Common Good and Trusts Investment Sub-Committee

Due to Scottish Government guidance relating to Covid-19, this meeting will be held remotely

Thursday, 26th November, 2020 - 3.30 p.m.

AGENDA

Members are reminded that should they have queries on the detail of a report they should, where possible, contact the report authors in advance of the meeting to seek clarification.

Morag Ferguson
Head of Legal and Democratic Services
Finance and Corporate Services

Fife House
North Street
Glenrothes
Fife, KY7 5LT

19th November, 2020

Please contact:
Wendy MacGregor, Committee Officer, Fife House
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THE FIFE COUNCIL - COMMON GOOD AND TRUSTS INVESTMENT SUB-COMMITTEE - GLENROTHES

27th November, 2019. **9.30 a.m. – 9.40 a.m.**

PRESENT: Councillors David Barratt, Bobby Clelland, Altany Craik, Colin Davidson, Dave Dempsey and Fiona Grant.

ATTENDING: Elaine Muir, Head of Finance, Laura C Robertson, Finance Operations Manager and Andrew Ferguson, Manager (Committee Services), Legal and Democratic Services, Finance and Corporate Services.

APOLOGIES FOR ABSENCE: Councillors Mino Manekshaw and Jonny Tepp.

1. DECLARATIONS OF INTEREST

Councillor Bobby Clelland declared an interest in the business on the agenda being a trustee of the Mineworkers' Pension Scheme.

2. APPOINTMENT OF CONVENER

The Committee unanimously agreed to appoint Councillor Dempsey as Convener.

3. MEMBERSHIP AND REMIT OF SUB-COMMITTEE

Decision

The Sub-Committee noted its membership and remit.

4. COMMON GOOD AND TRUST FUNDS

The Sub-Committee considered a report by the Executive Director (Finance and Corporate Services) providing an update on the market value of investments of the Common Good and Trust Funds.

Decision

The Sub-Committee

(1) noted the terms of the report; and

(2) that a further report be brought back to the Sub-Committee as soon as practicable with more detail on the Fund's investment strategy and its current advisers.

26th November, 2020

Agenda Item No. 4

Common Good and Trust Funds

Report by: Eileen Rowand, Executive Director of Finance and Corporate Services

Wards Affected: All

Purpose

The purpose of this report is to provide an update on the market value of investments of the Common Good and Trust Funds. This report is provided on an accrual basis and is to inform members of the investment performance over the last financial year.

Recommendation

Members are asked to note this report.

Resource Implications

None.

Legal & Risk Implications

None.

Policy & Impact Assessment

An EqIA is not required because the report does not propose a change or revision to existing policies or practices.

Consultation

N/A.

1.0 Background

1.1. Janus Henderson took over the management of the Common Good and Trust Funds investment portfolio in March 2001. As a result, £2.777m of Common Good and Trust funds were invested in the Preference & Bond Fund and the UK Equity Income Fund, with £1.725m in relation to the Fife Educational Trust Fund similarly invested on 8 June 2007.

1.2. The investment strategy for the Fife Educational Trust Fund and Common Good and Trust Funds is the same; to generate income whilst preserving and growing capital.

2.0 2019-20 Performance

2.1 The current valuations for these funds are shown below: -

	Common Good & Trust Funds £	**Fife Educational Trust Fund £**	**Total £**
Valuation as at 31 March 2019	5,527,042	1,842,944	7,369,986
Increase / (decrease) in year	(1,001,251)	(537,849)	(1,539,100)
Valuation as at 31 March 2020	4,525,791	1,305,095	5,830,886

2.2 The Fund Manager has provided the following narrative associated with the Fund performance during the last financial year:-

During the year to the end of March 2020, the Fund underperformed its FTSE All-Share benchmark, falling 27.1% on a total return basis (I Inc share class) relative to the FTSE All-Share which fell 18.5%. The majority of this underperformance was concentrated in March, when the Fund fell 22.7% relative to the FTSE All-Share which fell 15.1%.

The reason the portfolio underperformed during the one-year period under review can be partially explained by its sector weighting. The two largest overweight positions at the sector level are industrials and financials; on an attribution by sector it is these areas that are the two largest detractors. Within industrials one of the largest sub-sector exposures was civil aerospace, with positions exposed to this area including Senior, Rolls-Royce and Meggitt. When it became clear that passenger miles flown would be down materially this year, with the majority of the global plane fleet temporarily grounded, shares exposed to civil aerospace sharply underperformed in anticipation of earnings downgrades. The positioning in the civil aerospace area has since been reduced – the position in Rolls Royce has been sold on balance sheet concerns, and the position in Senior materially reduced.

Within financials, the largest overweight position is in insurers (rather than banks, where the portfolio has relatively little domestic banking exposure). For some insurers such as Hiscox, which writes (among other lines) business interruption and event cancellation insurance, as businesses were forced to close there became *uncertainty about how much of these losses would fall to insurance companies. The position in Hiscox was added to in May 2020 on an equity placing in order to strengthen the balance sheet against potential claims. There is currently a test case in the UK High Court to determine under which wording claims should be paid. Hiscox shares are trading at a valuation discount (on a price/book basis) versus where they have traded historically and in our view a poor claims outcome is currently priced into the shares, but until there is more certainty the shares are likely to be volatile.*

In addition to the sector weighting, the portfolio has always invested across the breadth of the market including selective small and medium sized UK companies. These smaller companies tend to be more domestically exposed on average than larger companies, and therefore at a time when there were substantial question marks about the outlook for the UK economy (driven not just by covid, but prior to that by Brexit and uncertainty ahead of the general election), domestically focussed shares have underperformed. In our view this presents a future opportunity; many of these businesses are well managed, market leading businesses that trade at a material discount to overseas peers, however in the short term it has detracted from returns.

2.3 Income earned by Janus Henderson Investors during 2019-20 is also shown, as is the investment Income as a percentage of the market value at the end of the financial year (i.e. the return)

	Common Good & Trust Funds £	**Fife Educational Trust Fund £**	**Total £**
Investment income earned in year	297,004	104,811	401,815
% of Valuation as at 31 March 2020	6.56%	8.03%	6.89%

2.4 This income is credited to the Common Good and Trust Fund revenue accounts and used to support expenditure in year

Report Contact

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26th November, 2020

Agenda Item No. 5

Review of Investment Arrangements - Common Good and Trust Funds

Report by: Eileen Rowand, Executive Director of Finance and Corporate Services

Wards Affected: All

Purpose

The purpose of this report is to provide details of the outcome of a review of the current investment strategy for Common Good and Trust Funds. The review was undertaken by Hymans Robertson and provides some recommendations which are included in this report.

Recommendation

Members are asked to:

1. Approve the recommendation made by Hymans Robertson to review the Investment Strategy and in doing so; remit
2. the Head of Finance to work with Hymans Robertson to investigate an alternative global equities mandate and
3. Remit the Head of Finance, with support from investment advisers, to appoint a fund manager to facilitate the move from investment in UK Equities to Global Equities.

Resource Implications

Commissioning further work on this area from investment adviser will incur a cost which will be charged to the funds on a proportionate basis.

Legal & Risk Implications

There are risks associated with all investments and the likely return that the Common Good and Trust Funds will receive depends on the investment mandate and market volatility.

Policy & Impact Assessment

An EqIA is not required because the report does not propose a change or revision to existing policies or practices.

Consultation

Consultation with Investment Advisers Hymans Robertson has been carried out in preparation of this report.

1.0 Background

1.1. It has been some considerable time since a review of the current investment arrangements for Fife Educational Trust, Common Good and Trust Funds was undertaken. In order to establish if the current arrangements continue to be fit for purpose a review was commissioned earlier this year to be undertaken by Hymans Robertson, one of the Investment Advisers used by the Council for Fife Pension Fund.

1.2. Hymans Robertson undertook a desktop review and have prepared the attached report detailing their findings, recommendations and suggested way forward.

1.3. The review was designed to establish the appropriateness of the investment strategy in meeting the Funds objectives and the appropriateness of the investment manager against the objective.

2.0 Issues

2.1 The objective for the Fife Educational Trust Fund and Common good and Trust Funds is to generate income whilst preserving and growing capital. Funds are currently invested with Janus Henderson in Preference & Bond Fund and the UK Equity Income Fund.

2.2 The attached report, prepared by Hymans Robertson, provides the following:

- Assessment of current investment strategy
- Review of Investment Managers
- Recommendation

2.3 The review of investment arrangements concludes the following:

- Hymans believe the current high-level asset allocation of 60% equities and 40% bonds strikes a good balance between growing the Funds' assets, whilst also providing some downside protection and reasonable level of income

- The main focus of the bond allocation is to deliver income and provide diversification across a range of assets classes within fixed income space. Based on the desktop review, there no concerns over the Janus Henderson Preference and Bond Fund.
- The review highlighted a lack of diversification within the equity allocation as this investment is focussed on UK Equities only. Further, the performance of the Janus Henderson UK Equity Income & Growth Fund has been lacklustre during a period when UK equity markets underperformed other regions.

2.4 The report recommends that there is a review of the investment strategy in particular in relation to the equity allocation and a move to a global equity mandate.

2.5 The report also recommends that a short Statement of Investment Principles is also considered.

3.0 Conclusions

3.1 It has been some considerable time since a review of the investment management arrangements associated with Common Good and Trust Funds and Fife Educational Trust was undertaken.

3.2 A review has been undertaken by Hymans Robertson and although there are no concerns associated with the asset allocations or the Janus Henderson Preference and Bond Fund, Hymans Robertson have recommended a review of equity allocations and a move to a global equity mandate.

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Review of investment arrangements

Addressee

This paper is addressed to the Superannuation Sub-Committee ("the Committee") of Fife Council for the purposes of considering the Common Good and Trust Funds ("the Funds"). This purpose of this paper is to consider the appropriateness of the Funds investment arrangements.

This paper has not been prepared for any other purpose. It should not be released or otherwise disclosed to any third party except as required by law or regulatory obligation or without our prior written consent. We accept no liability where the paper is used by, or released or otherwise disclosed to, a third party unless we have expressly accepted such liability in writing. Where this is permitted, the paper may only be released or otherwise disclosed in a complete form which fully discloses our advice and the basis on which it is given.

Purpose of the paper

The objective for the Fife Educational Trust Fund and Common Good and Trust Funds is to generate income whilst preserving and growing capital. The purpose of this paper is to consider:

- The appropriateness of the investment strategy for this objective and, if appropriate, propose an alternative strategy.
- The appropriateness of the investment managers and assess their performance against these objectives.

Executive summary

- We believe the current high-level asset allocation of 60% equities and 40% bonds strikes a good balance between growing the value of the Funds' assets, whilst also providing some downside protection and a reasonable level of income.
- The main focus of the bond allocation is to deliver income and provide diversification across a range of asset classes within fixed income space. Based on our desktop review, we have no concerns over the Janus Henderson Preference & Bond Fund.
- Our review highlights a lack of diversification within the equity allocation as this investment is focused on UK equities only. In addition, performance of the Janus Henderson UK Equity Income & Growth Fund has been lacklustre during a period when UK equity markets have also underperformed other regions.

We recommend the Committee reviews the equity allocation with a view of moving to a global equity mandate.

Prepared by:-

Simon Jones, Partner
Jordan Irvine, Investment Consultant

For and on behalf of Hymans Robertson LLP

March 2020

Assessment of current investment strategy

Outline objectives

The Funds overarching objective is to generate income whilst preserving and growing capital. Below are what we consider to be the key requirements of the investment strategy to help deliver this objective:

- Ability to deliver long-term enhanced returns;
- Ability to deliver a predictable level of income;
- Diversification by asset class and geography; and,
- Integrated approach to responsible investment.

In practice, there may need to be a trade-off between these different requirements to get the most appropriate balance to meet the Funds' specific needs and objectives.

We note that the Committee does not currently have a governance document in place for these assets and propose that consideration be given to drafting a (short) Statement of Investment Principles or similar document.

Current investment strategy

The current strategy is split between equities (60%) and bonds (40%) in funds managed by Janus Henderson as shown in Table 1 below.

Table 1: Asset allocation as at 29 February 2020

Fund	Educational Trust	Common Good	Combined (£)	Combined (%)
UK Equity Income/Growth	1,604,590	2,611,731	4,216,321	60%
Preference & Bond	64,999	2,727,790	2,792,789	40%
Total	**1,669,589**	**5,339,521**	**7,009,110**	**100%**

Source: Janus Henderson

We have summarised the key aspects of each element of the current investment strategy:

UK Equities: the objective of this allocation is to achieve long-term capital growth and dividend income through investment in shares of UK companies. Historically, UK companies have paid higher levels of dividends with the Janus Henderson UK Equity Income & Growth Fund delivering a yield of 4.6%. By focussing on UK equities, the Funds equity allocation does lack diversification. We have a general preference for a global equity approach as opposed to a regional approach and comment on this further in the next section.

Preference and bond fund: the fund's main focus is to deliver income and provide diversification across a range of asset classes within fixed income including: government bonds, investment grade bonds, high yield bonds and loans. The Janus Henderson Preference and bond funds is currently providing income of around 3.9%. The managers active style of investment means that the manager will tilt its positions depending on market conditions. This allocation should therefore provide some level of protection during an economic downturn, whilst also offering reasonable returns during periods of risk-on sentiment.

Risk and return

Table 2 illustrates the impact of varying the growth/bond split on the risk/return metrics.

Table 2: risk and return metrics

	80% equities / 20% bonds	60% equities / 40% bonds	40% equities / 60% bonds	20% equities / 80% bonds
Return above cash	3.3%	3.1%	2.7%	2.2%
Annual volatility of returns	13.6%	10.2%	6.9%	3.9%
Fall in value of assets in 1 in 20 event over a 1 year period	(£1.6m)	(£1.2m)	(£0.8m)	(£0.5m)

Note: we have assumed the bond allocation is an absolute return bond fund.

The current investment strategy is expected to deliver a long-term return above cash of 3.1% p.a. with an annual volatility of around 10%. The strategy also delivers income of around 4% p.a., equivalent to £300k per annum. We believe the current strategy strikes a good balance between growing the value of the Funds' assets, whilst also providing some downside protection and a reasonable level of income. As such, we would not recommend any changes to the high-level asset allocation.

Potential considerations

Moving to a global equity allocation

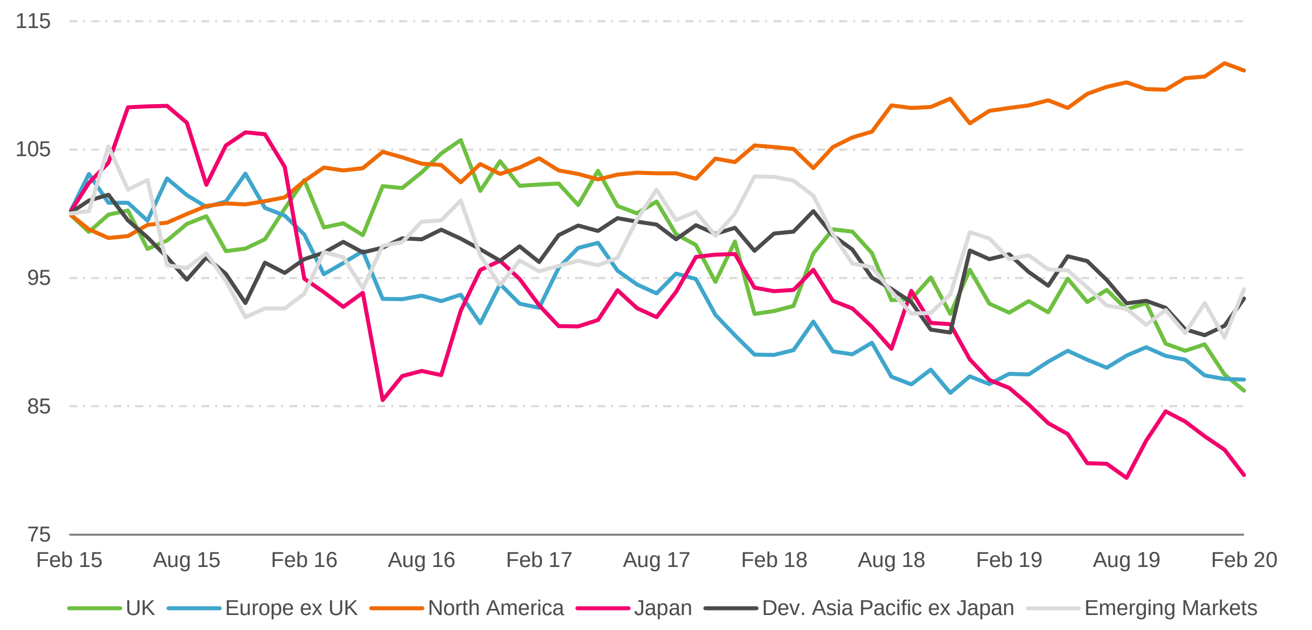
It is not uncommon for UK investors to have a 'home bias' towards their domestic market. An argument for UK pension schemes having a home bias to domestic stocks is that the UK equity market in some way reflects the UK economy and has exposure to sterling (like the liabilities of UK pension schemes). However, this argument is relatively weak as the UK market is a global market, with large multi-national firms listed in the UK generating a large proportion of their revenues from outside the UK (c.71% of the revenues generated by UK companies in the FTSE 100 Index are overseas). This makes the argument that the market reflects the UK economy or that it is largely sterling based a tenuous one (and in any case any currency concerns can be dealt with separately).

We believe there are a number of other reasons for considering a global portfolio of equity investments, rather than investing solely in the UK market.

- The UK market represents less than 5% of the global market, as measured by the allocation of the MSCI All Country World Index to UK-listed companies. Therefore, by allocating exclusively to UK-listed companies, the opportunity set is significantly limited. This results in significant levels of country risk and severely restricts portfolio diversification.
- The UK is also far from a representative subset of the global equity opportunity set when considered on a sector basis with a significantly higher proportion of stocks in the consumer staples, energy and materials sectors than the global market. It also has a significantly lower allocation to information technology stocks relative to the global market.
- Notably, two of the sectors which are disproportionately represented in the UK market, energy and materials, are considered to be among those most effected by macroeconomic factors such as global growth, geopolitical stability, oil prices and international trade. As a result, a UK equity portfolio will likely have a systematically greater concentration of exposure to these macroeconomic factors than a comparable international equity portfolio, which may not be desirable.

The chart below shows the underperformance of UK equities relative to global equities over the last five years.

Figure 1: Equity regional performance relative to FTSE All World (in local currency terms)



FTSE regional indices cumulative monthly returns relative to the FTSE All World cumulative monthly returns, in local currencies, rebased to 100. Feb 2015 – Feb 2020.
Source: DataStream

We have a general preference for a global equity approach as opposed to a regional approach because it provides the widest possible opportunity set for active managers to deliver returns. Many regions have relatively narrow markets with significant stock concentration (as noted above), making it increasingly difficult to add value relative to the overall market unless they get the decisions on only relatively few stocks right.

The above assumes the Committee wishes to remain invested in an actively managed equity fund. However, we would also be comfortable with the Committee moving to a passively managed strategy which would allow the Committee to reduce management fees and the level of tracking error, whilst gaining a global equity exposure.

We further assume that the Committee wishes to retain income from the mandate which would need to be factored into the review of this element of the strategy.

Sustainable investment

It is becoming increasingly prevalent amongst asset owners that the consideration of Environmental, Social and Governance (ESG) factors (of which climate risk is a particularly notable example) is necessary for the purposes of both risk mitigation and in creating potential investment opportunities. At present, the Committee does not have any particular focus on ESG issues within the development or implementation of its strategy beyond an implicit expectation that the manager should taken such issues into account.

Janus Henderson are rated by the PRI as A (Strategy Governance) with ratings for integration across equity and fixed interest varying between A and B. This suggests that Janus Henderson have scope for improvement.

Committee could give further consideration to the potential importance of this issue.

Review of investment managers

Janus Henderson Preference & Bond Fund

Overview

The fund's main focus is to deliver income and provide diversification across a range of sub asset classes within fixed income. The investment process takes a thematic approach to active asset allocation through the economic cycle, shifting towards different fixed income assets at different stages in the economic cycle. For example, as the economy begins to slow government bonds tend to perform more strongly; as the economy gets stronger high yield bonds are more likely to outperform. Each asset class is individually analysed using three key factors: fundamentals; valuation; and market momentum (which covers sentiment and technical factors). This helps to identify the asset classes that generate maximum income whilst aiming to preserve capital over the medium term. The manager is known for taking contrarian macroeconomic and market views, often moving away from conventional bond views and taking duration positions that are different to many peers, based on their views on the structural drivers of economies. This has benefited the fund's performance during a period of unconventional monetary policy since the 2008 global financial crisis where core bond yields have remained anchored at very low levels.

The style of credit investing is also a thematic overlay to the fund. The manager focusses on higher quality credit issuers across different regions and avoids certain industries and companies that are highly cyclical and operationally levered. The credit analysts filter through both internal and external ideas in order to select those companies that exhibit more stable characteristics.

This fundamental credit research incorporates ESG considerations and the managers have stated that they believe their preference for quality issuers means their approach typically avoids those companies with the worst ESG risk factors. The manager engages with companies and collaborates with their equity colleagues when engaging on ESG issues at the wider firm level.

The fund operates as a sophisticated UCITS Fund. A sophisticated UCITS Fund invests widely in financial derivatives or uses complex strategies and instruments. For this fund, the use of derivatives forms a fundamental part of the investment objective and they would be expected to be used in all market conditions. The manager uses credit default swaps (both index and individual names) to manage the credit exposure of the fund, and interest rate futures and swaps to manage the fund's duration positioning. The use of derivatives enables the separation of alpha and beta components and consequently their sources of return.

In terms of current positioning (as at 31 Jan 2020), the Fund has an interest rate duration of 4.8 years and a distribution yield of 3.9%. Currently, the fund is concentrated towards 'BBB' rated debt (allocation of 41%) and 'BB' rated bonds (allocation of 20%). The fund is well-diversified across the various fixed income sub sectors as shown in Table 3 below.

Table 3: asset class breakdown

Asset class breakdown	Weight
Investment Grade Non-Financial Corporate Bonds	35.5%
High Yield Non-Financial Corporate Bonds	28.8%
Investment Grade Financial Corporate Bonds	17.8%
Government Bonds	5.2%
High Yield Financial Corporate Bonds	4.6%
Loans	2.4%

Preference Shares	1.9%
Cash and derivatives	3.8%

Source: Janus Henderson. Position as at 31 January 2020.

Performance & Risk

Table 4 below shows the performance from the Fund and peer group over the last five years.

Table 4: calendar year performance (%)

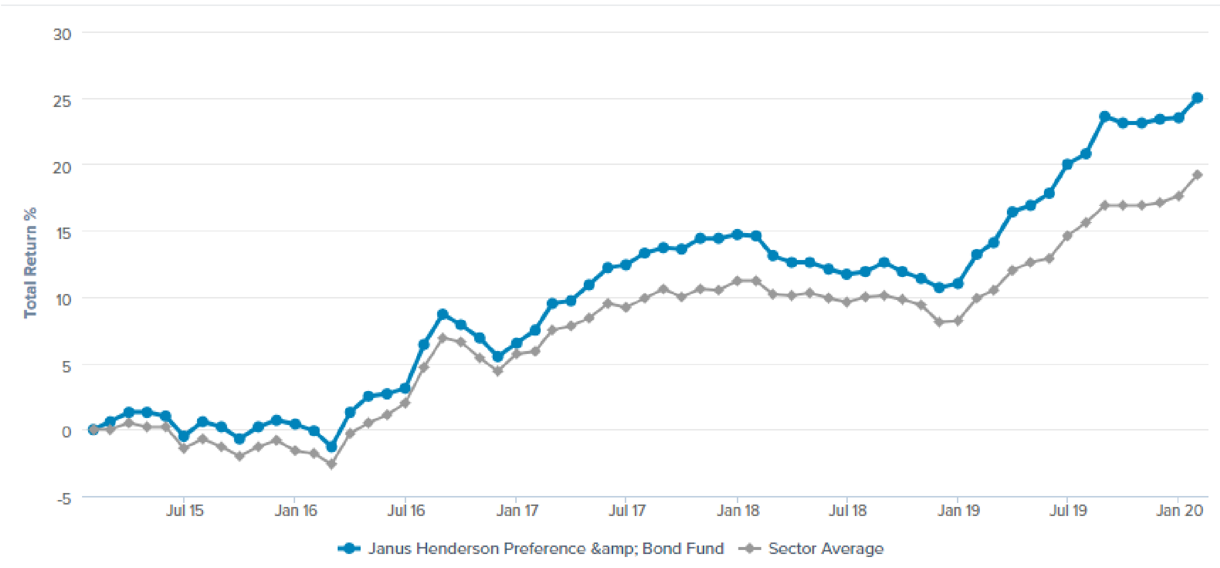
	2015	2016	2017	2018	2019
Janus Henderson Fund	2.4	5.7	8.2	-2.5	12.1
IA £ Strategic Bond Peer Group	-0.3	7.0	5.2	-2.5	9.2
Relative	**+2.7**	**+1.3**	**+3.0**	**0.0**	**+2.9**

Total returns for the I Acc share class (net of management fees), in GBP. Source: Henderson.

The fund has consistently outperformed its peer group, outperforming in four of the last five calendar years. In absolute terms, it has only posted two annual negative returns over the last decade (in 2018 and 2011).

Figure 2 below shows the cumulative five-year fund total return versus the peer group:

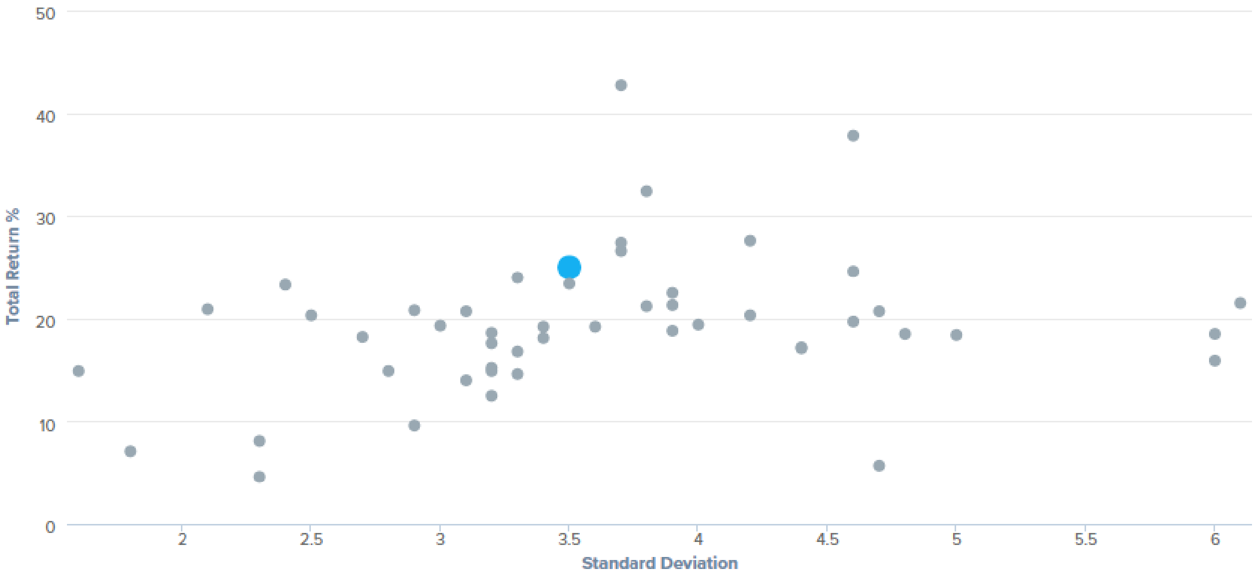
Figure 2: Total return vs. IA £ Strategic Bond Peer Group



Total returns, net of management fees, from 31 December 2014 to 31 December 2019, relative to the IA £ Strategic Bond peer group. Source: citywire.co.uk

In addition to delivering consistent outperformance of the peer group over the past five years, these returns have been delivered with a moderate level of volatility compared to peer funds:

Figure 3: Risk/Return vs. IA £ Strategic Bond Peer Group



Total returns and standard deviation, net of management fees, from 31 December 2014 to 31 December 2019. The Fund is marked in blue, compared to the other funds in the IA £ Strategic Bond peer group. Source: citywire.co.uk

Our view

We note the fund charges an annual management fee (AMC) of 0.60% p.a. with the current ongoing charges estimated at 0.69% p.a. For retail funds this seems reasonable, however a comparable institutional fund would charge around 30bps.

This is a strategic bond fund that offers well-diversified exposure across various fixed income sub-asset classes. It is managed by an experienced team, who have successfully applied their thematic approach over a long period. The managers are prepared to take contrarian views and will actively manage the Fund's duration, as they see appropriate. The Fund has delivered strong returns relative to its peer group over the last five years, although we would note this peer group contains a wide disparity of fixed income approaches that are not directly comparable.

Our research team do not formally rate the fund and would stress the views in this paper have been based on a desktop review only. However, based on our high-level review, we are comfortable that the fund can deliver the objectives of the Funds serving to provide some level of protection during an economic downturn, whilst also offering reasonable returns during periods of risk-on sentiment.

Janus Henderson UK Equity Income & Growth Fund

Overview

The Janus Henderson UK Equity Income & Growth Fund aims to deliver a stable yield (historically this has been around 4.6%) and capital appreciation over the medium to long-term. The manager's philosophy is that fundamental research can uncover undervalued stocks that are currently out-of-favour with the majority of investors. The manager applies this philosophy through a combination of focusing on large, stable high yield stocks and smaller-capitalisation stocks that may be under researched and/or going through operational issues which the manager believes are non-material and as a result these stocks can increase their dividend at an above average rate over time. This strategy leads to a value/high dividend yield tilt, contrarian positioning and a pronounced small-mid cap bias vs the wider market. In addition to common equity, the manager may also invest in bonds and convertible bonds to deliver returns.

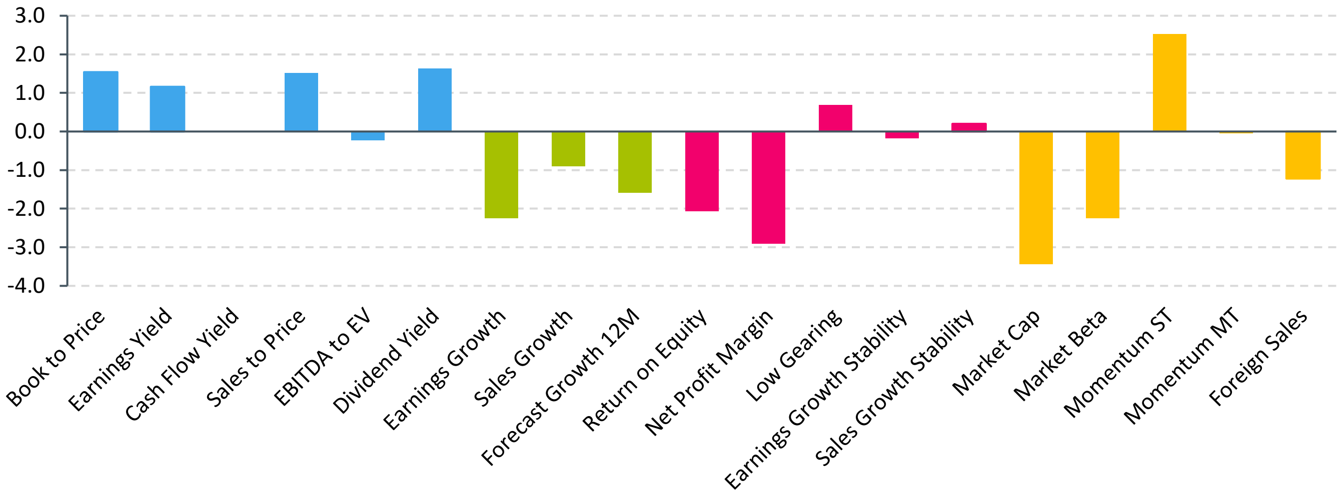
In terms of process, the manager starts with idea generation utilising quantitative screening and internal and external (independent) research to identify stocks that have an attractive dividend yield. There are no hard limits on the dividend yield requirement for the strategy and, as a result, the manager may invest in stocks with a low dividend yield if the manager believes the company will deliver an above-market dividend growth rate over a 3-year time horizon. The next step in the process is to determine the expected dividend growth rate and produce a valuation based on a discount model. This valuation is then assessed on an absolute basis and on a relative basis compared to peer equities and fixed income yields.

The final step in the process before a stock is added to the portfolio is a qualitative assessment of the business including analysis of competitive position, business model/operations and the management team. This element is assessed to determine a business' ability and/or the management team's willingness to increase dividend payments over time. For stocks that are currently undergoing operational issues the manager will scrutinise management's ability to turn-around the business and stress test the dividend and/or its future growth potential.

The final portfolio consists of around 80-160 stocks. Typically, the portfolio will include allocations to the larger capitalisation high dividend stocks in the index and a number of smaller-medium capitalisation stocks that can provide a higher opportunity for growth. The nature of the FTSE All-Share is that large high dividend companies represent a significant proportion of the benchmark and the allocation to these stocks helps to reduce the strategy's active risk. However, the manager combines these stocks with a number of higher risk small-cap stocks which can lead to large active positions and increase risk significantly. For example, the portfolio's third largest stock is currently iEnergizer PLC listed on the small-cap AIM market.

This approach to portfolio construction is conducive to a high tracking error of 6.4% (ex-ante) despite the large number of stocks. Portfolio risk is monitored regularly by the independent Investment Risk team reporting into the Chief Risk Officer (CRO). This includes analysing the current portfolio for ESG 'reg flags' and where issues are discovered the manager will engage with management, particularly on issues of governance. Figure 4 below shows the Fund's characteristics relative to the FTSE All Share index with value characteristics (blue bars) emphasised within the analysis.

Figure 4: Henderson UK Income & Growth portfolio vs. FTSE ALL-Share as a December 2019



Source: Style Analytics. NB Style tilts in excess of +/-1 are deemed to be significant.

Performance and risk

Table 4 below shows the performance from the Fund and peer group over the last five years.

Table 4: calendar year performance (%)

	2015	2016	2017	2018	2019
Janus Henderson UK Equity Income & Growth	3.0	9.5	8.8	-12.8	12.1
FTSE ALL-Share	1.0	16.8	13.1	-9.5	19.2
Relative	**+2.0**	**-7.3**	**-4.3**	**-3.3**	**-7.1**

Source: Henderson, returns for the I Inc share class (net of management fees) to 31st December 2019 in GBP

The performance of the fund has suffered since 2016, after the UK voted to leave the European Union which has been a headwind for the fund. Firstly, the perceived negative impact of the decision on the long-term health of the UK economy impacted the more domestically focused stocks, impacting the fund's overweight position to domestic financials. Relatedly, the fund's relative performance was also affected by having almost no exposure to the consumer staples sector, which has performed well since the Brexit vote as UK investors rotated into more defensive stocks, particularly those with international revenues streams.

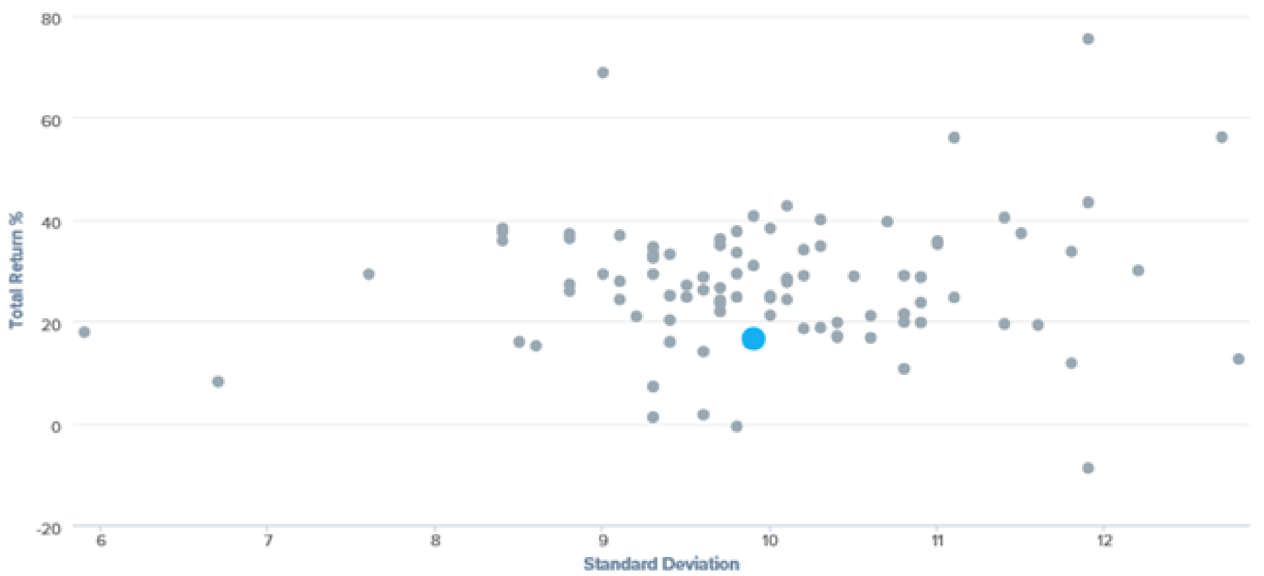
More recently, the fund's large overweight position to industrial stocks has detracted from performance. These stocks, while more internationally focused, have been negatively impacted by declining economic data and trade disputes. This effect is particularly evident since September 2018, when the fund has lagged the UK Income peer group significantly as shown below in Figure 5. It shows that the fund has underperformed the UK Equity Income peer group over the last 5 years returning 18.6% vs. the average peer group return of 29.6% (total return).

Figure 5 : Total Return Analysis vs. UK Equity Income Peer Group

Source: citywire.co.uk

Figure 6 below shows that over the last 5 years, the fund has achieved these returns at an average level of risk, as demonstrated by the fund's standard deviation of 9.9%, resulting in a lower Sharpe ratio than the peer group average. Sharpe ratio is a measure of the average return earned in excess of the risk-free rate per unit of total risk (i.e. the greater a portfolio's Sharpe ratio, the better its risk adjusted performance).

Figure 6: Total Return Analysis vs. UK Equity Income Peer Group



Source: citywire.co.uk

Our view

Janus Henderson charges an annual management fee (AMC) of 0.75% p.a. with total AMC including ongoing charges estimated at 0.84% pa.

The manager invests a significant portion (c.40%) of the fund in smaller capitalisation stocks which compose only 10% in the benchmark. These stocks are less liquid than their larger capitalisation peers and, as a result, this strategy has greater liquidity risk than many other UK equity funds.

The fund has underperformed its benchmark on a consistent basis and we believe there are better funds available in order to meet the Funds objectives.

Recommendation

Recommendation and next steps

We believe the current strategy asset allocation of 60% equities and 40% bonds provides a good balance between growing the value of the Funds' assets, whilst also providing some downside protection and a reasonable level of income. As such, we do not recommend any changes to the high-level asset allocation at this time.

We propose that the Committee prepare a short governance document setting out its approach to the management of assets for the Funds.

In terms of the bond allocation, we believe a diversified portfolio of fixed income assets best meets the Funds objectives. The Janus Henderson Preference and bond has the flexibility to rotate between asset classes as the macro background changes. The performance of the fund has been strong over an extended period of time and from our high-level review we do not have any concerns with the management of the fund. As such, we do not suggest any changes to the bond portfolio.

We have some concerns over the equity allocation, in particular:

- The lack of diversification from focussing solely on UK equities; and,
- The disappointing long term returns from the Janus Henderson UK Equity Income & Growth Fund.

Our recommendation is for the ISC to review their UK equity allocation with a view to moving to a global equity mandate.

Should the ISC agree to the above recommendation we would happy to provide details of our preferred global equity managers whether this be an active manager or passive market cap.

We look forward to discussing this paper with you.

General risk warnings

Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets.

Exchange rates may also affect the value of an overseas investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.

Hymans Robertson LLP, has relied upon or used third parties and may use internally generated estimates for the provision of data quoted, or used, in the preparation of this report. Whilst reasonable efforts have been made to ensure the accuracy of such estimates or data, we cannot be held liable for any loss arising from its use.