

NORTH YORKSHIRE COUNTY COUNCIL

PENSION FUND COMMITTEE

20 SEPTEMBER 2012

PERFORMANCE OF THE FUND'S PORTFOLIO FOR THE QUARTER AND YEAR ENDING 30 JUNE 2012

Report of the Treasurer

1.0 PURPOSE OF REPORT

- 1.1 To report the investment performance of the overall Fund, and of the individual Fund Managers, for the Quarter to 30 June 2012 and the twelve months ending on that same date.

2.0 PERFORMANCE REPORT

- 2.1 The report (**enclosed as a separate document**) produced by Mellon Analytical Solutions (MAS) provides a complete performance analysis of the North Yorkshire Pension Fund for the quarter and year ending 30 June 2012.
- 2.2 Using the format prepared by MAS the report highlights the performance of the total Fund by asset class against the customised Fund benchmark. There is also an analysis of the performance of each manager against their specific benchmark and a comparison of performance levels over time.

3.0 PERFORMANCE OF THE FUND

- 3.1 The performance of the various managers against their benchmarks for the Quarter ended 30 June 2012 is detailed on **pages 4 / 5** of the MAS report. This performance is measured on a time-weighted basis and expressed as a +/- variation to their benchmark.
- 3.2 **The absolute overall return for the quarter (-4%) was below the customised benchmark for the Fund (-3.1%) by 0.9%.**
- 3.3 **The Fund underperformed the Local Authority average (as measured by WM Performance Services) by 2.1% for the March 2012 quarter.** The customised benchmark was 1.2% below the Local Authority average.
- 3.4 **The 12 month absolute rolling return was -2.9%. This was 2.9% below the customised benchmark and 2% below the Local Authority average.**

Absolute and rolling relative returns for the 12 months to each of the last four quarter ends were as follows.

Year End	Absolute %	Relative %
30 June 2012	-2.9	-2.9
31 March 2012	+2.9	-2.6
31 December 2011	-4.9	-4.0
30 September 2011	-3.8	-2.9

Manager performance is detailed in **paragraph 4.2**.

3.5 These disappointing performance figures reflect a sustained period of challenging and volatile market conditions for the Fund. Markets fell back during the quarter after a rally in Q1 of 2012. Although markets have recovered since June 2012 this is based on low volumes and confidence is likely to be fragile. There remains a great deal of negative economic news coming out of the UK and Europe. It is therefore still essential to recognise, understand, and assess,

- the impact of further turbulence in the financial markets, and the potential long term implications of the various contributing factors
- the ongoing appropriateness of the investment strategy of the Fund (which was designed to operate in “normal” financial market conditions)
- the performance of individual fund managers in these unstable market conditions

It is also critical to understand the timescale over which any or all of these factors may impact on the future performance of the Fund.

3.6 With this in mind the Appendices used in this report have been designed to present a fuller picture of the reasons behind the recent investment performance.

3.7 The content of these Appendices is now as follows.

Appendix 1 Fund Manager Performance over the five years to 30 June 2012 in absolute percentage terms from a starting point of “100”

Appendix 2 Performance of NYPF relative to other LGPS Funds

Appendix 3 Solvency position (in % and £ terms) since the 2001 Triennial Valuation; this Appendix also shows in absolute terms the +/- in the value of assets and liabilities of the Fund

Appendix 4 Solvency graph – this shows the key figures from **Appendix 3** in a simple graphical format

Appendix 5 Details of Rebalancing @ 30 June 2012

3.8 The separate reports of the Investment Adviser and Investment Consultant explain what has been happening in the financial markets, and looking ahead, what may happen in the short, medium and longer term.

4.0 FUND MANAGER PERFORMANCE

4.1 In monetary terms the negative absolute return of -4% in the Quarter decreased the invested value of the Fund by £62.4m. Taking into account new money, the value of the Fund increased by £54m. In absolute terms this movement is primarily attributable to capital losses made by Standard Life (£32.5m), Baillie Gifford (£18.7m) and Fidelity (£15.2m).

4.2 Absolute performance in percentage and cash terms (capital and income) is shown in the following table.

	absolute performance (%)					absolute performance (£)	
	q/e Sep 2011	q/e Dec 2011	q/e Mar 2012	q/e Jun 2012	y/e Jun 2012	q/e Jun 2012	y/e Jun 2012
Baillie Gifford : Global Equities	-14.9	7.9	10.1	-4.9	-3.7	-12.6	-9.4
Baillie Gifford : LTGG	-15.9	2.1	14.7	-3.8	-5.3	-6.3	-8.7
FIL Inv Ser UK : Global Equities	-18.2	5.8	10.2	-4.3	-8.7	-15.2	-32.0
Standard Life : UK Equities	-23.0	5.6	19.3	-8.8	-11.5	-32.6	-43.7
Equities sub-total						-66.7	-93.8
Amundi AM : Global Bonds	9.9	10.6	-1.9	2.1	21.7	4.2	37.4
M&G Investments : Gilts			-3.6	1.4	-2.3	0.9	-1.6
European Credit Mgmt : Global Bonds	-5.3	-0.3	4.5	-0.4	-1.8	-0.5	-2.1
Fixed income sub-total						4.6	33.7
RC Brown Investment : UK Equities	-17.8	4.2	10.1	-8.2	-13.4	-0.2	-0.4
Hermes : UK Property				-0.4	-0.4	-0.1	-0.1
Movement in cash reserves						8.4	31.7
Movement in Fund Investments and Cash						-54.0	-28.9

Cumulative absolute performance by each manager over the last three years in percentage terms is illustrated at **Appendix 1**.

- 4.3 Negative absolute performance in the Quarter was suffered by all managers of performance seeking assets as markets fell back in the quarter following the rally in Q1 of 2012. At the end of the June 2012 quarter the value of the Fund was £28.9m below the value at the end of June 2011.

Performance relative to other LGPS Funds

- 4.4 **Appendix 2** shows the **performance of NYPF relative to other Funds in the LGPS universe**. Performance was below the Local Authority average in the June quarter by 2.1%, and was below for the 12 month period to March 2012 (-2%). NYPF has shown a strong and consistent correlation to the performance of other LGPS funds over the last 10 years but has tended to relatively outperform when markets are rising and underperform in falling markets conditions. This relates to a greater inherent potential for volatility in the NYPF Investment Strategy relative to many other LGPS funds.

Overseas Equities

- 4.5 **Fidelity** produced a positive relative return in the quarter (+0.8%) against a benchmark return of -5.1%. Performance over the year to June 2012 was flat. Since inception in November 2008 the manager is 0.2% below the benchmark gross of fees.

Allocations to Europe, North America and the Pacific outperformed; however for the seventh time in the last eight quarters, relative performance fell below the benchmark in Emerging Markets. As at the end of July 2012 the value of portfolio had increased by approximately 2% in absolute terms.

- 4.6 The Global Alpha fund managed by **Baillie Gifford** produced a negative relative return (-1.3%) following thirteen successive quarters of positive performance. In July 2012 financial markets rose and approximately 2% was added to the value of the portfolio.

The LTGG fund, also managed by **Baillie Gifford** produced a negative relative return (-0.2%) for the quarter. The Fund was 1.3% below the benchmark for the year to June 2012 but has outperformed the FTSE All World benchmark in every quarter except four, since 2007. In July 2012 the portfolio decreased in value by 1%.

- 4.7 Despite challenging market conditions both funds managed by Baillie Gifford have produced sustained relative outperformance. Global Alpha and LTGG are 1.6% and 2.5% respectively ahead of the FTSE All World benchmark since inception in September 2006 and focus on long term time horizons for performance purposes, broadly three to five years.

UK Equities

- 4.8 **Standard Life** produced a negative relative return (-3.6%) in the quarter against the FTSE 350 equally weighted benchmark return of -5.2%. Relative performance for the year was a disappointing 6.4% below the benchmark.

Compared to the FTSE All Share which was -2.6% for the quarter, the benchmark of the FTSE 350 Equally Weighted (excluding Investment Trusts) focuses investment towards the UK economy. Recent relevant economic indicators have worsened creating difficult trading conditions. Approximately 1% was added to the value of the portfolio in July 2012.

- 4.9 The ethical equity portfolio operated by **R C Brown** underperformed the FTSE All Share by 5.6% over the quarter and was negative over the rolling 12 month period (-10.3%). As Members are aware, this is a 'nominated manager' by a particular employer; discussions about the need to review the performance of this manager are underway with the employer.
- 4.10 These results give a combined relative performance (as reported by MAS) in global equities of -1.3% in the quarter.

Fixed Income

- 4.11 **ECM** produced -0.6% relative against the cash benchmark for the quarter and -2.5% relative for the year to June 2012. The quarterly return was however ahead of the Merrill Lynch European corporates index (-1.4%). The Eurozone sovereign debt crisis continues to distort markets. The value of the Fund rose in July 2012, up 1%.
- 4.12 Between July 2005 and May 2007 NYPF invested £125m with ECM. The valuation reached a peak of £141m in December 2007, dropped to a low point of £58m in February 2009. By the end of June 2012 the value of the investment stood at £114m.
- 4.13 **Amundi** beat the benchmark by 0.7% in the quarter and by 1.6% for the year to June 2012. The strong benchmark return for the year (+20.1%) was driven largely by nervousness about the outlook for financial markets. The investment with this manager has proven to be a helpful contributor to Fund performance when market sentiments are negative. By the end of July 2012 the value of the portfolio had slightly increased.
- 4.14 The investment in Gilts with **M&G** produced -0.1% against a rising benchmark (+1.5%) Yields rose slightly over the quarter, however in recent weeks they have fallen to record lows. By the end of July 2012 the value of the portfolio had slightly increased.
- 4.15 These results give a combined relative performance (as reported by MAS) in global fixed income of -0.2% in the quarter.

Property

- 4.16 The investment with **Hermes** commenced in Q1 of 2012. The first full quarter produced negative relative performance (-0.9%) against the RPI benchmark as conditions for property investment worsened, certainly in the short term.

5.0 RISK INDICATORS

- 5.1 The MAS Performance Report (**pages 12 to 13**) includes three long-term risk indicators.
- 5.2 The Fund's annualised **Standard Deviation** for the rolling three year period to June 2012 (18.1%) is lower than the average over the three year period to March 2012 (18.6%); this was essentially as a result of the extreme volatility during the second half of 2008 and the first half of 2009 gradually dropping out of the equation. Before the financial markets crashed in 2008 the figure was around the 6-7% level. This latest figure still reflects the unprecedented level of volatility of the Fund's return over recent years which is not surprising given the recent market conditions.
- 5.3 The **Tracking Error** figure is a consolidation of the difference between each Fund Manager's actual return versus their respective benchmark. The unprecedented increase since the middle of 2008 in this measure, rising from approximately 2% to 9%, reflected huge market volatility and the difficult financial market environment facing the Fund (and its investment managers). The fall since the end of the September 2011 quarter (3.2 against 9.4) reflects the relative decrease in volatility as the impact of those early years in the three year measure plays out.
- 5.4 The **Information Ratio** is a measure of manager skill and has been volatile over recent years. The figure fell to a negative number for four years to September 2011 which reflected the level of under-performance by most Managers during the worst of the financial crisis. At the end of June 2012 the ratio was slightly negative (-0.1%).
- 5.5 If the measures to reduce volatility (particularly regarding equities) inherent in the Investment Strategy (and the managers appointed) are successful it will gradually have a positive impact on the three measures referred to above.

6.0 SOLVENCY

- 6.1 The **solvency position** is presented in **Appendices 3 and 4**. As at 30 June 2012 the estimated solvency decreased in the last quarter from 58% to 56%.
- 6.2 The assets of the Fund decreased by 3.6% in the Quarter (including new money), whilst liabilities (as modelled by the Actuary) did not change, the two combining to produce a 2% decrease in solvency in the Quarter. Yields fell in the Quarter but this was offset by expectations of rising inflation which decreased liability values. Yields on long-dated gilts are used as the proxy discount rate to value liabilities, hence lower yields result in higher liability values and vice versa; the effect of yields and inflation on solvency is referred to further in **paragraph 6.3 (f)** below.
- 6.3 The relative position, over time, between liabilities and assets is shown very clearly in **Appendix 4** which is a simple graph using data from **Appendix 3**. It is clear from this graph that
- (a) "liability growth" was matched by "asset growth" for the period March 2004 to March 2007 (hence the steady improvement in solvency from 59% to 67% over that period)

- (b) from March 2007 to March 2009 “liability value” accelerated and “asset value” fell, which had
- (c) a significant and consequential impact on solvency – there is a point where the asset and deficit lines cross - this is effectively the 50% funding point (@ June / September 2008)
- (d) during 2009/10 changes in assumptions on inflation and bond yields resulted in no overall change in the valuation of liabilities throughout the year whilst asset values improved strongly over the same period
- (e) between March 2010 and June 2012 the overall improvement in asset values was achieved alongside a much more significant increase in liability values (as modelled by the Actuary), resulting in a fall in solvency of 11%
- (f) the most significant factors affecting liability values over the period since the 2010 Triennial Valuation have been the fall in the discount rate and market expectations of future interest rates. In isolation, had these two factors remained the same since this date solvency would be around 66% as at June 2012, 10% above the reported level. The “ex yield/inflation change” lines on **Appendix 4** illustrate the point in terms of liabilities and deficit in monetary terms.

6.4 What this analysis illustrates very clearly is that the Fund has no effective control over “liability value” because it is generated by market conditions, actuarial assumptions and political decisions regarding the macro economy. The Fund must therefore concentrate on the performance of its invested assets over the longer term.

7.0 REBALANCING

7.1 A sum of £12m was transferred from cash reserves to Threadneedle in June 2012. There has been no further rebalancing since the end of the June 2012 quarter. The rebalancing schedule is attached as **Appendix 5**.

8.0 PROXY VOTING

8.1 Available on request is the report from PIRC summarising the proxy voting activity in the period April to June 2012. This report covers the votes cast on behalf of NYPF at all relevant company AGM's in the period and includes an analysis of voting recommendations at selected meetings and responses to company engagement.

9.0 RECOMMENDATION

9.1 Members are asked to note the investment performance of the Fund for the Quarter and 12 months ending 30 June 2012.

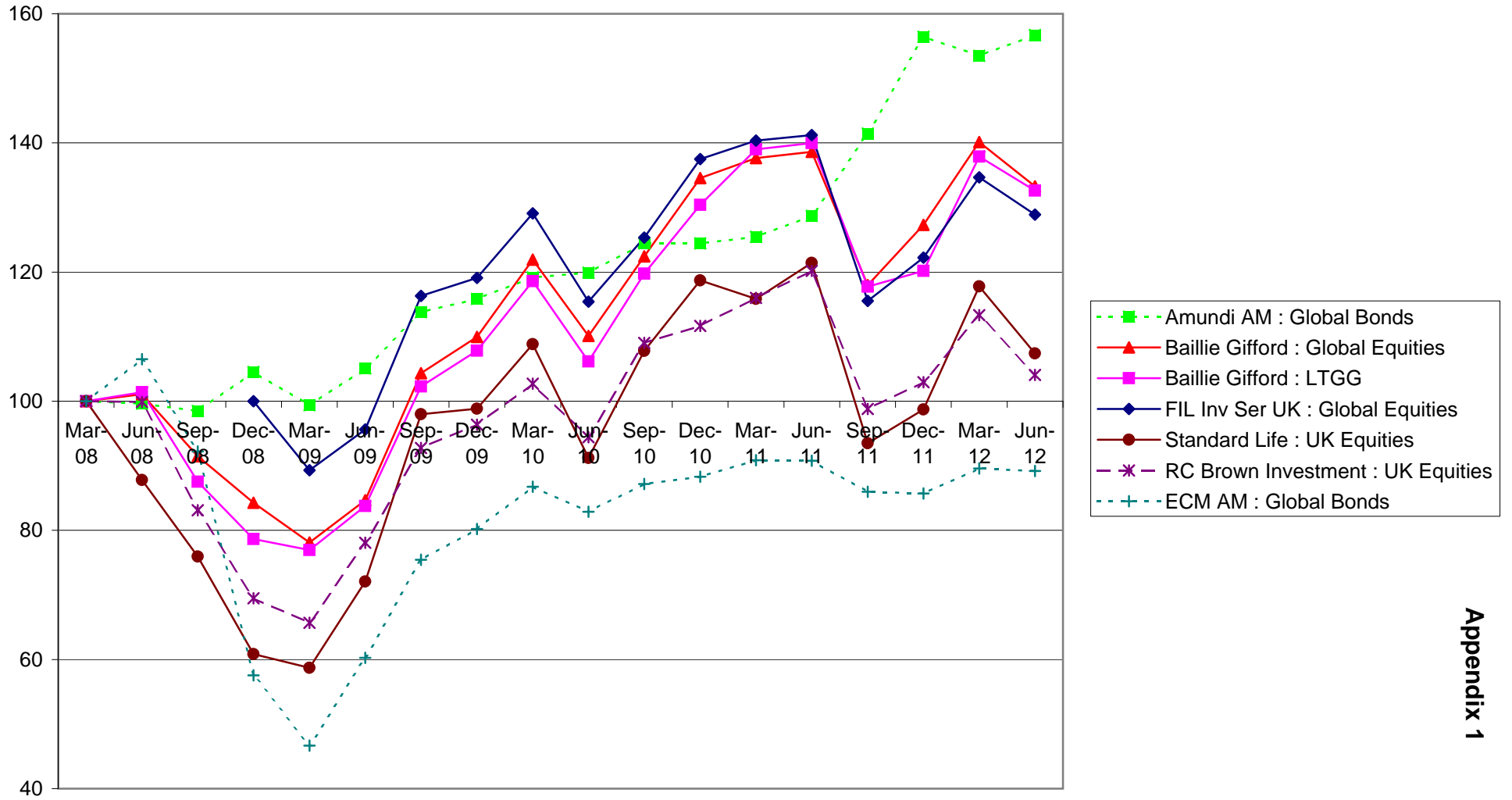
JOHN MOORE

Treasurer, Finance and Central Services
County Hall, Northallerton

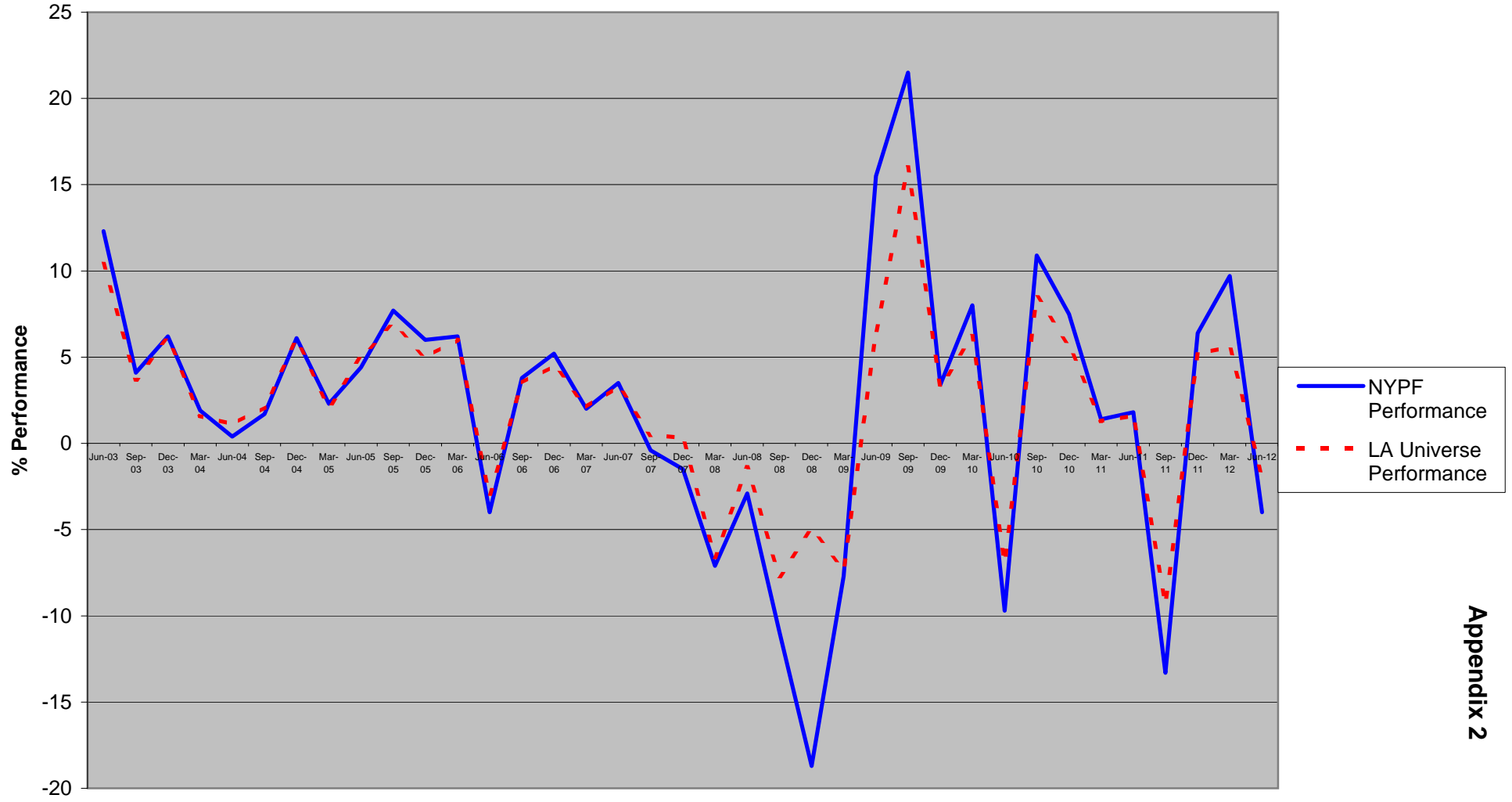
29 August 2012

Background documents: None

Investment Manager Performance - cumulative absolute performance since March 2008



Pension Fund Performance - NYPF vs Other Local Authorities

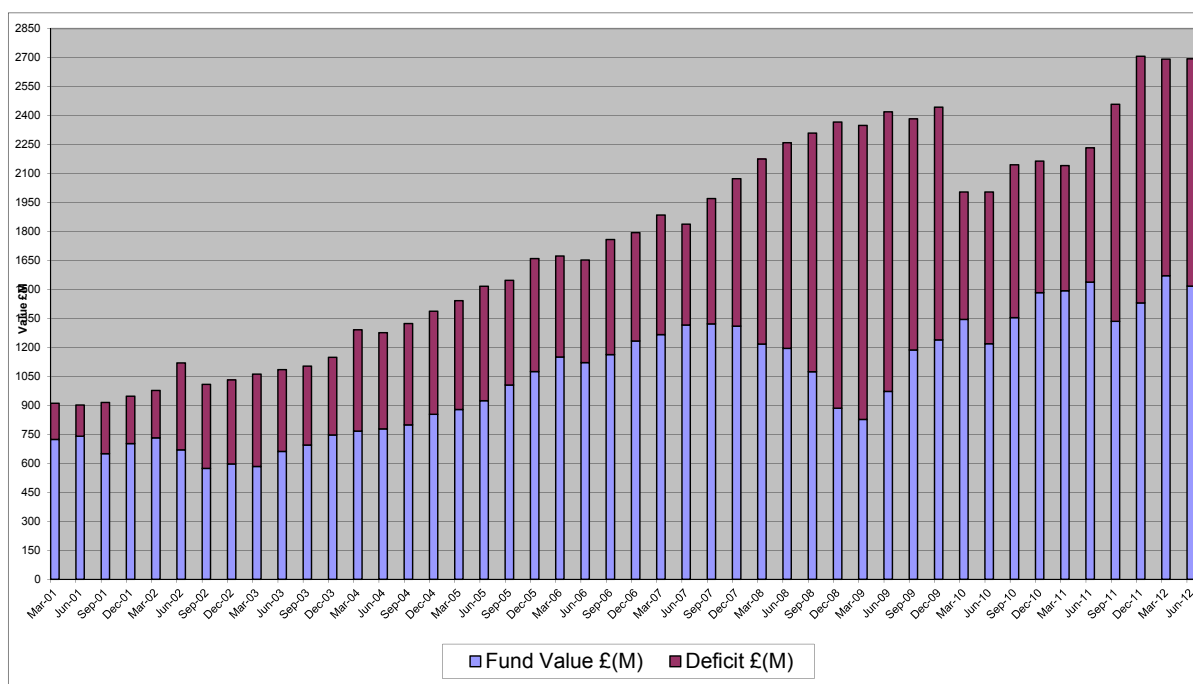


Actuarial Model of Quarterly Solvency Position

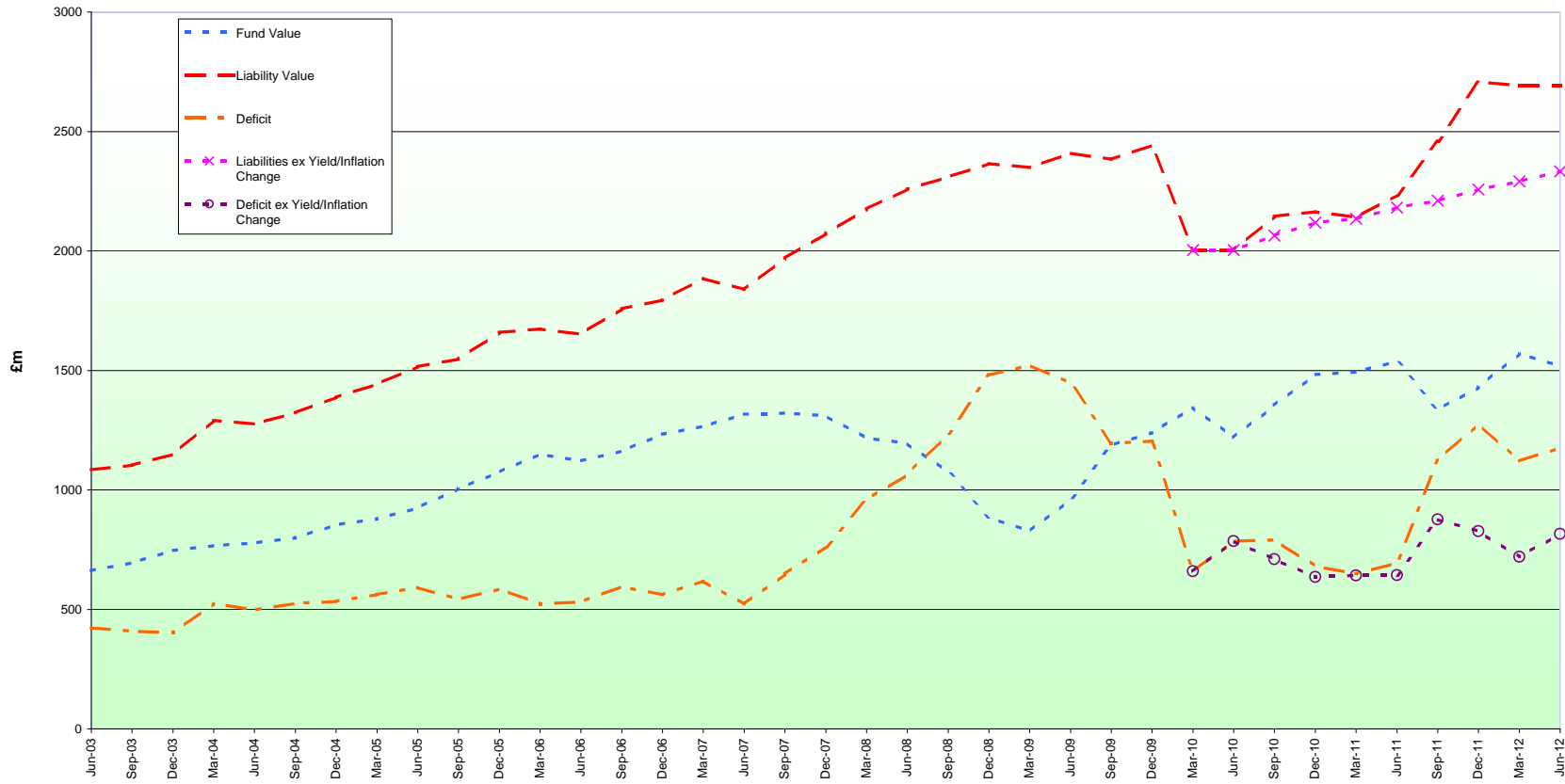
Date	Solvency	Deficit £(M)	Fund Value £(M)	FTSE 100
March 31, 2001	79%	187	724	5,634
June 30, 2001	82%	162	740	5,643
September 30, 2001	71%	265	650	4,903
December 31, 2001	74%	245	702	5,217
March 31, 2002	75%	245	732	5,272
June 30, 2002	60%	450	670	4,656
September 30, 2002	56%	435	574	3,722
December 31, 2002	58%	435	597	3,940
March 31, 2003	55%	478	584	3,613
June 30, 2003	61%	423	662	4,031
September 30, 2003	63%	408	695	4,091
December 31, 2003	65%	402	747	4,477
March 31, 2004	59%	524	767	4,386
June 30, 2004	61%	498	778	4,464
September 30, 2004	60%	524	799	4,571
December 31, 2004	62%	533	854	4,814
March 31, 2005	61%	563	879	4,894
June 30, 2005	61%	592	924	5,113
September 30, 2005	65%	542	1005	5,478
December 31, 2005	65%	585	1075	5,619
March 31, 2006	69%	523	1150	5,965
June 30, 2006	68%	531	1121	5,833
September 30, 2006	66%	595	1163	5,961
December 31, 2006	69%	561	1233	6,221
March 31, 2007	67%	619	1266	6,308
June 30, 2007	72%	522	1316	6,608
September 30, 2007	67%	648	1322	6,467
December 31, 2007	63%	763	1310	6,457
March 31, 2008	56%	958	1217	5,702
June 30, 2008	53%	1064	1195	5,625
September 30, 2008	47%	1235	1074	4,902
December 31, 2008	37%	1481	885	4,434
March 31, 2009	35%	1522	827	3,926
June 30, 2009	40%	1447	972	4,249
September 30, 2009	50%	1196	1187	5,134
December 31, 2009	51%	1204	1239	5,413
March 31, 2010	67%	659	1345	5,680
June 30, 2010	61%	785	1219	4,917
September 30, 2010	63%	791	1354	5,549
December 31, 2010	69%	681	1483	5,900
March 31, 2011	70%	648	1493	5,909
June 30, 2011	69%	695	1538	5,946
September 30, 2011	54%	1123	1335	5,129
December 31, 2011	53%	1277	1430	5,572
March 31, 2012	58%	1121	1571	5,768
June 30, 2012	56%	1176	1517	5,571

Triennial valuation results highlighted in grey

Movement in Assets and Liabilities



North Yorkshire Pension Fund Funding, Liabilities and Solvency



REBALANCING OF NYPF ASSETS AS AT 30 June 2012

Asset Class	Minimum Allocation to Non-Equities	Maximum Allocation to Non-Equities	Current Allocation as at June 2012	Allocation After Rebalancing
Equity + Cash	78%	50%	71.6%	71.6%
Bonds	15%	30%	18.4%	18.4%
Alternatives (ex property)	5%	10%	7.6%	7.6%
Property	2%	10%	2.4%	2.4%
Total	100%	100%	100%	100%

	30-Jun-12		Min		Max		Under	Over		
	Value £m	actual %	%	£m	%	£m				
Global Equity Managers										
Baillie Gifford Global Alpha	243.47	16.2%	12.0%	180.34	16.0%	240.45	0.00	-3.01	0.00	243.47 16.2%
Baillie Gifford Global Growth	155.87	10.4%	7.8%	117.22	10.4%	156.29	0.00	0.00	0.00	155.87 10.4%
(a)	<u>399.34</u>	<u>26.6%</u>	<u>19.8%</u>	<u>297.56</u>	<u>26.4%</u>	<u>396.75</u>	<u>0.00</u>	<u>-3.01</u>	<u>0.00</u>	<u>399.34 26.6%</u>
Global (ex UK) Equity Managers										
Fidelity	335.88	22.4%								335.88
(b)	<u>335.88</u>	<u>22.4%</u>	<u>19.8%</u>	<u>297.56</u>	<u>26.4%</u>	<u>396.75</u>	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>	<u>335.88 22.4%</u>
UK Equity Managers										
Standard Life	336.42	22.4%	20.4%	306.58	27.0%	405.76	0.00	0.00		336.42 22.4%
Yorkshire Fund Managers	1.07	0.1%	0.0%	0.00	0.2%	3.01	0.00	0.00		1.07 0.1%
(c)	<u>337.49</u>	<u>22.5%</u>	<u>20.4%</u>	<u>306.58</u>	<u>27.2%</u>	<u>408.77</u>	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>	<u>337.49 22.5%</u>
Equity sub-total	(a+b+c)=(d)	<u>1072.72</u>	<u>71.4%</u>	<u>60.0%</u>	<u>901.70</u>	<u>80.0%</u>	<u>1202.27</u>	<u>0.00</u>	<u>0.00</u>	<u>1072.72 71.4%</u>
Amundi	209.90	14.0%								209.90
M & G	66.99	4.5%								66.99
Fixed Income sub-total	(e)	<u>276.90</u>	<u>18.4%</u>	<u>15.0%</u>	<u>225.42</u>	<u>30.0%</u>	<u>450.85</u>	<u>0.00</u>	<u>0.00</u>	<u>276.90 18.4%</u>
ECM	113.72	7.6%								113.72
Alternatives sub-total	(f)	<u>113.72</u>	<u>7.6%</u>	<u>5%</u>	<u>75.14</u>	<u>10%</u>	<u>150.28</u>	<u>0.00</u>	<u>0.00</u>	<u>113.72 7.6%</u>
Hermes	23.66	1.6%								23.66
Threadneedle	12.56	0.8%								12.56
Property sub-total	(g)	<u>36.22</u>	<u>2.4%</u>	<u>2%</u>	<u>25.10</u>	<u>3%</u>	<u>50.04</u>	<u>0.00</u>	<u>0.00</u>	<u>36.22 2.4%</u>
Cash										
Internal Cash (Barclays a/c)	1.41									1.41
Currency Hedge Cash	1.87									1.87
Cash sub-total	(h)	<u>3.27</u>	<u>0.2%</u>	<u>0.0%</u>	<u>0.00</u>	<u>0.0%</u>	<u>0.00</u>	<u>0.00</u>	<u>-3.27</u>	<u>0.00</u>
(d+e+f+g+h)=(i)	<u>1502.83</u>	<u>100.0%</u>								<u>100.0%</u>
RC Brown	(j)	2.30								