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Brent Pension Fund Sub-Committee

Tuesday, 1 March 2011 at 6.30 pm
Committee Room 4, Brent Town Hall, Forty Lane, Wembley, HA9 9HD

Membership:

Members Councillors:	**first alternates** Councillors:	**second alternates** Councillors:
S Choudhary (Chair)	Denselow	Gladbaum
Mrs Bacchus	A Choudry	Daly
Crane	Harrison	Hector
Mitchell Murray	Hirani	Hossain
Brown	CJ Patel	
Hashmi	CJ Patel	
BM Patel	HB Patel	Baker

Non Voting Co-opted Members

George Fraser	GMBU
Ashok Patel	College of North West London

For further information contact: Joe Kwateng, Democratic Services Officer
(020) 8937 1354, joe.kwateng@brent.gov.uk

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www.brent.gov.uk/committees

The press and public are welcome to attend part of this meeting

recycle for Brent

Agenda

Introductions, if appropriate.

Apologies for absence and clarification of alternate members

7 **Report from Gartmore Investment Managers**

Adam McConkey and Martin Powis from Gartmore Investment will attend for this item.

8 **Monitoring report on fund activity for the quarter ended 31 December 2010** 47 - 68

This report provides a summary of fund activity during the quarter ended 31st December 2010. It examines the actions taken, the economic and market background, and investment performance, as well as commenting on events in the quarter

I have circulated a report from Henderson Global Investors and Legal & General Investment Managers for members only.

Tel: 020 8937 1472
martin.spriggs@brent.gov.uk

9 **Any other urgent business**

Notice of items to be raised under this heading must be given in writing to the Democratic Services Manager or his representative before the meeting in accordance with Standing Order 64.

10 **Exclusion of press & public**

The following report is not for publication is it contains the following category of exempt information as specified in the Local Government Access to Information Act 1972 namely;

In paragraph 3 Schedule 12(A)
“Information relating to the financial or business affairs of any particular person (including the Authority holding the information:

- Transition to Legal & General Investment Management

11 **Transition to Legal & General Investment Management**

Tel: 020 8937 1472
martin.spriggs@brent.gov.uk

12 Date of next meeting

There will be a special meeting on **<u>Wednesday 23 March 2011 at 9:15am.</u>**

Please remember to ***SWITCH OFF*** your mobile phone during the meeting.

- The meeting room is accessible by lift and seats will be provided for members of the public.
- Toilets are available on the second floor.
- Catering facilities can be found on the first floor near the Paul Daisley Hall.
- A public telephone is located in the foyer on the ground floor, opposite the Porters' Lodge

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LONDON BOROUGH OF BRENT

MINUTES OF THE BRENT PENSION FUND SUB-COMMITTEE
Tuesday, 30 November 2010 at 6.30 pm

PRESENT: Councillor S Choudhary (Chair), Councillor and Councillors Crane, Hashmi and A Choudry

The Director of Finance and Corporate Services (Clive Heaphy), the Head of Exchequer and Investment (Martin Spriggs) and the Independent Adviser (Valentine Furniss), were also present.

Apologies were received from: Councillors Mrs Bacchus and BM Patel

1. **Declarations of personal and prejudicial interests**

   None at this meeting

2. **Minutes of the previous meeting**

   RESOLVED:-

   that the minutes of the previous meeting held on 28 September 2010 be approved as an accurate record of the meeting.

3. **Matters arising**

   None.

4. **Deputations (if any)**

   None.

5. **Managers report on Private Equity - Capital Dynamics**

   Mark Drugan (MD) and Carolyn White (CW) attended on behalf of Capital Dynamics. MD explained that private equity had a different investment model from public equity, investing in privately held companies over a long period. In order to reduce risk, private equity was diversified with a typical investment horizon of 10 years, showing negative returns for the first 5 years followed by another 5-7 year phase of high returns ("J curve"). MD referred to his slide to support the view that private equity outperformed public equity whilst having a similar level of risk. He also updated the Sub-Committee that in the last 12 months, Capital Dynamics had increased its staff, opened offices, and had new product launches including the US solar fund. He drew members' attention to the highlights of Brent Pension Fund's diversified portfolio and added that the harvest period of the portfolio had been delayed by current economic uncertainty though there were signs of recovery.

During discussions, Councillor Crane asked how the fund manager managed the problems of currency exposure. Councillor Hashmi enquired about the extent of the fund's exposure to real estate and the impact that could result in the present economic climate. The Independent Adviser pointed out that quantitative easing was likely to result in inflationary pressures and that investment in India could carry high political risks.

In response, MD stated that as most managers denominated in euros, exchange rate movements did not affect trading in Europe. He added that the fund had no exposure to real estate. MD emphasised that capital Dynamics took into account of all known risks including political when investing particularly in India, Israel and China. He accepted the view expressed by the Independent Adviser that quantitative easing could create inflationary pressures.

Mark Drugan and Carolyn White were thanked for their presentation.

RESOLVED:-

That the report by Capital Dynamics on private equity be noted.

6. **Managers report on UK Small Companies - Gartmore Investment Management**

RESOLVED:-

That the presentation by Gartmore Investment Management on UK Small companies be deferred to a future meeting.

7. **Monitoring report on fund activity for the quarter ended 30 September 2010**

Members gave consideration to this report which provided a summary of the fund's activity during the quarter ended 30th September 2010. The Head of Exchequer and Investment informed members that during the quarter, equity markets rose sharply, recovering the losses sustained in the previous quarter, whilst other markets rose but less rapidly. Members noted that the Fund rose in value from £424.6m to £454.1m and outperformed its benchmark over the quarter (0.8%), but underperformed the average local authority fund (-1.4%). Over one year, the Fund outperformed its benchmark but underperformed the average fund (-3.4%).

MS drew members' attention to the main changes to the Brent Fund that had occurred as a result of market movements including agreed rebalancing and increased exposure to private equity. He explained that the main stock selection factors were fixed interest - the outperformance of core portfolio and the satellite fund; the outperformance of GTAA and the improved returns on European property helped by the recovering value of the euro. He noted that the hedge funds manager, Fauchier, continued to struggle.

The Independent Adviser stated that world trade was forecast to grow by 13% with global GDP expected to rise sharply. He noted that interest rates had been kept artificially low to prevent anaemic growth but expressed a view that the continued quantitative easing could produce inflationary pressures in future.

In the discussion that ensued, Councillor Choudry enquired as to whether the continuing low interest rates could have a ripple effect on the economy and if that was to happen, the role that the banks would play in minimising the impact. In response the Independent Adviser stated that the low interest rate could make it difficult to raise capital which would adversely impact on mergers and acquisitions. Councillor Crane also enquired about the impact on the fund's investment if China revalued its currency. The Independent Adviser felt that any revaluation of China's currency would harm their export trade but with a healthy internal economy, the overall impact would be minimal.

RESOLVED:-

That the report on fund activity for the period ended 30 September 2010 be noted.

8. **Hedge Fund Investment - proposal by Fauchier Partners**

The report examined a proposal by Fauchier Partners that the Brent Pension Fund invests in the Jubilee Special Situations Fund. The Head of Exchequer and Investment informed the Sub-Committee that the Brent Pension Fund Jubilee Absolute Return Fund (JARF) invested in a number of strategies and managers and managed by Fauchier Partners was currently valued at 41m, having grown from an investment of £34m. He continued that the credit related crisis since 2007 had highlighted a number of investment opportunities where companies had defaulted on debt, or were in financial or operational difficulties, or were seeking new investment capital, or whose bonds were trading at distressed prices in the market resulting in distressed credit opportunities. In these situations, specialist managers could work with management/other interested parties to realise value for investors.

Fauchier believe that there would be increasing opportunities over the next four years as leveraged and high yield loans matured and needed to be refinanced. Fauchier had therefore suggested that Brent invest in their Jubilee Special Situations Fund, both to improve returns and to increase diversification. The Fund would invest with 15 top quality managers chosen on the basis of their research, sourcing of opportunities, ability to identify undervalued situations, knowledge of processes and experience of driving change. The main opportunities would be in USA and Asia, but not much in Europe. Within Fauchier, the process would be controlled by the Investment Committee and two experienced analysts. The processes within Fauchier should allow managers to benefit from opportunities while maintaining downside protection. The new Fund would be around $220m, and Fauchier would commit $30m of its own resources (including individual investments).

He outlined the main risks attached to investment in the Special Situations Fund which included more risky and volatile situations than the average JARF and the need for a longer notice period to exit the Fund. There was a one year lock up period, thereafter investors can exit quarterly after giving 120 business days notice.

Fauchier were keen that Brent joined the Special Situations Fund, and had agreed that Brent would pay a similar fee to that paid in the JARF. The Head of Investment & Exchequer recommended that Brent invest 2% of the overall Brent Fund in the new Special Situations Fund (around £9m), taking the money from the existing JARF.

RESOLVED:-

That 2% of the Fund (£9m) be invested in the Jubilee Special Situations Fund, taking the money from existing investment in the Jubilee Absolute Return Fund.

9. **Brent Pension Fund - socially responsible investment**

The Sub-Committee gave consideration to a report that reviewed Socially Responsible Investment (SRI) policies for the Brent Pension Fund. In setting the background to the report Martin Spriggs informed members that the Health Partnerships Overview and Scrutiny Committee meeting on 14th October made a recommendation to the Pension Fund Sub Committee to reconsider the investments that Brent Council had in tobacco firms. The overview and scrutiny committee did not believe that the council should be investing pension fund money in companies that made profits at the expense of peoples' health and that it contradicted the council's work to promote tobacco control and its "no smoking policy"

He reminded members about the Council meeting of 13th February 1996 that re-confirmed its policy of non-political or administrative interference with the investment manager's investment decisions or involvement with companies in which the fund managers have acquired shares on behalf of the fund. In advising against the recommendation, Martin Spriggs reminded members about its decision on 20th February 2008 which reconfirmed its policy of non-political or administrative interference with managers' investment decisions. He added that fund managers were required to take investment decisions on the basis of the best interests of the Fund, which was held for beneficiaries.

Councillor Hashmi emphasised his concern that excluding tobacco investment would be the thin end of the wedge for other investments – members were guardians of the Fund, on behalf of beneficiaries. Councillor Crane believed that the issue would not go away, and that the Annual Report should outline the Brent approach to the issue. The Director of Finance and Corporate Services advised that the issue was one of stewardship.

RESOLVED:-

the existing investment policies as set out in paragraph 3.3 of this report and in the Statement of Investment Principles be re-confirmed.

10. **Any other urgent business**

None.

11. **Date of next meeting**

Tuesday 1 March 2011 at 6.30pm

The meeting closed at 8.45 pm

S CHOUDHARY
Chair

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	Pension Fund Sub Committee 1st March 2011 **Report from the Director of Finance and Corporate Services**
For Action	Wards Affected: ALL
AUDIT OPINION PLAN 2010/11	

1. SUMMARY

1.1 This report introduces the Audit Opinion Plan for the 2010/11 Pension Fund accounts.

2. RECOMMENDATIONS

2.1 Members are asked to note the Audit Opinion Plan.

3 DETAIL

3.1 The Department for Communities and Local Government (DCLG) introduced regulations in June 2007 requiring each local government pension fund to produce a separate annual report and accounts. Members will be aware that the Brent Pension Fund has produced a separate Annual Report and Accounts for many years.

3.2 The Audit Commission has produced an Audit Opinion Plan for the 201/11 Pension Fund Accounts. This outlines the main emphases that will be followed in the audit (page 6). Paul Viljoen from the Audit Commission will attend to present the Plan.

4. FINANCIAL IMPLICATIONS

These are set out within the Plan.

5 DIVERSITY IMPLICATIONS

The proposals in this report have been subject to screening and officers believe that there are no diversity implications arising from it.

6 STAFFING IMPLICATIONS

None

7 LEGAL IMPLICATIONS

There are no legal implications arising from the plans.

8 BACKGROUND

Pension Fund Sub Committee – Report and accounts for 2009/10 – September 28th 2010

Persons wishing to discuss the above should contact the Exchequer and Investment Section, Brent Financial Services, on 020 8937 1472/74 at Brent Town Hall.

CLIVE HEAPHY
Director of Corporate Services

MARTIN SPRIGGS
Head of Exchequer and Investment

Audit opinion plan

Brent Pension Fund

Audit 2010/11

The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services to deliver better outcomes for everyone.

Our work across local government, health, housing, community safety and fire and rescue services means that we have a unique perspective. We promote value for money for taxpayers, auditing the £200 billion spent by 11,000 local public bodies.

As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.

Contents

Introduction

This plan sets out the audit work that I propose to undertake for the audit of financial statements and the value for money conclusion 2010/11.

1 The plan is based on the Audit Commission's risk-based approach to audit planning, which assesses:

- current national risks relevant to your local circumstances; and
- your local risks.

2 I will discuss and agree this plan, and any reports arising from the audit, with the Pension Fund Sub Committee. However, as the pension fund accounts remain part of the financial statements of the London Borough of Brent Council as a whole, the Audit Committee will retain ultimate responsibility for receiving, considering and agreeing the audit plans, as well as receiving and considering any reports arising from the audit.

Responsibilities

The Audit Commission's Statement of Responsibilities of Auditors and of Audited Bodies sets out the respective responsibilities of the auditor and the audited body. The Audit Commission has issued a copy of the Statement to every audited body.

3 The Statement summarises where the different responsibilities of auditors and of the audited body begin and end and I undertake my audit work to meet these responsibilities.

4 I comply with the statutory requirements governing our audit work, in particular:

- the Audit Commission Act 1998; and
- the Code of Audit Practice.

5 Specifically, the work of auditors on pension fund accounts is defined by the Auditing Practices Board practice note 15 on the audit of pension fund accounts.

Fee for the audit

The indicative fee for the audit is £35,000.

6 The fee for the audit is £35,000, as indicated in my letter of 16 June 2010.

7 In setting the fee, I have assumed that:

- the level of risk in relation to the audit of accounts is consistent with that for 2009/10;
- good quality, accurate working papers are available at the start of the financial statements audit;
- audit trails are clear and easy to follow;
- the Council will supply good quality working papers to support the restatement of 2009/10 balances to comply with International Financial Reporting Standards (IFRS); and
- where required, we are able to rely on the work of Internal Audit and that this is available in a timely manner.

8 Where these assumptions are not met, I will be required to undertake additional work which is likely to result in an increased audit fee. Where this is the case, I will discuss this first with the Director of Finance and Corporate Services and I will issue supplements to the plan to record any revisions to the risk and the impact on the fee.

9 Further information on the basis for the fee is set out in Appendix 1.

Specific actions Brent Pension Fund could take to reduce its audit fees

10 The Audit Commission requires its auditors to inform audited bodies of specific actions it could take to reduce its audit fees. As in previous years, I will work with staff to identify any specific actions that the Brent Pension Fund could take and to provide ongoing audit support.

Auditors report on the financial statements

I will carry out the audit of the financial statements in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board (APB).

11 I am required to issue an audit report giving my opinion on whether the accounts give a true and fair view of the financial position of the Pension Fund as at 31 March 2011.

12 I am also required to review the pension fund annual report as per the LGPS regulations 1997.

Materiality

13 I will apply the concept of materiality in both planning and performing the audit, in evaluating the effect of any identified misstatements, and in forming my opinion.

Identifying opinion audit risks

14 I need to understand fully the audited body to identify any risk of material misstatement (whether due to fraud or error) in the financial statements. I do this by:

- identifying the business risks facing the Pension Fund, including assessing your own risk management arrangements;
- considering the financial performance of the Pension Fund;
- assessing internal control - including reviewing the control environment, the IT control environment and Internal Audit; and
- assessing the risk of material misstatement arising from the activities and controls within the Pension Fund information systems.

Identification of specific risks

I have considered the additional risks that are appropriate to the current opinion audit and have set these out below.

Table 1: **Specific risk**

Specific opinion risks identified

Risk area	Audit response
The Council is required to prepare the 2010/11 Pension Fund accounts according to International Financial Reporting Standards (IFRS) (including a full re-statement of 2009/10 balances).	I will: ■ review the Council's approach to the implementation of IFRS; ■ substantively test any restated 2009/10 balances; and ■ check all relevant disclosures have been made by the Council.
The Pension Fund has changed its financial IT systems during 2010/11 onto a new Oracle system that is used throughout the Council.	I will review the system changes to the new Oracle system as part of my work on the review of the overall IT systems within the Council.
The draft Pension Fund accounts for 2009/10 had disclosures required by the Statement of Recommended Practice (SoRP) missing or incomplete.	I will review the Council's approach to ensuring all disclosure requirements are identified and completed. I will also check all relevant disclosures have been complied with.
Some Pension Fund working papers for 2009/10 were not easy to follow and delays occurred in obtaining responses to some audit queries raised.	I will review working papers received at the start of the audit and report any issues immediately to officers. If I have any concerns that the quality of the working papers or any delays in audit responses may result in either additional fees or the deadline not being met, I will report this to the Director of Finance.
Pension Fund actuarial revaluation.	I will review the draft Pension Fund account disclosure notes against the actuarial revaluation reports.

Testing strategy

On the basis of risks identified above I will produce a testing strategy which will consist of testing key controls and/or substantive tests of transaction streams and material account balances at year end.

15 I can carry out the testing both before and after the draft financial statements have been produced (pre- and post-statement testing).

16 Wherever possible, I will complete some substantive testing earlier in the year before the financial statements are available for audit. I have identified the following areas where substantive testing could be carried out early.

- Review of accounting policies.
- Benefits.
- Bank reconciliations.
- Year-end feeder system reconciliations.

Where I identify other possible early testing, I will discuss it with officers.

17 Wherever possible, I will seek to rely on the work of Internal Audit to help meet my responsibilities. For 2010/11, I expect to be able to use the results of their work on:

- pension administration system.

18 I will also seek to rely on the work of other auditors and experts, as appropriate, to meet my responsibilities. For 2010/11, I plan to rely on the work of other auditors in the following areas.

- London Pension Fund Authority (the Audit Commission).
- SAS70/AAF01 reports on internal controls produced by the external auditors of the fund managers and custodians used by the Pension Fund (various auditors).

19 I also plan to rely on the work of experts in the following areas.

- Pension Fund assumptions and disclosures (Hewitt - Actuaries to the Pension Fund).
- Pension Fund assumptions (PricewaterhouseCoopers - Consulting Actuaries to the Audit Commission).

Key milestones and deadlines

The Pension Fund is required to prepare the financial statements by 30 June 2011. I am required to complete the audit and issue the opinion and value for money conclusion by 30 September 2011.

20 The key stages in producing and auditing the financial statements are in Table 2.

21 I will agree with you a schedule of working papers required to support the entries in the financial statements. The agreed fee is dependent on the timely receipt of accurate working papers.

22 Every week, during the audit, the audit team will meet with the key contact and review the status of all queries. I can arrange meetings at a different frequency depending on the need and the number of issues arising.

Table 2: **Proposed timetable**

Activity	Date
Control and early substantive testing	January 2011
Receipt of accounts	30 June 2011
Sending audit working papers to the auditor	30 June 2011
Start of detailed testing	14 June 2011
Progress meetings	Weekly
Present report to those charged with governance at the audit committee	September 2011 (to be confirmed)
Issue opinion	By 30 September 2011

The audit team

Table 3 shows the key members of the audit team for the 2010/11 audit.

Table 3: **Audit team**

Name	Contact details	Responsibilities
Andrea White District Auditor	a-white@audit-commission.gov.uk 0844 798 5784	Responsible for the overall delivery of the audit including the quality of outputs, signing the opinion and conclusion, and liaison with the Chief Executive.
Paul Viljoen Audit Manager	p-viljoen@audit-commission.gov.uk 0844 798 2688	Responsible for reviewing the quality of audit work and any specialist technical areas. Key point of contact for the Director of Finance.
Gary McLeod Audit Manager	g-mcleod@audit-commission.gov.uk 0844 798 5773	Manages and coordinates the different elements of the audit work. Key point of contact for the Director of Finance.

Independence and objectivity

23 I am not aware of any relationships that may affect the independence and objectivity of the District Auditor and the audit staff, which I am required by auditing and ethical standards to communicate to you.

24 I comply with the ethical standards issued by the APB and with the Commission's requirements in respect of independence and objectivity as summarised in Appendix 2.

Meetings

25 The audit team will ensure we have knowledge of your issues to inform our risk-based audit through regular liaison with key officers. Our proposals are set out in Appendix 3.

Quality of service

26 I aim to provide you with a fully satisfactory audit service. If, however, you are unable to deal with any difficulty through me and my team please contact Chris Westwood, Director of Professional Practice, Audit Practice, Audit Commission, 1st Floor, Millbank Tower, Millbank, London SW1P 4HQ (c-westwood@audit-commission.gov.uk) who will look into any complaint promptly and to do what he can to resolve the position.

27 If you are still not satisfied you may of course take up the matter with the Audit Commission's Complaints Investigation Officer (The Audit Commission, Westward House, Lime Kiln Close, Stoke Gifford, Bristol BS34 8SR).

Planned outputs

28 My team will discuss and agree reports with the right officers before issuing them to the Audit Committee.

Table 4: **Planned outputs**

Planned output	Indicative date
Annual governance report	September 2011 (day to be confirmed)
Auditor's report giving an opinion on the financial statements	September 2011 (day to be confirmed)
Final accounts memorandum	December 2011

Appendix 1 Basis for fee

The Audit Commission is committed to targeting its work where it will have the greatest effect, based upon assessments of risk and performance. This means planning work to address areas of risk relevant to our audit responsibilities and reflecting this in the audit fees.

The risk assessment process starts with the identification of the significant financial and operational risks applying to the Pension Fund with reference to:

- my cumulative knowledge of the Pension Fund;
  - planning guidance issued by the Audit Commission;
  - the specific results of previous and ongoing audit work;
- interviews with Pension Fund officers; and
- liaison with Internal Audit.

Assumptions

In setting the fee, I have assumed that:

- the level of risk in relation to the audit of the financial statements is not significantly different from that identified for 2009/10;
- you will inform me of significant developments impacting on the audit;
- Internal Audit meets the appropriate professional standards and undertakes appropriate work on all systems that provide material figures in the Pension Fund sufficient that I can place reliance for the purposes of my audit;
- you provide:
  - good quality working papers and records to support the financial statements by 30 June 2011;
  - information asked for within agreed timescales;
  - prompt responses to draft reports; and
- there is no allowance for extra work needed to address questions or objections raised by local government electors.

Where these assumptions are not met, I will be required to undertake additional work which is likely to result in an increased audit fee.

Appendix 2 Independence and objectivity

Auditors appointed by the Audit Commission are required to comply with the Commission's Code of Audit Practice and Standing Guidance for Auditors, which defines the terms of the appointment. When auditing the financial statements, auditors are also required to comply with auditing standards and ethical standards issued by the Auditing Practices Board (APB).

The main requirements of the Code of Audit Practice, Standing Guidance for Auditors and the standards are summarised below.

International Standard on Auditing (UK and Ireland) 260 (Communication of audit matters with those charged with governance) requires that the appointed auditor:

- discloses in writing all relationships that may bear on the auditor's objectivity and independence, the related safeguards put in place to protect against these threats and the total amount of fee that the auditor has charged the client; and
- confirms in writing that the APB's ethical standards are complied with and that, in the auditor's professional judgement, they are independent and their objectivity is not compromised.

The standard defines 'those charged with governance' as 'those persons entrusted with the supervision, control and direction of an entity'. In your case, the appropriate addressee of communications from the auditor to those charged with governance is the Audit Committee. The auditor reserves the right, however, to communicate directly with the Council on matters which are considered to be of sufficient importance.

The Commission's Code of Audit Practice has an overriding general requirement that appointed auditors carry out their work independently and objectively, and ensure that they do not act in any way that might give rise to, or could reasonably be perceived to give rise to, a conflict of interest. In particular, appointed auditors and their staff should avoid entering into any official, professional or personal relationships which may, or could reasonably be perceived to, cause them inappropriately or unjustifiably to limit the scope, extent or rigour of their work or impair the objectivity of their judgement.

The Standing Guidance for Auditors includes a number of specific rules. The key rules relevant to this audit appointment are as follows.

- Appointed auditors should not perform additional work for an audited body (ie work over and above the minimum required to meet their statutory responsibilities) if it would compromise their independence or might give rise to a reasonable perception that their independence could be compromised. Where the audited body invites the auditor to carry out risk-based work in a particular area that cannot otherwise be justified as necessary to support the auditor's opinion and conclusions, it should be clearly differentiated within the Audit and Inspection Plan as being 'additional work' and charged for separately from the normal audit fee.

- Auditors should not accept engagements that involve commenting on the performance of other auditors appointed by the Commission on Commission work without first consulting the Commission.
- The District Auditor responsible for the audit should, in all but the most exceptional circumstances, be changed at least once every seven years, with additional safeguards in the last two years.
- The District Auditor and senior members of the audit team are prevented from taking part in political activity on behalf of a political party, or special interest group, whose activities relate directly to the functions of local government or NHS bodies in general, or to a particular local government or NHS body.

The District Auditor and members of the audit team must abide by the Commission's policy on gifts, hospitality and entertainment.

Appendix 3 Working together

Meetings

The audit team will ensure we have knowledge of your issues to inform our risk-based audit through regular liaison with key officers.

My proposal for the meetings is as follows.

Table 5: **Proposed meetings with officers**

Council officers	Audit Commission staff	Timing	Purpose
Deputy Director of Finance and Corporate Resources	AM and Team Leader (TL)	March, July, September	General update plus: ■ March - audit plan; ■ July - accounts progress; and ■ September - annual governance report.
Audit Committee	DA and AM, with TL as appropriate	As determined by the Committee	Formal reporting of: ■ Audit Plan; ■ Annual governance report; and ■ other issues as appropriate.

Sustainability

The Audit Commission is committed to promoting sustainability in our working practices and I will actively consider opportunities to reduce our impact on the environment. This will include:

- reducing paper flow by encouraging you to submit documentation and working papers electronically;
- use of video and telephone conferencing for meetings as appropriate; and
- reducing travel.

Appendix 4 Glossary

Audit of the accounts

The audit of the accounts of an audited body comprises all work carried out by auditors in accordance with the Code to meet their statutory responsibilities under the Audit Commission Act 1998.

Audited body

A body to which the Audit Commission is responsible for appointing the external auditor, comprising both the members of the body and its management (the senior officers of the body). Those charged with governance are the members of the audited body. (See also 'Members' and 'Those charged with governance'.)

Auditing Practices Board (APB)

The body responsible in the UK for issuing auditing standards, ethical standards and other guidance to auditors. Its objectives are to establish high standards of auditing that meet the developing needs of users of financial information and to ensure public confidence in the auditing process.

Auditing standards

Pronouncements of the APB, which contain basic principles and essential procedures with which auditors are required to comply, except where otherwise stated in the auditing standard concerned.

Auditor(s)

Auditors appointed by the Audit Commission.

Code (the)

The Code of Audit Practice.

Commission (the)

The Audit Commission for Local Authorities and the National Health Service in England.

Ethical Standards

Pronouncements of the APB that contain basic principles that apply to the conduct of audits and with which auditors are required to comply, except where otherwise stated in the standard concerned.

Financial statements

The annual statement of accounts or accounting statements that audited bodies are required to prepare, which summarise the accounts of the audited body, in accordance with regulations and proper practices in relation to accounts.

Internal control

The whole system of controls, financial and otherwise, that is established in order to provide reasonable assurance of effective and efficient operations, internal financial control and compliance with laws and regulations.

Materiality (and significance)

The APB defines this concept as 'an expression of the relative significance or importance of a particular matter in the context of the financial statements as a whole. A matter is material if its omission would reasonably influence the decisions of an addressee of the auditor's report; likewise a misstatement is material if it would have a similar influence. Materiality is not capable of general mathematical definition, as it has both qualitative and quantitative aspects'.

Those charged with governance

Those charged with governance are defined in auditing standards as 'those persons entrusted with the supervision, control and direction of an entity'.

	Pension Fund Sub Committee 1st March 2011 **Report from the Director of Finance and Corporate Services**
For Action	Wards Affected: ALL
	2010 ACTUARIAL VALUATION OF THE BRENT PENSION FUND

1 SUMMARY

This report outlines the anticipated results of the Actuarial Valuation as at 31st March 2010, which indicates that the employers' contribution rates will rise. The actuary will attend the meeting of the Sub Committee to present their findings in more detail.

2 RECOMMENDATIONS

Members are asked to:-

a) Note the anticipated results of the 2010 Actuarial Valuation.

3 DETAIL

Background to the 2010 Actuarial Valuation

3.1 The Brent Pension Fund actuary, Aon Hewitt Ltd, is required to value the assets and liabilities of the fund every three years to determine its financial health. The assets of the fund are the equities, bonds, property, alternative investments (hedge fund, private equity, Global Tactical Asset Allocation, and infrastructure) and cash owned by the fund. The liabilities are the current and future pensions and lump sums owed to pensioners, deferred pensioners and active members. If the actuary finds that the assets may not be sufficient to meet liabilities when due, employers' contributions may be increased. If assets will be more than sufficient to meet liabilities, employers' contributions may be decreased. Employee contributions currently vary between 5.5% and 7.5%, depending on pay levels.

3.2 The 2007 Actuarial Valuation revealed the assets of the fund covered 72% of liabilities (from 67% in 2004). The main reasons for the improvement in the funding level were:-

a) Good investment returns during the period 2004/07. The Fund grew in value from £344m to £498m, however the deficit grew from £174m to £193.5m.
b) The impact of higher contributions designed to eliminate the deficit by 2033.
c) Changes in the advance credit taken for future investment returns (the discount rate) of 0.25% per annum consistent with asset allocation changes made between 2004 and 2007.

These were partially offset by:-

d) A higher allowance for future improvements in longevity – experience since 2004 suggested that pensioners are living longer than previously expected, increasing the cost of benefits.
e) Expectations for price inflation derived from the gilt market were higher than in 2004 (by 0.3% per annum).
f) Costs were increased by delays in implementing provisions for later retirement and by the recycling of 50% of savings into the new scheme.

3.3 The impact on employer contribution rates varied depending on individual employer circumstances. While rates for Brent Council remained stable, those for Brent Housing Partnership and the College of North West London fell, while those for admitted bodies rose. It should also be noted that the Valuation did not reflect the sharp deterioration in investment markets from mid 2007, though the actuary noted that if the deterioration was not reversed there would be adverse implications for the next Valuation.

2010 Actuarial Valuation

3.4 The 2010 Actuarial Valuation indicates a deterioration in the funding position since 2007. The Fund has declined in value (from £499m to £456m), the deficit has grown (from £193.5m to £295.4m) and the funding ratio fallen (from 72% to 61%). The 2007 discount rate assumed that assets would return 6.45% per annum, but instead equity markets fell sharply between 2007 and 2009.

3.5 The main factors affecting the Valuation are as follows:-

a) Negative - Poor investment returns.
b) Negative - Longevity. Staff are living longer as diets and health care improve.
c) Negative – Reducing payroll will mean fewer active members to contribute towards reducing the pension fund deficit.

d) Negative - Price inflation. The 2007 Valuation assumed RPI inflation of 3.2% per annum, but inflation is above that level (RPI is currently 5.1%), and future expectations are rising.
e) Positive – The government has announced that, in future, pension increases will be calculated using the Consumer Prices Index (CPI) rather than the Retail Prices Index (RPI). As the CPI has generally been considerably less than the RPI over the period of measurement (by an average of 0.7% per annum), the value of past service and future benefits has been reduced. This has meant that the funding level has improved slightly whilst the future service rate (the cost of providing for future service) has fallen.
f) Positive – The allowance for future investment returns (the discount rate) for long term Scheduled Bodies has been increased further. (There is less flexibility to do this for most admission bodies who may leave the Fund at any time.

3.6 The overall impact of the points above has reduced overall future service contribution rates slightly, but increased the deficit, and hence the contributions required to eliminate this over 25 years. The overall level of contributions has therefore increased slightly. Contributions for individual employers depend on their own particular circumstances.

3.7 However, the actuary has also been very concerned that progress in reducing the deficit would have been impeded by falling payrolls as local authorities, colleges and charities seek to manage the stark economic environment and falling revenues from government. The actuary has therefore expressed the target employer contributions as the sum of:-

a) a percentage (to cover the future service rate) plus
b) a monetary amount in each year to reduce the deficit.

Brent, as administering authority, will monitor future contributions to ensure that these target contributions are being met, and may need to increase rates further if contributions are too low in early years.

3.8 Converting the annual deficit amounts each year into estimated percentages of pay, on the basis of future payroll assumptions, the estimated impact on employers' contribution rates (excluding contractors) expressed as a percentage of pay is as follows:-

	2010/11	**2011/12**	**2012/13**	**2013/14**
	%	**%**	**%**	**%**
Brent Council and schools (S)	22.9	25.1	26.9	27.4
Brent Housing Partnership (S)	14.1	15.8	15.8	15.8
North West London College (S)	18.2	20.4	20.4	20.4
National Autistic Society (A)	23.7	26.4	32.1	37.7
Other Admitted Bodies (A)	20.1	23.5	23.5	23.5

The contributions payable by each employer are subject to confirmation by the actuary and may change.

3.9 The following points should be noted:-

a) For Brent Council the increase in contribution rates suggested by the 2010 Valuation is being phased in over six years. It is therefore anticipated that rates may need to rise further (after 2013/14). However, this will depend on revised regulations following the implementation of the Hutton review including potential increases to employee contribution rates as well as the Fund's experiences over the next three years. If future developments are favourable for the Fund's finances further increases may not be necessary
b) Brent Association for the Disabled is being treated on a standalone basis as there is only one active member of the Local Government Pension Scheme.
c) The Ark Academy, as a new Scheduled Body (S above) is being treated as a standalone body as it did not inherit a deficit.

Other issues arising from the Valuation

3.10 There is a case for considering raising the proportion of the fund invested in bonds (currently 18%) to safeguard income to pay benefits. A number of private sector funds have reviewed their asset allocation to increase the match to liabilities, which helped their performance during the market turmoil of 2007-09, but reduced comparative returns during the equity rally since March 2009. It can be argued that local authority funds have a longer investment horizon than their private sector counterparts, and can maintain a higher weighting in equities and other real assets. It is also apparent that gilts are currently very expensive, reflecting low interest rates, and yield low income. Gilts may also fall in price. An alternative route may be to increase exposure to other assets that have lower volatility and better prospective returns than bonds, such as hedge funds, infrastructure or (possibly) currency. It is suggested that changes to asset allocation await the review planned for 2011.

3.11 Brent Council, as Administering Authority for the Fund, is required to produce a Funding Strategy Statement (FSS) to reflect how the fund will meet its liabilities as the fall due. A revised draft FSS is attached as Appendix 1. The draft continues to reflect the 25 year recovery period (though it permits some flexibility up to 30 years), and has some changes to reflect the grouping of admitted bodies, the requirement for a bond as security if a body fails, and recognition that admitted bodies may struggle if employer rates are increased sharply. The draft has been circulated to employers and any responses will be communicated orally at the meeting.

4 FINANCIAL IMPLICATIONS

The Valuation will result in increased employers' contributions to the pension fund.

5 STAFFING IMPLICATIONS

None directly.

6 DIVERSITY IMPLICATIONS

The proposals in this report have been subject to screening and officers believe that there are no diversity implications arising from it.

7 LEGAL IMPLICATIONS

There are no legal implications arising from the report.

8 BACKGROUND

Aon Hewitt - Draft Actuarial Valuation papers 2010

Persons wishing to discuss the above should contact the Exchequer and Investment Section, Finance and Corporate Resources, on 0208 937 1472/74 at Brent Town Hall.

Clive Heaphy **Director of Finance and Corporate Services**
Martin Spriggs **Head of Exchequer & Investment**

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DRAFT

London Borough of Brent Pension Fund
Funding Strategy Statement: [March 2011]

Introduction

Overview

This Statement has been prepared consistent with Regulation 35 of the Local Government Pension Scheme (Administration) Regulations 2008 (the 'Administration Regulations'). The Statement describes London Borough of Brent's strategy, in its capacity as Administering Authority (the 'Administering Authority'), for the funding of the London Borough of Brent Pension Fund (the 'Fund').

As required by Administration Regulation 35(3)(a), the Statement has been reviewed (and where appropriate revised) having regard to guidance published by CIPFA in March 2004.

Consultation

In accordance with Administration Regulation 35(3)(b), all employers participating within the London Borough of Brent Pension Fund have been consulted on the contents of this Statement and their views have been taken into account in formulating the Statement. However, the Statement describes a single strategy for the Fund as a whole.

In addition, the Administering Authority has had regard to the Fund's Statement of Investment Principles published under Regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (the Investment Regulations).

The Fund Actuary, Aon Hewitt, has also been consulted on the contents of this Statement.

Policy purpose

The three main purposes of this Funding Strategy Statement are:

- To establish a clear and transparent strategy, specific to the Fund, which will identify how employer's pension liabilities are best met going forward.
- To support the regulatory requirement in relation to the desirability of maintaining as nearly constant employer contribution rates as possible.
- To take a prudent longer-term view of funding the Fund's liabilities.

Links to investment policy set out in the Statement of Investment Principles

The Administering Authority has produced this Funding Strategy Statement having taken an overall view of the level of risk inherent in the investment policy set out in the Statement of Investment Principles and the funding strategy set out in this Statement.

The assets that most closely match the liabilities of the Fund are fixed interest and index-linked Government bonds of appropriate term relative to the liabilities. The Fund's asset allocation as set out in the Statement of Investment Principles invests a significant proportion of the Fund in assets such as equities which are expected but not guaranteed to produce higher returns than Government bonds in the long term. The Administering Authority has agreed with the Fund Actuary that the Funding Target on the ongoing basis will be set after making some allowance for this higher expected return. However, the Administering Authority recognises that outperformance is not guaranteed and that, in the absence of any other effects, if the higher expected returns are not achieved the solvency position of the Fund will deteriorate.

The funding strategy recognises the investment targets and the inherent volatility arising from the investment strategy, by being based on financial assumptions which are consistent with the expected average return, and by including measures that can be used to smooth out the impact of such volatility.

The Administering Authority will continue to review both documents to ensure that the overall risk profile remains appropriate including, where appropriate, the use of asset liability modelling or other analysis techniques.

Review of this Statement

The Administering Authority undertook its latest substantive review of this Statement in [March 2011].

The Administering Authority will formally review this Statement as part of the triennial valuation as at 31 March 2013 unless circumstances arise which require earlier action.

The Administering Authority will monitor the funding position of the Fund on an approximate basis at regular intervals between valuations, and will discuss with the Fund Actuary whether any significant changes have arisen that require action.

Aims and Purpose of the Fund

The aims and purpose of the Fund

The main aims of the Fund are:

1. **To comply with Regulation 36 of the Administration Regulations and specifically to adequately fund benefits to secure the Fund's solvency while taking account of the desirability of maintaining as nearly constant employer contribution rates as possible.**

   The Administering Authority recognises that the requirement to keep employer contribution rates as nearly constant as possible can run counter to the following requirements:

   - the regulatory requirement to secure solvency,
   - the requirement that the costs should be reasonable, and
   - maximising income from investments within reasonable risk parameters

   Producing low volatility in employer contribution rates may require investment in assets which 'match' the employer's liabilities. In this context, 'match' means assets which behave in a similar manner to the liabilities as economic conditions alter. For the liabilities represented by benefits payable by the Local Government Pension Scheme, such assets would tend to comprise fixed interest and index linked investments.

   Other classes of assets, such as stocks and property, are perceived to offer higher long term rates of return, on average. Consistent with the requirement to maximise the returns from investments, the Administering Authority invests a substantial proportion of the Fund in such assets. However, these assets are more risky in nature, and that risk can manifest itself in volatile returns over short term periods.

   This short term volatility in investment returns can produce a consequent volatility in the measured funding position of the Fund at successive valuations, with knock on effects on employer contribution rates. The impact on employer rates can be mitigated by use of smoothing adjustments at each valuation.

The Administering Authority recognises that there is a balance to be struck between the investment policy adopted, the smoothing mechanisms used at valuations, and the resultant smoothness of employer contribution rates from one valuation period to the next.

The Administering Authority also recognises that the position is potentially more volatile for Admission Bodies with short term contracts where utilisation of smoothing mechanisms is less appropriate.

2. **To ensure that sufficient resources are available to meet all liabilities as they fall due.**

   The Administering Authority recognises the need to ensure that the Fund has, at all times, sufficient liquid assets to be able to pay pensions, transfer values, costs, charges and other expenses. It is the Administering Authority's policy that such expenditure is met, in the first instance, from incoming employer and employee contributions to avoid the expense of disinvesting assets. The Administering Authority monitors the position on a monthly basis to ensure that all cash requirements can be met.

3. **To manage employers' liabilities effectively.**

   The Administering Authority seeks to ensure that all employers' liabilities are managed effectively. In a funding context, this is achieved by seeking regular actuarial advice, ensuring that employers and Sub Committee members are properly informed, and through regular monitoring of the funding position.

4. **To maximise the income from investments within reasonable risk parameters.**

   The Administering Authority recognises the desirability of maximising investment income within reasonable risk parameters. Investment returns higher than those available on Government stocks are sought through investment in other asset classes such as equities and property. The Administering Authority ensures that risk parameters are reasonable by:

   - restricting investment to the levels permitted by the Investment Regulations.
   - restricting investment to asset classes generally recognised as appropriate for UK pension funds.
   - analysing the potential risk represented by those asset classes in collaboration with the Investment Adviser and Fund Managers.

The purpose of the Fund is to invest monies in respect of contributions, transfer values and investment income to produce a Fund to pay Scheme benefits over the long term and in so doing to smooth out the contributions required from employers over the long term.

Responsibilities of the Key Parties

Responsibilities of the key parties

The three parties whose responsibilities to the Fund are of particular relevance are the Administering Authority, the individual employers, and the Fund Actuary.

Other parties include the Independent Adviser and the Fund Managers. The investment roles of the Independent Adviser and the Fund Managers are set out in the Statement of Investment Principles.

Administering Authority

The Administering Authority will

- Collect employer and employee contributions and, as far as the Administering Authority is able to, ensure these contributions are paid by the due date.
- Invest surplus monies in accordance with the Regulations.
- Ensure that cash is available to meet liabilities as and when they fall due.
- Manage the valuation process in consultation with the Fund's Actuary.
- Ensure it communicates effectively with the Fund Actuary to:
  - agree timescales for the provision of information and provision of valuation results
  - ensure provision of data of suitable accuracy
  - ensure that the Fund Actuary is clear about the content of the Funding Strategy Statement
  - ensure that participating employers receive appropriate communication throughout the process
  - ensure that reports are made available as required by relevant guidance and Regulations
- Prepare and maintain a Statement of Investment Principles and a Funding Strategy Statement after due consultation with interested parties.
- Monitor all aspects of the Fund's performance and funding.

Individual employers

Individual employers will:

- Deduct contributions from employees' pay.
- Pay all contributions, including their employer contribution as determined by the Fund Actuary, promptly by the due date.
- Exercise discretions within the regulatory framework.
- Pay for added years in accordance with agreed arrangements.
- Notify the Administering Authority promptly of all changes to membership, or other changes which affect future funding

Fund Actuary

The Fund Actuary will:

- Prepare valuations including the setting of employers' contribution having regard to the Funding Strategy Statement.
- Prepare advice and calculations in connection with bulk transfers and individual benefit-related matters.

Funding Target and Solvency

Funding principle

The Fund is financed on the principle that it seeks to provide funds sufficient to enable payment of 100% of the benefits promised.

Funding Targets and assumptions regarding future investment strategy

The Funding Target is the amount of assets which the Fund needs to hold at any point in time such that the funds held, plus future anticipated investment returns on those funds, and taking into account the anticipated future experience of the membership and contributions due from the membership, meet the funding principle.

Some comments on the principles used to derive the Funding Target for different bodies in the Fund are set out below.

Scheduled Bodies and certain other bodies open to new entrants

The Administering Authority will adopt a general approach in this regard of assuming indefinite investment in a broad range of assets of higher risk than low risk assets for Scheduled Bodies and certain other bodies which are long term in nature.

Admission Bodies and bodies closed to new entrants

For Admission Bodies the Administering Authority will have specific regard to the potential for participation to cease (or to have no contributing members), the potential timing of such cessation, and any likely change in notional or actual investment strategy as regards the assets held in respect of the Admission Body's liabilities at the date of cessation (i.e. whether the liabilities will become 'orphaned' or whether a guarantor exists to subsume the notional assets and liabilities).

Orphan liabilities

These are liabilities with no access to funding from any employer in the Fund. To minimise the risk to other employers in the Fund the assets notionally related to these liabilities will be assumed to be invested in low risk investments. This is described in more detail later in this document.

Full funding

The Fund is deemed to be fully funded when the assets held are equal to 100% of the Funding Target. When assets held are greater than this amount the Fund is deemed to be in surplus, and when assets held are less than this amount the Fund is deemed to be in deficiency.

Solvency and 'funding success'

The Fund's primary aim is long-term solvency. Accordingly, employers' contributions will be set to ensure that 100% of the liabilities can be met over the long term.

The Fund is deemed to be solvent when the assets held are equal to or greater than 100% of a funding target set by reference to a similar level of prudence as used for the actuarial valuation of the Fund carried out as at 31 March 2007.

The Administering Authority deems funding success to have been achieved if the Fund, at the end of the Recovery Period, has achieved solvency on this measure.

Other Aspects of Funding Strategy

Recovery Periods

Where a valuation reveals that the Fund is in surplus or deficiency against the Funding Target, employer contribution rates will be adjusted to target restoration of full funding over a period of years (the Recovery Period). The Recovery Period applicable for each participating employer is set by the Fund Actuary in consultation with the Administering Authority and the employer, with a view to balancing the various funding requirements against the risks involved due to such issues as the financial strength of the employer and the nature of its participation in the Fund.

The Administering Authority recognises that a large proportion of the Fund's liabilities are expected to arise as benefit payments over long periods of time. For employers of sound covenant, the Administering Authority is prepared to agree to Recovery Periods which are longer than the average future working lifetime of the membership of that employer. The Administering Authority recognises that such an approach is consistent with the aim of keeping employer contribution rates as nearly constant as possible. However, the Administering Authority also recognises the risk in relying on long Recovery Periods and has agreed with the Fund Actuary a limit of 30 years. The Administering Authority's policy is to agree Recovery Periods with each employer which are as short as possible within this framework.

For employers whose participation in the Fund is for a fixed period it is unlikely that the Administering Authority and Fund Actuary would agree to a Recovery Period longer than the remaining term of participation.

Grouping

In some circumstances it may be desirable to group employers within the Fund together for funding purposes (ie to calculate employer contribution rates). Reasons might include reduction of volatility of contribution rates for small employers, facilitating situations where employers have a common source of funding or accommodating employers who wish to share the risks related to their participation in the Fund.

The Administering Authority recognises that grouping can give rise to cross subsidies from one employer to another over time. The Administering Authority's policy is to consider the position carefully at each valuation and to notify each employer that is grouped that this is the case, and which other employers it is grouped with. If the employer objects to this grouping, it will be set its own contribution rate. For employers with more than 50 contributing members, the Administering Authority would look for evidence of homogeneity between employers before considering grouping. For employers whose participation is for a fixed period grouping is unlikely to be permitted.

Employers may be grouped entirely, such that all of the risks of participation are shared, or only partially grouped such that only specified risks are shared.

Where employers are grouped together for funding purposes, this will only occur with the consent of the employers involved.

All employers in the Fund are grouped together in respect of the risks associated with payment of lump sum benefits on death in service – in other words, the cost of such benefits is shared across the employers in the Fund. Such lump sum benefits can cause funding strains which could be significant for some of the smaller employers without insurance or sharing of risks. The Fund, in view of its size, does not see it as cost effective or necessary to insure these benefits externally and this is seen as a pragmatic and low cost approach to spreading the risk.

Stepping

Again, consistent with the requirement to keep employer contribution rates as nearly constant as possible, the Administering Authority will consider, at each valuation, whether new contribution rates should be payable immediately, or should be reached by a series of steps over future years. The Administering Authority will discuss with the Fund Actuary the risks inherent in such an approach, and will examine the financial impact and risks associated with each employer. The Administering Authority's policy is that in the normal course of events no more than 3 equal annual steps will be permitted. Further steps may be permitted in extreme cases, but the total is unlikely to exceed 6 steps.

Inter-valuation funding calculations

In order to monitor developments, the Administering Authority may from time to time request informal valuations or other calculations. Generally, in such cases the calculations will be based on an approximate roll forward of asset and liability values, and liabilities calculated by reference to assumptions consistent with the most recent preceding valuation. Specifically, it is unlikely that the liabilities would be calculated using individual membership data, and nor would the funding strategy and assumptions be subject to review as occurs at formal triennial valuations.

Notional Sub-Funds for individual employers

Notional sub-funds

In order to establish contribution rates for individual employers or groups of employers it is convenient to notionally subdivide the Fund as a whole between the employers, as if each employer had its own notional sub-fund within the Fund.

This subdivision is for funding purposes only. It is purely notional in nature and does not imply any formal subdivision of assets, nor ownership of any particular assets or groups of assets by any individual employer or group.

Roll-forward of sub-funds

The notional sub-fund allocated to each employer will be rolled forward allowing for all cashflows associated with that employer's membership, including contribution income, benefit outgo, transfers in and out and investment income allocated as set out below. In general no allowance is made for the timing of contributions and cashflows for each year are assumed to be made half way through the year with investment returns assumed to be uniformly earned over that year.

Further adjustments are made for:

- A notional deduction to meet the expenses paid from the Fund in line with the assumption used at the previous valuation.
- Allowance for any known material internal transfers in the Fund (cashflows will not exist for these transfers). The Fund Actuary will assume an estimated cashflow equal to the value of the liabilities determined consistent with the Funding Target transferred from one employer to the other unless some other approach has been agreed between the two employers.
- An overall adjustment to ensure the notional assets attributed to each employer is equal to the total assets of the Fund which will take into account any gains or losses related to the orphan liabilities.

In some cases information available will not allow for such cashflow calculations. In such a circumstance:

- Where, in the opinion of the Fund Actuary, the cashflow data which is unavailable is of low materiality, estimated cashflows will be used
- Where, in the opinion of the Fund Actuary, the cashflow data which is unavailable is material, the Fund Actuary will instead use an analysis of gains and losses to roll forward the notional sub-fund. Analysis of gains and losses methods are less precise than use of cashflows and involve calculation of gains and losses relative to the surplus or deficiency exhibited at the previous valuation. Having established an expected surplus or deficiency at this valuation, comparison of this with the liabilities evaluated at this valuation leads to an implied notional asset holding.
- Analysis of gains and losses methods will also be used where the results of the cashflow approach appears to give unreliable results perhaps because of unknown internal transfers.

Attribution of investment income

Where the Administering Authority has agreed with an employer that it will have a tailored asset portfolio notionally allocated to it, the assets notionally allocated to that employer will be credited with a rate of return appropriate to the agreed notional asset portfolio.

Where the employer has not been allocated a tailored notional portfolio of assets, the assets notionally allocated to that employer will be credited with the rate of return earned by the Fund assets as a whole, adjusted for any return credited to those employers for whom a tailored notional asset portfolio exists.

Special Circumstances related to Admission Bodies

Smoothing of contribution rates for Admission Bodies

The Administering Authority recognises that a balance needs to be struck as regards the financial demands made of Admission Bodies. On the one hand, the Administering Authority requires all Admission Bodies to be fully self funding, such that other employers in the Fund are not subject to levels of expense as a consequence of the participation of those Admission Bodies. On the other hand, in extreme circumstances, requiring full funding may precipitate failure of the body in question, leading to significant costs for other participating employers.

In circumstances which the Administering Authority judges to be extreme, the Administering Authority will engage with the London Borough of Brent, as the dominant employer in the Fund, with a view to seeking agreement that the requirement that contribution rates target Full Funding can be temporarily relaxed.

Additionally, the Administering Authority may seek agreement from the London Borough of Brent that, should an Admission Body cease participation in the Fund during the relaxation period, it would provide a source of future funding for any deficiency developing in the Fund in respect of residual liabilities of the Admission Body (this process is called 'Subsumption' for the purposes of this document).

Such action has three implications:

- During any period when the requirement for targeting Full Funding has been relaxed, contribution rates for Admission Bodies can if necessary be set at a level lower than full funding would require.
- Should an Admission Body leave the Fund during a period when contribution rates do not target Full Funding, the funding requirement in any cessation valuation carried out under Regulation 38 will be reduced to the extent that

contributions, on a cumulative basis, have fallen short of what continued targeting of Full Funding would require. Where the Admission Body has a deficiency, relative to the Full Funding requirement, and also a deficiency relative to this reduced cessation valuation requirement, the Admission Body will only be required to make the position good up to the reduced cessation valuation requirement. Any consequent shortfall in the Fund relative to the Full Funding requirement will fall as a liability to the London Borough of Brent, to be met through adjustments to its contribution rate as part of future actuarial valuation exercises.

- Should an Admission Body leave the Fund during a period where the London Borough of Brent has agreed to subsumption of residual liabilities, the cessation funding requirement will be reduced to reflect the Fund's continuing access to funding, should a deficiency emerge in the future in respect of those liabilities.

At subsequent valuations the position will be reassessed with a view to returning Admission Bodies to paying contributions which target Full Funding.

Interim reviews for Admission Bodies

Regulation 38(4) of the Administration Regulations provides the Administering Authority with a power to carry out valuations in respect of Admission Bodies, and for the Actuary to certify revised contribution rates, between triennial valuation dates.

The Administering Authority's overriding objective at all times in relation to Admission Bodies is that, where possible, there is clarity over the Funding Target for that body, and that contribution rates payable are appropriate for that Funding Target. However, this is not always possible as any date of cessation of participation may be unknown (for example, participation may be assumed at present to be indefinite), and also because market conditions change daily.

The Administering Authority's general approach in this area is as follows:

- Where the date of cessation is known, and is more than 3 years hence, or is unknown and assumed to be indefinite, interim valuations will generally not be carried out at the behest of the Administering Authority.
- For Transferee Admission Bodies falling into the above category, the Administering Authority sees it as the responsibility of the relevant Scheme Employer to instruct it if an interim valuation is required. Such an exercise would be at the expense of the relevant Scheme Employer unless otherwise agreed.
- A material change in circumstances, such as the date of cessation becoming known, material membership movements or material financial information coming to light may cause the Administering Authority to informally review the situation and subsequently formally request an interim valuation.
- For admissions due to cease within the next 3 years, the Administering Authority will keep an eye on developments and may see fit to request an interim valuation at any time.

Notwithstanding the above guidelines, the Administering Authority reserves the right to request an interim valuation of any Admission Body at any time in accordance with Administration Regulation 38(4).

Guarantors

Some Admission Bodies may participate in the Fund by virtue of the existence of a Guarantor. The Administering Authority maintains a list of employers and their associated Guarantors. The Administering Authority, unless notified otherwise, sees the duty of a Guarantor to include the following:

- If an Admission Body ceases and defaults on any of its financial obligations to the Fund, the Guarantor is expected to provide finance to the Fund such that the Fund receives the amount certified by the Fund Actuary as due, including any interest payable thereon.
- If the Guarantor is an employer in the Fund and is judged to be of suitable covenant by the Administering Authority, the Guarantor may defray some of the financial liability by subsuming the residual liabilities into its own pool of Fund liabilities. In other words, it agrees to be a source of future funding in respect of those liabilities should future deficiencies emerge.
- During the period of participation of the Admission Body a Guarantor can at any time agree to the future subsumption of any residual liabilities of an Admission Body. The effect of that action would be to reduce the Funding Target for the Admission Body, which would probably lead to reduced contribution requirements.

Bonds and other securitization

Regulation 6 of the Administration Regulations creates a requirement for provision of risk reviews and bonds in certain circumstances. The Administering Authority's approach in this area is as follows:

- In the case of Transferee Admission Bodies admitted under Regulation 6(2)(a) of the Administration Regulations, and so long as the Administering Authority judges the relevant Scheme Employer to be of sufficiently sound covenant, any bond exists purely to protect the relevant Scheme Employer on default of the Admission Body. As such, it is entirely the responsibility of the relevant Scheme Employer to arrange any risk assessments and decide the level of required bond. The Administering Authority will be pleased to supply some standard calculations provided by the Fund Actuary to aid the relevant Scheme Employer, but this should not be construed as advice to the relevant Scheme Employer on this matter. The Administering Authority notes that levels of the required bond cover can fluctuate and recommends that relevant Scheme Employers review required cover regularly, at least once a year.
- In the case of Transferee Admission Bodies admitted under Regulation 6(2)(a) of the Administration Regulations, where the Administering Authority does not judge the relevant Scheme Employer to be of sufficiently strong covenant, the Administering Authority must be involved in the assessment of the required level of bond to protect the Fund. The admission will only be able to proceed once the Administering Authority has agreed the level of bond cover. The Administering Authority notes that levels of required bond cover can fluctuate and will require the relevant Scheme Employer to jointly review the required cover with it regularly, at least once a year.

In the case of Transferee Admission Bodies admitted under Regulation 6(2)(b) of the Administration Regulations, the Administering Authority must be involved in the assessment of the required level of bond to protect the Fund. The admission will only be able to proceed once the Administering Authority has agreed the level of bond cover. The Administering Authority notes that levels of required bond cover can fluctuate and will review the required cover regularly, at least once a year.

The Administering Authority may carry out risk reviews of Community Admission Bodies admitted under Administration Regulation 5 and may in certain circumstances require such bodies to put in place and maintain a bond or other securitization (such as a charge over available assets) to protect the Fund against potential losses. If this applies, the Administering Authority will determine the level of bond or protection required and will notify the Community Admission Body accordingly.

Subsumed liabilities	Where an employer is ceasing participation in the Fund such that it will no longer have any contributing members, it is possible that another employer in the Fund agrees to provide a source of future funding in respect of any emerging deficiencies in respect of those liabilities. In such circumstances the liabilities are known as subsumed liabilities (in that responsibility for them is subsumed by the accepting employer). For such liabilities the Administering Authority will assume that the investments held in respect of those liabilities will be the same as those held for the rest of the liabilities of the accepting employer. Generally this will mean assuming continued investment in more risky investments than Government bonds.
Orphan liabilities	Where an employer is ceasing participation in the Fund such that it will no longer have any contributing members, unless any residual liabilities are to become subsumed liabilities, the Administering Authority will act on the basis that it will have no further access for funding from that employer once any cessation valuation, carried out in accordance with Administration Regulation 38, has been completed and any sums due have been paid. Residual liabilities of employers from whom no further funding can be obtained are known as orphan liabilities. The Administering Authority will seek to minimise the risk to other employers in the Fund that any deficiency arises on the orphan liabilities such that this creates a cost for those other employers to make good the deficiency. To give effect to this, the Administering Authority will seek funding from the outgoing employer sufficient to enable it to match the liabilities with low risk investments, generally Government fixed interest and index linked bonds. To the extent that the Administering Authority decides not to match these liabilities with Government bonds of appropriate term then any excess or deficient returns will be added to or deducted from the investment return to be attributed to the employer's notional assets.
Cessation of participation	Where an Admission Body ceases participation, a cessation valuation will be carried out in accordance with Administration Regulation 38. That valuation will take account of any activity as a consequence of cessation of participation regarding any existing contributing members (for example any bulk transfer payments due) and the status of any liabilities that will remain in the Fund. In particular, the cessation valuation will distinguish between residual liabilities which will become orphan liabilities, and liabilities which will be subsumed by other employers. For orphan liabilities the Funding Target in the cessation valuation will anticipate investment in low risk investments such as Government bonds. For subsumed liabilities the cessation valuation will anticipate continued investment in assets similar to those held in respect of the subsuming employer's liabilities. Regardless of whether the residual liabilities are orphan liabilities or subsumed liabilities, the departing employer will be expected to make good the funding position revealed in the cessation valuation. In other words, the fact that liabilities may become subsumed liabilities does not remove the possibility of a cessation payment being required.

Identification of risks and counter measures

Approach

The Administering Authority seeks to identify all risks to the Fund and to consider the position both in aggregate and at an individual risk level. The Administering Authority will monitor the risks to the Fund, and will take appropriate action to limit the impact of these wherever possible. The main risks are considered below.

Choice of Funding Target

The Administering Authority recognises that future experience and investment income cannot be predicted with certainty. Instead, there is a range of possible outcomes, and different assumed outcomes will lie at different places within that range.

The more optimistic the assumptions made in determining the Funding Target, the more that outcome will sit towards the 'favourable' end of the range of possible outcomes, the lower will be the probability of experience actually matching or being more favourable than the assumed experience, and the lower will be the Funding Target calculated by reference to those assumptions.

The Administering Authority will not adopt assumptions for Scheduled Bodies and certain other bodies which, in its judgement, and on the basis of actuarial advice received, are such that it is less than 55% likely that the strategy will deliver funding success (as defined earlier in this document). Where the probability of funding success is less than 65% the Administering Authority will not adopt assumptions which lead to a reduction in the aggregate employer contribution rate to the Fund.

The Administering Authority's policy will be to monitor an underlying 'low risk' position (making no allowance for returns in excess of those available on Government stocks) to ensure that the Funding Target remains realistic.

Demographic risk

The main risks include changing retirement patterns and longevity. The Administering Authority will ensure that the Fund Actuary investigates these matters at each valuation or, if appropriate, more frequently, and reports on developments. The Administering Authority will agree with the Fund Actuary any changes which are necessary to the assumptions underlying the measure of solvency to allow for observed or anticipated changes.

If significant demographic changes become apparent between valuations, the Administering Authority will notify all employers of the anticipated impact on costs that will emerge at the next valuation and will review the bonds that are in place for Transferee Admission Bodies.

Regulatory risk

The risks relate to changes to Regulations, National pension requirements or HM Revenue and Customs' rules. The Administering Authority will keep abreast of all proposed changes. If any change potentially affects the costs of the Fund, the Administering Authority will ask the Fund Actuary to assess the possible impact on costs of the change. Where significant, the Administering Authority will notify employers of the possible impact and the timing of any change.

Governance risk

This covers the risk of unexpected structural changes in the Fund membership (for example the closure of an employer to new entrants or the large scale withdrawal or retirement of groups of staff), and the related risk of the Administering Authority not being made aware of such changes in a timely

	manner. The Administering Authority's policy is to require regular communication between itself and employers, and to ensure regular reviews of such items as bond arrangements, financial standing of non-tax raising employers and funding levels. Particular examples are set out below: **Early retirement strain payments** No allowance is made for the additional value of the benefits when a member is made redundant or leaves on the grounds of efficiency. To counter the potential 'strain' (or cost) emerging at the next valuation early retirement strain payments are required from the employer to the Fund to meet this additional cost over a period of no longer than 3 years from retirement. **Employers with small and declining number of contributing members** A recent legal judgement indicates that under the current Administration Regulations employers with no contributing members cannot be charged contributions. This ruling, however, does not affect the ability to collect contributions following a cessation valuation for Admission Bodies. The Regulations may alter in the future but in the meantime there is a risk of a non Admission Body ceasing to pay contributions with a deficit in the Fund. The Administering Authority will monitor employers with declining membership to ensure that funding is close to 100% on the solvency measure by the time the last member leaves service and this may affect the funding strategy accordingly. **Bodies ceasing to exist with unpaid deficiency** Some employers can cease to exist and become insolvent leaving the employers in the Fund open to the risk of an unpaid deficit. For Transferee Admission Bodies, any such deficit will be met by the relevant Scheme Employer and there is therefore little risk to other employers in the Fund (provided of course that the relevant Scheme Employer is itself regarded to be of good covenant). Other employers are more problematic and the Administering Authority will as far as practicable look to reduce risks by use of bond arrangements or ensuring there is a guarantor to back the liabilities of the body.
Statistical/ financial risk	This covers such items such as the performances of markets, Fund investment managers, asset reallocation in volatile markets, pay and /or price inflation varying from anticipated levels or the effect of possible increases in employer contribution rate on service delivery and on Fund employers. The Administering Authority will regularly assess such aspects to ensure that all assumptions used are still justified.
Smoothing risk	The Administering Authority recognises that utilisation of a smoothing adjustment in the solvency measurement introduces an element of risk, in that the smoothing adjustment may not provide a true measure of the underlying position. Where such an adjustment is used, the Administering Authority's policy is to review the impact of the adjustment at each valuation to ensure that it remains within acceptable limits.
Recovery Period risk	The Administering Authority recognises that permitting surpluses or deficiencies to be eliminated over a Recovery Period rather than immediately introduces a risk that action to restore solvency is insufficient between successive

	measurements. The Administering Authority will discuss the risks inherent in each situation with the Fund Actuary and limit the Recovery Period where appropriate. Details of the Administering Authority's policy are set out earlier in this Statement.
Stepping risk	The Administering Authority recognises that permitting contribution rate changes to be introduced by annual steps rather than immediately introduces a risk that action to restore solvency is insufficient in the early years of the process. The Administering Authority will limit the number of permitted steps as appropriate. Details of the Adminstering Authority's policy are set out earlier in this Statement.

BRENT COUNCIL	**Pension Fund Sub Committee** 1st March 2011 **Report from the Director of Finance and Corporate Services**
For Action	Wards Affected: ALL
	Monitoring report on fund activity for the quarter ended 31st December 2010

1. SUMMARY

This report provides a summary of fund activity during the quarter ended 31st December 2010. It examines the actions taken, the economic and market background, and investment performance, as well as commenting on events in the quarter. The main points arising are:

a) Equity markets rose during the quarter. Bond markets fell, on concerns about inflation and strengthening economic growth. Other markets also rose, but less rapidly.

b) The Fund has risen in value from £454m to £476m, and has outperformed its benchmark over the quarter (+2.4%) as a result of stock selection (outperformance in equities, GTAA and private equity). The Fund outperformed the average local authority fund (+1.1%), mainly as a result of good returns in equities and GTAA, offset by asset allocation (higher exposure to alternatives / lower exposure to equities). Over one year, the Fund has outperformed its benchmark (+2.1%) as a result of higher exposure to equities and good stock selection (equities, bonds, private equity and GTAA). Over one year, the Fund has underperformed the average fund (-1.9%) as a result of lower exposure to equities / higher exposure to alternative assets and poor performance in global equities, hedge funds and private equity.

2. RECOMMENDATIONS

Members are asked to note this report.

3 DETAIL

ECONOMIC AND MARKET BACKGROUND - QUARTER ENDED 31ST DECEMBER 2010

3.1 Equity markets rose during the quarter on the bases of world economic growth and renewed Quantitative Easing in USA and elsewhere. The UK market rose by 6%, USA 11%, Germany 16%, Japan 10% and HongKong 5%. The UK economic background was:

- UK base rates remained at 0.5%. Medium and long-term interest rates fell during the quarter. Concerns about the European banking system and various eurozone countries (Greece, Portugal and Spain) have affected these markets, but UK has benefited from a safe haven status.The Quantitative Easing programme in UK has been suspended. Rates may rise to head off inflationary expectations.
- Headline inflation (RPI) rose by 5.1% in the year to January (4.7% August), and the Index of Consumer Prices (CPI) rose by 4.0% (3.1% August). It is expected that inflation will remain at present levels or even rise in the short term, but should fall over a two year period as spare capacity and low pay increases bear down on prices, but it is expected that CPI will be above the Bank of England 2% target during 2011. However, with productivity rising and pay pressures contained, unit labour costs are falling.
- Average earnings growth (including bonuses) was 1.1% p.a. in December (1.8% July), below the Bank of England's 'danger level' (4.5%). Unemployment (claimant numbers) has fallen to 1.46m, but may rise as public expenditure is reduced and taxes raised following the recent budget.
- The UK economy shrunk by 0.5% in Q4 2010 (growing by 1.4% in 2010), following disruption from poor weather and a slowdown in growth. GDP is expected to recover in Q1 2011, and to grow by 1.5% / 2% in full year 2011.
- It has been anticipated that consumer spending will fall, though retail sales were up 1.1% in the year to November. The squeeze on incomes, and the decline in equity withdrawal from the housing market following price falls, may depress demand. House prices have fallen by 2.4% over one year to January (Halifax). Mortgage approvals are only 60% of their level two years ago. Capital Economics still expects further house price falls (15%/20%).

In summary,the UK economy is growing at a modest rate but interest rates are expected to remain low. The government was using both fiscal and monetary policy to combat the downturn, but fiscal policy will be tightened over the next four years. The recovery is expected to be slow with occasional setbacks, but sentiment has improved considerably.

3.2 Central banks have co-ordinated activity to supply liquidity to markets so that credit is available to support economic activity. It is expected that the USA economy has grown by 3% in 2010 (and will grow by 3% in 2011) following tax cuts and quantitative easing (QE) programmes. Improved payroll data, strong retail sales and a rebound in home construction have indicated that a recovery is underway, but house prices continue to fall. It is anticipated that company earnings will improve. It is expected that Eurozone GDP will grow by 1.5% in 2011, supported by strong growth in Germany. Growth in China and India was around 10% and 9% respectively in 2010 (forecast 8% and 8.5% 2011) – emerging market growth is strong and providing export growth to developed economies. China has raised interest rates and tightened banks' reserve requirements, while India has also raised rates. The world economy is expected to grow by 4.6% in 2010, and by 4% – 4.5% in 2011.

3.3 A paper on market events and future prospects, written by the Independent Adviser, is attached.

3.4 Table 1 below shows the changes in asset allocation, how asset allocation compares with the benchmark and with the average fund (WM Local Authority average), and how the change in the market value during the quarter is allocated across asset classes. Items marked (*) in columns 4 and 8 cannot be separately analysed, but are included elsewhere. The WM Local Authority average asset allocation indicates little change apart from increased exposure to alternative assets.

Table 1: Asset Allocation as at 31st December compared to the Benchmark

Market (1)	Market Value 30.09.10 £M (2)	Market Value 30.09.10 % (3)	WM LA Average 30.09.10 % (4)	Fund Benchmark 31.12.10 % (5)	Market Value 31.12.10 £M (6)	Market Value 31.12.10 % (7)	WM LA Average 31.12.10 % (8)
Fixed Interest							
UK Gilts	17.4	3.8	10.6	4.5	17.5	3.7	9.5
Corp.Bonds	25.1	5.5	*	4.5	23.8	5.0	*
IL Gilts	-	-	4.8	-	-	-	4.7
Overseas	0.0	0.0	2.2	-	-	-	2.2
Emerg. Market	8.5	1.9	-	2.0	8.4	1.8	-
Infrastructure	0.9	0.2	-	-	0.9	0.2	-
Secured loans	4.3	0.9	-	2.0	4.4	0.9	0.7
Credit Opps.	12.0	2.7	-	2.5	12.1	2.5	*
Credit Alpha	12.3	2.7	-	2.5	12.3	2.6	*
Currency Fund	0.7	0.2			0.6	0.1	
Equities							
UK FTSE350	109.1	24.0	30.9	12.5	72.3	15.2	30.9
UK Smaller co's	15.6	3.4	*	4.0	15.9	3.3	*
O/seas - developed	92.5	20.4	34.5	22.5	116.4	24.5	34.4
O/seas – emerging	13.4	2.9	*	8.0	37.1	7.8	*
Other							
Property – UK	23.8	5.2	6.2	8.0	25.2	5.3	6.0
Property – Eu.	6.6	1.5	*	*	6.6	1.4	*
Hedge funds	41.1	9.0	2.0	10.0	42.0	8.9	2.4
Private Equity	41.7	9.2	2.8	10.0	47.8	10.1	3.0
GTAA	12.7	2.8	1.3	4.0	16.5	3.5	1.7
Infrastructure	4.6	1.1	*	2.0	5.3	1.1	*
Cash	11.8	2.6	4.0	1.0	11.0	2.1	3.6
Total	**454.1**	**100.0**	**100.0**	**100.0**	**476.1**	**100.0**	**100.0**

3.5 The main changes to the Brent Fund have occurred as a result of market movements, agreed rebalancing and increased exposure to private equity (£5.6m, the main items being initial investment in the USA Solar Fund £2.5m, and further investment in the European Co-Investment Fund £1.5m), property (£1m), and infrastructure (£0.9m). The main rebalancing changes have been:-

a) exposure to UK Small Companies has been reduced (£2.4m) on the basis of concerns about the stability of the house, balanced by increased exposure to Global Tactical Asset Allocation (£2m).
b) Increased exposure to overseas equities (including emerging markets) and reduced UK equity exposure (£36m) in line with the revised benchmark.

Since the end of the quarter there has also been further investment in overseas equities (£2m – reinvestment of dividends relating to the AllianceBernstein portfolio) UK property (£1m) , GTAA (£2m), infrastructure (£0.2m) and private equity (£0.5m).

Performance of the Fund

3.6 The independent WM Company measures the returns on the Brent Pension Fund. Table 2 sets out returns for the quarter to 31st December 2010.

<u>Table 2: Investment Returns in Individual Markets</u>

Investment Category	RETURNS						Benchmark/ Index Description
	Quarter Ending 30.12.10			Year Ended 30.12.10			
	Fund %	Benchmark %	WM Local Auth %	Fund %	Benchmark %	WM Local Auth %	
Equities			8.6			16.2	
UK FTSE350 Equities	8.1	7.3	7.6	16.3	14.4	15.7	FTSE 350
UK Small Caps	15.8	8.6		21.6	16.9		FTSE Smallcap ex IT
Overseas	14.5	8.2	9.3	11.8	10.0	16.9	FTSE World 75% Hedge
Emerging markets	-	-	-	-	-	-	
Fixed Interest							
Total Bonds	-0.8	-0.7	-1.0	7.9	5.5	9.0	Brent benchmark
UK Bonds	-2.2	-2.1	-2.3	6.6	6.2	8.6	FTSE UK over 15 years
Index Linked UK	-	-	1.1	-	-	9.1	-
Corp Bonds	-2.1	-2.4	-	8.1	8.4	-	iBoxx Sterling Non-gilt
Secured Loans	3.3	0.9	-	12.9	3.7	-	3 month LIBOR +3%
Credit Opportunities fund	0.1	1.4	-	10.6	5.7	-	3 month LIBOR+5%
Other							
UK Property FOF	2.3	2.2	2.0	22.1	17.4	11.9	IPD Pooled index
Eu Property FOF	0.1	1.9	-	-2.2	8.0	-	IPD All properties
Hedge Funds	2.3	1.1	2.5	1.9	4.6	7.0	3 month LIBID+4%
Private equity	4.1	0.1	3.2	8.0	0.4	12.7	LIBID 7 Day
Infrastructure	-1.2	1.1	-	-1.4	4.6	-	3 Month LIBID +4%
GTAA	12.3	6.9	-	35.4	12.6	-	FTSE 100
Cash	1.0	0.1	0.1	n/a	2.4	1.7	GPB 7 DAY LIBID
Total	**6.8**	**4.4**	**5.7**	**11.5**	**9.4**	**13.4**	

3.7 Details of individual managers' performance tables are attached in Table 3, which shows three month, one year and longer-term information. Returns for the quarter outperformed the benchmark by 2.4%, despite transition costs. Part of the outperformance arose as a result of asset allocation (overweight equities), but there was also outperformance in most asset classes. The main stock selection factors were:-

a) UK Small Companies. The manager added value through investments in takeover targets (such as Nestor and Scott Wilson), companies that grew their profits, and the avoidance of underperformers such as Southern

Cross, Mouchel and Antisoma. The fund is overweight capital intensive industries and technology companies, and underweight financials, resources and consumer discretionary stocks.

b) Fixed interest. The core portfolio outperformed, but the satellite portfolio underperformed their investment target. The core portfolio benefitted from good sector selection in corporate bonds. The satellite fund rose in value as secured loans outperformed, but returns from other funds were positive but below target.

c) Overseas equities. It appears that AllianceBernstein outperformed (by 5.7%) during October and November. Performance was also helped by the overweighting in Emerging Markets during December.

d) GTAA. The manager outperformed sharply as equity and currency strategies added value. In equities, additional (long) exposure to Germany and Japan were particularly helpful. In currencies, the overweight to higher yielding currencies (such as Australia and Canada) added value, as did the short on the dollar.

e) Property. In the UK, there have been new entrants to the Fund, allowing the manager to purchase assets at a discount. The manager expects the market to fall slightly this year, and is positioning the fund to avoid lower quality assets. In European property, returns were flat. The european market has begun to improve, and the manager is looking for new funds to commit cash.

f) Hedge funds. In benign markets, the manager added value from equity hedged, long bias macro managers, event driven, and multiple strategies. Short bias managers continued to underperform. Fauchier have been active in removing managers that are suffering style drift or have become over cautious, and has increased exposure to event driven and specialist credit managers.

3.8 Over one year, the Fund outperformed the benchmark by 2.1%. Stock selection added value – UK equities, overseas equities, UK Small Cap, bonds, GTAA and private equity outperformed the benchmark.

3.9 The Brent fund has outperfomed the WM Local Authority average in Q4 (1.1%) despite asset allocation - low exposure to equities / high exposure to alternative investments. Both equities and GTAA have outperformed the average.

3.10 The Brent fund has underperformed the average local authority fund by 1.9% over one year, mainly because it has had a lower exposure to equities (higher exposure to alternatives – mainly hedge funds and private equity) in a period when equities have performed very strongly. However, there has been outperformance in UK equities and GTAA, partially offet by underperformance in overseas equities, hedge funds and private equity.

Actions taken by the Brent In-House UK Equity Manager during the Quarter

3.11 The main activity during the quarter was to sell stock (£22m) as part of the change in asset allocation to reduce exposure to UK equities and increase exposure to overseas equities. The strategy adopted was to sell large, mainly FTSE100 stocks that were liquid. The cost of sale was £22,000. Since the initial sale, there has been further action to rebalance the portfolio so that tracking error is low. This has involved selling larger FTSE 250 stocks. There have also been some purchases and sales during this quarter to invest dividends (£0.9m), improve tracking error, pay retirement lump sums, and invest in private equity.

Purchases

a) Took up rights issues.
b) To reduce tracking error.

Sales

a) Sold stocks to ensure more accurate index tracking or as they left the index (such as Edinburgh Dragon Trust).
b) Sold stocks to fund investment elsewhere or to pay retirement lump sums.

Future Strategy for the UK FTSE350 Index tracking fund

3.12 The strategy is that of tracking the FTSE 350 within 0.5% over the year. Activity during January included buying and selling stocks to improve tracking error and to invest dividends.

NEW DEVELOPMENTS AND FUTURE INVESTMENT OUTLOOK FOR THE BRENT FUND

3.13 Equity markets rose during January and early February, supported by increasing evidence of economic recovery and quantitative easing in USA.

3.14 Following the announcements that the head of small companies (Gervais Williams), the leading hedge fund manager and the chief investment officer were leaving, Gartmore Investment Management announced that it was conducting a strategic review of the business, and meeting interested companies with a view to a potential takeover. The Brent Fund had previously decided to reduce exposure to the UK and Irish Small Companies Fund, and continued that approach.

3.15 In January 2011, Gartmore announced that it was being taken over by Henderson Global Investors. It appears that the business 'fit' is very good – Gartmore runs some attractive retail funds and continues to employ some highly considered managers. As part of the agreement, Henderson has secured most of the leading managers at Gartmore (with long term agreements involving Henderson shares), in particular the two lead small companies managers (Rob Giles and Adam McConkey) and the rest of the small companes team. Following discussions with Adam McConkey and David Jacob (the Chief Investment Officer at Henderson), it is apparent that the UK and Irish Small Companies Fund will continue to follow the same investment processes as before. Undoubtedly there will be further 'rationalisation' to reduce costs, but the industry view is that Henderson undertook its previous takeover of the manager New Star very successfully, and has learnt more lessons (in particular with regard to securing leading managers) from that experience. Henderson had some smaller company funds, but the approach and emphasis (mainly on FTSE250 companies) has been different. Initially the small companies team will remain a discrete group within Henderson.

3.16 From the Brent viewpoint, the takeover secures our small company investment against the possible implosion of Gartmore. Henderson is a sound, well capitalised company. On this basis, further reduction in exposure to UK small companies has been suspended (£2.4m sold), but will not be reversed until the takeover is complete. It is ironic to note that the price of UK and Irish units has risen by more than 15% since the sale process commenced.

4. FINANCIAL IMPLICATIONS

These are contained within the body of the report.

5. STAFFING IMPLICATIONS

None directly.

6 DIVERSITY IMPLICATIONS

The proposals in this report have been subject to screening and officers believe that there are no diversity implications arising from it.

7 LEGAL IMPLICATIONS

There are no legal implications arising from the report.

8. BACKGROUND INFORMATION

Henderson Investors – December 2010 quarter report
Legal & General – December 2010 quarter report

Persons wishing to discuss the above should contact the Exchequer and Investment Section, Finance and Corporate Services , 020 8937 1472/1473 at Brent Town Hall.

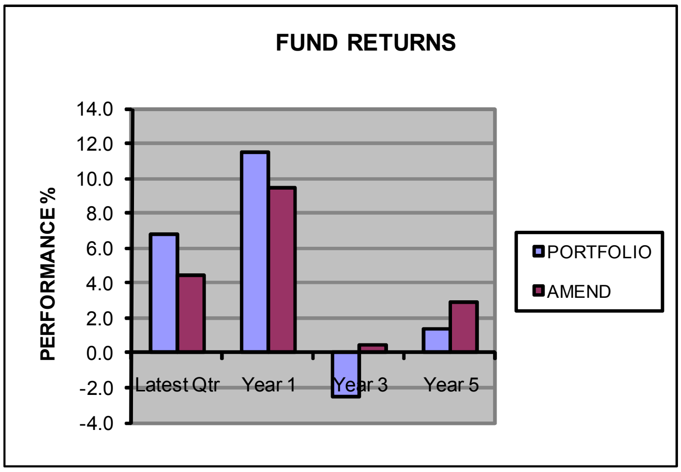
CLIVE HEAPHY
Director of Finance & CS

MARTIN SPRIGGS
Head of Exchequer and Investment

PERFORMANCE FOR INDIVIDUAL PORTFOLIOS 30th DECEMBER 2010

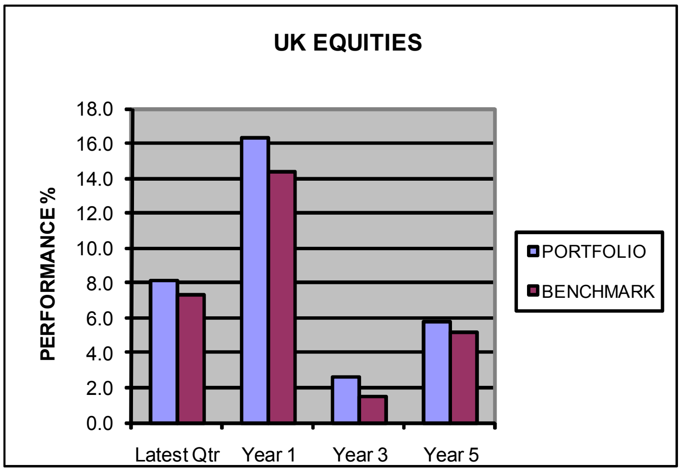
FUND RETURNS

	PORTFOLIO	BENCHMARK
Latest Qtr	6.8	4.4
Year 1	11.5	9.4
Year 3	-2.5	0.4
Year 5	1.4	2.9



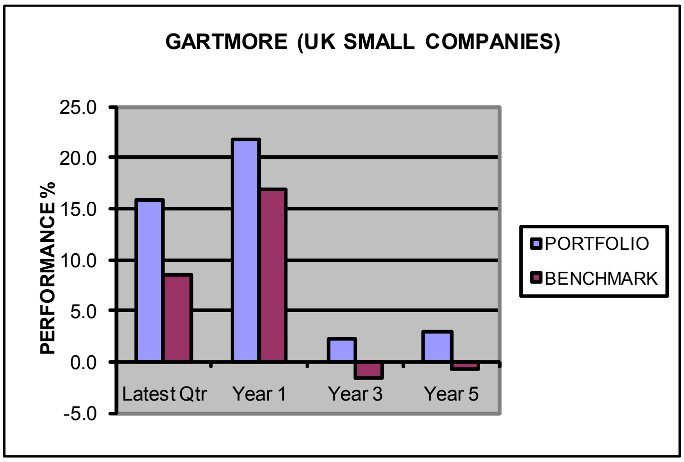
UK EQUITIES

	PORTFOLIO	BENCHMARK
Latest Qtr	8.1	7.3
Year 1	16.3	14.4
Year 3	2.6	1.5
Year 5	5.8	5.2



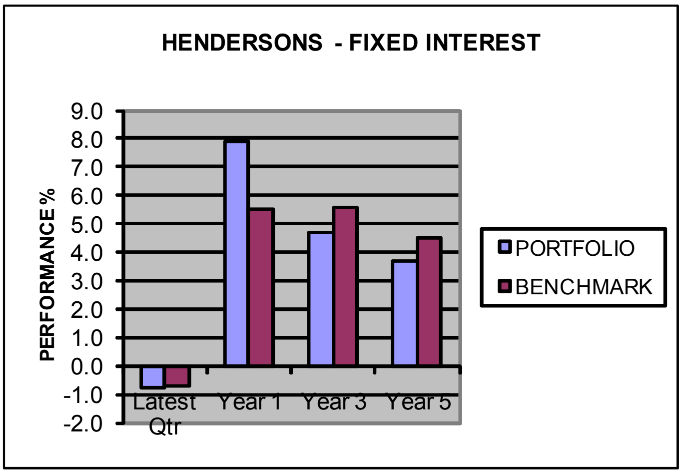
GARTMORE (UK SMALL COMPANIES)

	PORTFOLIO	BENCHMARK
Latest Qtr	15.8	8.6
Year 1	21.7	16.9
Year 3	2.3	-1.6
Year 5	3.0	-0.8



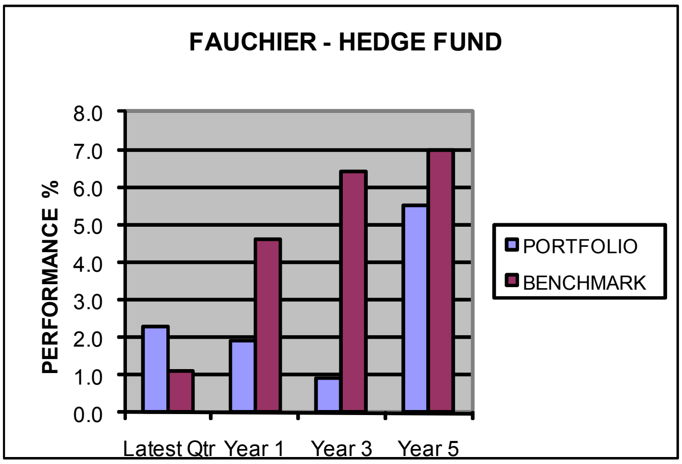
HENDERSONS - FIXED INTEREST

	PORTFOLIO	BENCHMARK
Latest Qtr	-0.8	-0.7
Year 1	7.9	5.5
Year 3	4.7	5.6
Year 5	3.7	4.5



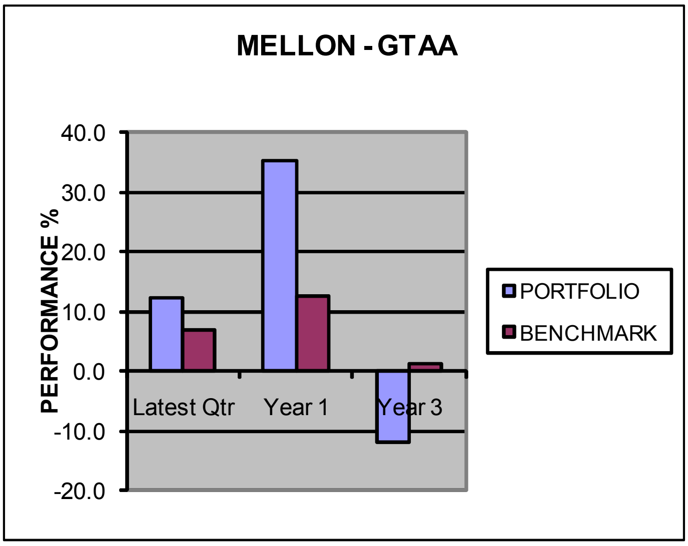
FAUCHIER - HEDGE FUND

	PORTFOLIO	BENCHMARK
Latest Qtr	2.3	1.1
Year 1	1.9	4.6
Year 3	0.9	6.4
Year 5	5.5	7.0



MELLON - GTAA

	PORTFOLIO	BENCHMARK
Latest Qtr	12.3	6.9
Year 1	35.4	12.6
Year 3	-11.7	1.2



Report from the Independent Adviser

Investment Report for the Quarter ended 31st December 2010

Market Commentary

The index returns and currency movements both for the quarter and year ended 31st December 2010 are shown in the tables below.

Index returns expressed in sterling

		Q/E 31.12.10
		%
Equities		
Japan	FTSE Developed Japan	12.8
North America	FTSE North America	11.6
Asia/Pacific	FTSE Developed Asia Pacific (ex Japan)	9.3
Emerging Markets	MSCI Emerging Markets Free	8.1
UK	FTSE All Share	7.4
Europe	FTSE Developed Europe (ex UK)	4.7
Fixed Interest		
UK ILGs	FTSE British Gov. Index Linked Over 5 years	1.1
UK Gilts	FTSE British Government All Stocks	-2.1
Corporate Bonds	Merrill Lynch Sterling – Non Gilts All Stocks	-2.4
Property	IPD	N/a
Cash	Merrill Lynch LIBOR 3 Month	0.1

Currency Movements for quarter ended 31st December 2010

Currency	30th September 2010	31st December 2010	Change %
USD/GBP	1.576	1.566	-0.6
EUR/GBP	1.154	1.167	+1.1
USD/EUR	1.365	1.342	-1.7
Yen/USD	83.540	81.105	-2.9

Index returns expressed in sterling

		Y/e 31.12.10
		%
Equities		
Asia/Pacific	FTSE Developed Asia Pacific (ex Japan)	23.7
Emerging Markets	MSCI Emerging Markets Free	22.9
North America	FTSE North America	19.1
Japan	FTSE Developed Japan	19.0
UK	FTSE All Share	14.5
Europe	FTSE Developed Europe (ex UK)	5.7
Fixed Interest		
UK ILGs	FTSE British Gov. Index Linked Over 5 years	9.1
Corporate Bonds	Merrill Lynch Sterling – Non Gilts All Stocks	8.5
UK Gilts	FTSE British Government All Stocks	7.2
Property	IPD	17.6*
Cash	Merrill Lynch LIBOR 3 Month	0.1

* For the year ended 30th November 2010

Currency Movements for year ended 31st December 2010

Currency	31st December 2009	31st December 2010	Change %
USD/GBP	1.615	1.566	-3.0
EUR/GBP	1.126	1.167	+3.7
USD/EUR	1.435	1.342	-6.5
Yen/USD	93.095	81.105	-12.9

As the return table for the quarter shows, the leader was Japan (+12.8%) making up for its lacklustre negative performance earlier in the year. This reflected a degree of increasing confidence in the Japanese economy which had disappointed for so long. Next came North America (+11.6%) on the realisation that its economy was demonstrating appreciably better economic growth than expected by most economists. Asia/Pacific (+9.3%) continued to be a favoured area for investors as it managed to maintain very robust rates of GDP growth. For much the same reason Emerging Markets returns grew by 8.1%. The UK featured next with a very respectable +7.4%. Last, but certainly not least, came Europe (+4.7%), despite the well publicised financial and economic problems within the smaller Eurozone countries and fears for the future of the euro. As so often in the past, it was Germany with its dominating export powered economy which continued to be the bedrock of the Eurozone. All in all the quarterly equity returns provided an exceptionally strong end to a truly banner year.

Fixed interest returns were negative for the quarter except for Index Linked Bonds. This was not surprising given the strength of fixed interest earlier in the year and the recent perception that yields on gilt edged securities stand at extremely low historic levels. This is reflected in their return of -2.1%. However, Corporate Bonds, after a strong positive 8.5% return for the year, produced a negative 2.4% for the quarter on the apprehension that the best may have been seen. The return of +1.1% for Index Linked bonds was due to the continuing relative popularity of this class as an insurance against the possibility that UK inflation rates experience further rises.

Property continued its recovery and benefited from increased investor confidence in the sector both from the UK and internationally. City of London offices performed particularly well with the largest increase in markets for 22 years. Residential property values, on the other hand, continued to fall.

The reported quarter brought to an end a year of unprecedented market and economic activity triggered by a plethora of mostly urgent initiatives from both governments and central banks in order to control and resuscitate their respective economies with the emphasis on growing their rates of GDP. This was especially prevalent within the industrialised nations of the Western Hemisphere, especially within the peripheral Eurozone countries together with the UK and the USA with their high trade deficits. These resuscitating actions included an amalgam of financial bail outs, quantitative easing programmes, bank rescue packages including nationalisations, and emergency economic stimulatory measures. For the year as a whole the market pendulum swung between fear and greed. The former was particularly prevalent in the first quarter of the year with worries of double dip recessions and the increasingly parlous economic state of the Eurozone peripheral nations.

There is no doubt that the above litany of gloom and doom acted as a severe depressant to equity market levels, particularly towards the end of the first quarter of 2010. However, very few investment strategists and commentators could possibly have foreseen the strong rate of equity recovery that was to come between March and the end of the year. The cause of this recovery was the fact that, as time went by, it became increasingly apparent that the government and central bank measures outlined above were causing respective economies to "muddle thorough" despite quantitative easing programmes (printing money by any other name) which, in the past, have almost always been followed by rising inflation rates. Apart from the surprising resilience of economies, it also became apparent that corporate health was in much better shape than once forecast. Earnings were better than expected, balance sheet strength was greatly improved with lower levels of debt and, most importantly, dividends were appreciably better than expected. It also became evident to investors that fears of double dip recessions were receding. Another important market influence was that, within the Western Hemisphere, the maintenance of extremely low levels of interest rates were helpful both to consumers and corporations alike. So, for all the aforementioned reasons equity markets took heart as is clearly shown in the above return tables both for the year and quarter ended 31st December 2010.

With regard to the markets of the Eastern Hemisphere and Emerging Markets, their economies grew at an appreciably faster rate compared with their Western counterparts. Particular strength was shown by China, India, Australia and Brazil.

UK

Positive Influences

- On Christmas Eve the FTSE 100 Index broke through the 6,000 barrier at 6,009, a level it reached 2 ½ years ago. However, at the year end it reacted to 5,900.
- Private Equity demonstrated a strong revival and accounted for a record 75% of all UK mergers and acquisitions in the first nine months of 2010.
- The newly formed Office for Budget Responsibility estimates economic growth in the UK of 1.8% in 2010 followed by 2.1% in 2011.
- The purchasing managers' index for December reached a 16 year high of 58.3 (November 57.5).

Negative Influences

- In the quarter to 31st October unemployment increased by a larger than expected 35,000 representing a rate of 7.9%, fractionally higher than the previous quarter's rate of 7.8%.
- The Office for National Statistics reported that the Consumer Price Index (CPI) in November was 3.3% p.a. versus the Bank of England's target of 2.0%. CPI has now exceeded its target for the past 49 months.
- The British Bankers' Association reported mortgage approvals for October of 30,766, down from 31,058 in September. This compares with an average rate over the previous 6 months of 33,914.

USA

Positive Influences

- November durable goods orders rose by 2.4% recovering strongly from October's fall of 1.9%.
- On 14th December the Federal Reserve Board left interest rates unchanged and stated that the Federal funding rate would remain at "exceptionally low levels" for an extended period.

- On 7th December President Obama transacted a fiscal deal with the opposition Republican Party in order to extend the Bush era tax cuts for two years. This could boost GDP in 2011.
- New claims for jobless benefit in November fell to a 2 year low of 407,000.
- The Institute of Supply Management's non manufacturing index advanced to 57.1 in December from 55.0 in November. This compared with estimates of 55.6. The Institute's index of factory activity rose to 57.0 in December (November 56.6) representing the seventeenth monthly rise.
- The private sector added 297,000 jobs in December up from 92,000 in November. This was the eleventh consecutive month of expansion. This result was appreciably higher than consensus economists' estimates of 100,000.
- Chicago's purchasing managers' index (a measure of manufacturing activity in the Mid West of America) increased markedly to 68.6 in December from November's 62.5.

Negative Influences

- Although October house prices rose by 0.7% they recorded a fall of 3.4% on an annualised basis.
- The unemployment rate in November rose to 9.8% from 9.6% in October.
- In mid December US Treasury stocks were hit by the biggest sell off for two years, directly attributable to soaring borrowing costs.
- October housing starts dropped by 11.7%.
- On 30th December, the US $ fell to a record low against the Swiss Franc of 0.9351 and a 28 year low against the Australian dollar of 1.1098.
- The Conference Board's index of consumer confidence decreased to 52.5 in December from 54.3 in November versus misjudged estimates of 57.0.

Europe

Positive Influences

- On 28th November the European Union arranged a €85B bail out for Ireland and agreed a formal mechanism for dealing with future debt crises in the Eurozone. This mechanism is specifically designed to head off further corrosive contagion. In that regard there is to be a new institution called the European Financial Stability Facility.
- The German economy has benefited considerably from the weakness of the euro.
- The German IFO November business survey hit a post unification high.
- Angela Merkel the German Chancellor was re-elected as leader of the ruling Christian Democratic Union.
- German industrial orders advanced strongly by 5.2% in November (October +1.6%).

Negative Influences

- Silvio Berlusconi's centre right coalition came under acute pressure and only just survived a vote of no confidence by 314 votes to 311.
- Financial contagion spread to Spain which is of distinct concern as it accounts for approximately 11.7% of the Eurozone's GDP.
- Eurostat stated that Eurozone inflation in December rose to 2.2% p.a. from 1.9% p.a. in November. This compares with the ECB's target of "close but below" 2.0% over the medium term.

- The Eurozone unemployment rate in November was unchanged at 10.0%. This masks a wide variation within the individual member countries e.g. Germany 6.7%, Ireland 13.9% and Spain a staggering 20.6%.

Japan

Positive Influences
- GDP increased in the third quarter of 2010 by 3.9%.
- The purchasing managers' index for December increased to 48.3 from 47.3 in November.

Negative Influences
- The Finance Ministry stated that November exports grew by 9.1% p.a. whilst imports advanced by a marked 14.2%. Thus, the all important trade balance deteriorated.

Asia/Pacific

Positive Influences
- On 25th December the People's Bank of China increased its lending rate to 5.81% in order to combat rising inflation.
- On 21st December China promised to take "concerted action" to support the Eurozone "if necessary" this includes purchasing Eurozone sovereign bonds.
- China's retail sales in October grew at a most robust 18.6% p.a.
- In the fourth quarter of 2010 China's foreign exchange reserves (the largest in the world) rose by a record £199B to $2,850B.
- India's GDP growth in the third quarter was a substantial 8.9% which was much higher than expected. It is therefore hardly surprising that the Reserve Bank of India intends to raise interest rates in order to cool economic growth. The government estimates that GDP growth for 2010 will be 8.5%.
- South Korea's industrial production in November increased by 1.4% compared to the 4.2% drop in October. Retail sales in November grew by 2.9% (October +0.2%).

Negative Influences
- China's CPI for November rose by 5.1% p.a. appreciably higher than the 4.4% p.a. increase in October. The government's target is 3.0%.
- China's purchasing managers' index for manufacturing slipped to 54.4 in December from 55.3 in November.
- New Zealand's third quarter rate of GDP decreased by 0.2% largely due to the strength of the New Zealand dollar and its negative effect on the nation's export growth.
- On 23rd November the inflammatory move by North Korea in shelling the South Korean island of Yeon Pygong reminded the whole region of North Korea's antagonistic regime with its nuclear capability.
- On 16th November South Korea increased interest rates by ¼% to 2.5% in order to better combat inflation which for October was up 4.1% p.a.
- On 2nd November the Reserve Bank of Australia raised rates by ¼% to 4 ¾%. This move caused the Australian dollar to temporarily reach parity with the US dollar.

- As widely expected, the Reserve Bank of India raised its interest rate by ¼% to 6 ¼%.

Principal influences of a general nature were as follows:-

- Most commodity prices boomed. On 7th December gold rose to a record $1,430.95 whilst silver rose to a 30 year high of $30. Copper achieved a record high of almost $9,447 a tonne in part due to the large demand from China. This represented a rise of 33% for 2010 which compared with an advance of 139% for 2009. Oil broke through a 26 month high of $90 with consumption levels the strongest for 30 years. Food commodities e.g. cereals also demonstrated substantial strength. It goes without saying that this unprecedented commodity strength was bad for the containment of inflation.
- The Organisation for Economic and Co-operative Development (OCED) forecast that the global GDP rate in 2011 would be 4.25% to be followed by 4.5% in 2012.
- Governments continued to be greatly influenced by wide spread trade protectionism as respective countries sort to benefit their vital export trade by manipulating their currencies.
- The pronounced build up of corporate balance sheet cash and lower debt levels caused increased merger and acquisition activity together with higher investment in research and development.
- Emerging Market economies were enhanced by a marked increase in the spending power of their growing middle classes.

Conclusion

As we start 2011 the background for capitalism both in the UK and globally appears to be distinctly more promising than that of a year ago. This more conducive background applies not just to equities, but to most other asset classes - private equity, property, infrastructure, hedge fund of funds, commodities, global tactical asset allocation and foreign exchange. The clear omission from this list is fixed interest. The reason for this is simply that the predominant allocation to this sector is usually in gilts, sovereign debt and index linked gilts. The yields on these sub sectors in such a low rate environment have been driven down to unprecedented low levels which makes them, with the exception of index linked bonds, look unattractive at this time, particularly as and when interest rates rise. Also sovereign risk is on going within the weaker economies of the Eurozone. However, with regard to the other sub sectors of Fixed Interest, corporate and secured bonds still seem moderately attractive with very few defaults likely. The sub sectors with more obvious attraction are high yield bonds, emerging market debt and absolute return bonds, provided they are sufficiently liquid. There is no doubt that future Fixed Interest strategies will need to be much more nimble and flexible than heretofore with gilts and sovereign debt constituting the minority part of a Fixed Interest portfolio from here on.

With regard to the other aforementioned sectors, private equity should continue to benefit from improved prospects for increased activity in IPOs and mergers and acquisitions which are both continuing to recover. Property also is recovering well with attractive valuations still available with a better environment in which to manage property assets. Infrastructure managers should continue to take advantage of an increasing flow of opportunities across the spectrum. Hedge fund of funds, after a generally poor 2010 relative performance, should be able to benefit from a likely increase in volatility with less correlation. Factors on which their returns are so dependent. t is hoped that there will be a considerable improvement in their long/short and global macro activities which proved such a performance detraction last year. Although both hard and soft commodities boomed in 2010 especially in minerals, useful gains should still be possible in 2011. However, a nearer term pause for breath could easily occur. Both the GTAA and foreign exchange sectors should be able to produce worthwhile gains on the back of increased volatility in the currency market, caused by more central bank and corporate treasury hedging activities.

In sum, even after the strong showing of most asset classes last year, conditions exist which should translate into meaningful gains in 2011, especially for high quality equities with strong balance sheets and the ability to produce consistently rising earnings and dividends. However, it seems sensible to caution that the course of markets for 2011, though upwards, is unlikely to be smooth with many periods of volatile uncertainty. After a 9 month period of an unexpectedly strong equity run it would be all to easy to fall into the trap of unbridled optimism. As always, much will depend on the macro economic news flow from around the world which can be summarised with the following conditions:-

- In the UK, the coalition government must continue to hold firm as its belt tightening austerity measures impact consumers and corporations alike. The absorption of the VAT rise to 20% from 17 ½% will be important. So far the British propensity to take the necessary harsh medicine has been surprisingly good. But it needs to remain so, as severe austerity is destined to last at least three more years. It will also provide a test for the Trade Union/Government relationships, particularly in the area of unemployment. At their current valuations equities could surprise on the upside with appreciably stronger balance sheets than a year ago. A double dip recession seems most unlikely.
- In the USA, President Obama will need to show that he can live with the Republican Party majority in the House of Representatives and demonstrate an ability to compromise on essential issues. Corporate profitability is likely to remain strong and could translate into higher rates of GDP than market forecasters currently expect.
- In Europe, the joint efforts of the European Central Bank, Angela Merkel, the German Chancellor, and the International Monetary Fund should show that they can cope with the grossly indebted economies of Greece, Ireland, Portugal and Spain. Above all, it is imperative that the domino effect of leverage contagion can be contained and the future of the Euro assured. In the near future it seems probable that the Portuguese economy will have to be bailed out. Eurozone unemployment rates will likely remain of constant concern. Certain high quality equities are on surprisingly cheap valuations.
- In Japan, it is imperative that the Government can demonstrate that the policies of the past are undergoing a radical change in order to spur consumers and corporations to spend so that the nation can grow itself away from the systemic deflation in which it has been mired for so long. A weaker yen would be helpful to Japanese exports, particularly to the Asian region.
- In Asia/Pacific, rates of GDP growth should continue apace, although at marginally lower levels than in 2010. This applies to China, India, South Korea, Singapore, Australia and less so to Russia. In particular, the People’s Bank of China will need to continue with measures to cool down its very strong rate of economic growth and, at the same time, to be seen to revalue its currency the renminbi. China seems well capable of achieving this, but it will have to keep a close eye on inflation, particularly in respect of food for its massive population.

China has, without doubt, become the centre of global trading with its insatiable demand for minerals, cars and so many big ticket items. It seems certain that it will continue to flex its muscles on the international stage.

- Emerging markets will most likely continue to attract long term investors, particularly the BRIC group which has really already matured from its emerging chrysalis stage such is the rapidity of their development. The same could be said of South Korea and Taiwan. There seems no doubt that in the longer term the equities and economic growth of the emerging market countries will outperform those of the classic Western Hemisphere developed countries. However, an area of concern for many emerging nations is the rapid rise in their inflation rates.
- In general, it seems both likely and essential that the Bank of England, the ECB and the Federal Reserve Board continue to maintain their currently very low level of interest rates.
- The encouraging upturn in world trade is likely to continue with the International Monetary Fund forecasting global growth of 4.3% in 2011. There has been a sharp increase in shipping container transport which is usually a reliable barometer of trade activity.
- As always, inflation rates will have to be carefully monitored. In that regard pressure is likely to come from the accelerating rise in food and energy prices.

Finally, at the risk of being repetitive, it should be stressed that portfolios that embrace globalisation in all asset classes are most likely, in the long term, to be rewarded in peer group performance tables.

Valentine Furniss

Investment Update for the Month of January 2011

	Indices	M.e 31.01.11
		%
Equities		
Europe	FTSE Developed Europe (ex UK)	2.8
North America	FTSE North America	-0.2
UK	FTSE All Share	-0.5
Asia/Pacific	FTSE Developed Asia Pacific (ex Japan)	-2.1
Japan	FTSE Developed Japan	-2.2
Emerging Markets	MSCI Emerging Markets Free	-4.9
Fixed Interest		
Corporate Bonds	Merrill Lynch Sterling – Non Gilts All Stocks	-0.5
UK Gilts	FTSE British Government All Stocks	-1.9
UK ILGs	FTSE British Government IL Over 5 years	-2.6
Property	IPD	N/a
Cash	Merrill Lynch LIBOR 3 Month	0.1

Currency movements for month ended 31st January 2011

Currency	31st December 2010	31st January 2011	Change %
USD/GBP	1.566	1.602	+2.3
EUR/GBP	1.167	1.168	+0.1
USD/EUR	1.342	1.371	+2.2
YEN/USD	81.105	81.930	+1.0

In strict contrast to the heady equity returns of the quarter ended 31st December 2010, the returns for the month of January 2011 provided a dose of New Year realism with many investors, both private and institutional, electing to take some worthwhile profits and to pause before making further market commitments. All returns with the exception of Europe were negative as is shown in the above table. Not surprisingly, the back marker on the leader board was Emerging Markets (-4.9%) which broke the extremely strong positive return for the year 2010, namely 22.9%. Apart from profit taking and fears of rising inflation, Emerging Markets also suffered as a result of the Middle East leadership successor crisis; although in reality the percentage that the countries in question bear to the total Emerging Markets capitalisation is extremely small. Japan malingered (-2.2%) as its stock market acknowledged that there was still no really clear evidence that the government was finally prepared to take the sufficiently radical steps necessary to address the country's woes and to place it on track for a meaningful and lasting economic recovery. Basically, Japan still has endemic problems with its stifling and outmoded culture. The Asia/Pacific markets (-2.1%) also suffered from profit taking, together with inflationary concerns, principally triggered by China. The UK was marginally lower (-0.5%) which should be seen as a reasonably resilient performance against a background in which the Coalition Government's austerity measures were beginning to bite. North America's performance (down a mere 0.2%) was also resilient in view of the country's ever increasing deficit. However, it benefited from generally encouraging macro economic data and also better than expected corporate earnings, especially from those companies experiencing strong demand from the Emerging Markets, particularly within the important car and heavy engineering industries. Another factor to influence North American returns was the perception that President Obama was making a much needed and better compromise with his political opponents. Of course, with the Democrats having lost their majority in Congress he really has no other choice. As mentioned, Europe was the star performer (+2.8%) as its markets reacted to the fact that, just possibly, the highly indebted peripheral countries of the Eurozone were slowly lifting themselves out of their grossly over leveraged mire.

As expected, returns from Fixed Interest as a whole were universally disappointing with UK Index Linked returning a negative 2.6%.

During January the factors and events of a general nature to affect the course of stock markets were as follows:-

- Air freight rose 20% in 2010 which reflected a healthy level of underlying world trade.
- IATA reported that airline passenger traffic grew by 8.2% in 2010.
- In the 2 months to mid January the price of steel rose by more than one third. For 2010 world steel output rose by 15%, the biggest annual increase for 50 years.
- On 19th January iron ore prices hit an all time high.
- On 19th January, Brazil's central bank increased interest rates by ½% to 11 ¼% in order to cool inflation. This runs the risk of attracting even more hot foreign money into the country.
- The ousting of Tunisia's Zein Al Abidine Ben Ali caused a wildfire contagion effect in the other dynastically ruled countries, namely Egypt, Libya, Syria and the Yemen. People power demonstrating in the streets came to the fore to challenge the long entrenched tyrannical dictatorships. One of the direct results of these confrontations was a steep rise in the price of oil, which on 31st January, broke through $100 per barrel for the first time since October 2008. Some of the rise can be attributed to disruption in shipping traffic through the Suez Canal. Another damaging effect was a pronounced fall in emerging market equities.

However, to put this in perspective, Egypt at the core of the current unrest, represents just 0.5% of the MSCI Emerging Markets index.

As a matter of possible interest, in addition to the leadership turmoil in Tunisia, the state of the other dynasties elsewhere in the Middle East is as follows:-

- In Egypt, President Hosni Mubarak has ruled for 30 years with the presumption that his reign will be followed by his son Gamal.
- In Syria, the dictatorship mantel was passed by President Hatel Al Assad to his son Bashar in 2000.
- In the Yemen. Ali Abdullah Saleh has been president since 1978 and it is generally assumed that he will be succeeded by his son, Ahmed Saleh.
- In Libya, Muammer Gaddafi has ruled since 1969 with a likely successor in his son Saif Al-Islam.

There is absolutely no doubt that the Middle East region will be beset by turmoil for quite some time to come. That is to say, until democracy is seen to replace high spending dictatorships and until poverty and living conditions and education can be demonstrably improved. The most worrying aspect is clearly the future politics of Egypt and its relationship both with Israel and of course the United States. Only time will tell and quite an amount of time at that.

During January the principal events and macro economic data within the regions were as below:-

United Kingdom

- With regard to job creation, for the 6 months to January both permanent and temporary placements accelerated.
- The January Purchasing Managers' Index level rose to 62 (December59), the highest level since records began.
- The National Institute for Economic and Social Research estimates GDP for 2011 of 1.5% advancing to 1.8% in 2012. This represents an increase in the Institute's previous estimates of 1.6% and 2.0% respectively.
- Dividends from companies listed on the Stock Exchange are estimated to rise by 11.5% in 2011.
- The consumer confidence index for January experienced its steepest drop since 1992. Not at all surprising in view of the Government's rigorous application of its austerity measures.
- Mervyn King at the Bank of England warned that inflation could rise to 5.0% this year.
- There are signs that action by the Trade Unions could become more concerted.
- Disappointingly, the Office for National Statistics reported that GDP fell 0.5% in the final quarter of 2010 versus a consensus estimate for a rise of 0.5%. This result was blamed on adverse weather conditions with the UK services traditionally unable to cope yet again.
- New home sales for November and December grew by a heartening 17.5%.
- December CPI was worryingly high at 3.7% p.a. up from November's 3.3% p.a. necessitating yet another explanatory letter from Mervyn King to the Chancellor of the Exchequer, George Osborne.

- On 14th January BP instigated a share swop with the Russian state oil producer Rosneft. The rationale being that the two companies could explore the opportunities in the Russian territories and in the Arctic Ocean. Since this announcement there have been some serious challenges to this joint initiative.

USA

- The Bureau of Labor estimates that in January the US economy only created 36,000 jobs against an expectation of 146,000 new jobs. This poor showing was partly due to the country's extreme snowfalls.
- The January unemployment rate was 9.0% down from 9.4% in December.
- Demand for capital equipment has been growing sharply.
- The United Parcel Corporation reported a 48% jump in profits. This is a most welcome rise as this company is considered to be a reliable barometer of economic growth.
- The Institute of Supply Management's index for January increased to 60.8 (December 58.5). This compared with estimates of 58 and represented the strongest reading since May 2004.
- The Chicago Purchasing Managers' index for January grew to 68.8 from 66.8 in December.
- GDP for the fourth quarter of 2010 grew by 3.2% p.a.
- In December new home sales retreated at a rate of 7.6% p.a.
- The Commerce Department reported that housing starts fell 4.3% in December which is equivalent to an annualised drop of 8.2%.
- On 26th January the Federal Reserve Board left interest rates unchanged.

Europe

- Ireland's central bank estimates GDP growth for 2011 at 1.0% down from its estimate of 2.3% only last October. The Government's official estimate for 2011 is 1.7%.
- In Ireland the Green party left the ruling coalition, thus causing the embattled prime minister, Brian Cowen to resign. He also resigned as leader of his party Fianna Fail.
- There has been a heavy demand for the debut bond issue of the Eurozone bailout fund. The demand has come from respective central banks and large private investors.
- German inflation in January was 2.0%.
- Germany's construction sector output fell steeply in December by 24.1%, largely due to severe weather conditions. This was the biggest drop for 20 years. In turn this affected the nation's industrial production which fell 1.5% in December (November -0.6%).
- Germany's IFO Institute's business climate index rose to 110.3 in January (December 109.8).
- Germany's ZEW index of investor confidence soared to 15.4 in December from 4.3 in November.
- The German government estimates economic growth of "about 2 ¼%" for 2011.
- Germany's rate of GDP grew by 3.6% in 2010 (2009 -4.7%) mainly due to a strong rebound in investment spending.
- Turkey's central bank cut interest rates by ¼% to an historic low level of 6 ¼% in order to "deter speculative inflows".

- Belgium's central bank reported that its business confidence index increased to 4.5 in December (November 3.1).
- The French statistical agency INSEE stated that the manufacturing sentiment index for December advanced to 108 from 102 in November.
- On 13th January Jean-Claude Trichet made one of his typically Delphic statements saying "we are never pre-committed not to move interest rates". Quite an unhelpful statement for markets to absorb. Trichet also hinted that, after the surge in December inflation to 2.2%, the ECB had never ruled out an increase in interest rates. He added that inflation could rise further in February.
- There continues to be much jockeying for position with regard to a successor to Trichet head of the ECB whose term expires at the end of October 2011.

Japan

- On 28th January the rating agency Standard & Poors downgraded Japan's long term credit rating, suggesting that Japan does not appear to have "a coherent strategy to adequately address its debt burden".
- Japan pledged to buy 20% of the Eurozone's first bond issue by the European government's stability facility.

Asia

- On 13th January the Bank of Korea lifted interest rates by ¼% to 2 ¾% representing the third rise since July 2010. The Bank of Korea estimates that inflation could rise from the current 2.9% to 3.5%.
- There has been a marked increase in renminbi deposits in Hong Kong.
- In the fourth quarter of 2010 Chinese GDP grew by a substantial 9.8% and for the year as a whole it advanced 10.3%.
- Chinese CPI for December decreased to 4.6% from 5.1% in November. This compares with the Government's target of 3.0%.
- It is interesting to note that China has lent more money to other developing countries over the past 2 years than to the World Bank.
- The People's Bank of China allowed the currency daily lending reference point to strengthen the renminbi to RM6.6.
- China's housing boom continues to give cause for concern lest it develop into a property bubble.
- China has continued with its attempt to improve both its international reputation and its influence. If this means giving a panda to Edinburgh Zoo so be it! China continues to fine tune the delicate balance between export reliance and domestic consumption.

Conclusion

After the lacklustre returns of both equities and fixed interest for the month of January, whither the markets for the remainder of the year? The realistic answer has inevitably to be qualified with a number of ifs and buts. Taking all things into consideration it does seem that the equity markets in particular will be successful in regaining their poise and producing positive returns for the year as a whole. But for this to happen investors both UK and global will need to see the following items come to pass:-

- That earnings and dividends should continue to surprise on the upside.
- That respective central banks can be successful in containing inflation, particularly in the UK and the Asia/Pacific region, especially China. In that regard, much will depend on reducing the price of food and energy.
- That when central banks raise interest rates, particularly in the UK and the USA, they will be at a level which will not damage recovery rates of GDP growth which for some countries are expected to be somewhat fragile.
- That the current turmoil in the Middle East over leadership succession will abate and that friction with relationships with Israel can be avoided. This latter item seems most unlikely to happen in the near future.
- That Emerging Markets will recover from their current down draught particularly China. And that these emerging countries with their superlative economic growth rates will continue to outperform the economies of the industrialised developed countries.
- That the peripheral countries of the Eurozone will be able to grow their way out of their acute economic and deficit problems. This will take time.
- And finally that, world trade levels can be maintained at a robust level.

In short, the events and macro economic data since the writing of the quarterly report to 31st December 2010 have not materially changed the forecasts contained therein. That is to say, portfolios are advised to maintain a position of full investment in order to take advantage of the higher investment valuations expected by the end of 2011. How high? Not nearly as high as those achieved in 2010 as a whole, but hopefully in the higher single digit area i.e. a cautiously optimistic expectation. The returns from equities, property and most alternative classes will most likely outperform the returns from Fixed Interest, especially gilt edged and other sovereign debt. Indeed many investors are nervous about the Fixed Interest sector. The nervousness seems well justified. Particularly with regard to the outlook for traditional gilt stocks in view of the likelihood that, later in the year, both interest rates (courtesy of Mervyn King) and inflation will rise. This would obviously be detrimental to Gilts. ndex Linked Gilts, however, should provide a modicum of protection, but not to the same extent as in 2010.The best of Corporate Bonds has probably been seen, but with regard to their superior yields they are still worth holding. There should continue to be further corporate bond issuance (attractively priced to go) as corporations find it less expensive to raise cash in that way rather than to have possibly disruptive rights issues. In conclusion, a Fixed Interest portfolio should embrace globalisation (currencies will need to be hedged as appropriate). Also it is an undeniable fact that there is a need for Fixed Interest portfolios to be much more actively managed than heretofore with the use of a wider range of products.

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