SUPERANNUATION FUND COMMITTEE - FRIDAY, 29 AUGUST 2014

Attached is a Background Document (UK Local Authority Annual Review 2013-14) for item D1 on the agenda for Friday, 29 August 2014 meeting of the Superannuation Fund Committee.

Agenda No	**Item**
D1	**Fund Position Statement** (Pages 3 - 36)

Yours sincerely

Peter Sass
Head of Democratic Services

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STATE STREET GLOBAL SERVICES.

UK Local Authority Annual Review 2013/14

A STATE STREET INVESTMENT ANALYTICS REPORT

CONTENTS

Special Topics 2

Some Thoughts on the DCLG Consultation 2

How Does Tobacco Affect Your Fund's Health? 7

2013/2014 10

Market Overview 10

Performance 11

Asset Allocation 12

Equities 13

Bonds 16

Longer Term 17

Performance 17

Risk and Returns 19

Asset Allocation 20

Equities 21

Bonds 22

Alternatives and Property 23

Performance Relative to Corporate Funds 25

Statistical Appendix 26

Annual, Three- and Five-Year Rolling Returns 26

Performance Relative to Market Indices 27

Asset Mix, Activity and Currency 29

Glossary 30

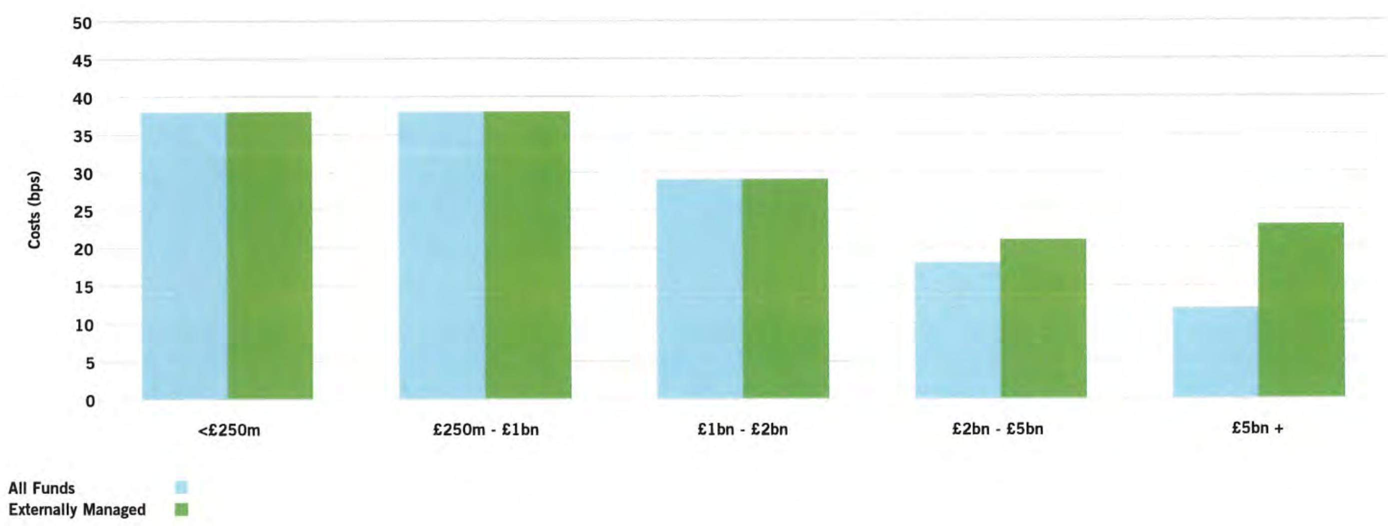
Some Thoughts on the DCLG Consultation

In May 2014, the Department for Communities and Local Government (DCLG) issued a consultation paper looking for opportunities for collaboration, cost saving and efficiencies within the Local Government Pension Scheme (LGPS). We are currently working on our response to this consultation but thought it may be interesting to share some of our thoughts around a couple of the issues raised.

Big Is Not Necessarily Better — However it is Cheaper

In last year's Local Authority Annual Review we showed that the largest funds within the LGPS had all performed well over the longer term — achieving an above median return at lower than median risk but we argued that size, in itself, was not enough to guarantee success. What increased size should bring about is reduced investment management costs and we demonstrated a clear correlation between fund size and investment management fees paid in the last cost survey 'Investment Management Running Costs' 2010, shown in Chart 1 below.

Chart 1: Fees by Fund Size*



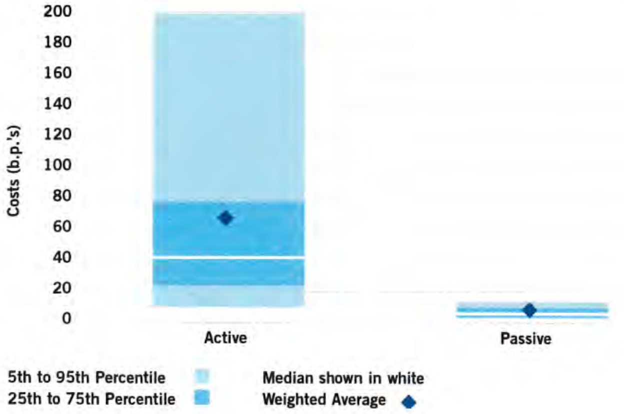
* Source: State Street Investment Analytics, 2014.

One of the proposals in the consultation is for Common Investment Vehicles to be put in place across the LGPS, allowing smaller funds to access the lower fees that could be negotiated previously only by funds with substantial asset values.

However, if the government is concerned only with costs, these savings will still be some way below the cost savings that can be made by moving from active to passive investing. This is demonstrated in Chart 2 below.

LOOKING AT COSTS IN ISOLATION IS MEANINGLESS. THE FOCUS SHOULD ALWAYS BE ON VALUE FOR MONEY.

Chart 2: Ranges of Costs by Active and Passive Management*



There is obviously considerably less opportunity to reduce the fees for passively-managed investment because of the relatively low fee levels already in place.

For alternative investments (which are almost entirely managed on an active basis) there is strong evidence to show that size matters. In the SSIA 2011 research 'Trends in Private Equity Investing and Reporting', we stated that:

'It is simply not enough to allocate to private equity. Investing in private equity may be worth pursuing because the market is inefficient, due to the academic findings relating to persistence of performance, and that fund performance improves with partnership experience. Selecting the right investments is crucial. The key question for investors is to consider how realistic or likely it is for them to gain access to the top managers in this market.'

Greater size will provide greater access in this area.

* Source: State Street Investment Analytics, 2014.

Past performance is not a reliable indicator of future results.

There is a similar argument to be made for property. Property can be accessed either directly or indirectly. Smaller funds tend to hold their investment in this area indirectly and this has cost them in terms of relative performance over the last decade:

Table 1: Performance of Property by Investment Type*

% p.a.	10 Years to end March 2014
IPD UK Monthly All Property Index	5.8
AREF/IPD UK All Property Index	3.6

A Focus On Costs Is Too Narrow

We have stated repeatedly that costs cannot be viewed in isolation, but need to be assessed together with any excess return delivered so that genuine value for money can be determined and evaluated.

If the principal focus was on costs, then all funds would move all their quoted equity and bond investment to passive mandates and disinvest from any alternative assets (including property). Over the recent past, this would have been a successful strategy in terms of investment returns too — avoiding alternatives would have added value (although fund volatility would have increased). However, making this move would mean that funds potentially missed out on value added through active management. Therefore, it is important to ask the question:

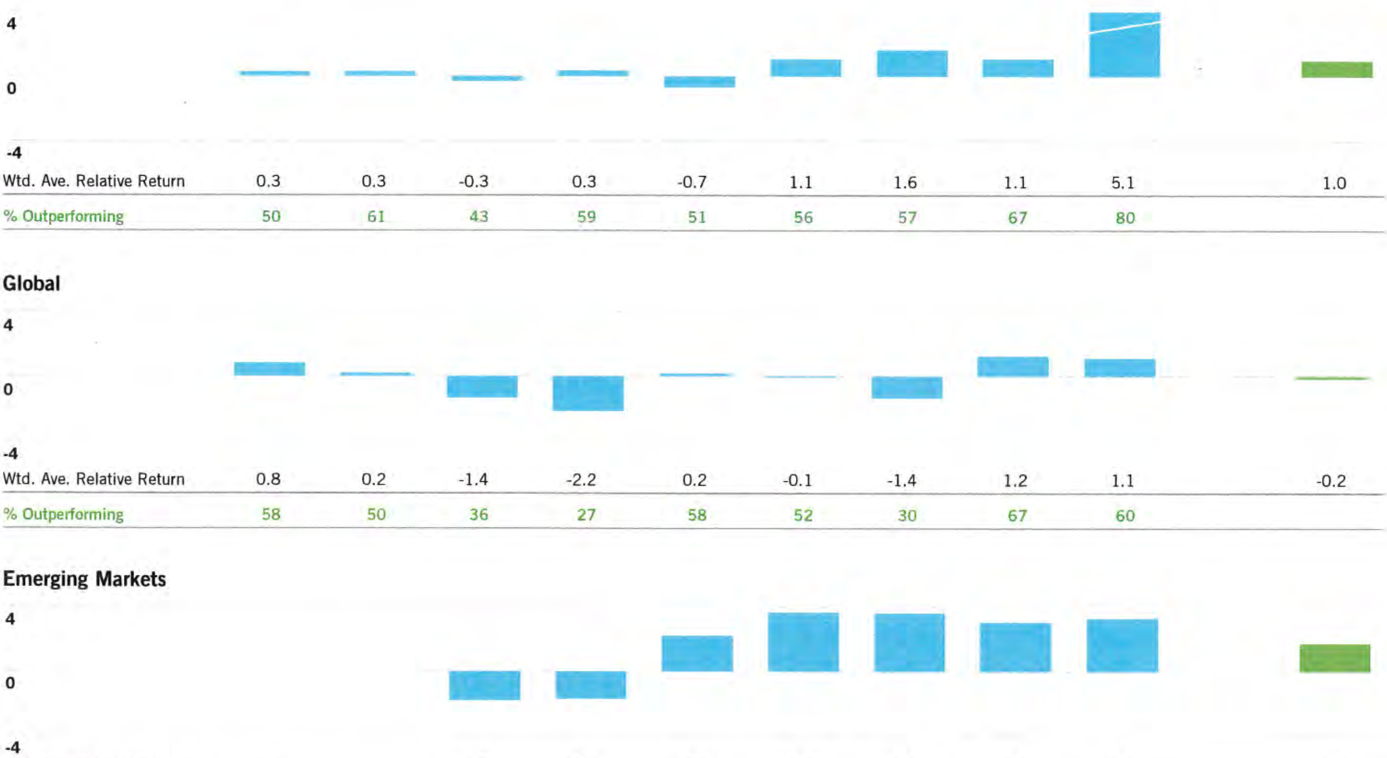
Does Active Management Deliver Value For Money?

"Most investors, both institutional and individual, will find that the best way to own common stocks (shares) is through an index fund that charges minimal fees. Those following this path are sure to beat the net results (after fees and expenses) of the great majority of investment professionals." Warren Buffet, 1996.

* Source: State Street Investment Analytics, 2014.

The results of our latest analysis of active equity managers (to end December, 2013) includes some interesting numbers:

Chart 3: Performance of Active Equity Managers Relative to Benchmark*



UK

	2005	2006	2007	2008	2009	2010	2011	2012	2013	% p.a. 9 Years[1]
Wtd. Ave. Relative Return	0.3	0.3	-0.3	0.3	-0.7	1.1	1.6	1.1	5.1	1.0
% Outperforming	50	61	43	59	51	56	57	67	80	

Global

	2005	2006	2007	2008	2009	2010	2011	2012	2013	% p.a. 9 Years[1]
Wtd. Ave. Relative Return	0.8	0.2	-1.4	-2.2	0.2	-0.1	-1.4	1.2	1.1	-0.2
% Outperforming	58	50	36	27	58	52	30	67	60	

Emerging Markets

	2005	2006	2007	2008	2009	2010	2011	2012	2013	% p.a. 9 Years[1]
Wtd. Ave. Relative Return	-	-	-1.8	-1.7	2.2	3.7	3.6	3.0	3.3	1.7
% Outperforming	-	-	39	42	62	61	61	81	70	

[1] The long-term percentage of funds outperforming the index is not shown because of the impact of survivor bias on the range of long-term results.

UK equity managers have outperformed their benchmarks in each of the last four years and in the latest calendar year by a significant margin, with 80% of portfolios outperforming. This brings the long-term result (9 years — the length of time this analysis has been run) for this area to 1% p.a. above index. After fees of 0.5% p.a. have been deducted, this is still an outperformance at 0.5% p.a. over this period.

The global equity results are more mixed and generally less positive. The move to global equity investing came largely on the back of a period of active underperformance across the traditional, regional style of investing. The two principal beneficiaries of this move attracted a very high concentration of UK pension fund money. These firms had a particularly poor period in 2007/2008 when many funds moved elsewhere. This manager concentration has reduced substantially.

* Source: State Street Investment Analytics, 2014.

Past performance is not a reliable indicator of future results.

Within emerging markets, active managers have performed well in each of the last five years. Although there has been a strong concentration with one (successful) investment manager, we are seeing the spread of managers disperse as this mandate gains popularity.

These numbers all include a mixture of pooled investments (shown after fees) and segregated investments (shown before fees).

Short-term results can just be 'noise' but the longer-term UK equity number is significant. However, UK equity mandates continue to decline as an overall part of the average local authority pension fund with funds preferring to invest globally. The global active numbers are, on aggregate, still not compelling.

In the Myners report of 2001, Paul Myners stated that:

"Trustees should consider explicitly for each asset class invested, whether active or passive management would be more appropriate given the efficiency, liquidity and level of transaction costs in the market concerned; and where they believe active management has the potential to achieve higher returns, set both targets and risk controls that reflect this, giving managers the freedom to pursue genuinely active strategies."

This approach was never fully implemented by most funds.

Active management can have a place, and many funds have benefited from the active approach. We believe that the funds that have benefited most are those which have been long-term investors, who understand the manager's approach and are comfortable with the inevitable periods of underperformance. The cost of switching managers is not insignificant and these costs have had a drag on the longer term performance of funds that switch relatively frequently.

Funds that currently have active management in place should not be compelled to change their strategy. However, funds that are looking to make changes should take on board the Myners recommendation and bear in mind the following:

Funds should only invest actively if they believe all of the following criteria can be fulfilled and demonstrated:

1. After fees, active managers can outperform the market in which they are looking to invest
2. They have the skill to identify that manager
3. They will appoint that manager at the right time.

ACTIVE MANAGEMENT SHOULD BE VIEWED AS A LONG-TERM COMMITMENT.

How Does Tobacco Affect Your Fund's Health?

With the responsibility for public health having recently transferred from the NHS to local government, investment in the tobacco sector has become (once again) a topic of much debate amongst LGPS funds.

The legal advice obtained by the LGPS Shadow Board in April 2014 found that:

"An administrating authority has both fiduciary and public law duties. The power of investment needed to be exercised for investment purposes.

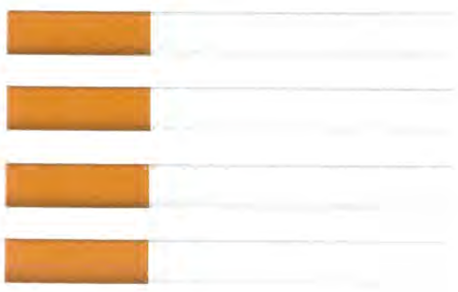
Investment decisions should therefore be directed towards achieving a wide variety of suitable investments, and to do what was best for the financial position of the fund, balancing risk and return in the normal way.

So long as that remains true, the precise choice of investment may be influenced by wider social, ethical or environmental considerations, so long as this does not risk material financial detriment to the fund."

Therefore, members of LGPS who have ethical objections to investing in tobacco stocks will be able to propose that their fund looks for alternatives to tobacco that deliver the same long term investment returns.

Screening equity portfolios to remove a given component will always have some level of influence on the return generated by the funds' investments, either positively or negatively. Any fund wishing to make a change should consider the following points when reviewing the tobacco sector:

- Holdings in cigarette manufacturers are viewed by investors as classic defensive stocks. They are cash generative, offering a predictable dividend yield along with a steady growth in earnings which, in turn, feeds through to rising stock prices



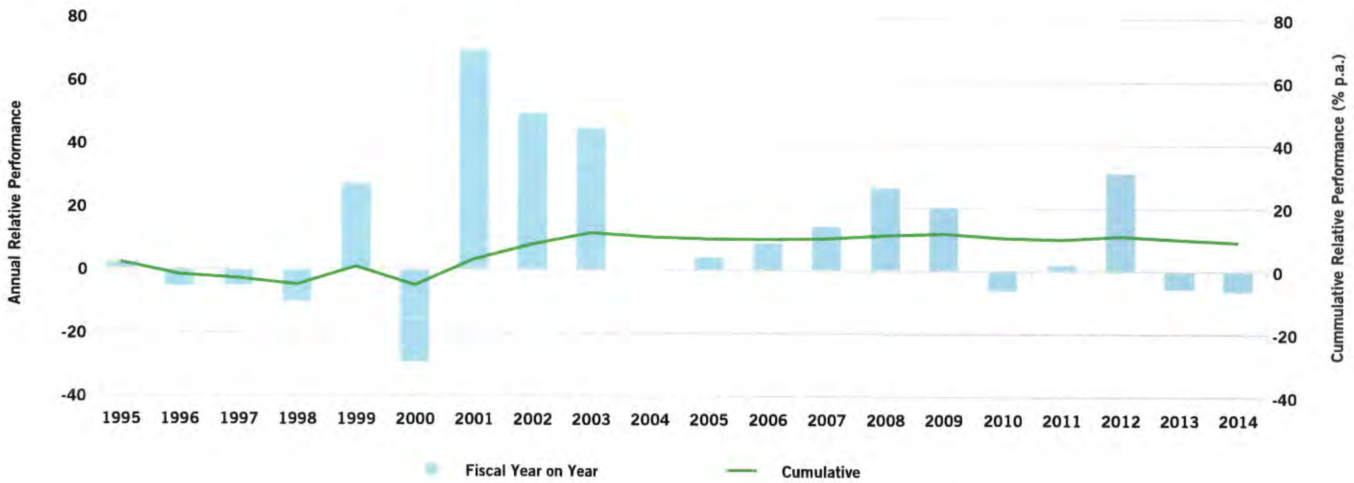
4% OF THE FTSE ALL-SHARE INDEX IS MADE UP OF THE TOBACCO SECTOR.

* Source: State Street Investment Analytics, 2014.

Past performance is not a reliable indicator of future results.

- The sector's defensive characteristics have allowed it to weather the two major financial storms of recent years — the bursting of the dotcom bubble in the early noughties and the global financial crisis precipitated by the fallout from the Lehman collapse
- Chart 4 below plots the performance of the sector relative to the broad FTSE All-Share Index over the last 20 years

Chart 4: Performance of Tobacco relative to FTSE All-Share Index*

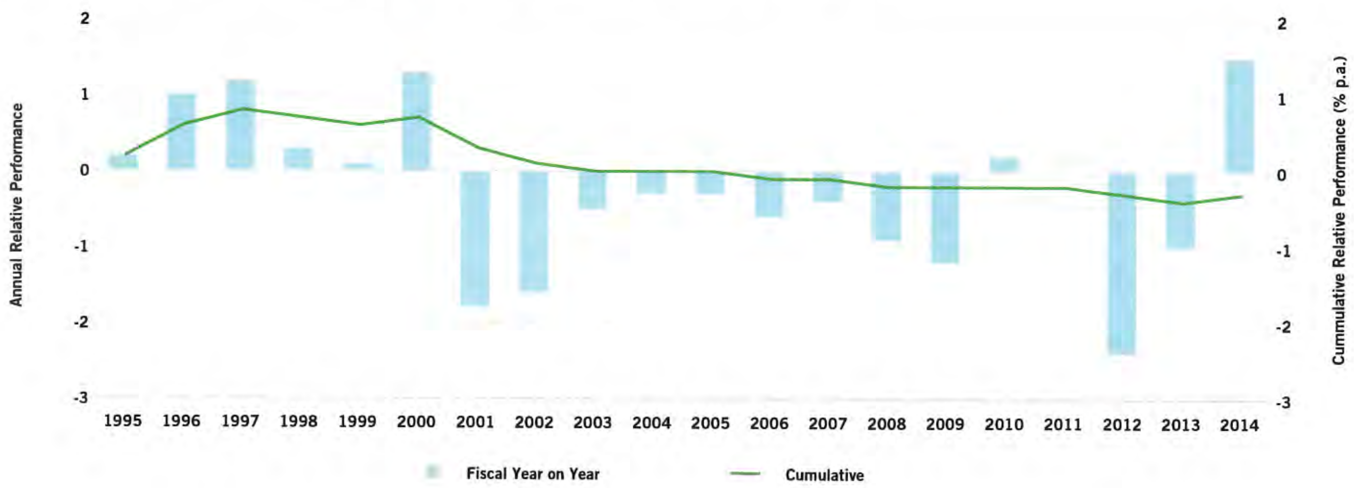


- The tobacco sector has outperformed the broad market in 13 of the last 20 years. Over the entire period, the sector has outperformed the market by almost 10% p.a.
- The tobacco sector represents around 4% of the FTSE All-Share Index. Although this weighting was lower in earlier periods, a UK equity portfolio eschewing the sector would have given up a relatively substantial level of return.

* Source: State Street Investment Analytics, 2014.

As well as the impact on performance, the decision not to invest will have an effect on the way the remaining portfolio behaves. A portfolio that excludes tobacco will perform quite differently from the index and this must be taken into account when deciding not to invest. We do not have data for the full 20 years for the FTSE All-Share ex Tobacco but do have for the FTSE All-Share ex Vices (the major component of which is tobacco). The performance of this index relative to the FTSE All-Share Index is shown in Chart 5 below:

Chart 5: Performance of the FTSE All-Share ex Vices Relative to the FTSE All-Share Index*



In periods of market exuberance, such as 2000 before the dotcom bubble burst, funds avoiding tobacco would have markedly outperformed as defensive stocks trailed badly. Thereafter, avoiding the sector was positive until the latest year.

If we look at the impact on volatility, we see that the risk of the screened index is higher over time.

In Summary

Divesting from any asset class will have potential long-term implications on both the return and the risk profile of the fund. These implications need to be fully understood and resolved to the satisfaction of the trustee before any decision is taken.

Table 2: Volatility of Indices in the Last 3, 5 and 10 Years*

% p.a.	3 Yrs	5 Yrs	10 Yrs
FTSE All-Share	12.2	13.8	14.0
FTSE All-Share ex Tobacco	12.4	14.1	14.3

* Source: State Street Investment Analytics, 2014.

Past performance is not a reliable indicator of future results.

2013/2014 Universe Results

The average local authority pension fund returned 6% in 2013/14. Equity markets continued to perform strongly with most developed markets producing returns in the high 'teens in local currency. However, much of this return was eroded for UK investors in the US and Japan by the strength of Sterling which gained 9% against the US Dollar and 17% against the Yen over the year.

DEVELOPED EQUITY MARKETS SURGED AHEAD WHILST EMERGING REGIONS CONTINUED TO LOSE VALUE.

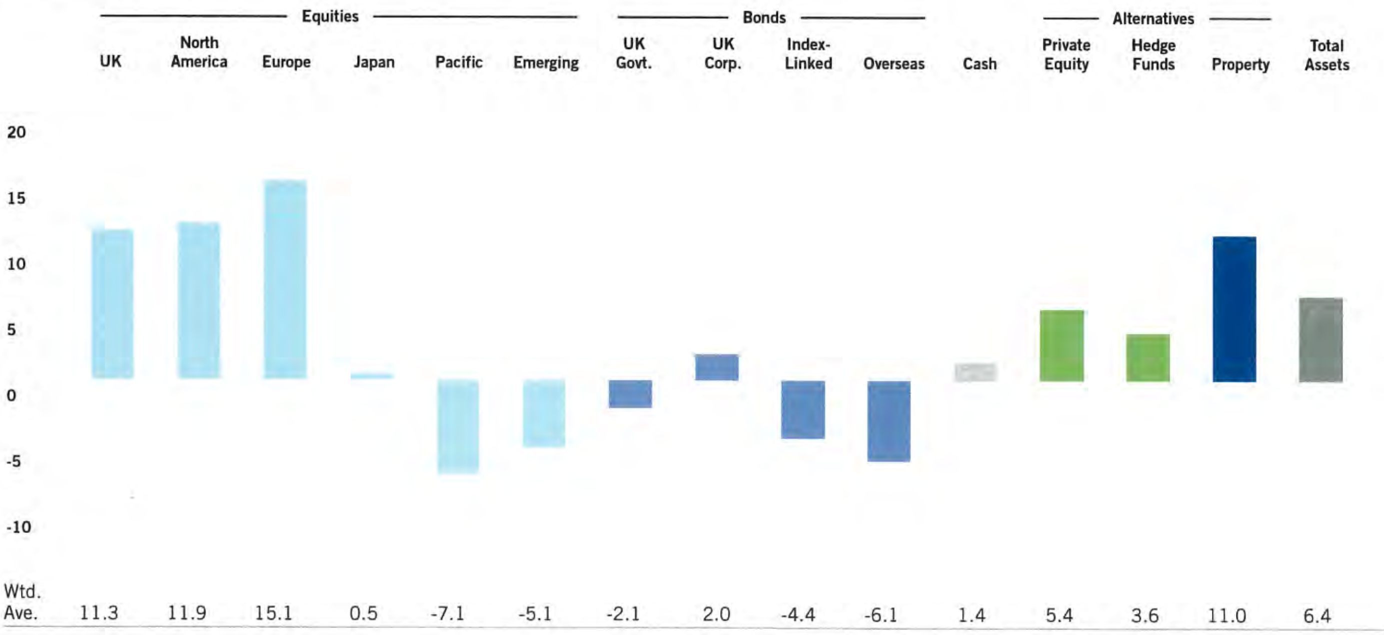
UK equities were below the overseas average but returned 11% for the year. Active managers continued to add value relative to the FTSE All-Share index, the fourth consecutive year that this has now occurred.

UK bonds posted only their third year of negative results in the last twenty, giving up some of the extremely strong results of the recent past. Index-linked gilts, likewise produced a small negative for the year.

The performance of alternative investments was disappointing. Private equity returned 5%, whilst hedge funds averaged only 4%. Pooled multi-asset (diversified growth) investments returned only 3% for the year.

Property returned 11% for the year, an excellent result in absolute terms, but below the IPD index. The range of results has stabilised. This year 90% of fund returns were within a range of 6% which is in line with both the previous 12 months and the longer-term norm. The range is driven by the return differential between equities and bonds.

Chart 6: 2013/14 Returns (%)*



* Source: State Street Investment Analytics, 2014.

Equity returns were 8% on average with the range of results increasing markedly on the previous year as developed and developing markets diverged significantly in terms of return outcomes. Sterling investors gave up most of their Japan return as a result of the steep fall in the value of the Yen.

The range of results from bonds, although it continued to reduce, was still almost as wide as that of equities. The large disparities between government and corporate debt that we had seen in 2012/13 were substantially reduced but overseas investment tended to drag down performance over the period.

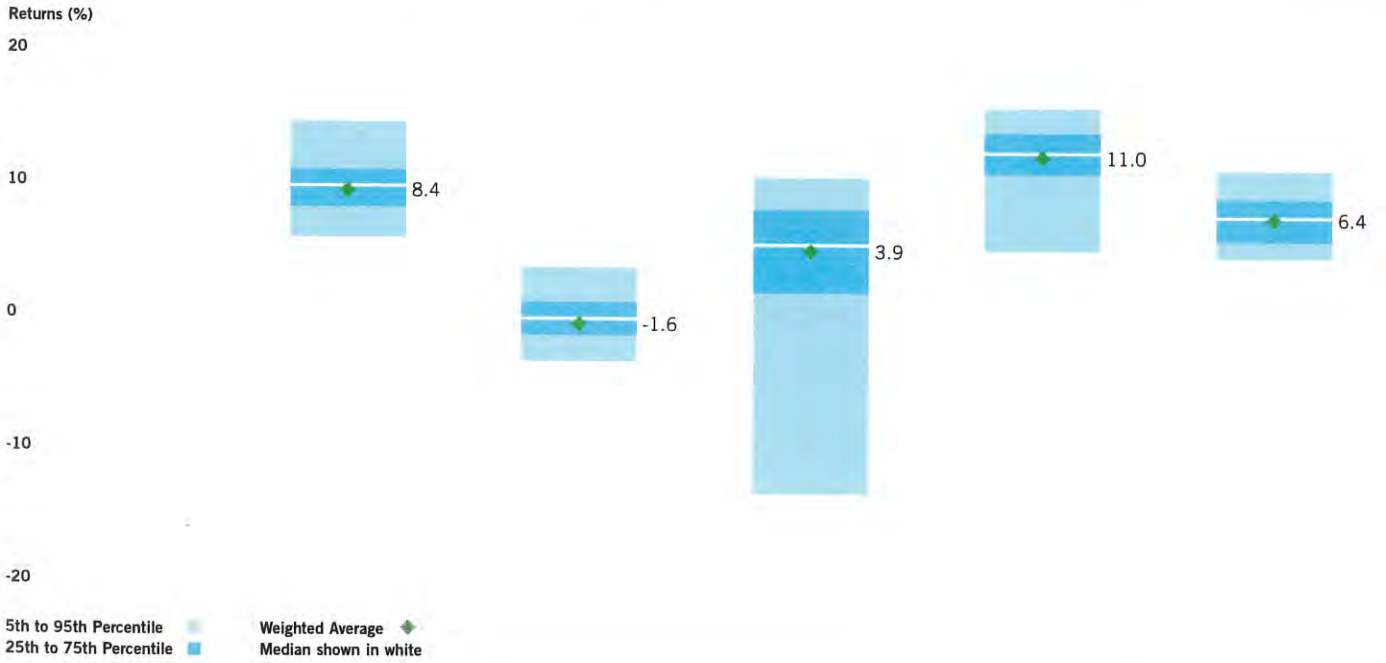
As is almost always the case, alternative assets delivered the largest range of results. Most funds that invest in alternatives now have exposure to more than one of the subgroups. Those who invested principally in private equity were at the top end of the range, whilst those with a high commitment to hedge funds were at the lower end.

The range of property returns narrowed as the differential performance between direct and indirect investment reduced.

85% of local authority funds continue to be cash flow positive. The net investment into the universe as a whole was up almost 50% from last year at £2.3 billion. This represented less than the level of income generated over the period, of £2.9 billion.

Chart 7: Universe Range of Returns 2013/14*

2013/14 (2012/13 in brackets)	Equities	Bonds	Alternatives	Property	Total Assets
5th - 95th Percentile	8.7 (2.9)	7.1 (8.5)	23.8 (17.9)	10.8 (17.0)	6.6 (6.1)
25th - 75th Percentile	2.8 (1.8)	2.5 (3.3)	6.3 (6.4)	3.1 (3.5)	3.2 (2.1)



* Source: State Street Investment Analytics, 2014.

Past performance is not a reliable indicator of future results.

Asset Allocation

It is likely that more funds will see cashflow moving from positive to negative in the relatively near term. This will create new challenges in terms of setting strategy and is ultimately likely to result in a more conservative asset allocation as funds worry about being forced sellers of volatile asset types such as equities. To date, most funds have decided to retain broadly unchanged strategic asset allocations and have not 'de-risked' in the same way that we have seen across corporate funds.

Table 3 shows that, in the last year, £0.7 billion was withdrawn from equities. This was invested, along with the new money, principally into property, bonds and cash. The inflow into bonds is almost certainly the result of rebalancing back to benchmarks as bond allocations fell on the back of relatively poor performance.

A RELATIVELY HIGH EQUITY COMPONENT WILL HAVE HAD A POSITIVE IMPACT ON PERFORMANCE.

Table 3: Universe Average Asset Allocation*

%	End March 2013	End March 2014	Net Inv. (£bn)
Equities	63	63	-0.7
Bonds	18	16	0.7
Cash	3	3	0.4
Alternatives	7	7	0.2
Pooled Multi-Asset	2	3	0.7
Property	7	8	1.2

Almost £1 billion was invested into pooled multi-asset mandates. These now make up 3% of the average fund. 32 funds now have some exposure to this area, ranging from over 60% of the total fund value down to less than 1%.

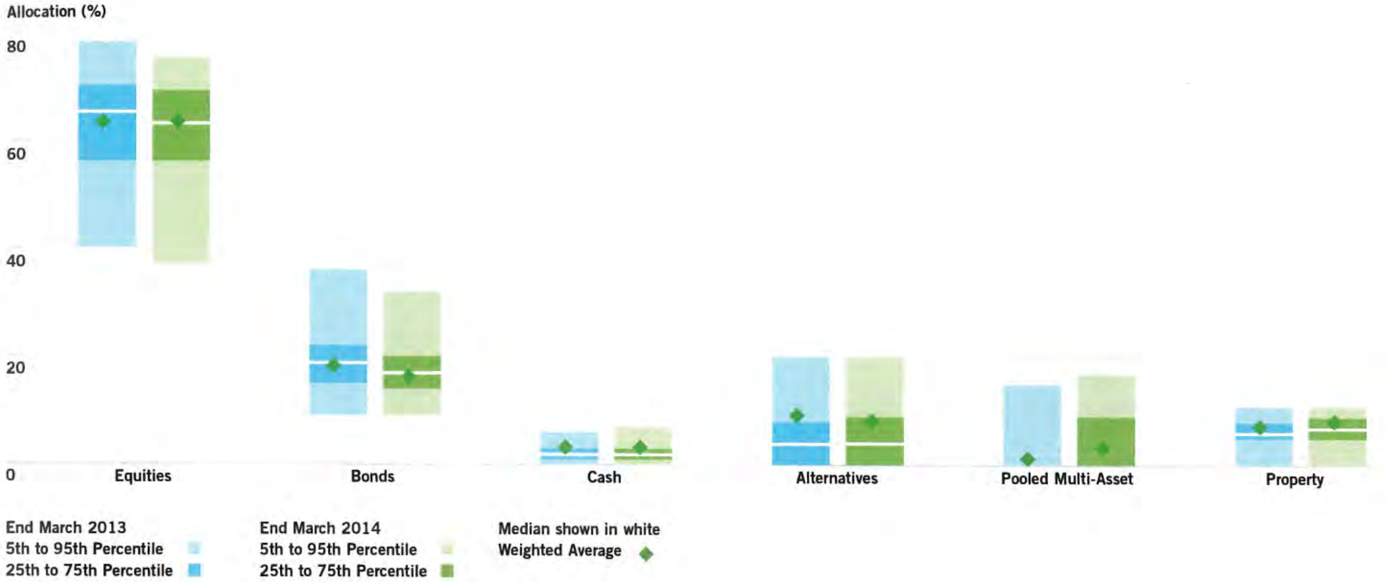
The exposure to alternatives continues to be quite skewed. 30% of funds still have no exposure to these assets while, at the other end of the scale, one fund has more than 30% of their entire fund invested in this area.

90% of funds have some allocation to property, with the average exposure increasing to 8%. This increase was a combination of the positive cash inflow and strong relative performance over the year.

* Source: State Street Investment Analytics, 2014.

Chart 8 shows the range of asset allocation across the funds in the universe. The ranges are broadly unchanged, with the bulk of funds clustering around a very similar strategic allocation.

Chart 8: Universe Range of Asset Allocations*



Equities

Table 4 shows that the average fund produced a total equity return of 8% for the year, 1.5% ahead of the FTSE All-World Index. This reflects the outperformance by UK equities over the aggregate of overseas markets (11.3% vs 6.4%) in the latest year.

The UK equity exposure of the average fund declined slightly further and is now only 38% of total equity investment as can be seen in Table 5 below.

Table 4: 2013/14 Performance Relative to FTSE All-World Index*

	% Return
Equity	8.4
Index	6.8
Relative Return	*1.6*

Table 5: UK Equity Weighting*

	End March 2013	End March 2014
% of Total Equity	39	38
% of FTSE All-World Index	8	8

* Source: State Street Investment Analytics, 2014.

Past performance is not a reliable indicator of future results.

Chart 9 shows the equity allocation as at the end of March 2014. There is a continued move to investing through global equity vehicles either pooled (global inc UK) or segregated, which will be shown under the regional allocations.

At regional level, fund performance in the UK and US was good, both in absolute terms and with outperformance of the index. In Europe, the market performed well but funds trailed the benchmark. Returns from the Pacific and emerging markets were disappointing but active managers were generally able to add value as can be seen in Chart 10.

Chart 9: Equity Allocation at Year End March 2014*

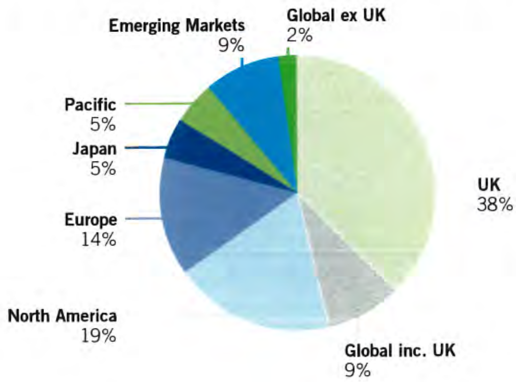
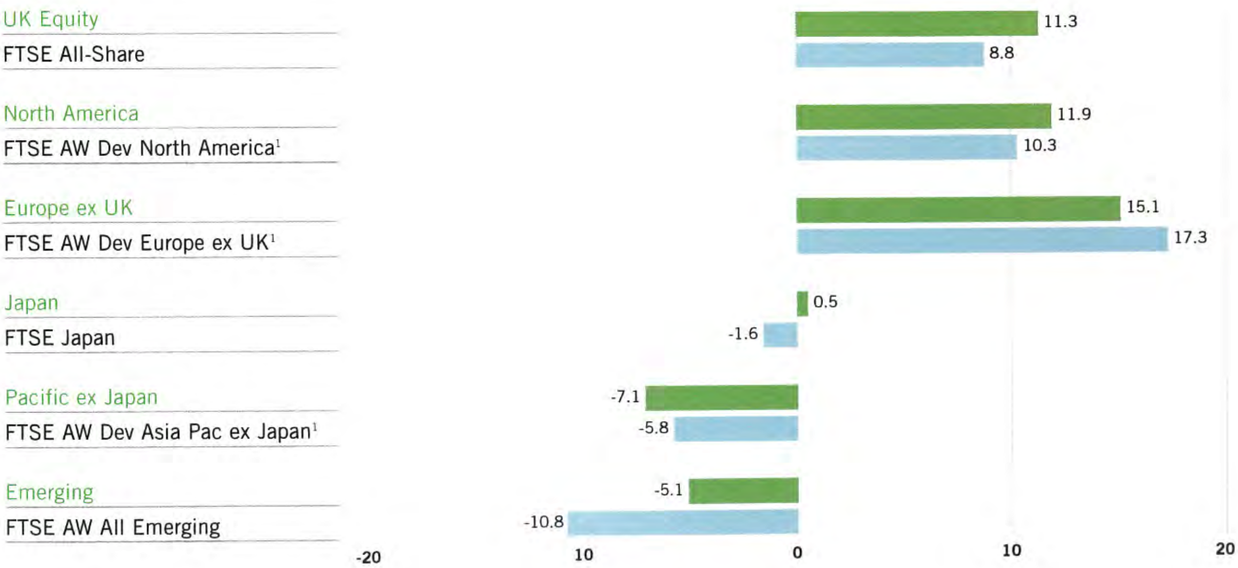


Chart 10: Regional Performance Relative to FTSE All World Index*



* Source: State Street Investment Analytics, 2014.
[1] FTSE World Index until end 2013.

Within the UK, larger stocks underperformed again in the latest year as can be seen in Table 6 below. At stock level (in Table 7) the largest contributors both positive and negative were a mixed bag with Banks featuring at both ends of the performance spectrum. At sector level, Chart 11 shows that the oil and gas and mining sectors continued to perform poorly whilst telecomms did very well on the back of the excellent performance of Vodafone.

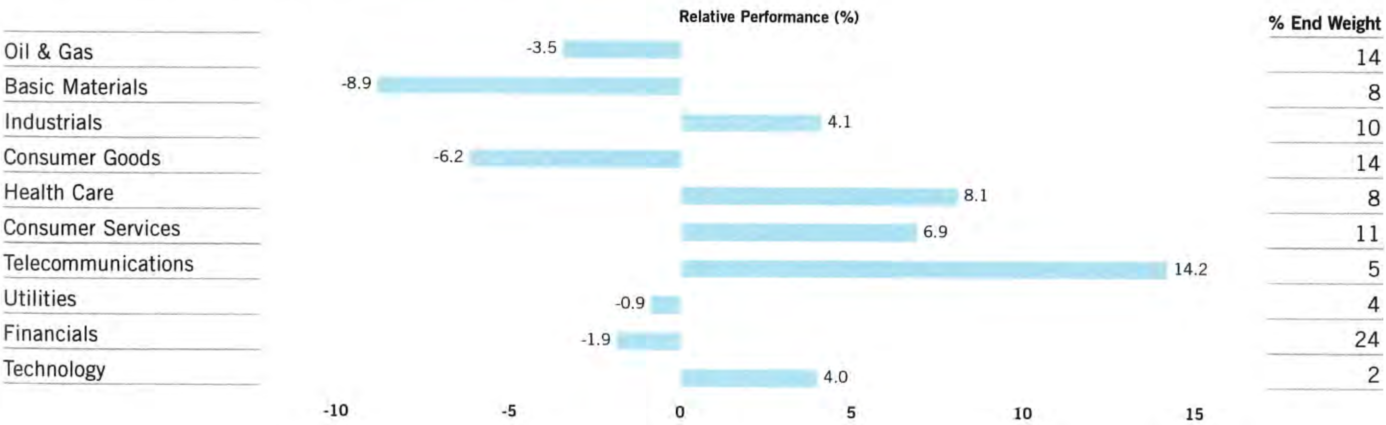
Table 6: UK Equity Index Returns 2013/14*

	% Return
FTSE All-Share	8.8
FTSE 100	6.7
FTSE 250	19.9
FTSE SmallCap	20.4

Table 7: UK Equity Top and Bottom Contributors 2013/14*

Top		Contribution %	Bottom		Contribution %
Vodafone Group	Mobile Telecommunications	1.0	Diageo	Beverages	-0.3
Lloyds Banking Group	Banks	0.6	Barclays	Banks	-0.3
BT Group	Fixed Line Telecommunications	0.4	Tesco	Food & Drug Retailers	-0.4
AstraZeneca	Pharmaceuticals & Biotechnology	0.4	Standard Chartered	Banks	-0.5
Aviva	Life Insurance	0.3	HSBC Holdings	Banks	-0.9

Chart 11: 2013/14 UK Equity Industry Relative to FTSE All-Share Index*



* Source: State Street Investment Analytics, 2014 / FTSE All-Share UK Monthly Review.

Past performance is not a reliable indicator of future results.

Bonds

Chart 12 shows that UK fixed income still makes up the majority of the average fund's total bond investment. At the end of the year, the split was two-thirds corporate/one-third government bonds, a split that has remained broadly unchanged over the recent past.

Table 8 shows that corporate bond returns were the strongest of the sector at 2%, some 4% above the return generated from investing in gilts. Long-dated gilts fell further than shorter-dated. This is reflected in the continued outperformance of funds' gilt investments relative to the FTSE UK Gilts All Stocks Index.

Overseas bonds remain a relatively small part of the average bond portfolio and last year the performance was relatively poor. Table 10 shows the range of results within this asset class. For most funds these investments remain an off-benchmark investment decision.

The absolute return bond portfolios (where the bond assets are tasked with returning a cash/cash-plus type return rather than a return based on a bond index) that we had begun to see in 2012/13 continued to gain traction in the latest year.

Table 8: UK Bond Performance 2013/14 (%)*

UK Bonds	0.4
UK Government Bonds	-2.1
FTSE UK Gilts All Stocks	-2.6
FTSE UK Gilts <5 yrs	-0.7
FTSE UK Gilts 5 – 15 yrs	-3.6
FTSE UK Gilts >15 yrs	-3.1
UK Corporate Bonds	2.0
BAML Corporate Bonds	1.6

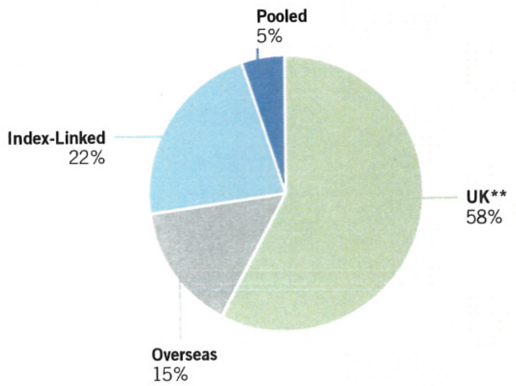
Table 9: Index-Linked Performance 2013/14 (%)*

Index-Linked	-4.4
FTSE UK Gilts Index-Linked All Stocks	-3.8
FTSE UK Gilts Index-Linked <5 Years	-1.5
FTSE UK Gilts Index-Linked >5 Years	-4.4
BAML US TIPS	-15.1

Table 10: Overseas Bond Performance 2013/14 (%)*

	£	Hedged
Overseas Bonds	-6.1	
JPM Global Government ex UK	-8.5	1.5
JPM US Government	-10.3	-1.6
BAML US Corporate	-7.6	1.4
JPM Euro Government	3.7	13.8
BAML Euro Corporate	1.8	11.8
JPM Japan Government	-16.4	0.5
JPM Japan Corporate	-16.0	1.0

Chart 12: Bond Allocation at End March 2014*



* Source: State Street Investment Analytics, 2014.
** UK Bonds were allocated to 33% Government Bonds/67% Corporate Bonds at the end of March 2014.

Longer Term

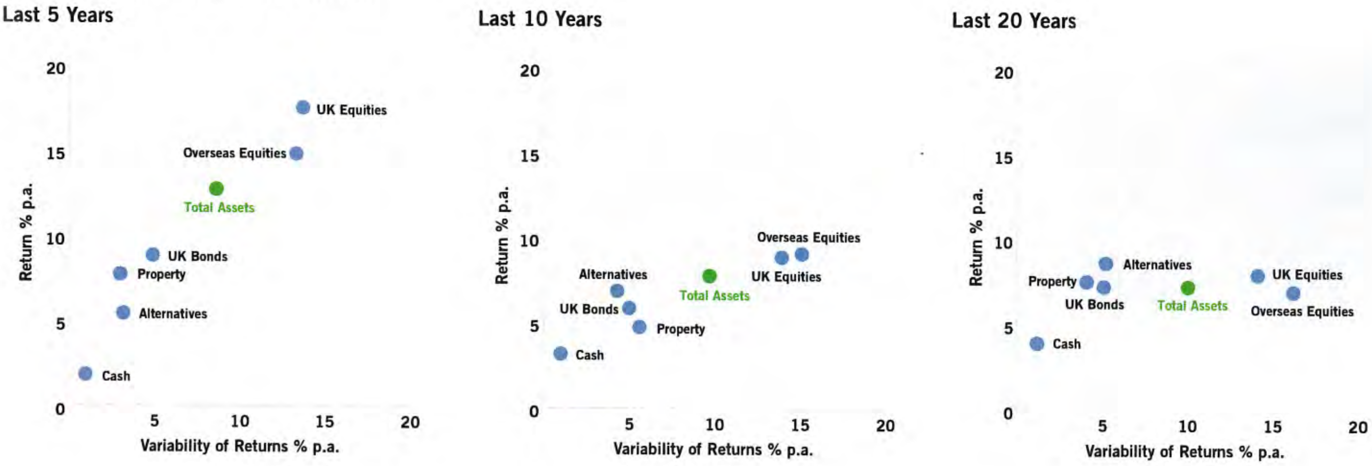
The chart on the following page shows that over the last 20 years, the average fund has achieved a return of 7% p.a. This was 4% p.a. above inflation.

Over the shorter term, performance has been slightly stronger. Over the last ten years, the average fund has returned 8% p.a., 4% p.a. ahead of inflation for the period. The five-year position, at 13% p.a., is better still now that it excludes the impact of the equity crash of 2008.

Chart 13 plots the asset classes in risk/return space over various time periods. The normal relationship is that, the more risk that is taken (the further out on the horizontal line) the more return will be achieved (the higher up the asset will be on the horizontal axis). In the last five and 10 years this relationship has been re-established although the twenty-year results are still flatter than may be expected — largely due to the strong performance of bonds in the earliest part of the period.

DESPITE THE CHALLENGING ENVIRONMENT FOR INVESTING, THE THREE-, FIVE-, TEN- AND 20-YEAR RETURNS ARE ALL POSITIVE AND WELL AHEAD OF INFLATION.

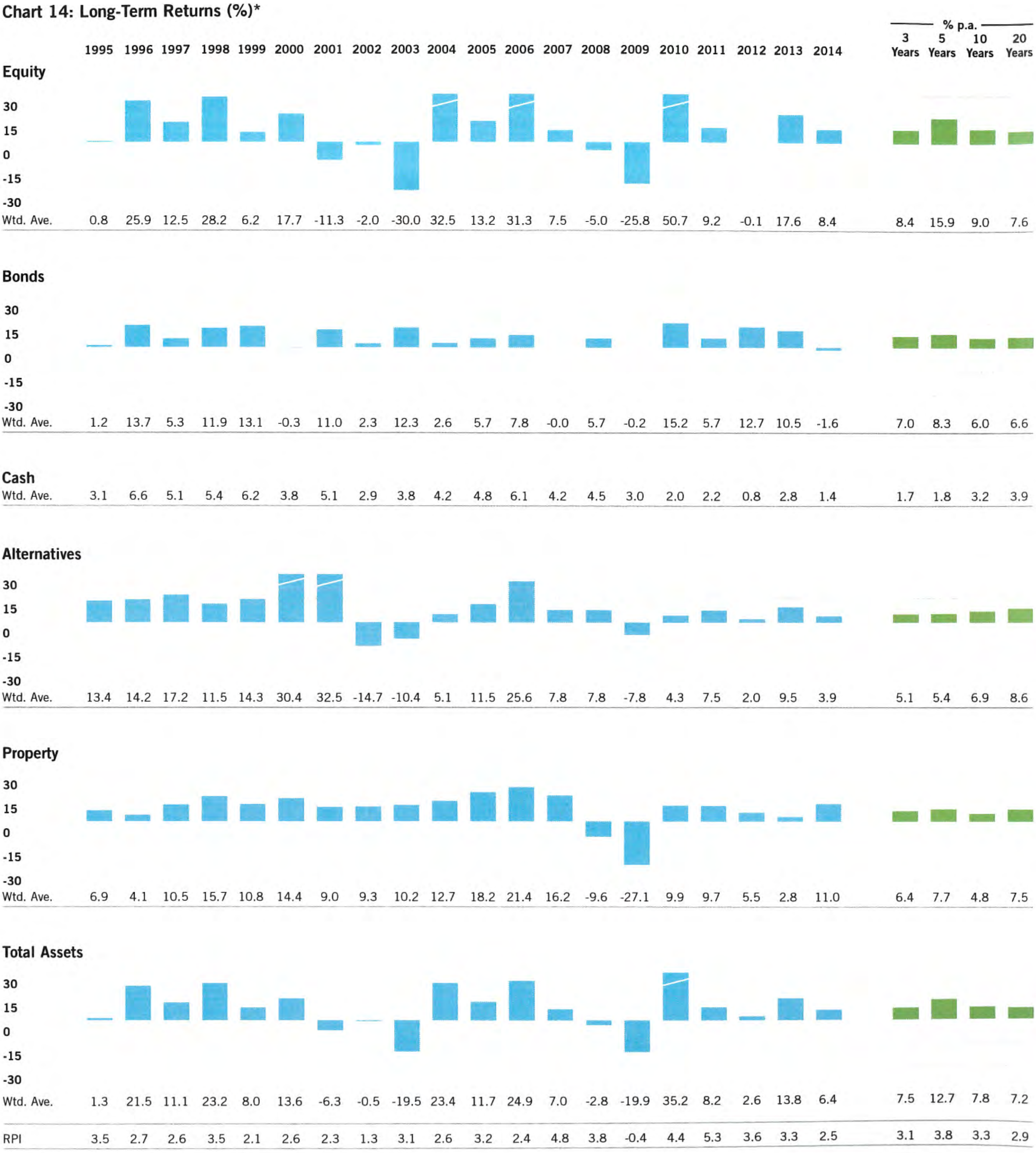
Chart 13: Long-Term Risk and Return*



* Source: State Street Investment Analytics, 2014.

Past performance is not a reliable indicator of future results.

Chart 14: Long-Term Returns (%)*

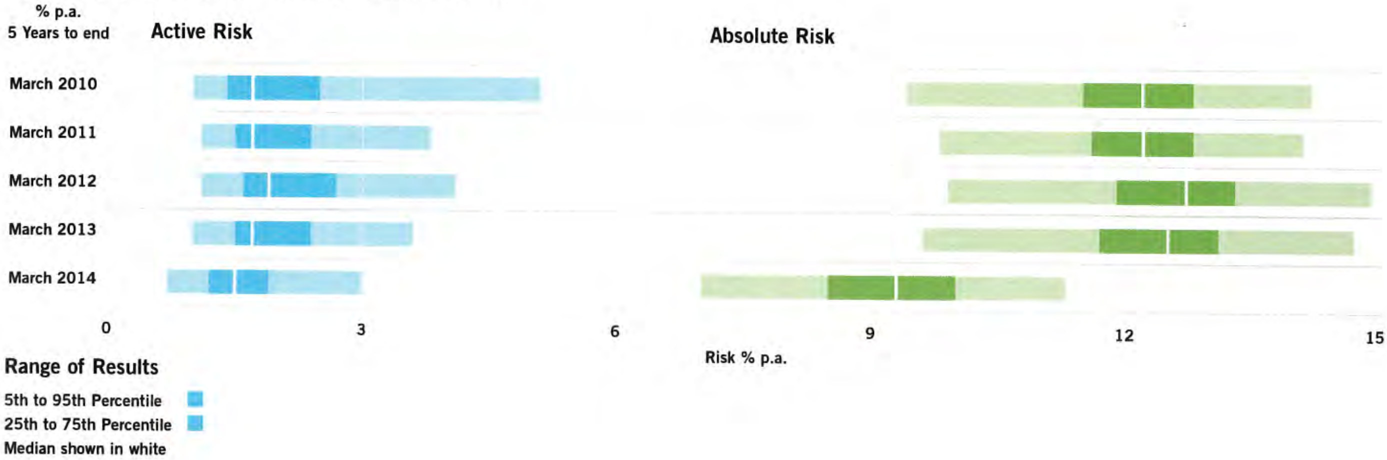


	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	3 Years	5 Years	10 Years	20 Years
Equity Wtd. Ave.	0.8	25.9	12.5	28.2	6.2	17.7	-11.3	-2.0	-30.0	32.5	13.2	31.3	7.5	-5.0	-25.8	50.7	9.2	-0.1	17.6	8.4	8.4	15.9	9.0	7.6
Bonds Wtd. Ave.	1.2	13.7	5.3	11.9	13.1	-0.3	11.0	2.3	12.3	2.6	5.7	7.8	-0.0	5.7	-0.2	15.2	5.7	12.7	10.5	-1.6	7.0	8.3	6.0	6.6
Cash Wtd. Ave.	3.1	6.6	5.1	5.4	6.2	3.8	5.1	2.9	3.8	4.2	4.8	6.1	4.2	4.5	3.0	2.0	2.2	0.8	2.8	1.4	1.7	1.8	3.2	3.9
Alternatives Wtd. Ave.	13.4	14.2	17.2	11.5	14.3	30.4	32.5	-14.7	-10.4	5.1	11.5	25.6	7.8	7.8	-7.8	4.3	7.5	2.0	9.5	3.9	5.1	5.4	6.9	8.6
Property Wtd. Ave.	6.9	4.1	10.5	15.7	10.8	14.4	9.0	9.3	10.2	12.7	18.2	21.4	16.2	-9.6	-27.1	9.9	9.7	5.5	2.8	11.0	6.4	7.7	4.8	7.5
Total Assets Wtd. Ave.	1.3	21.5	11.1	23.2	8.0	13.6	-6.3	-0.5	-19.5	23.4	11.7	24.9	7.0	-2.8	-19.9	35.2	8.2	2.6	13.8	6.4	7.5	12.7	7.8	7.2
RPI	3.5	2.7	2.6	3.5	2.1	2.6	2.3	1.3	3.1	2.6	3.2	2.4	4.8	3.8	-0.4	4.4	5.3	3.6	3.3	2.5	3.1	3.8	3.3	2.9

* Source: State Street Investment Analytics, 2014.

Chart 15 looks at the way the risk profile of funds in the universe has changed over time. The risk taken by funds can be divided into two main areas: absolute and active risk. The level of risk taken will determine the overall fund performance. The strategic benchmark set by the fund will determine the level of absolute risk taken, whilst relative risk is associated with the performance relative to that of the benchmark.

Chart 15: Ranges of Risk (Rolling 5-Year Periods)*



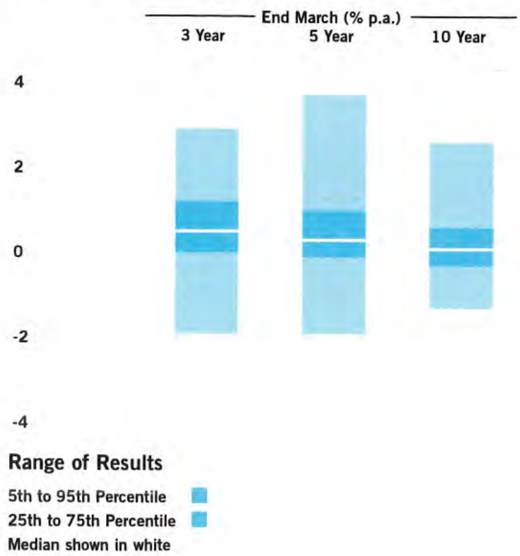
The chart shows that the absolute level of risk had hovered around 13% p.a., with funds quite tightly grouped until the latest period when it fell, quite sharply, to 9% p.a. This fall is the result of the volatility associated with the financial crisis in 2008/2009 dropping out of the numbers and is a return to the levels seen in the mid-2000's.

Relative risk has also reduced over the latest period and three-quarters of funds are now running a risk relative to benchmark of less than 2% p.a. This is an interesting reduction as it has not been brought about by any increase in the level of index-tracking assets — these have stayed almost unchanged at just under a quarter of the universe value.

The outperformance generated by the risk that funds are taking relative to benchmark is mixed, as can be seen in Chart 16 opposite;

More than half of funds have outperformed their benchmark in the last three years, but longer term relative performance remains disappointing for most.

Chart 16: Performance Relative to Benchmark*



* Source: State Street Investment Analytics, 2014.

Past performance is not a reliable indicator of future results.

Asset Allocation

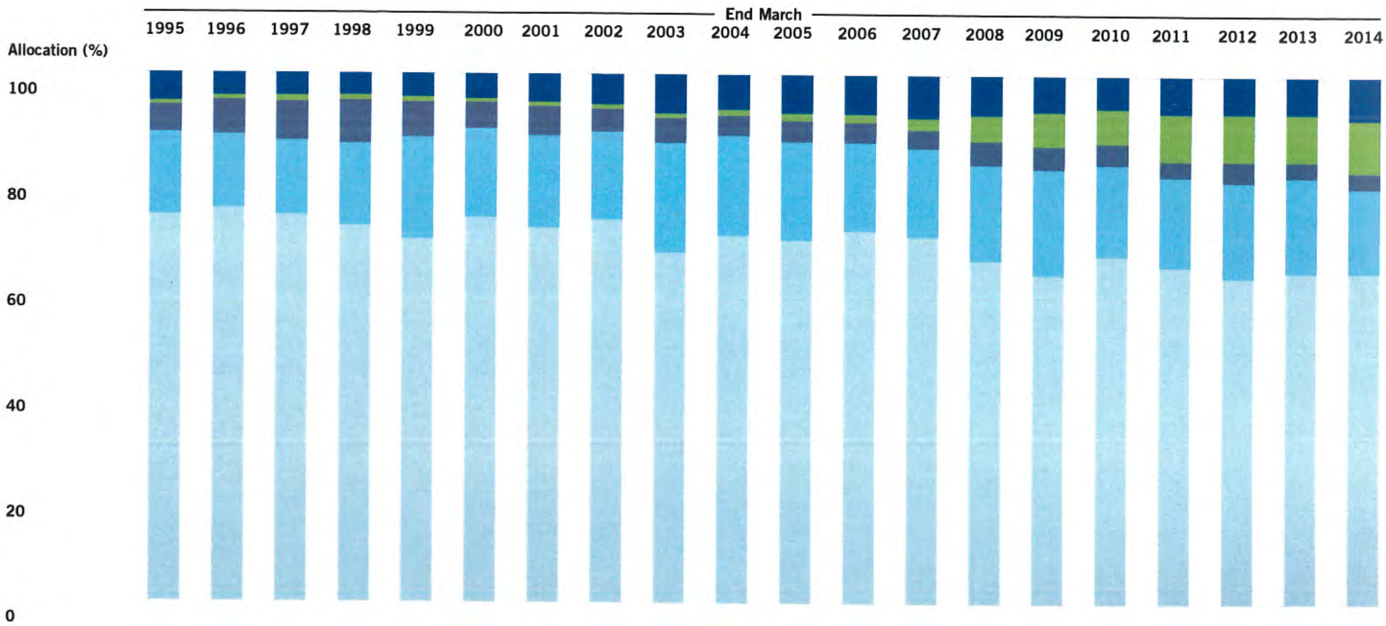
The equity allocation of the average fund has fallen from 73% of total assets at March 1995 to 63% at March 2014. Over the same period the exposure to bonds has remained broadly unchanged at 16%. The major change (and recipient of the equity disinvestment) has been alternative assets which have grown from almost nothing to 10% by the end of March 2014.

The continued relatively high commitment to equities is in stark contrast to corporate schemes that have, for the last decade, been moving to 'lower risk' investment strategies. Local authority schemes continue to remain open to new members and most currently still have positive cash inflows. This gives them a very different risk perspective.

Property, which is generally held as a diversifier for the equity component of funds, has remained at around 7% of the average fund for most of the last decade. There are barriers to increasing this exposure, the main one being the illiquidity of the asset.

OVER THE LAST DECADE, EQUITY EXPOSURE HAS DECLINED AS ALTERNATIVE ASSETS HAVE GROWN IN POPULARITY.

Chart 17: Longer-Term Asset Allocation*



	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Equities	73	75	73	71	69	73	71	73	66	70	69	70	69	65	62	66	64	62	63	63
Bonds	15	14	14	15	19	17	17	17	21	19	19	17	17	18	20	17	17	18	18	16
Cash	5	7	7	8	7	5	6	4	5	4	4	4	4	4	4	4	3	4	3	3
Alternatives**	1	1	1	1	1	1	1	1	1	1	1	2	2	5	7	7	9	9	9	10
Property	5	4	4	4	4	5	5	6	7	6	7	7	8	7	7	6	7	7	7	8

* Source: State Street Investment Analytics, 2014.
** Includes Pooled Multi-Asset from 2011.

Equities

Table 11 shows that UK equity exposure has declined from 60% of total equity allocation 10 years ago, to under 40% today. Funds have chosen to diversify their equity holdings by increasing their commitment to overseas assets. Most funds do this through investing in global equity portfolios managed against a market capitalisation based global index.

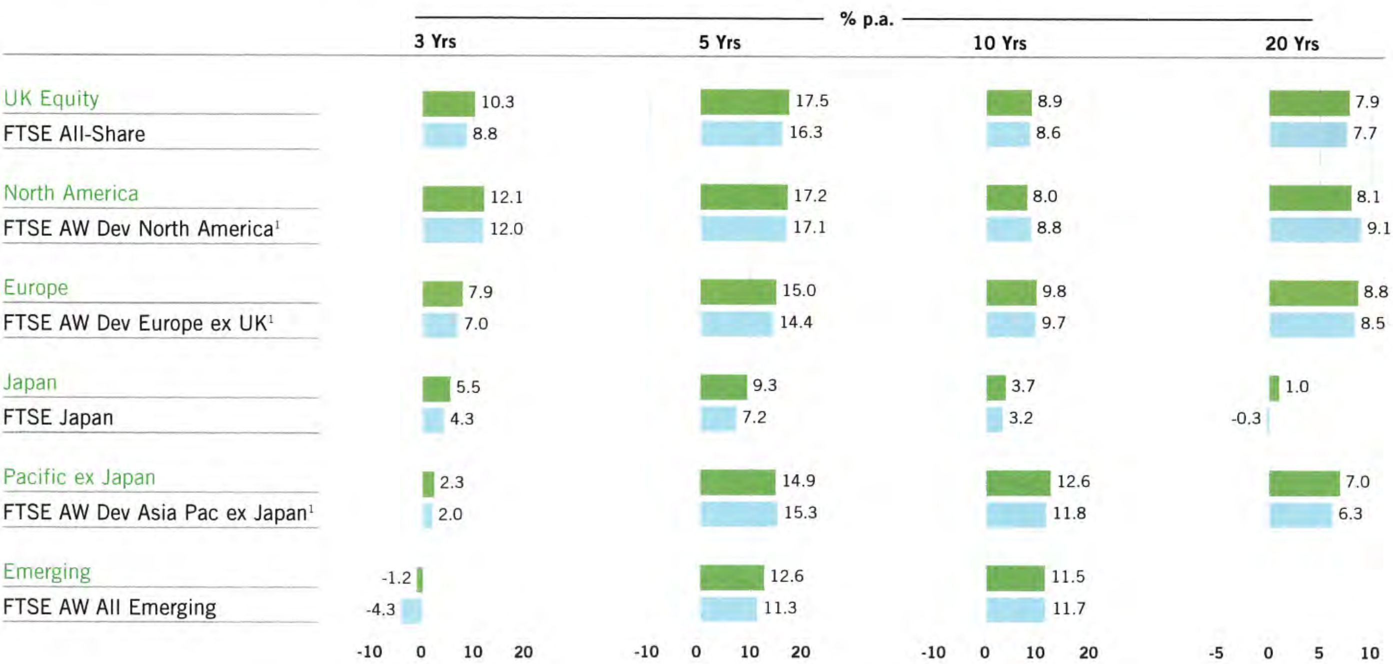
Chart 18 shows that performance within equity portfolios has been strong. UK equity performance has been excellent with three-quarters of funds outperforming the FTSE All-Share Index over the last three years and the average fund returning 1.4% p.a. above.

FUNDS ARE CONTINUING TO DIVERSIFY OVERSEAS WITHIN THEIR EQUITY HOLDINGS.

Table 11: Equity Allocation (%)*

	End March										
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
UK	60	58	56	54	50	47	43	42	40	39	38
Overseas	40	42	44	46	47	50	52	52	53	53	52
Global	-	-	-	-	3	3	4	6	7	8	10

Chart 18: Performance Relative to FTSE All-World Index*



* Source: State Street Investment Analytics, 2014.

[1] FTSE World Index until end 2013.

Past performance is not a reliable indicator of future results.

Overseas performance has also been ahead of index over the last three years. This is even the case in North America, albeit marginally, which is an extremely unusual result.

Performance has also improved over the longer term. Over the 20 years, funds have outperformed in all overseas areas except North America.

It needs to be noted that these numbers are before fees have been paid.

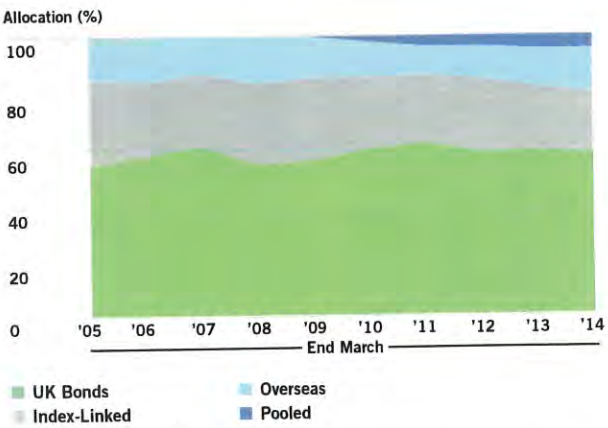
Bonds

The average bond allocation has remained at around 16% of total assets for the past decade. Within that allocation, however, there have been quite marked changes. Ten years ago, the UK bond allocation would have been held largely as government bonds: now two-thirds of this allocation is to corporates, reflecting the growth in that area and the wider investment remits given to managers. Recently, as can be seen in Chart 19, there has been an increase in the usage of pooled bond investments. Often these will be targeted against an absolute level of return rather than a market capitalisation benchmark.

Until the latest year, bond returns had been unusually strong in absolute terms. Table 12 shows that funds have also been able to outperform the FTSE UK Gilts All Stocks Index over all medium and long-term periods — this reflects the benefits of diversifying into corporate issues as well as the benefit derived from investing in longer-dated gilts.

Index-linked performance is broadly in line with the FTSE UK Gilts Index-Linked All Stocks Index over the longer term (Table 13) but, more recently, funds are outperforming. This reflects the greater diversification across this asset class as funds invest into corporate and overseas issues.

Chart 19: Bond Allocation*



* UK Bonds split 33% Government, 67% Corporate at end March 2014.

Table 12: Long-Term UK Bond Performance*

	% p.a.			
	3 Yrs	5 Yrs	10 Yrs	20 Yrs
UK	7.3	8.8	5.9	7.2
UK Government	6.5	5.8	-	-
FTSE UK Gilts All Stocks	5.5	4.5	5.3	6.5
UK Corporate	7.4	10.8	-	-
BAML UK Corporate Bonds	7.5	9.7	5.6	-

Table 13: Long-Term UK Index-Linked Performance*

	% p.a.			
	3 Yrs	5 Yrs	10 Yrs	20 Yrs
UK Index-Linked	8.5	8.8	6.9	7.3
FTSE Index-Linked All Stocks	7.8	8.0	6.8	7.1

* Source: State Street Investment Analytics, 2014.

Alternatives and Property

ALTERNATIVES

Ten years ago, most investment in what is now termed 'alternatives' was in private equity. In recent years there has been sizable cashflow into alternative assets which now encompass hedge funds, commodities and infrastructure amongst others. Chart 20 shows the range of allocations across private equity, hedge funds and pooled multi-asset investments. It can be seen how skewed the allocations are, with 30% of funds still having no investment in this area.

Performance of these assets has varied considerably as can be seen in Table 14. Whilst these results are still relatively short term, so far they have delivered a reasonable return ahead of cash but a performance that is some way behind that of equities.

Over the last five years, the average fund has achieved positive results from the major areas of investment within the alternative grouping. Active currency and Global Tactical Asset Allocation (GTAA) which failed to deliver the expected level of returns, have now almost disappeared within the investments held by local authority funds.

EXPOSURE TO ALTERNATIVES REMAINS SKEWED, ALTHOUGH SOME FUNDS HAVE MADE A SIGNIFICANT COMMITMENT TO THIS AREA.

Within each of the asset types there is a broad range of results, reinforcing the fact that ability to select skilful managers is particularly crucial in this sector.

As has been discussed before, one of the drivers for investment into these areas is diversification to reduce the overall fund risk. It needs to be pointed out that, to work effectively as a diversifier, any holding within these asset types needs to be at a significant level. An exposure of 1-2% in any asset type (which is extremely common within the alternative grouping) is unlikely to have any impact on the overall risk, or indeed on the return, of the fund as a whole.

Chart 20: Range of Allocation – Last Five Years*

Table 14: Alternative Performance (%)*

	Private Equity	Hedge Funds	Other Alternatives: Commodities	Other Alternatives: Infrastructure	Pooled Multi-Asset
2009/10	-2.4	12.1	14.0	12.1	-
2010/11	10.3	5.3	21.3	-1.4	-
2011/12	5.3	-0.1	-10.0	2.9	-1.0
2012/13	11.8	7.3	-3.2	10.6	9.9
2013/14	5.4	3.6	-10.7	1.6	3.1
Last 3 Years % p.a..	7.5	3.6	-8.0	4.9	3.9
Last 5 Years % p.a.	6.0	5.6	1.5	5.0	-

* Source: State Street Investment Analytics, 2014.

Past performance is not a reliable indicator of future results.

he new 'alternative' mandate is pooled multi-asset (also known as diversified growth). his is gaining considerable traction across funds prepared to give up some of their quity premium in order to reduce overall fund volatility. Again we would caution that inds should understand the risk/return tradeoff that they are hoping to achieve. The verage pooled multi-asset return over the last three years of 4% p.a. is considerably elow the 8% p.a. that was delivered by equities.

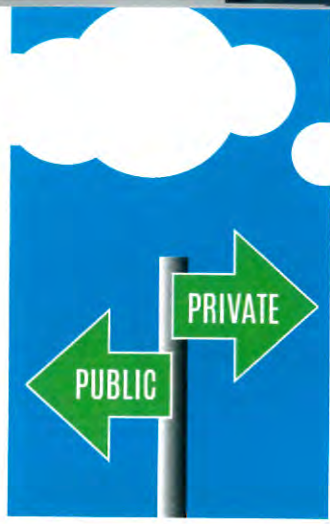
ROPERTY

able 15 shows that property returns over the last twenty years were good although some this added value was given up in the period 2007-2009. Over all periods funds are nderperforming the IPD benchmark index although they are ahead of the AREF/IPD UK l Property Index. This reflects the markedly different returns that have been achieved direct and indirect investments (as represented by the AREF index) over the period.

ble 15: Property Performance Relative to Market Indices (%)*

Year to End March											Annualised % p.a.			
2005	2006	2007	2008	2009	2010	2011	2012	2013	2014		3 Yrs	5 Yrs	10 Yrs	20 Yrs
18.2	21.4	16.2	-9.6	-27.1	9.9	9.7	5.5	2.8	11.0	L.A. UK Property	6.4	7.7	4.8	7.5
18.0	20.9	15.6	-10.7	-25.5	16.3	10.7	6.6	2.5	14.0	IPD UK Monthly All Property	7.6	9.9	5.8	8.2
0.2	*0.4*	*0.5*	*1.2*	*-2.1*	*-5.5*	*-0.9*	*-1.0*	*0.3*	*-2.6*	*Relative Return*	*-1.1*	*-2.0*	*-0.9*	*-0.6*
18.7	23.4	17.4	-13.4	-35.9	13.9	10.8	5.3	1.1	11.4	AREF/IPD UK All Property	5.9	8.4	3.6	-
-0.4	*-1.6*	*-1.0*	*4.4*	*13.7*	*-3.5*	*-1.0*	*0.2*	*1.7*	*-0.4*	*Relative Return*	*0.5*	*-0.6*	*1.2*	-

ource: State Street Investment Analytics, 2014.



Performance Relative to Corporate Funds

Table 16 shows that local authority funds produced an average return almost 3% ahead of their corporate peers in the latest year. The higher equity exposure and commensurate underweighting of bonds was (as ever) the key factor driving the outperformance, as can be seen in Chart 21.

Over the longer term, however, as can be seen in Table 17, both groups have provided broadly similar returns. This reflects the similarity of returns from the main asset classes over the last ten years.

THE MARKED DIVERGENCE IN ASSET STRATEGY BETWEEN THE TWO GROUPS, LARGELY REFLECTS THE CLOSURE OF MOST CORPORATE SCHEMES TO NEW ENTRANTS.

Table 16: Performance Relative to Corporates 2013/14*

	% Return
Local Authority Return	6.4
Corporate Return	3.7
Relative Performance	2.6
Attributable to:	
Asset Allocation	1.9
Stock Selection	0.7

Chart 21: Asset Allocation Relative to Corporates*

	Equity	Fixed Income	Cash	Alternatives	Pooled Multi-Asset	Currency Instruments	Property
LA End March 2013	63.0	17.6	3.1	7.5	2.0	0.0	6.8
LA End March 2014	62.7	16.5	3.0	7.5	2.8	0.0	7.5
Corporate End March 2013	36.7	44.8	3.0	9.3	0.2	-0.2	6.1
Corporate End March 2014	36.2	44.4	3.0	9.7	0.3	-0.1	6.5
Impact	1.1	1.7	-	-	-	-0.9	-

Table 17: Longer-Term Performance Relative to Corporates*

	% p.a. to End March											% p.a.		
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	3 Yrs	5 Yrs	10 Yrs
Local Authority	23.4	11.7	24.9	7.0	-2.8	-19.9	35.2	8.2	2.6	13.8	6.4	7.5	12.7	7.8
Corporate Funds	23.3	11.1	24.0	7.0	-0.4	-17.5	28.4	8.0	7.2	12.8	3.7	7.8	11.7	7.7
Relative	0.1	0.5	0.7	0.0	-2.4	-2.9	5.3	0.2	-4.3	0.9	2.6	-0.3	0.9	0.1

* Source: State Street Investment Analytics, 2014.

Past performance is not a reliable indicator of future results.

Statistical Appendix

Annual Returns (% to End March)*

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Total Equities	13.2	31.3	7.5	-5.0	-25.8	50.7	9.2	-0.1	17.6	8.4
Global Pooled inc UK	-	-	-	-3.1	-24.8	46.9	7.5	0.2	16.2	8.6
UK Equities	15.6	27.0	10.7	-8.9	-29.1	51.9	9.7	2.2	18.0	11.3
Overseas Equities	9.6	37.4	3.6	-0.6	-22.4	49.4	8.9	-2.1	17.5	6.4
North America	4.0	24.4	-2.9	-6.8	-16.6	42.9	9.8	5.7	19.0	11.9
Europe	18.1	37.2	10.9	1.2	-30.0	47.4	8.6	-9.2	20.4	15.1
Japan	-3.9	49.0	-10.8	-16.3	-14.0	32.6	-0.1	1.3	15.4	0.5
Pacific ex Japan	15.9	36.8	17.3	11.2	-20.5	64.8	13.2	-3.1	19.2	-7.1
Emerging Markets	12.7	60.5	7.0	16.2	-27.1	68.1	11.7	-8.1	10.5	-5.1
Total Bonds	5.7	7.8	0.0	5.7	-0.2	15.2	5.7	12.7	10.5	-1.6
UK Bonds	5.8	8.3	0.9	2.1	-1.7	16.9	5.9	11.1	10.6	0.4
Overseas Bonds	5.2	6.2	-3.1	8.0	9.2	13.6	2.7	7.3	10.0	-6.1
Index-Linked	5.6	8.0	2.7	11.8	-1.5	11.6	6.4	19.8	11.2	-4.4
Cash	4.8	6.1	4.2	4.5	3.0	2.0	2.2	0.8	2.8	1.4
Alternatives	11.5	25.6	7.8	7.8	-7.8	4.3	7.5	2.0	9.5	3.9
Property	18.2	21.4	16.2	-9.6	-27.1	9.9	9.7	5.5	2.8	11.0
Total Assets	**11.7**	**24.9**	**7.0**	**-2.8**	**-19.9**	**35.2**	**8.2**	**2.6**	**13.8**	**6.4**
Retail Price Index	*3.2*	*2.4*	*4.8*	*3.8*	*-0.4*	*4.4*	*5.3*	*3.6*	*3.3*	*2.5*
Average Earnings	*3.9*	*5.8*	*6.8*	*4.7*	*-1.1*	*6.8*	*2.0*	*1.0*	*-0.2*	*2.2*

Three-Year Rolling Returns*

	% p.a. to End March									
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Total Equities	1.6	25.3	16.9	10.3	-8.8	2.0	6.9	18.0	8.6	8.4
Global Pooled inc UK	-	-	-	-	-	2.3	5.9	16.5	7.8	8.1
UK Equities	2.1	24.7	17.6	8.6	-10.6	-0.6	5.7	19.4	9.8	10.3
Overseas Equities	0.7	26.0	16.0	12.2	-7.2	4.8	8.1	16.8	7.8	6.9
North America	-6.6	14.6	7.9	4.0	-8.9	3.6	9.4	18.4	11.4	12.1
Europe	1.9	29.7	21.6	15.4	-7.8	1.4	3.8	13.3	5.9	7.9
Japan	1.0	27.4	8.5	3.6	-13.7	-1.5	4.5	10.3	5.3	5.5
Pacific ex Japan	7.2	30.0	23.0	21.3	1.2	13.3	14.0	21.8	9.4	2.3
Emerging Markets	7.2	41.1	24.6	25.8	-3.3	12.5	11.0	19.9	4.3	-1.2
Total Bonds	6.8	5.3	4.4	4.4	1.8	6.7	6.7	11.2	9.6	7.0
UK Bonds	6.9	5.9	5.0	3.7	0.4	5.5	6.8	11.2	9.2	7.3
Overseas Bonds	6.2	3.5	2.7	3.6	4.5	10.2	8.4	7.8	6.6	3.5
Index-Linked	7.5	6.6	5.4	7.4	4.2	7.1	5.4	12.5	12.3	8.4
Cash	4.3	5.0	5.0	4.9	3.9	3.1	2.4	1.6	1.9	1.7
Alternatives	1.6	13.8	14.8	13.4	2.3	1.2	1.1	4.6	6.3	5.1
Property	13.6	17.3	18.6	8.4	-8.5	-10.2	-4.2	8.4	6.0	6.4
Total Assets	**3.6**	**19.9**	**14.3**	**9.1**	**-5.9**	**1.7**	**5.4**	**14.5**	**8.1**	**7.5**
Retail Price Index	*3.0*	*2.7*	*3.5*	*3.6*	*2.7*	*2.6*	*3.1*	*4.5*	*4.1*	*3.1*
Average Earnings	*4.3*	*4.8*	*5.5*	*5.8*	*3.4*	*3.4*	*2.5*	*3.2*	*0.9*	*1.0*

* Source: State Street Investment Analytics, 2014.

Five-Year Rolling Returns*

	% p.a. to End March									
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Total Equities	-1.8	6.2	8.2	15.0	2.4	8.4	4.5	3.0	7.5	15.9
Global Pooled inc UK	-	-	-	-	-	-	-	2.9	6.7	14.8
UK Equities	-1.0	5.8	8.4	14.4	1.0	6.7	3.6	1.9	7.3	17.5
Overseas Equities	-3.7	6.5	7.7	15.6	3.8	10.4	5.4	4.2	7.7	14.8
North America	-6.8	0.1	-0.4	6.4	-0.5	6.0	3.4	5.2	10.5	17.2
Europe	-2.2	6.7	9.9	19.6	4.9	9.7	4.7	0.6	4.1	15.0
Japan	-10.3	4.5	6.5	9.1	-1.7	4.9	-3.2	-0.7	5.9	9.3
Pacific ex Japan	3.7	13.5	14.6	23.4	10.4	18.5	14.1	9.8	11.4	14.9
Emerging Markets	-	18.8	16.2	28.3	10.3	19.5	11.2	7.9	6.8	12.6
Total Bonds	6.7	6.1	5.6	4.3	3.7	5.5	5.1	7.7	8.6	8.3
UK Bonds	6.3	6.4	5.9	4.1	3.0	5.1	4.6	6.6	8.4	8.8
Overseas Bonds	7.2	5.4	4.3	3.0	5.0	6.6	5.9	8.1	8.5	5.3
Index-Linked	5.5	6.7	6.6	6.8	5.2	6.4	6.1	9.4	9.3	8.6
Cash	4.2	4.4	4.6	4.8	4.5	3.9	3.2	2.5	2.1	1.8
Alternatives	3.5	2.4	7.3	11.3	8.5	7.0	3.7	2.6	2.9	5.4
Property	11.8	14.2	15.6	11.1	1.9	0.4	-1.6	-3.5	-1.0	7.7
Total Assets	**0.7**	**6.7**	**8.2**	**12.4**	**3.1**	**7.1**	**4.0**	**3.2**	**6.5**	**12.7**
Retail Price Index	*2.5*	*2.5*	*3.2*	*3.3*	*2.7*	*3.0*	*3.6*	*3.3*	*3.2*	*3.8*
Average Earnings	*4.0*	*4.3*	*5.1*	*5.1*	*4.0*	*4.6*	*3.8*	*2.6*	*1.7*	*2.3*

UK Equity Performance (% Year to End March)*

											Annualised % p.a.			
2005	2006	2007	2008	2009	2010	2011	2012	2013	2014		3 Yrs	5 Yrs	10 Yrs	20 Yrs
15.6	27.0	10.7	-8.9	-29.1	51.9	9.7	2.2	18.0	11.3	LA UK Equities	10.3	17.5	8.9	7.9
15.6	28.0	11.1	-7.7	-29.3	52.3	8.7	1.4	16.8	8.8	FTSE All-Share	8.8	16.3	8.6	7.7
-0.0	*-0.8*	*-0.4*	*-1.2*	*0.3*	*-0.2*	*0.9*	*0.8*	*1.1*	*2.3*	*Relative Return*	*1.4*	*1.0*	*0.3*	*0.1*
15.4	26.0	9.3	-6.3	-28.2	50.4	7.4	1.2	15.4	6.7	FTSE 100	7.6	15.0	8.0	7.5
17.1	41.7	21.6	-12.3	-34.0	64.2	16.7	2.4	24.3	19.9	FTSE 250	15.1	23.9	13.1	10.8
12.9	26.8	13.4	-22.1	-40.4	69.4	14.5	0.1	24.5	20.4	FTSE SmallCap	14.5	23.8	8.2	7.2
12.5	30.7	14.8	-1.9	-30.4	60.6	10.0	-2.8	15.3	8.3	FTSE 350 Low Yield	6.7	16.5	9.5	-
18.6	26.0	7.7	-12.2	-28.3	42.1	6.6	5.3	17.4	8.8	FTSE 350 High Yield	10.4	15.3	7.5	-

* Source: State Street Investment Analytics, 2014.

Past performance is not a reliable indicator of future results.

Overseas Equity Performance (% Year to End March)*

2005	2006	2007	2008	2009	2010	2011	2012	2013	2014		Annualised % p.a. 3 Yrs	5 Yrs	10 Yrs	20 Yrs
4.0	24.4	-2.9	-6.8	-16.6	42.9	9.8	5.7	19.0	11.9	LA North America	12.1	17.2	8.0	8.1
4.8	24.3	-0.9	-4.8	-14.0	43.2	9.6	6.9	19.3	10.3	FTSE AW Dev North America[1]	12.0	17.1	8.8	9.1
-0.7	*0.0*	*-2.1*	*-2.1*	*-3.0*	*-0.2*	*0.2*	*-1.1*	*-0.3*	*1.4*	*Relative Return*	*0.0*	*0.0*	*-0.8*	*-0.9*
18.1	37.2	10.9	1.2	-30.0	47.4	8.6	-9.2	20.4	15.1	LA Europe	7.9	15.0	9.8	8.8
18.6	36.0	12.4	2.8	-31.1	48.8	7.5	-11.4	18.0	17.3	FTSE AW Dev Europe ex UK[1]	7.0	14.4	9.7	8.5
-0.4	*0.8*	*-1.4*	*-1.6*	*1.5*	*-0.9*	*1.0*	*2.5*	*2.0*	*-1.9*	*Relative Return*	*0.9*	*0.5*	*0.1*	*0.3*
-3.9	49.0	-10.8	-16.3	-14.0	32.6	-0.1	1.3	15.4	0.5	LA Japan	5.5	9.3	3.7	1.0
-4.3	48.2	-9.9	-15.4	-10.6	29.6	-4.0	0.9	14.3	-1.6	FTSE Japan	4.3	7.2	3.2	-0.3
0.4	*0.5*	*-0.9*	*-1.1*	*-3.7*	*2.3*	*4.1*	*0.3*	*1.0*	*2.1*	*Relative Return*	*1.1*	*2.0*	*0.5*	*1.3*
15.9	36.8	17.3	11.2	-20.5	64.8	13.2	-3.1	19.2	-7.1	LA Pacific ex Japan	2.3	14.9	12.6	7.0
13.5	37.6	12.3	11.2	-23.1	67.2	14.6	-4.6	18.1	-5.8	FTSE AW Dev Asia Pac ex Japan[1]	2.0	15.3	11.8	6.3
2.1	*-0.5*	*4.5*	*0.0*	*3.4*	*-1.5*	*-1.2*	*1.6*	*0.9*	*-1.5*	*Relative Return*	*0.3*	*-0.4*	*0.8*	*0.6*
9.6	37.4	3.6	-0.6	-22.4	49.4	8.9	-2.1	17.5	6.4	LA Overseas	6.9	14.8	9.1	6.9
7.6	32.2	2.6	-0.9	-19.6	48.1	8.5	-0.3	17.2	6.9	FTSE All World Dev ex UK**	7.7	14.9	8.8	-
1.9	*3.9*	*1.0*	*0.3*	*-3.5*	*0.9*	*0.4*	*-1.8*	*0.3*	*-0.5*	*Relative Return*	*-0.7*	*-0.2*	*0.3*	-
13.2	31.3	7.5	-5.0	-25.8	50.7	9.2	-0.1	17.6	8.4	LA Equity	8.4	15.9	9.0	7.6
8.3	30.9	2.9	-1.4	-20.4	48.4	8.4	-0.2	17.1	6.8	FTSE All-World**	7.7	14.9	8.7	7.1
4.5	*0.3*	*4.5*	*-3.6*	*-6.8*	*1.5*	*0.7*	*0.0*	*0.4*	*1.6*	*Relative Return*	*0.7*	*0.9*	*0.3*	*0.5*

Bonds & Index-Linked Performance (% Year to End March)*

2005	2006	2007	2008	2009	2010	2011	2012	2013	2014		Annualised % p.a. 3 Yrs	5 Yrs	10 Yrs	20 Yrs
5.8	8.3	0.9	2.1	-1.7	16.9	5.9	11.1	10.6	0.4	LA UK Bonds	7.3	8.8	5.9	7.2
5.0	7.4	0.5	7.6	10.3	0.8	5.2	14.5	5.2	-2.6	FTSE UK Gilts All Stocks	5.5	4.5	5.3	6.5
4.4	4.8	2.9	8.2	8.7	3.0	2.1	5.0	1.6	-0.7	FTSE UK Gilts <5 years	1.9	2.1	4.0	5.3
5.1	6.3	0.3	9.7	14.6	-0.4	6.1	16.1	5.5	-3.6	FTSE UK Gilts 5–15 years	5.7	4.5	5.8	6.9
5.4	10.7	-1.1	5.1	8.6	-0.2	7.0	22.5	8.1	-3.1	FTSE UK Gilts >15 years	8.7	6.5	6.1	7.6
6.4	7.8	1.2	-0.8	-5.9	21.7	5.3	9.1	12.0	1.6	BAML Corporate Bonds	7.5	9.7	5.6	0.0
5.2	6.2	-3.1	8.0	9.2	13.6	2.7	7.3	10.0	-6.1	LA Overseas Bonds	3.5	5.3	5.1	5.2
6.6	3.7	5.1	8.7	8.1	2.6	2.5	7.1	4.8	1.5	JP Morgan ex UK (hedged)	4.4	3.7	5.0	6.9
-1.3	*2.4*	*-7.8*	*-0.7*	*1.1*	*10.7*	*0.2*	*0.1*	*5.0*	*-7.6*	*Relative Return*	*-0.9*	*1.5*	*0.1*	*-1.6*
5.6	8.0	2.7	11.8	-1.5	11.6	6.4	19.8	11.2	-4.4	LA Index-Linked	8.4	8.6	6.9	7.3
5.4	8.4	3.0	13.1	-1.3	10.3	6.5	18.1	10.2	-3.8	FTSE UK Gilts I/L All Stocks	7.8	8.0	6.8	7.1
0.1	*-0.4*	*-0.3*	*-1.1*	*-0.2*	*1.3*	*-0.1*	*1.4*	*0.9*	*-0.6*	*Relative Return*	*0.6*	*0.6*	*0.1*	*0.1*

* Source: State Street Investment Analytics, 2014.
** FTSE World Series to December 2000.
[1] FTSE World Index until end 2013.

Asset Allocation (% End March)*

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Total Equities	68.9	70.5	69.4	65.0	62.4	65.9	64.2	62.4	63.0	62.6
Global Pooled inc UK	-	-	-	1.5	1.8	2.6	3.7	4.4	5.3	5.6
UK Equities	40.2	39.1	37.8	32.5	29.4	28.7	27.1	25.4	24.4	23.9
Overseas Equities	28.6	31.4	31.6	31.0	31.3	34.6	33.5	32.6	33.3	33.1
North America	7.7	8.4	8.3	8.7	9.7	10.8	10.6	10.8	11.7	11.6
Europe	9.4	10.2	10.3	10.1	8.9	9.3	9.0	8.0	8.1	8.5
Japan	4.1	4.6	3.9	3.8	3.9	3.8	3.5	3.4	3.4	3.1
Pacific ex Japan	3.5	3.4	3.5	3.3	3.4	3.8	3.9	3.6	3.6	3.2
Other International Equities	3.9	4.7	5.7	5.1	5.4	7.0	6.5	6.8	6.5	6.7
Emerging Markets	0.1	0.7	0.7	4.3	4.6	6.1	5.3	5.2	5.7	5.8
Global Pooled ex UK	-	-	-	0.8	0.9	0.9	1.1	1.6	0.8	1.0
Total Bonds	18.6	16.7	16.7	18.1	20.0	17.3	17.1	18.0	17.6	16.5
UK Bonds	10.0	9.6	10.2	9.8	11.0	10.1	10.6	10.5	10.3	9.5
Overseas Bonds	2.7	2.7	2.1	2.9	2.7	2.0	1.6	1.9	2.3	2.5
Index-Linked	5.8	4.4	4.4	5.3	5.9	4.4	4.2	4.8	4.1	3.7
Pooled Bonds	-	-	-	-	0.1	0.4	0.7	0.8	1.0	0.8
Cash	4.0	3.8	3.5	4.4	4.3	4.0	3.3	3.5	3.2	3.0
Alternatives	1.4	1.6	2.3	5.0	6.6	6.6	8.5	7.7	7.5	7.5
Pooled Multi-Asset	-	-	-	-	-	-	-	1.0	2.0	2.8
Total Property	7.2	7.3	8.0	7.4	6.7	6.1	6.8	7.3	6.8	7.5
New Money (£bn)	*2.2*	*3.1*	*3.2*	*3.3*	*3.3*	*3.4*	*2.2*	*1.7*	*1.6*	*2.3*
New Money (%) of Initial Asset Value	*2.9*	*3.8*	*3.0*	*3.0*	*2.8*	*3.5*	*1.7*	*1.2*	*1.3*	*1.4*

Activity (% Year to End March)*

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
UK Equities	65	84	58	80	68	70	62	38	45	42
Overseas Equities	87	104	77	87	99	97	83	60	69	59
UK Bonds	234	220	124	140	139	234	110	96	90	61
Index-Linked	343	496	299	64	76	89	61	68	82	44
Total Securities	70	76	63	99	99	123	94	74	85	71

Activity is a measure of the degree to which stocks within a sector are sold to purchase others. This is considered to be voluntary dealing on the part of the fund manager, e.g., an activity level of 100% implies that the equivalent of 50% of the portfolio assets have been dealt in.

Currency (% Year to End March)*

2005	2006	2007	2008	2009	2010	2011	2012	2013	2014		Annualised % p.a. 3 Yrs	5 Yrs	10 Yrs	20 Yrs
1.89	1.74	1.96	1.99	1.43	1.52	1.60	1.60	1.52	1.67	US Dollar/£				
-2.7	*8.9*	*-11.6*	*-1.3*	*38.7*	*-5.5*	*-5.4*	*0.3*	*5.2*	*-8.9*	*Return*	*-1.3*	*-3.0*	*1.0*	*-0.6*
202	205	232	198	142	142	133	131	143	172	Japanese Yen/£				
-5.4	*-1.2*	*-11.6*	*17.1*	*39.7*	*-0.1*	*6.7*	*1.0*	*-7.9*	*-16.8*	*Return*	*-8.2*	*-3.8*	*1.1*	*-0.6*
1.45	1.43	1.47	1.25	1.08	1.12	1.13	1.20	1.18	1.21	Euro**/£				
2.9	*1.4*	*-2.7*	*17.5*	*16.2*	*-3.7*	*-0.8*	*-5.9*	*1.5*	*-2.2*	*Return*	*-2.3*	*-2.2*	*2.1*	*0.3*

* Source: State Street Investment Analytics, 2014.
** Deutschemark until end of March 1998.

Past performance is not a reliable indicator of future results.

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VHAT IS THE LOCAL AUTHORITY UNIVERSE?

- The Universe is a survey of UK public sector defined benefit pension funds. Funds' data is brought together to create aggregate returns, asset weightings, income and cash flows.
- At end March 2014, it comprised 85 funds with a combined asset value of £175 billion.
- All fund sizes are included.
- The Universe is estimated to represent somewhere in the region of 90% of the UK defined benefit pension market by value.
- The Universe has around 30 years of history.

WHY USE THE UNIVERSE?

- As a temperature check of the industry's current performance.
- As a temperature check of the industry's current asset allocation.
- To capture trends and changes over time.
- It provides an extensive historical return series.
- It tells us how asset classes are performing in isolation and relative to market indices.
- Fund performance and risk can be evaluated against the Universe backdrop.
- Asset manager performance and risk can be reviewed against the Universe backdrop.
- Data mining.

* Source: State Street Investment Analytics, 2014.

CALCULATION BASIS

- The aggregate Universe is calculated from first principles using raw data supplied by asset managers, asset owners or their custodians.
- This information is supplemented by pre-calculated performance data for a small number of funds whose inclusion ensures the representative nature of the Universe.
- Headline Universe returns and asset allocations are "asset weighted", i.e., the bigger funds will have a greater influence on the return and allocation profile of the Universe than smaller funds.
- Unweighted returns and allocations are also available, often described in percentile terms.

	Value (£ millions)	Return (%)	Weighted Contribution
Fund A	100	10	(100/160 x 10%) = 6.25%
Fund B	50	8	(50/160 x 8%) = 2.5%
Fund C	10	12	(10/160 x 12%) = 0.75%
Universe	160		Sum = 9.5%

In this simple three fund universe, the weighted average Universe return is 9.5% while the "median" return (or 50th percentile) is 10%.

UNIVERSE INDICATOR

The Local Authority Index seeks to provide an early indicator of the likely return from UK public sector pension funds. It simply applies standard market indices to the known allocation at the last Universe close.

STANDARDS

We ask data suppliers to meet the following default standards where appropriate:

- Data supplied before the deduction of investment manager fees (with fee data provided separately if available).
- Data supplied monthly.
- Income recorded on an accrued income or "as earned" basis.
- Bond values include accrued income, i.e., they are provided on a "dirty" basis.

ASSET CLASSIFICATIONS

The following is our current classification hierarchy:

Equities
- Pooled Global
- UK
- Overseas Equities
  - Pooled Global (ex UK)
  - North America
  - Europe (ex UK)
  - Japan
  - Asia Pacific (ex Japan)
  - Emerging

Bonds
- Pooled
- Conventional
  - UK
    - Gilts
    - Corporate
  - Overseas
- Inflation Linked
  - UK
  - Overseas

Alternatives
- Private Equity
- Hedge Funds
- Other
  - Commodities
  - GTAA
  - Infrastructure
  - Active Currency

Pooled Multi Asset

Property
- Pooled Global
- UK
- Overseas

Cash

Currency Hedging

Where required, we will re-classify managers' data for the purposes of Universe consistency.

The UK Local Authority Annual Review is produced by State Street Investment Analytics (SSIA), part of State Street Bank and Trust. We have more than 30 years of experience providing performance evaluation for a wide range of asset owners and managers.

We provide exclusive and unique information to support the decision-making of institutional investors. Our innovative range of performance and risk services combined with our industry-leading fund databases bring transparency to the entire investment process, enabling owners and managers to measure, evaluate, interpret and objectively report their performance.

The aim of this review is to record the key events of 2013/14 from our unique perspective on the UK local authority fund industry. Our database, which is the most comprehensive of its type, has been analysed to supply information on rates of return and asset allocation.

The significance of 2013/14 figures is highlighted in a number of commentaries. These put the data into context and also examine a number of factors that have gained importance during the year.

THE STATE STREET ADVANTAGE

State Street Corporation (NYSE: STT) is one of the world's leading providers of financial services to institutional investors including investment servicing, investment management and investment research and trading. With $27.5 trillion in assets under custody and administration and $2.4 trillion in assets under management* at March 31, 2014, State Street operates in more than 100 geographic markets worldwide, including the U.S., Canada, Europe, the Middle East and Asia. For more information, visit State Street's web site at www.statestreet.com.

ABOUT STATE STREET INVESTMENT ANALYTICS

State Street's Investment Analytics (SSIA) group provides performance and analytics services and employs a staff of 798 dedicated investment performance professionals across 18 offices worldwide.

SSIA serves approximately 1,277 global clients with asset volumes exceeding $12.2 trillion, offering comprehensive services in performance, risk and strategic analysis that help them monitor and measure the success of their investment strategies in any market and in any asset class, including alternative investments (March 31, 2014).

Assets under management include the assets of the SPDR Gold ETF (approximately $34 billion as of March 31, 2014), for which State Street Global Markets, LLC, an affiliate of SSgA, serves as the distribution agent.

For questions or comments about our Annual Review, contact:

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