

**Quarterly Investment Report  
for the  
London Borough of Bromley Pension Fund  
For the period ending 31 December 2011**

**30th January 2012**

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## EXECUTIVE SUMMARY

**“It’s not debt, per se, that overwhelms an individual or country. Rather it is a continuous increase in that debt in relation to income that causes trouble”**

**Warren Buffett**

### MARKETS

Most markets staged rallies leading into year end, although none of the fundamental economic issues assailing those markets in previous quarters appeared to have been solved or fixed.

For two years now, markets have traded in a range which rises when central banks throw money into the system (“risk off”) and which falls when perceived risks of systemic failure rise (“risk on”). The one sure thing is that interest rates have remained low and yields on “safe haven” sovereign bonds have fallen to around 2% or below. (3% back in July 2011).

Economic commentators and investment professionals are almost unanimous in stating that the eurozone problems and lack of decisive action by politicians will continue to dominate markets until resolved. As such, the eurozone crisis remains with us and seems to be at best, no better, as Merkel and Sarkozy continue to shuttle between Berlin, Paris and other European capitals, for yet another summit meeting. It remains difficult to find anything positive to write about this situation as the EU seems to be stumbling towards a Greek default, a recapitalization of many of its major banks and potentially a reduction in the number of countries using the Euro as their currency.

Elsewhere however, matters are showing signs of slight improvement, with some minor up ticks in US economic data, with households and businesses reducing their leverage and the 20 year mortgage rates hitting a record low during the quarter under review. It seems clear from Chairman Bernanke’s various “deific” pronouncements that the Federal Reserve will continue to use both conventional and unconventional means to try and stimulate the economy. In mid January he intimated that interest rates would stay down for the next few years, whilst in the UK, The Governor of the Bank of England, Mervyn King also recently implied that additional QE would be necessary in the not too distant future, should the economy not show some signs of growth.

It appears therefore, that we are moving through a period of unconventional Central Bank interventionism for which there is no past precedent. At least, in this instance, no one should be blindsided by “the lessons of history”.

Ongoing uncertainty as to how the debt problems of Eurozone countries, other than Greece, will be solved has made many investors even more risk averse than before, especially since Standard & Poors (the rating agency) downgraded France and Austria from AAA to AA+. Just two weeks into 2012, Spain (now A), Italy (now BBB+) and Portugal (BB) were also downgraded by 2 notches leaving Portugal as a non investment grade member of the Euro.

A verbal update on markets will be given at the next Pensions Investment sub Committee meeting on 9 February 2012.

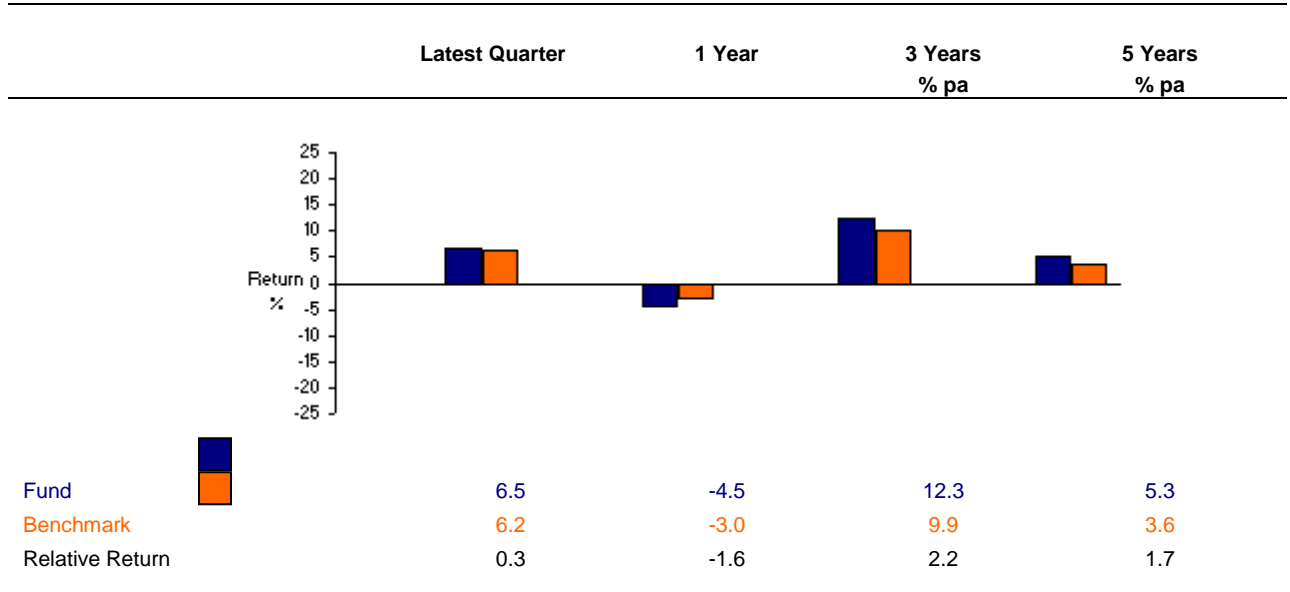
## FUND VALUE

The scheme value rose during the quarter to £461.8m (433.7m at 30 September 2011). The comparable value for December 2010 was £482.3m.

## INVESTMENT PERFORMANCE HIGHLIGHTS

The fund had positive returns for the quarter, gross of fees.

### Fund Returns



The graphs show the performance of the Fund and Benchmark over the latest period and longer term.

The relative return is the degree by which the Fund has out or underperformed the Benchmark over these periods  
Source: the WM Company

## **Baillie Gifford**

With markets rallying towards the end of the quarter BG achieved a small positive return of 0.4% over benchmark (6.3% versus 5.9%). For the twelve months they were behind the benchmark by 0.4% with both indices again negative (-4.5% versus -4.0%). Only at the rolling three year figures are the figures positive with a strong fund return of 13.2% pa against the benchmark of 9.8% pa.

This is a very good performance over the three year period delivering net positive returns over and above their target of 1-1.5% over the benchmark.

## **Fidelity**

The manager out performed the benchmark by 0.4% with a return of 6.8% against the benchmark of 6.4%. However, for the twelve months the fund under performed the benchmark by 2.7% (-4.5% versus -1.9%). Over the longer three year rolling measure the fund has generated positive returns of 1.2% pa when measured against the benchmark of 6.7% pa.

Members should note that when these returns are measured against the benchmark plus the out-performance target of 1.9% pa, the manager has underperformed by 0.7% pa over the rolling three year period.

## **Total Fund**

The fund out performed the benchmark for the quarter returning 6.5% versus a benchmark of 6.2%, but over the twelve month period the fund returned -4.5% versus the benchmark of -1.6%.

Over the three year rolling period the fund is ahead with a return of 12.3 % pa against the benchmark of 9.9% pa.

Overall, therefore, when measured against a benchmark including the aggregated targets of 1-1.5% for BG and 1.9% for Fidelity the Fund is slightly ahead of the combined target over the longer term with the majority of that out performance coming from Baillie Gifford.

## **MANAGER CHANGES**

**Baillie Gifford** announced the retirement of several senior executives in what had been a well flagged and well managed succession process. One of the Partners retiring is Nigel Moorcroft who has been Relationship Director on the Bromley account for many years. Each retiring partner has had a "shadow partner" for the last three years ensuring that succession and client continuity is not diminished. These changes should in no way diminish either the client service or the smooth running of the investment portfolios as far as this Fund is concerned

## **FUND GOVERNANCE and VOTING**

Baillie Gifford continues to own stock in Olympus Corp (which remains in the financial headlines over alleged overpayment of “consulting fees”). **BG should be asked for their views on the stock and whether they are contemplating joining a securities class action suit in order to potentially minimise value diminution to the Fund.**

Comprehensive reviews, covering governance and responsible investing, together with detailed schedules on governance engagement and voting actions during the period are included in the quarterly reports for the period

## **INVESTMENT MANAGER REVIEWS**

### **Baillie Gifford**

The manager has a composite benchmark calculated by weighting six indices by set percentage allocations and an out performance target of 1.0% to 1.5% before fees over rolling three year periods.

At the end of the period, assets under management rose to £247.8m from £233.0m (30 September 2011). Performance was positive although this was an aggregation of some positive and negative results across the spectrum as can be seen from the charts on page 6.

In terms of asset allocation, the manager is significantly underweight UK equities (18.6% versus 25%) and UK bonds (12.5% versus 18.0%). Those under weights have been redistributed between international equities which have an aggregate overweight position of 65.9% versus the benchmark of 54.0%.

Whilst the manager has a small positive performance for the quarter (+0.4% over benchmark) their performance over the previous year was slightly negative at -0.4%, albeit a good performance in the face of some strong negative economic headwinds. Over the rolling three years they have delivered strongly positive returns (13.2% pa versus 9.8% pa).

The two charts below, produced by The WM Company, clearly demonstrate the way in which Baillie Gifford has added or subtracted value both by stock selection and asset allocation across the various asset classes.

UK Equities    N. America    Europe ex UK    Tot Far East    Other Intl.    UK Bonds    Cash/Alts    Total Fund

**Asset Allocation**

Fund Start	18.6	19.1	19.9	9.7	15.0	12.5	5.2	100.0
Fund End	18.5	19.5	19.6	9.0	15.2	12.1	6.1	100.0
BM Start	25.0	18.0	18.0	9.5	9.5	18.0	2.0	100.0
BM End	25.6	18.9	17.6	9.1	9.3	17.6	1.9	100.0
Impact	-0.2	-	-	-	-0.1	0.1	-0.2	-0.3
Diff	-6.4	1.1	1.9	0.2	5.5	-5.5	3.2	0.0
	-7.1	0.6	2.0	-0.1	5.9	-5.5	4.2	0.0

**Stock Selection**

Fund	7.4	11.6	5.8	0.0	7.5	3.4	0.0	6.3
Benchmark	8.4	11.3	3.3	1.1	4.2	3.7	0.3	5.9
Impact	-0.2	0.1	0.5	-0.1	0.5	-	-	0.7
	-1.0	0.3	2.5	-1.0	3.2	-0.4	-0.2	0.3

Source: the WM Company

## Baillie Gifford Pooled Funds

Baillie Gifford Funds	Total Fund Value 31-Dec-11 £m	Number of Investors	Largest Investor £m	Bromley Investment £m	Bromley % holding in Fund	Bromley Ranking
Active Gilts Plus	93.8	86	43.7	10.8	11.5	tbc
Investment Grade Bonds	245.7	64	94.4	19.2	7.8	tbc
Japanese Small Co's	33.0	190	5.1	1.5	4.5	tbc
Emerging Mkt Leading Co's	354.2	82	94.4	18.7	5.3	tbc
Emerging Mkt Growth	652.8	tbc	265.8	18.9	2.9	tbc

Given the relative size of the pooled funds and the quantum of the Bromley investments there are no perceived concentration or liquidity risks with the above investments.

## FIDELITY INVESTMENT MANAGEMENT

The manager has a composite benchmark calculated by weighting seven indices by set percentage allocations and an out performance target of 1.9% before fees over rolling three year periods.

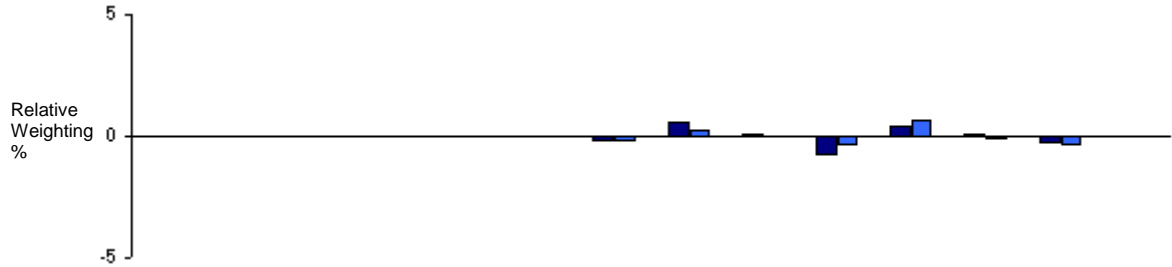
At the end of the period, assets under management rose to £214.4m from £201.0m (30 September 2011). Investment performance for the quarter and the twelve month period was slightly positive.

The rolling three year figures show a return of 11.4% pa over the benchmark of 10.0% pa and over the five years 5.3% pa versus 3.1% pa.

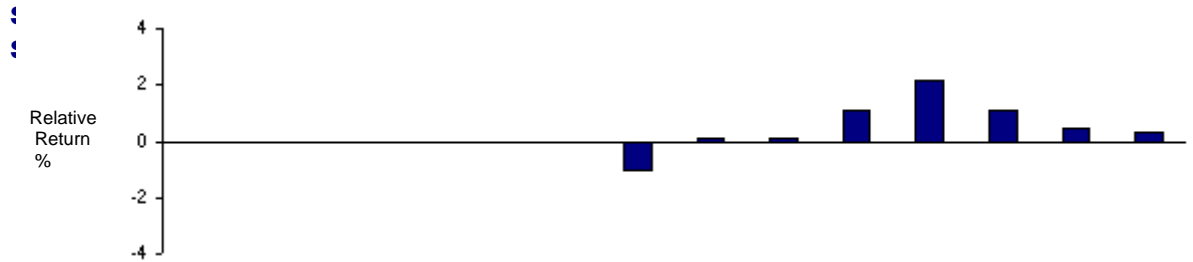
***NB If the out performance target of 1.9% over the rolling three year period is taken into account then Fidelity is running 0.5% pa behind the benchmark.***

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

**Asset Allocation**



Fund Start	9.8	35.6	12.6	11.8	5.4	5.1	19.7	100.0
Fund End	9.9	35.2	13.0	11.6	5.5	4.9	20.0	100.0
BM Start	10.0	35.0	12.5	12.5	5.0	5.0	20.0	100.0
BM End	10.0	35.0	13.0	11.9	4.8	5.0	20.3	100.0
Impact	-	-	-	-	-	-	-	-
Diff	-0.2	0.6	0.1	-0.7	0.4	0.1	-0.3	0.0
	-0.1	0.3	0.0	-0.4	0.7	-0.1	-0.4	0.0



Fund	6.1	8.5	12.0	4.9	6.9	-2.7	4.3	6.8
Benchmark	7.2	8.4	11.9	3.7	4.6	-3.8	3.8	6.4
Impact	-0.1	-	-	0.1	0.1	0.1	0.1	0.3
	-1.0	0.1	0.1	1.1	2.1	1.1	0.4	0.3

An asset allocation decision will have a positive impact if a Fund is invested more heavily than its Benchmark in an area that has performed well. Conversely, a positive benefit would be derived from having a relatively low exposure to an area that has performed poorly. Stock selection will have a positive impact if the Fund has outperformed the Benchmark in a particular area. The impact of both asset allocation and stock selection is weighted by the level of investment in the area.

# not invested in this area for the entire period

- indicates a value less than 0.05 and greater than -0.05

Source: The WM Company



## UK equities

The UK Equity mandate is managed on a segregated basis and basically delivered index performance for the last quarter at 8.5%.

However, it remains behind the index by 3.4% over the rolling 12 months (benchmark -6.9% against a return of -3.5%). Over the longer three year measure the fund has out performed the index by 2.4% pa % (15.3% pa versus 12.9% pa).

Commenting on this near index performance the manager stated that economic data continued to send mixed signals to the market. Holdings in the financial sector continued to show losses which were offset by gains in healthcare, aerospace and building materials. The overweight position in pharmaceuticals (GSK and Shire) and aerospace (Rolls Royce) contributed positive performance whilst the major detractors were holdings in BP and Royal Dutch Shell.

The manager continues to follow the same strategy outlined last quarter that of investing in mis-priced industry winners in the belief that their investment case remains intact.

## Fidelity Pooled Funds

The following table shows the values of the various OEIC's in which the Fund is invested. In the case of the Global Focus Fund there is a potential concentration/liquidity risk as the two largest investors own some 52% of the total fund.

Fidelity should be monitored closely and requested to advise Bromley in the event the largest, or any significant, holder instructs a full or partial redemption of their assets within a particular Fund or that significant other changes occur.

Fidelity Fund	Total Fund Value 30-Dec-11 £m	Number of Investors	Largest Investor £m	Bromley Investment £m	Bromley % holding in Fund	Bromley Ranking
America	451.2	26	125.2	28.0	6.2	5
Europe	447.3	122	102.6	24.7	5.5	5
Jaoan	358.2	109	66.2	10.6	3.0	10
South East Asia	237.5	113	33.3	11.7	4.9	8
Global Focus	87.3	17	24.6	21.2	24.3	<b>2</b>
Aggregate Bond	402.1	26	154.0	42.8	10.6	4

Source: AllenbridgeEpic Investment Advisers and Fidelity

## **America Fund**

The fund delivered a marginal out performance of 0.2% (12.1% versus 11.9% for the quarter, but was down 4.3% pa over the rolling twelve months (-1.9% pa against index of 2.4% pa). The fund is also down 0.5% pa to benchmark (10.5% pa versus 10.0% pa) over the three year rolling period. Positions held were similar to the previous quarter, albeit the underweight positions in large cap continued to hold performance back. Overweight positions in Google, Chevron and Philip Morris added value. Positions in the software & services sector detracted from performance. Sectorally the manager remains overweight Software and services, healthcare and diversified financials, all "funded" by underweight positions in utilities, insurance and real estate. Major sales and purchases included Exxon Mobil, Apple and Oracle on the sell side and Chevron, Procter & Gamble and Occidental petroleum on the buy side.

## **Europe (ex UK) Fund**

The fund had a good quarter and out performed its benchmark by 1.2% (benchmark 4.9% against a return of 3.7%). Unfortunately the good news stops there as the fund remains 2.1% pa behind the benchmark over the rolling twelve months (-16.0% pa against -13.9% pa) and is now -4.7% pa behind the benchmark (-2.5% pa versus +0.9% pa) over the three year rolling period.

Positive contributors from Saipen, Royal Dutch Shell (NL) and Banco Santander were reduced by negative contributions from holdings in Total and Fraport The manager continues to be overweight in Germany +6.8% to the benchmark and interestingly, for a Europe ex UK fund has a near 6.0% holding in the UK, (benchmark weight 0.0%!), with BG Group being one of the heaviest overweight stocks in the portfolio! The German and UK country overweight positions are now funded by underweight positions in Switzerland, (-3%). Sweden, (-4.8%) , and France (-5.2%).

## **Japan Fund**

The fund under performed its benchmark by 1.0% relative in the third quarter (benchmark -2.7.0% against a return of -3.7%), and remains flat to the index over the rolling twelve months (-11.5% pa versus -11.8% pa) Over the three year rolling period however, the fund remains strongly ahead of its benchmark by 3.2% pa (2.7% pa versus -0.5% pa).

Underweight positions in the Utilities sector coupled with overweight positions in the automobile parts and tyre manufacturers helped performance again this quarter. Major contributors were Mitsui, Fujitsu and Orix Corp. Negative performance came from holdings in Asahi Glass and Denso. Not holding NTT also detracted. The manager has used some of the cash

element in the portfolio to purchase Murata manufacturing and NKSJ Holdings.

### **South East Asia Fund**

Helped by better economic news the portfolio generated a strong performance this quarter returning 6.9% against the benchmark of 4.6%. It is ahead by 0.8% pa over the rolling twelve months and remains 2.3% pa ahead over the rolling three year measure.

The Fund has retained overweight benchmark positions in Thailand (+2.9%) Korea (+2.5%) and Hong Kong (+1.3%) offset by under- weights of 4.4% and 3.3% in Taiwan and Singapore respectively. The Fund has remained over weight in the retail and transportation sectors, with offsetting underweight positions in insurance and the food and beverage sectors. Contributors to performance included Samsung Electronics, Techtronic Industries and ANZ Banking Group with Commonwealth Bank of Australia and LG Household and Healthcare detracting from performance.

### **Global Focus Fund**

**NB. The Bromley holding of 24.3% of the total assets of this Fund by value, continues to presents a potentially significant concentration and liquidity risk.**

The fund under performed its benchmark by 1.1% in the fourth quarter (6.1% versus 7.2%). Despite having had a poor rolling twelve month return down 3.4% pa relative (-8.4% pa and -5.0% pa) the three year returns remain positive at +4.7% pa (13.3% pa versus 8.6% pa).

The manager operates on a go anywhere, bottom up approach with country and sector allocations secondary to "best investment opportunities". As a result the manager moves assets around to take advantage of relative value opportunities and has established overweight index positions in countries including India +3.3% (underweight in SE Asia Fund by 1.5%), Hong Kong/China + 2.8% and the UK +3.8%. These overweights are being "funded" by underweight index positions of 5.8% in the US, 2.4% in Canada and 3.4% in Germany.

Positive contributions came from holdings in Lowes, Occidental Petroleum (also owned by the America Fund) and Union Pacific Corp, whilst negative returns came from Lloyds Banking Group (also contributed to losses in the UK portfolio), Amazon and Baxter International. Currently, 49% of the fund investments are held in US stocks with Emerging Markets (8.5%), Europe (10%) and the UK (12%) being the other dominant areas of investment.

## Aggregate Bond Fund

The fund had a good fourth quarter with a positive performance of 0.5% over benchmark (4.3% v 3.8%), is ahead by 0.6% pa over the rolling twelve months and has performed very well over the three year period, with a margin over benchmark of 4.2% pa % (12.1% pa versus 7.9% pa).

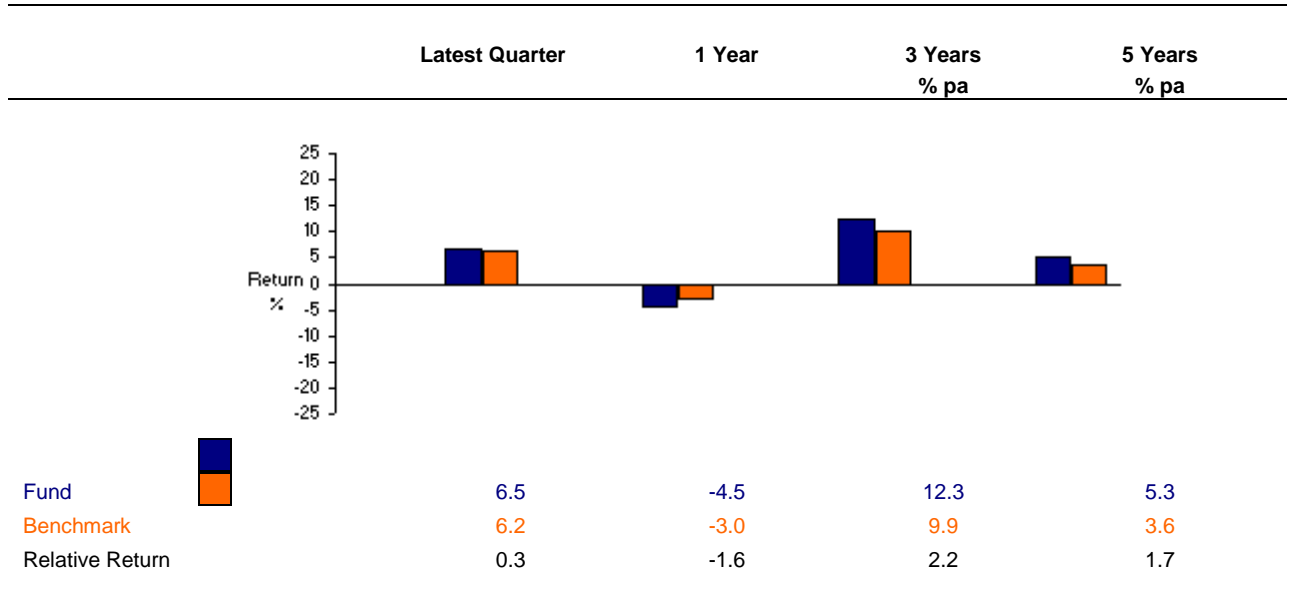
The majority of this quarter's performance was due to its holdings in the telecommunications sector with Verizon, HP and Centurytel all performing strongly.

Duration remains at the benchmark of 8.6 years for the second quarter in a row. In terms of a sectoral breakdown, the manager remains overweight the ABS/MBS (+3.2%) and banks and brokers (+4.1%) sectors with offsetting underweights in Government and Quasi supranationals and other sovereign debt instruments. These overweight positions are offset by below benchmark positions in Government bonds (-3.9%) and in Quasi/Sov/Supra/Agency bonds (-10.3%). The Fund has also retained its 2% holding in cash.

In terms of credit ratings, the fund is underweight Government and AAA rated bonds ((49.4% to 62.9%) and has maintained overweight positions in A and BBB rated bonds (37.5% versus 30.6%).

## TOTAL FUND REVIEW

### Fund Returns



The graphs show the performance of the Fund and Benchmark over the latest period and longer term.

The relative return is the degree by which the Fund has out or underperformed the Benchmark over these periods

# = Data not available for the full period

Source:the WM Company

The above chart clearly demonstrates that both managers delivered basically benchmark performance for the quarter under review and were behind the benchmark over the rolling twelve months. Only at the rolling three and five year periods does the positive performance show through and even these quality positive returns would be reduced should the "out performance targets of 1.0 to 1.5% pa and 1.9% pa over rolling three years be added in to the equation.

## **Asset Allocation**

The following chart combines the two fund manager asset allocations by value to create a total fund asset allocation picture.

In addition the various regional allocations within the Fidelity Global Focus Fund have been reviewed and for this quarter there are no material changes at total fund level.

I believe the Committee should consider the introduction of a total fund strategic benchmark and the subsequent inclusion of a total fund asset allocation chart. This would highlight under or overweight positions against a new aggregated benchmark thus enabling the Committee to see where their "risk" was being spent, or where it was not being taken, the over and underweight positions of the investment managers, rather than the current situation where Baillie Gifford and Fidelity are managed to separate benchmarks.

This chart highlights the extent to which **Baillie Gifford** utilise their asset allocation band widths. Currently they are underweight fixed income assets and overweight cash with a numerically neutral position in equities. However, whilst neutral to the aggregated benchmark, they have underweighted UK equities in favour of an over weight position in Emerging markets.

**Fidelity** on the other hand appears to have taken risk off the table and have once again stuck close to their central benchmarks.

## Fund Asset Allocations by Manager and at Total Fund levels

manager asset class	BGifford £m	Bmark %	actual allocation	Fidelity £m	Bmark %	actual allocation	Total Fund	% regional
<b>Equities</b>								
UK	45.9	25	18.5	73.7	35	34.4	119.6	25.9
North America	48.3	18	19.5	29.6	12.5	13.8	77.9	16.9
Europe ex UK	48.5	18	19.6	24.6	12.5	11.5	73.1	15.8
Japan				10.5	5	4.9	10.5	2.3
Developed Asia Pac	22.3	9.5	9.0	11.7	5	5.5	34	7.4
Pacific basin ex Japan							0	0.0
emerging markets	37.7	9.5	15.2				37.7	8.2
Global Focus				21.2	10.0	9.9	21.2	4.6
Sub total equities	202.7	80	81.8	171.3	80	80.0	374.0	<b>81.0</b>
<b>Fixed interest</b>								
UK £ bonds Gilts and Corporates	30.0	18	12.1	42.8	20	20.0	72.8	15.8
UK Bonds							0	0.0
Sub total bonds	30.0	18	12.1	42.8	20	20.0	72.8	<b>15.8</b>
Cash	15.0	2	6.1				15	<b>3.2</b>
Total fund	247.7	100	100	214.1	100.0	100	461.8	<b>100</b>

values may not correspond to other value number charts due to roundings

Alick Stevenson

Senior Adviser

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