

Democratic Services

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Date: 4 November 2010

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To: All Members of the Avon Pension Fund Committee - Investment Panel

Councillor David Bellotti (Chair), Councillor Gabriel Batt, Councillor Gordon Wood, Ann Berresford, Councillor Mary Blatchford and Bill Marshall

Chief Executive and other appropriate officers
Press and Public

Dear Member

Avon Pension Fund Committee - Investment Panel: Thursday, 11th November, 2010

You are invited to attend a meeting of the **Avon Pension Fund Committee - Investment Panel**, to be held on **Thursday, 11th November, 2010 at 1.30 pm** in the **Council Chamber - Guildhall, Bath**.

A buffet lunch will be provided for Members at 1.00 pm.

The agenda is set out overleaf.

Yours sincerely

Sean O'Neill
for Chief Executive

If you need to access this agenda or any of the supporting reports in an alternative accessible format please contact Democratic Services or the relevant report author whose details are listed at the end of each report.

This Agenda and all accompanying reports are printed on recycled paper

NOTES:

- 1. Inspection of Papers:** Any person wishing to inspect minutes, reports, or a list of the background papers relating to any item on this Agenda should contact Sean O'Neill who is available by telephoning Bath or by calling at the Riverside Offices Keynsham (during normal office hours).
- 2. Public Speaking at Meetings:** The Council has a scheme to encourage the public to make their views known at meetings. They may make a statement relevant to what the meeting has power to do. They may also present a petition or a deputation on behalf of a group. Advance notice is required not less than two full working days before the meeting (this means that for meetings held on Wednesdays notice must be received in Democratic Services by 4.30pm the previous Friday)

The public may also ask a question to which a written answer will be given. Questions must be submitted in writing to Democratic Services at least two full working days in advance of the meeting (this means that for meetings held on Wednesdays, notice must be received in Democratic Services by 4.30pm the previous Friday). If an answer cannot be prepared in time for the meeting it will be sent out within five days afterwards. Further details of the scheme can be obtained by contacting Sean O'Neill as above.

- 3. Details of Decisions taken at this meeting** can be found in the minutes which will be published as soon as possible after the meeting, and also circulated with the agenda for the next meeting. In the meantime details can be obtained by contacting Sean O'Neill as above.

Appendices to reports are available for inspection as follows:-

Public Access points - Riverside - Keynsham, Guildhall - Bath, Hollies - Midsomer Norton, and Bath Central, Keynsham and Midsomer Norton public libraries.

For Councillors and Officers papers may be inspected via Political Group Research Assistants and Group Rooms/Members' Rooms.

- 4. Attendance Register:** Members should sign the Register which will be circulated at the meeting.
- 5. THE APPENDED SUPPORTING DOCUMENTS ARE IDENTIFIED BY AGENDA ITEM NUMBER.**
- 6. Emergency Evacuation Procedure**

When the continuous alarm sounds, you must evacuate the building by one of the designated exits and proceed to the named assembly point. The designated exits are sign-posted.

Arrangements are in place for the safe evacuation of disabled people.

Avon Pension Fund Committee - Investment Panel - Thursday, 11th November, 2010

at 1.30 pm in the Council Chamber - Guildhall, Bath

A G E N D A

1. EMERGENCY EVACUATION PROCEDURE

The Chair will draw attention to the emergency evacuation procedure as set out under Note 9.

2. DECLARATIONS OF INTEREST

3. APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

To receive any declarations from Members of the Committee and Officers of personal/prejudicial interests in respect of matters for consideration at this meeting, together with their statements on the nature of any such interest declared.

4. TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

5. ITEMS FROM THE PUBLIC - TO RECEIVE DEPUTATIONS, STATEMENTS, PETITIONS OR QUESTIONS

6. ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

To deal with any petitions or questions from Councillors and, where appropriate, co-opted and added members.

7. MINUTES: 16 SEPTEMBER 2010 (Pages 1 - 4)

8. REVIEW OF HEDGE FUND MANAGERS (Pages 5 - 56)

9. MEET THE MANAGER - GOTTEX

10. MEET THE MANAGER - MAN

11. ALLOCATION TO PASSIVE UK EQUITIES (Pages 57 - 62)

12. GLOBAL EQUITY TENDER (Verbal Report)

The Committee Administrator for this meeting is Sean O'Neill who can be contacted on

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AVON PENSION FUND COMMITTEE - INVESTMENT PANEL

Minutes of the Meeting held

Thursday, 16th September, 2010, 2.00 pm

- Members: Councillor David Bellotti (Chair), Councillor Gordon Wood, Ann Berresford, Councillor Mary Blatchford and Andy Riggs (In place of Bill Marshall)
- Advisors: Dave Lyons (JLT Benefit Solutions)
- Also in attendance: Tony Bartlett (Head of Business, Finance and Pensions), Liz Feinstein (Investments Manager) and Matthew Betts (Assistant Investments Manager)

1 CHAIR'S WELCOME

The Panel noted the appointment of Cllr David Bellotti as Chair of the Panel for the remainder of the Municipal Year.

2 EMERGENCY EVACUATION PROCEDURE

The Democratic Services Officer read out the procedure.

3 DECLARATIONS OF INTEREST

There were none.

4 ITEMS FROM THE PUBLIC - TO RECEIVE DEPUTATIONS, STATEMENTS, PETITIONS OR QUESTIONS

There were none.

5 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

Apologies were received from Cllr Gabriel Batt and from Bill Marshall, for whom Andy Riggs substituted.

6 TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

There were none.

7 ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

There were none.

8 MINUTES: 27 MAY 2010

These were approved as a correct record and signed by the Chair.

9 PRESENTATION BY TT INTERNATIONAL

RESOLVED that having been satisfied that the public interest would be better served by not disclosing relevant information, and in accordance with the provisions of section 100(A)(4) of the Local Government Act 1972, the public be excluded from the meeting for this item of business because of the likely disclosure of exempt information as defined in paragraph 3 of Part 1 of schedule 12A of the Act as amended.

The Investments Manager reminded Members that concerns had been raised at the meeting of the Avon Pension Fund Committee held on 25th June 2010 that TT International had made several purchases of shares in BP on behalf of the Fund after the Deepwater Horizon oil spill had occurred. The Committee had agreed to invite TT to submit a written statement setting out the rationale for its decisions and to attend a meeting of the Panel to answer questions.

TT's statement had been circulated with the agenda. Peter Hunt and Martin Pluck of TT International made a presentation to the Panel and then answered questions.

RESOLVED

(i) that officers should continue to monitor the positions in the oil sector taken on behalf of the Fund by TT;

(ii) that TT should be invited to meet the Panel again within six months;

(iii) that a short report on today's discussion with TT should be tabled at the next meeting of the Avon Pension Fund Committee on 24th September 2010.

10 ANNUAL REVIEW OF PROPERTY PORTFOLIOS

Members had met representatives of Schroders and Partners at a Panel workshop held prior to this meeting.

RESOLVED that the Panel recommends that the Committee:

(i) approves the changes to the IMA guidelines for the property portfolio managed by Partners.

(ii) authorises the Panel to review the property portfolios annually and agree changes to the investment guidelines as appropriate, referring any strategic changes for agreement by the Committee.

11 PASSIVE INVESTING

The Investments Manager presented the report. She reminded Members that concern had been expressed at the meeting of the Committee on 25th June 2010 about the proportion of the Fund's assets invested passively by BlackRock and the exposure the Fund had to BP through its passively managed UK equity portfolio. The core portfolio passively invested by BlackRock accounted for 47% of the assets of the Fund.

The report set out three alternative options for reducing the risks to the Fund of the current passive investment portfolio. These were:

1. Reducing the strategic allocation to the regional/country indices in favour of less concentrated global indices.
2. Exploring the use of alternative indices as the benchmark for a passive portfolio.
3. Increasing the allocation to active management in the markets where concentration is an issue, such as the UK.

There was a general discussion about the passively managed portfolios and the concentration within the UK equity market. A Member noted that the assets managed passively across the south west LGPS funds ranged from 3-37%, which suggested that Avon's allocation of 47% was high. The Chair observed that the general aim of the Fund was to diversify and spread risk. The Investments Manager explained that the risks associated with passively managed investments were primarily corporate and operational (as there is no active management risk), and the Fund's assets are ring-fenced, i.e held in a beneficial name by an external custodian so if the investment manager became insolvent, creditors would have no claim on the Fund's assets.

RESOLVED to request JLT Benefit Solutions to prepare a paper for the next meeting of the Panel on the implications on the risk return profile of the Fund of switching from passively managed UK equities to passively managed global equities.

12 PERFORMANCE REVIEW FOR QUARTER ENDING 30 JUNE 2010

The Assistant Investments Manager summarized the key figures for the quarter. No issues of significant concern had been identified by JLT, though they had commented that SRI constraints on Jupiter might be at the cost of significant volatility relative to the benchmark. JLT had noted that the Fund had benefited from diversification. During the quarter it was announced that MAN had acquired GLG and Jupiter had become a public company. Both these developments would be closely monitored by Officers.

RESOLVED to note the report.

13 PANEL WORKPLAN

A Member asked when the Panel would consider Socially Responsible Investment (SRI). The Investments Manager said that it had not been possible to include this in the 2010/11 plan because of the existing workload, in particular the review of hedge funds and investment tenders. She was of the opinion that it would be better to defer SRI until after the local elections following which may give rise to significant changes in the membership of the Committee and any review of SRI would not necessarily be completed prior to this. The Member queried whether this was an adequate reason to defer SRI.

The Panel agreed that SRI should be the first priority of the new Committee.

RESOLVED to agree the workplan and to recommend it to the Committee.

14 ANY OTHER BUSINESS

There was none.

The meeting ended at 3.43 pm

Chair(person)

Date Confirmed and Signed

Prepared by Democratic Services

Bath & North East Somerset Council		
MEETING:	AVON PENSION FUND INVESTMENT PANEL	
MEETING DATE:	11 NOVEMBER 2010	AGENDA ITEM NUMBER
TITLE:	REVIEW OF FUND OF HEDGE FUND MANAGERS	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
<p>List of Attachments:</p> <p>Exempt Appendix 1 – JLT’s Report on Hedge Fund Managers November 2010</p> <p>Appendix 2 – Background information on MAN</p> <p>Appendix 3 – Background information on Gottex</p>		

1 THE ISSUE

- 1.1 Following the review of the Strategic Investment Strategy in June 2009, it was agreed that a formal review of the Fund’s investments in hedge funds be undertaken in 2010/11 once the mandates had been in place for three years. A Committee workshop will be arranged for 1Q11 where the strategic allocation to hedge funds and the managers will be reviewed.
- 1.2 Prior to the workshop, the Investment Panel have been asked to review performance of the individual Fund of Hedge Fund (FoHF) managers. The Panel will meet each of the managers and JLT have prepared a report (see Exempt Appendix 1) that reviews performance, operational and management issues as well as the managers’ exposure to the underlying investment strategies. JLT’s main findings are set out in 6.4. At this stage of the review, the focus is on the individual managers and not on the strategic decision to invest in hedge funds.
- 1.3 Appendices 2 & 3 provide background information on the managers presenting at this meeting, MAN and Gottex.

2 RECOMMENDATION

That the Investment Panel:

- 2.1 **Identifies issues with the individual hedge fund managers to be incorporated into the review of the Fund’s hedge fund investments**

3 FINANCIAL IMPLICATIONS

3.1 The budget provides for investment advice to review the hedge fund portfolio.

4 FRAMEWORK FOR REVIEW OF HEDGE FUNDS

4.1 The Investment Panel recommended the following framework for the review of the hedge fund portfolio:

- (1) Review of the managers by the Investment Panel
- (2) Strategic Review of allocation to hedge funds by the Investment Consultant
- (3) Review of regulation changes and potential impact on investment opportunities
- (4) Committee workshop in Q1 2011 to review hedge funds (covering 1-3 above).

5 CONTEXT - RECAP ON RATIONALE & STRUCTURE OF HEDGE FUND PORTFOLIO

5.1 In order to put the individual managers into context, the following briefly summarises the rationale for the hedge fund portfolio and the portfolio structure.

5.2 The Fund allocated 10% to fund of hedge funds and was seeking to generate consistent annual returns (net of fees) of LIBOR plus 4-6% with a volatility of less than 10%. The portfolio was to have a focus on capital preservation. The Fund was therefore looking for a relatively low volatility, low-medium return portfolio and given the nature of FoHF portfolios it was decided that more than one manager would need to be appointed in order to achieve the optimum volatility/return profile.

5.3 As a result the five FoHF managers were appointed, the combination of them providing the required volatility /return profile and a diverse exposure to underlying strategies. In particular, three of the managers, Signet, Gottex and Stenham were selected given their relatively low volatility profile, with commensurate lower return potential. MAN and Lyster Watson were selected as they had higher volatility and return objectives. Thus they would help the Fund achieve its return objective whereas as the lower volatility managers would provide capital protection and dampen overall volatility.

5.4 In addition, the five managers have different approaches to investing which means the overall portfolio will have a well diversified exposure to the main underlying investment strategies. *Please see pages 37-38 of JLT report (Exempt Appendix 1) for definition of investment strategies.*

5.5 MAN and Lyster Watson are multi-strategy managers meaning they are opportunistic and allocate capital across the full range of hedge fund strategies. The diversification within each portfolio will reduce volatility and help smooth returns over time.

5.6 Gottex, Signet and Stenham have more focussed approaches to investing. Stenham are a multi strategy manager but only invest in liquid investment strategies where they are not reliant on leverage to enhance returns. Therefore

they would expect to allocate most capital to long/short equity, macro, commodities and event driven strategies.

5.7 Gottex are a market neutral manager meaning they will not take any significant positions that rely on return being generated from market movements (i.e. do not bet on equity, bond, currency or commodity market trends). As a result they allocate capital to “relative value” and arbitrage strategies amongst others.

5.8 Signet focuses purely on fixed income and credit strategies; they will allocate to both market neutral and directional strategies within the fixed income and credit markets.

6 REVIEW OF INDIVIDUAL FUND OF HEDGE FUND MANAGERS

6.1 This review is in two parts: (i) a report by JLT and (ii) Panel meetings with each manager. These meetings and JLT’s report will form the basis for the assessment of the individual managers by the Investment Panel.

Report by JLT

6.2 JLT’s report in Exempt Appendix 1 provides analysis on each individual hedge fund manager. These managers have been managing assets on behalf of the Fund for just over three years, which has been a tumultuous period in financial markets and the global economy. The JLT report reviews what each manager might reasonably be expected of them against this backdrop. The report summarises their initial findings on each manager and highlights issues where the Panel may wish to obtain further assurance.

6.3 The report is set out as follows:

- (1) Section 1 – Investment Performance over last 3 years
- (2) Section 2 – Allocation to underlying investment strategies and how these have changed over time
- (3) Section 3 – Operational Structure and performance discusses how the managers have strengthened their operational and due diligence processes

6.4 **JLT’s initial findings** are summarised as follows (please refer to Executive Summary in Exempt Appendix 1, page 2 for full summary):

- (1) Performance has been disappointing as none of the managers have achieved their performance target since inception. However, this is mainly due to poor performance against target in 2008; performance has improved in 2009 and 2010. The investment return of the hedge fund portfolio has been significantly less volatile than the return from global equities.
- (2) As expected the managers have actively altered allocations between investment strategies in response to opportunities within their investment universe and have reduced exposure to strategies that relied on leverage to enhance return. However, JLT’s initial findings are that there is a risk that the highly diversified structure of some managers’ portfolios could dilute the overall contribution to return from the active management by the manager and therefore the Fund should review this issue.
- (3) All the managers faced significant operational challenges in 2008/09 with regard to managing redemptions and liquidity of underlying investments. As a result all managers have reviewed their internal processes and managers

have addressed areas identified as weak. JLT recommend that given the more challenging environment in which FoHF managers now operate, the Panel should conclude whether each of the managers has adequate resources and processes in place to meet these challenges.

Manager Meetings

6.5 At the meetings the Panel are asked to review performance of the FoHF managers, focusing on:

- (1) Their exposure to underlying investment strategies
- (2) The three year investment performance
- (3) Their operational / management performance, including changes introduced since 2008 financial crisis

6.6 MAN and Gottex will present to the Panel at the meeting on 11 November 2010. The other three FoHF managers will present at the Investment Panel meeting in January 2011.

6.7 Appendices 2 and 3 provide background information on MAN and Gottex, which should be read in conjunction with the report by JLT. Potential questions which cover areas the Panel may wish to focus on will be circulated at the presentations.

7 RISK MANAGEMENT

7.1 The Avon Pension Fund Committee is the formal decision-making body for the Fund. As such it has responsibility to ensure adequate risk management processes are in place. It discharges this responsibility by ensuring the Fund has an appropriate investment strategy and investment management structure in place that is regularly monitored. The creation of an Investment Panel further strengthens the governance of investment matters and contributes to reduced risk in these areas.

8 EQUALITIES

8.1 An equalities impact assessment is not necessary.

9 CONSULTATION

9.1 N/a

10 ISSUES TO CONSIDER IN REACHING THE DECISION

10.1 No decisions are being made. The issues being considered to make a recommendation to the Committee are contained in the report and comments are sought in the report.

11 ADVICE SOUGHT

11.1 The Council's Monitoring Officer (Council Solicitor) and Section 151 Officer (Divisional Director - Finance) have had the opportunity to input to this report and have cleared it for publication.

Contact person	Liz Feinstein, Investments Manager 01225 395306
Background papers	
Please contact the report author if you need to access this report in an alternative format	

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Access to Information Arrangements

Exclusion of access by the public to Council meetings

Information Compliance Ref: LGA-10-16

Meeting / Decision: Avon Pension Fund Committee

Date: 11 November 2010

Author: Liz Feinstein

Report Title: Review of fund of hedge fund managers

Exempt Appendix Title:

Appendix 1 – JLT's Report on Hedge Fund Managers November 2010

Stating the exemption:

- 3. Information relating to the financial or business affairs of any particular person (including the authority holding that information).*

The public interest test has been applied, and it is concluded that the public interest in maintaining the exemption outweighs the public interest in disclosure at this time. It is therefore recommended that the committee resolve to exclude the public. The paragraphs below set out the relevant public interest issues in this case.

PUBLIC INTEREST TEST

If the Committee wishes to consider a matter with press and public excluded, it must be satisfied on two matters.

Firstly, it must be satisfied that the information likely to be disclosed falls within one of the accepted categories of exempt information under the Local Government Act 1972. Paragraph 3 of the revised Schedule 12A of the 1972 Act exempts information which relates to the financial or business affairs of the investment managers which is commercially sensitive to the investment managers. The officer responsible for this item believes that this information falls within the exemption under paragraph 3 and this has been confirmed by the Council's Information Compliance Manager.

Secondly, it is necessary to weigh up the arguments for and against disclosure on public interest grounds. The main factor in favour of disclosure

is that all possible Council information should be public and that increased openness about Council business allows the public and others affected by any decision the opportunity to participate in debates on important issues in their local area. Another factor in favour of disclosure is that the public and those affected by decisions should be entitled to see the basis on which decisions are reached.

Weighed against this is the fact that the exempt appendix contains the observations and opinions of an external consultant about the expected and actual performance of investment managers. It also contains details of the investment processes/strategies of the investment managers.

It would not be in the public interest if advisors and officers could not express in confidence opinions which are held in good faith and on the basis of the best information available. The information to be discussed is also commercially sensitive and if disclosed could prejudice the commercial interests of the investment managers.

It is also important that the Committee should be able to retain some degree of private thinking space while decisions are being made, in order to discuss openly and frankly the issues under discussion in order to make a decision which is in the best interests of the Fund's stakeholders.

The Council considers that the public interest has been served by the fact that a significant amount of information regarding the outcome of the report has been made available on these issues – by way of the main report.

By virtue of paragraph(s) 3 of Part 1 of Schedule 12A
of the Local Government Act 1972.

Document is Restricted

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Review of Hedge Fund Managers: Appendix 2

Man Group

Mandate	Multi strategy fund of hedge funds
Inception date & initial investment	31 July 2007; £102m
Current mandate size (30 June 2010)	£92m
% of Fund	c. 4.5%
Performance target	LIBOR + 5.75-8.5% p.a.
Volatility target	4.25-6.5% p.a.
Fees	See JLT Report

Man have the highest return target and highest volatility target of the Fund's 5 FoHF managers. They also have the highest allocation, managing c.45% of the Fund's allocation to hedge funds.

1. Organisation

Founded in 1783 with origins in the sugar trade, Man Group plc as it is now called went into alternative investments funds in 1983 and has since become a specialist alternative investment management company, principally in hedge funds. They have 3 business units: multi manager (their fund of hedge funds business), single manager hedge funds, and a managed futures business (a strategy that takes long and short positions in futures contracts). The Fund is invested with their multi manager business which has c.£8.9bn under management in Fund of Hedge Funds at 30 June 2010. Man Group plc listed on the FSTE in 1994 and are a constituent of the FTSE 100.

2. Structure and Key Facts

The Fund's investments with Man are in 4 of their funds, each of which invest in a portfolio of underlying managers. The core fund is the Four Seasons Strategies fund which is a multi strategy fund, diversified across all strategies, this comprises c 40% of the allocation. Three other funds with more targeted strategies were included to achieve the target returns. These are Commodity Strategies Fund (c. 30%), Asian Opportunities Fund (c. 20%) and Distressed Strategies Fund (c. 10%).

The Fund's portfolio is invested across c. 150 underlying managers.

Redemption terms are quarterly with 95 days notice.

The Fund is registered in the Cayman Islands, and the firm is regulated by regulated by 21 regulatory authorities in respective global territories.

3. Philosophy & Process

Man utilise a wide spectrum of hedge fund styles and strategies that have a large variety of risk/return profiles. The investment team aims to construct portfolios that produce consistent absolute returns with low levels of risk through adopting a multi-manager approach that seeks to combine lowly correlated hedge fund strategies. RMF combines a top down (asset allocation) and bottom up (manager selection) approach across all of its products.

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Review of Hedge Fund Managers: Appendix 3

Gottex

Mandate	Market neutral fund of hedge funds
Inception date & initial investment	31 July 2007; £57m
Current mandate size (30 June 2010)	£50.7m
% of Fund	c. 2.5%
Performance target	LIBOR + 3-5% p.a.
Volatility target	1.5-2.5% p.a.
Fees	See JLT report

Gottex's market neutral approach seeks to achieve a low correlation to equities and fixed income markets, and each underlying manager must be market neutral. As such, Gottex have a relatively low volatility target with a moderate performance target when considered alongside the Fund's other FoHF managers.

1. Organisation

Founded in 1992, Gottex are an alternative investment group specialising in fund of hedge funds. They have £4.9bn under management, all of which is in fund of hedge funds. Gottex have developed from a background in managing assets on behalf of high net worth individual to a position where 85% of their client base are now institutions with the largest component being European pension funds. Gottex publicly listed on the Swiss stock exchange in 2007, but is still 55% employee owned.

2. Structure and Key Facts

The Fund's investments with Gottex are in their Market Neutral Fund. This means the fund invests in relative value, event driven and market neutral equity strategies and does not invest in any strategy that has directional bias such as macro and traditional long/short equity.

The Fund's portfolio is invested across c. 70 underlying managers.

Redemption terms are quarterly with 94 days notice.

The Fund is registered in the British Virgin Islands, and the firm is regulated by the SEC (USA), FSA (UK) and SFA (Hong Kong) regulatory authorities.

3. Philosophy & Process

Gottex is a specialist in the market neutral sector. The firm's investment philosophy has been to create absolute return products that maximize risk-adjusted returns. Gottex creates fund of fund products which have low levels of risk and moderate returns. The market neutral funds only invest in hedge funds that are themselves "market neutral" meaning that the funds are not exposed to any significant directional bets on the equity, fixed income, commodity or FX markets. Through focusing only on market-neutral hedge funds, Gottex can significantly reduce portfolio volatility and focus their research effort on a much smaller part of the hedge fund universe. Gottex also believe that diversification across uncorrelated strategies and managers, enables their strategy to generate a steady return profile with a greatly reduced risk of a drawdown (negative return).

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Bath & North East Somerset Council		
MEETING:	AVON PENSION FUND INVESTMENT PANEL	
MEETING DATE:	11 NOVEMBER 2010	AGENDA ITEM NUMBER
TITLE:	PASSIVE INVESTMENT	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
List of Attachments:		
Appendix 1 - Concentration within UK and Global Equity Indices		

1 THE ISSUE

1.1 At the Committee meeting on 24 September 2010, it was agreed that the Investment Panel would consider a further switch between the UK and overseas equity assets that are managed on a passive basis. This report provides the background to the issue and sets out the impact of altering the allocation on the Fund's risk level. The Panel are asked to consider whether any recommendations should be made to the Committee or whether any further work is required.

2 RECOMMENDATION

That the Investment Panel agrees:

2.1 Whether to recommend to the Committee that the allocation to passively managed UK equities should be reduced and the proceeds invested in a passively managed global equity portfolio

2.2 The percentage of assets to be switched under 2.1

3 FINANCIAL IMPLICATIONS

3.1 There is no impact on the investment management fees as the switch would be implemented within the passive equity portfolio managed by BlackRock.

4 BACKGROUND

4.1 The issue of concentration within the UK equity market has been discussed at previous Investment Panel and Committee meetings. The UK equity index is concentrated at both the stock and sector level. At the sector level the UK market is heavily weighted in financial stocks and oil & gas and at the stock level the top ten holdings account for 38% of the capitalisation of the index. In comparison, the top ten holdings in a Global index is 9% (see Appendix 1).

4.2 At the sector level there are significant differences to the allocations between the UK indices and global indices (see Appendix 1), in particular the technology, industrials, energy and materials sectors.

4.3 Concentration is an issue for the Fund due to its high allocation to passively managed UK equities. Within the UK equity allocation, 67% is managed passively (17% of total assets) and 33% is managed actively (8.5% of total Fund assets).

5 IMPACT ON FUND RISK & RETURN PROFILE OF SWITCH FROM UK EQUITIES TO OVERSEAS EQUITIES

5.1 In their paper of February 2010, JLT provided the following risk and return analysis if the UK equity exposure is reduced in favour of overseas/global equities managed on a passive basis:

UK:Overseas allocation	Expected Market Return	Absolute Volatility
45:55 (i.e. current allocation)	8.5%	16.0%
30:70	8.5%	16.2%

5.2 The expected long term return to the Fund does not alter if the allocation changes. However, a global universe would expose the Fund to increased stock and sector diversification.

5.3 The marginal increase in volatility is due to the currency risk introduced by the non-sterling equities. As the table demonstrates, an increase in the allocation by 15% to global equities generates a marginal increase in volatility, therefore a smaller increase of say 5% will result in a very small change in volatility. However, the Panel should note that the Fund will be actively hedging its currency exposure of its overseas equity portfolios in the future, thus the increase in volatility should be reduced.

5.4 The Fund currently invests 45% of its equity assets in UK equities and 55% in overseas equities. This is very similar to the allocation of the average WM LA Fund which allocated 44% to UK equities and 56% overseas equities (as at 31 March 2010).

5.5 The table below shows the effect of switching between passively managed UK and overseas equities from 45:55 to 30:70 on the equity allocation at the total fund level and on the allocation to passively managed UK and overseas equities at the total fund level:

		Current allocation (%)	Potential Allocations (%)		
			A	B	C
	% UK /Overseas equity within equity allocation	45 / 55	40 / 60	35 / 65	30 / 70
(1)	% of UK / overseas equities at total fund level	27 / 33	24 /36	21 / 39	18 / 42
(2)	% of UK / overseas equities managed passively at total fund level	17 / 12	14 / 15	11 / 18	8 / 21
(3)	% of UK / overseas equities managed actively at total fund level	10 / 21	10 / 21	10 / 21	10 / 21

5.9 The table shows that, for example, a 10% switch within the equity portfolio from UK to overseas equities (to 35% UK / 65% overseas – Column B) would result the following:

- (1) At the total fund level UK equities would fall to 21% from 27%, and overseas equities would rise from 33% to 39% of assets.
- (2) At the total fund level the UK equities managed passively would fall from 17% to 11%, and overseas equities managed passively would rise from 12% to 18% of assets
- (3) At the total fund level allocations to actively managed equities are unchanged.

5.10 Any switch between UK and overseas equities could be implemented within the passive portfolio managed by BlackRock in a cost effective way, without altering the level of assets managed by BlackRock. As discussed previously, given the passive nature of this portfolio the size of assets managed by BlackRock is not an issue.

5.11 The Panel needs to consider whether any recommendation needs to be made to the Committee or not. Officers are in favour of reducing the passively managed UK equity assets (by switching into passively managed global equities) to reduce stock/sector concentration risk that is significantly more prevalent in the UK equity index.

6 RISK MANAGEMENT

6.1 The Avon Pension Fund Committee is the formal decision-making body for the Fund. As such it has responsibility to ensure adequate risk management

processes are in place. It discharges this responsibility by ensuring the Fund has an appropriate investment strategy and investment management structure in place that is regularly monitored. The creation of an Investment Panel further strengthens the governance of investment matters and contributes to reduced risk in these areas.

7 EQUALITIES

7.1 An equalities impact assessment is not necessary.

8 CONSULTATION

8.1 N/a

9 ISSUES TO CONSIDER IN REACHING THE DECISION

9.1 No decisions are being made. The issues being considered to make a recommendation to the committee are contained in the report and comments are sought in the report.

10 ADVICE SOUGHT

10.1 The Council's Monitoring Officer (Council Solicitor) and Section 151 Officer (Divisional Director - Finance) have had the opportunity to input to this report and have cleared it for publication.

Contact person	Liz Feinstein, Investments Manager 01225 395306
Background papers	
Please contact the report author if you need to access this report in an alternative format	

APPENDIX 1

Concentration within UK and Global Equity Indices

UK - FTSE All Share *		Global - MSCI World **	
Stock	% of Index	Stock	% of Index
HSBC	7.1%	Exxon Mobil Corp	1.4%
Vodafone Group	4.9%	Apple Inc.	1.1%
Royal Dutch Shell - A Sh	4.0%	Microsoft Corp	1.0%
BP	4.0%	Procter & Gamble	0.8%
GlaxoSmithKline	4.0%	HSBC HOLDINGS (GB)	0.8%
Astrazeneca	3.0%	General Electric Co	0.8%
Rio Tinto	3.0%	Nestle	0.8%
Royal Dutch Shell - B sh	3.0%	IBM Corp	0.8%
Bristish American Tobacco	2.8%	Johnson & Johnson	0.8%
BHP Billiton	2.6%	JP Morgan Chase & Co	0.8%
Top 10 as % of index	38.4%	Top 10 as % of index	9.1%

Sources: BlackRock

* As at 30 June 2010

** As at 30 July 2010

UK - FTSE All Share		Global - MSCI World	
Sector	% of Index	Sector	% of Index
Financials	23.5%	Financials	20.8%
Oil & Gas	18.3%	Technology	11.5%
Basic Materials	11.7%	Energy	11.1%
Consumer Goods	11.6%	Industrials	10.4%
Consumer Services	9.7%	Consumer Staples	10.3%
Health Care	7.8%	Health Care	10.1%
Industrials	6.7%	Consumer Discretionary	9.2%
Telecoms	5.9%	Materials	7.5%
Utilities	3.5%	Utilities	4.6%
Technology	1.4%	Telecoms	4.5%
	100%		100%

Source: Thomson Datastream at 31/12/09

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