

PENSIONS COMMITTEE – 1 NOVEMBER 2006

PENSION FUND INVESTMENT REPORT TO 30 SEPTEMBER 2006

SUMMARY

This report notes the performance of the Pension Fund for the 6 months to 30 September 2006. The relative risk profiles adopted by each manager are also reported.

The performance of the balanced fund managers (Newton and UBS) are reported separately.

REPORTED FOR INFORMATION

1. Introduction

This report notes the performance and investment strategies of each fund manager and the position for the Fund in total. This report summarises performance for the period from April to September 2006.

Each fund manager's report for the period has been circulated with this agenda, together with a short paper from UBS on their actions on corporate governance and socially responsible investment. Both fund managers will be presenting to the meeting and there will be an opportunity to question them on their current investment strategies and prospects for the future.

2. Overall Balanced Manager Fund Performance

The total Fund value managed by UBS and Newton fell from £391.0m at 31 March 2006 to £372.8m as at the end of September 2006 showing a return of -0.8% compared to the benchmark return of 0.0%. During the period £13.4m was transferred to the new hedge fund and private equity fund of funds investment managers. The returns during the quarter to June 2006 were poor across all sectors, particularly Overseas Equities, but markets improved during the second quarter with all major sectors bouncing back to positive returns.

3. Investment Profiles and Relative Risk Target

Table 1 shows the profile of the portfolio as at 30 September 2006.

Table 1: Investment Profile

	Fund Benchmark %	Newton Profile %	UBS Profile %	Total Fund Profile %
UK Equities	39	39	41	40
Overseas Equities	31	30	30	30
UK Fixed Interest Gilts	12	14	11	12
Overseas Bonds	n/a	2	5	4
Index Linked	6	5	0	2
Corporate Bonds	12	7	11	9
Property	n/a	0	0	0
Cash	n/a	3	2	3
Total	100	100	100	100

Source : WM Company

Table 1 compares the managers' asset allocations against the Fund Specific Benchmark. The table shows the position that both Managers are taking on asset allocation compared to the benchmark; the most striking features being Newton's underweight position in Corporate Bonds in preference for cash and UK Gilts and UBS's underweight position in Index-linked stocks with a preference for Overseas Bonds.

The Fund's Statement of Investment Principles includes a series of control ranges within which the Managers must operate when investing the Fund's assets. Table 2 compares the current investment profiles for the Fund with the control ranges approved by the Pensions Committee.

Table 2: Control Ranges

	Asset Allocation Relative to the Fund Benchmark as at 30th September 2006			
	Newton Profile %	UBS Profile %	Total Fund Profile %	Control Ranges %
UK Equities	0	+2	+1	+/-10
Overseas Equities	-1	-1	-1	+/-10
UK Fixed Interest Gilts	+2	-1	0	+/-10
Overseas Bonds	+2	+5	+4	Up to 10
Index Linked	-1	-6	-4	+/-10
Corporate Bonds	-5	-1	-3	+/-10
Property	0	0	0	Up to 5
Cash	+3	+2	+3	Up to 10

Source : WM Company, UBS and Newton

The table shows that the managers are operating within the approved control ranges.

The relative risk of that part of the Fund managed by UBS was 1.9% at the end of September, whilst the relative risk reported by Newton was 0.9%. Both are within the approved relative risk target of 3.5%.

Table 3 below shows Asset Category Returns for the last six months.

Table 3 : Asset Category Returns

	Benchmark Return %	Newton Return %	UBS Return %	Total Fund Return %
UK Equities	1.7	1.4	1.2	1.2
Overseas	-4.1	-6.4	-4.0	-5.1
Gilts	1.6	1.7	1.3	1.5
Overseas Bonds	-3.1	-2.1	-3.0	-2.5
Index Linked	3.3	3.1	3.9 [#]	3.2
Corporate Bonds	1.4	1.7	1.6	1.6
Property	n/a	n/a	n/a	n/a
Cash	n/a	n/a	2.2	2.6
Total	0.0	-1.2	-0.4	-0.8

Source : WM Company, Newton, UBS

[#] For some categories returns are not shown, or may not appear consistent, because the managers were not invested in the asset throughout the whole period although they were invested in the category at the end of the period.

4. UBS Investment Report

During the last six months the value of assets managed by UBS fell from £206.7m to £197.9m and showed a return of -0.4% compared to the fund benchmark return of 0.0%. Part of the fall in funds can be attributed to the transfer of £7.1m to the new fund of funds investment.

5. Newton Investment Report

During the last six months the value of assets managed by Newton fell from £184.2m to £174.9m and showed a return of -1.2% compared to the fund benchmark return of 0.0%. Part of the fall in funds can be attributed to the transfer of £6.3m to the new fund of funds investment.

Newton raised the issue of trading in derivatives the last time they presented to the Committee. The Council's agreement with Newton permits them to invest in derivatives, subject to various limits and criteria, as long as the instruments used are allowed within the Local Government Pension Scheme regulations. The method by which Newton wished to invest in derivatives was investigated in depth. After discussion with the Fund's investment advisor, and an approach to the Chairman of CIPFA's Pensions Panel, it has been confirmed that Newton's proposal was technically just outside that permitted by the regulations and they were advised accordingly. There are other ways in which the same derivative position could be achieved within the regulations, but these are more expensive. In the event Newton has not felt to date that taking such a position justifies the extra cost required.

6. Fund of Funds Investments

Investments of £13.4m with the fund of funds managers for private equity and hedge funds were made towards the end of the period covered by this report. Members had the opportunity to meet the managers at the last meeting of this Committee on 22 September and a further meeting has been arranged for 5 April 2007. An update on these investments will be reported to that meeting.

Local Government Act 1972 – section 100d

List of background documents

UBS Investment Reports –September 2006

Newton Investment Reports – September 2006

WM Company Performance Reports – March 2006 and September 2006

Contact Officer: Michael Ellsmore, Assistant Director (A,T & E) ext 2646
Reporting to: David Berry, Deputy Chief Executive and Director of Finance and Business Services