Havering
LONDON BOROUGH

PENSIONS COMMITTEE 25 March 2014	REPORT

Subject Heading:	**PENSION FUND PERFORMANCE MONITORING FOR THE QUARTER ENDED 31 DECEMBER 2013**
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Policy context:	Pension Fund Managers' performances are regularly monitored in order to ensure that the investment objectives are being met.
Financial summary:	This report comments upon the performance of the Fund for the period ended 31 December 2013

The subject matter of this report deals with the following Council Objectives

Clean, safe and green borough	[]
Excellence in education and learning	[]
Opportunities for all through economic, social and cultural activity	[]
Value and enhance the life of every individual	[X]
High customer satisfaction and a stable council tax	[]

SUMMARY

This report provides the Committee with an overview of the performance of the Havering Pension Fund investments for the quarterly period to 31 December 2013. The performance information is taken from the Quarterly Performance Report supplied by each Investment Manager, the WM Company Quarterly Performance Review Report and Hymans Monitoring Report.

The net return on the Fund's investments for the **quarter** to 31 December 2013 was **2.7%.** This represents an under performance of **0.7%** against the combined tactical benchmark and an out performance of **3.7%** against the strategic benchmark.

The overall net return of the Fund's investments for the **year** to 31 December 2013 was **15.8%.** This represents an out performance of **2.3%** against the annual tactical combined benchmark and an out performance of **19.2%** against the annual strategic benchmark.

It is now possible to measure the individual managers' annual return for the new tactical combined benchmark since they became active on the 14th February 2005. These results are shown later in the report.

RECOMMENDATIONS

That the Committee:

1) Considers Hymans performance monitoring report and presentation (Appendix A).
2) Receive a presentation from the Funds Investment Grade Bonds Manager (Royal London).
3) Notes the summary of the performance of the Pension Fund within this report.
4) Considers the quarterly reports provided by each investment manager.
5) Considers and notes any Corporate Governance issues arising from voting as detailed by each manager.
6) Considers any points arising from officer monitoring meetings (section 4 refers.
7) Notes the analysis of the cash balances (paragraphs 2.2 and 2.3 refers).

REPORT DETAIL

1. Background

1.1 The Fund undertook a full review of the Statement of Investment Principles (SIP) during 2012/13 and following the appointments of the Multi Asset Managers in September 2013, who commenced trading in December 2013; this almost completes the fund's restructuring as the Fund is still considering options for an investment in Local Infrastructure.

1.2 A strategic benchmark has been adopted for the overall Fund of Gilts + 1.8% (net of fees) per annum. This is the expected return in excess of the fund's liabilities over the longer term. **The main factor in meeting the strategic benchmark is market performance.**

1.3 Individual manager performance and asset allocation will determine the out performance against the strategic benchmark. Each manager has been set a specific (tactical) benchmark as well as an outperformance target against which their performance will be measured. This benchmark is determined according to the type of investments being managed. This is not directly comparable to the strategic benchmark as the majority of the mandate benchmarks are different but contributes to the overall performance.

1.4 Changes to the Asset Allocation targets were agreed by members at the Pensions Committee meeting on the 26 March 2013 and 24 July 2013. The long term strategy of the fund adopted at those meetings was to reduce exposure to equities and invest in multi asset strategies. Two new multi asset Managers (Barings and Baillie Gifford Diversified Growth Fund) were appointed to the Fund in September 2013. During the quarter the Fund used the services of a Transitional Manager (Nomura) to transfer cash from Standard Life to Barings and cash was transferred from State Street Global Assets to the Baillie Gifford Diversified Growth Fund. Trading commenced for both new managers in December 2013.

1.5 The following table reflects the asset allocation split following the commencement of trading of the new multi asset managers:

Manager and % of target fund allocation	**Mandate**	**Tactical Benchmark**	**Out performance Target**
State Street (SSgA) 8%	UK/Global Equities - passive	UK- FTSE All Share Index Global (Ex UK) – FTSE All World ex UK Index	To track the benchmark
Baillie Gifford Street 17%	Global Equities - Active	MSCI AC World Index	1.5 – 2.5% over rolling 5 year period
Royal London Asset Management 20%	Investment Grade Bonds	➢ 50% iBoxx Sterling Non Gilt Over 10 Year Index ➢ 16.7% FTSE Actuaries UK Gilt Over 15 Years Index ➢ 33.3% FTSE Actuaries Index-Linked Over 5 Year Index	0.75%
UBS 5%	Property	IPD (previously called HSBC/AREF) All Balanced Funds Median Index	To outperform the benchmark
Ruffer 15%	Multi Asset	Not measured against any market index – for illustrative purposes LIBOR (3 months) + 4%.	To outperform the benchmark
Barings – Dynamic Asset Allocation Fund 20%	Multi Asset	Sterling LIBOR (3 months) +4%	To outperform the benchmark
Baillie Gifford – Diversified Growth Fund 15%	Multi Asset	UK Base Rate +3.5%	To outperform the benchmark

1.6 UBS, SSgA, Baillie Gifford and Barings manage the assets on a pooled basis. Royal London and Ruffer manage the assets on a segregated basis. Performance is monitored by reference to the benchmark and out performance target. Each manager's individual performance is shown in this report with a summary of any key information relevant to their performance.

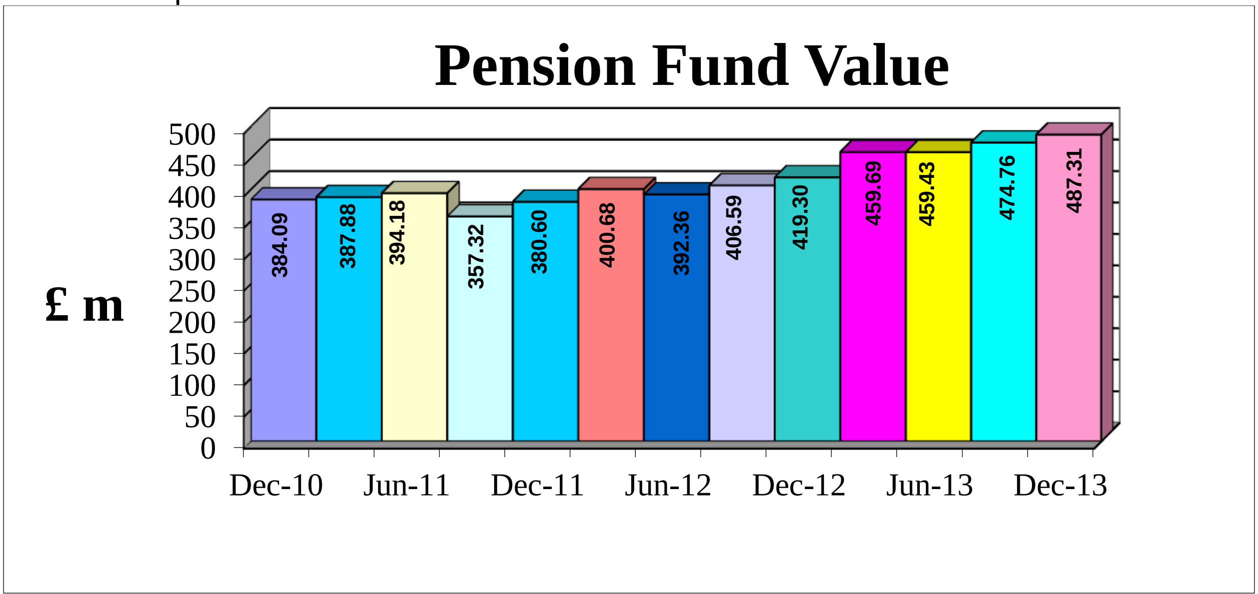
1.7 Since 2006, to ensure consistency with reports received from our Performance Measurers, Investments Advisors and Fund Managers, the 'relative returns' (under/over performance) calculations has been changed from the previously used arithmetical method to the industry standard geometric method (please note that this will sometimes produce figures that arithmetically do not add up).

1.8 Existing Managers are invited to present at the Pensions Committee Meeting every six months. On alternate dates, they meet with officers for a formal monitoring meeting. The exception to this procedure is the Multi Asset Managers (Ruffer), (Barings) and (Baillie Gifford) and the Passive Equity Manager (SSgA) who will attend two meetings per year, one with Officers and one with the Pensions Committee. However if there are any specific matters of concern to the Committee relating to the Managers performance, arrangements can be made for additional presentations.

1.9 Hyman's performance monitoring report is attached at **Appendix A.**

2. Fund Size

2.1 Based on information supplied by our performance measurers the total combined fund value at the close of business on 31 December 2013 was **£487.31m**. This valuation differs from the basis of valuation used by our Fund Managers and our Investment Advisor in that it excludes income. This compares with a fund value of £474.75m at the 30 September 2013; an **increase** of £12.55m. The movement in the fund value is attributable to an increase in assets of £13.55m and a decrease in cash of (£1.m). The internally managed cash level stands at **£2.72m** of which an analysis follows in this report.



Source: WM Company (Performance Measurers)

2.2 An analysis of the internally managed cash balance of **£2.72m** follows:

CASH ANALYSIS	**2011/12**	**2012/13 Updated**	**2013/14 30 Sep 13**
	£000's	£000's	£000's
Balance B/F	**-8495**	**-1194**	**-3474**
Benefits Paid	31123	31272	24373
Management costs	1606	1779	1305
Net Transfer Values	-58	-1284	-868
Employee/Employer Contributions	-30194	-30222	-23973
Cash from/to Managers/Other Adj.	4869	-3780	0
Internal Interest	-45	-45	-85
Movement in Year	**7301**	**-2280**	**752**
Balance C/F	**-1194**	**-3474**	**-2722**

2.3 As agreed by members on the 27June 2012 a cash management policy has now been adopted. The policy sets out that should the cash level fall below the de-minimus amount of £2m this should be topped up to £4m. This policy includes drawing down income from the bond and property manager.

3. Performance Figures against Benchmarks

3.1.1 The overall net performance of the Fund against the new **Combined Tactical Benchmark** (the combination of each of the individual manager benchmarks) follows:

	Quarter to 31.12.13	**12 Months to 31.12.13**	**3 Years to 31.12.13**	**5 years to 31.12.13**
Fund	2.7%	15.8%	8.3%	11.5%
Benchmark return	3.4%	13.2%	7.7%	10.8%
*Difference in return	-0.7%	2.3%	0.6%	0.6%

Source: WM Company

**Totals may not sum due to geometric basis of calculation and rounding.*

3.1.2 The overall net performance of the Fund against the **Strategic Benchmark** (i.e. the strategy adopted of Gilts over 15 years + 1.8% Net of fees) is shown below:

	Quarter to 31.12.13	**12 Months to 31.12.13**	**3 Years to 31.12.13**	**5 years to 31.12.13**
Fund	2.7%	15.8%	8.3%	11.5%
Benchmark return	-1.0%	-2.9%	9.9%	7.8%
*Difference in return	3.7%	19.2%	-1.4%	3.4%

Source: WM Company

**Totals may not sum due to geometric basis of calculation and rounding.*

3.1.3 The following tables compare each manager's performance against their **specific (tactical) benchmark** and their **performance target** (benchmark plus the agreed mandated out performance target) for the current quarter and the last 12 months.

QUARTERLY PERFORMANCE (AS AT 31 DECEMBER 2013)

QUARTER	Standard Life	Royal London	UBS	Ruffer	SSgA	Baillie Gifford Global Alpha
Return (performance)	1.9	-0.3	4.6	0.9	4.5	5.1
Benchmark	5.5	-0.8	4.3	0.1	5.0	5.0
***Over/(Under) Performance vs. Benchmark**	**-3.4**	**0.4**	**0.3**	**0.8**	**-0.5**	**0.1**
TARGET	6.0	-0.6	n/a	n/a	n/a	n/a
*** Over/(Under) Performance vs. Target**	**-3.9**	**0.2**	**n/a**	**n/a**	**n/a**	**n/a**

Source: WM Company, Fund Managers and Hymans

- Totals may not sum due to geometric basis of calculation and rounding.
- Barings and Baillie Gifford Diversified Fund not included as they were not invested for entire period.

ANNUAL PERFORMANCE (LAST 12 MONTHS)

ANNUAL	Standard Life	Royal London	UBS	Ruffer	SSgA	Baillie Gifford
Return (performance)	23.8	0.9	5.4	9.6	20.9	27.2
Benchmark	20.8	-1.0	9.1	0.5	21.0	21.1
***Over/(Under) Performance vs. Benchmark**	**3.0**	**1.9**	**-3.7**	**9.1**	**-0.1**	**5.0**
TARGET	22.8	-0.2	n/a	n/a	n/a	n/a
*** Over/(Under) Performance vs. Target**	**0.8**	**1.1**	**n/a**	**n/a**	**n/a**	**n/a**

Source: WM Company, Fund Managers and Hymans

- Totals may not sum due to geometric basis of calculation and rounding.

4. Fund Manager Reports

4.1. UK Equities (Standard Life)

a) Cash was transferred from Standard Life to Barings in two instalments on the 10 and 17 December 2013. The total amount transferred from Standard Life to Barings was £97,577,212.23.

4.2. UK Investment Grade Bonds (Bonds Gilts, UK Corporates, UK Index Linked, UK Other) – (Royal London Asset Management)

a) Representatives from Royal London are due to make a presentation at this committee therefore a brief overview of their performance as at 31 December 2013 follows.

b) The value of the Royal London portfolio fund saw a decrease of .36% in value since the previous quarter.

c) Royal London delivered a return of -0.3% but outperformed the benchmark by 0.4% over the quarter. The portfolio outperformed against the benchmark over the year by 1.9%.

4.3. Property (UBS)

a) In accordance with agreed procedures officers met with representatives from UBS on the 13 February 2014 at which a review of their performance as at 31 December 13 was discussed.

b) The value of the fund as at 31 December 13 rose by 3.36% since the previous quarter.

c) UBS delivered a return of 4.6% out performing its benchmark by 0.3% over the quarter. The Fund is behind the benchmark over the year by -3.7%.

d) The number of properties in the fund currently stands at 30 with a void rate of 5.86%, which is significantly lower than the benchmark of 10.1%. Average property yield is currently 6.99%.

e) As at the date of the meeting there was no redemption queue.

f) UBS stated that the modernisation of the fund with regard to the review into the structure and governance of the fund is going well. The independent review by John Forbes Consulting is now completed, with the recommendations approved in principle by the Fund’s General Partner, US Global Asset Management. The Key proposals are:

- The introduction of an Independent Supervisory board with oversight of the Manager and Fund governance, with the ability to facilitate dialogue between unit holders and the management team.
- The modernisation of the existing redemption provisions

g) UBS were asked if the modernisation review will impact the fund and they said that the salary costs will be charged to the fund but will only have a small impact. They are now actively recruiting for members for the new Supervisory Board, with experience from the Investment, Legal and Banking worlds. Members will be rotated and elected annually. It is anticipated that the Fund modernisation proposals will go before the EGM of investors in March/April 2014 and the Supervisory Board will be set up after this date.

h) The improving property market is driving capital growth with Central London leading the way. The funds industrial assets also performed strongly, driven in part by active leasing programmes. Several new leases were completed, including two new leases at Wardley Industrial Estate, two leases at Springfield Outlet Centre and a 12 year at St Helens.

i) Two sales were completed over the quarter a shopping centre in Yeovil, and an industrial property in Wellingborough.

j) Strategy for future purchases will be in multi let industrial, London and South East assets with diversified income streams and long term asset management potential.

k) UBS was asked if they planned on selling any of the Central London assets to capitalise on the current market buoyancy. They said that they have very recently completed an exchange of a London Office, The Rex Building for a multi let industrial estate in, Reading, at no cost to the fund. This also rebalances the weighting to the Industrial sector in the fund in line with their fund repositioning.

l) UBS has generated positive returns over the last two quarters and they were asked if they are in a position to maintain this outperformance now the fund has stabilised. UBS stated that quarter on quarter this may be difficult but believe that they can maintain outperformance over the long term.

m) UBS were asked to explain their process for selecting new purchases and how they determine the contribution new properties will have to future performance. They said that their strategy characteristics are quality over income, they look to purchase properties where they can maximise redevelopment options, increasing holdings in Industrial multi let properties where there are multiple asset management opportunities. The UK Funds strategy for 2014 sets down clear and measurable performance and portfolio targets, covering fund style, sector weightings, asset management and investment activity, performance attribution, cash/debt strategy and risk management, for UBS to deliver improved and sustained performance over the coming 12 months and beyond.

n) Following the events of the past two years UBS were asked if there was likely to be any changes to the team responsible for the management of the Fund and UBS mentioned that changes to the staffing restructure has already started with changes in staff and management reporting lines.

o) As previously reported UBS introduced a fee rebate to lower the Partnership's annual management fee from 0.75% per annum to 0.45% between 1 Jan 2013 and 31 Dec 2014 for continuing investors. Payments of rebates will be made annually at the end of each calendar year for 2013 & 2014, and will be made directly to investors. First rebate was received in February 2014.

p) As well as looking at the modernisation of the fund, UBS outlined the future stating that they still believe the fund has a potential to deliver outperformance of 9.5% p.a. over the next five years.

q) No whistle blowing issues or governance was reported.

4.4. Multi Asset Manager (Ruffer)

a) In accordance with agreed procedures officers will only meet with representatives from Ruffer once in the year with the other meeting to be held with members. Ruffer attended their last meeting with members on the 26 June 13 Pensions Committee meeting. Officers met with representatives from Ruffer on the 13 February 2014.

b) When Officers last met with Ruffer in February 2013, the value of the fund was £61,907,182 as at the end of January 13. The values of the fund as at 31 December 2013 was £64,804,848, this represented an increase of 4.7% during 2013.

c) Ruffer had outperformed the benchmark in the quarter by 0.7% (net of fees) and outperformed the benchmark in the year by 9.1% (net of fees).

d) The biggest contributor to the positive performance continued to be Japanese equities, investor confidence was boosted by a weakening in the Yen fuelled by Quantitative Easing announced by the Bank of Japan in April. Good stock selection enhanced returns in Western Equities.

e) The main negative contributor that hurt performance was exposure in Gold and Gold mining equities – gold prices moved sharply lower as bond yields rose producing corresponding falls in mining shares.

f) Ruffer was asked what is their current protective positioning within the portfolio bearing in mind that the protective assets hurt performance over 2013. They said that inflation linked bonds are the best protection against financial repression; the increased cash holding will enable them to react quickly to any unforeseen changes or opportunities in the market. They also said prospects for Gold and Gold mining stocks are expected to rise due to the low prices last year, but believe that it is the ultimate insurance protection and 4-5% is an appropriate holding.

g) Ruffer said that Japanese equity still offers potential for good returns, Japan is now pursuing the most aggressive monetary stimulus among the major economies, the new government and Bank of Japan appear determined to invigorate the market. They said that Japanese equities include most of the financial exposure, they feel Japanese Banks are safer than most, and that they are rotating in stocks to benefit from the improving domestic economy.

h) No whistle blowing issues or governance was reported.

4.5. Passive Equities Manager (SSgA)

a) In accordance with agreed procedures officers will only meet with representatives from SSgA once in the year with the other meeting to be held with members. SSgA attended their last meeting with members on the 17 December 2013 Pensions Committee meeting. Officers last met with representatives from SSgA on the 20 May 2013.

b) £25m was withdrawn on the 25 November 2013 and a further £45m was withdrawn on the 4 December 2013. The total £70m was transferred to the new Baillie Gifford Diversified Growth Fund.

c) SSgA underperformed the benchmark over the quarter by -0.5%

4.6. Global Equities Manager (Baillie Gifford)

a) In accordance with agreed procedures officers met with representatives from UBS on the 13 February 2014 at which a review of their performance as at 31 December 13 was discussed.

b) Since the last quarter the portfolio increased 5.1%.

c) Baillie Gifford have outperformed the benchmark over the quarter by 0.1% (net of fees) and outperformed the benchmark by 5% (net of fees) over the last year. Since inception they have outperformed the benchmark by 3.5%.

d) Baillie Gifford stated that the positive performance came from a wide range of stock contributors with no major detractors.

e) Their fund positioning remains unchanged over the past quarter, they continued to increase exposure to information technology & innovation and the focus in Emerging Markets continues to shift from infrastructure to consumer- oriented companies.

f) Current positioning of the portfolio has holdings in Growth Stalwarts (strong Brands) 23%, Rapid Growth (fastest growth) 24%, Cyclical

Growth (longer term performance) 37%, Latent Growth (stocks most out of favour with the markets) 14% and cash of 3%.

g) Activity during the quarter included some new purchases in Twitter, Bank of Ireland and Tullow Oil. Increased holdings in Qualcomm, Japan Exchange Group, TD Ameritrade, First Republic Bank, M&T Bank, Tokyo Electron and Royal Caribbean Cruises. Completed Sales in Omnicon, BIM Birlesik Magazalar Industries and Vodaphone. They also reduced holdings in Amazon, Trip Advisor and Svenska Handelsbanken.

h) Baillie Gifford was asked for their rational for the addition of the holdings in Twitter and was asked whether it has potential for growth. . They said that they are confident for the potential of growth, with comparison with other social network sites. It is a rapidly growing blogging network which has a scalable revenue model, meaning profits can be increased with relatively limited capital investment. The user base is over 215m globally with only a fraction of advertising being seen by the users but scale of growth in this area is expected to be significant.

i) Baillie Gifford is aware that they need to closely monitor other internet holdings, as fast growing companies (Twitter for example) will encroach on other’s territories. Winners in technology have increasing taken a large share of the spoils which means that there will be large losers.

j) Baillie Gifford was asked for their views of the US domestic economy and the announcements on the gradual withdrawal of quantitative easing and whether the portfolio is positioned to withstand likely volatility around this economic uncertainty? Baillie Gifford do not agree that tapering is a bad thing and a threat to market health and whilst this is likely to drive further volatility, the positive background is that the US domestic economy has continued to show steady growth. Tapering has been better received by the markets in the last quarter than earlier in the year and they see a move towards a more normal monetary position as a sign of a stronger economy.

k) Overall, Baillie Gifford’s outlook for the portfolio over the longer term indicates that bouts of volatility may continue but believes this provides opportunity for stock pickers. They are optimistic that the longer term investment case remains intact. They will continue to search for companies which are in good shape but believe that their stock driven approach is well placed to capitalise on long term opportunities.

l) Baillie Gifford distributed a paper covering their research agenda for 2014 and will provide updates during the year.

m) At their next meeting Baillie Gifford will cover both the Global Alpha Fund and the new Diversified Growth Fund.

n) No governance or whistle blowing issues were reported.

5. Corporate Governance Issues

The Committee, previously, agreed that it would:

1. Receive quarterly information from each relevant Investment Manager, detailing the voting history of the Investment Managers on contentious issues. This information is included in the Managers' Quarterly Reports, which is available for scrutiny in the Members Lounge.

2. Consider a sample of all votes cast to ensure they are in accordance with the policy and determine any Corporate Governance issues arising.

3. Receive quarterly information from the Investment Managers, detailing new Investments made.

    - Points 1 and 3 are contained in the Managers' reports.

    - With regard to point 2, Members should select a sample of the votes cast from the voting list supplied by the managers placed in the Member's room which is included within the quarterly report and question the Fund Managers regarding how Corporate Governance issues were considered in arriving at these decisions.

This report is being presented in order that:

- The general position of the Fund is considered plus other matters including any general issues as advised by Hymans.

- Hymans will discuss the managers' performance after which the particular manager will be invited to join the meeting and make their presentation. The manager attending the meeting will be from:

    Royal London

- Hymans and Officers will discuss with Members any issues arising from the monitoring of the other managers.

IMPLICATIONS AND RISKS

Financial Implications and risks:

Pension Fund Managers' performances are regularly monitored in order to ensure that the investment objectives are being met and consequently minimise any cost to the General Fund.

Legal Implications and risks:

None arising directly

Human Resources Implications and risks:

There are no immediate HR implications. However longer term, shortfalls may need to be addressed depending upon performance of the fund.

Equalities and Social Inclusion Implications and risks:

None arising directly

BACKGROUND PAPERS

Standard Life Quarterly report to 31 Dec 2013
Royal London Quarterly report to 31 Dec 2013
UBS Quarterly report to 31 Dec 2013
Ruffer Quarterly reports 31 Dec 2013
State Street Global Assets reports to 31 Dec 2013
Barings Quarterly Reports 31 Dec 2013
Baillie Gifford Quarterly Reports 31 Dec 2013
The WM Company Performance Review Report to 31 Dec 2013
Hyman's Monitoring Report to 31 Dec 2013