AGENDA ITEM 9

FALKIRK COUNCIL

Subject: **FUND MANAGER PERFORMANCE REVIEW**
Meeting: **PENSIONS COMMITTEE**
Date: **6 MARCH 2014**
Author: **CHIEF FINANCE OFFICER**

1. INTRODUCTION

1.1 The Local Government Pension Scheme Regulations require that Falkirk Council, as administering authority for the Pension Fund, review the investments of its Managers at least once every three months, which includes an analysis of returns and risk. This paper reports on performance for the overall Fund and on fund manager reviews.

1.2 The rates of return achieved by our Fund Managers are measured against pre-determined benchmarks. This service is provided by the Fund's custodian, Northern Trust.

1.3 The undernoted benchmarks are in place to measure the performance of each Manager.

Fund Manager	**Benchmark**
Aberdeen Asset Management (AAM)	MSCI All Countries World Index
Baillie Gifford Bonds (BGB)	Customised benchmark comprising UK Fixed Interest and UK Index Linked Bonds
Baillie Gifford Diversified Growth (BGDG)	UK base rate
Legal & General (L&G)	Customised benchmark comprising UK and Overseas Equities
Newton Investment Management (NIM)	FTSE All World Index
Schroder Investment Management (SIM) UK Equities	FTSE All Share Index
Schroder Investment Management (SIM) Property	AREF/IPD UK Quarterly Property Fund Indices All Balanced Funds

1.4 Full details of each Manager's portfolio activity and any engagement with companies on corporate governance issues are recorded in their individual quarterly investment reports, which are enclosed.

2. MARKET REVIEW AND OUTLOOK

2.1 The pattern of returns for the major asset classes in the fourth quarter of 2013 was very similar to the pattern over the whole year - the magnitude of changes was simply smaller. Global equity prices in most developed markets continued to rise in anticipation of improving economic growth and corporate profits. Many emerging market asset prices, on the other hand, were impacted by weakening currencies, which threatened to slow economic growth and squeeze corporate profitability. In a similar vein to last quarter, gains in UK equities were led by smaller capitalisation companies while the German equity market was the standout performer within Europe. Negative returns were posted by bond markets (yields rose) as US tapering (less QE) became a reality. UK commercial property markets finally showed some capital appreciation reflecting more robust domestic economic statistics.

2.2 The CPI headline rate of inflation in the UK reduced to 2% in December 2013. This is the first time since November 2009 that inflation has been at or below the target rate of 2% set by the UK Government. At their January meeting, the Bank of England's MPC voted unanimously to keep QE at £375bn and to keep the Bank Rate at 0.50%. QE has remained at that level since July 2012 and the Bank Rate since March 2009. Sterling strength, which has been a feature of 2013, continued in Q4 with the pound rising by approximately 2% against the dollar. UK economic data was supportive with third quarter GDP growth of 0.8% helped by a strengthening housing market.

2.3 Within Asia, sentiment towards Japanese equities benefited from Governor Kuroda's pledge to maintain the BOJ's monetary easing until the 2% inflation target is achieved and maintained. Positive momentum for Japanese equities continued in the fourth quarter and the Yen depreciated further against the dollar, boosting the share prices of exporters. Elsewhere in the region, Australian equities continued to struggle to keep pace with gains elsewhere as they face the challenge of boosting domestic consumption to offset a fall in mining investment. A further rate cut from the Reserve Bank of Australia is likely as households continue to deleverage.

2.4 The New Year did not begin as the previous one ended. Equities fell, particularly those in emerging markets. In his final meeting as chairman of the US central bank, Ben Bernanke indicated that "tapering" would continue. This has, of course, been anticipated by the markets and accordingly, government bond yields have been rising for several months. Global equities have wobbled, particularly the currencies and markets of countries with high inflation and large current account deficits. Countries such as Turkey and India raised interest rates to stem capital flight and help control inflation. It seems that the cost of money, driven lower by central banks, is beginning to rise slowly. The further interest rates rise, the greater will be the challenge for the prices of growth assets, such as equities. 2014 looks like being a volatile affair.

3. ANALYSIS OF PERFORMANCE RESULTS

3.1 The total fund and individual external manager returns are shown in the table in Appendix 1. The returns for the quarter ending 31 December 2013 are shown, but this is a very short period to measure performance. It simply reflects the regular reporting cycle. Each manager has been set its own individual investment objective, which depends on the type of mandate awarded. Each active manager is tasked with outperforming its benchmark over either three or five year periods. The table in Appendix 1 incorporates the relevant return and benchmark data and the excess return relative to the manager's benchmark and outperformance objective. More detail on individual manager mandates and objectives can be found in Appendix 2.

3.2 Developed markets produced a strong mid single digit return over the quarter (up over 20% for the year) while emerging markets were down marginally (down over 9% for the year). Both conventional fixed income and index-linked gilts fell slightly over the quarter. The Fund's property benchmark rose 4.3% reflecting improving UK commercial real estate values.

3.3 The overall Fund's return of +3.8% over the 4th quarter of 2013 was ahead of the benchmark return of 3.6%. Over the 3 year period the Fund benefited from equity market strength and SIM's outperformance in UK equities, rising +9.0% per annum compared with the benchmark return of +6.9% per annum, an excess return of +2.1% per annum. Long term return data shows Fund appreciation of +11.7% per annum over 5 years and +7.3% per annum since September 2001. These long term returns are above the benchmark returns.

3.4 Over the fourth quarter of 2013, the Fund's three active equity managers posted returns from +1.3% to +8.1%. Only SIM beat its benchmark by a large margin; NIM lagged its benchmark slightly and AAM lagged by a significant margin. The Fund's passive equity manager, L&G, produced a return of +5.2%, consistent with its mandate.

3.5 The return from BG's bond mandate was very slightly negative, but that was better than the benchmark, which returned -0.6%. BG's other mandate, the Diversified Growth portfolio, rose 2.5%, which was well ahead of its benchmark by 2.4%.

The property portfolio managed by SIM lagged its benchmark by 0.7%, but still rose 3.6% in absolute terms.

3.6 Longer term return data shows that SIM's UK equity portfolio is comfortably ahead of its objective of +1.25% per annum above the benchmark over the 3 year period and since inception.

NIM's global equity mandate stipulates an objective of +3% per annum above the benchmark over 5 year rolling periods. Returns over the past 3 years, 5 years and since inception have beaten the benchmark. Since inception in June 2006, returns are ahead of benchmark by 1% per annum, so NIM has added value, but it has not achieved its objective of +3% per annum above the benchmark.

The AAM mandate's objective is +3% per annum outperformance over 3 year rolling periods. After a very poor 2013, performance is now lagging the benchmark and objective over 3 years. After an excellent start to the mandate, the last 12 months performance has detracted from relative returns, which are now only ahead of benchmark by 0.2% per annum since inception in May 2010 and lagging the objective by 2.9% per annum. On the basis of these developments, there is now a need to place AAM under closer scrutiny. Officers will therefore be engaging further with AAM at an early opportunity.

The performance of BG's bond mandate is lagging its benchmark by 0.3% per annum since inception in 2007, but the 3 year performance has been very strong. The excess return over the benchmark of +1.4% per annum comfortably exceeds the objective of +0.9% per annum over rolling 3 year periods.

SIM's property performance has been disappointing in recent years, and this has reversed positive results in the early years of the mandate. Since inception in 2005, a period of low returns for commercial property owners, the portfolio has performed more or less in line with its benchmark, but has fallen short of the objective by 0.7% per annum.

4. CONCLUSION

4.1 The predominant feature of the quarter was the US Federal Reserve's decision to begin "tapering", albeit at a slower rate than some had predicted. Added to this, a flurry of better economic data (including GDP growth and the unemployment rate in the US) allowed US and UK markets to be largely unperturbed by the tapering announcement and as a result, most assets finished the year well.

4.2 The other significant trend of the quarter related to emerging markets, where some developing economies have struggled to adjust to the lower global growth environment and have been experiencing currency weakness and current account imbalances. The speed of tapering in the US and equivalent actions around the world, will continue to be a major factor on markets in 2014.

4.3 Over the quarter, the Fund value increased by 3.8% marginally ahead of the benchmark return of 3.6%. Strong performances by Schroder's UK Equities and Baillie Gifford's Diversified Growth mandates were slightly negated by the continuing defensive position held by Global Equity managers.

5. RECOMMENDATIONS

5.1 The Committee is asked to note:-

(i) the Managers' performance for the period ending 31 December 2013; and

(ii) the action taken by Managers during the quarter to 31 December 2013 in accordance with their investment policies.

Chief Finance Officer

Date : 20 February 2014

LIST OF BACKGROUND PAPERS

1. The Northern Trust Company – Fund Analytics 31 December 2013

Any person wishing to inspect the background papers listed above should telephone Falkirk 01324 506304 and ask for Alastair McGirr

APPENDIX 1 – PERFORMANCE MEASUREMENT (RATES OF RETURN)

Rates of Return by Manager with Excess Returns - 31 December 2013							
			Returns				
Manager	Market Value £	Weight	3 months	3 year	5 year	Since inception	Inception Date
Aberdeen Portfolio	207,165,697	13.4%	1.3%	7.8%	-	9.3%	May-10
Benchmark			5.0%	8.3%	-	9.1%	
Excess Versus Benchmark			**-3.7%**	**-0.5%**	**-**	**0.2%**	
Excess Versus Objective			**-**	-3.5%	**-**	-2.9%	
Baillie Gifford Bond Portfolio	131,392,343	8.5%	0.0%	7.8%	8.6%	5.9%	Mar-07
Benchmark			-0.6%	6.4%	6.6%	6.2%	
Excess Versus Benchmark			**0.6%**	**1.4%**	**2.1%**	**-0.3%**	
Excess Versus Objective				**0.5%**	**1.2%**	**-1.2%**	
Baillie Gifford Diversified Growth	158,173,688	10.3%	2.5%	-	-	7.4%	Feb-12
Benchmark			0.1%	-	-	0.5%	
Excess Versus Benchmark			**2.4%**	**-**	**-**	**6.9%**	
Excess Versus Objective *			**-**	**-**	**-**	3.4%	
Legal & General	327,558,213	21.2%	5.2%	9.0%	-	15.4%	Jan-09
Benchmark			5.2%	9.0%	-	15.3%	
Excess Versus Benchmark			**0.0%**	**0.1%**	**-**	**0.1%**	
Excess Versus Objective			**-**	**0.1%**	**-**	**0.1%**	
Newton	224,853,011	14.6%	4.4%	8.6%	13.8%	8.6%	Jun-06
Benchmark			5.0%	8.2%	12.4%	7.6%	
Excess Versus Benchmark			**-0.6%**	**0.4%**	**1.4%**	**1.0%**	
Excess Versus Objective			**-**	**-**	**-1.6%**	**-2.0%**	
Schroders UK Equity	262,766,049	17.0%	8.1%	16.9%	19.0%	10.1%	Sep-01
Benchmark			5.5%	9.4%	14.3%	7.3%	
Excess Versus Benchmark			**2.6%**	**7.4%**	**4.7%**	**2.8%**	
Excess Versus Objective			**-**	**6.2%**	**3.4%**	**1.5%**	
Schroders Property	108,619,363	7.0%	3.6%	4.3%	3.0%	1.4%	Nov-05
Benchmark			4.3%	5.4%	5.1%	1.3%	
Excess Versus Benchmark			**-0.7%**	**-1.0%**	**-2.2%**	**0.1%**	
Excess Versus Objective			**-**	**-1.8%**	**-2.9%**	**-0.7%**	
Total Fund	1,542,476,945	100.0%	3.8%	9.0%	11.7%	7.3%	Sep-01
Benchmark			3.6%	6.9%	10.3%	6.9%	
Excess Return			**0.3%**	**2.1%**	**1.4%**	**0.3%**	

*** Note that objectives are set over 3 or 5 year periods and Baillie Gifford's Diversified Growth mandate has not been in place for the requisite periods.**

There are small rounding effects in the table above.

APPENDIX 2 - INVESTMENT MANAGER COMMENTS

Aberdeen Global Equity
(13.4% of Total Fund)

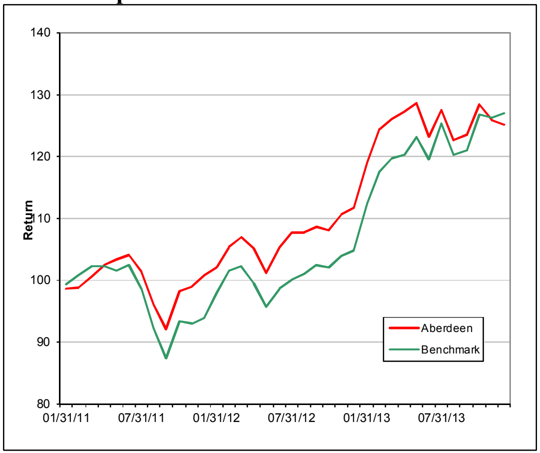
Investment Approach:

High conviction, research-driven house. Only invest in companies they have met. Regional teams produce Global buy list of 330 stocks. Global team carries out comparative analysis and produces model portfolio of 50 stocks from which team must build portfolio. Long-term horizon, trading highly price-sensitive.

Investment Objective:

To outperform the MSCI AC World Index in sterling by 3% per annum, gross of fees, over rolling 3 year periods (inception date 16 May 2010)

Since Inception Performance to 31 December 2013



Q4 2013	: -3.7% excess return
3 Years	: -0.5% excess return
Since inception	: +0.2% p.a. excess return

Summary

Poor short term performance, driven by overweight Emerging Markets/underweight US positioning, and this is starting to drag down longer term numbers. Not meeting objective. Things may get worse before they improve.

Portfolio

The portfolio is genuinely unconstrained, which indicates that it should be able to achieve its objectives. No single investment more than 5% of the portfolio is allowed, but sector and country limits are wide (+/-15% for sectors and +/-35% for countries allowed). Cash currently at 1.4%.

The portfolio is more geographically diverse than the benchmark. North America represents >50% of the benchmark, but the portfolio is u/w by > 20%. The fund is o/w the UK (+10%), Europe ex-UK (+5%), and LatAm (+6%). By sector, the portfolio remains heavily o/w defensive sectors, such as consumer staples (+7%), energy (+7%) and healthcare (+3%), and has low exposure to cyclical earnings, such as consumer discretionary shares (-10%), I.T. (-4%) and industrials (-2%). Financials are also underrepresented. Consequently, the portfolio is likely to perform relatively poorly in strong equity markets, but its defensive tilt should help protect it in the event of equity markets falling.

Performance was well behind the benchmark because of the overweight allocation to Latin America (Brazil) and underweight in North America, but also because of poor stock selection in the US, UK and Italy (picture very similar over 12 months as well). Performance hit by being o/wt staples and u/wt I.T., and from poor stock picking in financials (QBE Insurance, Banco Bradesco, Standard Chartered), energy (Petrobras) and healthcare (Quest Diagnostics). There was positive performance from CVS Caremark, Vodafone and Zurich Insurance, as well as Samsung Electronics.

Aberdeen will not change their process due to short term performance issues and will continue to invest in quality companies with lower than average levels of debt with stable earnings and cashflows. Remain cautious on corporate EPS growth and capex. Will not chase momentum. Lots of stocks on watch list, but hoping for more volatility to be able to capitalise on lower share prices. Still believe in the long term story in EMs, and believe there are more economic levers to pull in the event of a crisis than in the DMs.

Turnover remains very low. No new stock positions. Top ups of British American Tobacco, Shin Etsu Chemical, FEMSA and Baxter. Reductions in Quest Diagnostics, Zurich Insurance, Samsung Electronics. Aberdeen remains very cautious. Think that volatility could pick up in 2014, which would provide them with more opportunities to add value to the portfolio via topping and tailing positions without compromising their investment process/long term stance.

Key considerations/developments

Ownership has not changed but company acquired Artio Global Investors and a 50.1% stake in SVG Advisers in 2013, and are in process of taking over SWIP, which adds £136bn AuM to Group; the **client base** is stable (though -£681m in Q4 (3%) with 2 net clients lost) and the **investment process** has not changed/is standardised across equity products. This facilitates cross-fertilization of ideas and a team-led approach. Stable, well-resourced and experienced **investment team** (6 most senior team members average >19 years in industry and >12 years at Aberdeen), backed up by extensive and experienced regional teams.

Baillie Gifford Bonds

(8.5% of Total Fund)

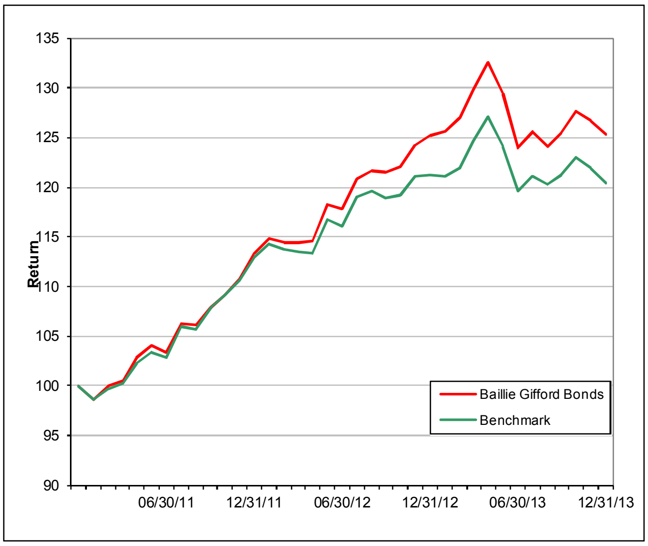
Investment Approach:

Baillie Gifford employs fundamental analysis to identify sustainable trends. It believes that there are inefficiencies that can be exploited in the areas of stock selection and interest rate and currency strategies.

Investment Objective:

To outperform a customised benchmark comprising index-linked gilts, conventional gilts and investment grade bonds by 0.9% per annum net of fees over rolling 3 year periods (inception date 30 March 2007).

3 Year Performance to 31 December 2013



Q4 2013	: + 0.6% excess return
3 Year	: + 1.4% p.a. excess return
Since inception	: - 0.3% p.a. excess return

Summary

	3 year performance is well ahead of the objective.

Portfolio

The portfolio has a customised benchmark (20% FT-Actuaries Over 5 Years Index Linked Gilt Index, 30% FT-Actuaries All Gilts, 50% Merrill Lynch Sterling Non-Gilt Index). Baillie Gifford (BG) invests in three BG Funds on a no-fees basis to achieve the appropriate exposure.

Over the quarter, corporate bonds fell -0.1%, index-linked gilts -0.9% and conventional gilts -1.4%. The portfolio's 20/30/50 benchmark performed better than the pre-2009 20/40/40 benchmark. BG continues to favour the higher weighting to corporate credit.

The portfolio's return of -0.04% over the quarter compared favourably with the benchmark return of -0.63%. Performance on a 3 year basis is also still well ahead of the benchmark and objective.

Stock selection made a significant positive contribution over the quarter and the year. In particular, positions in insurance companies and the subordinated debt of financials and utilities have benefited performance.

Currency also added a small amount of value over the quarter, but asset allocation was less successful over both the quarter and the year.

BG currently prefers lower rated bonds reflected in overweight positions in High Yield bonds (portfolio 4.5%, benchmark 0%) and 'BBB' rated bonds (portfolio 24.3%, benchmark 16.3%).

Key considerations/developments

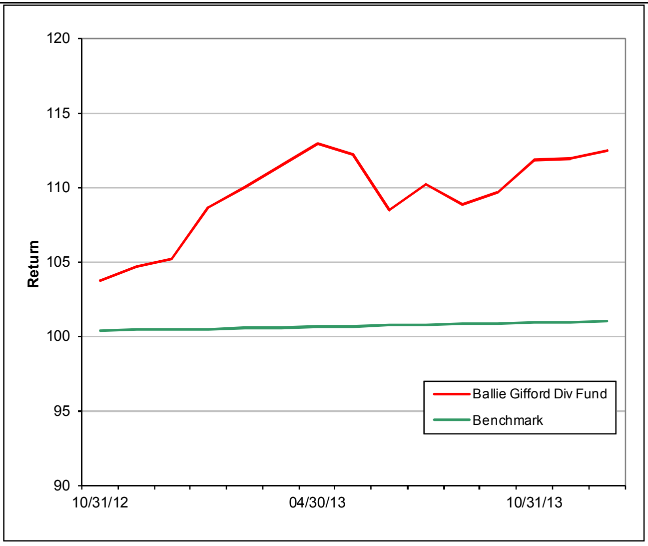
Baillie Gifford is a long established, reputable partnership; the client base is stable and the investment process has not changed.

Assets under management in the sterling aggregate product dropped from £1,238m to £570m over the quarter as they lost one "legacy client", who was "not in the pooled fund due to very restrictive investment guidelines". BG has been running the mandate for a very long standing client, but it is not the type of mandate that they would take on nowadays. 10 clients remain in the product.

In terms of staff changes, Duncan Sutherland has replaced Robert Baltzer as one of the 3 Fund Managers on BG's sterling aggregate product group. Robert remains part of the Credit Team and continues to provide research that feeds into the product.

Baillie Gifford

Since Inception Performance to 31 December 2013

Diversified Growth (10.3% of Total Fund)	

Investment Approach:

Baillie Gifford invests in a broad range of traditional and alternative asset classes, such as equities, bonds, property, private equity, infrastructure, commodities and currencies, adjusting portfolio weightings to reflect the relative attractiveness of the individual assets.

Investment Objective:

Objective: to outperform the UK base rate by at least 3.5% per annum (after fees) over rolling five year periods with an annual volatility of less than 10%. (Inception date 2 February 2012)

Q4 2013	: +2.4% relative to base rate
1 Year	: +6.4% relative to base rate
Since inception	: +6.9% pa relative to base rate

Summary

	The risk/return is beating the fund objectives (0.5% + 3.5% = 4% pa return with less than 10% volatility) realising 7.4% pa gross return with 6.8% volatility.

Portfolio

The portfolio, consisting of a range of 15 “asset classes”, is designed to create an investment vehicle with lower volatility than equity investments. The largest current exposure is, in fact, 15.6% in listed equities with 3.2% in listed private equities – BG’s risk analysis shows that these contribute 38% and 10% of the total “volatility”.

Other significant exposures are emerging market debt (12.5%) and high yield bonds (12.3%). Cash has been raised to 10% from 6% in Q3. So, there is a significant allocation to higher risk assets offset by a relatively high level of cash.

34% of the fund is invested in other Baillie Gifford funds: Global Alpha (5.4%), Global Income (5.1%), Long Term Global Growth (1.8%) and Japan (0.2%). Local currency emerging market debt exposure is mainly held through the Baillie Gifford Emerging Markets Bond Fund (8.9%). Cash exposure is through Baillie Gifford Worldwide Cash Plus Fund (2.1%). Other Baillie Gifford fund holdings are Baillie Gifford High Yield Bonds (4.8%) and Baillie Gifford Worldwide Credit (6.1%). These funds are “benchmark constrained” by their own benchmarks and objectives, which may differ from those of the Diversified Growth Fund and so, cause contradictions or add to risk (eg currency positions).

“Active Currency” is 0.3% of assets, and 6% of “volatility”, but in Q4 it was the second largest (positive) contributor to performance. This implies currency risk may be understated.

The predicted volatility is now 6.5% - with around half of this from (listed and private) equities. Targeted maximum volatility is 10% (cf global equities are 16.9%).

Key considerations/developments

Baillie Gifford is a long established, reputable partnership. Despite £5bn “capacity” (2012) and “closure to all new clients” (June 2013), client numbers in this product rose over Q4 by 13 (14 won and 1 lost) to 246, and **assets** increased to £5.2bn from £4.4bn with £0.5bn net inflows (£0.25bn Q3).

There have been no changes to the organisation, the **investment process or the team**. The “fund of funds” structure means the c1/3rd invested in other Baillie Gifford funds have zero fees but still pay (0.2%) expenses, while the c1/3rd invested in other manager’s funds bear full double-charging.

Newton Global Thematic Equity (14.6% of Total Fund)	**3 Year Performance to 31 December 2013**

Investment Approach:

Newton identifies structural trends to gain perspective on the important risks and opportunities in investment markets. This thematic framework drives stock selection, which results in a concentrated portfolio.

Investment Objective:

To outperform FTSE All World Index by 3% per annum (net of fees) over rolling 5 year periods (inception date 30 June 2006)

Q4 2013	: - 0.6% excess return
5 Years	: + 1.4% p.a. excess return
Since inception	: + 1.0% p.a. excess return

Summary

Portfolio is ahead of benchmark but not achieving objective since inception.
Underweight stance in Emerging Markets is helping short term performance.

Portfolio

The portfolio is genuinely unconstrained (48 stocks), indicating that it should be able to achieve its objectives. This is an equity portfolio, but the manager is able to hold up to 10% in cash. The manager continues to take a very defensive stance and cash (including short term US Treasuries) was 9.5% at quarter end.

Stock ideas flow from Newton's themes, which include deleveraging, financial concentration and growing Chinese influence. The portfolio is characterised by companies with stable earnings, strong cash flows, competitive advantages, inflation linkage, innovation, exposure to growth economies, good management & governance and attractive valuation.

The portfolio has high exposure to companies in the healthcare, staples, food producers and tobacco sectors, while financials, industrials and oil and gas companies with cyclical earnings are under-represented (though o/w materials). The portfolio is likely to perform relatively poorly during strong equity markets (especially given the 10% cash position), but its defensive tilt should protect it to some extent in the event of equity markets falling. The portfolio is overweight Europe (+8%) and UK (+7%) equities, and underweight North America (-8%), Japan (-6%), Pacific (-5%) and other/emerging markets (-8%).

Q4 underperformance can entirely be explained by the high cash and equivalents level in the portfolio given the strength in equity markets over the period. Stock picks within financials (Principal Financial, Equifax) and consumer goods (Continental, Disney, Mattel) were positive drivers, offset by negative performance from holdings in healthcare (Lab Corp), technology (EMC, Google, Apple) and industrials.

There was significant portfolio activity in Q4 (7 new stocks): Teva Pharmaceticals (improved development pipeline), PNC Financial (new CEO reinvigorating long term strategy), Ebay (ecommerce trend beneficiary), Vodafone (financial flexibility post Verizon Wireless sale), trucking agent CH Robinson (margin growth potential) and oil plays Wood Group and National Oilwell Varco. There were outright sales of energy companies Total and Baker Hughes, US regional banks Keycorp and Fifth Third, Applied Materials and CSX Corp, as well as Align Technology and China Mobile. Exposure to consumer services was increased, while technology and materials exposure was reduced.

Key considerations/developments

Newton remains one of Bank of New York Mellon's asset management subsidiaries based in London; in the face of weak relative returns, management reassessed the **investment process** in 2011/12 and made some personnel changes to improve rigour, but did so without changing the key elements of the global thematic strategy; the **client base** is fairly stable (£19m net outflow).

Schroders UK Equity

(17.0% of Total Fund)

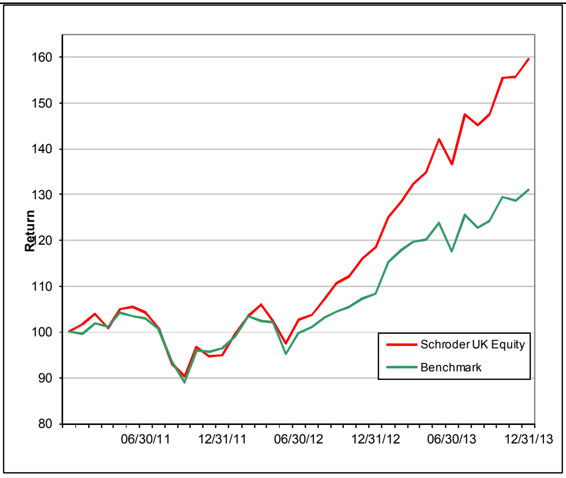
3 Year Performance to 31 December 2013

Investment Approach:

Schroder seek to identify stocks which trade at a substantial discount to their intrinsic value and where they believe that profits will surpass expectations. The investment style can be categorised as “value”.

Investment Objective:

To outperform FTSE All Share Index by 1.25% per annum (net of fees) over 3 year rolling periods (inception date 31 March 2007)



Q4 2013	: +2.6% excess return
3 Year	: +7.4% p.a. excess return
Since inception	: +2.8% p.a. excess return

Summary

Strong performance continued in Q4 on both an absolute and relative basis with manager comfortably ahead of the objective on all timeframes. Clearly articulated strategy with stable ownership, client base and investment team.

Portfolio

The portfolio of 42 stocks deviates from the benchmark meaningfully, which means that the objective should be achievable, but the return profile is likely to be highly variable.

Active sector positions are very similar to last quarter. The portfolio retains an overweight position in the life insurance and general retailers sectors though positions were trimmed in the latter during Q4. Mining is the biggest underweight though the team initiated a small position in Anglo American recently.

Relative returns in the fourth quarter were strong (+2.6%). The portfolio has gained 34.7% over the last 12 months versus an index up 20.8%. The portfolio benefited in Q4 from exposure to companies such as Darty, Trinity Mirror, Daily Mail & General Trust, ICAP and Resolution, which all outperformed significantly. Holdings in financials RSA Insurance and Royal Bank Of Scotland alongside retailers Debenhams, Morrisons and Tesco detracted from relative returns.

The team continued to trim some of the winners in the portfolio where the gap between fundamental value and share price has narrowed. Positions in Home Retail, Dixons, Next, Taylor Wimpey and DS Smith were all top-sliced on this basis. A new position was initiated in Direct Line Group with attractive valuations and a strong balance sheet. Tesco and Morrisons continue to experience operational pressure and sentiment is at depressed levels. The associated share price weakness provided the opportunity to add to existing holdings.

Having been zero weighted in the materials sector for some time, a small initial position was taken in Anglo American. Having done significant due diligence over an extended period of time, the portfolio manager suggested that while Anglo had its issues, they see absolute value in the name.

Key considerations/developments

Schroders is a publicly listed asset management company, which is still controlled by the family; the **client base** is fairly stable and the **investment process** has not changed. The UK Value product, in which Falkirk is invested, runs approximately £4.9bn in assets split roughly 1/3rd institutional and 2/3rd retail. The **investment team** appears to be stable and demonstrates high conviction in its investment approach.

Schroders Property Multi-Manager

(7.0% of Total Fund)

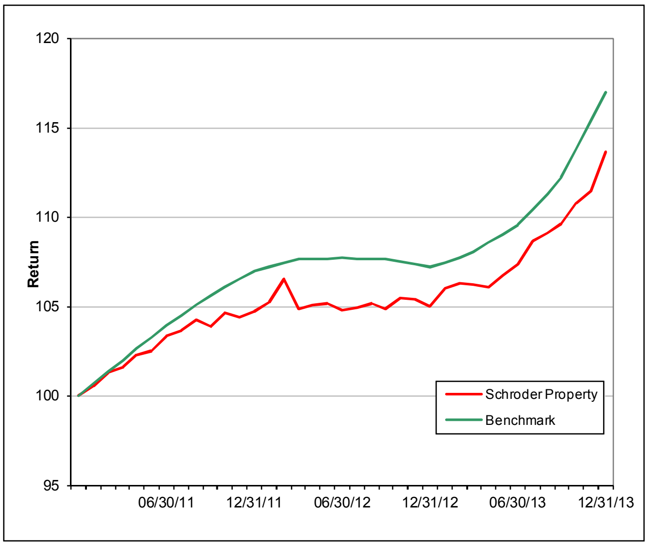
Investment Approach:

Schroders runs a segregated mandate providing a multi-manager portfolio of property funds. The manager seeks to identify attractive property markets and property funds with skilled managers, some of which are sector specialists.

Investment Objective:

To outperform IPD UK Pooled / Quarterly Property All Balanced Funds Weighted Average Index by 0.75% per annum (net of fees) over 3 year rolling periods (inception date April 2006)

3 Year Performance to 31 December 2013



Q4 2013	: -0.7% excess return
3 Year	: -1.0% p.a. excess return
Since inception	: +0.1% p.a. excess return

Summary

Latest 3 year performance remains weak (-0.9%pa relative). Since inception the performance is broadly in line with the benchmark, but less than the objective. Significant restructuring undergone to position the portfolio for the future.

Portfolio

The portfolio is comprised of a diverse group of 15 funds investing in property assets largely in the UK. Continental European exposure amounts to approximately 7% of the portfolio.

The poor three year relative performance has been dominated by exposure to Continental Europe, which is not in the benchmark. (Recap in '06-07, 10% of the portfolio was committed to Europe.) In addition, transaction costs and cash drag in a rising market affected performance.

The portfolio is valued at £109m. £15m of new equity was added between Dec '09 and Jun '10. Activity was fairly significant from 2009-2013, over £80m of property transactions took place, replacing 6 holdings with 6 new funds. Low future transaction activity is now anticipated.

The portfolio's risk profile has been rebalanced through greater investment in low geared, balanced property funds and those funds targeting an income focussed approach. As a result, the manager believes the portfolio is well positioned for the current investment environment, in which the income yield on property is very competitive with government bonds. He does concede, however, that the Continental European exposure will continue to impact performance relative to the benchmark for some time to come.

The portfolio now targets to hold minimal amounts of cash - it now represents 0.6% of the portfolio value.

Key considerations/developments

Schroders is a publicly listed asset management company, which is still controlled by the family; the **client base** is fairly stable and the **investment process** has not changed. The **investment team** appears to be stable, but the poor performance puts it on the defensive.

APPENDIX 3 – GLOSSARY

Benchmark - The yardstick used to measure the success and structure of a portfolio. All managers are measured against benchmarks. Passive managers are tasked with producing returns that are the same as the benchmark. Active managers are tasked with producing returns that are higher than the benchmark.

Benchmark return - Identifies the total return of the benchmark for the identified period. Return numbers for periods of one year or less show the actual return over the period. Returns for periods of greater than one year are annualised returns - they show the return per annum (%pa).

Dividend Yield - The dividend a company pays divided by its current price.

Duration - A measure of the sensitivity to interest rates of bonds. It identifies the approximate percentage change in a bond's price for a 100 basis point change in yield

Excess Return - Is the out / underperformance of the portfolio relative to the benchmark for the identified period. Return numbers for periods of one year or less show the actual return over the period. Returns for periods of greater than one year are annualised returns - they show the return per annum (%pa).

Investment Objective – All managers (and the Fund) are set investment objectives, which are related to a specific benchmark. The investment objective for a passive manager is to match the returns of the benchmark. The investment objective for an active manager is to exceed the returns of the benchmark by a pre-determined percentage per annum over a pre-determined period.

Market value (£) - Identifies the total market value of the portfolio / Fund

Portfolio return - Identifies the total time weighted rate of return of the assets of the portfolio for the identified period. Returns for periods up to 12 months are the return over that period. Returns for periods longer than 12 months are annualised returns – they show the return per annum (%pa).

Turnover - Is the level of purchases and sales for the period. High turnover is generally regarded as bad because trading costs are incurred.