Haringey Council

Report for:	Corporate Committee 28th June 2012	Item number	

Title:	Pension Fund: Asset Allocation advice

Report authorised by :	Interim Chief Financial Officer

Lead Officer:	Nicola Webb, Head of Finance – Treasury & Pensions nicola.webb@haringey.gov.uk 020 8489 3726

Ward(s) affected: N/A	**Report for** Non Key Decision

1. Describe the issue under consideration

1.1 This report considers the Pension Fund's current asset allocation and recommends the investment of cash currently managed in house.

2. Cabinet Member Introduction

2.1 Not applicable.

3. Recommendations

3.1 That £25m of the Pension Fund cash currently managed in house is allocated as part of the passively managed portfolio to overseas equities with the decision on the precise regional allocation to be taken by the Interim Chief Financial Officer in consultation with the Chair, having taken into account the views of the Pensions Working Group.

4. Other options considered

4.1 None.

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5. Background information

5.1 In April 2010 the Pensions Committee took the decision to sell bonds and hold £60m in cash on the advice of the investment adviser, Aon Hewitt. This cash has been managed in house and invested since then in line with the Council's Treasury Management Strategy.

5.2 In August 2011 a decision was made under the urgency procedures to invest £30m of this in overseas equities on the advice of the investment adviser as the price of equities had fallen considerably at that time.

5.3 The remaining £30m has been kept in cash pending the transition to the new investment strategy.

6. Comments of the Chief Financial Officer and financial implications

6.1 Allocating cash to overseas equities will bring the Pension Fund closer to the agreed benchmark. Over the long term, equities are expected to provide a higher investment return than investing in cash, although volatility in value is to be expected.

7. Head of Legal Services and Legal Implications

7.1 The Council as administering authority has the authority to invest the Pension Fund monies. Such investment will form part of the passive investment portfolio previously approved by Committee and the monies must be invested in accordance with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 and the Pension Fund Investment Strategy.

8. Equalities and Community Cohesion Comments

8.1 Not applicable.

9. Head of Procurement Comments

9.1 Not applicable.

10. Policy Implications

10.1 None.

11. Use of Appendices

11.1 Appendix 1: Aon Hewitt – Asset Allocation Update

12. Local Government (Access to Information) Act 1985

12.1 Not applicable.

13. Asset Allocation

13.1 Aon Hewitt have prepared a report setting out their advice and this is attached at Appendix 1. This shows that the Pension Fund is currently 5.3% underweight against the benchmark allocation to equities. The property and private equity allocations are also underweight, but these are long term asset classes which cannot be added to quickly. These asset classes will form part of the review of alternative asset classes to be undertaken initially by the working group.

13.2 The cashflow of the Pension Fund has changed significantly over the last 12 months. During 2010/11 the Fund had a surplus of around £1m per month of contributions over benefits. However following the reduction in active members and increase in pensioners during the early part of 2011/12, it is now in a situation where the contributions coming into the Fund every month are generally sufficient to cover benefits.

13.3 Allocating £25m to overseas equities will leave the Pension Fund with a balance of around £6-8m to meet benefit payments and to honour drawdown requests from the private equity manager. The balance will fluctuate during each month as contributions are received before benefits are paid out. However it is expected that this balance will be sufficient to manage the fluctuations.

AON Hewitt

London Borough of Haringey
Date: 14 June 2012
Prepared for: Corporate Committee
Prepared by: Colin Cartwright

Asset Allocation Update

Introduction

The reorganisation of the Fund's assets from active management to passive management is now complete. As part of this reorganisation the Corporate Committee decided to move the assets in their current regional allocation to LGIM and BlackRock and take decisions at subsequent meetings based on market conditions as to how to move to the long term benchmark. In addition the Fund has around £25m in cash that is available to invest. The purpose of this paper is to recommend whether any movement to the long term benchmark is appropriate at the current time and advise on how to invest the available cash.

31 May 2012 asset allocation

The table below shows the asset allocation as at 31 May 2012. At the time of writing these figures were unaudited and are therefore subject to change.

	CBRE		L&G		BlackRock		Pantheon		Total		
Asset Class	£m	%	£m	%	£m	%	£m	%	£m	%	Benchmark
Equity			147.2	75.3	313.1	76.8			459.9	64.7	70.0
UK Equity			27.7	14.0	160.2	39.3			187.5	26.4	17.25
Overseas Equity			119.5	61.3	152.9	37.5			272.4	38.3	52.25
Index-linked Gilts			20.8	10.7	94.8	23.3			115.7	16.3	15.0
Corporate Bonds			27.4	14.0					27.4	3.9	-
Property	53.4	100.0							53.4	7.5	10.0
Private Equity							29.8	100.0	29.8	4.2	5.0
Cash*									25.0	3.5	
Total	53.4	100.0	195.0	100.0	407.9	100.0	29.8	100.0	711.1	100.0	100.0

* Cash available to invest. Source: Northern Trust

Comments on asset allocation

- The Fund is underweight its strategic allocation to equities by 5.3% (64.7% vs 70.0%)
  - However, it is overweight UK equities by 8.9% and underweight overseas equities by 14.2%
- Index-linked gilts are 1.3% overweight
- Overweight corporate bonds as a result of medium term view
- The Fund is underweight alternatives by 3.3% with
  - Property underweight by 2.5% and
  - Private equity underweight by 0.8%

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Aon Hewitt Market outlook

Provided below is summary of our views on the main markets at the current time.

Equities

Global equities have been struggling for direction for over two years and there are few hints that this is about to change. We see equities continuing to be weighed down by Eurozone concerns and a looming slowdown in corporate profits. Inthis environment we see equities remaining trendless and volatile. Therefore we are recommending clients remain close to their strategic allocation to equities and use periods of market strength / weakness to rebalance back to their strategic target.

Within equities, we are currently reviewing our position on the different regions to consider the relative strength of the US and the ongoing concerns in the Eurozone.

Bonds

The ongoing perceived safe haven characteristics of the UK gilt market have kept UK gilts and index-linked gilt yields close to historic lows. However, we feel this position is unsustainable as persistent inflationary pressures and the government's large issuance needs mean gilt supply is rising rapidly. It is our view that UK gilt yields are on long and bumpy road to higher yields. In this sort of environment index-linked gilts should out perform fixed interest gilts and we continue to recommending clients hold index-linked over gilts.

Investment grade corporate bonds are well placed to outperform fixed interest gilts with the current level of credit spread adequately compensating investors for taking on the credit risk versus gilts. Even so, it should be noted that in a period of rising gilt yields, corporate bond returns would be dampened to some extent in absolute terms.

Alternative asset classes

With the conventional asset classes of equities and bonds facing their particular challenges we continue to encourage clients to consider alternative assets for diversification purposes and as a source of return. No allocation to alternative assets should be made until the Working Group has reviewed the Fund's current property and private equity holdings and considered a wider allocation to alternatives, which is scheduled for later this year.

Recommendations for the Fund

So far we have discussed the position of the Fund as at 31 May and Aon Hewitt's view of markets, we now need to consider the implications for the Fund - especially as there is around £25m of cash available to invest.

The Fund is currently 5.3% underweight its equity allocation (around £35m), therefore based on Aon Hewitt's market view that clients should be close to their strategic weighting we recommend that this underweight should be removed and ideally this should be following a period of market weakness.

Within equities this money should be directed towards overseas rather than UK to reduce the underweight allocation to overseas equities. The region within overseas equities that this money should be directed will depend on market conditions at the time. Aon Hewitt will provide a recommendation on which region to invest at the Corporate Committee meeting on 28 June which will also consider the merits of reducing the overweight to the UK.

The medium term allocation to corporate bonds should be maintained.

It should be noted that given the ongoing situation in the Eurozone and its impact on markets, Aon Hewitt will provide a verbal update on 28 June that these recommendations are still valid.

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