AllenbridgeEpic
investment advisers

APPENDIX 5

REPORT PREPARED FOR

# London Borough of Bromley Pension Fund

19 May 2015

**Alick Stevenson**
**AllenbridgeEpic Investment Advisers Limited (AllenbridgeEpic)**

alick.stevenson@allenbridgeepic.com
www.allenbridgeepic.com

**This quarterly report by your adviser, Alick Stevenson of AllenbridgeEpic Investment Advisers (AllenbridgeEpic), provides a summary of performance and an analysis of the investments of the London Borough of Bromley Pension Fund for the three months ending 31 March 2015.**

## Market Summary 1Q 2015

**"Better a tragic ending, than an endless tragedy"**

German proverb

It's becoming a bit of a broken record when the same four economic issues continue to dominate global markets.

- *Global growth, patchy and not yet firmly embedded*
- *Eurozone fears of a Greece exit, and despite the European Central Bank programme of quantitative easing no significant signs of sustainable growth*
- *Central banks versus markets on when interest rates will rise and by how much and*
- *No market perceived "bubbles" in asset prices leading to increased volatility and potential market declines*

Despite the "broken record" concept, the last quarter has been one of strong growth in equity markets, with major markets touching and, in some cases, breaching fifteen year levels.
Six years of quantitative easing and cheap money may have inflated asset values but have had much less success in kick starting economic growth. Equity market levels already owe much of their present levels to central bank actions rather than the everyday realities of economic growth.

Whilst this has led in many instances to aggressive corporate share buy-back programmes, share values have not necessarily been driven by consumer demand and thus corporate profits levels have to a certain extent been created artificially. These comments refer of course to points two, three and four above.

The hesitancy shown by central banks when considering interest rate rises, seems to be justified as any precipitate upward movement could cause a major sell off with all its negative implications and an end to the nascent economic growth. Central bankers around the world seem united in their public pronouncements that there will be no rate increases until they feel the global economic recovery is embedded sufficiently to withstand a rate increase. Point one above.

Markets will no doubt continue to test central bank resolve in the months to come.

The Eurozone side show in which Greece is the "major" player continues. That Greece should never have been allowed to join is apparent to all, however, Brussels and Germany have decreed that an exit is impossible without bringing doom and economic winter down around the collective known as the Eurozone. So further compromise, further meetings and further obfuscation will continue. Meanwhile the rest of the Eurozone stagnates with little or no economic growth.

Closer to home the General Election draws ever closer and a new government of whatever prescription will be formed soon after the results are declared. Whilst opinion polls seem hesitant in calling the result, current voting uncertainties do not appear to derail the strength of the UK equity market.

## Executive Summary

- **The fund had a good quarter, rising in value to £744.0m as at 31 March 2015 from £693.7m at 31 December 2014. The corresponding figure for 31 March 2014 was £625.5m.**

- **Investment performance was also good with the fund delivering a strong 7.3% (6.0%) return for the quarter, 18.5% (16.4%) for the rolling twelve months and 14.2%pa (12.1%pa) over the rolling three year period. These figures compare positively to the current actuarial assumption of 5.6%pa. (figures in brackets are the respective benchmarks)**

- **Baillie Gifford reported the closure, (to new business), of their Global Alpha Fund ("GAF"), and also advised that Charles Plowden, one of the portfolio managers on Global Alpha had taken a planned sabbatical for three months and would be returning in the summer. Jenny Davis, already one of the team, will step up as the third "decision maker" The GAF is well supported and I have no reason to express concern.**

## Fund Matters

The Third Phase of the investment reorganisation, that of reorganising the fixed income assets continues, Baillie Gifford and Fidelity will be attending the PISC meeting in May to present their alternatives to their current portfolio constructions.  Short papers covering the presentations they will make at the May meeting are provided separately..

## Fund Value as at 31 March 2015

| Manager Name | Asset Class | Value 31-Mar-15 £m | Actual % of Fund | Value 31-Dec-14 £m | Actual % of Fund | Strategic Asset Allocation % |
|---|---|---|---|---|---|---|
| Baillie Gifford | DGF | 45.5 | 6.1 | 44.0 | 6.3 | |
| Standard Life | DGF | 29.7 | 4.0 | 28.4 | 4.1 | |
| Sub total DGF | | 75.2 | 10.1 | 72.4 | 10.4 | 10.0 |
| Baillie Gifford | Global E | 248.3 | 33.4 | 227.7 | 32.8 | |
| BlackRock | Global E | 151.0 | 20.3 | 139.2 | 20.1 | |
| MFS | Global E | 151.3 | 20.3 | 139.2 | 20.1 | |
| Sub total GE | | 550.6 | 74.0 | 506.1 | 73.0 | 70.0 |
| Baillie Gifford | Fixed Int | 51.6 | 6.9 | 50.2 | 7.2 | |
| Fidelity | Fixed Int | 66.6 | 9.0 | 64.9 | 9.4 | |
| Sub total FI | | 118.2 | 15.9 | 115.1 | 16.6 | 20.0 |
| Fund Totals | | 744.0 | 100.0 | 693.6 | 100.0 | 100.0 |

**source: Baillie Gifford, BlackRock, Fidelity, MFS, Standard Life**

The fund moved easily through the £700m level by the end of the quarter, on the back of strong performances from the global equity managers, supported by good performances from DGF and fixed income.
As far as the strategic or long term asset allocations are concerned the fund remains slightly overweight equities and DGF assets and remains underweight fixed income. These over and underweight positions will be closely monitored and may be adjusted following completion of the Phase 3 Fixed Income restructuring.

## Fund Performance

**Summary**

| | | |
|---|---|---|
| Fund Return | | 7.3 |
| Benchmark Return | | 6.0 |
| Relative Performance | | 1.2 |
| | **attributable to:** | |
| | Asset Allocation | 0.1 |
| | Stock Selection | 1.2 |

Source: The WM Company

It is clear from the above charts that asset allocation has had a negligible negative impact on overall investment performance whereas stock selection was extremely robust, once again reflecting positively on the active manager structure.

## Manager Changes

There was one minor change reported at Baillie Gifford which is highlighted in the Executive Summary. This change should not affect the way in which the portfolio is managed.

No other changes which would affect the running of the various portfolios have been notified by the investment managers.

## Fund Governance and Voting

Voting and governance matters are covered in some detail within the various Investment Manager reports provided to the members under separate cover.

# INVESTMENT MANAGER REVIEWS

## Global Equity Portfolios

### Baillie Gifford Global Alpha (segregated)

This portfolio was funded as at 20 December 2013 with a performance objective to outperform the MSCI (“ACWI”) All Country World Index by 2-3% pa (before fees) over rolling five year periods.
(The Fund was closed to prospective investors at the beginning of the year but remains open for additional funding from existing clients).

Fund positioning has changed slightly during the quarter with funding for new stock purchases coming from sales of stocks, described by the manager, as “stalwarts” and recognising that perhaps their share prices could weaken on the back of uncertain earnings going forward. As a result complete disposals were made in BAT, Roche and Bunzl and from Teradata which had disappointed. New purchases included Zillow, an online US based estate agency, HDFC Bank and MS & AD Insurance. At the end of March 2015 the global equity fund was invested across 24 (24) countries and held 95 (97) different investments. These investments were spread over 8 (8) sectors and encompassed 38 (40) differing industries, thus providing a broadly diversified set of assets. It is worth noting that the active money within this portfolio is continuing to run at 93% (92%). This implies that the fund is not holding benchmark or index weightings relating to stocks making up the index and reflects the active stock picking philosophy of the manager.

For the quarter, the fund returned 8.5% against a benchmark of 7.5%. Since the portfolio reorganisation in December 2013, the fund has returned 17.0%pa against a benchmark of 15.5*%pa. (All returns shown as net of fees.)*

In terms of regional allocations Baillie Gifford remains significantly underweight the MSCI Index in North America (47.5% v 61.2%) and underweight Developed Asia Pacific (11.8% v 13.3%) but is running an overweight to Emerging Markets and a small underweight in the UK.

The “active money” style (stock picking) is clearly demonstrated with the top ten holdings accounting for just over 25% (25%) of the total portfolio. Prudential at 3.5%, Royal Caribbean Cruises at 3.9% and Naspers at 3.8%, retain the top three names whilst TD Ameritrade, AIA Group and Google take the bottom three positions with 2.0%, 1.8% and 1.8% respectively.

## BlackRock Ascent Life Enhanced Global Equity Fund (pooled)

This new portfolio was funded as at 20 December 2013 and has a Performance objective: to outperform the MSCI ACWI by 1-2% per annum whilst managing risk relative to the benchmark.

The manager can invest across the whole of the ACW Index and, as a result, held 814 stocks (846) at the end of the quarter and outperformed its benchmark by 0.7% (benchmark 8.3% v 7.6%). Since inception the fund has performed strongly and has a return of 19.9%pa against a benchmark of 16.8%pa. These returns are shown gross of fees. For net returns simply deduct 50bps

In terms of country risk, the manager is slightly overweight Canada and Germany and slightly underweight the US. It remains underweight in the UK and “Other Countries”.
Sectorally, the fund has remained overweight Info Tech, Telecoms and Utilities and continues with its underweight positions in Consumer Discretionary and Consumer Staples. Interestingly, the manager has moved from small underweights to small overweights in Financials and Materials.

Top ten stocks are little changed from last quarter with Apple (back at 2.9%) Verizon (1.5%) and Union Pacific Corp (1.3%) talking the top three positions. However, it should be mentioned that last quarter Apple held the top spot, BlackRock took the view that its valuation was becoming a bit “stretched” and sold the holding down from approx. 2.8%. to just 0.95% of the fund. They have since bought back into Apple following a reappraisal of its “real” value, hence it has regained its number one slot.

### MFS Global Equity Fund (segregated)

This portfolio was funded as at 18 December 2013 and has a performance objective to outperform the MSCI world index (net dividends reinvested) over full market cycles.

MFS currently invests in 15 (15) countries and has 108 (109) holdings. This contrasts with the benchmark of 1,633 holdings spread across 24 countries. For the quarter the fund returned 8.5% net against its benchmark of 7.5%.Since inception the fund has returned 19.2%pa (net) against the benchmark of 17.2% pa for a net outperformance of 2.0% pa.

Looking through the country and sector weights shows that the fund is currently underweight North America (53.1% v 61.2%) and Asia Pacific ex Japan (1.2% v 4.7%), and has maintained the overweight positions in Europe ex UK (+2.6%), UK (+2.1%) and Japan (+3.5%). The fund is also running a small +1.2% overweight in emerging markets.

Sectorally, the fund has again maintained its significant overweight position in Consumer Staples (20.2% v 9.8%), with small overweights in Industrials (+3.7%) and Telecommunication Services (+2.0%). These over weights are being "funded" by underweight positions in Information Technology (-2.1%), Consumer Discretionary (-4.4%), Utilities (-3.2%) , Energy (-3.3%) and Materials (-3.3%).

In terms of holdings, KDDI Corporation with 2.6% of the portfolio, Nestle (2.3%) and Johnson & Johnson at 2.2% are the three largest, with JP Morgan (1.8%) % and 3M Company (1.7%) are in ninth and tenth positions.

### Global Equity Crossholdings

There are no crossholdings within the aggregated top ten holdings of the three global equity managers.

## Diversified Growth Funds

Overall, Baillie Gifford has maintained its much lower allocation to global equities and has increased its exposure to high yield at the expense of a reduction in emerging market bonds. BG has made no major changes to its other investments.

In contrast, Standard Life holds just over 47% of its assets in derivative based investments backed by cash, favouring its relative value and directional investment strategies.

### Baillie Gifford

This mandate was funded on 8 December 2012 and has a performance objective to outperform UK base rate by at least 3.5% pa (net of fees) over rolling five year periods and with an annualised volatility of less than 10%.

The fund has performed well since its inception, generating a *net return of 6.4%pa* against the benchmark of 4.0%pa. For the 12 month period it has returned 7.9% against the benchmark of 4.0%. For the quarter the fund had a return of 3.2% versus the benchmark of 1.0%. Annualised volatility continues to well inside the upper limit of 10%.

Most asset classes delivered good returns over the quarter despite a fall in inflation as the effects of the lower oil price worked their way through. This, coupled with the ECB decision to back its rhetoric with real money, saw bond yields fall to record low levels. Almost without exception major sovereign debt issues now trade at a negative rate of return.

There were few major changes to the overall asset allocations over the quarter, the exceptions being increased investment in high yield bonds to 15.1% (11.7%) funded from a reduction in emerging market bond holdings and minor reductions in several other asset classes.

One of the primary directives for the fund, and one closely followed, is to keep volatility within target. At the end of the quarter the current figure was similar to that at the end of the previous quarter 4.4% (4.7%) well within the upper ceiling of +10%.

## Standard Life Global Absolute Return Fund

This mandate was funded on 7 December 2012 and has a performance objective to achieve +5% per year (gross) over 6 month LIBOR over rolling three year periods with expected volatility in the range of 4% to 8%

For the quarter the manager delivered a return of 4.4% net of fees against the benchmark of 0.2%, and since inception a strong net return of 7.7%pa. Positive contributions from directional currency investments and global equities were enhanced by good returns on relative value investments. Volatility within GARS was held at just 3.9% for the third consecutive quarter.

Asset allocations at the end of this quarter were almost exactly the same as those at the end of the third and second quarters.

| | Baillie Gifford | Baillie Gifford | Standard Life | Standard Life | Total DGF | Total DGF |
|---|---|---|---|---|---|---|
| | % | £m | % | £m | £m | % |
| Value at 31 March 2015 | | 45.5 | | 29.7 | 75.2 | |
| Asset Class | | | | | | |
| Global equities | 21.2 | 9.6 | 33.2 | 9.9 | 19.5 | 25.9 |
| Private equity | 1.6 | 0.7 | | | 0.7 | 1.0 |
| Property | 3.0 | 1.4 | | | 1.4 | 1.8 |
| Global REITS | | | | | | |
| Commodities | 4.9 | 2.2 | | | 2.2 | 3.0 |
| Bonds | | | | | | |
| High yield | 15.1 | 6.9 | 4.4 | 1.3 | 8.2 | 10.9 |
| Investment grade | 6.4 | 2.9 | 6.2 | 1.8 | 4.8 | 6.3 |
| Emerging markets | 10.0 | 4.6 | 8.6 | 2.6 | 7.1 | 9.4 |
| UK corp bonds | | | | | | |
| EU corp bonds | | | | | | |
| Government | | 0.0 | | | 0.0 | 0.0 |
| Global index linked | | | | | | |
| Structured finance | 12.6 | 5.7 | | | 5.7 | 7.6 |
| Infrastructure | 4.3 | 2.0 | | | 2.0 | 2.6 |
| Absolute return | 8.5 | 3.9 | | | 3.9 | 5.1 |
| Insurance Linked | 5.2 | 2.4 | | | 2.4 | 3.1 |
| Special )pportunities | 0.5 | 0.2 | | | 0.2 | 0.3 |
| Active currency | -0.3 | -0.1 | | | -0.1 | -0.2 |
| Cash | 7.0 | 3.2 | | | 3.2 | 4.2 |
| Cash and derivatives | | | 47.6 | 14.1 | 14.1 | 18.8 |
| Total | 100.0 | **45.5** | 100.0 | **29.7** | **75.2** | 100.0 |

**numbers may not add due to roundings**

**Source: Baillie Gifford and Standard Life**

The above table highlights the asset allocation differences between Baillie Gifford and Standard Life in sourcing investment returns

## FIXED INCOME PORTFOLIOS

### Baillie Gifford Aggregate Plus Portfolio

The transition to the Sterling Aggregate Bond Fund was completed on 15 April 2014. The new mandate has a performance objective to outperform, by 1.5% pa (gross of fees), a benchmark comprising 50% FTSE UL conventional All Stocks index and 50% Bank of America Merrill Lynch Sterling Non Gilt index over rolling three year periods.

The fund had a net return of 2.7% (net of fees) which matched the benchmark.

Portfolio duration is just fractionally longer than the benchmark at 9.7 years versus 9.2 years.

From a credit rating perspective the fund is marginally overweight benchmark with AAA rated bonds, underweight AA (-11.4% to the benchmark) and overweight BBB ( +7.0% to the benchmark) with a total of 95% invested in investment grade bonds.

High yield, or below investment grade, has a modest overweight of 4.1% to the index and is comprised largely of bonds rated BB which have lost their "BBB" rating, but in the opinion of the manager have the ability to regain that rating. The manager does not invest in any "C" rated bonds.

In terms of active money, ie. Those positions larger than the benchmark allocation, the manager holds 3.0% of the fund in KFW 2036, 2.1% in Tesco, 2044, 2% in WP Carey 2023 and 1.9% in Network Rail 2035.

### Fidelity Global Aggregate Fixed Income Portfolio

This portfolio was originally funded in April 1998 and has a performance objective to outperform by 0.75% pa (gross of fees) a benchmark comprising 100% of (IBoxx Composite (50% Gilts and 50% £ Non Gilts) over rolling three year periods.

The fund outperformed the benchmark during the quarter with a return of 2.9% (gross of fees) just 0.1% over the benchmark. Over the last three years the fund is ahead of the benchmark by 2.3% pa (13.5% pa v 11.2%pa) and since inception (30 April 1998) has outperformed the benchmark by 0.9% pa.

In terms of credit ratings, the fund has slightly over 90% invested in investment grade bonds, albeit underweight the index, especially in AA bonds, and has 21.6% invested in BBB rated bonds. The manager has increased his holdings to 6.3% (2.8%) in high yield bonds and holds the remaining 4% in a mix of cash and unrated investments.

There has been almost no change at all during the quarter to the sectoral allocations with US treasury assets accounting for approximately 37% (43%) of the portfolio. Overweight positions in the Financial Services, Communications and Insurance sectors are offset by underweights in Supranationals and Sovereign Assets and Utilities.

The portfolio is in line with the duration of the benchmark 9.4 years versus 9.5 years and has a running yield of just 3.0%.