Brent	**Pension Fund Sub-Committee** 20 November 2012 **Report from the Deputy Director of Finance**
For Information	Wards Affected: ALL

Monitoring report on fund activity for the quarter ended 30 September 2012

1. SUMMARY

1.1 This report provides a summary of fund activity during the quarter ended 30 September 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) The Fund has increased in value by £11.5m from £477.5m to £489.0m, and the Fund return of 3.0% was identical to its quarterly benchmark. The strong performance can be attributed to results in UK smaller companies equities which achieved an outstanding quarterly return of 12.8%, whilst UK equities, emerging market equities, and overseas developed market equities delivered returns of between 3.8% and 4.7%. Fixed income and the diversified growth fund outperformed their benchmarks with returns of 2.5% and 2.1% respectively, and the fund of hedge funds showed a positive return of 1.8%. Whilst less clear to gauge performance in the short term, private equity appears to be delivering a reasonable underlying performance over the longer term.

b) The positive performance for the quarter ended 30 September 2012 has continued during the month of October, where the Fund has continued to increase in value by an estimated £0.9m. An investment update for the month of October 2012, written by the Independent Adviser, is attached.

c) It should be noted that the Fund return of 3.0% represents an underperformance when compared to the WM Local Authority average fund return of 3.3% for the quarter, as a result of Brent’s asset allocation with its relatively low exposure to equities which had a strongly positive quarter and high exposure to alternatives which performed rather less so.

2. RECOMMENDATION

2.1 Members are asked to note the investment report.

3. DETAIL

Economic and market background – quarter ended 30 September 2012

3.1 Equity markets rallied during the quarter ended 30 September 2012, buoyed by stimulus measures provided by the Federal Reserve, Bank of Japan and the European Central Bank.

3.2 Domestic equities returned around 5%, where financial and technology stocks performed strongly whilst more defensive sectors retreated. Geographically, Europe and the lesser Pacific markets performed best with returns in the region of 7% and 8% respectively. Japan was the only area to produce a negative return. However, a modest strengthening of Sterling reduced the locally experienced returns from unhedged international assets.

3.3 Whilst risk assets performed well over the quarter, returns also remained positive for safer haven assets such as gilts where stubbornly weak global economic data and central bank support continued to maintain yields at close to record lows.

3.4 As a result of the latest positive outturn, year to date and rolling 12 month returns have improved markedly from the previous quarter.

Asset allocation of the Fund

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

Asset class	Increase in percentage allocation
UK equities	+0.9%
Bonds	+0.7%
Hedge funds	+0.3%
Cash	+0.3%
Infrastructure	+0.2%

3.6 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
Private equity	-0.9%
Overseas equities	-0.6%
Property	-0.6%
Diversified growth funds	-0.3%

<u>Table 1: Asset allocation as at 30 September 2012 compared to the benchmark</u>

Market (1)	Market Value 30.09.12 £M (2)	Market Value 30.09.12 % (3)	WM LA Average 30.09.12 % (4)	Fund Benchmark 30.09.12 % (5)	Market Value 30.06.12 £M (6)	Market Value 30.06.12 % (7)	WM LA Average 30.06.12 % (8)
Fixed Income							
Henderson – Total Return Bond Fund	79.1	16.2	19.1	15.0	77.1	16.1	18.4
Equities							
UK – Legal & General	68.2	13.9	25.8	13.0	65.1	13.6	24.9
UK - Small Companies Henderson	18.2	3.7	*	4.0	16.1	3.4	*
O/seas – developed Legal & General	105.9	21.7	30.4	19.0	102.1	21.3	36.4
O/seas – emerging Dimensional	29.5	6.0	5.4	8.0	28.4	5.9	*
Property							
Aviva	33.7	6.9	6.8	8.0	34.2	7.2	7.4
Private Equity							
Capital Dynamics	64.4	13.2	3.7	10.0	62.5	13.3	4.6
Yorkshire Fund	1.3	0.3	*		1.3	0.3	*
Hedge Funds							
Fauchier	40.2	8.2	2.7	10.0	39.5	8.2	2.4
Infrastructure							
Alinda	15.2	3.1	1.5	6.0	15.7	3.3	1.3
Henderson PFI Fund II	1.1	0.2	*		1.1	0.2	*
Pooled Multi Asset							
Baillie Gifford DGF	27.8	5.7	0.8	6.0	27.2	5.7	1.1
Cash	4.4	0.9	3.8	1.0	7.2	1.5	3.5
Total	**489.0**	**100.0**	**100.0**	**100.0**	**477.5**	**100.0**	**100.0**

3.7 Table 1 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. Aside from market movements, there have been no investment changes to the Brent Pension Fund during the quarter.

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

Table 2: Investment Returns in Individual Markets

Investment Category	RETURNS						Benchmark/ Index Description
	Quarter Ending 30.09.12			Year Ended 30.09.12			
	Fund %	Benchmark %	WM Local Auth %	Fund %	Benchmark %	WM Local Auth %	
Fixed Income							
Total Return Bond Fund Henderson	2.5	1.5	3.0	n/a	6.0	9.2	Absolute return 6% p.a.
Equities							
UK – Legal & General	4.7	4.7	5.0	n/a	17.2	18.1	FTSE All share
UK - Small Companies Henderson	12.8	11.0	n/a	15.4	21.4	n/a	FTSE Small Cap
O/seas – developed Legal & General	3.8	3.9	4.1	17.9	18.0	17.0	FTSE Dev World ex UK
O/seas – emerging Dimensional	4.0	4.6	5.0	10.7	11.8	13.6	MSCI Emerging Markets
Property							
Aviva	0.1	0.6	0.5	0.4	3.5	3.2	IPD All Properties Index
Private Equity							
Capital Dynamics	0.5	2.5	-0.2	1.8	10.0	0.8	Absolute return 10% p.a.
Yorkshire Fund Managers	n/a	2.5	n/a	n/a	10.0	n/a	Absolute return 10% p.a.
Hedge Funds							
Fauchier	1.8	1.4	1.3	1.1	5.5	3.4	LIBOR + 5% p.a.
Infrastructure							
Alinda	1.9	2.5	2.7	7.6	10.0	4.5	Absolute return 10% p.a.
Henderson PFI Fund II	-2.3	2.5	-	-18.9	10.0	-	Absolute return 10% p.a.
Pooled Multi Asset							
Baillie Gifford	2.1	1.0	2.2	n/a	4.0	6.2	Base Rate + 3.5% p.a.
Cash	0.1	0.1	0.2	0.5	0.5	0.8	LIBID 7-day
Total	**3.0**	**3.0**	**3.3**	**10.0**	**11.7**	**12.6**	

3.9 The Fund's overall return of 3.0% was identical to its quarterly benchmark. UK smaller companies equities, diversified growth fund, fixed income, and fund of hedge funds outperformed their respective benchmarks, whilst private equity, emerging market equities, and property underperformed against their benchmarks.

3.10 Over one year, the Fund return of 10.0% when compared to its benchmark of 11.7% equated to a net underperformance of -1.7%. Equities performed well over the period and were broadly in line with their benchmarks. Property, fund of hedge funds, and private equity all delivered disappointing returns in relation to their benchmarks. The Brent Fund's return of 10.0% has also underperformed when compared to the WM Local Authority average fund return of 12.6%, mainly due to the strongly positive performance of equities for which Brent has a lower proportionate exposure and poor performance of alternative assets where Brent has invested to a greater extent.

Indicative performance of the Fund since September 2012

3.11 Following a strongly positive quarter ended 30 September 2012, the Fund has continued to increase in value by an estimated £0.9m:

	As at 31 October 2012 £M	As at 30 September 2012 £M	Movement
Fixed Income			
Henderson	80.0	79.1	↑
Equities			
UK - Legal & General	68.9	68.2	↑
UK - Small Companies Henderson	18.7	18.2	↑
O/seas – developed Legal & General	105.4	105.9	↓
O/seas – emerging markets Dimensional	29.2	29.5	↓
Property			
Aviva	33.7	33.7	=
Private Equity			
Capital Dynamics	64.4	64.4	=
Yorkshire Fund Managers	1.3	1.3	=
Hedge Funds			
Fauchier	40.3	40.2	↑
Infrastructure			
Alinda	15.2	15.2	=
Henderson PFI Fund II	1.1	1.1	=
Pooled Multi Asset			
Baillie Gifford DGF	28.0	27.8	↑
Cash	3.7	4.4	↓
Total	**489.9**	**489.0**	↑

4. FINANCIAL IMPLICATIONS

4.1 These are included within the report.

5. DIVERSITY IMPLICATIONS

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

6. STAFFING IMPLICATIONS

6.1 None.

7. LEGAL IMPLICATIONS

7.1 There are no legal implications arising from this report.

8. BACKGROUND INFORMATION

Henderson Investors – September 2012 quarter report
Legal & General – September 2012 quarter report
Fauchier Partners – September 2012 quarter report
Dimensional Asset Management – September 2012 quarter report

9. CONTACT OFFICERS

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

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Report from the Independent Adviser

Investment Update for the Month of October 2012

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

	Indices	**Month ended 31st October 2012**
		%
Equities		
Europe	FTSE Developed Europe (ex UK)	2.2
UK	FTSE All Share	1.0
Asia/Pacific	FTSE Developed Asia Pacific (ex Japan)	1.0
Emerging Markets	MSCI Emerging Markets Free	-0.4
North America	FTSE North America	-1.4
Japan	FTSE Developed Japan	-1.7
Fixed Interest		
Corporate Bonds	Merrill Lynch Sterling – Non Gilts All Stocks	0.7
UK Index Linked Gilts	FTSE British Government Index Linked Over 5 years	0.5
UK Gilts	FTSE British Government All Stocks	-0.7
Property	IPD*	Not available
Cash	Merrill Lynch LIBOR 3 Month	0.1

* The IPD UK Property return from 31st August 2012 to 30th September 2012 was 0.2%.

Currency movements for month ended 31st October 2012

Currency	**28 September 2012**	**31st October 2012**	**Change %**
USD/GBP	1.615	1.611	-0.2
EUR/GBP	1.255	1.243	-0.9
USD/EUR	1.287	1.296	0.7
YEN/USD	77.800	79.930	2.7

The equity returns in the above table are considerably more muted than the strong returns achieved in the quarter ended 30th September 2012. But this is quite understandable against the uncertain investment background that prevailed for most of October. As the figures show, most markets were visibly flat to lower except for Europe (+2.2%) which continued to be buoyed by the increasing perception that the Eurozone problem would eventually be solved with the qualification that this would take time.

Unsurprisingly, as is so often the case, the lowest return came from Japan (-1.7%) as the weak government showed little evidence that it possessed the ability to re-energise the nation and steer the economy away for the quagmire of deflation. Fixed interest returns virtually marked time and, as forecast by many, the gilt return (-0.7%) underperformed the return on corporate bonds (+0.7%). The reason for this was on comparative yield grounds with investors becoming increasingly nervous about the historically low yields on 10 year gilts standing around 1.5%. When expressed in real returns this level of yield appears to be increasingly untenable. Property maintained its snail's pace recovery inching up 0.2% (this return was for the month of September, those for October being unavailable).

During October the principal events, macro economic data and forecasts within the regions were as follows:-

<u>UK</u>

- The Confederation of British Industry (CBI) predicts output growth of zero for 2012, 1.4% for 2013 and of 2.0% for 2014. These estimates were somewhat higher than those made by the CBI only three months ago.

- The Coalition Government was humiliated with regard to the EU budget vote.

- The purchasing managers' index of manufacturing activity slipped to 47.5 in October from 48.1 in September.

- The Japanese group Hitachi is to purchase from Germany the Horizon nuclear project for approximately £700M. This is a most welcome boost for the UK's vital nuclear expansion plans and removes a high degree of uncertainty about the project.

- The Heseltine report was published recommending that some £58B of funding should be transferred from the Government to local and regional enterprises in order to spur economic growth and to bring forward essential decisions on both energy and aviation in particular.

- The sheer scale of the banks' mis-selling of Payment Protection Insurance (PPI) beggars belief.

- The Ford Motor Company announced plans to shut two plants at Southampton and Dagenham with a loss of 1,250 jobs.

- 10% of Heathrow Airport is to be acquired by CIC, China's main sovereign wealth fund. Qatar Holdings, a Middle Eastern sovereign wealth fund already owns 20% of Heathrow. For 30% of Heathrow to be foreign owned is indeed unfortunate, particularly at a time when the UK's principal airport is being severely challenged by Germany, France and Holland. It also comes at a time when the future location of the airport is by no means settled.

- The Office for National Statistics reported a welcome advance of 1.0% in the rate of GDP for the third quarter of the year, thus ending a double dip recession. This is the strongest single quarter for growth in 5 years and was certainly helped by the Olympic Games.

- In the quarter to 31st August the number of people in work rose to the highest level since records began in 1971. The number of unemployed fell by 50,000 to 2.53M whilst the rate of unemployment fell from 8.1% to 7.9%.

- Nearly 1,000 retail stores closed in the first half of 2012. This compares with the total closure of 174 stores for the whole of 2011.

USA

- 171,000 new jobs were created in October compared with an estimate of only 125,000. The rate of unemployment in October inched up to 7.9% from 7.8% recorded in September.

- In late October, Hurricane Sandy (estimated to be the largest in Atlantic storm history) reeked havoc in its aftermath by causing power cuts, flooding and high winds. The most affected areas were the North Eastern states, especially New York including lower Manhattan and New Jersey. Even the New York stock exchange was closed for 2 days.

- Output for the third quarter of the year increased by 2.0% (second quarter +1.3%) with consensus estimates of 1.8%. Part of this rise was attributed to federal government spending.

- Corporations have recently been reporting weaker global demand.

- New houses starts advanced by a robust 15.0% in September.

- The consumer sentiment index improved to 83.1 in October from September's 78.3.

Europe

- Eurostat reported that September unemployment in the Eurozone hit a record 18.5M people out of work. The unemployment rate increased to 11.6% in September (11.5% in August). A year ago the rate was 10.3%.

- The number of corporate share buybacks have dropped to the lowest levels since 2009 as these corporations have sort to retain liquidity levels.

- There have been severe cases of civil action in the beleaguered countries of Greece and Spain.

- The Eurozone's purchasing managers' index decreased from 46.1 in September to 45.8 in October.

- In Spain, prime minister, Mariano Rajoy's centre right party has kept control of Galicia in an important local election. This result is a distinct boost against the background of the government's unpopular spending cuts and tax increases.

- The European Union was awarded the Nobel Peace Prize for its role in bringing reconciliation and democracy to the continent. This award was seen by many to be controversial against the current climate in the Eurozone.

Japan

- No announcements of any major import were made in the month of October. Japan with its old fashioned and slow moving culture traditionally experiences a paucity of news and often late macro economic data.

Asia/Pacific/Emerging Markets

- China's purchasing managers' index rose to 49.1 in October from 47.9 in September.

- China's GDP growth rate for the third quarter of the year was 7.4% p.a. representing the seventh consecutive quarter of decelerating growth.

- The Chinese government has stated that it intends to maintain more accommodative conditions, to increase infrastructure investment and to help the property market to recover.

- Chinese industrial production for September grew by 9.2% p.a. (August +8.9% p.a.) and the rate of sales growth in September was lifted by 14.2% p.a. against 13.2% p.a. in August.

- On 17th October, Wen Jiabao, the Chinese premier, gave an optimistic assessment of the economy, stating that it had stabilised and that the government's target of GDP growth of 7.5% p.a. was "well within reach".

- China's September CPI inflation rate was marginally lower at 1.9% down from August's 2.0%.

- China's September exports advanced a strong 9.9% p.a

- On 1st October the Reserve Bank of Australia cut its interest rate by ¼% to 3¼%.

Conclusion

Over the month of October nothing has occurred to materially change the mildly optimistic conclusion contained in the investment report for the quarter ended 30th September 2012. That is to say, on a year's view, sufficient remedial measures appear to be in place to suggest further progress in markets both in the UK and globally. However, it should be stressed that there will inevitably be periods of nervousness and volatility as markets wax and wane in reaction to the latest macro economic data, forecasts and events, particularly from the Eurozone. On an overall view equities should out-perform fixed interest. The following synopsis covers the outlook for other asset classes.

The current background of historically very low interest rates; minuscule returns on cash and extremely small real yields on sovereign debt (both from UK gilts and elsewhere) have certainly created an urgent search for higher income returns. Therefore there has been a pronounced concentration on the following asset classes:-

- High yielding quality equities, particularly those with consistently growing dividend streams and well financed balance sheets

- Emerging market debt

- Corporate bonds, even though their yields are not as attractive as they were.

In addition to the traditional classes of equities and fixed interest there is clear evidence that pension funds are spreading overall risk by buying into alternative asset classes, namely:-

- Absolute return multi asset funds

- Diversified growth funds

- Infrastructure

- Emerging market equities.

Other popular alternative classes continue to be Private Equity, provided that patience is exercised. If the past performances are to go by then such patience should, over time, be amply rewarded.

Asset classes that are currently out of favour are Foreign Exchange, Commodities and Hedge Fund of Funds. Although this last asset class, after a period of under performance, is now reporting better results.

The theme of globalisation is becoming increasingly applied to all asset classes. This does make eminent long term sense.

Regional observations are as follows:-

<u>In the UK</u>

- The population will continue to grind its way through continuing austerity with all the harsh aspects that this imposes particularly with regard to job security.

- The Coalition Government is experiencing some wobbly moments not the least of which is to reach agreement on the way forward in relation to the UK's future relationship with Europe.

In the USA

- The current focus of attention is without doubt the presidential election as it approaches its climax on 6th November. Whichever party wins (and it is allegedly a very close race) they will have to hit the decks running in order to avoid the so called "fiscal cliff" timetable. Whether the result is Republican or Democrat much will depend whether the successful party has a working majority both in the Senate and also Congress. Failing to achieve such a majority would of course weaken the President's ability to enact the essential legislation so urgently needed at this time, especially with regard to the aforementioned fiscal cliff.

- The country will also continue to struggle with the after affects of the drought together with the flood and wind damage caused by the recent Hurricane Sandy.

In Europe

- The 27 members of the Eurozone, particularly the peripheral countries, will continue to suffer from their respective austerity programmes, high rates of unemployment (especially amongst the young) and weak rates of economic growth.

- Greece continues to be a financial and recession riddled basket case. It also continues to be the epicentre of totally irresponsible behaviour. As such its toxic and contagious tentacles affect most other Eurozone countries. That said, there are at last some signs that the European leaders are getting closer to the release of 31.3B Euros of aid with regard to Greece's bailout programme on the understanding that the Greek government agrees to new austerity measures. However, with Greece's appalling record of provisos this initiative does not appear to have any better chance than any of the others.

In Japan

- The most contentious issue for the nation remains the weak government's ability to fund its ballooning deficit.

In Asia

- In China nothing has occurred to diminish the expectation that this mighty nation is most surely destined to eventually surpass the American economy and to become the world's largest and most influential economy. It will not only be the greatest contributor to world trade, but will also be a major benefactor to regional growth in Asia. The benefits should also be felt in Japan. In the shorter term much will depend on the soon to be announced group of new leaders in China. Practically the only thorn in China's side at this time is its spat with Japan over the ownership of the Senkaku Islands in the south China Sea. With regard to China's ownership of Hong Kong, this territory will remain a useful conduit for finance and trade with the rest of the world. It has to be admired how both the political regime and the People's Bank of China manage the course of the renminbi currency and deal with problems like the over extension of the property market and also of course raising the vast population's standard of living.

In General

- The International Monetary Fund estimates global growth of 3.3% in 2012 and 3.6% in 2013 compared with its July estimates of 3.5% and 3.9% respectively.

- More banks are coming under scrutiny with regard to the scandalous manipulation of LIBOR.

- Many nations are accelerating their search for shale deposits which could have a dramatic effect on countries with only small reserves of traditional oil.

- Whether a Democrat or Republican the next president of the USA will not be sworn in until 21st January 2013 such are the archaic rules of the US constitution which appears to be in increasing need of modernisation to better cope with the demands of the 21st century. However, many Americans would consider this to be sacrilege.

Valentine Furniss
7th November 2012