



AUDIT & GOVERNANCE COMMITTEE
18 March 2013

PENSION FUND INVESTMENTS – DECEMBER QUARTER 2012

SUMMARY AND PURPOSE:

This report deals with the investment transactions of the pension fund during the December 2012 quarter and the position of the fund as at 31 December 2012, together with other matters considered by the Investment Advisors Group (IAG) at its quarterly meeting of 15 February 2013.

RECOMMENDATION:

It is recommended that the committee note the content of the pension fund report for the quarter to 31 December 2012.

BACKGROUND:

1. The Investment Advisors Group is responsible for monitoring the activities of the Surrey Pension Fund and reporting to the county council and other employing bodies. This is achieved through the presentation of a quarterly report to the Audit and Governance Committee.

PENSION FUND INVESTMENTS – DECEMBER QUARTER 2012:

Position Statement as at 31 December 2012

2. The market value of the fund increased during the quarter from £2,236.9 million at 30 September 2012 to £2,322.4 million at 31 December 2012, an increase of 3.8%. The value of the fund as at close of business on 13 February 2013 is estimated at £2,427.0 million.
3. The value of the major asset classes at 31 December 2012 compared with 30 September 2012 was as follows:

	31 December		30 September	
	£m	%	£m	%
Fixed Interest				
UK Government	172.2	7.4	109.3	4.9
UK Non-Government	178.5	7.7	180.1	8.1
Overseas	2.3	0.1	44.5	2.0
Index Linked	90.3	3.9	83.3	3.7
Equities				
UK	612.6	26.4	633.1	28.3
Overseas	791.0	34.0	749.0	33.5
Property Unit Trusts	123.7	5.3	121.3	5.4
Private Equity	87.8	3.8	84.5	3.8
Diversified Growth	205.9	8.9	157.7	7.0
Cash	53.2	2.3	67.3	3.0
Currency hedge*	4.9	0.2	6.8	0.3
Total Fund	2,322.4	100.0	2,236.9	100.0

* Net unrealised profit/loss

4. The following table shows the breakdown of the market valuation as at 31 December 2012 by asset class and compares the totals with the target asset allocation. The total excludes any private equity funds or cash held by SCC included in the table above.

	TOTAL FUND	Actual	Target	Last Quarter	
	£m	%	%	£m	%
Fixed Interest					
UK Government	172.2	7.8	8.0	109.3	5.1
UK Non-Government	178.5	8.0	8.0	180.1	8.5
Overseas	2.3	0.1	0.0	44.5	2.1
Index Linked	90.3	4.1	4.0	83.3	3.9
Equities					
UK	612.6	27.7	28.0	633.1	29.7
Overseas	791.0	35.8	35.0	749.0	35.2
Property Unit Trusts	123.7	5.6	7.0	121.3	5.7
Diversified growth	205.9	9.3	10.0	157.7	7.4
Cash	27.3	1.2	0.0	45.1	2.1
Currency hedge	4.9	0.2	0.0	6.8	0.3
TOTAL	2,208.7	100.0	100.0	2,130.2	100.0

5. The following table breaks down the above to show the value of assets held by individual managers at quarter end:

		£m	Actual %	TARGET	LAST QUARTER	
				%	£m	%
Multi-Asset						
	LGIM	731.5	33.1	32.0	743.1	34.9
Bonds/Property						
	Western	270.9	12.3	11.0	266.6	12.5
	CBRE	126.5	5.7	7.0	127.1	6.0
UK Equity						
	Majedie	145.9	6.6	8.0	136.2	6.4
	Mirabaud	88.9	4.0	4.0	85.9	4.0
	UBS	181.5	8.2	8.0	170.0	8.0
Global Equity						
	Marathon	294.0	13.3	12.0	280.7	13.2
	Newton	162.7	7.4	8.0	161.9	7.6
Diversified Growth						
	Baillie Gifford	77.8	3.5	4.0	31.1	1.5
	Standard Life	128.1	5.8	6.0	126.6	5.9
Residual Cash		0.9	0.1	0.0	1.0	0.0
TOTAL		2,208.7	100.0	100.0	2,130.2	100.0

6. In July 2011 the Investment Advisors Group (IAG) started to review the investment strategy of the fund following the implementation of the 2010 actuarial valuation results. Changes to the investment strategy were approved by the IAG in March 2012 and began to be implemented in the June quarter.
7. During the December quarter, Baillie Gifford received funding of £45m to bring their total funding to £75m as agreed at the time of appointment based on their 4% target allocation.
8. At the IAG meeting in November 2012 the Group agreed that they wanted to use 50% of the gilts currently managed by Western to invest in a total return or absolute return bond strategy. The Group felt that it was the right time to decrease the allocation to gilts to realise the gains made in the last few years and to move to a product that would offer higher yields.
9. In December 2012 the Group held an extraordinary meeting to receive presentations from four fund managers, including Western, on potential investment options. The Group decided that the most attractive option was the Franklin Templeton Global Total Return Fund. This fund invests mainly in government and corporate bonds in developed and emerging markets.

10. On 11 February 2013 50% of the gilts managed by Western were redeemed into £67m of cash and invested into the pooled fund managed by Franklin Templeton.
11. As part of the strategy review, the Group had previously agreed to increase Majedie's benchmark allocation by 2% to 8% to fund a new investment into a global equities product Majedie were offering. Following the departure of key staff at Majedie, this investment will no longer be taking place. At the IAG meeting on the 15 February 2013, the Group discussed options reference the additional 2%. It was agreed the benchmark allocation to Majedie's UK Equity portfolio should increase by 1% to 7% and Legal & General Overseas Equities by 1% to 14%. This change will not require additional funding to be provided to either manager.
12. In the December quarter contributions from members exceeded the value of benefits paid and transfer values by £3.4m. Investment income (net of costs) totaled £8.9m. Market movements increased the value of the fund by £74.9m.

Investment Performance Results for the Period

13. The managed fund made a return of 3.3% over the quarter. This compares with a total fund customised benchmark return of 2.9% (+0.4%). The total fund return for the year to the end of December 2012 was 12.4% above the benchmark return of 10.7% (+1.7%).
14. For the quarter to 31 December 2012, performance returns for the individual fund managers, in absolute terms and relative to their benchmark target, were as follows:

Manager	Asset Class	Market Value 30 September	Market Value 31 December	Return %	Relative %
Multi-Asset					
LGIM	Multi-Asset	743.1	731.5	+3.0	-0.2
Bonds/Property					
Western	Bonds	266.6	270.9	+1.6	+0.7
CBRE	Property	127.1	126.5	-0.3	-0.1
Equity					
Majedie	UK	136.2	145.9	+7.3	+3.5
Mirabaud	UK	85.9	88.9	+3.6	-0.2
UBS	UK	170.0	181.5	+6.8	+3.0
Marathon	Global	280.7	294.0	+4.8	+2.6
Newton	Global	161.9	162.7	+0.5	-1.7
Diversified Growth					
Standard Life	Diversified Growth	126.6	77.8	+1.2	+1.0
Baillie Gifford	Diversified Growth	31.1	128.1	+2.8	+2.7
Residual Cash		1.0	0.9		
TOTAL MANAGED FUND		2,130.2	2,208.7	+3.3	+0.4

15. In summary in the quarter to 31 December 2012:
- The total fund return of 3.3% was greater than the customised (hedged) benchmark return of 2.9% (+0.4%).
 - In absolute terms, the best performing managers was Majedie with a return of +7.3%, compared to a benchmark return of 3.8% (+3.5%).
 - In relative terms, the best performing manager was also Majedie (+3.5%). UBS also performed strongly with a return of 6.8% compared with a benchmark of 3.8% (+3.0%).
 - Newton underperformed with a return of 0.5% compared to a benchmark of 2.2% (-1.7%). The reason for Newton's underperformance in the quarter was their underweight allocation to the financial sector which had performed well.
16. Under the fund's current strategy, short-term periods of underperformance (e.g. over individual quarters or years) should be expected. The overriding objective of the portfolio is to outperform the customised benchmark by 1% per annum over a rolling three-year period.
17. Each manager has a different target, depending on the type of mandate that they have. Having managers with different targets and different but complimentary styles means that short-term periods of underperformance are likely, with the expectation for the manager to perform over the longer term.
18. In the year to 31 December 2012 and in the period since inception (2004 for all managers, apart from Newton (December 2007) and Standard Life and Baillie Gifford (May 2012), performances for the individual managers were as follows:

Manager	Return for Year	Relative Performance to 31 Dec			Target Outperformance*
		%	year	3 years	since inception
Multi-Asset			p.a.	p.a.	p.a.
LGIM	+9.9	-0.1	+0.0	+0.0	n/a
Bonds/Property					
Western	+9.4	+1.7	-1.0	-0.8	0.75
CBRE	+0.9	+0.3	-1.0	-2.1	1.0
Equity					
Majedie	+16.2	+3.9	+2.5	+3.9	2.5
Mirabaud	+11.9	-0.4	+0.1	+1.8	2.5
UBS	+17.7	+5.4	+0.3	-0.8	2.0
Marathon	+18.8	+8.1	+5.6	+3.7	2.0
Newton	+14.5	+3.5	-0.9	-1.2	2.0
Diversified Growth					
Standard Life	n/a	n/a	n/a	1.5	5.0
Baillie Gifford	n/a	n/a	n/a	6.1	3.5
TOTAL MANAGED FUND	+12.4	+1.7	+0.2	-0.2	1.5

*Standard Life outperformance target is gross of fees, all others net

19. Over a rolling 3-year period:
- Marathon (+5.6%) achieved a return ahead of their performance target and Majedie (+2.5%) met their performance target.
 - UBS (+0.3%) and Mirabaud (+0.1%) slightly outperformed compared to benchmark.
 - Western (-1.0%), CBRE (-1.0%) and Newton (-0.9%) all underperformed compared with benchmark.
20. The overriding objective of the portfolio is to outperform the customised benchmark by 1% per annum over a rolling three-year period. Managers that underperform compared to benchmark over that period hamper the fund achieving its objective. The IAG continually monitors the performance of all managers and also monitors current developments to assess whether each manager has the ability to meet its target and help the fund achieve its objective.

<u>IMPLICATIONS:</u>

Financial:

There are no direct financial implications.

Equalities:

There are no direct equality implications.

Risk management and value for money:

Pension Fund risks are proactively monitored by officers and the Fund's Investment Advisors Group.

<u>WHAT HAPPENS NEXT:</u>

The February meeting was the last meeting of the IAG in its current form. Subject to a Council decision on 19 March 2013, the IAG will be transforming into a Pension Fund Board with full committee status. The first meeting of the newly formed Surrey Pension Fund Board will be on 31 May 2013.

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CONTACT DETAILS:

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Sources/background papers:

Investment Advisors Group meeting papers

Reports sourced from SAP, the Fund Custodian and Fund Managers.
