Nottinghamshire County Council

Report to Pensions Investment Sub-Committee

10 November 2011

Agenda Item: 4

REPORT OF THE SERVICE DIRECTOR (FINANCE)

THE LOCAL GOVERNMENT CHRONICLE INVESTMENT SUMMIT 2011

1. Purpose of the Report

To provide Members of the Pensions Investment Sub-Committee with a brief synopsis of the presentations made at the recent LGC Investment Summit.

2. Information and Advice

2.1 The Local Government Chronicle Investment Summit was held on the 8th – 9th September 2011 at the Celtic Manor Resort in Newport, South Wales. This is an annual event with specific focus on the Local Government Pension Scheme and is in its twenty third year. The Summit was attended by Councillor Mike Cox, Chairman of the Pensions Committee and Mr Neil Robinson, Group Manager (Investments).

2.2 Increasingly, those charged with the governance of pension funds are under pressure not only to improve their skills and good practice but to cope with a rapidly changing environment. The Local Government Pension Scheme faces a future of significant change and the Summit looked at a range of topics including the changing economic environment, asset allocation, responsible investment, risk reduction and the outcomes of the Hutton Review.

2.3 The first speaker was Mr Jim O'Neill, Chairman of Goldman Sachs Asset Management. Mr O'Neill gave his assessment of the fast moving economic and market events. His conclusion, on balance, was that the world economy has suffered a 'savage correction' rather than the beginning of a long term crisis. The partial recovery in 2009 was due in large part due to the friendly economic policies of the USA and the expansion in demand from China.

2.4 This recovery has been complicated, however, because of the structural problems within Europe, market concerns and, in turn, flimsy growth. Mr O'Neill suggested, however, that if the politicians could take a lead then maybe a stronger European Monetary Union could emerge.

2.5 The next speaker was Mr Nick Hamilton, Head of Global Equity Products, Invesco Perpetual. The title of Mr Hamilton's presentation was 'Global Equities with the Reins Off' in which he considered the favour that local authorities continue to show to equities and asked:

- Are the benchmarks we use too prescriptive?
- Does an unconstrained approach mean greater risk?
- What are the consequences of managing to the benchmark?

2.6 Mr Hamilton argued that, although active management can add value, benchmarks do not reflect the markets. The benchmark is the "equity risk free state" and, therefore, the outcome of the strategy is that you own what you like but you also own what you don't like. The unintended consequence of this is that you suffer the opportunity cost of not having 100% capital invested in stocks you want to own. Active management can play a positive role by improving risk exposure (through diversification) and by adding value to an investor's portfolio, but you should beware the "closet indexer"!

2.7 Mr Phil Triggs, Group Manager, Treasury and Pensions at Warwickshire County Council looked back at the events over the past year to try to learn some lessons for the future. He speculated on whether or not the cost of bailing out debt ridden countries is worth it and considered the size of US debt at $15 trillion where spending is simply too high for growth to be sustained.

2.8 Mr Triggs considered the consequences of a substantial number of LGPS members opting out and speculated on the different measures that the Government could introduce in reforming the Scheme, having already acknowledged that the LGPS is "different". Higher contributions with a lower accrual rate, greater collaboration between authorities and an increasing use of networks for reducing costs (he thinks) are all likely.

2.9 Claire Peck, Vice President of J P Morgan Asset Management, considered the strategic case for investing in emerging markets. The return on equity in these markets is driven by the "virtuous circle": urbanisation with improving infrastructure, followed by industrialisation and further improving infrastructure. Emerging markets now account for 13% - 16% of global profits and are too big to ignore, although they only account for 2% - 5% of asset allocations. With the macro outlook remaining favourable in these markets, therefore, Ms Peck argued for increased exposure to these assets and the development of specialists who could take a global view in managing this particular asset class.

2.10 Mr David Donora, Head of Commodities at Threadneedle Investments, examined the case for investing in commodities. He provided empirical data to show that they provide long term returns, provide opportunities for portfolio diversification, and are an effective inflation hedge, in addition to being a store of value against currency debasement. He suggested that investing in commodities now would take advantage of a weakening dollar (which is bullish for commodity prices over the long term). Mr Donora, unsurprisingly, suggested that investing in his company's Enhanced Commodities Fund was the way forward and explained in detail his investment team's approach.

2.11 Mr Trevor Greetham is the Asset Allocation Director for the Investment Solutions Group at Fidelity International and, in the final session of the Summit's first day, looked at the spectre of rising inflation and the real prospects of stagflation. He suggested that stagflation is possible in the developed economies which currently have loose monetary policy and that this is a major challenge to pension funds with inflation-linked liabilities rising, while real asset returns could remain low or even negative. We could expect short cycles driven by bouts of fiscal stimulus and, for pension funds, he concluded that diversification and asset allocation are key.

2.12 The first session of the second day of the Summit was provided by Mr Euan Munro from Standard Life Investments. Mr Munro continued with the theme of the critical investment issues facing pension committees in managing funding gaps and questioned the use of benchmarks. He argued that setting benchmarks dull managers' sense of responsibility and, with investors increasingly relying on fund managers to deliver positive investment returns, it is important that there is a dialogue between investors/managers rather than just relying on a benchmark.

2.13 Sally Bridgeland, Chief Executive Officer at BP Pension Trustees Limited asked "How can we best manage our assets and our liabilities?" Ms Bridgeland considered the current risk frameworks that are used, together with typical annual review cycles, monitoring and governance arrangements. In assessing their appropriateness her view was that we should ask how we would run it if the pension fund were a business. Particularly important are the skills of the trustees, together with the forms of governance that are in place.

2.14 Ronnie Bowie, Senior Partner at Hymans Robertson, in the final session of the conference, considered the evolution of the LGPS and its future. He set the scene: falling active membership, falling active liabilities, contributions covering expenditure until 2025, but with some "hotspots" where some employers are experiencing problems now. Employers need to discover what their particular situation is and then assess the risks in order to find the solutions. He suggested the following:

- Put risk on the Committee agenda
- Identify, then prioritise hotspots
- Assemble the risk management tools
- Consult employers
- Put a plan in place and be ready to act
- Measure and monitor success
- Refresh regularly

2.15 Overall the summit provided an opportunity to learn from many of the excellent presenters. There were over 200 delegates with a good mixture of Councillors and officers and, as a conference which had a specific local government focus, it provided an opportunity to meet with people from other authorities and share thoughts on common issues regarding pension matters.

3. Statutory and Policy Implications

3.1 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.

4. Recommendation

4.1 That the report be noted.

PAUL SIMPSON
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Background Papers available for inspection

Conference documentation.