Report No. RES11129

London Borough of Bromley

PART 1 - PUBLIC

Decision Maker:	**Pensions Investment Sub-Committee**
Date:	**9th November 2011**
Decision Type:	Non-Urgent Non-Executive Non-Key
Title:	**PENSION FUND PERFORMANCE**
Contact Officer:	Martin Reeves, Principal Accountant (Technical & Control) Tel: 020 8313 4291 E-mail: martin.reeves@bromley.gov.uk
Chief Officer:	Director of Resources
Ward:	All

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1. Reason for report

This report includes details of the investment performance of Bromley's Pension Fund for the first two quarters of the financial year 2011/12. It also contains information on general financial and membership trends of the Pension Fund and summarised information on early retirements. Representatives of Baillie Gifford will be present at the meeting to discuss performance, economic outlook/prospects and other matters.

RECOMMENDATION

The Sub-Committee is asked to note the report.

Corporate Policy

1. Policy Status: Existing policy. The Council's Pension Fund is a defined benefit scheme operated under the provisions of the Local Government Pension Scheme (LGPS) Regulations 2007, for the purpose of providing pension benefits for its employees. These regulations allow local authorities to use all the established categories of investments, e.g. equities, bonds, property etc, and to appoint external investment managers who are required to use a wide variety of investments and to comply with certain specific limits.

2. BBB Priority: Excellent Council.

Financial

1. Cost of proposal: No cost

2. Ongoing costs: Recurring cost. Total administration costs estimated at £2.8m (includes fund manager/actuary fees, Liberata charge and officer time)

3. Budget head/performance centre: Pension Fund

4. Total current budget for this head: £33.4m expenditure (pensions, lump sums, etc); £39.6m income (contributions, investment income, etc); £434m total fund value at 30th September 2011)

5. Source of funding: Contributions to Pension Fund

Staff

1. Number of staff (current and additional): 0.4 FTE

2. If from existing staff resources, number of staff hours: c 14 hours per week

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Legal

1. Legal Requirement: Statutory requirement. Local Government Pension Scheme (LGPS) Regulations 2007

2. Call-in: Call-in is not applicable.

Customer Impact

1. Estimated number of users/beneficiaries (current and projected): 5,103 current employees; 4,578 pensioners; 4,028 deferred pensioners

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Ward Councillor Views

1. Have Ward Councillors been asked for comments? No.

2. Summary of Ward Councillors comments: N/A

3. COMMENTARY

3.1 As the table and graph in paragraph 5.2 show, the total market value of Bromley's Fund has fluctuated considerably in the last few years. From a low of £180m at the end of 2002/03, the fund value rose steadily to £357m as at 31st March 2008. In 2008/09, however, turmoil in financial markets caused the fund value to fall to £298.1m, a fall of 16.5% in that year. The financial year 2009/10 saw a gain of almost 50% to £446.4m and, in 2010/11, there was a further increase to £489.7m. In the June 2011 quarter, in spite of some volatility, the fund value remained fairly stable overall and had risen to £494.1m as at 30th June 2011. Yet more turmoil in financial markets in the September quarter caused the fund value to fall to £434m as at 30th September 2011, a fall of 12% in the quarter. At the time of writing this report, the fund value had recovered some of this loss and stood at £466m as at 27th October 2011.

3.2 The report to the May 2011 meeting included details of the quarterly and cumulative performance of our two fund managers in 2010/11. These showed that Baillie Gifford returned 10.7% in the year (2.3% above their benchmark), while Fidelity returned 7.1% (0.6% below benchmark). An overall ranking of 22% was achieved in that year (1% being the highest in the WM Company local authority universe and 100% being the lowest), which was a good (top quartile) result after a very good year in 2009/10. For comparison, the rankings in the previous nine years were 2% in 2009/10, 33% in 2008/09, 5% in 2007/08, 100% in 2006/07, 5% in 2005/06, 75% in 2004/05, 52% in 2003/04, 43% in 2002/03 and 12% in 2001/02. Given the long-term nature of pension fund liabilities, medium and long-term returns are of greater importance and these have been extremely good. This is outlined in paragraphs 3.7 and 3.8.

Performance data for 2011/12

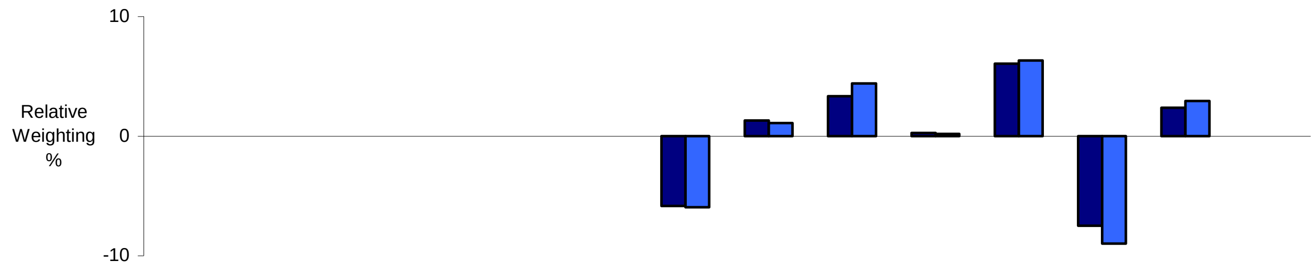
3.3 Before 1st April 2006, the Fund's performance was measured against the local authority average and both Baillie Gifford and Fidelity were set the target of outperforming against that average by 0.5% over rolling three-year periods. When the Fund was restructured in 2006, however, both managers were set performance targets relative to the strategic benchmarks agreed from 1st April 2006. Since then, Baillie Gifford's target has been to outperform the benchmark by 1.0% - 1.5% over three-year periods, while Fidelity's target has been 1.9% outperformance over three-year periods. From 2006, therefore, the WM Company has measured their results against these benchmarks instead of against its local authority indices and averages. At total fund level, however, it continues to use the local authority indices and averages and other comparisons with local authority averages may be highlighted from time to time to demonstrate, for example, whether the benchmark itself is producing good results.

3.4 A summary of the two fund managers' performance in the first two quarters of 2011/12 is shown in the following table and more details are provided in Appendices 1 and 2. . In the first quarter of 2011/12, Bromley's Fund achieved an overall local authority universe ranking of 85%. Details of the Fund's medium and long-term performance are set out in paragraphs 3.7 and 3.8. Local authority averages and rankings for the September quarter are not yet available and will be reported to the next meeting.

Quarter	**Baillie Gifford**		**Fidelity**		**Total Fund**		**LA Ave**
	Benchmark %	Return %	Benchmark %	Return %	Benchmark %	Return %	Return %
Jun-11	1.2	1.1	1.5	0.6	1.4	0.9	1.6
Sept-11	-11.9	-12.2	-10.5	-12.2	-11.2	-12.2	n/a
Cumulative	-10.8	-11.2	-9.2	-11.7	-10.0	-11.4	n/a

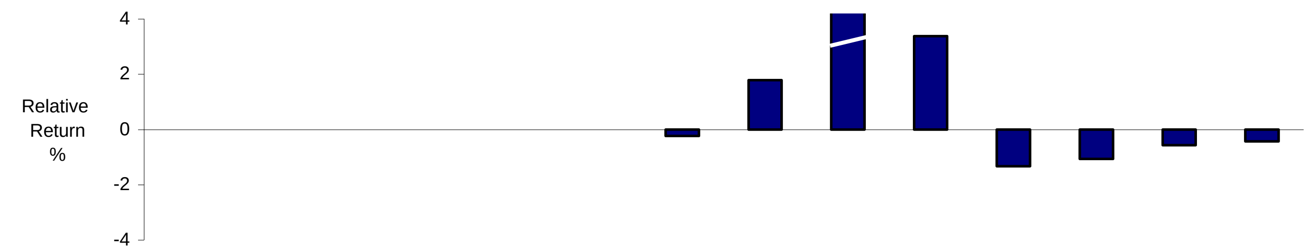
3.5 **Baillie Gifford** had a negative return of -12.2% in the September quarter (0.4% below benchmark) and had a cumulative negative return of -11.2% in the period 1st April 2011 to 30th September 2011 (0.4% below their benchmark). In the latest quarter, the WM Company attributed their relative under-performance primarily to asset allocation (-2.3%), mainly in UK bonds (-1.4%), European equities (-0.6%) and Other International equities (-0.6%). Stock selection compensated in part for this (+1.9%), with the main "gain" made on European equities (+1.7%). This is all represented in the following graphs.

Asset Allocation



	UK Equities	N. America	Europe ex UK	Tot Far East	Other Intl.	UK Bonds	Cash/ Alts	Total Fund
Fund Start	19.2	19.3	21.3	9.8	15.5	10.5	4.4	100.0
Fund End	18.6	19.1	19.9	9.7	15.0	12.5	5.2	100.0
BM Start	25.0	18.0	18.0	9.5	9.5	18.0	2.0	100.0
BM End	24.5	18.0	15.5	9.6	8.7	21.4	2.3	100.0
Impact	0.1	-	-0.6	-	-0.6	-1.4	0.2	-2.3

Stock Selection

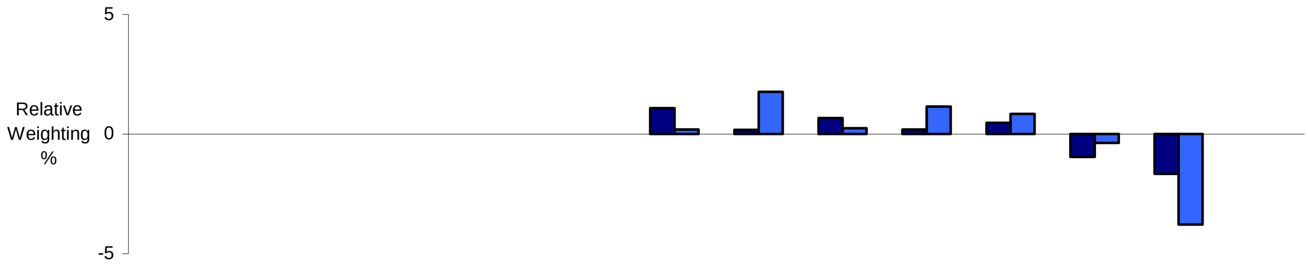


	UK Equities	N. America	Europe ex UK	Tot Far East	Other Intl.	UK Bonds	Cash/ Alts	Total Fund
Fund	-13.7	-10.2	-18.0	-8.3	-20.3	3.8	-0.4	-12.2
Benchmark	-13.5	-11.8	-24.3	-11.3	-19.2	5.0	0.2	-11.9
Impact	-	0.3	1.7	0.3	-0.2	-0.1	-	1.9

3.6 **Fidelity** had a negative return of -12.2% in the September quarter (1.9% below benchmark) and had a cumulative negative return of -11.7% in the period 1st April 2011 to 30th September 2011 (2.5% below their benchmark). In the latest quarter, the WM Company attributed most of their relative under-performance to stock selection (-1.6%), which comprised UK (-0.5%), American (-0.6%) and European equities (-0.3%) and UK bonds (-0.2%). Asset allocation also accounted for -0.3%, mainly on UK bonds. This is all represented in the following graphs.

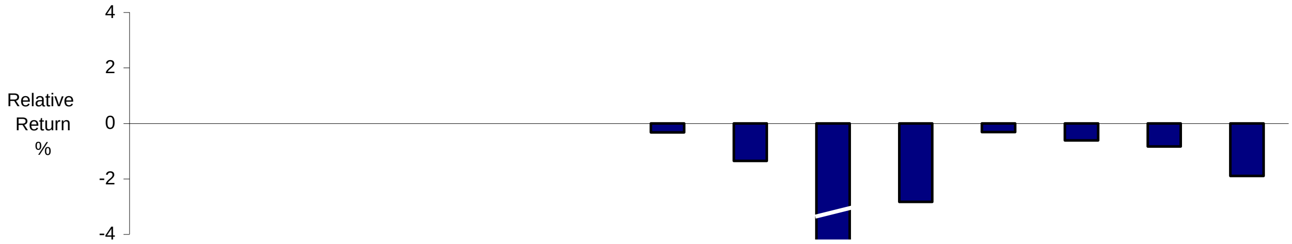
	Global	UK Equities	N. America	Europe ex UK	Pacific	Japan	UK Bonds	Total Fund

Asset Allocation



	Global	UK Equities	N. America	Europe ex UK	Pacific	Japan	UK Bonds	Total Fund
Fund Start	11.1	35.2	13.2	12.7	5.5	4.0	18.3	100.0
Fund End	9.8	35.6	12.6	11.8	5.4	5.1	19.7	100.0
BM Start	10.0	35.0	12.5	12.5	5.0	5.0	20.0	100.0
BM End	9.6	33.8	12.4	10.7	4.6	5.5	23.5	100.0
Impact	-	-	-	-	-	-	-0.2	-0.3

Stock Selection



	Global	UK Equities	N. America	Europe ex UK	Pacific	Japan	UK Bonds	Total Fund
Fund	-14.2	-14.7	-15.2	-25.9	-18.4	-2.8	4.3	-12.2
Benchmark	-14.0	-13.5	-11.4	-23.7	-18.1	-2.2	5.2	-10.5
Impact	-	-0.5	-0.6	-0.3	-	-	-0.2	-1.6

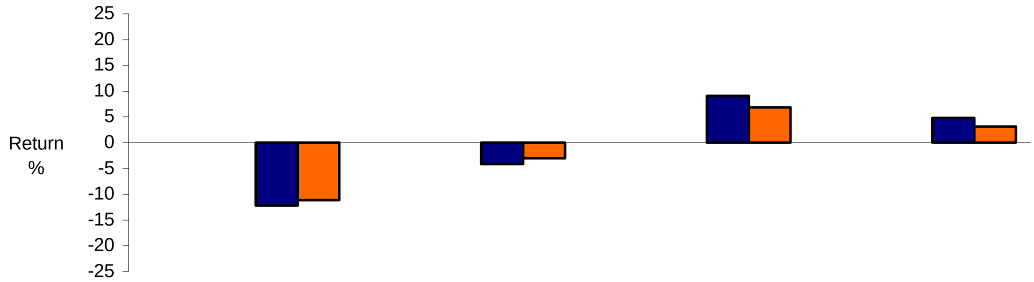
Medium and long-term performance data

3.7 The table below sets out comparative returns over 1, 3, 5 and 10 years for both Baillie Gifford and Fidelity for periods ended 30th September 2011, 30th June 2011 and 31st March 2011. Baillie Gifford's returns for all periods (-3.5%, 9.5%, 5.3% and 7.0% respectively) are now better than those of Fidelity (-5.0%, 8.5%, 4.7% and 6.2% respectively). To date, 2011 has been a difficult year and performance has been below benchmark. Local authority comparisons for the September quarter are not yet available, but Bromley's local authority universe ranking in the year to 30th June 2011 was in the 12th percentile. Longer-term rankings to 30th June 2011 (in the 2nd percentile for three years and the 5th percentile for five years) were very good and underlined the fact that Bromley's performance has been particularly strong in the last few years as the investment strategy driven by the revised benchmark adopted in 2006 has bedded in. The Fund's Statement of Investment Principles (approved at the September meeting) includes the following as one of the good governance principles the Fund is required to comply with: "Returns should be measured quarterly in accordance with the regulations; a longer time frame (three to seven years) should be used in order to assess the effectiveness of fund management arrangements and review the continuing compatibility of the asset/liability profile". This reinforces the point that Pension Fund management is a long-term business.

Annualised returns	Baillie Gifford Return	Baillie Gifford BM	Baillie Gifford +/-	Fidelity Return	Fidelity BM	Fidelity +/-	LA Ave
	%	%	%	%	%	%	%
Periods to 30/9/11							
1 year (1/10/10-30/9/11)	-3.5	-3.8	0.3	-5.0	-2.2	-2.8	n/a
3 years (1/1008-30/9/11)	9.5	6.9	2.4	8.5	6.7	1.7	n/a
5 years (1/10/06-30/9/11)	5.3	3.3	2.0	4.7	2.7	1.9	n/a
10 years (1/10/01-30/9/11)	7.0	5.9	1.0	6.2	5.7	0.5	n/a
Periods to 30/6/11							
1 year (1/7/10-30/6/11)	21.2	19.5	1.4	18.5	19.5	-0.8	17.8
3 years (1/7/08-30/6/11)	10.2	8.9	1.2	10.3	8.2	2.0	6.5
5 years (1/7/06-30/6/11)	8.5	6.6	1.8	7.8	5.7	2.0	5.0
10 years (1/7/01-30/6/11)	7.2	6.0	1.1	6.4	5.6	0.7	5.4
Periods to 31/3/11							
1 year (1/4/10-31/3/11)	10.7	8.2	2.3	7.1	7.8	-0.6	8.2
3 years (1/4/08-31/3/11)	9.7	7.8	1.8	9.9	6.8	2.9	5.4
5 years (1/4/06-31/3/11)	6.8	5.4	1.3	6.6	4.6	2.0	4.0
10 years (1/4/01-31/3/11)	7.3	6.0	1.2	6.5	5.6	0.9	5.3

3.8 The following graphs show, for periods ended 30th September 2011, performance relative to benchmark in the medium and long term for the whole fund and for Baillie Gifford and Fidelity individually.

Fund Returns

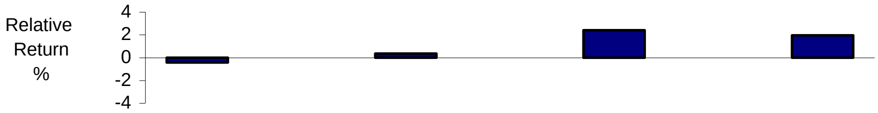


	Latest Quarter	1 Year	3 Years % pa	5 Years % pa
Fund	-12.2	-4.2	9.0	4.8
Benchmark	-11.2	-3.0	6.8	3.1
Relative Return	-1.2	-1.2	2.1	1.6

	Latest Quarter	1 Year	3 Years % pa	5 Years % pa

BAILLIE GIFFORD & CO - TOTAL ASSETS

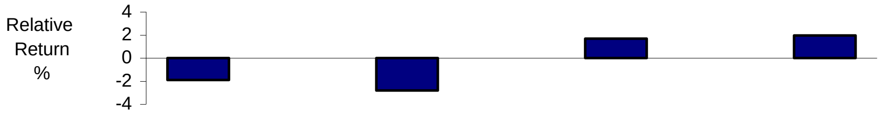
LB OF BROMLEY BGIFFORD BM



	Latest Quarter	1 Year	3 Years % pa	5 Years % pa
Portfolio	-12.2	-3.5	9.5	5.3
Benchmark	-11.9	-3.8	6.9	3.3
Relative Return	-0.4	0.3	2.4	2.0

FIDELITY INVESTMENT SERVICES LIMITED - TOTAL ASSETS

LB OF BROMLEY FIDELITY BM



	Latest Quarter	1 Year	3 Years % pa	5 Years % pa
Portfolio	-12.2	-5.0	8.5	4.7
Benchmark	-10.5	-2.2	6.7	2.7
Relative Return	-1.9	-2.8	1.7	1.9

Relative Return

The graphs show the performance of each manager relative to their Benchmark.

The relative return is the degree of out or underperformance of the Benchmark over these periods.

Fund Manager Comments on performance and the financial markets

3.9 The two fund managers were asked to provide a brief commentary on recent developments in financial markets, their impact on the Council's Fund and the future outlook. This will be a standing item in future reports to the Sub-Committee and the Baillie Gifford and Fidelity commentaries are attached as Appendices 4 and 5 respectively.

Early Retirements

3.10 A summary of early retirements by employees in Bromley's Pension Fund in the current year and in previous years is shown in the table below. With regard to retirements on ill-health grounds, this allows a comparison to be made between their actual cost and the cost assumed by the actuary in the triennial valuation. If the actual cost of ill-health retirements significantly exceeds the assumed cost, the actuary will be required to consider whether the employer's contribution rate should be reviewed in advance of the next full valuation. In the three year period 2007-2010, the long-term cost of early retirements on ill-health grounds was well below the actuary's assumption in the 2007 valuation of £800k p.a. In the latest valuation of the fund (as at 31st March 2010), the actuary assumed a figure of £82k in 2010/11, rising with inflation in the following two years, and, in the first six months of 2011/12, there were three ill-health retirements with a long-term cost of £258k. Although this is already well in excess of the actuary's estimate, this will not have a material impact on the employer contribution rate.

3.11 The actuary does not make any allowance for other early retirements, because it is the Council's policy to fund these in full by additional voluntary contributions. In the first six months of 2011/12, there were 28 other (non ill-health) retirements with a total long-term cost of £559k. Provision has been made in the Council's budget for severance costs arising from staff redundancies and contributions will be made to the Pension Fund from this provision to offset these costs.

Long-term cost of early retirements	Ill-Health		Other	
	No	£000	No	£000
Qtr 1 – Sept 11 - LBB	2	171	2	91
- Other	-	-	1	40
- Total	2	171	3	131
2011/12 to date – LBB	3	258	25	481
- Other	-	-	3	78
- Total	3	258	28	559
Actuary's assumption - 2010 to 2013		82 p.a.		N/a
- 2007 to 2010		800 p.a.		N/a
Previous years - 2010/11	1	94	23	386
- 2009/10	5	45	21	1,033
- 2008/09	6	385	4	256
- 2007/08	11	465	11	260

4. POLICY IMPLICATIONS

4.1 The Council's Pension Fund is a defined benefit scheme operated under the provisions of the Local Government Pension Scheme (LGPS) Regulations 2007, for the purpose of providing pension benefits for its employees. These regulations allow local authorities to use all the established categories of investments, e.g. equities, bonds, property, etc, and to appoint external investment managers who are required to use a wide variety of investments and to comply with certain specific limits.

5. FINANCIAL IMPLICATIONS

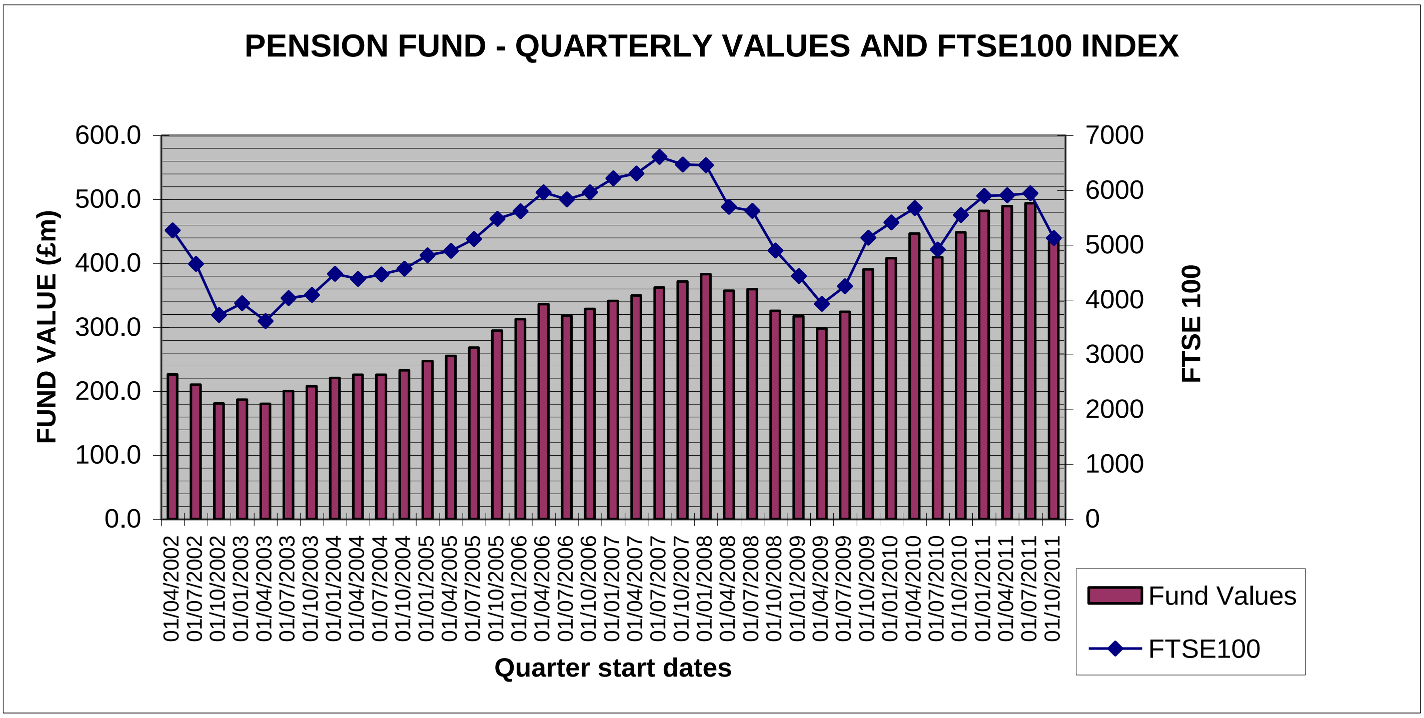
5.1 Details of the actual position to 30th September 2011 for the 2011/12 Pension Fund Revenue Account are provided in Appendix 3 together with fund membership numbers. A net surplus of £5.2m was achieved in the first half-year (entirely due to investment income) and total membership numbers rose by 82.

5.2 Movements in the Fund's Market Value are shown in the following table, together with details of distributions of the revenue fund surplus cash to the fund managers and movements in the value of the FTSE 100 index. The graph below plots fund value and FTSE index movements. The total value as at 31st March 2011 was £489.7m and this had fallen to £434m as at 30th September 2011. Members will note that the fund value tracks the movement in the FTSE 100 fairly closely, even though, since 2006, only around 30% of the fund has been invested in the UK equity sector.

Market Value as at	**Fidelity**	**Baillie Gifford**	**CAAM**	**Total**	Revenue Surplus Distributed to Managers*	FTSE 100 Index
	£m	**£m**	**£m**	**£m**	£m	
31st March 2002	112.9	113.3	-	226.2	0.5	5272
31st March 2003	90.1	90.2	-	180.3	-	3613
31st March 2004	112.9	113.1	-	226.0	3.0	4386
31st March 2005	126.6	128.5	-	255.1	5.0	4894

31st March 2006	164.1	172.2	-	336.3	9.1	5965
31st March 2007	150.1	156.0	43.5	349.6	4.5	6308
31st March 2008	151.3	162.0	44.0	357.3	2.0	5702
31st March 2009	143.5	154.6	-	298.1	4.0	3926
31st March 2010	210.9	235.5	-	446.4	3.0	5680
31st March 2011	227.0	262.7	-	489.7	3.0	5909
30th June 2011	228.4	265.7	-	494.1	-	5946
30th September 2011	201.0	233.0	-	434.0	-	5128

* Distribution of cumulative surplus during the year.



Non-Applicable Sections:	Legal and Personnel Implications
Background Documents: (Access via Contact Officer)	Analysis of portfolio returns (provided by WM Company). Monthly and quarterly portfolio reports of Fidelity and Baillie Gifford.

Appendix 1

Returns for quarter ended 30 September 2011

Baillie Gifford	Benchmark Weighting	Portfolio Weighting	Benchmark Returns	Portfolio Returns
	%	%	%	%
UK equities	25	18.6	-13.5	-13.7
Overseas equities				
North America	18	19.1	-11.8	-10.2
Europe	18	19.9	-24.3	-18.0
Far East	9.5	9.8	-11.3	-8.3
Other Int'l	9.5	15.0	-19.2	-20.3
UK bonds	18	12.4	5.0	3.8
Cash/other	2	5.2	0.2	-0.4
Total assets	100	100.0	-11.9	-12.2

Fidelity	Benchmark Weighting	Portfolio Weighting	Benchmark Returns	Portfolio Returns
	%	%	%	%
UK equities	35.0	35.6	-13.5	-14.7
Overseas equities				
USA	12.5	12.6	-11.4	-15.2
Europe	12.5	11.8	-23.7	-25.9
Japan	5.0	5.1	-2.2	-2.8
S E Asia	5.0	5.4	-18.1	-18.4
Global	10.0	9.8	-14.0	-14.2
UK bonds	20.0	19.7	5.2	4.3
Cash/other	-	0.0	0.1	n/a
Total assets	100.0	100.0	-10.5	-12.2

Fidelity's UK equity holding above (35.6% of portfolio) includes 1.1% non-UK equities, in accordance with the agreement by the Sub-Committee at its meeting on 3 May 2005 that their UK equity manager could invest up to 20% of his portfolio in non-UK equities.

Whole Fund	Portfolio Weighting	Benchmark Returns	Portfolio Returns
	%	%	%
UK equities	26.4	-13.5	-14.3
Overseas equities			
North America	16.1	-11.6	-12.1
Europe	16.1	-24.0	-20.5
Far East	10.1	-10.8	-9.7
Other Int'l	8.1	-19.2	-20.3
Global	4.6	-14.0	-14.2
UK bonds	15.8	5.1	4.1
Cash/other	2.8	0.2	-0.3
Total assets	100.0	-11.2	-12.2

Appendix 2

Returns for quarter ended 30 June 2011

Baillie Gifford	**Benchmark Weighting**	**Portfolio Weighting**	**Benchmark Returns**	**Portfolio Returns**
	%	%	%	%
UK equities	25	19.2	1.9	3.3
Overseas equities				
North America	18	19.3	-0.4	1.1
Europe	18	21.3	3.1	1.7
Far East	9.5	9.8	0.3	1.1
Other Int’l	9.5	15.5	-1.8	-3.1
UK bonds	18	10.5	2.2	2.4
Cash/other	2	4.4	0.2	0.1
Total assets	100	100.0	1.2	1.1

Fidelity	**Benchmark Weighting**	**Portfolio Weighting**	**Benchmark Returns**	**Portfolio Returns**
	%	%	%	%
UK equities	35.0	35.2	1.9	-0.1
Overseas equities				
USA	12.5	13.2	-0.2	-0.7
Europe	12.5	12.7	3.2	3.5
Japan	5.0	4.0	0.2	0.1
S E Asia	5.0	5.5	0.1	-0.1
Global	10.0	11.1	0.5	-0.6
UK bonds	20.0	18.3	2.3	2.7
Cash/other	-	0.0	0.1	-1.1
Total assets	100.0	100.0	1.5	0.6

Fidelity’s UK equity holding above (35.2% of portfolio) includes 1.6% non-UK equities, in accordance with the agreement by the Sub-Committee at its meeting on 3 May 2005 that their UK equity manager could invest up to 20% of his portfolio in non-UK equities.

Whole Fund	**Portfolio Weighting**	**Benchmark Returns**	**Portfolio Returns**
	%	%	%
UK equities	26.6	1.9	1.2
Overseas equities			
North America	16.5	-0.3	0.4
Europe	17.3	3.2	2.3
Far East	9.6	0.2	0.5
Other Int’l	8.4	-1.8	-3.1
Global	5.1	0.5	-0.6
UK bonds	14.1	2.2	2.6
Cash/other	2.4	0.2	0.1
Total assets	100.0	1.4	0.9

Appendix 3

PENSION FUND REVENUE ACCOUNT AND MEMBERSHIP

	Final Outturn 2010/11 £'000's	Estimate 2011/12 £'000's	Actual to 30/09/11 £'000's
INCOME			
Employee Contributions	6,040	6,100	2,800
Employer Contributions	22,204	22,500	10,000
Transfer Values Receivable	4,757	4,000	2,500
Investment Income	7,478	7,000	5,200
Total Income	40,479	39,600	20,500
EXPENDITURE			
Pensions	19,223	20,000	10,200
Lump Sums	6,006	6,500	3,400
Transfer Values Paid	2,734	4,000	800
Administration	3,049	2,800	900
Refund of Contributions	17	100	-
Total Expenditure	31,029	33,400	15,300
Surplus/Deficit (-)	9,450	6,200	5,200

MEMBERSHIP	**31/03/2011**	**30/09/2011**
Employees	5,246	5,103
Pensioners	4,522	4,578
Deferred Pensioners	3,859	4,028
	13,627	13,709

Appendix 4

Baillie Gifford Report for the quarter ended 30 September 2011
Investment Performance to 30 Sept 2011

	Fund	Benchmark	Performance
Three Years (% pa)	9.5	6.9	+2.4
One Year (%)	-3.5	-3.8	+0.3
Quarter (%)	-12.2	-11.9	-0.4

Commentary

The quarter to the end of September was a very nervous time for the financial markets. The economic backdrop has, in the short-term at least, clearly deteriorated. More significantly, in the last few months, investors have lost confidence in the authorities' ability to cope with the issues this creates, as protracted and highly politicised negotiations in the US culminated in the country's debt being downgraded and in Europe there remain deep disagreements about how to address the Greek and wider debt crisis. Sentiment has, understandably, worsened and equities have been weak.

There are, however, plenty of happier, and possibly more important, events taking place around the world. Interest rates seem to be on the turn in developing countries, as Brazil and Turkey have announced cuts and others are likely to follow. Emerging market current account surpluses are now clearly declining, and America's imports are increasing, helping rebalance the world economy. China continues to grow at 9.5%, giving some support to the view that China can prosper without selling ever larger amounts to the rest of us.

Moreover, the corporate sector is in much better health than at the time of the financial crisis, or perhaps we should say the beginning of the financial crisis, three years ago. The amount of cash on company balance sheets is well into unprecedented territory. There remains the prospect for a spike in merger and acquisition activity - usually positive for share prices.

Investment Performance

Within your fund, we have had a longstanding overweight position in equities, emerging market equities in particular, and corresponding underweight in bonds. These 'asset allocation' positions have detracted from relative performance (ie when compared to your benchmark) over the last quarter and year, although are still a positive contributor over the longer term. More encouragingly, the fund's equity holdings have held up reasonably well relative to the market as a whole during the recent sell off. Good 'stock selection' has therefore largely offset the drag from asset allocation in the last year, and the fund has performed roughly in line with the benchmark over the period. Stock selection has been helped by what we don't own (we've largely avoided Western banks and high street retailers for example) as well as what we do. In this latter category are stocks which we would categorise as steady growers - companies with some defensive characteristics but also good long term growth prospects - and stocks with excellent secular growth prospects which are trumping cyclical headwinds. The former category would include stocks such as Japan Tobacco and Nestlé, while the latter would range from Fast Retailing, an innovative retailer, which has been delivering growth despite operating largely in Japan, to a number of technology and internet-related companies, which are well-placed to capture the growth potential inherent in technological advances.

Changes to the Portfolio

Our long-term approach goes hand in hand with low portfolio turnover, and it is particularly important not to react to uncertain times by shortening our timeframes. Fundamental analysis of both existing and potential holdings remains key amid all the turmoil in markets and economies, and we take comfort from the fact that your portfolio is dominated by well-financed businesses, the growth prospects of which often depend on demand from the robust half of the global economy.

Having said that, volatility inevitably provides some opportunities to add to favoured stocks which have been underperforming, while our ongoing review of holdings will lead us to sell or reduce others where our conviction has lessened or the market has caught up with our enthusiasm.

In the UK, for example, we have added to Johnson Matthey, the environmental catalysts supplier. We believe the demand outlook for this business is very positive, and that this is not yet adequately reflected in the share price. Meanwhile we have sold out of Autonomy following the announcement of a recommended bid from Hewlett Packard. In the US, we have sold Ecolab, which is a leading provider of cleaning products and services. The company has recently made a significant acquisition which we believe was both expensive and strategically unsound.

With regards to the outlook, we acknowledge that there has been a short-term weakening in the outlook for (Western) economic growth and corporate profits. We may let cash levels rise, but we hope also to find more opportunities to add to favoured stocks and to invest in new opportunities during periods when markets are weak. Bond yields, both index-linked and conventional, have fallen to very low levels reflecting economic concerns and low interest rates. We remain cautious of bonds over the long term.

Appendix 5

2011 Q3 – Fidelity Market Commentary
Investment Performance to 30 Sept 2011

	Fund	Benchmark	Performance
Three Years (% pa)	8.5	6.7	+1.7
One Year (%)	-5.0	-2.2	-2.8
Quarter (%)	-12.2	-10.5	-1.9

The Fund underperformed over the quarter returning -12.2% relative to the composite benchmark return of -10.5%. Global equity markets suffered a sharp decline during the third quarter of 2011, with the FTSE All Share Index, for example, falling by 13.5%. Investor confidence was frequently tested by a number of different events, including a recurrence of concerns related to the sovereign debt crisis in the eurozone and a marked slowdown in global economic growth. In this highly volatile environment, the largest companies operating in defensive sectors, typically with higher-than-average dividend yields, proved to be safe havens.

In keeping with the overall market trend, most sectors ended in negative territory. Mining stocks fell the most during the quarter as metal prices declined amid increasing demand-related concerns. Financials also came under pressure as European debt issues remained in focus and credit default swap (CDS) spreads on many banks across Europe rose sharply. In this environment, investors increasingly focused on companies with the ability to deliver growth even during difficult economic conditions. The best performing stocks were typically those in defensive areas, such as tobacco, telecommunications, utilities and pharmaceuticals, where many companies have high and sustainable dividend yields to support their valuations.

The UK Fund continues to follow a strategy of investing in mispriced industry winners. These are typically larger companies, many of which have world class businesses and are, in my opinion, well-placed to benefit from the faster growth in overseas markets. We have spent much of the last three months blocking out the short-term market noise and focusing on meeting company management to reassess our views. In the majority of cases, the investment thesis remains intact and, where appropriate, we have added to the holdings.

The volatile global environment is likely to continue to impact the future performance of UK equities. The current environment is one that should favour companies with attractive valuations and strong balance sheets, with the potential for good long-term profit growth in tough economic conditions. Currently, UK equities appear to be fairly valued versus history, but they remain attractive when compared with other asset classes.

In the fixed income space during the period, heightened concerns about a potential Greek debt default and its impact on the rest of the eurozone, as well as the protracted political wrangling over increasing the US debt ceiling limit, contributed to rising risk aversion among investors. Government bonds advanced strongly and credit spreads widened, led by financials. Against this backdrop, the overweight position in credit hurt the fund's performance. In this environment, the portfolio underperformed the benchmark.

Gilt yields are likely to remain at ultra low levels in 2011 on the back of expectations for falling growth and inflation as well as additional monetary stimulus measures announced by the Bank of England. Looking ahead, markets will remain highly sensitive to the political events unfolding in Europe. Risk aversion may drive credit spreads wider in the short term, causing corporate bonds to underperform government bonds. However, the market volatility is providing an attractive entry point and Ian Fishwick is poised to take advantage of these selectively.