Regulatory and Other Committee

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

Report to:	**Pensions Committee**
Date:	**22 March 2018**
Subject:	**Investment Management Report**

Summary:

This report covers the management of the Lincolnshire Pension Fund assets over the period from 1st October to 31st December 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

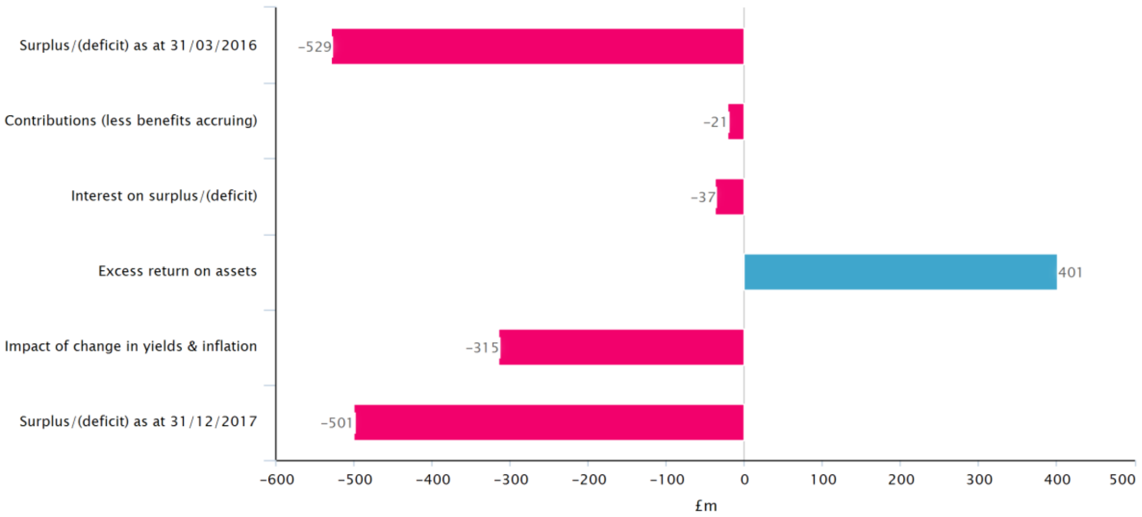
1. Funding Level Update

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 December 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 December 2017, where the funding level has increased to 82.1%.

Change in funding level since last valuation

1.3 Over that same time period the deficit, in real money, has decreased from £529m to £501m. The chart below shows the main impactors on the deficit, with the excess return in assets offsetting the negative changes in yields and inflation.



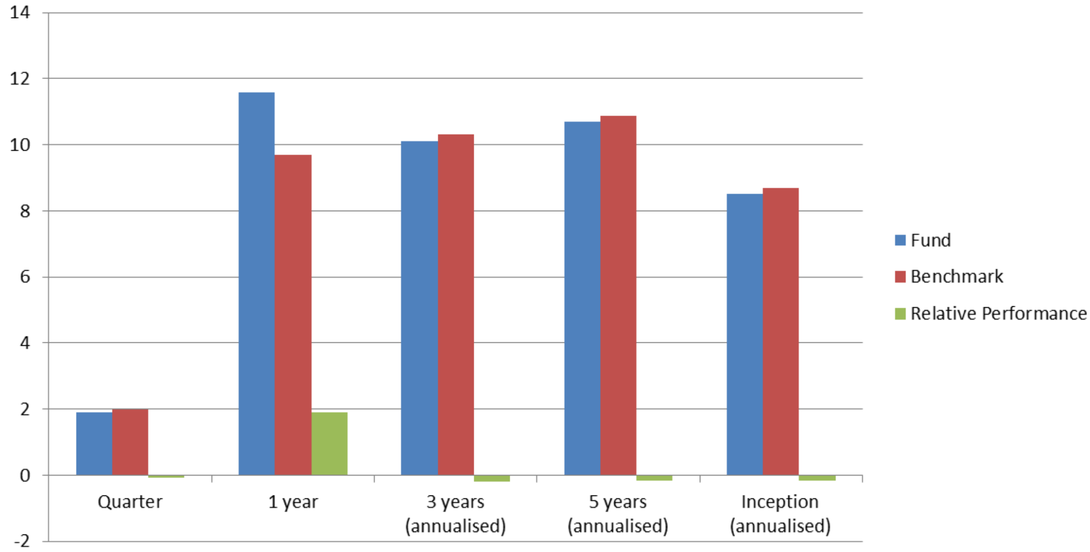
1.4 On a shorter term time horizon, looking at the last quarter, the funding level increased from 81.8% to 82.1% between 30th September 2017 and 31st December 2017, and the deficit increased from £492m to £501m.

2. Fund Performance & Asset Allocation

2.1 The Fund increased in value by £85.3m during the quarter from £2,160.7m to £2,246.0m, as the table below shows.

Asset Class	Q4 2017 £m	Q3 2017 £m	Asset Allocation %	Strategic Asset Allocation %	Difference %
UK Equities	433.7	413.0	19.3	20.0	(0.7)
Global Equities	981.1	930.7	43.7	40.0	3.7
Alternatives	310.4	303.7	13.8	15.0	(1.2)
Property	207.1	203.0	9.2	9.0	0.2
Infrastructure	32.7	31.8	1.5	2.5	(1.0)
Fixed Interest	265.5	261.2	11.8	13.5	(1.7)
Cash	15.5	17.3	0.7	0.0	0.7
Total	**2,246.0**	**2,160.7**	**100.0**	**100.0**	

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	1.9	1.98	(0.08)
1 year	11.58	9.69	1.89
3 years*	10.11	10.31	(0.2)
5 years*	10.7	10.87	(0.17)
Inception**	8.5	8.68	(0.18)

*Annualised from Yr 3 **Since Inception figures are from March 1987

2.3 Over the quarter, the Fund produced a positive return of 1.9% (as measured by JPMorgan), slightly underperforming the benchmark by (0.08%). The Fund was ahead of the benchmark over the 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 Morgan Stanley Alternative Investments has been moved from one notch down from preferred manager, but still within "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	Retain - preferred
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 one manager, Schroders, underperformed their benchmark over the quarter. Over the 12 month period, all managers have produced a positive absolute return, and all have matched or outperformed their benchmark.

	3 months ended 31/12/17			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	5.0	5.0	0.0	N/A	N/A	N/A	Match Index
Invesco (Global Equities (ex UK))	4.9	4.6	0.3	11.9	11.8	0.1	+1.0
Columbia Threadneedle (Global Equities)	6.5	5.0	1.4	20.8	13.8	6.1	+2.0
Schroder's (Global Equities)	4.0	4.9	(0.8)	16.0	13.2	2.4	+3.0
Morgan Stanley Global Brands	6.9	4.6	2.1	14.8	11.8	2.6	n/a
Blackrock (Fixed Interest)	2.5	2.5	0.0	3.3	3.2	0.1	Match Index
Blackrock Interim (Fixed Interest)	0.7	0.7	0.0	1.7	1.7	0.0	Match Index
Morgan Stanley (Alternative Investments)	2.2	1.1	1.1	7.6	4.5	3.0	3M LIBOR + 4%

Infrastructure

4.3 At the January 2017 meeting of this Committee, an increase in the strategic allocation to infrastructure was approved, and authority delegated to Officers to identify new investments to commit to. Officers updated the Committee on the first infrastructure commitment to Infracapital's Greenfield Partners I Fund at the October meeting. Following more research and due diligence undertaken by Officers and the Investment Consultant, it was agreed to commit an additional £15m to Pantheon's Global Infrastructure III fund.

4.4 Pantheon is a manager well known to the Lincolnshire Fund, as we have been invested in their private equity funds since 2000. Hymans Robertson regards Pantheon as a manager with strong credentials within infrastructure and with broad capabilities across the market.

4.5 Pantheon's Global Infrastructure III (PGI III) is targeting $1.2 billion in capital commitments to build a portfolio of high quality assets through secondaries and co-investments, partnering with leading infrastructure GPs. It will focus on developed economies, with the aim to capitalize on investment opportunities arising from infrastructure deficiencies, government policies supporting infrastructure investment and a growing range of mid-market opportunities coming from the private sector. It is targeting exposure to a range of sub-sectors, including energy (renewables and conventional power) transport, communications, water and social infrastructure. The focus is on brownfield and operating assets, with limited exposure to greenfield investments and development risks. This complements the previous commitment to Infracapital's fund that focuses on greenfield investments.

4.6 Progress on this investment will be included in the annual property and infrastructure report that is brought to the Committee each July.

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

Investment Process

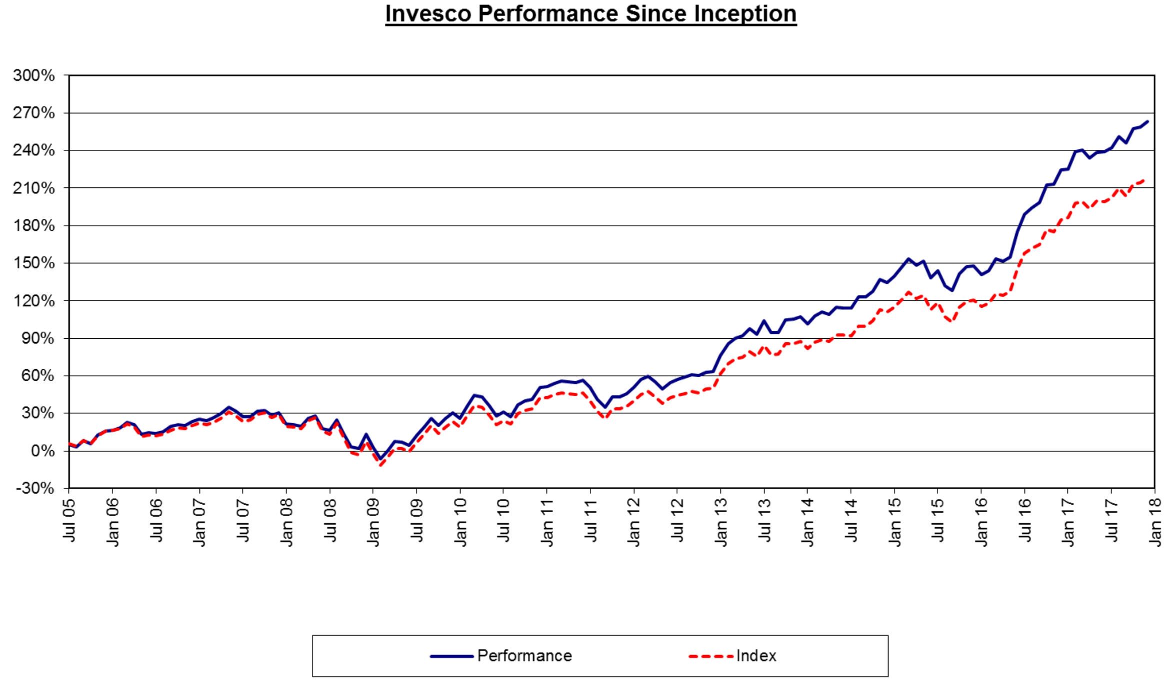
This portfolio is mandated to track the MSCI World ex UK Index, with a performance target of +1% and a tracking error of 1%. The aim is to achieve long-term capital growth from a portfolio of investments in large-cap global companies. Active performance is generated through a quantitative bottom-up investment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

Portfolio Valuation

Value at 30.09.17	Value at 31.12.17
£500,193,978	£524,978,456

Performance

During the quarter Invesco's strategy outperformed its benchmark, with two of three positive months. As should be expected, stock selection led the outperformance. Within stock selection, the stocks with high value scores were the highest contributors. Performance over the longer term continues to be above the target return of +1%.



	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception * %
Invesco	4.9	11.9	15.7	17.3	10.3
MSCI World ex UK	4.6	11.8	14.7	16.2	9.2
Relative Performance	0.3	0.1	0.8	0.9	1.0

* annualised, inception date 1st July 2005

Turnover

Holdings at 30.09.17	Holdings at 31.12.17	Turnover in Qtr %	Turnover in Previous Qtr %
463	454	7.5	8.8

Purchases and Sales

During the quarter, Invesco made a number of stock adjustments to the portfolio. Top purchases over the quarter included adding Marathon Petroleum, Nippon Express Co and Toll Brothers into the portfolio, and increasing their positions in Faurecia, Mastercard and Facebook. Top sales over the quarter were in selling out of their positions in Inditex, Sysco and DowDuPont, and decreasing their positions in Merck, Wellcare Health Plans and Philip Morris.

Largest Overweights

Wal-mart	1.00%
Boeing	0.96%
Citigroup	0.95%
Faurecia	0.86%
JP Morgan Chase	0.80%

Largest Underweights

Amazon	(0.66%)
Alphabet	(0.56%)
Verizon Communications	(0.52%)
DowDuPont	(0.44%)
Walt Disney	(0.44%)

* Measured against MSCI World ex UK (NDR)

Top 10 Holdings

1	Apple	14,664,876
2	Microsoft	9,397,342
3	JPMorgan Chase	9,338,109
4	Citigroup	7,717,235
5	Boeing	7,258,385

6	Wal-mart	7,256,081
7	Johnson & Johnson	5,928,430
8	Facebook	5,657,252
9	Bank of America	5,656,313
10	Procter & Gamble	5,176,044

Hymans Robertson View

This is a quantitative global equity strategy run from Invesco's Frankfurt office. The team aims to implement a factor based strategy in a systematic manner - producing a well-diversified equity portfolio exhibiting a low level of volatility. The portfolio managers carry out a final check on the proposed portfolio / trades but the portfolio construction process is essentially carried out within the model. The strategy has been successful in generating modest levels of outperformance at very low levels of risk.

There were no significant developments over the quarter.

Risk Control

The predicted tracking error of the portfolio slightly increased to 1.02%, 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 December 2017

Investment Process

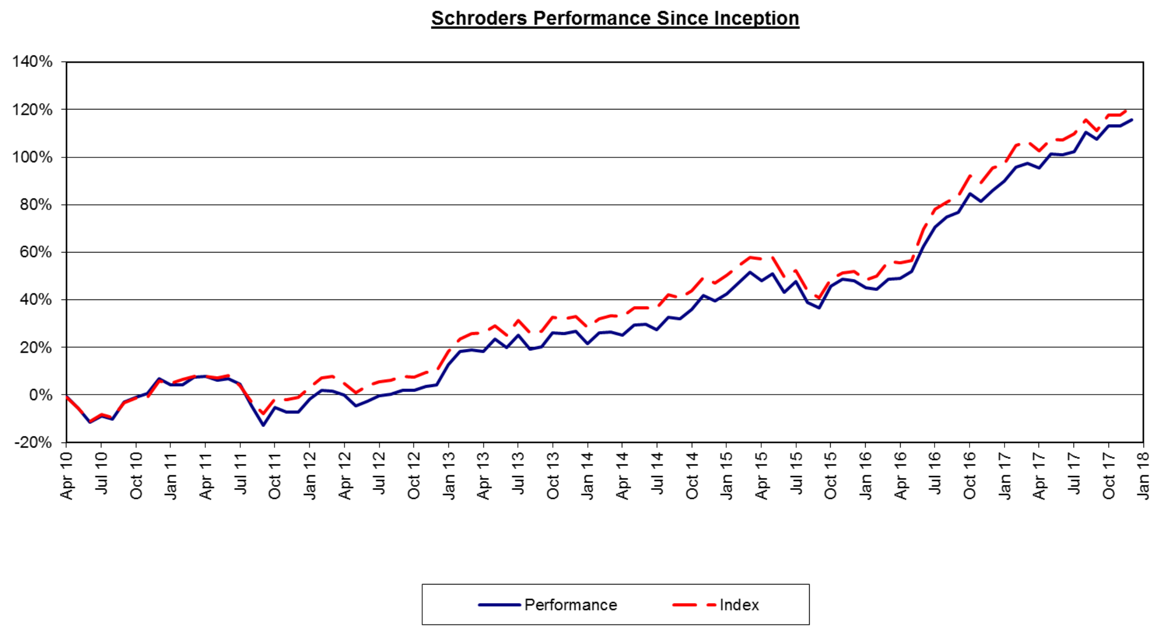
This portfolio is mandated to outperform the MSCI All Countries World Daily Net Index by 2% to 4% over rolling three year periods, gross of fees. This is achieved through an investment approach that is designed to add value relative to the benchmark through both stock selection and asset allocation decisions. 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 30.09.17	Value at 31.12.17
£123,955,124	£129,025,813

Performance

The portfolio underperformed the benchmark over the quarter, but strongly outperformed over the year. Stock selection, while weaker in this quarter, contributed most of the positive relative return in 2017. Positions in the IT, financial and healthcare sectors posed the principal headwinds and offset a stronger contribution from industrial stocks. By region, the underperformance was mainly attributable to the North American and emerging markets exposure, while Europe was positive.



	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Schroders	4.0	16.0	15.7	15.7	10.4
MSCI ACWI (Net)	4.9	13.2	14.6	15.0	10.8
Relative Performance	(0.8)	2.4	0.9	0.6	(0.3)

*annualised, Inception date April 2010

Turnover

Holdings at 30.09.17	Holdings at 31.12.17	Turnover in Qtr %	Turnover in Previous Qtr %
81	80	8.2	10.9

Purchases and Sales

Several trades were made over the quarter; closing a number of positions as either the investment thesis played out or the stock deviated from the expectations for the business. Proceeds were rotated into higher conviction ideas. Two key transactions were buying Toyota and selling TAX Group. Toyota has an extremely strong balance sheet and is making investments in new technologies that leave it well placed to emerge as a leader in the transition to electric vehicles. TAX Group had disappointed on a number of key milestones, notably same store sales and market share gains, and the position was exited.

Top 5 Contributions to Return

Estee Lauder	0.2%
Amazon.com	0.2%
Union Pacific	0.2%
General Electric	0.2%
United Health Group	0.1%

Bottom 5 Contributions to Return

Grupo Financiero	(0.2%)
Celgene	(0.2%)
Bayer	(0.2%)
Intesa Sanpaolo	(0.1%)
Amgen	(0.1%)

Top 10 Holdings

1	Citigroup	£4,110,581
2	Alphabet	£4,030,603
3	JPMorgan Chase	£3,359,795
4	United Health	£3,148,982
5	Comcast	£3,100,297

6	Amazon.com	£3,092,363
7	Taiwan Semiconductors	£3,060,477
8	DowDuPont	£3,008,911
9	Visa	£2,871,978
10	Union Pacific	£2,758,525

Hymans Robertson View

The Schroder's fundamental equity team has settled down under the leadership of Alex Tedder. We regard his actions in rebuilding the team as being a good foundation for the future and should improve consistency. There have been periods in recent years when portfolios focused on fundamental long term growth have struggled in markets dominated by low growth and risk aversion - though we support the broad philosophy of the team.

In October 2017, Frank Thormann joined the Global Equity team, from Union Investment. The recruitment of Thormann means there are now six Portfolio Managers on the team.

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 December 2017

Investment Process

The portfolio is designed to outperform the MSCI All Countries World Index by 2% per annum, gross of fees, over rolling three-year periods. The team focus on quality growth companies with high or rising returns on investor capital, and sustained or improving competitive advantage. The focus is on stock selection, with a well-diversified portfolio designed to deliver superior risk adjusted returns.

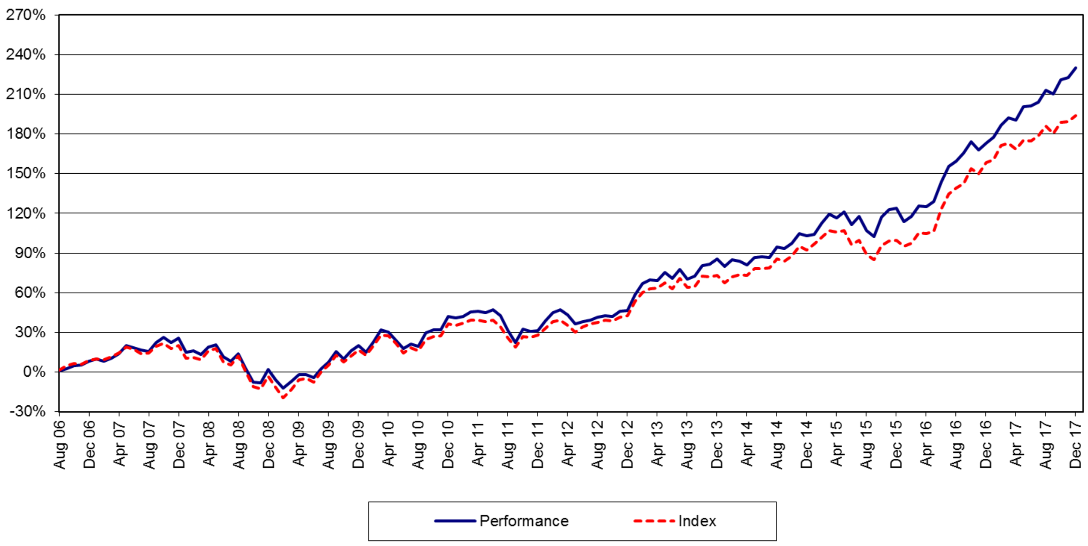
Portfolio Valuation

Value at 30.09.17	Value at 31.12.17
£129,173,578	£137,499,819

Performance

Gross of fees, the fund outpaced its index, extending its calendar-year relative gains. Stock selection drove returns, led by picks in financials and industrials. Top contributors included: Yaskawa, which continued to rise on positive sentiment surrounding the robotics space and themes of factory automation; Ping An, where markets continued to laud their tech driven expansion; and United Rentals, who extended its strong run on a positive quarterly earnings report in October, where the company exceeded estimates. Detractors included: Tesaro, which fell amid concerns over the competitive environment for the company's ovarian cancer therapy drug, Zejula; and Criteo, a position that was sold on potential business model disruption by Apple software.

Columbia Threadneedle Performance Since Inception



	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Columbia Threadneedle	6.5	20.8	17.6	17.6	11.0
MSCI ACWI	5.0	13.8	15.2	15.6	9.9
Relative Performance	1.4	6.1	2.1	1.8	1.0

* annualised, inception date 01/08/2006

Turnover

Holdings at 30.09.17	Holdings at 31.12.17	Turnover in Qtr %	Turnover in Previous Qtr %
84	81	12.7	5.1

Purchases and Sales

New positions were initiated in Rio Tinto, from a belief that it can benefit from its competitive cost advantage and attractive cash flow valuation, and Ingersoll-Rand, switching in from Johnson Controls. Ingersoll-Rand continues to win share in the commercial and residential heating, ventilation and air-conditioning (HVAC) business, and has the potential to deliver mid-teen earnings-per-share growth, driven by margin expansion and organic growth. Also a position in global biopharmaceutical company Celgene was bought, which offers strong prospects for operating margin improvements in the medium-term. This was funded by the exit from Novartis. Other new holdings included software giant Microsoft, and Tyler Technologies. Both Micron Technology and Costco were exited on valuations.

Top 5 Contributions to Return

Ping An Insurance	0.61%
Amazon.com	0.45%
Yaskawa Electric	0.40%
United Rentals	0.36%
Charles Schwab	0.33%

Bottom 5 Contributions to Return

Criteo SA	(0.25%)
Tesaro	(0.25%)
Macom Technology	(0.21%)
Gilead Sciences	(0.18%)
CRH plc	(0.11%)

Top 10 Holdings

1	Alphabet	£4,798,411
2	JPMorgan Chase	£3,495,452
3	Amazon.com	£3,423,472
4	Bank of America	£3,248,136
5	Goldman Sachs	£3,022,816
6	Charles Schwab	£3,008,226
7	Visa	£2,774,337
8	Microsoft	£2,725,024
9	Alibaba	£2,722,904
10	Mastercard	£2,703,412

Hymans Robertson View

The team's investment approach is based on fundamental research with a strong emphasis on inputs from the broader investment research resources at Columbia Threadneedle. The portfolios of around 60 - 70 stocks typically have a growth bias. The team is now well resourced and will hopefully enjoy a period of stability. William Davies is regarded as key to the operation of the team and we will be monitoring whether his expanded role as Head of Equities for EMEA has any detrimental impact in terms of his time spent on portfolio management.

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 December 2017

Investment Process

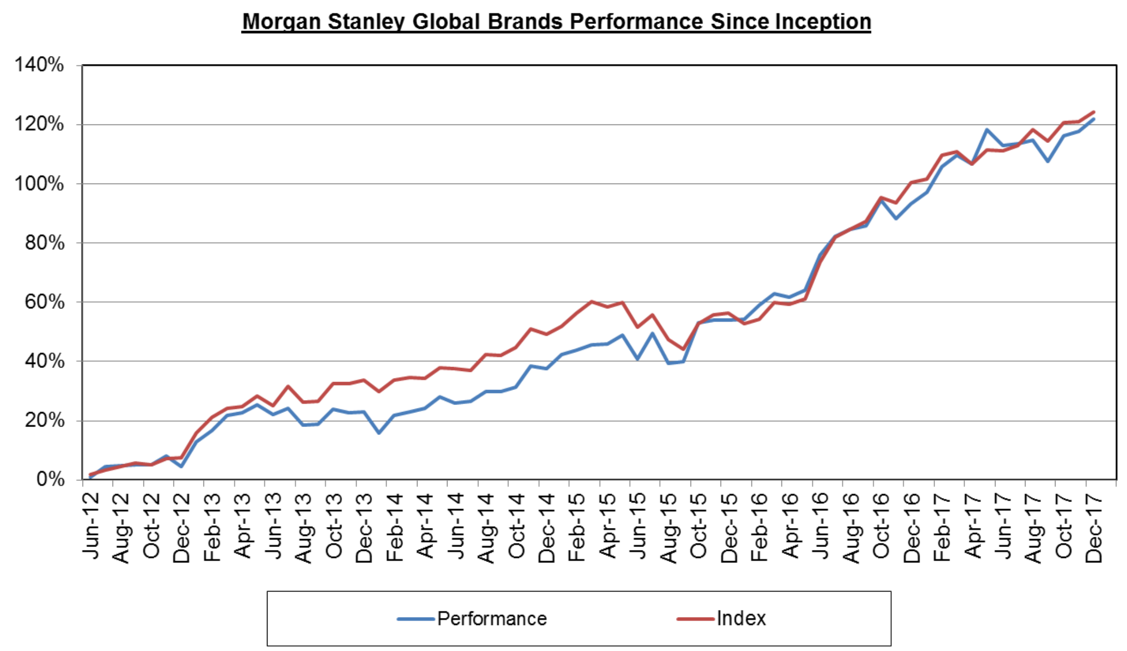
The Global Brands Fund is an open-ended investment company incorporated in the United Kingdom. The aim of the Fund is to provide long term capital appreciation through investing in a concentrated high quality global portfolio of companies with strong “intangible assets”. The Fund is benchmarked against 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 30.09.17	Value at 31.12.17
£177,386,063	£189,592,648

Performance

The portfolio outperformed in relative terms over the quarter, returning 6.9% versus 4.6% for the index. The key driver for the fourth quarter was stock selection in Consumer Discretionary, followed by stock selection and allocation in Information Technology and Health Care. Stock selection in Consumer Staples detracted, as did the underweights in Materials and Energy.



	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Morgan Stanley Global Brands	6.9	14.8	17.3	16.3	15.3
MSCI World Index	4.6	11.8	14.6	15.8	15.6
Relative Performance	2.1	2.6	2.4	0.4	(0.2)

*annualised, inception date 18/06/2012

Purchases and Sales

During the quarter, positions were initiated in FactSet and Fidelity National Information Services (FIS). FactSet is a financial software data and analytics vendor that continues to gain market share. FIS is a leading global provider of software solutions and innovations to the financial services industry. BAT was added to, given the firm's positive operational outlook and attractive valuation, and the positions in Danaher and RELX were increased. Positions were reduced in Unilever given strong performance, and also in Reckitt Benckiser, Nestlé and Disney. The position in Time Warner was sold, given concerns that intervention from the U.S. Department of Justice would block the proposed merger with AT&T.

Top Contributors to Return

Twenty-First Century Fox	1.23%
Microsoft	1.04%
Accenture	0.98%

Bottom Contributors to Return

Unilever	(0.29%)
Philip Morris	(0.20%)
Time Warner	(0.06%)

Top Ten Holdings

Company	Industry	% Weighting
British American Tobacco	Tobacco	8.64
Microsoft	Software	7.73
Accenture	IT Services	7.71
Reckitt Benckiser	Household Products	6.37
Unilever	Personal Products	6.35
Visa	IT Services	4.70
L'Oreal	Personal Products	4.56
SAP	Software	4.41
Twenty-First Century Fox	Media	4.17
Philip Morris	Tobacco	4.01

Hymans Robertson View

The manager runs concentrated portfolios of 20 - 40 stocks with a strong quality bias, low turnover and low volatility in absolute terms. Companies need to exhibit high returns on capital, be investing to protect their brands and have shareholder friendly management teams. There is a tendency for the portfolio to have large allocations to consumer and technology stocks, often with limited exposure to many other sectors of the market. On a regional basis the strategy is often overweight in UK listed stocks though high levels of revenue earned in emerging markets is a more important feature. The strategy is currently open but with limited capacity available. The long term track record is strong, performing well in relative terms in down markets and generally keeping pace in all but the most extreme up market phases. This provides stability when employed alongside other active equity managers.

No significant developments were reported over the quarter.

Lincolnshire Pension Fund
Passive Bonds – Blackrock
Quarterly Report December 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 December 2017

Portfolio	**30.09.17 £**	**31.12.17 £**
Corporate Bond All Stocks Index Fund	67,566,248	68,867,424
Over 5 Years UK Index-Linked Gilt Index Fund	40,571,464	42,165,987
All Stocks UK Gilts*	26,873,350	27,406,875
Cash (residual)	1	1
Total	**135,201,580**	**138,440,288**

*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	2.5	3.3	7.1	6.8	7.5
Composite Benchmark	2.5	3.2	7.0	6.7	7.4
Relative Performance	0.0	0.1	0.1	0.1	0.1

*annualised since inception 28/07/10

Hymans Robertson View

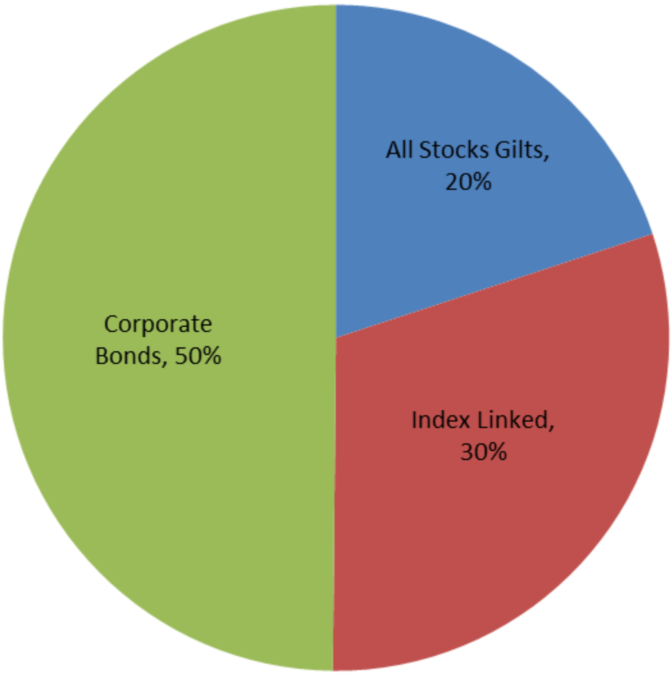
There were no significant developments within the Index Fixed Income team over the quarter.

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 December 2017.



Lincolnshire Pension Fund
Passive Bonds – Blackrock interim
Quarterly Report December 2017

Investment Process

Since the termination of BMO's Absolute Return bond fund, that element of the Fund's asset allocation has been temporarily housed in an interim Blackrock fund of short dated corporate bonds. The fund is managed passively, and aims to achieve index returns in line with the iBoxx Sterling Non-Gilts 1-5 Year Index.

Portfolio Valuation

Value at 30.09.17	Value at 31.12.17
£126,328,641	£127,064,948

Performance

Over all periods the portfolio has performed as expected.

	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Blackrock Interim	0.7	1.7	n/a	n/a	1.5
Benchmark	0.7	1.7	n/a	n/a	1.5
Relative Performance	0.0	0.0	n/a	n/a	0.1

*annualised since inception 14/09/16

Hymans Robertson View

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

Lincolnshire Pension Fund
Alternative Investments – Morgan Stanley
Quarterly Report December 2017

Investment Process

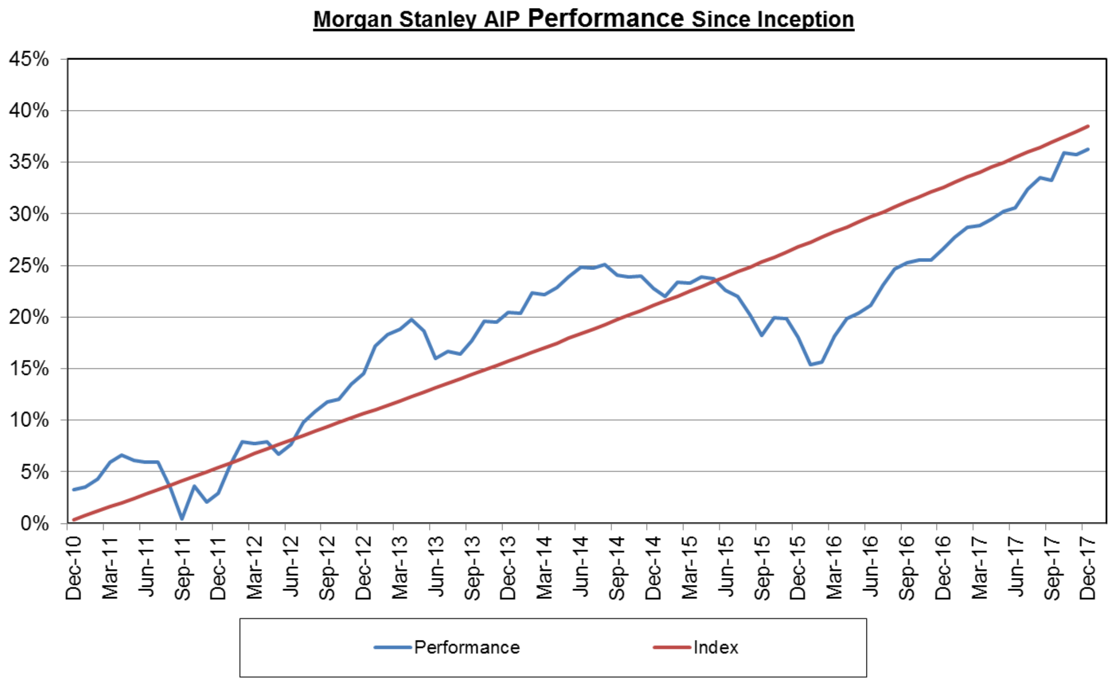
Morgan Stanley manages a bespoke absolute return alternative investment mandate for the Fund. The portfolio is invested in alternatives only, with no exposure to traditional equities or bonds. Investments are made to complement our existing Fund allocation. The manager has a target to beat the return of 3 Month LIBOR + 4%. Morgan Stanley also manage the legacy private equity investments, however they are excluded from this report.

Portfolio Valuation

Value at 30.09.17	Value at 31.12.17
£264,390,864	£273,986,004

Performance

The portfolio outperformed during the quarter, where private markets and hedge funds drove absolute returns. Tactical decisions were overall additive, particularly the increased frontier equity exposure, while manager selection modestly detracted from relative returns. Within manager selection, frontier equity, hedge funds and EM debt particularly lagged.



	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Morgan Stanley	2.2	7.6	3.5	3.5	4.5
3 Month LIBOR + 4%	1.1	4.5	4.6	4.6	4.7
Relative Performance	1.1	3.0	(1.0)	(1.0)	(0.2)

* 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;

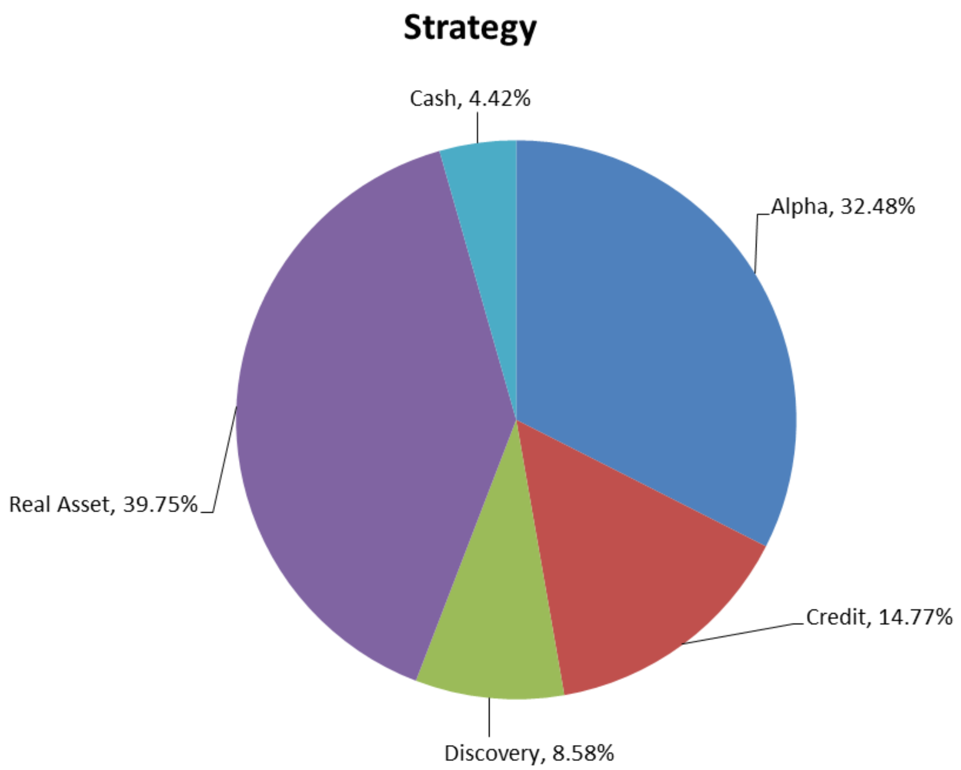
Alpha These are pure return seeking products based on Manager skill. The Alpha investments include Hedge Funds, Global Tactical Asset Allocation (GTAA) and Active Currency.

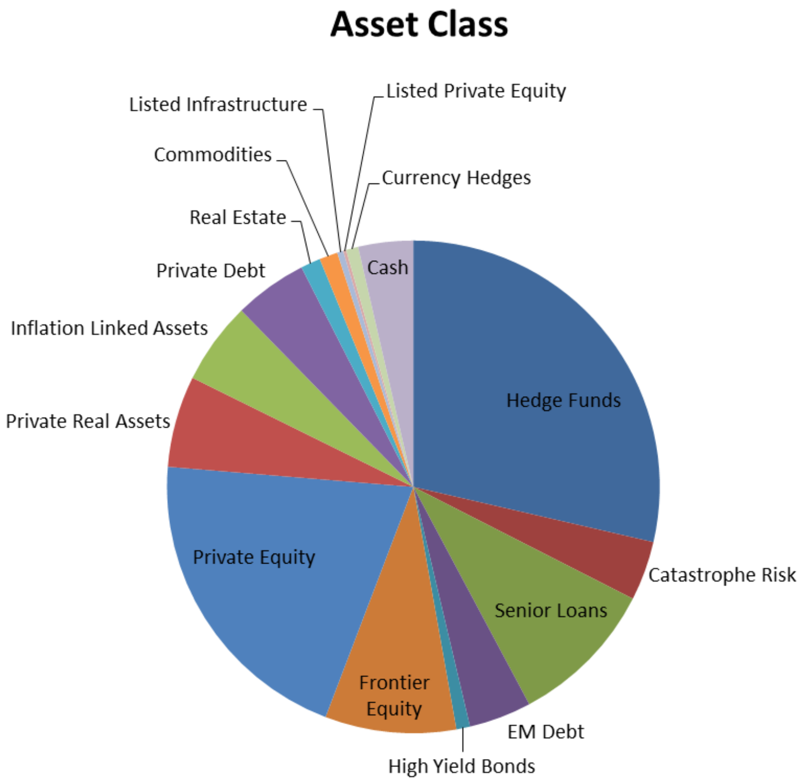
Long Term Real Asset These are long term investments that seek to access illiquidity premium. Investments include Private Equity, Infrastructure, Real Estate, Commodities and Inflation – linked strategies.

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.

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





Portfolio Outlook

Most assets performed well in 2017, as the combination of sustained economic expansion and continued easy financial conditions buoyed risky assets. As 2018 starts, it's difficult to see what will disrupt this not-too-hot, not-too-cold environment. Growth continues to surprise on the upside, but inflationary pressures remain dormant, implying the unusually slow pace of central bank policy normalisation will continue. In this world of a positive macroeconomic environment, somewhat high valuations and low correlations, alpha/issuer selection is likely to be a far bigger driver of performance.

There are always things to worry about from central bank policy surprises to geopolitical explosions. MS believe one of the key risks, if not maybe the most important risk, for 2018 is not so much the macroeconomic picture turns unfavourable, but that the market's demanding expectations are not met. Central banks may still normalise policy very slowly in comparison to previous cycles, but it will not take much to exceed current market pricing. This would happen if the Fed raises rates more than twice, if the ECB ends quantitative easing (QE) in September, or if the Bank of Japan shifts at all on its yield curve control policy. In the U.S., the composition of the FOMC still in flux, as President Trump has several more appointments to make. Given current valuations, the skew in potential outcomes for government bond markets is towards yields moving meaningfully higher rather than lower. Therefore, even if one's central scenario is not very different from what the market expects, it makes sense to position for higher yields.

In credit, the concern is that even a benign economic outlook may not be enough to drive outperformance given the spread compression that has already happened. One will need to be far more selective in where one takes spread risk to both eke out higher returns and minimise potential losses in a sell-off. Alpha/issuer selection is likely to be a far bigger driver of performance than just being long beta/carry. Given the greater diversity of macroeconomic situations, Emerging Markets may be an attractive space to look for alpha opportunities.

In terms of new research in private real assets, MS are cautious on current market pricing and we are exploring opportunities to purchase investor interests in existing assets and funds as a method of navigating elevated valuations. MS remain disciplined in their small and mid-cap private equity bias and have a consistently strong flow of attractive co-investment opportunities with their high quality partners. Also, MS increasingly see opportunities in private equity to participate in appealing investments that have non-standard structures and have negotiated several of these transactions during the fourth quarter that benefited from limited investor competition. During the quarter MS complemented the existing private debt portfolio with the addition of a real estate debt strategy, which is expected to provide attractive floating rate income through exposure to U.S. commercial real estate.

Hymans Robertson View

This strategy offers exposure to a broad range of alternative assets. Morgan Stanley employs an open architecture approach, investing through both internal and external fund managers. For liquidity purposes the portfolio has historically maintained a high allocation to hedge funds. In addition, the strategy is designed to remain fully invested and the manager will not make active use of cash or fixed income to preserve capital during stress periods in markets.

There were no significant developments over the quarter.

Risk Control

Portfolio volatility since inception is 3.70%, within the guidelines specified by the mandate.

Conclusion

Over the quarter, the Fund produced a positive return of 1.9%, slightly underperforming the benchmark which returned 1.98%.

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

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 Jo Ray, who can be contacted on 01522 553656 or jo.ray@lincolnshire.gov.uk.