



London Borough of Barnet Superannuation Fund

Quarterly update to 30 June 2014



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1 Market update

Introduction

The tables below summarise the various market returns to 30 June 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	2.2	13.1	8.9
Overseas Equities	2.6	9.4	8.5
USA	2.6	10.9	14.3
Europe	0.3	15.6	5.3
Japan	4.3	-1.7	5.7
Asia Pacific (ex Japan)	3.6	4.6	2.0
Emerging Markets	5.0	1.2	-2.2
Property	5.1	17.6	8.6
Hedge Fund	2.0	9.1	5.6
Commodities	0.1	-2.1	-1.9
High Yield	0.3	0.8	7.4
Emerging Market Debt	4.8	11.6	7.4
Senior Secured Loans	1.4	7.0	5.6
Cash	0.1	0.4	0.5

Market Returns	3 Mths	1 Year	3 Years
Bond Assets	%	%	% p.a.
UK Gilts (>15 yrs)	2.3	5.3	8.7
Index-Linked Gilts (>5 yrs)	1.1	4.3	7.8
Corp Bonds (>15 yrs AA)	2.8	9.2	9.4
Non-Gilts (>15 yrs)	3.4	9.3	9.6

* 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.

Change in Sterling	3 Mths	1 Year	3 Years
	%	%	%
Against US Dollar	2.6	12.7	2.1
Against Euro	3.2	7.0	4.1
Against Yen	0.9	15.0	10.1

Absolute Change in Yields	3 Mths	1 Year	3 Years
	%	%	%
UK Equities	-0.14	-0.26	0.28
UK Gilts (>15 yrs)	-0.09	-0.09	-0.88
Index-Linked Gilts (>5 yrs)	-0.02	-0.09	-0.60
Corp Bonds (>15 yrs AA)	-0.13	-0.35	-1.37
Non-Gilts (>15 yrs)	-0.16	-0.24	-1.09

Yields as at 30 June 2014	% p.a.
UK Equities	3.27
UK Gilts (>15 yrs)	3.34
Real Yield (>5 yrs ILG)	-0.12
Corporate Bonds (>15 yrs AA)	4.17
Non-Gilts (>15 yrs)	4.44

Inflation Indices	3 Mths	1 Year	3 Years
	%	%	% p.a.
Price Inflation - RPI	0.6	2.6	2.9
Price Inflation - CPI	0.5	1.9	2.4
Earnings Inflation *	0.2	0.7	1.2

Asset Class	Factors Affecting the Market	
	Positive	Negative
UK Equities	<ul style="list-style-type: none"> According to the National Institute of Economic and Social Research, Britain's economy witnessed its strongest calendar quarter in four years in Q2 2014, growing by an estimated 0.9%. 	<ul style="list-style-type: none"> Office for National Statistics' figures indicate that the trade deficit grew to an estimated GBP 9.6 billion in April from GBP 8.3 billion in March. Weak demand in the Eurozone (the UK's largest trading partner) has hindered the government's efforts to support stronger manufacturing exports.
	<ul style="list-style-type: none"> Data released in July showed that the labour market continues to strengthen. Unemployment fell by 121,000 to 2.12 million in the three months to May (an unemployment rate of 6.5%). This marks the lowest unemployment level since December 2008. 	<ul style="list-style-type: none"> June's report on the housing market from the Financial Policy Committee addressed evidences that less prudent lending standards were reaching pre-crisis peaks. UK house prices increased by 1% in June, taking the annual rate of increase to 11.8%.
	<ul style="list-style-type: none"> UK economic growth has been driven by increases in household spending and, more recently, business investments. The pick-up in household spending is reflected by the latest GfK consumer confidence survey, which in May reached levels not seen since 2005. 	<ul style="list-style-type: none"> The strength of the Pound has continued to impact the profits of many UK companies with international exposure.
Overseas Equities		
North American Equities	<ul style="list-style-type: none"> Dovish comments from the Fed chair Janet Yellen both dismissing rising inflationary pressures as "noise", and noting that the market valuations were within the historical norms, helped US equities surge to record highs. 	<ul style="list-style-type: none"> The US economy shrank in the first quarter with an annualised rate of 2.9%, much worse than the Bureau of Economic Analysis's second estimate of 1% contraction. This was the largest contraction since the first quarter of 2009. The weak number was mainly due to a smaller increase in the personal consumption than previously estimated.
	<ul style="list-style-type: none"> A series of upbeat economic data pointed to a pick-up in the growth momentum for the rest of the year. The unemployment rate fell to 6.1% amidst a strengthening labour market while inflation showed signs of a pickup, moving closer to the Fed's target of 2%. 	<ul style="list-style-type: none"> After reaching record highs for nearly two years, corporate profits declined in the first quarter. Earnings before taxes fell by 10% while profits after taxes plunged nearly 14%.

Asset Class	Factors Affecting the Market	
	Positive	Negative
European Equities	<ul style="list-style-type: none"> Despite disappointing corporate earnings, European equities managed to eke out marginal positive return over the second quarter. They were supported by expectations that the European Central Bank (ECB) would take steps to ease monetary policy in order to stimulate growth and fend off the spectre of deflation. 	<ul style="list-style-type: none"> Eurozone GDP growth for the first quarter was below expectations at 0.2%. Germany led the way with a growth rate of 0.8% while France saw no growth and the Italian economy contracted by 0.1%.
	<ul style="list-style-type: none"> The ECB launched a raft of measures to fight low inflation and boost the euro zone economy. It lowered the deposit rate to -0.1%, meaning it will effectively charge banks for holding their money overnight. It cut its main refinancing rate to 0.15% and the marginal lending rate to 0.40%. 	<ul style="list-style-type: none"> The Eurozone composite purchasing managers' index (PMI) hit a 35-month high of 54.0 in April but eased back to 53.5 in May and 52.8 in June, indicating a slowdown in growth over the quarter.
Japanese Equities	<ul style="list-style-type: none"> Consumer price inflation surged to an annualised rate of 3.4% in May. This is the highest reading in nearly 32 years for an economy that has been battling deflation for better part of the last two decades. A rise in the inflation levels for 12 months in a row indicates that the effects of loose monetary policy adopted by the Bank of Japan (BoJ) has started to yield results. However, a significant portion of this rise is due to the recent hike in the sales tax from 5% to 8%. 	<ul style="list-style-type: none"> In April, the BoJ's governor put an end to the speculation of further quantitative easing by keeping monetary policy unchanged with the money supply maintaining its current annual expansion rate of 60-70 trillion Yen. This led to a strengthening of the Yen over the quarter and had a negative impact on the investor sentiment.
	<ul style="list-style-type: none"> Prime Minister Shinzo Abe unveiled a package of reform proposals, commonly dubbed as the Third arrow of Abenomics, including changes in labour laws, increasing corporate governance standards, and reducing corporate taxes, among others. A poll by Reuters suggests that the reforms could boost the country's growth rate by 0.2% to 1.5% in the long term. 	

Asset Class	Factors Affecting the Market	
	Positive	Negative
<i>Asia Pacific (excluding Japan) Equities</i>	<ul style="list-style-type: none"> ■ South Korea recorded its 29th consecutive month of trade surplus owing to strong exports, which grew by 2.5% year-on-year in June. Taiwan's exports rose 1.2% year-on-year, the fifth consecutive month of growth, bolstered by strong demand for consumer goods. 	<ul style="list-style-type: none"> ■ MSCI removed the South Korean and Taiwanese equity markets from consideration for an upgrade to developed market status from their current standing of Emerging market status. The index provider cited absence of any significant improvements in market accessibility and currency liquidity.
	<ul style="list-style-type: none"> ■ S&P upgraded Philippines sovereign rating by one notch to BBB in May, citing the country's strong external liquidity, investment climate and effective monetary policy framework. 	<ul style="list-style-type: none"> ■ Indonesia's GDP growth slowed to a 5-Year low of 5.2% in Q1 2014 primarily due to weakening exports. The country also reported an unexpectedly large trade deficit of nearly USD 2 billion in April.
<i>Emerging Markets Equities</i>	<ul style="list-style-type: none"> ■ The official Chinese PMI rose to a six-month high of 51.0 in June, up from 50.8 in May. This improvement suggests that the government's mini-stimulus is filtering through to the real economy. The Chinese government has made efforts to boost official spending and to let banks lend more of their deposits. 	<ul style="list-style-type: none"> ■ MSCI chose not to include China's A-shares (Renminbi-denominated mainland shares) in its benchmark Emerging market equity index during its annual index review in June. Strict quota limits within the Renminbi Qualified Foreign Institutional Investor (RQFII) scheme and concerns over the tax regime were the primary reasons for the non-inclusion of the A-shares in the index.
	<ul style="list-style-type: none"> ■ Investors have poured USD 221.7 billion into Emerging market assets over the past 11 months based on expectations that interest rates in most developed economies will remain low at least until 2015. A survey by Bank of America Merrill Lynch for June shows a net overweight position held by fund managers on Emerging market equities for the first time since November 2013. 	<ul style="list-style-type: none"> ■ Argentina technically defaulted on its debt payment after it failed to reach a settlement with a group of US based hedge funds. In June, the US Supreme Court refused to hear Argentina's appeal to pay only the restructured bondholders and not others. The dispute between Argentina and its bond holders has been ongoing since the Argentine debt restructuring in 2005.
<i>Gilts</i>	<ul style="list-style-type: none"> ■ Growth expectations in the UK are very strong owing to a surge in the construction and manufacturing sector. However, the UK's dominant sector, the services industry, has been a drag over the quarter. The monthly Markit/CIPS purchasing managers' index (PMI) for services sector dropped to 57.7 in June from 58.6 in May, marking a three-month low. 	<ul style="list-style-type: none"> ■ The BOE governor Mark Carney hinted at a rise in interest rates later this year during the monetary policy committee meeting in June. The reasons behind an early rate hike is that they want to avoid the chances that a stronger than expected economic growth in the second half of 2014 would reduce spare capacity in the economy. This could cause unemployment to fall faster, but also put upward pressure on wages, requiring a tighter monetary policy.
	<ul style="list-style-type: none"> ■ Modest Inflation and more than estimated spare capacity in labour market (stated by the Bank of England (BOE) in the June monetary policy meeting) are hindering the ability of the BOE to undertake interest hikes. 	

Asset Class	Factors Affecting the Market	
	Positive	Negative
<i>Index-Linked Gilts</i>	<ul style="list-style-type: none"> ■ With limited issuance of new Index-linked gilts and investors continuing to seek inflation protection, demand for index-linked gilts remains high, thus supporting prices. 	<ul style="list-style-type: none"> ■ The UK consumer price index of inflation grew by a modest 1.5% in May 2014, down from 2% in December 2013.
		<ul style="list-style-type: none"> ■ In an environment where central banks are able to control inflation within a target range, there is limited upside to the return expectations on these instruments.
<i>Corporate Bonds</i>	<ul style="list-style-type: none"> ■ Corporations continue to maintain healthy balance sheets as deleveraging continues in expectations of rising interest rates. 	<ul style="list-style-type: none"> ■ The corporate bond market still suffers from liquidity constraints and the reduction in credit spreads over the past few months leaves little room for any further contraction.
<i>Property</i>	<ul style="list-style-type: none"> ■ Property values rose by 1.1% in May, marking the highest rise in 2014. UK Commercial property values have now risen by 8.5% over 13 months of consecutive growth. 	<ul style="list-style-type: none"> ■ The new affordability tests (MMR) introduced in April for house buyers are having an effect, leading to the number of mortgage approvals falling to an 11 month low, totalling 61,707 in May.
	<ul style="list-style-type: none"> ■ Residential prices in London are around 30% above their 2007 highs, while in the UK as a whole, prices are less than 1% above their pre-crisis peak. 	<ul style="list-style-type: none"> ■ In June, the Bank of England imposed constraints on lenders to limit the proportion of mortgages at a loan-to-income ratio of 4.5 times and above to no more than 15% of their mortgage portfolios.
	<ul style="list-style-type: none"> ■ The Construction PMI rose to 62.6 in June from 60.0 in May, the highest reading since February. 	

2 Total scheme performance

Manager	Fund	Start of quarter		Net new money (£)	End of quarter	
		Value (£)	Proportion of total (%)		Value (£)	Proportion of total (%)
Newton Investment Management Limited (Newton)	Real Return	257,735,581	31.1	-	261,134,985	31.0
Schroder Investment Management Limited (Schroder)	Diversified Growth	256,538,972	31.0	-	263,220,629	31.3
Legal and General Investment Management (L&G)	World (ex UK) Equity Index	43,305,475	5.2	-	44,378,012	5.3
Newton	Corporate Bond	125,428,296	15.1	-	128,903,322	15.3
Schroder	All Maturities Corporate Bond	118,080,502	14.3	-	120,597,176	14.3
L&G	Active Corporate Bond – All Stocks	17,457,130	2.1	-	17,835,000	2.1
Newton	Cash	324,660	0.0	-	508,617	0.1
Schroders	Cash	649,502	0.1	-	666,816	0.1
Internal	Cash	8,933,584	1.1	-	3,772,716	0.4
Asset split						
Growth assets		567,163,115	68.5	-	573,173,158	68.2
Bond assets		261,290,588	31.5	-	267,844,115	31.8
Total		828,453,702	100.0	-	841,017,273	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 Q2'14 (%)	Benchmark return Q2'14 (%)
Total Scheme	2.2	1.5
Growth portfolio		
Growth vs. global equity	2.0	2.4
Growth vs. RPI+5% p.a.	2.0	1.9
Growth vs. LIBOR + 4% p.a.	2.0	1.1
Bond portfolio		
Bond vs. over 15 year gilts	2.5	2.3
Bond vs. index-linked gilts (> 5 yrs.)	2.5	1.1

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. *Liability benchmark (see page 18).

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.

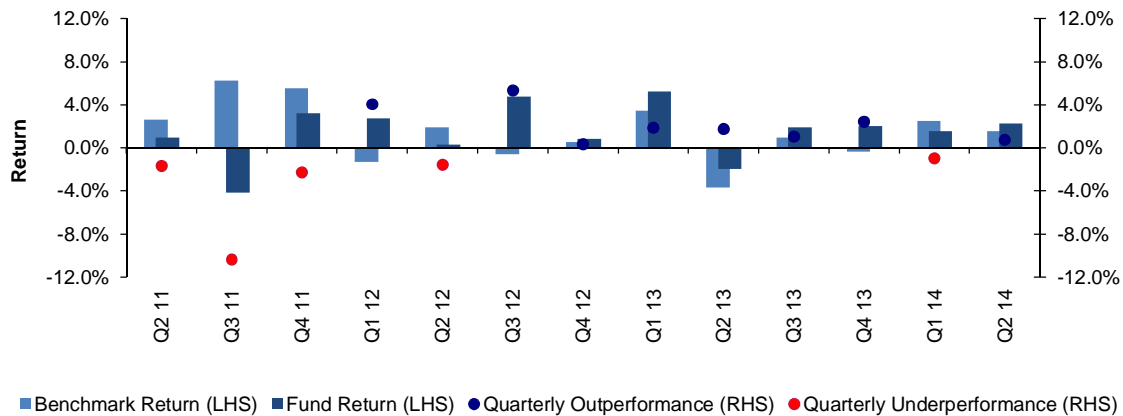
Individual manager performance

Manager/fund	Portfolio return Q2'14 (%)	Portfolio benchmark Q2'14 (%)
Newton Real Return	1.3	1.1
Schroder Diversified Growth	2.6	1.9
L&G – Overseas Equity	2.5	2.5
Newton Corporate Bond	2.9	3.1
Schroder Corporate Bond	2.1	2.1
L&G – Corporate Bond	2.2	2.0

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 previous 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 2.2% over the quarter and outperformed the liability benchmark return by 0.7%. 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, the Schroder Diversified Growth Fund was the best performing fund, outperforming its benchmark return by 0.7%.

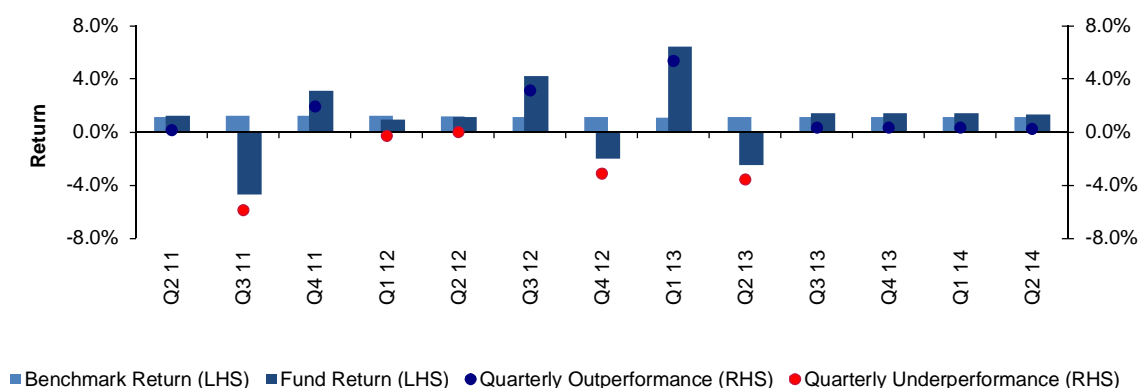
The Growth Portfolio, comprising the two DGF funds, underperformed the notional 60/40 global equity benchmark, by 0.4% over the quarter. It is usual to expect DGF funds to underperform equities in rising markets and conversely outperform in falling markets. The Growth portfolio marginally outperformed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

The Bond Portfolio, comprising the two corporate bond portfolios managed by Newton and Schroder, outperformed the Over 15 Year Gilts Index (by 0.2%) and the Over 5 Years Index Linked Gilts Index (by 1.4%).

3 Manager performance

3.1 Newton – Real Return Fund

Performance relative to portfolio benchmark



Source: Investment manager.

The Newton Real Return Fund returned 1.3% compared to its LIBOR + 4% p.a. benchmark return of 1.1%, thereby outperforming by 0.2%. In comparison to a notional 60/40 global equity benchmark return the Fund underperformed by 1.1%.

The Fund's positive absolute performance was mainly driven by its equity holdings in the Oil & Gas and Tobacco sectors. Notable examples were Total, Royal Dutch Shell, Japan Tobacco and Reynolds American. However, the Fund's Telecommunication holdings provided mixed results, as positive contribution from TDC and Telecom Corporation New Zealand, were offset by negative contributions from Sprint, Vodafone and Millicom.

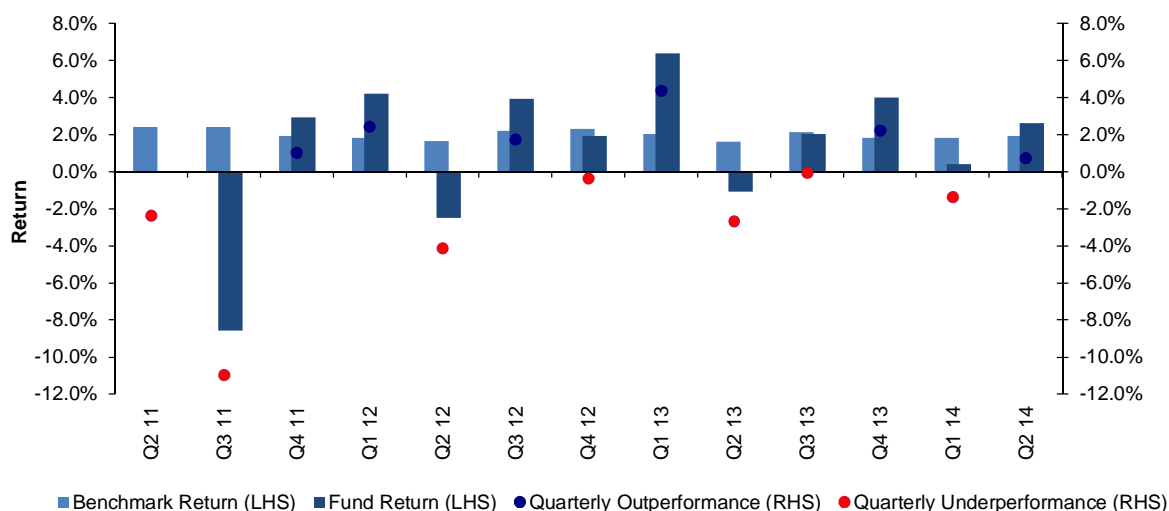
The Fund's government bond and index-linked holdings also contributed positively to performance. The overseas government bond holdings in the 30-year US Treasury and Australian government bonds finished the quarter among the leading positive contributors.

Sterling proved to be one of the strongest global currencies over the quarter. The currency's strength detracted from performance over the quarter.

Over the quarter, Newton reduced the Fund's exposure to corporate debt. However, it left a small allocation to sub-investment grade bonds believing that high yield bonds still offer an attractive risk-reward profile. There was also the addition of further equity-index protection. Over the 12 month period, the Fund returned 5.5% versus the benchmark return of 4.5%. In comparison to a notional 60/40 global equity benchmark return the Fund underperformed by 6.1%.

3.2 Schroder – Diversified Growth Fund

Performance relative to portfolio benchmark



Source: Investment manager.

The Schroder DGF return was 2.6% compared to its RPI + 5% p.a. portfolio benchmark return of 1.9% and outperformed by 0.7%. The Fund outperformed the notional 60/40 global equity benchmark by 0.2% over the quarter.

Nearly all asset classes held in the Fund contributed positively to performance over the quarter. Global, US and European equities were the main drivers of performance.

Allocations to Japanese, Emerging Market and Pacific (ex Japan) equities also added to performance, as did Commodities, Property and Infrastructure. The only detractors from performance were the Fund's UK Equity and Currency exposures.

Going forward, the Fund upgraded its view on emerging markets with a 2% position in emerging equities via the MSCI Emerging Markets Index, this being the first time in almost three years that Schroders has made an allocation to emerging market equities. The Fund added to its holding in the Schroder ISF Emerging Market Debt Absolute Return Fund, with the view that the position adds lower risk and focused exposure to emerging market debt and currencies.

Schroders continued to decrease its allocation to credit in favour of alternatives, on the view that it sees better opportunities for diversification and stronger potential returns. Over the 12 month period, the Fund returned a positive absolute return of 9.2% versus the benchmark return of 7.4%. In comparison to a notional 60/40 global equity benchmark return, the Fund underperformed by 2.4%.

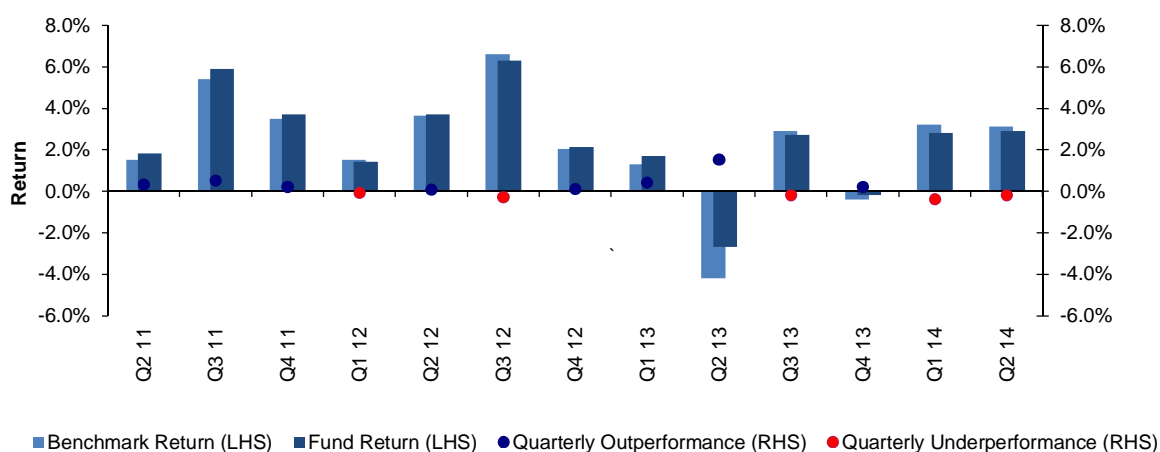
Asset allocation for growth managers: movement over the quarter

	Q2'14 Newton (%)	Q2'14 Schroder (%)	Q1'14 Newton (%)	Q1'14 Schroder (%)
UK equities	13.5	1.9	12.5	-1.6
Overseas equities	45.1	50.0	44.3	52.9
Fixed interest	12.8	-	17.9	-
Corporate bonds	2.7	1.9	10.0	1.8
High yield	-	5.3	-	7.0
Private equity	-	0.9	-	0.9
Commodities	2.8	4.6	2.8	3.3
Absolute return	-	14.3	-	13.5
Index-linked	1.2	2.9	1.2	3.0
Property	-	3.1	-	3.0
Cash/other	21.9	15.1	11.3	16.2
Total	100.0	100.0	100.0	100.0

Source: Investment managers.

3.3 Newton – Corporate Bond Portfolio

Performance relative to portfolio benchmark



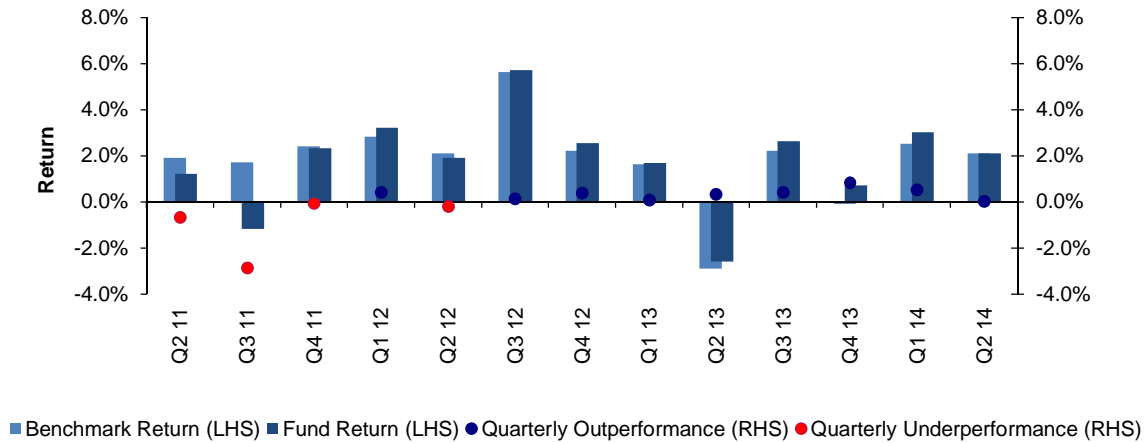
Source: Investment manager.

The Newton Corporate Bond portfolio underperformed its benchmark by 0.2%; it returned 2.9% versus the benchmark return of 3.1%. The underperformance was attributable to the Fund's relatively conservative positioning against the index, in which longer-maturity bonds issued by lower quality issuers produced the strongest returns over the period.

Over the 12 month period, the Fund returned 8.4% against the benchmark return of 9.0%.

3.4 Schroder – All Maturities Corporate Bond Portfolio

Performance relative to portfolio benchmark

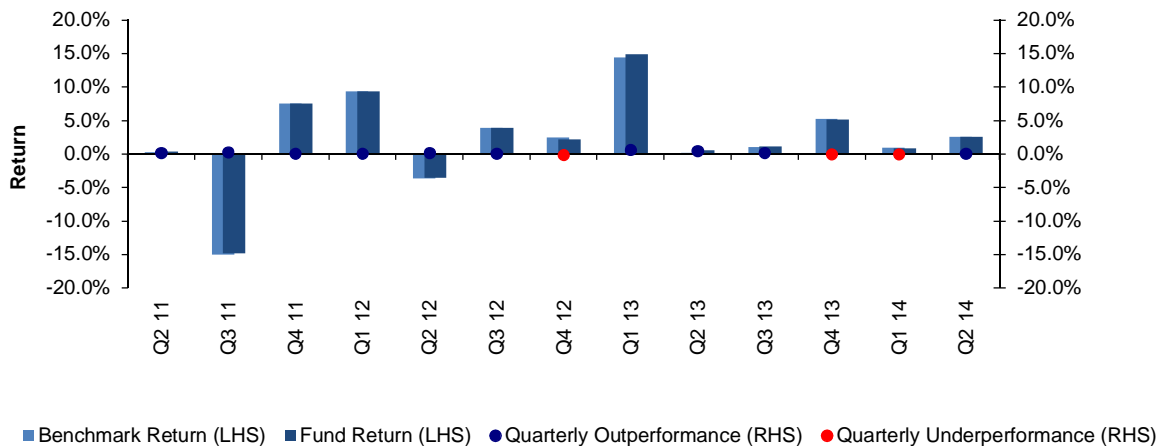


Source: Investment manager.

The Schroders Corporate Bond portfolio performed in line with its benchmark and produced an absolute return of 2.1%. Credit selection generated outperformance, though this was offset by the portfolio overweight to financial names which detracted.

Over the 12 month period, the Fund returned 8.7% versus the benchmark return of 6.9%.

3.5 L&G – Overseas Equities



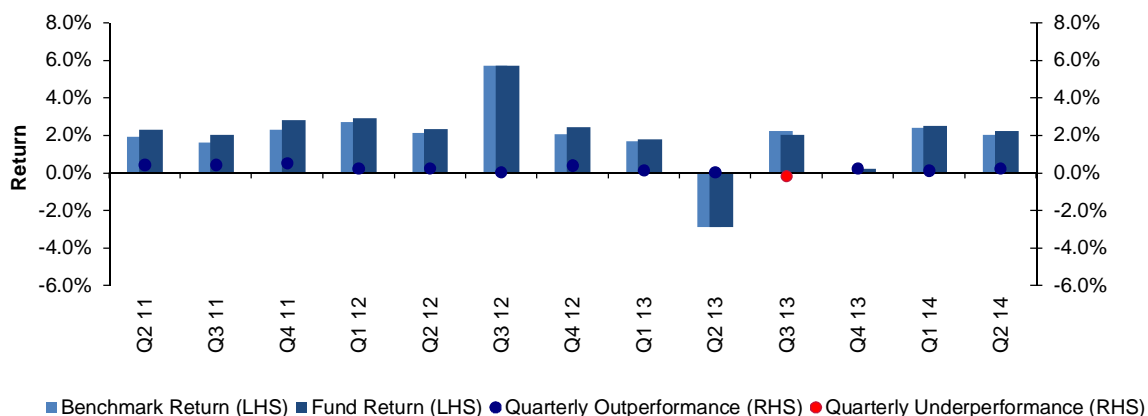
Source: Investment manager.

Over the second quarter of 2014, the Fund performed in line with its benchmark return and produced an absolute return of 2.5%.

The Fund generated an absolute return of 9.8% performing in line with its benchmarks over the 1 year period.

3.6 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 0.2% and produced an absolute return of 2.2% compared to the benchmark return of 2.0%.

The Fund very modestly outperformed over the quarter. In a market environment where taking credit risk was rewarded, the Fund's overweight position to credit risk added to performance as credit spreads tightened over the quarter. In addition there was a small positive impact from positioning within sectors.

The Fund has a modest exposure to both US dollar and Euro denominated bonds - which although producing positive absolute returns in themselves - were a drag on performance given that Sterling bond performance was in general stronger than those generated through the US dollar and Euro credit markets.

The Fund's preference towards financial bonds was overall beneficial to performance as these bonds performed well over the quarter; this was because the availability of additional yield attracted investors, in an environment where central banks continued to loosen monetary policy.

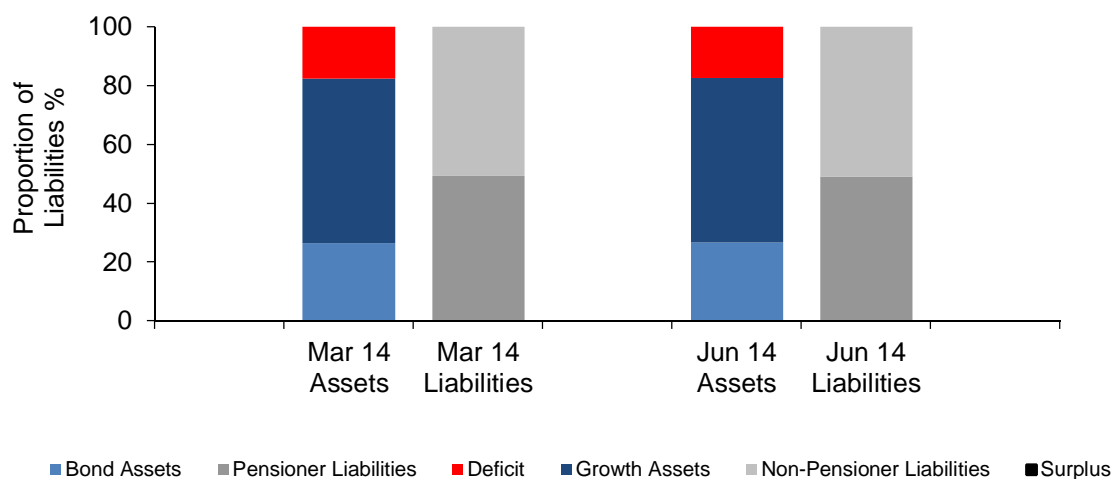
In terms of individual stock selection, the Fund's overweight position in the European Investment Bank (EIB) was helpful as EIB spreads tightened significantly over the period which lead to strong performance.

Over the 12 month period, the Fund has produced a return of 7.1% compared with the benchmark return of 6.8%.

4 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.

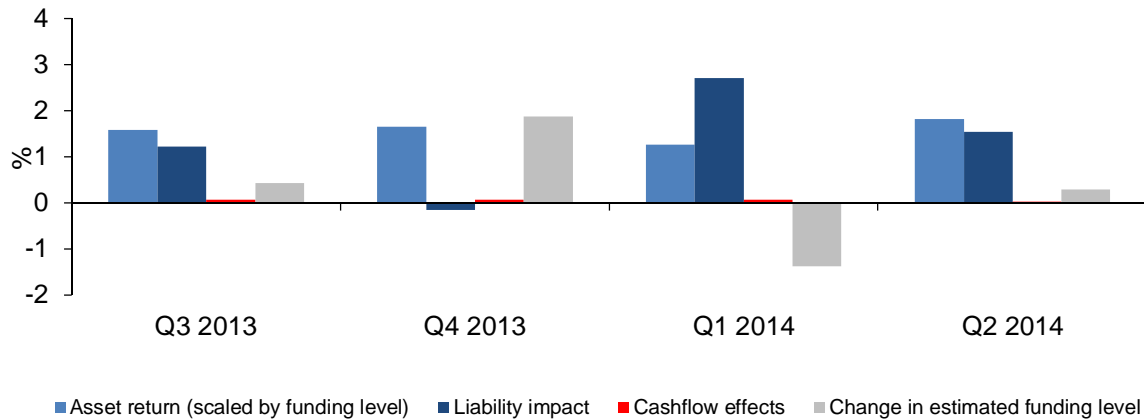
Over the quarter, the expected funding position increased by 0.3%, due to an increase in assets which was partially offset by an increase in expected liabilities. The Scheme was approximately 82.6% funded as at 30 June 2014.

The split between non-pensioner and pensioner liabilities is estimated to have remained fairly stable over the quarter. The Scheme remains very underweight to Bond assets relative to its estimated pensioner liabilities (circa £497 million as at 30 June 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.

In our last report (which used information from the Actuarial Valuation report as at 31 March 2010), the equivalent of the chart above showed an estimated deficit in the scheme. In the chart shown here, using updated liability information, a smaller deficit is revealed. This highlights the fact that investment market factors are not the only drivers of the funding position. For example, changes in mortality expectations, unexpected member movements and changes in the level of prudence adopted also have a significant impact on the estimated funding position.

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 increased by 0.3% due to an increase in assets which was partially offset by an increase in expected liabilities.

Overall, Q2 2014 has been a positive quarter for the Scheme in terms of the funding level.

5 Summary

Overall this has been a positive quarter for the Scheme as the assets grew and the funding level increased by 0.3%. We have updated the actuarial data as at 31 March 2013 which has resulted in a significant improvement in the funding level to that shown in the Q1 2014 investment report.

In absolute terms, the Scheme's assets produced a return of 2.2% over the quarter. All the underlying funds of the Growth and Bond portfolios produced positive absolute returns.

In relative terms, the Scheme outperformed the liability benchmark return (see page 18) by 0.7%. All of the underlying funds either outperformed or tracked their respective benchmarks except for the Newton Corporate Bond Fund which underperformed its benchmark.

The combined Growth portfolio underperformed a notional 60/40 global equity return producing a positive absolute return of 2.0%.

The combined Bond Portfolio outperformed the Over 15 Year Gilts Index by 0.2% and the Over 5 Years Index Linked Gilts Index by 1.4%.

Over the quarter it is anticipated, all other things being equal, that investment conditions had a positive impact on the Scheme's estimated funding level which was 82.6% as at 30 June 2014.

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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	<p>The following indices are used for asset returns:</p> <ul style="list-style-type: none"> ■ 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: 7 day London Interbank Middle 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.



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