AllenbridgeEpic
investment advisers

REPORT PREPARED FOR

London Borough of Islington Pension Fund

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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
AllianzGI (RCM)	One joiner and three leavers during the quarter.	Outperformed the Index by +1.4% for the quarter and by +0.9% p.a. over three years. Behind the target of +3.0% p.a. over three years.	£300 billion AUM as at 31st October 2014. Equity mandates constitute 37% of AllianzGI's total business.		
Newton	1 joiner and 4 leavers this quarter, three of whom were from the SRI team.	Outperformed the Index by +0.5% in the quarter. Also outperforming over three years by +1.7% per annum, slightly behind the target of +2% p.a.	£50.7 billion as at 31st December 2014, slightly down on June figures.		CIO Simon Pryke's changes can be seen to be positively impacting returns.
Standard Life	29 joiners (of whom five were in fixed income) and 7 leavers during the quarter.	Over three years the Fund has outperformed by +0.9% p.a. and is now ahead of the performance target of +0.8% p.a.	Underlying fund rose in value by £101.8m this quarter. London Borough of Islington's holding represents 5.6%.	Holding 6.2% in high yield non-benchmark bonds.	

Manager	Leavers, joiners and departure of key individuals	Performance	Assets under management	Change in strategy/risk	Manager specific concerns
Aviva	Mark Connolly appointed as CIO for fixed income and the UK asset manager.	Outperformed the gilt benchmark by +2.0% p.a. over three years.	Fund was valued at £1.3 billion as at end Q4 2014.		
Thread-needle	Six leavers in Q4 2014 and no joiners. None of these was from the property team.	Outperformed the benchmark by +2.1% per annum over three years – ahead of their performance target.	£95.1 billion in assets worldwide as at 31st December 2014. Pooled fund has assets of £1.45 billion of which Islington holds 4.5%.		Announced a rebranding of its business as Columbia Threadneedle Investments in the first half of 2015.
Legal and General	Senior management team has been restructured. Ali Toutounchi, managing director of index funds, will retire at the end of 2015.	Regional funds are all tracking the indices.	£477 billion of assets under management for over 3,000 clients worldwide as at end September 2014.		
Franklin Templeton	No changes in the private real estate team during the quarter.	Another good quarter with a return of +6.8%. Beating the performance target of 10% p.a. by +29.6% over 12 months.			

Manager	Leavers, joiners and departure of key individuals	Performance	Assets under management	Change in strategy/risk	Manager specific concerns
Hearth-stone	Prakash Shar, Interim Head of Finance, left the firm. Simon Knight, Managing Director, has announced his departure.	Ahead of the benchmark during the quarter by +0.1%, and behind by -0.4% for the twelve months to December 2014.	Fund was valued at £29.6m at end Q4 2014. Islington's holding represents 75% of the Fund.		Team is now just nine people. The lack of AUM inflows is a potential threat to the performance of the Fund – opportunities are not able to be taken up due to a lack of cash to invest.

Key to shading in Table 1:

Minor concern

Monitoring required

2. Individual Manager Reviews

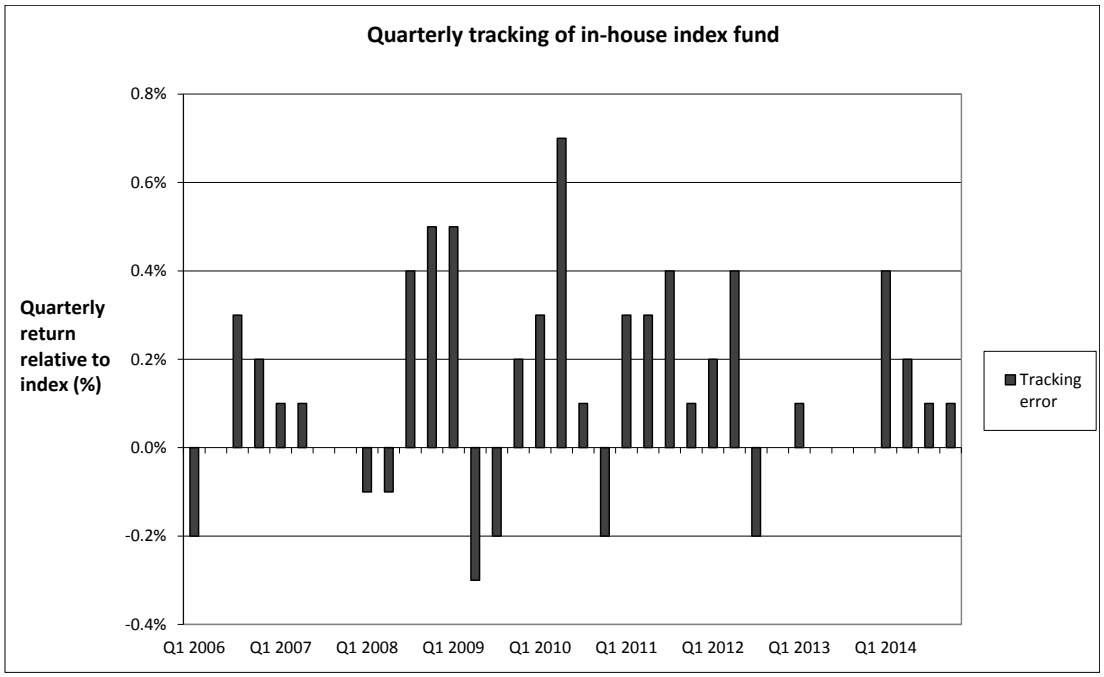
2.1. In-house – Passive UK Equities – FTSE All Share Index Fund

Headline comments: The portfolio continues to meet its objectives. The fund delivered a quarterly return slightly ahead of the index benchmark (+0.7% versus +0.6%). Over three years the fund has outperformed the index by +0.4% p.a.

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 as a result the portfolio has outperformed its benchmark by +0.4% per annum.

Chart 1



Source: AllenbridgeEpic based on WM figures

Portfolio risk: The tracking error on the portfolio as at end December was 0.24% per annum. In terms of sector bets, relative to the Index, the largest underweight sector position relative to the index was Financials (-0.8%). The fund was most overweight in Non-Cyclical Consumer Goods (+0.4%). 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 301 securities at the end of Q4 2014. There were no purchases or sales during the quarter.

2.2. AllianzGI (RCM) – Global Active Equities

Headline comments: In terms of relative performance, the fund recovered some of the poor relative performance of last quarter, outperforming the index by 1.4%. Over three years the fund is outperforming by +0.9% per annum: however, this is behind the target of 3% per annum.

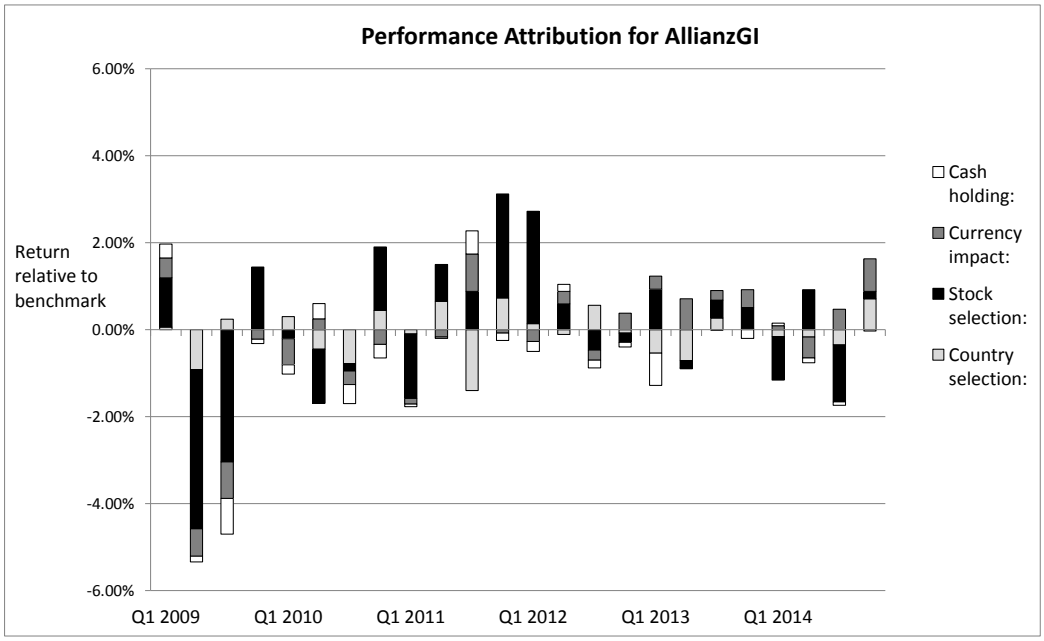
Mandate summary: An active global equity portfolio. AllianzGI operates a bottom-up global stock selection approach. They employ a team of research analysts to identify undervalued stocks in each geographical region (Europe, US, Asia Pacific). A global portfolio team is responsible for constructing the final portfolio. The objective of the fund is to outperform the FTSE All World Index by 3.0% per annum over rolling 3 year periods gross of fees.

Performance attribution: Chart 2 shows a breakdown of AllianzGI's quarterly performance since Q1 2009 relative to the benchmark.

Over the past three years, AllianzGI is ahead of its benchmark by +0.9% per annum, although **they are still trailing their performance target of 3% per annum**. Stock selection has made the biggest positive contribution over the past three years (+1.0% per annum). This is shown in the black bars in Chart 2 for each quarter.

Currency selection has also made a positive contribution over three years (+0.9% p.a.), but this has been partially offset by poor country bets (-0.1% p.a.) and by the cash holding (-0.5% p.a.)

Chart 2



Source: AllenbridgeEpic based on AllianzGI figures

Portfolio risk: In terms of sector bets, relative to the benchmark, the largest underweight sector position relative to the index is Consumer Services (-6.0%). The fund remains most overweight Industrials (+9.4%). **Note that these are the largest underweight/overweight positions held by the manager since inception.**

In terms of regional bets, the fund remains most overweight to Europe (+11.0% overweight). The largest underweight region is UK (-3.9% underweight). The cash position stood at 3.2% as at end December 2014.

Portfolio characteristics: The total number of holdings in the portfolio stood at 57 securities at the end of Q4 2014, within AllianzGI's normal range of 50-60 names. The beta on the portfolio was 1.03 at the end of December. This was a slightly more bullish position than as at end September when the beta stood at 0.99.

Staff turnover: There was one joiner and three leavers during the quarter. The team managing London Borough of Islington's portfolio remains unchanged, however.

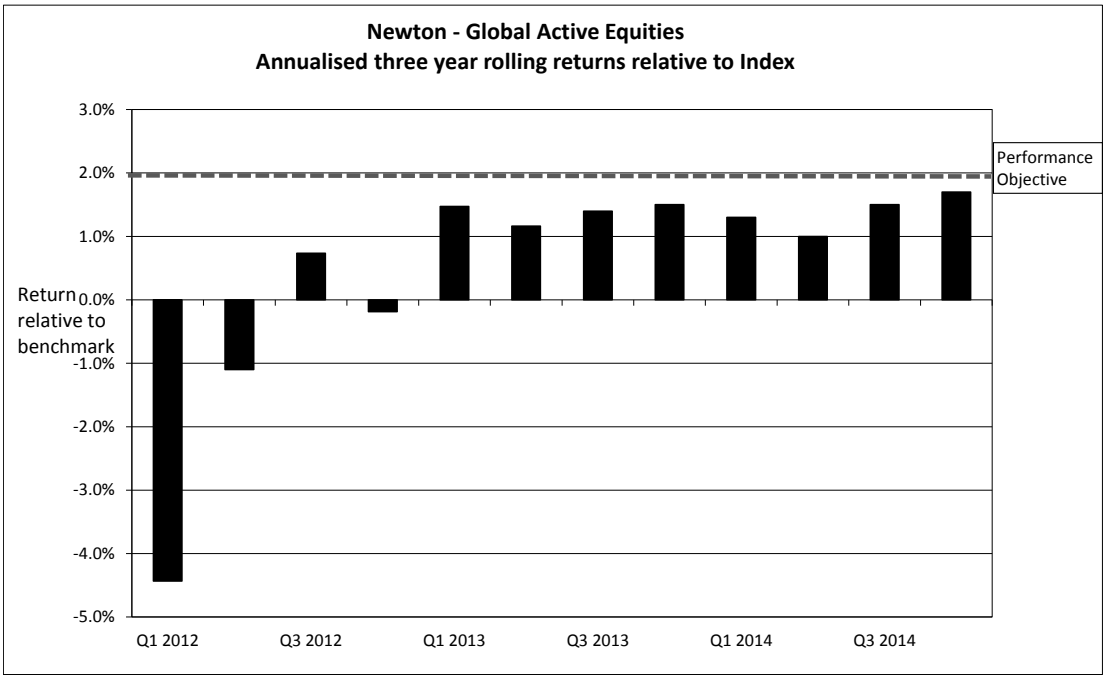
2.3. Newton – Global Active Equities

Headline comments: Newton were ahead by +0.5% during the quarter bringing the 12 month track record back into line with benchmark, having previously been underperforming. Over three years the portfolio has outperformed by +1.7% per annum, slightly behind the target of 2% p.a. The outperformance can be attributed to positive stock selection decisions (+2.2% p.a.) offset by slightly negative asset allocation decisions (-0.3% p.a.)

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: AllenbridgeEpic based on data from Newton and WM

Chart 3 shows the impact of the changes introduced by Simon Pryke, Newton's Chief Investment Officer, at the beginning of 2012. There has been a noticeable improvement in the three year rolling returns and **the portfolio is now closer to its performance target than at any time since inception** (shown by the right hand bar in Chart 3).

Over the three years to December 2014, Newton's return was +16.6% p.a. compared to the index return of +14.7% p.a., an outperformance of +1.7% p.a. Stock selection accounted for +2.2% outperformance whilst asset allocation was negative (-0.3%). Whilst the performance numbers are looking improved, it is worth noting that since the inception of Newton's portfolio in November 2008 the pension fund is currently no better off than it would have been with a passive mandate. Newton's since inception return is +13.9% per annum compared with the benchmark return at 14.0% per annum *(source: Newton)*.

In terms of stock and sector selection, during the quarter the most successful sector bet was Basic Materials (+0.3% contribution to relative performance) where Newton held an overweight position. The least successful sector was Technology (-0.3% relative performance). Despite a poor Q4, oil added 0.4% over the 12 months to end December 2014. Telecommunications was the worst sector in relative terms over 12 months, contributing -1.2%.

In terms of performance expectations in 2015, Newton considers the headwinds to include:

- Complicated currency moves which influence fund flows
- A strong dollar impacting emerging markets
- Earnings expectations not as high as expected

Portfolio Risk: The largest overweight regional allocation was in European Equities (+8.2% overweight). This has been a long-standing position that has been in place since Q3 2011. Successful stock selection in this region added +0.5% to relative performance during the quarter. The most underweight allocation remained Other Equities (-5.4%).

In terms of sector bets, Newton remained overweight in Consumer Services. **This position (+9.7% relative to benchmark) represents the largest sector overweight position in the portfolio since inception.** The most underweight sector remained in Financials (-9.4%).

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) has remained at 2.7%, within the normal range of 2% and 6%.

Portfolio characteristics: At the end of Q4 2014, the portfolio held 76 securities (80 as at the end of Q3 2014). The manager anticipates that the number of stocks may decrease further (as low as 70). They expect to become more concentrated over time. Turnover over the past 12 months was 29%, at the low end of Newton's normal expected range of turnover to 30%-70%.

Staff turnover: during the quarter one person joined and four left the firm (three of whom were from the SRI team).

The team managing London Borough of Islington's portfolio remains unchanged, with Terry Coles the portfolio manager, Jeff Munroe his alternate, James Mitchell the investment relationship manager and Rob Forder the client service executive.

Simon Pryke, the CIO, is beginning to spend more of his time focussing on Newton's US sales operation, and is assessing which products to bring to the US market.

Organisation: as at end December 2014, assets under management stood at £50.7 billion. In 2014, flows into Newton's Real Return strategy (DGF) were positive. Although Newton lost a large Asian equity mandate, global equity mandates have now stabilised, in response to improved performance figures.

In terms of the London CIV, Newton's global equity strategy is likely to go onto the platform, and this could be beneficial for London Borough of Islington.

2.4. Standard Life – Fixed Income

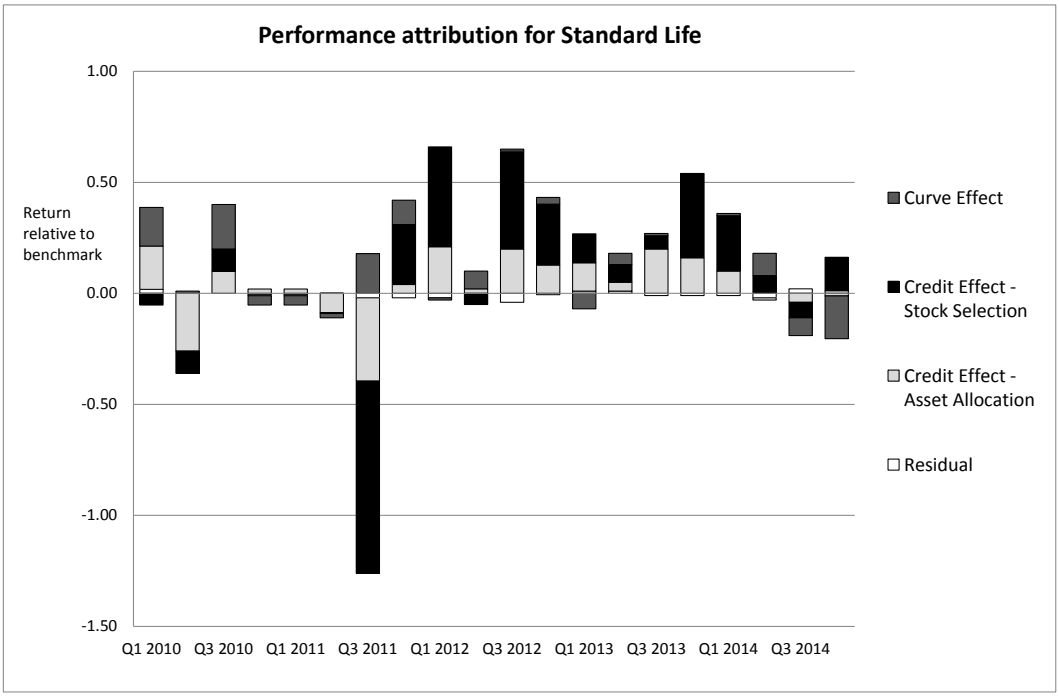
Headline comments: The portfolio was slightly behind the benchmark during the quarter (-0.1%). Over three years, Standard Life's outperformance was +0.9% per annum. They remain ahead of their performance target of +0.8% per annum.

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 performance attribution of the Corporate Bond Fund versus its benchmark.

Chart 4



Source: AllenbridgeEpic based on Standard Life figures

Over three years, the portfolio has returned +9.6% p.a. compared to the benchmark return of +8.6% p.a., an outperformance of +0.9% p.a. This remains a respectable absolute return, and the **fund is also meeting its performance objective of outperforming the benchmark by +0.8% per annum**.

Over the past three years, most of the outperformance has come from successful stock selection (+0.7%), with asset allocation contributing +0.4%.

Portfolio Risk: The largest holding in the portfolio at quarter end remains EIB 6% 2028 (2.0% of the portfolio). The largest overweight sector position remained Financials (+7.1%). The long-standing underweight position in sovereigns and sub-sovereigns remains (-14.9%).

The fund continues to hold 6.2% of the portfolio in non-investment grade bonds (these do not form part of the benchmark).

Portfolio characteristics: The value of Standard Life's total pooled fund at end September 2014 was £3,788.4 million, £101.8 million higher than at the end of Q3 2014 and slightly reversing the trend of outflows as investors changed strategy and moved into absolute return bond strategies and/or multi asset credit. This may reflect longer time horizons for expected interest rate increases. London Borough of Islington's holding of £213.4 million is 5.6% of the total fund value. When Islington first invested, the percentage holding was 3.4%.

Staff turnover: There were 29 joiners during the quarter, including five fixed income specialists. There were 7 leavers, none of whom were from the fixed income division.

2.5. Aviva Investors – Property – Lime Property Fund

Headline comments: The Fund underperformed the gilt benchmark by -6.1% during the quarter as gilts had another exceptional performance with the benchmark returning +8.2%. Over three years, however, the Fund is ahead of its benchmark by +2.0% per annum and beating the target of +1.5% per annum outperformance.

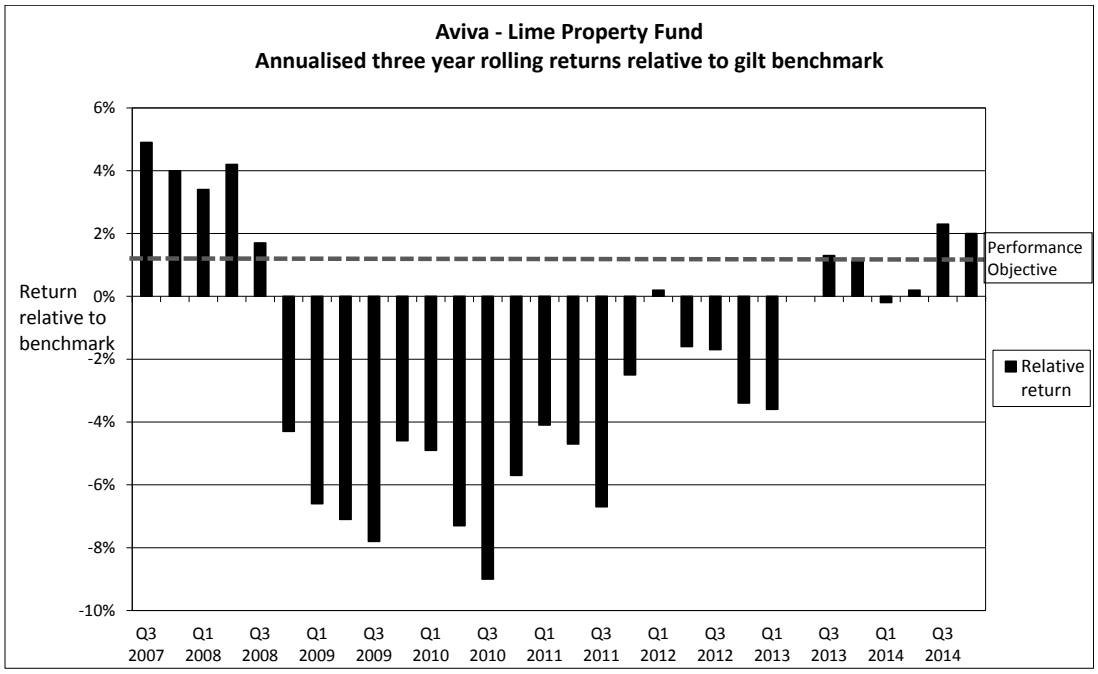
Mandate summary: An actively managed UK pooled property portfolio, the Lime Fund invests in a range of property assets including healthcare, education, libraries, offices and retail. The objective of the fund is to outperform a UK gilt benchmark, constructed of an equally weighted combination of the 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 was behind the gilt benchmark this quarter by -6.1% as gilts performed strongly for the second quarter in a row. The portfolio also trailed the IPD Index in Q4 2014 by -2.6% but in a rising property market this is to be expected with a low risk property portfolio such as the Lime Fund.

Over three years, the performance is more favourable, with the fund returning +7.3% p.a. compared to the gilt benchmark of +5.2% p.a., an outperformance of +2.0% per annum. The **portfolio is ahead of its performance objective of +1.5% per annum outperformance over three years**. Of the +7.3% fund return over three years, 5.5% came from income, with the balance from capital gain.

Chart 5 shows the relative performance of the Fund compared to its gilt benchmark on a three year rolling basis.

Chart 5



Source: AllenbridgeEpic based on WM figures

Portfolio risk: The purchase of a car showroom was completed in Q4 2014, and contracts for five hotels totalling £50 million were exchanged. The average unexpired lease term is now 20.3 years, with 8% of the portfolio's lease exposure in properties in over-35-year leases. 44% of the properties have public tenants with the largest sector exposure remaining supermarkets (21.5%). Aviva have stated that these supermarkets remain profitable. The cash allocation stood at 4.4% as at quarter end.

Portfolio characteristics: As at end June the Lime Fund was valued at £1.303 billion, an increase of £23.0 million from the previous quarter end. London Borough of Islington's holding represents 3.6% of the total Fund's value.

Staff turnover: Mark Connolly joined Aviva as chief investment officer (CIO) for fixed income and the UK asset manager. Prior to Aviva, he was head of fixed income at Scottish Widows Investment Partnership.

2.6. Threadneedle - Pooled Property Fund

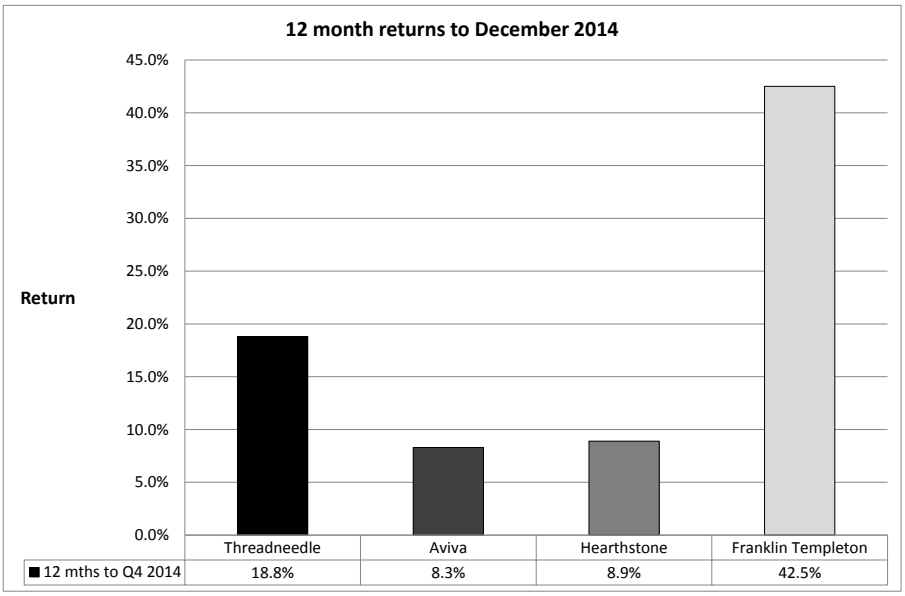
Headline comments: The Fund's performance was in line with its benchmark (the IPD All Balanced – Weighted Average (PPFI) Index) during the quarter. Over three years, the Fund has outperformed its benchmark by +2.1% per annum. The Fund is ahead of its benchmark and beating the performance target of 1% p.a. above benchmark over three years.

Mandate summary: An actively managed UK commercial property portfolio, the 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. The benchmark changed at the end of Q4 2013. Prior to this, the benchmark was the CAPS pooled property median fund.

Performance attribution: The portfolio was in line with the benchmark during the quarter. In terms of the three year performance, **the Fund is ahead of its benchmark and beating the performance target of outperforming by +1% per annum.** The portfolio returned +9.5% p.a. over three years compared with the benchmark return of +7.2% p.a.

Threadneedle ranked second across London Borough of Islington's property managers over the past 12 months. This is shown in Chart 6 which compares the returns for the four property managers.

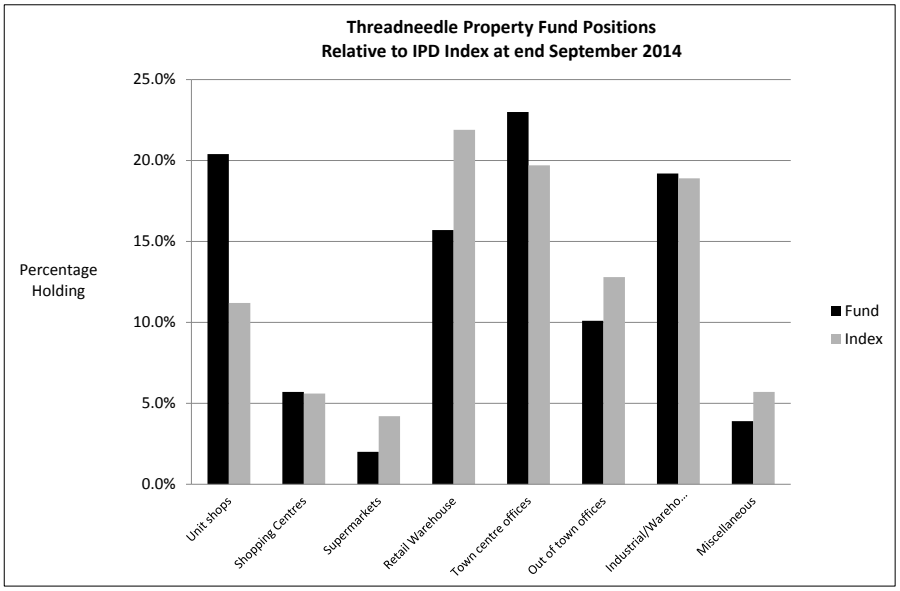
Chart 6



Source: AllenbridgeEpic based on WM data

Portfolio Risk: The fund made one opportunistic purchase of £6.6 million in Q4 2014. Chart 7 shows the current breakdown of the portfolio relative to its benchmark. For the year to December 2014, the fund succeeded in 169 new lettings and lease renewals. Of these 45 rent reviews generated an additional £920,000 p.a. in rental uplift.

Chart 7



Source: AllenbridgeEpic based on Threadneedle data.

Portfolio characteristics: As at 31st December 2014, the Threadneedle Property Fund was valued at £1.45 billion, an increase of £77.1 million compared with September 2014. Over the past twelve months the fund has grown by nearly £320 million. London Borough of Islington's investment represents 4.5%.

Staff turnover: there were six leavers and no joiners during Q4 2014, across the organisation. None of these was from the property division.

Organisation: just after the quarter end, Threadneedle announced a rebranding of its business. The new global brand, Columbia Threadneedle, will be rolled out in the first half of 2015, and brings together two affiliated firms both owned by Ameriprise Financial. Together, Columbia and Threadneedle have £316 billion of assets under management.

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 underperformed its market capitalisation-weighted counterpart in Q4 2014 by -3.8%. For the 12 months to Q4 2014 the underperformance was -7.0%.

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

Q3 2014	Fund	Index	Tracking
Europe	-0.5%	-0.6%	0.1%
Japan	1.6%	1.6%	0.0%
Asia Pacific ex Japan	0.5%	0.5%	0.0%
FTSE emerging markets	0.4%	0.3%	0.1%
RAFI emerging markets	-3.4%	-3.4%	0.0%

Source: LGIM

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 4.0% overweight.

Staff Turnover: During the quarter, LGIM announced a restructuring of its senior team. Global head of solutions Aaron Meder was appointed to a new role as head of investment. Going forward, he will be responsible for all Legal & General's investment teams (excluding real assets). Sarah Aitken was appointed head of distribution for Europe, the Middle East and Asia for both institutional and retail

divisions. Roger Bartley, head of fixed income, was appointed vice chair of investments and Mike Craston, global head of distribution, was appointed vice chair of America. Bill Hughes, previously managing director of property, will now be the head of real assets. Finally, Ali Toutounchi, managing director of index funds, will retire at the end of 2015.

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. The year to December 2014 was exceptionally good and the Fund return was +42.5% compared to its absolute return benchmark of 10% per annum. Over three years the performance numbers are improving and the fund has delivered a return of +9.4% per annum compared with the absolute return benchmark of 10% per annum.

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

Performance attribution: over the past twelve months, Franklin Templeton is the best performing fund across all four property managers, by some way, as shown in Chart 6. The fund is now entering its distribution phase and is performing well.

The global themes leading to opportunities in 2015 are, in Franklin Templeton's view: deleveraging, a lack of liquidity and distressed sponsors/investors.

Staff turnover: there were no changes to the private real estate team during Q4 2014.

Organisation: The private real estate management committee consists of Marc Weidner (Americas), Raymond Jacobs (Europe) and Glenn Uren (Asia) and the team now includes 14 professionals across five global offices. Assets under management total $5.7 billion (compared to $5.0 billion a year ago). Since 1997 the team has invested in more than 110 funds across 60 different manager relationships around the world.

2.9. Hearthstone – UK Residential Property Fund

Headline comments: The portfolio returned +1.1% compared to the benchmark return of +1.0% for the quarter ending December 2014. Over 12 months the return was +8.9% compared to the benchmark return of +9.4%. Staff turnover remains on the high side and in Q4 2014 Simon Knight, Managing Director, left the firm.

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 +8.9% compared to the return on the index of +9.4% over the past 12 months. This places Hearthstone third out of four property managers in terms of returns over the past year (see Chart 6), slightly

ahead of the Aviva Lime Fund. The yield on the portfolio was 5.6% at the end of December, after adjusting for voids.

In terms of expected returns for 2015, Hearthstone estimates a total portfolio return of 6-8% for the coming twelve months.

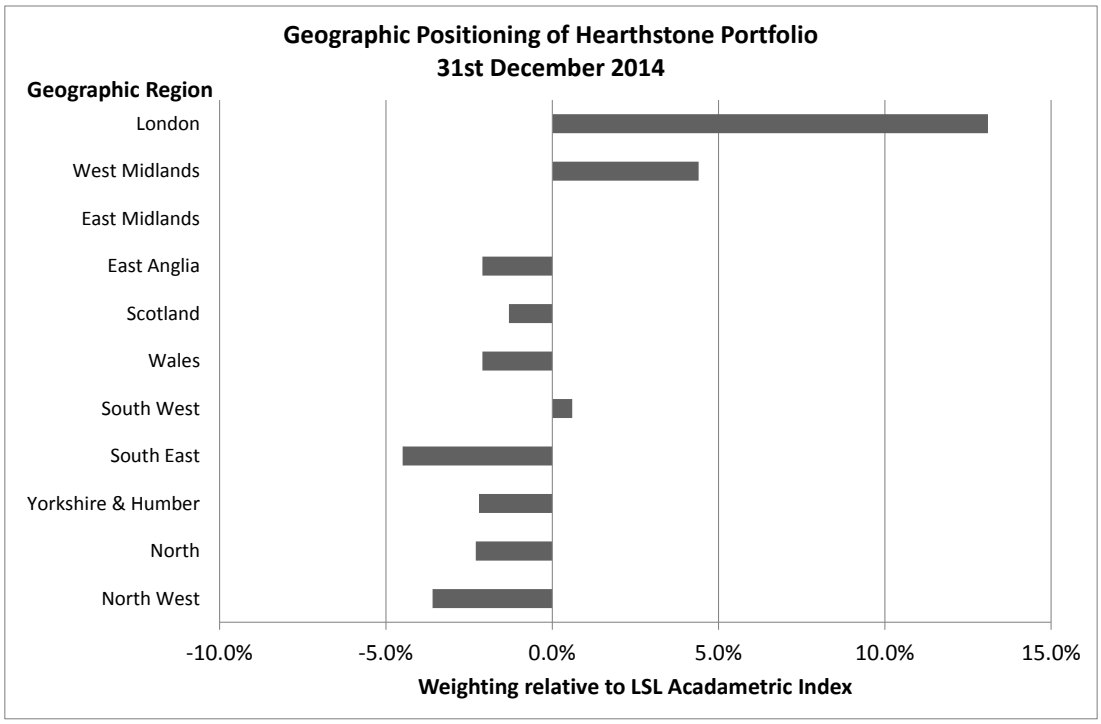
Portfolio risk: The portfolio still holds a significant overweight position in London, relative to the benchmark. This is a consequence of an investment opportunity in Wembley. Hearthstone's long term strategy is to maintain broadly neutral regional bets in the portfolio. However, their ability to achieve this is currently being constrained by the Fund size. Hearthstone estimates that the Fund needs to grow to around £85-90 million (compared to the current £30 million) in order to fully diversify the unit type and regional dispersion.

Voids have been managed very successfully and are nearly at zero. Touchstone, the agent, has been effective at finding tenants and Hearthstone remains comfortable with them.

Portfolio characteristics: Chart 9 shows the regional bets in the portfolio. The biggest overweight region is London (+13.1%). The most underweight region relative to the index was the South East (-4.5%).

There was no portfolio activity in Q4 2014 and the manager has suggested that the Fund is being constrained by the lack of cash inflows. The last acquisition was in March 2014, in Birmingham. They bought 14 vacant flats which were 100% let within two months of purchase. This represents a potential threat to the future performance of the portfolio because of opportunities which Hearthstone may not be able to access from a purely practical perspective (i.e. having no spare cash to invest).

Chart 9



Source: AllenbridgeEpic based on Hearthstone figures

The Fund has a 21% allocation to detached houses, 52% allocated to flats, 22% in terraced accommodation and 5% in semi-detached.

Organisation and staff turnover: Simon Knight, the Managing Director, left the firm at the end of January 2015. He has been offered a role of Chief Executive, elsewhere.

Hearthstone has no plans to replace Simon. They are trying to keep the cost base as low as possible. Chris Down, the CEO, will remain the relationship director for London Borough of Islington. The Hearthstone team is now just nine people, and they have indicated that they are unlikely to contract the company any further.

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17th February 2014