REVIEW ON PERFORMANCE MEASUREMENT OF THE PENSION FUND

Contact Officers	James Lake, 01895 277562
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 management performance for the London Borough of Hillingdon Pension Fund for the quarter to 31 December 2009. The value of the fund as at the 31 December was £531.7 million.

RECOMMENDATIONS

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

INFORMATION

1. The performance of the whole fund for the quarter to 31 December 2009 showed an underperformance of 0.81% with positive returns of 3.02%, compared to the benchmark of 3.83%. The one year figure has improved compared to the previous quarter by 0.74%. However, the longer term figures of three years, five years and since inception show a decline of 0.33%, 0.09% and 0.05% respectively.

Performance Attribution

	Q4 2009 %	1 Year %	3 Years %	5 Years %	Since Inception %
Goldman Sachs	0.46	3.98	(0.92)	(0.54)	(0.71)
UBS	(2.07)	(0.65)	(2.28)	(2.05)	1.20
Alliance Bernstein	(0.48)	(3.37)	(4.71)	-	(3.61)
UBS Property	(4.04)	(3.31)	(0.32)	-	(0.76)
SSgA	(0.03)	0.02	-	-	0.11
SSgA Temporary	0.07	-	-	-	0.18
SSgA Drawdown	0.02	-	-	-	0.17
Total Fund	**(0.81)**	**(0.77)**	**(2.73)**	**(1.95)**	**(0.31)**

2. The negative performance for this quarter was primarily due to asset allocation and the passive currency effect. Being overweight in underperforming areas and vice versa detracted 0.60% from performance. Overseas stock selection compensated for some of these losses.

3. Alliance Bernstein returned 3.47% over the quarter but underperformed against their benchmark by 0.48%. The largest negative impact on performance resulted from UK and Asia Pacific (ex Japan) stock selection.

4. GSAM returned 1.25% against their benchmark of 0.79%, outperforming by 0.46%. Corporate selection was the primary driver for excess returns. The portfolio's duration strategy of short positioning at the long end of the UK curve also helped excess returns as government bonds with longer maturities were sold. The cross sector strategy helped marginally with overweigh positions in corporates and mortgage backed securities paying off.

5. UBS delivered a positive performance of 3.41% but underperformed against their benchmark by 2.07%. Stock selection, primarily in financials was the major drag on performance.

6. Property saw a second quarter of gains with positive performance of 3.86%, however, UBS underperformed against their benchmark of 7.90% by 4.04%. Underperformance was primarily a result of three factors:- cash dilution in the first two months of the quarter, costs associated with acquisitions and the negative impact of the underperforming Triton fund.

7. The requirement for SSgA as a passive manager is to replicate their performance benchmark. Over the three funds there was underperformance of 0.03% on the main fund and outperformance of 0.07% and 0.02% of the temporary and draw down funds respectively.

Absolute Returns

	Alliance Bernstein £000	GSAM £000	SSgA (3 funds) £000	UBS £000	UBS Property £000
Opening Balance	103,828	60,292	191,205	97,344	39,882
Appreciation	3,060	679	5,651	2,450	1,060
Income Received	531	78	-	856	480
Investment Withdrawal	(426)	(246)	(766)	(400)	(165)
Closing Balance	106,992	60,803	196,090	100,250	41,257
Active Management Contribution	(450)	278	20	(1,963)	(1,595)

8. The above table provides details on the impact of manager performance on absolute asset values. The outperformance of GSAM and SSgA had a positive impact on the appreciation of holdings contributing £278k and £20k respectively. In contrast the underperformance of Alliance Bernstein, UBS and UBS property reduced asset appreciation by £450k, £1,963k and £1,595k.

9. At the end of December 2009, £28.04 million (book cost) had been invested in private equity, which equates to 5.27% of the fund against the target investment of 5%. However this level still remains within the limits of the over-commitment strategy of 8%. In terms of cash movements, over the quarter £638k was called

and £104k distributed by Adams Street whilst LGT called £696k and distributed £164k.

10. The securities lending activity for the quarter resulted in income of £21.3k. Offset against this was £7.4k of expenses leaving a net figure earned of £13.9k. The fund is permitted to lend up to 25% of the eligible assets total and as at 31 December 2009 the assets on loan totalled £37m representing approximately 18% of this total.

11. For the quarter ending 31 December 2009, Hillingdon returned 3.02%, underperforming against the WM average by 0.28%. However the one year performance figure has improved from underperformance in the previous quarter of 0.86% to an outperformance against the average of 0.88%.

M&G UK Companies Financing Fund - update

12. M&G maintain their view that the fund will be increasingly needed by companies over the next year or so. They also see the likelihood of investing in the first half of 2010 increasing quite significantly over the past months. Finally, they have been working to reduce the risk to investors of ending up with a small, undiversified fund

13. M&G still believe that many companies do not have access to alternate sources of funding away from their standard banking syndicate, which in many cases is more concentrated than it was following the withdrawal of non-UK banks. They also believe that the banking system remains under stress and a return to the easy funding environment of a few years ago is unlikely. It is certainly the case that large companies have access to the bond markets and that some mid-sized companies can also access some other funding sources. However, in their conversations M&G are finding a significant number of companies wishing to diversify away from the banks. Interestingly, this concern is now shared by the UK authorities and HM Treasury has just issued a discussion paper on non-bank lending. As one of the largest non-bank lenders in the UK, M&G will be responding to this paper.

14. M&G are in advanced discussions with four companies and have a number of other companies in the pipeline behind those. If everything goes as planned then M&G is likely to invest in two or three companies in the next three months. The investment would not be a significant portion of the fund, with the total drawdown being less than 10% of the funds committed, but they believe this could be an important marker for other companies seeking this kind of funding. These investments remain uncertain and so M&G are not asking investors to make any funds available yet.

15. M&G are aware that starting to invest brings its own risks. Although their central case is that more companies will wish to borrow from the fund over the next year, they cannot be certain that the market conditions will be conducive for lending. They believe that one of the risks for investors is that M&G make a small number of investments and then the funding market recovers completely. Although this would be positive for almost all other asset classes they are aware that investors may not want a fund that has a few investments with no prospect of further holdings. M&G have therefore spoken about this risk to Prudential Assurance Company (Prudential), the largest holder of the Fund. They have agreed that it would be reasonable for investors to have a working assumption that Prudential would offer to buy out any investors from their investments if they close the fund when it is

holding only two or three assets. M&G stress that this is not a cast-iron guarantee, but it shows the significant commitment that M&G and Prudential have to the investors in the fund.

Market Commentary

16. Equity markets continued to trend upwards during the fourth quarter of 2009, albeit at a rather muted pace compared to the previous two quarters. Emerging markets again outperformed developed markets with Brazil performing strongly. In terms of the developed markets Japan struggled, delivering a negative return for the quarter. The year ended with some, including the FTSE 100 back at levels last seen before the collapse of Lehman Brother in September 2008.

17. Bond yields remained narrow for much of the quarter before rising at the end as signs of economic recovery and the issue of government bond risk became evident. The reaction was negative to the UK pre budget report and this pushed yields progressively higher across most of the maturity spectrum. Credit and emerging market spreads narrowed over the quarter.

18. UK commercial property market showed further signs of improvement and has now rallied 9% since its lows in early 2009.

FINANCIAL IMPLICATIONS

These are set out in the report

LEGAL IMPLICATIONS

There are no legal implications arising directly from the report

BACKGROUND DOCUMENTS

None