

**INDEPENDENT ADVISOR'S REPORT FOR THE QUARTER ENDED
30 SEPTEMBER 2014**

Manager meetings London: 31 October 2014

This report covers the face-to-face fund manager meetings held with eight of the managers employed by the Suffolk Pension Fund. The meetings covered both the third quarter of 2014 and the current outlook for the various investment markets. In addition to the regular equity fund manager briefings the private equity manager Pantheon presented for the first time in over a year. As hosts in their new offices Pырford provided an overview of performance for the fund and also presented the economic overview that drives their investment decisions. Overall the meetings showed a continuation of the growing level of caution about markets we saw at the beginning of September. Given the relatively short period between meetings this was to be expected. Despite the sharp market set back seen in October some managers including Pырford expressed continued concern over the level of equity markets. In terms of overall Q3 performance most managers were close to or slightly above the benchmark return. Blackrock managed a slightly positive return in the UK despite the index falling over the three months, which was a credible result.

Newton: Actively managed global equity mandate

Our usual contacts Paul Markham (fund manager) and David Moylett (client director) presented the Q3 report from Newton. The team began with a brief overview of the investment landscape, noting that there remained a number of worrying themes affecting global markets including the over-hang of debt both public and private that was mentioned at the last meeting. The low growth economic environment coupled with uncertainty around the future path of central bank policy is causing markets to exhibit high levels of volatility. David gave the example of October where intra month moves in markets were greater in magnitude than the twelve-month return. Newton expects this type of environment to continue for some time. However this volatility does allow for active managers to add value and Newton seem reasonably confident that they can take advantage of these market conditions. Paul described how the portfolio they construct for Suffolk contains 70-80% core stocks that have a long-term (up to five year) investment thesis. This core is supplemented by a more cyclical 20% of stocks that are held opportunistically with the aim of creating value by exploiting shorter term market mispricing.

A key philosophy for Newton is to look for companies that offer strong free cash flow generation with dominant market shares and superior franchise value. This approach appears to be working well in the current market environment as is their relative defensive stance and negative view on emerging markets. In terms of performance Newton returned 3.8% for Q3 which is 0.8% ahead of the benchmark. Longer term the portfolio is over 1% per annum ahead over three years, helped by a very strong

2012 and 2013. Over five years Newton delivered a return in line with the index, they are however 0.4% per annum ahead since inception. These are reasonable performance figures although still some way behind the agreed target of 2.5% per annum over rolling three and five year periods

Of all the Fund managers that present to us Newton remain amongst the most “accessible” in terms of their presentation style with a refreshing transparent approach. It is also to their credit that Paul Markham who is our fund manager attends in person the vast majority of these quarterly meetings, which leads to a good continuity in the message, and also the opportunity of hearing this message from the “horse’s mouth” so to speak. Overall this was an informative briefing.

Alliance Bernstein: Active UK Equity mandate with a value investment style

Nicholas Davison (senior portfolio manager) and Ian Burton (client relations) presented the report from Alliance Bernstein. Ian started off with a quick review of performance for the third quarter. The portfolio fell 0.9% along with the UK market during Q3, leaving the portfolio still -0.6% relative for the year to date. As a bad quarter has now dropped out of the three-year figure this is now 0.9% positive. However no progress is being made on the longer term numbers down 1.9% and 3.0% per annum relative for five years and since inception respectively.

The UK market fell during the quarter, which was in contrast to most other equity markets where returns were modestly positive and Japan, which was extremely strong driven by excitement over the continued stimulation of the economy by the Japanese central bank including a planned \$750bn of quantitative easing. Resource stocks proved to be the worst performers as markets became worried about the outlook for global growth. Nicholas highlighted that earnings growth in aggregate had stalled over the last two years in the UK, but that the recent decline in the UK market had left it on a x13 price to earnings ratio for 2015 which compared to x14 for the world index. This was a level that Alliance Bernstein considered offered buying opportunities.

The meeting then moved on to cover the wider global economic picture with Alliance Bernstein highlighting the slowing growth in China and their caution on Europe, which they see as having many risks although they remain hopeful that improving credit conditions will allow for modest growth for 2015. The pound fell against the dollar partly on concerns over the Scottish referendum and partly as a result of dollar strength inspired by the long anticipated ending of Quantitative Easing.

The remainder of the presentation looked at stock contributions for the Q3 performance. Once again the largest contributors to relative performance were stocks not held in the portfolio. By avoiding the UK supermarket sector in general and Tesco in particular the portfolio benefited when the Tesco share price was rocked following a major profits warning and subsequent poor results. The major drag on relative performance was not holding pharmaceutical company Shire whose shares spiked higher on news it had agreed to a £32bn (\$54.7bn) takeover by the US drugs company AbbVie. Interestingly not holding Shire was also highlighted in the Q2 report from Alliance Bernstein. Checking the charts it does look as if the initial bid boosted the share price late in July and the good performance continued during

the third quarter. After the quarter ended the bid fell away and the share price fell dramatically so expected Shire to feature once again in Q4 but this time as mayor beneficiary of relative performance.

Other positive contributors highlighted were held in the portfolio; these were Barratt Developments which delivered good earnings figures, Vodafone which has bounced from the recently lows following disappointment over the lack of a take-over bid and Direct Line Insurance which is returning cash to shareholders and selling non-core businesses. Finally we were shown a case study on Royal Mail a recent purchase that Bernstein believes offers value because of cost cutting opportunities, scope to raise prices and undervalued property assets sitting on the balance sheet.

The meeting concluded with some general information regarding the performance of Tobacco Stocks in the portfolio, more detailed figures will be produced as this was requested but in very general terms holding tobacco had made the portfolio about £10m and this probably represented a £400-500K outperformance of the market overall.

Blackrock: Active UK equity mandate (blended style growth orientation)

Simon Betteley (client service) and Fred Wood (product specialist) presented the report from Blackrock. They began the meeting with a quick review of markets over the third quarter and commented on the volatile markets conditions faced during October, as concerns over economic growth and the end of US quantitative easing rocked equity markets and drove bond yields lower. The changing economic growth expectations particularly in Europe, along with concerns around Ebola and tensions in the Middle East are driving volatility but are also presenting good opportunities for active managers. Fred reiterated the Blackrock view that the UK economy should still be able to make progress even if Europe falls back into recession. They also believe that the ECB will do whatever it takes to avoid recession including outright quantitative easing if need be. In terms of stock selection Blackrock continue to favour stable growth companies and believe that the higher quality consumer staple companies will continue to re-rate to even higher levels.

The presentation then moved on to performance and individual stock contributions. Blackrock enjoyed a good third Quarter delivering a 0.3% positive return against a UK index return of -1.0%. In terms of positive contribution against the Index the fund benefitted from not holding Tesco at all, in fact even at the current lower share price Tesco was not seen as attractive and Fred commented that there still remained much work to be done for the company to resume its growth path. Being only half weighted in BP was also a positive as the stock fell over the quarter in response to a rapidly falling Oil Price. In contrast to Alliance Bernstein (see above) Blackrock benefitted from holding Shire Pharmaceuticals, but not holding Vodafone detracted from performance. In terms of future policy banks were seen a potentially benefitting from any rise in interest rates with Lloyds being the favoured way to play this. They also continue to favour stable consumer stocks and have recently added to BAT, Next and SAB Miller.

The meeting concluded with a brief additional report prepared on the tobacco sector that looked at the contribution of the sector as a whole to the index and also looked at the performance of the Suffolk Blackrock portfolio with and without tobacco exposure. Overall this was a good meeting, and it was certainly encouraging to have Blackrock present without any mention of changes to process or personnel. It does seem as if the many changes of the recent past have now bedded in and are beginning to have a positive impact on returns. After the strong quarter the portfolio has now returned a positive 2.1% above the index for the last twelve months. Blackrock are now ahead of benchmark over all periods. Particularly impressive is the since inception return of +2.3% per annum above the benchmark.

Pantheon : Private Equity managers.

Pantheon who had not presented a report in person for over a year was represented by Alex Scott (Principal) and Laurence Jonkler (Partner). The Suffolk pension fund has previously committed a total of £36.6m across ten separate Pantheon funds with vintage dates (that is the year where the fund started to invest) between 2002 and 2010. The ten private equity funds in which Suffolk pension fund has an interest are invested across the globe with separate funds targeting Asia, the US and Europe. In aggregate of the £36.6m that has been committed Pantheon has now drawn down £29.8 for investments. As of June 2014 £17.8m has been returned in distributions with £24.8m left as the net asset value of the remaining investments. The report contained aggregate performance for the ten funds as at the end of June 2014. At this date the overall internal rate of return was shown as 9.6% (internal rate of return is the usual way private equity funds show performance as it captures the various cash flows and timescales inherent in private equity investment) and with a multiple made on the money invested of x 1.43.

The rest of the report detailed the diversified exposure that has been achieved by the investment strategy adopted. This diversification is by geography and strategy as well as by vintage year. In terms of strategy Suffolk has exposure to underlying funds that invest in Buyouts, Venture Capital, Special Situations and Growth opportunities. There is also an element of co-investment, which is where Pantheon will invest directly in individual companies. About 25% of the underlying exposure is in 'secondary's' this is the term used when a firm like Pantheon will buy at a discount a position in an already established private equity fund from an investor looking to liquidate before the full life of the fund is completed.

The meeting concluded with a projection of the cash flows back to Suffolk over the coming years. The majority of the investment is projected to be returned over the next five years as the underlying funds mature and return money by way of distributions. However there is an element of the exposure to Pantheon that is in the form of a quoted vehicle that reinvests the proceeds from disposals. This can be thought of as a form of permanent private equity capital and will not naturally run down as is the case with the traditional funds and would have to be sold for the funds to be returned. The current NAV of the permanent capital was estimated to be £7.7m. This is in addition to the £24.8m of market value mentioned earlier.

Overall this was a useful meeting and confirmed that the majority of the investment will be returned to the fund over the next five years. Given this and assuming the Wilshire cash projections also remain unchanged the exposure to private equity will almost entirely disappear over this time period. It would be worth in my opinion formally reviewing the funds attitude to this asset class at a future date to determine if rebuilding exposure would be of benefit going forward.

Pyrford: Absolute return fund using traditional equities and bonds

As Pyrford were hosting the day our usual contacts Dan McDonagh (fund manager) and Felim Glynn (client contact) were joined by Paul Simons (Head of Portfolio Management Asia Pacific) who we had not met previously. Felim began the presentation by simply confirming that there had been no changes to the fund management team since the last meeting and again mentioned that Pyrford had recently signed up to the UN Principles for Responsible Investment.

Pyrford do not normally make many changes to the underlying portfolio and given that we had met with them in September this proved once more to be the case with no new positions mentioned. However here has been a change in the model fund asset allocation with equities reduced by a further 5% to 30% towards the end of the quarter. This is now the joint lowest level that Pyrford have held equities and is the level that the model fund held in 2007 just prior to the market crash. In terms of performance the total return was 0.99% for the third quarter. The year to date figure is 2.59%. The annualised since inception return is 3.93%. Needless to say all these figures are below the agreed benchmark of RPI +5%, however as mentioned in all previous reports it is unlikely Pyrford will perform at or ahead of the benchmark until such time as the markets correct significantly, which Pyrford believe will happen.

Following the update on the fund Paul Simons gave a comprehensive economic update which provides the rationale for the Pyrford view of investment markets and drives their extremely risk averse stance. Paul provided a number of economic charts many of them used previously in Pyrford presentations. The message, which has been explored many times in these manager-meeting reports, remains the same. Global debt both public and private remains high and has not been adequately addressed since the global financial crisis. The high levels of private debt to disposable income particularly in the UK will act as a break on spending (and growth) for the foreseeable future. With real wages stagnant or even falling, the capacity to repay debt remains compromised. Again in the UK, the low levels of interest rates necessary to avoid the debt burden are seriously damaging spending (from savers) and has led to an unprecedented increase in the average UK house prices, which will be a major problem when interest rates begin to normalise. Overall Pyrford remain consistent in their message and remain extremely risk averse in the positioning of the fund

M&G Investments: UK and European distressed debt: Debt Opportunities fund (DOF)

M&G Investments were represented by Andy Bishop (client director) and Andrew Amos (Deputy Fund Manager) unfortunately Paul Bishop (fund manager) who

presented so well in April was not available. This was the first meeting we have had with M&G since the launch of their second distressed debt fund. This second fund closed to new commitments in June 2014 having raised €300m, being slightly larger than the first fund which closed at €280m. Suffolk Pension Fund having committed £30m to fund I has also committed £15m, into fund two. As of the meeting date the second fund is 25% invested across six investments. The first fund is 100% invested across 20 investments and recycled €31m of income back into investments during Q3 which is the investment strategy during the early years of both funds. Andrew Amos began by reiterating the M&G approach to distressed debt emphasising their risk adverse approach, which is focused and analysis lead. M&G seek out good companies with bad balance sheets that are in some form of debt distress and provide lending solutions into these situations. At the outset a clear exit strategy is in place before any investment is made the exist strategies can take a number of forms but Andrew highlighted selling the restructured debt back into the market or selling restructured non-core parts of companies and using the proceeds to repay the debt as two typical exist strategies M&G used in the funds.

In terms of the overall market M&G still see plenty of opportunities but emphasised there are no 'easy pickings'. Particularly in the public markets, consequently they are placing more emphasis on the less liquid private opportunities. They also mentioned that the recent asset quality review of European banks might provide good opportunities if some banks are forced to remove certain assets from their balance sheets. The rest of the meeting focused on a case study for a Dublin based house developer where refinancing has been provided by both DOF I and DOF II. This type of refinance and restructuring deal is ideal for the distressed portfolio and uses the depth of the M&G credit team to move quickly and see off competition from other investors. The Dublin deal is expected to generate an internal rate of return around 20% with a multiple on money invested of around x1.6.

Unfortunately there was not much of an update on performance, no details at all were given on DOF II which given its early stage was not surprising. Rather more surprising was that there was no Q3 performance figures given for DOF I, the report had the end June numbers which were showing a year to date return of 7.06% and since inception 16.64%. The meeting was not as informative as the last meeting we had with M&G and it would be good if Paul Bishop was to present the next time we meet with them as he was extremely impressive and clear at the January meeting.

BlueCrest: Multi Strategy Hedge Fund

Once again Stephen William (Client team) presented for BlueCrest and he was joined by our new client contact Eleanor Robb who has just transferred in from the New York office she was previously employed at UBS. The entire first part of the meeting was Stephen and Eleanor explaining the corporate changes that were occurring at BlueCrest. The entire systematic/quantitative team at BlueCrest are splitting off into a new company called Systematica, under the leadership of Leda Braga, who is the current head of systematic investment and a member of the AllBlue asset allocation team. The reason for the split is far ranging but includes more flexibility in fees and products for the newly formed company. The ability to incentivise quant staff with equity, and to grow a stand-alone business were also

mentioned as important. The implications for investors in the AllBlue product were played down (as you would expect), however these were the main points I gleaned.

From January the AllBlue allocations committee (now without Leda Braga) will continue to allocate to the underlying seven strategies that form the product. The BlueTrend systematic trend following fund, which will now be run from the separate Systematica company will still be allocated to and we were told in exactly the same way as before. The other systematic fund, which is called BlueMatrix will also still be allocated to however this is under a different arrangement.

The BlueMatrix fund that has historically been in AllBlue will transfer to Systematica and will not be part of AllBlue going forward. The research team attached to BlueMatrix is being split in half with half moving to Systematica and half staying at BlueCrest. The team remaining at BlueCrest will run their own version of BlueMatrix, which at first will be identical to the version run at Systematica. However over time this new fund will develop its own research programme and will move away from the 'other' Blue Matrix. It is this version the fund that will receive allocation from AllBlue.

All in all this is a major change for BlueCrest but in the very short term is unlikely to make any material performance impact on the AllBlue product in which Suffolk invests. The meeting now focused on performance, up to September the fund has returned 5.7% with October verbally confirmed as down 0.40%. Credit strategies and BlueMatrix (which is systematic equity) are the main drivers of performance year to date. We have also now seen the first contributions for the new strategy in individual equity where BlueCrest have been building up significant resource over the past few years (85 staff across 30 trading units) the new strategy is called rather prosaically BlueCrest Equity Strategies and entered the AllBlue product at a 10% weighting. Other major weighing changes since the January meeting are in multi-strategy credit which is now held at 25% up from 21% and BlueTrend which has fallen in weight from 15% to 8%.

In terms of outlook the divergence in central bank policy going forward between regions is expected to present major opportunities for the traders at BlueCrest, the major stimulus programme in Japan is expected to give rise to many significant changes and volatility which can be exploited. After coming through the summer volatility fairly well BlueCrest look on course for a reasonable year and certainly better than the disappointing 2013 return which was only 1.8%. It remains to be seen how the loss of an entire systematic team affects returns if at all, however it would seem prudent to keep a watchful eye on developments within BlueCrest.

Winton : Systematic Hedge Fund

Jonathan Anayi (client contact) presented the report from Winton. It was confirmed that our previous client contact, Andrew Fraser has now left the company. Jonathan started the meeting with an update on staff changes. Since our last meeting, which was in January, Winton CEO Tony Fenner has left the company to work in the US. David Harding the founder of Winton has taken on the role of CEO in addition to his role as Chairman, he was described by Jonathan as being more hands on than ever. We were informed that it is David Harding's intention to give up the role of Chairman when a suitable replacement can be found. Jonathan also reported that staffing

levels were now up to 320 people with 40 new staff joining this year alone. The majority of the new joiners were in the research department and as is normal for Winton these new joiners could be described as scientists rather than finance professionals by training.

Winton run a fully systematic investment process that seeks to generate returns by investing in a wide range of asset classes. Although this is a dynamic process approximately 25% of the risk is taken in each of four areas; equities, bonds, commodities and currencies. Recently following extensive research development single stock equities now make up the majority of equity risk, which is a departure from the past where Winton tended to trade only in equity indices.

As at the end of September Suffolk pension fund has £35.3m invested with Winton. The return over the last twelve months has been a credible 8.12%, however this figure includes the very strong Q4 2013. The 2014 year to date return is only 1.94% and the since inception return is a slightly disappointing 5.2% on an annualised basis. In terms of the last quarter the fund went up by 0.74% with bond strategies the best performer and investment in crops being the worst. Jonathan mentioned that overall Winton had not managed to meet the targeted level of volatility during 2014, which is targeted at 10%. However the firm is not going to increase leverage in order to reach this target, as they firmly believe that using leverage in this way would not be well rewarded. Overall Winton need a good final quarter in order to deliver anything like their targeted return.

Mark Stevens
November 2014