Report No.
FSD17021

London Borough of Bromley

PART 1 - PUBLIC

Decision Maker:	**Pensions Investment Sub-Committee** **Council**
Date:	**Pensions Investment Sub-Committee 22nd February 2017** **Council 1st March 2017**
Decision Type:	Non-Urgent Non-Executive Non-Key
Title:	**PENSION FUND PERFORMANCE Q3 2016/17**
Contact Officer:	James Mullender, Principal Accountant Tel: 020 8313 4292 E-mail: james.mullender@bromley.gov.uk
Chief Officer:	Director of Finance
Ward:	All

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1. Reason for report

1.1 This report provides a summary of the investment performance of Bromley's Pension Fund in the 3rd quarter of 2016/17. More detail on investment performance is provided in a separate report from the Fund's external advisers, AllenbridgeEpic, which is attached as Appendix 5. Baillie Gifford has also provided a commentary on its performance and on its view of the economic outlook and this is attached as Appendix 3. The report also contains information on general financial and membership trends of the Pension Fund and summarised information on early retirements.

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2. RECOMMENDATIONS

2.1 The Pensions Investment Sub-Committee is asked to:

(a) Note the contents of the report;

(b) Agree the proposed Fund Manager attendance dates as detailed in para 3.7.2, and

(c) Note the latest indicative increase in transfer value relating to Bromley College as detailed in section 3.6.

2.2 Council is asked to note the latest indicative increase in transfer value relating to Bromley College as detailed in section 3.6.

Corporate Policy

1. Policy Status: Existing policy. The Council's Pension Fund is a defined benefit scheme operated under the provisions of the Local Government Pension Scheme (LGPS) Regulations, for the purpose of providing pension benefits for its employees. The investment regulations (The LGPS (Management and Investment of Funds) Regulations 2016) allow local authorities to use all the established categories of investments, e.g. equities, bonds, property etc, and to appoint external investment managers who are required to use a wide variety of investments and to comply with certain specific limits.

2. BBB Priority: Excellent Council.

Financial

1. Cost of proposal: No cost

2. Ongoing costs: Recurring cost. Total administration costs estimated at £3.4m (includes fund manager/actuary/adviser fees, Liberata charge and officer time)

3. Budget head/performance centre: Pension Fund

4. Total current budget for this head: £36.4m expenditure (pensions, lump sums, etc); £42.6m income (contributions, investment income, etc); £893.9m total fund market value at 31st December 2016)

5. Source of funding: Contributions to Pension Fund

Staff

1. Number of staff (current and additional): 0.4 FTE

2. If from existing staff resources, number of staff hours: c 14 hours per week

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Legal

1. Legal Requirement: Statutory requirement. Local Government Pension Scheme (LGPS) Regulations 2013, LGPS (Management and Investment of Funds) Regulations 2016

2. Call-in: Call-in is not applicable.

Customer Impact

1. Estimated number of users/beneficiaries (current and projected): 6,276 current employees; 5,223 pensioners; 5,425 deferred pensioners as at 31st December 2016

Ward Councillor Views

1. Have Ward Councillors been asked for comments? No.

2. Summary of Ward Councillors comments: N/A

3. COMMMENTARY

3.1 Fund Value

3.1.1 The market value of the Fund ended the December quarter at £893.9m (£863.3m as at 30th September 2016) and had risen further to £907.6m as at 31th January 2017. The comparable value as at 31st December 2015 was £732.0m. Historic data on the value of the Fund are shown in a table and in graph form in Appendix 1.

3.2 Performance Targets and Investment Strategy

3.2.1 Historically, the Fund's investment strategy has been broadly based on a high level 80%/20% split between growth seeking assets (representing the long-term return generating part of the Fund's assets) and protection assets (aimed at providing returns to match the future growth of the Fund's liabilities). Between 1998 and 2012, Baillie Gifford and Fidelity managed balanced mandates along these lines. In 2012, a comprehensive review of the Fund's investment strategy confirmed this high-level strategy. It concluded that the growth element would, in future, comprise a 10% allocation to Diversified Growth Funds (DGF) and a 70% allocation to global equities, with a 20% protection element remaining in place for investment in corporate bonds and gilts.

3.2.2 The revised strategy was implemented in three separate phases: Phase 1 (Diversified Growth) was implemented on 6th December 2012 with a transfer of £50m from Fidelity's equity holdings (£25m to both Baillie Gifford and Standard Life); Phase 2 (global equities) was implemented on 20th December 2013, with £200m being allocated to Baillie Gifford (from within their former equities holdings), £120m to MFS International (transferred from Fidelity) and £120m to Blackrock (£70m from Baillie Gifford and £50m from Fidelity); and Phase 3 (fixed income) was finalised in May 2015, when £6m was switched from the Baillie Gifford Sterling Aggregate Plus Fund into that company's Global Bond Fund (£3m) and Emerging Market Bond Fund (£3m).

3.3 Summary of Fund Performance

3.3.1 <u>Performance data for 2016/17 (short-term)</u>

A detailed report on fund manager performance in the quarter ended 31st December 2016 is provided by the fund's external adviser, AllenbridgeEpic, in Appendix 5. The total fund return for the third quarter was 3.6% against the benchmark of 4.0%. This compares to an estimated average of 3.2% across LGPS funds (based on initial figures from PIRC – see para 3.3.3 below). Further details of individual fund manager performance against their benchmarks for the quarter, year to date, 1, 3 and 5 years and since inception are provide in Appendix 2.

3.3.2 <u>Medium and long-term performance data</u>

Between 2006 and June 2016 WM Company measured the fund managers' results against their strategic benchmarks, and at total fund level, it used the local authority indices and averages. The Fund's medium and long-term returns have remained very strong, although the overall return of +0.1% for 2015/16 was down against the benchmark return of +0.5%. In 2014/15, the Fund returned +18.5% compared to the benchmark return of +16.4% and achieved an overall local authority average ranking in the 7th percentile. For comparison, the rankings in earlier years were 29% in 2013/14, 4% in 2012/13, 74% in 2011/12, 22% in 2010/11, 2% in 2009/10 (the second best in the whole local authority universe), 33% in 2008/09, 5% in 2007/08, 100% in 2006/07 (equal worst in the whole local authority universe), 5% in 2005/06, 75% in 2004/05, 52% in 2003/04, 43% in 2002/03 and 12% in 2001/02.

The following table shows the Fund's long-term rankings in all financial years back to 2005/06 and shows the medium to long-term returns for periods ended 30th June. The medium to long-term results have been good and have underlined the fact that the Fund's performance has been consistently strong over a long period.

Year	Whole Fund Return	Benchmark Return	Local Authority average	Whole Fund Ranking
	%	%	%	
Financial year figures				
2015/16	0.1	0.5	0.2	39
2014/15	18.5	16.4	13.2	7
2013/14	7.6	6.2	6.4	29
2012/13	16.8	14.0	13.8	4
3 year ave to 31/3/16	***8.4***	***7.5***	***6.4***	***6***
2012/13	14.2	12.1	11.1	5
2011/12	2.2	2.0	2.6	74
2010/11	9.0	8.0	8.2	22
5 year ave to 31/3/16	***8.8***	***7.6***	***7.1***	***6***
2010/11	10.7	9.2	8.8	11
2009/10	48.7	41.0	35.2	2
2008/09	-18.6	-19.1	-19.9	33
2007/08	1.8	-0.6	-2.8	5
2006/07	2.4	5.2	7.0	100
2005/06	27.9	24.9	24.9	5
10 year ave to 31/3/16	***7.7***	***6.4***	***5.6***	***4***

3.3.3 Performance Measurement Service

As previously reported, in April 2016, the Council was informed that WM Company (State Street) would cease providing performance measurement services to clients to whom they do not act as custodian, with effect from June 2016. There are currently no providers offering a like for like service, so the Council will utilise its main custodian, BNY Mellon, to provide performance measurement information going forward. The new service is now live, and has produced the summary of manager performance at Appendix 2. A new provider for LGPS comparator information, PIRC, has emerged and at the time of writing has 58 of the 89 LGPS funds (65%) signed up to the service, including the London Borough of Bromley and 26 London Boroughs. It is envisaged that comparator data will be available for the 4th quarter monitoring report.

3.4 Fund Manager Comments on performance and the financial markets

3.4.1 Baillie Gifford has provided a brief commentary on recent developments in financial markets, their impact on the Council's Fund and the future outlook. This is attached as Appendix 3.

3.5 Early Retirements

3.5.1 Details of early retirements by employees in the Fund are shown in Appendix 4.

3.6 Bromley College Transfer

3.6.1 As report to the Pensions Investment Sub-Committee in May 2016 and subsequently Council in July 2016, Bromley College was intending to merge with Greenwich Community College and had made a request to designate the London Pension Fund Authority (now the Local Pensions Partnership, LPP) as the administering body in place of the London Borough of Bromley.

3.6.2 Bromley College merged with Greenwich Community College on 1st August 2016, and following an application by the colleges, the Secretary of State directed that the assets and liabilities relating to all scheme members' employment with Bromley College shall transfer to the LPP. This means that the terms of the transfer were therefore set such that a full transfer of all of Bromley College's assets and liabilities in the Bromley Fund are to be transferred to the LPP and the transfer value payable will reflect solely the value of Bromley College's asset share in the Bromley Fund.

3.6.3 As required under the direction, the transfer value will therefore change over time until payment, in line with investment returns achieved up to payment date. Where available, investment returns, net of fees, achieved by the Bromley Fund will be used so as to minimise any mismatch between actual assets and the bulk transfer payment.

3.6.4 At the time the May report was written, the estimated asset share relating to Bromley College was £23.4m. The actuary has now updated the asset share using Pension Fund investment performance and cashflow data to 31st December 2016, and the illustrative asset share for Bromley College as at 31 December 2016 has been calculated to be around £29.5m. The main reason for the increase is the investment return achieved by the Fund since the initial calculation, as can be seen from the table in Appendix 2.

3.6.5 It should be noted that the final transfer payment is therefore still subject to further fluctuations and potentially by large amounts. For example, the estimated returns for January 2017 have been positive by around 1.5% and this plus subsequent returns will be factored into the final calculations. A further area that will impact on the final figure relates to cashflows; contributions by Bromley College ceased at the time of the merger and the Bromley Fund is about to cease pension payments for Bromley College pensioners. The actuary will ensure that complete data is encompassed into the calculations – although not as material as investment returns, the impact of cashflows can still have an impact, which could be around 1-2% in this case.

3.6.6 As agreed by Council in July 2016, authority has been delegated to the Director of Finance, in consultation with the Chairman and Vice-Chairman of Pensions Investment Sub-Committee, to agree the transfer of the appropriate asset share following the advice of the Council's independent Pension Fund advisor. It is anticipated that this will reflect any changes to the Asset Allocation Strategy that are proposed for the Pensions Investment Sub-Committee to consider on 22nd February 2017.

3.6.7 Given the significant increase in the transfer value since the indicative figure reported to the Sub-Committee and Council, reflecting the latest good performance of the Pension Fund, Pensions Investment Sub-Committee and Council are asked to note the change in transfer value, which remains indicative at this stage and subject to change as set out in para 3.6.5. The final figure will be reported to Pensions Investment Sub-Committee following the transfer.

3.7 Fund Manager attendance at meetings

3.7.1 Standard Life and Fidelity were scheduled to attend this meeting; however they have been requested to attend a later meeting to allow time for full consideration of other items on this agenda. It is proposed that Baillie Gifford attend the May meeting as previously scheduled, and that Standard Life and Fidelity attend in September.

3.7.2 While Members reserve the right to request attendance at any time if any specific issues arise, members are asked to agree attendance at the future meetings as follows:

Meeting 16th May 2017 – Baillie Gifford (global equities, fixed income and DGF)

Meeting 19th September 2017 – Standard Life (DGF) and Fidelity (fixed income)
Meeting 21st November 2017 – MFS (global equities)
Meeting 20th February 2018 – Blackrock (global equities)
Meeting 22nd May 2018 – Baillie Gifford (global equities, fixed income and DGF)

POLICY IMPLICATIONS

3.7.3 The Council's Pension Fund is a defined benefit scheme operated under the provisions of the Local Government Pension Scheme (LGPS) Regulations, for the purpose of providing pension benefits for its employees. The investment regulations (The LGPS (Management and Investment of Funds) Regulations 2016) allow local authorities to use all the established categories of investments, e.g. equities, bonds, property etc, and to appoint external investment managers who are required to use a wide variety of investments and to comply with certain specific limits.

4. FINANCIAL IMPLICATIONS

4.1.1 Details of final outturn for the 2015/16 Pension Fund Revenue Account and the position after the third quarter of 2016/17 are provided in Appendix 4 together with fund membership numbers. A net surplus of £7.0m was achieved during of 2015/16 (mainly due to investment income of £7.3m) and total membership numbers rose by 733. In the first three quarters of 2016/17 a net surplus of £2.9m was achieved and total membership numbers rose by 319.

4.1.2 It should be noted that the net surplus to date of £2.9m includes £6.1m investment income, which is currently reinvested in the fund. In cashflow terms, there is therefore a £3.2m cash deficit for the first three quarters of the year. As members will be aware, cashflow is one of the main drivers of the asset allocation review which is reported elsewhere on this agenda.

5. LEGAL IMPLICATIONS

5.1.1 The statutory provisions relating to the administration of the Local Government Pension Scheme are contained in the Local Government Pension Scheme (LGPS) Regulations 2013. The investment regulations (The LGPS (Management and Investment of Funds) Regulations 2016) set out the parameters for the investment of Pension Fund monies.

Non-Applicable Sections:	Personnel Implications, Impact on Vulnerable Adults and Children, Procurement Implications
Background Documents: (Access via Contact Officer)	Monthly and quarterly portfolio reports of Baillie Gifford, Blackrock, Fidelity, MFS and Standard Life.

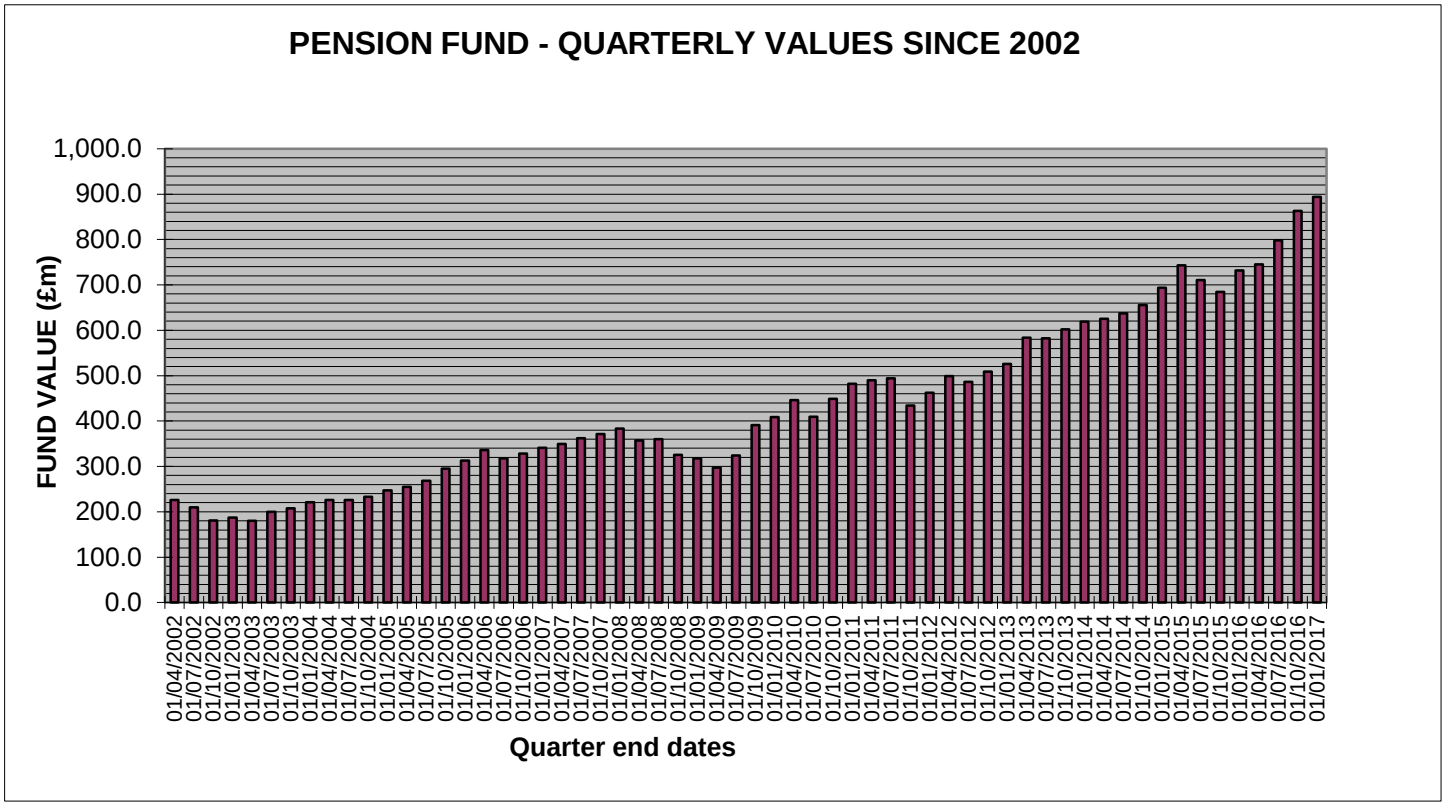
Appendix 1

MOVEMENTS IN PENSION FUND MARKET VALUE SINCE 2002

Date	Baillie Gifford					Fidelity			Blackrock	MFS	Standard Life	CAAM	
	Balanced Mandate	DGF	Fixed Income	Global Equities	Total	Balanced Mandate	Fixed Income	Total	Global Equities	Global Equities	DGF	LDI Investment	GRAND TOTAL
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
31/03/2002	113.3				113.3	112.9		112.9					226.2
31/03/2003	90.2				90.2	90.1		90.1					180.3
31/03/2004	113.1				113.1	112.9		112.9					226.0
31/03/2005	128.5				128.5	126.7		126.7					255.2
31/03/2006	172.2				172.2	164.1		164.1					336.3
31/03/2007	156.0				156.0	150.1		150.1				43.5	349.6
31/03/2008	162.0				162.0	151.3		151.3				44.0	357.3
31/03/2009	154.4				154.4	143.0		143.0					297.4
31/03/2010	235.4				235.4	210.9		210.9					446.3
31/03/2011	262.6				262.6	227.0		227.0					489.6
31/03/2012	269.7				269.7	229.6		229.6					499.3
31/03/2013#	315.3	26.5			341.8	215.4		215.4			26.1		583.3
31/03/2014@	15.1	26.8	45.2	207.8	294.9		58.4	58.4	122.1	123.1	27.0		625.5
31/03/2015		45.5	51.6	248.2	345.3		66.6	66.6	150.5	150.8	29.7		742.9
30/06/2015		45.1	49.6	236.9	331.6		64.4	64.4	143.3	142.3	29.3		710.9
30/09/2015		44.2	50.4	223.6	318.2		65.2	65.2	133.3	138.9	28.8		684.4
31/12/2015		44.9	50.1	247.5	342.5		65.2	65.2	143.3	151.7	29.3		732.0
31/03/2016		44.8	51.8	247.9	344.5		67.4	67.4	145.5	159.2	28.3		744.9
30/06/2016		45.2	54.7	265.3	365.2		70.7	70.7	157.0	177.3	28.0		798.2
30/09/2016		47.2	57.1	297.9	402.2		74.8	74.8	169.6	188.5	28.2		863.3
31/12/2016		47.9	55.5	310.9	414.3		72.6	72.6	181.1	197.3	28.6		893.9
31/01/2017		48.3	55.0	323.3	426.6		71.7	71.7	183.6	197.2	28.5		907.6

£50m Fidelity equities sold in Dec 2012 to fund Standard Life and Baillie Gifford DGF allocations.

@ Assets sold by Fidelity (£170m) and Baillie Gifford (£70m) in Dec 2013 to fund MFS and Blackrock global equities.


PENSION FUND - QUARTERLY VALUES SINCE 2002
FUND VALUE (£m)
1,000.0
900.0
800.0
700.0
600.0
500.0
400.0
300.0
200.0
100.0
0.0
01/04/2002
01/07/2002
01/10/2002
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01/01/2016
01/04/2016
01/07/2016
01/10/2016
01/01/2017
Quarter end dates

Appendix 2

PENSION FUND MANAGER PERFORMANCE TO DECEMBER 2016

Portfolio	Month %	3 Months %	Fiscal YTD %	1 Year %	3 Years %	5 Years %	Since Inception %
Fidelity Fixed Income	2.04	-2.91	8.34	12.18	8.94	11.54	6.95
Benchmark	1.89	-3.11	6.18	10.64	8.03	9.60	6.13
Excess Return	0.15	0.20	2.16	1.54	0.91	1.94	0.81
Baillie Gifford Global Equity	1.80	4.39	25.19	25.61	14.96	15.53	7.91
Benchmark	3.34	6.50	25.70	29.40	14.33	14.00	7.50
Excess Return	-1.54	-2.11	-0.52	-3.79	0.63	1.53	0.42
Standard Life DGF	2.10	1.43	0.84	-2.47	2.01		3.31
Benchmark	0.45	1.36	4.20	5.65	5.61		5.85
Excess Return	1.65	0.07	-3.36	-8.11	-3.60		-2.54
Baillie Gifford Fixed Income	2.32	-2.79	7.03	10.72	7.83		7.49
Benchmark	1.87	-2.88	6.57	11.37	8.03		7.43
Excess Return	0.45	0.08	0.46	-0.65	-0.19		0.06
Baillie Gifford DGF	1.72	1.52	7.10	6.89	4.69		5.04
Benchmark	0.31	0.92	2.89	3.91	3.98		4.15
Excess Return	1.41	0.59	4.21	2.99	0.71		0.89
MFS Global Equity	2.91	4.66	23.39	29.65	16.91		17.29
Benchmark	3.30	6.38	25.17	28.66	13.71		14.06
Excess Return	-0.39	-1.72	-1.78	0.99	3.20		3.23
Blackrock Global Equity	3.28	7.03	24.67	26.84	14.06		14.34
Benchmark	3.34	6.50	25.71	29.40	14.33		14.85
Excess Return	-0.05	0.54	-1.03	-2.56	-0.27		-0.51
Total Fund	**2.40**	**3.60**	**19.90**	**22.20**	**13.01**	**14.14**	**8.83**
Benchmark	**2.74**	**4.02**	**19.29**	**22.93**	**12.14**	**12.49**	
Excess Return	**-0.34**	**-0.41**	**0.61**	**-0.73**	**0.87**	**1.65**	

London Borough of Bromley
Summary Reports for the quarter ended
31 December 2016

Global Equities

Performance to 31 December (%)

	Fund Gross	Fund Net	Benchmark
Five Years (p.a.)*	15.6	15.3	14.0
Since 31/12/2013** (p.a.)	15.2	14.8	14.3
One Year	25.7	25.3	29.4
Quarter	4.3	4.2	6.5

**Balanced mandate prior to December 2013*

Investment Environment and Portfolio

Being long-term stock-pickers, the portfolio is constructed from a bottom-up basis and while political events have driven recent stock market moves, it is encouraging to see that, in general, the operational performance of the companies in your portfolio remains strong. As we have discussed in previous commentaries, many of the holdings have exposure to what we believe are three of the most exciting long-term growth areas: technological innovation, growing Asian consumption and a continued recovery in the US economy. We remain very excited by these structural growth drivers and they are reflected in some of the transactions that have been completed over the past few months.

Our continued work into 'Technology Platforms' has resulted in two transactions, the first of which was a new holding in the company, Line. It is the dominant messaging 'app' in Japan with 62 million monthly active users, but also has market leading positions in Taiwan, Thailand and Indonesia. Not only do we believe that it will increase monetisation rates in Japan, but it should also benefit from the very rapid growth in its other markets, fuelled by increasing smartphone penetration and high user engagement. As a result, we have placed Line in our rapid growth category and, reflecting its relatively high risk profile, have taken an incubator-sized 0.5% position.

Earlier in the year, we took an incubator holding in the Chinese travel platform, Ctrip. Productive meetings with the chairman and co-founder, James Liang and with the CFO, Cindy Wang, have strengthened our conviction in the sustainability of its dominant competitive position. The recent purchase of the Edinburgh-based online flight search engine, Skyscanner, will also allow it to integrate acquired metasearch technology into its own offering and will undoubtedly help Ctrip's expansion into markets outside China. We remain confident there is still considerable upside from here and so increased it to a 1% holding in your portfolio.

We have also taken a new holding in the data analytics company, Verisk. The roots of the company were in aggregating data on premiums and losses for the US property & casualty (P&C) insurance industry in the 1970s. However, over the past 45 years it has built up a comprehensive best-in-class data set and evolved into a data analytics company. Its data and analysis services allow customers in the P&C insurance, financial services and energy industries to price risk better and to design new products more quickly and in compliance with regulation. Verisk continues to build its database by exchanging the data that it receives from customers for a more holistic view of the market in which the customer operates. With its strong competitive position and customer-focused, long-term management, we believe the company should be able to generate double digit per annum earnings growth over the next ten years from cross selling, increasing the layers of analysis and international expansion.

In contrast, however, we have sold the holding in the Japanese company, THK. It has a dominant position in the production of linear motion guides, which are used in machines and robots. We believed that the company would benefit from the structural growth in industrial automation as well as being able to expand margins. Unfortunately this has not materialised, with weak demand from China suppressing revenue growth to a modest 2% per annum. Furthermore we have become concerned by management's move away from core markets into areas such as the automotive sector.

Outlook

In 2017, markets may well experience further bouts of volatility, driven by political or macro events. After all, the world awaits to see what Trump will do once he moves into the White House, what 'Brexit' will actually look like and what the outcomes of elections in the Netherlands, France and Germany will be.

We will, of course, monitor these events and look at what impact they might have on the long-term operations of the holdings in your portfolio. However, it is a

company's competitive position, its balance sheet, its management, their strategy and their willingness to invest for the future that have the greatest impact on how the company's share price performs over the long term. It is these fundamentals that we focus on. In periods of extreme market volatility, company fundamentals are often ignored by the market and this provides great opportunities for stock-pickers. We will continue to look to take advantage of these.

As in previous years, we are putting together some thoughts about what might be some of the key areas to shape the focus of our research over the next 12 months. We will share this 2017 Research Agenda with you in the next few weeks and look forward to discussing it with you and hearing your thoughts in the coming months.

BAILLIE GIFFORD

Diversified Growth

Performance to 31 December (%)

	Fund Net†	Base Rate +3.5%
Since Inception* (p.a.)	5.1	4.0
Three Years (p.a.)	4.7	4.0
One Year	6.9	3.9
Quarter	1.7	0.9

Summary Risk Statistics (%)

Delivered Volatility	4.3

Annualised volatility, calculated over 5 years to the end of the reporting quarter
Source Baillie Gifford

*06 December 2012
†Net of pooled fund's standard management charge.
The portfolio transferred from the Baillie Gifford Diversified Growth Pension Fund into the underlying Baillie Gifford Diversified Growth Fund (OEIC) on the 1st October 2016. The above performance is that of the Diversified Growth Fund (OEIC) since the portfolio's initial investment in the strategy
The Fund's objective is to outperform the UK Base Rate by at least 3.5% per annum (net of fees) over rolling five-year periods with an annualised volatility of less than 10%.
Source: StatPro, Baillie Gifford

Investment Environment and Outlook

The US presidential election was always likely to dominate the final quarter of the year. The sense of anticipation was heightened by the fact that the race featured the two least-popular candidates ever to seek the nomination. Markets softened ahead of the vote, with investors accumulating cash amid nervousness about the possible immediate impact of a Trump win. However, despite a sell-off in the immediate aftermath of his victory, markets rallied to finish the year on a high.

The market recovery came as Trump softened his language, placing greater emphasis on economic stimulus – cutting taxes, as well as simplifying regulation and encouraging spending on infrastructure. This diverged from rhetoric over the potential deportation of immigrants; withdrawal from the North America Free Trade Agreement (NAFTA) and other trade-unfriendly measures that had featured heavily in his campaign. The rally also perhaps reflected a recognition that, with the economy operating close to capacity, there has been a reasonably well-established period of growth and stability in the US which Trump is unlikely to wish to derail.This outlook for rising spending and falling taxes goes some way to explaining why we have seen a sharp rise in US government bond yields in recent months, as expectations of inflationary pressures continue to mount. Commodity prices have also strengthened over the year, with the oil price in particular continuing to trend upwards following OPEC's announcement of a cut in production. This would typically be supportive for a number of emerging market economies. However, the effect of a stronger dollar, together with the prospect of faster interest rate rises in the US, have actually seen money flowing out of emerging markets. Despite that,
the overall environment for some emerging economies improved over the course of the year as their currencies stabilised and structural reforms were gradually implemented.

In Europe, politics also remained highly relevant. A decisive result in the recent constitutional referendum in Italy led to the immediate resignation of Prime Minister Renzi, before a close call in the Austrian presidential election, which went against the populist candidate, threatened to compound the Brexit result and add to European instability. Despite these results, and concerns around the future of Deutsche Bank, the continent's largest bank, markets were notably resilient. Equity markets have risen and the German ten-year government bond is now offering a positive yield, after spending much of the summer in negative territory. Such a response is, in part, due to the European Central Bank maintaining its support, as evidenced by the recent extension of its quantitative easing programme. However, more importantly, growth numbers from both the UK and Europe have been reasonably strong and above what we would assess to be the current trend.

Markets in Japan were particularly buoyant. With the yen around 15% weaker against the US dollar over the quarter, the Nikkei outperformed most other major equity indices in local currency terms as companies enjoyed gains in the value of their foreign assets. The Chinese economy also continued to stabilise as the concerns over the growth outlook that many held at the beginning of the year continued to dissipate and economic data, particularly reported GDP growth, held up well. What we are not sure of, however, is the extent to which the improvement in data is the result of a set of stimulatory measures implemented ahead of next year's politburo conference. Ultimately, these may turn out to be a one-off aimed primarily at helping Xi Jinping strengthen his position within the Communist party.

Outlook

Our outlook for the global economy remains moderately optimistic. This view is based on both developed and emerging economies continuing on their current upward growth trajectory, and is supported by recent data from economic surveys. These, taken together, are consistent with global growth of close to 3% p.a.. Inflationary pressures are rising although, on the whole, headline CPI figures will probably be a less critical measure for central banks in the short to medium term, meaning a likely continuation of supportive monetary policies. While central banks have been dominant in shaping the broader economy in recent years, there is a groundswell of opinion which is questioning the efficacy of quantitative easing and exceptionally loose monetary policy, paving the way instead for a possible increase in fiscal stimulus in the year ahead. This is most obviously the case in the US.

Inflationary pressures, particularly in the labour market, were reflected in the Federal Reserve's decision to raise interest rates in December and its projection of three further hikes in 2017. However, the 25bp increase had been fully priced in by market participants and leaves policy rates well below their long-term average level. We expect interest rates to continue to rise in the US during 2017, especially in the face of falling unemployment and rising inflation. Indeed, this latter point is not restricted to just the US, as higher levels of headline inflation are observed across much of the developed world.

Opportunities and challenges which come as a result of political outcomes – expected or otherwise – will continue to require close observation. Mindful of this, Europe will be in the spotlight in 2017 as France, Holland and Germany all have national elections. Given recent events in the UK and the US, where populism and protectionism have been more in vogue, the outcome of these elections will give further insight into how Europe will be shaped in the future, both economically and socially, as well as how it trades as a bloc with the rest of the world. The evolution of Russia and China's international relationships, with the US in particular, will also be a point of substantial interest.

For the UK, as Brexit negotiations gather pace, it remains likely that the implications of a 'hard' or 'soft' Brexit will be more of a domestic problem rather than something that roils global markets. While a major topic here, Europe has several other agenda items to deal with in the year ahead, not least the elections mentioned above. However, in the short term at least, the immediate outlook for the UK economy means it is still likely to be one of the faster-growing developed economies.

In terms of our outlook for where asset prices might go to from here, one observation is that so much of what *might* go right has already been priced in, with valuations at or above their long-term fair value across a broad range of assets. Therefore, despite reasonably robust growth figures, in the face of interest rate normalisation and political uncertainties, higher levels of market volatility than we have seen in the last few years appear likely.

Portfolio Positioning and Performance

At the start of the quarter, we removed the remainder of our short sterling position, as sterling fell below $1.25 which was the target level at which we had planned to exit the trade at the time of its inception. This position had been established prior to the UK's referendum on EU membership as a partial hedge for the portfolio in case the decision in the referendum was to leave the EU, causing a sell-off in sterling.
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In commodities, we decided to sell our palladium holding. This commodity had experienced a sharp price rally, doubling over five years in South African rand terms, despite little change in its fundamentals. This provided an opportunity to take profits. We retain our position in platinum where we believe there is still a good fundamental case for price appreciation.

We typically invest in emerging market government bonds issued in the local currency of the issuing country. However, for some time, we have been considering the attractions of equivalent bonds issued in hard currency, typically US dollars. We think that there are currently some good opportunities in this area which, at an index level, yields around 6% for lending to BB+ quality governments. As a result, we invested around 2% of the Fund in a basket of US-dollar denominated emerging market government bonds. A further change within this asset class was the complete sale of the portfolio's Greek bonds which had performed particularly well in recent months. Indeed, while most other European government bond yields were rising following the US election, yields on Greek debt continued to fall, resulting in a strong price performance. We reinvested some of the proceeds of this trade in a new allocation to Argentinian (local currency) bonds, where a positive reform story is underway, with a new government and set of institutions tackling Argentina's fiscal problems and moving to an inflation-targeting regime.

Elsewhere, within our corporate credit exposure, we made a reduction to investment grade bonds as prospective returns became less attractive. We also removed the interest rate hedge on the remainder of our position, given the rise in Treasury yields to levels that look to be closer to fair value. In high yield credit, we reduced the Fund's exposure to listed US loan funds, which saw their discounts narrow. We also reduced our structured finance weighting as discount margins on senior issues tightened.

We kept some of the proceeds of these reductions in cash and T-Bills, anticipating future opportunities. We also made an investment in US index-linked government bonds. This trade was looking to achieve a better rate of interest than we get on cash, and should also benefit from any pick-up in US inflation.

Finally, within insurance linked securities we took a small holding in Horse Capital, an innovative bond brought to the market by the Italian insurer Generali. This issue covers the company against extreme losses in its motor business.

Fixed Income

Performance to 31 December (%)

	Fund	Benchmark
Since Reorganisation†	6.07	6.50
Since 09/12/13 (p.a.)**	7.86	7.71
One Year	11.11	11.32
Quarter	-2.60	-2.92

1/06/2015

** Inception date of bond mandate

† When the fund reorganised on 01/06/2015 the following benchmark has been used for reference purposes only; 88% Sterling Aggregate Benchmark (consisting of 50% FTSE Actuaries All stocks index and 50% Merrill Lynch Sterling Non-Gilt Index), 6% JP Morgan GBI-EM Global Diversified Index un-hedged in Sterling and 6% Barclays Global Credit Index, hedged to Sterling

Source: StatPro

Investment Environment

While analysts write millions of words every year scrutinising the minutiae of political and market events, remarkably few of these have had lasting impacts. In the past 40 years, one might point to the Reagan and Thatcher liberalising reforms, Federal Reserve Chairman Volcker's defeating inflation through higher interest rates, the creation of the euro, the collapse of the Soviet Union and the Chinese economic reforms begun in 1978. Correctly anticipating the market effects of these five events while ignoring everything else would have set any investor on the path to riches.

We say this, of course, because this has been a year of political surprises as Britain voted to leave the European Union and then Donald Trump won the US Presidential election. Not only did most analysts get the results wrong, the error was compounded by misjudging the consequences. Equity markets have reached new highs and US consumer confidence is at its highest level since 2001. This confounded those who expected dire market consequences from these 'populist' votes.

Nevertheless, Trump has been elected on a ticket of reversing the political and economic consensus in which, in his words, "Our politicians have aggressively pursued a policy of globalization — moving our jobs, our wealth and our factories to Mexico and overseas." We cannot know his precise actions on taking office at time of writing, and he must translate his rhetoric to actions and take legislation and budget plans through Congress. However, his rejection of globalisation and condemnation of trade as an enemy of US jobs is striking. We may well have just witnessed another major event with lasting consequences.

In the shorter term, the revised interpretation of his victory is that economic activity will increase through higher infrastructure spending and tax cuts. This is the principal reason why equity markets are cheered and high yield bonds traded well. Banking reforms are also expected to be rolled back, further boosting financial risk appetite. These economic stimuli will be debt funded, again reversing a period of fiscal conservatism which has seen US government spending fall as a share of GDP. Bonds have fared less well, with US yields reversing the falls of the first three quarters of 2016.

Taken at face value, Trump's plans would likely cause an increase in inflation because the US economy does not have the spare capacity to readily increase output. Commodity prices – already healthier than last year – should benefit too. The Federal Reserve may also bring forward interest rate hikes, both because higher inflation is anticipated and because fiscal action will replace monetary stimulus in sustaining economic growth. The US dollar should be a beneficiary as currency flows back into the United States to take advantage of higher interest rates and other new investment opportunities.

For credit markets, the first order effects have been judged to be mainly helpful. Corporate bonds are not as economically sensitive as equity, but moderate economic growth helps the company earnings which underpin creditworthiness and inflation reduces the real value of their debt burdens. Lower corporate taxes can also boost cash flow. The second order effects are trickier to evaluate. Central banks have supported corporate bonds indirectly, through easy monetary policies, and directly, through bond purchase programmes – we could see this change as monetary support begins to reduce.

Portfolio and performance

Yields rose sharply during the quarter and absolute returns were negative. Rising inflation expectations were the dominant driver of higher government bond yields, which also impacted returns on investment grade bonds. The additional yield spread provided by corporate bonds was little changed, although the higher starting yield cushioned losses on investment grade bonds relative to government bonds.

Overall interest rate positioning was changed during the quarter, moving the Fund to benefit should bond yields continue to rise. The notable change was initiating an underweight position in UK gilts, in the expectation of higher inflation and looser fiscal policy leading to higher bond yields in the future. The other change of note related to our view on Mexico where concern about higher inflation caused us to close the overweight position before the US election. The Fund had previously been overweight New Zealand relative to Australia – market pricing moved to reflect our view, so we closed both positions. Indeed, we initiated a modest overweight in Australia given the attractive real yield on offer. The position in South Korea, to benefit from lower bond yields, was closed as it hit its target. The position in Polish bonds relative to the Eurozone was also removed given increasing concerns on domestic politics.

Within corporate bonds, your Fund has a long-held underweight position in the banking sector, relative to the benchmark, with banks having to work hard to re-capitalise following the financial crisis – we much prefer businesses in other financial sectors such as insurers and financial services companies. However, Standard Chartered appears to be an improving story in terms of its credit-worthiness, so we took a holding. The bank has a credible management team, and most of its financial metrics are strong relative to its peers. We reduced your holding in Vonovia to fund the Standard Chartered purchase, with the bonds having performed well and looking less attractive on a relative basis. We also bought John Lewis bonds for your Fund. The well-known retailer continues to be robust operationally. However, unusually for a company of its size, the bonds do not have a credit rating from any of the rating agencies – there is now increased expectation it will look to acquire one, which would make the bonds more attractive to the market, potentially boosting returns. We reduced your holding in National Grid to provide the funding – the bonds had performed well but the risk of credit rating downgrades has increased as it sells off large parts of its business.

Within currency positioning, we retain overweight positions in higher-yielding countries such as Brazil and Russia. We are also overweight currencies in economies where we expect interest rates to rise ahead of market expectations – we have taken a new position in the US dollar while retaining our overweight in Sweden. On the contrary, we expect some of the lower yielding Asian nations to struggle if Donald Trump follows through on his election promise of increased trade tariffs. We retain the underweight in the South Korean won and added a new underweight position in the Singapore dollar during the period. We removed the underweight to South Africa rand as we have grown more constructive on the political outlook as the risk premium falls. Underweight currency positions in Turkey and Thailand were also closed, as was the overweight position in Indonesia.

Outlook

Our longer-term economic fundamental view is that global growth potential has fallen in recent years owing to ageing populations, declining productivity growth and debt overhangs. In the shorter term, Trump's radical agenda will very likely boost the US economy. His anti-trade agenda is a wild card. Globalisation has been an enormous engine of growth in emerging markets – has the trade tide now turned?

The world's central banks will continue to examine the actions of our politicians closely. While this is likely to see rate rises in the United States, the European and UK central banks may choose to continue their easy money policies until the political environment improves. Our assumption is that we have not seen the last political surprise.

Steady but low economic growth is the ideal backdrop for absolute returns in credit markets and has driven an eight-year-long bull market. Companies have taken advantage of low interest rates to issue bonds, often increasing their financial gearing by buying back equity with the proceeds. This has led us to conclude that we are approaching the final phases of this credit cycle and the market is vulnerable to a setback.

Overall, 2016 was a turbulent year after which all who make a living from predictions should have learned to be more humble. However, there are always opportunities as well as threats in change. For our clients, we will work hard to interpret the financial world and find opportunities in its bond markets.

Appendix 4

EARLY RETIREMENTS

A summary of early retirements and early release of pension on redundancy by employees in Bromley's Pension Fund in the current year and in previous years is shown in the table below. With regard to retirements on ill-health grounds, this allows a comparison to be made between their actual cost and the cost assumed by the actuary in the triennial valuation. If the actual cost of ill-health retirements significantly exceeds the assumed cost, the actuary will be required to consider whether the employer's contribution rate should be reviewed in advance of the next full valuation. In the latest valuation of the Fund (as at 31st March 2013), the actuary assumed a figure of £1m p.a from 2014/15, a significant increase over the estimate of £82k p.a. in the 2010 valuation. In 2014/15, there were seven ill-health retirements with a long-term cost of £452k, in 2015/16 there were nine ill-health retirements with a long-term cost of £1,126k, and in the first three quarters of 2016/17 there were five with a long-term cost of £228k. Provision has been made in the Council's budget for these costs and contributions have been and will be made to reimburse the Pension Fund, as result of which the level of costs will have no impact on the employer contribution rate.

The actuary does not make any allowance for other (non-ill-health) early retirements or early release of pension, however, because it is the Council's policy to fund these in full by additional voluntary contributions. In 2014/15, there were 19 other retirements with a total long-term cost of £272k, in 2015/16, there were 23 non ill-health retirements with a long-term cost of £733k, and in the first three quarters of 2016/17 there were 21 with a total cost of £571k. Provision has been made in the Council's budget for severance costs arising from LBB staff redundancies and contributions have been and will be made to the Pension Fund to offset these costs. The costs of non-LBB early retirements have been recovered from the relevant employers.

Long-term cost of early retirements	**Ill-Health**		**Other**	
	No	£000	No	£000
Qtr 3 – Dec 16 - LBB	-	-	-	-
- Other	1	51	-	-
- Total	1	51	-	-
Total 2016/17 - LBB	2	101	18	523
- other	3	127	3	48
- Total	5	228	21	571
Actuary's assumption - 2013 to 2016		1,000 p.a.		N/a
- 2010 to 2013		82 p.a.		N/a
Previous years – 2015/16	9	1,126	14	734
– 2014/15	7	452	19	272
– 2013/14	6	330	26	548
– 2012/13	2	235	45	980
- 2011/12	6	500	58	1,194

PENSION FUND REVENUE ACCOUNT AND MEMBERSHIP

	Final Outturn 2015/16 £'000's	Estimate 2016/17 £'000's	Actuals to 31/12/16 £'000's
INCOME			
Employee Contributions	6,284	6,400	4,708
Employer Contributions			
- Normal	20,712	21,000	14,742
- Past-deficit	6,005	6,000	4,504
Transfer Values Receivable	1,778	1,800	2,191
Investment Income	7,297	7,400	6,066
Total Income	42,076	42,600	32,211
EXPENDITURE			
Pensions	25,333	25,900	19,575
Lump Sums	5,372	5,500	4,602
Transfer Values Paid	828	1,500	2,169
Administration			
- Manager fees	2,617	2,500	2,045
- Other	884	870	903
Refund of Contributions	92	80	57
Total Expenditure	35,126	36,350	29,352
Surplus/Deficit (-)	6,950	6,250	2,859

MEMBERSHIP	**31/03/2016**	**31/12/2016**
Employees	6,234	6,276
Pensioners	5,084	5,223
Deferred Pensioners	5,287	5,425
	16,605	16,924

REPORT PREPARED FOR

London Borough of Bromley Pension Fund

February 2017

Alick Stevenson

AllenbridgeEpic Investment Advisers Limited (AllenbridgeEpic).

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 December 2016.

Executive Summary for the Quarter ended 31 December 2016

- **The fund value rose to £893.9m as at 31 December 2016, from £863.3m at 30 September 2016. The corresponding figure for 31 December 2015 was £732.0m.**

- **The total fund had an investment return of 3.6% for the quarter slightly behind the benchmark of 4.0%. For the twelve months the fund was also slightly behind the benchmark with a return of 22.3% v 22.9%. Over the longer and more meaningful periods the fund returned 13.0%pa (12.1%pa) for the three years and 14.1%pa (12.5%pa) for the rolling five year period. These performance figures now come from BNYMellon.**

- **Once again the majority of the growth in value came from the three global equity managers who benefited significantly as equity stock markets rose on the back of the Trump victory in the USA. Both DGF portfolios saw modest improvements to their asset values. Both fixed income portfolios fell slightly as the markets factored in potentially earlier than expected rate increases.**

- **As far as the strategic or long term asset allocations are concerned, the fund continues to remain overweight equities (77.1% v 70%), has moved away from the strategic asset allocation for DGF assets (8.6% v 10.0%) and remains underweight fixed income (14.3% v 20.0%).**

- **Assets of between £25m and 30m relating to the transfer of Bromley Academy will be moved out of the LBB Pension Fund within the next few months. A decision on which assets will be transferred has yet to be made.**

Market Commentary for the Quarter ended 31 December 2016

"This year will be worse than last year, but better than next year"

Enva Hoxha

President of Albania

The unexpected win by Donald Trump in the US presidential election, coupled with continued nervousness surrounding BREXIT might well have precipitated a fall in most global markets. Whilst the bond markets did have a small "sell off", on the theory that Trump's more expansionist policies would engender interest rate rises, equity markets, especially financials on the other hand moved sharply ahead (particularly in the US).

I make no excuse for repeating the following paragraph (from my 30 September 2016 INVESTREP) as it continues to have significance.

"Global markets remain under the "benign if opaque" control of the central banks; as they have since the "Lehman Crisis" of 2008. If anything, this control is now less overt, despite quantitative easing programmes continuing in Europe and the UK. Interest rates remain soft as central banks try to nudge economic growth upwards. Whilst growth in the UK and US economies seems to be warming up gradually, the EU continues to be locked in a low/no growth morass from which there seems little current potential or even appetite to escape. The Asia/Pacific region continues to have its own problems whilst Chinese issues could prove a negative tipping point globally".

Now that the US Elections are over and Donald Trump is installed in the White House it remains to be seen how many of his pre-election promises he will enact and what effects these will have on the US economy and the rest of the world. In the UK, the BREXIT juggernaut rolls on and as predicted some time ago, "the Remainers" continue to try and derail the Brexit process. Meanwhile in Europe, several countries will have elections this year, the outcomes of which are currently the subject of much speculation.

As far as markets are concerned, the Dow Jones broke through the 20,000 barrier and the UK once again broke through the 7,000 levels, perhaps in the belief that the Trump administration will launch a large fiscal stimulus plan that may well impact positively on the rest of the world. Despite that news, the ECB extended its quantitative easing programme until December 2017, although that programme is unlikely to help the Greek government which continues to debate economic matters with the EU.

One thing seems certain however, and that is inflationary pressures are building around the global recovery and with oil prices reaching a high for the year any hope of mitigation from a

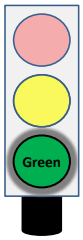
declining oil price has disappeared. All of these, together with a moderate uptick in economic activity may well combine to push inflation and interest rates higher over the coming months.

Fund Value as at 31 December 2016

Manager Name	Asset Class	**Value 31-Dec-16 £m**	**Actual % of Fund**		**Value 30-Sep-16 £m**	**Actual % of Fund**	Strategic Asset Allocation %
Baillie Gifford	DGF	**47.9**	**5.4**		**47.2**	**5.5**	
Standard Life	DGF	**28.6**	**3.2**		**28.1**	**3.3**	
Sub total DGF		**76.5**	**8.6**		**75.3**	**8.7**	10.0
Baillie Gifford	Global E	**310.9**	**34.8**		**297.9**	**34.5**	
BlackRock	Global E	**181.1**	**20.3**		**170.0**	**19.7**	
MFS	Global E	**197.3**	**22.1**		**188.5**	**21.8**	
Sub total GE		**689.3**	**77.1**		**656.4**	**76.0**	70.0
Baillie Gifford	Fixed Int	**55.5**	**6.2**		**57.1**	**6.6**	
Fidelity	Fixed Int	**72.6**	**8.1**		**74.8**	**8.7**	
Sub total FI		**128.1**	**14.3**		**131.9**	**15.3**	20.0
Fund Totals		**893.9**	**100.0**		**863.6**	**100.0**	100.0

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

The Fund for the quarter ended 31 December 2016



Overall the Fund managers have not changed their investment processes during the quarter, neither have any significant personnel changes been notified which might influence the way in which the managers' investment processes are managed.

Our recently appointed relationship manager at Standard Life, Alex Liddle, has left to join Nigel Cosgrove at Aviva. Mark Mckelvey has been appointed to replace Alex.

This change at Standard Life will have no impact on the investment management of the portfolio.

Fund investment performance for the quarter ended 31 December 2016

This is the first quarter that investment performance data has been supplied by BNYMellon following the decision by State Street to discontinue this service.

The fund returned 3.6% for the quarter which was 0.4% behind the benchmark.

For the twelve months the fund was also slightly behind the benchmark with a return of 22.3% v 22.9%. Over the longer and more meaningful periods the fund returned 13.0%pa (12.1%pa) for the three years and 14.1%pa (12.5%pa) for the rolling five year period.

Fund Governance and Voting

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

Market statistics for the quarter and rolling 12 months ended 31 Dec 2016

EQUITIES Total return	3 months %	12 months %
MSCI World	8.4	20.9
MSCI World ex USA	3.9	25.3
S & P 500	9.1	33.5
MSCI UK	4.2	19.2
MSCI Europe ex UK	5.0	19.7
MSCI AsiaPac ex Japan	0.0	27.7
MSCI Japan	5.0	22.5
MSCI All Emerging	0.8	33.1

FIXED INCOME Total return	3 months %	12 months %
FTSE Index Linked	-2.7	24.2
FTSE all Gilts	-3.4	10.1
J P Morgan Global Sov	-3.6	21.1
Bofa ML Corp >10yr IG	-4.9	15.4
ML HY constrained	**5.6**	**36.9**

Best Performing Sectors	3 months %	12 months %
Energy	13.1	52.2
Materials	8.2	46.8
Industrials	7.5	35.4
Financials	20.6	35.0
Information Technology	5.5	33.6

Inflation Indicators YOY%	As at 31-Dec-16	As at 31-Dec-15
UK RPI	1.9	1.2
UK CPI	1.1	0.2
US Core CPI	1.8	0.7
Euroland CPI	1.1	0.2

Other Assets	3 months	12 months

Worst Performing Sectors		
Utilities	2.0	27.5
Telecom Services	3.7	27.1
Consumer Discretionary	7.3	23.6
Consumer Staples	-0.6	22.0
Health Care	-0.4	11.7

	%	%
LIBOR 1 month	0.1	0.4
LBMA Gold Bullion	-8.0	29.7
Brent Crude	18.1	73.4
IPD property Index	1.3	1.4
HFRI Index	6.0	19.9

Sources: Datastream and Newton

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. This measurement commenced from 31 December 2013).

(The Fund was closed to prospective investors at the beginning of 2015 but remains open for additional funding from existing clients). Baillie Gifford are one of several investment managers that have been appointed to the London CIV and are currently appointed, with other managers, for both Global Equity and DGF mandates.

Rolling one year turnover was slightly lower than the previous quarter, at 13% (14.0%) which still implies an average holding period of around seven years, a recognition that Baillie Gifford continues to focus on the long term and prefer to look through the short term gyrations except when they see stock purchasing opportunities.

Baillie Gifford operate a long term growth investment strategy which aims to overcome short term political statements by buying and holding stocks across the world which exhibit long term fundamental strengths.

The portfolio statistics were little changed from the previous quarter September 2016. The fund was invested across 24 (24) countries and held 96 (96) different investments. These investments were spread over 10 (10) sectors and encompassed 37 (38) 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 a very high level of around 93% (92%). This "active money" ratio confirms 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 and its long term nature. During the quarter the manager added two new stocks and sold out of Dolby Laboratories and THK.

For the quarter, the fund had an investment return of 3.8%, some 2.7% behind the benchmark of 6.5%. Since the portfolio reorganisation in December 2013, the fund has returned 15.2%pa against a benchmark of 14.3*%pa. (All returns shown are net of fees.).*

The portfolio remains ahead on 3 and 5 year measures. Since inception in December 1999 has returned a net 7.3%pa against the benchmark of 6.7%pa.

The "active money" style (stock picking) is clearly demonstrated with the top ten holdings continuing to accounting for just over 28% of the total portfolio, in line with the previous quarter. Amazon 4.2% (4.7%), Prudential Corp at 3.5% (3.1%), and Royal Caribbean Cruises 3.1%. hold the top three positions with Naspers dropping back to fourth position with 3.0% (3.5%). Alphabet Inc, TD Ameritrade and CRH take the eighth, ninth and tenth positions with 2.4%, 2.3% and 2.2% respectively.

BlackRock Ascent Life Enhanced Global Equity Fund (pooled)

This 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 788 stocks (843) at the end of the quarter and delivered a net investment return for the quarter of 6.4% matching the index. For the rolling twelve months the manager remains behind the benchmark at *26.4% (benchmark 28.7%).* Over the three year rolling period the fund is just slightly ahead at 13.9%pa versus the benchmark of 13.7%pa and since inception, however, a positive net return of 14.4%pa against its benchmark of 13.3%pa. ***Whilst these performance numbers are above the actuarial assumptions they are behind the benchmark.*** The manager had explained to the Committee at the last regular meeting of the PISC that their "black box" had basically failed to address the number of seismic events in 2016 and thus had failed to achieve the performance objectives.

In terms of country allocations, the manager has maintained its neutral position in most major markets although it has moved underweight in Australia and overweight in Canada.

Sectorally, the fund has remained marginally overweight in Healthcare, stayed underweight in Financials, and has remained significantly overweight InfoTech and moved to a neutral position in Consumer Staples.

The top ten stocks have moved around over the quarter with Microsoft in first equal position with United Health Group at 1.3%, with Apple and Home Depot both with 1.2%. The top ten stocks account for some 11.4% (10.9%) of the overall portfolio.

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 is currently invested in 15 (15) countries and has 116 (116) holdings. This contrasts with the benchmark of 1,654 (1,637) holdings spread across 23 countries.

For the quarter the fund returned 4.5% net against its benchmark of 7.1% for an underperformance of 2.6%. Over the rolling twelve months the fund had a return of 29.5% against a benchmark of 28.2%, a very good return in volatile markets. Since inception the fund has returned 17.2%pa (net) against the benchmark of 15.1% pa.

The underperformance of 2.6% for the quarter was due to poor sector selection with stock selection a net neutral contributor.

A look through the country and sector weights shows that the fund remained underweight North America (59.3% v 63.7%) and Asia Pacific ex Japan (1.5% v 4.4%), and has maintained its overweight

positions in Europe ex UK at +3.2% (+3.5%), and Japan 1.3% (+2.4%). In the UK the neutral position from last quarter has moved slightly underweight at 0.7%. The fund continues to run a small +1.4% overweight in emerging markets.

Sectorally, the fund has again maintained its significant overweight position in Consumer Staples (18.8% v 9.7%), with smaller over-weights in Industrials at+5% (+4.7%) and Financials +2.9 (+2.7%). These over weights are being "funded" by underweight positions in Consumer Discretionary -5.9% (-5.1%), Utilities, where the manager has a zero weighting (-3.2%) and Energy -3.5%(-3.3%).

In terms of top ten holdings, Nestle (2.6%), JP Morgan Chase with 2.4% and Johnson & Johnson at 2.3% are the three largest, with KIDDI Corp at 1.9%, Philip Morris at 1.8% and Lockheed Martin at1.6% in eighth, ninth and tenth positions.

Global Equity Crossholdings

There are two crossholdings within the aggregated top ten holdings of the three global equity managers this quarter. MFS and BlackRock both hold JP Morgan Chase for a total value of £6.7m and Texas Instruments for a total value of £5.2m. These values translate to just 1.8% of the global equity portfolio and just 1.4% of total fund assets.

Diversified Growth Funds

Overall, the make-up of the Baillie Gifford fund has not changed significantly over the quarter. The manager has added slightly to its holdings in sovereign debt, funded by reducing holdings in high yield bonds.

In contrast, Standard Life holds over half of its assets in derivative based investments backed by cash, with just over 2/3rds of the portfolio invested in 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%.

For the 12 month period the portfolio has returned 6.9% against the benchmark of 3.9%. For this quarter the fund had a significant positive return of 4.4% versus the benchmark of 1.0%. Since inception, the fund has delivered a return of 5.1% (net of fees) against its benchmark of 4.0%.

Despite some major market movements over the quarter in the lead up to and then following Donald Trump's election as US president, the manager made few significant changes to the asset allocations within the fund; the exceptions being a small decrease in equities to 18.8% (19.3%) and in structured finance assets down to 9.5% (10.5%), although cash holdings rose to 7.4% (4.1%). The majority of the other changes in asset class values are primarily due to relative value impacts and reflect the differing investment performance of the various asset classes over the quarter.

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 of 4.3% matched that of the previous quarter and less than half of 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%pa.

The manager has reported a positive performance for the quarter but remains in negative territory for the rolling twelve months. For the quarter the fund had a positive return of 1.8% against its 6 month LIBOR benchmark of 0.1%, but for the twelve months reported a negative return of -2.1% against the benchmark of 0.6%. Since inception, the fund has generated a positive return (net of fees) of 3.3% pa, although this return is significantly behind the fund benchmark of 5.6%pa.

The volatility in equity markets post Brexit and during the quarter was positive for the fund holdings in US and European equities. In addition holdings in US investment grade credit and high yield bonds were also positive.

In terms of investment performance, there are four main components in the portfolio, Market Return Strategies were slightly positive, as were Directional Strategies, Relative Value strategies posted a small negative contribution 0.10% and currency hedging and flat. These when calculated against their respective overall fund allocations produced a positive return of 1.8% for the quarter.

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

		Baillie Gifford	Baillie Gifford	Standard Life	Standard Life	Total DGF	Total DGF
		%	£m	%	£m	£m	%
Value at 31 December 2016			47.9		28.6	76.5	
Asset Class							
Global equities		18.8	9.0	27.1	7.7	16.8	21.9
Private equity		1.3	0.6			0.6	0.8
Property		6.7	3.2			3.2	4.2
Global REITS				8.3	2.4	2.4	3.1
Commodities		2.0	1.0			1.0	1.3
Bonds							
High yield		12.7	6.1	3.9	1.1	7.2	9.4
Investment grade		2.8	1.3	9.8	2.8	4.1	5.4
Emerging markets		11.8	5.7			5.7	7.4
UK corp bonds				1.3	0.4	0.9	1.2
EU corp bonds				3.8	1.1	0.9	1.2
Government		5.8	2.8		0.0	2.8	3.6
Global index linked							
Structured finance		9.5	4.6			4.6	6.0
Infrastructure		7.6	3.6			3.6	4.8
Absolute return		8.2	3.9			3.9	5.1
Insurance Linked		4.6	2.2			2.2	2.9
Special Opportunities		0.3	0.1			0.1	0.2
Active currency		0.5	0.2			0.2	0.3
Cash		7.4	3.5			3.5	4.6
Cash and derivatives				45.8	13.1	13.1	17.1

Total		100.0	**47.9**	100.0	**28.6**	**76.5**	100.4

Numbers may not add due to roundings

FIXED INCOME PORTFOLIOS

Baillie Gifford Aggregate Plus Portfolio

This mandate was reorganised on 1 June 2015 and now has a reference benchmark comprising 44% Gilts, 44% Sterling non gilts, 6% global corporate bonds and 6% emerging market bonds. The manager's objective is to outperform this benchmark over rolling three year periods.

For the quarter, the fund had a return of -2.6% just 0.3% ahead of the benchmark of -2.9%. Since the original inception date of 9 December 2013, the fund has generated a return of 7.9% pa exceeding the benchmark of 7.7% pa. Since the reorganisation in June 2015 the fund remains slightly behind the benchmark with a return of 6.1%pa versus 6.5%pa.
From a credit rating perspective the fund moved marginally overweight benchmark levels with AAA rated bonds (9.6% v 9.3%), with a total of 98.8% (98.7%) invested in investment grade bonds.
High yield bonds, (below investment grade), have an overweight of 3.1% (4.0%) to the index and are 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 "C" rated bonds.

Regionally, the fund has remained underweight the UK at -6.1% (-5.4%) to the benchmark and over-weight the US at +9.0% (+7.1%)to the benchmark. Looked at by sector the fund has remained underweight sovereign debt -10.9% (-10.4%) and Utilities -4.3% (-3.6%) with corresponding over-weights in Industrials +6.5% (+7.8%) and Securitised loans +7.5% (+7.7%)

In terms of active money, those positions larger than the benchmark allocation, the manager continues to hold +2.6% in Annington Finance, 1.9% in Tesco Property Finance and 2.0% in KFW 5% 2036.

Overall, the fund is marginally short the benchmark duration at 8.7 years compared to 9.2 years for the benchmark. The running yield on the total portfolio is 4.35% compared to the benchmark of 3.59%

Fidelity Global Aggregate Fixed Income Portfolio

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

The fund outperformed the benchmark during the quarter, albeit both negative, with a return of -2.1% (gross of fees) against the benchmark of -3.1%. Over the rolling three years, the fund is ahead of the benchmark by 0.8% pa (8.8%pa% pa v 8.0%pa) and since inception (30 April 1998) has outperformed the benchmark by 0.8% pa with a return of 6.9% pa.

In terms of credit quality, the fund has slightly under 88% (92%) invested in investment grade bonds, albeit underweight the index, especially in AA bonds (fund 43.8% v 57.5%), and has 22.6% (21.0%)

invested in BBB rated bonds. The manager's holdings in high yield bonds has drifted down to 3.8% (5.8%) with the remaining 5.0% (2.8%) in a mix of cash and unrated investments.

There have been some changes during the quarter, with the sectoral allocation to US treasury assets falling back to 37.1% (39.7%) of the portfolio although this was more of a market value movement than a selling exercise by the manager. Overweight positions in the Financial Services (+5.6%), Insurance (+3.9%) and the Basic Industry (3.0%) sectors are offset by underweights in Supranationals and Sovereign Assets (-5.9%) and Consumer non cyclicals at (-1.4%).

The portfolio is tracking benchmark duration of 9.6 years and has a running yield of just 2.8% (2.4%)

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