HEALTH WEALTH CAREER

AVON PENSION FUND

COMMITTEE INVESTMENT PERFORMANCE REPORT QUARTER TO 31 DECEMBER 2015

FEBRUARY 2016

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- Care should be taken when comparing private equity / infrastructure performance (which is generally a money-weighted performance) with quoted investment performance (which is generally a time-weighted performance). Direct comparisons are not always possible.

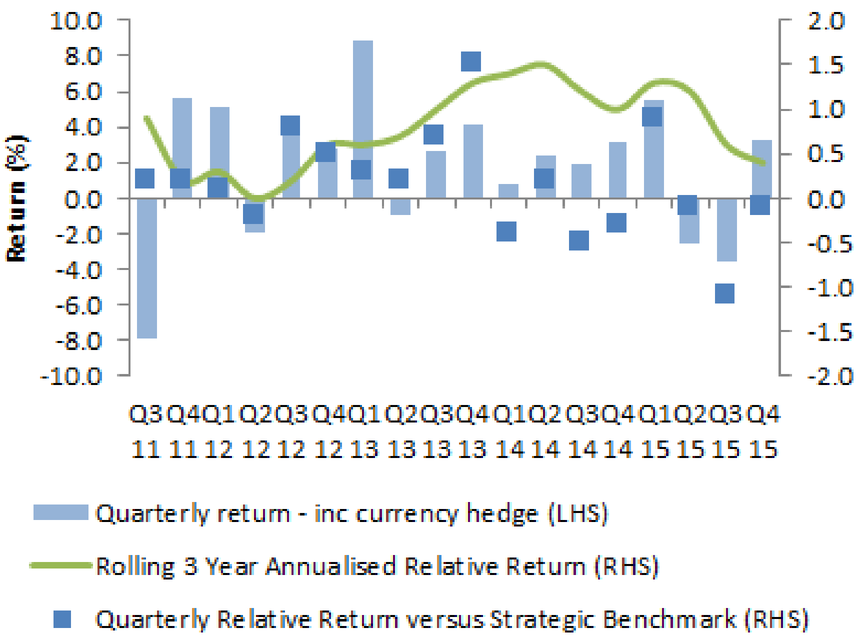
CONTENTS

SECTION 1
EXECUTIVE SUMMARY

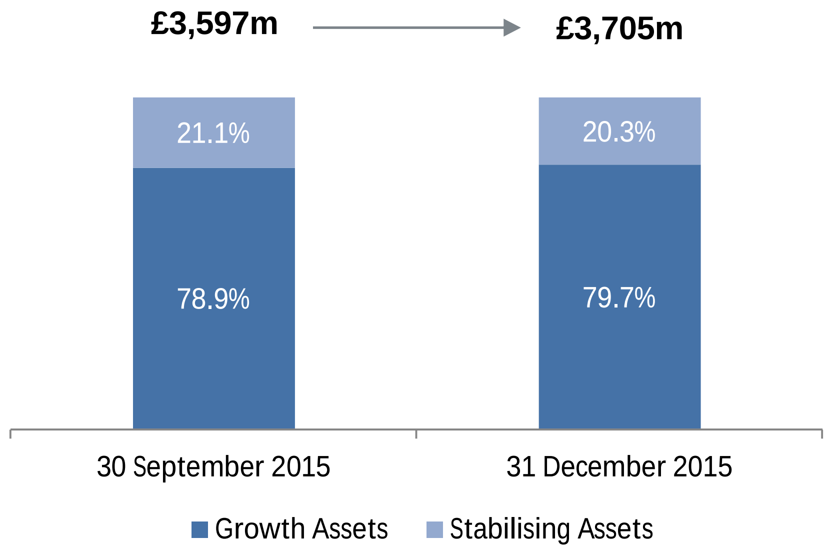
EXECUTIVE SUMMARY

	3 months (%)	1 year (%)	3 years (% p.a.)
Total Fund (inc currency hedge)	3.3	2.3	8.5
Total Fund (ex currency hedge)	3.9	3.2	8.7
Strategic Benchmark (no currency hedge)	3.4	2.9	8.1
Relative (inc currency hedge)	**-0.1**	**-0.6**	**+0.4**

Excess Return Chart



Asset Allocation



Commentary

Over the quarter total Fund assets (including currency hedging) increased from £3,597m (30 September 2015) to £3,705m.

This increase was primarily due to the positive performance across all strategies held (with the exception of the currency hedging mandate).

At a strategic level, the Fund was within the tolerance ranges in the Statement of Investment Principles for all asset classes, with the exception of developed market equities which were overweight relative to benchmark (and outside the range in the SIP) at the end of the quarter; this will be drawn down to fund the Infrastructure mandate.

The slight underperformance of the Fund return (when the currency hedge with Record is included) relative to the unhedged strategic benchmark return (which excludes currency hedging) over the quarter was largely a result of sterling depreciating over the quarter. The Fund return excluding currency hedging was 0.5% ahead of the unhedged strategic benchmark.

EXECUTIVE SUMMARY

This report has been prepared for the Avon Pension Fund ("the Fund"), to assess the performance and risks of the Fund's investments.

Funding level

- The estimated funding level increased by c. 3% over the fourth quarter of 2015, due to positive returns from growth assets over the quarter and a rise in the valuation discount rate (decreasing liabilities).

Fund performance

- The value of the Fund's assets increased by £108m over the quarter, to £3,705m at 31 December 2015. The Fund's assets returned 3.3% over the quarter (3.9% excluding the Record currency hedging mandate, given the depreciation of sterling over the quarter), as a result of positive returns from all strategies. This slightly underperformed (but outperformed when excluding currency hedge) the Strategic Benchmark return of 3.4%.

Strategy

- Global (developed) equity returns over the last three years at 13.6% p.a. have been significantly ahead of the assumed strategic return of 8.25% p.a. from the strategic review in March 2013. We remain neutral in our medium term outlook for developed market equities (over the next one to three years), and expect returns to be more modest over the next three years.

- The three year return from emerging market equities has fallen to -2.9% p.a. from -2.2% p.a. last quarter. The three year return remains well below the assumed strategic return (of 8.75% p.a.) as returns were affected by an ongoing commodity price slump, a stronger US dollar and slowing growth in China. As with developed markets, we are neutral in our medium term outlook for emerging market equities over the next one to three years.

Strategy (continued)

- UK government bond returns over the three years to 31 December 2015 remain above the long term strategic assumed returns (with fixed interest gilts returning 5.9% p.a. against an assumed return of 4.5% p.a., and index-linked gilts returning 6.4% p.a. versus an assumed return of 4.25% p.a.) as investor demand for gilts remains high. Whilst from an absolute return perspective government bonds remain unattractive due to the low yields available, we continue to believe that their role in the context of the overall portfolio is important from a liability risk management perspective.
- UK corporate bonds returned 4.5% p.a. over the three year period, falling behind their assumed return of 5.5% p.a., while property returns of 14.6% continue to be substantially above the assumed strategic return of 7% p.a.
- Hedge fund returns remain below long term averages and the strategic return of 6% p.a., as they are affected by low cash rates.
- With most listed assets looking close to fully valued, if not fully valued, we would expect 'alpha' driven investments such as hedge funds and dynamic multi-asset strategies to play an increasingly important role in return generation over the coming three years, particularly if 'beta' (i.e. market-driven) returns are lower looking forward. In light of reduced market liquidity, we also see opportunities for more dynamic and active strategies to add value, and believe that there are likely to be opportunities arising in distressed debt given the maturing credit cycle. Asset classes that can provide a reliable source of income such as Long Lease Property, Private Debt and Infrastructure also offer relatively attractive sources of return, in our view, given the current market outlook.

Managers

- Absolute returns of the managers over the quarter were all positive. Unlike Q3, risky assets had a positive quarter, in particular equities. State Street's Asia Pacific equity mandate delivered the highest positive return, whilst JP Morgan had the biggest relative return (at 4.1% relative to a benchmark return of 0.9%).
- Returns over the year were also positive. The Fund's global equity mandates in particular fared well, however emerging market returns for the year were disappointing given the turmoil in China, the strong dollar and plummeting oil prices, with Genesis and Unigestion returning -10.0% and -7.5% respectively, (the latter still meeting its outperformance target despite the negative return, reflecting its lower volatility premise).
- Over three years, all mandates with a three year track record produced positive absolute returns (with the exception of Genesis), with Partners failing to beat its benchmark. In addition, Schroder failed to achieve its three-year performance objective for the property and global equity mandates, despite both beating their benchmarks. The remainder of the active managers achieved their objectives.
- Over the quarter, Jupiter announced that Chris Watt (the portfolio manager for their Responsible Income Fund) is leaving the firm. While this doesn't directly affect the Fund's segregated mandate, which are managed by Charlie Thomas (rather than Watt), Thomas will be taking over Watt's role on the Responsible Income Fund, which could be a stretch on his time. It also brings into question whether Jupiter's Environmental and Sustainability investment team will be sufficiently resourced. Our researchers will be following up with Jupiter to determine if there has been any change to the ESG process. Our rating of 'B' is not being changed as a result, but we suggest the strategy is monitored.

EXECUTIVE SUMMARY

Key points for consideration

- Over the quarter, the transition of the hedge fund mandate to JP Morgan was largely completed. A major divestment of £49.2m was taken from Gottex on 16 November 2015, whilst £33.0m was divested from Signet. As at the end of the quarter, residual balances remain in these two funds until conditions to sell these down are met.

- Global and regional equity markets produced positive performance over the quarter, leading to the Fund's asset level increase. Over the quarter, this positive experience was helped by rising gilt yields, meaning the present value of the liabilities is expected to have decreased.

- The beginning of 2016 has however seen considerable volatility, with the FTSE All World returning -6.4% YTD to 5 February 2016, more than offsetting the gain of 4% made over 2015. Index-Linked Gilts (a proxy for the liabilities on the current funding basis) returned 5.6% YTD to 5 February 2016 as real yields fell.

- The Fund is in the process reviewing the Stabilising Asset portfolio and, as agreed at the last Panel meeting, is transitioning the current fixed interest gilts and overseas government bonds to index-linked gilts. This is expected to be completed in Q1 2016, depending on market conditions. Further discussion on liability risk management will be undertaken at the March 2016 funding and investment Committee workshop.

- The infrastructure mandate remains unfunded as yet, with the Fund having a commensurate overweight holding in developed equities.

SECTION 2

MARKET BACKGROUND

MARKET BACKGROUND
INDEX PERFORMANCE

Equity Market Review

All major equity markets posted a positive return over the quarter with global equities delivering a return of 8.1% and 5.9% in sterling and local currency terms respectively. Small capitalisation stocks, as measured by the FTSE World Small Cap Index, posted a positive return but underperformed the broader equity market, returning 6.7% and 3.8% respectively in sterling and local currency terms.

Japan was the strongest performing equity market, returning 12.5% in sterling and 9.9% in local currency terms, remaining supported by the extremely accommodative monetary policy regime and exceptional growth of corporate profits. In contrast, emerging markets were the worst performing region, returning 3.1% and 1.2% in sterling and local currency terms respectively.

In the UK, the FTSE All-Share Index delivered a positive return of 4.0% over the quarter but underperformed the global equity market, partly due to a relative overweight to oil and gas stocks and a relative underweight to technology stocks. Within the UK, large capitalisation stocks, as represented by the FTSE 100 Index, continued to underperform the smaller segments of the market represented by the FTSE 250 and FTSE Small Cap indices, largely due to the ongoing weakness of resource-led stocks which constitute a significantly larger proportion of the FTSE 100 Index.

Bond Market Review

Bond yields rose across all maturities over the quarter, resulting in negative returns for investors.

In the UK, government bond yields increased by c.10-20 bps across the curve, with the increase most pronounced at medium to long end of the curve. Despite this, nominal yields remain well below long-term average levels.

Real yields also rose over the quarter, with the Over 5 Year Index-Linked Gilts Index posting a negative return of 3.3%.

Credit spreads narrowed over the quarter by c.10 bps and amounted to c.1.4% for both the Sterling Non-Gilts All Stocks and Sterling Non-Gilts Over 10 Year indices at the end of December. The benefit from the narrowing of credit spreads along with the income earned on corporate bond investment more than offset the negative impact of a rise in gilt yields, leading UK credit assets to post a positive return of 0.5% in sterling terms.

Currency Market Review

Over the quarter, sterling depreciated by 2.7% and 2.3% against the US dollar and Japanese yen, respectively, but stayed largely unchanged against the euro. The relative appreciation of the US dollar was due to strengthening economic fundamentals in the US and the Federal Reserve Bank’s decision to raise short-term policy rates.

Commodity Market Review

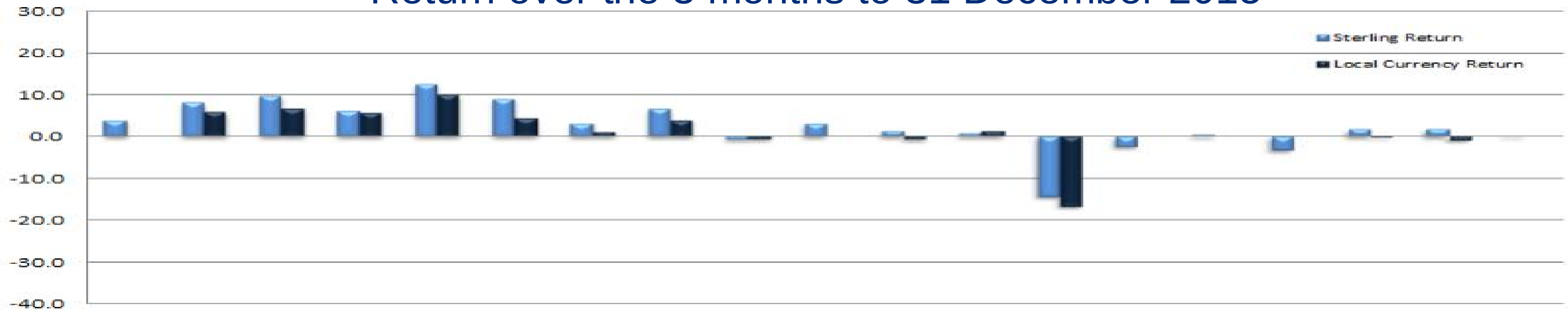
Commodity prices continued their fall over the quarter with energy prices leading the decline on the back of concerns over an energy supply glut, wavering consumer demand and US dollar strength. As at end December, Brent Crude Oil traded around $35.70/barrel, a decrease of c.24.9% over the quarter.

The negative price impact from the stronger US dollar also led to a fall in gold prices over the period by 4.7% with gold trading at $1,062/oz at end December.

Source: Thomson Reuters Datastream.

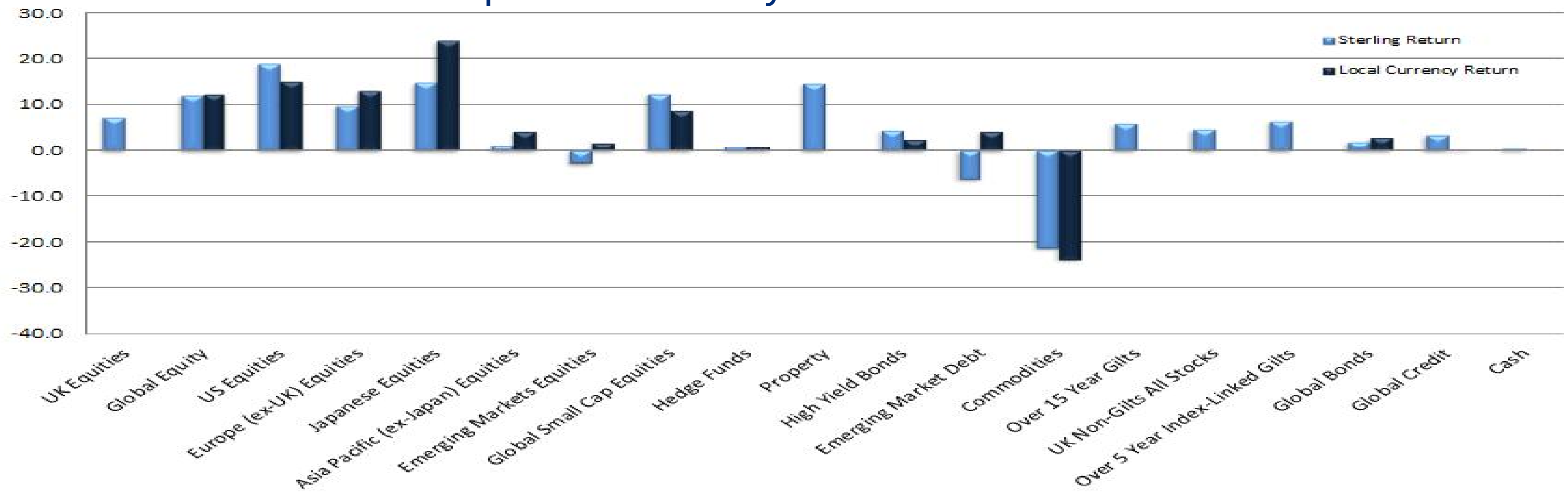
MARKET BACKGROUND
INDEX PERFORMANCE

Return over the 3 months to 31 December 2015



Return over the 12 months to 31 December 2015

Return p.a. over the 3 years to 31 December 2015

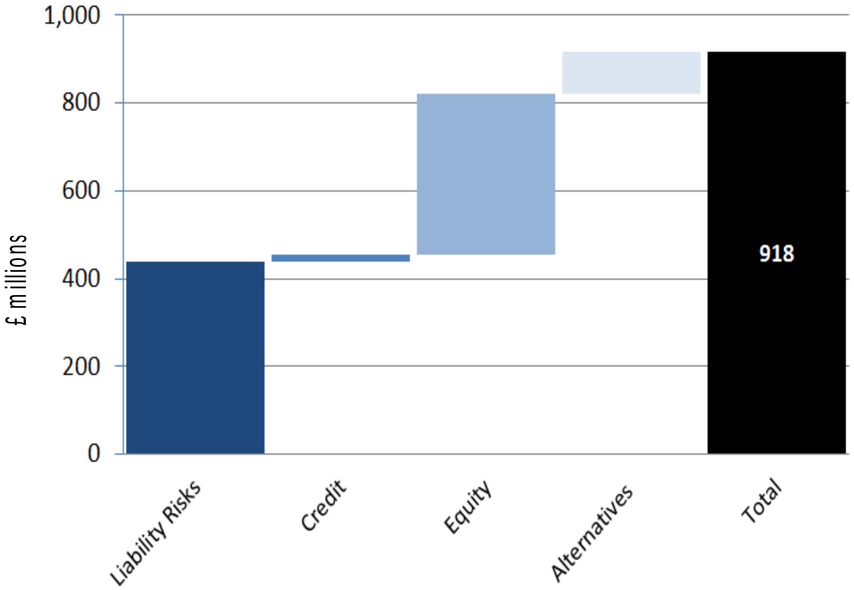


Source: Thomson Reuters Datastream.

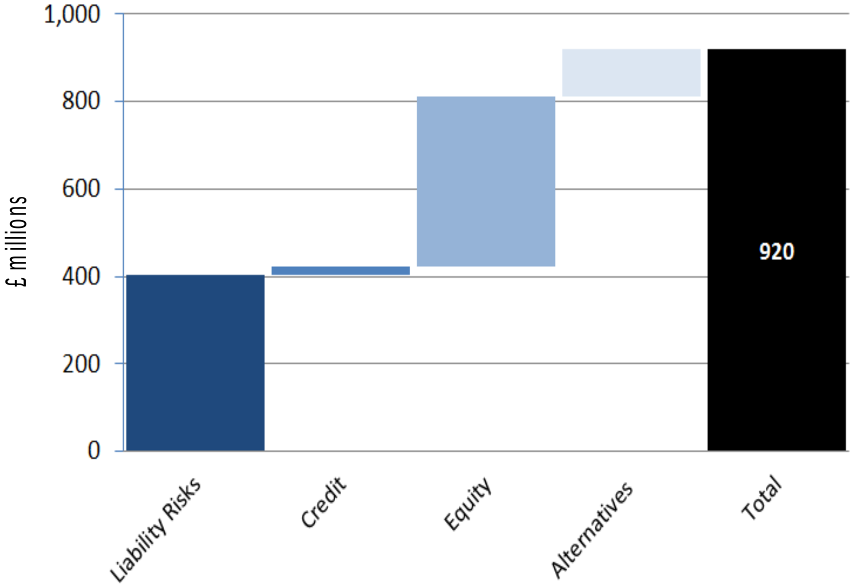
SECTION 3
STRATEGIC CONSIDERATIONS

STRATEGIC CONSIDERATIONS
RISK DECOMPOSITION

30 September 2015



31 December 2015



The two charts to the left illustrate not only the main risks the Fund is exposed to on the 2013 funding basis (which is why the funding position is volatile) but also the size of these risks in the context of the change in the deficit position.

The purpose of showing these charts is not to alarm, rather to ensure there is an awareness of the risks faced and how they change over time and to initiate debate on an ongoing basis, around how to best manage these risks, so as not to lose sight of the "big picture".

The black column on the right hand side of each chart shows the estimated 95th percentile Value at Risk figure over a one-year period. In other words, if we consider a downside scenario which has a 1 in 20 chance of occurring, what would be the impact on the deficit relative to our "best estimate" of what the deficit would be in one years time.

If we focus on the chart at 31 December 2015, the chart shows that if a 1 in 20 "downside event" occurred, we would expect that in one year's time, the deficit would increase by an additional **£920m** on top of the current deficit of **£1.2b**, creating a deficit of c. **£2.1b**.

Each bar to the left of the black bar represents the contribution to this total risk from the primary underlying risk exposures (interest rates and inflation, changes in credit spreads and volatility of equity markets and alternative assets).

The two charts show that the one-year risk over the quarter has stayed broadly the same. This reflects an increased contribution from growth asset volatility (as absolute holdings increased over the quarter), offset somewhat by an increased allocation to index-linked gilts and the currency hedging.

The contributions to the total risk from the various return drivers have, as expected, changed little. Liability risks (i.e. interest rate) and equity market risk dominate.

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

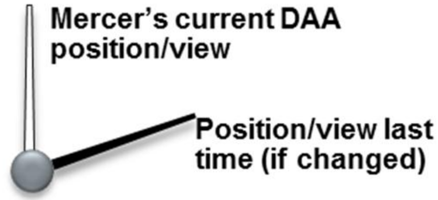
MARKET BACKGROUND
INDEX PERFORMANCE VERSUS STRATEGY

Asset Class	Strategy Assumed Return % p.a.	3 year Index Return % p.a.	Comment
Developed Equities (Global) (FTSE All-World Developed)	8.25	13.6	*Remains significantly ahead of the assumed strategic return.* *This has increased from 11.3% p.a. as the latest quarter's return of 8.6% was considerably higher than the 2.2% return of Q4 2012, which fell out of the 3 year return.*
Emerging Market Equities (FTSE AW Emerging)	8.75	-2.9	*The three year return from emerging market equities has fallen from -2.2% p.a. last quarter, despite a return of 3.1% experienced last quarter as this was lower than the quarter that fell out (5.1%). The three year return remains considerably below the assumed strategic return.*
Diversified Growth	Libor + 4% / RPI + 5%	4.5 / 6.8	*DGFs are expected to produce an equity like return over the long term but with lower volatility – this is the basis for the Libor and RPI based benchmarks. Low cash rates means that the Libor based benchmark has significantly underperformed the inflation (RPI) based benchmark and the long term expected return from equity. During periods of strong equity returns, such as the recent three year period, we would expect DGF to underperform equities.*
UK Gilts (FTSE Actuaries Over 15 Year Gilts)	4.5	5.9	*UK gilt returns remain above the long term strategic assumed return as yields remain low relative to historic averages. Returns have decreased compared to the previous quarter as a result of the rise in yields (and hence negative total returns) experienced in the last quarter. Corporate bond returns have also reduced this quarter, and looking back over three years continue to be below the strategic assumed return.*
Index Linked Gilts (FTSE Actuaries Over 5 Year Index-Linked Gilts)	4.25	6.4	
UK Corporate Bonds (BofAML Sterling Non Gilts)	5.5	4.5	
Overseas Fixed Interest (JP Morgan Global Government Bonds ex UK)	5.5	0.9	*Although still lagging the strategic assumed return, the 3 year performance from overseas fixed interest is now in positive territory due to positive returns this quarter.*
Fund of Hedge Funds (HFRX Global Hedge Fund Index)	6.0	0.8	*Hedge fund returns remain below long term averages and the strategic return, as they are affected by low cash rates. Volatility remains low and recent returns have fallen slightly. It should be noted that the index includes a wide variety of strategies that may have had very divergent returns.*
Property (IPD UK Monthly)	7.0	14.6	*Property returns continue to be above the expected returns, driven by the economic recovery in the US and the UK.*

Source: Thomson Reuters Datastream.

DYNAMIC ASSET ALLOCATION (DAA) DASHBOARD – Q1 2016

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



DEVELOPED MARKET EQUITIES

- ✓ Monetary policy remains generally supportive of equity markets
- ! Valuations have risen and, in the US in particular, are looking more expensive
- ! Continued concerns over global growth have led to a deterioration in market sentiment and increased volatility

EMERGING MARKET EQUITIES

- ✓ Valuations are well below long-term averages, though vary by region and country
- ! Risk of further currency depreciation including devaluation of Chinese Renminbi
- ! Interrelated headwinds include slowing Chinese growth, weak commodity prices and strong US dollar

These charts summarise Mercer's views on the medium term outlook for returns from the key asset classes; by medium term we mean one to three years. These views are relevant for reflecting medium term market views in determining appropriate asset allocation. We do not expect investors to make frequent tactical changes to their asset allocation based upon these views. These are also based from the view of an absolute return investor, and so do not take into account pension scheme liabilities.

DYNAMIC ASSET ALLOCATION (DAA) DASHBOARD – Q1 2016

FIXED INTEREST GILTS (ALL STOCK)

- ✔ Ongoing extraordinary monetary policy and concerns over slowing growth continues to restrain upward yield moves
- ⚠ Valuations remain stretched by historical norms
- ⚠ US monetary policy normalising could hurt performance of fixed income assets

INDEX-LINKED GILTS

- ✔ Real yields continue to trade below long-term averages
- ✔ Breakeven inflation levels at cyclical lows due to weak commodity prices
- ⚠ Core inflation expectations continue to fall amid concerns China may remain a deflationary force at the global level

DYNAMIC ASSET ALLOCATION (DAA) DASHBOARD – Q1 2016

NON-GOVERNMENT BONDS (£ ALL-STOCK)

- ✔ While credit spreads have tightened marginally over the quarter, these remain favourable relative to current default rates
- ! Yields remain historically low and lack of trading liquidity has led to risk of increased volatility
- ! General consensus that credit cycle is fairly mature and prospective returns are relatively limited

UK PROPERTY

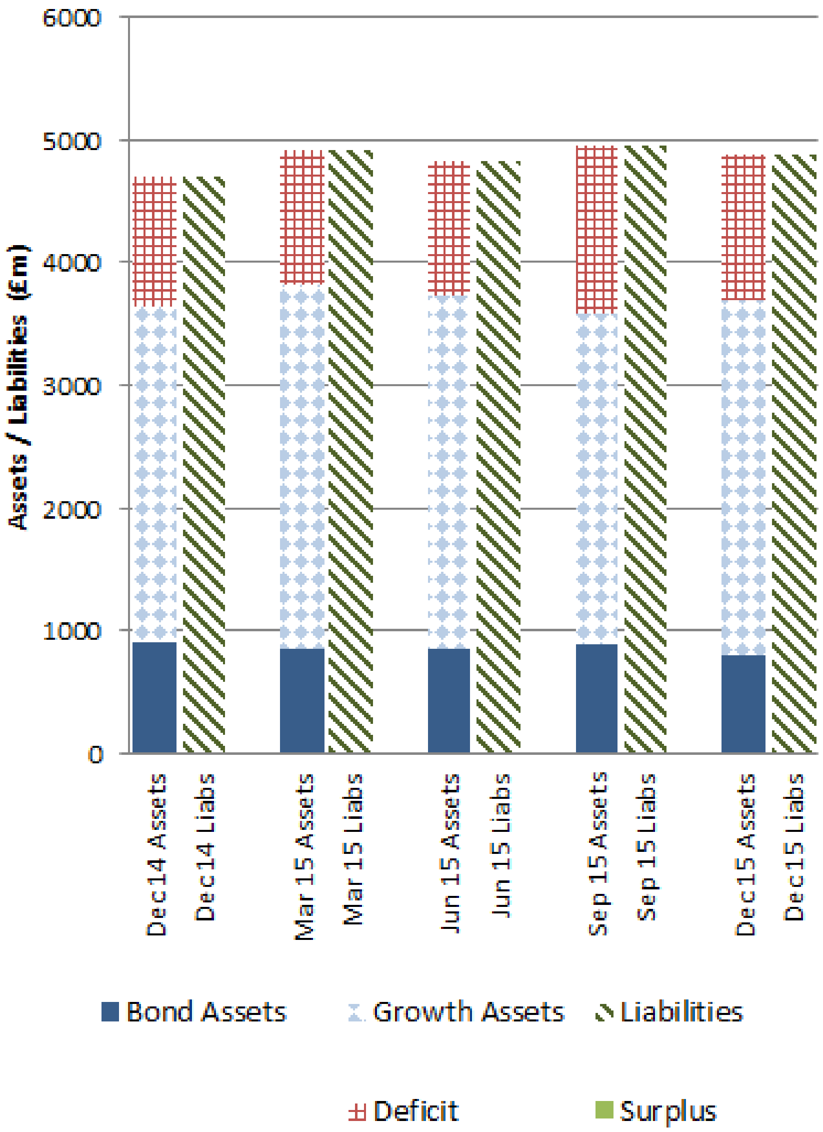
- ✔ Yields remain reasonable relative to other assets, despite a decrease in Q4
- ! Supply starting to come to market, leading to less favourable supply-demand imbalances
- ! Cautious of opportunistic strategies, and of London market over-heating

DYNAMIC ASSET ALLOCATION (DAA) DASHBOARD – Q1 2016

Asset Class	July 2015	Oct 2015	Jan 2016
Fixed Interest Gilts	Unattractive	Unattractive	Unattractive
Index-Linked Gilts	Unattractive	Unattractive	Unattractive
Eurozone Government Bonds	Unattractive	Unattractive	Unattractive
Non-Government Bonds (£ All-Stocks)	Unattractive	Unattractive	Unattractive
Non-Government Bonds (€ All-Stocks)	Unattractive	Unattractive	Unattractive
Global Equities	Neutral	Neutral	Neutral
Emerging Market Equities	Neutral	Neutral	Neutral
Small Cap Equities	Neutral	Neutral	Neutral
Low Volatility Equities	Neutral	Neutral	Neutral
UK Property	Neutral	Neutral	Neutral
High yield bonds	Neutral	Neutral	Neutral
Local currency emerging market debt	Neutral	Unattractive	Unattractive

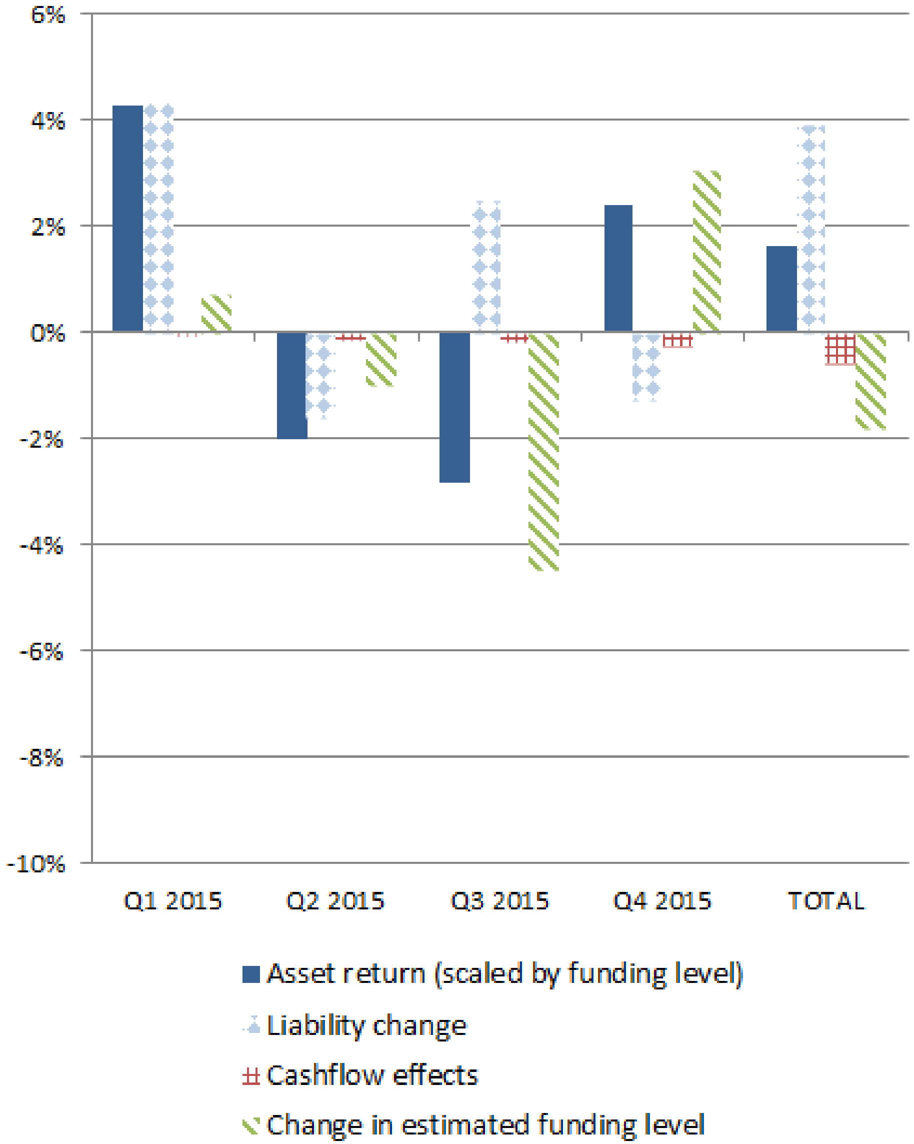
SECTION 4
CONSIDERATION OF FUNDING LEVEL

CONSIDERATION OF FUNDING LEVEL
ASSET ALLOCATION AND FUNDING LEVEL



- Based on financial markets, investment returns and cashflows into the Fund, the estimated funding level increased by c. 3% over the fourth quarter of 2015, all else being equal, from 73% to 76%. This was driven by:
  - A positive asset return on growth assets;
  - A positive effect from the liabilities, as the discount rate increased, decreasing the present value placed on the 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 decreased the overall funding level to 76%. This reduction has come mainly from the increase in the present value of the liabilities over the period (due to the falling discount rate).

CONSIDERATION OF FUNDING LEVEL
FUND PERFORMANCE RELATIVE TO ESTIMATED LIABILITIES



- The Fund's assets returned 3.3% over the quarter, which, when allowing for the funding position, increased the funding level by 2.4%.
- In addition, the Fund's estimated liabilities decreased by 1.3% over the quarter (primarily due to an increase in the discount rate).
- Over this quarter, the "cashflow effect" from contributions was negligible.
- Overall, the combined effect has led to a increase in the estimated funding level to 76% (from 73% at 30 September 2015).
- Over the 12 month period, the funding level has fallen by 1.7% primarily due a moderate fall in real yields, and interest on the liabilities exceeding investment returns.

SECTION 5

FUND VALUATIONS

FUND VALUATIONS
VALUATION BY ASSET CLASS

Asset Allocation								
Asset Class	**Start of Quarter (£'000)**	**End of Quarter (£'000)**	**Start of Quarter (%)**	**End of Quarter (%)**	**Target Strategic Benchmark (%)**	**Ranges (%)**		**Difference (%)**
Developed Market Equities	1,568,521	1,685,268	43.6	45.5	40.0	35 -	45	+5.5
Emerging Market Equities	293,957	302,627	8.2	8.2	10.0	5 -	15	-1.8
Diversified Growth Funds	357,914	365,235	9.9	9.9	10.0	5 -	15	-0.1
Fund of Hedge Funds	157,291	201,841	4.4	5.4	5.0	0 -	7.5	+0.4
Property	324,421	343,969	9.0	9.3	10.0	5 -	15	-0.7
Infrastructure	-	-	-	-	5.0	0 -	7.5	-5.0
Bonds	761,311	753,425	21.2	20.3	20.0	15 -	35	+0.3
Cash (including currency instruments)	133,923	52,665	3.7	1.4	-	0 -	5	+1.4
Total	**3,597,158**	**3,705,031**	**100.0**	**100.0**	**100.0**			**0.0**

Source: WM Performance Services, Mercer. Green numbers indicate the allocation is within tolerance ranges, whilst red numbers indicate the allocation is outside of tolerance ranges.

Invested assets increased over the quarter by £108m due to positive returns across growth assets. At the end of the quarter, developed market equities were overweight relative to benchmark (and outside the range in the SIP); this will be drawn down to fund the Infrastructure mandate.

FUND VALUATIONS
VALUATION BY MANAGER

Manager Allocation						
Manager	**Asset Class**	**Start of Quarter (£'000)**	**Cashflows (£'000)**	**End of Quarter (£'000)**	**Start of Quarter (%)**	**End of Quarter (%)**
BlackRock	Passive Multi-Asset	1,099,762	-3,012	1,133,399	30.6	30.6
Jupiter	UK Equities	168,771	-	176,056	4.7	4.8
TT International	UK Equities	193,736	-	205,993	5.4	5.6
Schroder	Global Equities	232,442	-	253,171	6.5	6.8
Genesis	Emerging Market Equities	132,393	-	136,357	3.7	3.7
Unigestion	Emerging Market Equities	161,564	-	166,270	4.5	4.5
Invesco	Global ex-UK Equities	260,036	-	284,392	7.2	7.7
SSgA	Europe ex-UK & Pacific inc. Japan Equities	109,756	-	119,872	3.1	3.2
Pyrford	DGF	120,916	-	123,750	3.4	3.3
Standard Life	DGF	236,999	-	241,485	6.6	6.5

Source: WM Services, Avon. Totals may not sum due to rounding.

FUND VALUATIONS
VALUATION BY MANAGER

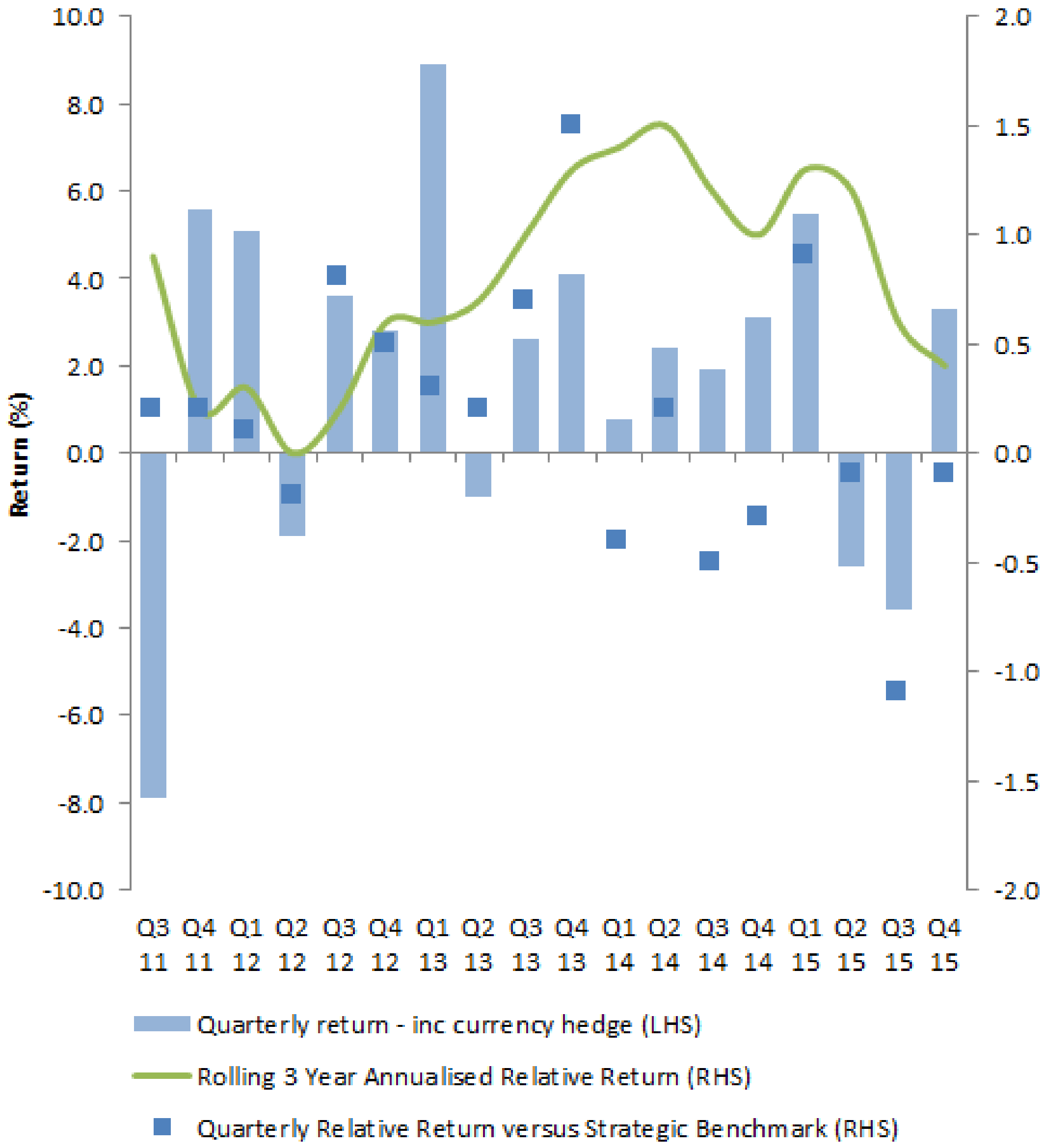
Manager Allocation

Manager	Asset Class	Start of Quarter (£'000)	Cashflows** (£'000)	End of Quarter (£'000)	Start of Quarter (%)	End of Quarter (%)
MAN	Fund of Hedge Funds	593	-	814	0.0	0.0
Signet	Fund of Hedge Funds	38,877	-32,957	5,186	1.1	0.1
Gottex	Fund of Hedge Funds	58,405	-49,249	9,564	1.6	0.3
JP Morgan	Fund of Hedge Funds	59,416	119,391*	186,277	1.7	5.0
Schroder	UK Property	189,410	-	194,007	5.3	5.2
Partners	Property	146,896	4,610	151,610	4.1	4.1
RLAM	Bonds	281,004	-	282,045	7.8	7.6
Record Currency Management	Currency Hedging	3,430	-	-17,595	0.1	-0.5
Internal Cash	Cash	102,710	-38,783*	52,377	2.9	1.4
Total		**3,597,158**	**-**	**3,705,031**	**100.0**	**100.0**

Source: WM Services, Avon. Totals may not sum due to rounding.
*Includes £59.6m in transition from internal cash to JP Morgan as at 30 September 2015, which was counted as cash in the Q3 2015 report and included in the Internal Cash figure above as at the start of the quarter.
** The cashflow column shows only the cash movements within the asset portfolio. It does not include non-investment cash movements such as employer contributions or pension payments made, however these amounts are included in the 'Internal Cash' start and end balance to reflect the asset value position of the total fund.

SECTION 6
PERFORMANCE SUMMARY

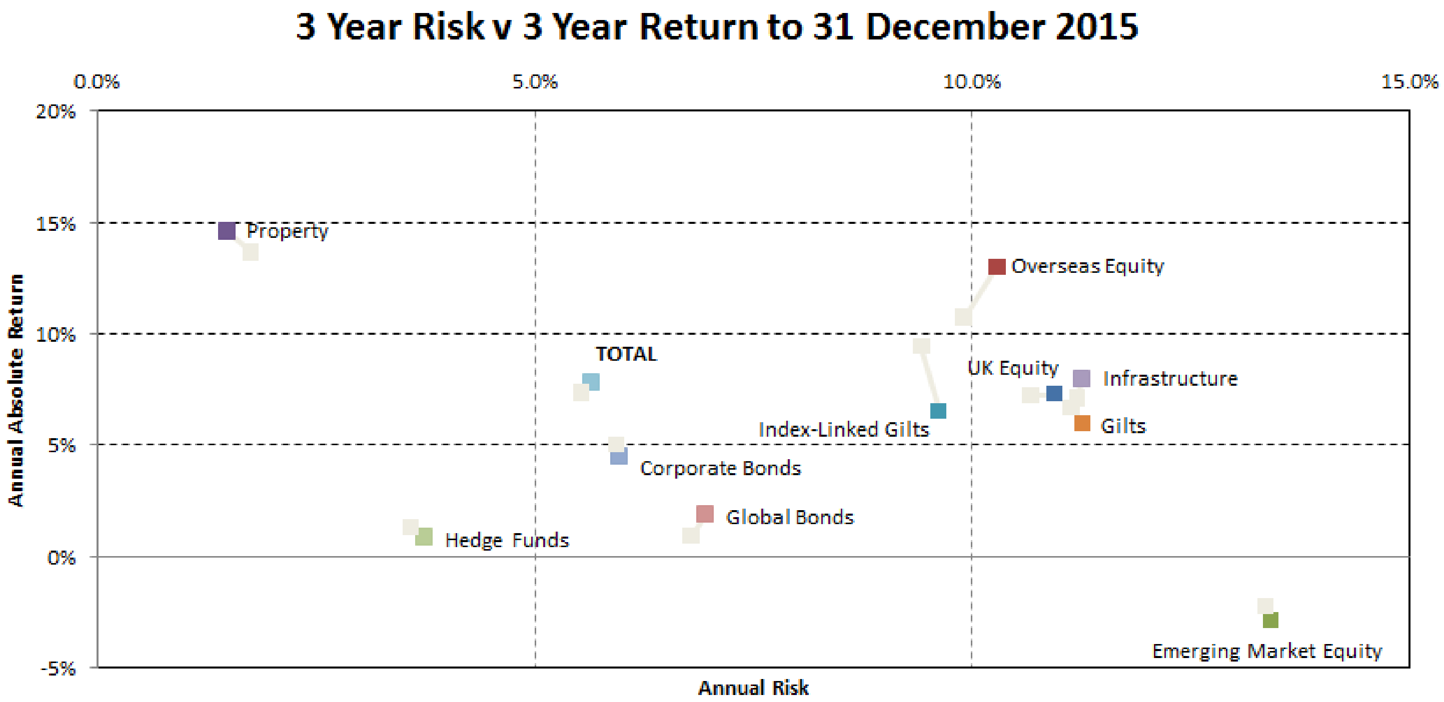
PERFORMANCE SUMMARY
TOTAL FUND PERFORMANCE



	3 months (%)	1 year (%)	3 years (% p.a.)
Total Fund (inc currency hedge)	3.3	2.3	8.5
Total Fund (ex currency hedge)	3.9	3.2	8.7
Strategic Benchmark (no currency hedge)	3.4	2.9	8.1
Relative (inc currency hedge)	**-0.1**	**-0.6**	**+0.4**

- Over Q4 2015, the Fund slightly underperformed its Strategic Benchmark by 0.1% when including the currency hedge but outperformed by 0.5% excluding the currency hedge.
- The Fund has underperformed the Strategic Benchmark over the year by 0.6% but outperformed over the three year period by 0.4% p.a.
- The latest quarter's underperformance has reduced the rolling three year outperformance from 0.6% p.a. to 0.4% p.a.
- The slight underperformance of the Fund (when the currency hedge with Record is included) relative to the unhedged strategic benchmark over the quarter was due to having the currency hedging mandate in place, as sterling depreciated over the quarter.

MANAGER MONITORING
RISK RETURN ANALYSIS

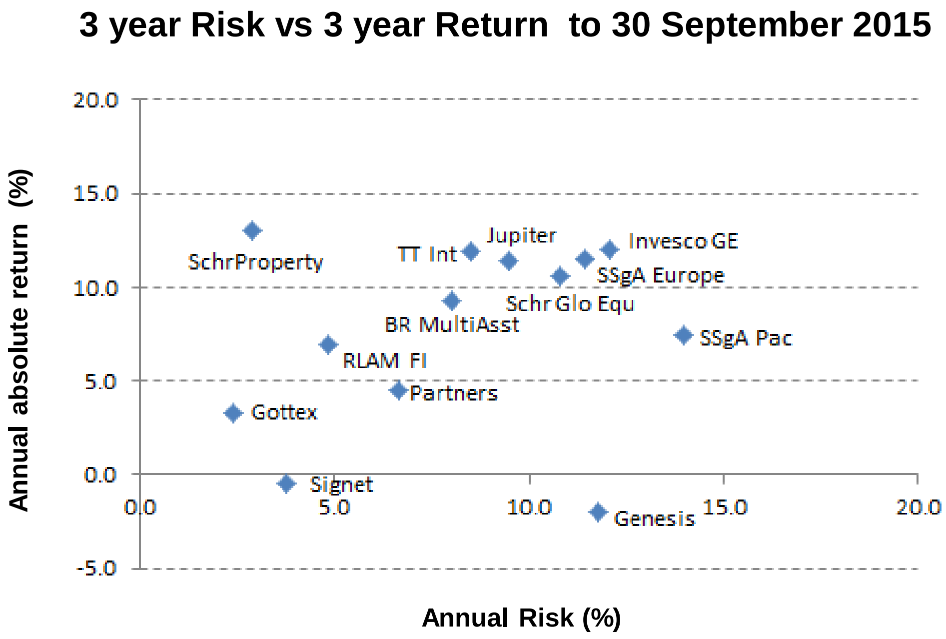


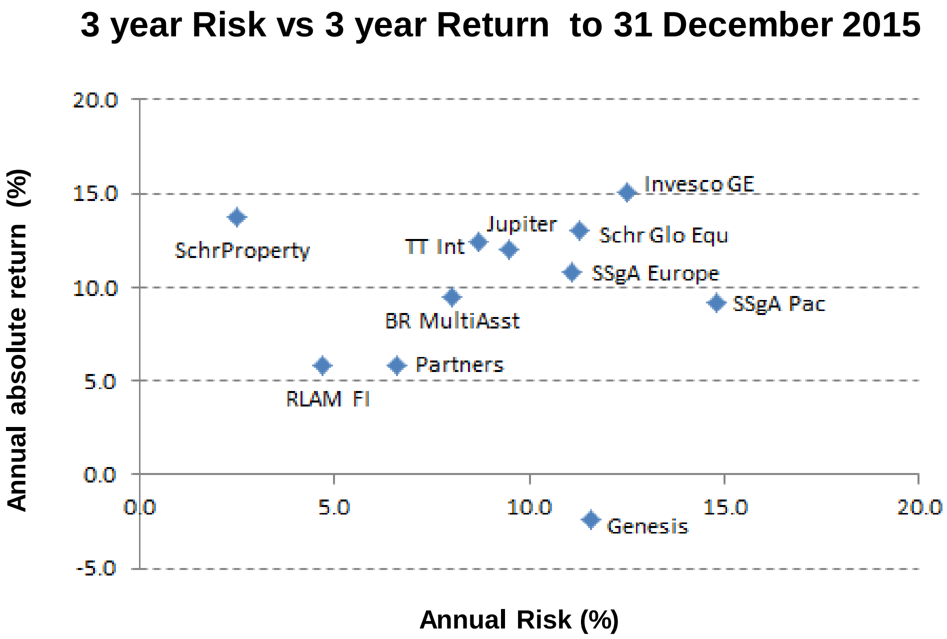
This chart shows the 3 year absolute returns against three year volatility (based on monthly data in sterling terms), to the end of December 2015, for each of the broad underlying asset benchmarks (using the indices set out in the Appendix), along with the total Fund strategic benchmark (using the benchmark indices and allocations from WM Services). We also show the positions as at last quarter, in grey.

Comments

- *There were limited shifts in observed returns and volatilities over the quarter, the two significant movements being an increase in returns and volatility for overseas equity (on the back of observed strong performance), and a drop in observed returns for gilts as yields rose.*

MANAGER MONITORING
RISK RETURN ANALYSIS





Comments

- *In general absolute returns of the funds increased over the quarter, whilst volatility remained relatively stable. This impact was most noticeable in Schroder and Invesco global equity funds as well as SSgA Pacific inc. Japan equity fund given the significantly positive returns delivered by those equity markets.*

MANAGER MONITORING
MANAGER PERFORMANCE TO 31 DECEMBER 2015

Manager / fund	3 months (%)			1 year (%)			3 year (% p.a.)			3 year outperformance target (% p.a.)	3 year performance versus target
	Fund	B'mark	Relative	Fund	B'mark	Relative	Fund	B'mark	Relative		
BlackRock Multi-Asset	3.4	3.4	0.0	2.8	2.7	0.1	9.6	9.5	0.1	-	Target met
Jupiter	4.2	4.0	0.2	5.4	1.0	4.4	12.2	7.3	4.6	+2	Target met
TT International	6.3	4.0	2.2	9.9	1.0	8.8	12.5	7.3	4.9	+3-4	Target met
Schroder Equity	8.7	8.1	0.6	6.7	3.8	2.8	12.9	11.8	1.0	+4	Target not met
Genesis	3.4	3.5	-0.1	-10.0	-9.7	-0.4	-2.6	-3.4	0.8	-	Target met
Unigestion	2.9	3.5	-0.5	-7.5	-10.0	2.7	N/A	N/A	N/A	+2-4	N/A
Invesco	9.4	8.8	0.5	5.5	5.5	0.0	15.2	14.0	1.0	+0.5	Target met
SSgA Europe	6.1	6.2	-0.1	6.5	5.2	1.2	10.9	10.1	0.8	+0.5	Target met
SSgA Pacific	10.9	11.6	-0.6	8.5	8.5	0.0	9.3	8.3	1.0	+0.5	Target met
Pyrford	2.3	1.6	0.7	2.1	6.2	-3.9	N/A	N/A	N/A	-	N/A
Standard Life	1.7	1.4	0.4	N/A	N/A	N/A	N/A	N/A	N/A	-	N/A
JP Morgan	4.1	0.9	3.2	N/A	N/A	N/A	N/A	N/A	N/A	-	N/A
Schroder Property	2.5	2.8	-0.3	11.9	12.5	-0.5	13.6	12.9	0.6	+1	Target not met
Partners Property	3.2	1.1	2.1	5.8	12.3	-5.8	5.9	11.0	-4.6	+2	Target not met
RLAM	0.4	0.4	0.0	1.0	0.5	0.5	5.8	4.4	1.4	+0.8	Target met
Internal Cash	0.1	0.1	0.0	0.3	0.3	0.0	0.4	0.4	0.0	-	N/A

Source: WM Services, Avon.
In the relative performance columns, returns in blue text exceeded their respective benchmarks, those in red underperformed, and black text shows performance in line with benchmark.
In the table above, and throughout this report, relative returns have been calculated geometrically (i.e. the portfolio return is divided by the benchmark return) rather than arithmetically (where the benchmark return is subtracted from the portfolio return).
A summary of the benchmarks for each of the mandates is given in Appendix 1.

APPENDIX 1
SUMMARY OF MANDATES

SUMMARY OF MANDATES

Manager	Mandate	Benchmark	Outperformance target (p.a.)
BlackRock	Passive Multi-Asset	In line with customised benchmarks using monthly mean fund weights	-
Jupiter Asset Management	UK Equities (Socially Responsible Investing)	FTSE All Share	+2%
TT International	UK Equities (Unconstrained)	FTSE All Share	+3-4%
Schroder	Global Equities (Unconstrained)	MSCI AC World Index Free	+4%
Genesis	Emerging Market Equities	MSCI EM IMI TR	-
Unigestion	Emerging Market Equities	MSCI EM NET TR	+2-4%
Invesco	Global ex-UK Equities (Enhanced Indexation)	MSCI World ex UK NDR	+0.5%
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%
Pyrford	Diversified Growth Fund	RPI +5% p.a.	-
Standard Life	Diversified Growth Fund	6 Month LIBOR +5% p.a.	-
JP Morgan	Fund of Hedge Funds	3 Month LIBOR +3% p.a.	-
Schroder	UK Property	IPD UK Pooled	+1%
Partners	Overseas Property	IPD Global Pooled	+2%
Royal London Asset Management	UK Corporate Bonds	iBoxx £ Non-Gilts All Maturities	+0.8%
Record	Passive Currency Hedging	N/A	-
Cash	Internally Managed	7 Day LIBID	-

APPENDIX 2
MARKET STATISTICS INDICES

MARKET STATISTICS INDICES

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

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

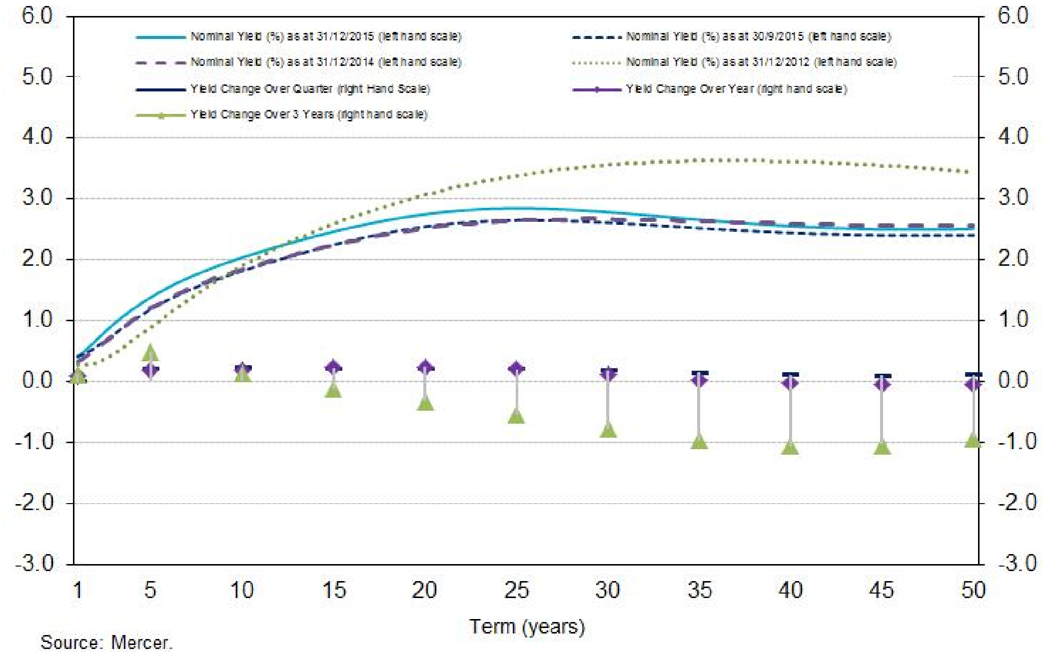
APPENDIX 3
CHANGES IN YIELDS

CHANGES IN YIELDS

Asset Class Yields (% p.a.)	31 December 2015	30 September 2015	31 December 2014	31 December 2013
UK Equities	3.70	3.71	3.37	3.28
Over 15 Year Gilts	2.57	2.38	2.42	3.58
Over 5 Year Index-Linked Gilts	-0.70	-0.83	-0.75	0.05
Sterling Non Gilts	3.23	3.16	2.99	3.85

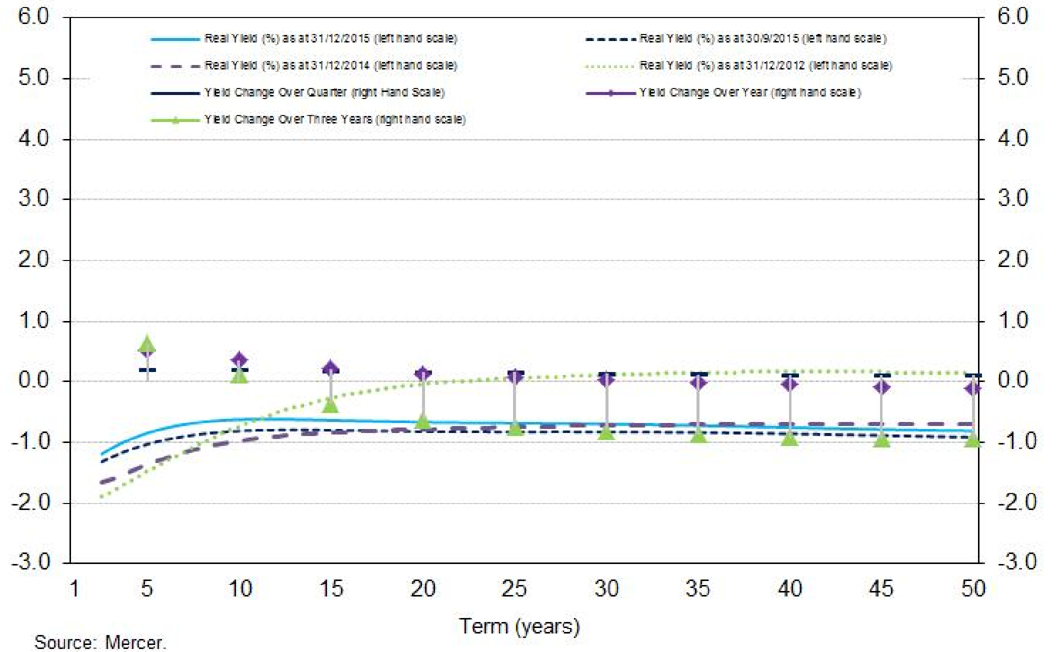
- Bond yields rose across all maturities over the quarter, resulting in negative returns for investors.
- In the UK, government bond yields increased by c.10-20 bps across the curve, with the increase most pronounced at medium to long end of the curve. Despite this, nominal yields remain well below long-term average levels.
- Real yields also rose over the quarter, with the Over 5 Year Index-Linked Gilts Index posting a negative return of 3.3%.
- Credit spreads narrowed over the quarter by c.10 bps and amounted to c.1.4% for both the Sterling Non-Gilts All Stocks and Sterling Non-Gilts Over 10 Year indices at the end of December. The benefit from the narrowing of credit spreads along with the income earned on corporate bond investment more than offset the negative impact of a rise in gilt yields, leading UK credit assets to post a positive return of 0.5% in sterling terms.

Nominal yield curves



Source: Mercer.

Real yield curves



Source: Mercer.

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