Avon Pension Fund

Review for period to 31 March 2013

May 2013

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1 Executive Summary

- This report is produced by JLT Investment Consulting ("JLT") to assess the performance and risks of the investment managers of the Avon Pension Fund (the "Fund"), and of the Fund as a whole.

Funding level

- There is expected to have been a deterioration in the funding level by around 2% over the first quarter of 2013.
- The drivers of this are:
  - A sharp rise in the Market Implied (RPI) inflation assumption used to project the liabilities. This increases the amount of future inflation-linked payments and hence increases the value placed on the liabilities, all else being equal.
  - This was despite a strong positive return from the assets, in particular equities.

Fund Performance

- The value of the Fund's assets increased by £262m over the first quarter of 2013 to £3,135m. The total Fund (including the impact of currency hedging) outperformed the Fund's strategic benchmark over the quarter by 0.3%, producing an absolute return of 8.9%.

Strategy

- Equity markets produced strong returns over the last quarter. Japan was the best performer at 19.2%, with emerging markets equities much lower at 5.4%. Over the last twelve months the US produced the best return at 20.1%. Japanese equity returns were reduced in Sterling terms by the weakening of the Yen but still produced comparable double-digit Sterling returns over 12 months (14.3%).
- The three year UK equity return has moved above the assumed strategic return, with overseas equities marginally below.
- Both nominal and index-linked bond returns have been high over the last three years and ahead of the assumed strategic return. This was a result of falling bond yields, and more recently falling real yields have boosted index-linked gilt returns.
- Overseas Fixed Interest and hedge funds remain below the assumed strategic return but there has been some improvement over the last quarter.
- The Property return has fallen behind the assumed strategic return, as the higher returns from 2010 fall out of the analysis and are replaced by lower recent returns. Since the start of 2012 income (rent) has been the main driver of returns rather than capital growth.

Managers

- In line with general market returns, all managers have produced positive returns over the last quarter, ranging from 0.8% from Schroders Property to 15.8% from SSgA Pacific. In relative terms, it has been a good quarter with all funds outperforming (apart from BlackRock Multi-Asset, which only underperformed by 0.1%).

- Over one year, the absolute return from each manager was positive, as equity and bond markets rose. In relative terms, only MAN, Schroder equity and the two Blackrock funds underperformed their benchmark.
- Only the four fund-of-hedge fund managers produced negative relative returns over three years.
- TT made changes in Q4 2011 and performance has continued to improve, with one year performance at 4% above the benchmark. TT's three year performance has improved to 0.5% p.a. above their benchmark, but this is below their target of +3-4% p.a. above the benchmark.
- Man restructured the portfolio in Oct 2012 and the Panel met them in early 2013 to review the impact on performance. Performance has improved over Q1 2013 but this is a short time period over which to draw any firm conclusions.
- The SSgA Europe ex UK Enhanced Equity pooled fund has fallen in size such that Avon's investment now represents over 90% of the pooled fund holdings. Avon's share is at the same level as when the Panel last investigated the issue in 2011, albeit the fund value is higher than at that time. Avon's share of the Pacific fund is also around 90% (again a similar share but a slightly higher fund value then when previously investigated). Performance of the SSgA Europe ex UK Enhanced Equity Fund does not appear to have been affected by its reduction in size.
- Stenham has recently changed the focus of its business strategy, focussing away from growing its institutional business to focus on servicing existing investors, strategic acquisitions and joint venture projects. The Stenham portfolio produced a strong quarterly return which has improved its longer term returns.
- The results of the Fund's recent strategic review should be taken into account before making any manager or asset allocation changes.

2 Market Background

The figures below cover the three months and 1 and 3 years to the end of March 2013.

Market Statistics

Yields as at 31 March 2013	% p.a.
UK Equities	3.35
UK Gilts (>15 yrs)	3.02
Real Yield (>5 yrs ILG)	-0.43
Corporate Bonds (>15 yrs AA)	4.06
Non-Gilts (>15 yrs)	4.06

Absolute Change in Yields	3 Mths %	1 Year %	3 Years %
UK Equities	-0.22	-0.10	0.19
UK Gilts (>15 yrs)	0.02	-0.24	-1.44
Index-Linked Gilts (>5 yrs)	-0.36	-0.32	-1.07
Corporate Bonds (>15 yrs AA)	-0.02	-0.57	-1.44
Non-Gilts (>15 yrs)	0.01	-0.65	-1.33

Market Returns Bond Assets	3 Mths %	1 Year %	3 Years % p.a.
UK Gilts (>15 yrs)	0.5	8.1	12.3
Index-Linked Gilts (>5 yrs)	9.0	11.7	13.0
Corporate Bonds (>15 yrs AA)	1.3	11.7	10.4
Non-Gilts (>15 yrs)	1.0	13.7	10.6

Market Returns Growth Assets	3 Mths %	1 Year %	3 Years % p.a.
UK Equities	10.3	16.8	8.8
Overseas Equities	14.4	17.2	8.2
USA	18.5	20.1	12.6
Europe	9.7	17.1	3.8
Japan	19.3	14.3	3.5
Asia Pacific (ex Japan)	8.8	16.7	7.3
Emerging Markets	5.4	7.4	3.2
Property	1.1	2.5	6.6
Hedge Funds	3.6	7.5	5.8
Commodities	7.6	0.0	3.0
High Yield	9.1	19.1	10.7
Emerging Market Debt	-2.3	10.1	9.9
Senior Secured Loans	2.8	8.7	5.7
Cash	0.1	0.5	0.5

Change in Sterling	3 Mths %	1 Year %	3 Years % p.a.
Against US Dollar	-6.6	-5.0	0.0
Against Euro	-4.1	-1.4	1.8
Against Yen	1.6	8.6	0.2

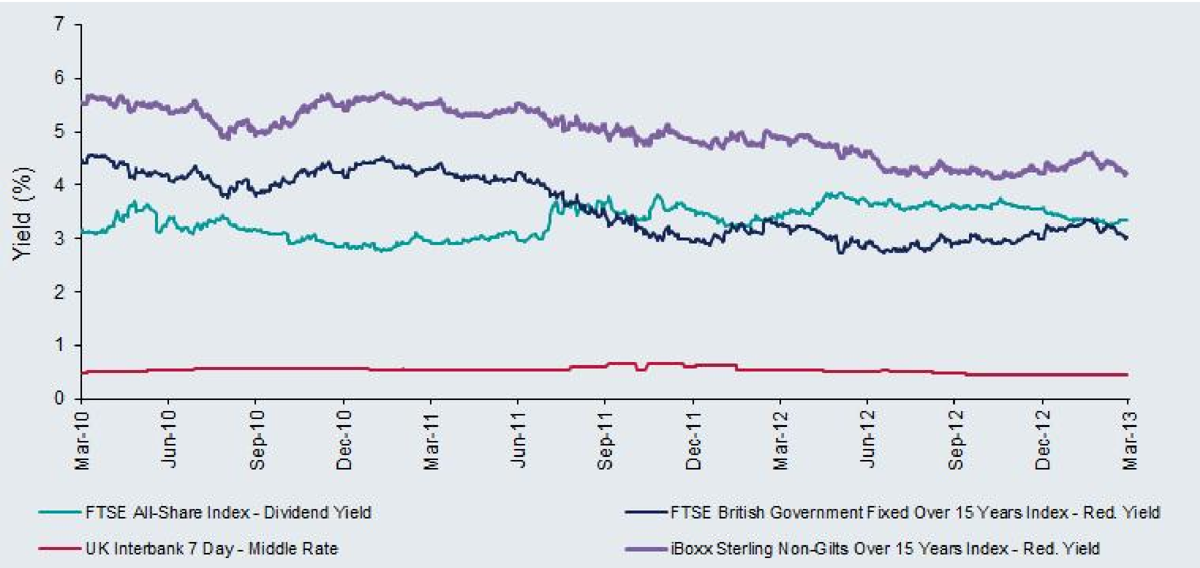
Inflation Indices	3 Mths %	1 Year %	3 Years % p.a.
Price Inflation - RPI	0.8	3.2	4.1
Price Inflation - CPI	0.7	2.8	3.5
Earnings Inflation *	-0.5	0.6	1.5

* Subject to 1 month lag

Source: Thomson Reuters and Bloomberg

Market Summary charts

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



The graph above shows the historic yields for gilts, corporate bonds, UK equities and UK cash over the last three years. The trend over the last 2 years shows falling gilt and corporate bond yields, whilst the yield on the FTSE All-Share Index has risen.

The table below compares general market returns (i.e. not achieved Fund returns) to 31 March 2013, with assumptions about returns made in the Investment Strategy agreed in 2009.

Asset Class	Strategy Assumed Return % p.a.	3 year Index Return % p.a.	Comment
UK Equities	8.4	8.8	Both around the assumed strategic return following a return of around 17% over the last twelve months. This followed flat returns of the previous 12 months.
Global Equities	8.4	8.2	
UK Gilts	4.7	12.3	Significantly ahead of the assumed strategic return as gilt yields fell significantly during 2011. Over the last twelve months, nominal gilt yields have stabilised whereas real yields and corporate bond yields have fallen, giving strong returns.
Index Linked Gilts	5.1	13.0	
UK Corporate Bonds	5.6	8.6	
Overseas Fixed Interest	5.6	4.3	Behind the assumed strategic return, affected by rising yields within European bonds, however there has been some improvement over the most recent quarter.
Fund of Hedge Funds	6.6	2.2	Behind the assumed strategic return following a negative return in 2011. More recent returns have been steady, albeit low. Low LIBOR levels could lead to continued low performance.
Property	7.4	6.6	This has fallen behind the assumed strategic return, as the higher returns from 2010 fall out of the analysis and are replaced by lower recent returns.

Source: Statement of Investment Principles, Thomson Reuters.

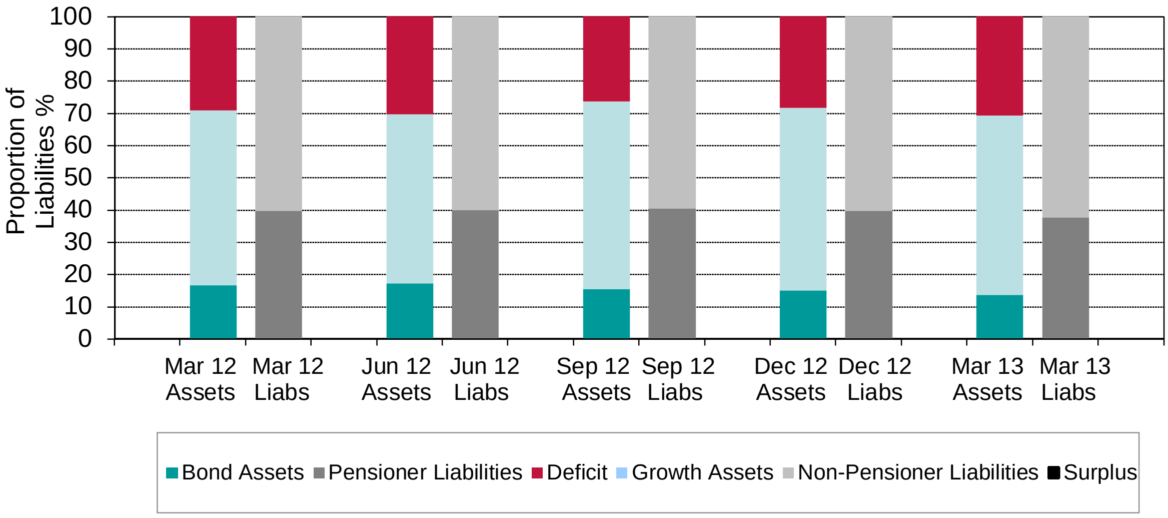
See appendix A for economic data and commentary.

3 Consideration of Funding Level

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

Asset allocation and liability split

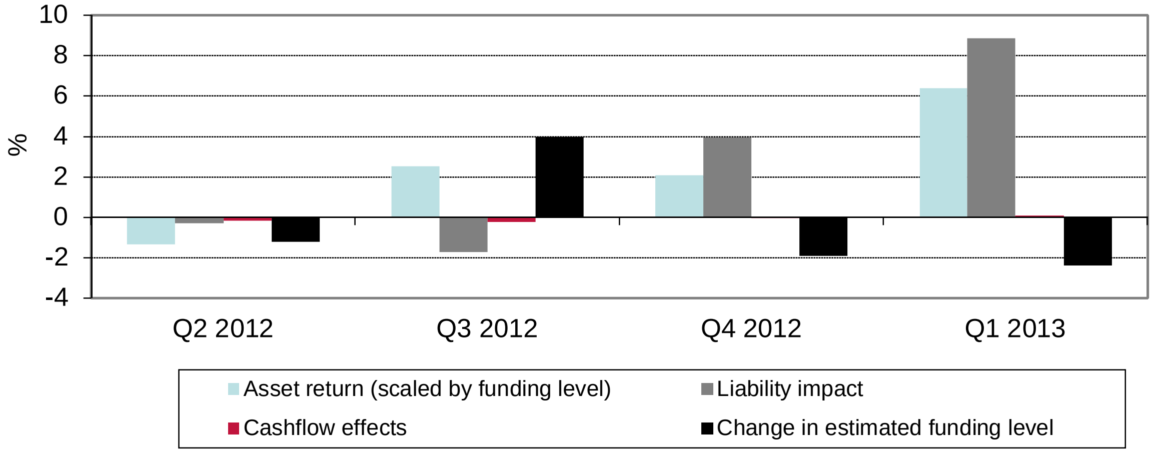
- The chart below shows the allocation of the Fund to Bond and Growth assets against the estimated liability split, which is based on changes in gilt yields underlying the Scheme Actuary's calculation of liabilities. The reference yield used for the liabilities is the Mercer Gilt yield (see appendix for definition). The liability benchmark is based on the valuation results from 31 March 2010.
- These calculations do not take account of any unexpected changes to the Fund membership or changes to the demographic assumptions and should not be construed as an actuarial valuation.



- Based on financial market values, investment returns and cashflows into the Fund, the estimated funding level decreased by around 2% over the first quarter of 2013, all else being equal. This was driven by:
  - A sharp rise in the Market Implied (RPI) inflation assumption used to project the liabilities. This increases the amount of future inflation-linked payments and hence increases the value placed on the liabilities, all else being equal.
  - This was despite a strong positive return from the assets, in particular equities.
- At the valuation date, 31 March 2010, the Scheme was 82% funded. Since then financial market movements have reduced the overall funding level, with most of the deterioration coming from lower real yields, especially since the second half of 2011 when bond yields fell sharply.

Scheme performance relative to estimated liabilities

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

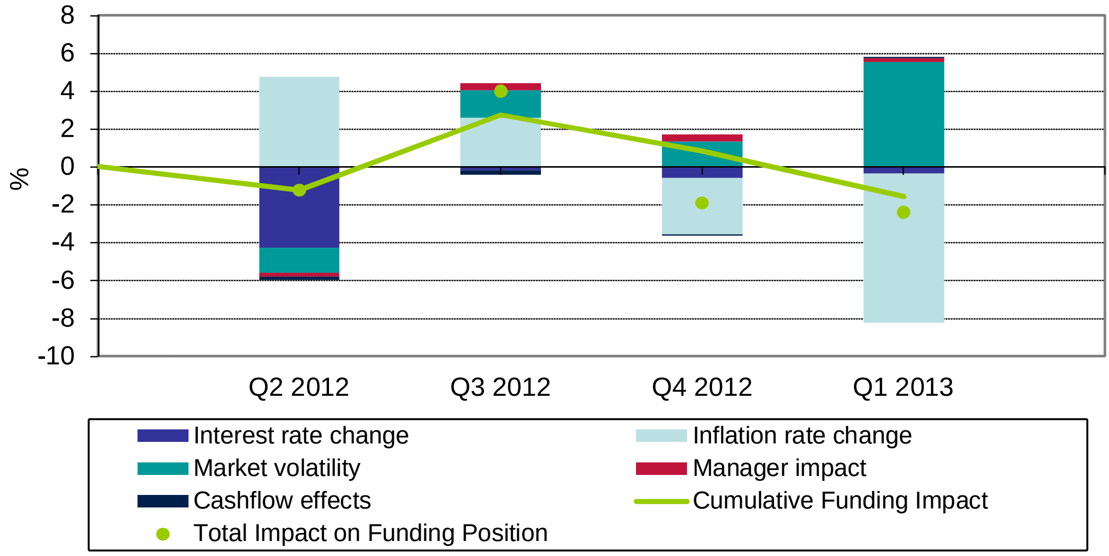


Note : A decrease in liabilities and an increase in assets improves the funding level and vice-versa.

- The graph above shows that the Fund's assets, scaled to take into account the estimated funding level, have produced an absolute return of 6.4%, over the last quarter.
- Over the quarter, the value placed on the liabilities increased by 8.9% due to an increase in the inflation assumption.
- Overall, the combined effect has led to a decrease in the estimated funding level to 69% (from 71% at 31/12/2012).

Key drivers of performance against the estimated liabilities

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



- 'Interest rate change' reflects the impact caused by the difference in the duration of the liabilities compared to the assets. As the liabilities have a longer duration than the assets, when yields fall this has a negative impact, for example as in Q2 2012. Over the last three quarters, the discount rate assumption has not changed, which results in a negligible contribution due to the liabilities unwinding.
- The Market Implied (RPI) inflation assumption rose sharply from 3.1% p.a. to 3.6% p.a. over the quarter. This increased the estimated liabilites and therefore was a negative contibution to the estimated funding level. This is the second consecutive quarter that the inflation assumption has risen and reverses the positive impacts of the first two quarters on the above chart.
- For Growth assets, 'Market volatility' is simply the (benchmark) return on the assets; for Bond assets it is the return less the return that would be expected given the changes in bond yields. This has been a strong positive contribution over the last quarter mainly due to the rise in equity markets.
- 'Manager impact' is the investment performance compared to the strategic benchmark. This was positive over the last quarter but gave a relatively small contribution, as expected, compared to the other factors.
- The small 'cashflow effects' reflect factors such as pension payments and contributions/disinvestments.
- Overall the financial factors have had a negative impact on the estimated funding level of the Fund over the last quarter.
- Over the last twelve months, the financial factors have had a negative effect mainly due to the 'interest rate' effect (a falling Mercer gilt yield discount rate) over Q2 2012 and the inflation impacts of the last two quarters. Rising markets (the 'market volatility' bars) were a positive, with the remaining components on the chart above each having a broadly neutral effect over the year.

4 Fund Valuations

- The table below shows the asset allocation of the Fund as at 31 March 2013, with the BlackRock Multi-Asset portfolio and the BlackRock property portfolio (assets "ring fenced" for investment in property) split between the relevant asset classes.

Asset Class	31 March 2013 Value £'000	Proportion of Total %	Strategic Benchmark Weight %
UK Equities	640,484	20.4	18.0
Overseas Equities	1,384,317	44.1	42.0
Bonds	611,590	19.5	20.0
Fund of Hedge Funds	221,147	7.1	10.0
Cash (including currency instruments)	55,550	1.8	-
Property	222,341	7.1	10.0
TOTAL FUND VALUE	**3,135,429**	**100.0**	**100.0**

Source: Data provided by WM Performance Services

- The value of the Fund's assets increased by £262m over the first quarter of 2013 to £3,135m. Each asset class contributed positively to the increase, however most of the increase (£233m) came from equities.
- In terms of the asset allocation, market movements resulted in a shift towards equities as they produced double-digit returns and outperformed other asset classes. This moved the allocation slightly further away from the strategic benchmark weights.
- The valuation of the investment with each manager is provided on the following page.

Manager	Asset Class	31 December 2012		Net new money £'000	31 March 2013	
		Value £'000	Proportion of Total %		Value £'000	Proportion of Total %
Jupiter	UK Equities	124,793	4.3	-	139,815	4.5
TT International	UK Equities	144,716	5.0	-	162,741	5.2
Invesco	Global ex-UK Equities	186,292	6.5	-	218,121	7.0
Schroder	Global Equities	174,947	6.1	-	199,613	6.4
SSgA	Europe ex-UK Equities and Pacific incl. Japan Equities	90,327	3.1	-	103,009	3.3
Genesis	Emerging Market Equities	147,442	5.1	-	158,436	5.1
MAN	Fund of Hedge Funds	62,264	2.2	-	63,955	2.0
Signet	Fund of Hedge Funds	66,339	2.3	-	67,197	2.1
Stenham	Fund of Hedge Funds	33,360	1.2	-	34,937	1.1
Gottex	Fund of Hedge Funds	53,559	1.9	-	55,059	1.8
BlackRock	Passive Multi-asset	1,305,849	45.4	-	1,446,466	46.1
BlackRock (property fund)	Equities, Futures, Bonds, Cash (held for property inv)	60,381	2.1	-2,710	60,652	1.9
RLAM	Bonds	172,159	6.0	-	176,526	5.6
Schroder	UK Property	131,330	4.6	-	132,500	4.2
Partners	Property	87,078	3.0	2,710	95,729	3.1
Record Currency Mgmt	Dynamic Currency Hedging	8,249	0.3	-	-3,117	-0.1
Record Currency Mgmt 2	Overseas Equities (to fund currency hedge)	8,924	0.3	-	7,955	0.3
Internal Cash	Cash	15,242	0.5	-	15,836	0.5
Rounding		-1	0.1	-	-1	-0.1
TOTAL		**2,873,250**	**100.0**	**0**	**3,135,429**	**100.0**

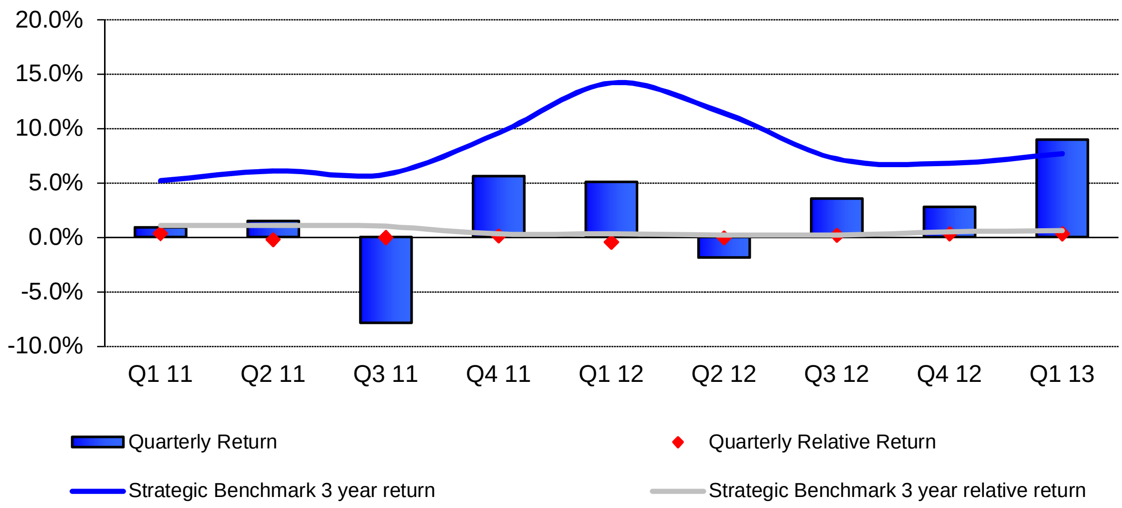
Source: Avon Pension Fund Data provided by WM Performance Services

5 Performance Summary

Total Fund performance

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

Total Fund absolute and relative performance



Manager / fund	**3 months (%)**	**1 year (%)**	**3 years (% p.a.)**
Total Fund (inc currency hedge)	8.9	13.8	N/A
Total Fund (ex currency hedge)	9.4	14.1	8.4
Strategic Benchmark	8.6	12.4	7.7
Relative (inc currency hedge)	+0.3	+1.4	N/A
Relative (ex currency hedge)	+0.8	+1.7	+0.7

Source: Data provided by WM Performance Services.

Strategy performance

- The table below shows the strategic allocation to each of the major asset classes and the benchmark returns over the quarter and year to 31 March 2013.

Asset Class	Weight in Strategic Benchmark	Index returns	Contribution to total benchmark	Index returns	Contribution to total benchmark
		Q1 2013	(quarter)	1 year	(1 year)
UK Equities	18%	10.3%	1.9%	16.8%	3.0%
Overseas Equities	42%	13.4%	5.6%	16.4%	6.9%
Index Linked Gilts	6%	9.0%	0.5%	11.7%	0.7%
Fixed Coupon Gilts	6%	0.4%	0.0%	8.1%	0.5%
UK Corporate Bonds	5%	1.7%	0.1%	12.0%	0.6%
Overseas Fixed Interest	3%	4.3%	0.1%	4.5%	0.1%
Fund of Hedge Funds	10%	3.5%	0.3%	2.7%	0.3%
Property	10%	0.8%	0.1%	1.0%	0.1%
Total Fund	100%				

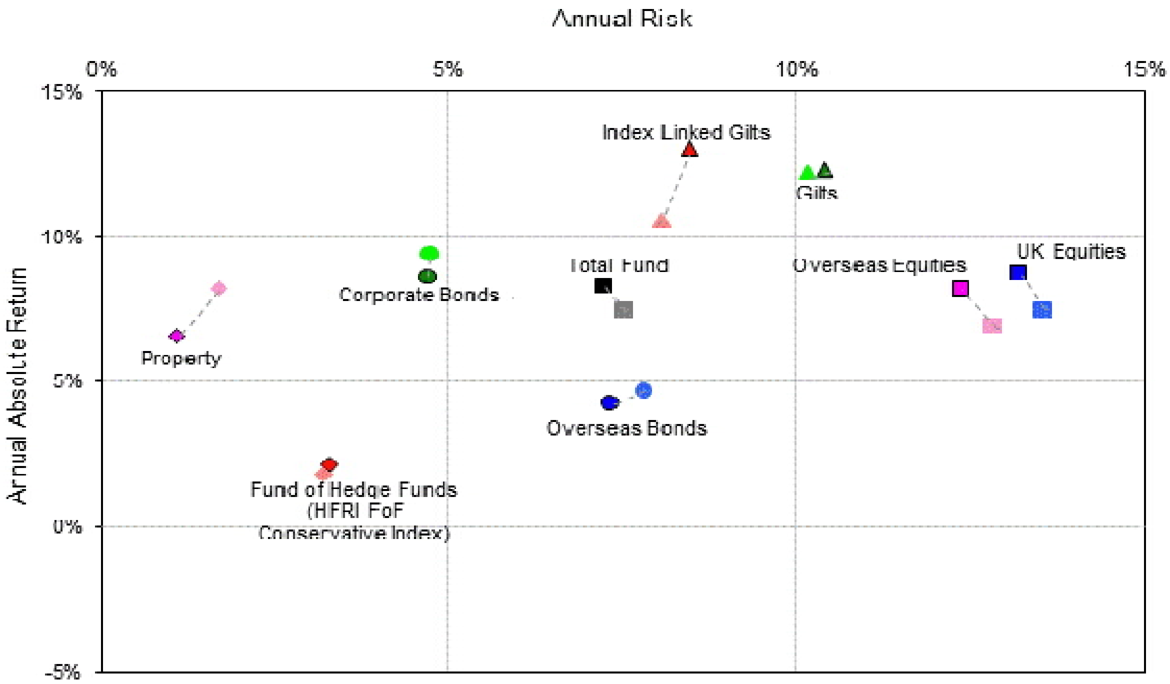
Source: Avon Pension Fund, Data provided by WM Performance Services.

- **Market impact**: Global equities moved sharply upwards in the first quarter, as both company and consumer confidence improved and companies increased dividends.
- The depreciation of Sterling against both the US Dollar and the Euro improved the overseas equity return in Sterling terms over the last quarter. Emerging market equities performed less strongly, due to a lack in the growth of exports to the developed world, but still returned 5.4%.
- Corporate bonds continued to outperform gilts, although the narrowing of the credit spread was less marked than in previous quarters. Index linked gilts significantly outperformed fixed coupon gilts, reflecting the increase in RPI inflation expectations following confirmation in January that there would be no change to the RPI calculation methodology.
- Property produced a small positive return, mainly due to the income (rent) element.
- **Strategic Benchmark**: performance of the strategy was driven by the two largest components, UK (18%) and overseas (42%) equities, which made up the bulk of the benchmark return in rising markets over both the quarter and year.
- Bond assets, which make up 20% of the benchmark, contributed 1.9% over the year.
- Hedge funds and property made small positive contributions, both over the quarter and year.

Risk Return Analysis

- The chart below shows the 3 year absolute return ("Annual Absolute Return") against the 3 year volatility of absolute returns ("Annual Risk"), based on monthly/quarterly (as available) data points in sterling terms, to the end of March 2013 of each of the underlying asset benchmarks, along with the total Fund strategic benchmark. We also show the position as at last quarter, as shadow points.
- This chart can be compared to the 3 year risk vs return managers' chart on page 20.

3 Year Risk v 3 Year Return to 31 March 2013



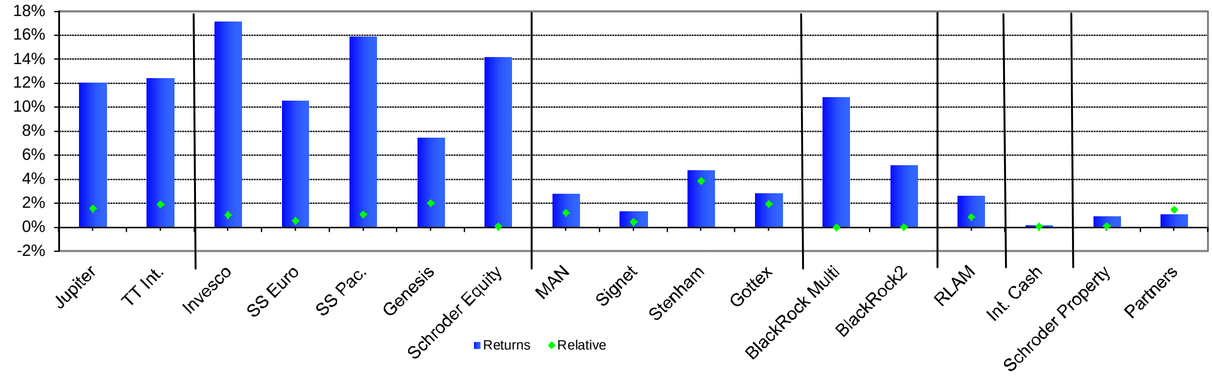
Source: Data provided by Thomson Reuters

- All of the underlying benchmarks have produced a positive return over the period (3 years p.a.).
- 3-year equity returns increased despite the strong returns of Q1 2009 falling out of the analysis, as equities produced double-digit returns in Q1 2013.
- The Property return continued to fall sharply as the lower returns seen over the last year continue.
- Hedge funds continue to produce a steady, albeit low, return, with the three year figures affected by the negative return of 2011.
- Index-linked gilts continued to rise, whereas conventional gilts were flat over the last quarter.
- In terms of risk, there was broadly little change with the exception of property. The volatility of equities continued to fall.
- Both the UK and overseas equity three-year returns rose, with the UK return now above its assumed strategic return of 8.4% p.a. and the overseas return only slightly behind. The three year return on each of the bond types (gilts, index linked gilts and corporate bonds) remains above the respective strategic returns. Property has fallen to below its assumed strategic return; overseas fixed interest and hedge funds remain below their assumed strategic return.

Aggregate manager performance

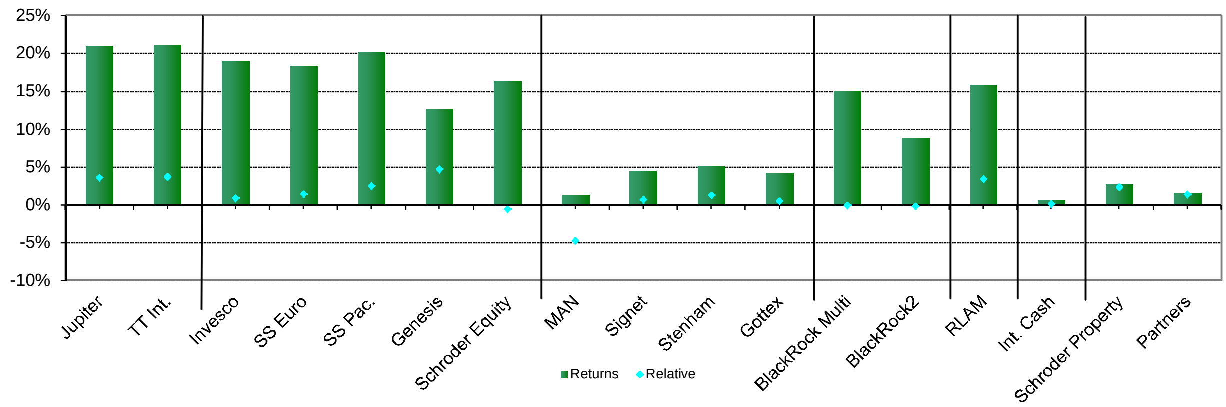
- The charts below show the absolute return for each manager over the quarter, one year and three years to the end of March 2013. The relative quarter, one year and three year returns are marked with green and blue dots respectively.

Absolute and relative performance - **Quarter to 31 March 2013**

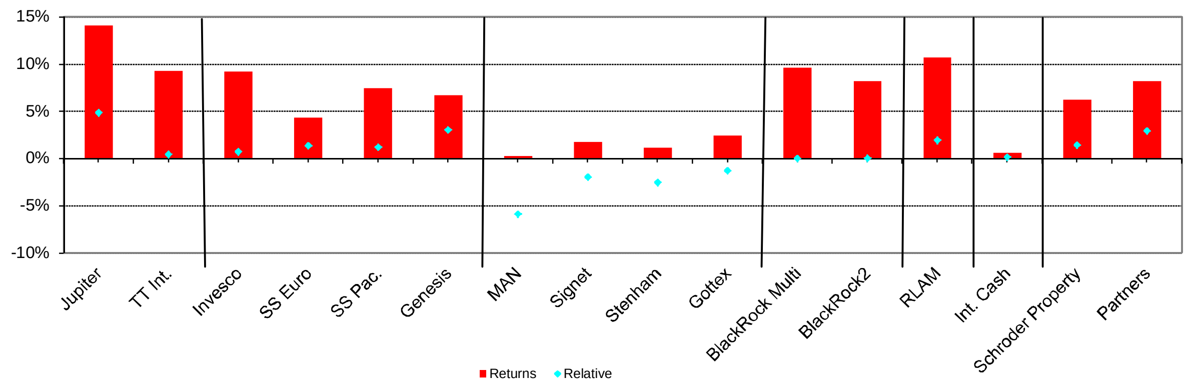


Partners data is lagged by 1 quarter.

Absolute and relative performance - **Year to 31 March 2013**



Absolute and relative performance - **3 years to 31 March 2013**



Source: Data provided by WM Performance Services

- The table below shows the relative returns of each of the funds over the quarter, one year and three years to the end of March 2013. Returns in blue text are returns which outperformed the respective benchmarks, red text shows an underperformance, and black text represents performance in line with the benchmark.

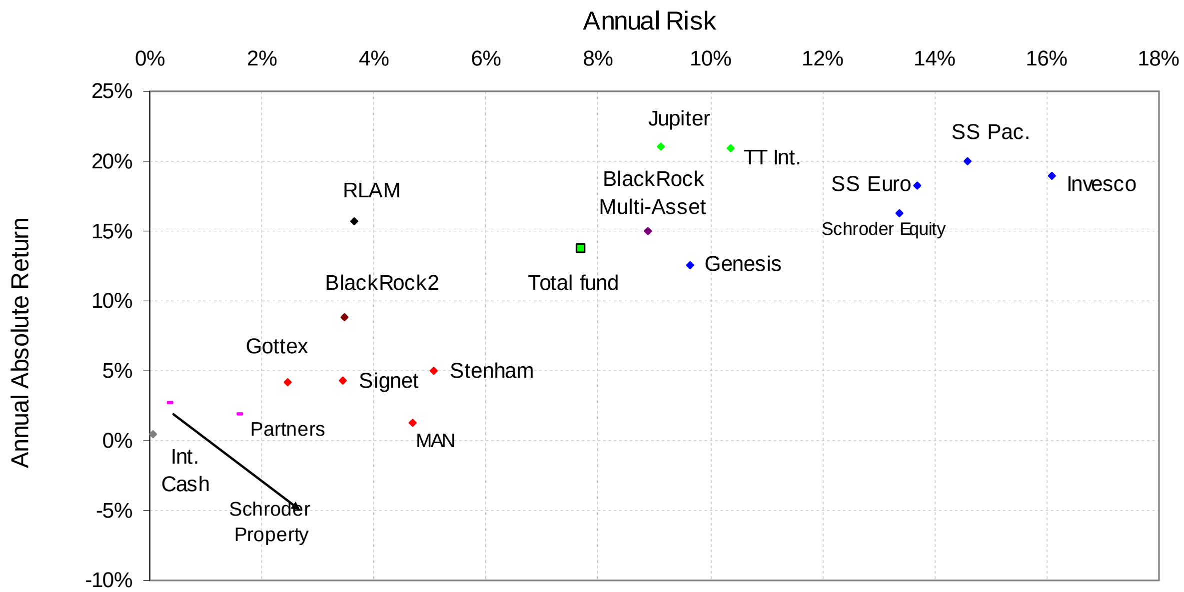
Manager / fund	3 months (%)	1 year (%)	3 years (% p.a.)	3 year performance versus target
Jupiter	+1.7	+4.1	+5.2	Target met
TT International	+2.1	+4.3	+0.4	Target not met
Invesco	+1.2	+1.1	+0.7	Target met
SSgA Europe	+0.5	+1.6	+1.3	Target met
SSgA Pacific	+1.2	+3.0	+1.2	Target met
Genesis	+2.1	+5.1	+3.1	Target met
Schroder Equity	+0.1	-0.7	N/A	N/A
Man	+1.2	-5.0	-6.2	Target not met
Signet	+0.4	+0.7	-2.1	Target not met
Stenham	+3.8	+1.3	-2.7	Target not met
Gottex	+1.9	+0.5	-1.4	Target not met
BlackRock Multi - Asset	-0.1	-0.1	0.0	Target met
BlackRock 2	0.0	-0.2	0.0	Target met
RLAM	+0.8	+3.8	+2.1	Target met
Internal Cash	0.0	+0.1	+0.2	N/A
Schroder Property	0.0	+2.4	+1.5	Target met
Partners Property	+1.4	+1.4	+3.1	Target met

Source: Data provided by WM Performance Services

Manager and Total Fund risk v return

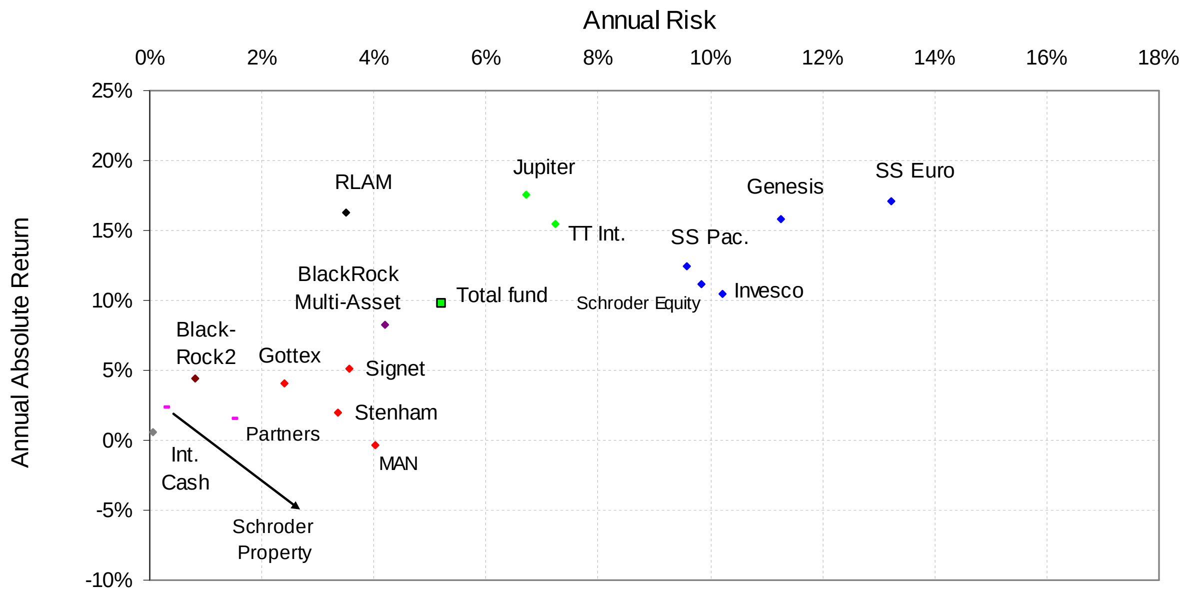
- The chart below shows the 1 year absolute return ("Annual Absolute Return") against the 1 year volatility of absolute returns ("Annual Risk"), based on monthly/quarterly (as available) data points in sterling terms, to the end of March 2013 of each of the funds. We also show the same chart, but with data to 31 December 2012 for comparison.

1 Year Risk v 1 Year Return to 31 March 2013



Source: Data provided by WM Performance Services

1 Year Risk v 1 Year Return to 31 December 2012

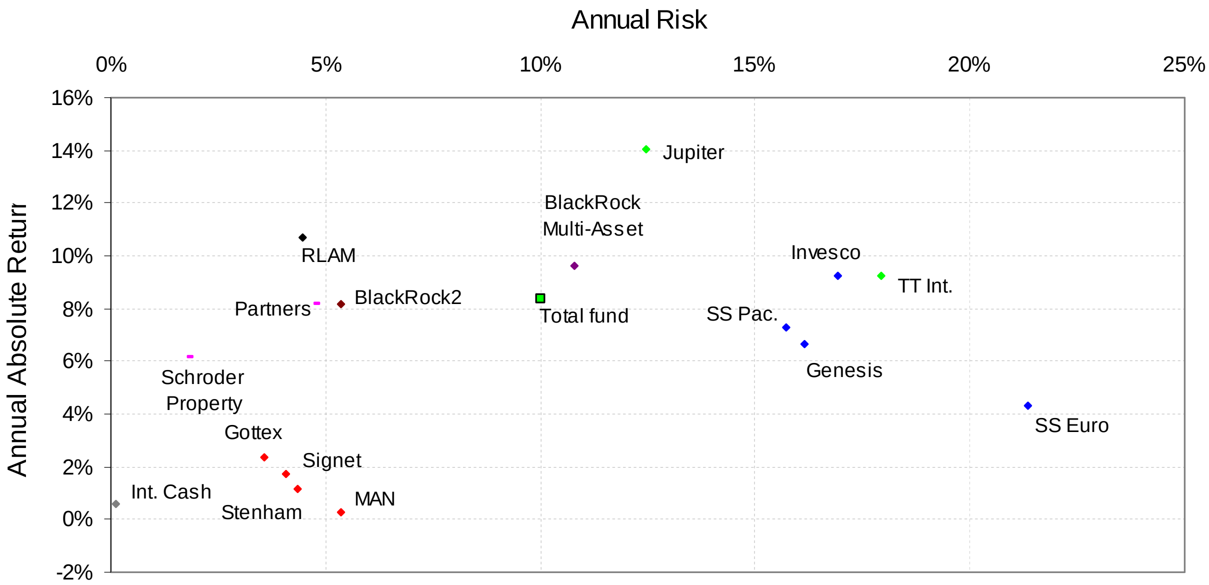


Source: Data provided by WM Performance Services

- The managers are colour coded by asset class, as follows:
  - Green: UK equities
  - Blue: overseas equities
  - Red: fund of hedge funds
  - Black: bonds
  - Maroon: multi-asset
  - Brown: BlackRock No. 2 portfolio
  - Grey: internally managed cash
  - Pink: Property
  - Green Square: total Fund
- The one-year returns are higher to March than to December for all funds apart from Genesis, Signet and RLAM.
- Notable increases are Invesco global equities (from 10.4% to 19.0%) and Stenham (from 2.0% to 5.0%), which puts Stenham's return ahead of Signet and Gottex.
- Genesis emerging market equity fund return over one-year has fallen from 15.8% to 12.6%.
- The one-year risk has generally increased for the equity-based funds and the Blackrock funds, and remained broadly unchanged elsewhere.

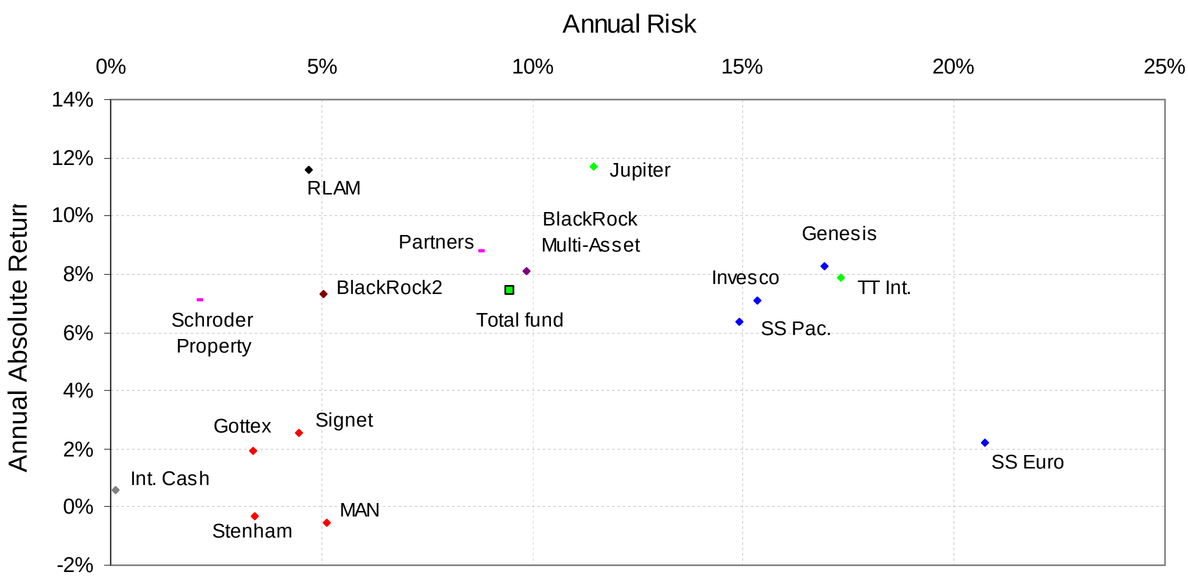
- The chart below shows the 3 year absolute return ("Annual Absolute Return") against the 3 year volatility of absolute returns ("Annual Risk"), based on monthly/quarterly (as available) data points in sterling terms, to the end of March 2013 of each of the funds. We also show the same chart, but with data to 31 December 2012 for comparison.

3 Year Risk v 3 Year Return to 31 March 2013



Source: Data provided by WM Performance Services

3 Year Risk v 3 Year Return to 31 December 2012



Source: Data provided by WM Performance Services

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

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

- The change in the three-year returns compared to last quarter reflect those of the one-year returns, with a notable improvement from most equity-based funds but a fall from Genesis, Signet and RLAM.
- The 3-year risk figures have generally increased for the equity-based funds and remained at a broadly consistent level for the other funds. As would be expected, the equity-based funds have the highest volatility and hedge funds, property and fixed interest the lowest, in line with the market returns chart on page 15.

Conclusion

- The strongest returns over the 1 year period are from equity funds, corporate bonds (RLAM) and Blackrock Multi-asset. Each of these produced a double-digit return.
- Over three years, the best performer is Jupiter at 14.1% p.a., followed by RLAM at 10.7% p.a. The other equity, property and multi-asset funds generally produced 4-9% p.a., with the hedge funds lowest at 0-3% p.a.
- The Fund of Hedge Fund managers have provided low volatility over both the 1 and 3 year period. However, over the longer 3 year period they have all underperformed their assumed strategic return. Each of the equity-based funds has outperformed the assumed strategic return over 3 years.

Appendix 1: Market Events

Asset Class	What happened?	
	Positive Factors	**Negative Factors**
UK Equities	• UK Equities had a good quarter. The FTSE All-Share Index delivered a 10.3% return over the quarter to 31 March 2013, smaller companies returned 13% whilst medium sized companies lagged slightly, returning 9.8%. Companies' confidence in the future is shown by the number of dividend increases being seen in many sectors, underpinning the yield support that equity prices have long experienced. • CPI inflation remained within the Bank of England's target range over the quarter; the latest figure for CPI inflation is 2.8% (as at 31 March 2013, which is likely to be revised over the quarter by the Office for National Statistics). • The UK Bank Rate remained at 0.5% over the quarter although there was no change to the level of QE, £375bn.	• Official forecasts now suggest a 'triple-dip' recession is unlikely. However, there is little room for manoeuvre – growth is expected to be less than 1% this year – and events beyond the government's control could easily reduce this further. Expected future rises in the inflation rate are also adding to potential problems. • The number unemployed, 2.51m, remains high, although the unemployment rate has held steady at 7.8% over recent months. Increases in wages continue to be subdued whilst the rate of inflation is putting further pressure on consumers.
Overseas Equities:		
North America	• The US Equity Market had a stellar first quarter of 2013 returning 18.5%. The housing market has been improving, and consumer confidence has picked-up somewhat. Corporate America helped, earnings for 2012 were largely as expected, forecasts for 2013 remain positive and there are signs of a pick-up in mergers and acquisitions (and even a return of the leveraged buyout). • The market welcomed the continuation of QE which is now officially dependent on the unemployment rate falling below 6.5% - and staying there – which a majority of the Fed Board do not expect until 2015/16. So QE appears to be here to stay, albeit in reduced monthly amounts.	• After the strong rise in equity prices in the first quarter it would not be surprising if there was a pause for breath in the short term, particularly if some of the mixed signals coming from more recent economic statistics continue. • Tax increases agreed as part of the 'fiscal cliff' negotiations at the end of 2012 added to the automatic spending cuts imposed by the 'sequester' in January have the potential to hold back any recovery.

Asset Class	What happened?	
	Positive Factors	**Negative Factors**
Europe	• The European markets delivered 9.7% growth over the quarter, continuing the strong rally it experienced over 2012. • Despite the grim big picture, many companies are increasing profits and, perhaps more importantly, dividends. Income is becoming a significant part of share prices' total return (as has been the case in the UK for some time). Europe should be treated as a market of many stocks, not a single stock market. There are opportunities to be grasped, even in the most unpromising areas.	• Unemployment remains high - particularly in the peripheral Eurozone countries as austerity measures impact on confidence. • The 'resolution' of the Cyprus crisis, has set a precedent that could be followed elsewhere – Spain, a possibility. There are already other, peripheral, countries heading into difficulty – Slovenia seemingly next in line – and it will be interesting to see if the same remedies are imposed in future negotiations. The Cyprus 'bail-in' will also have the effect of weakening already weak banks across the Eurozone as depositors move their uninsured cash to perceived 'strong' banks in the region – just in case.
Japan	• Japan was the best performing major market in the first quarter, with a return in sterling of 19.3% and even stronger return in local currency of 21.2%. It is a very long time since we have been able to make such a statement. • The new Prime Minister, Mr Abe, was elected on a platform of monetary and fiscal expansion to overcome deflation and boost the economy. He has already appointed a new Bank of Japan Governor, Mr Kuroda, who markets expect to be fully supportive of these efforts, unlike previous, ultra-conservative incumbents.	• There are still clouds on the horizon, not least international politics in the region. China, in particular, is not happy with the perceived 'beggar-thy-neighbour' policies being proposed and the US Congress might start to grumble if the yen weakens much more. But for the time being the rest of the developed world seem content for Japan to continue its experiment in reflation.
Asia Pacific	• The region had a relatively subdued first quarter, returning 8.8%. As usual, China has been the main area of returns and concern. The new President, Xi Jinping, took over in March, with stability the watchword, but with some major problems to address. Exports have recovered somewhat from the lows of last summer but the lack of growth in the Western developed world limits any rapid recovery. Overall GDP should grow in 2013 at about the same rate as last year – around 7.5% - which might sound high, but for China is nearly equivalent to stagnation.	• In the short term the new Chinese administration's room for manoeuvre is constrained by a property bubble – the legacy of the massive expansion in credit in 2008/9. Easing monetary conditions to promote growth is not possible until property lending throughout the economy can be controlled more rigorously. In addition, geopolitically there is, of course, the question of North Korea. So far markets have blithely ignored all the table-thumping and sabre-rattling but there is always the chance that the situation gets out hand.

Asset Class	What happened?	
	Positive Factors	**Negative Factors**
Emerging Markets	• Emerging Market indices rose approximately 5% over the quarter – a somewhat lacklustre performance. The reasons are very similar to those described above in the Asian section – a reliance on exports to a developed world growing little, if at all. However, the fastest growing areas in Emerging Markets generally are in the domestic economy – consumption and services – aimed at the burgeoning middle class in many countries with an increasing propensity to spend.	• Political instability is the main investor concern at present with the political leadership of China facing its first serious test in North Korea and the increasing uncertainties in Latin America proving a drag on growth. There is also a strong correlation between Emerging Market indices and the US dollar. When the latter is strong, as it has been, they tend to underperform – and vice versa.
Gilts	• Gilts returned 0.7% over the 3 months to the end of March 2013. The recent downgrade by Moody's to AA Stable in this asset class has not impacted on it continuing to be regarded as having 'safe haven' status at the moment.	• The safe haven position of Gilts is inextricably linked to the measures taken to resolve the Eurozone crisis. We continue to be concerned that this asset class may experience falling capital values in the near term as markets work through the sovereign crisis. There is a short term risk of yields decreasing on more QE.
Index Linked Gilts	• With limited supply and investors continuing to seek inflation protection, demand for Index Linked Gilts remains high, thus supporting prices. There are pockets of value to be found in this asset class.	• A negative real yield on long-dated index-linked stocks is unsustainable over the longer term in an environment in which central banks are able to successfully control inflation within a target range.
Corporate Bonds	• Sterling Corporate Bonds produced a positive return of 1.8%, benefiting from the strength of corporate balance sheets and the higher yields relative to gilts. The interest rate outlook is stable, and the returns available make the sector appealing to some investors.	• The Corporate Bond Market is currently suffering from a lack of liquidity and the tightening of credit spreads means that trading is becoming more difficult.
Property	• Tier 1 prime assets continue to outperform secondary and tertiary properties, as they did throughout 2012.	• The well established trend of overall void levels increasing in tandem with the lowering of capital values as well as falling rental yields continued through Q1 2013. The lack of growth in the UK economy compounded these issues.

Economic statistics

	Quarter to 31 March 2013			Year to 31 March 2013		
	UK	Europe(1)	US	UK	Europe(1)	US
Real GDP growth	0.3%	n/a	0.6%	0.6%	n/a	1.8%
Unemployment rate	7.9%	11.1%(4)	7.6%	7.9%	11.1%(4)	7.6%
Previous	*7.7%*	*11.0%*	*7.8%*	*8.3%*	*10.3%*	*8.2%*
Inflation change(2)	0.5%	0.5%	1.4%	2.8%	1.7%	1.5%
Manufacturing Purchasing Managers' Index	48.3	46.8	51.3	*48.3*	46.8	51.3
Previous	*51.4*	*47.5*	*50.7*	*51.9*	*47.7*	*53.4*
Quantitative Easing / LTRO (3)	£375bn	€1,018bn	$3,029bn	£375bn	€1,018bn	$3,029bn
Previous	*£375bn*	*€1,018bn*	*$2,774bn*	*£325bn*	*€1,018bn*	*$2,654bn*

Source: Thomson Reuters, market, Institute for Supply Management, Eurostat, United States Department of Labor, US Bureau of Economic Analysis. All figures to 31 March 2013 unless otherwise stated. "Previous" relates to data as at the previous quarter or year end.

(1) 15 Country Euro area; (2) CPI inflation measure; (3) Refers to amounts announced and therefore ignores changes due to debt maturing. LTRO refers to the European Central Bank's Long Term Refinancing Operation; (4) As at February 2013

Appendix 2: Glossary of Terms

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

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

Appendix 3: Summary of Mandates

Manager	Mandate	Benchmark	Outperformance target (p.a.)
Jupiter	UK Equities (Socially Responsible Investing)	FTSE All Share	+2%
TT International	UK Equities (Unconstrained)	FTSE All Share	+3-4%
Invesco	Global ex-UK Equities Enhanced (En. Indexation)	MSCI World ex UK NDR	+0.5%
Schroder	Global Equities (Unconstrained)	MSCI AC World Index Free	+4%
SSgA	Europe ex-UK Equities (Enhanced Indexation)	FTSE AW Europe ex UK	+0.5%
SSgA	Pacific inc. Japan Equities (Enhanced Indexation)	FTSE AW Dev Asia Pacific	+0.5%
Genesis	Emerging Market Equities	MSCI EM IMI TR	-
MAN	Fund of Hedge Funds	3M LIBOR + 5.75%	-
Signet	Fund of Hedge Funds	3M LIBOR + 3%	-
Stenham	Fund of Hedge Funds	3M LIBOR + 3%	-
Gottex	Fund of Hedge Funds	3M LIBOR + 3%	-
BlackRock	Passive Multi-asset	In line with customised benchmarks using monthly mean fund weights	0%
BlackRock	Overseas Property	Customised benchmarks using monthly mean fund weights	0%
RLAM	UK Corporate Bond Fund	iBoxx £ non-Gilts all maturities	+0.8%
Schroder	UK Property	IPD UK pooled	+1.0%
Partners	Global Property	IPD Global pooled	+2.0%
Cash	Internally Managed	7 day LIBID	

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