

# London Borough of Islington

Report to 31<sup>st</sup> March 2019

MJ Hudson Allenbridge

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MAY 2019

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# 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,<br>JOINERS AND<br>DEPARTURE<br>OF KEY<br>INDIVIDUALS | PERFORMANCE   | ASSETS<br>UNDER<br>MANAGE-<br>MENT  | CHANGE<br>IN<br>STRATEGY<br>/RISK | MANAGER<br>SPECIFIC<br>CONCERNS  |
|--|---|---|---|-----------------------------------|--|
| London CIV<br>–Allianz<br>(active<br>global<br>equities) | Monitored by<br>London CIV. No<br>changes<br>reported.        | Outperformed the<br>benchmark in the<br>quarter to March<br>2019, by +1.21%.<br>Outperformed by<br>+1.29% p.a. over<br>three years to end<br>March 2019 but<br>trailing the target of<br>+2.0% p.a.                     | As at end<br>March the<br>sub- fund's<br>value was<br>£118.5 million<br>and was 100%<br>owned by<br>London<br>Borough of<br>Islington.          |                                   | Withholding<br>tax issue<br>continues to<br>be a point of<br>discussion<br>with the<br>London CIV. |
| London CIV<br>– Newton<br>(active<br>global<br>equities) | Monitored by<br>London CIV. No<br>changes<br>reported.        | Underperformed<br>against the index by<br>-1.17% in the<br>quarter. Over three<br>years the fund is<br>behind the<br>benchmark return<br>by -2.22% and failing<br>to achieve the<br>performance target<br>of +1.5% p.a. | As at end<br>March the<br>sub- fund's<br>value was<br>£605.9<br>million.<br>London<br>Borough of<br>Islington<br>owns 36.0% of<br>the sub-fund. |                                   |  |

| MANAGER                                  | LEAVERS, JOINERS AND DEPARTURE OF KEY INDIVIDUALS   | PERFORMANCE  | ASSETS UNDER MANAGEMENT   | CHANGE IN STRATEGY /RISK | MANAGER SPECIFIC CONCERNS  |
|--|---|--|---|--------------------------|--|
| BMO/LGM (emerging and frontier equities) | Two new analysts joined in January 2019.  | Underperformed the benchmark by -2.20% in the quarter to March 2019. Ahead over one year by +1.86%.  | Not reported.   |                          |  |
| Standard Life (corporate bonds)          | 19 joiners, but 42 leavers (including seven from fixed income).   | The fund was in-line with the benchmark in the quarter to March 2019. Over three years the fund is 0.56% p.a. ahead of the benchmark return net of fees, but behind the performance target of +0.8% ahead p.a. | Fund value fell to £2,855 million in Q1 2019, a fall of £18.8 million. London Borough of Islington's holding stood at 5.5% of the fund's value. |                          | Press reports of staff being unhappy about bonus cuts, and the higher than average turnover, present minor concerns. |
| Aviva (UK property)                      | 17 new joiners and 6 leavers across the firm. On the Lime Fund team Michael Maddox joined as a Long Income Origination Manager. | Underperformed the gilt benchmark by -2.27% for the quarter to March 2019 but outperforming by +1.24% p.a. over three years, net of fees.  | Fund was valued at £2.23 billion as at end Q1 2019. London Borough of Islington owns 5.3% of the fund.  |                          |  |
| Columbia Threadneedle (UK property)      | Four joiners and one leaver in Q1 2019, but no changes to the team managing the Islington portfolio.                            | Outperformed the benchmark return by +0.12% in Q1 2019. Underperformed by -0.03% p.a. over three years. Trailing the target of 1% p.a. outperformance.   | Pooled fund has assets of £2.03 billion. London Borough of Islington owns 4.4% of the fund.   |                          |  |

| MANAGER                                    | LEAVERS, JOINERS AND DEPARTURE OF KEY INDIVIDUALS  | PERFORMANCE   | ASSETS UNDER MANAGEMENT  | CHANGE IN STRATEGY /RISK                                      | MANAGER SPECIFIC CONCERNS  |
|--|--|---|--|---|--|
| Legal and General (passive equities)       | Mark Zinkula announced that he will retire as CEO of LGIM in August 2019.  | Funds are tracking as expected. Both index funds marginally underperformed their benchmark indices.   | Assets under management of £1.02 trillion at end December 2019. Net flows of +£42.6 bn in 2018   |   |  |
| Franklin Templeton (global property)       | One new joiner in Q1 2019. Chris Orr, London Borough of Islington's CRM, left the firm just after the quarter end. | Portfolio return over three years was +20.39% p.a., well ahead of the target of 10% p.a.  | \$714 billion of assets under management as at end February 2019.  |   |  |
| Hearthstone (UK residential property)      | One leaver and one joiner in Q1 2019.  | Underperformed the IPD UK All Property Index by -0.04% in Q1. Trailing the IPD benchmark over three years by -3.51% p.a. to end March 2019. | Fund was valued at £56.3m at end Q1 2019. London Borough of Islington owns 50.6% of the fund.  |   | Meeting held with Hearthstone to discuss the practicalities of exiting the fund. |
| Schroders (multi-asset diversified growth) | During Q1 one new member joined the DGF team as a multi-asset fund manager.  | Fund returned +4.94% during the quarter and +5.20% p.a. over 3 years, -2.77% behind the target return.                                      | Total AUM stood at £421.4 billion as at end December 2018. Schroders reported net outflows of £9.5 bn in 2018 leading to a 6% drop in AUM. | The volatility of the fund is lower than expected at present. |  |

| MANAGER  | LEAVERS,<br>JOINERS AND<br>DEPARTURE OF<br>KEY INDIVIDUALS | PERFORMANCE         | ASSETS<br>UNDER<br>MANAGE-<br>MENT | CHANGE IN<br>STRATEGY/R<br>ISK                          | MANAGER<br>SPECIFIC<br>CONCERNS |
|--|--|---------------------|------------------------------------|---|---------------------------------|
| Quinbrook<br>(renewable<br>energy<br>infrastructur<br>e) | None reported  | Too early to assess |                                    | A new infra-<br>structure<br>private<br>markets<br>fund |                                 |

Source: MJ Hudson Allenbridge

**Minor Concern**

**Major Concern**

# Individual Manager Reviews

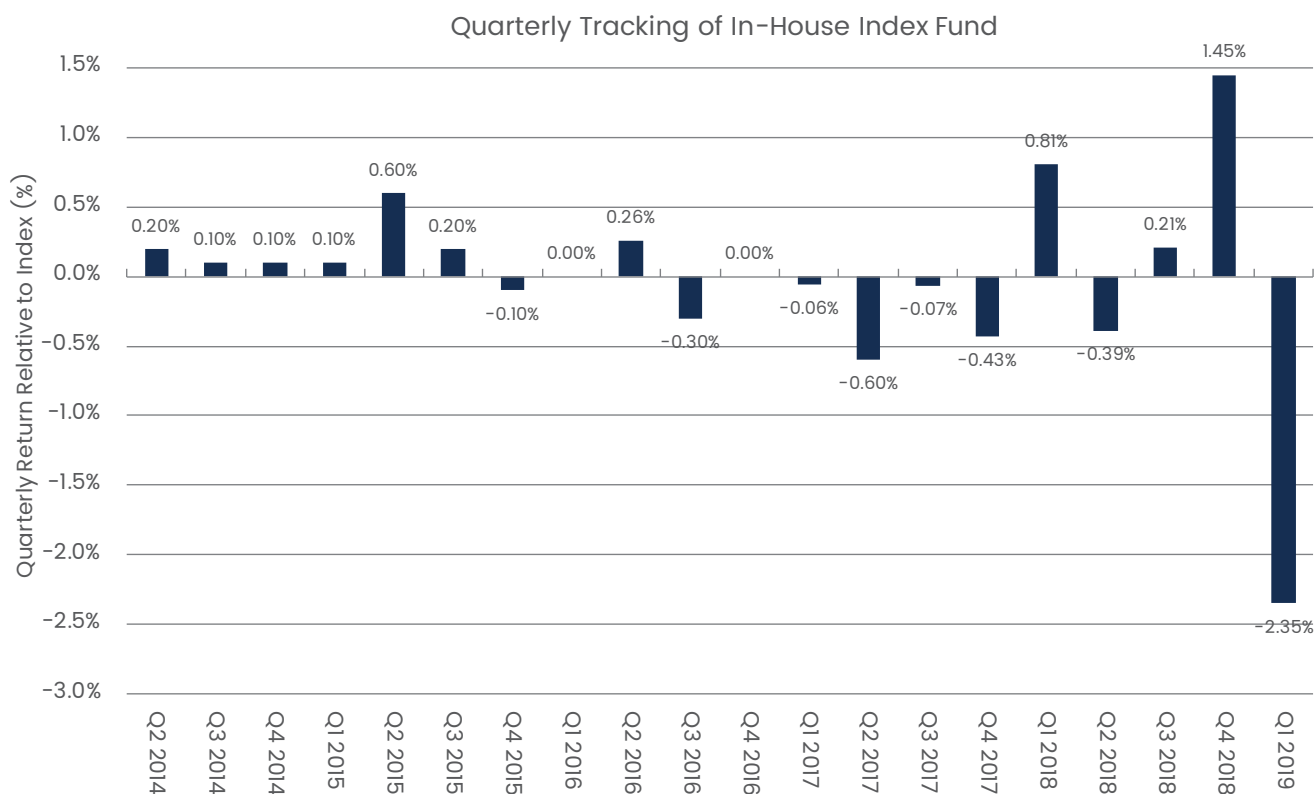
## In-house – Passive UK Equities – FTSE UK Low Carbon Optimisation Index

**Headline Comments:** At the end of Q1 2019 the fund returned +7.06%, this was behind the FTSE All-Share index return of +9.41%. Also, over three years the fund has returned +9.14% p.a., underperforming against the FTSE All-Share Index by -0.37%.

**Mandate Summary:** A UK equity index fund designed to match the total return on the UK FTSE All-Share Index. In Q3 2017, the fund switched to tracking the FTSE UK Low Carbon Optimisation Index. This Index aims to deliver returns close to the FTSE All-Share Index, over time. The in-house manager uses Barra software to create a sampled portfolio whose risk/return characteristics match those of the low carbon index.

**Performance Attribution:** Chart 1 shows the quarterly tracking error of the in-house index fund against the FTSE All-Share Index over the last five years. There are no performance issues although the new mandate is resulting in wider deviations quarter-on-quarter since the transition to the low carbon fund. Over three years, the portfolio underperformed its three-year benchmark by -0.37% p.a.

**CHART 1:**



Source: MJH Allenbridge; BNY Mellon

**Portfolio risk:** In Q3 2017, the index fund transitioned into a low carbon passive portfolio. As at quarter end, the portfolio had a tracking error of 0.4% against the FTSE UK Low Carbon Optimisation Index.

## London CIV – Allianz – Global Equity Alpha Fund

**Headline Comments:** In Q1 2019 the London CIV – Allianz sub-fund outperformed the benchmark by 1.21%, the first time it has done so since Q1 2018. Over three years the fund is outperforming the benchmark by +1.29% p.a. however it is still behind the performance target of +2.0% p.a.

**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 (since Q4 2015) is to outperform the MSCI World Index by +2.0% p.a. over rolling three-year periods net of fees.

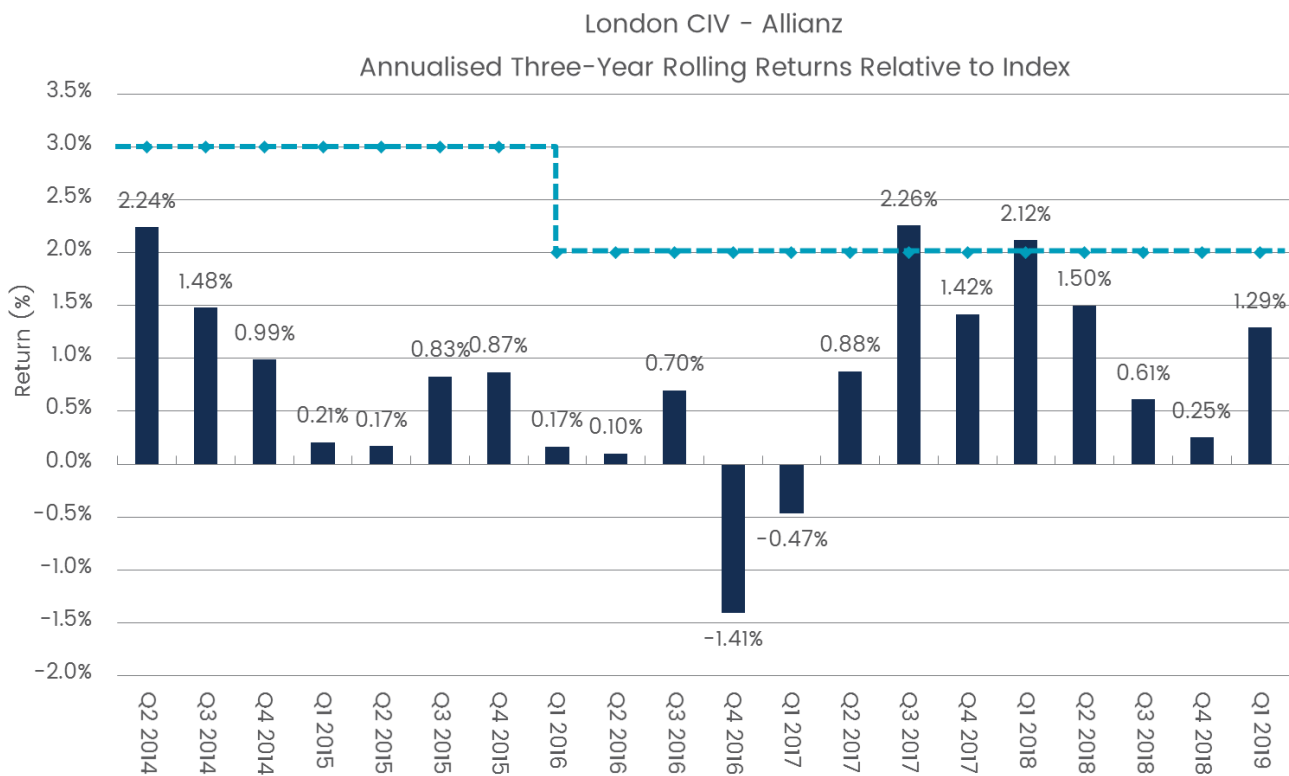
**Performance Attribution:** For the three years to March 2019, the Allianz portfolio was ahead of the benchmark, but trailing the performance target of +2.0% p.a., shown by the dotted line in Chart 2. Note that the dotted line drops in Q4 2015 when the mandate transferred to the London CIV sub-fund, which has a lower performance objective than when Allianz ran a bespoke mandate for London Borough of Islington.

The portfolio's outperformance, for the quarter to end March 2019, was attributed by the London CIV to gains in the IT, consumer staples and industrial sectors. The largest contributors to returns came from holdings in Microsoft (+0.68%) and Amadeus IT (+0.49%).

Holdings in United Internet and Tencent were the biggest detractors from performance (detracting -0.32% and -0.27% respectively).



**CHART 2:**



Source: MJH Allenbridge; BNY Mellon

**Portfolio Risk:** since London Borough of Islington became the sole investor in the fund, cost effective options for transitioning assets to the new manager have been explored and the problems around withholding tax have been discussed with the London CIV (LCIV). At the time of writing, LCIV remained in discussion with their lawyers and custodian to find a longer-term solution for this issue.

The active risk on the portfolio as at end March was +2.82% and the beta was 1.01 (if the market rises 10%, the fund is expected to rise 10.1%).

**Portfolio Characteristics:** as at end Q1 2019, the portfolio held 51 stocks (one new position from last quarter).

**Staff Turnover:** The London CIV did not report any staff changes during the quarter.

## London CIV – Newton – Global Active Equities

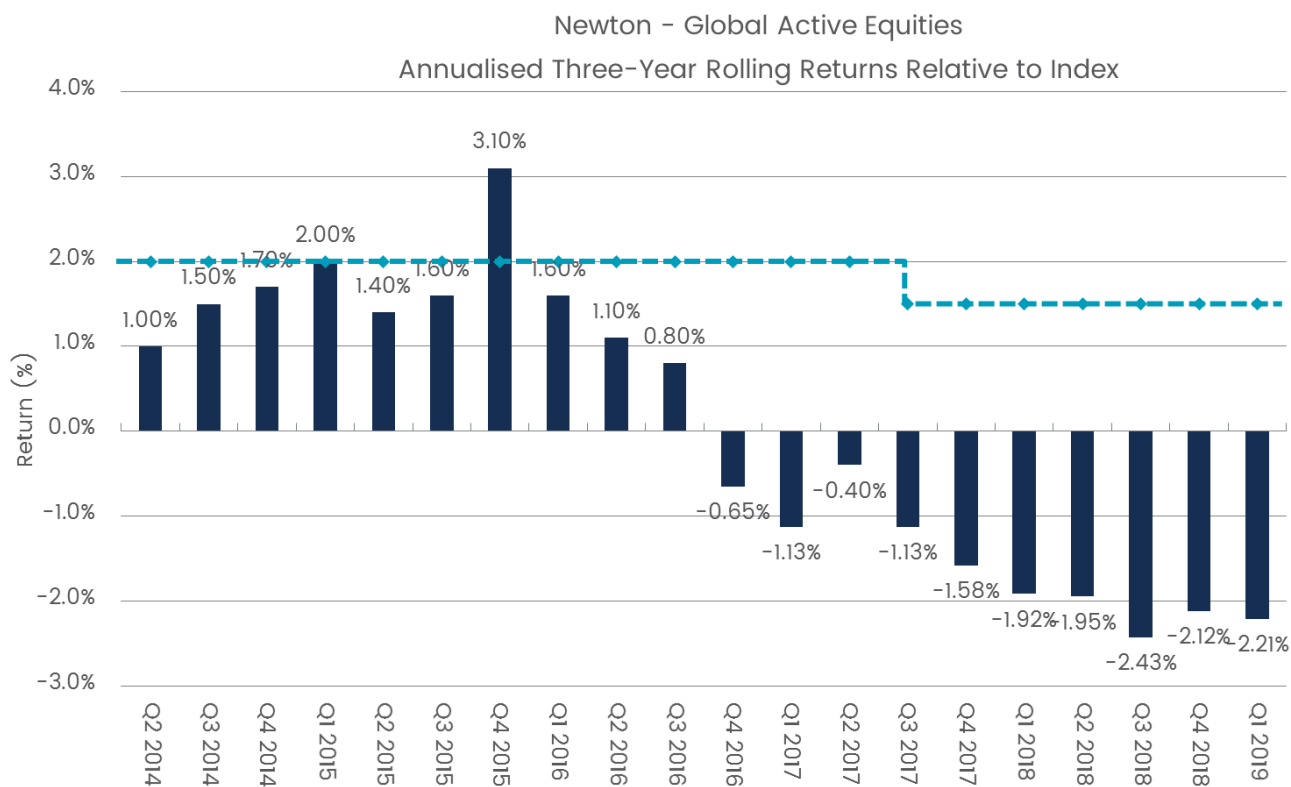
**Headline Comments:** The London CIV – Newton sub-fund underperformed its benchmark during Q1 2019 by -1.17%. In addition, over three years the portfolio continues to underperform the performance target of benchmark +1.5% p.a. and remains well below the performance that could be achieved with a passive mandate.

**Mandate Summary:** An active global equity portfolio. Newton operates a thematic approach based on 12 key themes that they believe will 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 since 22<sup>nd</sup> May 2017 is to outperform the FTSE All-World Index by +1.5% p.a. over rolling three-year periods, net of fees.

**Performance Attribution:** Chart 3 shows the three-year rolling returns of the portfolio relative to the benchmark (the navy bars) and compares this with the performance target, shown by the blue dotted line.

**CHART 3:**



Source: MJH Allenbridge; BNY Mellon

For the three-year period to the end of Q1 2019, the fund has trailed the benchmark by -2.21% p.a. This means it is trailing the performance objective by -3.71% (the performance objective is shown by the dotted line and dropped in May 2017 when the assets transferred into the London CIV sub-fund).

London CIV attributed the underperformance in the quarter to March 2019 to the equity markets bouncing back after the fund had increased allocations to defensive areas of the market. Also, the fund was underweight in financials, which was the strongest performing sector in the quarter.

Positive contributions to the total return came from holdings such as Cisco (+0.66%) and Microsoft (+0.58%). Meanwhile, Sonoco was the biggest detractor (-0.23%) from the fund's quarterly return of +8.62% followed by Suzuki (-0.22%).

The continued underperformance of this manager over a three-year period remains a concern although it is worth noting that the one-year performance is positive, with a fund return of +14.16% vs the Index return of +11.06%, an outperformance of +3.09%.

**Portfolio Risk:** the active risk on the portfolio stood at 2.53% as at quarter end. The portfolio remains defensive, with the beta on the portfolio at end March standing at 0.92 (if the market increases by +10% the portfolio can be expected to rise +9.2%).

At the end of Q1 2019, the London CIV sub-fund's assets under management were £606m, compared with £557m last quarter. London Borough of Islington now owns 36.1% of the sub-fund.

**Portfolio Characteristics:** The number of stocks in the portfolio stood at 60 as at quarter-end (up from 58 last quarter). The two positions added were Goldman Sachs and Bayer.

**Staff Turnover:** The London CIV did not report any staff changes during the quarter.

## BMO/LGM – Emerging Market Equities

**Headline Comments:** The total portfolio delivered a return of +5.28% in Q1 2019, compared with the benchmark return of +7.48%, an underperformance of -2.20%. The emerging market component of this portfolio returned +8.74% (source: BMO) compared with the index return of +9.92%. The frontier markets portfolio was also behind the index return of 5.45%, delivering a positive return of +1.73% (source: BMO). Over one year, the total fund is ahead of the benchmark return by +1.86%.

**Mandate Summary:** the manager invests in a selection of emerging market and frontier market equities, with a quality and value, absolute return approach. The aim is to outperform a combined benchmark of 85% MSCI Emerging Markets Index and 15% MSCI Frontier Markets Index by at least 3% p.a. over a three-to-five-year cycle.

**Performance Attribution:** during the quarter, the largest positive contributors to performance for the emerging markets portfolio came from Yum China Holdings Inc (+1.1%), Tingyi (+0.9%) and Inner Mongolia Yili Indus A (+0.9%). Companies which detracted most from performance included Mr Price Group (-0.8%), Discovery (-0.3%) and AVI (-0.2%).

In the frontier market portfolio, positive contributors included Eastern Co (+1.2%) and Sonatel (+0.8%). Companies which detracted from performance included Delta Corporation (-1.4%), BBVA Banco Frances (-0.6%) and Famous Brands (-0.4%).

**Portfolio Risk:** Within the emerging markets portfolio, 16% was allocated to developed or frontier markets, and cash stood at 2.4% as at quarter-end. Turnover for the previous 12 months was 31.3%. The largest overweight country allocation in the emerging markets portfolio remained India (+8.5% overweight). The most underweight country allocation remained South Korea (-13.0%) where the fund has no allocation.

Within the frontier markets portfolio, it is worth noting that 63% of the portfolio was invested in countries that are not in the benchmark index, including Egypt, Costa Rica and Peru. The most overweight country allocation remained Egypt (+12.7%) and the most underweight was Argentina (-13.9%), closely followed by Vietnam (-13.5%).

**Portfolio Characteristics:** The frontier markets portfolio held 40 stocks as at end March compared with the benchmark which had 115. The emerging markets portfolio held 38 stocks as at end March compared with the benchmark which had 1,138.

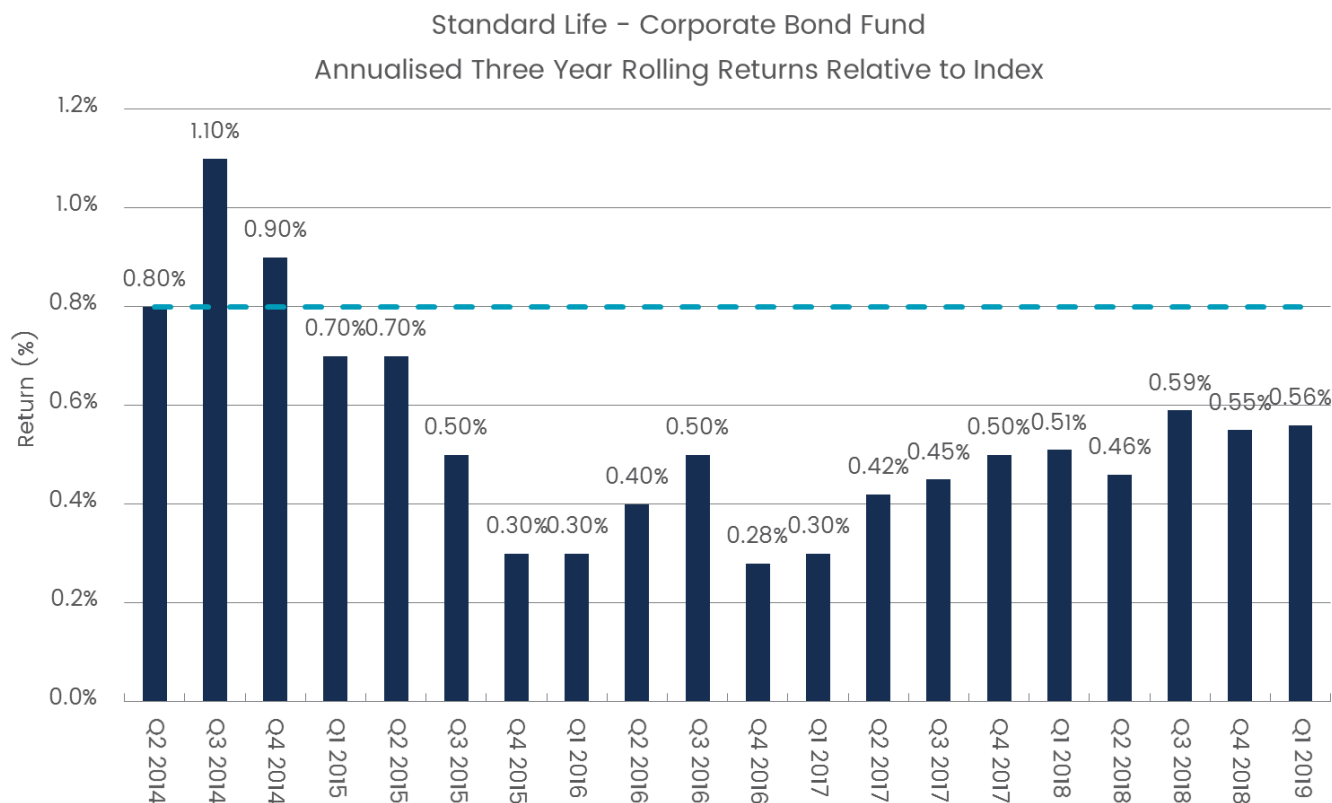
**Organisation:** Two new analysts joined LGM in January 2019.

## Standard Life – Corporate Bond Fund

**Headline Comments:** The portfolio was exactly on target with the benchmark return during the quarter. Over three years, the fund was ahead of the benchmark return but behind the performance target of benchmark +0.8% p.a.

**Mandate Summary:** The objective of the fund is to outperform the iBoxx Sterling Non-Gilt Index (a UK investment grade bond index) by +0.8% p.a. over rolling three-year periods.

**Performance Attribution:** Chart 4 shows the three-year performance of the Corporate Bond Fund compared to the Index, over the past five years. This shows the fund is ahead of the benchmark over three years but trailing the performance objective (shown by the dotted line in Chart 4).

**CHART 4:**

Source: MJH Allenbridge; BNY Mellon

Over three years, the portfolio has returned +5.24% p.a. net of fees, compared to the benchmark return of +4.68% p.a. Over the past three years, stock selection has added +0.34% value, followed by asset allocation (+0.19%) and curve plays (+0.09%).

**Portfolio Risk:** The largest holding in the portfolio at quarter-end remained EIB 5.625% 2032 at 1.6% of the portfolio. The largest overweight sector position remained Financials (+5.6%) and the largest underweight position remained sovereigns and sub-sovereigns (-14.2%). Contribution from the curve effect was negative this quarter.

The fund holds 3.3% of the portfolio in non-investment grade (off-benchmark/BB and below) bonds.

**Portfolio Characteristics:** The value of Standard Life's total pooled fund at end March 2019 stood at £2,855m, £18.8m lower than at the end of December 2018. London Borough of Islington's holding of £157.8m stood at 5.5% of the total fund value (compared to 6.9% last quarter). The drop for London Borough of Islington's holding reflects the transfer of £46 million into the new infrastructure managers' funds.

**Staff Turnover:** there were 26 joiners, but there were 22 people who left the firm, reflecting the ongoing rationalisation of the merged Aberdeen and Standard Life teams. Of the 22 leavers, six were from the fixed income team, including two investment directors, two investment managers, an investment analyst and the head of Australian fixed income.

Meghan Hughes has replaced Emma Andhagen as the client manager for London Borough of Islington. Frances Smyth remains the client director.

## Aviva Investors – Property – Lime Property Fund

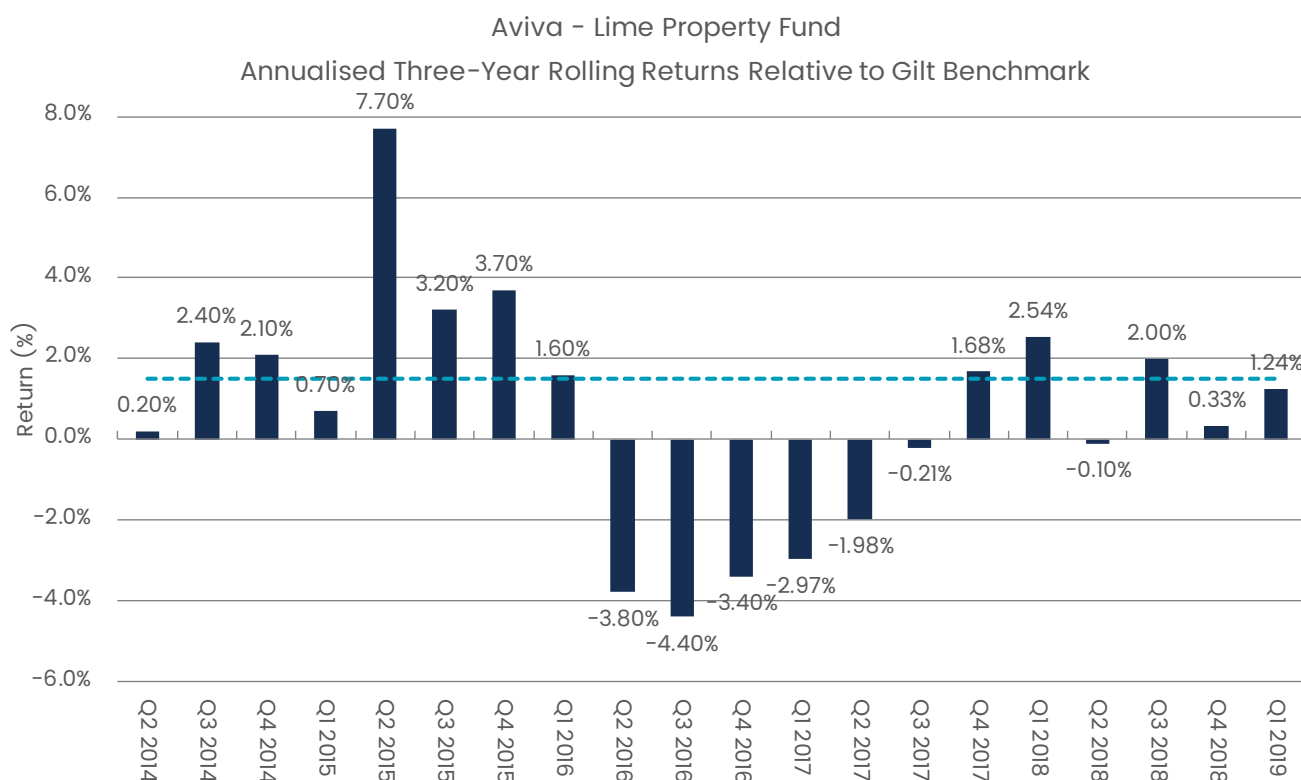
**Headline Comments:** The Lime Fund delivered another quarter of steady returns though behind the gilt benchmark return. Over three years, the fund is ahead of the benchmark return.

**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% p.a., over three-year rolling periods.

**Performance Attribution:** The fund's Q1 2019 return was attributed by Aviva to 0.84% capital return and 0.95% income return.

Over three years, the fund has returned +5.84% p.a. ahead of the gilt benchmark of +4.60% p.a., by +1.24% p.a., but the portfolio is slightly behind its outperformance target of +1.5% p.a., as can be seen in Chart 5.

### CHART 5:



Source: MJH Allenbridge; BNY Mellon

Over three years, 57% of the return came from income and 43% from capital gain.

**Portfolio Risk:** This quarter the fund completed an “asset management initiative” on Carnival House in Southampton whereby it agreed a rent reduction, in return for an increased lease from 10 to 20 years. It also replaced the open market rent reviews with RPI linked rent reviews.

The fund also completed on a transaction with Bouygues/John Laing and the University of Brighton to fund the development of new student accommodation on the main campus. This is scheduled to complete in September 2021.

The average unexpired lease term was 19.5 years as at end March 2019. 11.8% of the portfolio’s lease exposure in properties is in 30+ year leases, the largest sector exposure remains offices at 27.1%, and the number of assets in the portfolio is now 81, up from 80. The weighted average unsecured credit rating of the Lime Fund remained A-.

**Portfolio Characteristics:** As at end March 2019, the Lime Fund was valued at £2.23bn, an increase of £31.3m from the previous quarter end. London Borough of Islington’s investment represents 5.3% of the total fund. The fund had 70.9% allocated to inflation-linked rental uplifts as at end March 2019.

**Staff Turnover/Organisation:** Overall there were 6 leavers and 17 joiners across the whole Real Assets franchise. Regarding the Lime Fund in particular, there was one change to the team, Michael Maddox joined as a Long Income Origination Manager.

There were also some changes at the senior management level. Susan Ebenston has been appointed President and Chief Operating Officer, and as part of that role she heads the non-investment teams, including “Operations”, “Global Client Solutions”, and “People”.

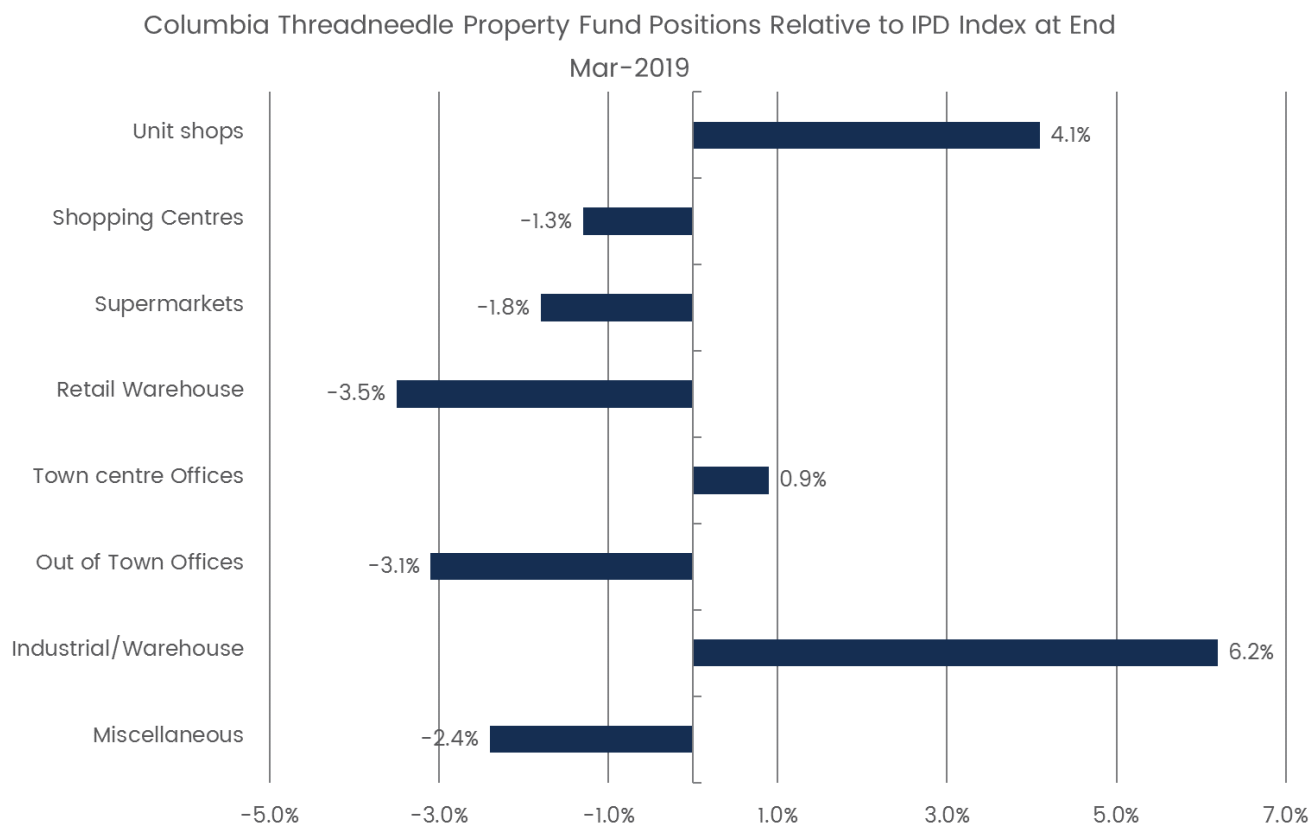
## Columbia Threadneedle – Pooled Property Fund

**Headline Comments:** The fund was ahead of the benchmark return in Q1 2019. Over three years, the fund has marginally underperformed the benchmark, and as such is behind the performance target of +1.0% 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 1.0% p.a., net of fees, on a rolling three-year basis.

**Portfolio Risk:** Chart 6 shows the relative positioning of the fund compared with the benchmark.

## CHART 6:



Source: MJH Allenbridge; Columbia Threadneedle

The overweight allocation to unit shops is skewed because IPD (against which the portfolio is measured) classifies two of the largest properties in Columbia Threadneedle's portfolio as retail. These are the Heals building and the South Molton Street property. In fact, based on square footage, these assets are significantly more office than retail.

During the quarter, the fund completed £16.4m worth of acquisitions including two industrial estates, one retail warehouse and one office, and disposed of £34.4 million of sales.

The fund has a higher than benchmark void rate at 9.7% versus 7.7%. This is something to monitor because it will pull the performance down on a relative basis. The fund has also had a higher cash balance, at 9.1%, than many peers, which has a similar effect.

**Performance Attribution:** The portfolio outperformed the benchmark by +0.12% in Q1 2019, delivering a return of +0.4%. The manager continued to note wide deviation in performance between different sectors. The retail sector, for example, delivered a return of -1.3% in Q1, compared with the industrial sector which returned +1.2% and the office sector which returned +1.1%.

Over three years, the fund is now behind of its benchmark by -0.03% p.a., with a return of +6.12% p.a., and is therefore also trailing the outperformance target of +1.0% p.a.



**Portfolio Characteristics:** As at end March 2019, the fund was valued at £2.02bn, a decrease of £22m compared with December 2018. London Borough of Islington’s investment represented 4.37% of the fund.

**Staff Turnover:** There were four joiners and one leaver across the firm in Q1 2019. No one directly involved with the London Borough of Islington portfolio was among these.

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

**Headline Comments:** The two passive index funds were within the expected tracking range when compared with their respective benchmarks. Both index funds marginally underperformed their benchmark indices.

**Mandate Summary:** Following a change in mandate in June 2017, the London Borough of Islington now invests in two of LGIM’s index funds: one is designed to match the total return on the FTSE-RAFI Emerging Markets Equity Index; the second is designed to match the total return on the MSCI World Low Carbon Target Index. The MSCI World Low Carbon Target is based on capitalisation weights but tilting away from companies with a high carbon footprint. The FTSE-RAFI Index is based on fundamental factors.

**Performance Attribution:** The two index funds both tracked their benchmarks as expected, as shown in Table 2.

**TABLE 2:**

|                              | Q1 2019 FUND | Q1 2019 INDEX | TRACKING |
|------------------------------|--------------|---------------|----------|
| FTSE-RAFI Emerging Markets   | +5.74%       | 5.77%         | -0.03%   |
| MSCI World Low Carbon Target | +10.14%      | +10.16%       | -0.02%   |

Source: LGIM

**Portfolio Risk:** The tracking errors are all within expected ranges. The allocation of the portfolio, as at quarter end, was 80% to the MSCI World Low Carbon Target index fund, and 20% allocated to the FTSE RAFI Emerging Markets index fund.

**Staff Turnover/Organisation:** LGIM’s CEO, Mark Zinkula announced that he will retire from LGIM in August 2019. After the quarter end, LGIM announced that Michelle Scrimgeour has been appointed as his replacement. She was previously the chief executive officer for Europe, Middle East and Africa (EMEA) at Columbia Threadneedle.

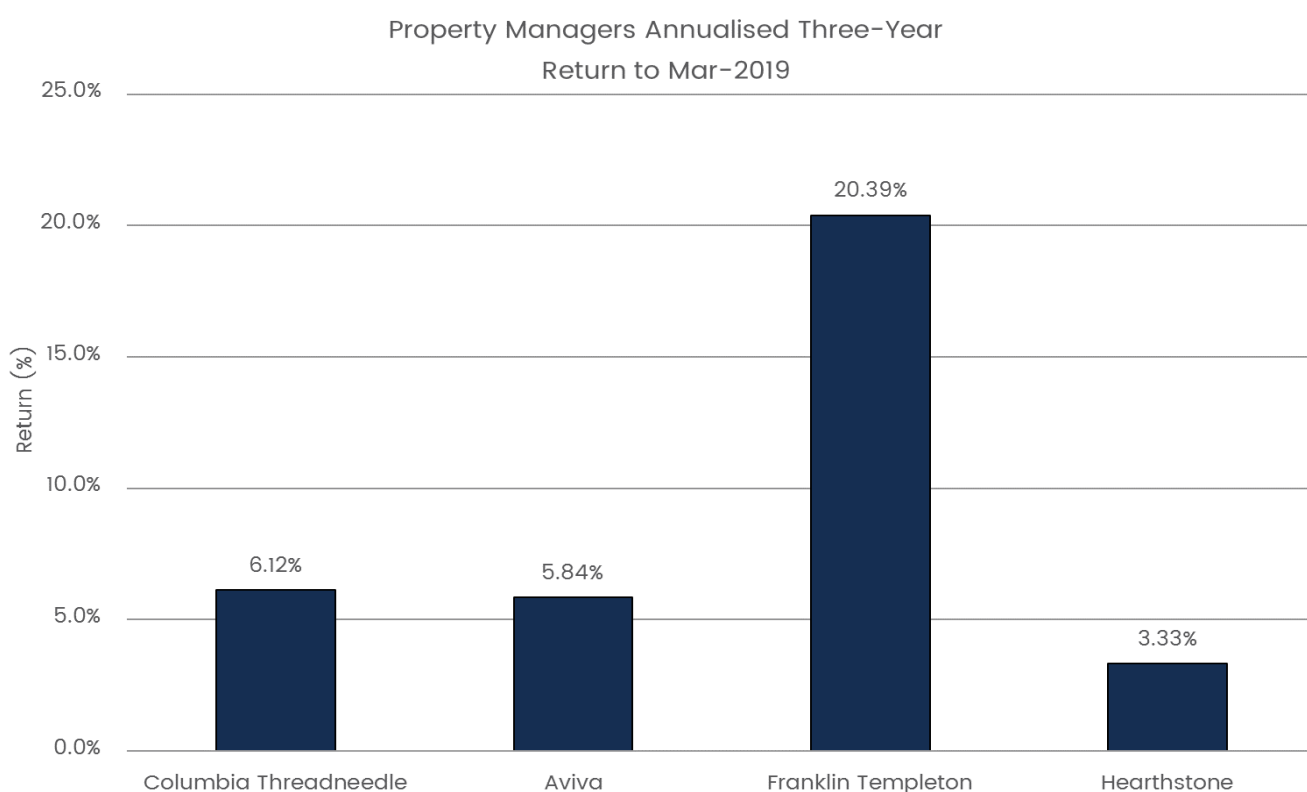
## Franklin Templeton – Global Property Fund

**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. The portfolio in aggregate outperformed the absolute return benchmark of 10% p.a. over three years.

**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% p.a.

**Performance Attribution:** Over the three years to March 2019, Franklin Templeton continues to be the best performing fund across all four property managers. Chart 7 compares their annualised three-year performance, net of fees.

### CHART 7:



Source: MJH Allenbridge; Columbia Threadneedle

**Portfolio Risk:** Fund I is now in its distribution phase. Distribution activity has been strong, and the fund has paid across 142.5% of the initial commitment. Leverage stood at 53% as at end Q1 2019.

The largest allocation in Fund I is to Sweden (46% of funds invested), followed by the US (21%) and Spain (17%).

Three of the underlying funds are performing well ahead of expectations, five are above expectations, four are on target and two are below expectations (Sveafastigheter III and Lotus Co-Investment, the latter now having been fully liquidated).

Fund II is now fully invested and is beginning to make distributions. As at end March 2019, 42.2% of committed capital had been distributed. Leverage stood at 55%.

The largest allocation in Fund II is to Italy (46% of funds invested), followed by the US (33%) and Spain (12%).

Two of the underlying funds are performing well ahead of expectations, one is above expectations, five are on target and, for the remaining two, it is too soon to assess.

**Staff Turnover/Organisation:** There was one new joiner in the team during Q1 to the California office: Timothy Smolarski joined as an impact research analyst. London Borough of Islington's relationship director, Chris Orr, left the team just after quarter end. Adam Lees has taken over as the primary point of contact.

## Hearthstone – UK Residential Property Fund

**Headline Comments:** The portfolio underperformed the benchmark for the quarter ending March 2019 and over three years.

**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. The benchmark used by BNY Mellon is the IPD UK All Property Monthly Index.

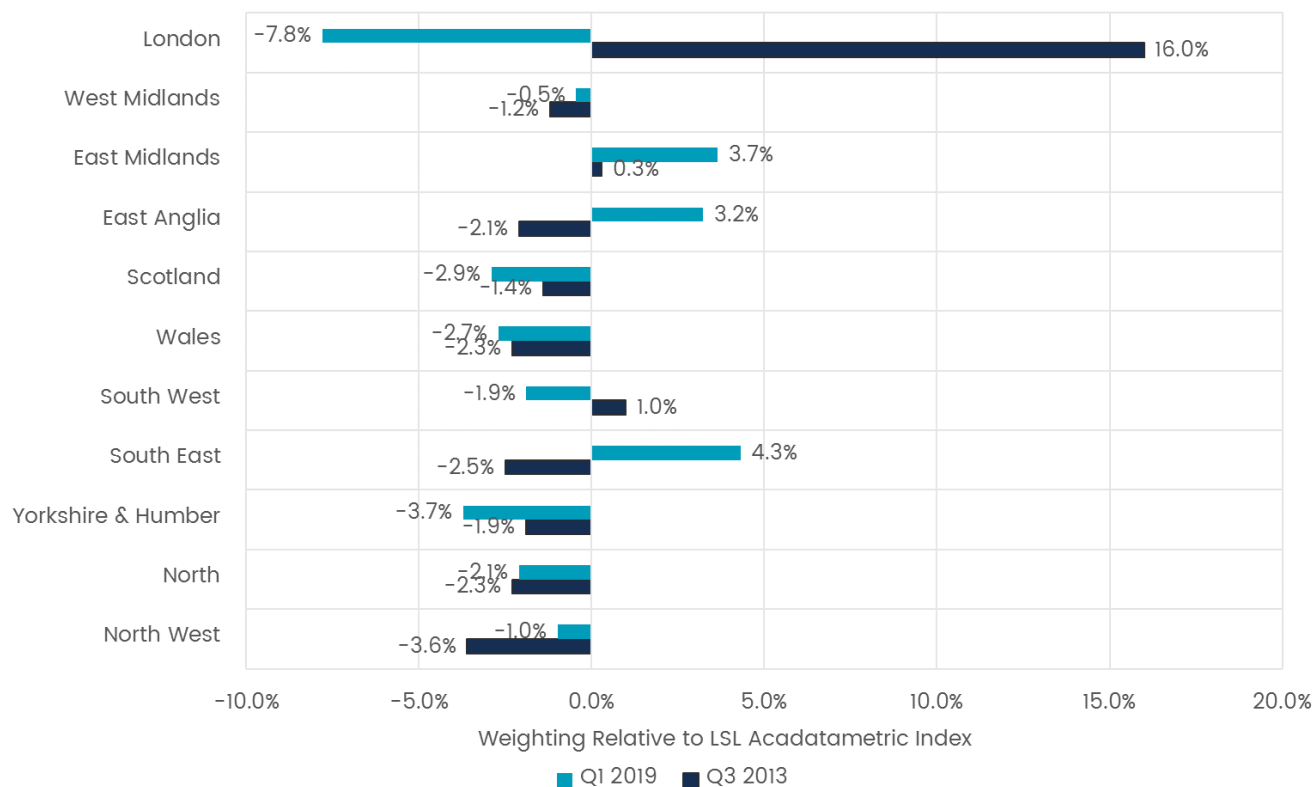
**Performance Attribution:** The fund underperformed the IPD index over the three years to March 2019 by -3.51% p.a., returning +3.33% p.a. versus the index return of +6.84% p.a. The gross yield on the portfolio as at March 2019 was 4.81%. Adjusting for voids, however, the yield on the portfolio falls to 4.70%.

**Portfolio Risk:** The cash and liquid instruments on the fund stood at 11.43%.

It remains Hearthstone's long-term intention to run the portfolio on a region-neutral basis. However, they do not wish to be overweight in central London at the present time and are also looking to decrease their overweight allocation to the South East. Chart 8 compares the regional bets in the portfolio in Q1 2019 (turquoise bars) with the regional bets at the start of the mandate, in Q3 2013 (navy bars).

## CHART 8:

Geographic Positioning of Hearthstone Portfolio Q3 2013 vs Q1 2019



Source: MJH Allenbridge; Hearthstone

**Portfolio Characteristics:** By value, the fund has a 12% allocation to detached houses, 44% allocated to flats, 24% in terraced accommodation and 21% in semi-detached.

As at end March there were 200 properties in the portfolio and the fund stood at £56.3m. London Borough of Islington's investment represents 50.6% of the fund. This compares with 72% at the start of this mandate in 2013.

There have been no changes to the investment process since London Borough of Islington invested. Hearthstone continue to focus on mainstream homes with regional diversification, although they currently have no allocation to prime locations such as Central London. A point to note is that Hearthstone does not invest in social housing, or affordable housing, and they have no plans to do this.

The Touchstone contract (as the residential property manager) has been put on hold until the new asset manager has been in situ for at least six months. Hearthstone had already asked an external consultant to scan the market which revealed that four firms had the necessary criteria to deliver to the contract. Three of these had quoted similar fees, but none of them (including Touchstone) could provide the superior ESG reporting being requested by Hearthstone.

**Organisation and Staff Turnover:** During the quarter, one business development manager left the team following a period of performance management. Chris Reynolds has replaced

him. After the quarter end, Marie Cooper, the asset manager, announced that she would be leaving the firm. Hearthstone have already found a replacement, and the new person will combine asset management and fund management, reporting to Alan Collett. Until they start, however, Alan will run the fund on a full-time basis.

## Schroders – Diversified Growth Fund (DGF)

**Headline Comments:** The DGF delivered a positive return in Q1 2019. Over three years, the fund is behind the target return of RPI plus 5% p.a.

**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% p.a. over a full market cycle, with two-thirds the volatility of equities.

**Performance Attribution:** The DGF delivered a return of +4.94% in Q1 2019. This is +3.91% above the RPI plus 5% p.a. target return of +1.03% for Q1. In a quarter when all major asset classes produced a positive return, this fund should be expected to deliver a strong return against its benchmark. Over three years, the DGF delivered a return of +5.20% p.a. compared with the target return of +7.97% p.a., behind the target by -2.78% p.a. This underperformance remains a concern, but the bounce back in Q1 has reduced the underperformance over three years from -4.89% p.a. as at end Q4 2018, to -2.78% p.a. as at end Q1 2019 so there has been some improvement since the end of last year.

In Q1 2019, equity positions added +3.4%, alternatives added +0.5%, credit and government debt added +1.1%, and cash and currency was negative -0.3% (figures are gross of fees).

The return on global equities was +10% p.a. for the three years to March 2019 compared with the portfolio return of +5.20% (a 50% capture of the equity return, somewhat lower than expected). Over a full three-to-five-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 three to five-year market cycle. Over the past three years, the volatility of the fund was 4.3% compared to the three-year volatility of 9.3% in global equities (i.e. 46% of the volatility) so is less risky than expected.

**Portfolio Characteristics:** The fund had 32% in internally managed funds (up from last quarter's 27% allocation), 35% in internal bespoke solutions (down from 39% last quarter), 3% in externally managed funds (same as previous quarter), and 27% in passive funds (down from 30% last quarter) with a residual balance in cash, as at end March 2019. In terms of asset class exposure, 42.6% was in equities, 22.8% was in alternatives and 30.5% in credit and government debt, with the balance in cash.

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

**Organisation:** During the quarter, one person joined the DGF team as a multi-asset fund manager.

## Quinbrook – Low Carbon Power Fund

**Headline Comments:** A new investment made by London Borough of Islington of \$67 million made at the end of December 2018. Performance from 31 January to end March 2019 was positive at 6.64%, reflecting the immediate uplift from the fund.

**Mandate Summary:** The fund invests in renewable energy and low carbon assets across the UK, US and Australia as well as selected OECD countries. The fund is expected to make between 10 and 20 investments in its lifetime and targets a net return of 12% per annum. The fund held a final closing in February 2019 with \$730 million committed by 15 limited partners.

**Portfolio Characteristics:** The fund has currently invested \$252 million into 12 assets ranging from onshore wind farms, solar power plants, battery storage and natural gas distribution.

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