012.

6 INVESTMENT PERFORMANCE

6.1 The Fund achieved a return of 4.8% which is 0.2% below the benchmark of 5.0%.

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, mandate and funds held under management are set out below:

Table 2: Management Structure

Manager	Mandate	Value £M	Target % of Fund	Actual % of Fund	Difference %	Date Appointed
GMO	Global Equity	200.2	25.0%	24.1%	-0.9%	29 Apr 2005
Baillie Gifford	Global Equity	137.0	16.0%	16.5%	0.5%	5 Jul 2007
L & G UK Equity	UK Equity	166.5	20.0%	20.0%	0.0%	2 Aug 2010
Baillie Gifford Diversified Growth	Absolute Return	41.7	5.0%	5.0%	0.0%	22 Feb 2011
Ruffer Total Return Fund	Absolute Return	41.0	5.0%	4.9%	-0.1%	8 Mar 2011
L & G Index Linked- Gilts	UK Index Linked	46.0	3.0%	5.5%	2.5%	2 Aug 2010
Investec Bonds	Bonds	95.5	14.0%	11.5%	-2.5%	26 Apr 2010
Schroder	Property	95.1	12.0%	11.4%	-0.6%	30 Sep 2004
Cash	Currency	7.6	0.0%	0.9%	0.9%	
Total		830.8	100.0%	100.0%	0.0%	

- 7.2 The fund value of £830.8 million held by the managers has increased by £35.7 million (4.49%) 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	-2.80%	-0.60%	-0.70%	-0.20%
Baillie Gifford	1.10%	1.70%	3.70%	2.30%
L & G UK Equity	0.10%	0.10%	0.10%	N/A
Baillie Gifford Diversified Growth	5.00%	4.00%	3.90%	N/A
Ruffer Total Return Fund	1.80%	2.50%	1.40%	N/A
L & G Index Linked-Gilts	0.00%	0.10%	0.10%	N/A
Investec Bonds	2.10%	-2.90%	-2.20%	N/A
Schroder	-0.60%	-1.50%	-3.30%	-0.60%
Total Variance (Relative)	-0.20%	-0.10%	-0.40%	-0.40%

- 7.4 **GMO** underperformance this quarter continues a trend where the managers relative performance in rising markets have tended to be worse than falling markets as a result of the portfolio being skewed toward defensive sectors (e.g. Health Care, Telecommunications, Utilities and Energy). The portfolio is underweight financial sector which was one of the best performing sectors in the quarter. The Funds strategic allocation is currently overweight Eurozone companies because the manager believes that these companies stocks are priced at a discount due to pessimism toward Eurozone economies. Specifically, GMO believe that Eurozone stocks in Telecoms, Energy and Pharmaceuticals should offer good returns in the future.
- 7.5 **Baillie Gifford** – the fund outperformed in the quarter with stock selection driving returns. Main contributors to performance include Svenska Handelsbanken, a Swedish bank and Naspers, a South African media company. The portfolio strategy continues to lean toward growth stocks and the manager has been able to purchase companies with faster than average growth prospects at a discount.
- 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 **Investec (Bonds)** – the fund return 2.2% last quarter, which equates to a 2.1% outperformance of the benchmark of 0.1%. All areas of the portfolio contributed to performance. Corporate bonds performed strongly on the back of the second round of European Long-Term Refinancing (ELTR) operation. Emerging markets was an equally strong performer in the quarter adding 0.6% to relative performance.
- 7.9 **Schroder (Property)** - Although overall fund return was positive (0.2%), performance lagged benchmark of 0.8%. Continental Europe continues to be a drag on returns, but the manager’s view is that there will be limited opportunity to exit or reduce Eurozone holdings. UK performance has picked up since the crash of 2009/10, but 3 year performance remains below the benchmark.
- 7.10 **Baillie Gifford Diversified Growth Fund (Absolute Return)** the fund has had another strong quarter delivering returns of 5.1%, which is 5.0% above benchmark of 0.1%.
- 7.11 **Ruffer Total Return Fund (Absolute Return)** the fund overperformed benchmark (0.3%) by 1.8%, delivering absolute return of 2.1%. Positive contributors to performance included the fund’s holdings in Japanese equities.

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 31 March 2012 are as set out below:

Table 4: Asset Allocation

Mandate	Benchmark 31 Mar 2012	Fund Position	Variance as at 31 Mar 2012	Variance as at 31 Mar 2011
UK Equities	20.0%	20.0%	0.0%	0.9%
Global Equities	41.0%	40.6%	-0.4%	-0.6%
Total Equities	61.0%	60.6%	-0.4%	0.3%
Property	12.0%	11.5%	-0.5%	-1.2%
Bonds	14.0%	11.5%	-2.5%	-2.2%
UK Index Linked	3.0%	5.5%	2.5%	1.8%
Alternatives	10.0%	10.0%	0.0%	-0.2%
Cash	0.0%	0.9%	0.9%	1.5%
Currency	0.0%	0.0%	0.0%	0.0%
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. 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.

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 1st Quarter Report 2012 – prepared by Hymans Robertson LLP

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

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