WIRRAL COUNCIL

PENSIONS COMMITTEE

16 NOVEMBER 2010

REPORT OF THE DIRECTOR OF FINANCE

ASSET ALLOCATION

1. EXECUTIVE SUMMARY

1.1 This paper outlines proposed changes to the strategic asset allocation following a detailed analysis undertaken by the investment consultant Mercer, and discussions held with the internal investment management team and the independent adviser.

2. BACKGROUND

2.1 The decision as to how and where the MPF should invest assets, the "strategic asset allocation", is of critical importance in determining the likelihood of the Pension Fund achieving its objectives of optimising investment returns and meeting its longer term liabilities within acceptable levels of risk.

2.2 The strategic asset allocation is the long-term allocation between the main asset classes and involves the following decisions:

- The balance between equities and bonds
- The allocation between UK and overseas equity investment, and the balance within the overseas equity portfolio between the major regional markets
- The allocation within the bond portfolio between fixed interest and index linked gilts
- The use of alternative investments, such as private equity, hedge funds and property.

2.3 Although the balance between equities and bonds has historically been the most important consideration, the development of more global equity markets and a number of technical factors affecting bond markets has raised the profile of investments in alternative assets to achieve greater diversification and potentially greater risk adjusted returns.

3. CURRENT ASSET ALLOCATION

3.1 The current strategic asset allocation is tabulated below.

Current Strategic Asset Allocation MPF		
Asset Class	**Weighting**	**Benchmark index**
UK Equities	**30.00%**	FTSE ALL SHARE INDEX
Overseas Equities	**29.00%**	
US	8.00%	FTSE AW NORTH AMERICA
European	10.00%	FTSE WORLD EUROPE EX UK
Japan	4.00%	FTSE AW JAPAN
Pacific	3.00%	FTSE AW DEV ASIA PAC EX JAPAN
Emerging Markets	4.00%	MSCI EMERGING MARKETS FREE
Fixed Interest	**20.00%**	
UK Gilts	4.00%	FTSE A ALL STOCKS
Overseas Gilts	0.00%	JPM GLOBAL GOVT EX UK
UK Index Linked	12.00%	FTSE UK GILTS INDEXED ALL STKS
Corporate Bonds	4.00%	ML £ NON GILTS
Property	**10.00%**	IPD ALL PROPERTIES INDEX
Alternatives	**10.00%**	
Private Equity	4.00%	GBP 7 DAY LIBID
Hedge Funds	6.00%	GBP 7 DAY LIBID
Cash	**1.00%**	GBP 3 MONTH LIBID
TOTAL	**100.00%**	**SPECIFIC BENCH MARK**

3.2 Based on the recent analysis undertaken by Mercer, MPF is currently targeting a 79% exposure to “growth” assets such as equities, property and “alternative” assets, and 21% to “matching” assets such as risk-free UK Government bonds or gilts which provide the best “match” for liabilities in terms of payments to members in future years.

3.3 In the latest review of the current investment strategy, Mercer has calculated a "best estimate return expectation" of 3.1% p.a. in excess of the return on the theoretical portfolio of gilts that would best match the projected future cashflow liabilities.

3.4 Mercer has reported that "all other things being equal, the current strategy is found to support the investment assumptions used within the funding strategy being developed as part of the 2010 valuation process".

3.5 Although the analysis suggests that no significant changes to the strategic asset allocation are required, following discussions a number of changes are being recommended.

4. REVISED ASSET ALLOCATION

4.1 The recommended revised asset allocation is tabulated below.

Proposed Strategic Asset Allocation MPF		
Asset Class	**Weighting**	**Benchmark index**
UK Equities	**25.00%**	FTSE ALL SHARE INDEX
Overseas Equities	**30.00%**	
US	8.00%	FTSE AW NORTH AMERICA
European	8.00%	FTSE WORLD EUROPE EX UK
Japan	4.00%	FTSE AW JAPAN
Pacific	4.00%	FTSE AW DEV ASIA PAC EX JAPAN
Emerging Markets	6.00%	MSCI EMERGING MARKETS FREE
Fixed Interest	**20.00%**	
UK Gilts	4.00%	FTSE A ALL STOCKS
Overseas Gilts	0.00%	JPM GLOBAL GOVT EX UK
UK Index Linked	12.00%	FTSE UK GILTS INDEXED ALL STKS
Corporate Bonds	4.00%	ML £ NON GILTS
Property	**10.00%**	IPD ALL PROPERTIES INDEX
Alternatives	**14.00%**	
Private Equity	4.00%	GBP 7 DAY LIBID
Hedge Funds	5.00%	GBP 7 DAY LIBID
Thematics	3.00%	GBP 7 DAY LIBID
Infrastructure	2.00%	GBP 7 DAY LIBID
Cash	**1.00%**	GBP 3 MONTH LIBID
TOTAL	**100.00%**	**SPECIFIC BENCH MARK**

5. RECOMMENDED CHANGES

5.1. Equities

- UK equities are reduced from 30% to 25%. The reclassification of the Thematics portfolio to a cash benchmark will account for 3% of the reduction. 1% will be reallocated to overseas equities and infrastructure respectively.

- Overseas equities will increase from 29% to 30%.

- European equities will be reduced from 10% to 8% of the portfolio in line with the allocation to North American equities as there are no compelling reasons for this differential to persist.

- The allocation to Pacific equities will increase by 1% to 4% and Emerging Markets will rise to 6% from 4% to take account of greater opportunities for growth going forward and the increased share of emerging markets in world equity indices.

5.2. Fixed Interest

- No changes are recommended to the fixed income element of the portfolio with the overall allocation remaining at 20%.

5.3. Property

- No change is recommended to the property allocation which remains at 10%.

5.4. Alternatives

- It is recommended that the allocation to alternatives is increased to 14%. The reclassification of the Thematics portfolio to a cash benchmark accounts for 3% of this increase and it is recommended that infrastructure is represented within alternatives as a separate asset class with an allocation of 2%. MPF currently holds infrastructure related investments within its existing Property, Alternatives, and Thematics portfolios.

6. CONCLUSION

6.1 The strategic asset allocation is set within the context of the 2010 triennial valuation results and is designed to maximise the likelihood of achieving the longer term investment objectives within a controlled risk environment.

7. **FINANCIAL IMPLICATIONS**

7.1 Mercer has calculated that the strategy could provide an absolute return of 7.6% p.a. which is 3.1% p.a. in excess of the expected return on the “least risk portfolio” and ahead of the current funding assumption which assigns a target return of 1.4% p.a. above the return on gilts. According to the Mercer “best estimate”, the current strategy is expected to achieve a 92% funding level in 10 years time with a 5% risk that the funding level is 41% or lower.

8. **STAFFING IMPLICATIONS**

8.1. There are none arising directly from this report.

9. **EQUAL OPPORTUNITY IMPLICATIONS**

9.1. There are none arising directly from this report.

10. **COMMUNITY SAFETY IMPLICATIONS**

10.1. There are no specific implications arising from this report.

11. **LOCAL MEMBER SUPPORT IMPLICATIONS**

11.1. There are no specific implications for any Member or Ward.

12. **LOCAL AGENDA 21 IMPLICATIONS**

12.1. There are no specific implications arising from this report.

13. **PLANNING IMPLICATIONS**

13.1. There are no specific implications arising from this report.

14. **BACKGROUND PAPERS**

14.1. Merseyside Pension Fund Risk Return Analysis and Strategy Healthcheck – Mercer – September 2010

14.2. Asset Allocation - November 2007

15. **RECOMMENDATION**

15.1 That Members approve the new strategic asset allocation strategy

IAN COLEMAN
DIRECTOR OF FINANCE

FNCE/209/10