Havering
LONDON BOROUGH

PENSIONS COMMITTEE

16 December 2014

Subject Heading:	**PENSION FUND PERFORMANCE MONITORING FOR THE QUARTER ENDED 30 SEPTEMBER 2014**
CMT Lead:	**Andrew Blake Herbert**
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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 30 Sept 2014

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 30 September 2014. 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 30 September 2014 was **2.7%.** This represents an outperformance of **0.2%** against the tactical benchmark and an under performance of **-4.7%** against the strategic benchmark.

The overall net return of the Fund's investments for the **year** to 30 Sept 2014 was **8.6%.** This represents a performance in line with the tactical combined benchmark and an under performance of **-5.2%** 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 Ballie Gifford for their Diversified Growth Fund and Global Alpha Fund.
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. 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.

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 Global Assets (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 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 At a Special meeting of the Pension Committee on the 23 October 2014 members agreed to appoint GMO and invest in their Global Real Return (UCITS) Fund (GRRUF). Officers are in the process of completing the relevant documentation and cash will be transferred from the SSgA Sterling Liquidity cash account once this has been completed and verified. This will be managed on a pooled basis. The GMO (GRRUF) will replace the investment with Barings.

1.7 UBS, SSgA, Baillie Gifford 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.

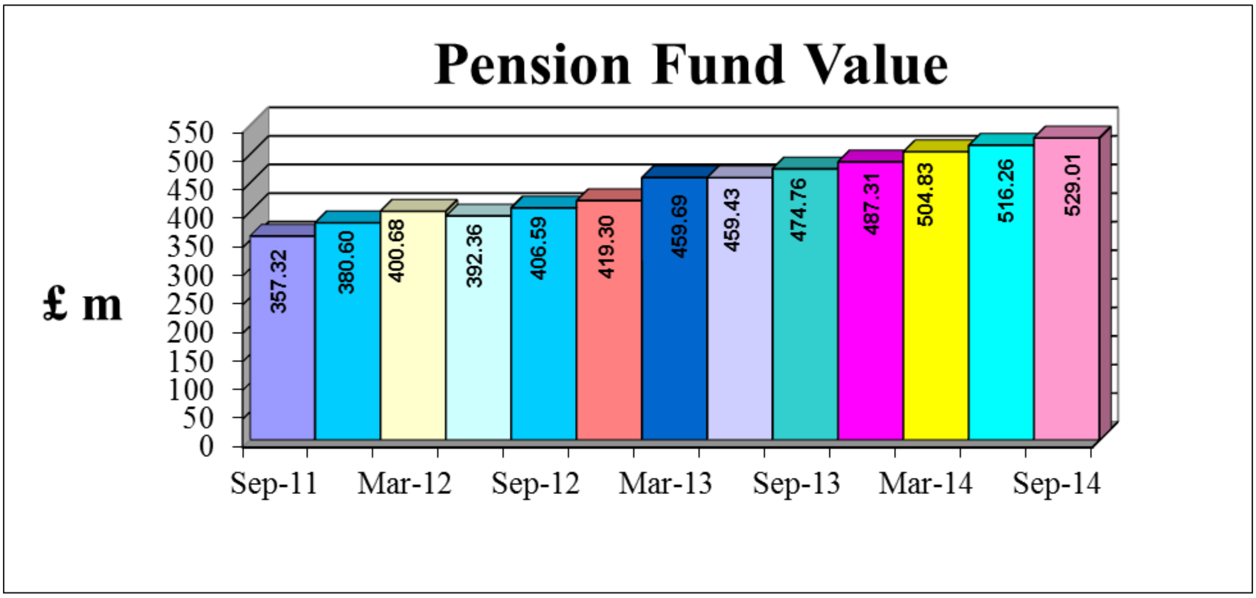
1.8 Since 2006, to ensure consistency with reports received from our Performance Measurers, Investments Advisors and Fund Managers, the 'relative returns' (under/over performance) calculations has been changed from the previously used arithmetical method to the industry standard geometric method (please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

1.9 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 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.

1.10 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 30 Sept 2014 was **£529.01m**. 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 £516.25m at the 30 June 2014; an **increase** of **£12.76m**. The movement in the fund value is attributable to an increase in assets of £14.11m and a decrease in cash of £1.35m. The internally managed cash level stands at **£5.38m** of which an analysis follows in this report.



Source: WM Company (Performance Measurers)

2.2 An analysis of the internally managed cash balance of **£5.38** follows:

CASH ANALYSIS	**2012/13**	**2013/14 Updated**	**2014/15 30 Sep 14**
	£000's	£000's	£000's
Balance B/F	**-1194**	**-3474**	**-5661**
Benefits Paid	31272	32552	17000
Management costs	1779	2312	268
Net Transfer Values	-1284	-1131	60
Employee/Employer Contributions	-30222	-45659	-18393
Cash from/to Managers/Other Adj.	-3780	9825	1368
Internal Interest	-45	-86	-24
Movement in Year	**-2280**	**-2187**	**279**
Balance C/F	**-3474**	**-5661**	**-5382**

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 30.09.14	**12 Months to 30.09.14**	**3 Years to 30.09.14**	**5 years to 30.09.14**
Fund	2.7%	8.6%	12.9%	8.9%
Benchmark return	2.5%	8.5%	11.0%	9.0%
*Difference in return	0.2%	0.0%	1.7%	-0.1%

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 30.09.14	**12 Months to 30.09.14**	**3 Years to 30.09.14**	**5 years to 30.09.14**
Fund	2.7%	8.6%	12.9%	8.9%
Benchmark return	7.8%	14.5%	9.3%	10.6%
*Difference in return	-4.7%	-5.2%	3.3%	-1.6%

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 30 SEPTEMBER 2014)

Fund Manager	**Return (Performance)**	**Benchmark**	**Performance vs benchmark**	**Target**	**Performance vs Target**
Royal London	5.26	5.46	**-0.20**	5.65	**-0.39**
UBS	4.13	4.03	**0.10**	n/a	**n/a**
Ruffer	2.93	0.10	**2.83**	n/a	**n/a**
SSgA	3.18	3.18	**0.0**	n/a	**n/a**
SSgA Sterling Liquidity Fund	0.13	0.09	**0.04**	n/a	**n/a**
Baillie Gifford (Global Alpha Fund)	2.00	3.20	**-1.20**	n/a	**n/a**
Barings (DAAF)	1.00	0.07	**0.30**	n/a	**n/a**
Baillie Gifford (DGF)	1.70	1.00	**0.70**	n/a	**n/a**

Source: WM Company, Fund Managers and Hymans

- Totals may not sum due to geometric basis of calculation and rounding.
- Barings up to 29 August 2014

ANNUAL PERFORMANCE (LAST 12 MONTHS)

Fund Manager	Return (Performance)	Benchmark	Performance vs benchmark	Target	Performance vs Target
Royal London	11.47	10.59	**0.88**	11.34	**0.13**
UBS	19.48	16.85	**2.63**	n/a	**n/a**
Ruffer	3.71	0.50	**3.21**	n/a	**n/a**
SSgA	11.70	11.74	**-0.04**	n/a	**n/a**
SSgA Sterling Liquidity Fund	0.48	0.35	**0.13**	n/a	**n/a**
Baillie Gifford (Global Alpha Fund)	9.80	11.80	**-2.00**	14.30	**-4.50**
Barings	n/a	n/a	**n/a**	n/a	**n/a**
Baillie Gifford (DAAF)	n/a	n/a	**n/a**	n/a	**n/a**

Source: WM Company, Fund Managers and Hymans

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

4. Fund Manager Reports

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

a) In accordance with agreed procedures officers met with representatives from Royal London on the 05 November 2014 at which a review of their performance as at 30 September 14 was discussed.

b) The Royal London portfolio fund saw an increase in value of 5.3% since the previous quarter.

c) Royal London delivered a return of 5.26% during the quarter and underperformed the benchmark by -0.20% and the target by -0.39%. Since inception they outperformed the benchmark by 0.76% and the target by -0.05%.

d) Royal London reported on market events during the quarter:

- Government Bonds (Gilts) returned 3.73% over the quarter, due to flight to quality following escalating geopolitical tensions, European Central Bank introducing measures to stimulate the Eurozone economy and the Scottish referendum creating additional volatility. Along with the UK economy continuing to improve, consumer confidence remained well above pre crisis average. Quarter 3 GDP 0.7% bringing year on growth to 3%.
- Index linked Market backdrop – Index linked gilts returned 5.32% over the quarter, real yields fell to a record low. UK inflation remains below

target, partly reflecting the intensifying supermarket price war. The European Central Bank cut interest rates The Global index linked bond performance was mixed, with the UK outperforming the US and Canada, but underperformed Europe.

- Credit market backdrop (corporate bonds) – The credit bonds underperformed gilts. Issuance was at its lowest level for the year to date. Credit remains undervalued versus government bonds.

e) Asset Allocation within the portfolio was 56.5% in corporate bonds, 27.8% Sterling Index Linked bonds, 10.6% Sterling conventional Bonds, 3.8% in Overseas Bonds and 1.3% in cash.

f) There has been little portfolio changes during the 3rd quarter, Portfolio activity and opportunities during the quarter are as follows:

- Active duration management. Expected UK government bond yields to rise moderately towards their year-end forecast. Overall short duration maintained throughout quarter three. Long dated index linked bonds were sold as yields reached record lows in August. Short duration reduced in to Scottish referendum as fears of 'Yes' vote grew.
- Off-benchmark positions in US and Canadian index linked government bonds, as yields significantly higher than the UK.
- Continued opportunities created by on-going market volatility. Overweight ultra-long bonds as they are not expected to be supplied again in 2014.
- New credit bond Issues, activity subdued in quarter three as issuance considerably lower, They purchased A+/A2 rated, 12 year transaction from charity Motability.

g) The fund was overweight in corporate bonds relative to government bonds, with a bias towards benefiting from enhanced security, showing significant overweight in structured and secured sectors (investment trust, property and social housing). It is overweight in financials, with a preference for subordinated debt and senior secured bank bonds over senior unsecured debt, with significant underweighting to supranational and government bonds.

h) Asset Allocation in favour of corporate bonds was a key detractor over the quarter. Off benchmark positions in overseas bonds were a small benefit to performance.

i) Royal London was asked given the continuing strong performance in absolute terms, should the Fund be reducing its overall allocation to bonds? They said that equity will not be introduced into the portfolio, they will continue with selective purchasing rather than changes in strategies.

j) Royal London was asked if they still expect interest rates to rise or do they hold the belief that rates will remain lower for longer? Previously they expected interest rates rises in Feb/Mar 15, but this view has moved out to June to July (after the election) gradually rising quarter on quarter in small increments up to 2% by the middle of 2016. Their view is influence by the increased growth in the UK economy with lower unemployment. The only detraction from this is the lower than expected wage growth and inflation in recent months which may delay rate rises. They said that the economy is sensitive to small changes in interest rates.

k) We asked what they see as the key risks to achieving your outperformance target over the next 12 to 18 months. They said that the 2 main risks to absolute returns are if inflation grows and yields rise (prices will fall), and if financials reduce, they have a higher weighting to financials; they will need to move investments in credit.

l) The Royal London Investment outlook is to remain cautious on the outlook for medium term global growth; deleveraging process will take several years. Central case assumes modest reacceleration of global activity over the coming year. They expect UK gilt yields to rise from current levels, and remain positive on corporate relative to government/supranational bonds.

m) No governance or whistle blowing issues were reported.

4.2. Property (UBS)

a) In accordance with agreed procedures officers met with representatives from UBS on the 05 November 2014 at which a review of their performance as at 30 September 14 was discussed.

b) The value of the fund as at 30 September 14 rose by 2.62% since the previous quarter.

c) UBS delivered a return of 4.1% over the quarter, outperforming its benchmark by 0.1%. The Fund is ahead of the benchmark over the year by 2.3%. Since inception UBS are behind their benchmark by -0.2%.

d) The number of properties in the fund currently stands at 29 and a void rate of 8.13%, which is lower than the benchmark of 10.1%. Average property yield is currently 6.32%.

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

f) UBS stated that the modernisation of the fund in 2014 has strengthened governance and improved the Funds liquidity and redemption.

g) The new Independent Supervisory Board has been established and provides oversight of the Managers and Fund governance, with the ability to facilitate dialogue between investors and the management team. The board comprises three individuals independent of UBS and investors. Initial members are John Forbes, Sue Forster and Michael Strancombe. Members will be rotated and elected annually. UBS said that although it was early days, the new board was working well.

h) UBS achieved the Global Real Estate Sustainability Benchmark (GRESB) “Green Star” status in 2014 and ranks strongly amongst its peers.

i) UBS Triton’s sustainability strategy is now embedded in the fund investment process. The benefits from this award include tax breaks, and lower energy costs, which make them more attractive to tenants and buyers when selling.

j) Three sales were completed over in the year to date, two shopping centres, one in Birmingham and one in Newport and an office block in London that was swapped for an industrial estate in Reading.

k) UBS has purchased 2 new properties, both are industrial units. The first is a multi-let industrial estate in Reading, at no cost to the fund, by securing a sale price of the Rex building in London at 6% above valuation. The second is in Hatfield, which is a state of the arts building with a long lease until June 2028.

l) Although the Supervisory Board has been a fairly recent governance change and only met for the first time in October, we asked UBS if this has borne any immediate benefit for their management of the fund. They said that since the board has in place they have been through a thorough review process which they have passed with flying colours, but it is too early to see immediate benefits.

m) We asked UBS what they perceive to be the attractions of investment in private rented sector residential property. The said that they are actively looking at residential properties for rental to students. In the right location these properties have a good sustainable rental income, with very low voids, with relatively low risks.

n) Recent transactions have been in line with UBS’s stated strategy but, given current market conditions, we asked what other changes to your strategy are you considering at this time? They do not plan any major changes to their current strategy, other than the investment into residential property for rental to students as previously mentioned.

o) No whistle blowing issues or governance was reported.

4.3. 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. The Pensions Committee last met with Ruffer at the June 2014 meeting at which their performance as at the end of March 14 was discussed. Officers will meet with representatives from Ruffer in February 2015. An overview of their performance as at 30 Sept 2014 follows.

b) Since the June 14 quarter end the value of the portfolio has increased by 3.16%.

c) Ruffer has outperformed the benchmark in the quarter by 2.83% (net of fees) and outperformed the benchmark in the year by 3.21% (net of fees).

d) Portfolio had a good quarter as they benefitted from the turnaround in the US dollar that more than reversed its losses earlier in the year and made further gains in long-dated UK Index linked bonds. Main detractor on performance came from Gold as this fell back as the dollar surged and commodity process fell.

4.4. 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 are next due to meet the committee in March 2015. Officers last met with representatives from SSgA on the 12 May 2014 at which a review of their performance as at 31 March 14 was discussed. An overview of their performance as at 30 Sept 2014 follows.

b) Following the redemption of the Baring's mandate £100.6m was transferred to the SSGA Sterling Liquidity Fund. Now that a replacement Fund Manager has been appointed this money will be transferred out once all the relevant documentation has been completed.

c) Pending consideration of options for an investment in Local Infrastructure the £11.5m is still invested in the SSGA Sterling Liquidity Fund.

d) The SSgA Sterling liquidity fund has outperformed the benchmark by 0.04% over the quarter.

e) The SSgA passive Equity mandate has performed in line with the benchmark over the latest quarter and since inception.

f) SSgA mentioned that they are looking at ways of enhancing returns in Index Equity Portfolio management. The opportunities that are available are options for the portfolio to track different indices that may deliver better returns. Officers in conjunction with the fund's investment adviser will consider the options available and report back to the Committee, as appropriate.

4.5. Global Equities Manager (Baillie Gifford)

a) Representatives from Baillie Gifford are due to make a presentation at this Committee therefore a brief overview of their performance as at 30 September 2014 follows:

b) Since the last quarter the portfolio increased in value by 2.0%.

c) Baillie Gifford underperformed the benchmark over the quarter by -1.20% (net of fees) and underperformed the benchmark by -2.0% (net of fees) over the last year. Since inception they have outperformed the benchmark by 1.6%.

4.6. Multi Asset Manager (Baillie Gifford Diversified Growth Fund)

a) Representatives from Baillie Gifford are due to make a presentation at this Committee therefore a brief overview of their performance as at 30 September 2014 follows:

b) Since the last quarter the portfolio increased in value by 1.7%.

c) Baillie Gifford outperformed their benchmark by 0.70% over the quarter (net of fees).

4.7. Multi Asset Manager (Barings – Dynamic Asset Allocation Fund)

a) As reported in the last Quarterly monitoring report the mandate with Barings was terminated on the 29 August 2014. The redemption value was £100.6m and the cash was invested in the SSgA Sterling liquidity fund on the 4 September 2014, pending transfer to the new Fund Manager.

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 will be distributed to members electronically.

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

   - Points 1 and 2 are contained in the Managers' reports.

3. Voting – Where the fund does not hold a pooled equity holding, Members should select a sample of the votes cast from the voting list supplied by the managers (currently only Ruffer) 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:

Baillie Gifford

- 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 30 Sept 2014
Royal London Quarterly report to 30 Sept 2014
UBS Quarterly report to 30 Sept 2014
Ruffer Quarterly reports 30 Sept 2014
State Street Global Assets reports to 30 Sept 2014
Barings Quarterly Reports 30 Sept 2014
Baillie Gifford Quarterly Reports 30 Sept 2014
The WM Company Performance Review Report to 30 Sept 2014
Hyman's Monitoring Report to 30 Sept 2014