Havering
LONDON BOROUGH

PENSIONS COMMITTEE **20 December 2011**	**REPORT**

Subject Heading:	**PENSION FUND PERFORMANCE MONITORING FOR THE QUARTER ENDED 30 SEPTEMBER 2011**
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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 September 2011

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 2011. 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 2011 was **-8.8%.** This represents an under performance of **-2.1%** against

the combined tactical benchmark and an under performance of **-20.7%** against the strategic benchmark.

The overall net return of the Fund's investments for the **year** to 30 September 2011 was **-2.2%**. This represents an under performance of **-2.0%** against the annual tactical combined benchmark and an under performance of **-14.3%** against the annual strategic benchmark.

Members should bear in mind that the markets have seen unprecedented volatility since the latter half of 2007, with further market falls during 2008. The markets did rally during 2009 and 2010, erasing some of the earlier losses. However the outlook for the global economy remains unclear with the immediate priority being the debt crisis in the US and the Euro-zone.

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 Property Manager (UBS) and the Funds UK/Global Equities Passive Manager (State Street Global Assets).
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, 2.3 and 2.4 refers).

REPORT DETAIL

1. Background

1.1 A major restructure of the fund took place in the first quarter of 2005. A further restructure of the fund took place during the first half of 2008 and these changes were reflected in a revised Statement of Investment Principles (SIP) adopted by members in September 2008 and subsequently updated in June 2010 and November 2011. Implementation of the revised strategy is currently ongoing.

1.2 A strategic benchmark has been adopted for the overall Fund of Gilts + 2.6% (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. No revisions were made to individual fund manager benchmarks as part of the investment strategy review. However the asset allocation has been revised and these are shown in the following table against the manager's benchmarks:

Manager and % of total Fund awarded	**Mandate**	**Tactical Benchmark**	**Out performance Target**
Standard Life 20%	UK Equities -Active	FTSE All Share Index	2%
State Street (SSgA) (Account 2) 25%	UK/Global Equities - passive	UK- FTSE All Share Index Global (Ex UK) – FTSE All World ex UK Index	To track the benchmark
State Street (SSgA) (Account 1) 15%	UK/Global Equities - Passive	UK- FTSE All Share Index Global (Ex UK) – FTSE All World ex UK Index	To track the benchmark
Royal London Asset Management 25%	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 10%	Property	IPD (previously called HSBC/AREF) All Balanced Funds Median Index	To outperform the benchmark
Ruffer 5%	Multi Asset	Not measured against any market index – for illustrative purposes LIBOR (3 months) + 4%.	To outperform the benchmark

1.4 The Committee appointed a Multi-Asset Manager (Ruffer) and a Passive Equity Manager (State Street Global Advisors Limited (SSgA)) in February 2010. Both Managers commenced trading from 8th September 2010.

1.5 The mandate with the Global Equities Manager (Alliance Bernstein) was terminated in February 2011. Assets were transferred to State Street Global Advisors pending further consideration of the investment strategy. The Fund has gone through the tendering process in the search for a new Global Equity Manager and a Special Pensions Committee has been scheduled for the 15th December at which an appointment will be made.

1.6 UBS and SSgA manage the assets on a pooled basis. Standard Life, 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.

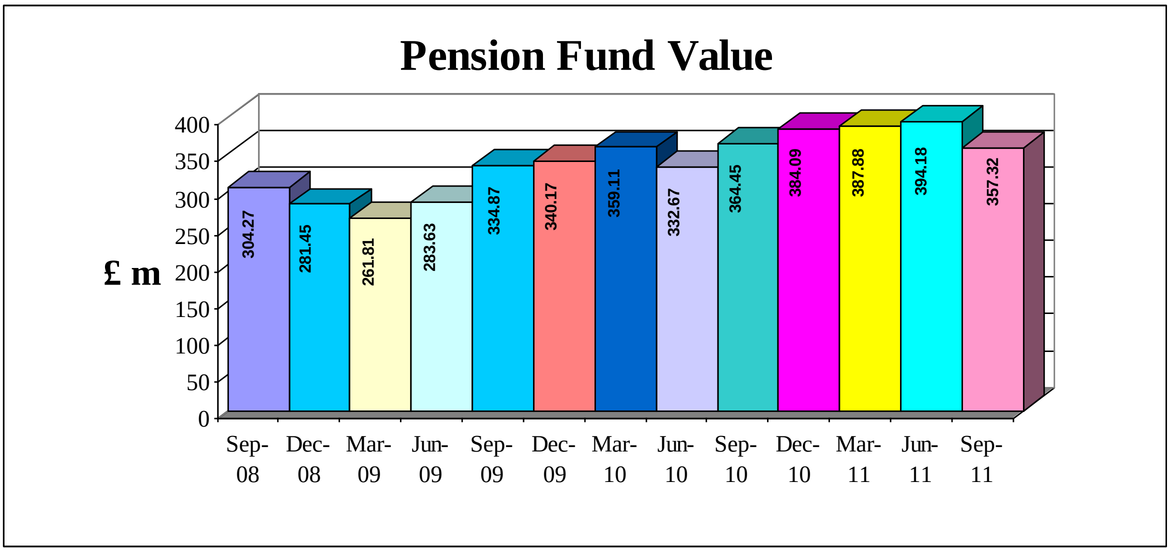
1.7 Since 2006, to ensure consistency with reports received from our Performance Measurers, Investments Advisors and Fund Managers, the 'relative returns' (under/over performance) calculations has been changed from the previously used arithmetical method to the industry standard geometric method (please 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 (Ruffer) and the Passive Equity (SSGa) Managers who will attend two meetings per year, one with Officers and one with 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 30 September 2011 was **£357.32m**. 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 £394.2m at the 30 June 2011; a **decrease** of **£36.86m**. The movement in the fund value is attributable to a decrease in cash of £2.47 and a decrease in fund performance of £34.39m. The internally managed cash level now totals **£1.1m**, of which an analysis follows in this report.



Source: WM Company (Performance Measurers)

2.2 An analysis of the internally managed cash balance of **£1.1m** follows:

CASH ANALYSIS	**2009/10**	**2010/11 (Updated)**	**2011/12**
	£000's	£000's	£000's
Balance B/F	**-7999**	**-4763**	**-8495**
Benefits Paid	26926	25702	16170
Management costs	1939	1895	647
Net Transfer Values	2639	-3053	-172
Employee/Employer Contributions	-28251	-28333	-13944
Cash from/to Managers/Other Adj.	0	176	4696
Internal Interest	-17	-119	-8
Movement in Year	**3236**	**-3732**	**7389**
Balance C/F	**-4763**	**-8495**	**-1106**

The 2011/12 figures are based upon an interim report and are subject to further adjustments.

2.3 Internally managed cash had been decreasing during 2009/10; the significant factor being the reduction in net transfer values (more members of the fund transferring out than in). A clarification in the regulations was required before a number of 'Transfers In' could be processed. This has since been received and the numbers of 'Transfers In' processed had increased, hence why the cash levels have risen.

2.4 As agreed by members on the 24 March 11, internally managed cash of £7m was transferred to UBS in May 2011. Income received of £2.1m not needed for reinvestment by Fund managers was transferred from our custodian on the 25 May 2011 to top up the internally managed cash.

2.5 Officers are anticipating that internally managed cash in 2011/12 will continue to reduce due to the amount of benefits being paid out of the scheme exceeding contributions received. Officers will be looking at ways of accessing income earned from investments to boost the cash flow for 2012/13.

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 30.09.11	**12 Months to 30.09.11**	**3 Years to 30.09.11**	**5 years to 30.09.11**
Fund	-8.8%	-2.2%	5.2%	0.2%
Benchmark return	-6.9%	-0.1%	6.7%	2.6%
*Difference in return	-2.1%	-2.0%	-1.4%	-2.4%

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 + 2.6%) is shown below:

	Quarter to 30.09.11	**12 Months to 30.09.11**	**3 Years to 30.09.11**	**5 years to 30.09.11**
Fund	-8.8%	-2.2%	5.2%	0.2%
Benchmark return	14.9%	14.2%	13.8%	9.7%
*Difference in return	-20.7%	-14.3%	-7.6%	-8.7%

Source: WM Company

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

The Fund's revised strategy adopted in September 2008 has not been fully implemented and historical performance greater than three years is no reflection of the revised strategy.

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 2011)

QUARTER	Standard Life	Royal London	UBS	Ruffer	SSgA A/C 1	SSgA A/C 2
Return (performance)	-20.1	6.4	0.8	-1.3	-14.6	-14.9
Benchmark	-13.5	7.5	1.6	0.2	-14.6	-14.9
***Over/(Under) Performance vs. Benchmark**	**-7.7**	**-1.1**	**-0.9**	**-1.5**	**0.0**	**0.0**
TARGET	-13.0	7.7	n/a	n/a	n/a	n/a
*** Over/(Under) Performance vs. Target**	**-8.1**	**-1.2**	**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.

ANNUAL PERFORMANCE (LAST 12 MONTHS)

ANNUAL	Standard Life	Royal London	UBS	Ruffer	SSgA A/C 1	SSgA A/C 2
Return (performance)	-12.2	8.0	8.7	n/a	n/a	n/a
Benchmark	-4.4	8.0	7.2	n/a	n/a	n/a
***Over/(Under) Performance vs. Benchmark**	**-8.2**	**0.0**	**1.5**	**n/a**	**n/a**	**n/a**
TARGET	-2.4	8.7	n/a	n/a	n/a	n/a
*** Over/(Under) Performance vs. Target**	**-10.0**	**-0.7**	**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.
- Ruffer and SSGa Inception from 8 Sept 2010

4. Fund Manager Reports

4.1. UK Equities (Standard Life)

a) In accordance with agreed procedures officers met with representatives from Standard Life on the 17 November 2011 at which a review of their Quarter 3 performance was discussed.

b) The value of the fund decreased by 25% on the previous quarter.

c) Standard Life underperformed the benchmark in the quarter by -7.7% and underperformed the target in the quarter by -8.1%. Since inception they are below benchmark by -1.7% and -3.7% against the target. As at the date of the meeting performance was up against the benchmark.

d) Standard Life reported that the third quarter saw global equity markets fall sharply with a lack of resolution to the European debt crisis, US credit rating downgrade and other countries in the Euro-zone dominating he news, all weighed heavily on the markets.

e) Standard Life's view on the economy are as follows:
   - They think that a double dip recession is unlikely but markets have set prices on this basis.
   - They anticipate that there will be modest global growth in 2012 and eventual solution to the euro-zone will allow global recovery to continue.
   - Defensive companies are now on a relative basis very expensive and given their growth prospects they remain unattractive. There are some interesting buying opportunities where companies' prospects remain attractive and balance sheets strong and Standard Life will seek to take advantage of where the market has excessively discounted economic weakness.

f) Standard Life's underperformance was largely down to its overweight position to resource stocks. Rio Tinto, Xstrata, and Vedanta Resources led the decline. Overweight positions in the Banking and Travel and Leisure sub sectors also suffered significantly.

g) Positive attribution in stock selection came from **Glaxosmithkline** as shares outperformed mainly on defensive merits. **Easyjet** – helped by lower oil price. **Howden Joinery** - strong trading as peers exit the market. **Persimmon** - Housing trends improving.

h) Negative attribution in stock selection came from **Vedanta, Rio Tinto**, **Xstrata** – concerns over global growth. **Barclays**, **Lloyds**, **RBS** – shares fell heavily on EU Sovereign issues. **Cookson Group**, **GKN** – Shares fell heavily on global growth concerns.

i) The portfolio activity during Quarter 3 were as follows :
   - Purchased BT – continues to take market share in broadband, cost cutting and global services recovery.

- Purchased Wolseley – new management delivering self help (selling French business).
- Increased holding in Shell – as it became evident that its heavy capital expenditure was delivering cash flows in the Middle East.
- Reduced holdings in Glaxosmithkline, Pearson and Next –due to strong relative performance
- Reduced holding in Vodafone – due to strong relative performance on back of Verizon wireless dividend and defensive characteristics.

j) Standard Life highlighted that the dividend yields are higher than 10 Year Bond yields and that the FTSE 100 is the same as it was 13 years ago.

k) Standard Life was asked if they have made any changes to the portfolio if the ‘worst case’ scenario happens and the euro-zone breaks down. They have been reducing risk and trimming back those stocks that have links to Europe. They have been investing in stocks that have growth and will use the market conditions to seek advantages in buying cheap cyclical stocks.

l) Standard Life believes that European solution is the key to markets recovering and this together with low equity valuations will drive a significant market rally. Standard Life has the view that current concerns over a euro-zone collapse will be resolved before the end of 2011 as they believe that the European Central Bank will launch Quantitative Easing.

m) Standard Life were informed of the updated Investment Strategy positions and were informed that the Committee have decided to reduce their exposure to UK Equities and a reduction will be made to their portfolio to fund the mandate with the Global Equity manager, who will be appointed at the end of December.

n) No governance or whistle blowing issues were reported.

4.2. 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 17 November 2011 at which a review of their Quarter 3 performance was discussed.

b) The value of the fund as at 30 September 2011 saw an increase of 6.3% on the previous quarter.

c) Royal London experienced its first quarter of underperformance in over two years. Royal London underperformed the benchmark for the quarter by -1.2% and -1.3% against the target. Since inception they outperformed benchmark by 0.3% but below target by -0.5%.

d) Asset allocation of the fund during the quarter was 56.6% Sterling Credit (corporate) Bonds, 29.4% Index Linked, 13.5% Government Bonds, 0.5% cash.

e) Royal London was overweight in UK corporate bonds, UK index Linked bonds and overseas fixed interest bonds and underweight in Government bonds.

f) Royal London's overweight position in corporate bonds contributed to underperformance. Stock selection within the corporate bond portfolio also detracted from performance. Royal London benefitted from its long dated holdings in the index linked portfolio, helping to offset some of the underperformance.

g) The <u>duration</u> position (the sensitivity of a bond's price to shifts in interest rates) of the fund on average was shorter than the benchmark during the quarter but this position was increased towards the end of the quarter. This marginally detracted from performance.

h) In respect of <u>asset allocation</u> Royal London's activity during the quarter was as follows:
   - Maintained an overweight position in corporate bonds – Corporate bonds underperformed UK government bonds in the period. This was a negative contributor.
   - Maintained an overweight position in index linked bonds – these underperformed as inflation expectations were revised down on slower growth prospects. Detracted from performance.
   - In respect of <u>stock selection</u> the activity during the quarter was as follows:
   - Maintained the minimal exposure to supranational bonds over the quarter – this was a negative factor for performance
   - Ran an overweight position in subordinated financial bonds- this was detrimental to performance.
   - Maintained the overweight position in asset backed securities– this was a benefit in the quarter
   - Added to the covered bond weighting by purchasing Nationwide, Abbey and Lloyds. This was negative to performance but believe that the relative valuations of these bonds will lead to outperformance in the medium term.
   - Underweight positions were held in auction stocks – positive effect on portfolio performance.

i) Royal London was asked how their bias towards security bonds fared in the quarter. They explained that they performed well relative to other areas, and although they underperformed against government bonds they did better than the financial bonds.

j) Royal London central case assumes a resolution to the Euro crisis. Royal London thinks that the risk of the Euro break down is about 20% but said that they were happy with their positions in the fund. They believe that their positioning is right for the economic crisis and are positioned with the right amount of risk.

k) Royal London was asked whether they have any exposure to overseas bonds and how they deal with the corresponding currency exposure. Royal London during the quarter had holdings in Dutch and French Government Bonds but they hedge the currency exposure to eliminate the risk of loss from movements in exchange rates.

l) No governance or whistle blowing issues were reported.

4.3. Property (UBS)

a) Representatives from UBS are to make a presentation at this committee, therefore a brief overview of their Quarter 3 performance follows:

b) The value of the fund as at 30 September 2011 saw a decrease of .38% since the previous quarter.

c) UBS under performed the benchmark in the quarter by -.86% and is ahead of the benchmark in the year by 1.47%.

d) Two industrial assets were purchased in the South East England, representing the funds first purchases in nearly four years. Three assets were sold where asset management improvements had been completed

e) UBS held their UK EGM meeting on the 17 November 2011 where a number of changes in relation to the UBS Triton Property Fund were proposed which required investor approval. Following consultation with the Fund's investment advisor, Havering Pension Fund as an investor voted in favour of the proposals via proxy.

f) Key Fee changes as follows:

- **Change the fund's benchmark from median to a weighted average.** Currently there are 28 funds included in the benchmark, some of which have significant different portfolios to UBS Triton due to their size or strategy. The median measure treats each fund equally whereas the weighted average measure will provide a more consistent and comparable measure.
- **Increase the measurement period for performance fee calculation from 1 to 3 years.** More appropriate than one year to test performance and encourages manager to take a longer term view in making investment decisions.
- **Introduce tiered annual management fee which will decrease as the fund grows.** As the fund grows, the average annual management fee will reduce reflecting the economies of scale in managing the fund and also reducing

the business pressure to grow the fund which may potentially compromise performance**.**

4.4. Multi Asset Manger (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 first meeting with members at the 24 March 11 Pensions Committee meeting. Officers were not due to meet with officers but a brief review of their Quarter 3 performance follows:

b) The value of the fund as at 30 September 2011 saw a decrease of 1.33% since the previous quarter.

c) Ruffer underperformed in the quarter by -1.50%.

d) Main contributor to performance came from Index linked bonds as a flight to safety' drove government bond yields sharply lower, and with currency trades being sold the US dollar appreciated sharply against the Australian and Canadian currency.

e) Economically sensitive equities drove share prices lower. Notable losses in Ericsson, Deutsche Post, BP and Invensys. Falling bond yields drove the net asset value of T& D lower causing a fall in the share price.

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. Representatives from SSgA are to make a presentation at this committee, therefore a brief overview of their Quarter 3 performance follows:

b) The value of the fund (Account 1) as at 30 September 11 decreased by -17.06% since the last quarter. SSgA outperformed the benchmark in the quarter by 0.05%. Since inception Account 1 has out performed the benchmark by 0.07%.

c) On termination with the funds Global Asset Manager (Alliance Bernstein) a second wave of assets was transferred to SSgA on the 23 February 2011 to be managed passively (Account 2). The value of Account 2 has decreased by -17.57% since the last quarter. SSgA outperformed the benchmark in the quarter by 0.04%. Since inception Account 2 has out performed the benchmark by 0.04%.

d) The second account is being kept separate, as the current intention is that this is a temporary measure until the investment strategy have progressed and a new Global Equity Manager has been appointed.

e) Officers will have discussions with the Fund's advisor regarding consideration of switching to currency hedging within the portfolio.

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 managers attending the meeting will be from:

  UBS and State Street Global Assets (SSgA)

- 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 2011
Royal London Quarterly report to 30 Sept 2011
UBS Quarterly report to 30 Sept 2011
The WM Company Performance Review Report to 30 Sept 2011
Hyman's Monitoring Report to 30 Sept 2011