

Open Report on behalf of Executive Director of Finance and Public Protection

Report to:	Pensions Committee
Date:	13 July 2017
Subject:	Investment Management Report

Summary:

This report covers the management of the Lincolnshire Pension Fund assets over the period from 1st January to 31st March 2017.

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

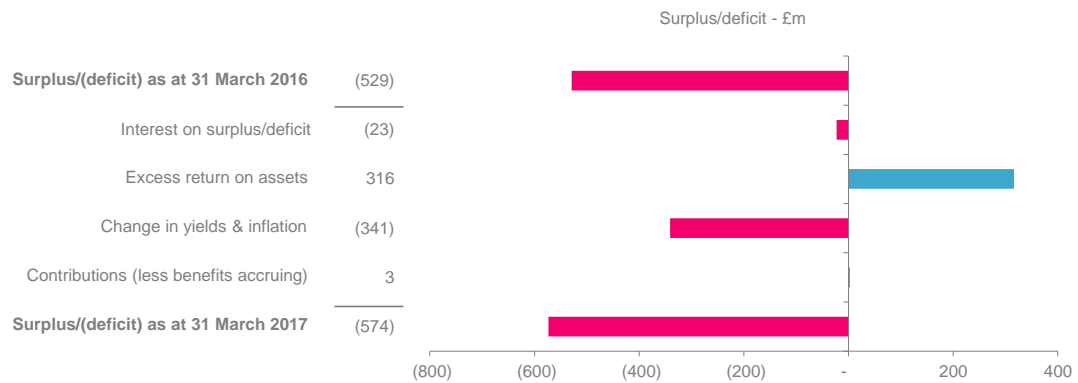
1.1 The funding update is provided to illustrate the estimated development of the funding position of the Lincolnshire Pension Fund from the latest formal valuation, 31st March 2016, to the current quarter end, 31st March 2017. The accuracy of this type of funding update is expected to decline over time, as the period since the last valuation increases. This is because the funding update does not allow for changes in individual members' data since the last valuation. It is, however, a useful tool to assist the Committee to identify whether the time is right to reduce the overall risk in the asset allocation of the Fund, as it approaches a 100% funding level.

1.2 The graph below shows the funding level at the latest formal valuation, at 76.9%, and its movement to 31st March 2017, where the funding level has increased to 78.9%.

Change in funding level since last valuation



- 1.3 Over that same time period the deficit, in real money, has increased from £529m to £574m. The chart below shows the main impactors on the deficit, with the excess return in assets being more than offset by the negative changes in yields and inflation.



- 1.4 On a shorter term time horizon, looking at the last quarter, the funding level increased from 77.3% to 78.9% between 31st December 2016 and 31st March 2017, and the deficit reduced from £602m to 574m.

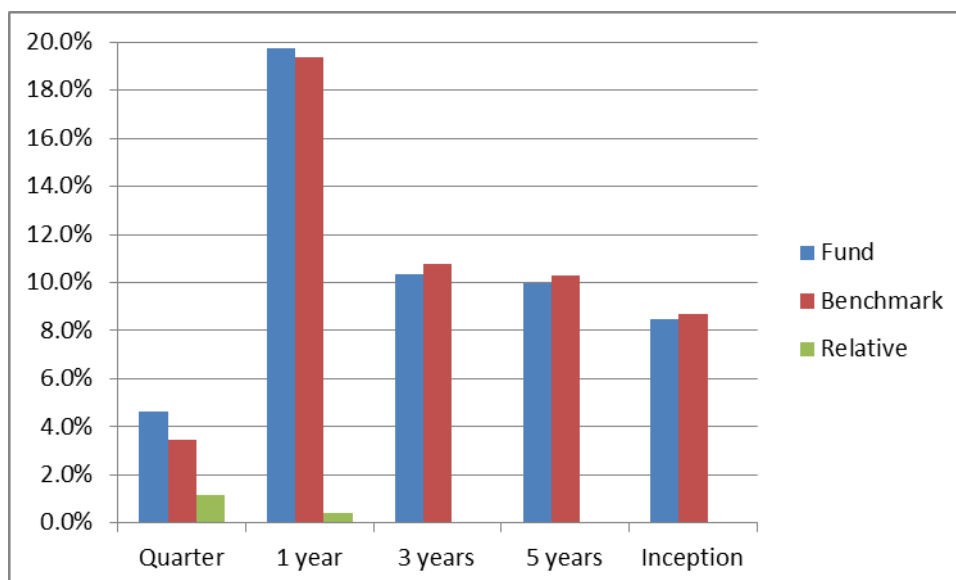
2. Fund Performance & Asset Allocation

- 2.1 The Fund increased in value by £95.0m during the quarter from £2,004.9m to £2,099.9, as the table below shows.

Asset Class	Q1 2017 £m	Q4 2016 £m	Asset Allocation %	Strategic Asset Allocation %	Difference %
UK Equities	398.5	387.3	19.0	20.0	(1.0)
Global Equities	911.1	859.5	43.4	40.0	3.4
Alternatives	291.9	270.5	13.9	15.0	(1.1)
Property*	194.6	209.1	9.3	9.0	0.3
Infrastructure*	31.4	N/A	1.5	2.5	(1.0)
Fixed Interest	262.2	243.9	12.5	13.5	(1.0)
Cash	10.4	34.6	0.5	0.0	0.5
Total	2,099.9	2,004.9	100.0	100.0	

*Property and Infrastructure were previously combined. An additional £15m was invested in Blackrock Property in Feb 17

2.2 The graph and table 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.



	Fund	Benchmark	Relative Performance
Quarter	4.6	3.5	1.2
1 year	19.8	19.3	0.4
3 years	10.4	10.8	(0.4)
5 years	10.0	10.3	(0.4)
Inception	8.5	8.7	(0.2)

* Since Inception figures are from March 1987

2.3 Over the quarter, the Fund produced a positive return of 4.64% (as measured by JPMorgan), outperforming the benchmark by 1.17%, which returned 3.47%. The Fund was ahead of the benchmark over the quarter and one year period, but behind its benchmark over three and five years, and since inception.

3. Hymans Robertson Manager Ratings

- 3.1 Hymans Robertson, as the Fund's Investment Consultant, regularly meet managers to discuss current issues, management changes and performance. Each 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	
Columbia 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 4.2.
- 4.2 Manager Returns – As shown below it was a good quarter for the Fund with all managers producing a positive absolute return. Only two managers underperformed their benchmark over that period, Invesco and Blackrock. Over the 12 month period, all managers have produced a positive absolute return, with only Columbia Threadneedle and Morgan Stanley Global Brands having underperformed their benchmark.

	3 months ended 31/03/17			Previous 12 months			
Manager	Manager Return %	Index Return %	Relative Variance %	Manager Return %	Index Return %	Relative Variance %	Target p.a. %
Legal & General (UK Equities)* *From February 17	2.0	1.7	0.3	N/A	N/A	N/A	Match Index
Invesco (Global Equities (ex UK))	4.9	5.2	(0.3)	34.3	32.5	1.3	+1.0
Columbia Threadneedle (Global Equities)	7.0	5.8	1.2	29.4	33.0	(2.6)	+2.0
Schroder's (Global Equities)	6.1	5.6	0.4	32.7	32.2	0.3	+3.0
Morgan Stanley Global Brands	8.4	5.1	3.1	28.6	31.9	(2.5)	n/a
Blackrock (Fixed Interest)	1.7	1.8	(0.1)	13.9	13.9	0.0	Match Index
Blackrock Interim (Fixed Interest) *From Sept 2016	0.7	0.7	0.0	N/A	N/A	N/A	Match Index
Morgan Stanley (Alternative Investments)	1.8	1.1	0.7	9.1	4.5	4.4	3M LIBOR + 4%

Lincolnshire Pension Fund
Global Equities – Invesco (Global Ex UK Enhanced)
Quarterly Report March 2017

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.

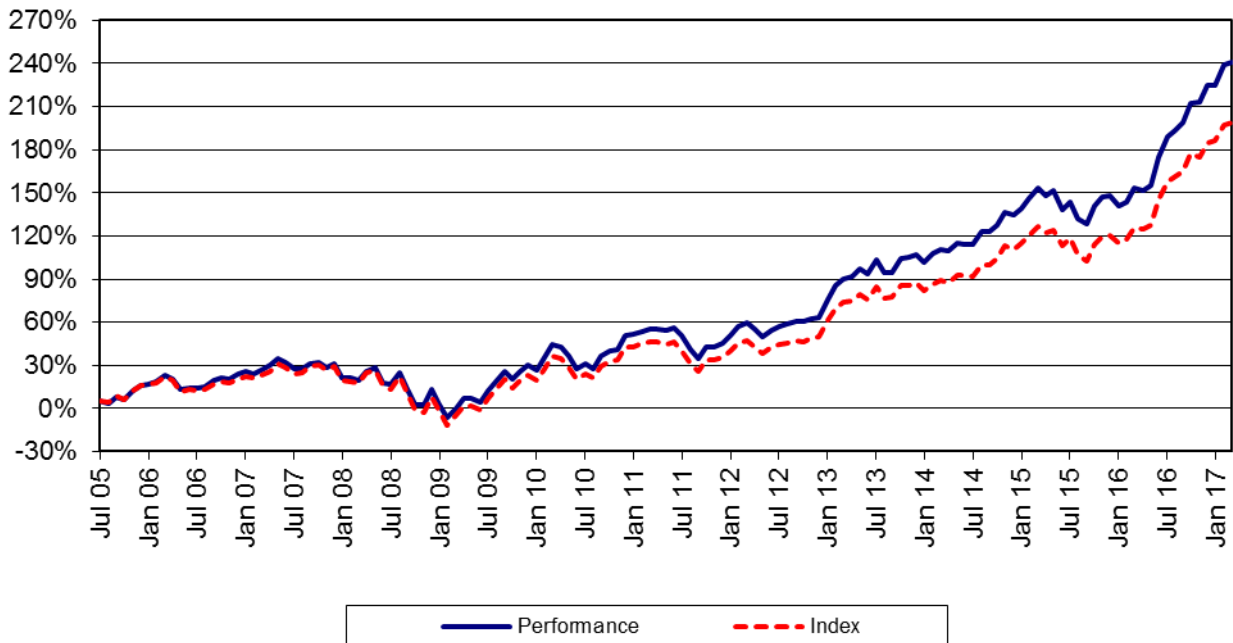
Portfolio Valuation

Value at 31.12.16	Value at 31.03.17
£468,673,452	£492,283,815

Performance

During the quarter Invesco's strategy underperformed its benchmark. Stock selection caused a drag on performance over the quarter, whilst style factors, sectors, countries and currencies were near neutral as expected. Within stock selection, the overweight positions in stocks with attractive Management and Quality scores were the main detractors. Performance over the longer term continues to be above the target return of +1%.

Invesco Performance Since Inception



	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Invesco	4.9	34.3	17.3	16.3	11.0
MSCI World ex UK	5.2	32.5	16.6	15.2	9.8
Relative Performance	(0.3)	1.3	0.6	1.0	1.1

* annualised, inception date 1st July 2005

Turnover

Holdings at 31.12.16	Holdings at 31.03.17	Turnover in Qtr %	Turnover in Previous Qtr %
529	506	8.7	11.4

Purchases and Sales

During the quarter, Invesco made a number of stock adjustments to the portfolio. Top purchases over the quarter included adding Piedmont Reality Trust and LVMH Moët Hennessy into the portfolio, and increasing their positions in Walmart, Apple and HRG Group. Top sales over the quarter were in selling out of their positions in International Paper and Adidas, and decreasing their positions in Altria and Ahold Delhaize.

Largest Overweights

Walmart	0.84%
Boeing Co	0.66%
Citigroup	0.65%
Intel	0.62%
JP Morgan Chase	0.60%

Largest Underweights

Alphabet	(0.71%)
Exxon Mobil	(0.64%)
Chevron	(0.61%)
Visa	(0.50%)
Amazon	(0.45%)

* Measured against MSCI World ex UK (NDR)

Top 10 Holdings

1	Apple	£13,948,439	6	Walmart	£5,732,070
2	JP Morgan Chase	£7,499,469	7	Verizon	£5,718,150
3	Microsoft	£7,086,619	8	Citigroup	£5,620,913
4	Johnson & Johnson	£6,997,334	9	Intel	£5,488,830
5	AT&T	£6,458,102	10	Proctor & Gamble	£5,467,453

Hymans Robertson View

There were no relevant business issues reported over the period.

Risk Control

The predicted tracking error of the portfolio was 1.06%, compared to a target of 1%, with 93% of the active risk associated with Stock Selection Factors.

**Lincolnshire Pension Fund
Global Equities – Schroders
Quarterly Report March 2017**

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.

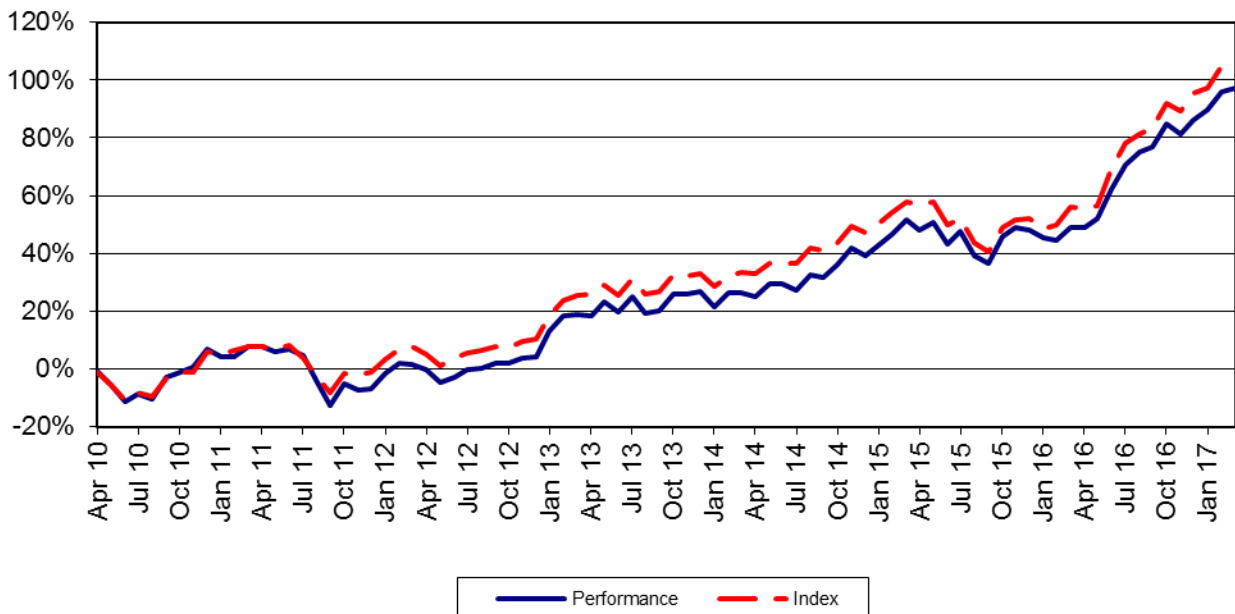
Portfolio Valuation

Value at 31.12.16	Value at 31.03.17
£111,053,310	£117,950,863

Performance

The portfolio outperformed over the quarter, with stock selection the dominant contributor to relative performance. The acute movement in style factors witnessed late last year has dissipated amidst declining stock correlations and a less macro-driven market environment. Investors appear to be refocusing their attention on fundamentals and earnings. Any transition to a new phase in the market cycle will inexorably introduce short-term volatility, as consensus expectations re-adjust to the new environment, but Schroders believe that their portfolio is well positioned to exploit opportunities as they develop through 2017.

Schroders Performance Since Inception



	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Schroders	6.1	32.7	16.0	14.2	10.2
MSCI ACWI (Net)	5.6	32.2	15.7	13.9	10.9
Relative Performance	0.4	0.3	0.3	0.3	(0.6)

*annualised since Inception April 16 2010

Turnover

Holdings at 31.12.16	Holdings at 31.03.17	Turnover in Qtr %	Turnover in Previous Qtr %
80	78	7.2	5.3

Purchases and Sales

Overall, portfolio activity this quarter was focused on streamlining; sales slightly outweighed new purchases. Aviva was bought ahead of its positive earnings release and the company has already had a positive effect on performance. Other purchases included Rockwell Automation, a high quality industrial with a strong brand, and Bayer and Synchrony Financial. Numerous sales were made to raise funds, from stocks either having reached their targets or deviated from their original investment thesis.

Top 5 Contributions to Return

HDFC Bank	0.2%
Jardine Strategic	0.2%
Exxon Mobil	0.1%
SMC	0.1%
Check Point	0.1%

Bottom 5 Contributions to Return

Cimarex	(0.3%)
Occidental Petroleum	(0.2%)
Statoil ASA	(0.2%)
Schlumberger	(0.2%)
Citigroup	(0.2%)

Top 10 Holdings

1	Citigroup	£3,768,021	6	Amazon	£2,713,254
2	Alphabet	£3,470,661	7	Taiwan Semicond.	£2,679,948
3	Comcast	£3,283,643	8	US Bancorp	£2,638,078
4	JP Morgan	£2,978,531	9	United Health	£2,531,033
5	Apple	£2,814,114	10	Nestle	£2,516,829

Hymans Robertson View

There were no significant developments over the quarter.

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 – Columbia Threadneedle
Quarterly Report March 2017**

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

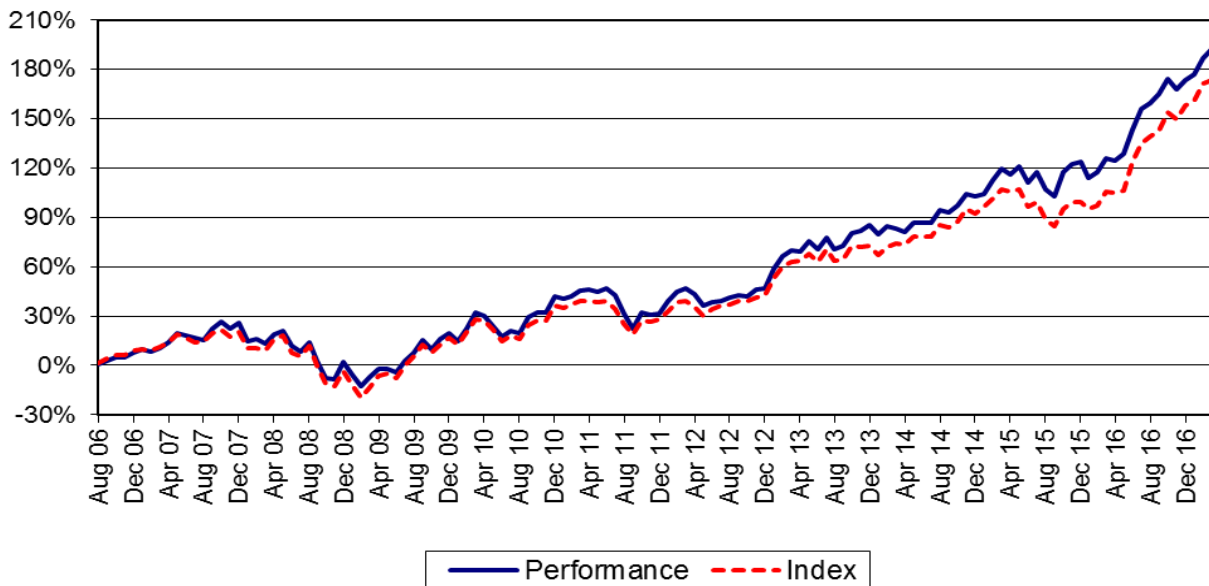
Value at 31.12.16	Value at 31.03.17
£113,866,498	£121,818,723

Performance

Columbia Threadneedle outperformed its benchmark over the quarter. Regional allocation effects detracted in aggregate, but stock selection proved beneficial, with their picks in emerging markets and the US the top performers. Asset allocation and stock selection were both beneficial in sector terms: the overweight in technology added value, as did stock selection in technology and the consumer sectors.

Columbia Threadneedle expect their focus on quality growth stocks to be rewarded over the coming year, and have, where appropriate, been adding to companies that stand to benefit from the shift in economic sentiment, particularly in the US, but without compromising their focus on quality. They also continue to like defensive and secular growth companies, which frequently have the ability to deliver consistent levels of growth despite the economic outlook.

Columbia Threadneedle Performance Since Inception



	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Columbia Threadneedle	7.0	29.4	16.8	14.7	10.6
MSCI ACWI	5.8	33.0	16.3	14.4	9.9
Relative Performance	1.1	(2.6)	0.4	0.3	0.6

* annualised, inception date 01/08/2006

Turnover

Holdings at 31.12.16	Holdings at 31.03.17	Turnover in Qtr %	Turnover in Previous Qtr %
88	85	12.5	6.4

Purchases and Sales

During the quarter Threadneedle initiated new positions in Bank of America, Bridgestone, Centene and Kubota Corp, and added to their holdings of Goldman Sachs. Positions in Willis Towers Watson, ASML Holding, UPS, Cellnex and Sabre Corp were fully sold.

Top 5 Contributions to Return

Activision Blizzard	0.74%
Micron Technology	0.42%
Facebook	0.41%
Unilever	0.41%
Amazon	0.39%

Bottom 5 Contributions to Return

Spirit Airlines	(0.14%)
Occidental Petroleum	(0.13%)
Sabre Corp	(0.13%)
United Parcel Service	(0.13%)
BT Group	(0.10%)

Top 10 Holdings

1	Alphabet	£4,040,856	6	Anheuser-Busch	£2,473,624
2	Amazon	£3,132,269	7	Activision Blizzard	£2,433,686
3	Facebook	£3,049,909	8	Unilever	£2,405,734
4	Visa	£2,550,791	9	Mastercard	£2,358,052
5	Schwab Corp	£2,543,340	10	Pfizer	£2,340,271

Hymans Robertson View

There were no significant developments over the quarter.

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 March 2017

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.

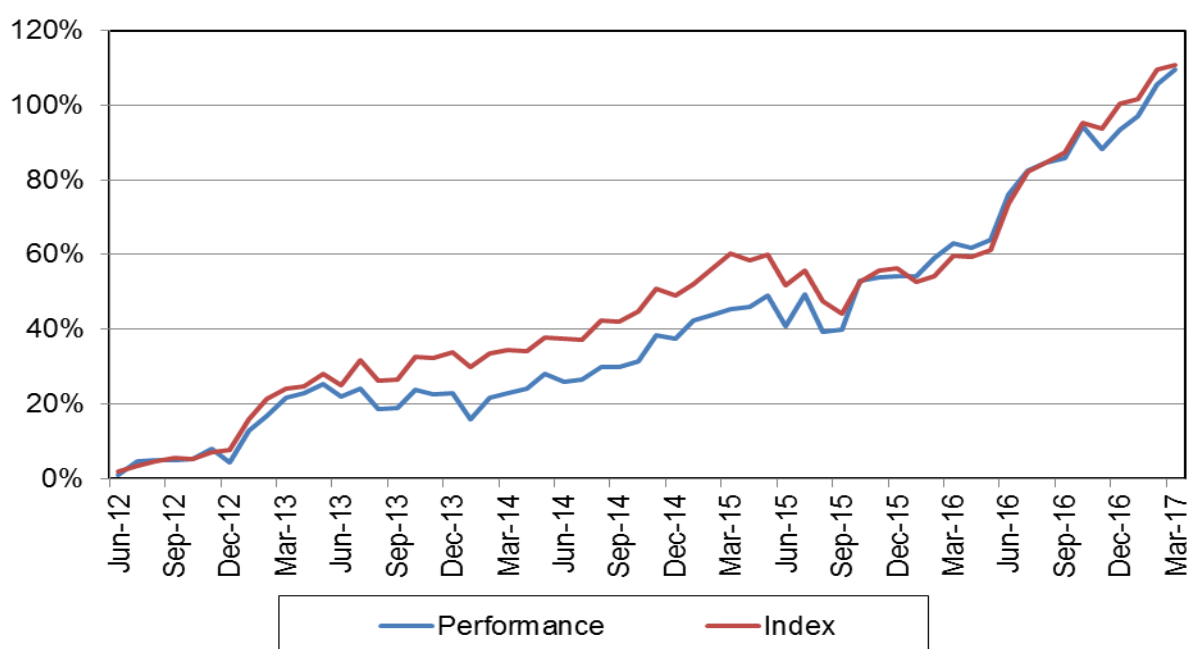
Portfolio Valuation

Value at 31.12.16	Value at 31.03.17
£165,210,491	£179,016,235

Performance

During the quarter, the Morgan Stanley Global Brands Fund performed strongly. Sector allocation was positive, as it was a good time to be zero weight Energy stocks and overweight Information Technology and Consumer Staples. Stock selection was distinctly positive. Strong performance in Consumer Staples, where the portfolio's stocks were 5% ahead of the sector index, and to an extent from Consumer Discretionary, outweighed the relative hit in Information Technology. The portfolio's positions in Information Technology did okay in the quarter (up 5%) but couldn't match the sector index, which was boosted by a very strong quarter for two heavyweights the portfolio does not own, namely Facebook and Apple.

Morgan Stanley Global Brands Performance Since Inception



	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception * %
Morgan Stanley Global Brands	8.4	28.6	19.5	N/A	16.5
MSCI World Index	5.1	31.9	16.1	N/A	16.7
Relative Performance	3.1	(2.5)	2.9	N/A	(0.1)

*annualised, inception date 18/06/2012

Purchases and Sales

During the quarter a position was initiated in Zoetis, the world's leading animal health company. Its sales are roughly 60% livestock and 40% companion animals (i.e. pets), and are well diversified by both geography and product. The animal health business has many of the attractions of the Pharmaceutical industry, notably the high returns on capital and defensiveness, but is less threatened by generic risk and politics. The customer base is highly fragmented and brand loyal, while the direct sales force provides an extra barrier to entry. During the period the manager also added to and reduced select Consumer Staples, Consumer Discretionary and Information Technology names for quality or valuation reasons.

Top Contributors to Return

Unilever	156 bps
Philip Morris	82 bps
Brit American Tobacco	80 bps

Bottom Contributors to Return

Zoetis	(5 bps)
ADP	(3 bps)

Top Ten Holdings

Company	Industry	% Weighting
Unilever	Personal Products	9.60
Reckitt Benckiser	Household Products	8.43
Microsoft	Software	6.77
L'Oreal	Personal Products	5.61
Altria	Tobacco	5.32
British American Tobacco	Tobacco	4.93
Twenty-First Century	Media	4.75
Philip Morris	Tobacco	4.59
Accenture	IT Services	4.50
Reynolds American	Tobacco	4.45

Hymans Robertson View

There were no relevant business issues reported over the period.

**Lincolnshire Pension Fund
Passive Bonds – Blackrock
Quarterly Report March 2017**

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.

Pooled Fund	Indexing Method
Aquila Life Corporate Bond All Stocks Index Fund	Sampled
Aquila Life Over 5 Years UK Index-Linked Gilt Index Fund	Full Replication
Aquila Life All Stocks UK Gilt Index Fund	Sampled

Portfolio Valuation at 31st March 2017

Portfolio	31.12.16 £	31.03.17 £
Corporate Bond All Stocks Index Fund	66,383,698	67,580,423
Over 5 Years UK Index-Linked Gilt Index Fund	41,083,739	41,896,507
All Stocks UK Gilts*	26,477,489*	26,763,537
Cash (residual)	10	1
Total	133,944,936	136,240,468

*Switched from Overseas Bond Index Fund in February 17

Performance

Over all periods the portfolio has performed as expected.

	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Blackrock	1.7	13.9	10.3	7.7	8.2
Composite Benchmark	1.8	13.9	10.2	7.6	8.1
Relative Performance	(0.1)	0.0	0.1	0.1	0.1

*annualised since inception 28/07/10

Hymans Robertson View

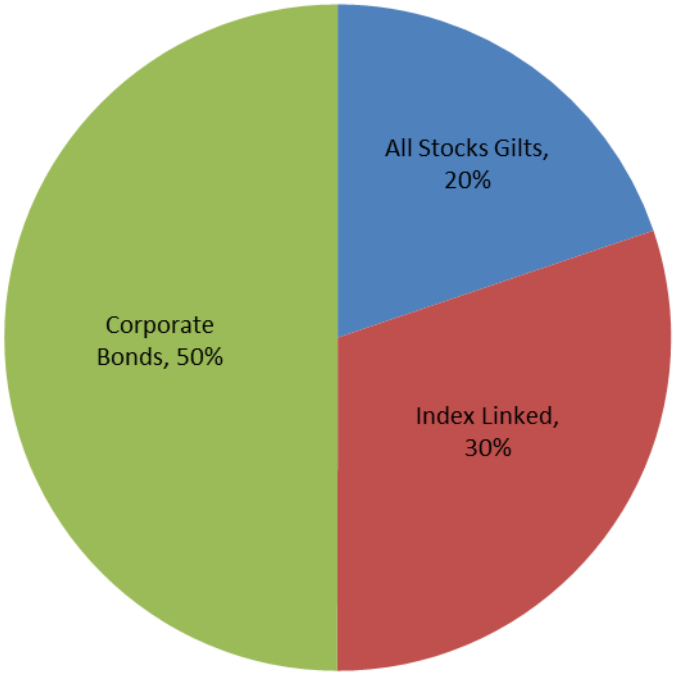
There were no significant developments within the Index Fixed Income team over the quarter.

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 All Stocks UK Gilt Index Fund	20%

The pie chart below shows the allocation as at 31st March 2017.



**Lincolnshire Pension Fund
Alternative Investments – Morgan Stanley
Quarterly Report March 2017**

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 Fund allocation. The manager has a target to beat the return of 3 Month LIBOR + 4%. Morgan Stanley also manages the legacy private equity investments, however they are excluded from this report.

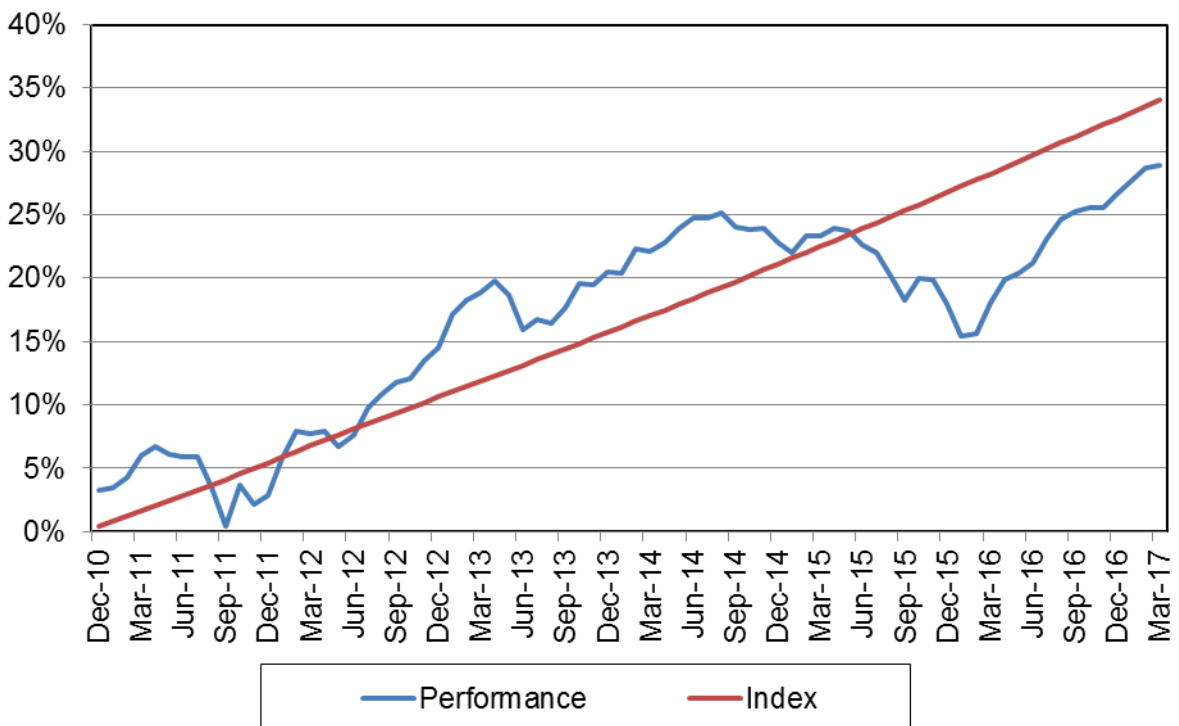
Portfolio Valuation

Value at 31.12.16	Value at 31.03.17
£219,318,494	£246,459,818

Performance

The portfolio returned 1.18% during the first quarter. Hedge funds drove absolute returns, followed by frontier equity and infrastructure. Lagged and negative marks in private equity and real estate dragged on returns. Manager selection also modestly detracted from relative returns, while tactical decisions were muted. Within manager selection, commodities and frontier equity particularly lagged.

Morgan Stanley AIP Performance Since Inception



	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Morgan Stanley	1.8	9.1	1.8	3.7	4.1
3 Month LIBOR + 4%	1.1	4.5	4.6	4.7	4.7
Relative Performance	0.7	4.4	(2.7)	(1.0)	(0.6)

* 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;

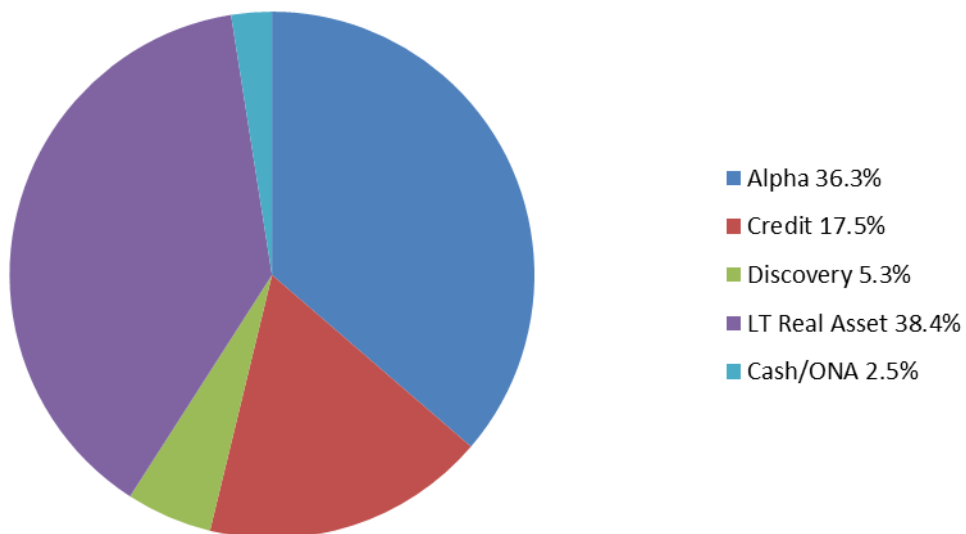
Alpha – These are pure return seeking products based on Manager skill. The Alpha investments include Hedge Funds, Global Tactical Asset Allocation (GTAA) and Active Currency.

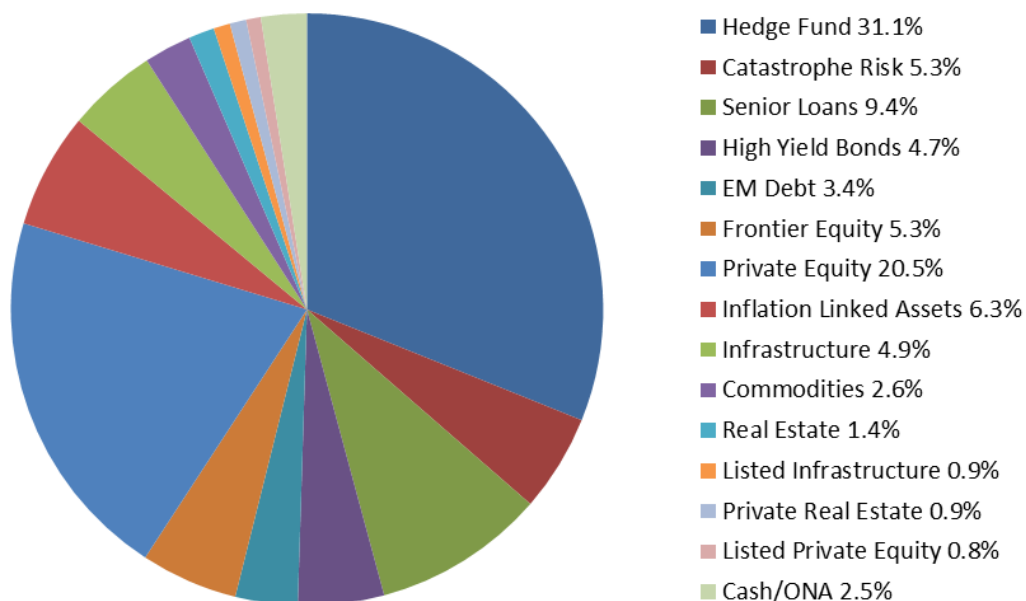
Long Term Real Asset – These are long term investments that seek to access illiquidity premium. Investments include Private Equity, Infrastructure, Real Estate, Commodities and Inflation – linked strategies.

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.

The pie charts below shows the strategy and asset class positions of the Morgan Stanley portfolio as at 31st March 2017.





Portfolio Positioning

Hedge funds continue to be the largest allocation within the portfolio. Many of the conditions that hurt hedge funds over the last few years have, to a large extent, dissipated, e.g. ultra-accommodative monetary policy, volatility suppression tactics and crowding into limited pockets of opportunity during a prolonged low rate low growth environment. Correlations across asset classes, sectors and stocks have dropped while dispersion has increased, auguring an increase in alpha. MS believe that a well selected hedge fund portfolio across the different strategies can provide both return potential and differentiated risks to a portfolio without too much dependency on the interest rates, credit or equity markets.

On the liquid side, the credit allocation is comprised of senior loans, high yield and EM debt, where MS continue to favour senior loans and keep a relatively low duration exposure. As it relates to liquid real assets, we maintain a significant tactical underweight - we remain cautious on REITs and listed private equity based on valuation levels and aim to minimize energy equity exposure (through listed infrastructure) alongside our broader energy investment theme.

MS continue to build out the private markets portfolio. During the previous quarter they focused on natural resources opportunities and made a commitment to a private fund dedicated to investing in farmland assets in the U.S. During the first quarter of 2017, they continued this research and are currently evaluating opportunities to add complementary southern hemisphere exposure.

Hymans Robertson View

There were no significant developments over the quarter.

Risk Control

Portfolio volatility since inception is 3.85%, within the guidelines specified by the mandate.

Conclusion

Over the quarter, the Fund produced a positive return of 4.64%, outperforming the benchmark which returned 3.47%.

Consultation

a) Have Risks and Impact Analysis been carried out?

Yes

b) Risks and Impact Analysis

The Pension Fund has a Risk Register which can be obtained by contacting the author of this report.

Background Papers

This report was written by Jo Ray, who can be contacted on 01522 553656 or jo.ray@lincolnshire.gov.uk.

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