Havering
LONDON BOROUGH

PENSIONS COMMITTEE

22 June 2011

Subject Heading:	**PENSION FUND PERFORMANCE MONITORING FOR THE QUARTER ENDED 31 MARCH 2011**
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Policy context:	Pension Fund Managers' performances are regularly monitored in order to ensure that the investment objectives are being met.
Financial summary:	This report comments upon the performance of the Fund for the period ended 31 March 2011

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

Clean, safe and green borough	[]
Excellence in education and learning	[]
Opportunities for all through economic, social and cultural activity	[]
Value and enhance the life of every individual	[X]
High customer satisfaction and a stable council tax	[]

SUMMARY

This report provides the Committee with an overview of the performance of the Havering Pension Fund investments for the quarterly period to 31 March 2011. The performance information is taken from the Quarterly Performance Report supplied by each Investment Manager, the WM Company Quarterly Performance Review Report and Hymans Monitoring Report.

The net return on the Fund's investments for the **quarter** to 31 March 2011 was **0.9%.** This represents an under performance of **-0.2%** against the combined tactical benchmark and an out performance of **1.7%** against the strategic benchmark.

The overall net return of the Fund's investments for the **year** to 31 March 2011 was **6.3%**. This represents an underperformance of **-1.9%** against the annual tactical combined benchmark and an under performance of **-3.3%** against the annual strategic benchmark.

Members should bear in mind that the markets have seen unprecedented volatility since the latter half of 2007, with further market falls during 2008. The markets did rally during 2009, erasing some of the losses from the year before. In the quarter ending March 2011, equity markets proved remarkably resilient to the political tension in the Arab countries and the implications in Japan during the quarter. One of the major influences on markets was increased inflationary pressures, particularly in emerging markets. In the developed markets, the economic improvement has been more evident in the corporate sector supported by strong earnings growth and the re-building of balance sheets.

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).
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 major restructure of the fund took place in the first quarter of 2005. A further restructure of the fund took place during the first half of 2008 and these changes were reflected in a revised Statement of Investment Principles (SIP) adopted by members in September 2008 and subsequently updated in June 2010. Implementation of the strategy is currently ongoing.

1.2 As part of the SIP a strategic benchmark was adopted for the overall Fund of Gilts + 3.6% gross (3% net) per annum. In the revised SIP the strategic benchmark adopted for the overall Fund is Gilts plus 2.9% (net of fees) per annum. This is the expected return in excess of the fund's liabilities over the longer term. **The main factor in meeting the strategic benchmark is market performance.**

1.3 Individual manager performance and asset allocation will determine the out performance against the strategic benchmark. Each manager has been set a specific (tactical) benchmark as well as an outperformance target against which their performance will be measured. This benchmark is determined according to the type of investments being managed. This is not directly comparable to the strategic benchmark as the majority of the mandate benchmarks are different but contributes to the overall performance. No revisions were made to individual fund manager benchmarks as part of the investment strategy review. However the asset allocation has been revised and these are shown in the following table against the manager's benchmarks:

Manager and % of total Fund awarded	**Mandate**	**Tactical Benchmark**	**Out performance Target**
Standard Life 20%	UK Equities -Active	FTSE All Share Index	2%
State Street (SSgA) (Account 2) 25%	UK/Global Equities - passive	UK- FTSE All Share Index Global (Ex UK) – FTSE All World ex UK Index	To track the benchmark
State Street (SSgA) (Account 1) 15%	UK/Global Equities - Passive	UK- FTSE All Share Index Global (Ex UK) – FTSE All World ex UK Index	To track the benchmark
Royal London Asset Management 25%	Investment Grade Bonds	• 50% iBoxx Sterling Non Gilt Over 10 Year Index • 16.7% FTSE Actuaries UK Gilt Over 15 Years Index • 33.3% FTSE Actuaries Index-Linked Over 5 Year Index	0.75%
UBS 10%	Property	IPD (previously called HSBC/AREF) All Balanced Funds Median Index	To outperform the benchmark
Ruffer 5%	Multi Asset	Not measured against any market index – for illustrative purposes LIBOR (3 months) + 4%.	To outperform the benchmark

1.4 The Committee appointed a Multi-Asset Manager (Ruffer) and a Passive Equity Manager (State Street Global Advisors Limited (SSgA)) in February 2010. Both Managers commenced trading from 8th September 2010.

1.5 The mandate with the Global Equities Manager (Alliance Bernstein) was active during the quarter ending March 2011 but was terminated in February 2011. Assets were transferred to State Street Global Advisors pending further consideration of the investment strategy.

1.6 UBS and SSgA manage the assets on a pooled basis. Standard Life, Royal London, Alliance Bernstein 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.

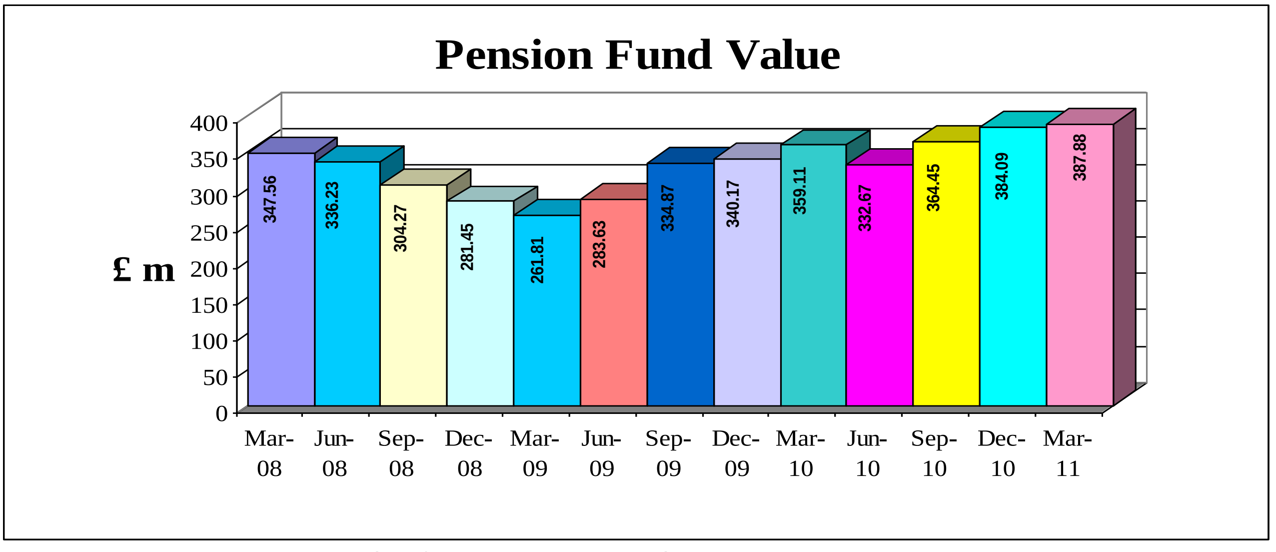
1.7 Since 2006, to ensure consistency with reports received from our Performance Measurers, Investments Advisors and Fund Managers, the 'relative returns' (under/over performance) calculations has been changed from the previously used arithmetical method to the industry standard geometric method (please 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 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. <u>Fund Size</u>

2.1 Based on information supplied by our performance measurers the total combined fund value at the close of business on 31 March 2011 was **£387.88m**. 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 £384.09m at the 31 December 2010; an increase of **£3.79m**. The movement in the fund value is attributable to an increase in fund performance of £3.77m and an increase in cash of £.02m. The internally managed cash level totals **£8.4m**, of which an analysis follows in this report.



Source: WM Company (Performance Measurers)

2.2 An analysis of the internally managed cash balance of **£8.4m** follows:

CASH ANALYSIS	**2008/09**	**2009/10**	**2010/11**
	£000's	£000's	£000's
Balance B/F	**-6673**	**-7999**	**-4763**
Benefits Paid	23878	26926	25634
Management costs	1742	1939	1970
Net Transfer Values	156	2639	-2985
Employee/Employer Contributions	-26546	-28251	-28408
Cash from/to Managers	-315	0	163
Internal Interest	-241	-17	-37
Movement in Year	**-1326**	**3236**	**-3663**
Balance C/F	**-7999**	**-4763**	**-8426**

2.3 Internally managed cash had been decreasing during 2009/10; the significant factor being the reduction in net transfer values (more members of the fund transferring out than in). A clarification in the regulations was required before a number of 'Transfers In' could be processed. This has since been received and the numbers of 'Transfers In' processed had increased, hence why the cash levels have risen.

3. Performance Figures against Benchmarks

3.1 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 31.03.11	**12 Months to 31.03.11**	**3 Years to 31.03.11**	**5 years to 31.03.11**
Fund	0.9%	6.3%	3.1%	1.8%
Benchmark return	1.1%	8.3%	5.8%	4.1%
*Difference in return	-0.2%	-1.9%	-2.6%	-2.1%

Source: WM Company

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

3.2 The overall net performance of the Fund against the **Strategic Benchmark** (i.e. the strategy adopted of Gilts over 15 years + 3% per and then revised to 2.9%) is shown below:

	Quarter to 31.03.11	**12 Months to 31.03.11**	**3 Years to 31.03.11**	**5 years to 31.03.11**
Fund	0.9%	6.3%	3.1%	1.8%
Benchmark return	-0.8%	9.9%	8.1%	6.8%
*Difference in return	1.7%	-3.3%	-4.6%	-4.6%

Source: WM Company

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

The Fund's revised strategy adopted in September 2008 has not been fully implemented and historical performance greater than three years is no reflection of the revised strategy.

3.3 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 2011)

	Standard Life	**Alliance Bernstein (as at Feb 11 only)**	**Royal London**	**UBS**	**Ruffer**	**SSGA**
Return (performance)	0.0	2.4	0.6	2.9	-0.6	1.8
Benchmark	1.0	2.0	-0.1	1.9	0.2	1.8
***Over/(Under) Performance vs. Benchmark**	**-1.0**	**0.4**	**0.7**	**1.0**	**-0.8**	**0.0**
TARGET	1.5	2.6	0.1	n/a	n/a	n/a
*** Over/(Under) Performance vs. Target**	**-1.5**	**(0.2)**	**0.5**	**n/a**	**n/a**	**n/a**

Source: WM Company, Fund Managers and Hymans

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

ANNUAL PERFORMANCE (LAST 12 MONTHS)

ANNUAL	**Standard Life**	**Alliance Bernstein (as at Feb 11 only)**	**Royal London**	**UBS**	**Ruffer**	**SSGa**
Return (performance)	5.1	5.9	8.3	10.7	n/a	n/a
Benchmark	8.7	8.0	6.5	8.9	n/a	n/a
***Over/(Under) Performance vs. Benchmark**	**-3.3**	**(1.9)**	**1.7**	**1.8**	**n/a**	**n/a**
TARGET	10.7	10.5	7.3	n/a	n/a	n/a
*** Over/(Under) Performance vs. Target**	**(5.2)**	**(4.1)**	**1.0**	**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 Inception from 8 Sept 2010
- Alliance Bernstein not a full quarter – mandate terminated February11

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 10 May 2011 at which a review of the quarter 1 performance was discussed.

b) Market Value of the fund as at 31 March increased by 0.09% compared with the previous quarter.

c) Standard Life underperformed the benchmark in the quarter by -1% and underperformed the target in the quarter by -1.5%. Since inception they are below benchmark by -0.6% and -2.5% against the target. As at the date of the meeting performance was flat against the benchmark.

d) Standard Life reported that UK equities moved modestly over the quarter after a strong finish to 2010. Consumer and oil sensitive stock exposures held back performance. Equities volatile on the back of events in Japan, Middle East and North Africa and concerns persisted over the euro area.

e) Standard Life explained that they are increasing their exposure to non-life insurance in response to a question about the economic outlook and whether there are likely to be any changes in the type of stocks they hold going forward.

f) Household Goods & Home Construction, Life Insurance and Industrial Engineering contributed to the positive outperformance. Negative contributors came from General Retailers, Media and Oil & Gas Producers.

g) Positive attribution in stock selection came from not holding Tesco stocks as they reported poor sales results. Resolution as management gave greater clarity on their strategy. Aviva and RSA as the sector performed well as a beneficiary of rising bond yields. Galliford Try as trading across the house building sector improving.

h) Negative attribution in stock selection came from Dixons as they reported weak Christmas trading. GKN gave up some of its gains from quarter 4 and there were market concerns regarding input cost pressures and supply distribution from Japan. British Airways fell back on worries over rising fuel prices. Lloyds Banking Group as sector came under pressure on worries over potential regulatory change.

i) The portfolio activity during Quarter 1 were as follows :
   - Purchased Anglo American –low valuation
   - WS Atkins (engineering consultant) – benefits from the recovery in construction activity.
   - Purchased Premier Farnell (distributor of parts) – improving industrial demand and a management restructuring program to shift the business into higher margin areas.

- Purchased WPP – further earnings revisions likely as company benefits from a broad based recovery in global advertising trends.
- Purchased Prudential – attractive valuation, particularly given the growth in their Asian business and 20% increase in the dividend gives an indication in conference in future cash flow.
- Sold stocks in IAG – on concerns that the rise in the fuel price hadn't been discounted by the market.
- Sold Aviva – reduced following a strong run in shares and the life sector generally.
- Took profits in Inchcape after good performance.

j) Standard Life were asked about the underweight position in the Oil & Gas sector and whether this was based on the prospects for the oil price or are the valuations less attractive. They responded by saying that it is not a sector issue but management issues over spending with Shell.

k) Going forward Standard Life believe that stock picking will be the main driver.

l) No governance or whistle blowing issues were reported.

4.2. Global Equities (Alliance Bernstein)

a) Members decided at the committee meeting held on the 14 December 10 to terminate the mandate held with Alliance Bernstein. Assets were transferred to State Street Global Advisors on the 23 February 2011 on a temporary basis until further decisions about the investment strategy can be made.

b) As trading ceased on the 4 February 11no performance reports were submitted by Alliance Bernstein. The WM performance data shows that during the partial quarter Alliance Bernstein outperformed the benchmark by 0.4% but were below target by -0.2%.

4.3. 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 10 May 2011 at which a review of the quarter 1 performance was discussed.

b) Market Value of the fund as at 31 March increased 0.49% compared with the previous quarter.

c) Royal London outperformed the benchmark for the quarter by 0.7% and 0.5% against the target. Since inception they outperformed benchmark by 0.4% but below target by -0.3%.

d) Asset allocation of the fund during the quarter was 56.3% Sterling Credit Bonds, 29.2% Index Linked, 10.3% Government Bonds, 4.2% Overseas Government Bonds.

e) Royal London's tactical overweight position in corporate bonds and overseas bonds and an underweight position in index linked and conventional government bonds was kept marginally unchanged in the quarter.

f) Stock selection, asset allocation and duration views were the key contributors to performance.

g) The <u>duration</u> position, the sensitivity of a bond's price to shifts in interest rates, of the fund on average was longer than the benchmark on duration and this added to performance.

h) In respect of <u>asset allocation</u> Royal London's activity during the quarter was as follows:
   - Maintained an overweight position in corporate bonds – this was a positive contributor
   - Tactical off-benchmark positions in overseas index linked bonds - holdings of overseas bonds added value over the quarter.

i) In respect of <u>stock selection</u> the activity during the quarter was as follows:
   - Held no supranational bonds over the quarter – this was a positive factor for performance
   - Ran an overweight position in subordinated financial bonds- this was beneficial.
   - Increased the overweight position in asset backed securities through new issues of covered bonds – this was a benefit in the quarter
   - Participated in several new issues with a bias towards covered and consumer bonds – the fund gained from its participation particularly in covered bonds.
   - Underweight positions were held in auction stocks – positive effect on portfolio performance.

j) Royal London was asked to explain why they held an overweight position in corporate bonds relative to government bonds. They believe that the three drivers of this positioning are that they are good value (cheap to buy), the market and the returns.

k) Royal London explained that their 'bias towards security' in terms of holdings in real estate, social housing, structured and unrated issues is on a sector basis.

l) As Royal London had increased their holdings in covered bonds they were asked to explain what these were and whether they plan to hold onto them in the long term. They explained that these were senior bonds that were covered by mortgages and the new issues they bought in Nationwide, Abbey and Lloyds were bought cheap. It is their intention to hold covered bonds for the longer term.

m) In the presentation pack there was a slide on their Absolute Return Bond Fund. Royal London went on to explain that this is a new product that they will be launching within the next three months. They see this as a fund that clients will hold as an additional holding rather than a replacement for bond mandates as this will be measured against a cash benchmark. They explained that it will be a 'best ideas fund' and will be managed by the same managers of our existing fund. They gave assurances that this will not be detrimental to the management of our existing portfolio.

n) Members have agreed a change to our portfolio that allows bonds to be held if they are downgraded after purchase to below investment grade BBB- . This means that Royal London would avoid having to be forced to sell those downgraded bonds. Royal London has been granted some flexibility over the disposal of these bonds during a period where it is expected a higher than usual numbers of bonds are being downgraded. It will not be permitted to allow purchase of bonds below BBB- only to have some flexibility when to sell if downgraded.

o) Royal London explained that for those assets that were downgraded earlier in the year and were not forced to sell benefited the portfolio.

p) No governance or whistle blowing issues were reported.

q) The committee agreed at its meeting on the 24 March 11 to reduce the funds holdings in Bonds by 5% in order to rebalance the fund. UPDATE: the cash of £19m was transferred to Ruffer on the 20 April 11

4.4. Property (UBS)

a) Representatives from UBS are to make a presentation at this committee, therefore a brief overview of Quarter 1 performance follows:

b) The value of the fund as at 31 March 2011 increased by 2.45% since the last quarter.

c) UBS out performed the benchmark in the quarter by 1.0% and out performed the benchmark in the year by 1.8%.

d) The committee agreed at its meeting on the 24 March 11 to increase its investment with UBS in order to rebalance the fund and move the asset allocation for property nearer to its 10% planned allocation. UPDATE: £7m was transferred to UBS on the 17 May 2011 which was funded from internally managed cash.

4.5. Multi Asset Manger (Ruffer)

a) In accordance with agreed procedures officers will only meet with representatives from Ruffer once in the year with the other meeting to be held with members. Ruffer attended their first meeting with members at the 24 March 11 Pensions Committee meeting. Officers were not due to meet with officers but a brief review of the quarter 1 performance follows:

b) The value of the fund as at 31 March 11 decreased by .47% since the previous quarter.

c) The small decline in fund values mainly reflected their gold and dollar positions.

d) Ruffer underperformed in the quarter by -0.6%.

e) Japanese equities fell sharply in the aftermath of the March's earthquake and tsunami, but losses were mitigated by gains made in January and February, some ground was recovered in the balance of March, but most of their Japanese equities ended down for the period.

f) At its meeting on the 24 March 11 Ruffer gave a presentation about how the mandate is managed and how the mandate had performed since their inception date of 8 September. At this meeting the committee agreed to increase its investments with Ruffer as part of the fund's rebalancing, this was funded from reducing the bond's holding by 5%. UPDATE: £19m was transferred to Ruffer on the 20 April 11.

4.6. 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. Therefore officers met with representatives from SSgA on the 10 May 2011 at which a review of the quarter 1 performance was discussed.

b) This was the first meeting with SSgA since inception of 8 September 2010.

c) The value of the fund (account 1) as at 31 March 11 increased by 1.8%.

d) On termination with the funds Global Asset Manager (Alliance Bernstein) a second wave of assets were transferred to SSgA on the 23 February 2011 (Account 2).

e) State Street explained that as part of the first transfer of funds they undertook rebalancing of the asset allocation over three phases. Phase 1 (at inception) the split was 67% in UK Equities and 33% in the FTSE All World (ex UK) index. Phase 2 split as at end of September was 50% in UK Equities and 50% in FTSE All World (ex UK) index. The final phase was completed at the end of October and the benchmark split was 33% in UK Equities and 67% in the FTSE All World (ex UK) index.

f) State Street went on to explain that instead of measuring the benchmark against a number of regional sub funds they have moved to the All World Fund. This makes no difference to the overall benchmark but makes it easier to measure against the one benchmark.

g) Since inception State Street has performed in line with the benchmark. Although they were behind the benchmark by -0.2%) at the quarter ending December 10. This in part was part was due to transfer costs and the movement in the fund to achieve the target asset weighting.

h) The second account is being kept separate, as the current intention is that this is a temporary measure until further discussions on the investment strategy have progressed.

i) State Street was asked if there were any outstanding issues over the second transfer of assets and if they are now fully invested. The only outstanding issue is the sweeping up of cash from Alliance Bernstein. This is being carried out on a regular basis via our custodian and will continue until all dividends, tax reclaims and trades have all been settled in the Alliance Bernstein account.

j) State Street explained that when a new stock is included in the FTSE ALL Share Index, in order to manage their exposure, they stagger the purchases by buying a few days before and after.

k) State Street enquired as to whether we would consider switching to currency hedging within the portfolio. After discussion officers said that they would consult with the funds advisor and get back to them.

l) 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:

  UBS

- 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 Mar 2011
Alliance Bernstein Quarterly report to 31 Mar 2011
Royal London Quarterly report to 31 Mar 2011
UBS Quarterly report to 31 Mar 2011
The WM Company Performance Review Report to 31 Mar 2011
Hyman's Monitoring Report to 31 Mar 2011