COMMITTEE:	DATE:	CLASSIFICATION:	REPORT NO.	AGENDA NO.
Pensions Committee	**19 November 2014**	**Unrestricted**		

REPORT OF:	TITLE:
Acting Corporate Director of Resources ORIGINATING OFFICER(S): Bola Tobun - Investment & Treasury Manager	**Investment Performance Review for Quarter End 30 September 2014** Ward(s) affected: N/A

Community Plan Theme	**All**
Strategic Priority	**One Tower Hamlets**

1. SUMMARY

1.1 This report informs Members of the performance of the Fund and its investment managers for the quarter ending 30th September 2014.

1.2 For the quarter, the Fund performance lagged behind the benchmark by 0.3%, delivering a positive absolute return of 1.2% against benchmark return of 1.5%.

1.3 The Fund is ahead its benchmark for the last twelve months to end of September 2014, the Fund returned 8.6%, and this exceeds the benchmark by 0.4%.

1.4 For longer term performance the Fund posted three year returns of 11.2% ahead the benchmark return of 10.9% and posted five year returns of 8.2% against benchmark return of 8.4%.

1.5 For this quarter end, five out of the eight mandates matched or achieved returns above the benchmark. The Fund performance was below the benchmark over the quarter, this was mainly due to poor relative returns from Baillie Gifford Global Equities, GMO and Schroder's property portfolio.

1.6 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 the strategic benchmark weight.

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. It considers the activities of the investment managers and ensures that proper advice is obtained on investment issues.

5.2 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 Pensions Committee.

5.3 This report informs Members of the performance of the Fund and its investment managers for the quarter 30 September 2014.

Legal & General Investment Management

5.4 Legal & General was appointed (2 August 2010) to manage passively UK Equity and UK Index-Linked Mandates, which at 30 September 2014 had a market value of £214.8m. The value of the assets taken on at the commencement of the contract was £204.7m.

5.5 The performance target is to track the FTSE All Share index for the UK Equity mandate and FTSE A Gov Index-Linked > 5 years benchmark for the UK Index-Linked Mandates.

Baillie Gifford & Co

5.6 Baillie Gifford manage two distinct mandates; global equity mandate and diversified growth fund mandate. The global equity fund had a value of £118.9m at the start of the mandate in July 2007. The value of assets under management as of 30 September 2014 was £187.3m. The performance target for this mandate is +2% to 3% above the benchmark MSCI AC World Index gross of fees over a rolling 3-5 year periods.

5.7 The diversified growth fund mandate was opened in February 2011 with contract value of £40m. The value of assets under management as at 30 September 2014 was £48.8m. The performance target for this mandate is to outperform the benchmark (UK base rate) net of fees over rolling 5 years with annual volatility of less than 10%.

GMO

5.8 GMO manages a Global Equity Mandate which at 30 September 2014 had a market value of £267.8m. The initial value of the assets taken on at the commencement (29 April 2005) of the contract was £201.8m.

5.9 The performance target is to outperform a balanced global equity benchmark by 1.5% per annum net of fees over a rolling three year period.

Investec Asset Management

5.10 Investec manages a Global Bond Mandate which at 30 September 2014 had a market value of £98.7m. The initial value of the assets taken on at the commencement (26 April 2010) of the contract was £97m.

5.11 The performance target is to outperform the benchmark (3 Month LIBOR) by 2.0% per annum net of fees over a rolling three year period.

Ruffer Investment Management

5.12 Ruffer manages an Absolute Return Fund; the value of this contract on the 28 February 2011 was £40m. The value of assets under management as of

30 September 2014 was £46.3m.

5.13 Their overall objective is firstly to preserve the capital over rolling 12 month periods and secondly to grow portfolio at a higher rate after fees than could reasonably be expected from the alternative of depositing the cash value of the portfolio in a reputable UK bank.

Schroder Investment Management

5.14 Schroder manage a property mandate. The value of this mandate on 20 September 2004 was £90m. The value of assets under management at 30 September 2014 was £114.3m.

5.15 The performance target for this mandate is to outperform the IPD UK Pooled Property Fund Indices All Balanced Funds Median by 0.75% net of fees over a rolling three year period.

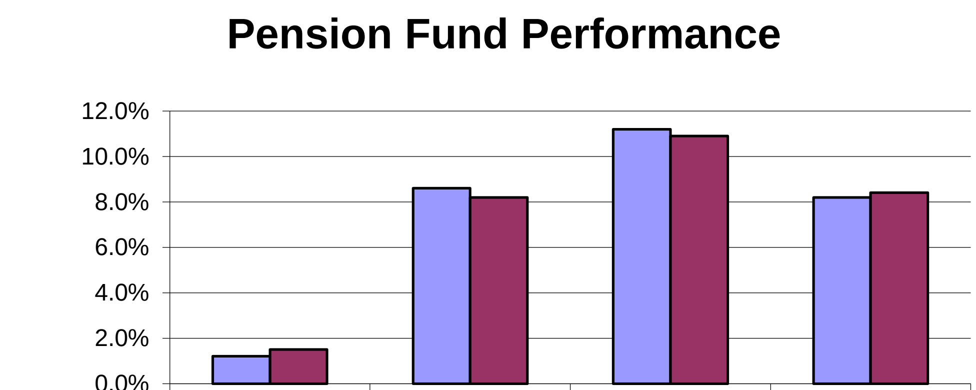
6. INVESTMENT PERFORMANCE

6.1 The Fund's overall value has increased by £14.64m from £1,035.06m as of 30 June 2014 to £1,049.7m as of 30 September 2014.

6.2 The fund underperformed the benchmark this quarter with a return of 1.2% compared to the benchmark return of 1.5%. The twelve month period sees the fund outperforming the benchmark by 0.4%.

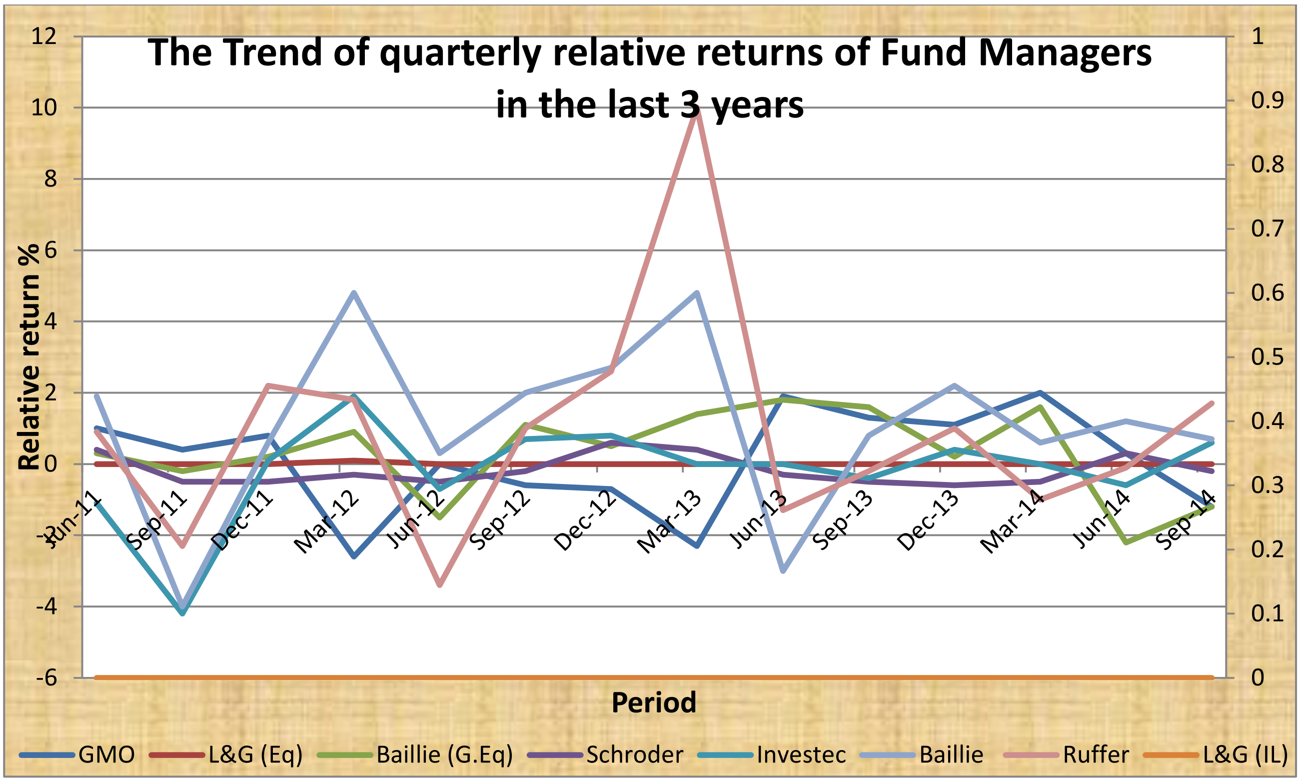
6.3 The performance of the fund over the longer term is as set out in table 1.

Table 1 – Pension Fund Performance



	Current Quarter	One Year	Three Years	Five Years
Fund	1.2%	8.6%	11.2%	8.2%
Bench Mark	1.5%	8.2%	10.9%	8.4%

6.4 The graph below 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 an effectively ride out short term volatility in markets.



7. MANAGERS

7.1 The Fund currently employs six specialist managers with eight mandates. The managers, mandate and funds held under management are set out below:

Table 2: Management Structure

Manager	Mandate	Value September 2014 £M	Benchmark Weight % of Fund Managers	Actual Weight % of Fund Managers	Difference %	Value June 2014 £M	Date Appointed
GMO	Global Equity	**267.83**	25.0%	25.5%	0.5%	**267.0**	29 Apr 2005
Baillie Gifford	Global Equity	**187.28**	16.0%	17.9%	1.9%	**183.6**	5 Jul 2007
L & G UK Equity	UK Equity	**214.80**	20.0%	20.5%	0.5%	**216.9**	2 Aug 2010
Baillie Gifford Diversified Growth	Absolute Return	**48.77**	5.0%	4.6%	-0.4%	**48.0**	22 Feb 2011
Ruffer Total Return Fund	Absolute Return	**46.34**	5.0%	4.4%	-0.6%	**45.3**	8 Mar 2011
L & G Index Linked-Gilts	UK Index Linked	**52.68**	3.0%	5.0%	2.0%	**49.7**	2 Aug 2010
Investec Bonds	Bonds	**98.69**	14.0%	9.4%	-4.6%	**97.5**	26 Apr 2010
Schroder	Property	**114.27**	12.0%	10.9%	-1.1%	**110.1**	30 Sep 2004
Cash	Currency	**19.03**	0.0%	1.8%	1.8%	**17.0**	
Total		**1,049.69**	**100.0%**	**100.0%**	**0.0%**	**1,035.1**	

7.2 The Fund was valued at £1,049.7million as at 30 September 2014. This includes cash held and being managed internally (LBTH Treasury Management), this has increased to 1.8% of the total assets value.

7.3 The performance, gross of fees 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 Global Equities	-1.2%	2.2%	-0.1%	0.2%
Baillie Gifford Global Equities	-1.2%	-2.0%	1.3%	1.9%
L & G UK Equity	0.0%	0.1%	0.1%	N/A
Baillie Gifford Diversified Growth	0.7%	3.0%	3.0%	N/A
Ruffer Total Return Fund	1.7%	0.6%	3.0%	N/A
L & G Index Linked-Gilts	0.0%	0.1%	0.1%	N/A
Investec Bonds	0.6%	-0.7%	-0.7%	N/A
Schroder	-0.2%	-1.0%	-0.8%	-1.4%
Total Variance (Relative)	**-0.3%**	**0.4%**	**0.3%**	**-0.2%**

7.4 **GMO** made absolute return of 0.4% in the quarter, underperforming the benchmark of 1.6% by 1.2%. The portfolio value has increased by £0.8m since 30 June 2014. If the portfolio was managed in line with the benchmark index, the portfolio would have increased by £4.27m.

7.5 The global equity market made a modest return over this quarter. GMO, European value position (c.40% of total portfolio weight) detracted, as European stocks lagged the broader market. GMO Emerging markets position also underperformed the index.

7.6 GMO stock selection impact has been negative this quarter Sector wise, the major contributor to performance was China Telecommunications while Russia Energy and Brazil Utilities are the two major country-sector detractors for the quarter.

7.7 Strong performance over the past 12 months means that the portfolio's performance since inception is now marginally above the benchmark, despite the poor relative performance exhibited during 2012 and Q1 2013.

7.8 **Baillie Gifford –** the portfolio underperformed the benchmark of 3.3% over the quarter, delivering a return of 1.9% resulting in relative underperformance of -1.2%. The portfolio is relatively concentrated and seeks to generate strong absolute returns over the long-term through the use of an unconstrained bottom-up approach. The portfolio has delivered on this over the longer term, as performance remains ahead of the benchmark over 3 years and 5 years.

7.9 For this quarter, the portfolio increased by £3.65m. Assuming the portfolio posted the benchmark return of 3.3% for the quarter, the portfolio would have increased by £5.88m, but unfortunately the manager strategic positioning did not beat the index return for the quarter.

7.10 The fund one year performance was also under the benchmark return. Although the fund has delivered on its objective over the longer term, as performance remains ahead of the benchmark over 3 years, 5 years and since inception.

7.11 The relative underperformance against the benchmark for the quarter came from North America and UK stocks.

7.12 **L & G (UK Equity)** – The portfolio returned -1.0% matching the index return over the quarter. At the quarterly review sixteen companies were added.

7.13 **L & G Index Linked Gilts** – The portfolio returned 5.9% matching the index return over the quarter.

7.14 During the quarter there were four bond auctions, with maturities of 2019, 2024, 2040 and 2052.

7.15 The portfolio held all 22 stocks contained within the benchmark index. The portfolio and index both had a modified duration of 21.66 years at the end of the quarter and the real yield was -0.35% (yield curve basis)

7.16 **Investec (Bonds)** – The portfolio posted a return of 1.2% against a performance comparison index return of 0.12% over the quarter. The outperformance here was predominantly driven by the currency exposure where a number of positions contributed to relative returns.

7.17 The portfolio's currency positions were a significant contributor to positive performance. This was a particularly favourable outcome given the limited risk exposure with which these gains were achieved. The currency performance came from a wide range of strategic and tactical positions adopted across the broader developed and emerging market universe. Long exposure to the US dollar and short positions in the euro, Australian and New Zealand dollars were particularly beneficial.

7.18 The portfolio's interest rate positioning posted favourable returns for the quarter, despite relatively contained moves across most major bond markets through the quarter. Interest rate performance emanated from the range of various exposure types. Specifically, outright duration, country selection, as well as yield curve trades.

7.19 Global corporate credit markets experienced weakness over the quarter with spreads widening fairly consistently, with a couple of major, temporary pull-backs. The portfolio had already been defensively positioned within its corporate credit allocation and adjustments were largely made on the basis of individual asset opportunities, rather than significant allocation changes. The manager also continued to hold reasonably sized broad-market hedges over the quarter – this helped reduce the weakness brought about by spreads widening.

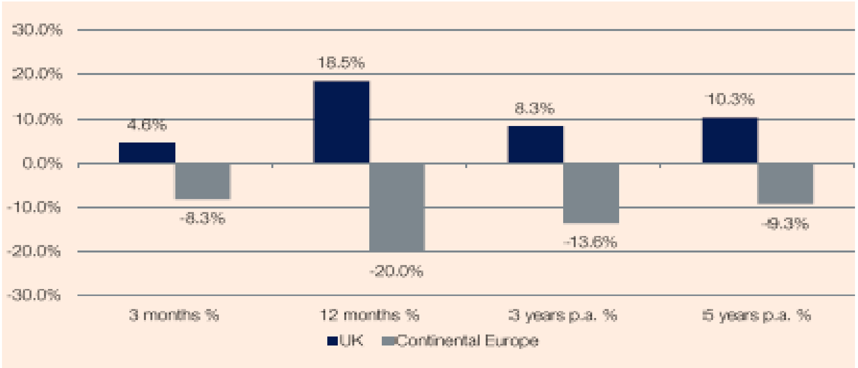
7.20 Longer term performance remains below the benchmark for 12 months, 3 years and since inception. 12 months to reporting period the benchmark returned 2.5% and the portfolio has delivered 1.9%.

7.21 **Schroder (Property)** returned 3.8% in the quarter against a benchmark of 4.0% resulting in marginal underperformance of the benchmark by 0.2%.

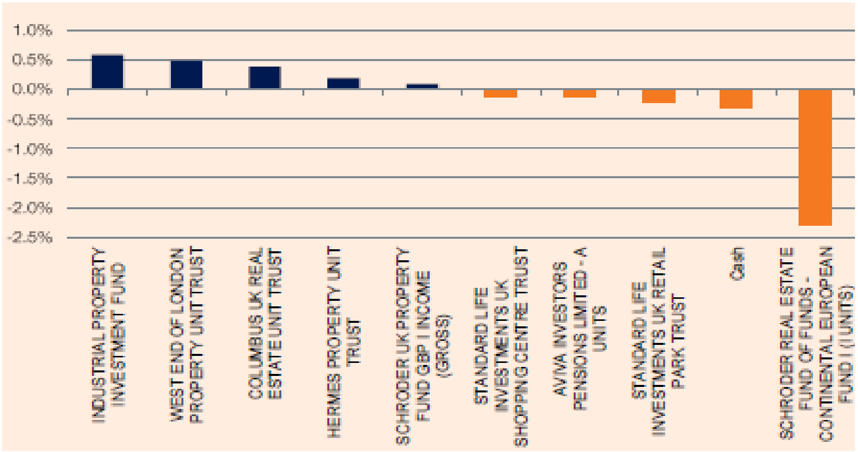
7.22 Longer term performance continues to lag the benchmark; with an underperformance 1.0% p.a. over the 5 years to 30 September 2014.

7.23 Please see below charts which illustrate the key drivers of performance in detail.

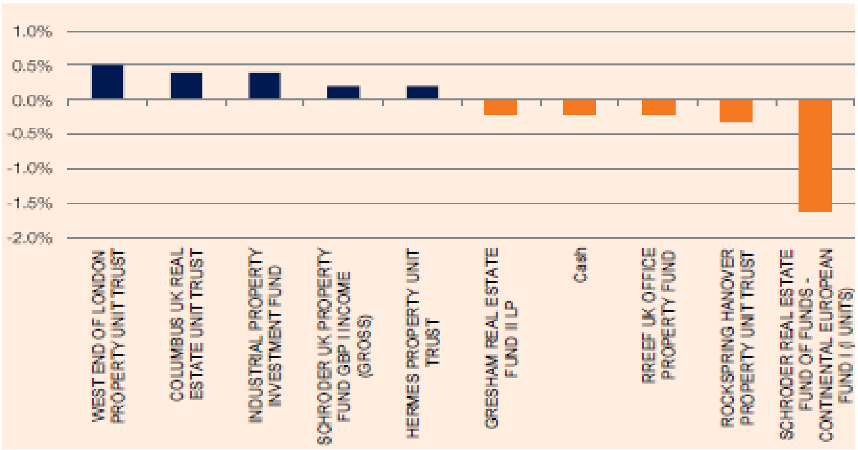
Total return by region
Periods to end 30 Sep 2014



Total return attribution relative to benchmark top & bottom five contributors
12 months to 30 Sep 2014



Total return attribution relative to benchmark top & bottom five contributors
3 years to 30 Sep 2014



7.24 The portfolio's UK assets (95% of the portfolio’s value) outperformed by +1.7% over the past twelve months and returns have now exceeded the benchmark over the quarter, one three and five year periods. However, negative returns from continental Europe (5% of portfolio) have held overall portfolio returns below the benchmark.

7.25 Sector specialist UK funds have been key positive drivers of returns over recent quarters. Industrial funds such as industrial Property Investment Fund (IPIF) have benefitted from increasing occupier demand for business space across the UK and more competitive pricing from investors.

7.26 Central London office funds such as West End of London PUT (WELPUT) remain positive contributors to return.

7.27 The Continental European Fund produced a total return of -4.7% (Euros) this quarter. The negative return has been driven by three main factors: a substantial fail in the valuation of CG Mails Europe, a decline in the valuation of Corestate German Residential and weakness in equity markets which particularly affected Immobiliare Grande Distribuzione.

7.28 **Baillie Gifford Diversified Growth Fund** generated a return of 1.7% return for the quarter, outperformed the benchmark of 1.0% by 0.7%.

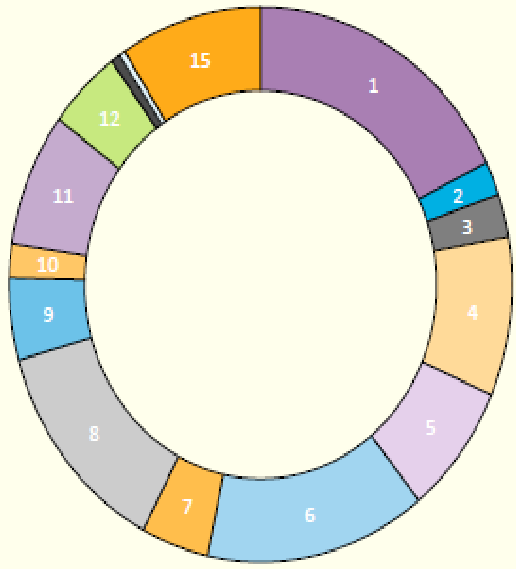
7.29 Across the past three months, the largest contributors to performance have been the active currency positions, in particular the short Australian dollar hedge position, which added 0.4% alone to performance as the currency fell 7.3% on Chinese growth concerns, as well as Insurance Linked Securities and Property.

7.30 The long term performances are ahead of the benchmark. The last 12 months are ahead by 3.0% and the last 3 years by 3.0% above benchmark returns.

7.31 Please see below charts which illustrate the strategic asset allocation of the portfolio at the quarter end.

Asset Allocation at Quarter End

		(%)
1	Listed Equities**	17.7
2	Private Equity	2.0
3	Property	2.5
4	High Yield Credit	9.3
5	Investment Grade Bonds	7.7
6	Structured Finance	14.2
7	Commodities	4.3
8	Emerging Market Bonds	12.9
9	Infrastructure	4.8
10	Government Bonds	2.0
11	Absolute Return	7.8
12	Insurance Linked	4.7
13	Special Opportunities	0.6
14	Active Currency	0.4
15	Cash and Equivalents	9.1
	Total	100.0



7.32 The fund returns have exceeded the performance target over all periods as shown on table 3, page 5. Active currency management drove returns over the quarter. The fund’s short position in the Australian dollar had detracted from performance in the first half of the year; however it had a significant positive contribution to returns as the currency depreciated over 7% during the third quarter.

7.33 Insurance linked securities, property, emerging market bonds and Japanese equities also enhanced returns over the quarter while exposure to high yield bonds and European equities detracted.

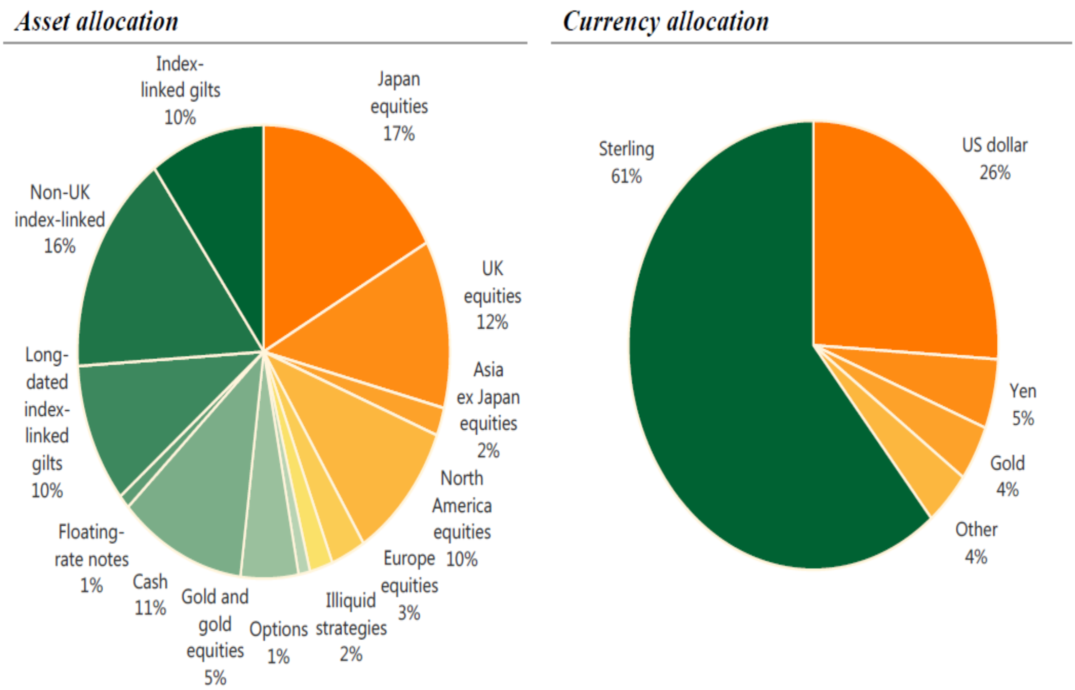
7.34 **Ruffer Total Return Fund (Absolute Return)** – The portfolio delivered a positive absolute return of 2.4% over the quarter.

7.35 The portfolio had a good quarter, as its benefited from a turnaround in the US dollar, more than reversed its losses from earlier this year, and from further gains from the long-dated index-linked bonds, especially in the UK.

7.36 Other major contributors to positive returns were Japanese equities and key individual stock selections such as Microsoft, Lockheed Martin and ITV. This performance was set against a mixed background for risk assets as equity markets ran out of steam and commodity prices fell sharply, meanwhile bond yields hit new lows reflecting continued growth concerns, especially in the Eurozone.

7.37 This improvement in portfolio performance was somewhat overdue and brings the portfolio back into positive territory for the year. In the first half of 2014, the portfolio performance suffered from the cost of protection assets (US dollar and options) and the lack of progress from our largest equity position, namely Japan.

7.38 Please see below charts which illustrate the strategic asset and currency allocations of the portfolio.



Cash Management

7.39 Cash is held by the managers at their discretion in accordance with limits set in their investment guidelines, and internally by LBTH to meet working requirements, although transfers can be made to Fund managers to top up or rebalance the Fund.

7.40 The Pension Fund invests in accordance with the Council's Treasury Management strategy agreed by Full Council in February 2014, which is delegated to the Acting Corporate Director of Resources to manage on a day to day basis within set parameters.

7.41 As at 30 September 2014 the Pension Fund internal cash balance was £19m.

7.42 Members will continue to be updated quarterly of the Pension Fund in house cash investment strategy. Security of the Fund's cash remains the overriding priority, ahead of yield. As at 31 October 2014 the Pension Fund in house cash position stood at £19.65m.

8 ASSET ALLOCATION

The benchmark asset distribution and the fund position at 30 September 2014 are as set out below:

Table 4: Asset Allocation

Mandate	Benchmark	Fund Position as at 30 Sept 2014	Variance as at 30 Sept 2014
UK Equities	24.0%	24.7%	0.7%
Global Equities	37.0%	39.7%	2.7%
Total Equities	**61.0%**	**64.4%**	**3.4%**
Property	12.0%	10.6%	-1.4%
Bonds	14.0%	9.4%	-4.6%
UK Index Linked	3.0%	4.8%	1.8%
Alternatives	10.0%	9.0%	-1.0%
Cash	0.0%	1.8%	1.8%
Currency	0.0%	0.0%	0.0%
Total Equities	**100.0%**	**100.0%**	

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 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 Acting Corporate Director Resources are incorporated in 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 should cover the following matters:

(a) the advisability of investing money in a wide variety of investments; and

(b) 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.

The Council must 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 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.

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***
Quarterly reports (Investec, Schroders, Baillie Gifford, Ruffer and WM Quarterly Performance Review	*Bola Tobun Investment &Treasury Manager x4733*