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| COMMITTEE: Pensions Committee | DATE: 14 November 2013 | CLASSIFICATION: Unrestricted | AGENDA NO. |
| REPORT OF: Interim Corporate Director of Resources ORIGINATING OFFICER(S): Paul Thorogood –Interim Service Head, Finance and HR Development Oladapo Shonola – Chief Financial Strategy Officer | | TITLE: Report of Investment Panel for Quarter Ending 30 June 2013. Ward(s) affected: N/A | |

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 2013.
- 1.2 In the quarter to the end of June 2013 the Fund achieved a return of 0.1% which is 0.4% above the benchmark -0.3%. The twelve month Fund return of 15.0% exceeds the benchmark by 2.0% at 13.0%. Over the longer term, performance is ahead of the benchmark with three year returns of 9.8% being 0.9% above the benchmark and five year returns matches benchmark of 6.0%.
- 1.3 The latest performance figures show that performance is heading in the right direction and the Fund matches or ahead of benchmark over all reported time periods. This is as a result of a combination of market recovery, especially equities, and strategic decisions made by the Investment Panel on new allocations and investment manager appointments.
- 1.4 Five out of eight managers matched or achieved returns above the benchmark in this quarter. It was a relatively good month for global equity with both GMO and Baillie Gifford returning significant relative outperformance over benchmark. Both of the absolute return managers, Baillie Gifford Diversified Growth and Ruffer, underperformed benchmark along with the property mandate holder, Schroders.
- 1.5 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.

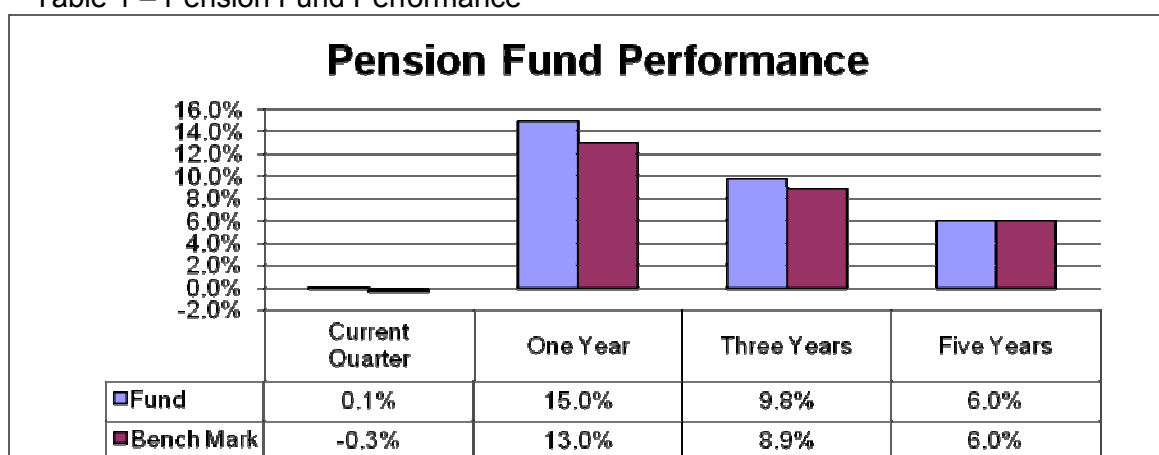
5. BACKGROUND

- 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 2013.

6 INVESTMENT PERFORMANCE

- 6.1 The Fund achieved a return of 0.1% in the quarter which is 0.4% above the benchmark of -0.3%.
- 6.2 The performance of the fund over the longer term is as set out in table 1.

Table 1 – Pension Fund Performance



- 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 pension 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 | 232.6 | 25.0% | 25.0% | 0.0% | 29 Apr 2005 |

| | | | | | | |
|----------------------------|-----------------|--------------|---------------|---------------|-------------|-------------|
| Baillie Gifford | Global Equity | 165.9 | 16.0% | 17.8% | 1.8% | 5 Jul 2007 |
| L & G UK Equity | UK Equity | 191.5 | 20.0% | 20.6% | 0.6% | 2 Aug 2010 |
| Baillie Gifford Div Growth | Absolute Return | 45.0 | 5.0% | 4.8% | -0.2% | 22 Feb 2011 |
| Ruffer Total Return Fund | Absolute Return | 45.0 | 5.0% | 4.8% | -0.2% | 8 Mar 2011 |
| L & G Index Linked-Gilts | UK Index Linked | 47.6 | 3.0% | 5.1% | 2.1% | 2 Aug 2010 |
| Investec Bonds | Bonds | 97.2 | 14.0% | 10.4% | -3.6% | 26 Apr 2010 |
| Schroder | Property | 96.8 | 12.0% | 10.4% | -1.6% | 30 Sep 2004 |
| Cash | Currency | 9.4 | 0.0% | 1.0% | 1.0% | |
| Total | | 931.0 | 100.0% | 100.0% | 0.0% | |

7.2 The fund value of £931 million as at 30 June 2013, which includes cash held, has remained stable over the quarter.

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 | 2.00% | -1.50% | -0.50% | -0.40% |
| Baillie Gifford | 2.00% | 5.70% | 2.80% | 2.10% |
| L & G UK Equity | 0.00% | 0.10% | 0.20% | N/A |
| Baillie Gifford Diversified Growth | -2.80% | 7.20% | 5.10% | N/A |
| Ruffer Total Return Fund | -1.30% | 12.50% | 4.30% | N/A |
| L & G Index Linked-Gilts | 0.00% | 0.00% | 0.00% | N/A |
| Investec Bonds | 0.00% | 1.70% | 0.40% | -1.10% |
| Schroder | -0.30% | 0.20% | -0.70% | -0.90% |
| Total Variance (Relative) | 0.10% | 0.00% | -0.30% | -0.40% |

7.4 **GMO** made absolute return of 2.3% in the quarter, outperforming benchmark and target by 2% and 0.5% respectively. Although, this quarter's results help to mitigate recent underperformance, long term performance still lags benchmark/target significantly. The portfolio continues to benefit from the overweight position in Japan, which was the best performing equity market over the quarter. In terms of performance of asset type, the value based stocks in the financial and insurance sectors were the largest contributor to performance in the quarter.

7.5 **Baillie Gifford** returned 1.9% in the quarter against a benchmark of -0.1% resulting in relative outperformance of 2% - over 3 year relative return exceed target by 0.3%. Two notable contributors to outperformance this quarter are Tesla Motors and Ryanair. Tesla stocks benefited from the release of positive quarterly results, whilst Ryanair continues to grow its market share and thus generating strong revenues.

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 matched benchmark of 0.1% this quarter. Although the portfolio has outperformed benchmark by 1.7% over the past 12 months, this falls short of the target of 2% and longer term performance significantly lags benchmark/target. The portfolio's interest rate strategy was the main contributor to outperformance this quarter along with some defensive positioning borne out by debt holdings in developed markets. The manager believes that there are still opportunities in emerging markets going forward and are encouraged by improved valuations of corporate bonds.
- 7.9 **Schroder (Property)** marginally underperformed benchmark by 0.3% in the quarter. The portfolio of assets continues to suffer from underperformance in Continental Europe, but some of this underperformance was mitigated by outperformance in the UK. In the longer term, performance lags benchmark/target.
- 7.10 **Baillie Gifford Diversified Growth Fund** underperformed benchmark by 2.7% this quarter. This quarter's performance reverses some of the gains made in the last quarter pegging back year to date returns to 2.3%. Return in the longer term is ahead of benchmark and portfolio volatility is also within target. Underperformance this quarter was mostly as a result of losses relating to gold and emerging market bonds, although some of the losses were mitigated by gains in insurance linked securities and infrastructure holdings.
- 7.11 **Ruffer Total Return Fund (Absolute Return)** underperformed by 1.3% in the quarter. Similar to Baillie Gifford, the Ruffer portfolio suffered from a fall in the value of gold and gold mining stocks. But the portfolio benefited from its exposure to Japanese equities. The portfolio maintains a high allocation (33%) to index linked holdings an indication of the manager's continued concerns regarding inflation.

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 30 June 2013 are as set out below:

Table 4: Asset Allocation

| Mandate | Benchmark 30 Jun 2013 | Fund Position | Variance as at 30 Jun 2013 | Variance as at 31 Mar 2012 |
|-----------------------|----------------------------------|--------------------------|---|---|
| UK Equities | 20.0% | 20.6% | 0.6% | 0.0% |
| Global Equities | 41.0% | 42.8% | 1.8% | -0.4% |
| Total Equities | 61.0% | 63.4% | 2.4% | -0.4% |
| Property | 12.0% | 10.4% | -1.6% | -0.5% |
| Bonds | 14.0% | 10.4% | -3.6% | -2.5% |
| UK Index Linked | 3.0% | 5.1% | 2.1% | 2.5% |
| Alternatives | 10.0% | 9.7% | -0.3% | 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.

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 Regulation 11(3) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 requires the Council, as an administering authority, to invest fund money that is not needed immediately to make payments from the Pensions Fund. Regulation 11(1) requires the Council to have a policy in relation to its investments. The investment policy must be formulated with a view –

(a) to the advisability of investing money in a wide variety of investments; and
 (b) to the suitability of particular investments and types of investments. The Council is also required to have a Statement of Investment Principles in accordance with regulation 12 (1) which cover the following matters:

- (a) the types of investment to be held;
- (b) the balance between different types of investments;
- (c) risk, including the ways in which risks are to be measured and managed;
- (d) the expected return on investments;
- (e) the realisation of investments;
- (f) the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments;
- (g) the exercise of the rights (including voting rights) attaching to investments, if the authority has any such policy; and
- (h) stock lending.

In accordance with Regulation 11(5), The Council is required to take proper advice at reasonable intervals about its investments and must consider such advice when taking any steps in relation to its investments.

- 10.2 Under regulation 8(1), 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"

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

None