

NORTH YORKSHIRE COUNTY COUNCIL

PENSION FUND COMMITTEE

22 NOVEMBER 2012

PERFORMANCE OF THE FUND'S PORTFOLIO FOR THE QUARTER AND YEAR ENDING 30 SEPTEMBER 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 September 2012 and the twelve months ending on that same date.

2.0 PERFORMANCE REPORT

- 2.1 The performance report (**circulated as a separate document**) produced by officers provides a performance analysis of the North Yorkshire Pension Fund for the quarter and for the year ending 30 September 2012.
- 2.2 The usual report produced by Mellon Analytical Solutions (MAS) has been phased out as it relied upon the legacy ABN Amro performance reporting platform which had been experiencing data integrity issues. The new style report, based on the BNY Mellon platform is in the process of being configured and will be presented to the Committee at the next PFC meeting on 21 February 2013.
- 2.3 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 2012 is detailed on **pages 2 / 3** of the 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 (+4.3%) was above the customised benchmark for the Fund (+3.6%) by 0.7%.**
- 3.3 **The 12 month absolute rolling return was +16.8%. This was 0.9% above the customised benchmark.**

Absolute and relative returns over the year to each of the last four quarter ends, were as follows.

| Year End | Absolute % | Relative % |
|-------------------|------------|------------|
| 30 September 2012 | +4.3 | +0.7 |
| 30 June 2012 | -4.0 | -0.9 |
| 31 March 2012 | +9.7 | +2.1 |
| 31 December 2011 | +6.4 | -1.0 |

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

3.5 These performance figures reflect a sustained period of challenging and volatile market conditions for the Fund. Over the last three years absolute performance has been positive in every quarter except for the June 2010 (-9.7%), September 2010 (-13.3%) and June 2012 (-9%). This appears to reflect the view that economic conditions are gradually improving and the worst may be behind us, but markets remain fragile and do not react well to bad news. The prospect of a slowdown in China, stuttering growth in western economies and most significantly concerns over certain faltering European economies have all contributed to these downward spikes in performance. 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 originally designed to operate in “normal” financial market conditions and is in the process of being adapted to more effectively address abnormal circumstances)
- 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 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 September 2012 in absolute percentage terms from a starting point of “100”

Appendix 2 Performance of NYPF relative to other LGPS Funds over the last ten years

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 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 positive absolute return of +4.3% in the Quarter increased the invested value of the Fund by £64.7m. Taking into account new money, the value of the Fund increased by £67.2m. In absolute terms this movement is primarily attributable to capital gains made by Standard Life (£34.8m), Baillie Gifford (£19.2m) and Fidelity (£15.4m).

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

| | absolute performance (%) | | | | | absolute performance (£) | |
|--|--------------------------|--------------|--------------|--------------|--------------|--------------------------|--------------|
| | q/e Dec 2011 | q/e Mar 2012 | q/e Jun 2012 | q/e Sep 2012 | y/e Sep 2012 | q/e Sep 2012 | y/e Sep 2012 |
| Baillie Gifford : Global Equities | 7.9 | 10.1 | -4.9 | 5.3 | 19.0 | 12.9 | 40.9 |
| Baillie Gifford : LTGG | 2.1 | 14.7 | -3.8 | 4.1 | 17.2 | 6.3 | 23.8 |
| FIL Inv Ser UK : Global Equities | 5.8 | 10.2 | -4.3 | 4.6 | 16.8 | 15.4 | 50.6 |
| Standard Life : UK Equities | 5.6 | 19.3 | -8.8 | 10.3 | 26.8 | 34.8 | 79.1 |
| Equities sub-total | | | | | | 69.4 | 194.4 |
| Amundi AM : Global Bonds | 10.6 | -1.9 | 2.1 | -4.1 | 6.2 | -8.6 | 18.0 |
| M&G Investments : Gilts | | -3.6 | 1.4 | -3.6 | -2.1 | -2.4 | -1.4 |
| European Credit Mgmt : Global Bonds | -0.3 | 4.5 | -0.4 | 2.5 | 6.3 | 2.8 | 6.9 |
| Fixed income sub-total | | | | | | -8.2 | 23.5 |
| RC Brown Investment : UK Equities | 4.2 | 10.1 | -8.2 | 5.6 | 11.3 | 0.1 | 0.2 |
| Hermes : UK Property | | | -0.4 | -0.5 | -0.9 | -0.1 | -0.2 |
| Threadneedle : UK Property | | | | -0.2 | -0.2 | 0.0 | 0.0 |
| Movement in cash reserves | | | | | | 6.0 | 31.8 |
| Movement in Fund Investments and Cash | | | | | | 67.2 | 249.7 |

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

- 4.3 Positive absolute performance in the Quarter was achieved by all managers of performance seeking assets except for property, with liability matching managers suffering losses in absolute terms. This was expected as “risk on” sentiment increased during the quarter. At the end of the September 2012 quarter the value of the Fund was £249.7m above the value at the end of September 2011.

Performance relative to other LGPS Funds

- 4.4 **Appendix 2** shows the **performance of NYPF relative to other Funds in the LGPS universe**. 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 reflects to a greater inherent potential for volatility in the NYPF Investment Strategy relative to many other LGPS funds. At the time of writing figures for the Local Authority average for September 2012 were not available.

Overseas Equities

- 4.5 **Fidelity** produced a positive relative return in the quarter (+0.3%) against a benchmark return of +4.3%. Performance over the year to September 2012 was +2.1% relative. Since inception in November 2008 the manager is now only 0.1% below the benchmark gross of fees.

Allocations to Europe, North America and the Pacific again outperformed; however for the eighth time in the last nine quarters, relative performance fell below the benchmark in Emerging Markets. The manager has been asked to provide an update when he presents to Members of the Committee on 30 November 2012.

- 4.6 The Global Alpha fund managed by **Baillie Gifford** produced a positive relative return (+1.3%) reversing the losses suffered in the June 2012 quarter, which followed thirteen successive quarters of positive performance. The Fund was 1.7% above the benchmark for the year to September 2012.

The LTGG fund, also managed by **Baillie Gifford** produced a positive relative return (+0.1%) for the quarter. The fund was 0.1% below the benchmark for the year to September 2012 but has outperformed the FTSE All World benchmark in every quarter except four, since 2007.

- 4.7 Despite challenging market conditions both funds managed by Baillie Gifford have produced sustained relative outperformance. Global Alpha and LTGG are 1.7% and 2.4% 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 positive relative return (+1.8%) in the quarter against the FTSE 350 equally weighted benchmark return of +8.5%. Relative performance for the year was 4.1% above the benchmark although since inception the fund is below the benchmark by 2.5%.

Compared to the FTSE All Share which was +4.7% for the quarter, the benchmark of the FTSE 350 Equally Weighted (excluding Investment Trusts), which focuses investment towards the UK economy, demonstrated stronger performance.

- 4.9 The ethical equity portfolio operated by **R C Brown** outperformed the FTSE All Share by 0.9% over the quarter and was negative over the rolling 12 month period (-5.9%).
- 4.10 These results give a combined relative performance in global equities of +1% in the quarter.

Fixed Income

- 4.11 **ECM** produced +2.4% relative against the cash benchmark for the quarter and +5.6% relative for the year to September 2012. The quarterly return matched the Merrill Lynch European corporates index and exceeded it over the year by 1.1%.
- 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 September 2012 the value of the investment stood at £117m.
- 4.13 **Amundi** fell slightly below the benchmark (-0.2%) in the quarter but was 0.3% above for the year to September 2012. The strong benchmark return for the year (+5.9%) was driven largely by nervousness about the outlook for financial markets although this was less pronounced than in 2011. The investment with this manager has proven to be a helpful contributor to Fund performance when market sentiments are negative but this counterbalancing effect tends not to generate positive returns when markets are strong.
- 4.14 The investment in Gilts with **M&G** produced -3.6% against a falling benchmark (-3.9%). Yields fell slightly over the quarter.
- 4.15 These results give a combined relative performance in global fixed income of +0.7% in the quarter.

Property

- 4.16 The investments with **Hermes** and **Threadneedle** produced -1.5% and -1.2% respectively against the RPI benchmark.

5.0 RISK INDICATORS

- 5.1 The Report (**page 5**) includes three long-term risk indicators.
- 5.2 The Fund's annualised **Standard Deviation** for the rolling three year period to September 2012 (14.6%) is lower than the average over the three year period to June 2012 (18.1%); this is 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 high 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 (2.8 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 September 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 September 2012 the estimated solvency increased in the last quarter from 56% to 60%.
- 6.2 The assets of the Fund increased by 4.4% in the Quarter (including new money), whilst liabilities (as modelled by the Actuary) fell by 2.6%, the two combining to produce a 4% increase in solvency in the Quarter. Yields remained relatively stable in the Quarter but expectations of rising inflation 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
- "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)
 - from March 2007 to March 2009 "liability value" accelerated and "asset value" fell, which had
 - 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)
 - 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 September 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 7%
- (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 67% as at September 2012, 7% above the reported level, ie what it was at the last Valuation date of March 2010. 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 The rebalancing schedule is attached as **Appendix 5**. £20m was transferred to Legal & General on 1 November 2012 out of cash reserves (**see Fund Manager Matters paragraph 2.2**).

8.0 PROXY VOTING

8.1 Available on request is the report from PIRC summarising the proxy voting activity in the period July to September 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 September 2012.

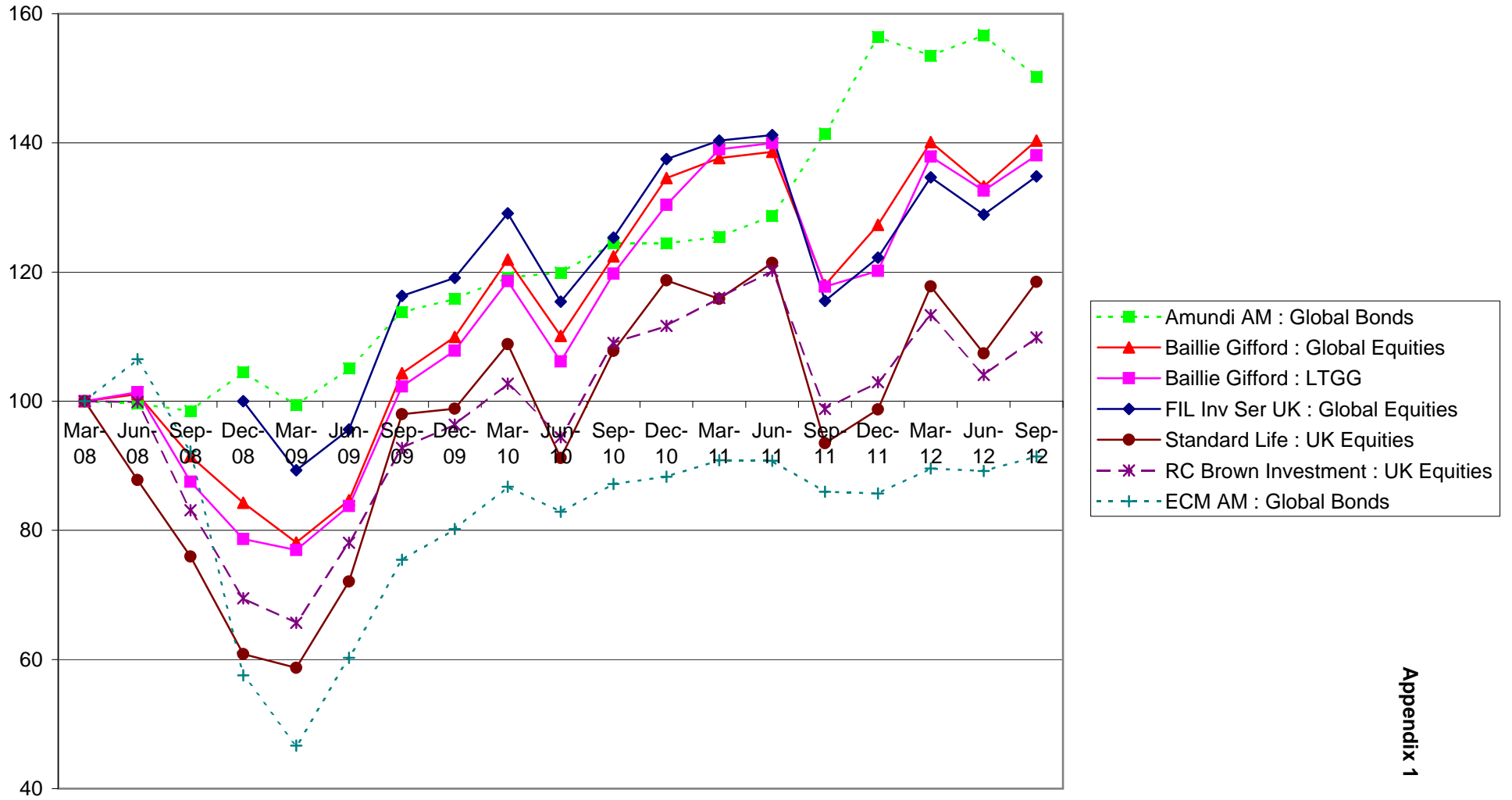
GARY FIELDING
Treasurer

Central Services
County Hall, Northallerton

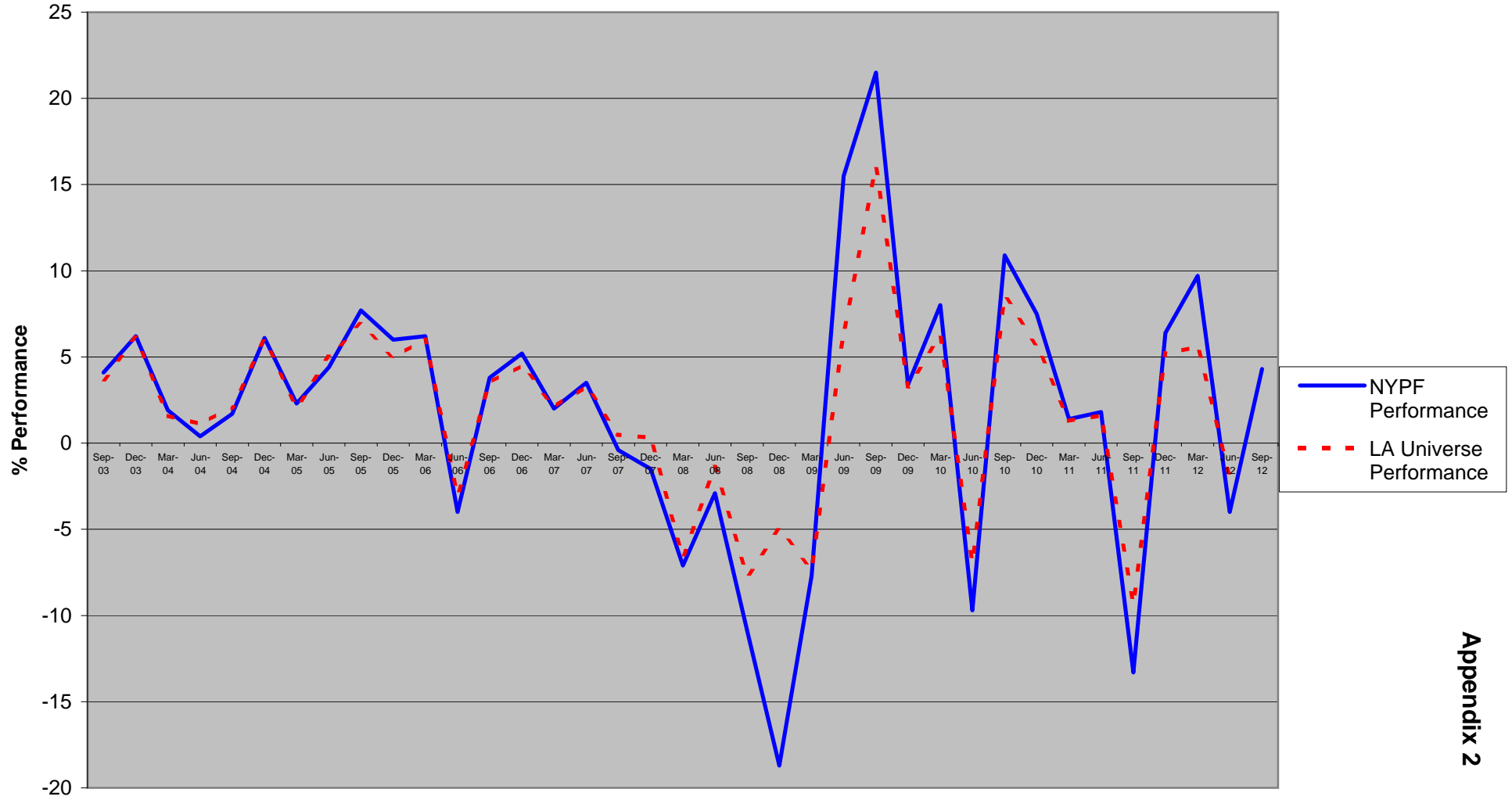
1 November 2012

Background documents: None

Investment Manager Performance - cumulative absolute performance since March 2008



Pension Fund Performance - NYPF vs Other Local Authorities

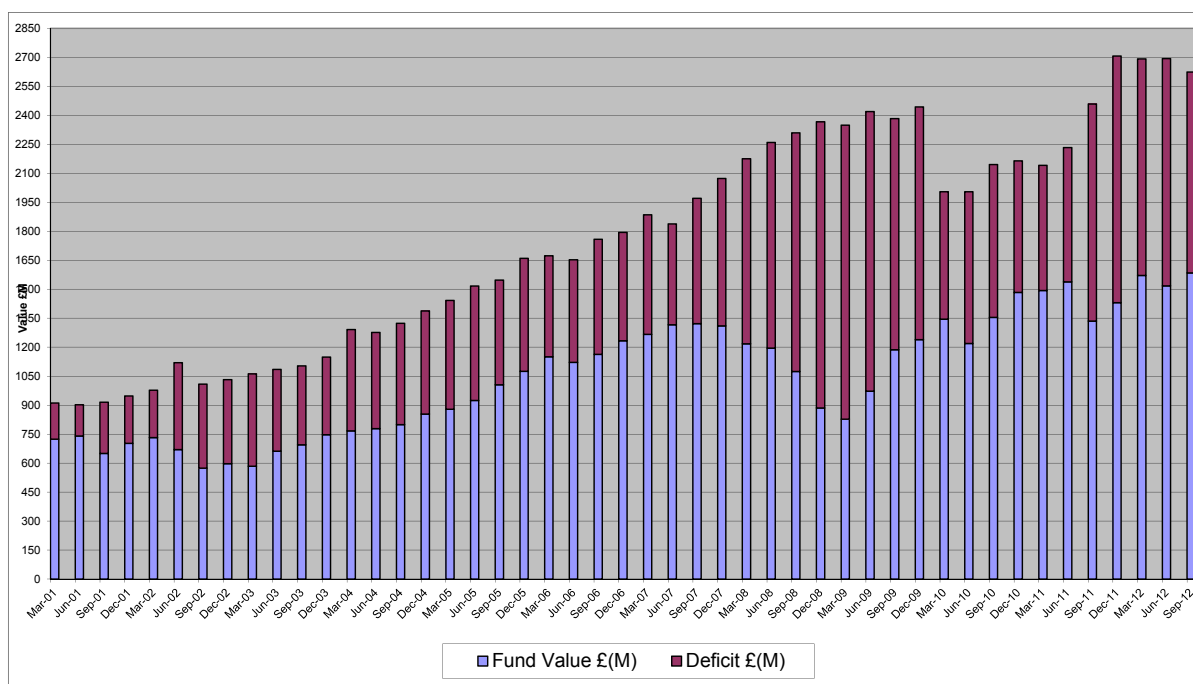


Actuarial Model of Quarterly Solvency Position

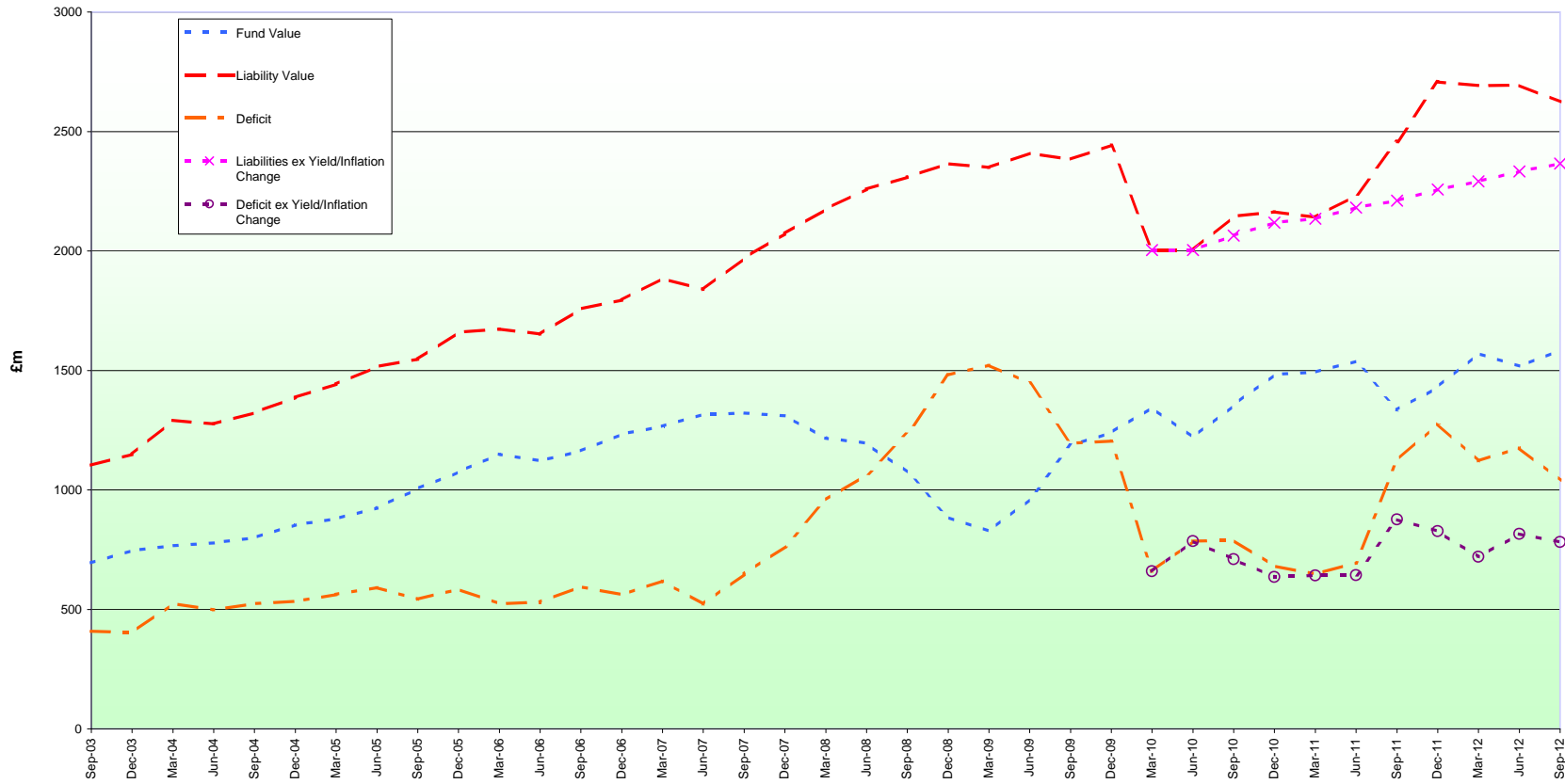
| Date | Solvency | Deficit £(M) | Fund Value £(M) | FTSE 100 |
|--------------------|----------|--------------|-----------------|----------|
| March 31, 2001 | 79% | 187 | 724 | 5,634 |
| June 30, 2001 | 82% | 162 | 740 | 5,643 |
| September 30, 2001 | 71% | 265 | 650 | 4,903 |
| December 31, 2001 | 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 |
| September 30, 2012 | 60% | 1040 | 1584 | 5,742 |

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 Sept 2012

| Asset Class | Minimum Allocation to Non-Equities | Maximum Allocation to Non-Equities | Allocation as at June 2012 | Current Allocation as at Sept 2012 | Allocation After Rebalancing |
|----------------------------|------------------------------------|------------------------------------|----------------------------|------------------------------------|------------------------------|
| Equity + Cash | 75% | 50% | 71.6% | 73.3% | 72.1% |
| Bonds | 15% | 30% | 18.4% | 16.9% | 16.9% |
| Alternatives (ex property) | 5% | 10% | 7.6% | 7.4% | 7.4% |
| Property | 5% | 10% | 2.4% | 2.3% | 3.6% |
| Total | 100% | 100% | 100% | 100% | 100% |

| | 30-Jun-12 Value £m | 30-Sep-12 Value £m | actual % | Min | | Max | | Under | Over | | | | |
|--|--------------------------|--------------------------|----------------|-------|--------|--------|--------|---------|-------|--------|--------|---------------|-------|
| | | | | % | £m | % | £m | | | | | | |
| Global Equity Managers | | | | | | | | | | | | | |
| Baillie Gifford Global Alpha | 243.47 | 256.27 | 16.3% | 12.0% | 188.39 | 16.0% | 251.18 | 0.00 | -5.09 | 0.00 | 256.27 | 16.3% | |
| Baillie Gifford Global Growth | 155.87 | 162.22 | 10.3% | 7.8% | 122.45 | 10.4% | 163.27 | 0.00 | 0.00 | 0.00 | 162.22 | 10.3% | |
| (a) | 399.34 | 418.49 | 26.7% | 19.8% | 310.84 | 26.4% | 414.45 | 0.00 | -5.09 | 0.00 | 418.49 | 26.7% | |
| Global (ex UK) Equity Managers | | | | | | | | | | | | | |
| Fidelity | 335.88 | 351.32 | 22.4% | | | | | | | | 351.32 | | |
| (b) | 335.88 | 351.32 | 22.4% | 19.8% | 310.84 | 26.4% | 414.45 | 0.00 | 0.00 | 0.00 | 351.32 | 22.4% | |
| UK Equity Managers | | | | | | | | | | | | | |
| Standard Life | 336.42 | 371.20 | 23.6% | 20.4% | 320.26 | 27.0% | 423.87 | 0.00 | 0.00 | | 371.20 | 23.6% | |
| Yorkshire Fund Managers | 1.07 | 0.87 | 0.1% | 0.0% | 0.00 | 0.2% | 3.14 | 0.00 | 0.00 | | 0.87 | 0.1% | |
| (c) | 337.49 | 372.07 | 23.7% | 20.4% | 320.26 | 27.2% | 427.01 | 0.00 | 0.00 | 0.00 | 372.07 | 23.7% | |
| Equity sub-total | (a+b+c)=(d) | 1072.72 | 1141.88 | 72.7% | 60.0% | 941.94 | 80.0% | 1255.92 | 0.00 | 0.00 | 0.00 | 1141.88 | 72.7% |
| Amundi | 209.90 | 201.25 | 12.8% | | | | | | | | 201.25 | | |
| M & G | 66.99 | 64.55 | 4.1% | | | | | | | | 64.55 | | |
| Fixed Income sub-total | (e) | 276.90 | 265.80 | 16.9% | 15.0% | 235.48 | 30.0% | 470.97 | 0.00 | 0.00 | 0.00 | 265.80 | 16.9% |
| ECM | 113.72 | 116.52 | 7.4% | | | | | | | | 116.52 | | |
| Alternatives sub-total | (f) | 113.72 | 116.52 | 7.4% | 5% | 78.49 | 10% | 156.99 | 0.00 | 0.00 | 0.00 | 116.52 | 7.4% |
| Hermes | 23.66 | 23.54 | 1.5% | | | | | | | | 23.54 | | |
| Legal & General | 0.00 | 0.00 | 0.0% | | | | | | | 20.00 | 20.00 | | |
| Threadneedle | 12.53 | 12.54 | 0.8% | | | | | | | | 12.54 | | |
| Property sub-total | (g) | 36.22 | 36.08 | 2.3% | 2% | 26.22 | 3% | 52.28 | 0.00 | 0.00 | 20.00 | 56.08 | 3.6% |
| Cash | | | | | | | | | | | | | |
| Internal Cash (Barclays a/c) | 1.41 | 3.89 | | | | | | | | -16.00 | -12.11 | | |
| Currency Hedge Cash and outstanding trades | 1.87 | 5.72 | | | | | | | | -4.00 | 1.72 | | |
| Cash sub-total | (h) | 3.27 | 9.62 | 0.6% | 0.0% | 0.00 | 0.0% | 0.00 | 0.00 | -9.62 | -20.00 | -10.38 | -0.7% |
| (d+e+f+g+h)=(i) | 1502.83 | 1569.90 | 100.0% | | | | | | | | | 100.0% | |
| RC Brown | (j) | 2.30 | 2.43 | | | | | | | | | | |
| Total Assets | (i+j)=(k) | 1505.14 | 1572.33 | | | | | | | | | | |
| Report Total | | 1505.14 | 1572.33 | | | | | | | | | | |