Avon Pension Fund

Annual Investment Review to 31 March 2014

Contents

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1 Executive Summary

This report is produced by JLT Employee Benefits ("JLT") to assess the one and three year performance and risks of the investment managers of the Avon Pension Fund (the "Fund"), and of the Fund as a whole.

- Absolute returns – one year
  - Over the year the Fund has not met its strategic return target of 7.2% (based on JLT return expectations), returning 6.6% (5.8% excluding Record)
  - Only UK equities and property outperformed their strategic return assumption.
- Relative returns – one year
  - The Fund return of 5.8% outperformed the benchmark of 4.5% (i.e. if the fund had been invested passively in line with benchmark allocations).
  - This was mainly due to the asset allocation, as the Fund was overweight to developed equities and underweight to emerging market equities. Active management also added value, in particular from UK equities.
- Absolute returns – three years
  - Over 3 years the Fund has outperformed its strategic return target of 7.2% p.a., returning 7.8% p.a. excluding the impact of Record (7.9% p.a. with Record).
  - UK equities and UK bonds (gilts, corporates and index-linked) outperformed their strategic return assumption. Overseas equities, hedge funds, emerging market equity and hedge funds underperformed the strategic return assumption. The Property return of 6.9% p.a was very close to the strategic return assumption of 7.0% p.a.
- Relative returns – three years
  - The three-year benchmark return was 6.5% p.a. Hence the fund outperformed its benchmark by 1.3% p.a., and this outperformance took the Fund return above the assumed strategic return.
  - Over three years, active management in UK and overseas equities were the main contributors to the outperformance. The Fund also benefited from being underweight in hedge funds and property.
- Returns relative to gilts
  - The strategic absolute return assumptions above are derived from the long term expected return from gilts plus the expected outperformance over gilts over the long term from the asset classes within the Fund's strategic benchmark. This is because gilt returns are a key driver in the valuation of the liabilities. It is therefore informative to compare the Fund's returns relative to gilt returns.
  - Over the year, compared to the strategic return assumption relative to gilts, the Fund significantly outperformed its target.
    - Gilts returned -3.1% and therefore the Fund outperformed, returning 6.6% versus the gilts based target of -0.4% (i.e. -3.1% from gilts +2.7% assumed outperformance).
    - Emerging market equities, index-linked gilts and overseas fixed interest underperformed their gilts based targets whilst all other asset classes outperformed.

- Over three years the Fund underperformed its gilts based target, with all asset classes except index-linked gilts (and, obviously gilts) underperforming their assumed target return relative to gilts.
  - The Fund returned 7.9% p.a. versus a gilts based target of 11.4% p.a.
  - This is driven by the unusually high returns from gilts, which returned 8.7% p.a. over the past three years compared to a long term assumed return of 4.5% p.a.
- It should be noted that the changes in strategy agreed in 2011 have meant the assumed return above gilts going forward will be +2.8% p.a.

- Risk
  - The three-year volatility of each asset class (as measured by the standard deviation of monthly return) has remained broadly stable compared to the same measure 12 months ago.
  - There has been a small fall in the volatility of gilts and developed equities as uncertainty over the European Sovereign Debt crisis has reduced over the period, and the Japanese earthquake disaster which caused volatility in early 2011 is now not part of the three year figures.
- Currency
  - The impact of currency movements adds to the volatility of the Fund's assets. The dynamic currency hedge has reduced this volatility and added value compared to having an unhedged portfolio.
- Funding level
  - Over the past twelve months, there is an estimated improvement in the funding level driven by investment returns and manager outperformance.

Conclusions

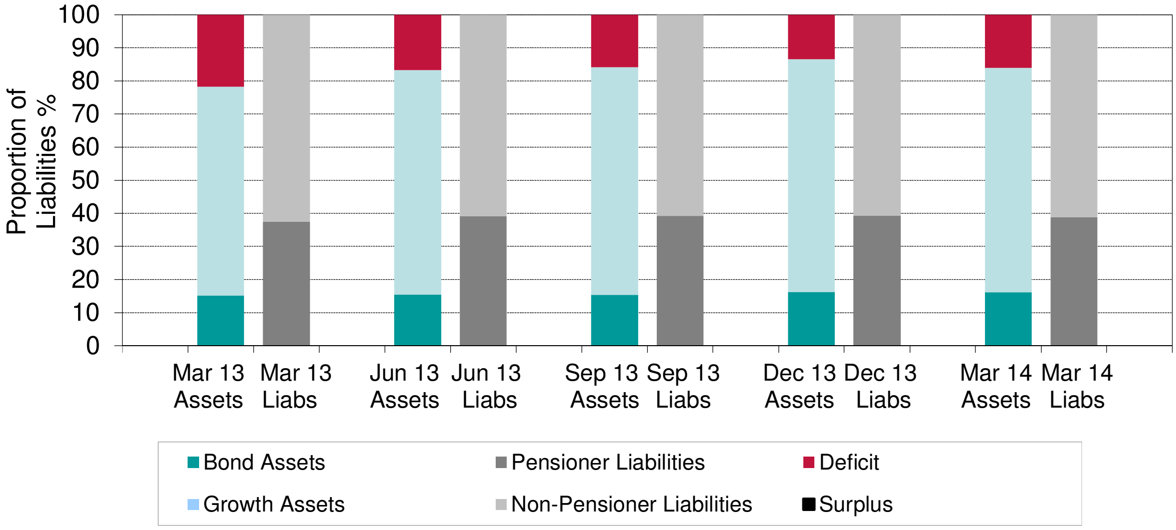
- Over twelve months, the strategy has underperformed the absolute strategic assumption but significantly outperformed relative to the 2.7% outperformance assumption over gilts.
- Over three years, the Fund has delivered the assumed strategic return due to outperformance from both active management and from asset allocation, but it underperformed relative to the gilts based target.
- We believe the strategy is well positioned to deliver the required return relative to gilts going forward:
  - The new allocations to diversified growth and infrastructure offer diversification relative to equities following a period of strong equity returns
  - Gilt returns are expected to be below their long term absolute assumed return in an environment of rising interest rates
- We expect that absolute returns may continue to be below the absolute assumed strategic return whilst interest rates and yields remain below their long term average. However we do not consider this to require a change in strategy.

2 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

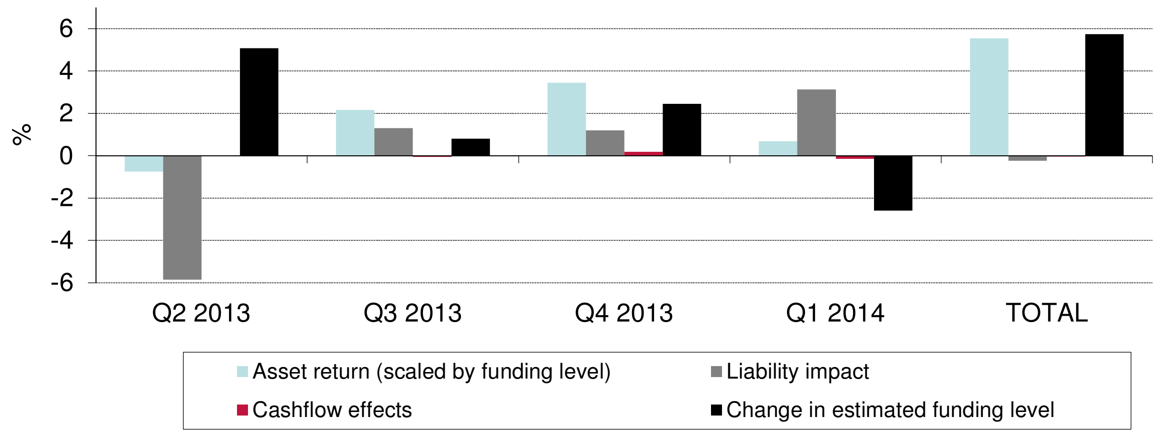
- The chart below shows the allocation of the Fund to Bond and Growth assets against the estimated liability split, which is based on changes in gilt yields underlying the Scheme Actuary's calculation of liabilities. The reference yield used for the liabilities is the Mercer Gilt yield. The liability benchmark is based on the valuation results from 31 March 2013.
- 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 approximately 6% over the year, all else being equal. This was driven by:
  - A positive asset return, following positive returns from nearly all portfolios, in particular from the developed equity funds and property. Part of this contribution came from most managers' outperformance above their benchmarks.
  - A smaller positive effect from the liabilities, as the interest rate used to value the liabilities slightly increased over the year, reducing the value placed on liabilities.
- At the valuation date, 31 March 2013, the Scheme was 78% funded. Since then financial market movements, actual cashflows, and investment returns are expected to have increased the overall funding level to 84%.

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.

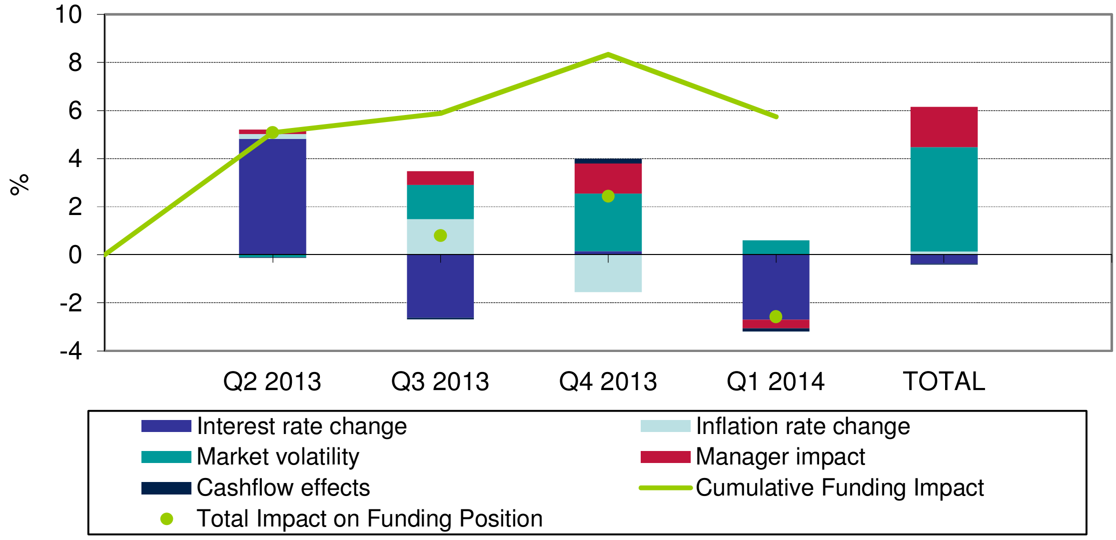


Note : A decrease in liabilities and an increase in assets improves the funding level and vice-versa.

- The graph above shows that the Fund's assets, scaled to take into account the estimated funding level, have produced an absolute return of 5.5% over the year, following positive returns in the last three quarters. Of this return, 1.7% was due to outperformance above the benchmark.
- The value placed on the liabilities increased by an estimated 0.2% over the year as rising yields, particularly in Q2 2013, offset the majority of the impact of the unwinding of the discount rate.
- Overall, the combined effect has led to an increase in the estimated funding level by 6%, from 78% to 84%, over the year.

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 rise, this has a positive impact, as in Q2 2013. Over the year, the rise in yields in the first quarter was offset by the unwinding of the liabilities in subsequent quarters, giving a negligible 'interest rate change' effect.
- The Market Implied (RPI) inflation was unchanged over the year, having decreased in Q3 2013 only to increase again in Q4 2013. This gives a negligible contribution for the year.
- 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 positive impact over the year, mainly due to equity markets posting positive returns.
- 'Manager impact' is the investment performance compared to the strategic benchmark. This was positive over the year as most portfolios outperformed their respective benchmarks, and also due to the positive impact of currency hedging.
- The small 'cashflow effects' reflect factors such as pension payments, contributions and disinvestments.
- Overall the investment factors are estimated to have had a positive impact on the estimated funding level of the Fund over the year.

3 Fund Valuations

Manager	Asset Class	31 March 2013 Value £'000	31 March 2013 Proportion of Total %	Net new money £'000	31 March 2014 Value £'000	31 March 2014 Proportion of Total %
Jupiter	UK Equities	139,815	4.5	-	160,880	4.8
TT International	UK Equities	162,741	5.2	-	185,267	5.6
Invesco	Global ex-UK Equities	218,121	7.0	-	239,795	7.2
Schroder	Global Equities	199,613	6.4	-	214,480	6.4
SSgA	Europe ex-UK Equities and Pacific incl. Japan Equities	103,009	3.3	-	107,146	3.2
Genesis	Emerging Market Equities	158,436	5.1	-	145,088	4.4
MAN	Fund of Hedge Funds	63,955	2.0	-61,898	1,115	0.0
Signet	Fund of Hedge Funds	67,197	2.1	-	66,155	2.0
Stenham	Fund of Hedge Funds	34,937	1.1	-	37,654	1.1
Gottex	Fund of Hedge Funds	55,059	1.8	-	58,062	1.7
BlackRock	Passive Multi-asset	1,446,466	46.1	-462,075	1,026,945	30.9
BlackRock (property fund)	Equities, Futures, Bonds, Cash (held for property inv)	60,652	1.9	-16,600	45,643	1.4
RLAM	Bonds	176,526	5.6	45,000	249,851	7.5
Schroder	UK Property	132,500	4.2	-	150,249	4.5
Partners	Property	95,729	3.1	11,100	112,058	3.4
Record Currency Mgmt	Dynamic Currency Hedging	-3,117	-0.1	-	12,044	0.4
Record Currency Mgmt 2	Overseas Equities (to fund currency hedge)	7,955	0.3	-	15,988	0.5
Pyrford	DGF	-	-	105,000	104,542	3.1
Barings	DGF	-	-	210,000	209,798	6.3
Unigestion	Emerging Market Equities	-	-	165,000	166,687	5.0
Internal Cash	Cash	15,836	0.8	4,473	20,915	0.6
Rounding		-1	-	-	-	-
TOTAL		**3,135,429**	**100.0**	**0**	**3,330,362**	**100.0**

Source: Avon Pension Fund Data provided by WM Performance Services

The table below shows the asset allocation of the Fund as at 31 March 2014, 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 Mar 2013 Value £'000	Strategic Benchmark Weight %	31 Mar 2014 Value £'000	31 Mar 2014 Proportion of Total %	Strategic Benchmark Weight %
Developed Market Equities	1,866,365	60.0*	1,567,935	47.1	40.0
Emerging Market Equities	158,436	-	311,776	9.4	10.0
Diversified Growth Funds	-	-	314,340	9.4	10.0
Bonds	611,590	20.0	640,599	19.2	20.0
Fund of Hedge Funds	221,147	10.0	162,986	4.9	5.0
Infrastructure	-	-	-	-	5.0
Cash (including currency instruments)	55,550	-	71,739	2.2	-
Property	222,341	10.0	260,987	7.8	10.0
TOTAL FUND VALUE	**3,135,429**	**100.0**	**3,330,362**	**100.0**	**100.0**

* On 31 March 2013 the strategic benchmark for equities was 18% UK equities and 42% overseas equities. The Fund had an investment in emerging markets of around 5% but this was not explicitly part of the benchmark.

Source: Data provided by WM Performance Services

- The value of the Fund's assets increased by £195m over the year to £3,330m.
- In terms of asset allocation, the main changes over the year were as follows:
  - Emerging Market equity exposure was approximately doubled to 9.4% following the investment in Unigestion.
  - The Fund invested in two Diversified Growth Funds with Pyrford and Barings.
  - The Blackrock passive investment was significantly reduced to fund the investments in Emerging Market Equity and Diversified Growth.
  - MAN fund-of hedge fund was redeemed due to concerns with performance. This took the hedge fund allocation down to the revised benchmark allocation of 5%.
  - There was an increase in corporate bonds following a change in the strategic allocation to corporates bonds from 5% to 8%.
- There are some deviations from the strategic benchmark weight on 31 March 2014 that will continue until the changes to the investment strategy, agreed in 2013, are fully implemented.
- An allocation to infrastructure is expected to be built up over time.

4 Performance

Total Fund performance

The table below shows the performance of the total Fund over 1 and 3 year periods.

Fund	1 year (%)	3 years (% p.a.)
Total Fund (ex currency hedge)	5.8	7.8
Total Fund (inc currency hedge)	6.6	N/a
Strategic Benchmark (no currency hedge)	4.5	6.5
Relative (ex currency hedge)	+1.3	+1.2
Relative (inc currency hedge)	+2.0	N/a

Source: Data provided by WM Performance Services

Benchmark allocation

The table below shows the strategic allocation to each of the major asset classes and the benchmark returns over 1 and 3 years to 31 March 2014, and thereby analyses what we would expect the strategy to return if all assets had been invested passively and met their benchmark returns. The final two columns shows how the index returns compare to the Fund's long term strategic assumed returns, and the contribution of each asset class to the difference, over a three year period, between the benchmark return and the assumed strategic return. For example, overseas equities returned 7.1% p.a. compared to an assumed return of 8.25% p.a,, contributing -0.5% p.a. to the difference between the benchmark return and assumed strategic return.

Asset Class	Weight in Strategic Benchmark		Index returns	Contribution to total benchmark	Index returns	Contribution to total benchmark	Assumed strategic return	
	Until Sep 13	From Oct 13	1 year	1 year	3 yrs pa	3 yrs pa	Return pa	Contrib pa
UK Equities	18%	15%	8.8%	1.5%	8.8%	1.6%	8.25%	0.1%
Overseas Equities	42%	25%	7.3%	2.2%	7.1%	2.7%	8.25%	-0.5%
Emerging Market Equities	-	10%	-10.0%	-0.2%	-3.8%	-0.1%	8.75%	-0.3%
Diversified Growth Funds	-	10%	4.5%	0.2%	4.8%	0.1%	8.25%	0.0%
UK Government Bonds	6%	3%	-3.1%	-0.2%	8.7%	0.6%	4.5%	0.3%
UK Corporate Bonds	5%	8%	1.5%	0.1%	7.4%	0.4%	5.5%	0.1%
Index Linked Gilts	6%	6%	-4.4%	-0.3%	8.9%	0.6%	4.25%	0.3%
Overseas Fixed Interest	3%	3%	-8.5%	-0.3%	0.3%	0.0%	5.5%	0.0%
Fund of Hedge Funds	10%	10%	3.2%	0.3%	-0.4%	-0.0%	6.0%	-0.7%
Property	10%	10%	11.9%	1.2%	6.1%	0.6%	7.0%	-0.1%
Total Fund	**100%**	**100%**		**4.5%**		**6.5%**	**7.2%**	**-0.7%**

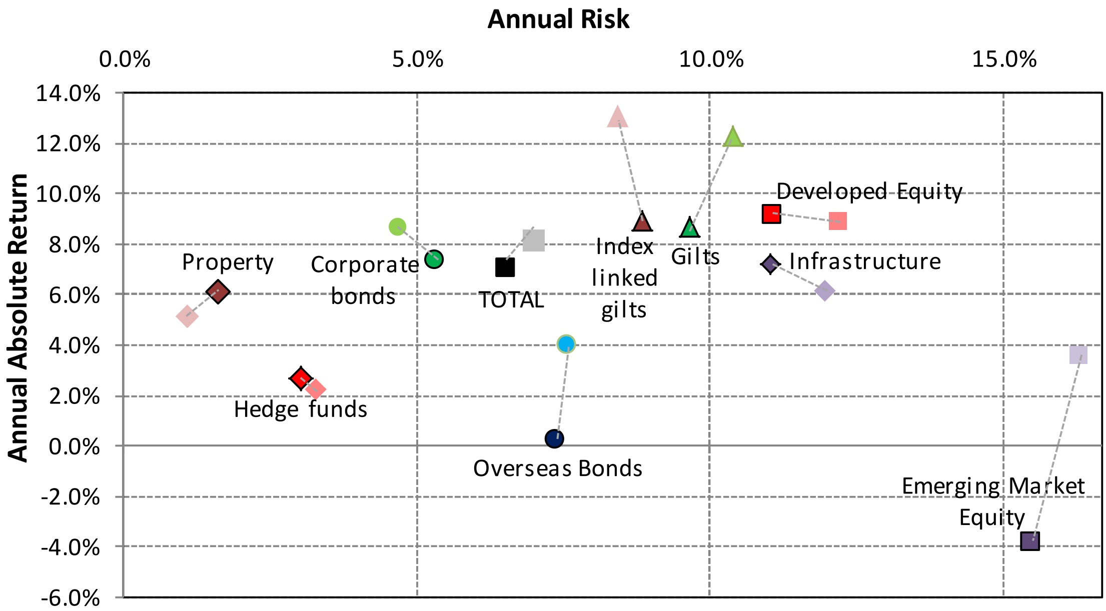
Source: Returns data provided by WM Performance Services

- The benchmark weights above are those held by WM to partly reflect the changes to the investment strategy, agreed in 2013, whilst they are implemented.
- Over one year, the benchmark was 4.5%, which was mainly driven by the contributions from UK and overseas equities, which represented 60% of the index at the start of the year.
- Over three years the benchmark was 6.5% p.a. Again equities were the main contributor, with UK bonds and property also contributing.
- The assumed strategic return for the Fund as a whole, weighted by the strategic benchmark allocation over the last three years, is 7.2% p.a. Hence the actual three-year benchmark return was 0.7% p.a. behind this. The contributors to this difference are shown in the right hand column above.
  - The 3 year benchmark for overseas equities (7.1% p.a.) and fund of hedge funds (-0.4% p.a.) are below their assumed strategic returns of 8.25% and 6.0% respectively. These were the main contributors to the Fund not meeting its assumed strategic return.
  - Positives were from UK bonds and index-linked gilts, which were ahead of the assumed strategic return over three years.

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 data points in sterling terms, to the end of March 2014 of each of the underlying asset benchmarks, along with the total Fund strategic benchmark. We also show the position as the end of March 2013, as shadow points.

3 Year Risk v 3 Year Return to 31 March 2014 and 31 March 2013



- Gilt returns have fallen from the earlier high returns that resulted from the "flight to quality" after the 2009 credit crisis. The three year return at the end of March 2014 remains higher than we would expect in the long run.
- Overseas bond returns have fallen due to a negative return in the last year, affected by rising yields within European bonds, and more recently by the view that the US Federal Reserve would start 'tapering' its Quantitative Easing.
- The three year emerging market equity return has fallen as the return over the last twelve months of -9.9% has replaced a return on 12.4% in the year to March 2011.
- Property returns have been improving over the last 12 months – this also explains the increase in the risk figure. The hedge fund index continues to produce steady returns, with very little change in the rolling 3 year return.
- In terms of risk, the three-year volatility for equities has reduced over the three year period, particularly due to lower experienced volatility over the past 12 months.
- The volatility of gilts has fallen as returns have been more consistent over the last year (albeit low/negative) compared to 2010-11, when monthly returns ranged from -3.7% (in Jan'11) to +8.4% (in Aug'10). Similarly, developed equities were more volatile in 2010 than in 2013.
- Factors contributing to volatility at the start of the period were the uncertainty over the European Sovereign Debt Crisis and the Japanese earthquake disaster in March 2011.
- Emerging market equity volatility remains high as there were significant negative returns towards the end of 2011, followed by a recovery at the start of 2012. Volatility at the start of the period was driven by the political uncertainty in the US and Europe, whereas more recent volatility has been driven by concerns over slowing emerging market growth, structural concerns and a return of capital to developed markets following the tapering of the US's quantitative easing programme.

Drivers of performance - market

Over the last year, market returns have been driven by increasing optimism over the developed market economic recovery. Positive economic news from the US, UK and, albeit to a lesser extent, Europe, has seen risk assets in general provide positive returns, particularly Developed market equities. Bond returns have been negative or subdued as the market brought forward its expectations of interest rate rises. Gilt yields continued to rise from their 2012 lows, which resulted in negative returns from UK government bonds.

Optimism over the developed market recovery saw (primarily retail) investors reallocate from emerging markets. This, along with concerns over slowing growth and economic structural headwinds in emerging markets, particularly China, saw negative equity return from emerging markets and Asia, in sharp contrast the to the developed market equity returns described above.

Developed Equities - UK

- The UK equity benchmark (FTSE All Share) was positive over the last year due to improved business confidence, earnings and falling employment.
- These factors also contributed to developed equities being the best performing asset class over three years, exceeding the assumed strategic return.

Developed Equities - overseas

- Over the last twelve months, overseas equity returns varied considerably by region. European and US equities produced double-digit returns of 15.7% and 11.3% respectively due to similar factors as in the UK. Negative returns came from Asia Pacific (-6.5%) and Japan (-1.6%), as economic growth in both regions was not as high as expected and there was a slowing commodity demand.
- The Far Eastern equity performance over the last twelve months contributed to the overall return from overseas equities (7.1%) being below the assumed strategic return (8.25%).

Emerging market equities

- Emerging market equities produced a significant negative return (-10.0%) over the last twelve months due to the sentiment from slowing growth and a weakening of domestic and export demand in China.
- Negative Emerging Market equity returns were also seen in 2011 when there was political uncertainty in the US and the US Federal Reserve implemented quantitative easing. Emerging market equity is the worst performing asset class in this report over three years, with a negative absolute return of -3.8% p.a.

Multi-asset/DGF

- Libor(and therefore LIBOR +4% p.a.) is currently at a historically low level, and behind the assumed strategic return.
- Note, however, that the impact of this is small as DGF only became part of the strategic benchmark in November 2013.

Bonds

- Gilt yields have risen over the last year, resulting in a negative return for UK Government Bonds (-3.1%). Spreads (yield relative to gilts) on corporate bonds fell, hence corporate bonds saw a small positive return (+1.5%).

- Over the longer three-year period, significant falls in gilt yields during the second half of 2011 resulted in high gilt returns (in the one year to March 2012, gilts returned 22.5%). This contributed to the three-year return being above the assumed strategic return.
- Overseas bonds performed relatively poorly over both the last year and the three year period as they were affected by rising yields, particularly in peripheral Europe.

Fund of Hedge Funds

- The majority of hedge fund strategies have performed reasonably well over the 12 month period, and since Q3 2012 returns have been steady at around 1% to 3% per quarter.
- Low short term interest rates have meant, though, that hedge funds have generally performed below the long term assumed strategic return.

Property

- Over the last year, both UK commercial property values and house prices have begun to rise, resulting in a one-year return well ahead of the assumed strategic return.
- Prior to this, over the last three years the majority of property returns came from rental income rather than capital appreciation.

5 Active investment manager contribution

Attribution – asset allocation and active management

The tables below attributes the difference between the achieved fund return and the benchmark return over the 1 and 3 year periods. Note that the manager-by-manager analysis that follows these tables includes only the current active managers and so the total contribution to performance shown in the later tables does not reconcile with the tables below because the managers that the Fund no longer holds, such as MAN, are not included. Additionally, WM compare all property elements against Schroder's benchmark for their attribution analysis in the tables below whereas later in the report we look at the individual fund benchmarks.

1 year attribution

Asset Class	Weight in Strategic Benchmark		Average overweight position*	Fund return	Index return	Asset allocation impact	Active mgm't impact
	Start	End					
UK Equities	18%	15%	+1.5%	12.2%	8.8%	0.1%	0.6%
Overseas Equities	42%	25%	+3.9%	7.2%	7.3%	0.2%	0.1%
Emerging Market Equities	-	10%	-0.3%	-10.1%	-10.0%	0.3%	0.0%
Diversified Growth Funds	-	10%	-0.2%	-	2.2%	0.2%	-0.2%
UK Government Bonds	6%	3%	-1.3%	-3.3%	-3.1%	0.1%	0.0%
UK Corporate Bonds	5%	8%	+0.6%	3.9%	1.5%	0.0%	0.2%
Index Linked Gilts	6%	6%	+0.2%	-4.5%	-4.4%	-0.1%	0.0%
Overseas Fixed Interest	3%	3%	-0.6%	-8.5%	-8.5%	0.1%	0.0%
Fund of Hedge Funds	10%	10%	-4.0%	2.6%	3.2%	0.0%	-0.1%
Property	10%	10%	-1.1%	9.4%	11.9%	0.1%	-0.4%
Cash	-	-	+1.2%	1.2%	-	0.0%	0.0%
Total Fund	**100%**	**100%**		**5.8%**	**4.5%**	**1.0%**	**0.3%**

Source: Data provided by WM Performance Services * Average of overweight position at the start and end of the period.

- Over the last year, if the Fund had been invested passively in line with strategic allocation, it would have returned 4.5% over last year.
- The actual fund return was 5.8% (ex currency hedging), outperforming the by benchmark 1.3% (absolute difference). This outperformance was attributed +1.0% due to asset allocation and +0.3% due to active management.
- **Asset allocation:** The Fund benefited from being overweight to developed equities and underweight to emerging market equities. An overall underweight position to bonds also contributed, as government and overseas bonds posted negative returns.
- **Active management:** The largest contributor in terms of active management was from UK equities, which added 0.6%.

3 Year attribution

Asset Class	Weight in Strategic Benchmark		Average overweight position*	Fund return	Index return	Asset allocation impact	Active mgm't impact
	Start	End		pa	pa	pa	pa
UK Equities	27%	15%	-0.4%	10.6%	8.8%	0.0%	0.3%
Overseas Equities	33%	25%	+4.5%	7.5%	7.1%	-0.1%	0.3%
Emerging Market Equities	-	10%	0.0%	-0.8%	-3.8%	0.1%	0.1%
Diversified Growth Funds	0%	10%	-0.2%	-	4.8%	0.0%	0.0%
UK Government Bonds	6%	3%	-0.1%	8.4%	8.7%	0.1%	0.0%
UK Corporate Bonds	5%	8%	+0.1%	9.2%	7.4%	0.0%	0.1%
Index Linked Gilts	6%	6%	-0.1%	8.9%	8.9%	0.0%	0.0%
Overseas Fixed Interest	3%	3%	-0.5%	0.3%	0.3%	0.0%	0.0%
Fund of Hedge Funds	10%	10%	-3.4%	0.8%	-0.4%	0.1%	0.1%
Property	10%	10%	-0.7%	6.9%	6.1%	0.1%	0.0%
Cash	0%	0%	+1.0%	0.9%	-	0.0%	0.0%
Total Fund	**100%**	**100%**		**7.8%**	**6.5%**	**0.5%**	**0.8%**

Source: Data provided by WM Performance Services * Average of overweight position at the start and end of the period

- Over three years, the Fund outperformed by 1.3% p.a. compared to had it been invested passively in line with strategic allocation. This outperformance was attributed +0.5% p.a. due to asset allocation and +1.0% p.a. due to active management.
- **Asset allocation:** The fund benefited from being underweight in hedge funds and property during a time when these asset classes experience low returns.
- The overall asset allocation impact is not as marked as over one year because there was less variation in the index returns between the different asset classes.
- **Active management:** UK and overseas equities were the main contributors to the outperformance due to active management. Each asset class made a small positive contribution apart from UK Government Bonds.

Developed Equities – UK

Fund	Return (%pa)	Benchmark (%pa)	Relative (%pa)	Target (%pa)	Contribution to outperformance (%pa)
Jupiter FTSE All Share					
1 year	15.0	8.8	+5.7		+0.28
3 years	13.7	8.8	+4.5	+2.0	+0.22
TT International FTSE All Share					
1 year	13.9	8.8	+4.7		+0.26
3 years	11.9	8.8	+2.8	+3.0	+0.16
TOTAL					
1 year	**14.4**	**8.8**	**+5.2**		**+0.54**
3 years	**12.7**	**8.8**	**+3.6**	**+2.5**	**+0.38**

Source: Data provided by WM Performance Services, totals and contributions are JLT estimates

Returns

- Both UK equity managers have outperformed their benchmarks over both 1 and 3 years. This has contributed to 0.54% to the overall Fund return over the past 12 months, 50% of the total outperformance.
- Jupiter's industry allocation has continued to remain considerably different to the benchmark allocation (as expected given Socially Responsible Investing criteria used in the mandate), so the variability of relative returns (tracking error) is expected to be high.
- Nonetheless, Jupiter has also shown that its stock selection has added value and the fund manager continues to believe in his philosophy that seeking companies which contribute to or benefit from the trend toward environmentally and socially sustainable activity will lead to outperformance over the long term.
- TT's performance is slightly below their target over three years but this has improved over the year.

Market environment

- At the beginning of the three 3 period, equity markets were in a "risk on / risk off" phase, meaning that different equity stocks were rising and falling together without much distinction for the underlying fundamentals of one company over another. However, as the global economy has showed signs of recovery over the past 12 months, fundamentals have become the driver of changing equity prices once more, which is more conducive to outperformance for an active equity manager.
- This provides an environment over the past 12 months for good active management decisions to be rewarded and the strong performance from both managers is pleasing. This, as well as good performance over the more testing 3 year period has led to outperformance over 3 years also.

Investment activity

- No significant activity to note for the Fund's UK equity managers.

Developed Equities – Overseas

Fund	Return (%pa)	Benchmark (%pa)	Relative (%pa)	Target (%pa)	Contribution to outperformance (%pa)
Invesco MSCI World ex UK NDR					
1 year	9.9	8.6	+1.2		+0.09
3 years	10.1	8.9	+1.1	+0.5	+0.08
SSgA Europe FTSE AW Europe ex UK					
1 year	19.4	17.2	+1.9		+0.02
3 years	7.8	6.3	+1.4	+0.5	+0.02
SSgA Pacific FTSE AW Dev Asia Pac					
1 year	-3.7	-4.1	+0.4		+0.01
3 years	4.2	3.3	+0.9	+0.5	+0.02
Schroder MSCI AC World Free					
1 year	7.4	6.7	+0.6		+0.04
Since inception	5.6	7.4	-1.7	+4.0	-0.11
TOTAL					
1 year	**8.0**	**7.0**	**+0.9**		**+0.16**
3 years	**7.5**	**7.5**	**+0.0**	**+1.8**	**+0.01**

Source: Data provided by WM Performance Services, totals and contributions are JLT estimates

Returns

- Both Invesco and SSgA enhanced indexation have outperformed their targets over 1 and 3 years.
- Overall, outperformance from the Fund's active overseas / global equity managers contributed just less than 0.2% to the overall Fund return over the year.
- Schroder's held companies in "later-cycle sectors", such as capital goods, which performed well. Financials stocks, such as insurance companies and US banks, also performed well.
- The Schroder Global Equity Portfolio has not yet been in place for three years but has underperformed its target over the period since inception, April 2011.

Market environment

- As with UK equities, the environment over the past 12 months has been more favourable for active management than compared to the 3 year period.
- Increasing sentiment in Europe and its peripheral countries has given opportunity for outperformance, which has been delivered by all funds.
- The Pacific region has suffered from negative sentiment over the past 12 months and the outflow of capital and has been a difficult environment in which to outperform.
- Over a period where there have been large differences in equity returns between regions, Schroder's unconstrained stock picking approach could have suffered due to country allocation. They have outperformed over 1 year but remain significantly behind their outperformance target, and they are behind both benchmark and target over the period since inception.

Investment activity

- In April 2014 it was announced that the Financial Conduct Authority fined Invesco £18.6m for breaches in their risk systems. The issue has not impacted the Fund's investment in the Global ex UK Enhanced Indexation Fund but a further update will be provided following meetings between JLT and Invesco later in the quarter.

- In January 2014, State Street were fined £22.9m by the FCA for overcharging six clients that used its transition management service between June 2010 and September 2011. We note that this was a different part of the business to their fund management and does not affect the funds.

- Both the SSgA Europe ex UK and Pacific incl Japan enhanced equity pooled funds are at a size such that Avon's investment now represents almost all of the pooled fund holdings. However, the Panel has concluded that the funds could be sustained even if the Avon Pension Fund was the only investor.

- Over the year, the lead portfolio manager for the Schroder Global Equity Portfolio, Virginie Maisonneuve, left Schroder for another opportunity. The Avon Pensions Committee met with the new fund manager, Simon Webber (who had worked under Virginie on the portfolio), and were comfortable that no immediate action was necessary.

- In April 2014 Schroder announced the appointment of Alex Tedder as Head of Global Equity to replace some of the management responsibilities that Virginie Maisonneuve previously undertook. Such an appointment was consistent with the message Schroder provided following Virginie's departure.

- In May 2014 Schroder announced the promotion of Peter Harrison from Head of Equities to Head of Investment. The progress of Peter within Schroder is not a surprise, albeit this was not necessarily expected to occur imminently.

Emerging Market Equities

Fund	Return (%pa)	Benchmark (%pa)	Relative (%pa)	Target (%pa)	Contribution to outperformance (%pa)
Genesis MSCI EM					
1 year	-8.5	-9.9	+1.6		+0.07
3 years	-0.5	-3.8	+3.4	0.0	+0.15
Unigestion MSCI EM					
1 year	n/a	n/a	n/a		n/a
3 years	n/a	n/a	n/a	0.0	n/a

Source: Data provided by WM Performance Services, contributions are JLT estimates

Returns

- Outperformance from Genesis contributed 0.1% to the overall Fund return over the past 12 months.
- The poor absolute performance is solely due to market impact as Genesis outperformed and met their objective. The Genesis fund is overweight to India and South Africa, while underweight to South Korea, Russia and China.
- The Fund doubled its exposure to emerging markets in January 2014 through a £165m allocation to Unigestion.

Market environment

- Negative sentiment towards emerging markets has led to negative returns over the 1 and 3 year periods and significant underperformance relative to developed market equities. This has also coincided with generally more volatility.
- Emerging market equities are expected to continue to be volatile, with events in Ukraine and slowing growth in China contributing to volatility. However, strong demographics, favourable debt levels (compared to many developed markets) and higher growth rates (albeit slower than previously) are key reasons the allocation is expected to outperform developed markets over the long term.
- The volatility within markets means that there is scope to outperform but, particularly over the short term, correctly identifying the macro factors that will affect individual companies' prospects is vital. Furthermore, whilst there may be opportunities from volatility, the stock price of companies with strong fundamentals may not outperform immediately.
- In this context, the consistent outperformance from Genesis is pleasing.
- Whilst the Unigestion investment has only recently been made, their investment approach is to take into account macro factors. However, in a strongly rising market they are likely to underperform and similarly protect value relative to the benchmark in negative markets.

Investment activity

- No significant activity to note for the Fund's emerging market equity managers.

Fund of Hedge Funds

Fund	Return (%pa)	Benchmark (%pa)	Relative (%pa)	Target (%pa)	Contribution to outperformance (%pa)
Signet 3M LIBOR + 3%					
1 year	-1.5	3.5	-4.9		-0.10
3 years	0.2	3.7	-3.8	+3.0	-0.07
Stenham 3M LIBOR + 3%					
1 year	7.8	3.5	+4.2		+0.05
3 years	3.3	3.7	-0.3	+3.0	-0.00
Gottex 3M LIBOR + 3%					
1 year	5.4	3.5	+1.8		+0.03
3 years	2.7	3.7	-1.0	+3.0	-0.02
TOTAL					
1 year	**3.1**	**3.5**	**-0.3**		**-0.02**
3 years	**1.7**	**3.7**	**-2.0**	**+3.0**	**-0.10**

Source: Data provided by WM Performance Services, totals and contributions are JLT estimates

Returns

- In aggregate, the performance of the Fund's Fund of Hedge Fund managers is expected to have had a neutral contribution to the Fund's total return.
- Over the year, outperformance from Gottex and, in particular, Stenham, offset underperformance from Signet.

Market environment

- Strong equity returns have favoured long/short equity strategies (which generally have a long bias) as well as the return of company fundamentals as a key driver for equity returns.
- It is therefore not surprising to see Stenham outperform the other two managers given their respective mandates as Stenham focus on macro considerations whereas Signet focus on fixed income and Gottex on market neutral strategies. Nonetheless, Stenham correctly identified an opportunity to increase the level of risk within their portfolio.
- The majority of hedge fund strategies performed well over the 12 month period, thus outperformance would be expected.

Investment activity

- The Panel met Signet at the last meeting and discussed their joint venture with Morgan Creek Capital Management.
- In December 2013 Gottex announced a merger with EIM. The Panel met with Gottex to assess the potential impact of the proposed merger.
- Stenham appointed Damian Brannan to the role of Managing Director in July 2013 to help Stenham's business development and management.

Multi-asset and DGF

Fund	Return (%pa)	Benchmark (%pa)	Relative (%pa)	Target (%pa)	Contribution to outperformance (%pa)
BlackRock (passive multi-asset) Customised					
1 year	5.3	4.8	+0.5		+0.15
3 years	8.8	8.7	+0.1	0.0	+0.03
Pyrford RPI + 5%					
1 year	n/a	n/a	n/a		n/a
3 years	n/a	n/a	n/a	0.0	n/a
Barings 3 Month Libor + 4%					
1 year	n/a	n/a	n/a		n/a
3 years	n/a	n/a	n/a	0.0	n/a

Source: Data provided by WM Performance Services, contributions are JLT estimates

Investment activity

- The passive multi asset (equity and bond) portfolio managed by Blackrock continues to perform as expected in line with the indices.
- The Pyrford and Barings investments were made in Q4 2013, and therefore have a limited impact on the overall 1 and 3 year Fund returns.
- Initial conclusions can be drawn in the 31 March 2015 annual review.

Bonds

Fund	Return (%pa)	Benchmark (%pa)	Relative (%pa)	Target (%pa)	Contribution to outperformance (%pa)
RLAM iBoxx £ non-Gilts all mat					
1 year	4.0	1.5	+2.5		+0.18
3 years	9.3	7.3	+1.8	+0.8	+0.14

Source: Data provided by WM Performance Services

Returns

- Outperformance from Royal London has contributed 0.2% to the overall Fund return over the past 12 months.
- RLAM have maintained a consistent investment approach since appointment and the portfolio remains significantly underweight to AAA and to a lesser extent AA and A rated bonds.

Market environment

- Investor's appetite for yield has seen spreads (yield relative to gilts) on riskier, higher yielding assets fall.
- Thus outperformance would be expected given RLAM's investment approach.

Investment activity

- Royal London acquired the Co-operative Banking Group's Life Insurance and Asset Management businesses, comprising Co-operative Insurance Ltd and The Co-operative Asset Management.
- Additional investments with RLAM were made of £19m in August 2013 and £45m in October 2013 as part of strategic changes.

Property

Fund	Return (%pa)	Benchmark (%pa)	Relative (%pa)	Target (%pa)	Contribution to outperformance (%pa)
Schroder IPD UK pooled					
1 year	12.9	11.9	+0.9		+0.04
3 years	7.4	5.7	+1.6	+1.0	+0.07
Partners IPD Global pooled					
1 year	8.0	9.1	-1.0		-0.03
3 years	5.9	5.2	+0.7	0.0	+0.02
BlackRock Customised					
1 year	3.5	3.3	+0.2		0.00
3 years	7.5	7.5	0.0	0.0	0.00
TOTAL					
1 year	**9.7**	**9.6**	**+0.1**		**+0.01**
3 years	**6.9**	**5.8**	**+1.0**	**+0.5**	**+0.09**

Source: Data provided by WM Performance Services, totals and contributions are JLT estimates

Returns

- Over the year, outperformance from Schroder offset the underperformance from Partners such that, in aggregate, relative performance from the property managers did not contribute negatively or positively to performance.
- Schroder Property has benefited from exposure to central London offices. The Schroder property return has moved ahead of the assumed strategic return due to their outperformance.
- Partner's draw downs are being made gradually over time, and the full extent of the Fund's commitment has not yet been invested. Their IRR since inception is 9.9%, in line with the mandate's expectations.
- The Blackrock portfolio refers to the monies held to invest in property. It is invested in equities, gilts and cash.

Market environment

- Increasing demand for commercial property from institutional investors within the UK provides opportunity for outperformance but it also provides challenges as high demand can make attractive opportunities scarce. Relative performance will have been driven by positioning over the long term.
- Partners performance over the shorter term can be impacted by the (re-)development stage of properties they purchase, the dilution effect of new monies coming into the funds and currency fluctuations. Therefore the focus should be on their longer term relative performance.

Investment activity

- No significant activity to note for the Fund's Property managers. Partners have continued their drawdown programme in line with expectations, whilst Schroder are now fully invested.

6 Record – Active Currency Hedging

The tables below show the assess performance of Record currency hedging over the one and three year period.

Performance (Total Hedging Portfolio)

	1 year (%)	3 years (% p.a.)
Record Hedge	2.7	n/a
50% Illustrative Hedge	4.6	n/a
Relative	-1.8	n/a

Currency Hedging 1 Year Performance in Sterling Terms

	Start Exposure (£)	End Exposure (£)	Currency Return (%)	50% Hedge Return (%)	Record Hedge Return (%)	Net Return (%)
USD	552,310,659	438,127,692	-8.9	4.7	2.3	-6.6
EUR	202,454,635	195,291,888	-2.2	1.2	-0.3	-2.5
JPY	140,321,606	115,802,811	-16.8	9.4	9.2	-7.7
Total	**895,086,899**	**749,222,392**	**-8.6**	**4.6**	**2.7**	**-5.9**

Source: Record Currency Management. Note: Exposures are 1 month lagged. Returns are estimated by JLT.

Returns

- The total size of the mandate (i.e. the amount of foreign currency assets that are in the programme) has reduced over the year as global equities (as well as UK equities) were reduced to fund allocations to DGFs and Emerging market equities.
- Exposure to overseas currency, particularly the Yen and US$, has been a detractor over the 12 month period, detracting approximately -2.5% to the total Fund return (although this is shown within the overseas equity return).
- The strengthening of Sterling against the US dollar, Euro and Yen meant that the impact of currency hedging has had a beneficial impact, reducing the negative effect of currency movements. The impact of Record's currency hedging activity has added 0.8% to the total Fund return over the past 12 months.
- The combination of the currency effect (-2.5%) and the impact of Record (+0.8%) gives the overall impact of currency exposure, adjusted for Record's hedging, of -1.7%.

Market environment

- Whilst Record have underperformed a passive 50% hedge (an alternative to dynamic hedging), they have reduced the negative cashflows associated with currency hedging.
- Record's process performs best in environments where currency movements are trending, rather than when currency movements are largely "sideways". It is therefore expected that Record's Yen and US$ hedging added value whilst hedging of the Euro detracted slightly.

Appendix 1: 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	-
Unigestion	Emerging Market Equities	MSCI EM NET TR	-
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%
Pyrford	DGF	RPI + 5%	-
Barings	DGF	3 Month Libor + 4%	-
Cash	Internally Managed	7 day LIBID	

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