Barnett Waddingham

London Borough of Bromley Pension Fund

Investment strategy review

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Investment strategy review process

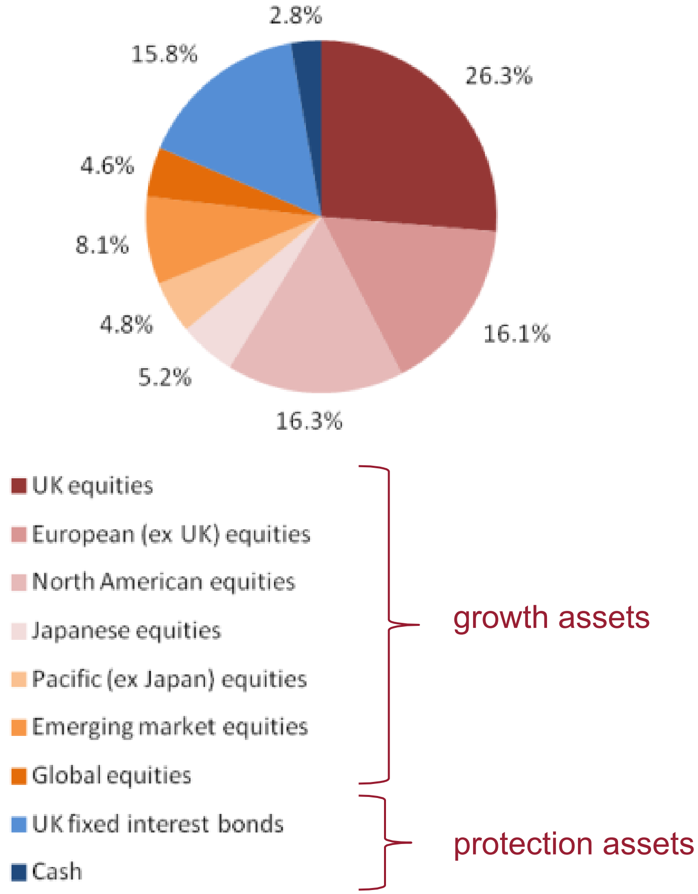
- Review of current status
- Identification of key objectives
- Growth/ protection split
- Design of overall mandate structure
- Growth strategy
- Portfolio strategy

Outside scope of review:

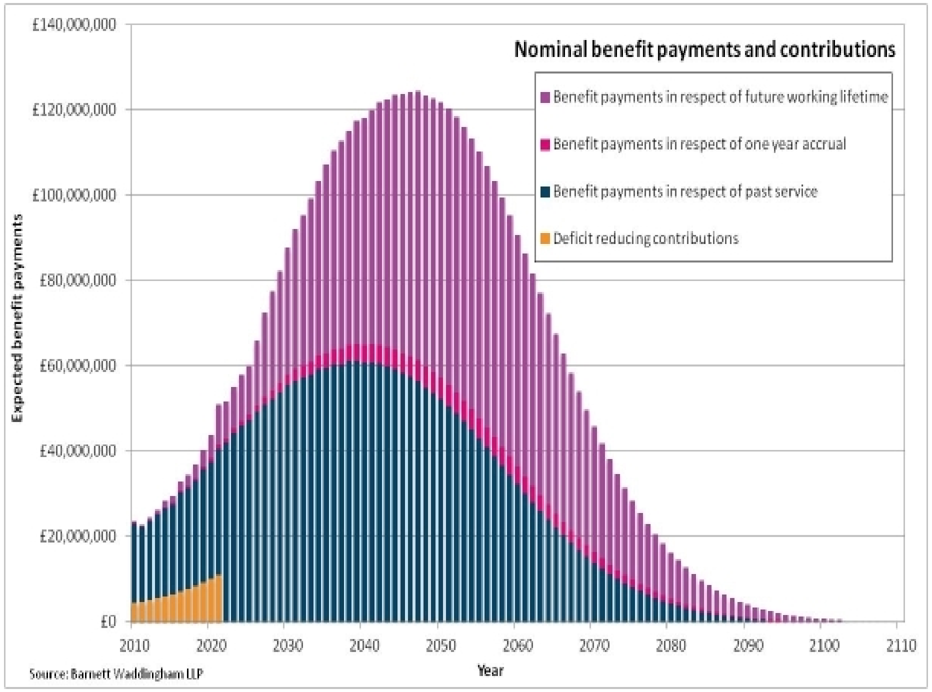
- Manager/fund selection
- Implementation considerations

Current Fund position

Asset allocation



Liability profile



Source:
Asset information as at 30.09.2011. Valuations sourced from Baillie Gifford and Fidelity.
Liability cashflows provided by Barnett Waddingham Public Sector Consulting Team as at 31 March 2010.

Fund objectives

- To ensure that sufficient resources are available to meet all liabilities as they fall due.
- To achieve this with as stable as possible employer contributions at the minimum level agreed by the Actuary.
- To maximise the returns from investments within reasonable risk parameters.

Source: Funding Strategy Statement

Funding strategy sets investment return targets

Changing profile of the LGPS

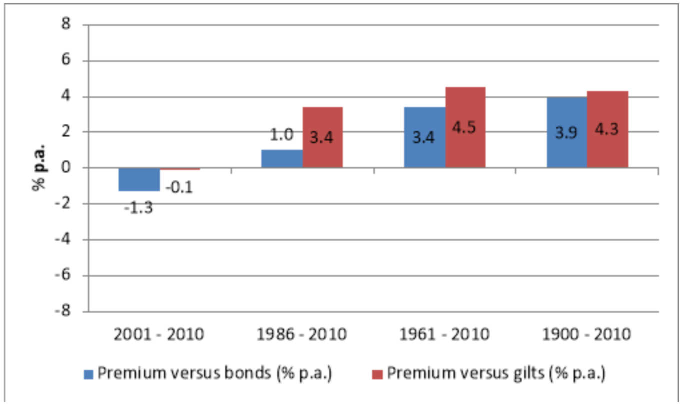
Long-term net investor

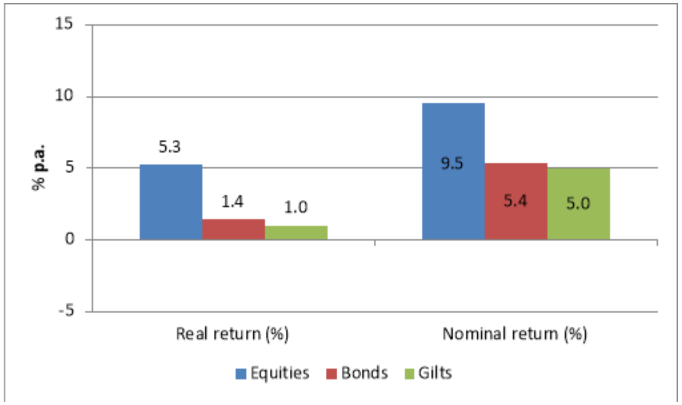
Growth/protection split

- **Actuary's investment assumptions**

Investment return assumption	% per annum	Real % per annum
Equities/absolute return funds	7.5	4.0
Gilts	4.5	1.0
Bonds	5.6	2.1

- **Are these returns achievable?**





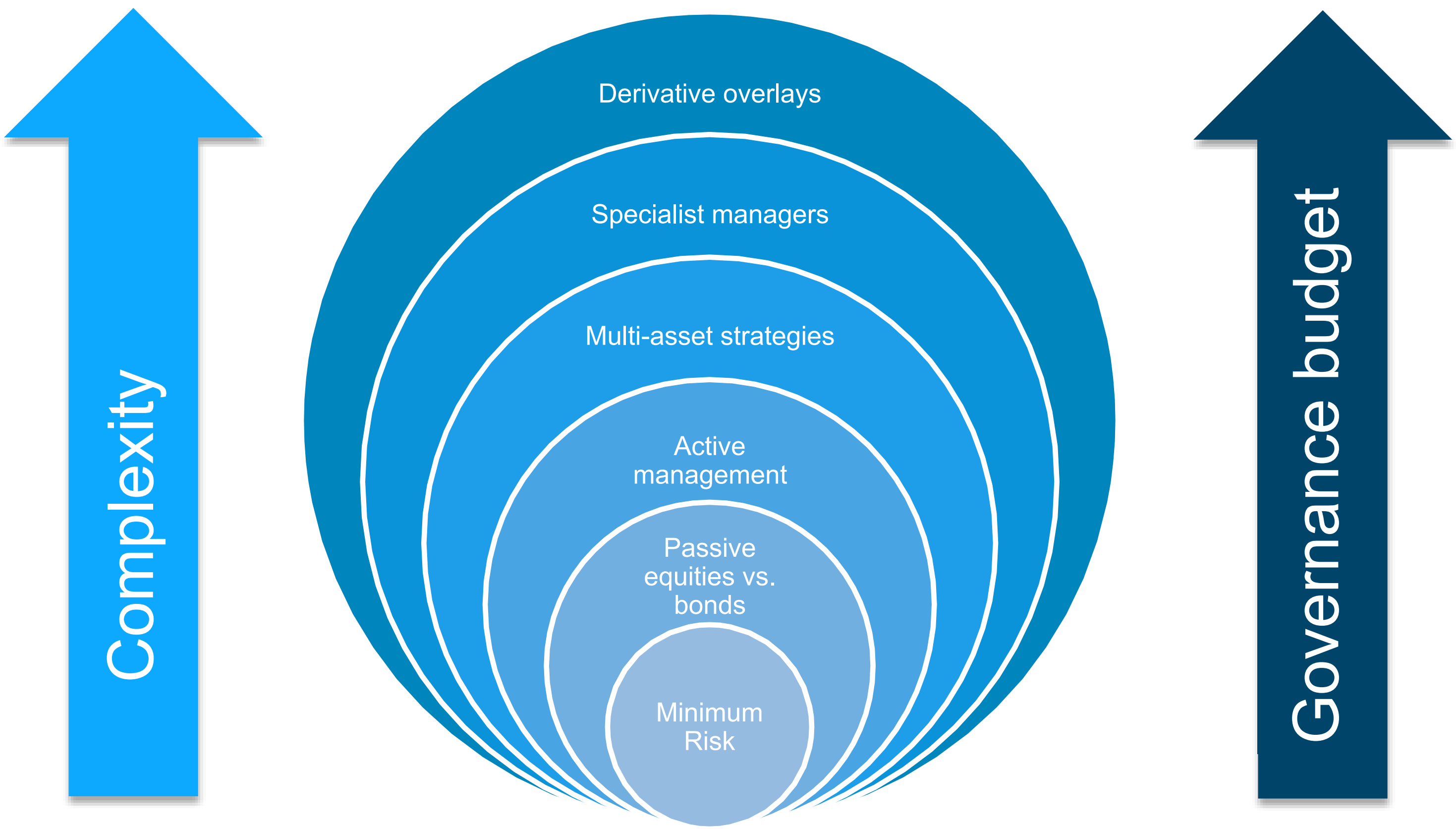
Source: Elroy Dimson, Paul Marsh and Mike Staunton, Credit Suisse Global Investment Returns Sourcebook 2011

- **80%:20% growth:protection allocation remains appropriate….**
- **…. but consider the separation into explicit growth and protection mandates**

Design of overall mandate structure

A LOOK AT THE BUILDING BLOCKS

Importance of the governance budget



Governance budget in operation

- Consider use of passive management
- Reduced pressure on governance budget

- Introduce additional diversification into growth portfolio
- Increased pressure on governance budget

Passive core/ active satellite structure

Asset classes

Asset classes

Money

- Cash
- Gold
- Commodities

Debt

- Government bonds
- Corporate bonds
- High yield
- Emerging market debt
- ABS/MBS

Equity

- UK shares
- Overseas shares
- Emerging market shares
- Property
- Private equity
- Infrastructure

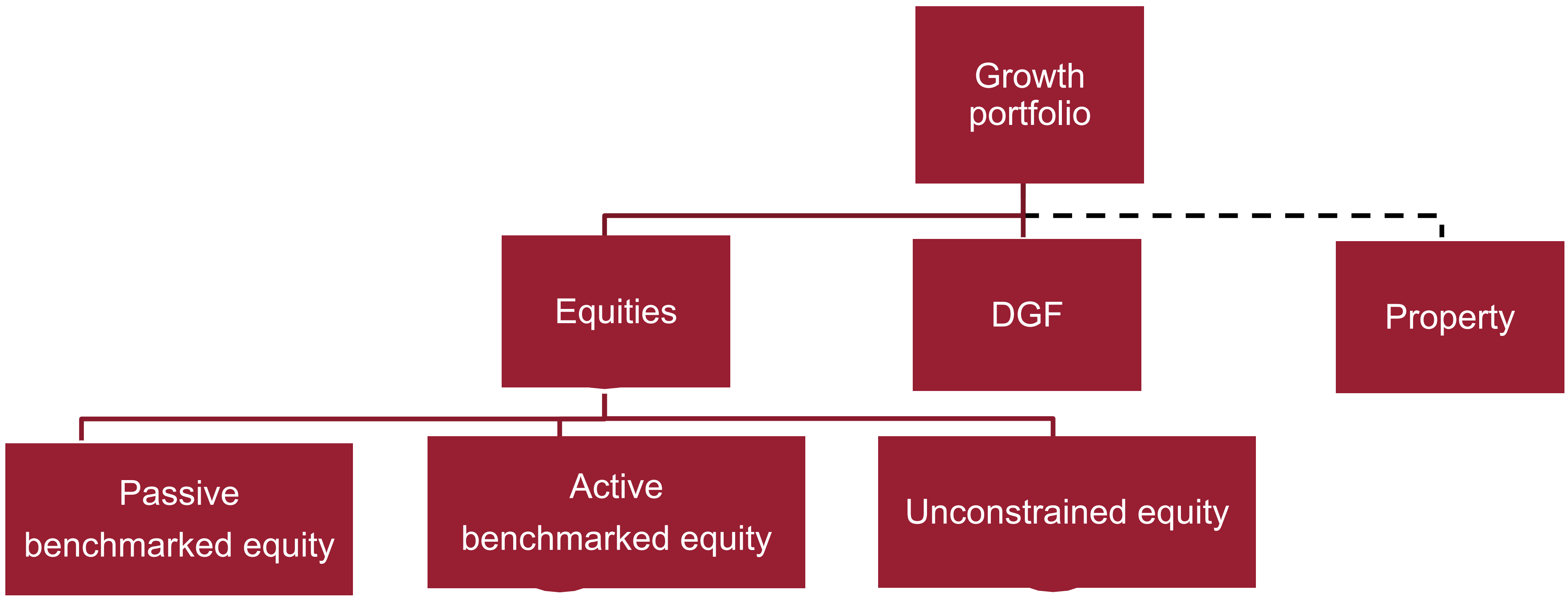
Other

- Hedge funds
- Derivatives

Growth strategy

CHOOSING RETURN-SEEKING ASSETS

Possible growth portfolio strategies



Traditional investing vs DGF investing

Traditional investing

Performance objective relates to a benchmark

Managers rarely deviate materially from benchmark

Asset class	Example benchmark (%)	Example ranges (%)
UK equities	30	25 - 35
US equities	10	8 - 12
European equities	10	8 - 12
Japan/Asia equities	10	8 - 12
Bonds	40	35 - 45
Cash	0	0 - 5

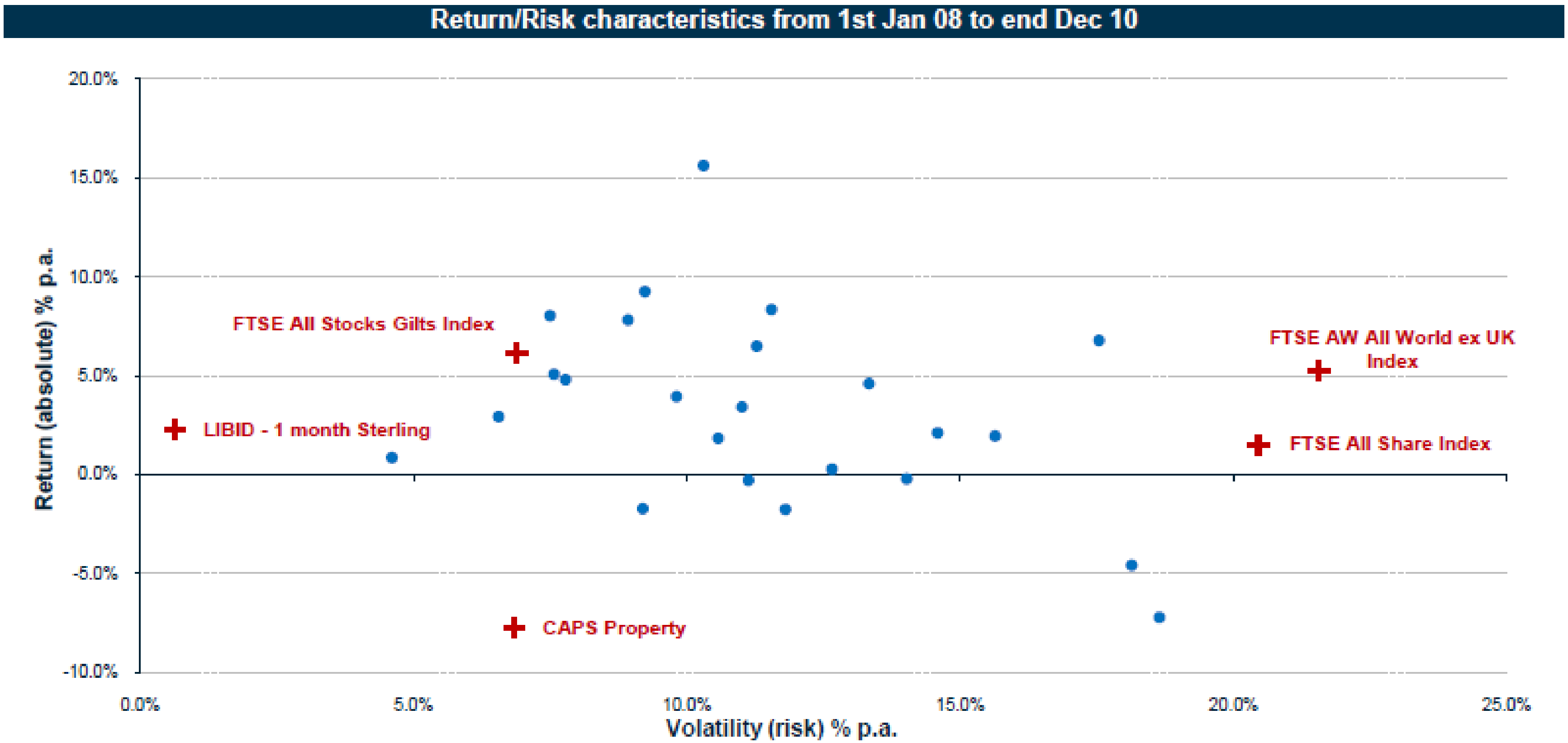
DGF investing

Performance objective is independent of benchmark

Managers have freedom to invest in a diverse portfolio of assets

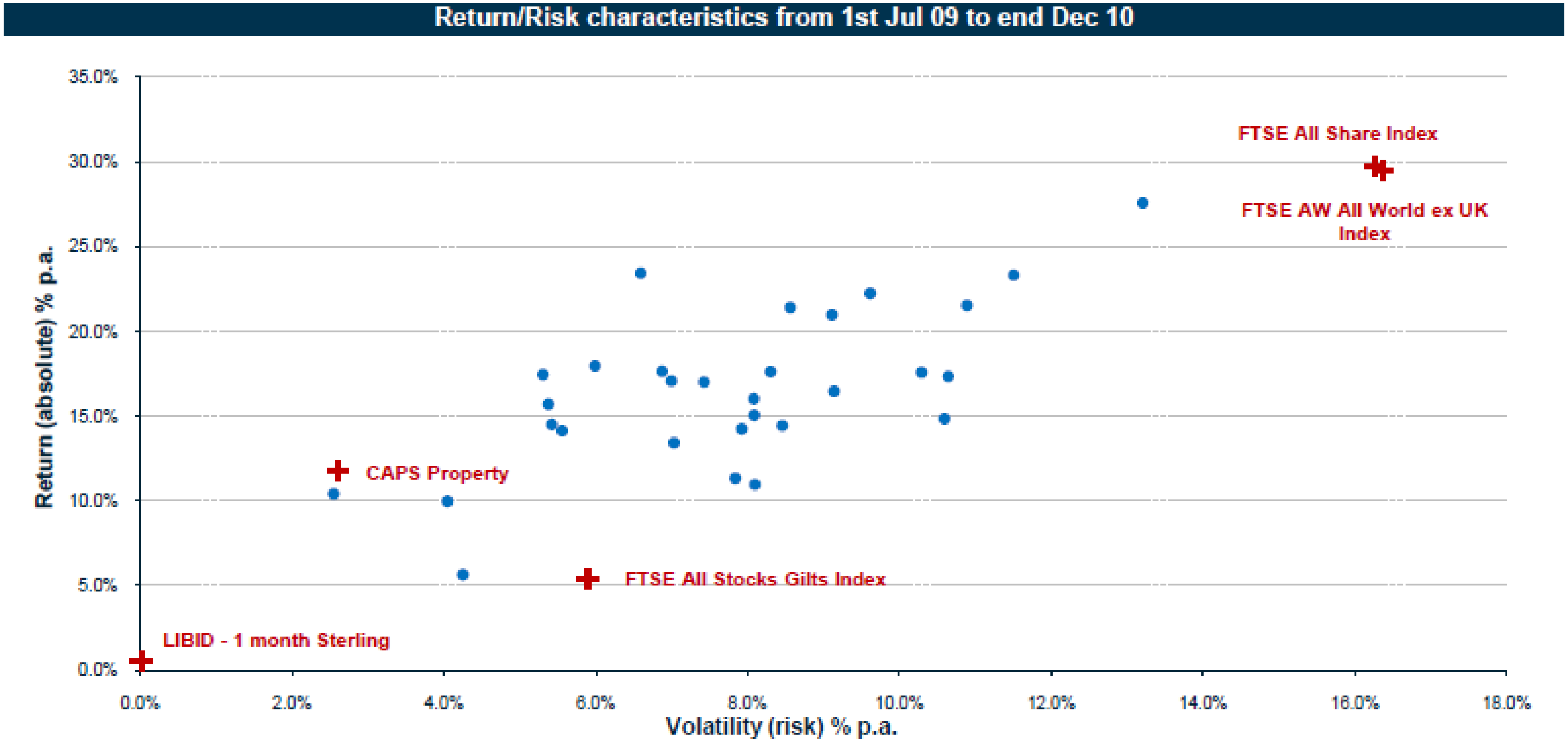
Asset class	Example ranges (%)
Equities	0 - 75
Bonds	0 - 75
Alternative assets	0 - 20
Cash	0 - 100

DGF: Risk vs return



Source: Barnett Waddingham

DGF: Bull market



Source: Barnett Waddingham

Protection strategy

MATCHING THE FUND’S LIABILITIES

Protection portfolio recommendations

- Fund liabilities are entirely inflation-linked…….
- ……..but the Fund's bond assets are entirely fixed interest.

Maintain equal weighting to government and corporate debt

Switch fixed interest gilts into index-linked gilts

- To introduce inflation protection into the Fund

Consider passive index-linked gilt exposure

- Limited size of index-linked gilt market

Investment strategy proposals

Proposal		Section reference
Equity:bond split	– Maintain a strategy structured around an investment of **80%** in growth type assets (i.e. equities) and **20%** in protection type assets (i.e. bonds). – However, consider the separation of the current multi-asset briefs into **explicit growth and protection mandates**.	5
Management structure	– Consider adopting a core/satellite management structure, including an assessment of the **merits of active versus passive management** and the extent to which single mandates could be added to the investment strategy having regard for the resulting governance implications.	6
Growth portfolio	– Whilst we believe the Fund's current equity portfolio is suitably diversified, we would favour the use of an **unconstrained global equity** mandate, where the manager would be given the freedom to invest in different equity regions on a tactical basis rather than being constrained to benchmark allocations. – No separate strategic allocation to **emerging market or frontier market equities** to be considered given exposure within the above mandates.	7.1
	– Adding complexity to the investment strategy as noted above leads us to believe that, whilst the introduction of **property** to the investment strategy is not unreasonable, there are other demands on the governance budget that should take precedence at the current time.	7.2
	– An active approach to **commodity** investing is preferred, although no separate strategic allocation to commodities is proposed for the Fund at this time. Instead, consider exposure to commodities through a diversified growth fund.	7.3
	– Introduce diversification away from the equity market within the growth portfolio via the use of a **diversified growth mandate**.	7.4
Protection portfolio	– Maintain an **equal weighting to government and corporate bonds** within the protection portfolio. – Replace the fixed interest gilts exposure with **index-linked gilts** thus introducing an element of inflation protection into the Fund.	8

Proposed mandate allocation

All allocations as a % of total Fund assets		
	80% growth	**20% protection**
Core: 40%	30%	10%
	- passive global equities	- passive index-linked gilts
Satellite: 60%	50%	10%
	- 40% allocated between an unconstrained equity mandate and the Fund's existing mandates - 10% diversified growth	- active corporate bonds