

Trustee Investment Report

I. Investment Strategy

The Trustee has delegated the power to set investment strategies on a scheme-by-scheme basis after taking advice from The Pensions Trust's (the Trust's) independent investment consultants to the Investment Committee. This scheme specific approach to investment strategy was introduced with effect from 1 October 2004. It replaced the previous arrangement of apportioning the total investment portfolio between the participating schemes using a single strategy.

In January 2010, the Trustee agreed a set of ten Investment Beliefs that the Investment Committee must use as a framework when making decisions and agreeing the investment strategy. The Investment Beliefs are:

1. In general, to achieve a higher investment return requires taking higher risk.
2. Any risks should only be tolerated to the extent that the Trustee Board is satisfied that it can be fully underwritten by the relevant sponsoring employers.
3. Diversification of risky assets, both within and across asset classes, reduces volatility.
4. Asset allocation is more important to returns than manager or stock selection.
5. Equities are usually expected to outperform Government bonds in the long-term.
6. The real world is complex; judgement and qualitative research are at least as important as quantitative analysis.
7. Investor behaviour can result in market inefficiencies and opportunities for long-term investors.
8. Good governance improves the quality of investment decision-taking.
9. Responsible investment can enhance long-term portfolio returns.
10. We believe that members and employers should have the opportunity to opt for investments which reflect their ethical concerns.

The Trustee will review the Investment Beliefs annually.

Assets invested in the Main Investment Portfolio comprise eight principal asset funds – Global Equity, Passive Global Equity, Fixed Interest Bonds, Long Dated Fixed Interest Bonds, Index-Linked Bonds, Property, Fund of Hedge Funds, a Growth Plan specific fund and Money Market – as described in the abridged Trustee Investment Strategy on pages 24 to 26. The Trust also offers Socially Responsible Investment (SRI) and ethical options where appropriate. Members who participate in the Trust's Flexible Retirement Plan are able to construct their own investment portfolio from a range of options. These options include composite funds that invest in the Trust's Main Investment Portfolio, SRI Portfolio and Guest Manager Options. The objective for each of the Trust's managed funds is set out on pages 24 to 26.

In accordance with the requirements of the Pensions Act 1995, a Statement of Investment Principles (SIP) has been prepared by the Trustee, which incorporates the investment strategy.

The abridged Trustee Investment Strategy is on pages 24 to 26.



Derek Mitchell and Kulwinder Bhumbra work for Includem, a Scottish charity set up ten years ago to support Scotland's most vulnerable teenagers and youngsters. Derek is a Project Worker and Kulwinder is an Assistant HR Officer.

2. Investment Management

The day-to-day management of the Trust's investments is delegated to professional external investment managers. During the year to 30 September 2010 these were as follows:

Manager	Type of Investment	2010		2009	
		£m	%	£m	%
Global Equity Fund					
AXA Rosenberg Investment Management	Pan European Equities	1	–	442	11.4
BlackRock	Global Tactical Asset Allocation	126	2.9	129	3.3
BlueBay Asset Management	Distressed Opportunities	51	1.2	–	–
King Street Capital	Distressed Opportunities	49	1.1	–	–
Lazard Asset Management	Global Equities	319	7.3	280	7.2
Legal & General Investment Management	Global Equities	621	14.3	731	18.8
Marathon Asset Management	Japan and Asia Pacific Equities	241	5.5	207	5.3
RCM (UK)	Global Equities	249	5.7	230	5.9
Ruffer	Absolute Return	250	5.8	–	–
TT International	UK Equities	225	5.2	138	3.5
Total Global Equity Fund		2,132	49.0	2,157	55.4
Passive Global Equity Fund					
Legal & General Investment Management	Global Equities	131	3.0	–	–
Total Passive Global Equity Fund		131	3.0	–	–
Growth Plan Fund					
Legal & General Investment Management	Corporate Bonds and Equity Option Contracts – Passive	193	4.4	–	–
Total Growth Plan Fund		193	4.4	–	–
Fixed Interest Fund					
Legal & General Investment Management	UK Bonds – Passive	178	4.1	177	4.5
Royal London Asset Management	UK Bonds – Active	230	5.3	194	5.0
Standard Life Investments	UK Bonds – Active	306	7.0	255	6.5
Total Fixed Interest Fund		714	16.4	626	16.0
Long Dated Fixed Interest Fund					
Legal & General Investment Management	UK Bonds – Passive	1	0.0	1	0.0
Total Long Dated Fixed Interest Fund		1	0.0	1	0.0
Index-Linked Fund					
Legal & General Investment Management	UK Bonds – Passive	57	1.3	50	1.3
Total Index-Linked Fund		57	1.3	50	1.3
Property Fund					
CB Richard Ellis Investors	UK Commercial Property – Active	165	3.8	139	3.6
CB Richard Ellis Investors	European Commercial Property – Active	36	0.8	37	0.9
Standard Life Investments	UK Commercial Property – Active	48	1.1	38	1.0
Total Property Fund		249	5.7	214	5.5
Fund of Hedge Funds					
Mesirow Advanced Strategies	Fund of Hedge Funds – Active	146	3.4	127	3.2
Total Fund of Hedge Funds		146	3.4	127	3.2
Money Market Fund					
Aviva Investors	UK Money Market – Active	277	6.4	291	7.5
Total Money Market Fund		277	6.4	291	7.5
MAIN INVESTMENT PORTFOLIO		3,900	89.6	3,466	88.9

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Manager	Type of Investment	2010		2009	
		£m	%	£m	%
Annuity Policies					
Paternoster	Insurance Policies	256	5.9	265	6.8
Other Insurers	Insurance Policies	19	0.4	14	0.4
Total Annuity Policies		275	6.3	279	7.2
SRI Fund					
Legal & General Investment Management	Global Equities and UK Bonds – Passive	81	1.9	72	1.8
Total SRI Fund		81	1.9	72	1.8
Unitised Ethical Fund					
F&C Asset Management	UK Equities – Active	62	1.4	49	1.3
Total Unitised Ethical Fund		62	1.4	49	1.3
Flexible Retirement Plan – Guest Manager Options					
Standard Life Investments	Global Equities, Bonds Property – Passive and Active	4	0.1	3	0.1
Total Flexible Retirement Plan		4	0.1	3	0.1
Other					
Other Assets and Cash		32	0.7	26	0.7
Total Other		32	0.7	26	0.7
TOTAL		4,354	100	3,895	100

All investment managers are subject to ongoing monitoring by the Trust and each manager makes an annual report on performance to the Investment Committee or the Investment Manager Review Group. All managers are required to confirm on an annual basis that they have complied with the Trust's SIP.

The appointment of investment managers is reviewed as and when appropriate, in line with the development of investment strategy. Due diligence reviews of all investment managers are carried out on a rolling programme.

The Trust allows the use of derivatives by its investment managers for the control of investment risk and to enable the efficient management of portfolios. Limits have been set on the amount and type of derivatives that may be used following advice from our independent investment consultants. In addition, derivative contracts are used as part of the Growth Plan (the Plan) investment strategy to gain exposure to the increase in a basket of equity indices up to a predefined level and also to provide some degree of downside protection.

The Trustee carried out a comprehensive review of the risks facing the Plan and as a result of this review invested in an insurance policy with Paternoster in August 2008. This investment will match the liabilities of pensions in payment from the Plan.

Investment managers are advised of the individual controls and targets for the assets they manage. Actual asset allocation may vary from the target according to the investment performance of each manager.

Investment managers are remunerated by fees based on a percentage of funds under management, except for BlackRock, BlueBay and King Street who also receive performance-related fees. The Trust's investment approach, under which individual scheme assets are aggregated for investment purposes, enables the Trust to negotiate very competitive fees with our investment managers.

All investments held during the year were in accordance with the Trustee's Statement of Investment Principles.

Exposure to overseas equity markets (as at 30 September 2010)

	2010		2009	
	£m	% of Portfolio	£m	% of Portfolio
Europe	461	10.6	444	11.4
North America	535	12.3	557	14.3
Japan	304	7.0	204	5.2
Pacific Basin (excl. Japan)	124	2.8	163	4.2
Emerging Markets	131	3.0	78	2.0
Others	4	0.1	6	0.2
Total	1,559	35.8	1,452	37.3

3. Custody and Self-investment

Custodian services (including fund performance measurement) are provided by The Northern Trust Company. In accordance with normal practice, the investments are held in the name of or to the order of the Trustee. The Trustee reviews the internal control reports produced by the custodian and regularly reconciles the custodian's records of securities and cash to the investment managers' records. The assets are held by custodians as shown in our list of advisers on pages 66 and 67 or by their appointed sub-custodians. Where investments are units in a pooled investment vehicle, the manager of that fund is responsible for custody of the underlying assets. For self-investment, see note 14 to the Financial Statements on page 52. (Annuity policies are valued by the Fund Actuary using scheme valuation assumptions).

4. Property

The property portfolio at the year end comprised directly owned freehold properties including offices, industrial units, retail premises and retail warehouses, and units in pooled investment vehicles, including a European Property Fund and a High Lease to Value Fund.

Rent review periods for directly owned properties are mainly five years. Properties in this portfolio are valued each year by our independent property advisers, Cluttons Chartered Surveyors. Their valuations are used in the Financial Statements in line with best practice.

5. Activities During the Year

The Investment Committee has continued to monitor the performance of both investment funds and investment managers.

- As reported last year, the Committee was looking to appoint managers to run distressed opportunity and absolute return mandates. This process has now been completed, with BlueBay Asset Management and King Street Capital appointed to manage distressed opportunity mandates and Ruffer appointed to manage an absolute return mandate. These mandates were funded throughout February and March 2010.
- The AXA Rosenberg mandate was terminated during the year, and the assets under management transferred to Legal & General.

During the financial crisis the Investment Committee focused heavily on the security of the Trust's assets. Once this work had been completed the focus then fell on the governance structure, the speed of decision making and whether any changes were necessary given recent experiences.

The Board formed an Investment Governance Working Party to review the decision making process under the current structure, the parties involved and ways in which it could be improved. Following a full review that included input from the Board and the officers of the Trust as well as their advisers, a number of changes were implemented. These included:

- Compiling a set of Investment Beliefs that enable the Trust to make investment decisions in line with an agreed set of principles (see pages 22 and 23).
- A review of the responsibilities of the Investment Committee which concluded with the delegation of further responsibilities to the Investment Committee.
- The formation of the Investment Managers Review Group to conduct the ongoing review of managers who have no current issues.
- The formation of the Investment Strategic Opportunities Group in order to evaluate the attractiveness of new investment ideas.
- The appointment of a Chief Investment Officer to develop the investment service offered to individual schemes, including liability risk management and dynamic de-risking.
- Redefining the way the Trust groups its growth assets.

The last change is aimed at changing the way the Trust categorises assets with the focus moving away from grouping of similar asset classes to considering their wider characteristics. With this in mind the Trust will be reorganising the current fund structures to provide a broader group of assets that share commonality such as liquidity, risk and return characteristics and expected source of return.

The Board also formed an Ethical Investment Working Party to review the Trust's ethical and responsible investment policy. The aim of this was to canvass members on their views on the subject in order to gain a better understanding of areas of concerns and the products they would like to see provided to meet these needs.

With the results of this survey in mind, and based on further work carried out by the Ethical Investment Working Party on the products available in the market, a redesigned Unitised Ethical Plan (UEP) has now been agreed. The aim of this is to enable the Trust to capture some of the members' concerns, whilst also providing a product that meets the retirement saving needs of the members investing in the UEP.

6. Fund Performance – Year to 30 September 2010

As described above we have spent considerable time over the past year redefining the way in which the Trust groups its growth assets. This is designed to enable us to provide portfolios that are better able to meet the long-term commitments of our pension schemes. Alongside this, we have been changing the way we report investment performance within each of the individual schemes, moving the focus away from comparisons against benchmark towards an analysis of the contributions made by the investments to the long-term funding of the scheme. The individual nature of each scheme makes it difficult to report this at an overall Trust level in a meaningful way, although the analysis of the performance of the Main Investment Portfolio against RPI (shown in section 8) is perhaps the closest proxy for this. The measurement of the underlying components of the Main Investment Portfolio against their individual benchmarks remains relevant, primarily to enable the Investment Committee to monitor the progress against target for individual mandates.

The annualised investment return and relative performance of the funds that comprise the Main Investment Portfolio in the year ended 30 September 2010 is summarised in the table below:

	£m	The Trust %	Benchmark %	Variance %
Global Equity Fund	2,132	10.6	9.9	0.7
Passive Equity Fund	131	9.7	10.0	(0.3)
Growth Plan Fund	193	3.3	3.3	0.0
Fixed Interest Fund	714	12.1	10.1	2.0
Long Dated Fixed Interest Fund	1	7.2	7.2	0.0
Index-Linked Fund	57	9.5	9.5	0.0
Property Fund	249	14.5	22.6	(8.1)
Fund of Hedge Funds	146	4.9	3.7	1.2
Money Market Fund	277	0.7	0.4	0.3
Main Investment Portfolio	3,900	9.8	9.5	0.3

The benchmark shown above for the Main Investment Portfolio is the weighted average return of the benchmarks of the component funds. The variance between this and the return on the Main Investment Portfolio indicates the aggregate relative performance of all of the investment managers of the component funds. Annuity policies, cash and other assets are excluded from the Main Investment Portfolio for performance measurement purposes.

The annualised investment returns and relative performance of the Trust's other investments in the year ended 30 September 2010 is summarised as follows:

	£m	The Trust %	Benchmark %	Variance %
Socially Responsible Investment Fund	81	9.1	9.1	0.0
Unitised Ethical Fund	62	15.7	12.5	3.2
Flexible Retirement Plan – Guest Manager Options	4	11.0	11.0	0.0

The benchmark shown above for the Flexible Retirement Plan – Guest Manager Options is the weighted average return of the benchmarks of all of these options. The variance between this and the actual return indicates the aggregate relative performance of the Guest Manager.

Details of the performance of the Guest Manager Options are available on the Trust's website www.thepensionstrust.org.uk

7. Fund Performance – Five Years to 30 September 2010

The Trust's annualised investment performance for the five years to 30 September 2010 is summarised in the table below:

	The Trust % p.a.	Benchmark % p.a.	Variance % p.a.
Main Investment Portfolio	3.9	4.1	(0.2)
SRI Fund	2.8	2.8	0.0
Unitised Ethical Fund	2.6	4.5	(1.9)
Flexible Retirement Plan – Guest Manager Options*	3.2	3.2	0.0

* The Flexible Retirement Plan commenced on 1 November 2006. Performance shown is for the period from commencement to 30 September 2010.

8. Fund Performance – Longer-term

The longer-term investment performance of the Main Investment Portfolio is summarised in the table below:

	5 years % p.a.	10 years % p.a.
Main Investment Portfolio	3.9	3.7
Retail Prices Index	3.1	2.7

9. Fund Performance – Commentary

Over the course of 2010 markets have continued their recovery with all major asset classes experiencing positive returns over the year to 30 September 2010. As world economies stabilised, surprisingly strong GDP growth figures have been reported in a number of countries, not least the UK. However, as a backdrop to this a number of concerns still remain, with an EU funded bail out of Greece and Ireland and a fresh round of quantitative easing in the US highlighting the fragility around continued growth. In the UK the austerity measures that were announced in the Comprehensive Spending Review highlight the levels of cuts ahead, with the impact that this could have on consumer confidence weighing heavily on the economy.

Equity markets rallied as investor confidence grew, driven by strong performance over a number of sectors. Oil and gas was the laggard over the year, although this is to be expected following the pressure placed on stocks within this sector following the Gulf of Mexico spill. Bond markets also proved strong following the return of liquidity to the market and an increase in investor appetite for risk which led to a movement out of the relative safety of Government bonds. So far the market has yet to experience the high levels of defaults that had been priced into the market over the previous years, which helped to ease pressure on all but the highest rated bonds. UK property returns were exceptionally strong over the year, albeit this being to some extent a reflection of how far capital values had fallen. European markets proved weaker over the same period although this was more a function of timing, with the European market lagging that of the UK by around a year.

Over the year to 30 September 2010 the Global Equity Fund outperformed its benchmark, with strong performances from the Asia Pacific and Global Tactical Asset Allocation mandates driving this outperformance. Performance of the Trust's global equity mandates over the period was disappointing, despite employing different strategies to pick their constituents. The Trust continues to focus on their longer-term performance, and will take action to remedy any persistent performance issues where necessary.

The Fixed Interest Fund performed well over the year, outperforming its benchmark in all quarters. Throughout the year a rebound in the valuation of certain corporate bonds held by the Trust which had been negatively affected during the liquidity crisis helped drive performance, with both stock and sector selection proving positive.

The Property Fund performance over the year was disappointing, underperforming the UK market as measured by the Investment Property Databank. This underperformance was mainly due to the European Property mandate heavily underperforming its benchmark, which as mentioned above was affected by the timing in which the European Property market entered into decline. The allocation to property is long-term in nature, designed to reduce the concentration of global equities within our growth asset exposure. Performance of this nature from time to time should not be unexpected.

Overall the main investment portfolio exceeded its benchmark by 0.3%.

The Unitised Ethical Plan (UEP) outperformed its benchmark over the year, with a large proportion of this performance coming about in the second quarter. The main contributor to this performance came through its inability to hold BP, whose share price was heavily depressed following the oil spill in the Gulf of Mexico, due to the negative screening criteria applied to the UEP.