NORTH YORKSHIRE COUNTY COUNCIL

PENSION FUND COMMITTEE

23 FEBRUARY 2012

PERFORMANCE OF THE FUND'S PORTFOLIO FOR THE QUARTER AND YEAR ENDING 31 DECEMBER 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 31 December 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 31 December 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 31 December 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 Fund outperformed the Local Authority average (as measured by WM Performance Services) by 1.2% and was in the top quartile for the December 2011 quarter**. The customised benchmark was 2.2% above the Local Authority average, reflecting the challenging target the Fund has been set.

3.3 **The absolute overall return for the quarter (+6.4%) was below the customised benchmark for the Fund (+7.4%) by 1%.**

3.4 **Over the rolling year the Fund performance was 4% below the customised benchmark. The 12 month absolute rolling return was -4.9%.**

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

Year End	**Absolute %**	**Relative %**
31 December 2011	-4.9	-4.0
30 September 2011	-3.8	-2.9
30 June 2011	+23.0	+1.7
31 March 2011	+9.2	-0.8

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

3.4 These performance figures reflect a sustained period of challenging and volatile market conditions for the Fund. Although markets rallied during the quarter there remains a great deal of negative news flow particularly from the UK and Europe. Unpredictable trading conditions are expected to continue for some time. Looking forward to Q1 of 2012, the rally in equity markets in January 2012 started the quarter well and was the strongest since 1998 with the Fund increasing in value by 5%. 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 31 December 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 @ 31 December 2011

3.7 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 6.4% in the Quarter increased the invested value of the Fund by £84.7m. Taking into account new money, the value of the Fund increased by £95.5m. In absolute terms this movement is primarily attributable to capital gains made by Amundi (£27.4m), Baille Gifford (£20.1m), Fidelity (£17.6m) and Standard Life (£16.4m).

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

	absolute performance (%)					absolute performance (£)	
	q/e Mar 2011	q/e Jun 2011	q/e Sep 2011	q/e Dec 2011	y/e Dec 2011	q/e Dec 2011	y/e Dec 2011
Baillie Gifford : Global Equities	2.3	0.7	-14.9	7.9	-5.4	17.1	-13.2
Baillie Gifford : LTGG	6.6	0.7	-15.9	2.1	-7.9	3.0	-12.0
FIL Inv Ser UK : Global Equities	2.1	0.6	-18.2	5.8	-11.1	17.6	-39.8
Standard Life : UK Equities	-2.4	4.8	-23.0	5.6	-16.8	16.4	-63.5
Equities sub-total						54.1	-128.5
Amundi AM : Global Bonds	0.8	2.6	9.9	10.6	25.6	27.4	57.6
M&G Investments: Gilts						2.6	2.6
European Credit Mgmt : Global Bonds	2.9	-0.1	-5.3	-0.3	-3.0	-0.3	-3.4
Fixed income sub-total						29.7	56.8
RC Brown Investment : UK Equities	3.9	3.6	-17.8	4.2	-7.7	0.1	-0.1
Movement in cash reserves						11.6	27.6
Movement in Fund Investments and Cash						95.5	-44.2

The figure movement in cash reserves for the quarter is artificially high because of the timing of cash flows over the New Year bank holiday period. Cumulative absolute performance by each manager over the last three years in percentage terms is illustrated at **Appendix 1**.

4.3 Positive absolute performance in the Quarter was achieved by all managers except one as markets rallied following the losses in Q3 of 2011. At the end of the December 2011 quarter the value of the Fund was £44.2m below the value at the end of December 2010. 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**. Performance was above the Local Authority average in the December quarter by 1.2%, but was behind for the 12 month period to December 2011 (-3.4%) due to the poor September 2011 quarter. 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 underperform in falling markets conditions and outperform when markets are rising.

Overseas Equities

4.5 **Fidelity** produced a negative relative return in the quarter (-0.1%) against a benchmark return of +5.9%. Performance over the year to September 2011 was also negative (-1.6% relative). Since inception in November 2008 the manager is 0.8% below the benchmark gross of fees.

Relative performance fell below the benchmark in North America and Emerging Markets with Europe and the Pacific outperforming. Performance remains below expectations, however the manager remains comfortable with the portfolio positioning and expects their approach to investing to recover value in due course. As at the end of January 2012 the portfolio had increased by another 4.8% in absolute terms.

4.6 The Global Alpha fund managed by **Baillie Gifford** produced a positive relative return (+0.5%) for the twelfth quarter in succession further extending an already exceptional run of out-performance. In January 2012 a further 4.4% was added to the value of the portfolio.

The LTGG fund, also managed by **Baillie Gifford** produced a negative relative return (-5.3%) for the quarter and was 1.3% below the benchmark for the year to December 2011. However the Fund has outperformed the FTSE All World benchmark in every quarter except three, since 2007. In January 2012 the portfolio increased in value by 7.4%.

4.7 Both funds managed by Baillie Gifford have produced sustained relative outperformance. Global Alpha and LTGG are both 1.8% 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 (+1.3%) in the quarter against the FTSE 350 equally weighted benchmark return of +4.3%. Relative performance for the year was 8.1% below the benchmark.

The manager's investment process strongly focuses on individual stock fundamentals and detailed research. These factors were largely outweighed in 2011 by challenging macro economic conditions, however Standard Life expect the recovery in Q4 of 2011 to yield superior performance in 2012. The manager added 10.5% to the value of the portfolio in January 2012.

4.9 The ethical equity portfolio operated by **R C Brown** underperformed the FTSE All Share by 4.2% over the quarter and was negative over the rolling 12 month period (-4.2%).

Fixed Income

4.10 **ECM** produced -0.4% against the cash benchmark for the quarter and -3.2% relative for the year to December 2011. Credit returns for the calendar year registered the second worst result on record with the corporate bond index most resembling the portfolio returning -4.2%. During the year, the manager was given the flexibility to add duration, which helped to mitigate loss to an extent. Performance in January 2012 was +2%.

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. By the end of December 2011 stood at £109m.

4.12 **Amundi** was below the benchmark by 1.5% in the quarter and 0.4% for the year to December 2011. There was however a strong benchmark return for the quarter (+12.1%) and for the year (+26%) which was driven largely by changing expectations of future interest rates and a very high demand for gilts. In January 2012 the portfolio increased in value by 1.2%.

4.13 These results give a combined relative performance (as reported by MAS) in global fixed income of +7.9% in the quarter.

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 December 2011 (19.6%) is lower than the average over the three year period to December 2011 (23.3%) essentially as a result of the extremely volatile Q4 of 2008 dropping out of the equation. Before the financial markets crashed in 2008 the figure was around the 6-7% level. This latest figure therefore 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 reflects 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 (4.5 against 9.4) reflects the unusual volatility in Q4 of 2008.

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. The ratio is now positive, for the first time since September 2007.

6.0 SOLVENCY

6.1 The **solvency position** is presented in **Appendices 3 and 4**. As at 31 December 2011 the estimated solvency had decreased in the last quarter from 54% to 53%. 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 increased by 6.4% in the Quarter (including new money), whilst liabilities (as modelled by the Actuary) rose by 11.1%, the two combining to produce a 1% reduction in solvency in the Quarter. Yields on long-dated gilts fell once again and are used as the proxy discount rate to value liabilities, hence lower yields result in higher liability values and vice versa; the effect of low yields 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 December 2011 the 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 14%

(f) the most significant factor affecting liability values over the period since the 2010 Triennial Valuation has been the fall in the discount rate. In isolation, had the rate remained the same since this date solvency would be around 72% as at December 2011. The "ex yield 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 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 £66m was transferred to M&G Investments in December 2011, £60m from Amundi and £6m from cash. £5m was transferred from cash reserves to Standard Life in January 2012. Further rebalancing is expected in the March 2012 quarter as funds are allocated to the recently appointed property managers. 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 September to December 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

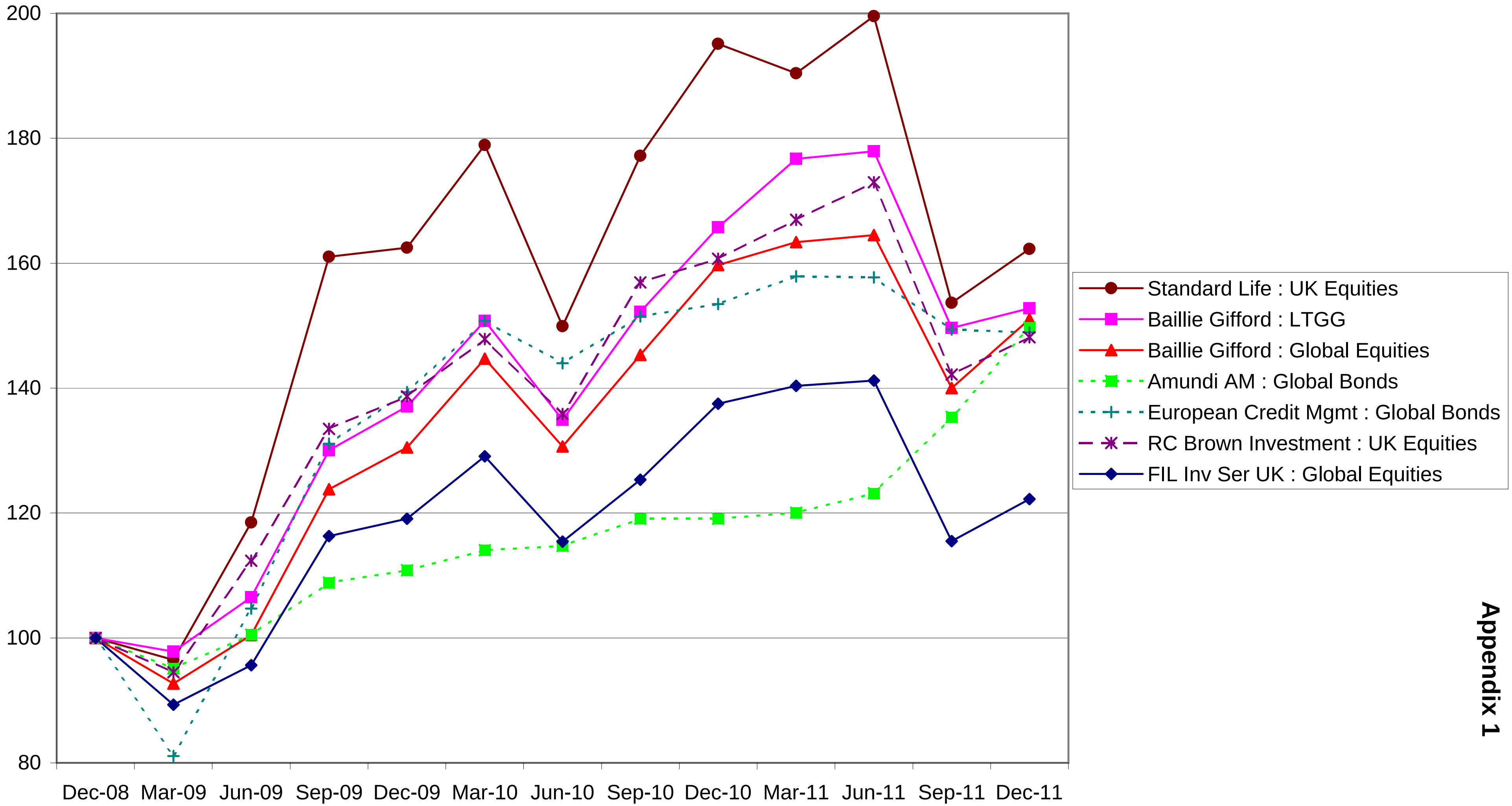
9.1 Members are asked to note the investment performance of the Fund for the Quarter and 12 months ending 31 December 2011.

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

6 February 2012

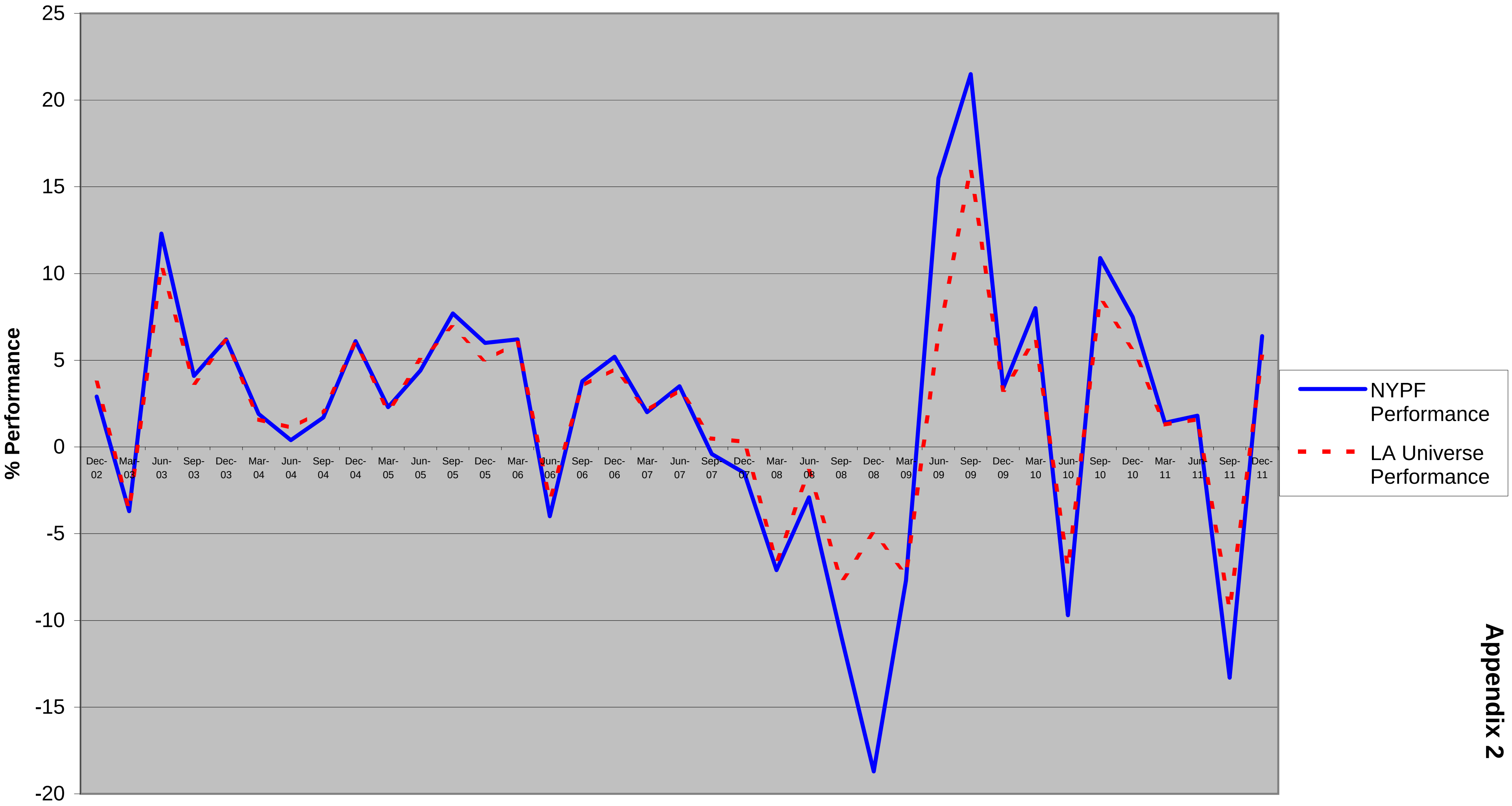
Background documents: None

Investment Manager Performance - cumulative absolute performance over 3 years



Appendix 1

Pension Fund Performance - NYPF vs Other Local Authorities



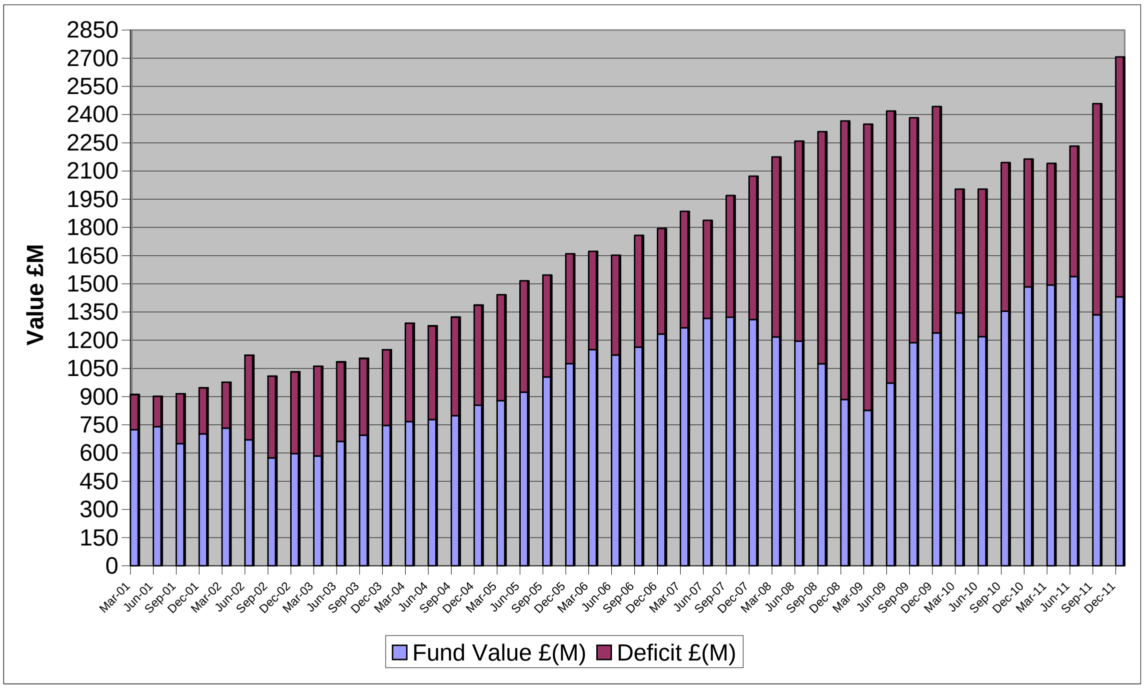
Appendix 2

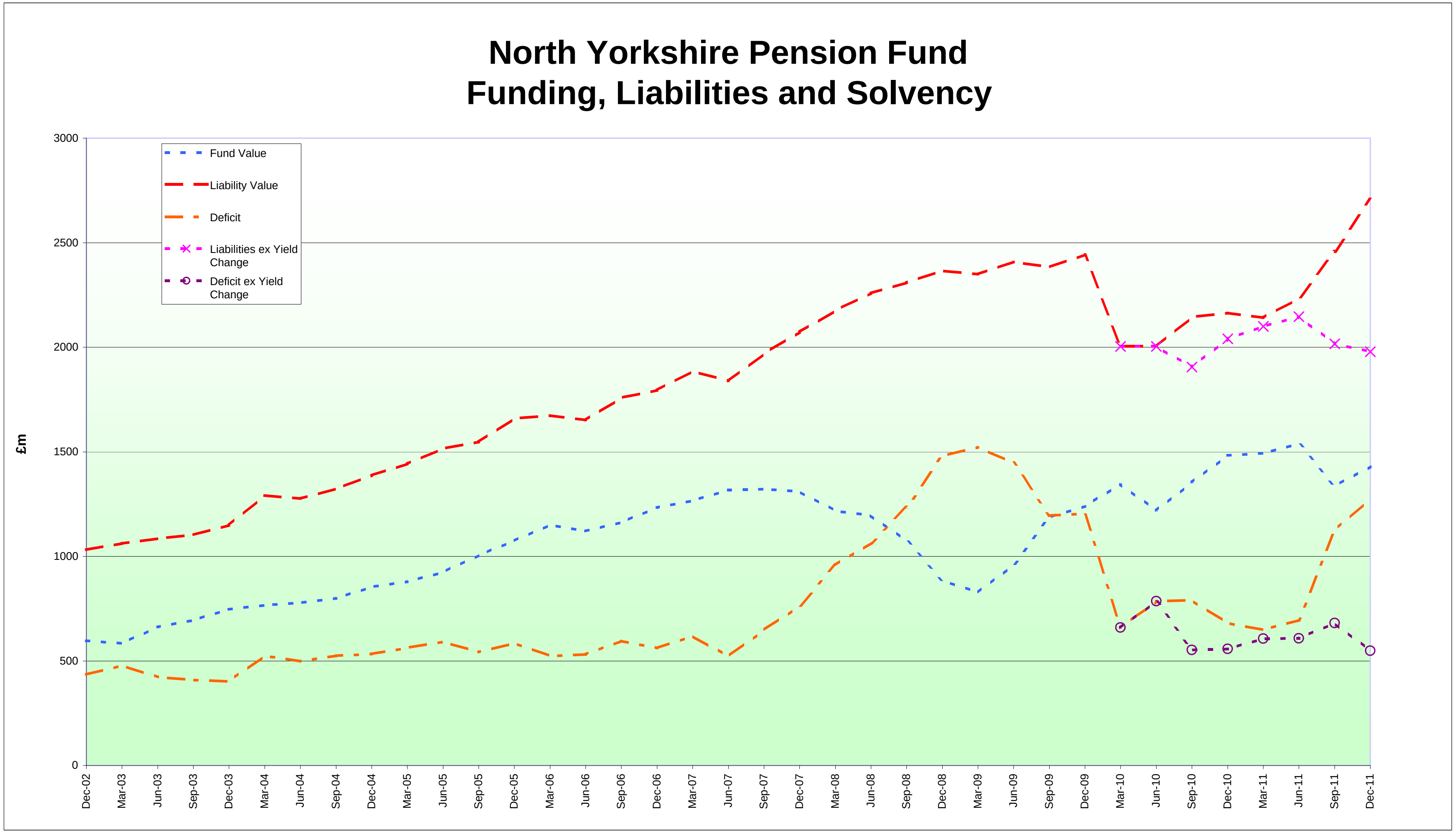
Actuarial Model of Quarterly Solvency Position

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

Triennial valuation results highlighted in grey

Movement in Assets and Liabilities




North Yorkshire Pension Fund
Funding, Liabilities and Solvency
£m
3000
2500
2000
1500
1000
500
0
Fund Value
Liability Value
Deficit
Liabilities ex Yield Change
Deficit ex Yield Change
Dec-02
Mar-03
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APPENDIX 4

REBALANCING OF NYPF ASSETS AS AT 31 DECEMBER 2011

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

Current Allocation as at December 2011	Allocation After Rebalancing
71.6%	71.6%
20.7%	20.7%
7.7%	7.7%
0	0
100%	**100%**

		31-Dec-11										
		Value	actual	**Min**		**Max**		Under	Over			
Global Equity Managers		**£m**	**%**	**%**	**£m**	**%**	**£m**					
Baillie Gifford Global Alpha		232.44	16.4%	12.0%	169.93	16.0%	226.57	0.00	-5.86	0.00	232.44	16.4%
Baillie Gifford Global Growth		141.37	10.0%	7.8%	110.45	10.4%	147.27	0.00	0.00	0.00	141.37	10.0%
	(a)	373.80	26.4%	19.8%	280.38	26.4%	373.84	0.00	-5.86	0.00	373.80	26.4%
Global (ex UK) Equity Managers												
Fidelity		318.51	22.5%								318.51	
	(b)	318.51	22.5%	19.8%	280.38	26.4%	373.84	0.00	0.00	0.00	318.51	22.5%
UK Equity Managers												
Standard Life		308.96	21.8%	20.4%	288.88	27.0%	382.34	0.00	0.00	5.00	313.96	22.2%
Yorkshire Fund Managers		1.34	0.1%	0.0%	0.00	0.2%	2.83	0.00	0.00		1.34	0.1%
	(c)	310.30	21.9%	20.4%	288.88	27.2%	385.17	0.00	0.00	5.00	315.30	22.3%
Equity sub-total	(a+b+c)=(d)	1002.61	70.8%	60.0%	849.65	80.0%	1132.86	0.00	0.00	5.00	1007.61	71.2%
Amundi		224.80	15.9%								224.80	
M & G		68.59	4.8%								68.59	
Fixed Income sub-total	(e)	293.39	20.7%	15.0%	212.41	30.0%	424.82	0.00	0.00	0.00	293.39	20.7%
ECM		109.34	7.7%								109.34	
Alternatives sub-total	(f)	109.34	7.7%	5%	70.80	10%	141.61	0.00	0.00	0.00	109.34	7.7%
Cash												
Internal Cash (Barclays a/c)		9.74								-5.00	4.74	
Currency Hedge Cash		1.00									1.00	
Cash sub-total	(g)	10.74	0.8%	0.0%	0.00	0.0%	0.00	0.00	-10.74	-5.00	5.74	0.4%
	(d+e+f+g)=(h)	**1416.08**	**100.0%**									**100.0%**
RC Brown	(i)	2.15										
Total Assets	(h+i)=(j)	**1418.23**										