

## Regulatory and Other Committee

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

Report to:	<b>Pensions Committee</b>
Date:	<b>09 October 2014</b>
Subject:	<b>Investment Management Report</b>

#### Summary:

This report covers the management of the Lincolnshire Pension Fund assets, over the period from 1st April to 30th June 2014.

#### Recommendation(s):

That the committee note this report.

### Background

This report is split into four areas:

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

#### 1. Funding Level Update

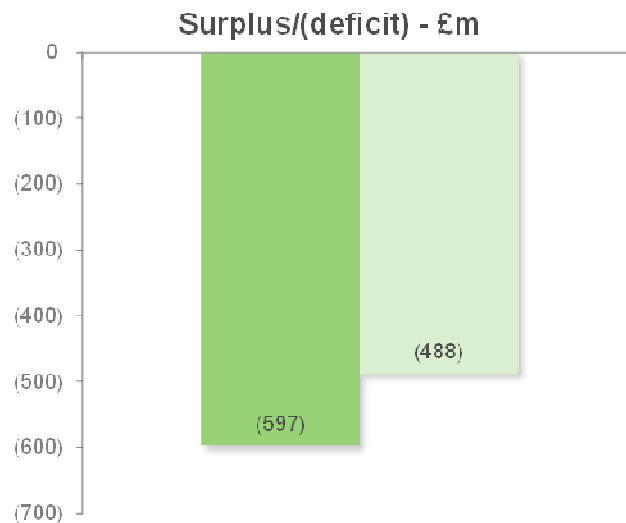
- 1.1 The funding update is provided to illustrate the estimated development of the funding position from 31<sup>st</sup> March 2013 to 30<sup>th</sup> June 2014, for the Fund.
- 1.2 As the graph below shows, the funding level at the latest formal valuation was 71.5%. As at 30<sup>th</sup> June 2014 the funding level has increased to 76.8%. This is largely as a result of an increase in bond yields, and subsequent higher discount rate, which places a lower value on the Fund's liabilities. The performance of the Fund's assets has also been greater than expected, serving to further increase the funding level.
- 1.3 In the period since 31st March 2014, yields have been relatively stable but asset performance has again been greater than expected. The combined

effect of these items has been an increase in the funding level since 31st March 2014.

Change in funding level since last valuation



1.4 As shown below, the deficit in real money has reduced from £597m to £488m between the period 31<sup>st</sup> March 2013 and 30<sup>th</sup> June 2014. The deficit at 31<sup>st</sup> March 2014 was £489m.



**2. Fund Performance & Asset Allocation**

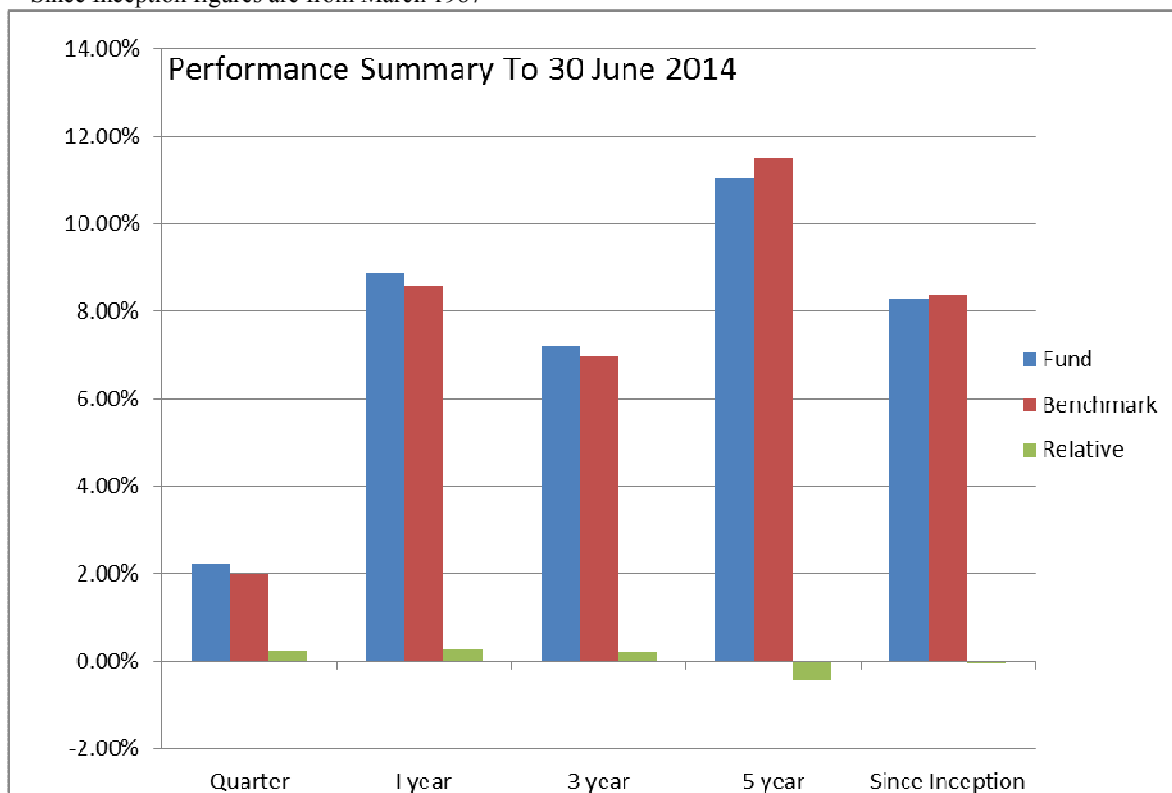
2.1 The Fund increased in value by £31.2m during the quarter from £1,587.5m to £1,618.7m, as the chart below shows. The Fund was overweight to UK and global equities and underweight fixed interest, alternatives and property.

Asset Class	Q1 2014 £	Q2 2014 £	Asset Allocation %	Strategic Asset Allocation %	Difference %
UK Equities	326.5	319.0	20.2	20.0	0.2
Global Equities	671.7	659.3	41.4	40.0	1.4
Alternatives	230.9	228.0	14.3	15.0	(0.7)
Property	182.5	176.1	11.3	11.5	(0.2)
Fixed Interest	201.4	198.6	12.4	13.5	(1.1)
Cash	5.7	6.5	0.4	0.0	0.4
<b>Total</b>	<b>1,618.7</b>	<b>1,587.5</b>	100.0	100.0	

2.2 The graph below shows the Fund's performance against the benchmark over the quarter, one year, three years, five years and since inception. The Fund has a target to outperform the strategic benchmark by 1% per annum.

2.3 Over the quarter, the Fund produced a positive return of 2.23% and outperformed the benchmark which returned 2%. The Fund is slightly ahead of the benchmark over one and three years but is behind the benchmark over five years and since inception.

\* Since Inception figures are from March 1987



### 3. Hymans Robertson Manager Ratings

3.1 Hymans Robertson regularly meet managers to discuss current issues, management changes and performance. The manager is then allocated one of five ratings between replace and retain. The table below shows Hymans

Robertson's rating of all managers that have been appointed by the Lincolnshire Pension Fund.

- 3.2 The Fund has twenty managers and there has been no change in the rating of any of these managers over the quarter. Hymans Robertson still rate sixteen managers as retain and have categorised three managers, Reef Property Ventures Fund 3, Aviva Pooled Property Fund and Schrodgers, as "on watch" and Neptune as "strongly on watch". Officers will monitor these managers closely and arrange meetings to discuss any potential issues.

Manager	Rating			
	Replace		On Watch	Retain
Invesco Global Equities (Ex-UK)				X
Threadneedle Global Equity				X
Schrodgers Global Equity			X	
Neptune Global Equity		X		
Morgan Stanley Global Brands				X
F&C Absolute Return Bonds				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. Over the quarter four managers outperformed their benchmark and two matched their benchmark. Neptune, Threadneedle and Invesco all underperformed their benchmark over the quarter. Over the 12 month period all managers have produced positive absolute returns and only three of the managers underperformed against the index. Against their target, only the in house team, Invesco and Blackrock have matched or beaten the required return.

	3 months ended 30/06/14			Previous 12 months			
Manager	Manager Return %	Index Return %	Relative Variance %	Manager Return %	Index Return %	Relative Variance %	Target p.a. %
Passive UK Equity In house	2.3	2.2	0.1	12.8	12.8	(0.1)	+/- 0.5
Invesco (Global Equities (ex UK))	1.6	2.1	(0.5)	10.9	9.8	1.0	+1.0
Threadneedle (Global Equities)	1.9	2.6	(0.7)	9.6	9.6	0.0	+2.0
Neptune (Global Equities)	2.1	2.6	(0.5)	8.0	9.6	(1.5)	+4.0
Schroder's (Global Equities)	2.4	2.4	0.0	8.2	9.1	(0.8)	+4.0
Morgan Stanley Global Brands	2.4	2.2	0.2	3.1	10.0	(6.3)	n/a
Blackrock (Fixed Interest)	1.3	1.3	0.0	3.4	3.4	0.0	Match Index
F&C (Fixed Interest)	1.5	0.9	0.6	5.1	3.6	1.5	3M LIBOR + 3%
Morgan Stanley (Alternative Investments)	2.2	1.1	1.0	7.6	4.6	2.9	3M LIBOR + 4%

**Lincolnshire Pension Fund**  
**UK Equities – In House (Passive UK)**  
**Quarterly Report June 2014**

**Investment Process**

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

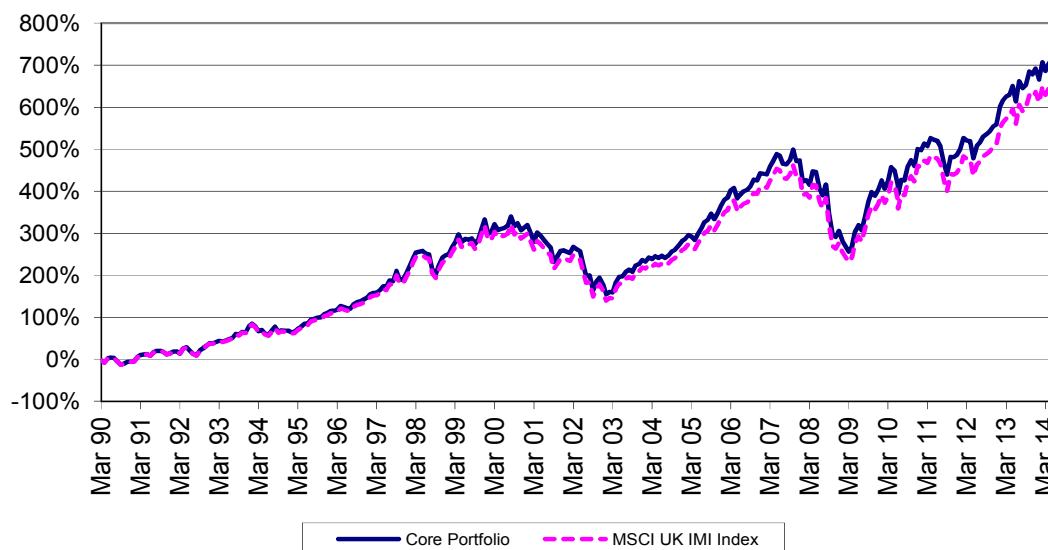
**Portfolio Valuation**

Value at 31.03.14	Value at 30.06.14
£318,959,025	£326,491,228

**Performance**

During the quarter the portfolio produced a positive return of 2.3% and outperformed the index by 0.1%. The outperformance was achieved through the portfolio's positioning in financials with overweight positions in Insurance, which produced positive returns, and an underweight position in Banks, which produced negative returns. Over all other periods the portfolio's performance is closely matching the index and within the target of +/- 0.5%.

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



	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
UK Equities – In House	2.3	12.8	9.1	14.6	8.8
MSCI UK IMI	2.2	12.8	8.9	14.4	8.4
Relative Performance	0.1	(0.1)	0.2	0.1	0.3

\* annualised, inception date 01/10/1989

## Turnover

Holdings at 31.03.14	Holdings at 30.06.14	Turnover in Quarter %	Turnover in Previous Quarter %
242	247	0.9	1.9

## Purchases and Sales

During the quarter the manager performed a number of trades. Positions were increased in Direct Line, RSA Insurance, HSBC and Royal Dutch Shell, whilst new positions were taken in Quindell, The Restaurant Group and Bank of Georgia. The manager sold out of Debenhams, Fidessa Group, Renishaw and Supergroup as their weightings in the index had reduced below the level where the manager holds a stock.

## Largest Overweights

Vodafone Group	0.13%
BP	0.11%
Rio Tinto	0.10%
British American Tobacco	0.09%
Royal Dutch Shell	0.08%

## Largest Underweights

Lloyds Banking	(0.32%)
Shire PLC	(0.13%)
Barclays	(0.12%)
Astrazeneca	(0.09%)
Intu Properties	(0.08%)

\* Measured against MSCI UK IMI

## Top 10 Holdings

1	Royal Dutch Shell	£25,944,943
2	HSBC Holdings	£18,677,753
3	BP	£15,973,763
4	GlaxoSmithkline	£12,996,978
5	British American Tobacco	£11,078,856

6	Vodafone Group	£9,241,200
7	Astrazeneca	£8,688,680
8	Diageo	£7,799,730
9	BG Group	£6,882,840
10	Rio Tinto	£6,597,756

## Risk Control

The portfolio has a tracking error limit of 0.5%. At the end of June 2014 the tracking error was 0.29%.

**Lincolnshire Pension Fund**  
**Global Equities – Invesco (Global Ex UK Enhanced)**  
**Quarterly Report June 2014**

**Investment Process**

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

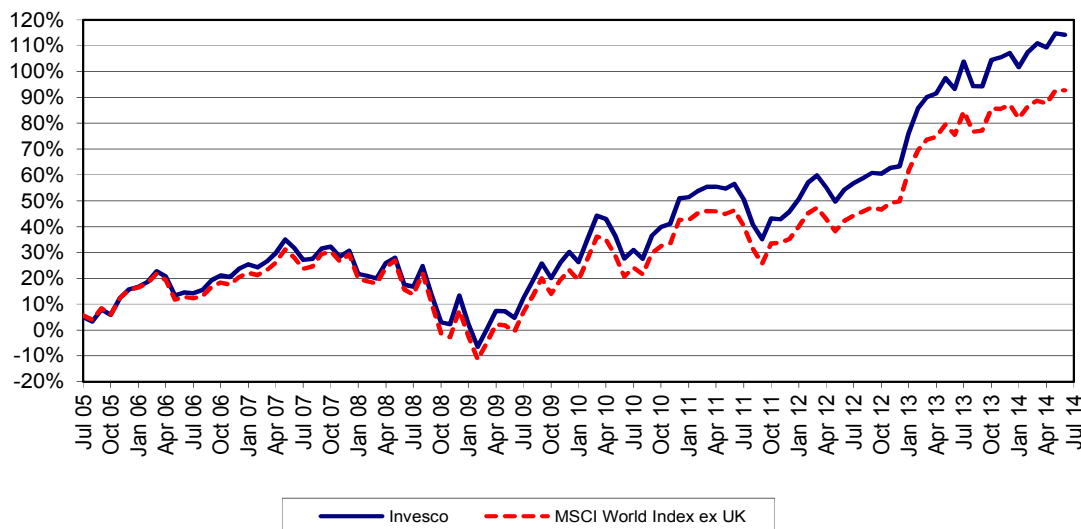
**Portfolio Valuation**

Value at 31.03.14	Value at 30.06.14
£333,440,937	£338,749,574

**Performance**

During the quarter Invesco underperformed their benchmark by 0.5%. The largest negative impact on the strategy was Stock Selection, with an overweight in Information Technology and an underweight in Consumer Discretionary being the main detractors. Contributions from Countries and Currencies were positive, in particular an underweight in Italian stocks. Over the longer period Invesco continue to outperform the index and match or outperform their target.

**Invesco Performance Since Inception**



	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Invesco	1.6	10.9	11.1	15.4	8.8
MSCI World ex UK	2.1	9.8	9.6	14.2	7.6
Relative Performance	(0.5)	1.0	1.3	1.1	1.2

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



## Turnover

Holdings at 31.03.14	Holdings at 30.06.14	Turnover in Quarter %	Turnover in Previous Quarter %
424	435	7.7	6.5

## Purchases and Sales

During the quarter, Invesco made a number of stock adjustments to the portfolio as a result of their Stock Selection model. Invesco added General Dynamics, Capital One Financial and Convergys. They also increased their positions in Google and Merck and Co. Invesco sold out of Verizon Communications, Seacor, Devon Energy and Visa.

## Largest Overweights

Pfizer	0.95%
Northrop Grumman	0.94%
Archer Daniels	0.90%
JP Morgan Chase	0.71%
Lockheed Martin	0.67%

## Largest Underweights

Verizon Comms	(0.66%)
Google	(0.54%)
Walt Disney	(0.47%)
Amazon	(0.41%)
Sanofi	(0.41%)

\* Measured against MSCI World ex UK (NDR)

## Top 10 Holdings

1	Apple Inc	£7,087,214	6	General Electric Co	£3,993,989
2	Microsoft Corp	£5,533,661	7	Citigroup Inc	£3,434,291
3	Pfizer Inc	£5,238,689	8	Northrop Grumman	£3,428,008
4	JPMorgan Chase	£4,748,241	9	Google Inc	£3,419,364
5	Exxon Mobil Corp	£4,625,395	10	Cisco Systems Inc	£3,363,038

## Hymans Robertson View

High profile Invesco UK equity manager, Neil Woodford, has left Invesco to set up his own, rival business. St James Place (SJP) is withdrawing £8bn of assets from Invesco which represents just over 10% of Invesco's UK assets and under 2% of global assets. The revenue impact is less significant as the fees on the SJP assets were well below the typical retail fee on the majority of Invesco's UK assets. This is a blow to Invesco's reputation and finances but not sufficiently to lead to any changes in the firm's development plans.

Hymans do not anticipate any direct impact on the product that Lincolnshire is invested in.

## Risk Control

The predicted tracking error of the portfolio decreased to 1.02% (actual target 1%).

**Lincolnshire Pension Fund  
Global Equities – Neptune  
Quarterly Report June 2014**

**Investment Process**

This portfolio is mandated to outperform the MSCI All Countries World Index by 2% to 4% over rolling three year periods, net of fees. This is achieved through generating capital growth from a concentrated portfolio of global securities, selected from across world equity markets. The investment process of Neptune means that they will usually generate more volatile returns than the Fund's other Global Equity Managers and are seen as benchmark agnostic.

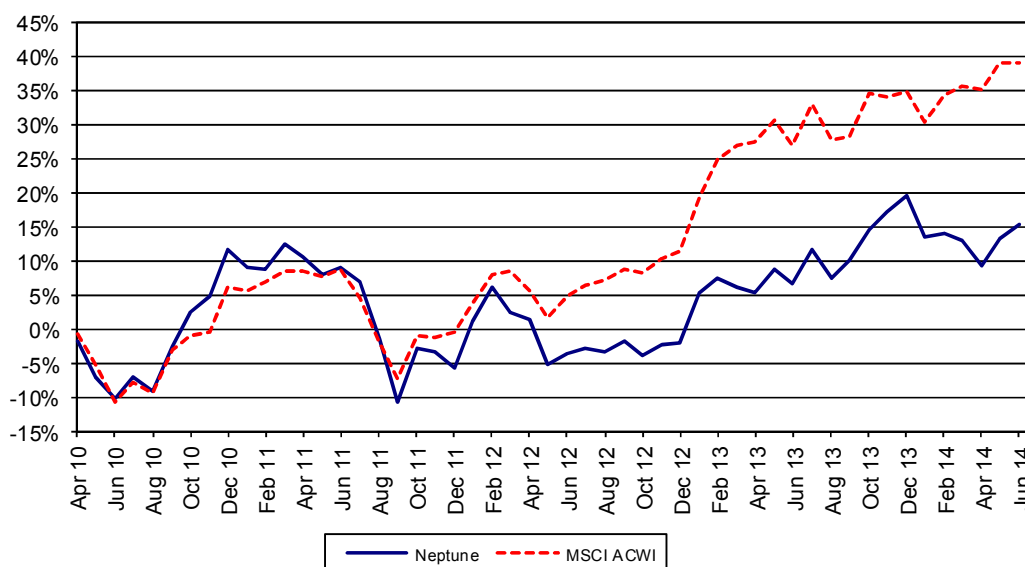
**Portfolio Valuation**

Value at 31.03.14	Value at 30.06.14
£78,632,843	£80,183,778

**Performance**

During the quarter Neptune produced a positive return of 2.1% but underperformed the index by 0.5%. This was due to continued concerns about US growth following the first quarter's bad weather and poor economic data, which led to strong performance from stocks which met investors' requirements for both defensive characteristics and yield. As it was throughout the first quarter, this was detrimental to the Fund given Neptune's overweight position in cyclical sectors, such as industrials, financials, consumer discretionary and IT. Towards the end of the quarter different factors were impacting the markets. The Federal Reserve reiterated its commitment to tapering quantitative easing and the European Central Bank moved closer to using unconventional monetary measures. Markets responded more positively to this news and as a result Neptune saw a strong end to the quarter and saw their performance move closer to benchmark.

**Neptune Performance Since Inception**



	Quarter %	1 Year %	3 Year %	5 Year %	Inception* %
Neptune	2.1	8.0	1.9	n/a	3.4
MSCI ACWI**	2.6	9.6	8.5	n/a	8.1
Relative Performance	(0.5)	(1.5)	(6.2)	n/a	(4.3)

\* annualised, inception date 16/04/2010

## Turnover

Holdings at 31.03.14	Holdings at 30.06.14	Turnover in Quarter %	Turnover in Previous Quarter %
55	51	25.39	1.2

## Purchases and Sales

On the back of Modi's election in India, who promises to deliver long needed structural changes, Neptune initiated new positions in the Indian market, via blue chip stocks. This took Neptune back to being overweight emerging markets at the end of the quarter. Over the quarter Neptune also increased the size of their overweight in financials at the expense of selling down some names within the consumer discretionary sector.

### Top 5 Contributions to Return

Baidu.Com Spon ADR	0.6%
Taisei Corp	0.5%
Apple Computer	0.4%
Estee Lauder Co	0.3%
Facebook Inc	0.2%

### Bottom 5 Contributions to Return

Linkedin Corp	(0.4%)
Ping An Ins Grp	(0.3%)
Amazon	(0.2%)
Cme Group	(0.2%)
Icici Bank Spn ADR	(0.2%)

## Top 10 Holdings

1	Amazon.Com Inc	£2,849,197
2	Baidu Inc	£2,731,380
3	Facebook Inc	£2,557,651
4	CME Group Inc	£2,489,692
5	Morgan Stanley	£2,457,292

6	Marsh & McLennan	£2,423,604
7	Yum Brands Inc	£2,373,892
8	Fanuc Corp	£2,319,036
9	Taisei Corp	£2,263,066
10	Tencent Holdings	£2,231,749

## Hymans Robertson View

There is no significant news over the quarter and Hymans maintain a central research rating of "2" – "on watch – review options".

## Risk Control

The portfolio may invest up to a maximum of 10% of value in securities outside the benchmark index and, in addition, may hold a maximum of 20% of value in cash, in any currency. The portfolio has no regional constraints but will always maintain exposure to at least seven of the ten MSCI Global Sectors and a broad geographical reach.

**Lincolnshire Pension Fund  
Global Equities – Schroders  
Quarterly Report June 2014**

**Investment Process**

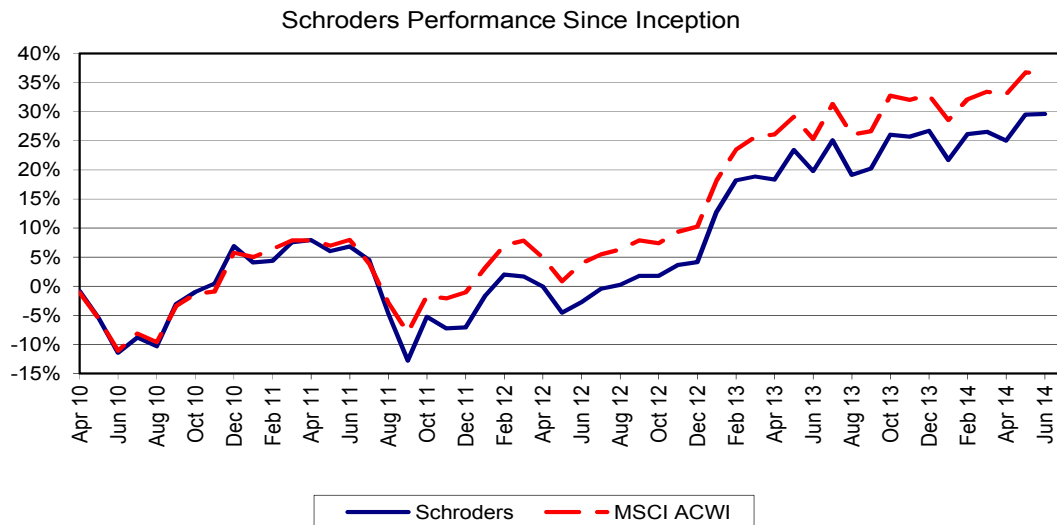
This portfolio is mandated to outperform the MSCI All Countries World Daily Net Index by 2% to 4% over rolling three year periods, gross of fees. This is achieved through an investment approach that is designed to add value relative to the benchmark through both stock selection and asset allocation decisions. 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 31.03.14	Value at 30.06.14
£84,539,978	£86,622,173

**Performance**

During the quarter the portfolio produced a positive absolute return of 2.4% which matched the index. The top contributors were energy names supported by rising energy prices, whilst detractors were Credit Suisse, eBay and Owens Corning. Over the 12 month period Schroders have produced a positive absolute return of 8.2% which was behind the index which produced a return of 9.1%.



	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Schroders	2.4	8.2	6.7	n/a	6.3
MSCI ACWI (Net)	2.4	9.1	8.2	n/a	7.6
Relative Performance	0.00	(0.8)	(1.4)	n/a	(1.2)

\*annualised since Inception April 16 2010

## Turnover

Holdings at 31.03.14	Holdings at 30.06.14	Turnover in Quarter %	Turnover in Previous Quarter %
68	67	10.8	15.5

## Purchases and Sales

During the quarter Schroder's biggest buys included Zimmer, one of the world's largest orthopaedic implant manufacturers. They also purchased Comcast, a media and television broadcasting service, and Bridgestone, a world leading tyre maker based in Japan. Bristol Myers was Schroders largest sell in the quarter, as its shares had moved substantially towards their estimate of fair value and profits were banked. Schroders exited their position in Sanofi due to ongoing margin pressure driven by weaker emerging market currencies.

### Top 5 Contributions to Return

Schlumberger	0.3%
Canadian Pacific Rail	0.2%
Cimarax Energy	0.2%
Tripadvisor	0.2%
Interpublic Group	0.2%

### Bottom 5 Contributions to Return

Credit Suisse	(0.3%)
Owens Coming	(0.2%)
Apple	(0.2%)
eBay	(0.2%)
Bristol-Myers Squibb	(0.2%)

## Top 10 Holdings

1	Schlumberger	£2,442,723
2	Amgen	£2,191,352
3	Roche Holdings	£2,077,910
4	Google	£1,969,212
5	SMC	£1,940,360

6	Citigroup	£1,936,092
7	Nokia	£1,934,583
8	Interpublic Group	£1,862,915
9	Harley Davidson	£1,774,264
10	Walgreen	£1,743,193

## Hymans Robertson View

In April, Schroder's announced that Alex Tedder was joining as Head of Global Equities as a replacement for Virginie Maisonneuve who left in late 2013. Schroders then announced in May that Peter Harrison would take on the newly created role of Head of Investments. Hymans have not yet seen any material impact from the changes at portfolio level, and at this point see no need to change their rating as a result of these announcements.

## Risk Control

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

**Lincolnshire Pension Fund  
Global Equities – Threadneedle  
Quarterly Report June 2014**

**Investment Process**

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

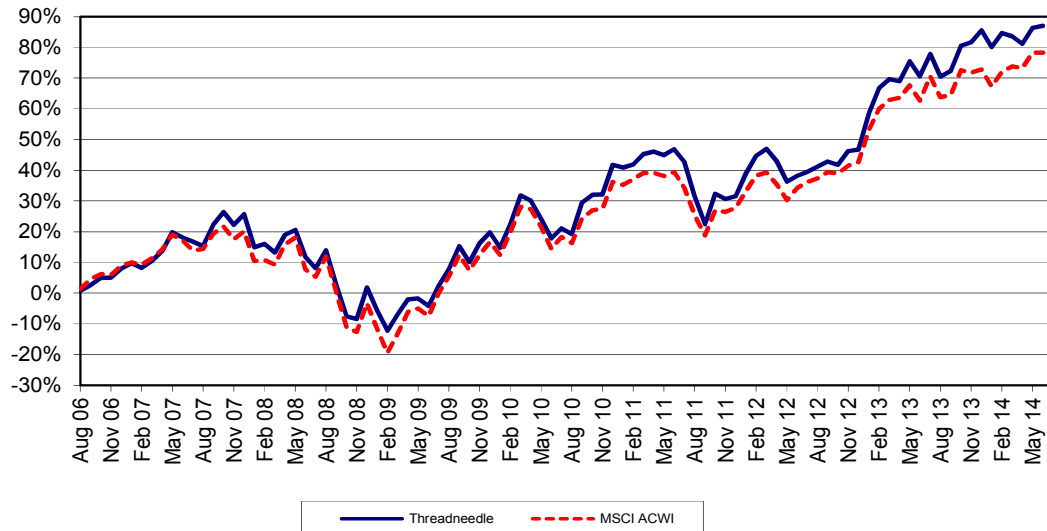
**Portfolio Valuation**

Value at 31.03.14	Value at 30.06.14
£87,978,532	£89,614,986

**Performance**

During the quarter the portfolio produced a positive absolute return of 1.9% but underperformed the index by 0.7%. The underperformance was due to unfavourable regional positioning, as emerging markets and the UK, where the portfolio is underweight, both outperformed. At a sector level, favourable selections in consumer discretionary, consumer staples and energy were offset by pronounced weakness in financials and IT. Over the longer periods Threadneedle is closely matching the index but behind their target of 2% outperformance.

**Threadneedle Performance Since Inception**



	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Threadneedle	1.9	9.6	8.4	14.3	8.2
MSCI ACWI	2.6	9.6	8.5	14.0	7.6
Relative Performance	(0.7)	0.0	(0.1)	0.3	0.6

\* annualised, inception date 01/08/2006

## Turnover

Holdings at 31.03.14	Holdings at 30.06.14	Turnover in Quarter %	Turnover in Previous Quarter %
100	94	19.8	11.6

## Purchases and Sales

During the quarter Threadneedle bought a position in Total, which has a higher cashflow growth rate than its peers. Threadneedle also opened positions in Wolseley, which is set to benefit from improving conditions in the construction and property industries, and IT giant Hewlett Packard, which they feel has improving prospects. They also opened a holding in Bank of Ireland, which they feel has been oversold and now represents good value. These purchases were funded by exiting eBay, Tyco International and Las Vegas Sands.

### Top 5 Contributions to Return

Suncor Energy	0.3%
Covidien	0.3%
Charter Comms	0.3%
Apple	0.3%
Gilead Sciences	0.2%

### Bottom 5 Contributions to Return

UBS	(0.3%)
eBay	(0.2%)
Pfizer	(0.2%)
Bank of Ireland	(0.2%)
JPMorgan Chase	(0.2%)

## Top 10 Holdings

1	Apple Inc	£2,154,100	6	JPMorgan Chase	£1,837,569
2	Gilead Sciences Inc	£1,945,307	7	Wesco Intl Inc	£1,764,717
3	Suncor Energy Inc	£1,916,577	8	Total SA	£1,748,208
4	Pfizer Inc	£1,908,347	9	Nestle SA	£1,737,373
5	Anheuser-Busch	£1,860,258	10	United Rentals Inc	£1,730,879

## Hymans Robertson View

Threadneedle hired 3 new analysts over the quarter as part of the rebuilding of the US equity team. Although there has been high turnover in senior staff in recent months, Hymans believe that Threadneedle are now happy with their level of resource within the US equity team and that no further new hires are imminent. Hymans will monitor events closely going forward, and for now maintain their central rating at "retain".

## 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 2014**

**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 31.03.14	Value at 30.06.14
£74,714.992	£76,514,346

**Performance**

During the quarter the portfolio produced a positive absolute return of 2.4% and outperformed the benchmark which returned 2.2%. The outperformance was mainly due to stock selection in consumer staples. The portfolio's overweight in consumer staples and underweight in financials and stock selection in consumer discretionary also contributed to positive performance. Morgan Stanley's stock selection in information technology and the zero weight in energy were the main detractors from performance for the period.

	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Morgan Stanley Global Brands	2.4	3.1	N/A	N/A	11.7
MSCI World Index	2.2	10.0	N/A	N/A	16.5
Relative Performance	0.2	(6.3)	N/A	N/A	(4.2)

\*annualised, inception date 18/06/2012

**Purchases and Sales**

During the quarter Morgan Stanley initiated a position in Publicis, one of the world's leading global advertising services companies, and exited the last of their position in Admiral. They also added to the recently initiated position in Time Warner, partly funded by selling a small position in Time Inc., the magazine business spun off from the parent company.

**Top 3 Contributions to Return**

British American Tobacco	0.4%
Unilever	0.4%
Nestle	0.3%

**Bottom 3 Contribution to Return**

SAP	(0.3%)
Procter & Gamble	(0.2%)
Visa	(0.1%)



## Top Ten Holdings

Company	Industry	% Weighting
British American Tobacco	Tobacco	9.7
Nestle	Food Products	9.1
Unilever	Food Products	8.0
Reckitt Benckiser	Household Products	7.0
Sanofi-Aventis	Pharmaceuticals	5.5
Diageo	Beverages	4.6
Accenture	IT Services	4.5
Philip Morris	Tobacco	4.5
Procter & Gamble	Household Products	4.5
Microsoft	Software	4.3

## Hymans Robertson View

Hymans are happy to maintain a preferred manager status for the fund. They feel the Global Brands strategy has a long and impressive track record and a clear and well thought out investment approach.

Global Brands is closed to new business but Morgan Stanley has opened a "sister" strategy, Global Quality. The manager insists that the new strategy will not raise capacity issues for Global Brands; nonetheless, Hymans will be keeping a close eye on the issue.

**Lincolnshire Pension Fund  
Passive Bonds – Blackrock  
Quarterly Report June 2014**

**Investment Process**

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

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

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

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

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

**Portfolio Valuation at 30<sup>th</sup> June 2014**

<b>Portfolio</b>	<b>31.03.14 £</b>	<b>30.06.14 £</b>
Corporate Bond All Stocks Index Fund	49,376,160	50,369,749
Over 5 Years UK Index-Linked Gilt Index Fund	29,622,864	29,959,128
Overseas Bond Index Fund	18,977,279	18,902,402
<b>Total</b>	<b>97,976,303</b>	<b>99,231,279</b>

**Performance**

Over all periods the portfolio has matched or very slightly outperformed the benchmark.

	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Blackrock	1.3	3.4	6.0	n/a	6.4
Composite Benchmark	1.3	3.4	6.0	n/a	6.4
Relative Performance	0.0	0.1	0.0	n/a	0.0

\*annualised since inception 28/07/10

### Hymans Robertson View

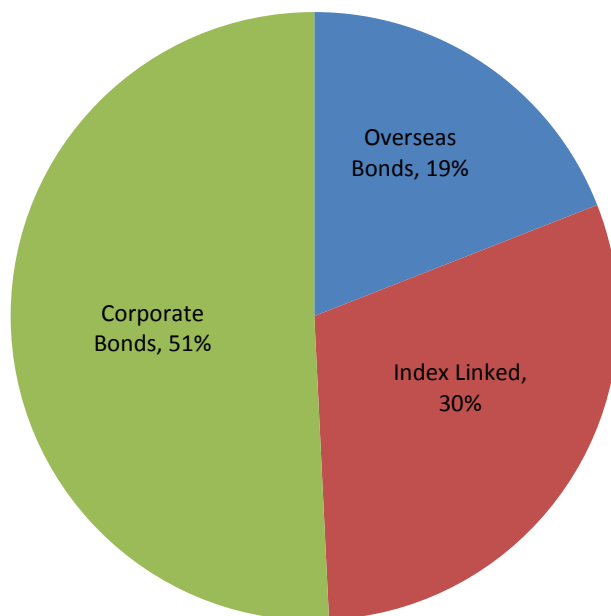
There were no significant developments within the Index Fixed Income team over the quarter; as such Hymans continue to rate Blackrock as one of their preferred passive fixed income managers.

### Allocation

The target allocation between the three funds is:

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

The pie chart below shows the allocation as at 30<sup>th</sup> June 2014



**Lincolnshire Pension Fund  
Absolute Return Bonds – F&C  
Quarterly Report June 2014**

**Investment Process**

F&C manage an absolute return bond mandate for the Fund. The Pension Fund is invested in their multi-manager target return fund, with an investment objective to achieve a low level of return in excess of anticipated money market returns, within a multi-manager structure. The managers are selected to exploit various investment opportunities, including the money market, interest rate, equity, commodity, currency and credit markets. The manager has a target to beat the return of 3 month LIBOR +3%.

**Portfolio Valuation**

Value at 31.03.14	Value at 30.06.14
£100,617,139	£102,127,622

**Performance**

During the quarter the portfolio produced a positive absolute return of 1.5% and outperformed the index by 0.6%. All three strategies generated a positive return over the quarter, but the day-to-day correlation between their returns remain low. The quarter was a strong period for risk assets. Government bond markets also rallied, despite many investors having taken a negative stance towards interest rate duration in the last year or so. As a result high yield and investment grade credit markets also generated positive returns, in both Europe and the US. Geopolitical risk has increased but markets have not yet reacted strongly. The pending default of Argentina at the end of July, the Ukrainian / Russian "conflict", and the terrorist group formally known as Isis all have the potential to cause volatility should investors decide they care. So far, the impact has been isolated and the markets have been more concerned about economic data and the potential for any form of QE from the ECB.

	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
F&C	1.5	5.2	3.2	n/a	3.0
3 Month LIBOR + 3%	0.9	3.6	3.8	n/a	3.8
Relative Performance	0.6	1.5	(0.5)	n/a	(0.8)

\* annualised since inception date 19/07/2010

**Allocation**

The target return fund is currently split between three managers, listed below with their speciality investment areas:

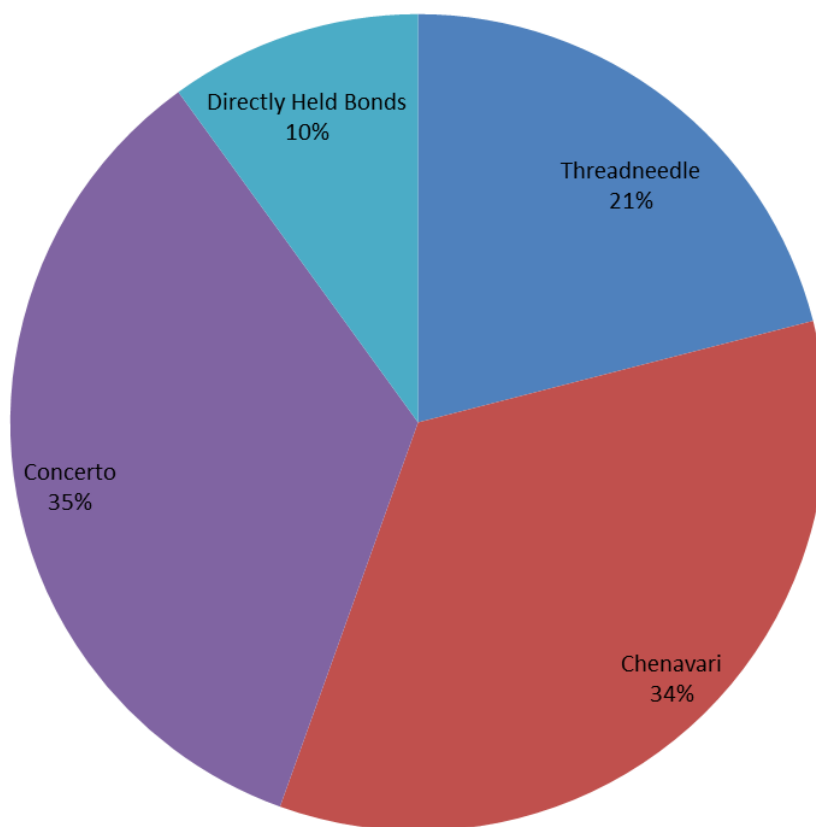
Threadneedle	Interest rates, currency
Chenavari	Credit
Concerto	Credit

### Hymans Robertson View

F&C has recently announced the Bank of Montreal has completed the acquisition of its asset management business. Hymans do not expect much change at F&C and on a positive note think it will bring much needed stability to the ownership of the business.

The other large investor in the Absolute Return Fund has recently liquidated their holding but the manager has assured Hymans that they be promoting the fund going forward.

The pie chart below shows the allocation as at 30<sup>th</sup> June 2014



**Lincolnshire Pension Fund  
Alternative Investments – Morgan Stanley  
Quarterly Report June 2014**

**Investment Process**

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

**Portfolio Valuation**

Value at 31.03.14	Value at 30.06.14
£138,520,944	£143,833,989

**Performance**

During the quarter the portfolio gained 2.2% and outperformed the benchmark by 1%. Strategic allocation was the largest driver of returns, while manager selection modestly detracted. All asset classes, with the exception of global macro and the volatility position, contributed positively to returns. Within manager selections, frontier equity drove underperformance whereas hedge funds outperformed. Tactical contributions were muted for the quarter.

	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Morgan Stanley	2.2	7.6	5.6	n/a	6.4
3 Month LIBOR + 4%	1.1	4.6	4.8	n/a	4.8
Relative Performance	1.0	2.9	0.8	n/a	1.5

\* annualised since inception date 24/11/2010

**Allocation**

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

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

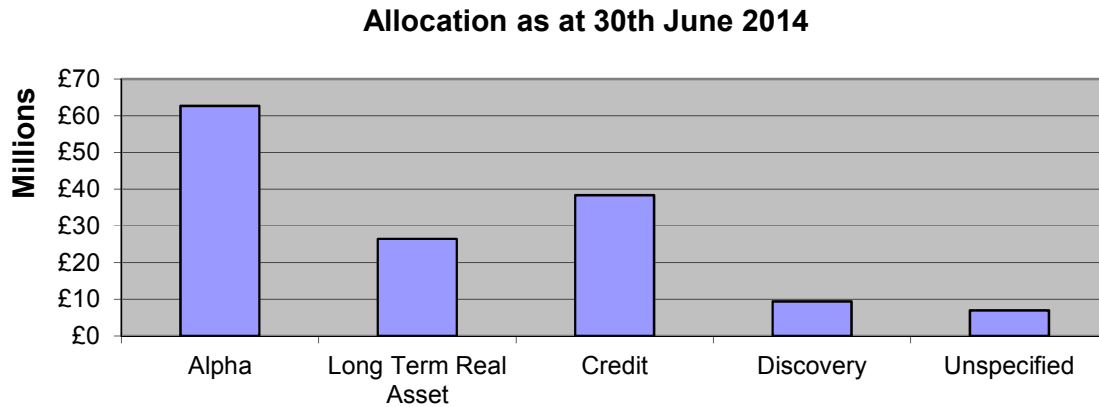
Long Term Real Asset – These are long term investments that seek to access illiquidity premium. Investments include Private Equity, Infrastructure, Real Estate, Commodities and Inflation – linked strategies.

Credit – These are the purchase of the lower rated bonds where higher default is more likely. Manager selection is important to ensure the correct bonds are purchased that will appreciate following rating upgrades and merger and acquisition

activity. Credit opportunities include Emerging Market Debt, High Yield Bonds, Senior Loans and Convertibles.

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

Unspecified – These are cash balances held with Morgan Stanley.



### **Portfolio Positioning**

During the quarter, Morgan Stanley increased their overall allocation to hedge funds, and given their conviction on active management, they introduced a liquid alpha fund and restructured the macro allocation to include a more focused global tactical asset allocation strategy.

Morgan Stanley continued to decrease their overall allocation to expanded credit through reductions in senior loans, convertible bonds and high yield.

### **Hymans Robertson View**

Morgan Stanley remain one of Hymans preferred managers for diversified alternatives mandates. They feel Morgan Stanley have a wealth of experience investing on alternative assets and the team responsible for this Fund have an impressive track record and a clear and well thought out investment approach.

### **Risk Control**

Portfolio volatility since inception is 4.07% within the guidelines specified by the mandate.

## **Conclusion**

The quarter saw all managers produce positive absolute returns ranging from 1.3% to 2.4%. Over twelve month managers have also produced positive absolute returns ranging from 3.1% to 12.8%.

## **Consultation**

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

n/a

## **Background Papers**

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

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