



PENSIONS COMMITTEE 2 October 2012	

Subject Heading:	PENSION FUND PERFORMANCE MONITORING FOR THE QUARTER ENDED 30 JUNE 2012
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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 June 2012

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

Clean, safe and green borough	<input type="checkbox"/>
Excellence in education and learning	<input type="checkbox"/>
Opportunities for all through economic, social and cultural activity	<input type="checkbox"/>
Value and enhance the life of every individual	<input checked="" type="checkbox"/>
High customer satisfaction and a stable council tax	<input type="checkbox"/>

SUMMARY

This report provides the Committee with an overview of the performance of the Havering Pension Fund investments for the quarterly period to 30 June 2012. 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 June 2012 was **-2.3%**. This represents an under performance of **-1.1%** against the

combined tactical benchmark and an under performance of **-9.1%** against the strategic benchmark.

The overall net return of the Fund's investments for the **year** to 30 June 2012 was **0.3%**. This represents an under performance of **-1.8%** against the annual tactical combined benchmark and an under performance of **-23.4%** against the annual strategic benchmark.

After a strong start to the year UK Equities fell in the second quarter. In a volatile quarter the Euro-zone crisis and signs of slowing global economical growth undermined market confidence and investors sought for safety. Political turmoil in Greece, banking problems in Spain and a change of Government in France added to market uncertainty. There were no changes to UK interest rates at 0.5% and inflation is continuing to fall.

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 and considers whether action with regard to UBS is required (paragraph 4.3 (h – l) refers).
- 7) Notes the analysis of the cash balances (paragraphs 2.2 and 2.3 refers).

REPORT DETAIL

1. Background

- 1.1 A 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)

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adopted by members in September 2008 and subsequently updated in June 2010 and November 2011.

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 in line with the Statement of investment Principles as at November 2011, the asset allocations are shown in the following table against the manager's benchmarks:

1.4

Manager and % of target fund allocation	Mandate	Tactical Benchmark	Out performance Target
Standard Life 17%	UK Equities -Active	FTSE All Share Index	2%
State Street (SSgA) 26%	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	<ul style="list-style-type: none"> • 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 10%	Multi Asset	Not measured against any market index – for illustrative purposes LIBOR (3 months) + 4%.	To outperform the benchmark

1.5 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.

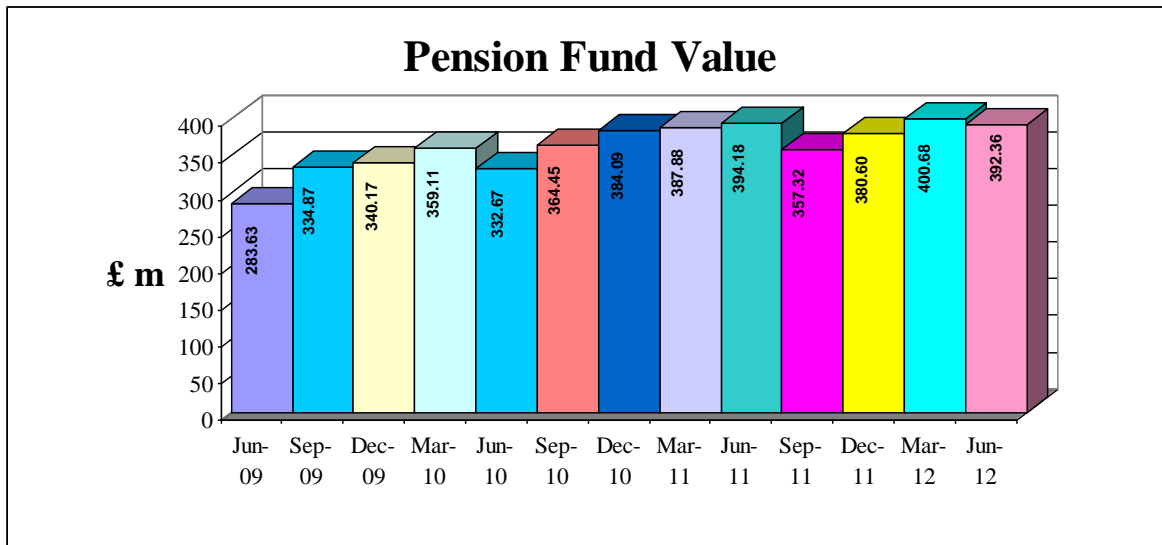
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- 1.6 The mandate with the Global Equities Manager (Alliance Bernstein) was terminated in February 2011. Assets were transferred to State Street Global Advisors pending further consideration of the investment strategy. The Fund has completed the tendering 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.
- 1.7 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%.
- 1.8 A Transition Manager (Nomura) was appointed to manage the transition of assets from the existing fund managers to Baillie Gifford; part of the transition process also saw a rebalancing of the funds investments with SSgA. The transition exercise was successfully completed during April 2012.
- 1.9 UBS, SSgA and Baillie Gifford 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.
- 1.10 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).
- 1.11 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.
- 1.12 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 June 2012 was **£392.36m**. 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 £400.68 at the 31 March 2012; a **decrease of (£8.32m)**. The movement in the fund value is attributable to an increase in cash of £2.57m and a decrease in fund performance of (£10.89m). The

internally managed cash level stands at **£1.75m** of which an analysis follows in this report.



Source: WM Company (Performance Measurers)

2.2 An analysis of the internally managed cash balance of **£1.75** follows:

<u>CASH ANALYSIS</u>	<u>2010/11</u>	<u>2011/12</u> <u>Updated</u>	<u>2012/13</u>
	£000's	£000's	£000's
Balance B/F	-4763	-8495	-1194
Benefits Paid	25702	31123	8027
Management costs	1895	1606	62
Net Transfer Values	-3053	-58	-125
Employee/Employer Contributions	-28333	-30194	-6520
Cash from/to Managers/Other Adj.	176	4869	-2000
Internal Interest	-119	-45	-9
Movement in Year	-3732	7301	-565
Balance C/F	-8495	-1194	-1759

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

2.3 As agreed by members on the 27 June 2012 a cash management policy has now been adopted. This policy included drawing down income from the bond and property manager. Officers are currently in the process of setting up this arrangement with the fund's custodian and bond 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 30.06.12	12 Months to 30.06.12	3 Years to 30.06.12	5 years to 30.06.12
Fund	-2.3%	0.3%	11.4%	0.7%
Benchmark return	-1.2%	2.1%	12.6%	3.5%
*Difference in return	-1.1%	-1.8%	-1.0%	-2.7%

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 30.06.12	12 Months to 30.06.12	3 Years to 30.06.12	5 years to 30.06.12
Fund	-2.3%	0.3%	11.4%	0.7%
Benchmark return	7.4%	30.9%	15.4%	13.9%
*Difference in return	-9.1%	-23.4%	-3.5%	-11.6%

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 JUNE 2012)

	Standard Life	Royal London	UBS	Ruffer	SSgA	Baillie Gifford¹
QUARTER						
Return (performance)	-6.7	3.1	-0.1	-2.9	-3.7	-2.3
Benchmark	-2.5	3.2	0.3	0.2	-3.6	-0.9
*Over/(Under) Performance vs. Benchmark	-4.2	-0.1	-0.4	-3.1	-0.1	-1.4
TARGET	-2.0	3.4	n/a	n/a	n/a	n/a
* Over/(Under) Performance vs. Target	-4.7	-0.3	n/a	n/a	n/a	n/a

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Source: WM Company, Fund Managers and Hymans

¹ Trading commenced 25 April so not trading for the full period. Target is measured using annualised data, so not yet applicable.

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

ANNUAL PERFORMANCE (LAST 12 MONTHS)

	Standard Life	Royal London	UBS	Ruffer	SSGa	Baillie Gifford
ANNUAL						
Return (performance)	-10.1	17.8	2.6	-0.2	-4.1	n/a
Benchmark	-3.1	17.5	4.1	0.6	-4.1	n/a
*Over/(Under) Performance vs. Benchmark	-7.0	0.3	-1.5	0.8	0.0	n/a
TARGET	-1.1	18.2	n/a	n/a	n/a	n/a
* Over/(Under) Performance vs. Target	-9.0	-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
- Baillie Gifford inception 25 April 2012

4. Fund Manager Reports

4.1. UK Equities (Standard Life)

- Representatives from Standard Life are to make a presentation at this committee; therefore a brief overview of their performance as at 30 June 2012 follows.
- During the quarter £16.8m was withdrawn from Standard Life and transferred to the new Global Equity Manager Baillie Gifford.
- The value of the Standard Life portfolio fund saw a decrease in value of 5.7% since the previous quarter (excludes transfer)
- Standard Life under performed the benchmark in the quarter by -4.2% and under performed the benchmark in the year by -7.2%.

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

- Representatives from Royal London are to make a presentation at this committee; therefore a brief overview of their performance as at 30 June 2012 follows.

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- b) During the quarter £15.7m was withdrawn from Royal London and transferred to the new Global Equity Manager Baillie Gifford and £2m was withdrawn and transferred to internally managed cash to boost the cash position.
- c) After deducting for the transfer of assets the value of the Royal London portfolio fund saw an increase in value of 3% since the previous quarter.
- d) Royal London under performed the benchmark in the quarter by -0.1% and out performed the benchmark in the year by 0.3%.

4.3. Property (UBS)

- a) In accordance with agreed procedures officers met with representatives from UBS on the 02 August 2012 at which a review of their performance as at 30 June 12 was discussed.
- b) The value of the UBS portfolio saw a decrease in value of 0.5% since the previous quarter.
- c) UBS under performed the benchmark in the quarter by -0.4% and under performed the benchmark in the year by -1.5%. UBS explained that timings of settlement in deals are why there are peaks and troughs in performance.
- d) UBS were asked what actions they were taking to address continuing underperformance from shopping centres in the portfolio. They mentioned that part of their strategy will be to also accept that it may be necessary to accept lower rents than leave units empty.
- e) The number of properties in the fund currently stands at 40.
- f) The void rate as at 31 December 11 was 6% against a benchmark 10.7%. There are two lettings going through the legal process at the moment so this may reduce.
- g) Over the quarter rental income was the main driver of performance.
- h) A discussion took place regarding the departure of the Portfolio Manager who is due to leave in September 2012. Responsibilities will transition to UBS Triton's assistant portfolio managers, Jo Love and John Murnaghan. Jo and John have combined experience of 25 years and report to Anthony Shayle, the Head of Global Real Estate.
- i) UBS reiterated that the transition process is being carefully managed and a clear timetable has been set and they are in line with this. Anthony explained that the quality of candidates is strong and the shortlist is down to five and hope to appoint a replacement by end of the year. There will be no change to day to day operations and the Investment committee still make the decisions.

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- j) The redemption queue is now valued at around £101m. This has risen from around £30m. UBS were asked how much of the £101m grew as response to the announcement regarding the Portfolio Manager and this equates to around £40m.
- k) UBS were asked how performance may be affected by the need to fulfil redemptions. They did say that there will be an impact and they have implemented a sales strategy to meet the 12 month redemption queue. They will identify any asset bubbles which are those assets that they can sell for more than their worth. They are undertaking a full scale valuation so that assets can be ranked in order and are looking at ways to reduce risk in certain areas where they have over exposure.
- l) **UPDATE:** UBS have now appointed a new portfolio Manager – Howard Meaney who joins the team on the 17 September 2012.
- m) 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 at the 27 June 12 Pensions Committee meeting. Officers are not due to meet with Ruffer until February 2013. A brief overview of their performance as at 30 June 2012 follows:
- b) The value of the Ruffer portfolio decreased by -2.4% compared to the previous quarter.
- c) Ruffer under performed the benchmark in the quarter by -3.0% and under performed the benchmark in the year by -0.8%.
- d) Positive contribution came from holdings in equities with strong balance sheets and cash-flows. Holdings in Johnson & Johnson, Vodafone, Wal-Mart and Kraft were among the major contributors.
- e) Negative performance came from economically sensitive equities, these included holdings in INPEX, which declined with the falling oil price and technology related holdings Cisco, Texas Instruments and Ericsson. Holdings in gold equities were also a negative contributor.

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. Officers met with representatives from SSgA on the 15 May 2012 and members are due to meet with SSgA at the December meeting.

- b) 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). Since Baillie Gifford was appointed as the new global equity manager assets totalling £30m were transferred to Baillie Gifford in April 12. Accounts 1 and 2 will now be merged into one account.
- c) The new merged single account dropped in value by 2.7%
- d) As expected the portfolio performed in line with the benchmark over the quarter.

4.6. Global Equities Manager (Baillie Gifford)

- a) In accordance with agreed procedures officers met with representatives from Baillie Gifford on the 02 August 2012 at which a review of their performance as at 30 June 12 was discussed.
- b) Trading commenced 25 April 2012. Asset values at time of transfer were £62,437,956.00. There has been a decrease in the fund value of -2.4% since inception.
- c) Since inception Baillie Gifford are below the benchmark by -1.4%.
- d) Underperformance largely due to concerns surrounding the Euro zone. Stock performed as expected but market volatility main driver of performance. Main detractors from performance were Brazilian Oil Company ODX and Yamaha.
- e) This was the first officers meeting with Baillie Gifford since appointment so they were asked to provide a recap on the four categories of investments and how these are used to structure the portfolio and generate return. The four categories are:
 - Growth Stalwarts – This group holds strong brands and have consistent growth. Holdings in this category currently stand at about 21%.
 - Rapid Growth – Stocks in this group have the fastest growth during a year of 15 – 20%. Holdings in this category currently stand at about 24%.
 - Cyclical Growth – Would expect stocks in this group to have more growth over the longer term. Holdings in this category currently stand at about 38%.
 - Latent Growth – This group would hold stocks that are most out of favour with market. More turnover of stock in this group and companies will either move to another group or be sold off. Holdings currently stand at about 15%.
- f) Baillie Gifford were asked if the structure of the portfolio will be affected by potential further market volatility in the short term and they explained that they may make some tactical reductions in holdings. They explained their investment philosophy as focusing on the longer term and believe in having

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patience, making investment not speculation and seek to turn time and volatility to their advantage.

- g) Activity over the last six months has been increasing exposure to Rapid and Cyclical Growth stocks.
- h) Outlook remains uncertain and volatility likely to continue. Baillie Gifford feels that there are significant opportunities for long-term, patient investors.
- i) No governance or whistle blowing issues were reported.

4.7 WM Performance Measurers

Officers met with a WM representative on the 2 August 2012 who gave a presentation on the 2011/12 returns of the WM universe. A summary of the major points are as follows:

- WM universe is made up of 84 funds.
- The benchmark for the universe was 2.6%.
- Havering Pension Fund return was 4.4% and outperformed the universe benchmark by 1.8%. The outperformance can be attributed to the effects of asset allocation of 0.7% and stock selection of 1.1%.
- A positive decision in asset allocation (the split between asset classes of equities, bonds etc) means that the fund invested more than the benchmark in an area that has performed well or invested less in an area that has performed poorly. Bonds and Alternatives were the positive contributory asset classes.
- Stock selection will be positive if the fund has outperformed the benchmark in a particular area (Stocks are selected by the various Fund Managers). Stocks in equities were the only negative contributor.
- Havering Pension Fund achieved an overall ranking for the year of 23rd.
- Inflation over the last year was 3.6%, and 4.5 over three years and 3.3 % for the five and ten year periods. See table below for comparison to the Havering pension fund.

	2011/12	3 Yrs	5 Yrs	10 Yrs
Fund Return	4.4	15.6	1.8	4.5
Benchmark (WM Universe)	2.6	14.5	3.2	5.7
Relative Return	1.8	0.9	-1.3	-1.1
Ranking	23	32	81	88
Inflation (RPI)	3.6	4.5	3.3	3.3

- In 2011/12 the fund generated a return of 4.4% which exceeded inflation thereby generating a real return of 0.8% for the year. Over three years the fund can also be seen to have generated real returns when compared with inflation. However over the five year cycle the fund has not generated above inflation returns.

- WM also produced charts that show the relationship between the absolute level of return achieved and the risk taken in obtaining that return for the main assets classes. Chart showed that the Havering Pension Fund had achieved increased levels of return whilst maintaining a moderate risk level when compared with other funds in the WM universe.

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 30 June 2012
Royal London Quarterly report to 30 June 2012
UBS Quarterly report to 30 June 2012
Ruffer Quarterly report to 30 June 2012
State Street Global Assets reports to 30 June 2012
The WM Company Performance Review Report to 30 June 2012
Hyman's Monitoring Report to 30 June 2012