The Scott Trust
Endowment Fund Performance Report

theguardian

Statement by the Chairman of the Scott Trust, Alex Graham

The Scott Trust Endowment Fund and our other investment assets are central to securing the long-term future of the Guardian.

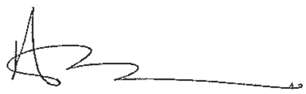
The genesis of the Endowment Fund was the disposal in mid-2007 of a minority stake in Trader Media Group. This allowed us to invest a portion of these proceeds (£200m) in a diversified investment portfolio. We commenced investment in mid-2008, the heart of the financial crisis, and this was of course challenging. However, the investment portfolio weathered the storm well, and has subsequently flourished. The Endowment Fund has increased in scale since 2008 through a combination of organic growth and other cash injections as Guardian Media Group has disposed of non-core assets over time.

The investment objectives of the Fund were (and still are) three-fold – to generate long-term returns to secure the financial and editorial independence of the Guardian in perpetuity; to provide diversification in economies other than that of the UK, and to provide diversification in sectors other than the media industry, which has been undergoing substantial change over the past decade. We believe investing in a global, diversified, multi-asset portfolio is an appropriate investment strategy, in terms of risk and return.

In this Performance Report we detail how the Endowment Fund has evolved over the past nine years, the successes it has achieved, our approach to socially responsible investment, including the Fund's alignment with the Guardian's fossil fuel divestment campaign 'Keep it in the Ground', and how the Fund is currently positioned.

The Endowment Fund is now a unique and critical part of the Guardian's make up, and it is essential that those of us charged with overseeing its investment and its work take a long view, and bear in mind its ultimate purpose: to secure the Guardian's financial and editorial independence, in perpetuity. That is the guiding principle for every decision we make around the Fund.

We are delighted to share with Guardian staff and other stakeholders some detail on our assets, with a particular focus on the Endowment Fund, its evolution, composition and performance over the past twelve months.



Report on the Endowment Fund

1. Structure of Investment Assets

At 30 June 2017, the Fund's aggregate investment assets were in excess of £1bn. The split between different components of the investment assets and their respective roles is as follows:

Investment Asset	Balance	Role of Investment Asset
Endowment Fund	£763.2m	This fund aims to generate risk-adjusted returns over the long term to support the Guardian in perpetuity.
Medium Term Fund	£148.2m	This fund provides for the Guardian's spending requirement for its business and operations in the medium term. Funds are invested conservatively in high quality corporate bonds.
Money Market Funds	£61.7m	This fund holds cash for the Guardian's spending requirements for the business and operations in the short-term. Funds are invested in a range of AAA rated money market funds.
Cash	£20m	Funds are held in cash to meet near-term working capital requirements.
New Investments	£35.7m	These funds may be drawn down over time to facilitate new investments.
Total	£1,028.8m	

2. Performance

Since inception in mid-2008 to 31 March 2017, the Endowment Fund has generated an annualised return of +6.6%, ahead of its portfolio benchmark (+5.1%). This portfolio benchmark reflects the Endowment Fund's Strategic Asset Allocation (SAA), i.e. the combination of assets which over the long-term should enable us to meet our investment objectives.

As for many UK-based institutions with globally diversified portfolios, recent returns have been strong, principally thanks to the sharp depreciation of sterling in the aftermath of the Brexit referendum result. For the twelve-month period to 31 March 2017 (in line with our fiscal year end period), the Endowment Fund generated a return of +20.6%, of which we estimate approximately one-third of this gain was due to favourable currency movements.

3. Governance of the Endowment Fund

For practical purposes, the Scott Trust has delegated authority for most decisions relating to the management of the assets to the Scott Trust Investment Committee ("Investment Committee" or "Committee"). The Investment Committee meets on a quarterly basis to review the performance and strategy of the Endowment Fund and other funds.

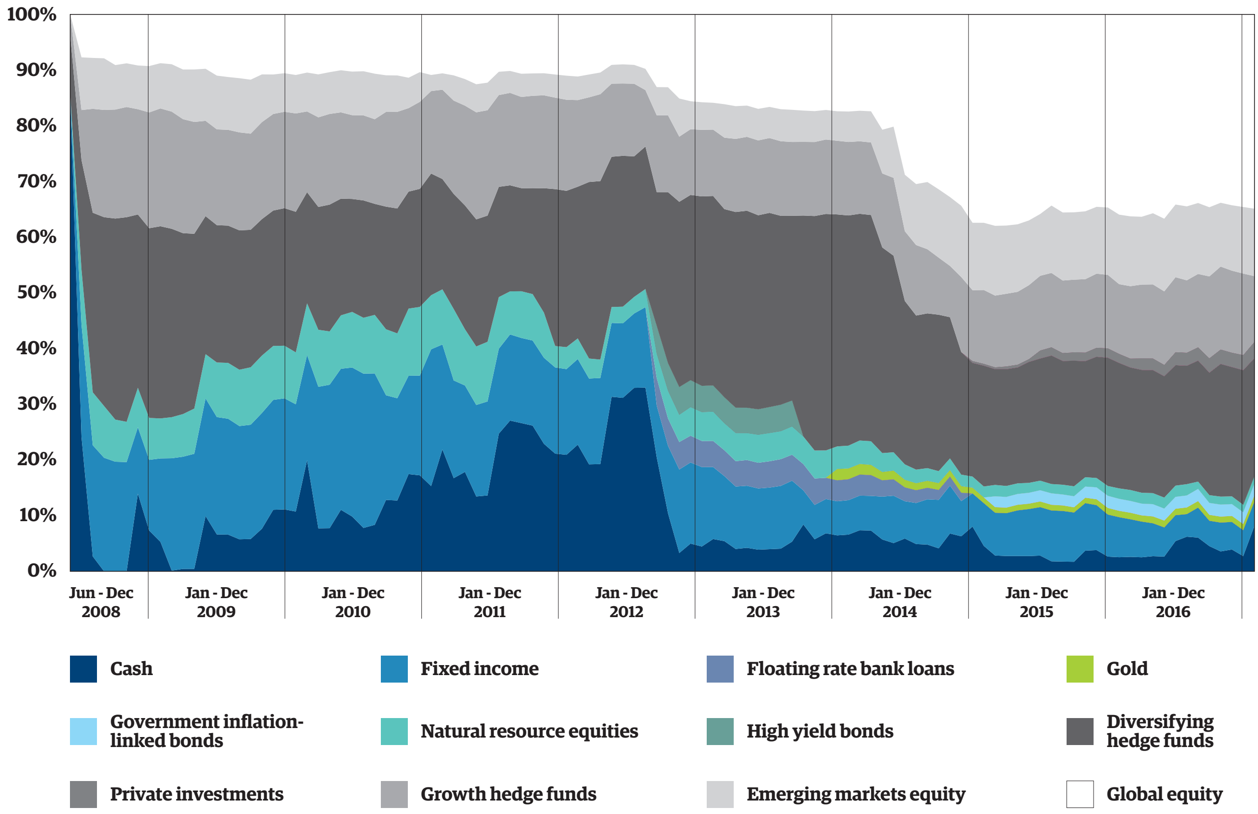
The Committee is comprised of both Scott Trust and GMG plc Board members - the current membership is as follows:

- Neil Berkett, (Chair)
- Catherine Howarth
- Ole Jacob Sunde
- Coram Williams

The Scott Trust and Investment Committee has retained Cambridge Associates as an advisor to work with the Investment Committee and Executive team on strategic asset allocation, tactical tilts and managing day to day aspects of the Fund.

4. Review of Investment Activities

Evolution of Asset Allocation



The table above shows the evolution of the Endowment Fund's asset allocation since inception in mid 2008 to February 2017.

In the aftermath of the 2008 financial crisis, we would highlight the defensive positioning of the portfolio. It was necessary at that time to draw meaningful amounts of capital from the portfolio to fund on-going business needs.

In more recent years, the Endowment Fund has adopted a more return-seeking stance - reflected in the greater exposure to equity assets from 2014 onwards. We have set up Money Market Funds and the Medium Term Fund to finance short to medium term requirements of the business, instead of drawing from the Endowment Fund. The Endowment Fund is currently invested in twelve different asset classes.

4. Review of Investment Activities (cont.)

Overview of Performance

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017 TD	Annual since inception
GMG total assets (with currency overlay)	-9.3%	+17.5%	+10.7%	-2.8%	+4.5%	+10.6%	+8.2%	+0.2%	+17.7%	+3.7%	+6.6%
GMG portfolio benchmark (hedged)	-12.1%	+12.9%	+7.8%	-2.4%	+4.6%	+7.8%	+7.1%	+0.4%	+17.3%	+3.9%	+5.1%
Value added	+2.8%	+4.6%	+2.9%	-0.4%	-0.1%	+2.8%	+1.1%	-0.1%	+0.4%	-0.2%	+1.5%

Note - returns above are for calendar year end periods to December. 2017 YTD relates to the period to 31 March 2017

The table and charts above show the total portfolio's performance since inception on both a calendar year (to December) and annualised basis ("Ann. Since Inception"). The portfolio has generated significant outperformance (net of fees) versus the portfolio benchmark since inception. We also note that positive relative performance has been generated in both rising and falling equity markets.

In terms of performance for the 12-month period to 31 March 2017, we highlight the following:

- The strong absolute performance was driven by the Developed and Emerging Market Equity allocations (47% of the portfolio as at 31 March 2017), which returned +36% and +36.2% respectively. While these figures are strengthened by the currency effect of translating returns back into sterling in the aftermath of Brexit, the performance of the underlying third party managers was nevertheless strong and ahead of their respective benchmarks.

- In mid-2014 we approved an allocation to Private Investments, including both private equity and venture capital. This is an illiquid asset class which is expected to outperform listed equity markets over time and requires a very long-term mindset. Building exposure to the asset class will take time, and analysis of performance is meaningless for the first few years. We are nevertheless encouraged by the access we have achieved to high quality managers across the spectrum of private investments. Since the end of 2014, we have committed a total of £90m to 18 different partnerships.

- The portfolio has an allocation to Growth and Diversifying Hedge Funds. We have split these investment strategies in separate components because we want to be clear about the roles that each is expected to perform in the portfolio. Growth strategies have to provide equity-like returns, while diversifying strategies need to help control overall volatility. The Growth and Diversifying Hedge Fund allocations generated strong positive returns in £ for 2017 (+25.6% and +22.1% respectively). However, based on detailed analysis of these hedge fund allocations, a number of changes are underway, focusing on moving to more concentrated portfolios populated by lower cost strategies. We would note, however, that hedge funds have added meaningful value to the Endowment Fund over the longer term.

- The portfolio has an allocation to Inflation Sensitive assets. This component of the portfolio is made up of inflation-linked bonds, natural resource equities and gold. (Note - given our commitment to divest from fossil fuels, we will be unwinding all positions in natural resource equities in the medium term). In aggregate this allocation returned +20.2% in the 12 months to 31 March 2017.

- The Deflation Hedging component of the portfolio, intended to provide downside protection in the event of a period of acute market volatility and deflationary pressures re-emerging, returned +3.8% - a strong return in the context of global government bonds (£-hedged) generating a small negative return.

4. Review of Investment Activities (cont.)

Diversification

The Endowment Fund invests through third party fund managers, globally, across multiple asset classes. These managers are subject to rigorous initial and ongoing review. The Endowment Fund is highly diversified, with allocation to any single active manager limited to 5% of the overall portfolio, at the time of investment. The Endowment Fund also invests part of the assets passively in both equities and bonds to help control costs.

Cost cutting

Given the on-going efforts throughout Guardian to save costs, we have reduced annual costs of managing the Fund by around 20%. We are also paying particular attention to third party manager fees and have proactively engaged with them in an effort to negotiate reductions. Over the course of 2016 and 2017 we have been able to achieve significant cost savings.

Managers

Below we provide examples of the type of manager in which the Endowment Fund is invested:

- **Global Equity: Generation Global Equity**
  This is the largest allocation to an active manager in the portfolio (around 5% as at 31 March 2017). Generation runs a quality-focused strategy that puts sustainability at the heart of its research process. This manager has been a core component of our Global Equity mandate since portfolio inception in mid-2008 and has generated an annualized return of +16.2%, well ahead of its benchmark.

- **Emerging Markets Equity: Acadian Sustainable Emerging Markets Equity ex-Fossil Fuels**
  This position was incepted into the portfolio in December 2016 and has had a solid start, returning +15.4%, ahead of its benchmark. This strategy applies a fossil fuel filter to its investable universe.

- **Diversifying Strategies: Farallon's Fossil Fuel Free Fund (F5)**
  This is a multi-strategy hedge fund across all asset classes, global in nature. It pursues event driven opportunities across equities, credit and special situations. Given its strategy, it provides diversification to our portfolio. Farallon also applies its own proprietary fossil fuel filter to its investment process, excluding companies and activities associated with the exploration, extraction and production of fossil fuels, as well as those with a material dependency on the fossil fuel industry. Since it was added to the portfolio in February 2016, this strategy has generated an annualized return of +7.9%

- **Fixed Income: Colchester Global Bond Fund**
  We think it appropriate to invest actively in fixed income with a value-focused manager in order to avoid the most expensive parts of the market. This strategy has worked well - since addition to the portfolio in June 2010, Colchester has generated an annualized return of +4%, ahead of the broad government bond index.

4. Review of Investment Activities (cont.)

Risk

The objective of the Endowment Fund is to maximize returns for a given level of risk. At the asset allocation policy level, the Fund has four distinct components, as shown below.

			Macroeconomic hedges	
Four key roles	**Growth dividers** Goal: Generate growth to support longer - term objectives	**Diversifiers** Goal: Mitigate equity risk while attempting to improve overall risk/ return profile	**Inflation sensitive** Goal: Provide protection in a period of sharp unexpected inflation	**Deflation hedge** Goal: Provide protection in a period of economic contraction
Example asset classes	● Global developed equities ● Emerging market equities ● High yield credit ● Equity - oriented hedge funds ● Private equity and venture capital	● Balanced/multi - asset manager ● Investment grade credit ● Less directional hedge fund strategies ● Private credit	● Commodities ● Natural resource equities ● Private property ● Property equities ● Gold	● Government bonds ● Cash

The Growth Drivers allocation is focused on generating long-term growth for the Fund and, as such, is focused on listed and private equity assets. The allocation to Diversifying Strategies is intended to mitigate the volatility inherent in an equity-orientated portfolio. To our mind this portfolio component plays a particularly important role given the extended valuations we see in government bonds, which have historically served to dampen volatility effectively. The final two components of the portfolio, Inflation Sensitive and Deflation Hedging serve as insurance against two macro-economic risks that can undermine the purchasing power of the Fund over the long-term, namely inflation and deflation. This long-term policy ensures that we take enough risk to meet our long-term investment objectives, but also limits potential drawdowns over shorter periods. (Note - Given our commitment to divest from fossil fuels, we will exit natural resource equities (as set out in the table above) fully in the medium term).

Over shorter periods we monitor risk in a number of ways, for example at the total portfolio level, the monitoring of beta (i.e. sensitivity to the broad equity market) and volatility (as measured by Standard Deviation) offer insight into the positioning of the portfolio.

We also consider the geographic and sector positioning of the listed equity allocations to ensure that portfolio positioning is in line with our view on relative valuations.

Another important consideration is the monitoring of currency risk. With the Guardian's future spending from the Fund to be very substantially in £, there is a mismatch with the currency exposure of a globally diversified portfolio, where the $ is the dominant currency, along with the € (to a lesser extent). We therefore use a passive currency overlay to hedge back the portfolio's currency exposure to a £ range of 40-70%.

5. Socially Responsible Investment

The primary focus of the Endowment Fund is to generate strong and sustainable risk-adjusted returns in order to ensure the editorial independence of the Guardian in perpetuity. The Scott Trust believes that sustainability should be at the heart of the investment approach in order to generate the long-term results we need. This also allows us be consistent with the Scott Trust's values and to meet the expectations of stakeholders, including Guardian's members.

We have developed a Sustainable Investment Plan that rests on five pillars:

1. **UN PRI:** we are a signatory and proactively put into practice the United Nations Principles for Responsible Investment ("UN PRI") as defined by PRI (the world's leading proponent of responsible investment)
2. **Engagement:** we engage with asset managers and portfolio companies on climate change and ESG issues
3. **ESG Integration:** we invest with managers that have a robust, integrated ESG strategy
4. **Proactive Investments:** we seek out investment managers that are actively investing in companies that help bring about a low carbon future
5. **Divestment:** we are divesting the portfolio from fossil fuel exposure over the medium term to align the portfolio with "keep it in the ground", the Guardian's climate campaign.

We have achieved significant progress on all five areas of its plan as illustrated by the table below:

	UN PRI	Engagement	ESG integration	Proactive investments towards low carbon economy	Fossil fuel divestment
Progress in 2016/2017	Completed second report and received 'A+' and 'A' scores across all modules	Engaged with all asset managers in the portfolio Joined ShareAction and the Institutional Investors Group on Climate Change	37% of the portfolio is invested in ESG integrated managers, well exceeding the 10% target	Investments in managers in public and private markets totalling 3.1% of the Endowment Fund	Target is to half the fossil fuel exposure of the fund by the end of 2017. Steps in progress indicate that the reduction will exceed 60%

As a UN PRI signatory (see above), we reported in our first (voluntary) reporting cycle in 2016 (where we scored five A's). We sought feedback from the UN PRI regarding how we can continue to improve our performance. This was achieved in the 2017 reporting cycle, where we scored an A+ in the listed equity module, the largest single allocation of our Endowment Fund, (versus ours peers median score of B). We scored A's in four other modules (versus our peers median scores of one A and three C's). We will continue to be an active and committed signatory going forward.

We have been one of the largest funds globally to divest from fossil fuels. We are focused on continuing to do this without sacrificing financial returns.

Thanks to this strong commitment, we have been successful in changing investment managers' behavior and driving the creation of new products, which have subsequently attracted new capital. One notable example is the creation of the world's first fossil-free emerging market equity fund managed by Acadian Asset Management. We were the seed investor in the fund in December 2016 and played a key role in the fund's design. Our role has been catalytic as the fund has now grown to over $200m in assets.