

COMMITTEE: Pensions Committee	DATE: 15 November 2012	CLASSIFICATION: Unrestricted	REPORT NO.	AGENDA NO.
REPORT OF: Corporate Director of Resources		TITLE: Report of Investment Panel for Quarter Ending 30 June 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 30 June 2012.
- 1.2 In the quarter to the end of June 2012 the Fund achieved a return of -2.6% which is 0.5% below the benchmark -2.1%. The twelve month Fund return of -2.5% significantly lags benchmark by -1.1% at -1.4%. Over the longer term, performance is more in line with benchmark.
- 1.3 Four managers matched or achieved returns above the benchmark and the other four 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. For example, in contrast to poor quarter returns for Baillie Gifford, GMO, the Fund's other global equity manager matched its benchmark in what was a challenging quarter for global equities.
- 1.4 The Fund is still in line with its long term strategic equity asset allocation and the distribution of the Fund's assets amongst the different asset classes is broadly in line with 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 committee members of the performance of pension fund managers and the overall performance of the Tower Hamlets Pension Fund.

4. ALTERNATIVE OPTIONS

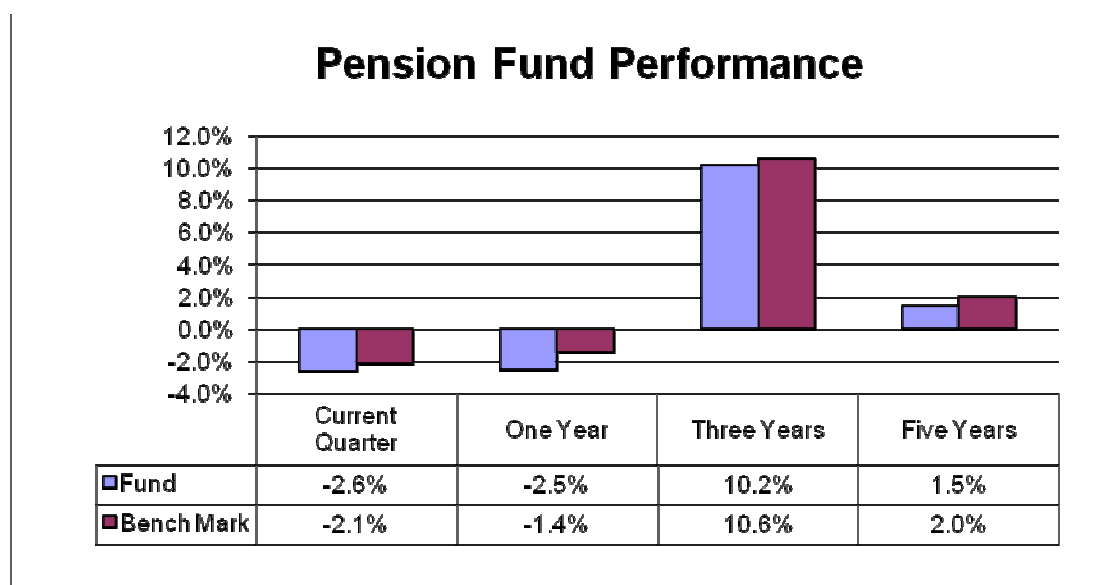
- 4.1 The Pension Fund Regulations require that the Council establishes arrangements for monitoring the investments of the Pension Fund.

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. Officers and fund advisers meet regularly with investment managers to discuss their strategy and performance and may recommend that investment managers are invited to explain further to the Investment Panel.
- 5.4 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 2012.

6. **INVESTMENT PERFORMANCE**

- 6.1 The Fund achieved a return of -2.6% in the quarter which is -0.5% below the benchmark of -2.1%.
- 6.2 The performance of the fund over the longer term is as set out in table 1.



- 6.3 The chart 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	191.5	25.0%	23.7%	-1.3%	29 Apr 2005
Baillie Gifford	Global Equity	130.1	16.0%	16.1%	0.1%	5 Jul 2007
L & G UK Equity	UK Equity	162.2	20.0%	20.0%	0.0%	2 Aug 2010
Baillie Gifford Diversified Growth	Absolute Return	42.0	5.0%	5.2%	0.2%	22 Feb 2011
Ruffer Total Return Fund	Absolute Return	39.8	5.0%	4.9%	-0.1%	8 Mar 2011
L & G Index Linked-Gilts	UK Index Linked	46.4	3.0%	5.7%	2.7%	2 Aug 2010
Investec Bonds	Bonds	95.1	14.0%	11.7%	-2.3%	26 Apr 2010
Schroder	Property	94.8	12.0%	11.7%	-0.3%	30 Sep 2004
Cash	Currency	8.4	0.0%	1.0%	1.0%	
Total		810.3	100.0%	100.0%	0.0%	

7.2 The fund value of £810.3 million as at 30 June 2012, which includes cash held, has decreased by £20.5 million (2.47%) over the quarter. This was particularly driven by equity prices which continue to be affected by uncertainties in the Eurozone.

7.3 The performance of the individual managers relative to the appropriate benchmark 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	0.00%	-1.60%	-0.30%	-0.20%
Baillie Gifford	-1.30%	-0.10%	2.60%	1.90%
L & G UK Equity	0.00%	0.10%	0.10%	N/A
Baillie Gifford Diversified Growth	0.50%	2.40%	3.60%	N/A
Ruffer Total Return Fund	-3.30%	-1.80%	-1.40%	N/A
L & G Index Linked-Gilts	0.00%	0.00%	0.10%	N/A
Investec Bonds	-0.50%	-2.40%	-2.20%	N/A
Schroder	-0.70%	-2.40%	-2.10%	-1.00%
Total Variance (Relative)	-0.50%	-1.10%	-0.40%	-0.50%

7.4 **GMO** performed in line with benchmark in this quarter at -4.4% against a benchmark of -4.4% giving a relative performance of 0%. The portfolio suffered losses as a result of overweight exposure to European equities, but some of these losses were offset by stock selection. The portfolio is also currently overweight defensive stocks which partly accounts for the resilience of the Fund in a falling market. Looking ahead, the manager is confident that its overweight position in the Eurozone will eventually pay off and believe that the worst outcomes have already been discounted into European equity prices.

- 7.5 **Baillie Gifford** – has experienced its first negative quarter in over 3 years, but the manager is convinced that the portfolio is well placed to recover lost ground. The Fund delivered return of -4.9% against a benchmark of -3.6% resulting in relative underperformance of -1.3%. The portfolio was affected by the fall in equities due to concerns over the Eurozone, but the major detractor in the quarter was the performance of OGX, a Brazilian oil company which announced disappointing results. It is worth noting that the manager's long term performance is still good. Looking ahead, the manager is confident that they can continue to find growth opportunities in what they acknowledge is a challenging macroeconomic environment.
- 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)**– delivered a return of -0.4% this quarter against a benchmark of 0.1%, which equates to underperformance of -0.5%. Corporate bonds were a major drag on performance, but some hedging helped to minimise losses. Currency also detracted from performance over the quarter with a number of Asian and emerging market positions hurting performance. Looking ahead, the manager has reduced underweight exposure to the Euro in the expectation of a recovery.
- 7.9 **Schroder (Property)**– delivered a return of -0.4% this quarter against a benchmark of 0.3%, which equates to a relative underperformance of -0.7%. European property and currency continue to detract from performance, especially Spanish and Portuguese properties. Schroders continue to aim to lower the portfolio risk profile by aiming for an ungeared balanced portfolio and also add properties that offer attractive levels of income.
- 7.10 **Baillie Gifford Diversified Growth Fund (Absolute Return)** the fund delivered a return of 0.6% this quarter against a benchmark of 0.1%, which equates to a relative outperformance of 0.5%. The Baillie Gifford absolute return mandate, continue to perform strongly as it has done since inception.
- 7.11 **Ruffer Total Return Fund (Absolute Return)**– this was a particularly poor quarter for Ruffer. It delivered returns of -3.0% against a benchmark of 0.3%, which equates to a relative underperformance of -3.3%. Unlike the Baillie Gifford absolute return fund, the Ruffer fund is far more exposed to equities with nearly half of fund assets allocated to equities, so more susceptible to changes in the economic sensitive equities market. Consequently, the fall in global equity prices had a significant impact on returns. The portfolio manager is looking for opportunities to reduce exposure to equities given ongoing concerns with corporate earnings growth.

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 2012 are as set out below:

Table 4: Asset Allocation

Mandate	Benchmark 30 Jun 2012	Fund Position	Variance as at 30 Jun 2012	Variance as at 31 Mar 2012
UK Equities	20.0%	20.0%	0.0%	0.0%
Global Equities	41.0%	39.8%	-1.3%	-0.4%
Total Equities	61.0%	59.8%	-1.3%	-0.4%
Property	12.0%	11.7%	-0.3%	-0.5%
Bonds	14.0%	11.7%	-2.3%	-2.5%
UK Index Linked	3.0%	5.7%	2.7%	2.5%
Alternatives	10.0%	10.1%	0.1%	0.0%
Cash	0.0%	1.0%	1.0%	0.9%
Currency	0.0%	0.0%	0.0%	0.0%
Total Equities	100.0%	100.0%		

8.3 Allocations are therefore considered to be broadly in line with the benchmark. Individual managers have discretion within defined limits to vary the asset distribution. At its last meeting, Committee agreed to use L&G as a 'swing manager' to rebalance between equities and bonds where necessary, since L&G manages both an equities mandate and a bonds mandate on behalf of 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 the Council and 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
2nd Quarter Report 2012 – prepared by Hymans Robertson
LLP*

***Name and telephone number of holder
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