

# Trustee Investment Report

## I. Investment Strategy

The Trustee sets investment strategies on a scheme-by-scheme basis after taking advice from the Trust's independent investment consultants. 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.

Assets invested in the Main Investment Portfolio comprise seven principal asset funds – Global Equity, Fixed Interest Bonds, Long Dated Fixed Interest Bonds, Index-Linked Bonds, Property, Fund of Hedge Funds and Money Market – as described in the abridged Trustee Investment Strategy on pages 23 to 25. 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 and SRI Portfolio and Guest Manager Options.

The objective for each of the Trust's managed funds is set out on pages 23 to 25.

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. This is shown on pages 21 to 22. The abridged Trustee Investment Strategy is on pages 23 to 25.



*Behind every team of riders is an invaluable support crew, looking after unglamorous but essential tasks like maintenance and administration.*

## 2. Investment Management

The day-to-day management of the Trust's investments is delegated to professional external investment managers. As at 30 September 2009 these were as follows:

Manager	Type of Investment	2009		2008	
		£m	%	£m	%
<b>Global Equity Fund</b>					
AXA Rosenberg Investment Management	Pan European Equities – Active	442	11.4	339	9.6
Barclays Global Investors	Global Tactical Asset Allocation – Active	129	3.3	0	0.0
Lazard Asset Management	Global Equities – Active	280	7.2	233	6.6
Legal & General Investment Management	Global Equities – Passive	731	18.8	272	7.8
Marathon Asset Management	Japan and Asia Pacific Equities – Active	207	5.3	159	4.5
RCM (UK)	Global Equities – Active	230	5.9	231	6.6
State Street Global Advisors	Global Equities – Passive	–	–	453	12.8
TT International	UK Equities – Active	138	3.5	123	3.5
<b>Total Global Equity Fund</b>		<b>2,157</b>	<b>55.4</b>	<b>1,810</b>	<b>51.4</b>
<b>Fixed Interest Fund</b>					
Legal & General Investment Management	UK Bonds – Passive	177	4.5	187	5.1
Royal London Asset Management	Global Bonds – Active	194	5.0	183	5.2
Standard Life Investments	Global Bonds – Active	255	6.5	246	7.2
<b>Total Fixed Interest Fund</b>		<b>626</b>	<b>16.0</b>	<b>616</b>	<b>17.5</b>
<b>Long Dated Fixed Interest Fund</b>					
Legal & General Investment Management	UK Bonds – Passive	1	0.0	1	0.0
<b>Total Long Dated Fixed Interest Fund</b>		<b>1</b>	<b>0.0</b>	<b>1</b>	<b>0.0</b>
<b>Index-Linked Fund</b>					
Legal & General Investment Management	UK Bonds – Passive	50	1.3	52	1.5
<b>Total Index-Linked Fund</b>		<b>50</b>	<b>1.3</b>	<b>52</b>	<b>1.5</b>
<b>Property Fund</b>					
CB Richard Ellis Investors	UK and European Commercial Property – Active	176	4.5	205	5.8
Standard Life Investments	UK and European Commercial Property – Active	38	1.0	43	1.2
<b>Total Property Fund</b>		<b>214</b>	<b>5.5</b>	<b>248</b>	<b>7.0</b>
<b>Fund of Hedge Funds</b>					
Mesirow Advanced Strategies	Fund of Hedge Funds – Active	127	3.2	120	3.4
<b>Total Fund of Hedge Funds</b>		<b>127</b>	<b>3.2</b>	<b>120</b>	<b>3.4</b>
<b>Money Market Fund</b>					
Aviva Investors	UK Money Market – Active	291	7.5	281	8.0
<b>Total Money Market Fund</b>		<b>291</b>	<b>7.5</b>	<b>281</b>	<b>8.0</b>
<b>MAIN INVESTMENT PORTFOLIO</b>		<b>3,466</b>	<b>88.9</b>	<b>3,128</b>	<b>88.8</b>

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Manager	Type of Investment	2009		2008	
		£m	%	£m	%
<b>Annuity Policies</b>					
Paternoster	Insurance policies	265	6.8	257	7.3
Other Insurers	Insurance policies	14	0.4	11	0.3
<b>Total Annuity Policies</b>		<b>279</b>	<b>7.2</b>	<b>268</b>	<b>7.6</b>
<b>SRI Fund</b>					
Legal & General Investment Management	Global Equities and UK Bonds – Passive	72	1.8	61	1.7
<b>Total SRI Fund</b>		<b>72</b>	<b>1.8</b>	<b>61</b>	<b>1.7</b>
<b>Unitised Ethical Fund</b>					
F&C Asset Management	UK Equities – Active	49	1.3	41	1.2
<b>Total Unitised Ethical Fund</b>		<b>49</b>	<b>1.3</b>	<b>41</b>	<b>1.2</b>
<b>Flexible Retirement Plan – Guest Manager Options</b>					
Standard Life Investments	Global Equities, Bonds, Property – Active	3	0.1	2	0.1
<b>Total Flexible Retirement Plan</b>		<b>3</b>	<b>0.1</b>	<b>2</b>	<b>0.1</b>
<b>Other</b>					
	Other Assets and Cash	26	0.7	23	0.6
<b>Total Other</b>		<b>26</b>	<b>0.7</b>	<b>23</b>	<b>0.6</b>
<b>TOTAL</b>		<b>3,895</b>	<b>100.0</b>	<b>3,523</b>	<b>100.0</b>

All investment managers are subject to ongoing monitoring by the Trust and each manager makes an Annual Report on performance to the Investment Committee. 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.

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 AXA Rosenberg, Mesirow Advanced Strategies and Barclays Global Investors 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.

The Trustee carried out a comprehensive review of the risks facing the Growth 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 of the Growth Plan.

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)

	2009		2008	
	% of £m	% of Portfolio	% of £m	% of Portfolio
Europe	444	11.4	361	10.2
North America	557	14.3	407	11.6
Japan	204	5.2	182	5.2
Pacific Basin (excl. Japan)	163	4.2	100	2.8
Others	84	2.2	60	1.7
<b>Total</b>	<b>1,452</b>	<b>37.3</b>	<b>1,110</b>	<b>31.5</b>

### 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 page 64 and 65 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 50. (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 advisors, 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 had appointed Barclays Global Investors to run a Global Tactical Asset Allocation mandate within the Global Equity Fund. This mandate was funded in January 2009.
- The State Street Global Advisors' mandate was terminated during the year, and the assets under management transferred to Legal & General.

In response to the turmoil in financial systems during 2008, The Pensions Trust commissioned a report from its advisers entitled 'Implication of market events on asset security' and instructed the Trust's officers to report to its satisfaction that the following risks were being properly managed:

- Concentration of assets: that appropriate diversification existed within and across individual portfolios.
- Derivative counterparty exposure across all portfolios.
- The continued investment in hedge funds especially with regard to liquidity risks and the level of redemptions.
- The continued investment in the global tactical asset allocation fund.
- Securities lending: the programme having been suspended in 2007.
- The custody of assets especially with regards to the operational risks, co-mingling of funds and the management of cash for both pooled and segregated mandates.

This exercise was completed in February 2009. As a result of this review the Trust commissioned the services of Thomas Murray to provide an ongoing risk monitoring service.

The Trust is satisfied that these risks are being appropriately managed but it continues to assess and develop its risk management capabilities.

## 6. Fund Performance – Year to 30 September 2009

As described above the Trust's scheme specific approach to investment strategy requires the allocation of the Trust's investment portfolio into the separate funds, as described in the investment strategy statement. The annualised investment return and relative performance of the funds that comprise the Main Investment Portfolio in the year to 30 September 2009 is summarised in the table below:

	£m	The Trust %	Benchmark %	Variance %
Global Equity Fund	2,157	7.3	7.9	(0.6)
Fixed Interest Fund	626	11.0	12.7	(1.7)
Long Dated Fixed Interest Fund	1	11.9	11.9	0.0
Index-Linked Fund	50	3.9	3.9	0.0
Property Fund	214	(13.4)	(19.2)	5.8
Fund of Hedge Funds	127	5.1	5.2	(0.1)
Money Market Fund	291	2.4	1.4	1.0
Main Investment Portfolio	3,466	6.2	6.5	(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.

The annualised investment returns and relative performance of the Trust's other investments in the year to 30 September 2009 is summarised as follows:

	£m	The Trust %	Benchmark %	Variance %
SRI Fund	72	6.3	6.3	0.0
Unitised Ethical Fund	49	3.7	10.8	(7.1)
Flexible Retirement Plan – Guest Manager Options	3	2.7	2.7	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 Pensions Trust's website at [www.thepensionstrust.org.uk](http://www.thepensionstrust.org.uk)

## 7. Fund Performance – Five Years to 30 September 2009

The Trust's annualised investment performance for the five years to 30 September 2009 is summarised in the table below:

	The Trust % p.a	Benchmark % p.a	Variance % p.a
Main Investment Portfolio	6.0	6.6	(0.6)
SRI Fund	3.9	3.9	0.0
Unitised Ethical Fund	3.5	6.7	(3.2)
Flexible Retirement Plan – Guest Manager Options*	0.5	0.5	0.0

\*The Flexible Retirement Plan commenced on 1 November 2006. Performance shown is for the period from commencement to 30 September 2009.

## 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	6.0	4.0
Retail Prices Index	2.7	2.6
Average Earnings Index	3.2	3.7

## 9. Fund Performance – Commentary

2009 proved to be extremely challenging with world markets continuing to fall in the first half of the year as the financial crisis deepened. Governments and monetary authorities around the world took extreme measures to avert a collapse of the financial system and an economic depression. These actions prompted a strong recovery in the second half of the year in both bond and equity markets as sentiment turned. The Main Investment Portfolio produced a positive return of 6.2%. For a second year performance fell short of benchmark, by 0.3%, so that five year underperformance against benchmark widened to 0.6% p.a.

The two largest components of the Main Investment Portfolio, the Global Equity Fund and the Fixed Interest Fund, both underperformed against their respective benchmarks. The underperformance of the Global Equity Fund occurred in the second half when markets were recovering. Markets were led up by financials and sectors sensitive to economic activity whereas the longer-term, thematic or value based strategies used by most of our managers lagged. As we stated in the previous Annual Report, we do not believe that the performance of individual managers can be fairly judged over the short-term. However the Investment Committee continues to monitor our active managers closely and has placed two equity managers on watch for special attention due to their underperformance.

The Fixed Interest Fund underperformed as the managers faced extremely volatile conditions in the first half of the year when the debt of many financial institutions was priced for the high likelihood of failure. The managers outperformed in the second half of the year, as confidence returned.

Property markets suffered over the year as reflected by the performance of the Property Fund which fell in value in absolute terms; although it did manage to outperform the market as represented by the Investment Property Database Monthly Index.

Due to the rigorous ethical screening process used for the Unitised Ethical Fund the manager is obliged to remain underweight in certain sectors compared to its benchmark. This means that the Fund has certain style and size biases which from time to time results in performance significantly different from its benchmark.

Events of the past two years suggests that when extreme events occur diversification across asset classes has very limited success in mitigating the impact of sudden declines in markets. This was evidenced by the fact that in the market conditions we have recently experienced, just about all asset classes declined in value simultaneously.

Our recent experience has demonstrated the need for greater short-term flexibility in our investment policy, at least in some circumstances, and active consideration is being given to ways of achieving this whilst retaining sufficient safeguards.

The Investment Committee has agreed to invest a portion of the Main Investment Portfolio in 'Alternative Asset Classes' with a view to exploiting the market's undervaluation of certain assets, having the ability to take short-term tactical positions, and the preserving of capital. The Committee also believes that under less extreme conditions alternative investments offer diversification benefits. A first step was taken with the appointment of Barclays Global Investors to manage a global tactical asset allocation mandate and Mesirow for a fund of hedge funds mandate. Additional managers will be appointed in the coming year in the asset classes of distressed opportunities, and absolute returns.

## 10. Fund Performance – Individual Schemes

The investment performance of the underlying schemes will vary depending on each scheme's asset allocation strategy. Details of the investment performance attributable to each scheme are reported in the supplementary accounts for each scheme.

This Report was approved by the Investment Committee on 17 November 2009.