hpc health professions council

Finance and Resources Committee Meeting – 20th November 2007

Investment manager report

Executive summary and recommendations

Introduction

In the Investment Policy, Section 5, the Rensburg Sheppards fund manager is invited to provide a summary report of fund performance and address any questions the Committee may have relating to the funds under Rensburg Sheppard's management.

Decision

The Committee is requested to note the Rensburg Sheppards report and approve continuation of the Investment fund manager (Rensburg) as appropriate.

Background information

The Rensburg Sheppards funds managed achieved an annual return of 9.4% for the 12 months ending September 2007 and 11.3% for the 12 months ending September 2006. Rensburg cited the benchmark performance for the annual period ending Sept 2007 as a 9.7% return.

The investment strategy requires that "the portfolio to be managed in a way that will balance immediate income with long term capital appreciation in accordance with HPC's Investment Policy document. No benchmark was set, but the Trustees confirmed that the portfolio should remain positioned on the lower risk side of neutral." See also separate paper to review the HPC Investment Policy.

Resource implications

Nil

Financial implications

Rensburg Sheppards commission charges of approx £9k per annum. Rensburg Sheppards charge a flat fee and transaction charges equating to about 0.5% of the funds managed as commission.

Appendices

- Rensburg Sheppards letter dated 15th October 2007

Date of paper

8th November 2007

Rensburg
Sheppards

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Member firm of the London Stock Exchange. Member of LIFFE
Authorised and regulated by the Financial Services Authority
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Our Ref : JM/VM/COUNC0004

15th October 2007

Charlotte Milner
Health Professions Council
Park House
184 Kennington Park Road
London
SE11 4BU

Dear Charlotte

Health Professions Council

I am writing to enclose the quarterly report for the period 30th June to 30th September 2007. Over this period the portfolio has shown a net fall in value of £45,060 to £1,986,276.

On a time weighted total return basis the portfolio has fallen by –2.1% compared to a fall of +0.3% for the benchmark. Over the rolling twelve months the portfolio has appreciated by 9.4% compared to 9.7% for the benchmark.

The last quarter was dominated by lack of liquidity in credit markets. The future direction of bond, equity or property markets will be heavily influenced by how the authorities respond and how long it will take.

UK bonds had very variable performances over the quarter with parts falling sharply, parts moribund and government securities rising strongly, benefiting from an investor flight to safety. The portfolio's fixed interest investments fell by –0.8% compared to the benchmark Government securities index which rose by 4.1% (but has gained only 0.6% over the past year). With gilt yields ranging from 5% on short dated maturities to 4.25% on long dated stocks, it was felt better to hold cash (which provided a higher running yield) rather than add to gilts and be at risk that the attempted reliquification of markets is seen as inflationary. Corporate bonds fared slightly worse but still managed small gains with AAA corporate bonds rising by 3.1% and AA bonds by 1.1%. In the light of the recent turmoil underlying covenants are being questioned and any concerns are being treated adversely by the market, to this extent the high yielding Bradford & Bingley holding has been adversely affected following the problems at Northern Rock. In other parts of the credit and credit derivatives markets there is very little liquidity making it difficult for institutions to value their holdings and forcing them to make conservative assessments. For example, UBS has announced write downs of US$1.3bn and Citibank of US$6bn recently.

The UK equity market fell by 11% in July before recovering the majority of the fall to close down -2.6% for the quarter. The UK equity proportion of the portfolio had a disappointing quarter falling by -3.8%. Leadership in the recovery has been extremely stock specific with eight stocks (of which 6 were resource stocks) appreciating by over 10%, markets taking the view that increasing demand from the emerging countries will more than counter any western economic weakness. However, stocks related to the domestic UK economy like housebuilders, retailers and those adversely affected by the credit squeeze like financial institutions (in particular Northern Rock) have performed very poorly with 28 of the stocks in the FTSE 100 index falling by more than 10%. The FTSE 250 index fell by 4.3% underperforming partially because takeover premiums dissipated as credit became more difficult for acquirers, and also because the index is more domestically orientated and does not have as large an exposure to the mining and oil sectors. Given the length of the current economic cycle it is disappointing that western governments have continued to overspend, rather than repair their balance sheets, leaving little room for manoeuvre if economies do slow. If the Labour Government is now looking for re-election in 2009 they may need to take some painful decisions early, especially as some of the problems to be faced are Gordon Brown's legacy.

The portfolio was underweight in ex-mortgage banks and exposure to homebuilders was reduced earlier in the year. We have also been negative on consumer related stocks for some time with the only retailer held being Kingfisher, which owns B&Q but 50% of revenues are now derived from abroad, mainly France, Poland and China. The basic materials sector appreciated by 14.2% over the 3 months, but yields just 1.4% compared to a market average of 3%. The next best sector, telecommunications, appreciated by 4.5%. The underperformance is primarily due to the underweight position in the resource stocks which we unfortunately reduced early with a sale of BHP Billiton and reduced the holding of Merrill Lynch World Mining which is shown in the valuation under international equities. The scale of volatility of both the total market and individual stocks and sectors has been quite extreme and the process of finding an equilibrium has been hampered by short term speculative flows.

Interest rates have been increased five times since last Summer from 4.5% to 5.75% and the recent credit crisis has meant that the tightening process initiated by the Bank of England may now be going further than was intended or necessary. Expectations for further interest increases have dissipated and markets are starting to consider a possible cut by the Bank of England. So far the UK economy has remained reasonably robust, but it is too early to tell how seriously consumer sentiment has been impacted, but markets have clearly taken a pessimistic view. The Bank of England could cut interest rates on the basis that there has now been excessive tightening in the UK economy, but given the amount of criticism they received for their about turn on the credit markets, and in particular Northern Rock, they may be reluctant to make an immediate about turn on interest rates.

The US equity market, like the UK, has also recovered much of the losses seen earlier in the quarter, rising by 1.7% in local currency but only 0.5% in sterling (having been down by 10%). This market has also distinguished between

stocks related to the domestic economy which have performed poorly and those which are seeing strong overseas growth and benefiting from a weak US dollar. To this extent the enormous US trade gap has been narrowing. We have purchased a holding in AXA Framlington American Growth Fund which looks to invest in companies that have real growth rather than cyclical growth. US new house sales have fallen by 40% since October 2005 and median house prices have fallen by 7.5% over the past year, with many commentators predicting worse to come. Indeed the former Governor of the Federal Reserve says there is a 50/50 chance the US economy will go into recession. But the new Governor, Ben Bernanke, has cut interest rates sharply from 5.25% to 4.75% in an attempt to significantly reduce these odds.

In Europe economic growth has remained strong but there are concerns that the continuing rise in the value of the euro is impacting competitiveness and reducing the benefit of export growth. The FTSE Europe (ex-UK) fell by 3.0% in local currency but this translated into a gain of 0.8% for sterling based investors.

The best performing sector was the Far East (ex-Japan) which rose by 12.0% in sterling and showed a very strong recovery in September fuelled by belief that economic growth will continue, that Far Eastern companies have strong balance sheets, countries have strong trade surpluses and governments have large currency reserves. However, the domestic Chinese market is now on 51x earnings and India is on 25x earnings, which looks expensive relative to 13x for the UK market and a prospective PE of 14x for the US market.

Japan's economy continues to thwart expectations of those looking for an economic recovery, but the most recent quarterly Tankan survey suggests the economy has remained firm. The resignation of Mr Abe and replacement by 71 year old Mr Yasuo Fukuda should help the political process which had become stalled. There is good value in Japanese equities, especially by historic standards, but there appears little pressure for this to be realised in the near future. Nevertheless, if the growth in demand from emerging economies continues, Japanese companies will benefit.

The main question for investors is whether economic leadership can pass from indebted western countries to the emerging economies and can they continue to grow without any impact from slower western growth. The scale of the development of some of these economies has been spectacular but the US economy is still one third of world GDP and it is too early to see whether the current market confidence can withstand any weaker economic numbers. Cutting interest rates may reduce the pain but it will not really solve the problems of consistent overspending. Higher food prices, oil and raw material prices and rising wage costs in both India and China may force the western authorities into difficult decisions between promoting growth (or containing any slowdown) and fighting inflation, which has implications for bond, equity and property markets. Geo politics continues to also provide cause for concern, particularly President Putin's positioning ahead of elections in December, but also Iran/Iraq and simmering tensions elsewhere in the Middle East.

In the last quarter we have clearly been too conservative but unlike the other short term setbacks that markets have seen over the last few years this has felt more fundamental and the risks of disappointment have increased.

With kind regards.

Yours sincerely

James Minett
Senior Investment Director

Encl.