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 30 June 2013. The total value of the fund's investments as at the 30 June was £681m. This represents a drop of £2m from the end of financial year in March 2013. However, in the months since June the Fund's value has increased again to around £695m at the end of August.

RECOMMENDATION

1. **That the content of this report be noted and the performance of the Fund Managers be discussed.**

1. INFORMATION

The performance of the Fund for the quarter to 30 June 2013 showed an out-performance of 0.44%, with a return of 0.21% compared to the benchmark of -0.23%. The whole fund out-performance is attributable to four fund managers during the quarter. One year figures show returns of 14.38%, 2.67% better than the benchmark.

Performance Attribution Relative to Benchmark

	Q2 2013 %	1 Year %	3 Years %	5 Years %	Since Inception %
JP Morgan	(2.41)	(0.67)	-	-	0.17
Kempen	(4.04)	-	-	-	(5.42)
Macquarie	4.40	-	-	-	-
M&G Investments	0.05	3.96	0.13	-	0.08
Newton	(0.88)	-	-	-	0.52
Ruffer	0.08	13.74	7.48	-	6.29
SsgA	(0.10)	(0.09)	(0.02)	-	0.03
SsgA Drawdown	(0.60)	(1.61)	(0.82)	-	(0.52)

UBS	4.84	8.48	2.79	1.49	1.15
UBS Property	0.22	(1.18)	(0.38)	(0.96)	(0.66)
Total Fund	**0.44**	**2.39**	**1.26**	**0.01**	**0.05**

Market Commentary

Gold had another bad quarter as investors started to abandon it as a safe-haven asset as they became more confident in the Federal Reserve's assertion that the US economy was recovering. The UK Gilt market was affected by the sell off in US government bonds, even though monetary policy in the UK is likely to remain looser for longer. Gilts recorded a return for the period of -3.8%. Overseas bonds were also negative, but Sterling weakness moderated the return of -2.9% on the Citigroup World Government Bond index. Index linked bonds fell, while investment grade corporate bonds, high yield bonds and emerging market debt were also badly affected by a general sell-off in fixed income assets.

Equity markets were also badly affected, with many of the smaller emerging and Asian markets falling sharply in the expectation that tighter US monetary policy would stifle investment flows. The emerging market complex lost 7.8% for the quarter, while the Pacific region lost 7.7%. Among the larger markets, Japan had a spectacular rally, fell 20%, but still ended with a positive return of 4.5%. The US also managed a positive return as did Europe, but the UK suffered a modest loss of 1.7% for the period. Commercial property had a steady return for the period of 1.7% reflecting continued foreign interest in the London office market.

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 0.17%. However, in the quarter under review, JP Morgan underperformed by (2.41) % with a return of (1.57) % 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 is to seek to maximise returns consistent with prudent investment management. The Fund aims to provide an absolute return of Libor +4-6% (net of fees). Additional returns may be achieved through equity participation or success fees.
Approach: The objective of the Fund is to create attractive levels of current income for investors, while maintaining relatively low volatility of Net Asset Value. The fund was 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

	Q2 2013 %	1 Year %	3 Years %	5 Years %	Since Inception %
Performance	1.16	8.73	4.94	-	4.89
Benchmark	1.11	4.59	4.81	-	4.80
Relative Return	0.05	3.96	0.13	-	0.08

Over the second quarter of 2013, M&G produced a 1.16% return, just 5 basis points ahead of the 3 Month LIBOR +4% p.a. Over the last year the account registers 8.73% against 4.59% whilst since inception at the end of May 2010, the portfolio return falls to 4.89% pa against the benchmark of 4.80% pa. The since inception Internal Rate of Return (IRR) for this portfolio moves further ahead of the target with a figure of 5.63% opposed to the comparator of 4.71%.

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 produced 0.20% over the last three months, which is just 8 basis points above the return of 0.13% for LIBOR 3 Month GBP. Driven by last quarter's return all longer periods show high absolute and relative returns, so over the last twelve month post a return of 14.50% against 0.67% for the target, resulting in the highest Out-performance of all mandates at 13.74%. While since the inception of the fund in May 2010 nine out of twelve quarters show positive returns and lead to figures of 7.13% versus 0.79% per annum, which translates as a relative return of 6.29%.

2.4 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:

Account		Q2 2013 %	1 Year %	Since Inception %
SSgA Main Account	Performance	(1.83)	16.65	13.31
	Benchmark	(1.73)	16.76	13.28
	Relative Return	(0.10)	(0.09)	0.03
SSgA Drawdown Account	Performance a/c 2	(2.01)	1.65	4.19
	Benchmark a/c 2	(1.42)	3.32	4.74
	Relative Return	(0.60)	(1.61)	(0.52)

Since its inception in November 2008 the SSgA main portfolio has delivered a return relative to its benchmark index of 0.03%. The Draw-Down fund which commenced June 2009 has underperformed its benchmark with a since inception return of (0.52) %. Performance is not always flat and quarterly variances should be expected as a result of a number of factors including; cash drag, stock lending cycles and rights Issue opportunities, however over the longer period these are expected to smooth out.

2.5 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:

	Q2 2013 %	1 Year %	3 Years %	5 Years %	Since Inception %
Performance	3.10	27.94	15.95	9.48	10.18
Benchmark	(1.66)	17.93	12.80	7.88	8.93
Relative Return	4.84	8.48	2.79	1.49	1.15

Performance for the quarter was positive and ahead of the benchmark with the largest contributions to out-performance coming from overweight positions in Lloyds Banking Group, Dixons and GlaxoSmithKline. In fact, UBS outperformed the benchmark all through one, three and five year periods. This resulted in the since inception performance relative return increasing to 1.15% from 1.06% in the previous quarter.

2.6 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:

	Q3 2013 %	1 Year %	3 Years %	5 Years %	Since Inception %
Performance	1.63	1.28	4.36	(1.03)	(0.69)
Benchmark	1.40	2.49	4.76	(0.07)	(0.03)
Excess Return	0.22	(1.18)	(0.38)	(0.96)	(0.66)

The UBS Property portfolio produced a return of 1.63%, beating the IPD UK PPFI All Balanced Funds index figure of 1.40% by 22 basis points. Although this is not enough to overturn the underperformance seen in all long periods, with 1 and 3 year showing positive absolute returns of 1.28% and 4.36% respectively but these were -1.18% and -0.38% below the benchmark. Since inception, in March 2006, the funds loses value with a figure of -0.66% and while the benchmark also falls with -0.03%, the underperformance is now -66 basis points.

2.7 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:

In contrast to the previous quarters JP Morgan investments fell this period by -1.57%, when compared to the 0.87% target of the 3 Month LIBOR + 3%, this translates as a -2.41% relative underperformance, the second lowest of all mandates. This now means for the year to date and 1 year periods they fall behind target with relative returns of -2.90% and -0.67% respectively, while since inception (November 2011) remains just ahead with figures of 3.95% versus 3.77%, which is 0.17% on a relative annualised basis.

2.8 Manager: Kempen International

Performance Objective: Seek to outperform their benchmark index by 2-4% per annum over rolling three year periods.

Approach: To earn a higher total return than its benchmark, MSCI World Total Return Index, including reinvestment of net dividends.

Performance:

In the first full quarter for the new Kempen mandate the fund fell -2.63% against 1.46% for the MSCI All World Index +2%, leading to the poorest underperformance seen this period of -4.04%. Since inception in January 2013, the absolute return improves to 3.14%, but the relative return falls further to -5.42% when compared to the benchmark of 9.06%.

2.9 Manager: Newton
Performance Objective:
To outperform the FTSE World Index by over 2% p.a. over rolling five year periods.
Approach: Increasing income and capital growth over the long term by investing in shares (i.e. equities) and similar investments of companies listed or located throughout the world.
Performance:
During the first full quarter of investment Newton posted a -0.42% return compared to 0.46% for the FTSE World Index +2%, leading to an underperformance of -0.88%. However since its inception on 24th January 2013, the fund delivers growth of 7.80% against the benchmark of 7.23%, producing a relative return of 0.52%.

3. ABSOLUTE RETURNS FOR THE QUARTER

	Opening Balance £000's	Net Investment	Appreciation £000's	Income Received £000's	Closing Balance £000's	Active Management Contribution £000's
Barings	-	61,977	(722)	-	61,255	(1,546)
JP Morgan	74,981	-	(1,174)	-	73,807	(1,835)
Kempen	46,884	1	(1,235)	-	45,650	(1,952)
Macquarie	8,536	(347)	457	-	8,646	384
M&G	16,351	3,135	218	-	19,704	24
Newton	22,819	-	(96)	-	22,723	(210)
Ruffer	131,488	(47,948)	(32)	615	84,123	64
SSgA	136,072	-	(2,485)	-	133,587	(138)
SSgA Drawdown	6,163	-	(124)	-	6,039	(35)
UBS	135,790	(13,947)	1,810	1,963	125,616	5,936
UBS Property	49,251	-	304	496	50,051	110

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 Companies Fund - The NAV was valued at £836 million on June 30, 2013 compared with £949 million at the end of the previous quarter. The decrease resulted from the semi-annual distribution and the early repayment of the Northgate loan at 102%. During the period the fund NAV also benefited from a reduction in the mark to market of the interest rate swap. Since inception, the fund has returned 5.05%, compared with 4.98% at the end of the last period. For the second quarter 2013 the fund returned 1.34% compared with 1.06% in the same period last year. The annual distribution yield was 5.11.

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, four draw-downs totalling £3.41m for the M&G Debt opportunities fund was made, representing 22.75% of our commitments (£15m) to the fund and total drawdown to date of £6.5m. The fund's NAV as at 30 June 2013 was £81.20m with a total return since inception of 15.80%.

Investments made by the Fund this quarter - In Q2 the fund was able to take advantage of weaker markets and some new opportunities; the fund purchased over €80m of debt in nominal terms and has now drawn approximately half of the commitments. The fund made the first purchases in high yield bonds and made further purchases in leveraged loans. In total the fund invested in five high yield bond issuers over the quarter.

While the fund's trades in the quarter were dominated by activity in the high yield bond market, there were also opportunities in the leverage loan market, which also experienced a sell off. The fund invested in loans issued by a European print and media company. M&G has been invested in the loans since primary syndication; the restructuring team became involved after the business deteriorated, which led to a covenant breach. Analysis of the situation showed that the leverage loans offered long-term value at the current market price, so the Fund took the opportunity to purchase some of the debt at a significant discount to par. The fund also made its first investment in a European construction company and added to its position in two existing investments.

5. Macquarie Update

Overall cost of investment in Infrastructure by the fund was £5.4m as at 30 June 2013. This is spread across three Macquarie funds. This is down by £3m from last quarter as a result of equalisation payments totalling about £3m received between April and June 2013.

MSIF – Macquarie SBI Infrastructure Fund - The Net Asset Value ("NAV") of the Fund was USD 563.8 million as at 30 June 2013, an increase of USD 47.7 million from USD 516.1 million as at 31 March 2013. During the quarter ended 30 June 2013, MSIF reached financial closure of its investment of up to USD 50.7 million into GJEL and up to USD 60.8 million into TTPL. Both are operating toll roads located in south India. Financial closure of the investment into GJEL was achieved on 23 April 2013 and that of TTPL was achieved on 21 June 2013.

MEGCIF - The operations of our three completed investments performed broadly in line with our expectations during the second quarter:

- Shenyang Shengyuan Water continued its robust performance. The business performed in line with expectations, growing substantially compared with the prior period. Growth in utilisation was in line with expectations. Shenyang City will host

China's National Games in August and September and Shengyuan will play a key role, providing tap water to the Games.

- Longtan Tianyu Terminal's shipping volume for the second quarter was 53% above the prior corresponding period (‚pcp') due to higher than expected handling volume in a number of cargo products. Financials were in line with expectations for the quarter and are in line with expectations for the year. During the quarter LTT completed the construction of a new warehouse which further enhances its position as the key terminal in Nanjing for the shipping of fertilizer and other high value cargo.

- Zhejiang Wanna Environmental continued the ramp-up of its operations during the quarter and EBITDA for the year-to-date is in line with expectations. In order to drive top line growth, MEGCIF continues to work with the management to increase waste volumes across the portfolio, primarily through the expansion of waste collection concession rights into neighbouring counties. During the quarter, management signed binding agreements to acquire two new plants and is in the final stages of securing the rights to a third BoT plant, bringing total capacity additions to 2,000 tonnes/ day in the year to date, ahead of forecast.

MEIF4 - Macquarie European Infrastructure Fund 4 - The fundraising period ended on 30 April 2013, with the Fund reaching a final size of €2,745.0 million. Following a series of equalisation payments, each investor now has 17.6 per cent of their original commitment invested in two assets, Open Grid Europe (OGE) and Czech Gas Networks (CGN). The Manager is now focused on the investment of the remaining un-invested commitments.

Following quarter end, on 8 July 2013, MEIF4 announced a public takeover offer to acquire at least 2/3 of the voting rights of Theolia, a Euronext Paris listed renewable energy company. Theolia has a predominantly operational portfolio of wind assets in Germany and France. The total capacity of the portfolio is 1,269MW, with 77 per cent of the installed base in Germany and 16 per cent in France. The core operational nature of the business provides the opportunity for MEIF4 to gain exposure to renewable energy assets and build a diversified portfolio. Following the receipt of approval from the French Financial Markets Authority (AMF), the formal offer opened to shareholders on 26 July 2013 and will be open until 6 September 2013. Should MEIF4 obtain the 2/3 approval required, a drawdown is expected to be made by the Fund in September in order to fund the acquisition. The Board of Theolia issued a unanimous recommendation for shareholders to accept the takeover offer, which also has support of the company's management.

6. Other Items

At the end of June 2013, £28m (book cost) had been invested in **private equity**, which equates to 4.11% of the fund against the target investment of 5.00%. This level still remains within the limits of the over-commitment strategy of 8.75%. In terms of cash movements over the quarter, Adams Street called £391k and distributed £1,017k, whilst LGT called £348k and distributed £957k. 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 £16.8k. Offset against this was £5.9k of expenses leaving a net figure earned of £10.9k. The fund is permitted to lend up to 25% of the eligible assets total and as at 30 June 2013 the average value of assets on loan during the quarter totalled £27.5m representing approximately 14.0% of this total.

The passive currency overlay agreed by Committee was put in place at the end of January 2011 with 100% Euro and 50% Australian dollars (June 2012) hedges. The latest quarterly roll occurred on the 13 August 2013 and resulted in a realised loss of £235k.

For the quarter ending 30 June 2013, Hillingdon returned 0.21%, outperforming against the WM average of (0.80) % by 1.01%. The one year figure however, shows an under-performance of (0.72) %, returning 14.38% against the WM average return of 15.10%.

FINANCIAL IMPLICATIONS

These are set out in the report

LEGAL IMPLICATIONS

There are no legal implications arising directly from the report

BACKGROUND DOCUMENTS

None