AGENDA ITEM 7

FALKIRK COUNCIL

Subject: **FUND MANAGER PERFORMANCE REVIEW**
Meeting: **PENSIONS COMMITTEE**
Date: **5 JUNE 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 reviews individual manager performance and developments.

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 Bank of England 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

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 Global financial markets had to face a combination of geo-political tensions stemming from Russia's intervention in Crimea, prospects of monetary policy tightening in the US and a loss of economic momentum, particularly in China where policymakers are grappling with high levels of credit. The backdrop favoured bonds over equities, but only at the margin. Developed market equities managed to eke out a small gain with Europe ex UK leading. Index-linked gilts, however, produced better returns but still in the low-mid single digits.

2.2 The CPI headline rate of inflation fell throughout the quarter ending at 1.6% in March. The expectation is that it will remain subdued in the short to medium term aided by a modestly stronger sterling. During the quarter the Bank of England's Monetary Policy Committee (MPC) made no change to quantitative easing (QE) or the UK Bank Rate at £375bn and 0.50% respectively. Notable UK economic statistics this quarter included the year-on-year increase in average weekly earnings which has caught up with the inflation rate for the first time in six years (apart from two months in 2010). Stronger-than-expected retail sales in February and house prices rising 8.7% year over year in March direct attention to the prospects for higher interest rates. Consensus expectations are for interest rates to start rising during 2015.

2.3 Expectations across the Channel are quite different. The European Central Bank (ECB) maintained its benchmark interest rate at 0.25% but members of the ECB were unanimous in their willingness to begin QE if inflation, currently sitting at 0.5%, stayed well below the 2% target. Policymakers also raised the idea of further cuts in the ECB's benchmark interest rate, taking it to below zero. Mario Draghi said such measures could be needed because of the strength of the Euro. The current strength of the Euro is estimated to account for a half percentage point of the decline in the annual inflation rate.

2.4 Further afield, the new Fed Chair Janet Yellen suggested a six month gap between QE ending and interest rates rising. Given the excellent stock market returns since 2009, investors are obviously nervous about the reversal of policies that have supported financial asset prices. In Japan, a weak equity market in the quarter reflected some concerns about a sales tax increase, which might offset some of the economic and inflation momentum that recent policies have achieved. The increasingly important Chinese economy remains highly controversial and some weakening in the currency may signal a change of policy or simply an attempt to dissuade financial speculation. Given the rapid credit expansion following the global financial crisis, this bears watching as China is large enough to affect asset prices across the globe.

2.5 As always, investment markets are fraught with uncertainty. What can be observed with some certainty, however, are the real returns available from index-linked gilts, probably the best match for the liabilities of the Fund. These are decidedly and uncomfortably negative. The policies that have engineered such a situation are equally responsible for declining yields in other assets from bonds to equities to property. Nobody knows when these falling yields/rising prices might reverse direction, but some of the Fund's managers fear that valuations are high enough and prospective returns low enough that a turnaround is inevitable.

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 March 2014 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 their 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 equity markets were little changed over the first quarter of 2014 (+0.6%) while emerging markets declined modestly (-0.8%). Index-linked gilts (+3.6%) was the best major asset class in the UK closely followed by commercial property (+3.3%), corporate bonds (+2.5%) and conventional gilts (+2.1%).

3.3 The overall Fund's return of +0.9% over the quarter was ahead of the benchmark return of 0.7%. Over the 3 year period the Fund benefited from equity market strength and SIM's outperformance in UK equities, rising +8.8% per annum compared with the benchmark return of +6.6% per annum, an excess return of +2.2% per annum. Long term return data shows Fund appreciation of +13.5% per annum over 5 years and +7.2% per annum since September 2001. These long term returns are above the benchmark returns.

3.4 Over the first quarter of 2014, the Fund's three active equity managers posted returns from -2.2% to +2.4%. AAM and NIM beat their benchmark of global equities while SIM lagged its UK benchmark. The Fund's passive equity manager, L&G, produced a return of +0.2%, in line with its benchmark return, and so consistent with its mandate.

The return from BG's bond mandate was +2.9%, ahead of its benchmark by 0.3%. BG's other mandate, the Diversified Growth portfolio, rose 0.7%, ahead of its benchmark by 0.6%.

The property portfolio managed by SIM lagged its benchmark by 0.2%, but rose 3.1% in absolute terms.

3.5 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 and since inception have beaten the benchmark, but have lagged over 5 years. 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 objective, but is ahead of the benchmark over 3 years. After an excellent start to the mandate, the last 12 months performance has detracted from relative returns. Returns are now ahead of benchmark by 0.7% per annum since inception in May 2010, but lag the objective by 2.4% per annum.

The performance of BG's bond mandate is lagging its benchmark by 0.2% per annum since inception in 2007, but the 3 and 5 year performance have 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 in line with its benchmark, but has fallen short of the objective by 0.7% per annum.

4. CONCLUSION

4.1 Following the market gains of 2013, the FTSE All-Share Index retreated by 0.6% on the back of disappointing US earnings returns. However this only told part of the story as political tensions between Russia and Ukraine, US tapering pronouncements, subdued inflation figures and interest rate predictions all played a part in influencing market sentiment.

4.2 All managers managed to beat their benchmarks during the quarter, except for Schroders – the UK Equity mandate pausing for breath after strong returns in 2013 and the Property mandate still suffering from the exposure to Continental Europe. Despite failing to meet the benchmark, the property mandate has nonetheless appreciated by over 10% (around £11m) during 2013/14. It was also both pleasing and reassuring to note that Aberdeen Asset Management were once more ahead of benchmark after a period of underperformance.

5. RECOMMENDATIONS

5.1 **The Committee is asked to note:-**

(i) the Manager's performance for the period ending 31 March 2014; and

(ii) the action taken by Managers during the quarter to 31 March 2014 in accordance with their investment policies.

Chief Finance Officer

Date: 23 May 2014

Contact Officer: Alastair McGirr

LIST OF BACKGROUND PAPERS

1. The Northern Trust Company – Fund Analytics 31 March 2014

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 March 2014							
			Returns				
Manager	Market Value £	Weight	3 months	3 year	5 year	Since inception	Inception Date
Aberdeen Portfolio	212,088,663	13.7%	2.4%	8.4%	-	9.3%	May-10
Benchmark			0.6%	7.7%	-	8.7%	
Excess Versus Benchmark			**1.8%**	**0.6%**	**-**	**0.7%**	
Excess Versus Objective			**-**	-2.4%	**-**	-2.4%	
Baillie Gifford Bond Portfolio	135,255,136	8.7%	2.9%	8.7%	11.1%	6.2%	Mar-07
Benchmark			2.6%	7.2%	7.7%	6.4%	
Excess Versus Benchmark			**0.3%**	**1.4%**	**3.4%**	**-0.2%**	
Excess Versus Objective				**0.5%**	**2.5%**	**-1.1%**	
Baillie Gifford Diversified Growth	189,496,135	12.2%	0.7%	-	-	6.9%	Feb-12
Benchmark			0.1%	-	-	0.5%	
Excess Versus Benchmark			**0.6%**	**-**	**-**	**6.4%**	
Excess Versus Objective *			**-**	**-**	**-**	2.9%	
Legal & General	328,238,499	21.1%	0.2%	8.5%	15.7%	14.7%	Jan-09
Benchmark			0.2%	8.4%	15.5%	14.6%	
Excess Versus Benchmark			**0.0%**	**0.1%**	**0.2%**	**0.1%**	
Excess Versus Objective			**-**	**0.1%**	**0.2%**	**0.1%**	
Newton	227,508,643	14.6%	1.2%	8.3%	14.7%	8.5%	Jun-06
Benchmark			0.5%	7.7%	15.0%	7.4%	
Excess Versus Benchmark			**0.6%**	**0.7%**	**-0.3%**	**1.0%**	
Excess Versus Objective			**-**	**-**	**-3.3%**	**-2.0%**	
Schroders UK Equity	223,860,100	14.4%	-2.2%	15.7%	20.4%	9.7%	Sep-01
Benchmark			-0.6%	8.8%	16.4%	7.1%	
Excess Versus Benchmark			**-1.6%**	**6.9%**	**4.1%**	**2.6%**	
Excess Versus Objective			**-**	**5.6%**	**2.8%**	**1.3%**	
Schroders Property	112,076,532	7.2%	3.1%	4.8%	5.3%	1.7%	Nov-05
Benchmark			3.3%	5.8%	7.6%	1.7%	
Excess Versus Benchmark			**-0.2%**	**-1.0%**	**-2.3%**	**0.1%**	
Excess Versus Objective			**-**	**-1.7%**	**-3.0%**	**-0.7%**	
Total Fund	1,553,394,729	100.0%	0.9%	8.8%	13.5%	7.2%	Sep-01
Benchmark			0.7%	6.6%	12.3%	6.9%	
Excess Return			**0.2%**	**2.2%**	**1.2%**	**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

(13.7% of Total Fund)

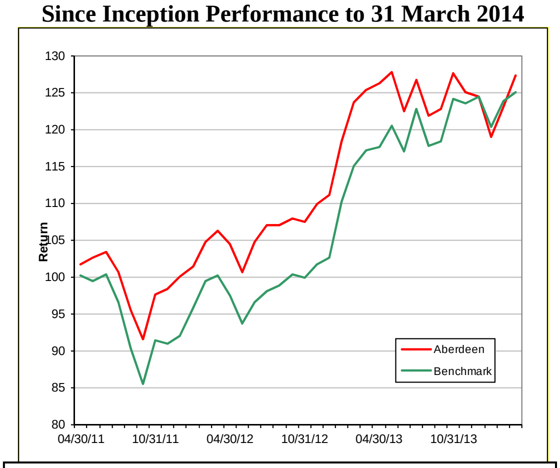
Investment Approach:

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 March 2014



Q1 2014	: +1.8% excess return
3 Years	: +0.6% excess return
Since inception	: +0.7% p.a. excess return

Summary

Better performance this quarter after a terrible 2013. Careful examination and justification of holdings is comforting from a long term perspective.

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 2.7%.

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 (+9%), Europe ex-UK (+4%), and LatAm (+6%). By sector, the portfolio remains heavily o/w defensive sectors, such as consumer staples (+6%), energy (+7%), materials (+3%) 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 (-5%). 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. Aberdeen's rhetoric and its portfolio positioning remain very cautious.

Performance was comfortably ahead of the benchmark because of the overweight allocation to Europe ex-UK and underweight in Japan, but also because of good stock selection in the US and Asia Pacific ex-Japan. The o/wt in healthcare and u/wt in consumer discretionary and good stock selection in energy, healthcare, financials and I.T. were significant contributors to this quarter's good performance – EOG Resources, QBE Insurance, Banco Bradesco and Potash all rose more than 10%, while Vodafone and Vale fell by 10% or more.

Aberdeen continue to follow their process investing in quality companies with lower than average levels of debt and relatively stable earnings and cashflows. In the absence of major price volatility, portfolio activity has been, and can be expected, to be low. Over the past year, there have been two new stock positions, MTN Group and BHP Billiton and two outright divestments, China Mobile and Canon. Otherwise, transactions have involved topping up and top-slicing existing shareholdings largely to reflect shifts in valuations.

Key considerations/developments

Ownership has not changed, but the acquisition of SWIP is very large – it adds £138bn of assets under management taking the Group's assets to £325bn - there will be integration distractions, but there is a potential short term positive - some of SWIP's global portfolios will be retained and invested in the existing holdings of Aberdeen's portfolio; the **client base** is quite stable (-£593m in Q1 (3%), but 3 net clients won) and the **investment process** has not changed/is standardised across equity products. This facilitates cross-fertilisation 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

(8.7% of Total Fund)

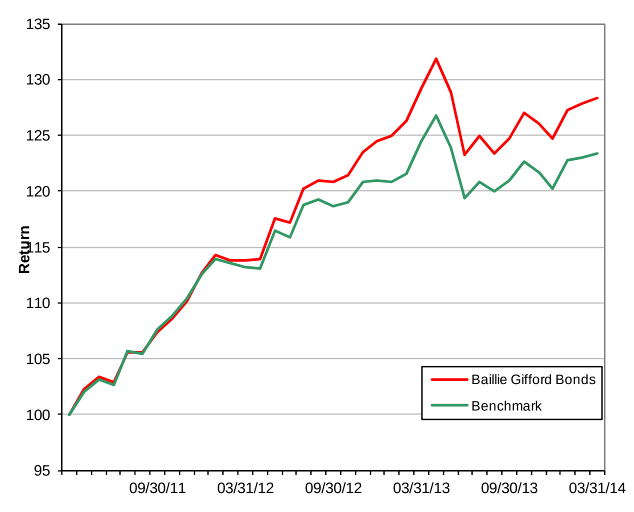
Investment Approach:

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 March 2014



Q1 2014	: + 0.3% excess return
3 Year	: + 1.4% p.a. excess return
Since inception	: - 0.2% 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.

Geo-political issues came to the fore over the quarter and there was a significant 'flight to safety' effect from the political uncertainties generated by the position in Ukraine. As a result of this and the market perception that US interest rates would be held low for longer, bonds generally had a very good quarter, with Index-Linked gaining 3.6%, Corporate Bonds 2.5% and UK Gilts 2.1%.

The portfolio had a further quarter of positive relative performance, returning 2.9% over the quarter against a benchmark return of 2.6%. Over both the quarter and the one year periods, stock selection has been the dominant factor in the positive relative return generating a +1.2% contribution over the year. Their positioning in securitised, insurance companies', and lower credit rated bonds have all proved positive for the portfolio. The portfolio's position in high yield reduced during the quarter, although mainly due to the ratings upgrade of their Daily Mail position to investment grade. Asset allocation also added to the performance over the quarter, due to the portfolio's modest overweight in corporate bonds relative to sovereigns. As a post quarter event, they noted that they had liquidated their small Russian sovereign bond position, and replaced it with a US swap, maintaining a synthetic rather than physical exposure.

However, currency detracted from the relative performance over both the quarter and the one year period. Their Emerging Market currency strategy is to seek relative value rather than taking directional positions. They are therefore overweight Mexico / underweight Chile, and similarly overweight Columbia / underweight Peru. However their biggest position relative to the benchmark is +2.4% overweight US Dollar (which they had increased during the quarter). They are also 1% underweight GBP. They are hardly the only frustrated US Dollar bulls and sterling bears in the market, but the position is a slight negative early in the second quarter.

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 increased slightly from £570m to £581 over the quarter. There were no changes to clients in the fund or to the investment staff.

Baillie Gifford Diversified Growth

(12.2% of Total Fund)

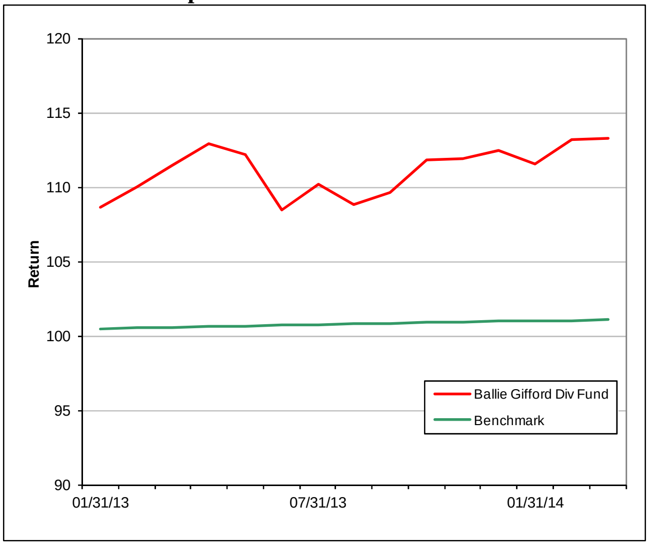
Investment Approach:

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)

Since Inception Performance to 31 March 2014



Q1 2014	: +0.6% relative to base rate
1 Year	: +1.1% relative to base rate
Since inception	: +6.4% relative to base rate

Summary

Since Falkirk invested in Feb 2012, the risk/return is beating the modest fund objectives of (0.5% + 3.5% =) 4% pa net return with less than 10% volatility, by realising 6.4% pa net return with 6.5% volatility.

Portfolio

While net performance beats the modest 4% pa target since inception, it is broadly flat year on year (chart above). BG now sees "risk less well rewarded" and expect lower return from here. They have reduced High Yield by 2% to 5% and with just 1% yield premium for corporate bonds ask "when do we step away?" Cash is now 9.5% of the fund (up from 6% last year) and Govt/Investment grade bonds are up to 14.5% - having just bought ECB 5 year bonds returning 1.5% pa. Neither of these will hit the 4% pa return target.

Around 1/3rd of the fund is invested in other Baillie Gifford funds. These are "benchmark constrained" by their own benchmarks and objectives, which may differ from that of Diversified Growth, causing contradictions and adding to risk. For example, they have 8.6% of the fund invested in their Emerging Markets Bond fund, which has c10% of its benchmark in Russia. Hence, they have c1% of the fund in Russian bonds.

"Active Currency" is reported at "0.0% of assets", and "5% of volatility". But in Q1, currency was the major negative impact to performance at -0.7% derived from a c8% fund short position in Australian Dollars. (Half of this was reported as the contribution from "Absolute Return" assets.) The short positions in Australian Dollar, Yen, Sterling, Euro and Swiss Francs are >30%. This implies FX risk may be understated.

The predicted volatility is now 6.6% - 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 determining £5bn "capacity" end 2012 and "closure to all new clients" in June 2013, **assets** increased in Q1 to £5.36bn on £105m net inflows (after £0.75bn net inflows 2H 2013). There have been no changes to the organisation, the **investment process** or **the team**.

Newton Global Thematic Equity
(14.6% of Total Fund)

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)

3 Year Performance to 31 March 2014

Q1 2014	: + 0.6% excess return
5 Years	: - 0.3% p.a. excess return
Since inception	: + 1.0% p.a. excess return

Summary

Portfolio not achieving objective, but is ahead of benchmark since inception. It has been constructed to take advantage of weak equity markets.

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 (mostly short term US Treasuries) was 9% 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 is overweight Europe (+7%) and UK (+5%) equities, and underweight North America (-6%), Japan (-5%), Pacific (-5%) and other/emerging markets (-6%). It has high exposure to companies in the healthcare and consumer goods sectors, while financials, industrials and oil and gas companies with cyclical earnings are under-represented (though is o/w materials). The portfolio is likely to perform relatively poorly during strong equity markets, but its defensive tilt and high cash position should protect it if equity markets fall.

The portfolio outperformed in Q1 benefiting from good selection in other/emerging markets and Japan. The overweight allocation to a strong healthcare sector was a major positive contributor. The top contributors within healthcare were Teva Pharmaceuticals, Roche, Express Scripts and Novartis and, within I.T., Microsoft and EMC. Detracting from performance within the telecommunications sector were Vodafone and Sprint and within financials Citigroup and AIA Group.

During the quarter, four new stocks were introduced: Apple, Kraft Foods, Wolters Kluwer (publisher) and TJX Companies (retailer); three stocks were sold outright (Lab Corp, Fresenius, Principal Financial) and one reduced (Associated British Foods).

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 stable (no flows in or out).

Schroders UK Equity

(14.4% of Total Fund)

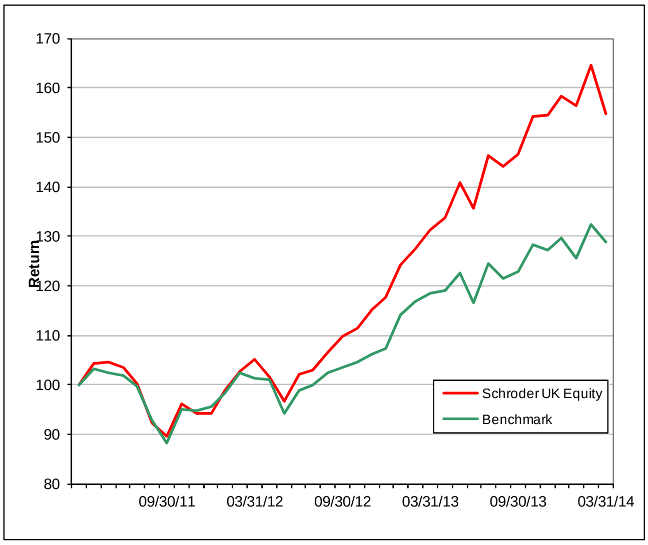
Investment Approach:

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)

3 Year Performance to 31 March 2014



Q1 2014	: -1.6% excess return
3 Year	: +6.9% p.a. excess return
Since inception	: +2.6% p.a. excess return

Summary

Underperformance in Q1 perhaps unsurprising given recent strength. Manager comfortably ahead of the objective on all long term timeframes. Clearly articulated strategy with stable ownership, client base and investment team.

Portfolio

The portfolio of 39 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 general retailers and life insurance sectors. Mining is the biggest underweight.

Relative returns in the first quarter were negative (-1.6%), yet the portfolio is still +9.1% over the most recent 12 months. Life insurance stocks suffered in Q1 as a result of UK Budget proposals to change the structure of the annuity market while gaming stocks were negatively impacted by the unexpected hike in the rate of duty on fixed-odds betting machines. Food retailers were again under pressure with a profit warning from Morrisons serving to highlight the ongoing competitive threat from the "hard discounters", such as Lidl and Aldi. More positively, Astrazeneca shares were buoyed by a better outlook for long term drug sales. The team are closely following the situation regarding the Pfizer bid for Astrazeneca.

The team has continued to trim the winners in the portfolio where the gap between fundamental value and share price has narrowed. These names include Close Brothers, Daily Mail, Trinity Mirror, Home Retail, Dixons and Rentokil. RSA Insurance was also trimmed following a succession of value destructive acquisitions, which caused the balance sheet to deteriorate. Proceeds have been used to add to cash and top up positions in Tesco, Vodafone and Pearson.

The resurgence in equity market confidence is highlighted following marked increases in the volumes of acquisition activity and equity issuance. The team have regularly cautioned that equity market returns from here are not going to match those of the recent past. They take this one step further with the following comment in the report: "...when market conditions mean significant prospective gains are not possible, the best way to guard against long-term capital losses is to favour the least expensive companies available that also have strong finances".

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 £5.3bn 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

(7.2% of Total Fund)

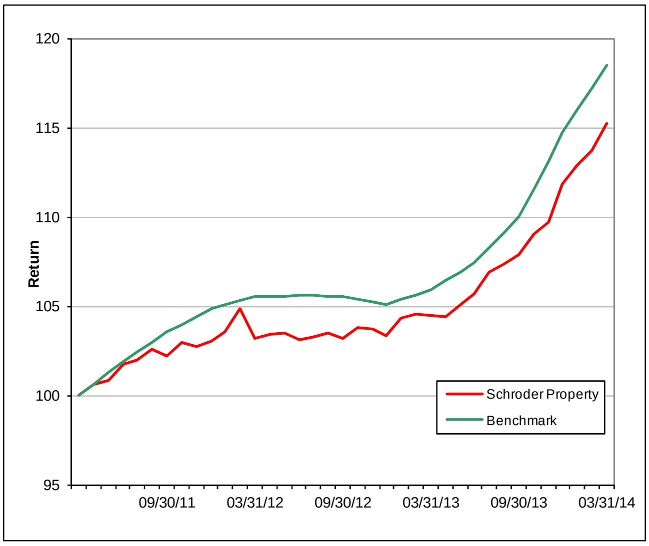
Investment Approach:

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 AREF/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 March 2014



Q1 2014	: -0.2% 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 (-1.1%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. The portfolio is valued at £113m. Activity was fairly significant from 2009-2013, with over £80m of property transactions taking place, replacing 6 holdings with 6 new funds. There is now expected to be low levels of future transaction activity.

Continental European exposure amounts to approximately 6% 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's risk profile has been rebalanced through greater investment in low geared, core 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.

The portfolio now targets to hold minimal amounts of cash - which now represents 0.7%, and is expected to reduce further as capital is drawn from the Local Retail Fund.

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.