

<b>COMMITTEE:</b> <b>Pensions Committee</b>	<b>DATE:</b> <b>13 June 2013</b>	<b>CLASSIFICATION:</b> <b>Unrestricted</b>	<b>REPORT NO.</b>
<b>REPORT OF:</b> <b>Interim Corporate Director of Resources</b>		<b>TITLE:</b> <b>Report of Investment Panel for Quarter Ending 31 December 2012.</b>	
<b>ORIGINATING OFFICER(S):</b> Paul Thorogood –Interim Service Head, Finance and HR Development Oladapo Shonola – Chief Financial Strategy Officer		<b>Ward(s) affected:</b> N/A	

<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 31 December 2012.
- 1.2 In the quarter to the end of December 2012 the Fund achieved a return of 2.8% which is 0.5% above the benchmark 2.3%. The twelve month Fund return of 7.7% exceeds the benchmark by 0.1% at 7.6%. Over the longer term, performance is in line with benchmark.
- 1.3 Although, the level of returns achieved varies between the managers, seven out of eight managers matched or achieved returns above the benchmark. 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 lags benchmark. It should also be noted that GMO have achieved returns of 8% in the past 12 months.
- 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**

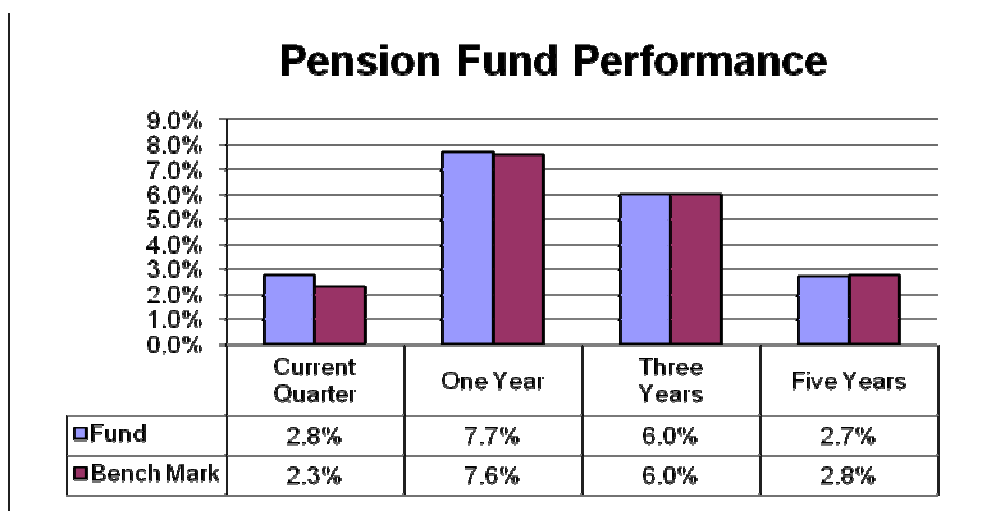
- 4.1 The Pension Fund Regulations require that the Council establishes arrangements for monitoring the investments of the Pension Fund.

## 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 31 December 2012.

## 6 **INVESTMENT PERFORMANCE**

- 6.1 The Fund achieved a return of 2.8% in the quarter which is 0.5% above the benchmark of 2.3%.
- 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	204.2	25.0%	23.9%	-1.1%	29 Apr 2005
Baillie Gifford	Global Equity	140.8	16.0%	16.5%	0.5%	5 Jul 2007
L & G UK Equity	UK Equity	176.3	20.0%	20.6%	0.6%	2 Aug 2010
Baillie Gifford Diversified Growth	Absolute Return	44.1	5.0%	5.2%	0.2%	22 Feb 2011
Ruffer Total Return Fund	Absolute Return	41.3	5.0%	4.8%	-0.2%	8 Mar 2011
L & G Index Linked-Gilts	UK Index Linked	47.2	3.0%	5.5%	2.5%	2 Aug 2010
Investec Bonds	Bonds	96.9	14.0%	11.3%	-2.7%	26 Apr 2010
Schroder	Property	94.7	12.0%	11.1%	-0.9%	30 Sep 2004
Cash	Currency	9.0	0.0%	1.1%	1.1%	
<b>Total</b>		<b>854.5</b>	<b>100.0%</b>	<b>100.0%</b>	<b>0.0%</b>	

- 7.2 The fund value of £854.5 million as at 31 December 2012, which includes cash held, has increased by £24.3million (2.92%) 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	-0.70%	-3.90%	-0.40%	-0.10%
Baillie Gifford	0.70%	1.70%	2.30%	2.10%
L & G UK Equity	0.00%	0.10%	0.20%	N/A
Baillie Gifford Diversified Growth	2.90%	11.00%	5.40%	N/A
Ruffer Total Return Fund	2.70%	2.00%	0.90%	N/A
L & G Index Linked-Gilts	0.00%	0.10%	0.00%	N/A
Investec Bonds	0.80%	3.30%	-1.30%	N/A
Schroder	0.50%	-0.60%	-1.60%	-0.90%
<b>Total Variance (Relative)</b>	<b>0.10%</b>	<b>0.00%</b>	<b>-0.30%</b>	<b>-0.40%</b>

- 7.4 **GMO** underperformed benchmark this quarter, delivering returns of 3.4% which was 0.7% below its benchmark of 4.1%. The portfolio has two main strategies - Momentum and Value. Momentum strategy looks to take advantage of current trends in the market (i.e. buy rising stocks and sell falling stocks) whereas value strategy invests for the long term and seeks to invest in stocks that are trading at lower values than what indicators such as dividend yield, earnings, etc. suggest they should be trading at. For this quarter, the negative returns from the momentum strategy were such that they could not be fully recovered from positive returns from the value strategy, hence the underperformance. The momentum

strategy has performed well in the past whilst also providing some portfolio diversification, but recent successes meant that the portfolio was overweight momentum when value stocks started to increase in value due to renewed optimism about the economy.

- 7.5 **Baillie Gifford Global Alpha Fund** delivered returns of 3.0% outperforming its benchmark by 0.7% in this quarter. Baillie Gifford are confident about the fund's portfolio and their ability to continue to pick growth stocks. The portfolio benefited from not holding any Apple stocks this quarter as the company shares fell significantly over the quarter.
- 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 portfolio delivered strong returns this quarter with return of 1.0% against benchmark by 0.9%. The main contributor to out-performance was exposure to emerging markets debts, in particular South African bonds performed well this quarter as prices recovered from falls earlier in the year caused by labour disputes and sovereign credit downgrade.
- 7.9 **Schroder (Property)** achieved returns of 0.1% against benchmark of -0.4%, therefore, outperforming its benchmark by 0.5%. Most of the out-performance over this quarter and the past 12 months have come from UK property holdings even as European property continue to be a drag on the portfolio.
- 7.10 **Baillie Gifford Diversified Growth Fund (Absolute Return)** fund delivered a return of 2.9% this quarter against a benchmark of 0.1%, which equates to a relative out-performance of 2.8%. This was another strong quarter for Baillie Gifford absolute return mandate as it continues to post strong returns for the Fund. Local currency emerging markets contributed significantly to this quarter's out-performance as the portfolio has a significant allocation to these markets. Although, the strongest contributor to this quarter's performance was from the basket of private equity funds in the portfolio.
- 7.11 **Ruffer Total Return Fund (Absolute Return)** the fund posted strong figures for Q4 delivering returns of 2.8% against a benchmark of 0.1%, which equates to a relative out-performance of 2.7%. The fund benefited from the Japanese equities rebound following the re-election of Shinzo Abe as the Prime Minister.

## **8 ASSET ALLOCATION**

- 8.1 The original 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 December 2012 are as set out below:

**Table 4: Asset Allocation**

<b>Mandate</b>	<b>Benchmark 31 Dec 2012</b>	<b>Fund Position</b>	<b>Variance as at 31 Dec 2012</b>	<b>Variance as at 31 Mar 2012</b>
UK Equities	20.0%	20.6%	0.6%	0.0%
Global Equities	41.0%	40.4%	-0.6%	-0.4%
<b>Total Equities</b>	<b>61.0%</b>	<b>61.0%</b>	<b>0.0%</b>	<b>-0.4%</b>
Property	12.0%	11.1%	-0.9%	-0.5%
Bonds	14.0%	11.3%	-2.7%	-2.5%
UK Index Linked	3.0%	5.5%	2.5%	2.5%
Alternatives	10.0%	10.0%	0.0%	0.0%
Cash	0.0%	1.1%	1.1%	0.9%
Currency	0.0%	0.0%	0.0%	0.0%
<b>Total Equities</b>	<b>100.0%</b>	<b>100.0%</b>		

- 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.

## **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.

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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"*

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

None