HEALTH WEALTH CAREER

AVON PENSION FUND

COMMITTEE INVESTMENT PERFORMANCE REPORT QUARTER TO 31 DECEMBER 2016

MARCH 2017

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- The valuation of investments in property based portfolios, including forestry, is generally a matter of a valuer's opinion, rather than fact.
- When there is no (or limited) recognised or secondary market, for example, but not limited to property, hedge funds, private equity, infrastructure, forestry, swap and other derivative based funds or portfolios it may be difficult for you to obtain reliable information about the value of the investments or deal in the investments.
- Where the investment is via a fund of funds the investment manager typically has to rely on the underlying managers for valuations of the interests in their funds.
- 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.

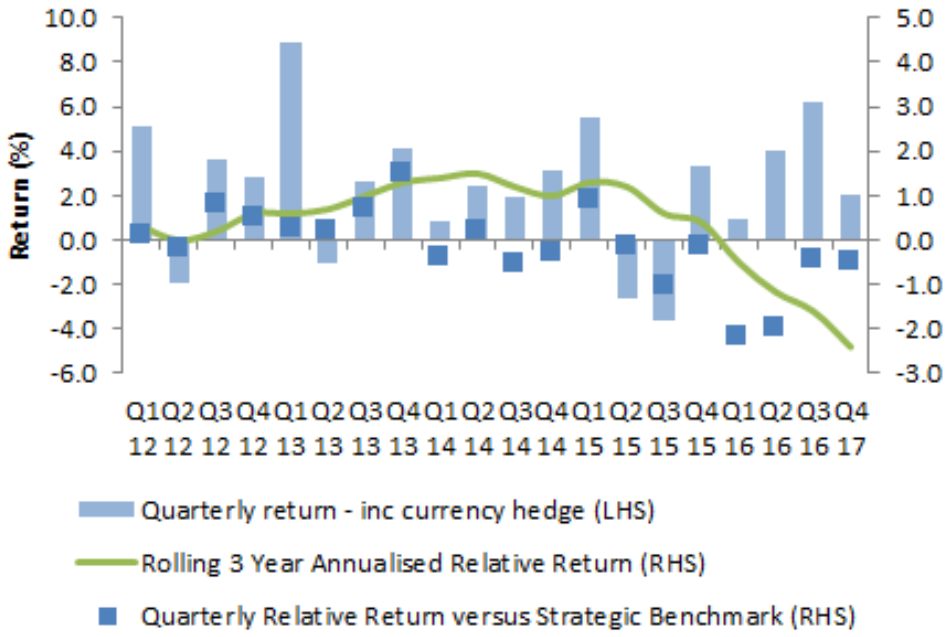
CONTENTS

SECTION 1
EXECUTIVE SUMMARY

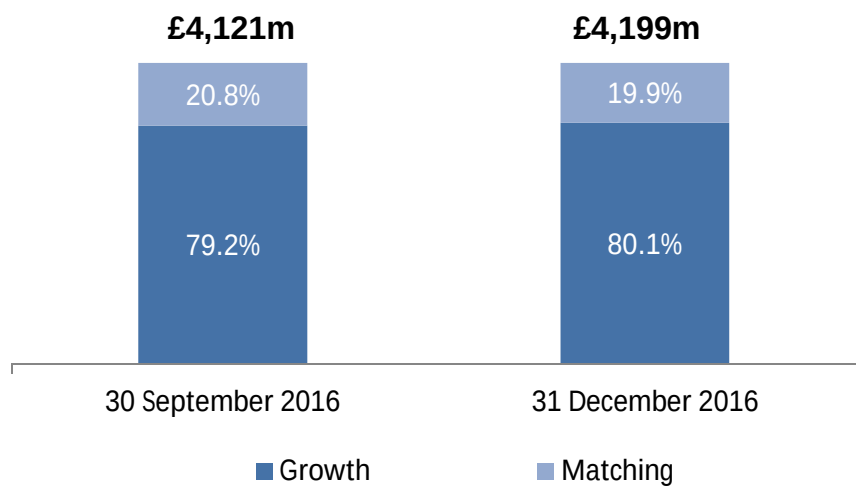
EXECUTIVE SUMMARY

	3 months (%)	1 year (%)	3 years (% p.a.)
Total Fund (inc currency hedge)	2.0	13.7	8.0
Total Fund (ex currency hedge)	2.5	17.9	9.7
Strategic Benchmark (no currency hedge)	2.5	19.4	10.4
Relative (inc currency hedge)	**-0.5**	**-5.7**	**-2.4**

Excess Return Chart



Asset Allocation



Quarterly Commentary

Over the quarter, total Fund assets increased from £4,121m (30 September 2016) to £4,199m.

This increase has come from growth assets, with strong returns in particular from global equities over the quarter.

At a strategic level, all asset class allocations were within the agreed tolerance ranges at the end of the quarter.

The 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 against the US Dollar. The Fund return excluding currency hedging was in line with the unhedged strategic benchmark.

The underperformance over the year excluding the currency hedge was largely due to underperformance of a number of the Fund's active equity managers and Standard Life GARS.

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. 1% over the third quarter of 2016 to 94%, as the return on the assets exceeded the increase in liabilities. This is based on liability values that have been recalibrated since the Q3 2016 report, where the funding level was reported as 89%.

Fund performance

- The value of the Fund's assets increased by £78m over the quarter, to £4,199m at 31 December 2016. The Fund's assets returned 2.0% over the quarter (2.5% excluding the Record currency hedging mandate, given the depreciation of sterling over the quarter), as a result of positive returns from growth assets, with strong returns in particular from global equities. The return including currency hedging underperformed the Strategic Benchmark return of 2.5%.

Strategy

- Global (developed) equity returns over the last three years at 15.0% p.a. have been ahead of the assumed strategic return of 8.25% p.a. from the review in March 2013. We remain broadly neutral in our medium term outlook for developed market equities (over the next one to three years). Accommodative monetary policy remains generally supportive of equity markets but uninspiring earnings growth and downwards revisions to earnings estimates persist.

- The three year return from emerging market equities has increased to 9.4% p.a. from 8.4% p.a. last quarter. The three year return is therefore now above the assumed strategic return (of 8.75% p.a.) as returns have been strong over the last year and fundamentals have improved. As with developed markets, we are neutral in our medium term outlook for emerging market equities over the next one to three years.

EXECUTIVE SUMMARY

Strategy (continued)

- UK government bond returns over the three years to 31 December 2016 remain significantly above the long term strategic assumed returns (with fixed interest gilts returning 14.4% p.a. against an assumed return of 4.5% p.a., and index-linked gilts returning 15.2% p.a. versus an assumed return of 4.25% p.a.) as investor demand for gilts remains high. However gilt yields did rise over the quarter leading to negative returns.

- UK corporate bonds returned 7.8% p.a. over the three year period, being above their assumed return of 5.5% p.a., while UK property returns of 11.8% p.a. 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, and as active managers in general have struggled to generate meaningful returns.

- Looking forward into 2017, Mercer have four key themes and opportunities we believe will play out in markets;
  - **Political fragmentation and "deglobalisation"** - growing nationalism together with what some have dubbed "the death of liberal politics" are likely to remain prominent political influences for some time. The risks to growth from increasing isolationism and protectionist trade policies are therefore high.
  - **Shift from monetary to fiscal stimulus** - 2016 saw the limits of monetary stimulation being recognised whilst mainstream economic voices and populist politicians called for greater fiscal stimulus. This switch in focus could have important implications in the years ahead, particularly for inflation.
  - **Capital abundance** - After eight years of monetary stimulation real yields are below zero in much of the developed world and most asset classes have seen significant price inflation. We believe it could be difficult to generate strong real returns over the next 3-5 years, but that by ensuring a diverse range of return drivers will improve investors' chances of doing so. A flexible approach will be required.
  - **Understanding structural change** - Whilst general elections will continue to grab the headlines, demographic and climate change together with technological disruption are longer term trends that cannot be ignored. Identifying the broad market outcomes from these forces will help investors manage risk and returns by investors over the long term.

EXECUTIVE SUMMARY

Managers

- Absolute returns of the managers over the quarter were largely positive. The exceptions were Royal London and Unigestion, who delivered returns of -1.8% and -1.3% respectively, though Royal London's performance is understandable given the rise in corporate bond yields over the quarter. Invesco produced the highest return over the quarter, returning nearly 10%. After a period of underperformance, Standard Life GARS outperformed its benchmark.
- Absolute returns over the year to 31 December 2016 were strong. All mandates (with the exception of Standard Life GARS) delivered positive absolute returns, and all overseas equities mandates returned over 20%, largely due to the weakening of sterling over 2016.
- Over three years, all mandates with a three year track record produced positive absolute returns. A number of active funds underperformed their benchmarks over the period: Jupiter, Schroder Global Equities and Property, Genesis, Unigestion, Pyrford and Partners (although see comments on the measurement of Partners' performance later). On the other hand, Invesco and the SSgA mandates achieved their three-year performance objectives. TT and Royal London failed to achieve their performance objectives despite achieving benchmark returns net of fees.

EXECUTIVE SUMMARY

Key points for consideration

- There were significant currency swings over the quarter, with sterling falling 4.9% against the US dollar, but appreciating against the euro and Japanese yen by 1.3% and 9.6% respectively.
- Relative returns of the UK equity managers have been disappointing over both the quarter and year. This has been a period of significant volatility with the fallout from the EU Referendum result and also the impacts of the US election towards the end of the period. TT's underperformance has come about through consistent underperformance in each quarter. However Jupiter's underperformance largely came in Q2 2016 due to the fund's overweight exposure to UK domestic-focused companies, as the result of the EU Referendum led to concerns of economic growth in the UK, and an underweight position in oil & gas and mining stocks and exposure to consumer staples stocks such as tobacco.
- The Fund is in the process of implementing the liability risk management mandate with BlackRock. In addition, the final drawdown from IFM has been called and, as a result, c£80m has been disinvested from US equities. This follows advice from Mercer and also reflects an overweight position in US equities.
- The Fund is looking to consider options on Responsible Investment, in particular regarding the Fund's passive equity holdings, following the review last quarter. This will also be considered in the context of a wider investment strategy review, which is due to be undertaken in Q2 2017.

SECTION 2
MARKET BACKGROUND

MARKET BACKGROUND
INDEX PERFORMANCE

Equity Market Review

The fourth quarter of 2016 saw equity markets continuing to rise. Most major developed equity markets moved higher over the quarter, with returns in sterling terms for US equities further boosted by the depreciation of sterling against the US dollar.

Within UK equities, large capitalisation stocks, as measured by the FTSE 100 index, returned 4.3% over the quarter, lagging parts of Europe and in particular the US. Small and mid-sized companies, as measured by the FTSE Small Cap Index and FTSE 250 Index, rose by 4.0% and 1.7% respectively over the quarter, underperforming large cap stocks. The continued uncertainty surrounding Brexit seems unlikely to be resolved in the short term.

Within global equity markets, US equities rose following the presidential and congressional elections, with investors anticipating infrastructure spending, tax reforms and deregulation. This rally was further buoyed by upbeat housing and labour market data. In Europe, performance varied by country, as investors digested a mixed bag of economic news. Positive manufacturing and consumer confidence data was offset by somewhat disappointing retail sales figures. Meanwhile, Japanese equities moved higher in local currency terms, helped by the significant decline of the yen relative to the US dollar. Performance of Emerging Markets equities was modest as a group in sterling terms and slightly negative in local currency terms. Performance continues to vary by country; Brazil was the big underperformer over the quarter following a smaller than expected benchmark interest rate cut of 25bps to 13.75%. Russia was one of the few standout performers, and benefitted from rising oil prices after OPEC announced its first oil production cut in eight years.

Bond Market Review

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

In the UK, gilt yields rose amid expectations for higher inflation and the yield curve also steepened. The Over 15 Year Gilt Index underperformed the broader global bond market over the quarter, generating a negative return of 6.0%.

Real yields also rose over the quarter, though to a lesser extent, with increases varying between c.10bps and 20bps across the curve. The Over 5 Year Index-Linked Gilts Index was down 3.0% over the quarter.

Movements in credit spreads were marginal over the quarter, with the sterling Non-Gilts All Stocks Index ending the quarter at c.1.2% and the sterling Non-Gilts All Stocks over 10 years Index ending the quarter at c.1.3%. UK credit assets posted a negative return of 2.8% over the quarter, driven by rising bond yields and underperforming the broader global credit market.

Currency Market Review

Over the quarter, Brexit uncertainty coupled with a rate rise by the Federal Reserve in the US led to sterling extending its depreciation against the US dollar (by c.4.9%). Sterling appreciated marginally against the euro (by c.1.3%) and materially against the Japanese yen (by c.9.6%), as the Bank of Japan's ongoing commitment to manage the yield curve through its bond purchase programme led to a weaker yen.

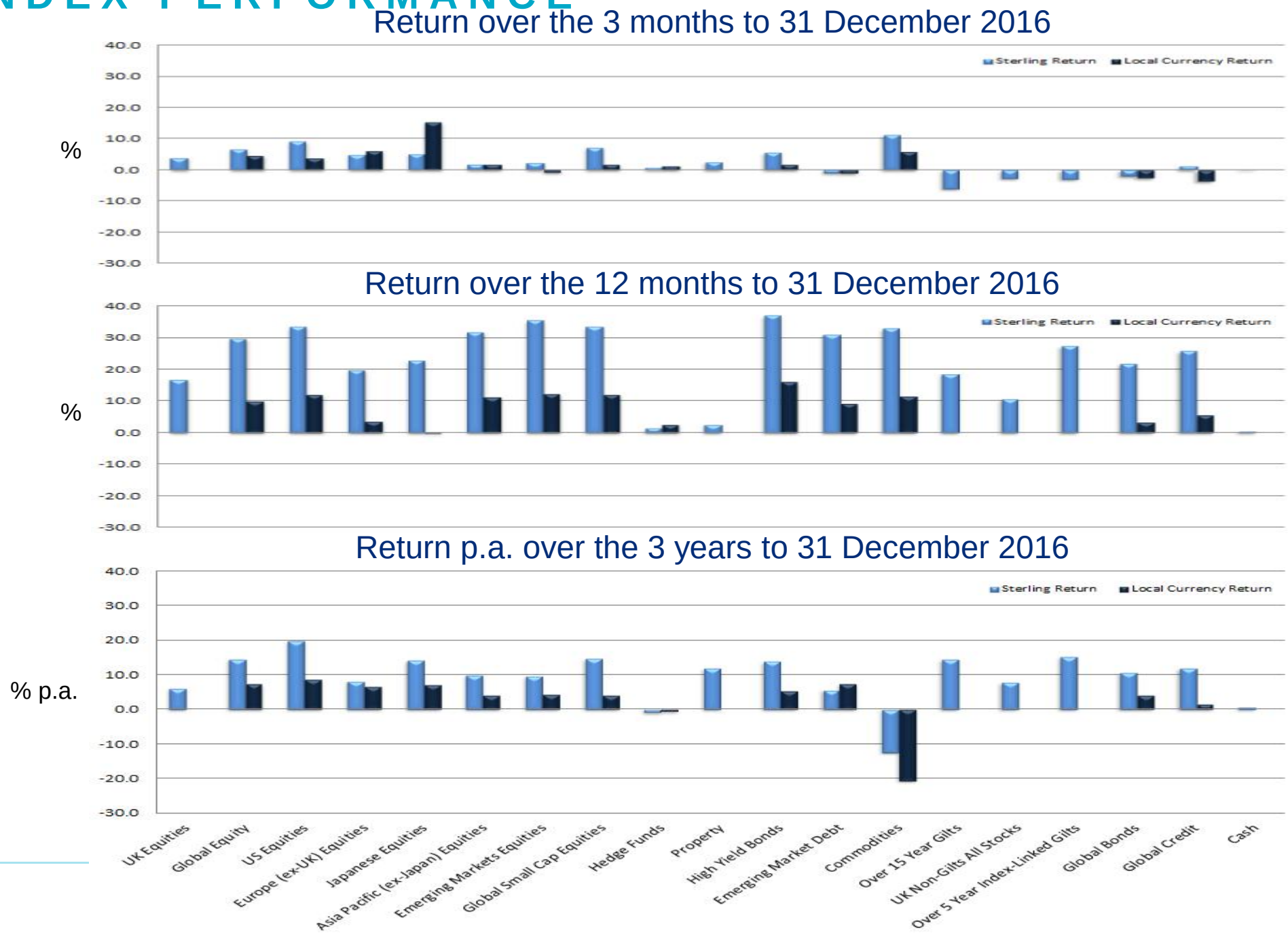
Commodity Market Review

Most global commodity prices rose over the quarter, with returns driven by rebounding livestock prices and a pick up in the oil price following OPEC agreement to cut production. Negative returns were experienced by the precious metals sector, driven by a fall in the price of gold, and to a lesser extent the agriculture sector.

Brent Crude Oil price increased materially from US$48.97/barrel to US$56.71/barrel. Gold prices fell from c.$1,321/oz to c.$1,157/oz , as the previous uncertainty around the US elections subsided.

Source: Thomson Reuters Datastream.

MARKET BACKGROUND
INDEX PERFORMANCE

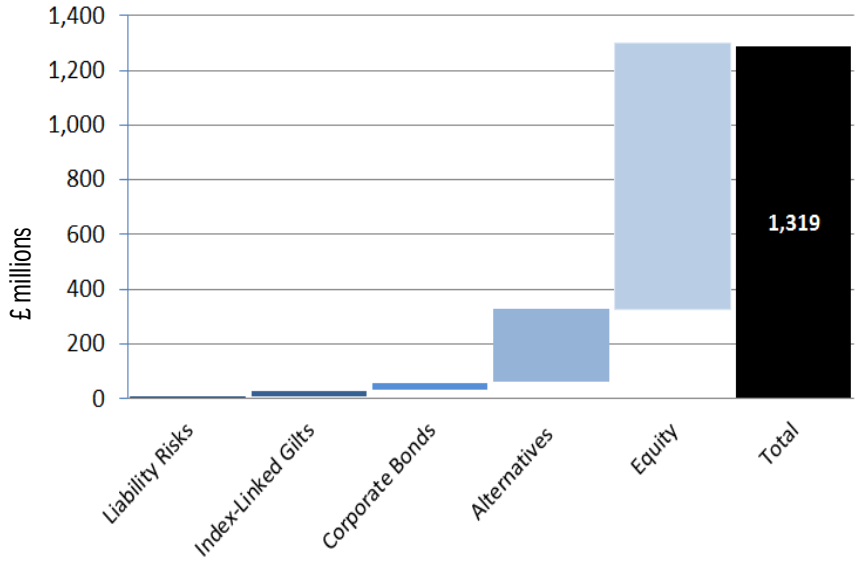


Source: Thomson Reuters Datastream.

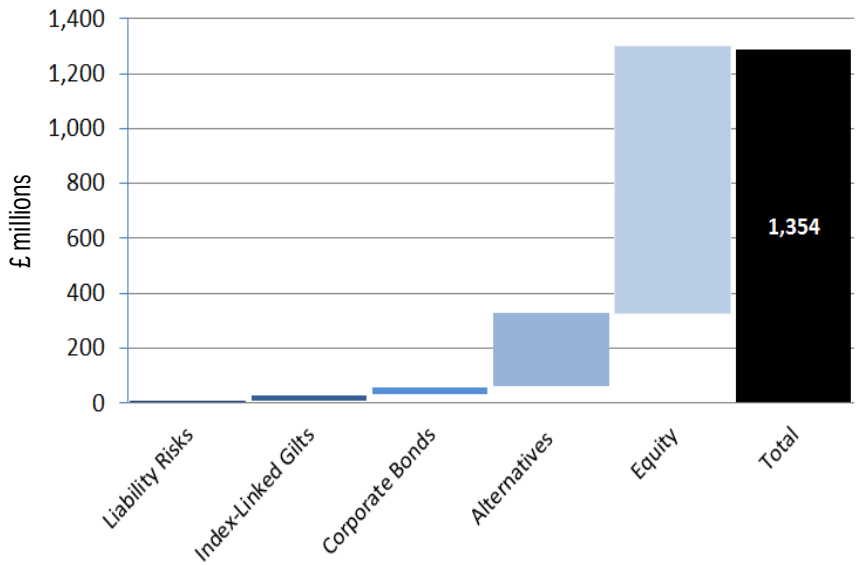
SECTION 3
STRATEGIC CONSIDERATIONS

STRATEGIC CONSIDERATIONS
RISK DECOMPOSITION

30 September 2016



31 December 2016



The two charts to the left illustrate the main risks that the Fund is exposed to on the 2016 funding basis and 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 three years’ time.

If we focus on the chart at 31 December 2016, it shows that if a 1 in 20 “downside event” occurred, we would expect that in three years’ time, the deficit would increase by an additional **£1.4b** on top of the current deficit of **£0.3b**, creating a deficit of c. **£1.7b**.

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 increased slightly. This largely reflects an increased contribution from equity volatility, as asset values have increased.

The contributions to the total risk from the various return drivers have, as expected, changed little. Equity market risk dominates.

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.

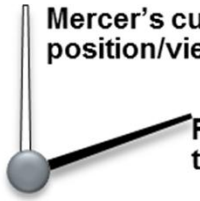
MARKET BACKGROUND
INDEX PERFORMANCE VERSUS STRATEGY

Asset Class	Strategy Assumed Return % p.a.	3 year Index Return % p.a.	Comment
Developed Equities (Global) (FTSE All-World Developed)	8.25	15.0	*Remains ahead of the assumed strategic return.* *This has increased from 14.4% p.a. last quarter as the latest quarter's return of 7.1% was higher than the 5.6% return of Q4 2013, which fell out of the 3 year return.*
Emerging Market Equities (FTSE AW Emerging)	8.75	9.4	*The three year return from emerging market equities has increased from 8.4% p.a. last quarter, as the return of 2.2% experienced last quarter was higher than the quarter that fell out of the period (-0.7%), in large part due to the weakening of sterling. The three year return is now above the assumed strategic return.*
Diversified Growth	Libor + 4% / RPI + 5%	4.6 / 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 and low inflation means that both benchmarks have significantly underperformed the long term expected return from equity. During periods of strong equity returns we would expect DGF to underperform equities.*
UK Gilts (FTSE Actuaries Over 15 Year Gilts)	4.5	14.4	*UK gilt returns remain considerably above the long term strategic assumed return as yields remain low relative to historic averages, though returns have decreased compared to the previous quarter as yields increased over Q4 as the market began to price in inflation and more likely interest rate rises after Trump's election victory. Corporate bond returns are also ahead of the strategic assumed return.*
Index Linked Gilts (FTSE Actuaries Over 5 Year Index-Linked Gilts)	4.25	15.2	
UK Corporate Bonds (BofAML Sterling Non Gilts)	5.5	7.8	
Fund of Hedge Funds (HFRX Global Hedge Fund Index)	6.0	-1.0	*Hedge fund returns remain below long term averages and the strategic return, as they are affected by low cash rates. 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	11.8	*Property returns continue to be ahead of the expected returns. Slowing rental growth post-Brexit has meant fundamentals have weakened and a more cautious outlook may be required. Nevertheless, property returned 2.6% over the fourth quarter of 2016.*
Infrastructure (S&P Global Infrastructure)	7.0	14.7	*Infrastructure returns are well above the expected returns, driven by a strong return in the first half of 2016. This return was in part driven by currency as sterling depreciated over the year. Returns of this index have been largely driven by currency moves. The 100% hedge in place for the infrastructure mandate removes the currency effect from the actual returns earned. This is also true of the global property mandate with Partners.*

Source: Thomson Reuters Datastream. Returns are in sterling terms.

DYNAMIC ASSET ALLOCATION (DAA) DASHBOARD – Q1 2017

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



DEVELOPED MARKET EQUITIES

- Accommodative monetary policy remains generally supportive of equity markets
- Stronger global growth coupled with supportive fiscal policy should translate into improved corporate earnings
- Valuations have continued to trend upwards and a number of downside risks remain as a result of political uncertainty

EMERGING MARKET EQUITIES

- Valuations remain around or slightly below long-term averages, though have risen over the year
- Positive earnings surprises and diminishing headwinds from key economies (e.g. China) as well as improving fundamentals
- The potential for protectionist policies in the US as well as monetary policy normalisation could hurt the asset class

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 2017

FIXED INTEREST GILTS (ALL STOCK)

- Ongoing extraordinary monetary policy in some economies coupled with geopolitical uncertainties may limit further upward yield movement
- Valuations remain expensive, with nominal yields well below long-term average levels. US Fed expected to continue its rate hiking cycle throughout 2017

INDEX-LINKED GILTS

- Breakeven inflation levels continue to rise, as global and UK inflation dynamics strengthen
- Valuations increasingly expensive, with real yields well below long-term averages

DYNAMIC ASSET ALLOCATION (DAA) DASHBOARD – Q1 2017

NON-GOVERNMENT BONDS (£ ALL-STOCK)

- Despite tightening slightly over the quarter, credit spreads provide adequate coverage given expectations that the downgrade environment should remain benign
- Yields remain historically low and prospective total returns appear to be relatively limited
- Risk of increased volatility due to reduction in trading liquidity and heightened geopolitical downside risk

UK PROPERTY

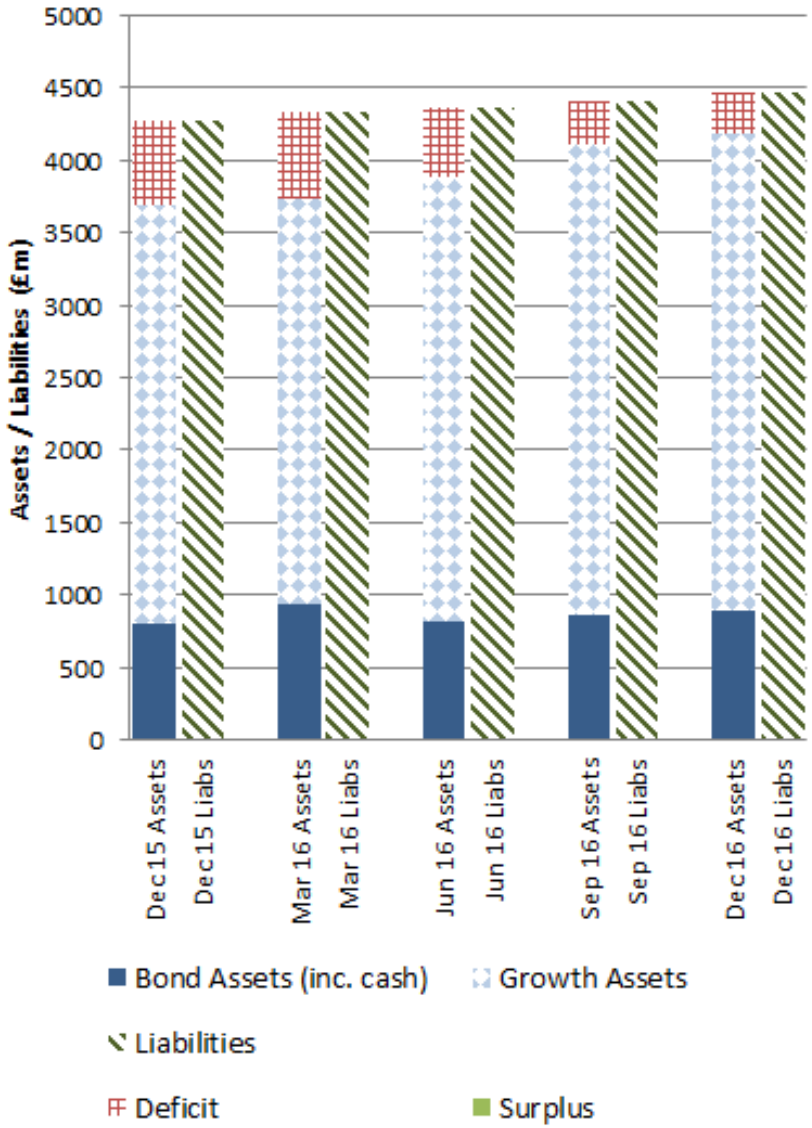
- Relative to other asset classes, some parts of the market still present attractive opportunities (e.g. HLV property)
- Valuations remain expensive despite a slight rise in yields in most sectors
- 'Brexit' and slowing rental growth have caused fundamentals to weaken and outlook may be more cautious

DYNAMIC ASSET ALLOCATION (DAA) DASHBOARD – Q1 2017

Asset Class	Jul 2016	Oct 2016	Jan 2017
Fixed Interest Gilts	Unattractive	Unattractive	Unattractive
Index-Linked Gilts	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	Unattractive
UK Property	Unattractive	Unattractive	Unattractive
High yield bonds	Neutral	Unattractive	Unattractive
Local currency emerging market debt	Neutral	Neutral	Neutral

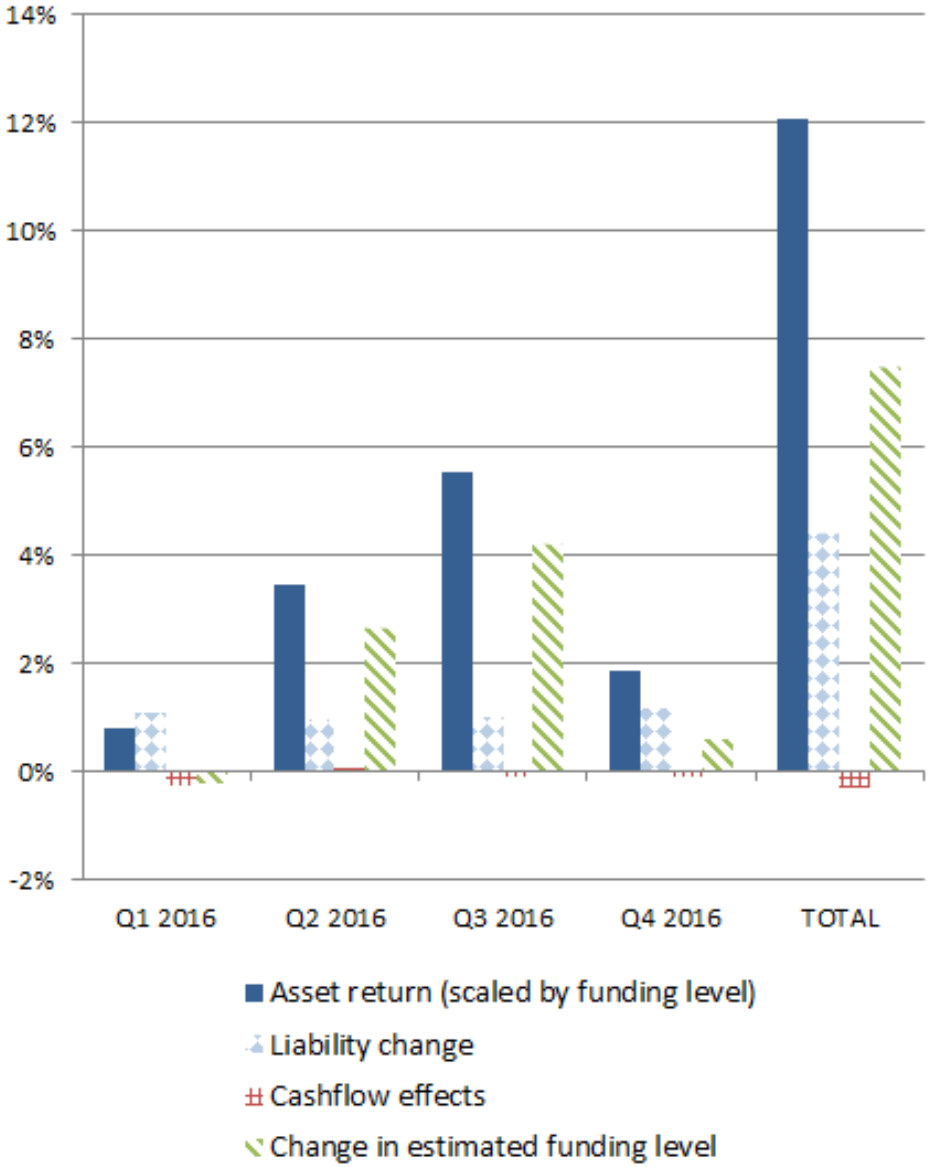
SECTION 4
CONSIDERATION OF FUNDING LEVEL

CONSIDERATION OF FUNDING LEVEL
ASSET ALLOCATION AND FUNDING LEVEL



- Based on financial markets, investment returns and net cashflows into the Fund, the estimated funding level increased by c. 1% over the fourth quarter of 2016, all else being equal, from 93% to 94%.
- This was driven by the positive return on the Fund's assets exceeding the increase in the present value of the liabilities over the quarter.
- This is calculated using the new actuarial valuation as at 31 March 2016 and the "CPI plus" discount basis.
- *Liability figures have been recalibrated since the Q3 2016 report and reflect a slightly stronger position than previously shown.*

CONSIDERATION OF FUNDING LEVEL
FUND PERFORMANCE RELATIVE TO ESTIMATED LIABILITIES



- The Fund's assets returned 2.0% over the quarter which, when allowing for the funding position, increased the funding level by 1.9%.
- The Fund's estimated liabilities increased by 1.2% over the quarter.
- Over this quarter, the "cashflow effect" from contributions was negative but small.
- Overall, the combined effect has led to a increase in the estimated funding level to 94% (from 93% at 30 September 2016).
- Over the 12 month period, the estimated funding level has risen by c.7%.
- *Liability figures have been recalibrated since the Q3 2016 report and reflect a slightly stronger position than previously shown.*

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	1,752,287	1,790,409	42.5	42.6	40.0	35 - 45	+2.6
Emerging Market Equities	385,222	385,005	9.3	9.2	10.0	5 - 15	-0.8
Diversified Growth Funds	368,673	373,249	8.9	8.9	10.0	5 - 15	-1.1
Fund of Hedge Funds	215,363	228,329	5.2	5.4	5.0	0 - 7.5	+0.4
Property	372,582	364,773	9.0	8.7	10.0	5 - 15	-1.3
Infrastructure	153,772	161,546	3.7	3.8	5.0	0 - 7.5	-1.2
Bonds	858,641	836,387	20.8	19.9	20.0	15 - 35	-0.1
Cash (including currency instruments)	14,011	58,805	0.3	1.4	-	0 - 5	+1.4
Total	**4,120,797**	**4,198,502**	**100.0**	**100.0**	**100.0**		**0.0**

Source: BNY Mellon, 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 £78m largely due to positive returns from growth assets. At the end of the quarter, all asset classes were within the agreed tolerance ranges.

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	1,176,622	-61,379	1,128,514	28.6	26.9
Jupiter	UK Equities	188,908	-	192,988	4.6	4.6
TT International	UK Equities	222,410	-	227,933	5.4	5.4
Schroder	Global Equities	301,486	-	317,853	7.3	7.6
Genesis	Emerging Market Equities	179,161	-	181,570	4.3	4.3
Unigestion	Emerging Market Equities	206,060	-	203,435	5.0	4.8
Invesco	Global ex-UK Equities	337,782	-	370,926	8.2	8.8
SSgA	Europe ex-UK & Pacific inc. Japan Equities	142,333	-	149,560	3.5	3.6
Pyrford	DGF	135,239	-	136,061	3.3	3.2
Standard Life	DGF	233,435	-	237,188	5.7	5.6

Source: BNY Mellon, Avon. Totals may not sum due to rounding.

FUND VALUATIONS
VALUATION BY MANAGER CONTINUED

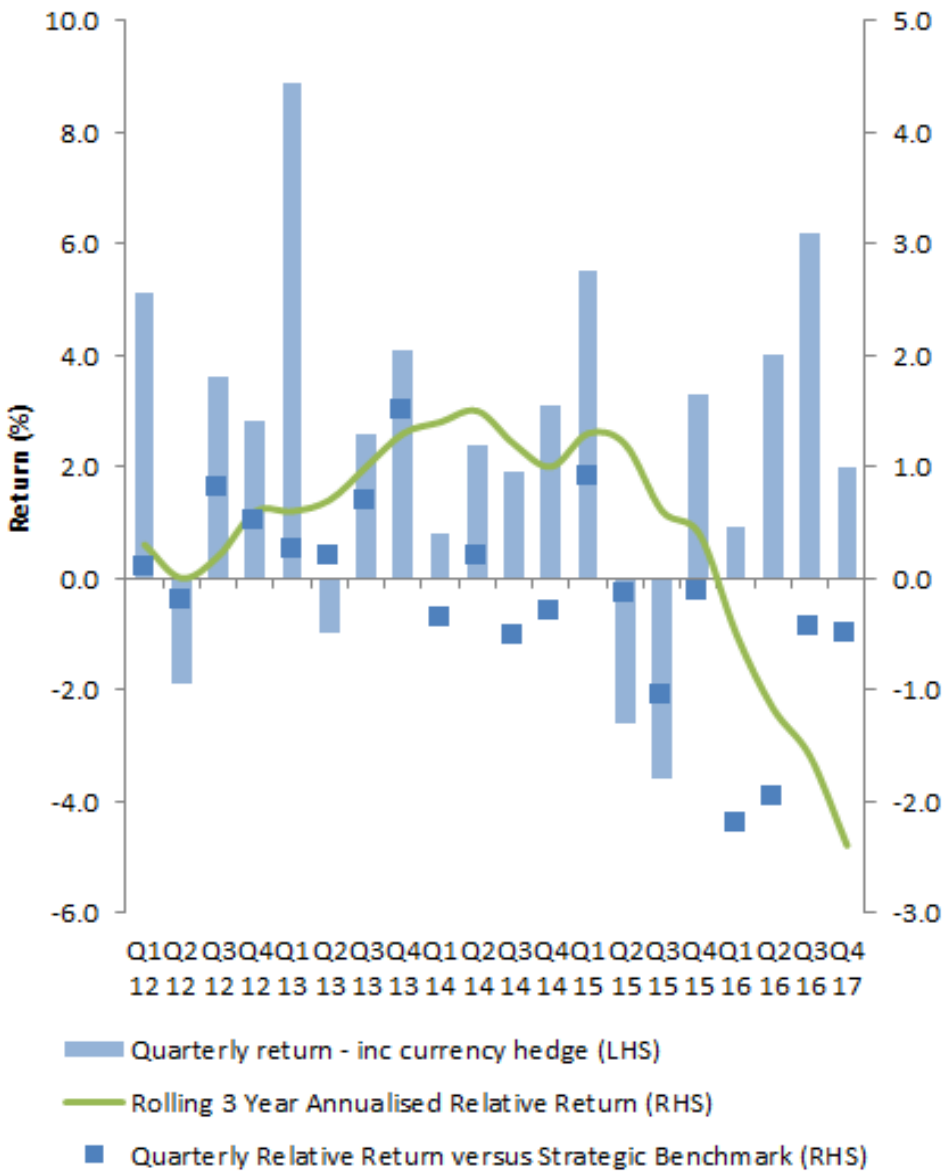
Manager Allocation

Manager	Asset Class	Start of Quarter (£'000)	Cashflows (£'000)	End of Quarter (£'000)	Start of Quarter (%)	End of Quarter (%)
MAN	Fund of Hedge Funds	404	-	408	0.0	0.0
Signet	Fund of Hedge Funds	1,000	-	1,069	0.0	0.0
Gottex	Fund of Hedge Funds	3,334	-2,519	983	0.1	0.0
JP Morgan	Fund of Hedge Funds	210,966	-	225,869	5.1	5.4
Schroder	UK Property	194,155	-	197,435	4.7	4.7
Partners	Property	188,135	-5,845	186,687	4.6	4.4
IFM	Infrastructure	153,772	-	161,546	3.7	3.8
RLAM	Bonds	258,577	-	253,848	6.3	6.0
Record Currency Management	Currency Hedging	-62,320	63,600	-21,287	-1.5	-0.5
Internal Cash	Cash	49,337	6,143	45,918	1.2	1.1
Total		**4,120,797**	**-**	**4,198,502**	**100.0**	**100.0**

Source: BNY Mellon, Avon. Totals may not sum due to rounding.
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



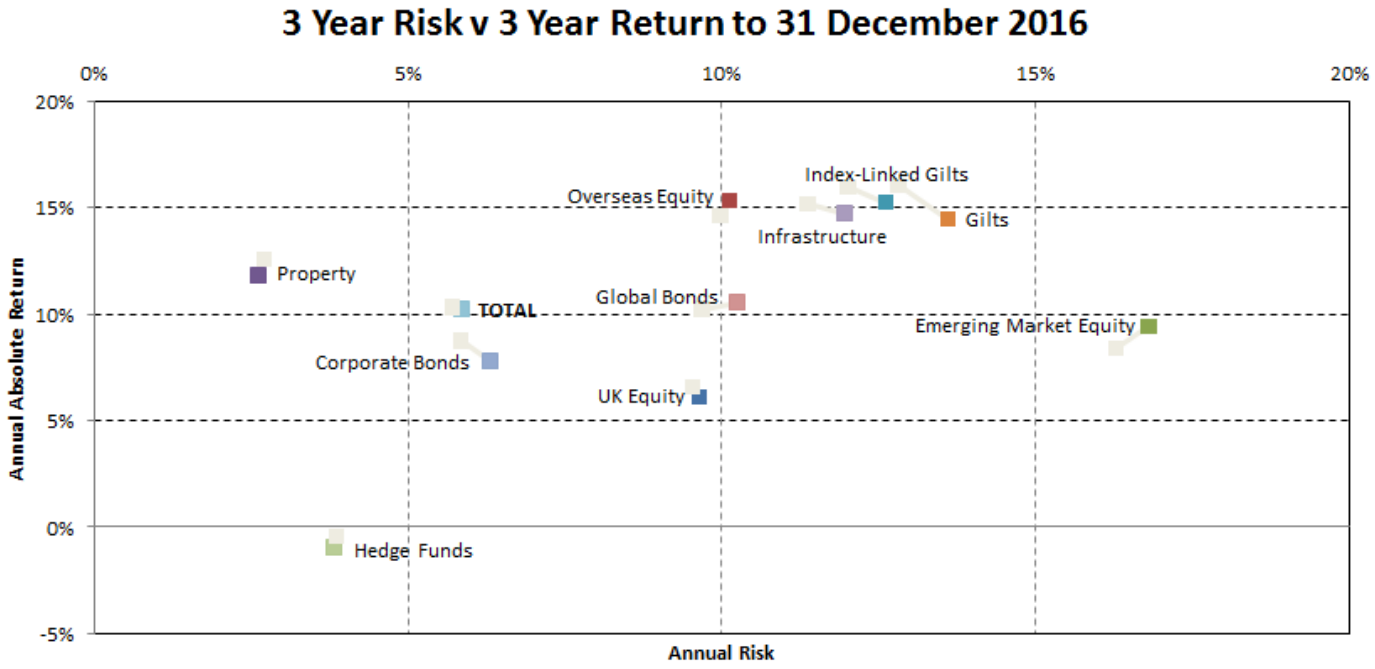
	3 months (%)	1 year (%)	3 years (% p.a.)
Total Fund (inc currency hedge)	2.0	13.7	8.0
Total Fund (ex currency hedge)	2.5	17.9	9.7
Strategic Benchmark (no currency hedge)	2.5	19.4	10.4
Relative (inc currency hedge)	**-0.5**	**-5.7**	**-2.4**

- Over Q4 2016, the Fund underperformed its Strategic Benchmark by 0.5% when including the currency hedge and performed in line excluding the currency hedge (as Sterling continued to weaken).

- The Fund has underperformed the Strategic Benchmark over the year by 5.7% and by 2.4% p.a. over the three year period. Over the year, this was mostly due to the recent weakening of sterling and to a lesser degree manager underperformance (mainly in equities and Standard Life GARS). The most significantly underperforming equity managers over the year were:
    - Jupiter (-6.4%) - largely due to not holding oil stocks over the year in line with its SRI mandate, as the oil price rebounded;
    - TT (-5.4%) – due to poor stock selection and sector allocation;
    - Schroder (-3.3%) - due to a “growth” bias in its portfolio as value stocks outperformed over the year; and
    - Unigestion (-7.8%) – due to its lower volatility style that typically lags a strongly rising market as the benchmark returned +32.6% over the year.

- Due to the latest quarter’s underperformance, the rolling three year underperformance increased from -1.6% p.a. to -2.4% p.a.

MANAGER MONITORING
RISK RETURN ANALYSIS



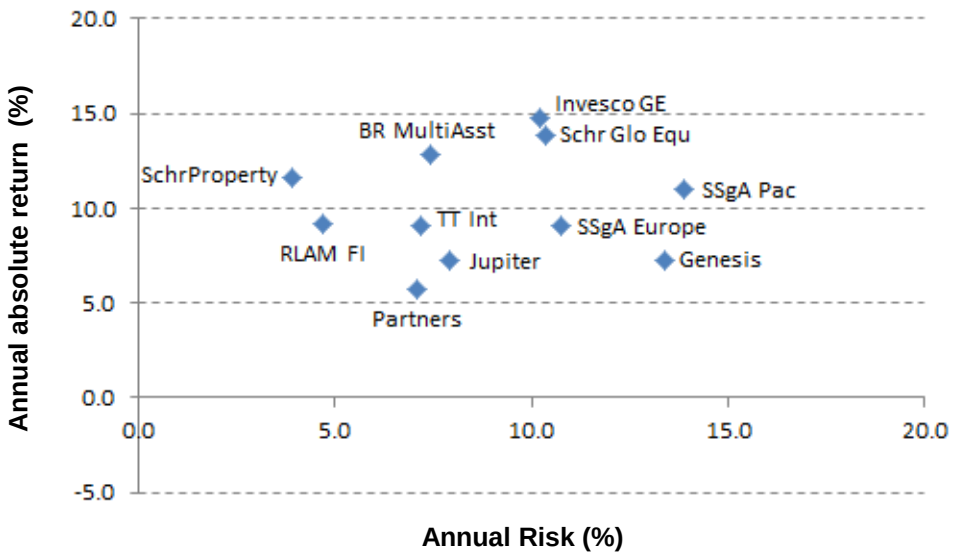
This chart shows the 3 year absolute returns against three year volatility (based on monthly data in sterling terms), to the end of December 2016, for each of the broad underlying asset benchmarks (using the indices set out in the Appendix), along with the total Fund strategic benchmark (using the benchmark indices and allocations from BNY Mellon). We also show the positions as at last quarter, in grey.

Comments

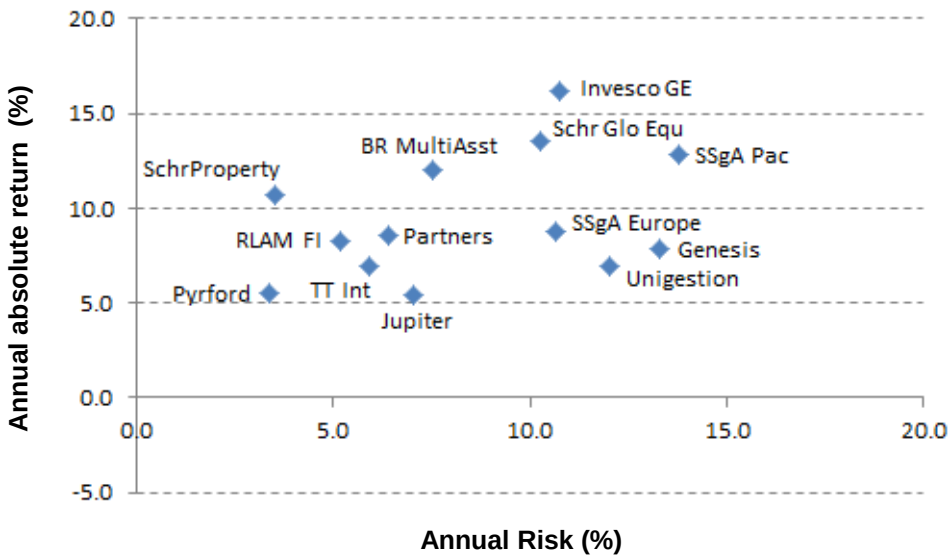
- *There were very limited changes in observed returns and volatilities over the quarter. Emerging market 3-year return increase to 9.4% p.a., meaning the asset class is now above the assumed strategic return (of 8.75% p.a.). Gilt returns also fell over the quarter as yields rose.*

MANAGER MONITORING
RISK RETURN ANALYSIS

3 year Risk vs 3 year Return to 30 September 2016



3 year Risk vs 3 year Return to 31 December 2016



Comments

- *Jupiter and TT saw their returns and volatilities decrease over the quarter. Royal London's return also decreased but with increased volatility. On a positive note, Partners' return increased.*
- *Unigestion and Pyrford have reached their three year since inception date.*

MANAGER MONITORING
MANAGER PERFORMANCE TO 31 DECEMBER 2016

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	1.3	1.2	0.0	23.1	23.2	-0.1	12.0	11.9	+0.1	-	Target met
Jupiter	2.1	3.9	-1.7	9.2	16.8	-6.4	5.2	6.1	-0.8	+2	Target not met
TT International	2.5	3.9	-1.4	10.5	16.8	-5.4	6.9	6.1	+0.8	+3-4	Target not met
Schroder Equity	5.4	6.5	-1.0	25.2	29.4	-3.3	13.3	14.3	-0.9	+4	Target not met
Genesis	1.3	0.8	+0.5	32.9	33.1	-0.1	7.8	7.8	-0.1	-	Target not met
Unigestion	-1.3	0.8	-2.0	22.4	32.6	-7.8	7.0	8.4	-1.3	+2-4	Target not met
Invesco	9.8	7.3	+2.3	30.4	29.0	+1.1	16.2	15.3	+0.8	+0.5	Target met
SSgA Europe	5.8	4.8	+0.9	21.0	19.6	+1.1	8.7	8.1	+0.6	+0.5	Target met
SSgA Pacific	4.6	3.7	+0.9	26.4	25.5	+0.7	12.7	11.9	+0.7	+0.5	Target met
Pyrford	0.6	2.0	-1.4	10.0	7.5	+2.3	5.9	6.9	-0.9	-	Target not met
Standard Life	1.4	1.4	+0.1	-2.4	5.6	-7.6	N/A	N/A	N/A	-	N/A
JP Morgan*	1.9	1.0	+0.9	1.5	3.8	-2.2	N/A	N/A	N/A	-	N/A
Schroder Property	1.7	2.3	-0.5	2.0	2.8	-0.8	10.4	10.7	-0.2	+1	Target not met
Partners Property	N/A	N/A	N/A	N/A	N/A	N/A	8.0**	10.0**	-1.8**	-	Target not met
IFM*	-0.1	0.7	-0.8	N/A	N/A	N/A	-0.5**	1.5**	-1.9**	-	N/A
RLAM	-1.8	-2.6	+0.8	10.8	10.7	+0.1	8.2	7.7	+0.5	+0.8	Target not met
Internal Cash	0.1	0.0	0.0	0.3	0.3	+0.0	0.4	0.3	0.0	-	N/A

- Source: BNY Mellon, Avon, Mercer estimates.
- Returns are in GBP terms, consistent with overall fund return calculations before currency hedging in applied, except for JP Morgan, Partners and IFM, whose performance is shown as IRR in local currency terms.
- 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).
- In the table above, Partners performance is measured against an IRR target of 10% p.a.
- A summary of the benchmarks for each of the mandates is given in Appendix 1.

* Returns are in US dollar terms.
** Performance is shown since inception.

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	Net IRR of 10% p.a. (local currency)	-
IFM	Infrastructure	6 Month LIBOR +2.5% p.a.	-
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
Infrastructure	S&P Global Infrastructure
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.

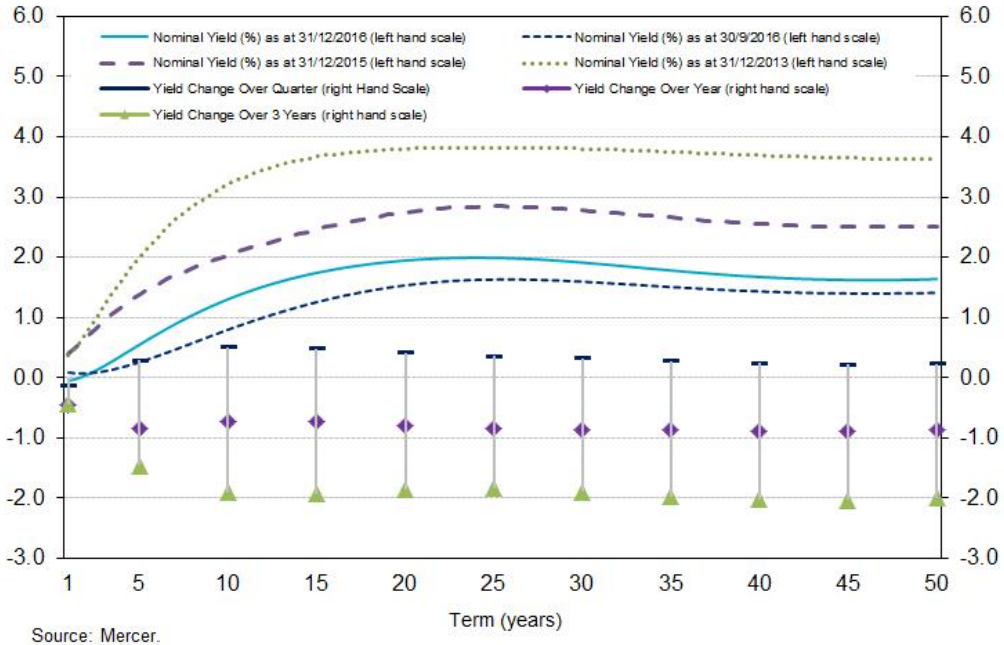
APPENDIX 3
CHANGES IN YIELDS

CHANGES IN YIELDS

Asset Class Yields (% p.a.)	31 December 2016	30 September 2016	31 December 2015	31 December 2014
UK Equities	3.47	3.46	3.70	3.37
Over 15 Year Gilts	1.76	1.42	2.57	2.42
Over 5 Year Index-Linked Gilts	-1.66	-1.78	-0.70	-0.75
Sterling Non Gilts	2.29	1.99	3.23	2.99

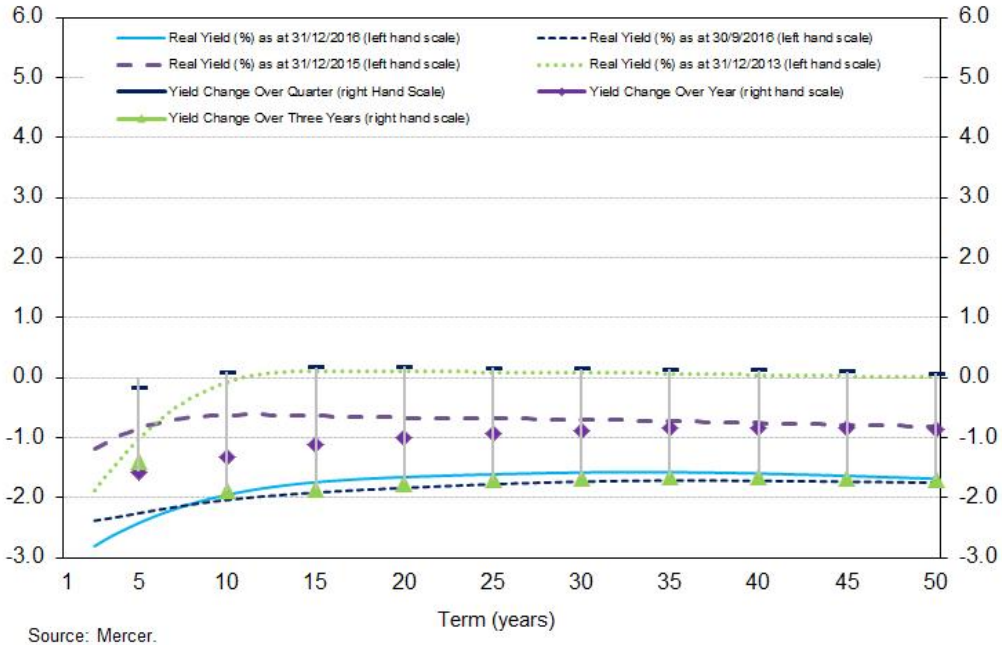
- Bond yields rose across all maturities over the quarter, resulting in negative absolute returns for investors.
- In the UK, gilt yields rose amid expectations for higher inflation and the yield curve also steepened. The Over 15 Year Gilt Index underperformed the broader global bond market over the quarter, generating a negative return of 6.0%.
- Real yields also rose over the quarter, though to a lesser extent, with increases varying between c.10bps and 20bps across the curve. The Over 5 Year Index-Linked Gilts Index was down 3.0% over the quarter.
- Movements in credit spreads were marginal over the quarter, with the sterling Non-Gilts All Stocks Index ending the quarter at c.1.2% and the sterling Non-Gilts All Stocks over 10 years Index ending the quarter at c.1.3%. UK credit assets posted a negative return of 2.8% over the quarter, driven by rising bond yields and underperforming the broader global credit market.

Nominal yield curves



Source: Mercer.

Real yield curves



Source: Mercer.

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