Nottinghamshire County Council

Report to Pensions Sub-Committee

13 December 2012

Agenda Item: 8

REPORT OF SERVICE DIRECTOR – FINANCE & PROCUREMENT

LOCAL GOVERNMENT CHRONICLE (LGC) INVESTMENT SUMMIT 2012

Purpose of the Report

1. To report on the LGC Investment Summit 2012 held at Celtic Manor.

Information and Advice

2. The LGC Investment Summit 2012 was held on 6th to 7th September 2012 at the Celtic Manor Resort. In accordance with prior approval and as part of the Fund's commitment to ensuring those charged with decision-making and financial management have effective knowledge and skills, the conference was attended by Councillor Reg Adair, Mr Simon Cunnington (Senior Accountant – Pensions & Treasury Management) and Mr Eric Lambert, the Fund's independent adviser.

3. ***Growing economies and markets***
   The conference began with Joshua McCallum, an economist from UBS, who outlined three major uncertainties facing investments:
   a. the Eurozone
   b. a 'new normal' or return to growth
   c. inflation.

4. The Eurozone is at a 'tipping equilibrium'. If solutions are found, fears will ease, confidence increase and borrowing costs will reduce. If not, fears will increase resulting in bank runs and countries exiting the Euro. Solutions exist but all rely on the core countries paying. He argued that the Core's best approach is to be supportive but are dragging out the process.

5. The current crisis is not in the same league as the great depression and the US long run trend continued after that period. For the last 20 years, the UK has been above trend so perhaps we are reverting to the 'old normal'. Inflation would reduce debt quicker but transfers wealth from savers to debtors. Wages are unlikely to increase while unemployment is high. The best approach overall is to think globally.

6. ***Future of the LGPS***
   The next session was presented by Bob Holloway from the Department for Communities and Local Government. The LGPS 2014 project had two workstreams. Workstream 1 was concerned with the main benefit structure. The results of the informal consultation earlier in the year were strongly supportive and

the plan was to have a formal statutory consultation beginning in September to ensure new Regulations were in place by 30 March 2013. This consultation is now planned before Christmas.

7. Workstream 2 was concerned with cost management, governance and administration. The main features are independent oversight of the scheme (most likely by the Pensions Regulator) and greater scrutiny of funds and valuations. The Public Service Pensions Bill appears to include many of these provisions. The Investment Regulations are not being changed but there are calls for a full review to be carried out.

8. ***The Panel comes together***
   This session convened a panel to discuss elements of the LGPS 2014 project. Nathan Elvery (Deputy Chief Executive, LB Croydon) focused on making procurement more efficient. Rather than merging funds, this should be done by restructuring purchasing power through framework agreements. Nicola Mark (Head, Norfolk Pension Fund) was clear that we need to get workstream 2 right in order to make the new scheme work. It is essential to get the structure right and to resource properly.

9. Richard McIndoe (Head of Pensions, Strathclyde Pension Fund) stated that a single fund approach would not guarantee savings and are now looking at collaborative working. A big issue, however, is membership changes and consequent impact on cash flows. Bob Holloway joined the panel and questioned whether councillors are prepared for the increased scrutiny likely to result from workstream 2.

10. ***Emerging markets***
    This session replaced the advertised session on contrarian investing. John Stopford from Investec Asset Management outlined the potential benefits of emerging markets (EM) including:
    - Younger demographic
    - Lower debt levels and higher interest rates
    - Current account surpluses and high savings rates

11. EM equities have historically had high returns but with high volatility. EM debt was previously only available in US Dollars or Euros but bonds denominated in local currencies are now available. Yields are still higher than developed markets, although credit quality is regarded as relatively high. Choosing companies rather than countries (bottom-up rather than top-down) is likely to lead to better returns.

12. ***Opportunities in emerging market debt***
    This session, by Peter Marber (HSBC), presented more reasons to invest in EM debt. EM debt returns have been higher over the last 10 years than both EU and high yield debt (with similar volatility levels) and have outperformed EM equities (with half the volatility). Emerging markets now contribute about 50% of global GDP growth and over 50% of EM debt is now investment grade. In addition, the major EM currencies are undervalued on a ‘purchasing power parity’ basis.

13. ***Are global equities fit for purpose?***

Martyn Hole from Capital International reminded delegates that real returns from equities have recently been poor while bonds have outperformed (since 2000, equities have returned just 1.2% pa). The main reason for this is that prices were too high in 2000. Currently, equity prices are low (with EM equities cheaper than developed) and dividend payout ratios are also low. 'Dividend growers' tend to have lower volatility and outperform companies who offer share buy-backs.

14. Laurence Taylor from T. Rowe Price continued the theme, stating that the last decade had been the worst for 110 years but also included 2 of the biggest profit collapses in term of depth and time. Equities were overvalued in 2000. Low growth prospects are currently priced in but companies have high levels of cash and lower debt levels than in 2008. This should feed through to dividends and share buy-backs. Periods of severe stress are often followed by high returns.

15. ***Harnessing global fixed income alpha***
Daniel James (Aviva Investors) believes that excess return comes from quality of ideas implemented in a structured and efficient way. Investment managers are bad at generating market returns (beta) as they concentrate on excess returns (alpha). It is, however, possible to achieve excess returns without beta by concentrating on 7 to 8 diversified sources of alpha. This is achieved by assessing the correlations of different strategies and allocating levels of risk to each to achieve a target return.

16. ***Bricks and mortar – where and when?***
The penultimate session featured a joint presentation from Schroders and Legal & General. Property returns are driven by rent income, rental value growth (achieved through new leases and lease breaks) and yield impact. Currently there is a wide gap between prime and secondary yields.

17. A number of challenges exist at the moment including:
    - The different impact of austerity measures on different regions
    - Banks reducing property exposure
    - Ageing population
    - Changes in retail environment (more on-line and 'top-up' shopping)

18. To counter these challenges investors can use a number of strategies:
    - Capturing growth from owners under pressure to sell and from active management on secondary properties
    - Looking for fixed (or index-linked) increases in rental
    - Income partnerships through sale and long lease back arrangements
    - Assisted living schemes and care homes

19. ***Driving up funding levels***
As has become tradition, the conference ended with Ronnie Bowie (Senior Partner, Hymans Robertson) who gave an Olympic inspired presentation comparing the LGPS to the Calpers fund in the US and the ABP fund in the Netherlands. The LGPS has more members but lower assets than the others, but also has lower benefits. The LGPS wins on long term returns but short term returns are not as good. Both administration and investment costs are lower in the LGPS and employer costs are similar to ABP but lower than Calpers.

20. The average funding level of the LGPS is 64% against 90% for ABP and 47% for Calpers. The Calpers and LGPS asset allocations are broadly similar whereas ABP has a much higher allocation to bonds. In ABP's view, the current low interest rate environment is 'not sound'. The conclusion was that there needs to be more emphasis on cash flows and a move towards (but not too far towards) ABP's allocation.

21. Overall, the conference confirmed that the Nottinghamshire strategy is sound and well placed to meet the challenges of the future. A number of sessions prompted the allocation to emerging markets to be considered and this has been reviewed since the conference.

Statutory and Policy Implications

22. This report has been compiled after consideration of implications in respect of finance, equal opportunities, human resources, crime and disorder, human rights, the safeguarding of children, sustainability and the environment and those using the service and where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

RECOMMENDATION/S

1) That it be noted that attendance at key conferences is part of the Fund's commitment to ensuring those charged with decision-making and financial management have effective knowledge and skills.
2) That the report be noted

Report author:
Simon Cunnington
Senior Accountant – Pensions & Treasury Management

For any enquiries about this report please contact: Simon Cunnington

Background Papers
None