

# Avon Pension Fund Committee Investment Panel

**Date: Wednesday, 27th February, 2019**

**Time: 2.00 pm**

**Venue: Kaposvar Room - 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**

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## 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. We request that those filming/recording meetings avoid filming public seating areas, children, vulnerable people etc; however, the Council cannot guarantee this will happen.

The Council will broadcast the images and sounds live via the internet [www.bathnes.gov.uk/webcast](http://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 - Wednesday, 27th February, 2019**

**at 2.00 pm in the Kaposvar Room - 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 (Pages 5 - 8)
8. BRUNEL PENSION PARTNERSHIP - UPDATE ON POOLING (Pages 9 - 56)
9. DRAFT PLAN 2019 STRATEGIC REVIEW (Pages 57 - 62)
10. PRIVATE DEBT - ASSET CLASS UPDATE (Pages 63 - 78)
11. REVIEW OF INVESTMENT PERFORMANCE FOR PERIODS ENDING 31 DECEMBER 2018 (Pages 79 - 198)
12. WORKPLAN (Pages 199 - 202)

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.

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

## AVON PENSION FUND COMMITTEE INVESTMENT PANEL

### Minutes of the Meeting held

Monday, 12th November, 2018, 2.00 pm

**Members:** Councillor Patrick Anketell-Jones (Chair), Councillor David Veale, Councillor Rob Appleyard, Pauline Gordon and Shirley Marsh

**Advisors:** Steve Turner (Mercer) and Ross Palmer (Mercer)

**Also in attendance:** Tony Bartlett (Head of Business, Finance and Pensions), Liz Woodyard (Investments Manager) and Nathan Rollinson (Assistant Investments Manager)

#### 24 EMERGENCY EVACUATION PROCEDURE

The Democratic Services Officer advised the meeting of the procedure.

#### 25 DECLARATIONS OF INTEREST

There were none.

#### 26 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

Apologies were received from Councillor Mary Blatchford.

#### 27 TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

There was none.

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

There were none.

#### 29 ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

There were none.

#### 30 MINUTES: 10 SEPTEMBER 2018

The public and exempt minutes of the meeting of 10 September 2018 were approved as a correct record and signed by the Chair.

#### 31 REVIEW OF INVESTMENT PERFORMANCE FOR PERIODS ENDING 30 SEPTEMBER 2018

The Assistant Investments Manager presented the report and summarised the key information.

Mr Turner presented the Mercer Performance Monitoring Report. He drew attention to Unigestion's stellar outperformance during the period; they had made excellent

returns in a falling market because their low volatility approach favours stocks that did well in that environment.

Before considering 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 section 100(A)(4) of the Local Government Act 1972, that the public should be excluded from the meeting for the consideration of this report, 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 the Panel had returned to open session, Mr Turner presented three Mercer papers: “Is there a Bear Market on the Horizon?”, “Political Risk: ‘Big Things’ lie ahead” and “From QE to QT”.

Members noted Mercer’s view that there would be a higher volatility environment for some time. The Head of Business, Finance and Pensions agreed that the political dynamics of an increase in nationalism and populism were likely to cause high volatility into the next valuation, and it would be difficult to assess the likely impact on economic growth. Incorporating the right balance between investment growth and liquidity into the strategy would be a challenge.

The Chair asked how the review of the investment strategy would be co-ordinated with the transition to Brunel. The Investments Manager replied that the review of strategy will have to take into account the timeline of the Brunel transition. The new strategy would take some time to implement. If a suitable Brunel portfolio did not exist to enable the Fund to implement part of its strategy, she would want to start discussions with them as soon as possible.

A Member said that the Panel had noted that sometimes the approach of one manager complemented that of another. She wondered how that kind of linkage could be implemented through Brunel. The Investments Manager replied that this can be done through Brunel; their proposed UK equities portfolio, for example, contains managers of quite contrasting styles. Brunel can tweak the allocation between the different managers in a portfolio depending on their view of the market and how each managers style will perform in that environment; this is an important means by which pooling can add value over the longer term.

**RESOLVED** to note the information as set out in the reports.

## **32 DIVERSIFIED GROWTH FUNDS UPDATE**

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 Schedule 12A of the Act as amended.

After discussion the Panel **RESOLVED** to approve the officer recommendations with amendments.

**33 CASH MANAGEMENT - EXCHANGE-TRADED FUND SOLUTION**

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 Schedule 12A of the Act as amended.

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

**34 UPDATE ON POOLING OF ASSETS**

The Investments Manager presented the report.

Before considering the appendices 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 Schedule 12A of the Act as amended.

After discussion the Panel **RESOLVED** to note:

- 1. the progress made on the pooling of assets;
- 2. the project plan for the transition of assets.

**35 WORKPLAN**

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

The meeting ended at 4.10 pm

Chair(person) .....

Date Confirmed and Signed .....

**Prepared by Democratic Services**

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## Access to Information Arrangements

### Exclusion of access by the public to Council meetings

Information Compliance Ref: 297/19
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Meeting / Decision: Avon Pension Fund Investment Panel
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Date: 27 <sup>th</sup> February 2019
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Author: Liz Woodyard
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<b>Report Title: Brunel Pension Partnership – Update on pooling</b>
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<b>List of attachments to this report:</b>
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Exempt Appendix 1 – Emerging Markets Equities Paper Exempt Appendix 2 – Global High Alpha Equities paper Exempt Appendix 3 – LDI paper Exempt Appendix 4a – Project plan for transition of Avon's assets to Brunel portfolios Exempt Appendix 4b – Risk Register for transition of Avon's assets to Brunel portfolios
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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:
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3. <i>Information relating to the financial or business affairs of any particular person (including the authority holding that information).</i>
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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.

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Bath & North East Somerset Council		
MEETING:	AVON PENSION FUND INVESTMENT PANEL	
MEETING DATE:	27 February 2019	AGENDA ITEM NUMBER
TITLE:	Draft Plan 2019 Strategic Review	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
List of attachments to this report:		
Exempt Appendix 1 – Draft Plan		

## 1 THE ISSUE

- 1.1 The Investment Strategy is designed to meet the long term funding objective, which is to generate returns to meet the Fund liabilities with an appropriate level of risk. It also has to ensure that employer contribution rates are both affordable and stable over time.
- 1.2 In line with best practice the Fund periodically reviews its strategic policy in order to ensure the investment strategy can still deliver in line with the funding objective. The review in 2019 will reflect the outcome of the 2019 valuation and take into account the transition plan for pooling the Fund's assets in the Brunel Pension Partnership.
- 1.3 Fund officers are drafting the plan for the Strategic Review with Mercer, the Fund's advisor. The final plan will be presented to Committee at its March meeting. The draft plan is set out in Exempt Appendix 1. The Panel are asked to comment on the plan.

## 2 THE RECOMMENDATION

**That the Panel:**

- 2.1 Provides feedback on the draft plan.

## 3 FINANCIAL IMPLICATIONS

- 3.1 Estimated costs for the Strategic Review 2019 will be provided for in the 2019/20 budget (to be agreed at March 2019 Committee meeting).

## 4 DRAFT PLAN

- 4.1 The draft plan includes all aspects of the current strategy that need to be reviewed. This includes both asset allocation and risk management including the Fund's current equity protection strategy and its approach to managing the financial risks arising from climate change.

- 4.2 The draft plan includes a timetable for the review. The timing is affected by the Local elections in May 2019 which will affect the membership of the Committee. The plan allows time for sufficient introductory training for new members.

## **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 Are set out in the report.

## **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.

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

## **Access to Information Arrangements**

### **Exclusion of access by the public to Council meetings**

Information Compliance Ref: 296/19

Meeting / Decision: Avon Pension Fund Investment Panel

Date: 27<sup>th</sup> February 2019

Author: Liz Woodyard

**Report Title: Brunel Pension Partnership – Update on pooling**

**List of attachments to this report:**

Exempt Appendix 1 – Draft Plan

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 appendix 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 appendix contains commercially sensitive information, which if disclosed 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.

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Bath & North East Somerset Council		
MEETING:	AVON PENSION FUND INVESTMENT PANEL	
MEETING DATE:	27 February 2019	AGENDA ITEM NUMBER
TITLE:	Private Debt – Asset Class Update	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
Appendix 1 – Mercer Paper: Private Debt Asset Class Update		
Exempt Appendix 2 – Brunel Private Debt Portfolio Specification		

## 1 THE ISSUE

- 1.1 Opportunities to invest in Private Debt (PD) were recommended as a long term objective of the 2017 investment strategy review. As an asset class, PD is expected to generate attractive risk adjusted returns, earning an illiquidity premium and credit spread, that outstrips its publically traded equivalent, high yield debt. It is envisaged that PD may form one of the recommendations of the 2019 strategic review and this paper serves to provide Panel with an introduction to the asset class ahead of that review.
- 1.2 Increasing regulation and more stringent capital requirements following the global financial crisis have led to a retraction in bank loans to middle market companies. This has created an opportunity for unconventional lenders, namely institutional investors, to fill the void and, in many cases, negotiate terms with borrowers directly. The increasing opportunity set is not without its risks, which are discussed in more detail below and in the Mercer Asset Class Update Paper at Appendix 1.
- 1.3 Brunel will be developing a dedicated Private Debt portfolio. The specification for this portfolio is included at Exempt Appendix 2.

## 2 RECOMMENDATION

**That the Panel:**

- 2.1 **Notes the information contained in the Report and Appendices**

## 3 FINANCIAL IMPLICATIONS

- 3.1 Costs associated with PD investing are typically higher than investing in liquid public debt markets given the extra due diligence that is required of managers. A managers ability to negotiate favourable loan terms or ‘covenants’ is a critical part of the investment process but adds a layer of complexity that increases fees.

- 3.2 As PD continues to attract investors there is evidence of downward pressure on management fees as funds compete for capital. Research by PREQIN in 2017 cites a record high of 324 PD funds (a 12% year-on-year increase) in the market seeking a combined \$153bn in capital commitments, which is indicative of both the demand in this asset class as well as the breadth of the opportunity set.
- 3.3 Average management fees for PD funds are at their lowest point across the last 10 years (PREQIN, 2017), with the average at 1.50%, compared to 1.75% the prior year. Management fees for PD funds have traditionally ranged from 1% to >2%, depending on level of risk and complexity of the underlying loans, where high levels of complexity can command a premium for management.
- 3.4 As competition for institutional capital remains high among PD funds, further fee contraction is not totally unexpected. That said, certain funds that specialise by industry or region for instance, are likely to continue to demand a relatively high premium.

#### **4 PRIVATE DEBT – ASSET CLASS OVERVIEW**

- 4.1 In its simplest form PD involves non-bank lenders (typically institutional investors) extending credit to unlisted middle-market companies. Middle market companies are defined as having earnings broadly in the range of \$20m-\$60m. In most cases the borrower will be owned by a private equity firm (sponsored) but could also be family- or management-owned (non-sponsored).
- 4.2 The return profile of PD funds varies widely as managers can invest across the whole capital structure. Senior debt represents the lowest risk as it is first to be repaid on default. Junior is moderately risky and is subordinate to senior debt, meaning it has a secondary claim on default of the borrower. Mezzanine<sup>1</sup> and distressed financing represents the highest risk/return profile.
- 4.2 Returns from PD assets are made up of exposure to credit risk and an 'illiquidity premium'. The illiquidity premium means an investment cannot easily be realised and, when subscribing to a fund, can often be subject to a lock-up period as fund managers look to deploy committed capital. In PD this premium is expected to add between 1.0%-1.5%% to returns. Additionally, PD is perceived as offering investors superior protections compared to traditional bonds. Managers can often customise loan terms with a borrower, building in strong covenants designed to minimise the risk of a company suffering a credit event.

#### **5 PRIVATE DEBT – FURTHER CONSIDERATIONS**

- 5.1 **Concentration risk:** Many PD strategies will be concentrated in a niche area, are less diversified and significantly smaller than traditional debt funds. Any allocation to this asset class should be well diversified across sector and region.
- 5.2 **Credit risk:** Given credit risk is a primary driver of returns in PD thorough due diligence needs to be undertaken both at an underlying loan level by the manager and at a fund selection level to identify the extent to which leverage is used for instance. Higher risk PD funds tend to be more exposed to any cyclical downturn in the market where default rates increase chance of loss.

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<sup>1</sup> Mezzanine debt is a hybrid of debt and equity and falls between senior secured debt and equity in a company's capital structure. Mezzanine debt structures are customised and negotiated between lenders and borrowers, making them considerably more illiquid than high-yield bonds and unsecured loans available to larger companies.

- 5.3 **Capacity:** With an increased level of demand from investors to access specialist PD funds, capacity constraints should be a consideration, where a large allocation may not be deployed immediately.

## **6 RISK MANAGEMENT**

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

## **7 EQUALITIES**

- 10.1 An equalities impact assessment is not necessary.

## **8 ISSUES TO CONSIDER IN REACHING THE DECISION**

- 8.1 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.

<b>Contact person</b>	Nathan Rollinson, Assistant Investments Manager (Tel: 01225 395357)
<b>Background papers</b>	Mercer Paper to Officers December 2018
<b>Please contact the report author if you need to access this report in an alternative format</b>	

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HEALTH WEALTH CAREER

# PRIVATE DEBT ASSET CLASS UPDATE

OCTOBER 2018



# ASSET CLASS OVERVIEW

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Private debt (sometimes referred to as private credit or direct lending) refers to loans that are privately negotiated between a lender and a borrower (as opposed to syndicated loans, also known as bank loans, where the bank negotiates the terms with the borrower and then syndicates the loan to 100+ investors, creating a semi-liquid tradeable market for the loan).

Private debt generally is broken into two broad categories: corporate and asset-backed. The asset-backed category is, in turn, broken into real estate, infrastructure and niche subcategories, such as aircraft lending.

Corporate private debt lending strategies can be broadly characterized as either cash-flow-based or asset-based. Cash-flow-based lending strategies dominate in terms of dollars committed and the number of investment options offered. The focal point of these strategies is the cash flow (EBITDA or adjusted EBITDA) of the borrower, and private debt funds are differentiated by a wide variety of criteria, including, for instance, by how deep in the capital structure a manager is willing to lend (for example, senior, junior or preferred equity).

These various private lending strategies are generally compared to non-investment grade syndicated leveraged loan and high-yield bond markets. The syndicated loans and bonds are rated and relatively liquid, whereas private loans are of similar credit quality (unrated, but typically B/BB equivalent, and can range wider depending on strategy) and provide both an illiquidity premium (100–500 basis points) and a stronger ability to drive outcomes if a loan's credit quality weakens.

Private loans range in duration from a few months to seven years, but typically the actual tenure of these loans is around three to five years, with some being repaid early, bringing the average life down to around three years. Although many variations are used, typically private debt fund structures have a two-to-four-year investment period followed by a two-to-four-year wind-down period.



# INVESTMENT RETURN UPDATE

Fund offerings are highly nuanced, vary by the level of leverage utilized to augment returns and reflect some mix of the following characteristics:



## PRIORITY OF LOAN

- Senior debt
- Junior debt
- Unitranche



## SIZE OF BORROWER

- Lower middle market
- Middle market
- Upper middle market



## OWNERSHIP OF BORROWER

- Sponsored
- Non-sponsored

### Explanations:

**Senior debt:** First lien. Generally provides up to 4.5x EBITDA in capital to the borrower. An exception would be loans to venture-stage companies (that is, venture lending), which are typically based on revenue rather than EBITDA.

**Junior debt:** Mezzanine and second lien. Generally provides additional debt capital to borrower (behind the first lien in priority) in a range of 4.5x–7.0x EBITDA. Second lien can be considered senior or junior capital (based on the actual legal rights of the tranche) but, in the main, should be considered junior debt.

**Unitranche:** These loans cover the entire debt needs of the borrower (senior and junior debt combined) and have elements of both senior and junior debt. Unitranche loans generally go as deep into the capital structure as junior debt (4.5x–7.0x EBITDA), but are importantly first lien in priority, as no debt tranche is in front of them.

**Lower middle market:** Companies that generate EBITDA ranging up to \$20 million annually.

**Middle market:** Companies that generate EBITDA in a range of \$20 million to \$60 million annually.

**Upper middle market:** Companies that generate EBITDA over \$60 million annually.

**Sponsored:** Companies owned by a professional private equity investment firm.

**Non-sponsored:** Companies owned by management or family owned businesses.

For example, some funds focus on first lien lending to sponsor-backed lower middle market companies, whereas other funds focus on mezzanine debt lending to upper middle market non-sponsored companies. Return objectives vary by strategy and the level of leverage utilized. Most private debt funds are unlevered outside the US, but when leverage is used it is typically 0.5x to 1.0x debt/equity (although some can use more leverage).

### US AND EUROPEAN APPROXIMATE CURRENT MIDDLE MARKET RETURNS

	US	EUROPE
	Effective yield*	
Senior first lien	6.50%–7.25%	7.00%–8.00%
Unitranche	8.00%–9.25%	8.00%–9.00%
Second lien	10.00%–11.50%	9.00%–11.00%
Subordinated	11.00%–13.00%	12.00%–14.00%

\* Assumes fee income of 2%–3% in the US and 3%–3.5% in Europe, three-month LIBOR of 2.3% in the US and GBP LIBOR of 0.5% in Europe. Assumes fees amortize over three years.

# OPPORTUNITY OUTLOOK

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In Europe, private senior lending began in earnest in the wake of the global financial crisis (GFC) as banks reduced their lending to middle market companies due to regulatory pressures and for strategic reasons. Many European-focused senior lending managers have track records of five years or less, and very few have track records of 10 years or more. The US private senior loan market (as well as the syndicated loan market) is more mature compared to Europe. US banks have been reducing their leveraged lending activities since the 1990s, and a number of senior private debt managers have 10-to-20-year track records.

Junior capital lending has a longer history in both Europe and the US compared to private senior debt. Mezzanine debt investing was pioneered by insurance companies, along with a very small number of private debt managers (both in Europe and the US), beginning in the early 1990s and has been an important private debt niche ever since.

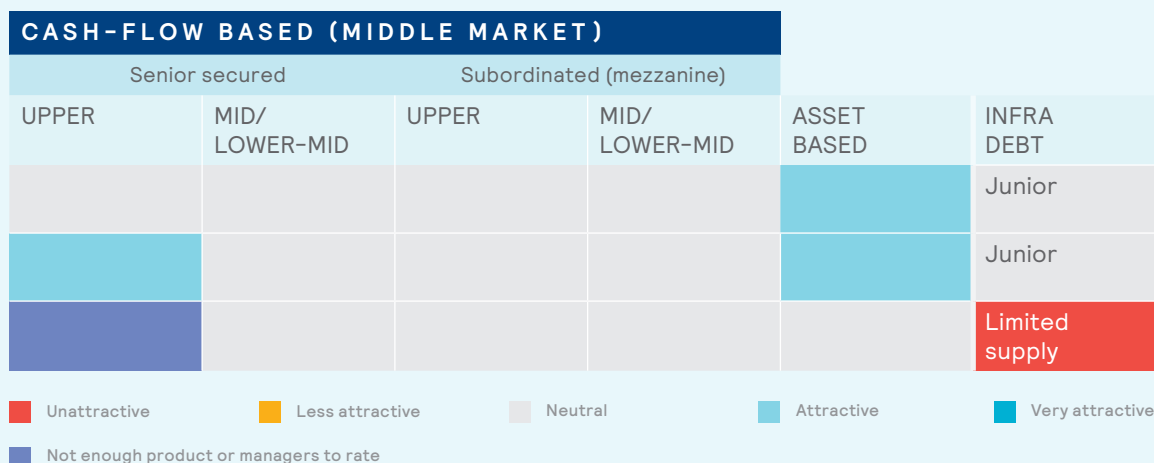
Still, private debt offerings have expanded considerably post GFC. Lengthy track records, both senior and junior, are relatively rare and are a meaningful differentiator in both markets. Track records that go back long enough to include the global financial crisis of 2007/2008 are rarer still.

Although there are excellent managers and strategies geographically focused on both markets, the opportunity set has shifted somewhat from the US to Europe due to the different speed of recovery from the GFC within the banking sector, different regulations influencing banks on their use of their balance sheets, and the differing role and prominence of the high-yield markets.

Currently, competitive pressures resulting from the high level of capital aimed at middle market lending and still low default rates have combined to create a borrower-friendly environment, particularly in the US. In recent years, loan covenants have weakened (or are nonexistent in some US upper middle market situations) and spreads (typically expressed as a premium to LIBOR) have become tighter; however, loan covenants are still attractive relative to the even greater tightening witnessed in liquid credit markets. Strategies that are least vulnerable to these competitive pressures often center on non-sponsored transactions and/or the lower middle market size segment.

The following represents our views in the context of building a private debt portfolio:

#### PRIVATE DEBT OUTLOOK – MERCER'S HEAT MAP



# RISKS AND IMPLEMENTATION

---

Compared to traditional asset classes and most other growth fixed income categories, the private debt implementation process looks different and operates more in line with the implementation of private equity allocations.

Private debt funds are typically less diversified (by number of positions) than senior bank loan funds (usually by a multiple of around 10 times less diversified). Also, the issuers are typically quite small. For most corporate private debt funds, the sum of the enterprise values of all of the issuers would be less than the market cap of the typical issuer of a single corporate bond. These points underscore the importance of diversifying a private debt allocation across a number of underlying funds rather than investing it all into a single fund. Very little upside can be gained from holding a concentrated portfolio in private debt — leaving aside any equity-linked kickers, the best that can happen is that you get your money back with interest, as per the terms of the loan agreements. On the flip side, if your private debt portfolio is too concentrated and something goes wrong, then the downside could be significant, leaving you very few prospects for making enough from your other holdings to recoup your losses.

Private debt managers typically accept new monies only during their fundraising periods, with managers usually capacity constrained in terms of being able to accept new money, and then call/invest the committed capital over the following years. Therefore, it will take time to allocate capital to a set of high-quality managers, and it will take additional time until they have invested the committed amount — that is, a high-quality private debt portfolio cannot be invested overnight.

## CONCLUSION

In our view, the structural changes that have led to the emergence of private debt as an established asset class are here to stay. We strongly believe direct lending should not be viewed as a short-term investment thesis or a trade but, instead, a long-term investment opportunity in an established and growing asset class. Once the credit cycle does ultimately turn, direct lending is likely to be a defensive investment compared to many other asset classes. That being said, there is a high level of dispersion in the quality of managers, and we believe that successful investing in this area requires putting in place a long-term plan to commit capital to a diversified mix of high-quality funds.

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## **Access to Information Arrangements**

### **Exclusion of access by the public to Council meetings**

Information Compliance Ref: 298/19

Meeting / Decision: Avon Pension Fund Investment Panel

Date: 27<sup>th</sup> February 2019

Author: Nathan Rollinson

#### **Report Title: Private Debt – Asset Class Update**

##### **List of attachments to this report:**

Appendix 1 – Mercer Paper: Private Debt Asset Class Update

Exempt Appendix 2 – Brunel Private Debt Portfolio Specification

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 appendix 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 appendix contains 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.

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Bath & North East Somerset Council		
MEETING:	AVON PENSION FUND INVESTMENT PANEL	
MEETING DATE:	27 February 2019	AGENDA ITEM NUMBER
TITLE:	Review of Investment Performance for Periods Ending 31 December 2018	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
<p>List of attachments to this report:</p> <p>Appendix 1 – Fund Valuation</p> <p>Appendix 2 – Mercer Performance Monitoring Report</p> <p>Exempt Appendix 3 – RAG Monitoring Summary Report</p> <p>Exempt Appendix 4 – Risk Management Framework Quarterly Monitoring Report</p> <p>Appendix 5 – Mercer Global Dynamic Asset Allocation Update</p> <p>Appendix 6 – Sample Brunel Quarterly Performance Report</p>		

## **1 THE ISSUE**

- 1.1 This paper reports on the performance of the Fund's investment managers and seeks to update the Panel on routine aspects of the Fund's investments. The report contains performance statistics for period ending 31 December 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 22 March 2019.
- 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 decreased by £134m (c.-2.8%) in the quarter ending 31 December 2018 giving a value for the investment Fund of £4,648m. Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and managers.
- 4.2 Global equity markets declined over the quarter by 12.4%. Developed markets fell by 13.0% while emerging markets were down over 7%. US equities were heavily impacted on continued political uncertainty and trade tensions. The yield on the US 10-year government bond ended December at 2.69%, 0.37% lower than the previous quarter. In the UK, 10-year gilt yields fell 0.31% over the quarter and ended December at 1.27%. The Fed's fourth rate hike in the year came in December against the unusual backdrop of the S&P500 having dropped nearly 10.0% since the previous meeting in November. In the UK, despite a strong labour market the Bank of England left policy unchanged as it pointed to a softening outlook for global growth and intensified Brexit uncertainties. The Fund's currency hedge detracted from Fund performance as sterling depreciated against the US Dollar, Euro and the Yen.
- 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 22 March 2019.

#### **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 absolute returns over the quarter were on the whole negative; with the weakest performance coming from the Fund's overseas developed market equities. Returns from the Fund's diversified growth and hedge fund strategies posted negative returns but did provide protection from the sharp fall in equities, fulfilling their role as portfolio diversifiers. The Fund's infrastructure and property mandates generated positive absolute returns over the quarter, with the infrastructure return enhanced by the depreciation in sterling against the US Dollar. Over the 12 months to 31 December the majority of managers posted negative absolute returns. More information on the mandates 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, added value on an aggregate basis in line with expectations, generating unrealised gains to compensate for the fall in the value of the underlying equity holdings. 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 12.3% p.a., ahead of the assumed strategic return of 8.1% p.a. on the same basis. The 3 year return from emerging market equities was 14.8% in 4Q18; well ahead of the assumed 3 year return of 8.7% but below their long-term historical averages. Over the three-year period index-linked gilts returned 9.2% p.a. versus an assumed return of 2.2%. Similarly, property and infrastructure are ahead of their assumed strategic returns on a 3 year basis. Hedge fund returns are 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. The Fund transitioned its Active UK equity portfolio to Brunel in November and completed the divestment from ASI GARS and proportional redeployment of capital amongst its existing DGF managers.
- 5.3 **Private Markets Investments:** In the 2017 Strategic review, the Fund allocated 2.5% to Renewable Energy (on a look through basis) and 7.5% to Secured Income assets, with both allocations to be managed within Brunel's private market portfolios. In 4Q18, the first drawdowns of the Fund's committed capital occurred. Of the capital committed to Renewables, EUR13m was drawn down in December and deployed across two pan-European funds. One fund invests solely in renewable energy; the other includes sustainable and social infrastructure such as mass transport (metros) which are typically electric, and social infrastructure such as hospitals and government accommodation as well as renewable energy projects such as renewable energy powered district network heating assets. Shortly after the quarter closed, £16.5m was drawn down in the Secured Income portfolio by one of the selected funds.
- 5.4 Brunel has begun reporting from 4Q18 on the assets they now manage on behalf of the Fund. The report can be found in Appendix 6. However, Mercer will continue to provide quarterly commentary and analysis of all the Fund's mandates and at the strategic total fund level.

## **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.

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

## AVON PENSION FUND VALUATION - 31 DECEMBER 2018

	Brunel Portfolios	Passive Multi-Asset	QIF	Active Equities				Funds of Hedge Funds	DGFs		MAC	Property		Infra- structure	Currency Hedging	In House Cash	TOTAL	Avon Asset Mix %
All figures in £m	Multi	BlackRock	BlackRock	Jupiter (SRI)	Genesis	Unigestion	Schroder Global	JP Morgan	Pyrford	Ruffer	Loomis	Schroder (UK)	Partners (Overseas)	IFM	Record	General Cash		
<b>Equities</b>																		
UK	170.8			167.7													338.5	7.3%
Emerging Markets					104.0	110.1											214.1	4.6%
Global Developed Markets			399.3	9.4			346.2										754.9	16.2%
Global Low Carbon	473.0																473.0	10.2%
Equity Derivatives <sup>1</sup>			67.4												20.0		87.4	1.9%
<b>Total Overseas</b>	<b>473.0</b>		<b>466.7</b>	<b>9.4</b>	<b>104.0</b>	<b>110.1</b>	<b>346.2</b>								<b>20.0</b>		<b>1529.4</b>	<b>32.9%</b>
<b>Total Equities</b>	<b>643.8</b>		<b>466.7</b>	<b>177.1</b>	<b>104.0</b>	<b>110.1</b>	<b>346.2</b>								<b>20.0</b>		<b>1867.9</b>	<b>40.2%</b>
<b>DGFs</b>									<b>212.7</b>	<b>370.0</b>							<b>582.7</b>	<b>12.5%</b>
<b>Hedge Funds</b>								<b>231.5</b>									<b>231.5</b>	<b>5.0%</b>
<b>MAC</b>											<b>466.2</b>						<b>466.2</b>	<b>10.0%</b>
<b>Property</b>												<b>233.7</b>	<b>211.8</b>				<b>445.5</b>	<b>9.6%</b>
<b>Infrastructure</b>														<b>330.0</b>			<b>330.0</b>	<b>7.1%</b>
<b>Renewable Infrastructure</b>	<b>11.7</b>																<b>11.7</b>	<b>0.3%</b>
<b>Secured Income</b>	<b>16.5</b>																<b>16.5</b>	<b>0.4%</b>
<b>LDI Assets &amp; Bonds</b>																		
LDI Assets			561.1														561.1	12.1%
Corporate Bonds		80.3															80.3	1.7%
<b>Total Bonds</b>		<b>80.3</b>	<b>561.1</b>														<b>641.4</b>	<b>13.8%</b>
<b>Cash</b>				12.1			7.6					5.4				51.4	<b>76.5</b>	<b>1.6%</b>
<b>FX Hedging</b>															-22.1		<b>-22.1</b>	<b>-0.5%</b>
<b>TOTAL</b>	<b>672.0</b>	<b>80.3</b>	<b>1027.8</b>	<b>189.2</b>	<b>104.0</b>	<b>110.1</b>	<b>353.8</b>	<b>231.5</b>	<b>212.7</b>	<b>370.0</b>	<b>466.2</b>	<b>239.1</b>	<b>211.8</b>	<b>330.0</b>	<b>-2.1</b>	<b>51.4</b>	<b>4647.8</b>	<b>92.6%</b>

<sup>1</sup> Negative equity values mean the equity protection strategy in the BlackRock QIF has detracted from overall performance

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# AVON PENSION FUND

## PANEL INVESTMENT PERFORMANCE REPORT QUARTER TO 31 DECEMBER 2018

FEBRUARY 2019

Page 85

Steve Turner

# IMPORTANT NOTICES

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Please also note:

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

# CONTENTS

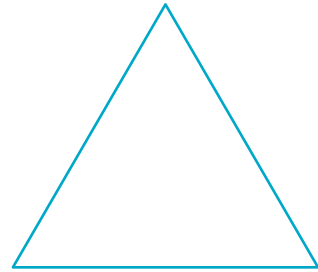
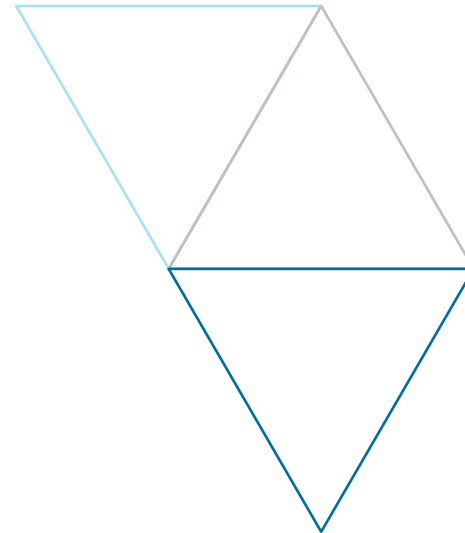
• Executive Summary	3
• Market Background	8
• Strategic Assumptions	11
• Fund Valuations	14
• Performance Summary	18
• Manager Performance	22
• Appendices	44

Page 87

# SECTION 1

## EXECUTIVE SUMMARY

Page 88



# EXECUTIVE SUMMARY

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

## Fund Performance

- The value of the Fund’s assets decreased by £134m over the fourth quarter of 2018, to £4,648m as at 31 December 2018. This decrease was driven primarily by negative returns from both domestic and overseas equities.

## Strategy

- Global (developed) equity returns over the last three years were 12.3% p.a., above the assumed strategic return of 8.05% p.a. from the review in April 2017. We remain broadly neutral in our medium-term outlook for developed market equities (over the next one to three years) but have become slightly more positive. Following the sell-off in Q4 18, valuations are more attractive now, the macro environment does not seem to be as bad as previously perceived by the market and the risk of Fed tightening triggering a recession this year is materially lower.

Page 89

Emerging market equities have returned 14.8% p.a. over the three-year period. It is above the assumed return of 8.70% p.a. as returns have been reasonably strong and fundamentals have improved. Compared to developed market equities, we continue to be slightly more positive in our medium-term outlook for emerging market equities over the next one to three years. Despite ongoing challenges, long-term economic fundamentals remain solid for emerging markets. Emerging market equities have also become even more attractively valued over the quarter due to the broad sell-off in risk assets and are now below their long-term historical averages.

- UK government bond returns over the three-year period remain materially higher than the long-term assumed strategic returns as investor demand for gilts remains high. Fixed interest gilts returned 7.1% p.a. versus an assumed return of 1.90% p.a. and index-linked gilts returned 9.2% p.a. versus an assumed return of 2.15% p.a. Gilt yields decreased over the quarter, and as a result gilt returns were positive over the period.
- UK corporate bonds returned 4.2% p.a. over the three-year period against an assumed strategic return of 3.25% p.a.
- The three-year UK property return of 7.0% p.a. remains higher than the assumed return of 5.75% p.a.
- Hedge fund returns were negative in Q4 18 and remain below long-term averages and the strategic return of 5.10% p.a., having been affected by low cash rates. Active managers in general have struggled to generate meaningful returns in recent years.
- The Fund’s currency hedging policy was negative overall for Fund performance, since Sterling depreciated against the US Dollar, the Euro and the Japanese Yen over the quarter.

# EXECUTIVE SUMMARY

## Managers

- Manager total returns over the quarter were on the whole negative, with the weakest performance coming from the overseas Developed Market Equity managers. The Fund's three Diversified Growth Fund ("DGF") strategies also posted negative returns, but provided protection during the equity market downturn and fulfilled their role within the Fund's overall investment strategy. Over Q4 18, the Fund's overall equity portfolio fell by c.10.6% whereas the overall DGF portfolio decreased in value by c.3.8% (based on changes in asset values over the quarter), illustrating the protection offered by the DGF managers during the volatile market environment. The Fund's Property and Infrastructure mandates generated positive absolute returns over the quarter.
- Absolute returns over the year to 31 December 2018 were mixed across the Fund's investment managers. The majority of mandates posted negative absolute returns, with the UK Socially Responsible Investing ("SRI") strategy and one of the emerging market equity mandates delivering the largest negative returns over the period.
- In terms of relative performance, out of the active equity managers, only the defensive active emerging market equity manager outperformed.
- The Fund's DGF and Multi-Asset Credit ("MAC") mandates delivered material underperformance versus their respective total return targets over the one year period.
- Over the three-year period all mandates with a three-year track record (except Aberdeen Standard Investments) produced positive absolute returns. The majority of active funds underperformed their benchmarks over the period, with only the UK Property and Infrastructure mandates generating positive relative returns. The Fund of Hedge Funds and UK Property mandates achieved their performance objectives, net of fees.

## Key Points for Consideration

- In November 2018, the unconstrained active UK equity mandate was terminated with the proceeds allocated to the Brunel active UK Equity strategy.
- In November 2018, the Aberdeen Standard Investments mandate was terminated with the proceeds allocated to the Fund's two other DGF mandates.

# EXECUTIVE SUMMARY

## MANAGER INFORMATION

Manager	Type	Mandate	Research Rating	Short Term Performance (1 year)	Long Term Performance (3 year)	ESG	Page
Brunel	Passive	Global Low Carbon Equities	N/A	N/A	N/A	P1	23
BlackRock	Passive	Global Equities	A	✓	✓	P2	24
BlackRock	Passive	Corporate Bond	A	✓	✓	N	24
BlackRock	Passive	LDI	A	✓	✓	N	24
Brunel	Active	UK Equities	N/A	N/A	N/A	-	25
Jupiter	Active	UK Equities	B	×	×	2	26
Jupiter	Active	Global Sustainable Equities	N	N/A	N/A	N	28
Schroder	Active	Global Equities	B+	×	×	2	29
Genesis	Active	Emerging Market Equities	A	×	×	3	30
Unigestion	Active	Emerging Market Equities	R	✓	×	N	31
Meets criteria	✓	A or B+ rating; achieved performance target					
Partially meets criteria	-	B, N or R rating; achieved benchmark return but not performance target					
Does not meet criteria	×	C rating; did not achieve benchmark					

### Focus Points

- All active equity managers have underperformed their benchmarks over the longer-term. In some cases this can be explained by the managers' style biases underperforming the wider market, for example Unigestion has a low-volatility bias, which although has helped over the recent period, will be expected to underperform in the rising market that we have seen over the longer period
- A general lack of exposure to value stocks has benefitted the Fund over the one-year period.
- Schroders has announced that Nicky Richards, currently Global Head of Equities, will be stepping down from the role and will be replaced by Rory Bateman, currently Head of UK and European Equities, in March 2019. Despite this change, we are not recommending any actions. See page 29 for further details.

# EXECUTIVE SUMMARY

## MANAGER INFORMATION CONTINUED

Manager	Type	Mandate	Research Rating	Short Term Performance (1 year)	Long Term Performance (3 year)	ESG	Page
Pyrford	Active	DGF	R	×	×	N	32
Ruffer	Active	DGF	A	×	N/A	3	34
JP Morgan	Active	Fund of Hedge Funds	B+	✓	✓	4	36
Schroder	Active	UK Property	B	-	×	3	39
Partners	Active	Global Property	B+	×	×	4	40
IFM	Active	Infrastructure	B+	✓	N/A	2	41
Loomis Sayles	Active	Multi-Asset Credit	A	×	N/A	3	42
Record Currency Management	Active	Currency Hedging	N	N/A	N/A	N	43
Meets criteria	✓	A or B+ rating; achieved performance target					
Partially meets criteria	-	B, N or R rating; achieved benchmark return but not performance target					
Does not meet criteria	×	C rating; did not achieve benchmark					

### Focus Points

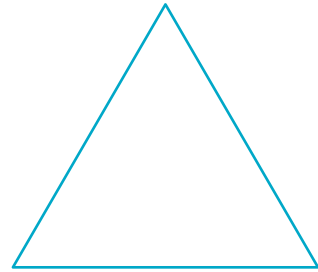
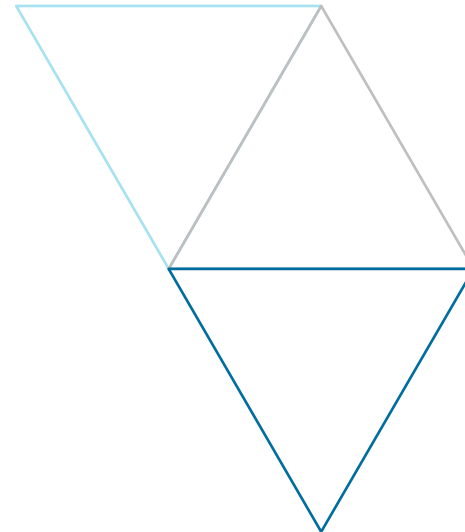
- Partners' performance target is 10% p.a. and benchmark taken as 8% p.a. (estimated net IRR, in local currency terms).



# SECTION 2

## MARKET BACKGROUND

Page 93



# MARKET BACKGROUND INDEX PERFORMANCE

## Equity Market Review

Against the backdrop of a perceived global slowdown, trade tensions and concerns over tighter monetary policy, risk assets saw their worst quarter since the end of 2008. The continued weakness of sterling slightly reduced the losses for sterling investors.

UK and overseas equities experienced a tough quarter with domestically focused companies in particular being hurt. Political uncertainty, including an unsuccessful attempt to oust Prime Minister May by her own party, added to the weakness, as chances of a no-deal Brexit have increased. GDP expanded by 1.5% annualised over the third quarter driven by household consumption while business investment dropped. CPI inflation fell to 2.3% at the end of November and the Bank of England kept interest rates at 0.75%.

Within global equity markets, the US economy grew by 3.0% on a quarterly basis over the third quarter and is set to have grown at the same rate in the fourth quarter. While the near-term outlook remains upbeat, expectations of a slowdown in late 2019 are rising, as the US reaches the later stage of the business cycle. The Federal Reserve continued to raise rates in December pushing them to 2.25-2.50%. Growth expectations for the Eurozone continue to weaken amid a slowdown in Germany and France as well as persistent weakness in Italy. Japanese growth expectations have slowed. Trade tensions between the US and China remained unresolved during the quarter even though it now seems more likely that a deal will be struck in 2019. Some emerging markets have been slowing, mostly due to reduced demand from China which has started to feel the impact of tariffs.

## Bond Market Review

Nominal yields were down at the shorter end of the curve over the quarter.

The Over 15 Year Gilt Index underperformed the broader global bond market over the quarter, generating a return of 2.6%.

Real yields also fell across the curve over the quarter. This led to the Over 5 Year Index-Linked Gilts Index returning 2.0%.

Credit spreads increased sharply over the quarter, with the sterling Non-Gilts All Stocks Index credit spread ending the quarter at c.1.6% p.a. UK credit assets delivered a nil return over the quarter.

## Currency Market Review

Over the quarter, sterling depreciated against the dollar by 2.3%, against the euro by 0.8% and against the Japanese yen by 5.7%.

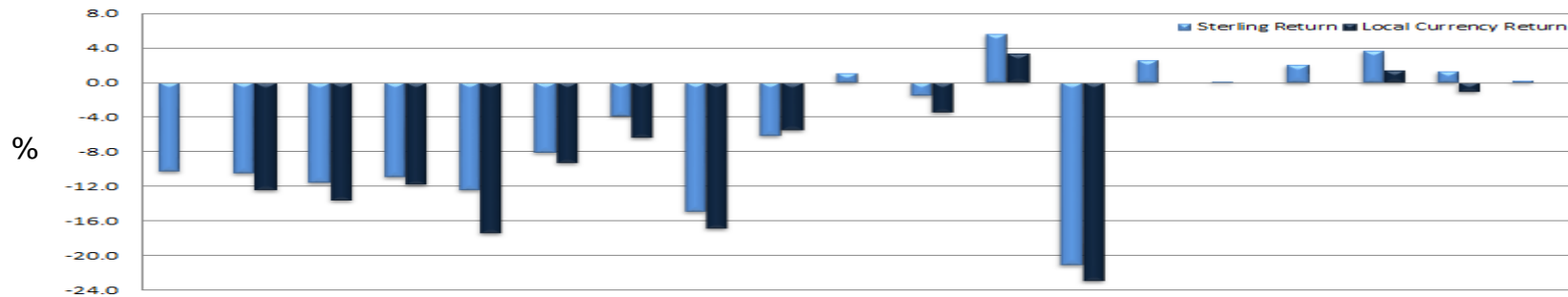
## Commodity Market Review

Commodity performance was poor over the quarter with losses in all sectors, except precious metals due to its safe haven characteristics. Energy led the losses, declining by almost 34% while industrial metals fell by 7%. The softer economic outlook is leading to concerns that global consumption might come out lower than expected next year and this has hit energy and industrial metals especially hard. For oil, unexpected waivers on sanctions on Iran eased the fears of imminent supply constraints.

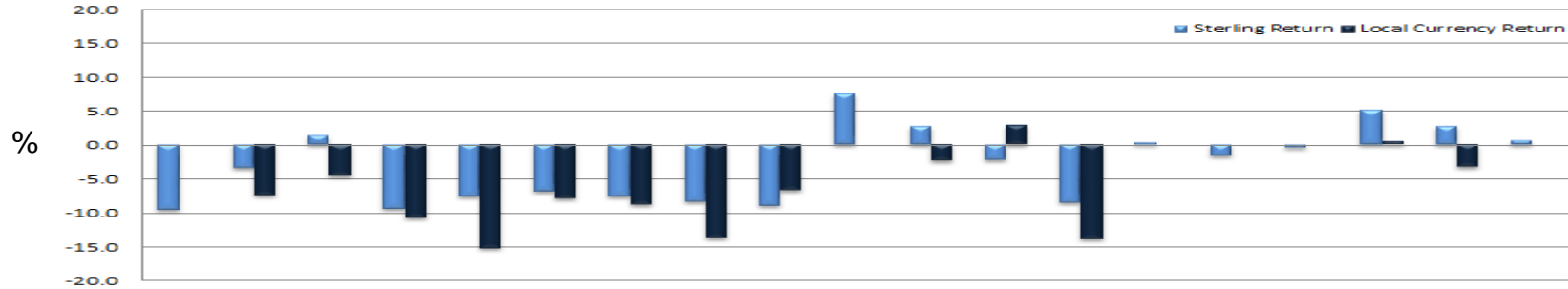
Source: Thomson Reuters Datastream.

# MARKET BACKGROUND INDEX PERFORMANCE

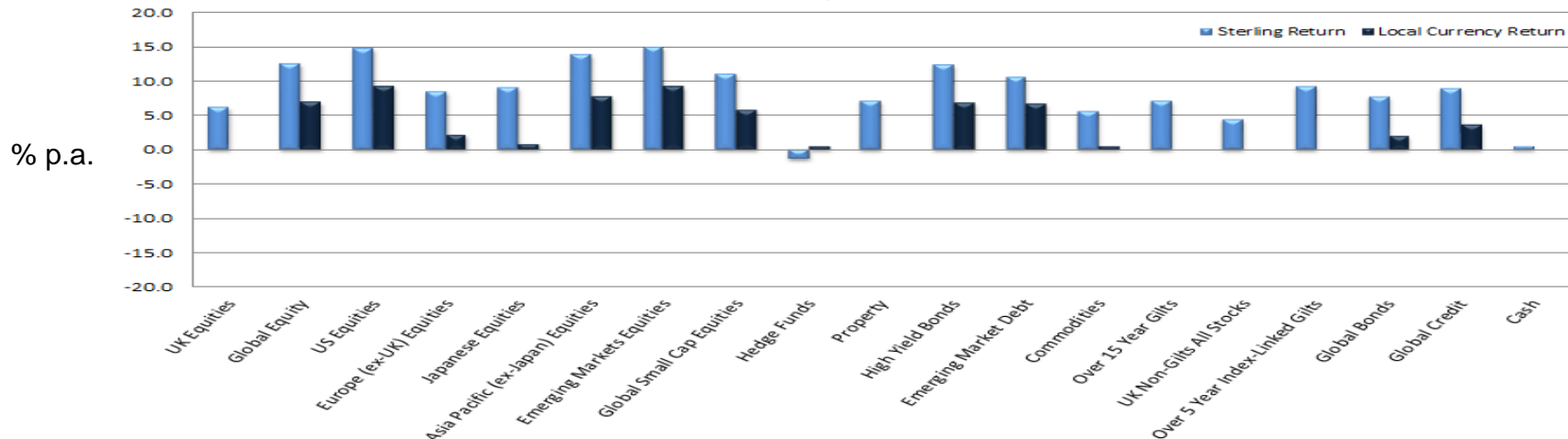
Return over the 3 months to 31 December 2018



Return over the 12 months to 31 December 2018



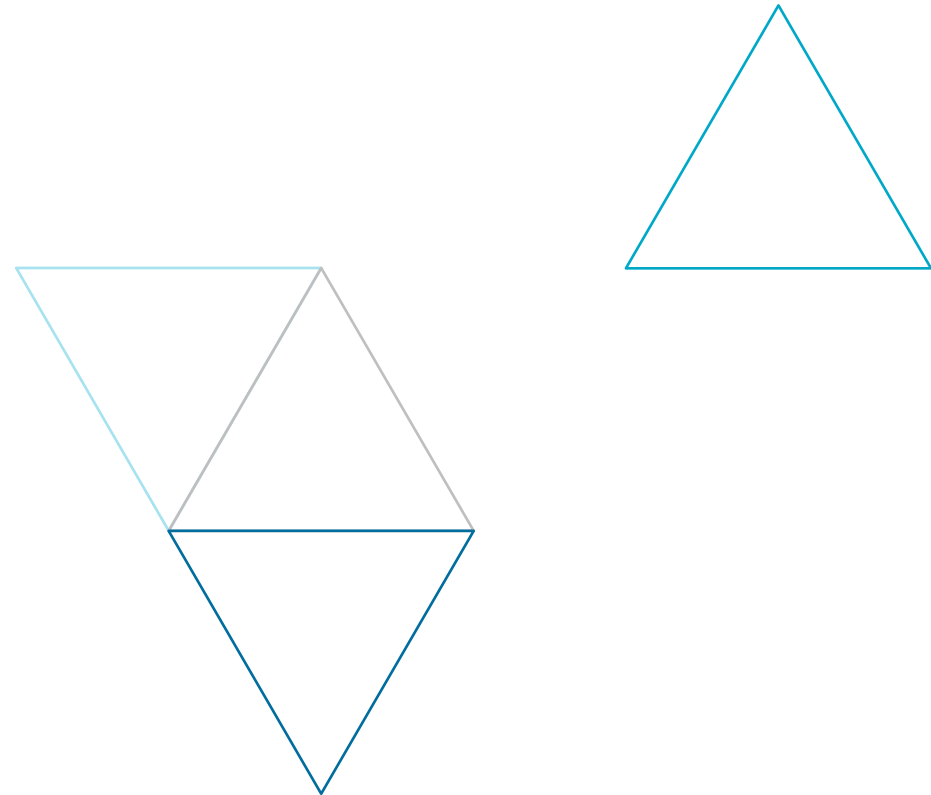
Return p.a. over the 3 years to 31 December 2018



# SECTION 3

## STRATEGIC ASSUMPTIONS

Page 96



# MARKET BACKGROUND

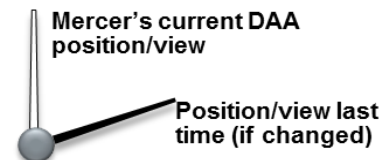
## INDEX PERFORMANCE VERSUS STRATEGY

Asset Class	Strategy Assumed Return % p.a.	3 year Index Return % p.a.	Comment
<b>Developed Equities (Global)</b> (FTSE All-World Developed)	8.05	12.3	Remains ahead of the assumed strategic return. This has decreased from 20.1% p.a. last quarter as the latest quarter's return of -11.2% was materially lower than the 8.6% return of Q4 2015, which fell out of the 3 year return.
<b>Emerging Market Equities</b> (FTSE AW Emerging)	8.70	14.8	The three year return from emerging market equities has decreased from 17.5% p.a. last quarter, as the return of -3.9% over Q4 2018 was lower than the return for the quarter that fell out of the period (3.1%). The three year return is above the assumed strategic return.
<b>Diversified Growth</b>	6.95 (Libor + 4% / RPI + 5%)	6.0 (4.5 / 8.1)	DGFs are expected to produce an attractive return over the long term but with lower volatility than equities – this is the basis for the Libor and RPI based benchmarks. Low cash rates means benchmark has underperformed the long term expected return from equity, but recent higher inflation means RPI benchmark has outperformed. An absolute strategic return of 6.95% p.a. has been used, along with the specific manager targets for comparison. During periods of strong equity returns we would expect DGFs to underperform equities.
<b>UK Gilts</b> (FTSE Actuaries Over 15 Year Gilts)	1.90	7.1	UK gilt returns remain considerably above the long term strategic assumed return as yields remain low relative to historic averages. Over the last quarter, returns were positive for nominal gilts and index linked gilts as yields fell. Corporate bond returns are broadly in line with the strategic assumed return.
<b>Index Linked Gilts</b> (FTSE Actuaries Over 5 Year Index-Linked Gilts)	2.15	9.2	
<b>UK Corporate Bonds</b> (BofAML Sterling Non Gilts)	3.25	4.2	
<b>Fund of Hedge Funds</b> (HFRX Global Hedge Fund Index)	5.10	-1.2	Hedge fund returns were negative this quarter and remain below long term averages and the strategic return, as they are affected by low cash rates. It should be noted that the index includes a wide variety of strategies that may have had very divergent returns.
<b>Property</b> (IPD UK Monthly)	5.75	7.0	Actual property returns continue to be ahead of the expected returns. Slowing rental growth post-Brexit has meant fundamentals have weakened and a more cautious outlook may be required. Nevertheless, property returned 1.1% over the fourth quarter of 2018.
<b>Infrastructure</b> (S&P Global Infrastructure)	6.95	12.3	The infrastructure three year return is above the strategic return. This performance was in part driven by currency as sterling depreciated against the US dollar and euro over the last three years. Returns of this index have been largely driven by currency moves. The 100% hedge in place for the infrastructure mandate removes the currency effect from the actual returns earned. This is also true for the global property mandate with Partners.

Source: Thomson Reuters Datastream. Returns are in sterling terms.

# DYNAMIC ASSET ALLOCATION (DAA) DASHBOARD – Q1 2019

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



## Equities



## Growth Fixed Income & Property (Core)



## Matching Assets

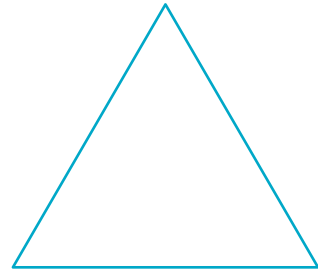
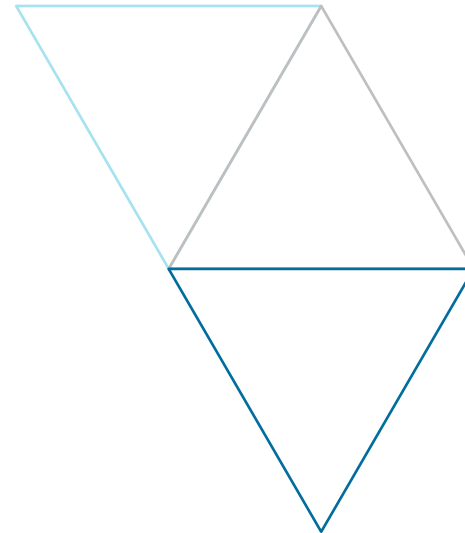


The charts above summarise Mercer's views on the medium term (1-3 years) outlook for returns from the key asset classes. These views are relevant for reflecting medium term market views in determining appropriate asset allocation. We do not expect the Scheme to make frequent tactical changes to their asset allocation based upon these views.

# SECTION 4

Page 99

## FUND VALUATIONS



# FUND VALUATIONS

## VALUATION BY ASSET CLASS

Asset Allocation									
Asset Class	Start of Quarter (£'000)	End of Quarter (£'000)	Start of Quarter (%)	End of Quarter (%)	Target Strategic Benchmark (%)	Ranges (%)			Difference (%)
Developed Market Equities	1,790,290	1,587,452	37.4	34.2	34.0	29	-	39	+0.2
Emerging Market Equities	224,816	214,209	4.7	4.6	6.0	3	-	9	-1.4
Diversified Growth Funds	605,788	582,786	12.7	12.5	15.0	10	-	20	-2.5
Fund of Hedge Funds	231,734	231,533	4.8	5.0	5.0	0	-	7.5	0.0
Property	440,154	450,262	9.2	9.7	10.0	5	-	15	-0.3
Infrastructure	318,714	328,989	6.7	7.1	5.0	0	-	7.5	+2.1
Multi-Asset Credit	477,807	466,241	10.0	10.0	11.0	6	-	16	-1.0
Corporate Bonds	80,258	80,345	1.7	1.7	2.0	No set range			-0.3
LDI*	497,558	628,409	10.4	13.5	12.0	No set range			+1.5
Cash (including currency instruments)	114,646	77,488	2.4	1.7	-	0	-	5	+1.7
Total	4,781,764	4,647,715	100.0	100.0	100.0				0.0

Source: Investment Managers, Mercer. Green numbers indicate the allocation is within tolerance ranges, whilst red numbers indicate the allocation is outside of tolerance ranges.

\* Valuation includes mark-to-market value of equity protection strategy.

- Invested assets decreased over the quarter by £134m due to negative returns from domestic and overseas equities in particular. All of the asset classes remain within their tolerance ranges.



# FUND VALUATIONS

## VALUATION BY MANAGER

Manager Allocation						
Manager	Asset Class	Start of Quarter (£'000)	Cashflows (£'000)	End of Quarter (£'000)	Start of Quarter (%)	End of Quarter (%)
Brunel	Global Low Carbon Equities	532,884		472,992	11.1	10.2
BlackRock	Global Equities	451,513		399,349	9.4	8.6
BlackRock	Corporate Bonds	80,258		80,345	1.7	1.7
BlackRock	LDI*	497,558		628,409	10.4	13.5
Brunel	UK Equities	-	176,737	170,763	0.0	3.7
TT International	UK Equities	195,422	-176,737	655	4.1	0.0
Jupiter	UK Equities	200,748		179,756	4.2	3.9
Jupiter	Global Sustainable Equities	10,652		9,434	0.2	0.2
Schroder	Global Equities	399,071		354,505	8.3	7.6
Genesis	Emerging Market Equities	110,373		104,077	2.3	2.2
Unigestion	Emerging Market Equities	114,443		110,133	2.4	2.4

Source: Investment Managers, Mercer. Totals may not sum due to rounding.

\* Valuation includes mark-to-market value of equity protection strategy.

# FUND VALUATIONS

## VALUATION BY MANAGER CONTINUED

Manager Allocation						
Manager	Asset Class	Start of Quarter (£'000)	Cashflows (£'000)	End of Quarter (£'000)	Start of Quarter (%)	End of Quarter (%)
Pyrford	DGF	139,091	77,000	212,778	2.9	4.6
Aberdeen Standard	DGF	236,975	-230,000	-	5.0	0.0
Ruffer	DGF	229,721	153,000	370,008	4.8	8.0
JP Morgan	Fund of Hedge Funds	231,734		231,533	4.8	5.0
Schroder	UK Property	234,696		238,437	4.9	5.1
Partners	Property	205,458		211,826	4.3	4.6
IFM	Infrastructure	318,714		328,989	6.7	7.1
Loomis Sayles	Multi-Asset Credit	477,807		466,241	10.0	10.0
Record Currency Management	Currency Hedging	29,380	-28,650	-2,101	0.6	0.0
Internal Cash	Cash	85,266		79,589	1.8	1.7
<b>Total</b>		<b>4,781,764</b>		<b>4,647,715</b>	<b>100.0</b>	<b>100.0</b>

Source: Investment Managers, Mercer. Totals may not sum due to rounding.

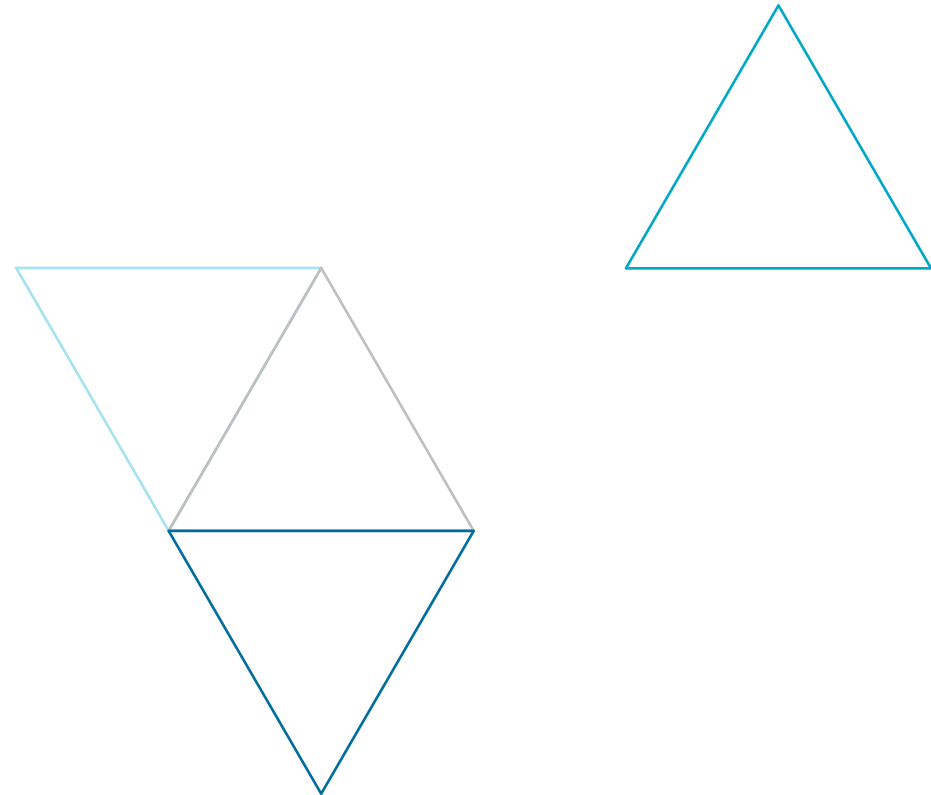
The cashflow column shows only the cash movements within the asset portfolio. It does not include non-investment cash movements such as employer contributions or pension payments made, however these amounts are included in the 'Internal Cash' start and end balance to reflect the asset value position of the total Fund.

# SECTION 5

## PERFORMANCE

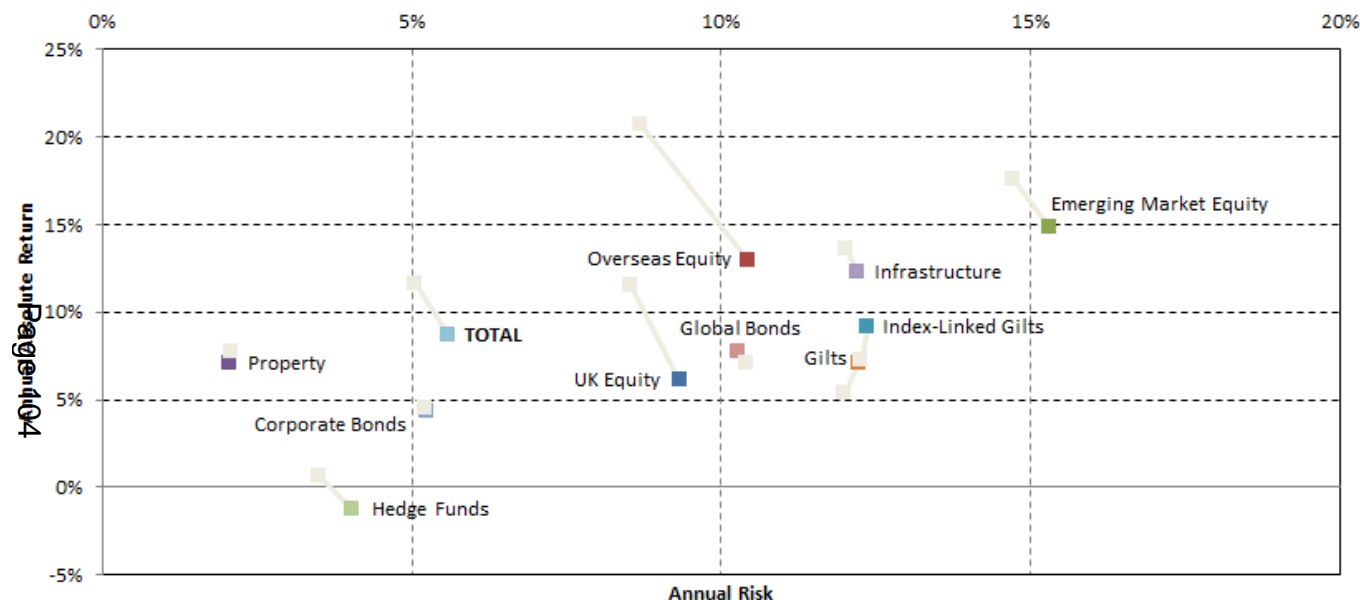
### SUMMARY

Page 103



# MANAGER MONITORING RISK RETURN ANALYSIS

3 Year Risk v 3 Year Return to 31 December 2018



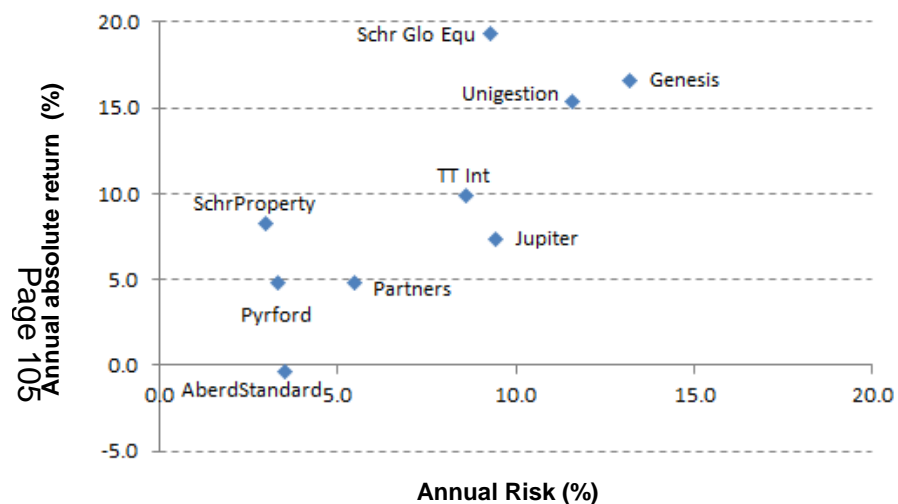
This chart shows the 3 year absolute returns against three year volatility (based on monthly data in sterling terms), to the end of December 2018, for each of the broad underlying asset benchmarks (using the indices set out in the Appendix), along with the total Fund strategic benchmark (using the benchmark indices and allocations from BNY Mellon). We also show the positions as at last quarter, in grey.

## Comments

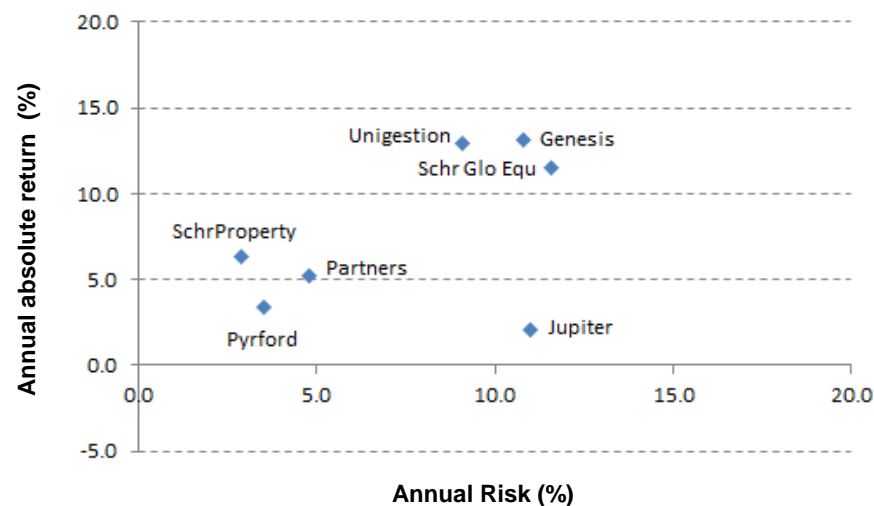
- Changes in observed returns and volatilities over the quarter were limited to some asset classes. Equities saw notable decreases in the three-year returns and increases in the associated volatility.

# MANAGER MONITORING RISK RETURN ANALYSIS

3 year Risk vs 3 year Return to 30 September 2018



3 year Risk vs 3 year Return to 31 December 2018



## Comments

- The equity mandates saw their three-year return decreasing more significantly over the quarter.

# MANAGER MONITORING

## MANAGER PERFORMANCE TO 31 DECEMBER 2018

Manager/ Asset Class	3 Months			1 Year			3 Year			3 Year Performance Target (% p.a.)	3 Year Performance vs Target
	Fund (%)	B'mark (%)	Relative (%)	Fund (%)	B'mark (%)	Relative (%)	Fund (% p.a.)	B'mark (% p.a.)	Relative (% p.a.)		
Brunel Passive Low Carbon Equity	-11.2	-11.2	0.0	N/A	N/A	N/A	N/A	N/A	N/A	-	N/A
BlackRock Equities	-11.6	-11.8	+0.2	-2.1	-2.1	0.0	11.3	11.1	+0.2	-	N/A
BlackRock Corp Bonds	-0.4	-0.5	+0.1	-4.0	-4.1	+0.1	6.5	6.4	+0.1	-	N/A
BlackRock LDI	1.5	1.5	0.0	9.8	9.8	0.0	9.9	10.0	-0.1	-	N/A
TT International ***	-6.1	-5.2	-0.9	-3.8	-1.5	-2.3	6.2	7.8	-1.5	+3-4	Target not met
Jupiter UK Equity	-10.5	-10.2	-0.3	-11.5	-9.5	-2.2	2.1	6.1	-3.8	+2	Target not met
Jupiter Glb Sust Equity	-11.4	-10.6	-0.9	N/A	N/A	N/A	N/A	N/A	N/A	+2-4	N/A
Schroder Equity	-11.2	-10.6	-0.7	-3.9	-3.3	-0.6	11.5	12.5	-0.9	+4	Target not met
Genesis	-5.6	-5.2	-0.4	-11.0	-8.9	-2.3	13.1	15.1	-1.7	-	Target not met
Unionvest	-3.8	-5.3	+1.6	-0.5	-9.3	+9.7	12.9	14.7	-1.6	+2-4	Target not met
Pyramid	-1.7	1.8	-3.4	-0.9	7.9	-8.2	3.4	8.2	-4.4	-	Target not met
Aberdeen Standard ***	-2.4	1.3	-3.6	-5.3	5.8	-10.5	-2.0	5.6	-7.2	-	Target not met
Russell 1000	-4.6	1.5	-6.0	-6.0	5.8	-11.2	N/A	N/A	N/A	-	N/A
JP Morgan	-3.0	1.3	-4.2	1.4	5.1	-3.5	2.6	4.3	-1.6	-	Target not met
Schroder Property	0.7	0.9	-0.2	6.6	6.5	+0.1	6.3	6.4	-0.1	+1	Target not met
Partners Property *	1.0	2.5	-1.5	6.8	10.0	-2.9	5.2	10.0	-4.4	-	Target not met
IFM	0.8	1.2	-0.4	15.1	4.5	+10.1	14.8 **	3.9 **	+10.4 **	-	N/A
Loomis Sayles	-2.4	1.2	-3.6	-4.4	4.8	-8.8	N/A	N/A	N/A	-	N/A

- Source: Investment Managers, Mercer estimates.
- **Returns are in GBP terms**, consistent with overall fund return calculations before currency hedging is applied, **except for JP Morgan, Partners and IFM, whose performance is shown as IRR in local currency terms.**
- In the relative performance columns, returns in blue text exceeded their respective benchmarks, those in red underperformed, and black text shows performance in line with benchmark.
- In the table above, and throughout this report, relative returns have been calculated geometrically (i.e. the portfolio return is divided by the benchmark return) rather than arithmetically (where the benchmark return is subtracted from the portfolio return).
- In the table above, Partners performance is measured against an IRR target of 10% p.a.
- A summary of the benchmarks for each of the mandates is given in Appendix 1.

\* Performance to 30 September 2018 as this is the latest date that this is available to.

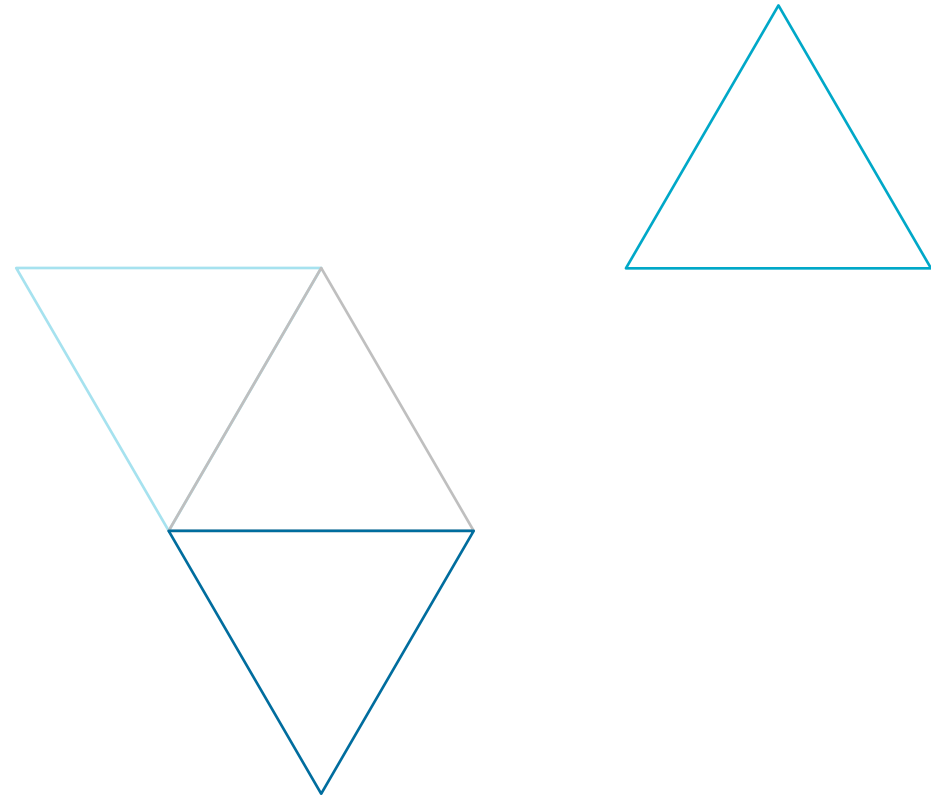
\*\* Performance is shown since inception.

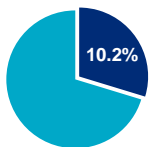
\*\*\* Performance for TT and Aberdeen Standard shown to 31 October 2018 as that is the closest month end to termination. 3 months performance represents performance over October 2018.

# SECTION 6

## MANAGER PERFORMANCE

Page 107





# BRUNEL – PASSIVE GLOBAL LOW CARBON EQUITIES

£473.0M END VALUE (£532.9M START VALUE)

## Item Monitored

## Outcome

Mercer Rating



N/A

Performance Objective

*In line with the benchmark*



Too early to determine

## Manager Research and Developments

- Mandate was initiated in July 2018. LGIM is the underlying manager.
- The fund returned -11.2% over Q4 2018, broadly in line with its benchmark.

Page 108

## Reason for investment

To provide asset growth as part of a diversified equity portfolio and to provide a decarbonised equity portfolio.

## Reason for manager

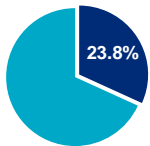
- Investment made via the Brunel pool

## Sector Allocation

Information Technology	19.2
Financials	17.4
Industrials	13.0
Health Care	12.9
Consumer Discretionary	12.8
Consumer Staples	8.2
Energy	4.7
Materials	3.4
Communication Services	3.0
Other	5.4

As at 30 September 2018.





# BLACKROCK – PASSIVE MULTI-ASSET & LDI (POOLED EQUITIES & QIF)

£1,108.1M END VALUE (£1,029.3M START VALUE) (INC. EQUITY PROTECTION STRATEGY)

## Item Monitored

## Outcome

Mercer Rating



A (no change over period under review). ESGp2 for equities

Performance Objective

*In line with the benchmark*



Portfolios performed broadly in line with their benchmarks over three years

## Manager Research and Developments

- Equities returned -11.6% and Corporate Bonds returned -0.4% over Q4, performing broadly in line with their benchmarks as expected, whilst returns over one and three year periods were within the tracking error ranges. Further, the LDI portfolio returned 1.8%. The LDI benchmark return has been assumed to be equal to the LDI fund return.

Page 109

## Reason for investment

To provide asset growth as part of a diversified portfolio

## Reason for manager

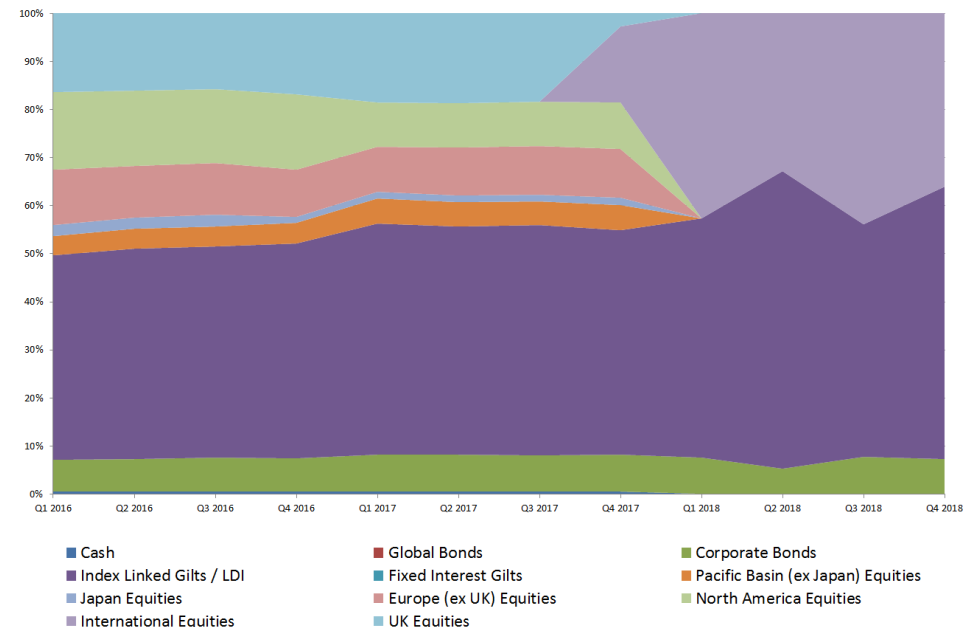
- To provide low cost market exposure across multi asset classes
- Provide efficient way for rebalancing between bonds and equities within a single portfolio

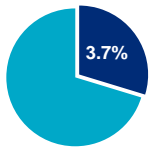
## Performance

	Quarter (%)		1-Year (%)		3-Year (% p.a.)	
	Fund	Benchmark	Fund	Benchmark	Fund	Benchmark
Equities	-11.6	-11.8	-2.1	-2.1	11.3	11.1
Corporate Bonds	-0.4	-0.5	-4.0	-4.1	6.5	6.4
LDI*	1.5	1.5	9.8	9.8	9.9	10.0

\* LDI performance reflects legacy index-linked gilt holdings prior to 30 June 2017 and QIF holdings thereafter. Equity protection strategy performance is not reflected.

## Asset Allocation





## BRUNEL – ACTIVE UK EQUITIES

£170.8M END VALUE (£0.0M START VALUE)

### Item Monitored

### Outcome

Mercer Rating



N/A

Baillie Gifford

Invesco

Aberdeen Standard

Performance Objective

*In line with the benchmark*



Too early to determine

### Manager Research and Developments

- Mandate was initiated in November 2018. Aberdeen Standard, Baillie Gifford and Invesco are the underlying managers.

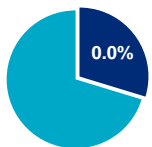
Page 110

### Reason for investment

To provide asset growth as part of a diversified equity portfolio

### Reason for manager

- Investment made via the Brunel pool



# TT INTERNATIONAL – UK EQUITIES (UNCONSTRAINED) (SEGREGATED)

£0.0M END VALUE (£195.4M START VALUE)

## Item Monitored

## Outcome

Mercer Rating



B (no change over period under review). ESG3

Performance Objective  
Benchmark +3-4% p.a.

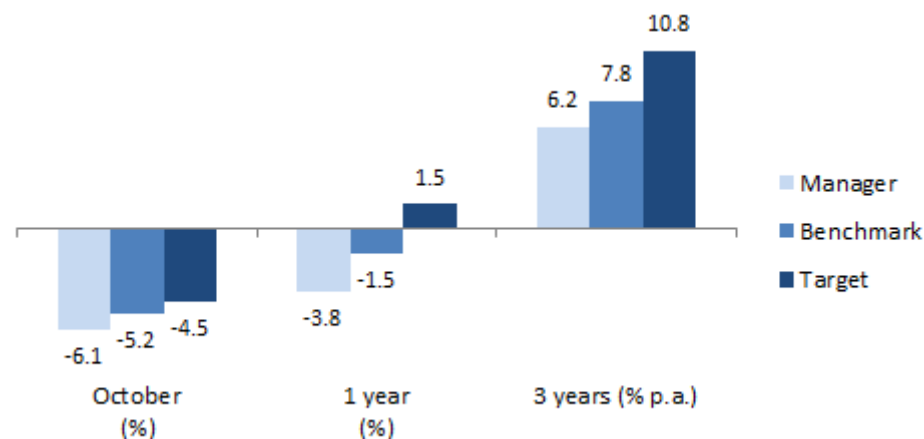


Underperformed benchmark by 1.5% p.a. over three years

## Manager Research and Developments

- The strategy was terminated over Q4 18 with proceeds allocated to the Brunel UK Active Equity strategy.
- Performance is shown to 31 October 2018.
- In October, the mandate returned -6.1%, underperforming its benchmark. The strategy finished behind its benchmark due to underperformance in the Financials, Consumer and Utilities sectors. Security selection detracted from performance with ConvaTec, a Medical equipment company, being the largest detractor after releasing disappointing results.
- In the Financials sector, the portfolio suffered from being underweight HSBC, which rose after a set of strong results.

## Performance

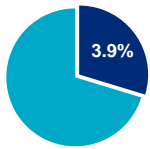


## Reason for investment

To provide asset growth as part of a diversified equity portfolio

## Reason for manager

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



# JUPITER ASSET MANAGEMENT – UK EQUITIES (SRI) (SEGREGATED)

## £179.8M END VALUE (£200.7M START VALUE)

### Item Monitored

### Outcome

Mercer Rating



B (no change over period under review). ESG2

Performance Objective  
*Benchmark +2% p.a.*



Underperformed benchmark by 3.8% p.a. over three years

Tracking error was 4.6% p.a. –  
*source: Jupiter*

Number of stocks: 55

### Manager Research and Developments

- Jupiter underperformed its benchmark over the quarter by 0.3%.
- Keller Group's share price fell significantly over the quarter following a decision to place its operations in the Asia Pacific region under review. Victrex declined after a very strong period of share price performance as fears mounted over the stage of the global industrial cycle. The overweight allocation to these names had a negative impact on the portfolio.
- Jupiter underperformed the benchmark by 2.2% over the year and by 3.8% p.a. over the three years to 31 December 2018.
- Jupiter has outperformed the wider UK equity market in only 2 out of the last 12 quarters. Whilst the lack of exposure to the oil and gas sector amidst the rise in oil prices can help explain this, the degree of the underperformance does also raise questions about Jupiter's stock-picking capabilities over recent years.

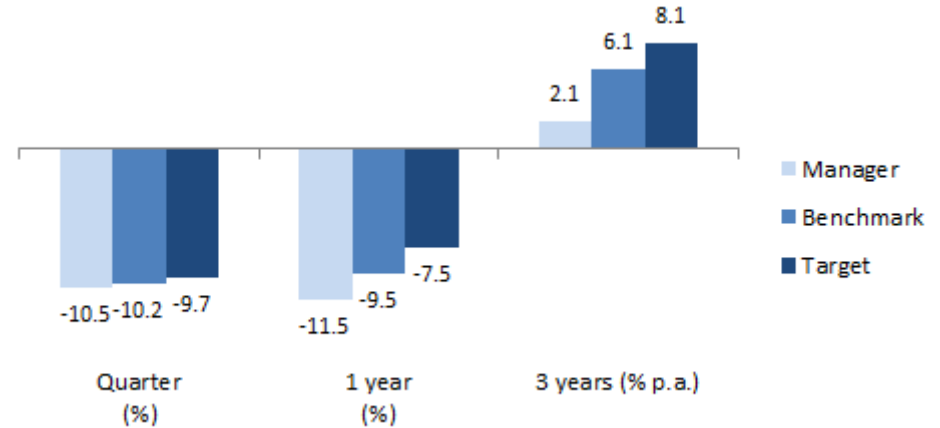
### Reason for investment

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

### Reason for manager

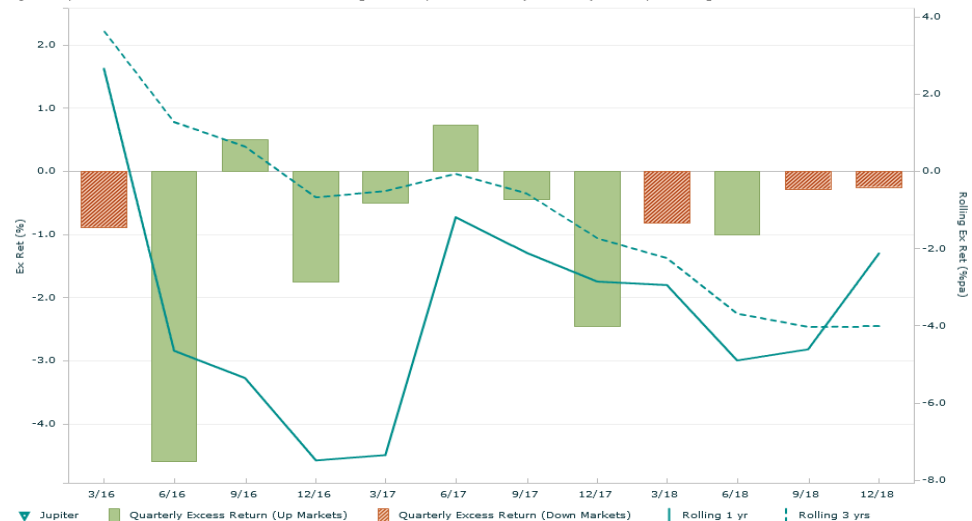
- Clear and robust approach to evaluating SRI factors within the investment process
- Dedicated team of SRI analysts to research SRI issues and lead engagement and voting activities
- Corporate commitment to SRI investment approach within a more mainstream investment team

### Performance



### Rolling relative returns

Quarterly Excess Return vs. FTSE All Share with rolling 1 and 3 yr lines in GBP (after fees) over 3 yrs ending December-18





# JUPITER ASSET MANAGEMENT – GLOBAL SUSTAINABLE EQUITIES (POOLED)

£9.4M END VALUE (£10.7M START VALUE)

## Item Monitored

## Outcome

Mercer Rating



N (no change over period under review)

Performance Objective  
Benchmark +2-4% p.a.



Too early to determine

## Manager Research and Developments

- Mandate was initiated in June 2018.
- The fund returned -11.4% over Q4 2018, underperforming the benchmark return of -10.6%.

Page 113

## Reason for investment

Modest initial allocation to provide an indication of the typical performance of sustainable equities.

## Reason for manager

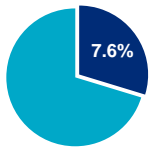
- Preference for global sustainability approach rather than negative screen approach due to integration of ESG factors into investment process
- Global approach provides access to a large universe of stocks to select from
- Clear investment philosophy and portfolio construction reflects team's highest conviction ideas

## Sector Allocation

Industrials <sup>1</sup>	36.1%
Financials	20.5%
Technology	10.1%
Health Care	7.5%
Consumer Goods	7.1%
Basic Materials	5.2%
Utilities	3.4%
Consumer Services	3.3%
Telecommunications	1.1%
	94.4%
Cash	5.6%
Total	100.0%

<sup>1</sup>Includes general electronic equipment, medical equipment and consumer financial stocks (16.62%).

Source: Jupiter.  
As at 31 December 2018.



# SCHRODER – GLOBAL EQUITY PORTFOLIO (SEGREGATED)

## £354.5M END VALUE (£399.1M START VALUE)

### Item Monitored

### Outcome

Mercer Rating



B+ (no change over period under review). ESG2

Performance Objective  
Benchmark +4% p.a.



Underperformed benchmark by 0.9% p.a. over three years

Three year tracking error was 2.1% p.a. – source: Mercer

### Manager Research and Developments

- The fund has underperformed the benchmark by 0.7% over the quarter, by 0.6% over the year and by 0.9% p.a. over the three years to 31 December 2018.
- Not holding stocks in real estate and utilities weighed down most on returns, along with the portfolio's positions in consumer discretionary. Healthcare holdings proved to be more resilient. From a regional perspective, the North America exposure was the largest detractor, while the UK and Pacific ex Japan exposure added value. Alcoa and Occidental (OXY) were the largest stock specific detractors over the quarter with the largest contributors being AIA and HDFC.
- Schroders has announced that Nicky Richards, currently Global Head of Equities, will be stepping down from the role and moving into a part-time "Senior Advisor" position. Rory Bateman, currently Head of UK and European Equities, will take over as Global Head of Equities from March 2019. Schroders has said they have started the recruitment process for a new Head of UK and European equities. Bateman does not have any portfolio management responsibilities. Bateman has been at Schroders since 2008 having previously been an analyst and portfolio manager at Goldman Sachs. He initially worked as a European equity portfolio manager at Schroders, progressing to Head of UK and European Equities in 2013. We have viewed his management and leadership capabilities positively, and suspect he will be well suited to the role. We do not have any concerns over this change.

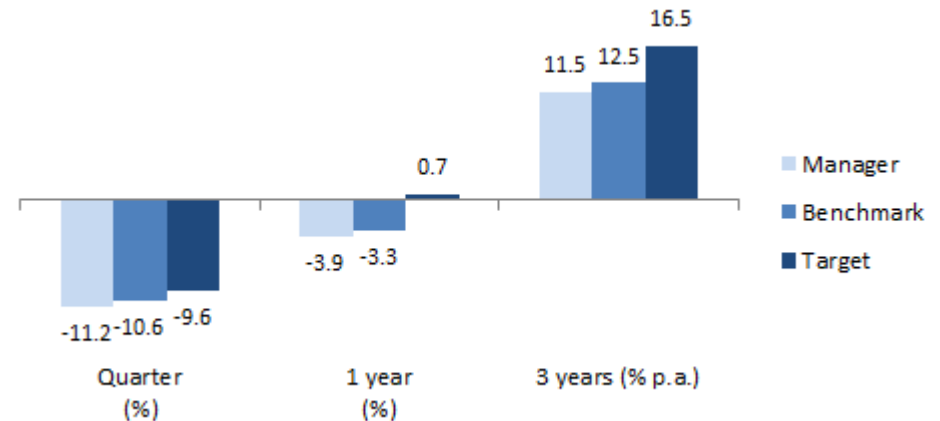
### Reason for investment

To provide asset growth as part of a diversified equity portfolio

### Reason for manager

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

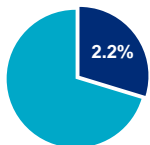
### Performance



### Rolling relative returns

Quarterly Excess Return vs. MSCI AC World with rolling 1 and 3 yr lines in GBP (after fees) over 3 yrs ending December-18





# GENESIS ASSET MANAGERS – EMERGING MARKET EQUITIES (POOLED)

## £104.1M END VALUE (£110.4M START VALUE)

### Item Monitored

### Outcome

Mercer Rating



A (no change over period under review). ESG3

Performance Objective  
*Benchmark*



Underperformed benchmark by 1.7% p.a. over three years

Three year tracking error was 3.5% p.a. – source: Genesis

Number of stocks: 115

### Manager Research and Developments

- The fund has underperformed by 0.4% over the quarter, by 2.3% over the year and by 1.7% p.a. over the three years to 31 December 2018.
- Regionally, Brazil was the largest contributor to returns over the quarter, whilst China was the largest detractor. The largest stock specific contributors were Linx and Garanti Bank from Brazil and Turkey respectively, whilst the largest detractor was the Chinese Internet company 58.com. In terms of sectors, Financials was the largest contributor, whilst Communications was the largest detractor.
- Given the types of quality, growth companies Genesis favours, we would normally expect them to do better in flat or down markets and struggle in environments where markets rise. Therefore, Q4 weak relative performance was disappointing.
- Our researchers met with Genesis in November 2018 to discuss this strategy. Despite the recent underperformance, we believe this remains an appealing strategy with a portfolio management team that has the investment acumen to deliver attractive investment returns. Whilst we may have expected outperformance over the year given market returns were negative, it is important to note that the majority of the underperformance came in the first three quarters of the year, which is what we would anticipate in an environment where cyclical areas of the market are being rewarded. However, the strategy did not provide as much downside protection during the market sell-off in Q4 2018 as may have been expected.

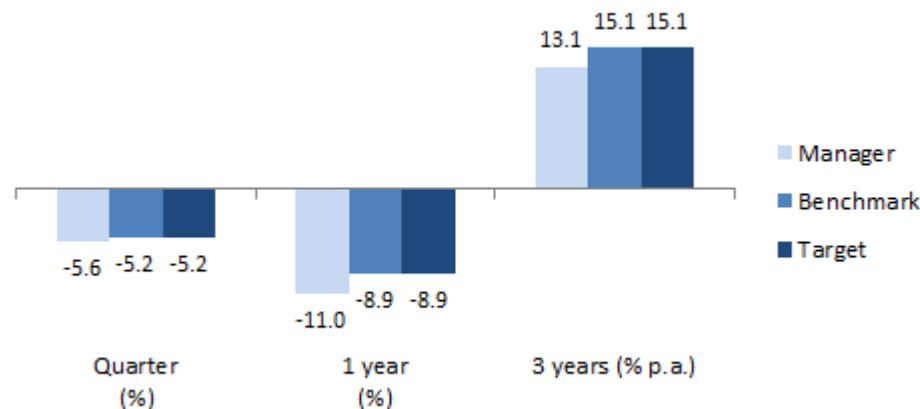
### Reason for investment

To provide asset growth as part of a diversified equity portfolio

### Reason for manager

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

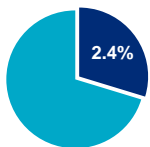
### Performance



### Rolling relative returns

Quarterly Excess Return vs. MSCI EM with rolling 1 and 3 yr lines in GBP (after fees) over 3 yrs ending December-18





# UNIGESTION – EMERGING MARKET EQUITIES (POOLED – SUB-FUND)

£110.1M END VALUE (£114.4M START VALUE)

## Item Monitored

## Outcome

Mercer Rating



R (no change over period under review)

Performance Objective

Benchmark +2-4% p.a.



Underperformed benchmark by 1.6% p.a. over three years

Three year tracking error was 6.9% p.a. – source: Unigestion

Number of stocks: 96

## Manager Research and Developments

- The fund has outperformed by 1.6% over the quarter and by 9.7% over the year, but underperformed by 1.6% p.a. over the three years to 31 December 2018.
- The fund outperformed over October and December. The relatively strong performance of the Telecoms and Banks sectors added value in October, as did the underweight to Media. Performance in December was supported by being underweight Retailing and Technology, and overweight Telecoms and Autos. Stock selection was also positive, with good stock picking in Energy, Transportation and Insurance.
- Volatility since inception is 13.4%, lower than the index (16.6%) and consistent with the strategy's objectives (and bias to quality and large- or mega-cap stocks).
- The fund uses a defensive, high quality, low volatility approach, which should outperform in times of market volatility, but underperform in upward markets. In this respect, relative performance was strong in Q4 2018, as it was in the previous quarter.

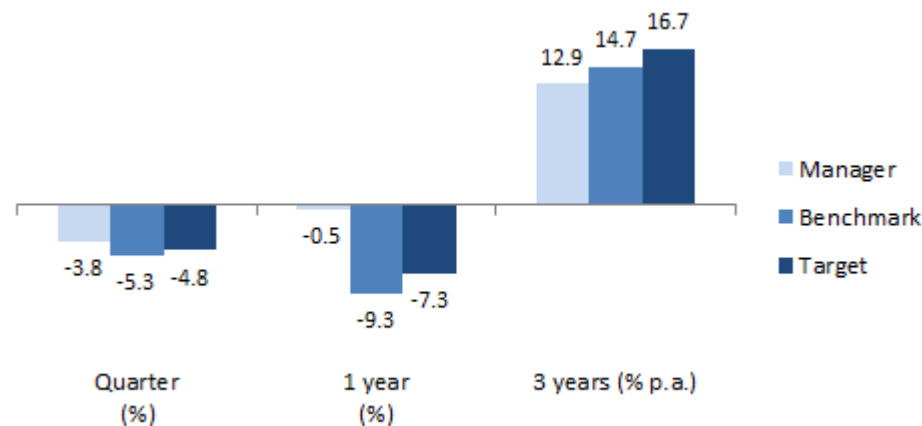
## Reason for investment

To provide asset growth as part of a diversified equity portfolio

## Reason for manager

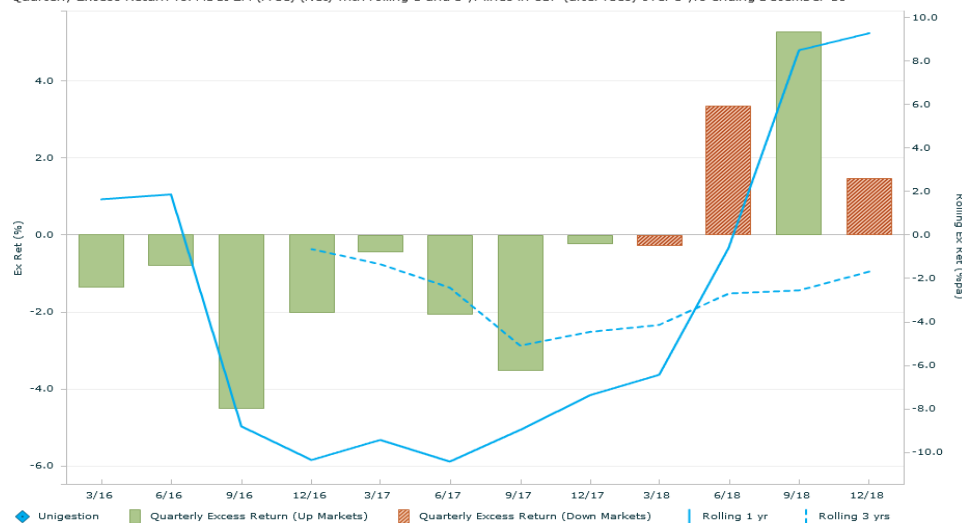
- Risk-based active management approach
- Aim for lower volatility than the MSCI Emerging Markets Index
- Combine fundamental and quantitative analysis

## Performance

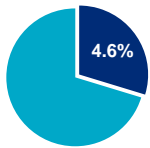


## Rolling relative returns

Quarterly Excess Return vs. MSCI EM (Free) (Net) with rolling 1 and 3 yr lines in GBP (after fees) over 3 yrs ending December-18







# PYRFORD – DGF (POOLED)

## £212.8M END VALUE (£139.1M START VALUE)

### Item Monitored

### Outcome

Mercer Rating



R (no change over period under review)

Performance Objective  
RPI +5% p.a.



Underperformed objective by 4.4% p.a. over three years

### Manager Research and Developments

- The fund has underperformed its objective (RPI + 5% p.a.) over the quarter by 3.4%, by 8.2% over the year and by 4.4% p.a. over three years.
- The defensive positioning was beneficial due to the market volatility seen over the quarter. The key driver for the portfolio over the quarter was the bond allocation with both UK bonds (+0.3%) and overseas bonds (+1.0%) posting positive returns. Finally the overall effect of currency hedging was marginally positive over the quarter.
- Strategic allocation of the portfolio remained unchanged over the quarter.
- Pyrford continues to adopt a defensive stance by owning short duration securities in order to protect the capital value of the portfolio from expected rises in yields.

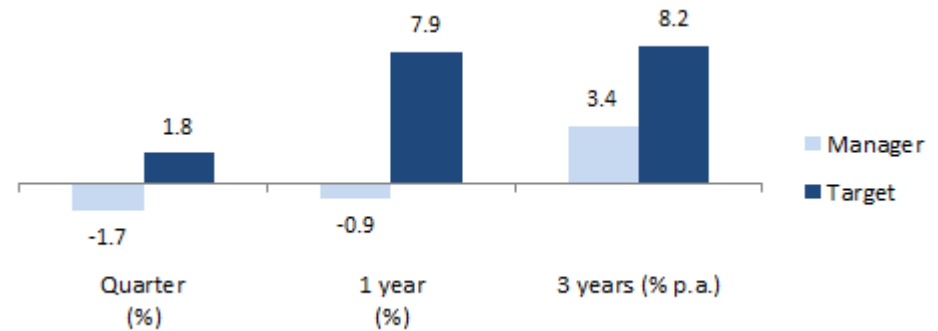
### Reason for investment

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

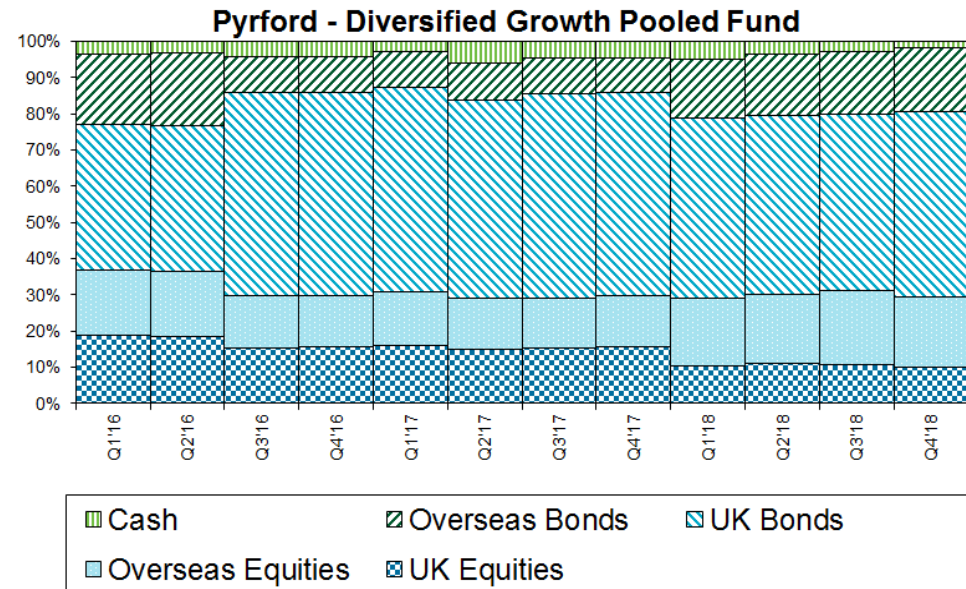
### Reason for manager

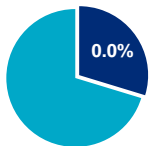
- Asset allocation skill between equities, bonds and cash
- Fundamental approach to stock selection

### Performance



### Asset Allocation





## ABERDEEN STANDARD – DGF <sup>(POOLED)</sup> £0.0M END VALUE (£237.0M START VALUE)

### Item Monitored

### Outcome

Mercer Rating



B+ (no change over period under review). ESG4

Performance Objective  
*Cash +5% p.a.*



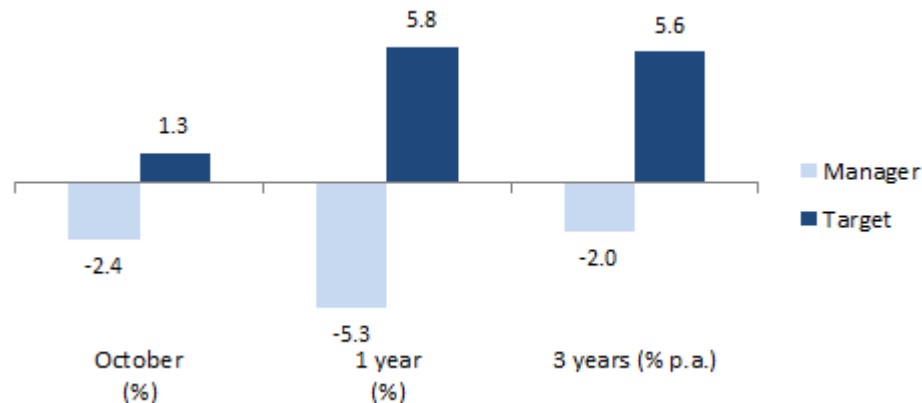
Underperformed objective by 7.2% p.a. over three years

### Manager Research and Developments

- The strategy was terminated over the quarter with proceeds split between the Fund's other DGF strategies managed by Pyrford and Ruffer.
- Performance shown to 31 October 2018.
- In October, the mandate returned -2.4%, underperforming its benchmark.

Page 118

### Performance

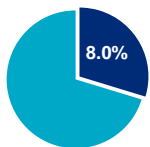


### Reason for investment

To provide attractive absolute returns over the long term

### Reason for manager

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



# RUFFER – DGF (POOLED) £370.0M END VALUE (£229.7M START VALUE)

## Item Monitored

## Outcome

Mercer Rating



A (no change over period under review). ESG3

Performance Objective  
Cash +5% p.a.



Underperformed objective by 11.2% p.a. over the year

## Manager Research and Developments

- Ruffer delivered a performance of -4.6% over the quarter, against a benchmark of 1.5%, and a performance of -6.0% over the year, against an objective of 5.8%.
- Losses for the quarter were largely driven by the equity exposure. The strategy's equity allocation was focused on cyclicals and financials, which fell as much, if not more than the broader equity indices. Index-linked bonds and equity protection provided only muted protection amidst the wider market volatility. One of Ruffer's more traditional diversifiers – gold – provided strong returns and helped protect over Q4.
- Ruffer continues to be defensively positioned with 64% of the portfolio allocated to defensive assets (index-linked gilts, gold and gold equities, cash and illiquid strategies and options). However, these defensive assets did not offer the protection over Q4 18 that may have been anticipated, as the index-linked bonds and equity protection failed to provide much of an offset to the losses stemming from the strategy's equity exposure.
- Ruffer's primary focus remains capital preservation and to not lose money in any twelve-month period. Therefore, whilst recent performance is somewhat disappointing, it should be noted that 2018 was only Ruffer's third calendar year loss in almost quarter of a century.

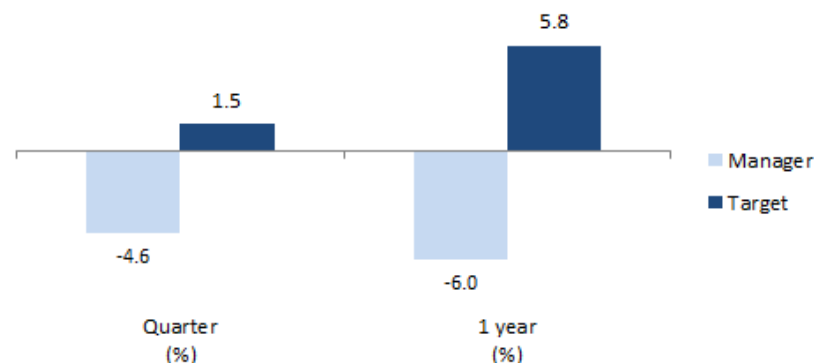
## Reason for investment

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

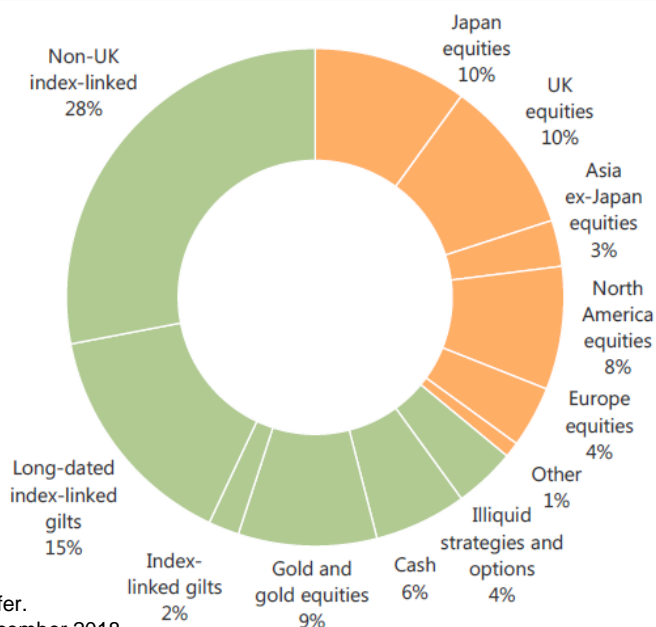
## Reason for manager

- Experience and insights of the investment team
- Focus on capital preservation
- Dynamic allocation between risk and defensive assets depending on market conditions

## Performance



## Sector Allocation



Source: Ruffer.  
As at 31 December 2018.

# DGF MANDATES

Performance characteristics vs. BofAML LIBOR 6 month average UK in GBP (after fees) over 3 yrs ending December-18

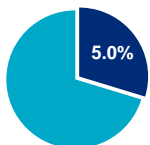
Comparison with the International Multi-asset GBP (Net) universe (Actual Ranking) (quarterly calculations)



	Ret (%pa)	Std Dev (%pa)	IR
▲ Pyrford DGF	3.4 (22)	3.5 (39)	0.8 (9)
⬡ Ruffer DGF	2.7 (28)	4.8 (33)	0.4 (26)
95th Percentile	8.4	9.1	1.1
Upper Quartile	5.2	6.9	0.7
Median	3.3	5.6	0.5
Lower Quartile	1.7	4.6	0.2
5th Percentile	-0.4	3.0	-0.5
Number	44	44	44

## Commentary

- Over the three years to 31 December 2018, **Pyrford** outperformed the **Ruffer** pooled fund by 0.7% p.a.
- Pyrford** is slightly above the median of the DGF universe for performance, whilst **Ruffer** is below that level. It should be noted that this universe is very diverse in styles.
- This performance was achieved with a volatility of 3.5% p.a. by **Pyrford**, while **Ruffer** had a volatility of 4.8% p.a.
- Pyrford** was less volatile than most managers in the universe, while **Ruffer** was in the third quartile of the universe.
- The information ratio (a measure of risk adjusted returns) for **Pyrford** was in the upper quartile of the universe, whereas for **Ruffer** was around the median level.
- The information ratio (IR) measures the amount of 'information' that the manager can extract from the market. Expressed in another way this is the amount of excess return generated per unit of risk or tracking error added. The IR is therefore a measure of the skill of the manager. If the IR is large and it is measured over a reasonable period of time, then this is an indication that the manager has some skill in managing money. Mercer defines the IR as the annualised excess return divided by the annualised tracking error.



# JP MORGAN – FUND OF HEDGE FUNDS

## £231.5M END VALUE (£231.7M START VALUE)

Item Monitored	Outcome
Mercer Rating	<span style="color: green;">●</span> B+ (no change over period under review). ESG4
Performance Objective <i>Cash +3% p.a.</i>	<span style="color: red;">●</span> Below target over three years (in USD)

Item	
------	--

Number of funds 31 (as at 30 November 2018)

Strategy	Contribution to Performance over the Quarter in USD (%)
Relative Value	0.15
Opportunistic/Macro	-0.42
Long/Short Equities	-2.68
Merger Arbitrage/Event Driven	-0.21
Credit	0.27
<b>Total</b>	<b>-3.0 (including cash and fees)</b>

In USD terms, the fund return was -3.0% over Q4 (below benchmark). This return was above the wider hedge fund indices, discussed over the next two pages.

### Reason for investment

To reduce volatility of the Growth portfolio and increase diversification

### Reason for manager

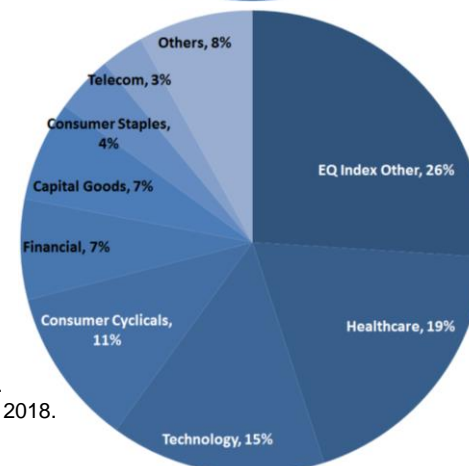
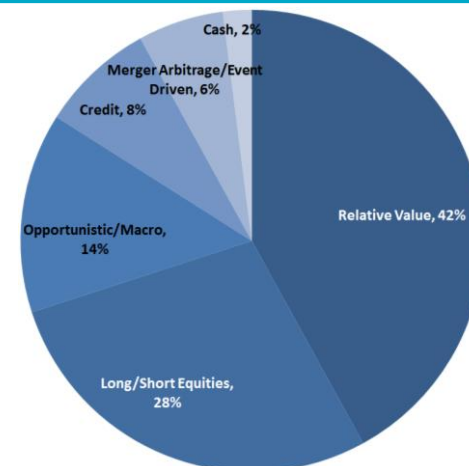
- Niche market neutral investment strategy
- Established team with strong track record
- Complemented other funds in the portfolio

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### Performance (GBP, JP Morgan return converted from USD)

Last Quarter	-0.6%	Target	0.9%
Last Year	7.6%	Target	3.6%
Last 3 Years (p.a.)	7.7%	Target	3.5%

### Portfolio Composition and Equity Sector Allocation

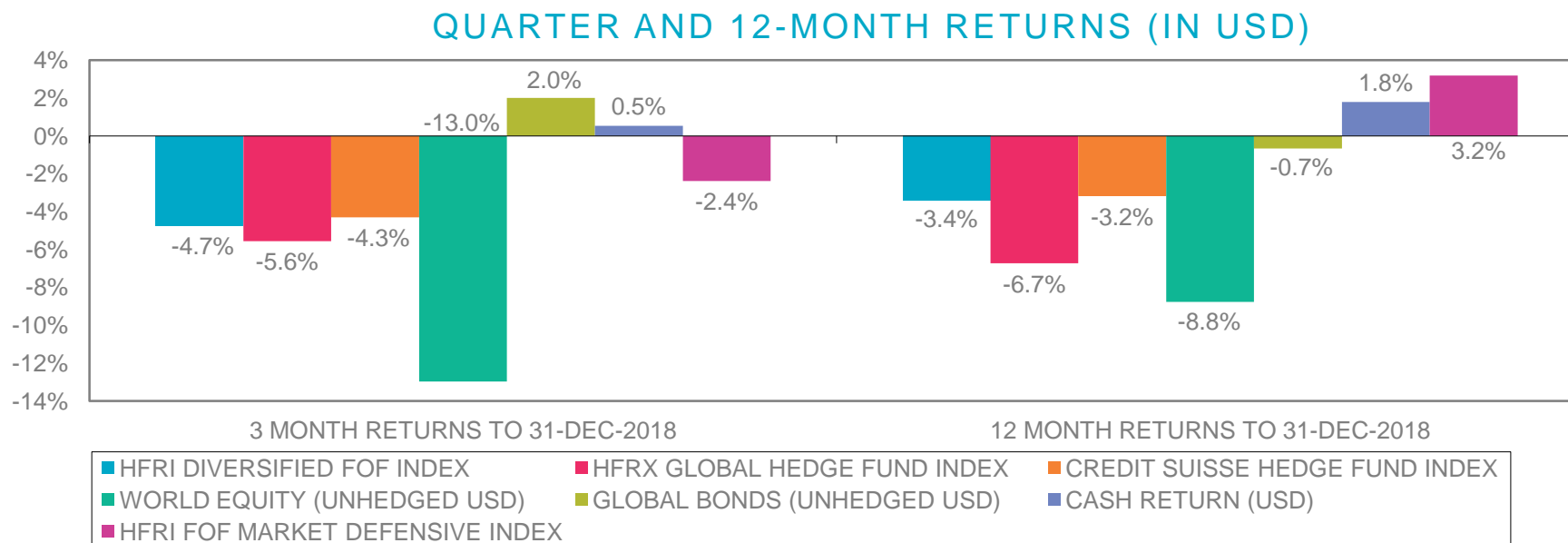


Source: JP Morgan.  
As at 30 November 2018.

# HEDGE FUND COMMENTARY – Q4 2018

- Hedge funds were able to grind out positive returns during most of the year's volatility, though they weren't immune to the broad market declines witnessed in the 4th quarter. While the average portfolio of hedge funds declined for the quarter and year, they still served to reduce drawdowns and add value over a traditional stock/bond mix, outperforming a naïve 60/40 asset allocation with a fraction of the volatility.
- A hedge fund portfolio's ability to diversify traditional risk factors is often best illustrated during difficult periods for broad markets. As witnessed over the past year, hedge funds have continued to serve as a diversifier, earning positive returns during up markets and capturing only a fraction of broad market declines. In the current environment of increased market volatility, reduced liquidity and uncertain returns from traditional risk assets, we are pleased that the value proposition for hedge funds has remained largely intact. We note, however, that hedge funds will likely continue to lag in strong risk-on periods and generally require healthy market liquidity in order to add value and avoid forced de-risking.

Page 122



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

# HEDGE FUND COMMENTARY – Q4 2018

Page 123

## Relative Value (42%)

- Equity Market Neutral (“EMN”) strategies declined for the quarter and year. Over 2018, those strategies fell by 1.0%.
- Convertible arbitrage declined 3.5% on the year. Most of the difficulty came in Q4, as convertible bond valuations retraced materially. Following material issuance for most of the year, the primary market was muted late in Q4 amidst equity market instability.

## Long/Short Equities (28%)

- Long/Short Equity strategies declined for the quarter and year, falling 6.9% over the year.
- Long/Short Equity strategies trailed the hedge fund group for the year, primarily impacted by Q4 drawdowns. Directional strategies unsurprisingly performed worse, though a mixed alpha generating and strained liquidity environment proved difficult for many hedged strategies as well.
- While overall security selection opportunities became more limited as correlations increased in Q4, sector rotation still offered a healthy opportunity set for many strategies. The dispersion of manager returns was notably wide during the year.

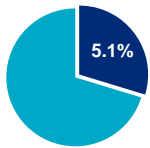
## Opportunistic / Macro (14%)

- Macro strategies generated varied returns for the quarter and year.
- Discretionary strategies posted slight gains, earning 0.5% for the year. Positive performance was generated on the back of rate and currency positioning.
- Systematic strategies, however, generated losses, declining 6.0% during 2018, as market inflection points proved challenging for many trend followers.

## Merger Arbitrage / Event Driven (6%)

- Event Driven and Distressed strategies posted mixed results for the year.
- Merger Arbitrage led the way, earning 3.2% during 2018. The strategy was boosted by the 2nd largest annual deal volume on record and a number of successful deal completions, as well as the overall relative value positioning of the strategy.
- More directionally-oriented event strategies, however, produced modest losses in 2018, with distressed strategies declining 1.6%. Spread widening and market sensitivity overcame progress in many restructuring and liquidation situations.

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



# SCHRODER – UK PROPERTY FUND OF FUNDS

## £238.4M END VALUE (£234.7M START VALUE)

### Item Monitored

### Outcome

Mercer Rating



B (no change over period under review). ESG3

Performance Objective  
Benchmark +1% p.a.



Underperformed benchmark by 0.1% p.a. over five years

### Manager Research and Developments

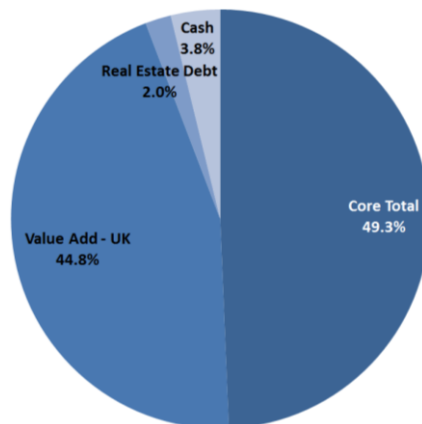
- The fund underperformed the benchmark over the quarter. UK Retail Warehouse Fund was the strongest detractor, with valuation falls reflective of further distress in the retail sector.
- Over the five year period, the fund has delivered a slight underperformance of 0.1% p.a. versus its benchmark. Value add strategies continue to be the largest contributor.
- There were c. £1.0m of purchases in the final quarter, with c. £640k invested in Income Plus Real Estate Debt Fund and £400k invested in Multi-Let Industrial PUT. A further £2.0m of Standard Life Pooled Pension Property Fund was sold in Q4, continuing the reduction in exposure to this underperforming holding.

### Manager and Investment type splits

#### Top 5 Holdings

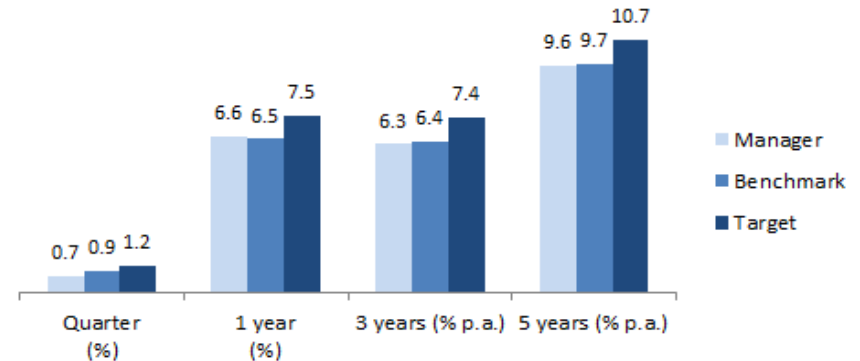
#### Proportion of Total Fund (%)

Industrial Property Investment Fund	15.7
Metro Property Unit Trust	9.9
L&G Managed Property Fund	9.7
Hermes Property Unit Trust	9.6
BlackRock UK Property Fund	9.1

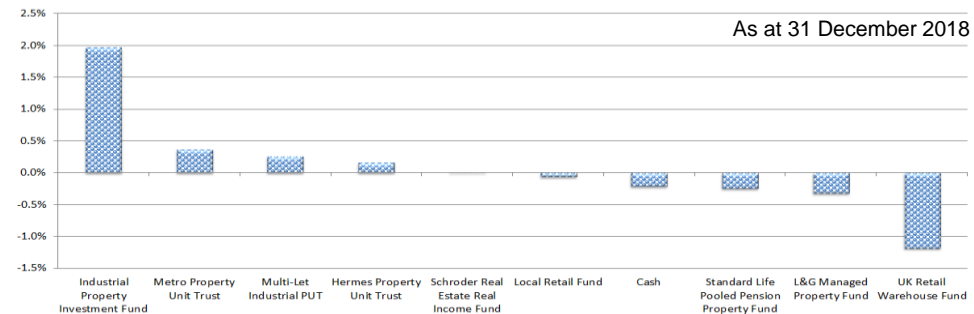


As at 31 December 2018

### Performance



### Top 5 Contributing and Detracting Funds over 12 Months



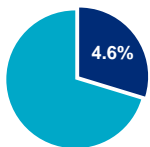
### Reason for investment

To reduce volatility of the Growth portfolio and increase diversification

### Reason for manager

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





# PARTNERS – OVERSEAS PROPERTY

## £211.8M END VALUE (£205.5M START VALUE)

### Item Monitored Outcome

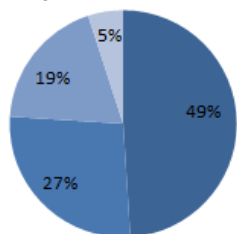
Mercer Rating	● B+ (no change over period under review). ESG4
Performance Objective IRR of 10% p.a.	● IRR since inception to 30 September 2018 at 7.2% p.a. (in local currency) is below target of 10% p.a.

### Manager Research and Developments (Q3 2018)

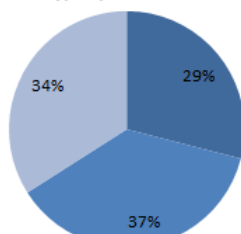
- The portfolio delivered a net return of -1.0% over Q1 2018 for USD programmes in local currency, and 1.3% for EUR programmes, versus the target of c. 2.5%.
- Partners' drawdowns are made gradually over time, and the Fund is not yet fully invested. As a result of the volatile timing of cash flows for such investments, such as the initial costs of purchasing and developing properties, focus should be on longer term performance. Their IRR from inception to 30 September 2018 at 7.2% p.a. (in local currency) is below their target of 10% p.a.; over the three years to 30 September 2018 IRR was 5.2% p.a. (in local currency terms).
- Over Q3, the allocation to Europe decreased (from 50% to 49%), with North America increasing (from 26% to 27%) and Asia Pacific remaining at 19%. These remain within the guidelines.
- Note that Partners are rated B+ for global real estate, but A for secondary global real estate (as a result of their private equity skill set).

### Geographical and Investment type splits as at 30 September 2018

Geographical Split Based on Net Asset Value



Investment Type Split Based on Net Asset Value



■ Europe (10% - 50%) ■ North America (10% - 50%) ■ Direct (0% - 30%) ■ Primary (40% - 100%)  
■ Asia Pacific (10% - 50%) ■ Rest of World (0% - 20%) ■ Secondary (0% - 50%)

### Portfolio update to 30 September 2018

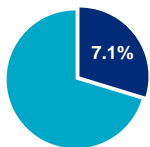
Partners Fund	Total Drawn Down (£m)	Total Distributions (£m)	Net Asset Value (£m)	Since Inception Net IRR (local currency)
Global Real Estate 2008	30.98	29.61	9.59	5.0
Real Estate Secondary 2009	19.63	17.61	13.36	9.3
Asia Pacific and Emerging Market Real Estate 2009	17.69	14.22	7.74	2.5
Distressed US Real Estate 2009	14.08	17.45	4.51	8.5
Global Real Estate 2011	25.10	21.30	17.11	9.3
Direct Real Estate 2011	11.44	9.14	8.04	6.6
Real Estate Secondary 2013	11.72	8.22	11.62	18.4
Global Real Estate 2013	89.78	8.25	107.16	7.3
Real Estate Income 2014	20.65	4.04	20.90	3.3
Asia Pacific Real Estate 2016	4.89	1.00	6.62	17.3
<b>Total</b>	<b>245.94</b>	<b>130.82</b>	<b>206.65</b>	<b>7.2</b>

### Reason for investment

To reduce volatility of the Growth portfolio and increase diversification

### Reason for manager

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



# IFM – INFRASTRUCTURE (POOLED)

## £329.0M END VALUE (£318.7M START VALUE)

### Item Monitored

### Outcome

Mercer Rating



B+ (no change over period under review).  
ESG2

Performance Objective  
Cash +2.5% p.a.



Outperformed objective by 10.1% over the  
year (in USD)

### Item

Number of holdings

15

### Manager Research and Developments

- Over the quarter the fund returned 0.8% in US Dollar terms, against Avon's performance objective of 1.2% (cash + 2.5% p.a.).
- IRR since inception on 1 June 2016 is 14.8%. Please note that this is still early in the life of the fund.
- During the quarter, IFM completed two acquisitions: a 37.5% stake in GCT Global Container Terminals, an operator of four container terminals in Canada and the US, as well as a 50% stake in Impala Terminals, a diversified portfolio of base metal terminal infrastructure assets located in Peru, Spain and Mexico.
- The pooled fund also received income of \$153.9m over the quarter amid major dividend distributions from Mersin International Port, Manchester Airports Group and Colonial Pipeline Company.

### Reason for investment

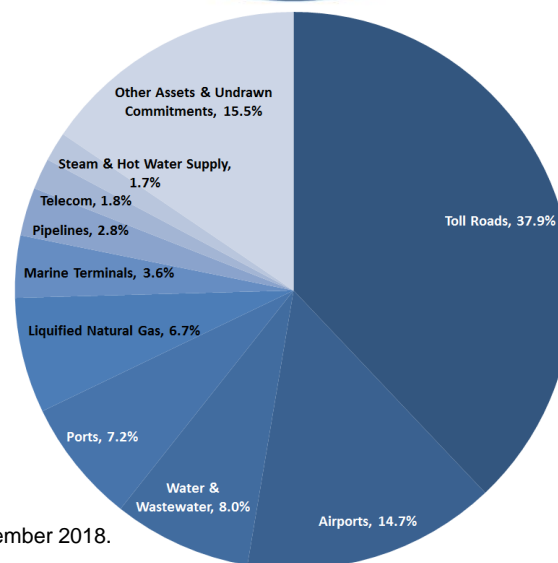
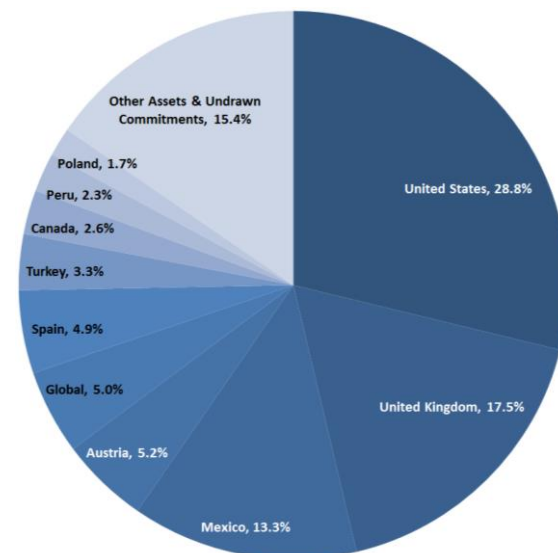
To reduce volatility of the Growth portfolio and increase diversification

### Reason for manager

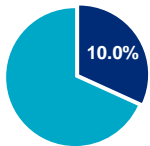
- Invests in core infrastructure assets in countries with established regulatory environments and strong rule-of-law
- Seeks to invest in assets with strong market positions, predictable regulatory environments, high barriers to entry, limited demand elasticity and long lives

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### Geographical and Sub-Sector Allocation



Source: IFM.  
As at 31 December 2018.



# LOOMIS SAYLES – MULTI-ASSET CREDIT (POOLED)

£466.2M END VALUE (£477.8M START VALUE)

## Item Monitored

## Outcome

Mercer Rating



A (no change over period under review). ESG3

Performance Objective  
Cash +4% p.a.



Too early to determine

## Manager Research and Developments

- Loomis delivered a performance of -2.4% over the quarter, against an objective of 1.2%. Over the year, the fund returned -4.4%, materially underperforming its objective.
- Despite the US/China trade tensions resulting in most US dollar-denominated EM assets posting negative returns for the quarter, within the portfolio, EM issues contributed marginally to performance. Securitised assets also bolstered performance over the quarter with exposure to asset-backed securities in particular having a positive impact on the portfolio's performance. Global investment grade corporate bonds underperformed treasuries during the quarter as spreads widened. Despite stable earnings, credit markets underperformed as trade dispute concerns, slowing global growth and rate hike expectations dampened investor sentiment. Investment grade corporate selections detracted from performance, with energy and financial issues having the largest negative impact. Likewise, global high yield corporate bonds weighed on performance as spreads meaningfully widened during the quarter.
- In general, the high yield exposure was the largest contributor to quarterly underperformance. Over 2018 as a whole, the strategy has been hurt primarily by the EM exposure which has suffered on the back of US dollar strength and increased volatility.
- The overall duration of the portfolio rose to 5.7 years.

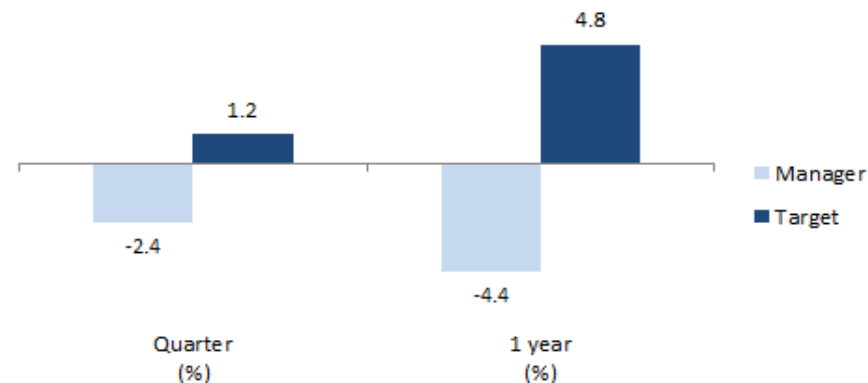
## Reason for investment

To be a diversified return seeker within the Fund's fixed income portfolio

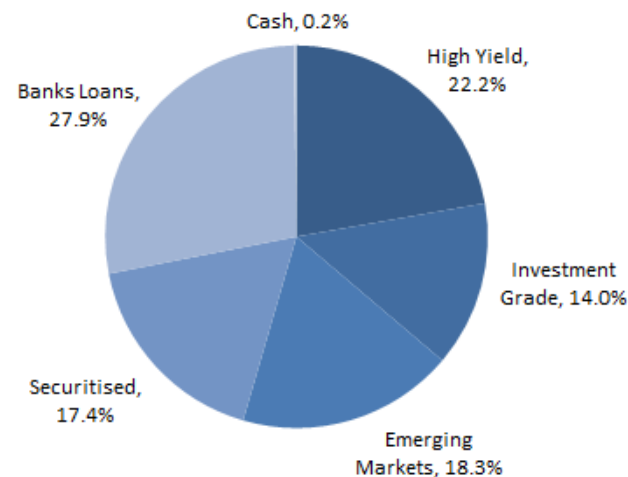
## Reason for manager

- Core low to moderate risk Multi-Asset Credit option
- Depth and breadth of fundamental credit analysis

## Performance



## Sector Allocation



Source: Loomis Sayles.  
As at 31 December 2018.

# RECORD – CURRENCY HEDGING (SEGREGATED)

## £-2.1M END VALUE (£29.4M START VALUE)

Item Monitored	Outcome
Mercer Rating	<span style="color: orange;">●</span> N (no change over period under review)
Performance Objective N/A	<span style="color: grey;">●</span> In line with the 50% hedging position

### Manager Research and Developments

Over the quarter, sterling depreciated against the dollar by 2.3%, against the euro by 0.8% and against the Japanese yen by 5.7%.  
(These currency exchange movements are based on end of day pricing, which may not tie in precisely with the pricing points used by Record).

The Fund's policy is to passively hedge 50% of currency exposure on developed global equities (dollar, euro and yen), and 100% on the hedge fund global property and infrastructure mandates.

Performance for each of these separate accounts is shown to the right; as expected, performance for the passive mandate has been broadly in line with the (informal) 50% benchmark; where this differs from the movement in currency rates this relates to the timing of the implementation trades (2pm) and the currency rates quoted (4pm fix).

### Reason for investment

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

### Reason for manager

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

### Currency Hedging Q4 2018 Performance (£ terms)

#### Passive Developed Equity Hedge

Currency	Start Exposure (£)	End Exposure (£)	Currency Return (%)	50% Benchmark Return (%)	Record Hedge Return (%)	Net Return (%)
USD	806,481,513	794,176,374	2.39%	(1.43%)	(1.42%)	0.96%
EUR	165,537,252	154,567,183	0.77%	(0.23%)	(0.21%)	0.57%
JPY	94,546,203	96,731,636	6.00%	(2.80%)	(2.74%)	3.20%
<b>Total</b>	<b>1,066,564,968</b>	<b>1,045,475,193</b>	<b>2.44%</b>	<b>(1.35%)</b>	<b>(1.34%)</b>	<b>1.09%</b>

#### Passive Hedge Fund Hedge

Currency	Start Exposure (£)	End Exposure (£)	Currency Return (%)	100% Benchmark Return (%)	Record Hedge Return (%)	Net Return (%)
USD	232,553,183	231,159,101	2.39%	(2.86%)	(2.87%)	(0.45%)
<b>Total</b>	<b>232,553,183</b>	<b>231,159,101</b>	<b>2.39%</b>	<b>(2.86%)</b>	<b>(2.87%)</b>	<b>(0.45%)</b>

#### Passive Property Hedge

Currency	Start Exposure (£)	End Exposure (£)	Currency Return (%)	100% Benchmark Return (%)	Record Hedge Return (%)	Net Return (%)
USD	27,544,473	24,721,606	2.39%	(2.86%)	(2.89%)	(0.47%)
EUR	180,934,264	182,811,407	0.77%	(0.49%)	(0.46%)	0.35%
<b>Total</b>	<b>208,478,737</b>	<b>207,533,014</b>	<b>1.00%</b>	<b>(0.81%)</b>	<b>(0.79%)</b>	<b>0.25%</b>

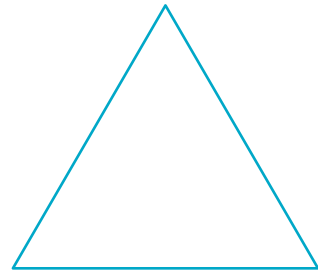
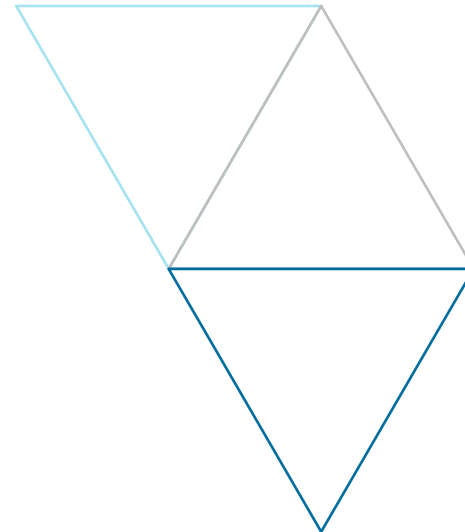
#### Passive Infrastructure Hedge

Currency	Start Exposure (£)	End Exposure (£)	Currency Return (%)	100% Benchmark Return (%)	Record Hedge Return (%)	Net Return (%)
USD	152,448,618	149,292,893	2.39%	(2.83%)	(2.84%)	(0.46%)
EUR	26,219,669	48,733,538	0.77%	(0.47%)	(0.57%)	0.21%
<b>Total</b>	<b>178,668,287</b>	<b>198,026,431</b>	<b>2.20%</b>	<b>(2.47%)</b>	<b>(2.49%)</b>	<b>(0.30%)</b>

# APPENDIX 1

## SUMMARY OF MANDATES

Page 129



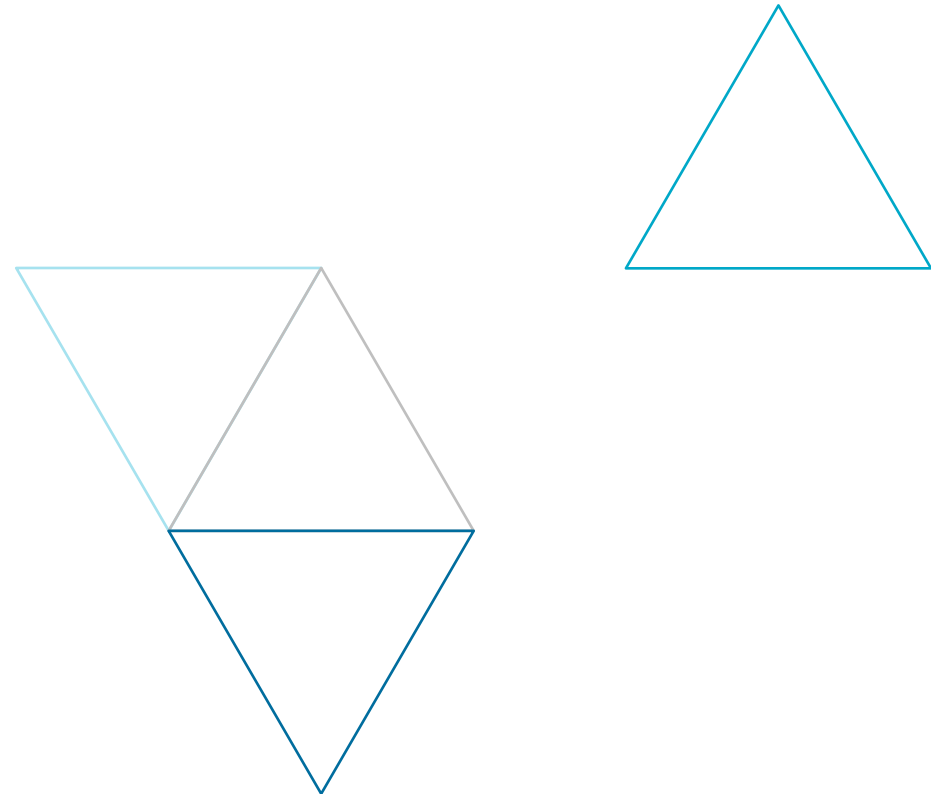
# SUMMARY OF MANDATES

Manager	Mandate	Benchmark	Outperformance Target (p.a.)
Brunel	Passive Global Low Carbon Equity	MSCI World Low Carbon	-
BlackRock	Passive Global Equity	MSCI World	-
BlackRock	Passive Corporate Bond	iBoxx £ Non-Gilts Over 15 Years	-
BlackRock	Matching (Liability Driven Investing)	Return on liabilities being hedged	-
Brunel	Active UK Equities	FTSE All Share	+2%
Jupiter Asset Management	UK Equities (SRI)	FTSE All Share	+2%
Jupiter Asset Management	Global Sustainable Equities (SRI)	MSCI AC World	+2-4%
Schroder	Global Equities (Unconstrained)	MSCI AC World	+4%
Genesis	Emerging Market Equities	MSCI Emerging Markets IMI TR	-
Unigestion	Emerging Market Equities	MSCI Emerging Markets NET TR	+2-4%
Pyrford	Diversified Growth Fund	RPI +5% p.a.	-
Ruffer	Diversified Growth Fund	3 Month LIBOR +5% p.a.	-
JP Morgan	Fund of Hedge Funds	3 Month LIBOR +3% p.a.	-
Schroder	UK Property	IPD UK Pooled	+1%
Partners	Overseas Property	Net IRR of 10% p.a. (local currency)	-
IFM	Infrastructure	6 Month LIBOR +2.5% p.a.	-
Loomis Sayles	Multi-Asset Credit	3 Month LIBOR +4% p.a.	-
Record	Passive Currency Hedging	N/A	-
Cash	Internally Managed	7 Day LIBID	-

# APPENDIX 2

## MARKET STATISTICS INDICES

Page 131



# MARKET STATISTICS INDICES

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

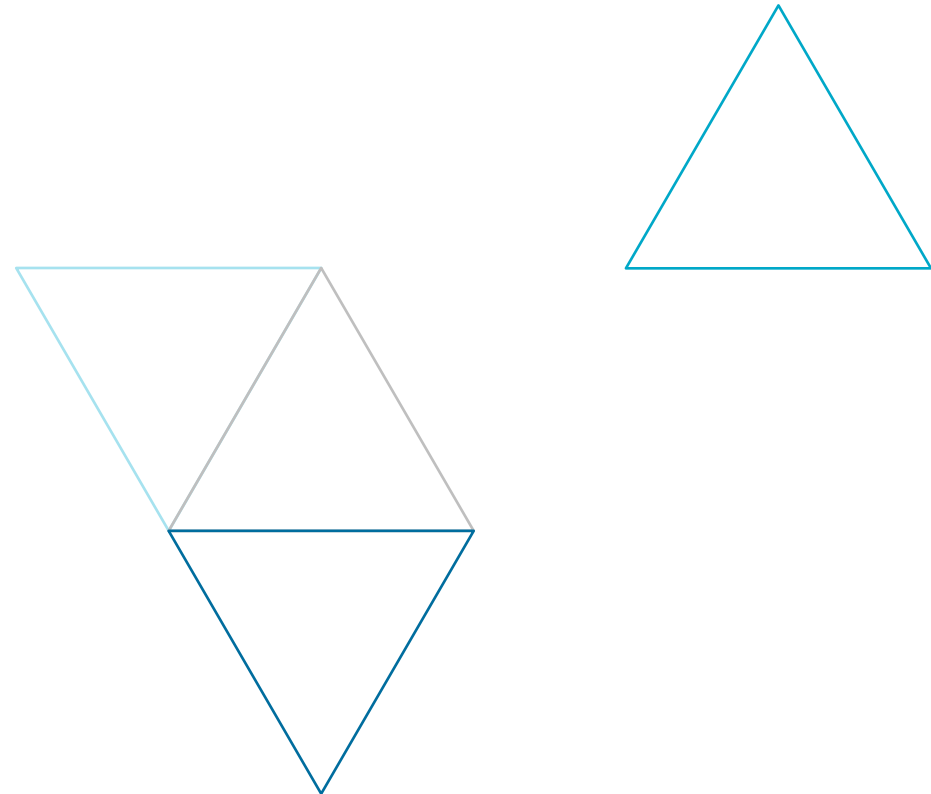
These are the indices used in this report for market commentary; individual strategy returns are shown against their specific benchmarks.



# APPENDIX 3

## CHANGES IN YIELDS

Page 133



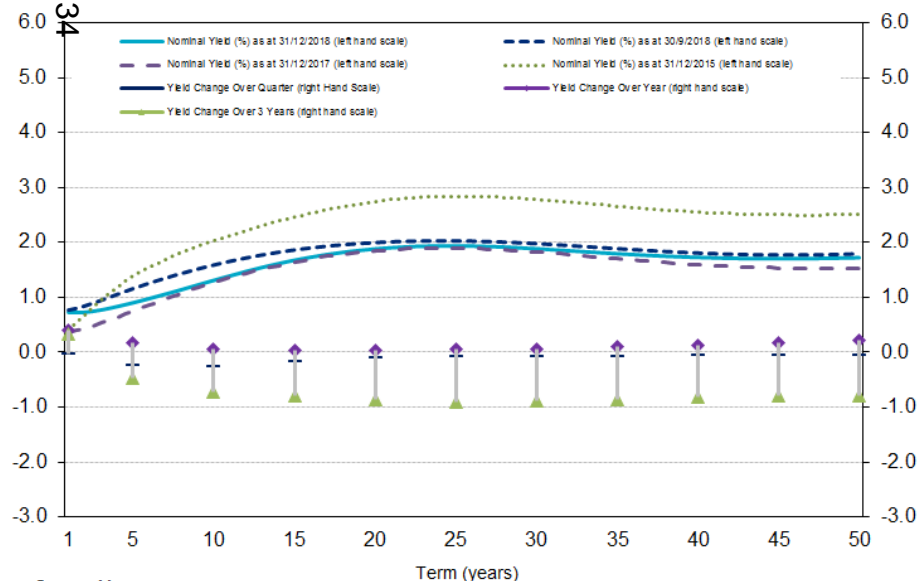
# CHANGES IN YIELDS

Asset Class Yields (% p.a.)	31 Dec 2018	30 Sep 2018	31 Dec 2017	31 Dec 2016
UK Equities	4.46	3.80	3.59	3.47
Over 15 Year Gilts	1.76	1.86	1.68	1.76
Over 5 Year Index-Linked Gilts	-1.58	-1.49	-1.66	-1.66
Sterling Non Gilts	2.75	2.63	2.17	2.29

- Nominal yields were down at the shorter end of the curve over the quarter.
- The Over 15 Year Gilt Index underperformed the broader global bond market over the quarter, generating a return of 2.6%.
- Real yields also fell across the curve over the quarter. This led to the Over 5 Year Index-Linked Gilts Index returning 2.0%.
- Credit spreads increased sharply over the quarter, with the sterling Non-Gilts All Stocks Index credit spread ending the quarter at c.1.6% p.a. UK credit assets delivered a nil return over the quarter.

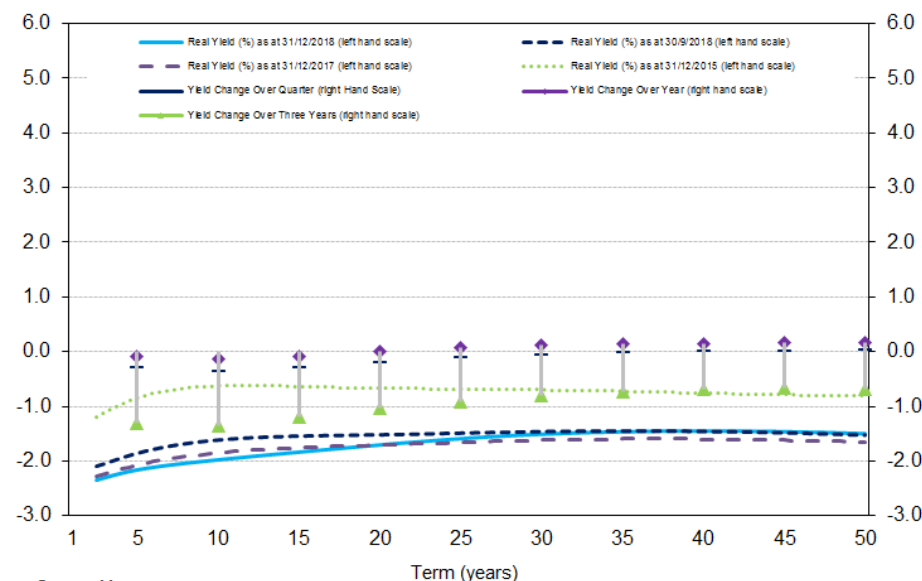
Page 134

## Nominal yield curves



Source: Mercer.

## Real yield curves

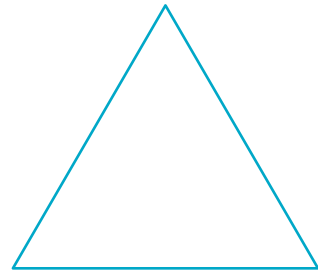
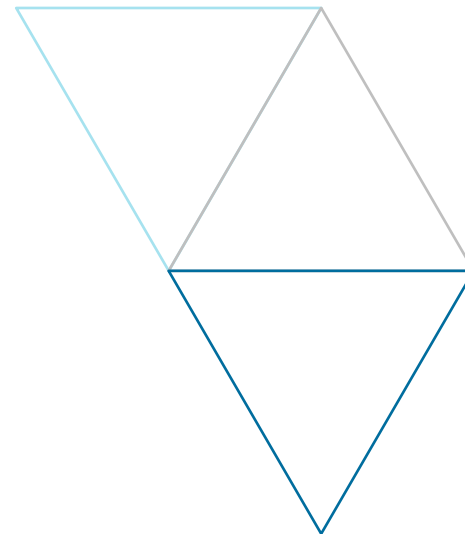


Source: Mercer.

# APPENDIX 4

## GUIDE TO MERCER RATINGS

Page 135



# GUIDE TO MERCER RATINGS

## INTRODUCTION

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

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

## WHAT DO MERCER'S RATINGS SIGNIFY?

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

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

## WHAT DO MERCER'S RATINGS NOT SIGNIFY?

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

### Past Performance

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

### Creditworthiness

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

### Vehicle-Specific Considerations

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

### Management Fees

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

# GUIDE TO MERCER RATINGS

## Operational Assessment

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

## FACTORS CONSIDERED IN FORMING A RATING

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

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

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

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

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

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

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

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

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

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

# GUIDE TO MERCER RATINGS

## MERCER RATING SCALE

Ratings	Rationale
A	Strategies assessed as having “above average” prospects of outperformance
B+	Strategies assessed as having “above average” prospects of outperformance, but which are qualified by at least one of the following: <ul style="list-style-type: none"> <li>There are other strategies that Mercer believes are more likely to achieve outperformance</li> <li>Mercer requires more evidence to support its assessment</li> </ul>
B	Strategies assessed as having “average” prospects of outperformance
B-	Strategies assessed as having “below average” prospects of outperformance
Base R	Strategies not currently rated by Mercer
no rating	The R rating is applied in three situations: <ul style="list-style-type: none"> <li>Where Mercer has carried out some research, but has not completed its full investment strategy research process</li> <li>In product categories where Mercer does not maintain formal ratings but where there are other strategies in which we have a higher degree of confidence</li> <li>Mercer has in the past carried out its full investment-strategy research process on the strategy, but we are no longer maintaining full research coverage</li> </ul>

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

# GUIDE TO MERCER RATINGS

## SUPPLEMENTAL INDICATORS

### Provisional (P)

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

### Watch (W)

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

### Specifically Assigning (P) and (W) Supplemental Indicators

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

### High Tracking Error (T)

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

## NICHE STRATEGIES

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

# GUIDE TO MERCER RATINGS

## RESEARCH INDICATIONS – INDICATIVE VIEW

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

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

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

## OPERATIONAL RISK ASSESSMENTS

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

## ENVIRONMENTAL, SOCIAL, AND CORPORATE GOVERNANCE RATINGS

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



# GUIDE TO MERCER RATINGS

## ESG Rating Scale

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

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

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## **Access to Information Arrangements**

### **Exclusion of access by the public to Council meetings**

Information Compliance Ref: 299/19

Meeting / Decision: Avon Pension Fund Investment Panel

Date: 27<sup>th</sup> February 2019

Author: Nathan Rollinson

**Report Title: Review Of Investment Performance For Periods Ending 31 December 2018**

**List of attachments to this report:**

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  
Appendix 5 – Mercer Global Dynamic Asset Allocation Update  
Appendix 6 – Sample Brunel Quarterly Performance 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 appendix contains information on potential future trades by the fund, and includes information on costs and structures that may impact the ability to procure efficiently in the near future. This information is commercially sensitive and could prejudice the commercial interests of the organisation if released. It would not be in the public interest if advisors and officers could not express in confidence opinions or proposals which are held in good faith and on the basis of the best information available.

It is also important that the 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.

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of the Local Government Act 1972.

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JANUARY 2019

# NAVIGATING THROUGH TURBULENT MARKETS

## MERCER GLOBAL DYNAMIC ASSET ALLOCATION UPDATE

The good news is  
that valuations on  
global equities are  
much more  
reasonable,  
particularly relative  
to defensive assets.

Global equity markets tumbled nearly 13% in the fourth quarter of 2018. Concerns over Fed tightening, protectionism and slowing Chinese growth contributed to the first leg of the sell-off in October. A deteriorating global growth and earnings outlook seemed to drive the second leg that began in December. Thin liquidity around the holidays likely exacerbated the losses. Emerging market assets showed some resilience. Emerging market equities fell about half as much as developed market equities, and local currency debt posted a positive return of 2%. While emerging market equities and debt (both hard and local currency) still trailed for the full calendar year, it suggests investors had already priced in a lot of bad news. Investment-grade and high yield credit suffered relative to US Treasury bonds during the quarter as credit spread spiked.

In our view, the magnitude of the sell-off was not justified by changes in fundamentals. As we have noted, downside risks to the global growth outlook have grown over the past several months, but we continue to believe that a global recession is unlikely in 2019. The good news is that valuations on global equities are much more reasonable (figure 1), particularly relative to defensive assets. As such, we suggest clients use this as an opportunity to rebalance portfolios.

Figure 1: MSCI World Shiller P/E Ratio



Source: Datastream, MSCI, Mercer

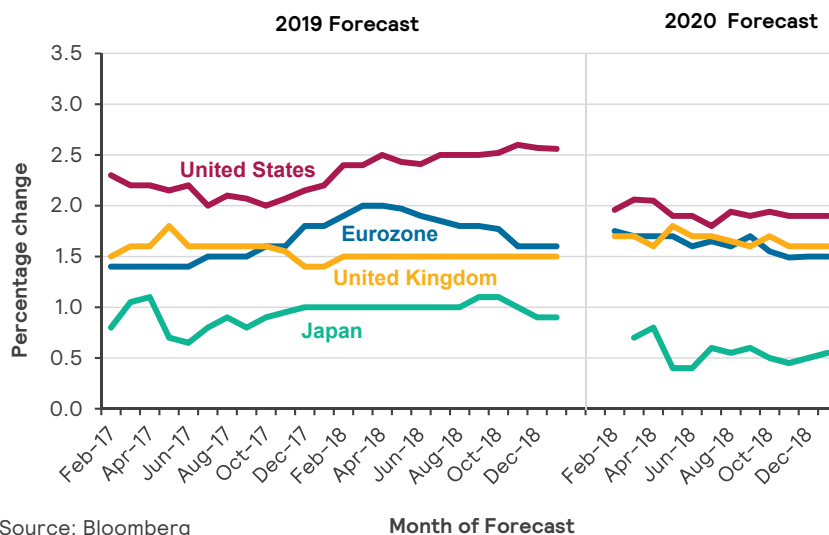
Our dynamic asset allocation (DAA) recommendations for the fourth quarter of 2018 suggested a modestly defensive stance through an underweight to growth fixed income and an overweight to cash, which provided some protection during the quarter as credit spreads widened. We now suggest removing the defensive positioning by returning to neutral on growth fixed income. We also have a marginally more positive view on equities. We continue to prefer emerging market assets relative to developed, both in fixed income and equities, due to relatively attractive valuations.

## GLOBAL GROWTH OUTLOOK

As discussed in our annual economic and market outlook released late last year, we expect global economic growth to weaken from 2018 levels. Nevertheless, the downbeat assessment implied by markets during December appears overdone.

The US was the driver of the global expansion in 2018. Growth in the US will certainly slow from the unsustainable 2018 pace, but should remain above the 2% trend in 2019 (figure 2). Growth in US business investment has flagged, partially due to falling energy prices and trade uncertainties. However, US household finances remain solid. Household income is growing as a result of the strong jobs market and wage gains, which should keep consumer spending strong. There is a risk of a more significant slowdown in 2020 due to fading fiscal stimulus and labor supply constraints. Nevertheless, even if there is a recession in 2020, it should be mild as there are no obvious excesses in the US economy at this point.

Figure 2: Revisions to Consensus Growth Forecasts



Source: Bloomberg

The growth picture outside the US is more uncertain, and China in particular presents downside risk. The direction of trade tensions between the US and China is a key uncertainty. A further escalation could lead to a material slowdown in global economic growth, especially if it lowers business confidence. The recent re-opening of negotiations between the US and China is encouraging. A silver lining of the equity market rout is that it should provide President Trump more incentive to

The downbeat assessment implied by markets during December appears overdone.

We expect the Fed to tighten policy in 2019 as the economic expansion continues.

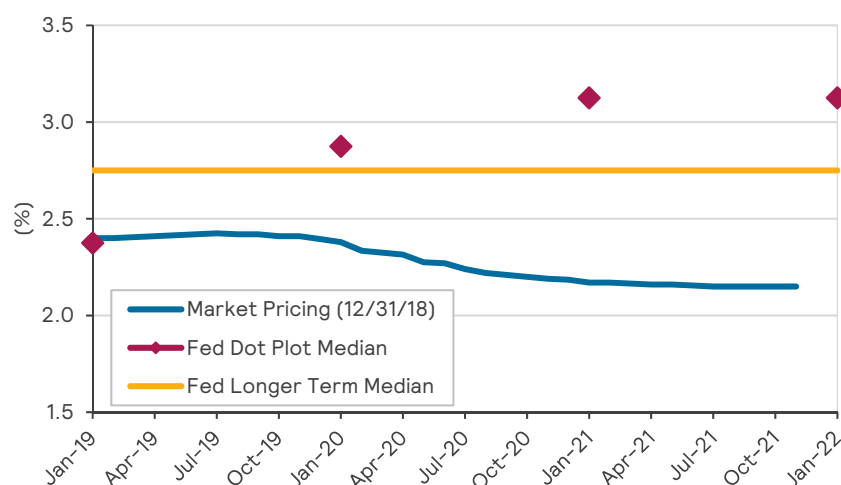
complete a deal. Elsewhere, data out of the Eurozone has been particularly disappointing of late, partially due to temporary factors. Going forward, Eurozone data should stabilize as a result of strong consumer spending. Brexit uncertainty still looms, but we believe an uncoordinated “no deal” break is unlikely.

An earnings slowdown could weigh on markets as profit growth will likely decelerate sharply in 2019. In the US, corporate tax cuts will not directly contribute to 2019 earnings growth as they did in 2018. Decelerating GDP growth and wage pressures resulting from the tight labor market are further headwinds. This is evident in downward revisions in analyst 2019 earnings projections, which probably have further to go. Decelerating economic growth outside the US will mean similar pressures for non-US equities, although with more labor market slack outside the US, wage pressures should be less intense. The good news is that the sharp decline in valuations during the fourth quarter suggests that this may have already been priced-in.

#### MONETARY POLICY AND FINANCIAL CONDITIONS

Recent market turbulence has reduced the risk of a hawkish surprise from the Fed, which we saw as a key risk for equities in 2019. As expected, the Fed lifted its policy rate by a quarter-point at its December meeting to a range of 2.25% to 2.5%. However, the number of rate hikes implied by the “dot plot” median for 2019 fell from three to two. The market has gone much further. It now prices no rate hikes by the Fed in 2019 and the potential for a rate cut in late-2019 or early-2020 (figure 3), which implies a very downbeat view on economic growth. A dovish statement made by Fed Chairman Powell last week seems to be consistent with the view that short-dated rates in the US might increase at a much slower pace this year than expected only a few weeks ago. We expect the Fed to tighten policy in 2019 as the economic expansion continues, which suggests downside for duration. However, it does appear the Fed is approaching the end of this tightening cycle.

Figure 3: Fed Funds Rate Expectations



Source: Bloomberg

Another event that might have contributed to volatility was the end of ECB bond purchases in December. Combined with balance sheet reduction from the Fed, global central banks will likely be net sellers of assets in 2019, which will drain liquidity from the system. However, investors have known this for months, so we are skeptical that it has had a major role in the recent sell-off.

Financial conditions are a feedback mechanism from capital markets to the economy. A material tightening in financial conditions increases the odds of a recession because it makes it more costly for business and consumers to borrow. The recent widening in credit spreads combined with earlier Fed rate hikes has led to tighter financial conditions, although the decline in longer-term bond yields has offset this to some extent. While financial conditions have tightened (figure 4), a further deterioration would be required to cause a recession.

Figure 4: GS Financial Conditions Index



Source: Bloomberg

## CONCLUSIONS

We expect markets will continue to exhibit bouts of volatility in 2019 as global monetary policy becomes less accommodative, economic growth slows and trade developments make headlines. Nevertheless, we think the sell-off during the fourth quarter has removed much of the frothiness in equity valuations. While we do not think global equity valuations are sufficiently attractive for a significant overweight in light of the downside risks, we have become more constructive on the outlook, especially relative to defensive assets. As 2019 progresses, we will keep clients informed of opportunities and risks as they develop.

For more information, please visit our [website](#).

While we do not think global equity valuations are sufficiently attractive for a significant overweight in light of the downside risks, we have become more constructive on the outlook, especially relative to defensive assets.



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[Download a guide on key index definitions.](#)

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## Quarterly Performance Report for Period Ending 31 December 2018

# About Brunel and News

## About Brunel

Brunel Pension Partnership (Brunel) was established on 18 July 2017 as one of eight national Local Government Pension Scheme (LGPS) Pools. The pool brings together circa £30 billion investments of 10 likeminded funds.

We manage the investments for the pension funds of Avon, Buckinghamshire, Cornwall, Devon, Dorset, Environment Agency, Gloucestershire, Oxfordshire, Somerset and Wiltshire.

Brunel is authorised and regulated by the Financial Conduct Authority No. 790168.

## Brunel News

Quarter 4 2018 provided us with the chance to share the news of the progress we've made, as well as celebrating some high points.

- Brunel's CIO Mark Mansley received the Funds Europe award for CIO of the Year in the category of Institutional Manager
- We published our Stewardship Policy
- We issued a press release regarding our appointment of Colmore as our private markets service provider
- We launched our pre-search for the Emerging Markets mandate
- For the second year running, Brunel's CEO Dawn Turner has been named one of the 100 Most Influential Women in Finance by FN London
- Brunel was shortlisted in the Finance for the Future Awards' Investing and Financing category, and as Pool of the Year at the LAPF Investment Awards
- We introduced our ACS scheme and published our Asset Management Accord

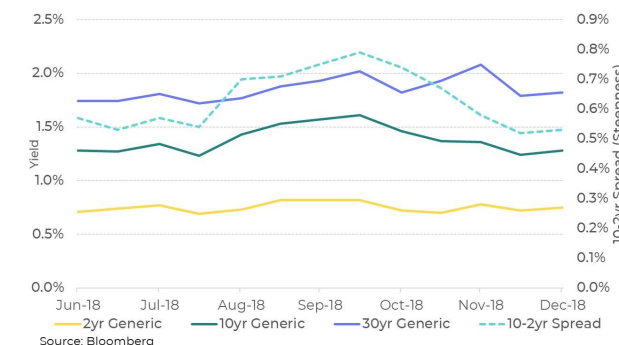


# Market Summary – Chief Investment Officer

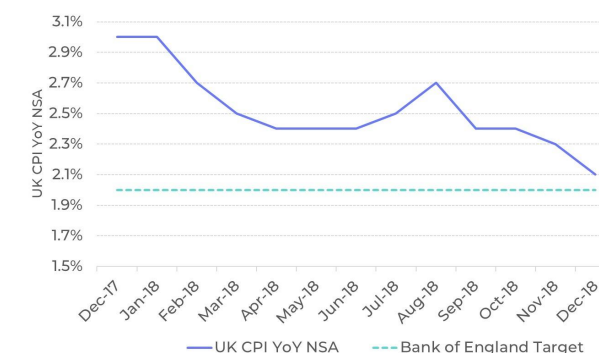
The last quarter of 2018 resulted in further return dispersion within fixed income. Global concerns on international trade – fuelled by the ongoing dispute between the US and China – have prompted investors to sell risk assets. These fears were compounded by a drop in US business surveys and inflation data. Domestically speaking, the delay in the Commons Brexit vote in December stoked further fears amongst investors. Hence, the overall risk-off environment has prompted higher sovereign bond demand, which has caused falling yields.

- UK Gilts have appreciated by +2.1% in local terms over the last quarter
  - UK investment grade bonds and European high yield have not done so well following rising credit spreads, which have offset the positive impact from falling government yields. These asset classes have fallen by -0.1% and -3.8% respectively
- Fixed income has had a tough 2018 overall; most parts of the market have fallen
  - The only exceptions to this are US Treasuries and UK Gilts, which had local returns of +0.9% and +0.5% respectively
  - The worst performing area of the market across 2018 was European high yield, which returned -3.7% in local terms
  - It is worth noting that default rates in European high yield were low in 2018 despite the poor performance
  - Default rates in 2018 were a mere 0.3%, the lowest observed over the last 20 years
- UK yields have fallen significantly in Q4 2018
  - The 10-year bond yield has fallen from by 29bps down to 1.28%; this has been a result of the ongoing complications with the Brexit negotiations
  - UK yields have fallen across the curve; however, curve steepness has decreased following a peak in October 2018
  - The 10-2yr spread on yields is now 0.53%; this is down from a high of 0.79% in October
- Headline inflation fell globally in the last quarter
  - Global headline inflation was 2.4% as at November, down from 2.7% in September
  - UK headline inflation expectations are almost unchanged over the quarter, with headline CPI measuring 2.3% as at November 2018
  - This remains 0.3% above the Bank of England's headline inflation target of 2%
  - Services inflation has continued to remain flat at 2.5%, which remains below the long-term average of 3.4% since 2000

**UK Gilt Yields & Curve Steepness Q3 2018**



**UK CPI vs Bank of England Target**



# Market Summary – Chief Investment Officer

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- The Federal Reserve raised rates in December to a range of 2.25-2.5%, which was the fourth rate rise of 2018
  - This move was no surprise to markets; however, Jay Powell announced later in the month that the Fed will consider pausing further tightening measures
  - The Fed also mentioned that two rate hikes are anticipated for 2019, which is still ahead of the broad market consensus
  - The announcement prompted further falls in the US 10-year yield, which fell to 2.68% at the end of the year
  - The 10-year US yield was as high as 3.2% as recently as November 2018; it has since fallen as a result of trade tensions

Source: Bloomberg as at 31/12/18

Tickers:

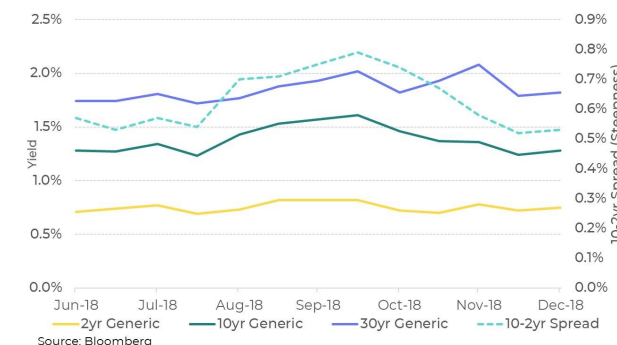
- GUKG2:IND - UK Govt Bonds 2 Year Note Generic Bid Yield
- GUKG10:IND - UK Govt Bonds 10 Year Note Generic Bid Yield
- GUKG30:IND - UK Govt Bonds 30 Year Note Generic Bid Yield

# Market Summary – Chief Investment Officer

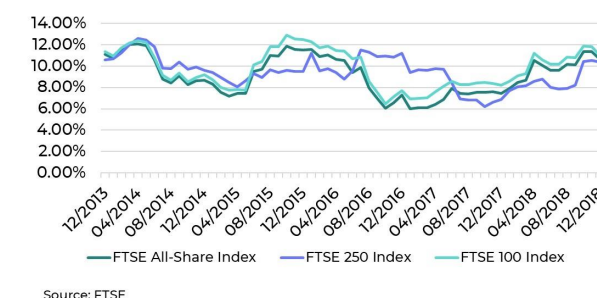
Equity markets experienced a difficult end to the year as Q4 saw a global sell-off due in part to the continuing USA/China trade tensions and increased quantitative tightening. A US government shutdown also added to investor anxiety. Despite this recent market decline, global earnings have remained strong. This combination of falling prices in the presence of strong earnings has depressed equity valuations with P/E's in US, Europe and EM currently 22% below their 2018 peaks.

- US equities led the sell-off in Q4 as the FED continued to raise interest rates and investor fears that the escalating tariffs were having detrimental effects on US business resulted in the S&P declining -13.5% in dollar terms over the quarter
  - The Industrials, Energy and the Tech sectors were the largest detractors to performance posting total returns from -23.8% to -17.1%
  - However, going into 2019 US economic data remains strong, with the US economy adding 2.64 million jobs over 2018 as wage growth increased by 3.2%, its largest annual growth in a decade
- Emerging Markets also ended the year on a low
  - The MSCI Emerging Index posted a -7.4% return in USD for Q4, resulting in a fall of 14.2% over the year
  - The year started positively with a Q1 return of 1.47%, however escalating trade tariffs and an increasing US dollar led to MSCI Emerging suffering 3 consecutive negative quarters
  - As mentioned last quarter, China has a 30% weighting in the Emerging markets and the performance of China has an effect on most other EM countries
  - This quarter, hampered by fears of economic slowdown, China detracted -10.73% in USD terms over the quarter, again largely contributing to the negative returns in Emerging markets
- European markets were down 11.6% in Euro terms over the quarter largely due to earnings downgrades and revisions
  - Industrial and Tech Sectors were the largest underperformers over the quarter, returning -15.1 and -15.8% respectively, closely followed by the Financial sector, which fell -13.6% over the quarter
  - Defensive sectors such as Utilities fared better over the quarter, posting a 4% total return
- FTSE All share was down 10.2% in Q4, and the FTSE 250 underperformed the FTSE 100 by 3.7%, returning -13.3%
  - The continued uncertainty surrounding Brexit has contributed to increased 1 year volatility

**2018 Cumulative Returns in GBP**



**1 Year Rolling Volatility of UK Indices**



# Market Summary – Chief Investment Officer

within the FTSE All Share index, which had been 7.5% at the start of the year and increased to 11.4% at its peak in November

- o GBP was down 2.55% vs the USD in Q4 and 6% in 2018. Against the EUR however, GBP declined -1.16% in Q4, representing 80% of the total -1.45% decline for 2018

- In contrast to the declining Equities markets, the price of Gold increased 11.3% in GBP terms over Q4 as many investors sought a safe haven
  - o Oil on the other hand was affected by the slowing global economy, falling 36.9% over Q4 and 21.9% over 2018

Sterling returns for indices:

- FTSE All-Share: -10.2% (3m) -9.5% (12m)
- MSCI Europe: -10.6% (3m) -9.0% (12m)
- MSCI Europe ex UK: -11.0% (3m) -9.1% (12m)
- MSCI ACWI: -10.6% (3m) -3.3% (12m)
- MSCI ACWI ex USA: -9.3% (3m) -8.4% (12m)
- MSCI Emerging: -5.2% (3m) -8.9% (12m)
- MSCI Emerging ex China: -3.6% (3m) -6.5% (12m)
- S&P 500: -11.5% (3m) 1.6% (12m)
- GBP Vs USD: -2.3% (3M) -3.5% (12M)

Page 186

# Market Summary – Head of Private Markets

## Overview

Global economic growth has decelerated and is expected to continue to decline for 2019 and beyond. In this environment, markets look set to remain volatile with a high risk of further market corrections. While downside risk has risen, falling asset prices could be an opportunity for long-term investors to exploit potential mispricing of macro risk.

The uncertainty caused by fears of a US-China trade war in December and the extended US federal shutdown this year suggests that the Federal Reserve may not rush to raise US interest rates much higher than the current 2-2.5%. Earnings predictions, particularly in the US, remain optimistic. In this context, the economic cycle appears to still have support.

## Infrastructure

In 2018, unlisted infrastructure fundraising marked an all-time high with total capital raised reaching \$85bn. This annual record is likely to be surpassed again in 2019.

However, 67 funds closed in the year, down from 94 in 2017. Mega funds dominated through the year, and the average fund size rose from \$864m in 2017 to \$1.3bn.

Aided by record fundraising, dry powder has climbed to a new record of \$172bn as at December 2018. 71% of funds closed through the year exceeded their fundraising targets.

Looking ahead, 208 funds are in the market, targeting an aggregate \$193bn in January, which would be a record high. Brookfield Infrastructure Fund IV and Global Infrastructure Partners IV are each targeting c\$20bn.

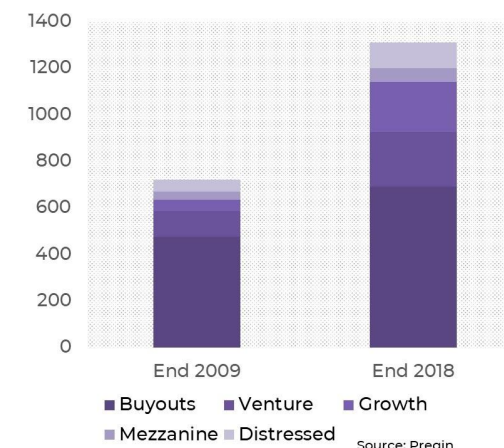
Investor interest in infrastructure shows no sign of abating in 2019 given the uncertain outlook and the asset class' relatively defensive characteristics. The asset class is not risk free and there is a danger that it is increasingly being perceived as so.

Brunel committed €50m to a pan-European core infrastructure fund and €30m to a renewable energy generation fund (onshore wind and solar electricity) in Q4 2018. Both have good sustainability credentials and are a good fit with Brunel's RI outlook.

## Private Equity

Private equity activity remained robust despite public equity market volatility, with investors taking

**Unfunded Commitments to PE Fund Worldwide, \$bn**



# Market Summary – Head of Private Markets

advantage of market disruptions.

Although exits decreased by c\$22bn in Q4 to c\$63bn, there has been an overall increase from last year (\$330bn 2018 vs. \$294m 2017). 460 companies acquired by PE firms were divested in Q4 2018.

PE Funds with final close in Q4 raised \$98bn – a decline from 2017. However, momentum has persisted with 2018 being the third consecutive year in which LPs committed more than \$400bn. Of this, 55% was invested in buyout funds and c20% in VC. The US remained the dominant market at 56%, with the remainder split equally between Europe and Asia/RoW.

Global committed but undrawn capital increased by \$131bn in 2018, to a record of >\$1.3tr. Investors should remain resolute and focus on building a portfolio with a view to the long-term. In times like this, consistent deployment by vintage and sound portfolio construction comes to the fore. The biggest mistakes in terms of investor behaviour are made in the tough market environments, yet the best performing funds emerge from these very circumstances.

The secondary market deal value has grown an estimated 15-20% since 2017 to c\$50bn, enhancing liquidity in portfolios and benefiting from attractive pricing levels. Using the secondary market as a portfolio risk management tool has become a popular strategy across large LPs globally. Brunel committed \$50m to a secondary fund in Q4 2018.

## Property

It is anticipated that investors will commit over €70bn to global property in 2019, despite the generally subdued outlook for the sector. In the UK, returns are expected to be particularly low (less than 4% p.a. total return over the next five years).

Rising interest rates in the US and compressed yields in the developed world real estate sectors have left the asset class looking expensive in many geographies. In addition, profit warnings and rationalisations in the traditional retail sector will continue in 2019. In the UK, even demand for industrial assets is expected to be more subdued this year, with total returns of over 15% in 2018 expected to reduce to around 6% in 2019. The office sector has remained surprisingly resilient in 2018 and has benefited in the UK from overseas investor interest and, in Europe, from supply shortages in specific cities.

Two large UK property fund managers, Columbia Threadneedle and Kames, have already re-priced several of their funds to a bid basis, following recent redemption requests. Clients should expect other UK generalist funds to adopt this policy in 2019, as managers seek to slow redemptions either

# Market Summary – Head of Private Markets

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by repricing units or by 'gating' funds. The FCA has proposed that UK property Non-UCITs Retail Schemes (NURS) should suspend dealing when there is 'material uncertainty' around the value of more than 20% of the fund's assets. Fund liquidity may therefore be tighter this year, but opportunities are likely to arise as valuations start to reflect the economic outlook.

# Responsible Investment Governance & Stewardship Review

## Listening to Your Views

We enjoyed the opportunity to share our approach to responsible investment and stewardship at stakeholder engagement days in November. It was helpful to hear the views and concerns of the committee and board members so we can reflect this in shaping and prioritising our work in this area.

One clear priority was the importance of reporting on what we are doing to deliver on our responsible investment commitments. We are delighted that from this quarter you will receive voting and engagement reports for assets invested in the Brunel portfolios. We are also working on providing more information directly and on our website on key themes.

## UK Regulatory Developments

In addition to our responsible investment and stewardship policies, we also publish responses to government and policy makers' consultations on our website. The most recent of these was to the [Bank of England](#) who were consulting on their draft supervisory statement which sets out "expectations regarding firms' approaches to managing the financial risks from climate change. These centre on how managing the far-reaching and foreseeable risks from climate change requires a strategic approach which considers how actions today affect future financial risks." (Prudential Regulation Authority (PRA))

On the theme of consultations, we welcomed the publication of Sir John Kingman's [Review of the Financial Reporting Council \(FRC\)](#) on 18 December 2018. The recommendations addressed all the concerns we had raised in our response and engagement with the FRC. The review recommends "the FRC be replaced with an independent statutory regulator, accountable to Parliament, with a new mandate, new clarity of mission, new leadership and new powers. The new regulator would be called the Audit, Reporting and Governance Authority."

## Diversity and Inclusion

We participated in an engagement, organised by the 30% Club, with Ross McEwan, CEO of the Royal Bank of Scotland (RBS) on the Bank's approach to diversity and inclusion. The bank's approach focuses on five different aspects of diversity and inclusion with commitments linked to measurable objectives and challenging targets. McEwan provided numerous examples of how being a more inclusive employer was supporting the delivery of their strategic plan and business growth.





## Climate Change

In 2015, at COP 21 in Paris, a landmark agreement was reached to combat climate change and to accelerate and intensify the actions and investments needed for a sustainable low carbon future. The central aim of this agreement was to keep temperature rises below 2 degree Celsius above pre-industrial levels. In December, the Conference of the Parties to the United Nations Framework Convention on Climate change met for COP24. Discussions focused on putting the Paris agreement into practice. Climate change is a key theme for Brunel. Assessment of the impacts of climate change encompass adaptation and physical risks as well as those risks and opportunities arising from the transition to a low carbon economy.

We are a signatory of [Climate Action 100+](#) (CA 100+), a five-year initiative led by investors to engage with systemically important greenhouse gas emitters and other companies across the global economy that have significant opportunities to drive the clean energy transition and help achieve the goals of the Paris Agreement. 310 Investors, with more than \$32 trillion in assets under management, are calling on companies to improve governance on climate change, curb emissions and strengthen climate-related financial disclosures. The initiative is coordinated by five partner organisations, Brunel is a member of two of these: [Principles for responsible investment](#) (PRI) and the Institutional [Investors Group on Climate Change](#) (IIGCC).

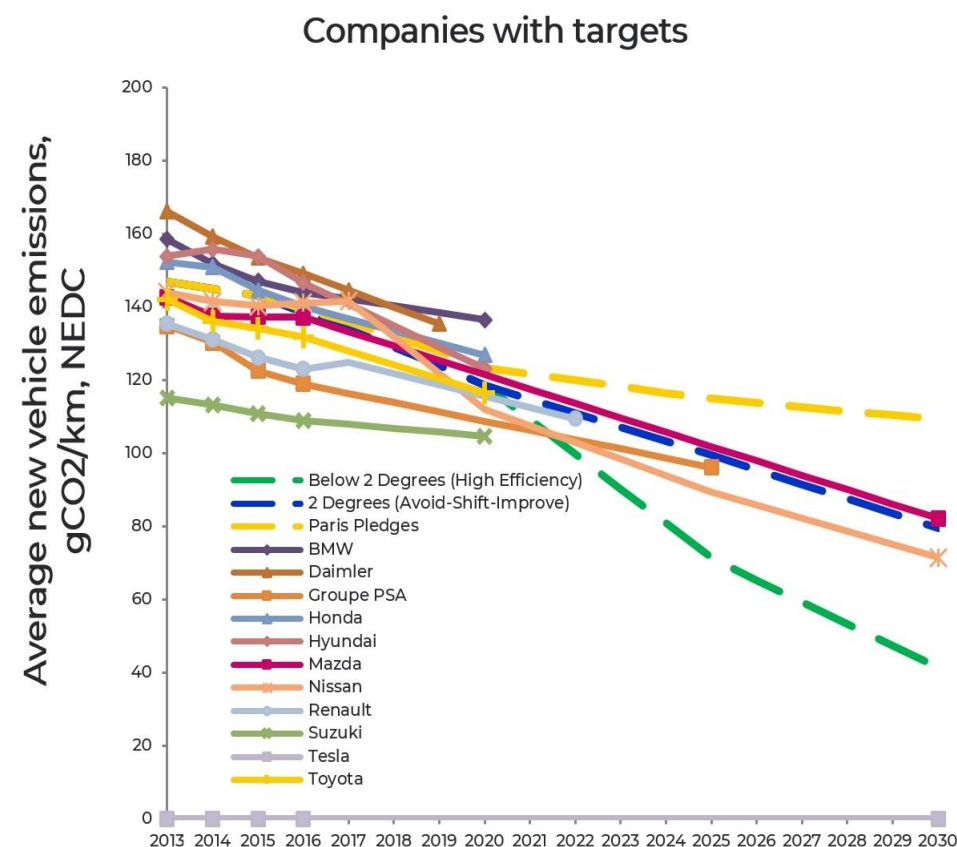
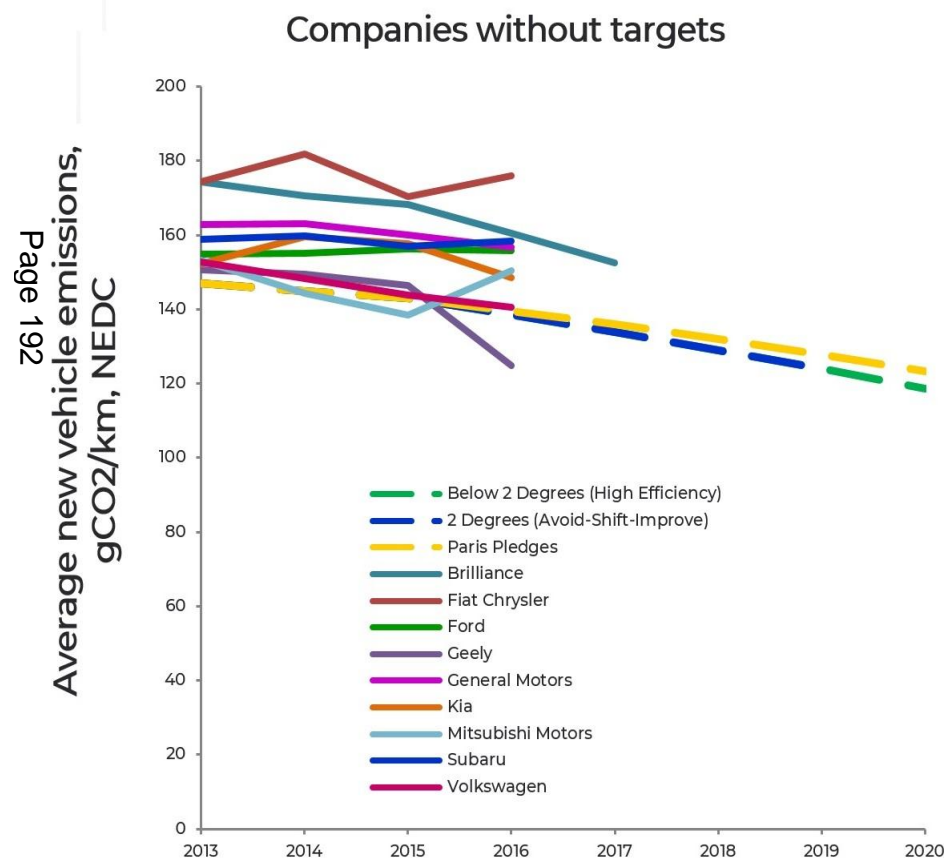
CA 100+ has made good progress towards its goals, including a trebling in support from companies for the recommendations of the Financial Stability Board's [Task Force on Climate-related Financial Disclosures](#) (TCFD). In December they announced a milestone achievement. Following collaborative engagement by CA 100+, Shell have committed to setting specific Net Carbon Footprint targets for shorter-term periods (three or five years) from 2020 to operationalise its long-term target ambitions. Furthermore, Shell will be taking the step to incorporate a link between energy transition and long-term remuneration into its policy.

## Transition Pathway Initiative

Research from the Transition Pathway Initiative (TPI) informs the engagements undertaken by CA 100+. Throughout Q4 18, the TPI released several publications, most recently a report on [Management Quality and Carbon Performance of automobile manufacturers](#). The following charts are an extract from this report and demonstrate the reduction in emissions achieved from target setting vs non-target setting. We will continue to provide outcomes of engagement in our regular reporting.



## Companies with targets have lower emissions than companies without targets



# Brunel Portfolios Overview

Portfolio	Benchmark	AUM (GBPm)	Perf. 3 Month	Excess 3 Month	Perf. 1 Year	Excess 1 Year	Perf. 3 Year	Excess 3 Year	Perf. 5 Year	Excess 5 Year	Perf. SI	Excess SI	Inception Date
Brunel UK Active Equity	FTSE All Share	171	-3.38%	-0.24%							-3.38%	-0.24%	21 Nov 2018
Passive Low Carbon Equities	MSCI World Low Carbon Target	473	-11.24%	-0.01%							-7.31%	-0.12%	11 Jul 2018

# Passive Low Carbon Equities

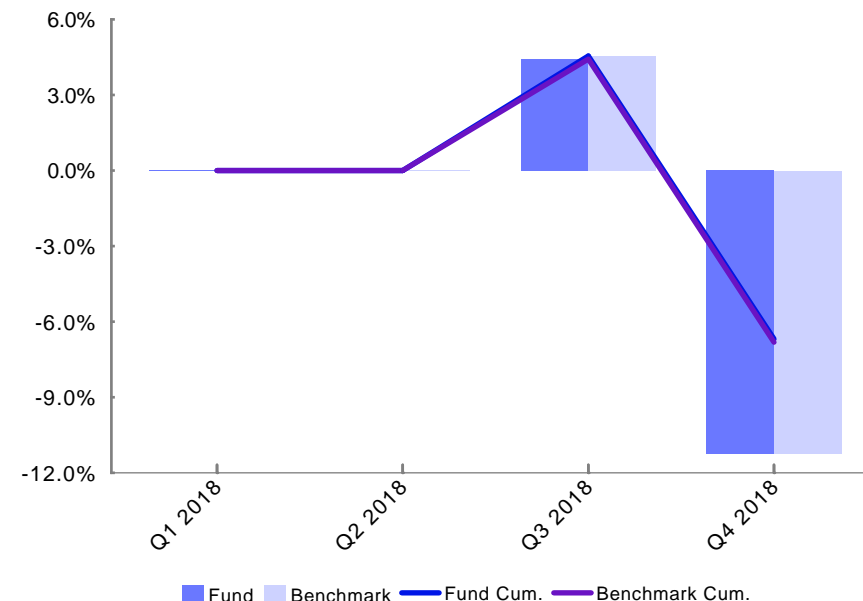
## Overview

	Description
Portfolio Objective:	Provide exposure to equity returns and global economy with low exposure to carbon emissions and fossil fuels.
Investment Strategy & Key Drivers:	Portfolio is invested in global equities in accordance with Low Carbon index.
Liquidity:	High
Risk/Volatility:	Absolute: High Relative: V.Low
Holding:	£472,991,524

## Quarterly performance

All values in %	Fund	BM	Excess
3 Month	-11.24	-11.23	-0.01
Fiscal YTD	0.00	0.00	0.00
1 Year	0.00	0.00	0.00
3 Years	0.00	0.00	0.00
5 Years	0.00	0.00	0.00
10 Years	0.00	0.00	0.00
Since Inception	-7.31	-7.19	-0.12

## Rolling Performance



Passive Low Carbon returned negative performance over the quarter. Performing in line with its MSCI Low Carbon benchmark, the portfolio returned -11.24%.

- The Low Carbon portfolio was affected by the global equity sell off throughout Q4. As the US has such a large allocation to global equities, around 60%, this region was the largest contributor to negative performance
- With regards to global sectors, Financials and Technology were the largest contributors to global negative performance

# Active UK Equities

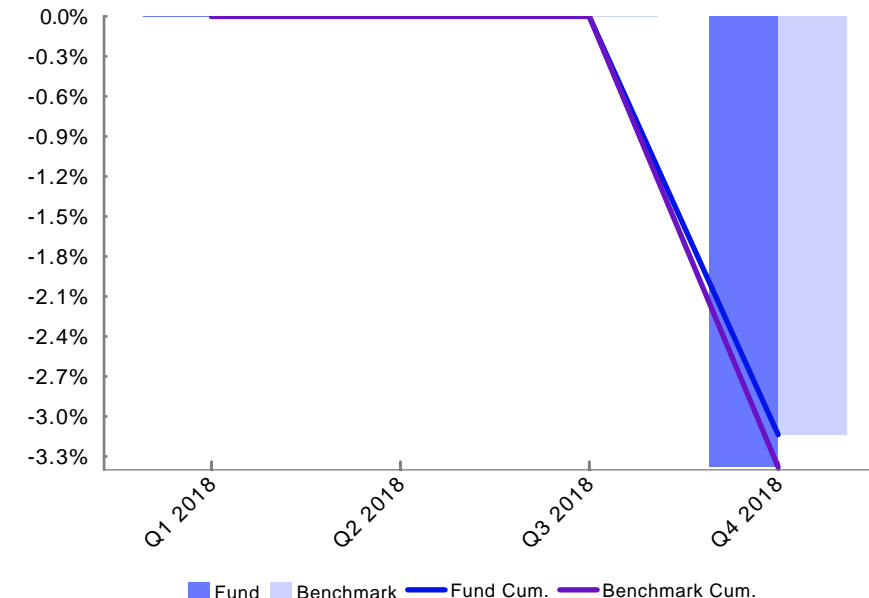
## Overview

	Description
Portfolio Objective:	Provide exposure to UK Equities, together with enhanced returns from manager skill.
Investment Strategy & Key Drivers:	Skilled managers will create opportunities to add long term value through stock selection and portfolio construction.
Liquidity:	Managed level of liquidity. Less exposure to more illiquid assets.
Risk/ Volatility:	High absolute risk with moderate relative risk, around 4% Tracking error.
Holding:	£170,762,981

## Quarterly performance

All values in %	Fund	BM	Excess
3 Month	-3.38	-3.14	-0.24
Fiscal YTD	0.00	0.00	0.00
1 Year	0.00	0.00	0.00
3 Years	0.00	0.00	0.00
5 Years	0.00	0.00	0.00
10 Years	0.00	0.00	0.00
Since Inception	-3.38	-3.14	-0.24

## Rolling Performance



During the course of Q4, client assets transitioned into the Brunel portfolio from incumbent managers. The portfolio consists of three sub managers with an allocation of 25% Baillie Gifford, 25% Aberdeen Standard and 50% Invesco.

- Since inception on 21 November, the portfolio has underperformed the FTSE All share by 0.2%. However, this is on a net basis and is inclusive of all restructuring costs to achieve the target portfolio
- The one-month return for December, which will exclude a number of costs associated with restructuring, is -3.9% vs -3.75%, with a slight underperformance of 0.15%. However, we can still attribute 4bps of relative underperformance to an illiquid portfolio of incumbent assets
- The vast majority of illiquid assets have been sold down. Going forward we do not expect any restructuring costs associated with the transition to impact future returns

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Bath & North East Somerset Council		
MEETING:	AVON PENSION FUND INVESTMENT PANEL	
MEETING DATE:	27 February 2019	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
May 2019	<ul style="list-style-type: none"><li>• Cancelled due to elections</li></ul>
September 2019 (extended meeting)	<ul style="list-style-type: none"><li>• Review performance</li><li>• Transition of assets - plan update</li><li>• Introduce Brunel Client reports for assets managed by Brunel</li><li>• Consider options for Equity protection and LDI strategies given 2019 valuation market levels</li><li>• Implementation considerations from strategic review</li></ul>
November 2019	<ul style="list-style-type: none"><li>• Review performance</li><li>• Transition of assets - plan update</li><li>• Agree future strategy for equity protection and LDI post strategic review workshops</li><li>• Implementation considerations from strategic review</li></ul>
February 2020	<ul style="list-style-type: none"><li>• Review performance</li><li>• Transition of assets - plan update</li><li>• Implementation considerations from strategic review</li><li>• Agree Private Market commitments to Brunel portfolios (by 31 March 2020)</li></ul>

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.

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

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