REVIEW ON PERFORMANCE MEASUREMENT OF THE PENSION FUND

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Papers with this report	Northern Trust Executive Report WM Local Authority Quarter Reports Private Equity Listing Private Equity reports from Adams Street and LGT

SUMMARY

This report reviews the fund manager performance for the London Borough of Hillingdon Pension Fund for the period ending 31 March 2013. The total value of the fund's investments as at the 31 March 2013 was £683m.

RECOMMENDATIONS

That Committee

1. **Notes the contents of this report and the performance of the Fund Managers.**
2. **Notes that the Statement of Investment Principles has been updated to reflect the inclusion of Bearings Asset Management as a Fund Manager.**

1. INFORMATION

The performance of the Fund for the quarter to 31 March 2013 showed an outperformance of 1.01% with a return of 7.84% compared to the benchmark of 6.82%. Four of the eight monitored portfolios outperformed their benchmarks with rest showing figures below their prescribed benchmarks during the quarter. One year figures show returns of 12.33%, an out-performance of 1.68%.

Performance Attribution Relative to Benchmark

	Q1 2013 %	1 Year %	3 Years %	5 Years %	Since Inception %
JP Morgan	(0.50)	0.41	-	-	2.05
M&G	0.98	1.06	-	-	0.07
Ruffer	10.20	10.21	-	-	6.88
SSgA	(0.01)	(0.10)	0.06	-	0.06
SSgA Drawdown	0.13	(1.65)	(0.61)	-	(0.42)
UBS	(0.38)	3.29	0.35	(0.08)	1.06
UBS Property	(0.46)	(1.46)	(0.78)	(1.06)	(0.72)
Total Fund	**1.01**	**1.68**	**1.20**	**(0.42)**	**0.03**

2. MANAGER PERFORMANCE

2.1 Manager: JP Morgan

Performance Objective: The investment objective of the company is to achieve a return of +3% over Libor 3 Month rate.

Approach: The aim of the portfolio is to be diversified across various corporate bonds with an average quality of BBB+ and derivatives may be used to achieve fund objectives.

Performance: To incorporate an element of risk adjusted return, the benchmark has been set to include outperformance of an absolute benchmark, in this case 3 Month Libor, by a further 3%. In relation to this benchmark JP Morgan have outperformed since inception (Nov 2011) by 2.05% and in the quarter under review, underperformed by 0.50% with a return of 0.37% against benchmark return of 0.87%.

2.2 Manager: M&G

Performance Objective: The investment objective of the Prudential/M&G UK Companies Financing Fund LP and M&G Debt Opportunities Fund is to seek to maximise returns consistent with prudent investment management. The Funds aim to provide an absolute return of Libor +4% (net of fees). Additional returns may be achieved through equity participation or success fees.

Approach: The objectives of the Funds are to create attractive levels of current income for investors, while maintaining relatively low volatility of Net Asset Value. The funds were set up to provide medium to long term debt financing to mid-cap UK companies with strong business fundamentals that are facing difficulties refinancing existing loans in the bank market.

Performance

During the quarter under review, M&G investments out-performed its' benchmark of 3 Month LIBOR +4% p.a. target by 0.98% with a portfolio return of 2.09% against benchmark figure of 1.11%. For one year the returns was 5.78% compared to benchmark returns of 4.72%, resulting in out-performance of 1.06%. Since inception at the end of May 2010, the portfolio registers a 4.90% pa return against the benchmark of 4.83% pa, just out-performing the benchmark by (0.07)%. The since inception Internal Rate of Return for this portfolio is now 4.98% and 14.10% respectively.

2.3 Manager: RUFFER

Performance Objective: The overall objective is firstly to preserve the Client's capital over rolling twelve month periods, and secondly to grow the Portfolio at a higher rate (after fees) than could reasonably be expected from the alternative of depositing the cash value of the Portfolio in a reputable United Kingdom bank.

Approach: Ruffer applies active asset allocation that is unconstrained, enabling them to manage market risk and volatility. The asset allocation balances "investments in fear", which should appreciate in the event of a market correction and protect the portfolio value, with "investments in greed", assets that capture growth when conditions are favourable.

There are two tenets that Ruffer believe are central to absolute return investing which are to be agnostic about market direction and also to remove market timing from the portfolio.
Performance: The Ruffer portfolio returned 10.33% during the quarter and against the return of 0.13% for LIBOR 3 Month GBP delivers an outperformance of 10.20%. This further consolidates outperformance of the previous quarter and means that the year to date and 1 year numbers are now ahead of target. This culminates in a since inception return from May 2010 of 6.88% pa, which translates as an excess return of 7.70% against the benchmark of 0.82% pa.

2.5 Manager: SSgA
Performance Objective: To replicate their benchmark indices
Approach: The calculation of the index for passive funds assumes no cost of trading. In order to simply match the index, it is necessary to trade intelligently in order to minimise costs, and where possible, make small contributions to return in order to mitigate the natural costs associated with holding the securities in the index. Activities which SSgA employ to enhance income include; tactical trading around index changing events and stock lending. They also aim to alleviate costs by efficient trading through internal and external crossing networks.
Performance:
The SSGA passively managed portfolio produced a return of 10.32% in the quarter, just (0.01) % behind the benchmark. Both the year to date return and one year figures are just behind their expected targets by (0.01) % and (0.10) % respectively. Positive absolute performance in line with the benchmark is seen in longer periods; with the since inception return of 14.61% pa only 0.06% above the benchmark.

2.6 Manager: UBS
Performance Objective: To seek to outperform their benchmark index by 2% per annum, over rolling three year periods.
Approach: UBS follow a value-based process to identify businesses with good prospects where, for a variety of reasons, the share price is under-estimating the company's true long term value. Ideas come from a number of sources, foremost of which is looking at the difference between current share prices and UBS's price target for individual stocks. The value-based process will work well in market environments where investors are focussing on long term fundamentals.
Performance:

	Q1 2013 %	1 Year %	3 Years %	5 Years %	Since Inception %
Performance	9.94	20.06	9.13	7.87	10.16
Benchmark	10.32	16.77	8.78	7.95	9.10
Excess Return	(0.38)	3.29	0.35	(0.08)	1.06

The UK equity portfolio marginally underperformed the FTSE All-Share index during the quarter, with a return of 9.94% against the index figure of 10.32% culminating in an underperformance of (0.38)%. In terms of attribution, the largest positive contributors were overweight positions in 3i Group, the private equity investor and International Consolidated Airlines Group (formerly British Airways/Iberia). The largest negative contributors were overweight positions in mining stocks Rio Tinto and Anglo American as well as weakness in Lloyds Banking Group at the end of the quarter.

2.7 Manager: UBS Property

Performance Objective: To seek to outperform their benchmark index by 0.75% per annum over rolling three year periods.

Approach: UBS take a top down and bottom up approach to investing in property funds. Initially the top down approach allocates sector and fund type based on the benchmark. The bottom up approach then seeks to identify a range of funds which are expected to outperform the benchmark.

Performance:

	Q1 2013 %	1 Year %	3 Years %	5 Years %	Since Inception %
Performance	0.61	(0.09)	4.56	(2.05)	(0.94)
Benchmark	1.07	1.38	5.35	(0.99)	(0.22)
Excess Return	(0.46)	(1.46)	(0.78)	(1.06)	(0.72)

The UBS Property portfolio made a positive return, with a figure of 0.61%, translating to an underperformance of (0.46) % behind the IPD UK PPFI All Balanced Funds index return of 1.07%. This also feeds into the one year as the portfolio now shows a loss of (0.09) %, which is (1.46) % behind the IPD. All long periods also demonstrate underperformance. and with the exception of the 4.56% pa return over three years, absolute returns are also negative. Since inception, in March 2006, these losses stand at (0.94) % and while the benchmark also falls with (0.22) %, the underperformance is now 72 basis points.

UBS Triton Update

At the end of January unit holders of UBS Triton were notified that the Fund would be liquidated effective 1 August 2013 unless £150 million of redemption requests were withdrawn or equivalent new money is raised by 30 April 2013. Since this announcement, a large investor submitted a redemption request and the queue subsequently increased to 79% of the NAV as at 31 March 2013.

Accordingly the target amount of redemption requests to be withdrawn and/or new money raised now stands at around £300 million. The Manager is exploring a number of avenues with respect to securing the future of the Fund. Several of the proposals received from prospective investors would introduce sufficient capital into the Fund to meet all or a majority of redemption requests. Whilst there is no guarantee an investment will be made, the General Partner believes there is a reasonable prospect of this being achieved. It is expected that discussions will be ongoing beyond 30 April 2013, with a view to completing a transaction on or before 31 July 2013 and therefore enabling UBS Triton to continue as a viable fund. If sufficient new funding is not secured by this date (and/or redemption requests withdrawn) then the fund will be placed into liquidation.

As a result of this latest information the decision was taken to withdraw Hillingdon's redemption notice.

3. ABSOLUTE RETURNS FOR THE QUARTER

	Opening Balance £000's	Appreciation £000's	Income Received £000's	Net Investment	Closing Balance £000's	Active Management Contribution £000's
Adams Street	21,082	1,990	10	(455)	22,627	1,990
JP Morgan	74,704	276	0	0	74,980	(372)
Kempen	-	2,585	0	44,299	46,884	(705)
LGT	17,077	985	0	(776)	17,286	983
Macquarie	6,304	173	0	2,060	8,537	97
M&G	14,930	334	0	1,087	16,351	157
Newton	-	1,449	0	21,370	22,819	(351)
Ruffer	119,176	11,712	599	-	131,487	12,156
SSgA	123,348	12,724	0	0	136,072	(7)
SSgA Drawdown	6,102	61	0	0	6,163	8
SSgA Temporary	62,124	2,136	0	(64,260)	-	-
UBS	123,512	11,243	1,035	0	135,790	(475)
UBS Property	48,951	(264)	564	0	49,251	(226)
Cash	13,618	-	15	(4,000)	9,633	-
Nomura	47	1,815	39	(1,454)	447	(1,296)

The above table provides details on the impact of manager performance on absolute asset values over the quarter based on their mandate benchmarks.

4. M&G Update

M& G UK Companies Fund
The NAV was valued at £949 million on March 31, 2013 compared with £939 million at the end of the previous quarter. The increase resulted from the earned income after fees which were offset by the mark to market value on the interest rate swap. Since inception, the fund has returned 4.98%, compared with 5.11% at the end of the last period. For the first quarter 2013 the fund returned 1.06% compared with 1.39% in the same period last year. The lower yield reflects the roll off of arrangement fees in the fund. At present, all the loans remain marked at par, with a weighted average credit rating of BB.

M&G Debt Opportunities Fund IV
During the quarter under review, one drawdown of £850k for the M&G Debt opportunities fund was made in April 2013, representing 5.67% of our commitments (£15m) to the fund and total drawdown to date of £3.09m. The fund's NAV as at 31 March 2013 was £46.24m with a total return since inception of 14.10%. In the previous three months the fund invested in two corporate issuers. These companies both issue into the leverage loan

market and neither are the “flow names” which are frequently being traded by hedge funds.

Debt Opportunities Fund’s first investment was in February; the Fund bought into the capital structure of a leverage loan issuer that has previously been through a restructuring. M&G has followed this credit for years and is one of the largest lenders to the company. As such, we have a strong relationship with management and know the other lenders well through our position on a lender-led steering group.

The second purchase followed in March where the fund bought into the post-restructuring capital structure of a logistics business. The fund bought into a senior secured leverage loan, which trades with stapled equity interest. Debt Opportunities Fund was able to acquire a reasonable position in the credit due to our strong reputation and good relationship with the seller.

5. Macquarie Update

Overall cost of investment in Infrastructure by the fund was £8.4m as at 31 March 2013. This is spread across three Macquarie funds.

MSIF – Macquarie SBI Infrastructure Fund
The Net Asset Value (“NAV”) of the Fund was USD 516.1 million as at 31 March 2013, an increase of USD 44.7 million from USD 471.4 million as at 31 December 2012.

MSIF issued capital call notices totalling USD 19.3 million in February 2013 to fund MSIF’s commitments to MB Power (Madhya Pradesh) Limited and for payment of management fees. The total capital drawn from MSIF investors as at 31 March 2013 increased to USD 604.1 million (66.39%) from USD 584.8 million (64.27%) as at the previous quarter-end. USD 25.8 million was called from investors in March 2013 for the financial closure of MSIF’s investment into GJEL, which was funded by investors subsequent to the quarter end. At the end of the quarter under review, Hillingdon’s contribution to this fund was $2.6m out of a total commitment of $3.97m.

MEGCIF
At the end of the quarter under review, MEGCIF reached final close of US$870 million, in line with expectations at the beginning of the year. This is one of the largest Greater China-focused infrastructure fund raisings since the global financial crisis and demonstrates the growing international investor appetite for China infrastructure.
Hillingdon’s contribution to this fund as at 31 March 2013 was $1.7m as against a commitment of $4.75m.

MEIF4 - Macquarie European Infrastructure Fund 4
This sought partners’ approval as required under its article of memorandum to extend the final closing date by a month, from 28 March 2013 to 20 April 2013. This approval was received from over 75% of partners and thus implemented. It allowed MEIF4 to five additional Limited Partners commit to the fund. On Tuesday 30 April MEIF4 completed its final closing, taking total commitments to the Fund (including the French FCPR) to €2,745m, with support from 63 investors. The LP commitments vary in size from €3m to

€250m, with 59% coming from EMEA, 22% from North America and 19% from Asia and Australia (including the GP commitment).
To date, the total contribution by the Pension Fund to MEIF4 is Eur3.9m out of EUR16.0m committed to the fund.

6. Other Items

At the end of March 2013, £29.16m (book cost) had been invested in private equity, which equates to 4.29% of the fund against the target investment of 5.00%. In terms of cash movements over the quarter, Adams Street called £636k and distributed £1.4m, whilst LGT called £148k and distributed £1.1m. This trend is set to continue in the next few years as the fund's investments in private equity enters its' vintage years and more distributions will be received as the various funds mature.

The securities lending programme for the quarter resulted in income of £19.6k. Offset against this was £6.9k of expenses leaving a net figure earned of £12.7k. The fund is permitted to lend up to 25% of the eligible assets total and as at 31 December 2012 the average value of assets on loan during the quarter totalled £43.8m representing approximately 18.9% of this total.

The passive currency overlay agreed by Committee was put in place at in May 2010 with 100% Euro and 50% Australian dollars (June 2012) hedges. The latest quarterly roll occurred on the 6 May 2013 and resulted in a realised profit of 455k, with hedged Euro position accounting for £473k of the overall gain. Since inception, the programme has made a net gain of £345k.

For the quarter ending 31 March 2013, Hillingdon returned 7.84%, underperforming against the WM average of 9.00% by (1.16) %. The one year figure shows an underperformance of (1.47) %, returning 12.33% against the WM average return of 13.8%.

FINANCIAL IMPLICATIONS

These are set out in the report

LEGAL IMPLICATIONS

There are no legal implications arising directly from the report

BACKGROUND DOCUMENTS

None