

COMMITTEE: Pensions Committee	DATE: 25 February 2014	CLASSIFICATION: Unrestricted	REPORT NO. .
REPORT OF: Interim Corporate Director of Resources ORIGINATING OFFICER(S): Kevin Miles – Chief Accountant		TITLE: Report of Investment Panel for Quarters Ending 30 September and 31 December 2013 Ward(s) affected: N/A	

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 two quarters ending 31st December 2013. Full details are contained in Hymans Robertson's quarterly reports for the two quarters are the appendices to this report.
- 1.2 In the quarter to the end of September 2013 the Fund achieved a return gross of fees of 3.0% which is 0.5% above the benchmark of 2.5%. In the quarter to December there was a return of 4.1% compared to a benchmark of 3.7%. The twelve month Fund return of 15.5% exceeds the benchmark by 1.9% at 13.6%. Over the longer term, performance is ahead of the benchmark with three year returns of 8.1% being 0.2% above the benchmark and five year returns of 8.1%, 0.1% under the benchmark of 8.2%.
- 1.3 The latest performance figures show that performance is heading in the right direction and the Fund matches or is ahead of benchmark over all reported time periods except for the five year time span. 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 Six out of eight managers matched or achieved returns above the benchmark in the December quarter, this is up from five in the previous quarter. It was a relatively good half year for global equity with both GMO and Baillie Gifford returning relative outperformance over benchmark. Of the absolute return managers, Baillie Gifford Diversified Growth outperformed the benchmark in both quarters. Ruffer outperformed in the December quarter but was behind the benchmark in the September quarter. Schroder's, the property mandate holder and Investec, the bond fund manager underperformed the benchmark in both quarters.
- 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.

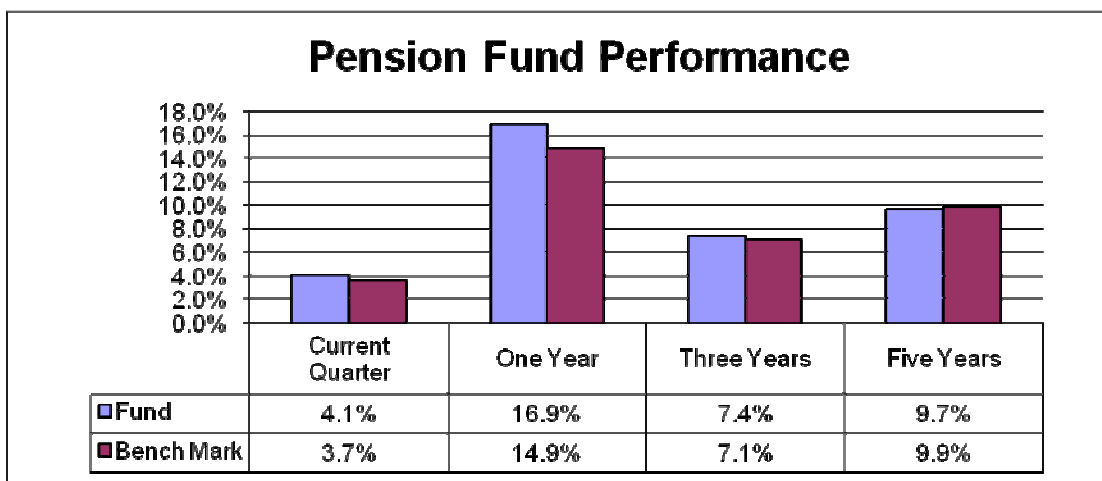
5. BACKGROUND

- 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 half year ending 31 December 2013.

6 INVESTMENT PERFORMANCE

- 6.1 In the September quarter, the Fund achieved a return of 3.0% (gross of fees) which is 0.5% above the benchmark of +2.5%. Net of fees, the performance was +2.9%, 0.4% above the benchmark.
- 6.2 In the December quarter, the Fund achieved a return of 4.1% (gross of fees) which is 0.4% above the benchmark of +3.7%. Net of fees, the performance was +4.0%, 0.4% above the benchmark.
- 6.3 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 Dec 2013 £M	Target % of Fund	Actual % of Fund	Difference %	Value Sept 2013 £M	Date Appointed
GMO	Global Equity	255.4	25.0%	25.6%	0.6%	242.0	29 Apr 2005
Baillie Gifford	Global Equity	179.4	16.0%	18.0%	2.0%	170.6	5 Jul 2007
L & G UK Equity	UK Equity	213.4	20.0%	21.4%	1.4%	202.3	2 Aug 2010
Baillie Gifford Diversified Growth	Absolute Return	46.5	5.0%	4.7%	-0.3%	45.5	22 Feb 2011
Ruffer Total Return Fund	Absolute Return	45.4	5.0%	4.5%	-0.5%	44.9	8 Mar 2011
L & G Index Linked-Gilts	UK Index Linked	47.5	3.0%	4.8%	1.8%	47.9	2 Aug 2010
Investec Bonds	Bonds	97.4	14.0%	9.7%	-4.3%	96.9	26 Apr 2010
Schroder	Property	102.3	12.0%	10.2%	-1.8%	98.7	30 Sep 2004
Cash	Currency	11.7	0.0%	1.1%	1.1%	8.2	
Total		998.9	100.0%	100.0%	0.0%	957.0	

7.2 The fund value of £957 million as at 30 September 2013, which includes cash held, has increased by over 7% in the last six months.

7.3 The performance, gross of fees 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	Previous Quarter	One Year	Three Years	Five Years
GMO	1.20%	1.30%	2.20%	0.20%	-0.60%
Baillie Gifford	0.20%	1.70%	5.50%	2.60%	4.10%
L & G UK Equity	0.00%	0.00%	0.20%	0.10%	0.20%
Baillie Gifford Diversified Growth	1.50%	0.10%	1.90%	1.80%	N/A
Ruffer Total Return Fund	0.40%	-0.80%	6.70%	1.50%	N/A
L & G Index Linked-Gilts	0.00%	0.10%	0.10%	0.10%	0.00%
Investec Bonds	-0.10%	-0.90%	-1.90%	-2.60%	-3.10%
Schroder	-0.60%	-0.30%	-1.00%	-0.90%	-2.10%
Total Variance (Relative)	+0.40%	+0.50%	+1.80%	+0.30%	-0.20%

- 7.4 **GMO** made absolute return of 5.5% in the quarter, outperforming the benchmark of 4.3%. by 1.2% (Sept. - 4.1% v 2.6% benchmark). Although the last three quarter's results has been above benchmark and help to mitigate recent underperformance in 2012, long term performance still lags slightly benchmark/target. The portfolio benefited from Europe and US stock selection in the last quarter. Though high quality US shares underperformed, GMO believe that these represent good value compared to other stocks.
- 7.5 In the quarter to December, GMO have announced that they are changing their investment strategy – this will mean that they will not be looking for returns from “momentum stocks” and instead will focus on return from value stocks. Officers had a meeting with GMO in December to discuss this change in investment strategy. GMO are convinced that this change to their investment strategy will be beneficial to the pension scheme.
- 7.6 **Baillie Gifford** returned 5.2% in the quarter against a benchmark of 5.0% resulting in relative outperformance of 0.2% (Sept – 2.9% v 1.7% benchmark). Over 12 months, a return of 27.8% is 5.5% above the benchmark. Over 3 years relative return exceeded benchmark by 2.6%, which is in line with their target. Two notable contributors to outperformance over the last quarter were Amazon and Prudential. Baillie Gifford believes emerging markets remain a good long term investment.
- 7.7 **L & G (UK Equity)** performance has been in line with the index benchmark (FTSE-All Share) since inception, as expected.
- 7.8 **L & G Index Linked Gilts** performance has been generally in line with the index benchmark (FTSE-A Index-Linked Over 15 Years Gilts) since inception.
- 7.9 **Investec (Bonds)** – The fund return was behind the benchmark of 0.6% by 0.1% this quarter (Sept 0.6% v 0.9% benchmark). Though corporate bond investment performed well in the quarter, exposure to emerging and US dollar currencies has been the main reason for underperformance this half year. The portfolio has been behind the benchmark since inception.
- 7.10 **Schroder (Property)** marginally underperformed benchmark by 0.6% in the quarter and by 0.3% in the previous quarter. The third quarter underperformance was due to investment in Continental Europe, though UK investments outperformed. In the longer term, performance lags benchmark/target. The manager is relocating its property management business so it is based entirely in

London. There have been recent senior management changes in Schroders with the Head of Property stepping down.

- 7.11 **Baillie Gifford Diversified Growth Fund** outperformed the benchmark of 1.0% by 1.4% (Sept 1.1% v 1.0% benchmark). Performance in the last 12 months was 1.4% above benchmark. Listed equity performance has been the biggest contributor to this above benchmark return. High yield debt also contributed to returns, however emerging market and gold investments held back performance. Return in the longer term is ahead of benchmark and portfolio volatility is also within target.
- 7.12 **Ruffer Total Return Fund (Absolute Return)** outperformed by 0.4% in the quarter, though underperformed by 0.8% in the previous quarter. Performance was helped from investments in Volkswagen, BP, Lockheed Martin and Microsoft. The fund still has a high exposure to Japanese equities. Over the last year, the fund has been 6.7% above the benchmark, so has performed relatively well.

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 fund position at the 31 December 2013 are as set out below:

Table 4: Asset Allocation

Mandate	Benchmark 31Dec 2013	Fund Position	Variance as at 31Dec 2013	Variance as at 30 Sept 2013
UK Equities	24.0%	25.5%	1.5%	1.0%
Global Equities	37.0%	38.7%	1.7%	1.6%
Total Equities	61.0%	64.2%	3.2%	2.6%
Property	12.0%	10.2%	-1.8%	-1.8%
Bonds	14.0%	9.7%	-4.3%	-3.9%
UK Index Linked	3.0%	4.8%	1.8%	2.0%
Alternatives	10.0%	9.2%	-0.8%	-0.6%
Cash	0.0%	2.0%	2.0%	1.6%
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. The overweight position in equities has helped the fund's performance in recent months.

9. COMMENTS OF THE CHIEF FINANCIAL OFFICER

9.1. The comments of the Corporate Director Resources have been incorporated into the report.

10. LEGAL COMMENTS

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. The Committee's consideration of the information in the report contributes towards the achievement of the Council's statutory duties.
- 10.4 There are no immediate legal consequences arising from this report.

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