Schroders

For professional investors only

Royal Borough of Kingston upon Thames Pension Fund

Q4 2018

Investment Report

The Team

Client Director
Olivia Docker
Tel: 020 7658 3552
Olivia.Docker@schroders.com

Client Executive
Client Service Solutions Team
Tel: 0800 032 0553
CSSTeam@Schroders.com

Portfolio Manager
QEP Investment Team
Tel: 020 7658 6000

Overview

Portfolio Valuation

Value at 30 Sep 2018	GBP	129,199,030
Net cash flow	GBP	-
Value at 31 Dec 2018	**GBP**	**115,721,801**

Performance

Periods 31 December 2018

Total returns GBP	3 months %	12 months %	3 years % pa	5 years % pa	Inception % pa	Inception % total
Fund at closing prices (Net)	**-10.53**	**-6.50**	**10.74**	**8.07**	**8.96**	**121.38**
MSCI World	-11.35	-3.04	11.61	10.20	10.62	154.85
Difference	**+0.82**	**-3.46**	**-0.87**	**-2.13**	**-1.66**	**-33.47**
MSCI AC World	-10.67	-3.79	11.92	9.88	10.03	142.63
Difference	**+0.14**	**-2.71**	**-1.18**	**-1.81**	**-1.07**	**-21.25**

Fund inception date: 25 Sep 2009

Returns are shown net of fees at closing market prices. Fund NAV performance may differ from performance calculated at closing market prices. The fund is index unconstrained and therefore short term performance can differ significantly from market cap indices. Indices are net dividend reinvested (NDR).

We have decided to amend the wording of the investment objective of this fund as we seek to make language consistent across all funds in the SPML range. There has been no change to how the fund is managed and the wording change does not impact your existing holding. This does not require unitholder approval and you are not required to take any action in respect of this change.

Q4/2018

Schroders

Schroder Life QEP Global Active Value Fund

In this section

Fund Overview

Investment Objective and Policy

The Schroder Life QEP Global Active Value Fund seeks to achieve its investment objective by investing 100% in the Schroder QEP Global Active Value Fund ("the Fund").

The Fund aims to provide capital growth and income by investing in equity and equity related securities of companies worldwide.

The Fund invests at least 80% of its assets in equity or equity related securities of companies worldwide. As the Fund is index-unconstrained it is managed without reference to an index.

The Fund invests in companies that have certain "Value" characteristics. Value is assessed by looking at indicators such as cash flows, dividends and earnings to identify securities which the manager believes have been undervalued by the market.

The Fund may also invest in collective investment schemes, warrants and money market instruments, and hold cash.

The Fund may use derivatives with the aim of achieving investment gains, reducing risk or managing the Fund more efficiently.

Performance Target

The fund aims to return 3% per annum (gross of fees) in excess of suitable global equity indices over a complete market cycle. As the investment strategy is index-unconstrained, an index is used for performance reference purposes only. The primary reference index is the MSCI AC World (NDR).

Summary

Global equities retreated sharply towards the end of 2018, posting their worst quarterly loss since late 2011 at the height of the Eurozone debt crisis. The MSCI World index declined by more than 11% in Q4. The selling pressure intensified during the quarter as investors reacted to concerns about a slowing global economy, less supportive central banks and a range of geopolitical worries, not least the uncertainty surrounding Brexit negotiations and US-Sino trade relations. Government bond yields generally fell (i.e. prices rose), reflecting the broad uncertainty.

Against this volatile backdrop, Global Value strongly outperformed its reference index in Q4, driven by strong stock selection within the industrials and health care sectors as well as our longstanding aversion to the widely owned FAANGs (Facebook, Apple, Amazon, Netflix and Google). The main headwind was our positioning within financials. Whilst we actively monitor the financial strength of our holdings, the whole sector lagged behind due to concerns about a cyclical slowdown. Positioning within the naïve bond proxy sectors (US real estate and utilities), which we view as expensive, also weighed on returns as they performed strongly as bond yields fell.

Market Summary and Performance Review

Global equities retreated sharply towards the end of 2018, posting their worst quarterly loss since late 2011 at the height of the Eurozone debt crisis. The MSCI World index declined by more than 11% during Q4. The selling pressure intensifying during the quarter as investors reacted to concerns about a slowing global economy, less supportive central banks and a range of geopolitical worries, not least the uncertainty surrounding Brexit negotiations and US-Sino trade relations. Government bond yields generally fell (i.e. prices rose), reflecting the broad uncertainty. Declining yields and the preference for defensive assets naturally favoured the traditional bond proxy areas such as utilities, which was one of the only sectors to post positive returns during the period, as well as real estate and some consumer staples. At the other end of the performance table, energy stocks were hit by the sharp selloff in oil prices. The fading allure of the growth darlings continued to unfold with stocks such as Facebook, Amazon, Netflix and Apple all declining more than 20% whilst chipmaker Nvidia halved in value over the quarter.

For 2018 as a whole the MSCI World index fell significantly, one of its worst yearly performance since the height of the global financial crisis in 2008. However, it was a year of two halves. The start of the year continued on where 2017 left off, and was dominated by continued momentum in a handful of large cap US growth stocks (with Facebook being the main exception due to a data breach scandal). This partially reversed as the year progressed against the backdrop of rising market volatility. Downward revisions to earnings expectations going ahead were a large contributory factor behind the rotation as elevated valuations were increasingly difficult to justify. Nevertheless, US stocks were the standout area for the year as a whole, despite losing some of their lustre towards the close of 2018. These US gains were helped by the strength of the USD whilst Emerging markets were the main loser, again largely due to currency weakness. A long running trade dispute with the US leading to future growth concerns and a tightening of regulations on shadow banking made China one of the world's worst performing stock markets in 2018.

The relative performance of the Global Value strategy, over the year as a whole, reflected the shifting themes during the year with the headwinds that dominated during 2017 initially following through before partially reversing towards the close of the year. Whilst Value based strategies still have some way to go before making up the ground lost in recent years, the stabilisation in performance is encouraging and attributable in no small part to a broadening out in stock performance away from a narrow group of index heavy growth stocks. This backdrop had been a clear detractor to diversified managers such as us. The reversion in market volatility after a protracted period of relative calm has also been beneficial as we observe that our best performance is often associated with market turning points accompanied by a rotation in leadership. Despite this, for the year as a whole, Global Value lagged behind its reference index, predominantly driven by its positions within financials, which declined as expectations relating to the cyclical backdrop soured. Not holding any of the expensive growth stocks was also a detractor that has only partially reverted. On the plus side, our long held allocation to health care (particularly pharmaceuticals) and stock selection within the energy sector was beneficial over the year as a whole.

Against a volatile backdrop, Global Value strongly outperformed its reference index in the fourth quarter, driven by good stock selection within the industrials and health care sectors as well as our longstanding aversion to the FAANGs. The main headwinds were our underweight allocation to the naïve bond proxy sectors and our positioning within financials. Whilst we actively monitor the financial strength of our holdings, the whole sector lagged behind due to concerns about a cyclical slowdown.

As investors reset their expectations for their future growth in the prior market darlings, our longstanding underweight positions in these names contributed positively during Q4. In particular, not holding index heavyweights Apple (hardware) and Amazon (online retail), contributed positively as their 2019 earnings were revised downwards. The fund also benefitted from good stock selection in technology more broadly. In particular, avoiding many expensive stocks in the highly cyclical semiconductor industry was beneficial. For example, not holding Nvidia continued to benefit the portfolio as it was off a further 18% through December, having more than halved in value over the quarter.

Stock selection within industrials also contributed positively to performance in Q4 due to our focus on good quality companies that trade at reasonable valuations. Underweight positions among poorer quality names in the sector, such as General Electric and Fedex Corp, proved to be a boon. Additionally, our longstanding overweight position in Central Japan Railway was positive.

The fund also benefitted from stock selection within the health care sector, particularly in the US and Continental Europe, where we have a number of longstanding overweight positions that performed well (Abbvie, Eli Lilly, Roche and Novartis). Our focus on companies that have a track record of generating stable profitability was also rewarded. The sector performed strongly during 2018 and some retracement was evident during December although avoiding the more expensive stocks against this backdrop, notably in the US, was beneficial. Offsetting this relative outperformance, the fund's position in Japan's Astellas Pharma weighed on returns amidst intense international competition and uncertainty about patent expirations.

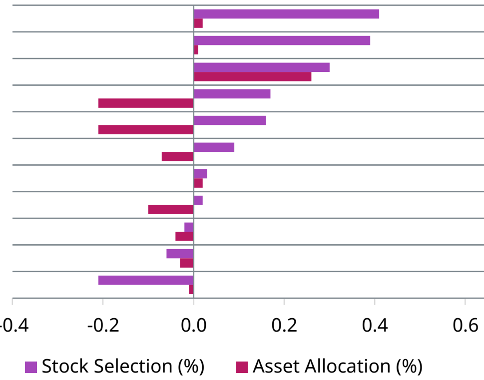
On the negative side, overweight positions in attractively valued US financials weighed on returns as the sector suffered during the final quarter amidst negative sentiment due to rising fears of an impending cyclical slowdown. Similarly, our longstanding underweight in utilities and real estate, notably in the US, also detracted as bond yields declined. Utilities were in fact the best performing sector through both Q4 and 2018 as a whole. We maintain a low weight to the naïve bond proxy sectors where valuations are not appealing given their fairly unattractive fundamentals.

Schroders Royal Borough of Kingston upon Thames Pension Fund

Schroder Life QEP Global Active Value Fund

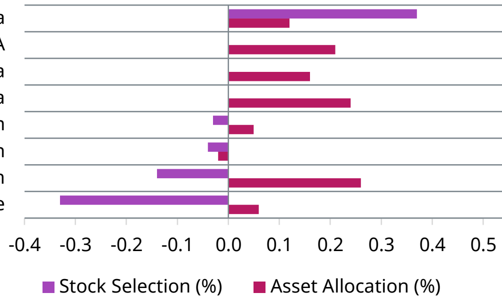
Relative Fund Performance vs MSCI World

Sector
3 months to 31 Dec 2018



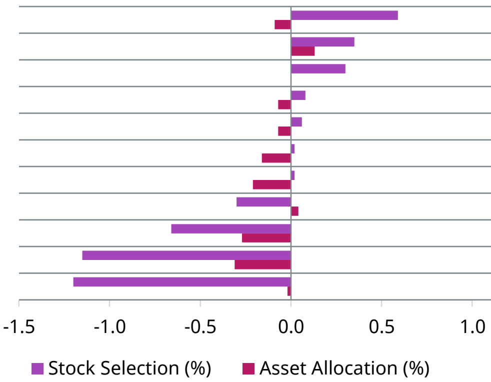
	SS (%)	AA (%)
Industrials	0.41	0.02
Communication Services	0.39	0.01
Information Technology	0.30	0.26
Utilities	0.17	-0.21
Energy	0.16	-0.21
Health Care	0.09	-0.07
Consumer Discretionary	0.03	0.02
Real Estate	0.02	-0.10
Consumer Staples	-0.02	-0.04
Materials	-0.06	-0.03
Financials	-0.21	-0.01

Region
3 months to 31 Dec 2018



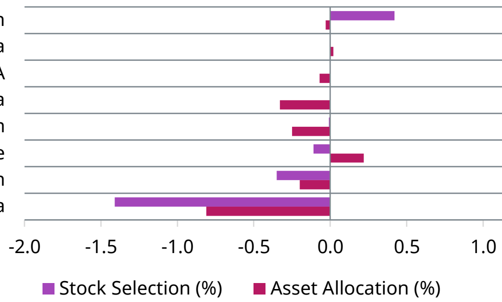
	SS (%)	AA (%)
North America	0.37	0.12
Emerging EMEA	0.00	0.21
Emerging Asia	0.00	0.16
Emerging Latin America	0.00	0.24
United Kingdom	-0.03	0.05
Japan	-0.04	-0.02
Pacific Ex Japan	-0.14	0.26
Continental Europe	-0.33	0.06

Sector
12 months to 31 Dec 2018



	SS (%)	AA (%)
Energy	0.59	-0.09
Industrials	0.35	0.13
Health Care	0.30	0.00
Real Estate	0.08	-0.07
Consumer Staples	0.06	-0.07
Utilities	0.02	-0.16
Materials	0.02	-0.21
Communication Services	-0.30	0.04
Financials	-0.66	-0.27
Information Technology	-1.15	-0.31
Consumer Discretionary	-1.20	-0.02

Region
12 months to 31 Dec 2018



	SS (%)	AA (%)
Pacific Ex Japan	0.42	-0.03
Emerging Latin America	0.00	0.02
Emerging EMEA	0.00	-0.07
Emerging Asia	0.00	-0.33
United Kingdom	-0.01	-0.25
Continental Europe	-0.11	0.22
Japan	-0.35	-0.20
North America	-1.41	-0.81

Source: Schroders & Investment Team Classifications.

Portfolio Activity and Policy

We continue to find a range of attractive value opportunities across most sectors and regions, from deep value in financials and resources to higher quality yield stocks in health care.

Within financials we are exploiting a wide range of options across the quality spectrum. Deeper value prospects are evident in European and Asian banks whilst, at the other end of the spectrum, we have broad exposure to high quality companies trading on attractive valuations, particularly complex banks and life & health insurers within the US and UK. Over December, we added to our exposure in US and European banks following a period of underperformance that in our view has been excessive and indiscriminate with regard to Quality. Following these trades, the fund has moved back into a net overweight position in US banks.

Within resources, we retain a preference for higher quality value within chemicals, miners and larger integrated oil companies. Over the quarter we rotated out of positions in large US integrated oil companies, where valuations are no longer compelling, funding an increase to our allocation to cheaper and higher yielding European oil companies.

We also took advantage of renewed market volatility, trimming certain positions in US consumer staples and EM & European telecoms (positions that we had built up earlier in the year when valuations were more attractive). This in part funded an increase in our exposure to industrials: across both regions and industries, split between building up some very deep value positions (e.g. within Japan) and adding stocks offering high quality dividend yields at currently reasonable prices across Europe and the US. We have also added a number of risk-adjusted positions across some deeper value areas of the consumer discretionary sector where we observe some large, low-leveraged companies trading at exceptionally low prices (e.g. global auto and UK house builders).

We maintain a low exposure in utilities and real estate, where we view valuations for most stocks as unattractive, particularly in the US.

Looking ahead to 2019, we are encouraged by the recent shift away from concentrated markets which has resulted in wider market breadth, a trend that we expect to continue as expectations towards the most popular stocks converge with reality. We have been highlighting this theme for the past year, noting that the elevated implied growth rates in many of these stocks over the next few years was vulnerable to disappointment. More generally, we favour normal levels of market volatility as this provides us with more opportunities to exploit transient shifts in sentiment. We would also argue that our strategic holdings in very affordable but higher quality companies will be rewarded against a backdrop of a cyclical slowdown. As part of this, we are particularly focused on identifying stocks with strong balance sheets, defendable dividend yields and stability in earnings whilst avoiding elevated valuations in more cyclical areas.

From a sustainability perspective, a focus on corporate governance has been a key component of our process for many years. We continue to integrate ESG considerations into our approach to stock selection and portfolio construction across the QEP investment desk with the ESG profiles of our strategies monitored on a continuous basis. Alongside this, we work collaboratively with Schroders' dedicated Sustainable Investment Team on our stewardship activities including engagement and voting.

In addition to the firm wide engagement programme, the QEP team actively identifies candidates for engagement by Schroders' Sustainable Investment team's dedicated ESG analysts. Engagement with these companies encompasses the full spectrum of environmental, social and governance issues. Over the course of 2018, the Sustainable Investment Team initiated engagements with companies held in QEP portfolios on a broad range of topics including board structure and compensation, water management, firearm sales, human capital, data privacy & cyber risks and CEO succession. On an ongoing basis, we monitor progress and outcomes during our monthly review meetings with the Sustainable Investment Team.

We also recognise our responsibility to make considered use of voting rights with a view to act in line with our fiduciary responsibilities in what we deem to be the interests of our clients. Throughout the course of 2018, Schroders voted at 5,227 meetings and approximately 99.0% of firm wide holdings. With regard to QEP strategies specifically, we voted at 2100 meetings on almost 23,000 resolutions during 2018. In terms of the direction of the votes cast, 10.1% of votes were not "with" management.

Schroder Life QEP Global Active Value Fund

Portfolio Characteristics at 31 Dec 2018

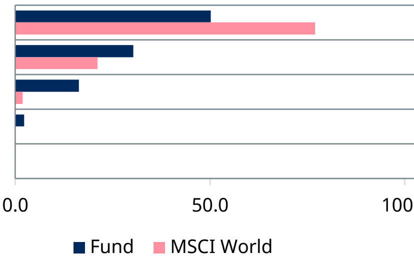
Characteristics	Fund	Index
Active Share	78.9%	
Weight in non-index stocks	27.6%	
Ex ante Tracking Error	3.1%	
Number of stocks	503	1,634
Company Market Cap	50,574	139,340
Dividend Yield (Gross)	3.8%	2.7%
Carbon Intensity (CO_2 t/M$ Sales)	160.3	190.2

Source: Schroders & MSCI. Tracking Error is sourced from Style Research.

Index: MSCI World

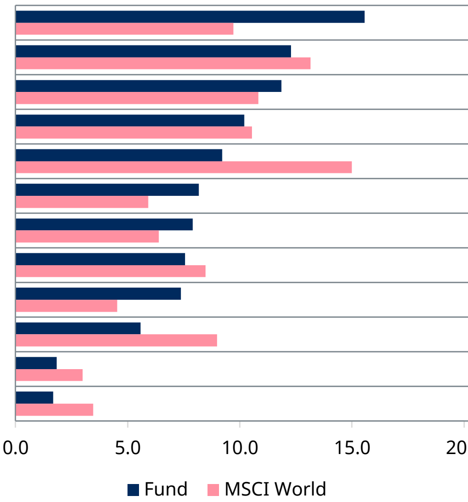
Portfolio Analysis

Portfolio Weightings Market Capitalisation (%) at 31 Dec 2018



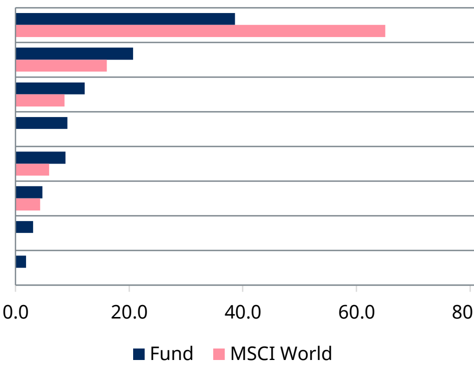
	Fund	Index
Mega-cap >US$20bn	50.19	76.98
Large-cap US$5bn to US$20bn	30.31	21.12
Mid-cap US$1bn to US$5bn	16.37	1.90
Small-cap US$250m to US$1bn	2.30	0.00
Micro-cap <US$250m	0.05	0.00

Sector (%) at 31 Dec 2018



	Fund	Index
Banks	15.56	9.71
Health Care	12.29	13.15
Industrials	11.85	10.83
Consumer Discretionary	10.20	10.54
Information Technology	9.21	15.00
Energy	8.17	5.92
Insurers/Asset Mgt	7.91	6.39
Communication Services	7.56	8.48
Materials	7.37	4.53
Consumer Staples	5.58	8.99
Real Estate	1.84	2.99
Utilities	1.68	3.46

Region (%) at 31 Dec 2018



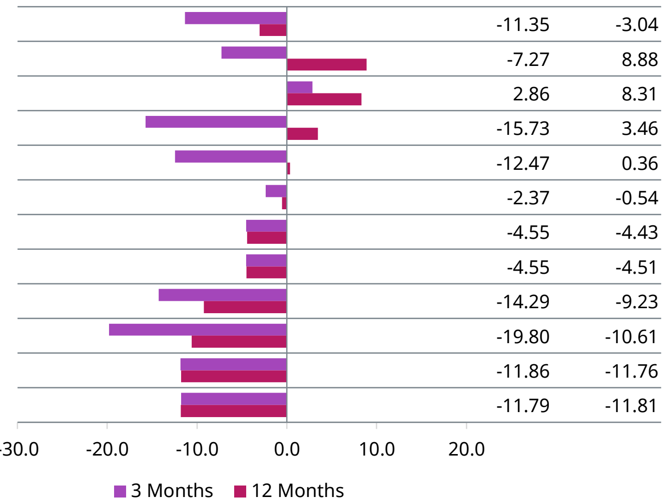
	Fund	Index
North America	38.65	65.07
Continental Europe	20.67	16.08
Japan	12.20	8.60
Emerging Asia	9.16	0.00
United Kingdom	8.81	5.92
Pacific Ex Japan	4.76	4.34
Emerging EMEA	3.08	0.00
Emerging Latin America	1.88	0.00

Source: Schroders & Investment Team Classifications.

Market Analysis

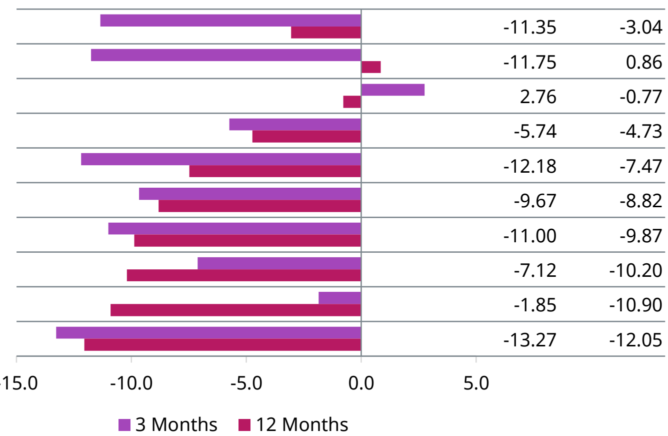
MSCI World Index Returns

Sector (GBP, %) to 31 Dec 2018



	3 Months	12 Months
MSCI World Index	-11.35	-3.04
Health Care	-7.27	8.88
Utilities	2.86	8.31
Information Technology	-15.73	3.46
Consumer Discretionary	-12.47	0.36
Real Estate	-2.37	-0.54
Communication Services	-4.55	-4.43
Consumer Staples	-4.55	-4.51
Industrials	-14.29	-9.23
Energy	-19.80	-10.61
Materials	-11.86	-11.76
Financials	-11.79	-11.81

Region (GBP, %) to 31 Dec 2018



	3 Months	12 Months
MSCI World Index	-11.35	-3.04
USA	-11.75	0.86
Emerging Latin America	2.76	-0.77
Pacific Ex Japan	-5.74	-4.73
Japan	-12.18	-7.47
United Kingdom	-9.67	-8.82
Europe Ex UK	-11.00	-9.87
Emerging Asia	-7.12	-10.20
Emerging EMEA	-1.85	-10.90
Canada	-13.27	-12.05

Source: Factset, Schroders & Investment Team Classifications.

Notes

Responsible Investment: Schroders Socially Responsible Investment and Corporate Governance policies can be found on our website http://www.schroders.com/global/about-schroders/corporate-responsibility/responsible-investment/. We also publish regular articles on Socially Responsible Investing, which can be found on Schroders Talking Point www.schroders.com/talkingpoint.

Schroders