

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

Report to:	Pensions Committee
Date:	04 October 2018
Subject:	Investment Management Report

Summary:

This report covers the management of the Lincolnshire Pension Fund assets over the period from 1st April 2018 to 30th June 2018.

Recommendation(s):

That the committee note this report.

Background

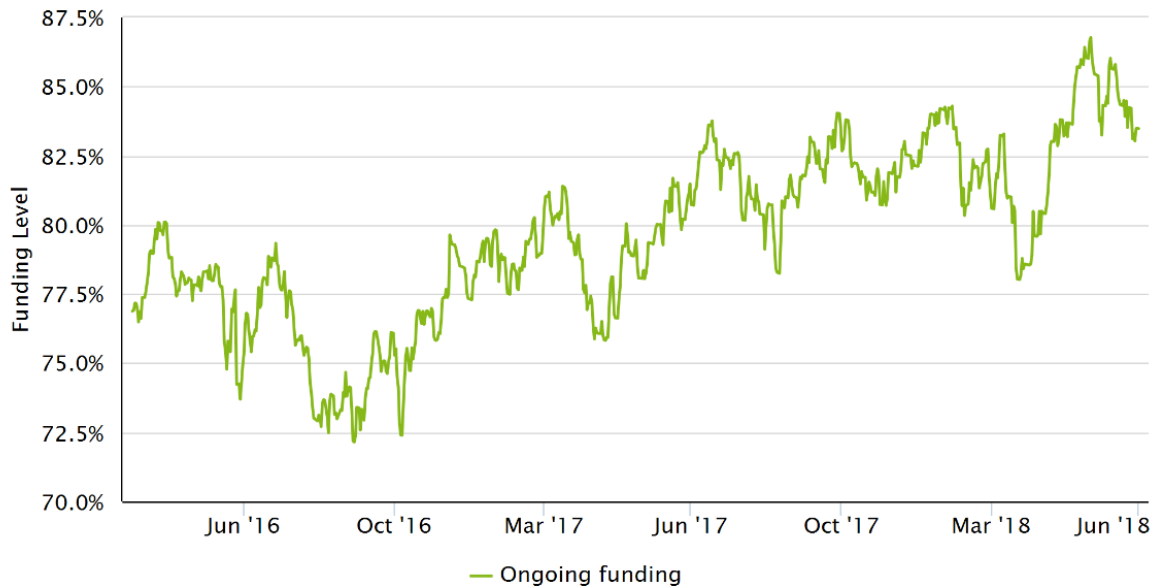
This report is split into four areas:

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

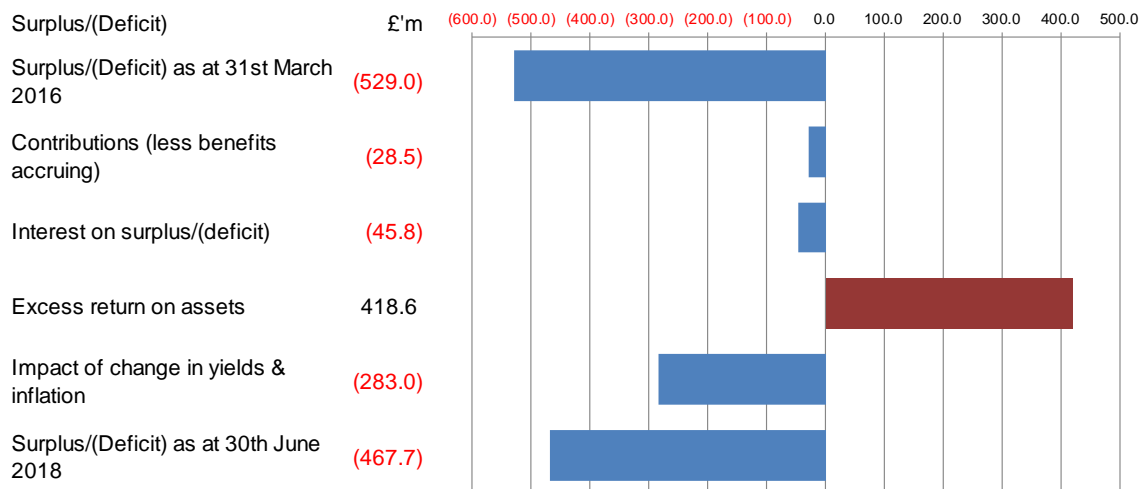
1. Funding Level Update

- 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, 30th June 2018. 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 over page shows the funding level at the latest formal valuation, at 76.9%, and its movement to 30th June 2018, where the funding level has increased to 83.5%.

Change in funding level since last valuation



1.3 Over the period 31st March 2016 to 30th June 2018 the deficit, in real money, has decreased from £529m to £468m. The chart below shows the main impactors on the deficit. The excess return on assets has more than offset the negative changes in yields and inflation seen over this period.



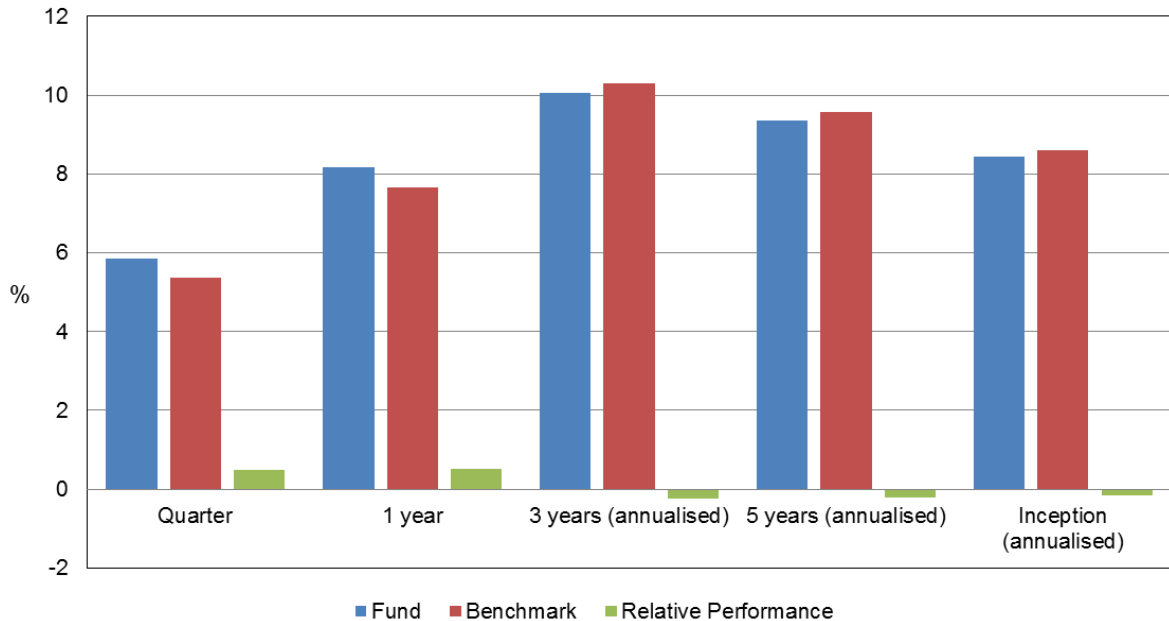
1.4 On a shorter term time horizon, looking at the last quarter, the funding level increased from 78.6% to 83.5% between 31st March 2018 and 30th June 2018, and the deficit reduced from £608.5m to £467.7m.

2. Fund Performance & Asset Allocation

2.1 The Fund increased in value by £124.6m during the quarter from £2,175.9m to £2,300.5m, as the table below shows. The most significant movements in the quarter were seen on UK Equities which increased in value by 9.2% or £37.1m, and Global Equities which increased by 8.5% or £79.3m.

Asset Class	Q2 2018 £m	Q1 2018 £m	Asset Allocation %	Strategic Asset Allocation %	Difference %
UK Equities	441.1	404.0	19.2	20.0	(0.8)
Global Equities	1,015.5	936.2	44.1	40.0	4.1
Alternatives	318.5	312.3	13.8	15.0	(1.2)
Property	207.6	207.6	9.0	9.0	0.0
Infrastructure	39.2	35.4	1.7	2.5	(0.8)
Fixed Interest	264.2	264.1	11.5	13.5	(2.0)
Cash	14.4	16.3	0.6	0.0	0.6
Total	2,300.5	2,175.9	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	5.84	5.36	0.48
1 year	8.18	7.67	0.51
3 years*	10.06	10.30	(0.24)
5 years*	9.36	9.57	(0.21)
Inception**	8.44	8.61	(0.17)

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

2.3 Over the quarter, the Fund produced a positive return of 5.84% (as measured by JPMorgan), outperforming the benchmark by 0.48%. The Fund was also ahead of the benchmark over the one year period, but marginally 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 meets 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 nineteen managers. During the quarter there have not been any changes in the manager ratings. Officers continue to monitor managers closely and arrange meetings to discuss any potential issues.

Manager	Rating				
	Replace		Retain – suitable	Retain – positive	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	
Igloo Regeneration Partnership				X	
Aviva Pooled Property Fund				X	
Royal London PAIF				X	
Standard Life Pooled Property Fund				X	
Blackrock Property				X	
Infracapital Greenfield Partners I				X	
Pantheon Global Infrastructure				X	

3.3 Notification of a key person change at Morgan Stanley Alternative Investments has been received after the end of this reporting quarter. Hymans Robertson is currently reviewing the manager rating in light of this change. A verbal update will be given at the meeting if further information is available.

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 Over the quarter, all managers showed a positive return relative to their benchmarks, with the exception of Invesco and Schrodgers. Over the 12 month period, all managers have matched or outperformed their benchmark.

Manager	3 months ended 30 th June 2018			Previous 12 months			Target p.a. %
	Manager Return %	Index Return %	Relative Variance %	Manager Return %	Index Return %	Relative Variance %	
Legal & General (UK Equities)	9.2	9.2	0.0	9.1	9.1	0.0	Match Index
Invesco (Global Equities (ex UK))	7.8	8.0	(0.2)	10.3	9.4	0.8	+1.0
Columbia Threadneedle (Global Equities)	7.3	7.0	0.3	13.7	9.5	3.9	+2.0
Schroder's (Global Equities)	6.6	6.8	(0.2)	9.7	8.9	0.7	+3.0
Morgan Stanley Global Brands	12.2	8.1	3.8	10.2	9.3	0.8	n/a
Blackrock (Fixed Interest)	(0.4)	(0.4)	0.0	1.4	1.3	0.1	Match Index
Blackrock Interim (Fixed Interest)	0.5	0.4	0.0	0.6	0.6	0.0	Match Index
Morgan Stanley (Alternative Investments)	1.1	1.2	0.0	6.5	4.6	1.8	3M LIBOR + 4%

Lincolnshire Pension Fund
Global Equities – Invesco (Global Ex UK Enhanced)
Quarterly Report June 2018

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 Expectations, Market Sentiment, Management & Quality and Value.

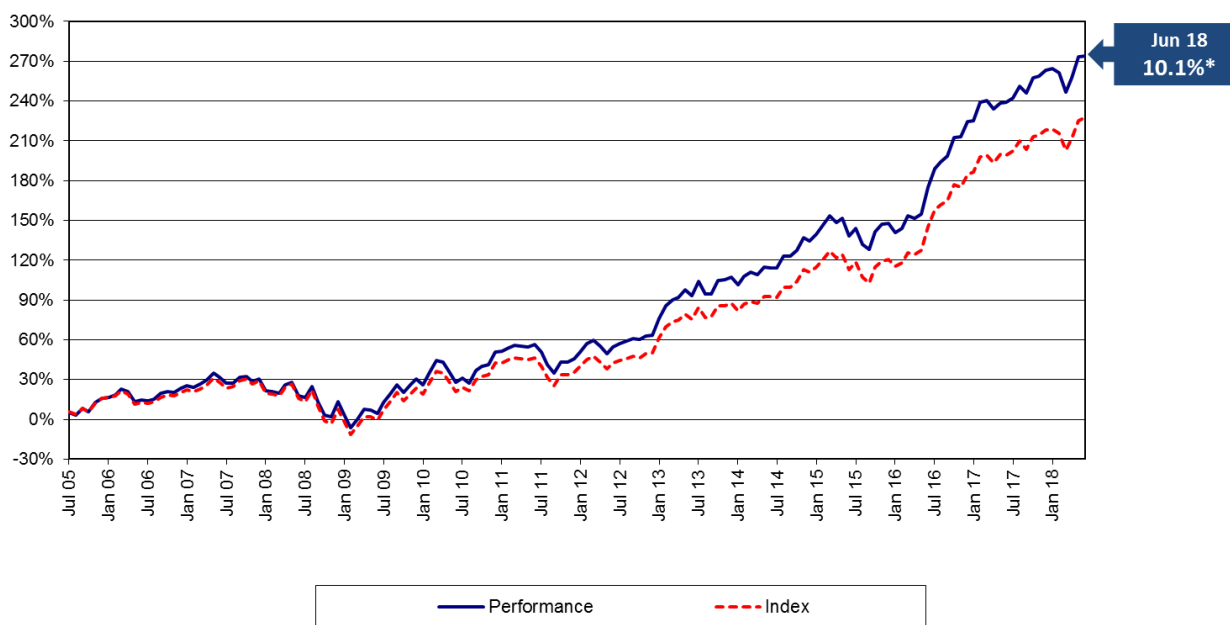
Portfolio Valuation

Value at 31.03.18	Value at 30.06.18
£500,748,990	£540,403,488

Performance

Overall during the quarter Invesco's strategy marginally underperformed its benchmark. On a monthly basis it outperformed its benchmark in two out of three months and underperformed in the final month of the quarter. Stock selection was the major influencing factor in all months, making the most positive contribution in the two months of outperformance and was the most significant detractor in the month of underperformance. Performance over the longer term continues to be above the target return of +1%.

Invesco Performance Since Inception



* Annualised Manager Performance since inception

	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception * %
Invesco	7.8	10.3	16.2	14.1	10.1
MSCI World ex UK	8.0	9.4	15.4	13.3	9.1
Relative Performance	(0.2)	0.8	0.6	0.7	1.0

* annualised, inception date 01/07/2005

Turnover

Holdings at 31.03.18	Holdings at 30.06.18	Turnover in Qtr %	Turnover in Previous Qtr %
453	455	8.8	11.7

Purchases and Sales

During the quarter, Invesco made a number of stock adjustments to the portfolio. Top purchases over the quarter included adding Huntmans, Walt Disney and L'Oreal, and increasing their positions in Asahi Glass Co, Host Hotels and Resorts and Hyatt Hotels. Top sales over the quarter came from selling out of positions in Subsea 7, Electrolux B and Taisei Corp and decreasing their positions in Capital Power, Walmart and Comcast.

Largest Overweights

Boeing	0.84%
JPMorgan Chase	0.73%
Citigroup	0.73%
Conocophillips	0.65%
Aflac	0.58%

Largest Underweights

Amazon	(0.64%)
Alphabet	(0.61%)
Netflix	(0.45%)
DowDupont	(0.41%)
Nvidia	(0.36%)

* Measured against MSCI World ex UK (NDR)

Top 10 Holdings

1	Apple	£14,313,877
2	Microsoft	£11,093,392
3	JPMorgan Chase	£9,012,727
4	Boeing	£7,143,025
5	Amazon	£6,561,955

6	Facebook	£6,380,369
7	Citigroup	£6,347,043
8	Bank of America	£5,534,527
9	Alphabet	£5,490,075
10	Cisco	£4,839,600

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 1.06%, compared to a target of 1%, with 94% of the active risk associated with Stock Selection Factors.

Lincolnshire Pension Fund Global Equities – Schroders Quarterly Report June 2018

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.

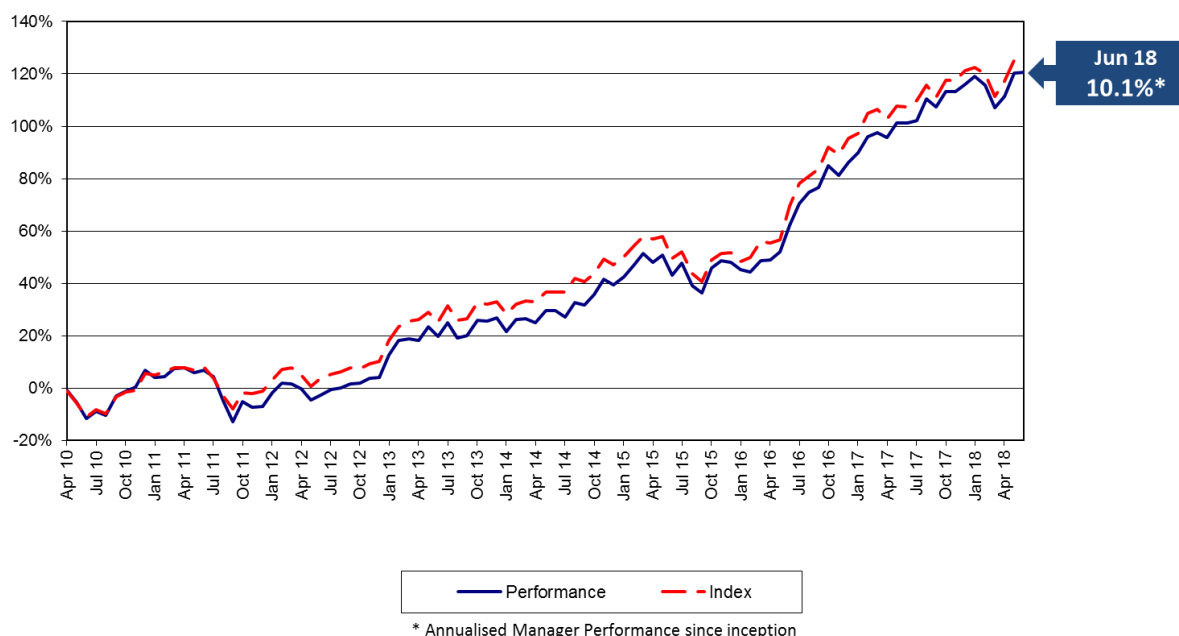
Portfolio Valuation

Value at 31.03.18	Value at 30.06.18
£123,755,393	£131,834,349

Performance

The portfolio underperformed against the benchmark over the quarter, reversing some of the gains seen over recent quarters. By sector, stock selection was most challenging in technology, industrials and consumer discretionary, while healthcare holdings were most supportive. From a regional perspective, performance in North America and Japan held back returns, while European holdings were additive.

Schroders Performance Since Inception



	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Schroders	6.6	9.7	15.5	13.0	10.1
MSCI ACWI (Net)	6.8	8.9	14.7	12.5	10.4
Relative Performance	(0.2)	0.7	0.7	0.4	(0.3)

*annualised, Inception date April 2010

Turnover

Holdings at 31.03.18	Holdings at 30.06.18	Turnover in Qtr %	Turnover in Previous Qtr %
86	89	9.0	18.5

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. Holdings were reduced in TSMC based on Schroders view of the semi-conductor cycle and Heidelberg Cement based on demand in this area. Purchases were made in Continental, a diversified auto supplier and best-in-class tyre manufacturer. Elsewhere, purchases have been made in Bunzl Group, a global leader in non-food consumables. Holdings in Makita have been sold out, as it faces foreign exchange headwinds and rising cost pressures.

Top 5 Contributions to Return

Amazon	0.7%
Estee Lauder	0.6%
Visa	0.5%
United Health	0.4%
Alcoa	0.3%

Bottom 5 Contributions to Return

Comcast	(0.5%)
Reckitt Benckiser Group	(0.5%)
Microsoft	(0.4%)
Proctor & Gamble	(0.4%)
Nestle	(0.3%)

Top 10 Holdings

1	Amazon	£4,329,604
2	Alphabet	£4,219,121
3	Visa	£3,593,571
4	Bank of America	£3,552,805
5	United Health	£3,395,821

6	JPMorgan Chase	£3,350,329
7	Apple	£3,013,564
8	Total	£2,870,136
9	Comcast	£2,773,710
10	Union Pacific	£2,707,376

Hymans Robertson View

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. Although 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, a more consistent performance record has now been established and we support the broad philosophy of the team. However, Schroders do need to demonstrate more consistent stock selection.

There were not significant changes 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 June 2018**

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.

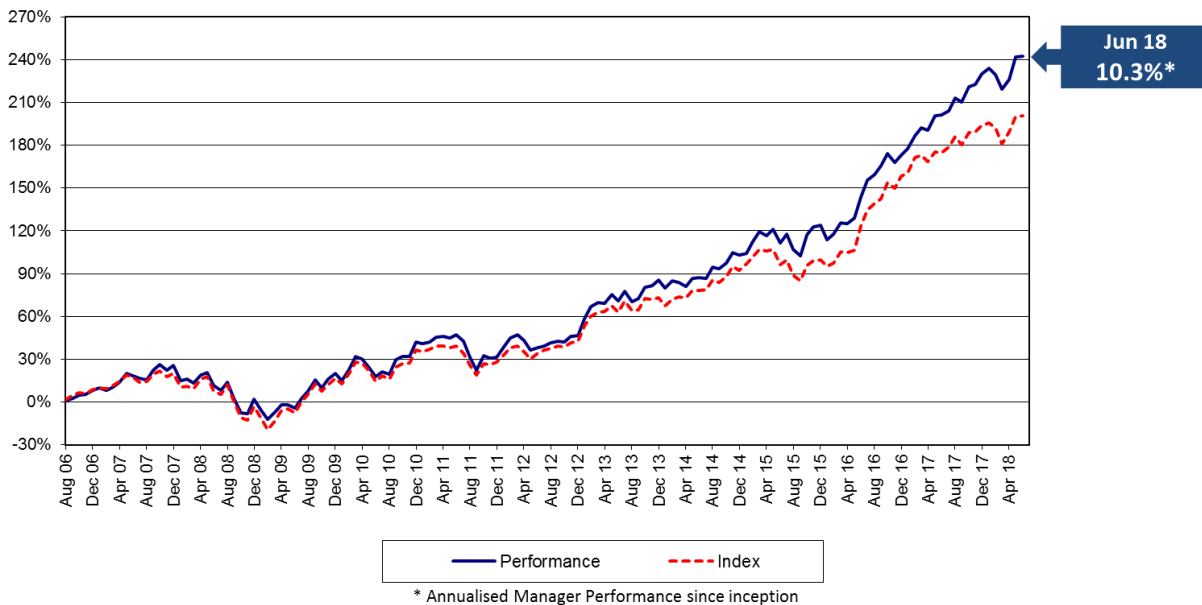
Portfolio Valuation

Value at 31.03.18	Value at 30.06.18
£132,967,366	£142,627,006

Performance

Gross of fees, the fund outperformed its index over the quarter, but individually in only one of the three months. Asset and sector selection detracted, owing to the consumer sector being underweight and technology being overweight. Stock selection also detracted, despite strong picks within the materials sector, healthcare and financial stock picks. Top contributors included: e-commerce company Alibaba, gene sequencing specialist Illumina and oil and gas company Diamondback Energy. Detractors included: multinational lighting manufacturer Osram, gaming company Nintendo and Halliburton.

Columbia Threadneedle Performance Since Inception



	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Columbia Threadneedle	7.3	13.7	17.4	14.9	10.3
MSCI ACWI	7.0	9.5	15.3	13.1	9.1
Relative Performance	0.3	3.9	1.8	1.6	1.0

* annualised, inception date 01/08/2006

Turnover

Holdings at 31.03.18	Holdings at 30.06.18	Turnover in Qtr %	Turnover in Previous Qtr %
80	76	12.8	7.8

Purchases and Sales

New positions were initiated in: Adidas, which continues to gain market share and oil field services company Schlumberger due to healthy US pumping and drilling growth. Positions were extended in Lam Research, a semi-conductor equipment manufacturer, who are using technology which is driving share gains. This was funded by the exit from Nike which has seen its valuation becoming rich following a strong run, financial services provider UBS as the company's capital returns are taking longer than anticipated to materialise and Thai bank Siam Commercial as anticipated loans-growth from the improving economic backdrop may be deferred.

Top 5 Contributions to Return

Amazon	0.75%
Alphabet	0.53%
Centene	0.49%
Facebook	0.49%
Mastercard	0.43%

Bottom 5 Contributions to Return

Nintendo	(0.36%)
OSRAM Licht	(0.36%)
PT Bank Rakyat Indonesia	(0.27%)
PagSeguro Digital	(0.26%)
Goldman Sachs	(0.14%)

Top 10 Holdings

1	Alphabet	£5,415,665
2	Amazon	£5,053,992
3	Microsoft	£4,037,315
4	JPMorgan Chase	£3,877,283
5	Alibaba Group	£3,770,350

6	Mastercard	£3,586,061
7	Diamondback Energy	£3,533,779
8	CRH	£3,511,016
9	Centene	£3,418,985
10	Visa	£3,408,973

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 June 2018

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.

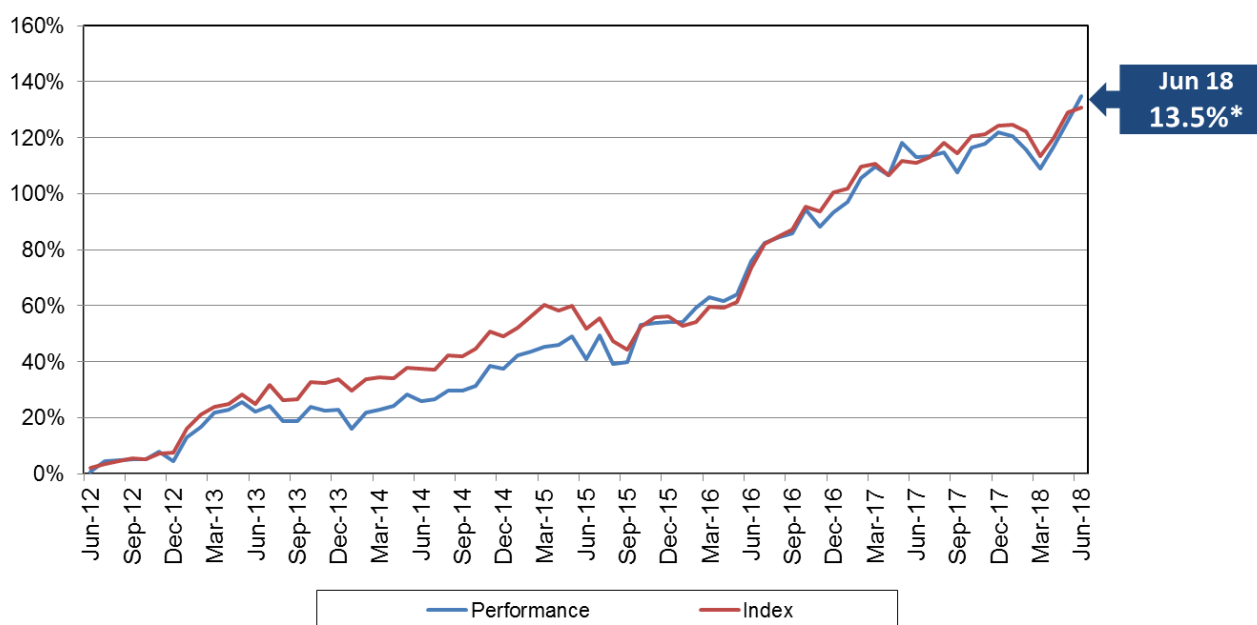
Portfolio Valuation

Value at 31.03.18	Value at 30.06.18
£178,714,621	£200,632,953

Performance

The portfolio outperformed in relative terms over the quarter, returning 12.2% versus 8.1% for the index. Sector allocation was positive as pressure on consumer staples eased off, plus the benefit from being underweight in financials and industrials. Stock selection drove outperformance from the bidding war over Twenty-First Century Fox and from owning the more stable operators in information technology. The largest contributors in absolute performance in the quarter were: Twenty-First Century Fox, Nike and Microsoft. The largest detractors were British American Tobacco, Phillip Morris International and Heineken.

Morgan Stanley Global Brands Performance Since Inception



	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception * %
Morgan Stanley Global Brands	12.2	10.2	18.6	14.0	13.5
MSCI World Index	8.1	9.3	15.0	13.0	13.2
Relative Performance	3.8	0.8	3.1	0.8	0.3

*annualised, inception date 18/06/2012

Purchases and Sales

During the quarter, positions were initiated in Baxter International, a leader in the dialysis and medical solutions business. Holdings in British American Tobacco were reduced from a top 5 to a top 10 holding due to a deterioration in the US market and growth in e-cigarettes. Positions were exited from Intuit, the business and financial software company, due to valuation and International Flavors and Fragrances after the company undertook a major acquisition. Holdings in Disney were completely sold out by the end of the quarter due to bid received from Disney for Twenty-First Century Fox and the cumulative size of holdings in both companies post merger.

Top Contributors to Return

Twenty First Century Fox	2.23%
Nike	1.06%
Microsoft	0.92%

Bottom Contributors to Return

British American Tobacco	(0.60%)
Philip Morris	(0.57%)
Heineken	(0.06%)

Top Ten Holdings

Company	Industry	% Weighting
Reckitt Benckiser	Household Products	7.81
Twenty First Century Fox	Media	7.40
Unilever	Personal Products	7.16
Microsoft Group	Software	6.78
Accenture	IT Services	6.62
Visa	IT Services	4.58
British American Tobacco	Tobacco	4.52
Philip Morris	Tobacco	4.42
SAP	Software	4.41
L'Oreal	Personal Products	4.22

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.

There were no significant changes over the quarter.

**Lincolnshire Pension Fund
UK Equities – Legal & General (LGIM)
Quarterly Report June 2018**

Investment Process

This pooled fund employs a tracking strategy, aiming to replicate the performance of the FTSE All-Share Index to within +/-0.25% p.a. for two years out of three. The fund follows a pragmatic approach to managing an index fund, either investing directly in the securities of that index or indirectly through other LGIM funds. The fund may also hold index and single stock futures for efficient portfolio management.

Portfolio Valuation

Value at 31.03.18	Value at 30.06.18
£403,792,800	£440,924,723

Performance

Over all periods the portfolio has performed as expected.

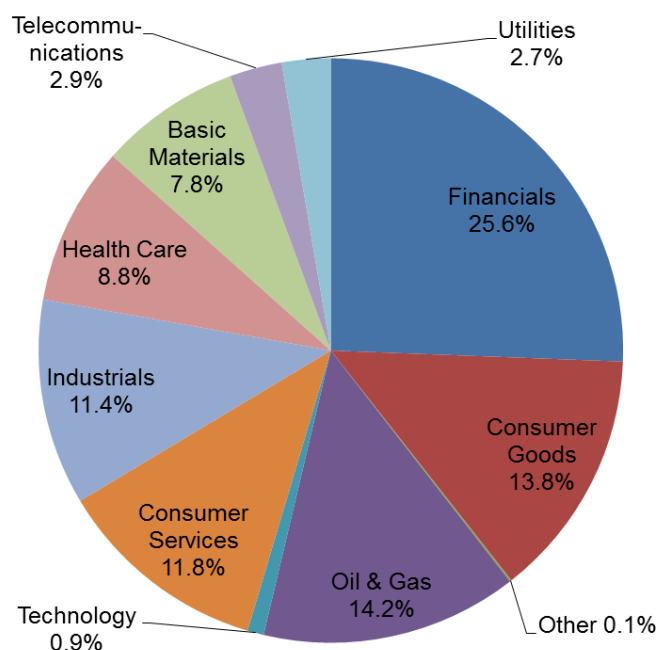
	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
LGIM	9.2	9.1	n/a	n/a	6.3
Benchmark	9.2	9.1	n/a	n/a	6.1
Relative Performance	0.0	0.0	n/a	n/a	0.1

*annualised, inception date February 2017

Top Ten Holdings

Company	% Weighting
Royal Dutch Shell A	9.1
HSBC Holdings	5.8
BP	4.6
British American Tobacco	3.6
GlaxoSmithKline	3.0
AstraZeneca	2.7
Diageo	2.0
Vodafone	2.0
Rio Tinto	2.0
Unilever	2.0
Total	37.5

Whole Fund Sector Breakdown



**Lincolnshire Pension Fund
Passive Bonds – Blackrock
Quarterly Report June 2018**

Investment Process

Blackrock manage a passive bond mandate for the Pension Fund. The 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

Portfolio	31.03.18 £	30.06.18 £
Corporate Bond All Stocks Index Fund	68,069,339	67,998,449
Over 5 Years UK Index-Linked Gilt Index Fund	42,252,449	41,744,814
All Stocks UK Gilts*	27,482,479	27,539,092
Cash (residual)	1	1
Total	137,804,268	137,282,356

*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	(0.4)	1.4	7.3	6.7	6.4
Composite Benchmark	(0.4)	1.3	7.2	6.5	6.3
Relative Performance	0.0	0.1	0.1	0.1	0.1

*annualised since inception 28/07/10

Hymans Robertson View

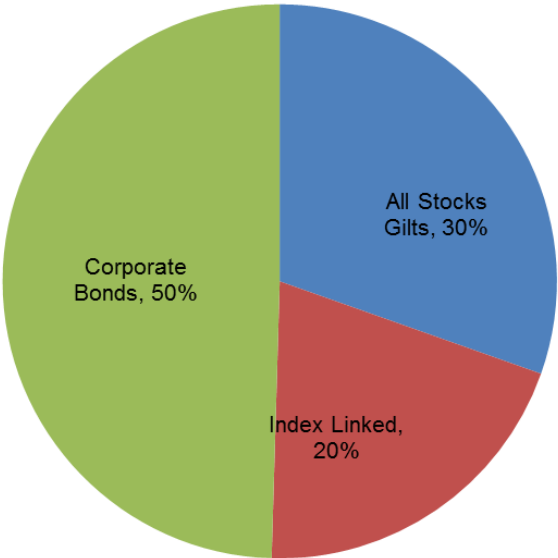
There were no significant developments within the Index Fixed Income team over the quarter.

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 30th June 2018.



**Lincolnshire Pension Fund
Passive Bonds – Blackrock interim
Quarterly Report June 2018**

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 31.03.18	Value at 30.06.18
£126,292,803	£126,875,984

Performance

Over all periods the portfolio has performed as expected.

	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Blackrock Interim	0.5	0.6	n/a	n/a	1.0
Benchmark	0.4	0.6	n/a	n/a	1.0
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 June 2018**

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 the 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.

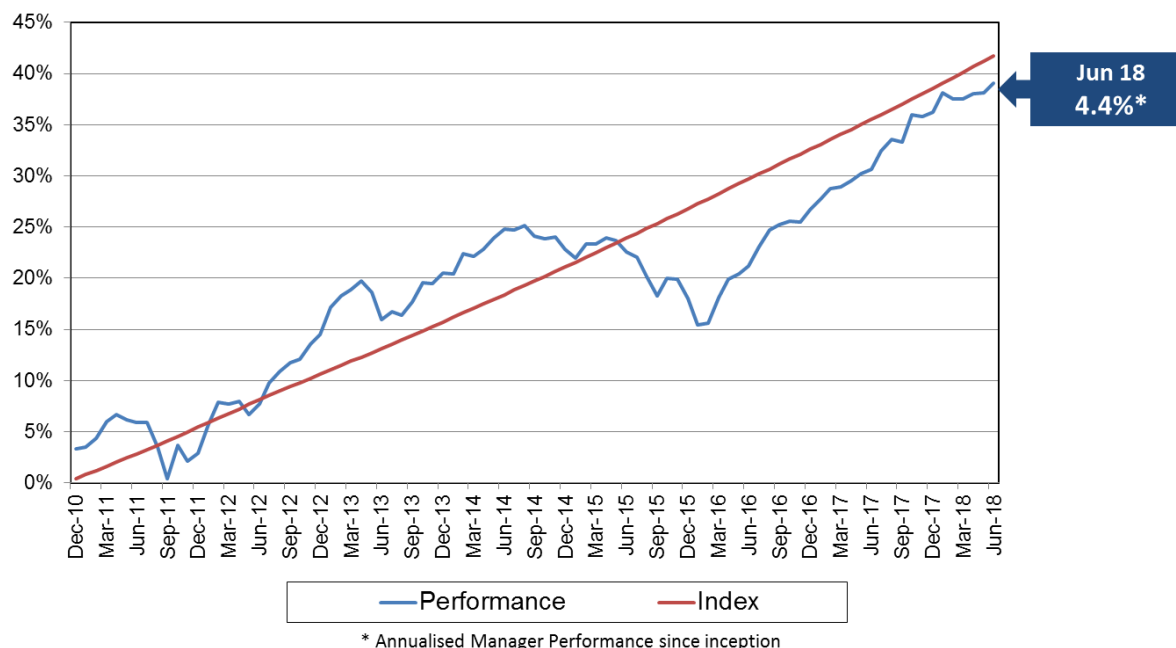
Portfolio Valuation

Value at 31.03.18	Value at 30.06.18
£280,714,740	£288,073,606

Performance

The total alternatives portfolio returned +1.1% during this quarter. Positive contributions from private markets and hedge funds led returns, offsetting declines across frontier/emerging markets assets and catastrophe insurance. Tactical decisions and manager selection modestly added to returns. Within manager selection, frontier equity, inflation linked assets and hedge funds particularly outperformed.

Morgan Stanley AIP Performance Since Inception



	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Morgan Stanley	1.1	6.5	4.3	3.7	4.4
3 Month LIBOR + 4%	1.2	4.6	4.6	4.6	4.7
Relative Performance	0.0	1.8	(0.3)	(0.9)	(0.3)

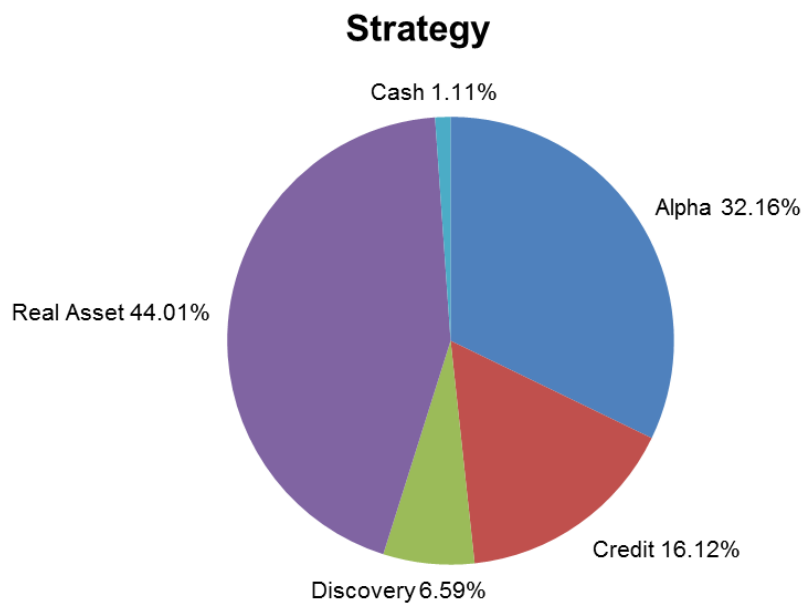
* annualised since inception date 24/11/2010

Allocation

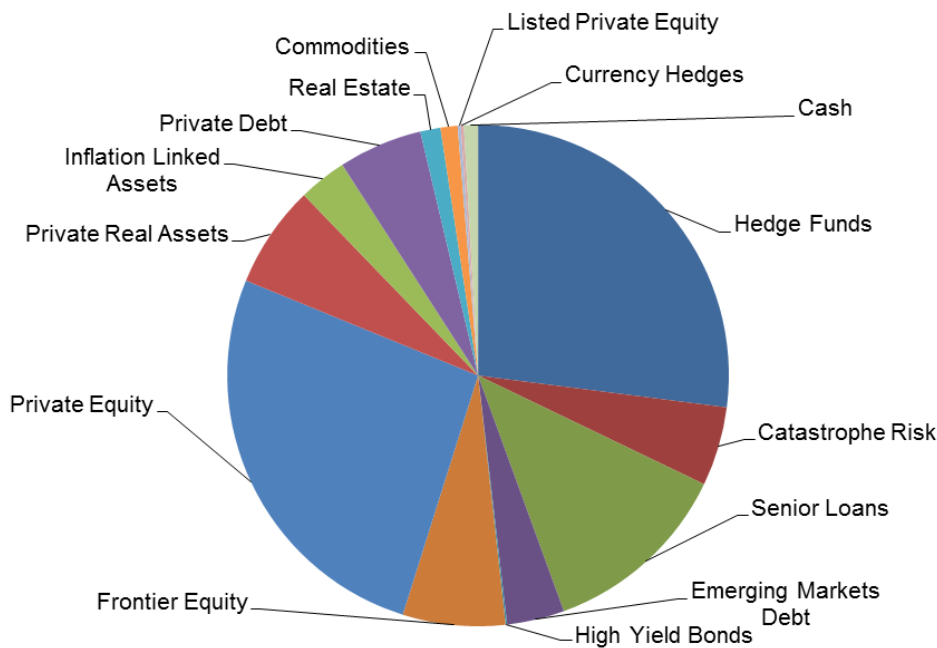
Morgan Stanley has split out investments into a bespoke portfolio of alternatives comprising five different asset allocations:

- **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 show the strategy and asset class positions of the Morgan Stanley portfolio as at 30th June 2018.



Asset Class



Portfolio Outlook

Until recently, Morgan Stanley's base case for 2018 had been that the global economy would see a continuation of the growth momentum enjoyed in 2017, despite some soft patches outside the U.S. (most notably in Europe) in the first quarter. However, activities struggled to pick up in Europe, and there has also been a further deceleration in indicators in China and emerging markets. It appears that Trump's combative rhetoric on trade has weighed on sentiment and potentially global growth. As the U.S. goes ahead with plans to impose tariffs on an additional \$200 billion in Chinese imports and China vowed to take the necessary countermeasures, the probability of a full-blown trade war is much higher and it could undermine the global growth meaningfully. Furthermore, the global economy continues to face an incremental tightening in financial conditions.

Emerging markets suffered broadly in the second quarter on the strengthening US Dollar, rising bond yields and increased trade tensions. These markets are likely to remain under pressure given ongoing trade war concerns and country-specific risks. However, the robust policy response from many countries and cheaper valuations are making many markets look more attractive.

Looking ahead, the second half of the year is likely to remain beset by ongoing uncertainty, and as a result portfolio positioning is more cautious and will rely on value creation from hedge funds and private markets. Morgan Stanley are currently managing a very active pipeline in real assets, including a fund commitment in less developed infrastructure markets and an exclusive negotiation to restructure the ownership of two existing power generation assets in the UK managed by a specialist asset manager. In private debt, they are in the process of finalising a complementary real estate debt commitment that they believe is well placed to benefit from opportunities in the US. Lastly, they are in the process of finalizing a complex but highly attractive restructuring investment for the private equity portfolio that is focused on a private company with significant near term upside potential.

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.

Notification of a key person change at Morgan Stanley Alternative Investments has been received after the end of this reporting quarter. Hymans Robertson is currently reviewing the manager rating in light of this change. A verbal update will be given at the meeting if further information is available.

Risk Control

Portfolio volatility since inception is 3.6%, within the guidelines specified by the mandate.

Conclusion

Over the quarter, the Fund produced a positive return of 5.84%, outperforming the benchmark which returned 5.36%.

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 Claire Machej, who can be contacted on 01522 553641 or claire.machej@lincolnshire.gov.uk.