London Borough of Barnet Superannuation Fund

Quarterly update to 31 December 2014

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1 Executive Summary

- Over 2014, the total scheme assets returned 8.3%. This was significantly below the liability benchmark return of 15.2% due to the dramatic fall in gilt yields over the year. As a result the scheme's estimated funding level has fallen to around 75.6% as at 31 December 2014.

- Newton's Real Return Fund and Schroders' Diversified Growth Fund produced modest returns over 2014 of 3.9% and 6.4% respectively. This was significantly below L&G's overseas equity fund of 12.3%, but the returns were ahead of the UK equity market return of 1.2%.

- The Corporate Bond funds performed strongly over 2014 against a background of falling bond yields, but the returns were significantly below that achieved on long dated fixed interest and index-linked gilts.

- Since the inception of the current strategy in December 2010, the 'bond' portfolio has outperformed the 'growth' portfolio in three of the last four years (see section 4 for more details).

- Over the last four years, the two DGF funds have underperformed their respective benchmarks and also the return on UK and overseas equity markets (see section 4 for more details).

2 Market update

Introduction

The tables below summarise the various market returns to 31 December 2014, to relate the analysis of your Scheme's performance to the global economic and market background.

Market Returns	3 Mths	1 Year	3 Years
Growth Assets	%	%	% p.a.
UK Equities	0.6	1.2	11.1
Overseas Equities	4.9	12.2	15.1
USA	8.9	20.3	20.4
Europe	-1.4	-1.4	12.8
Japan	1.6	2.7	9.9
Asia Pacific (ex Japan)	3.2	10.0	9.4
Emerging Markets	0.4	7.9	4.8
Frontier Markets	-9.0	13.9	13.8
Property	4.4	19.3	10.6
Hedge Fund	0.8	4.5	7.5
Commodities	-24.8	-28.9	-13.0
High Yield	1.5	6.1	8.7
Emerging Market Debt	-0.6	7.4	6.1
Senior Secured Loans	-0.1	2.3	7.4
Cash	0.1	0.5	0.5

Market Returns	3 Mths	1 Year	3 Years
Bond Assets	%	%	% p.a.
UK Gilts (>15 yrs)	11.2	26.1	6.9
Index-Linked Gilts (>5 yrs)	9.4	21.4	7.1
Corp Bonds (>15 yrs AA)	6.7	18.9	9.3
Non-Gilts (>15 yrs)	6.6	19.0	10.2

Change in Sterling	3 Mths	1 Year	3 Years
	%	%	%
Against US Dollar	-3.8	-5.9	0.1
Against Euro	0.4	7.2	2.5
Against Yen	5.1	7.4	16.1

Absolute Change in Yields	3 Mths	1 Year	3 Years
	%	%	%
UK Equities	0.03	0.09	-0.15
UK Gilts (>15 yrs)	-0.56	-1.16	-0.52
Index-Linked Gilts (>5 yrs)	-0.40	-0.80	-0.52
Corp Bonds (>15 yrs AA)	-0.42	-1.01	-1.27
Non-Gilts (>15 yrs)	-0.41	-0.89	-1.08

Yields as at 31 December 2014	% p.a.
UK Equities	3.37
UK Gilts (>15 yrs)	2.42
Real Yield (>5 yrs ILG)	-0.77
Corporate Bonds (>15 yrs AA)	3.41
Non-Gilts (>15 yrs)	3.74

Inflation Indices	3 Mths	1 Year	3 Years
	%	%	% p.a.
Price Inflation - RPI	0.0	1.6	2.5
Price Inflation - CPI	-0.2	0.5	1.7
Earnings Inflation *	0.4	1.6	1.2

* Subject to 1 month's lag

Source: Thomson Reuters and Bloomberg

Yields and the absolute change in yields are shown to 2 decimal places to clearly show the changes.

Asset Class	Factors Affecting the Market	
	Positive	**Negative**
UK Equities	According to the Office of National Statistics (ONS), the annual GDP growth was revised down to 2.6% in Q3 2014 from the prior estimate of 3%. Despite the downward revision, the UK is still one of the fastest growing economies in the G7.	The uncertainty around the outcome of the general election scheduled for May 2015 is likely to be a headwind for the equity market in the near term. The rise of the UK Independence, Scottish Nationalist and, to a lesser extent, Green parties has increased the range of possible election outcomes.
	The number of people in the UK claiming unemployment benefits fell by 26,900 in November, while the UK unemployment rate remained unchanged at 6% over the three months to October. Also, figures from the Office for National Statistics (ONS) indicate that wage growth in the UK is picking up, as average earnings excluding bonuses in the August-to-October 2014 period were up 1.6% from the year earlier.	The ONS figures indicate that the country's current account deficit further widened from 5.5% of GDP in Q2 2014 to 6.0% in Q3 2014.
Overseas Equities		
North American Equities	The US economy expanded at an annualised rate of 5% in Q3 2014, the fastest pace since 2003. This strong growth follows a 4.6% annualised expansion in Q2 2014. The US GDP has grown at an annualised pace of 3.5% or higher in four of the last five quarters.	The Federal Reserve ended the latest round of quantitative easing in October 2014 citing improvement in the labour market and a strengthening economy. The uncertainty around the timing of the first interest rate rise remains a headwind for the equity markets in the near term.
	The US job market added 252,000 jobs in December, marking 2014 as the best year for employment growth since 1999. The unemployment rate stood at 5.6% as at the end of December 2014.	
European Equities	Mario Draghi's briefing in December 2014 indicated that the European Central Bank (ECB) has stepped up preparations to undertake additional stimulus measures to help revive growth in the fragile Eurozone economy. Drawing cues from the recent remarks by Mario Draghi, the market is now anticipating a full-fledged bond-buying program to be announced in Q1 2014.	The tail end of Q4 2014 witnessed the resurfacing of talks about Greece leaving the Eurozone as the Greek parliament failed to elect a president, forcing an early election to take place at the end of January 2014.
		Inflation in the Eurozone turned negative in December 2014, as prices fell 0.2% year-on-year, marking the first time since 2009 that prices have dipped into negative territory. The slide into deflation, driven mainly by lower energy costs due to the plunging oil prices, is likely to intensify pressure on the ECB to take further action to stimulate the Eurozone's economy.

Asset Class	Factors Affecting the Market	
	Positive	Negative
Japanese Equities	The Bank of Japan (BOJ), in a surprise move in October 2014, announced an increase in its asset purchase program from Yen 60-70 trillion per annum to Yen 80 trillion annually. The BOJ would also triple its annual purchase of exchange-traded funds and domestic real estate investment trusts. This was the first policy change since the program started in 2013.	In Q3 2014, the Japanese economy contracted by 1.9% on an annualised basis, following a 7.3% contraction in Q2 2014, pushing the economy into a technical recession. The economy has been battling the negative impacts of the sales-tax hike for the last two quarters. Private consumption, which accounts for nearly 60% of the economy, has been particularly hit.
	In October 2014, the government approved the revised asset allocation target for the Government Pension Investment Fund (GPIF). The new allocation would now target domestic and international equities of 25% each, up from 12% each earlier.	
	Shinzo Abe's ruling Liberal Democratic Party (LDP) won the snap elections held in December 2014. After retaining a two-thirds majority, Mr Abe now plans to push through reform measures. The Prime Minister had dissolved the lower house of Parliament in November, a day after the data showed that the economy shrank in Q3 2014. The second round of tax increases was also delayed by 18 months to April 2017.	
Asia Pacific (excluding Japan) Equities	Asia Pacific (excluding Japan) equities ended Q4 2014 with a return of 3.2%, owing to strong performance by the Chinese equities and hopes of further stimulus measures by the ECB.	The Australian economy grew at a slower-than-expected pace of 0.3% quarter-on-quarter in Q3 2014, missing analysts' estimates of 0.7%. Impact of falling commodity prices and decline in mining investments were the biggest detractors to growth.
	South Korea recorded its 35th consecutive month of trade surplus owing to strong exports, which grew by 3.7% year-on-year in December 2014.	

Asset Class	Factors Affecting the Market	
	Positive	**Negative**
Emerging Markets Equities	Chinese equities surged nearly 37% (in local currency terms) in Q4 2014 backed by growing expectations of a further policy stimulus. The launch of the Shanghai-Hong Kong Stock Connect program, allowing greater access of Chinese shares to foreigners, also contributed to this boost.	Russian stocks plunged a little over 30% (in local currency terms) in Q4 2014 amidst fears of an economic collapse triggered by falling oil prices. With Russian oil and gas accounting for 70% of exports and 50% of tax receipts, a continued price slump could indicate big budget cuts for the energy-dependent nation. Moreover, the Russian parliament approved the 2015 budget in December 2014 assuming oil prices at $100 a barrel.
	Indian equities rallied 3.3% (in local currency terms) in Q4 2014 as expectations of falling inflation, driven by falling oil prices, raised hopes of interest rate cuts by the Reserve Bank of India.	In December 2014, the Brazilian central bank sharply revised down its growth forecast for the year 2014 to 0.2% from 0.7% earlier. The central bank also raised the benchmark interest rate to 11.75% in December 2014 from 11.25% earlier amidst rising inflation and a weakening currency.
Gilts	A slowdown in the pace of growth in the UK economy contributed to strong gilts performance over Q4 2014. The average reading for UK Markit/CIPS manufacturing purchasing managers' index (PMI) fell marginally from 53.1 in Q3 2014 to 53.0 in Q4 2014, the weakest reading since Q2 2013. Also, the PMI for service sector, which accounts for nearly 78% of the British economy, fell to 55.8 in December from 58.6 in November. Moreover, a reduction in global growth forecast by the International Monetary Fund (IMF) in October 2014 further boosted gilt prices.	UK Labour Productivity, as measured by output per hour, increased in Q3 2014 by 0.6% and 0.3% when compared to Q2 2014 and Q3 2013 respectively. Output per hour increased in all of the main industrial groupings in the Q3 2014, by 0.5% in the manufacturing sector and 0.6% in the services sector.
Index-Linked Gilts	Limited issuance of new index-linked gilts compared with their demand drivers, i.e. pension liabilities, contributed to limited returns in the asset class in Q4 2014.	Performance of index-linked gilts was muted as compared with conventional gilts in Q4 2014. The decelerating pace of UK inflation resulted in subdued performance. The consumer price index (measure of inflation) grew by 1% in November 2014, down from 2% in December 2013, significantly below the Bank of England (BOE) target of 2%.
		Yields rose in the beginning of November as UK Debt Management Office auctioned £800 million worth of index-linked bonds in the first week of the month.
Corporate Bonds	Investment grade credit continues to be an attractive asset class. Central bank policies remain supportive, while regulatory action is forcing banks to improve their creditworthiness. Also, bond defaults remain low as corporates are increasingly reporting improved operational performance.	The downward revision of global growth forecast by the IMF and reduction in credit spreads over the past few months has left little room for any further contraction of spreads.

Asset Class	Factors Affecting the Market	
	Positive	Negative
Commodities		Crude oil prices fell sharply in Q4 2014 as robust global production exceeded demand. After reaching monthly peaks of USD 112 per barrel in June, Brent crude price fell to USD 62 per barrel in December 2014. Prices accelerated on the downside as Opec decided not to cut output at its November 2014 meeting. While lower energy bills will act as a boon for oil importing nations, the steep fall in prices will put further downward pressure on inflation in the developed economies where inflation is stubbornly low and well below the targets of most central banks.
Property	UK commercial property values rose by 4.5% for three months ending November 2014 impacting property yields which continue to fall across all sectors. Industrials continue to outpace offices, while retail continues to lag behind.	Mortgage approvals fell to 59,030 in November 2014 from 59,510 in October 2014, showing signs of an impact of tough new affordability tests.
		Construction PMI fell to 57.6 in December 2014 from 59.4 in November 2014. Although the reading remains above its long-run average of 54.5, it is well below economists' forecasts of 59.0.

3 Total scheme performance

Manager	Fund	Start of quarter Value (£)	Start of quarter Proportion of total (%)	Net new money (£)	End of quarter Value (£)	End of quarter Proportion of total (%)
Newton Investment Management Limited (Newton)	Real Return	262,285,103	30.7	-	264,250,494	30.1
Schroder Investment Management Limited (Schroder)	Diversified Growth	266,003,362	31.2	-	271,913,590	31.0
Legal and General Investment Management (L&G)	World (ex UK) Equity Index	45,941,316	5.4	-	48,211,546	5.5
Newton	Corporate Bond	133,932,331	15.7	-	140,970,588	16.1
Schroder	All Maturities Corporate Bond	123,538,554	14.5	-	128,297,429	14.6
L&G	Active Corporate Bond – All Stocks	18,359,769	2.2	-	19,196,790	2.2
Newton	Cash	403,425	0.0	-	730,460	0.1
Schroders	Cash	685,860	0.1	-	711,056	0.1
Internal	Cash	2,410,504	0.3	-	2,842,075	0.3
Asset split						
Growth assets		577,326,145	67.6	-	587,928,760	67.0
Bond assets		276,234,078	32.4	-	289,195,267	33.0
Total		**853,560,224**	**100.0**	**-**	**877,124,027**	**100.0**

Source: Investment managers, bid value used for LGIM, NAV for Schroders and mid value used for Newton. Please note that the Internal Cash is assumed to have earned no interest over the quarter. The Cash from the Newton and Schroder portfolios has been shown separately. The Newton Cash is assumed to be held in the Bond portfolio and the Schroders Cash in the Growth portfolio.
Total may not sum due to rounding.

Total scheme performance

	Portfolio return Q4'14 (%)	Benchmark return Q4'14 (%)	Portfolio return 2014 (%)	Benchmark return 2014 (%)
Total scheme	2.7	6.1	8.3	15.2
Growth portfolio				
Growth vs. global equity	1.5	2.3	5.2	5.6
Growth vs. RPI+5% p.a.	1.5	1.3	5.2	7.0
Growth vs. LIBOR + 4% p.a.	1.5	1.1	5.2	4.5
Bond portfolio				
Bond vs. over 15 year gilts	4.7	11.2	13.9	26.1
Bond vs. index-linked gilts (> 5 yrs.)	4.7	9.4	13.9	21.4

The Growth portfolio excludes L&G equities. The global equity benchmark is 60% FTSE All-Share Index, 40% FTSE AW All-World (ex UK) Index.

The Bond portfolio excludes L&G Corporate Bond Fund.

The Total Scheme return is shown against the liability benchmark return (see page 18). The Growth portfolio return is the combined Newton and Schroder DGF portfolios and is shown against a notional 60/40 global equity benchmark and the underlying benchmarks of each fund for comparison purposes. The Bond portfolio is the combined Newton and Schroder Corporate Bond Portfolios and is shown against the Over 15 Year Gilts Index and Index Linked (Over 5 years) Index.

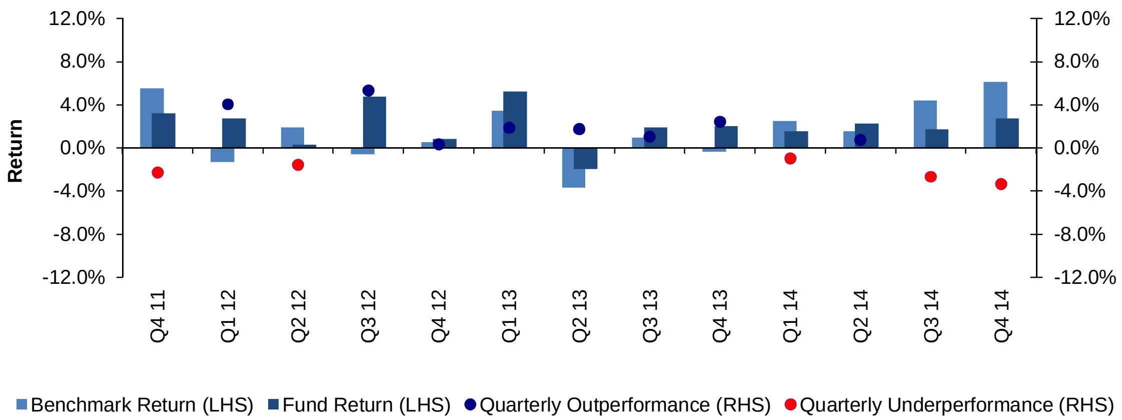
Individual manager performance

Manager/fund	Portfolio return Q4'14 (%)	Benchmark return Q4'14 (%)	Portfolio return 2014 (%)	Benchmark return 2014 (%)
Growth Assets				
Newton Real Return	0.7	1.1	3.9	4.5
Schroder Diversified Growth	2.2	1.3	6.4	7.0
L&G – Overseas Equity	4.9	5.0	12.3	12.3
Bond Assets				
Newton Corporate Bond	5.5	6.2	15.9	18.0
Schroder Corporate Bond	3.9	4.3	11.9	12.3
L&G – Corporate Bond	4.6	4.3	12.7	12.2

Source: Investment managers, Thomson Reuters. Performance is money-weighted and based on bid values for LGIM, NAV for Schroders and mid values for Newton.

The above table shows the breakdown of the individual manager/portfolio returns against their underlying benchmarks.

Total scheme performance relative to liability benchmark



Source: Investment managers, Thomson Reuters.

The Scheme achieved a return of 2.7% over the quarter and underperformed the liability benchmark return by 3.4%. The over 15-year gilt yield upon which the liability analysis is based, decreased over the quarter resulting in an increase in the estimated value of the liabilities.

The Scheme generated a positive absolute return as all the underlying funds generated positive absolute returns. The Newton Corporate Bond Fund was the best performing fund in absolute terms (although underperformed its benchmark), while on a relative basis, all the underlying funds underperformed their respective benchmarks except for the Schroder DGF and the L&G Active Corporate Bond Fund.

The Growth Portfolio, comprising the two DGF funds, underperformed the notional 60/40 global equity benchmark by 0.8% over the quarter. It is usual to expect DGF funds to underperform equities in rising markets and conversely outperform in falling markets. The Growth portfolio outperformed the RPI +5% benchmark and the LIBOR +4% benchmark by 0.2% and 0.4% respectively over the same period. The Growth portfolio's positive absolute return over the quarter was driven by the performance of both the DGF Funds with the Schroder DGF performing significantly ahead of the Newton Real Return, a similar pattern of what happened last quarter where Schroder outperformed Newton.

The Bond Portfolio, comprising the two corporate bond portfolios managed by Newton and Schroder, underperformed the Over 15 Year Gilts Index (by 6.5%) and the Over 5 Years Index Linked Gilts Index (by 4.7%).

Over 2014, the Scheme achieved a return of 8.3% which was 6.9% below the liability benchmark return of 15.2%.

The three corporate bond funds performed strongly in absolute terms against a background of falling yields, but significantly underperformed the return from long dated fixed interest and index-linked gilts.

Within the growth assets, the two DGF funds produced modest returns and underperformed their respective benchmarks, although the Schroder DGF outperformed the Newton Real Return Fund by 2.5% over the year. Both DGF funds significantly underperformed the return on overseas equities, but they outperformed the return achieved by the UK equity market.

4 Longer Term Performance

The table below shows the performance of the scheme's assets over the last four years, i.e. since the implementation of the current investment strategy in December 2010.

	2011 (%)	2012 (%)	2013 (%)	2014 (%)	4 years (%pa)
Total scheme	**1.0**	**8.7**	**7.0**	**8.3**	**6.2**
Growth portfolio	**-1.8**	**5.8**	**8.9**	**5.2**	**4.4**
UK equity	-3.5	12.3	20.8	1.2	7.3
Overseas equity	-6.9	12.1	21.2	12.2	9.1
RPI + 5% p.a.	9.8	8.1	7.7	7.0	8.1
LIBOR + 4% p.a.	4.5	4.5	4.5	4.5	4.5
Bond portfolio	**8.3**	**13.9**	**1.3**	**13.9**	**9.2**
Over 15 year gilts	26.3	2.9	-5.9	26.1	11.4
Index-linked gilts (> 5 yrs.)	23.3	0.5	0.6	21.4	10.9

- Over the last four years, the bond portfolio outperformed the growth portfolio by 4.8% pa.

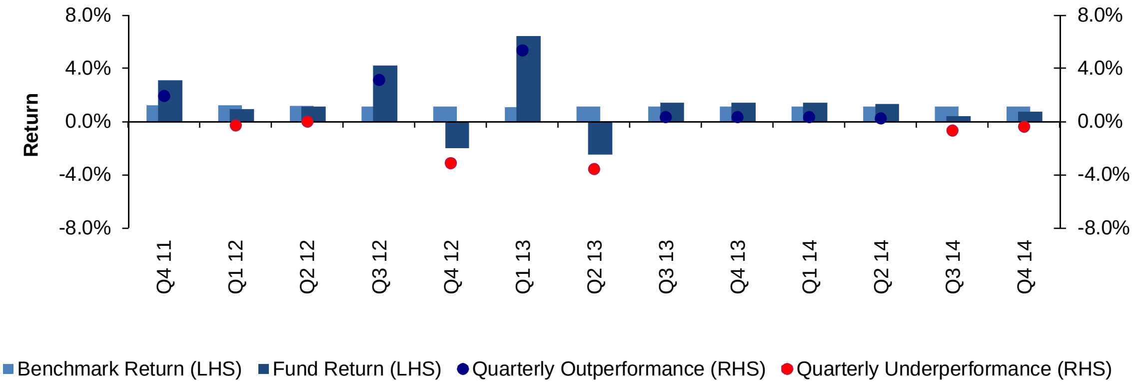
Manager/fund	2011 (%)	2012 (%)	2013 (%)	2014 (%)	4 Years (%pa)
Growth Assets					
Newton Real Return	0.9	4.2	6.4	3.9	3.8
Schroder Diversified Growth	-4.5	7.6	11.6	6.4	5.1
L&G – Overseas Equity	-6.1	11.9	22.7	12.3	9.7
Bond Assets					
Newton Corporate Bond	12.4	13.9	0.4	15.9	10.5
Schroder Corporate Bond	4.1	13.9	2.4	11.9	8.0
L&G – Corporate Bond	8.2	14.0	1.0	12.7	8.9

- Over the last four years, the Schroder DGF has outperformed the Newton RRF, but both have returned less than the UK and overseas equity markets.
- Newton's corporate bond fund has performed above the other bond funds, but this is due to it being benchmarked against a longer duration index.

5 Manager performance

5.1 Newton – Real Return Fund

Performance relative to portfolio benchmark



Source: Investment manager.

The Newton Real Return Fund returned 0.7% compared to its LIBOR + 4% p.a. benchmark return of 1.1%, thereby underperforming by 0.4%. In comparison to a notional 60/40 global equity benchmark return the Fund underperformed by 1.6%.

The Fund produced a positive absolute performance but underperformed relative to its performance objective over the quarter. The Fund's equity and government bond holdings provided a positive contribution over the period. The derivative positions, corporate bonds and precious metal holdings all detracted from performance. The notable contributors to performance over the quarter were media related holdings Wolters Kluwer, Vivendi and Reed Elsevier. Other notably positive contributions came from Accenture.

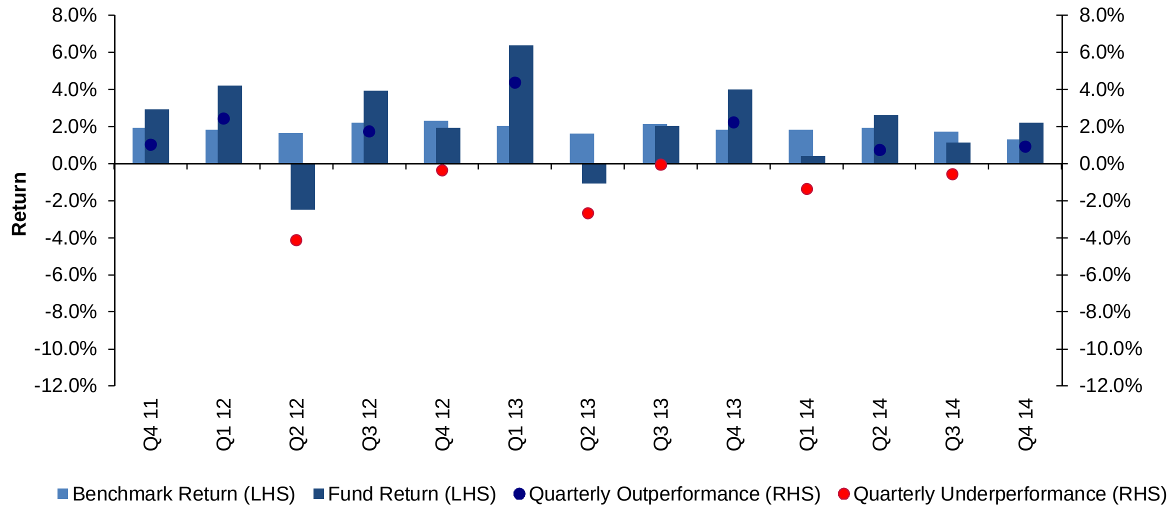
The Fund's holdings related to the oil sector did not fare so well due to the sharp fall in the price of oil. Furthermore, despite gold being one of the only commodities to post positive return over the period, gold mining shares suffered. Government bond exposures made a positive contribution as yields in many countries fell to historic lows.

The Fund continues to maintain a significant proportion of its holdings in stabilising and hedging assets, which includes physical cash and short-dated cash equivalent bonds, currencies, precious metals, and bond instruments, as well as significant equity derivative protection. However, half of the Fund's gold mining exposure was switched into direct gold exposure, due to gold companies highly financially levered nature and their vulnerability to further falls in the gold price.

Over the 12 month period, the Fund returned 3.9% versus the benchmark return of 4.5%. In comparison to a notional 60/40 global equity benchmark return the Fund underperformed by 1.7%.

5.2 Schroder – Diversified Growth Fund

Performance relative to portfolio benchmark



Source: Investment manager.

The Schroder DGF return was 2.2% compared to its RPI + 5% p.a. portfolio benchmark return of 1.3% and outperformed by 0.9%. The Fund marginally underperformed the notional 60/40 global equity benchmark by 0.1% over the quarter.

The Fund outperformed against both its objective and its global equity comparator over the quarter. The Fund's regional equity allocation was the main contributor to performance with the allocations to Global, US and Japanese equities being key contributors to performance, while European equities and commodities were the main detractors.

Allocations to absolute returns, government bonds, and UK and emerging market equities also added to performance, as did the Fund's currency positioning.

Schroders went into the period expecting increased volatility and had positioned the portfolio defensively. The Fund favoured developed markets and had added government bonds due to concerns about potential Eurozone deflation. Furthermore, the Fund sold out broad commodities and initiated short positions in US small caps and US utilities, with the view that both were overvalued relative to the overall market.

However, mid-quarter, the Fund changed its strategy to take advantage of particular buying opportunities, increasing equity exposure by closing the short positions in US small caps and topping up the Fund's holding in the 'old-tech' basket. Profits were also taken on US inflation linked bonds. Positions were introduced in US and European energy stocks; however, initial gains were eroded as the oil price fell further than expected. These positions were closed at a small loss before the steep fall in December.

Conversely, Schroders took tactical positions in US consumer discretionary sector due to lower energy prices which can act as a 'tax cut' for consumers and combined with the continued improvement in the US economy, allows consumers to spend a greater proportion of their incomes on discretionary purchases. The Fund also added gold back into the portfolio as a hedge against rising political risk across Europe.

Over the 12 month period, the Fund returned a positive absolute return of 6.4% versus the benchmark return of 7.0%. In comparison to a notional 60/40 global equity benchmark return, the Fund outperformed by 0.8%.

Asset allocation for growth managers: movement over the quarter

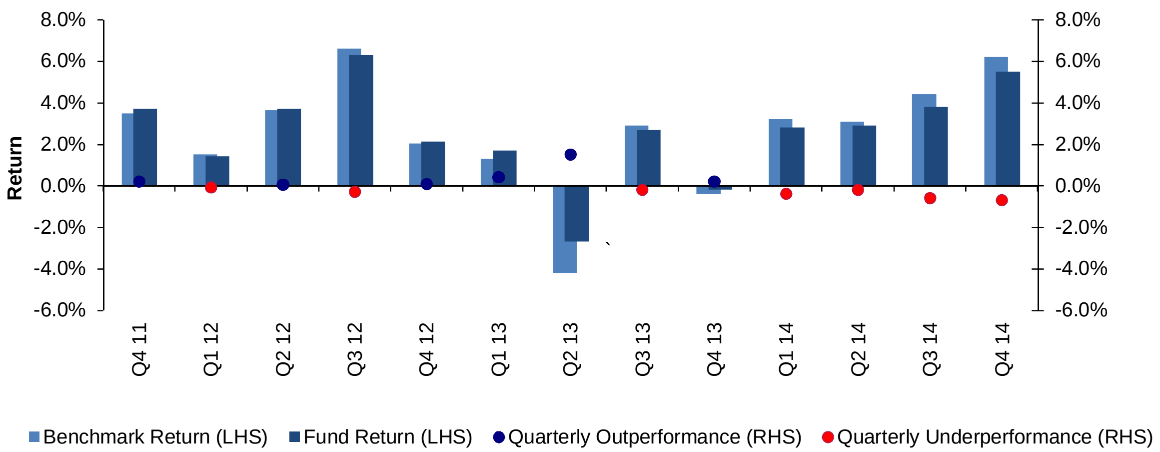
	Q4'14 Newton (%)	Q4'14 Schroder (%)	Q3'14 Newton (%)	Q3'14 Schroder (%)
UK equities	10.7	2.0	13.8	3.2
Overseas equities	48.1	46.0	49.5	47.5
Govt bonds	18.4	6.3	13.7	5.7
Corporate bonds	1.2	-	2.9	-
High yield	-	2.9	-	4.7
Private equity	-	0.8	-	0.8
Commodities	4.4	3.9	2.7	1.4
Absolute return	-	12.2	-	12.5
Index-linked	2.6	-	1.2	2.5
Property	-	3.3	-	3.2
Other*	4.9	12.8	1.7	10.9
Cash	9.7	9.7	14.5	7.5
Total	100.0	100.0	100.0	100.0

* Includes convertible bonds, asset backed and insurance-linked securities, infrastructure and

Source: Investment managers.

5.3 Newton – Corporate Bond Portfolio

Performance relative to portfolio benchmark



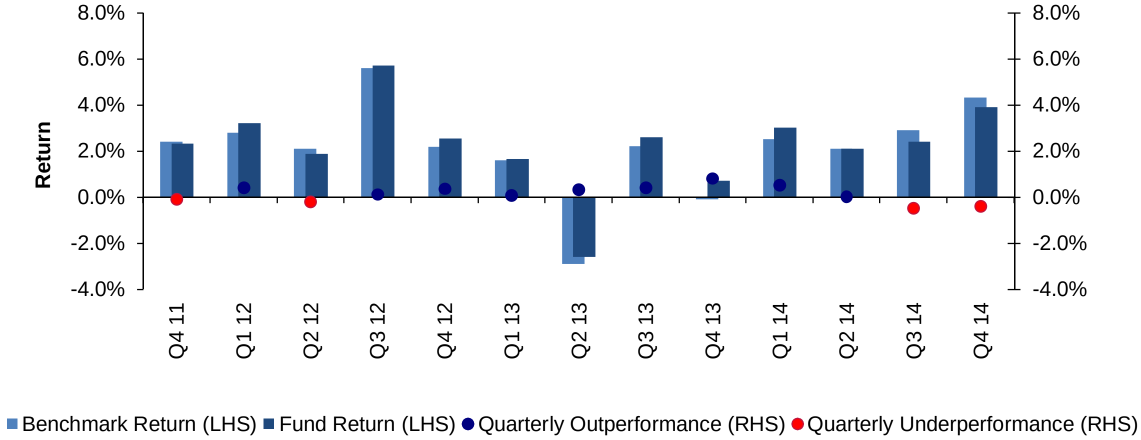
Source: Investment manager.

The Newton Corporate Bond portfolio underperformed its benchmark by 0.7%; it returned 5.5% versus the benchmark return of 6.2%. The underperformance was attributable to the Fund's overall short duration relative to the index over the period.

Over the 12 month period, the Fund returned 15.9% against the benchmark return of 18.0%.

5.4 Schroder – All Maturities Corporate Bond Portfolio

Performance relative to portfolio benchmark

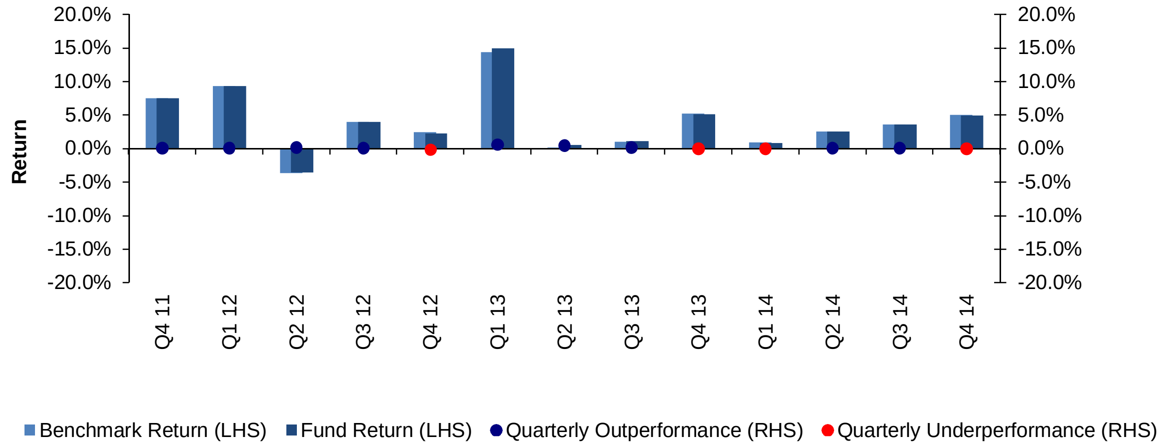


Source: Investment manager.

The Schroders Corporate Bond portfolio underperformed its benchmark by 0.4% and produced an absolute return of 3.9%. The Fund's sector allocation detracted from performance and the worst performers were energy, real estate and retail sector over the quarter.

Over the 12 month period, the Fund returned 11.9% versus the benchmark return of 12.3%.

5.5 L&G – Overseas Equities



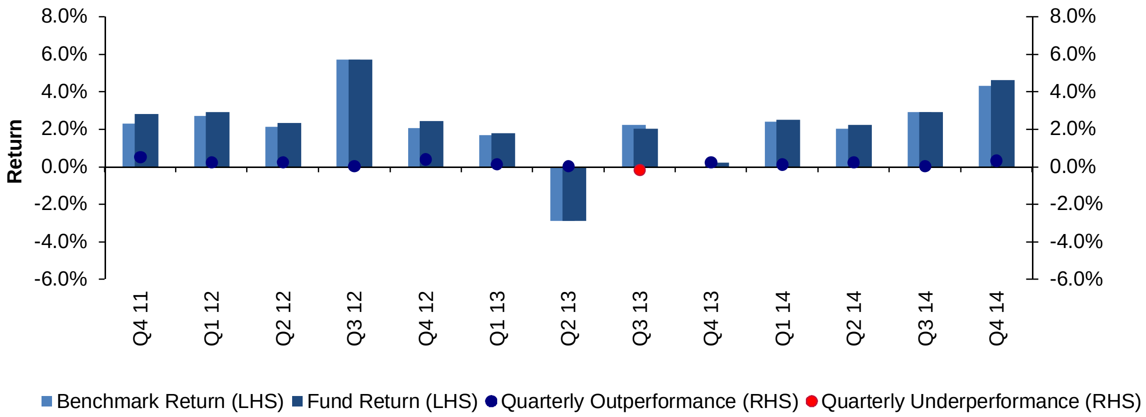
Source: Investment manager.

Over the fourth quarter of 2014, the Fund marginally underperformed its benchmark return by 0.1% and produced an absolute return of 4.9%.

The Fund generated an absolute return of 12.3% performing in line with its benchmark of 12.3% over the 1 year period.

5.6 L&G – Active Corporate bond – All Stocks Fund

Performance relative to portfolio benchmark



Source: Investment manager.

Over the quarter, the Fund outperformed its benchmark by 0.3% and produced an absolute return of 4.6%.

The Fund outperformed the benchmark over the quarter to a modest extent. This was largely driven by the Fund's underweight positioning in non-financial bonds, in particular the oil & gas and retail sectors. Oil & gas was the worst performing sector, as the oil price continued to fall, so the Fund's underweight position in this sector had a substantial positive impact on performance. The Fund's underweight positioning in Tesco bonds also proved positive, as the company remained out of favour given ongoing problems.

The Fund was overweight in UK government bonds, which had a positive impact on performance as gilt yields decreased further and gilts outperformed Sterling corporate bonds over the quarter.

The Fund's small exposure to both US dollar and euro denominated bonds contributed positively to performance, with the performance of the latter driven by expectations of quantitative easing by the European Central Bank.

The Fund was slightly underweight credit risk, which also contributed positively to performance as credit spreads ended the quarter marginally wider.

However, the Fund's underweight positioning in sovereign, sub-sovereign and senior financial bonds was a small negative, as they performed strongly.

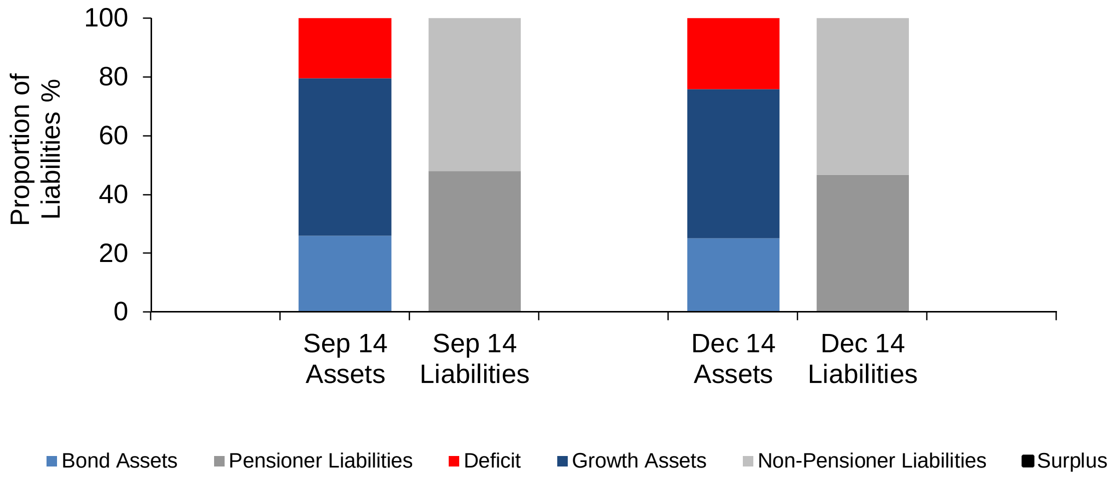
The Fund continues to hold significant exposure to UK government bonds and an underweight positon in supranationals. This reflects LGIM's 'defensive' positioning and provides them with a source of liquidity to take advantage of any future market weakness.

Over the 12 month period, the Fund has produced a return of 12.7% compared with the benchmark return of 12.2%.

6 Consideration of funding level

This section of the report considers the funding level of the Scheme. Firstly, it looks at the Scheme asset allocation relative to its liabilities. Then it looks at market movements, as they have an impact on both the assets and the estimated value placed on the liabilities.

Allocation to bond and growth assets against estimated liability split



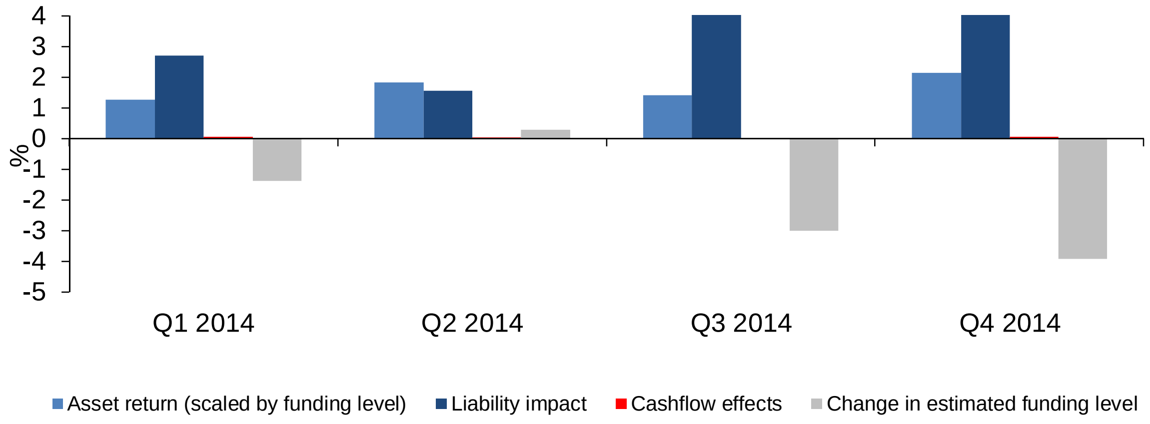
The chart above shows the allocation of the Scheme to Bond and Growth assets (see Glossary of Terms for definition) against the estimated liability split, which is based on changes in gilt yields underlying the Scheme Actuary's calculation of liabilities. The reference yield for the liabilities is the over 15-year gilt yield, as shown in the Market Statistics table in Section 1. These calculations do not take account of unexpected changes to Scheme membership and should not be construed as an actuarial valuation. However, by showing approximations to these liabilities, this chart should assist the Panel in making informed decisions on asset allocation.

Over the quarter, the expected funding position decreased by 4.0%, due to an increase in expected liabilities which was partially offset by an increase in assets. The Scheme was approximately 75.6% funded as at 31 December 2014.

The split between non-pensioner and pensioner liabilities moved in favour of non-pensioners over the quarter. The Scheme remains very underweight to Bond assets relative to its estimated pensioner liabilities (circa £538 million as at 31 December 2014); a mismatch that leaves the Scheme exposed to interest rate risk.

The "liabilities" estimated above represent the actuarial liabilities disclosed in the Actuarial Valuation report as at 31 March 2013.

Scheme performance relative to estimated liabilities



The above chart shows, for each quarter, how changes in the value of the assets and the liabilities, combined with the cashflow of the Scheme, have affected the funding level. As detailed earlier, the value of the liabilities has been estimated with reference to changes in the gilt yields underlying the Scheme Actuary's calculation of liabilities, as shown in the Market Statistics table.

Over the quarter, the estimated funding level decreased by 4.0% due to an increase in expected liabilities which was partially offset by an increase in assets.

Overall, Q4 2014 has been a negative quarter for the Scheme in terms of the funding level.

7 Summary

Overall this has been a negative quarter for the Scheme as the liabilities grew and the funding level decreased by 4.0%.

In absolute terms, the Scheme's assets produced a return of 2.7% over the quarter. All the underlying funds of the Growth and Bond portfolios produced positive absolute returns.

In relative terms, the Scheme underperformed the liability benchmark return by 3.4%. All of the underlying funds underperformed their respective benchmarks except for the Schroder DGF and the L&G Active Corporate Bond Fund.

The combined Growth portfolio underperformed the notional 60/40 global equity return by 0.8% producing a positive absolute return of 1.5%.

The combined Bond Portfolio underperformed the Over 15 Year Gilts Index and the Over 5 Years Index Linked Gilts Index by 6.5% and 4.7% respectively.

Over the quarter it is anticipated, all other things being equal, that investment conditions had a negative impact on the Scheme's estimated funding level which was 75.6% as at 31 December 2014.

Appendix 1:

Summary of current funds

Manager	Fund	Date of appointment	Management style	Monitoring benchmark	Target
Newton Investment Management Limited (Newton)	Real return	December 2010	Active, pooled	1 month LIBOR plus 4% p.a.	To achieve significant real rates of return in sterling terms predominantly from a portfolio of UK and international securities and to outperform the benchmark over rolling 5 years.
Newton	Corporate bond	December 2010	Active, pooled	Merrill Lynch Sterling Non Gilt Over 10 Years Investment Grade Index	To outperform the benchmark by 1% p.a. over rolling 5 years.
Schroder Investment Management Limited (Schroder)	Diversified growth	December 2010	Active, pooled	Retail Price Index plus 5% p.a.	To outperform the benchmark over a market cycle (typically 5 years).
Schroder	All maturities corporate bond	December 2010	Active, pooled	Merrill Lynch Sterling Non-Gilts All Stocks Index	To outperform the benchmark by 0.75% p.a. (gross of fees) over rolling 3 years.
Legal and General Investment Management (L&G)	World (ex. UK) Equity Index Fund	September 2008	Passive, pooled	FTSE AW World (ex UK) Index	Track within +/- 0.5% p.a. the index for 2 years in every 3.

Manager	Fund	Date of appointment	Management style	Monitoring benchmark	Target
L&G	Active Corporate Bond – All Stocks	December 2008	Active, pooled	iBoxx Sterling Non-Gilts All Stocks Index	Outperform by 0.75% p.a. (before fees) over rolling 3 years.
Internal	Property	n/a	Active, property unit trust portfolio	UK IPD Property Index	Outperform the index.
Newton Investment Management Limited (Newton)	Balanced	April 2006	Active, segregated	WM Local Authority Weighted Average	Outperform by 1% p.a. over rolling 3 years, and not to underperform by 3% in any rolling 12 month period.
Schroder Investment Management Limited (Schroder)	Balanced	1994	Active, segregated	WM Local Authority Weighted Average ex property, Japan and other international equities	Outperform by 1% p.a. over rolling 3 years, and not to underperform by 3% in any rolling 12 month period.

Liability benchmarking

An assessment of Scheme liabilities and how they change would require details of membership changes and actuarial valuation calculations to be carried out. However, by considering the changes in value of a suitable notional portfolio, based on your own liabilities, we can obtain an approximation to the changes in liabilities which will have occurred as a result of investment factors. In this report, when we refer to “liabilities” we mean the notional portfolio representing the actuarial liabilities disclosed in the actuarial valuation report dated 31 March 2013, adjusted approximately to reflect changes in investment factors. This will, therefore, not reflect any unanticipated member movements since the actuarial valuation. However, as a broad approximation it will allow more informed decisions on investment strategy. When we refer to the "liability benchmark" we mean the estimated impact on the liabilities (as referred to above) based on market movements alone.

Glossary of terms

Term	Definition
Absolute return	The overall return on a fund.
Bond asset	Assets held in the expectation that they will exhibit a degree of sensitivity to yield changes. The value of a benefit payable to a pensioner is often calculated assuming the invested assets in respect of those liabilities achieve a return based on UK bonds.
Growth asset	Assets held in the expectation that they will achieve more than the return on UK bonds. The value of a benefit payable to a non-pensioner is often calculated assuming the invested assets in respect of those liabilities achieve a return based on UK bonds plus a premium (for example, if holding equities an equity risk premium may be applied). The liabilities will still remain sensitive to yields although the Growth assets may not.
Duration	The average time to payment of cashflows (in years), calculated by reference to the time and amount of each payment. It is a measure of the sensitivity of price/value to movements in yields.
Funded liabilities	The value of benefits payable to members that can be paid from the existing assets of the scheme (i.e. those liabilities that have assets available to meet them).
Market statistics indices	The following indices are used for asset returns: ▪ UK Equities: FTSE All-Share Index ▪ Overseas Equities: FTSE World Index Series (and regional sub-indices) ▪ UK Gilts: FTSE-A Gilt >15 Yrs Index ▪ Index Linked Gilts: FTSE-A ILG >5 Yrs Index ▪ Corporate Bonds: iBoxx Corporate Bonds (AA) Over 15 Yrs Index ▪ Non-Gilts: iBoxx Non-Gilts Over 15 Yrs Index ▪ Property: IPD Property Index ▪ High Yield: ML Global High Yield Index ▪ Commodities: S&P GSCI GBP Index ▪ Hedge Funds: CSFB/Tremont Hedge Fund Index ▪ Cash: IBA GBP IBK LIBOR 1 Week Delayed – Offered Rate ▪ Price Inflation: Retail Price Index (excluding mortgages), RPIX ▪ Earnings Inflation: Average Earnings Index
Market volatility	The impact of the assets producing returns different to those assumed within the actuarial valuation basis, excluding the yield change impact.
Money weighted rate of return	The rate of return on an investment including the amount and timing of cashflows.
Non-pensioner liability	The value of benefits payable to those who are yet to retire, including active and deferred members.
Pensioner liability	The value of benefits payable to those who have already retired, irrespective of their age.
Portfolio benchmark	The benchmark return of the each manager/fund.

Term	Definition
Relative return	The return on a fund compared to the return on another fund, index or benchmark. For IMAGE purposes this is defined as: return on fund less return on index or benchmark.
Scheme investments	Refers only to the invested assets, including cash, held by your investment managers.
Standard deviation	A statistical measure of volatility. We expect returns to be within one standard deviation of the benchmark 2 years in every 3. Hence as the standard deviation increases so does the risk.
Surplus/deficit	The estimated funding position of the Scheme. This is not an actuarial valuation and is based on estimated changes in liabilities as a result of bond yield changes, asset movements and, if carried out, output from an asset liability investigation (ALI). If no ALI has been undertaken the estimate is less robust.
Time weighted rate of return	The rate of return on an investment removing the effect of the amount and timing of cashflows.
Unfunded liabilities	The value of benefits payable to members that cannot be paid from the existing assets of the Scheme (i.e. those liabilities that have no physical assets available to meet them). These liabilities are effectively the deficit of the Scheme.
Yield (gross redemption yield)	The return expected from a bond if held to maturity. It is calculated by finding the rate of return that equates the current market price to the discounted value of future cashflows.
Three year return	The total return on the fund over a three year period expressed in percent per annum.

JLT Manager Research Tier Rating System

Tier	Definition
Buy	Significant probability that the manager will meet the client's objectives.
Hold	Reasonable probability that the manager will meet the client's objectives. This fund will not be put forward for new investments but there is no intention to sell existing holdings.
Review	The manager may reach the client's objectives but a number of concerns exist. The JLT Manager Research Team are currently reviewing this fund.
Sell	There is a reasonable probability that the manager will fail to meet the client's objective due to a number of key concerns and therefore we recommend clients to redeem their assets.

JLT Employee Benefits

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