AGENDA ITEM 11

FALKIRK COUNCIL

Subject: FUND MANAGER PERFORMANCE REVIEW
Meeting: JOINT MEETING OF THE PENSIONS PANEL AND COMMITTEE
Date: 12 MARCH 2015
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 attached.

2. MARKET REVIEW AND OUTLOOK

2.1 The final quarter of 2014 was very positive for owners of equity, bond and property assets while holders of US assets benefited from the continuing strength of the US dollar. In a world of very low interest rates, investors continue to search desperately for assets yielding more than cash.

2.2 Consensus economic thinking changed modestly with expectations for global growth for 2015 slightly higher (3.5% versus 3.2%) with much of this coming from China and the benefits of the lower oil price. The gradual improvement in the US economy continued and broadened, and it shows no signs of reversing in the near future. The ending of QE by the Federal Reserve was reassuringly a complete non-event. The appearance of incipient wage inflationary pressure means that the UK is perhaps the only other brightly shining star in the developed world firmament, and India occupies the same lonely position amongst emerging markets.

2.3 The rest of the world continues to struggle with anaemic economic growth, disinflation, and in many cases deflation. Worse still, certain countries, most notably Russia and Brazil, have sunk into stagflation.

2.4 However, the two big moribund economies - Eurozone and Japan - have been jolted positively by major policy initiatives. In Q1 2015, the ECB surprised investors with its own high octane version of QE, and Japan has reinforced its commitment to achieving a 2% inflation target by whatever means necessary. Both aim to reach their goals primarily through currency depreciation, an increasingly common strategy these days. Emerging markets are behind the curve in terms of proactive monetary and fiscal policies, but there are signs that an effective response will be forthcoming in some of these countries in the near future.

2.5 The level of geopolitical risk is now arguably higher than at any point since the fall of the Berlin Wall and the Cold War. Unfolding developments in Greece, the Ukraine, China and the Middle East are preying on investors' minds. They should all be manageable to the extent that it is nobody's interest that they spiral out of control. But if they do, then the world economy and risk assets could experience a setback, and the policy response might be muted by a shortage of central bank ammunition. However, the central case must be that these problems are (as usual) successfully muddled through in one way or another.

2.6 In the absence of a geopolitical shock, signs of the US expansion running out of steam could threaten asset prices and investors will have to assess the effect on financial markets of the policies of central banks and governments, which are dealing with unprecedented economic conditions and the usual unsettling election cycles.

2.7 Meantime, the agents of economic change are responding to policies in predictable ways. Negative interest rates and a lack of confidence in the robustness of economic growth support asset prices in the short term as merger & acquisition activity shrinks the supply of equity with a beneficial impact on valuations.

2.8 The distribution of global economic growth may be uneven, but a 3.5% improvement is forecast and this should be sufficient to generate solid profits growth. There are no obvious reasons for any change in valuation, suggesting that equity markets are capable of generating a mid-single digit return. And the search for yield continues to support other asset prices, including bonds and property. Long term, however, it is worth noting that government bond returns are expected to be negative in real terms.

3. ANALYSIS OF PERFORMANCE RESULTS

3.1 The total fund and individual external manager returns are shown in the table in Appendix 1. The returns for the quarter ending 31 December 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 Global equity market indices returned +4.6% in sterling terms over the fourth quarter of 2014. The FTSE All Stock Bond index performed even better rising +6.3% with index-linked gilts +9.4%. UK commercial property rose +4.6%.

3.3 The overall Fund's return of +3.1% over the quarter was ahead of the benchmark return by 0.1%. Over the 3 year period the Fund benefited from equity market strength, rising +12.4% per annum compared with the benchmark return of +10.2% per annum, an excess return of +2.1% per annum. Long term return data shows Fund appreciation of +10.2% per annum over 5 years and +7.4% per annum since September 2001. These long term returns are above the benchmark returns.

3.4 Over the fourth quarter of 2014, the returns of the Fund's three active equity managers ranged from +0.2% to +5.8%. SIM and NIM outperformed their respective benchmarks, while AAM underperformed. The Fund's passive equity manager, L&G, produced a return of +3.1%, in line with its benchmark return, and so consistent with its mandate.

The return from BG's bond mandate was +5.2%, behind its benchmark by 0.7%. BG's other mandate, the Diversified Growth portfolio, rose 0.8%, ahead of its benchmark by 0.7%.

The property portfolio managed by SIM lagged its benchmark by 0.3%, but rose 4.3% 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 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. Returns since inception in May 2010 slipped below the benchmark for the first time in the fourth quarter.

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 very strong. The excess return over the benchmark of +1.5% 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 News flow in the final quarter of 2014 included an improvement in global growth expectations (from 3.2% to 3.5%), a falling oil price and increased geopolictical tensions. Japan and the Eurozone embarked on further quantitative easing, whilst the US Federal Reserve ended its own QE programme without any significant impact. Investment markets, including equities and bonds, generally had a positive quarter.

4.2 The overall Fund return during the quarter was marginally ahead of benchmark (3.1% v 3%). The underlying story was one of solid performances from Schroder UK equities and Newton global equities, but disappointing returns from Aberdeen global equities.

4.3 Aberdeen's performance from inception in May, 2010 is now below the benchmark (8.9% v 9.6%) with the risk that the sluggish performance could lead to outflows from Aberdeen funds further depressing asset values. For that reason, they have been reduced from "green" to "amber" status in terms of monitoring their ongoing performance. Aberdeen remain of the view that their investments are in good quality profit-making companies and that the underlying value of these assets will ultimately be recognised by the market.

5. RECOMMENDATIONS

5.1 The Panel and Committee are asked to note:-

(i) the Managers' performance for the period ending 31 December, 2014; and

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

Chief Finance Officer

Date : 26 February 2015

LIST OF BACKGROUND PAPERS

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

Manager	Market Value £	Weight	Returns 3 months	3 year	5 year	Since inception	Inception Date
Aberdeen Portfolio	222,879,286	13.2%	0.2%	10.2%	-	8.9%	May-10
Benchmark			4.5%	14.6%	-	9.6%	
Excess Versus Benchmark			**-4.4%**	**-4.4%**	**-**	**-0.7%**	
Excess Versus Objective			**-**	-7.4%	**-**	-3.7%	
Baillie Gifford Bond Portfolio	151,216,433	8.9%	5.2%	8.4%	9.9%	7.1%	Mar-07
Benchmark			5.9%	6.9%	8.4%	7.3%	
Excess Versus Benchmark			**-0.7%**	**1.5%**	**1.5%**	**-0.2%**	
Excess Versus Objective				**0.6%**	**0.6%**	**-1.1%**	
Baillie Gifford Diversified Growth	199,118,612	11.8%	0.8%	-	-	6.9%	Feb-12
Benchmark			0.1%	-	-	0.5%	
Excess Versus Benchmark			**0.7%**	**-**	**-**	**6.4%**	
Excess Versus Objective *			**-**	**-**	**-**	2.9%	
Legal & General	353,008,772	20.9%	3.1%	13.8%	10.2%	14.1%	Jan-09
Benchmark			3.1%	13.7%	10.1%	14.0%	
Excess Versus Benchmark			**0.0%**	**0.1%**	**0.1%**	**0.1%**	
Excess Versus Objective			**-**	**0.1%**	**0.1%**	**0.1%**	
Newton	253,211,061	15.0%	5.8%	15.8%	11.8%	9.1%	Jun-06
Benchmark			4.5%	14.7%	10.5%	8.0%	
Excess Versus Benchmark			**1.3%**	**1.1%**	**1.3%**	**1.0%**	
Excess Versus Objective			**-**	**-**	**-1.7%**	**-2.0%**	
Schroders UK Equity	229,767,768	13.6%	2.6%	19.0%	12.1%	9.3%	Sep-01
Benchmark			0.6%	11.1%	8.7%	6.8%	
Excess Versus Benchmark			**2.0%**	**7.9%**	**3.4%**	**2.5%**	
Excess Versus Objective			**-**	**6.6%**	**2.2%**	**1.2%**	
Schroders Property	126,292,812	7.5%	4.3%	8.0%	7.5%	2.9%	Nov-05
Benchmark			4.6%	8.6%	8.9%	3.0%	
Excess Versus Benchmark			**-0.3%**	**-0.6%**	**-1.4%**	**0.0%**	
Excess Versus Objective			**-**	**-1.4%**	**-2.1%**	**-0.8%**	
Total Fund	1,692,807,063	100.0%	3.1%	12.4%	10.2%	7.4%	Sep-01
Benchmark			3.0%	10.2%	8.4%	7.0%	
Excess Return			**0.1%**	**2.1%**	**1.8%**	**0.4%**	

*** 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.**

N.B. There are some small rounding differences in the table above.

APPENDIX 2 - INVESTMENT MANAGER COMMENTS

Aberdeen Global Equity

(13.2% of Total Fund)

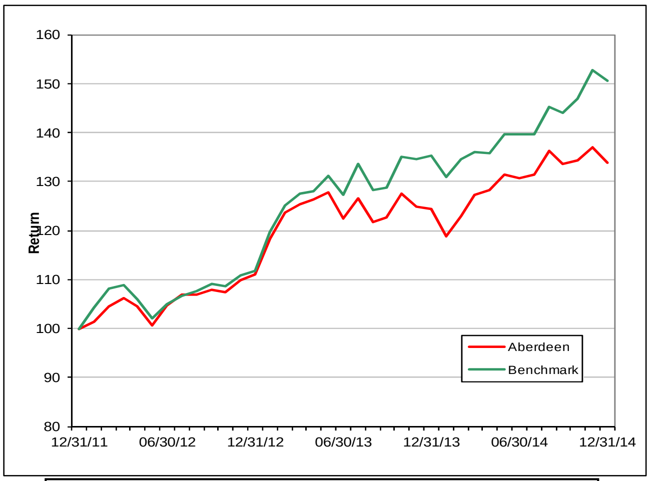
Investment Approach:

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 31 December 2014



Q4 2014	:	-4.4% excess return
3 Years	:	-4.4% excess return
Since inception	:	-0.7% p.a. excess return

Summary

A very poor 3 year performance could presage outflows from the product. Since inception performance is now behind benchmark performance too.

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 currently at 3.2%.

Sector and country positioning remains very defensive and stable, with changes incremental. N. America represents 56% of the benchmark, but the portfolio is u/w by 20%. The fund is o/w the UK (+8%), Europe ex-UK (+5%, with Switzerland +11%), and LatAm (+5%). By sector, the portfolio remains o/w consumer staples (+8%), and has high relative exposure to energy (+5%) and materials (+5%). There is low exposure to cyclical earnings, such as consumer discretionary (-10%), although industrials and I.T. weights are now more neutral. Financials are also underrepresented (-6%). 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 views remain very cautious, especially on the valuation of the US market.
More than half the underperformance was attributable to regional and sector allocation, specifically being u/w North America, o/w Europe and o/w energy and materials as well as u/w consumer discretionary stocks. Stock selection was also poor, however, driven by weakness in Europe (Asian selection was positive and N. American was flat). By sector, the weakness from stock selection was predominantly down to poor stock picks in financials (Standard Chartered), energy (Tenaris, ENI, Petrobras, Schlumberger) and healthcare (Roche). There were few bright spots, though stock selection from I.T. was positive (Oracle, TSMC, Samsung Electronics), and there were strong individual performances from CVS Healthcare, Visa and United Technologies.
Aberdeen continue to follow their process investing in good quality companies with lower than average levels of debt and relatively stable earnings and cashflows. However, poor 3 year performance numbers means that there is a heightened risk of flows turning decisively negative, not least because consultants may well revisit Aberdeen’s position on their ‘buy’ lists. Should this occur, the sheer weight of assets means that the company is unlikely to be nimble enough to avoid a downward spiral. Portfolio activity was again limited, with Jardine Matheson added as a new stock and Petrochina & Petrobras sold into deteriorating performance/fundamentals.

Key considerations/developments

Ownership has not changed, but the acquisition of SWIP is large – it adds £138bn of assets under management taking the Group’s assets to £325bn - integration is largely complete now; the client base is stable with a net of 1 client gained (flow mildly positive again this quarter) and the investment process has not changed/is standardised across equity products although relies on country/regional team picks for opportunity set. Cross-fertilisation of ideas and a team-led approach is key selling point. 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

(8.9% of Total Fund)

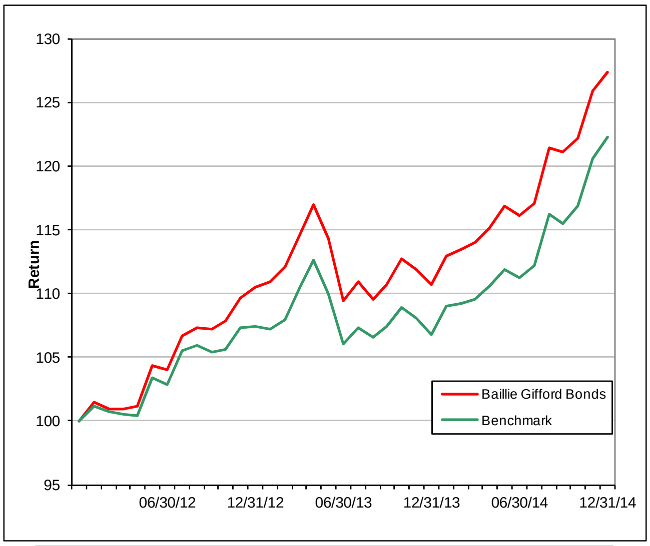
Investment Approach:

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

Investment Objective:

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

3 Year Performance to 31 December 2014



Q4 2014	: - 0.7% excess return
3 Year	: + 1.5% p.a. excess return
Since inception	: - 0.2% p.a. excess return

Summary

A very good 3 and 5 year performance ahead of objective by 0.6%pa over both periods. 3 year performance is ahead of the objective. Exposure to recent currency weakness in oil-producing nations has caused a rethink of importance of politics in Rates and Currency team process.

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, led by an exceptional 9.4% gain from Index Linked Gilts, had another good quarter. With low UK inflation and the search for yield at virtually any price continuing, Corporate Bonds returned 4.3% and conventional fixed income bonds returned 6.3%.

However, in relative terms, the portfolio had a slightly disappointing quarter, returning 5.2% compared with 6.0% for the benchmark. The main culprit was the portfolio's currency positions, which detracted 1.1%., while stock selection continued to be positive as it has been all year. Falling oil prices affected long positions in the currencies of major oil producing countries, such as Norway, Colombia and the Mexican Peso, the largest overweight. The manager believes the movement has been overdone and so retains the overweight Mexican and Colombian positions and is considering adding to the Colombian Peso. A long US Dollar position was positive in the quarter. Looking forward, the Rates and Currency Team is reassessing the weight it places on political considerations.

In bonds, an underweight position in Turkey and an overweight in Russia both contributed to the negative relative return and have both subsequently been removed.

The portfolio is broadly diversified with only 8 non-sovereign issuers accounting for more than 1% of the portfolio. The tracking error increased slightly from 0.74% to 0.79%, and although Stock selection is still the main contributor to portfolio risk (47%), currency now accounts for 32% of the risk relative to the benchmark (Q3:25%).

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 £695m to £732m over the quarter. They are losing two clients (~£58m) from the Fund in Q1 2015. They explained that one was a small client transitioning to an LDI approach, and the other simply reducing their Bond exposure in light of the exceptional recent returns rather than moving to another Bond Manager.

Baillie Gifford Diversified Growth

(11.8% of Total Fund)

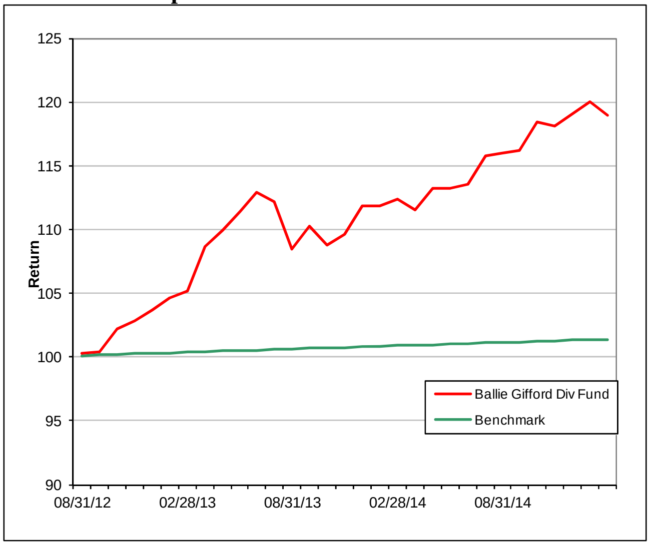
Investment Approach:

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 31 December 2014



Q4 2014	:	+0.7% relative to base rate
1 Year	:	+5.4% relative to base rate
Since inception	:	+6.4% relative to base rate

Summary

Unexpected resignation of co-head of team (former head of risk at BG). Fund is ahead of modest risk/return objective since Falkirk first invested, but return target challenging and stated currency risk and predicted volatility look too low.

Portfolio

“Active Currency” risk is now stated at “-0.9% of assets” and “-0.6% of predicted volatility” (ie minus -0.6% contribution to risk). In Q3 it was stated at “0.4% of assets” and “0.1% of predicted volatility”. In Q2 it was stated at “-0.2% of assets” and “5% of predicted volatility”. This fall in stated risk over Q3 and Q4 looks very odd given that in Q3 and Q4 “Active Currency” was by far the largest contribution to return: 1.3% gain out of the total 1.8% in Q3; -0.8% loss (from oil-related Mexico, Norway, etc) out of total 0.8% in Q4. 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. Obviously this stated risk looks wrong: ignoring possible big FX losses (as in Q4).

Insurance Linked bonds, are 5.3% of the fund but are quoted at “0.3%” of the risk. This also seems a very low figure for what is essentially writing “catastrophe” insurance.

While net performance beats the modest 4% pa target since inception, it has been falling; the 5 years to Q2 2014 return was 10.6% pa, but the last 3 year return was 7.1% pa; last year was 5.3% pa, and last quarter was 2.4% pa. The manager forecasts “lower returns than in recent years”: that no asset class will achieve cash +3.5% net.

The stated predicted volatility is now 7.0% - with 62% of this from (listed and private) equities @24% of fund. Targeted maximum volatility is 10%. (Global equities are 16.9%)

Key considerations/developments

Mike Brooks – co-head of team and former head of risk at BG – resigned 21st Jan. But process remains unchanged.

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

Baillie Gifford announced £5bn “capacity” in the strategy in Q4 2012, and “closure to all new clients” in June 2013. In Q4 2014 clients fell by 2 to 243. But on £14m net inflows in Q4, assets increased to £5.73bn - £952m net inflows since this “closure”.

Newton Global Thematic Equity

(15.0% of Total Fund)

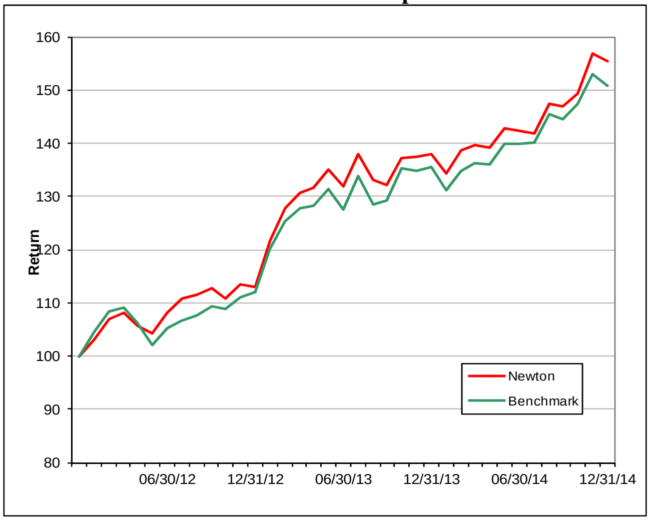
Investment Approach:

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 September 2014



Q4 2014	: +1.3% excess return
5 Years	: +1.3% 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 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 equity markets.

Portfolio

The portfolio is fairly concentrated with 44 stocks, (the manager would like to reduce further), 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 9.6% 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 (+9%) equities and cash (+10%), and underweight all other regions. It has high exposure to companies in the consumer services sector, while financials and oil & gas companies are under-represented. The large underweight of a year ago in industrial shares has been eliminated and the consumer goods sector reduced in favour of consumer services. The portfolio's high cash position should continue to protect it if equity markets fall, but otherwise there is less of a defensive tilt than previously.

The portfolio beat its benchmark in Q4. The portfolio's underweight exposure to Oil & Gas was a key benefit. Stock selection in and high allocation to the consumer services (Walgreen, TJX) and healthcare (Express Scripts, Medtronic) sectors was positive. Offsetting these positives was the performance of Yamana Gold, Centrica, Vallourec and Mattel.

During the quarter, three new stocks were introduced: Google, Trimble Navigation and L'Oreal; Toyota, Air Liquide, Royal Dutch Shell and EMC were sold outright. Align Technology was bought and sold within the quarter for a substantial capital gain.

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

(13.6% of Total Fund)

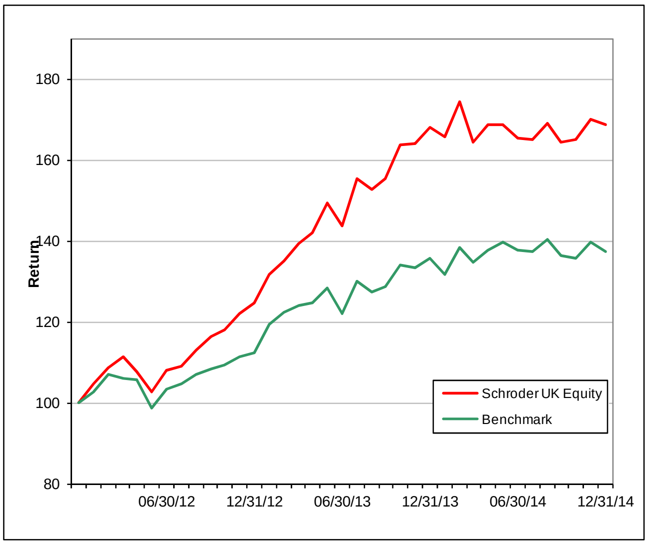
Investment Approach:

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 31 December 2014



Q4 2014	: +2.0% excess return
3 Year	: +7.9% p.a. excess return
Since inception	: +2.5% p.a. excess return

Summary

Excellent long term performance puts manager comfortably ahead of the objective over all timeframes. Clearly articulated strategy with stable ownership, client base and investment team. Cash increased to 7% reflecting dearth of attractively valued new stocks.

Portfolio

The portfolio of 38 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 food & drug retailers sectors, while mining is the biggest underweight. Relative returns in the fourth quarter were positive (+2.0%). Friends Life and Debenhams were the biggest positive contributors to relative returns in the quarter with the underweight in BG Group also adding relative value. The biggest detractors were Qinetiq and Darty.

The manager once again commented that, with the market close to all time highs, attractive new ideas in absolute terms are harder to identify. They have more sell ideas than buy ideas. With the cyclically adjusted P/E of the UK market slightly above its long term average, expected returns on a 10 year view are somewhat less than those achieved historically. The team are confident that their value discipline will result in outperformance over a similar timeframe.

With that market context in mind, it is perhaps unsurprising that cash has risen to almost 7% of the portfolio. Profits were taken in companies that have performed well with reductions in Direct Line, Dixons Carphone and Astrazeneca. Holdings in Centrica and Tesco were increased on share price weakness. The reduction in the Astrazeneca holding was the biggest single reduction the team have ever made and brings the weight back in line with other large positions.

Cyclically adjusted P/Es are a "phenomenally" good indicator on average but the manager suggested that while mining shares look cheap on this basis, the mining cycle is longer than 10 years so profits are essentially inflated. Areas that do look cheap are banks and supermarkets. At the other end of the spectrum, he cautioned that anything with perceived stability is "extraordinarily overvalued", examples being staples and tobacco.

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 £5.5bn 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

(7.5% of Total Fund)

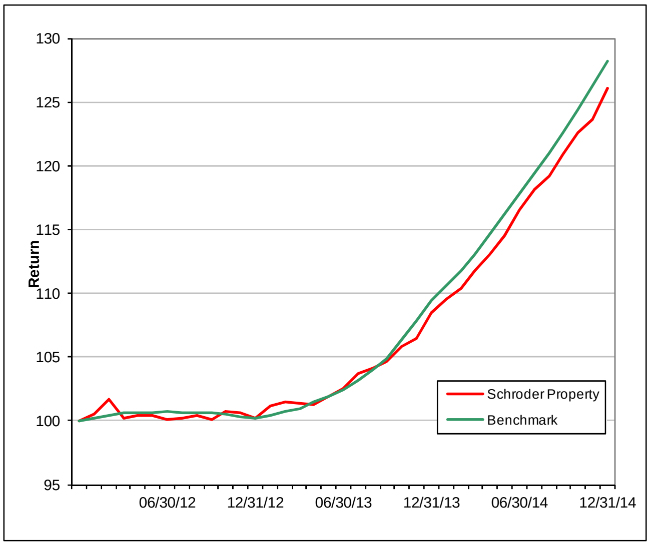
Investment Approach:

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 31 December 2014



Q4 2014	: -0.3% excess return
3 Year	: -0.6% p.a. excess return
Since inception	: +0.0% p.a. excess return

Summary

Latest 3 and 5 year performance remains weak – continental European exposure has been a major drag. The portfolio has been restructured. With 66% in large core UK funds, risk and return relative to benchmark have been reduced.

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 £127m. Activity was fairly significant from 2009-2013, and there is now expected to be low levels of future transaction activity.

The manager is shifting to a neutral position in London offices by serving a redemption request on WELPUT and is re-investing in industrial property (via a new partnership managed by a specialist at Jones Lang).

The Continental European exposure underperformed and now amounts to approximately 5% of the portfolio. (Recap in '06-07, 10% of the portfolio was committed to Europe.) The poor three year relative performance has been dominated by exposure to Cont. Europe, which is not in the benchmark. In addition, transaction costs and cash drag in a rising market affected performance. Schroders is actively seeking divestment opportunities from its European portfolio.

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 0.1%.

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 relative 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.