

THE HIGHLAND COUNCIL
RESOURCES COMMITTEE
INVESTMENT ADVISORY GROUP

Minutes of Meeting of the Investment
Advisory Group held in Committee Room 1,
Council Headquarters, Glenurquhart Road,
Inverness on Wednesday 24 May 2006 at
2.15 pm.

PRESENT

Mr J N Matheson
Mrs G McCreath
Mr T Jackson

Mr D W Briggs
Mr A Gordon
Mr A Campbell (Western Isles Council)

Officials in attendance:-

Mr B Williams, Head of Corporate Finance, Finance Service
Mrs L Dunn, Committee Administrator, Corporate Services

Also in attendance:-

Mr A Howse, Fidelity International Limited (Item 3 only)

Mr J N Matheson in the Chair

1. APOLOGIES FOR ABSENCE

Apologies for absence were intimated on behalf of Mrs E MacRae, Mr W J Smith and Mr B J Murphy.

2. PENSION FUND INVESTMENT REPORTS

There was circulated to Members only Report No INV/05/06 by the Director of Finance which highlighted the diversification of the Pension Fund's assets under the management of Baillie Gifford; Alliance Bernstein; Legal & General; and Fidelity and Schroders for the quarter ended 31 March 2006. The report also provided information on the Managers' investment performances, measured against their respective strategic benchmarks.

It was reported that the investment performance of the Combined Fund for the quarter ended 31 March 2006 was 1% above the rolling three year collective benchmark return.

In relation to the Managers' individual performances against their respective strategic benchmarks, the report advised as follows:-

Baillie Gifford

Performance over the quarter exceeded the benchmark by 1.1%. The return for the year to date was favourable at 33.2% against the benchmark of 31.1%. Managers continued to favour quality, growth companies and had maintained an overweight position in North American and emerging markets.

Alliance Bernstein

The return for the quarter was 8.8%, which was an over-performance against the benchmark of 7.5% and the return for the year to date exceeded the benchmark by 1%. The Managers favoured continued exposure to financials, energy and industrial commodities and selected emerging market companies. They had also increased weightings in utilities stocks over the last few quarters in anticipation of strengthening returns.

Legal & General

The Fund's assets were invested in UK Equity, All Stocks Gilts and Over 5 Year Index-Linked Gilts pooled funds. As mandated the Managers tracked, within specified tolerances, the total return of the relative market indices for each of the sector index funds where invested.

Fidelity

The Portfolio delivered a marginal out-performance over the quarter with a return of -0.5% against the benchmark of -0.7%. The Manager had maintained an underweight position in government bonds in favour of asset-backed securities to maintain investment diversification and counter potential risks of increasing emerging merger and acquisition activities in the United States of America, Europe and Japan.

Schroders

The Portfolio's value, net of income and interest, increased by 4.7% in the quarter and stood in total at £80.6m as at 31 March 2006. Over the quarter the portfolio return had been 5.6% against a benchmark of 4.8% and the return for the year was 22.6% against a benchmark of 20.6%. The Managers had increased allocations to the office sector and reduced those of the retail sector in line with recent moves in the markets and they intended to research new opportunity funds and exposure to alternative property sectors.

The Group **NOTED** the report.

3. PRESENTATION BY FIDELITY INVESTMENT SERVICES LIMITED

Mr Andy Howse from Fidelity Investment Services Limited gave a presentation to the Group outlining recent investment performance and future investment strategy proposals.

There was tabled an investment management report to Members which highlighted the following key areas:-

- Benchmark and Performance Objective
- Total Fund Performance to 31 March 2006
- Component Performance to 31 March 2006
- Market Background
- Asset Allocation Position as at 31 March 2006
- UK Gilt Portfolio Over 12 Months to 31 March 2006
- UK Corporate Bond Portfolio Over 12 Months to 31 March 2006
- International Bond Portfolio Over 12 Months to 31 March 2006
- UK Index Linked Portfolio Over 12 Months to 31 March 2006

On speaking to the report, Mr Howse advised that recent changes to strategy included:-

- Reduced exposure to longer-dated bonds (UK 50 and 30 year government bonds) was expensive and more issuance;
- Reduced selective exposure to telecommunication bonds and increased holdings within the asset-backed and banking sector. LBO activity (systematic risk) and risk of an economic downturn was the motivation behind this;
- The overall fund duration of the UK Gilt and Corporate bond funds was kept short in the quarter in anticipation of rising bond yields later in the year;
- Profits on index-linked positions in the quarter in UK bond mandates was taken;
- In February, the fund manager positioned the portfolio to benefit from a steepening of the US yield curve (o/w 10, u/w 30 year). The trade was implemented given the view that the Fed was likely to pause in its tightening cycle during 2006;
- Global Fund : Maintained Defensive position : u/w governments, u/w corporate bonds, o/w asset backed.

In summary, Mr Howse advised that:-

- recent softening of bond markets follows reasonable returns but low volatility;
- corporate bonds had performed in line with gilts and lower quality had outperformed AAA;
- demand from pension funds had dominated longer end of the gilt market
- at present sterling conventional bonds were preferred to index-linked and international bonds; and
- greater market volatility should help active management.

The Group **NOTED** the presentation and the Chairman thanked Mr Howse for attending the meeting.

It was **AGREED** that Fidelity's quarterly Portfolio reports be issued direct to Members for information.

The meeting closed at 3.00 pm.