Bath & North East Somerset Council

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Date: 17 May 2016
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To: All Members of the Avon Pension Fund Committee - Investment Panel

Councillor Christopher Pearce (Chair), Councillor David Veale, Councillor Cherry Beath, Ann Berresford, Councillor Mary Blatchford and Shirley Marsh

Chief Executive and other appropriate officers
Press and Public

Dear Member

Avon Pension Fund Committee - Investment Panel: Wednesday, 25th May, 2016

You are invited to attend a meeting of the **Avon Pension Fund Committee - Investment Panel**, to be held on **Wednesday, 25th May, 2016** at **2.00 pm** in the **Cadbury Room - Fry Club and Conference Centre, Keynsham.**

The agenda is set out overleaf.

Yours sincerely

Sean O'Neill
for Chief Executive

If you need to access this agenda or any of the supporting reports in an alternative accessible format please contact Democratic Services or the relevant report author whose details are listed at the end of each report.

This Agenda and all accompanying reports are printed on recycled paper

NOTES:

1. **Inspection of Papers:** Any person wishing to inspect minutes, reports, or a list of the background papers relating to any item on this Agenda should contact Sean O'Neill who is available by telephoning Bath 01225 395090 or by calling at the Guildhall Bath (during normal office hours).

2. **Public Speaking at Meetings:** The Council has a scheme to encourage the public to make their views known at meetings. They may make a statement relevant to what the meeting has power to do. They may also present a petition or a deputation on behalf of a group. Advance notice is required not less than two full working days before the meeting (this means that for meetings held on Wednesdays notice must be received in Democratic Services by 4.30pm the previous Friday)

   The public may also ask a question to which a written answer will be given. Questions must be submitted in writing to Democratic Services at least two full working days in advance of the meeting (this means that for meetings held on Wednesdays, notice must be received in Democratic Services by 4.30pm the previous Friday). If an answer cannot be prepared in time for the meeting it will be sent out within five days afterwards. Further details of the scheme can be obtained by contacting Sean O'Neill as above.

3. **Recording at Meetings**:-

   The Openness of Local Government Bodies Regulations 2014 now allows filming and recording by anyone attending a meeting. This is not within the Council's control.

   Some of our meetings are webcast. At the start of the meeting, the Chair will confirm if all or part of the meeting is to be filmed. If you would prefer not to be filmed for the webcast, please make yourself known to the camera operators.

   To comply with the Data Protection Act 1998, we require the consent of parents or guardians before filming children or young people. For more information, please speak to the camera operator

   The Council will broadcast the images and sound live via the internet www.bathnes.gov.uk/webcast An archived recording of the proceedings will also be available for viewing after the meeting. The Council may also use the images/sound recordings on its social media site or share with other organisations, such as broadcasters.

4. **Details of Decisions taken at this meeting** can be found in the minutes which will be published as soon as possible after the meeting, and also circulated with the agenda for the next meeting. In the meantime details can be obtained by contacting Sean O'Neill as above.

   Appendices to reports are available for inspection as follows:-

   Public Access points - Reception: Civic Centre - Keynsham, Guildhall - Bath, Hollies - Midsomer Norton, and Bath Central, Keynsham and Midsomer Norton public libraries.

   For Councillors and Officers papers may be inspected via Political Group Research Assistants and Group Rooms/Members' Rooms.

5. **Attendance Register:** Members should sign the Register which will be circulated at the meeting.

6. THE APPENDED SUPPORTING DOCUMENTS ARE IDENTIFIED BY AGENDA ITEM NUMBER.

7. Emergency Evacuation Procedure

When the continuous alarm sounds, you must evacuate the building by one of the designated exits and proceed to the named assembly point. The designated exits are sign-posted.

Arrangements are in place for the safe evacuation of disabled people.

Avon Pension Fund Committee - Investment Panel - Wednesday, 25th May, 2016

at 2.00 pm in the Cadbury Room - Fry Club and Conference Centre, Keynsham

A G E N D A

1. EMERGENCY EVACUATION PROCEDURE

   The Chair will draw attention to the emergency evacuation procedure as set out under Note 9.

2. DECLARATIONS OF INTEREST

   At this point in the meeting declarations of interest are received from Members in any of the agenda items under consideration at the meeting. Members are asked to complete the green interest forms circulated to groups in their pre-meetings (which will be announced at the Council Meeting) to indicate:

   (a) The agenda item number in which they have an interest to declare.

   (b) The nature of their interest.

   (c) Whether their interest is a **disclosable pecuniary interest** or an **other interest**, (as defined in Part 2, A and B of the Code of Conduct and Rules for Registration of Interests)

   Any Member who needs to clarify any matters relating to the declaration of interests is recommended to seek advice from the Council's Monitoring Officer or a member of his staff before the meeting to expedite dealing with the item during the meeting.

3. APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

   To receive any declarations from Members of the Committee and Officers of personal/prejudicial interests in respect of matters for consideration at this meeting, together with their statements on the nature of any such interest declared.

4. TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

5. ITEMS FROM THE PUBLIC - TO RECEIVE DEPUTATIONS, STATEMENTS, PETITIONS OR QUESTIONS

6. ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

   To deal with any petitions or questions from Councillors and, where appropriate, co-opted and added members.

7. MINUTES: 24TH FEBRUARY 2016 (Pages 7 - 10)

8. LIABILITY RISK MANAGEMENT FRAMEWORK (Pages 11 - 80)

Before discussing Exempt Appendix 1, Members are invited to pass the following resolution

> The Committee, having been satisfied that the public interest would be better served by not disclosing relevant information, RESOLVES, in accordance with the provisions of Section 100 (A) (4) of the Local Government Act 1972, that the public shall be excluded from the meeting while Exempt Appendix 1 to this item is discussed, because of the likely disclosure of exempt information as defined in paragraph 3 of Part 1 of Schedule 12A of the Act as amended.

9. REVIEW OF INVESTMENT PERFORMANCE (Pages 81 - 174)

Before discussing Exempt Appendix 3, Members are invited to pass the following resolution

The Committee, having been satisfied that the public interest would be better served by not disclosing relevant information, RESOLVES, in accordance with the provisions of Section 100 (A) (4) of the Local Government Act 1972, that the public shall be excluded from the meeting while Exempt Appendix 3 to this item is discussed, because of the likely disclosure of exempt information as defined in paragraph 3 of Part 1 of Schedule 12A of the Act as amended.

10. WORKPLAN (Pages 175 - 178)

The Committee Administrator for this meeting is Sean O'Neill who can be contacted on 01225 395090.

Protocol for Decision-making

Guidance for Members when making decisions

When making decisions, the Cabinet/Committee must ensure it has regard only to relevant considerations and disregards those that are not material.

The Cabinet/Committee must ensure that it bears in mind the following legal duties when making its decisions:

- Equalities considerations
- Risk Management considerations

- Crime and Disorder considerations
- Sustainability considerations
- Natural Environment considerations
- Planning Act 2008 considerations
- Human Rights Act 1998 considerations
- Children Act 2004 considerations
- Public Health & Inequalities considerations

Whilst it is the responsibility of the report author and the Council's Monitoring Officer and Chief Financial Officer to assess the applicability of the legal requirements, decision makers should ensure they are satisfied that the information presented to them is consistent with and takes due regard of them.

Bath and North East Somerset Council

AVON PENSION FUND COMMITTEE - INVESTMENT PANEL

Minutes of the Meeting held

Wednesday, 24th February, 2016, 2.00 pm

Members: Councillor David Veale, Ann Berresford, Councillor Mary Blatchford and Shirley Marsh
Advisors: Steve Turner (Mercer), James Giles (Mercer) and Tony Earnshaw (Independent Advisor)
Also in attendance: Tony Bartlett (Head of Business, Finance and Pensions) and Matt Betts (Assistant Investments Manager)

22 EMERGENCY EVACUATION PROCEDURE

The Democratic Services Officer read out the procedure.

23 DECLARATIONS OF INTEREST

There were none.

24 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

Apologies were received from Councillor Chris Pearce and Councillor Cherry Beath.

25 TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

There was none.

26 ITEMS FROM THE PUBLIC - TO RECEIVE DEPUTATIONS, STATEMENTS, PETITIONS OR QUESTIONS

There were none.

27 ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

There were none.

28 MINUTES: 18 NOVEMBER 2015

These were approved as a correct record and signed by the Chair.

29 REVIEW OF INVESTMENT PERFORMANCE FOR PERIODS ENDING 31 DEC 2015

The Assistant Investments Manager presented the summary report. He highlighted the following:

- After a fall in the previous quarter, the Fund's assets increased by £104m in the quarter ending 31st December 2015. However since the end of the quarter there had been significant volatility in markets.

- JP Morgan Hedge Fund mandate was now fully funded.

- The agreed changes to the bond portfolio were being implemented and it was hope that this would be completed by the end of the current quarter, subject to market conditions.

- Two managers were rated as amber: Schroder Global Equity, though their relative performance had continued to improve during the quarter and Partners Group. Partner's IRR return was 8.8% p.a., compared to their IRR target of 10%. They were thus within their tolerance for a green rating on the basis of IRR returns. They were rated amber because they were behind the cash + 4% benchmark over 3 years. It was expected that over time that the IRR and cash + 4% performance would converge. The IRR figure was probably a truer measure of performance of this type of mandate.

Members agreed to focus on IRR returns versus IRR target in future reporting of Partners performance.

- Two allocations were outside the normal range under the new rebalancing policy. Developed market equities were overweight pending the drawdown of investments for the infrastructure mandate. Emerging market equities were underweight; because of the recent volatility in emerging markets officers were monitoring the position closely.

- As requested at the previous meeting Mercer had provided the ESG rating for each manager.

- The implementation of MIFID II had been delayed until January 2018.

Mr Turner introduced the Mercer performance report. He said that the performance of equity markets so far this year had probably been the worst ever, though they had rallied recently. Overall they were down about 7%. Developing markets had done a bit better than developed markets. The fall in equities had as usual encouraged a move into gilts. Gilt yields, which had been low, had consequently fallen further. Index-linked gilts were the best proxy for the Fund's liabilities. The result was that the liabilities of the Fund had probably risen about 6%, while the value of its assets had dropped about 5%. This was in the context of the actuarial valuation taking place on 31st March this year. However, the liabilities might not be as great as they appeared on a gilt basis, because of the changes in the way they would be valued.

Mr Giles commented on the performance of managers and asset classes. He said that the majority of managers had outperformed over the longer term and that Schroders were improving. The allocation to JP Morgan Hedge Fund was now fully in place. There were still some illiquid assets with Man Group that needed to be phased out over time. He drew attention to the summary of manager performance on agenda pages 27 and 28.

Members asked about the ESG ratings. Mr Turner explained that 1 was the highest rating, and that an N in the ESG column meant that Mercer had not formally tested that manager. A Member was disappointed to note that Invesco was only rated 4. The Assistant Investments Manager said that Invesco's investment style did not give them scope for achieving high ratings, but that over the past few years Invesco had employed an engagement overlay service to engage with companies through correspondence rather than face-to-face, but it was an improvement on their previous practice.

Members discussed the SRI mandate. Mr Turner replied that Mercer would not positively rate a manager simply because of investment exclusions, e.g. not investing in armaments or nuclear power. Mercer was looking for best practice. A Member suggested that there was a difference between ESG and SRI; ESG was about processes, not about the nature of the assets in which investments were made. The Member, however, agreed with the suggestion that ESG had to be taken account of in assessing SRI. Mr Turner said that the demand for SRI mandates was not high. Jupiter was performing well and it was hard to say whether this was down to skill or their exclusion criteria.

Members and officers discussed how the performance of managers should be taken into account in decisions about pooling. The following points were made:

- Pooling could mean reducing the number of managers currently employed by the participating funds to manage a particular asset class from 10 to 2 or 3. We would not wish to disinvest from managers who were performing well.

- Transaction costs had to be minimised.

- There was no manager so bad that that Members would want to disinvest from them in the next three to six months.

The Head of Business, Finance and Pensions said that pooling would be implemented over a period of years and a series of decisions about investment managers would have to be taken. Other funds in the pool would have to input into these decisions. However, the timetable for pooling was not entirely in the control of funds; the Government expected funds to pool their assets, and at some point would start having conversations with funds which appeared slow in doing so.

There was discussion about opportunities for investment in energy companies and in debt.

Mr Turner distributed a set of slides on current topics in investment and commented on them. The slides reviewed 2015 and identified key themes for 2016. The review of 2015 identified things that worked as:

- diversification
- style factor investing
- property
- equity options

Things that did not work were:

- emerging market debt and equity
- hedge funds
- commodities

Key themes identified for 2016 were;

- reduced market liquidity
- a maturing credit cycle
- tilt from alpha to beta
- need to think long term
- EU referendum and "Brexit"

Mr Turner said that Mercer believed that the impact of a vote for Brexit would be less than that of major market events, e.g. a sharp fall in the markets in China. He did not believe that the Fund should alter its portfolios in anticipation of the outcome of the referendum. The Head of Business, Finance and Pensions said that even if there was a vote for Brexit, the impact would only be felt over the longer term, because of the time it would take to reconfigure the UK's international relationships.

Mr Giles commented on the section of the document dealing with the impact of going cashflow negative. The Head of Business, Finance and Pensions noted that the Fund was facing a "double whammy" with a maturing scheme and a shrinking payroll base. In reply to a comment from a Member the Assistant Investments Manager explained that local government funds would not be pooling their liabilities. The Head of Business, Finance and Pensions said that the exit cap would be a serious deterrent against leaving the Fund early and could lead to an increase in the age profile of members.

RESOLVED

(i) to note the information as set out in the report;

(ii) that there are no issues to be notified to the Committee.

The meeting ended at 3.51 pm

Chair(person) ....

Date Confirmed and Signed ....

Prepared by Democratic Services

Bath & North East Somerset Council		
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**	
MEETING DATE:	**25 May 2016**	**AGENDA ITEM NUMBER**
TITLE:	**LIABILITY RISK MANAGEMENT FRAMEWORK**	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
List of attachments to this report: Exempt Appendix 1 – Mercer Report: Risk Management – Implementation Framework		

1 THE ISSUE

1.1 At the November meeting the Panel agreed in principle the Fund should put in place a framework to more effectively use the investment assets to match liabilities, and requested a framework be prepared for consideration by the Panel to recommend to Committee. The Committee discussed and noted this at their December meeting and additional information was provided to Committee in a training session on the subject in March 2016.

1.2 The report from Mercer at Exempt Appendix 1 sets out the proposed framework for approval for recommendation to Committee.

2 RECOMMENDATION

2.1 **The Panel recommends to Committee:**

(1) The liability risk management framework summarised on pages 24 and 25 of Exempt Appendix 1.

(2) The implementation of the framework be delegated to Officers in consultation with the Investment Panel.

3 FINANCIAL IMPLICATIONS

3.1 There is provision in the 2015/16 budget for investment advice relating to the review of the Fund's management of liability risks. Any future implementation of a liability risk management framework may incur additional costs for future budgets.

4 BACKGROUND

4.1 In November, the Panel agreed in principle to more effectively use the investment assets to match liabilities, specific elements included:

(1) An immediate change to the UK government bond portfolio to improve matching – already implemented.

(2) Developing a three year plan to increase the level of matching and to establish a longer term plan to reach a target level of matching when affordable – set out in the proposed implementation framework.

4.2 The proposed framework is the culmination of work by the Committee, Panel Officers and Mercer over the preceding 12 months.

5 PROPOSED IMPLEMENTATION FRAMEWORK

5.1 Mercer's report at Exempt Appendix 1 sets out the proposed Liability risk management framework. The report describes the rationale for the framework, the framework itself and provides information for future considerations on implementation. It comprises the following:

Recap:

(1) Outline of the objective and explanation of the impact of increasing certainty on the Fund's ability to improve affordability and/or reduce asset risk

(2) Estimate of potential costs (depending on implementation choices made)

For approval:

(3) **Establishment of target level of hedging and a plan to get there**

(4) **Yield trigger framework: Types of triggers, reference rates, how triggers are set, action at each trigger level and how work in practice**

For information and future consideration by Officers and Panel:

(5) Implementation considerations such as types of instruments used, leverage employed, structure of investment vehicle, monitoring.

6 RECOMMENDATIONS

6.1 The implementation framework proposed by Mercer for approval is summarised on pages 24 and 25 of Exempt Appendix 1.

7 RISK MANAGEMENT

7.1 The Avon Pension Fund Committee is the formal decision-making body for the Fund. As such it has responsibility to ensure adequate risk management processes are in place. It discharges this responsibility by ensuring the Fund has an appropriate investment strategy and investment management structure in place that is regularly monitored. The creation of an Investment Panel further strengthens the governance of investment matters and contributes to reduced risk in these areas.

8 EQUALITIES

8.1 An equalities impact assessment is not necessary as the report contains only recommendations to note.

9 CONSULTATION

9.1 N/a

10 ISSUES TO CONSIDER IN REACHING THE DECISION

10.1 Are set out in the report.

11 ADVICE SOUGHT

11.1 The Council's Section 151 Officer (Divisional Director – Business Support) has had the opportunity to input to this report and has cleared it for publication.

Contact person	Liz Woodyard, Investments Manager 01225 395306
Background papers	<u>Report to March 2016 Committee workshop</u>: Mercer Report ‘Managing Liabilities through the investment Portfolio’ <u>Report to November 2015 Panel meeting</u>: Managing Liabilities - Scenario analysis, with Mercer Report ‘Further training and scenario analysis’ <u>Report to September 2015 Panel meeting</u>: Managing Liabilities, with Mercer Report ‘Risk Management Framework’. <u>Report to June 2015 Committee meeting</u>: Liability Risk Management with Mercer Report ‘Management of Liability Risks: Developing a Risk Management Framework’
Please contact the report author if you need to access this report in an alternative format	

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Bath & North East Somerset Council

Access to Information Arrangements

Exclusion of access by the public to Council meetings

Information Compliance Ref: LGA 0844/16

Meeting / Decision: AVON PENSION FUND INVESTMENT PANEL
Date: 25th May 2016

Author: Matt Betts
Report Title: Item - Liability Risk Management Framework Exempt Appendix 1 – Risk Management – Implementation Framework Report

The Report contains exempt information, according to the categories set out in the Local Government Act 1972 (amended Schedule 12A). The relevant exemption is set out below.

Stating the exemption: 3. *Information relating to the financial or business affairs of any particular person (including the authority holding that information).*

The public interest test has been applied, and it is concluded that the public interest in maintaining the exemption outweighs the public interest in disclosure at this time. It is therefore recommended that the Report be withheld from publication on the Council website. The paragraphs below set out the relevant public interest issues in this case.

<u>PUBLIC INTEREST TEST</u>

If the Committee wishes to consider a matter with press and public excluded, it must be satisfied on two matters.

Firstly, it must be satisfied that the information likely to be disclosed falls within one of the accepted categories of exempt information under the Local Government Act 1972. Paragraph 3 of the revised Schedule 12A of the 1972 Act exempts information which relates to the financial or business affairs of the organisations which is commercially sensitive to the organisations. The officer responsible for this item believes that this information falls within the exemption under paragraph 3 and this has been confirmed by the Council's Information Compliance Manager.

Secondly, it is necessary to weigh up the arguments for and against disclosure on public interest grounds. The main factor in favour of disclosure is that all possible Council information should be public and that increased openness about Council business allows the public and others affected by any decision the opportunity to participate in debates on important issues in their local area. Another factor in favour of disclosure is that the public and those affected by decisions should be entitled to see the basis on which decisions are reached.

The exempt appendix contains information on potential future trades by the fund, and includes information on costs and structures that may impact the ability to procure efficiently in the near future. This information is commercially sensitive and could prejudice the commercial interests of the organisation if released. It would not be in the public interest if advisors and officers could not express in confidence opinions or proposals which are held in good faith and on the basis of the best information available.

It is also important that the Committee should be able to retain some degree of private thinking space while decisions are being made, in order to discuss openly and frankly the issues under discussion in order to make a decision which is in the best interests of the Fund's stakeholders.

The Council considers that the public interest has been served by the fact that a significant amount of information regarding the Report has been made available – by way of the main report. The Council considers that the public interest is in favour of not holding this matter in open session at this time and that any reporting on the meeting is prevented in accordance with Section 100A(5A)

By virtue of paragraph(s) 3 of Part 1 of Schedule 12A
of the Local Government Act 1972.

Document is Restricted

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Bath & North East Somerset Council		
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**	
MEETING DATE:	**25 MAY 2016**	**AGENDA ITEM NUMBER**
TITLE:	**Review Of Investment Performance For Periods Ending 31 March 2016**	
WARD:	**ALL**	
AN OPEN PUBLIC ITEM		
List of attachments to this report: Appendix 1 – Fund Valuation Appendix 2 – Mercer performance monitoring report (Panel version) Exempt Appendix 3 – RAG Monitoring Summary Report Appendix 4 – Fossil Fuel Investments and Sustainable Investment Appendix 5 – Mercer: Current Topics		

1 THE ISSUE

1.1 This paper reports on the performance of the Fund's investment managers and seeks to update the Panel on routine aspects of the Fund's investments. The report contains performance statistics for period ending 31 March 2016.

1.2 The report focuses on the performance of the individual investment managers. The full performance report with aggregate investment and funding analysis will be reported to the Committee meeting on 24 June 2016.

2 RECOMMENDATION

That the Investment Panel:

2.1 **Notes the information as set out in the reports.**

2.2 **Identifies any issues to be notified to the Committee.**

FINANCIAL IMPLICATIONS

2.3 The returns achieved by the Fund for the three years commencing 1 April 2013 will impact the next triennial valuation which will be calculated as at 31 March 2016. The returns quoted are net of investment management fees.

3 INVESTMENT PERFORMANCE

A – Fund Performance

3.1 The Fund's assets increased by £37m (return of c. 1%) in the quarter ending 31 March 2016 giving a value for the investment Fund of £3,742m. Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and managers.

3.2 Developed market equities all delivered negative returns over the quarter with the UK All Share Index, one of the better performers, falling just 0.4%. Emerging markets in contrast was the best performing region (+8.1% in sterling terms). Bond yields fell across all maturities over the quarter leading to positive returns from Gilts, and corporate bonds contributed a positive performance over the quarter (+3.0%).

3.3 The Fund's overall performance relative to benchmarks is unavailable at the time of publishing. Full performance data will be reported to the Pensions Committee on 24 June 2016.

B – Investment Manager Performance

3.4 A detailed report on the performance of each investment manager has been produced by Mercer – see pages 26 to 46 of Appendix 2.

3.5 Jupiter, Invesco, SSgA (Europe and Pacific), Genesis, BlackRock and RLAM are all outperforming their three year performance targets. Schroder global equity and Partners Group are underperforming their respective 3 year targets whilst Schroder property and TT although slightly under are broadly in line with their performance target.

3.6 Exempt Appendix 3 summarises the latest Performance Monitoring Report used internally to monitor manager performance. The summary report highlights the managers that are rated Amber or Red, detailing the performance and/or organisational issue(s), how they are being monitored and any actions taken by officers and/or the Panel. This quarter only Schroder (global equity mandate) is rated amber. There is an update on Schroder global equity in Exempt Appendix 3 along with an overview of Partners IRR returns. Schroder (property mandate) and TT are both underperforming their 3 year target but are within the tolerance level and so retain a green rating.

4 INVESTMENT STRATEGY AND PORTFOLIO REBALANCING

4.1 **Asset Class Returns**: Returns from developed equities, index linked gilts, gilts and property outperformed the strategic assumptions over three years, the latter 2 were significantly ahead of the assumed return. Emerging market equities and hedge funds underperformed significantly whilst the UK corporate bond return is marginally below the three year strategic assumption.

4.2 **Infrastructure**: \$195m of the Fund's \$300m commitment to infrastructure was drawdown in the fund managed by IFM on 1st April.

4.3 **Bond Portfolio**: Changes to the bond portfolio agreed at the previous meetings have now been fully implemented.

4.4 **Rebalancing**: The Fund's new Rebalancing Policy was approved by Committee in December and now looks at the allocations to each asset class rather than just the equity:bond ratio. Following a large drawdown by the infrastructure manager, the overweight to equities has been reduced to within the rebalancing range. As at 11 May there are no allocations outside the rebalancing ranges.

4.5 **Current Topics**: Appendix 5 highlights some current topics provided by Mercer for information.

5 FOSSIL FUEL INVESTMENTS

5.1 Ahead of the planned review of the Fund's responsible investment policy, Appendix 4 from Mercer provides an estimate of the magnitude of the Fund's exposure to carbon (much more detailed analysis will form part of the review), and an overview of opportunities in sustainable investing.

5.2 All of the Fund's active equity managers are currently underweight the oil and gas sector. Current weights relative to benchmark of the Fund's active equity managers for the oil and gas sector are as follows:

Manager	Oil & Gas Benchmark Weight	Oil and Gas Manager Weight
Jupiter (UK SRI mandate)	10.6%	0%
TT (UK equity mandate)	10.6%	7.8%
Schroder (global equity mandate)	6.5%	6.2%
Genesis (emerging markets equity mandate)	7.7%	3.7%
Unigestion (emerging markets equity mandate)	7.7%	4.1%

5.3 The Fund has also been active in supporting LAPFF's engagement with Companies on carbon exposure risks. The Fund is a co-filer on shareholder resolutions on strategic resilience at Rio Tinto, Glencore and Anglo American, all of which have received support from company management. The resolutions ask for commitment to reporting on emissions management, low carbon research and development, key performance indicators and public policy positions. This follows successful resolutions at BP and Shell in 2015 with Chevron and Exxon to follow in May 2016.

6 RISK MANAGEMENT

6.1 The Avon Pension Fund Committee is the formal decision-making body for the Fund. As such it has responsibility to ensure adequate risk management processes are in place. A key risk to the Fund is that the investments fail to generate the returns required to meet the Fund's future liabilities. This risk is managed via the Asset Liability Study which determines the appropriate risk adjusted return profile (or strategic benchmark) for the Fund and through the selection process followed before managers are appointed. This report monitors the performance of the investment managers. The Investment Panel has been established to consider in greater detail investment performance and related matters and report back to the Committee on a regular basis.

7 EQUALITIES

7.1 An equalities impact assessment is not necessary as the report is primarily for information only.

8 CONSULTATION

8.1 This report is primarily for information and therefore consultation is not necessary.

9 ISSUES TO CONSIDER IN REACHING THE DECISION

9.1 The issues to consider are contained in the report.

10 ADVICE SOUGHT

10.1 The Council's Section 151 Officer (Divisional Director – Business Support) has had the opportunity to input to this report and has cleared it for publication.

Contact person	Matt Betts, Assistant Investments Manager (Tel: 01225 395420)
Background papers	Data supplied by The WM Company
Please contact the report author if you need to access this report in an alternative format	

APPENDIX 1

AVON PENSION FUND VALUATION - 31 MARCH 2016

	Passive Multi-Asset	Active Equities					Enhanced Indexation		Active Bonds	Funds of Hedge Funds		DGFs		Property		Infra-stucture	In House Cash	TOTAL	Avon Asset Mix %
All figures in £m	BlackRock	TT Int'l	Jupiter (SRI)	Genesis	Unigestion	Schroder Global	Invesco	SSgA	Royal London	JP Morgan	Terminating Mandates	Pyrford	Standard Life	Schroder - UK	Partners -	IFM	Currency Hedging		
EQUITIES																			
UK	167.8	189.4	162.9			32.0												552.1	14.75%
North America	165.7					142.8												308.5	8.2%
Europe	118.1					30.7		42.6										191.4	5.1%
Japan	24.3					20.7		45.3										90.3	2.4%
Pacific Rim	40.8					5.1		31.9										77.9	2.1%
Emerging Markets				149.2	178.1	20.8											0.0	348.1	9.3%
Global ex-UK							289.7											289.7	7.7%
Global inc-UK																	11.3	11.3	0.3%
Total Overseas	***348.9***	***0.0***	***0.0***	***149.2***	***178.1***	***220.1***	***289.7***	***119.8***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***11.3***	***1317.2***	***35.2%***
Total Equities	**516.7**	**189.4**	**162.9**	**149.2**	**178.1**	**252.2**	**289.7**	**119.8**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**11.3**	**1869.3**	**50.0%**
DGFs												**126.9**	**234.0**					**360.9**	**9.6%**
Hedge Funds										187.7	5.0							**192.7**	**5.2%**
Property														195.1	172.2			**367.3**	**9.8%**
Infrastructure																		**0.0**	**0.0%**
BONDS																			
Index Linked Gilts	435.9																	435.9	11.6%
Conventional Gilts																		0.0	0.0%
Corporate Bonds	66.8								289.6									356.4	9.5%
Overseas Bonds																		0.0	0.0%
Total Bonds	**502.7**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**289.6**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**792.3**	**21.2%**
Cash	6.1	12.6	11.0			1.6								0.8		135.6	-8.3	**159.4**	**4.3%**
TOTAL	**1025.6**	**202.0**	**173.9**	**149.2**	**178.1**	**253.8**	**289.7**	**119.8**	**289.6**	**187.7**	**5.0**	**126.9**	**234.0**	**195.9**	**172.2**	**135.6**	**3.0**	**3742.0**	**100.0%**

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HEALTH WEALTH CAREER

AVON PENSION FUND

PANEL INVESTMENT PERFORMANCE REPORT QUARTER TO 31 MARCH 2016

MAY 2016

MAKE TOMORROW, TODAY

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- The value of investments can go down as well as up and you may not get back the amount you have invested. In addition investments denominated in a foreign currency will fluctuate with the value of the currency.
- The valuation of investments in property based portfolios, including forestry, is generally a matter of a valuer's opinion, rather than fact.
- When there is no (or limited) recognised or secondary market, for example, but not limited to property, hedge funds, private equity, infrastructure, forestry, swap and other derivative based funds or portfolios it may be difficult for you to obtain reliable information about the value of the investments or deal in the investments.
- Where the investment is via a fund of funds the investment manager typically has to rely on the underlying managers for valuations of the interests in their funds.
- Care should be taken when comparing private equity / infrastructure performance (which is generally a money-weighted performance) with quoted investment performance (which is generally a time-weighted performance). Direct comparisons are not always possible.

CONTENTS

SECTION 1

EXECUTIVE SUMMARY

Page 90

This report has been prepared for the Investment Panel of the Avon Pension Fund ("the Fund"), to assess the performance and risks of the investment managers of the Fund.

Fund performance

- The value of the Fund's assets increased by £37m over the quarter, to £3,742m at 31 March 2016.

Strategy

- Global (developed) equity returns over the last three years at 9.3% p.a. have been ahead of the assumed strategic return of 8.25% p.a. from the strategic review in March 2013. We remain neutral in our medium term outlook for developed market equities (over the next one to three years).

- The three year return from emerging market equities has increased to -1.8% p.a. from -2.9% p.a. last quarter. The three year return remains well below the assumed strategic return (of 8.75% p.a.) as returns have been affected by the general emerging markets weakness in recent years, although performance in Q1 was strong compared to developed markets, largely due to the weakening US dollar and increasing commodities prices. As with developed markets, we are neutral in our medium term outlook for emerging market equities over the next one to three years.

- UK government bond returns over the three years to 31 March 2016 remain above the long term strategic assumed returns (with fixed interest gilts returning 8.6% p.a. against an assumed return of 4.5% p.a., and index-linked gilts returning 5.6% p.a. versus an assumed return of 4.25% p.a.) as investor demand for gilts remains high.

Strategy (continued)

- UK corporate bonds returned 5.0% p.a. over the three year period, falling behind their assumed return of 5.5% p.a., while property returns of 14.6% continue to be substantially above the assumed strategic return of 7% p.a.
- Hedge fund returns remain below long term averages and the strategic return of 6% p.a., as they are affected by low cash rates, and as active managers in general have struggled to generate meaningful returns.
- With most listed assets looking close to fully valued, if not fully valued, we would continue to expect 'alpha' driven investments such as hedge funds and dynamic multi-asset strategies to play an increasingly important role in return generation over the coming three years, particularly if 'beta' (i.e. market-driven) returns are lower looking forward. In light of reduced market liquidity, we also see opportunities for more dynamic and active strategies to add value, and continue to believe that there are likely to be opportunities arising in distressed debt given the maturing credit cycle. Asset classes that can provide a reliable source of income such as Long Lease Property, Private Debt and Infrastructure also offer relatively attractive sources of return, in our view, given the current market outlook.

Managers

- Absolute returns of the managers over the quarter were mixed. UK equities struggled in light of concerns over the EU referendum and the slowing of economic growth at the start of the quarter, and Jupiter and TT delivered negative relative returns. Genesis and Unigestion had the highest returns benefitting from a positive quarter for emerging markets equities, while Standard Life GARS performance over the quarter was disappointing (-3.3% relative to a benchmark of +1.4%).
- Brexit concerns led to a weakening of sterling versus other major currencies; as a result, the currency hedging overlay detracted value over the quarter. In the event of a strengthening pound, for example possibly following a vote to 'remain' in June, it will be expected to add value.
- With the exception of property, returns over the year to 31 March 2016 were generally muted. The equity mandates (with the exception of TT) delivered negative absolute returns despite a strong Q1. Emerging market returns for the year were disappointing, with Genesis and Unigestion returning -6.4% and -7.1% respectively (although both still met their outperformance target despite the negative returns).
- Over three years, all mandates with a three year track record produced positive absolute returns (with the exception of Genesis), with only Schroder global equity and Partners failing to beat their benchmarks (although see comments on the measurement of Partners' performance later). In addition, TT and Schroder property failed to achieve their three-year performance objectives, despite both beating their benchmarks. The remainder of the active managers achieved their objectives.

Key points for consideration

- Initial funding has begun for the infrastructure mandate, which has a 5% strategic benchmark allocation. On 24 March, £146m ($195m) of passive developed market equities were sold to fund the investment. This was held as cash by IFM and invested on 1 April. A currency hedging overlay will be put in place with Record to hedge the underlying currency exposures.

- Over the quarter, changes took place in the Stabilising Asset portfolio as fixed interest gilts and overseas government bonds were fully transitioned to index-linked gilts. Current holdings in index-linked gilts are approximately £436m, or 11.7% of the Fund.

EXECUTIVE SUMMARY
MANAGER INFORMATION

Manager	Mandate	Research Rating	Short Term Performance (1 year)	Long Term Performance (3 year)	ESG	Page
BlackRock	Passive Multi-Asset	✓	✓	✓	P2	*27*
Jupiter	UK Equities	-	✓	✓	2	*28*
TT International	UK Equities	-	✓	-	3	*29*
Schroder	Global Equities	✓	✕	✕	2	*30*
Genesis	Emerging Market Equities	✓	✓	✓	3	*31*
Unigestion	Emerging Market Equities	-	✓	N/A	N	*32*
Invesco	Global ex-UK Equities	✓	✕	✓	4	*33*
SSgA	Europe ex-UK Equities	-	✓	✓	N	*34*
SSgA	Pacific inc. Japan Equities	-	-	✓	N	*35*

Meets criteria	✓	A or B+ rating; achieved performance target
Partially meets criteria	-	B, N or R rating; achieved benchmark return but not performance target
Does not meet criteria	✕	C rating; did not achieve benchmark

Focus Points

- BlackRock have informed us that Amy Schioldager, Senior Managing Director and Global Head of Beta Strategies, will be leaving the firm. See page 27 for detail.
- Schroders have announced that Michael Dobson is to move from CEO to Chairman and will be replaced by Peter Harrison. See page 30 for detail.
- SSgA have announced its intention to acquire GE Asset Management. See page 34 for detail.
- There were no changes to any ratings over the quarter.

EXECUTIVE SUMMARY
MANAGER INFORMATION CONTINUED

Manager	Mandate	Research Rating	Short Term Performance (1 year)	Long Term Performance (3 year)	ESG	Page
Pyrford	**DGF**	-	✕	N/A	N	*36*
Standard Life	**DGF**	✓	✕	N/A	4	*37*
JP Morgan	**Fund of Hedge Funds**	✓	N/A	N/A	N	*39*
Schroder	**UK Property**	-	-	-	3	*42*
Partners	**Global Property**	✓	✕	✕	4	*43*
RLAM	**Bonds**	✓	-	✓	3	*44*
Record Currency Management	**Currency Hedging**	-	N/A	N/A	N	*45*

Meets criteria	✓	**A or B+ rating; achieved performance target**
Partially meets criteria	-	**B, N or R rating; achieved benchmark return but not performance target**
Does not meet criteria	✕	**C rating; did not achieve benchmark**

Focus Points

- Partners' performance relative to benchmark is explained in more detail on page 43.
- There were no changes to any ratings over the quarter.

SECTION 2

MARKET BACKGROUND

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MARKET BACKGROUND
INDEX PERFORMANCE

Equity Market Review

The major equity markets outside of the US posted negative returns over the quarter to end March, with global equities falling by 1.3% in local currency terms (though noting that a gain of 3.0% was achieved in sterling terms due to the relative depreciation of sterling). Small capitalisation stocks, as measured by the FTSE World Small Cap Index, outperformed the broader equity market, posting a positive return of 3.4% and 0.8% respectively in sterling and local currency terms.

Emerging markets were the strongest performing equity market measured, returning 8.8% in sterling and 3.3% in local currency terms, supported by the backdrop of a weaker US dollar and strengthening commodity prices. In contrast, Japan was the weakest performing equity market, returning -4.3% in sterling and -12.8% in local currency terms, as the significantly stronger yen also contributed to downward revisions of corporate earnings.

In the UK, the FTSE All-Share Index delivered a negative return of -0.4% over the quarter, outperforming the global equity market on a local currency basis but underperforming in sterling, mostly due to the negative return posted by financial stocks. Within the UK, large capitalisation stocks (represented by the FTSE 100 Index) delivered a positive return and outperformed smaller segments of the market (represented by the FTSE 250 and FTSE Small Cap indices) due to its larger exposure to resource stocks which benefitted from a recovery in commodity prices towards the end of the quarter.

Bond Market Review

Bond yields fell across all maturities over the quarter, resulting in positive returns for investors.

In the UK, nominal government bond yields decreased by c.40-60 bps across the curve over the quarter with the Over 15 Gilts Index returning 8.2%. Nominal yields are now roughly at levels seen a year ago.

Real yields also fell over the quarter, albeit to a slightly lesser extent of c.20-40 bps, with the Over 5 Year Index-Linked Gilts Index posting a positive return of 6.5%.

Credit spreads widened over the quarter by c.14 bps and ended the quarter at c.1.5% and 1.6% for the Sterling Non-Gilts All Stocks and Sterling Non-Gilts Over 10 Year Indices, respectively. Despite the widening of credit spreads, UK credit assets posted a positive return of 3.0% in sterling terms due to the positive benefits from a decrease in government bond yields as well as income earned from coupons.

Currency Market Review

Over the quarter, sterling depreciated significantly against its major counterparts as Brexit fears sparked investor concerns. After reaching a seven year low against the US dollar in February, sterling recovered slightly in March as the Federal Reserve Bank lowered its projections for the pace of further rate rises in the US.

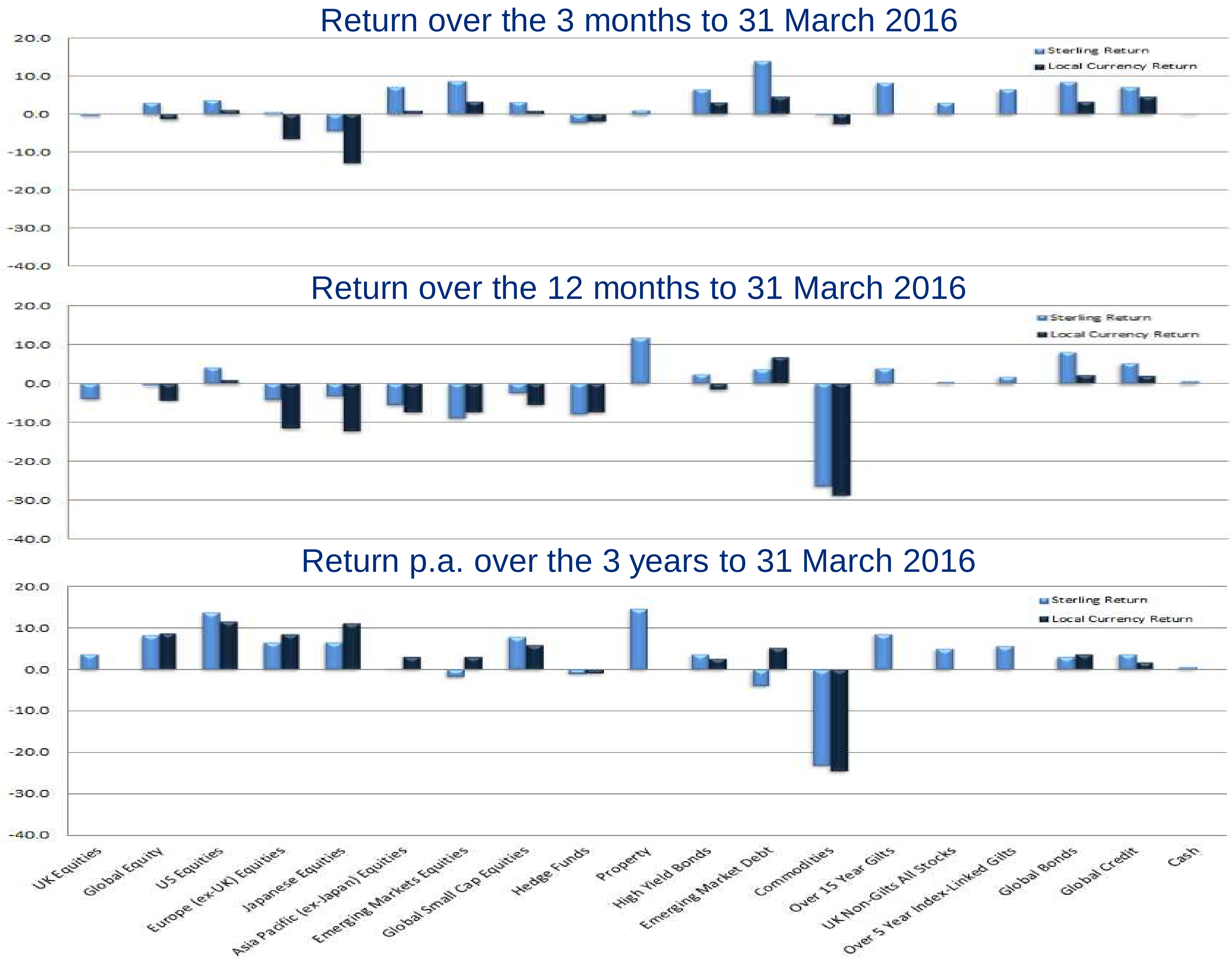
Commodity Market Review

The performance of major commodity sub-indices was mixed, with negative returns in the energy, agriculture and livestock and sub-indices more than offsetting positive returns from the precious metals and industrial metals sub-indices.

Brent Crude Oil prices recovered from a multi-year low of US$28/barrel in late January to a price of US$40/barrel as at end March, an increase of 43%. Gold rose by 16.2% over the quarter, reaching a 13 month high of US$1,234/oz as at end March on the back of a weaker US dollar.

Source: Thomson Reuters Datastream.

MARKET BACKGROUND
INDEX PERFORMANCE



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Source: Thomson Reuters Datastream.

SECTION 3

STRATEGIC ASSUMPTIONS

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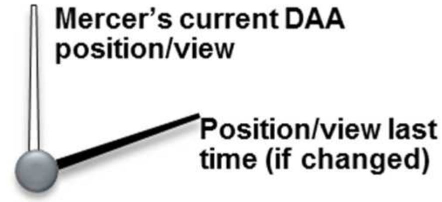
MARKET BACKGROUND
INDEX PERFORMANCE VERSUS STRATEGY

Asset Class	Strategy Assumed Return % p.a.	3 year Index Return % p.a.	Comment
Developed Equities (Global) (FTSE All-World Developed)	8.25	9.3	*Remains ahead of the assumed strategic return.* *This has decreased from 13.6% p.a. last quarter as the latest quarter's return of 2.4% was considerably lower than the 15.1% return of Q1 2013, which fell out of the 3 year return.*
Emerging Market Equities (FTSE AW Emerging)	8.75	-1.8	*The three year return from emerging market equities has increased from -2.9% p.a. last quarter, as the return of 8.8% experienced last quarter was higher than the quarter that fell out of the period (5.4%). The three year return remains considerably below the assumed strategic return.*
Diversified Growth	Libor + 4% / RPI + 5%	4.6 / 6.6	*DGFs are expected to produce an equity like return over the long term but with lower volatility – this is the basis for the Libor and RPI based benchmarks. Low cash rates and low inflation means that both benchmarks have significantly underperformed the long term expected return from equity. During periods of strong equity returns, such as the last three year period, we would expect DGF to underperform equities.*
UK Gilts (FTSE Actuaries Over 15 Year Gilts)	4.5	8.6	*UK gilt returns remain above the long term strategic assumed return as yields remain low relative to historic averages. Returns have decreased compared to the previous quarter as the quarter that fell out of the 3-year return offset the fall in yields (and hence positive total returns) experienced in the last quarter. Corporate bond returns have increased this quarter, but over three years continue to be below the strategic assumed return.*
Index Linked Gilts (FTSE Actuaries Over 5 Year Index-Linked Gilts)	4.25	5.6	
UK Corporate Bonds (BofAML Sterling Non Gilts)	5.5	5.0	
Overseas Fixed Interest (JP Morgan Global Government Bonds ex UK)	5.5	2.6	*Although still lagging the strategic assumed return, the 3 year performance from overseas fixed interest increased over the quarter due to a strong quarterly return of 9.8%.*
Fund of Hedge Funds (HFRX Global Hedge Fund Index)	6.0	-1.0	*Hedge fund returns remain below long term averages and the strategic return, as they are affected by low cash rates. It should be noted that the index includes a wide variety of strategies that may have had very divergent returns.*
Property (IPD UK Monthly)	7.0	14.6	*Property returns continue to be above the expected returns, driven by the economic recovery in the US and the UK.*

Source: Thomson Reuters Datastream.

DYNAMIC ASSET ALLOCATION (DAA) DASHBOARD – Q2 2016

- Extremely Unattractive
- Unattractive
- Neutral
- Attractive
- Extremely Attractive



DEVELOPED MARKET EQUITIES

- Monetary policy remains generally supportive of equity markets
- Valuations have risen slightly and equities on the whole are at the upper end of fair value range
- Negative earnings growth over the last 12 months and downwards revisions to earnings estimates are uninspiring

EMERGING MARKET EQUITIES

- Valuations remain below long-term averages, despite a slight rise over the quarter
- Bearish market sentiment may leave room for surprises on the upside
- Structural headwinds remain in place: slowing Chinese growth, weak commodity prices and currency mismatches on EM balance sheets

These charts summarise Mercer's views on the medium term outlook for returns from the key asset classes; by medium term we mean one to three years. These views are relevant for reflecting medium term market views in determining appropriate asset allocation. We do not expect investors to make frequent tactical changes to their asset allocation based upon these views. These are also based from the view of an absolute return investor, and so do not take into account pension scheme liabilities.

DYNAMIC ASSET ALLOCATION (DAA) DASHBOARD – Q2 2016

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FIXED INTEREST GILTS (ALL STOCK)

- Ongoing extraordinary monetary policy and concerns over slowing growth continue to restrain upward yield moves
- Valuations remain stretched by historical norms and have increased further
- US monetary policy normalisation could hurt performance of fixed income assets

INDEX-LINKED GILTS

- Breakeven inflation levels at cyclical lows due to weak commodity prices
- Valuations remain expensive, with real yields well below long-term averages
- Core inflation expectations continue to fall amid concerns China may remain a deflationary force at the global level

DYNAMIC ASSET ALLOCATION (DAA) DASHBOARD – Q2 2016

NON-GOVERNMENT BONDS (£ ALL-STOCK)

- ✓ Credit spreads have widened slightly over the quarter and remain favourable relative to current default rates
- ! Yields remain historically low and lack of trading liquidity has led to risk of increased volatility
- ! General consensus that credit cycle is fairly mature and recent macro events have led to greater uncertainty

UK PROPERTY

- ✓ Yields remain reasonable relative to other assets and continue to be supported by strong fund inflows
- ! Supply starting to come to market, leading to less favourable supply-demand dynamics
- ! Signs of prime London market approaching the top of the cycle

SECTION 4

FUND VALUATIONS

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FUND VALUATIONS
VALUATION BY ASSET CLASS

Asset Allocation

Asset Class	Start of Quarter (£'000)	End of Quarter (£'000)	Start of Quarter (%)	End of Quarter (%)	Target Strategic Benchmark (%)	Ranges (%)	Difference (%)
Developed Market Equities	1,685,251	1,545,029	45.5	41.3	40.0	35 - 45	+1.3
Emerging Market Equities	302,627	327,299	8.2	8.7	10.0	5 - 15	-1.3
Diversified Growth Funds	365,235	360,928	9.9	9.6	10.0	5 - 15	-0.4
Fund of Hedge Funds	201,841	192,715	5.4	5.2	5.0	0 - 7.5	+0.2
Property	343,969	367,077	9.3	9.8	10.0	5 - 15	-0.2
Infrastructure	-	-	-	-	5.0	0 - 7.5	-5.0
Bonds	753,425	792,149	20.3	21.2	20.0	15 - 35	+1.2
Cash (including currency instruments)	52,683	156,579	1.4	4.2	-	0 - 5	+4.2
Total	**3,705,031**	**3,741,775**	**100.0**	**100.0**	**100.0**		**0.0**

Source: WM Performance Services, Mercer. Green numbers indicate the allocation is within tolerance ranges, whilst red numbers indicate the allocation is outside of tolerance ranges.

Invested assets increased over the quarter by £37m due to positive returns from most asset classes (in particular, bonds). At the start of the quarter, developed equities were overweight relative to benchmark (and outside the range in the SIP); at 31 March 2016 they remained overweight but within the agreed tolerance ranges. £146m was disinvested from developed market equities to fund the infrastructure mandate (held as cash at 31 March 2016).

FUND VALUATIONS
VALUATION BY MANAGER

Manager Allocation						
Manager	**Asset Class**	**Start of Quarter (£'000)**	**Cashflows (£'000)**	**End of Quarter (£'000)**	**Start of Quarter (%)**	**End of Quarter (%)**
BlackRock	Passive Multi-Asset	1,133,399	-148,294	1,025,565	30.6	27.4
Jupiter	UK Equities	176,056	-	173,896	4.8	4.6
TT International	UK Equities	205,993	-	201,993	5.6	5.4
Schroder	Global Equities	253,171	-	253,764	6.8	6.8
Genesis	Emerging Market Equities	136,357	-	149,181	3.7	4.0
Unigestion	Emerging Market Equities	166,270	-	178,118	4.5	4.8
Invesco	Global ex-UK Equities	284,392	-	289,696	7.7	7.7
SSgA	Europe ex-UK & Pacific inc. Japan Equities	119,872	-	119,803	3.2	3.2
Pyrford	DGF	123,750	-	126,947	3.3	3.4
Standard Life	DGF	241,485	-	233,981	6.5	6.3

Source: WM Services, Avon. Totals may not sum due to rounding.

FUND VALUATIONS
VALUATION BY MANAGER CONTINUED

Manager Allocation

Manager	Asset Class	Start of Quarter (£'000)	Cashflows (£'000)	End of Quarter (£'000)	Start of Quarter (%)	End of Quarter (%)
MAN	Fund of Hedge Funds	814	-	422	0.0	0.0
Signet	Fund of Hedge Funds	5,186	-	1,056*	0.1	0.0
Gottex	Fund of Hedge Funds	9,564	-6,453	3,542	0.3	0.1
JP Morgan	Fund of Hedge Funds	186,277	-	187,695	5.0	5.0
Schroder	UK Property	194,007	-	195,868	5.2	5.2
Partners	Property	151,610	-	171,992**	4.1	4.6
RLAM	Bonds	282,045	-	289,662	7.6	7.7
Record Currency Management	Currency Hedging	-17,595	23,000	-29,293	-0.5	-0.8
Internal Cash	Cash	52,377	131,747	167,927***	1.4	4.5
Total		**3,705,031**	**0**	**3,741,775**	**100.0**	**100.0**

Source: WM Services, Avon. Totals may not sum due to rounding.
* Change in valuation methodology from using Net Asset Value to listed price
** Estimated value.
*** Includes £136m to be transferred into the IFM infrastructure fund on 1 April.

SECTION 5

PERFORMANCE SUMMARY

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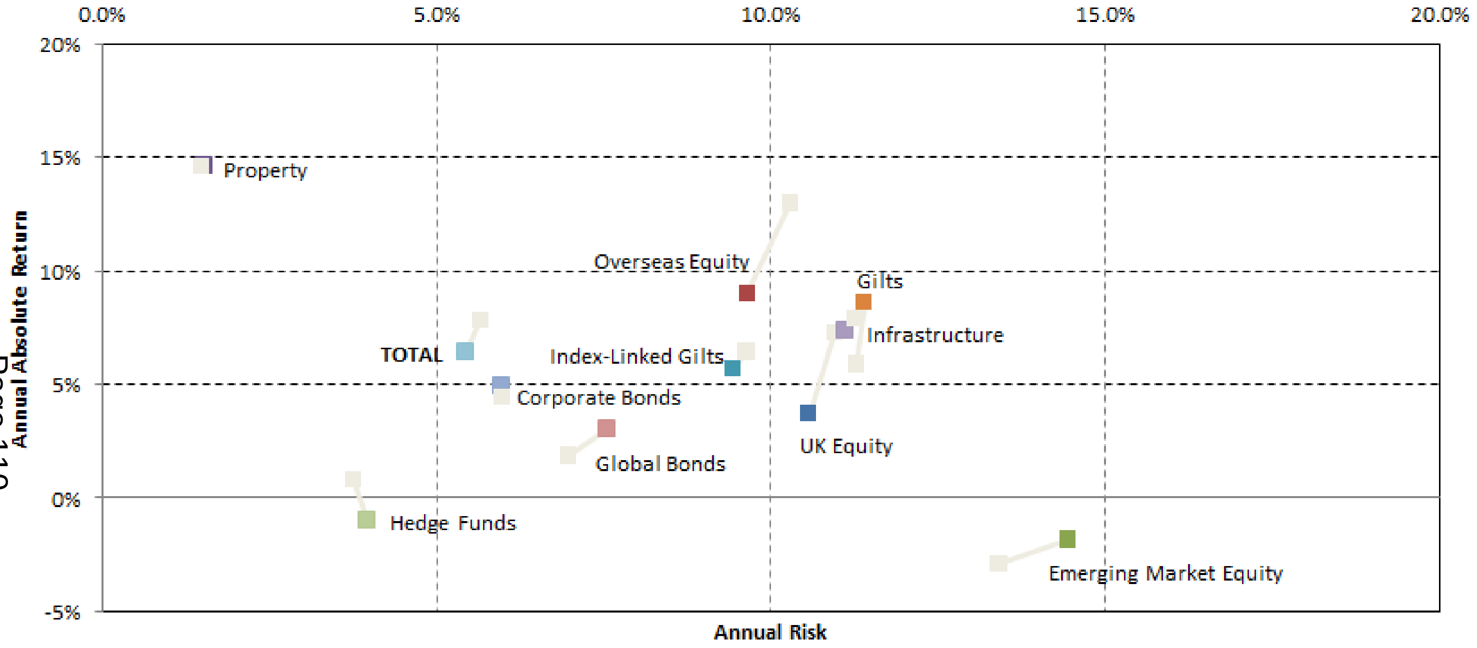
3 Year Risk v 3 Year Return to 31 March 2016



This chart shows the 3 year absolute returns against three year volatility (based on monthly data in sterling terms), to the end of March 2016, for each of the broad underlying asset benchmarks (using the indices set out in the Appendix), along with the total Fund strategic benchmark (using the benchmark indices and allocations from WM Services). We also show the positions as at last quarter, in grey.

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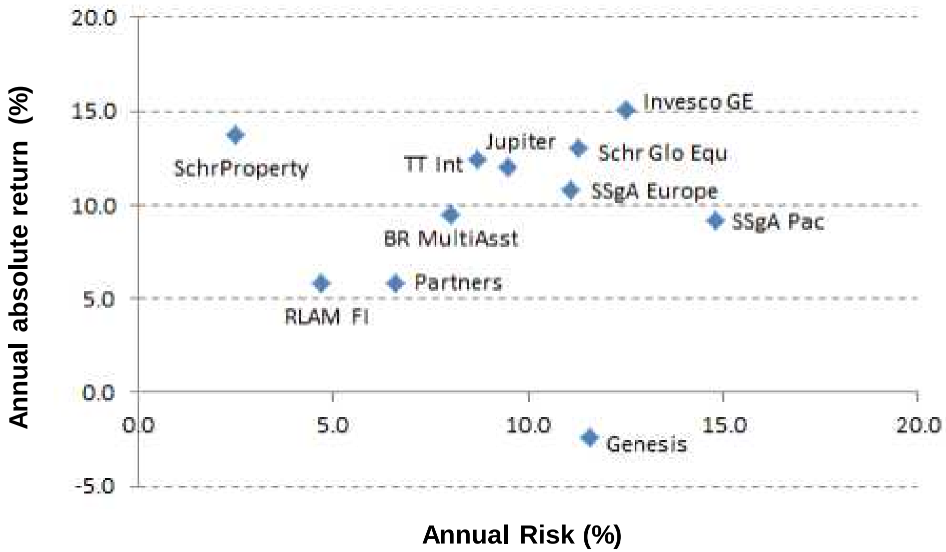
Comments

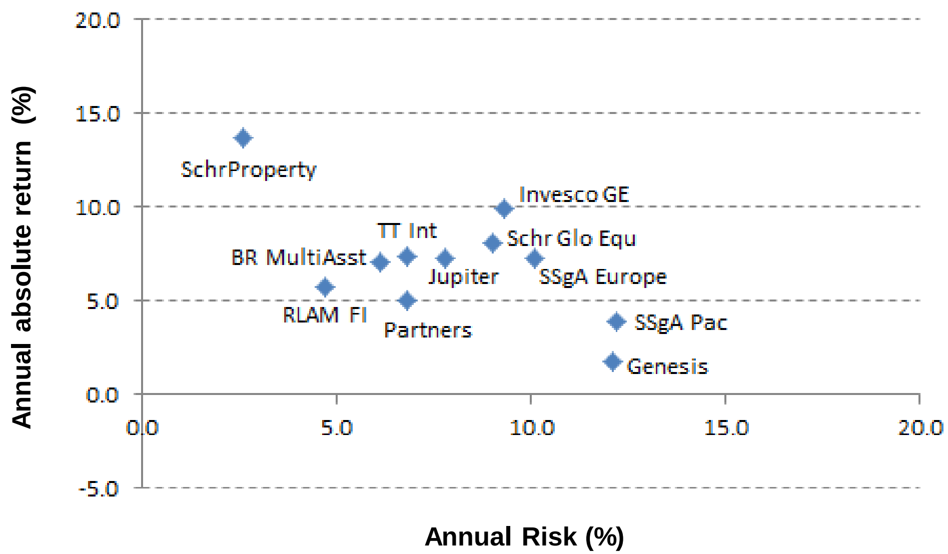
- *There were limited shifts in observed returns and volatilities over the quarter, the most significant being in equities (as a result of lower returns in Q1 2016 than in Q1 2013). Whilst UK and overseas equities saw a decrease in returns and volatility, emerging markets equities moved in the opposite direction.*

MANAGER MONITORING
RISK RETURN ANALYSIS

3 year Risk vs 3 year Return to 31 December 2015



3 year Risk vs 3 year Return to 31 March 2016



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Comments

- *In general absolute returns and volatility of the funds decreased over the quarter, in particular for developed market equities (consistent with the picture seen on page 23).*

MANAGER MONITORING
MANAGER PERFORMANCE TO 31 MARCH 2016

Manager / fund	3 months (%)			1 year (%)			3 year (% p.a.)			3 year outperformance target (% p.a.)	3 year performance versus target
	Fund	B'mark	Relative	Fund	B'mark	Relative	Fund	B'mark	Relative		
BlackRock Multi-Asset	3.7	3.8	-0.1	1.1	0.7	+0.4	7.3	6.9	+0.3	-	Target met
Jupiter	-1.2	-0.4	-0.8	-1.3	-3.9	+2.7	7.5	3.7	+3.7	+2	Target met
TT International	-2.0	-0.4	-1.6	3.4	-3.9	+7.6	7.3	4.5	+2.7	+3-4	Target not met
Schroder Equity	0.1	2.9	-2.7	-1.5	-0.6	-0.9	8.3	8.5	-0.2	+4	Target not met
Genesis	9.3	8.4	+0.8	-6.4	-8.8	+2.6	-1.8	-2.4	+0.6	-	Target met
Unigestion	7.1	8.4	-1.2	-7.1	-9.1	+2.2	N/A	N/A	N/A	+2-4	N/A
Invesco	1.9	2.4	-0.5	-0.6	0.2	-0.8	9.9	9.4	+0.5	+0.5	Target met
SSgA Europe	0.2	0.0	+0.2	-3.9	-5.0	+1.2	7.4	6.6	+0.7	+0.5	Target met
SSgA Pacific	-0.2	-0.5	+0.3	-4.0	-4.4	+0.4	4.0	3.3	+0.7	+0.5	Target met
Pyrford	2.6	1.4	+1.1	1.8	6.6	-4.5	N/A	N/A	N/A	-	N/A
Standard Life	-3.3	1.4	-4.6	-4.5	5.6	-9.6	N/A	N/A	N/A	-	N/A
JP Morgan	0.6	0.9	-0.3	N/A	N/A	N/A	N/A	N/A	N/A	-	N/A
Schroder Property	1.2	1.1	+0.1	10.6	10.6	0.0	13.6	13.0	+0.5	+1	Target not met
Partners Property	2.9	1.1	+1.8	4.5	8.6	-3.8	6.5	11.6	-4.5	+2	Target not met
RLAM	2.7	3.2	-0.5	0.4	0.4	0.0	5.8	4.9	+0.9	+0.8	Target met
Internal Cash	0.1	0.1	0.0	0.3	0.3	0.0	0.4	0.4	0.0	-	N/A

Source: WM Services, Avon, Mercer estimates.
In the relative performance columns, returns in blue text exceeded their respective benchmarks, those in red underperformed, and black text shows performance in line with benchmark.
In the table above, and throughout this report, relative returns have been calculated geometrically (i.e. the portfolio return is divided by the benchmark return) rather than arithmetically (where the benchmark return is subtracted from the portfolio return).
A summary of the benchmarks for each of the mandates is given in Appendix 1.

SECTION 6

MANAGER PERFORMANCE

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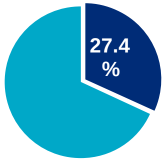

BLACKROCK – PASSIVE MULTI-ASSET (POOLED EQUITIES, SEGREGATED BONDS)
£1,025.6M END VALUE *(£1,133.4M START VALUE)*

Item Monitored		Outcome
Mercer Rating	●	A (no change over period under review). ESGp2 for equities
Performance Objective *In line with the benchmark*	●	Outperformed benchmark by 0.3% p.a. over three years

Manager Research and Developments

- Returns have been in line with the benchmark over the quarter, which is expected for a passive mandate with a benchmark based on monthly mean fund weights.
- Fixed interest gilts and overseas government bonds were fully transitioned to index-linked gilts over the quarter.
- In addition, on 24 March, £146m ($195m) was disinvested from developed equities with BlackRock to fund the IFM infrastructure mandate.
- We have been informed by BlackRock that Amy Schioldager, Senior Managing Director and Global Head of Beta Strategies is to retire in 12 months, after being with the firm for 26 years. Schioldager leads the team managing BlackRock's index strategies as well as iShares ETFs. BlackRock have confirmed that they will be disclosing the specifics of their plans as Schioldager's retirement date approaches. We do not propose any changes to the ratings of BlackRock's passive products as a result.

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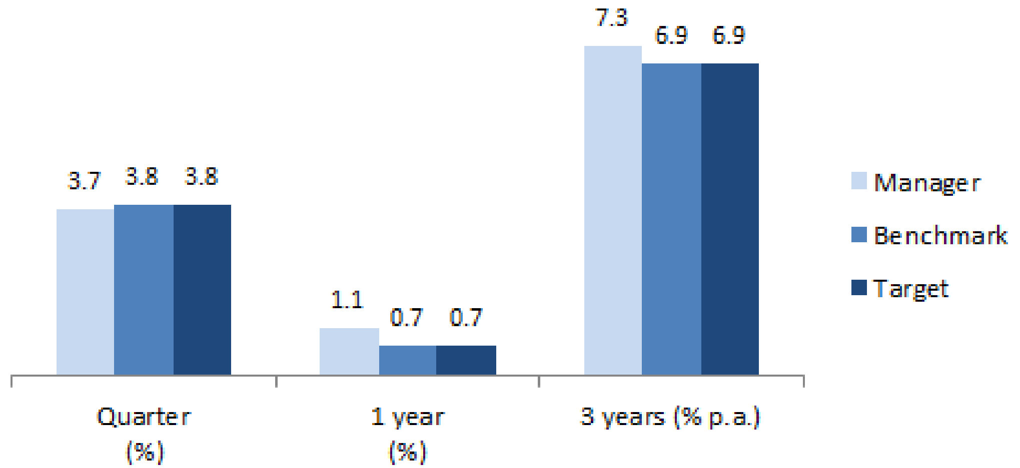
Reason for investment

To provide asset growth as part of a diversified portfolio

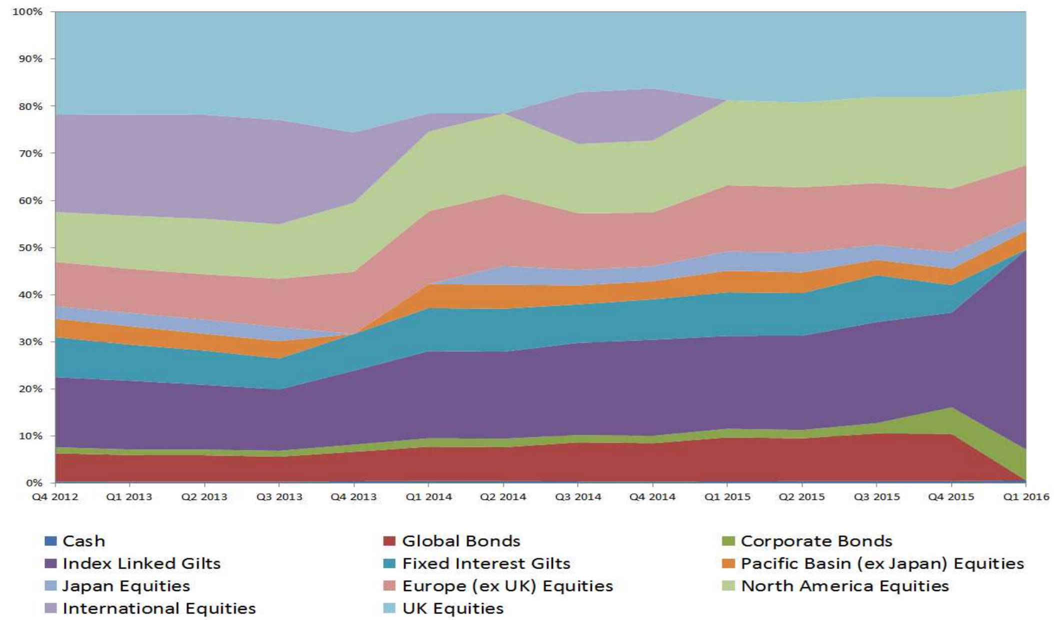
Reason for manager

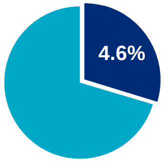
- To provide low cost market exposure across multi asset classes
- Provide efficient way for rebalancing between bonds and equities within a single portfolio

Performance



Asset Allocation





JUPITER ASSET MANAGEMENT – UK EQUITIES (SRI) (SEGREGATED)
£173.9M END VALUE *(£176.1M START VALUE)*

Item Monitored		Outcome
Mercer Rating	🟠	B (no change over period under review). ESG2 – see below.
Performance Objective *Benchmark +2% p.a.*	🟢	Outperformed benchmark by 3.7% p.a. over three years
Tracking error was 3.6% p.a. (Q4: 3.6%) – *source: Jupiter*		Number of stocks: 57

Manager Research and Developments

- The fund outperformed its target over the year and three year periods, but underperformed the benchmark over the quarter.
- The underperformance was a reflection of the underweight positions in the resources sector. The period's strongest sectors were Oil & Gas and Basic Materials (the latter to a large extent driven by the mining subsector) as sentiment towards the oil and broader commodity markets improved.
- Our researchers met with Jupiter in February 2016 to discuss ESG issues for the Jupiter Responsible Income Fund (the pooled vehicle managed by Charlie Thomas which is most similar to the Fund's segregated mandate). We regard a rating of ESG2 as appropriate for the strategy. The portfolio is constructed with strong reference to ESG issues as drivers of investment opportunities have been made. Changes to the overall ESG processes within the organisation have increased oversight and generated heightened consideration of ESG issues across the product range. Active ownership for the strategy remains well organised. However we do feel the core Environment and Sustainability Investment Team is small compared to their peers. While we now have more confidence in the robustness of the ESG processes, we will continue to monitor as part of our regular review processes.

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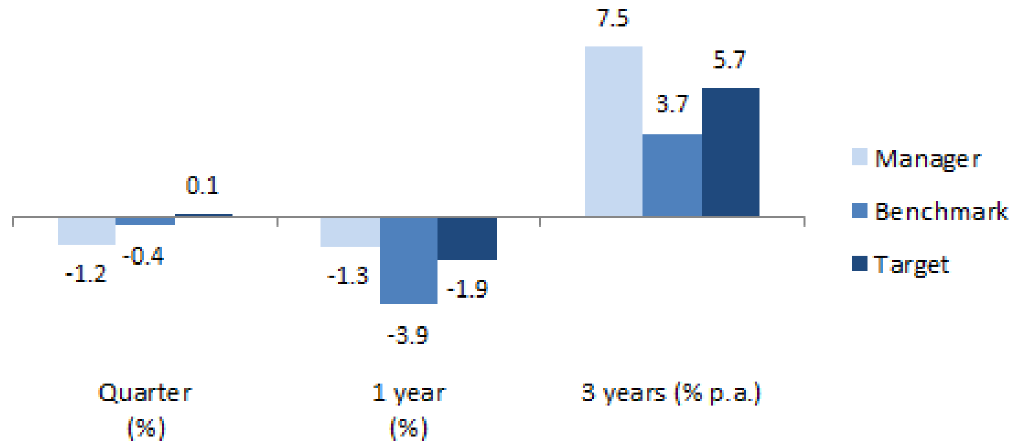
Reason for investment

To provide asset growth as part of a diversified equity portfolio and to provide a specific SRI allocation

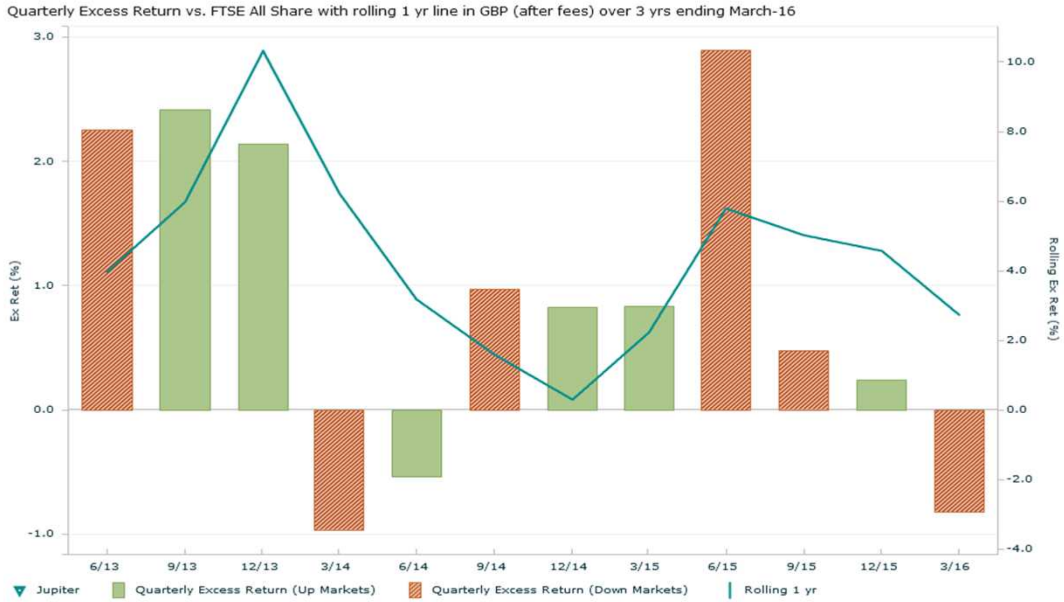
Reason for manager

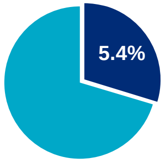
- Clear and robust approach to evaluating SRI factors within the investment process
- Dedicated team of SRI analysts to research SRI issues and lead engagement and voting activities
- Corporate commitment to SRI investment approach within a more mainstream investment team

Performance



Rolling relative returns





TT INTERNATIONAL – UK EQUITIES (UNCONSTRAINED) (SEGREGATED)
£202.0M END VALUE *(£206.0M START VALUE)*

Item Monitored	Outcome	
Mercer Rating	●	B (no change over period under review). ESG3
Performance Objective *Benchmark +3-4% p.a.*	●	Outperformed benchmark by 2.7% p.a. over three years
Three year tracking error was 4.4% p.a. – *source: Mercer*		Number of stocks: 46

Manager Research and Developments

- TT have underperformed their benchmark by 1.6% over the quarter, but significantly outperformed by 7.6% over the year to 31 March 2016.
- This underperformance over the quarter was largely due to stock selection in the Financials and Industrials sectors (detracting 1.5% from returns in total).
- In terms of sector positioning, TT gained from being underweight Financials.
- Turnover increased from 23.7% in Q4 to 30.5% in Q1 2016 while the three year tracking error (a proxy for risk relative to benchmark) rose from 4.1% to 4.4%.
- Three-year information ratios have decreased over the quarter.
- Assets under management in TT's UK equity strategies decreased over the quarter to c. £516m in light of negative returns; this consists of the assets of TT's pooled fund, and three segregated accounts (one of which being the Fund's holdings). This compares to £526m in December 2015, £496m in March 2015 and £574m in March 2013). A significant portion (c.40%) of the firm's UK equity assets are managed on behalf of the Fund.
- Our researchers met with TT in February 2016 and no change to the strategy rating was recommended. We acknowledge their strong performance, but our researcher continue to believe that a 'B' rating is appropriate for the strategy as we cannot identity any strong discernable edge over other strategies.

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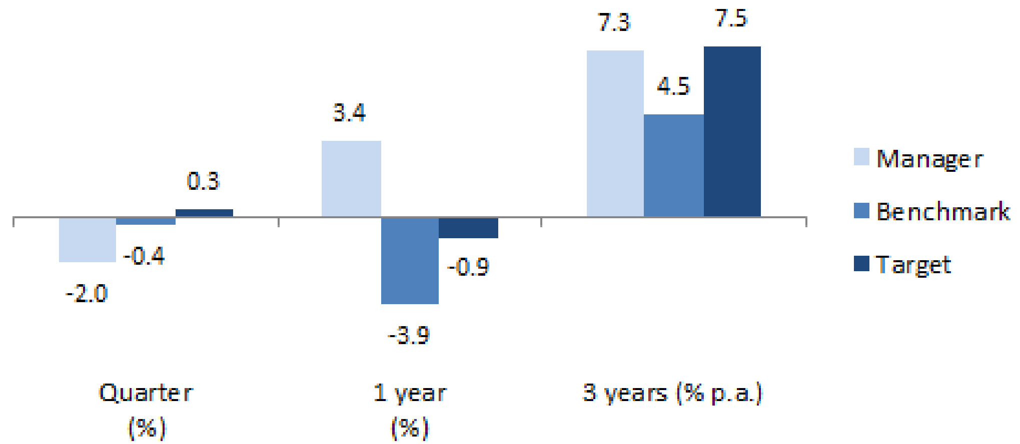
Reason for investment

To provide asset growth as part of a diversified equity portfolio

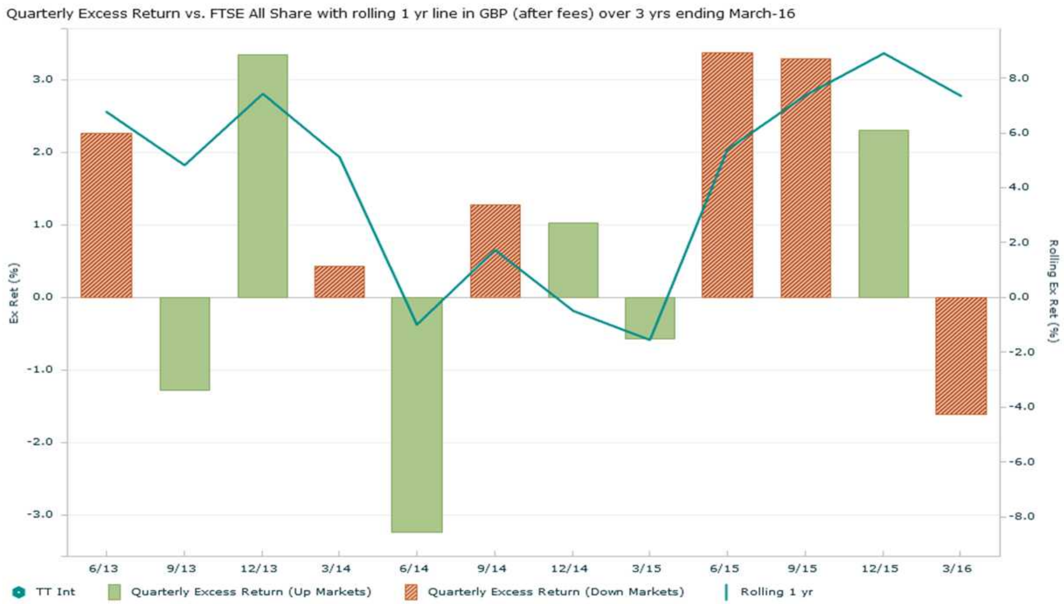
Reason for manager

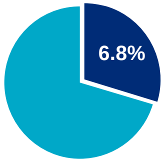
- Favoured the partnership structure that aligns manager's and Fund's interests
- Focussed investment activity and manages its capacity
- Clear, robust stock selection and portfolio construction

Performance



Rolling relative returns





SCHRODER – GLOBAL EQUITY PORTFOLIO (SEGREGATED)
£253.8M END VALUE *(£253.2M START VALUE)*

Item Monitored	Outcome
Mercer Rating	B+ (no change over period under review). ESG2
Performance Objective *Benchmark +4% p.a.*	Underperformed benchmark by 0.2% p.a. over three years

Three year tracking error was 2.7% p.a. – *source: Mercer*

Manager Research and Developments

- The fund has significantly underperformed the benchmark over the quarter, largely through stock selection in financials (which detracted -1.1%) and industrials (-1.0%).
- The portfolio's growth bias weighed on performance over the quarter as the market rally in the second half of the quarter was driven by lower quality, cyclical companies. Stock selection in the US was particularly unfavourable.
- The largest detractor over the quarter was Citigroup. Holdings in the bank sector weighed on returns amid concerns about the sector's exposure to the energy sector and the impact of interest rates staying "lower for longer" in major economies.
- Three year tracking error increased from 2.1% to 2.7% p.a. since last quarter.
- Schroders have announced some widely anticipated management changes. Michael Dobson is to step down as CEO and will be replaced by Peter Harrison. Dobson will take on the role of Chairman which is surprising as we had expected a clean break in terms of management change. In practice we anticipate that Harrison will have control over any changes he deems necessary. There has been no change to the portfolio management team., and we do not propose any changes to the strategy's ratings. Nonetheless, we note that this move goes against current views on best corporate governance practice.

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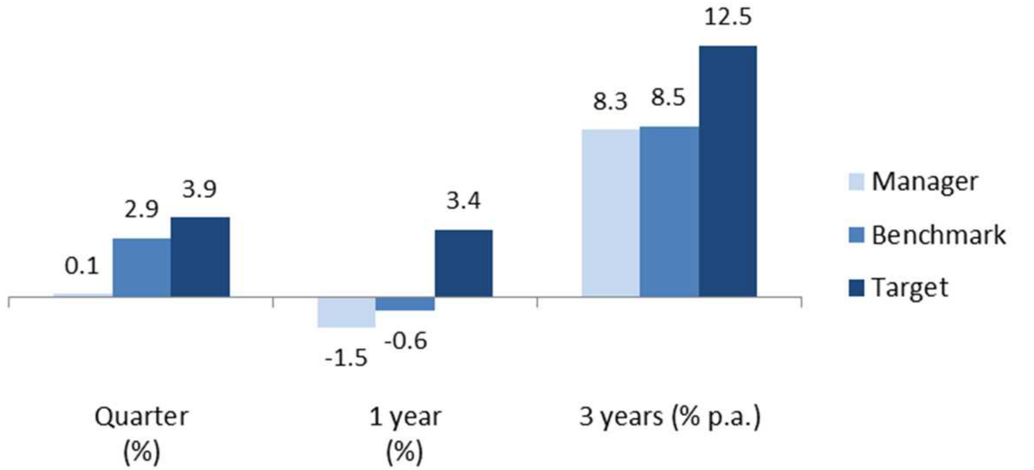
Reason for investment

To provide asset growth as part of a diversified equity portfolio

Reason for manager

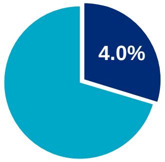
- Clear philosophy and approach
- Long term philosophy aligned with Fund's goals, commitment to incorporating ESG principles throughout the investment process
- Evidence of ability to achieve the Fund's performance target

Performance



Rolling relative returns

Quarterly Excess Return vs. MSCI AC World with rolling 1 yr line in GBP (after fees) over 3 yrs ending March-16



GENESIS ASSET MANAGERS – EMERGING MARKET EQUITIES (POOLED)
£149.2M END VALUE *(£136.4M START VALUE)*

Item Monitored	Outcome
Mercer Rating	A (no change over period under review). ESG3
Performance Objective *Benchmark*	Outperformed benchmark by 0.6% p.a. over three years
Three year tracking error was 3.5% p.a. (Q4: 3.5%) – *source: Genesis*	Number of stocks: 151

Manager Research and Developments

- The fund has outperformed its benchmark over the quarter. China was by the biggest contributor to relative performance, as an underweight meant that there was less exposure to the market's 5% fall. Further relative gains were made in South Africa and Thailand.
- Some relative performance was lost through poor stock picking in Nigeria and South Korea and from being underweight in Malaysia and Brazil.
- The biggest contributor was Anglo American from South Africa whilst the biggest detractor was Lupin from India. Turnover over the quarter was 21%.
- The portfolio one-year returns are 2.6% above benchmark, and three year returns are 0.6% ahead.
- Our researchers met with Genesis in April 2016 and no change to the strategy rating is recommended.

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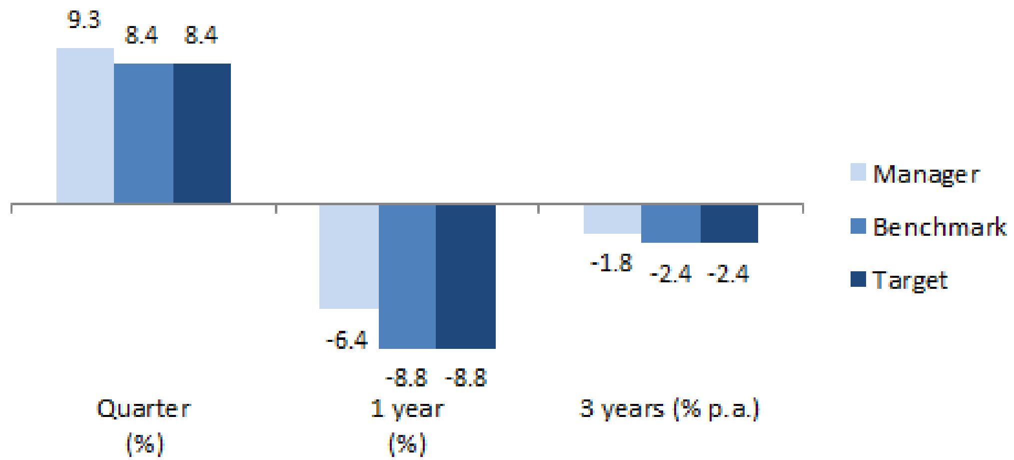
Reason for investment

To provide asset growth as part of a diversified equity portfolio

Reason for manager

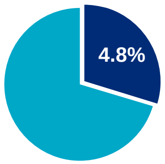
- Long term investment approach which takes advantage of evolving growth opportunities
- Niche and focussed expertise in emerging markets
- Partnership structure aligned to delivering performance rather than growing assets under management

Performance



Rolling relative returns

Quarterly Excess Return vs. MSCI EM with rolling 1 yr line in GBP (after fees) over 3 yrs ending March-16



UNIGESTION – EMERGING MARKET EQUITIES (POOLED – SUB-FUND)
£178.1M END VALUE *(£166.3M START VALUE)*

Item Monitored	Outcome
Mercer Rating	R (no change over period under review)
Performance Objective *Benchmark +2-4% p.a.*	Outperformed benchmark by 2.2% over the year
Tracking error since inception was 7.4% p.a. – *source: Unigestion*	Number of stocks: 102

Manager Research and Developments

- The fund has underperformed by 1.2% over the quarter but outperformed by 2.2% over the year to 31 March 2016.
- This underperformance over the quarter largely occurred in March, where the fund returned 6.1% against a benchmark return of 9.8%. This largely came from the negative selection effect in Food, Materials and Banks and from the asset allocation, with an overweight in Telecommunication and underweight in Energy and Banks.
- From a geographical point of view, the underweight to Brazil and South Africa was detrimental to relative performance, as both countries were among the best performers in Emerging Markets.
- Volatility since inception is 16.3%, lower than the index (at 18.9%) and consistent with their objectives (and the strategy's bias towards quality and large- or mega-cap stocks).

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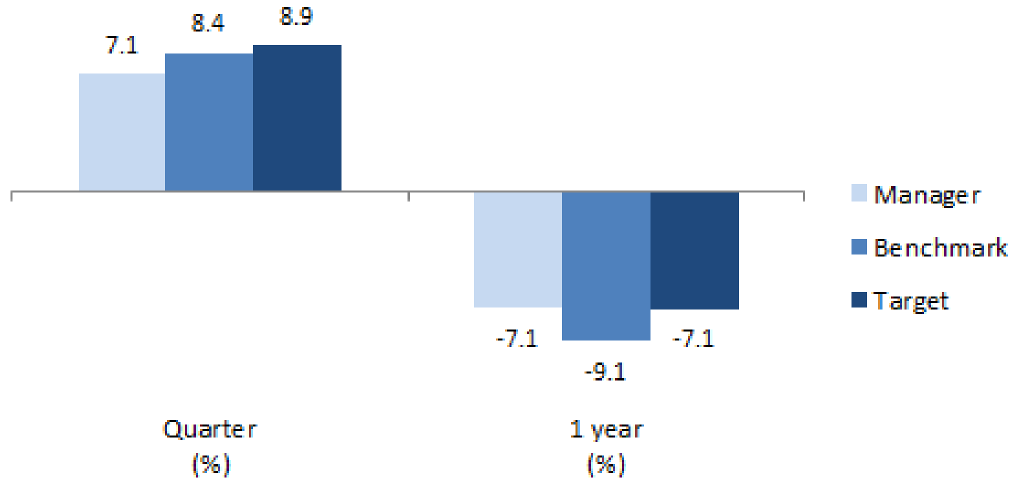
Reason for investment

To provide asset growth as part of a diversified equity portfolio

Reason for manager

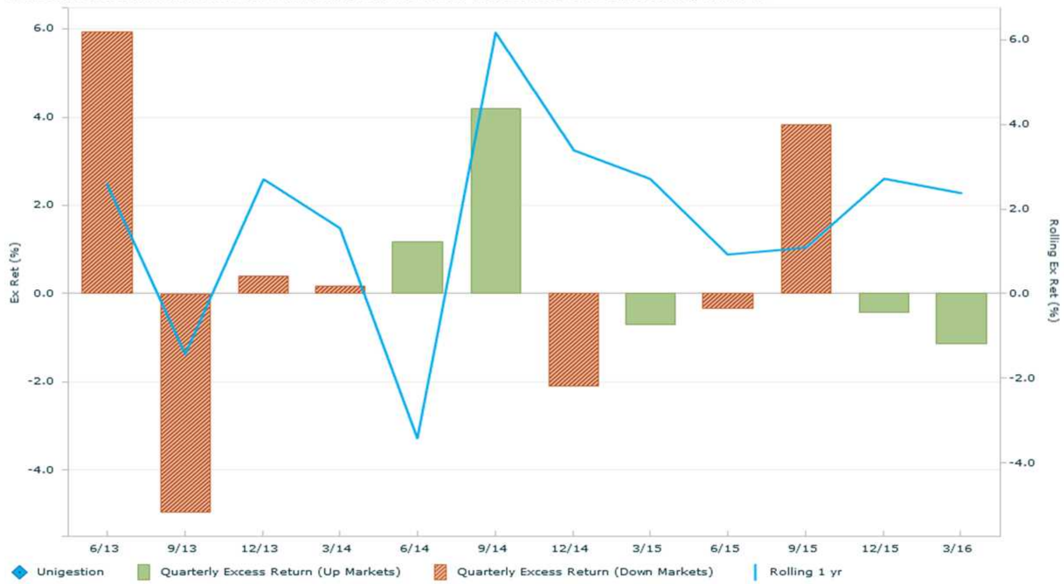
- Risk-based active management approach
- Aim for lower volatility than the MSCI Emerging Markets Index
- Combine fundamental and quantitative analysis

Performance

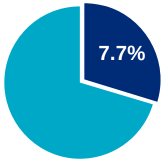


Rolling relative returns

Quarterly Excess Return vs. MSCI EM with rolling 1 yr line in GBP (before fees) over 3 yrs ending March-16



Note: Chart is pooled fund performance, gross of fees



INVESCO – GLOBAL EX-UK EQUITIES (ENHANCED INDEXATION) (POOLED)
£289.7M END VALUE *(£284.4M START VALUE)*

Item Monitored		Outcome
Mercer Rating	🟢	B+ (no change over period under review). ESG4
Performance Objective *Benchmark +0.5% p.a.*	🟢	Outperformed benchmark by 0.5% p.a. over three years
Tracking error since inception was 1.5% p.a. – *source: Invesco*		Number of stocks: 454 (up from 432)

Manager Research and Developments

- The fund has underperformed its benchmark by 0.5% over the last quarter (with stock selection the largest negative impact on relative performance); nonetheless it met its outperformance target over 3 years (source: Invesco). Beta remains near to one, as expected.
- All sector and country allocations were within +/- 1.0% of benchmark weightings, in line with general expectations for an enhanced indexation product.

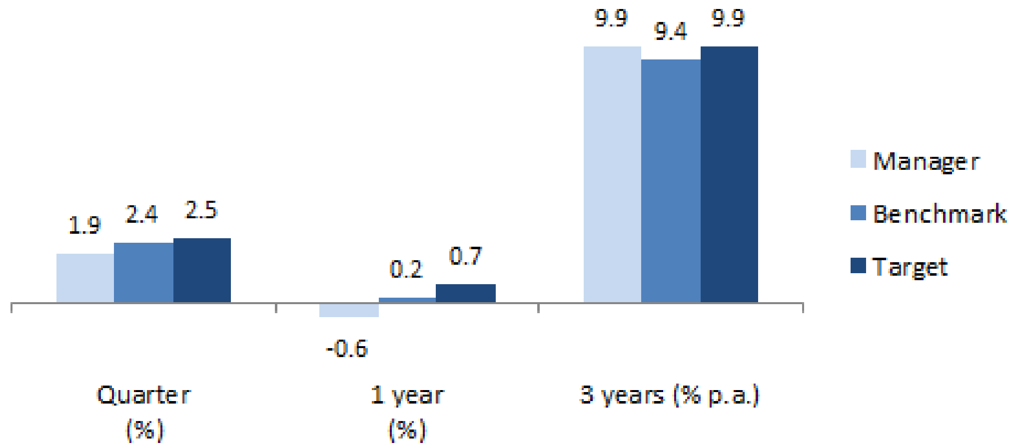
Reason for investment

To provide asset growth as part of a diversified equity portfolio

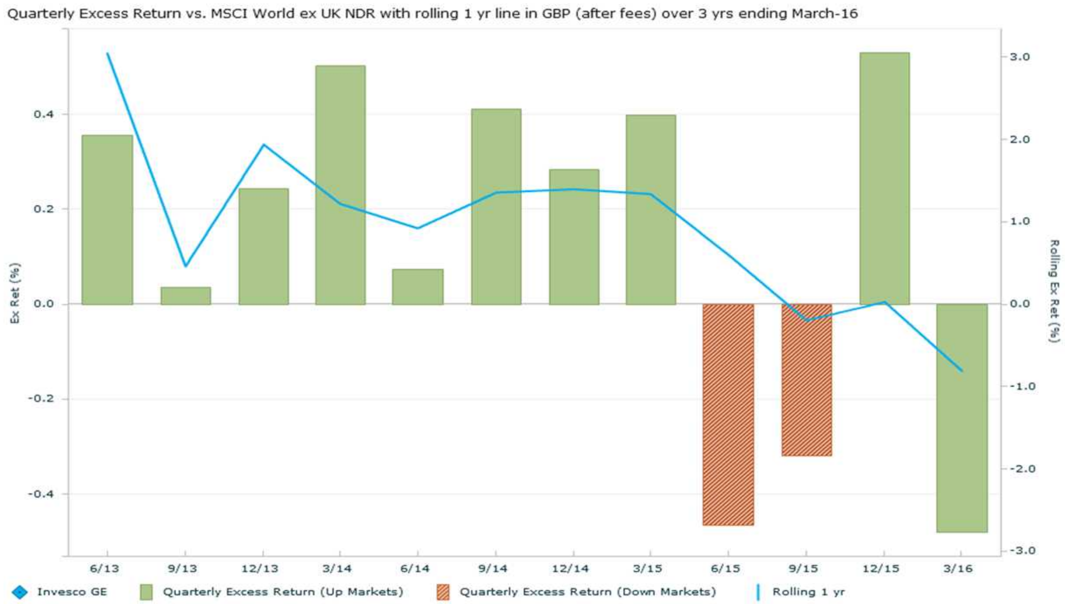
Reason for manager

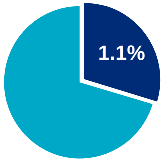
- Robust investment process supported by historical performance record, providing a high level of assurance that the process could generate the outperformance target on a consistent basis
- One of few to offer a Global ex UK pooled fund

Performance



Rolling relative returns





SSGA – EUROPE EX-UK EQUITIES (ENHANCED INDEXATION) (POOLED)
£42.6M END VALUE *(£42.6M START VALUE)*

Item Monitored	Outcome
Mercer Rating	R (no change over period under review)
Performance Objective *Benchmark +0.5% p.a.*	Outperformed benchmark by 0.7% p.a. over three years
Three year tracking error was 0.9% p.a. – *source: Mercer*	Number of stocks: 215

Manager Research and Developments

- The fund outperformed its performance target over the three year period.
- The total pooled fund size on 31 March 2016 was £42.7m. This means that the Fund is practically the only investor, although the Panel has previously concluded that the Fund could be sustained even if the Avon Pension Fund was the only investor.
- The fund holds 215 out of 392 stocks in the index, around 55%, within the expected range of 35-65%. Beta over three years is as expected at around 1.
- SSgA have announced its intention to acquire GE Asset Management (GEAM) for up to $485 million in a transaction expected to close during Q3 2016. We believe the GEAM product offering does not overlap with any SSgA strategies and the acquisition of GEAM is largely complimentary to SSgA's core business of passive equity. We believe SSgA has the size and scale to quickly and efficiently integrate GEAM's AUM and employees. We are maintaining our existing ratings on all SSgA strategies (when applicable).

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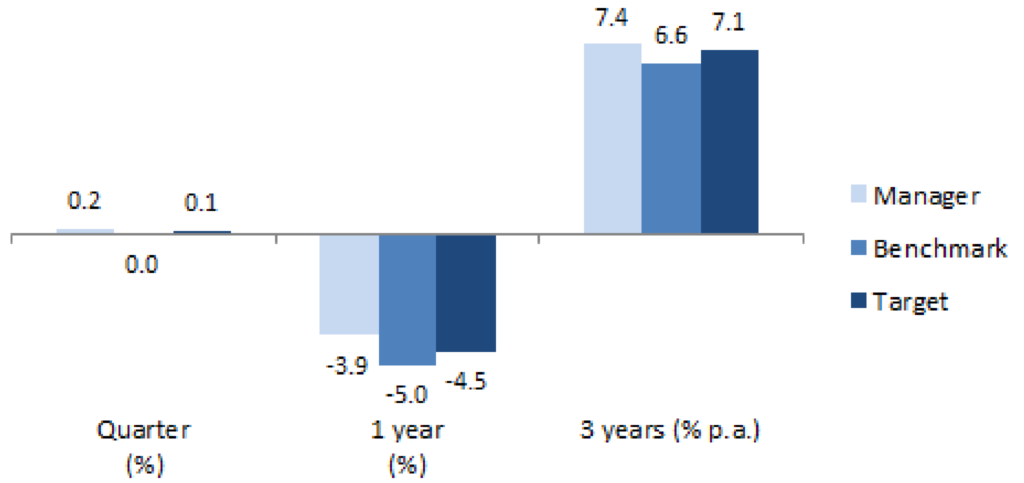
Reason for investment

To provide asset growth as part of a diversified equity portfolio

Reason for manager

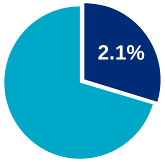
- Strength of their quantitative model and process, and ongoing research to develop the model
- Historic performance met the risk return parameters the Fund was seeking
- Two Funds (European and Pacific) to achieve the Fund's customised asset allocation within overseas equities

Performance



Rolling relative returns

Quarterly Excess Return vs. Europe ex UK (WM) with rolling 1 yr line in GBP (after fees) over 3 yrs ending March-16



SSGA – PACIFIC INC. JAPAN EQUITIES (ENHANCED INDEXATION) (POOLED)
£77.2M END VALUE *(£77.3M START VALUE)*

Item Monitored	Outcome	
Mercer Rating	●	N (no change over period under review)
Performance Objective *Benchmark +0.5% p.a.*	●	Outperformed benchmark by 0.7% p.a. over three years
Three year tracking error was 0.8% p.a. – *source: Mercer*		Number of stocks: 395

Manager Research and Developments

- The fund outperformed its performance target over the three year period.
- The total pooled fund size on 31 March 2016 was £77.2m. As with the European fund, the conclusion has been that the Fund could be sustained even with the Avon Pension Fund as the only investor.
- As with the European fund, Beta is around 1 (i.e. broadly in line with a market cap approach).
- SSgA have announced its intention to acquire GE Asset Management. See page 34 for details.

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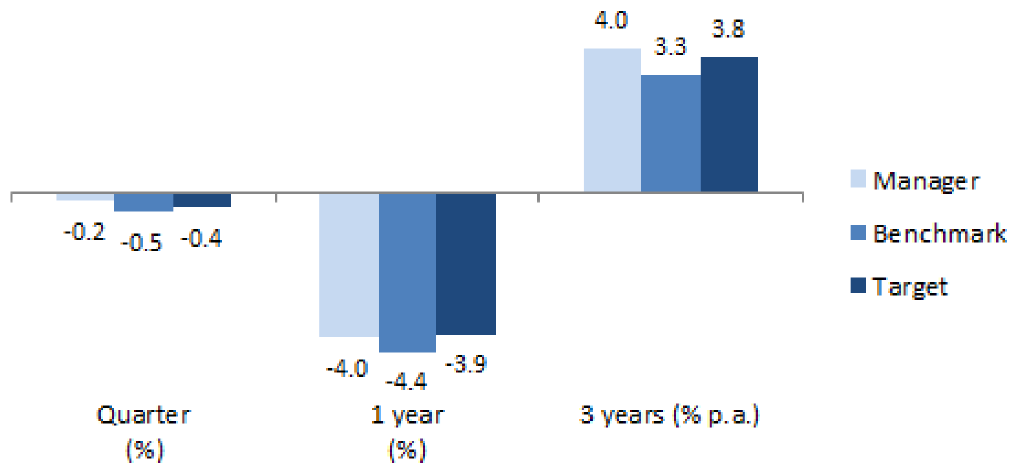
Reason for investment

To provide asset growth as part of a diversified equity portfolio

Reason for manager

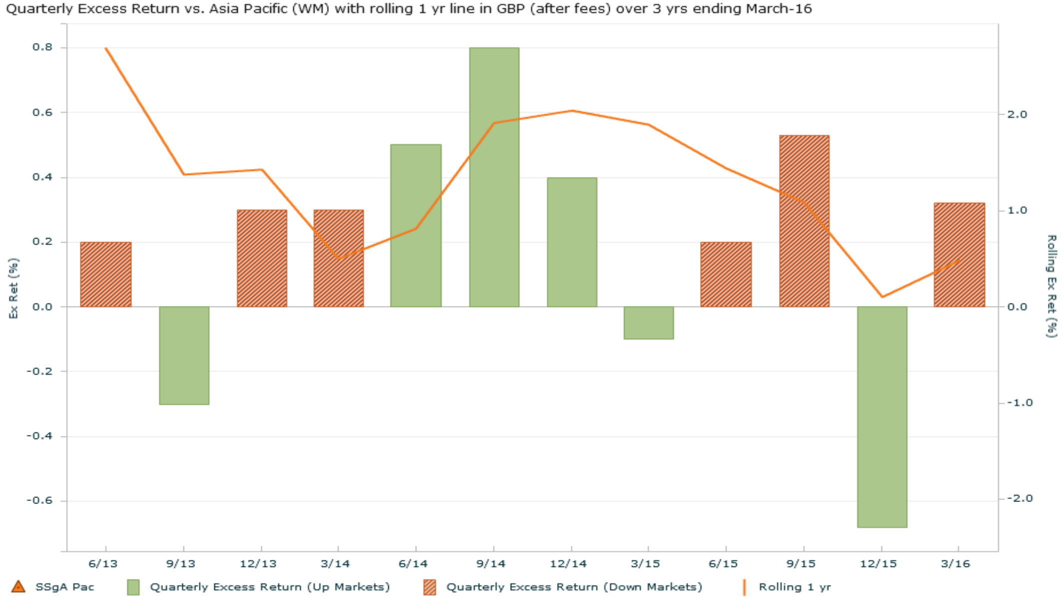
- Strength of their quantitative model and process, and ongoing research to develop the model
- Historic performance met the risk return parameters the Fund was seeking
- Two Funds (European and Pacific) to achieve the Fund's customised asset allocation within overseas equities

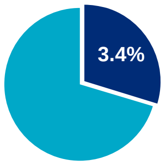
Performance



Rolling relative returns

Quarterly Excess Return vs. Asia Pacific (WM) with rolling 1 yr line in GBP (after fees) over 3 yrs ending March-16





PYRFORD – DGF (POOLED)
£126.9M END VALUE *(£123.8M START VALUE)*

Item Monitored	Outcome
Mercer Rating	R (no change over period under review)
Performance Objective *RPI +5% p.a.*	Underperformed benchmark by 4.5% p.a. over one year

Manager Research and Developments

- The fund has outperformed its performance objective (RPI + 5% p.a.) over the quarter by 1.1% but significantly underperformed over the year by 4.5%.
- During the first quarter Pyrford made the decision to increase its equity allocation by 5%. This decision was made by Pyrford’s Investment Strategy Committee in light of sharp falls in equity markets. The target allocation is now 35% in equities, 62% in fixed income and 3% in cash.
- Performance in Q1 was above benchmark, with a return of 2.6%. The defensive positioning with only 30% in equities at the start of the quarter aided performance, as did the equity holdings which were defensive themselves.
- Pyrford continues to adopt a defensive stance by owning short duration securities in order to protect the capital value of the portfolio from expected rises in yields. At the end of the quarter the modified duration of the fixed income portfolio fell to 1.3 years.

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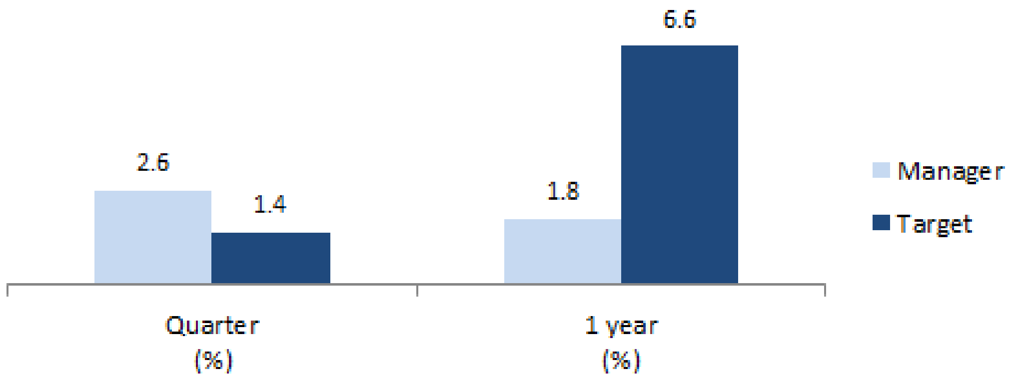
Reason for investment

To provide equity like return over the long term but with a lower level of volatility

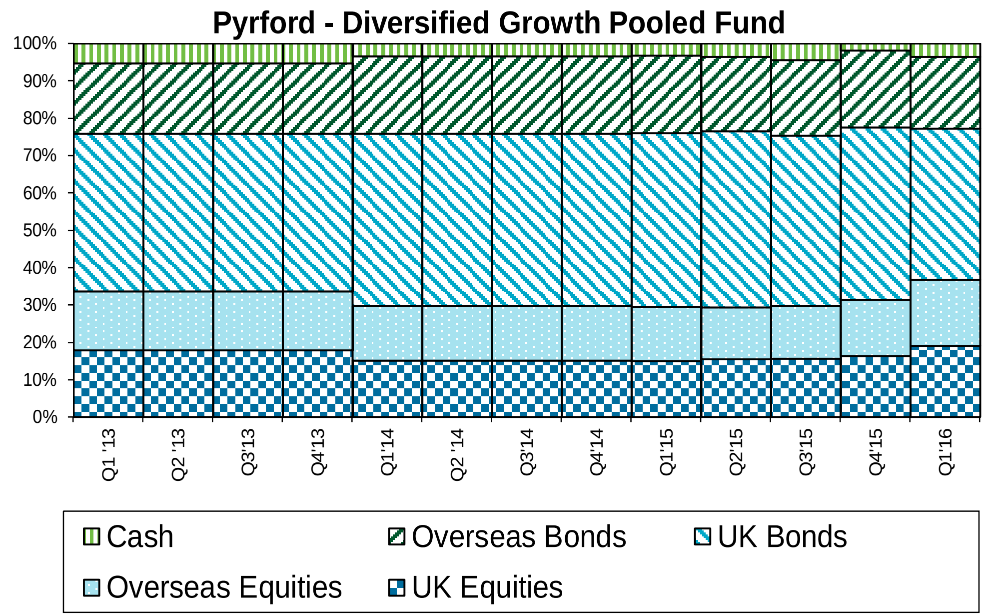
Reason for manager

- Asset allocation skill between equities, bonds and cash
- Fundamental approach to stock selection

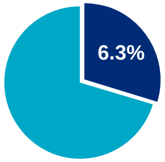
Performance



Asset Allocation



Annual data prior to Q1 2015.



STANDARD LIFE – DGF (POOLED)
£234.0M END VALUE *(£241.5M START VALUE)*

Item Monitored	Outcome
Mercer Rating	B+ (no change over period under review). ESG4
Performance Objective *Cash +5% p.a.*	Underperformed benchmark by 9.6% p.a. over the year

Manager Research and Developments

- Over the quarter the fund returned -3.3% against a benchmark of 1.4%, and returned -4.5% against a benchmark of 5.6% over the year.
- Performance suffered in the quarter as the portfolio was positioned to benefit from continued positive economic data from the US, which did not transpire in practice. This affected the US Dollar and the expected path of interest rates.
- Long position in European and Japanese equities also detracted from performance.
- In response to weak performance, the manager has reduced the short duration strategy and closed their Mexica Peso vs Australian Dollar position.

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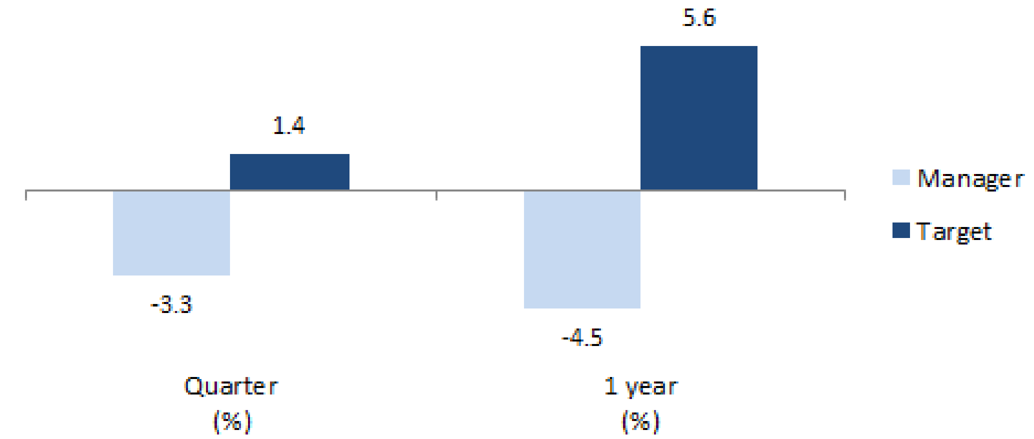
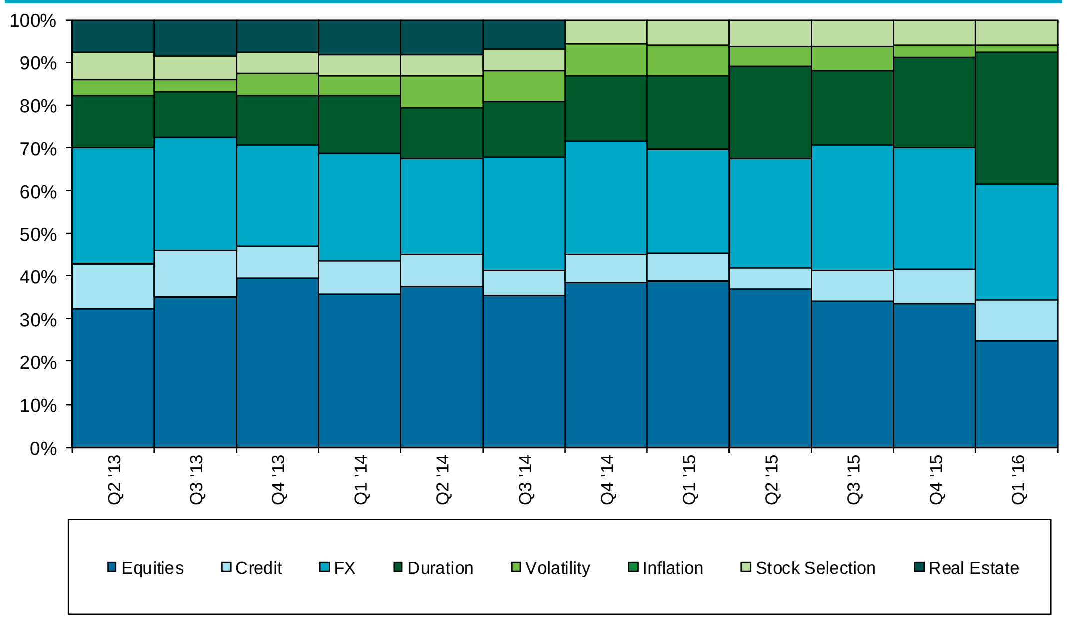
Performance



Asset Allocation/Risk Exposure



Reason for investment

To provide equity like return over the long term but with a lower level of volatility

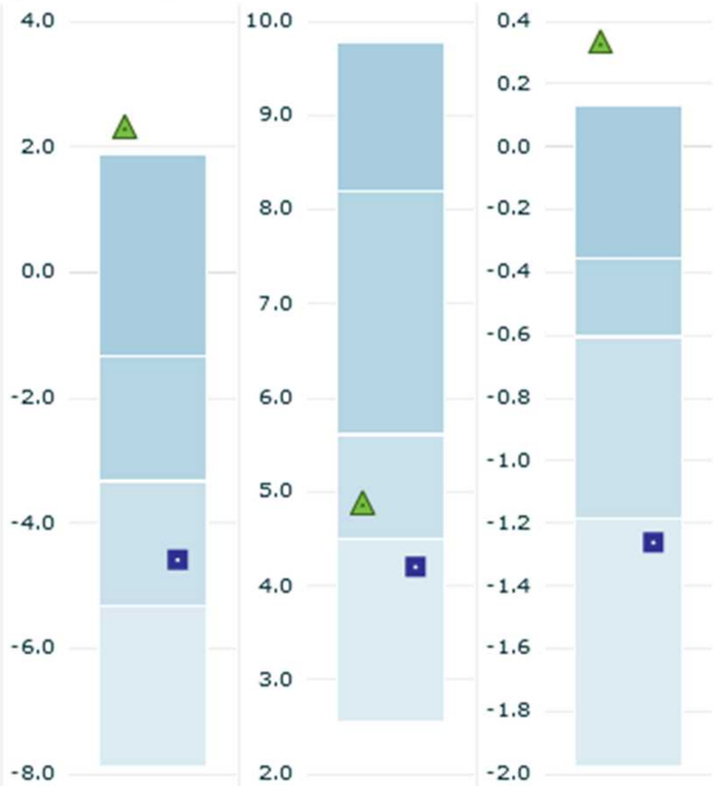
Reason for manager

- Diversification from equities
- Exposure to relative value strategies and different approach to Pyrford's largely static asset allocation investment strategy

DGF MANDATES

Performance characteristics vs. BofAML LIBOR 6 month average UK in GBP (after fees) over 1 yr ending March-16

Comparison with the International Multi-Asset GBP (Net) universe (Actual Ranking) (quarterly calculations)



	Ret (%)	Std Dev (%)	IR
Pyrford DGF	2.3 *(3)*	4.9 *(28)*	0.3 *(2)*
SLI GARS	-4.6 *(29)*	4.2 *(37)*	-1.3 *(34)*
95th Percentile	1.9	9.8	0.1
Upper Quartile	-1.3	8.2	-0.4
Median	-3.3	5.6	-0.6
Lower Quartile	-5.3	4.5	-1.2
5th Percentile	-7.9	2.5	-2.0
Number	43	43	43

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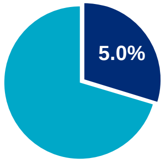
Commentary

- Over the year to 31 March 2016, the Standard Life GARS pooled fund significantly underperformed Pyrford by 6.9%.
- This placed Pyrford above the 95th percentile of the DGF universe for performance. On the other hand, Standard Life was below the median manager of the universe. It should be noted that this universe is very diverse in styles.
- This was achieved whilst taking relatively similar levels of risk, with Pyrford's volatility standing at 4.9% against Standard Life's 4.2%.
- Both managers were below the median for risk, meaning they took less risk than most managers in the universe.
- As a result, the information ratio (a measure of risk adjusted returns) for Pyrford was in the top of the universe and for Standard Life was in the lower quartile.
- Note that this is a short time-frame over which to measure risk, and reflects the limited period the Fund has been invested for. More telling analysis will emerge as the track record grows.
- The information ratio (IR) measures the amount of 'information' that the manager can extract from the market. Expressed in another way this is the amount of excess return generated per unit of risk or tracking error added. The IR is therefore a measure of the skill of the manager. If the IR is large and it is measured over a reasonable period of time, then this is an indication that the manager has some skill in managing money. Mercer defines the IR as the annualised excess return divided by the annualised tracking error.



JP MORGAN – FUND OF HEDGE FUNDS
£187.7M END VALUE *(£186.3M START VALUE)*

Item Monitored	Outcome
Mercer Rating	B+ (no change over period under review)
Performance Objective *Cash +3% p.a.*	Underperformed benchmark by 0.3% p.a. over the quarter

Item	
Number of funds	33

Strategy	Contribution to Performance over the Quarter in USD (%)
Relative Value	-0.09
Opportunistic/Macro	-0.15
Long/Short Equities	-1.07
Merger Arbitrage/Event Driven	-0.38
Credit	0.00
Total	**-1.87 (including cash and fees)**

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Reason for investment

To reduce volatility of the Growth portfolio and increase diversification

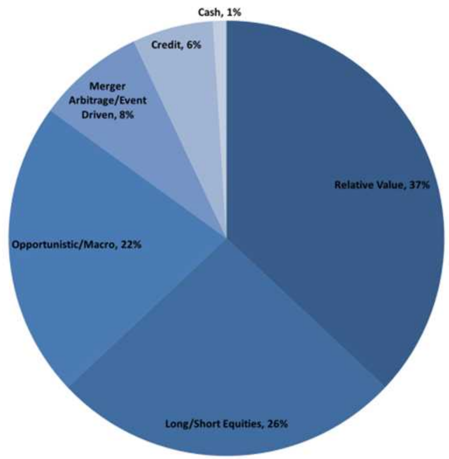
Reason for manager

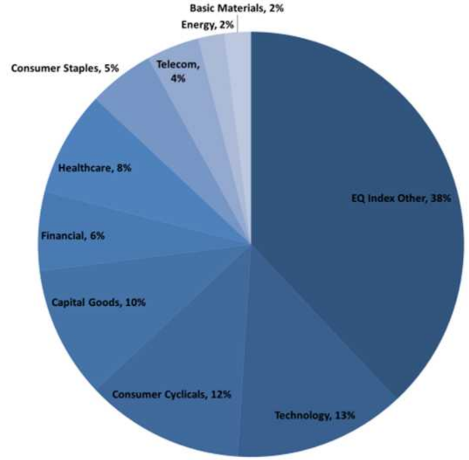
- Niche market neutral investment strategy
- Established team with strong track record
- Complemented other funds in the portfolio

Performance (GBP, JP Morgan return converted from USD)

Last Quarter	0.6%	Benchmark	0.9%

Portfolio Composition and Equity Sector Allocation





Source: JP Morgan.
As at 31 March 2016.

HEDGE FUND COMMENTARY – Q1 2016

- Hedge funds broadly produced negative returns in the first quarter of 2016. The HFRI index returned -2.8%, the HFRX index returned -1.9% and the Dow Jones Credit Suisse Hedge Fund Index declined 2.2% (USD returns).
- The first quarter of 2016 was a tale of two halves for risky assets with many broad markets still managing to finish Q1 in the black despite the volatility. While hedge funds generally protected capital during the sell-off, a broad reduction in risk levels and a subsequent short-covering rally limited hedge funds' participation in the market's turnaround. As a result, hedge funds collectively misfired to open the new year.
- The hedge fund industry contracted, ending the quarter at $2.86 trillion in assets. Investors pulled $15 billion from hedge funds in Q1, marking the largest net redemptions since 2Q09 and the 2nd consecutive quarterly outflow from the space.
- While successive redemptions is notable, Q1 redemptions represent just a fraction (less than 1%) of industry assets. Ultimately, we view a small "culling" of the industry to be healthy and a net benefit to the opportunity set for hedge fund investing.

Returns are in USD. Source: Source: Credit Suisse Hedge Index LLC.

HEDGE FUND COMMENTARY – Q1 2016

Relative Value (37%)

- Fixed income and convertible arbitrage strategies declined 1.2% and 0.4%, respectively, during the quarter.
- Volatility across and within markets created a challenging environment for relative value managers broadly in Q1.
- Fixed income strategies suffered from instability in yield and spread trading, while convertibles declined slightly in light of tepid new issuance and general credit market and liquidity uncertainty.

Long/Short Equities (26%)

- Long/short equity declined 3.8% in Q1, while market neutral strategies finished the quarter down 0.4%.
- Long/short equity strategies performed quite poorly in Q1 given the modestly positive backdrop from directional exposure (global equities finished positive) and dispersion. Many managers were "whipsawed" during the period, as portfolios were de-risked during the sell-off early in the quarter and unable to benefit from the short-covering rally that followed. Security selection fundamentals were also relatively poor, as the correlations among stocks were elevated and overall market dispersion was modest, leading to poor results for many idiosyncratic long and short positions.

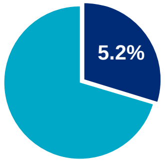
Opportunistic / Macro (22%)

- The broad global macro universe declined 2.2% during the quarter, while managed futures earned 4.3%. Macro strategies overall posted mixed results in Q1.
- Systematic strategies demonstrated particular strength during the sell-off, largely driven by a significant rally in rates as well as favorable positioning in FX and energy.
- Discretionary strategies broadly experienced slight declines, as many managers were caught off guard by the extent of the market's reaction to China, concerns for a US recession, and subsequent USD weakness.

Merger Arbitrage / Event Driven (8%)

- The multi-strategy / event space continued to struggle, posting broad losses in Q1.
- Merger arbitrage strategies, however, held up relatively well. Global activity remained supportive for the strategy, with nearly $1 trillion in announced deals during the quarter, a year-over-year increase from Q1 2015.
- Outside of mergers, catalyst-oriented and distressed situations generally struggled, as a lack of deal progress, reduced credit market liquidity and energy-related exposure punished many portfolios. However, we did witness modest dispersion in manager results, with a number of stressed/distressed situations contributing meaningfully to results.

Returns are in USD. Source: Source: Credit Suisse Hedge Index LLC.



SCHRODER – UK PROPERTY FUND OF FUNDS
£195.9M END VALUE *(£194.0M START VALUE)*

Item Monitored	Outcome	
Mercer Rating	●	B (no change over period under review). ESG3
Performance Objective *Benchmark +1% p.a.*	●	Outperformed benchmark by 0.5% p.a. over three years

Manager Research and Developments

- The fund has outperformed the benchmark over the quarter by 0.1%, as core fund holdings have marginally outperformed the benchmark.
- Over the three year period, the fund has outperformed its benchmark by 0.5% p.a., largely due to strong performance from Value Add strategies, with holdings in central London offices and the industrial sector being the main positive drivers of returns.
- Purchases over the quarter, with c. £2.8m invested in total, include Metro Property Unit Trust (c. £1.4m), Schroder Real Estate Real Income Fund (c. £1.0m) and the Regional Office Property Unit Trust (c. £0.4m).

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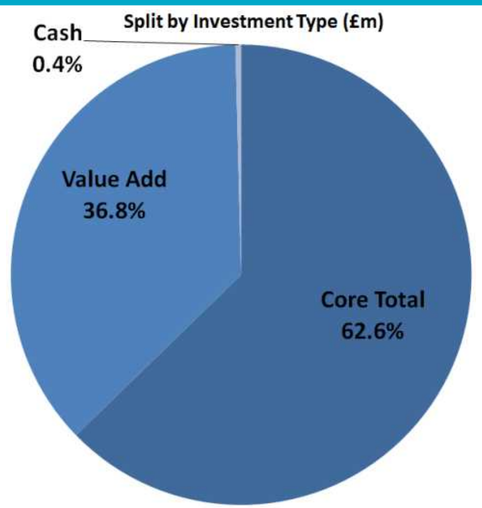
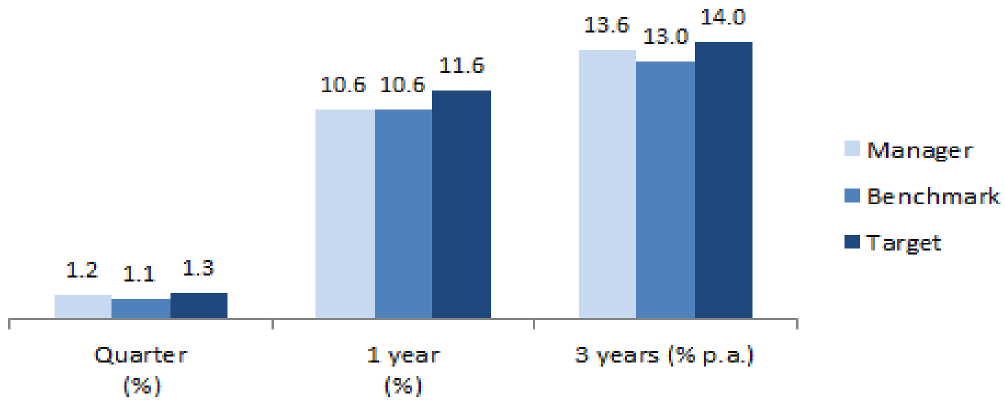
Manager and Investment type splits

Top 5 Holdings	Proportion of Total Fund (%)
L&G Managed Property Fund	12.9
BlackRock UK Property Fund	12.6
Industrial Property Investment Fund	11.4
Standard Life Pooled Pension Property Fund	9.9
Aviva Investors Pensions	9.4

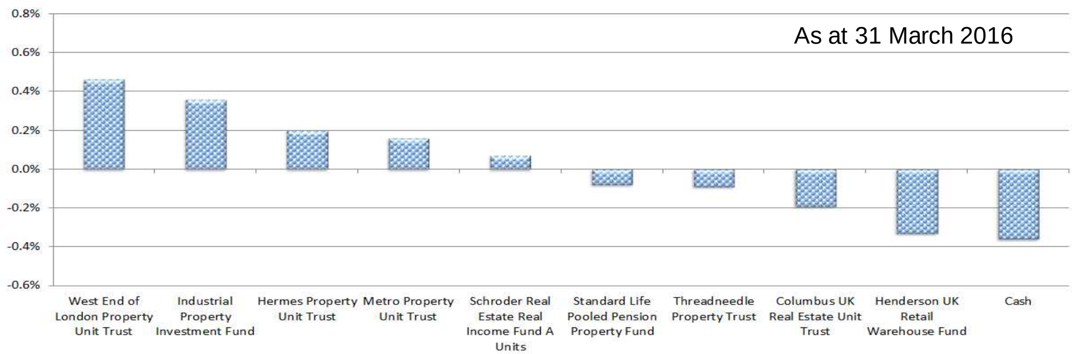


As at 31 March 2016

Performance



Top 5 Contributing and Detracting Funds over 12 Months

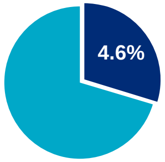


Reason for investment

To reduce volatility of the Growth portfolio and increase diversification

Reason for manager

- Demonstrable track record of delivering consistent above average performance
- Team though small is exclusively dedicated to UK multi-manager property management but can draw on extensive resources of Schroder's direct property team
- Well structured and research orientated investment process



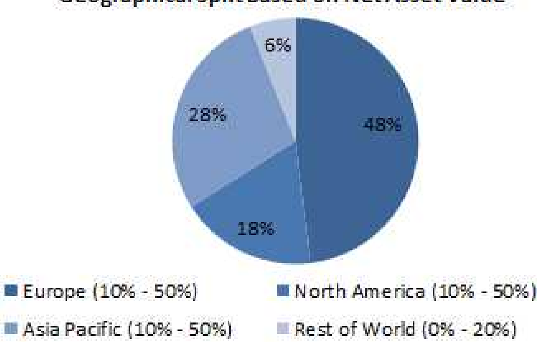
PARTNERS – OVERSEAS PROPERTY
£172.0M END VALUE *(£151.6M START VALUE)*

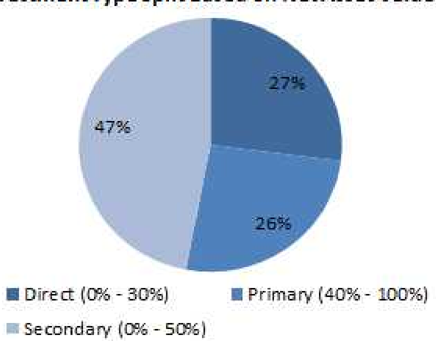
Item Monitored		Outcome
Mercer Rating	🟢	B+ (no change over period under review). ESG4
Performance Objective *IRR of 10% p.a.*	🔴	IRR since inception to 31 December 2015 at 8.9% p.a. is below target of 10% p.a.

Manager Research and Developments

- The portfolio delivered a net return of 6.2% over Q4 2015 for USD programmes in local currency, and 1.4% for EUR programmes, versus the target of c. 2.5%.
- Partners' drawdowns are made gradually over time, and the Fund is not yet fully invested. As a result of the volatile timing of cash flows for such investments, for example the initial costs of purchasing and developing properties, focus should be on longer term performance. Their IRR from inception to 31 December 2015 at 8.9% p.a. (in local currency) is below their target of 10% p.a.; over the 12 months to 31 December 2015 IRR was 7.2% (I local currency terms).
- Over Q4, the allocation to Europe decreased (from 50% to 48%), with North America falling slightly (from 19% to 18%) and Asia Pacific increased (from 25% to 28%). These remain within the guidelines.
- Exposure to Secondary opportunities rose during the fourth quarter (from 44% to 47%), with Direct falling (from 30% to 27%) and Primary remaining at 26%. Primary exposure continues to be below the guidelines. Short-term deviation from the guidelines is expected whilst the amount drawn-down is below target.
- Note that Partners are rated B+ for global real estate, but A for secondary global real estate (as a result of their private equity skill set).

Geographical and Investment type splits as at 31 December 2015





Portfolio update as at 31 December 2015

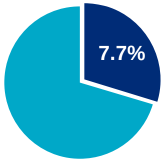
Partners Fund	Total Drawn Down (£m)	Total Distributions (£m)	Net Asset Value (£m)	Since Inception Net IRR
Global Real Estate 2008	31.66	17.45	20.71	7.5
Real Estate Secondary 2009	19.65	4.84	20.66	12.5
Asia Pacific and Emerging Market Real Estate 2009	17.71	8.71	12.32	4.2
Distressed US Real Estate 2009	14.74	13.75	7.56	9.4
Global Real Estate 2011	25.14	6.98	23.65	11.8
Direct Real Estate 2011	10.79	4.90	10.42	10.0
Real Estate Secondary 2013	6.70	0.36	8.53	30.0
Global Real Estate 2013	34.77	0.00	33.44	2.3
Real Estate Income 2014	13.26	0.46	12.67	2.1
Asia Pacific Real Estate 2016	3.33	0.00	5.31	55.4
Total	**177.74**	**57.45**	**155.27**	**8.9**

Reason for investment

To reduce volatility of the Growth portfolio and increase diversification

Reason for manager

- Depth of experience in global property investment and the resources they committed globally to the asset class
- The preferred structure for the portfolio was via a bespoke fund of funds (or private account) so the investment could be more tailored to the Fund's requirements



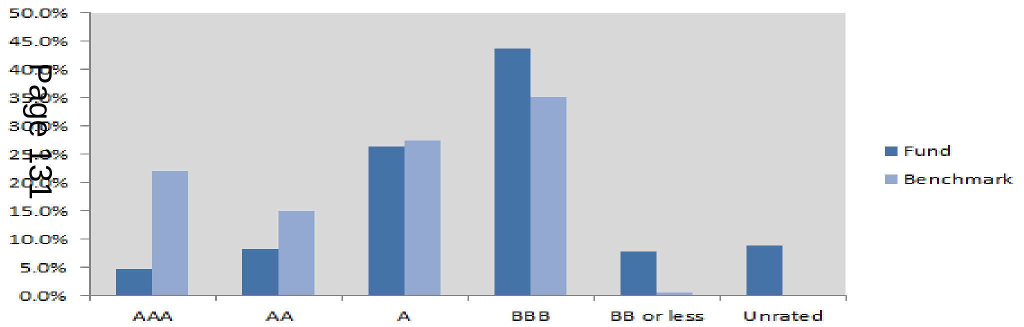
ROYAL LONDON ASSET MANAGEMENT – FIXED INTEREST (POOLED)
£289.7M END VALUE *(£282.0M START VALUE)*

Item Monitored		Outcome
Mercer Rating	●	A (no change over period under review). ESG3
Performance Objective *Benchmark +0.8% p.a.*	●	Outperformed benchmark by 0.9% p.a. over three years

Manager Research and Developments

- Royal London remain underweight AAA-A bonds, and overweight BBB-unrated, a strategy which has performed strongly over the three year period.

Credit Rating Allocation



Weighted Duration	Start of Quarter	End of Quarter
Fund	*7.5*	*7.5*
Benchmark	*7.7*	*7.8*

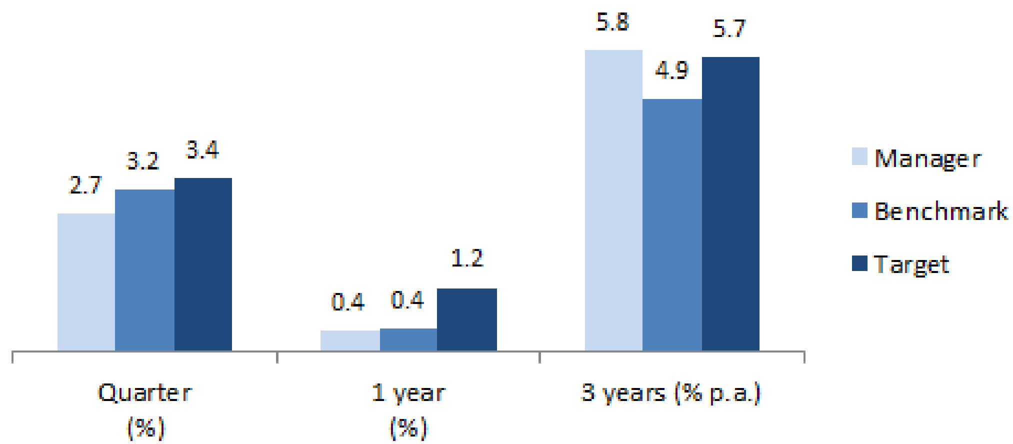
Reason for investment

To maintain stability in the Fund as part of a diversified fixed income portfolio

Reason for manager

- Focussed research strategy to generate added value
- Focus on unrated bonds provided a "niche" where price inefficiencies are more prevalent. Product size means can be flexible within market

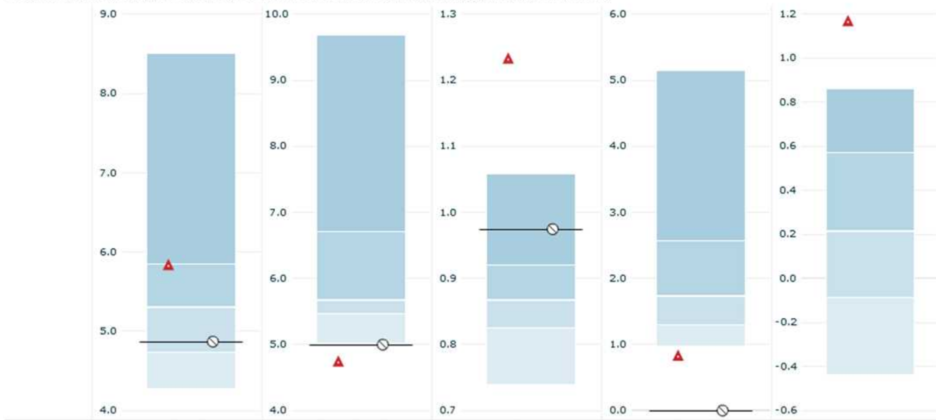
Performance



Risk and Return relative to benchmark

Performance characteristics vs. Markit iBoxx Non Gilts Overall in GBP over 3 yrs ending March-16

Comparison with the UK Fixed Income (Govt & Non-Govt) universe (Actual Ranking) (quarterly calculations)



	Ret (%pa)	Std Dev (%pa)	Ret/SD	TE (%pa)	IR
▲ RLAM FI	5.8 *(8)*	4.7 *(28)*	1.2 *(1)*	0.8 *(28)*	1.2 *(2)*
⃠ IBNGO	4.9 *(21)*	5.0 *(27)*	1.0 *(7)*	0.0 *(29)*	-
95th Percentil	8.5	9.7	1.1	5.1	0.9
Upper Quartile	5.8	6.7	0.9	2.6	0.6
Median	5.3	5.7	0.9	1.7	0.2
Lower Quartile	4.7	5.5	0.8	1.3	-0.1
5th Percentile	4.3	5.0	0.7	1.0	-0.4
Number	28	28	28	28	28

RECORD – CURRENCY HEDGING (SEGREGATED)
-£29.3M END VALUE *(-£17.6M START VALUE)*

Item Monitored	Outcome
Mercer Rating	N (no change over period under review)
Performance Objective *N/A*	The three initiated hedging mandates have all slightly outperformed their informal benchmark returns over the quarter

Manager Research and Developments

Over the quarter, sterling depreciated against the US dollar, the euro and the yen as Brexit fears sparked investor concerns.

The passive funds include accounts to hedge 50% of the currency exposure on developed global equities (dollar, euro and yen), and 100% on the hedge fund and global property mandates.

Performance for each of these separate accounts is shown to the right; as expected, performance for the passive mandate has been broadly in line with the (informal) benchmark; where this differs from the movement in currency rates this relates to the timing of the implementation trades (2pm) and the currency rates quoted (4pm fix).

Reason for investment

To manage the volatility arising from overseas currency exposure, whilst attempting to minimise negative cashflows that can arise from currency hedging

Reason for manager

- Straightforward technical (i.e. based on price information) process
- Does not reply on human intervention
- Strong IT infrastructure and currency specialists

Currency Hedging Q1 2016 Performance (£ terms)

Passive Developed Equity Hedge

Currency	Start Exposure (£)	End Exposure (£)	Currency Return (%)	50% Benchmark Return (%)	Record Hedge Return (%)	Net Return (%)
USD	543,272,596	572,761,642	2.55%	(1.37%)	(1.33%)	1.33%
EUR	201,088,471	188,644,012	7.57%	(3.55%)	(3.52%)	3.89%
JPY	136,648,893	130,089,526	9.75%	(4.81%)	(4.68%)	5.13%
Total	**881,009,960**	**891,495,180**	**4.69%**	**(2.33%)**	**(2.28%)**	**2.43%**

Passive Hedge Fund Hedge

Currency	Start Exposure (£)	End Exposure (£)	Currency Return (%)	100% Benchmark Return (%)	Record Hedge Return (%)	Net Return (%)
USD	183,189,146	194,312,572	2.55%	(2.85%)	(2.73%)	(0.05%)
Total	**183,189,146**	**194,312,572**	**2.55%**	**(2.85%)**	**(2.73%)**	**(0.05%)**

Passive Property Hedge

Currency	Start Exposure (£)	End Exposure (£)	Currency Return (%)	100% Benchmark Return (%)	Record Hedge Return (%)	Net Return (%)
USD	31,048,435	36,421,737	2.55%	(2.89%)	(2.75%)	0.04%
EUR	110,809,724	134,164,968	7.57%	(7.26%)	(7.18%)	(0.02%)
Total	**141,858,158**	**170,586,705**	**6.47%**	**(6.29%)**	**(6.19%)**	**(0.00%)**

APPENDIX 1

SUMMARY OF MANDATES

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SUMMARY OF MANDATES

Manager	Mandate	Benchmark	Outperformance target (p.a.)
BlackRock	Passive Multi-Asset	In line with customised benchmarks using monthly mean fund weights	-
Jupiter Asset Management	UK Equities (Socially Responsible Investing)	FTSE All Share	+2%
TT International	UK Equities (Unconstrained)	FTSE All Share	+3-4%
Schroder	Global Equities (Unconstrained)	MSCI AC World Index Free	+4%
Genesis	Emerging Market Equities	MSCI EM IMI TR	-
Unigestion	Emerging Market Equities	MSCI EM NET TR	+2-4%
Invesco	Global ex-UK Equities (Enhanced Indexation)	MSCI World ex UK NDR	+0.5%
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%
Pyrford	Diversified Growth Fund	RPI +5% p.a.	-
Standard Life	Diversified Growth Fund	6 Month LIBOR +5% p.a.	-
JP Morgan	Fund of Hedge Funds	3 Month LIBOR +3% p.a.	-
Schroder	UK Property	IPD UK Pooled	+1%
Partners	Overseas Property	3 Month LIBOR +4% p.a.	-
Royal London Asset Management	UK Corporate Bonds	iBoxx £ Non-Gilts All Maturities	+0.8%
Record	Passive Currency Hedging	N/A	-
Cash	Internally Managed	7 Day LIBID	-

APPENDIX 2

MARKET STATISTICS INDICES

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MARKET STATISTICS INDICES

Asset Class	Index
UK Equities	FTSE All-Share
Global Equity	FTSE All-World
Overseas Equities	FTSE World ex UK
US Equities	FTSE USA
Europe (ex-UK) Equities	FTSE W Europe ex UK
Japanese Equities	FTSE Japan
Asia Pacific (ex-Japan) Equities	FTSE W Asia Pacific ex Japan
Emerging Markets Equities	FTSE AW Emerging
Global Small Cap Equities	FTSE World Small Cap
Hedge Funds	HFRX Global Hedge Fund
High Yield Bonds	BofA Merrill Lynch Global High Yield
Emerging Market Debt	JP Morgan GBI EM Diversified Composite
Property	IPD UK Monthly Total Return: All Property
Commodities	S&P GSCI
Over 15 Year Gilts	FTA UK Gilts 15+ year
Sterling Non Gilts	BofA Merrill Lynch Sterling Non Gilts All Stocks
Over 5 Year Index-Linked Gilts	FTA UK Index Linked Gilts 5+ year
Global Bonds	BofA Merrill Lynch Global Broad Market
Global Credit	Barclays Capital Global Credit
Eurozone Government Bonds	BofA Merrill Lynch EMU Direct Government
Cash	BofA Merrill Lynch United Kingdom Sterling LIBOR 3 month constant maturity

These are the indices used in this report for market commentary; individual strategy returns are shown against their specific benchmarks.

APPENDIX 3
CHANGES IN YIELDS

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CHANGES IN YIELDS

Asset Class Yields (% p.a.)	31 March 2016	31 December 2015	31 March 2015	31 March 2014
UK Equities	3.77	3.70	3.33	3.41
Over 15 Year Gilts	2.17	2.57	2.23	3.43
Over 5 Year Index-Linked Gilts	-0.97	-0.70	-0.91	-0.08
Sterling Non Gilts	2.90	3.23	2.65	3.69

- Bond yields fell across all maturities over the quarter, resulting in positive returns for investors.
- In the UK, nominal government bond yields decreased by c.40-60 bps across the curve over the quarter with the Over 15 Gilts Index returning 8.2%. Nominal yields are now roughly at levels seen a year ago.
- Real yields also fell over the quarter, albeit to a slightly lesser extent of c.20-40 bps, with the Over 5 Year Index-Linked Gilts Index posting a positive return of 6.5%.
- Credit spreads widened over the quarter by c.14 bps and ended the quarter at c.1.5% and 1.6% for the Sterling Non-Gilts All Stocks and Sterling Non-Gilts Over 10 Year Indices, respectively. Despite the widening of credit spreads, UK credit assets posted a positive return of 3.0% in sterling terms due to the positive benefits from a decrease in government bond yields as well as income earned from coupons.

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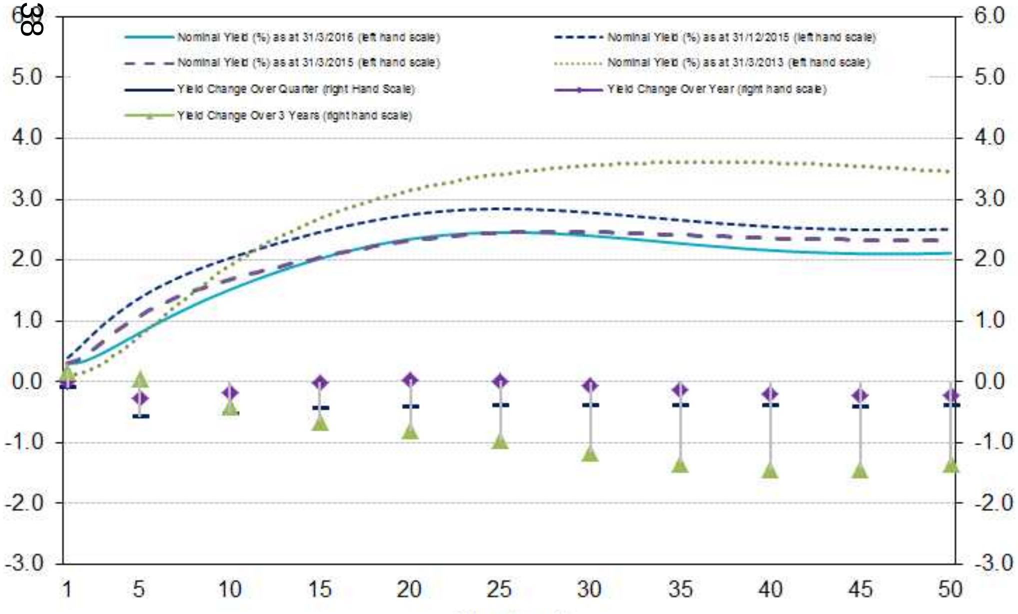
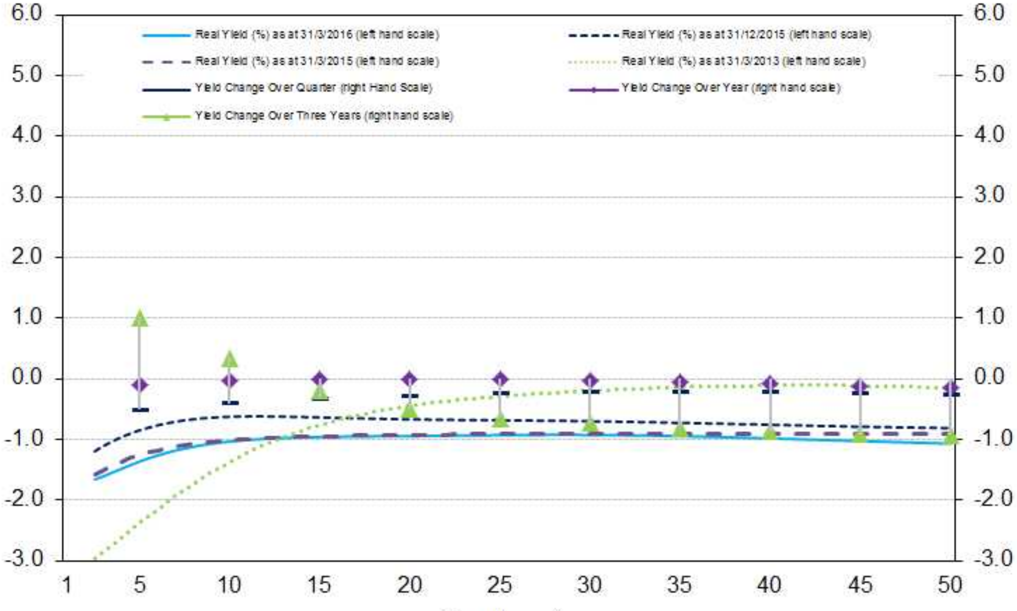
Nominal yield curves



Source: Mercer.

Real yield curves



Source: Mercer.

APPENDIX 4
GUIDE TO MERCER RATINGS

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INTRODUCTION

This is a guide to the investment strategy research ratings (herein referred to as rating[s]) produced by Mercer's Investments business (herein referred to as Mercer). It describes what the ratings are intended to mean and how they should and should not be interpreted.

If you have any questions or would like more information about specific topics after reading this guide, please contact your Mercer consultant or click "Contact us" on our website www.mercer.com.

WHAT DO MERCER'S RATINGS SIGNIFY?

Mercer's ratings signify Mercer's opinion of an investment strategy's prospects for outperforming a suitable benchmark over a time frame appropriate for that particular strategy (herein referred to as outperformance). The rating is recorded in the strategy's entry on Mercer's Global Investment Manager Database (GIMD™) at www.mercergimd.com.

Mercer's ratings are normally assigned to investment strategies rather than to specific funds or vehicles. In this context, the term "strategy" refers to the process that leads to the construction of a portfolio of investments, regardless of whether the strategy is offered in separate account format or through one or more investment vehicles. There are exceptions to this practice. These are primarily in real estate and private markets where the rating is normally applied to specific funds.

WHAT DO MERCER'S RATINGS NOT SIGNIFY?

This section contains important exclusions and warnings; please read it carefully.

Past Performance

The rating assigned to a strategy may or may not be consistent with its past performance. While the rating reflects Mercer's expectations on future performance relative to a suitable benchmark over a time frame appropriate for the particular strategy, Mercer does not guarantee that these expectations will be fulfilled.

Creditworthiness

Unlike those of credit rating agencies, Mercer's ratings are not intended to imply any opinions about the creditworthiness of the manager providing the strategy.

Vehicle-Specific Considerations

As Mercer's ratings are normally assigned to strategies rather than to specific investment vehicles, potential investors in specific investment vehicles should consider not only the Mercer ratings for the strategies being offered through those investment vehicles but also any investment vehicle-specific considerations. These may include, for example, frequency of dealing dates and any legal, tax, or regulatory issues relating to the type of investment vehicle and where it is domiciled. Mercer's ratings do not constitute individualized investment advice.

Management Fees

To determine ratings, Mercer does not generally take investment management fees into account. The rationale for this is that, due to differing account sizes, differing inception dates, or other factors, the fees charged for a specific strategy will vary among clients. Potential investors in a specific strategy should therefore consider not only the Mercer rating for that strategy but also the competitiveness of the fee schedule that they have been quoted. The area of Alternative Investments is an exception — Mercer follows market practice for "Alternatives" and rates strategies on a net of fees basis.

Operational Assessment

Mercer's research process and ratings do not include an evaluation of a manager's custodian, prime brokerage, or other vendor relationships, or an assessment of the manager's back office operations, including any compliance, legal, accounting, or tax analyses of the manager or the manager's investment vehicles. Research is generally limited to the overall investment decision-making process used by managers. In forming a rating, Mercer's investment researchers do not generally perform corporate-level operational infrastructure due diligence on a manager and do not perform financial or criminal background checks on investment management staff. Unless Mercer's investment researchers are aware of material information to the contrary (such as a view expressed by a manager's auditors or Mercer Sentinel®; see section 9), they assume that the manager's operational infrastructure is reasonable. Operational weaknesses that Mercer's investment researchers discover during their analysis of the four factors outlined in section 4 will be noted and, where appropriate, taken into account in determining ratings.

FACTORS CONSIDERED IN FORMING A RATING

In order to determine the rating for a particular strategy, Mercer's investment researchers review the strategy on the basis of four specific factors — idea generation, portfolio construction, implementation, and business management — each of which is assigned one of four scores: negative (-), neutral (=), positive (+), or very positive (++).

Mercer believes that idea generation, portfolio construction, and implementation are the main components of every investment process. These factors are defined as:

Idea generation encompasses everything that the investment manager (herein referred to as manager) does to determine the relative attractiveness of different investments.

Portfolio construction refers to the manner in which the manager translates investment ideas into decisions on which investments to include in a portfolio and what weightings to give to each of these investments.

Implementation refers to the capabilities surrounding activities that are required to achieve the desired portfolio structure.

Mercer believes that managers that do these activities well should have above-average prospects of outperformance. However, Mercer also believes that to remain competitive over longer periods, managers must be able to maintain and enhance their capabilities in these three areas. To do this, managers need to have significantly strong business management, which is the fourth factor Mercer assesses.

Business management refers to the overall stability of the firm, firm resources, and overall operations.

The four factors above apply to most product categories that Mercer researches. Variations on these factors are used in some product categories. Examples here include passive strategies, liability driven investment and private markets.

A strategy's overall rating is not determined as a weighted average of the four factor scores, and no prescribed calculations are made to arrive at the four-factor score or the overall rating. Instead, for each strategy, Mercer's investment researchers identify which factors Mercer believes are most relevant to a manager's investment process and place weight on the factors accordingly. Example considerations include:

- Mercer's confidence in the manager's ability to generate value-adding ideas.
- Mercer's view on any specified outperformance target.
- The opportunities available in the relevant market(s) to achieve outperformance.
- An assessment of the risks taken to try to achieve outperformance.
- An assessment of the strategy relative to peer strategies.
- An assessment of the manager's business management and its impact on particular strategies.

MERCER RATING SCALE

Ratings	Rationale
A	Strategies assessed as having “above average” prospects of outperformance
B+	Strategies assessed as having “above average” prospects of outperformance, but which are qualified by at least one of the following: ▪ There are other strategies that Mercer believes are more likely to achieve outperformance ▪ Mercer requires more evidence to support its assessment
B	Strategies assessed as having “average” prospects of outperformance
C	Strategies assessed as having “below average” prospects of outperformance
N/no rating	Strategies not currently rated by Mercer
R	The R rating is applied in three situations: ▪ Where Mercer has carried out some research, but has not completed its full investment strategy research process ▪ In product categories where Mercer does not maintain formal ratings but where there are other strategies in which we have a higher degree of confidence ▪ Mercer has in the past carried out its full investment-strategy research process on the strategy, but we are no longer maintaining full research coverage

The above definitions apply to the majority of product categories researched by Mercer. However for some product categories the rating scale reflects Mercer’s degree of confidence in a manager’s ability to achieve a strategy’s stated aims. Examples of where this applies include low volatility equities, cash, passive, liability driven strategies and DC specific solutions.

SUPPLEMENTAL INDICATORS

Provisional (P)

If the Mercer strategy rating is followed by a (P) - for example, A (P) or B+ (P) - the rating is “provisional” - that is, there is temporary uncertainty about the rating, but it is expected that this will soon be resolved. For example, should two managers announce a merger, but without further details, this uncertainty may be highlighted by modifying the rating strategies for one or both of those firms - for instance, from A to A (P). (P) indicators are intended to be temporary and should normally last for no more than two weeks. As soon as the temporary uncertainty has been resolved, or if it becomes apparent that this uncertainty is unlikely to be resolved quickly, the (P) indicator will be removed and the rating confirmed or changed, or the strategy will be assigned the indicator “watch” (W).

Watch (W)

If the Mercer strategy rating is followed by a (W) – for example, A (W) or B+ (W) - the rating is “watch” - there is some uncertainty about the rating and resolution is not expected soon, but Mercer believes there is a low probability that the resolution of this uncertainty will lead to a change in the strategy’s rating. (W) indicators are typically issued when there is an expectation of long-term uncertainty surrounding the rating - for example, a change, or potential change, in a manager’s ownership.

Specifically Assigning (P) and (W) Supplemental Indicators

(P) and (W) indicators are assigned - and removed - by the regular ratings review process described earlier; however, there are circumstances where organizational or reputational issues that affect a manager warrant the specific assignment of a (P) or (W) indicator to an existing rating. In such circumstances, the decision to apply - or remove - a (P) or (W) indicator is taken by two senior members of the leadership group of the Manager Research team. These occasions are rare, and the relevant investment researchers will contribute to any discussions before a (P) or (W) indicator is assigned or removed.

High Tracking Error (T)

If the Mercer strategy rating is followed by a (T) — for example, A (T) or B+ (T) — the strategy is considered to have the potential to generate a tracking error substantially higher than the average for the relevant product category. In this context, “tracking error” refers to the variability of performance relative to the nominated benchmark for the strategy. A strategy may be assigned the (T) indicator because the potential for high tracking error has been demonstrated by the strategy’s past performance and/or because the nature of the investment process is such that a significantly higher than average tracking error could be expected. The absence of a (T) following a rating does not guarantee that the strategy’s tracking error will not be higher than the average for the relevant product category.

NICHE STRATEGIES

Mercer categorize a limited number of strategies as Niche. The Niche categorization is applied to strategies that are perceived as highly differentiated. Mercer does not have specific rules as to what characterizes a Niche strategy but examples might include strategies where a manager is seeking to exploit anomalies not generally recognized by other market participants. It might also be applied to strategies with a short track record and/or limited assets under management.

RESEARCH INDICATIONS – INDICATIVE VIEW

For strategies where Mercer has conducted some initial research, we may apply Mercer Research Indications. Mercer's Research Indications are an indication of whether a strategy merits deeper / further due diligence. This indication is shown by an assigned indicative view, identified as a colour. A Research Indication does not necessarily result in future research. All Research Indications are assigned as R rating.

- Red – further research has "below average" prospects of resulting in an investable rating.
- Amber – further research has "average" prospects of resulting in an investable rating.
- Green – further research has "above average" prospects of resulting in an investable rating.

An investable rating is defined as an A or B+.

OPERATIONAL RISK ASSESSMENTS

Mercer Sentinel, a division within Mercer, undertakes operational risk assessments (ORAs) on managers, most often on behalf of clients. These ORAs assess managers' operations and implementation risk profiles and cover some of the areas mentioned in section 3, as well as other areas related to operational risk. ORAs are undertaken separately from the Manager Research process; however, the results are shared with the Lead Researcher for the manager. A Mercer Sentinel ORA that concludes with an unsatisfactory rating (namely, a "Review" rating) for a manager will result in an immediate (P) rating for all that manager's relevant rated strategies. Discussions will follow and any subsequent change in investment rating will be ratified by the standard Manager Research process. Contact your Mercer consultant for more information.

ENVIRONMENTAL, SOCIAL, AND CORPORATE GOVERNANCE RATINGS

Mercer also assigns ratings to strategies that represent Mercer's view on the extent to which environmental, social and corporate governance (ESG) and active ownership practices (voting and engagement) are integrated into the manager's investment process and decision-making across asset classes. ESG factors are incorporated into the investment process on the basis that these issues can impact revenue, operating costs, competitive advantage, and the cost of capital. During discussions with managers about ESG integration, Mercer assesses the use of ESG information to generate outperformance.

ESG Rating Scale	
ESG1	The highest ESG rating is assigned to strategies that Mercer believes to be leaders in integrating ESG and active ownership into their core processes, and that provide clear evidence that ESG overall, or a particular ESG theme, is core to idea generation and portfolio construction.
ESG2	The second highest rating is assigned to strategies that, in Mercer's view, include ESG factors as part of decision making, with a strong level of commitment made at a firmwide level and some indication that data and research are being taken into account by the managers in their valuations and investment process.
ESG3	The penultimate rating is assigned to strategies for which, in Mercer's view, the manager has made some progress with respect to ESG integration and/or active ownership, but for which there is little evidence that ESG factors are taken into consideration in valuations and investment process.
ESG4	The lowest ESG rating is assigned to strategies for which, in Mercer's view, little has been done to integrate ESG and active ownership into their core process.

For passive strategies, Mercer applies an ESGp1 through to ESGp4. There are two key distinctions between ESG ratings for passive and active strategies. First, for passive, the bulk of the focus is on voting and engagement practices. Second, most of Mercer's analysis focuses on firm-wide levels of commitment rather than at the individual strategy level.

RATINGS REVIEW COMMITTEES

Mercer has a process for reviewing and ratifying the ratings proposed by individual investment researchers. For most product categories, strategy ratings are reviewed regularly by one of several RRCs that operate within Mercer. These committees are composed of professionals from Mercer's investment research and consulting groups who draw on research carried out by Mercer investment researchers and consultants. The role of the RRCs is to review this research from a quality control perspective and ensure consistency of treatment across strategies within a product category.

For certain asset classes, ratings will not have been reviewed by an RRC; however, the rating will have been reviewed by at least two suitably qualified investment researchers or consultants other than the recommending researcher. An R rating will not necessarily have been reviewed by an RRC but will have been subject to Mercer's standard peer review process.

CONFIDENTIALITY OF MERCER'S RATINGS

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MERCER

MAKE TOMORROW, TODAY

Bath & North East
Somerset Council

Access to Information Arrangements

Exclusion of access by the public to Council meetings

Information Compliance Ref: LGA 0843/16

Meeting / Decision: AVON PENSION FUND INVESTMENT PANEL
Date: 25th May 2016

Author: Matt Betts
Report Title: Item - Review Of Investment Performance For Periods Ending 31 March 2016 Appendix 1 – Fund Valuation Appendix 2 – Mercer performance monitoring report (Panel version) Exempt Appendix 3 – RAG Monitoring Summary Report Appendix 4 – Fossil Fuel Investments and Sustainable Investment

The Report contains exempt information, according to the categories set out in the Local Government Act 1972 (amended Schedule 12A). The relevant exemption is set out below.

Stating the exemption: 3. *Information relating to the financial or business affairs of any particular person (including the authority holding that information).*

The public interest test has been applied, and it is concluded that the public interest in maintaining the exemption outweighs the public interest in disclosure at this time. It is therefore recommended that the Report be withheld from publication on the Council website. The paragraphs below set out the relevant public interest issues in this case.

PUBLIC INTEREST TEST

If the Committee wishes to consider a matter with press and public excluded, it must be satisfied on two matters.

Firstly, it must be satisfied that the information likely to be disclosed falls within one of the accepted categories of exempt information under the Local Government Act 1972. Paragraph 3 of the revised Schedule 12A of the 1972 Act exempts information which relates to the financial or business affairs of the organisations which is commercially sensitive to the organisations. The officer responsible for this item believes that this information falls within the exemption under paragraph 3 and this has been confirmed by the Council's Information Compliance Manager.

Secondly, it is necessary to weigh up the arguments for and against disclosure on public interest grounds. The main factor in favour of disclosure is that all possible Council information should be public and that increased openness about Council business allows the public and others affected by any decision the opportunity to participate in debates on important issues in their local area. Another factor in favour of disclosure is that the public and those affected by decisions should be entitled to see the basis on which decisions are reached.

Weighed against this is the fact that the exempt report and appendix contains the opinions of Council officers and Panel members. It would not be in the public interest if advisors and officers could not express in confidence opinions which are held in good faith and on the basis of the best information available.

The exempt appendix also contain details of the investment processes/strategies of the investment managers. The information to be discussed is commercially sensitive and if disclosed could prejudice the commercial interests of the investment managers.

It is also important that the Committee should be able to retain some degree of private thinking space while decisions are being made, in order to discuss openly and frankly the issues under discussion relating to the investment managers in order to make a decision which is in the best interests of the Fund's stakeholders.

The Council considers that the public interest has been served by the fact that a significant amount of information regarding the Investment Performance Report has been made available – by way of the main report. The Council considers that the public interest is in favour of not holding this matter in open session at this time and that any reporting on the meeting is prevented in accordance with Section 100A(5A)

By virtue of paragraph(s) 3 of Part 1 of Schedule 12A
of the Local Government Act 1972.

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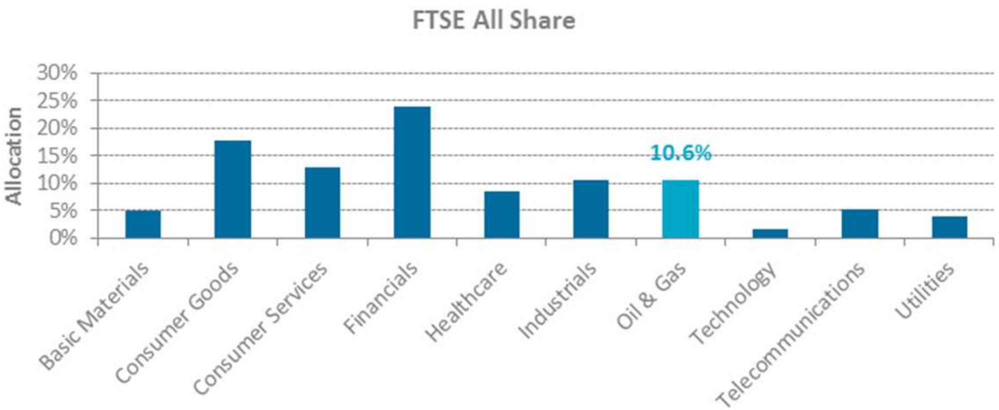
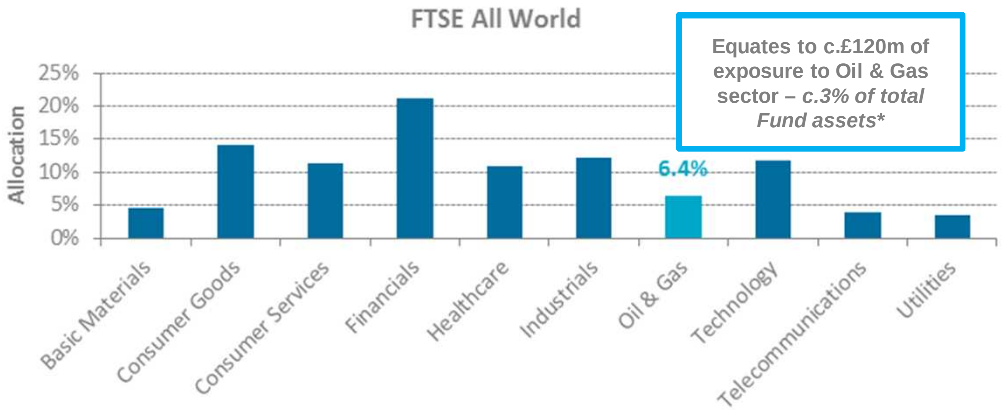
AVON PENSION FUND: FOSSIL FUELS

OIL AND GAS SECTOR EXPOSURE (31 MARCH 2016)





* Figure is based on total equity holdings as at 31 March 2016, assumed to be invested in line with the FTSE All World Index. Note that this does not reflect the actual holdings of managers, which will be specifically reviewed later in the year.

The charts above show the Index exposure to the Oil and Gas sector as at 31 March 2016 for UK and global equities. Basic materials also contains mining companies, industrials includes transport services, utilities including gas and electricity distribution and consumer services includes airlines and travel and tourism, which are all fossil fuel intensive industries Note that there are a number of more sophisticated approaches to considering fossil fuel exposure of holdings, primarily looking at companies which have a fossil fuel reserves for energy purposes, or that generate at least a certain proportion of their revenue from extracting thermal coal or producing oil from oil sands.

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KEY ISSUES

- Investors are increasingly aware of the need to manage risks posed by climate change, including policy related risks.
- The recent Paris Agreement sets out the ambition of global governments to manage carbon emissions and tackle climate change. It is anticipated that the policy response to managing climate change will become more urgent in the coming years.
- Some of the key financial risks associated with climate change are rising carbon prices and the potential for "stranded assets" i.e. the possibility that a proportion of existing fossil fuel reserves will never be utilised due to changes in regulation, demand and technology. As a result, the companies that own these stranded assets face a potential future reduction in value.

DISINVESTMENT VS. OTHER OPTIONS

- Disinvestment from fossil fuel related companies may offer a clear signal of intention to beneficiaries BUT divestment is not as simple as it sounds:
  - There is no standard definition of "Fossil Fuels". Some investors have focused on divesting from the most carbon intensive sectors, such as coal or tar sands.
  - Divestment does not offer exposure to opportunities aligned with a shift to a low carbon industry.
- Engagement can be useful to discourage future investment by companies in high carbon projects while encouraging investment in lower carbon alternatives.
- Will be covered in more detail in the RI review later in the year

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AVON PENSION FUND: SUSTAINABLE INVESTMENT

THEMES AND RATIONALE

Renewable and alternative energy (solar power, wind farms)
- Predicted by 2030 over 50% of energy will be zero-emission

Energy efficiency
- Significant pressure on largescale investment in this area

Water infrastructure and technologies
- Population growth and water shortages

Pollution control
- Increasing regulations on pollution

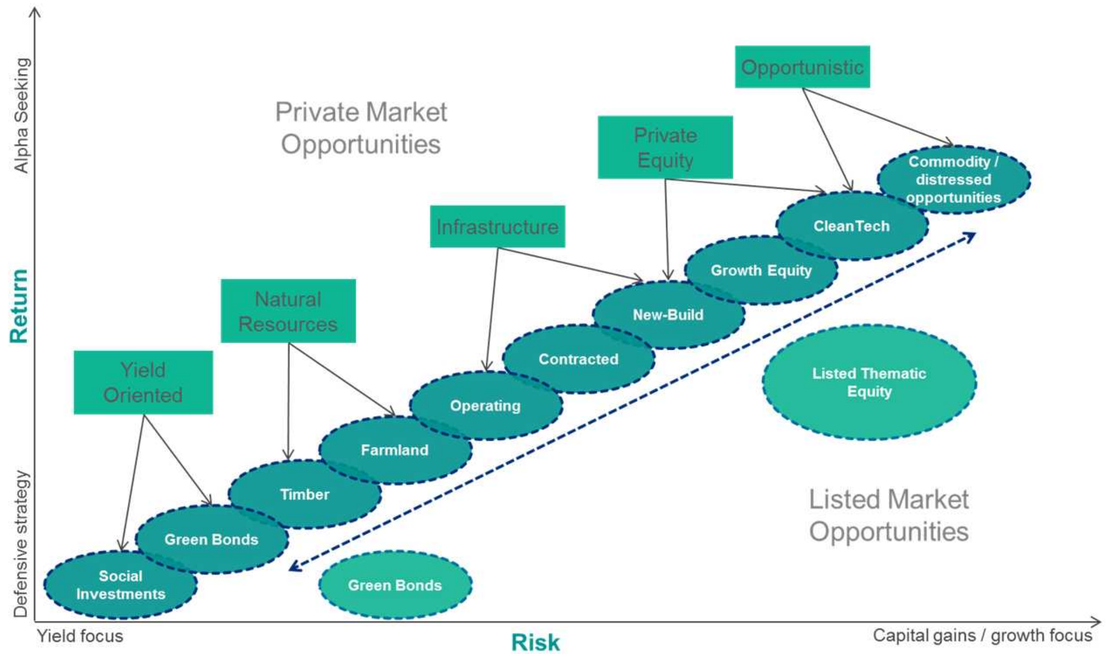
Waste management and technologies
- Increasing waste in landfill – opportunities for energy and recycling

Environmental support services
- Significant growth in the area as regulation increases

Sustainable resource management
- Changing demographics, climate change and water access

Green bonds, impact investing, private debt, real estate
- Fast growing markets

OPPORTUNITY SET: RISK AND RETURN PROFILE



INVESTMENT OPTIONS

- Sustainability themed investments can be accessed via:
  - Specialist thematic equity funds – either broad market or sector focused (e.g. water)
  - Private market funds (including fund of funds) across a range of geographies and asset classes, including private equity, infrastructure, real estate, timber and agriculture.
  - Direct investment – more complex; harder to diversify; increased need for expertise / delegation
- Exposure to real assets typically fits well with broader LGPS investment strategies.

OTHER CONSIDERATIONS

- The most attractive opportunities are anticipated to be in the illiquid, private markets. The LGPS asset pooling agenda will need to be considered.
- The regulatory environment continues to be a key driver of investment but also risk: e.g. regulatory uncertainty around subsidy support continues.
- Currently high demand for UK based assets – valuation metrics need to be assessed carefully.
- Historical performance has been mixed: manager selection is critical.

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CURRENT TOPICS

MAY 2016

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- 2016 Update and Brexit
- Update on High Yield and Distressed Debt
- How to be a More Opportunistic Investor
- Small Caps: Too Big to Ignore

2016 UPDATE AND BREXIT

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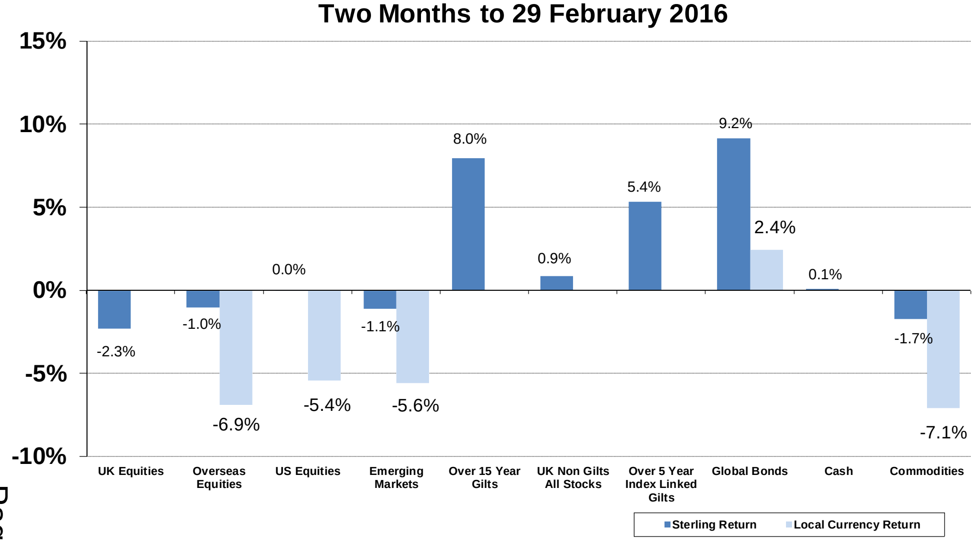
2016 UPDATE AND BREXIT

WHAT DID WE OBSERVE?



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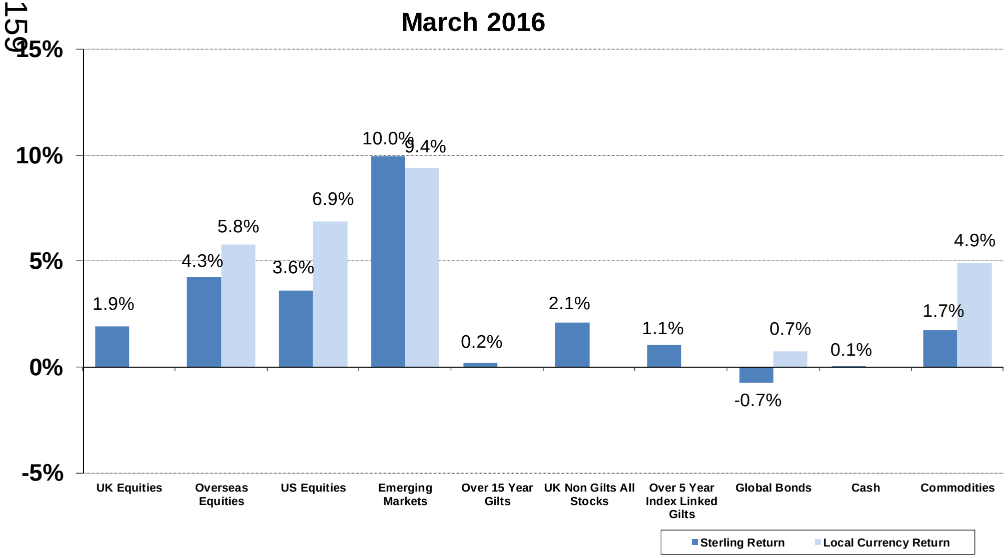


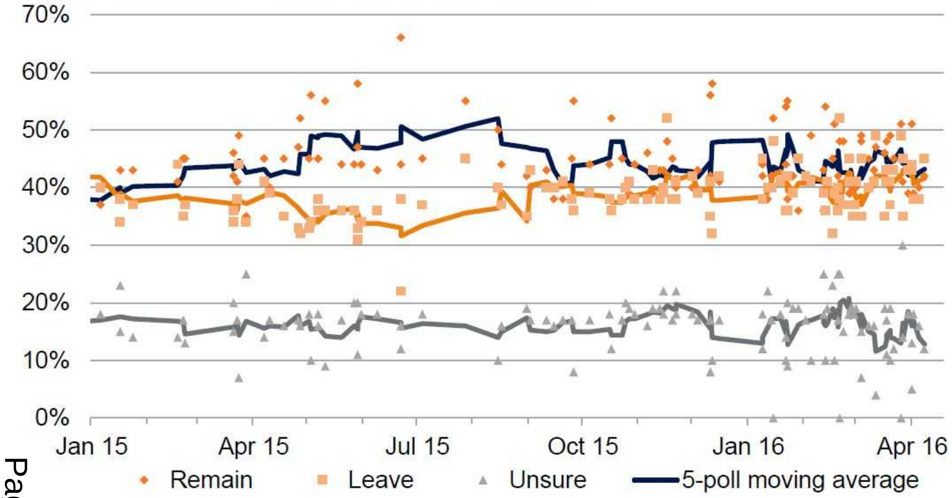
- Bond yields **fell sharply, continuing the trend of significant intra-month volatility.**
- Global equity markets generally declined, although returns were supported for unhedged UK investors by the depreciation of Sterling over the period (primarily a reaction to the announcement of the EU Referendum).
- **Credit spreads widened over the period,** reflecting the ‘risk off’ sentiment.
- Overall this was a weak period for most UK pension schemes in funding level terms.

- Over March 2016 we saw a **rebound in global equity markets,** led by Emerging Markets and the US.
- In addition, commodities rebounded after their year-long slump; by late-April 2016 the oil price had risen 55% from the multi-year low it reached in February.

Source: Thomson Reuters Datastream.

2016 UPDATE AND BREXIT
POLLING DATA

UK membership of the EU (% share of popular vote)



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Source: ComRes, ICM, ORB, YouGov, BMG Research, Survation, Ipsos MORI Panelbase, Pew Research Centre, Norstat, Populus, TNS-BMRB, Opiniom, Greenberg Quinlan Rosner Research. Schroders Economics Group. Last survey conducted 10 April 2016.

Implied probability

Source: Oddschecker.com. Schroders Economics Group. 14 April 2016.

- Polling data remains too close to call as at mid-April 2016, with a significant proportion of voters still undecided.
- While polling data remains inconclusive, implied odds are suggesting a vote to ‘Remain’ is the more likely outcome, with a ‘Brexit’ having an implied probability of 33.8% as at 14 April 2016 (as demonstrated by the chart on the bottom left).
- As a reminder, given the prevailing uncertainty around the outcome we are recommending investors:
  - Consider dynamic trigger-based liability hedging frameworks to take advantage of market dislocation to hedge at attractive levels;
  - Consider the size of any UK bias within their equity portfolios;
  - Consider whether currency hedge ratios remain appropriate given the potential for heightened volatility, and for a depreciation of the Pound in the event of a ‘Leave’ vote;
  - Ensure that collateral positions within LDI mandates remain robust given the potential for gilt yields to spike in the event of a ‘Leave’ vote.

UPDATE ON HIGH YIELD AND DISTRESSED DEBT

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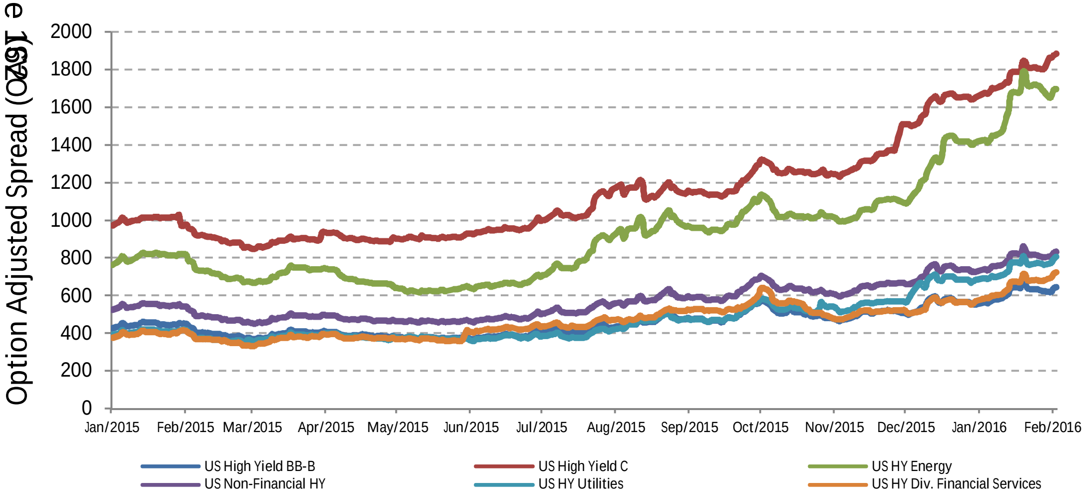
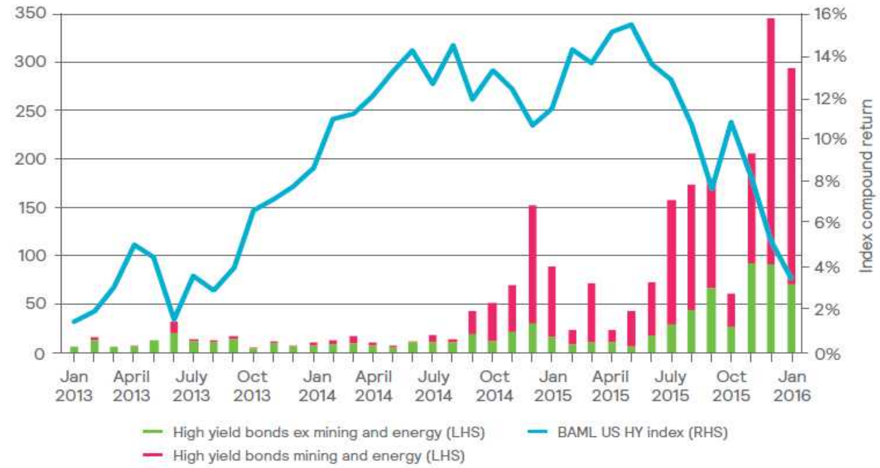
MARKET BACKGROUND OVER 2015 & 2016 YTD

- 2015 was a year that most corporate credit investors would like to forget. Marked by **severe volatility, a deterioration in credit quality and market liquidity**, all US-based High Yield credit indices finished in negative territory, posting the worst annual returns since the 2008 crisis, while European High Yield also declined.
- Selling momentum was strong, and a second consecutive year of outflows from the asset class have left **spreads on the edge of pricing in a global recession**. The degree of the sell-off is captured by the chart on the right, which show the number of US High Yield credits that have experienced more than a 10% price loss in a month.
- Overall, the **Yield to Worst on US HYD is approximately 9%; the highest level since October 2011**, when markets sold off as a result of a 'risk off' environment caused by the Eurozone crisis.



Source: BAML



Source: BlueBay Asset Management, BAML

- Over the second half of 2015, the marked decline in market liquidity exacerbated the volatility in credit trading, leading to **dramatic swings in otherwise stable, liquid positions**. Weaker prices caused further selling, stop-losses were triggered and redemptions caused a degree of panic selling by retail investors (a sector that owns approximately 25% of the High Yield market).
- However, the chart on the left demonstrates that **much of the poor performance of corporate credit in recent years has been due to losses in energy and commodity related issuers**, as weaker worldwide demand and excess supply sent oil and commodity prices down.

US High Yield spreads are on the edge of pricing in a global recession

KEY AREAS OF OPPORTUNITY & RISK

- Since the Global Financial Crisis, tighter regulations have discouraged banks from holding credit. **This has led to a significant reduction in market liquidity**. Without the banks there were often no willing buyers – this in turn exacerbated volatility, leading to dramatic swings in prices.
- The blue line in the chart on the right tracks primary dealer inventory over time, a good proxy for the presence of banks in the market. The significant reduction since the financial crisis presents an **opportunity for patient, long term investors with an illiquidity budget to step into the void left by the banks.**
- The extensive outflows from retail investors seen recently have led to more attractive valuations in the large cap space, which undoubtedly presents opportunities. However**, these issues will also be most volatile in the face of further market 'panic'.**

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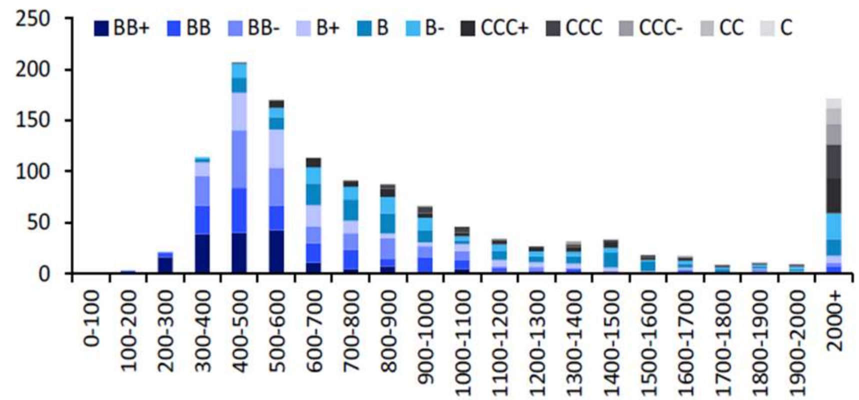
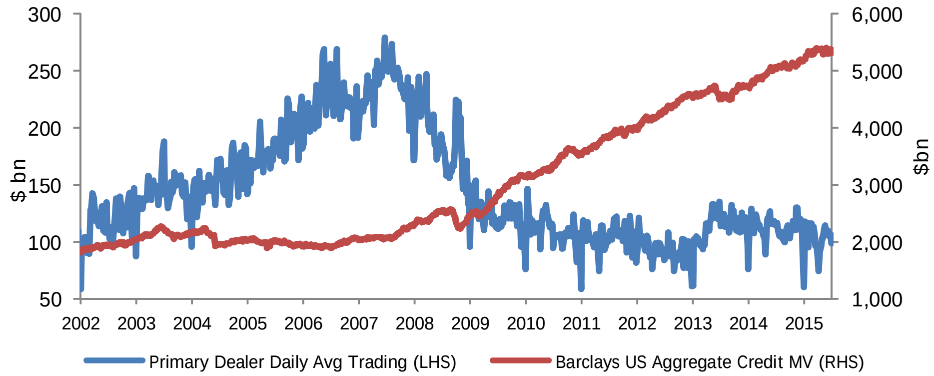


Source: Deutsche Bank

Primary Dealer daily average trading and outstanding Corporate Debt



- While the energy sector has driven losses, what is clear is that **stressed pricing is not just confined to energy**. What started off as turmoil in the energy sector has spilled over into non-commodity related areas, creating new opportunities in a range of industries including, for example, Telecom, Media, Retail and Healthcare.
- This leads to a broader question of whether **markets are experiencing 'contagion' from a concentrated weakness in certain sectors**. This dislocation between sentiment and fundamentals increases the likelihood of systematic asset mispricing, **and hence increases the opportunities available for active managers in this space**.
- Whilst the headline index spread for US HY stands in excess of 800bps (including energy/mining names), little more than 10% of the outstanding market notional trades within +/-100bps of the index average. We highlight this bifurcation in the USD HY market in the chart on the left. This further supports the **need for active management to capture opportunities**.

The new paradigm in market liquidity has exacerbated volatility, leading to dramatic swings in otherwise stable positions

KEY AREAS OF OPPORTUNITY & RISK

- There are **clear signs that the credit cycle is maturing**. The peak of the credit cycle is characterised by, amongst other things, an increase in M&A activity; as the chart on the right shows this has been increasing significantly over the past year. Investors should therefore start preparing for the conditions and opportunities that present themselves at the later stages in the credit cycle.

- One such opportunity is that weaker lending standards typically lay the ground for a period of **higher default rates and opportunities for distressed debt investors.**

- In such periods, idiosyncratic risk is highlighted and dispersion in performance among credits is more likely. Once again, this supports the case for allocating to managers that are **willing to adjust their market exposure dynamically over time. This includes managers that are willing to hold cash as 'dry powder' to deploy in stressed market conditions.**

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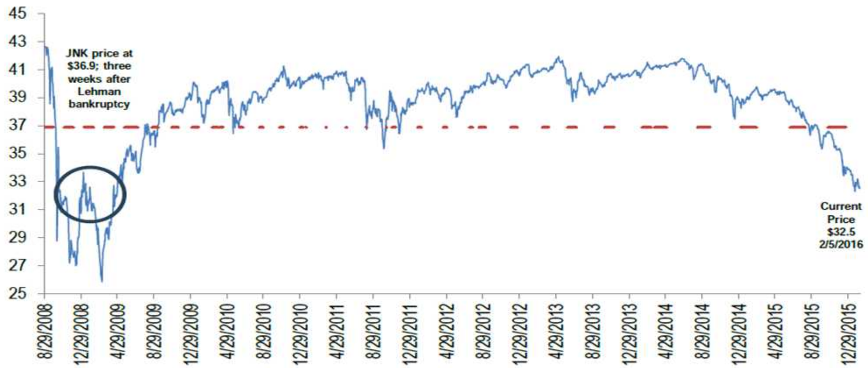
Source: Bloomberg



Source: Beach Point, Bloomberg

- The risk of a period of weak global growth has increased. However, the chart on the left shows that the JNK (High Yield ETF) was at a lower price in February than it was 3 weeks post-Lehman. **This further points to the likelihood of attractive opportunities for a skilled manager to exploit.**

- **Geopolitical risk** remains, not least a looming referendum on EU membership in the UK on 23 June. The impact of a potential Brexit is uncertain, but whether Britain leaves the EU or not, the only certainty in the short term is the increased market volatility globally as the referendum approaches.

There is a strong case for allocating to managers what are willing to adjust their market exposure dynamically over time

IMPLEMENTATION CONSIDERATIONS

- We believe there are opportunities in the High Yield space at present for active management through careful stock selection and dynamic asset allocation. As the credit cycle continues to mature, we believed that stressed and distressed credit could offer investors a rare opportunity to generate attractive returns in today's low (or negative) yield environment. However, **there is not a 'one size fits all' solution.**

- Investors will need to consider how they access the opportunity set, taking into account their return objectives, time horizon and threshold for short term losses.

- Strategies targeting credit opportunities vary significantly in their return objectives and liquidity terms. The following are broad strategies that may be worthy of consideration:

  - **Multi-Asset Credit:** these strategies are towards the lower end of the risk/return spectrum, but can provide diversified exposure to credit markets including high yield and distressed debt.
  - **Long-only "credit opportunities" funds:** these strategies could be thought of as higher up the risk/return spectrum, with less liquidity than traditional multi-asset credit funds.
  - **Credit-oriented hedge funds:** These strategies have the flexibility to invest on both the long and short side, and as such are likely to be less exposed to the "beta" of the opportunity in credit markets, with a higher reliance on manager alpha.
  - **Private Markets vehicles:** Distressed Debt funds will often form part of a diversified private markets portfolio, will typically sit at the higher end of the risk/return spectrum, and will tend to offer the least liquidity to the end investor.

A variety of implementation approaches are available, depending on risk and return objectives and constraints

HOW TO BE A MORE OPPORTUNISTIC INVESTOR

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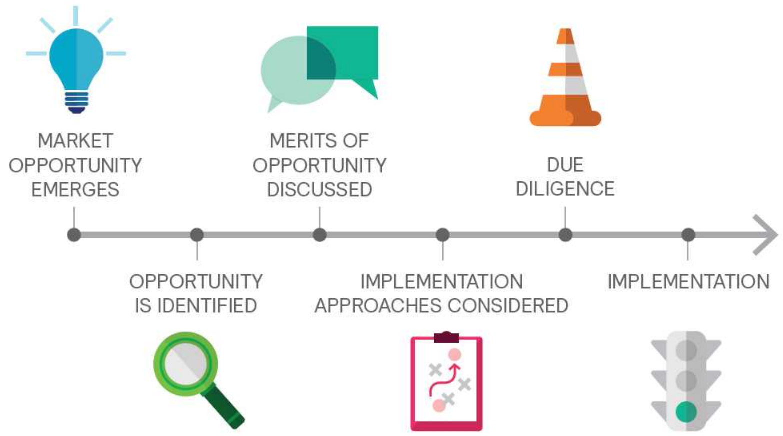
BACKGROUND: WHAT IS OPPORTUNISTIC INVESTING?

- The relatively stable investment environment of 2013 to mid-2015 has since given way to a period of market volatility. We expect to see more such disruptions over the coming years as investors react (and overreact) to ongoing macroeconomic uncertainty.

- Meanwhile, low interest rates and historically rich equity valuations present a challenging investment environment and a scarcity of cheap 'beta'. As such, generating a targeted return in future may require a greater degree of opportunism on behalf of investors.



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- We believe investors should consider how they can behave more dynamically to changes in market conditions, whilst managing the challenges associated with speed of response and the governance burden. Ultimately the goal of introducing more dynamism is to add value (absolute or risk-adjusted) relative to a long term strategic asset allocation.

- There are a number of approaches that investors can take, which are set out on the next slide. Arguably, regardless of the implementation approach the most important condition for success is adopting the right mindset; in particular a willingness to exploit opportunities that arise in previously untapped segments of the market.

An opportunistic approach to investing can take advantage of market volatility and mis-pricings to generate alpha

IMPLEMENTATION APPROACHES (1)

Floating Asset Allocation

What is it?

Floating Asset Allocation replicates the DAA framework but with a more fluid asset allocation strategy with fewer constraints.

Advantages?

Less anchored to the SAA than the DAA approach, and isn't limited to a fixed infrequent review period. Therefore it can adapt more quickly as the market and economic environment change.

Disadvantages?

This approach requires a stronger governance framework given the lack of constraints. In addition, it becomes more difficult to attribute performance between long term thinking and shorter term dynamic/market views.

Dynamic Asset Allocation

What is it?

A DAA approach usually supplements a longer term strategic asset allocation (SAA). It usually involves establishing medium term (1-3 year) views on major asset classes and tilting the allocation accordingly.

Advantages?

Governance hurdles to implementing Dynamic Asset Allocation (DAA) tilts are relatively low. DAA incorporates current market conditions and expected returns, while retaining the long term Strategic Asset Allocation (SAA) as the base. The medium term nature of DAA views is such that a quarterly meeting cycle is usually sufficient.

Disadvantages?

As the SAA remains the 'anchor' this approach tends to not be flexible enough to accommodate a full exit from an asset class that has become unattractive unless the SAA is altered.

Opportunistic Investing

What is it?

Opportunistic investing is a more flexible approach to tactical investing than DAA, as it isn't necessarily constrained by asset classes and manager or strategies in the existing portfolio

Advantages?

Opportunistic investments can be illiquid, which broadens the opportunity set and allows investors to monetise long time horizons.

Disadvantages?

Additional governance. Responsibility for opportunistic investing can be delegated to in-house teams or sub-committees, but the impact of these changes should be monitored on a periodic basis.

A combination of the above approaches may be appropriate **dependent on governance constraints**. Responsibility can be delegated to an **in-house investment team, sub-committee or external investment manager.**

IMPLEMENTATION APPROACHES (2)

Broader Investment Mandates

- Giving managers more flexibility through broader investment mandates should introduce more dynamism, and Mercer generally recommend broad over narrow investment mandates.
- An example of this would be substituting a High Yield Debt strategy for Multi-Asset Credit ("MAC"),which would expand the opportunity set significantly, increasing the manager's ability to act opportunistically.

Idiosyncratic Multi-Asset Strategies

- Idiosyncratic Multi-Asset Strategies place heavy emphasis on tactical/dynamic asset allocation (albeit with a long bias) and idiosyncratic trade ideas. As such, they are suitable for diversifying a traditional stock/bond portfolio and tend to provide good 'bang for your buck' when seeking opportunistic allocations.
- Key considerations are the sizing of any allocation to such strategies, as well as the degree of flexibility inherent in the approach.

Hedge Funds

- The term 'hedge fund' covers a disparate collection of investment strategies, but their investment mandates and structures tend to give them far more flexibility than traditional, long only investments.
- For example, global macro funds seek to capture cross-asset class opportunities, including positions in interest rates, credit, equities and currencies.
- Investors with a material allocation to hedge funds will tend to have more opportunistic investing embedded in their approach than those without.

Using external investment managers to invest more opportunistically should offer **greater flexibility and responsiveness and a streamlined implementation of new ideas**

SMALL CAPS: TOO BIG TO IGNORE

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BACKGROUND

Mercer's advice on constructing equity portfolios has evolved over the past few years to incorporate the importance of incorporating the following 'style factors'; value, size, momentum, low volatility, and profitability.

As part of that analysis, we proposed allocations with suggested exposure ranges that would produce a similar level of volatility to a global market-cap weighted portfolio but with a higher return.

An allocation to Small Cap equities of c. 15% would be a crucial component of our recommended portfolio, which is set out in the table on the right. However, there is evidence that investors have limited Small Cap exposure, often citing reasons including:

- A fee differential of c. 10-50 basis points over Large Cap equities;
- Potentially lower liquidity, and higher trading costs

Component	Allocation (%)	Range (%)
Broad Market Equities	50	30-60
Emerging Markets	10	0-25
Smaller Companies	15	0-25
Low Volatility	20	10-30
Niche (Opportunistic/Theme-Specific)	5	0-10

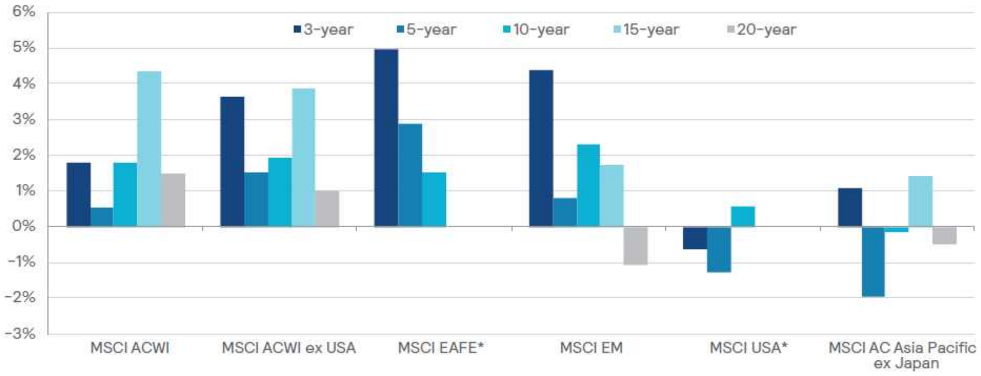
Source: Mercer

We believe that the benefits of Small Cap investing outweigh the negatives, and that investors should reconsider their exposure to this asset class, bearing in mind the potential for superior risk-adjusted returns and potentially some diversification benefits.

Underweighting of Small Caps represents a substantial active management decision, with likely opportunity costs

SMALL CAP: A FERTILE SOURCE OF ALPHA

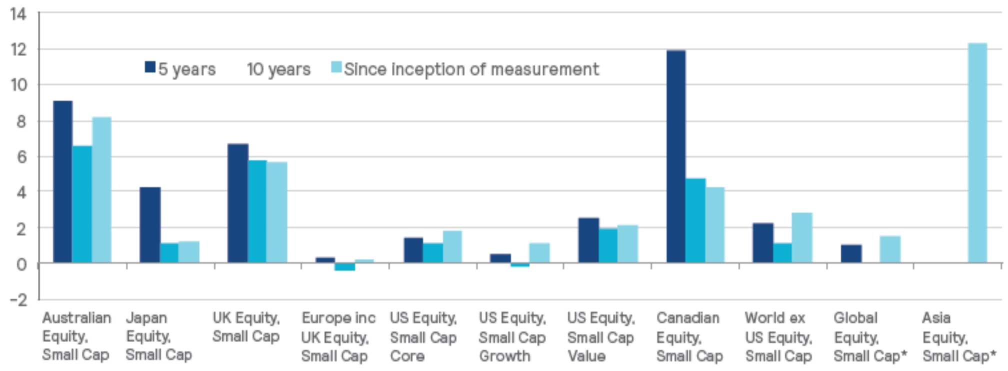
Outperformance of broader index



Source: Mercer as at end-September 2015. Performance is Gross of Fees.

* 10 Year data unavailable for "Global Equity, Small Cap" as measurement started in 2010. 5/10 Year data unavailable for "Asia Equity, Small Cap" as measurement started in 2014

Contribution from Active Management



Source: Mercer as at end-September 2015. Performance is Gross of Fees.

* 10 Year data unavailable for "Global Equity, Small Cap" as measurement started in 2010. 5/10 Year data unavailable for "Asia Equity, Small Cap" as measurement started in 2014

Academic and mainstream industry thinking has frequently pointed to the existence of a size-related or small-cap premium. This has broadly been backed up by performance over longer time periods, as the above chart highlights by looking at the difference between Small and Large/Mid Cap performance in different regions.

However, we would be cautious of proposing Small Cap equities as a 'free lunch' in beta terms. Instead, we believe investors should consider allocating to the asset class because of the potential for skilled active managers to generate consistent excess returns, as well as diversification benefits (e.g. notable disparity in sector weightings versus Large Cap).

We believe that Small Cap represent one of the most inefficient segments of the equity investment universe. This is demonstrated by the performance of our 'A rated' strategies in each universe, as demonstrated by the table above.

Pricing inefficiencies in the asset class may stem from a number of causes, including low research coverage, less competition and high cross-sectional volatility.

We do not think it is unreasonable to expect annualised excess returns of between 100 and 250 basis points from active management over the long term.

We believe the scope for excess returns outweigh the negatives associated with illiquidity and higher fees

MAKE
TOMORROW,
TODAY

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Bath & North East Somerset Council		
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**	
MEETING DATE:	**25 MAY 2016**	**AGENDA ITEM NUMBER**
TITLE:	**WORKPLAN**	
WARD:	**ALL**	
AN OPEN PUBLIC ITEM		
List of attachments to this report: Nil		

1 THE ISSUE

1.1 This report sets out the workplan for the Panel to December 2016. The workplan is provisional as the Panel will respond to issues as they arise and as work is delegated from the Committee. The workplan over this period includes projects arising from the revised Investment Strategy.

1.2 The workplan will be updated for each Panel meeting and reported to the Committee.

2 RECOMMENDATION

That the Panel:

2.1 **Note the workplan to be included in Committee papers.**

3 FINANCIAL IMPLICATIONS

3.1 There are no financial implications arising from this report. Costs for meeting managers are provided for in the budget.

4 PROVISIONAL WORKPLAN

4.1 The provisional workplan is as follows:

Panel meeting / workshop	Proposed agenda
Panel Meeting 25 May 2016	• Review managers performance to March 2016 • Managing liabilities – recommendation to Committee
Panel Meeting 5 September 2016	• Review managers performance to June 2016 • Managing liabilities – Implementation
Panel Meeting 14 November 2016	• Review managers performance to September 2016

4.2 The Panel's workplan will be included in the regular committee report setting out the committee's and pensions section workplans. This will enable the Committee to alter the planned work of the Panel.

5 PROPOSED MANAGER MEETING SCHEDULE

5.1 In light of the heavy workload of the Panel and Committee the usual 'Meet the Manager' workshops are on hold until workload permits. Obviously where issues arise with particular managers, meetings will be incorporated into the schedule as necessary.

6 RISK MANAGEMENT

6.1 The Avon Pension Fund Committee is the formal decision-making body for the Fund. As such it has responsibility to ensure adequate risk management processes are in place. It discharges this responsibility by ensuring the Fund has an appropriate investment strategy and investment management structure in place that is regularly monitored. The creation of an Investment Panel further strengthens the governance of investment matters and contributes to reduced risk in these areas.

7 EQUALITIES

7.1 An equalities impact assessment is not necessary as the report contains only recommendations to note.

8 CONSULTATION

8.1 N/a

9 ISSUES TO CONSIDER IN REACHING THE DECISION

9.1 This report is for information only.

10 ADVICE SOUGHT

10.1 The Council's Monitoring Officer (Divisional Director – Legal & Democratic Services) and Section 151 Officer (Divisional Director – Business Support) have had the opportunity to input to this report and have cleared it for publication.

Contact person	Liz Woodyard, Investments Manager 01225 395306
Background papers	
Please contact the report author if you need to access this report in an alternative format	

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