

Open Report on behalf of Pete Moore, Executive Director of Finance and Public Protection

Report to:	Pensions Committee
Date:	11 January 2018
Subject:	Investment Management Report

Summary:

This report covers the management of the Lincolnshire Pension Fund assets over the period from 1st July to 30th September 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

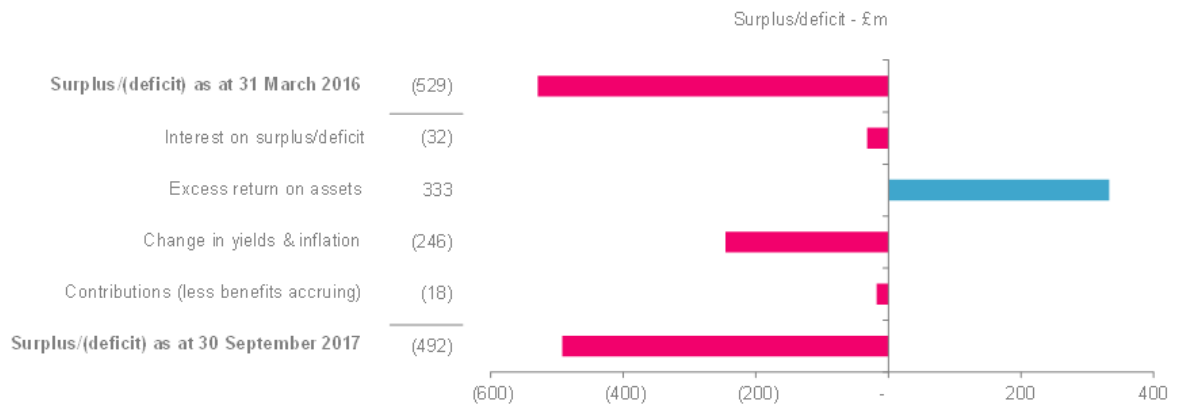
1. Funding Level Update

- 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, 30th September 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 30th September 2017, where the funding level has increased to 81.8%.

Change in funding level since last valuation



1.3 Over that same time period the deficit, in real money, has decreased from £529m to £492m. The chart below shows the main impactors on the deficit, with the excess return in assets offsetting the negative changes in yields and inflation.



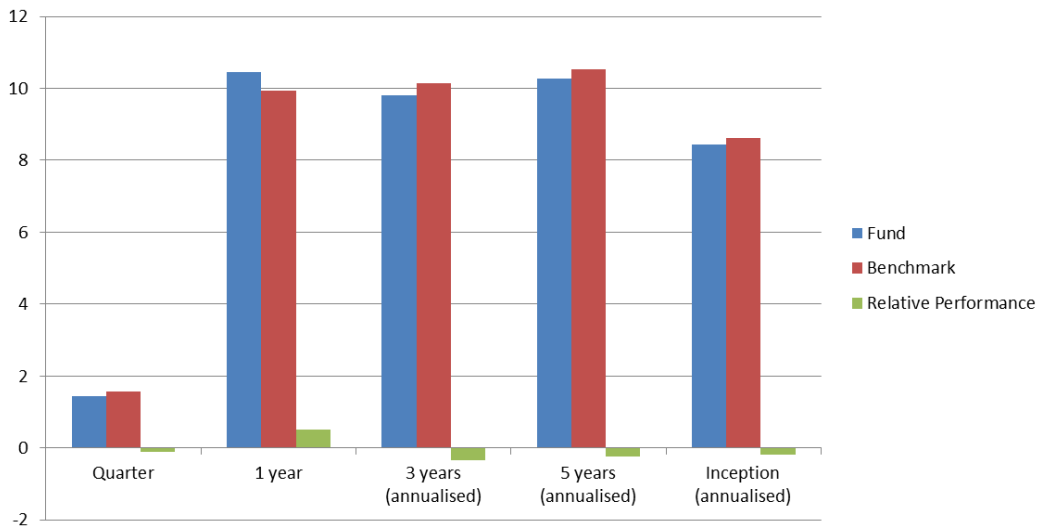
1.4 On a shorter term time horizon, looking at the last quarter, the funding level increased from 80.7% to 81.8% between 30th June and 30th September 2017, and the deficit reduced from £519m to £492m.

2. Fund Performance & Asset Allocation

2.1 The Fund increased in value by £39.0m during the quarter from £2,121.7m to £2,160.7, as the table below shows.

Asset Class	Q3 2017 £m	Q2 2017 £m	Asset Allocation %	Strategic Asset Allocation %	Difference %
UK Equities	413.0	404.1	19.1	20.0	(0.9)
Global Equities	930.7	917.6	43.4	40.0	3.4
Alternatives	303.7	298.0	13.9	15.0	(1.1)
Property	203.0	198.1	9.2	9.0	0.2
Infrastructure	31.8	31.4	1.5	2.5	(1.0)
Fixed Interest	261.2	261.4	12.2	13.5	(1.3)
Cash	17.3	11.1	0.8	0.0	0.8
Total	2,160.7	2,121.7	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	1.45	1.56	(0.11)
1 year	10.45	9.93	0.52
3 years*	9.8	10.14	(0.34)
5 years*	10.28	10.53	(0.25)
Inception**	8.43	8.62	(0.19)

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

2.3 Over the quarter, the Fund produced a positive return of 1.45% (as measured by JPMorgan), slightly underperforming the benchmark by (0.11%). 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 Aviva Pooled Property Fund has been moved from "on watch" to "retain". Seventeen managers remained rated as "retain", and one manager, Rreef Ventures Fund 3, as "on watch". Officers continue to monitor managers closely and arrange meetings to discuss any potential issues

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

4. Individual Manager Update

4.1 The manager returns and index returns for equity, fixed interest and alternative managers are shown in the table below. A detailed report on each manager outlining the investment process, performance, purchases and sales and Hymans Robertson's manager view can be found after the table at 4.2.

4.2 Manager Returns – As shown below it was a good quarter for the Fund with most managers producing a positive absolute return. Only one manager

underperformed their benchmark over that period, Morgan Stanley Global Brands. Over the 12 month period, all managers other than Blackrock (Fixed Interest) have produced a positive absolute return, with only Morgan Stanley Global Brands and Blackrock having underperformed their benchmark.

Manager	3 months ended 30/09/17			Previous 12 months			Target p.a. %
	Manager Return %	Index Return %	Relative Variance %	Manager Return %	Index Return %	Relative Variance %	
Legal & General (UK Equities)* <small>*From February 17</small>	2.2	2.2	0.0	N/A	N/A	N/A	Match Index
Invesco (Global Equities (ex UK))	2.1	1.5	0.6	15.9	14.6	1.1	+1.0
Columbia Threadneedle (Global Equities)	3.0	2.0	1.0	21.2	19.3	1.6	+2.0
Schroder's (Global Equities)	3.1	1.8	1.3	17.4	14.9	2.2	+3.0
Morgan Stanley Global Brands	(2.5)	1.5	(4.0)	11.8	14.4	(2.3)	n/a
Blackrock (Fixed Interest)	(0.3)	(0.3)	0.0	(2.0)	(2.1)	0.1	Match Index
Blackrock Interim (Fixed Interest)	0.1	0.1	0.0	1.1	1.2	(0.1)	Match Index
Morgan Stanley (Alternative Investments)	2.0	1.1	0.9	6.4	4.4	1.9	3M LIBOR + 4%

Lincolnshire Pension Fund
Global Equities – Invesco (Global Ex UK Enhanced)
Quarterly Report September 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.

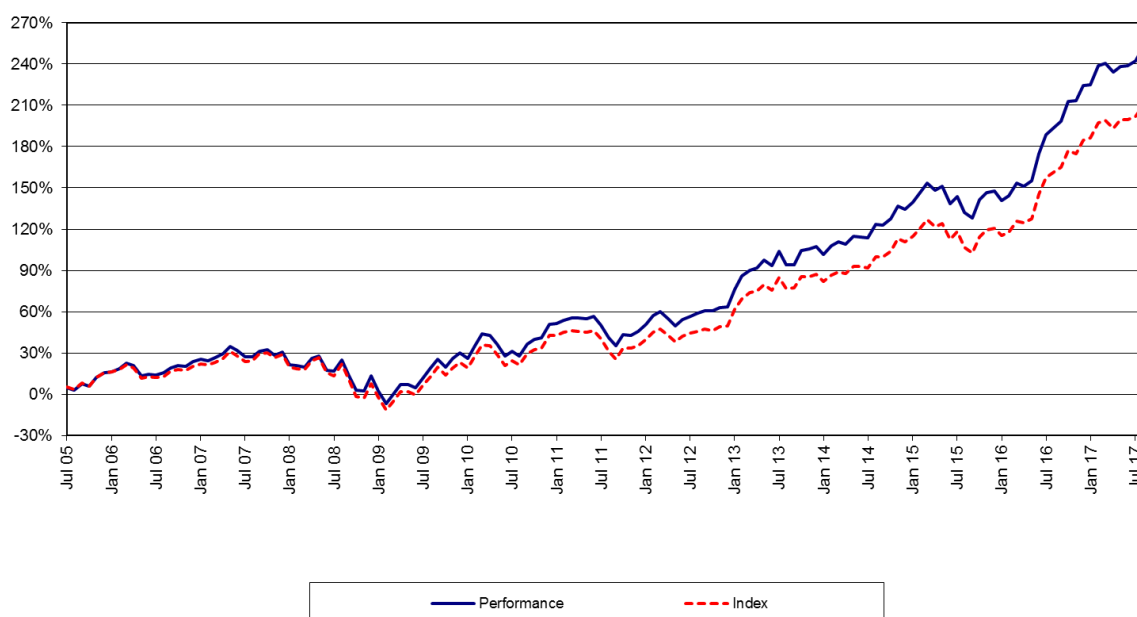
Portfolio Valuation

Value at 30.06.17	Value at 30.09.17
£489,896,500	£500,193,978

Performance

During the quarter Invesco's strategy outperformed its benchmark, with 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%.

Invesco Performance Since Inception



	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Invesco	2.1	15.9	15.8	16.6	10.7
MSCI World ex UK	1.5	14.6	15.0	15.6	9.5
Relative Performance	0.6	1.1	0.7	0.9	1.1

* annualised, inception date 1st July 2005

Turnover

Holdings at 30.06.17	Holdings at 30.09.17	Turnover in Qtr %	Turnover in Previous Qtr %
471	463	8.8	9.3

Purchases and Sales

During the quarter, Invesco made a number of stock adjustments to the portfolio. Top purchases over the quarter included adding Royal Caribbean Cruises, Sumitomo Rubber Industries and Xerox into the portfolio, and increasing their positions in Novartis, American Tower Corporation and Prologis. Top sales over the quarter were in selling out of their positions in Atlas Copco and Darden Restaurants, and decreasing their positions in K's Holding Corporation and Apple.

Largest Overweights

Citigroup	0.98%
Boeing Co	0.87%
Wal-mart	0.83%
JPMorgan Chase	0.70%
Canadian Nat Railway	0.65%

Largest Underweights

General Electric	(0.54%)
Alphabet	(0.54%)
Verizon Comms	(0.51%)
Amazon	(0.48%)
Visa	(0.38%)

* Measured against MSCI World ex UK (NDR)

Top 10 Holdings

1	Apple	£12,833,659
2	JPMorgan Chase	£8,143,751
3	Microsoft	£8,001,947
4	Citigroup	£7,602,291
5	Boeing Co	£6,305,763

6	Wal-mart	£5,751,740
7	Johnson & Johnson	£5,556,439
8	Procter & Gamble	£5,159,885
9	AT&T	£4,952,648
10	Bank of America	£4,891,967

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.

In August, Invesco announced it had completed the acquisition of Source, a specialist ETF provider. The plan is to combine Source into Invesco's existing PowerShares ETF business.

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 September 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.

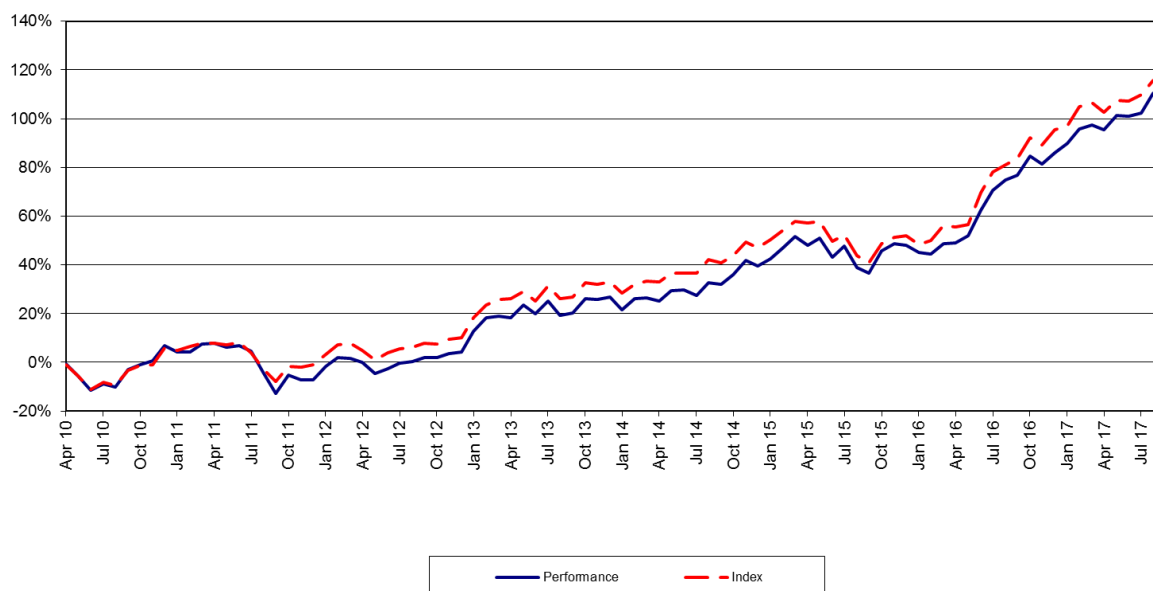
Portfolio Valuation

Value at 30.06.17	Value at 30.09.17
£120,218,612	£123,955,124

Performance

The portfolio outperformed over the quarter with stock selection generating the majority of the positive relative return. Positions in IT and industrials were especially strong, but holdings in most sectors contributed positively. The only exceptions were in consumer stocks – both discretionary and staples - which detracted slightly. Regional performance was also fairly broad-based. The US, emerging markets and Japanese stocks generated the majority of the outperformance, and the UK and Europe stocks posed a modest headwind.

Schroders Performance Since Inception



	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Schroders	3.1	17.4	16.3	15.3	10.2
MSCI ACWI (Net)	1.8	14.9	14.4	14.4	10.5
Relative Performance	1.3	2.2	1.6	0.8	(0.2)

*annualised, Inception date April 2010

Turnover

Holdings at 30.06.17	Holdings at 30.09.17	Turnover in Qtr %	Turnover in Previous Qtr %
77	81	10.9	9.1

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 Schroders expectations for the business. Proceeds were rotated into higher conviction ideas. The two key transactions were the sale of KBC Group, as the shares appeared fully valued, and the purchase of Infineon Technologies, which has exposure to a number of industrial areas where high growth is expected, such as electric cars and automated driving as well as factory automation and data centres.

Top 5 Contributions to Return

Alcoa	0.3%
Keyence	0.2%
Cimarex Energy	0.1%
Alibaba Group	0.1%
Infineon Technologies	0.1%

Bottom 5 Contributions to Return

Reckitt Benckiser	(0.3%)
Medtronic Public	(0.2%)
Comcast	(0.1%)
Nestle	(0.1%)
Procter & Gamble	(0.1%)

Top 10 Holdings

1	Citigroup	£4,268,627
2	Alphabet	£3,646,337
3	Comcast Corp	£3,085,945
4	JPMorgan Chase	£3,017,514
5	DowDuPont	£2,943,199

6	Taiwan Semiconductor	£2,862,955
7	United Health	£2,815,909
8	Visa	£2,666,381
9	Amazon	£2,560,782
10	Nestle	£2,559,213

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 September 2017**

Investment Process

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

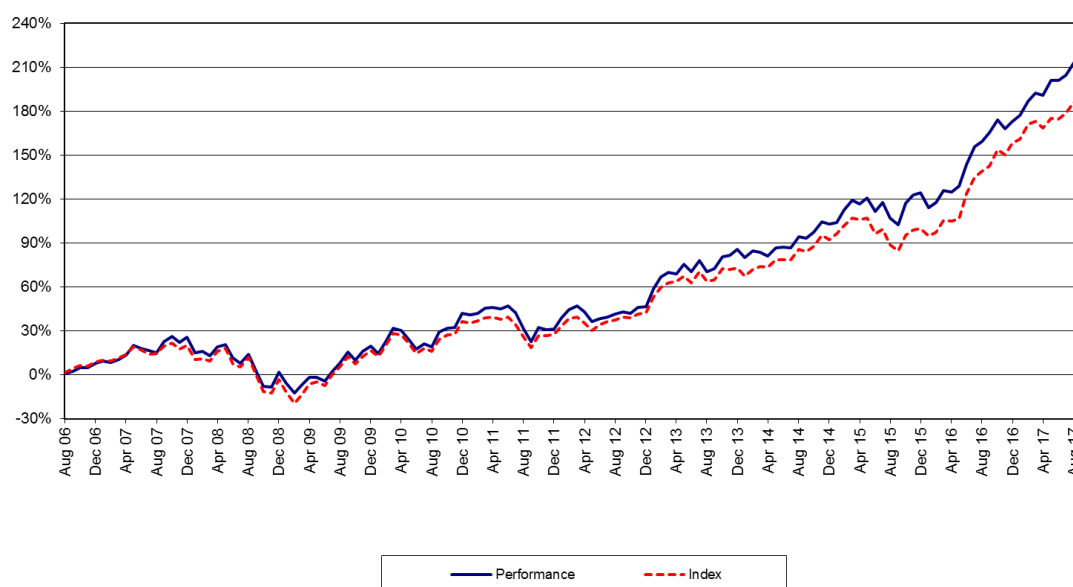
Portfolio Valuation

Value at 30.06.17	Value at 30.09.17
£125,484,056	129,173,578

Performance

Columbia Threadneedle outperformed its benchmark strongly over the quarter. Stock selection drove returns, with holdings in technology leading the way; positions in consumer staples and healthcare were also notable contributors. Yaskawa Electric continued its recent strong run, strongly outperforming the benchmark over the quarter. The stock was propelled by growing demand for automation technology in industries including packaging and food. Micron Technology also sustained its run of outperformance, as it continued to benefit from secular drivers such as high demand from data centres. Further, equipment-hire company United Rentals was buoyed by positive pricing trends in its industry. Detractors included Nike, which fell after retailer Foot Locker missed earnings expectations; however, this did little to offset a strong month for the fund.

Columbia Threadneedle Performance Since Inception



	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Columbia Threadneedle	3.0	21.2	17.0	16.8	10.7
MSCI ACWI	2.0	19.3	15.0	15.0	9.7
Relative Performance	1.0	1.6	1.7	1.6	0.9

Turnover

Holdings at 30.06.17	Holdings at 30.09.17	Turnover in Qtr %	Turnover in Previous Qtr %
86	84	5.1	7.0

Purchases and Sales

A new position was opened in Tesaro, which develops cancer therapeutics and supportive care products. Tesaro stands to benefit from developments in its treatments, which could eventually be used to treat more than one cancer type. Tencent was sold, and holdings were reduced in Activision Blizzard and Facebook. All three technology companies' valuations having risen sharply and profits were reallocated into firms retaining stronger long-term growth prospects. The position in Spirit Airlines was also closed; due to concerns about the company's earnings amid pricing pressures and increased competition, and the belief that preferable alternatives now exist elsewhere.

Top 5 Contributions to Return

Micron Technology	0.36%
Yaskawa Electric	0.34%
United Rentals	0.27%
Alibaba Group	0.25%
Mastercard	0.25%

Bottom 5 Contributions to Return

Spirit Airlines	(0.42%)
Nike	(0.25%)
Johnson Controls Int'l	(0.14%)
Dentsply Sirona	(0.13%)
Criteo SA	(0.13%)

Top 10 Holdings

1	Alphabet	£4,470,499
2	Amazon	£2,834,972
3	JPMorgan Chase	£2,820,811
4	Unilever	£2,788,606
5	Mastercard	£2,758,388

6	Schwab (Charles)	£2,748,082
7	Visa	£2,575,730
8	Bank of America	£2,548,179
9	Anheuser-Busch	£2,506,201
10	Facebook	£2,495,215

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 September 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.

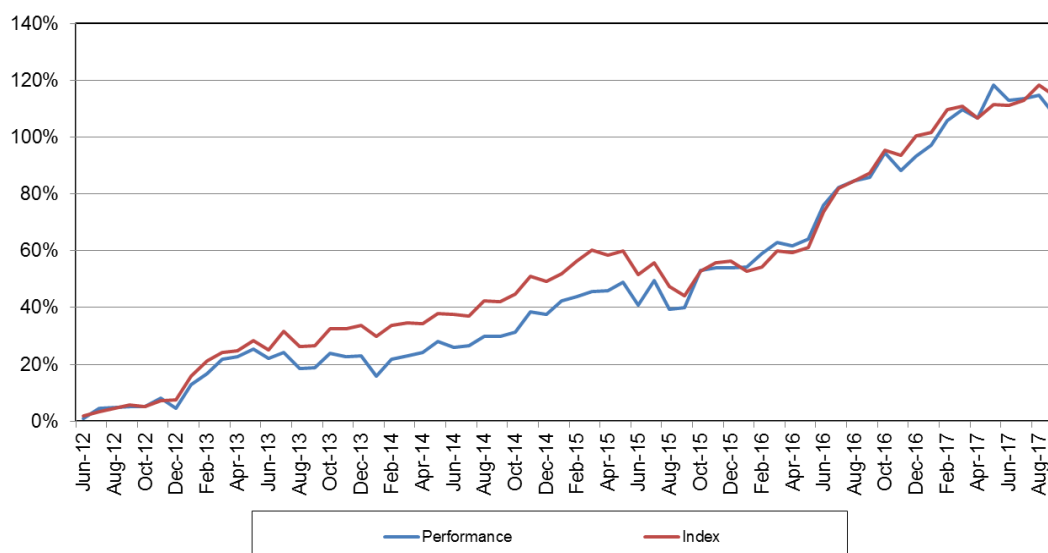
Portfolio Valuation

Value at 30.06.17	Value at 30.09.17
£181,969,012	£177,386,063

Performance

For the quarter the portfolio underperformed in relative terms, returning -2.52% versus 1.50% for the index. The portfolio was hurt by both stock selection and sector allocation. For sector allocation, the dominant issue was the overweight in Consumer Staples, which lagged 5% behind the overall index, while for stock selection both Consumer Discretionary and Consumer Staples showed underperformance against their respective benchmarks. The largest contributors to absolute performance during the quarter were Unilever, Visa and Microsoft. The main absolute detractors were Reckitt Benckiser, British American Tobacco and Altria.

Morgan Stanley Global Brands Performance Since Inception



	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Morgan Stanley Global Brands	(2.5)	11.8	17.0	14.6	14.7
MSCI World Index	1.5	14.4	14.7	15.2	15.4
Relative Performance	(4.0)	(2.3)	1.9	(0.5)	(0.6)

Purchases and Sales

During the quarter, a position in Danaher, the US health care/industrial company, was initiated, having been on the radar for a long time. The position in Accenture, the leading IT company, was added to, and the position in British American Tobacco also grew, though this was largely due to the absorption of MS's Reynolds American position as the takeover completed. During the period, positions were also added to and reduced in select Consumer Staples, Information Technology, Industrials, Consumer Discretionary and Health Care names for quality or valuation reasons..

Top Contributors to Return

Unilever	42bps
Visa	36bps
Microsoft	34bps

Bottom Contributors to Return

Reckitt Benckiser	(94bps)
British American Tobacco	(73bps)
Altria	(72bps)

Top Ten Holdings

Company	Industry	% Weighting
Unilever	Personal Products	9.32
British American Tobacco	Tobacco	7.75
Accenture	IT Services	7.27
Reckitt Benckiser	Household Products	7.23
Microsoft	Software	7.20
SAP	Software	4.86
Visa	IT Services	4.79
L'Oreal	Personal Products	4.78
Philip Morris	Tobacco	4.50
Twenty First Century Fox	Media	4.14

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 September 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 30th September 2017

Portfolio	30.06.17 £	30.09.17 £
Corporate Bond All Stocks Index Fund	67,467,917	67,566,248
Over 5 Years UK Index-Linked Gilt Index Fund	40,885,768	40,571,464
All Stocks UK Gilts*	26,990,517	26,873,350
Cash (residual)	1	1
Total	135,344,203	135,201,580

*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	(0.3)	(2.0)	8.2	6.7	7.4
Composite Benchmark	(0.3)	(2.1)	8.0	6.6	7.3
Relative Performance	0.0	0.1	0.2	0.1	0.1

*annualised since inception 28/07/10

Hymans Robertson View

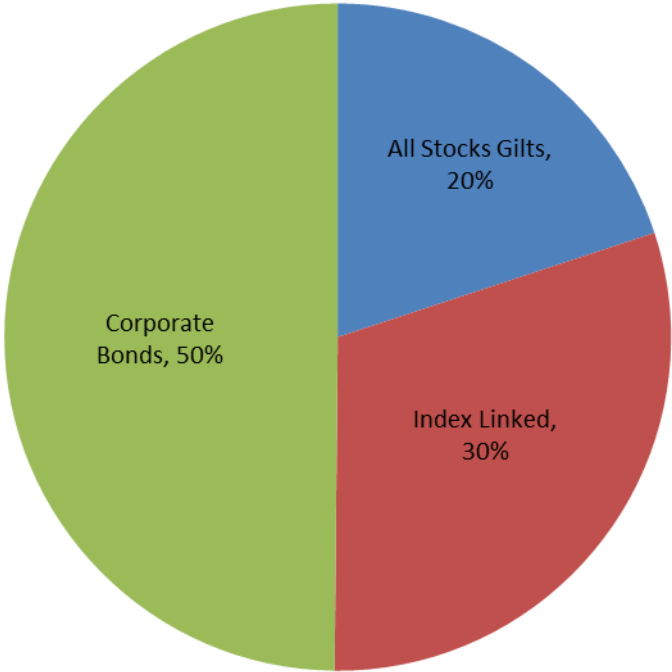
There were no significant developments within the Index Fixed Income team over the quarter.

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 September 2017.



Lincolnshire Pension Fund
Passive Bonds – Blackrock interim
Quarterly Report September 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 30.06.17	Value at 30.09.17
£126,198,322	£126,328,641

Performance

Over all periods the portfolio has performed as expected.

	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Blackrock Interim	0.1	1.1	n/a	n/a	1.3
Benchmark	0.1	1.2	n/a	n/a	1.2
Relative Performance	0.0	(0.1)	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 September 2017**

Investment Process

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

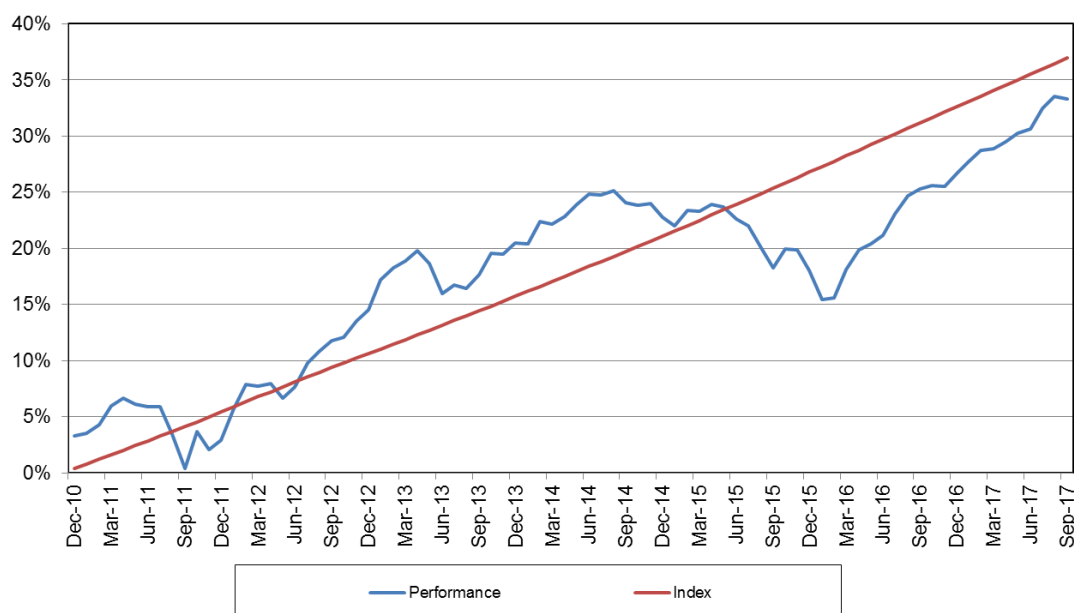
Portfolio Valuation

Value at 30.06.17	Value at 30.09.17
£256,042,873	£264,390,864

Performance

The portfolio outperformed during the quarter. Hedge funds, private market investments and frontier equities drove absolute returns, offsetting losses from catastrophe risk. Tactical decisions were overall additive, particularly increasing the frontier equity exposure, while manager selection modestly detracted from relative returns. Within manager selection, catastrophe risk and frontier equity particularly lagged.

Morgan Stanley AIP Performance Since Inception



	Quarter %	1 Year %	3 Year* %	5 Year* %	Inception* %
Morgan Stanley	2.0	6.4	2.4	3.6	4.3
3 Month LIBOR + 4%	1.1	4.4	4.6	4.6	4.7
Relative Performance	0.9	1.9	(2.1)	(1.0)	(0.4)

* 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;

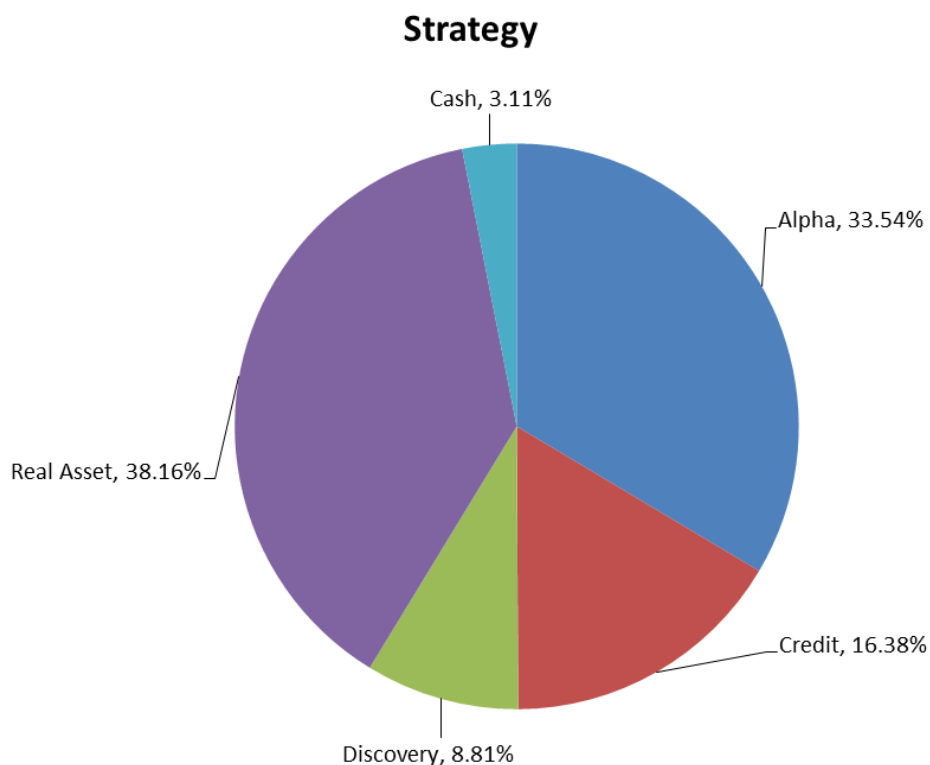
Alpha These are pure return seeking products based on Manager skill. The Alpha investments include Hedge Funds, Global Tactical Asset Allocation (GTAA) and Active Currency.

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.

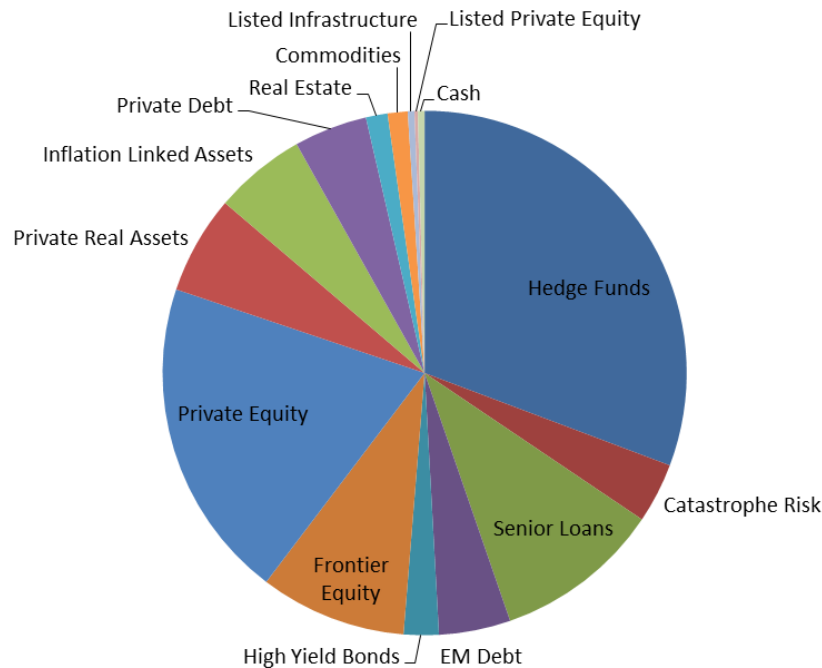
Credit These are the purchase of the lower rated bonds where higher default is more likely. Manager selection is important to ensure the correct bonds are purchased that will appreciate following rating upgrades and merger and acquisition activity. Credit opportunities include Emerging Market Debt, High 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 30th September 2017.



Asset Class



Portfolio Positioning

MS continue to expect benign global growth on the signs of investment spending rebounds. The Fed announced the decision to start balance sheet reduction in October, but it is not expected to bring an abrupt end to the current positive market environment, on the assumption that the normalisation process will be gradual and predictable. European Central Bank President Mario Draghi has led markets to expect an announcement in October of a further reduction in Quantitative Easing purchase, which could put further upward pressure on bond yields. Coupled with spread compression, an underweight to credit is being maintained. The credit allocation is comprised of senior loans, Emerging Market debt and a smaller allocation to high yield. Similarly, on the liquid real asset side, a tactical underweight is maintained, based predominantly on valuation levels.

On the hedge fund side, lower beta equity long-short, merger arbitrage, Commercial Mortgage Backed Securities (CMBS) and catalyst-driven relative value investing are areas of emphasis that are expected to perform well in the current environment. These investments are balanced with a positive view on discretionary and systematic macro as a way to help mitigate the downside should the volatility environment shift.

The private markets portfolio continues to be build out. This quarter, diligence was completed on a private debt strategy focused on lending to the lower middle market, which MS believe remains capital-constrained relative to the broader private lending market. In real assets, diligence on a North America focused infrastructure strategy was finalised, that is very well positioned in a market that is very competitive, but offers significant opportunities across both operating assets and development projects. Lastly, MS remain disciplined in their small and mid-cap private equity bias and see an increasing amount of attractive co-investment

opportunities with high quality partners. MS are selective in our pursuit of secondary opportunities, but are participating in some opportunities that include a level of complexity that they believe will limit the competition.

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.

There were no significant developments over the quarter.

Risk Control

Portfolio volatility since inception is 3.73%, within the guidelines specified by the mandate.

Conclusion

Over the quarter, the Fund produced a positive return of 1.45%, underperforming the benchmark which returned 1.56%.

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.

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