

# Glebe Administration Board

## Diocesan Endowment Report on Investment Performance to 31 December 2011

### Introduction

1. The purpose of this paper is to report on the investment performance of the Diocesan Endowment for the 12 months ended 31 December 2011.

### Background

#### *Investment Objective for the Diocesan Endowment*

2. The investment objective is set out in the Investment Policy Statement for the Diocesan Endowment and is as follows –

“To achieve a real rate of return over rolling 5 year periods of 5% per annum net of external investment management fees and adjusted for tax effects, subject to –

- (a) preserving the real value of the Diocesan Endowment over rolling 10 year periods with a 70% probability, and
- (b) the sum of the distributions from the Diocesan Endowment plus administrative and other costs (not including external investment management expenses) not exceeding 5%, on average over rolling 5 years periods.”

3. The Investment Policy Statement can be found on the website at <http://www.sds.asn.au/Site/104303.asp?ph=cb>.

#### *Asset Classes and Strategic Asset Allocation*

4. The property of the Diocesan Endowment is invested in accordance with the following asset classes, strategic asset allocation (SAA) and asset class ranges –

<b>Asset Class</b>	<b>Min %</b>	<b>SAA %</b>	<b>Max %</b>
Australian Shares	15	23	35
Overseas Shares – Developed	0	16	28
Overseas Shares – Emerging	0	2	5
St Andrew’s House Fund <sup>1</sup>	20	29	33
<b>Total Growth Assets</b>	<b>50</b>	<b>70</b>	<b>80</b>
Australian Sovereign Bonds	0	9	20
Overseas Sovereign Bonds	0	7	20
Banking Services (net capital) <sup>2</sup>	10	13	20
Investment Cash (not included in Banking Services)	0	1	30
<b>Total Defensive Assets</b>	<b>20</b>	<b>30</b>	<b>50</b>

1. GAB, as trustee of the Endowment, is a holder of a 50% interest in St Andrew’s House (the other 50% stakeholder is Anglican Church Property Trust Diocese of Sydney as trustee of the Endowment of the See).
2. The strategic asset allocation for the banking services reflects the amount of capital of the Endowment allocated to the banking services activities (lending, deposit taking and treasury activities) undertaken by the Endowment.

### Invested Funds

5. Investments in the Australian shares, Overseas shares, Overseas Shares – Emerging Markets, Australian Sovereign bonds and Overseas Sovereign bonds asset classes are undertaken through funds operated by Mercer Investment Nominees Limited and approved by GAB. Each of these funds is a multi-manager fund, meaning that the property invested in a Mercer fund is, in turn, invested in underlying funds operated by fund managers who are specialists in the relevant asset class.
6. The approved funds for each of these asset classes is as follows –

Asset Class	Mercer Investment Product
Australian Shares	Mercer Socially Responsible (SR) Australian Shares Fund
Overseas Shares – Developed (hedged)	Mercer Hedged Overseas Shares Plus Fund
Overseas Shares – Developed (unhedged)	Mercer Overseas Shares Plus Fund
Overseas Shares – Emerging (unhedged)	Mercer Emerging Markets Fund
Australian Sovereign Bonds	Mercer Australian Sovereign Bonds Fund
Overseas Sovereign Bonds (hedged)	Mercer Overseas Sovereign Bonds Fund

7. GAB considers that investing in multi-managed funds benefits the Endowment by –
  - (a) giving it exposure to a range of investment managers in each asset class, thus reducing the risks associated with over-exposure to any one manager, and
  - (b) requiring that Mercer, rather than GAB, monitor and assess the performance of each investment manager, and
  - (c) simplifying the investment processes of GAB and reducing the overall costs of administering the Endowment.
8. The oversight of the investment in St Andrew’s House, the management of the Legacy Assets, the undertaking of Banking Services and the management of cash is undertaken by staff of Sydney Diocesan Secretariat on behalf of GAB.

### Investments of the Diocesan Endowment

9. The following table sets out the investments of the Endowment as at 31 December 2011 (with information as at 31 December 2010 included for comparison) –

Assets	As at 31 December 2011		As at 31 December 2010	
	\$000s	% weight	\$000s	% weight
<b>Growth Assets</b>				
Australian Shares	23,616	21.9	26,752	24.4
Overseas Shares – Developed	16,753	15.6	17,530	16.0
Overseas Shares – Emerging	2,452	2.3	2,820	2.6
St Andrew’s House Fund	33,597 <sup>1</sup>	31.2	31,629	28.8
Legacy Assets	14	0.0	1,032	0.9
<b>Total Growth</b>	<b>76,432</b>	<b>71.0</b>	<b>79,763</b>	<b>72.6</b>
<b>Defensive Assets</b>				
Australian Sovereign Bonds	8,295	7.7	9,953	9.1
Overseas Sovereign Bonds	4,232	3.9	4,297	3.9
Banking Services	11,651	10.8	14,070	12.8
Investment Cash	6,991	6.5	1,736	1.6
<b>Total Defensive</b>	<b>31,169</b>	<b>29.0</b>	<b>30,056</b>	<b>27.4</b>
<b>Total (Net Assets)</b>	<b>107,601</b>	<b>100</b>	<b>109,819</b>	<b>100</b>

1. The impact of the revaluation of St Andrew's House as at 31 December 2011 has not been taken into account in determining the value of the interest of the Diocesan Endowment in the St Andrew's House Fund, since the revaluation has not been reviewed by St Andrew's House Corporation or its external auditor. The valuation report indicates an increase in value from \$83.0 million as at 31 December 2010 to \$99.5 million as at 31 December 2011.
10. GAB is holding substantially more cash for investment purposes (6.5% of the portfolio as at 31 December 2011) than is warranted by the SAA referred to in paragraph 4. This reflects a short term allocation or tilt away from investments in overseas sovereign bonds which are considered to be over-valued.
  11. The hedging policy of GAB in relation to the Overseas shares asset classes is that 50% of the exposure is hedged back to Australian dollars, and 50% is unhedged. Acting on the advice of the investment manager, GAB has adopted a short term tilt with 60% of the exposure unhedged and 40% hedged on the basis that the Australian dollar is considered to be over-valued against other currencies, and is expected to fall in value as against those other currencies. The holding of Overseas sovereign bonds is fully hedged back to Australian dollars.

## Investment Performance

12. The performance of the portfolio on a calendar year to date basis and for the 12 months ended 31 December 2011 was as follows –

Assets	12 months Ended 31 December 2011 %		
	Return (after fees)	Index	Variance
<b>Growth Assets</b>			
Australian Shares	(8.0)	(11.0)	3.0
Overseas Shares – Developed (hedged)	(6.7)	(2.0)	(4.7)
Overseas Shares – Developed (unhedged)	(9.0)	(5.3)	(3.7)
Overseas Shares – Emerging (unhedged)	(20.7)	(18.4)	(2.3)
St Andrew's House	6.2 <sup>1</sup>	8.7	(2.5)
<b>Defensive Assets</b>			
Australian Sovereign Bonds	12.2	13.4	(1.2)
Overseas Sovereign Bonds (hedged)	10.4	11.1	(0.7)
Banking Services	21.3 <sup>2</sup>	15.0	6.3
Cash	6.5	4.9	1.6
<b>Total Return on Net Assets Vs Weighted Index</b>	<b>2.1</b>	<b>2.9</b>	<b>(0.8)</b>

1. The impact of the revaluation of St Andrew's House as at 31 December 2011 has not been taken into account.
2. The impact of the need to provide for the potential non-recovery of part of a loan made as part of GAB Banking Services has not been taken into account as the amount of any provision has not yet been considered by GAB.

The performance of each asset class is measured against the following indices –

<b>Asset Class</b>	<b>Index</b>
Australian Shares	S&P/ASX 300 Accumulation Index
Overseas Shares –Developed (hedged)	Morgan Stanley Capital International World Index (ex Aust) hedged into \$A with net dividends reinvested
Overseas Shares – Developed (unhedged)	Morgan Stanley Capital International World Index (ex Aust) in \$A with net dividends reinvested
Overseas Shares – Emerging (unhedged)	Morgan Stanley Capital International Emerging Markets Free Float Index
St Andrew's House	CPI plus 5% (being the Investment Objective)
Australian Sovereign Bonds	UBSW Australian Treasury Bond Index (All Maturities)
Overseas Sovereign Bonds	JP Morgan Global Government Bond Index in \$A (Hedged)
Banking Services	Benchmark return of 15% pa
Cash	Reserve Bank of Australia cash rate

## Comments on Externally Managed Investments

13. Mercer has reported in writing to GAB about the performance of the investments in the Mercer multi-managed funds for the December quarter, and made a presentation to a joint meeting of GAB and the Investment and Finance Committee of the Property Trust. (Mercer also manages investments for the Property Trust's Long Term Pooling Fund.) The comments in relation to each asset class invested with Mercer can be summarised as follows.

### ***Australian Shares***

14. The investments of the Mercer SR Australian Shares Fund, in which the Endowment invests, are invested in the socially responsible funds of 3 underlying investment managers. During the December quarter the Fund marginally underperformed the index primarily due to the stock selections of two of the underlying fund managers and, in particular, stocks which underperformed by reason of downwards earnings revisions.

### ***Overseas Shares – Developed***

15. The investments of the Mercer Overseas Shares Fund, in which the Endowment invests, are invested through the funds of 6 underlying investment managers. During the December quarter the asset class underperformed the index by almost 2.5% due primarily to underperformance of 3 managers, one of which had an overexposure to a major stock which underperformed by reason of a downwards earnings revision, and the other 2 of which were exposed emerging markets which were impacted by the poorer global economic environment during the quarter. Two of the other managers strongly outperformed the index.

### ***Emerging Markets***

16. The investments of the Mercer Emerging Markets Fund, in which the Endowment invests, are invested through the funds of 2 underlying investment managers. The Fund underperformed the index during the December quarter, primarily because of slowing growth in the Indian economy, to which the fund of one manager was particularly exposed.

### ***Australian Sovereign Bonds***

17. The investments of the Mercer Australian Sovereign Bond Fund, in which the Endowment invests, are invested through the funds of 3 underlying investment managers. The Fund marginally underperformed the index during the December quarter because the performance of one of the managers was impacted by retaining a greater exposure to cash, and hence missing out on the positive impact of lower bond yields during the period.

### **Overseas Sovereign Bonds**

18. The investments of the Mercer Overseas Sovereign Bond Fund are made through the funds of 3 underlying investment managers. The Fund also underperformed index during the December quarter due to the fund's short duration position which was impacted as yields fell (particularly in Europe).

### **Comments on Internally Managed Investments**

19. The following comments are made about the St Andrew's House and banking services asset classes, which are managed by staff of Sydney Diocesan Secretariat.

#### **St Andrew's House**

20. The value of the interest in the St Andrew's House fund continue to increase, principally by reason of the retention of cash in the St Andrew's House fund for major capital works which have now commenced. The largest asset of the St Andrew's fund, the St Andrew's House building, is only formally revalued once each year. The impact of the revaluation as at 31 December 2011 is not yet reflected in the 12 month performance results.

#### **Banking Services**

21. Banking services comprises the lending, deposit taking and treasury activities undertaken by the Endowment. For prudential purposes, a portion of the capital of the Endowment is allocated to banking services – that portion is 12.5% of the total amount of the loans made by GAB from time to time. The return is ahead of the index because the amount of capital allocated to banking is decreasing because the total amount of the loans made by GAB is decreasing. However, the return as at 31 December 2011 does not yet take into account a provision for non-recovery of part of a loan made as part of GAB Banking Services. GAB has not yet considered the amount which should be provided.

### **Performance having regard to the Investment Objective**

22. The investment objective for the Diocesan Endowment (set out in paragraph 2 of this report) can be broadly restated as the maintenance of the real value of the capital of Endowment and an additional return of 5% per annum for spending by the Synod and paying of the expenses of the Endowment.
23. The restructure of the investments of the Endowment (in particular, the settling of revised investment policies including approved asset classes and the adoption of a new strategic asset allocation) was undertaken in June 2010. Over the period 30 June 2010 to 31 December 2011, the value of the net assets of the Endowment increased from \$103.4 million to \$107.1 million. Accordingly, given the current inflation rate (of about 3% per annum), the real value of the net assets of the Endowment has not been maintained over that period. However, the impact of the expected significant revaluation of St Andrew's House as at 31 December 2011 has not yet been taken into account. When the revaluation is taken into account, the real value of the Endowment over the period 30 June 2010 to 31 December 2011 will have been maintained.

MARK PAYNE  
**Chief Executive Officer**

20 February 2012