

Glebe Administration Board

Diocesan Endowment

Report on Performance to 30 September 2011 and 31 October 2011

Introduction

1. The purpose of this paper is to report on the investment performance of the Diocesan Endowment for the periods ending 30 September 2011 and 31 October 2011. September was a particularly difficult month with international economic instability (particularly in Europe) having a significant negative impact on equities markets. However, market sentiment improved in October and this had a significant positive impact on equities markets. For this reason, information for both September 2011 and October 2011 is included in this report.

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 –

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

Notes:

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.

Measurement of Performance

9. The performance of each of the asset classes is monitored according to the indices referred to in paragraph 15.

Risk

10. GAB monitors the risk associated with the investment of the Endowment on an ongoing basis. The ways in which risk is monitored are described in the Investment Policy Statement.

Investments of the Diocesan Endowment

11. The following table sets out the investments of the Endowment as at 30 September 2011 and 31 October 2011 (with information as at 31 December 2010 included for comparison) –

Assets	As at 30 September 2011		As at 31 October 2011		As at 31 December 2010	
	\$000s	% weight	\$000s	% weight	\$000s	% weight
Growth Assets						
Australian Shares	23,351	21.9	25,318	23.2	26,784	25.2
Overseas Shares – Developed	15,111	14.1	15,700	14.4	17,530	16.0
Overseas Shares – Emerging	2,395	2.3	2,564	2.4	2,820	2.6
St Andrew's House	33,182	31.1	33,386	30.6	31,629	28.8
Total Growth	74,026	69.4	76,969	70.6	79,763	72.6
Defensive Assets						
Australian Sovereign Bonds	9,708	9.1	9,646	8.8	9,953	9.1
Overseas Sovereign Bonds	4,363	4.0	4,358	4.0	4,297	3.9
Banking Services	11,798	11.1	11,780	10.8	14,070	12.8
Investment Cash	6,771	6.4	6,304	5.8	1,736	1.6
Total Defensive	32,640	30.6	32,088	29.4	30,056	27.4
Total (Net Assets)	106,666	100	109,057	100	109,819	100

12. It is to be noted that GAB is holding substantially more cash for investment purposes (5.8% of the portfolio as at 31 October 2011) than is warranted by the SAA referred to in paragraph 4. In particular, this reflects a short term allocation or tilt away from investments in overseas sovereign bonds.

Investment Performance

13. The performance of the portfolio on a calendar year to date basis and for the 12 months ended 30 September 2011 was as follows –

Assets	Calendar Year to 30 September 2011			12 months Ended 30 September 2011		
	Return (after fees)	Index	Variance	Return (after fees)	Index	Variance
Growth Assets						
Australian Shares	(11.3)	(11.7)	0.4	(7.8)	(8.7)	0.9
Overseas Shares – Developed (hedged)	(15.7)	(14.4)	(1.3)	(5.3)	(1.3)	(4.0)
Overseas Shares – Developed (unhedged)	(9.2)	(8.0)	(1.2)	(7.8)	(4.5)	(3.3)
Overseas Shares – Emerging (unhedged)	(19.3)	(17.6)	(1.7)	(19.0)	(16.5)	(2.5)
St Andrew's House	4.9	7.0	(2.1)	16.6	8.8	7.8
Defensive Assets						
Australian Sovereign Bonds	8.9	9.9	(1.0)	8.4	9.1	(0.7)
Overseas Sovereign Bonds (hedged)	8.7	9.0	(0.3)	7.3	7.8	(0.5)
Banking Services	15.9	11.1	4.8	21.7	15.0	6.7
Cash	3.4	2.6	0.8	6.3	5.3	1.0
Total Return on Net Assets Vs Weighted Index	(0.3)	0.1	(0.4)	5.0	3.1	1.9

14. The investment performance of the portfolio on a calendar year basis and for the 12 months ended 31 October 2011 was as follows –

Assets	Calendar Year to 31 October 2011 %			12 months Ended 31 October 2011 %		
	Return (after fees)	Index	Variance	Return (after fees)	Index	Variance
Growth Assets						
Australian Shares	(3.0)	(6.5)	3.5	(1.3)	(3.9)	2.6
Overseas Shares – Developed (hedged)	(4.9)	(2.0)	(2.9)	(0.3)	3.8	(4.1)
Overseas Shares – Developed (unhedged)	(8.4)	(6.4)	(2.0)	(8.9)	(6.1)	(2.8)
Overseas Shares – Emerging (unhedged)	(17.1)	(14.5)	(2.6)	(18.0)	(14.6)	(3.4)
St Andrew's House	5.6	7.4	(1.8)	16.5	8.6	7.9
Defensive Assets						
Australian Sovereign Bonds	8.2	9.0	(0.8)	7.9	8.6	(0.7)
Overseas Sovereign Bonds (hedged)	8.6	8.7	(0.1)	7.4	7.6	(0.2)
Banking Services	18.2	12.6	5.6	21.8	15.0	6.8
Cash	5.6	4.2	1.4	6.4	5.0	1.4
Total Return on Net Assets Vs Weighted Index	2.7	2.8	(0.1)	6.6	4.6	2.0

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

Asset Class	Index
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

16. Mercer has reported in writing to GAB about the performance of the investments in the Mercer multi-managed funds for the September 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

17. 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 September quarter the Fund outperformed the index primarily due to one of the underlying fund managers holding an overweight position in shares in the healthcare sector which performed relatively well, and another fund manager holding an underweight position in resources, which was a poor performing sector during the quarter.

Overseas Shares – Developed

18. 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 September quarter the Fund had mixed performance with some managers underperforming the index because of overweight exposures to poor performing sectors (such as the IT sector), and others investing in sectors which outperformed the index. Overall the Fund underperformed the index. It is to be noted that the return on the unhedged portion of the investment exceeded the return on the hedged portion, reflecting the depreciation of the Australian dollar over the period.

Emerging Markets

19. The investments of the Mercer Emerging Markets Fund, in which the Endowment invests, are invested through the funds of 2 underlying investment managers. The return on the Fund during the September quarter, while negative, was better than the index performance, primarily because of beneficial stock selections by the underlying managers.

Australian Sovereign Bonds

20. The investments of the Mercer Australian Sovereign Bond Fund, in which the Endowment invests, are invested through the funds of 2 underlying investment managers. The Fund underperformed the index during the September quarter because of a short duration interest rate strategy adopted by one of the underlying investment managers which impacted performance as bond yields fell during the quarter.

Overseas Sovereign Bonds

21. The investments of the Mercer Overseas Sovereign Bond Fund are made through the funds of 3 underlying investment managers. The Fund performed in line with the index during the September quarter.

Comments on Internally Managed Investments

22. 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

23. 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 next revaluation will be undertaken as at 31 December 2011. The impact of the revaluation as at 31 December 2010 is reflected in the 12 month performance results.
24. It is pleasing to report that during the September quarter, agreements for lease were signed for levels 3, 4 and 5 of St Andrew's House. The incoming tenants will take occupation of their respective floors in 2012 as the capital works being undertaken are completed. The execution of these agreements is expected to have a significant positive impact on the valuation of the St Andrew's House building, when undertaken as at 31 December 2011.

Banking Services

25. 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 is decreasing because of a reduction in the total amount of loans made by GAB.

Performance having regard to the Investment Objective

26. 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.
27. 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 October 2011, the value of the net assets of the Endowment increased from \$103.4 million to \$109.1 million. Accordingly, given the current inflation rate (of about 3% per annum), the real value of the net assets of the Endowment has been maintained over that period. However, it is to be noted that this is the result of the very strong performance of the St Andrew's House and Banking Services asset classes.

MARK PAYNE
Chief Executive Officer

23 November 2011