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 provides a summary of fund manager performance for the quarter ending 30 June 2014. The total value of the fund's investments as at 30 June 2014 was £734m.

RECOMMENDATION

That the content of this report be noted.

1. GENERAL BACKDROP

Recent years have seen all financial markets respond positively to the cheap liquidity that has flooded the globe. Consequently any reversal is most likely to be negatively for capital values. The Fund (and all other investors) would be adversely impacted by such a decline unless it was accompanied by a rising yield structure (which would reduce the current value of the projected liabilities).

Conversely the current economic expansion, which began in 2009, is very mature by historical standards and yet many regions e.g. Europe continue to face fundamental challenges. Central bankers and policymakers would have investors believe that the recovery is still in its infancy; the reality threatens to be quite different.

Principal among the trends exposed to change has been the policy response to the Great Financial Crisis (GFC) of ultra-low interest rates. The money markets already discount higher policy rates. By Q3, 2016 the US Federal Reserve and UK's Monetary Policy Committee are each expected to raise rates by around 1.5% respectively. However this has been the case for much of the period since the GFC; markets failed to anticipate this unprecedented period of low rates. Nonetheless there is clear appetite among central bankers to generate a higher rate structure. The rationale is not to dampen excess demand. Rather the current near-zero rate structure would be a wholly inappropriate starting point for monetary when the next recession hits.

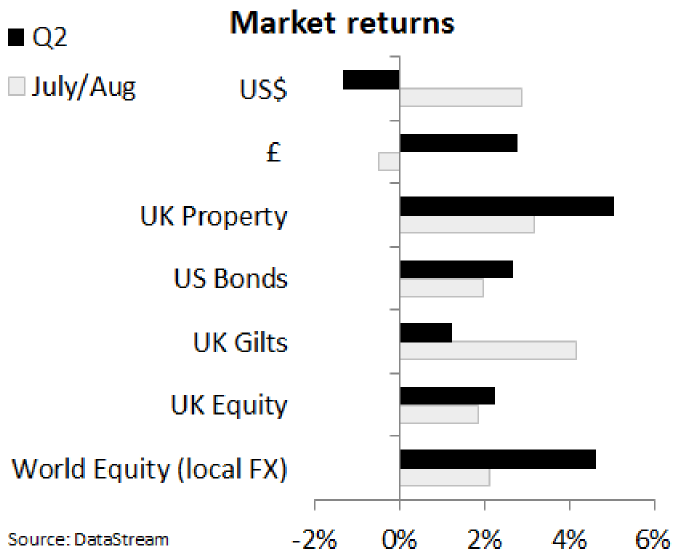
The exception to this is Europe where the deterioration in economic activity and the associated slide towards deflation (EU CPI stands at a mere +0.3%) now sees markets discounting effectively a decade of near zero interest rates. It is hard to believe that market expectations are wrong in this instance.

This emerging contrast between the US and elsewhere is likely to prove one of the most significant developments in the months ahead. It is likely to lead to a stronger US$; something that US Federal Reserve will probably not resist. This will help transfer US final demand into other areas of the world that are struggling to show any progress whatsoever.

Further comments on the market backdrop are contained in the detailed report prepared by Northern Trust and in the Investment Advisor's report.

2. MAJOR MARKET RETURNS

After a problematic start to the year, Q2 brought positive returns across all asset classes are economic activity in the US recovered following the harsh winter weather and the threat of higher monetary policy in the US receded.



Sterling's progress reflected the ongoing improvement seen in the UK economy and the strong gains being achieved in the property market – especially in the London area.

Bond yields continued to fall despite the data improvements. Pension funds and their like remain under-exposed to the asset class; the higher equity markets are allowing Funds to lock into these low yields. Generally cash remains an expensive asset.

Yield themed equities tended to underperform despite the strength of bond markets. These are defensive shares always likely to lag strength in the broader market.

3. FUND PERFORMANCE

The performance of the Fund for the quarter to 30 June 2014 showed a relative underperformance of 0.12%, with a return of 1.93% compared to the benchmark of 2.05%. One year figures show returns of 8.76%, 0.08% relatively behind than the benchmark.

The investment objective for the Hillingdon Pension Fund, agreed with the Actuary, is to generate, over the longer term, a real rate of return of 4% per annum; the current asset allocation is judged appropriate to that objective. Other LGPS will have set their objectives appropriate to their Scheme characteristics. Funds seeking greater returns will typically operate a higher allocation to riskier investments and vice versa. Against the average LGPS (as captured by WM data) for the quarter ending 30 June 2014, the Fund underperformed by 0.07%. The one year figure also shows underperformance, this time by 0.54%.

The WM survey combines all LGPS regardless of their objectives. The chart immediately below depicts the higher level contrast between the asset allocation of the average LGPS and that currently maintained by Hillingdon. The principle difference lies in the weightings to equities and multi-asset programmes. The past 12 months have seen equity markets outperform multi-asset programmes.

The Hillingdon Pension Fund’s investment strategy comprises a deliberate defensive bias both through the strong allocation to multi-asset programmes – where the managers are tasked to deliver specific investment returns rather than track establish market benchmarks – and through the allocation to equity programmes that have a focus on sustainable dividend yields. Recent quarters have seen many investors turn much more optimistic about the outlook for the world economy and financial markets. In the face of ongoing debt accumulation and the continued threat of outright deflation, such optimism is judged dangerous.

4. MANAGER / PROGRAMME SUMMARY

The table below provides an update on the range of programmes into which the assets of the Pension Fund are deployed. With the exception of the State Street allocation, all programmes are actively managed.

Performance Attribution Relative to Benchmark (rounded)

	Value £m	**Q2 2014 %**	**1 Year %**	**3 Years (% p.a.)**	**5 Years (% p.a.)**	**Since Inception (% p.a.)**	**Target (% p.a.)**	**Fees (% p.a.)**
AEW	10.0	-	-	-	-	-		0.70
Barings	64.1	0.52	0.02	-	-	(1.64)	4.0	0.50
JP Morgan	63.1	0.07	2.24	-	-	0.95	3.0	0.30
Kempen	80.3	0.89	(4.74)	-	-	(7.10)	2.0	0.42
Macquarie	5.3	(3.25)	(11.36)	(10.40)	-	(10.42)	3.0	1.38
M&G	27.9	0.21	1.00	0.92	-	0.30	4.0	1.5
Adams St*	21.0	2.72	7.96	10.14	13.08	2.70	4.0**	1.20
LGT*	15.1	0.64	2.67	4.61	9.40	8.15	4.0**	1.00
Newton	24.2	(0.73)	(4.80)	-	-	(3.03)	2.0	0.75
Ruffer	84.8	0.25	0.33	4.42	-	4.80	4.0**	0.80
SSgA	147.0	(0.03)	(0.10)	(0.01)	0.01	0.00	0.0	0.10
UBS TAA	13.6	(2.06)	3.89	-	-	3.89	0.0	n/a
UBS Eq	116.0	3.91	2.73	3.53	1.51	1.22	2.0	0.35
UBS Property	58.0	1.05	0.72	(0.20)	(1.04)	(0.50)	1.0	0.20
Total Fund	**734.3**	**(0.12)**	**(0.08)**	**0.81**	**0.36**	**0.05**	**2.2**	**0.45**

*Absolute performance
**Set against LIBOR

Highlights:

- MacQuarie is in the build-up phase of their programme; initial capital write-downs are common at this stage. An issue with an Indian telecoms investment has been mentioned previously.

- The marked-to-market loss on the US index-linked bond (held in the UBS TAA account) was due to adverse currency translation which has since been reversed.

- Kempen and Newton operate equity programmes around the dividend yield theme; markets have been treating this style harshly especially in the US.

Also shown in the table are the individual programme costs. Across the Scheme, the aggregate annual excess return pursued in the spread of mandates is 2.2% against which the Scheme incurs approximate investment management costs of 0.45% p.a. This is a ratio of 5:1, ahead of an approximate norm of 4:1.

Further details on manager performance are contained in the Northern Trust report.

5. Other Items

At the end of June 2014, £19.823m (book cost) had been invested in **Private Equity**, which equates to 2.70% of the fund against the target investment of 5.00%. In terms of cash movements over the quarter, Adams Street called £169k and distributed £662k, whilst LGT called £336k and distributed £1,194k. This trend is set to continue in the next few years as the fund’s investments in private equity climbs up the “J-Curve” and more distributions will be received as the various funds mature.

The **securities lending** programme for the quarter resulted in income of £7.5k. Offset against this was £2.7k of expenses leaving a net figure earned of £4.8k. The fund is permitted to lend up to 25% of the eligible assets total and as at 30 June 2014 the average value of assets on loan during the quarter totalled £13.6m representing approximately 7.10% of this total.

FINANCIAL IMPLICATIONS

These are set out in the report

LEGAL IMPLICATIONS

There are no legal implications arising directly from the report

BACKGROUND DOCUMENTS

None