Havering
LONDON BOROUGH

PENSIONS COMMITTEE 26 March 2013	REPORT

Subject Heading:	**PENSION FUND PERFORMANCE MONITORING FOR THE QUARTER ENDED 31 DECEMBER 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 31 December 2012

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 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 31 December 2012 was **3.0%.** This represents an out performance of **0.7%** against the combined tactical benchmark and an out performance of **2.5%** against the strategic benchmark.

The overall net return of the Fund's investments for the **year** to 31 December 2012 was **10.5%.** This represents an out performance of **1.3%** against the annual tactical combined benchmark and an out performance of **4.4%** against the annual strategic benchmark.

Global economic data showed signs of stabilisation, particular in the US and China; the Eurozone economy remained mixed. The re-election of President Obama in November offered some clarity politically but markets fell sharply in the immediate aftermath as the focus shifted to the approaching 'fiscal cliff' debate. The fourth quarter was positive for UK equities. In December the Office for Budget Responsibility and the Bank of England revised their growth forecasts downwards and austerity measures are to be prolonged. Index linked gilts returned 4.3% during the quarter, reflecting increased demand for longer dated bonds and outperformed fixed interest gilts.

It is now possible to measure the individual managers' annual return for the new tactical combined benchmark since they became active on the 14 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), the Funds Investment Grade Bonds Manager (Royal London) and the Funds Global Equities Manager (Baillie Gifford).
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 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) adopted by members in September 2008 and subsequently updated in June 2010 and November 2011. The SIP is currently being amended to reflect the outcomes of the recent Investment Strategy review.

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:

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	• 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

Manager and % of target fund allocation	Mandate	Tactical Benchmark	Out performance Target
Ruffer 10%	Multi Asset	Not measured against any market index – for illustrative purposes LIBOR (3 months) + 4%.	To outperform the benchmark

1.4 Changes to the asset allocation will be reflected in a future report, once the amended SIP has been agreed.

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 8 September 2010.

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 completed a tendering process in the search for a new Global Equity Manager and at a Special Pensions Committee on the 15 December 2011, awarded the mandate to Baillie Gifford. Baillie Gifford commenced trading from April 2012.

1.7 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.

1.8 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.

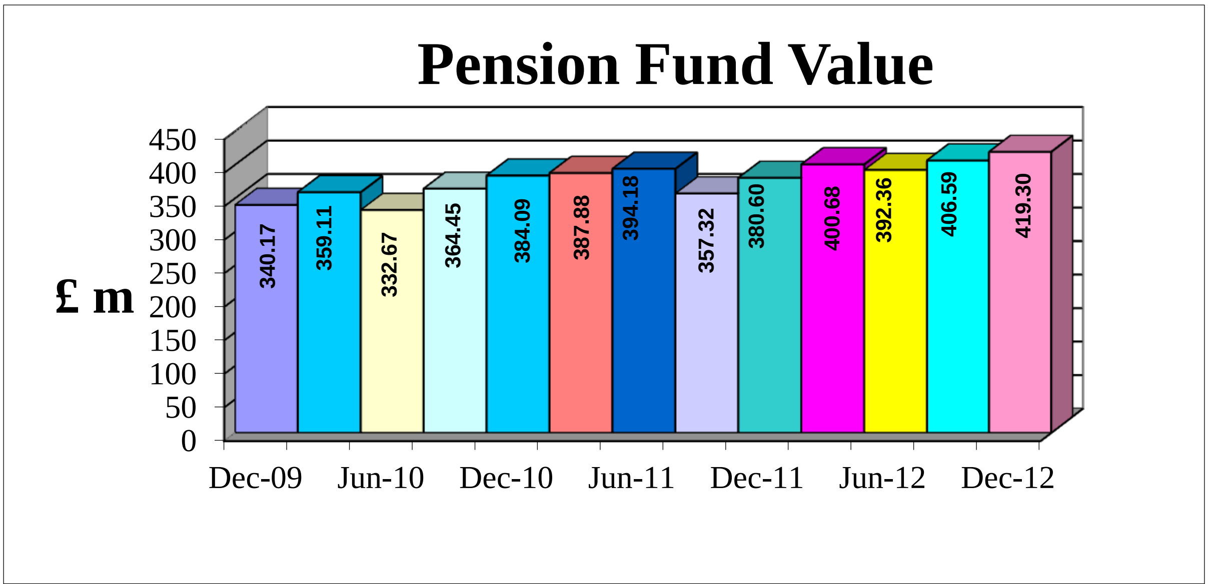
1.10 Due to the change in date of the December committee meeting the scheduled presentation from Baillie Gifford will be given at this meeting

1.11 Hyman's performance monitoring report is attached at **Appendix A. (Exempt report)**

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 2012 was **£419.30m**. 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 £406.59m at the 31 September 2012; an **increase** of £12.71m. The movement in the fund value is attributable to an increase in cash of £0.17m and an increase in fund performance of £12.54m. The internally managed cash level stands at **£2.63m** of which an analysis follows in this report.



Source: WM Company (Performance Measurers)

2.2 An analysis of the internally managed cash balance of **£2.63m** follows:

CASH ANALYSIS	**2010/11**	**2011/12 Updated**	**2012/13 31 Dec 12**
	£000's	£000's	£000's
Balance B/F	**-4763**	**-8495**	**-1194**
Benefits Paid	25702	31123	23558
Management costs	1895	1606	1163
Net Transfer Values	-3053	-58	-1250
Employee/Employer Contributions	-28333	-30194	-21272
Cash from/to Managers/Other Adj.	176	4869	-3603
Internal Interest	-119	-45	-31
Movement in Year	**-3732**	**7301**	**-1435**
Balance C/F	**-8495**	**-1194**	**-2629**

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

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.

2.4 In October 2012 rental income totalling £1.6m was transferred to cash from the property manager. Whilst the SIP is under review disinvesting from managers will be discussed before disinvestment is undertaken.

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 31.12.12	12 Months to 31.12.12	3 Years to 31.12.12	5 years to 31.12.12
Fund	3.0%	10.5%	7.0%	2.3%
Benchmark return	2.3%	9.0%	7.9%	4.1%
*Difference in return	0.7%	1.3%	-0.8%	-1.8%

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 31.12.12	12 Months to 31.12.12	3 Years to 31.12.12	5 years to 31.12.12
Fund	3.0%	10.5%	7.0%	2.3%
Benchmark return	0.5%	5.9%	15.2%	11.8%
*Difference in return	2.5%	4.4%	-7.1%	-8.8%

Source: WM Company

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

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

QUARTERLY PERFORMANCE (AS AT 31 DECEMBER 2012)

QUARTER	Standard Life	Royal London	UBS	Ruffer	SSgA	Baillie Gifford[1]
Return (performance)	7.8	3.4	-8.0	2.5	2.5	2.9
Benchmark	3.8	2.6	-0.4	0.1	2,5	2.2
***Over/(Under) Performance vs. Benchmark**	**3.9**	**0.8**	**-7.6**	**2.4**	**0.0**	**0.7**
TARGET	4.3	2.8	n/a	n/a	n/a	n/a
*** Over/(Under) Performance vs. Target**	**3.3**	**0.6**	**n/a**	**n/a**	**n/a**	**n/a**

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)

ANNUAL	Standard Life	Royal London	UBS	Ruffer	SSgA	Baillie Gifford
Return (performance)	20.3	9.8	-8.8	2.4	11.9	n/a
Benchmark	12.3	7.7	0.2	0.8	11.9	n/a
***Over/(Under) Performance vs. Benchmark**	**7.1**	**2.0**	**-9.0**	**1.6**	**0.0**	**n/a**
TARGET	14.3	8.5	n/a	n/a	n/a	n/a
*** Over/(Under) Performance vs. Target**	**5.2**	**1.3**	**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.
- Baillie Gifford inception 25 April 2012

4. Fund Manager Reports

4.1. UK Equities (Standard Life)

a) Representatives from Standard Life are due to make a presentation at this committee therefore a brief overview of their performance as at 31 December 2012 follows.

b) The value of the Standard Life portfolio fund saw an increase in value of 8.01% since the previous quarter.

c) Standard Life outperformed the benchmark in the quarter by 3.9% and outperformed the target in the quarter by 3.3%. Since inception they are below benchmark by -0.6% and -2.6% against the target.

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

a) Representatives from Royal London are due to make a presentation at this committee therefore a brief overview of their performance as at 31 December 2012 follows.

b) The value of the Royal London portfolio saw an increase of 3.39% on the previous quarter.

c) Royal London outperformed the benchmark by 0.8% and outperformed the target in the quarter by 0.6%. Since inception they are above benchmark by 0.6% and below the target by -0.1%.

4.3. Property (UBS)

a) In accordance with agreed procedures officers met with representatives from UBS on the 13 February 2013 at which a review of their performance as at 31 December 12 was discussed.

b) The value of the UBS portfolio fund saw a decrease in value of 8.28% since the previous quarter.

c) UBS underperformed the benchmark in the quarter by -7.6% and underperformed the benchmark in the year by -9.0%. UBS explained that the underperformance is due to the valuations including a ‘marked to sell’ across the portfolio due to the redemption queue.

d) The discussions at the meeting focussed on the current situation with regard to the liquidation notice issued on the 31 January 2013 and the events leading up to this.

e) At the EGM there was a 97% support to move the redemption notice period from 12 to 24 months. However only 50% of those already in the redemption queue supported this change and a 75% threshold is required.

f) Since mid-2012, UBS Triton redemption queue has grown to more than £400m, now reflecting 60% of the total £694m net asset value (as at 31 December 2012).

g) UBS has implemented a sales programme to meet the redemption requests, however the volume of sales required to meet the requests has a significant impact on the value of the Fund’s property assets and its overall performance.

h) Unless the redemptions reduce by £150m by the 30 April 2013 the fund will be liquidated. The redemption requests are covered up to the end of July.

i) If liquidation of the fund goes ahead this will take affect from the 1 August 2013 and this will remove the notice period for those in the queue already and an orderly sales programme will be put in place. The wind-up will see all investors being paid out on a pro-rata basis over a period of 3 to 5 years.

j) As at the date of the meeting UBS explained that they are having on-going discussions with investors to revoke redemption notices

k) The number of properties in the fund currently stands at 36.

l) UBS were asked to explain how the fund will look if it continues. They have two strategies in place depending on how many sales will need to be made to meet redemptions. The retained portfolio post £250m sales will have 22 properties and post £400m sales 19 properties will remain. They plan to sell off the shopping centre units and retain the higher yielding industrial properties. Reducing the number of shopping centre units would also reduce the void rate.

m) The void rate as at 31 December 12 was 6.2% against a benchmark 10.5%. UBS state this will reduce to below 4% post sales programme.

n) 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 met with representatives from Ruffer on the 13 February 2013 at which a review of their performance as at 31 December 12 was discussed.

b) The value of the Ruffer portfolio fund saw an increase in value of 2.81% since the previous quarter.

c) At the time of the meeting the value of the portfolio at the end of January 13 was reported as £61,907,182. This includes the £20m withdrawn from the passive equities manager (SSGA) and transferred to Ruffer in two tranches.

d) Ruffer had outperformed the benchmark in the quarter by 2.4% and outperformed the benchmark in the year by 4.2%.

e) The main drivers for performance were due to equity markets remaining buoyant; Japanese holdings surged on hopes of further Quantitative Easing (QE) following the election of Prime Minister Abe.

f) One of the largest negative contributions came from having exposure to Gold through equities rather than gold bullion. Gold equities rallied in the summer in anticipation of further QE, but surrendered much of these gins during the fourth quarter.

g) Ruffer were asked to explain any investment strategy changes and they went on to explain the following:

h) Following the open-ended nature of the US QE announcement until further notice, Ruffer thought that the 25-30% dollar exposure in the portfolio was too high and reduced it in October to around 15% – big enough to help protect the portfolio in a market setback, small enough to bear the pain if the dollar slowly weakens.

i) Ruffer believes that there is now a risk that if unemployment falls more quickly than expected in the US, bond yields could rise, which would impact their short-dated index-linked bonds. To safeguard these positions, they have bought some derivative protection, a call option, which rises in value if nominal yields rise, but importantly allows them to maintain the inflation exposure of the index-linked bonds, vital since the Fed's switch to an unemployment target further risks an outcome of higher inflation.

j) They also mentioned the change to the way they have exposure to derivatives (for example, as above). Any derivative exposures that Ruffer has acquired have been placed in a wrapper called a 'warrant' (buying shares from a company at a later date and for a specific price), to aid dealing and liquidity. Going forward, these will be housed in a new vehicle called Ruffer Protection Strategies, to improve further their efficiency and risk management. After the meeting Ruffer sent a briefing explaining this vehicle.

k) 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 met with members on the 12 December 2012 and officers last met with representatives from SSgA on the 15 May 2012.

b) The value of the State Street portfolio increased by 2.48% compared to the previous quarter.

c) As at the end of January 13 the value of the SSgA portfolio was £103,556,316.04. This reflects the £20m that was transferred to the Multi Asset Manager (Ruffer.

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 13 February 2013 at which a review of their performance as at 31 December 12 was discussed.

b) Due to the change of date of the December Committee meeting Baillie Gifford will give its first presentation at this meeting with members, which will cover a review of performance since inception.

c) The value of the Baillie Gifford portfolio fund saw an increase in value of 2.87% since the previous quarter.

d) Baillie Gifford had outperformed the benchmark in the quarter by 0.7% and outperformed the benchmark in the year by 0.1%.

e) Baillie Gifford has returned 5.4% since inception (net of fees) in line with their benchmark. They returned 2.9% for the quarter, outperforming the benchmark by 0.5%.

f) Outperformance was helped by some progress on eurozone crisis and US ‘fiscal cliff’. Key drivers of performance were that eight out of the top ten stock contributors were linked to US recoveries. Main detractors from performance were Brazilian Oil Company OGX.

g) Current positioning of the portfolio has holdings in Growth Stalwarts (strong Brands) 23%, Rapid Growth (fastest growth) 24%, Cyclical Growth (longer term performance) 38% and Latent Growth (stocks most out of favour with the markets) 15%.

h) Baillie Gifford confirmed that there had been no strategy changes but they were focussed on growth and in particular the potential growth in technology stocks. Baillie Gifford were asked if there was a risk of market saturation which will stifle growth but they are confident that this is still an immature market and have added exposure to technology stocks within the last six months. They purchased stocks from Visa, TripAdvisor, Terradyne and Dolby Laboratories. They increased their holdings in Tokyo Electron and Life Technologies.

i) Baillie Gifford’s outlook for the portfolio over the longer term indicates that bouts of volatility may continue but believes this provides opportunity for stock pickers. They also stated that there are more buy than sell ideas coming from the research team. Baillie Gifford were asked whether this implied that they were generally optimistic about equity markets and global recovery and they responded by explaining that their philosophy is about being optimistic about individual companies rather than sectors or countries. They will continue to search for companies which can grow even if the economic recovery is slow.

j) Baillie Gifford reiterated that their investment philosophy as focusing on the longer term and believe in having patience, making investment not speculation and seek to turn time and volatility to their advantage.

k) No governance or whistle blowing issues were reported.

5. Corporate Governance Issues

The Committee, previously, agreed that it would:

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

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

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

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

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

This report is being presented in order that:

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

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

  Standard Life, Royal London and 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 31 December 2012
Royal London Quarterly report to 31 December 2012
UBS Quarterly report to 31 December 2012
Ruffer Quarterly report to 31 December 2012
State Street Global Assets reports to 31 December 2012
The WM Company Performance Review Report to 31 December 2012
Hyman's Monitoring Report to 31 December 2012