



London Borough of Hammersmith & Fulham Pension Fund

Investment Governance Report – Quarter 1 2012

May 2012



CAMRADATA
Pension Reporting

Summary

The assets of the Scheme are considered in terms of four equally weighted sections: UK Equities, Overseas Equities, Dynamic Asset Allocation Mandates and the Matching Fund.

The UK Equities are managed by Majedie and the Overseas Equities by MFS. There are two Dynamic Asset Allocation managers, Barings and Ruffer, managing three quarters and one quarter of this section respectively. The Matching Fund is split equally between a global bond mandate managed by Goldman Sachs and a Liability Driven Investment (LDI) fund managed by Legal & General. With the exception of the LDI fund, all others are actively managed by fund managers who aim to meet or exceed their stated benchmark.

Liability Benchmark (LB)

To match the predicted growth in the liabilities, the Total Fund return needs to meet a return equivalent to the Liability Benchmark plus 2.2% p.a. (net of fees). The Total Fund strategy aims to exceed this and targets a return 2.5% p.a. (net of fees) in excess of the Liability Benchmark. Within this, the Matching Fund is targeting a return of 1% p.a. in excess of the Liability Benchmark.

The liabilities move in accordance with changes in relevant gilt yields. For this reason, the benchmark used to measure the estimated movement in liabilities, the "Liability Benchmark" is calculated based on the movement of a selection of Index-Linked gilts, in the following proportions:

45% Index-linked Treasury Gilt 1¼% 2017, 20% Index-linked Treasury Gilt 1¼% 2027, 10% Index-linked Treasury Gilt 1½% 2037, 5% Index-linked Treasury Gilt 0¾% 2047, 20% Index-linked Treasury Gilt 1¼% 2055.

This Liability Benchmark was last reviewed in December 2011.

Manager Benchmarks

Each Investment Manager has a benchmark which they are monitored against on an ongoing basis. These are:

Majedie	<i>FTSE All Share + 2% p.a. over three year rolling periods</i>
MFS	<i>MFS Custom Benchmark</i>
Barings	<i>3 month Sterling LIBOR + 4% p.a.</i>
Ruffer	<i>3 month Sterling LIBOR + 4% p.a.</i>
Goldman Sachs	<i>3 month Sterling LIBOR + 2% p.a.</i>
Legal & General	<i>L&G Benchmark</i>

Private Equity

Additionally, the Panel has agreed to invest up to £15 million in four private equity fund of funds. Two managed by Invesco, which has approximately 75% invested in the United States and 25% in Europe, and the other two by Unigestion which is invested almost entirely in Europe.

Breakdown of Scheme Performance by Manager as at 31st March 2012

Fund	Manager	Market Value (£000)	% of Total Fund	Target % of Total Fund	3 month return (%)	1 year return (%)	2 year return (%) p.a.	3 year return (%) p.a.
Total Fund		641,524	100.0	100.0	5.0	8.2	7.4	15.4
	<i>New Liability Benchmark + 2.2% p.a.</i>				<i>(0.4)</i>	<i>21.7</i>	<i>15.0</i>	<i>14.7</i>
	<i>Difference</i>				<i>5.4</i>	<i>(13.5)</i>	<i>(7.6)</i>	<i>0.7</i>
UK Equities		165,495	25.8	25.0				
	Majedie				6.2	6.5	7.6	20.1
	<i>FTSE All Share + 2% p.a.</i>				6.6	3.4	7.1	21.2
	<i>Difference</i>				<i>(0.4)</i>	<i>3.1</i>	<i>0.5</i>	<i>(1.1)</i>
Overseas Equities		167,829	26.2	25.0				
	MFS				11.9	7.2	6.9	18.8
	<i>MFS Custom Benchmark</i>				10.7	2.6	5.1	18.2
	<i>Difference</i>				<i>1.2</i>	<i>4.6</i>	<i>1.8</i>	<i>0.6</i>
Dynamic Asset Allocation Mandates		153,629	23.9	25.0	3.3	4.8	5.9	12.8
	Barings	114,060	17.8	18.8	3.4	4.7	5.7	12.6
	<i>3 month Sterling LIBOR + 4% p.a.</i>				1.3	5.0	4.9	4.9
	<i>Difference</i>				<i>2.1</i>	<i>(0.3)</i>	<i>0.8</i>	<i>7.7</i>
	Ruffer	39,569	6.2	6.2	3.0	4.8	6.5	13.3
	<i>3 month Sterling LIBOR + 4% p.a.</i>				1.3	5.0	4.9	4.9
	<i>Difference</i>				<i>1.7</i>	<i>(0.2)</i>	<i>1.6</i>	<i>8.4</i>
Matching Fund		141,441	22.0	25.0	(1.0)	15.3	8.9	9.5
	<i>Liability Benchmark + 1% p.a.</i>				<i>(0.7)</i>	<i>20.3</i>	<i>13.9</i>	<i>13.7</i>
	<i>Difference</i>				<i>(0.3)</i>	<i>(5.0)</i>	<i>(5.0)</i>	<i>(4.2)</i>
	Goldman Sachs	59,637	9.3	12.5	2.6	0.7	1.3	4.2
	<i>3 month Sterling LIBOR + 2% p.a.</i>				0.8	3.0	2.9	2.8
	<i>Difference</i>				<i>1.8</i>	<i>(2.3)</i>	<i>(1.6)</i>	<i>1.4</i>
	Legal & General	81,804	12.8	12.5	(3.5)	28.9	15.6	14.2
	<i>L&G Benchmark</i>				(2.2)	56.6	30.8	27.3
	<i>Difference</i>				<i>(1.3)</i>	<i>(27.7)</i>	<i>(15.2)</i>	<i>(13.1)</i>
Private Equity		13,131	2.0	0.0	(3.3)	11.7	15.3	-
	Invesco	7,600	1.2	0.0	(2.4)	19.3	18.0	-
	Unicapital	5,530	0.9	0.0	(4.5)	3.0	11.9	-

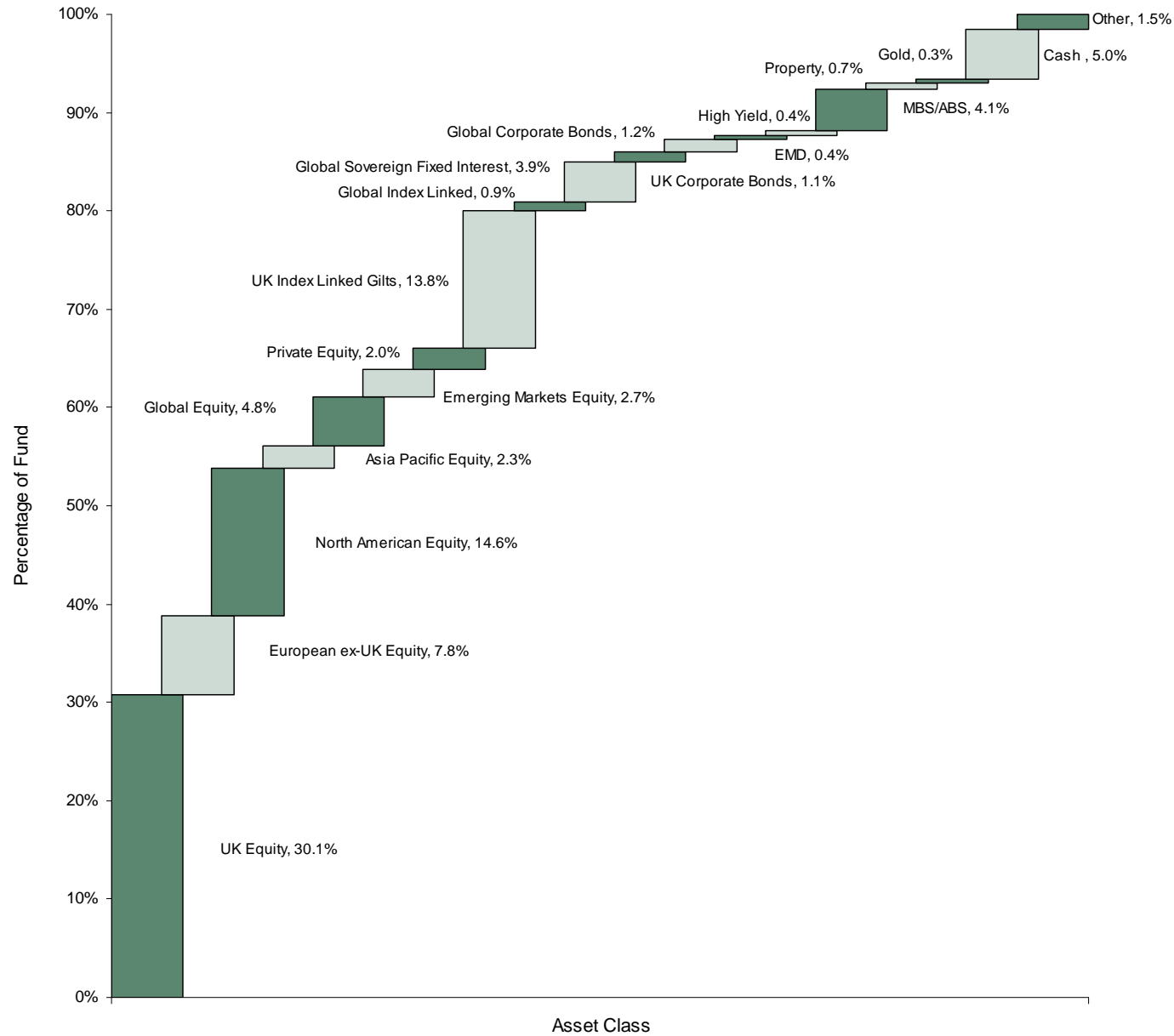
Notes:

1) All numbers are sourced from the Custodian, Northern Trust, and have not been independently verified. Figures may be affected by rounding.

Asset Reconciliation and Valuation										
Fund	Manager	Closing Market Value as at 31st December 2011 £000	% of Total Fund	Net Investment £000	Appreciation £000	Income Received £000	Fees £000	Closing Market Value as at 31st March 2012 £000	% of Total Fund	Target % of Total Fund
Total Fund		611,722	100.0	(672)	28,045	2,461	-	641,524	100.0	100.0
UK Equities	Majedie	155,777	25.5	-	7,962	1,755	-	165,495	25.8	25.0
Overseas Equities	MFS	149,978	24.5	-	17,388	463	-	167,829	26.2	25.0
Dynamic Asset Allocation Mandates		148,760	24.3	-	4,626	243	-	153,629	23.9	25.0
	Barings	110,359	18.0	-	3,673	28	-	114,060	17.8	18.75
	Ruffer	38,401	6.3	-	952	215	-	39,569	6.2	6.25
Matching Fund		142,959	23.4	-	(1,485)	-	-	141,441	22.0	25.0
	Goldman Sachs	58,183	9.5	(27)	1,481	0	-	59,637	9.3	12.5
	Legal & General	84,777	13.9	(6)	(2,967)	-	-	81,804	12.8	12.5
Private Equity		14,247	2.3	(672)	(445)	-	-	13,131	2.0	0.0
	Invesco	8,184	1.3	(398)	(186)	-	-	7,600	1.2	0.0
	Unicapital	6,063	1.0	(273)	(259)	-	-	5,530	0.9	0.0

Notes: All numbers are sourced from the Custodian, Northern Trust, and have not been independently verified. Figures may be affected by rounding.

Asset Class Breakdown as at 31 March 2012



Notes: Breakdown has been estimated by CAMRADATA based on the available manager data.

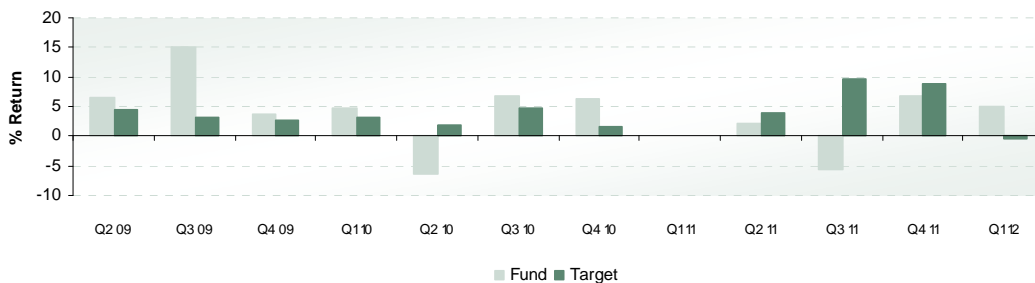
Historical Plan Performance



	Three Months	One Year	Two Years	Three Years	Inception To Date
Fund	4.99	8.20	7.44	15.39	4.02
Target	-0.42	21.71	14.99	14.66	3.01

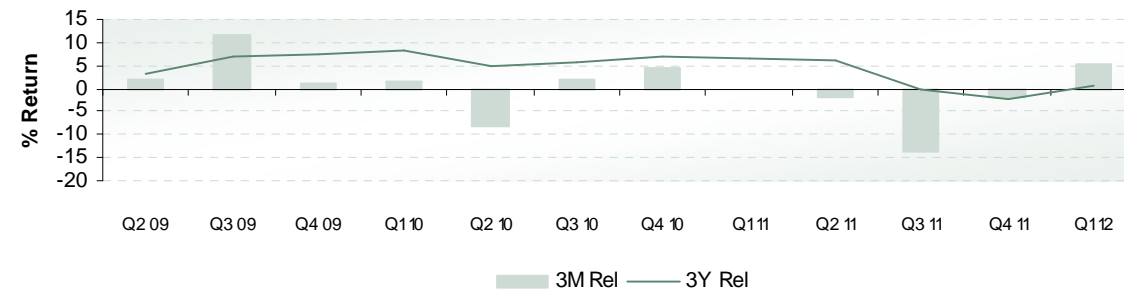
The Fund outperformed its liability benchmark by 5.41% over the quarter, returning 4.99% compared to the target of -0.42%. Whilst market volatility remains return seeking assets fared well over the quarter while gilt yields have risen from their low at the end of 2011 resulting in the outperformance. The Fund's performance of 8.20% over the year was behind its target by 13.51%, as it suffered from the underperformance of on-risk assets over the third quarter of 2011. The Fund has outperformed over the last 3 years and since inception.

Three Years Rolling Quarterly Returns



	Q2 09	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
Fund	6.46	15.21	3.59	4.75	-6.34	6.87	6.20	0.14	2.27	-5.62	6.79	4.99
Target	4.47	3.09	2.57	3.21	2.00	4.68	1.57	0.17	4.07	9.54	8.98	-0.42

Three Years Rolling Relative Returns

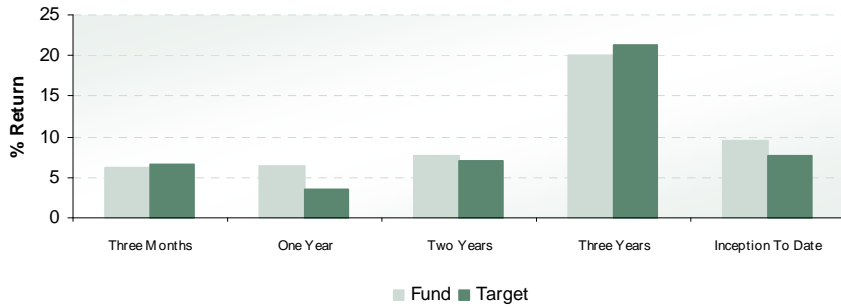


	Q2 09	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
3M Rel	1.90	11.76	1.00	1.49	-8.18	2.09	4.56	-0.03	-1.73	-13.84	-2.01	5.43
3Y Rel	3.37	7.14	7.52	8.10	4.86	5.57	6.83	6.55	5.98	-0.22	-2.22	0.64

Notes: All numbers are sourced from the Custodian, Northern Trust, and have not been independently verified. All performance figures over 1 year have been annualised.

Majedie are a small boutique specialist active UK Equity manager with a flexible investment approach. Their approach to investment is mainly as stock pickers. They were appointed in July 2005 following an OJEU tender process. They started managing investments for the fund in August 2005.

Historical Plan Performance



	Three Months	One Year	Two Years	Three Years	Inception To Date
Fund	6.24	6.48	7.55	20.08	9.53
Target	6.62	3.41	7.08	21.20	7.55

Quarterly Manager update

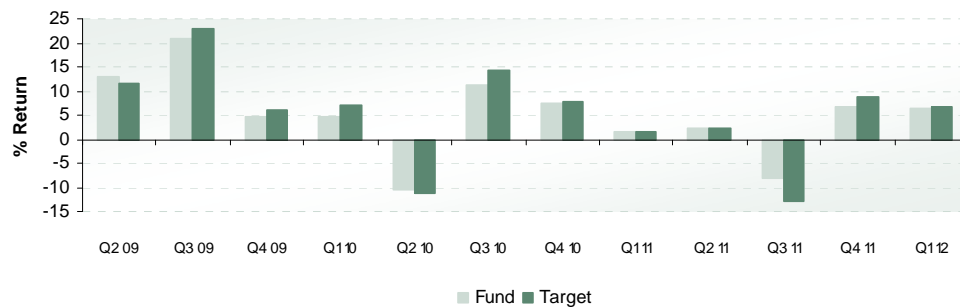
Organisation No significant changes over the quarter.

Product No significant changes over the quarter.

Performance The fund performance was 6.24% over the quarter, 0.38% behind its target. Over 12 months, the portfolio was 3.07% ahead of its target. The portfolio's short position in Apple, who continue to experience strong revenue growth, and long position in First Group, who have seen a deterioration in trading despite new management, harmed performance. However, the portfolios positions in Barclays and Marks & Spencer aided the overall performance.

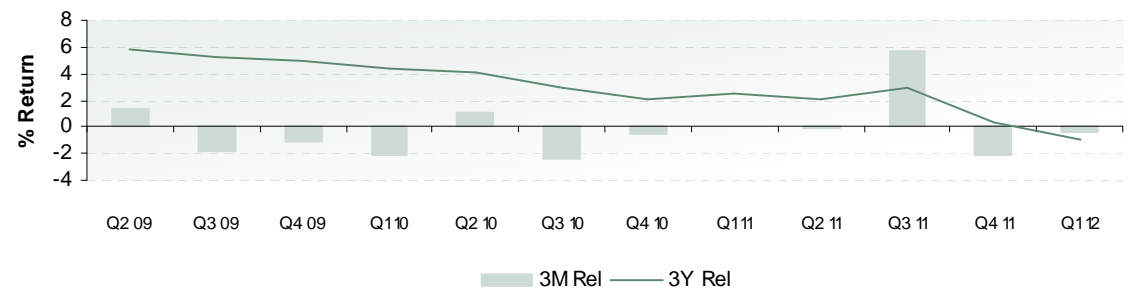
Process No significant changes over the quarter.

Three Years Rolling Quarterly Returns



	Q2 09	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
Fund	12.97	20.72	4.80	4.73	-10.47	11.36	7.29	1.56	2.34	-8.15	6.63	6.24
Target	11.43	22.94	5.99	6.93	-11.35	14.17	7.90	1.53	2.41	-13.05	8.92	6.62

Three Years Rolling Relative Returns



	Q2 09	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
3M Rel	1.38	-1.81	-1.12	-2.06	0.99	-2.46	-0.57	0.03	-0.07	5.64	-2.10	-0.36
3Y Rel	5.82	5.27	4.96	4.35	4.11	2.93	2.11	2.48	2.13	3.00	0.32	-0.92

Notes: All numbers are sourced from the Custodian, Northern Trust, and have not been independently verified. All performance figures over 1 year have been annualised.

MFS are owned by Sun Life Financial based in Boston. Their investment philosophy is to select the best investment opportunities across regions and sectors. They were appointed in July 2005 following an OJEU tender process. They started managing investments for the fund in August 2005.

Historical Plan Performance



	Three Months	One Year	Two Years	Three Years	Inception To Date
Fund	11.90	7.21	6.93	18.78	9.94
Target	10.71	2.55	5.11	18.23	8.43

Quarterly Manager update

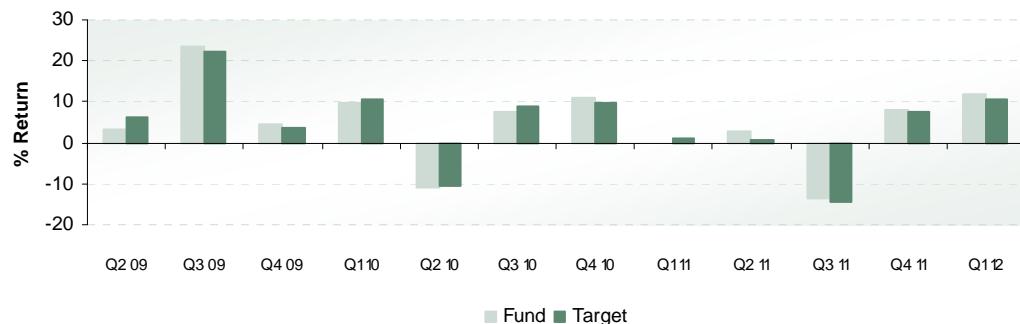
Organisation No significant changes over the quarter.

Product No significant changes over the quarter.

Performance The performance over the quarter was 11.90%, 1.20% ahead of the target. Over 12 months, the fund was 4.66% ahead of its target. Stock selection in retailing, financial services and industrial goods & services aided performance. As did an underweight position in Japanese Yen and individual stock holdings in Autodesk, LPS Brasil-Consultoria de Imoveis, Thermo Fisher Scientific, EMC and not holding McDonalds. However, stock selection in technology and the funds cash holding was detrimental to performance. Individual holdings of Rio Tinto, Procter & Gamble, Julius Baer, Schindler Holdings, Sonova Holdings and not holding Toyota also detracted from performance over the quarter.

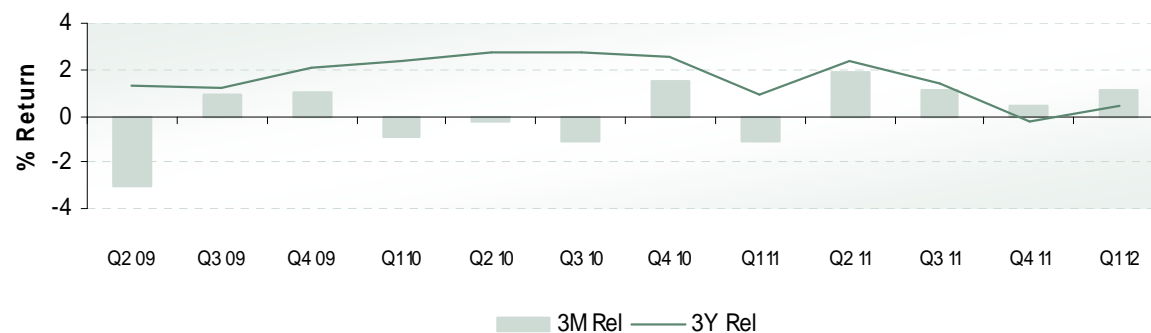
Process No significant changes over the quarter.

Three Years Rolling Quarterly Returns



	Q2 09	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
Fund	3.23	23.43	4.74	9.83	-10.85	7.54	11.19	0.04	2.73	-13.61	7.96	11.90
Target	6.44	22.30	3.73	10.80	-10.65	8.77	9.57	1.16	0.86	-14.56	7.49	10.71

Three Years Rolling Relative Returns



	Q2 09	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
3M Rel	-3.02	0.92	0.98	-0.87	-0.22	-1.13	1.48	-1.11	1.85	1.11	0.44	1.07
3Y Rel	1.32	1.21	2.11	2.39	2.71	2.76	2.59	0.90	2.38	1.44	-0.25	0.47

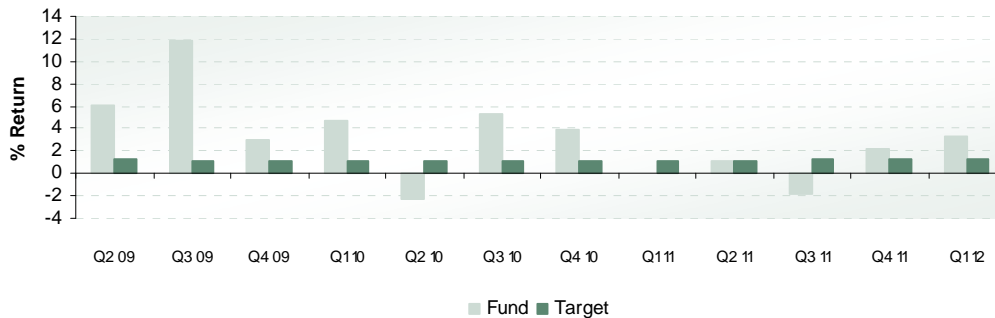
Historical Plan Performance



	Three Months	One Year	Two Years	Three Years	Inception To Date
Fund	3.27	4.76	5.90	12.79	10.58
Target	1.25	4.98	4.88	4.88	4.98

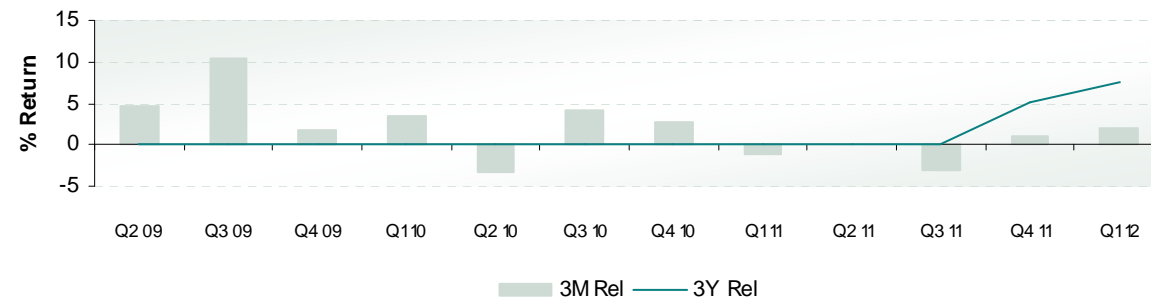
The performance of the group over the quarter was 3.27%, the LIBOR-based target returned 1.25%. Both Barings and Ruffer enjoyed similar gains as a result of a general rally in global equity markets over the quarter. Over the past 12 months, performance has been 0.22% below target, as both managers have underperformed the target.

Three Years Rolling Quarterly Returns



	Q2 09	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
Fund	6.10	11.82	2.99	4.73	-2.22	5.32	3.94	0.01	1.8	-1.86	2.16	3.27
Target	1.33	1.19	1.14	1.14	1.16	1.17	1.17	1.18	1.19	1.21	1.24	1.25

Three Years Rolling Relative Returns



	Q2 09	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
3M Rel	4.71	10.51	1.83	3.54	-3.34	4.10	2.74	-1.16	-0.01	-3.03	0.91	2.00
3Y Rel	-	-	-	-	-	-	-	-	-	-	5.10	7.54

Barings are a large UK based investment manager investing in global asset classes. They were appointed for the Dynamic Asset Allocation mandate in June 2008 following an OJEU tender process. They started managing investments for the fund in August 2008.

Historical Plan Performance



	Three Months	One Year	Two Years	Three Years	Inception To Date
Fund	3.35	4.74	5.69	12.62	9.10
Target	1.25	4.98	4.88	4.88	5.42

Quarterly Manager update

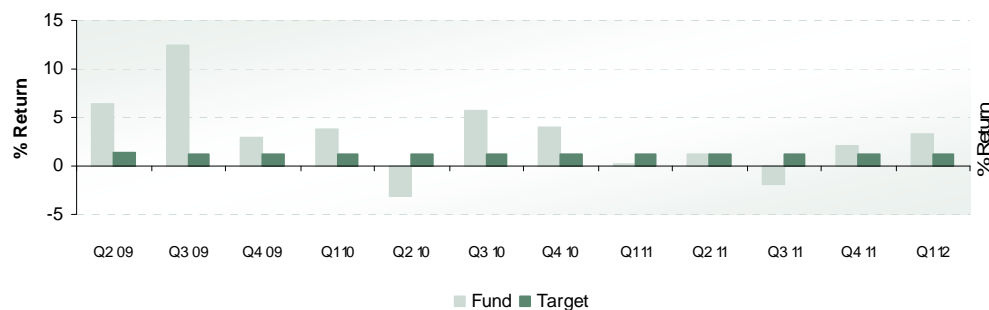
Organisation No significant changes over the quarter.

Product No significant changes over the quarter.

Performance The fund performance was 3.35% over the quarter, 2.10% ahead of its target. Over 12 months, the fund is 0.24% below target. The fund manager correctly identified that risk assets such as equity were going to continue their strong rally, despite a drop off in March. However, he was less successful in identifying the best markets undermining the overall performance compared to what might have been achieved.

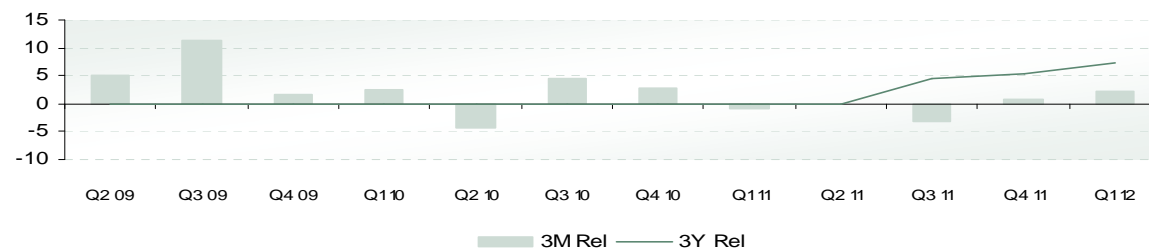
Process No significant changes over the quarter.

Three Years Rolling Quarterly Returns



	Q2 09	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
Fund	6.42	12.50	2.94	3.77	-3.12	5.73	3.88	0.22	1.19	-1.89	2.07	3.35
Target	1.33	1.19	1.14	1.14	1.16	1.17	1.17	1.18	1.19	1.21	1.24	1.25

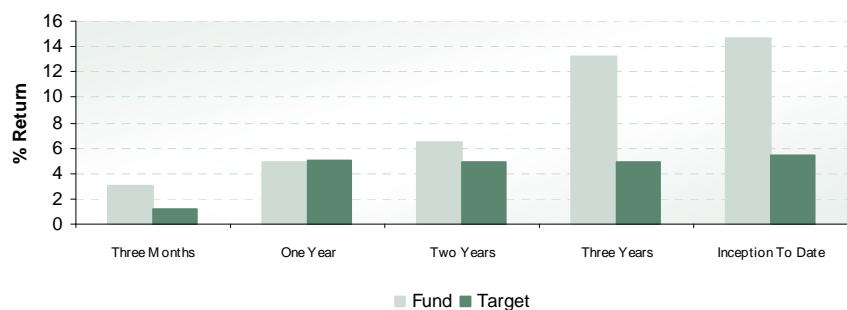
Three Years Rolling Relative Returns



	Q2 09	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
3M Rel	5.02	11.18	1.78	2.59	-4.23	4.51	2.68	-0.95	0.00	-3.06	0.82	2.07
3Y Rel	-	-	-	-	-	-	-	-	-	4.51	5.26	7.38

Ruffer are a small boutique investment manager investing in global asset classes. They were appointed for the Dynamic Asset Allocation mandate in June 2008 following an OJEU tender process. They started managing investments for the fund in August 2008.

Historical Plan Performance



	Three Months	One Year	Two Years	Three Years	Inception To Date
Fund	3.04	4.83	6.50	13.28	14.67
Target	1.25	4.98	4.88	4.88	5.42

Quarterly Manager update

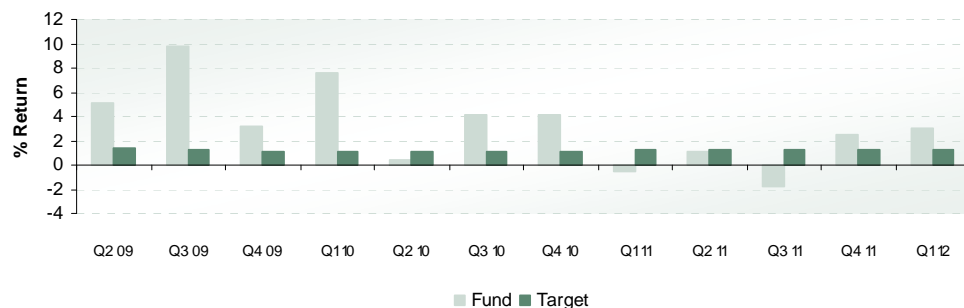
Organisation No significant changes over the quarter.

Product No significant changes over the quarter.

Performance The fund performance was 3.04% over the quarter, 1.79% ahead of its target. Over 12 months, the fund was 0.15% below the target. The portfolio made gains from an increased exposure to equities, particularly in Japan. However, the portfolio's US Dollar position and its exposure to index-linked Gilts and Tesco tempered its performance over the quarter.

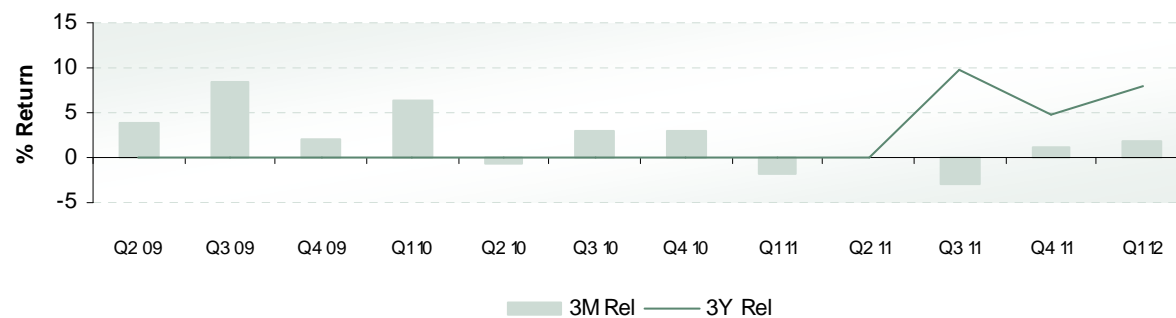
Process No significant changes over the quarter.

Three Years Rolling Quarterly Returns



	Q2 09	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
Fund	5.17	9.81	3.12	7.64	0.41	4.13	4.11	-0.61	1.13	-1.80	2.44	3.04
Target	1.33	1.19	1.14	1.14	1.16	1.17	1.17	1.18	1.19	1.21	1.24	1.25

Three Years Rolling Relative Returns



	Q2 09	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
3M Rel	3.79	8.52	1.96	6.42	-0.74	2.93	2.91	-1.77	-0.06	-2.97	1.19	1.77
3Y Rel	-	-	-	-	-	-	-	-	-	9.79	4.86	8.01

Historical Plan Performance

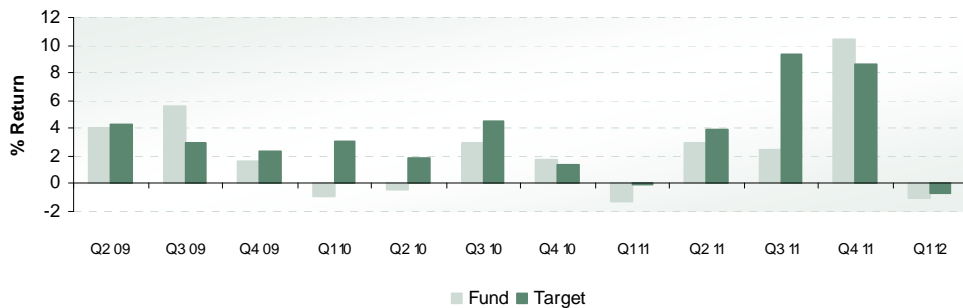


	Three Months	One Year	Two Years	Three Years	Inception To Date
Fund	-1.04	15.25	8.90	9.52	6.55
Target	-0.71	20.31	13.90	13.66	11.25

LGIM have implemented a new Matching Fund solution for the Fund, the solution has created a bespoke mandate within the confines of a pooled fund. This now allows the Fund access to use a broad toolkit of matching assets as appropriate for prevailing market conditions. It aims to enhance the ability to manage risk whilst also allowing for a slightly higher return from the matching assets.

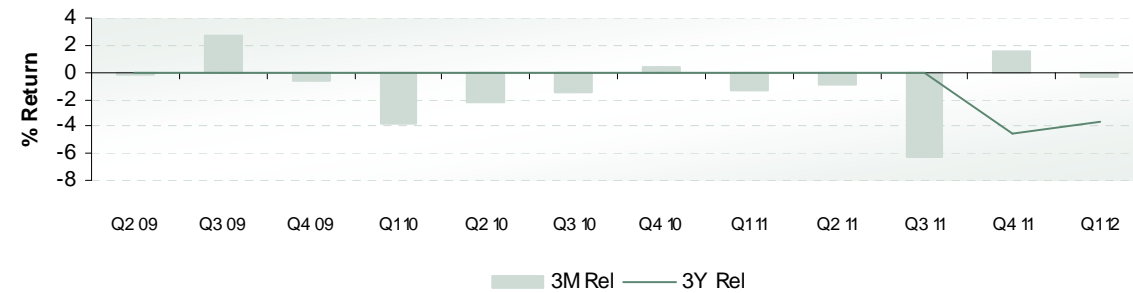
The performance of the Matching Fund over the quarter of -1.04% was 0.33% below its gilts-based liability benchmark. The Matching Fund return of 15.25% over the year was 5.06% below target.

Three Years Rolling Quarterly Returns



	Q2 09	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
Fund	4.04	5.66	1.67	-0.88	-0.48	2.98	1.75	-1.32	2.90	2.50	10.42	-1.04
Target	4.28	2.90	2.38	3.02	1.81	4.49	1.38	-0.01	3.88	9.35	8.67	-0.71

Three Years Rolling Relative Returns



	Q2 09	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
3M Rel	-0.23	2.68	-0.69	-3.79	-2.25	-1.45	0.36	-1.31	-0.94	-6.26	1.61	-0.33
3Y Rel	-	-	-	-	-	-	-	-	-	-	-4.47	-3.64

Goldman Sachs are a very large American investment bank who were first appointed in 1999 following a tender process. They have managed both equities and bonds on an active basis and since February 2009 manage an active bond fund.

Historical Plan Performance



	Three Months	One Year	Two Years	Three Years	Inception To Date
Fund	2.55	0.68	1.34	4.23	2.92
Target	0.76	2.97	2.86	2.77	2.07

Quarterly Manager update

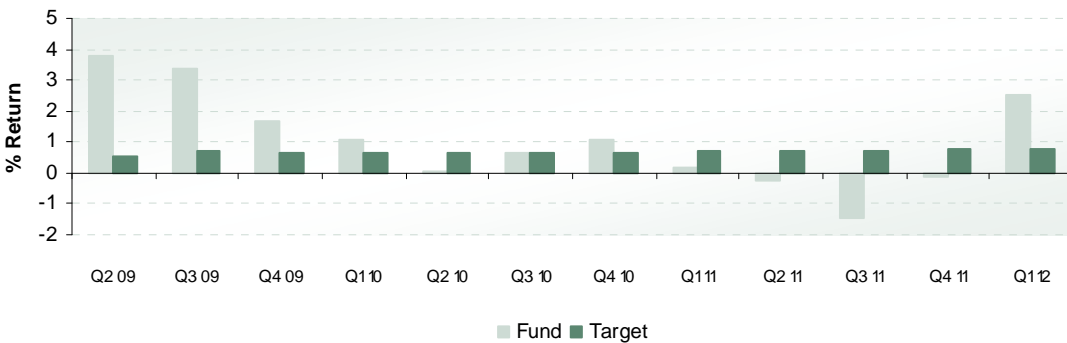
Organisation No significant changes over the quarter.

Product No significant changes over the quarter.

Performance The fund performance was 2.55% over the quarter, 1.79% ahead of its target. Over 12 months, performance was 2.29% below the target. The outperformance was led predominantly by the funds cross-sector strategy with positive contributions also coming from duration and currency strategies. The country strategy marginally detracted over the period.

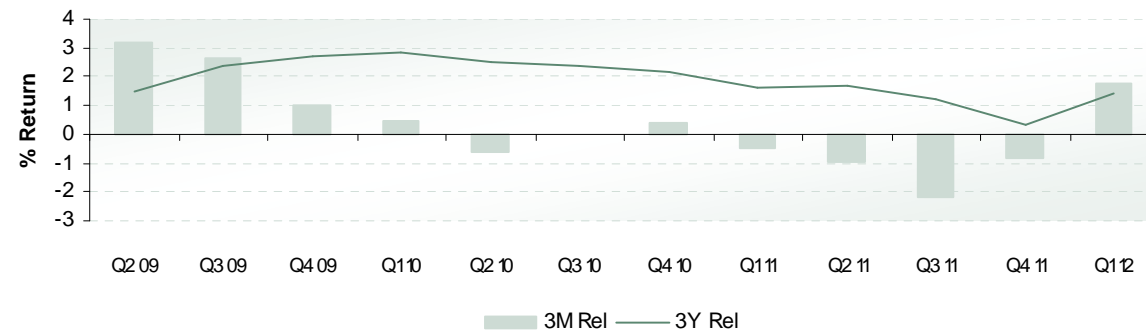
Process No significant changes over the quarter.

Three Years Rolling Quarterly Returns



	Q2 09	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
Fund	3.78	3.36	1.66	1.10	0.03	0.68	1.10	0.18	-0.27	-1.45	-0.11	2.55
Target	0.56	0.70	0.65	0.65	0.67	0.68	0.68	0.69	0.70	0.72	0.75	0.76

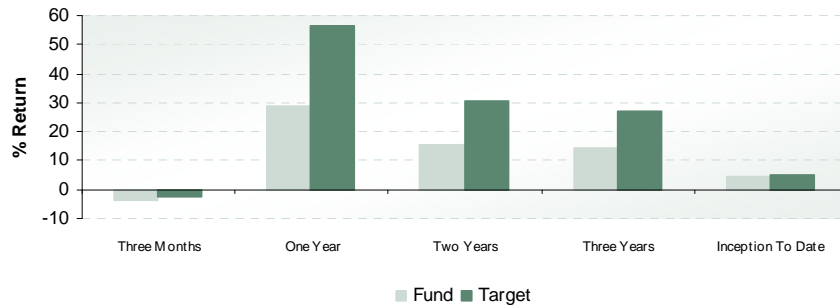
Three Years Rolling Relative Returns



	Q2 09	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
3M Rel	3.20	2.64	1.01	0.44	-0.64	0.00	0.42	-0.51	-0.96	-2.15	-0.85	1.78
3Y Rel	1.48	2.37	2.68	2.86	2.51	2.37	2.19	1.60	1.68	1.20	0.34	1.42

Legal & General are a very large manager of indexed funds. They were first appointed to manage investments for the fund in 1993. They have managed both equities and bonds on an indexed basis. Their current investment mandate started in the first quarter of 2012, although performance has been blended with the previous holding in the LGIM 2055 Index-Linked Gilt Fund.

Historical Plan Performance



	Three Months	One Year	Two Years	Three Years	Inception To Date
Fund	-3.50	28.85	15.62	14.15	4.27
Target	-2.22	56.56	30.76	27.28	4.88

Quarterly Manager update

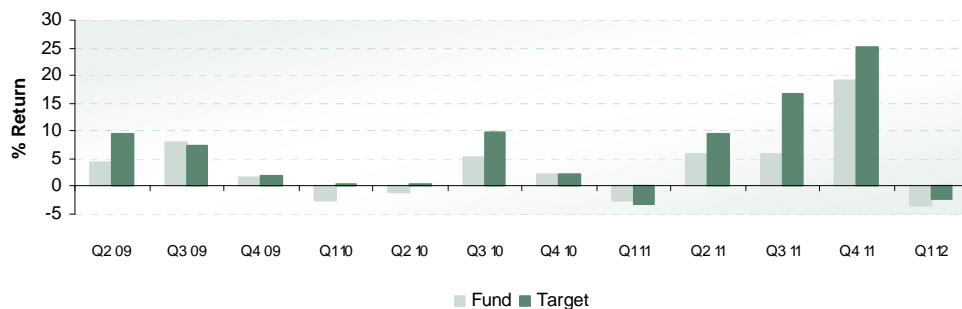
Organisation No significant changes over the quarter.

Product LGIM have implemented a new Matching Fund solution for the Fund.

Performance The fund performance was -3.50% over the quarter, 1.28% behind its new bespoke target. Over 12 months, performance was 27.71% behind the new target. The underperformance can, in the main, be attributed to the Fund previously holding the 2055 Index-Linked Gilt Fund which was only an approximate match for the objective of the fund. Transition to the new mandate will also have had an impact on performance.

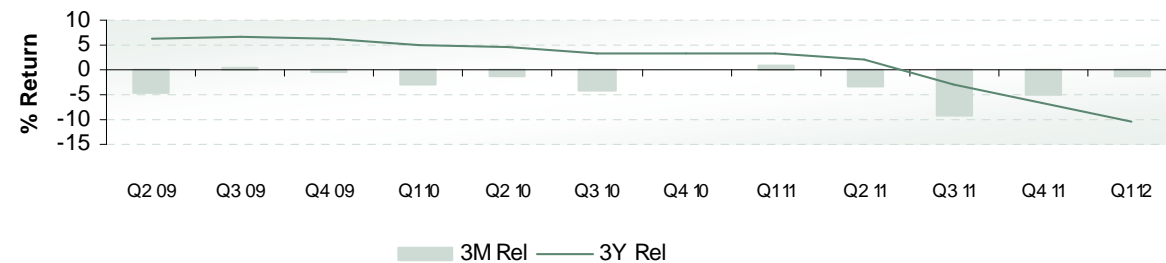
Process The Fund now holds a bespoke mandate with LGIM within the confines of a pooled fund.

Three Years Rolling Quarterly Returns



	Q2 09	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
Fund	4.29	7.85	1.68	-2.69	-0.96	5.18	2.34	-2.69	5.85	5.96	19.04	-3.50
Target	9.52	7.48	2.08	0.36	0.39	9.89	2.38	-3.30	9.60	16.73	25.16	-2.22

Three Years Rolling Relative Returns



	Q2 09	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12
3M Rel	-4.77	0.34	-0.40	-3.03	-1.34	-4.29	-0.04	0.63	-3.42	-9.23	-4.89	-1.31
3Y Rel	6.34	6.46	6.29	5.20	4.71	3.23	3.22	3.37	1.89	-2.92	-6.51	-10.32

The first quarter of 2012 was dominated by the continuation of the European crisis. In a bid to restore order in Greece, the European Central Bank (ECB) announced it would exchange Greek Sovereign bonds for those in the new Eurozone bailout fund, European Financial Stability Facility (EFSF), thus reducing some of the burden on Greece. This move will eliminate up to €11bn from the Greek debt burden. Publicly held Greek bonds are to be exchanged for a combination of newly issued Greek bonds and cash. This will potentially cut a further €100bn of Greek debt. The Federal Reserve continued with “Operation Twist” in an attempt to keep longer interest rates low, and the ECB completed its second round of Long Term Refinancing Operations (LTRO) in February arguably heading off a full-blown credit crunch.

In the UK, the Bank of England (BoE) announced a further £50bn of Quantitative Easing, bringing the total purchases of gilts to £325bn. Over the quarter, interest rates have risen for all but the 1-5 year durations and this lead to UK Government debt and AAA corporate bonds experiencing negative returns (see figure 1). Looking at the annual returns, all UK debt sectors posted positive returns, the UK Gilts All Stocks Index returned 14.5%. The FTSE 100 had a strong quarter, returning 4.6% and is now in positive territory over the year, returning 1.2%.

In March, George Osborne delivered a fiscally neutral budget which should increase the probability of safeguarding the UK’s ‘AAA’ sovereign debt rating. However, he also managed to deliver a budget which should be taken positively by both sides of the coalition government and aid investment and growth.

Given poor growth prospects and recent news that the UK is back in recession, UK monetary policy has been constrained at the lower bound interest rate of 0.5%, therefore to stimulate growth the BoE may be forced to continue to focus on asset purchases or further quantitative easing going forward. There are rumours in markets that the Bank will move to buy index-linked gilts in addition to more conventional gilts. The corresponding fall in gilt yields could hit pension liabilities and cause large shortfalls in the income needed for pension funds.

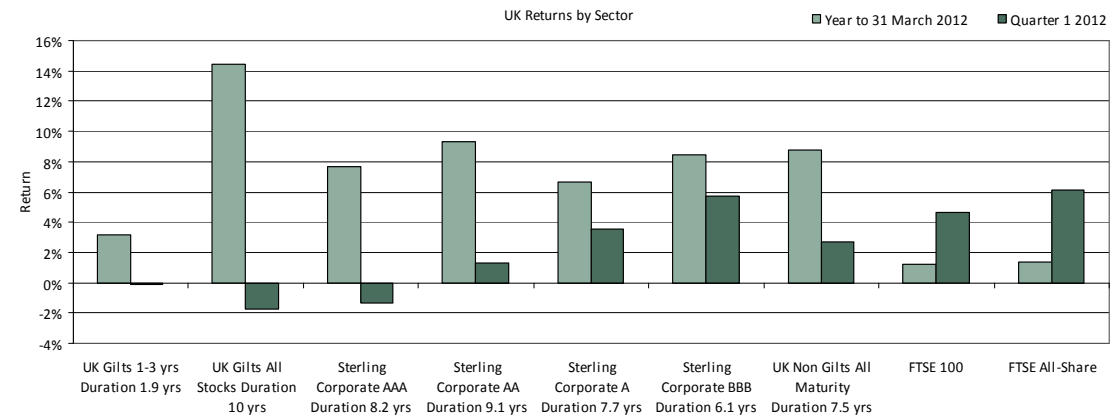


Figure 1 – UK returns by sector

In the US, the effect on financial markets of the central bank-fuelled liquidity and the slight pickup in employment over the first quarter has been obvious. The S&P 500 was up 12.6% in Q1 2012, which according to Bloomberg is the best start to a year since 1928. Commodities such as gold and crude oil were also up 6.7% and 3.6% respectively.

There was less of an impact on the US by the Eurozone crisis during quarter 1. By the end of the quarter, credit spreads reduced to levels seen 12 months prior, however they still remain at elevated levels compared to before the credit crunch.

Looking at individual US sector performance, government and agency debt sectors posted negative returns for the quarter although all debt sectors are still in positive territory for the 12 months to 31 March 2012.

In Europe the debt crisis continued throughout the quarter, although the measures to stem issues in Greece alleviated some concerns. Corporate credit spreads in the Eurozone contracted to 2.8% above government bonds from highs of around 3.3% in January. This was attributed largely to the purchase of European sovereign debt by banks using a 3 year credit line offered by the ECB. This provided evidence that the intervention is having a positive impact on the state of the economy.

The credit line amounted to €489bn. In February the Greek parliament accepted the fiscal austerity package offered by government creditors, the conditions of the package included budget, pension and minimum wage cuts. Investor demand for peripheral bonds appeared to return over the quarter as a result of the ECBs intervention; Spanish and Italian 10 year yields fell substantially since the end of November when they were around the 7% mark (see figure 2).

The Bank of Japan recently expanded its asset purchase program resulting in a weakening of the Japanese Yen. Equity markets in Japan appeared to have rebounded in the first quarter of 2012 with the TOPIX rising 18.6% (in yen terms) due to higher industrial production and benefits of the weaker Yen which is expected to lead to growth for this export led economy. The FTSE World Japan Equity Index posted a return of 7.9% and 0.9% over the quarter and year respectively.

ECB Action - Impact on Spanish and Italian Government Bonds

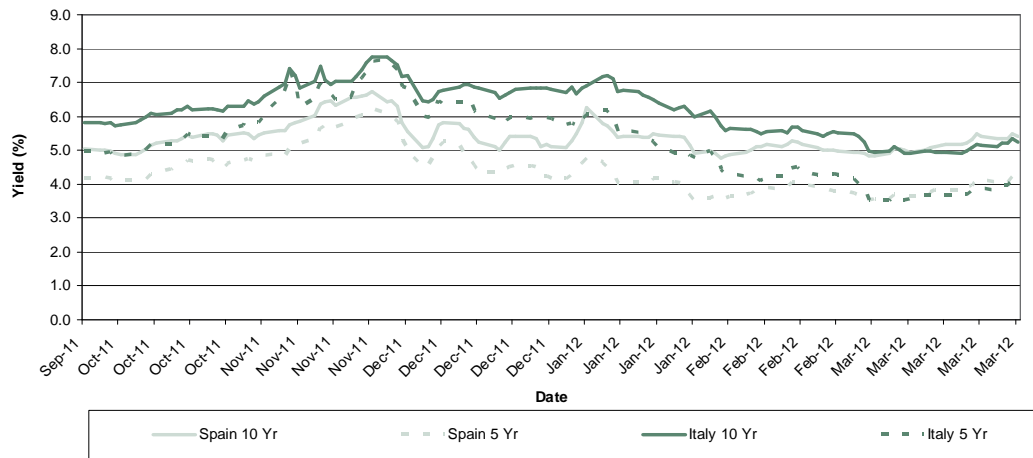


Figure 2 – ECB action driving down Italian and Spanish Government Bond Yields

Overall debt markets in Europe had a positive quarter. The strongest debt sector over the year was Sub Sovereign Debt, returning 8.6% over the year.

Eurozone equity markets also started the year on a strong note; the CAC40 had a positive quarter, but over the year the return was -10.3%. The FTSE World Europe (ex UK) Index posted a return of 9.8% over the quarter. However, over the year the return is negative at -11.4%.

In the rest of Asia, the improved economic data from the US and expectations of monetary easing in China led to Asian equities posting their best quarterly performance since 2010. This was despite the fact that Beijing cut its annual GDP growth forecast to 7.5% which came as little surprise. Sentiment was boosted further in late March on evidence that manufacturing activity in China had been greater than expected.

An aspect of the current economic outlook is that the emerging market economies of China, Brazil and India are slowing as a result of past inflation fighting policy. However, the positive impact of the LTRO programme from the ECB and China's decision to lower banks' reserve ratio requirement led to a rally in Emerging Market equities. The FTSE All World Emerging Market Index posted a return of 10.6% over the quarter with the smaller markets such as Egypt, Turkey and Hungary being the main outperformers.

Sources: Datastream.

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Datasource: Data has been sourced from the Custodian, Northern Trust, and the Managers.

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