BRENT COUNCIL	**Pension Fund Sub Committee** **25 September 2012** **Report from the Director of Finance and Corporate Services**
For Action	Wards Affected: ALL
Report Title:	**Monitoring report on fund activity for the quarter ended 30 June 2012**

1. SUMMARY

This report provides a summary of fund activity during the quarter ended 30 June 2012. 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 fell in the second quarter, and government bonds rose in value amid concerns over an uncertain economic outlook and the Euro debt crisis.

b) Whilst the Fund has fallen in value from £485m to £478m, the fund return of -1.2% was broadly in line with its quarterly benchmark of -1.1%. The marginal underperformance can be attributed to poor results in emerging market equities, UK smaller companies equities, and hedge fund of funds.

c) It should be noted that the fund return of -1.2% represents an outperformance when compared to the WM Local Authority average fund return of -1.9% for the quarter, as a result of Brent's asset allocation with its relatively low exposure to equities and high exposure to alternatives. This has provided a greater degree of diversification which has protected the fund from the fall in equities. Indeed, Brent was within the top quartile of investment returns for the quarter ended 30 June 2012 with a ranking of 16 out of 82 LGPS funds who currently subscribe to the WM performance reporting service.

2. RECOMMENDATION

2.1 Members are asked to note the investment report.

3. DETAIL

Economic and Market Background – Quarter ended 30 June 2012

3.1 Equity markets retreated in the second quarter of 2012; they fell sharply in May but recovered some of their losses in June. North America faired best with a return of -1.4% while the UK fell 2.6%. The Asia Pacific markets fell by 4.4% with Europe down 3.2% and the emerging markets falling by 7.1%.

3.2 Events in the Eurozone continued to be the main driver of general market sentiment. In May, Greek and French elections unsettled the markets but they rallied in June as a second Greek election resulted in a pro-euro coalition. Further support came from a successful European summit late in June that helped Spain's troubled banking system, as a result of which it was agreed to accelerate moves to a single supervisor for euro-zone banks and allowed the use of the permanent rescue fund to directly re-capitalise struggling banks.

3.3 Economic data remained weak with slowdowns in the US and China, and the UK tipped back into recession along with Italy and Spain. Across the industrial sectors, the largest declines were in the export, commodity and financial stocks, whilst defensive areas such as utilities and telecoms held up well.

3.4 Quality government bonds were again a safe haven for many investors so yields fell even further; the UK Gilts All Stocks, for example, returned just under 4% for the quarter. Less secure issuers such Spain and Italy saw their yields spike at over 7% and 6% respectively before falling back below these levels towards the end of the quarter.

3.5 Sterling weakened by nearly 2% against the US Dollar but it appreciated by 3% against the Euro.

3.6 An investment update for the month of July 2012, written by the Independent Adviser, is attached.

Asset allocation of the Fund

3.7 The WM Local Authority average asset analysis for the quarter ended 30 June 2012 shows increased allocations into the following asset classes:

Asset class	Increase in percentage allocation
Diversified growth funds	+0.9%
Private equity	+0.7%
Hedge funds	+0.6%
Property	+0.4%
Infrastructure	+0.3%
Bonds	+0.3%

3.8 Those asset classes out of favour with the WM Local Authority average during the quarter are shown as follows:

Asset class	Reduction in percentage allocation
UK equities	-2.1%
Overseas equities	-0.8%
Cash	-0.3%

3.9 Table 1 on the next page 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 within the relevant asset class.

Table 1: Asset Allocation as at 30 June 2012 compared to the Benchmark

Market (1)	Market Value 30.06.12 £M (2)	Market Value 30.06.12 % (3)	WM LA Average 30.06.12 % (4)	Fund Benchmark 30.06.12 % (5)	Market Value 31.03.12 £M (6)	Market Value 31.03.12 % (7)	WM LA Average 31.03.12 % (8)
Fixed Interest Bonds							
Henderson – Total Return Bond Fund	77.1	16.1	18.4	15.0	75.9	15.6	18.1
Equities							
UK – in-house managed	65.1	13.6	24.9	13.0	86.5	17.8	27.0
UK - Small Companies Henderson	16.1	3.4	*	4.0	16.0	3.3	*
O/seas – developed Legal & General	102.1	21.4	36.4	19.0	118.0	24.3	37.2
O/seas – emerging Dimensional	28.4	5.9	*	8.0	31.0	6.4	*
Property							
Aviva	34.2	7.2	7.4	8.0	34.5	7.1	7.0
Private Equity							
Capital Dynamics	63.8	13.4	4.6	10.0	60.9	12.6	3.9
Hedge Funds							
Fauchier	39.5	8.3	2.4	10.0	40.4	8.3	1.8
Infrastructure							
Alinda	15.7	3.3	1.3	6.0	15.5	3.2	1.0
Henderson PFI Fund II	1.1	0.2	*		1.1	0.2	*
Pooled Multi Asset							
Baillie Gifford DGF	27.2	5.7	1.1	6.0	0.0	0.0	0.2
Cash	7.2	1.5	3.5	1.0	5.6	1.2	3.8
Total	**477.5**	**100.0**	**100.0**	**100.0**	**485.4**	**100.0**	**100.0**

3.10 The main investment changes to the Brent Fund have occurred as a result of:

a) market movements;
b) transfer of the UK equities portfolio from in-house to Legal & General;
c) the bond portfolio managed by Henderson was restructured at the end of March 2012 to invest purely in the Total Return Bond Fund; and
d) funds were transferred from equities to the Baillie Gifford Diversified Growth Fund in June 2012.

Performance of the Fund

3.11 The independent WM Company measures the returns on the Brent Pension Fund. Table 2 sets out returns for the quarter to 30 June 2012.

Table 2: Investment Returns in Individual Markets

Investment Category	RETURNS						Benchmark/ Index Description
	Quarter Ending 30.06.12			Year Ended 30.06.12			
	Fund %	Benchmark %	WM Local Auth %	Fund %	Benchmark %	WM Local Auth %	
Fixed Interest Bonds							
Total Return Bond Fund Henderson	1.6	1.5	2.0	6.9	6.0	11.9	Absolute return 6% p.a.
Equities							
UK – in-house managed	-2.1	-2.6	-2.7	-4.0	-3.0	-2.7	FTSE 350
UK - Small Companies Henderson	-6.4	-4.1	-	-9.9	-6.4	-	FTSE Small Cap
O/seas – developed Legal & General	-3.2	-3.2	-4.3	-3.6	-3.5	-6.8	FTSE Dev World ex UK
O/seas – emerging Dimensional	-8.6	-7.1	-6.6	-20.9	-13.7	-12.2	MSCI Emerging Markets
Property							
Aviva	0.0	0.7	0.2	0.4	5.6	3.7	IPD All Properties Index
Private Equity							
Capital Dynamics	5.0	2.5	2.1	-0.3	10.0	3.0	Absolute return 10% p.a.
Hedge Funds							
Fauchier	-2.3	1.2	-0.8	-5.2	4.9	-1.0	3 month LIBID + 4%
Infrastructure							
Alinda	2.9	2.5	-2.1	4.3	10.0	-3.2	Absolute return 10% p.a.
Cash	0.1	0.1	0.7	0.5	0.5	1.1	GBP 7-day LIBID
Total	**-1.2**	**-1.1**	**-1.9**	**-3.0**	**0.9**	**-0.9**	

3.12 The fund's overall return of -1.2% was broadly in line with its quarterly benchmark of -1.1%. The marginal underperformance can be attributed to poor stock selection in emerging market equities, UK smaller companies equities, and hedge funds. Positive contributions were made during the quarter in respect of private equity, infrastructure, and bonds.

3.13 Over one year, the Fund return of -3.0% when compared to its benchmark of 0.9% equated to a net underperformance of -3.9%. Whilst equities in general were down, the emerging markets portfolio showed a particularly poor return of -20.9%. The hedge fund investment also continued to disappoint with an annual return of -5.2%. The Brent fund's return of -3.0% has also underperformed when compared to the WM Local Authority average fund return of -0.9%, mainly because of the underperformance in emerging markets and hedge funds.

Indicative performance of the Fund since June 2012

3.14 Following a disappointing quarter ended 30 June 2012, the Fund has since recovered some ground with its value increasing by an estimated £3.4m:

	30 July 2012 £M	**30 June 2012 £M**	**Movement**
Fixed Interest Bonds			
Henderson	78.3	77.1	↑
Equities			
UK - Legal & General	67.3	65.1	↑
UK - Small Companies Henderson	16.6	16.1	↑
O/seas – developed Legal & General	104.4	102.1	↑
O/seas – emerging markets Dimensional	28.2	28.4	↓
Property			
Aviva	33.8	34.2	↓
Private Equity			
Capital Dynamics	64.0	63.8	↑
Hedge Funds			
Fauchier	39.6	39.5	↑
Infrastructure			
Alinda	15.7	15.7	=
Henderson PFI Fund II	1.1	1.1	=
Pooled Multi Asset			
Baillie Gifford DGF	27.3	27.2	↑
Cash	4.6	7.2	↓
Total	**480.9**	**477.5**	↑

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 – June 2012 quarter report
Legal & General – June 2012 quarter report
Fauchier Partners – June 2012 quarter report
Dimensional Asset Management – June 2012 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.

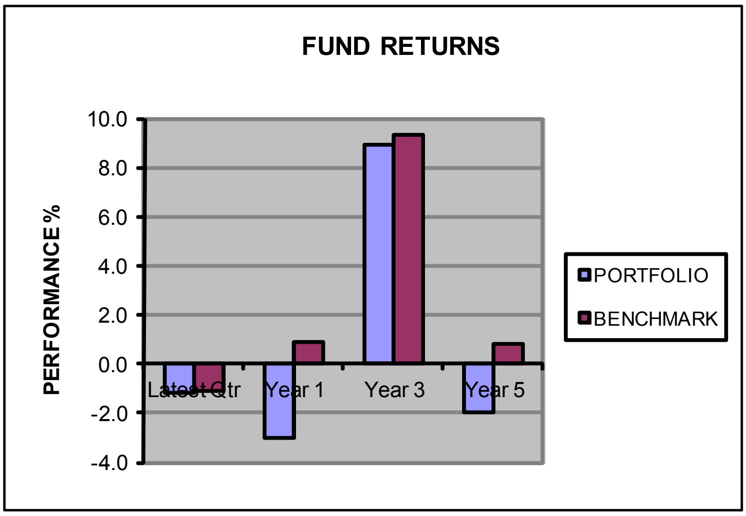
CLIVE HEAPHY
Director of Finance & CS

ANTHONY DODRIDGE
Head of Exchequer and Investment

TABLE 3: PERFORMANCE FOR INDIVIDUAL PORTFOLIOS 30th June 2012

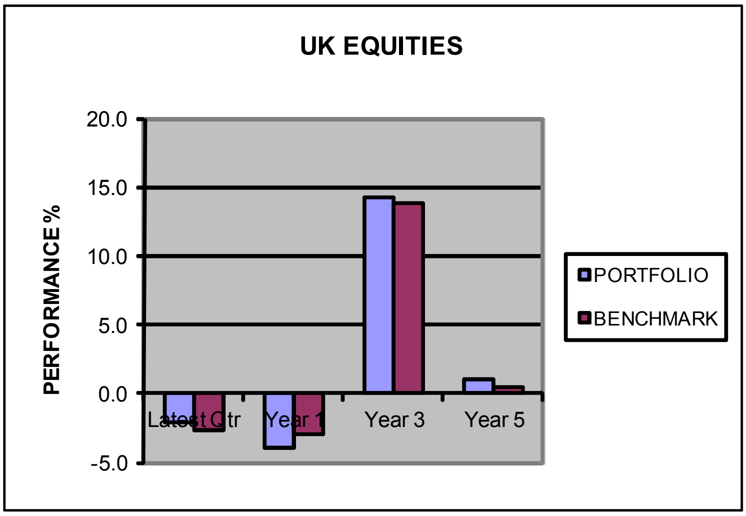
FUND RETURNS

	PORTFOLIO	BENCHMARK
Latest Qtr	-1.2	-1.1
Year 1	-3.0	0.9
Year 3	8.9	9.3
Year 5	-2.0	0.8



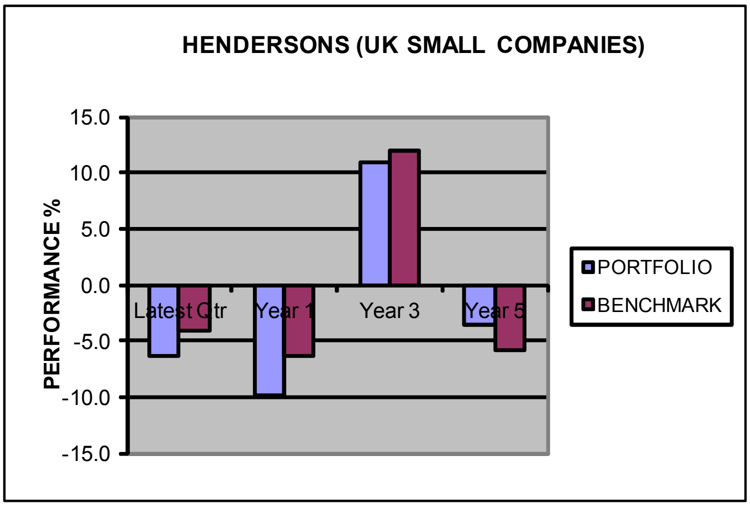
UK EQUITIES (In-House)

	PORTFOLIO	BENCHMARK
Latest Qtr	-2.1	-2.6
Year 1	-4.0	-3.0
Year 3	14.3	13.8
Year 5	1.0	0.5



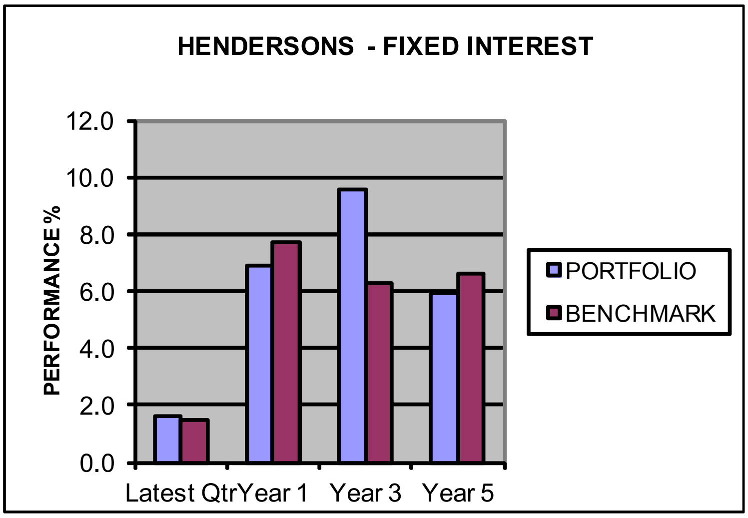
HENDERSONS (UK & Irish Small Companies)

	PORTFOLIO	BENCHMARK
Latest Qtr	-6.4	-4.1
Year 1	-9.9	-6.4
Year 3	10.9	11.9
Year 5	-3.5	-5.9



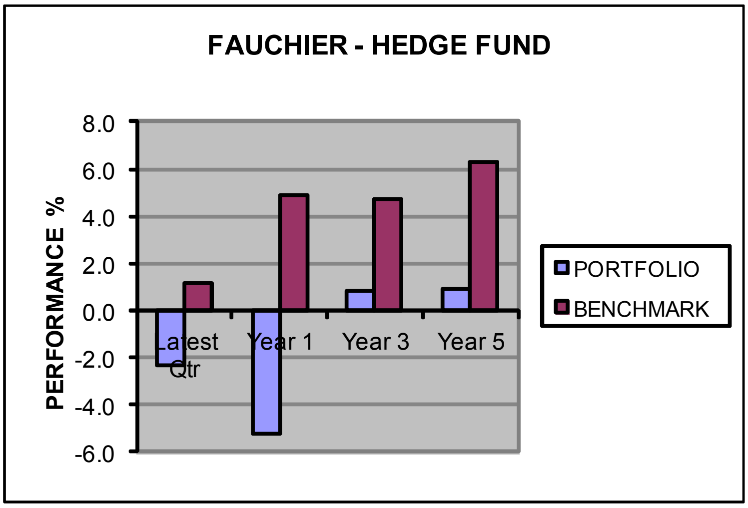
HENDERSONS - FIXED INTEREST

	PORTFOLIO	BENCHMARK
Latest Qtr	1.6	1.5
Year 1	6.9	7.7
Year 3	9.6	6.3
Year 5	5.9	6.6



FAUCHIER - HEDGE FUND

	PORTFOLIO	BENCHMARK
Latest Qtr	-2.3	1.2
Year 1	-5.2	4.9
Year 3	0.8	4.7
Year 5	0.9	6.3



Report from the Independent Adviser

Investment Update for the Month of July 2012

The index returns and exchange rate movements for the month of July are shown in the tables below.

	Indices	**Month ended 31 July 2012**
		%
Equities		
Asia/Pacific	FTSE Developed Asia Pacific (ex Japan)	5.4
Emerging Markets	MSCI Emerging Markets Free	2.1
North America	FTSE North America	1.5
UK	FTSE All Share	1.3
Europe	FTSE Developed Europe (ex UK)	1.2
Japan	FTSE Developed Japan	-2.2
Fixed Interest		
Corporate Bonds	Merrill Lynch Sterling – Non Gilts All Stocks	3.9
UK Gilts	FTSE British Government All Stocks	2.0
UK Index Linked Gilts	FTSE British Government Index Linked Over 5 years	0.1
Property	IPD*	Not available
Cash	Merrill Lynch LIBOR 3 Month	0.1

* The IPD UK Property return from 31 May 2012 to 30 June 2012 was 0.1%.

Currency movements for month ended 31 July 2012

Currency	**29 June 2012**	**31 July 2012**	**Change %**
USD/GBP	1.568	1.567	-0.1
EUR/GBP	1.236	1.272	+2.9
USD/EUR	1.269	1.232	-3.0
YEN/USD	79.790	78.100	-2.1

The positive equity returns in the above table are in marked and heartening contrast to the dismal returns for the quarter ended 30 June 2012. The reason for these better performances appears to have been twofold. Firstly, equity markets for the preceding quarter had been oversold and had perhaps over discounted the negative events and bearish factors with which they had to contend. It was certainly a quarter in which fear and apprehension reigned. Secondly, the main uplifting influence in the month of July was the perception and hope that the situation in the Eurozone was showing signs that the authorities (namely the ECB, the IMF and the German government) might at long last be that much closer to enacting the crucial and urgent measures needed to ensure the future of the Eurozone and the Euro. That is to say, a genuine fiscal and monetary union.

With regard to the ranking of equity returns, it was understandable that, with investors seemingly prepared to take on more risk, the first and second positions on the leader board were the Asia/Pacific region (+5.4%) and Emerging Markets (+2.1%). At the other end of the spectrum was Japan with a negative return of 2.2%. Scarcely surprising, in the light of the nation's old fashioned procedures and seeming inability to once and for all throw off its lacklustre image and consistently poor political leadership.

Within the Fixed Interest sector, corporate bonds led the way with a 3.9% return, undoubtedly caused by investors taking advantage of the high relative yields available which were appreciably above most other Fixed Interest products. Nevertheless, gilts still managed a return of 2.0% despite their historically very low yield levels. Part of this resilience can be attributed to their continuing safe haven status. The return on property for the month of June (July's figures are not yet available) was a minuscule and disappointing 0.1%.

During July the principal events and macro economic data within the regions were as follows:-

<u>UK</u>

- The purchasing managers' index for the services sector receded to 51.0 in July from 51.3 in June.

- The purchasing managers' index for manufacturing was markedly lower at 45.4 in July, down from 48.4 in June. This was the lowest level since May 2009.

- The Office for National Statistics revised its estimate of GDP growth in the second quarter of the year from -0.7% to -0.5%. A small crumb of less negative comfort.

- It was indicated that the Royal Bank of Scotland could become entirely state owned. The state's stake is currently 82.0%.

- On 23 July the yield on 10 year gilts fell to a record low of 1.41%.

- In the quarter to 31 May, the number of unemployed people fell by 65,000 to 2.58M. This represented a 9 month low.

- CPI inflation for June fell to 2.4% compared with a prediction by economists that it would remain at 2.8%.

- In general, corporate balance sheets were in good shape with relatively low levels of debt.

- It was announced that the HSBC bank may have inadvertently allowed the laundering of Mexican drug money. As a result, the bank's chief compliance office resigned during a US Senate hearing.

- The Institute of Economic and Social Research estimated that the economy would contract by 0.5% in 2012, but grow by 1.3% in 2013. These estimates were reduced from zero growth in 2012 and +0.2% in 2013.

- The International Monetary Fund changed its estimate for GDP growth for 2012 to just 0.2%, down from previous estimate made last summer of 2.3%. It also downgraded its estimate for 2013 to 1.4% from 2.0%.

- In two years time the Bank of England expects the economy to be expanding at a rate of 2.1% down from its May forecast of 2.6%.

- On 5th July, the Bank of England announced it would effect further quantitative easing of £50B.

- Marcus Agius, the chairman of Barclays Bank announced his intention to resign as a result of the LIBOR manipulation scandal.

- As expected, the LIBOR (the London Interbank Offered Rate) manipulation scandal has escalated with Ben Bernanke of the FED stating that LIBOR is structurally flawed and suggesting that it would be difficult to restore the rate's credibility. Mervyn King of the Bank of England said "the first I knew of any alleged wrongdoing was when the reports came out two weeks ago". Such a pathetic statement is hardly likely to enhance the Bank's reputation for transparency and due diligence. More banks are now under investigation by the regulators for possible LIBOR manipulation, namely Credit Agricole, HSBC, Deutsche Bank and Société Générale. It seems this scandal has further to run. Yet another case of own goals amongst the banking fraternity. A spokesman for the European Commission described the falsification of the LIBOR benchmark rate as "a betrayal of the financial system". He is absolutely correct. Yet further reputational damage to the City of London as the World's leading financial centre.

- Just when it was assumed that the UK banks had mostly learnt their lesson from their past misdemeanours, the New York Department of Financing Services (a lesser known financial watchdog) blew the whistle on the Standard Chartered Bank accusing it of amassing $250B worth of dollar transactions on behalf of Iranian clients through its New York subsidiary in marked contradiction of banking law. An accusation hotly refuted by Standard Chartered who is considering a counter suit against the agency.

USA

- The Commerce Department reported that factory goods demand decreased by 0.5% in June compared with economists' estimates for a 0.7% rise.

- June retail sales fell by 0.5% in June, the third consecutive monthly decline.

- America is experiencing its worst drought in 50 years. This has caused a sharp rise in the price of corn, soya bean and wheat. America supplies nearly half the world's imports of corn.

- The economy has continued to benefit from the extraction of shale oil and gas.

- The Federal Open Market Committee (FOMC) stated "The Committee will closely monitor incoming information on economic and financial developments and will provide additional accommodation as needed". This is a clear measure of the FED's concern about the outlook.

- Unemployment rose from 8.2% in June to 8.3% in July.

- 163,000 new jobs were created in July versus the consensus forecast of 100,000.

- The Bureau of Labour reported that job vacancies in July were at 3.76M, the highest level since September 2008.

- The Institute of Supply Management said its manufacturing index inched up to 49.8 in July from 49.7 in June compared with estimates of 50.2.

- The Republican candidate, Mitt Romney, has continued to be gaffe-prone in his public oratory and statements.

- Market chaos was caused by a rogue trader at Knight Capital, a New York brokerage house that is responsible for more than a tenth of dealing in American shares. Due to "super fast" trading. The resultant loss was $440M.

Europe

- Mario Draghi, head of the European Central Bank, stated "the Euro is irreversible, it stays". He added "it is pointless to bet against the Euro. It is pointless to go short on the Euro". The ECB, also stated that the bank was "ready to do whatever it takes to preserve the single currency".

- The rate of Eurozone unemployment rose to a record 11.2% in June; just above the 11.1% figure for May.

- The IMF again stressed that the priority for the Eurozone is banking union together with fiscal union.

- The Bank of France predicts that GDP in the third quarter of 2012 will fall by 0.1%.

- Greek output for the second quarter of the year plunged by 6.2% p.a. following the 6.5% drop in the first quarter figure.

- There are signs that Angela Merkel's Christian Democratic Party is being increasingly challenged by the rival Social Democratic Party. The general election is scheduled for autumn 2013.

Japan

- Announcements of macro economic data and reporting of events are extremely badly co-ordinated in Japan and so it proved during July with no matter of any real import being recorded.
- For the second quarter of 2012 the rate of GDP grew 1.4%; markedly lower than the 5.5% growth in the first quarter of the year.

Asia/Pacific/Emerging

- India's productivity has been greatly hindered by massive power cuts. Some 620M people have been affected.

- China's manufacturing purchasing managers' index for June was fractionally lower at 50.1 (May 50.2) representing an 8 month low.

- China's factory output in July decreased to 9.2% p.a. from 9.5% p.a. in June.

- China's July exports sank to 1% in July versus 11.3% in June.

- South Korea's exports for July slumped by 8.8% p.a.

- On 12th July the Central Bank of Korea cut its interest rate by ¼% to 3.0%. The bank reported that its rate of GDP fell to 2.4% in the second quarter of 2012.

- The World Bank cut its 2012 GDP forecast for South Africa from 3.1% to 2.5%.

- Non-residents in Hong Kong are to be allowed to convert unlimited amounts of renminbi.

- The IMF's estimates for GDP growth for 2012 are China 8.0%, India 6.1% and Brazil 2.5%.

- Brazil's central bank estimates that the economy will recover and grow at a pace of 4.0% in the second half of 2012.

Conclusion

It seems virtually certain that news emanating from the Eurozone will continue to be the world's premier concern with the Grecian saga continuing to run and run. In that regard, due to the repeated failure of the authorities, markets have come to realise that there is no quick fix solution for the Eurozone. However, due to recent pronouncements from the ECB, the IMF and the Bundestag there is a sense that the point of denouement has finally come and that a major policy move may be in the offing. It is hoped such a move would cause the aforesaid authorities to step up to the plate with a sufficiently credible way forward to inspire confidence and hence provide markets with some much needed upward traction. In short, you either believe that such a major incentive is nigh or you don't. Right now this appears to be more believable than not. On balance the current mood of investors, strategists and economists appears to be slightly more optimistic. In all this, it does of course depend upon the peripheral Eurozone protestors realising that there is absolutely no alternative to their respective austerity programmes.

Elsewhere in the world:-

In the UK

- Consumers, savers and the population at large will necessarily have to grind on through the coalition's government's increasingly unswerving and rigid austerity measures. However, there is no doubt that morale has been considerably boosted by the welcome distractions of the Queen's Jubilee celebrations and of course the magnificent success of the London Olympic Games. It is to be hoped that some of this "Team GB" national fervour will transfer to the economy and to the stock market. It is also to be hoped that the coalition might place greater emphasis on growing the ailing economy out of recession. More carrot less stick.

In the USA

- The nation is becoming ever more pre-occupied with the outcome of the forthcoming presidential election. It appears increasingly likely that Obama's slick oratory will outwit Romney's gaffe prone campaigning. There is evidence to show that corporate earnings are mostly better than forecast.

In the Asia/Pacific/Emerging Markets

- China's power and ability to continue to grow is becoming increasingly questioned. Even if the Chinese economy is weakening toward the 7% GDP growth level this is an infinitely more buoyant level compared to western industrialised economies.

- Regional trade within the Asia/Pacific nations should continue to prosper. It is significant that Hu Jintao and Vladimir Putin are meeting to discuss closer strategies and economic ties, particularly in the area of trade between their nations.

- Despite their still enviable rate of economic growth, the stock markets of most emerging markets have continued to be nervous as they are still perceived to be high on the Richter scale of risk. This perception seems likely to change the longer these economies continue to demonstrate relatively strong rates of GDP growth. It remains clear that the global balance of power continues to shift from West to East.

In General

- The IMF cut its global growth forecast for 2012 to 3.5% from its April forecast of 3.6%.

- Not before time the European Securities and Markets Authority has begun inspecting the credit rating agencies Standard and Poors, Moody's and Fitch to ensure that their processes are sufficiently "vigorous and transparent". Markets have become severely critical of these agencies' timing of their rating changes. So often too little, too late.

- It is becoming increasingly vital, within the financial system, to separate investment banking from commercial banking.

In sum, although equity markets will continue to be volatile in the shorter term, towards the end of the year ingredients currently exist to suggest that they will become less volatile and range bound and be able to make some reasonable headway against a background of gradually improving macro economic data. Within the Fixed Interest arena most subsector returns are expected to be flat; especially when adjusted for inflation. This expectation applies particularly to sovereign bonds.

The caveat to any market forecast has to be the possible emergence of yet more Euroshocks.

Valentine Furniss
15 August 2012