Avon Pension Fund

Review for period to 30 June 2014

Contents

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1 Executive summary

This report is produced by JLT Employee Benefits ("JLT") to assess the performance and risks of the investment managers of the Avon Pension Fund (the “Fund”), and of the Fund as a whole.

Funding level

- There is expected to have been an improvement in the funding level by around 3% over the second quarter of 2014.
- The drivers of the improvement were:
    - A positive asset return, following positive returns from most managers.
    - The receipt of advance deficit payments.
    - A smaller negative effect from the liabilities, as the valuation interest rate was slightly decreased, increasing the value placed on liabilities. This was partially offset by a fall in inflation linked liabilities due to lower inflation expectations.

Fund Performance

- The value of the Fund's assets increased by £156m over the second quarter of 2014 to £3,486m. The total Fund returned 2.4%, which was a result of modest positive returns from most funds. The Fund return was ahead of the benchmark of 2.2%. Excluding Record, the Fund return was in line at 2.2%.

Strategy

- The three-year volatility of each asset class (as measured by the standard deviation of returns) has remained broadly stable compared to the same measure last quarter. There has been a small rise in the volatility of property as returns have recently picked up.
- The impact of currency movements adds to the volatility of the Fund’s assets. The dynamic currency hedge has reduced this volatility and added value compared to having an unhedged portfolio.
- Equities rose over the quarter as economic data improved, although developed equities fell back slightly towards the end of the quarter following some indicators of a slower growing economy for the remainder of 2014. The best performing region was the emerging markets, which returned 5.0% over the quarter, more than making up its lost ground from Q1 2014. UK equities returned 2.2%, whilst the worst performing equity region was Europe at 0.3%.
- Over the last twelve months, European equities produced the best return of 15.5%; the UK and USA also produced double-digit returns. Eastern markets lagged, with a negative one-year return from Japanese equities.
- The three year developed market equity returns remained ahead of the assumed strategic return but the emerging market equity return is significantly behind its assumed strategic return over three years.
- Gilts produced modest positive returns, as yields fell slightly. Corporate bonds produced a higher return over the quarter as the yield gap narrowed. Over the three year period returns remain ahead of the assumed strategic return. However, note that the next two quarters to fall out of the analysis

(Q3 2011 and Q4 2011) were very high returns and so the rolling three year return is expected to fall, all else being equal.

- The Overseas Fixed Interest return has fallen back to -0.9% p.a. over three years, as US yields rose.
- Hedge funds remain below the assumed strategic returns although the three year return showed further improvement this quarter. The Property return has moved further ahead of the assumed strategic return – over the last 12 months the return was 17.6%.
- The strengthening of Sterling against the US dollar, Euro and Yen meant that the impact of currency hedging has had a beneficial impact, reducing the negative effect of currency movements.

Managers

- At the quarter end, ten managers had met their three year performance target; TT International were short of the target but had outperformed the benchmark; Schroder global equity, Signet and Gottex all underperformed the benchmark over the three year period. Partners also outperformed the benchmark but do not have a formal outperformance target.
- Absolute returns from the managers were mixed over the last quarter. The highest returns were from the two emerging market equity funds and Schroder Property, which all produced returns of approximately 5%. The only two portfolios with a negative absolute return were TT (-1.0%) and SSgA Europe (-0.3%) - the TT portfolio was significantly below the FTSE All-Share Index of 2.2% whereas the SSgA Europe fund outperformed its benchmark.
- Over one-year, the highest return came from SSgA Europe (17.2%), closely followed by Schroder Property (16.9%). Jupiter, TT and Invesco also had double-digit one-year returns.
- The negative markets earlier in the year continued to affect the one-year SSgA Pacific and Genesis returns, although both managers outperformed their benchmarks over one year.
- Over three years, similarly developed equities produced the best absolute returns. Each equity manager apart from Schroder exceeded their benchmark over three years, and all except TT and Schroder also met their targets.
- The Schroder Global Equity Portfolio has now been in place for three years and has underperformed its target over this period by 1.9% p.a.
- Stenham met its three-year target (albeit with a return of 4.4% p.a.); Gottex outperformed over one-year but remain below their three year benchmark; Signet remain significantly below their three-year target.

Key points for consideration

- The increase in the allocation to emerging market equities over Q1 has proved beneficial given the recent market performance.
  - However, it is important to note that this allocation is a long term position and, over the short term, is likely to exhibit more volatility than developed market equities.
  - The new manager used for the increase in the allocation, Unigestion, is expected to provide a lower volatility than the benchmark and have a contrasting style to the existing emerging market manager, Genesis.
    - It is therefore pleasing that both have outperformed a rising market over the quarter.
- Allocations to infrastructure are expected to begin over the remainder of 2014 and into 2015, expected to be funded from the overweight allocations to developed market equities.

- Pyrford are particularly defensively positioned, echoing some market commentators' concerns that equity markets are showing too little volatility given certain geopolitical events and whether developed market economic growth will continue its momentum.
  - The introduction of the DGF managers who are expected to provide active asset allocation, as well as the introduction of a further diversifying asset class, infrastructure, provides some protection for the Fund against these concerns.
- Credit spreads (the additional yield on corporate bonds relative to gilts) have continued to tighten, leading some market commentators to become concerned over whether a correction is due.
  - Active management within corporate bonds, undertaken by RLAM for the Fund, means that these risks are considered individually for each bond held, providing some protection.
  - The Fund has increased its allocation to corporate bonds but it remains at a modest level. It should be noted that the allocation to high yield bonds has decreased as a result of action taken within the Barings Dynamic Asset Allocation Fund.
- The Avon Pension Fund is currently reviewing its hedge fund portfolio.
  - Stenham and Gottex in particular are showing improving trends in performance, albeit equity related strategies are amongst the main contributors to this performance.
- In August 2014, Barings announced that Percival Stanion, Andrew Cole and Shaniel Ramjee are to leave Barings. Percival is the head of the Barings Multi-Asset team, lead fund manager of the Dynamic Asset Allocation Fund and chairs the strategic policy committee; Andrew is one of the founding members of the multi-asset team and a co-manager of the Dynamic Asset Allocation Fund; Shaniel is a junior member of the multi-asset team.

2 Market Background

The figures below cover the three months, 1 year and 3 years to the end of June 2014.

Market Statistics

Yields as at 30 June 2014	% p.a.
UK Equities	3.27
UK Gilts (>15 yrs)	3.34
Real Yield (>5 yrs ILG)	-0.12
Corporate Bonds (>15 yrs AA)	4.17
Non-Gilts (>15 yrs)	4.44

Absolute Change in Yields	3 Mths %	1 Year %	3 Years %
UK Equities	-0.14	-0.26	0.28
UK Gilts (>15 yrs)	-0.09	-0.09	-0.88
Index-Linked Gilts (>5 yrs)	-0.02	-0.09	-0.60
Corporate Bonds (>15 yrs AA)	-0.13	-0.35	-1.37
Non-Gilts (>15 yrs)	-0.16	-0.24	-1.09

Market Returns Bond Assets	3 Mths %	1 Year %	3 Years % p.a.
UK Gilts (>15 yrs)	2.3	5.3	8.7
Index-Linked Gilts (>5 yrs)	1.1	4.3	7.8
Corporate Bonds (>15 yrs AA)	2.8	9.2	9.4
Non-Gilts (>15 yrs)	3.4	9.3	9.6

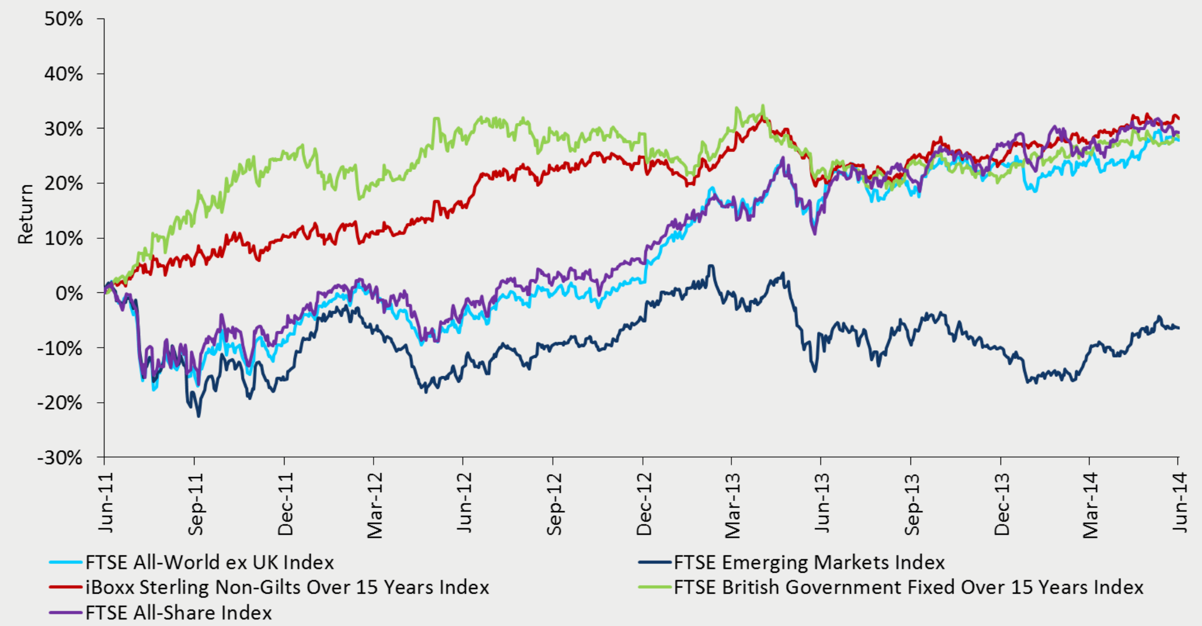
Source: Thomson Reuters and Bloomberg

Market Returns Growth Assets	3 Mths %	1 Year %	3 Years % p.a.
UK Equities	2.2	13.1	8.9
Overseas Equities	2.6	9.4	8.5
USA	2.6	10.9	14.3
Europe	0.3	15.6	5.3
Japan	4.3	-1.7	5.7
Asia Pacific (ex Japan)	3.6	4.6	2.0
Emerging Markets	5.0	1.2	-2.2
Property	5.1	17.6	8.6
Hedge Funds	2.0	9.1	5.6
Commodities	0.1	-2.1	-1.9
High Yield	0.3	0.8	7.4
Emerging Market Debt	4.8	11.6	7.4
Senior Secured Loans	1.4	7.0	5.6
Cash	0.1	0.4	0.5

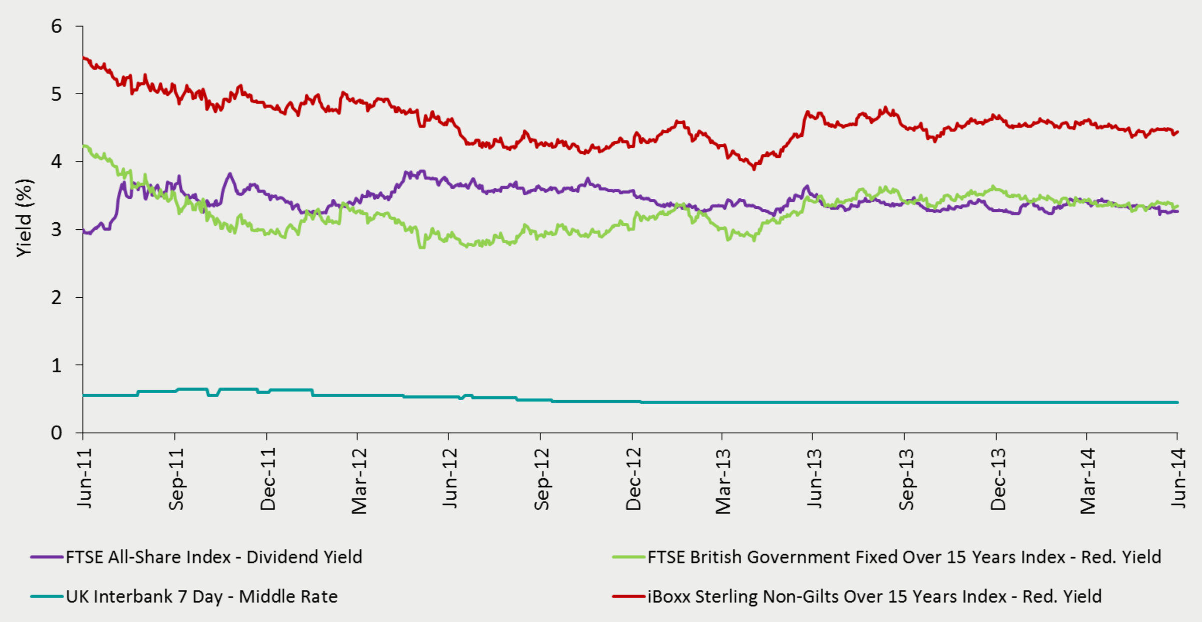
Change in Sterling	3 Mths %	1 Year %	3 Years % p.a.
Against US Dollar	2.6	12.7	2.1
Against Euro	3.2	7.0	4.1
Against Yen	0.9	15.0	10.1

Inflation Indices	3 Mths %	1 Year %	3 Years % p.a.
Price Inflation – RPI	0.6	2.6	2.9
Price Inflation – CPI	0.5	1.9	2.4
Earnings Inflation	0.7	0.7	1.2

Market Summary charts



The graph above shows market returns for the last three years; both the medium-term trend and the short-term volatility.



The trend over the last 3 years until the end of April 2013 shows falling UK gilts and the corporate bond yields whilst the dividend yield on the FTSE All-Share Index has risen. Bond yields were more stable in the second half of 2013 but have fallen over the first six months of 2014, whilst the dividend yield has remained relatively flat over the last one year.

The table below compares general market returns (i.e. not achieved Fund returns) to 30 June 2014, with assumptions about returns made in the Investment Strategy agreed in 2013.

Asset Class	Strategy Assumed Return % p.a.	3 year Index Return % p.a.	Comment
Developed Equities	8.25	9.8	Ahead of the assumed strategic return despite the negative quarterly return at the start of the 3 year period. In Q3 2011, uncertainty about the global economic outlook, the banking system and Eurozone debt produced a return of -14.4%. Excluding this, the developed equity return for the last 2¾ years is 17.2% p.a.
Emerging Market Equities	8.75	-2.1	The 3-year return from emerging market equities remains negative although has improved over the most recent quarter. As with developed equities, excluding Q3 2011 gives a very different picture, with the return over the last 2¾ years being 6.0% p.a.
Diversified Growth	Libor + 4% / RPI + 5%	4.7 / 7.6	DGFs are expected to produce an equity like return over the long term – this is the basis for the Libor and RPI based benchmarks. Low cash rates means that the Libor based benchmark has significantly underperformed the inflation (RPI) based benchmark and the long term expected return from equity. During periods of very strong equity returns, such as the recent three year period, we would expect DGF to underperform equities but deliver a return close to the long term assumed strategic return from equity.
UK Gilts	4.5	8.7	Ahead of the assumed strategic return mainly as a result of the fall in gilt yields during the second half of 2011. Returns have been positive during 2014 as gilts have been seen as a 'safe haven', particularly during the events in Ukraine.
Index Linked Gilts	4.25	7.8	
UK Corporate Bonds	5.5	7.4	
Overseas Fixed Interest	5.5	-0.9	Well behind the assumed strategic return and has fallen back into negative territory as strong growth and potential inflation acceleration in the US increased yields.
Fund of Hedge Funds	6.0	3.4	Behind the assumed strategic return following negative returns in 2011 and early 2012. More recently returns have been improving. Over the last two years returns have been steady at around 1% to 3% per quarter, which would meet the assumed strategic return.
Property	7.0	8.6	This has moved further ahead of the assumed strategic return as returns have escalated over the last year.

Source: Statement of Investment Principles, Thomson Reuters.

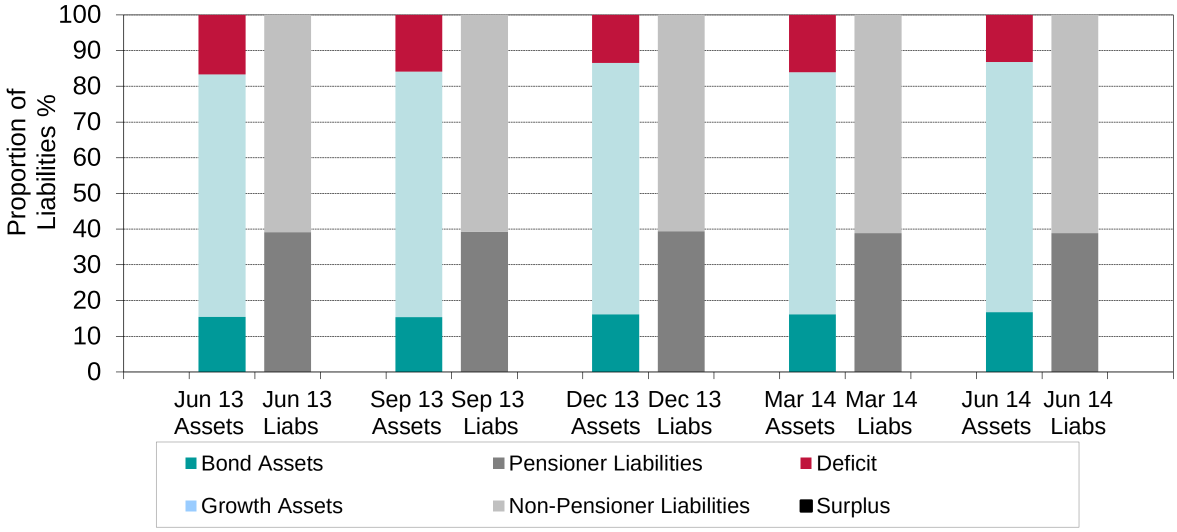
See appendix A for economic data and commentary.

3 Consideration of Funding Level

This section of the report considers the estimated funding level of the Fund. Firstly, it looks at the Fund asset allocation relative to its liabilities. Then it looks at market movements, as they have an impact on both the assets and the estimated value placed on the liabilities.

Asset allocation and liability split

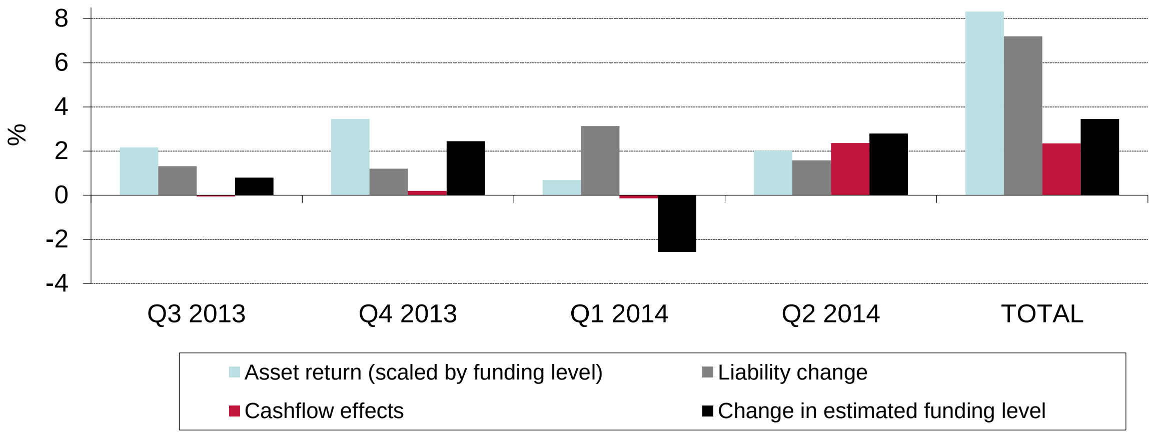
- The chart below shows the allocation of the Fund to Bond and Growth assets against the estimated liability split, which is based on changes in gilt yields underlying the Scheme Actuary's calculation of liabilities. The reference yield used for the liabilities is the Mercer Gilt yield (see appendix for definition). The liability benchmark is based on the valuation results from 31 March 2013.
- These calculations do not take account of any unexpected changes to the Fund membership or changes to the demographic assumptions and should not be construed as an actuarial valuation.



- Based on financial market values, investment returns and cashflows into the Fund, the estimated funding level increased by circa 3% over the second quarter of 2014, all else being equal. This was driven by:
  - » A positive asset return following positive returns from most managers.
  - » The receipt of advance deficit payments.
  - » A smaller negative effect from the liabilities, as the valuation interest rate was slightly decreased, increasing the value placed on liabilities. This was partially offset by a fall in inflation-linked liabilities due to lower inflation expectations.
- At the valuation date, 31 March 2013, the Scheme was 78% funded. Since then financial market movements, actual cashflows, and investment returns are expected to have increased the overall funding level to 87%. This improvement has come mainly from positive asset returns over the period.

Scheme performance relative to estimated liabilities

- The chart below shows, quarter by quarter, the return on the assets and the impact on the liabilities due to changes in financial market values and expected member movements.
- As detailed above, such movements in liabilities are based upon the bond yield underlying the Scheme Actuary's calculation of liabilities.

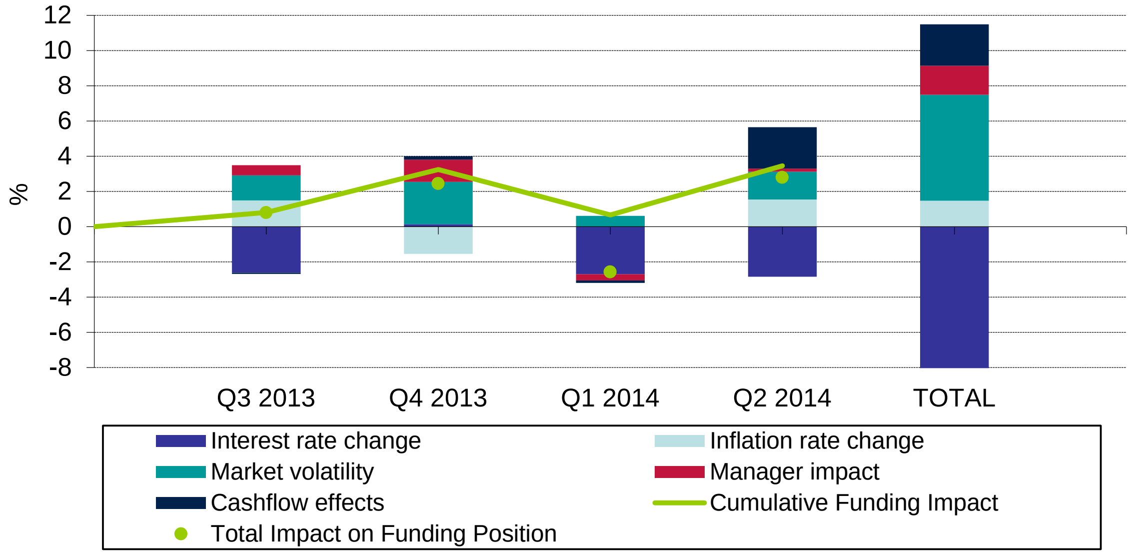


Note : A decrease in liabilities and an increase in assets improves the funding level and vice-versa.

- The graph above shows that the Fund's assets, scaled to take into account the estimated funding level, have produced an absolute return of 2.0%, over the last quarter.
- The value placed on the liabilities increased by 1.0% due to a small fall in the discount rate, offset to some extent by a decrease in the inflation assumption used to value inflation-linked liabilities.
- The 'cashflow effect' of 2.3% represents several employing bodies paying their deficit payments in advance over the quarter.
- Overall, the combined effect has led to an increase in the estimated funding level to 87% (from 84% at 31 March 2014).

Key drivers of performance against the estimated liabilities

- The chart below shows the main contributors to the change in the estimated funding level. For reference, please note that the underlying calculations are based on the Mercer gilt yield.



- ‘Interest rate change’ reflects the impact caused by the difference in the duration of the liabilities compared to the assets. As the liabilities have a longer duration than the assets, when yields fall, this has a negative impact, as in Q2 2014.
- The Market Implied (RPI) inflation assumption fell by 0.1% p.a. over the quarter. This gives a positive contribution as future inflation-linked payments are lower.
- For Growth assets, ‘Market volatility’ is simply the (benchmark) return on the assets; for Bond assets it is the return less the return that would be expected given the changes in bond yields. This has had a positive impact over the quarter as Growth assets posted positive returns.
- 'Manager impact’ is the investment performance compared to the strategic benchmark. This was marginally positive over the last quarter as the total fund returned 0.2% above the benchmark.
- The ‘cashflow effects’ reflect factors such as pension payments, contributions and disinvestments. The positive over the last quarter reflects the deficit payments.
- Overall the investment factors have had a positive impact on the estimated funding level of the Fund over the last quarter.
- Over the last year, investment factors have had a positive effect due to asset returns from both markets (‘market volatility’) and manager outperformance (‘manager impact’).
- This effect was reduced due to a fall in the discount rate assumption which increases the value placed on the liabilities (‘interest rate change’) together with the unwinding of the liabilities.

4 Fund Valuations

The table below shows the asset allocation of the Fund as at 30 June 2014, with the BlackRock Multi-Asset portfolio and the BlackRock property portfolio (assets “ring fenced” for investment in property) split between the relevant asset classes.

Asset Class	31 March 2014 Value £'000	31 March 2014 Proportion of Total %	30 June 2014 Value £'000	30 June 2014 Proportion of Total %	Strategic Benchmark Weight %
Developed Market Equities	1,567,935	47.1	1,592,727	45.7	40.0
Emerging Market Equities	311,776	9.4	327,819	9.4	10.0
Diversified Growth Funds	314,340	9.4	346,321	9.9	10.0
Bonds	640,599	19.2	673,456	19.3	20.0
Fund of Hedge Funds	162,986	4.9	164,589	4.7	5.0
Infrastructure	-	-	-	-	5.0
Cash (including currency instruments)	71,739	2.2	116,595	3.4	-
Property	260,987	7.8	264,693	7.6	10.0
TOTAL FUND VALUE	**3,330,362**	**100.0**	**3,486,200**	**100.0**	**100.0**

Source: Data provided by WM Performance Services

- The value of the Fund's assets increased by £156m over the second quarter of 2014 to £3,486m.
- The amount invested in DGF’s has increased towards the benchmark weight as cash was invested with both Barings and Pyrford.
- In addition, several employing bodies paid their deficit payments in advance, some of which was invested with the two DGF managers and Royal London. The remainder of the deficit payments remained in Cash at the quarter-end, hence the relatively high Cash allocation as seen within the following table.
- The allocation to Developed Market Equities decreased from 47.1% to 45.7% due to cashflows being directed elsewhere, as described above. This takes its exposure closer to the strategic benchmark weight.
- Deviations from the strategic benchmark weight will continue during the period that changes to the investment strategy, agreed in 2013, are implemented.
- In particular, it is expected that the allocation to developed market equities will begin to fall over 2014 and 2015 towards its benchmark weight, as investments in infrastructure are made.

Manager	Asset Class	31 March 2014 Value £'000	31 March 2014 Proportion of Total %	Net new money £'000	30 June 2014 Value £'000	30 June 2014 Proportion of Total %
Jupiter	UK Equities	160,880	4.8	-	163,584	4.7
TT International	UK Equities	185,267	5.6	-	183,391	5.3
Schroder	Global Equities	214,480	6.4	-	219,456	6.3
Genesis	Emerging Market Equities	145,088	4.4	-	152,851	4.4
Unigestion	Emerging Market Equities	166,687	5.0	-	174,969	5.0
Invesco	Global ex-UK Equities	239,795	7.2	-	244,970	7.0
SSgA	Europe ex-UK Equities and Pacific incl. Japan Equities	107,146	3.2	-	109,464	3.2
Pyrford	DGF	104,542	3.1	12,000	117,921	3.4
Barings	DGF	209,798	6.3	15,000	228,400	6.6
MAN	Fund of Hedge Funds	1,115	0.0	-	890	0.0
Signet	Fund of Hedge Funds	66,155	2.0	-	67,005	1.9
Stenham	Fund of Hedge Funds	37,654	1.1	-	38,056	1.1
Gottex	Fund of Hedge Funds	58,062	1.7	-	58,639	1.7
BlackRock	Passive Multi-asset	1,026,945	30.9	-	1,038,803	29.8
BlackRock (property fund)	Equities, Futures, Bonds, Cash (held for property inv)	45,643	1.4	-1,000	44,470	1.3
RLAM	Bonds	249,851	7.5	23,000	279,336	8.0
Schroder	UK Property	150,249	4.5		159,480	4.6
Partners	Property	112,058	3.4	1,000	108,905	3.1
Record Currency Mgmt	Dynamic Currency Hedging	12,044	0.4	-	14,069	0.4
Record Currency Mgmt 2	Overseas Equities (to fund currency hedge)	15,988	0.5	-	22,858	0.7
Internal Cash	Cash	20,915	0.6	31,400	58,685	1.7
Rounding		-	-	-	-2	-0.2
TOTAL		**3,330,362**	**100.0**	**81,400**	**3,486,200**	**100.0**

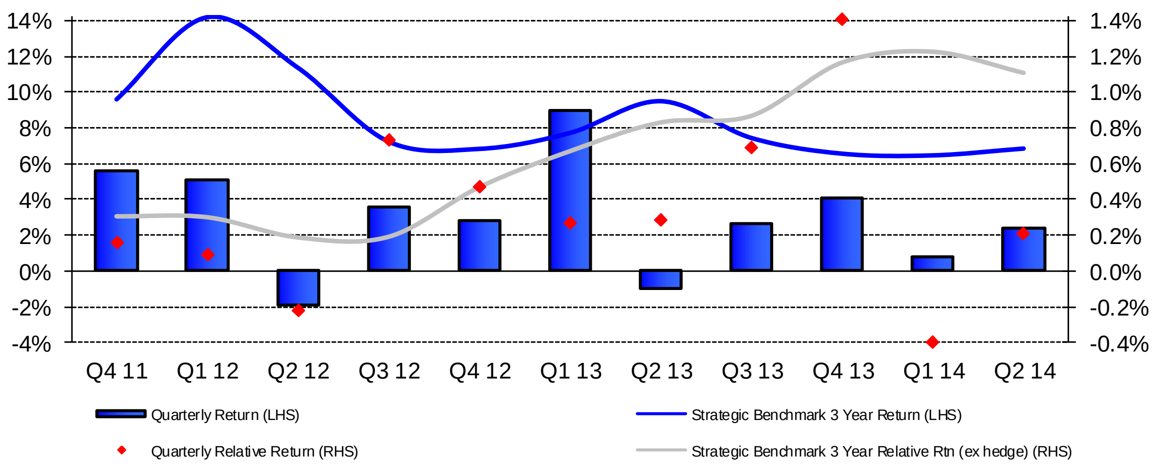
Source: Avon Pension Fund Data provided by WM Performance Services

5 Performance Summary

Total Fund performance

The chart below shows the absolute performance of the total Fund's assets over the last 3 years.

Total Fund absolute and relative performance



fund	3 months (%)	1 year (%)	3 years (% p.a.)
Total Fund (inc currency hedge)	2.4	10.3	8.3
Total Fund (ex currency hedge)	2.2	9.2	8.0
Strategic Benchmark (no currency hedge)	2.2	8.2	6.8
Relative (inc currency hedge)	+0.2	+1.9	+1.4

Source: Data provided by WM Performance Services

Benchmark allocation

The table below shows the strategic allocation to each of the major asset classes and the benchmark returns over the quarter and 1 year to 30 June 2014, and thereby analyses what we would expect the strategy to return if all assets had been invested passively and met their benchmark returns.

Asset Class	Weight in Strategic Benchmark		Index returns	Contribution to total benchmark	Index returns	Contribution to total benchmark
	Sep 13	Jun 14	Q2 2014	(quarter)	1 year	(1 year)
UK Equities	18%	15%	2.2%	0.3%	13.1%	2.2%
Overseas Equities	42%	25%	2.1%	0.5%	10.7%	2.9%
Emerging Market Equities	-	10%	3.9%	0.4%	1.5%	0.2%
Diversified Growth Funds	-	10%	1.1%	0.1%	5.6%	0.4%
UK Government Bonds	6%	3%	2.3%	0.1%	5.3%	0.2%
UK Corporate Bonds	5%	8%	2.0%	0.2%	6.7%	0.5%
Index Linked Gilts	6%	6%	1.1%	0.1%	4.3%	0.3%
Overseas Fixed Interest	3%	3%	-0.4%	-0.0%	-6.1%	-0.2%
Fund of Hedge Funds	10%	10%	1.1%	0.1%	2.2%	0.2%
Property	10%	10%	4.3%	0.4%	15.1%	1.5%
Total Fund	**100%**	**100%**		**2.2%**		**8.2%**

Source: Returns data provided by WM Performance Services

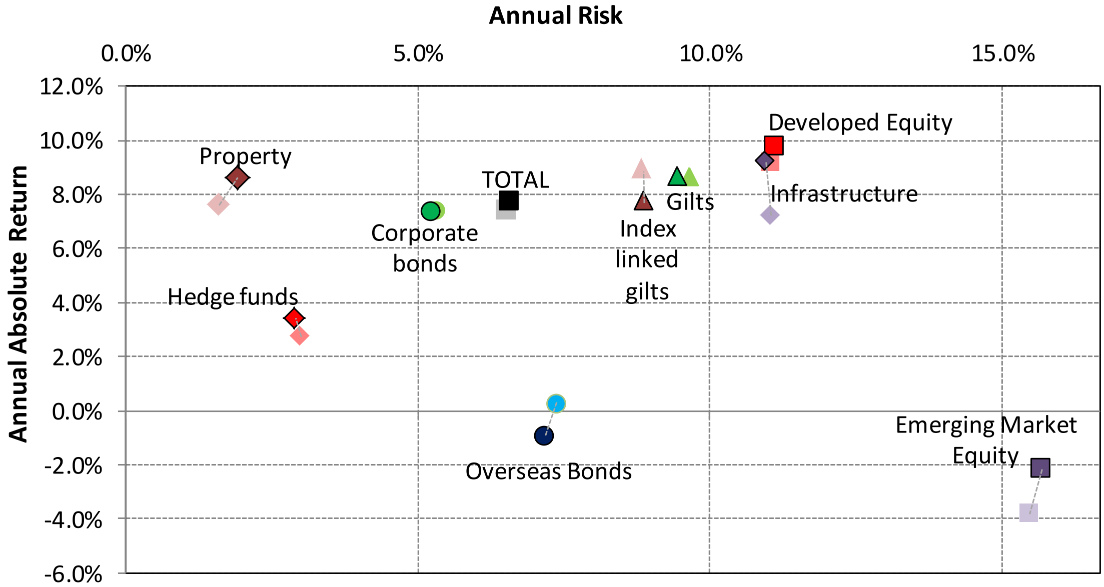
- The benchmark weights above are those held by WM to partly reflect the changes to the investment strategy, agreed in 2013, whilst they are implemented.
- Over the quarter, the benchmark was 2.2%, which was mainly driven by the contributions from equities, which represented 60% of the index at the start of the year, and property.
- Over the last twelve months, the benchmark was 8.2% p.a. All asset classes except Overseas Fixed Interest gave a positive contribution, with equities the main contributor.
- The assumed strategic return for the Fund as a whole, weighted by the strategic benchmark allocation over the last year, is 7.3% p.a. Hence the actual three-year benchmark return was 0.9% p.a. ahead of this.
  - The 1 year benchmark for UK equities (13.1%) and overseas equities (10.7%) were ahead of their assumed strategic return of 8.25%. The property benchmark of 15.1% was also well ahead of its assumed strategic return of 7%.
  - Emerging market equities, Overseas Fixed Interest and Fund of Hedge Funds were below their assumed strategic returns over the year. The DGF return is below mainly because of current low LIBOR levels in the Barings (LIBOR+4%) part of this benchmark.

Risk Return Analysis

The chart below shows the 3 year absolute return ("Annual Absolute Return") against the 3 year volatility of absolute returns ("Annual Risk"), based on monthly/quarterly (as available) data points in sterling terms, to the end of June 2014 of each of the underlying asset benchmarks, along with the total Fund strategic benchmark. We also show the position as at last quarter, as shadow points.

This chart can be compared to the 3 year risk vs return managers' chart on page 11DAH.

3 Year Risk v 3 Year Return to 30 June 2014

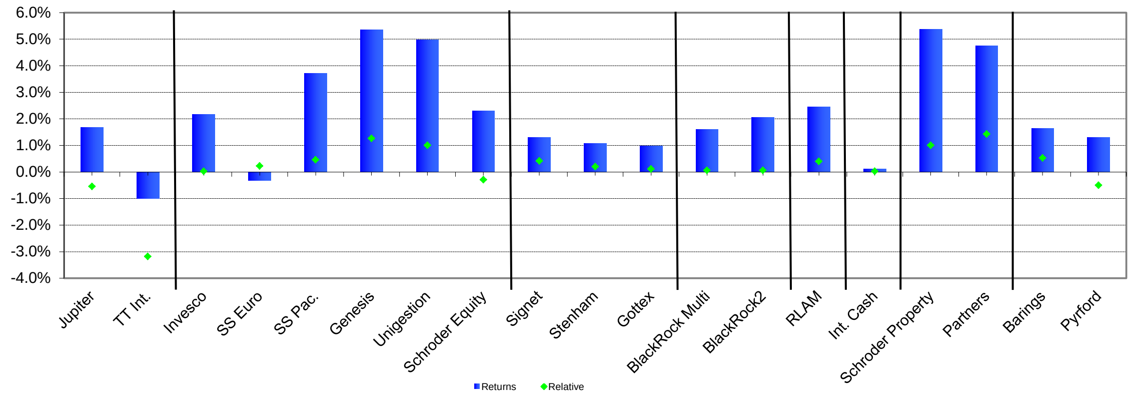


- Overall there has been little change in the three-year risk/return characteristics over the last quarter compared to the previous quarter.
- Developed equity produced the best 3-year return, of 9.8% p.a. Returns of between 7% and 9% p.a. were also produced by gilts, index linked gilts, property, infrastructure and corporate bonds.
- The hedge fund index continues to produce steady improving returns, increasing the three-year return to 3.4% p.a.
- The emerging market equity return improved but remains negative at -2.1% p.a.
- Overseas bonds moved back into negative territory as US bond yields rose.
- In terms of risk, the three-year volatility has remained broadly stable for each asset class in the above chart. The only notable change was on property, increasing from 1.6% p.a. to 1.9% p.a.
- The three-year return on developed equities, property, gilts, index-linked gilts and corporate bonds remain above their assumed strategic return. Hedge funds remain below their assumed strategic return, with overseas bonds and emerging market equities well below.

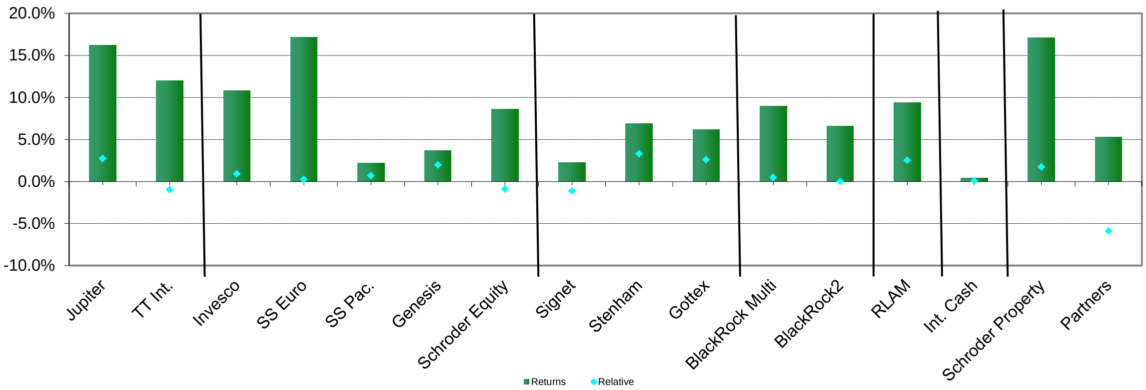
Aggregate manager performance

The charts below show the absolute return for each manager over the quarter, one year and three years to the end of June 2014. The relative quarter, one year and three year returns are marked with green and blue dots respectively.

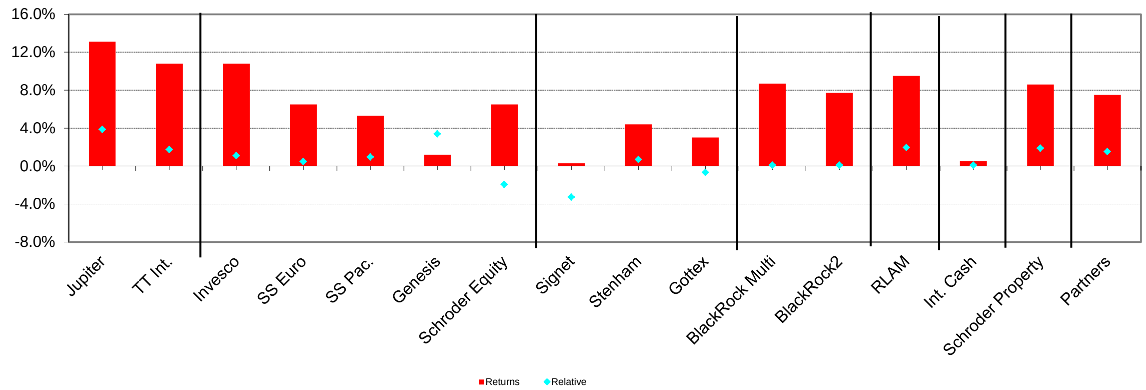
Absolute and relative performance - **Quarter to 30 June 2014**



Absolute and relative performance - **Year to 30 June 2014**



Absolute and relative performance - **3 years to 30 June 2014**



Source: Data provided by WM Performance Services

The table below shows the relative returns of each of the funds over the quarter, one year and three years to the end of June 2014. Returns in blue text are returns which outperformed the respective benchmarks, red text shows an underperformance, and black text represents performance in line with the benchmark.

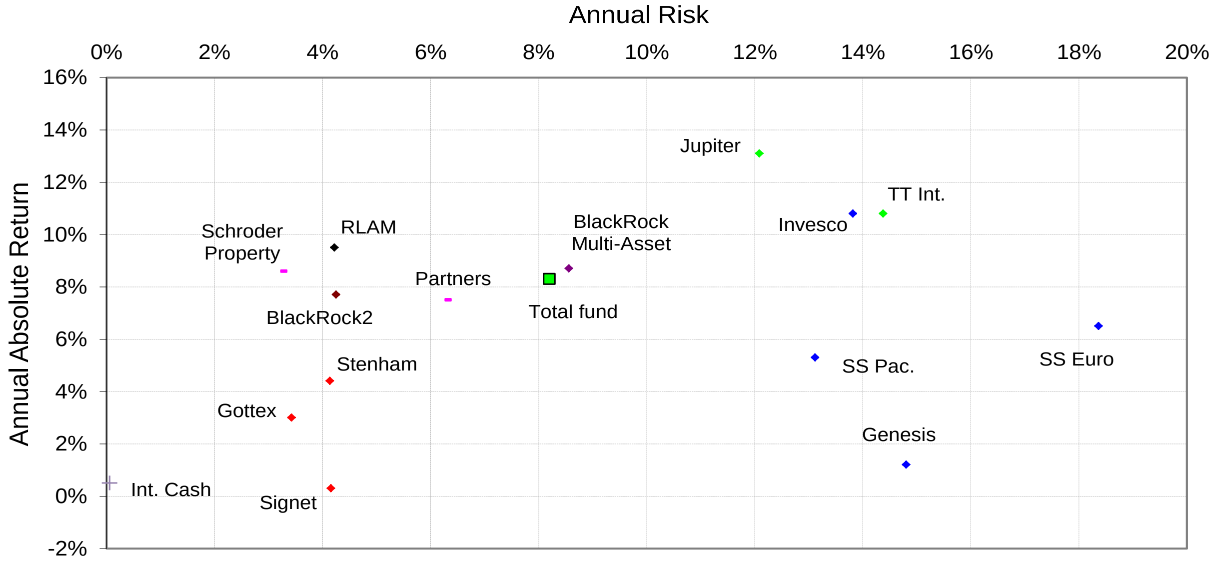
Manager / fund	3 months (%)	1 year (%)	3 years (% p.a.)	3 year performance versus target
Jupiter	-0.5	+2.7	+3.9	Target met
TT International	-3.2	-1.0	+1.7	Target not met
Invesco	0.0	+0.9	+1.1	Target met
SSgA Europe	+0.2	+0.3	+0.5	Target met
SsgA Pacific	+0.5	+0.7	+1.0	Target met
Genesis	+1.3	+2.0	+3.4	Target met
Unigestion	+1.0	N/A	N/A	N/A
Schroder Equity	-0.3	-0.9	-1.9	Target not met
Signet	+0.4	-1.2	-3.3	Target not met
Stenham	+0.2	+3.3	+0.7	Target met
Gottex	+0.1	+2.6	-0.7	Target not met
BlackRock Multi - Asset	+0.1	+0.5	+0.1	Target met
BlackRock 2	+0.1	0.0	+0.1	Target met
RLAM	+0.4	+2.5	+2.0	Target met
Internal Cash	0.0	+0.1	+0.1	N/A
Schroder Property	+1.0	+1.7	+1.9	Target met
Partners Property	+1.4	-5.9	+1.5	N/A
Barings	+0.5	NA	NA	N/A
Pyrford	-0.5	NA	NA	N/A

Source: Data provided by WM Performance Services

Manager and Total Fund risk v return

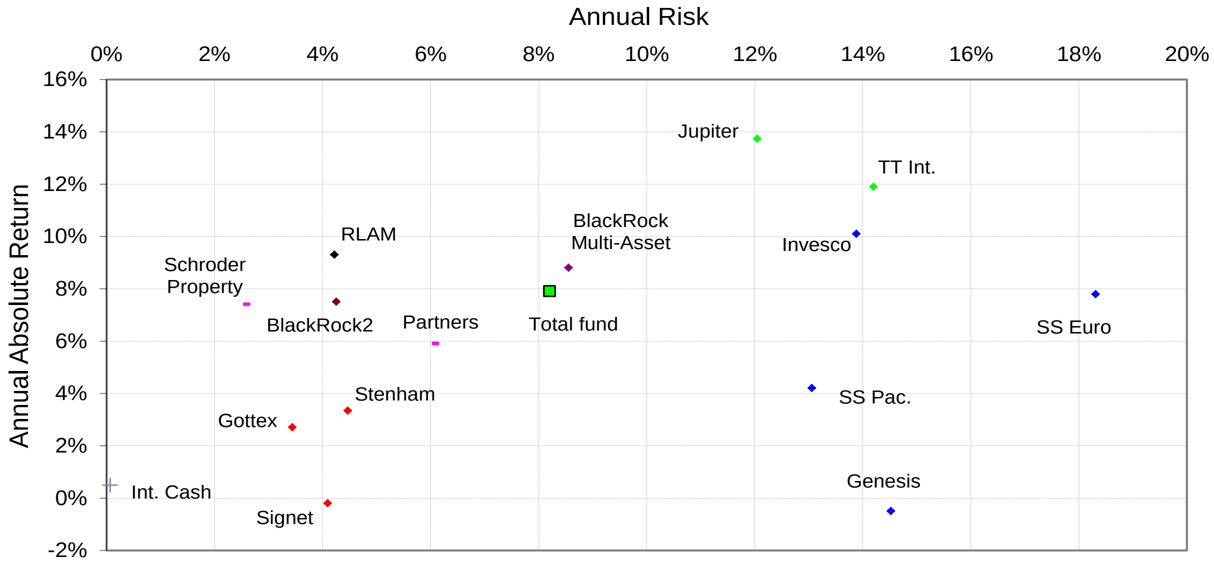
The chart below shows the 3 year absolute return ("Annual Absolute Return") against the 3 year volatility of absolute returns ("Annual Risk"), based on monthly/quarterly (as available) data points in sterling terms, to the end of June 2014 of each of the funds. We also show the same chart, but with data to 31 March 2014 for comparison.

3 Year Risk v 3 Year Return to 30 June 2014



Source: Data provided by WM Performance Services

3 Year Risk v 3 Year Return to 31 March 2014



Source: Data provided by WM Performance Services

The managers are colour coded by asset class, as follows:

- » Green: UK equities — Blue: overseas equities
- » Red: fund of hedge funds — Black: bonds
- » Maroon: multi-asset — Brown: BlackRock No. 2 portfolio
- » Grey: internally managed cash — Pink: Property
- » Green Square: total Fund

- The three-year returns have remained reasonably stable for all funds.
- The UK equity managers' returns fell slightly (Jupiter from 13.7% p.a. to 13.1% p.a. and TT from 11.9% p.a. to 10.8% p.a.) but they remain the best performing funds in absolute terms over three years.
- The other main shifts in the equity funds' three year returns were SSgA Pacific (up from 4.2% p.a. to 5.3% p.a.) and SSgA Euro (down from 7.8% p.a. to 6.5% p.a.).
- The hedge fund managers' thee-year returns all improved over the quarter, in particular Stenham, and Signet, the latter of which moved into positive territory.
- The three-year risk figures remained very stable, with the largest change being 0.7% p.a. (from Schroder Property). Otherwise the risk figures have changed by 0.3% p.a. or less since last quarter. As would be expected, the equity-based funds have the highest volatility and hedge funds, property and fixed interest the lowest, in line with the market returns chart on page 8.
- Over the longer three year period, the three fund of hedge fund managers have underperformed our asset class assumed strategic return.
- Jupiter, TT, Invesco and RLAM bonds have all outperformed our assumed strategic return and also outperformed their benchmarks (although TT are slightly below target).
- Genesis and the two SSgA funds have underperformed our assumed strategic return, but outperformed their individual targets.
- Schroder Equity is now included on the June chart as the Fund has invested for just over three years; this fund underperformed both our assumed strategic return and its individual target.

Appendix 1: Market Events

Asset Class	What happened? Positive Factors	Negative Factors
UK Equities	■ According to the National Institute of Economic and Social Research, Britain's economy witnessed its strongest calendar quarter in four years in Q2 2014, growing by an estimated 0.9%. ■ Data released in July showed that the labour market continues to strengthen. Unemployment fell by 121,000 to 2.12 million in the three months to May (an unemployment rate of 6.5%). This marks the lowest unemployment level since December 2008. ■ UK economic growth has been driven by increases in household spending and, more recently, business investments. The pick-up in household spending is reflected by the latest GfK consumer confidence survey, which in May reached levels not seen since 2005.	■ Office for National Statistics' figures indicate that the trade deficit grew to an estimated GBP 9.6 billion in April from GBP 8.3 billion in March. Weak demand in the Eurozone (the UK's largest trading partner) has hindered the government's efforts to support stronger manufacturing exports. ■ June's report on the housing market from the Financial Policy Committee addressed evidences that less prudent lending standards were reaching pre-crisis peaks. UK house prices increased by 1% in June, taking the annual rate of increase to 11.8%. ■ The strength of the Pound has continued to impact the profits of many UK companies with international exposure.
Overseas Equities:		
North America	■ Dovish comments from the Fed chair Janet Yellen both dismissing rising inflationary pressures as "noise", and noting that the market valuations were within the historical norms, helped US equities surge to record highs. ■ A series of upbeat economic data pointed to a pick-up in the growth momentum for the rest of the year. The unemployment rate fell to 6.1% amidst a strengthening labour market while inflation showed signs of a pickup, moving closer to the Fed's target of 2%.	■ The US economy shrank in the first quarter with an annualised rate of 2.9%, much worse than the Bureau of Economic Analysis's second estimate of 1% contraction. This was the largest contraction since the first quarter of 2009. The weak number was mainly due to a smaller increase in the personal consumption than previously estimated. ■ After reaching record highs for nearly two years, corporate profits declined in the first quarter. Earnings before taxes fell by 10% while profits after taxes plunged nearly 14%.

<table>
<tr><th rowspan="2">Asset Class</th><th colspan="2">What happened?</th></tr>
<tr><th>Positive Factors</th><th>Negative Factors</th></tr>
<tr><td>Europe</td><td>Despite disappointing corporate earnings, European equities managed to eke out marginal positive return over the second quarter. They were supported by expectations that the European Central Bank (ECB) would take steps to ease monetary policy in order to stimulate growth and fend off the spectre of deflation. The ECB launched a raft of measures to fight low inflation and boost the euro zone economy. It lowered the deposit rate to -0.1%, meaning it will effectively charge banks for holding their money overnight. It cut its main refinancing rate to 0.15% and the marginal lending rate to 0.40%.</td><td>Eurozone GDP growth for the first quarter was below expectations at 0.2%. Germany led the way with a growth rate of 0.8% while France saw no growth and the Italian economy contracted by 0.1%.
The Eurozone composite purchasing managers' index (PMI) hit a 35-month high of 54.0 in April but eased back to 53.5 in May and 52.8 in June, indicating a slowdown in growth over the quarter.</td></tr>
<tr><td>Japan</td><td>Consumer price inflation surged to an annualised rate of 3.4% in May. This is the highest reading in nearly 32 years for an economy that has been battling deflation for better part of the last two decades. A rise in the inflation levels for 12 months in a row indicates that the effects of lose monetary policy adopted by the Bank of Japan (BoJ) has started to yield results. However, a significant portion of this rise is due to the recent hike in the sales tax from 5% to 8%.
Prime Minister Shinzo Abe unveiled a package of reform proposals, including changes in labour laws, increasing corporate governance standards, and reducing corporate taxes, among others. A poll by Reuters suggests that the reforms could boost the country's growth rate by 0.2% to 1.5% in the long term.</td><td>In April, the BoJ's governor put an end to the speculation of further quantitative easing by keeping monetary policy unchanged with the money supply maintaining its current annual expansion rate of 60-70 trillion Yen. This led to a strengthening of the Yen over the quarter and had a negative impact on the investor sentiment.</td></tr>
<tr><td>Asia Pacific</td><td>South Korea recorded its 29th consecutive month of trade surplus owing to strong exports, which grew by 2.5% year-on-year in June. Taiwan's exports rose 1.2% year-on-year, the fifth consecutive month of growth, bolstered by strong demand for consumer goods.
S&P upgraded Philippines sovereign rating by one notch to BBB in May, citing the country's strong external liquidity, investment climate and effective monetary policy framework.</td><td>MSCI removed the South Korean and Taiwanese equity markets from consideration for an upgrade to developed market status from their current standing of Emerging market status. The index provider cited absence of any significant improvements in market accessibility and currency liquidity.
Indonesia's GDP growth slowed to a 5-Year low of 5.2% in Q1 2014 primarily due to weakening exports. The country also reported an unexpectedly large trade deficit of nearly USD 2 billion in April.</td></tr>
</table>

Asset Class	What happened? Positive Factors	What happened? Negative Factors
Emerging Markets	▪ The official Chinese PMI rose to a six-month high of 51.0 in June, up from 50.8 in May. This improvement suggests that the government's mini-stimulus is filtering through to the real economy. The Chinese government has made efforts to boost official spending and to let banks lend more of their deposits. ▪ Investors have poured USD 221.7 billion into Emerging market assets over the past 11 months based on expectations that interest rates in most developed economies will remain low at least until 2015. A survey by Bank of America Merrill Lynch for June shows a net overweight position held by fund managers on Emerging market equities for the first time since November 2013.	▪ MSCI chose not to include China's A-shares (Renminbi-denominated mainland shares) in its benchmark Emerging market equity index during its annual index review in June. Strict quota limits within the Renminbi Qualified Foreign Institutional Investor (RQFII) scheme and concerns over the tax regime were the primary reasons for the non-inclusion of the A-shares in the index. ▪ Argentina technically defaulted on its debt payment after it failed to reach a settlement with a group of US based hedge funds. In June, the US Supreme Court refused to hear Argentina's appeal to pay only the restructured bondholders and not others. The dispute between Argentina and its bond holders has been ongoing since the Argentine debt restructuring in 2005.
Gilts	▪ Growth expectations in the UK are very strong owing to a surge in the construction and manufacturing sector. However, the UK's dominant sector, the services industry, has been a drag over the quarter. The monthly Markit/CIPS purchasing managers' index (PMI) for services sector dropped to 57.7 in June from 58.6 in May, marking a three-month low. ▪ Modest Inflation and more than estimated spare capacity in labour market (stated by the Bank of England (BOE) in the June monetary policy meeting) are hindering the ability of the BOE to undertake interest hikes.	▪ The BOE governor Mark Carney hinted at a rise in interest rates later this year during the monetary policy committee meeting in June. The reasons behind an early rate hike is that they want to avoid the chances that a stronger than expected economic growth in the second half of 2014 would reduce spare capacity in the economy. This could cause unemployment to fall faster, but also put upward pressure on wages, requiring a tighter monetary policy.
Index Linked Gilts	▪ With limited issuance of new Index-linked gilts and investors continuing to seek inflation protection, demand for index-linked gilts remains high, thus supporting prices.	▪ The UK consumer price index of inflation grew by a modest 1.5% in May 2014, down from 2% in December 2013. ▪ In an environment where central banks are able to control inflation within a target range, there is limited upside to the return expectations on these instruments.
Corporate Bonds	▪ Corporations continue to maintain healthy balance sheets as deleveraging continues in expectations of rising interest rates.	▪ The corporate bond market still suffers from liquidity constraints and the reduction in credit spreads over the past few months leaves little room for any further contraction.

Asset Class	What happened? Positive Factors	Negative Factors
Property	■ Property values rose by 1.1% in May, marking the highest rise in 2014. UK Commercial property values have now risen by 8.5% over 13 months of consecutive growth. ■ Residential prices in London are around 30% above their 2007 highs, while in the UK as a whole, prices are less than 1% above their pre-crisis peak. ■ The Construction PMI rose to 62.6 in June from 60.0 in May, the highest reading since February.	■ The new affordability tests (MMR) introduced in April for house buyers are having an effect, leading to the number of mortgage approvals falling to an 11 month low, totalling 61,707 in May. ■ In June, the Bank of England imposed constraints on lenders to limit the proportion of mortgages at a loan-to-income ratio of 4.5 times and above to no more than 15% of their mortgage portfolios.

Economic statistics

	Quarter to 30 June 2014			Year to 30 June 2014		
	UK	Europe(1)	US	UK	Europe(1)	US
Real GDP growth	0.8%	n/a	1.0%	3.1%	n/a	2.4%
Unemployment rate	6.5%	11.6%	6.1%	6.5%	11.6%	6.1%
Previous	*6.9%*	*11.8%*	*6.7%*	*7.8%*	*11.2%*	*7.6%*
Inflation change(2)	0.5%	0.2%	0.9%	1.9%	0.5%	2.1%
Manufacturing Purchasing Managers' Index	57.5	51.8	55.3	57.5	51.8	55.3
Previous	*55.3*	*53.0*	*54.9*	*52.5*	*48.8*	*50.9*

Source: Thomson Reuters, market, Institute for Supply Management, Eurostat, United States Department of Labor, US Bureau of Economic Analysis. "Previous" relates to data as at the previous quarter or year end.

(1) EU changing composition area; (2) CPI inflation measure

Appendix 2: Glossary of Terms

Term	Definition
Absolute Return	The actual return, as opposed to the return relative to a benchmark.
Annualised	Figures expressed as applying to 1 year.
Bond Assets	Assets held in the expectation that they will exhibit a degree of sensitivity to yield changes. The value of a benefit payable to a pensioner is often calculated assuming the invested assets in respect of those liabilities achieve a return based on UK bonds.
Growth Assets	Assets held in the expectation that they will achieve more than the return on UK bonds. The value of a benefit payable to a non-pensioner is often calculated assuming the invested assets in respect of those liabilities achieve a return based on UK bonds plus a premium (for example, if holding equities an equity risk premium may be applied). The liabilities will still remain sensitive to yields although the Growth assets may not.
Duration	The weighted average time to payment of cashflows (in years), calculated by reference to the time and amount of each payment. It is a measure of the sensitivity of price/value to movements in yields.
Funded Liabilities	The value of benefits payable to members that can be paid from the existing assets of the plan (i.e. those liabilities that have assets available to meet them).
High Yield	A type of bond which has a lower credit rating than traditional investment grade corporate bonds or government bonds. These bonds pay a higher yield than investment grade bonds.
Market Statistics Indices	The following indices are used for asset returns: UK Equities: FTSE All-Share Index Overseas Equities: FTSE AW All-World ex UK UK Gilts (>15 yrs or >20 yrs): FTSE Brit Govt Fixed Over 15 (or 20) Years Index Corporate Bonds(>15 yrs AA): iBoxx £ Corp 15+ Years AA Index Non-Gilts (>15 yrs): iBoxx £ Non-Gilts 15+ Years Index Index Linked Gilts (>5yrs): FTSE Brit Govt Index Link Over 5 Years Index Hedge Funds: CS/Tremont Hedge Fund Index Commodities: S&P GSCI Commodity GBP Total Return Index High Yield: Bank Of America Merrill Lynch Global High Yield Index Property: IPD Property Index (Monthly) Infrastructure: FTSE MACQ Global Infrastructure Index Cash: 7 day London Interbank Middle Rate Price Inflation: All Items Retail Price Index Earnings Inflation: UK Average Weekly Earnings Index - Whole Economy excluding Bonuses
Market Volatility	The impact of the assets producing returns different to those assumed within the actuarial valuation basis, excluding the yield change and inflation impact.

Term	Definition
Mercer Gilt Yield	An estimate of the yield available on a notional portfolio of UK Government conventional gilt stocks whose cashflows approximately match the Fund's estimated benefit cashflows
Money-Weighted Rate of Return	The rate of return on an investment including the amount and timing of cashflows.
Non-Pensioner Liability	The value of benefits payable to those who are yet to retire, including active and deferred members.
Pensioner Liability	The value of benefits payable to those who have already retired, irrespective of their age.
Relative Return	The return on a fund compared to the return on another fund, index or benchmark. For IMAGE purposes this is defined as: Return on Fund less Return on Index or Benchmark.
Scheme Investments	Refers only to the invested assets, including cash, held by your investment managers.
Surplus/Deficit	The estimated funding position of the Scheme. This is not an actuarial valuation and is based on estimated changes in liabilities as a result of bond yield changes, asset movements and, if carried out, output from an asset liability investigation (ALI). If no ALI has been undertaken the estimate is less robust.
Three-Year Return	The total return on the fund over a three year period expressed in percent per annum.
Time-Weighted Rate of Return	The rate of return on an investment removing the effect of the amount and timing of cashflows.
Unfunded Liabilities	The value of benefits payable to members that cannot be paid from the existing assets of the Scheme (i.e. those liabilities that have no physical assets available to meet them). These liabilities are effectively the deficit of the Scheme.
Yield (Gross Redemption Yield)	The return expected from a bond if held to maturity. It is calculated by finding the rate of return that equates the current market price to the value of future cashflows.

Appendix 3: Summary of Mandates

Manager	Mandate	Benchmark	Outperformance target (p.a.)
Jupiter	UK Equities (Socially Responsible Investing)	FTSE All Share	+2%
TT International	UK Equities (Unconstrained)	FTSE All Share	+3-4%
Invesco	Global ex-UK Equities Enhanced (En. Indexation)	MSCI World ex UK NDR	+0.5%
Schroder	Global Equities (Unconstrained)	MSCI AC World Index Free	+4%
SSgA	Europe ex-UK Equities (Enhanced Indexation)	FTSE AW Europe ex UK	+0.5%
SSgA	Pacific inc. Japan Equities (Enhanced Indexation)	FTSE AW Dev Asia Pacific	+0.5%
Genesis	Emerging Market Equities	MSCI EM IMI TR	-
Unigestion	Emerging Market Equities	MSCI EM NET TR	+2-4%
Signet	Fund of Hedge Funds	3M LIBOR + 3%	-
Stenham	Fund of Hedge Funds	3M LIBOR + 3%	-
Gottex	Fund of Hedge Funds	3M LIBOR + 3%	-
BlackRock	Passive Multi-asset	In line with customised benchmarks using monthly mean fund weights	0%
BlackRock	Overseas Property	Customised benchmarks using monthly mean fund weights	0%
RLAM	UK Corporate Bond Fund	iBoxx £ non-Gilts all maturities	+0.8%
Schroder	UK Property	IPD UK pooled	+1.0%
Partners	Global Property	IPD Global pooled	+2.0%
Pyrford	DGF	RPI + 5%	-
Barings	DGF	3 Month Libor + 4%	-
Cash	Internally Managed	7 day LIBID	

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