

London Borough of Hammersmith & Fulham Pension Fund

Investment Governance Report – Quarter 1 2013

This report is addressed to the Audit & Pensions Committee of the London Borough of Hammersmith & Fulham Pension Fund only.

– Not for onward distribution

Summary

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

The UK Equity Mandate is managed by Majedie and the Overseas Equity Mandate by MFS. There are two Dynamic Asset Allocation managers, Barings and Ruffer. 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 1¼% 2037, 5% Index-linked Treasury Gilt 0¼% 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>Bespoke liability related benchmark (2 x LB - 3 month Sterling LIBOR)</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 Unicapital which is invested almost entirely in Europe.

Performance Overview

Breakdown of Fund Performance by Manager as at 31st March 2013								
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		725,891	100.0	100.0	10.4	15.1	11.6	10.0
	<i>New Liability Benchmark + 2.2% p.a.</i>				8.0	11.6	16.5	13.9
	<i>Difference</i>				2.4	3.5	(4.9)	(3.9)
UK Equity Mandate		173,369	23.9	22.5				
	Majedie				9.6	20.7	13.4	11.8
	<i>FTSE All Share + 2% p.a.</i>				10.9	19.1	11.0	10.9
	<i>Difference</i>				(1.3)	1.6	2.4	0.9
Overseas Equity Mandate		171,759	23.7	22.5				
	MFS				13.9	16.4	11.7	10.0
	<i>MFS Custom Benchmark</i>				14.4	16.2	9.2	8.7
	<i>Difference</i>				(0.5)	0.2	2.5	1.3
Dynamic Asset Allocation Mandates		203,111	28.0	30.0	7.1	9.3	7.0	7.0
	Barings	123,116	17.0	18.8	5.6	7.9	6.3	6.4
	<i>3 month Sterling LIBOR + 4% p.a.</i>				1.1	4.7	4.9	4.8
	<i>Difference</i>				4.5	3.2	1.4	1.6
	Ruffer	79,994	11.0	11.2	9.6	11.3	8.0	8.1
	<i>3 month Sterling LIBOR + 4% p.a.</i>				1.1	4.7	4.9	4.8
	<i>Difference</i>				8.5	6.6	3.1	3.3
Matching Fund		164,316	22.6	25.0	12.0	16.2	15.7	11.3
	<i>Liability Benchmark + 1% p.a.</i>				7.6	10.3	15.2	12.7
	<i>Difference</i>				4.4	5.9	0.5	(1.4)
	Goldman Sachs	62,919	8.7	12.5	1.4	5.5	3.1	2.7
	<i>3 month Sterling LIBOR + 2% p.a.</i>				0.6	2.7	2.8	2.8
	<i>Difference</i>				0.8	2.8	0.3	(0.1)
	Legal & General	101,397	14.0	12.5	19.8	24.0	26.4	18.3
	<i>Bespoke liability related benchmark (2 x LB - 3 month Sterling LIBOR)</i>				14.9	17.7	35.7	26.2
	<i>Difference</i>				4.9	6.3	(9.3)	(7.9)
Private Equity		13,336	1.8	0.0	7.6	12.8	12.2	14.5
	Invesco	7,265	1.0	0.0	7.1	12.7	15.9	16.2
	Unicapital	6,071	0.8	0.0	8.3	12.5	7.7	12.1

Notes:

- 1) Over the 3 months to 31 March 2013, 3 month LIBOR returned 0.1%, over a 12 month period the return was 0.7%.
- 2) All numbers are sourced from the Custodian, Northern Trust, and have not been independently verified.
- 3) Returns are shown gross of fees throughout.
- 4) Figures may be affected by rounding.

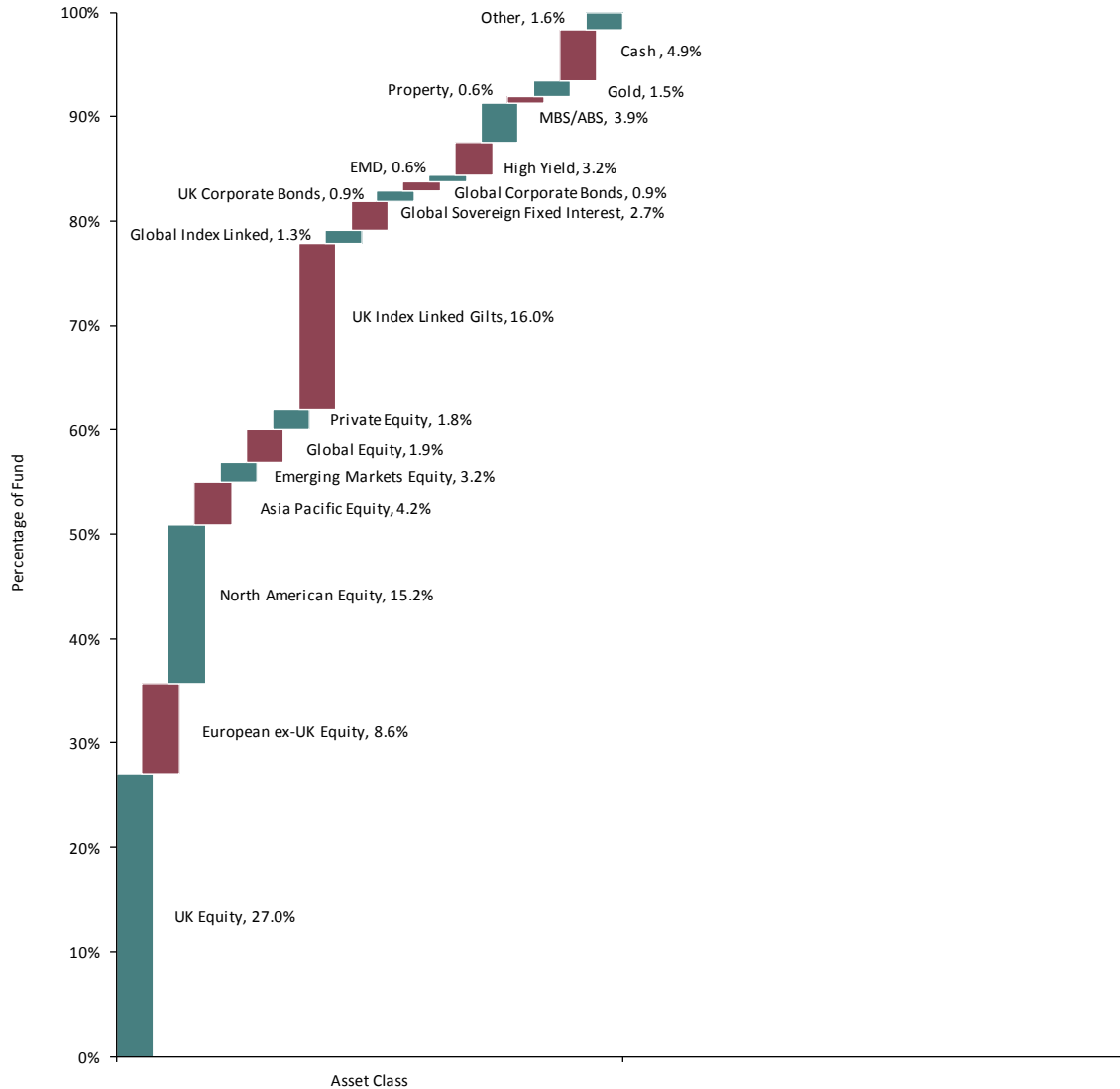
Asset Reconciliation and Valuation

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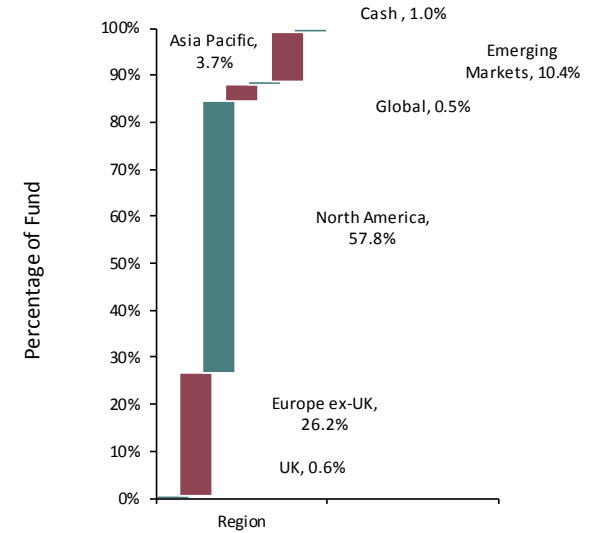
Asset Reconciliation and Valuation										
Fund	Manager	Closing Market Value as at 31st December 2012 £000	% of Total Fund	Net Investment £000	Appreciation £000	Income Received £000	Fees £000	Closing Market Value as at 31st March 2013 £000	% of Total Fund	Target % of Total Fund
Total Fund		657,705	100.0	(1)	65,952	2,133	1	725,890	100.0	100.0
UK Equity Mandate	Majedie	158,221	24.1	-	13,807	1,317	-	173,369	23.9	22.5
Overseas Equity Mandate	MFS	150,823	22.9	(1)	20,449	464	1	171,759	23.7	22.5
Dynamic Asset Allocation Mandates		189,594	28.8	-	13,136	352	-	203,110	28.0	30.0
	Barings	116,586	17.7	-	6,483	29	-	123,116	17.0	18.8
	Ruffer	73,008	11.1	-	6,652	323	-	79,994	11.0	11.2
Matching Fund		146,673	22.3	0	17,621	-	0	164,316	22.6	25.0
	Goldman Sachs	62,025	9.4	(0)	885	-	0	62,919	8.7	12.5
	Legal & General	84,648	12.9	0	16,736	-	-	101,397	14.0	12.5
Private Equity		12,393	1.9	-	940	0	-	13,336	1.8	0.0
	Invesco	6,787	1.0	-	477	0	-	7,265	1.0	0.0
	Unicapital	5,607	0.9	-	463	-	-	6,071	0.8	0.0

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

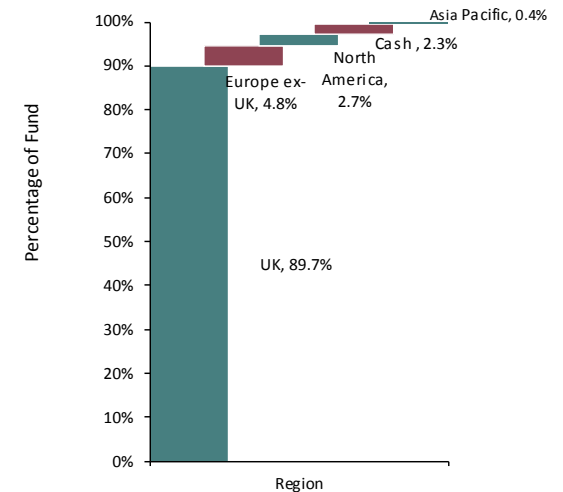
Asset Class Breakdown as at 31 March 2013



Breakdown of the MFS mandate

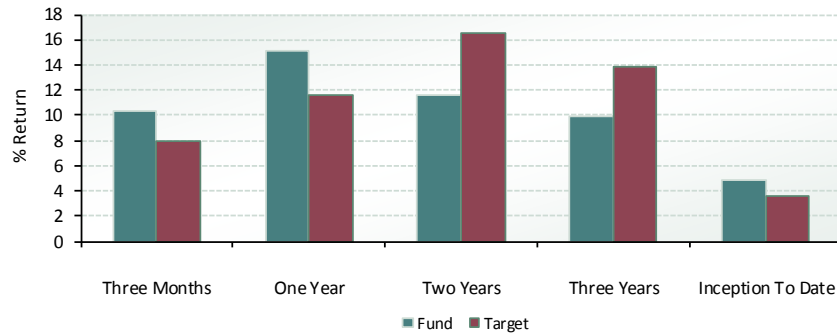


Breakdown of the Majedie mandate



Notes: Breakdown has been estimated by P-Solve based on the available manager data.

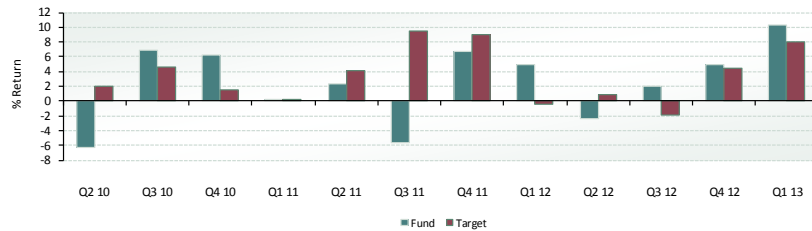
Historical Fund Performance



	Three Months	One Year	Two Years	Three Years	Inception To Date
Fund	10.37	15.14	11.61	9.95	4.82
Target	7.96	11.60	16.54	13.85	3.63

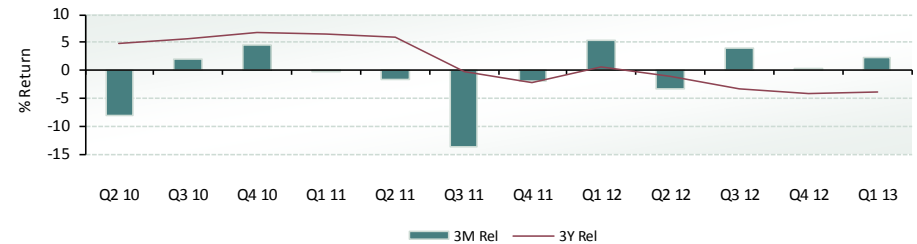
The Fund outperformed its liability benchmark by 2.41% over the quarter, returning 10.37% compared to the target of 7.96%. The Fund's performance of 15.14% over the year was ahead of its target by 3.54%. The Fund has failed to keep pace over the last 3 years but has outperformed by 1.19% since inception.

Three Years Rolling Quarterly Returns



	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12	Q1 13
Fund	-6.34	6.87	6.20	0.14	2.27	-5.62	6.79	4.99	-2.42	1.96	4.85	10.37
Target	2.00	4.68	1.57	0.17	4.07	9.54	8.98	-0.42	0.94	-1.96	4.46	7.96

Three Years Rolling Relative Returns



	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12	Q1 13
3M Rel	-8.18	2.09	4.56	-0.03	-1.73	-13.84	-2.01	5.43	-3.33	4.00	0.39	2.41
3Y Rel	4.86	5.57	6.83	6.55	5.98	-0.22	-2.22	0.64	-1.12	-3.46	-4.07	-3.90

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. Returns are gross of fees. Three Year Rolling Relative Returns have been calculated arithmetically from Q4 2012 onwards.

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 Fund Performance



	Three Months	One Year	Two Years	Three Years	Inception To Date
Fund	9.57	20.73	13.38	11.78	10.94
Target	10.85	19.08	10.97	10.94	9.00

Quarterly Manager update

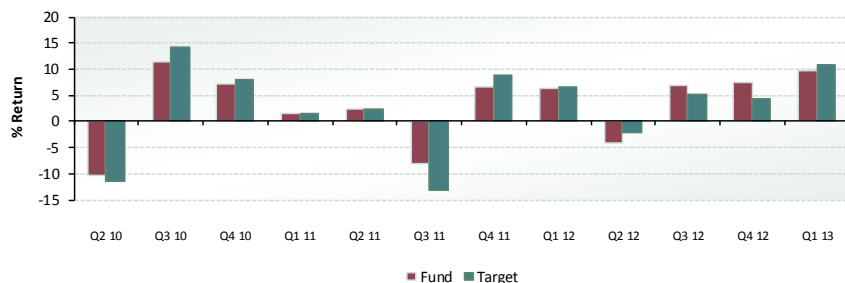
Organisation No significant changes over the quarter.

Product No significant changes over the quarter.

Performance The fund performance was 9.57% over the quarter, 1.28% behind its target. Over 12 months, the portfolio was 1.65% ahead of its target. Performance drivers were holdings in HP and Sony, with other positive contributions from Brammer, Blur Group, Lookers, Bolo, ITM Power and Torotrak. The main negative contribution was from Telecom Italia whose share price fell due to a combination of weak operational results and further concerns regarding the domestic economy.

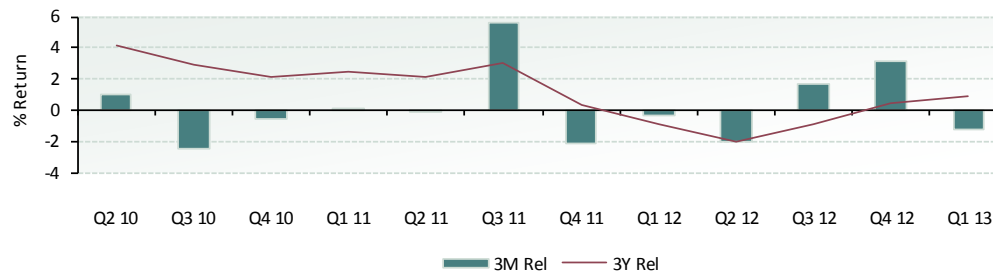
Process No significant changes over the quarter.

Three Years Rolling Quarterly Returns



	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12	Q1 13
Fund	-10.47	11.36	7.29	1.56	2.34	-8.15	6.63	6.24	-4.10	6.96	7.42	9.57
Target	-11.35	14.17	7.90	1.53	2.41	-13.05	8.92	6.62	-2.14	5.21	4.33	10.85

Three Years Rolling Relative Returns



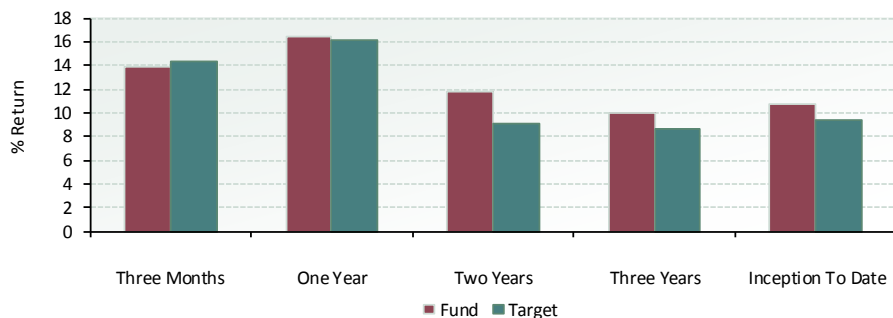
	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12	Q1 13
3M Rel	0.99	-2.46	-0.57	0.03	-0.07	5.64	-2.10	-0.36	-2.00	1.66	3.09	-1.28
3Y Rel	4.11	2.93	2.11	2.48	2.13	3.00	0.32	-0.92	-2.04	-0.90	0.48	0.84

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. Returns are gross of fees.

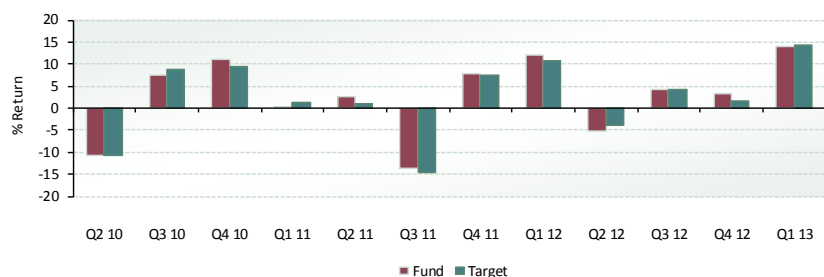
MFS are owned by Sun Life Financial based in Boston. Their investment philosophy is to select the best investment opportunities across regions and sectors. They were appointed in July 2005 following an OJEU tender process. They started managing investments for the fund in August 2005.

Historical Fund Performance



	Three Months	One Year	Two Years	Three Years	Inception To Date
Fund	13.88	16.40	11.71	10.00	10.77
Target	14.35	16.18	9.15	8.67	9.42

Three Years Rolling Quarterly Returns



	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12	Q1 13
Fund	-10.85	7.54	11.19	0.04	2.73	-13.61	7.96	11.90	-5.08	4.31	3.23	13.88
Target	-10.65	8.77	9.57	1.16	0.86	-14.56	7.49	10.71	-3.97	4.20	1.53	14.35

Notes:

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Quarterly Manager update

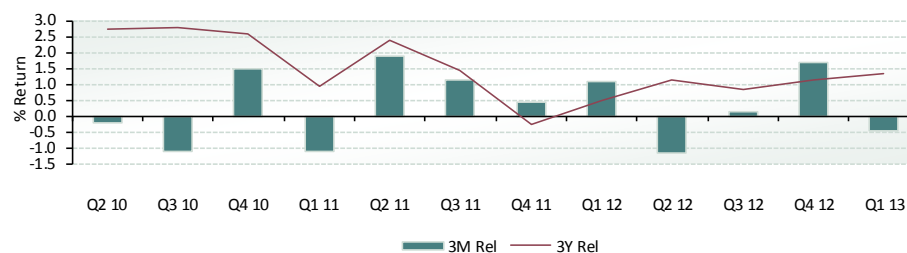
Organisation No significant changes over the quarter.

Product No significant changes over the quarter.

Performance The performance over the quarter was 13.88%, 0.47% behind the target. Over 12 months, the fund was 0.22% ahead of its target. An underweight position in materials sector and Apple, overweight position in Yahoo Japan and Franklin Resources (US asset management company) has aided performance. However, stock selection in Transportation and Health Care as well as Li & Fung (leading supplier), LVHM (global luxury goods company), Rio Tinto (mining company) and Saipem (oil services company) all detracted from performance over the quarter.

Process No significant changes over the quarter.

Three Years Rolling Relative Returns



	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12	Q1 13
3M Rel	-0.22	-1.13	1.48	-1.11	1.85	1.11	0.44	1.07	-1.16	0.11	1.70	-0.47
3Y Rel	2.71	2.76	2.59	0.90	2.38	1.44	-0.25	0.47	1.10	0.83	1.14	1.33

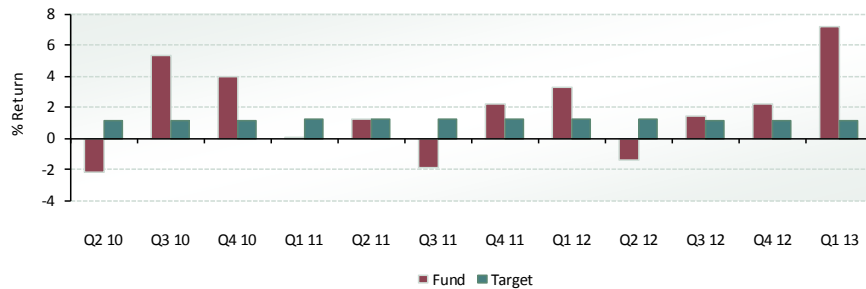
Historical Fund Performance



	Three Months	One Year	Two Years	Three Years	Inception To Date
Fund	7.13	9.33	7.02	7.03	10.28
Target	1.11	4.72	4.85	4.82	4.91

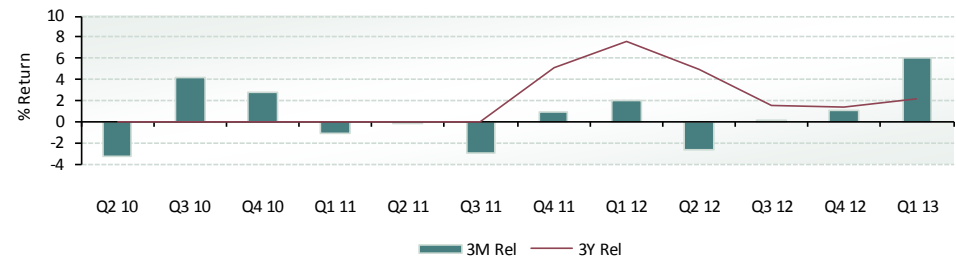
The performance of the group over the quarter was 7.13%, the LIBOR-based target returned 1.11%. Outperformance was driven by a continued rally in equity markets over the quarter while Index-linked gilts performed particularly well due to the surprise announcement by the National Statistician not to alter the way RPI inflation is measured. This means that the RPI rate will continue to run above the CPI measure for the foreseeable future. Over the past 12 months, performance has been 4.61% ahead of the target.

Three Years Rolling Quarterly Returns



	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12	Q1 13
Fund	-2.22	5.32	3.94	0.01	1.18	-1.86	2.16	3.27	-1.44	1.37	2.15	7.13
Target	1.16	1.17	1.17	1.18	1.19	1.21	1.24	1.25	1.23	1.17	1.12	1.11

Three Years Rolling Relative Returns



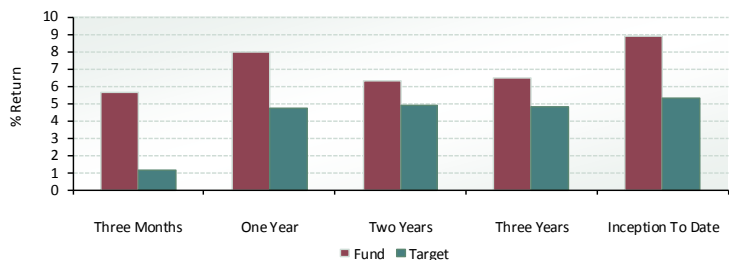
	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12	Q1 13
3M Rel	-3.34	4.10	2.74	-1.16	-0.01	-3.03	0.91	2.00	-2.64	0.20	1.03	6.02
3Y Rel	-	-	-	-	-	-	5.10	7.54	4.97	1.59	1.39	2.21

Notes:

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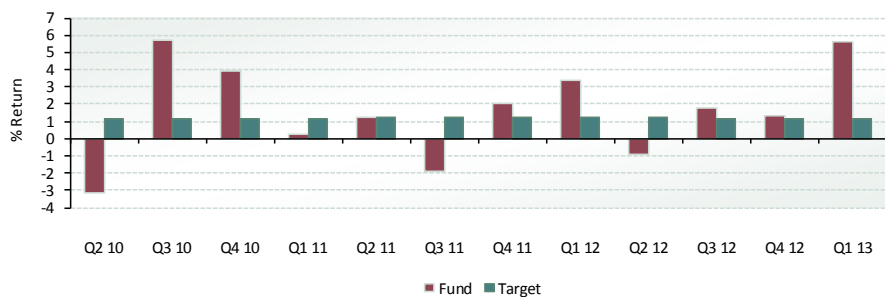
Barings are a large UK based investment manager investing in global asset classes. They were appointed for the Dynamic Asset Allocation mandate in June 2008 following an OJEU tender process. They started managing investments for the fund in August 2008.

Historical Fund Performance



	Three Months	One Year	Two Years	Three Years	Inception To Date
Fund	5.60	7.94	6.33	6.43	8.85
Target	1.11	4.72	4.85	4.82	5.27

Three Years Rolling Quarterly Returns



	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12	Q1 13
Fund	-3.12	5.73	3.88	0.22	1.19	-1.89	2.07	3.35	-0.90	1.78	1.34	5.60
Target	1.16	1.17	1.17	1.18	1.19	1.21	1.24	1.25	1.23	1.17	1.12	1.11

Quarterly Manager update

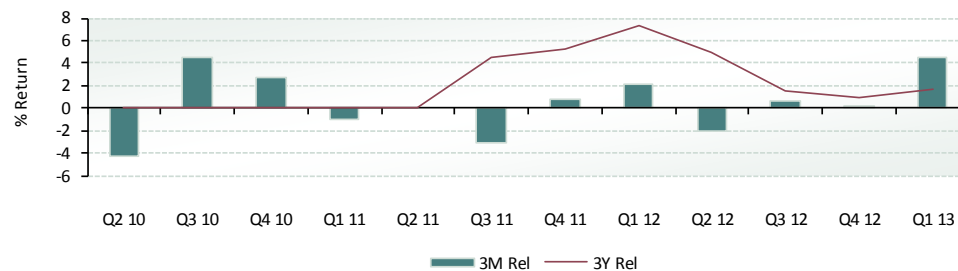
Organisation No significant changes over the quarter.

Product No significant changes over the quarter.

Performance The fund performance was 5.60% over the quarter, 4.49% ahead of its target. Over 12 months, the fund is 3.22% ahead of target. The strongest returns in the quarter came from UK equities followed by overseas equities with an additional modest return in Japanese equities. Overall currency hedging activity had a negative net contribution to returns due to a large position, hedging out of the US dollars back into Sterling to maintain the portfolio weight in the base currency above the 60% minimum level.

Process No significant changes over the quarter.

Three Years Rolling Relative Returns



	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12	Q1 13
3M Rel	-4.23	4.51	2.68	-0.95	0.00	-3.06	0.82	2.07	-2.10	0.60	0.22	4.49
3Y Rel	-	-	-	-	-	4.51	5.26	7.38	4.90	1.46	0.98	1.61

Notes:

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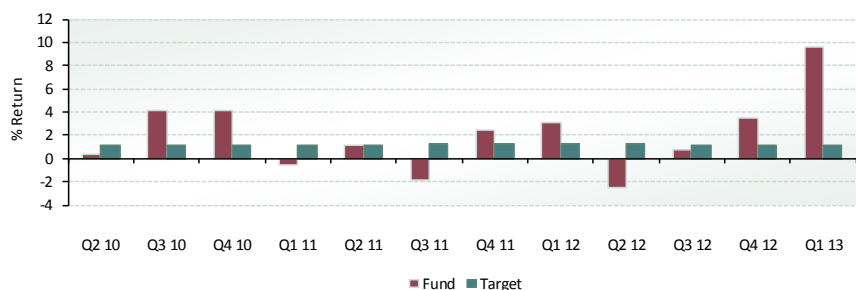
Ruffer are a small boutique investment manager investing in global asset classes. They were appointed for the Dynamic Asset Allocation mandate in June 2008 following an OJEU tender process. They started managing investments for the fund in August 2008.

Historical Fund Performance



	Three Months	One Year	Two Years	Three Years	Inception To Date
Fund	9.57	11.27	8.00	8.06	13.94
Target	1.11	4.72	4.85	4.82	5.27

Three Years Rolling Quarterly Returns



	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12	Q1 13
Fund	0.41	4.13	4.11	-0.61	1.13	-1.80	2.44	3.04	-2.55	0.71	3.47	9.57
Target	1.16	1.17	1.17	1.18	1.19	1.21	1.24	1.25	1.23	1.17	1.12	1.11

Notes:

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Quarterly Manager update

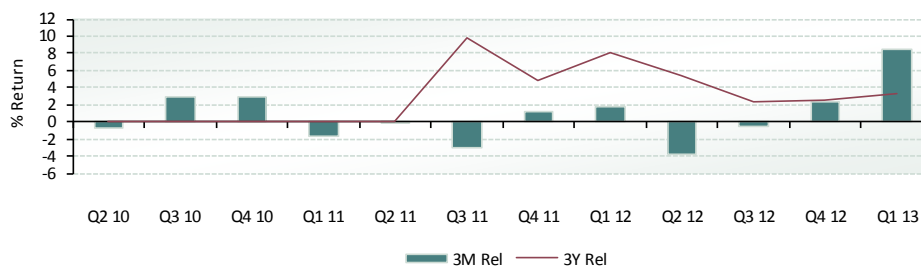
Organisation No significant changes over the quarter.

Product No significant changes over the quarter.

Performance The fund performance was 9.57% over the quarter, 8.46% ahead of its target. Over 12 months, the fund was 6.55% above the target. The returns for the portfolio were driven by positive contributions from Japanese equity exposure, index-linked bonds, US dollar position and UK and US equities. The main contributors to Japanese equity came from holdings in Daiei, Kao, Seven & I, SMFG and Toyota. There were no significant detractors to performance over the quarter.

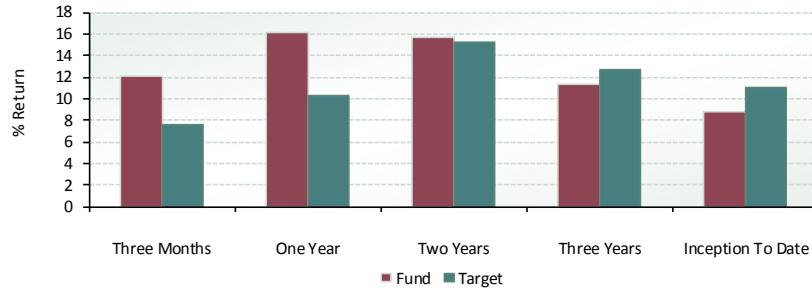
Process No significant changes over the quarter.

Three Years Rolling Relative Returns



	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12	Q1 13
3M Rel	-0.74	2.93	2.91	-1.77	-0.06	-2.97	1.19	1.77	-3.73	-0.45	2.35	8.46
3Y Rel	-	-	-	-	-	9.79	4.86	8.01	5.34	2.35	2.60	3.24

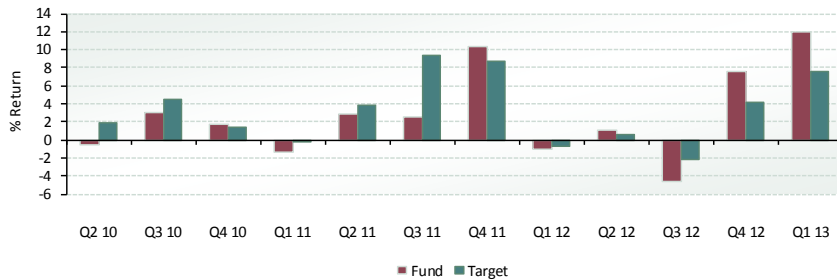
Historical Fund Performance



	Three Months	One Year	Two Years	Three Years	Inception To Date
Fund	12.03	16.17	15.71	11.27	8.74
Target	7.64	10.29	15.19	12.69	11.03

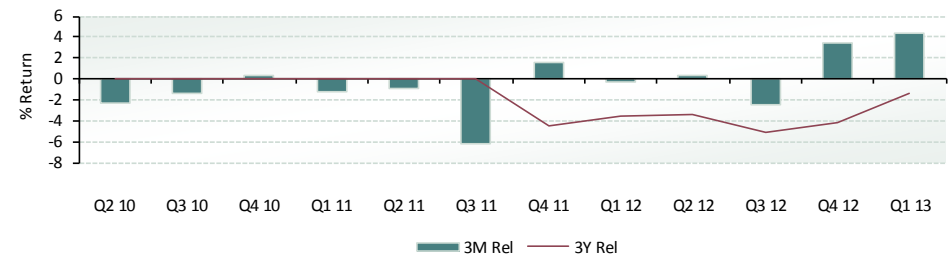
The performance of the Matching Fund over the quarter was 12.03%, 4.39% ahead of its gilts-based liability benchmark. The Matching Fund return of 16.17% over the year and was 5.88% above target. The UK Index-linked market was a strong performer due to the decision by the Statistical Office not to change the method of calculation of RPI index. Yields were already negative on these instruments, but they went further into negative territory on the announcement.

Three Years Rolling Quarterly Returns



	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12	Q1 13
Fund	-0.48	2.98	1.75	-1.32	2.90	2.50	10.42	-1.04	1.03	-4.60	7.59	12.03
Target	1.81	4.49	1.38	-0.01	3.88	9.35	8.67	-0.71	0.64	-2.25	4.15	7.64

Three Years Rolling Relative Returns



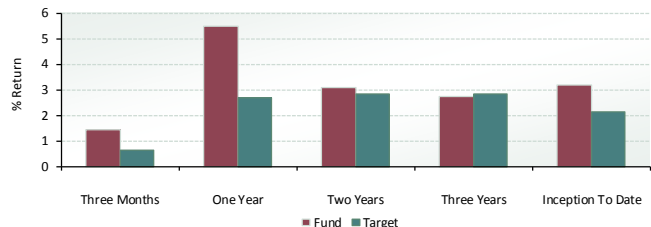
	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12	Q1 13
3M Rel	-2.25	-1.45	0.36	-1.31	-0.94	-6.26	1.61	-0.33	0.39	-2.40	3.44	4.39
3Y Rel	-	-	-	-	-	-	-4.47	-3.64	-3.45	-5.07	-4.23	-1.42

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. Returns are gross of fees.

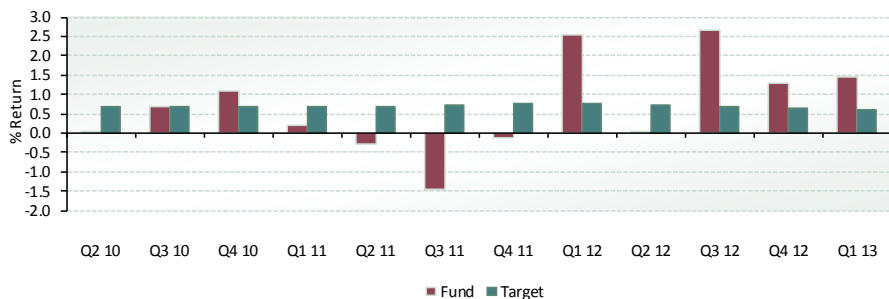
Goldman Sachs are a very large American investment bank who were first appointed in 1999 following a tender process. They have managed both equities and bonds on an active basis and since February 2009 managed an active bond fund.

Historical Fund Performance



	Three Months	One Year	Two Years	Three Years	Inception To Date
Fund	1.44	5.50	3.06	2.71	3.18
Target	0.62	2.70	2.83	2.81	2.13

Three Years Rolling Quarterly Returns



	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12	Q1 13
Fund	0.03	0.68	1.10	0.18	-0.27	-1.45	-0.11	2.55	0.03	2.67	1.27	1.44
Target	0.67	0.68	0.68	0.69	0.70	0.72	0.75	0.76	0.74	0.68	0.63	0.62

Notes:

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Quarterly Manager update

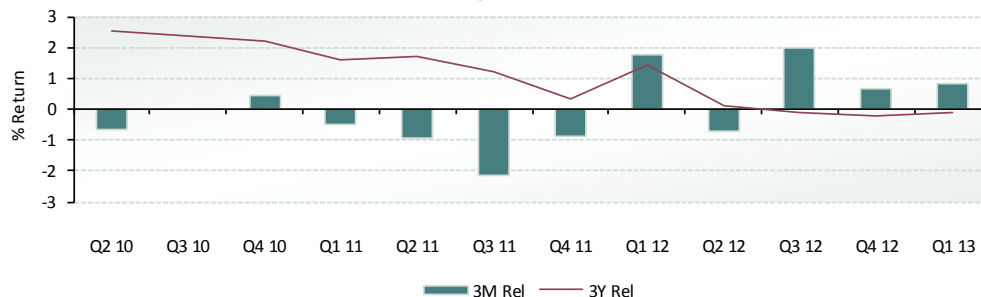
Organisation No significant changes over the quarter.

Product No significant changes over the quarter.

Performance The fund performance was 1.44% over the quarter, 0.82% ahead of its target. Over 12 months, performance was 2.80% ahead of the target. The portfolio's outperformance was again led predominantly by the fund's cross-sector and currency strategies. The duration strategy, however, detracted from excess returns over the quarter. The short Japan 7-year futures trade detracted from excess returns over the period.

Process No significant changes over the quarter.

Three Years Rolling Relative Returns



	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12	Q1 13
3M Rel	-0.64	0.00	0.42	-0.51	-0.96	-2.15	-0.85	1.78	-0.70	1.98	0.64	0.82
3Y Rel	2.51	2.37	2.19	1.60	1.68	1.20	0.34	1.42	0.12	-0.10	-0.23	-0.10

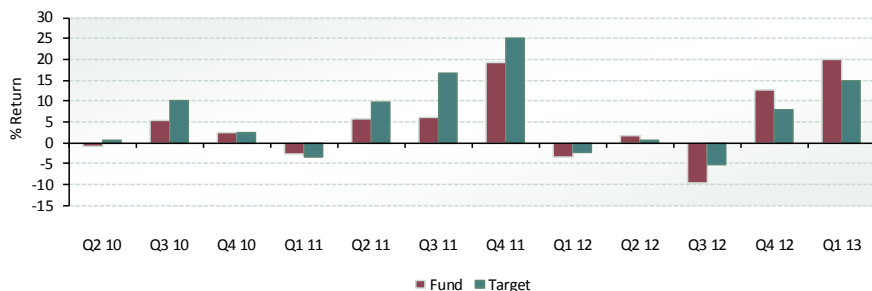
Legal & General are a very large manager of indexed funds. They were first appointed to manage investments for the fund in 1993. They have managed both equities and bonds on an indexed basis. Their current investment mandate started in the first quarter of 2012, although performance has been blended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

Historical Fund Performance



	Three Months	One Year	Two Years	Three Years	Inception To Date
Fund	19.79	23.95	26.38	18.33	5.59
Target	14.89	17.66	35.72	26.24	5.76

Three Years Rolling Quarterly Returns

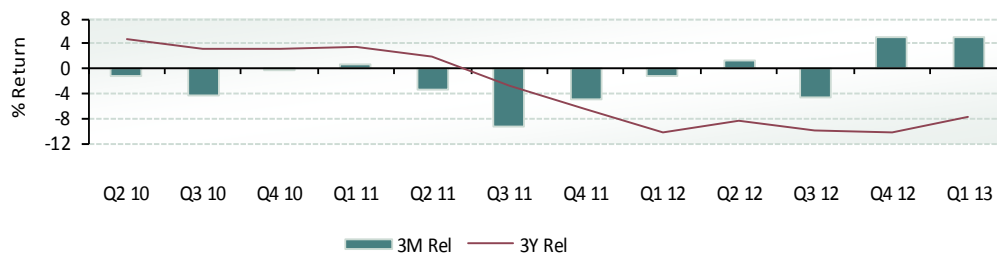


	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12	Q1 13
Fund	-0.96	5.18	2.34	-2.69	5.85	5.96	19.04	-3.50	1.76	-9.81	12.75	19.79
Target	0.39	9.89	2.38	-3.30	9.60	16.73	25.16	-2.22	0.38	-5.27	7.69	14.89

Quarterly Manager update

- Organisation** No significant changes over the quarter.
- Product** No significant changes over the quarter.
- Performance** The fund performance was 19.79% over the quarter, 4.90% ahead of its bespoke target. Over 12 months, performance was 6.29% ahead of the target.
- Process** No significant changes over the quarter.

Three Years Rolling Relative Returns



	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12	Q1 13
3M Rel	-1.34	-4.29	-0.04	0.63	-3.42	-9.23	-4.89	-1.31	1.37	-4.79	5.06	4.90
3Y Rel	4.71	3.23	3.22	3.37	1.89	-2.92	-6.51	-10.32	-8.41	-10.01	-10.26	-7.91

Notes:

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Continued loose monetary policy and improving investor confidence helped risky assets make a strong start to the year. While the return of European debt issues in the form of a banking crisis in Cyprus slowed momentum in late March, some equity markets still reached record highs over the quarter and others surpassed levels last seen before the 2008 financial crisis.

US equities were amongst the strongest performers with both the major stock indices posting double digit returns and reaching record highs. UK equities followed suit, also producing double digit returns while European markets lagged slightly. High yield corporate credit posted modest gains over the quarter and in contrast to developed markets, emerging market debt and equity experienced small losses due to concerns about inflation, a slowdown in China and depressed commodity prices.

In currency markets the big news over the quarter was the sharp fall in the value of sterling which depreciated substantially versus most major currencies before recovering somewhat towards the end of March. The slide took many by surprise with lots of explanations put forward including continued poor growth figures, stubbornly high government debt and an easing of concerns in the Eurozone leading to a reduction in the need for sterling as a safe haven.

Despite the general risk-on theme of the first quarter, gilt yields remained largely unchanged over the period. Index-linked gilts performed particularly well due to the surprise announcement by the National Statistician not to alter the way RPI inflation is measured. This means that the RPI rate will continue to run above the CPI measure for the foreseeable future, resulting in a larger than expected rise in the liabilities of schemes heavily linked to inflation.

In a move that was largely expected by investors, ratings agency Moody's cut the UK's credit rating one notch from its coveted AAA status citing continued sluggish growth, largely as a result of on-going poor growth prospects for the global economy in 2013. George Osborne presented his fourth annual budget in March announcing that economic growth is now expected to be half of that originally forecast at just 0.6% for this year, while borrowing and public sector debt are now both projected to be higher in the coming years than originally expected. A number of measures were announced including further plans to help struggling home buyers, an increase in the personal tax allowance a year earlier than planned and an updated remit for the Bank of England to allow the use of "unconventional monetary instruments" to boost economic growth.

In Europe, key events included the Italian elections held in February which yielded no clear winner and the emergence of the Cypriot banking crisis which served as a reminder that European sovereign debt issues still pose a significant threat to markets and global growth, irrespective of the size of the particular economy in focus. Away from the furore, economic fundamentals for the region as a whole remain depressed as unemployment reached a record high of 12%, manufacturing continued to contract and growth remains sluggish. Given that most governments are looking to control their fiscal budgets and reduce debt to more sustainable levels, a tough economic climate is expected to continue in the short to medium term with 2013's growth forecast pointing to a 0.4% contraction.

The US economy continued to lead the way for much of the rest of the developed world, with key economic indicators such as job creation and manufacturing experiencing strong growth. The housing market, a bellwether of the economic recovery, also showed signs of strengthening with gains in house prices, homes sales and construction spending.

Elsewhere, in Asia, Japanese equity markets have seen some of the strongest returns over the quarter with the Nikkei index rising over 20%. This was largely in response to the new Prime Minister, Shinzo Abe, announcing his intentions to loosen monetary policy via a new large stimulus package and a higher inflation target of 2%.

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

IMPORTANT INFORMATION

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