Q4 2009 Investment Performance Review
Powys County Council

17 February 2010

Prepared for

The Investment Committee

Prepared by

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Executive Summary

Introduction

This section sets out the asset allocation of the Powys County Council Pension Fund ("the Fund") and performance for the managers over three and twelve months to 31 December 2009. The current Hewitt rating for each product is also shown below.

Please note that Barclays Global Investors and BlackRock successfully merged on 1 December 2009. The Fund will suffer no adverse effects from this. The only change is that the holdings are now with BlackRock Global Investors (BGI).

Asset allocation

Mandate	30/09/2009 £'000	30/09/09 %	31/12/09 £'000	31/12/09 %	Hewitt Rating
Balanced Fund					
BlackRock Global Investors (BGI)	140,313	47.0	144,011	46.9	4
Global Equities					
AXA Rosenberg	26,259	8.8	26,917	8.8	3
BGI Equity Warehouse	29,307	9.8	30,233	9.9	4
Private Equity					
Standard Life	4,706	1.6	4,869	1.6	4
HarbourVest Partners	3,683	1.2	4,188	1.4	4
Global Bonds					
Western Asset Management	43,363	14.5	43,623	14.2	3
BGI Bond Warehouse	8,993	3.0	6,004	2.0	4
Property					
Aviva Investors – UK	9,302	3.1	10,092	3.3	4
CB Richard Ellis Investors – European	10,965	3.7	11,036	3.6	3
Cash					
BGI Cash Fund	5,656	1.9	5,664	1.8	4
Cash in BGI Equity Warehouse Fund	4,438	1.5	4,444	1.4	
Cash in BGI Bond Warehouse Fund	11,618	3.9	14,636	4.8	
Internal Cash Account	839	0.0	1,119	0.4	
TOTAL	**299,442**	**100**	**306,836**	**100.0**	

Source: WM and Managers.
Note: Figures are subject to rounding

Asset allocation split by asset class

Set out below is the Fund's asset allocation as at 31 December 2009 split by asset class. We have compared the current allocation with the strategic allocation as set out in the Statement of Investment Principles (SIP) dated June 2007. The SIP is currently under review and will be updated again once the global equity, currency and hedge fund of funds managers have been appointed.

Asset class	Current allocation (%)	Strategic allocation (%)	Relative (%)
UK Equity	23.3	20.0	3.3
Overseas Equity	18.2	25.0	-6.8
Bonds	39.8	40.0	-0.2
Property	6.9	10.0	-3.1
Private Equity	3.0	5.0	-1.7
Cash	9.1	0.0	9.1

Source: WM Company and Managers

Note: The allocation of cash includes £4,444,000 of cash held in the BGI Equity Warehouse Fund and £14,636,000 of cash held in the BGI Bond Warehouse Fund. Figures are subject to rounding.

Commentary

As shown in the above table, the current overseas equity, property and private equity allocations are still below their strategic allocations. A strong performance from UK equities contributed to the overweight position. The Fund is now in line with the Strategic allocation to Bonds.

The Fund is still holding 9.1% of its assets in cash which will be transferred to the new managers upon appointment.

The strategic allocations above are those set out in the current SIP and do not reflect the target allocations in force under the MTAA service. As at 1 January 2010 the target changed to 50% equity / 50% bond from 45% equity / 55% bond.

Performance

The table below sets out the performance of the individual managers and the combined fund over the quarter and 12 months to 31 December 2009.

Mandate		Quarter (%)	12 months (%)	Allocation (%)
BlackRock Global Investors (Balanced Fund)	Fund	2.6	13.8	46.9
	Benchmark	2.9	14.0	
Western Asset Management (Global Bonds)	Fund	0.6	18.6	14.2
	Benchmark	0.4	14.6	
BlackRock Global Investors (Equity warehouse)	Fund	2.8	N/A	9.9
	Benchmark	2.7	N/A	
AXA Rosenberg (Global Unconstrained Equity)	Fund	2.5	8.9	8.8
	Benchmark	3.2	16.4	
CB Richard Ellis Investors (European Property)	Fund	-2.8	-21.9	3.6
	Benchmark*	10.4	-5.4	
Aviva Investors (UK Property)	Fund	8.5	0.8	3.3
	Benchmark	8.1	-3.4	
BlackRock Global Investors (Bond warehouse)	Fund	0.1	N/A	2.0
	Benchmark	0.1	N/A	
BlackRock Global Investors (Cash)	Fund	0.1	N/A	1.8
	Benchmark	0.1	N/A	
Standard Life Investments (Private Equity)	Fund	-2.9	-10.7	1.6
	Benchmark	3.5	19.9	
HarbourVest Partners VII (Private Equity)	Fund	7.2	-13.7	0.8
	Benchmark	3.5	19.9	
Harbourvest Partners VIIIa - Buyout (Private Equity)	Fund	8.6	-6.9	0.2
	Benchmark	3.5	19.9	
Harbourvest Partners VIII - Venture (Private Equity)	Fund	3.0	-9.9	0.4
	Benchmark	3.5	19.9	
Combined Fund	**Fund**	2.0	9.1	N/A
	Benchmark	2.6	14.1	N/A

Source: WM Company and Managers.
*The CBRE benchmark shown is the UK IPD Pooled Property Index

Quarterly Manager Summary

BlackRock Global Investors

- BlackRock Global Investors (BGI) manages global equities and bonds in its Balanced Fund. These assets are passively managed and BGI has successfully managed to track the relevant indices to within an acceptable range. The Balanced Fund achieved a return of 2.6% over the quarter.
- BGI also aims to track the relevant indices of the equity and bond warehoused funds. All the indices were tracked within an acceptable range over the quarter.
- On 1 December 2009, Barclays Global Investors successfully merged with BlackRock. This has changed the names of the funds only.

AXA Rosenberg

- The Fund has been invested in AXA Rosenberg's Global Equity Fund since 2003. Short to medium term performance has been negatively affected by a series of inflection points in the market. AXA Rosenberg, like many other quantitative managers, has suffered from a disconnect between earnings and stock prices. As we have seen over the last few quarters, investor sentiment, rather than strong company fundamentals, has been the main driving factor behind the market movements.
- Nonetheless we continue to regard AXA Rosenberg as a high quality unconstrained global equity manager and we believe they have the capability to outperform their benchmark going forward.
- AXA Rosenberg have been invited to present at the Investment Committee meeting on 25 February 2010.

Standard Life Investment

- The Standard Life private equity fund has produced a negative absolute return this quarter and has underperformed the benchmark.
- Against a backdrop of volatile equity markets, the diversification offered by this type of investment is particularly valuable and we continue to regard this fund highly.

HarbourVest Partners

- Unlike the Standard Life fund, the HarbourVest funds achieved positive absolute returns this quarter. The two buyout funds, the 2005 Cayman Buyout fund VII and the Cayman Buyout fund VIII, both outperformed the benchmark by 3.7% and 5.1% respectively, whereas the Cayman Venture fund underperformed by 0.5%.
- As with the investment with Standard Life, these funds offer good diversification within the Fund's portfolio.
- HarbourVest currently run US and non-US private equity funds which can be used as an additional source of diversification.

Western Asset Management

- The Fund has been invested in Western's Global Bond portfolio since 2003.
- Over the quarter the fund outperformed the benchmark by 0.2%. The main drivers of performance during the quarter were overweight positions in Financials and Asset Backed Securities. It reduced these positions during the quarter as spreads tightened. In addition, the manager added value through an underweight duration position.

Aviva Investors

- The Fund has been invested in Aviva's UK Property Fund (previously the Morley Property Fund) since 2004.
- Falling property markets have led to losses within the fund, although the market in general has started to pick up of late and especially last quarter. The fund outperformed by 0.4% over the quarter, and is now ahead of the benchmark across all periods.

CB Richard Ellis Investors

- The Fund has been invested in CBRE's European Property Fund since the end of 2007.
- The fund performed poorly this quarter and produced negative returns.
- The funds performance target is measured against the UK Retail Price Index and hence the benchmark does not reflect the price fluctuation in property markets over the time periods.
- To assist with the performance measurement we have also set out the returns from the IPD UK Pooled Property Funds Index.

BlackRock Global Investors – Balanced Fund

Mandate

As at 31 December 2009, the Fund had £144.0m invested in BlackRock Global Investors' (BGI) Balanced Fund (the main account), which was split 48.5% equity and 51.5% bonds as at 31 December 2009.

BGI also hold equities and bonds in warehoused portfolios. As at 31 December 2009 the amounts held in these portfolios were £30.2m and £6.0m respectively, excluding cash. The Fund also holds cash in the respective BGI Sterling Liquidity Funds which totalled £27.7m as at 31 December 2009.

Within the Balanced Fund, the target for BGI is to achieve a return within 0.5% pa of the benchmark return for each asset class over rolling three year periods and not to achieve a return more than 0.75% away from the benchmark over any rolling twelve-month period.

Performance analysis

BGI Balanced Fund Performance

	Q4 2009 (%)	12 months (%)	3 years (% pa)
Balanced Fund	2.6	13.8	4.7
Benchmark	2.9	14.0	4.7
Relative	-0.3	-0.2	0.0

BGI Warehouse Funds Performance

	Equity Warehouse Q4 2009 (%)	Bond Warehouse Q4 2009 (%)
Balanced Fund	2.8	0.1
Benchmark	2.7	0.1
Relative	0.1	0.0

Source: WM Company

- The underlying funds each continued to track their benchmarks to within an acceptable range, leading to the overall fund tracking the benchmark closely.
- Over the quarter, the returns for all equity funds were positive, with the exception of the Japanese Equity fund. The highest return was from the UK equities held.
- Equity funds achieved higher returns compared to bond funds as we continued to see signs of recovery in the equity markets.
- Fixed Interest Gilts performed poorly over the period, which is reflected in the -2.2% return from the GilTrak Fund. However, the majority of the Fund's bonds are held in Index-Linked Gilts which had a positive return of 1.5% over the quarter.
- In October £6m was transferred from fixed interest gilts and £3m was transferred from index linked gilts to the Sterling fund.

Hewitt rating

As shown in the rating sheet overleaf, we rate BGI highly and regard them as a suitable passive manager. Please see Appendix B for an explanation of our manager ratings.

BlackRock Rating Sheet

Factor	Rating	Previous rating	Other comments
Business	4	3	BlackRock is a high-quality, well-diversified, global asset management business. We continue to rate this business highly and believe it is well positioned relative to competitors in the current economic climate. The acquisition of Barclays Global Investors expands its product coverage, particularly in UK Defined Contribution services and quantitatively driven strategies. There is a reasonable element of staff ownership.
Organisation & Staff	3	(no change)	Investment personnel are generally very impressive. The equity and fixed income teams contributing to the management of the portfolio are experienced with high level of technical expertise.
Investment Process	4	(no change)	BlackRock's passive investment process is pragmatic and well structured. It uses (nearly) full replication in developed equity and government bonds markets and stratified sampling for less developed equity markets and corporate bonds. The process is aimed at limiting tracking error while aiming to add value when index changes occur. Some pooled funds include integrated securities lending and swaps programmes to enhance returns.
Risk Management	4	(no change)	The investment culture is very focused on risk awareness. Risk control is an integral part of the overall investment process. Pre trade analysis is run as part of the process.
Performance Analysis	4	(no change)	Performance has been slightly ahead of the benchmark for most funds but within the risk target. Performance attribution shows that value is added mostly from index changes and stock lending.
Other	3	(no change)	
Systems			BlackRock has committed itself to expenditure on the development of new systems and improvements to existing ones. These are very impressive. BlackRock doesn't insure clients against losses on its stock lending program, although it hasn't lost money since the inception of the program in 1981.
Client Service			The quality of client servicing is variable. Larger clients have a more attentive service with more experienced client directors. Smaller clients are serviced by less experienced client directors or on a web-based service
Fees			Fees are in line with the market.
Environmental, Social and Governance Integration			The manager has a corporate governance policy that aims to promote best practice by actively engaging with companies. There is clear disclosure of voting history.

Overall rating	4	(no change)	BlackRock has a very strong culture of risk management combined with good systems and performance. The team is experienced and has a good understanding of technical issues around indexing.

Major new issues

Business update

BlackRock announced on 1 December 2009 that it had completed the merger with BGI. It also confirmed that John Varley, CEO of Barclays, and Robert E. Diamond Jr, CEO of Corporate and Investment Banking and Wealth Management, joined the board of BlackRock. The client and consultant teams have been merged, which resulted in a number of redundancies. Andrew Dyson, who was the Head of International Institutional Business at BlackRock, moved to San Francisco to become the Global Head of Institutional for the merged group. Mike O'Brien is the new Head of Institutional for the Europe, Middle East and Asia regions, while Juliet Bullick retains her role as Head of UK Institutional in the UK. We are pleased to note that the integration continues to go according to plan and run smoothly. We continue to closely monitor the integration with regards to its impact on investment strategies, client service and systems.

We have upgraded the business rating from a 3 to a 4 following the completion of the acquisition. The rating is in line with our rating on BlackRock prior to the BGI acquisition.

AXA Rosenberg – Global Equities

Mandate

As at 31 December 2009 the Fund had £26.9m invested in AXA Rosenberg's Global Equity Fund.

AXA Rosenberg's mandate is to actively manage the Global Equity Fund, with a target outperformance of 3% p.a, gross of fees, over a rolling three year period.

Performance analysis

AXA Rosenberg Performance

	Q4 2009 (%)	12 months (%)	3 years (% pa)
Global Equities	2.5	8.9	-2.5
MSCI World	3.2	16.4	1.2
Relative	-0.7	-7.5	-3.7

Source: AXA Rosenberg and WM Company

- The Global Equity fund underperformed the benchmark over the quarter by 0.7%. The fund now trails the 12 month benchmark by 7.5%.
- Stock selection continued to be the main contributor to the underperformance. Poor stock selection was related to the exposure AXA Rosenberg had to share price momentum and value factors which detracted from returns.
- On a positive note we saw AXA's earnings forecast model add value over the quarter, which is a change from earlier quarters.
- The manager continues to be positioned in stocks that are attractive from both an earnings forecast and valuation perspective. We are encouraged to see earnings visibility improve as this has historically led to subsequent outperformance.
- We rate AXA Rosenberg highly and continue to believe that they are well positioned to take advantage of a rebound of fundamental factors as they start being rewarded again.

AXA Rosenberg Rating Sheet

Factor	Rating	Previous rating	Other comments
Business	3	(no change)	AXA Rosenberg is backed by a strong parent in the AXA Group, and appears to have a good deal of autonomy. We are comfortable with AXA Financial's strategic direction of AXA's investment management businesses.
Organisation & Staff	4	(no change)	AXA Rosenberg has dedicated research teams based in the US and London who are impressive. Staff in the UK have responsibility for the UK and European portfolios and are of a high quality. The team is stable and works well together.

AXA Rosenberg Rating Sheet

Factor	Rating	Previous rating	Other comments
Investment Process	3	(no change)	The process is fundamentally based and differentiated from its competitors in many ways. In our opinion, the manager could benefit from a more dynamic approach to exposures in various factors to better deal with inflection points. AXA Rosenberg, as with all quantitative managers, relies on the integrity and consistency of the data it receives from company accounts.
Risk Management	3	(no change)	Risk management is integral to the construction of portfolios. The decision on which stocks are bought or sold takes account of the change in the risk positions and the potential stock return that would result.
Performance Analysis	3	(no change)	Short to medium term performance has been negatively affected by a series of inflection points in the market. AXA Rosenberg, like many other quantitative managers, has suffered from a disconnect between earnings and stock prices. In our opinion, the manager will be well positioned to generate attractive risk-adjusted returns as the above discrepancy reverses.
Other	3	(no change)	
Systems			AXA Rosenberg's systems are able to handle a great deal of data from various sources. Reporting systems are impressive.
Client Service			The client servicing team is well resourced and feedback from clients is that its efforts in this area are good.
Fees			Fees are in line with peers for similar products.
Environmental, Social and Governance Integration			The manager is below average when it relates to ESG issues. Customised accounts can consider ESG issues but it would be at the client's request.
Overall rating	3	(no change)	Global Alpha is one of the flagship offerings of AXA Rosenberg. The strategy provides access to very high quality people. The quantitative investment process is continuously enhanced but we would like to see the manager be more dynamic around its exposures to various factors.

Key issues to monitor

Ongoing Research

We have seen a number of enhancements to both the earnings forecast and valuation models over the years. AXA Rosenberg is now undertaking research in what it calls "company life modeling". While this still is a long way from being implemented it is expected to have a significant impact on the manager's process. The idea is to model a company's various stages in life and to use that information to better apply the earnings forecast and valuation models. We will continue to monitor any progress here and report back to clients.

Business Update

The firm's total assets under management have declined from £47.3bn to £44.1bn over the fourth quarter of 2009. Outflows were related to a combination of asset allocation calls, restructuring and under performance. The manager's European business saw £3.0bn worth of outflows; primarily from European strategies. AXA Rosenberg continues to have a very low staff turnover rate, with no senior departures over the fourth quarter.

During February 2010, AXA announced that they are making 10% of world wide firm staff redundant to recognise falling assets and the level of work load associated with it.

The decision primarily affects administration, operations and technical/programming roles and not investment professionals. Out of 35 people that are being let go only five are investment professionals. All key investment staff remain the same and client servicing people in London have been left untouched with the exception of one "client facing PM" (similar to product specialists for other managers). The global equity fund will not be affected.

We believe that the organisation remains sufficiently resourced in order to continue to run its investment strategies without a negative effect from cutting staff. This announcement will have no impact on our staff rating of a "4" which is reflection of a high quality team in our opinion. Business is currently rated a "3" and remains a "3". With this decision AXA Rosenberg has taken a defensive step that will add some margin making further cost saving exercises less likely going forward.

Voting & Engagement

AXA Rosenberg’s senior management has engaged the Institutional Shareholder Services (ISS) for voting decisions as it believes the ISS has the expertise and knowledge to gather information and make appropriate voting decisions on client's behalf. The manager is however currently reviewing the proxy policy with its parent company, AXA Investment Management, to determine how to best leverage off of the firm's research and engagement services. In our opinion, this activity is given appropriate attention.

Standard Life Investment – Private Equity

Mandate

As at 31 December 2009 the fund had £4.9m invested with Standard Life investments in their Private Equity European Fund.

The Fund has given Standard Life an investment objective to outperform the benchmark by 5% pa over a rolling three year period. The benchmark is the MSCI AC World ex UK GDR Index.

Performance analysis

Standard Life Investments Performance

	Q4 2009 (%)	12 months (%)	3 Years (%)
Private Equity Fund	-2.9	-10.7	-6.1
MSCI AC World ex UK GDR	3.5	19.9	2.7
Relative	-6.4	-30.6	-8.8

Source: WM Company

- The Standard Life private equity fund had negative absolute performance this quarter, and is now 30.6% behind the benchmark over the twelve months to 31 December 2009.
- As the fund is largely focused on European buyouts, and the benchmark used is the MSCI All World Index, there is an inconsistency between the fund and the benchmark index used for comparison.
- The performance relative to the benchmark can often be misleading. Benchmarking in private equity continues to be problematic as many participants do not believe that there is a reliable and robust way to benchmark the asset class over all periods.

Standard Life Rating Sheet

Factor	Rating	Previous rating	Other comments
Business	3	(no change)	Having raised over €6bn, Standard Life (SL) serve as a market leader, and with senior staff ownership in place through the SL Capital Partners structure, we believe that the corporate structure in place is of good quality. Nine senior staff own 40% of the SL Capital Partners partnership, with Standard Life Investments owning the remaining 60%. Through clients, the executives can evoke forced sale of 14% by the parent, and therefore take themselves to majority owner if this is in the best interest of the clients.

Standard Life Rating Sheet

Factor	Rating	Previous rating	Other comments
Organisation & Staff	3	(no change)	The team has grown to 16 investment professionals, with 10 of these team members having over a decade of experience in the private equity industry. Standard Life continue to build out the investment and marketing teams, and the more recent additions at the more junior level has addressed the issue of a previously "top-heavy" team. Although there were issues relating to the US team, we do not feel that this should have any effect on the European product.
Investment Process	3	(no change)	The process is well structured, with approximately 15-20 investments per fund being made. Investment managers do research on funds as well as the analysts and ideas are then discussed throughout the process by the Investment Committee. The choice of "funds-only" or "funds and co-investments" is one we support.
Risk Management	3	(no change)	Although the portfolio is diversified with respect to country and industry, the firm invests entirely in European buyout. Although the team seems to understand the risk implications of such a strategy, we feel the risk involved remains substantial. Each fund investment is limited to 10% of committed capital - a restriction that we support.
Performance Analysis	4	(no change)	Performance of previous funds looks good and the team have a good understanding of the reasons behind this. We continue to have confidence in the ability to outperform.
Other Client Service	3	(no change)	Experience of client servicing has been positive.
Fees			Fees are not out of line from their peers,
Overall rating	4	(no change)	We believe that their location is beneficial to research, and that the product is a good fit in US biased portfolios, or those that use sector/geographic specialists in a concentrated manner

Key issues to monitor

ESP 2004 update

The ESP 2004 Funds and Co-investments fund was 77% drawn at 31 December 2009, with the funds component being fully committed in 20 investments. The co-investment section has 16 investments made, committing 80% of that available to co-investments. We expect there to be an additional 2-3 co-investments made before the fund is fully complete.

Market conditions are improving, with debt markets opening up for the small and mid market deals, so exit opportunities are coming around.

Performance

Like many others, the performance of select investments in the ESP fund range has suffered in recent market conditions. These include:

- Candover – restructuring of fund taking after difficulties.

■ Permira IV – poor performance and negotiation with largest investor resulting in the fund size being reduced to €9.4bn from €11bn.

■ Alchemy Plan – annual commitment to Alchemy halted, with recent issues involving management changes.

Conversely, fund investments with Advent and Industri Kapital have shown early signs of good performance. Although too early for audited numbers, we expect Q4 2009 valuations to produce an uplift from 30 September 2009.

Fundraising

For information, SLI continue to raise ESP 2008, with investor consent allowing the fund to remain open until May. When this fund is concluded, SLI will form ESP 2010, along with two smaller, more specialist funds:

-Small funds product focussing on Europe – targeting small end of the buyout market (funds under €1bn)

-Small funds product focussing on North America – targeting small end of the buyout market (funds under $1bn).

HarbourVest Partners – Private Equity

Mandate

The Fund is invested in three private equity funds as set out below:

Name of Fund	Date Invested	Amount as at 31 December 2009 (£m)
HarbourVest Partners VII – 2005 Cayman Buyout Partnership Fund	November 2005	2.5
HarbourVest Partners VIIIa – Cayman Venture Fund	October 2006	1.3
HarbourVest Partners VIIIb – Cayman Buyout Fund	October 2006	0.5

Source: WM Company

- The funds at HarbourVest do not have a stated investment objective; however HarbourVest strives to achieve returns that will place them in the top quartile of the industry. The Fund has given HarbourVest an investment objective to outperform the benchmark by 5% pa over a rolling three year period.
- As for Standard Life, the MSCI AC World ex UK GDR has been used as the benchmark for the three funds.
- The table below sets out the performance versus the benchmark for the three funds.

Performance analysis

HarbourVest Performance

	Q4 2009 (%)	12 months (%)
HarbourVest VII	7.2	-13.7
MSCI World Index	3.5	19.9
Relative	3.7	-33.6
HarbourVest VIII – Venture Fund	3.0	-9.9
MSCI World Index	3.5	19.9
Relative	-0.5	-29.8
HarbourVest VIII – Buyout Fund	8.6	-6.9
MSCI World Index	3.5	19.9
Relative	5.1	-26.8

Source: WM Company

- All three funds achieved positive absolute performance this quarter.
- Returns over the 12 month period have been poor, but not out of sync with the rest of the private equity market, with the HarbourVest VII fund underperforming by over 30%.
- The new FAS 157 valuation basis requires private equity investments to be valued appropriately; often with reference to comparable quoted companies. As quoted equities performed well during the third quarter, this has filtered through to the private equity market in the fourth quarter of 2009. The lag is due to the time it takes to audit private equity accounts. However, private equity companies are normally less

established and often more exposed to lower earnings in a recession. This reduces valuations. Furthermore, the FAS valuation basis requires a level of prudence such that we would not expect the private markets to rebound as much or as quickly as quoted markets have done in recent months.

HarbourVest Rating Sheet

Factor	Rating	Previous rating	Other comments
Business	4	(no change)	HarbourVest Partners are the largest independent private equity fund of funds manager both in terms of staff numbers and assets under management. Ownership of the organisation is well spread across the 21 managing directors who all have a long tenure at the firm. HarbourVest focuses on private equity fund of funds.
Organisation & Staff	4	(no change)	Most partners have direct investment experience in private equity. Staff are of high quality and there is a great deal of depth in the team. We believe there is a clear path to partnership for middle level employees that keeps them well motivated, and as a result staff turnover is relatively low.
Investment Process	3	(no change)	There is a clear screening process which reduces potential investment opportunities down to the handful of commitments that they make each year. Churn between partnerships is low at approximately 20%. This means that a good performing manager is likely to feature in HarbourVest's next partnership too. The firm has good access to the largest and most oversubscribed funds, however due to the large size of HarbourVest's fund of funds, many smaller opportunities will have to be ignored. The ability that clients have to adjust exposure between US buyout and US venture capital is beneficial.
Risk Management	3	(no change)	HarbourVest claim the handful of investments they make each year each receive approximately a month of due diligence prior to investment. Partnerships are well diversified with respect to type of investment and by sector.
Performance Analysis	3	(no change)	HarbourVest have consistently achieved top quartile results, however funds continued to evolve to become significantly larger than their previous funds. We have some concerns relating to HarbourVest's ability to be able to commit these larger sums of money without compromising investment quality.
Client Service	3	(no change)	Experience of client servicing has been positive. HarbourVest show willingness to meet requirements, with updated fee structures being implemented in forthcoming funds.

HarbourVest Rating Sheet

Factor	Rating	Previous rating	Other comments
Fees			Fees are not out of line from their peers.
Overall rating	4	(no change)	HarbourVest partners are a top-tier private equity fund of funds manager. The organisation and staff are of the highest calibre.

Major new issues

Staff

From Q4 2009, Kevin Delbridge stepped down his activities from position as Senior Managing Director and now holds a position as Senior Advisor. This had been expected by the firm since the beginning of 2009. Succession planning of other senior staff is continually discussed, with two other senior members of the team signalling intent to reduce roles from the start of the next fundraising cycle in 2014/5. This clarity on the intentions of Ed Kane and Fred Maynard serves to aid the continuity of a team we believe is already extremely well resourced. At 31 December, there were 82 investment professionals on the team.

Key issues to monitor

Fund update

HarbourVest continue to raise and invest the most recent non-US vehicle in HIPEP VI, with commitments at c.50% of the target €1.5bn. Activity in the second half of 2008 and first half of 2009 was slow, picking up slightly towards the end of the year.

HarbourVest Partners IX, the next US fund of funds partnership, is expected to be formed in March, coinciding with the end of the commitment period of HVP VIII. Both the buyout and venture sections of this fund raise will be smaller, mirroring the move in the markets for underlying funds to reduce sizes.

Fund size

We have previously noted our concerns over the increased size of HarbourVest's recent funds and the firm's ability to repeat past good performance with this larger weight of money. HarbourVest have shown some willingness to reverse this trend when required, as signalled by the reduced size of the upcoming funds, although this is perhaps more a function of market conditions.

Western Asset Management – Bonds

Mandate

As at 31 December 2009 the Fund had £43.6m invested in Corporate Bonds with Western Asset Management.

The investment objective of the new mandate continues to be to outperform the benchmark by 0.75% pa, net of fees, over the medium term (3 - 7 years).

Performance analysis

Western Asset Management Performance

	Q4 2009 (%)	12 months (%)	3 years (% pa)
Global Bond Fund	0.6	18.6	6.3
Benchmark	0.4	14.6	8.6
Relative	0.2	4.0	-2.3

Source: Western Asset Management

- The Fund has performed well over the quarter and the last twelve months. However, over 3 years it has still underperformed compared to the benchmark.
- Over the quarter the fund outperformed the benchmark by 0.2%. The main drivers of performance during the quarter were overweight positions in Financials and Asset Backed Securities. Western reduced these positions during the quarter as spreads tightened. In addition, the manager added value through an underweight duration position.
- On 23 March 2009, after advice from Hewitt, the Fund transferred £19.9m of gilts away from Western, leaving mainly corporate bonds invested with them. Corporate Bonds have, since 31 March 2009, returned 25.2% versus a benchmark of 17.1% to 31 December 2009.

Western Rating Sheet

Factor	Rating	Previous rating	Other comments
Business	3	(no change)	Western Asset Management is a dedicated fixed income only business. It is wholly owned by Legg Mason but is given a high degree of autonomy. Western is headquartered in the US and has expanded successfully into London and Singapore.
Organisation & Staff	3	(no change)	Western has made a number of senior hires in 2009 to address the underperformance and introduce new ideas to a team that has been stable for a long time. The key decision makers in the UK are of good quality and there is firmwide depth in resources.
Investment Process	3	(no change)	Western adopts a top down, fairly judgmental approach to fixed income management. High level decisions are mainly made by, and centred around, the judgement of key individuals.

Western Rating Sheet

Factor	Rating	Previous rating	Other comments
Risk Management	3	(no change)	The separate risk management team has a comprehensive set of risk monitoring tools at its disposal. Portfolio information is focused on supporting the managers in taking risk positions, rather than controlling risk across portfolios, which is consistent with the investment style.
Performance Analysis	2	(no change)	Performance data can be volatile as investment positions are focused on the medium term. The volatility is compounded when markets are highly correlated and portfolio positions are heavily influenced by a single factor. Performance has been consistent with the investment philosophy but has struggled to achieve the objective since the onset of the credit crisis, although it has recovered somewhat in 2009.
Other Systems	2	(no change)	The systems appear well developed with sophisticated packages for monitoring risk and checking both pre and post-trade compliance.
Client Service			Client reporting has improved as Western have resolved the problem of US style fund reports. Western is generally responsive to client demands.
Fees			Fees are in line with the wider market.
Overall rating	3	(no change)	Western is a strong bond manager and we believe that it has the ability to add value in the medium to longer term. Western is particularly well suited to managing a broad bond mandate which allows scope for asset allocation decisions.

Major new issues

Research update

We conducted a full research visit at Western's office in November 2009. It was a chance to review our opinion of the fixed income team following a number of changes in 2009. The two most high profile hires were:

- Andrew Belshaw as head of the London office. We have known Andrew for many years and rate him highly. We think his hire has strengthened Western. He has made a number of small improvements to the investment process to make it more robust. These include:
  - Introduction of daily meetings with the full team;
  - Change to position sizing. Andrew focuses more on limiting the downside and we expect him to be more aggressive in cutting positions when they hit the limit;
  - Better integration of risk within the investment process. At our meeting in November 2009, we spoke separately to the risk team and portfolio managers about the construction of a recent trade. We found that the two sides worked together to analyse the impact of the trade on portfolios as well as simulating different scenarios.
- Dipankar Shewaram as head of European credit. We have a more mixed view of Dipankar. He is confident, dynamic and has helped revamp the credit process in a team that had seen little changes until

the departure of Jonathan Gregory. He also has good top down asset allocation skills and is more focused on short/medium term performance than his predecessor. However, his track record at BlueBay is weaker. He was responsible for the BlueBay Global Credit fund during some of his time there. This fund was closed in Q2 08 after disappointing performance and falling AUM. We are therefore monitoring closely his performance at Western.

We believe that Andrew and Dipankar work together very well. This is important for the right decisions to be made around allocation to credit/government bonds and will drive performance going forward.

In addition to those signings, Western has hired a new financial analyst, who is scheduled to start in February 2010. He comes from Gartmore and knows the current US financial analyst, Ivor Schucking (who was hired from PIMCO). The previous European financial analyst, Otto Dichtl left in April 2009. This is a positive step and means that the credit team will shortly be fully resourced on the investment grade side. In high yield, Western is looking to hire an analyst to replace Omar Saeed who left in Q3 2009.

Staff turnover has increased in the past year at Western but the vast majority of it was the result of change initiated by Western and comes after a long period of stability. We are not therefore concerned by it and think it is positive that the manager has replaced some of the leadership after the very poor performance of 2008/early 2009.

We believe the appointment of Dipankar and Andrew will lead to a better integration of risk within the investment process. The two individuals come from managers which have a more disciplined approach to risk management and this has influenced the way investment decisions are now being taken at Western. For example, the risk team now attends strategy meetings and is involved at an earlier stage of the decision process.

Key issues to monitor

Business update

Total outflows at Legg Mason, the parent company of Western, were approximately $33 billion (c. 5% of AUM) in Q4 2009. The manager suffered $115bn of net outflows (16% of AUM) in 2009, with the majority coming from US clients. Fixed Income, Equity and Liquidity outflows were $24 billion, $4 billion and $5 billion, respectively in Q4 2009. At December 31, 2009, Fixed Income represented 54% of total AUM, equity 25% and liquidity 21%. Legg Mason reported a profit of £27.8m in Q4 2009 despite the large outflows and was profitable in the nine months December 31.

In Europe, Western continues to be successful at retaining the majority of its clients. There were however 4 clients redeeming c.£250m this quarter, mainly due to the changes in asset allocation views and poor performance in 2008. This is an area we are closely monitoring, particularly because the US business is suffering from outflows.

Aviva Investors – UK Property

Mandate

The Fund had £10.1m invested in the Aviva Investors UK Property Fund as at 31 December 2009.

The objective of the mandate is to outperform the IPD UK PPF Balanced Index by 1% p.a. over a rolling three year period.

Performance analysis

Aviva Investors Performance

	Q4 2009 (%)	12 months (%)	3 years (% pa)
Aviva Investors	8.5	0.8	-9.2
IPD PPFI All Balanced Funds Index Median	8.1	-3.4	-12.2
Relative	0.4	4.2	3.0

Source: WM Company

- In relative terms the fund is now outperforming the benchmark over all time periods.
- After commenting last quarter about Aviva's overweight cash position, they have purchased 8 properties totalling over £100m this quarter, including a large retail park in Torquay, a business park in Oxford, a hotel and two Sainsbury's supermarkets.
- Despite this, the fund is still holding an above average cash weighting which hindered performance slightly.
- Aviva expect that 2010 will see stabilisation in property values and that returns can recover robustly.

Aviva Rating Sheet

Factor	Rating	Previous rating	Other comments
Business	3	(no change)	We believe that the Aviva Group is committed to Aviva Investors (Aviva), as illustrated through the strategic plans to increase the earnings contribution from fund management. There is flexibility within the bonus structure to reward key individuals, but there is virtually no equity ownership. The property business continues to be a core business of Aviva.
Organisation & Staff	3	(no change)	We rate the lead fund manager (Robert Walton) highly and he has adequate support. The asset managers are less experienced but have impressed us to date. In addition, the team is supported by the wider Aviva property research team.

Aviva Rating Sheet

Factor	Rating	Previous rating	Other comments
Investment Process	4	(no change)	There is a well articulated and embedded process, with detailed top down (macroeconomic) and bottom up (property appraisal) assessments being integral to the process. The team is supported by a Strategy & Research team and there is a clear view of forward looking strategy and property specific business plans. All potential transactions are discussed at a monthly market review meeting, or whenever necessary for mid month transactions.
Risk Management	3	(no change)	There is a prescribed risk process and a formal procedure for delegating authority. Positions are assessed monthly at the market review meeting and every transaction is assessed on a wide range of risk metrics. Property appraisal forms exist for all existing and potential holdings.
Performance Analysis	4	(no change)	The fund has performed ahead of benchmark over the medium term and long term, by an amount commensurate with its low risk strategy. Investment professionals are able to articulate performance attribution and have a very good understanding of the drivers of performance. The fund is a low risk fund which aims to modestly outperform its benchmark. Its ungeared nature represents a headwind in strong markets.
Other	3	(no change)	
Systems			Aviva largely use standard off the shelf systems. CIRCLE is used for valuations, whereas accounting and property management are outsourced. Aviva do not have electronic access to the systems used for the outsourced processes but face-to-face contact is on a monthly basis. Aviva also use bespoke spreadsheets and appraisal systems for individual property analysis.
Client Service			Generally we have received positive feedback from clients regarding the quality and level of servicing provided by Aviva.
Fees			Fees are broadly in line with industry standard for this type of product.
Overall rating	4	(no change)	The investment process in place at Aviva is strong and we believe that it enables Aviva to formulate sound forward looking strategies. Stock sourcing and asset management disciplines are in line with the low risk ethos of the fund. The lead fund manager is of good quality and asset management is strong. This is a low risk fund suitable for broad property exposure and low variability of returns. Performance has been ahead of benchmark over the medium and long term.

Major new issues

Cash holdings and fund closure

Over recent months, Aviva has been successful in raising significant additional capital from investors. The fund size is now £925m, of which £225m (24%) is currently held as cash. Aviva has therefore taken the decision to close the fund to new investors, in order to protect the performance of the fund for existing investors. We support this course of action as any cash holdings will dilute performance in a positive return environment for property, such as the one we are currently seeing.

Aviva will queue investors outside the fund and will accept investments on a first come, first served basis as and when it feels comfortable it can do so. Aviva has indicated that up to £200m of capital could enter this queue shortly, if it is successful in recent business pitches. In order to invest the cash, Aviva is currently embarking on a strong acquisition phase, and is in varying stages of purchasing £125m of assets, some of which are in solicitors hands and should complete soon. This will bring the cash weighting down to £100m (11%), which is closer to Aviva's long term target of a 5-10% cash holding.

CB Richard Ellis Investors – European Property

Mandate

The fund invested £15m in CBRE's Europe (ex UK) Alpha fund in July 2007. As at 31 December 2009 the Fund had £11.0m invested in the Alpha fund.

The investment objective of the Alpha Fund is to provide a total return of between 8% - 10% p.a, net of all fees and expenses, by investing in European Property Funds. The Fund has given CBRE Investors the objective of outperforming the UK Retail Prices Index by 5% p.a. over a rolling three year period.

Performance analysis

CB Richard Ellis Investors Performance

	Q4 2009 (%)	12 months (%)
European Property Fund	-2.8	-21.9
UK Retails Price Index	1.3	2.4
IPD UK Pooled Property Index	10.4	-5.4
Relative to property benchmark	-13.2	-16.5

Source: WM Company and Investment Property Databank.
Note: The performance figures above include a 2 month lag.

- The Fund's performance target is benchmarked against the UK Retail Price Index on a quarterly basis. We have included figures from the IPD UK Pooled Property Index in the table above to be used as a more appropriate comparison as an equivalent European index is only published annually. The relative performance is not, therefore, representative of the Fund's performance relative to its peer group.
- This quarter the Alpha Fund underperformed the IPD UK Property benchmark by 13.2% and by 16.5% over the twelve month period.
- The marked downturn in the European property market has significantly reduced the prospects for the Alpha Fund to reach its performance target with a number of underlying funds experiencing significant valuation writedowns.
- While recent underperformance reduces the prospects of the Fund reaching the 8-10% p.a. return by the manager over the Fund's lifetime, we remain positive on CBRE's abilities to manage the Fund effectively.

CBRE Rating Sheet

Factor	Rating	Previous rating	Other comments
Business	3	(no change)	CBREI is the independent investment management affiliate of CB Richard Ellis, a global provider of real estate services. Like other major real estate businesses, CB Richard Ellis has been hit hard by the global economic downturn. However, progress has been made with capital raising, debt restructuring and cost savings. This progress has been reflected in a significant recovery in the share price from March 2009 lows. CBREI remains healthy with approximately $35 billion of property assets under management worldwide. The Global Multi Manager division has global assets under management of £1.9 billion plus approximately £0.4bn available to invest.
Organisation & Staff	3	(no change)	The Global Multi Manager division (GMM) was established in June 2006 when CBREI acquired Oxford Property Consultants (OPC). The team has grown since the acquisition. Recent recruitment has improved coverage of the Asian and North American markets, and CBREI are looking to recruit another European focussed portfolio manager. Fund manager Jeremy Plummer, who is the Managing Director of GMM, has been investing across continental Europe for more than 10 years. Senior directors have a profit share scheme which gives added security that these key individuals should remain in place in the medium term. They are not permitted to own shares in the CBRE Group.
Investment Process	3	(no change)	The team combines a broad top-down approach in terms of target countries and sectors with strong stock picking skills. The team uses research from the wider CBRE business in respect of more localised market conditions. Investments are focused on specialist fund managers with a track record for adding value.
Risk Management	3	(no change)	There is a good understanding of the inherent risks within the portfolio. Investment controls centre around the Investment Committee, responsible for approving all transactions and ensuring the strategies are in-line with the overall house view. The committee includes members external to CBREI. CBREI has an AAF 01/06 Internal Controls Report produced detailing all the processes within the business. The most recent annual audit did not identify any exceptions.

CBRE Rating Sheet

Factor	Rating	Previous rating	Other comments
Performance Analysis	2	(no change)	Long-term performance data is not yet available for the Alpha Fund which is nearing the end of its investment build-up phase. Unaudited performance since inception in mid-2007 to end Q3 2009 is -8.2% p.a. for the GBP Hedged Share class vs the target of +8% p.a. Whilst the performance is disappointing, it is largely market-driven and is expected to continue into 2010. That being said, we remain happy with CBREI's approach, fund choice and ongoing monitoring of underlying funds.
Other Systems	3	NR	There are a broad range of tools available to portfolio managers. Bespoke systems are in place for each stage of the investment process
Client Service			CBREI has been efficient with providing information to clients and Hewitt.
Fees			Fees are consistent with standard market levels.
Overall rating	3	(no change)	The marked downturn in the European property market has significantly reduced the prospects for the Alpha Fund to reach its performance target with a number of underlying funds experiencing significant valuation writedowns. However, it remains a well managed and diversified fund. We have confidence in the abilities of the management team which has long-term experience investing across Europe and managing fund of funds products.

Key issues to monitor

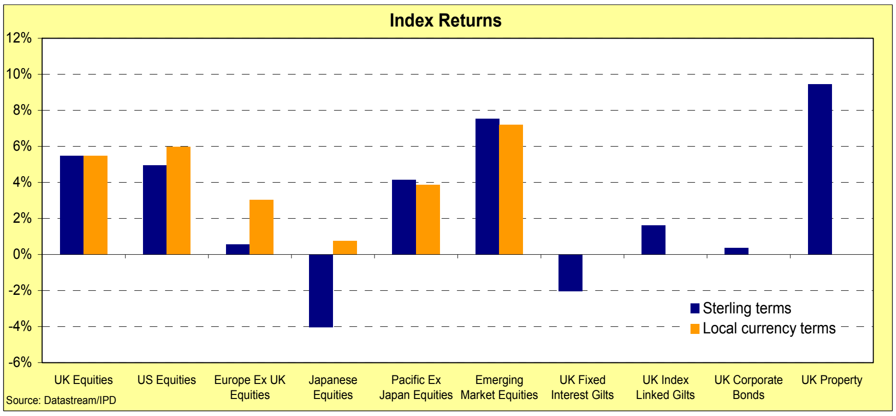
Recapitalisation of Underlying Funds

Lending terms for commercial property loans often specify a minimum loan to value ratio between the property value and loan outstanding. Due to falling values, a number of underlying property funds in the Alpha Fund have asset valuations that are close to breaching these loan to value covenants. Unless terms can be agreed with the lenders, these funds may need to raise equity to pay down part of the loan.

Values are stabilising in some markets which has clearly reduced the immediate need for some funds to recapitalise. However, the manager of the Protego Nordic Retail Fund has determined that further equity is required to remedy any potential loan to covenant breaches and finance ongoing capital expenditure projects. The proposal is to raise €40-50 million of equity (7-9% of total equity commitments) which will be offered to existing investors prorated to their existing commitment. CBREI have analysed the opportunity and decided that the Alpha Fund will participate in this capital raise. This will be funded by cash held in the Alpha Fund.

Market Review – Q4 2009

Summary: 3 months to 31 December 2009



General background

- Equity markets continued to rise over the three months to 31 December as positive economic data showed a recovery is underway in most of the major economies.
- Although yields on fixed interest gilts rose, yields on index-linked gilts fell as longer term inflation expectations rose and demand for inflation protection from investors increased.
- Corporate bonds produced a small positive return this quarter as credit spreads continued to decline.
- Commercial property rose very strongly as the IPD index gained 9.4%.

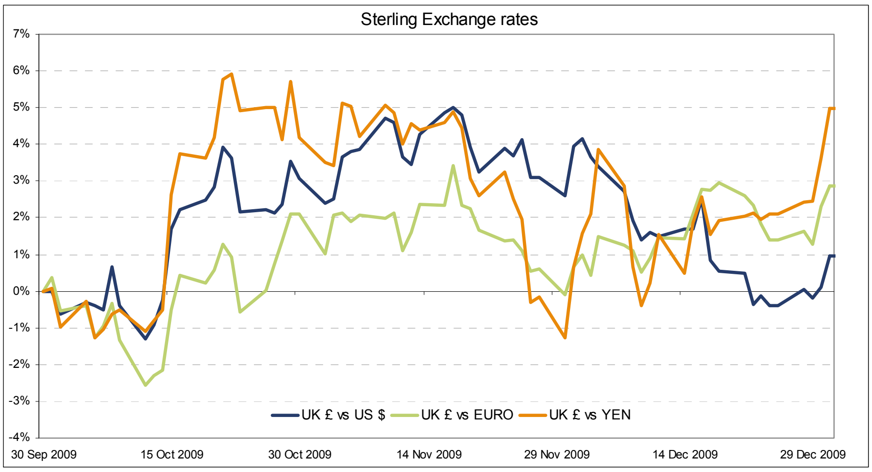
UK equities

- Ending a run of three quarters of underperformance, large cap companies outperformed small and mid cap companies by 9.7% and 3.6% respectively.
- Of the major sectors, the Basic Materials sector had the strongest performance by far (23.3%), reflecting a strong increase in commodity prices.
- The Financial sector returned -4.9%, making it the only major sector to post a negative return.
- The Construction sub-sector (-9.6%) posted the worst return of the sub-sectors despite the apparent stabilisation in the housing market.

Overseas equities

- In local currency terms, all of the major regions experienced positive returns this quarter with emerging market equities (7.2%) registering the highest return.
- Sterling rose sharply against the yen over the quarter causing returns on Japanese equities to fall from 0.8% to -4.0% when denominated in pounds rather than yen.
- Similarly, sterling rose against the euro over the quarter leading to a marginal return of 0.6% on European equities for a sterling investor.
- Globally, as in the UK, the Basic Materials sector (10.7%) had the best performance while the Financial sector (-2.5%) had the worst.

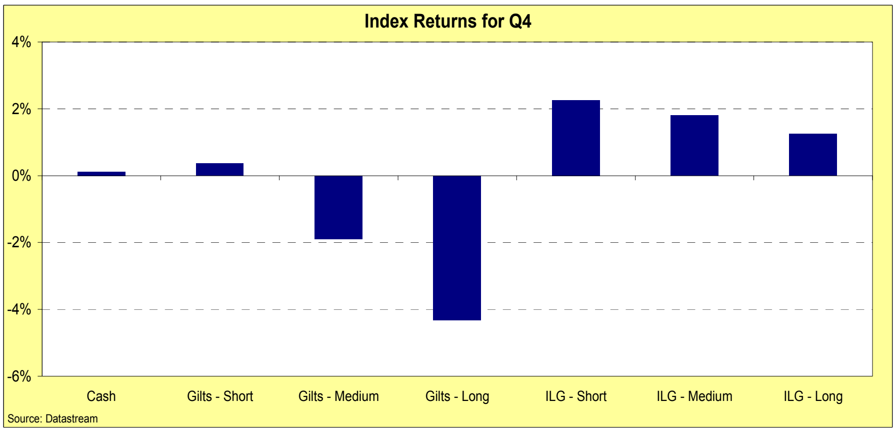
Currencies and interest rates



- Sterling rose against the yen (5.0%), the euro (2.9%) and the dollar (1.0%) offsetting some of the third quarter's decline against these currencies.
- Interest rates in the UK, US and Japan were unchanged once again over the quarter, with the focus being on other aspects of monetary policy.y
- In November, the Bank of England extended its quantitative easing program by £25bn to £200bn.
- Although the Federal Reserve is still purchasing securities under its quantitative easing program, in December they outlined plans for an exit strategy from their rescue package.

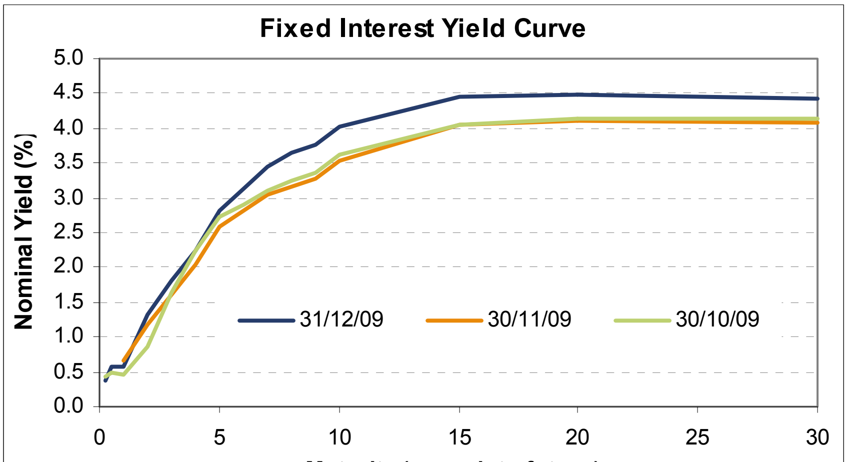
Gilt returns and yields

Overall gilts market

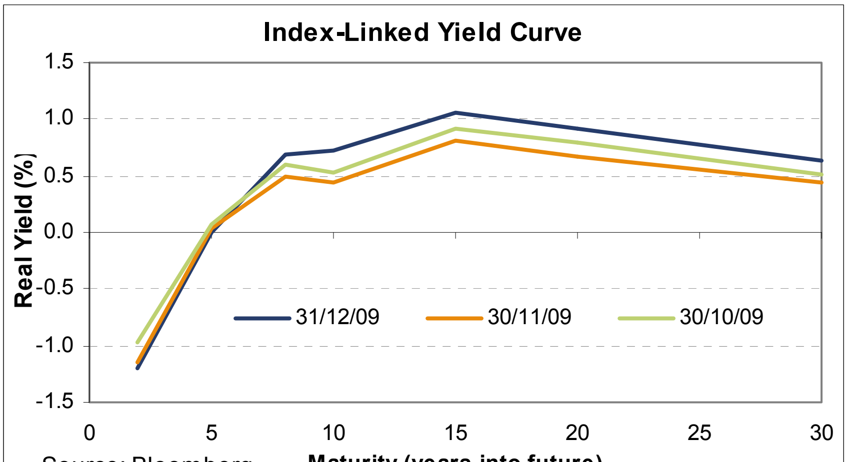


- Fixed interest gilt yields rose for all but the shortest maturities as the economic outlook improved and concerns over the level of government debt increased.
- The yields on index-linked gilts fell across all maturities as demand for inflation protection increased and longer term inflation expectations rose.
- Yields on longer dated fixed interest gilts rose more than the yields on shorter dated gilts which were anchored by exceptionally low base rates.

Fixed interest and index-linked yield curves

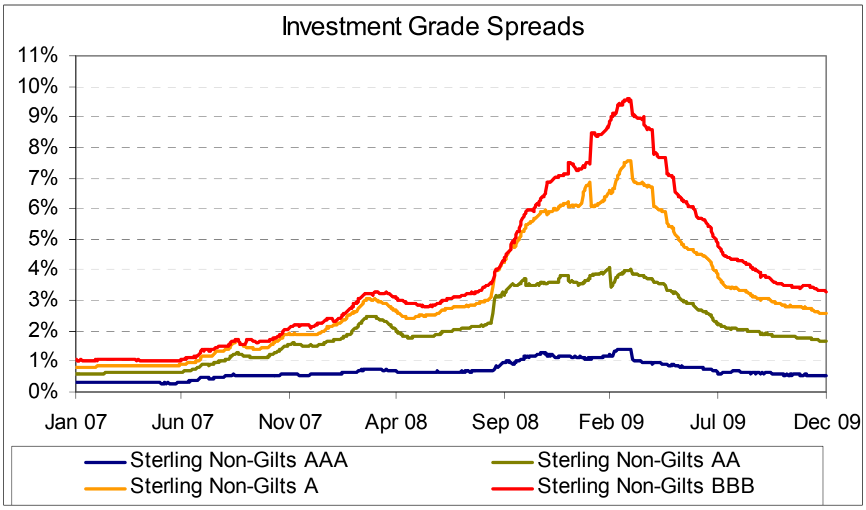


Source: Bloomberg



Source: Bloomberg

Corporate bonds



- Credit spreads – the difference between the yields on non-government bonds and equivalent maturity government bonds – declined again over the quarter with the credit spreads on investment grade bonds down to levels last seen in August 2008.
- The rise in underlying gilt yields more than offset the contraction in spreads causing the yield on the Sterling Non-Gilt AA index to increase from 4.8% as at 30 September to 5.1% as at 31 December.

Appendix A – Manager Mandates

Investment Manager	Mandate	Benchmark	Objective
AXA Rosenberg	Global Equity	MSCI World	To outperform the benchmark by 3% pa over rolling 3 year periods
Barclays Global Investors	Balanced	Composite benchmark	To track the benchmark
Aviva Investors	UK Property	IPD/PPFI All Balanced Funds Medium Index	To outperform the benchmark by 1% pa over rolling 3 year periods.
CB Richard Ellis	European Property	UK Retails Price Index (The IPD UK Pooled Property Index will also be used for comparison purposes)	Provide investors with a return of 8-10% pa, net of fees and expenses.
Western Asset Management	Global Bonds (After 23 March 2009 this is a corporate bonds mandate)	To 23/3/09 27% FTSE – A Gilts All Stocks Index, 27% Merrill Lynch Sterling Non-gilts All Stocks Index, 27% JP Morgan Global Gov. Bonds ex UK index, 19% FTSE – A ILG Over 5 Years Index From 24/3/09: Merrill Lynch Sterling Non-Gilts Index.	To outperform the benchmark by 0.75% pa, net of fees, over the medium term (3-7 years)
Standard Life Investment	Private Equity (European)	FTSE All Share (price index)	Absolute return
HarbourVest Partners	Private Equity (US)	MSCI World	No stated objective, just to produce returns which place HarbourVest in the top quartile in the industry

Note: Indices above are total return indices unless otherwise stated.

Appendix B – Manager Ratings

Hewitt's Ratings

Each criterion is individually rated from 1 (very poor) to 4 (very good). An overall rating is then derived for the product from the individual ratings. We do not assign a fixed weight to each criterion to establish the overall rating; instead we consider each case individually.

The overall rating score can be interpreted as follows:

4. The manager is very highly regarded and would appear on most short lists for a new appointment.
3. The manager is well regarded and may be on a short list for a new appointment.
2. We do not have serious concerns with this manager; however, it would not currently appear on a short list.
1. We have serious concerns about the manager and recommend that clients formally review the appointment.

The comments and assertions reflect our views of the manager and our opinion of its strengths and weaknesses.

We have recently updated our rating sheets to include consideration of a manager's Environmental, Social and Governance integration within the "Other" category.

In Q3 2009, we began including a separate rating and commentary on the capabilities of our equity managers in the area of Environmental, Social and Governance Integration. We did this as we believed, and continue to believe, that this consideration has an increasing importance as part of the investment management process and that an increasing number of Trustees no longer see these factors as peripheral, accepting that they can have meaningful impacts on investment manager performance.

As with the overall ESG rating, we believe that the effective incorporation of voting and engagement can truly add value to a long-term investment approach. Therefore, as an extension of our existing analysis, our assessment of investment manager performance in these areas now includes a more focussed set of questions relating to voting and engagement. Although we had previously considered voting and engagement as part of the overall manager evaluation, we believe that the specific focus of the additional questionnaire offers a more granular insight into the investment manager capabilities in these areas.

This enhancement also coincides with the publication of the Walker Report published in November 2009, which highlighted best practice guidelines in these areas and flagged the responsibility of pension funds, as long-term investors, to take active decisions in these fields. The more detailed evaluation of investment managers in these disciplines, perhaps coupled with our newly developed consolidated monitoring report on key voting and engagement measures, not only moves the Trustees more closely in line with the best practice recommendations of both the Walker Report and the specific section of the Myners Review (relating to the Institutional Shareholder Committee's Code on Responsibilities of Institutional Investors), but also offers yet another valuable insight into the relative strengths of investment managers' processes.
