Avon Pension Fund

Review for period to 30 June 2013

Contents

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1 Executive Summary

This report is produced by JLT Employee Benefits ("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 an improvement in the funding level by around 5% over the second quarter of 2013.
- The drivers of this were:
  - A sharp rise in the discount rate assumption used to project the liabilities. This reduces the value placed on future pension payments and hence decreases the value placed on the liabilities, all else being equal.
  - This improvement was despite a small negative return from the assets, in particular from emerging market equities and bonds.

Fund performance

- The value of the Fund's assets decreased by £36m over the second quarter of 2013 to £3,099m. However the total Fund (including the impact of currency hedging) outperformed the Fund's strategic benchmark over the quarter by 0.2%, producing an absolute return of -1.0%.

Strategy

- Equity markets paused over the last quarter following two very strong quarters. Japan was once again the best performer at 4.5%, with emerging markets equities producing a negative return of -7.5%. Over the last twelve months, European and Japanese equities produced the highest returns (of 26.7% and 26.3%), with emerging market equities trailing at 7.2%.
- The three year equity returns were well ahead of the assumed strategic return. The three-year figure includes the very strong markets towards the end of 2010, which will be the next to fall out of the analysis.
- Both the three year nominal and index-linked bond returns were lower than at 31 March but continued to exceed their assumed strategic returns. This was a result of falling bond yields, particularly during 2011, although yields began to rise over the most recent quarter.
- Overseas Fixed Interest remained below the assumed strategy return, affected by rising yields within European bonds.
- Both Hedge funds and Property remain below their assumed strategic returns but there has been some further improvement over the last quarter.

Managers

- In line with general market returns, the absolute manager returns have been mixed over the last quarter. The UK, European and global equity funds saw small rises, with the SSgA Pacific and Genesis funds falling in value. Apart from Genesis (at -7.1%), all of the manager returns were in a narrow range between -2.6% and 1.9%.
- 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 5.8% above the benchmark. TT's three year performance has improved again to 1.7% p.a. above their benchmark, but this is below their target of +3-4% p.a. above the benchmark.
- All managers apart from TT and the four fund-of-hedge funds outperformed their 3-year targets.
- Both the SSgA Europe ex UK and Pacific incl Japan enhanced equity pooled funds are now at a size such that Avon's investment now represents almost all of the pooled fund holdings. However, the Panel has previously concluded that the funds could be sustained even if the Avon Pension Fund was the only investor.
- 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. Officers will continue to monitor the impact of the changes made.

Key points for consideration

- The results of the Fund's recent strategic review should be taken into account before making any manager or asset allocation changes.
- Performance of the SSgA Europe ex UK Enhanced Equity Fund does not appear to have been affected by its reduction in size.
- In June 2013 Signet announced that they have agreed to sell their Fund of Hedge Funds business to Morgan Creek Capital Management, a US based alternatives manager with $7bn under management. The deal is still subject to regulatory approval and some consolidation within the hedge fund industry is to be expected. This deal appears to be a complimentary fit as it gives Morgan Creek access to Signet's fixed income team, and will continue to be monitored.
- The Global Fixed Income team relevant to the Avon Pension Fund is not changing.

2 Market Background

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

Market Statistics

Yields as at 30 June 2013	% p.a.
UK Equities	3.53
UK Gilts (>15 yrs)	3.43
Real Yield (>5 yrs ILG)	-0.03
Corporate Bonds (>15 yrs AA)	4.52
Non-Gilts (>15 yrs)	4.67

Absolute Change in Yields	3 Mths %	1 Year %	3 Years %
UK Equities	0.18	-0.16	0.19
UK Gilts (>15 yrs)	0.41	0.51	-0.71
Index-Linked Gilts (>5 yrs)	0.40	0.07	-0.70
Corporate Bonds (>15 yrs AA)	0.46	0.27	-0.80
Non-Gilts (>15 yrs)	0.44	0.05	-0.72

Market Returns Bond Assets	3 Mths %	1 Year %	3 Years % p.a.
UK Gilts (>15 yrs)	-5.9	-4.6	7.8
Index-Linked Gilts (>5 yrs)	-7.4	2.7	9.6
Corporate Bonds (>15 yrs AA)	-4.6	1.2	7.4
Non-Gilts (>15 yrs)	-4.3	4.4	7.9

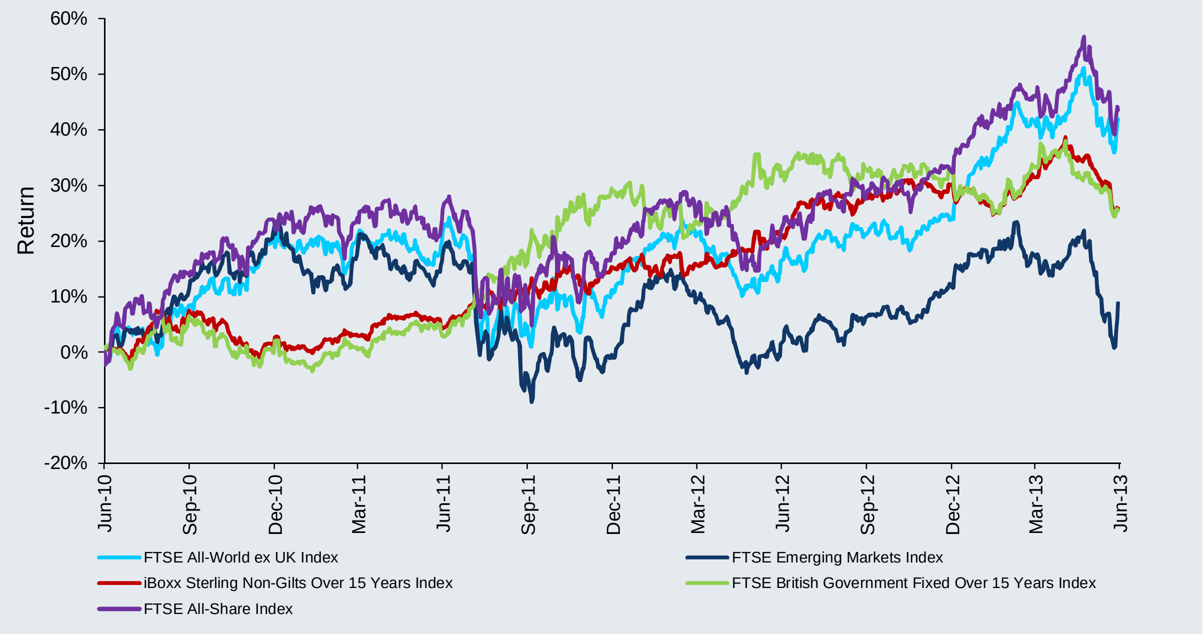
Source: Thomson Reuters and Bloomberg

Market Returns Growth Assets	3 Mths %	1 Year %	3 Years % p.a.
UK Equities	-1.7	17.9	12.8
Overseas Equities	0.1	21.9	12.4
USA	3.0	24.9	17.9
Europe	0.4	26.7	9.4
Japan	4.5	26.3	8.2
Asia Pacific (ex Japan)	-7.4	13.4	7.1
Emerging Markets	-7.5	7.2	2.8
Property	1.9	4.1	6.0
Hedge Funds	0.2	9.5	6.7
Commodities	-5.8	5.5	4.3
High Yield	-1.2	15.0	10.5
Emerging Market Debt	-5.6	1.1	7.3
Senior Secured Loans	1.3	8.7	6.4
Cash	0.1	0.4	0.5

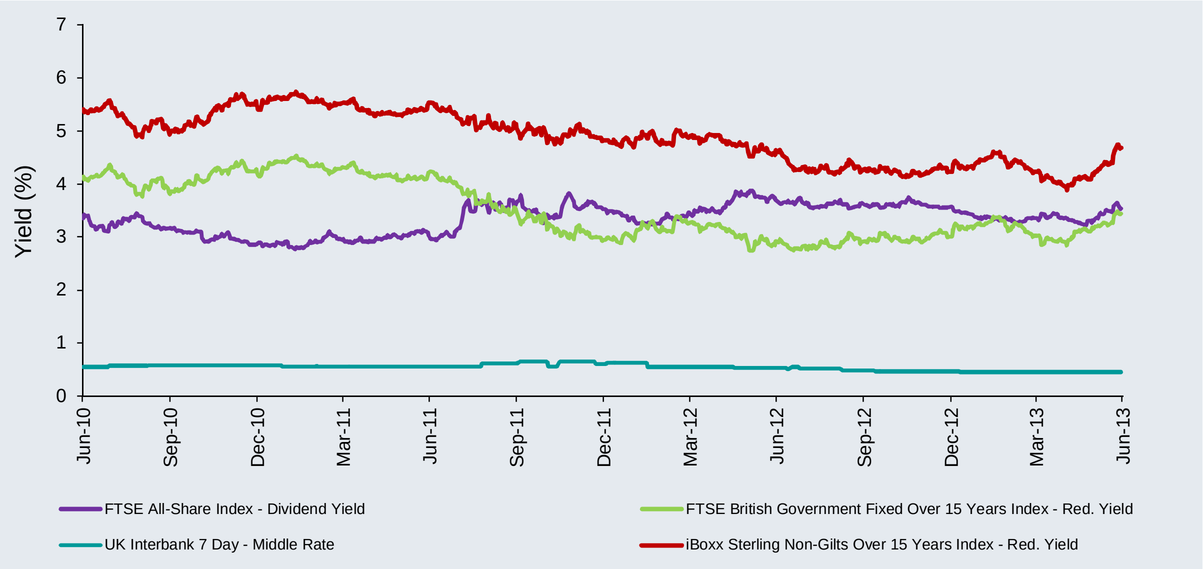
Change in Sterling	3 Mths %	1 Year %	3 Years % p.a.
Against US Dollar	-0.1	-3.3	0.5
Against Euro	-1.3	-5.6	-1.5
Against Yen	5.5	20.4	4.4

Inflation Indices	3 Mths %	1 Year %	3 Years % p.a.
Price Inflation - RPI	0.4	3.3	3.7
Price Inflation - CPI	0.2	2.9	3.2
Earnings Inflation	1.0	0.9	1.7

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 2011 and 2012 shows falling gilt and corporate bond yields, whilst there has been a rise over the second quarter of 2013.

The table below compares general market returns (i.e. not achieved Fund returns) to 30 June 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	12.8	Well ahead of the assumed strategic return following strong returns throughout the period apart from mid-2011. Returns were particularly strong towards the end of 2010, which will fall out of the analysis in the coming quarters.
Global Equities	8.4	12.4	
UK Gilts	4.7	7.8	Significantly ahead of the assumed strategic return as gilt yields fell significantly during 2011. However the returns are lower than in the previous report as gilt yields have begun to rise over the most recent quarter.
Index Linked Gilts	5.1	9.6	
UK Corporate Bonds	5.6	6.9	
Overseas Fixed Interest	5.6	2.3	Behind the assumed strategic return, affected by rising yields within European bonds.
Fund of Hedge Funds	6.6	2.9	Behind the assumed strategic return following a negative return in 2011. More recent returns have been steady and an improvement on 2011, with return over the last twelve months being 6.9%. Low LIBOR levels could lead to continued low performance.
Property	7.4	6.0	This remains behind the assumed strategic return, although there have been some signs of a potential recovery during 2013.

Source: Statement of Investment Principles, Thomson Reuters.

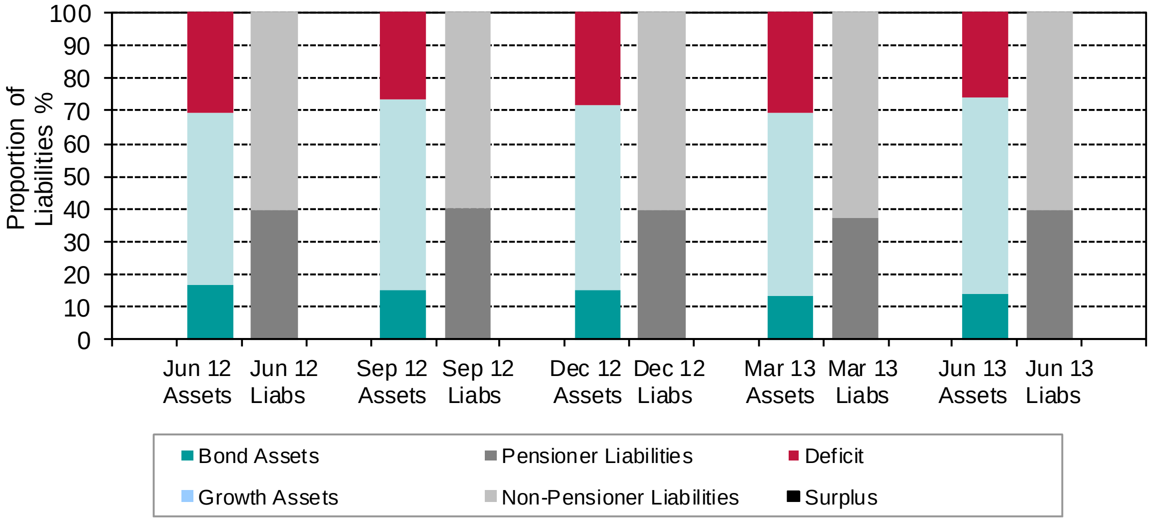
See appendix A for economic data and commentary.

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

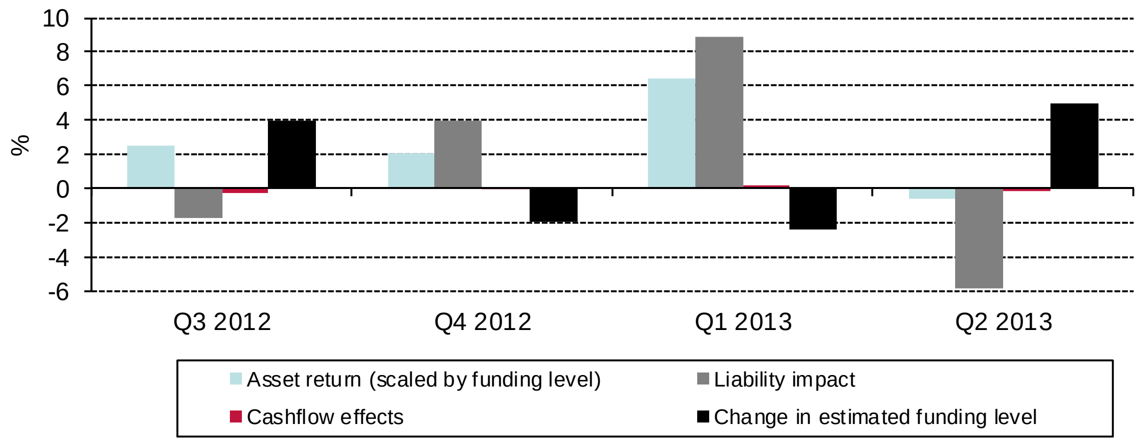
- The chart below shows the allocation of the Fund to Bond and Growth assets against the estimated liability split, which is based on changes in gilt yields underlying the Scheme Actuary's calculation of liabilities. The reference yield used for the liabilities is the Mercer Gilt yield (see appendix 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 increased by around 5% over the second quarter of 2013, all else being equal. This was driven by:
  - » A sharp rise in the discount rate assumption used to project the liabilities. This reduces the value placed on future pension payments and hence decreases the value placed on the liabilities, all else being equal.
  - » This improvement was despite a small negative return from the assets, in particular from emerging market equities and bonds.
- At the valuation date, 31 March 2010, the Scheme was 82% funded. Since then financial market movements, actual cashflows, and investment returns are expected to have reduced the overall funding level, all else being equal. Most of the deterioration came in the second half of 2011, when bond yields fell sharply, but there has been some correction of this impact over the last quarter.

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.

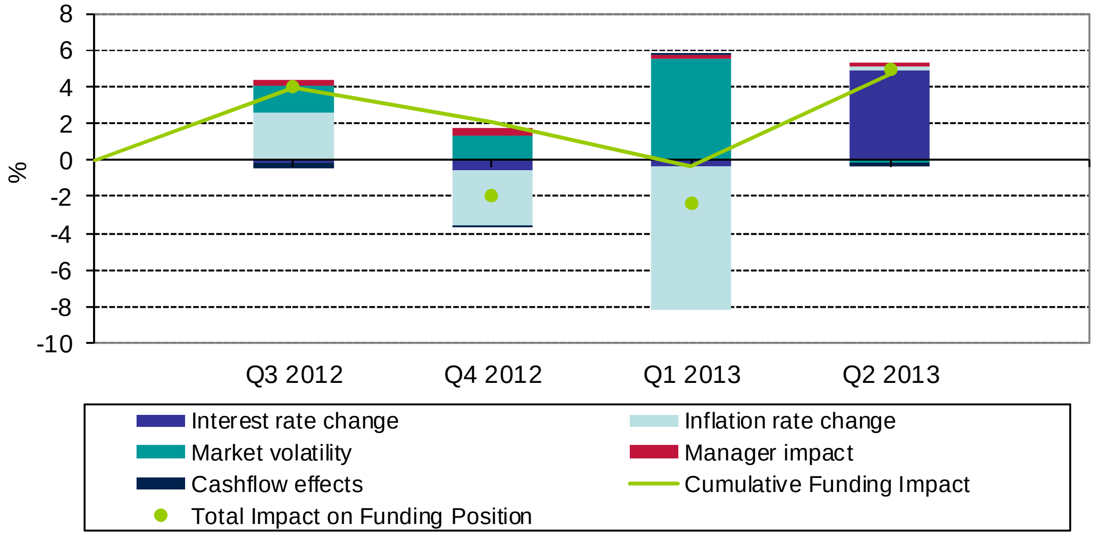


Note : A decrease in liabilities and an increase in assets improves the funding level and vice-versa.

- The graph above shows that the Fund's assets, scaled to take into account the estimated funding level, have produced an absolute return of -0.7%, over the last quarter.
- The value placed on the liabilities decreased by 5.8% mainly due to an increase in the Actuary's discount rate assumption.
- Overall, the combined effect has led to an increase in the estimated funding level to 74% (from 69% at 31/03/2013).

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.



- The main impact over the last quarter has been 'interest rate change', which reflects the effect of the difference in the duration of the liabilities compared to the assets. As the liabilities have a longer duration than the assets, when yields rise (as in Q2 2013), this has a positive impact.
- The Market Implied (RPI) inflation assumption remained unchanged at 3.6% p.a. over the quarter. This gives an almost zero contribution - the small positive contribution on the chart is the 'experience' effect for the quarter due to actual national earnings inflation being lower than the absolute level assumed in the actuarial valuation.
- 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 had a very small negative impact over the quarter as, overall, markets were reasonably flat.
- '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 investment factors (i.e. all the factors included in the chart above) have had a positive impact on the estimated funding level of the Fund over the last quarter.
- Over the last twelve months, the investment factors have had a positive effect mainly due to the 'interest rate change' effect over the last quarter and generally rising markets (the 'market volatility' bars). There was also a contribution from the managers' outperformance. The main detractor was the increase in the inflation assumption during the first quarter of 2013.

4 Fund Valuations

The table below shows the asset allocation of the Fund as at 30 June 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	30 June 2013 Value £'000	Proportion of Total %	Strategic Benchmark Weight %
UK Equities	629,591	20.3	18.0
Overseas Equities	1,380,640	44.6	42.0
Bonds	580,204	18.7	20.0
Fund of Hedge Funds	220,407	7.1	10.0
Cash (including currency instruments)	51,222	1.7	-
Property	237,079	7.6	10.0
TOTAL FUND VALUE	**3,099,143**	**100.0**	**100.0**

Source: Data provided by WM Performance Services

- The value of the Fund's assets decreased by £36m over the second quarter of 2013 to £3,099m. Each asset class (except for Property) contributed to the fall with the majority (£31m) coming from bonds.
- In terms of the asset allocation, market movements resulted in a shift away from bonds and towards property and overseas equities as bonds produced a return of around -5%. This moved the bond allocation further away from the strategic benchmark weight but the property allocation closer.
- The Fund remains overweight in equities and underweight in bonds, hedge funds and property.
- The valuation of the investment with each manager is provided on the following page.

Manager	Asset Class	31 March 2013 Value £'000	31 March 2013 Proportion of Total %	Net new money £'000	30 June 2013 Value £'000	30 June 2013 Proportion of Total %
Jupiter	UK Equities	139,815	4.5	-	140,717	4.5
TT International	UK Equities	162,741	5.2	-	163,649	5.3
Invesco	Global ex-UK Equities	218,121	7.0	-	221,159	7.1
Schroder	Global Equities	199,613	6.4	-	201,966	6.5
SSgA	Europe ex-UK Equities and Pacific incl. Japan Equities	103,009	3.3	-	101,947	3.3
Genesis	Emerging Market Equities	158,436	5.1	-	147,236	4.8
MAN	Fund of Hedge Funds	63,955	2.0	-	64,160	2.1
Signet	Fund of Hedge Funds	67,197	2.1	-	65,478	2.1
Stenham	Fund of Hedge Funds	34,937	1.1	-	35,591	1.1
Gottex	Fund of Hedge Funds	55,059	1.8	-	55,178	1.8
BlackRock	Passive Multi-asset	1,446,466	46.1	1,000	1,418,832	45.8
BlackRock (property fund)	Equities, Futures, Bonds, Cash (held for property inv)	60,652	1.9	-4,800	55,380	1.8
RLAM	Bonds	176,526	5.6	-	171,978	5.5
Schroder	UK Property	132,500	4.2	-	135,421	4.4
Partners	Property	95,729	3.1	3,800	104,279	3.4
Record Currency Mgmt	Dynamic Currency Hedging	-3,117	-0.1	-	-3,609	-0.1
Record Currency Mgmt 2	Overseas Equities (to fund currency hedge)	7,955	0.3	-	6,832	0.2
Internal Cash	Cash	15,836	0.5	-	12,949	0.4
Rounding		-1	-0.1	-	-	-
TOTAL		**3,135,429**	**100.0**	**0**	**3,099,143**	**100.0**

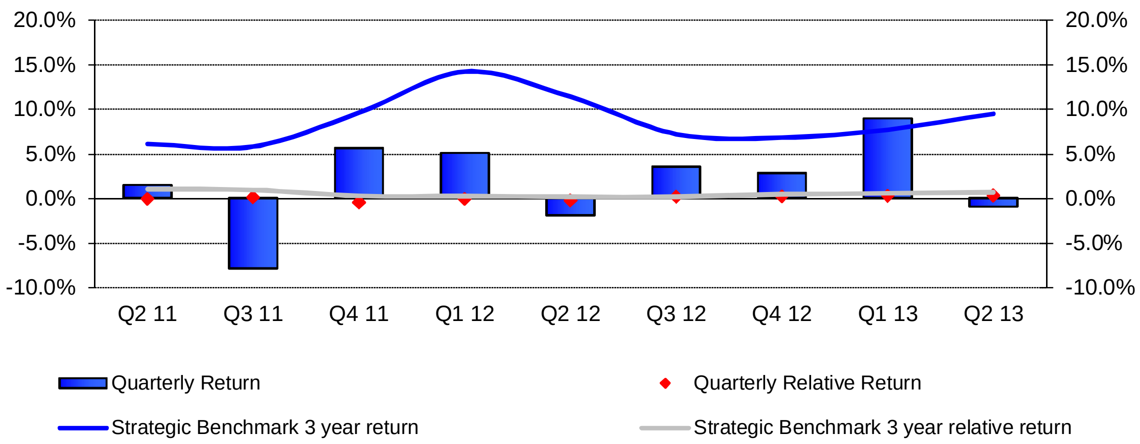
Source: Avon Pension Fund Data provided by WM Performance Services

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)	-1.0	14.9	N/a
Total Fund (ex currency hedge)	-0.9	14.9	10.4
Strategic Benchmark	-1.2	12.8	9.5
Relative (inc currency hedge)	+0.2	+1.9	N/a
Relative (ex currency hedge)	+0.3	+1.8	+0.8

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 30 June 2013.

Asset Class	Weight in Strategic Benchmark	Index returns	Contribution to total benchmark	Index returns	Contribution to total benchmark
		Q2 2013	(quarter)	1 year	(1 year)
UK Equities	18%	-1.7%	-0.3%	17.9%	3.2%
Overseas Equities	42%	-0.7%	-0.3%	20.9%	8.8%
Index Linked Gilts	6%	-7.3%	-0.4%	2.7%	0.2%
Fixed Coupon Gilts	6%	-5.9%	-0.4%	-4.7%	-0.3%
UK Corporate Bonds	5%	-2.9%	-0.1%	6.5%	0.3%
Overseas Fixed Interest	3%	-2.9%	-0.1%	-1.7%	-0.0%
Fund of Hedge Funds	10%	2.1%	0.2%	6.6%	0.7%
Property	10%	1.4%	0.1%	2.2%	0.2%
Total Fund	100%				

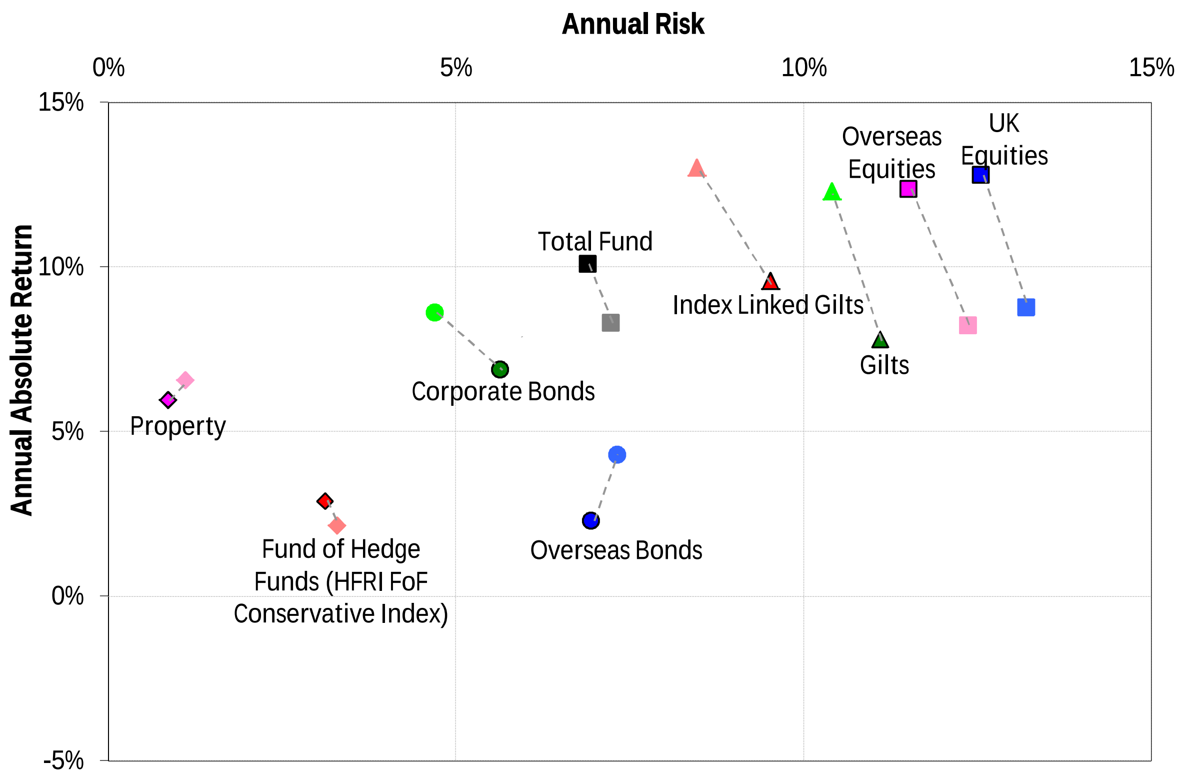
- **Market impact:** After a strong start to the quarter, global equities fell in June following the suggestion that US Quantitative Easing would be reduced if their economy continued to recover.
- Asia Pacific and emerging market equities were affected by the strength of the US Dollar, which reduced the competitiveness of these economies. These regions were also affected by weak Chinese economic data.
- Both Government and corporate bond markets were affected by rises in gilt yields. There has been a reduction in corporate bond spreads, meaning that corporate bonds performed better than gilts.
- The property market has been driven by improving rental yields. House prices have risen across the country, particularly in London.
- **Strategic Benchmark:** Over the quarter, performance of the strategic benchmark was driven by a small negative contribution from most asset classes. Over the year, equities made the largest contribution, with overseas equities, which make up the bulk of the benchmark allocation, providing the largest driver to the benchmark.
- 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 June 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 18.

3 Year Risk v 3 Year Return to 30 June 2013

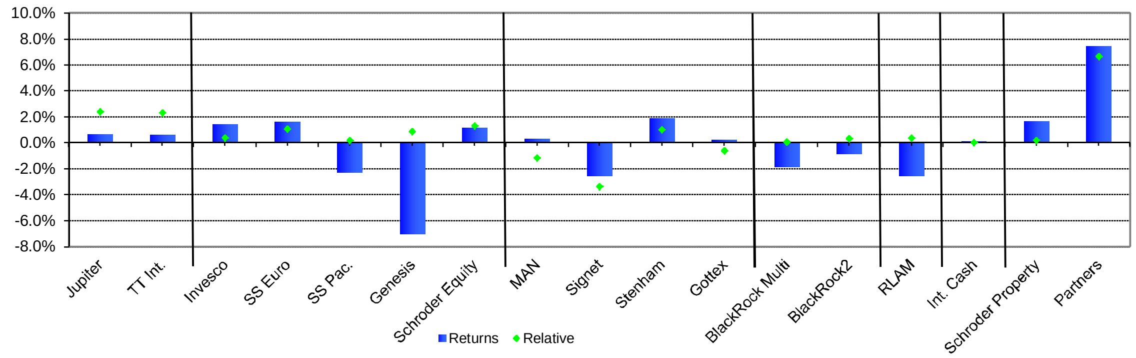


- All of the underlying benchmarks have produced a positive return over the period (3 years p.a.).
- 3-year equity returns increased by 4% p.a. to over 12% p.a. as the sharp falls of Q2 2010 fell out of the analysis. This was also despite a slight fall in UK equities over the last quarter.
- The Property return continued to fall, although not as sharply as in previous quarters as returns begin to show some improvement.
- Hedge funds continue to produce a steady, albeit low, return, with returns stabilising over the last year.
- Both gilt and index-linked gilt 3-year returns fell as yields rose over the last quarter and led to negative quarterly returns. Corporate Bond and Overseas Bond returns were also affected by yield rises.
- In terms of risk, the 3-year equity volatility decreased as negative Q2 2010 returns were replaced by more steady returns, with the opposite occurring for Gilts, Index-linked Gilts and Corporate Bonds.
- The three-year return on equities, gilts, index-linked gilts and corporate bonds are above their assumed strategic return. Property, overseas fixed interest and hedge funds remain below their assumed strategic return.

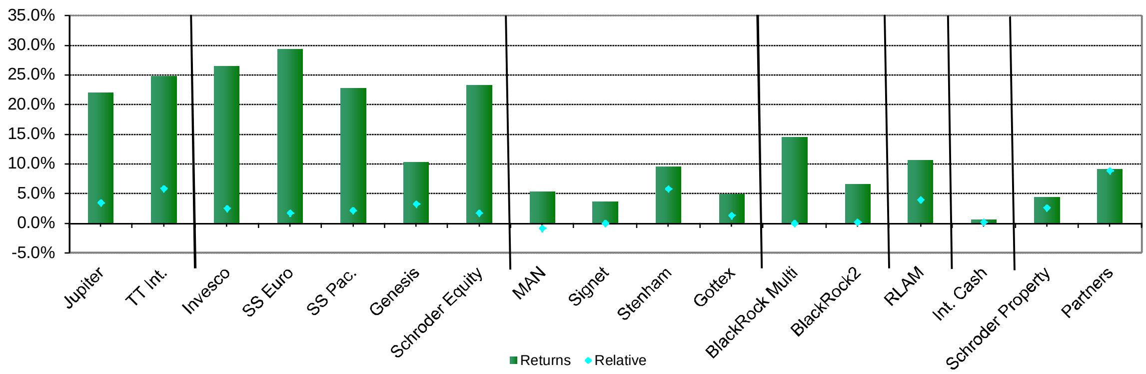
Aggregate manager performance

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

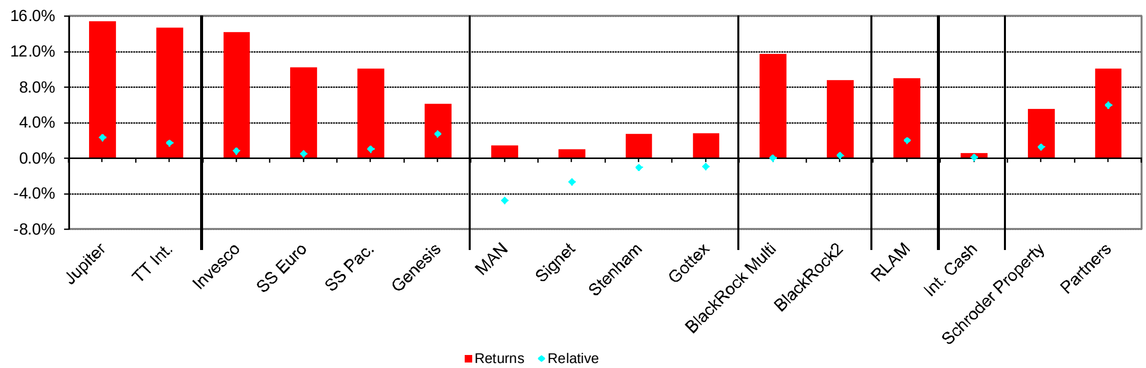
Absolute and relative performance - **Quarter to 30 June 2013**



Absolute and relative performance - **Year to 30 June 2013**



Absolute and relative performance – **3 years to 30 June 2013**



Source: Data provided by WM Performance Services

Partners returns are lagged by 1 quarter.

The table below shows the relative returns of each of the funds over the quarter, one year and three years to the end of June 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.

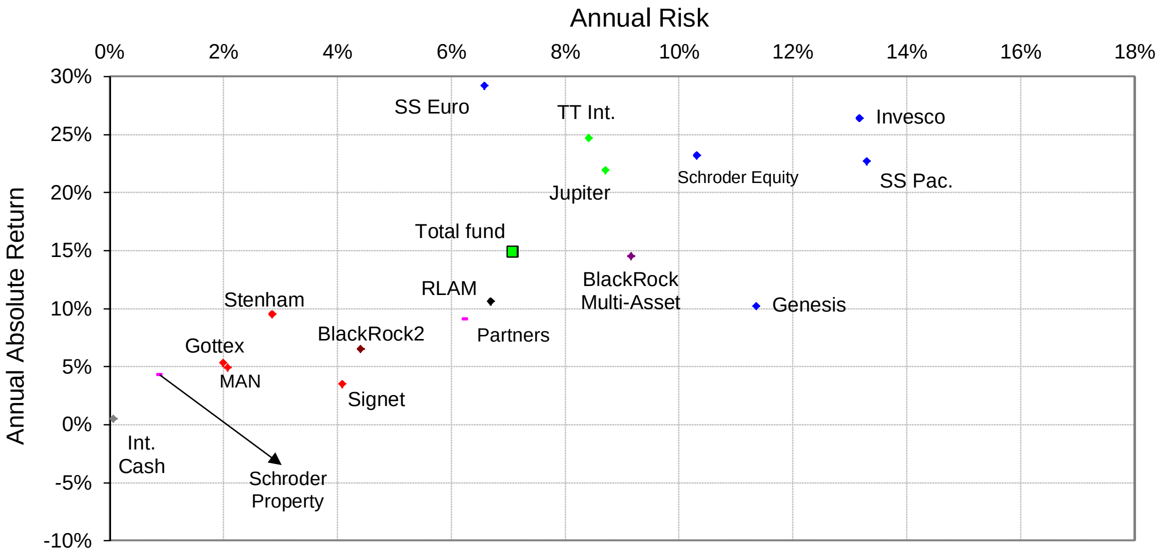
Manager / fund	3 months (%)	1 year (%)	3 years (% p.a.)	3 year performance versus target
Jupiter	+2.3	+3.4	+2.3	Target met
TT International	+2.3	+5.8	+1.7	Target not met
Invesco	+0.3	+2.4	+0.8	Target met
SSgA Europe	+1.0	+1.7	+0.5	Target met
SSgA Pacific	+0.2	+2.1	+1.0	Target met
Genesis	+0.8	+3.2	+2.7	Target met
Schroder Equity	+1.3	+1.7	N/A	N/A
Man	-1.2	-0.9	-4.8	Target not met
Signet	-3.4	-0.1	-2.7	Target not met
Stenham	+1.0	+5.7	-1.1	Target not met
Gottex	-0.6	+1.3	-1.0	Target not met
BlackRock Multi - Asset	0.0	-0.1	0.0	Target met
BlackRock 2	+0.3	+0.1	+0.3	Target met
RLAM	+0.3	+3.8	+2.0	Target met
Internal Cash	0.0	+0.1	+0.1	N/A
Schroder Property	+0.2	+2.6	+1.2	Target met
Partners Property	+6.6	+8.8	+6.0	Target met

Source: Data provided by WM Performance Services

Manager and Total Fund risk v return

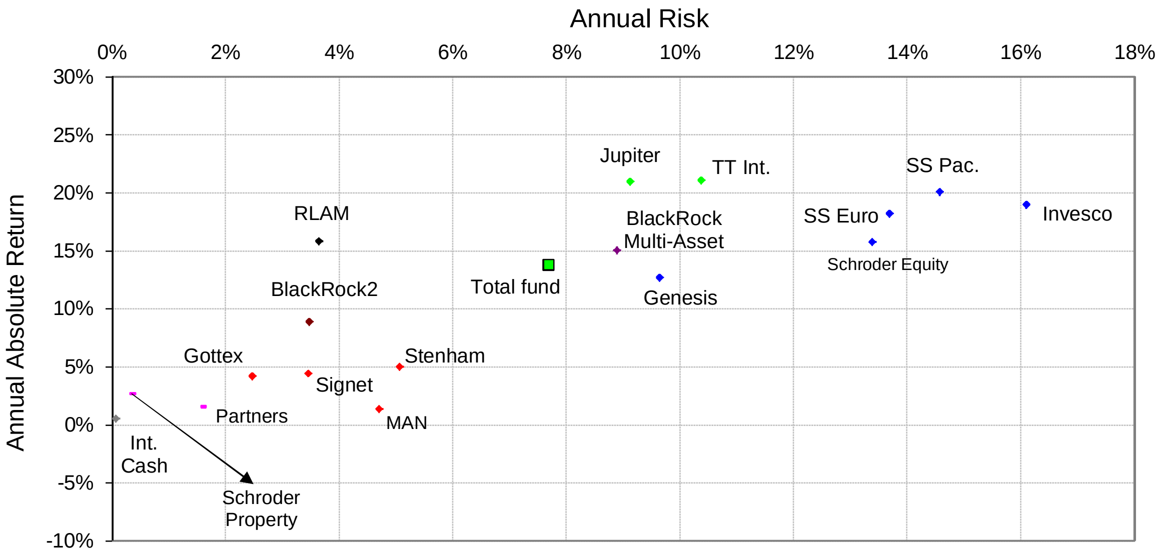
The chart below shows the 1 year absolute return ("Annual Absolute Return") against the 1 year volatility of absolute returns ("Annual Risk"), based on monthly/quarterly (as available) data points in sterling terms, to the end of June 2013 of each of the funds. We also show the same chart, but with data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

1 Year Risk v 1 Year Return to 30 June 2013



Source: Data provided by WM Performance Services

1 Year Risk v 1 Year Return to 31 March 2013

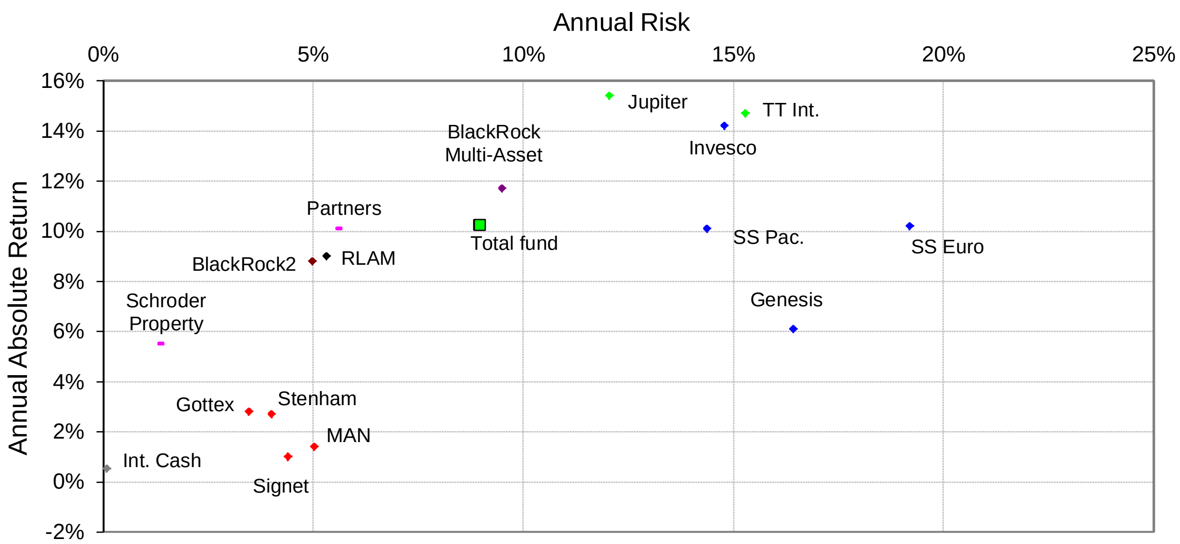


Source: Data provided by WM Performance Services

- 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 of each of the developed equity managers have risen to above 20%, with the risk falling. Conversely, the return of the emerging equity manager, Genesis, has fallen from 12.6% to 10.2%, with its risk increasing.
- Stenham have seen their one-year returns significantly increase following the changes made in December 2012.
- RLAM's one-year return has fallen from 15.7% to 10.6%.

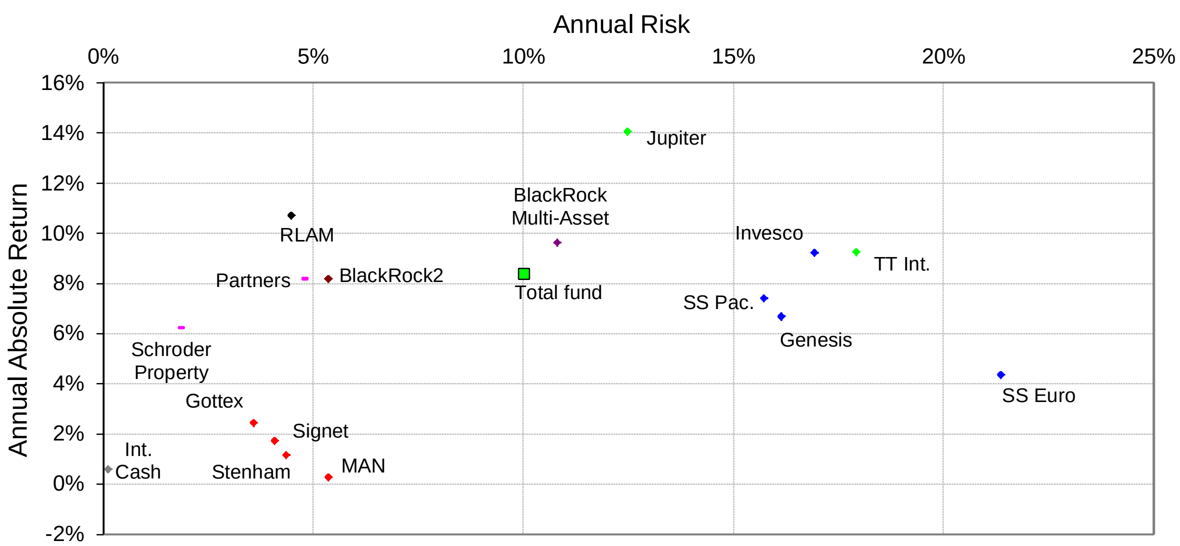
The chart below shows the 3 year absolute return ("Annual Absolute Return") against the 3 year volatility of absolute returns ("Annual Risk"), based on monthly/quarterly (as available) data points in sterling terms, to the end of June 2013 of each of the funds. We also show the same chart, but with data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

3 Year Risk v 3 Year Return to 30 June 2013



Source: Data provided by WM Performance Services

3 Year Risk v 3 Year Return to 31 March 2013



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 change in the three-year chart since last quarter is similar to that seen in the one-year chart.
- The three-year return from the developed equity managers has improved, with risk reducing, whereas Genesis's return has reduced and risk increased.
- RLAM's three-year return has decreased from 10.7% p.a. to 9.0% p.a.
- Three-year returns from the hedge fund managers have improved apart from Signet.
- The 3-year risk figures have remained at a broadly consistent level for non-equity returns. 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 13.

Conclusion

- The strongest returns over the 1 year period are from equity funds, Blackrock Multi-asset and corporate bonds (RLAM). Each of these produced a double-digit return.
- Over three years, the best performer remains Jupiter at 15.4% p.a., closely followed by TT and Invesco. Whilst the hedge fund returns improved, they were still the lowest at 1-3% p.a.
- The Fund of Hedge Fund and property managers have provided low volatility over both the 1 and 3 year period. However, over the longer 3 year period they have each underperformed their assumed strategic return. Each of the equity-based funds has outperformed the assumed strategic return over 3 years.

Appendix 1: Market Events

<table>
<tr><th rowspan="2">Asset Class</th><th colspan="2">What happened?</th></tr>
<tr><th>Positive Factors</th><th>Negative Factors</th></tr>
<tr><td>UK Equities</td><td>Comments from the new Governor of the Bank of England (BOE), suggests that he is more concerned about stimulating economic growth rather than bringing the rate of CPI inflation down to the target level of 2%.
UK Equities do not look expensive by historical standards, especially after the fall in prices in June, and dividend yields compare favourably with the yield on gilts.
UK corporate earnings and dividends are still rising, in particular those of 'blue chip' companies. The low level of interest rates and the recent improvement in GDP figures also benefited the equity market.
The BOE's £80bn Funding for Lending Scheme (FLS) has been extended to January 2015. This has led to an increase in the availability of mortgage products and a reduction in the interest rate payable for fixed rate mortgages.</td><td>The mere suggestion by the Chairman of the US Federal Reserve that the current level of Quantitative Easing ('QE') would be reduced if the US economy continued to recover (so called 'tapering' of QE) caused a global rapid retreat in equity prices towards the end of the quarter, with the UK equity market falling to a five month low.
Fears surrounding the deteriorating outlook for Chinese GDP growth also weighed on investor sentiment.
The Chancellor's Spending Review, set out further government spending cuts in many sectors of the UK economy.
The FLS has also contributed to the reduction in savings rates as banks become less reliant upon savers to fund their lending activity.</td></tr>
<tr><td colspan="3">Overseas Equities:</td></tr>
<tr><td>North America</td><td>Underpinned by the policy of QE, the S&P 500 index rose to a record high in May and, despite the fall in June, the performance in the first half of 2013, was the best first half performance since 1998.
Assuming the economy continues to grow, equities do not look expensive.
Investors have switched billions of dollars out of cash into bond funds and equity funds on the back of an improvement in sentiment and encouraged by hopes of a sustainable economic recovery.
There has been a significant improvement in the US housing market.</td><td>The Chairman of the US Federal Reserve hinted that there might be a 'tapering' of QE later this year and that QE might come to an end in 2014 with a possible rise in interest rates in 2015.
These comments led to an increase in Treasury bond yields and equity markets experienced a major sell off in June.
Whilst US corporate earnings have been growing, this has often been the result of cost cutting measures and tax changes – revenues in many cases have been static or declining.
US GDP has been adversely affected by a drop in federal spending, suggesting that the cuts could limit future economic growth.</td></tr>
</table>

Asset Class	What happened?	
	Positive Factors	**Negative Factors**
Europe	■ In September, there is a presidential election in Germany and the German Constitutional Court is expected to provide a judgement it is legal for the European Central Bank ('ECB') to buy, without limit, the government bonds of troubled Eurozone countries. ■ In an attempt to boost economic growth, the ECB reduced the Eurozone's interest rate from 0.75% to 0.50%. ■ The Eurozone trade surplus was €14.9bn in April compared with €13.3bn in April 2012. ■ As widely expected, but initially denied, the 'bail out' terms imposed on Cyprus, which included losses for depositors with large cash balances, will become the template for future rescues. ■ Leading indicators and the low level of company inventories suggest that some boost to GDP is likely to arise from re-stocking in the future.	■ The suggestion that US QE might be tapered and concerns regarding a slowdown in China led to a fall in European equity markets. ■ The record high Eurozone unemployment rate of 12% has reduced demand and led to downward pressure on the rate of CPI inflation, which is below the ECB's target rate of 'close to but below 2%'. ■ Mediobanca, Italy's second largest bank, has said that 'Italy is likely to need an EU bailout within six months as the country slides deeper into crisis and a credit crunch spreads to larger companies'. ■ Greece became the first developed country to be cut to Emerging Market status by MSCI.
Japan	■ In his election campaign, the new Japanese prime minister, Mr Abe promised measures to stimulate the economy, measures that have been implemented following the appointment of a new Governor of the Bank Of Japan ('BOJ'). In particular, the BOJ announced that it would pursue a policy of QE amounting to U$1.4 trillion. ■ Contrary to some expectations, money is not flowing out of Japan in search of higher yields (as has happened in the past) and it seems that, at least in part, cash is entering the real economy and the equity market.	■ Similar measures have met with varying degrees of success since the peak of the equity market in December 1989. ■ Although the equity market rose strongly after the announcement of the QE policy, investor confidence and sentiment were adversely affected by poor communications from the BOJ, regarding the new strategy and the reasons for believing that it would be successful in stimulating a lasting economic recovery. QE has led to the Yen appreciating sharply against the Dollar, which will hurt companies that have large export volumes. ■ In common with the other major equity markets, the Japanese equity market fell sharply after the comments on US QE from the US Federal Reserve and on the deteriorating outlook for the Chinese economy.

Asset Class	What happened?	
	Positive Factors	**Negative Factors**
Asia Pacific	■ Many Asian companies, especially those selling to domestic consumers, are continuing to prosper with profits and dividends increasing. Notwithstanding the recent slowing of the Chinese economy, the longer term story for the region, including China, has not changed. ■ A decrease in commodity prices has led to an easing of inflationary pressures in the Asian Pacific region.	■ Recent official Chinese economic statistics have given mixed signals which has led to some analysts becoming concerned that the Chinese economy could slow with severe repercussions for the global economy. ■ The flow of weak Chinese economic data has continued with falling consumer demand likely to lead to lower GDP growth, a squeeze on corporate profits and lower wage growth. ■ China's long term currency rating was cut from AA- to A+ by Fitch. The credit rating agency cited underlying structural weakness in the economy and concerns about a rise in debt levels.
Emerging Markets	■ Emerging Market Equities do not look expensive but could fall further if the US dollar continues to strengthen. Exposure to domestic consumption (and the companies that benefit from it) will be particularly important over the next year when investing in this asset class rather than investing in the index stock weightings.	■ The recent strength of the US Dollar has weakened the competitiveness of Emerging Market economies as their exports are usually priced in Dollars, and many of their currencies are still linked, officially or unofficially to the US Dollar.
Gilts	■ The US Federal Reserve has tried to calm markets by suggesting that ‘tapering’ still depends on the strength of US economic growth and the reduction in the rate of unemployment. ■ Mark Carney took up his appointment as Governor of the BOE on 1 July and seems likely to maintain the current low level of interest rates for some time.	■ No prospect of capital gains in most areas of the fixed income market and every expectation of capital losses over time. Government securities look particularly vulnerable to a rise in yields (fall in price), with the volatility in prices over the past few weeks giving a taste of what might happen.
Index Linked Gilts	■ Fears over rising inflation have underpinned prices.	■ Many stocks offer a negative real yield, which is not appealing to investors.
Corporate Bonds	■ Given the strength of corporate balance sheets and good profitability, the returns available on corporate bonds are attractive relative to those available on gilts.	■ There is a low level of liquidity in this market at present and the reduction in credit spreads over the past few months leaves little room for any further reduction in credit spreads.
Property	■ Rental yields appear to be improving with activity centred around London. ■ Mortgage approvals in the UK rose to a three and a half year high. House prices are rising across the country with the fastest rate of growth seen in London where prices are now 5% above their previous peak.	■ There have been concerns about the increase in the level of voids and a fall in capital values in the Secondary and Tertiary markets.

Economic statistics

	Quarter to 30 June 2013			Year to 30 June 2013		
	UK	Europe[1]	US	UK	Europe[1]	US
Real GDP growth	0.6%	n/a	0.4%	1.4%	n/a	1.4%
Unemployment rate	7.8%	11.2%[4]	7.6%	7.8%	11.2%[4]	7.6%
Previous	*7.9%*	*11.1%*	*7.6%*	*8.1%*	*11.2%*	*8.2%*
Inflation change[2]	0.2%	0.1%	0.3%	2.9%	1.6%	1.8%
Manufacturing Purchasing Managers' Index	52.5	48.8	50.9	52.5	48.8	50.9
Previous	*48.3*	*46.8*	*51.3*	*48.4*	*45.1*	*49.7*
Quantitative Easing / LTRO[3]	£375bn	€1,018bn	$3,284bn	£375bn	€1,018bn	$3,284bn
Previous	*£375bn*	*€1,018bn*	*$3,029bn*	*£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 30 June 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 May 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%
Partners	Global Property	IPD Global pooled	+2%
Cash	Internally Managed	7 day LIBID	

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