

| | | | | |
|--|---|---|---------------------------|------------|
| COMMITTEE: Pensions Committee | DATE: 26th June 2008 | CLASSIFICATION: Unrestricted | REPORT NO (PC/003/089) | AGENDA NO. |
| REPORT OF: Corporate Director of Resources | | TITLE: Report of Investment Panel for Quarter Ending 31st March 2008. | | |
| ORIGINATING OFFICER(S): Investment Panel | | Ward(s) affected: N/A | | |

1. SUMMARY

- 1.1 This report informs Members of the activities of the Investment Panel and investment performance of the Fund and the investment managers for the period ending 31 March 2008.
- 1.2 In the quarter the Fund achieved a return of -6.1% which was marginally behind the benchmark return of -5.9%. The returns for longer periods continue to lag the benchmark with the one year return of -3.9% being -1.3% below the benchmark return of -2.6%. However this long term underperformance must be considered in the context of the extensive restructuring of the fund undertaken in the year which would have an adverse impact on performance.
- 1.3 The performance of individual managers was variable. Three managers achieved returns above the benchmark whilst the remaining three were below. Martin Currie continued to under perform the benchmark and have a return since there appointment in 2006 of -1.7% which has underperformed the benchmark of +3.8% by 5.5%. Preliminary indications are that the performance of Martin Currie has improved in the current quarter and the position will be reviewed at the end of the current financial year.
- 1.4 The distribution of the fund amongst the different asset classes is broadly in line with the benchmark although there is increasing underweighting in equities attributable to the continuing declines in world financial markets as a result of the sub prime loan issues.
- 1.5 The appointment of two currency managers is currently being progressed.

2. RECOMMENDATIONS

- 2.1 Members are recommended to note the contents of this report.

**LOCAL GOVERNMENT ACT, 1972 SECTION 100D (AS AMENDED)
LIST OF BACKGROUND PAPERS USED IN THE PREPARATION OF THIS
REPORT**

Brief description of "background papers"

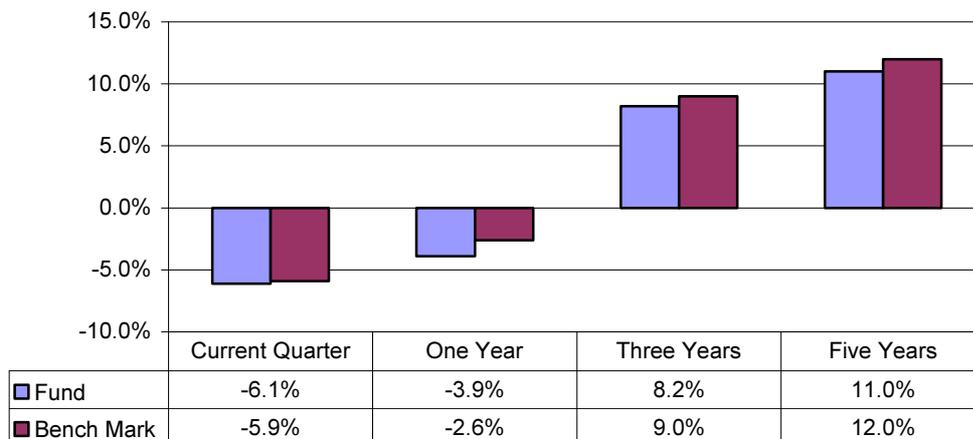
Name and telephone number of holder
And address where open to inspection

3. **BACKGROUND**

- 3.1 The Regulations require that the Council establish arrangements for monitoring the investments of the Fund and the activities of the investment managers and ensuring that proper advice is available on investment issues.
- 3.2 This Committee has established the Investment Panel, which meets quarterly for this purpose. The Panel's membership comprises all Members of the Pensions and Accounts Committee, an Investment Professional as Chair, an Independent Financial Adviser, and the Director of Resources. Trade Union representatives also attend as observers. The Investment Panel is an advisory body which makes recommendations to the Pensions and Accounts Committee which is the decision making body.
- 3.3 This report informs Members of the activities of the Investment Panel and performance of the Fund and investment managers for the period ending 31 March 2008.

4 **INVESTMENT PERFORMANCE**

- 4.1 The Fund achieved a return of -6.1% in the quarter which compared to a benchmark of -5.9%. This underperformance of 0.2% continues the long term underperformance of the fund.
- 4.2 The performance of the fund over the long term is as set out in table 1.



- 4.3 The performance of the fund should however be considered in the context of a major restructuring of the fund in the last two years which was undertaken to address the long term performance issues.
- 4.4 The restructuring has involved the appointment of five managers and a redistribution of the assets to increase the exposure to equities. Restructuring of this level will inevitably adversely impact on short term performance.
- 4.5 The long term impact of the restructuring has yet to be fully reflected in performance and it is considered that this can only be assessed when the revised structure has been fully operational for a minimum of two years, and realistically three years
- 4.6 The negative returns in the one year figures illustrates the volatility and cyclical nature of financial markets and are within the range of expectations used by the fund actuary in assessing the funding position. The Fund can take a long term perspective on investment issues principally because a

high proportion of its pensions liabilities are up to sixty years in the future. Consequently it can effectively ride out short term volatility in markets.

5. MANAGERS

- 5.1 The Fund currently employs six specialist managers with mandates corresponding to the principal asset classes. The managers are as set out below:

| Manager | Mandate | Value £M | Target % of Fund | Date Appointed |
|-----------------|---------------|----------|------------------|----------------|
| GMO | Global Equity | 173.5 | 25% | 29 Apr 2005 |
| Baillie Gifford | Global Equity | 109.8 | 16% | 5 Jul 2007 |
| Martin Currie | UK Equity | 88.5 | 15% | 17 Jan 2006 |
| Aberdeen | UK Equity | 67.1 | 11% | 6 Jul 2007 |
| Aberdeen | Bonds | 163.2 | 21% | 28 Feb 2006 |
| Schroder | Property | 82.7 | 12% | 30 Sep 2004 |
| | | £684.8 | 100% | |

- 5.2 The performance of the individual managers is as set out in table 3.

| | Current Quarter | One Year | Three Years | Five Years |
|----------------------|-----------------|----------|-------------|------------|
| GMO | 1.3% | -0.4% | | |
| Baillie Gifford | 0.5% | 1.8% | | |
| Martin Currie | -0.7% | -6.7% | -5.2% | |
| Aberdeen UK Equities | -1.4% | -3.9% | | |
| Aberdeen Bonds | -0.3% | -0.4% | | |
| Schroder | 0.8% | 2.8% | 2.0% | |
| Total Fund | -0.2% | -1.4% | -0.8% | -0.9% |

- 5.3 **GMO** achieved a return of -7.6% in the quarter which outperformed the benchmark of -8.9% by 1.3%. The improvement in performance over the annual return was attributable to a change in investment strategy by GMO which increased the proportion of US quality stocks within the portfolio.
- 5.4 **Bailey Gifford** achieved a return of -8.3% in the quarter which outperformed the benchmark of -8.8% by 0.5%. The out performance since inception is attributable to an overweight position in the energy sector which has performed well.
- 5.5 **Martin Currie** has performed poorly since its appointment in 2006. It has underperformed the benchmark return of 3.8% by 5.5% since appointment. Martin Currie has a concentrated approach and high return target and this inevitably involves a degree of volatility. However the manager's overweight position in financials was adversely affected by the sub prime issue during the period. This position has now been cut and their overweight positions in mining and energy stocks will benefit future performance. There have however been changes in key personnel which concerned the Panel but it was considered appropriate to review the position at the end of the financial year.

- 5.6 **Aberdeen (UK Equities)** lagged the benchmark return by 1.4% in the quarter principally because of the underweight position in the energy and raw materials sectors.
- 5.7 **Aberdeen (Bonds)** performance was 0.3% behind the benchmark but performance since their appointment is marginally ahead of the benchmark.
- 5.8 **Schroders** have consistently outperformed the benchmark since their appointment. The diversification into continental Europe has offset the declines in the UK commercial property market.
- 5.9 The performance of individual managers should be considered in the context of the structure of the overall fund which has been constructed on the basis of complimentary management styles. Whilst individual managers may under perform the relevant benchmark this may be appropriate because their position will contribute to the overall stability of the fund.

6 **ASSET ALLOCATION**

- 6.1 The allocation of investments between the different asset classes was determined in conjunction with the Council's professional advisors in 2004. The asset allocation is determined by a number of factors including:-
 - 6.1.1 The risk profile. Generally there is a trade-off between the returns obtainable on investments and the level of risk. Equities have higher potential returns but this is achieved with higher volatility. However, as the fund remains open to new members and able to tolerate this long term benefits of the increased returns.
 - 6.1.2 The age profile of the Fund. The younger the members of the fund are the longer the period before pensions become payable and investments have to be realised for this purpose. This enables the Fund to invest in more volatile asset classes because it has the capacity to ride out adverse movements in the investment cycle.
 - 6.1.3 The deficit recovery term. All Council funds are in deficit because of falling investment returns and increasing life expectancy. The actuary determines the period over which the deficit is to be recovered and considers the need to stabilise employer's contribution rates. The actuary has set a twenty year deficit recovery term for this Council which enables a longer term investment perspective to be taken.
- 6.2 The benchmark asset distribution and the position at the 31st March 2008 is as set out below:

6.3 Individual managers have discretion within defined limits to vary the asset distribution.

6.4 In addition the distribution will vary according to the relative returns of the different asset classes. Global equity markets have seen heavy declines as a result of sub prime loan issues. This has distorted the distribution in the short term. It is considered

Table 4: Asset Allocation

| | Benchmark % | Quarter % | Variance % |
|-------------------|----------------|--------------|---------------|
| UK Equities | 30.0% | 28.3% | -1.7% |
| Overseas Equities | 37.0% | 36.8% | -0.2% |
| Total Equities | 67.0% | 65.1% | -1.9% |
| Property | 12.0% | 11.4% | -0.6% |
| UK Bonds | 12.5% | 12.5% | 0.0% |
| Overseas Bonds | | 1.8% | 1.8% |
| Index Linked | 8.5% | 7.9% | -0.6% |
| Cash | | 1.3% | 1.3% |
| | 100.0% | 100.0% | 0.0% |

that the position will correct in the long term and consequently no rebalancing is required at the current time.

7 CURRENCY MANAGERS

- 7.1 The Investment Panel considered submissions by 23 companies for the currency mandate in an exercise administered by the Council's investment advisor Hymans Robertson.
- 7.2 The Panel interviewed a short list of five managers and recommended that Auriel and Record be appointed for the mandates.
- 7.3 The Panel's recommendation was endorsed by the Director of Finance in accordance with the delegated authority granted by this Committee on the 16th March 2006.
- 7.4 The appointment is currently being progressed by Corporate Finance in conjunction with Hymans Robertson.

8. COMMENTS OF THE CHIEF FINANCIAL OFFICER

- 8.1. The comments of the Director of Resources have been incorporated into the report.

9. RISK MANAGEMENT IMPLICATIONS

- 9.1 Any form of investment inevitably involves a degree of risk.
- 9.2 To minimise risk the Investment Panel attempts to achieve a diversified portfolio. This diversification relates to both asset classes and management styles.
- 9.3 The current management changes attempt to blend complementary investment styles to minimise risk.

10. CONCURRENT REPORT OF THE ASSISTANT CHIEF EXECUTIVE (LEGAL)

- 10.1 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 require Councils, which administer Pension Funds to invest contributions until such time as they are required to pay pensions.
- 10.2 The Regulations require that when undertaking such investment Councils are required to ensure that such investments are diversified to minimise risk and to obtain and consider proper advice.
- 10.3 The report details how the Council fulfils its obligations in this regard.

11. ANTI-POVERTY IMPLICATIONS

- 11.1 There are no specific anti poverty implications.

12. EQUAL OPPORTUNITIES IMPLICATIONS

- 12.1 There are no equality implications.

13. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

13.1 There are no Sustainable Action for A Greener Environment implications.

