

# Avon Pension Fund Committee Investment Panel

**Date: Friday, 25th February, 2022**

**Time: 2.00 pm**

**Venue: Virtual Meeting - Zoom - Public Access via  
YouTube**

**<https://www.youtube.com/bathnescouncil>**

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

Councillor Shaun Stephenson-McGall (Chair), Councillor Paul Crossley, Councillor Chris Dando, John Finch, Pauline Gordon and Shirley Marsh-Hughes

Chief Executive and other appropriate officers  
Press and Public



**Mark Durnford**

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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>

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.

**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 can be found at:

<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 - Friday, 25th February, 2022

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### A G E N D A

1. WELCOME & INTRODUCTIONS
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: 19TH NOVEMBER 2021 (PUBLIC & EXEMPT) (Pages 7 - 24)
8. PRIVATE MARKET PORTFOLIOS (Pages 25 - 72)

The investment cycles for the Brunel private markets are every two years. Cycle 3 (2022-2024) portfolio specifications have been finalised and new capital committed will be invested from April 2022. Brunel will provide an update on the Cycle 1 & 2 portfolios as well as a Cycle 3 forward-look at the meeting.

9. REVIEW OF INVESTMENT PERFORMANCE FOR PERIODS ENDING 31 DECEMBER 2021 (Pages 73 - 182)

This paper reports on the performance of the Brunel and legacy portfolios and seeks to update the Panel on routine aspects of the Fund's investments. The report contains performance statistics for periods ending 31 December 2021.

10. RISK MANAGEMENT FRAMEWORK REVIEW FOR PERIODS ENDING 31 DECEMBER 2022 (Pages 183 - 222)

The Funding and Risk Management Group (FRMG) is responsible for agreeing the operational aspects relating to the Fund's risk management framework thereby ensuring that strategic objectives continue to be met. This report informs Panel of issues considered and decisions made by FRMG as well as any recommendations.

11. FORWARD AGENDA (Pages 223 - 226)

This report sets out the forward agenda for the Panel for 2022/23. It 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 Mark Durnford who can be contacted on 01225 394458.



**BATH AND NORTH EAST SOMERSET**

**AVON PENSION FUND COMMITTEE INVESTMENT PANEL**

Friday, 19th November, 2021

**Present:-** Councillor Shaun Stephenson-McGall (Chair), Councillor Paul Crossley, Councillor Chris Dando, John Finch, Pauline Gordon and Shirley Marsh-Hughes

**Advisors:** Steve Turner (Mercer) and Josh Caughey (Mercer)

**Also in attendance:** Tony Bartlett (Service Director - Financial Control and Pensions), Liz Woodyard (Group Manager for Funding, Investment & Risk) and Nathan Rollinson (Investments Manager)

**25 WELCOME & INTRODUCTIONS**

The Chairman welcomed everyone to the meeting. He made a statement to the Panel regarding the recent COP 26 meeting. A copy of the statement can be found as an online appendix to these minutes, a summary is set out below.

I am encouraged by the commitments made across constituencies, sectors and national jurisdictions as part of COP including action on coal, vehicles, finance and nature. I see a lot of these pledges as a direct reflection of the work undertaken by the Fund.

As a Fund we have recently made a significant decision to realign our equities portfolio – moving over half a billion of equities to a Paris aligned fund which is designed to divert capital away from carbon intensive sectors and companies and reward those that are well positioned for the transition. This includes the complete exclusion of coal and tar sands companies as well as companies whose primary business function relates to the exploration, extraction or distribution of fossil fuels and will ultimately see us reduce carbon emissions by 7% each year in line with a 2050 net zero trajectory.

COP saw The Glasgow Financial Alliance for Net Zero (GFANZ) announce that capital committed to net zero by 2050 now stands at over \$130tn. Included within this staggering statistic are the IIGCC Paris Aligned Asset Owners group, to which the Fund belongs. This framework commits us not only to achieving net zero emissions by 2050, but also to delivering significant reductions in emissions in the interim. To that end, we have recently adopted two new decarbonisation objectives, which will see the Fund reduce absolute emissions by 43% by 2025 and 69% by 2030 (vs. a 2020 baseline).

Recognising the importance that commitments are backed up by tangible action we have agreed to divest over £280m from emerging market companies, which will produce an immediate reduction of Fund emissions by 28%; exiting regions where wholesale policy shifts are more difficult to achieve. The proceeds will instead be invested in a broad range of climate and environmental solution providers as well as companies that contribute to social sustainability.

Over the last 6 months we have increased our communications with members by utilising social media and connecting with our membership directly. This month saw the launch of our first ESG member survey; the results of which will be used to inform future strategy on climate.

The role for the Fund and its strategic partners remains as critical as ever. We will continue to collaborate, engage with companies to accelerate progress towards net zero, and continue to advocate for a supportive policy environment that will facilitate change ultimately for the benefit of our members.

**26 DECLARATIONS OF INTEREST**

There were none.

**27 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS**

There were none.

**28 TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR**

There was none.

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

There were none.

**30 ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS**

There were none.

**31 MINUTES: 17TH SEPTEMBER 2021 AND 17TH SEPTEMBER 2021 EXEMPT**

The Panel were minded to approve the minutes.

**32 INFRASTRUCTURE PORTFOLIOS**

The Group Manager for Funding, Investment & Risk introduced this item to the Panel and highlighted the following areas from the report.

The legacy portfolio is 'generalist' in that it invests across a range of infrastructure assets whereas to date the Fund has invested in Brunel's renewables portfolio, noting that Brunel have also offered a 'generalist' infrastructure portfolio in each investment cycle. Therefore, the legacy portfolio provides diversification within infrastructure for the Fund.

Brunel is in process of finalising the private market portfolio specifications for the next cycle of private market investments. The portfolio specification has not been agreed as yet and Mercer advice is subject to the final portfolio offered.

This paper is for the Panel to explore the potential options and implications (operationally, timing) for the legacy portfolio. Allocations to the next cycle of private market portfolios offered by Brunel will be agreed at the Panel meeting in 1Q22, once portfolio specifications are available.

The Fund can allocate to the next Brunel infrastructure portfolio to maintain the current strategic allocation independently of any decision concerning the legacy portfolio.

The Panel, having been satisfied that the public interest would be better served by not disclosing relevant information, **RESOLVED**, in accordance with the provisions of the Section 100(A)(4) of the Local Government Act 1972 that the public should be excluded from the meeting for this item of business, because of the likely disclosure of exempt information as defined in paragraph 3 of Part I of Schedule 12A of the Act as amended.

The Panel were minded to note the report and next steps outlined.

### 33 PERFORMANCE MONITORING

The Investments Manager introduced this report to the Panel and highlighted the following points.

- The Fund's assets increased by £139m in the quarter (2.9% net investment return) ending 30 September 2021 giving a value for the Fund of £5,710m. Sustainable Equities did well despite the surge in Gas prices. No major concerns to raise at this stage.
- Responsible Investment – COP 26: Onus to drive change on the private sector. Climate disclosures becoming more mandatory.
- Draft TCFD report and Responsible Investment Annual Report due for discussion at Committee meeting in December.

Josh Caughey, Mercer addressed the Panel and highlighted points from within Appendix 2 - Mercer Performance Monitoring Report.

#### **Executive summary**

- Funding level and risk: The funding level is estimated to have improved slightly over Q3 to just over 101%, as asset growth outweighed the rise in the value of the liabilities. It is estimated to have increased by 8% over the year to 30 September 2021.
- The Value-at-Risk rose over the quarter to £1,206m, or 21.4% of liabilities, mainly due to the increase in the absolute value of the assets. Risk as a proportion of liabilities has reduced over the year, largely due to the decision to move towards a dynamic equity option strategy.

## **Market Outlook**

- Global equity returns were flat over the quarter in US dollar terms on the back of heightened fears over recent increases in the price of energy and related supply chain disruptions. However, central banks and in particular the US Federal Reserve continued to assert that the rise in inflation was transitory and would dissipate over time. A weaker sterling led to positive global equity returns in the low single digits for unhedged UK investors.
- Economic activity remained strong although the rise of the delta variant and shortages of people and goods in some sectors slowed activity through the quarter. While governments mostly avoided imposing new lockdowns, activities in certain face-to-face sectors, most notably travel, softened. In addition, ongoing supply disruptions in a range of sectors (most notably the auto sector) led to both less activity and higher prices.
- We expect economic growth to remain strong, although supply disruptions and near term weakness in China, could lead to near term growth being weaker than we had thought. However, any growth shortfall this year may be offset by better growth next year, especially in China and supply constrained sectors. It seems likely that the impact of COVID on economies and markets will fade, especially in those economies that have vaccinated the most.

## **Performance vs. expected strategic returns**

Returns have been above expectations for all equity mandates, given the strength of equity markets since 2019.

BlackRock Passive Global Equity - Returns are above strategic expectations and the mandate has tracked the underlying market.

Brunel Global Sustainable - Strong returns from equity markets and the mandate has now outperformed thanks to a strong third quarter.

Brunel Emerging Markets - Returns are above strategic expectations though the mandate has underperformed benchmark since inception.

Brunel Diversified Returns - Returns above expectation so far thanks to exposure to rising equity markets and some of the asset class positioning of the four underlying managers.

Brunel UK Property - Mandate inception in January 2021; too early to draw conclusions although property market has fared well so far in 2021.

Brunel Renewable Infra - Returns above expectations (despite contracting over one year period), but mandate is still in the drawdown phase.

Shirley Marsh-Hughes asked if the Value at Risk takes into account the risk strategies put in place.

Josh Caughey replied that it does in terms of reduction in assumed volatility in equities and allows for the ongoing dynamic protection that is in place.

Shirley Marsh-Hughes suggested that within a future report a comparison is shown for VaR without the risk strategies.

Steve Turner replied that that would be possible. He added that they could also attempt to show a comparison with other LGPS funds.

The Service Director for Financial Control and Pensions commented that there is always likely to be an element of risk within the portfolio and asked if the Fund was taking on more risk than normal due to the growth of the portfolio.

Steve Turner replied that the level of risk within the investment strategy would always take into account wider funding elements. He added that work is being carried out on this and was a topic that could be discussed more widely in the future.

He then highlighted some main points within Appendix 5 – Mercer Paper: Managing Inflation Risk to the Panel.

- Given that the Fund's liabilities are linked to inflation, one of the Fund's key risks is that investment returns don't keep pace with the liabilities in an elevated and sustained inflationary scenario. If inflation rises by 1% and the assets don't keep pace, then this would be equivalent to a 30% fall in the value of the Fund's equity holdings (c. £700m funding strain).
- The investment portfolio is robust to a wide range of inflationary scenarios through the direct inflation hedging within the liability driven investment (LDI) strategy, as well as allocations to real assets such as infrastructure and property that provide some inflation sensitivity.
- Important to have lots of diversification within the portfolio because different asset classes will help us in different ways in different times.

### Introduction

- Long term secular forces driving disinflation such as globalisation could be turning the other way now.
- Direct inflation risks have also increased as a result of changed central bank philosophies and more monetary/fiscal coordination.
- Governments may prefer to reduce public debt indirectly through higher inflation rather than outright taxation.
- We believe the risk of seeing a wider range of outcomes has increased, including among them:
  - more frequent inflation regime changes
  - higher inflation volatility
  - longer periods of higher inflation levels

### Markets may be underestimating the risk of higher inflation

- Inflation levels are currently well above the Bank of England's 2% p.a. target, but most central banks' current view is that this is transitory.
- The risk is that current inflation becomes more entrenched and problematic, noting higher inflation is also associated with higher volatility of inflation.
- Across the developed world, short term inflation is highest in the UK, however, we view the weakening of secular disinflationary forces is a global phenomenon.

### What's the fundamental issue with inflation?

- The Fund's liabilities are directly linked to (uncapped) CPI inflation. A rise of inflation by 1% p.a. would increase the size of the liabilities by 20% (all else equal).
- This means that the investment strategy has to deliver an additional 1% p.a. otherwise this would lead to a funding strain putting upwards pressure on contributions.
- The Fund's discount rate for past service is currently CPI + 1.75% p.a. meaning if (CPI) inflation is higher, the Fund's investments need to return more in order to satisfy the discount rate requirements.

### Assessing inflation risk

- The likelihood of certain inflationary scenarios occurring has increased.
- Equity/bond dominated portfolios have performed well through the last two decades of disinflation...but a transition to a more inflationary regime could negatively impact both equities and bonds.
- Rising likelihood and adverse impact means inflation exposure for the average portfolio should be reviewed to avoid taking unrewarded risk. This inflation risk may require a re-alignment of portfolios.

### Different scenarios are shaped by different inflation drivers...

We consider different forward-looking economic scenarios of how economies and markets could behave under different conditions resulting from different combinations of inflation drivers and other factors that interact.

- Demand-pull drivers: Economic Growth / Monetary & Fiscal Policy
- Cost-push drivers: Supply costs / Labour costs / Technological productivity gains

Pauline Gordon asked if further discussion was required with the Actuary regarding CPI+ and the basis.

Steve Turner replied that around two valuations ago it was common for LGPS to have discount rates that were Gilts based, but struggled to lock into them. He added that a broader discussion with the Actuary would be welcome. He said that Mercer were comfortable with CPI+ basis.

## Building scenarios - Incorporating energy transition

- A major scenario that has not been discussed so far is that of energy transition. We believe this is a critical consideration and needs to be considered separately from broader economic scenario analysis.
- Rather than being an economic scenario on its own, we expect it to occur alongside many of the scenarios considered here.
- The risks and opportunities presented by energy transition are likely to be more dependent on specific strategy selection than higher level asset class allocation, which means it is harder to generalise in an asset class heat-map.

## Asset classes to mitigate inflationary environments

### Private Debt

- Vast majority of cases a floating-rate asset class that provides a 'hedge' against central bank rate response to inflation.
- Higher starting yields make them a more attractive option than listed floating rate instruments.
- Could become a useful part of the portfolio going forward.

### Commodities, and commodity related strategies

- Commodities hedge against cost-push inflation as they tend to exhibit high 'inflation beta'. Economic transformation drives demand for commodities – urbanization and energy transition are structural forces that could support prices over the longer term.
- Volatile, with ESG implications.

Equity Protection to act as a shock absorber.

## Summary

No single asset class gives universal inflation protection to all scenarios – we need to invest across a selection of strategies to help broaden the protection and the Fund has many of the building blocks already.

The Fund is well positioned for growth scenarios where inflation moderately exceeds central bank targets (balanced growth) or where central banks force nominal yields below inflation (financial repression) – equities and traditional real assets such as property and infrastructure can provide what we feel to be sufficient protection.

The Fund is vulnerable to the overheat scenario where inflation spins out of control and central banks need to respond. Where they scramble to rein it in, rate risk may become more significant than inflation risk, and floating rate strategies such as private debt may soften the blow. Long nominal bonds (gilts and corporate bonds) are very exposed in these scenarios, suggesting maintaining a low interest rate hedge ratio.

Under the pandemic stagflation scenario where growth and inflation pull the central bank in different directions, the addition of gold or commodities can help protect against tail inflation risks but these present governance and operational difficulties.

Under the hard landing scenario, downside protection that worked in the past such as government bonds will be of limited use for valuation reasons. The equity protection downside strategy will help manage downside risk and introducing gold could be considered as an alternative to government bonds.

### Conclusion and next steps

The Fund is well positioned against growth-oriented and/or long term inflation scenarios. Outright inflation protection through the LDI portfolio but with a low interest rate hedge ratio, as well as allocations to equities, infrastructure and real estate with inflation sensitivity.

A next step for the Fund could be to review the level of inflation protection at a portfolio level across the different inflationary scenarios and the impact of different investment strategies. This would look to assess direct and indirect sensitivities.

The Panel could look to increase the inflation hedge ratio (for example, by 10%, up to the current maximum permitted under the risk management framework) via the BlackRock LDI mandate, which could be implemented quickly, however there are practical considerations around the level of collateral required to implement this change. The FRMG will be considering whether the hedge ratios remain appropriate in more detail.

A diversified exposure across a range of assets is a pragmatic solution to help the Fund mitigate various inflationary scenarios.

Shirley Marsh-Hughes asked if we were to increase Inflation Protection without having a high level of Interest Rates protection there would be a risk that we would become out of balance.

Steve Turner replied that it was not impossible to increase Inflation Protection, but that the Fund would have to depart from its current framework and analyse so that risk is not increased elsewhere within the portfolio.

The Panel were minded to note the information as set out in the reports.

## **34 RISK MANAGEMENT FRAMEWORK**

The Investments Manager introduced this report and highlighted the following points to the Panel.

- The Liability Driven Investment (LDI) strategy was additive to returns with no triggers breached during this period.
- The Equity Protection Strategy (EPS) was additive to returns in September but has since detracted since inception. It is currently 'amber' (under review)



as it needs to be restructured following decision to change the equity allocations.

- All Risk Management strategies are performing as expected.
- The Funding and Risk Management Group (FRMG) has considered how many counterparties the additional global equity exposure should be split across, which counterparty should be selected and the process for implementation.

The Panel, having been satisfied that the public interest would be better served by not disclosing relevant information, **RESOLVED**, in accordance with the provisions of the Section 100(A)(4) of the Local Government Act 1972 that the public should be excluded from the meeting for this item of business, because of the likely disclosure of exempt information as defined in paragraph 3 of Part I of Schedule 12A of the Act as amended.

The Panel were minded to:

- (i) Note the current funding level and LDI hedging position
- (ii) Note the impact and performance of the equity protection strategy
- (iii) Note the current collateral adequacy position
- (iv) Note the current FRMG workstreams as summarised in sections 5-7 below

## 35 FORWARD AGENDA

The Group Manager for Funding, Investment & Risk introduced this report to the Panel.

Shirley Marsh-Hughes asked if the Taskforce on Climate-related Financial Disclosures (TCFD) report could be shared in advance of the December Avon Pension Fund Committee meeting.

The Group Manager for Funding, Investment & Risk replied that she would do so.

The Panel were minded to note the forward agenda.

The meeting ended at 4.10 pm

Chair(person) .....

Date Confirmed and Signed .....

**Prepared by Democratic Services**

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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:	25 FEBRUARY 2022	AGENDA ITEM NUMBER
TITLE:	Private Market Portfolios	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
List of attachments to this report:		
Exempt Appendix 1 – Brunel Private Markets Update		
Exempt Appendix 2 – Mercer Paper: Brunel Private Markets Cycle 3 Commitments		

## 1 THE ISSUE

- 1.1 The investment cycles for the Brunel private markets are every two years. Cycle 3 (2022-2024) portfolio specifications have been finalised and new capital committed will be invested from April 2022.
- 1.2 The Fund is not altering its strategic allocations to the private market portfolios; these were agreed by the Committee in April 2020. The Fund currently has strategic allocations to the Secured Income, Renewable Infrastructure and Private Debt portfolios.
- 1.3 As the overall value of the Fund has increased since the Fund made its Cycle 2 commitments in 2020, the capital committed is short of the target allocations in monetary terms. Therefore, more capital is being committed to Cycle 3 portfolios to ensure the Fund reaches and then maintains its strategic allocation targets.
- 1.4 Brunel will provide an update on the Cycle 1 & 2 portfolios as well as a Cycle 3 forward-look at the meeting. Their presentation can be found at Exempt Appendix 1.
- 1.5 Mercer has provided assurance that the Cycle 3 private market portfolios still meet our strategic objectives (see Exempt Appendix 2).

## 2 RECOMMENDATION

- 2.1 **The Panel notes the capital being committed to Cycle 3 private market portfolios to reach the existing strategic allocations as outlined in Exempt Appendix 2.**

### **3 FINANCIAL IMPLICATIONS**

- 3.1 The fees that Avon will pay to its investment managers including Brunel are provided for in the Fund's annual budget. The fees on private market portfolios are higher than that for listed market portfolios.

### **4 CYCLE 3 PRIVATE MARKET COMMITMENT TOP-UP**

- 4.1 Given the commitment/draw down nature of private market investing, where committed capital takes time (1-5 years) to be invested, coupled with distributions of capital over the life of the fund (particularly in the latter years of a fund's life), it is difficult to achieve and maintain the strategic allocation. To mitigate this, the Fund periodically commits more capital when it is falling behind the target allocation, targeting a 2% 'overcommitment' to maintain the allocation over the life cycle of the underlying investments.
- 4.2 Commitments to Brunel private market portfolios are a fixed monetary amount at each 2 yearly cycle, based on the Fund value at the time of each cycle. As the Fund's value has increased since the strategic allocations to private markets were agreed in April 2020, the capital committed to private market portfolios has fallen behind the target allocations. Therefore more capital is being committed to achieve the overall strategic allocations to private market portfolios.
- 4.3 The Fund currently has a 10% allocation to the Secured Income portfolio which provides the Fund with contractual, inflation-linked long dated cashflows.
- 4.4 The Fund has a 10% overall allocation to infrastructure split equally between core infrastructure (5%), which is managed by the legacy manager IFM, and Renewable Infrastructure (5%), managed by Brunel. The renewable infrastructure allocation remains a key strategic allocation given the Fund's wider climate change objectives. Although Brunel Cycle 3 will not offer an explicit renewables 'sleeve' Mercer have confirmed the Cycle 3 specification for this portfolio meets the Fund's climate and risk/return objectives given the focus for Cycle 3 is climate mitigation solutions.
- 4.5 The Fund has a 5% allocation to private debt which serves to enhance risk/return through the so-called 'illiquidity premium' and is made up of primarily floating rate loans, therefore minimising the Fund's exposure to increasing interest rates.
- 4.6
- 4.7 Mercer have provided assurance (see Exempt Appendix 2) that the portfolio specifications for each of the Cycle 3 portfolios are in line with the Fund's investment risk and return objectives. The increased monetary commitments are also set out in Exempt Appendix 2.

### **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 CLIMATE CHANGE**

6.1 The Fund is implementing a digital strategy across all its operations and communications with stakeholders to reduce its internal carbon footprint. The Fund acknowledges the financial risk to its assets from climate change and is addressing this through its strategic asset allocation to Low Carbon Equities and renewable energy opportunities. The strategy is monitored and reviewed by the Committee.

## **7 EQUALITIES**

7.1 A proportionate equalities impact assessment has been carried out using corporate guidelines and no significant issues have been identified.

## **8 OTHER OPTIONS CONSIDERED**

8.1 None.

## **9 CONSULTATION**

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, Investments Manager; 01225 395357
<b>Background papers</b>	Brunel Client Group papers
<b>Please contact the report author if you need to access this report in an alternative format</b>	

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**Access to Information Arrangements**

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

Information Compliance Ref: 748539

Meeting / Decision: AVON PENSION FUND INVESTMENT PANEL

Date: 25<sup>th</sup> February 2022

Author: Nathan Rollinson

**Report Title:** Private Market Portfolios

**Exempt Appendix 1 – Brunel Private Markets Update**

**Exempt Appendix 2 – Mercer Paper: Brunel Private Markets Cycle 3  
Commitments**

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

Stating the exemption:

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

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

**PUBLIC INTEREST TEST**

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

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

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

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

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

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

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

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of the Local Government Act 1972.

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<b>Bath &amp; North East Somerset Council</b>	
MEETING:	<b>AVON PENSION FUND INVESTMENT PANEL</b>
MEETING DATE:	<b>25 FEBRUARY 2022</b>
TITLE:	<b>Review of Investment Performance for Periods Ending 31 December 2021</b>
WARD:	ALL
<b>AN OPEN PUBLIC ITEM</b>	
<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 – Quarterly Portfolio Monitoring Summary</p> <p>Appendix 4 – Brunel Quarterly Performance Report</p> <p>Appendix 5 – Mercer Paper: Themes and Opportunities 2022</p>	

## 1. THE ISSUE

- 1.1. This paper reports on the performance of the Brunel and legacy portfolios and seeks to update the Panel on routine aspects of the Fund's investments. The report contains performance statistics for periods ending 31 December 2021.
- 1.2. The Mercer Performance Monitoring Report at Appendix 2 is presented in its revised format and will continue to evolve over time to focus on strategic issues. At the time of writing the capital markets data required to calculate the Fund's Value at Risk (VaR) was unavailable. An updated report will be distributed to Members via email ahead of the meeting.
- 1.3. The performance of the Fund's Risk Management Framework is considered separately under Agenda Item 9 – Risk Management Framework Review.
- 1.4. Exempt Appendix 3 contains a summary table which is designed to flag any concerns from a performance and/or RI perspective. The table has been compiled using data provided by Brunel as part of their routine reporting process. At the time of writing the Client Group meeting which Fund officers use to scrutinise quarterly performance reporting had not taken place. Any material issues arising from this meeting will be tabled at the meeting.
- 1.5. Appendix 4 is the quarterly performance report published by Brunel which focuses on the performance of the Brunel portfolios and responsible investment activity undertaken on the Fund's behalf over the quarter.
- 1.6. Appendix 5 is a Mercer paper that examines several different themes that investors should consider in their decision-making in 2022. It is a discussion document – there are no recommendations.

## **2. RECOMMENDATION**

**2.1. Notes 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 2019 will impact the next triennial valuation which will be calculated as at 31 March 2022. The returns quoted are net of investment management fees.

## **4. INVESTMENTS UPDATE**

### **A – Fund Performance**

4.1. The Fund's assets increased by £185m in the quarter (3.6% net investment return) ending 31 December 2021 giving a value for the Fund of £5,895m. (see Appendix 5 for asset allocation).

4.2. The final quarter of 2021 saw high volatility levels caused by ongoing inflationary pressures and the rise of the Omicron variant in November. However, falls then reversed into December as reports suggested reduced severity in this new variant, leading to positive overall returns for some risk assets. Most equity assets rose in value over the quarter, while commodities were mixed and corporate credit struggled. In the UK, as inflation hit 5.2% in November, its highest rate in a decade, the Bank of England (BoE) became the first developed market to raise interest rates. Despite this rise, the BoE expects inflation to continue its upwards path into 2022 due to a strong labour market. The quarter also saw central bank movements elsewhere as the US Federal Reserve announced a tapering of asset purchases, at double the pace previously communicated, and the European Central Bank considered reducing similar stimulus. Despite geopolitical concerns over the continued build-up of Russian military assets near Ukraine, global developed equities rose by 7% mainly due to strong US performance. However, Emerging Markets performance turned negative, losing 1.7%, due to slowing growth in China and persistent concerns over its indebted property sector. In UK LDI markets, Q4 brought falling gilt prices due to interest rates rises, with December seeing 5-year gilt yields increasing 20bps, 10-year yields increasing 16bps to 0.97% and 30-year yields increasing 26bps to 1.12% versus November. Many investors looked to Infrastructure assets to help protect against inflation, while the quarter saw the \$1.2trn US Infrastructure bill pass with new spending on transport and utilities. Renewables saw increased attention following COP26, which added to already high demand from investors. Private Debt saw issuance slow in December, but defaults remained minimal. UK commercial property was the best performing property sector to the end of 2021. Similarly, global real estate remained strong, with a reversal in assets that suffered during lockdown (offices, apartments, retail). Sterling appreciated against the US Dollar by 0.5%, by 2.4% against the Euro and by 3.7% against the Japanese Yen. Further information on 4Q asset class performance can be found in the Mercer report at Appendix 2.



## **B – Investment Manager Performance**

- 4.3. Brunel reports on the performance of the assets they manage on behalf of the Fund. The report for each Brunel portfolio can be found on pages 15-42 of Appendix 4.
- 4.4. The Mercer report at Appendix 2 provides strategic level information including total fund level performance, current funding level and an analysis of how the Fund's mandates are performing against expected strategic returns.
- 4.5. The Global Sustainable Equity portfolio again posted strong performance, achieving a 6.8% absolute return over the quarter, which was 0.5% ahead of its benchmark due to positive sector allocation. The High Alpha portfolio returned 6.3% in absolute terms, underperforming the index by 1.1%. Underperformance in this portfolio was driven by stock selection, which was weakest in IT, and an overweight to China as some Covid winners started to give up their gains. The new Paris Aligned Portfolio posted an absolute return of 3.8% in the two months since its inception on 1st November 2021, in line with its benchmark. The legacy passive Low Carbon portfolio, which is due to be wound down and proceeds re-allocated to the sustainable equity portfolio by the end 1Q22, posted an absolute return of 7.4% for the quarter. Multi Asset Credit (MAC) achieved a 0.4% return vs. the 1% cash benchmark return, having been negatively affected by rising inflation. Core Infrastructure, Renewable Infrastructure, Secured Income and UK Property all saw positive absolute returns despite the uncertainties brought on by Omicron variant and rising inflation. Of those mandates with a 1-year track record the majority earned positive absolute returns with notable outperformance across the Brunel UK Property and Global Sustainable Equity portfolios. The currency hedge also positively contributed to returns over the quarter as Sterling strengthened.

## **5. INVESTMENT STRATEGY AND PORTFOLIO REBALANCING**

- 5.1. **Returns versus Strategic Assumptions:** Returns since the last valuation date (March 2019) for all equity mandates and core and renewable infrastructure are ahead of the assumed strategic returns used during the 2019/20 investment review. International property is below expectations as the mandate has been impacted by the pandemic. Due to the way this portfolio invests (capital drawn down over time) the focus should be on longer-term performance. Brunel Diversifying Return Funds is also marginally behind expectations due to a dampening of performance in the second half of 2021. Other mandates are either still in build-up phase or do not have a sufficient track record to properly compare against strategic return assumptions.
- 5.2. **Rebalancing:** The quarter saw a number of portfolio changes in line with recommendations from the Equity Review. October saw a £575m sale from Brunel's Low Carbon Passive portfolio into their new Paris Aligned Benchmark (PAB) Fund, while in December the Emerging Markets portfolio was sold (c£275m) with proceeds being fully re-invested in Global High Alpha. The wind down of the JPM hedge fund mandate continues with the first redemption completing in November and the second due to settle in February.

**5.3. Responsible Investment (RI) Activity:** A summary of RI activity undertaken by Brunel is included on page 10 of Appendix 4.

During the quarter the fund sent out a survey to its membership as part of its reporting requirements and in order to canvas member opinions on RI and our activities in this area. The results of this survey have now been collated and analysed, with results to be shared during March's committee meeting.

**5.4. Voting and Engagement Activity:** Hermes engaged with 200 companies held by Avon in the Brunel active portfolios on a range of 660 ESG issues. Environmental topics featured in 34.5% of engagements, 83.3% of which related directly to climate change. Social topics featured in 25.8% of engagements, where conduct and culture, human rights and diversity featured prominently. Of the 23.8% of Governance related engagements most focussed on executive remuneration and board diversity. Over the last quarter Hermes made voting recommendations at 92 meetings (867 resolutions). At 39 meetings they recommended opposing one or more resolutions. 63% of the issues Hermes voted against management on comprised board structure and remuneration. During the quarter, the underlying investment managers undertook the following voting activity on behalf of the Fund:

Companies meetings voted: 419

Resolutions voted: 3,648

Votes For: 3,124

Votes Against: 468

Abstained: 22

Withheld vote\*: 34

*\* A Withheld vote is essentially the same as a vote to abstain, it reflects a view to vote neither for nor against a resolution. Although the use of 'abstain' or 'withheld' reflects the different terms used in different jurisdictions, a 'withheld' vote can often be interpreted as a more explicit vote against management. Both votes may be counted as votes against management, where a minimum threshold of support is required*

## **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 Investment Panel further strengthens the governance of investment matters and contributes to reduced risk in these areas.

## **7. EQUALITIES**

7.1. A proportionate equalities impact assessment has been carried out using corporate guidelines and no significant issues have been identified.

## 8. CLIMATE CHANGE

8.1. The Fund is implementing a digital strategy across all its operations and communications with stakeholders to reduce its internal carbon footprint in line with the Council's Climate Strategy. The Fund acknowledges the financial risk to its assets from climate change and is addressing this through its strategic asset allocation to Paris Aligned Global Equities, Sustainable Equities and renewable energy opportunities. The strategy is monitored and reviewed by the Committee.

## 9. OTHER OPTIONS CONSIDERED

9.1. None

## 10. CONSULTATION

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

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## AVON PENSION FUND VALUATION - 31 DECEMBER 2021

	Brunel Portfolios	Cash Management Strategy	QIF	Funds of Hedge Funds	Property		Infra-structure	Currency Hedging	In House Cash	TOTAL	Avon Asset Mix %
All figures in £m	Multi	BlackRock	BlackRock	JP Morgan	Schroder (UK)	Partners (Overseas)	IFM	Record	General Cash		
<b>Equities</b>											
UK										0.5	0.0%
Emerging Markets										0.0	0.0%
Global Developed Markets	756.0		297.1							1053.2	17.9%
Global Sustainable Equities	649.1									649.1	11.0%
Global Low Carbon/PAB	822.2									822.2	13.9%
Equity Derivatives <sup>1</sup>			-25.4					31.6		6.2	0.1%
<b>Total Overseas</b>	<b>2227.3</b>		<b>271.7</b>							<b>2499.0</b>	<b>42.9%</b>
<b>Total Equities</b>	<b>2227.3</b>		<b>271.7</b>					<b>31.6</b>		<b>2530.7</b>	<b>42.9%</b>
<b>Exchange-Traded Funds</b>		65.5								<b>65.5</b>	<b>1.1%</b>
<b>DGFs</b>	<b>536.0</b>									<b>536.0</b>	<b>9.1%</b>
<b>Hedge Funds</b>				<b>228.3</b>						<b>228.3</b>	<b>3.9%</b>
<b>MAC</b>	<b>324.2</b>									<b>324.2</b>	<b>5.5%</b>
<b>Property</b>	<b>198.3</b>				<b>11.9</b>	<b>173.5</b>				<b>383.7</b>	<b>6.5%</b>
<b>Infrastructure</b>							<b>416.8</b>			<b>416.8</b>	<b>7.1%</b>
<b>Renewable Infrastructure</b>	<b>80.3</b>									<b>80.3</b>	<b>1.4%</b>
<b>Secured Income</b>	<b>438.5</b>									<b>438.5</b>	<b>7.4%</b>
<b>Private Debt</b>	<b>42.4</b>									<b>42.4</b>	<b>0.7%</b>
<b>LDI Assets &amp; Bonds</b>											
LDI Assets			640.8							640.8	10.9%
Corporate Bonds			133.5							133.5	2.3%
<b>Total Bonds</b>			<b>774.3</b>							<b>774.3</b>	<b>13.1%</b>
<b>Cash</b>									81.1	<b>82.6</b>	<b>1.4%</b>
<b>FX Hedging</b>								-9.3		<b>-9.3</b>	<b>-0.2%</b>
<b>TOTAL</b>	<b>3847.0</b>	<b>65.5</b>	<b>1046.1</b>	<b>228.3</b>	<b>11.9</b>	<b>173.5</b>	<b>416.8</b>	<b>22.4</b>	<b>81.1</b>	<b>5894.6</b>	<b>100%</b>

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# Avon Pension Fund

## Panel Investment Report Quarter to 31 December 2021

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February 2022

Steve Turner  
Joshua Caughey



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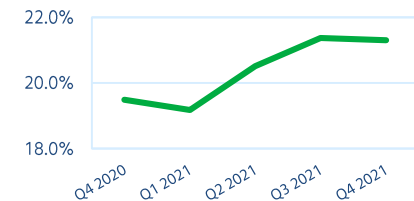
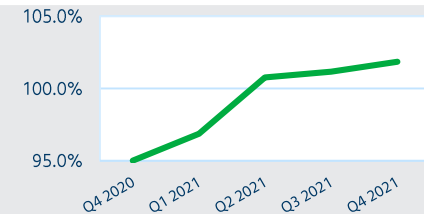


# Executive summary



# Executive summary

<p>Market background</p>	<ul style="list-style-type: none"> <li>The fourth quarter of 2021 came with a number of challenges. Global supply chains remained stretched and the new Covid-19 variant was discovered mid-quarter. Soaring inflation also forced some major central banks to accelerate their exit strategies from ultra-loose monetary policies.</li> <li>In spite of these headwinds, risk assets fared reasonably well with a few exceptions. The variant scare eased after it proved to be less vaccine resistant and severe than initially feared.</li> <li>Inflation expectations increased, and gilt yields generally declined slightly over the quarter.</li> </ul>
<p>Mercer market views</p>	<ul style="list-style-type: none"> <li>Our medium term macroeconomic outlook for 2022 remains solid despite some turbulence in January.</li> <li>Low unemployment should bolster a consumption driven recovery, and inflation is likely to peak in the coming months and fall back towards central bank targets.</li> </ul>
<p>Funding level and risk</p>	<div data-bbox="291 701 1207 832"> <ul style="list-style-type: none"> <li>The funding level is estimated to have improved over Q4 to c.102%, as asset growth outweighed the rise in the value of the liabilities.</li> <li>It is estimated to have increased by 7% over the year to 31 December 2021 (as illustrated to the right).</li> </ul> </div> <div data-bbox="291 901 1199 1068"> <ul style="list-style-type: none"> <li>The Value-at-Risk rose over the quarter to £1,233m, mainly due to the increased allocation to equities under the new strategic asset allocation.</li> <li>It was however broadly unchanged as a percentage of liabilities at 21.3%.</li> <li>Risk as a proportion of liabilities is lower compared to last year thanks to the decision to move to the dynamic equity option strategy.</li> </ul> </div>



# Executive summary

Performance

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- Most assets delivered positive returns over the quarter, particularly the global equity portfolios.
- Property and Infrastructure also generally fared well.

- Underperformance relative to the strategic benchmark over the one and three year period to 31 December 2021 is mainly due to the impact of the equity protection strategy.
- Relative performance was mixed at the mandate level, though the Hedge Fund and Core Infrastructure mandates have continued to stand out in outperforming their benchmarks. The Secured Income mandate has also done well over the year.

	3 Months (%)	1 Year (%)	3 Years (% p.a.)
Total Fund <b>(1)</b>	3.6	14.2	8.2
Strategic Benchmark <b>(2)</b> (ex currency hedge)	3.8	16.0	10.3
Relative <b>(1 - 2)</b>	<b>-0.2</b>	<b>-1.8</b>	<b>-2.1</b>

- Absolute returns for all global equity mandates have been comfortably above the strategic returns modelled at the last investment strategy review in March 2019, given the strength of equity markets. Emerging market equities fell below strategic expectations prior to termination in Q4, due to contractions in 2021.
- Infrastructure returns have been above expectations, and the Brunel UK Property mandate has had a good first year. Returns from the Partners Overseas Property mandate are below strategic expectations since 2019, though it has fared better over longer time horizons.

Asset  
allocation and  
strategy

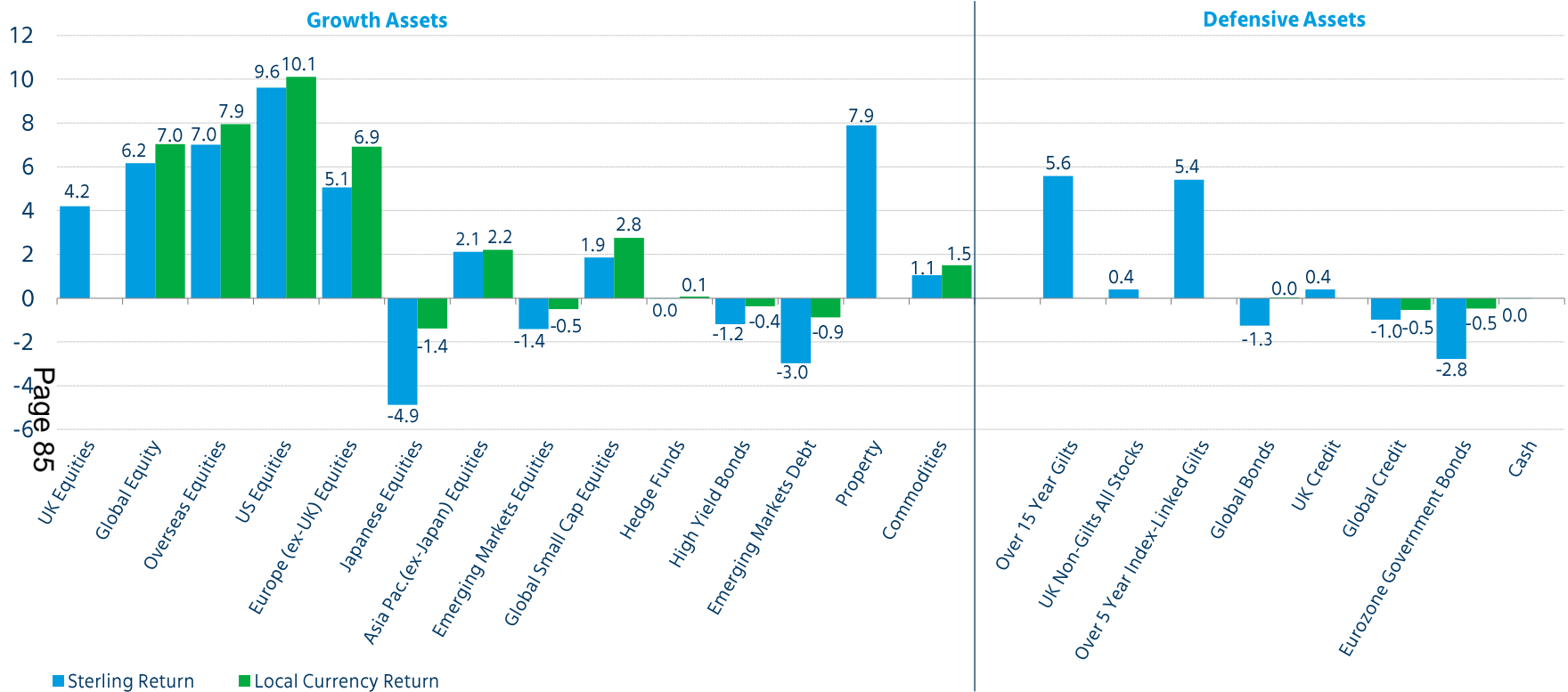
- During the quarter, the Fund transferred most holdings in the Low Carbon Equity fund to the Brunel passive Paris-Aligned Equity fund.
- It also terminated its holdings in Emerging Markets Equity, for which the strategic allocation was distributed between the High Alpha and Sustainable Equity mandates (which still contain emerging markets exposure).
- In practice the High Alpha holdings were topped up during the period, with the Sustainable Equity top-up to take place in 2022 using the remaining Low Carbon equity holdings.
- From a strategic perspective, the allocation to Diversified Returns was also reduced, and the global equity mandates correspondingly increased in order to maintain the overall expected return of the portfolio in light of the reduction in emerging markets equities.
- At quarter-end, all asset classes were within their ranges, except for the Renewable Infrastructure and Private Debt mandates which are still in the process of being drawn down.

# Market background



# Market background

## Return over 3 months to 31 December 2021 (%)

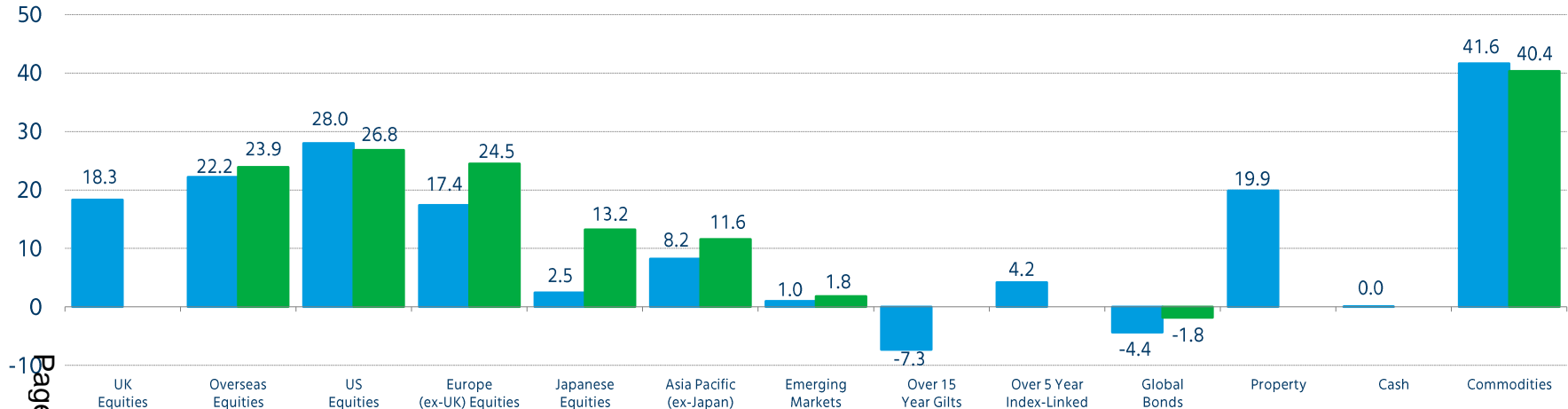


The fourth quarter of 2021 came with a number of challenges. Global supply chains remained stretched and some countries in continental Europe re-introduced Covid-19 related restrictions. This intensified with the discovery of a new variant, Omicron, mid-quarter. To make it worse, soaring inflation forced some major central banks in developed and emerging economies to accelerate their exit strategies from ultra-loose monetary policies. In spite of these headwinds, risk assets fared reasonably well with a few exceptions.

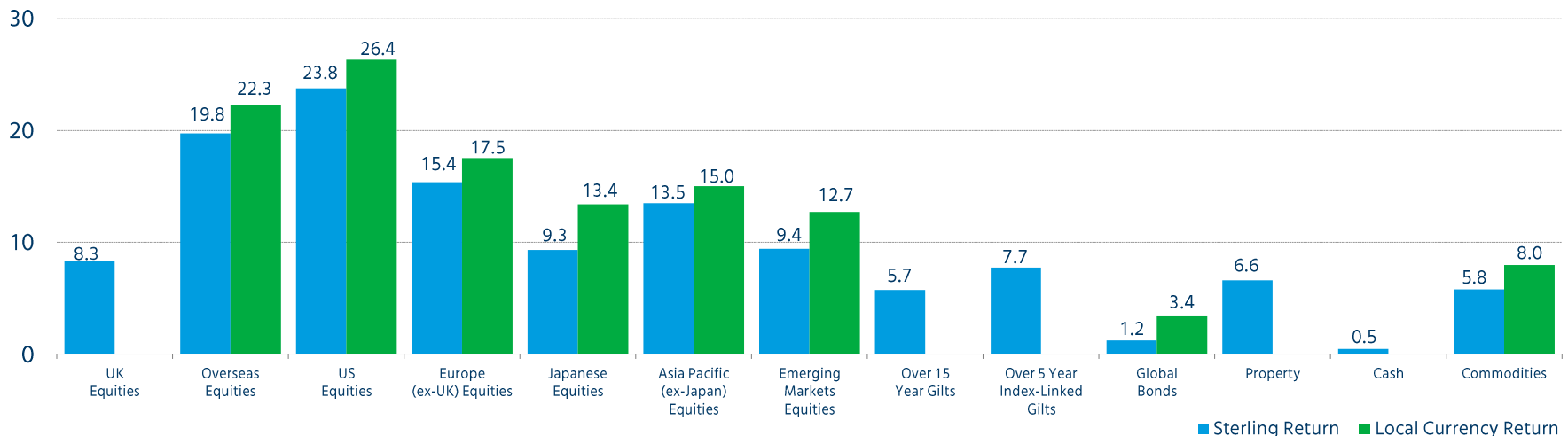
The variant scare eased after it proved to be less vaccine resistant and severe than initially feared. Whilst less accommodative monetary conditions would normally be bad news, markets had been pricing in tighter monetary policy for a while.

# Market background – longer term

## Return over 12 months to 31 December 2021 (%)



## Return over 3 years to 31 December 2021 (% p.a.)



■ Sterling Return ■ Local Currency Return

# Mercer market views



# Market Outlook (January 2022)

Mercer's current position/view  
Position/view last time (if changed)

Global equities rallied strongly into year end finishing the year up 23.5% in GBP terms. 2021 was the third year in a row of double digit equity returns with US equities roughly doubling over that period. In the fourth quarter, equities were boosted by strong economic and corporate profit growth and an ongoing expectation that central banks would be measured in terms of withdrawing some of the monetary support provided in the crisis. Bond yields were little changed.

After a slight slowdown in the third quarter because of the delta variant and supply chain disruptions, economic growth reaccelerated in the fourth quarter, despite a further pickup in inflation. Unemployment rates continued to fall sharply, with it ending 2021 not far above the levels seen before COVID, which in countries, such as the US, was the lowest in decades. Wage growth continued to rise, especially in the US and UK.

The Omicron variant is likely to lead a near term slowing in most economies as it moves rapidly through populations around the world. However, data from South Africa and London suggests it is less likely to lead to severe outcomes and as a result its economic impact is likely to be modest. Once Omicron waves are completed, strong economic growth is likely to resume with the possible exception of China which is hoping to suppress the virus completely via targeted lockdown, which may be challenging as Omicron is highly contagious. While economic growth in 2022 is likely to be very strong as a whole, growth rates should fall back as the year progresses in response to less accommodative monetary and fiscal policy.

Inflation, which has risen sharply, should moderate, although remain above target well into 2023. While we expect supply disruptions to ease over time and elevated natural gas prices in Europe to fall back at some point, tight labour markets and rising wage growth may cause inflation to stay higher for longer. In the US and UK, this may put the Fed and the Bank of England in a difficult position, although it is to be welcomed in Japan and the Eurozone.

We have made no changes to our main dial positions. In relation to equities, strong corporate profit growth should provide support, although rich valuations and the possibility of a rise in interest rates and bond yields are headwinds. Pulling these together gives us a neutral outlook. Growth fixed income also has a neutral outlook, with valuations again a negative, but the likelihood of low defaults a tailwind. We remain underweight defensive fixed income and think the Federal Reserve and Bank of England will raise interest rates several times in 2022, while the European Central Bank might start to indicate some sort of tightening in 2023. It is worth noting that we think the returns on equities and growth fixed income are closely linked to the performance of government bonds. If government bond yields do not rise, then equities and growth fixed income could substantially outperform cash. Within our sub dial positions, we have become slightly more positive on UK sovereign bonds which we funded by reducing the strong conviction overweight in securitised to just overweight.



LISTED EQUITIES



GROWTH FIXED INCOME



DEFENSIVE FIXED INCOME



CASH\*

\* In lieu of cash, investors might consider liquid alpha-oriented strategies with low sensitivity to equity, credit and duration.



# Listed equities

ASSET CLASS	OCTOBER 2021	JANUARY 2022	COMMENTARY
Global Equity	Neutral	Neutral	<b>The MSCI World Index returned 7.4% in GBP terms over 2021Q4 and returned 23.5% year-to-date<sup>1</sup>. We have maintained our broad market equity sector position at neutral within the global equities portfolio.</b> Valuations remain our main concern after another quarter of strong returns. The earnings outlook for 2022 remains favorable for the US with analysts expecting earnings growth in the high single digits even after the spectacular rebound in 2021 <sup>2</sup> . Fears over the economic impact from the latest Covid-19 variant have been receding after an initial scare and monetary policy tightening is now expected. However, valuations leave no room for error such as monetary policy turning even more hawkish than already priced in, the curve steepening or corporate margins falling short of expectations. The index also has a larger proportion in growth equities which we expect will fare less well in a rising rate environment.
Global Small Cap Equity	Neutral	Neutral	<b>The MSCI Small Cap index returned 1.9% in GBP terms over 2021Q4 and 17.3% on a year-to-date basis<sup>1</sup>. We have maintained our small cap allocation at the overweight side of neutral.</b> The macro environment remains favorable in the medium term as the current Covid-19 related headwinds have abated. We believe that a higher weight in value sectors will help small cap equities to do better than their growth-heavy large cap peers in an environment of tightening monetary policy and strong consumption spending. Wage pressure is a downside risk to this view but we note that this is now increasingly affecting growth sectors as well where labor costs amount to an even larger share of total expenses. In relative terms, valuations have also become more attractive relative to large cap over the quarter. In absolute terms, small cap valuations also look attractive relative to their own history by some metrics.
Emerging Markets	Neutral	Neutral	<b>The MSCI Emerging Markets index returned close to -1.7% in GBP terms over 2021Q4 and approximately -1.3% on a year-to-date basis<sup>1</sup>. We have maintained our position at the overweight side of neutral for emerging markets equities within the global equities portfolio.</b> Valuations remain more inviting than for other equity sectors after a quarter of negative performance when developed market equities had strong returns. However, even if our outlook for EM over a three year time horizon remains positive, macro risks remaining in the near term both in China and other EM countries has informed our decision to maintain our more prudent position for now. This positive tilt positions us to benefit from potential upside surprises, after so much negativity has been priced in during the quarter.

<sup>1</sup>Source: Bloomberg, DataStream as of end of 4Q2021

<sup>2</sup>Source: Factset

# Growth fixed income

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ASSET CLASS	OCTOBER 2021	JANUARY 2022	COMMENTARY
EM Debt (Local Currency)	Neutral	Neutral	<b>EMD local currency market returns fell through Q4 2021, posting a return of -3% in GBP hedged terms<sup>1</sup>. We have maintained our position at a higher conviction neutral within the growth fixed income portfolio.</b> We maintain a slight preference relative to Hard Currency due to more attractive spread valuations, historically cheap EM currencies, and generally lower duration profile, despite the inherent volatility of the sector. The Fed's more hawkish stance, and the persistence of inflation, will weigh on emerging markets as will the direction of the US dollar which strengthened over the quarter, and was a notable headwind for EM performance. Whilst Turkey's unusual monetary policy poses a contagion risk, we are yet to see major spill over effects into the broader EM market. We maintain a preference for local currency due to the attractive carry offered, lower duration profile and upside potential for EM currencies.
EM Debt (Hard Currency)	Neutral	Neutral	<b>EMD hard currency markets marginally underperformed through Q4 2021, posting a return of -0.9% in GBP hedged terms<sup>1</sup>. We have maintained our overall neutral allocation within the growth fixed income portfolio.</b> Spreads are wider than pre-pandemic levels with the HY portion of the index offering greater scope for spread compression relative to the IG portion. Tail risks emanating from China, particularly within the real-estate sector, continue to persist, with further volatility expected. Increasing tensions between Russia and NATO over Ukraine, as well as China's increased aggression towards Taiwan, may pose a threat. Significant real rate premiums, relative to developed market, continue to draw investors in. However, inflows slowed towards the end of the year. Sentiment remains vulnerable to the evolution of the Covid pandemic in emerging markets, to inflation and to US rate hikes. This factor is heightened by the greater underlying duration of this asset class.
Global Loans	Neutral	Neutral	<b>Over 2021Q4, global loans returned 0.3% in GBP hedged terms<sup>1</sup>. We have maintained our bank loans position at neutral within the growth fixed income portfolio.</b> With an average price below par and a yield of 4.2%, global loan valuations look relatively attractive given the general context of low to negative yields globally. Further, their floating rate nature and senior secured position makes them quite appealing in the current environment. Forward looking default rate expectations remain low, and we believe investors are seeing sufficient reward for the level of risk. Our outlook for elevated interest rate volatility has us favoring the floating-rate nature of the loan asset class versus high yield.
High Yield	Neutral	Neutral	<b>Over 2021Q4, global high yield returned -0.8% on a GBP hedged basis<sup>1</sup>. We have maintained our global high yield position at the negative side of neutral within the growth fixed income portfolio.</b> High yield valuations have become less attractive as spreads have continued to narrow and are now inside of where they entered 2020. As a result, further spread compression appears quite limited at this point. While strong fundamentals, easy lending support and low default activity, spreads may be vulnerable to any hiccups in growth expectations. We hold a slight preference for global loans over high yield given the floating rate nature and senior secured status of the loan asset class.

# Defensive fixed income

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ASSET CLASS	OCTOBER 2021	JANUARY 2022	COMMENTARY
UK Sovereign Fixed Income	Neutral	Neutral	<b>Over 2021Q4, UK sovereign fixed income returned 2.4% in GBP terms<sup>1</sup>. We have stayed within the neutral bucket but moved the dial up by one notch in UK sovereign fixed income within the defensive fixed income portfolio.</b> At the margin, Gilts have become more attractive as yields bounced back higher following the rate hike decision as investors priced in a more aggressive rate hike schedule off inflation fears, with the Bank of England surprising markets by opting to raise rates by 15bps in December – the first major developed market to do so in the pandemic era. UK inflation soared over the quarter – reaching 5.1%, the highest in over a decade, prompting the MPC to act.
UK Inflation-Linked Bonds	Underweight	Underweight	<b>Over 2021Q4, UK inflation linked bonds returned 4.8% in GBP terms<sup>1</sup>. We have maintained our underweight position in UK inflation linked bonds within the defensive fixed income portfolio.</b> UK breakevens marched higher over Q4 in the face of high CPI inflation prints and increasing energy prices, and remain unattractive due to their structural richness (due to UK pension scheme demand) at current levels, and due to recent strong performance versus nominals. In particular we note the sensitivity to changes in real rates in the UK linkers market, and a decidedly more hawkish BoE in Q4. However, we acknowledge a wider possible range of future inflation outcomes for the market, and the supply chain issues, partly Brexit-induced. There remains uncertainty in the UK linker market as a judicial review was granted on the government's November 2020 decision to move away from RPI as a measure in 2030.
UK Investment Grade Credit	Neutral	Neutral	<b>Over 2021Q4, UK investment grade credit returned 0.4% in GBP terms<sup>1</sup>. We have maintained UK investment grade credit within the defensive fixed income portfolio at neutral.</b> Sterling corporate spreads widened over the quarter largely driven by concerns over the new Omicron variant and its potential economic impact. However corporate spreads remain tight, both on an absolute and historical basis, although this is in part a reflection of the quality of the market. However, upside potential seems limited and we therefore deem a neutral position still appropriate. Persistent supply chain bottlenecks pose a risk to corporate earnings, although this should abate as these disruptions ease into 2022. Up until now firms have been able to comfortably pass these higher costs onto the consumer, however their ability to continue do this is uncertain as government support packages are scaled back. The UK is particularly vulnerable as it is not only suffering from a surge in energy prices and overall inflation, but Brexit headwinds remain and consumers face large tax hikes in the coming months.

# Market Outlook Update (February 2022)

Markets have had a turbulent start to 2022 with equities tumbling and bond yields soaring, as markets became increasingly aware of tighter monetary policy. Geopolitical tensions only added to the gloom. As a result, this January was the worst start to a year on record with global developed equity markets falling nearly 9% from their early January peak to trough. Although equity markets did bottom out towards the end of January, making up some lost ground. Government bond yields in the meantime moved higher through January with the US 10-year yield increasing c.43 basis points to 1.94% as of February - a level not seen since late 2019.

The volatility witnessed through January was driven by a confluence of factors:

- **Inflation:** Rising energy prices as well as ongoing wage pressures and some lingering base effects kept inflation well above central bank targets in January for most large developed and emerging market economies with few exceptions.
- **Monetary Policy:** With inflation continuing to remain at multi-decade highs, central bankers became even more hawkish than the market had been pricing in towards year end:
  - The Federal Reserve accelerated its plans to tighten monetary policy in 2022. Tapering of asset purchases is expected to be completed by the end of February and markets have now priced in up to five interest rate hikes in the US for this year, which was probably the key driver of market volatility over the last few weeks.
  - The Bank of England increased short dated rates for the second consecutive time, by 25 basis points to 0.5% in February.
  - Even in the Eurozone, inflation has hit the new highs since the euro was introduced, especially in core countries such as Germany. The European Central Bank ('ECB') refused to rule out raising short-dated interest rates this year in order to get back to their inflation target.
  - The only major economies where inflation continues to be below 2% so far is Japan and China. The former has not made significant changes to their monetary policy stance whilst the latter has actually started to ease, as Chinese policy-makers have grown concerned about the economic impact of last year's regulatory and deleveraging drive.
- **Geopolitics:** Russia and NATO remained embroiled in a stand-off on the Ukrainian border. The possibility of a war in Eastern Europe added to negative sentiment. Russia also flexed its muscles by helping put down demonstrations in Kazakhstan.
- **Covid-19:** Whilst featured prominently in the media, the economic and market impact of the Omicron variant has been more limited. Supply chains deteriorated at the margin and some services such as flights were disrupted due to higher employee absenteeism, but with the exception of China and a handful of small European countries, no major economy brought back significant restrictions. Encouragingly, Omicron cases appear to have peaked in mid/late January and have dropped precipitously since then.

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# Market Outlook Update (February 2022)

Mercer's Global DAA committee met in early February to discuss the heightened volatility witnessed throughout January, and **decided not to alter the current DAA positioning for now.**

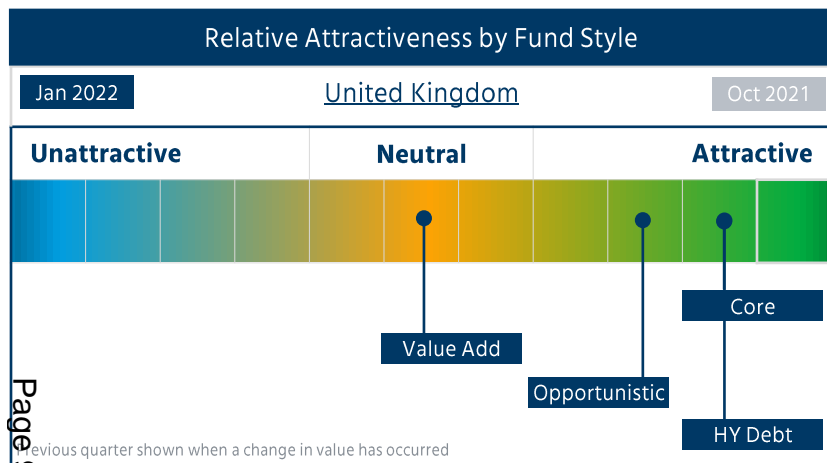
The committee noted that although interest rates have spiked and volatility has increased, the macroeconomic outlook for 2022 remains solid and conducive of our current positioning:

- The global economic recovery remains robust and still in its mid-cycle phase. Unemployment has fallen to multi-decade lows across major developed regions and consumers remain in a strong financial position. This sets the scene for an ongoing strong consumption driven recovery. This should have the knock-on effect of keeping business investment strong to meet surging demand. Interest rates are set to rise due to higher inflation, but this is unlikely to offset the aforementioned tailwinds.
- Inflation still remains elevated but is likely to peak in coming months and fall back towards – but remain above – central bank targets by the end of the year. The inflationary impulse from government spending should wane over the course of the year, and central banks are tightening policy. In addition, supply should gradually rise to meet demand, as the disruption in the supply chain subsides.
- Geopolitics and the Ukraine situation in particular remain a tail risk with a binary outcome which makes them difficult to factor into a portfolio.

**Overall, the Fund is expected to be in a position to navigate spikes in downside volatility in equity markets relatively well, due to the dynamic equity protection strategy.**

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# Real Estate Outlook and Opportunities



Page 94.

**Core:** We have not changed our positive view on core investment strategies compared with last quarter. We expect the strong end to 2021 to continue into early 2022 as the broad recovery of investment and occupier markets. We expect the core UK institutional investor base to remain focused on income security and inflation protection, such as residential and long lease strategies.

- **Value Add:** Income risk strategies remain at neutral with no change on last quarter. The recovery of occupier markets has surprised on the upside but risks remain elevated for some sectors of occupier demand, for example offices and retail.
- **Opportunistic:** Opportunistic strategies remain attractive in our view as the probability of achieving asset acquisitions at discounted pricing remains elevated as market dislocations play out. Special situations opportunities are most likely to emerge in the retail and leisure sectors. Increasing obsolescence due to the growth of ESG requirements may also result in redevelopment opportunities.
- **High Yield Debt:** Real estate debt funds continue to look attractive for income seeking investors as traditional bank lenders reduce activity while underlying assets devalue. Together, these features mean higher margins can be achieved by non-bank lenders particularly outside of London and the most liquid sectors.

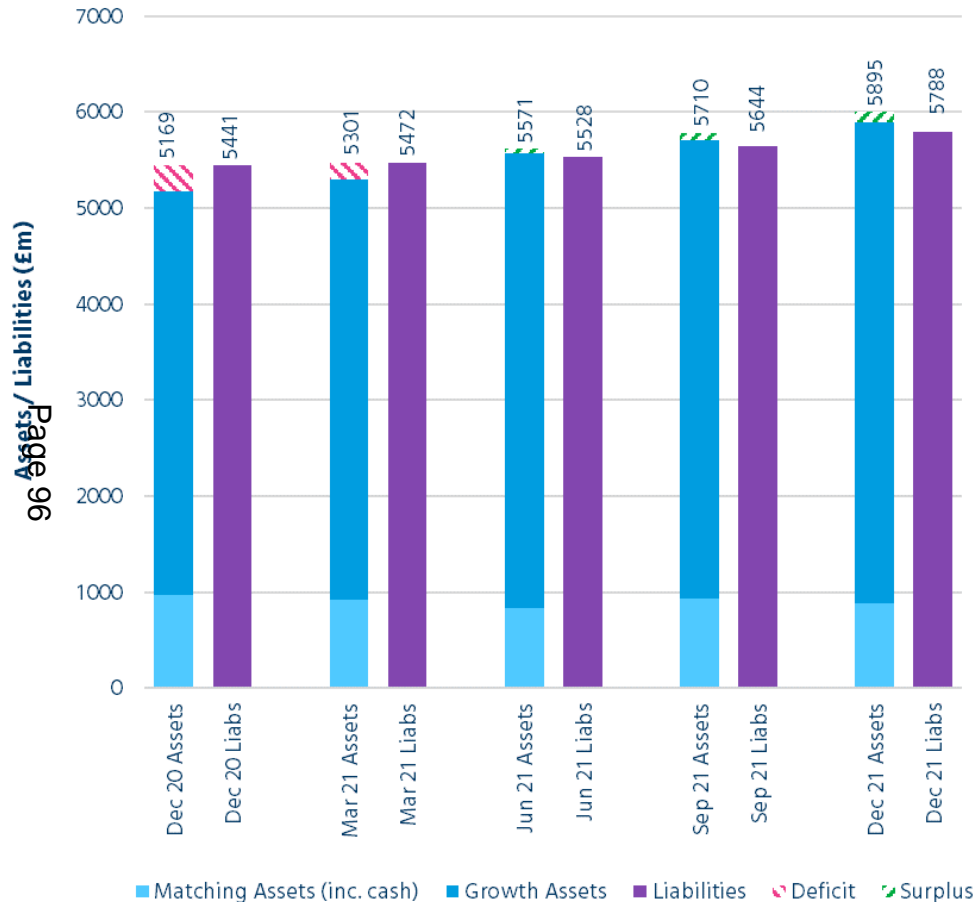
## Market Outlook

- We expect there to be a short lived slowdown of the UK economy in early 2022 due to the Omicron wave. Growth should pick-up followed by another slowdown later in the year as a result of tighter monetary and fiscal policy. The Bank of England has become more hawkish as inflation has remained very high and labour markets very strong, with unemployment falling sharply and now near pre crisis levels. Gilt yields rose sharply in early 2022 and the Bank of England is expected to make a series of rate hikes during the year.
- In our view the outlook for UK real estate remains positive overall, although we expect a moderation of returns following a remarkably strong post Covid recovery. Despite the prospect of higher interest rates, we think the relative pricing of the sector should remain fundamentally attractive, especially to income seeking investors. And while market dislocations continue to play out in some areas, we think the backdrop for opportunistic investment strategies is attractive.
- Our top three sector/geographic picks in terms of real estate fundamentals:
  1. **Mid-market Private Rented Residential:** We think strategies targeting higher yielding Private Rented Residential assets that are affordable to average households should be attractive. The sector has robust supply and demand dynamics and should be attractive to cash flow focused investors in search of diversification and inflation protection. However, operational expertise are the key to minimizing cost inefficiencies.
  2. **Urban Logistics:** The fundamentals of supply and demand remain strong for logistics sites in and around major urban areas as commerce continues to move towards a home delivery model while supply is generally constrained by competing land uses. Attractive pricing is difficult to achieve for standing assets and so build to core strategies appear more attractive.
  3. **Non-fashion retail warehousing:** Following several years of declining values as a result of weakening occupier demand we think there now appears to be relative value in the sector, although risks remain elevated. We think accessible retail parks with rebased rents, sustainable income profiles and low fashion exposure have attractive risk return dynamics at current pricing levels.

# Funding level and risk



# Change in deficit



Based on financial markets, investment returns and net cashflows into the Fund, the surplus was estimated to have increased further over Q4 to £107m.

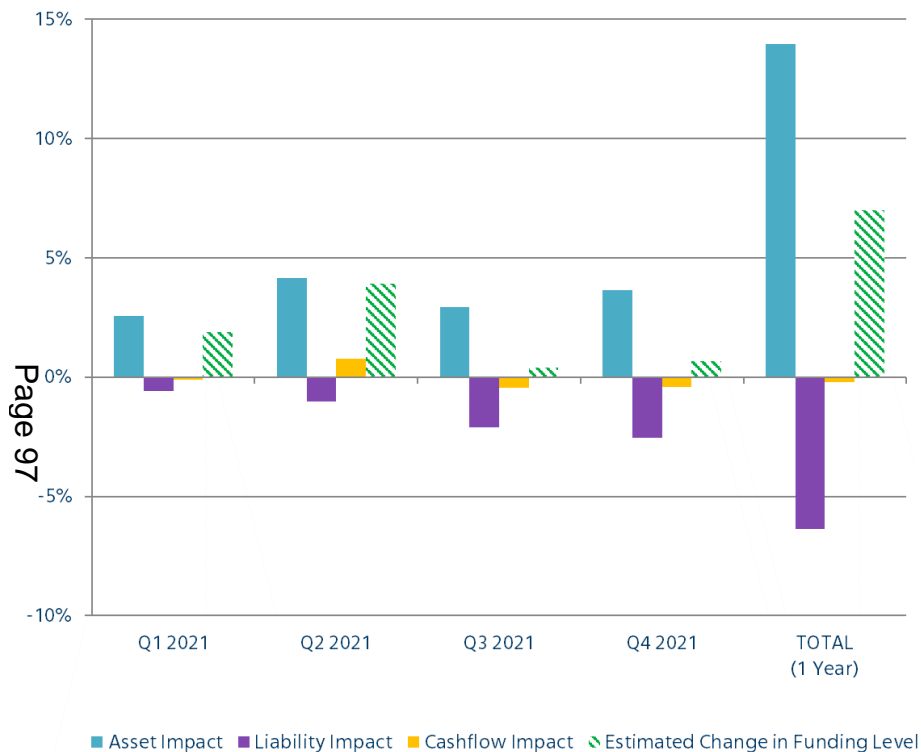
This occurred as the value of the assets rose by more than the present value of the liabilities over the period.

This is calculated using the actuarial valuation assumptions as at 31 March 2019 and the 'CPI plus' discount basis.

Liability values are estimated by Mercer.



# Funding level attribution



The Fund's assets returned 3.6% over the quarter, whilst the liabilities are expected to have increased by c. 2.6% due to the rise in inflation.

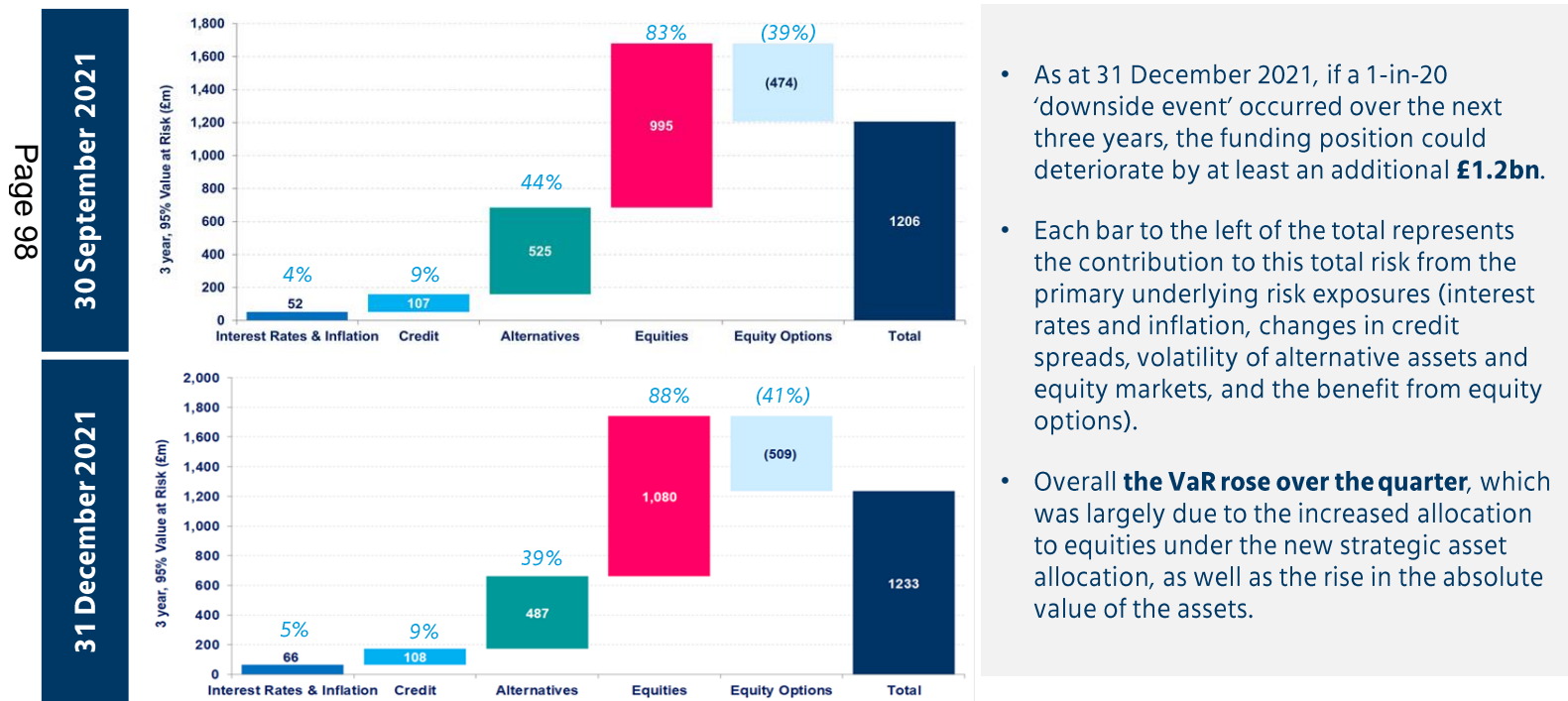
The combined effect of this, also allowing for expected cashflow over the period, saw the funding level improve slightly to just over 102%.

The funding level is estimated to have increased by c. 7% over the year to 31 December 2021.

Impact figures are estimated by Mercer.

# Risk decomposition – 3 year Value at Risk

- The two charts below illustrate the main risks that the Fund is exposed to on the 2019 funding basis, and the size of these risks in the context of the change in the deficit position.
- The purpose of showing these is to ensure there is an awareness of the risks faced and how they change over time, and to initiate debate on an ongoing basis around how to best manage these risks, so as not to lose sight of the 'big picture'.
- The final columns show the estimated 95<sup>th</sup> percentile Value-at-Risk (VaR) over a one-year period. In other words, if we consider a downside scenario which has a 1-in-20 chance of occurring, what would be the impact on the deficit relative to our 'best estimate' of what the deficit would be in three years' time.

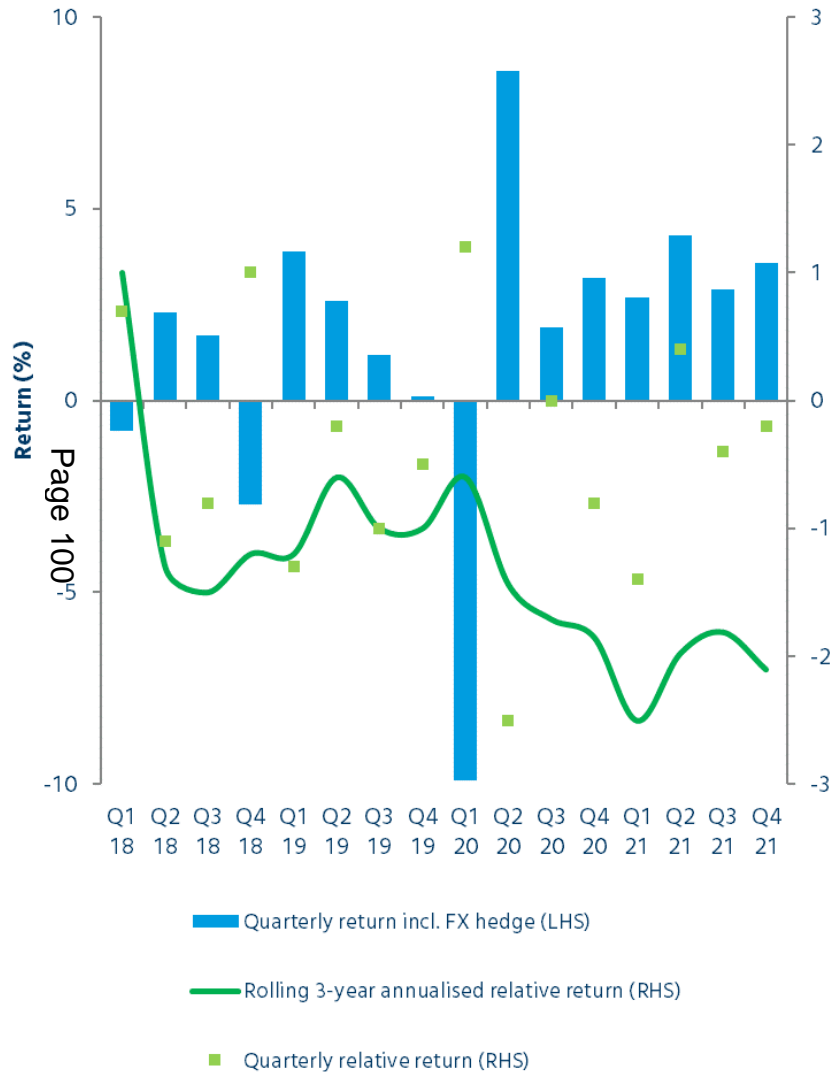


VaR figures shown are based on approximate liability data rather than actual Fund cashflows, and are based on the strategic asset allocation at the time. They are therefore illustrative only and should not be used as a basis for taking any strategic decisions.

# Performance summary



# Total Fund performance

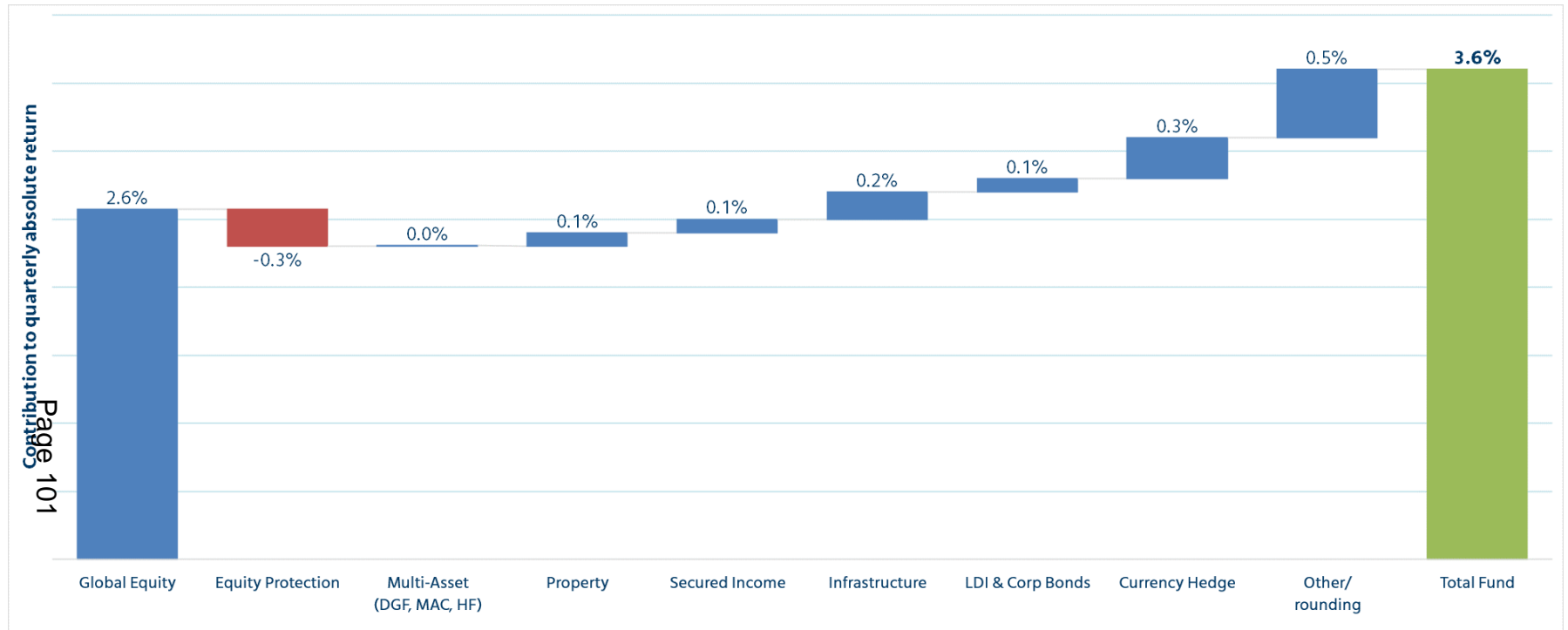


	3 Months (%)	1 Year (%)	3 Years (% p.a.)
Total Fund <b>(1)</b>	3.6	14.2	8.2
Total Fund (ex currency hedge)	3.3	14.0	7.8
Strategic Benchmark <b>(2)</b> (ex currency hedge)	3.8	16.0	10.3
<b>Relative (1 - 2)</b>	<b>-0.2</b>	<b>-1.8</b>	<b>-2.1</b>

## Commentary

- Most assets delivered positive returns over the quarter, with Global Equities doing particularly well. Property and Infrastructure also had a strong period amid a benign valuation environment for the underlying assets.
- The Fund underperformed its benchmark mainly due to the detractor from the equity protection as developed equities were strong, and underperformance of the High Alpha mandate and multi-asset mandates against their benchmarks. The Currency Hedge overlay added to overall returns due to a strengthening of sterling.
- High Alpha underperformed due to stock selection and an overweight to China, though elsewhere within the equity portfolio, the Sustainable Equity mandate outperformed thanks to sector allocation, particularly in IT. These mandates make up over a quarter of the Fund's strategic allocation.
- Over the one year and three year periods, the outperformers continue to be the Hedge Fund and Core Infrastructure mandates compared to their cash plus benchmarks, whilst the Property portfolios have underperformed. Secured Income has also done well over the year.
- The Equity Protection strategy is the main reason for underperformance relative to the strategic benchmark over the one and three year periods, though this is in line with expectations given the increase in the underlying equity markets. The Currency Hedge made a positive contribution over both periods as sterling strengthened.

# Total Fund performance attribution



Source: Custodian and Mercer estimates

'Other' contributions to the total can include the relatively small holdings in the ETF, cash, the impact of cashflows and terminated mandates, as well as rounding error.

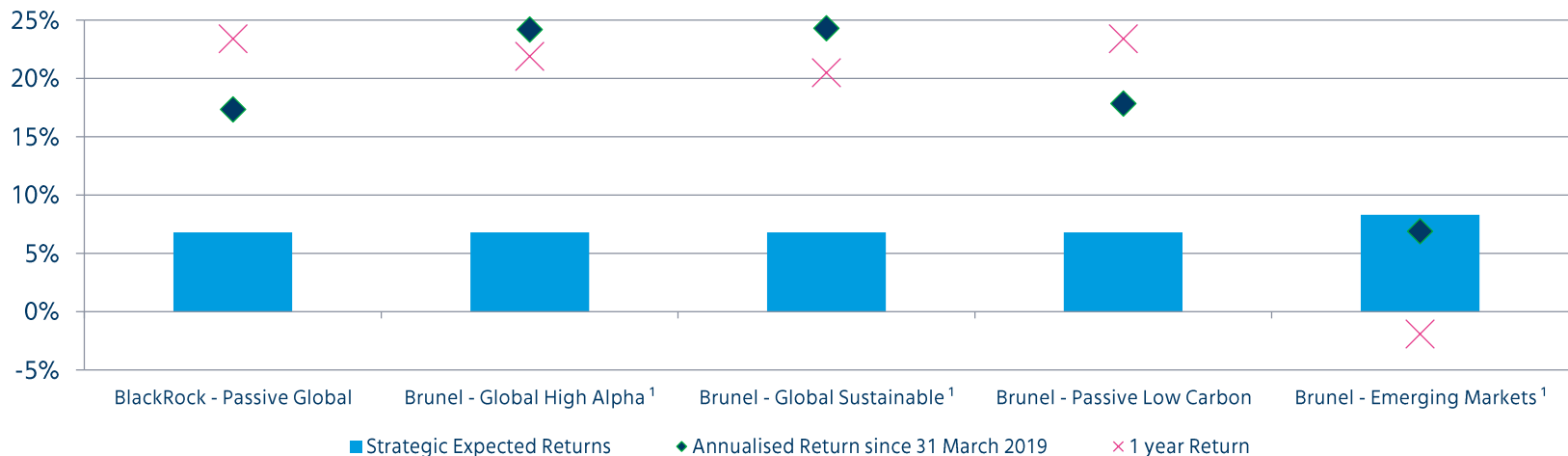
Equities continue to be the biggest driver of returns, and contributed over 70% of returns in the fourth quarter.

The only detracting asset class from absolute returns over the period was the equity protection (due to the rising underlying markets).

# Performance vs. expected strategic returns

	BlackRock Passive Global Equity	Brunel Global High Alpha	Brunel Global Sustainable	Brunel Passive Low Carbon	Brunel Emerging Markets
Benchmark allocation	4.0%	13.0%	14.5%	10.0%	-
Commentary	Returns have been above expectations for all global equity mandates, given strength of equity markets since 2019.				
	Returns are above strategic expectations and the mandate has tracked the underlying market	Strong initial manager outperformance adding to returns, despite more recent underperformance	Pick up in recent outperformance adding to returns above expectations	Returns are above strategic expectations and the mandate has tracked the underlying market	Returns below expectations due to contractions in 2021, meaning mandate underperformed against overall expectations since inception. Mandate terminated in Q4.

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## Notes:

We have illustrated the performance of the key mandates within the Fund's investment strategy.

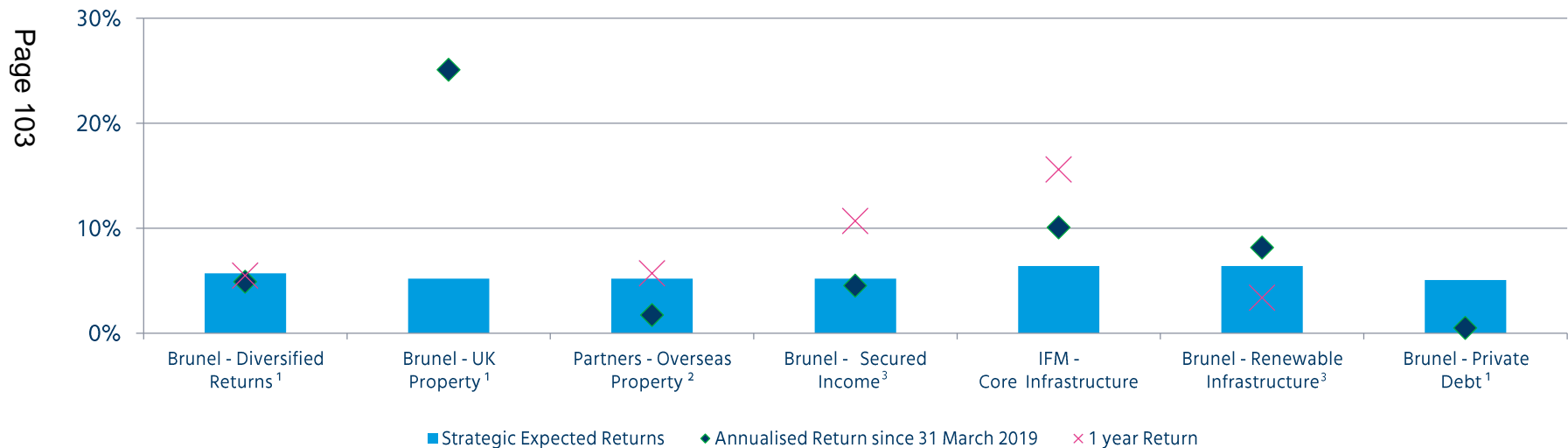
Actual returns are from 31 March 2019 to 31 December 2021, except if otherwise stated below. Returns for periods over a year have been annualised.

The strategic expected returns are from the 2019 strategy review, which reflect the 20 year mean Mercer Q1 2019 asset model assumptions.

<sup>1</sup> Mandate was inception after 31 March 2019. A list of inception dates can be found in the Appendix.

# Performance vs. expected strategic returns

	Brunel Diversified Returns	Brunel UK Property	Partners Overseas Property	Brunel Secured Income	IFM Core Infra	Brunel Renewable Infra	Brunel Private Debt
<b>Benchmark allocation</b>	10.0%	3.75%	3.75%	10.0%	5.0%	5.0%	5.0%
<b>Commentary</b>	Returns marginally below expectations due to a dampening of performance in the second half of 2021, mainly due to adverse currency positions within the UBS portfolio.	Mandate inception in January 2021; early to draw conclusions although property market fared very well in 2021	Returns below expectations as mandate still in drawdown phase (so focus should be on more longer-term performance). Improvements seen in 2021	Returns marginally below expectations but mandate is still in the drawdown phase. Recent signs of improvement from underlying assets.	Returns above expectations as real assets have delivered. Recent outperformance assisted by non-recurring gains on certain assets and valuation increases.	Returns above expectations (despite underperforming over one year period), but mandate is still in the drawdown phase	Mandate inception in September 2021; too early to draw conclusions.



## Notes:

We have illustrated the performance of the key mandates within the Fund's investment strategy.

Actual returns are from 31 March 2019 to 31 December 2021, except if otherwise stated below. Returns for periods over a year have been annualised.

The strategic expected returns are from the 2019 strategy review, which reflect the 20 year mean Mercer Q1 2019 asset model assumptions.

<sup>1</sup> Mandate was inception after 31 March 2019. A list of inception dates can be found in the Appendix.

<sup>2</sup> Returns are shown up to 30 September 2021, as this is the latest data available.

<sup>3</sup> Returns currently reflect those for the first commitment cycles only.

# Mandate performance to 31 December 2021

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.)		
BlackRock Passive Global Equity	7.9	7.3	+0.6	23.4	22.9	+0.4	19.6	19.2	+0.3	-	N/A
Brunel Global High Alpha Equity	6.3	7.4	-1.0	21.9	23.5	-1.3	N/A	N/A	N/A	+2-3	N/A
Brunel Global Sustainable Equity	6.8	6.3	+0.5	20.5	20.1	+0.3	N/A	N/A	N/A	+2	N/A
Brunel Passive Global Low Carbon Equity	7.4	7.4	0.0	23.1	23.2	-0.1	20.1	20.2	-0.1	-	N/A
Brunel Emerging Market Equity	-1.8	-1.7	-0.1	-1.9	-1.3	-0.6	N/A	N/A	N/A	+2-3	N/A
Brunel Diversified Returns Fund	0.5	0.8	-0.3	5.5	3.1	+2.3	N/A	N/A	N/A	+4-5	N/A
Brunel Private Debt	-0.9	1.0	-1.9	N/A	N/A	N/A	N/A	N/A	N/A	-	N/A
JP Morgan FoHF	0.2	0.8	-0.6	4.9	3.2	+1.7	10.0	4.3	+5.5	-	Target met
Brunel Multi-Asset Credit	0.4	1.0	-0.6	N/A	N/A	N/A	N/A	N/A	N/A	-	N/A
Brunel UK Property	7.9	7.5	+0.4	N/A	N/A	N/A	N/A	N/A	N/A	-	N/A
Partners Overseas Property*	4.4	2.5	+1.8	5.7	10.0	-3.9	2.1	10.0	-7.2	-	Target not met
Brunel Secured Income	2.1	2.4	-0.3	10.7	5.4	+5.0	N/A	N/A	N/A	+2	N/A
IFM Core Infrastructure	3.3	1.3	+2.0	15.6	5.2	+9.9	8.9	5.6	+3.1	-	Target met
Brunel Renewable Infrastructure	4.6	2.4	+2.1	3.4	5.4	-1.9	N/A	N/A	N/A	+4	N/A
Brunel Private Debt	-0.9	1.0	-1.9	N/A	N/A	N/A	N/A	N/A	N/A	-	N/A
BlackRock Corporate Bonds	1.1	1.1	0.0	-4.9	-4.9	0.0	7.3	7.4	0.0	-	N/A
BlackRock LDI	1.0	1.0	0.0	48.0	48.0	0.0	8.1	8.1	0.0	-	N/A
Equity Protection Strategy	-0.9			-5.7			-5.0			-	N/A

Since inception performance for Partners, which was the largest underperformer over the three year period, has been more favourable at 5.7% p.a. \*

Source: Investment Managers, Custodian, Mercer estimates. Returns are net of fees.

Returns are in GBP terms, except for JP Morgan whose performance is shown in local terms.

Relative returns have been calculated geometrically (i.e. the portfolio return is divided by the benchmark return) rather than arithmetically.

A summary of the benchmarks for each of the mandates is given in the Appendix.

Green = mandate exceeded benchmark. Red = mandate underperformed benchmark. Black = mandate performed in line with benchmark (mainly reflecting passive mandates).

Performance for JP Morgan and Partners in IRR terms. Performance for IFM is in TWR terms.

Performance of the Secured Income and Renewable Infrastructure mandates currently reflect those for the first commitment cycles only.

Performance of the Equity Protection Strategy is estimated by Mercer based on the change in market value of the options over time, accounting for realised profit/loss upon rolling of the strategy.

\*Partners performance is to 30 September 2021 as this is the latest date that this is available. The mandate's inception was in 2009.



# Asset allocation



# Valuations by asset class

Asset Class	Start of Quarter (£'000)	End of Quarter (£'000)	Start of Quarter (%)	End of Quarter (%)	Benchmark (%)	Ranges (%)			Relative (%)
Global Equity	760,524	1,086,633	13.3	18.4	17.0	12	-	22	+1.4
Global Sustainable Equity	607,893	649,094	10.6	11.0	14.5	9.5	-	19.5	-3.5
P. Low Carb/ Paris-Aligned Equity	763,187	822,170	13.4	13.9	10.0	5	-	15	+3.9
Emerging Market Equity	280,490	-	4.9	-	-	-	-	-	-
Diversified Returns Fund	533,213	535,962	9.3	9.1	6.0	4	-	10	+3.1
Fund of Hedge Funds*	288,796	228,309	5.1	3.9	-	No set range			-
Multi-Asset Credit	322,864	324,157	5.7	5.5	6.0	3	-	9	-0.5
Property	346,729	383,740	6.1	6.5	7.5	5	-	10	-1.0
Secured Income**	385,384	438,515	6.7	7.4	10.0	5	-	15	-2.6
Core Infrastructure	403,824	416,777	7.1	7.1	5.0	2.5	-	7.5	+2.1
Renewable Infrastructure**	70,741	80,341	1.2	1.4	5.0	2.5	-	7.5	-3.6
Private Debt	19,530	42,418	0.3	0.7	5.0	0	-	7.5	-4.3
Corporate Bonds	132,115	133,538	2.3	2.3	2.0	No set range			+0.3
LDI & Equity Protection	630,516	615,390	11.0	10.4	12.0	No set range			-1.6
Cash***	164,295	137,325	2.9	2.3	-	0	-	5	+2.3
<b>Total</b>	<b>5,710,314</b>	<b>5,894,582</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>				

Source: Custodian, Investment Managers, Mercer. Red numbers indicate the allocation is outside of tolerance ranges.

Totals may not sum due to rounding and other residual holdings.

\*Mandate due to be terminated.

\*\*Valuations include both funding cycle allocations.

\*\*\*Valuation includes the ETF and currency instruments, as well as assets in transit.

Renewable Infrastructure and Private Debt mandates are still being drawn down so allocations are below target ranges.

# Valuations by manager

Manager	Asset Class	Start of Quarter (£'000)	Cashflows (£'000)	End of Quarter (£'000)	Start of Quarter (%)	End of Quarter (%)
BlackRock	Global Equity	275,451		297,132	4.8	5.0
Brunel	Global High Alpha Equity	448,289	275,580	756,038	7.9	12.8
Brunel	Global Sustainable Equity	607,893		649,094	10.6	11.0
Brunel	Global Low Carbon Equity	763,187	-574,942	225,669	13.4	3.8
Brunel	Passive Dev Eq Paris Aligned	0	574,901	596,501	0.0	10.1
Brunel	Emerging Market Equity	280,490	-275,580	0	4.9	0.0
Brunel	Diversified Returns Fund	533,213		535,962	9.3	9.1
JP Morgan	Fund of Hedge Funds	288,796	-59,332	228,309	5.1	3.9
Brunel	Multi-Asset Credit	322,864		324,157	5.7	5.5
Brunel	UK Property	140,467	43,880	198,282	2.5	3.4
Sprotter	UK Property	29,669	-17,980	11,909	0.5	0.2
Partners	Overseas Property	176,593	-8,030	173,549	3.1	2.9
Brunel	Secured Income*	385,384	44,062	438,515	6.7	7.4
IFM	Core Infrastructure	403,824		416,777	7.1	7.1
Brunel	Renewable Infrastructure*	70,741	6,130	80,341	1.2	1.4
Brunel	Private Debt	19,530	22,963	42,418	0.3	0.7
BlackRock	Corporate Bonds	132,115		133,538	2.3	2.3
BlackRock	LDI & Equity Protection	630,516		615,390	11.0	10.4
Record	Currency Hedging**	16,330	-12,000	22,354	0.3	0.4
BlackRock	ETF	102,066	-40,000	65,532	1.8	1.1
Internal Cash	Cash***	80,830		81,060	1.4	1.4
<b>Total</b>		<b>5,710,314</b>	<b>-20,451</b>	<b>5,894,582</b>	<b>100.0</b>	<b>100.0</b>

Source: Investment Managers, Mercer. Totals may not sum due to rounding and other residual holdings.

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.

\* Valuations include both funding cycle allocations.

\*\* Valuation includes the collateral holdings for the currency overlay.

\*\*\* Start of quarter valuation includes assets in transit.

# Current topics



# Current topics

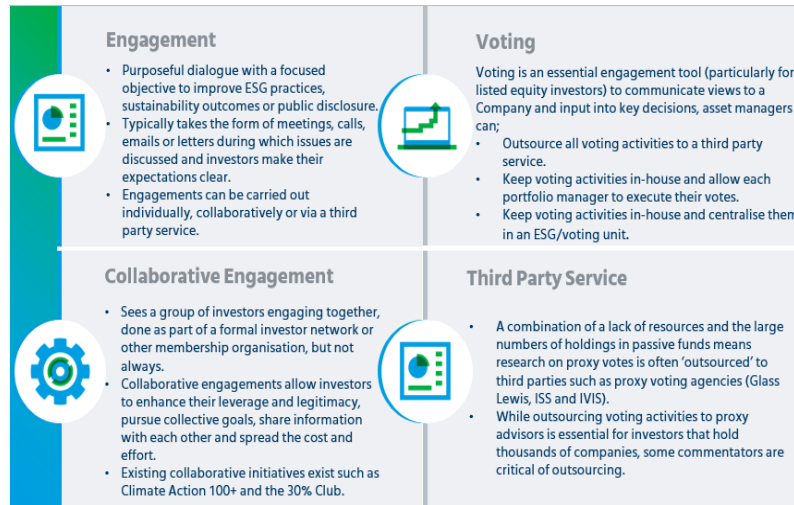
## Effective Stewardship - What it is and why do it

### What is stewardship?

**The use of influence by institutional investors to maximise overall long-term value including the value of common economic, social and environmental assets, on which returns and clients' and beneficiaries' interests depend.**

Source: PRI Page 109

### Types of stewardship



### Developing an effective framework



### Relevance to the Fund

**The Fund documents its monitoring of manager voting and engagement activity in its annual RI report.**

**The Fund is a member of the LAPFF, CA100+ and IIGCC collaborative initiatives.**

## COP26 – Actions speak louder than words

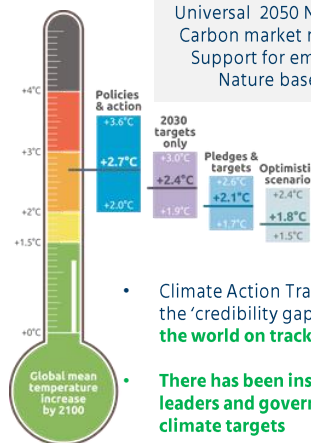
### Assessment

COP26 was the 2021 edition of the UN annual climate change conference.

Under the Paris Agreement, countries committed to put forward plans setting out how much they would reduce their emissions - known as Nationally Determined Contributions, "NDC's".

**COP26 would be the first moment when countries confirm their NDC's.**

Moreover, the commitments made in Paris did not come close to limiting global warming to 1.5°C, which the window is closing for.



Universal 2050 Net Zero goal – **moderate progress**  
Carbon market mechanisms – **moderate progress**  
Support for emerging markets – **behind target**  
Nature based solutions – **partial success**

- Climate Action Tracker's latest estimates highlight the 'credibility gap', noting that **current NDCs put the world on track for 2.4 degrees of warming**
- There has been insufficient momentum from leaders and governments to increase 2030 climate targets**

### 'Actions speak louder than words'

Investors will need to demonstrate how they are transitioning their investments for real world impact. Commitments and pledges are important, but only the practical application and implementation of a credible net zero transition plan will position investors well over the coming decade.

### What should schemes do?

- Implement a **net zero plan**.
  - Align long term funding objective with **climate aware objectives**.
- Take **climate change risks and opportunities** into account throughout investment decision-making
  - Assess your scheme's covenant risk to climate change risks.
- Exercise **active climate stewardship** through oversight of voting and engagement actions in your portfolio and engaging with managers and climate groups such as Climate Action 100+.

### Relevance to the Fund

**The Fund has committed to net zero by 2050, and has developed a plan to implement and monitor this.**

**The 2022 strategy review will include a revisit of potential sustainable investment opportunities.**

# Current topics

## Metamorphosis: What it means for UK Schemes

### Changing of the guard



Monetary policy at crossroads. QE tapering and rate rises signal new era

Deep political divisions, inequality, climate change shape fiscal policy in West

Asia will be growth engine of 21st century

- Seek appropriate opportunities to increase real asset exposure
- Stress-test exposure to traditional market beta, given increased potential for more frequent episodes of market deleveraging
- Consider higher exposures to Asia (incl. China where appropriate) in equity, debt and alternatives portfolios
- Assess whether portfolio is overly exposed to potential bubbles (big tech)?

### Position for transition



Climate change is global multi-industry challenge

High transition risk assets to perform poorly

Impact investments and sustainability assets likely will drive portfolio returns

- Identify risks and plan RITE actions to remedy them
- With pace of climate change accelerating, regulatory changes proliferating, actions need to be prioritised
- Be mindful to identify “the green, the grey, and the in-between”. “Greenwashing” and virtue signaling inevitable, so critical to “look under the hood”

### Modern Diversification



Prospective returns on traditional beta will be poor

Individual assets and sectors will have starkly divergent returns

Protection strategies and zero-beta active management will make a comeback

- Consider hard hedges (convertible bonds, dynamic equity option strategies)
- Seek liquidity diversification in private markets with less mark-to-market risk and where risk/return looks more rewarding
- Consider strategies which have struggled in the benign market environment of the past decade that rely more on manager skill (such as absolute return fixed income, credit opportunities, hedge funds). Whilst still tilting to areas which could drive growth (e.g. barbell strategy).

### Relevance to the Fund



The growth prospects of Asia and emerging markets in general was noted as part of the equity portfolio review, and weighed up against the other relevant considerations at play.

The Fund is in a good position from a climate transition perspective in light of work undertaken to date on ACT analysis, decarbonisation targets and TCFD reporting, among other things.

The Fund is well-versed in different risk management options, with the equity protection strategy, inflation hedging and selective use of active management implemented within the portfolio.

# Appendix

# Q4 2021 equity market review

Equity markets performance was strong over the fourth quarter.

**Global Equities** returned 7.0% in local currency terms. Markets sold off mid-quarter as the risk of meaningful Covid-19 restrictions returning following the discovery of the latest variant were priced in; but rallied towards year end when this did not materialise.

**US equities** returned 10.1% in local terms, supported by the favourable earnings outlook, whilst **European (ex-UK) equities** returned 6.9%.

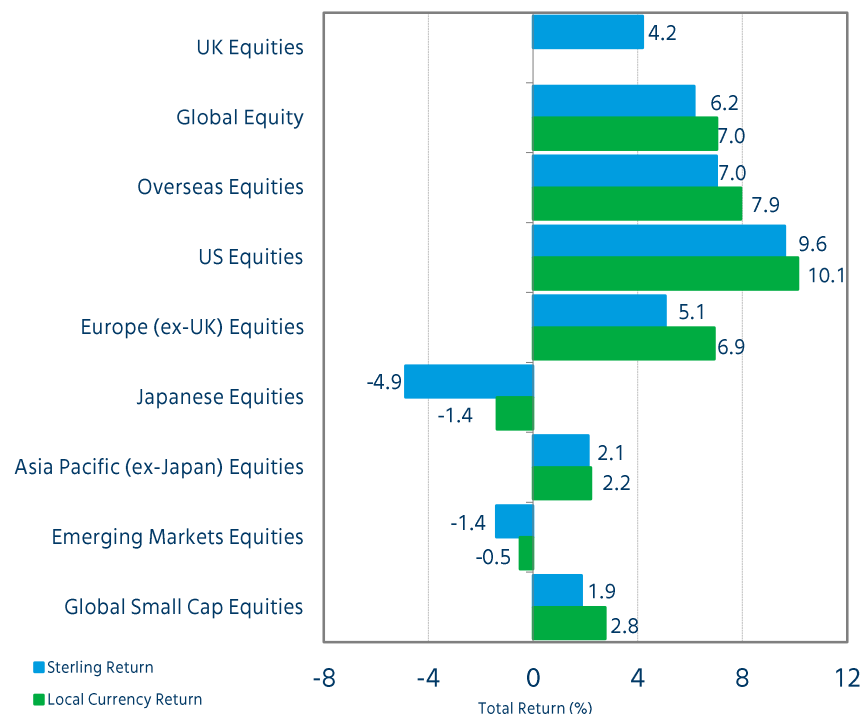
**Japanese equities** stood out as the only large developed market with negative returns of -1.4%. For both Europe and Japan, the aforementioned supply chain stresses and high energy prices were headwinds.

**Emerging markets equities** returned -0.5% in local terms. Russian and Brazilian equity markets performed poorly over the quarter as the commodity price rally stalled somewhat, China continued to grapple with the impact of the property market slowdown on the wider economy whilst supply chain stresses were also a headwind for South Korea.

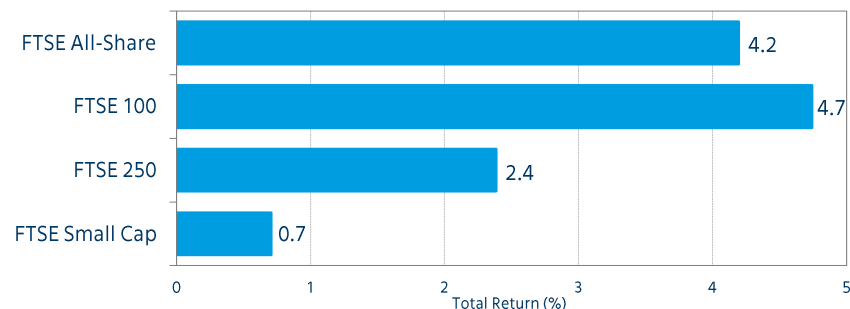
**Global small cap stocks** returned 2.8% in local terms. Small caps lagged global equities as investors opted for less cyclical stocks in a quarter that cast some doubt on the durability of the economic rebound, at least in the short term.

**The FTSE All Share index** returned 4.2% over the quarter with the large cap FTSE 100 index returning 4.7%. UK small cap and mid-cap stocks produced positive returns, after initial sell-offs amid the risk of the latest Covid-19 variant on consumption and business activity in the short term.

Equity Performance - Three Months to 31 December 2021



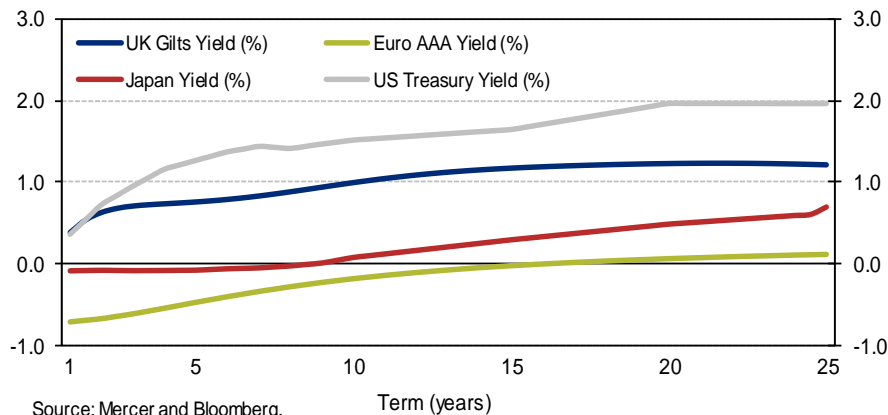
FTSE Performance by Market Cap - Three Months to 31 December 2021



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# Q4 2021 bond market review



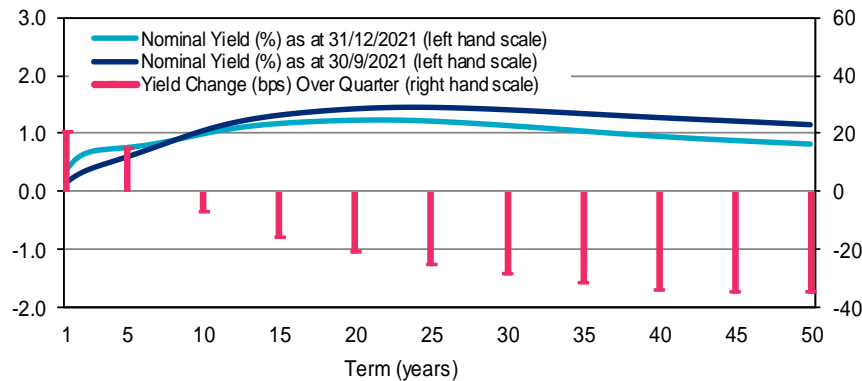
Source: Mercer and Bloomberg.  
End date taken as at 30 December 2021.

## Government Bond Yields

Global government bond yields generally declined slightly over the quarter as concerns around the Omicron variant sparked risk-off sentiment. Gilt yields fell by most compared to other countries and the curve flattened, whereas US 10-year Treasuries remained largely unchanged over the quarter.

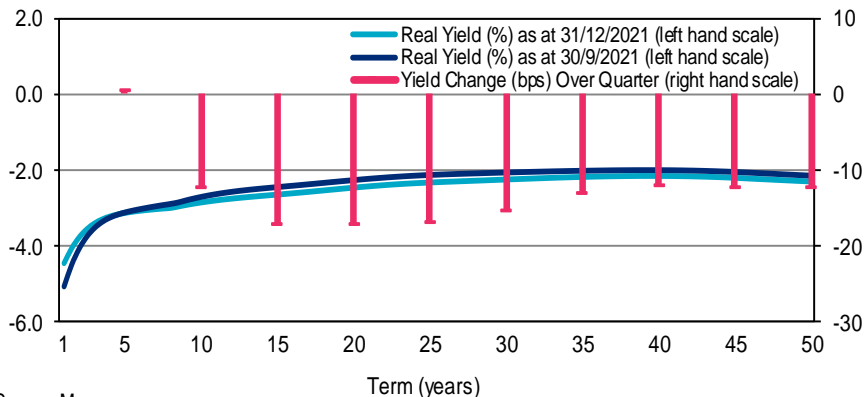
Both the Federal Reserve and the Bank of England signalled less accommodative stances, heralding an end to ultra-loose monetary policy. This triggered an increase in short term rates in both the US and UK. The effect was less pronounced in the Eurozone.

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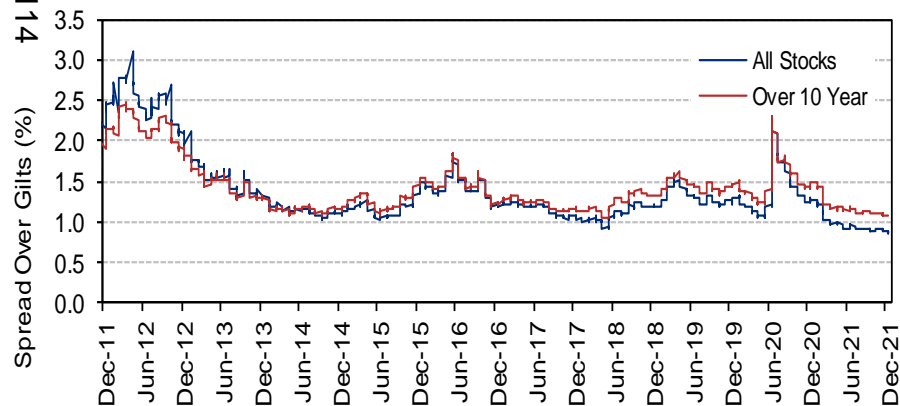
Source: Mercer.  
End date taken as at 31 December 2021.

# Q4 2021 bond market review



Source: Mercer.  
End date taken as at 31 December 2021.

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Source: Refinitiv.  
End date taken as at 31 December 2021.

## UK Index-Linked Gilt Yields

UK real yields fell across the curve, except for at the short end. Market based measures of inflation expectations, in the form of breakeven inflation, shifted upwards which added to the modest fall in nominal yields. The UK 10-year breakeven rate rose to 4.2% intra-quarter but fell back to 4.0% by quarter end – still the highest level since the 2008 Financial Crisis.

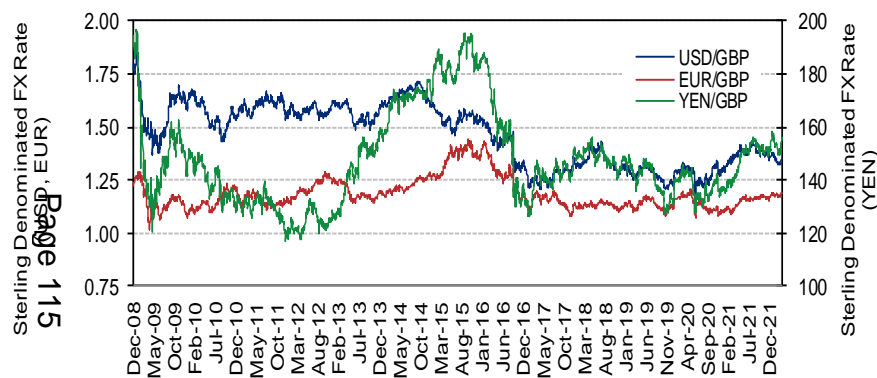
## Corporate bonds

Spreads on UK investment grade credit generally rose which largely offset the decrease in gilt yields, leading to almost flat performance over the quarter.

# Q4 2021 currency market review

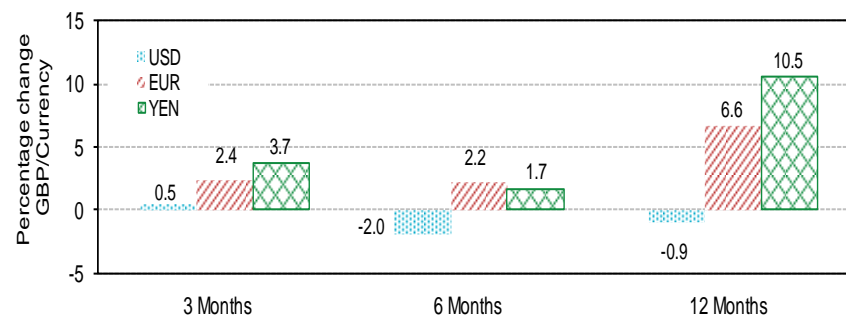
Sterling appreciated against the US dollar, euro and yen over the quarter, following the Bank of England's interest rate increase at year end. For the year as a whole, sterling has appreciated considerably vs yen and euro as stronger economic growth and the prospect of rising UK yields makes sterling more attractive relative to the former two, but has weakened marginally against US dollar as US monetary conditions are tightening as well.

**Sterling Denominated FX Rate**



Source: Refinitiv

**Change in sterling against foreign currencies**



Source: Refinitiv.

Performance figures for 3 months, 6 months and 12 months are shown since 31 December 2021, 30 June 2021 and 31 December 2020 to 31 December 2021 respectively.

## Q4 2021 property

UK property as measured by the MSCI Index increased by 7.9% over the quarter to 31 December 2021.

# Summary of mandates

Manager	Mandate	Benchmark/Target	Outperformance Target (p.a.)	Inception Date
BlackRock	Passive Global Equity	MSCI World	-	December 2017
Brunel	Global High Alpha Equity	MSCI World	+2-3%	November 2019
Brunel	Global Sustainable Equity	MSCI AC World	+2%	September 2020
Brunel	Passive Global Low Carbon Equity	MSCI World Low Carbon	-	July 2018
Brunel	Passive Paris Aligned Developed Equity	FTSE Developed World PAB Index	-	October 2021
Brunel	Emerging Market Equity	MSCI Emerging Markets	+2 -3%	October 2019
Brunel	Diversified Returns Fund	SONIA	+4-5%	July 2020
JP Morgan	Fund of Hedge Funds	3 Month LIBOR +3% p.a.	-	July 2015
Brunel	Multi-Asset Credit	SONIA	+4-5%	June 2021
Chroder	UK Property	IPD UK Pooled	+1%	January 2009
Brunel	UK Property	MSCI/AREF UK Quarterly Property Fund Index	-	January 2021
Partners	Overseas Property	Net IRR of 10% p.a. (local currency)	-	September 2009
Brunel	Secured Income	CPI	+2%	January 2019
IFM	Core Infrastructure	3 Month LIBOR +5% p.a.	-	April 2016
Brunel	Renewable Infrastructure	CPI	+4%	December 2018
Brunel	Private Debt	3 Month LIBOR + 4% p.a.	-	September 2021
BlackRock	Buy-and-Maintain Corporate Bonds	Return on bonds held	-	February 2016
BlackRock	Matching (Liability Driven Investing)	Return on liabilities being hedged	-	February 2016
Record	Passive Currency Hedging	N/A	-	March 2016
BlackRock	Exchange-Traded Fund (ETF)	Bespoke benchmark to reflect total Fund allocation	-	March 2019
Cash	Internally Managed	7 Day LIBID	-	-

# Market background indices

Asset Class	Index
UK Equity	FTSE All-Share
Global Equity	FTSE All-World
Overseas Equity	FTSE World ex UK
US Equity	FTSE USA
Europe (ex-UK) Equity	FTSE World Europe ex UK
Japanese Equity	FTSE Japan
Asia Pacific (ex-Japan) Equity	FTSE World Asia Pacific ex Japan
Emerging Markets Equity	FTSE AW Emerging
Global Small Cap Equity	MSCI World Small Cap
Hedge Funds	HFRX Global Hedge Fund
High Yield Bonds	BofA Merrill Lynch Global High Yield
Emerging Market Debt	JP Morgan GBI EM Diversified Composite
Property	IPD UK Monthly Total Return: All Property
Commodities	S&P GSCI
Over 15 Year Gilts	FTA UK Gilts 15+ year
Sterling Non Gilts	BofA Merrill Lynch Sterling Non Gilts
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

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**Access to Information Arrangements**

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

Information Compliance Ref: 748512

Meeting / Decision: AVON PENSION FUND INVESTMENT PANEL

Date: 25<sup>th</sup> February 2022

Author: Nathan Rollinson

**Report Title:** Review of Investment Performance for Periods Ending 31 December 2022

Appendix 1 – Fund Valuation

Appendix 2 - Mercer Performance Monitoring Report

**Exempt Appendix 3 – Quarterly Portfolio Monitoring Summary**

Appendix 4 – Brunel Quarterly Performance Report

Appendix 5 – Mercer Paper: Managing Inflation Risk

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 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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## Performance Report for Quarter Ending 31 December 2021

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Page 12	- Asset Allocation of Pension Fund
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Page 15	- Brunel Portfolios Overview

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For Brunel, the quarter was marked by two important events in the pool's development: the transition of £3bn of client assets to the new Paris-aligned benchmarks we developed in coordination with FTSE Russell and the COP 26 meeting in Glasgow. In recognition of the first of these landmark moments, more than 20 people from Brunel, our clients and Legal & General Investment Management, met in London for our opening of the London Stock Exchange. The second gathering effectively began just as Brunel was opening the market in London. Faith Ward, in her role as Chair of the IIGCC, travelled to COP 26 in Glasgow with an all-areas pass and represented our views in talks, panels and informal meetings. You can find more on both events – the market opening and COP 26 – in the Responsible Investment section of our quarterly report. Our approach to benchmarks and our presence at COP 26 are two of the ways in which our RI credentials were evident through the period.

They were also apparent in how we manage the business and our staff. The first few weeks of the fourth quarter saw the spread of Covid slowing dramatically in the UK and other developed markets, until the emergence of the Omicron variant in late November. Brunel was therefore obliged to reverse some of the office opening measures introduced over the third quarter, although the company's prioritisation of mental health meant it still kept the office open for limited use.

The last of Brunel's 17 listed markets portfolios launched over the summer, and the latter months of the year was also awards season – and the investment team was widely recognised by the industry. First of all, Financial News recognised Brunel's CEO for her leadership across pensions and Responsible Investment. Pensions for Purpose named Brunel as the winner of its Paris Alignment Award. Individual awards soon followed, as Helen Price received the ICGN's Rising Star Award, and LAPF named Faith Ward 'Personality of the Year'. At the Investment & Pensions Europe Awards, held in Madrid in December, Brunel won in three categories: Innovation, Portfolio Construction & Diversification, and Climate-Related Risk Management – beating candidates from across Europe.

The awards felt like a fitting end to a momentous year, in which Brunel made a clear Net Zero commitment; launched its fixed income portfolios, thereby completing its full suite of listed market portfolios; completed the transition of seven of its ten clients to the Brunel Property portfolio (as well as launching an Affordable Housing sleeve); and co-created a new set of Paris-aligned benchmarks, to which clients then committed £3 billion (with more to come in 2022).

At the most fundamental level of pooling, it was also highly significant that the year ended with around 80% of all client funds transitioned into partnership portfolios. After a year marked by both major partnership achievements and the continued challenges – both corporate and personal – posed by lockdowns, it was especially gratifying that the team was able to gather in Bristol in December to celebrate the year – and to look ahead.

The year also ended with the launch of Brunel's Climate Stocktake. The Stocktake has always been a crucial part of our long-term plan, since it enables us to judge whether our approach to climate investing is working – and to identify areas for improvement. In December, our CIO, Chief Responsible Investment Officer, Chief Stakeholder Officer and Head of Communications therefore met with representatives from Southwest Action on Pensions, UNISON (Bath & Northeast Somerset) and Fossil Free Oxfordshire. The meeting enabled Brunel staff to explain our approach to climate investing to a local audience whose priority is divestment. With a broader audience in mind, Faith Ward gave a video interview hosted by Asset TV. In *No Excuses on Net Zero*, Faith explained Brunel's hopes for COP 26 – and for investor progress in particular.

# Executive Summary

## High Level Performance of Pension Fund

- The fund delivered absolute performance of 3.6% over the quarter in GBP terms. This was slightly behind the benchmark return of 3.8%.
- Total fund return for the one-year period to 31 December was 14.1%, behind the benchmark return of 16.0%.

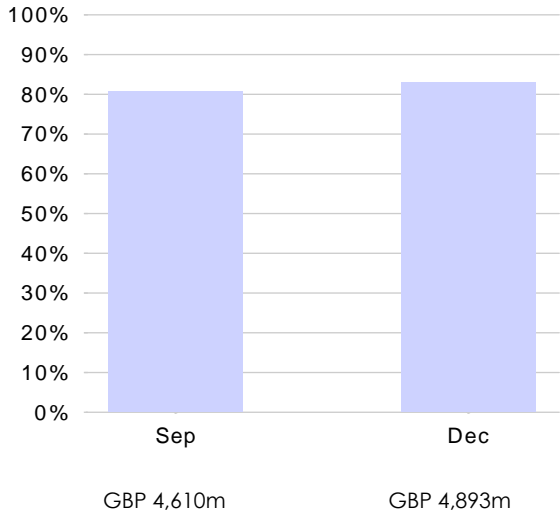
## Key points from last quarter

- 3.6% absolute net performance Q4; -0.2% relative net performance vs benchmark Q4
- 14.1% absolute net performance 1Y; -1.9% relative net performance vs benchmark 1Y
- An investment was initiated into the newly created Passive Developed Equity Paris Aligned strategy funded from the Low Carbon holding.

## Total Fund Valuation

	Total (GBPm)
30 Sep 2021	5,710
31 Dec 2021	5,895
Net cash inflow (outflow)	-20

## Assets Transitioned to Brunel





# Market Summary – Listed Markets

The fourth quarter proved positive for some risk assets, despite the ongoing inflationary headwinds that persisted throughout 2021. The quarter was characterised by high volatility, as the Omicron variant that emerged at the end of November sent risk assets falling. This fall quickly reversed in late December, as anecdotal evidence that emerged played down the severity of the variant. Consequently, most equity assets actually rose in Q4 2021, whilst corporate credit assets struggled. It was a mixed quarter for commodities, following stellar performance over the first three quarters of 2021.

Monetary policy continued to tighten in major economies as markets began to price in rate rises in both the US and UK. The Bank of England (BoE) lifted its base rate by 15bps to 0.25% in its December meeting, which was its first rate rise in three years. The Monetary Policy Committee at the BoE cited concerns of a tighter labour market coupled with increasing inflationary pressures as the catalysts for a rate rise. In the United States, officials from the Federal Reserve signalled that the scaling back of asset purchases and subsequent rate rises may come as soon as March 2022 to combat high inflation; this was several months ahead of prior market expectations. As a result, significant pressure on shorter-dated yields were observed in both the US and the UK. In the US, the policy sensitive 2yr yield rose from 0.29% to 0.73%; similarly, the UK 2yr yield rose from 0.31% to 0.60%.

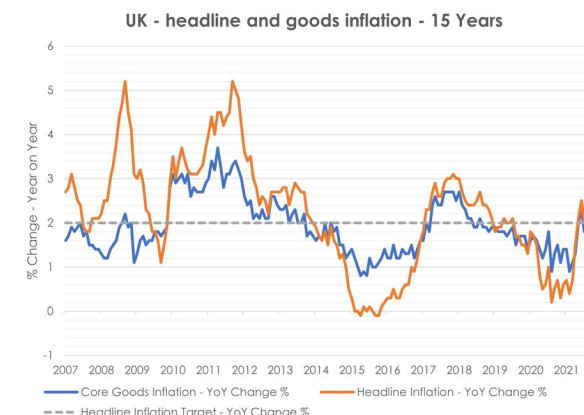
UK inflation hit the highest level in a decade, rising to 5.2% in November. This was predominantly driven by petrol and second-hand car price rises. However, the underlying details showed that upward pressure in prices was observed across almost all goods and services, implying that price rises are now widespread. The latest inflation numbers surprised economists, who had predicted a median increase of 4.8%.

## Equities

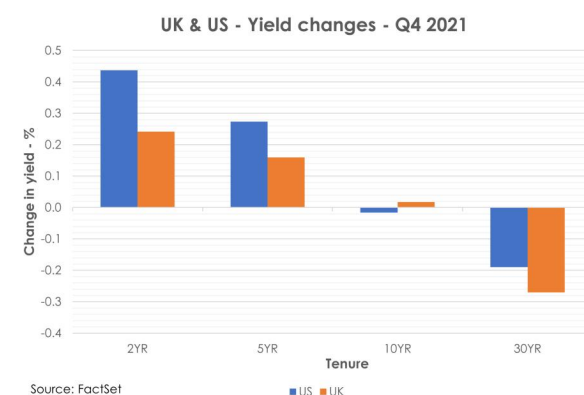
On the geopolitical stage, concerns rose in the Ukraine as Russia continued to increase the military presence on its borders. Markets reacted in typical fashion, with Russian assets – proxied by MSCI Russia – dropping 9.4% over the quarter.

Global developed equities, proxied via MSCI World, increased by 7% in GBP terms over the quarter. This was skewed by the performance of the United States equity market, which appreciated by 9.6% over the period. Emerging markets were the clear laggards; the emerging world continued to struggle as a result of slowing growth in China, coupled with lingering concerns over its over-indebted property sector. Broader emerging markets – proxied by MSCI Emerging Markets – fell 1.7% in GBP terms, almost entirely driven by a fall of 6.5% in China alone. In terms of style, quality companies led the way last quarter, outperforming by 3% on a global basis. The least successful style was momentum, which underperformed

## UK inflation at highest level for a decade



## Longer-duration assets outperform shorter counterparts in the UK & US



# Market Summary – Listed Markets

the broader market by 2.4% over the quarter.

## Fixed Income

In credit, investment grade (IG) and high yield corporates (HY) were both down by around 0.7% over the quarter in local terms. This was mostly driven by increasing yields at the policy-sensitive shorter end of the yield curve; as a result, longer-duration assets significantly outperformed their shorter counterparts. In both IG & HY, carry from income was not sufficient enough to offset losses from rate rises.

Option-adjusted spread levels ended at the same level as the start of the quarter; however, there was considerable intra-month movement following news of the Omicron variant. High yield spreads, proxied by the Bloomberg Barclays Global High Yield Index, ended at 380bps but were as high as 437bps at the height of Omicron concerns. A similar pattern was observed in investment grade markets on a considerably smaller spread scale.

## Commodities

It was a mixed experience for commodities during Q4 2021. Crude oil was broadly flat on a quarter-on-quarter basis but, like many risk assets, experienced significant volatility following the Omicron announcement. Industrial metals had mixed fortunes, with copper and iron ore diverging significantly; they returned +6.7% and -6.4% respectively in GBP terms. Precious metals such as gold held up well, returning 3.6% in GBP terms over the quarter.

# Market Summary – Head of Private Markets

The final quarter of 2021 saw fears over rising cases of the Omicron variant, along with the potential for the return of restrictions as hospitalisations rose in several countries. These restrictions were introduced for travel and hospitality sectors in many European countries to try to slow the spread.

Against the backdrop of uncertain growth, many UK retailers continued to struggle with supply chain disruption. Coupled with volatile gas supply and maintenance on nuclear power plants leading to a sharp rise in gas and electricity prices in Europe, the result was that inflation was pushed higher. The Bank of England reacted to the inflation rise and the tightening labour market by raising rates by 0.15% to 0.25%. The US Federal Reserve's rhetoric turned increasingly hawkish; Jay Powell suggested tapering could be accelerated, and that the Fed may stop referring to inflation as "transitory"; US rate hikes are therefore expected this year.

## Infrastructure

The emergence of the Omicron variant brought new uncertainties to the market in the last quarter of 2021, whilst inflation continued its upward trend with CPI rising above 5.0% (RPI 7%) in November, leading the Bank of England to raise interest rates (and expectations) for the first time in three years and the Federal Reserve to accelerate its tapering. Investors looked at infrastructure with an eye to inflation protection and relatively uncorrelated returns to equities. Of the more than 50 LPs surveyed by Campbell Lutyens in December, 80% plan to increase their allocation to the asset class. Prequin forecasts assets under management in private infrastructure will reach \$1.87tn by 2026, overtaking real estate to become the largest real asset class.

In the last quarter of 2021, the last hurdles were passed for the \$1.2tn US Infrastructure bill, which includes \$550bn in new spend in transport, utilities and environment remediation.

COP 26 in Glasgow brought renewed attention to renewables and other climate change and energy transition-related infrastructure. Despite record energy prices, expected returns from investing in traditional renewables are suffering material compression due to weight of capital from the top and cost pressures from supply chain issues related to Covid and forced labour in Xinjiang, from beneath. At the same time, COP 26 highlighted the need for more investment beyond renewables in areas such as decarbonization of industry, heating and transport or strengthening energy storage and transmission.

## Private Equity

Investment sentiment and activity remained strong and continued in Q4 2021. Year-to-date volume in US private equity reached its pre-Covid peak showing strong signs of a continued recovery. Inflation fears and Fed hikes are the key issues the market is monitoring and private equity firms are assessing the effects on deal activity and portfolio performance. Although dry powder is at record levels, the fund-

# Market Summary – Head of Private Markets

raising market is strong with major mega-funds expected to come back to market in 2022. Asset valuations remain high, evidenced in strong exits and continued demand. Private Equity firms have further increased their focus on ESG and ways to embed it in their processes to drive value in portfolio investments.

VC investments in Europe crossed \$113bn for the first time, with the UK (Europe's most developed VC market) raising the most. In the US, the tech sector continues to drive the majority of deal activity in the market.

The fundraising market is expected to have another record this year. Mega-funds continue to dominate the market (a total of 31 mega funds closed in 2021, raising \$329bn) with buyout, growth, and venture the main strategies of interest. Established platforms continue to look for new strategies and are offering investors different products from their flagship funds.

## Private Debt

US high yield bond prices were flat over the quarter. Primary issuance was muted in December but 2021 was a record-breaking year, with ~\$490bn of new issuance. Default rates were at benign levels with only ~0.44% of the high yield bond market in default over the calendar year. European high yield bonds underperformed their US counterparts over the quarter as Omicron spread more rapidly across Europe and the UK.

Elevated levels of private equity activity through Q4 drove a surge in financing activity and deal flow for private debt managers. Anecdotal evidence suggests that leverage and pricing was more stable in Europe whereas, in the US, leverage levels were pushed slightly higher on the back of intense competition for deals.

Private debt managers have been able to deploy capital faster than expected and many have already started to think about their next vintage funds. ICG and Arcmont are two notable European managers who are expected to begin fundraising in Q1 2022.

## Property

The UK commercial property sectors dominant in 2021 remained market-leading in Q4, both in terms of transactional activity and investment performance. The industrial sector is set to see a further year of strong rental growth, driven by demand/supply imbalances, and retail warehouses remain the destination of choice for most shoppers, as anxieties around Covid linger. Regulatory strengthening of EPC standards in 2023 and 2030 have focused UK investors' attention on managers' ability to future-proof legacy assets. Valuations for offices, industrial assets and residential space have already started to distinguish between developments and refurbishments which incorporate net zero carbon pathways and tenant well-being and those assets that do not.

# Market Summary – Head of Private Markets

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Global real estate markets performed well in 2021, fuelled by unprecedented amounts of monetary and fiscal stimulus, the unleashing of pent-up consumer demand, and measures that allowed the world to reopen and a much quicker-than-expected resurgence in economic growth. City office, apartment and retail markets that suffered during the lockdowns started to come back into favour, with capital increasingly finding its way into higher-returning operational assets, where returns are linked to long-term trends such as digital transformation, ageing populations and environmental sustainability.

# Responsible Investment & Stewardship Review

## Index Investing

Over the course of 2021, we made a number of significant announcements, among them, the decision to formally commit to Net Zero, and the launch of a new series of Paris-aligned benchmarks that we had developed in coordination with FTSE Russell.

In the fourth quarter, these two developments gained fresh significance, as we announced the transition of £3 billion of client funds into the new benchmarks – with more to come.

The transition came courtesy of five of our clients being ready to commit funds at this early stage, and thereby formed one of the largest passive fund launches in the history of Legal & General Investment Management, which manages the fund.

In recognition of the significance of the moment, Brunel was invited to open the London Stock Exchange on 2 November.

Our mission at Brunel is not just to Paris-align our own portfolios, but to act as a spur to the wider industry. The benchmarks launch shows how indices can be a major part of the solution to climate change and we hope to see these benchmarks much more widely adopted in the coming months.

## Page 13 COP 26

The opening of the London Stock Exchange, though it was covered in industry and national media, was quickly overshadowed by COP 26, which began in earnest on the same morning. Our own size meant we did not have access to the negotiating area – the ‘blue zone’ – of the conference.

However, in December 2020 the Brunel Board approved Faith Ward to become Chair of the Institutional Investors Group on Climate Change (IIGCC).

The IIGCC represents more than €50 trillion in assets. It was in her role as IIGCC Chair that Faith not only received an all-areas pass, but also delivered speeches and sat on panels, as well as holding more informal meetings with figures from across politics, finance and environmentalism.

There are many highlights we could pick out, but two are especially worth mentioning. Faith sat on a panel with Mark Carney (former BoE governor), Professor John Rockström (Stockholm Resilience Centre), Jeremy Oppenheim (founder-chair of SystemIQ) and David Blood (founder of Generation IM). The panel was called [Deploying capital in the age of planetary boundaries](#).

She also sat on an IIGCC-PRI panel called [The Investor Agenda: Accelerating global investor actions for a net-zero emissions economy](#).

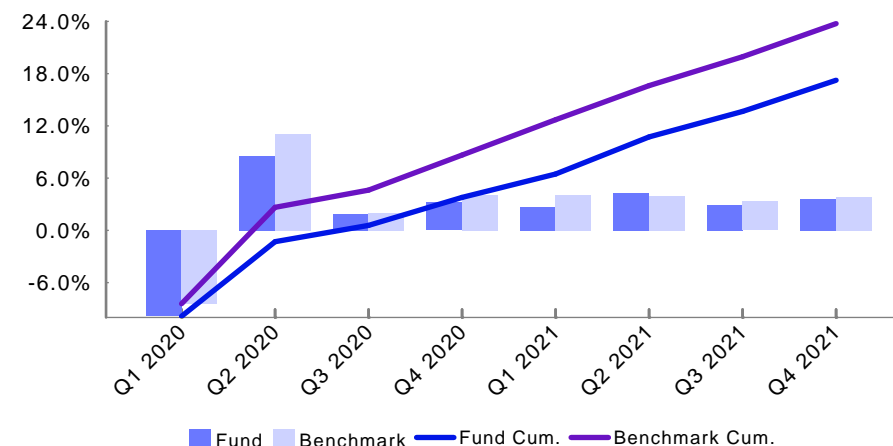
In all of these forums, Faith was keen to emphasise the importance of Paris-aligned investment objectives for investors, the opportunity presented by Paris-aligned benchmarks, and the need for investors to work closely with governments in order to meet transition aims.

# Summary of Pension Fund Performance

## Performance of Fund Against Benchmark (Annualised Performance)

Period	Fund	Strategic BM	Excess
3 Month	3.6%	3.8%	-0.2%
Fiscal YTD	11.2%	11.4%	-0.3%
1 Year	14.1%	16.0%	-1.8%
3 Years	8.2%	12.1%	-3.9%
5 Years	6.9%	9.1%	-2.2%
10 Years	8.3%	9.8%	-1.5%
Since Inception	8.4%		

## Rolling Quarter Total Fund (Net of Manager Fees)

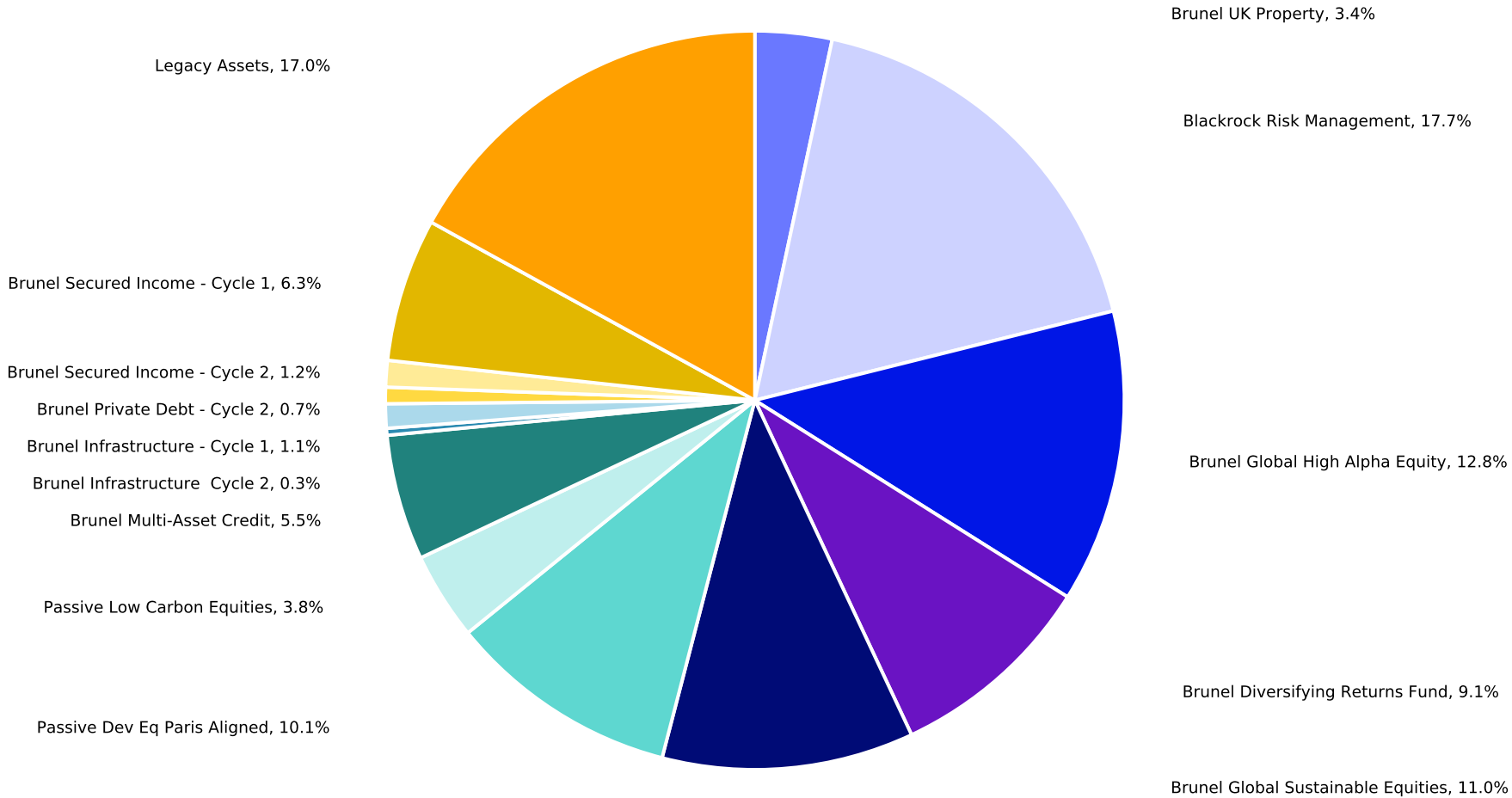


## Key drivers of performance

Portfolio performance of note for the quarter include:

- Global High Alpha Equity underperformed the benchmark over Q4 with a return of 6.3% against that of the benchmark of 7.4%.
- Global Sustainable Equities generated a positive return over the three months of 6.8% which was ahead of the benchmark reference by 0.5%.
- The Diversifying Returns Fund return was 0.5% over the Q4 which was 0.3% behind the benchmark.
- The Multi-Asset Credit portfolio generated a return of 0.4% over the quarter behind the benchmark by 0.6%.

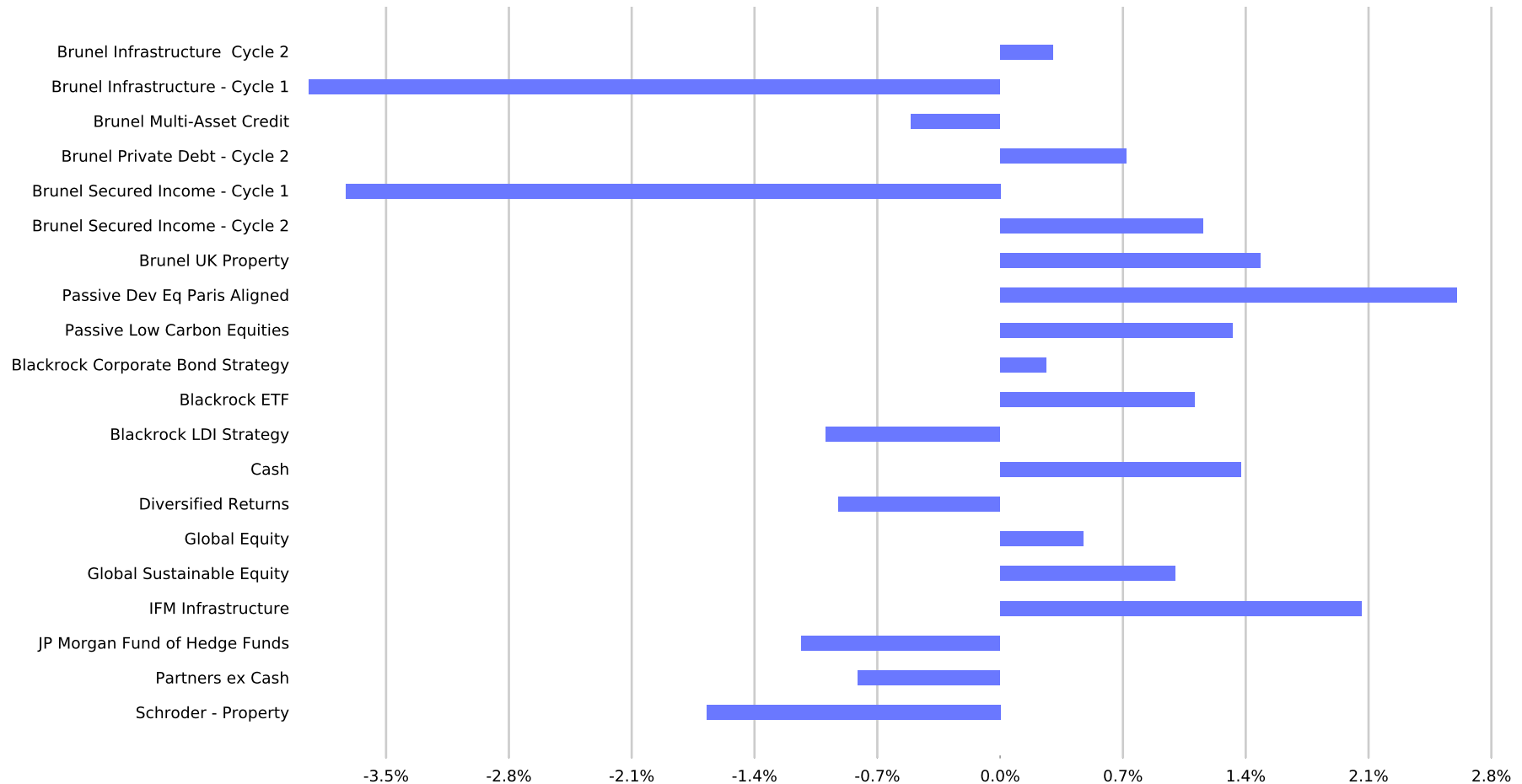
Asset Allocation Split





# Asset Allocation of Pension Fund

## Allocation Against Strategic Benchmark



# 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. SII*	Excess SII*	Initial Investment
Brunel Global High Alpha Equity	MSCI World TR Gross	756	6.3%	-1.1%	21.9%	-1.6%					24.2%	6.6%	15 Nov 2019
Brunel Global Sustainable Equities	MSCI AC World GBP Index	649	6.8%	0.5%	20.5%	0.3%					24.3%	0.7%	30 Sep 2020
Brunel Diversifying Returns Fund	SONIA +3% Benchmark	536	0.5%	-0.3%	5.5%	2.4%					4.9%	2.0%	27 Jul 2020
Brunel Multi-Asset Credit	SONIA + 4%	324	0.4%	-0.6%							1.2%	-1.2%	02 Jun 2021
Passive Dev Eq Paris Aligned	FTSE Developed Paris-Aligned (PAB) Net Index	597									3.8%	-0.1%	29 Oct 2021
Passive Low Carbon Equities	MSCI World Low Carbon Target	226	7.4%	-0.0%	23.1%	-0.1%	20.1%	-0.1%			14.6%	-0.1%	11 Jul 2018

\*Since Initial Investment

Performance based on tradeable NAV

Where there are disparities between returns quoted above and returns provided for the same fund and period in the following pages, this is because the fund-specific pages reflect the posttransition phase, important for monitoring the performance of selected managers, while those given above reflect the Clients' actual experience from the point of initial investment, which in some cases includes the shared impact of transition costs.

Tradeable NAV performance reflects NET performance. The following product pages reflect the portfolio's NET performance

# Brunel Portfolios Overview (Exited)

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. SII*	Excess SII*	Initial Investment
Brunel Emerging Market Equity	MSCI EM TR Gross		-1.8%	-0.1%	-1.9%	-0.5%					6.9%	-0.8%	09 Oct 2019

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\*Since Initial Investment

Performance based on tradeable NAV

Where there are disparities between returns quoted above and returns provided for the same fund and period in the following pages, this is because the fund-specific pages reflect the posttransition phase, important for monitoring the performance of selected managers, while those given above reflect the Clients' actual experience from the point of initial investment, which in some cases includes the shared impact of transition costs.

Tradeable NAV performance reflects NET performance. The following product pages reflect the portfolio's NET performance

# Brunel Global High Alpha Equity

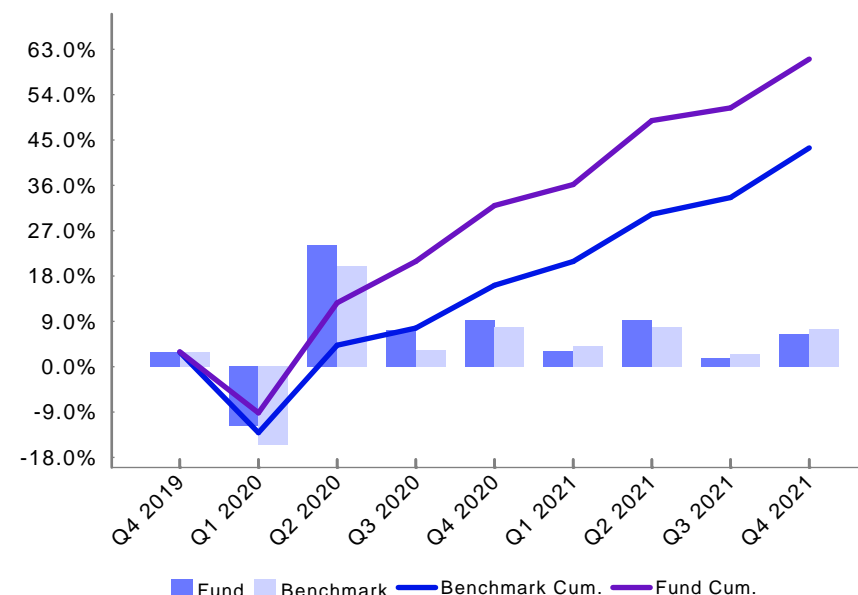
## Overview

	Description
Portfolio Objective:	Provide global equity market exposure together with excess returns from accessing leading managers.
Investment Strategy & Key Drivers:	High conviction, concentrated portfolios with strong style/factor biases invested in a unconstrained manner.
Liquidity:	Managed liquidity. Less exposure to more illiquid assets.
Risk/Volatility:	High absolute risk with moderate to high relative risk, around 5-6% tracking error.
Total Fund Value:	£3,651,503,641

## Performance to Quarter End

Ann. Performance	Fund	BM	Excess
3 Month	6.4%	7.4%	-1.0%
Fiscal YTD	18.3%	18.6%	-0.4%
1 Year	22.0%	23.5%	-1.5%
3 Years			
5 Years			
10 Years			
Since Inception	25.9%	19.0%	6.9%

## Rolling Performance\*



\* Partial returns shown in first quarter

The quarter witnessed a new development in the COVID pandemic with the emergence of the Omicron variant which threatened a new cycle of lockdowns and a corresponding negative impact on global economic activity and growth. However, as evidence emerged of a milder (if more transmissible) variant, those concerns dissipated somewhat and, following a comeback of the 're-opening' trade in December, global equity markets ended 2021 near all-time highs.

Global developed equities (as proxied by the MSCI World index) returned 7.4% this quarter, continuing the unbroken run of positive absolute quarterly returns since the drawdown in Q1 2020 at the outset of the COVID pandemic. All sectors except for Communications Services posted positive absolute returns, with IT leading the way as large benchmark names such as Apple, Microsoft and NVIDIA posted strong returns (25%, 19% and 41% respectively). The US dominated regional equity market returns this quarter, whilst Europe underperformed the index but outperformed Asia and Japan, the latter experiencing a reversal after last quarter's standout performance. Emerging markets continued to underperform their developed market counterparts through the quarter, led by China as concerns about the continuing real estate debt crisis and the country's zero COVID policy weighed on sentiment.

# Brunel Global High Alpha Equity

The Sub-Fund returned 6.4% over the quarter, underperforming the MSCI World Index (the benchmark) by 1%.

- Sector attribution showed the underperformance was driven almost entirely by stock selection which was weakest in the IT sector. Being underweight Apple was the largest single detractor as the company returned 25% and became the first \$3 trillion company only 16 months after breaking through the \$2 trillion valuation threshold. Apple makes up 4.3% of the index and the Sub-Fund is 3% underweight. The Sub-Fund was also underrepresented in some semiconductor names which performed strongly such as Advanced Micro Devices, Broadcom and Qualcomm which returned 39%, 37% and 42% respectively. Weaker stock selection was also evident in the Consumer Discretionary sector as we saw some previous COVID related winners held at overweight give up some of their gains (Peloton -59%, Alibaba -17% and Pinduoduo -36%), with the former down 59% as revenue missed estimates and revenue forecasts were cut significantly.
- Country attribution showed a negative impact from being overweight China as the concerns highlighted above impacted Sub-Fund holdings, in particular Pinduoduo (Chinese e-commerce, -36%) and Beigene (Chinese biopharmaceutical, -26%). Being underweight the US also had a detrimental impact on performance but to a much lesser extent.

Fiera and RLAM outperformed over the quarter (+3.2% and +1.1% respectively) reflecting their focus on quality characteristics which were rewarded generally by the market, whilst AB performed in line with the benchmark. Baillie Gifford were again the largest underperformer (-10.5%), reflecting the headwinds faced by the longer-term growth companies held in their portfolio. These headwinds were caused by the double impact of improved sentiment on future broad growth prospects meaning investors were less keen to pay high valuations for future growth, and the prospect of increasing discount rates disproportionately hurting valuations of such companies given the size of cash flows further out into the future. Although Harris underperformed during the quarter (-4.8%), a strong outperformance in December (+2.5%) helped to offset some of the underperformance in other portfolios during this time.

Since inception the Sub-Fund has outperformed the index by 6.9% on an annualised basis, still significantly above target despite the impact of recent underperformance over the last two quarters. Attribution analysis shows that this outperformance has largely resulted from positive stock selection which reflects the approach of employing fundamental managers chosen for their ability to select concentrated portfolios of high conviction names. Four managers remain above benchmark since inception with three also performing above performance target (Baillie Gifford, Fiera and RLAM).

A new calendar year is always an opportunity to take stock and look at the prospects for the year ahead. Outlook statements by market commentators and participants varied quite widely. They did however agree on two things with regards to equities – an expectation of a positive return in 2022, and a continuance of increased volatility in equity markets. Sources of volatility over the coming year appear plentiful and somewhat interconnected. They include: the impact of COVID on the global economy, how supply chain issues and labour market dynamics evolve, the future path of inflation and central banks' policy response, the impact of large amounts of cash seeking a home, slower growth in China impacting global growth, and the impact of the transition to a net zero economy.

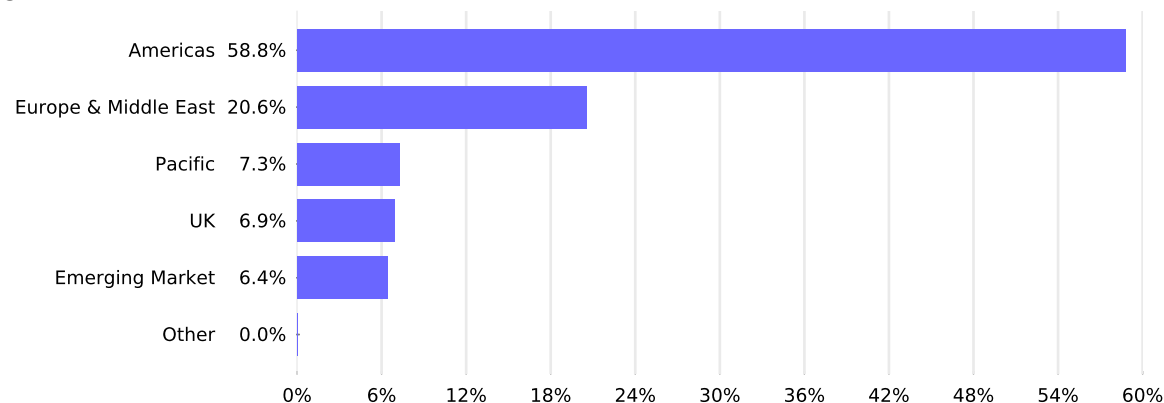
There were seven client trades during the quarter resulting in a net inflow to the Sub-Fund of £141m. The largest trade of £267m was made using the proceeds from a redemption from the Brunel Emerging Market Equity fund. The purchase was netted off against two separate client redemptions of £70m and £50m, resulting in transaction cost savings to all three clients.

# Brunel Global High Alpha Equity – Region & Sector Exposure

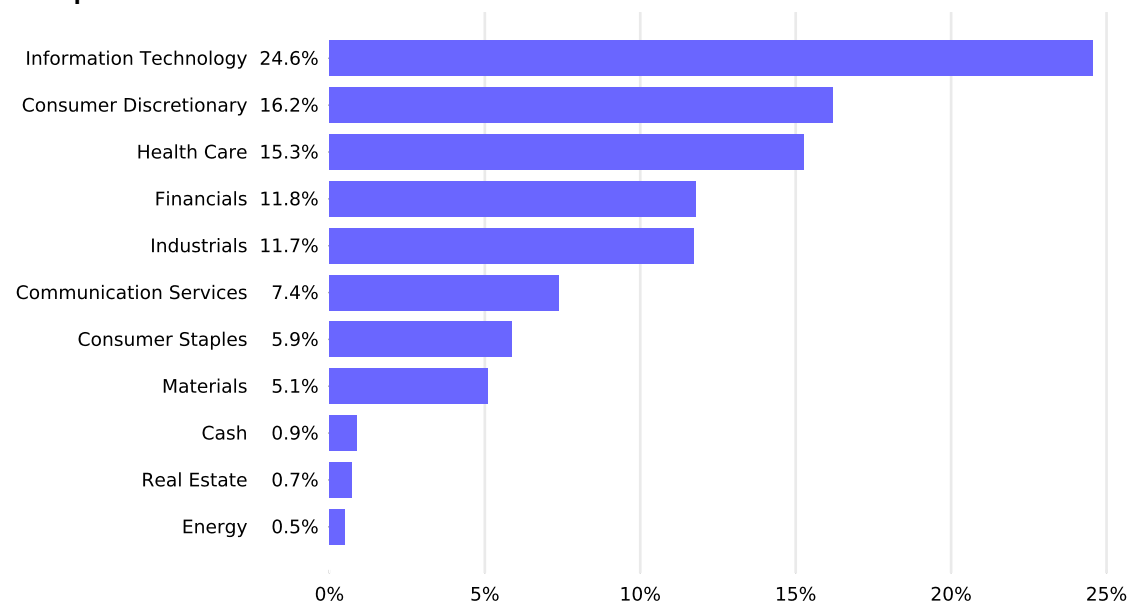
## Top 20 Holdings

	Mkt. Val.(GBP)
MICROSOFT CORP	171,387,354
ALPHABET INC-CL A	124,053,609
MASTERCARD INC - A	95,889,293
AMAZON.COM INC	89,303,822
MOODY'S CORP	74,890,781
KEYENCE CORP	70,036,268
NESTLE SA-REG	69,126,490
TAIWAN SEMICONDUCTOR-SP ADR	68,410,477
TJX COMPANIES INC	66,680,968
NIKE INC -CL B	64,472,605
ASML HOLDING NV	64,018,730
SCHWAB (CHARLES) CORP	60,816,182
CAPGEMINI SE	55,713,239
UNITEDHEALTH GROUP INC	55,326,151
APTIV PLC	44,313,424
AUTOZONE INC	42,524,708
SHERWIN-WILLIAMS CO/THE	42,394,133
RECRUIT HOLDINGS CO LTD	41,678,446
AUTOMATIC DATA PROCESSING	41,616,070
META PLATFORMS INC-CLASS A	41,577,894

## Regional Exposure



## Sector Exposure



# Brunel Global High Alpha Equity – Responsible Investment

## Top 10 ESG Contributors to Overall Score

	Insight	Momentum
1. KEYENCE CORP	75.2	70.3
2. RECRUIT HOLDINGS CO LTD	69.3	74.1
3. ASML HOLDING NV	63.2	52.1
4. CAPGEMINI SE	62.6	55.6
5. NESTLE SA	59.8	50.0
6. APTIV PLC	62.5	69.0
7. NIDEC CORP	63.6	44.2
8. CARRIER GLOBAL CORP	66.8	73.3
9. ADMIRAL GROUP PLC	76.8	33.7
10. SAP SE	64.0	40.4

## Bottom 10 ESG Detractors to Overall Score

	Insight	Momentum
1. SHERWIN-WILLIAMS CO/THE	47.4	25.5
2. MOODY'S CORP	50.5	59.6
3. AMAZON.COM INC	50.5	58.2
4. AUTOZONE INC	45.1	84.4
5. META PLATFORMS INC	42.9	65.9
6. NIKE INC	46.4	50.0
7. JOHNSON & JOHNSON	39.2	32.1
8. ALPHABET INC	45.8	61.6
9. TJX COS INC/THE	37.0	17.4
10. MICROSOFT CORP	47.0	31.0

\* Position 1 is the top contributor/detractor.



Weighted Average ESG Score	2021 Q3	2021 Q4
Portfolio	54.6	54.7
MSCI World	54.3	54.6

TruValue Labs & SASB

## Brunel Assessment:

- Amazon** (Consumer Goods) made a deal with Stellantis to add to its electric van fleet and develop in-car software using Alexa software. Amazon workers continue attempts to unionise for better worker rights. The Senate Judiciary Committee overwhelmingly passed antitrust legislation barring tech's biggest platforms from favoring their products and services over competitors.
- Aptiv** (Auto Parts) won 2021 Automotive News' PACE Award for innovation. It's Solid State Electrical Center reduces vehicle weight and provides superior performance while using fewer resources, less energy and less space. The auto industry continues to be hit by supply chains issues and will likely not return to pre-pandemic production levels until post-2022.
- SAP** (Software) launched new circular economy software solution, enabling sustainable product design by providing visibility of material flows, waste reduction and cost of downstream reuse and recycling systems.
- Johnson & Johnson** (Healthcare) ongoing talc litigation, which as of July totalled roughly 34,600 lawsuits linking Johnson's Baby Powder to ovarian cancer. A \$465 million opioid ruling in Oklahoma was overturned.

80% of the bottom 10 ESG detractors are covered by engagement or specific voting activities.

The portfolio continues to have a carbon intensity significantly lower than its benchmark. Revenues from extractive activity and the extractives value of holdings are less than half that of its benchmark.

## Weighted Average Carbon Intensity (WACI)



Source: Trucost

## Extractive Exposure

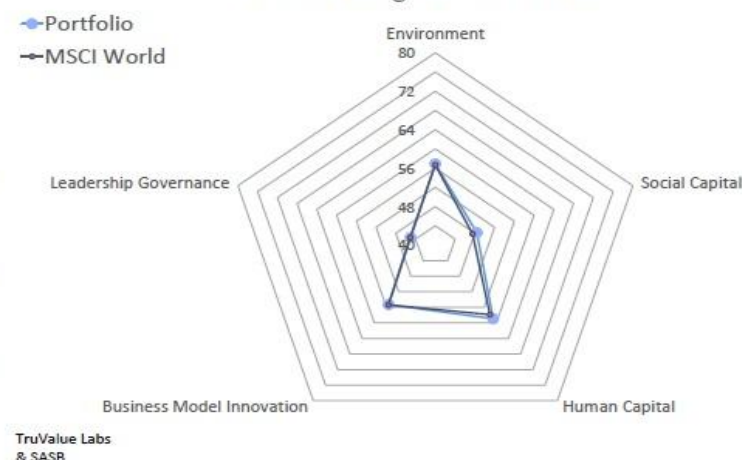
	Total Extractive Exposure <sup>1</sup>		Extractive Industries (VOH) <sup>2</sup>	
	Q3	Q4	Q3	Q4
Portfolio	1.4	0.9	1.8	1.8
MSCI World	2.9	2.6	5.1	5.1

<sup>1</sup> Extractive revenue exposure as share (%) of total revenue.

<sup>2</sup> Value of holdings (VOH)-companies who derive revenues from extractives.

Source: Trucost

## Absolute Weighted ESG Scores



TruValue Labs & SASB

# Brunel Global Sustainable Equities

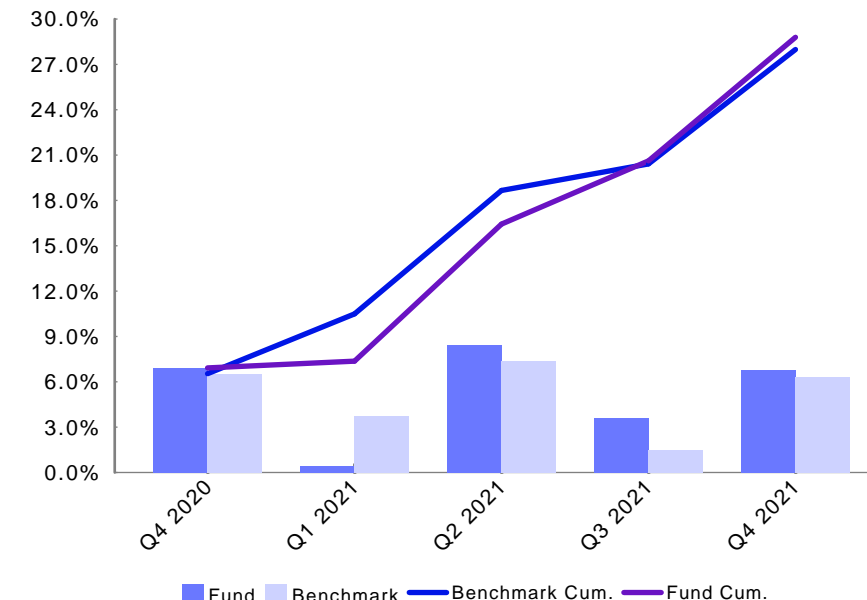
## Overview

	Description
Portfolio Objective:	To provide exposure to global sustainable equities markets, including excess returns from manager skill and ESG considerations.
Investment Strategy & Key Drivers:	Actively managed, diversified by sector and geography. Consideration for a companies Environmental & Social sustainability.
Liquidity:	Managed Liquidity.
Risk/Volatility:	High, representing an equity portfolio.
Total Fund Value:	£2,662,340,541

## Performance to Quarter End

	Ann. Performance	Fund	BM	Excess
3 Month		6.8%	6.3%	0.5%
Fiscal YTD		20.0%	15.8%	4.1%
1 Year		20.5%	20.1%	0.3%
3 Years				
5 Years				
10 Years				
Since Inception		23.5%	22.8%	0.6%

## Rolling Performance\*



\* Partial returns shown in first quarter

Whilst markets focussed on the risks arising from the Omicron variant and the threat of rising inflation, the long anticipated COP26 conference on climate change which took place in Glasgow during November drew the world's media attention (if not the market's) to more existential threats. Whilst perhaps falling short of some of its' pre-event ambitions, COP26 did mark an acceleration of policy change on emissions reduction and bio-diversity and served to amplify the importance of progress over the next 10 years if we are to successfully tackle the challenges ahead. The focus of this Sub-Fund and the underlying managers on addressing sustainability through the companies they invest in, should mean it is well placed to contribute to the aims set out in COP26 and broader sustainable ambitions.

Global equities (as proxied by the MSCI All Countries World Index) returned 6.3% this quarter. The Sub-Fund returned 6.8%, an outperformance of 0.5% versus the benchmark (MSCI All Countries World Index).

- Sector attribution showed the Sub-Fund benefitted from sector allocation. The Sub-Fund's largest overweight was to IT, the best performing sector (returning 12%), whilst the largest underweight was to Communications Services (returning -2%), the worst performing sector.



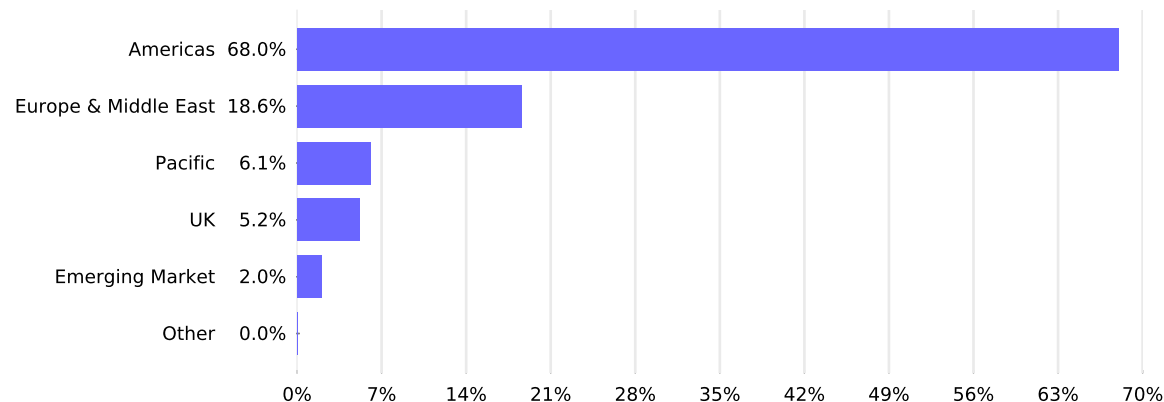
- Stock selection was marginally negative with weak selection in IT. Not holding Apple which performed strongly, and overweights to payments platforms companies PayPal and Adyen which both gave up previous gains (returning -28% and -7% respectively), were the larger detractors. This was offset by positive selection in Financials where the financial exchange companies InterContinental Exchanges and Tradeweb were the largest contributors (returning 19% and 24% respectively).
- Attribution by country showed that country allocation also helped, driven by the underweight to China which returned -6% as worries persisted about the continuing real estate debt crisis and the country's zero COVID policy. The Sub-Fund's overweight to the US, the strongest performing region in the index, also added to relative returns.
- Nordea and RBC outperformed the benchmark (+3.4% and +0.6% respectively) whilst Mirova and Ownership underperformed (-1% and -1.1%). The more diversified and risk managed approach of RBC and the thematic approach of Nordea performed more strongly in the market environment. In particular, during a quarter that witnessed a spike in fossil fuel prices to levels not reached since the GFC, significant contribution to Nordea's outperformance came from their energy efficiency and smart grid themes. Overweights in ON semiconductor (energy efficient electronics), Teradyne (semiconductor testing), Synopsys (chip design to optimise power consumption) and Jiangsu Zhongtian Technology (optical fibre solutions), that returned 48%, 49%, 23% and 88% respectively, were the largest contributors to Nordea's relative performance.
- Since inception the Sub-Fund has outperformed the benchmark by 0.6% on an annualised basis.
- The Sustainability ESG scores for the Sub-Fund remain superior to that of the MSCI ACWI benchmark and we continue to see a carbon intensity reduction in comparison to the benchmark.
- There were four small client trades in the Sub-Fund this quarter resulting in a net outflow of c. £4m. The asset value of the Sub-Fund stands at £2.7 billion at quarter end.

# Brunel Global Sustainable Equities – Region & Sector Exposure

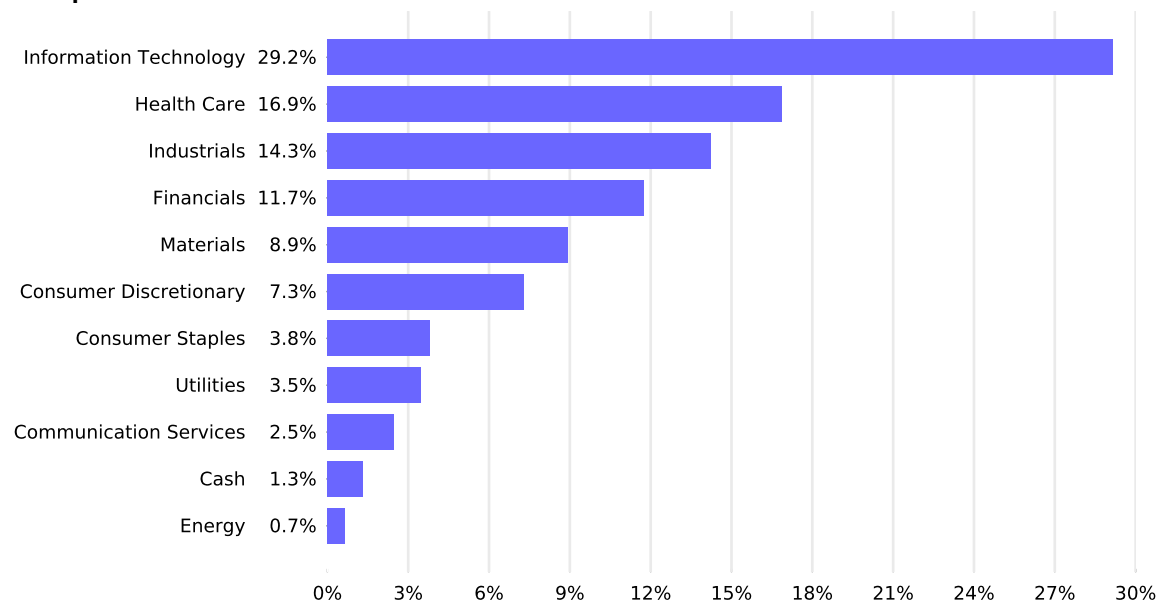
## Top 20 Holdings

	Mkt. Val.(GBP)
MICROSOFT CORP	67,169,386
MASTERCARD INC - A	61,494,633
ADYEN NV	59,440,050
ANSYS INC	58,998,874
ECOLAB INC	57,852,308
MARKETAXESS HOLDINGS INC	53,161,425
WORKDAY INC-CLASS A	50,324,764
ALPHABET INC-CL A	48,600,088
DANAHER CORP	48,540,184
INTUIT INC	48,334,409
TRADEWEB MARKETS INC-CLASS A	45,391,113
MASIMO CORP	44,666,667
UNITEDHEALTH GROUP INC	42,449,746
EDWARDS LIFESCIENCES CORP	41,062,915
SYNOPTIS INC	40,856,630
TYLER TECHNOLOGIES INC	40,777,025
ROCHE HOLDING AG-GENUSSCHEIN	38,045,480
ASML HOLDING NV	37,422,608
BIO-TECHNE CORP	35,883,063
NVIDIA CORP	35,596,376

## Regional Exposure



## Sector Exposure



# Brunel Global Sustainable Equities – Responsible Investment

## Top 10 ESG Contributors to Overall Score

	Insight	Momentum
1. ECOLAB INC	69.5	34.3
2. MASIMO CORP	71.9	79.2
3. ORSTED AS	73.6	62.1
4. ABIOMED INC	77.8	85.9
5. ANSYS INC	65.2	50.0
6. FORTIVE CORP	70.1	50.0
7. CRODA INTERNATIONAL PLC	75.5	75.8
8. TRADEWEB MARKETS INC	65.3	82.4
9. WORKDAY INC	64.4	18.6
10. ZEBRA TECHNOLOGIES CORP	75.4	70.5

## Bottom 10 ESG Detractors to Overall Score

	Insight	Momentum
1. DANAHER CORP	53.8	59.8
2. UNITEDHEALTH GROUP INC	53.0	33.7
3. INTUIT INC	53.5	48.2
4. ROCHE HOLDING AG	50.3	50.0
5. SYNOPSIS INC	50.4	50.0
6. ILLUMINA INC	47.6	27.3
7. ALPHABET INC	45.8	61.6
8. MARKETAXESS HOLDINGS INC	46.3	13.7
9. TJX COS INC/THE	37.0	17.4
10. MICROSOFT CORP	47.0	31.0



Source: Trucost

## Extractive Exposure

	Total Extractive Exposure <sup>1</sup>		Extractive Industries (VOH) <sup>2</sup>	
	Q3	Q4	Q3	Q4
Portfolio	3.1	2.9	3.4	3.3
MSCI ACWI	3.0	2.6	5.4	5.4

1 Extractive revenue exposure as share (%) of total revenue.

2 Value of holdings (VOH)-companies who derive revenues from extractives.

Source: Trucost

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Weighted Average ESG Score	2021 Q3	2021 Q4
Portfolio	59.2	59.7
MSCI ACWI	54.5	54.9

TruValue Labs & SASB

\* Position 1 is the top contributor/detractor.

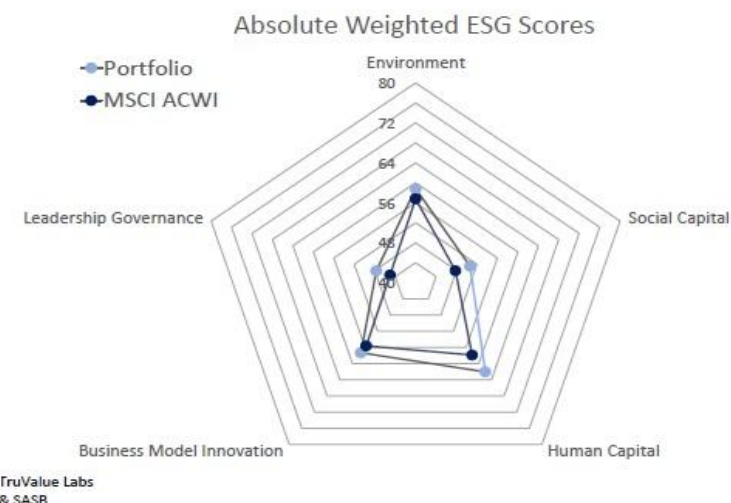


## Brunel Assessment:

- illumina** (Healthcare) received a statement of objections for closing the bid for Grail Inc before securing regulatory clearance. EU antitrust regulators warned of interim measures, they will decide by Feb. 4th whether to clear the deal.
- Alphabet** (Technology) committed to immediately improve enforcement of an age-sensitive ad policy after Reuters found ads for adult content, liquor and high-risk investments in its search engine that should have been blocked under its efforts to comply with UK regulations.
- Fortive** (Technology) research and innovation is being used to reduce nitrous oxide (NOX) and carbon dioxide (CO2) emissions from medium and heavy-duty vehicles, helping to meet ever-tightening environmental regulations.
- Orsted** (Technology) implemented multiple corporate power purchase agreements (CPPA) for its offshore wind power in Germany, a 25 year agreement with BASF and a 12-year agreement with Google. The 25 year agreement is the longest CPPA for offshore wind ever announced.

70% of the bottom 10 ESG detractors are covered by engagement or specific voting activities.

As expected from this Sustainable Portfolio, the carbon intensity and exposure to extractive industries are significantly below benchmark. The Portfolio has considerably higher ESG scores compared to its Benchmark across Environment, Social and Human Capital categories.



TruValue Labs & SASB

# Brunel Emerging Market Equity

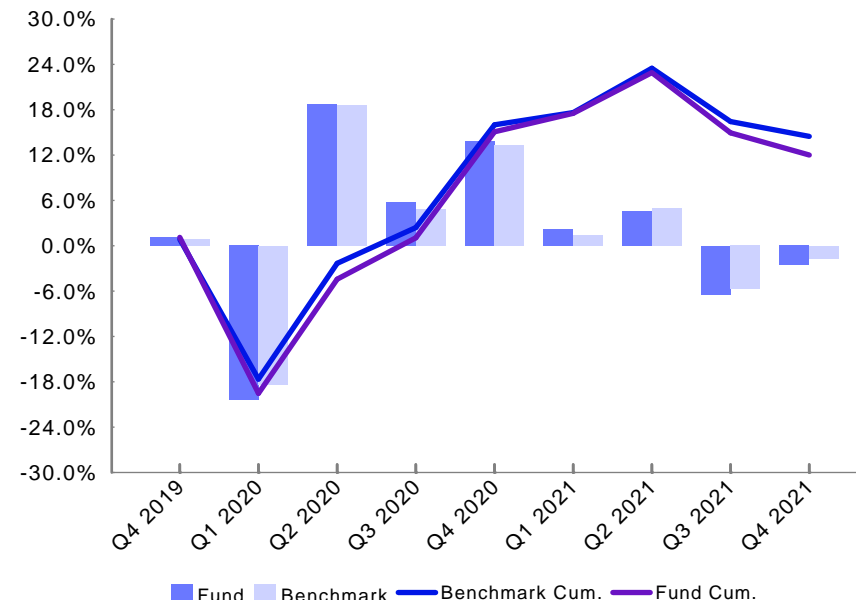
## Overview

	Description
Portfolio Objective:	Provide exposure to emerging market equities, targeting excess returns and enhanced risk control from leading managers.
Investment Strategy & Key Drivers:	A geographically diverse portfolio, typically expected to achieve higher long-term growth rates than developed economies.
Liquidity:	Managed liquidity. Less exposure to more illiquid assets
Risk/Volatility:	High absolute risk with moderate to high relative risk, around 5% tracking error.
Total Fund Value:	£1,213,237,265

## Performance to Quarter End

	Ann. Performance	Fund	BM	Excess
3 Month		-2.6%	-1.7%	-0.9%
Fiscal YTD		-4.7%	-2.7%	-2.0%
1 Year		-2.7%	-1.3%	-1.3%
3 Years				
5 Years				
10 Years				
Since Inception		5.4%	6.5%	-1.1%

## Rolling Performance\*



\* Partial returns shown in first quarter

Q4 2021 was once again tough and highly eventful for emerging market equities. The discovery of a new COVID variant in South Africa, Omicron, rattled emerging equity markets, casting further doubt on the economic recovery and a return to normality. In China – which represents 34% of the index – concerns over slower economic growth, a tight regulatory environment, property market strains and strict zero tolerance on COVID continued to linger from previous quarters. In contrast to most key central banks, the People's Bank of China also lowered the one-year loan prime rate by 5bps to 3.8% to tackle sluggish growth. Outside of China, geo-politics also raised its ugly head as tensions between Russia and the Ukraine put further pressure on Russian equities, which fell -11% in GBP terms. There was also further volatility on the Turkish Lira, which ended the year a staggering 44% lower vs the US Dollar.

Overall, only a late rally in December ensured that emerging market equities – proxied by MSCI Emerging Markets – ended the quarter at a modest -1.7% down in GBP terms.

The portfolio struggled to keep pace with broader emerging markets. Total performance for the period was -2.5% on a net of fees basis, -86bps behind MSCI Emerging Markets. Performance was once again mixed between the managers; Genesis underperformed by -291bps, whereas Ninety-One and Wellington

# Brunel Emerging Market Equity

had stronger quarters, outperforming by +78bps and +19bps respectively.

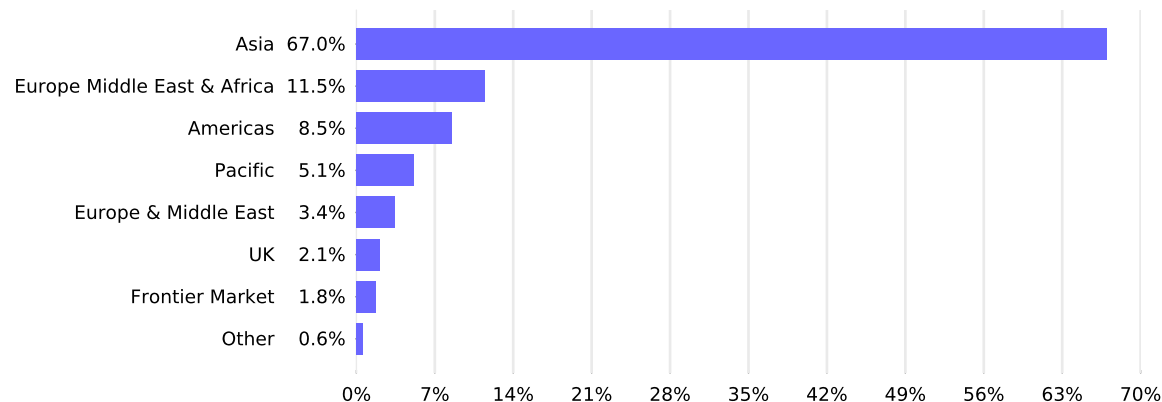
- At a manager level, Genesis' relative performance was driven by their exposure to Russian names, such as Sberbank and Yandex, as well as their underweight to Taiwanese names, which performed well. Ninety-One's positive relative return came from favourable sector positioning, particularly their underweights to health care and consumer discretionary companies. They also demonstrated strong stock selection in China. Wellington have a sector neutral approach, which was mixed last quarter. 6 of the 11 sectors detracted from relative performance, which was offset by very strong relative performance in technology and consumer discretionary.
- At a stock level, names such as AIA Group, Yandex and Country Garden Services put pressure on relative performance; the three names fell -13.2%, -24.4% and -24.6% respectively. The three names collectively account for around -60bps of relative performance. AIA Group, a Hong Kong based insurer, has been under pressure as a result of slowing growth in China and profit taking amongst longer term investors. Yandex, a Russian search engine and web portal, has fallen due to the potential invasion of Ukraine by Russia, despite beating Q3 2021 earnings expectations. A potential decline in the Rouble and economic sanctions from the west are negative for the company. Country Garden Services, a Chinese property services company, has been impacted by the broader concerns on the Chinese property market. On the positive side, Compagnie Financiere Richemont was the standout performer in the fund, returning +43.2% following stellar like for like sales growth of +32% vs a market consensus of +18%. Richemont added +31bps to relative performance.
- At a sector level, there was evidence that selection within financials was a material negative contributor, detracting -74bps from relative performance. Financial stocks within the portfolio returned -5.7%, which was behind the benchmark equivalent of -0.8%. AIA Group and Sberbank – both high conviction names held by Genesis - were the main drivers of this underperformance, both stocks fell by -13.2% and -15.4% respectively.
- At a country level, there was some evidence that the country allocation was significant. Total impact from country allocation was -56bps. The most significant benchmark constituent was Taiwan, which appreciated by +10.1% over the quarter, comfortably in excess of the benchmark return of -1.6%. Taiwan's economy has recently benefited from strength in exports, particularly in technology. The portfolio currently has an underweight position of -3%.
- Style had a limited impact on relative performance last quarter. The portfolio maintains a style agnostic approach with a mild tilt towards quality orientated companies. Quality companies – proxied by MSCI Emerging Markets Quality Index - outperformed the broader benchmark by +5% over the quarter, which provided a very small tailwind towards relative performance.
- Since inception relative performance remains negative. The fund has returned +5.5% on a net of fees annualised basis, which is -104bps behind the benchmark. This is once again mixed between managers as at quarter end; Genesis, Wellington and Ninety-One have since inception annualised relative returns of -280bps, +106bps and +76bps respectively.

# Brunel Emerging Market Equity – Region & Sector Exposure

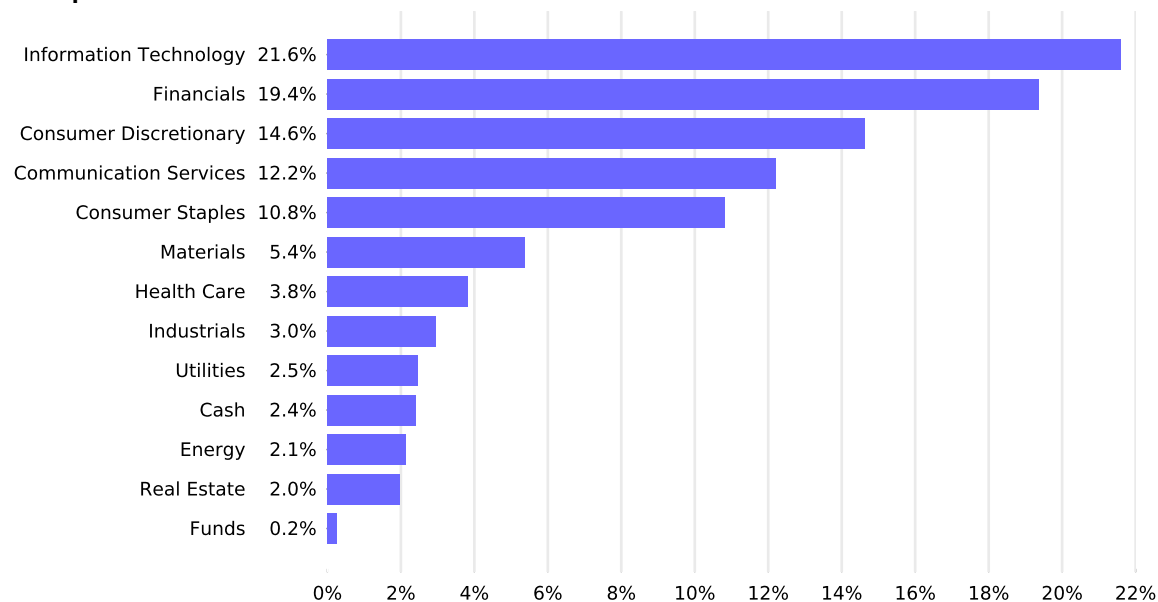
## Top 20 Holdings

	Mkt. Val.(GBP)
TAIWAN SEMICONDUCTOR MANUFAC	96,642,924
TENCENT HOLDINGS LTD	67,533,704
SAMSUNG ELECTRONICS CO LTD	44,150,651
AIA GROUP LTD	21,493,634
SBERBANK PJSC -SPONSORED ADR	19,021,818
INFOSYS LTD-SP ADR	17,536,643
MEDIATEK INC	16,957,660
ALIBABA GROUP HOLDING LTD	12,887,897
CONTEMPORARY AMPEREX TECHN-A	12,884,594
SAMSUNG ELECTRONICS-PREF	12,693,088
BID CORP LTD	11,853,934
ALIBABA GROUP HOLDING-SP ADR	11,663,092
CHINA CONSTRUCTION BANK-H	11,457,096
YANDEX NV-A	11,360,056
JD.COM INC-ADR	11,282,394
HDFC BANK LTD-ADR	10,982,263
CHINA LONGYUAN POWER GROUP-H	10,904,758
NASPERS LTD-N SHS	10,837,162
ICICI BANK LTD-SPON ADR	10,284,937
WULIANGYE YIBIN CO LTD-A	9,512,590

## Regional Exposure



## Sector Exposure





# Brunel Emerging Market Equity – Responsible Investment

## Top 10 ESG Contributors to Overall Score

	Insight	Momentum
1. TAIWAN SEMICONDUCTOR MANUFACTURING CO LTD	58.7	23.5
2. MEDIATEK INC	66.2	77.9
3. CHINA LONGYUAN POWER GROUP CORP LTD	71.4	64.6
4. CONTEMPORARY AMPEREX TECHNOLOGY CO LTD	67.5	67.5
5. INNER MONGOLIA YILI INDUSTRIAL GROUP CO LTD	74.9	56.9
6. CROMPTON GREAVES CONSUMER ELECTRICALS LTD	82.5	50.0
7. AIA GROUP LTD	60.8	78.8
8. BY-HEALTH CO LTD	70.7	80.5
9. DELTA ELECTRONICS INC	72.4	24.4
10. ITC LTD	71.8	82.5

## Bottom 10 ESG Detractors to Overall Score

	Insight	Momentum
1. HIKMA PHARMACEUTICALS PLC	33.9	10.7
2. REALTEK SEMICONDUCTOR CORP	25.8	15.6
3. ICICI BANK LTD	42.8	50.0
4. ANTA SPORTS PRODUCTS LTD	40.8	68.7
5. YANDEX NV	42.7	20.7
6. BID CORP LTD	41.1	20.1
7. KIMBERLY-CLARK DE MEXICO SAB DE CV	23.1	9.1
8. ALIBABA GROUP HOLDING LTD	47.5	27.9
9. SAMSUNG ELECTRONICS CO LTD	52.2	73.3
10. TENCENT HOLDINGS LTD	49.2	64.4

\* Position 1 is the top contributor/detractor.



Weighted Average ESG Score	2021 Q3	2021 Q4
Portfolio	55.3	56.4
MSCI EM	55.7	56.9

TruValue Labs & SASB

## Brunel Assessment:

- Kimberly-Clark De Mexico** (Consumer Goods) were fined by Mexico City (AP), a regulatory commission in Mexico, for price fixing on diapers and tampons between 2008 - 2014.
- ITC** (Food & Beverage) received ICSI (The Institute of Company Secretaries of India) Corporate Social Responsibility Excellence Award for large scale impactful initiatives. Examples include, women's economic empowerment programmes, livestock development programmes and large-scale afforestation programme greening over 900,000 acres and generating over 160 million person-days of employment among small and marginal farmers.
- Taiwan Semiconductor** (Semiconductors) bought another 1.2GW of wind power to create Asia's largest direct purchase of green energy. TSMC will purchase more than 3.69 billion kWh of green electricity each year, which can reduce at least 1.85 million tonnes of carbon emissions.
- Yandex** (Internet Media & Services) settled an anti-monopoly claim with the Federal Antimonopoly Service of Russia (FAS). The claim, relating to allegations of abuse of market dominance with the placement of enriched search results, has been terminated.

70% of the bottom 10 ESG detractors are covered by engagement or specific voting activities.  
The weighted average carbon intensity of the portfolio saw a slight decline over the quarter. The portfolio remains below its benchmark, the MSCI Emerging Markets, for both extractives revenue exposures and extractive industries value of holdings.

## Weighted Average Carbon Intensity (WACI)



Source: Trucost

## Extractive Exposure

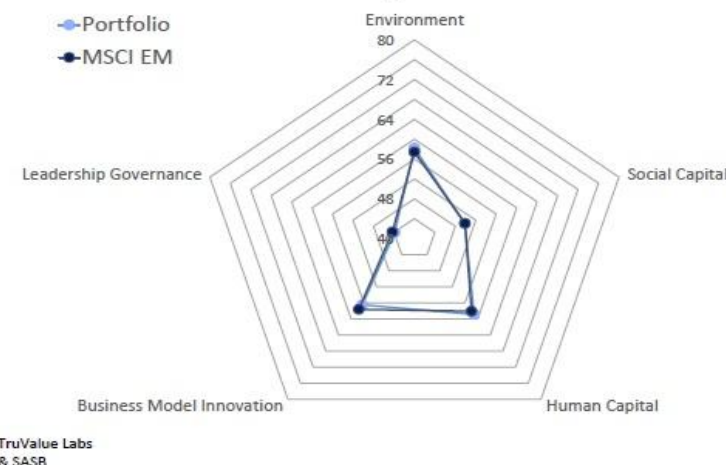
	Total Extractive Exposure <sup>1</sup>		Extractive Industries (VOH) <sup>2</sup>	
	Q3	Q4	Q3	Q4
Portfolio	1.9	1.3	4.1	3.9
MSCI EM	3.6	3.3	7.7	7.8

<sup>1</sup> Extractive revenue exposure as share (%) of total revenue.

<sup>2</sup> Value of holdings (VOH)-companies who derive revenues from extractives.

Source: Trucost

## Absolute Weighted ESG Scores



TruValue Labs & SASB

# Brunel Diversifying Returns Fund

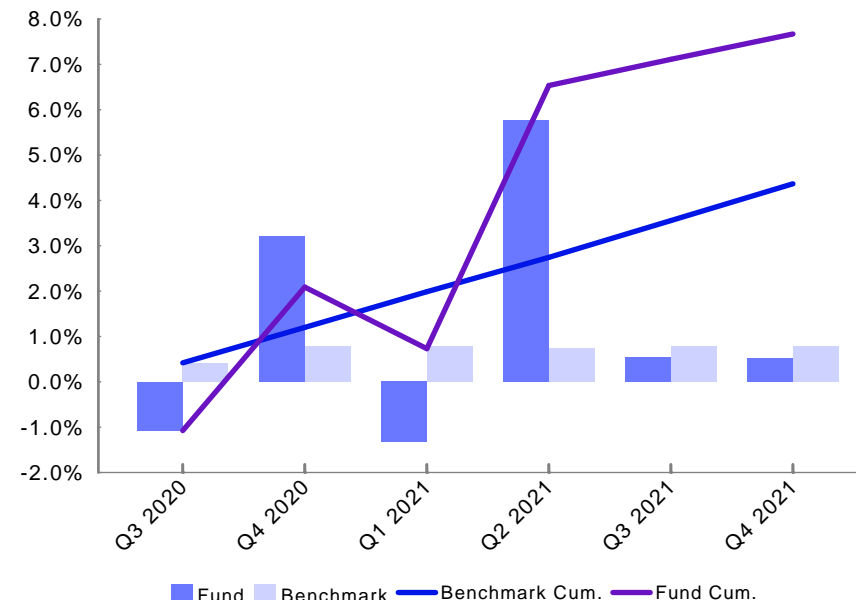
## Overview

	Description
Portfolio Objective:	Provide exposure to a range of alternative return drivers and a degree of downside protection from equity risk.
Investment Strategy & Key Drivers:	Actively managed to achieve growth at moderate absolute risk, diversified between asset classes and by geography.
Liquidity:	Managed Liquidity.
Risk/Volatility:	Moderate absolute risk against cash.
Total Fund Value:	£1,685,010,873

## Performance to Quarter End

	Ann. Performance	Fund	BM	Excess
3 Month		0.5%	0.8%	-0.3%
Fiscal YTD		6.9%	2.3%	4.6%
1 Year		5.5%	3.1%	2.3%
3 Years				
5 Years				
10 Years				
Since Inception		5.5%	3.1%	2.3%

## Rolling Performance\*



\* Partial returns shown in first quarter

Over Q4 2021, the Diversifying Returns Fund returned 0.5%. For the same period, the benchmark return was 0.8%. Although aggregate fund returns were very similar to those of Q3, the dispersion of returns of the underlying managers was greater in a quarter that demonstrated the benefit of including numerous sources of return within the fund.

- JPM returned 4.1% over the quarter. Equity factor signals made the largest contribution to performance, particularly value and quality. Volatility in sovereign bond markets resulted in negative performance for the fixed income factor signals. Given market volatility, it is unsurprising that FX momentum and commodity trend signals also made a negative contribution to returns but the commodity carry signal produced a marginally positive return.
- Exposure to developed market equities provided the majority of this quarter's return for Lombard Odier who generated a return of 0.9%. Slightly negative performance from commodity exposure was largely cancelled out by marginally positive performance from fixed income, with credit outperforming sovereign bonds.
- UBS had a weaker quarter, returning -2.6%. The biggest detractor from performance was a long position in the Japanese Yen as pricing reflected the view the Bank of Japan will not need to raise interest rates as quickly or as aggressively as central banks in other parts of the world. Exposure to the Colombian Peso also detracted from performance. The long Brazilian Real position and a short position in the Euro both contributed positively to performance.



# Brunel Diversifying Returns Fund

- Over the three months, William Blair delivered performance of 1.2%. The currency book made the largest contribution to the losses with long exposures to Emerging Market currencies performing poorly over the quarter. The security selection component of the portfolio made a positive contribution to returns. Equity exposure also made a positive contribution while fixed income exposure had a negligible impact.

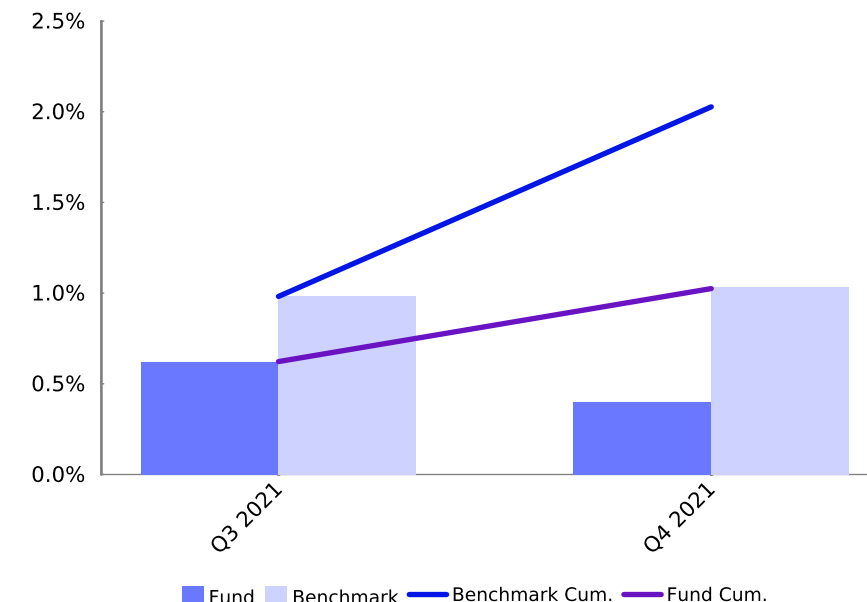
## Overview

	Description
Portfolio Objective:	To gain exposure to a diversified portfolio of enhanced credit opportunities with modest exposure to interest rate risk.
Investment Strategy & Key Drivers:	Exposure to specialised, higher yielding bond sectors which provide diversified credit driven returns.
Liquidity:	Managed liquidity
Risk/Volatility:	Moderate absolute and relative risk with high relative risk vs cash.
Total Fund Value:	£2,382,670,704

## Performance to Quarter End

	Ann. Performance	Fund	BM	Excess
3 Month		0.4%	1.0%	-0.6%
Fiscal YTD				
1 Year				
3 Years				
5 Years				
10 Years				
Since Inception		1.0%	2.0%	-1.0%

## Rolling Performance\*



\* Partial returns shown in first quarter

The environment for credit was somewhat soured in the first two months of Q4 2021 by rising inflationary expectations, the potential reduction in quantitative easing and the broader economic uncertainty surrounding the Omicron variant of Covid-19. However, during December, as understanding of the severity and transmissibility of the variant developed, markets saw a swift recovery.

The rapid economic recovery pushed energy prices higher over the quarter, further contributing to rising inflation, which reached 7% in the US, 5.4% in the UK.

The further indications in December that central banks may accelerate the pace of rate rises, including the first Bank of England rate rise in 3 years, had an impact on credit markets which now expect as many as 4 rate rises from the Federal Reserve in 2022. Shorter dated credit was particularly impacted, with the US 2-year yield rising to 0.73% from 0.29%, and in the UK the 2-year yield rising to 0.60% from 0.31%.

This pressure on short-dated credit was a headwind against which both investment grade and high yield corporate bonds struggled, both falling around

-0.7% over the quarter. Performance in the quarter was stronger in loan indices, with the European Senior Loans returning +80bps, proxied by the Credit Suisse Western European Leveraged Loan Index (USD Hedged), and US Senior Loans returning +50bps proxied by the Credit Suisse Leveraged Loan Index.

Geographically, US and European credit saw a strong quarter, contrasted with emerging market corporate debt, which was subject to a number of challenges, including rising case numbers, slowing growth in China, and most notably rising concern over the potential military actions between Russia and the Ukraine. US and European high yield corporate bonds – proxied by the Bloomberg US and European High Yield corporate indices - returned +71bps and 0bps respectively in local currency; this was significantly ahead of the -209bps returned in EM USD corporates, proxied by Bloomberg Emerging USD corporates, over the same period.

In this environment the portfolio was well positioned, with significant allocations to Loans and other floating rate assets, which performed strongly. This is attributable to income, rather than rising market values, which were flat over the quarter. The portfolio was also helped by US, UK & European credits with only minor exposure to emerging market debt. While the volatility of the market created difficult conditions for reaching a SONIA+4% target, each manager and the portfolio as a whole outperformed the secondary benchmark, which is a composite benchmark of 50:50 high yield to leveraged loans, hedged to GBP.

The portfolio returned +0.44% over the quarter, below the +1.01% return of the SONIA +4% benchmark but significantly above the -0.13% of the 50:50 high yield to leveraged loan indices. CQS, who have the largest exposure to Loans, had the strongest performance over the quarter with +0.69%, while Oaktree who are also positioned with a majority of the portfolio in loans & asset backed securities returned +0.48%. Neuberger Berman returned +0.34% as market reversals in December buoyed US & European high yield and investment grade exposures.

# Passive Dev Eq Paris Aligned

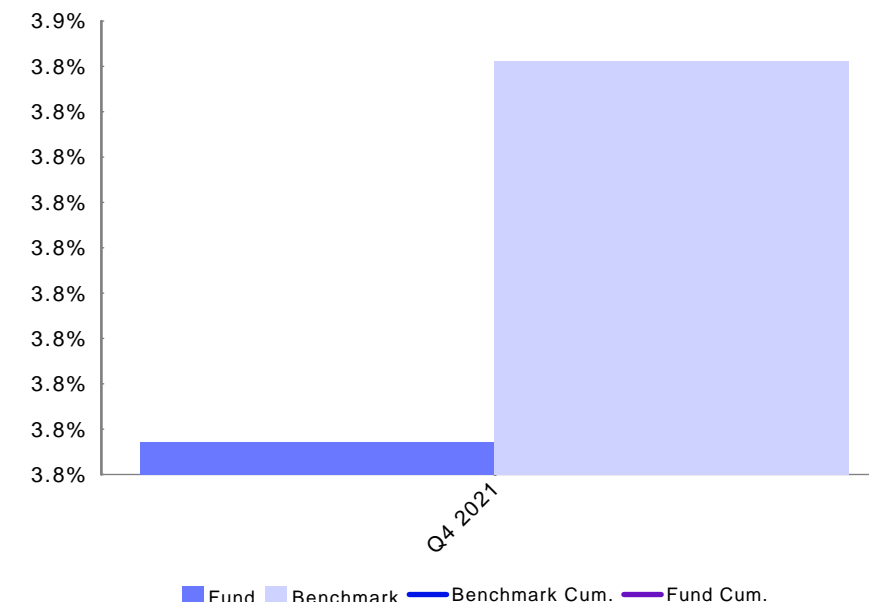
## Overview

	Description
Portfolio Objective:	Provide global equity market exposure, reduce carbon exposure and align to the Paris Agreement.
Investment Strategy & Key Drivers:	Portfolio is invested in global equities in accordance with FTSE Global Developed PAB Index.
Liquidity:	High
Risk/Volatility:	Volatility: high. Relative/active risk: very low.
Total Fund Value:	£1,945,252,319

## Performance to Quarter End

Ann. Performance	Fund	BM	Excess
3 Month			
Fiscal YTD			
1 Year			
3 Years			
5 Years			
10 Years			
Since Inception	3.8%	3.8%	-0.1%

## Rolling Performance\*



\* Partial returns shown in first quarter

The Paris Aligned Developed Equities product was launched on 1 November 2021, in partnership with five Brunel client funds. A hedged and unhedged version of the product were launched, with a collective value of approximately £2.5bn at launch date.

The performance track record for this strategy is limited to two months. Over this period, the portfolio returned 3.8%, in line with the benchmark. The hedged portfolio underperformed the unhedged portfolio over the period, returning 2.9%.

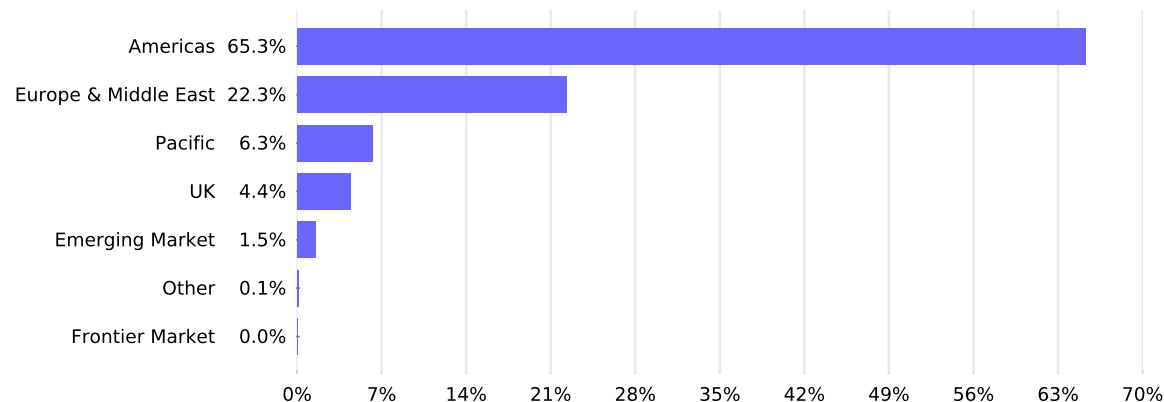
Technology, Materials and Healthcare drove performance over the period, whilst Energy and Financials were the only sectors where performance was negative. In terms of countries, Korea, France, Switzerland, and the United States were among the best performers.

# Passive Dev Eq Paris Aligned – Region & Sector Exposure

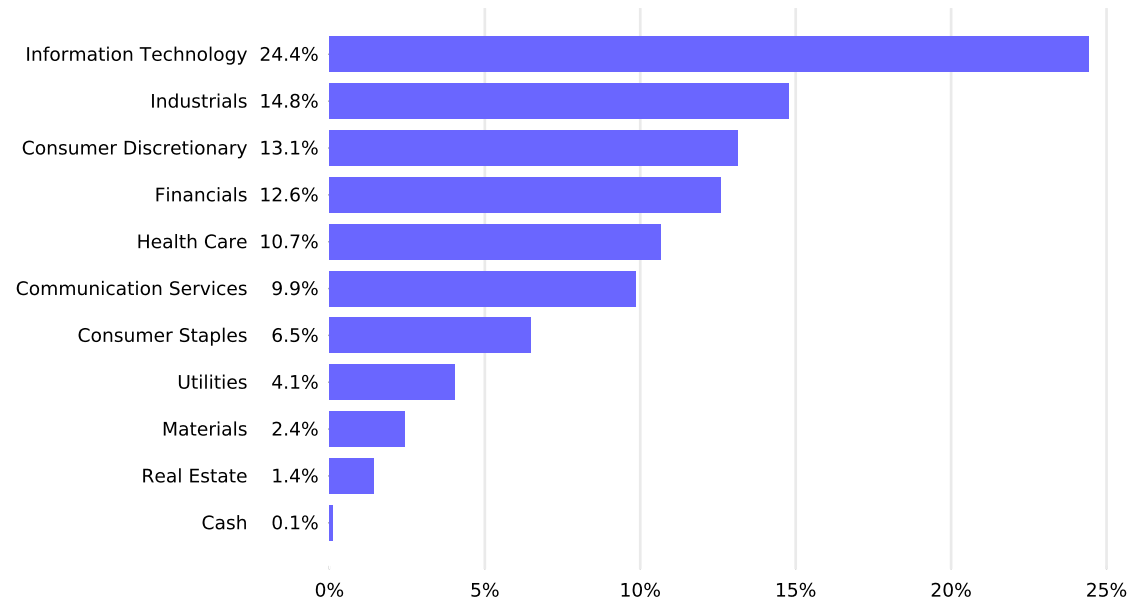
## Top 20 Holdings

	Mkt. Val.(GBP)
APPLE INC	137,684,172
MICROSOFT CORP	131,539,002
AMAZON.COM INC	110,503,838
ALPHABET INC-CL A	61,527,863
ALPHABET INC-CL C	59,689,304
HONEYWELL INTERNATIONAL INC	48,179,473
TESLA INC	39,948,527
SCHNEIDER ELECTRIC SE	39,594,242
UNILEVER PLC	36,817,646
NESTLE SA-REG	31,790,459
THERMO FISHER SCIENTIFIC INC	29,042,981
UNITEDHEALTH GROUP INC	25,300,028
NVIDIA CORP	21,952,305
VERIZON COMMUNICATIONS INC	21,666,861
LVMH MOET HENNESSY LOUIS VUI	21,012,642
SAP SE	20,748,491
SAMSUNG ELECTRONICS CO LTD	18,265,994
JPMORGAN CHASE & CO	18,227,060
SIEMENS AG-REG	17,481,363
MASTERCARD INC - A	17,279,972

## Regional Exposure



## Sector Exposure



# Passive Dev Eq Paris Aligned – Responsible Investment

## Top 10 ESG Contributors to Overall Score

	Insight	Momentum
1. HONEYWELL INTERNATIONAL INC	70.4	80.6
2. SCHNEIDER ELECTRIC SE	72.2	50.0
3. SIEMENS AG	67.0	72.2
4. SAP SE	64.0	40.4
5. TEXAS INSTRUMENTS INC	66.1	79.6
6. ANALOG DEVICES INC	69.8	72.9
7. UNILEVER PLC	59.4	66.3
8. ENGIE SA	68.8	61.2
9. NESTLE SA	59.8	50.0
10. IBERDROLA SA	66.9	30.6

## Bottom 10 ESG Detractors to Overall Score

	Insight	Momentum
1. HOME DEPOT INC/THE	49.1	35.9
2. PFIZER INC	46.9	45.6
3. JPMORGAN CHASE & CO	49.3	69.5
4. AT&T INC	46.3	71.4
5. ABBVIE INC	39.6	19.9
6. CHUBB LTD	36.1	70.2
7. AMAZON.COM INC	50.5	58.2
8. MICROSOFT CORP	47.0	31.0
9. APPLE INC	47.1	56.5
10. ALPHABET INC	45.8	61.6

\* Position 1 is the top contributor/detractor.



Weighted Average ESG Score	2021 Q3	2021 Q4
Portfolio		55.6
FTSE Dev. World	54.4	54.7

TruValue Labs & SASB

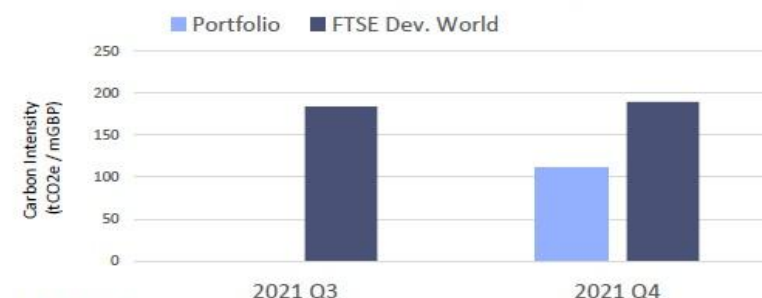
## Brunel Assessment:

- Amazon** (Consumer Goods) made a deal with Stellantis to add to its electric van fleet and develop in-car software using Alexa software. Amazon workers continue attempts to unionise for better worker rights. The Senate Judiciary Committee overwhelmingly passed antitrust legislation barring tech's biggest platforms from favoring their products and services over competitors.
- SAP** (Software) launched new circular economy software solution, enabling sustainable product design by providing visibility of material flows, waste reduction and cost of downstream reuse and recycling systems.
- Schneider Electric** (Electrical Goods) was included on Fortune's annual Change the World List and is among the top 5 corporate sustainability leaders in the Corporate Knights' 2022 Global 100 list.
- Home Depot** (Consumer Goods) stop selling security cameras linked to Uyghur surveillance. In Canada the company's foundation launched TradeWorx, a new targeted investment to combat youth homelessness by creating opportunities for career education and skilled trades training.

100% of the bottom 10 ESG detractors are covered by engagement or specific voting activities.

The Passive Developed Paris Aligned Portfolio has a carbon intensity and extractive exposure significantly below that of its reference index, the FTSE World Developed Index.

## Weighted Average Carbon Intensity (WACI)



Source: Trucost

## Extractive Exposure

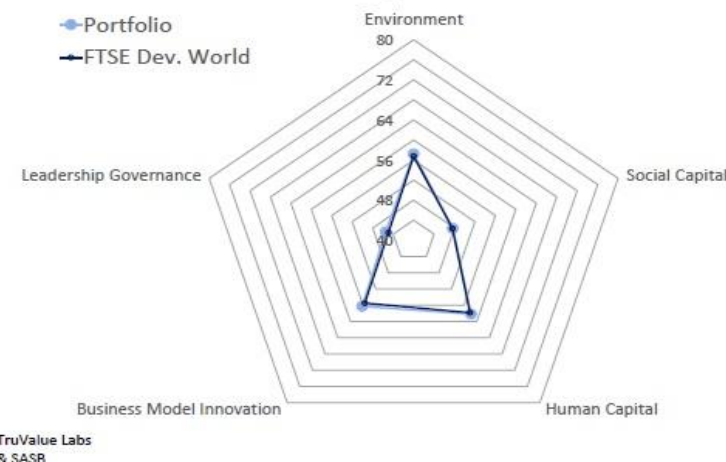
	Total Extractive Exposure <sup>1</sup>		Extractive Industries (VOH) <sup>2</sup>	
	Q3	Q4	Q3	Q4
Portfolio		1.0		1.7
FTSE Dev. World	2.9	2.6	5.1	5.1

1 Extractive revenue exposure as share (%) of total revenue.

2 Value of holdings (VOH)-companies who derive revenues from extractives.

Source: Trucost

## Absolute Weighted ESG Scores



TruValue Labs & SASB

# Passive Low Carbon Equities

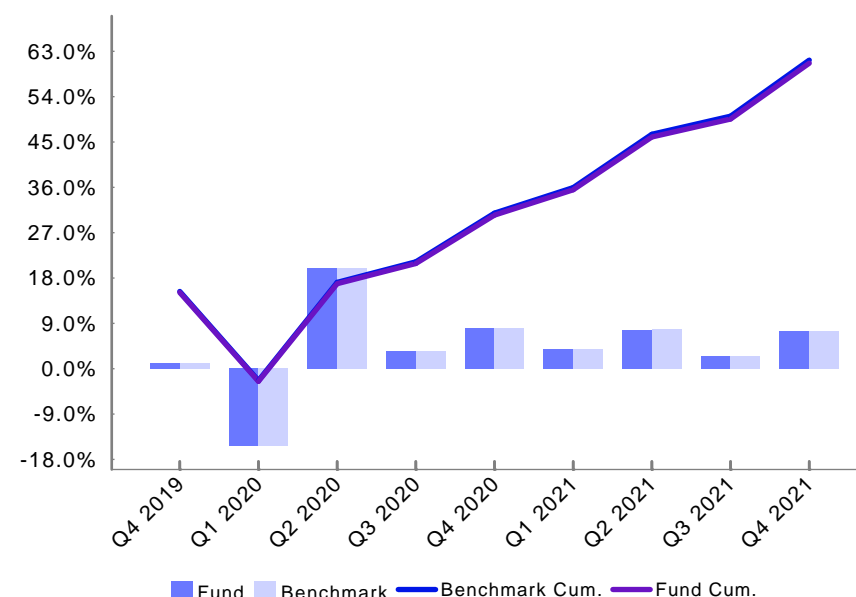
## Overview

	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:	High absolute risk with very low tracking error.
Total Fund Value:	£305,510,046

## Performance to Quarter End

	Ann. Performance	Fund	BM	Excess
3 Month		7.4%	7.4%	0.0%
Fiscal YTD		18.5%	18.6%	-0.1%
1 Year		23.1%	23.2%	-0.1%
3 Years		20.1%	20.2%	-0.1%
5 Years				
10 Years				
Since Inception		14.6%	14.7%	-0.1%

## Rolling Performance\*



\* Partial returns shown in first quarter

The Passive Low Carbon portfolio recorded a return of 7.4% during Q4 2021, replicating the performance of the MSCI World Low Carbon Target Index. The MSCI World Low Carbon Target performed in line with the MSCI World index, which also returned 7.4% over the quarter.

The Information Technology sector was the best-performing over the quarter, although the portfolio's underweight to the sector slightly detracted from returns. The Utilities sector also performed well, particularly the stocks in this sector included in the low carbon index, which outperformed those of the traditional index.

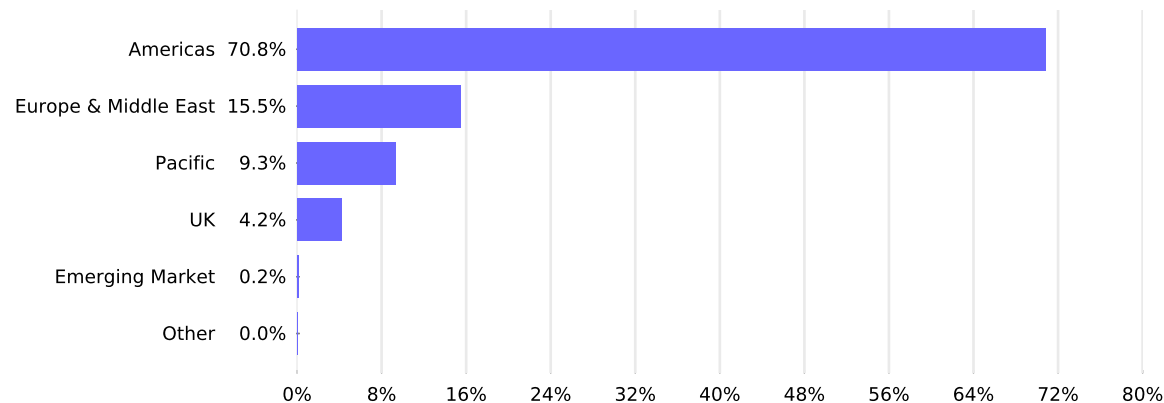
Over the previous 12 months, the Passive Low Carbon portfolio returned 23.1%, underperforming the MSCI World Index which returned 23.5%.

# Passive Low Carbon Equities – Region & Sector Exposure

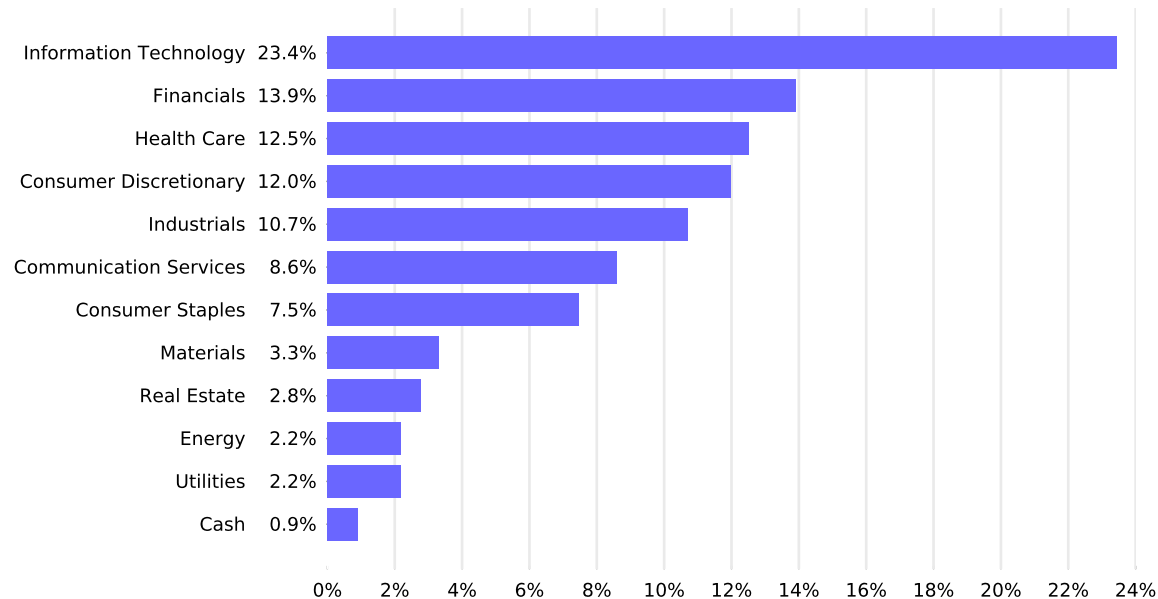
## Top 20 Holdings

	Mkt. Val.(GBP)
APPLE INC	14,247,404
MICROSOFT CORP	11,610,365
AMAZON.COM INC	7,405,787
ALPHABET INC-CL C	6,737,787
TESLA INC	4,339,699
META PLATFORMS INC-CLASS A	3,889,811
NVIDIA CORP	3,580,422
JOHNSON & JOHNSON	2,278,910
JPMORGAN CHASE & CO	2,261,205
UNITEDHEALTH GROUP INC	2,230,811
HOME DEPOT INC	2,115,282
PROCTER & GAMBLE CO/THE	2,068,469
NESTLE SA-REG	1,925,226
VISA INC-CLASS A SHARES	1,840,246
BERKSHIRE HATHAWAY INC-CL B	1,722,982
PFIZER INC	1,667,921
ASML HOLDING NV	1,610,364
BANK OF AMERICA CORP	1,595,542
ALPHABET INC-CL A	1,555,147
MASTERCARD INC - A	1,550,340

## Regional Exposure



## Sector Exposure





# Passive Low Carbon Equities – Responsible Investment

## Top 10 ESG Contributors to Overall Score

	Insight	Momentum
1. ASML HOLDING NV	63.2	52.1
2. HONEYWELL INTERNATIONAL INC	70.4	80.6
3. KEYENCE CORP	75.2	70.3
4. NEXTERA ENERGY INC	70.4	53.6
5. NESTLE SA	59.8	50.0
6. SCHNEIDER ELECTRIC SE	72.2	50.0
7. TEXAS INSTRUMENTS INC	66.1	79.6
8. SALESFORCE.COM INC	62.7	71.3
9. SIEMENS AG	67.0	72.2
10. ACCENTURE PLC	60.9	43.0

## Bottom 10 ESG Detractors to Overall Score

	Insight	Momentum
1. PFIZER INC	46.9	45.6
2. NETFLIX INC	44.7	65.3
3. BROADCOM INC	44.8	50.0
4. ABBVIE INC	39.6	19.9
5. AMAZON.COM INC	50.5	58.2
6. JOHNSON & JOHNSON	39.2	32.1
7. META PLATFORMS INC	42.9	65.9
8. ALPHABET INC	45.8	61.6
9. MICROSOFT CORP	47.0	31.0
10. APPLE INC	47.1	56.5

\* Position 1 is the top contributor/detractor.



Weighted Average ESG Score	2021 Q3	2021 Q4
Portfolio	54.2	54.5
Passive Dev Equities	54.4	54.7

TruValue Labs & SASB

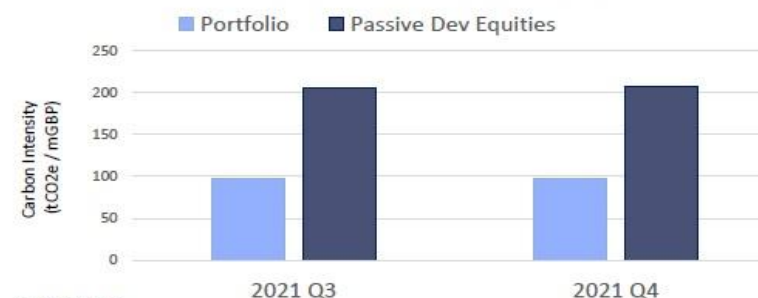
## Brunel Assessment:

- Amazon** (Consumer goods) made a deal with Stellantis to add to its electric van fleet and develop in-car software using Alexa software. Amazon workers continue attempts to unionise for better worker rights. The Senate Judiciary Committee overwhelmingly passed antitrust legislation barring tech's biggest platforms from favoring their products and services over competitors.
- Johnson & Johnson** (Healthcare) ongoing talc litigation, which as of July totalled roughly 34,600 lawsuits linking Johnson's Baby Powder to ovarian cancer. A \$465 million opioid ruling in Oklahoma was overturned.
- Salesforce** (Software) announced \$300 Million in Investments to Accelerate Ecosystem Restoration and Climate Justice. Salesforce is prioritizing reducing emissions as quickly as possible and aligning its own full value chain emissions (Scope 1, 2, and 3) to the global trajectory of ~50% emissions reductions by 2030, and near-zero emissions by 2040.
- Schneider Electric** (Electrical Goods) was included on Fortune's annual Change the World List and is among the top 5 corporate sustainability leaders in the Corporate Knights' 2022 Global 100 list.

100% of the bottom 10 ESG detractors are covered by engagement or specific voting activities.

The benchmark is the MSCI Developed World so that carbon reductions achieved to create the Brunel Passive Low Carbon Portfolio can be monitored. Carbon intensity of the Portfolio is half that of the MSCI Developed World Index.

## Weighted Average Carbon Intensity (WACI)



Source: Trucost

## Extractive Exposure

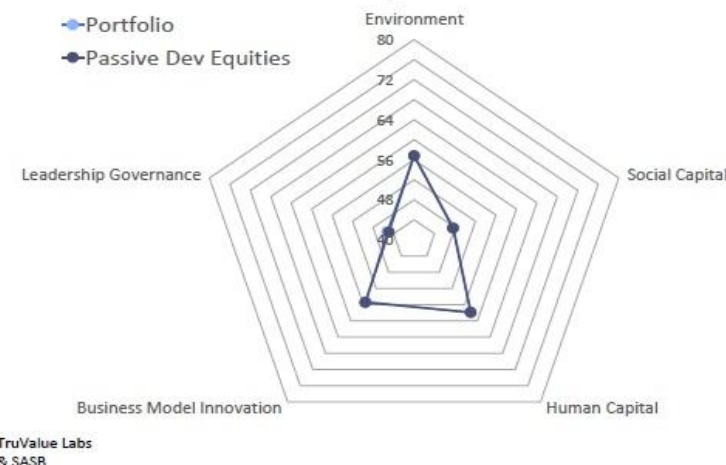
	Total Extractive Exposure <sup>1</sup>		Extractive Industries (VOH) <sup>2</sup>	
	Q3	Q4	Q3	Q4
Portfolio	2.2	1.9	3.2	3.0
Passive Dev EQ	3.0	2.7	5.1	5.1

<sup>1</sup> Extractive revenue exposure as share (%) of total revenue.

<sup>2</sup> Value of holdings (VOH)-companies who derive revenues from extractives.

Source: Trucost

## Absolute Weighted ESG Scores



TruValue Labs & SASB

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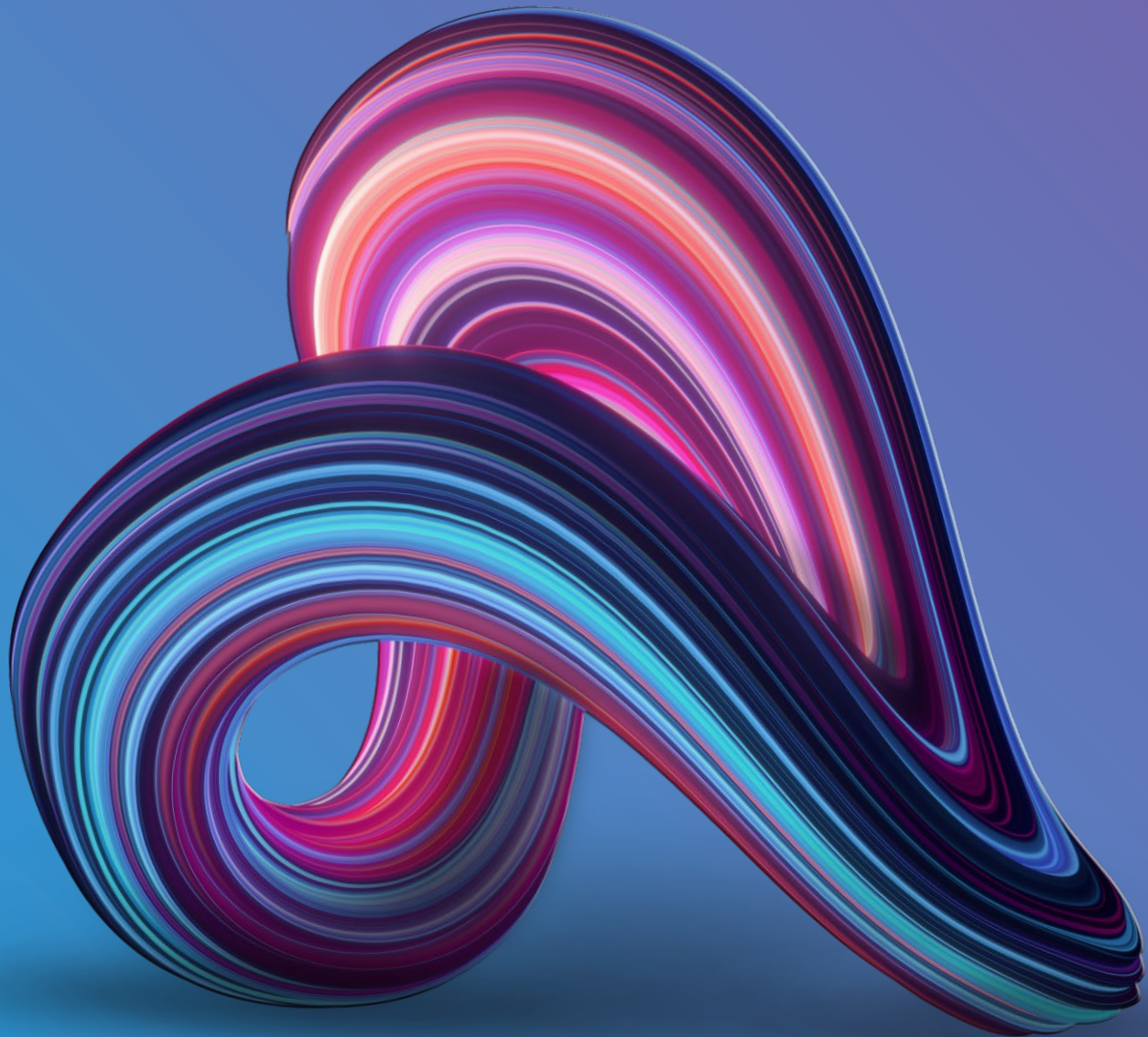
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Themes and Opportunities 2022

# Metamorphosis





# Summary

Substantial and profound changes are rapidly reshaping the world as we know it, with significant implications for investors. This vibrant reimagining can be encapsulated in a single word: metamorphosis.

Investors cannot just think about the here and now; they must consider the issues most likely to drive future financial, social and political developments in a way that allows them to make the decisions needed to meet their objectives.

Through consideration of these key trends and challenges, we believe investors stand the best chance of long-term success. In the following pages, we discuss a number of different themes we believe investors should consider in their decision-making in 2022 and beyond.

# Introduction

The world is in the midst of a revamp on various fronts. Monetary policy and thinking are being reshaped as inflation balloons beyond central bank targets, and policymakers grapple with the consequences of bloated balance sheets, inflated asset markets and disintegrating global supply chains. In parallel, regulators are increasingly active, with the unexpected announcement of a global minimum corporation tax of 15% and China imposing outright bans on cryptocurrency transactions and some areas of for-profit education.

We have also seen increased global coordination in the fight against climate change, with the US, China, India, Australia and Saudi Arabia all now also committing to net zero targets; and significant degrees of innovation and resulting disruption across a number of sectors, most notably healthcare (in the wake of the SARS-CoV-2 pandemic) and finance (where total asset value locked into the DeFi system has burst through the US\$100 billion mark).<sup>1</sup>

To translate these and other developments into relevant themes for investors, we have identified three overarching themes which we believe will impact investment decisions in 2022 and beyond:

- **Changing of the guard:** Understanding the effects of the changing fortunes of economic players and ways of thinking that have held sway for a long time, including the evolving responsibilities of monetary policies; the prospect of an “Asian century”; the dramatic re-morphing of how finance is provided
- **Position for transition:** How investors should plan for the changes required to put us on a most sustainable path; the role of impact investing; the management of resources to facilitate the green transition; and the power that can be exercised through engagement
- **Modern diversification:** How portfolios should be reinvented to hit target returns while maintaining protection; the use of dynamic allocation between strategies and themes; and how to gain access to emergent innovators

<sup>1</sup> Source: DeFi Pulse, <https://defipulse.com/>

# Changing of the guard

## Policy pathways

Terms like monetary intervention and quantitative easing are now common parlance. A new one — Modern Monetary Theory — is quite different from others, however. Referring to continuing, coordinated monetary and fiscal stimulus, it reflects the precedence that jobs and growth have taken over austerity, with resulting economic and financial consequences.

The results of such largesse have been potent: Inflation has spiked, first in pandemic-impacted sectors due to supply chain issues and labor shortages, and later in sectors

turbocharged by stimulus and consumer spending from flush balance sheets. In parallel, the drivers of disinflation — particularly globalization and continuous technological improvement — that have been ever present over the last half century are being significantly challenged. Grudges in inter- and intra-national politics also continue to grate, with tribalism threatening to undermine the gains of globalization. As a result, though financial markets have seen stellar performance, investors should consider ensuring their portfolios are resilient to inflationary scenarios going forward.

### Key takeaways

- The use of commodities, gold, and sustainable natural resource equities can provide scenario-specific inflation protection for which many portfolios are currently unprepared.
- Longer-term exposure to real assets and select equity strategies can also be beneficial.
- Floating-rate assets, such as private debt and structured credit, can remove expensive duration risk and access more attractive spreads in light of bond market headwinds for investors who can tolerate some illiquidity.



## The Asian Century

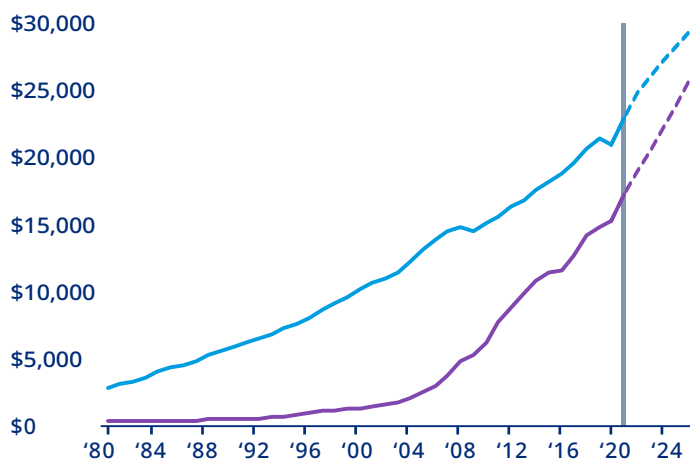
While the United States will continue to be a dominant player, China will rival it on the world stage by the end of 2030.<sup>2</sup> This is just one part of a regional transformation that will unfold over the coming years. An Asian Century is upon us, fuelled by a spectrum of structural forces: demographics, urbanization, innovation, technology adoption, domestic consumption growth, and intra-regional trade integration. Quite simply, this is one of the most transformative themes unfolding over the next few decades.

Actively managed, unconstrained emerging markets allocations can provide access to the prospective Asian Century. But while emerging market equity benchmarks have high exposure to Asia, a heavy bias to China offshore shares means weightings to onshore shares are almost inconsequential. Dedicated China allocations are therefore required,<sup>3</sup> which also may offer strong potential for manager outperformance and enhanced diversification.

Active management of China allocations is particularly important given the speed of change, China's economy is undergoing a profound transition, recently evidenced by surges in regulatory activity.

Opportunities also abound elsewhere, with high Chinese labor costs forcing basic good manufacturing to more competitive countries to create a Southeast Asian powerhouse. India, another rising consumer market, should also benefit from favorable demographic trends. Immense intra-Asia trade flows are forming large consumer and producer hubs, with East Asia benefiting particularly from trade spillovers due to a high degree of integration. These trends mean there is a lot to be constructive about, though investors should be aware of the potential for automation to stymie a centralized manufacturing base in Southeast Asia and create more of a "pass the parcel" effect between markets.

**Figure 1. China's economic trajectory  
(current prices GDP in US\$ billions)**



Source: IMF.

### Key takeaways

- Actively managed, unconstrained EM public equity allocations can provide investors with exposure to the Asian Century trend, but could be enhanced through the inclusion of dedicated China allocations to benefit from onshore opportunities. EM ex-China mandates can then be used in combination with All Share China mandates to access India and smaller ASEAN markets.
- Asian private equity exposure can complement portfolios by providing exposure to areas less accessible via public markets, including early-stage technology.

<sup>2</sup> CEBR forecast 2028 as the catch-up date. World Economic League Table 2021. <https://cebr.com/wp-content/uploads/2020/12/WELT-2021-final-23.12.pdf>

<sup>3</sup> <https://www.mercer.com/our-thinking/wealth/investing-in-china.html>

## The future of finance

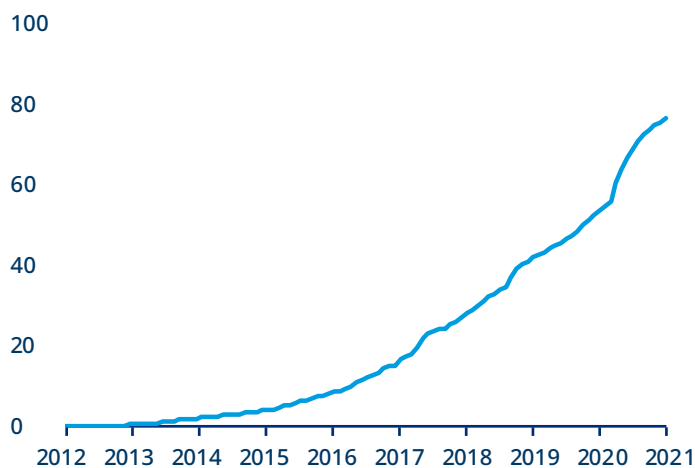
Originally arising from the ashes of the global financial crisis, decentralized cryptocurrencies are in good health, despite much naysaying over the years. While most are incredibly volatile, the adoption rate has been steady, reflected in the smooth increase in the number of digital wallets. New price records have been broken in the second half of 2021, with the rise of the financial services system for cryptocurrencies — known as decentralized finance (DeFi) — providing a sign of maturity.

Providing financial services to holders of cryptocurrencies, it has seen a huge rise in interest, with assets controlled by the system surpassing the US\$100 billion mark in 2021.<sup>4</sup> Given its largely autonomous nature, this parallel financial service system, which is native to the internet, has the potential for numerous efficiency improvements relative to the traditional banking system.

Inevitably, greater pickup had resulted in greater scrutiny, with sustainability proving a particular problem. Cryptocurrencies will need to make energy efficiency savings of magnitude to be viable long term, an aim of so-called proof-of-stake protocols,<sup>5</sup> which are currently in a test phase.

Although we do not recommend strategic allocations to cryptoassets themselves, given their largely unregulated nature, there may be merit in a so-called “pick and shovel” play, where investments are made in areas that benefit from serving the sector. Fintech firms, for example, are particularly concerned with the potential profits of disintermediating the banking system. While evolution and disintermediation in the financial system is nothing new, the changes happening today have a different, more democratic, character, with banks no longer acting as the sole arbiters of finance.

**Figure 2. Blockchain wallets worldwide (millions)**



Source: Statista. Data as of September 13, 2021.

### Key takeaways

- Allocations to private equity, specifically specialist venture capital firms investing in fintech platforms, can potentially allow investors to potentially benefit from exposure to disruptive technological developments.
- Private debt and hedge fund platforms can also offer access to new loans coming from fintech platforms.
- Investment grade private debt funds aim to compete large, high-quality corporate and commercial real estate loans away from banks with the promise of quicker, more flexible execution while reaping a spread to public markets.

<sup>4</sup> Source: DeFi Pulse, <https://defipulse.com/>

<sup>5</sup> Actors on the network prove their good intentions by staking their assets in what is essentially an escrow account. Staking protocols could replace the extremely energy-intensive proof-of-work protocols, such as those that are used to generate the bitcoin blockchain.

## Inequality street

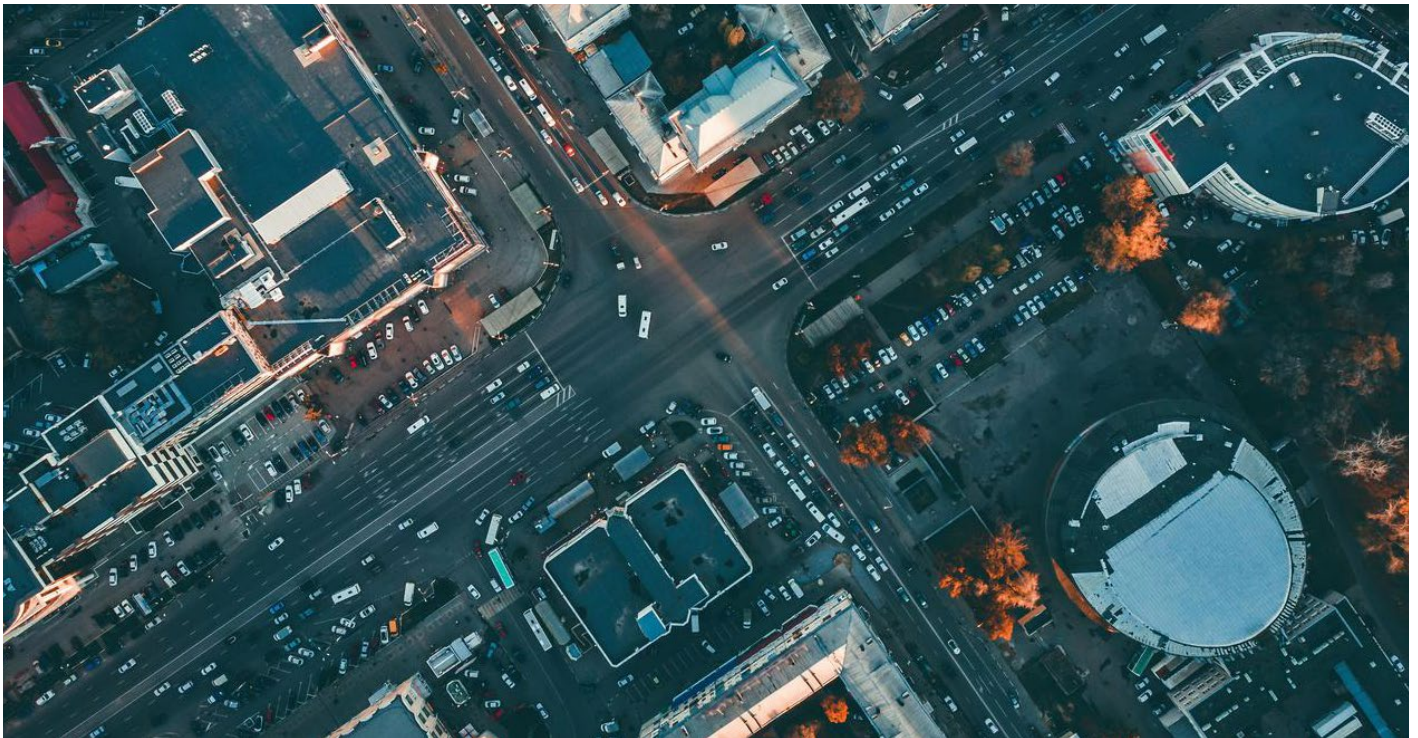
Despite being an impediment due to its effects on productivity and in stifling talent, inequality has been gradually rising over the past 50 years in many economies.

With a base case of future policies more balanced toward labor, but not outright destructive toward capital, assets tied to the success of the real economy and Main Street could be relatively better than financial assets.

Investors also need to be aware of the potential implications of policy outcomes in different regions or sectors. Certain sectors, such as technology, run the risk of regulatory action due to perceived impacts in social cohesiveness, something that has already happened in China and is being threatened in the US and Europe. Multinational companies may suffer due to increased risk of trade wars, as politicians look for rallying cries that suit the masses.

### Key takeaways

- Proper diversification across regions, sections and market caps we believe is an opportunity to make your portfolio robust to the risk of society potentially transitioning toward a more inclusive economic model.



# Position for transition

## The gray, the green and the in-between

Assets in a portfolio exist in a spectrum. “Gray” assets have high emissions and transition risk and so are only viable as long-term sustainable investments if clear and actionable transition plans are in place. In contrast, “green” assets have low/zero emissions and low transition risk, with the greenest actually actively aiding emissions reductions.

The majority of assets are “in between,” exhibiting moderate transition risk that needs managing through emissions reduction plans, and all moving at different speeds in putting those plans into action. Like any major trend, climate transition won’t happen in a straight line, and neither will price recognition. Investors need flexibility in their strategic climate transition plans to decarbonize at the right price. China is a good case in point: It has made its carbon-neutral pledge, which will involve massive investments and massive opportunities. Policy details are currently being drafted for

this multidecade initiative, and we believe early investors are likely to reap the greatest returns.

The concerns for investors on whether to buy, sell or hold assets relate to the potential existence of an ESG bubble and whether assets are being “greenwashed” rather than truly green. The former may mean sound assets are not purchased; the latter that regressive assets are maintained or added to. The idea of an ESG bubble is, however, potentially overstated, with an MSCI study<sup>7</sup> showing that high-ESG rated companies have outperformed mostly due to growth in earnings, with the top tercile of highly rated firms seeing a slight multiple contraction. Greenwashing concerns can also be avoided simply by being specific in sustainability requirements, which can also ensure avoidance of backward justifying.

“**Today’s IPCC Working Group 1 Report is a code red for humanity. The alarm bells are deafening, and the evidence is irrefutable: Greenhouse gas emissions from fossil fuel burning and deforestation are choking our planet and putting billions of people at immediate risk. Global heating is affecting every region on Earth, with many of the changes becoming irreversible.**”

António Guterres,  
Secretary General of the United Nations<sup>6</sup>

### Key takeaways

- Climate change is a global, multi-industry problem and therefore requires a total portfolio response, utilizing sustainably oriented strategies in both the public and private markets.
- Investors can now develop total portfolio climate transition plans, establishing targets for total portfolio emission reductions and for each asset class based on exposures and capacity for adaptation.
- Tackling the whole sustainability issue holistically might be overwhelming for some investors; sustainability can be addressed in stages depending on individual requirements.

<sup>6</sup> The full statement available here: “Secretary-General’s Statement on the IPCC Working Group 1 Report on the Physical Science Basis of the Sixth Assessment | United Nations Secretary-General.”

<sup>7</sup> “Is ESG Investing a Price Bubble? Probably Not.”, MSCI.

## The age of engagement

Engagement levels have returned with renewed vigor in the run-up to COP26 following a “COVID pause,” with 86 new firms committing to net-zero goals by 2040, and examples of activism increasing, such as that of a hedge fund securing pro-sustainability board seats in an oil major via just a 0.02% holding.

However, a broader frontier of engagement can include a range of other items, with much more needed than voting proxies on listed equities alone. This includes scrutinizing diversity, equity and inclusion policies of asset managers; and checking with beneficiaries on how they want to see their assets managed (often they are keener on sustainability than their fiduciaries assume, but too rarely are they asked their opinion).

What we have seen over the past year as a result of the pandemic is that COVID has fundamentally altered work patterns, often to the detriment of diverse employees. Firms therefore need to be encouraged to embrace DEI practices which encourage staff retention and build good decision-making.

In fact, diversity of talent should be a particular focus for firms, with companies with diverse management teams exhibiting EBIT margins 9% higher than those with below average diversity, and a significantly higher percentage of innovation revenue (45% versus 26% for less diverse firms).<sup>8</sup>

### Key takeaways

- **Much work is still required on DEI, particularly in the financial industry. More diverse teams can generate robust diversity of thought, which can lead to stronger, risk-adjusted returns by reducing groupthink.**
- **Engagement is now about more than voting proxies on listed equities: Bondholders can also influence decision-making.**

<sup>8</sup> Source: Boston Consulting Group, <https://www.bcg.com/publications/2018/how-diverse-leadership-teams-boost-innovation>.



## Implement with intent

Meaning matters: People want to make money, but also want to make a difference. Data suggests that purpose-driven companies have 40% higher levels of workforce retention than their competitors,<sup>9</sup> indicating that making an impact (which is often assumed to be nonfinancial in nature) can, in fact, have ties to the intangibles that make enterprises work.

Impact investments are made with an explicit intention and objective to deliver positive, meaningful, and measurable social and/or environmental outcomes in underserved areas, alongside a financial return. Most investors report

that the impact investments they made have performed in line with their financial expectations.<sup>10</sup> However, there are instances where certain impact investors may wish to willingly sacrifice returns in order to generate a specific type of impact. The impact financing gap over the next decade is substantial, with the UN Conference on Trade and Development estimating that US\$5 trillion–US\$7 is required by 2030 to meet the Sustainable Development Goals.<sup>11</sup> This includes investment in areas such as biodiversity, an area currently on the brink as a tremendous species decline threatens food security and increases our contact with disease.

### Key takeaways

- Private markets, particularly venture capital, offer the capacity for a substantial level of control over enterprises and therefore the potential to make the greatest impact.
- Providing finance to impact projects via sustainable bonds is a direct way to invest in change.

<sup>9</sup> Source: Deloitte DI 2020 Global Marketing Trends.pdf (deloitte.com).

<sup>10</sup> Source: GIIN, 2020 Annual Impact Investor Survey. 68% report in line performance, 20% report outperformance, and 12% report underperformance versus expectations. What You Need to Know about Impact Investing | The GIIN

<sup>11</sup> <https://sdgimpact.undp.org/fact.pdf>

## Resource code

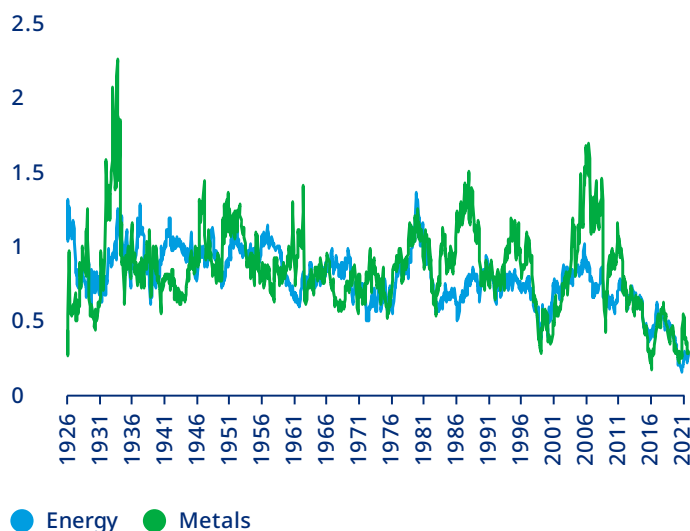
Carbon emissions have understandably been a key focus for attention to avoid or diminish the climate crisis. However, a wider lens is needed to sustainably service the food, water, housing, labor and transport needs of almost eight billion people. Biodiversity, adequate freshwater supplies and topsoil management are needed for food security; minerals for electric vehicles; and energy from sources such as nuclear and gas, given the intermittency of renewables. Put simply, a resource transition is needed, not simply an energy transition.

While emission reduction efforts focus on energy and transport, agriculture and land use — which account for around a quarter of emissions — are not being given sufficient attention. Global topsoil levels have halved in the past 150 years,<sup>12</sup> coinciding with dramatic insect (as vital pollinators) loss<sup>13</sup> and an increase in the frequency of droughts. Innovation is needed to bring farming into the 21st century globally.

In other areas, vast amounts of metals are needed for a sustainable, electrified economy. It is estimated that the six major metals will see a two- to sixfold increase in demand over the 21st century.<sup>14</sup> Although vital for the transition, it is possible that “portfolio cleaning” — that is, indiscriminately excluding high-emissions firms from portfolios — may have led to the sector being mispriced and underinvested in, as valuations versus the wider equity market are at historic lows just as demand spikes. Exposures in this area also have the potential to offer some inflation protection over the longer term as resources are a key component of inflation.

A key part of the solution to the resource code is the circular economy, where recycling is emphasized. For example, compared to primary aluminum, recycled aluminum emissions are 95% lower.<sup>15</sup> Aluminum production on its own accounts for 2% of global emissions,<sup>16</sup> and so recycling just aluminum would produce a significant emissions reduction. As carbon taxes increase, metal recycling enterprises will likely become more profitable.

**Figure 3. Valuation of energy and metals companies relative to the S&P 500**



Source: Statista. Data as of September 13, 2021.

## Key takeaways

- Investors must think about the practical aspects of reaching net-zero emissions goals — a broader resource transition is needed.
- Areas such as biodiversity and responsible agriculture are critical to meeting long-term sustainability goals, but so are those metals which are needed to power the “great electrification.”

<sup>12</sup> Source: WWF, <https://www.worldwildlife.org/threats/soil-erosion-and-degradation>.

<sup>13</sup> Hallmann CA, Sorg M, Jongejans E, Siepel H, Hofland N, Schwan H, et al. More than 75% percent decline over 27 years in total flying insect biomass in protected areas. PLoS One. 2017 Oct 18; 12(10).

<sup>14</sup> “Major metals demand, supply, and environmental impacts to 2100: A critical review”. Resources, Conservation and Recycling. Volume 164, January 2021, 105107. Takuma Watari, Keisuke Nansai, Kenichi Nakajima.

<sup>15</sup> “Life-cycle analysis of energy consumption and GHG emissions of aluminium production in China”. Energy Procedia 158 (2019) 3937–3943. Tianduo Peng, Xunmin Ou, Xiaoyu Yan, Gehua Wang.

<sup>16</sup> <https://www.greenbiz.com/article/why-addressing-aluminum-industrys-carbon-footprint-key-climate-action>

# Modern diversification

## Beyond beta

While the past decade has been one of the best on record for the traditional 60/40 portfolio, all good things come to an end. With bond yields and spreads near all-time lows and cyclically adjusted PE ratios higher than anytime other than the run-up to the TMT crash, traditional beta exposures are priced for perfection in an uncertain world.

Investors may therefore struggle to achieve portfolio objectives if they rely solely on long-term beta exposures.

In a diversification context, fixed income will struggle to offer its past benefits during periods of sub-par economic or equity performance, with such low starting yields and the risk of higher yields from rising inflation.

More dynamic portfolio exposure management will be needed, and this may require changes to governance and/or mandates; for instance, via more alpha-centric approaches, or targeted long-term specialist or thematic exposures.

### Key takeaways

- Investors may no longer be able to rely on traditional beta exposures alone to secure accustomed returns.
- Diversification is critical, but must be multifaceted and dynamic, as the complementarity of equity and bond portfolios may no longer be reliable.
- Active management and the use of long-term strategic holdings can help meet investment goals.



## The protection conundrum

As we reach the latter stages of a 40-year fixed income bull market, we have seen an incredible limbo dance in yields, resulting in the once-improbable phenomenon of over a trillion dollars invested in negatively yielding corporate bonds, and a normalization of paying for the privilege of lending to governments.

The level of portfolio protection from high-quality debt instruments that generations of investors have relied on is no longer there. Investors need more tools in the toolkit. Gold and some currencies can protect well, but are subject to idiosyncratic risks and are noncontractual; their protective capacities are essentially market conventions or rules of thumb. Contractual approaches to protection, specifically

options on equity indices or on market volatility could also be warranted today, though these can raise issues over the cost of carry (spend on option premiums), which generates a drag on returns in persistently buoyant markets.

Given the need to manage a range of exposures dynamically, there is a role for hedge fund strategies, including macro managers, which may be better equipped at managing through a transitional period. Furthermore, given the potential for higher correlation between equities and bonds, reducing exposure to traditional beta in favor of strategies that are expected to generate returns regardless of market direction has merit.

### Key takeaways

- The effectiveness of duration — for years the dominant and powerful risk protection strategy for most investors — cannot be relied upon going forward.
- The different styles of downside - protection-oriented strategies each have some risk scenarios where they work and some where they don't. A mixed approach to portfolio protection can be beneficial, albeit highly governance intensive.
- Increasing exposure to strategies like hedge funds, which can provide returns regardless of market direction, could have merit.

## Accessing innovation

Innovation is occurring on multiple fronts, in areas already referenced, such as climate change solutions, and fintech, but also adaptive robotics, automation of manufacturing, applications of artificial intelligence and many others. One area of particular interest is healthcare. The necessity of coping with the pandemic proved to be the mother of much scientific invention and technology adoption (e-medicine being one example). The process of fully applying these advances will continue for years.

An unfolding genomics-led revolution is making individualized medicine more likely as costs of genomic sequencing<sup>17</sup> continue to come down by orders of magnitude, creating greater certainty as to whether a

certain drug will be efficacious at treating particular patients and whether they will suffer side effects. These technologies will continue to bear fruits for decades, making healthcare more than a fad investment as populations age and are subject to ever-more-complex healthcare demands.

With some types of innovation happening at early stages in company lifecycles, considering private market investments (including venture capital) could bear fruit. One example is the emergence of ultra-high-pedigree “hybrid funds” offered by several top public/private equity investors, which are skewed toward mid-to-later rounds of growth equity and offer a more liquid profile versus traditional venture capital.

### Key takeaways

- The massive drop in the cost of solar energy production over the past decade is testament to the power of innovation. These trends must continue to support climate transition imperatives.
- Recent pandemic experiences have accelerated technological development, creating attractive investment opportunities. In particular, healthcare shows exciting long-term opportunities due to a range of innovations.
- Private markets exposure, including exposure via hybrid funds, can provide access to innovation in early-stage companies.

<sup>17</sup> Genomic sequencing refers to the process of obtaining a complete genetic map of an individual.

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November 2021

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<b>Bath &amp; North East Somerset Council</b>	
MEETING:	<b>AVON PENSION FUND INVESTMENT PANEL</b>
MEETING DATE:	<b>25 FEBRUARY 2022</b>
TITLE:	<b>Risk Management Framework Review for Periods Ending 31 December 2022</b>
WARD:	ALL
<b>AN OPEN PUBLIC ITEM</b>	
List of attachments to this report:	
<b>Exempt Appendix 1 – Mercer Report: Risk Management Framework Review to 31 December 2022</b>	
<b>Exempt Appendix 2 – Mercer Paper: Inflation Hedging Considerations</b>	

## 1. THE ISSUE

- 1.1. The Funding and Risk Management Group (FRMG) is responsible for agreeing the operational aspects relating to the Fund's risk management framework thereby ensuring that strategic objectives continue to be met. This report informs Panel of issues considered and decisions made by FRMG as well as any recommendations.
- 1.2. Since the last Panel meeting there has been one meeting of the FRMG on the 4 February 2022. There are no strategic issues or concerns to raise with the Panel.
- 1.3. Exempt Appendix 1 summarises the risk management strategies at 31 December 2021. No LDI triggers were breached during the period. The Equity Protection Strategy (EPS) is currently 'amber' (under review) as it has underperformed unhedged equities, creating a drag on performance. At the end of the period the Fund had sufficient collateral to support the risk management strategies. A verbal update on the outcome of the change to the protection strategy to reflect the removal of the Fund's strategic allocation to Emerging Market equities will be provided at the meeting.
- 1.4. Mercer will present the paper "Inflation Hedging Considerations" (Exempt Appendix 2) at the meeting.

## 2. RECOMMENDATION

**The Avon Pension Fund Investment Panel is asked to:**

- 2.1. **Note the current funding level and LDI hedging position**
- 2.2. **Note the impact and performance of the equity protection strategy**
- 2.3. **Note the current collateral adequacy position**
- 2.4. **Note the current FRMG workstreams as summarised in sections 5-7 below**

### 3. FINANCIAL IMPLICATIONS

- 2.5. The risk management strategies have been implemented to provide greater certainty that the funding plan will be achieved and therefore contribution levels will be stable and minimised. Any changes to the framework can affect the level of employer contributions in the future.

### 4. UPDATE ON RISK MANAGEMENT STRATEGIES AND FUNDING LEVEL

- 4.1. FRMG reviews the performance of each strategy each quarter ahead of the Panel meeting. At the last meeting it also examined the impact an increase in the inflation hedge ratio could have on the Fund in light of the recent material rises in inflation. (see section 5 below).
- 4.2. The **funding level** was estimated to be 102% (net of the impact from the equity protection strategy) at the end of December 2021. This shows that the Fund's position was ahead of the expected funding level by c.7%.
- 4.3. **The Liability Driven Investment (LDI)** strategy seeks to hedge the impact of inflation and interest rates on the value of the Fund's liabilities. The liability hedging component of the risk management framework delivered a return of 0.4% over the quarter due to changes in inflation expectations. No interest rate or inflation triggers were breached over the quarter and based on the current liability benchmark the hedge ratios are estimated to be 11% and 38%, respectively. The mandate has performed as expected and the manager is in compliance with investment guidelines.
- 4.4. **The Equity Protection Strategy (EPS)** protects the fund's equity assets from a material fall in value whilst allowing the Fund to participate in equity gains sufficient to support the actuarial valuation assumptions. The underlying equities returned 11.2% over the quarter and the EPS detracted -1.1% to produce a net return of 10.1%. Periodic returns are included on pages 8-9 of Exempt Appendix 1.
- 4.5. **The Corporate Bond Buy-and-Maintain Strategy** seeks to reduce the funding risk in respect of the 'low risk' bucket of liabilities, which are valued on a corporate bond discount basis. There has been minimal change in the cashflow matching within the portfolio over the period and credit spreads have returned to pre-pandemic levels. No further action is required in respect of this portfolio at this stage.
- 4.6. **Collateral and Counterparty Position.** When interest rates rise, inflation falls or the EPS declines in value the investment manager is required to post collateral to maintain the strategies. An 'early warning' and 'top up' trigger allow the Fund time to source collateral from elsewhere in the portfolio. As a secondary line of defence, the investment manager has access to a pooled fund of listed equities that they can sell to generate cash collateral should the need arise. At 31 December 2021 the Fund's existing pool of collateral was within guidelines and could sustain a 3.4% rise in interest rates, a 0.5% fall in inflation or an 11% decline in the value of the EPS before triggering the 'early warning' test.

### 5. INFLATION HEDGING CONSIDERATIONS

- 5.1. Following its last meeting the Panel asked FRMG to consider the quantitative impacts of rising inflation on the Fund's investment strategy, specifically in relation to the LDI hedge ratio. FRMG examined the impact of different inflation hedge ratios in terms of risk/return, collateral and in the context of the wider investment strategy, noting how the Fund's already well diversified portfolio is

well positioned to mitigate a range of downside risks. FRMG concluded that the Fund should maintain the current inflation hedge ratio while continuing to monitor the inflationary environment based on the fact increasing the hedge ratio at this stage:

(I) Increases Value at Risk, although reduces the negative funding impact under an inflation shock scenario

(II) Reduces expected return, potentially putting upward pressure on contributions

(III) Puts a significant strain on the Fund's collateral position

The hedge ratio and trigger framework are reviewed by Committee on an annual basis. Further work relating to the Fund's 'natural' level of inflation protection at the underlying asset level will form part of the 2022/23 strategic review.

## **6. LOW RISK BUCKET – IMPLEMENTATION CONSIDERATIONS**

6.1. FRMG reviewed the current "low risk" investment strategy in place for the Fund's orphan liabilities and considered options designed to limit the funding level volatility brought on by extreme moves in inflation and/or interest rates for employers whose liability terms differ significantly to the average liability term in the low-risk bucket. Further consideration of the various implementation approaches will form part of the 2022 valuation and FSS review.

## **7. EQUITY PROTECTION STRATEGY RESTRUCTURE – POST TRADE UPDATE**

7.1. The EPS was restructured in December 2021 to take account of the changes to the underlying equity portfolio that were agreed as part of the wider equity allocation review in September i.e. the removal of the dedicated emerging market equity allocation and the subsequent increase to developed market equities.

7.2. FRMG considered the post-trade report prepared by Mercer which showed transaction costs for exiting the emerging market exposure came in higher than expected (0.21% of exposure traded vs. 0.14% estimate) as a result of increased volatility at the time of trading. Transaction entry costs for the new developed market exposure were in line with pre-trade estimates (0.07% of exposure traded).

7.3. There was a net gain (after all entry and exit costs) for holding the emerging market protection strategy of c. £4.5m.

## **8. RISK MANAGEMENT**

8.1. 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 Investment Panel further strengthens the governance of investment matters and contributes to reduced risk in these areas.

## **9. EQUALITIES**

9.1. A proportionate equalities impact assessment has been carried out using corporate guidelines and no significant issues have been identified.

## **10. CLIMATE CHANGE**

10.1. The Fund is implementing a digital strategy across all its operations and communications with stakeholders to reduce its internal carbon footprint in line

with the Council's Climate Strategy. The Fund acknowledges the financial risk to its assets from climate change and is addressing this through its strategic asset allocation to Paris Aligned Global Equities, Sustainable Equities and renewable energy opportunities. The strategy is monitored and reviewed by the Committee.

## **11. OTHER OPTIONS CONSIDERED**

11.1. None

## **12. CONSULTATION**

12.1. The Section 151 Officer have had the opportunity to input to this report and have cleared it for publication.

<b>Contact person</b>	Nathan Rollinson, Investments Manager (Tel. 01225 395357)
<b>Background papers</b>	FRMG papers
<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: 748535

Meeting / Decision: AVON PENSION FUND INVESTMENT PANEL

Date: 25<sup>th</sup> February 2022

Author: Nathan Rollinson

**Report Title:** Risk Management Framework Review for Periods Ending 31 December 2022

**Exempt Appendix 1 – Mercer Report: Risk Management Framework Review to 31 December 2022**

**Exempt Appendix 2 – Mercer Paper: Inflation Hedging Considerations**

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

Stating the exemption:

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

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

**PUBLIC INTEREST TEST**

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

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

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

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

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

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

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

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Bath & North East Somerset Council		
MEETING:	AVON PENSION FUND INVESTMENT PANEL	
MEETING DATE:	25 FEBRUARY 2022	AGENDA ITEM NUMBER
TITLE:	Forward Agenda	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
List of attachments to this report: Nil		

## **1 THE ISSUE**

- 1.1 This report sets out the forward agenda for the Panel for 2022/23. It is provisional as the Panel will respond to issues as they arise and as work is delegated from the Committee.

## **2 RECOMMENDATION**

- 2.1 **That the Panel notes the Panel forward agenda.**

## **3 FINANCIAL IMPLICATIONS**

- 3.1 There are no financial implications arising from this report.

## **4 FORWARD AGENDA**

- 4.1 The provisional agenda is as follows:

<b>Date</b>	<b>Proposed agenda</b>
27 May 2022	<b>Strategic</b> <ul style="list-style-type: none"> <li>• Collateral plan</li> <li>• Mercer ACT Climate Analysis</li> </ul> <b>Monitoring</b> <ul style="list-style-type: none"> <li>• Investment performance including IFM wind down plan</li> <li>• Risk Management Framework</li> </ul>
9 Sept 2022	<b>Strategic</b> <ul style="list-style-type: none"> <li>• Blackrock Equity Fund in QIF</li> <li>• Cashflow/Liquidity Review</li> <li>• TCFD Statement</li> </ul> <b>Monitoring</b> <ul style="list-style-type: none"> <li>• Investment performance</li> <li>• Risk Management Framework</li> </ul>
25 Nov 2022	<b>Strategic</b> <ul style="list-style-type: none"> <li>• Update on 2022 Stocktake project</li> </ul> <b>Monitoring</b> <ul style="list-style-type: none"> <li>• Investment performance</li> <li>• Risk Management Framework</li> </ul>
Feb 2023 (TBC)	<b>Strategic</b> <ul style="list-style-type: none"> <li>• Update on Brunel's revised Climate Policy</li> </ul> <b>Monitoring</b> <ul style="list-style-type: none"> <li>• Investment performance</li> <li>• Risk Management Framework</li> </ul>

## **5 RISK MANAGEMENT**

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## **7 EQUALITIES**

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## **8 OTHER OPTIONS CONSIDERED**



8.1 None.

## **9 CONSULTATION**

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, Investments Manager 01225 395357
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