Pension Fund Sub-Committee
29 June 2010

Report from the Director of Finance and Corporate Resources

Wards affected:
ALL

Monitoring report on fund activity for the quarter ended 31 March 2010

1. SUMMARY

This report provides a summary of fund activity during the quarter ended 31st March 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 and credit markets rose during the quarter. Economic growth is improving.

b) The Fund has grown in value from £431m to £455m, and has outperformed its benchmark over the quarter (1.1%) mainly as a result of outperformance in UK equities, fixed interest, GTAA and private equity. The Fund underperformed the average local authority fund (-1.4%), as a result of lower exposure to equities. Over one year, the Fund has underperformed its benchmark (-0.9%) mainly as a result of poor returns in private equity offset by good stock selection, and underperformed the average fund (-6.3%) as a result of lower exposure to equities / higher exposure to alternative assets.

2. RECOMMENDATIONS

Members are asked to note this report.

3 DETAIL

ECONOMIC AND MARKET BACKGROUND - QUARTER ENDED 31ST MARCH 2010

3.1 All equity markets, rose during the quarter following the end of the the recession. The UK rose by 5%, USA 5%, Germany 8%, HongKong 10% and Japan by 5%. The UK economic background was:

- UK base rates remained at 0.5%. Medium and long-term interest rates rose during the quarter. Credit markets had improved – LIBOR and LIBID had moved closer to bank rate, but concerns about Greece and other eurozone economies

have recently reversed this process. The Quantitative Easing programme in UK has been suspended at present.

- Headline inflation (RPI) rose by 5.1% in the year to May (2.4% December), and the Index of Consumer Prices (CPI) rose by 3.4% (2.9% December), as the reversal of the VAT reduction and rising fuel costs increased inflationary pressures. It is expected that inflation will fall in the second half of 2010 as spare capacity and low pay increases bear down on prices, but there are concerns about inflationary pressures.
- Average earnings growth (including bonuses) was 4.9% p.a. in February (1.9% November), above the Bank of England's 'danger level' (4.5%) as a result of bonus payments. Unemployment has risen to 2.51m, and may rise further as public expenditure is reduced and taxes raised.
- The UK economy has been in recession (GDP falling by 4.8% in 2009), but grew by 0.4% in Q4 2009 and 0.3% in Q1 2010. GDP is expected to grow by 1.5% in 2010 (and 1.5% / 2% in 2011).
- It has been anticipated that consumer spending will fall, though retail sales were up 1.8% in the year to April. The squeeze on incomes, and the decline in equity withdrawal from the housing market following price falls, may depress demand. However, house prices have risen by 10% over one year (Nationwide). Mortgage approvals are only 60% of their level two years ago, but have risen since 2009. Capital Economics still expects further house price falls (10%/15%).

In summary,the recession has ended but interest rates are expected to remain low. The government is using both fiscal and monetary policy to combat the downturn, but it is expected that fiscal policy will tighten. 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 may grow by 3% in 2010 (but only 1.5% in 2011) following tax cuts, interest rate cuts, and quantitative easing programmes. Improved payroll data, strong retail sales and a rebound in home construction indicate that a recovery is underway. It is anticipated that company earnings will also improve. It is expected that Eurozone GDP will grow by 1.5% in 2010, supported by strong growth in Germany. Growth in China and India will be around 10% and 8% respectively in 2010 – emerging market growth is strong and providing export growth to developed economes – and China has raised interest rates and tightened banks' reserve requirements. The world economy is expected to grow by 4% in 2010, but only expand by 2% 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 market movements and reductions in UK equity exposure / increases in overseas equity exposure.

Table 1: Asset Allocation as at 31st March 2010 compared to the Benchmark

Market (1)	Market Value 31.03.10 £M (2)	Market Value 31.03.10 % (3)	WM LA Average 31.03.10 % (4)	Fund Benchmark 31.03.10 % (5)	Market Value 31.12.09 £M (6)	Market Value 31.12.09 % (7)	WM LA Average 31.12.09 % (8)
Fixed Interest							
UK Gilts	14.9	3.3	10.1	4.5	15.7	3.6	10.2
Corp.Bonds	22.3	4.9	*	4.5	23.0	5.5	*
IL Gilts	-	-	4.4	-	-	-	5.3
Overseas	0.5	0.1	2.0	-	-	-	2.6
Emerg. Market	8.3	1.8	-	2.0	4.3	1.0	-
Infrastructure	0.8	0.2	-	-	0.7	0.2	-
Secured loans	8.6	1.9	-	2.0	17.4	4.0	-
Credit Opps.	11.5	2.5	-	2.5	13.1	3.0	-
Credit Alpha	11.1	2.4	-	2.5	7.9	1.8	-
Currency Fund	1.3	0.3					
Equities							
UK FTSE350	117.2	25.8	30.0	18.5	115.1	26.7	33.6
UK Smaller co's	15.4	3.4	*	4.0	15.2	3.5	*
Overseas	111.4	24.5	35.9	26.5	103.2	24.0	33.3
USA	55.9	12.3	10.8	-	45.8	11.1	9.3
Europe	22.1	4.9	9.3	-	28.5	6.2	9.0
Japan	7.7	1.7	3.8	-	4.7	1.1	3.8
Pacific	9.9	2.2	3.8	-	10.1	3.6	3.7
Other	15.8	3.4	6.1	-	14.1	1.9	6.1
Other							
Property – UK	20.5	4.5	6.1	8.0	19.2	4.4	5.6
Property – Eu.	6.8	1.5	*	*	6.8	1.6	*
Hedge funds	41.9	9.2	2.3	10.0	41.3	9.5	1.6
Private Equity	38.1	8.4	3.1	8.0	33.7	7.9	2.4
GTAA	11.5	2.5	1.2	4.0	10.5	2.4	*
Infrastructure	5.0	1.1	*	2.0	5.0	1.2	*
Cash	7.7	1.7	4.0	1.0	-1.0	-0.3	4.1
Total	**454.8**	**100.0**	**100.0**	**100.0**	**430.9**	**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. During the quarter, £1.8m was invested in private equity, £0.4m in infrastructure and £0.2m in UK property. It has been agreed that £0.75m should be returned from the fixed interest portfolio each month (until March), and £1.25m per month invested in global equities (until May 2010). Since the end of the quarter there has also been further investment in UK property (£1m) and private equity (£0.4m), and sales of UK equities (£2m). The Fund is currently overweight in UK equities and

underweight in overseas equities and property, but steps are being taken to correct these imbalances.

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 March 2010.

Table 2: Investment Returns in Individual Markets

Investment Category	RETURNS						Benchmark/ Index Description
	Quarter Ending 31.03.10			Year Ended 31.03.10			
	Fund %	Benchmark %	WM Local Auth %	Fund %	Benchmark %	WM Local Auth %	
UK Equities			6.6			51.9	
UK Equities	6.9	6.5		54.3	52.0		FTSE 350
UK Small Caps	1.7	1.8		62.3	68.7		FTSE Smallcap ex IT
Global Equities	4.9	5.8	9.1	47.2	48.7	49.8	FTSE World 75% Hedge
North America	11.3	7.3	11.9	36.7	47.7	42.9	FTSE USA
Europe	4.4	3.1	4.5	57.4	52.3	47.4	FTSE Eu Ex UK
UK	7.7	6.0	6.6			51.9	FTSE All Share
Japan	11.3	10.2	16.0	45.7	28.3	32.6	FTSE Japan
Pacific (ex Jap)	9.2	2.8	8.8	67.8	60.1	64.8	FTSE Pac. Ex Jap
Emerging	6.6	6.7	8.5	76.8	36.9	68.1	FTSE World (Other)
Fixed Interest							
Total Bonds	3.6	1.5	3.5	22.9	7.0	15.2	Brent benchmark
UK Bonds	0.1	0.2	3.4	0.8	-0.2	16.9	FTSE UK over 15 years
Index Linked UK	-	-	2.5	-	-	11.6	-
Corp Bonds	3.6	3.9	-	19.1	20.9	-	iBoxx Sterling Non-gilt
Secured Loans	6.3	0.9	-	52.9	4.0	-	3 month LIBOR +3%
Credit Opportunities fund	8.3	1.4	-	8.3	5.0	-	3 month LIBOR+5%
Other							
UK Property FOF	6.5	5.7	4.5	-	-	9.9	IPD Pooled index
Eu Property FOF	-0.6	1.9		-	-	-	IPD All properties
Hedge Funds	1.6	1.1	3.2	13.3	5.1	12.1	3 month LIBID+4%
Private equity	8.2	0.1	6.9	-11.8	1.2	-2.4	LIBID 7 Day
Infrastructure	1.2	1.1	-	-	-	-	3 Month LIBID +4%
GTAA	8.6	6.0	-	92.4	50.4	-	FTSE 100
Cash	-0.5	0.1	-0.1	n/a	2.4	2.0	GPB 7 DAY LIBID
Total	**4.9**	**3.8**	**6.3**	**28.9**	**29.8**	**35.2**	

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 were positive, outperforming the benchmark by 1.1%. The main stock selection factors were:-

a) Fixed interest. Once again there was outperformance in government and corporate bonds as the manager overweighted fast recovering corporate bonds. Secured loans and the Credit Opportunities Fund also recovered in improving credit markets. The manager has reweighted the fund to increase exposure to the Credit Opportunities, Emerging Markets and Credit Alpha

funds, to take profits in secured loans, to gain exposure to the currency fund, and to increase the weighting in the core fund.

b) Hedge fund of funds outperformed as equity related, macro, event driven and multiple strategies continued to be successful.

c) GTAA. The manager outperformed as three strategies (stock v bond, bond v bond and currency) added value. In particular, the overweight in equities, the short on Japanese bonds, and the longs on the Japanese yen and Australian dollar increased returns.

d) Global equities underperformed the benchmark as stock (financials) and currency selection lost value.

3.8 Over one year, the Fund underperformed the benchmark by 1.1%. Asset allocation – lower exposure to UK Small companies and overseas equities, higher exposure to bonds and cash (held to fund the Infrastructure mandate) - has been negative. Stock selection added value - private equity underperformed sharply, and global equities and UK small companies underperformed, but other stock selection was positive – UK equities, bonds, GTAA and hedge funds added value.

3.9 The relative underperformance of the Brent fund against the WM Local Authority average in Q4 (1.4%) arises as a result of

a) The asset allocation followed by the Brent Fund (lower exposure to equities / higher exposure to alternative assets)

b) Reduced returns in global equities, partly as a result of the currency hedge.

c) Offset in part by gains in stock selection and exposure to secured loans and credit.

3.10 The Brent fund has underperformed the average local authority fund by 6.3% 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. Relative performance has also suffered as a result of reduced returns in global equities.

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

3.11 There has been some purchases and sales during this quarter to invest dividends (£0.7m) improve tracking error, rebalance the Fund towards global equities, and invest in private equity.

<u>Purchases</u>

a) Took up rights issues.

<u>Sales</u>

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 (£5m).

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 April and May included selling stocks to fund increased exposure to global equities, property and private equity.

NEW DEVELOPMENTS AND FUTURE INVESTMENT OUTLOOK FOR THE BRENT FUND

3.13 Equity markets have fallen since the end of March following their strong rise earlier in the year and worries about Greece / the Euro area and the impact of fiscal tightening. UK gilts had lost value as markets anticipated rising interest rates to fund the government deficit and to control inflation, but the ‘flight to safety’ from the euro and equities have lifted prices. Furthermore, it is anticipated that growth may be slow, and that hopes of sharply rising profits may prove over optimistic.

3.14 The Department of Communities and Local Government (DCLG) has issued the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009. The main issues covered in the new regulations are:-

a) The pension fund will no longer be able to invest cash balances with the administering authority. Previously, pension fund cash balances were invested with Brent and a prescribed (7 day) interest rate was paid. Although the new regulation is administratively cumbersome because in-house pension fund balances are usually fairly low, a new deposit account has been set up for the Brent pension fund.

b) The administering authority is authorised to borrow for up to 90 days to cover cash flow purposes (payment of benefits or a transition management situation), though not for investment. In effect, this replaces the access to the funds of the administering authority previously enjoyed when cash balances were pooled.

c) An administering authority must include in its Statement of Investment Principles, information about its policy on the lending of stock or other assets. Brent does not currently lend stock.

d) The Statement of Investment Principles (SIP) must include details of compliance with revised guidance on the Myners’ Principles. The SIP must also be amended within six months of any substantial changes of policy.

3.15 One of the leading hedge fund managers at Gartmore was suspended following a breach of internal guidelines about trading counterparties. Although this will have no direct impact on the UK and Irish Small Companies Fund, the Gartmore Company share price dropped sharply, which will impact bonuses (paid in shares) and may open the company to further takeover activity. The ‘star’ manager has since been reinstated as an analyst, but he is being investigated by the FSA and the episode reveals tensons within Gartmore.

3.16 The Capital Fund for London has published its accounts for the year to 31st December 2009. Members will be aware that the Brent Fund committed up to £5m (currently £2.75m committed) to the private equity fund that invests in local small

and medium size enterprises (SMEs), and is underwritten for losses up to £15m by the Department for Trade and Industry. The current valuation of assets indicates that losses within the London Fund exceed £15m, so that Brent has a book loss of £538,000. The manager predicts that losses will be recovered over the long term, but progress is very slow in a volatile and difficult area.

3.17 Members will be aware that the value of the investment in the Henderson PFI Secondary II Fund (Infrastrcture Fund) has fallen sharply. The Fund management has held a conference to update investors on progress. The chairman and chief executive pointed to progress / plans in the following areas:-

a) Pension Fund – rising values, extra funding, increased exposure to bonds and steps to reduce risk should cap liabilities. The trustees are planning to close the fund to new accruals from 2011, and possibly to cap pension increases.

b) Increased value of the projects that are under way by lifting the cash yield received.

c) Built up capital to fund new projects / bids over the period to 2014. Before the takeover of Laings, the company undertook some £30m / £40m projects per annum. The target is £120m by 2010. Market research shows that the projects are available world-wide. Laings has an international presence and reputation, as well as a good record in converting bids to projects.

d) The Fund has taken steps to reduce costs in such areas as tax, staff and insurance.

Overall, prospects are more favourable and the value of the business has risen from the lows seen in 2009.

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

AllianceBernstein – March 2010 quarter report.
Henderson Investors – March 2010 quarter report

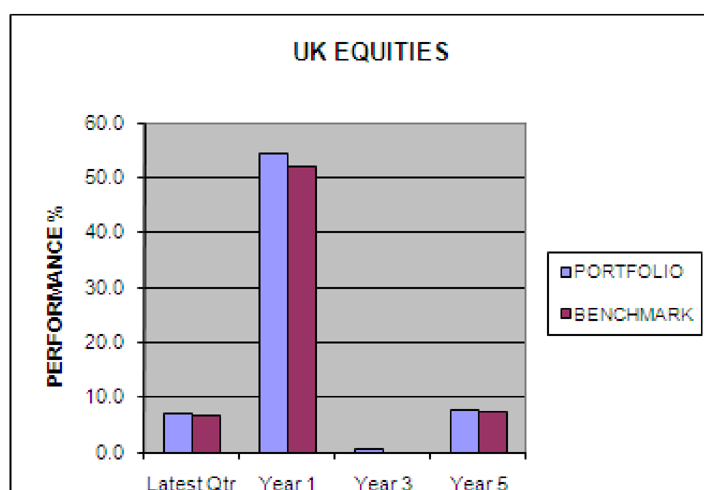
Persons wishing to discuss the above should contact the Exchequer and Investment Section, Finance and Corporate Resources, 020 8937 1472/1473 at Brent Town Hall.

DUNCAN McLEOD | **MARTIN SPRIGGS**
Director of Finance & CR | **Head of Exchequer and Investment**

PERFORMANCE FOR INDIVIDUAL PORTFOLIOS 31st March 2010

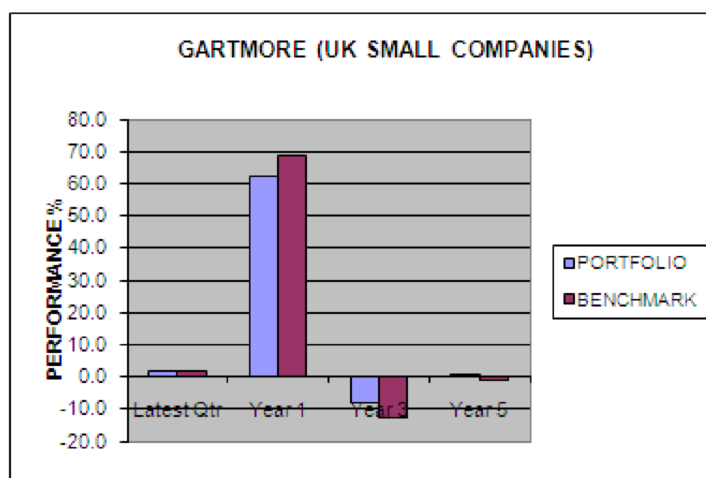
UK EQUITIES

	PORTFOLIO	BENCHMARK
Latest Qtr	6.9	6.5
Year 1	54.3	52.0
Year 3	0.4	0.0
Year 5	7.7	7.3



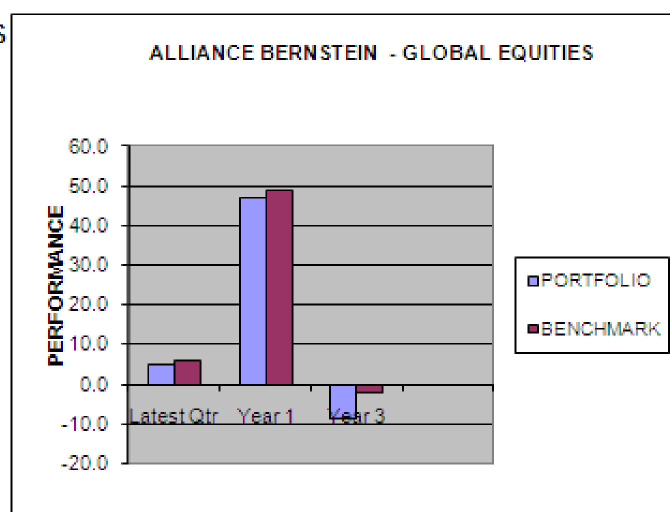
GARTMORE (UK SMALL COMPANIES)

	PORTFOLIO	BENCHMARK
Latest Qtr	1.7	1.8
Year 1	62.3	68.7
Year 3	-7.8	-12.8
Year 5	0.2	-1.2



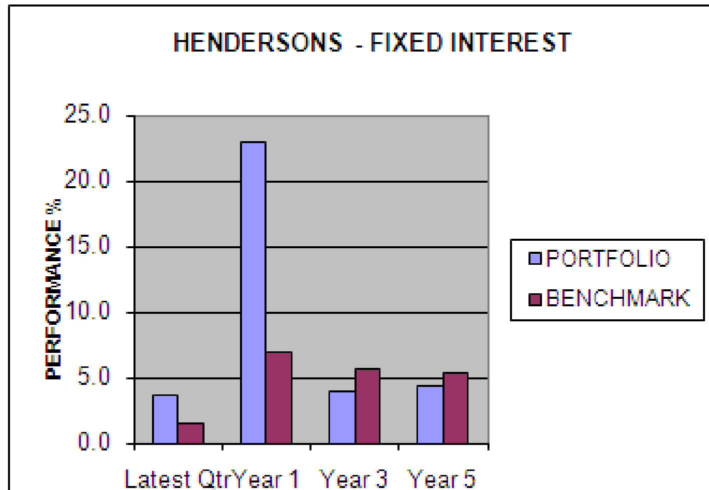
ALLIANCE BERNSTEIN - GLOBAL EQUITIES

	PORTFOLIO	BENCHMARK
Latest Qtr	5.0	5.8
Year 1	47.2	48.7
Year 3	-8.6	-2.3



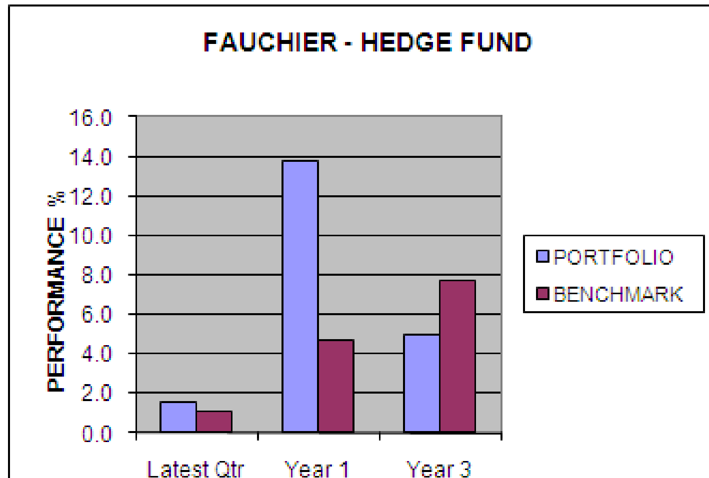
HENDERSONS - FIXED INTEREST

	PORTFOLIO	BENCHMARK
Latest Qtr	3.6	1.5
Year 1	22.9	7.0
Year 3	4.0	5.7
Year 5	4.4	5.4



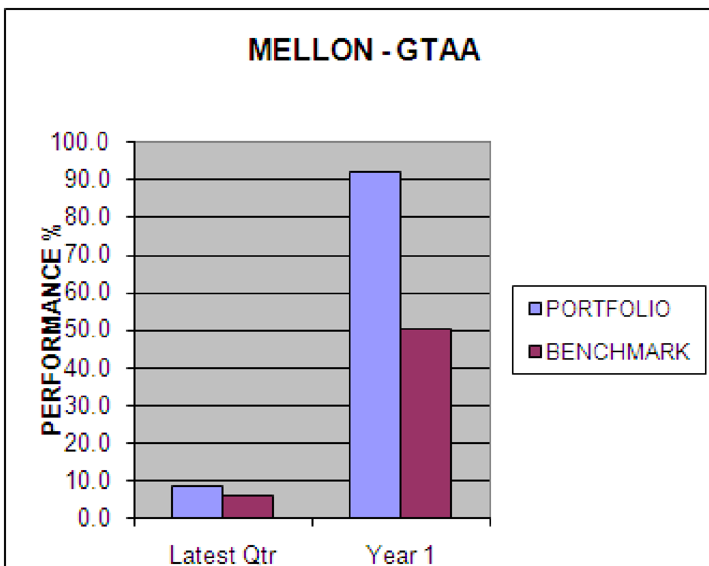
FAUCHIER - HEDGE FUND

	PORTFOLIO	BENCHMARK
Latest Qtr	1.6	1.1
Year 1	13.8	4.7
Year 3	5.0	7.7



MELLON - GTAA

	PORTFOLIO	BENCHMARK
Latest Qtr	8.6	6.0
Year 1	92.4	50.4



Report from the Independent Adviser

Investment Report for the Quarter ended 31st March 2010

Market Commentary

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

Index returns expressed in sterling

		Q/e 31/03/2010
		%
Equities		
Japan	FTSE Developed Japan	15.4
North America	FTSE North America	12.5
Asia/Pacific	FTSE Developed Asia Pacific (ex Japan)	9.8
Emerging Markets	MSCI Emerging Markets Free	9.1
UK	FTSE All Share	6.4
Europe	FTSE Developed Europe (ex UK)	3.9
Fixed Interest		
Corporate Bonds	Merrill Lynch Sterling – Non Gilts All Stocks	4.0
UK ILGs	FTSE British Government IL Over 5 years	2.0
UK Gilts	FTSE British Government All Stocks	1.1
Property	IPD	N/ a
Cash	Merrill Lynch LIBOR 3 Month	0.1

Currency Movements for quarter ended 31st March 2010

Currency	31st December 2009	31st March 2010	Change %
USD/GBP	1.615	1.517	-6.1
EUR/GBP	1.126	1.121	-0.4
USD/EUR	1.435	1.353	-5.7
Yen/USD	93.095	93.440	+0.4

Head of the leader board was Japan (+15.4%). Whilst this performance reflected an improvement in the country's economy it was to an extent a catch up move from the very poor relative return experienced in 2009 when fears over deflationary conditions were paramount. Next came the USA (+12.5%) reflecting a more encouraging economic outlook, especially with regard to the recovery in productivity. The 9.8% rise for Asia Pacific reflected the continuance of strong growth and export prospects across the region, particularly in China, as is so often the case. Emerging markets again put up a robust performance in returning 9.1%, thus building on the excellent returns from this area for last year. The FTSE all share index returned 6.4%, a very creditable achievement against a background of a high fiscal deficit together with political uncertainty ahead of a General Election. The laggard on the leader board was Europe returning 3.9% despite the financial problems of Greece which in turn fuelled concerns over other weak Eurozone countries namely Portugal, Ireland and Spain.

Within Fixed Interest, the clear first runner was corporate bonds which returned 4.0% due to the fact that it was one of the highest yielding sub sectors and not prone to sovereign debt problems. Investors also became less worried about the default risk in

corporate bonds. Index linked gilts returned 2.0% due to greater fears that inflation was likely to re-emerge. UK gilts returned a subdued 1.1%, largely due to their relatively lower yields within the Fixed Interest sector and also worries over the sovereign debt problems referred to above. Another market apprehension within the gilt market was the likelihood that sterling would continue to be a weak currency. LIBOR 3 month cash returned a minuscule 0.1%. Small wonder that investors were switching out of very low yield deposits into other higher yielding asset classes, particularly equities.

The currency exchange rate table highlights the weakness of sterling over the quarter, down 6.1% against the US dollar. This weakness reflects investor nervousness in holding a currency with one of the largest global fiscal deficits expressed as a percentage of GDP

As can be clearly seen from the returns table, the resilience of equity markets experienced in 2009 has continued into the first quarter of 2010 although all markets suffered a dose of realism in January with negative returns for that month. Such resilience for the quarter has stemmed from the fact that, in most equity markets, the underlying positive influences have far outweighed the negative influences. The principal positive influences which have driven markets are as follows:-

- The still substantial levels of liquidity held in historically very low yielding deposits which have driven investors both institutional and private to switch into safe haven high quality equities on more attractive yields with strongly financed balance sheets.
- Corporate earnings and dividends have been appreciably better than expected, often accompanied by relatively optimistic trading statements.
- Inflation rates have generally been contained.
- Central banks have continued to hold interest rates at extremely low historic levels to the obvious advantage of highly leveraged companies and consumers.
- The continuing radical measures and stimuli by governments and central banks to provide essential life blood liquidity to their respective financial systems.
- The rebuilding of corporate inventories at a greater pace than expected.
- An export boost, particularly to those countries with weak currencies.
- The expectation by the IMF that world trade will make a meaningful recovery in 2010.

The principal negative and corrosive influences have been the obvious ones. That is to say, very anaemic increases in economic growth, particularly in the case of the UK and Europe. And the dramatic ballooning of fiscal deficits which is also especially marked in the UK and currently stands at a massive £178B. Global politics have also played a part in the direction of respective equity markets and indeed other asset classes. These are highlighted below:-

<u>In the UK</u>

Such is the preoccupation of the three main political parties ahead of the General Election on 6th May, that any major legislation will necessarily be postponed. It goes without saying that, whichever party is elected, it will face the mammoth task of reducing the gargantuan fiscal deficit. Then expect acute cutting of public costs and severe

taxation increases. In reality this process could grind on for at least 3 to 4 years. Of great concern to stock markets is the possibility of a hung parliament which could result in a weak political mandate with which to address all the country's current problems. In the meantime the Government and the Bank of England are grappling with a programme to dismantle the emergency measures created during the financial crisis not the least of which is the exit from quantitative easing (printing money) which runs the risk of re-igniting inflation.

In the USA, President Obama, after a rocky start, struggled to enact the promises for change he so eloquently extolled at the hustings. However, he has since done well, under stiff opposition from the Republican Party, to wrestle through Congress the very emotive Health Reform Bill. This is indeed a feather in his cap and has considerably enhanced his presidential status both within the USA and also on the world stage.
In Europe,the acute indebtedness of Greece has posed a problem. Angela Merkel of Germany and Nicolas Sarkozy of France would have liked to effect a totally Eurozone rescue plan to the apprehension of Trichet, head of the European Central Bank. In the event, the solution has been a joint support programme by the International Monetary Fund and the Eurozone. This should serve to protect the current Eurozone structure with its single currency.
In Japan, the newly elected Democratic Party have made a slow and disappointing start to extracting the economy from the mire of 10 years of deflation. A much more powerful economic policy needs to be urgently enacted.
In Asia, many countries have produced worthwhile rates of GDP growth together with increasing levels of exports in strict contrast to most of the economies of their Western Hemisphere counterparts. In particular, the Politburo of China together with the Peoples Bank of China have combined to flex their mighty international muscle in many ways:- effecting deals with some of the world's largest mineral and other extractive companies in order to secure adequate future supplies for their steel, oil and gas industries and of course for increasing the future supply of water in a nation where current levels are very low. There are also signs that China is at last starting to respond to international calls for a fairer system of managing its currency, the renminbi. Indeed, high level meetings are currently taking place between the USA and China in that regard.

Regional Influences

UK

Positive Influences

- In the fourth quarter of 2009 the Office for National Statistics revised up its GDP growth estimate to 0.4% from its original estimate of 0.1%.
- In the Budget the government estimated GDP growth of 1% to 1 ½% in 2010 rising to 3% to 3 ½% in 2011.
- CPI inflation in February fell to 3.0% from 3.1% in January.
- Dividend payouts to shareholders are estimated to rise by 18% for the FTSE 100 companies.
- The Office for National Statistics reported that the trade deficit in February was £6.2B down from £8.1B in January. This was below the consensus estimate of £7.3B and the smallest deficit since June 2006.

- Remarkably the Organisation for Economic Co-operation and Development predicts that in the first half of 2010, the UK will have the fastest rate of economic expansion of any of the World's large industrialised countries. The UK "Think Tank" forecasts that output will increase by 2.0% in the first quarter of 2010 and by 3.1% in the second quarter of 2010.
- Ernst & Young say that corporate profit warnings dropped to a 10 year low in the first quarter of 2010.

Negative Influences

- In the Budget public spending is estimated to be £167B in 2010 which is £11B less than the estimate made in December. The government estimates that the deficit will fall to £163B in 2011 and to £74B in 2014/15.
- In the fourth quarter of 2009, whilst public sector employment rose 7,000, private sector employment fell 61,000.
- Bankruptcies are at an all time high.

US

Positive Influences

- The Labour Department reported that new claims for jobless benefits fell by 14,000 to 442,000 for the week ending 19th March. This was the lowest level since December 2008. In March 162,000 new jobs were created, the best performance for 3 years. The unemployment rate remained unchanged at 9.7%.
- Larry Summers, the senior economic adviser to Obama, stated "there is the sense that the country's long term problems – healthcare, energy, education and long run fiscal deficits are being addressed. All of these should increase a generalised sense of confidence and, this will be a source of stimulus to the economy".
- The Conference Board's consumer confidence index for March showed a strong increase for March to 52.5 from 46.4 in February.
- The US Institute for Supply Management's manufacturing index for March grew to 59.6 (February 56.5). This is the highest level since July 2004 and is in part due to a rebound in inventories.
- On 16th March the Federal Reserve Board kept its interest rate on hold saying economic conditions were likely to warrant "exceptionally low" interest rates for an extended period". Inflation is likely to remain subdued "for sometime".
- The Commerce Department stated that consumer spending in February grew by 0.3% (January +0.4%), its fifth consecutive monthly rise.

Negative Influences

- Although February new orders for durable goods advanced 0.5% this was below consensus estimates of 1.0%.
- Sales of new houses fell to 308,000 in February, the lowest level since records began in 1963.

- The National Association of Realtors reported that sales of existing houses in February decreased by 0.6%, the third consecutive monthly drop, but nevertheless an increase of 7.0% on an annualised basis.
- The Labour Department reported that the February producer price index dropped 0.6% which was worse than expected, but 4.4% higher for the year.
- The Commerce Department reduced its estimate of GDP for the fourth quarter of 2009 from 5.9% to 5.6%.
- February housing starts fell by 5.9% partly blamed on severe winter storms.

Europe

Positive Influences

- The Eurozone corporate purchasing managers' index (includes both manufacturing and services) advanced in March to 55.9 (February 53.7), its eighth consecutive month of growth and the fastest rate since August 2007.
- The European Commission reported that industrial production in the Eurozone rose 0.9% in February which was faster than expected.

Negative Influences

- Irish GDP shrank by 2.3% in the fourth quarter of 2009 partly due to devastating floods there.
- The leading rating agency Fitch downgraded Portugal's credit rating to AA- from AA stating "significant budgeting under performance in 2009" and "the structured weakness in the country's economy".
- In France the mid term election results augured particularly badly for Nicolas Sarkozy's UMP party which was trounced by the socialists.
- On 31st March Moody's, the rating agency, downgraded 5 leading Greek banks. Indeed, Greek banks have had to seek more aid as savers have withdrawn deposits due to the obvious threat over a further escalation of the current debt crisis.
- Eurostat reported that, in the fourth quarter of 2009, GDP was unchanged due in part to the phasing out of the government's emergency measures within the financial system.

During the quarter there was, unusually, a distinct paucity of macro economic data from both the Asia/Pacific region and also Japan. The principal influences are shown below:-

Asia/Pacific

Positive Influences

- China's rate of GDP surged a remarkable 11.9% in the first quarter of 2010.
- The World Bank predicts that the Chinese economy will expand by 9.5% in 2010. This represents an increase on their previous estimate of 8.7%.
- There was a surge in merger and acquisition activity in Asia.
- Singapore's GDP in the first quarter of 2010 was extremely strong and rose +13.1%.

Japan

Negative Influence

- February machine orders fell by a marked 5.4%

Conclusion

So, in conclusion, what is the principal combination of factors needed for equity returns to make further meaningful progress between now and the end of 2010 and to build on the surprisingly robust returns already achieved in the first quarter of the year? The answer is that the required factors are very much the same as those that have been needed for quite some time. They are as follows:-

- Evidence that the crisis in the international banking system is largely overcome with no further major incidents or casualties.
- That governments and central banks will be able to successfully exit from the plethora of stimuli, rescue programmes and emergency measures that they applied in 2008 and 2009; particularly with regard to quantitative easing. In exiting it will be important to ensure that the respective financial systems continue to remain adequately hydrated.
- That the main industrialised nations are able to demonstrate that their economies are healing and once again showing worthwhile underlying rates of GDP growth. In other words that these countries are climbing out of their respective recessionary conditions and thereby decreasing the oft mentioned fear that economies might relapse into double dip recessions.
- Whilst it is becoming generally accepted that, later in 2010 interest rates will have to rise, it is vital that this will not impact or snuff out a return to economic growth which in certain cases could be somewhat anaemic.
- That corporations will continue to improve productivity, rebuild inventories, strengthen their balance sheets and provide consistently rising earnings and dividends.
- That investors, both institutional and private, will continue to regain their confidence and feel good factor and make further switches out of cash into still attractive high yielding equities.
- That inflation remains under control. In that regard the finite reserves of minerals, oil and gas are concerning. OPEC estimates that the price of oil could average $80 a barrel between now and the year end. It is, of course, inevitable that inflation will pick up as economies recover.
- That fiscal deficits will be seen to reduce, especially in the UK and USA. It will also be important that, within the Eurozone, the “intensive care” economies of Greece, Ireland, Portugal and Spain are kept closely under the monitoring radar. In the case of the UK, were it to lose its triple A credit rating, then there would be acute difficulty with future gilt auctions and sterling would most surely endure further suffering. It is a current worry that, at this time in the UK, there does not appear to be a creditable policy to reduce its bloated level of structured debt.
- That there will be a distinct improvement in consumer morale due in part to an increase in employment levels together with better job security.

- It is desirable that merger and acquisition activity picks up to include IPOs (initial public offerings).
- That there is evidence that World trade is making a genuine recovery.
- That in the UK it is imperative that further globalisation takes place. However, in that regard, let it not be forgotten that Britain has very substantial international investments with almost half of the FTSE 100 company earnings coming from overseas. Not to mention their ownership of very substantial global assets.

If most of the prerequisites contained in the above wish list come to pass, and it is a big "if", then these favourable factors should be reflected in improved equity levels, particularly in emerging markets, but nothing like to the same extent as the returns achieved in 2009. In sum and at best, equity returns for the year as a whole could be in the mid to high single digit area. But, because of the strong returns already achieved in the first quarter of 2010, the implication is that the best of respective returns have already been seen for the year with quieter markets to be expected between now and the year end. Financially secure corporate balance sheets and rising earnings levels will be at a premium. Stocks with these attributes will continue to provide a sanctuary for investors, particularly those with relatively high yields. This applies to stocks both within the UK and globally. As always, foreign exchange rates will have to be most carefully watched. Particularly sterling which has been one of the worst casualties of the World recession.

With regard to other asset classes:

- Fixed Interest returns will probably be somewhat flat, particularly with regard to sovereign debt, especially UK gilts which are still under the cloud of a possible downgrade by the rating authorities. Index linked stocks could make further progress as they offer a protection against inflation which is generally expected to increase. Corporate bonds could also make further advances, but only to a small extent after their strong returns in 2009.
- Property should continue with its gradual recovery from its most severe down cycle. There are certainly strong signs of investor interest returning to the sector to take advantage of many attractive valuations; even with regard to large trophy offices.
- Private Equity stands likely to benefit due to a greater availability of liquidity and also a distinct improvement in the IPO market. The secondary market in private equity pooled funds has current attractive offerings as it is a way of circumventing the "j" curve effect.
- Hedge Fund of Funds should continue to take advantage of current attractive opportunities. They should also continue to prove their worth as a form of portfolio insurance which is normally uncorrelated to other asset classes.
- Global Tactical Asset Allocation (GTAA) should find better opportunities than in 2009 and should benefit from lower market volatility. Also currency positioning should prove a better source of profits than in the past.
- Infrastructure should be able to further enhance its attraction as an asset class due to the many good value investments that abound, especially in the USA and China whose economies are both so dependent on an efficient national infrastructure. This continues to be an excellent long term asset class for a pension fund.

On the economic front it should be re-emphasised that strong rates of GDP growth are continuing to be achieved in China, India and Brazil. It is significant that, over the last decade, the stock markets of those countries, including Russia have outperformed the traditional industrialised countries' stock markets by an extremely substantial amount. Is this a pointer for the future? Emphatically yes. In the longer term globalisation in all asset classes should prove beneficial to pension fund performances.

Valentine Furniss FCSI
15th April 2010

Investment Report for the month of April 2010

April proved to be a truly eventful month both in the UK and globally. The main features and investment influences were as follows:-

- Within the UK there has been a fascination regarding the forthcoming General Election. The most obvious apprehension being the possibility of a hung parliament at a time when essential legislation needs to be speedily enacted.
- Another concern has been the BP oil spillage in the Gulf of Mexico and the affect that it is likely to have both on the company itself and also on the price of oil.
- Within the US, Barack Obama has an increasingly successful programme in bringing to account those financial institutions found to be the main culprits behind the sub prime financial disgrace. More recently, even Goldman Sachs have been pilloried by the Senate committee in an attempt to establish their exact role at the time of the financial crisis.There is little doubt that the Senate will give its closest attention to the last leg of the Financial Regulation Bill.
- In Europe there has been close attention to the day to day events within the hugely indebted country of Greece. The greatest concerns being amongst the substantial holders of Greek bonds within the European banking system and also those that fear that Greece might infect some of the other weak Eurozone nations like Portugal, Spain and Ireland. Although the current situation with regard to Greece is understandably dire, it is in all Eurozone governments' and central banks' interests to keep Europe intact and not to severely set back the integration process which has been going on for some 50 years. It will be a very great challenge for George Papandreou, the Greek Prime Minister, in the near future, to impose the very austere measures that his country so urgently needs without being impeded by public outrage.
- As if the above concerns were not enough the Icelandic volcano Eyjafjallajőkull chose to cover a substantial part of the UK and Europe with a large amount of ash, thus causing airlines much disruption and lost revenues.

Index returns expressed in sterling for the month of April 2010

		Month ended 30/04/10
		%
Equities		
North America	FTSE North America	0.6
Asia/Pacific	FTSE Developed Asia Pacific (ex Japan)	0.6
Emerging Markets	MSCI Emerging Markets Free	0.3
Japan	FTSE Developed Japan	-1.0
UK	FTSE All Share	-1.4
Europe	FTSE Developed Europe (ex UK)	-4.1
Fixed Interest		
Corporate Bonds	Merrill Lynch Sterling – Non Gilts All Stocks	0.9
UK Gilts	FTSE British Government All Stocks	0.7
UK ILGs	FTSE British Government IL Over 5 years	0.1
Property	IPD	N/a
Cash	Merrill Lynch LIBOR 3 Month	0.1

Currency Movements for month ended 30th April 2010

Currency	31stMarch 2010	30th April 2010	Change %
USD/GBP	1.517	1.531	0.9
EUR/GBP	1.121	1.151	2.7
USD/EUR	1.353	1.330	-1.7
Yen/USD	93.440	94.010	0.6

The above table shows that equities experienced flat to negative returns for the month. The lowest return was a negative 4.1% from Europe, a clear reflection of the mounting investor concern over the escalation of Greece's debt problem. The negative 1.4% return from the UK was scarcely surprising in the nervous run up to the General Election and the widely held view that the result might be a hung parliament. Within Fixed Interest the returns on both corporate bonds (+0.9%) and UK gilts (+0.7%) held up well against the generally adverse background that prevailed. However, the microscopic 0.1% return on UK index linked gilts was disappointing and seemed to indicate that investors are expecting inflation to decrease – a somewhat brave assumption.

During April the principal events and macro economic data within the regions were:-

UK

- The rate of GDP in the first quarter of 2010 grew by a weak 0.2%.
- The public sector borrowing requirement for the fiscal year 2009/2010 was revised down to £163.4B which is still a post war record low level.
- March inflation rose to 3.4% from 3.0% in February.
- In February the unemployment rate increased to 8.0%, the highest level for nearly 16 years.

USA

- The Conference Board's index of leading indicators (a gauge of the likely performance of the US economy over the next 3 to 6 months) rose by 1.4% in February, its twelfth successive advance.
- On 14th April, in a testimony before Congress, Bernanke of the FED stated "it looks like we are on the path to moderate recovery and that the risk of a double dip recession, whilst certainly not negligible, is less than it was a few months ago".
- On 16th April the Securities and Exchange Commission (SEC) charged Goldman Sachs the well known investment bank with fraud related to sub prime mortgages. The charge is all to do with the structured credit business and the use of synthetic collateral debt obligations.
- On 29th April the Federal Reserve Board left interest rates unchanged and pledged "to keep interest rates low for an extended period". By comparison, although the Bank of Canada also held its rate at the record low level of ¼%, it signalled that a rate rise was imminent and stated that the bank " would begin to lessen the degree of monetary stimulus".

Europe

- The Bank for International Settlements estimates that European banks have some $189B of exposure to Greece.
- On 22nd April the European Commission calculated that the Greek budget deficit represented 13.6% of the 2009 GDP. This compares with the Greek government's own projection of 12.7%.
- On 27th April, the rating agency Standard & Poors downgraded Greek debt to junk status and the next day downgraded Spanish debt to AA from AA+.
- At one stage the yield on 2 year Greek government bonds rose to 13.5%, the highest yield on short dated government bonds anywhere in the world.
- The dividends from European banks are running at their lowest level on record as they strive to conserve earnings in order to boost capital.
- Eurozone finance ministers and the International Monetary Fund approved a €110B package of emergency loans (split €80B Eurozone and €30B IMF), aimed at averting a sovereign default by Greece. In return Greece is expected to reduce its budget deficit of 13.6% of GDP to below 3.0% by 2014.

Japan

- On 22nd April the Fitch rating agency warned that Japan's sovereign debt rating is at risk unless the government can introduce a plan to lower the national debt levels.
- There is considerable concern over the Bank of Japan's inflation target with which to combat the nation's inherent deflation problem.

Asia/Pacific

- China's central bank, for the third time this year, is to raise the amount that banks must hold in reserve. This is a measure designed to cool down the booming economy.

- There is still considerable controversy over the Chinese government's foreign exchange rate policy. There is the continuing suspicion that China keeps it currency low in order to boost the country's exports.
- In India wholesale prices for March rose by 9.9% p.a.
- On 6th April, the Reserve Bank of Australia increased its interest rate by ¼% to 4 ¼%. The bank estimates that GDP for 2010 will be between 3 ¼% and 3 ½% with inflation close to its 2.0% to 3.0% target range. The bank also stated that interest rates "would probably need to rise further in the period ahead".
- On 21st April the Reserve Bank of India increased interest rates by ¼%.

Conclusion

In sum, there is very little to add to the principal conclusions reached in the investment report for the quarter ended 31st March 2010. That is to say "at best equity returns for the year as a whole could be in the mid to high single digit area. But, because of the strong equity returns already achieved in the first quarter of 2010, the implication is that the best of respective returns have already been seen for the year with quieter markets to be expected between now and the year end". Prospects for other asset classes remain broadly unchanged. Very soon in the UK we shall know the political colour of the General Election and will learn, for the first time, the proposed measures and timetable for curing the country's ills not the least of which will be the UK's massive fiscal deficit. Most certainly the citizens of this country will necessarily have to suffer an austerity programme with a capital A lasting several years. It will be interesting to assess whether the current level of the stock market has sufficiently discounted this harsh reality. On the currency front it seems reasonable to suggest that both Sterling and the Euro seem likely to weaken against the US$ between now and the year end with the General Election aftermath affecting the former and the indebtedness of the weaker Eurozone economies affecting the latter.

Valentine Furniss FCSI
6th May 2010