FALKIRK COUNCIL

Subject: **FUND MANAGER PERFORMANCE REVIEW**
Meeting: **JOINT MEETING OF THE PENSIONS COMMITTEE AND PENSION BOARD**
Date: **24 SEPTEMBER 2015**
Author: **DIRECTOR OF CORPORATE & HOUSING SERVICES**

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:

- Aberdeen Asset Management (AAM) – MSCI All Countries World Index
- Baillie Gifford Bonds (BGB) – a customised benchmark comprising UK Fixed Interest and UK Index Linked Bonds
- Baillie Gifford Diversified Growth (BGDG) – UK base rate
- Legal & General (L&G) – a customised benchmark comprising UK and Overseas Equities
- Newton Investment Management (NIM) – the FTSE All World Index
- Schroder Investment Management (SIM)
    - (i) UK Equities – the FTSE All Share Index
    - (ii) Property – HSBC/APUT Pooled 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 Over the period both developed and emerging equity markets were largely directionless. This does not mean that the quarter was uneventful - far from it. Not only did the Greek government threaten to default on its debts and leave the Eurozone, but the Chinese equity market was also highly volatile and investors became increasingly pessimistic on the prospects for Chinese economic growth.

2.2 However, the general outlook for asset markets and the world economy remained broadly positive, which meant that equities were able to take this bad news comfortably in their stride. Moreover, the global policy backdrop is favourable, with most central banks continuing to implement programmes that support economic growth.

2.3 The US market (the largest in the world) declined marginally in the second quarter. Notable features were the out-performance of small cap stocks over their larger counterparts, and a high level of merger and acquisitions activity. The Federal Reserve meeting in June indicated that economic growth was slower than expected, but the economic expansion continues to make progress despite the disruption caused by harsh winter weather. Of particular note are the improvements in wages, consumer confidence and house prices.

2.4 The Japanese market was the best performer: not only are corporate profits recovering well after several years in the doldrums, but government policies to reform the economy and raise rates of economic growth and inflation seem to be bearing fruit.

2.5 The UK market also performed well as the potential uncertainty of a hung parliament was removed by the result of the May General Election.

2.6 The Chinese stock market was very volatile: it rose by almost two thirds to its peak in mid-June, and subsequently fell sharply. Chinese authorities introduced a broad range of measures to moderate equity market volatility. Chinese growth is slowing, but it remains enviably high relative to all other major economies. Longer term economic expansion will be supported by looser monetary policy, and a switch in focus from investment-driven to consumer-driven growth.

2.7 European stock markets initially pushed ahead, but retreated at the end of June when the Greek crisis flared up. The European economy is showing encouraging signs of gentle recovery, profits are improving and there is a strong commitment to keeping the Eurozone intact.

2.8 Bond prices were volatile, with long bond yields rising in most developed markets. German bond yields spiked from almost zero in March to 1%, after which they eased back to 0.7%.

2.9 All eyes are on the direction of monetary policy in the USA. It is the only major country where economic conditions appear robust enough to warrant an increase in interest rates in the near term. However, the Federal Reserve remains relatively dovish, and has reassured investors that the pace of rate increases should be gradual compared to previous cycles. Higher interest rates could be expected to cause the US dollar to strengthen further.

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 30 June 2015 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 Global equity market indices returned -5.2% in sterling terms over the second quarter of 2015. Returns were negatively influenced by the strength of sterling. The FTSE All Stock gilt index fell 3.4% and the FTSE Index Linked gilt index returned -2.7%. The Fund's UK commercial property benchmark index rose +3.3%.

3.3 The overall Fund's return of -2.6% over the quarter was behind the benchmark return by -0.3%. Over the 3 year period the Fund benefited from equity market strength, NIM's outperformance in global equities, SIM's outperformance in UK equities and Baillie Gifford's outperformance of its Diversified Growth Fund cash benchmark. It rose +11.4% per annum compared with the benchmark return of +9.6% per annum, an excess return of +1.8% per annum. Long term return data shows Fund appreciation of +10.6% 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 second quarter of 2015, the returns of the Fund's three active equity managers ranged from -1.7% to -6.6%. AAM and SIM underperformed their respective benchmarks, while NIM outperformed. The Fund's passive equity manager, L&G, produced a return of -3.9%, in line with its benchmark return, and so consistent with its mandate.

Aberdeen proposed temporary fee adjustment for the period of 12 months between 1 October 2015 – 30 September 2016 from current fee of 0.55% on the first £100m and 0.50% thereafter to flat fee of 0.4% per annum. Temporary fee adjustment was accepted in August 2015.

The return from BG's bond mandate was -3.9%, behind its benchmark by -0.3%. BG's other mandate, the Diversified Growth portfolio, fell -0.6%, behind its benchmark by -0.8%.

The property portfolio managed by SIM rose +2.8%, but lagged its benchmark by -0.3%.

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 5 years and since inception have beaten the benchmark, but they have not achieved the objective.

The AAM mandate's objective is +3% per annum outperformance over 3 year rolling periods. Performance is lagging the benchmark and the objective by a wide margin over 3 years and since inception.

The performance of BG's bond mandate is essentially in line with its benchmark since inception in 2007, but the 3 and 5 year performance have been strong. The excess return over the benchmark of +0.9% per annum is in line with 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 broadly in line with its benchmark, but has fallen short of the objective by 0.9% per annum. It should be noted that there has been a significant staffing change on this mandate and this can be explored when Schroders present later in the meeting.

4. CONCLUSION

4.1 The second quarter experienced several developments. Europe was dominated by Greek government threat to default on its debt and exit Eurozone. Chinese market was highly volatile. However general outlook for the world economy remained positive. UK market performed well, as uncertainty over General Election results was removed. Increased likelihood of rise in US interest rates may strengthen US dollar further, but with particular consequences for emerging markets.

4.2 The Fund achieved a return of -2.6% during the quarter, -0.3% behind the benchmark. Aberdeen and Schroders underperformed their respective benchmarks, while Newton outperformed. Both Baillie Gifford mandates – Bonds and Diversified Growth fell short of achieving quarterly benchmarks. Schroders Property performance improved, but still fell behind its benchmark.

5. RECOMMENDATIONS

5.1 The Committee and Board are asked to note:-

(i) the Managers' performance for the period ending 30 June, 2015; and

(ii) the actions taken by Managers during the quarter to 30 June, 2015 in accordance with their investment policies.

pp **Director of Corporate & Housing Services**
Date : 11 September 2015
Contact Officer: Bryan Smail, Bruce Miller

LIST OF BACKGROUND PAPERS

1. The Northern Trust Company – Fund Analytics 30 June 2015

Any person wishing to inspect the background papers listed above should telephone 0131 469 3866 and ask for Bruce Miller

APPENDIX 1 – PERFORMANCE MEASUREMENT (RATES OF RETURN)

Rates of Return by Manager with Excess Returns - 30 June 2015							
			Returns				
Manager	**Market Value £**	**Weight**	**3 months**	**3 year**	**5 year**	**Since inception**	**Inception Date**
Aberdeen Portfolio	218,919,995	12.6%	-6.6%	**7.9%**	9.3%	**7.6%**	May-10
Benchmark			-5.1%	**13.5%**	11.4%	**9.0%**	
Excess Versus Benchmark			-1.5%	**-5.7%**	-2.1%	**-1.4%**	
Excess Versus Objective			-	**-8.7%**	-5.1%	**-4.4%**	
Baillie Gifford Bond Portfolio	149,310,353	8.6%	-3.9%	**6.5%**	8.2%	**6.5%**	Mar-07
Benchmark			-3.6%	**5.7%**	7.1%	**6.7%**	
Excess Versus Benchmark			-0.3%	**0.9%**	1.2%	**-0.2%**	
Excess Versus Objective			**-**	**0.0%**	0.3%	**-1.1%**	
Baillie Gifford Diversified Growth	204,727,436	11.8%	-0.6%	6.9%	**-**	**6.7%**	Feb-12
Benchmark			0.1%	0.5%	**-**	**0.5%**	
Excess Versus Benchmark			-0.8%	6.4%	**-**	**6.2%**	
Excess Versus Objective			**-**	**-**	**-**	**2.7%**	
Legal & General	362,996,452	20.9%	-3.9%	13.2%	11.5%	13.4%	Jan-09
Benchmark			-3.8%	13.1%	11.4%	13.3%	
Excess Versus Benchmark			0.0%	0.1%	0.1%	0.1%	
Excess Versus Objective			**0.0%**	**0.1%**	**0.1%**	**0.1%**	
Newton	265,800,441	15.3%	-3.5%	14.7%	**12.8%**	**9.1%**	Jun-06
Benchmark			-5.0%	13.6%	**11.4%**	**7.8%**	
Excess Versus Benchmark			1.6%	1.1%	**1.4%**	**1.3%**	
Excess Versus Objective			-	-	**-1.6%**	**-1.7%**	
Schroders UK Equity	236,935,637	13.6%	-1.7%	**17.1%**	13.8%	**9.2%**	Sep-01
Benchmark			-1.6%	**11.0%**	10.7%	**6.8%**	
Excess Versus Benchmark			-0.2%	**6.1%**	3.0%	**2.4%**	
Excess Versus Objective			-	**4.9%**	1.8%	**1.1%**	
Schroders Property	133,037,136	7.7%	2.8%	**9.9%**	7.6%	**3.3%**	Nov-05
Benchmark			3.3%	**10.6%**	8.5%	**3.4%**	
Excess Versus Benchmark			-0.5%	**-0.7%**	-0.9%	**-0.1%**	
Excess Versus Objective			-	**-1.4%**	-1.7%	**-0.9%**	
Total Fund	1,736,640,140	100.0%	-2.6%	11.4%	10.6%	7.3%	Sep-01
Benchmark			-2.3%	9.6%	9.0%	6.9%	
Excess Return			**-0.3%**	**1.8%**	**1.5%**	**0.4%**	

*** Note that objectives vary and are set over 3 or 5 year periods highlighted in bold for each manager.**

There are small rounding effects in the table above.

APPENDIX 2 - INVESTMENT MANAGER COMMENTS

Aberdeen Global Equity

(12.6% of Total Fund)

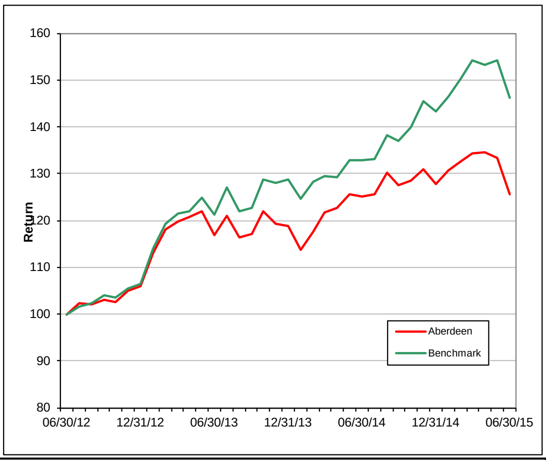
Investment Approach:

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)

3 Year Performance to 30 June 2015



Q2 2015	:	-1.5% excess return
3 Years	:	-5.7% excess return
Since inception	:	-1.4% p.a. excess return

Summary

Very poor 3 year performance is worsening and significant outflows continue. Since inception performance is below benchmark and objective.

Portfolio

A concentrated portfolio of 50 stocks should be able to achieve its objectives - it is largely unconstrained. 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 has risen to 3.9%.

Sector and country positioning remains defensive. N. America represents 55% of the benchmark, but the portfolio is u/w by 19%. The fund is o/w the UK (+8%), Europe ex-UK (+4%, with Switzerland +8%), and LatAm (+4%). By sector, the portfolio remains o/w consumer staples (+9%), and has high relative exposure to cyclical sectors such as materials (+4%), energy (+3%) and industrials (+3%) (in contrast to 2 years ago), although exposure to consumer discretionary remains very low (-10%). The underrepresentation of financials has grown (-7%). The portfolio continues to perform poorly and its defensive tilt failed to protect it in the recent quarter when equity markets fell. Aberdeen's views remain ever cautious, especially on US market valuations although the US weight is now the highest in several years. One new buy: German detergents/adhesives manufacturer Henkel.

In Q2, the portfolio lagged the index return by a meaningful 1.5%, due to poor stock selection in most regions and despite a positive benefit from regional allocation. By sector, the underperformance was attributable to poor stock selection in industrials (Canadian National Railway, Atlas Copco), technology (Ericcson, Samsung Electronics, Oracle) and energy (EOG Resources, Royal Dutch Shell), partially offset by positive selection in staples (Japan Tobacco, Philip Morris). There was also a small drag from the underweight position in financials but otherwise sector allocation was largely neutral. Cash was a small positive given the weak markets in the quarter.

Aberdeen continue to follow their process investing in good quality companies with lower than average levels of debt and relatively stable earnings/cash flows. However, poor (and deteriorating) 3 year performance means there is a heightened risk of flows turning decisively negative, not least because consultants may well revisit Aberdeen's position on their 'buy' lists. We estimate that Aberdeen's Global strategies have already "lost" 30% of their performance-adjusted AuM over the last 2 years and arguably outflows are now driving (or at least exacerbating) the underperformance. Long term investors have remained loyal so far. Aberdeen have reduced the fee at Falkirk's request.

Key considerations/developments

Ownership has not changed; the **client base** looks stable due to segregated fund client inertia yet AuM has declined ~30% over last 2 years as pooled fund assets steadily withdrawn (£1.8bn lost in Q2); the **investment process** has not changed/is standardised across equity products although relies on country/regional team picks for opportunity set. Recent promotion of Devan Kaloo as Head of Equities likely to mean renewed focus on ESG at earlier stage of process. Cross-fertilisation of ideas and team-led approach key selling points. Stable, well-resourced and experienced **investment team** (6 most senior team members average >20 years in industry and >13 years at Aberdeen), backed up by extensive and experienced regional teams.

Baillie Gifford Bonds

3 Year Performance to 30 June 2015

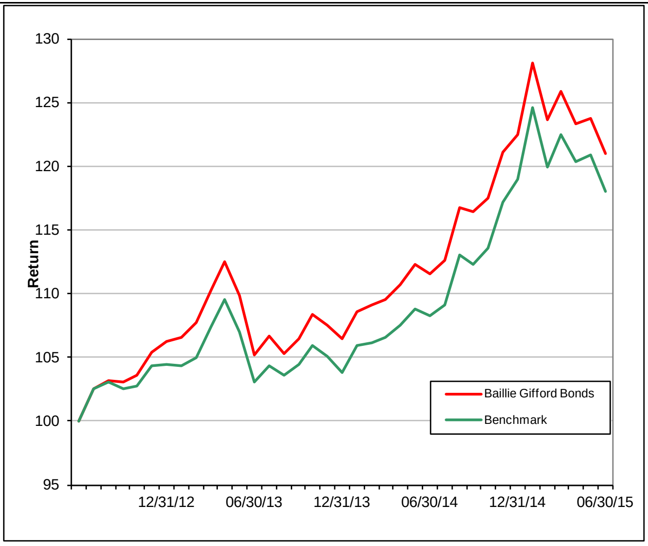
(8.6% of Total Fund)

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).



Summary

With a further weak quarter, the 3 year performance is now in line with the objective before fees, but the 5 year performance remains above the target

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.

Q2 was a complete reversal of Q1. Concern over the possibility of a Greek exit from the Euro replaced the optimism over low oils prices and inflation. Index Linked Gilts returned -3.3% (Q1:+3.3%), Conventional Gilts -3.4% (Q1:+2.2%) and Corporate Bonds -3.9% (Q1:+3.3%) as the narrowing of spreads in Q1 was almost completely unwound.

The 3 year relative performance dropped from 1.2%p.a. to 0.9% p.a. over the quarter as a quarter of good performance dropped out of the numbers. So, the portfolio is above benchmark and in line with objective before fees over the latest 3 year period. The main negative relative contribution was from Asset Allocation where the 5% underweight position in government bonds hurt as credit spreads increased.

Although the overweight USD and MXN position contributed negatively for the quarter, the currency positions as a whole were a small positive with some of the short positions, such as NZD, performing better. The portfolio's largest positions are now 5.7% long US Dollar and 2.7% long Mexican Peso offset by a 3.5% short position in the Euro.

Stock selection was marginally positive over the quarter but contributed over +0.4% for the year. As noted last quarter, the manager no longer holds any positions in Emerging Market Credit. They consider that Q4 2014 demonstrated that the sound fundamental positions could be "swamped" by wider country and geo-political considerations.

Nevertheless, they have taken a new position in Columbian Index Linked Bonds where they are actively seeking to take the Country risk, although the Brazilian and Columbian index-linked positions together only total 0.8% of the fund.

The tracking error dropped marginally from 0.88% to 0.85%, with Stock Selection accounting for 62% (Q1:58%) of the risk relative to the benchmark. Currency has remained at 20% of the portfolio risk.

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 decreased from £684m to £668m over the quarter as the drop in bond prices outweighed a £10m inflow resulting from an existing client re-balancing their fund.

Baillie Gifford Diversified Growth

(11.8% of Total Fund)

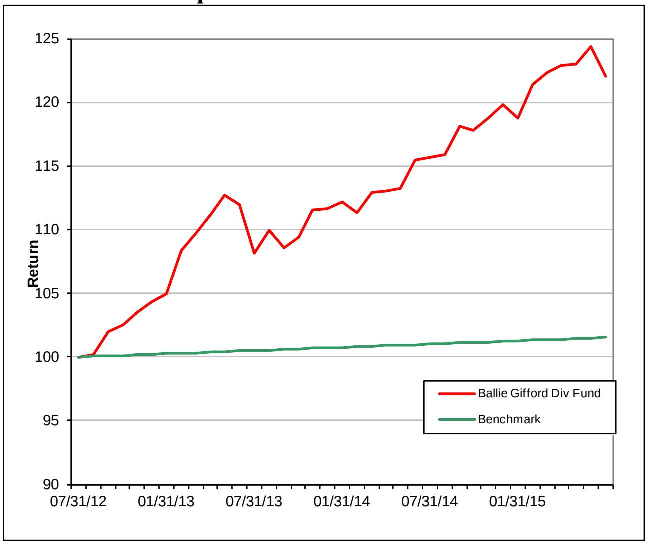
Investment Approach:

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 30 June 2015



Q2 2015	: -0.8% gross relative to base rate
3 Year	: +6.4% gross relative to 0.5% base rate
Since inception	: +6.2% gross relative to 0.5% base rate

Summary

Co-head of team resigned Jan 2015. As ex Head of Risk at BG, this is a concern as the target return from here may be too high and estimated risk may be too low - notably “Active Currency” at minus “-0.1% of predicted volatility”.

Portfolio

“Active Currency” risk is now stated at “0.5% of assets” and “-0.1% of predicted volatility” – still very low given that it was the biggest positive contributor to return in Q2 (and the biggest contributor in Q4 and Q3 and the second biggest in Q1). The net long and short FX positions are both around 40% of the fund, so total FX exposure is around 80% of the fund – again by far the largest asset exposure. Q2 trading was £130m equity, £12m bonds and £14,682m FX forwards. The stated risk underestimates possible FX losses/gains.

Insurance Linked bonds are 4.5% of the fund but are quoted at “0.3%” of the risk. This also seems an extraordinarily low figure for what is essentially writing “catastrophe” insurance. The manager claims not to have major exposure to any one catastrophe risk.

The stated predicted volatility is now 6.2% with 57% of this from (listed and private) equities, which are 23% of fund. Targeted maximum volatility is 10%. (Global equities are 16.9%).

Key considerations/developments

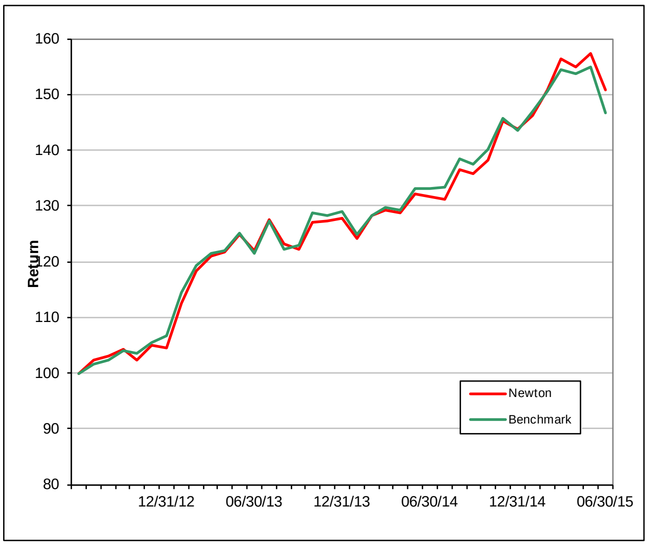
Mike Brooks – ex co-head of team – resigned 21st January and left the firm in March. Felix Amoako has been named as a (replacement) fund manager. But he has been an analyst on Diversified Growth since 2013 after joining BG as a graduate in 2011. They plan to recruit a new external analyst in September.

After 0.7% charges, none of the manager’s 10-year expected returns on any asset class now meet the net fund performance target of cash plus 3.5% net.

Baillie Gifford announced “closure” in the strategy in Q4 2012 at £2.8bn, reflecting £5bn “capacity” and “closure to all new clients” in June 2013. Yet even now they “will continue to accept routine cashflows from clients”. In Q2 they had another £16m more net inflows. Assets were £5.94bn - £1,006m net inflows since this “closure”. Capacity management is under scrutiny given the size of the firm. Interestingly, the “Multi-Asset Team” is to launch a similar fund this September “to enable more capacity”, with “the same process run by the same people” (excluding c5% in Insurance-Linked Securities) with “£5-10bn capacity”.

Newton Global Thematic Equity
(15.3% of Total Fund)

3 Year Performance to 30 June 2015



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)

Q2 2015	: +1.6% excess return
5 Years	: +1.4% p.a. excess return
Since inception	: +1.3% p.a. excess return

Summary

Another strong quarter. Portfolio ahead of benchmark since inception, but still short of objective, especially net of fees. It is creditable that the portfolio has beaten the index return over the 5 year bull market as it has been constructed to take advantage of weak markets.

Portfolio

The portfolio is concentrated in just 41 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 9.8% 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.

Little change to geographic or sector positioning. The portfolio remains overweight Europe/UK (+8%) equities and cash (+10%), and underweight all other regions. It continues to have high exposure to companies in the consumer services sector (+9%), while financials (-11%) and oil & gas (-5%) companies are still significantly under-represented. The portfolio's high cash position should continue to protect it if equity markets fall, but there is less of a defensive tilt due to the underrepresentation of cyclical stocks in the portfolio than previously.

The portfolio beat its benchmark again in Q2, mainly due to positive stock selection in the US and UK. The key positive contributors included stock selection in Consumer Services (Yum Brands, Discovery Communications), Utilities (Centrica) and Consumer Goods (Japan Tobacco). Stock selection within industrials (CH Robinson, Trimble Navigation) and healthcare (Medtronic, Teva) detracted from relative performance. During the quarter, there were no new additions to the portfolio, although allocations to stocks such as CH Robinson and TripAdvisor were increased. The stock count continues to fall (now 41) with the outright sales of AGCO, Renaissance Re and Vallourec. The cash/bonds position added mildly to relative performance.

Key considerations/developments

Newton remains one of Bank of New York Mellon's asset management subsidiaries based in London; the investment process is unchanged since a review in 2011/12 when personnel changes were made; the client base is stable (no flows in or out).

Schroders UK Equity
(13.6% of Total Fund)

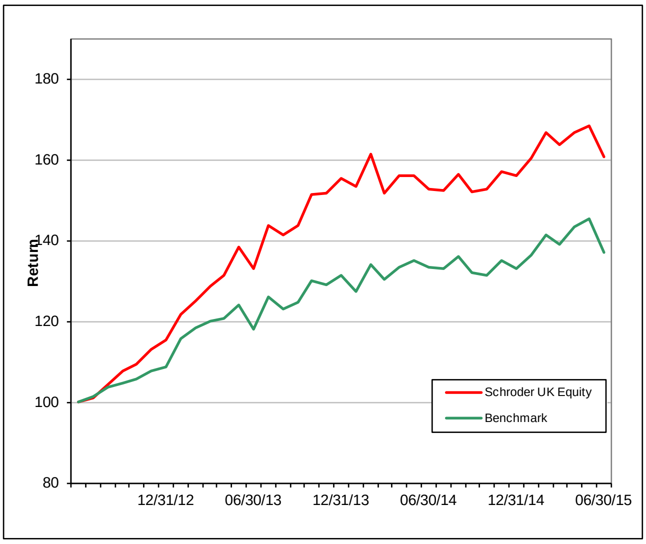
Investment Approach:

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 30 September 2001)

3 Year Performance to 30 June 2015



Q2 2015	: -0.2% excess return
3 Year	: +6.1% p.a. excess return
Since inception	: +2.4% p.a. excess return

Summary

Slightly below index performance in Q2, but the manager is comfortably ahead of the objective over 3 years. Clearly articulated strategy with stable ownership, client base and investment team.

Portfolio

The portfolio of 36 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 food & drug retailers and life insurance sectors. Tobacco & beverages are the largest underweight sectors and are both zero weighted.

Rentokil Initial and Debenhams were the biggest positive contributors to relative returns in the quarter while positions in Aviva, BAE Systems and GlaxoSmithKline were the biggest detractors, alongside the underweight exposure to BG Group.

Nick highlighted that the impact of QE has created "complacency in some areas". He suggested bond proxies, or low volatility equities with strong balance sheets have become expensive. Examples of this are beverage and tobacco names, hence the zero weighting. Companies newly entering their valuation screens are "almost entirely" within the mining space. Having added to Anglo American in the quarter they have yet to invest in other names within the sector but noted that there are prices at which that might change. As prices fall, they are likely to add.

The number of holdings has fallen to 36. This downward trend has been fairly consistent as the team continue to take profits in names that have done very well for them over the last few years. Cash remains elevated at 6.8% (including accruals) as the team continue to be in a position where they are happy to take profits in existing names but struggle with the risk and reward balance of new opportunities.

In terms of activity, the team reduced their holding in BAE Systems and added to holdings in Anglo American, Drax and Home Retail Group. The combination of Aviva and Friends Life has resulted in Aviva being a modest outlier in terms of position size (6.1%). The team are in the process of reviewing this currently.

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 investment process has not changed. UK Value product, in which Falkirk is invested, runs approximately £5.8bn in assets split roughly 1/3rd institutional and 2/3rd retail. Stable investment team, demonstrates conviction in its investment approach. The team continue to be cautious on the UK market given elevated market levels.

Schroders Property Multi-Manager

(7.7% of Total Fund)

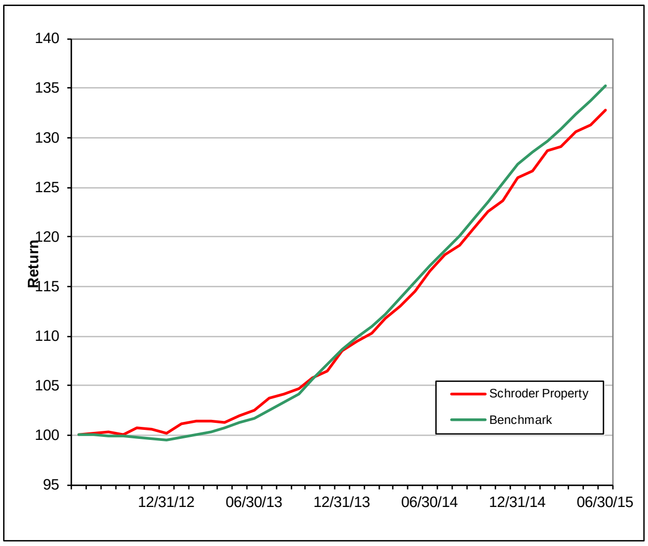
Investment Approach:

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 30 November 2005)

3 Year Performance to 30 June 2015



Q2 2015	: -0.5% excess return
3 Year	: -0.7% p.a. excess return
Since inception	: -0.1% p.a. excess return

Summary

Portfolio manager resigned, so resources under pressure; latest 3 year performance remains weak relative (-0.7% pa), but strong absolute (+10% pa). Portfolio has been restructured and is now positioned for the future.

Portfolio

The portfolio is comprised of a diverse group of 15 funds investing in property assets largely in the UK (97%). UK performance has outperformed the benchmark in each long/short period, but the Cont. European exposure remains a drag on performance. The portfolio is valued at £133m.

The manager has re-positioned away from London offices by continuously selling WELPUT[1] and has made commitments for investing in industrial property and a small lot size multi-sector partnership fund (Metro PUT via a new partnership managed by Hermes). The partnership fund is only available to Schroders' clients.

Continental Europe now amounts to 3% of the portfolio. It produced a positive return in € due to asset disposals for the second consecutive quarter after adjusting for distribution, but the positive return was offset by EUR/GBP depreciation. (Recap in '06-07, 10% of the portfolio was committed to Europe.) The poor three year relative performance has been dominated by this exposure, which is not in the benchmark. Schroders is expecting the recovery in Europe will continue and plans to hold the exposures till maturity (2018).

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.

Given a constructive outlook, the manager targets to hold minimal amounts of cash after the above commitments have been drawn. Schroders' real estate return forecast is 15% for 2015, but 6-8% per annum for 2014-2019.

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** is changing meaningfully: post end of quarter, the portfolio manager departed.

[1] West End of London Property Unit Trust

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.