Allenbridge

REPORT PREPARED FOR

London Borough of Islington Pension Fund

February 2017

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1. Fund Manager Overview

Table 1 provides an overview of the external managers, in accordance with the Committee's terms of reference for monitoring managers.

Table 1

Manager	Leavers, joiners and departure of key individuals	Performance	Assets under management	Change in strategy/risk	Manager specific concerns
London CIV - Allianz	Monitored by London CIV – no changes reported.	A disappointing quarter to end the year, with the sub fund underperforming the Index by -5.1%. Underperforming by -1.4% p.a. over 3 years to end December 2016 and behind the target of +2.0% p.a.	London CIV sub fund had £625 million of assets under management as at end December, an increase of £11 million since end September 2016.	New performance target is 2% per annum outperformance over 3 years (was 3% prior to transferring onto CIV).	
Newton	Hanneke Smits has taken up the CEO role after being approved by the FCA. Susan Noble has been appointed Chair of the Board.	Underperformed the Index by -4.65% in the quarter. Now trailing the benchmark over three years by -0.65% per annum. Trailing the performance target of 2% p.a. outperformance.	£53.2 billion as at 31st December 2016, down £1.4 billion on the previous quarter.		Sub-fund likely to be available on the London CIV from May.
Standard Life	10 joiners (3 in fixed income), and 9 leavers (none from fixed income) during the quarter.	Over three years the Fund is +0.3% p.a. ahead of the benchmark return of 7.8% p.a. but behind the performance target of +0.8% p.a.	Underlying fund value rose by £27.9 million in Q4 2016. Islington's holding is 5.8% of the Fund's value.		

Manager	Leavers, joiners and departure of key individuals	Performance	Assets under management	Change in strategy/risk	Manager specific concerns
Aviva	There were three real estate leavers in Q4, and 11 joiners, including Kris McPhail, the new Assistant Fund Manager for the Lime Property Fund.	Underperformed the gilt benchmark by -3.4% p.a. over three years.	Fund was valued at £1.83 billion as at end Q4 2016. London Borough of Islington owns 3.2% of the Fund.		
Columbia Thread-needle	Michelle Scrimgeour appointed as Chief Executive of Europe, Middle East and Africa. There were three leavers and one joiner, but none from property.	Outperformed the benchmark by +0.5% per annum over three years (source Columbia Threadneedle). Behind the performance target of 1% p.a. outperformance.	Pooled fund has assets of £1.70 billion.		
Legal and General	Not reported.	Funds are all tracking as expected.	Assets under management of £853 billion at end June 2016.		

Manager	Leavers, joiners and departure of key individuals	Performance	Assets under management	Change in strategy/risk	Manager specific concerns
Franklin Templeton	One new member of the real estate team in New York.	Portfolio return over three years was +31.2% p.a., well ahead of the target of 10% p.a.			
Hearth-stone	Chris Downing, Chief Executive, resigned in Q4. David Gibbins, fund manager, retiring at end of February.	Outperformed the benchmark by +2.8% p.a. over three years to end December 2016.	Fund was valued at £51.4 m at end Q4 2016.		Departure of CEO and retirement of fund manager are key man triggers.
Schroders	68 joiners and 61 leavers for the UK business but no changes to the DGF team.	Fund returned +2.5% during the quarter and +7.0% over 12 months, -0.6% behind the target return.	Total AUM of £375.0 billion as at 30th September 2016.		

Key to shading in Table 1:

Minor concern

Monitoring required

2. Individual Manager Reviews

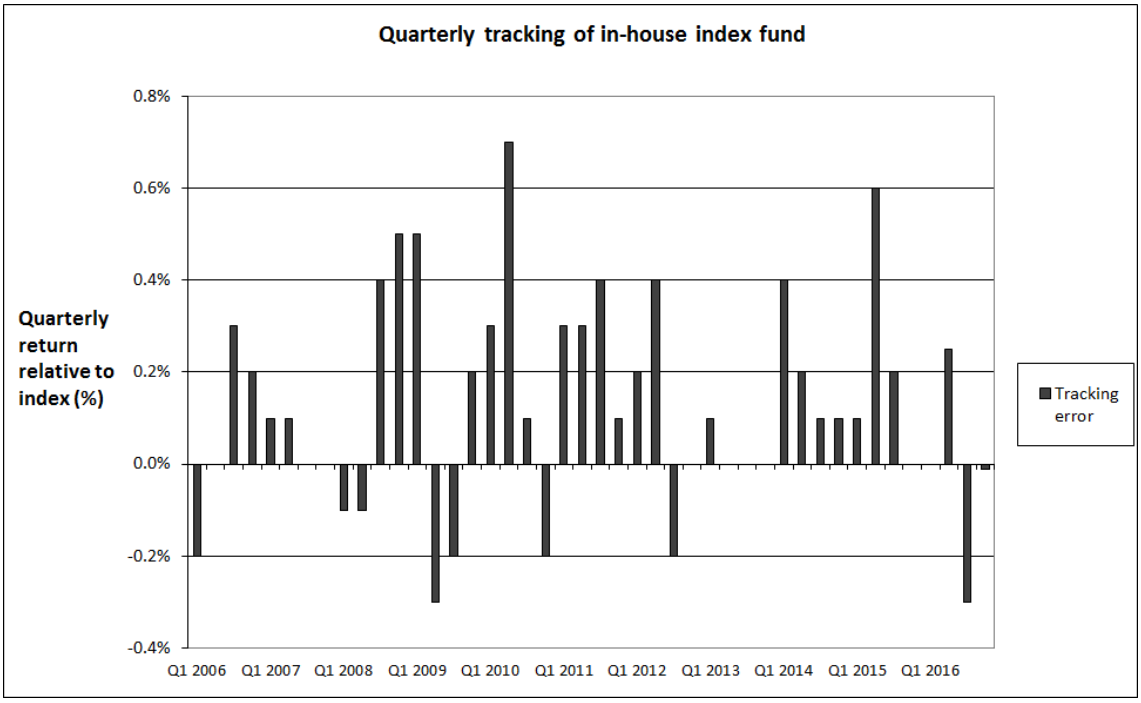
2.1. In-house – Passive UK Equities – FTSE All Share Index Fund

***Headline comments*:** The portfolio continues to meet its objectives. The fund delivered a quarterly return of +3.9%, which was in line with the index benchmark return of +3.9%. Over three years the fund has outperformed the index by +0.64% p.a. and delivered a return of +6.7% per annum.

Mandate summary: A UK equity index fund designed to match the total return on the UK FTSE All Share Index. The in-house manager uses Barra software to create a sampled portfolio whose risk/return characteristics match those of the index.

Performance attribution: Chart 1 shows the tracking error of the in-house index fund against the FTSE All Share Index since Q1 2006. **There are no performance issues.** Over three years, the small quarterly positive relative returns (shown in Chart 1) have accumulated, and thus the portfolio has outperformed its three-year benchmark by +0.64% per annum.

Chart 1



Source: Allenbridge based on BNY Mellon performance calculations

Portfolio risk: The tracking error on the portfolio at the end of September was 0.38% per annum. This is slightly higher than has been experienced historically, but the manager was accumulating higher-than-normal cash balances to cover losses on the currency hedging strategy, which had occurred following sterling's depreciation. In terms of sector bets, relative to the Index, the largest underweight sector position relative to the index was Investment Trusts (-1.25%). The fund was most overweight in Industrials (+0.8%). This compares with sector bets of around 5-10% for the active managers.

Portfolio characteristics: The total number of holdings in the portfolio stood at 307 securities at the end of Q3 2016.

2.2. London CIV – Global Equity Alpha Fund – Allianz

Headline comments: The London CIV – Allianz sub fund had a disappointing quarter, after a strong Q3. The fund delivered a return of +2.1% against the benchmark return of +7.2% in Q4 2016. Over three years the fund is trailing the benchmark by -1.4% per annum and is behind the performance target of 2% per annum.

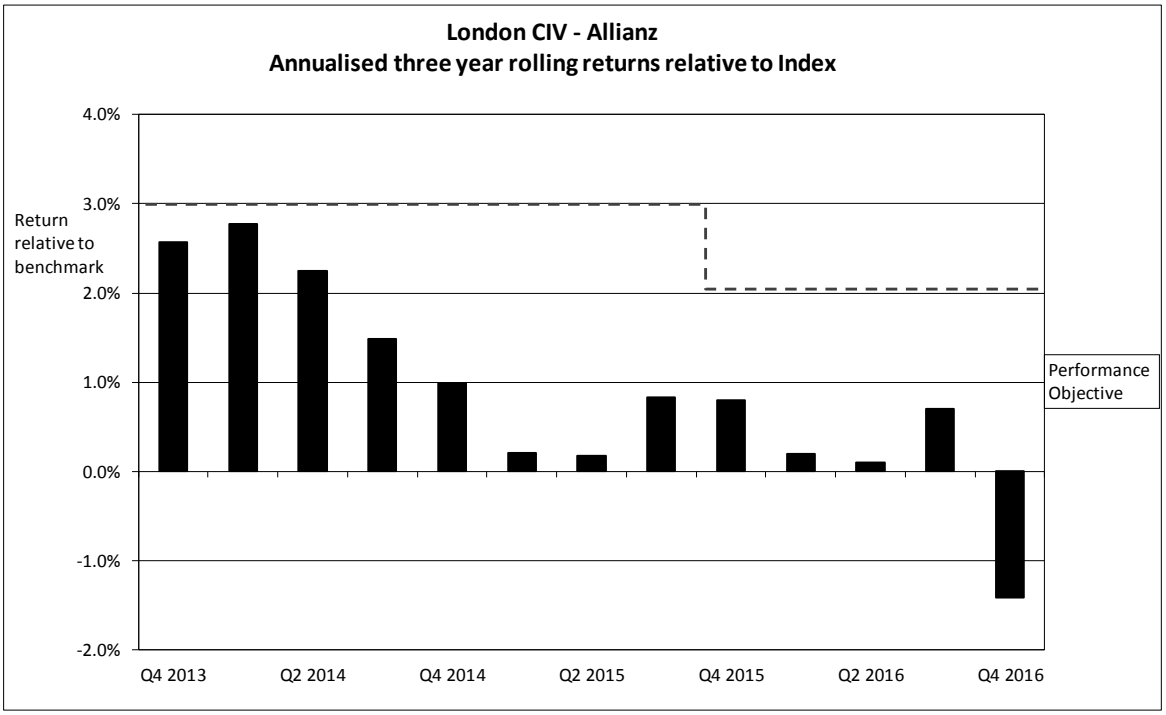
Mandate summary: An active global equity portfolio, with a bottom-up global stock selection approach. A team of research analysts identifies undervalued stocks in each

geographical region (Europe, US, Asia Pacific). A global portfolio team is responsible for constructing the final portfolio. The objective of the fund is to outperform the MSCI World Index by 2.0% per annum over rolling 3 year periods net of fees.

Performance attribution: For the three years to December 2016, the AllianzGI portfolio is behind its benchmark by -1.4% per annum, so is **trailing the performance target of 2% per annum**, shown by the dotted line in Chart 2. Note that the dotted line drops in Q4 2015 when the mandate transferred to the London CIV sub fund, which has a lower performance objective than when Allianz ran a bespoke mandate for London Borough of Islington.

The portfolio's underperformance in Q4 was attributed by the London CIV to the market's rotation out of growth stocks into value and cyclical stocks. In particular, the allocation to the financial sector detracted -1.9%. The sub fund's allocation to the industrial sector also detracted -1.1% although this was mostly attributed to some specific stock selection issues. It is worth noting that **the London CIV has expressed some concern about the manager's ability to add value in the current market environment** and is maintaining a watching brief on this sub-fund.

Chart 2



Source: Allenbridge based on BNY Mellon performance data

Portfolio Risk: The largest overweight regional allocation was in European Equities (+7.6% overweight). The most underweight allocation was Japan Equities (-4.4% underweight). In terms of sector bets, the most overweight allocation was in Information Technology (+12.5% overweight). This is the largest overweight sector position that the manager has taken since the inception of the mandate in 2009. Energy was the most underweight sector (-5.0%).

Portfolio Characteristics: as at end Q4 2016, the portfolio held 50 stocks, up from 49 as at end Q3 2016. The portfolio has a beta of 1.00 so is neutral relative to the market.

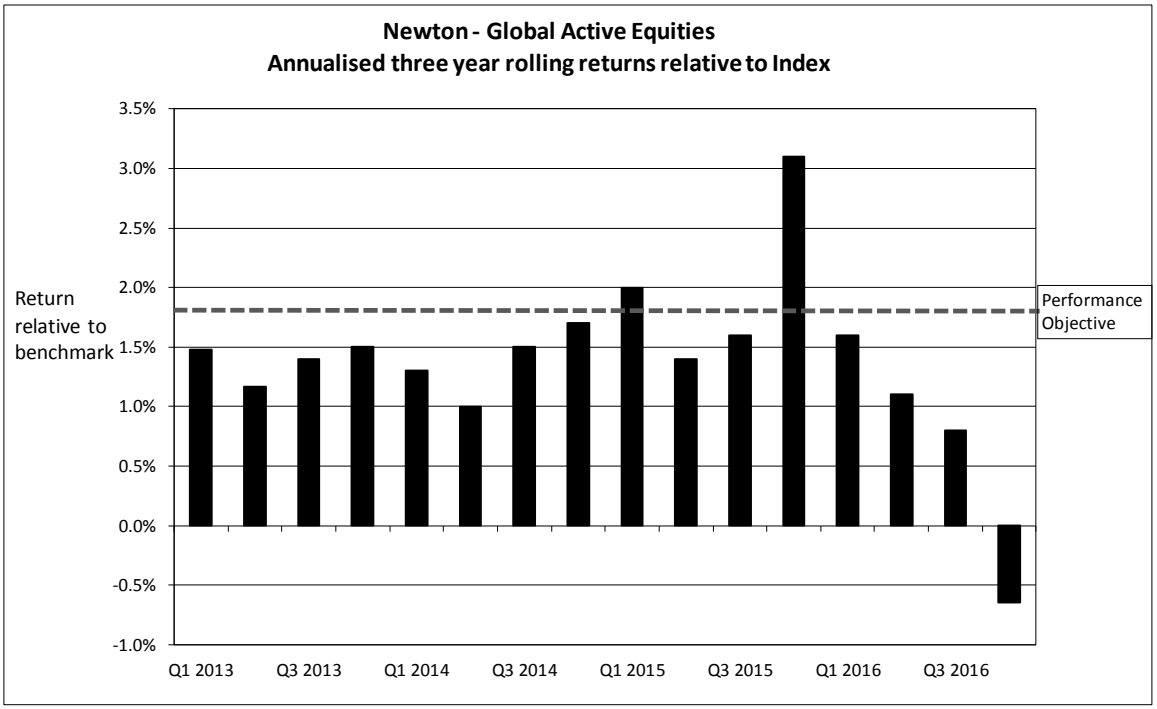
2.3. Newton – Global Active Equities

Headline comments: Newton were behind their benchmark by -4.65% during Q4 2016 bringing the one-year underperformance to -8.7%. Over three years the portfolio has underperformed by -0.65% per annum, behind the target of +2% p.a. This underperformance can be attributed mostly to poor stock selection (-0.4%).

Mandate summary: An active global equity portfolio. Newton operates a thematic approach based on 12 key themes that impact the economy and industry. Some are broad themes that apply over the longer term; others are cyclical. Stock selection is based on the industry analysts' thematic recommendations. The objective of the fund is to outperform the FTSE All World Index by 2.0% per annum over rolling 3 year periods, net of fees.

Performance attribution: Chart 3 shows the three year rolling returns of the portfolio relative to the Index (the black bars) and compares this with the performance target, shown by the dotted line.

Chart 3



Source: Allenbridge based on BNY Mellon performance numbers

For the three-year period to the end of Q4 2016, the fund (shown by the right hand black bar) has, for the first time since 2012, trailed the benchmark by -0.65% per annum. This also means it is trailing the performance objective (the performance objective is shown by the dotted line).

Over the three years to December 2016, Newton's absolute return, however, remained relatively strong at +13.8% p.a. compared to the index return of +14.5% p.a. The underperformance over three years was mostly attributed by Newton to poor stock selection which detracted -0.4% p.a.

Since the inception of Newton's portfolio in November 2008, the fund is now marginally trailing its benchmark by -0.2% per annum, before taking fees into account. Newton's

'since inception' return is +14.3% per annum, compared to the benchmark return at 14.5% per annum *(source: Newton, gross of fees performance)*.

Newton attributed the poor relative performance to the market rotation into cyclicals stocks, which began in the summer and gathered pace in Q4. This rotation was boosted by optimism over Trump's success which was felt to signal greater investment, economic progress, rising inflation and the normalisation of US interest rates. The best performing
sectors in Q4 were Financials and Energy. Newton was underweight Financials by 11.6%, and underweight Energy by 5.1%. The underweight allocation to Financials detracted -0.8% to the relative return in Q4 and in oil and gas stocks the allocation detracted -0.3%.

The two poorest performing sectors in absolute terms, in Q4, were Consumer Staples and Healthcare. Newton have been overweight Healthcare as a sector since the inception of the mandate, and they have held an overweight allocation to Consumer Goods since the end of 2009, in line with their thematic views. The Healthcare allocation detracted -0.3% and Consumer Goods -0.1% in Q4, with poor stock selection in these two sectors detracting a further -1.0%.

Portfolio Risk: The largest overweight regional allocation was in UK Equities (+4.6% overweight). The most underweight allocation was Other Equities (-5.9%). The cash holding had fallen somewhat from nearly 5% as at end Q3 to 4.0% at end Q4, but the balance remains high.

In terms of sector bets, Newton remained most overweight in Consumer Services (+9.9% relative to benchmark.) The most underweight sector remained in Financials (-11.6%). This underweight position has been in place since Q2 2009.

The level of active risk in the portfolio (i.e. the relative risk of the active bets being taken by Newton, or the tracking error) stood at 3.35%, as at end December 2016. This is within Newton's normal range of 2% and 6%.

Portfolio characteristics: At the end of Q4 2016, the portfolio held 61 securities (62 as at the end of Q3 2016). Turnover over the past 12 months was 32%, at the low end of Newton's normal expected range of turnover to 30%-70%.

Staff turnover: Hanneke Smits took up her position as Chief Executive of Newton in November, after receiving formal approval and authorisation from the FCA. Susan Noble was appointed Chair of the Board of Directors from the 1st of January 2017, after Helena Morrissey - the previous Chief Executive and then Chairman - resigned from this role. Susan was previously a nonexecutive director at Newton.

(Helena Morrissey is joining Legal and General Investment Management (LGIM) to help build LGIM's direct relationships with savers.)

2.4. Standard Life – Fixed Income

Headline comments: The portfolio was slightly behind the benchmark during the quarter but delivered a negative absolute return of -2.85%. Over three years, Standard

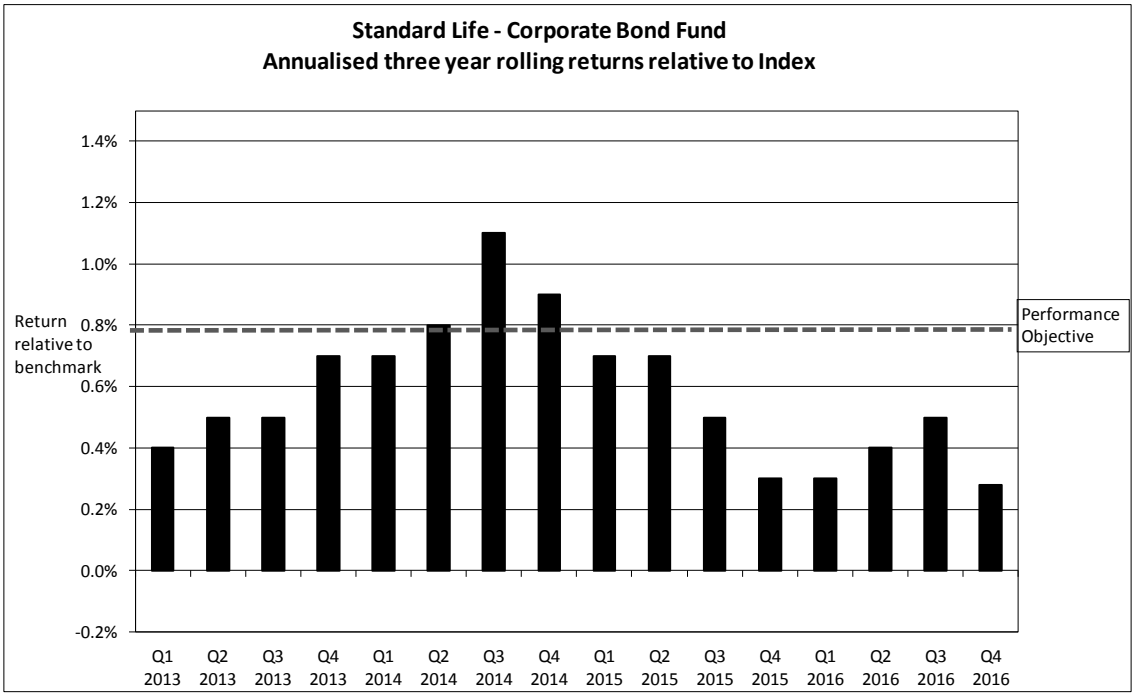
Life's return was +0.3% p.a. ahead of the benchmark return of +7.8% p.a., but behind the performance target of +0.8% per annum.

Mandate summary: An actively managed bond portfolio, invested in Standard Life's Corporate Bond Fund. The objective of the fund is to outperform the Merrill Lynch UK Non Gilt All Stocks Index by 0.8% per annum over rolling 3 year periods.

Performance attribution:

Chart 4 shows the three-year performance of the Corporate Bond Fund compared to the Index, over the past three years. This shows the fund falling back slightly in Q4 relative to the performance objective (shown by the dotted line in Chart 4).

Chart 4



Source: Allenbridge based on BNY Mellon performance data

Over three years, the portfolio has returned +8.1% p.a. compared to the benchmark return of +7.8% p.a. Over the past three years, stock selection has added value, followed by asset allocation. This has been offset by a negative contribution to performance from curve plays.

Portfolio Risk: The largest holding in the portfolio at quarter end was UK Government 4.5% 2034 (1.3% of the portfolio). The largest overweight sector position remained Financials (+7.4%) and the largest underweight position remained sovereigns and sub-sovereigns (-15.2%).

The fund holds 4.5% of the portfolio in non-investment grade bonds.

Portfolio characteristics: The value of Standard Life's total pooled fund at end December 2016 was £4,101.9 million, £27.9 million higher than at the end of Q3 2016. London Borough of Islington's holding of £239.4 million is 5.8% of the total fund value.

Staff turnover: there were 10 joiners and 9 leavers during the quarter. The new joiners included three new members of staff in fixed income. Pete Skolnik joined as a bond

trade, Roubesh Adaya joined as an Investment Specialist in fixed income, and Vicki Cockbain joined as a credit Investment Director. Of the nine leavers, none was from the fixed income team.

2.5. Aviva Investors – Property – Lime Property Fund

Headline comments: Gilts delivered negative returns in Q4 of -4.5%, compared with the Lime Fund which continued to deliver consistent performance of +2.1%, well ahead of the gilt benchmark this quarter. Over three years, the Fund returned +7.2% p.a. and underperformed the gilt benchmark by -3.4% p.a., an improvement on the three-year relative return last quarter, which stood at -4.4%.

Mandate summary: An actively managed UK pooled property portfolio, the Lime Fund invests in a range of property assets including healthcare, education, libraries, offices and retail. The objective of the fund is to outperform a UK gilt benchmark, constructed of an equally weighted combination of the FTSE 5-15 Years Gilt Index and the FTSE 15 Years+ Gilt Index, by +1.5% per annum, over three year rolling periods.

Performance attribution: The Fund's Q4 return of +2.1% was attributed by Aviva to 1.2% from income, with the balance from capital gains.

Over three years, the fund has returned +7.2% p.a. compared to the gilt benchmark of +10.6% p.a., an underperformance of -3.4% per annum. The **portfolio is trailing its performance objective of +1.5% per annum outperformance over three years**. However, the property fund itself continues to deliver a steady three-year absolute return of around 7-8% and compares well against other Funds in the IPD universe of property funds, on a risk-adjusted return basis. The Lime Fund has also been awarded the 2016 Professional Pension award for Long Income Manager of the year.

Of the +7.2% p.a. fund return over three years, 4.9% p.a. came from income, with the balance from capital gain.

Aviva have indicated that their own originated deals are now forming the bulk of new transactions within the Lime Fund. The market has become very competitive and overvalued so the fund manager is increasingly relying on their own originated deals instead.

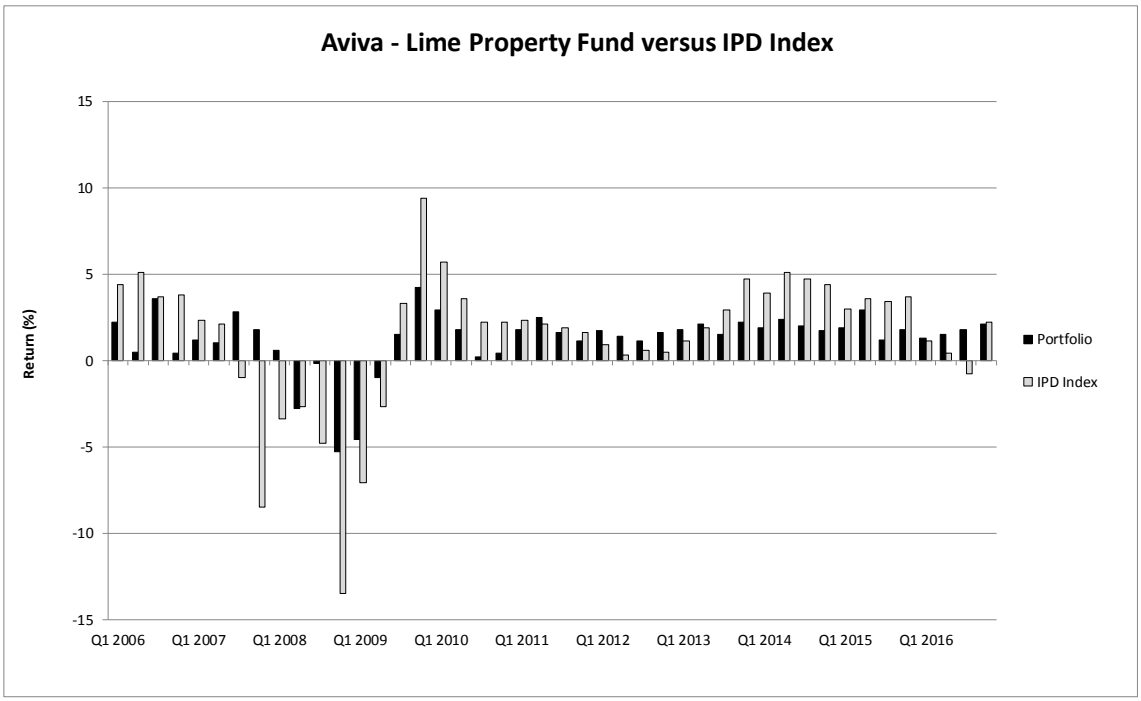
Portfolio risk: There was one purchase in Q4 which completed. This was a site in West Smithfield, London, which is planned for development to become a Premier Inn Hotel. The property has a 25 year least term and inflation linked rental uplifts, making it an ideal candidate for inclusion in the Lime portfolio.

The average unexpired lease term was 19.4 years. 8.3% of the portfolio's lease exposure in properties is in 30-35 year leases. The largest sector exposure remains offices at 29.9%, and the number of assets in the portfolio stood at 71 as at quarter end.

The fund continues to see a flow of new capital joining the investment queue for the Fund. Some of these new investors are switching into Lime from bond allocations, others are moving out of other commercial property investments as a deleveraging switch. This deleveraging opportunity is shown clearly in Chart 5 which shows the absolute performance of the Fund each quarter compared to the IPD Index. The chart

shows the return stream of the portfolio (in black) following a more muted profile (in both up and down markets) than the IPD Index as a whole.

Chart 5



Source: Allenbridge based on WM and BNY Mellon performance data

Portfolio characteristics: As at end December 2016 the Lime Fund was valued at £1.832 billion, an increase of £89.5 million from the previous quarter end. London Borough of Islington's investment represents 3.2% of the total fund.

The Fund has 68% allocated to inflation-linked rental uplifts.

Staff turnover/organisation: There were three leavers from the real estate team and 11 joiners during Q4. The joiners included Kris McPhail who joined in December as an Assistant Fund Manager for the Lime Property Fund. Kris was previously a senior originator on M&G's Secure Property Income Fund.

2.6. Columbia Threadneedle - Pooled Property Fund

Headline comments: The Fund delivered a return of +2.8% in Q4 2016 (source: Columbia Threadneedle), ahead of the benchmark by +0.5%. Over three years, the Fund has outperformed the benchmark by +0.5% per annum, but is behind the performance target of 1% p.a. above benchmark.

Mandate summary: An actively managed UK commercial property portfolio, the Columbia Threadneedle Pooled Property Fund invests in a diversified, multi-sector portfolio of UK property assets. Its performance objective is to outperform the AREF/IPD All Balanced – Weighted Average (PPFI) Index by at least 1% p.a., net of fees, on a rolling three-year basis.

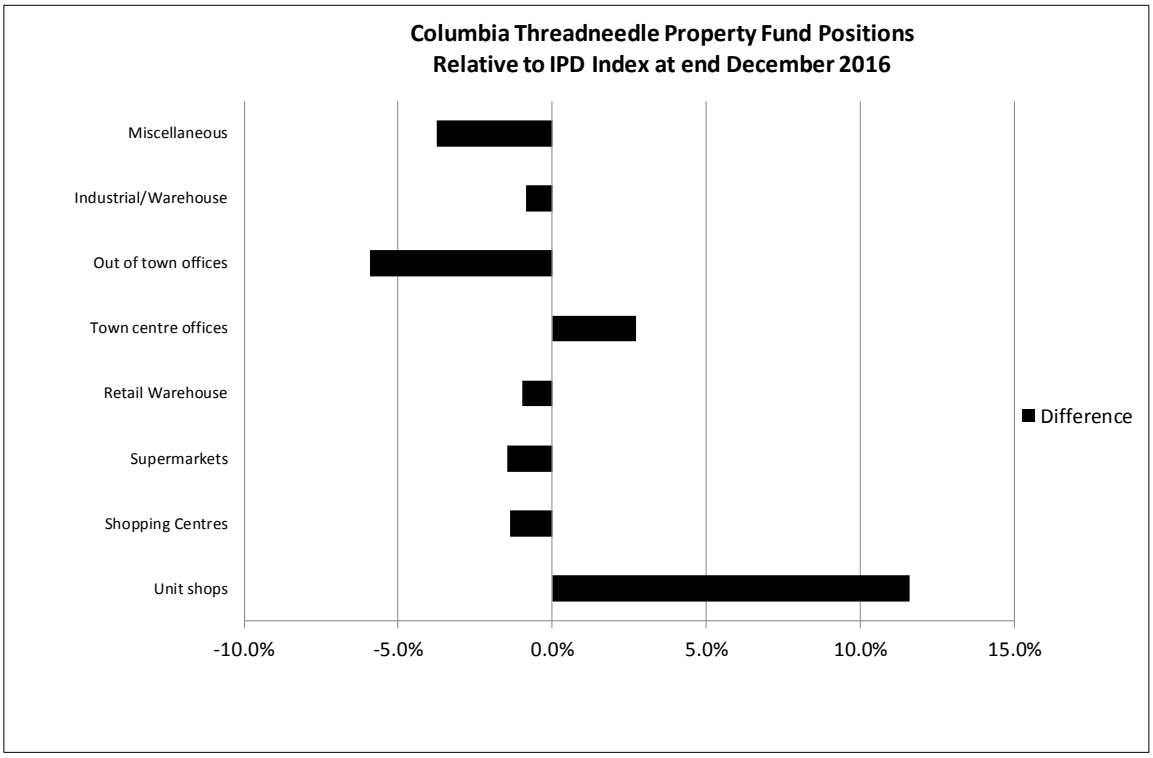
Performance attribution: The portfolio was ahead of the benchmark in Q4 2016, by +0.5%, delivering a return of +2.8%. In terms of the three-year performance, the Fund is ahead of its benchmark by +0.5% per annum but is trailing the performance target of +1% per annum. The absolute return over three years is beginning to decline. At the end

of Q3, the three year return was +12.3% per annum. At the end of Q4, this had dropped to +11.2% per annum.

Portfolio Risk: The Fund made five purchases and three disposals during the quarter. The average income yield on the purchases was 6.5%.

Chart 6 shows the relative positioning of the Fund compared with the benchmark. The Fund has a significant overweight allocation to unit shops.

Chart 6



Source: Allenbridge based on Columbia Threadneedle data.

Portfolio characteristics: As at 31st December 2016, the Threadneedle Property Fund was valued at £1.698 billion, an increase of £22.7 million compared with September 2016. London Borough of Islington's investment represented 4.1% of the Fund as at end December 2016.

Staff turnover: in December, Columbia Threadneedle announced the appointment of Michelle Scrimgeour as Chief Executive Officer (CEO), Europe, Middle East & Africa and CEO of Threadneedle Asset Management Limited. She joined from M&G Investments, where she was Chief Risk Officer of M&G Group Limited.

2.7. Legal and General Investment Management (LGIM) – Overseas Equity Index Funds

Headline comments: All the index funds were within the expected tracking range when compared with their respective benchmarks and there are no issues. The fundamental FTSE-RAFI Emerging Markets index fund outperformed its market capitalisation-weighted counterpart in Q4 by +6.3%. For the 12 months to Q4 2016 the outperformance was +23.2%.

Mandate summary: Four regional overseas equity index funds, in Europe, Japan, Asia Pacific ex Japan, and emerging markets, designed to match the total return on the FTSE

All World Regional Indices. One additional index fund is designed to match the total return on the FTSE-RAFI Emerging Markets Equity Index. The FTSE All World Indices are based on capitalisation weights whereas the FTSE-RAFI Index is based on fundamental factors.

Performance attribution: **The regional portfolios are all tracking their benchmarks**, as shown in Table 2.

Table 2

Q4 2016	Fund	Index	Tracking
Europe	4.8%	4.8%	0.0%
Asia Pacific ex Japan	1.6%	1.5%	0.0%
FTSE emerging markets	2.1%	2.2%	0.0%
RAFI emerging markets	8.4%	8.6%	-0.2%

Source: LGIM

The RAFI emerging markets index fund outperformed the market capitalisation index by 6.3% in Q4. For the 12-month period, this took the relative outperformance to +23.2%. The RAFI index fund returned a staggering +58.4% in sterling terms, for the 12 months to end December 2016.

Portfolio Risk: The percentage allocation to each regional fund is based on pre-agreed band widths, which also take into account the global equity managers' allocations. The largest deviation from the benchmark allocation is North America which is 4.4% overweight.

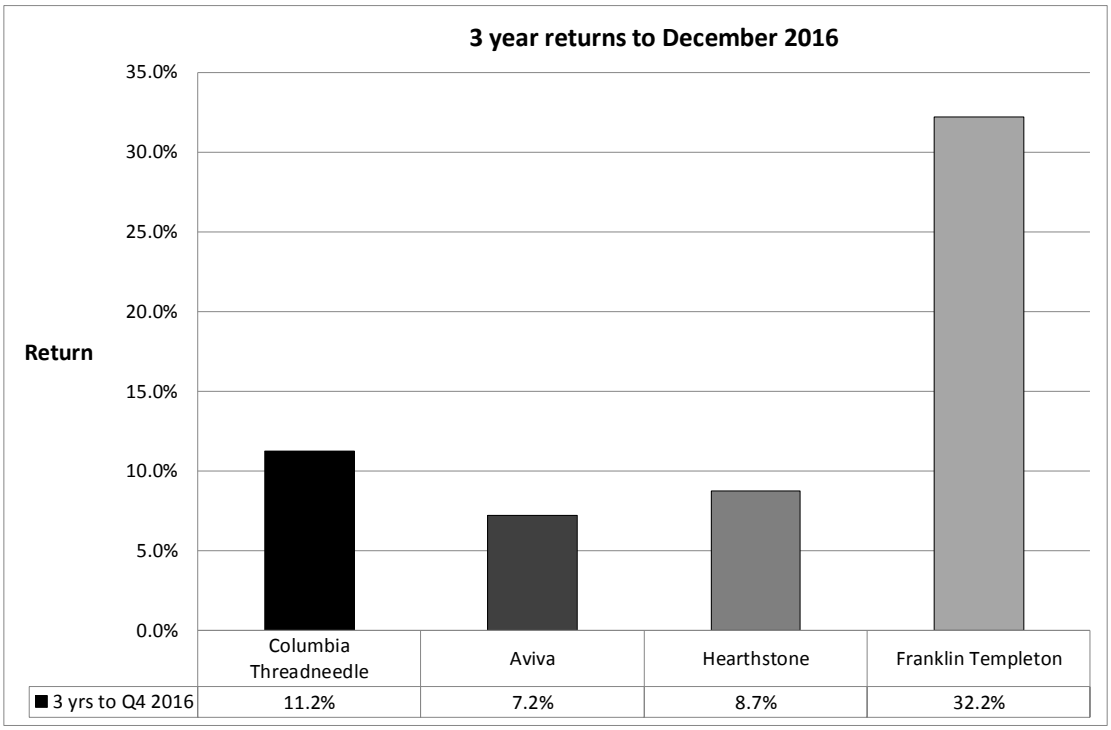
2.8. Franklin Templeton – Global Property Fund

Headline comments: This is a long term investment and as such a longer term assessment of performance is recommended. There are two funds in which London Borough of Islington invests. Both funds are on track. The portfolio in aggregate delivered a return of +32.2% per annum over the three years to end December 2016, outperforming the absolute return benchmark by +21.2% per annum.

Mandate summary: Two global private real estate fund of funds investing in sub funds. The performance objective is an absolute return benchmark over the long term of 10% per annum.

Performance attribution: Over the three years to December 2016, Franklin Templeton was the best performing fund across all four property managers. Chart 7 compares the three-year performance of the other three property managers.

Chart 7



Source: BNY Mellon, Columbia Threadneedle

Portfolio risk: Leverage on Fund 1 was 52% as at end December (down from 55% since end September), with all funds showing leverage below 70%. Leverage on Fund 2 was 45% as at end December 2016, little change on the previous quarter.

Of the 14 investments in Fund 1, three are substantially above target, five are above target, four are on target and two are below target. The funds that are below target are Sveafastigheter AB and Lotus Co-investment.

Of the four investments in Fund 2, one is above target, two are on target and one is too early to assess. Fund 2 is targeting investment in the three regions (US/Europe/Asia) equally distributed. There is a cap of 20% to Emerging Markets.

Staff turnover/organisation: during the quarter, Michael Davis joined the New York private real estate team as an Investment Manager. His role will be to support the Asia and U.S. investment teams in the sourcing, underwriting and monitoring of private real estate investments.

2.9. Hearthstone – UK Residential Property Fund

Headline comments: The portfolio returned +1.9% compared to the benchmark return of +2.6% for the quarter ending December 2016. Over three years, the Fund delivered a return of +8.7% p.a. compared to the benchmark return of +5.9% p.a., an outperformance of +2.8% p.a.

Mandate summary: The Fund invests in private rented sector housing across the UK and aims to outperform the LSL Acadametrics House Price Index (note that this excludes income), as well as providing an additional income return.

Performance attribution: The Fund returned +8.7% p.a. compared to the return on the index of +5.9% p.a. over the three years to December 2016, an outperformance of

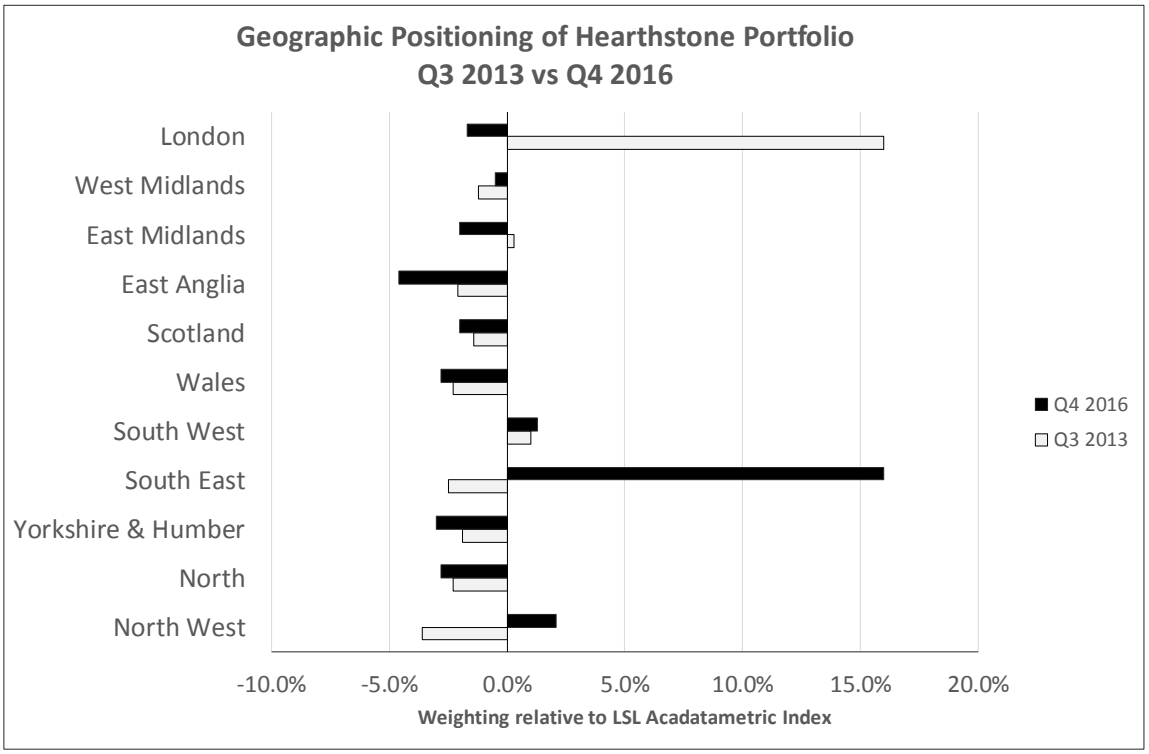
+2.8% p.a. The gross yield on the portfolio as at 31st December 2016 was 5.2%. Adjusting for voids, however, the gross yield on the portfolio falls to 4.8%. This compares with an average gross yield across England and Wales, reported by Your Move, of 4.7%.

One of issues facing the fund at the beginning of 2016 was that only 68.5% of the fund was invested in property, with the balance being held in cash. This has now been addressed through a sequence of acquisitions. The fund has, over the course of the past twelve months, gone from 122 to 187 properties in the portfolio, with acquisitions in Colchester, Manchester, Bristol and Haywards Heath.

Portfolio risk: the regional allocation, shown in Chart 7 relative to the benchmark Index, continues to have a heavy overweighting to the South East. Hearthstone have made efforts to bring the regional allocation back to neutral (relative to the benchmark) but had found that the availability of opportunities last year was mainly in the South East and South West. Because their scale is still relatively small, it has limited them in what they could find, that would be suitable for the portfolio. It remains their intention, however, to run the portfolio on a region-neutral basis, however.

Chart 7 compares the regional bets in the portfolio in Q4 2016 with the regional bets at the start of the mandate, in Q3 2013. The overweight allocation to the South East is shown by the large black bar.

Chart 7



Source: Hearthstone

The overweight allocation in London in Q3 had been focussed on Wembley (shown by the top light grey bar in Chart 7) and as such brought high concentration risk into the portfolio. The overweight allocation to the South East, however, is more diversified, being in various locations such as Horsham and Eastbourne.

Portfolio characteristics: The Fund has an 14% allocation to detached houses, 51% allocated to flats, 29% in terraced accommodation and 6% in semi-detached. The

allocation to flats remains a significant overweight position relative to the Index (51% for the Fund compared to 17% for the Index). This is offset by an underweight position in semi-detached houses (6% for the Fund compared to 24% for the Index).

As at end December 2016, the Fund stood at £51.4 million. London Borough of Islington's investment now represents 51% of the Fund. This compares with 72% at the start of this mandate in 2013.

Organisation and staff turnover: During the quarter, the Chief Executive, Christopher Down, resigned from Hearthstone. This followed dissatisfaction from the corporate shareholders with the rate of growth of the residential property fund in which London Borough of Islington invests. Peter Beaumont has taken up the post of Managing Director since October 2016 and will continue to run Hearthstone until they can seek a replacement Chief Executive. Peter Beaumont is on a three-day-a-week secondment from the family office for whom he works.

Alan Collett, the Chairman, is also in the office three days a week. He is preparing the strategy, writing up a business plan and will begin to implement that. He will also take over the fund management of the residential property fund when David Gibbins, the current portfolio manager, retires at the end of February. Alan Collett will be supported by Marie Cooper (Asset Manager) and Paul Thorsen (Investment Manager).

With both the Chief Executive and Investment Manager leaving the firm**, this represents a key man trigger** and as such a review of this mandate is now recommended. With that in mind, it may be helpful to consider the strategy and vision being proposed by the new Chairman.

Proposed strategy

The proposed business strategy now focuses entirely on the retail market as the manager's principal opportunity. There are two parts to the strategy. The first is to expand the business to business (B2B) sales team significantly. The second is direct business to consumer (B2C) sales. The markets which particularly interest them are the Lifetime ISA and Junior ISA. These investors are saving directly or indirectly for house purchases. Hearthstone is hoping that a residential property ISA will attract "hundreds of thousands".

The manager is also planning a change in the share class from accumulation to income units, pending FCA approval. All five existing share classes will change to income units, once this is approved, with an option to reinvest.

Hearthstone are planning a "significant re-launch", probably in September. By this time, they should have one or two additional people in the sales team. They anticipate that this will have a significant impact on subscription levels towards the end of the year.

The Chair has indicated that they have, at this stage, not considered institutional sales and this is a consideration for the London Borough of Islington. However, the manager has pointed out that the investment objective will not change, and that performance is likely to improve because they can bring the regional allocation back into line with the benchmark as the fund grows.

Options for withdrawing assets/terminating the mandate

Should the committee decide to withdraw assets, or terminate the mandate, there are two options. The first option would be to give a full quarter's notice to the manager to redeem on the next deal day (deal days are once a quarter). For a large amount, the manager would switch the pricing of units to bid so that they did not disadvantage other investors, so this could result in significant transition costs.

The second option would be to wait until Hearthstone's new sales effort begins to pay off. In the first full year after launch, Hearthstone are expecting £50-100 million of subscriptions, and after that £250 million a year. If Islington wanted to reduce or terminate their mandate, it should be possible to exchange units with new investors. This would significantly reduce the transition cost.

2.10. Schroder – Diversified Growth Fund (DGF)

Headline comments: The Diversified Growth Fund delivered a return of +2.5% in Q3 2016. This compared with the RPI plus 5% p.a. target return of +2.0% for Q4. Over one year, the Fund's return was +7.0%, compared to the target return of +7.5%, so it is trailing the target over one year by -0.5%.

Mandate summary: The Fund invests in a broad mix of growth assets and uses dynamic asset allocation over the full market cycle, with underlying investments in active, passive and external investment, as appropriate. Schroders aim to outperform RPI plus 5% per annum over a full market cycle, with two-thirds the volatility of equities.

Performance attribution: In Q4 2016, Schroders' exposure to global equities again made the largest contribution to the portfolio return (+1.3%). This was followed by North American equities (+1.0% contribution). Negative contributions came from commodities (-0.3%), emerging market equities (-0.1%) and absolute return strategies (-0.1%).

Over 12 months, the largest contributor was again global equities (+2.7%) followed by high yield debt (+1.2%), North American equities (+1.0%) and currency and cash (+1.0%). The negative detractors were Japanese equities (-1.3%) and Europe ex UK equities (-0.6%).

The return on global equities was +13.4% for the 12-month period, compared with +7.1% for the Fund. Over a full 3-5 year market cycle the portfolio is expected to deliver equity-like returns.

Portfolio risk: The portfolio is expected to exhibit two-thirds the volatility of equities over a full 3-5 year market cycle. Over the past 12 months, the volatility of the Fund was 5.8% compared to a 12-month volatility of 14.9% in equities (i.e. less than 40% of the volatility of the Index).

Portfolio characteristics: The Fund had 15% in internally managed funds, 39% in internal bespoke solutions (down from 46% last quarter), 12% in externally managed funds, 25% in passive funds and 8% in cash, as at end December 2016. In terms of asset class exposure, 44.9% was in equities, 30.5% was in alternatives and 16.2% in credit and government debt, with the balance in cash.

Alternative assets include absolute return funds, infrastructure, property, insurance-linked securities, private equity and commodities.

Organisation: during the quarter, there were no changes to the team responsible for the Diversified Growth Fund. For the wider UK business, in Q4 there were 68 joiners and 61 leavers.

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20th February 2016