Havering
LONDON BOROUGH

PENSIONS COMMITTEE **27 March 2012**	**REPORT**

Subject Heading:	**PENSION FUND PERFORMANCE MONITORING FOR THE QUARTER ENDED 31 DECEMBER 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 31 December 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 31 December 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 31 December 2011 was **6.5%.** This represents an under performance of **-0.3%** against the

combined tactical benchmark and an under performance of **-3.2%** against the strategic benchmark.

The overall net return of the Fund's investments for the **year** to 31 December 2011 was **-0.6%**. This represents an under performance of **-1.8%** against the annual tactical combined benchmark and an under performance of **-23.1%** 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 UK Equities Manager (Standard Life) and 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, 2.3 and 2.4 refers).
8) Considers rebalancing options with regard to the overweight position in bonds (paragraph 1.5, 2.5 and 4.2 (d) 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 at a Special Pensions Committee on the 15 December 2011, the committee agreed to award the Global Equity Mandate to Baillie Gifford. Baillie Gifford was selected from six investment managers who were appointed to the Global Equity Manager framework. The funding of this mandate will see an approximate reduction in holdings from the pension fund managers; Standard Life by 4.5%, SSgA UK Equities by 4.7%, SSgA Global by 3.7% and a possible reduction to Royal London of 4.2%. Asset allocations will be updated for the committee after the transition process.

1.6 A Transition Manager (Nomura) has been appointed to manage the transition of assets from the existing fund managers to Baillie Gifford. **A verbal update will be provided at this meeting with regard to the progress of the transition arrangements.**

1.7 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.

1.8 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).

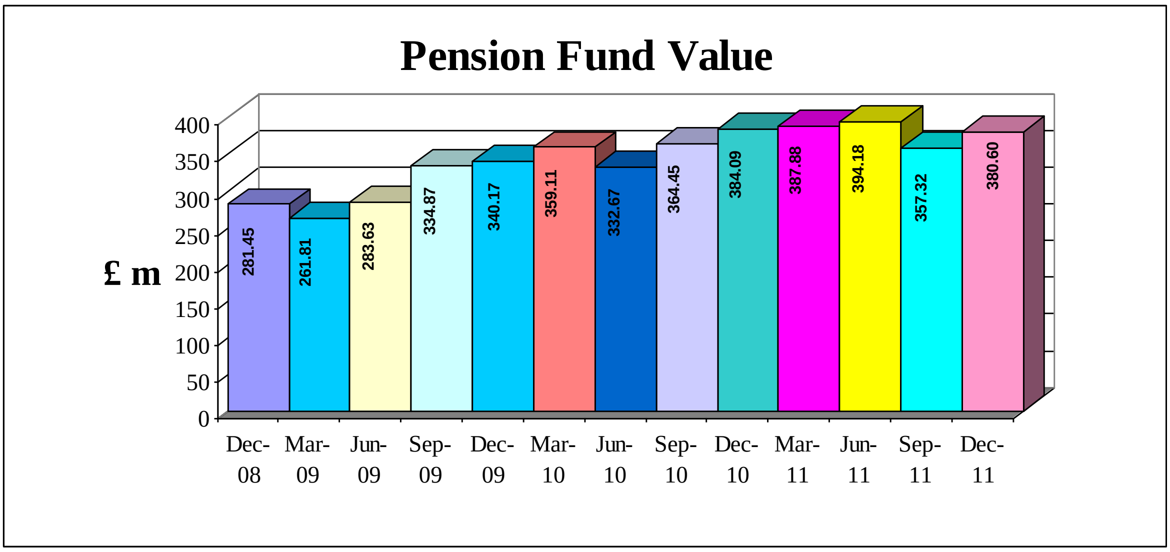
1.9 Existing Managers are invited to present at the Pensions Committee Meeting every six months. On alternate dates, they meet with officers for a formal monitoring meeting. The exception to this procedure is the Multi Asset (Ruffer) and the Passive Equity (SSgA) Managers who will attend two meetings 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.

1.10 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 31 December 2011 was

£380.59m. 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 £357.32m at the 30 September 2011; an **increase** of **£23.28m**. The movement in the fund value is attributable to a decrease in cash of £0.10m and an increase in fund performance of £23.38m. The internally managed cash level now totals **£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 **£1.0m** 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	23296
Management costs	1939	1895	806
Net Transfer Values	2639	-3053	471
Employee/Employer Contributions	-28251	-28333	-21934
Cash from/to Managers/Other Adj.	0	176	4869
Internal Interest	-17	-119	-18
Movement in Year	**3236**	**-3732**	**7490**
Balance C/F	**-4763**	**-8495**	**-1005**

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 had since been received and the numbers of 'Transfers In' processed had increased, hence why the cash levels rose in 2010/11.

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 31.12.11	**12 Months to 31.12.11**	**3 Years to 31.12.11**	**5 years to 31.12.11**
Fund	6.5%	-0.6%	10.5%	0.6%
Benchmark return	6.1%	1.3%	10.6%	3.2%
*Difference in return	0.3%	-1.8%	-0.1%	-2.5%

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 31.12.11	**12 Months to 31.12.11**	**3 Years to 31.12.11**	**5 years to 31.12.11**
Fund	6.5%	-0.6%	10.5%	0.6%
Benchmark return	10.0%	29.2%	12.4%	11.8%
*Difference in return	-3.2%	-23.1%	-1.7%	-10.0%

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 31 DECEMBER 2011)

QUARTER	Standard Life	Royal London	UBS	Ruffer	SSgA A/C 1	SSgA A/C 2
Return (performance)	8.0	7.3	1.6	2.5	7.6	7.4
Benchmark	8.4	6.6	1.3	0.3	7.6	7.4
***Over/(Under) Performance vs. Benchmark**	**-0.4**	**0.7**	**0.3**	**2.2**	**0.0**	**0.0**
TARGET	8.9	6.8	n/a	n/a	n/a	n/a
*** Over/(Under) Performance vs. Target**	**-0.8**	**0.5**	**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	17.9	8.5	1.8	-5.8	n/a
Benchmark	-3.5	17.6	6.8	0.9	-5.8	n/a
***Over/(Under) Performance vs. Benchmark**	**-9.1**	**0.3**	**1.7**	**0.9**	**0.0**	**n/a**
TARGET	-1.5	18.3	n/a	n/a	n/a	n/a
*** Over/(Under) Performance vs. Target**	**-10.7**	**-0.4**	**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 (A/c 1) Inception from 8 Sept 2010
- SSGa (A/c 2) Inception February 2011

4. Fund Manager Reports

4.1. UK Equities (Standard Life)

a) Representatives from Standard Life are to make a presentation at this committee; therefore a brief overview of their performance as at 31 December 2011 follows.

b) The value of the Standard Life portfolio has increased by 7.9% on the previous quarter.

c) Standard Life underperformed the benchmark in the quarter by -0.4% and underperformed the target in the quarter by -0.9%. Since inception they have underperformed the benchmark by -1.7% and underperformed against the target by -3.7%.

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 to make a presentation at this committee; therefore a brief overview of their performance as at 31 December 2011 follows.

b) The value of the Royal London portfolio saw an increase of 7.3% on the previous quarter.

c) Royal London outperformed the benchmark by 0.6% and outperformed the target by 0.5%. Since inception they outperformed the benchmark by 0.3% but below target by -0.4%.

d) The proportion of allocation of funds to Royal London exceeds the target of 20% by 7.3%. In accordance with the Fund's Statement of Investment Principles a 5% difference will trigger a rebalancing. Members are to consider options for rebalancing the fund's allocation to Royal London.

4.3. Property (UBS)

a) In accordance with agreed procedures officers met with representatives from UBS on the 7 February 2012 at which a review of their performance as at 31 December 2011 was discussed.

b) The value of the UBS portfolio fund saw a slight increase in value of 1% since the previous quarter and grew slightly by 0.36% as at the 31 January 2012.

c) UBS out performed the benchmark in the quarter by 0.3% and out performed the benchmark in the year by 1.7%.

e) The number of properties in the fund currently stands at 42.

f) The void rate as at 31 December 11 was 5.9% against a benchmark 9.7%. UBS don't expect the void rate to reduce much further and it's expected to fluctuate between 5.5% to 7.5% in the future but this will be kept under control.

g) The redemption queue is now valued at around £20m and assets for sale total £37m.

h) Over the quarter rental income was the main driver of performance. Assets within the retail warehouse and industrial sectors added most to the returns and performed sufficiently well to more than make up losses from shopping centre assets, which had struggled over the quarter.

i) Detractors from performance came from vacancies at some sites and lower than expected rentals.

j) UBS explained some of their investment outlooks for property in 2012 and believe that capital values will fall but income yields will rise. Part of their strategy will be to accept that it may be necessary to accept lower rents than leave units empty. They are also looking to investigate assets that cater to the demography of the UK (e.g. aging population).

k) UBS were questioned why the majority of sales were in the retail sector and they made clear that this was an asset view and not a sector view.

l) It was enquired as to whether UBS have managed to increase its allocation to industrials as intended. They gave details of the two sites they have acquired and confirmed that they would seek to add to the portfolio but there are no acquisitions' in the pipeline.

m) UBS reiterated that they have taken a number of steps to strengthen their governance arrangements around the rate of growth (as this is what has caused problems with the portfolio in the past). They have developed guidelines and introduced thresholds so any variance within the threshold would have to be sanctioned by their investment committee.

n) At the EGM in November Key Fee changes were approved 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**.**

o) No whistle blowing issues or governance was reported.

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. In accordance with agreed procedures officers met with representatives from Ruffer on the 7 February 2012 at which a review of their performance up to 31 December 2011 was discussed.

b) The value of the Ruffer portfolio increased by 2.7% compared to the previous quarter.

c) Ruffer out performed the benchmark in the quarter by 2.2% and out performed the benchmark in the year by 0.9%.

d) The returns over the quarter were driven by gains in selected equities and long-dated UK index-linked gilts. The US Dollar position fared well as the dollar held steady over the quarter.

e) One of the highest positive contributions came from holding Government bonds in the UK and US. In the UK, index linked gilts continued to perform well as further quantitative easing was announced in the UK and the new issuance was comfortably absorbed.

f) One of the largest negative contributions came from the fund's equity exposure to Gold

g) The only substantial trade during the quarter was to take profits in part of the holding in the Red Kite Compass fund.

h) In response to a question about portfolio positioning Ruffer explained that they attempt to remove the impact of market timing and always ask how they can be wrong – they analyse the assets held and question whether they are holding assets that move in different directions to markets and whether this results in asset doubling or offsetting risk. They consider it fundamental to analyse future events, not just a quantitative analysis of past practice.

i) Ruffer was asked about their positioning with regard to Japanese equities.

j) Their original logic in investing in Japan was due to the fact that they believe that Japan has a high savings culture contributing to a strong currency position. As equity prices have been falling the Yen has strengthened. However, they would like to see a policy shift, namely currency intervention and joining in the western money printing-fest, but they take comfort from the fact that while rising inflation is generally hostile to equity valuations, Japan is the one major market with absolutely nothing to fear from its return. During January they have added to their exposure to Japanese Banks.

k) Ruffer was asked to provide an update on Jonathan Ruffer's retirement plans and how this will impact the fund. Ruffer emphasized that there will be no change in investment philosophy and that whilst Jonathan Ruffer will cease to be full time from 31 March 2012; he will still be responsible for asset allocation in partnership with Henry Maxey, who will become the Chief Executive Officer.

l) 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 a meeting with members at the 24 March 11 Pensions Committee meeting. Officers were not due to meet with SSgA but a brief overview of their performance as at 31 December 2011 follows:

b) The value of the fund (Account 1) increased by 7.6% since the last quarter. SSgA matched the benchmark in the quarter. Since inception Account 1 has underperformed the benchmark by -0.03%.

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 increased by 7.3% since the last quarter. SSgA matched the benchmark. Since inception Account 2 has out performed the benchmark by 0.05%.

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

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:

    Standard Life and 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 December 2011
Royal London Quarterly report to 31 December 2011
UBS Quarterly report to 31 December 2011
Ruffer Quarterly report to 31 December 2011
State Street Global Assets reports to 31 December 2011
The WM Company Performance Review Report to 31 December 2011
Hyman's Monitoring Report to 31 December 2011