Allenbridge

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	Not reported.	Underperformed the Index for the quarter by -1.6%% but outperforming by +0.2% p.a. over three years to end March 2016. Behind the target of +2.0% p.a. over three years.	£358 billion AUM as at 31st March.	Now on the London CIV. New performance target is 2% per annum outperformance over 3 years (was 3%).	
Newton	One joiner and no leavers this quarter.	Underperformed the Index by -1.0% in the quarter. Outperforming over three years by +1.6% per annum and by +0.71% per annum since inception.	£48.3 billion as at 31st March 2016, up from £47.0 billion as at 31st December 2015.		
Standard Life	18 joiners (none in fixed income), and six leavers (one from fixed income) during the quarter.	Over three years the Fund has outperformed by +0.3% p.a., behind the performance target of +0.8% p.a.	Underlying fund value rose by £94 million in Q1 2016. London Borough of Islington's holding is 6.1% of the value of the total pooled fund.	Holding 6.4% 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	Mike Craston joined as new Head of Business Development. Dan James appointed Head of Global Fixed Income.	Outperformed the gilt benchmark by +1.5% p.a. over three years and in line with the performance target.	Fund was valued at £1.65 billion as at end Q1 2016. Firm-wide assets under management of £290 billion as at end December 2015, up from £267 billion as at end June 2015.		
Columbia Thread-needle	Three joiners and three leavers in the quarter	Outperformed the benchmark by +0.5% per annum over three years. Slightly behind their performance target.	Combined assets of new firm £323 billion as at 31st March 2016. Pooled fund has assets of £1.70 billion.		
Legal and General	Not reported.	Regional funds are all tracking the indices.	Assets under management of £757 billion at end December 2015. £288 billion in passive strategies.		
Franklin Templeton	Still seeking a replacement for the fund manager, Witsard Schaper, who left in Q4 2015.	Outperformed the absolute return target of 10% p.a. by 13.8% per annum.			

Manager	Leavers, joiners and departure of key individuals	Performance	Assets under management	Change in strategy/risk	Manager specific concerns
Hearth-stone	Team of three new staff from Mill Group has joined the firm.	Outperformed the benchmark by +2.1% p.a. over three years to end March 2016.	Fund was valued at £45.5 m at end Q1 2016. Islington's investment represents 56% of the Fund.		
Schroders	Vice Chairman and global head of distribution is retiring.	Fund returned -0.9% during the quarter.	Total AUM of £324.9 billion as at 31st March 2016.		

Key to shading in Table 1:

Minor concern

Monitoring required

2. Individual Manager Reviews

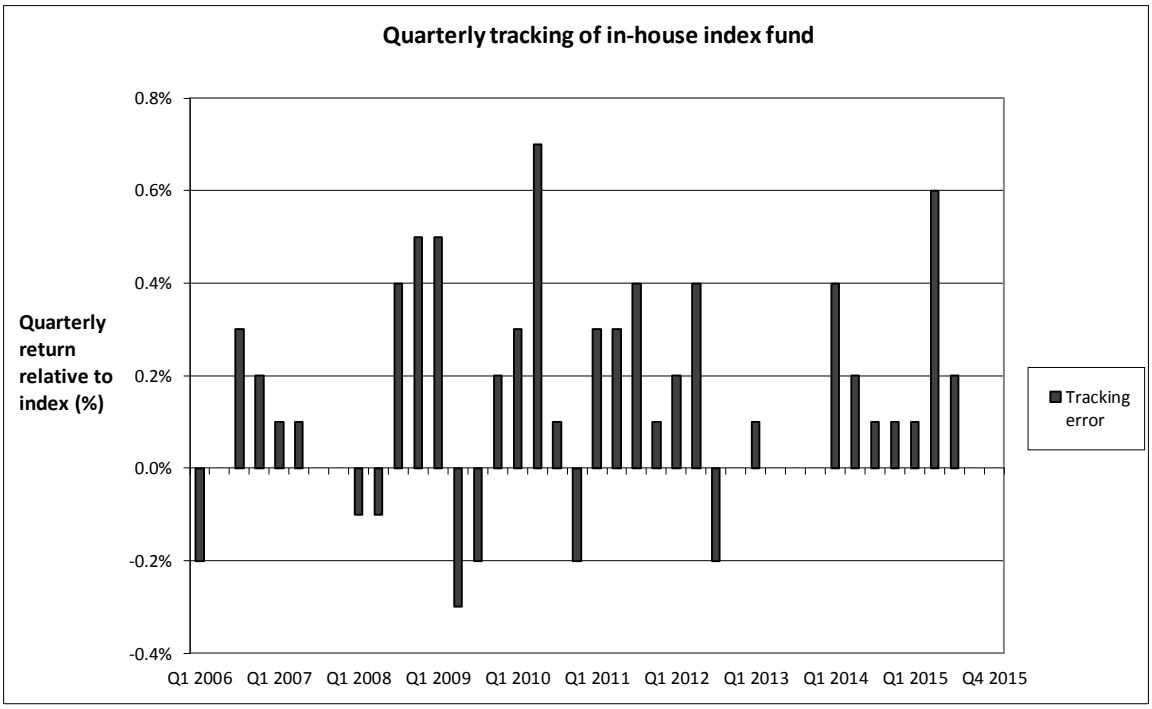
2.1. In-house – Passive UK Equities – FTSE All Share Index Fund

***Headline comments*:** The portfolio continues to meet its objectives. The fund delivered a quarterly return in line with the index benchmark return of -0.4%. Over three years the fund has outperformed the index by +0.6% p.a. and delivered a return of +4.3% 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 as a result the portfolio has outperformed its three-year benchmark by +0.6% per annum.

Chart 1



Source: Allenbridge based on WM figures

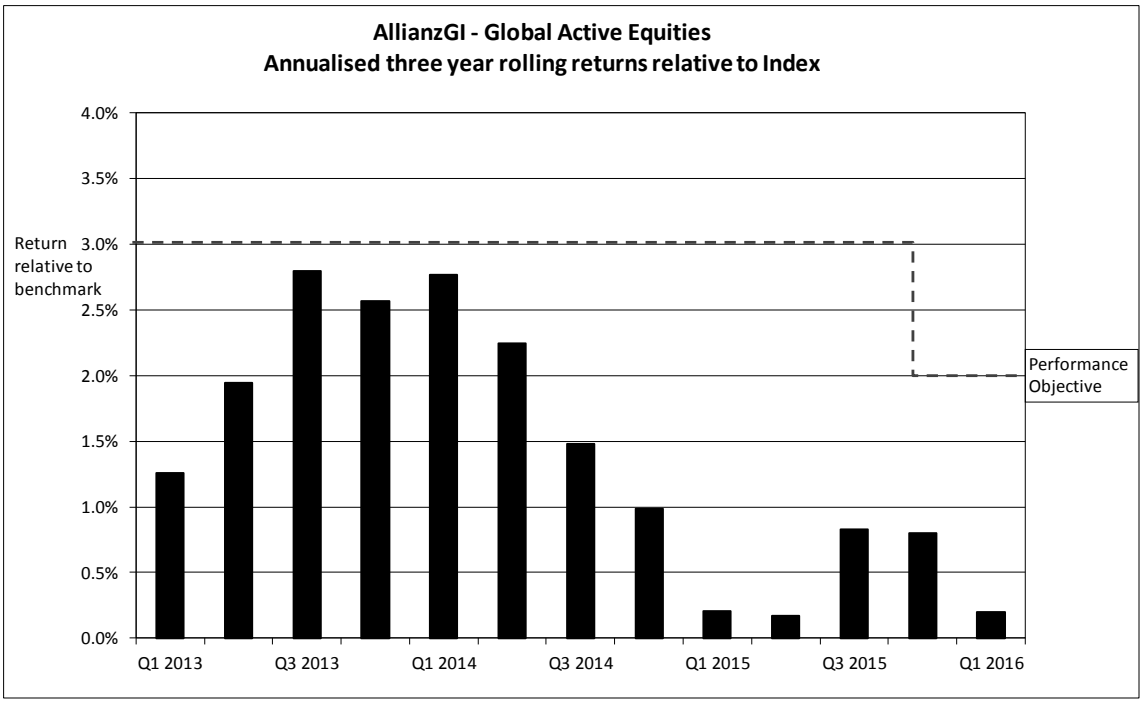
2.2. AllianzGI (RCM) – Global Active Equities

Headline comments: In terms of relative performance, the fund was behind the benchmark return of +2.2% for Q1 2016, delivering an absolute return of +0.6%. Over three years the fund is ahead of the benchmark by 0.2% 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. London Borough of Islington invests in this approach via the London CIV. The new objective of the fund (after transferring to the CIV) 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 March 2015, AllianzGI is ahead of its benchmark by +0.2% per annum, although **they are still trailing their new 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 AllianzGI ran a bespoke mandate for London Borough of Islington.

Chart 2



Source: Allenbridge based on AllianzGI figures

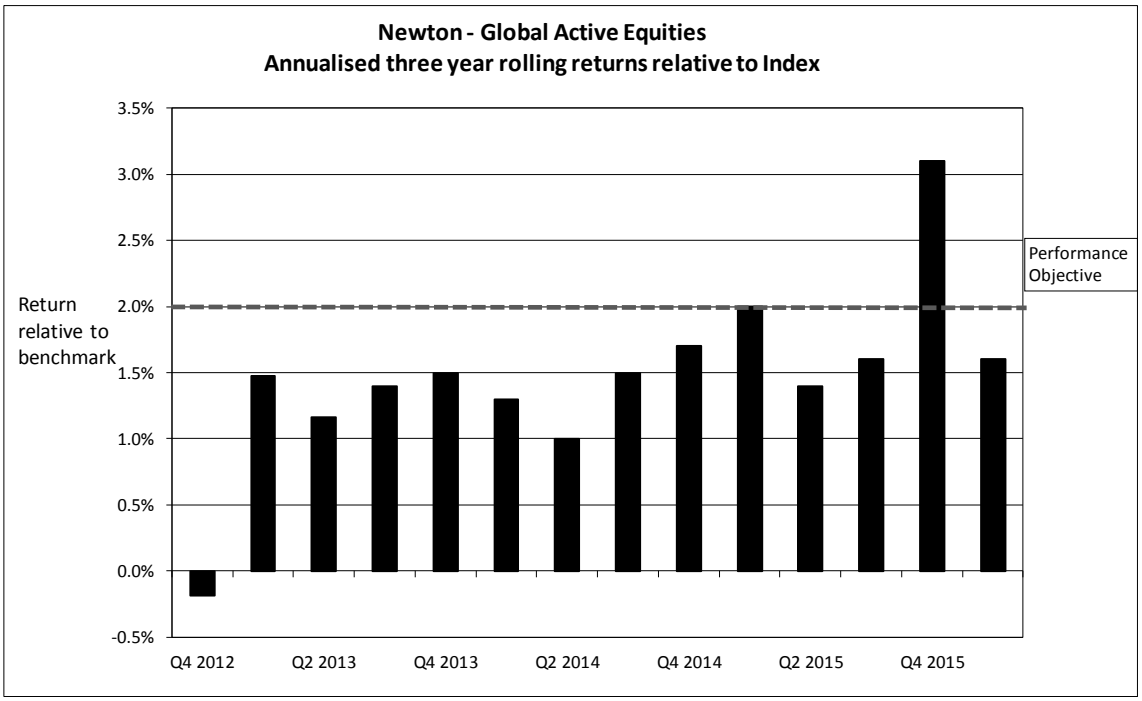
2.3. Newton – Global Active Equities

Headline comments: Newton were behind their benchmark by -1.0% during Q1 2016, trailing for the first time in almost two years. Over three years the portfolio outperformed by +1.6% per annum, behind the target of 2% p.a. Two-thirds of the outperformance of +1.6% per annum over three years can be attributed to successful stock selection with the rest coming from successful asset allocation.

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 data from Newton and WM

Chart 3 shows the good progress being made by the manager, relative to the performance objective, although for the three-year period to the end of Q1 2016, the fund (shown by the right hand black bar) is +1.6% p.a. ahead of benchmark so trailing the performance objective by -0.4% per annum ahead (shown by the dotted line).

Over the three years to March 2016, Newton's return was +9.9% p.a. compared to the index return of +8.2% p.a., an outperformance of +1.6% p.a. Stock selection accounted for two-thirds of the outperformance with the balance from asset allocation.

Since the inception of Newton's portfolio in November 2008, the pension fund is better off than it would have been with a passive mandate. Newton's 'since inception' return is +13.2% per annum, compared to the benchmark return at 12.5% per annum, an outperformance of +0.7% p.a. *(source: Newton, gross of fees performance shown)*.

During the quarter the most successful sector was Consumer Services (+0.7% contribution to relative performance), most of which came from strong stock selection, but which was boosted by an overweight allocation to the sector (+9.9% overweight position). The least successful sector was Healthcare (-0.76% from relative performance). This was evenly attributed to poor stock selection and an overweight allocation to the sector.

Portfolio Risk: The largest overweight regional allocation was in UK Equities (+3.4% overweight). This replaced the long-standing overweight allocation to Europe that had been in place since Q3 2011. The most underweight allocation was Other Equities (-5.6%) - being underweight emerging markets detracted from performance as news from China improved and commodity prices dramatically reversed.

In terms of sector bets, Newton remained overweight in Consumer Services (+9.9% relative to benchmark.) The most underweight sector remained in Financials (-13.0%). This underweight position has been in place since Q2 2009 but is now at its largest level.

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 2.6%, as at end March 2016. This is within Newton's normal range of 2% and 6%.

Portfolio characteristics: At the end of Q1 2016, the portfolio held 64 securities (67 as at the end of Q4 2015). The steady drop in the number of stocks in the portfolio continues. At the end of 2009, Newton held 138 stocks. Turnover over the past 12 months remained at 22%, at the low end of Newton's normal expected range of turnover to 30%-70%.

Staff turnover: during the quarter there was one new joiners and no leavers. Ashwin Palta joined the fixed income team as a credit analyst and Jon Bell left his role as a portfolio manager to move to Newton's commercial team.

2.4. Standard Life – Fixed Income

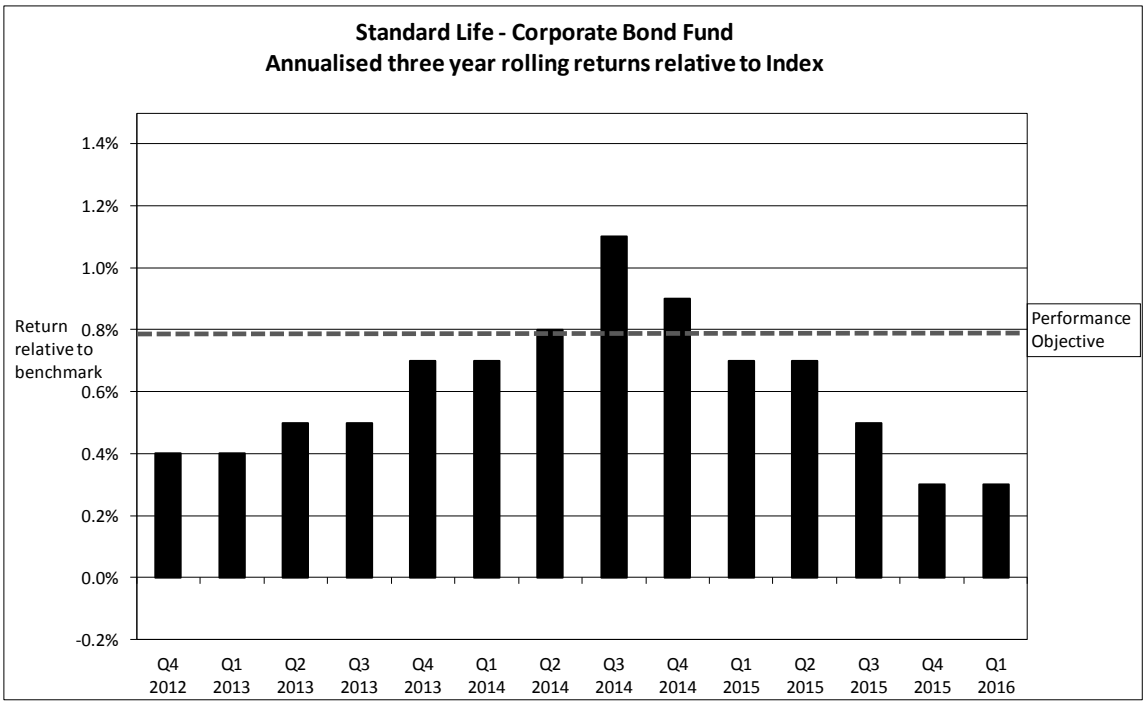
Headline comments: The portfolio was in line with the benchmark during the quarter with a return of +3.0%. Over three years, Standard Life's outperformance was +0.3% per annum relative to the benchmark, but this is behind their performance target of +0.8% per annum.

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 the Corporate Bond Fund versus its benchmark and performance target.

Chart 4



Source: Allenbridge based on WM figures

Over three years, the portfolio has returned +5.2% p.a. compared to the benchmark return of +4.9% p.a., an outperformance of +0.3% p.a. The fund is behind 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, followed by asset allocation. The outperformance has been partly offset by a negative contribution to performance from curve plays.

It is also worth noting that the absolute level of the three-year return on the portfolio has nearly halved since three years ago. At the end of Q1 2013 the portfolio returned +8.9% p.a. compared to +5.1% p.a. as at the end of Q1 2016.

Portfolio Risk: The largest holding in the portfolio at quarter end was EIB 5.625% 2032 (1.3% of the portfolio). The largest overweight sector position remained Financials (+7.6%). The long-standing underweight position in sovereigns and sub-sovereigns remains (-18.6%) and now stands at its largest relative position since inception.

The fund holds 6.4% 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 March 2016 was £3,640.4 million, £90.8 million higher than at the end of Q4 2015. London Borough of Islington's holding of £220.8 million is 6.1% of the total fund value. When Islington first invested, the percentage holding was 3.4%.

Staff turnover: there were 18 joiners during the quarter (none in fixed income), and six leavers including Mark Kedar who was an Investment Director in the Fixed Income – Credit team.

2.5. Aviva Investors – Property – Lime Property Fund

Headline comments: With gilts performing strongly in Q1, the Lime Fund lagged its gilt benchmark by -4.7% in Q1 (having outperformed by +3.5% during Q4 2015). Over three years, the Fund returned +7.7% p.a. compared to the gilt benchmark return of +6.1% p.a. – an outperformance of +1.5% p.a. and in line with the performance 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 trailed the gilt benchmark this quarter by -4.7%, as bond markets rose sharply. The fund rose by +1.3% whilst the benchmark increased by +6.3%. The portfolio was ahead of the IPD Index in Q1 2016 by +0.2%.

Over three years, the fund has returned +7.7% p.a. compared to the gilt benchmark of +6.1% p.a., an outperformance of +1.5% per annum. The **portfolio is meeting its performance objective of +1.5% per annum outperformance over three years**. Of the

+7.7% fund return over three years, 5.1% came from income, with the balance from capital gain.

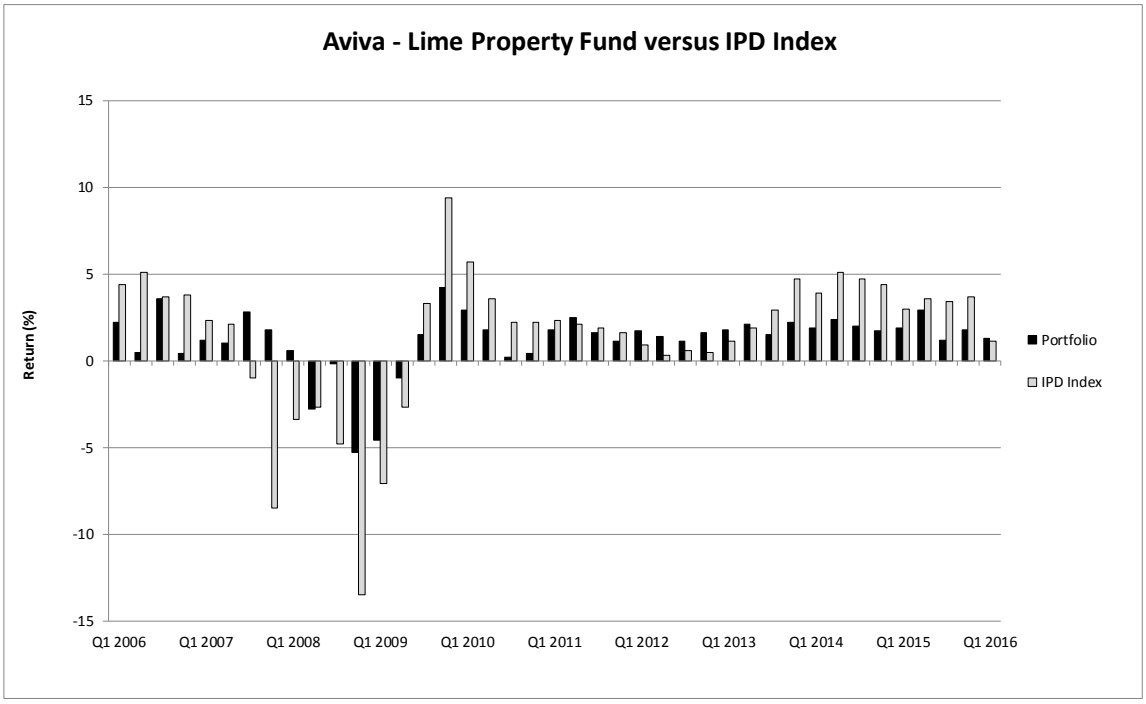
Portfolio risk: There were no purchases during the quarter but three assets were placed under offer, valued at approximately £250 million. The average unexpired lease term fell slightly below 20 years for the first time in several years. The manager anticipates that this is temporary and the average unexpired lease term will be over 20 years again by the end of next quarter. 9.3% of the portfolio's lease exposure in properties is in 30-35 year leases, and 1.9% in over-35-year leases. The largest sector exposure remains offices at 28.4%. The cash allocation stood at 5.9% as at quarter end.

Diversification is a key feature of Aviva's strategy. They had implemented a soft ceiling of 25% in their allocation to supermarkets, but this allocation is now down to 15.2%. The number of assets in the portfolio has also increased from 61 to 69.

As the fund has grown, finding deals has been a challenge because Aviva will not consider assets under £25 million. This restricts the number of assets that are eligible. However, they are now looking to be more creative, for example, partnering with their other funds, in order to invest in larger assets than the fund could prudently consider on its own.

The Lime Fund is a low risk property portfolio and this is shown clearly in Chart 5 which shows the absolute performance of the Fund each quarter compared to the IPD Index. This 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 figures

Portfolio characteristics: As at end March 2016 the Lime Fund was valued at £1.647 billion, an increase of £16 million from the previous quarter end.

Lime has now been running for just over 11 years. The fund has built a strong reputation of delivering a consistent return profile. It continues to diversify and grow. Aviva have

recently seen some large new commitments of around £430 million. This means that London Borough of Islington is now no longer in the top five investors: once all the new investors are drawn down, the pension scheme will rank as the 14th largest investor.

The Fund has 88% allocated to inflation linked/fixed uplifts, and approximately two-thirds of this allocation is inflation-linked. In terms of recent new assets, three out of the five transactions have been "off market" and 100% were inflation-linked, with an average unexpired term of 25 years.

Staff turnover/organisation: Last July, Ed Casaal was appointed as CEO of Aviva's global real estate division. He has been reviewing the global real estate business, and has made some organisational changes, which were communicated to London Borough of Islington in February 2016.

Renos Booth was previously a fund manager for both the Lime Fund and the Aviva Staff Pension Fund's real estate portfolio. In the new team structure, Renos Booth is the Lead Fund Manager for the Lime Fund, with Andrew Davey as the Co-Fund manager. Andrew Davey has also been promoted to take over responsibility for the staff pension fund. This has freed Renos up to become the overall Head of Real Estate Long Income. Renos is looking to grow his team and there is a budget for two additional staff. This will release some of Renos' time on the execution side of transactions, which will be applied to his new role.

London CIV: Aviva are hoping the Lime Fund will go onto the CIV. They have just been appointed to a second London Borough.

2.6. Columbia Threadneedle - Pooled Property Fund

Headline comments: The Fund's performance was ahead of its benchmark in Q1 2016 by +0.6%. Over three years, the Fund has outperformed by +1.2% per annum, ahead of the performance target of 1% p.a. above benchmark over three years.

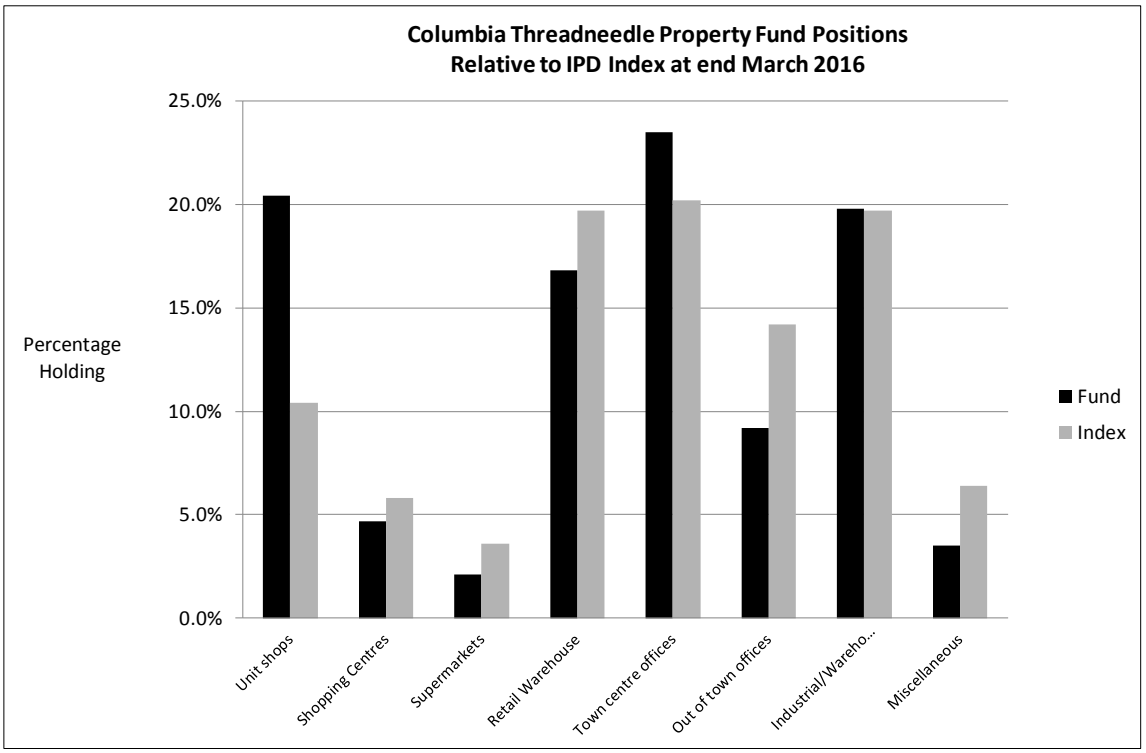
Mandate summary: An actively managed UK commercial property portfolio, the Columbia Threadneedle Pooled Property Fund invests in a diversified, multi-sector portfolio of UK property assets. Its performance objective is to outperform the AREF/IPD All Balanced – Weighted Average (PPFI) Index by at least 1% p.a., net of fees, on a rolling three year basis. 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 ahead of the benchmark in Q1 2016, by +0.6% (source: Columbia Threadneedle), delivering a return of +1.3%. Income accounted for all the return this quarter, with a slightly negative capital return. In terms of the three-year performance, the Fund is ahead of its benchmark by +1.2% per annum and ahead of the performance target of +1% per annum. The absolute return over three years remains strong. The portfolio returned +13.7% p.a. over three years compared to the benchmark return of +12.3% p.a.

Portfolio Risk: the Fund made one acquisition and two disposals during the quarter. The acquisition was a £15.3 million purchase of Octavia House in Banner Street in London EC1. Threadneedle intends to develop the asset, floor by floor, and re-let. The disposals

included an office in Piccadilly in London, which was sold for £9.9 million, crystallising a profit of £2.1 million.

Chart 6



Source: Allenbridge based on Columbia Threadneedle data.

Portfolio characteristics: As at 31st March 2016, the Threadneedle Property Fund was valued at £1.70 billion, an increase of £24.1 million compared with December 2015. London Borough of Islington's investment represented 4.4% of the Fund as at end March 2016.

Staff turnover: three joiners and three leavers in the quarter. Jeremy Collin, one of the leavers, worked in the property team but was not involved in the TPEN Fund, so his departure does not affect London Borough of Islington's investment.

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 Q1 by +2.8%. For the 12 months to Q1 2016 the outperformance was +3.3%.

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

Q1 2016	Fund	Index	Tracking
Europe	+0.1%	+0.1%	0.0%
Asia Pacific ex Japan	5.6%	5.6%	0.1%
FTSE emerging markets	8.8%	8.8%	0.0%
RAFI emerging markets	14.8%	14.9%	-0.1%

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 4.2% overweight.

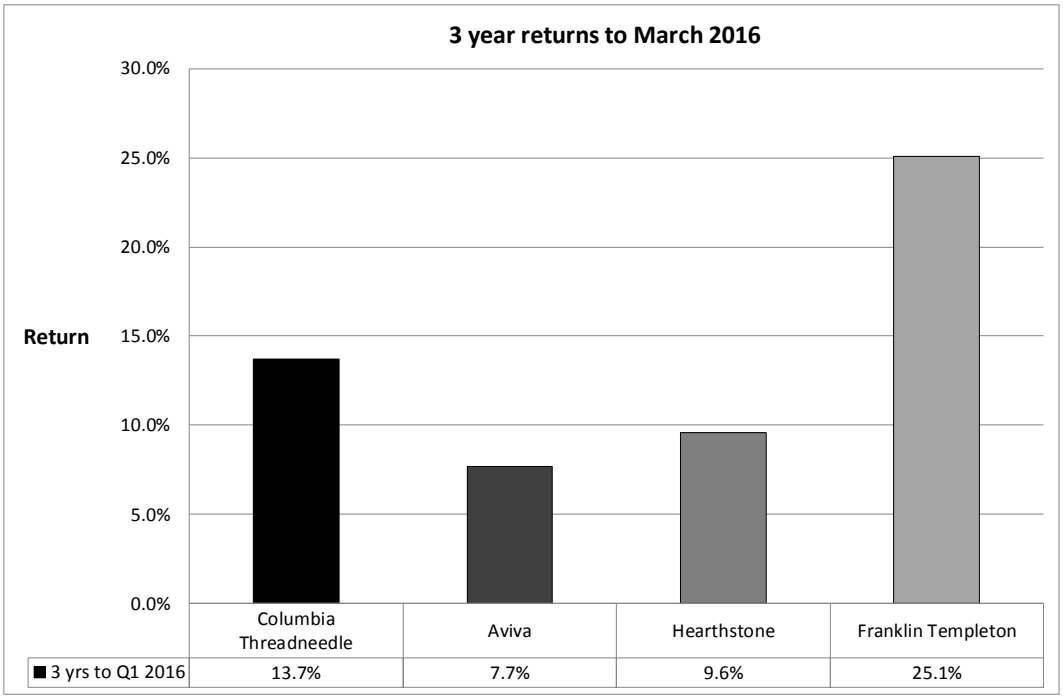
2.8. Franklin Templeton – Global Property Fund

Headline comments: This is a long term investment and as such a longer term assessment of performance is recommended. There are now two funds in which London Borough of Islington invests. The portfolio in aggregate delivered a return of +25.1% per annum over the three years to end March 2016, outperforming the absolute return benchmark by +13.8% 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 March 2016, **Franklin Templeton was the best performing fund across all four property managers**, by some way, as shown in Chart 7. The Fund is now comfortably ahead of its target absolute return of 10% per annum, and for the three years to March delivered a return of +25.1% per annum.

Chart 7



Source: WM

Portfolio risk: Leverage on Fund 1 was 53% as at end March, with all funds showing leverage below 70%. Leverage on Fund 2 was 47% as at end March 2016.

Franklin Templeton describe their current level of leverage as "modest", and at levels well below what is seen in their peers' Funds. They also argue that the risk/reward trade-off is attractive: Fund 1 is generating a 20% IRR for 53% leverage.

Of the 14 investments in Fund 1, four are on target (10%-15% projected net internal rate of return (IRR)), seven are above target (15-25% projected net IRR) and three are substantially above target (more than 25% projected net IRR). The three funds which are substantially above target are: GreenOak, Project Redfish (a Toyko fund managed by Green Oak) and Secured Capital Japan V. Fund 1 is now 96% committed so can be considered to be fully invested.

Of the three investments in Fund 2, one is on target and two are 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.

The expected primary vs co-investment ratio in Fund 2 is expected to be 60/40. Leverage, at 53%, is below target. The projected IRR (investment rate of return) is 18.28%.

Franklin Templeton are ahead of their timeline, in terms of capital deployment. They expect to call a more capital towards the end of 2016. This is a function of deal flow which is strong at present.

Staff turnover/organisation: following on from Witsard Schaper's departure in Q4 2015, Franklin Templeton have confirmed that it is their intention to replace the portfolio manager. David Germer in London is, in the meantime, covering Witsard's role. They are not in a rush to replace Witsard because they want to find the right person. There have been no other changes to team, which consists of 16 real estate investment professionals in five global offices: London, Geneva, Singapore, New York and California.

Franklin Templeton have $764 billion in assets under management, of which $195 billion is in institutional mandates. The alternatives division (which oversees the London Borough of Islington mandate) has assets under management of $16.5 billion. $4.1 billion of this is in real asset strategies.

2.9. Hearthstone – UK Residential Property Fund

Headline comments: The portfolio returned +1.3% compared to the benchmark return of +1.8% for the quarter ending March 2016. Over three years, the Fund delivered a return of +9.6% p.a. compared to the benchmark return of +7.4% p.a., an outperformance of +2.1% 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.

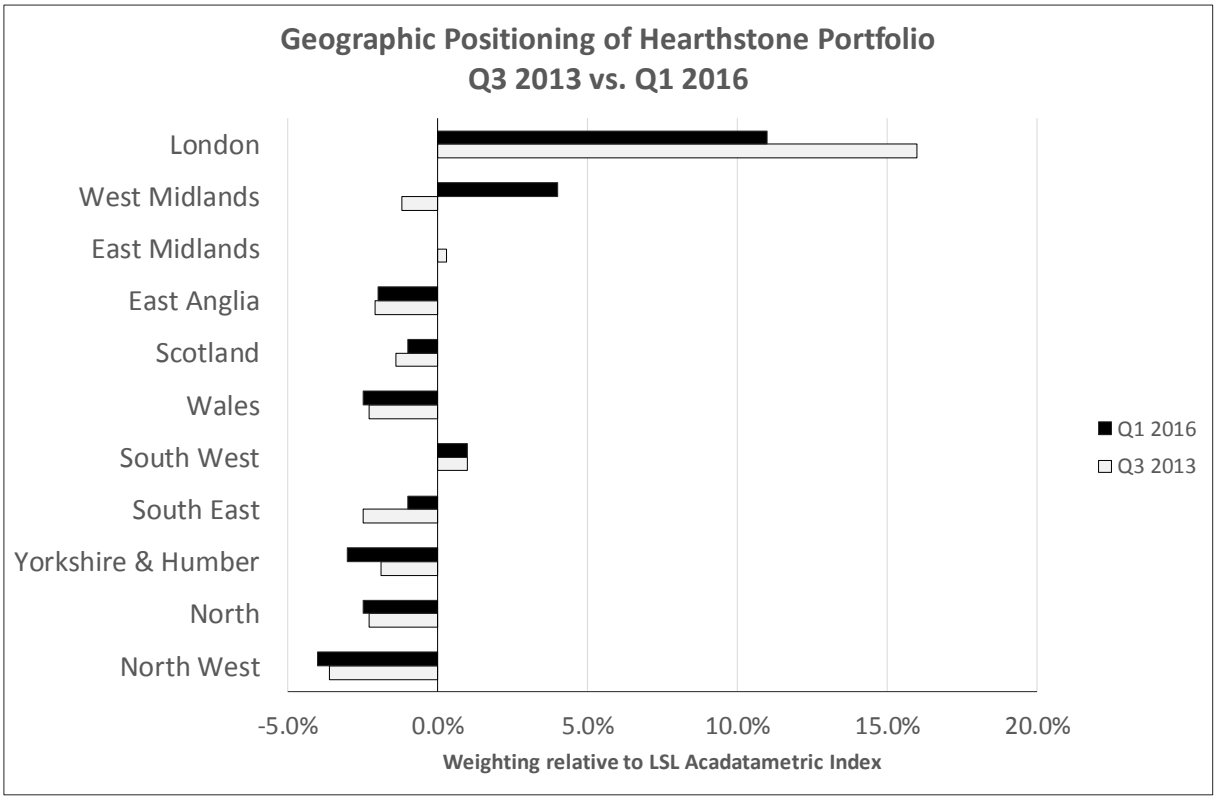
Performance attribution: The Fund returned +9.6% p.a. compared to the return on the index of +7.4% p.a. over the three years to March 2016, an outperformance of +2.1% p.a.

The gross yield on the portfolio was 5.4% at the end of March. This compares with LDL's average gross yield for properties in England and Wales (as calculated for their Buy to Let Index) of 5.0%.

Portfolio risk: The overweight position in London, primarily a result of the Wembley investment opportunity, is gradually decreasing as the Fund attracts new money which is being invested in other regions. Hearthstone's long term strategy is to maintain broadly neutral regional bets in the portfolio. At the end of Q3 2013, the Fund was 16.0% overweight to London. At the end of Q1 2016, that had dropped to an 11% overweight position.

Chart 7 compares the regional bets in the portfolio in Q3 2013 with the bets in Q1 2016. The reduced London overweight is shown by the top black bar (2015), compared with the top grey bar (2013).

Chart 7



Source: Allenbridge based on Hearthstone figures

Portfolio characteristics: The Fund has an 18% allocation to detached houses, 47% allocated to flats, 31% in terraced accommodation and 4% in semi-detached. The allocation to flats remains a significant overweight position relative to the Index (47% for the Fund compared to 17% for the Index). This is offset by an underweight position in semi-detached houses (4% for the Fund compared to 24% for the Index).

Hearthstone have reported that they are seeing fund flows increase quite significantly, since the middle of last year. A key milestone was hitting their three-year performance

track record. Now they are seeing inflows of approximately £1.5 million a month, compared to the average last year of £1 million per month.

As a result, as at end March 2016, the Fund stood at £45.5 million. When it reaches £50 million, Hearthstone will gain entry to the wealth manager platforms. Once it reaches £100 million it can open up to even more flows. At the same time, Hearthstone have reported that there has been relatively little in terms of redemptions. As at end March, London Borough of Islington's investment represented 56% of the total Fund, compared to 74% at the end of March 2015.

Organisation and staff turnover: During the quarter, Hearthstone acquired a small team from Mill Group. Andrew Smith, Richard Otten and Cristoforo Rocco are all now Hearthstone employees.

Andrew Smith was previously from Aberdeen Asset Management, Richard Otten was more recently at Fairbridge Estates, and Cristoforo Rocco spent 15 years at Schroders on the institutional fund raising side, especially working with LGPS investors.

London CIV: in terms of dialogue to date, Hearthstone has not yet engaged with the London CIV.

2.10. Schroder – Diversified Growth Fund (DGF)

Headline comments: The Diversified Growth Fund delivered a return of -0.9% in Q1 2016.This compared with their RPI plus 5% p.a. target return of +1.4% for Q1.

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 Q1 2016, Schroders' exposure to absolute return made the largest contribution to the portfolio return (+0.6%), with smaller contributions from government debt (+0.3%). This was offset by negative contributions from Japanese equities (-1.2%), European equities (-0.6%), and global equities (-0.3%).

Portfolio risk: The portfolio is expected to deliver equity-like returns with two-thirds the volatility of equities. However, this is over a full 3-5 year market cycle. Over the past 12 months, the volatility of the Fund was 8.9% compared to a 12-month volatility of 16.0% in equities.

Portfolio characteristics: The Fund had 11% in internally managed funds, 40% in bespoke solutions, 14% in externally managed funds, 29% in passive funds and 6% in cash, as at end March 2016. In terms of asset class exposure, 37.4% was in equities, 31.8% in alternatives and 25.2% 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.

Karen Shackleton

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6th June 2016