

38. Central Finance Board

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Summary statement of change in unit holders' net assets

Year to 29 February 2016

CFB Funds	Net Assets at 28/2/2015 £'000s	Net Creations/ Cancellations £'000s	Change in Net assets £'000s	Net Assets at 29/02/2016 £'000s
UK Equity Fund	375,905	17,644	(38,301)	355,248
Overseas Fund	163,000	457	(4,176)	159,281
Gilt Fund	35,675	(3,357)	1,145	33,463
Corporate Bond Fund	93,919	2,573	(1,906)	94,586
Short Fixed Interest Fund	9,185	821	156	10,162
Inflation Linked Fund	30,141	(577)	956	30,520
Property Fund	18,107	790	1,391	20,288
Deposit Fund	360,057	(2,252)	0	357,805
Less: CFB Deposit Fund balances held in other CFB funds	(5,660)	3,220		(2,440)
Total	1,080,329	19,319	(40,735)	1,058,913

Review of the year ended 29 February 2016

Small mercies

In the past twelve months we have had to cope with: the fifth straight year of falling commodity prices; the bursting of the Chinese stock market bubble; growing concerns that the global economy is slowing; debt levels too high; productivity too low; the political status quo under threat from mass migration, and terrorist outrages an ever present threat. Given these factors investors may feel that they have come through the year relatively unscathed, with property and bond prices higher, whilst equity prices closed well above the lows, which for the UK market had been over 20% below its April peak. Over the course of the year, the net asset values fell by £41 million, which partly offset by £19 million net new investment in CFB funds, saw CFB funds total £1,059 million at the end of February. Together with £217 million of non-CFB Epworth clients, total funds under management were down £37 million over the year at £1,276 million

Equity funds outperform falling markets

A number of striking characteristics relating to the CFB approach to investment management have been identified by our performance and risk measurement consultants. CFB equity returns tend to hold up much better than the market as a whole when prices are falling, whilst capturing the vast majority of the upside when prices are rising. The result is above average long term returns despite adopting a below average level of risk. Consequently, although equity prices fell in the year under review, the relative returns of the CFB

funds were ahead of their benchmarks. After all expenses the UK Equity Fund outperformed the CFB Proprietary Ethical Index by 0.9% and the more traditional ethical index by 2.1%. Despite it being a poor year for ethical strategies, the CFB also outperformed the unconstrained FTSE All Share Index by 0.2%. Similarly, the CFB Overseas Fund outperformed its benchmark by 0.2%, after all expenses and unrecoverable tax. Bond yields continued to fall, but despite a cautious low duration approach, the CFB Gilt and Corporate Bond funds only underperformed by 0.1%, less than their total expenses. However, a poor year for corporate bonds, which both the Short Fixed and Inflation Linked funds hold, compared to government bonds resulted in disappointing returns relative to their government only benchmarks. The distribution on the CFB Deposit Fund at just over 0.5% continues to exceed its benchmark, and ended the year higher than it began for the first time in five years. The CFB Property Fund returns were not only the best in absolute terms at 14.7%, but also in relative terms, 2.0% above its benchmark.

Ethical issues

Ethics remains a high priority for the CFB and it was therefore pleasing that the Principles for Responsible Investment initiative ranked us in the top A+ band of signatories for our “overarching approach” in its 2015 assessment, despite our comparatively modest resources. Issues we addressed for the first time included farm animal welfare, corporate lobbying and funeral poverty. We also analysed our attempts over the past five years to encourage companies to become Living Wage Foundation employers and found that almost two thirds of targeted companies had shown a notable shift in their positions. Much work is done with our Church Investor Group partners, which allows for a more efficient use of resources. As a result the CFB was able to take on the lead role in the new water risk initiative. For the first time a single global CIG voting template was agreed allowing our votes to have maximum impact. Engagement continued on a variety of issues including human trafficking, the Palestinian Occupied Territories and Nestlé. The initiative to find a sustainable model for mining continued with the CFB participating in the programme of visits to mines and their surrounding communities and sitting on the steering committee directing the project.

Listening to the Conference

However, it was climate change that dominated the ethical agenda, with the Conference debating the *Fossil Fuels and Ethical Investment* report, the replies to three Memorials calling for divestment from fossil fuels, and a Notice of Motion on fossil fuels and climate change. These provided a welcome opportunity for Methodism to discuss and understand better the advice the CFB receives from the Joint Advisory Committee on the Ethics of Investment (JACEI) and the way we interpret it. We paid close attention to the request of the Conference to develop a strategy for increasing CFB investment in renewable energy and whilst the Memorials were declined, the seriousness of the subject was recognised in the replies. Thankfully, the new CFB Policy relating to different fuels had already been adopted. This called for divestment from companies: with a significant exposure to tar sands and thermal coal; mainly providing services to the fossil fuel industry; and with business models dedicated to exploring for and developing new fossil fuel assets. We have since been implementing the policy, beginning with the oil, extractives and oil service sectors. This has resulted in a number of additional ethical exclusions, which now total over 16% of the FTSE All Share Index, but does not include BP or Royal Dutch Shell, where engagement is still in our judgement the correct approach. Last year we were active in the *Aiming for A* coalition that co-filed shareholder resolutions calling for more disclosure related to climate change. Intense discussions with senior management resulted in their support for the resolutions, which were carried with over 98% of votes in favour. We also noted the Tax Justice Memorial, a subject that is very much in the public eye following the release of the *Panama Papers*. I have taken a personal interest in tax justice, representing the CFB at one related conference. It is an enormous subject and the CFB will need to work closely with others if significant progress is to be reported to the 2018 Conference, as requested.

Robust finances

It was good to see that the CFB achieved a £380,000 surplus last year and is now within £75,000 of its target to hold free reserves equal to 50% of budgeted expenditure: well ahead of schedule. One reason for the surplus was that fees were raised at the beginning of September, in order to finance additional staff and IT spending. Whilst even after the increase, CFB fees remain at the low end of the spectrum for most of our

clients, it was important for us ensure we remain competitive to our largest clients. Consequently, we introduced a differential charging structure that ensures that they will now benefit from economies of scale. In order to accommodate the differential charging structure an additional class of units was created. Although the fee increases may not have been welcomed, the reasons for them were understood and generally accepted.

Personnel

Although a better than budgeted financial position is to be welcomed, it is unfortunate that this was partly due to being unable to hire the experienced client relations and marketing staff we had hoped to do. In addition we also lost the services of our fixed interest fund manager and have not yet found a replacement. This has meant that all staff have been under greater pressure than we had anticipated and I am exceedingly grateful for their efforts. During the year, Stephen Beer was confirmed as Chief Investment Officer, a role in which he had been acting since Russell Sparkes was taken ill in 2014. We hope that Russell will recover and ultimately be able to return to work, but it was important for the continuity of the CFB that Stephen's position be made permanent, a decision that he has already fully justified.

One of our trainees also departed during the year. We were blessed that not only was Senior CFB Fund Administrator, Safiya Nelson, both well qualified and enthusiastic about taking on the role of Trainee Fund Manager, but also that Charlotte Jenkins joined us as Fund Administrator. In order to continue providing the high quality service that Methodism has come to expect from the CFB, we require not only high quality staff but also inspirational leadership. Next year, our Chief Executive, Bill Seddon will retire after thirty years in the role. Consequently, we are actively seeking his successor, who we hope to be able to announce in June.

Epworth

During the past year Epworth has not made the progress I would have liked. Non-CFB Epworth funds under management declined by £20 million to £217 million, of which £16 million was from the Affirmative Deposit Fund following an unusually high level a year ago. There was a steady trickle of new money from existing clients but with no major new clients this was insufficient to make up for the decline in equity prices over the year. Our hopes of a major push on marketing were thwarted by a combination of being unable to find the right people to add to our team and having to divert resources when our fixed interest manager departed. I am convinced that growing the Epworth client base is vital to the future success of the CFB, but it is a long-term project that cannot be rushed if we are to ensure that we retain our reputation for providing a high quality service to our clients.

Departures

I would like to express my thanks for the wisdom and support of our Council over the past year. As always there have been some departures. John Reynolds stood down as he felt he was unable to devote the necessary time due to increased responsibilities elsewhere. Happily, a change in his circumstances allowed us to co-opt Graham Boyd back onto the Council after an absence of a year. We also lose our Vice-Chair, John Gibbon, having completed the maximum nine years on Council, where his knowledge and fund management experience will be sorely missed. However, it is not a complete goodbye as he will remain on the Epworth board. We were all saddened to learn of the deaths of two former Council members, Peter Cussons and Sir James Birrell, as well as the CFB's first Investment Manager, Charles Jacob. It is appropriate for us to pay tribute to the contribution Charles made to Methodism through establishing the CFB Investment Unit, bringing together the bulk of Methodist investments under the CFB's stewardship and establishing our reputation for providing above average returns whilst employing an ethical approach to investment. In recognition of his achievements, we have instituted an annual *Charles Jacob Memorial Lecture* as part of our General meeting. The inaugural speaker will be the Revd Brian Brown, a member of JACEI from its inception, where he represented what was then the Division of Social Responsibility, rather than the CFB.

Transition

It is good to look back on a rich heritage, but I am also keenly aware that we cannot rest on our laurels and it is important to consider to the future. Major changes are inevitable over the next year as we transition to new senior leadership and build up the supporting team. By this time next year we will have a new Chief Executive and there will be new faces in the staff team, Council and Board. However, some things will not change foremost of which are our collective commitment to service and excellence as the CFB seeks to continue delivering good investment returns in line with the ethical position of the Methodist Church.

*****RESOLUTIONS**

38/1. The Conference adopts the Report of the Central Finance Board.

38/2. The Conference elects the following persons to the Central Finance Board for the period of one year from 1 September 2016:

Dr Keith Aldred, Amanda Amor, Ruby Beech, Graham Boyd, Christopher Daws, Ralph Dransfield, Caroline Edwards, Ashley France, John Gibbon, Anne Goodman, Hazel Griffiths, Alan Groves, Frank Guaschi, David Haslam, Sue Haworth, Peter Hobbs, the Revd Dr Peter Howson, the Revd R Andrew Laird, the Revd Leslie Newton, Theophilus Mensah, Nick Moore, John O'Brien, Colin Pearson, Alan Pimlott, the Revd Jennifer Potter, Martin Rees, John Reynolds, John Sandford, Maureen Sebanakitta, Gordon Slater, Andrew Slim, the Revd Eleanor Smith, Anthea Sully, the Revd Graham Thompson, Geoffrey Wilcox, Michael Willett, Terry Wynn, Garry Young.

Investment Performance

External Assessment

(Source: Portfolio Evaluation, except where stated)

29 February 2016

Index	1 year to 29.02.16 %	5 years to 29.02.16 % p.a.	10 years to 29.02.16 %p.a.
Equity			
CFB UK Equity Fund	-7.1	+5.2	+4.9
FTSE All Share Index	-7.3	+5.1	+4.9
CFB proprietary ethical Index	-8.0	+5.4	+4.8
FTSE All Share Index (traditional ethical adjustment)	-9.2	+4.4	+4.2
CFB Overseas Fund	-1.4	+8.2	+7.0
FTSE All World ex U.K Index	-1.6	+7.8	+6.9
CFB Managed Equity Fund¹	-6.3	+5.6	+5.3
Managed Equity Fund Composite Index	-6.5	+5.5	+5.2
Managed Equity Fund Composite Index (using CFB proprietary UK Index)	-7.1	+5.8	+5.1
Managed Equity Fund Composite Index (using traditional UK ethical adjustment)	-8.0	+4.9	+4.6
CFB Managed Mixed Fund¹	-2.4	+6.2	+5.7
Managed Mixed Composite Index	-2.6	+6.0	+5.5
Managed Mixed Composite Index (using CFB proprietary UK Index)	-3.1	+6.2	+5.4
Managed Mixed Composite Index (using traditional UK ethical adjustment)	-3.8	+5.6	+5.1
Fixed Interest			
CFB Managed Fixed Interest Fund¹	+4.0	+5.3	+5.2
Managed Fixed Interest Composite	+4.3	+5.5	+5.1
CFB Short Fixed Interest Fund	+3.4	+4.0	+4.7
Short Gilt Composite Index	+4.3	+4.1	+4.8
CFB Gilt Fund	+5.3	+6.5	+5.5
FTSE All Stock Gilt Index	+5.4	+6.8	+5.6
CFB Corporate Bond Fund¹	+1.1	+6.6	+5.7
Corporate Bond Composite Index	+1.2	+6.6	+4.7
Inflation Linked			
CFB Inflation Linked Fund	+3.6	+8.2	+6.9
FTSE All Stock Index Linked Index (gilt only)	+4.6	+8.6	+7.1
Property			
CFB Property Fund^{1,3}	+14.7	+9.7	+4.1
IPD All Balanced Funds Index ^{2,3}	+12.7	+9.0	+3.8
Cash (AERs)			
CFB Deposit Fund¹	+0.5	+0.9	+2.2
Higher Rate Bank Deposits (over £10,000)	+0.1	+0.1	+0.7
1 Week LIBID	+0.4	+0.4	n/a

¹ Source: CFB

² Source: IPD

³ Performance to 31st December 2015