# Pensions CIV Sectoral Joint Committee

Item no: 11

# Sub-fund performance Report

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|---|---|---|---|
| **Report by:** | Julian Pendock | **Job title:** | Chief Investment Officer |
| **Date:** | 12 July 2017 | | |
| **Contact Officer:** | Julian Pendock | | |
| **Telephone:** | 020 7934 9887 | **Email:** | julian.pendock@londonciv.org.uk |

**Summary:**

This report provides the Joint Committee with an Investment update including performance of the London CIV sub-funds and Stewardship activities.

Appended are the Manager Review Meeting reports which are held with all existing sub-fund managers.

**Recommendations:** The committee is recommended to note the contents of this report.

**Sub-fund performance**

1. Performance data for each sub-fund is shown below. This performance is for the quarter to 30th June 2017.

## LONDON CIV – QUARTERLY PERFORMANCE STATISTICS

### Q2 2017 APRIL – JUNE 2017

| FUND (Underlying Manager) | PRICE (Pence) | FUND SIZE £M | Q2 | YTD | 1 year | SINCE INCEPTION | INCEPTION DATE |
|---|---|---|---|---|---|---|---|
| **UK Equity Sub-Fund** | | | | | | | |
| **LCIV MJ UK Equity (Majedie)** | 97.4 | £510 | N/A | -2.60% | N/A | -2.60% | 18/05/17 |
| *Benchmark: FTSE All Share Index* | | | | *-1.28%* | | *-1.28%* | |
| **Performance Against Benchmark** | | | | **-1.32%** | | **-1.32%** | |
| **Global Equity Sub-Funds** | | | | | | | |
| **LCIV Global Equity Alpha (Allianz Global Investors)** | 133.3 | £691 | 3.89% | 10.95% | 25.12% | 35.95% | 02/12/15 |
| *Benchmark: MSCI World Net GBP Index* | | | *0.14%* | *5.27%* | *21.64%* | *34.31%* | |
| **Performance Against Benchmark** | | | **3.75%** | **5.68%** | **3.48%** | **1.64%** | |
| **LCIV BG Global Alpha Growth (Baillie Gifford)** | 140.1 | £1,674 | 4.62% | 12.56% | 31.13% | 41.23% | 11/04/16 |
| *Benchmark: MSCI All Countries World Gross Index* | | | *0.71%* | *6.12%* | *21.81%* | *33.53%* | |
| **Performance Against Benchmark** | | | **3.91%** | **6.44%** | **9.32%** | **7.70%** | |
| **LCIV NW Global Equity (Newton)** | 100.7 | £659 | N/A | 0.70% | N/A | 0.70% | 22/05/17 |
| *Benchmark: MSCI All Countries World Gross Index* | | | | *1.11%* | | *1.11%* | |
| **Performance Against Benchmark** | | | | **-0.41%** | | **-0.41%** | |
| **DGF/Total Return Sub-Funds** | | | | | | | |
| **LCIV PY Total Return (Pyrford)** | 109.3 | £225 | 0.18% | 1.86% | 5.60% | 9.30% | 17/06/16 |
| **LCIV Diversified Growth (Baillie Gifford)** | 116.2 | £362 | 1.75% | 4.63% | 11.74% | 16.77% | 15/02/16 |
| **LCIV RF Absolute Return (Ruffer)** | 110.7 | £473 | -0.45% | -0.45% | 8.61% | 11.00% | 21/06/16 |
| **LCIV NW Real Return (Newton)** | 104.6 | £346 | 1.16% | 3.16% | N/A | 4.60% | 16/12/16 |
| **Total LCIV Assets Under Management** | | **£4,940** | | | | | |

Data taken from Bloomberg as at 30/06/2017
All performance reported Net of fees and charges with dividends reinvested

2. Due to the timing of this committee meeting in the reporting cycle, there is no investment commentary on each fund or a market review for the quarter ending June 2017. This will be provided to the committee at its next meeting.

**Manager Review Meeting Reports**

3. Appended to this report are the Quarterly Investment Manager Review meeting reports for the Quarter ending 31st March 2017.

4. These reports summarise the quarterly meetings that the LCIV CIO and investment team hold with the portfolio manager of each sub-fund. These meetings serve as the primary oversight function of the ACS Operator and provide the opportunity to challenge the manager on the previous quarter's performance, portfolio positioning, and each manager's market outlook at both a micro and macro level.

5. These reports have previously been circulated to members of the Joint Committee, Treasurers, and Pension officers.

**Recommendations**

6. The Committee is recommended to note the contents of this report

**Financial Implications**

7. There are no financial implications for London Councils.

**Legal Implications**

8. There are no legal implications for London Councils.

**Equalities Implications**

9. There are no equalities implications for London Councils.

# LCIV Global Equity Alpha (Allianz)
# Q1 Manager Review
March 20th 2017

*CIV Investment Team*

# LCIV Global Equity Alpha (Allianz) Fund

| | |
|---|---|
| **Inception date** | 2/12/2015 |
| **Fund Size** | £667m<br>(as at 31/3/2017) |
| **Number of holdings** | 53 |
| **Benchmark** | MSCI World Index |

**Investment objective**

*The Sub-fund aims to achieve capital growth by outperforming the MSCI World Index Total Return (Net) GBP by 2% p.a. net of fees.*

## Agenda

1. Review the first quarter performance of the portfolio.
2. Outline any changes to portfolio holdings.

| | Allianz GEA | MSCI World |
|---|---|---|
| Q1 2017 | 6.79% | 5.12% |
| Since LCIV Inception | 30.86% | 34.11% |

Source: Bloomberg, as at 31/3/2017 Net of fees with dividends re-invested.

## Executive summary

After a difficult fourth quarter in 2016 the fund bounced back in the first quarter of 2017 by delivering a 6.79% return; an outperformance of 1.67% above the MSCI world benchmark. This in large part can be explained by the reversal of the previous value rally back towards global growth stocks.

At the stock level, Priceline.Com and Facebook were the strongest performers contributing 0.39% and 0.31% to relative returns respectively. The decision not to own Apple and the position in Wabtec corp were the top detractors from relative performance.

In terms of portfolio activity, Allianz started a position in Charles Schwab and added to Celgene. They also sold the entire Ralph Lauren position and reduced allocations to EOG Resources, Microsoft, SMC, and UnitedHealth.

## Q1 Performance review:

After a difficult fourth quarter in 2016 the fund bounced back in the first quarter of 2017 by delivering a 6.79% return; an outperformance of 1.67% above the MSCI world benchmark. In the previous quarter value sectors such as financials and energy rallied hard as markets were quick to re-price assets following Donald Trump's election victory in the U.S., as well as the Federal Reserve's decision to raise the federal funds rate by 25 basis points to a 0.5-0.75% corridor.

This quarter saw U.S. equities post their strongest quarterly gain in four years. According to Allianz the region's equities were bolstered by signs of improving economic momentum, optimism over company earnings and by hopes that the new administration would introduce tax and regulatory reform. However, the rally stalled towards the quarter end amid concerns about President Trump's ability to implement his election promises after legislation to replace Obamacare failed to gather sufficient support in Congress. This, in part, helped fuel a rotation in momentum in the U.S. away from value sectors such as financials and energy towards global large cap growth stocks such as Facebook, Amazon and Google, providing a significant tailwind for the portfolio.

In terms of contributions of returns at the stock level, Priceline.Com and Facebook were the strongest performers, contributing 0.39% and 0.31% to relative returns respectively.
Priceline posted strong Q4 results with growth across all brands and key geographies. Online travel bookings are growing faster than total travel bookings and Allianz continue to believe Priceline is best positioned amongst the online travel agencies given its exposure to faster growing Asia, lower mix of chain hotel business, and scale advantages.

Facebook also reported strong results; user growth remains solid and overall engagement increased slightly despite the enormous scale of the company's business and rising competition. The emphasis on video along with continued robust growth of Instagram and the potential for monetization of Messenger and WhatsApp reinforce the team's positive view that revenues can move higher and they therefore continue to view Facebook as very well positioned in one of the best secular growth markets.

Not owning Apple was the top detractor to performance this quarter costing 0.33% relative to the benchmark. Allianz have a preference for other names such as Facebook and Tencent, which they believe have a more favorable long-term growth trajectory.

Wabtec Corp, a position amounting to 1.8% in the portfolio, was the second largest detractor from performance at a 0.23% loss relative to the benchmark. According to Allianz, train control and signaling provide a long runway for growth and, multi-year funding supportive of U.S. transit growth, as well as the incremental benefits and synergies with Faiveley and a stabilizing aftermarket should serve to offset the expected freight and locomotive headwinds and drive an improved 2017 and 2018 earnings profile. They therefore remain confident in holding Wabtec Corp.

## Portfolio activity:

**Significant transactions:**

Purchases:

- **Charles Schwab Corporation (CS) –** Allianz started a 1% position in Charles Schwab. CS offer a variety of financial services to individual investors, independent investment managers, retirement plans, and institutions. The company provides its' clients with securities brokerage, banking, and related financial services through offices in the US, Puerto Rico, and the UK. Allianz believe Schwab is a well-managed and highly valued company that trades at a premium to peers based on the potential to unlock the interest-rate-sensitive earnings as short-term interest rates rise. Allianz also see bulk transfers of money market funds to bank deposits as another incremental driver of earnings growth as well as numerous initiatives to drive both incremental organic growth and a higher fee rate.

Additions:

- **Celgene –** Allianz increased the position by 0.8% of the portfolio**.** In Healthcare, concerns about US regulation on drugs have now dissipated and Allianz expect the exposures in the managed care and specific therapeutic areas to also be rewarded, benefiting companies such as Celgene.

Sales:

- **Ralph Lauren** – Allianz opted to sell the entire (0.8%) Ralph Lauren position. According to Allianz the challenges in the industry remain abundant and having CEO Stefan Larsson leave (abruptly) in the midst of a four-year turnaround strategy left some corporate governance concerns and not a clear plan, so they felt that their investment case was not supported anymore.

Reductions:

- **EOG Resources** - EOG Resources has performed weakly, in line with the energy sector, which has recorded negative returns amid weak oil prices on fears that rising US supply would outweigh OPEC's agreement to curb production. EOG guidance is for higher growth and lower capital expenditure, indicating that the company continues to expect increasing efficiencies despite the threat of oil services inflation. Allianz believes the investment thesis remains intact but decided to reduce their holding by 0.5% of the portfolio.

- **SMC** - Position reduced by 0.8% of the portfolio. No rationale given.
- **Microsoft**- Position reduced by 0.4% of the portfolio. No rationale given.
- **UnitedHealth** - Position reduced by 0.3% of the portfolio. No rationale given.

## CIO conclusion:

The reversion of the markets towards a "quality" and "growth" bias benefitted the fund's performance and has somewhat unwound the large relative loss experienced in the final quarter of 2016. As the fund is highly sensitive to changes in factor momentum we will endeavour to monitor the rationale across the portfolio in light of a recent global monetary tightening (albeit from a highly easy base) and uncertain fiscal direction, particularly in the U.S.

**Meeting Attendees**

**Team CIV:**
Julian Pendock; CIO
Frederick Fuller; Head of IO
Jill Davys; Client Director

**Allianz**
Lucy Macdonald; Portfolio Manager
Joanne Wheatley; Client RM

# LCIV Global Alpha Growth Fund (Baillie Gifford) Q1 Manager Review
25th April 2017

*CIV Investment Team*

# LCIV Global Alpha Growth (Baillie Gifford) Fund

| | |
|---|---|
| **Inception date** | 11/04/2016 |
| **Fund Size** | £1,602m<br>(as at 31/03/2017) |
| **Number of holdings** | 99<br>(as at 31/03/2017) |
| **Benchmark** | MSCI All Country World Index |

### Investment objective

The objective of the Sub-fund is to exceed the rate of return of the MSCI All Country World Index by 2-3% per annum on a gross fee basis over rolling five year periods.

### Agenda

1. Review the first quarter performance and any significant contributors since the fund's inception.
2. Discuss any portfolio activity relating to the fourth quarter.
3. Explain the rationale for the thematic positioning of the fund and how market developments may impact any allocations.

| | Global Alpha Growth | MSCI AC World Index |
|---|---|---|
| Q1 2017 | 7.60% | 5.37% |
| Since LCIV Inception | 35.00% | 32.59% |

**Source: Bloomberg, as at 31/03/2017.** Net of fees with dividends re-invested.

## Executive summary

In the first quarter of 2017 the fund posted a positive return of 7.60%, outperforming the benchmark by 2.23%. The equity market rose even as wider asset markets remained relatively calm, following the volatility in the previous quarter.

The Baillie Gifford team made few changes to the portfolio, with one new purchase during the quarter in the semi-conductor producer Infineon Technologies, as well as the complete sale of Wolseley.

The team is increasingly upbeat on the individual opportunities for the fund, and continue to view themes such as US economic normalisation and new trade routes in emerging markets as providing a supportive backdrop to the equity markets for the foreseeable future.

## Q1 Performance review

Since the inception of the fund in April of 2016, the Global Alpha Growth strategy (GAG) has achieved a positive return of 35.00%. The current AUM is just over £1.6 billion. The fund delivered a strong return of 7.60%, outperforming the benchmark by 2.23% as equity markets continued to rise during Q1.

The strongest contributors to return were Royal Caribbean Cruises (+0.4%) as 2016 earnings rose 26% helped by rising demand in North America and China, and Amazon (+0.3%) which between them make up 8% of the total portfolio.

Detractors included TD Ameritrade (-0.3%) and Apache (-0.3%), which had a weaker quarter after a strong rally in the last three months of 2017. BG view Apache's strength as an excellent exploratory energy company lying in excellent individuals making up their teams combined with low lifting costs; they remain confident that the company retains good growth prospects over the next three to five years.

## Portfolio activity:

In the recent quarter the Baillie Gifford ('BG') team made few changes to the portfolio as they took stock following the volatility at the end of 2016.

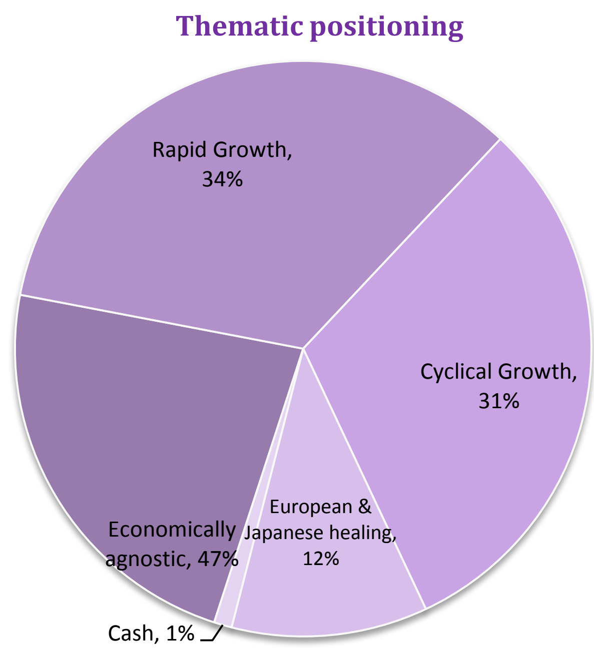
**Significant transactions:**

Purchases:

- **Infineon Technologies –** Infineon technologies is a semi-conductor manufacturer based in Germany with over 45% of its sales coming from the automotive industry and with China as its single largest market at 28%. The BG team have viewed the significant company change and consolidation within the industry as a positive. Structurally higher margins, alongside increased demand for chips (especially with regard to the proliferation of high-end, high-tech smart vehicles), gives the potential for strong growth prospects over the medium to long term.

Sales

- **Wolseley** – A company in the 'cyclical growth' portion of the portfolio, the stock had posted a positive return of over 30% and the Baillie Gifford have now closed out the position.
- **First Republic Bank** – The BG team had become increasingly worried by valuations and accordingly have taken some profits from the position over the quarter.




## Portfolio discussion:

As discussed during the last quarterly report, the BG team did not anticipate or chase the market reaction to the US Presidential election result, and thus did not benefit from the reflation trade that occurred in Q4 2016 (leading to an underperformance of 2.51% vs the index during that period). The partial reversal of the reflation trade (which was focussed on financials and more operationally leveraged, cyclical sectors), benefitted the fund on a relative basis in 1Q17.

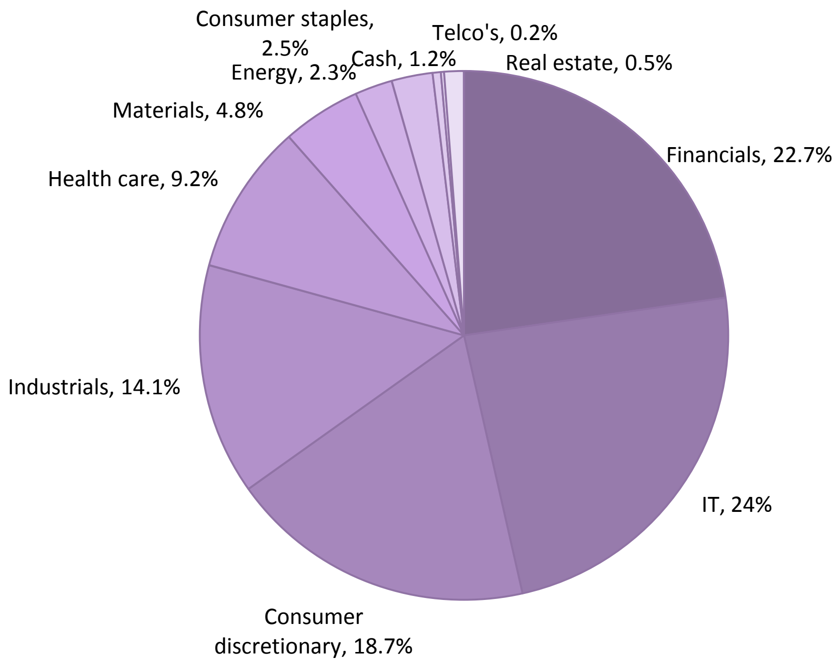
The Trump reflation trade turned out to have a short half-life, as the euphoria of promises of tax reform and infrastructure spending dissipated, with President Trump falling at the first hurdle with his healthcare reform bill. The previous quarter's discussion had focused on how BG anticipated the composition of global growth to be increasingly distributed towards the US as a result of the Trump presidency.

The team now anticipates further normalization in US rates, combined with a gradual tapering of stimulus in the EU. A key concern for the BG team (and the wider world) is the strength of underlying economies if and when rates are hiked and liquidity support is withdrawn. In short, the real question that needs attention is not how many rate increases can the US economy withstand, but at what point do these hikes become a problem for asset markets.

Healthcare stocks struggled during the quarter as political machinations and uncertainty weighed heavy and pricing pressures became even more apparent. Myriad Genetics, Stericycle and Novo Nordisk are all having their investment cases reviewed by the BG team as a result. LCIV will follow up with the manager at the next meeting on these stocks and the healthcare sector in general.

Financials were a topic of discussion, with the banking sector a recent focus of the team's attention. They remain of the view that the sector needs significantly more than the shaky growth and inflation expectations that exist today and more competitiveness and structural self-reflection is required; in other words, structural challenges remain, despite the apparent cyclical bounce.

BG feels that US investment banks may prove to have reached an inflection point. It can be argued that the sector has reached 'peak compliance', with any repeal or amendments to Dodd-Frank by the Trump administration likely to push the banks back into an attractive light. Based on this thesis the BG team have an investment in Leucadia, which is the holding company of Jeffries (as an investment banking proxy stock.) An interesting point to note is that because of the structure of the holding company, it is only covered by one analyst on Wall Street, something that BG view as an advantage.



As can be viewed above, the portfolio remains tilted towards IT and Financials, with neither likely to change as the two highest proportions of the portfolio in the near future. Geographical allocation remains heavily tilted to the US with a 49.1% allocation, with Europe (ex UK) and Emerging Markets both shy of 18% each.

Finally, with regard to the risk management and scenario testing that are continually undertaken on the portfolio; BG noted that they had begun to introduce more positive scenarios into the mix (such as accelerating global growth expectations) rather than the more common market collapses and viral pandemics. The team agreed this mirrored their increasingly optimistic view of the opportunity set available to the fund.

## CIO conclusion:

The BG team had already invested in the normalisation of the US economy, and therefore there was no need to chase the "Trumpflation" rally – moreover, the BG team look at individual companies from the bottom up, and on a five-year view. The performance remains in line with the mandate, and it is encouraging that the BG team report that they are seeing more, rather than fewer, new investment ideas. As noted LCIV will continue to monitor the portfolios position in regards to Healthcare.

# LCIV Diversified Growth Fund (Baillie Gifford) Q1 Manager Review

25th April 2017

*CIV Investment Team*

# LCIV Diversified Growth Fund (Baillie Gifford)

| | |
|---|---|
| **Inception date** | 15/2/2016 |
| **Fund Size** | £355m<br>(as at 31/03/2016) |
| **Number of holdings** | N/A |
| **Benchmark** | N/A |

### Investment objective

The objective is to achieve long term capital growth at lower risk than equity markets.

## Agenda

1. Review the first quarter performance and the significant contributors across the various sub-asset classes.
2. Discuss any portfolio activity relating to the fourth quarter.
3. Explain the general macroeconomic views of the team and how positioning aligns to such.

| | LCIV BG Diversified Growth |
|---|---|
| **Q1 2017** | 2.83% |
| **Since Inception** | 14.76% |

Source: Bloomberg, as at 31/03/2017. Net of fees with dividends re-invested.

# Executive summary

The fund delivered a 2.83% return against a backdrop of relatively stagnant financial markets in the first quarter. Equities, infrastructure and emerging market bonds posted the highest returns of the asset classes in the fund.

The Baillie Gifford ('BG') team have taken stock following the tumultuous final quarter of 2016, making a number of small tweaks to the equity and high yield exposures of the fund on valuation grounds, whilst adding to the emerging market and inflation-linked allocations.

The team retain a 9% allocation to cash however as they still view volatility coming through at some point in the near future and wish to deploy this "dry powder" as quickly as possible.

## Q1 performance review:

Since the inception of the fund in February of 2016 the BG Diversified Growth strategy has delivered 14.76%, helping AUM to grow to £355m.

The fund delivered a 2.83% return against a backdrop of relatively stagnant financial markets in the first quarter, dominated by concerns over reflation and President Trump's ability to implement his much touted financial reforms. The fund has shown its agility in producing a similar return to that of the last quarter despite almost antithetical market conditions.

The BG team were keen to stress the secondary aim of the fund, which is to produce annualised volatility of less than 10% over rolling 5 year periods. The rationale for this number is based upon a target of volatility of around half that of traditional equities (whose average historic volatility is in the high 'teens', hence the 10% figure.)

The fund is well within this target, with a current average volatility of 4.1% per annum over the last 5 years. Although they acknowledged that risk does not necessarily equate to volatility, they pointed out that the secondary aim does serve an important function within the wider context of the strategies' purpose, especially with regard to a pension funds strategic asset allocation.

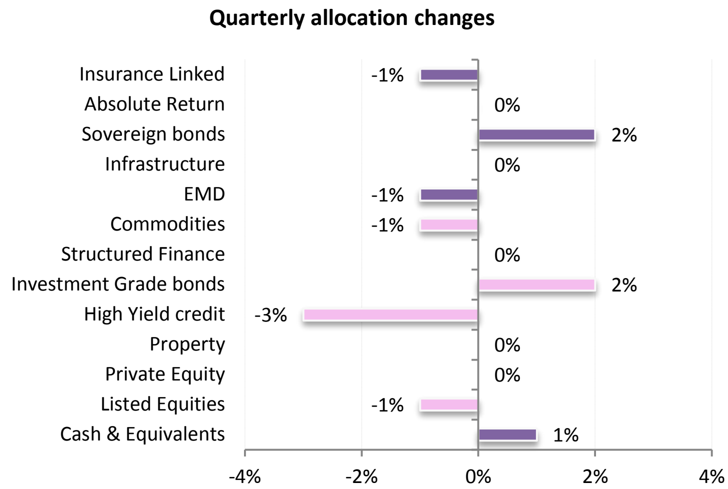
As will be discussed in more detail further on, this was another quarter of nearly all asset classes within the portfolio producing a positive return (which is should be noted is a rare occurrence in historic terms.) The fund's equity exposure provided a positive return of 1.3%, accompanied by a return of 0.6% from Emerging Market Bonds as investors across the globe looked to fully utilise the apparent improvement in global growth, with emerging market bond valuations appearing well positioned. Structured finance and Infrastructure were the only other major positive contributors, adding 0.6% combined.

Little or no overall performance was gained from Government bonds, special opportunities and Absolute return, while the only negative performance came from the portfolio's active currency positions.

## Portfolio activity:

In the first quarter of 2017 Baillie Gifford made some small alterations to holdings as markets recalibrated after the volatility of the last quarter of 2016.

**Significant transactions:**




➢ Government Bonds:

The team added to their position in US inflation linked government bonds (TIPs) after a similar addition last quarter. They continue to view TIPs as providing a better rate of interest than cash and a continuation in inflation protection as the US began to experience the much heralded pick-up. In addition, the team said that they remained a preference over UK inflation linked gilts (linkers) and, as a result of having hedged out the TIPs they are purely used for their inflation protection properties. The subject of credit risk raised its head again during the meeting, with BG running LCIV through their use of Euro-Bobl futures in order to short European interest rates, thereby offsetting some of the credit risk inherent in the portfolio (BG were at pains to point out that they did recognise the apparent late cycle risk.)

➢ Emerging Market Bonds:

The BG team shuffled the holdings as they added to US denominated bonds and reduced local currency bond exposure. The team noted that even with all of the discussion on EM bond valuations that continues to dominate much market discourse, the typical 8.5% return available at the moment is only 0.5% below the long term average and accordingly investors need to keep a watchful eye on yields as the year progresses.

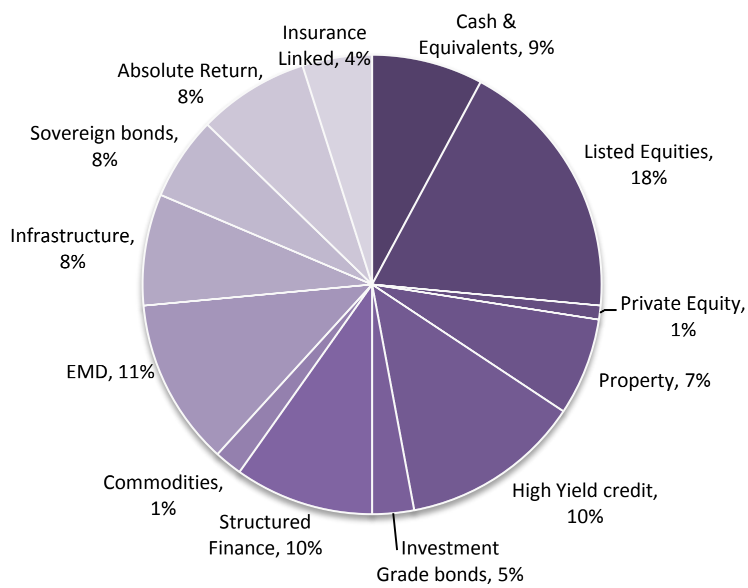
➢ High Yield:

The high yield allocation of the fund currently sits at 10%, with a historical average of 15-20%, demonstrating that the team continues to see better value elsewhere in the portfolio. During the quarter they trimmed back the High Yield exposure by another 3% as they saw demand continue to push prices upwards (this reduction was split between European and US bonds.) With spreads currently sitting at 400 basis points in the US (and BG seeing the correct long term average as between 475 and 500 bps) they felt this was the opportune time to adjust the holding (it should be remembered that the BG team made a timely and sizable tilt towards the HY space following that market's dislocation (in the US) in February 2016).

➢ Listed equities:

The team made a small reduction in listed equities in light of rising valuations across developed markets (the reduction was made both to global equities and European dividends.) The topic of the Trump effect was discussed at length (something that gave a strong tailwind to cyclical stocks during Q4 2016 and hurt the equity performance of the fund relative to the wider market.) The BG team were keen to stress that they do not view themselves as a 'trading book' and therefore would not have attempted to trade the 'dash for trash'. Instead they simply waited until the trade un-wound slightly, which meant that much of the underperformance was reversed.

There appears to be a slight conflict however in the BG team's message that they are not a 'trading book' since they gain exposure to global equities through the Baillie Gifford Global Alpha fund, which itself takes a longer term view on equities, but run the DGF in order to produce tactical asset allocation which inherently needs an element of short-termism. It may be that BG does not view equities as the portion of the portfolio that they would use for short term allocation; however, at such a large percentage of the portfolio this reduces the potential upside when making allocation decisions. This will be revisited with the manager in the future.



## Macro discussion:

The Trump reflation trade, which markets eagerly grabbed with both hands quickly deflated as the euphoria at promises of tax reform and infrastructure spending dissipated, with President Trump falling at the first hurdle with his healthcare reform bill. The previous quarter's discussion had focussed on how BG anticipated the composition of global growth to be increasingly distributed towards the U.S. as a result of the Trump presidency.

The team now view US rates as requiring a movement upwards in the near future and stimulus within the EU (in various guises) to come down. As with most of the market, discussion had moved on from the shift in growth and inflation to the speed of any policy transition, particularly within the US. The real question that needs attention is not how many rate increases can the US economy withstand, but at what point do these hikes become a problem for asset markets.

The BG team said they would continue to expect more modest returns from the markets due to the base effect of the last 7-8 years. However, they remain relatively cash 'heavy' at around 9% in order to deploy when they see volatility come through (which, taking into account the lack of any real correctional event since the China fears 2016, may be quite extreme.)

The BG team remain cautiously optimistic on Europe, with a view that there remains much more to come from ROCE and corporate margins, as well as much more for aim for. It should be noted that the DGF actually gains its EU exposure through dividend futures (specifically on the Eurostoxx 50.) The rationale behind this is that they do not wish to gain exposure to the higher operating leverage of Eurozone corporates.

The US remains a substantial exposure of the portfolio. The LCIV CIO commented on the run rate of US retail closures and questioned how the BG team might factor in any effect of the unwinding of QE. The response was that was part of the reason that the fund did not hold any direct exposure to US real estate.

They do however have a relatively favourable view of the UK on valuation grounds. This is in part because the REITs appear to be pricing in larger property price falls that the BG team expects and accordingly are predominately trading at discounts to NAV. The fund retains some German real estate (such as Deutsche Wohnen) as it would appear that Germany in particular has taken to real estate to offset prevalent negative real interest rates, mainly caused by ECB policy. It was remarked upon however, that this would make the unwinding of QE in Germany a particularly interesting exercise.

## CIO Conclusion:

The fund delivered another credible result. It is worth bearing in mind that equities remain an important allocation. Therefore it is worth bearing in mind that the use of BG's in-house funds to express their view on equity markets, rather than employing single names as in other asset classes, could be tested in the future. This is because the investment approach and philosophy of BG's active funds is specific (thematic such as the Global Alpha Growth, where the stocks are selected to perform over a five-year time horizon). The age of QE ushered in a world where stock dispersion on the whole materially decreased during the global, Central Bank-sponsored asset price rally. As market conditions again change, one might expect a greater variance in stock dispersion, which in turn may well mean that the ability to express a broad view on equities in a tactical manner, utilising a narrow subset of equities bought for specific long term characteristics, could be found wanting.

**Meeting Attendees**

**Team CIV:**
Julian Pendock; CIO
Freddie Fuller; Head of IO
Jill Davys; Client Director

**Baillie Gifford**:
Patrick Edwardson; Head of Multi Asset
Tom Wright; Client RM

# LCIV PY Global Total Return Fund
# Q1 Manager Review

April 21st 2017

***CIV Investment Team***

# LCIV PY Global Total Return Fund

| | |
|---|---|
| **Inception date** | 21/6/2016 |
| **Fund Size** | £204m<br>(as at 31/3/2017) |
| **Number of holdings** | N/A |
| **Benchmark** | N/A |

### Investment objective

The Sub-fund's objective is to provide a stable stream of real total returns over the long term with low absolute volatility and significant downside protection.

### Investment Policy

The ACS Manager aims to achieve the objective by investing solely in the Pyrford Global Total Return (Sterling) Fund, a sub-fund of BMO Investments.

### Agenda

1. Review the Q1 2017 performance of the fund.
2. Understand any changes made to the portfolio during the quarter
3. Discuss macroeconomic & political developments and how they relate to the portfolio.

| | LCIV PY Global Total Return |
|---|---|
| **Q1 2017** | 1.68% |
| **Since LCIV Inception** | 9.1% |

Source: Bloomberg, as at 31/3/2017. Net return with dividends re-invested.

## Executive summary

In the first quarter of 2017 the fund delivered a 1.68% net return. In terms of contribution of returns, the fund's 30% allocation to equities contributed 88% of the total return for the quarter.

There were no asset allocation changes made to the portfolio, but the GTR did alter equity holdings by adding CH Robinson and AMEX, and exiting the position in Exxon. Pyrford also implemented a Canadian dollar hedge against sterling.

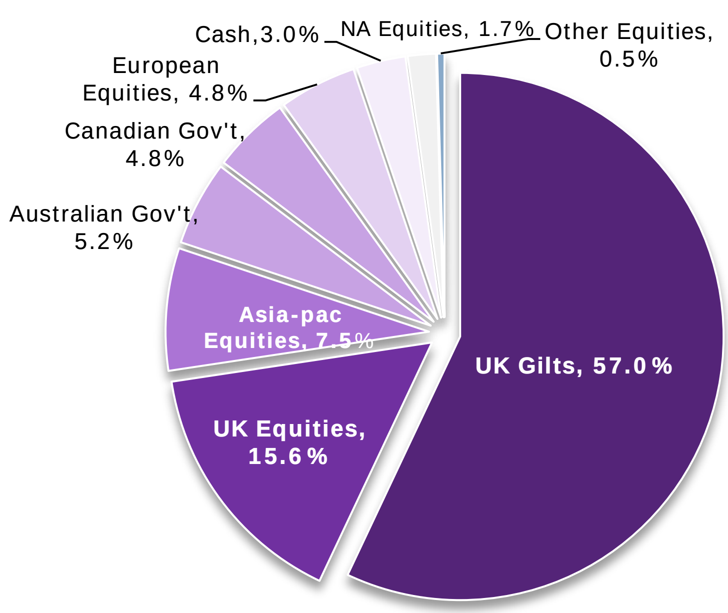
Macroeconomic views have not changed since the previous quarter. The fund remains as defensively positioned as it has been since inception, given concerns over the current valuation of global asset prices.

## Q1 performance review:

Since the inception of the sub-fund in June of 2016 the Pyrford Global Total Return strategy (GTR) has delivered 9.1%, helping AUM to reach £204m. In the first quarter of 2017 the fund delivered a 1.68% net return. In terms of contribution of returns, the GTR's 30% allocation to equities contributed 88% of the total return for the quarter, as many of the defensive names that underperformed in Q4 rebounded sharply as bond yields reversed. The remaining contribution to return arrived predominantly from overseas bonds. The relative performance of the overseas bond position compared to the JP Morgan global bond ex UK index was particularly strong at +2.18% (gross). Cash and currency hedging detracted marginally from overall performance.

## Portfolio activity:

In the first quarter of 2017 there were no asset allocation changes made to the portfolio. The current portfolio allocation amounts to: 30% equities, 67% bonds (largely short-dated), and 3% cash. This reflects the GTR team's continued view that that there is very little fundamental value in either equities or long duration quality sovereign bonds, and that capital market valuations do not discount the significant structural economic and material risks that exist.



**Significant transactions[1]:**

Purchases:

***Equity:***

- **CH Robinson** - CH Robinson is the largest US based third party logistics company. It will benefit as more companies look to outsource their logistics functions as well as continuing to take market share in the transportation market given its superior technology offering. The company is currently selling at a reasonably low valuation and offers an attractive dividend yield.

- **American Express** – 'AMEX' is one of the world's largest credit card companies and there are few other competitors with the scale and reach of AMEX. It has a strong global brand and a proprietary "closed loop" network which allows it to understand its card member needs much better than other competitors. The company has a long history of rewarding shareholders and continues to benefit from the secular conversion of cash based payments to electronic/card based methods.

***FX:***

- **Canadian dollar hedge** - The GTR team decided to hedge some of the Canadian dollar exposure. As a result only 10% of the portfolio remains exposed to unhedged non-sterling assets.

Sales:

**Equity:**

- **Exxon Mobil** - The oil conglomerate has struggled in an environment of volatile oil prices and this has put pressure on the cash flows of the company. Given the current oil price it is expected that dividend growth will be anaemic and this limits the total return that can be expected from the investment. In light of this and other more attractive investment opportunities, the GTR team opted to exit the position.

[1] Transaction commentary sourced from Pyrford directly

## Macro discussion & portfolio positioning:

In terms of macroeconomic views very little has changed since LCIV last met with Pyrford in Q4. Much of our previous discussion was dominated by the impact that the newly elected president Trump would have on the U.S economy and both equity and fixed income markets. The GTR team questioned the blistering equity market rally towards the back end of the final quarter and opted not to alter their equity market allocation in anticipation of a sense prevailing pull-back given the fiscal constraints on the U.S government. The success of this decision should be evaluated in years, not in quarters, but the recent evidence from U.S long-term bond yields suggest that reflation expectations are beginning to diminish. Trump's inability to execute many of his electoral policies, such as his first attempt at the repeal of Obamacare, has created scepticism over the extent to which the new administration can raise growth prospects in the U.S.

The GTR team are aware of upward trending inflation arriving from tighter labour markets across many developed market economies, as well as through oil price base effects. Inflation has now moved into positive territory in all nineteen Eurozone countries, has passed the 2% target in the UK and U.S., and is above zero in japan. Monetary tightening has started in the U.S. with the market now overwhelmingly expecting the Fed to raise the federal funds rate in June for what would be the second rate rise this calendar year. The European and UK (though to a lesser extent) both lag behind the US economic cycle by a matter of years, but markets are starting to ponder the likelihood of the timing of future rate rises. Calls for tapering have also found more press in recent months, and the probability of a reduction of the balance sheets of the major central banks is increasing with inflation expectations.

What does all of this mean for markets? According to Pyrford, gradual monetary tightening is yet another reason to be cautious over soaring equity valuations. The current Cyclically Adjusted Price-to-Earnings ratio of 29x, rivalled only by the great depression and the global financial crisis in 2008, is indicative of equities being overpriced and logically begets a conservative allocation to equities. Pyrford also see very little value across sovereign bond markets despite the mild correction in valuations for many longer dated issues of different sovereign issuers. In their opinion, offerings such as the 30 year UK gilt at a yield of 1.6% are extremely unattractive on both an absolute and relative basis, and offer little by way of compensation for the capital risk that the holder would carry. Whilst US issues offer slightly more yield than UK issues of similar maturities (e.g. +100 to 150 bps on 30 year), the expected inflation differential between the two country's result in similar real rates of return.

The GTR team continue to adopt an extremely defensive stance by owning short duration securities in order to protect the capital value of the portfolio from expected rises in yields. At the end of the first quarter the modified duration of the fixed income portfolio stood at 1.8 years; the lowest level since the fund's inception.

In the previous quarter, the GTR team outlined the macro scenario which would inflict the most relative pain on the fund, explaining that ''the portfolio would struggle if bond yields fall to new lows and President Trump comes to the rescue for global growth and equity markets. The potential loosening, or wholesale bonfire, of tight U.S. banking regulations and the resulting revival of the velocity of money could provide a bumpy ride for the portfolio in its current form''. As already discussed it appears that Mr Trump will not revive growth, at least to the extent to that markets had pined for. The jury is still out over banking deregulation, but early indications are less than promising.

As for bond yields falling to new lows, the London CIV are growing more cautious of the view that (sovereign) yields must naturally mean revert toward neutral rates of previous decades. This is based on the following observations. Firstly, productivity growth in developed countries remains at multi decade lows, with little sign of a return to previous trend. Secondly, Global demographic trends are approaching an unprecedented inflection point with dependency ratios that are accelerating at an alarming rate. As populations mature, the capital per worker rises, leaving economies awash with capital that then bids down returns on securities, a force that is particularly detrimental to income producing assets as workers approach retirement. Furthermore, the mountain of debt taken on by governments and households necessitate financial repression, and low interest rates are the natural re-distributory tool. These concerns are unlikely to evaporate in the medium run. Cyclical tightening, including both rate rises and/or tapering may support the Pyrford's view in the short-run, but long-run structural issues remain across the globe.

Views on interest rates are an important driver of performance of the portfolio, and whilst the Pyrford team are not static in their mind-set, this is a topic the London CIV must monitor closely.

## CIO conclusion:

The GTR team have maintained their discipline, which is key in environments (and markets) with a "high noise to signal ratio". Markets have a tendency to latch onto the next perceived "story", but the GTR team's adherence to fundamentals paid off.

**Meeting Attendees**

**Team CIV:**
Julian Pendock; CIO
Jill Davys; Client Director
Frederick Fuller; Head of IO
Ryan Smart; Investment analyst

**Pyrford:**
Tony Cousins; CEO/PM
Felim Glyn; Client RM

# LCIV RF Absolute Return Fund
# Q1 Manager Review
24th April 2017

***CIV Investment Team***

# LCIV RF Absolute Return Fund

| | |
|---|---|
| **Inception date** | 21 June 2016 |
| **Fund Size** | £413.12m<br>(as at 31/03/2017) |
| **Number of holdings** | N/A |
| **Benchmark** | Not applicable |

### Investment objective

*To achieve low volatility and positive returns in all market conditions. Capital invested in the Sub-fund is at risk and there is no guarantee that a positive return will be delivered over any one or a number of twelve-month periods*

### Investment policy

*The ACS Manager aims to achieve the objective by investing solely in the CF Ruffer Absolute Return Fund, and cash and near cash.*

## Agenda

1. Review the quarterly performance of the fund.
2. Examine changes to Ruffer's scenario analysis, taking into account significant recent macroeconomic & political developments.
3. Discuss the rationale, given economic expectations, for both current holdings and any portfolio changes.

| | LCIV Ruffer Absolute Return Fund |
|---|---|
| Q1 2017 | 0.0034% |
| Since LCIV Inception | 11.50% |

Source: Bloomberg, as at 31/04/2017. Net of fees with dividends re-invested.

# Executive summary

The performance of the Absolute Return fund was flat in 1Q17, following the impressive performance numbers in the previous quarter.

The first quarter of 2017 proved one of drawing breath after the trials and tribulations of a volatile end to 2016. With the focus across the globe sharpened on increased inflation and much heralded growth prospects, the Ruffer team took the time to re-evaluate the portfolio positioning with only small changes in the underlying holdings, but with a sense of optimism at the opportunities available across the asset classes.

The strategy is designed to offset a variety of risks over different time periods whilst taking advantage of opportunities as they arise.

# To note

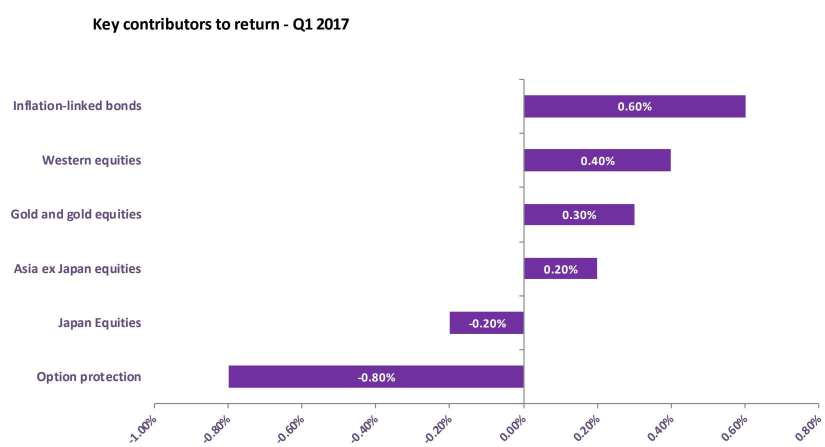
It was announced towards the end of 2016 that Ruffer would be appointing a new Chief Executive Officer to replace Henry Maxey (who held the dual role of CEO and CIO.) Mr Maxey will remain as CIO, with Clemmie Vaughan (who was previously the head of Private Client at Ruffer) taking over as Chief Executive.

The change has now taken place, with the Ruffer team noting the smoothness of the transition, with relatively little noticeable change within the company. LCIV will be swiftly informed of any further impact resulting from the split of these roles.

In addition, an important step taken by Ruffer (and particularly pertinent to LCIV investors) is the decision to stop paying for investment research out of their funds, at some point in the near future and begin paying for it out of the company's own profits. Ruffer have estimated this will save current investors in the fund around 3 basis points per annum (or based on current AUM, around £120,000 to the whole fund per annum.) Further updates on the timing of this change will be provided to investors when the timeline is confirmed.

# Q1 performance review

Since the inception of the sub-fund in June of 2016 the Ruffer Absolute Return strategy has delivered 11.5%, with a current AUM increased to £413m after a substantial inflow to the fund. In the first quarter of 2017, the sub-fund produced a flat return of 0.0034% during a quarter of lumpy but ultimately rather stagnant market performance dominated by concerns over reflation and President Trump's ability to implement his much touted financial reforms.




Source: Ruffer, as at 31/03/2017.

Option protection was the main detractor from performance as markets rose. Ruffer's exposure (including VIX call options and options on rising rates in the UK, EU and Japan) suffered as volatility was subdued during the quarter and bond yields fell back. This fall gave the inflation linked bonds ('linkers' which now make up 40% of the portfolio) a boost leading to a 0.6% rise.

A softer dollar meant that the fund's gold exposure recovered most of the losses that they incurred at the end of 2016, as well as giving support to the fund's small amount of emerging market equities, which rose 0.2%. Western equities added 0.4% of performance as individual stocks such as Lloyds and ITV had a strong showing, despite some underwhelming performance from the fund's oil equities. However the market move back to 'bond like' stocks (which Ruffer remain wary of on valuation grounds) resulted in a broadly flat performance of the fund as a whole.

Finally, a strengthening Yen proved too much for the strong performance of individual stocks (such as Sony, which is covered in more detail further on,) with Japanese equities costing the portfolio around -0.2% of performance.

## Macro discussion[1]:

The Trump reflation trade, which markets eagerly grabbed with both hands quickly deflated as the euphoria at promises of tax reform and infrastructure spending dissipated, with President Trump falling at the first hurdle with his healthcare reform bill. The previous quarter's discussion with Ruffer's investment team on the possibility of a benign global growth environment with accompanying policy normalisation and rate rises still holds firm but focus now is shifting towards how politics (particularly in the US) will interfere with fiscal policy and its implementation. Ruffer noted the increasing divergence of hard and soft data in the US and the Eurozone, with consumer confidence surveys often at odds with real data such as retail sales and industrial production.

That being said, Ruffer remain of the view that the US is 'fine' and that despite the wavering sector cycles, the US economy is robust enough to withstand a 25 basis point increase in rates in June. Furthermore, subject to any further moments of political upheaval during the months to come, they view a further one or two rate hikes as not out of the question taking into account the US's resilience. The real question that needs attention is not how many rate increases can the US economy withstand, but at what point do these hikes become a problem for asset markets.

[1] All opinions and statements made hereafter in this section reflect the views and opinions of the Ruffer Investment Team and are not the opinions of the LCIV Investment Team.

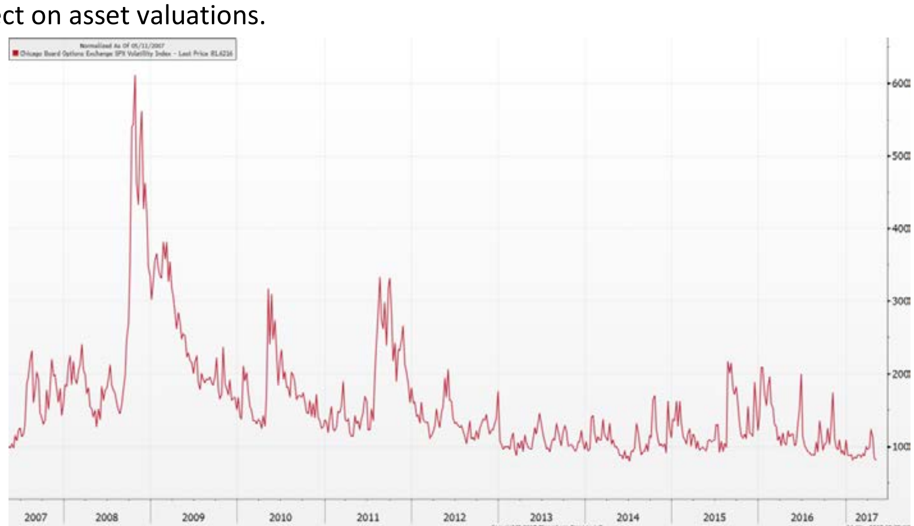
In this context it was noted that the Fed would need to make a decision as to how far in front or behind the recovery, with the LCIV CIO noting that it appeared that the market had priced in Janet Yellen running the economy 'hot' for the foreseeable future. However, with Donald Trump yet to announce his two appointments to the Fed, the very makeup and inclinations of the Fed may dramatically shift over the upcoming months and years and so any speculation on Fed reactions will continue to be spurious at best. Further discussions will be held with the manager as these events progress throughout the year.

## Portfolio positioning and rationale:

With the expectations of bumpy but sustainable growth coming through (albeit peppered with the uncertainty brought about by the numerous looming European elections) Ruffer continue to look at valuations and growth on a relative basis. Ruffer reinforced the point that they would rather hold Mitsubishi Motors at 10 x earnings than they would Kraft at 28 x earnings. Although Ruffer agreed that a similar view could be taken on much of the Eurozone, they felt that it was prudent to spend more of their risk budget on global companies based in Japan. The Ruffer team felt that eurozone valuations were back to their normal valuation discount in comparison to US markets and therefore did not offer a cost-effective way to gain operating leverage exposure to the narrative of a healing global economy.

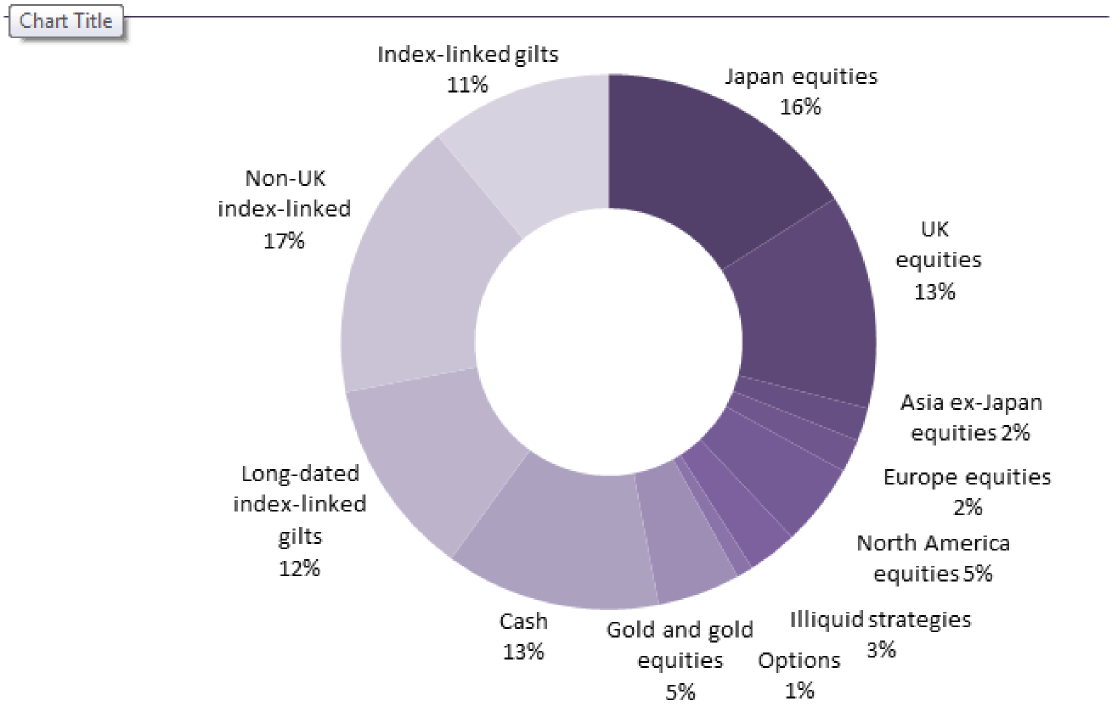
The question of political upheaval in Europe was briefly discussed, with general agreement that although similar in appearance (in the same way Brexit and Tump initially appeared) nothing of note could be gleaned from the election result in Holland, nor the first round victory of Emmanuel Macron in the French elections.

Market volatility continues to remain at extreme lows (the VIX continues to bump along the bottom compared with the last decade as shown in the chart below) with Ruffer noting that there hasn't been a major market event since the China fears in 2016. As such they, as with much of the market, are becoming increasingly wary of the impact of any major market event and its effect on asset valuations.




Source: Bloomberg 04/05/2017

## Asset Allocation




The portfolio duration remains unchanged, with Ruffer reiterating that they do not trade duration especially at the long end, which they simply focus on protecting, as the options positions in the portfolio do a good job of managing it for them. As such duration remains unchanged at around 8 years.

With long term inflation expectations remaining unabated, the Ruffer team remained bullish on their “linkers” exposure, offering an example of the asymmetric pay-off offered by the UK’s longest dated inflation linked bond (0.125% maturing in 2068.) If the current real yield of -1.9% continues to fall (influenced by inflation rising faster that interest rate expectations) and reached -5.6%, the price would increase by 660% whilst an equal but opposite shift to a real yield of +2.4% would result in a 90% fall.

With TIPS looking pricy on a relative basis (although arguably not when compared with Treasuries) it would appear that European and Japanese inflation linked bonds will offer value, supported by the base effect of the ECB’s QE programme (although reference should be made to any signs of prospective tapering.)

Within the equity exposure of the portfolio, Ruffer note that the rise in bond yields in Q4 2016 demonstrated the impact of a small change in discount rates on equity valuations as ‘bond proxy’ stocks were hit hard, with Ruffer arguing that the market often forgets the extremely low starting levels of discount rates.

Ruffer remain poised to take advantage of unloved stocks that they feel will benefit strongly from any growth tailwinds coming forward in the second half of 2017 (an example of this approach was their investment in Westrock (a US packaging giant) who in just over a year have experienced a 100% increase in their share price).

The stock was arguably undervalued by the market as a whole and was leveraged to global growth and supported by affordable raw material pricing in a fragmented market. This combined with good management and a strong balance sheet meant that the Ruffer team were able to benefit from strong share price growth in 2016 and then sell off the position.

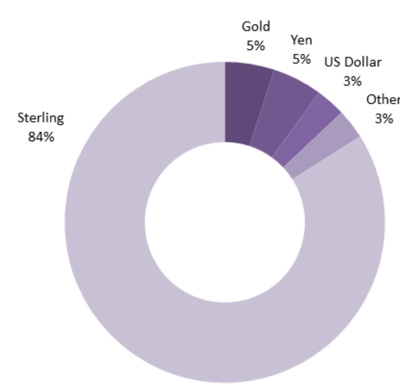
The current tailwind behind the UK banking sector means that the portfolio holds not only Lloyds Banking Group but now Royal Bank of Scotland (RBS). Although the investment team acknowledged that there remained many caveats around not only this sector, but RBS in particular, they felt that the business case combined with the fact that it would act as a hedge against rising UK interest rates meant that this presented an opportune moment to initiate a position.

Ruffer are of the view that if UK growth continues on an upward trend for the foreseeable future, the expected increase in borrowing (especially in the SME area, which RBS are heavily exposed to and the majority of which are based on LIBOR + 'X'%) and any increase in interest rates will benefit the bank's balance sheet. They noted that they remain more comfortable with their Lloyds holding as a means to exposure to the UK banking sector, although this does come down in part to the fact that Lloyds is less overshadowed by ongoing fines that RBS has experienced and continues to account for.

The day before the meeting, Sony rose 4% after the company raised its guidance again for the year, with forecast operating profit of $4.5 billion for the fiscal year through March 2018, bringing about the possibility of beating its record profit set in 1998.

Sony's ongoing 'turnaround' which has seen years of restructuring and is now unarguably mature, seems to have finally reaped dividends, with the company's focus on both consumer and shareholder value through their concentration on gaming, semi-conductor and mobile communications divisions.

Finally, the portfolio remains almost entirely hedged, with Ruffer of the view that they have removed most of the GBP risk in the portfolio. Small exposures to dollar and yen remain.



## CIO Conclusion:

The flat performance of the fund in 1Q17 needs to be put into the context of a strong run by the fund. The investment style of the fund naturally produces "lumpy" performance, and the combination of low volatility and conflicting data was not therefore the best market environment for the investment team.

Nonetheless, following on the from the investment team's nimbleness of the previous quarters, it is possible to make the argument that some of the signs were there. The CIV team discussed with the Ruffer team the divergence of the encouraging headline data and the underlying reality, citing China's continued attempts to get a grip on the debt problem, and how the Chinese banking sector's balance sheet clean-up was mostly financial engineering and window-dressing rather than anything of substance.

Overall however, the performance remains solid and the Ruffer team continue to be data driven whilst maintaining their ability to think laterally and strategically.

## Meeting Attendees

**Team CIV:**
Julian Pendock; CIO
Frederick Fuller; Head of IO
Jill Davys; Client Director

**Ruffer**
Trevor Bradley; Investment Director
Alex Lennard; Investment Director
David Balance; Investment Director

# LCIV NW Real Return Fund
# Q1 Manager Review
April 21st 2017

*CIV Investment Team*

# Newton Real Return Fund

| | |
|---|---|
| **Inception date** | 16/12/2016 |
| **Fund Size** | £332m<br>(as at 31/3/2017) |
| **Number of holdings** | N/A |
| **Benchmark** | 1month Libor +3% per annum over 5 years (Net) |

### Investment objective

The sub-fund's objective is to achieve real rates of return in Sterling terms. The Sub-fund seeks a minimum return of cash (1 month GBP LIBOR) +3% per annum over 5 years net of fees.

### Investment Policy

The sub-fund invests 100% in the Newton Real Return Fund to achieve its objective. Reference to Newton or the portfolio refers to the Newton Real Return fund.

## Agenda

1. Review the first quarter performance of the fund and any significant drivers of returns.
2. Discuss any portfolio activity relating to the first quarter.
3. Offer an overview of the macroeconomic views of the real return team.

| | LCIV Newton Real Return | 1month Libor +3% |
|---|---|---|
| Q1 2017 | 1.97% | 0.80% |
| Since LCIV Inception | 3.40% | 0.94% |

Source: Bloomberg, as at 31/3/2017. Net of fees with dividends re-invested. Both the fund and benchmark performance as stated are periodic returns.

## Executive summary

The LCIV NW Real Return Fund delivered a 1.97% net return for the first quarter, and a 3.4% return since its December 2016 inception.

The Newton strategy comprises a return seeking core with a layer of stabilizing assets and hedging positions. Newton have not felt the need to make significant changes to the core of the fund during the quarter but did add to defensive equities as valuation opportunities arose. This resulted in the return seeking asset exposure drifting up to 29% of the overall portfolio allocation.

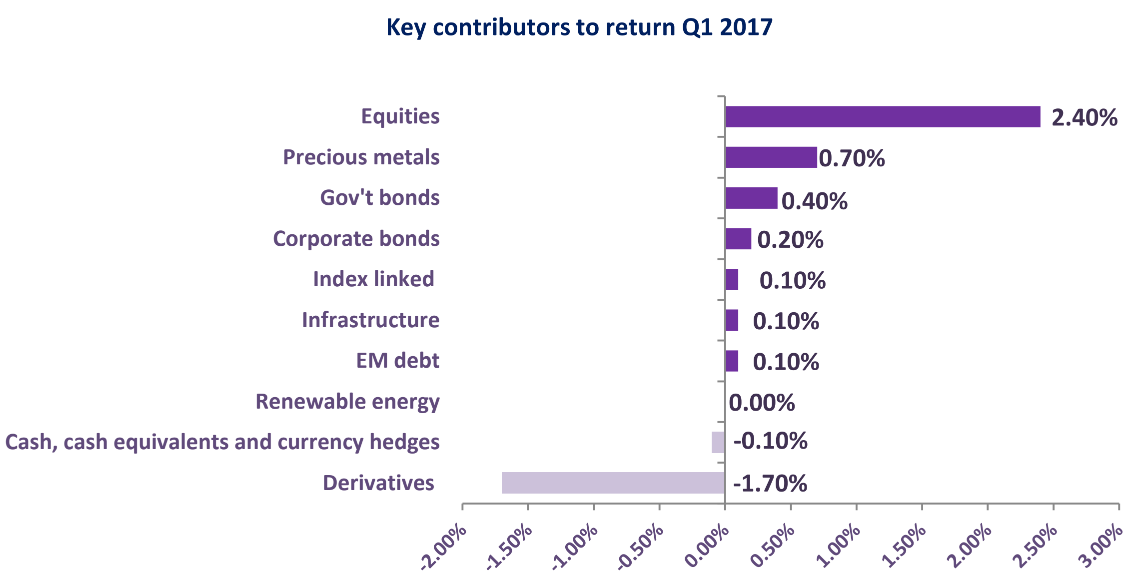
The overarching Macroeconomic views of the Newton team have not changed. More thought is being allocated toward the political and economic ramifications of the upcoming UK and European elections.

## Q1 performance review[1]:

The LCIV NW Real Return Fund delivered a 1.97% net return this quarter, a 1.17% outperformance relative to the benchmark, 1 month Libor+3%. Since the inception of the fund in December this outperformance has grown to 2.46% helping AUM of the fund to reach £332m.

In terms of contributions to returns the equity holdings were the main driver contributing 2.4% to the overall return for the quarter as the fund's stable compounding equity holdings performed in line with broad global equity indices. Positive global macroeconomic data, particularly in Europe and the U.S. underpinned strong performance in equity markets; The MSCI Europe ex UK and the S&P500 rose 7.4% and 4.8% respectively in GBP terms[2]. One consequence of positive equity markets during the quarter was that the equity protection employed within the Fund represented a significant cost. This played an extensive part in the 1.7% negative contribution to overall returns, as asset markets defied the growing perception of geopolitical risk. This was combined with a drop in volatility.

Exposure to gold and government bonds generated positive contributions of 0.7% and 0.4% and offset the cost of equity derivatives somewhat. Elsewhere within the core of return-seeking assets, corporate bonds provided a small positive contribution, as did exposure to Mexican government bonds and infrastructure assets in the UK.




[1] Source: Newton Investment Management & Pace. Data relates to Newton's direct fund holdings which does not perfectly correlate with the returns received by local London authorities but serves as a reasonable approximation.
[2] Source: Datastream

## Portfolio activity[3]:

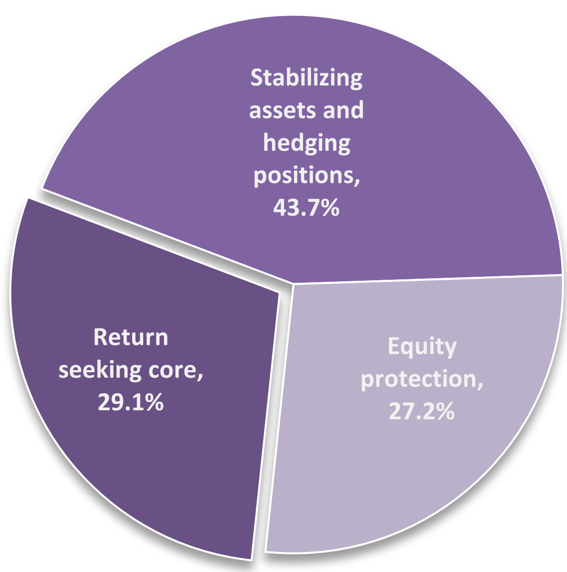
Given the background and environment Newton have not felt the need to make significant changes to the core of the Fund during the quarter. Instead they have selectively added to defensive equities that have lagged behind during recent strong market performance, including Dollar General, Reynolds American, Dong Energy and Associated British Foods. Strong performance allowed Newton to take some profits in technology holdings such as Microsoft, SAP and Samsung SDI; companies that had previously benefitted from the previous equity market optimism with the election of Donald Trump.

They also initiated a holding in Mexican government bonds after a sell-off prompted by Trump rhetoric created an attractive entry point. Newton added equity exposure in emerging markets, buying retailer Walmart de Mexico and ITC.

Finally, Newton also trimmed the gold equity exposure after strong performance and reinvested the proceeds back into physical gold; they continue to like the hard commodity, but prefer exposure to the underlying asset without the operational leverage associated with gold miners.

These changes have resulted in a 4% increase in the return seeking core to 29% of the fund, a 3% fall in stabilizing assets to 44%, and a marginal reduction in equity protection.

**Positioning at 31 March 2017**




[3] Source: Newton investment management Q1 2017 investment report.

## Macro discussion

In our previous meeting in December of 2016 Newton were keen to express their nervousness over the valuation of risk assets across the globe. The raft of central bank liquidity was cited as the cause, and the disappointment over the efficacy of monetary policy was clearly outlined. Instead the Manager awaits a market led, organic solution aimed at mitigating against any unintended consequences of policy errors, whilst allowing the economic system to repair itself. These views have not changed and continue to firmly underpin the relative allocations between risk assets and stabilizing assets. The team remain committed to preserving capital until markets price risk more realistically.

The Newton team were also reluctant to significantly alter the portfolio in Q4 2016 in response to the election of Donald Trump in the United States, despite many market participants expressing supreme optimism over the revival of the U.S economy. Whilst Newton's scepticism did not allow the fund to participate in some of the upside in equity markets in Q4, it did protect the fund as the euphoria was reined back in this quarter. According to Newton, it was not the US financials and energy stocks that led markets higher in Q1, it was the global large cap stocks, such as Facebook, Amazon, Netflix and Google. Whilst these companies performed well in Q1, questions over the sustainability of the business models due to increasing regulatory pressures may trouble the likes of Facebook and Google in times ahead. With regards to U.S bond yields the Newton team's Trump reflation scepticism leads them to suspect that yields have reached their upper limit. At the end of March the U.S 10-year stood at 2.4%.

Newton also have specific concerns over the valuation of the S&P500, most notably including the 29x Shiller cyclically adjusted price-to-earnings (CAPE) ratio that flirts near all time highs whilst economic fundamentals remain a source of debate. Furthermore, the team are seeing increasing competitive pressures across the *piste*, which could pose a challenge for profits going forward i.e. there remain concerns about the potential for profit margins (at least partially) to mean revert. For these reasons the team continue to feel that the S&P 500 is the most attractive index on which to base the majority of their equity protection.

Away from the U.S., the Newton team is troubled by the significant intervention in the Chinese economy by the People's Bank of China (PBoC). Vast sums have been pumped into the Chinese shadow banking system in recent years contributing to sustained demand in the region that has held up pricing power for many domestic companies. The Newton team doubts that this development can continue and are watching monetary trends in the area closely. Whilst the team are not particularly bullish on EM as a whole at this moment in time (in large part due to Chinese economic concerns, and to the eventual reversal of central bank liquidity across the globe), they remain open to tilting the portfolio back towards EM over time should the underlying economic fundamentals improve. Furthermore, and in line with their thematic idea generation, they continue to find interesting idiosyncratic stories, such as their recent investments in both the Indian tobacco company and Mexican government bonds.

In Europe, the Newton continue to view opportunities on a stock by stock basis, rather than from a top-down approach. They find many European stocks trading at a discount to their U.S counterparts as they often have throughout history due to the lower earnings (on average) produced by European companies. The French election between Emmanuel Macron and Marine

Le Pen is causing some anxiety in both European equity and bond markets. In order to protect the portfolio going into the election the team opted to implement some derivate protection on the equity and sovereign side in anticipation of higher government bond yields associated with the removal of French political risk in the case of a Macron victory. On the equity side, whilst valuations may be relatively more appealing, the team are struggling to find highly attractive names in the region that suitably fit that fund's criteria.

Finally, Newton felt that Theresa May's decision to call a snap election could be a good opportunity for the conservative party to increase their negotiation leverage at the Brexit table. They expect a comfortable conservative victory (pre any manifesto offering), and have decided to reduce their underweight sterling position as a result. That said, they do anticipate increased levels of uncertainty surrounding UK assets in the run-up to the election in June.

## CIO conclusion:

The fund has comfortably beaten its index since inception, in markets which continue to surprise on the upside. The managers were not alone in being blindsided by markets' apparent insouciance in the face of growing risks and threats, and the team has remained consistent in its views whilst remaining vigilant in terms of new risks.

**Meeting Attendees**

**Team CIV:**
Julian Pendock; CIO
Jill Davys; Client Director
Frederick Fuller; Head of IO
Ryan Smart; Investment analyst

**Newton:**
Peter Hensman; Portfolio manager
James Mitchell; Client RM

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