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## Regulatory and Other Committee

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| <b>Open Report on behalf of Executive Director of Finance and Public Protection</b> |
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|            |                                     |
|------------|-------------------------------------|
| Report to: | <b>Pensions Committee</b>           |
| Date:      | <b>06 October 2016</b>              |
| Subject:   | <b>Investment Management Report</b> |

**Summary:**

This report covers the management of the Lincolnshire Pension Fund assets, over the period from 1st April to 30th June 2016.

**Recommendation(s):**

That the committee note this report.

### Background

This report is split into four areas:

- Funding Level Update
- Fund Performance & Asset Allocation
- Hymans Robertson Manager Ratings
- Individual Manager Update

#### 1. Funding Level Update

1.1 The funding update is provided to illustrate the estimated development of the funding position from 31<sup>st</sup> March 2013 to 30<sup>th</sup> June 2016, for the Fund.

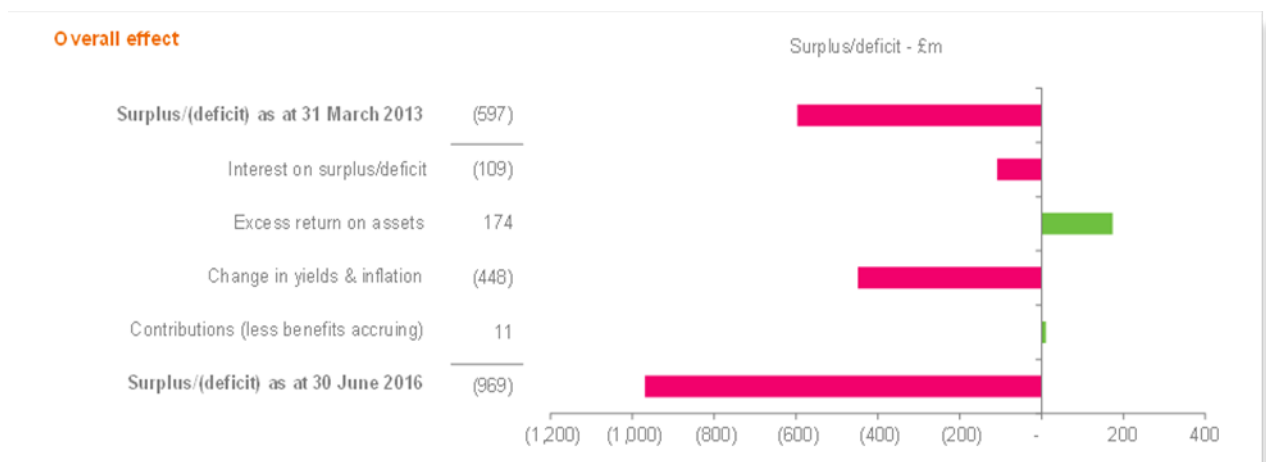
1.2 As the graph below shows, the funding level at the latest formal valuation was 71.5%. As at 30<sup>th</sup> June 2016 the funding level has decreased to 65.9%. This, however, is not based on the formal Valuation funding level for March 2016, as the modelling used for this report is a roll forward of the March 2013 valuation. The 2016 Valuation results will be available later in the year.

### Change in funding level since last valuation



1.3 As shown below, the deficit in real money has increased from £597m to £969m between the period 31<sup>st</sup> March 2013 and 30<sup>th</sup> June 2016. This is largely as a result of a decrease in bond yields, and subsequent discount rate, which places a higher value on the Fund's liabilities. This has been offset by a decrease in inflation and strong asset performance.

1.4 What's happened since last valuation?



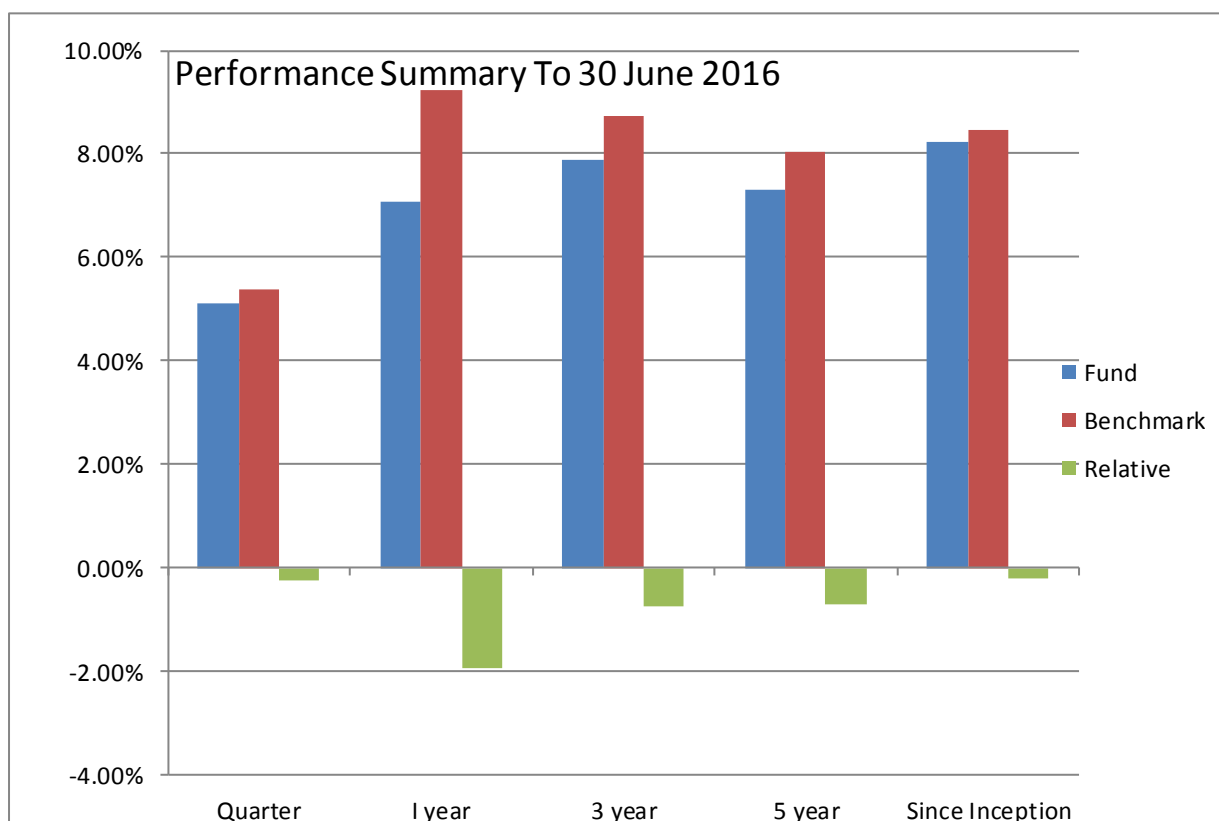
## 2. Fund Performance & Asset Allocation

2.1 The Fund increased in value by £86.9m during the quarter from £1,750.2m to £1,837.1m, as the table below shows.

| Asset Class     | Q1 2016<br>£   | Q4 2015<br>£   | Asset<br>Allocation<br>% | Strategic Asset<br>Allocation % | Difference<br>% |
|-----------------|----------------|----------------|--------------------------|---------------------------------|-----------------|
| UK Equities     | 352.8          | 335.4          | 19.2                     | 20.0                            | (0.8)           |
| Global Equities | 788.2          | 730.1          | 42.8                     | 40.0                            | 2.8             |
| Alternatives    | 256.9          | 250.5          | 14.0                     | 15.0                            | (1.0)           |
| Property        | 203.3          | 202.0          | 11.1                     | 11.5                            | (0.4)           |
| Fixed Interest  | 236.4          | 227.6          | 12.9                     | 13.5                            | (0.6)           |
| Cash            | (0.5)          | 4.6            | 0.0                      | 0.0                             | 0.0             |
| <b>Total</b>    | <b>1,837.1</b> | <b>1,750.2</b> | <b>100.0</b>             | <b>100.0</b>                    |                 |

2.2 The graph below shows the Fund's performance against the benchmark over the quarter, one year, three years, five years and since inception. The Fund has a target to outperform the strategic benchmark by 0.75% per annum.

2.3 Over the quarter, the Fund produced a positive return of 5.12% but underperformed the benchmark which returned 5.38%. The Fund is behind the benchmark over all periods. The underperformance is due to significant underperformance from two managers in the Fund, Neptune and BMO; and both managers were terminated at the July meeting of this Committee.



\* Since Inception figures are from March 1987

### 3. Hymans Robertson Manager Ratings

3.1 Hymans Robertson regularly meet managers to discuss current issues, management changes and performance. The manager is then allocated one of five ratings between replace and retain. The table below shows Hymans Robertson's rating of all managers that have been appointed by the Lincolnshire Pension Fund.

3.2 The Fund has eighteen managers and during the quarter there was one rating change where Aviva Pooled Property Fund has been moved from "on watch" to "retain". Seventeen managers remained rated as "retain", and one manager, Rreef Ventures Fund 3, as "on watch". Officers continue to monitor managers closely and arrange meetings to discuss any potential issues

| Manager                                 | Rating  |  |          |   |        |
|---|---------|--|----------|---|--------|
|   | Replace |  | On Watch |   | Retain |
| Invesco Global Equities (Ex-UK)         |         |  |          | X |        |
| Threadneedle Global Equity              |         |  |          | X |        |
| Schroders Global Equity                 |         |  |          | X |        |
| Morgan Stanley Global Brands            |         |  |          |   | X      |
| Morgan Stanley Alternative Investments  |         |  |          |   | X      |
| Blackrock Fixed Interest                |         |  |          |   | X      |
| Standard Life European Property         |         |  |          | X |        |
| Innisfree Continuation Fund 2           |         |  |          |   | X      |
| Innisfree Secondary Fund                |         |  |          |   | X      |
| Innisfree Secondary Fund 2              |         |  |          |   | X      |
| Franklin Templeton European Real Estate |         |  |          | X |        |
| Franklin Templeton Asian Real Estate    |         |  |          | X |        |
| RREEF Ventures Fund 3                   |         |  | X        |   |        |
| Igloo Regeneration Partnership          |         |  |          | X |        |
| Aviva Pooled Property Fund              |         |  |          | X |        |
| Royal London PAIF                       |         |  |          | X |        |
| Standard Life Pooled Property Fund      |         |  |          | X |        |
| Blackrock Property                      |         |  |          | X |        |

### 4. Individual Manager Update

4.1 The manager returns and index returns for equity, fixed interest and alternative managers are shown in the table below. A detailed report on each manager outlining the investment process, performance, purchases and sales and Hymans Robertson's manager view can be found after the table at 4.3.

4.2 Manager Returns – As shown below it was a good quarter for the Fund with all managers, except for BMO, producing a positive absolute return. Disappointingly over the quarter, only two managers outperformed their benchmark, UK Equity in-house and Schroders. Over the 12 month period three managers have failed to produce a positive absolute return, Morgan Stanley Alternatives, Neptune and BMO. These three managers have also disappointed against their benchmark.

4.3 Individual manager reports have not been prepared for Neptune and BMO as performance to June 2016 was discussed at the July Pension Committee, where the decision to terminate the Funds mandate with both managers was taken.

|  | 3 months ended 30/06/16 |                |                     | Previous 12 months |                |                     |               |
|--|-------------------------|----------------|---------------------|--------------------|----------------|---------------------|---------------|
| Manager                                  | Manager Return %        | Index Return % | Relative Variance % | Manager Return %   | Index Return % | Relative Variance % | Target p.a. % |
| Passive UK Equity In house               | 5.5                     | 5.3            | 0.2                 | 2.4                | 2.5            | (0.1)               | +/- 0.5       |
| Invesco (Global Equities (ex UK))        | 8.3                     | 8.8            | (0.5)               | 15.3               | 15.3           | 0.0                 | +1.0          |
| Threadneedle (Global Equities)           | 7.9                     | 8.8            | (0.9)               | 15.2               | 13.9           | 1.1                 | +2.0          |
| Neptune (Global Equities)                | 4.7                     | 8.8            | (4.1)               | (6.5)              | 13.9           | (17.9)              | +4.0          |
| Schroder's (Global Equities)             | 9.1                     | 8.6            | 0.5                 | 13.5               | 13.3           | 0.2                 | +3.0          |
| Morgan Stanley Global Brands             | 8.0                     | 8.6            | (0.6)               | 25.0               | 14.4           | 9.3                 | n/a           |
| Blackrock (Fixed Interest)               | 7.8                     | 7.9            | (0.1)               | 16.0               | 16.0           | 0.1                 | Match Index   |
| BMO (Fixed Interest)                     | (0.5)                   | 0.2            | (0.7)               | (3.5)              | 2.5            | (5.9)               | 3M LIBOR + 3% |
| Morgan Stanley (Alternative Investments) | 2.6                     | 1.2            | 1.4                 | (1.2)              | 4.7            | (5.6)               | 3M LIBOR + 4% |

**Lincolnshire Pension Fund  
UK Equities – In House (Passive UK)  
Quarterly Report June 2016**

**Investment Process**

This portfolio is managed internally and mandated to track the MSCI UK IMI index +/- 0.5% around the index, with a tracking error of 0.5%. Approximately 250-300 stocks are held.

**Portfolio Valuation**

|                   |                   |
|-------------------|-------------------|
| Value at 31.03.16 | Value at 30.06.16 |
| £335,436,113      | £352,763,615      |

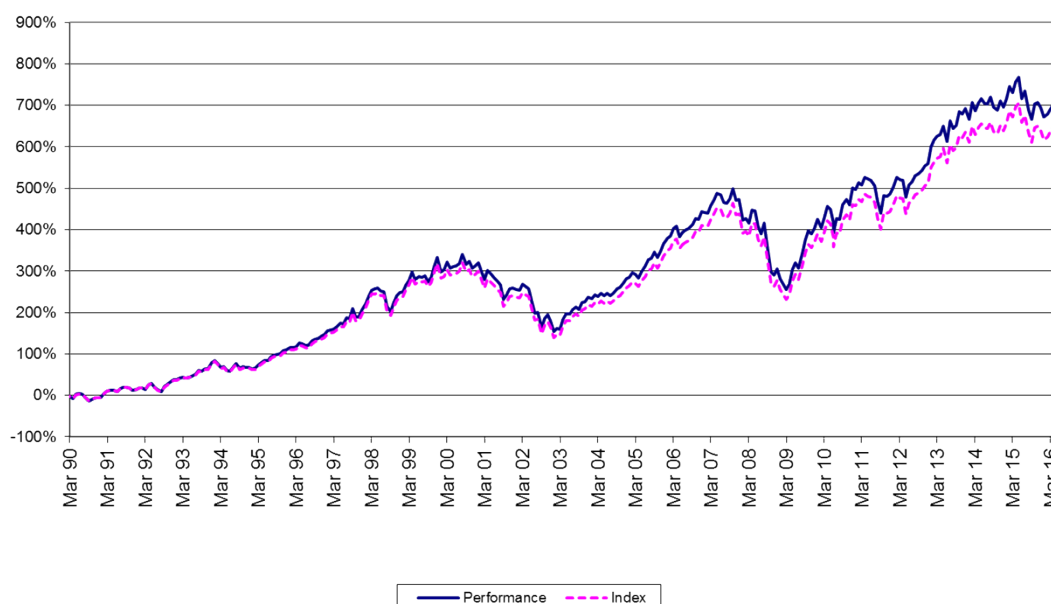
**Performance**

During the quarter the portfolio produced a positive return of 5.5% which was 0.2% above the benchmark. The portfolio is slightly behind the benchmark over one and three year time periods but ahead over five years and since inception.

|                        | Quarter % | 1 Year % | 3 Year* % | 5 Year* % | Inception * % |
|------------------------|-----------|----------|-----------|-----------|---------------|
| UK Equities – In House | 5.5       | 2.4      | 5.4       | 6.2       | 8.3           |
| MSCI UK IMI            | 5.3       | 2.5      | 5.5       | 6.1       | 8.0           |
| Relative Performance   | 0.2       | (0.1)    | (0.1)     | 0.1       | 0.3           |

\* annualised, inception date 01/10/1989

**UK Equities In House Portfolio Performance Since Inception**



## Turnover

| Holdings at 31.03.16 | Holdings at 30.06.16 | Turnover in Quarter % | Turnover in Previous Quarter % |
|----------------------|----------------------|-----------------------|--------------------------------|
| 270                  | 284                  | 1.0                   | 0.0                            |

## Purchases and Sales

During the quarter the manager made a number of trades reducing the cash holding from £10m to £1m. With the vote on "Brexit" causing uncertainty around markets, the decision was made to split purchases before and after June 23<sup>rd</sup>. This proved beneficial to performance with the week following "Brexit" adding 0.11% outperformance.

## Largest Overweights

|              |       |
|--------------|-------|
| Rangold      | 0.19% |
| Tullow Oil   | 0.12% |
| Paddy Power  | 0.10% |
| Hikma Pharma | 0.10% |
| Babcock      | 0.10% |

## Largest Underweights

|               |         |
|---------------|---------|
| Shire plc     | (0.39%) |
| Mediclinic    | (0.11%) |
| BP            | (0.09%) |
| HSBC          | (0.08%) |
| National Grid | (0.07%) |

\* Measured against MSCI UK IMI

## Top 10 Holdings

|   |                          |             |    |             |             |
|---|--------------------------|-------------|----|-------------|-------------|
| 1 | Royal Dutch Shell        | £29,211,500 | 6  | Vodafone    | £11,081,960 |
| 2 | HSBC                     | £16,388,666 | 7  | Astrazeneca | £9,992,226  |
| 3 | British American Tobacco | £16,075,938 | 8  | Diageo      | £9,287,769  |
| 4 | BP                       | £14,175,485 | 9  | Reckitt     | £8,421,681  |
| 5 | GlaxoSmithKline          | £14,097,594 | 10 | Unilever    | £8,212,828  |

## Risk Control

The portfolio has a tracking error limit of 0.5%. At the end of June 2016 the tracking error was 0.26%.

**Lincolnshire Pension Fund**  
**Global Equities – Invesco (Global Ex UK Enhanced)**  
**Quarterly Report June 2016**

**Investment Process**

This portfolio is mandated to track the MSCI World ex UK Index, with a performance target of +1% and a tracking error of 1%. The aim is to achieve long-term capital growth from a portfolio of investments in large-cap global companies. Active performance is generated through a quantitative bottom-up investment process, driven by stock selection and based on four concepts: Earnings Momentum, Price Trend, Management Action and Relative Value.

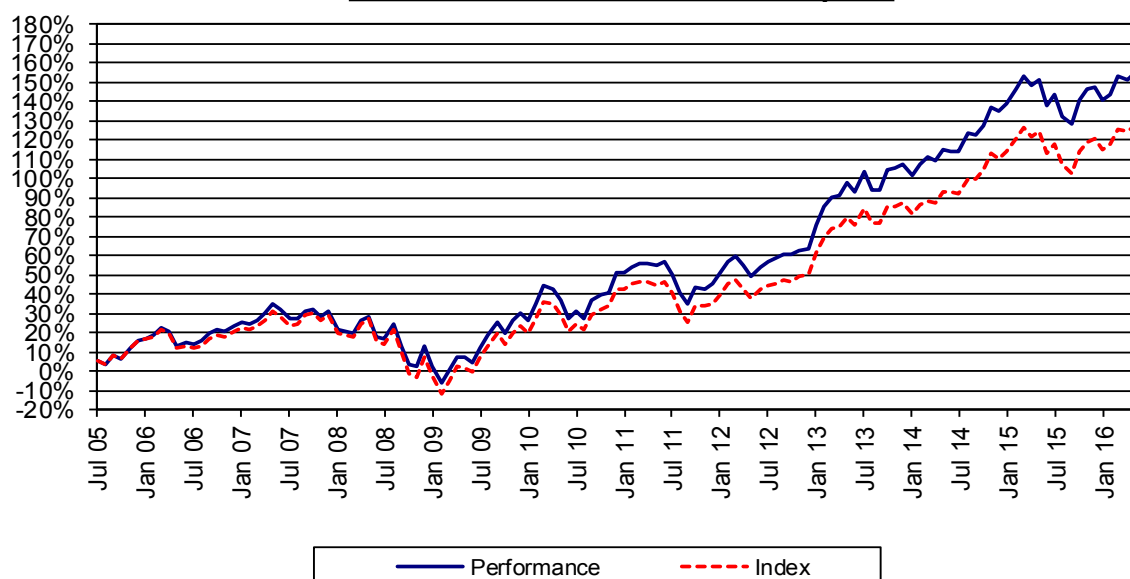
**Portfolio Valuation**

|                   |                   |
|-------------------|-------------------|
| Value at 31.03.16 | Value at 30.06.16 |
| £366,712,212      | £397,419,103      |

**Performance**

During the quarter Invesco's strategy underperformed its benchmark. Stock Selection had a negative impact on relative performance. Overweight positions in stocks with attractive valuation levels also detracted from performance. In contrast, Invesco's momentum related factors, Market Sentiment and Earnings Expectations, were able to add performance.

**Invesco Performance Since Inception**



|                      | Quarter % | 1 Year % | 3 Year* % | 5 Year* % | Inception* % |
|----------------------|-----------|----------|-----------|-----------|--------------|
| Invesco              | 8.3       | 15.3     | 12.4      | 11.9      | 9.6          |
| MSCI World ex UK     | 8.8       | 15.3     | 11.8      | 10.9      | 8.5          |
| Relative Performance | 0.5       | 0        | 0.6       | 0.9       | 1.0          |

\* annualised, inception date 1<sup>st</sup> July 2005



## Turnover

| Holdings at 31.03.16 | Holdings at 30.06.16 | Turnover in Quarter % | Turnover in Previous Quarter % |
|----------------------|----------------------|-----------------------|--------------------------------|
| 494                  | 496                  | 9.0                   | 7.4                            |

## Purchases and Sales

During the quarter, Invesco made a number of stock adjustments to the portfolio. They added Aflac and increased positions in Verizon Communications, Procter & Gamble, AT&T and Gilead Sciences. Invesco sold out of General Dynamics and decreased their position in General Electric, American International and Endesa.

## Largest Overweights

|                   |      |
|-------------------|------|
| Verizon           | 1.0% |
| Intel             | 1.0% |
| Comcast           | 0.8% |
| JPMorgan          | 0.8% |
| Johnson & Johnson | 0.8% |

## Largest Underweights

|                      |        |
|----------------------|--------|
| Exxon Mobil          | (0.8%) |
| Alphabet             | (0.7%) |
| Chevron              | (0.7%) |
| Visa                 | (0.5%) |
| Bristol-Myers Squibb | (0.4%) |

\* Measured against MSCI World ex UK (NDR)

## Top 10 Holdings

|   |                   |            |    |                  |            |
|---|-------------------|------------|----|------------------|------------|
| 1 | Apple             | £9,766,175 | 6  | Intel            | £5,881,083 |
| 2 | Johnson & Johnson | £7,550,152 | 7  | AT&T             | £5,662,406 |
| 3 | Microsoft         | £7,119,321 | 8  | Comcast          | £5,416,407 |
| 4 | Verizon           | £7,001,931 | 9  | General Electric | £4,749,060 |
| 5 | JPMorgan          | £6,276,774 | 10 | Citigroup        | £4,647,539 |

## Hymans Robertson View

There were no relevant business issues reported over the period.

## Risk Control

The predicted tracking error of the portfolio slightly increased to 1.08% (actual target 1%).

## Lincolnshire Pension Fund Global Equities – Schroders Quarterly Report June 2016

### Investment Process

This portfolio is mandated to outperform the MSCI All Countries World Daily Net Index by 2% to 4% over rolling three year periods, gross of fees. This is achieved through an investment approach that is designed to add value relative to the benchmark through both stock selection and asset allocation decisions. Schroders believe that stock markets are inefficient and they can exploit this by undertaking fundamental research and taking a long term view.

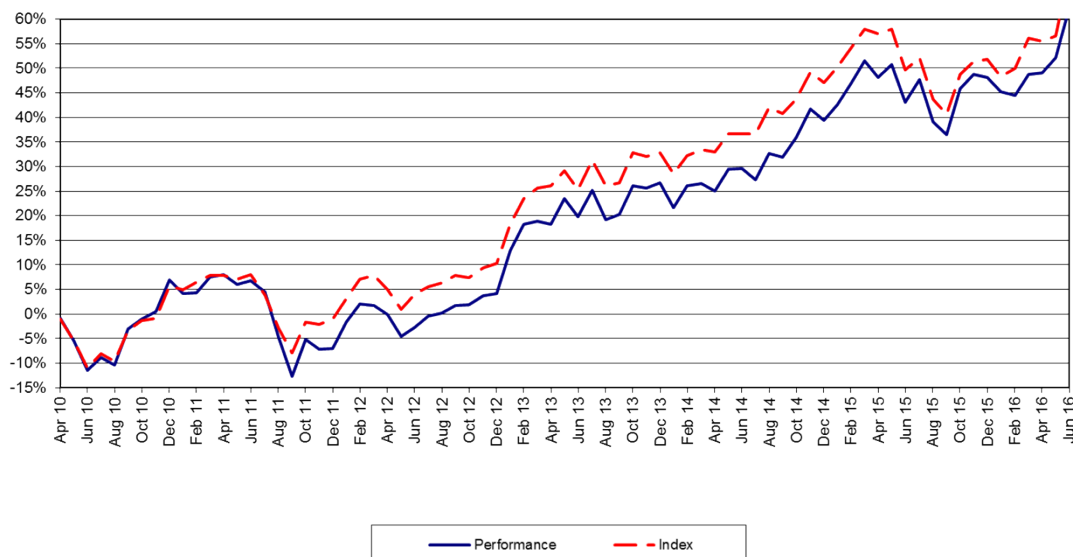
### Portfolio Valuation

|                   |                   |
|-------------------|-------------------|
| Value at 31.03.16 | Value at 30.06.16 |
| £88,886,819       | £97,002,603       |

### Performance

During the quarter the portfolio outperformed the benchmark. From a sector perspective, stock selection was particularly beneficial in the consumer discretionary, healthcare, energy and telecoms sectors. By region, stock selection was strong almost across the board, with the exception of stock selection in the UK. Schroder's also gained from their off-benchmark exposure to emerging markets. By sector, their holdings in financials and consumer staples proved a headwind to performance.

Schroders Performance Since Inception



|                      | Quarter % | 1 Year % | 3 Year* % | 5 Year* % | Inception* % |
|----------------------|-----------|----------|-----------|-----------|--------------|
| Schroders            | 9.1       | 13.5     | 10.7      | 8.7       | 8.1          |
| MSCI ACWI (Net)      | 8.6       | 13.3     | 10.6      | 9.4       | 8.8          |
| Relative Performance | 0.5       | 0.2      | 0.1       | (3.2)     | (0.7)        |

\*annualised since Inception April 16 2010

## Turnover

| Holdings at 31.03.16 | Holdings at 30.06.16 | Turnover in Quarter % | Turnover in Previous Quarter % |
|----------------------|----------------------|-----------------------|--------------------------------|
| 77                   | 79                   | 7.4                   | 14.2                           |

## Purchases and Sales

During the quarter Schroder's biggest purchase was Brazilian telecoms firm Telefonica Brasil. They also initiated a position in pharmaceutical firm Shire. Notable sales included French aircraft engine manufacturer Safran and Japanese convenience store chain, Seven & I.

### Top 5 Contributions to Return

|                |      |
|----------------|------|
| Pfizer         | 0.3% |
| Keyence        | 0.3% |
| Cimarex Energy | 0.3% |
| Amazon         | 0.2% |
| Statoil ASA    | 0.2% |

### Bottom 5 Contributions to Return

|                    |        |
|--------------------|--------|
| Lloyds             | (0.5%) |
| Banco Bilbao       | (0.2%) |
| Alphabet           | (0.2%) |
| Bayerische Motoren | (0.2%) |
| Prudential         | (0.2%) |

### Top 10 Holdings

|   |              |            |
|---|--------------|------------|
| 1 | Alphabet     | £2,912,297 |
| 2 | TWN Semicont | £2,857,037 |
| 3 | Comcast      | £2,663,388 |
| 4 | Pfizer       | £2,372,919 |
| 5 | Citigroup    | £2,271,420 |

|    |               |            |
|----|---------------|------------|
| 6  | United Health | £2,235,033 |
| 7  | Reckitt       | £2,196,368 |
| 8  | Danaher       | £2,102,146 |
| 9  | Amazon        | £2,048,682 |
| 10 | Statoil Hydro | £2,024,010 |

## Hymans Robertson View

There was no relevant business issues reported over the period.

## Risk Control

The portfolio can have a maximum 10% off-benchmark exposure; any increase in this would require the consent of the Pension Fund.

## Lincolnshire Pension Fund Global Equities – Threadneedle Quarterly Report June 2016

### Investment Process

This portfolio is mandated to outperform the MSCI All Countries World Index by 2% per annum, gross of fees over rolling three year periods. This is achieved through investment managers who can draw on their own knowledge and that of other parts of the organisation to implement a thematic approach to stock selection.

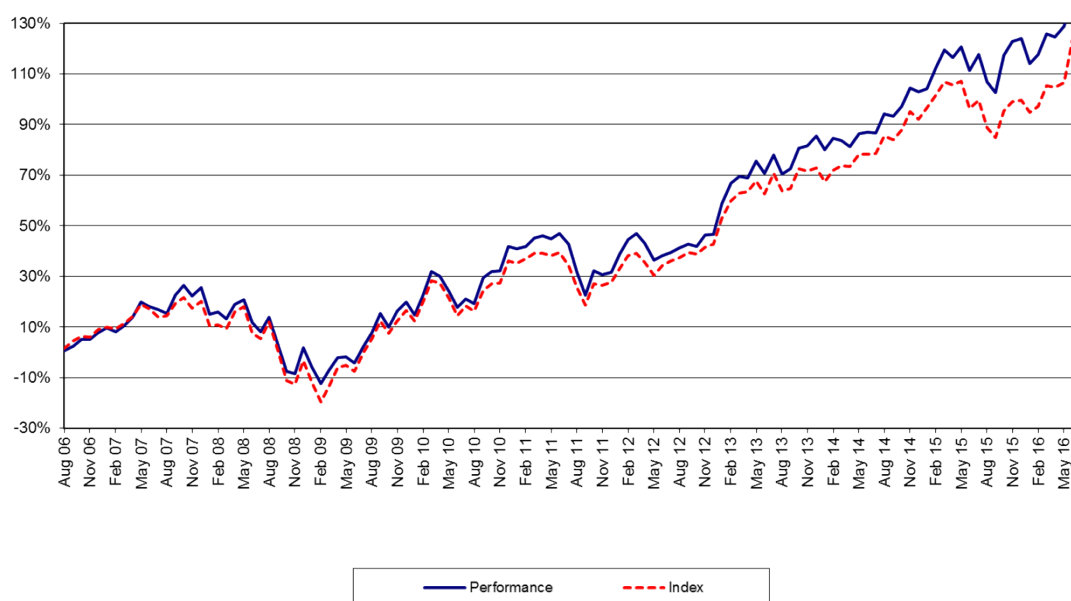
### Portfolio Valuation

|                   |                   |
|-------------------|-------------------|
| Value at 31.03.16 | Value at 30.06.16 |
| £94,090,170       | £101,510,274      |

### Performance

Threadneedle underperformed its benchmark in the quarter. Allocation and security selection detracted at the regional level, driven by their overweight position and stock-level picks in Europe ex UK. In sector terms, allocation detracted, notably their underweight in energy and overweight in technology, but stock selection added value, particularly in consumer discretionary.

Threadneedle Performance Since Inception



|                      | Quarter % | 1 Year % | 3 Year* % | 5 Year* % | Inception* % |
|----------------------|-----------|----------|-----------|-----------|--------------|
| Threadneedle         | 7.9       | 15.2     | 12.6      | 10.7      | 9.4          |
| MSCI ACWI            | 8.8       | 13.9     | 11.2      | 9.9       | 8.5          |
| Relative Performance | (0.9)     | 1.1      | 1.3       | 0.7       | 0.9          |

\* annualised, inception date 01/08/2006

## Turnover

| Holdings at 31.03.16 | Holdings at 30.06.16 | Turnover in Quarter % | Turnover in Previous Quarter % |
|----------------------|----------------------|-----------------------|--------------------------------|
| 85                   | 84                   | 8.4                   | 12.4                           |

## Purchases and Sales

Threadneedle took advantage of share price weakness to open a new position in US banking franchise BB&T. They also initiated a holding in British American Tobacco. Threadneedle exited Continental to reduce their exposure to European cyclical stocks and also closed a small position in Japan Exchange, and trimmed a holding in JPMorgan, in order to reduce their exposure to capital markets.

### Top 5 Contributions to Return

|                      |      |
|----------------------|------|
| Amazon               | 0.7% |
| Pfizer               | 0.6% |
| Bristol-Myers Squibb | 0.4% |
| Unilever             | 0.4% |
| Tencent              | 0.4% |

### Bottom 5 Contributions to Return

|                 |        |
|-----------------|--------|
| Bank of Ireland | (0.3%) |
| Japan Exchange  | (0.2%) |
| UBS             | (0.2%) |
| Continental     | (0.2%) |
| Brenntag        | (0.1%) |

### Top 10 Holdings

|   |          |            |    |                 |            |
|---|----------|------------|----|-----------------|------------|
| 1 | Alphabet | £2,999,592 | 6  | Facebook        | £2,334,157 |
| 2 | Amazon   | £2,987,103 | 7  | Gilead Sciences | £2,148,511 |
| 3 | Unilever | £2,760,657 | 8  | Inbev           | £2,081,672 |
| 4 | Pfizer   | £2,627,361 | 9  | Activision      | £2,062,136 |
| 5 | Aon      | £2,362,060 | 10 | Tencent         | £2,021,253 |

## Hymans Robertson View

In May 2016 Threadneedle announced that Leigh Harrison, Head of Equities, Europe would be retiring at end June 2016. Harrison also headed the UK Equity team and will be succeeded in that role by Richard Colwell who joined Threadneedle in 2010. William Davies, Head of Global Equities will become Head of Equities, EMEA effectively assuming additional overall responsibilities for Threadneedle's UK and European equity teams as well as the EMEA based US, Asia and Emerging Markets teams. Davies will also be appointed to the Firm's Executive Committee. Davies will relinquish his analytical responsibilities and Hymans will endeavour to monitor whether his broader role detracts from his focus on global equity management.

## Risk Control

The portfolio can have a maximum 10% off-benchmark exposure; any increase in this would require the consent of the Pension Fund.

**Lincolnshire Pension Fund  
Global Equities – Morgan Stanley Global Brands  
Quarterly Report June 2016**

**Investment Process**

The Global Brands Fund is an open-ended investment company incorporated in the United Kingdom. The aim of the Fund is to provide long term capital appreciation through investing in a concentrated high quality global portfolio of companies with strong “intangible assets”. The Fund is benchmarked against the MSCI World Index. Managers aim to gain an absolute return to the Fund rather than a relative return against their benchmark index.

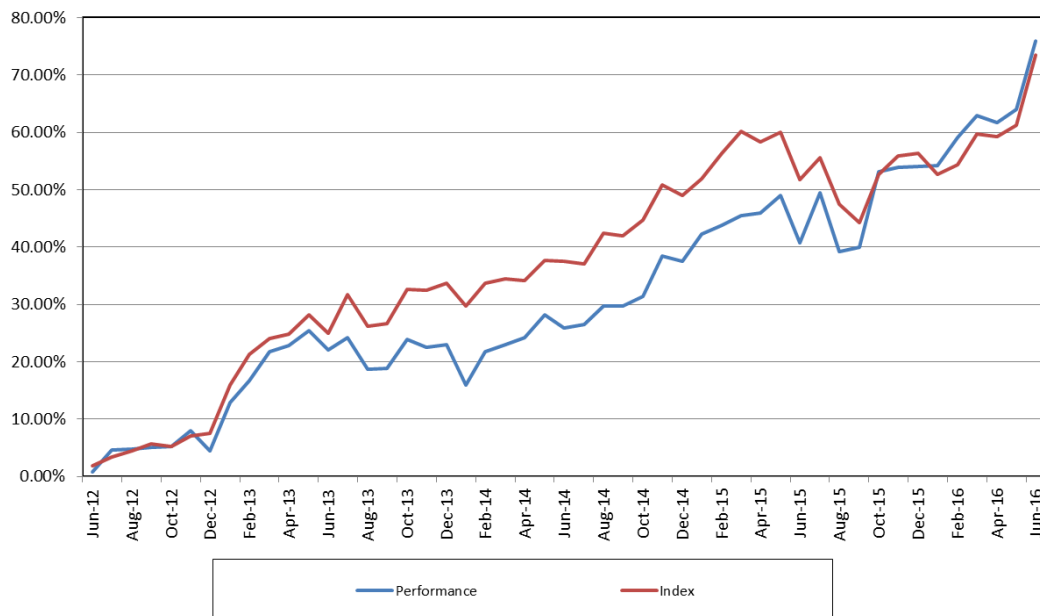
**Portfolio Valuation**

|                   |                   |
|-------------------|-------------------|
| Value at 31.03.16 | Value at 30.06.16 |
| £99,033,147       | £106,966,954      |

**Performance**

During the quarter Morgan Stanley Global Brands returned 8% but underperformed its benchmark by 0.6%, which returned 8.6%. The underperformance for the quarter was due to the absence, or near absence, of the strongly performing Energy, Health Care and Utility sectors, while the large overweight in Consumer Staples and the lack of Financials exposure helped absolute performance.

**Morgan Stanley Global Brands Performance Since Inception**



|                              | Quarter % | 1 Year % | 3 Year* % | 5 Year* % | Inception * % |
|------------------------------|-----------|----------|-----------|-----------|---------------|
| Morgan Stanley Global Brands | 8.0       | 25.0     | 13.0      | N/A       | 14.8          |
| MSCI World Index             | 8.6       | 14.4     | 11.5      | N/A       | 14.4          |
| Relative Performance         | (0.6)     | 9.3      | 1.3       | N/A       | 0.3           |

\*annualised, inception date 18/06/2012

### Purchases and Sales

During the quarter Morgan Stanley initiated positions in two stocks, International Flavours and Fragrances (IFF) and Coca Cola. These were funded by exiting positions in Sanofi and 3m.

### Top 3 Contributions to Return

|                          |     |
|--------------------------|-----|
| British American Tobacco | 18% |
| L'Oreal                  | 17% |
| Reckitt Benckiser        | 13% |

### Bottom Contribution to Return

|      |      |
|------|------|
| Nike | (3%) |
|------|------|

### Top Ten Holdings

| Company                  | Industry           | % Weighting |
|--------------------------|--------------------|-------------|
| Reckitt Benckiser        | Household Products | 8.01        |
| British American Tobacco | Tobacco            | 7.84        |
| L'Oreal                  | Personal Products  | 6.99        |
| Microsoft                | Software           | 6.84        |
| Unilever                 | Personal Products  | 6.23        |
| Reynolds American        | Tobacco            | 4.86        |
| Altria                   | Tobacco            | 4.85        |
| Nestle                   | Food Products      | 4.84        |
| Accenture                | IT Services        | 4.51        |
| Visa                     | IT Services        | 4.01        |

### Hymans Robertson View

There were no relevant business issues reported over the period.

**Lincolnshire Pension Fund  
Passive Bonds – Blackrock  
Quarterly Report June 2016**

**Investment Process**

Blackrock manage a passive bond mandate for the Pension Fund. Their portfolio is made up of three pooled funds; an index-linked bond fund, a corporate bond fund and an overseas bond fund. All three funds are designed to match the return of their relevant benchmarks. The manager uses two methods to manage index-tracking funds; full replication and stratified sampling.

Full replication involves holding each of an index's constituent bonds in exactly the same proportion as the index. This method is used where the number of constituents in an index is relatively low and liquidity is above a certain level.

Stratified sampling is the method used when full replication is not possible or appropriate. This approach subdivides the benchmark index according to various risk characteristics, such as currency/country, maturity, credit rating, sector of issuer etc. Each subset of bonds is then sampled to select bonds for inclusion within the pooled fund.

The table below shows the indexing method for each of the three pooled funds in which the Fund invests.

| <b>Pooled Fund</b>                                       | <b>Indexing Method</b> |
|--|------------------------|
| Aquila Life Corporate Bond All Stocks Index Fund         | Sampled                |
| Aquila Life Over 5 Years UK Index-Linked Gilt Index Fund | Full Replication       |
| Aquila Life Overseas Bond Index Fund                     | Sampled                |

**Portfolio Valuation at 30<sup>th</sup> June 2016**

| <b>Portfolio</b>                             | <b>31.03.16<br/>£</b> | <b>30.06.16<br/>£</b> |
|--|-----------------------|-----------------------|
| Corporate Bond All Stocks Index Fund         | 59,931,423            | 62,542,960            |
| Over 5 Years UK Index-Linked Gilt Index Fund | 35,858,495            | 39,844,065            |
| Overseas Bond Index Fund                     | 23,774,105            | 26,567,430            |
| Cash (residual)                              | 10                    | 10                    |
| <b>Total</b>                                 | <b>119,564,033</b>    | <b>128,954,465</b>    |

**Performance**

Over all periods the portfolio has slightly outperformed the benchmark.

|                      | Quarter<br>% | 1 Year<br>% | 3 Year*<br>% | 5 Year*<br>% | Inception*<br>% |
|----------------------|--------------|-------------|--------------|--------------|-----------------|
| Blackrock            | 7.8          | 16.0        | 9.1          | 8.3          | 8.2             |
| Composite Benchmark  | 7.9          | 16.0        | 8.9          | 8.2          | 8.2             |
| Relative Performance | (0.1)        | 0.1         | 0.1          | 0.1          | 0.1             |

\*annualised since inception 28/07/10



## Hymans Robertson View

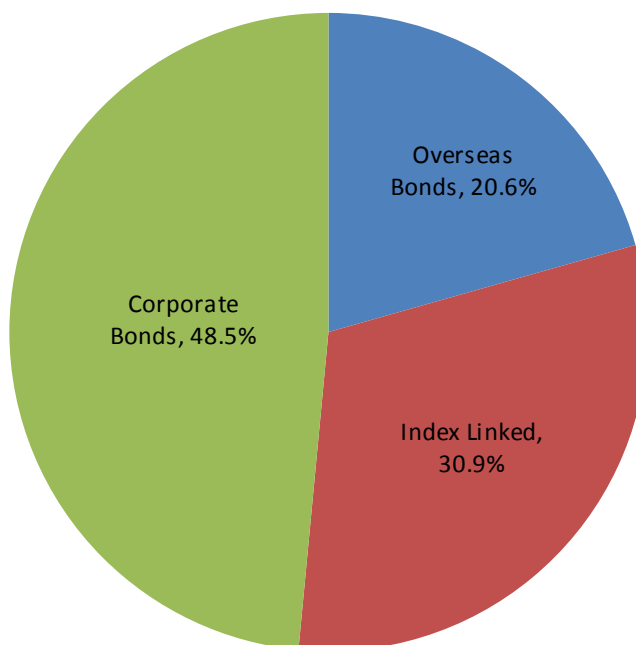
There were no significant developments within the Index Fixed Income team over the quarter; as such Hymans continue to rate Blackrock as one of their preferred passive fixed income managers.

## Allocation

The target allocation between the three funds is:

|  |     |
|--|-----|
| Aquila Life Corporate Bond All Stocks Index Fund         | 50% |
| Aquila Life Over 5 Years UK Index-Linked Gilt Index Fund | 30% |
| Aquila Life Overseas Bond Index Fund                     | 20% |

The pie chart below shows the allocation as at 30<sup>th</sup> June 2016.



**Lincolnshire Pension Fund  
Alternative Investments – Morgan Stanley  
Quarterly Report June 2016**

**Investment Process**

Morgan Stanley manages a bespoke absolute return alternative investment mandate for the Fund. The portfolio is invested in alternatives only, with no exposure to traditional equities or bonds. Investments are made to complement our existing portfolio and in future will include our Private Equity portfolio. The manager has a target to beat the return of 3 Month LIBOR + 4%.

**Portfolio Valuation**

|                   |                   |
|-------------------|-------------------|
| Value at 31.03.16 | Value at 30.06.16 |
| £188,933,585      | £199,911,984      |

**Performance**

The portfolio returned 2.6% during the first quarter. Most asset classes generated positive performance. Credit drove absolute returns, followed by real assets, and to a lesser extent, alpha strategies. Morgan Stanley's decision to increase their high yield exposure was particularly beneficial.

|                      | Quarter % | 1 Year % | 3 Year* % | 5 Year* % | Inception * % |
|----------------------|-----------|----------|-----------|-----------|---------------|
| Morgan Stanley       | 2.6       | (1.2)    | 1.5       | 2.7       | 3.5           |
| 3 Month LIBOR + 4%   | 1.2       | 4.7      | 4.7       | 4.8       | 4.8           |
| Relative Performance | 1.4       | (5.6)    | (3.0)     | (1.9)     | (1.2)         |

\* annualised since inception date 24/11/2010

**Allocation**

Morgan Stanley has split out investments into a bespoke portfolio of alternatives comprising five different asset allocations;

Alpha – These are pure return seeking products based on Manager skill. The Alpha investments include Hedge Funds, Global Tactical Asset Allocation (GTAA) and Active Currency.

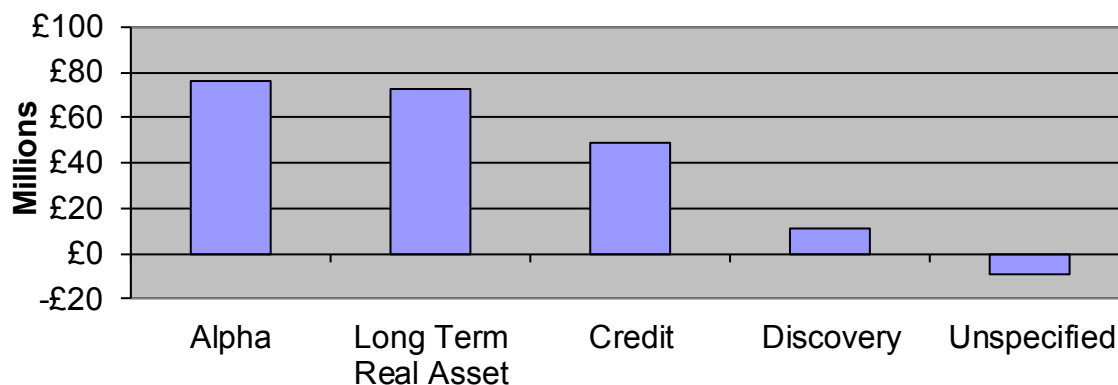
Long Term Real Asset – These are long term investments that seek to access illiquidity premium. Investments include Private Equity, Infrastructure, Real Estate, Commodities and Inflation – linked strategies.

Credit – These are the purchase of the lower rated bonds where higher default is more likely. Manager selection is important to ensure the correct bonds are purchased that will appreciate following rating upgrades and merger and acquisition activity. Credit opportunities include Emerging Market Debt, High Yield Bonds, Senior Loans and Convertibles.

Discovery – These are new opportunities of investments and can include Frontier Markets, Distressed Opportunities and Volatility.

Unspecified – These are cash balances held with Morgan Stanley.

### Allocation as at 30th June 2016



### Portfolio Positioning

For much of the quarter, market risks continued to abate. Oil continued to stabilise, financial conditions continued to ease and the U.S. economy reached a point where the Fed had been preparing the markets for a potential June or July rate hike. In contrast, the June 23rd vote in the UK on EU membership represented a risk for markets, ultimately resulting in a combination of strong negative reactions for risk assets globally and, perhaps more significantly, a sharp increase in uncertainty. Almost all global equity markets sold off sharply in the two days following the vote, with European markets experiencing, not surprisingly, very sharp declines. Commodities also fell sharply, as did sterling, and to a lesser extent the euro. Losses were partially pared back following the initial two day decline. Further, Spain went to the polls three days after the UK vote for a second time in six months, for a result that, as expected, was once again unhelpfully inconclusive. Morgan Stanley expected volatility to return to markets as these events played out on both sides of the Atlantic.

### Hymans Robertson View

There were no significant changes over the quarter.

### Risk Control

Portfolio volatility since inception is 4.04% within the guidelines specified by the mandate.

## **Conclusion**

Over the quarter the Fund has produced a positive return of 5.12% which is behind the benchmark which returned 5.38%.

## **Consultation**

### **a) Policy Proofing Actions Required**

n/a

## **Background Papers**

No background papers within Section 100D of the Local Government Act 1972 were used in the preparation of this report.

This report was written by Nick Rouse, who can be contacted on 01522 553641 or [nick.rouse@lincolnshire.gov.uk](mailto:nick.rouse@lincolnshire.gov.uk).