Havering
LONDON BOROUGH

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| **PENSIONS COMMITTEE**<br>**26 June 2013** | **REPORT** |

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| **Subject Heading:** | **PENSION FUND PERFORMANCE MONITORING FOR THE QUARTER ENDED 31 MARCH 2013** |
| **CMT Lead:** | **Andrew Blake Herbert** |
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| **Policy context:** | Pension Fund Managers' performances are regularly monitored in order to ensure that the investment objectives are being met. |
| **Financial summary:** | This report comments upon the performance of the Fund for the period ended 31 March 2013 |

**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 March 2013. 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 March 2013 was **9.5%.** This represents an out performance of **0.9%** against the combined tactical benchmark and an out performance of **8.2%** against the strategic benchmark.

The overall net return of the Fund's investments for the **year** to 31 March 2013 was **14.4%.** This represents an out performance of **1.1%** against the annual tactical combined benchmark and an out performance of **2.9%** against the annual strategic benchmark.

Global economic data remained mixed with the signs of gradual recovery in the US whilst Eurozone continued to be weak. Most Equity markets made gains over the first quarter of 2013. Government bonds came under pressure but renewed concerns over Eurozone ensured some revival in demand for safe havens. Index Linked bonds outperformed fixed interest bonds following the decision to retain the current RPI calculation methodology. GPD was estimated at -0.3%. CPI inflation rose to 2.8% and no change to UK interest rates.

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), the Funds Multi Asset Absolute Return Manager (Ruffer) and the funds Global Equity 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. A change to the SIP was last agreed in March 2013 and the portfolio is currently being restructured to reflect those decisions.

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.

1.4 Changes to the Asset Allocation targets were agreed by members at the Pensions Committee meeting on the 26 March 2013. The long term strategy of the fund adopted at the meeting is to reduce exposure to equities and be invested in multi asset strategies. Pending appointment of the providers of the multi-asset mandates members agreed to adopt an interim strategy which considered the fund rebalancing its overweight position in equities. During May, 5% of the fund was switched from SSgA's UK/Global Equities Manager to an SSgA cash fund. The long term strategy decisions are likely to be progressed during July 2013. No other changes have yet been made to the individual manager allocation and 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<br>17% | UK Equities -Active | FTSE All Share Index | 2% |
| State Street (SSgA)<br>21% | UK/Global Equities - passive | UK- FTSE All Share Index<br>Global (Ex UK) – FTSE All World ex UK Index | To track the benchmark |
| Baillie Gifford Street<br>17% | Global Equities - Active | MSCI AC World Index | 1.5 – 2.5% over rolling 5 year period |
| Royal London Asset Management | Investment Grade | • 50% iBoxx Sterling Non Gilt Over 10 Year Index | 0.75% |

| Manager and % of target fund allocation | Mandate | Tactical Benchmark | Out performance Target |
|---|---|---|---|
| 20% | Bonds | • 16.7% FTSE Actuaries UK Gilt Over 15 Years Index<br>• 33.3% FTSE Actuaries Index-Linked Over 5 Year Index | |
| UBS<br>10% | Property | IPD (previously called HSBC/AREF) All Balanced Funds Median Index | To outperform the benchmark |
| Ruffer<br>10% | Multi Asset | Not measured against any market index – for illustrative purposes LIBOR (3 months) + 4%. | To outperform the benchmark |
| State Street (SSgA) 5% | Sterling Liquidity Cash Fund | 7-day LIBID | To outperform the benchmark |

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 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.

1.6 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.

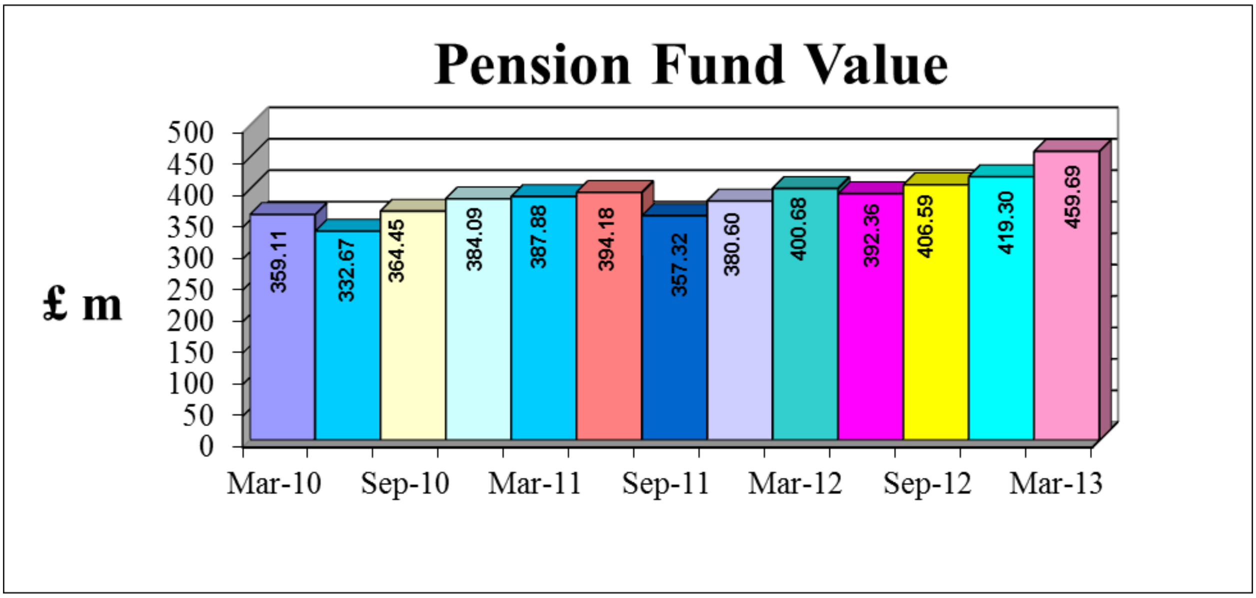
1.7 Since 2006, to ensure consistency with reports received from our Performance Measurers, Investments Advisors and Fund Managers, the 'relative returns' (under/over performance) calculations has been changed from the previously used arithmetical method to the industry standard geometric method (please 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 31 March 2013 was **£459.69m**. 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 £419.30m at the 31 December 2012; an **increase** of £40.39m. The movement in the fund value is attributable to an increase in cash of £0.56m and an increase in fund performance of £39.83m. The internally managed cash level stands at **£3.19m** of which an analysis follows in this report.




*Source: WM Company (Performance Measurers)*

2.2 An analysis of the internally managed cash balance of **£3.19** follows:

| **CASH ANALYSIS** | **2010/11** | **2011/12 Updated** | **2012/13 31 Mar 13** |
|---|---|---|---|
| | £000's | £000's | £000's |
| | | | |
| **Balance B/F** | **-4763** | **-8495** | **-1194** |
| | | | |
| Benefits Paid | 25702 | 31123 | 31122 |
| Management costs | 1895 | 1606 | 995 |
| Net Transfer Values | -3053 | -58 | -916 |
| Employee/Employer Contributions | -28333 | -30194 | -29556 |
| Cash from/to Managers/Other Adj. | 176 | 4869 | -3603 |
| Internal Interest | -119 | -45 | -41 |
| | | | |
| **Movement in Year** | **-3732** | **7301** | **-1999** |

| | | | |
|---|---|---|---|
| | | | |
| **Balance C/F** | **-8495** | **-1194** | **-3193** |

**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.

## 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 31.03.13** | **12 Months to 31.03.13** | **3 Years to 31.03.13** | **5 years to 31.03.13** |
|---|---|---|---|---|
| Fund | 9.5% | 14.4% | 8.2% | 5.6% |
| Benchmark return | 8.5% | 13.1% | 8.8% | 7.1% |
| *Difference in return | 0.9% | 1.1% | -0.5% | -1.4% |

*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 31.03.13** | **12 Months to 31.03.13** | **3 Years to 31.03.13** | **5 years to 31.03.13** |
|---|---|---|---|---|
| Fund | 9.5% | 14.4% | 8.2% | 5.6% |
| Benchmark return | 1.2% | 11.2% | 15.3% | 12.0% |
| *Difference in return | 8.2% | 2.9% | -6.1% | -5.7% |

*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 MARCH 2013)

| QUARTER | Standard Life | Royal London | UBS | Ruffer | SSgA | Baillie Gifford[1] |
|---|---|---|---|---|---|---|
| Return (performance) | 8.9 | 3.7 | -2.1 | 9.6 | 14.0 | 15.8 |
| Benchmark | 10.3 | 3.8 | -0.8 | 0.1 | 14.0 | 14.0 |
| ***Over/(Under) Performance vs. Benchmark** | **-1.4** | **-.10** | **-2.8** | **9.5** | **0.0** | **1.5** |
| TARGET | 10.8 | 3.9 | n/a | n/a | n/a | n/a |
| *** Over/(Under) Performance vs. Target** | **-1.9** | **-.3** | **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) | 17.2 | 13.9 | -11.2 | 10.0 | 17.0 | n/a |
| Benchmark | 16.8 | 12.7 | 0.3 | 0.7 | 17.1 | n/a |
| ***Over/(Under) Performance vs. Benchmark** | **0.4** | **1.2** | **-11.5** | **9.3** | **-0.1** | **n/a** |
| TARGET | 18.8 | 13.4 | n/a | n/a | n/a | n/a |
| *** Over/(Under) Performance vs. Target** | **-1.6** | **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.
- Baillie Gifford inception 25 April 2012

## 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 20 May 13 at which a review of their performance as at 31 March 13 was discussed.

b) The value of the fund as at 31 March saw an increase in value of 8.82% on the previous quarter.

c) Standard Life underperformed the benchmark in the quarter by -1.4% and underperformed the target in the quarter by -1.9%. Since inception they are below benchmark by -0.8% and -2.7% against the target. As at the date of the meeting performance matched the benchmark.

d) Standard Life reported that equity markets made a strong start to 2013, but caution grew towards the end of the period. The terms of the Cypriot bailout, rising tensions in North Korea and weaker jobs data in the US in March dampened enthusiasm. Europe remains troubled with most countries struggling under the weight of austerity programmes. The strong quarter returns mask sector rotation in favour of more defensive sectors.

e) Food producers, Beverages and Fixed Line telecommunications all performed well in response to macro-economic concerns around Cyprus and North Korea. In contrast, banks, chemicals and oil producers all weakened. In particular, mining companies were hit on fears of weak economic activity affecting metal prices.

f) Standard Life's positive performance was largely down to its exposure to International Consolidated Airlines Group and easy jet. Negative contributors to performance were due to overweight holdings in Rio Tinto and Vedanta. Weakness in commodity process dragged shares, despite positive management change at Rio Tinto and encouraging regulatory news at Vedanta.

g) The portfolio activity during the quarter were as follows :
   - Added to holdings in **Essar Energy** – increased holding on the basis of successful debt refinancing and encouraging regulatory news on power generation in India.
   - Purchased **Serco** (specialises in bidding for outsourced services**)** the outlook for new contract wins in the UK and AMEA is very strong.
   - Added to holdings in **Vodafone** – increased likelihood of a deal to sell its stake in Verizon Wireless.
   - Purchased First Quantum Minerals – following a positive view on synergies from their acquisition of Inmet.
   - Sold **RSA** – following a disappointing dividend cut.
   - Reduced holdings in **RBS**, in response to disappointing results.
   - Sold **Kingfisher** (owner of B&Q) followings concerns over product sourcing strategy at the same time as their French building business was struggling
   - Sold **Telecity** a concern over their expansion plan which involves establishing new data centres was proceeding slower than planned.

h) Even though Standard Life had reduced their holdings in RBS it is still one of the largest holdings in the portfolio and they were asked why they believe the banking sector offers the potential for excessive returns. Banks have already suffered the worst of the damages and believe that share prices will respond to the more recent rise in margins, following lower debts and risk.

i) They were also asked about their zero weighting positions in British American Tobacco and Diageo (Sells beers and spirits). They explained that high illicit trades and e-cigarettes have impacted trading for American Tobacco and Diageo shares have a high valuation.

j) In the quarter Stock selection detracted -0.99% from performance and the sector allocation detracted -0.38%.

k) Sector selection has been negative over the quarter and the year and Standard Life were asked how important sector selection was? They confirmed stock selection was predominately the driving force of the decisions.

l) A discussion was held with Standard Life about their views on the actions announced by the Bank of Japan. They believe QE has a positive impact on equities due to the lower yields on bonds and that investors on their quests for yields will switch from bonds to equities. They also felt that Europe will be under pressure to introduce QE but will not happen until after the elections in Germany at the end of the summer.

m) Standard Life believes that the UK Equity market outlook remains attractive as Eurozone risks diminish and US growth recovery is on a good path.

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 20 May 13 at which a review of their performance as at 31 March 13 was discussed.

b) The value of the fund as at 31 March 2013 saw an increase of 3.8% on the previous quarter.

c) The fund achieved a net return of 3.8% during the quarter which was flat against the benchmark and below target by -0.3%. Since inception they outperformed the benchmark by 0.6% but below target by -0.2%.

d) Royal London reported on market events during the quarter which saw the base rate kept low at 0.5% and believes that this will remain low for the next couple of years. The UK Economy still remains weak and the UK was downgraded in the quarter by two credit rating agencies, inconsequential in terms of the market. Inflation remains above target and unexpectedly there was no change to methodology of calculating RPI. The banking sector progress remains slow with regulation constraining new lending. Concerns still persisted over sovereign risk within Europe with the indecisive results from the Italian election and negotiations over the support package to Cyprus adding to the volatility.

e) Asset allocation of the fund during the quarter was 58.9% in Sterling Credit (corporate) Bonds, 26.7% in Index Linked Bonds, 7.7% in Government Bonds, 6.1% in Overseas Bonds and 0.9% cash. The weighting to Government Bonds was reduced by 6.5% and overseas bonds were increased by 5%.

f) The fund was underweight in Index Linked Bonds in anticipation of an implied fall in inflation following a change in the methodology of RPI. This detracted from performance as the ONS left the methodology unchanged.

g) The fund was fully invested in corporate bonds and asset allocation was a positive factor in performance.

h) Exposure to Overseas bonds was increased during the quarter but this off benchmark position was marginally detrimental to performance.

i) There were a few portfolio positioning changes during the quarter with regard to duration and yield curve which were both detrimental to performance.

j) Sector and stock selection decisions within this position also added to positive performance, in particular the zero weighting position in supranational bonds and overweight position to covered bonds and subordinated financial debt. Stock selection in government bonds added value

k) Portfolio activity and opportunities during the quarter are as follows:
    - Within government bonds the fund was centred on the relative expensiveness of UK gilts and index linked securities particularly at the 10 to 15 year sector. A switch was made to both longer dated bonds and into overseas assets.
    - Within corporate bonds several new issues were purchased:
        - A debut hybrid utility bond from EDF and National Grid – Hybrid bonds provide the issuer with the option to extend the maturity of the bond beyond its call date.
        - Structured bonds from UPP (provide dedicated campus accommodation), Tesco and INTU (new name for shopping centres) and High Speed Rail Finance
    - No exposure to supranational debt remains
    - Their bias towards secured bonds were maintained

l) Royal London was asked to explain why they increased exposure to overseas bonds. They explained that following the ONS decision on RPI they felt that 10 year yield levels were expensive, so they built up positions in Swedish, US, Canadian, Australian and German index linked bonds. However UK Index Linked bonds continued to outperform and whilst German and Australian did well and sold profitably this still marginally detracted from performance. At the time of the meeting the overseas exposure has now been trimmed down to around 3%.

m) Secured bonds represent over 30% of the portfolios assets so Royal London were asked what measures are in place to monitor and/or change this position should the view change. Royal London believes that very little could happen to make them change their view at the moment, they believe they are good long term investments and mainly focus on the assets backing the bonds. They keep these bonds under review and would sell out for a good price or would sell if any dangers arise.

n) A discussion was had with Royal London as to whether there are any areas of the fixed income market that offers value but the current mandate restricts them from investing. Whilst Royal London do not believe that changing the mandate would offer any potential value they will follow this up with Hymans.

o) No governance or whistle blowing issues were reported.

**4.3. Property (UBS)**

a) Representatives from UBS are due to make a presentation at this committee therefore a brief overview of their performance as at 31 March 2013 follows.

b) The value of the UBS portfolio fund saw a decrease in value of 1.47% since the previous quarter.

c) UBS underperformed the benchmark in the quarter by -2.9% and underperformed the benchmark in the year by -11.5%. This underperformance is primarily due to the valuations including a 'marked to sell' across the portfolio due to the redemption queue.

**4.4. Multi Asset Manager (Ruffer)**

a) Representatives from Ruffer are due to make a presentation at this committee therefore a brief overview of their performance as at 31 March 2013 follows.

b) 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.

c) During January 2013 £20m was transferred to Ruffer from the passive equities manager which is reflected in the fund value of £64.3m as at the end of March 2013.

d) Ruffer had outperformed the benchmark in the quarter by 9.5% and outperformed the benchmark in the year by 9.3%.

**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 last met with members on the 12 December

2012 and officers met with representatives from SSgA on the 20 May 2013, at which a review of their performance as at 31 March 13 was discussed.

b) During January 2013 £20m was transferred to the Multi Asset Manager (Ruffer). This is reflected in the value of the fund decreasing by 4.82% compared to the previous quarter.

c) As expected the portfolio performed in line with the benchmark over the quarter.

d) The only subject that State Street reported on when asked if there were any issues in any of the regional markets over the quarter was the introduction by the French who has brought in a new tax on share trading in French equities.

e) Members agreed at the Pensions Committee on the 26 March to transfer £20m into an SSgA cash fund on a short term basis pending the implementation of the strategy to reduce exposure to equities and increase exposure to multi assets. This decision was driven by risk diversification and preservation of capital. On advice received from Hymans £20m was transferred from the MPF passive equity portfolio to the MPF Sterling Liquidity Fund during May 2013.

f) The MPF Sterling Liquidity Fund policy is to maintain safety of principal by investing in short-term money market instruments and fixed deposits. It is a Pooled fund and is measured against a benchmark of 7-day LIBID.

g) No other governance issues or whistle blowing were reported.

**4.6. Global Equities Manager (Baillie Gifford)**

d) Representatives from Baillie Gifford are due to make a presentation at this committee therefore a brief overview of their performance as at 31 March 2013 follows.

a) The value of the Baillie Gifford portfolio fund saw an increase in value of 15.79% since the previous quarter.

b) Baillie Gifford had outperformed the benchmark in the quarter by 1.5% and outperformed the benchmark since inception 2.1%.

**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, Ruffer 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 March 2013
Royal London Quarterly report to 31 March 2013
UBS Quarterly report to 31 March 2013
Ruffer Quarterly report to 31 March 2013
State Street Global Assets reports to 31 March 2013
The WM Company Performance Review Report to 31 March 2013
Hyman's Monitoring Report to 31 March 2013