



PENSIONS COMMITTEE

17 December 2013

REPORT

Subject Heading:	PENSION FUND PERFORMANCE MONITORING FOR THE QUARTER ENDED 30 SEPTEMBER 2013
CMT Lead:	Andrew Blake Herbert
Report Author and contact details:	Debbie Ford Pension Fund Accountant (01708) 432569 debbie.ford@havering.gov.uk
Policy context:	Pension Fund Managers' performances are regularly monitored in order to ensure that the investment objectives are being met.
Financial summary:	This report comments upon the performance of the Fund for the period ended 30 September 2013

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 September 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 30 September 2013 was **3.3%**. This represents an out performance of **1.1%**

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against the combined tactical benchmark and an out performance of **1.2%** against the strategic benchmark.

The overall net return of the Fund's investments for the **year** to 30 September 2013 was **16.1%**. This represents an out performance of **3.7%** against the annual tactical combined benchmark and an out performance of **17.9%** against the annual strategic benchmark.

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 UK/Global Equities Passive Manager (State Street Global Assets) 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 The Fund undertook a full review of the Statement of Investment Principles (SIP) during 2012/13 and whilst this was on-going members agreed an interim change to the strategy in December 2012 which increased the asset allocation to the Absolute Return Manager from 10% to 15%. The final SIP was agreed in July 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 + 1.8% (net of fees) per annum. This is the expected return in excess of the fund's

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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 and 24 July 2013. The long term strategy of the fund adopted at the meeting is to reduce exposure to equities and invest in multi asset strategies. Pending appointment of the providers of the multi-asset mandates members had agreed to adopt an interim strategy which rebalanced the fund's overweight position in equities and during May 2013, 5% of the fund was switched from SSgA's UK/Global Equities Manager to an SSgA cash fund. In September 2013 two multi asset mandates were awarded to the Baillie Gifford Diversified Growth Fund and Barings Dynamic Asset Allocation Fund. A transition manager (Nomura) have been appointed to manage the transfer of assets from Standard Life to Barings and assets are in the process of being transferred. A verbal update to the progress made will be given at the meeting. Once the fund managers have commenced trading the following table will be updated.

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) 21%	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

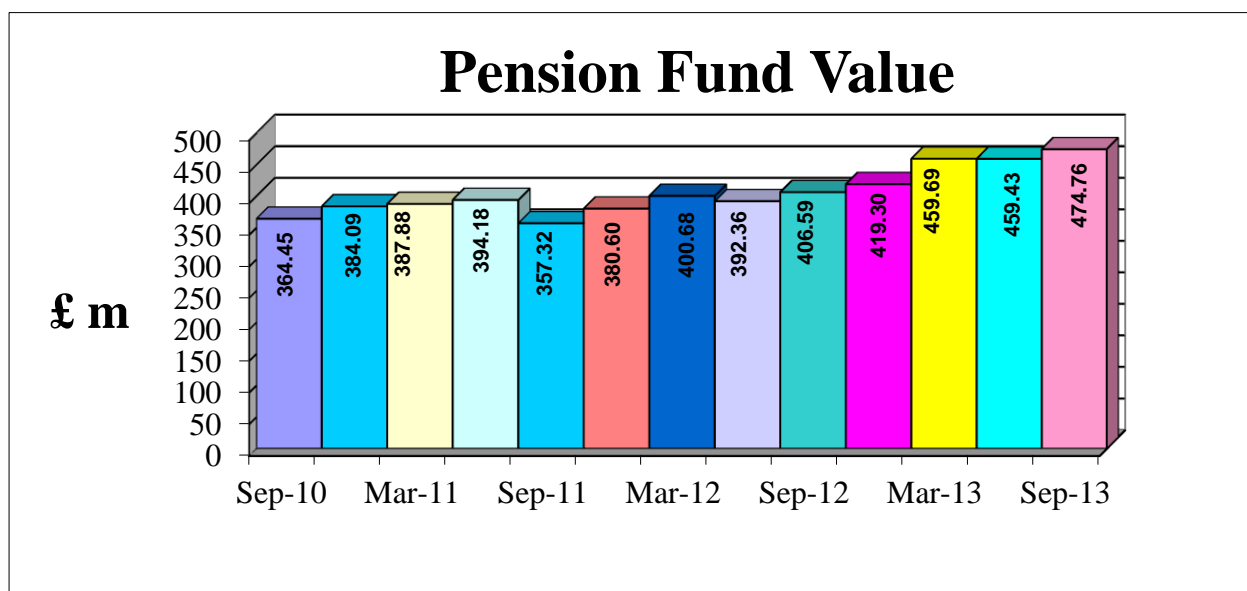
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Manager and % of target fund allocation	Mandate	Tactical Benchmark	Out performance Target
State Street (SSgA) 5%	Sterling Liquidity Cash Fund	7-day LIBID	To outperform the benchmark

- 1.5 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.
- 1.6 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).
- 1.7 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 the 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.
- 1.8 Hyman's performance monitoring report is attached at **Appendix A**.

2. Fund Size

- 2.1 Based on information supplied by our performance measurers the total combined fund value at the close of business on 30 September 2013 was **£474.75m**. 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 £459.43m at the 30 June 2013; an **increase** of £15.32m. The movement in the fund value is attributable to an increase in assets of £15.50m and a decrease in cash of (£0.18m). The internally managed cash level stands at **£3.72m** of which an analysis follows in this report.



Source: WM Company (Performance Measurers)

2.2 An analysis of the internally managed cash balance of **£3.72m** follows:

<u>CASH ANALYSIS</u>	<u>2011/12</u>	<u>2012/13</u> <u>Updated</u>	<u>2013/14</u> <u>30 Sep 13</u>
	£000's	£000's	£000's
Balance B/F	-8495	-1194	-3474
Benefits Paid	31123	31272	16391
Management costs	1606	1779	758
Net Transfer Values	-58	-1284	-585
Employee/Employer Contributions	-30194	-30222	-16738
Cash from/to Managers/Other Adj.	4869	-3780	0
Internal Interest	-45	-45	-74
Movement in Year	7301	-2280	-248
Balance C/F	-1194	-3474	-3722

2.3 As agreed by members on the 27 June 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 30.09.13	12 Months to 30.09.13	3 Years to 30.09.13	5 years to 30.09.13
Fund	3.3%	16.1%	9.1%	9.0%
Benchmark return	2.2%	12.0%	8.2%	9.1%
*Difference in return	1.1%	3.7%	0.8%	0.1%

Source: WM Company

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

3.1.2 The overall net performance of the Fund against the **Strategic Benchmark** (i.e. the strategy adopted of Gilts over 15 years + 2.6%) is shown below:

	Quarter to 30.09.13	12 Months to 30.09.13	3 Years to 30.09.13	5 years to 30.09.13
Fund	3.3%	16.1%	9.1%	9.0%
Benchmark return	2.1%	-1.5%	9.2%	11.0%
*Difference in return	1.2%	17.9%	-0.2%	-1.7%

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 30 SEPTEMBER 2013)

	Standard Life	Royal London	UBS	Ruffer	SSgA	Baillie Gifford ¹
QUARTER						
Return (performance)	10.2	2.5	2.7	0.1	0.9	2.8
Benchmark	5.6	1.9	2.4	0.1	1.2	1.2
*Over/(Under) Performance vs. Benchmark	4.4	0.6	0.3	0.0	-0.2	1.6
TARGET	6.1	2.0	n/a	n/a	n/a	n/a
* Over/(Under) Performance vs. Target	3.9	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.

ANNUAL PERFORMANCE (LAST 12 MONTHS)

	Standard Life	Royal London	UBS	Ruffer	SSgA	Baillie Gifford
ANNUAL						
Return (performance)	30.8	4.6	-7.4	11.3	17.7	24.5
Benchmark	18.9	2.4	4.2	0.5	18.2	18.0
*Over/(Under) Performance vs. Benchmark	10.0	2.2	-11.6	10.8	-0.4	5.5
TARGET	20.9	3.1	n/a	n/a	n/a	n/a
* Over/(Under) Performance vs. Target	8.2	1.5	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.

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 5 November 2013 at which a review of their performance as at 30 September 13 was discussed.
- b) The value of the fund as at 30 September saw an increase in value of 10.31% on the previous quarter.
- c) Standard Life outperformed the benchmark in the quarter by 4.4% and outperformed the target in the quarter by 3.9%. Since inception they outperformed the benchmark by 0.1% and underperformed by -1.9% against the target.
- d) Due to the pending termination of the mandate with Standard Life the meeting focussed on covering events during the quarter ending 30 September 13 and discussed likely issues that may impact the mandate during termination.
- e) Standard Life reported that equity markets continued to make progress, up over 5% during the quarter, with the UK economy moving towards modest growth. Europe has stabilised although risks still remain with Croatia struggling under the weight of austerity programmes. Global economic trends are improving, being driven by the US.
- f) Standard Life's positive performance was largely down to its exposure to International Consolidated Airlines Group following strong traffic and yield growth on North Atlantic routes and holdings in GKN, which had positive automotive growth data from the US and Asia.

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- g) Negative performance mainly came from an underweight position in ARM holdings as shares rose in the quarter due to an unexpected announcement from Apple that it would use ARM's processors in its new smartphone
- h) The portfolio activity during the quarter were as follows :
- Added to holdings in **Anglo-American** – increased holding following a positive meeting with new management.
 - Purchased **Burberry** (specialises in luxury goods) as the brand is consistently taking market share and has a strong online presence.
 - Increased holdings in **Barclays** – as they expected the rating of shares to change in response to the Regulators shift from risk-weighting to leverage ratios.
 - Purchased **UBM** (United Business Media) – attracted by the modest value, strong dividend yield and attractive growth profile of its events business.
 - Reduced holdings in **Dixons**, following strong run in shares, to the point where the valuation seems to be over optimistically applying a premium multiple to a blue sky earnings number that depends on a complete recovery across their markets.
 - Reduced holdings in **Lloyds** following a strong rise in the share values.
 - Further reduced holdings in **Tesco** due to on-going weak trading and loss of market share in core UK market.
 - Reduced holdings in **Phoenix** share price rose considerably in response to leaks of a merger with Swiss Re.
- i) Standard Life were asked to identify any issues that may impact on the termination of the mandate and they stated that there were no main issues but will need to unravel the portfolio and a Transition Manager to be appointed to liquidate holdings. There may be a need for a Care and Maintenance provision.
- j) The planned transfer of assets from Standard Life to the Barings Dynamic Asset Allocation Fund is due for completion on the 10 December 2013.
- k) No governance or whistle blowing issues were reported.
- l) On behalf of the Committee Standard Life were thanked for the management of the portfolio over the last eight years.

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 5 November 2013 at which a review of their performance as at 30 September 13 was discussed.

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- b) The value of the fund as at 30 September 13 saw an increase in value of 2.98% on the previous quarter.
- c) Royal London achieved a net return of 2.47% during the quarter and outperformed the benchmark by 0.62% and the target by 0.43%. Since inception they outperformed the benchmark by 0.69% and the target by 0.06%.
- 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. UK growth remained weak and UK inflation was above target partly due to upward pressure from energy prices. Eurozone risks reduced after the Eurozone moved out of recession. Despite widespread speculation that the US Federal Reserve would begin reducing the pace of its monetary support, the expected change was not introduced.
- e) Asset allocation of the fund during the quarter was 56.5% in Sterling Credit (corporate) Bonds, 27.6% in Index Linked Bonds, 12.7% in Government Bonds, 3.5% in Overseas Bonds and -0.3% cash.
- f) Credit sector and stock selection was one of the major drivers of performance over the quarter, the off-benchmark positions in overseas bonds also added value, particularly US inflation linked bonds which performed strongly on the announcement by the US Federal Reserve of a delay to 'tapering' of their monthly asset purchase programme. The portfolio's short duration position was also beneficial, as real and nominated yields rose early in the quarter.
- g) Portfolio activity and opportunities during the quarter were as follows:
- Government Bonds - Activity remained high within government bonds, reflecting volatile market positions. An underweight position in duration was increased during the quarter to a neutral position and then reduced again by the end of the quarter. Tactically purchased off benchmark positions in index linked overseas government bonds.
 - Corporate bonds – there was a subdued flow of new issues early in the quarter but this picked up in September and some of the new deals they bought were from Leeds Communities (structured bonds), America Movil (telecoms) and Poplar Housing (social housing). After strong performance they reduced exposure to covered bonds through sales of Yorkshire, Leeds and Coventry building societies. Royal London's bias towards secured bonds was maintained; this represents almost 30% of fund assets and remains the best performing sector outside of financials.
- h) The first ever 55 year index-linked gilt was issued during the quarter, Royal London was asked how the portfolio structured in anticipation of this issue, and if there was an impact on performance. Royal London said that because the investment banking syndicate managed the issue very well, there was no movement of yield curve, no impact on performance.

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- i) Royal London was asked what impact did the announcement of the US federal reserve of a delay to “tapering” of their monthly assets purchase programme have on the portfolios strategy and performance. Royal London said that although this made the markets volatile there was barely any change in real yield in Q3.
- j) Royal London were asked what their rationale was for increasing the allocation of overseas bonds and whether this would continue in the future and they explained that they were getting better returns for overseas bonds, offering good relative value versus gilts with real yields between 1% and 1.5% higher. UK inflation linked bonds were sold at breakeven to fund this. Their preference for overseas bonds expected to continue in the future but they did not give an indication as to whether this would be increased.
- k) 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 30 September 2013 follows.
- b) The value of the UBS portfolio fund saw an increase of 1.97% in value since the previous quarter.
- c) UBS delivered a return of 2.7% and outperformed the benchmark by 0.3% over the quarter. The portfolio is behind the benchmark over the year by – 11.6%.

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 26 June 13 Pensions Committee meeting. Officers met with representatives from Ruffer on the 13 February 2013.
- b) Since the additional investment with Ruffer in January 2013, the value of the portfolio has increased by 7.96%.
- c) Ruffer was broadly flat against the benchmark in the quarter and outperformed the benchmark in the year by 10.7%.
- d) Any positive gain to performance was negated by the strengthening pound against a weakened US dollar.

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

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held with members. Officers last met with representatives from SSgA on the 20 May 2013, at which a review of their performance as at 31 March 13 was discussed. Representatives from SSgA are due to make a presentation at this committee therefore a brief overview of their performance as at 30 September 2013 follows.

- b) The value of the portfolio has increased in value by 0.95% since the last quarter.
- c) As expected the portfolio performed in line with the benchmark over the quarter.
- d) Members agreed at the Pensions Committee on the 26 March 2013 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. Since inception the Sterling Liquidity Fund has increased in value by 0.15%.
- e) Following the award of a multi asset mandate to the Baillie Gifford Diversified Growth Fund the Sterling Liquidity account will be closed and the cash transferred to the new Baillie Gifford mandate on the 9 December 2103.
- f) Members also agreed to fund the new Baillie Gifford Diversified Growth Fund from disinvesting £50m of the SSgA mandate. Holdings with SSgA will be sold and the cash will be transferred in three tranches in late November and early December.

4.6. Global Equities Manager (Baillie Gifford)

- a) Representatives from Baillie Gifford are due to make a presentation at this committee therefore a brief overview of their performance as at 30 September 2013 follows.
- b) The value of the Baillie Gifford portfolio saw an increase in value of 2.82% since the previous quarter.
- c) Baillie Gifford have outperformed the benchmark over the quarter by 1.6% (net of fees) and outperformed the benchmark by 6.5% (net of fees) over the last year. Since inception they have outperformed the benchmark by 3.9%.

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

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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, State Street Global Assets (SSgA) 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

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Human Resources Implications and risks:

There are no immediate HR implications. However longer term, shortfalls may need to be addressed depending upon performance of the fund.

Equalities and Social Inclusion Implications and risks:

None arising directly

BACKGROUND PAPERS

Standard Life Quarterly report to 30 Sept 2013
Royal London Quarterly report to 30 Sept 2013
UBS Quarterly report to 30 Sept 2013
Ruffer Quarterly reports 30 Sept 2013
State Street Global Assets reports to 30 Sept 2013
The WM Company Performance Review Report to 30 Sept 2013
Hyman's Monitoring Report to 30 Sept 2013