AGENDA ITEM 11

FALKIRK COUNCIL

Subject: FUND MANAGER PERFORMANCE REVIEW
Meeting: PENSIONS COMMITTEE
Date: 25 SEPTEMBER 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 The bull trend in global equity markets continued in the second quarter of 2014, supported by easy monetary policies, positive economic developments and a shortage of compelling investment alternatives given the low yields available in bond markets. The disruptive geopolitical situation, including conflicts in the Middle East, Ukraine and parts of Africa, did not have a durable impact on asset prices.

2.2 US bond and equity markets were underpinned by supportive monetary policy and signs of a recovery in US corporate confidence. There is strong evidence that businesses are shifting from limited shelf-life strategies, such as cost cutting and debt reduction, to ones that involve investing for growth. Although the Fed continues to taper asset purchases, the absence of broad inflationary pressures in the US economy means that bond markets are anticipating an orderly increase in yields in the summer of next year. US economic growth also surprised to the upside after a shocking 2.9% drop in the first quarter, the worst number in five years. In Q2 GDP expanded by 4% versus the consensus expectation of 3%. These trends also caused the US dollar to strengthen against most currencies.

2.3 Globally, the biggest positive economic surprise has been in the UK where GDP growth exceeded expectations to the extent that sterling strengthened, mortgage availability was restricted and investors became increasingly concerned that an increase in interest rates was just around the corner. Some commentators note that growth is unbalanced, and the UK economy is displaying some of the disturbing characteristics last experienced in the late 1980s.

2.4 The much heralded European economic recovery has failed to fully materialise, and fears of more stagnation and disinflation (or even Japanese-style deflation and depression) prompted the ECB to ease monetary policy further. Nevertheless, monetary policy still remains too restrictive for the Continent as a whole, implying that growth and inflation will probably remain weak and the debt overhang excessive.

2.5 And in Japan itself the situation is also rather lacklustre, in part due to the April increase in the consumption tax from 5% to 8%. Abe's growth and restructuring programme has so far under-delivered when judged by tangible results. However, pro-inflationary government policies, gathering reform momentum and resilient business and consumer confidence suggest that second half growth should be relatively robust.

2.6 Growth in the larger emerging economies also continues to be weak, generally due to high inflation rates and restrictive monetary policies. Russian economic problems are exacerbated by an adventurous foreign policy, and China continues to grapple with structural issues and the gradual deflation of its property bubble. However, the overall picture is becoming less bleak, and some emerging countries were actually able to ease monetary policy in Q2, most notably Mexico, Turkey, Thailand and Hungary. There are also rare pockets of outright enthusiasm, for example in the Indian stock market following the election of Modhi based on a programme of reform and restructuring.

2.7 Many equity investors are becoming more cautious, and their concerns are justified. The developed world equity bull market is maturing and valuations are becoming extended: in the US they have reached their most stretched level since the bubble years at the turn of the century. More unsettling, and perhaps the biggest surprise so far in 2014, is the failure of bond yields to rise. This might be signalling problems in the pipeline, maybe in the normalisation of monetary policy in 2015.

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 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 and emerging market equity indices returned +2.6% and +4.0% respectively over the second quarter of 2014. Index-linked gilts managed a +1.0% return while conventional gilts were flat at shorter maturities, but +2.3% at longer (>15 year) maturities. UK commercial property led the pack (+4.3%).

3.3 The overall Fund's return of +2.3% <u>over the quarter</u> was ahead of the benchmark return of 2.1%. <u>Over the 3 year period</u> the Fund benefited from equity market strength and SIM's outperformance in UK equities, rising +8.9% per annum compared with the benchmark return of +7.0% per annum, an excess return of +1.9% per annum. <u>Long term return data</u> shows Fund appreciation of +12.8% per annum over 5 years and +7.2% per annum since September 2001. These long term returns are above the benchmark returns.

3.4 <u>Over the second quarter of 2014</u>, the Fund's three active equity managers all posted positive returns from +0.6% to +2.8%. Only AAM beat its benchmark of global equities while NIM and SIM lagged their equity benchmarks. The Fund's passive equity manager, L&G, produced a return of +2.5%, in line with its benchmark return, and so consistent with its mandate.

The return from BG's bond mandate was +1.9%, ahead of its benchmark by 0.2%. BG's other mandate, the Diversified Growth portfolio, rose 2.4%, ahead of its benchmark by 2.3%.

The property portfolio managed by SIM lagged its benchmark by 0.1%, but rose 4.2% in absolute terms.

3.5 <u>Longer term return data</u> 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 and 5 years and since inception have narrowly beaten the benchmark, 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 lagging the benchmark and objective over 3 years. After an excellent start to the mandate, returns are still 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 Global equity indices posted solid gains in the quarter aided by some broadly encouraging economic data, continued loosening of monetary policy from the European Central Bank, and in the face of significant geopolitical tensions. In the UK, with the improving labour market and signs of improvements in earnings, the Bank of England's Monetary Policy Committee will be focusing on interest rate rises towards the end of 2014.

4.2 All managers managed to deliver positive returns during the quarter, although only Aberdeen and Baillie Gifford (in both their Bond and Diversified Growth mandates), managed to achieve the benchmark return. The best performing asset class of the quarter was property with a return of 4.3%. The Schroders property mandate, despite the challenges of its Continental European exposure, almost matched the benchmark with a return of 4.2%.

5. RECOMMENDATIONS

5.1 The Committee is asked to note:-

(i) the Managers' performance for the period ending 30 June 2014; and

(ii) the action taken by Managers during the quarter to 30 June 2014 in accordance with their investment policies.

Chief Finance Officer

Date: 25 August 2014

Contact Officer: Alastair McGirr

LIST OF BACKGROUND PAPERS

1. The Northern Trust Company – Fund Analytics 30 June 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 - 30 June 2014

Manager	Market Value £	Weight	Returns 3 months	3 year	5 year	Since inception	Inception Date
Aberdeen Portfolio	218,012,365	13.7%	2.8%	8.2%	-	9.4%	May-10
Benchmark			2.6%	8.6%	-	8.8%	
Excess Versus Benchmark			**0.2%**	**-0.4%**	**-**	**0.6%**	
Excess Versus Objective			**-**	-3.4%	**-**	-2.4%	
Baillie Gifford Bond Portfolio	137,768,897	8.7%	1.9%	8.3%	9.8%	6.2%	Mar-07
Benchmark			1.6%	6.9%	7.5%	6.4%	
Excess Versus Benchmark			**0.2%**	**1.4%**	**2.4%**	**-0.2%**	
Excess Versus Objective				**0.5%**	**1.5%**	**-1.1%**	
Baillie Gifford Diversified Growth	194,014,068	12.2%	2.4%	-	-	7.2%	Feb-12
Benchmark			0.1%	-	-	0.5%	
Excess Versus Benchmark			**2.3%**	**-**	**-**	**6.7%**	
Excess Versus Objective *			**-**	**-**	**-**	3.2%	
Legal & General	336,292,146	21.2%	2.5%	9.0%	14.4%	14.5%	Jan-09
Benchmark			2.5%	9.0%	14.3%	14.3%	
Excess Versus Benchmark			**0.0%**	**0.1%**	**0.1%**	**0.1%**	
Excess Versus Objective			**-**	**0.1%**	**0.1%**	**0.1%**	
Newton	231,967,919	14.6%	2.0%	9.0%	14.3%	8.5%	Jun-06
Benchmark			2.7%	8.5%	14.0%	7.5%	
Excess Versus Benchmark			**-0.7%**	**0.5%**	**0.3%**	**0.9%**	
Excess Versus Objective			**-**	**-**	**-2.7%**	**-2.1%**	
Schroders UK Equity	225,286,536	14.2%	0.6%	14.7%	16.9%	9.5%	Sep-01
Benchmark			2.2%	8.9%	14.5%	7.2%	
Excess Versus Benchmark			**-1.6%**	**5.7%**	**2.4%**	**2.4%**	
Excess Versus Objective			**-**	**4.5%**	**1.2%**	**1.1%**	
Schroders Property	116,788,669	7.3%	4.2%	5.7%	7.6%	2.2%	Nov-05
Benchmark			4.3%	6.6%	9.2%	2.1%	
Excess Versus Benchmark			**-0.1%**	**-1.0%**	**-1.6%**	**0.0%**	
Excess Versus Objective			**-**	**-1.7%**	**-2.4%**	**-0.7%**	
Total Fund	1,589,283,871	100.0%	2.3%	8.9%	12.8%	7.2%	Sep-01
Benchmark			2.1%	7.0%	11.5%	6.9%	
Excess Return			**0.2%**	**1.9%**	**1.3%**	**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)

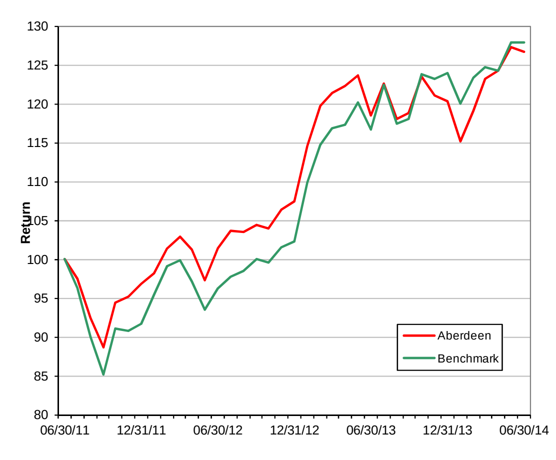
Investment Approach:

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)

3 Year Performance to 30 June 2014



Q2 2014	: +0.2% excess return
3 Years	: -0.4% excess return
Since inception	: +0.6% p.a. excess return

Summary

Mild outperformance this quarter after a good Q1 but terrible 2013. Long term performance is positive, but below target.

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 3.9% as 3 stocks were sold in Q2 and just 1 purchased.

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 (+8%), Europe ex-UK (+5%), and LatAm (+6%). By sector, the portfolio remains heavily o/w defensive sectors, such as consumer staples (+6%), energy (+8%) and materials (+3.5%), and has low exposure to cyclical earnings, such as consumer discretionary shares (-10%), I.T. (-3%) 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 ahead of benchmark due mainly to the overweight allocation and stock picking within the Energy sector. Schlumberger, EOG Resources, Petrobras, Petrochina and Royal Dutch Shell all rose by >10%. Outside of Energy, the u/wts in Consumer Discretionary and Financials also helped. Stock picking was strong in Industrials, but there was weakness from I.T., Healthcare, Telecoms and Staples. QBE Insurance, Vodafone and Ericsson were amongst the biggest fallers, although not holding Apple was the biggest detractor from performance as it returned almost 20% in Q2.

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. Portfolio initiated a position in global payments company Visa and sold its positions in Verizon, QBE Insurance and Quest Diagnostics outright. 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. Integration is proceeding apace – active SWIP portfolios have already been restructured to the Aberdeen shape; perhaps the biggest concern is the **client base**, where instability of flows could be disruptive given the large stakes that Aberdeen holds in some companies – flows were negative in the quarter (-£1554m in Q2 (7%), but 2 net clients won); 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. Andy Brown (senior inv mgr) has transferred from the GEM team on 1 August.

Baillie Gifford Bonds

(8.7% of Total Fund)

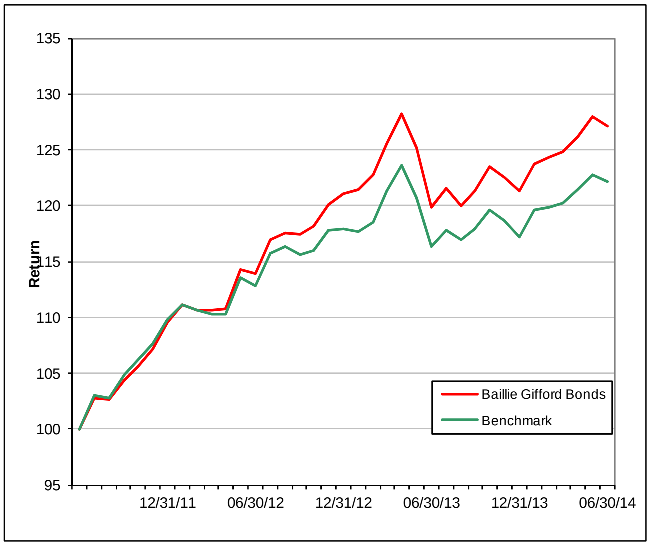
Investment Approach:

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 30 June 2014



Q2 2014	: + 0.2% excess return
3 Year	: + 1.4% p.a. excess return
Since inception	: - 0.2% p.a. excess return

Summary

3 year performance is 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.

Bonds, particularly corporate bonds, had another good quarter as the search for some yield at virtually any price continued. Corporate Bonds returned 2.1% and both conventional and Index Linked Gilts returned 1.1% over the quarter.

The Portfolio had a quarter of modest positive relative performance, returning 1.9% against a benchmark return of 1.6%. Over the quarter asset allocation, and to a lesser extent currency contributed positively to the relative return. However, over a one year period, stock selection remains the dominant factor in the positive relative return generating nearly +1.4% contribution over the year where their positioning in securitized, insurance companies', and lower credit rated bonds have all proved positive.

Looking forward, they have further reduced their weighting in lower credit rated instruments, and are concerned that there is sufficient return relative to the additional risk. They are still looking to add value by stock selection in EM and corporate bonds as well as through the active currency positions, although currency has given a neutral return over the year. They have maintained their biggest currency position relative to the benchmark which is +2.5% overweight USD, as well as some favoured EM Countries such as Mexico. They also continue to be 1% underweight GBP.

There has previously been some discussion around the potential to unwind the change to the Portfolio's benchmark and revert back to the previous one of 20/40/40, thereby reducing the proportion of Investment Grade Credit in the portfolio in favour of UK Government securities. The change has had a beneficial performance effect since it was made, with the spread of corporate bond yield over the equivalent sovereign bond yield reducing significantly. Given the very good run that IG and HY credit have had, supported by BG's views on the market outlook, this may be the time to seriously consider reducing the IG weighting in the benchmark going forward.

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 from £581m to £613m over the quarter. However, this didn't represent new business to BG, rather a client transferring from separate Gilts and IG Funds. There were no changes to the investment staff in the quarter.

Baillie Gifford Diversified Growth
(12.2% of Total Fund)

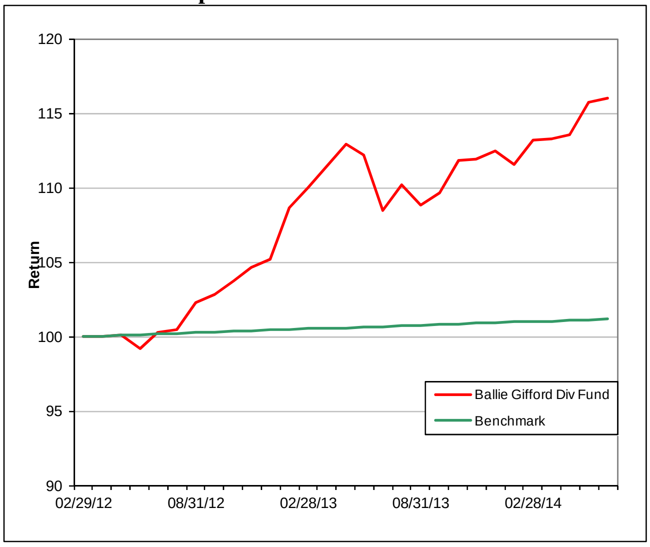
Investment Approach:

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 30 June 2014



Q2 2014	: +2.3% relative to base rate
1 Year	: +6.5% relative to base rate
Since inception	: +6.7% 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 7.2% pa net return with 5.6% delivered volatility.

Portfolio

While net performance beats the modest 4% pa target since inception, it has been falling; over the last 5 years it was 10.6% pa, but over the last 3 years it was 5.2% pa. They say that "we believe that prospective returns are likely to be lower than they have been in the past. Indeed, we are increasingly concerned that volatility, a good measure of the extent to which markets are worried about risks, has recently reached a record low". Indeed, for Q2 they produced a "Special paper – why we hold cash".

Including the 5.8% in cash, and a new 3% investment in "Allianz Merger Arbitrage Strategy" fund (returning 2%), nearly half of the fund (and most of the new investment) is now in assets which are expected to fail to meet the 4% pa return target.

Around 1/3rd of this fund is invested in other managers' funds, with another 1/3rd in other Baillie Gifford funds. These funds have their own benchmarks and objectives, which may differ from that of Diversified Growth, causing contradictions and adding to risk, while the other managers' funds (notably hedge and PE) also add to total charges.

"Active Currency" is reported at "-0.2% of assets", and "5% of predicted volatility". But they report "gross long positions of 42%" in FX, which means gross long and short are 84% - suggesting net FX bets are >60% of the fund. This implies FX risk is understated.

Their "predicted volatility" is still 6.6% - with around half of this from (listed and private) equities and 5% FX. Targeted maximum volatility is 10%. (cf global equities are 16.6%).

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 Q2 to £5.56bn on £68m net inflows - making £926m net inflows since June "closure".

There have been no changes to the organisation, the investment process or the team.

The 2/3^{rds} "**fund of funds**" structure blurs objectives and adds hidden charges. The 1/3rd in Baillie Gifford funds have zero fees but still pay (0.2%) expenses, while the 1/3rd invested in other managers' funds bear full double-charging.

Newton Global Thematic Equity
(14.6% of Total Fund)

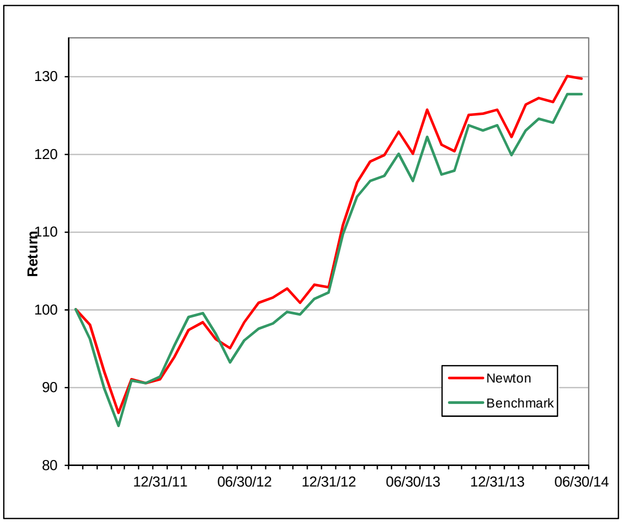
Investment Approach:

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 30 June 2014



Q2 2014	: - 0.7% excess return
5 Years	: + 0.3% p.a. excess return
Since inception	: + 0.9% 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 (45 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/UK (+12%) equities, and underweight North America (-6%), Japan (-4%), Pacific (-4.5%) 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. 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 underperformed in Q2 as strong performance in Europe was offset by weakness from holdings in/allocations to N. America, Emerging Markets and cash/bonds. There were positive contributions from consumer goods (tobacco) holdings, industrials (CH Robinson) and financials (underweight allocation), but these were more than offset by poor stock selection in healthcare (Express Scripts), technology (EMC, SAP) and consumer services, telecoms (Vodafone) and utilities.

During the quarter, three new stocks were introduced and six stocks sold outright

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
(14.2% of Total Fund)

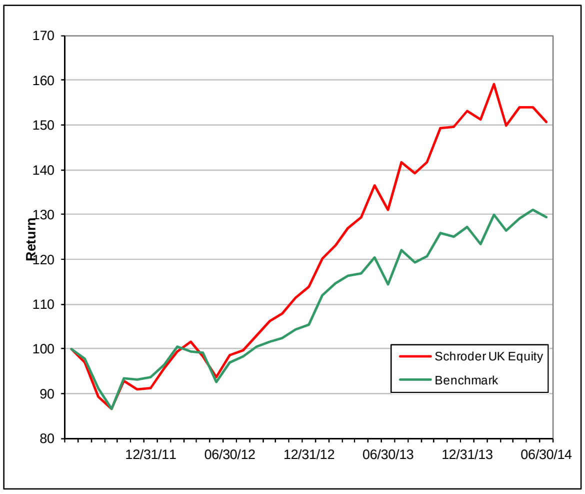
Investment Approach:

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 2014



Q2 2014	: -1.6% excess return
3 Year	: +5.7% p.a. excess return
Since inception	: +2.4% p.a. excess return

Summary

Short term underperformance (Q2 and Q1) though manager comfortably ahead of the objective on all timeframes. Clearly articulated strategy with stable ownership, client base and investment team.

Portfolio

The portfolio of 37 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, mining is the biggest underweight.

Relative returns in the second quarter were negative (-1.6%), however, the portfolio is still +1.9% over the most recent 12 months. Profit-taking was noticeable amongst names that had performed strongly over the preceding 12 months, this included Rentokil Initial, Trinity Mirror, and a number of the high street retailers. More positively, Astrazeneca shares continued to be buoyed by interest from Pfizer, while the insurance names rebounded from a difficult prior quarter where share prices were impacted by the Budget changes to the structure of the annuity market.

Once again, the team has continued to trim the winners in the portfolio where the gap between fundamental value and share price has narrowed. Interestingly, this is not something they have done with Astrazeneca, where 8% of the Fund is invested. The reason for this is the ongoing lack of attractive new ideas. They have taken advantage of weakness to add to existing holdings in Morrisons and Pearson, and initiated a new position in Centrica where market mistrust and new management allows an attractive entry point.

The team continue to caution with regards to market valuations, suggesting they are "operating conservatively and prudently to defend...capital gains". Pockets of value can be found in banks and other financials but new ideas have less upside than they did a few years ago. Suggestions that they are "clustering in big cap, blue-chip names...with a bit more of a buffer" and looking for things that "aren't expensive" rather than outright cheap further highlight their cautionary tone.

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

(7.3% of Total Fund)

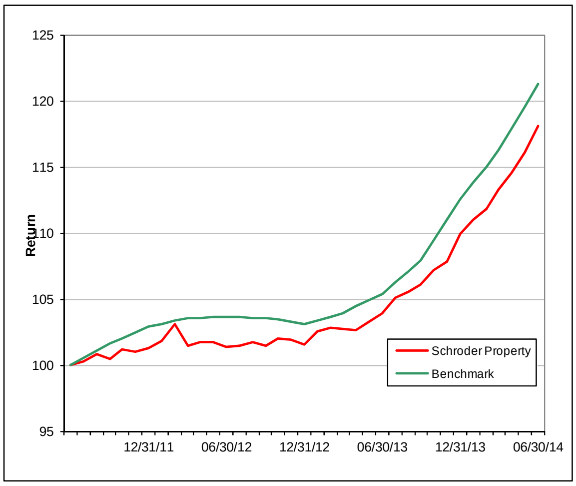
Investment Approach:

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 2014



Q2 2014	: -0.1% excess return
3 Year	: -1.0% p.a. excess return
Since inception	: +0.0% p.a. excess return

Summary

Latest 3 year performance remains weak (-1.0%pa relative). Since inception the performance is in line with the benchmark, but less than the objective. The 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. The portfolio is valued at £118m. 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. The manager plans to reallocate a small amount c3% from London offices to industrial property (in a new partnership to be managed by a specialist at Jones Lang).

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 1.1%.

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 has put 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.