Item 8

Pension Fund Investment Board
21 May 2012

Update on the Fund Manager Appointment Process

Recommendation

That the Board note the current position with regard to the ongoing fund manager appointment process.

1.0 Introduction

1.1 On 1 August 2011, a formal review of the investment strategy for the Fund was presented to the Investment Board. One of the conclusions was that there was some scope for a modest reduction in investment risk given, the funding position at that time.

1.2 At the Board meeting on 14 November 2011, further specific recommendations regarding the detailed asset allocation and investment manager structure were submitted to the Investment Board. These included recommendations to establish two new mandates, namely, investments in a multi asset absolute return fund and a fixed income absolute return fund. Each new investment is to be funded from the Fund's existing equity investments.

1.3 Following the Board meeting of 13 February 2012, the Treasury and Pensions Group proceeded with the appointment process with regard to absolute return (fixed income and multi-asset) pooled funds.

1.3 Since the February meeting, there has been a deterioration in the funding position of all LGPS funds as a result of falls in UK Government bond yields. Although the Hymans analysis has not been rerun, the scope for reductions in investment risk is likely to have reduced as a result. For that reason, Hymans would be wary of reducing the expected return on the Fund's assets by any significant extent.

2.0 New Mandates

2.1 It remains as Hymans' stance that they recommend that the Fund's exposure to volatile equity investments should be reduced. The multi-asset absolute return investment will have the objective of delivering broadly equity-like returns but with a lower level of volatility. Therefore, Hymans would not expect this new investment to reduce the expected long term returns from the Fund at all.

2.2 In terms of bond funds, there are a wide range of 'absolute return' and 'target return' bond funds available. Some lower risk funds have the objective of providing a modest premium over cash (LIBOR), which would currently equate to an absolute return target in the region of 2-3% p.a. (with little prospect of higher cash rates in the near future). Such an investment would provide some protection against sharp rises in gilt yields (and consequent falls in prices), though the absolute level of return targeted is low when set against the requirement for the Fund to earn an attractive real rate of return over the long term.

2.3 Other bond funds are more focused on delivering an attractive rate of return with less sensitivity to the level of bond yields. They may have, for example, a strong bias towards relatively short-dated bonds and/or have a focus on lower quality bonds where returns are more dependent on income receipts. The advantage of these funds is that they offer the potential of more attractive returns without the same volatility as equity markets. They also tend to have less duration risk and therefore offer more protection against rises in yields than is the case with the Fund's existing bond investments.

2.4 This will be discussed in more detail as part of the selection exercise for an absolute return bond fund investment and will take into account the background of a weaker funding position compared with that of last year.

2.5 Officers and advisors will report at the Board meeting.

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