

NORTH YORKSHIRE COUNTY COUNCIL

PENSION FUND COMMITTEE

24 NOVEMBER 2011

PERFORMANCE OF THE FUND'S PORTFOLIO FOR THE QUARTER AND YEAR ENDING 30 SEPTEMBER 2011

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 September 2011 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 September 2011.
- 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 September 2011 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 (-13.3%) was below the customised benchmark (-10.6%) by 2.7%.**
- 3.3 **Over the rolling year the Fund performance was 2.9% below the customised benchmark. The 12 month absolute rolling return was -3.8%.**

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

Year End	Absolute %	Relative %
30 September 2011	-3.8	-2.9
30 June 2011	+23.0	+1.7
31 March 2011	+9.2	-0.8
31 December 2010	+16.3	-0.4

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

3.4 These performance figures reflect a period of challenging and volatile market conditions for the Fund. The latest UK growth figures putting the economy on a slower recovery path than after the Great Depression in the 1930's. The Greek government teetering on the brink of collapse and the record high of the yield on Italian Government debt are but the latest in a series of events having a negative impact on financial markets. It is therefore still essential to try and understand, and assess,

- the potential for 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.

3.5 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.

3.6 The content of these Appendices is now as follows.

Appendix 1 Fund Manager Performance over the three years to 30 September 2011 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 September 2011

3.7 The separate reports of the Investment Adviser and Investment Consultant explain what has been happening in the financial markets, and 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 -13.3% in the Quarter decreased the invested value of the Fund by £202.3m. Taking into account new money, the value of the Fund decreased by £198.7m. In absolute terms this movement is primarily attributable to capital losses made by Standard Life (£89m) and Fidelity (£68m).

4.2 Absolute performance in percentage and cash terms is shown in the following table.

	absolute performance (%)					absolute performance (£)	
	q/e Dec 2010	q/e Mar 2011	q/e Jun 2011	q/e Sep 2011	y/e Sep 2011	q/e Sep 2011	y/e Sep 2011
Baillie Gifford : Global Equities	9.9	2.3	0.7	-14.9	-3.7	-37.7	-8.3
Baillie Gifford : LTGG	8.9	6.6	0.7	-15.9	-1.8	-26.2	-2.5
FIL Inv Ser UK : Global Equities	9.7	2.1	0.6	-18.2	-7.9	-67.0	-25.8
Standard Life : UK Equities	10.1	-2.4	4.8	-23.0	-13.3	-88.5	-46.7
Equities sub-total						-219.4	-83.3
Amundi AM : Global Bonds	0	0.8	2.6	9.9	13.6	23.3	25.7
European Credit Mgmt : Global Bonds	1.3	2.9	-0.1	-5.3	-1.5	-6.1	-1.7
Fixed income sub-total						17.2	24.0
RC Brown Investment : UK Equities	2.4	3.9	3.6	-17.8	-9.4	-0.4	-0.2
Movement in cash reserves						3.9	27.4
Movement in Fund Investments and Cash						-198.7	-32.1

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

4.3 Positive absolute performance was achieved by the liability matching Manager with all performance seeking managers producing negative returns. Market volatility during the quarter reached the levels experienced in 2008. This and other issues are further discussed in the report of the Investment Adviser.

Performance relative to other LGPS Funds

- 4.4 **Appendix 2** shows the **performance of NYPF relative to other Funds in the LGPS universe**. At the time of writing figures for the Local Authority average for the September 2011 quarter were not available. Performance was above the Local Authority average in the June quarter by 0.1% placing the Fund in the second quartile, and was also ahead for the 12 month period to June 2011 (+5.2%). NYPF has shown a strong and consistent correlation to the performance of other LGPS funds over the last 10 years.

After being ranked as the top performing Local Authority Fund in 2009/10 as measured by WM Performance Services NYPF was placed in the top quartile three times in 2010/11 and once in the bottom quartile, and was the 16th best performer over the year.

Overseas Equities

- 4.5 **Fidelity** produced a negative relative return in the quarter (-1.3%) against a benchmark return of -16.9%. Performance over the year to September 2011 was also negative (-0.7% relative). Since inception in November 2008 the manager is 0.8% below the benchmark gross of fees.

Relative performance fell below the benchmark in Europe, North America and the Pacific with only Emerging Markets outperforming. The manager has said financial markets during the quarter were such that valuations became unreliable, and expects losses to be recovered as uncertainty reduces. Performance however remains below expectations. The manager will be presenting to the PFC on 2 December 2011.

- 4.6 The Global Alpha fund managed by **Baillie Gifford** produced a positive relative return (+0.1%) for the eleventh quarter in succession further extending an already exceptional run of out-performance.

The LTGG fund, also managed by **Baillie Gifford** produced a negative relative return (-0.9%) for the quarter. However the Fund has outperformed the FTSE All World benchmark in every quarter except two, since 2007.

- 4.7 Both funds managed by Baillie Gifford have produced sustained relative outperformance. Global Alpha and LTGG are 1.8% and 2.9% 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 (-6.9%) in the quarter against the FTSE 350 equally weighted benchmark return of -16.1%. Relative performance for the year was 9.7% below the benchmark.

The Fund has a material overweight position in stocks sensitive to the UK economy and the micro reasons for holding individual companies has been swamped by concerns over the UK and the global economies. The manager anticipates a positive response from equity markets over the coming months. Standard Life will be presenting to the Committee on 25 November 2011.

- 4.9 The ethical equity portfolio operated by **R C Brown** underperformed the FTSE All Share by 4.3% over the quarter and was negative over the rolling 12 month period (-5.0%).

Fixed Income

- 4.10 **ECM** produced -5.4% against the cash benchmark for the quarter. This wiped out the positive contribution over the previous three quarters leaving the manager 1.7% below the benchmark for the year to September 2011. Despite these disappointing figures, other credit indices fared worse over this volatile period. The ER40 BBB corporates index was down 8% and the VIX (Volatility Index) traded above 30% for two straight months.
- 4.11 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, and by the end of September 2011 stood at £110m (this relative “flightpath” is shown clearly in **Appendix 1**).
- 4.12 **Amundi** was above the benchmark by 0.8% in the quarter and 0.3% for the year to September 2011. Although the strong benchmark return for the quarter (+9.1%) was driven largely by changing expectations of interest rates this and the relative performance of the manager was welcome news in an otherwise disappointing quarter.
- 4.13 These results give a combined relative performance (as reported by MAS) in global fixed income of +4.8% in the quarter.

5.0 RISK INDICATORS

- 5.1 As reported to the September 2011 PFC meeting, 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 September 2011 (23.1%) is marginally higher than the average over the three year period to September 2010 (23.0%). This shows the unprecedented level of volatility of the Fund’s return over recent years which is not surprising given the recent market conditions. Before the financial markets crashed in 2008 the figure was around the 6-7% level.
- 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 reflects huge market volatility and the difficult financial market environment facing the Fund (and its investment managers).

5.4 The **Information Ratio** is a measure of manager skill and has been volatile over recent years. The figure has fallen to a negative number which reflects the level of under-performance in the three year period to September 2011 by most Managers, largely due to a poor second half of 2008/09.

6.0 SOLVENCY

6.1 The **solvency position** is presented in **Appendices 3 and 4**. As at 30 September 2011 the estimated solvency had decreased in the last quarter from 69% to 54%. The Solvency position has been updated in **Appendix 3** following the 2010 Valuation hence the large change in solvency between the December 2009 and March 2010 Quarters.

6.2 The assets of the Fund decreased by 13.2% in the Quarter (including new money), whilst liabilities (as modelled by the Actuary) rose by 10.1%, the two combining to produce a 15% reduction in solvency in the Quarter. Yields on long-dated gilts fell and are used as the proxy discount rate to value liabilities, hence lower yields result in higher liability values and vice versa.

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 2011 the improvement in asset values was achieved alongside a less significant increase in liability values (as modelled by the Actuary), resulting in a small but welcome improvement in solvency
- (f) during mid 2011 continuing concerns about the UK and the world economy, most notably the Euro Zone crisis, led to another crash of financial markets, depressing the asset value of the Fund and significantly increased liabilities as valued by the Actuary at the end of the September quarter
- (g) during the month of October 2011 asset levels improved by approximately 6% combined with a small drop in liabilities due to changing yields improving solvency to approximately 58%

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

7.0 REBALANCING

7.1 The latest round of rebalancing the Fund’s assets took place in July 2011, as reported to the PFC on 22 September 2011, based on the assets held at the end of the June quarter. Further rebalancing will take place when funds are transferred to M & G Investments in November or December 2011. 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 June to September 2011. 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

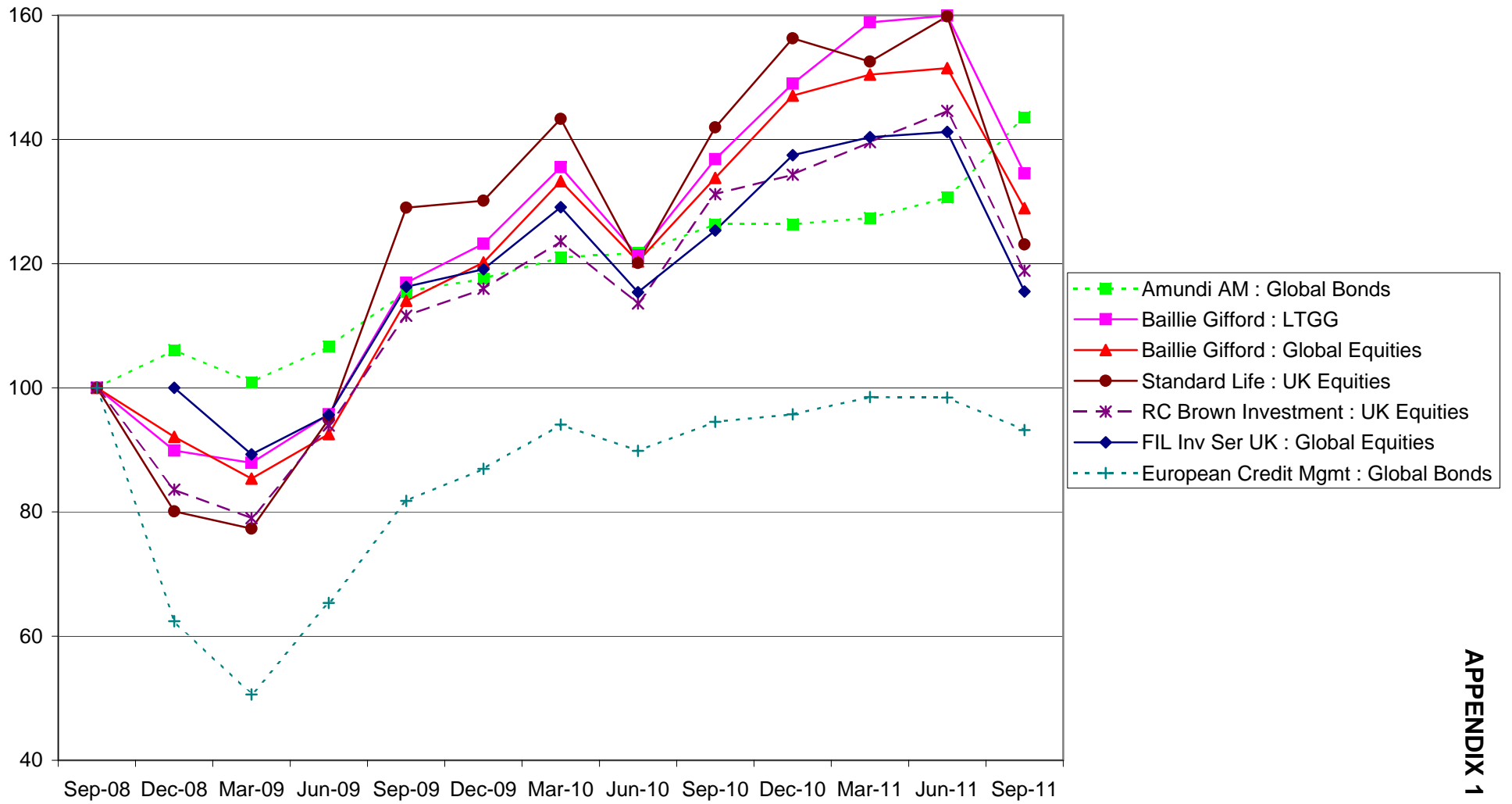
9.1 Members are asked to note the investment performance of the Fund for the Quarter and 12 months ending 30 September 2011.

JOHN MOORE
Treasurer, Finance and Central Services
County Hall, Northallerton

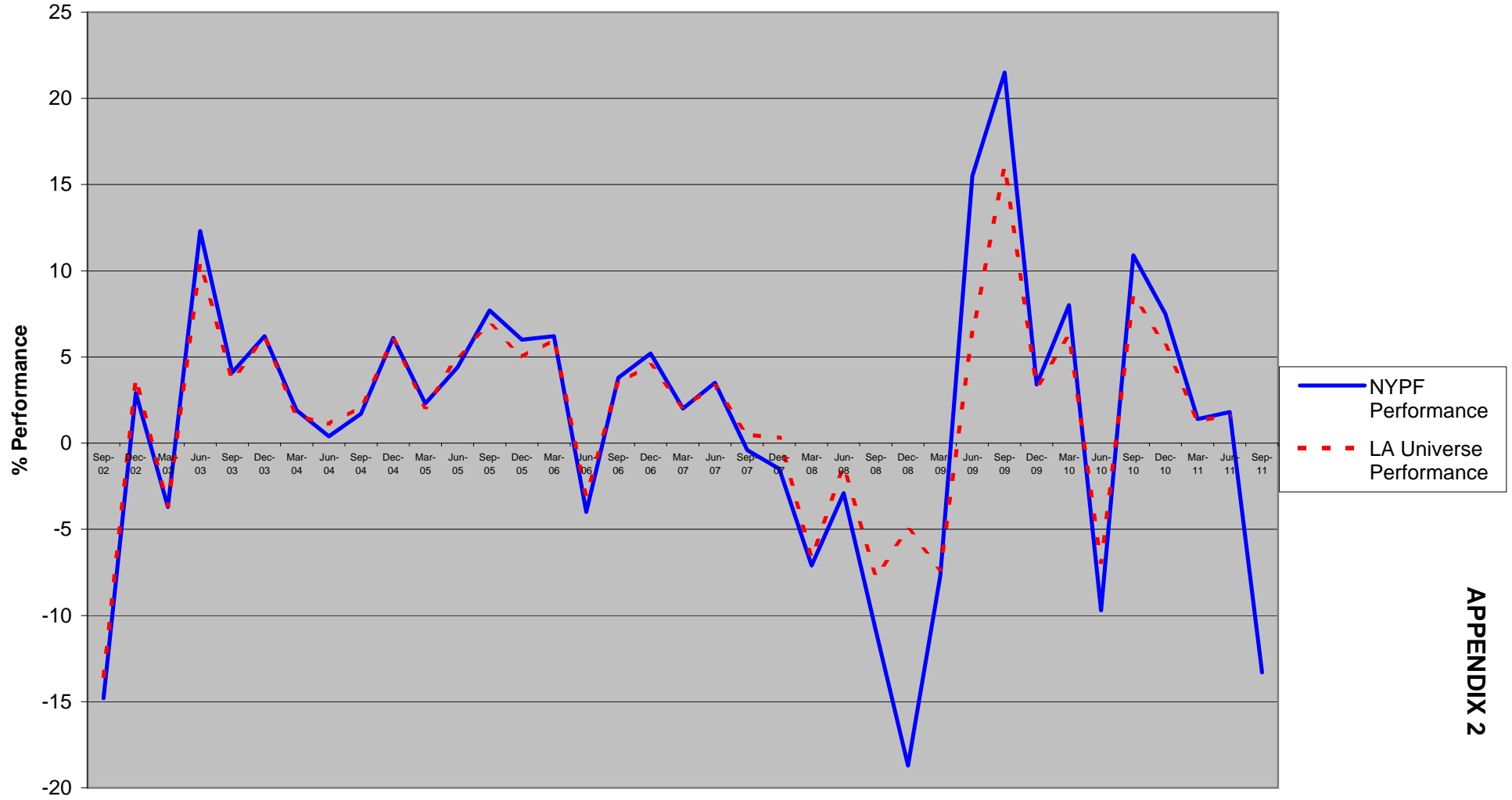
9 November 2011

Background documents: None

Investment Manager Performance - cumulative absolute performance over 3 years



Pension Fund Performance - NYPF vs Other Local Authorities

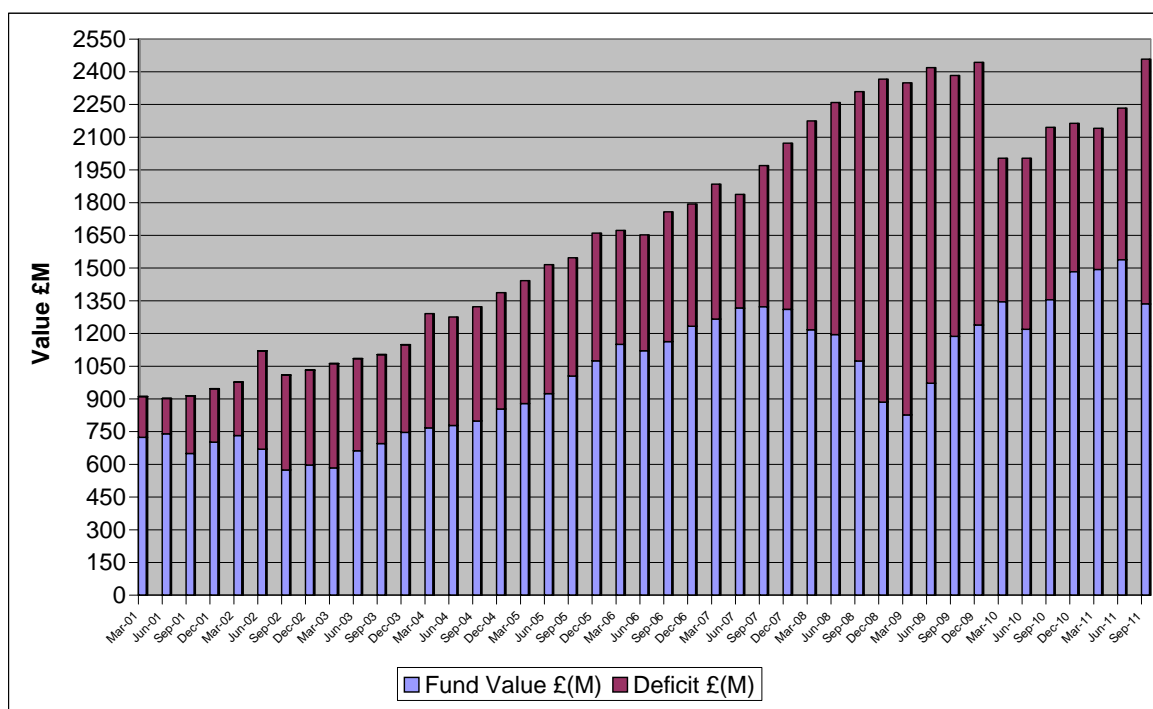


Actuarial Model of Quarterly Solvency Position

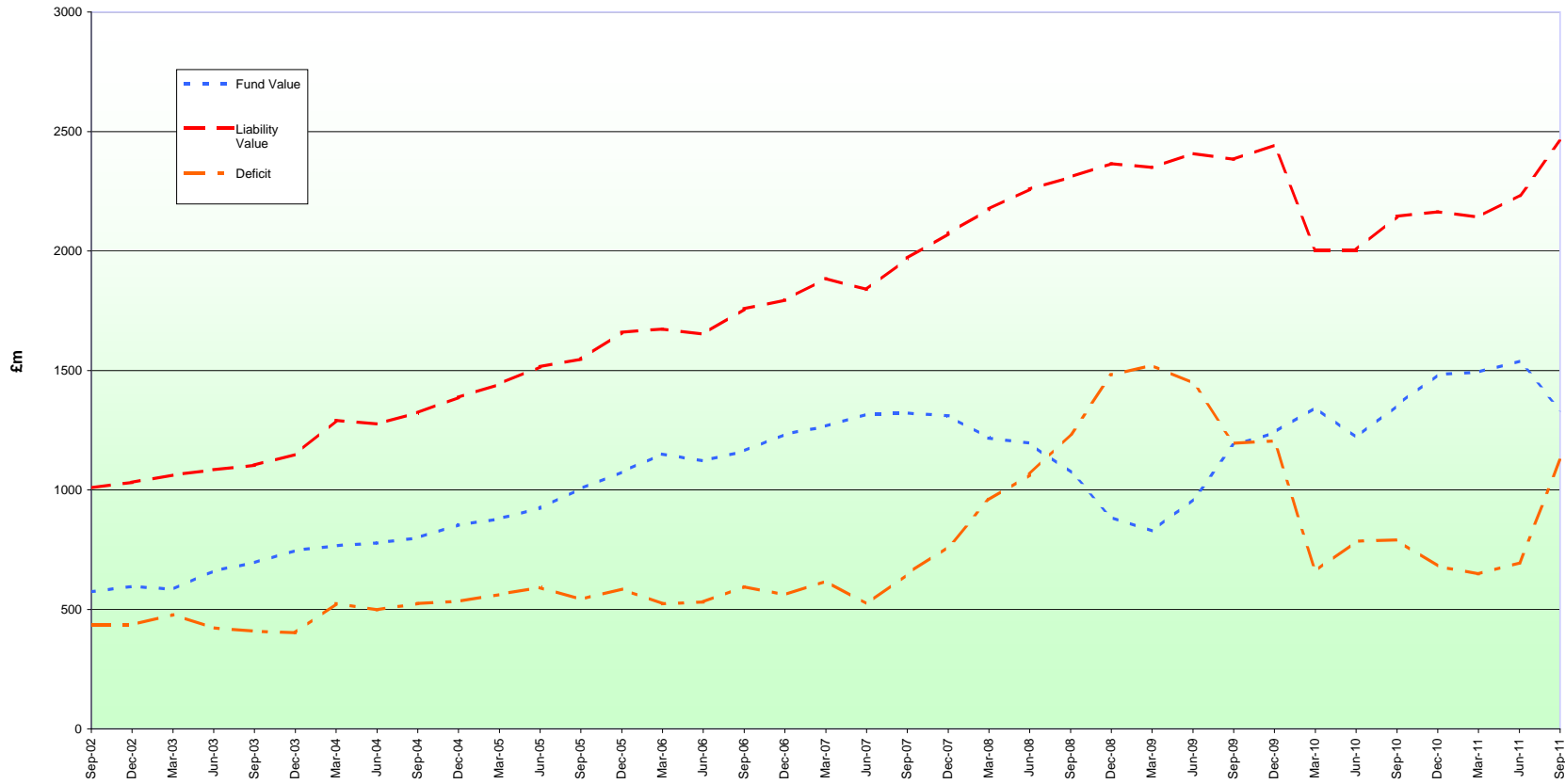
Date	Solvency	Deficit £(M)	Fund Value £(M)	FTSE 100
March 31, 2001	79%	187	724	5,634
June 30, 2001	82%	162	740	5,643
September 30, 2001	71%	265	650	4,903
December 31, 2001	74%	245	702	5,217
March 31, 2002	75%	245	732	5,272
June 30, 2002	60%	450	670	4,656
September 30, 2002	56%	435	574	3,722
December 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

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 September 2011

Asset Class	Minimum Allocation to Non-Equities	Maximum Allocation to Non-Equities
Equity + Cash	80%	60%
Liability Matching	15%	30%
Alternatives (ex property)	5%	10%
Property	0%	0%
Total	100%	100%

Current Allocation as at September 2011	Allocation After Rebalancing
72.2%	72.2%
19.5%	19.5%
8.3%	8.3%
0	0
100%	100%

		30-Sep-11		Min		Max		Under	Over			
		Value	actual	%	£m	%	£m					
Global Equity Managers												
Baillie Gifford Global Alpha		215.35	16.3%	12.0%	158.83	16.0%	211.77	0.00	-3.58	0.00	215.35	16.3%
Baillie Gifford Global Growth		138.43	10.5%	7.8%	103.24	10.4%	137.65	0.00	-0.78	0.00	138.43	10.5%
	(a)	<u>353.78</u>	<u>26.7%</u>	<u>19.8%</u>	<u>262.07</u>	<u>26.4%</u>	<u>349.43</u>	<u>0.00</u>	<u>-4.36</u>	<u>0.00</u>	<u>353.78</u>	<u>26.7%</u>
Global (ex UK) Equity Managers												
Fidelity		300.92	22.7%								300.92	
	(b)	<u>300.92</u>	<u>22.7%</u>	<u>19.8%</u>	<u>262.07</u>	<u>26.4%</u>	<u>349.43</u>	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>	<u>300.92</u>	<u>22.7%</u>
UK Equity Managers												
Standard Life		292.56	22.1%	20.4%	270.01	27.0%	357.37	0.00	0.00		292.56	22.1%
Yorkshire Fund Managers		1.34	0.1%	0.0%	0.00	0.2%	2.65	0.00	0.00		1.34	0.1%
	(c)	<u>293.90</u>	<u>22.2%</u>	<u>20.4%</u>	<u>270.01</u>	<u>27.2%</u>	<u>360.02</u>	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>	<u>293.90</u>	<u>22.2%</u>
Equity sub-total	(a+b+c)=(d)	<u>948.60</u>	<u>71.7%</u>	<u>60.0%</u>	<u>794.15</u>	<u>80.0%</u>	<u>1058.87</u>	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>	<u>948.60</u>	<u>71.7%</u>
Amundi		258.21	19.5%								258.21	
M&G Investments		0.00									0.00	
Fixed Income sub-total	(e)	<u>258.21</u>	<u>19.5%</u>	<u>15.0%</u>	<u>198.54</u>	<u>30.0%</u>	<u>397.08</u>	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>	<u>258.21</u>	<u>19.5%</u>
ECM		109.64	8.3%								109.64	
Alternatives sub-total	(f)	<u>109.64</u>	<u>8.3%</u>	<u>5%</u>	<u>66.18</u>	<u>10%</u>	<u>132.36</u>	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>	<u>109.64</u>	<u>8.3%</u>
Cash												
Internal Cash (Barclays a/c)		7.82									7.82	
Currency Hedge Cash		-0.69									-0.69	
Cash sub-total	(g)	<u>7.13</u>	<u>0.5%</u>	<u>0.0%</u>	<u>0.00</u>	<u>0.0%</u>	<u>0.00</u>	<u>0.00</u>	<u>-7.13</u>	<u>0.00</u>	<u>7.13</u>	<u>0.5%</u>
	(d+e+f+g)=(h)	<u>1323.59</u>	<u>100.0%</u>								<u>1323.59</u>	<u>100.0%</u>
RC Brown	(i)	2.07									2.07	
Total Assets	(h+i)=(j)	<u>1325.65</u>									<u>1325.65</u>	
Mellon Analytical Services Report Total		1322.65									1322.65	

Note 1 - 5% of the Fund will be transferred to M & G Investments in due course from internal cash with the balance from Amundi.

Note 2 - Upon appointment of Property Managers, £75m will be transferred from existing managers and cash.