Bath & North East Somerset Council

Avon Pension Fund Committee Investment Panel

Date: Monday, 12th November, 2018
Time: 2.00 pm
Venue: Council Chamber - Guildhall, Bath

To: All Members of the Avon Pension Fund Committee Investment Panel

Councillor Patrick Anketell-Jones (Chair), Councillor David Veale, Councillor Rob Appleyard, Councillor Mary Blatchford, Pauline Gordon and Shirley Marsh

Chief Executive and other appropriate officers
Press and Public

Sean O'Neill
Democratic Services
Lewis House, Manvers Street, Bath, BA1 1JG
Telephone: 01225 395090
Web-site - http://www.bathnes.gov.uk
E-mail: Democratic_Services@bathnes.gov.uk

NOTES:

1. **Inspection of Papers:** Papers are available for inspection as follows:

Council's website: https://democracy.bathnes.gov.uk/ieDocHome.aspx?bcr=1

Paper copies are available for inspection at the **Public Access points:-** Reception: Civic Centre - Keynsham, Guildhall - Bath, The Hollies - Midsomer Norton. Bath Central and Midsomer Norton public libraries.

2. **Details of decisions taken at this meeting** can be found in the minutes which will be circulated with the agenda for the next meeting. In the meantime, details can be obtained by contacting 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 The Council may also use the images/sound recordings on its social media site or share with other organisations, such as broadcasters.

4. **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. They may also ask a question to which a written answer will be given. **Advance notice is required not less than two full working days before the meeting. This means that for meetings held on Thursdays notice must be received in Democratic Services by 5.00pm the previous Monday.** Further details of the scheme:

https://democracy.bathnes.gov.uk/ecCatDisplay.aspx?sch=doc&cat=12942

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

6. Supplementary information for meetings

Additional information and Protocols and procedures relating to meetings

https://democracy.bathnes.gov.uk/ecCatDisplay.aspx?sch=doc&cat=13505

Avon Pension Fund Committee Investment Panel - Monday, 12th November, 2018

at 2.00 pm in the Council Chamber - Guildhall, Bath

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: 10 SEPTEMBER 2018 (Pages 5 - 14)

8. REVIEW OF INVESTMENT PERFORMANCE FOR PERIODS ENDING 30 SEPTEMBER 2018 (Pages 15 - 54)

   Appendices 2 and 4 to follow.

9. DIVERSIFIED GROWTH FUNDS UPDATE (Pages 55 - 60)

10. CASH MANAGEMENT - EXCHANGE-TRADED FUND SOLUTION (Pages 61 - 98)

11. UPDATE ON POOLING OF ASSETS (Pages 99 - 146)

12. WORKPLAN (Pages 147 - 150)

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

Bath and North East Somerset Council

AVON PENSION FUND COMMITTEE INVESTMENT PANEL

Minutes of the Meeting held

Monday, 10th September, 2018, 2.00 pm

Members: Councillor Patrick Anketell-Jones (Chair), Councillor David Veale, Councillor Mary Blatchford, Pauline Gordon and Shirley Marsh
Advisors: Steve Turner (Mercer) and Nick Page (Mercer)
Also in attendance: Tony Bartlett (Head of Business, Finance and Pensions), Liz Woodyard (Investments Manager), Nathan Rollinson (Assistant Investments Manager) and Ileana Constantinescu (Investments Officer)

11 EMERGENCY EVACUATION PROCEDURE

The Democratic Services Officer advised the meeting of the procedure.

12 DECLARATIONS OF INTEREST

There were none.

13 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

There were none.

14 TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

The Chair welcomed Pauline Gordon to her first meeting of the Panel since her appointment as an Independent Member.

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

There were none.

16 ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

There were none.

17 MINUTES: 23RD MAY 2018

The public and exempt minutes of the 23rd May were approved as a correct record and signed by the Chair.

18 UPDATE ON POOLING OF ASSETS

The Investments Manager presented the report.

She said the Fund had made its first commitments to the Secure Income and Infrastructure portfolios set up by Brunel. It was good to note that establishing the

private market portfolios was ahead of schedule. The Authorised Contractual Scheme (ACS), the tax transparent vehicle for actively-managed equity assets for the pool, would comprise segregated portfolios, giving Brunel, with its approach to stewardship and stock lending as set out in Exempt Appendix 4, a greater degree of control over them.

The Panel, having been satisfied that the public interest would be better served by not disclosing relevant information, **RESOLVED,** in accordance with the provisions of section 100(A)(4) of the Local Government Act 1972, that the public be excluded from the meeting during the consideration of Exempt Appendices 1-5b and that the reporting of this part of the meeting be prevented, because of the likely disclosure of exempt information as defined in paragraph 3 of Part I of Schedule 12A of the Act as amended.

After discussion it was **RESOLVED:**

1. To note the progress made on pooling of assets;

2. to note the project plan for the transition of assets.

19 LDI TRIGGER FRAMEWORK ANNUAL REVIEW

The Assistant Investments Manager presented the report. He reminded Members that the LDI framework triggers are reviewed annually to ensure that they remain appropriate. A full review of the Liability Risk Management Framework would be considered by the Committee at its meeting on 21st September.

The Panel, having been satisfied that the public interest would be better served by not disclosing relevant information, **RESOLVED,** in accordance with section 100(A)(4) of the Local Government Act 1972, that the public should be excluded from the meeting for the consideration of the Mercer LDI Trigger Annual Review, and that the reporting of this part of the meeting should be prevented, because of the likely disclosure of exempt information as defined by paragraph 3 of Part I of Schedule 12A of the Act as amended.

After discussion it was **RESOLVED** to recommend to the Avon Pension Fund Committee:

1. To maintain the current trigger framework and monitor the viability of either increasing the interest rate hedge or lowering the interest rate triggers over time and as the funding level improves;

2. that monitoring and implementation of any change to the framework should be delegated to officers in conjunction with the investment consultant.

20 CORPORATE BOND INVESTMENT

The Panel, having been satisfied that the public interest would be better served by not disclosing relevant information, **RESOLVED,** in accordance with section 100(A)(4) of the Local Government Act 1972, that the public should be excluded from the meeting for the consideration of this item, and that the reporting of this part of the meeting should be prevented, because of the likely disclosure of exempt

information as defined by paragraph 3 of Part I of Scheduled 12A of the Act as amended.

After discussion the Panel **RESOLVED** to approve the recommendations.

21 REVIEW OF THE ROLE OF DIVERSIFIED GROWTH FUNDS

The Investments Manager presented the report.

The Panel noted that the review of the role of the Diversified Growth Fund had been prompted by recent underperformance against absolute returns specific to these mandates. There had also been discussion about the timing of transitioning these funds to Brunel.

The Panel having been satisfied that the public interest would be better served by not disclosing relevant information, **RESOLVED,** in accordance with section 100(A)(4) of the Local Government Act 1972, that the public be excluded during the consideration of the Mercer Review of the Diversified Growth Funds and that the reporting of this part of the meeting be prevented, because of the likely disclosure of exempt information as defined in paragraph 3 of Part I of Schedule 12A of the Act as amended.

After discussion it was **RESOLVED** to note:

1. The information contained at Exempt Appendix 1;

2. that a detailed review of DGFs will be undertaken as part of the investment strategy review in 2019.

22 REVIEW OF INVESTMENT PERFORMANCE FOR PERIODS ENDING 30 JUNE 2018

The Assistant Investments Manager presented this item and summarised the key facts.

- Manager absolute returns over the quarter were broadly positive, reflective of market returns.

- Developed market equity mandates delivered the strongest growth.

- One LDI inflation trigger was breached in the fifth maturity bucket.

- The equity protection strategy detracted value on an aggregate basis and was performing in line with expectations.

- Collateral in the QIF remained within its prescribed parameters. The QIF now holds a passive equity fund which will be called on if additional collateral is required.

Mr Turner presented the Mercer performance monitoring report.

Before consideration of the Mercer Risk Management Framework Quarterly Monitoring Report the Panel, having been satisfied that the public interest would be better served by not disclosing relevant information, **RESOLVED** in accordance with the provisions of section 100(A)(4) of the Local Government Act 1972, that the public should be excluded for the consideration of this report, and that the reporting of this part of the meeting be prevented, because of the likely disclosure of exempt information as defined in paragraph 3 of Part I of Schedule 12A of the Act as amended.

Mr Page presented the Mercer Risk Management Quarterly Monitoring Report.

After discussion the Panel **RESOLVED:**

1. To note the information as set out in the reports.

23 WORKPLAN

The Investments Manager presented this item.

RESOLVED to note the workplan to be included in the Committee papers.

The meeting ended at 4.17 pm

Chair(person) .....

Date Confirmed and Signed .....

Prepared by Democratic Services

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

Document is Restricted

This page is intentionally left blank

Bath & North East Somerset Council		
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**	
MEETING DATE:	**12 November 2018**	**AGENDA ITEM NUMBER**
TITLE:	**Review Of Investment Performance For Periods Ending 30 September 2018**	
WARD:	**ALL**	
AN OPEN PUBLIC ITEM		

List of attachments to this report:

Appendix 1 – Fund Valuation

Appendix 2 – Mercer Performance Monitoring Report [TO FOLLOW]

Exempt Appendix 3 – RAG Monitoring Summary Report

Exempt Appendix 4 – Risk Management Framework Quarterly Monitoring Report [TO FOLLOW]

Appendix 5 – Mercer Paper: Is a Bear Market on the Horizon?

Appendix 6 – Mercer Paper: Political Risk: “Big Things” Lie Ahead

Appendix 7 – Mercer Paper: From QE to QT – Building Robust Portfolios

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 30 September 2018.

1.2 The report focuses on the performance of the individual investment managers and the implementation of the investment strategy. The full performance report with aggregate investment and funding analysis will be reported to the Committee meeting on 7 December 2018.

1.3 The report also includes the report from Mercer monitoring the Risk Management strategies (Liability Driven Investing and Equity Protection Strategy).

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.**

3 FINANCIAL IMPLICATIONS

3.1 The returns achieved by the Fund for the three years commencing 1 April 2016 will impact the next triennial valuation which will be calculated as at 31 March 2019. The returns quoted are net of investment management fees.

4 INVESTMENT PERFORMANCE

A – Fund Performance

4.1 The Fund's assets increased by £72m (c.1.5%) in the quarter ending 30 September 2018 giving a value for the investment Fund of £4,782m. Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and managers.

4.2 During the quarter global equities were largely flat and moved lower late into the quarter, with the exception of US equities which benefited from strong economic growth. The combination of rising US interest rates and a strong US Dollar presented a challenge for many regions, particularly for Emerging Markets where borrowing is often US Dollar denominated. The oil price rose by 6% and notably US bond yields moved higher, with the yield on the 10-year bond breaching 3% for the first time since 2013. This, along with mounting trade tensions between China and the US, provided the impetus late into the quarter to push equity prices down; a trend that continued into 4Q18. For the calendar year to 12th October the MSCI World and Emerging Markets Indices posted losses of 11% and 20% respectively. At time of writing, the US technology sector had been leading declines. The NASDAQ, the index that comprises many US technology companies, is set to post losses of 11% in October, which would make it the worst performing month since 2008. Over the quarter, sterling depreciated against the US Dollar by 1.2% and against the Euro by 0.7% and appreciated against the Japanese Yen by 1.3%.

4.3 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 7 December 2018.

B – Investment Manager Performance

4.4 A detailed report on the performance of each investment manager has been produced by Mercer – see pages 22 to 41 of Appendix 2.

4.5 Manager total returns over the quarter were mixed; with the strongest performance coming from the Fund's overseas developed market equities. Returns from the Fund's diversified growth strategies were muted. The Fund's infrastructure manager was a standout performer over the quarter, with returns enhanced by the depreciation in sterling against the US Dollar. Over 1 year the majority of managers posted positive absolute returns. More information on those mandates that detracted value on an absolute basis can be found at Appendix 2. Over the 3 year period all mandates with a 3 year track record produced positive absolute returns however a number of funds did underperform their respective benchmarks.

4.6 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.

C - Risk Management Framework Quarterly Monitoring Report

4.7 A detailed report of the performance of the Fund's risk management strategies, namely the LDI and equity protection strategies has been produced by Mercer (see Exempt Appendix 4).

4.8 No triggers relating to the LDI framework were breached during the quarter.

4.9 The equity protection strategy, designed to guard against a large draw-down in equity markets, detracted value on an aggregate basis and performed in line with expectations; most notably capping gains on the Fund's physical US equity holdings which was one of the few regions that increased in value through the quarter. The net impact of the equity protection strategy can be found on page 7 of Exempt Appendix 4.

4.10 Collateral held in the Qualified Investor Fund (QIF) that is used to capitalise the risk management strategies remained within its prescribed parameters and was sufficient to absorb the stress tests that are routinely carried out to ensure operational efficiency. To allow additional collateral to be raised when required and in order to keep leverage within the specified guidelines, the QIF owns units in a global passive equity fund that the manager has discretion to liquidate when cash is required for collateral purposes.

5 INVESTMENT STRATEGY AND PORTFOLIO REBALANCING

5.1 **Asset Class Returns versus Strategic Assumptions**: Developed market equity returns over the last 3 years were 20.1% p.a., materially ahead of the assumed strategic return of 8.1% p.a. on the same basis. The 3 year return from emerging market equities was 17.5% in 3Q18; again well ahead of the assumed 3 year return of 8.7%. Index-Linked Gilts remain considerably above the assumed strategic return as yields remain low relative to historic averages. Over the three-year period index-linked gilts returned 7.2% p.a. versus an assumed return of 2.2%. Similarly, property and infrastructure are significantly ahead of their assumed strategic returns on a 3 year basis. Hedge fund returns picked up this quarter but remain below long-term averages and the strategic return of 5.1% p.a., having been affected by low cash rates.

5.2 **Rebalancing:** At quarter end all asset allocations were within the control ranges for rebalancing based on the strategic benchmark. Officers did not undertake any rebalancing activity during the quarter.

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 has had the opportunity to input to this report and has cleared it for publication.

Contact person	Nathan Rollinson, Assistant Investments Manager (Tel: 01225 395357)
Background papers	Data supplied by State Street Bank & Trust Performance Measurement
Please contact the report author if you need to access this report in an alternative format	

APPENDIX 1

AVON PENSION FUND VALUATION - 30 SEPTEMBER 2018

	Brunel Portfolios	Passive Corporate Bonds	QIF	Active Equities					Funds of Hedge Funds	DGFs			MAC	Property		Infra-stucture	Currency Hedging	In House Cash	TOTAL	Avon Asset Mix %
All figures in £m	Multi-Manager	BlackRock	BlackRock	TT Int'l	Jupiter (SRI)	Genesis	Unigestion	Schroder Global	JP Morgan	Pyrford	Standard Life	Ruffer	Loomis	Schroder (UK)	Partners (Overseas)	IFM	Record	General Cash		
Equities																				
UK				194.4	189.8														384.2	8.0%
Emerging Markets						109.7	114.4												224.2	4.7%
Global Developed Markets			451.4		10.7			393.7											855.7	17.9%
Global Low Carbon	532.9																		532.9	11.1%
Equity Derivatives[1]			-58.4														51.9		-6.5	-0.1%
Total Overseas	***532.9***		***392.9***	***0.0***	***10.7***	***109.7***	***114.4***	***393.7***									***51.9***		***1606.2***	**33.6%**
Total Equities	**532.9**		**392.9**	**194.4**	**200.4**	**109.7**	**114.4**	**393.7**									**51.9**		***1990.4***	**41.6%**
DGFs										**139.1**	**237.0**	**229.7**							***605.8***	**12.7%**
Hedge Funds									**231.7**										***231.7***	**4.8%**
MAC													**477.8**						***477.8***	**10.0%**
Property														**232.0**	**205.5**				***437.4***	**9.2%**
Infrastructure																**318.7**			***318.7***	**6.7%**
LDI Assets & Bonds																				
LDI Assets			556.1																556.1	11.6%
Corporate Bonds		80.3																	80.3	1.7%
Total Bonds		**80.3**	**556.1**																***636.4***	**13.3%**
Cash				0.7	11.0			4.7						2.6				85.2	***104.2***	**2.2%**
FX Hedging																	-22.8		***-22.8***	**-0.5%**
TOTAL	**532.9**	**80.3**	**949.1**	**195.2**	**211.4**	**109.7**	**114.4**	**398.4**	**231.7**	**139.1**	**237.0**	**229.7**	**477.8**	**234.6**	**205.5**	**318.7**	**29.1**	**85.2**	**4779.7**	**100.0%**

[1] Negative equity values mean the equity protection strategy in the BlackRock QIF has detracted from overall performance

This page is intentionally left blank

Bath & North East Somerset Council

Access to Information Arrangements

Exclusion of access by the public to Council meetings

Information Compliance Ref: 1811/18

Meeting / Decision: AVON PENSION FUND INVESTMENT PANEL
Date: 12th November 2018

Author: Nathan Rollinson
Report Title: Review Of Investment Performance For Periods Ending 30 September 2018 Appendix 1 – Fund Valuation Appendix 2 – Mercer performance monitoring report Exempt Appendix 3 – RAG Monitoring Summary Report Exempt Appendix 4 – Risk Management Framework Quarterly Monitoring 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 exempt appendices 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 Panel 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 appendices contain 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 Panel 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

This page is intentionally left blank

OCTOBER 2018

IS A BEAR MARKET ON THE HORIZON?

The VIX volatility index, commonly known as the 'fear gauge' of Wall Street, spiked to nearly 25, although it remained well below 37 , which was the level hit in February.

Last week, global stock markets went through their most pronounced downturn in more than six months, before a moderate rebound ensued towards the end of the week. The S&P 500, which had set an all-time high this summer despite higher interest rates in the US and mounting trade tensions, has suffered a 5%[1] decline throughout this month up to October 12th. As of that date, the S&P's downturn has taken the index back to early July levels. Many non-US markets still had not fully recovered from the downturn in February in USD terms, and returns in October have sent them further in the red. The MSCI World ex-US and MSCI Emerging Markets were down 11% and 20%[2], respectively, through to October 12th from late-January highs. In a flashback to the market turbulence of February 2018, the VIX volatility index, commonly known as the 'fear gauge' of Wall Street, spiked to nearly 25, although it remained well below 37[3], which was the level hit in February.

Source: Thompson Reuter Data Stream, Mercer Analysis

The previous high-flying technology sector was hit particularly badly. The tech-heavy NASDAQ composite dropped nearly 7%[4] this month up to October 12th.

Many analysts are pointing the blame at rising bond yields as the reason behind the latest sell off. Following rising optimism in the US economy's strength last week, the US 10 year government bond yield soared to a seven-year high of 3.23%[5] in the first week of October, as investors prepared for further rate rises from the Federal Reserve. This move in bond yields may have been sufficient enough to alarm equity markets. However, rising yields on their own probably were not the sole point of blame for this sell-off.

In February, when rising yields caused a short sell-off, these pressures were exacerbated by the collapse of two exchange-traded funds that shorted VIX futures on a bet on the stock markets remaining calm. When volatility spiked, these funds and other traders were forced to cover their positions, causing volatility to increase further. A similar concept might have been behind the sell-off this week. Data from the Commodity Futures Trading Commission indicate as far, that speculators net short position in VIX futures reached levels comparable to January. In addition, risk management strategies that reduce equity exposure as volatility rises and markets fall have grown popular since the financial crisis, which can exacerbate market swings.

The Federal Reserve is tightening monetary policy for the world's primary reserve currency, which is slowly draining liquidity from global markets (as covered more in detail in our commentary From Quantitative Easing to Quantitative Tightening and Preparing for Late Credit Cycle Dynamics). We should expect to see more of these short sharp markets sell-offs as the Federal Reserve and other major central banks withdraw stimulus.

At the time of this writing, global equity markets have calmed at the end of what has been a turbulent week for global stocks. Following the most recent sell-offs, equities have managed to recover somewhat, but we would not be surprised if these quick instances of volatility were to persist.

At this point, we do not believe there are any urgent actions for investors to take. In our forthcoming Global Dynamic Asset Allocation report for the fourth quarter of 2018, we do suggest modestly reducing exposure to risk assets by underweighting corporate credit securities, where spreads, we feel, leave little upside potential. Nevertheless, we suggest maintaining a neutral allocation to equities. We do not see this as the start of a bear market since macro conditions remain solid. However, we also do not view this as a buying opportunity for developed market equities (apart from rebalancing) either, as valuations, particularly in the US, remain elevated and could come under pressure from higher rates and risks to the outlook remain (particularly with regard to trade). We expect that this evolution will create higher volatility over the next few years, and investors should expect sharp drops from time to time. We will also be looking for opportunities to take advantage of larger dislocations, if movements become more substantial.

For more information, please visit our website.

At this point, we do not believe there are any urgent actions for investors to take.

We expect that this evolution will create higher volatility over the next few years, and investors should expect sharp drops from time to time.

FOOTNOTES

[1] *S&P 500 Composite Index, total return in USD. Source: Thompson Reuters Data Stream and Mercer Analysis for this index and all indices mentioned below.*
[2] *MSCI All World ex USA and MSCI Emerging Market Indices, both total return in USD.*
[3] *CBOE Volatility VIX Index.*
[4] *NASDAQ Index, price return in USD.*
[5] *ICE BofAML US Treasury Current 10 Year Redemption Yield*

IMPORTANT NOTICES

References to Mercer shall be construed to include Mercer LLC and/or its associated companies.

Information contained herein has been obtained from a range of third party sources. While the information is believed to be reliable, Mercer has not sought to verify it independently. As such, Mercer makes no representations or warranties as to the accuracy of the information presented and takes no responsibility or liability (including for indirect, consequential or incidental damages) for any error, omission or inaccuracy in the data supplied by any third party.

No investment decision should be made based on this information without first obtaining appropriate professional legal, tax and accounting advice and considering your circumstances.

Investing involves risk. The value of your investment will fluctuate over time, and you may gain or lose money.

Mercer Investment Management, Inc. and Mercer Investment Consulting LLC are federally registered investment advisers under the Investment Advisers Act of 1940, as amended. Registration as an investment adviser does not imply a certain level of skill or training. Mercer's Form ADV Part 2A & 2B can be obtained by written request directed to: Compliance Department, Mercer Investments, 701 Market Street, Suite 1100, St. Louis, MO 63101.

Download a guide on key index definitions.

This page is intentionally left blank

POLITICAL RISK: "BIG THINGS" LIE AHEAD

SEPTEMBER 2018

INTRODUCTION

Since the seismic events of 2016 – the EU referendum and the election of Donald Trump – many UK pension schemes have discussed and debated the potential risks they pose, but it has been very difficult to know what to do about it.

To the surprise of many political and economic commentators markets have been unexpectedly calm. Sterling initially fell, then recovered, and remains well above its post-referendum lows. The UK equity market has followed a similar pattern. Volatility in the gilt market has been remarkably low. In the US, the impact of Trump's policies, particularly the large scale tax cuts, has led to continued strength in the economy, and despite a moderate correction in February, the equity market is now sitting around all-time highs. The dollar was weak for a time; but is now rising. The US Federal Reserve has continued to raise rates and unwind QE, and while US Treasury yields have risen the once-feared bond market meltdown has not materialised.

So, what's the problem? Should pension schemes really be worried about political risk? Is there anything they can do about it anyway?

By focussing on Brexit and Trump, and the relentless media coverage of every twist and tweet, there is risk we are all missing something really big – the unwinding of decades of internationalism, deregulation and trade liberalisation. Arguably both Brexit and Trump are the products of the same seismic wave of discontent that has swept the world since the Arab Spring. The so-called "Washington Consensus", or neoliberalism, that started with Reagan and Thatcher and has dominated Western political thinking for nearly four decades may have run its course. The wealth generating and peace-promoting benefits of neoliberalism are there for all to see. But what many people see is that their own lives have not gotten as better as some, and in some cases, they have gotten worse.

Until this problem of those that feel "left behind" is solved, if it can be solved, political risk should be high on the agenda of all investors, but especially pension funds with funding challenges, or uncertain sponsor covenants.

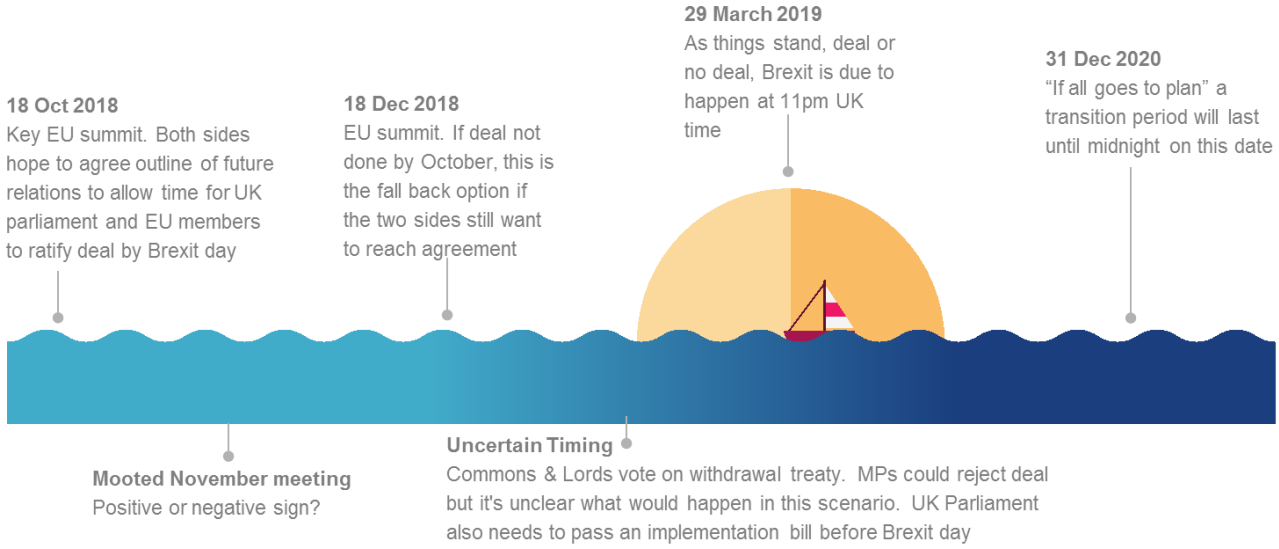
As we sit here in early September 2018, we find ourselves at a critical juncture with regard to both Brexit and the Trump Presidency. But we also need to be aware of other events linked to the same root cause - from Turkey and Eastern Europe, to Italy and Germany, not to mention Sweden. The shape of the distribution of possible outcomes for Brexit and Trump has become clearer but such clarity is not independent of "big things" happening elsewhere. If the outcome for Brexit is trade based WTO rules, the uncertainty will remain if the WTO rules themselves are under threat, or reformed. Seeking a free trade agreement with other countries will not happen, if they too turn their backs on free trade. Regardless of how much longer Trump is in the White House, his personal fate will not matter if his election has changed the political landscape of America for a generation. If "America First" replaces the Washington Consensus, or if China under Xi seizes the leadership void left by an isolationist America, the world will be a very different place long before most UK pension schemes have paid out their last pension.

In this paper, we focus on the immediate political risks which pension schemes need to consider – Brexit and Trump. But we should all be aware that Brexit and Trump might not be just "blips", after which everything will go back to normal. "Populism", as it has been condescendingly termed, could also be called "democracy" or "people power". Such people power may shape politics, economies and financial markets for decades to come, just as the neoliberalism championed by Reagan and Thatcher has shaped the past four decades.

BREXIT MEANS…BREXIT?

More than two years after the vote to leave the EU, and with only 6 months until we are due to do so, the UK finds itself in a situation where almost nothing material has been agreed (even in principle) and where the Prime Minister is championing her so-called "Chequers" deal, despite it being unacceptable both to the EU and to the majority of politicians on both sides of the debate. The October EU meeting - which was to be the watershed for reaching a deal - is rumoured now to be followed by a November meeting. With the Government releasing papers on contingency plans for a "no deal" scenario, and the Bank of England Governor warning the Cabinet of the dire short-term consequences of "no deal", it is difficult to discern what is fact, what is posturing, and what is simply negotiating tactics.

Figure 1 – Key Brexit Dates



What we know with reasonable confidence is that the parliamentary arithmetic with regard to Brexit is challenging for the Government. After surrendering her slender majority in the 2017 election, the Prime Minister is in a situation where it is unclear whether any Withdrawal Agreement can pass through Parliament. The risk of a constitutional and political crisis poses almost as much political risk as a "no deal" or "cliff edge" Brexit.

There are two separate aspects of our future relationship with the EU that bring about Brexit-related political risk. The first is the immediate question of the shape of the economic and political situation on “day one”. The second is the ultimate form of our relationship with the EU where any differential impact, positive or negative, is likely to be felt only over the medium to long term.

When considering political risk as a “left tail” event, what should concern Trustees is the immediate need to agree a Withdrawal Agreement (“WA”). The WA (a Treaty) would be the agreement between the UK and EU under Article 50 of the Lisbon Treaty. In relation to future relations between the UK and the EU, it is intended that the WA will make a *non-binding* declaration of what the economic arrangements will look like. It has also been agreed that the WA will allow for a “Transition Period” from 29 March 2019 to 31 December 2020, during which trade will continue as now, but with the UK no longer providing input on the rules.

Notably, the EU and the UK agreed in December 2017 that the WA would also contain a legally binding backstop provision to ensure that under no scenario would there be a hard border between Northern Ireland and the Republic of Ireland. This backstop would kick in if the subsequent negotiation of the future relationship (post March 2019) failed to reach an agreement that would prevent a hard border.

It is likely that the long term nature of the relationship between the UK and the EU will not become clear for some time after withdrawal on 29 March 2019, and many commentators are sceptical that a deal can be reached by the end of 2020. Nonetheless, something tangible must happen in the next few months, and the implications may be material.

Below we set out what we view as the potential outcomes *as we see them today*, and the risks and implications inherent in each. Please note the percentages applied to these scenarios are purely indicative, and it is not possible to have any real conviction in these given the complexity of the situation.

Negotiated Deal (c.60% likelihood)

The Transition Period could begin on 30 March 2019 with a broad framework agreed by the UK and EU for the terms of a future trade deal (but, notably, not necessarily a huge amount of detail) that would then be worked on during the period to 31 December 2020. As noted above, this would require a legally binding backstop to be agreed with regard to Northern Ireland. This has essentially been “Plan A” for the UK since the “Lancaster House” speech in January 2017, where membership of the Single Market and Customs Union was effectively ruled out by Theresa May, although the UK was hoping for a deeper partnership than is currently in place with Canada (which now appears to be what would be on offer, at least in the short term).

The Chequers deal - in particular, the proposal to stay aligned with the Single Market for goods but not for services - is considered untenable by many commentators both because it violates the integrity of the Single Market, the maintenance of which is the single highest priority of the EU, and

also because it appears unlikely to enjoy parliamentary support. Indeed, the pro-Brexit European Research Group believe as many as 80 Conservative MPs would vote against it.

With the rhetoric from the EU having softened over recent weeks, it would seem, however, that an agreement of some kind is the most likely outcome. If this can be kept sufficiently broad (i.e. if it manages to kick some of the most divisive "cans" further down the road) it might lead to another uneasy truce, of the kind we have experienced at various points in the process so far. While the DUP (whose votes the Conservatives currently rely on in Parliament) would be vehemently opposed to any outcome that resulted in Northern Ireland remaining in a Customs Union with the EU, they might take the pragmatic view that the risk of a UK Government led by Jeremy Corbyn, who has supported a united Ireland throughout his political life, together with the economic implications of "no deal" on Northern Ireland, are greater evils.

No Deal ("Carney's Carnage" or "Negotiated") (c. 20% likelihood)

The risk of no agreement whatsoever before 29 March (i.e. no WA, no contingency agreements in place and no extension of the Article 50 deadline) has the potential to be the ultimate "Doomsday" scenario (e.g. legal contracts voided, airplanes grounded). In this case, the economic impact would be immediate and profound. Such an outcome has been termed "Carney's Carnage" by the media, following the Governors' leaked testimony to the Cabinet. It is very difficult to conceive this happening intentionally because of the implications for all sides, but it seems plausible that this could happen inadvertently - the product of inept brinkmanship at the eleventh hour. This would likely open the door for a Prime Ministerial challenge, vote of no confidence in the government, and/or a snap election.

However, the other "no deal" alternative is that agreement could be reached that no comprehensive trade deal is achievable in the short term, as there is too much difference between the two sides (i.e. the government might employ the familiar maxim that "no deal is better than a bad deal"). Since WTO rules apply only in the absence of a framework of rules that govern the relationship between trading partners, both sides could agree a series of mini-agreements to keep the critical current trade arrangements going (replacing, in effect, the "status quo" of a Transition Period). This would mean the impact on the economy would be one of disruption rather than catastrophe. Such an approach is favoured by many Leave campaigners.

However, in this scenario, the UK might refuse to make the "divorce payment" of c. £40bn (given there would be no trade deal) which the EU would see as the UK defaulting on payments it is legally obliged to make. It is therefore highly likely that while the EU would agree to some mini-agreements (e.g. to keep planes in the air) they would be motivated only to negotiate deals that were unambiguously beneficial to member states/EU businesses, rather than the more comprehensive set of agreements that the UK would seek. Depending on what is actually agreed, this scenario could still result in sharp economic disruption and, as noted above, a prime ministerial challenge, a vote of no confidence in the government, and/or a snap election.

Extension of Article 50 (c. 20% likelihood)

It is highly unlikely that Theresa May would get to a position where she asked the EU for an extension to Article 50, for this would (in essence) be accepting that her Government have failed to take preparing to leave the EU sufficiently seriously, or alternatively that their negotiating tactics had been particularly weak. There would most likely be a leadership challenge, on the basis that Brexiteers would be able to deliver Brexit in the agreed timeframe, whatever the implications.

However, it is entirely possible that if there is "regime change" in the UK before 29 March then the new Government (regardless of which party they come from) may ask the EU to extend Article 50 to give them more time for negotiations. Given the EU does not want a "no deal" scenario, and the formation of a new Government in the UK might imply an eventual relationship that is closer than currently looks likely, the EU would probably accept this. If Article 50 was extended (e.g. by a year) then any Transition Period would also be extended, and therefore any change to the current trade relationship would be pushed back further.

Remain (??%)

There is a cross-party campaign underway to stop Brexit by holding a second referendum – a "People's Vote" on the final deal with an option to Remain. It seems likely that the Labour Party will agree at its upcoming conference to making a referendum on the final deal with the EU official policy, but it is not clear that "Remain" will be an option at the time of writing.

We assign no probability to Remain, as it would only be possible through "regime change" under one of the options already provided (Theresa May has explicitly ruled this out). It would also likely require an extension of Article 50 given the timescales involved.

Although markets may be supportive, a second referendum that resulted in the UK remaining in the EU introduces risks of its own, particularly the perceived implications for democracy if the result of the first referendum is not honoured. This is a low probability event both because of the low likelihood of a second referendum taking place, and also the fact it is also unclear that it would yield a different result. Although polls in 2018 have suggested a consistent, small majority for Remain, this is not large enough to have any real predictive power given the uncertainty of how the (repeat) referendum campaign would unfold in practice.

The extent and severity of the impact of Brexit-related political risk for UK pension scheme will obviously depend on which scenario ultimately plays out in practice, as well as the scheme's investment strategy, funding position and, most importantly of all, sponsor covenant. But whatever the outcome is, things will not remain the same – the economy will be affected, sterling, gilt yields and UK equity prices will move. Any sponsor which has direct or indirect linkages with EU countries will be affected in some way.

BREXIT MEANS…CORBYN?

Any of the scenarios discussed above could result in the collapse of the current government, at any time between now and the end of March. While this is a political risk in itself given the potential for it to jeopardise the overall Brexit timetable (and, say, make a "Carney's Carnage" scenario more likely), the consequences also depend on who steps into the void:

Boris Johnson / Jacob Rees-Mogg – This would make a no deal scenario of some variety highly likely, with the associated economic implications.

Phillip Hammond / Amber Rudd – If Remain backing Tories are able to win the support of Parliament for a "soft" Brexit (e.g. EEA), or even a second referendum (neither of which are consistent with the policy of the May Government), this could mitigate most of the negative economic outcomes from Brexit.

Jeremy Corbyn – An immediate election that resulted in a victory for Corbyn and Labour would, regardless of the circumstances, introduce a different set of risks over the resulting Parliament and beyond. In addition, given Corbyn's historical distrust for the EU, it is unclear to what extent if any the probable outcomes would be affected (although the Parliamentary Labour Party would seek to use their influence to guide towards the EEA or a second referendum).

The fact that Corbyn managed to successfully overcome the attempted coup by Owen Smith and Labour moderates in 2016 has faded in the minds of political commentators. But the implications are profound. For the foreseeable future, the battle for the heart of the Labour Party has been won by a faction that would have been considered as Far-Left extremists during the New Labour period.

The UK therefore faces the very real prospect of a genuinely socialist Labour Government taking power for the first time since 1945. It is unclear to what extent the checks and balances built into the UK political system would act to moderate the legislative agenda of a Corbyn Government, but even the Shadow Chancellor John McDonnell has been forthright about what Labour would expect the immediate market impact to be: the flight of capital from the UK and a run on sterling.

Clearly, any immediate rise in corporate or personal taxation would hurt the competitiveness of the UK economy at a time when the strength of London as a financial centre remains a bulwark against some of the negative impact of Brexit. The impact of a move to re-nationalise certain industries such as rail and water would clearly be less immediate, although it would increase direct and indirect covenant risk to many UK schemes.

More broadly, given the disarray in the Conservative Party if the current government collapses, and the fact they will would be forced to "own" any Brexit related upheaval, any election victory for Labour could result in a lengthy tenure (first by Corbyn and then a far left successor given the power of Momentum) which would have the potential to fundamentally change the nature of the economic and political direction of the UK, in the opposite direction to the Thatcher government in the 1980s.

THE ELEPHANT IN THE SITUATION ROOM

Donald Trump was not a conventional candidate and he is not a conventional President. But the mistake many commentators have made is to muddle up their views on the personal morality and unpredictability of the President, with the actual impact of the policies he champions, and has in some cases implemented.

Trump has courted controversy with his rhetoric on issues such as immigration, international relations and Islam, and many have argued his presence in the White House has damaged the office of President and America's standing in the world. But these issues are cultural not economic, and do not pose the same risks to investors as they do to the neo-liberal institutions of the free press. Indeed, with regard to issues of taxation and regulation, Trump has followed a traditional Republican pro-business agenda, which has almost unarguably helped to support the US equity market and risk assets more broadly.

However, from an economic perspective it has been argued by many that the fiscal stimulus (tax cuts) package came at precisely the wrong point in the economic cycle, and will only increase the severity of the inevitable recession that will come at the end of this period of economic expansion. In addition, one area where there has been understandable concern around Trump's agenda is on trade, and in particular, the actions he has taken based on his view that international trade is a zero sum game, and a large trade deficit (e.g. with China or the European Union) means that America is "losing" from the relationship.

Trump, with his slogan of "America First", has been consistent in his disdain for multi-lateral trade deals, calling NAFTA the "worst trade deal ever" and withdrawing from the Trans-Pacific Partnership. Part of his attraction as a candidate to those in the "rust belt" states that were critical to his election was the fact he sought to defend those who had lost their jobs as a result of the march of globalisation.

Despite Trump being Trump, many conservatives have been surprised by the extent to which he has been willing to use tariffs to provoke America's trade partners into taking action to correct the imbalances he believes to exist, hurting the economic interests of all involved. In 2018, Trump has slapped tariffs on billions of dollars' of goods from China, the EU, Canada and Mexico (who have largely responded in kind). It may be this is purely presentational, and he has gained some headlines from apparent "wins" through paper concessions and the desire to move to a "fairer" relationship (e.g. from Jean-Claude Juncker), but he does truly appear to believe that America is treated deeply unfairly by its trading partners. While Trump has a point about intellectual property theft, his central complaint that the US's large trade deficit is evidence that China is taking advantage of the US is false. A country's current account deficit/surplus is the result of a country's savings and investment imbalance and is not due to tariffs or other impediments to trade. China's overall current account surplus has come down sharply over recent years, and some expect China to be in overall balance in a few years.

The probability of an all-out trade war (e.g. punitive tariffs on 100% of goods traded between America and China) is difficult to assess, but clearly this would have a negative impact on the world economy. It may already be weighing on emerging market countries that have benefited from trade liberalisation. One defence against a full trade war is that no-one around the President appears to believe it would be good for the American people; although he can act unilaterally at times, he does rely on the input of those around him with more technical expertise. In addition, the negative impact of tariffs being implemented (e.g. on consumer goods such as iPhones) would be felt by American consumers swiftly, which would likely hurt public support for his policies and lower his approval ratings further.

Of course, the key issue is whether Trump will serve his full term. It is not a great position to be in for a President when reputable news sources are genuinely debating whether he has the ability to pardon himself, and whether he is therefore “above the law”. Unfortunately for Trump, while the founding fathers were very keen to ensure independence of the Executive from the Legislature, there are built in checks and balances that mean there is a chance he is removed as President.

The on-going special counsel investigation headed by Robert Mueller on potential Russian interference in the 2016 election has taken some interesting turns, but none more intriguing than the indictment of Trump’s former lawyer Michael Cohen for charges related to the payment of “hush money” to women with whom Trump allegedly had affairs. If it is proven that these payments were made at the direction of Trump, there is precedent to suggest this can be interpreted as an illegal campaign payment which would be a violation of federal law. Such lawbreaking – compared with, say, committing murder or treason – may not be sufficient to warrant impeachment or removal, but could cause a constitutional crisis (Trump, unlike Nixon, is unlikely to “jump” before he is “pushed”).

In terms of the mechanics, impeachment of a sitting President requires a simple majority in the House of Representatives but a two-thirds majority in the Senate. While the Republicans currently hold the House, it is widely expected that they could lose control in the mid-term elections in November, and if this occurs such impeachment proceedings are virtually guaranteed to be bought to the House at some point. While it still seems very unlikely that enough Republicans would turn against Trump for a two-thirds majority in the Senate, the scenario where Trump is held responsible for losses in the mid-term elections and an escalating trade war begins to affect the economy is not implausible. The recent “Op-Ed” scandal, where it is alleged that a member of the cabinet wrote an anonymous article for the New York Times suggesting that discussions were being held regarding invoking the 25th Amendment to the Constitution, under which Trump would be deemed “unfit to serve”, might be appealing both to Mr Pence and the Cabinet at times, but it would undoubtedly spark a political and constitutional crisis. One could also imagine mass protests from Mr Trump’s base.

While the future of the President is of interest to many, it is not clear what the economic or market impact might be. Mike Pence is ultra-conservative on social and most economic issues, but his congressional track record suggests he is in favour of free trade. So, with Trump gone, would the prospect of a trade war evaporate? Or, would Pence continue with Trump’s policies to secure Trump’s core vote, in order to propel him into a second term?

The real political risk of the Trump presidency is that the US continues down the path of isolationism, which is what “America First” is really about. History teaches us that American politics lurches between isolationism and globalism on multi-decadal cycles. It would be ironic if China became the champion of multilateralism and free trade, but this is a possibility if “Trumpism” persists after Trump, as Reaganism long-outlived the former president.

For UK pension schemes, the risk of escalating trade wars is why the Trump saga is relevant. The shift to America First likely scuppers the hope of beneficial trade deals with the US, or other countries, after Brexit. As the Economist magazine has frequently pointed in various articles over the course of 2018, by bending the rules of the WTO (i.e. invoking “national security”), rejecting multilateralism, and ranting against all the institutions that have underpinned the Washington Consensus and neo-liberalism, Trump might leave an economic legacy which will be felt for decades after he is gone. Pence, if he follows his long held beliefs, could avert this outcome.

WHAT CAN WE DO?

Whatever unfolds over the remainder of 2018 and beyond, the key point about political risk is that “big things” lie ahead. Just as politics in the UK and Europe have been changed by Brexit, and the surge in support for so-called “populist” movements, the Trump presidency has changed politics in the birthplace of the Washington Consensus and neo-liberalism. It might not be too late for this trend to reverse, but such a reversal needs to happen soon. Momentum in political thinking is a powerful thing, irrespective of whether the “elites” think it is sensible or not.

In a world of rising tariffs, other beggar-thy-neighbour policies, more restrictive immigration and unilateralism, we all get poorer. This is not speculation: history teaches us that trade and free movement of resources produces stronger growth, and rising wealth. The reverse does the opposite. More importantly, in a global financial system more complex than it has ever been, policies which restrict economic flows will ultimately have profound and potentially rapid effects on financial flows. This has not happened yet; but then neither has Brexit or a full-blown trade war.

Many Trustees and sponsors dedicated time in 2016 to considering the potential impact of Brexit and the US election on funding and investment strategy, both before and after the events took place. However, the fact is that in 2016 we could only guess at what would happen, whereas now we have a clearer view of the potential outcomes and their implications, make this more urgent. “Contingency plans” may need to become “actions” in the short-term, let alone the medium term.

At a minimum, we would recommend that Trustees seek to undertake or revisit scenario analysis and stress testing of their portfolios, in light of the most up to date information. This is especially relevant for those running material market risk (e.g. with large equity portfolios), or with particular concentrations to the UK and US markets.

Perhaps more importantly, we recommend that Trustees consider the viability of their sponsor covenant under different scenarios, particularly for schemes where there could possibly be a high correlation between demands on the covenant (i.e. risks of higher deficits) and weakness of the sponsoring employer. It is likely that most sponsors are already undertaking detailed assessments of the impact of Brexit on their business and making contingency plans. Trustees should be seeking access to such assessments and plans. Failing that, the analysis which has been produced on the Brexit impact on different sectors is publicly available, and the (somewhat rudimentary) papers on the impact and potential mitigations under a “no deal” scenario are currently being issued by the government.

Important Notices

References to Mercer shall be construed to include Mercer LLC and/or its associated companies.

This contains confidential and proprietary information of Mercer and is intended for the exclusive use of the parties to whom it was provided by Mercer. Its content may not be modified, sold or otherwise provided, in whole or in part, to any other person or entity, without Mercer's prior written permission.

The findings, ratings and/or opinions expressed herein are the intellectual property of Mercer and are subject to change without notice. They are not intended to convey any guarantees as to the future performance of the investment products, asset classes or capital markets discussed. Past performance does not guarantee future results. Mercer's ratings do not constitute individualised investment advice.

Information contained herein has been obtained from a range of third party sources. While the information is believed to be reliable, Mercer has not sought to verify it independently. As such, Mercer makes no representations or warranties as to the accuracy of the information presented and takes no responsibility or liability (including for indirect, consequential or incidental damages), for any error, omission or inaccuracy in the data supplied by any third party.

This does not constitute an offer or a solicitation of an offer to buy or sell securities, commodities and/or any other financial instruments or products or constitute a solicitation on behalf of any of the investment managers, their affiliates, products or strategies that Mercer may evaluate or recommend.

For the most recent approved ratings of an investment strategy, and a fuller explanation of their meanings, refer to your Mercer representative and/or for MercerInsight subscribers, see www.mercerinsight.com, as appropriate.

For Mercer's conflict of interest disclosures, contact your Mercer representative or see www.mercer.com/conflictsofinterest

HEALTH WEALTH CAREER

FROM QE TO QT

BUILDING ROBUST PORTFOLIOS

OCTOBER 2018

WHERE HAVE WE COME FROM?

The reaction of the monetary authorities to the global financial crisis of 2008 and 2009 was to put in place extraordinary monetary policies with the explicit aim of avoiding both a downward spiral in economic activity and price deflation. These policies included record low short-term interest rates and central bank asset purchases (known as "quantitative easing" or QE) as well as other measures to provide liquidity to the banking sector.

These policies worked. The potential downward spiral in world economies was averted and deflation was avoided. The policies also fueled an exceptional boom in asset prices generally. The current bull market was kick-started by low interest rates feeding through to higher asset prices through the discount rate effect. Thereafter, the increased confidence of markets that central banks would "do whatever it takes" together with a long, drawn-out and gradual upswing in economic growth saw asset prices driven to new highs in a bull market that is approaching its 10th anniversary.

As these extraordinary monetary policies were put in place, there was a widespread expectation that they would ultimately be inflationary (a reasonable assumption in that they were explicitly seeking to counteract deflationary forces). However, meaningful price inflation has not, as yet, resulted from these policies — although we have witnessed substantial asset price inflation in a number of asset markets. Only now, after nearly 10 years, are there modest signs of an inflationary upturn in consumer prices — in the US, for example — and these can be attributed to the strength of the real economy feeding through to the labor and commodity markets, rather than there being a direct causal link with QE itself.

WHERE ARE WE NOW?

The era of extraordinary monetary policies is coming to an end. Globally, monetary policy has started to turn less stimulative as major central banks are planning to gradually remove their support. The Fed is likely to raise the overnight lending rate to near 2.5% by the end of 2018 and to over 3% by the end of 2019. We expect other central banks to cease or scale back their asset purchases and, eventually, consider increasing policy rates.

EXHIBIT 1: QUANTITATIVE EASING BECOMES QUANTITATIVE TIGHTENING

Source: Fed, ECB, BoJ, BoE, JPMorgan.

WHAT HAPPENS NEXT?

How might this shift in policy feed through to asset markets, and how might portfolios be shaped to both reduce downside risk exposures and capture profitable investment opportunities?

At one level, we don't know because just as those extraordinary monetary policies have not been put in place before, neither have they been "unwound" before. However, we do have past experience of previous monetary policy cycles, when policymakers attempted to slow the pace of economic expansion and reduce the risk of inflation accelerating.

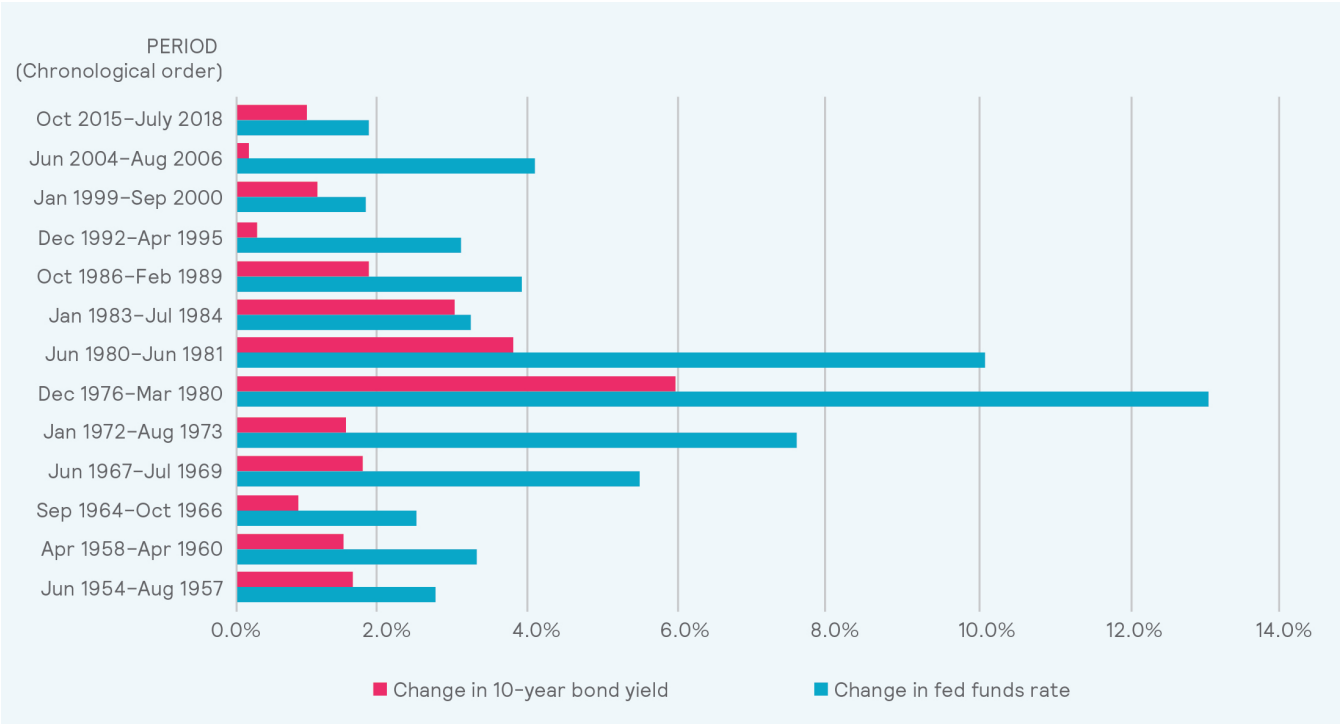
In the next section ("How Does Monetary Tightening Impact Asset Returns?"), we have set out our thoughts on how this changing policy environment might affect the returns from individual asset classes, based on the "rising rate" phase of previous economic cycles. In the following sections, we look at portfolio construction in more holistic terms and suggest some actions that might be taken.

HOW DOES MONETARY TIGHTENING IMPACT ASSET RETURNS?

Much depends upon the speed at which monetary policy is tightened. The normal pattern of a policy tightening is for short rates to be increased in steps in order to counteract rising inflationary pressures in an economy that is considered to be growing too fast. This tightening aims to slow growth sufficiently to "choke off" inflationary pressures. Hence, the policy action of higher rates is generally followed, sometime later, by a reaction of slowing growth in the economy.

The extent to which higher short-term rates are coincident with increasing longer-term bond yields depends on market expectations for longer-term inflation and how these are changed by the policy action being taken. Using the US as a case study, the chart below shows that in the past, when the Federal Reserve has increased short-term rates, longer-term bond yields have also generally increased, albeit to a lesser extent.

EXHIBIT 2: FED FUND RATES AND BOND YIELDS DURING RISING RATE PERIODS



Source: Federal Reserve Bank of St Louis, Robert Shiller; Yale School of Management.

RISKS AND IMPLEMENTATION

Since the global financial crisis, longer-term bond yields have arguably not reflected the ongoing environment of economic growth and inflation, being depressed by both the persistently low levels of short rates and asset purchases under QE programs. However, with short-term interest rates on the rise and the ending of asset purchases under the QE program, it may be reasonable to expect longer-term interest rates to also rise as demand for longer-term bonds falls.

How longer dated bond yields react will therefore be a function of the upward pressure from increased supply of these bonds to the market (QT), and the upward or downward pressure that will be exerted by how the market transforms these policies into expectations of future inflation and growth. The ending of QE could also be expected to encourage a widening of credit spreads as non-government bonds have formed a material part of the asset purchase program (especially in Europe).

A period of rising short rates, rising bond yields and widening credit spreads seems to be a plausible, if daunting, scenario — therefore we should begin to consider how asset markets will behave in this environment.[1]

A period of rising short rates, rising bond yields and widening credit spreads seems to be a plausible, if daunting, scenario.

[1] We discuss current credit cycle dynamics and their portfolio implications in more detail in a paper entitled "Preparing for Late Cycle Dynamics."

THOUGHTS ON ASSET CLASSES

BONDS AND BOND-LIKE ASSETS

Non-government or credit bonds might be expected to perform worse than government bonds of similar duration if the expectation that the QE to QT transition results in credit spreads widening is borne out in practice.

One reason for this expectation is that QE has included the buying of credit assets (in Europe, for example), and therefore QT might reverse this. Equally, in scenarios of strong economic growth in the latter stages of the credit cycle, credit spreads will tighten as the market demands more and more credit as companies' finances improve. Given these conflicting arguments, the outlook for credit markets is highly uncertain, but with credit spreads remaining reasonably tight in a historical context, our global dynamic asset allocation view remains underweight at the time of writing.

It is likely that, if there is a general increase in bond yields and provided inflation is not seriously out of control, inflation-linked bond real yields could also be expected to rise despite not featuring in QE purchases (in the way that they have fallen as nominal yields have fallen, in the last few years, while inflation has remained modest).

So sovereign bonds and credit bonds, fixed interest and inflation-linked, might all be expected to struggle in this environment of rising rates and yields (absent a downward shock in growth or an upward shock in inflation). But there are also bond-like assets which pay a floating (rather than fixed) rate of interest (usually based on LIBOR or equivalent) which should be less vulnerable to, and even benefit from, a rise in underlying rates.

Floating rate notes (such as bank loans) are the obvious choice, but most private debt instruments are also structured as floating rates (albeit with a floor that may be above current LIBOR rates) and the returns from these should also increase to reflect higher headline rates. The challenge is whether higher interest costs will "press the brake too hard," leading the economy into recession, putting leveraged companies under increased financial stress, feeding through to more debt defaults and, ultimately, capital losses from the higher rates.

Absolute return bond funds have grown to become sizable players in the fixed income market in the last few years. In theory, these funds, which are targeting modest positive absolute returns in all market environments, should be a safe haven in a rising interest rate environment. They aim to have a neutral position of zero interest rate duration so, in theory, rising yields need not be a headwind. Currencies always offer the possibilities of positive returns (they can't all go down together), as well as short interest rate positions, floating rate instruments, volatility trading, short dated bonds and those bonds where other fundamentals outweigh the impact of the general upward move in yields and spreads (for example, some emerging market debt).

The absolute return bond fund manager does have access to a wide range of sources of return, but effective reading of the market, as well as skill and conviction in positioning the portfolio, will be necessary to deliver target levels of return. And if inflation does pick up meaningfully, this would be a headwind for these funds as "absolute" returns may be very low (or even negative) in real terms.

LEVERAGED ASSETS

If funds with embedded interest rate duration and exposure to credit spreads are in the "firing line" when it comes to an environment of QT, then assets with leverage (assuming the leverage is a variable rate) will also be exposed. Both assets and funds that rely on leverage to generate returns are likely to be adversely affected by rising rates. Some real estate funds incorporate leverage to increase returns; unless this leverage is fixed and long term in nature, future returns will be impaired by rising rates.

Some assets are much more sensitive to the rising rates of leverage than others, such as heavily geared companies (which might have above-average representation in smaller cap or "value" equity portfolios). Portfolio structures that incorporate leverage (such as risk parity strategies) should also be reviewed to assess whether they are robust in an environment of rising rates (and yields). Leveraged liability-matching portfolios should be stress-tested to understand the potential effect of higher rates and yields on collateral requirements.

Sectors and companies where financial and operational leverage are both high are expected to be exposed to high rates and the likely slowdown in growth.

EQUITY PORTFOLIOS

Equity portfolios, where valuations are generally already relatively high, would be expected to react unfavorably if there is a move in rates and/or bond yields that is sufficient to be considered restrictive to growth, with both the "discount rate" effect and the anticipation of a slowdown in future growth having an impact. The effect would likely be different across the range of sectors, stocks and styles of management, as well as across different regions.

Sectors and companies where financial and operational leverage are both high are expected to be exposed to high rates and the likely slowdown in growth. For some stocks and sectors, the customer base is also likely to be highly interest rate sensitive. Brick-and-mortar stores, for example, that are already having a hard time competing with online retailers, could be impacted as shoppers find it more expensive to borrow and fund spending.

Systematic low volatility equity portfolios are often flagged as being likely to suffer from rising rates, although it is not clear to us that this relationship would always hold.[2] Other defensive equity strategies (such as strategies with a bias to defensive quality), if they are constructed of businesses that have low financial and operational leverage, could be expected to be relative gainers in a weak equity market if that weakness is driven by higher interest rates and lower growth.

[2] This issue was explored in more detail in a recent paper, "Low Volatility Equities – Time to Leave the Party?" available at https://www.mercer.com/content/dam/mercer/attachments/private/nurture-cycle/gl-2018-wealth-low-volatility-equities-time-to-leave-the-party-mercer.pdf

HOW SHOULD PORTFOLIOS BE POSITIONED?

As we have emphasized earlier, we don't have all the answers. The degree of uncertainty is high because there is little precedent for the policy environment that we may be entering.

Uncertainty is high, volatility has picked up (since the start of 2018) and downside risks have probably increased. This environment does not appear to be one in which there is the opportunity for particularly strong asset class returns, offering compensation for higher uncertainty. So the risk/reward trade-off appears to have deteriorated.

The most important question to be asked in terms of portfolio construction and dynamic asset allocation becomes, "Is the right amount of risk being taken, being mindful of the asset returns likely to be available?"

So the first and most important step in reviewing portfolio construction is to ensure that the risk/return balance is appropriate. Holding assets with significant exposure to market risks, or "beta," has generally been well-rewarded in recent years — it could well be that the riskiness of these assets (the likelihood of downside outcomes) has gone up, but this has not been offset by an increase in the likelihood of stronger returns.

In light of a more cautious view on the risk/return trade-off over the medium term, there could be an improved case for a reduction in growth asset allocations in favor of low-risk assets. Such low-risk assets would be unlikely to be "ordinary" bonds, unless used for liability or cashflow matching. Less volatile assets generally, even cash or funds with an embedded lack of exposure to market direction, such as hedge funds and other liquid alternatives, may be particularly worth considering at this unusual time.

It is likely to make sense to avoid leverage wherever possible, and to understand (and limit) exposures to interest rate duration that are not specifically hedging an equivalent liability. Portfolio structures that incorporate leverage (such as risk parity strategies) should also be reviewed to assess whether they are robust in an environment of rising rates (and yields). Leveraged liability-matching portfolios should be stress-tested to understand the potential effect of higher rates and yields on collateral requirements.

Private market assets were excluded from QE buying programs, and may look attractive in the current environment as a result, since they are therefore unlikely to be directly impacted by QT — particularly where leverage remains at conservative levels.

As always, we would advocate maintaining an equity portfolio with a diverse mix of style exposures. It may be worth trying to understand the interest rate sensitivity of the total equity portfolio, and whether sufficient exposure to defensive equities has been incorporated in the structure.

The real winners are likely to be strategies with inherent negative correlation to interest rates and equities, the "purest" of which are specific protection strategies.

In an environment of rising rates, yields and widening credit spreads, which is likely to be tough for many asset classes and portfolios, it is much easier to spot those assets with the potential to be adversely affected than to find a wide range of assets that will be relative beneficiaries of QT. The real winners are likely to be those strategies with inherent negative correlation to interest rates and equities, the "purest" of which are specific protection strategies.

There may be relatively few places where it will be possible to "hide" and certainly few where strong positive returns are likely to be available. We should perhaps be grateful for the long bull market that most asset classes have experienced since 2009 and be moderate in our expectations for medium-term gains from here.

CONCLUSION

We believe we are at a stage where, as QE becomes QT, an environment of rising rates, rising yields and widening credit spreads is a distinct possibility. This is likely to be an environment of heightened investment risks but without higher expected asset returns to compensate for these risks. This makes a review of portfolio structure important, first assessing the overall portfolio's likely risk/return characteristics against appetite for risk in this environment, and second, considering the appropriateness of reducing the exposure to return-seeking assets in favor of lower-risk assets, being mindful of the different range of assets that fall into this lower-risk category, at this stage of the economic cycle.

References to Mercer shall be construed to include all associated companies.

The findings, ratings and/or opinions expressed herein are the intellectual property of Mercer and are subject to change without notice. They are not intended to convey any guarantees as to the future performance of the investment products, asset classes or capital markets discussed. Past performance does not guarantee future results. Mercer's ratings do not constitute individualized investment advice.

Information contained herein has been obtained from a range of third party sources. While the information is believed to be reliable, Mercer has not sought to verify it independently. As such, Mercer makes no representations or warranties as to the accuracy of the information presented and takes no responsibility or liability (including for indirect, consequential or incidental damages) for any error, omission or inaccuracy in the data supplied by any third party.

This does not constitute an offer or a solicitation of an offer to buy or sell securities, commodities and/or any other financial instruments or products or constitute a solicitation on behalf of any of the investment managers, their affiliates, products or strategies that Mercer may evaluate or recommend.

For the most recent approved ratings of an investment strategy, and a fuller explanation of their meanings, contact your Mercer representative.

For Mercer's conflict of interest disclosures, contact your Mercer representative or see www.mercer.com/conflictsofinterest.

Mercer's universes are intended to provide collective samples of strategies that best allow for robust peer group comparisons over a chosen timeframe. Mercer does not assert that the peer groups are wholly representative of and applicable to all strategies available to investors.

Bath & North East Somerset Council

Access to Information Arrangements

Exclusion of access by the public to Council meetings

Information Compliance Ref: LGA 1848/18

Meeting / Decision: Avon Pension Fund Investment Panel
Date: 12th November 2018

Author: Liz Woodyard
Exempt Report Title: Diversified Growth Funds update

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 exempt 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 Panel 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 report 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 would 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 Panel 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 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

This page is intentionally left blank

Bath & North East Somerset Council

Access to Information Arrangements

Exclusion of access by the public to Council meetings

Information Compliance Ref: 1812/18

Meeting / Decision: AVON PENSION FUND INVESTMENT PANEL
Date: 12th November 2018

Author: Nathan Rollinson
Exempt Report Title: Cash Management – Exchange-Traded Fund Solution Exempt Appendix 1 – Mercer Paper: Exchange-Traded Funds – An Effective Tool for Implementation Exempt Appendix 2 – Potential Portfolio Solutions: BlackRock Liquid Beta Sleeve

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 exempt report and appendices 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 Panel 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 report and appendices contain 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 Panel 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 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

This page is intentionally left blank

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

Document is Restricted

This page is intentionally left blank

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

Document is Restricted

This page is intentionally left blank

Bath & North East Somerset Council		
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**	
MEETING DATE:	**12 November 2018**	**AGENDA ITEM NUMBER**
TITLE:	**Brunel Pension Partnership – Update on pooling**	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
List of attachments to this report: Exempt Appendix 1 – Passive Equities Transition Report (Brunel) Exempt Appendix 2 – Passive Equities Transition Report (Analytics) Exempt Appendix 3 – Portfolio Selection Report Exempt Appendix 4 – Fee savings update Exempt Appendix 5a – Project plan for transition of Avon's assets to Brunel portfolios Exempt Appendix 5b – Risk Register for transition of Avon's assets to Brunel portfolios		

1 THE ISSUE

1.1 This report outlines the progress on pooling of assets with specific reference to the investment activities.

1.2 Brunel's transition plan is monitored by the Client Group Investment sub-group on a regular basis.

1.3 The Avon Risk Register for the transition of its assets to Brunel is included as an appendix.

1.4 A verbal update will be provided at the meeting.

2 RECOMMENDATION

That the Panel:

2.1 **Notes the progress made on pooling of assets.**

2.2 **Notes the project plan for the transition of assets.**

3 FINANCIAL IMPLICATIONS

3.1 The fees that Avon will pay to Brunel are included in the budget for 2018/19. They have been calculated in line with the pricing policy that was agreed for 2018/19. As this is a year of transition, the fees are based on a mixture of equal1/10ths and AUM. In later years a greater element of costs will be paid via portfolio fees.

4 PROGRESS UPDATE

4.1 **Investments:**

a) The transition reports for the passive equity portfolios are in Exempt Appendices 1 & 2. The Brunel Report sets out the full outcome. Inalytics advised Brunel on the transition and provides external validation of the costs.

b) The tender process to select managers for the Active UK Equity portfolio and Low Volatility Global Equity portfolio is now complete. The Selection paper for the UK Equity Portfolio is in Exempt Appendix 3.

Avon is transitioning its active UK Equity assets into the UK Equity Portfolio. Mercer has confirmed that this will meet our strategic objective.

c) The Client Group and Brunel are finalising the process for monitoring the transition process for each portfolio to ensure the process is in line with Brunel policies. They are also developing the process for monitoring the portfolios once into Business as Usual.

4.2 An update of the fee savings achieved to date from the Brunel Portfolios is included in Exempt Appendix 4.

4.3 Avon's project plan for the transition of its assets (see Exempt Appendix 5a) which is based on Brunel's current timeline for transitioning the assets has been updated. The timing of transitioning of assets is continuously reviewed by Brunel and the Client Group to ensure Client priorities are considered. Actual timing will depend on a number of considerations including the complexity of each transition and market conditions. Please note that this plan only includes the portfolios relating to Avon mandates; additional portfolios will be established along the same timelines.

4.4 Avon's project plan includes a Risk Register (see Exempt Appendix 5b) of risks specific to the transition for Avon.

5 RISK MANAGEMENT

5.1 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.

6 EQUALITIES

10.1 An equalities impact assessment is not necessary.

7 CONSULTATION

7.1 N/a

8 ISSUES TO CONSIDER IN REACHING THE DECISION

8.1 Report is for noting only.

9 ADVICE SOUGHT

9.1 The Council's Section 151 Officer has had the opportunity to input to this report and have cleared it for publication.

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

This page is intentionally left blank

Bath & North East Somerset Council

Access to Information Arrangements

Exclusion of access by the public to Council meetings

Information Compliance Ref: LGA 1862/18

Meeting / Decision: Avon Pension Fund Investment Panel
Date: 12th November 2018

Author: Liz Woodyard
Report Title: Brunel Pension Partnership – Update on pooling List of Exempt attachments to this report: Exempt Appendix 1 – Passive Equities Transition Report (Brunel) Exempt Appendix 2 – Passive Equities Transition Report (Analytics) Exempt Appendix 3 – UK Equity Portfolio Selection Report Exempt Appendix 4 – Fee savings update (to follow) Exempt Appendix 5a – Project plan for transition of Avon's assets to Brunel portfolios Exempt Appendix 5b – Risk Register for transition of Avon's assets to Brunel portfolios

The Appendices to the Report contain 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 Exempt appendices 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 Panel 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 appendices contain 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 would 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 Panel 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

This page is intentionally left blank

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

Document is Restricted

This page is intentionally left blank

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

Document is Restricted

This page is intentionally left blank

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

Document is Restricted

This page is intentionally left blank

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

Document is Restricted

This page is intentionally left blank

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

Document is Restricted

This page is intentionally left blank

Bath & North East Somerset Council		
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**	
MEETING DATE:	**12 November 2018**	**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 1Q20. The workplan is provisional as the Panel will respond to issues as they arise and as work is delegated from the Committee.

2 RECOMMENDATION

That the Panel:

2.1 **Notes the Panel 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	Proposed agenda
February 2019 (extended meeting)	• Review performance • Transition of assets - plan update • Review policies/options ahead of Strategic review • Review Private Market commitments to Brunel portfolios (by 31 March 20189)
May 2019	• Cancel due to elections
September 2019 (extended meeting)	• Review performance • Transition of assets - plan update • Introduce Brunel Client reports for assets managed by Brunel • Consider options for Equity protection and LDI strategies given 2019 valuation market levels • Implementation considerations from strategic review
November 2019	• Review performance • Transition of assets - plan update • Agree future strategy for equity protection and LDI post strategic review workshops • Implementation considerations from strategic review
February 2020	• Review performance • Transition of assets - plan update • Implementation considerations from strategic review • Agree Private Market commitments to Brunel portfolios (by 31 March 2020)

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.

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

5 RISK MANAGEMENT

5.1 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.

6 EQUALITIES

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

7 CONSULTATION

7.1 N/a

8 ISSUES TO CONSIDER IN REACHING THE DECISION

8.1 This report is for information only.

9 ADVICE SOUGHT

9.1 The Council's Section 151 Officer has 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	

This page is intentionally left blank