Mercer

Avon Pension Fund

Panel Investment Report
Quarter to 30 June 2021

September 2021

Steve Turner
Joshua Caughey

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Executive summary

Executive summary

Market background	• The gradual emergence of many developed countries from restrictions as vaccine rollouts continued drove investor optimism, helping to bring about another strong quarter for risk assets. • Markets largely saw through continued elevated inflation expectations, but it remains a key question as well as the potential impact of the delta variant on the economic recovery. Government bond yields fell thanks to central bank signals that have been less dovish than expected.
Mercer market views	• Our medium term views on the global economy are favourable, as we expect it to strengthen sharply as economies re-open more fully. Governments and central banks are likely to continue to support economic activity.
Funding level and risk	• The funding level is estimated to have improved from 97% to 101% over Q2 as asset growth outweighed the rise in the value of the liabilities. • It is estimated to have increased of by 9% over the year to 30 June 2021 (as illustrated to the right). • The Value-at-Risk rose over the quarter to £1,134m, or 20.5% of liabilities. • Risk as a proportion of liabilities has reduced over the year, largely due to the decision to move towards a dynamic equity option strategy. • Whilst this was implemented in Q2 2021, its impact has been illustrated from Q4 2020.

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Executive summary

Performance

- Fund returns over the quarter were driven by the continued strength in growth assets.
- Most underlying mandates delivered positive relative returns, particularly those monitored against cash plus benchmarks.
- Underperformance relative to the strategic benchmark over the one and three year period to 30 June 2021 is mainly due to the impact of the equity protection strategy, but this has behaved in line with expectations given the increase in the underlying equity markets.
- Relative performance was mixed at the mandate level, though the High Alpha Equity, Hedge Fund and Core Infrastructure mandates have continued to stand out in outperforming their benchmarks.

	3 Months (%)	1 Year (%)	3 Years (% p.a.)
Total Fund **(1)**	4.3	12.6	5.6
Strategic Benchmark **(2)** (ex currency hedge)	3.9	14.7	7.6
Relative **(1 - 2)**	**+0.4**	**-2.1**	**-2.0**

- Absolute returns for all growth mandates, except for the two older property fund holdings, have been above the strategic returns modelled at the last investment strategy review in March 2019.

Asset allocation and strategy

- In May, the Fund implemented the new dynamic structure for the equity option strategy.
- In June, the Fund terminated its Multi-Asset Credit holdings with Loomis Sayles, transferring these to a new MAC fund with Brunel.
- At quarter end, all asset classes were within their ranges, except for the Renewable Infrastructure and Private Debt mandates which are still in the process of being drawn down.

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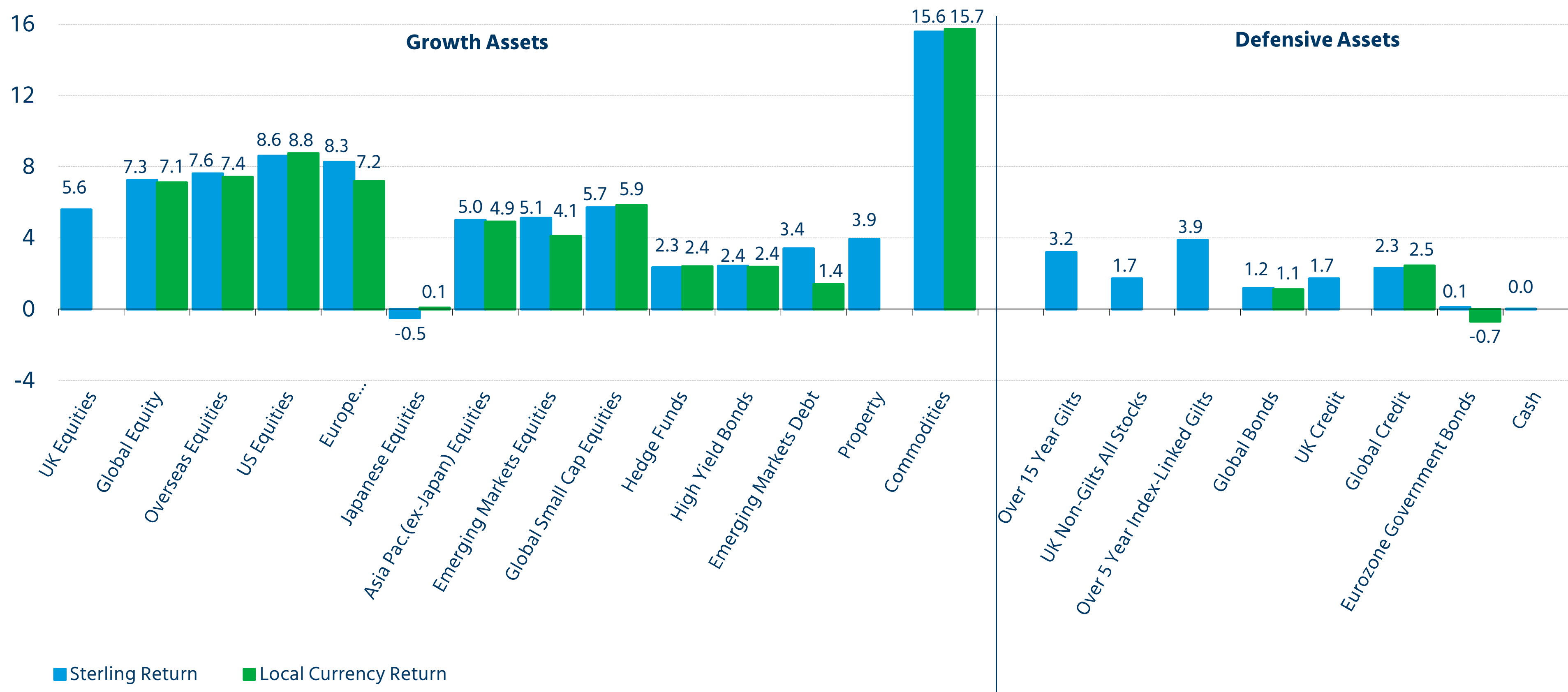
Market background

Market background



The second quarter of 2021 began with many developed countries gradually emerging from restrictions as vaccine rollouts started to have a notable positive impact on healthcare systems, in spite the emergence of a "variant of concern" first identified in India. However, countries with lower vaccination rates across Asia Pacific increased restrictions again towards quarter end. Global growth momentum remained robust as the service sector started to recover lost ground whilst goods demand remained solid. Supply chain stress and base effects drove a strong rebound in inflation that still exceeded already elevated expectations, at least for the US.

However, markets largely saw through this in what was another strong quarter for risk assets.

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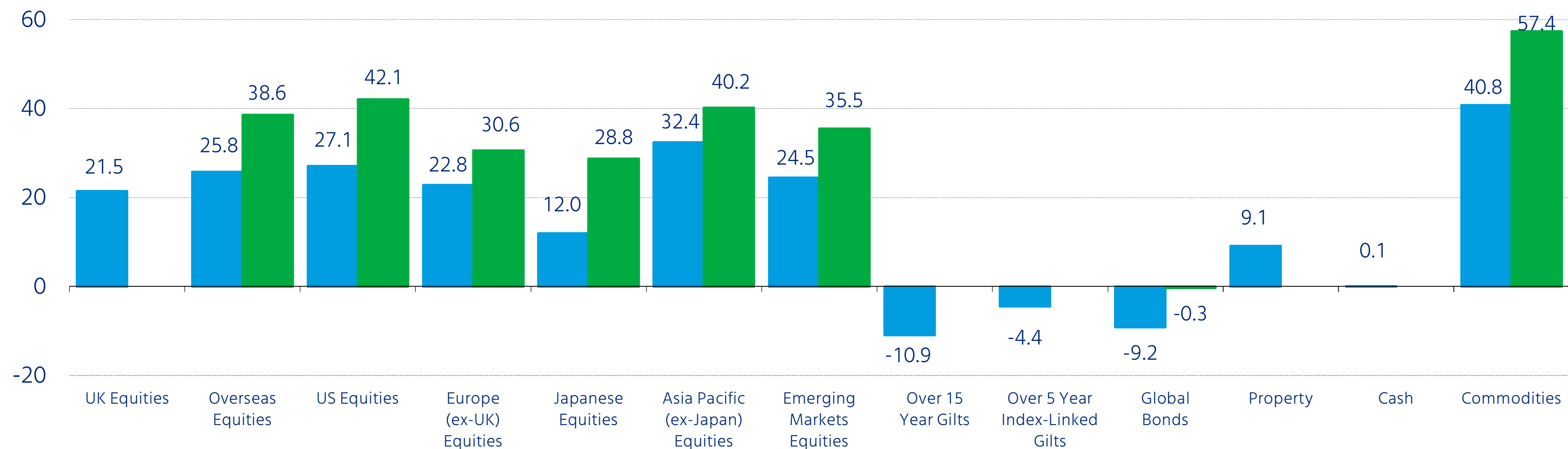
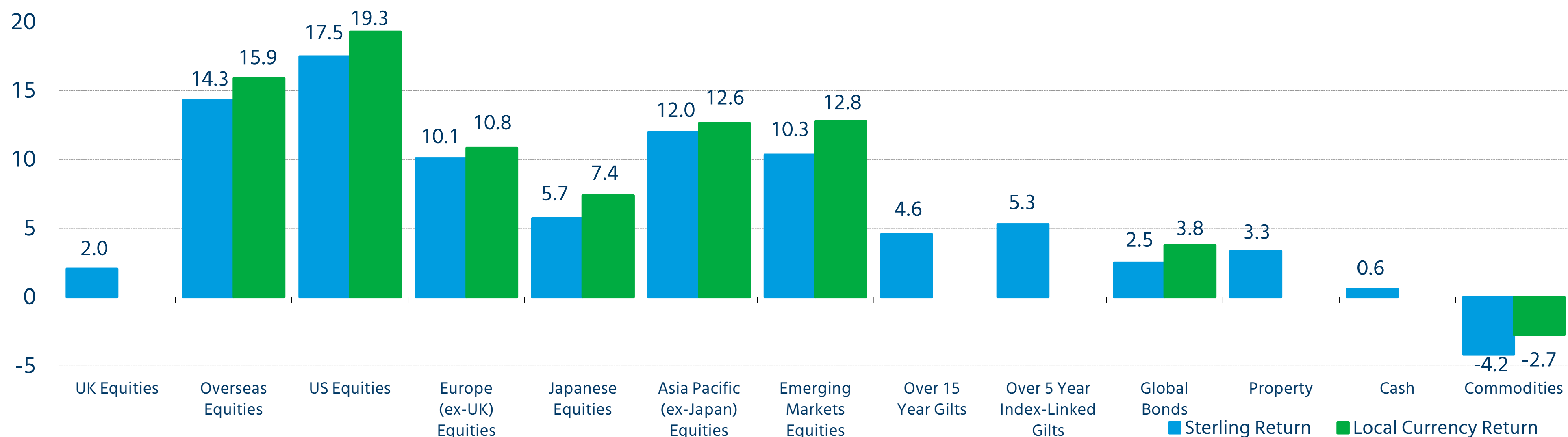
Source: Thomson Reuters Datastream.

Market background – longer term

Return Over 12 Months to 30 June 2021 (%)



Return Over 3 Years to 30 June 2021 (% p.a.)



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Source: Thomson Reuters Datastream.

Mercer market views

Market Outlook

Overweight Neutral weight Underweight

Mercer's current position/view

Position/view last time (if changed)

Global equities continued to rally with the US S&P 500 index now twice the level it was in March 2020. Equity markets continue to be driven higher by hopes of strong economic growth and loose monetary policy. The vaccine rollout has continued at pace across most of the developed world, allowing economies to re-open. Concern over the COVID-19 Delta variant did not undermine markets.

COVID, mobility restrictions, the policy response and the vaccine rollout continued to drive economic growth. In the UK, Eurozone and North America, a largely successful vaccine rollout has led to an easing of restrictions and a surge in consumption and broader economic activity. In countries where the vaccine rollout has been much slower, economic activity has been more mixed, although manufacturing has been strong almost everywhere. The re-opening of economies & supply side disruptions in some sectors have contributed to higher inflation. Much of the increase is the result of temporary factors that will abate, although we remain alert to signs of tightness in labor markets, which could lead to a broader pick-up in inflation.

We expect the global economy to grow at a rapid rate in the middle and later part of 2021. This will be driven by the reopening of economies across the world as the vaccine rollout progresses. Consumers, whose savings rates have been abnormally high over last 18 months, are set to spend a lot more, especially on things that have been closed or restricted. Consumers may also spend some of the savings that have been built up over the last 18 months. Business investment is expected to remain strong supported by high confidence levels and easy access to finance.

The US Federal Reserve has started to consider tapering its bond purchases, while other central banks are starting to sound less dovish. Despite this, monetary policy remains exceptionally loose and is set to remain so for some time. Central banks, especially in the developed world, have indicated they err on the side of caution.

In terms of financial markets we think the outlook for risk assets such as equities and growth fixed income remains positive, although our concern about valuations have increased a little. Strong economic growth is likely to lead to strong corporate profit growth and this alongside still very supportive monetary policy provides a strong tailwind to equities and growth fixed income. We continue to prefer equities over growth fixed income as equities have greater upside given tight bond spreads. In terms of risk, the COVID-19 Delta variant has the potential to stop economies from reopening. Further out and assuming COVID-19 is brought under, the key risk comes from tighter US and global monetary policy.

We have a preference to be positioned for an economic recovery, which should benefit risk assets. We acknowledge that after five consecutive quarters of strong performance, valuations for most assets are stretched. Nevertheless, we believe we are still in the early stages of a strong recovery and therefore risk assets should continue to outperform defensive assets over the near term.

LISTED EQUITIES

GROWTH FIXED INCOME

DEFENSIVE FIXED INCOME

CASH*

** In lieu of cash, investors might consider liquid alpha-oriented strategies with low sensitivity to equity, credit and duration.*

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The views on these slides are as at July 2021, and the charts summarise Mercer's views on the medium term (1-3 years) outlook for returns .

These views are relevant for reflecting medium term market views in determining appropriate asset allocation. We do not expect the Fund to make frequent tactical changes to their asset allocation based upon these views.

Listed equities

ASSET CLASS	APRIL 2021	JULY 2021	COMMENTARY
Global Equity	Neutral	Neutral	**The MSCI World Index returned around 8% in GBP terms over 2021Q2 and 12% year-to-date[1]. We have maintained our broad market equity sector position at neutral/negative within the global equities portfolio.** At this time our concerns about valuations and frothy sentiment in equity markets are offset by the strong foundation for the economic recovery laid by successful vaccine roll-outs in the US and UK with Europe gradually catching up, and robust fiscal and monetary policy support on a global level. While the current environment favors broad market equities in absolute terms, other sectors such as small cap equities stand to benefit more strongly from these positive expected developments in the near term.
Global Small Cap Equity	Neutral	Neutral	**The MSCI Small Cap index returned almost 5% in GBP terms over 2021Q2 and 14% on a year-to-date basis[1]. We have maintained our small cap allocation at the overweight side of neutral.** The macro environment remains favorable, especially for small caps that are expected to benefit significantly from the full and unconstrained domestic reopening that have happened in the US and UK already with other developed countries to follow as vaccine roll-out picks up. Small caps' greater exposure to value sectors relative to broad market equities also makes them a good proxy to express our preference of value over growth. Arguably this trade had a good run now but we believe that the reopening trade has not peaked yet.
Emerging Markets	Overweight	Neutral	**The MSCI Emerging Markets index returned around 5% in GBP terms over 2021Q2 and 6.5% on a year-to-date basis[1]. We have downgraded our overweight position to the overweight side of neutral for emerging markets equities within the global equities portfolio.** Valuations are still more inviting than for other equity sectors. However, even if our outlook for EM over a three year time horizon remains positive, the macro headwinds we are seeing both in China and other EM countries in the near term has informed our decision to reduce the outright overweight position.

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[1]Source: Bloomberg, DataStream as of end of 2Q2021

Growth fixed income

ASSET CLASS	APRIL 2021	JULY 2021	COMMENTARY
EM Debt (Local Currency)	Neutral	Neutral	**EMD local currency markets advanced through Q2 2021, posting positive GBP return of 3.4%.[1]. We have maintained our position at a higher conviction neutral within the growth fixed income portfolio.** EM FX continues to screen inexpensive relative to USD with EM rates, whilst still at historic lows, offering value relative to DM rates. The increasingly robust rollout of the COVID-19 vaccine and improving global growth numbers should be particularly supportive of EM markets. Global trade and manufacturing continue to improve on both demand and supply factors; a broad strengthening of commodity prices will also be supportive to a number of EM countries. We maintain a preference for local currency due partly to the lower duration profile but also as a result of FX valuations continuing to appear cheap on a historic basis.
EM Debt (Hard Currency)	Neutral	Neutral	**EMD hard currency markets advanced through Q2 2021, as at June 30 2021, the index was up 3.9% in GBP terms.[1]. We have maintained our overall neutral allocation within the growth fixed income portfolio.** Whilst the risk-off sentiment seen during Q1 2021 abated during Q2, inflation expectations continue to act as a slight dampener to the positive sentiment stemming from the roll-out of the COVID-19 vaccines and greater global growth expectations. The spread dislocation between investment and non-investment grade continues with higher quality spreads broadly returning to pre-COVID tights. Overall, the economic backdrop for emerging markets has improved with measures of global trade and manufacturing continuing to recover on both demand and supply factors along with further stability in commodity prices. The arrival of COVID-19 vaccines and improving global growth should be particularly supportive of EM markets.
Global Loans	Neutral	Neutral	**Over 2021Q2, global loans returned 1.3% in GBP terms[1]. We have maintained our bank loans position at neutral within the growth fixed income portfolio.** With an average price below par and a yield over 4.2%, global loan valuations look relatively attractive given the general context of low to negative yields globally. Further, their floating rate nature and senior secured position makes them quite appealing in the current environment. Forward looking default rate expectations continue to trend lower, and we believe investors are seeing sufficient reward for the level of risk. Our outlook for strong growth and elevated rate volatility has us favoring the floating-rate nature of the loan asset class versus high yield.
High Yield	Neutral	Neutral	**Over 2021Q2, global high yield returned 2.3% on a GBP hedged basis[1]. We have maintained our global high yield position at the negative side of neutral within the growth fixed income portfolio.** High yield valuations have become less attractive as spreads have continued to narrow and are now inside of where they entered 2020. As a result, further spread compression, particularly within the higher quality segment of the market, appears quite limited at this point. While the backdrop remains favorable for credit assets, we hold a slight preference for global loans over high yield given the floating rate nature and senior secured status of the loan asset class.

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[1]Source: Bloomberg, DataStream as of end of 2Q2021

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Defensive fixed income

ASSET CLASS	APRIL 2021	JULY 2021	COMMENTARY
UK Sovereign Fixed Income	Neutral	Neutral	**Over 2021Q2, UK gilts returned 0.6% in GBP terms[1]. We have maintained a marginally negative neutral position in UK gilts within the defensive fixed income portfolio.** Following the sell-off in Q1, rates stabilised over the second quarter and edged back towards the record lows seen during the Covid-19 crisis with markets gradually becoming more confident, that, for now, inflation will be transitory and that Bank of England actions will keep inflation expectations under control. We expect a continued range-bound environment over the short term, and possibly upward bias in rates reflecting a durable global economic recovery, especially in the light of the UK's full reopening and an eventual pull back of policy-led stimulus over longer periods.
UK Inflation Linked Bonds	Neutral	Underweight	**Over 2021Q2, UK index linked bonds returned 3.6% in GBP terms[1].** Despite the pull back in breakevens over the quarter, **we have moved from the negative side of neutral to an underweight position within the defensive fixed income portfolio with market pricing for inflation appearing expensive considering the subsiding tail risk of runaway inflation.** UK Breakevens remain unattractive on outright valuation grounds, and also relative to nominal sovereign bonds, with UK inflation unlikely to average 3.5% over the next 10 years. However, we acknowledge a wider possible range of future inflation outcomes for the market. UK breakevens continue to be supported by a captive local market supported by lack of issuance. In late 2020 it was decided that RPI would switch to CPIH from 2030; however, we still believe there exists some degree of uncertainty around the final outcome.
UK Buy and Maintain Credit	Neutral	Neutral	**Over 2021Q2, UK credit returned 1.7% in GBP terms[1]. We have maintained UK investment grade credit within the defensive fixed income portfolio at neutral.** Spreads ground marginally tighter from Q1, and we expect them to consolidate at current levels, offering carry but limited capital gain with very few areas offering value. Over the short term, the corporate bond market should continue to benefit from a stronger economy and technical tailwinds in the form of investor demand for spread products, and expected weaker supply than over the second half of 2021. Over the medium term we are becoming more cautious, with a lot of good news already priced in but with very little reward for tail risks.

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[1]*Source: Bloomberg, DataStream as of end of 2Q2021*

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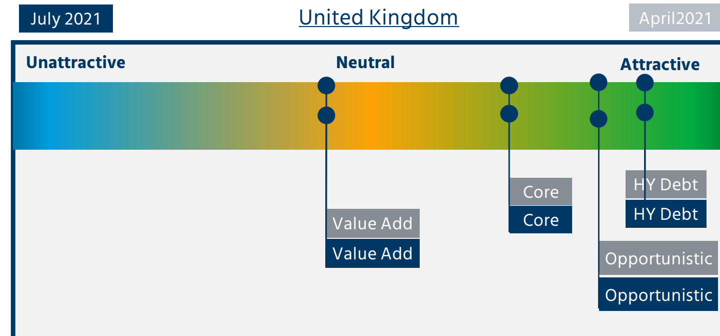
Real estate outlook and opportunities

Relative attractiveness by Fund Style



- **Core:** We have maintained our positive view on core investment strategies compared with last quarter. We expect this positivity to translate into improved investment sentiment and occupier demand, albeit from a low base. Investors will continue to focus on income security, such as that offered by long lease strategies, but pricing of mainstream core real estate remains attractive relative to other asset classes and we expect performance to recover strongly by year end.

- **Value Add:** Income risk strategies remain at neutral. The market has most likely moved through the depths of the economic downturn and optimism about the path to recovery is returning, but risks remain elevated for some sectors of real estate occupier demand, for example offices and retail.

- **Opportunistic:** Opportunistic strategies remain attractive in our view as the probability of achieving asset acquisitions at discounted pricing increases the longer the pandemic continues. Special situations opportunities are most likely to emerge in the retail and leisure sectors. Increasing obsolescence due to the growth of ESG requirements may also result in redevelopment opportunities.

- **High Yield Debt:** Real estate debt funds continue to look attractive for income seeking investors as traditional bank lenders reduce activity while underlying assets devalue. Together, these features mean higher margins can be achieved by non-bank lenders particularly outside of London and the most liquid sectors.

Market Outlook

- In the UK, a largely successful vaccine rollout has led to an easing of restrictions and a surge in consumption and broader economic activity. We expect the economy to grow at a rapid rate in the middle and later part of 2021, led by consumer spending, while monetary policy is set to remain exceptionally loose for some time.

- In our view the outlook for real estate remains positive overall given the improving macro-economic backdrop. However, valuations in some sub-sectors, for example weaker retail and office assets, may have further to fall amid ongoing uncertainty about secular shifts occupier demand.

- Our top three sector/geographic picks in terms of real estate fundamentals:

1. **Operational real estate:** Funds targeting assets where real estate performance is linked to an operating platform, including residential, self-storage, senior housing and leisure.

2. **Logistics:** Fundamentals remain strong for logistics sites in and around major urban areas, although attractive pricing is difficult to achieve for standing assets. Build to core strategies attractive.

3. **Accessible non-fashion retail**: Retail Parks with rebased rents, sustainable income profiles and low fashion exposure have attractive risk return dynamics at current pricing levels.

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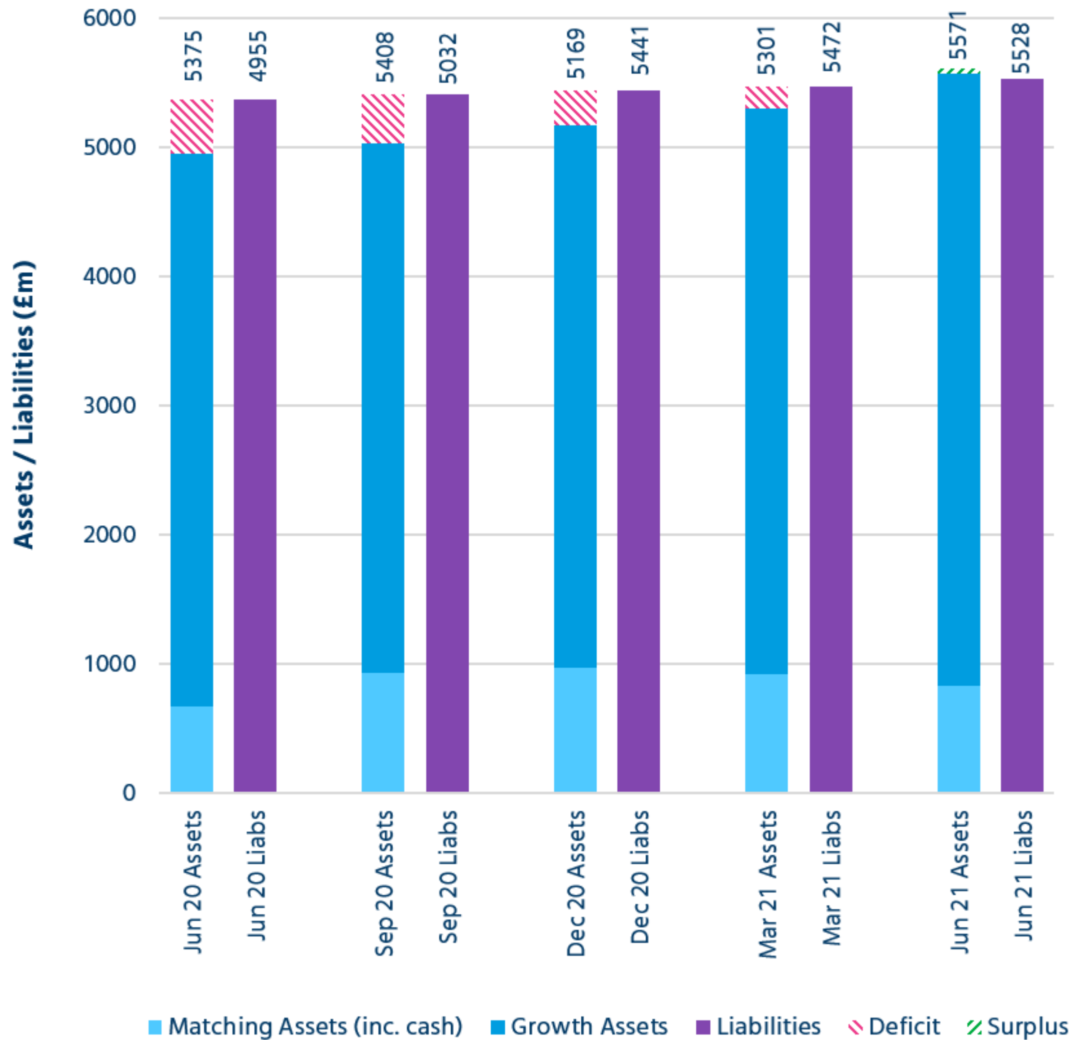
Funding level and risk

Change in deficit



Based on financial markets, investment returns and net cashflows into the Fund, the deficit was estimated to have been eliminated over Q2 for the to Fund to finish the quarter with a surplus of £43m.

This occurred as the value of the assets rose by more than the present value of the liabilities over the period.

This is calculated using the actuarial valuation assumptions as at 31 March 2019 and the 'CPI plus' discount basis.

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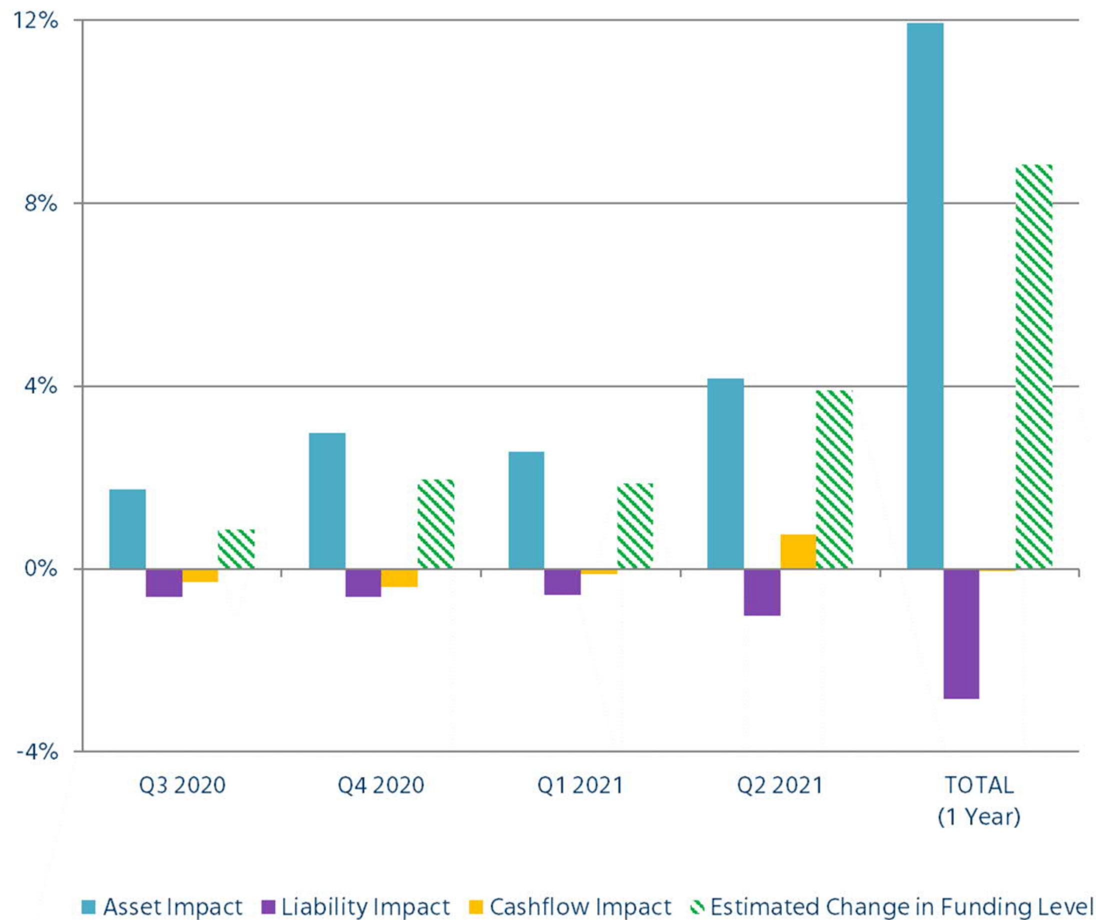
Funding level attribution



Impact figures are estimated by Mercer.

The Fund's assets returned 4.3% over the quarter, whilst the liabilities are expected to have increased by c. 1% due to the rise in inflation.

The combined effect of this, also allowing for expected cashflow over the period, saw the funding level improve from 97% to 101%.

The funding level is estimated to have increased by c. 9% over the year to 30 June 2021.

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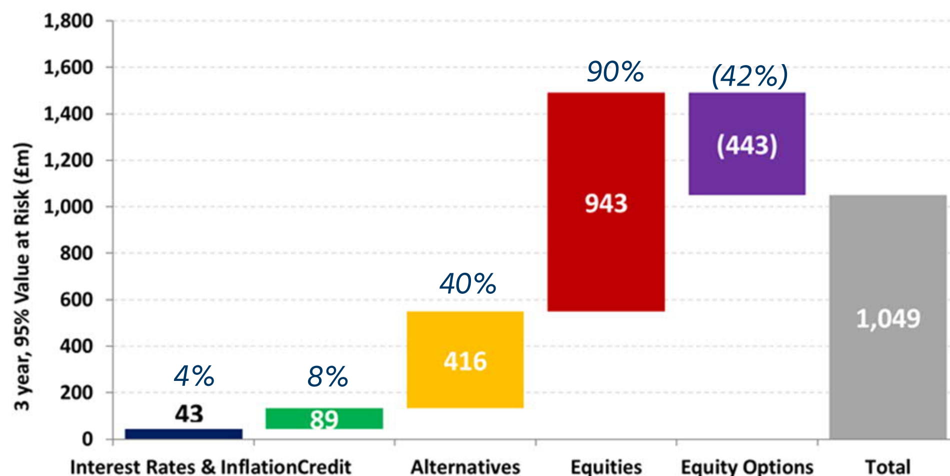
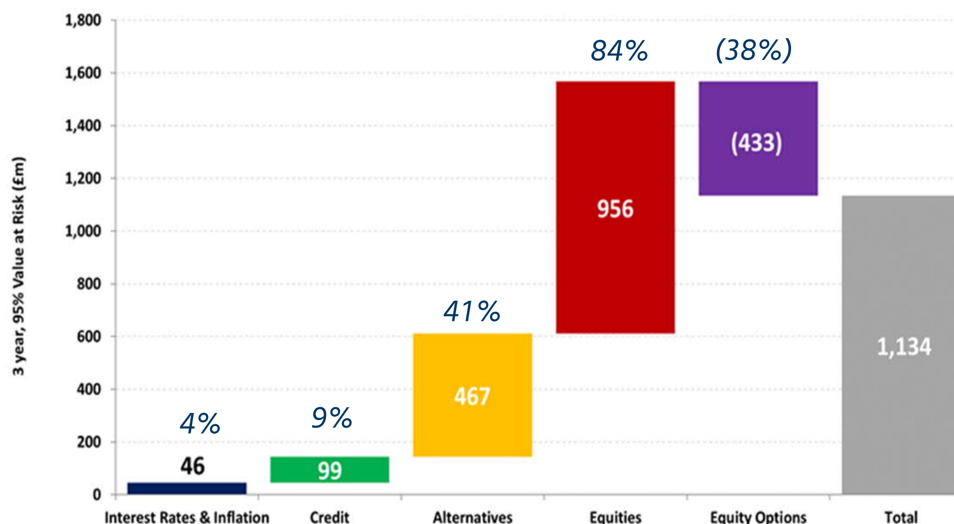
Risk decomposition – 3 year Value at Risk

31 March 2021



30 June 2021



- The two charts to the left illustrate the main risks that the Fund is exposed to on the 2019 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 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 grey column on the right hand side of each chart shows the estimated 95th percentile Value-at-Risk (VaR) 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 30 June 2021, it shows that if a 1-in-20 'downside event' occurred over the next three years, the funding position could deteriorate by at least an additional **£1.1bn**.
- Each bar to the left of the grey bar represents the contribution to this total risk from the primary underlying risk exposures (interest rates and inflation, changes in credit spreads, volatility of alternative assets and equity markets, and the benefit from equity options).
- Overall, **the VaR rose over the quarter**, which was largely due to the increase in the absolute value of all asset classes over the period.
- Both decompositions illustrate the use of a dynamic equity option strategy, which the Fund implemented during the quarter. This has significantly reduced the VaR via an increased offsetting amount from the equity options.

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

Performance summary

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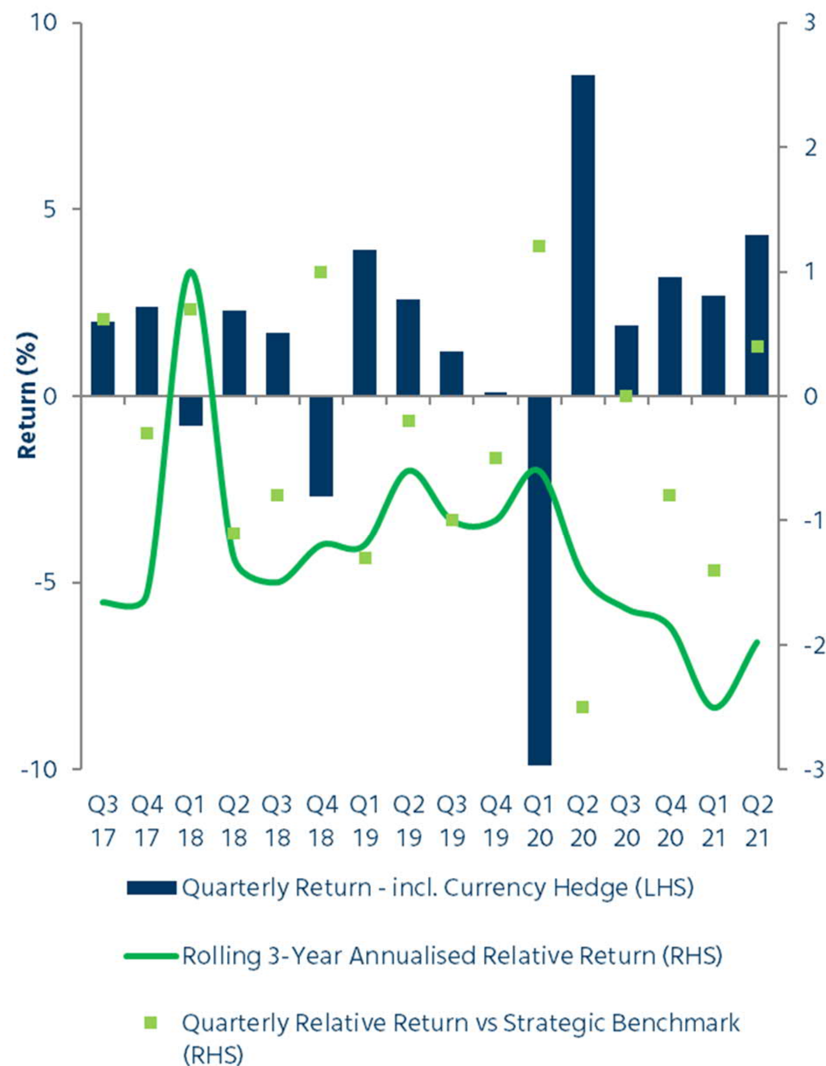
Total Fund performance



	3 Months (%)	1 Year (%)	3 Years (% p.a.)
Total Fund **(1)**	4.3	12.6	5.6
Total Fund (ex currency hedge)	4.4	10.3	5.4
Strategic Benchmark **(2)** (ex currency hedge)	3.9	14.7	7.6
Relative (1 - 2)	**+0.4**	**-2.1**	**-2.0**

Commentary

- Fund returns over the quarter were driven by the continued strength in growth assets.
- The continued rise in equity markets bolstered the physical equity holdings, and the two active global mandates topped this up with outperformance thanks to stock selection and sustainable-themed holdings doing well. Markets also helped the Diversified Returns mandate to become the largest outperformer in the portfolio, against its cash plus benchmark, though at the portfolio level returns were curtailed again by the equity protection in place. The Hedge Fund and Core Infrastructure mandates also did well against their cash plus benchmarks.
- Relative performance at the mandate level has been mixed over the one year period to 30 June 2021. The High Alpha Equity mandate remains strongly up, and Hedge Funds and Core Infrastructure have continued to do particularly well. The Renewable Infrastructure mandate is in negative territory, but this largely reflects that it is still in the drawdown phase, and it has nevertheless still outperformed its benchmark since inception after a strong start.
- Underperformance relative to the strategic benchmark over the one and three period is mainly due to the impact of the equity protection strategy, but it is important to note that this has behaved in line with expectations given the increase in the underlying equity markets. The currency hedging policy made a positive contribution over both periods as sterling strengthened.

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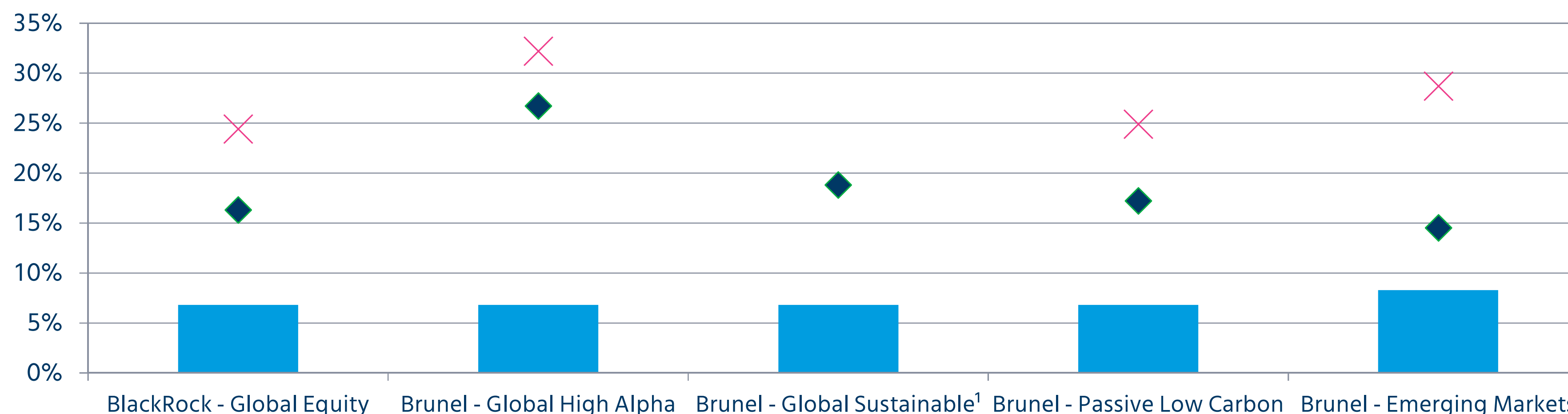
Performance vs. expected strategic returns

	BlackRock Global Equity	Brunel Global High Alpha	Brunel Global Sustainable	Brunel Passive Low Carbon	Brunel Emerging Markets
Benchmark allocation	12.0%	10.0%	10.0%	10.0%	5.5%
Commentary	Returns have been above expectations for all equity mandates, given the strength of equity markets since 2019.				
	Returns are above strategic expectations and the fund has tracked the underlying market	Strong manager outperformance adding to returns	Strong returns from equity markets, although the fund has underperformed the benchmark to date	Returns are above strategic expectations and the fund has tracked the underlying market	Returns are above strategic expectations as the fund has performed broadly in line with the underlying market



Notes:
We have illustrated the key mandates within the Fund's investment strategy.
The strategic expected returns are from the 2019 strategy review, which reflect the 20 year mean Mercer Q1 2019 asset model assumptions.
Actual returns between 31 March 2019 to 31 March 2021, except if otherwise stated below.
[1] Returns are shown since the mandate's inception date (not annualised).

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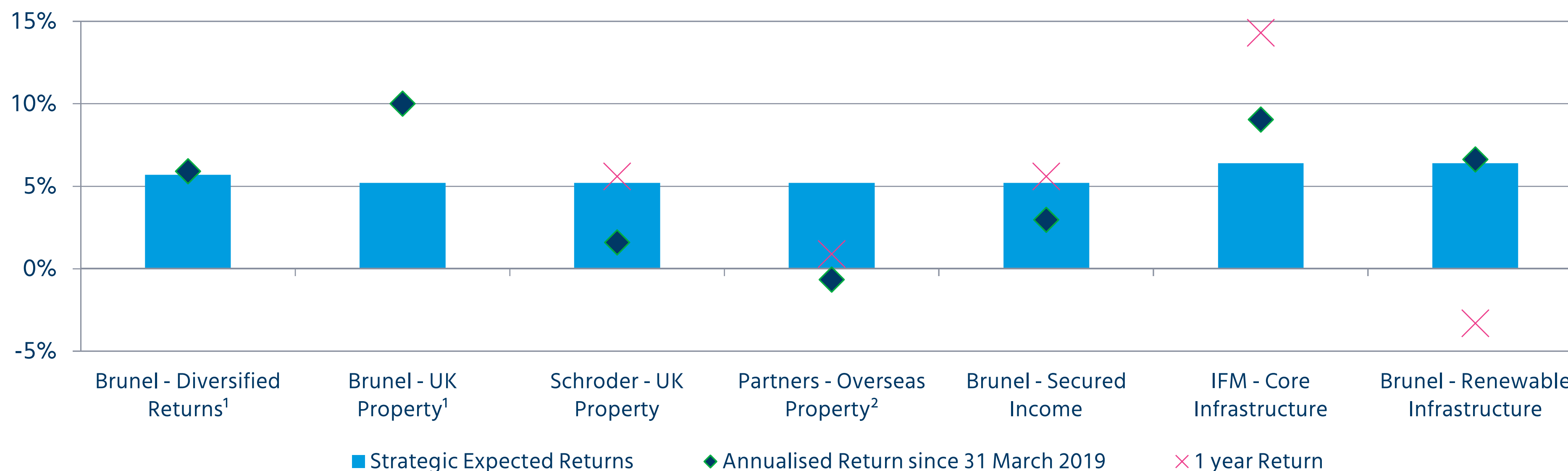
Performance vs. expected strategic returns

	Brunel Diversified Returns	Brunel UK Property	Schroder UK Property	Partners Overseas Property	Brunel Secured Income	IFM Core Infra	Brunel Renewable Infra
Benchmark allocation	10.0%	3.75%	0% *(Transferring to Brunel)*	3.75%	10.0%	5.0%	5.0%
Commentary	Returns above expectation so far thanks to exposure to rising equity markets, as well as currency positioning by one of the managers	Mandate incepted in January 2021; too early to draw conclusions although property market has fared well so far in 2021	Returns below expectations due to the impact of the pandemic on some of the holdings, including retail and leisure	Returns below expectations due as mandate still in drawdown phase (so focus should be on more longer-term performance). Pandemic has had recent impact on some of the holdings, including in hospitality, retail and senior housing	Returns marginally below expectations but mandate is still in the drawdown phase	Returns above expectations as real assets have continue to deliver	Returns above expectations (despite contracting over one year period) but mandate is still in the drawdown phase



Notes:

We have illustrated the key mandates within the Fund's investment strategy.

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Actual returns between 31 March 2019 to 31 March 2021, except if otherwise stated below.

[1] Returns are shown since the mandate's inception date (not annualised).

[2] Returns are shown up to 31 March 2021, as this is the latest data available.

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Manager performance to 30 June 2021

Manager / Asset Class	3 Months Fund (%)	3 Months B'mark (%)	3 Months Relative (%)	1 Year Fund (%)	1 Year B'mark (%)	1 Year Relative (%)	3 Year Fund (% p.a.)	3 Year B'mark (% p.a.)	3 Year Relative (% p.a.)	3 Year Performance Target (% p.a.)	3 Year Performance vs Target
BlackRock Global Equity	7.6	7.6	0.0	24.4	24.4	0.0	13.7	13.3	+0.4	-	Target met
Brunel Global High Alpha Equity	9.3	7.8	+1.4	32.2	24.9	+5.8	N/A	N/A	N/A	+2-3	N/A
Brunel Global Sustainable Equities	8.4	7.4	+0.9	N/A	N/A	N/A	N/A	N/A	N/A	+2	N/A
Brunel Global Low Carbon Equity	7.7	7.8	-0.1	24.9	25.1	-0.2	N/A	N/A	N/A	-	N/A
Brunel Emerging Market Equity	4.6	5.0	-0.4	28.7	26.4	+1.8	N/A	N/A	N/A	+2-3	N/A
Brunel Diversified Returns Fund	5.8	0.0	+5.8	N/A	N/A	N/A	N/A	N/A	N/A	+4-5	N/A
JP Morgan FoHF	2.5	0.8	+1.7	17.6	3.3	+13.9	9.5	4.6	+4.6	-	Target met
Schroder UK Property	2.2	3.8	-1.5	5.6	8.5	-2.6	2.1	3.0	-0.9	+1	N/A
Brunel UK Property	5.6	3.8	+1.7	N/A	N/A	N/A	N/A	N/A	N/A	-	N/A
Partners Overseas Property*	0.9	2.5	-1.6	0.9	10.0	-8.3	1.0	10.0	-8.2	-	Target not met
Brunel Secured Income	2.7	1.7	+1.0	5.6	2.5	+3.0	N/A	N/A	N/A	+2	N/A
IFM Core Infrastructure**	6.1	1.2	+4.9	14.3	5.2	+8.7	10.4	5.7	+4.5	-	Target met
Brunel Renewable Infrastructure	-0.7	1.7	-2.4	-3.3	2.5	-5.7	N/A	N/A	N/A	+4	N/A
BlackRock Corporate Bonds	2.6	2.6	0.0	2.0	2.0	0.0	7.0	7.0	0.0	-	N/A
BlackRock LDI	2.5	2.5	0.0	27.3	27.3	0.0	3.7	3.7	0.0	-	Target met

Since inception performance for Partners, which was the largest underperformer over the three year period, has been more favourable at 5.4% p.a. *

Source: Investment Managers, Custodian, Mercer estimates.
Returns are in GBP terms, consistent with overall fund return calculations before currency hedging is applied, **except for JP Morgan and Partners , whose performance is shown in local terms. Returns are net of fees.**
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 (mainly reflecting passive mandates).
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.
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 the Appendix.
*Partners performance is to 31 March 2021 as this is the latest date that this is available. The mandate's inception was in 2009.
**IFM returns are in GBP terms after the manager switched to GBP reporting in January 2020. Historical USD performance has been converted to GBP.

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Asset allocation

Valuations by asset class

Asset Class	Start of Quarter (£'000)	End of Quarter (£'000)	Start of Quarter (%)	End of Quarter (%)	Benchmark (%)	Ranges (%)	Difference (%)
Global Equity	688,410	755,574	13.0	13.7	12.0	7 - 17	1.7
Global Sustainable Equity	541,101	586,798	10.2	10.7	10.0	5 - 15	0.7
Global Low Carbon Equity	691,544	745,054	13.0	13.6	10.0	5 - 15	3.6
Emerging Market Equity	286,760	299,916	5.4	5.5	5.5	3 - 9	0.0
Diversified Growth Funds	501,330	530,215	9.5	9.6	10.0	5 - 15	-0.4
Fund of Hedge Funds*	276,402	283,763	5.2	5.2	-	No set range	0.2
Multi-Asset Credit	317,539	317,354	6.0	5.8	6.0	3 - 9	-0.2
Property	377,969	353,307	7.1	6.4	7.5	5 - 10	-1.1
Secured Income**	280,324	350,558	5.3	6.4	10.0	5 - 15	-3.6
Core Infrastructure	365,544	389,545	6.9	7.1	5.0	2.5 - 7.5	2.1
Renewable Infrastructure**	50,205	55,286	0.9	1.0	5.0	2.5 - 7.5	-4.0
Private Debt	-	-	-	-	5.0	0 - 7.5	-
Corporate Bonds	130,825	134,187	2.5	2.4	2.0	No set range	0.4
LDI & Equity Protection	562,219	526,595	10.6	9.6	12.0	No set range	-2.4
Cash***	230,621	169,542	4.4	3.1	-	0 - 5	3.1
Total	5,301,031	5,570,651	100.0	100.0	100.0		

Source: Custodian, Investment Managers, Mercer. Green numbers indicate the allocation is within tolerance ranges, whilst red numbers indicate the allocation is outside of tolerance ranges.
Totals may not sum due to rounding and other residual holdings.
*Mandate due to be terminated.
Valuations include both funding cycle allocations.
***Valuation includes the ETF and currency instruments, as well as assets in transit towards the new Brunel MAC mandate.

Renewable Infrastructure and Private Debt mandates are still being drawn down so allocations are below target ranges.

Valuations by manager

Manager	Asset Class	Start of Quarter (£'000)	Cashflows (£'000)	End of Quarter (£'000)	Start of Quarter (%)	End of Quarter (%)
BlackRock	Global Equity	249,770		268,832	4.7	4.9
Schroder	Global Equities	1,515		1,524	0.0	0.0
Brunel	Global High Alpha Equity	403,274		440,841	7.6	8.0
Brunel	Global Sustainable Equity	541,101		586,798	10.2	10.7
Brunel	Global Low Carbon Equity	691,544		745,054	13.0	13.6
Brunel	Emerging Market Equity	286,760		299,916	5.4	5.5
Brunel	Diversified Returns Fund	501,330		530,215	9.5	9.6
Brunel	Multi-Asset Credit	-	317,354	317,354	0.0	5.8
JP Morgan	Fund of Hedge Funds	276,402		283,763	5.2	5.2
Loomis Sayles	Multi-Asset Credit	317,539	-320,925	-	6.0	0.0
Brunel	UK Property	106,841	2,469	115,388	2.0	2.1
Schroder	UK Property	92,565	-34,487	58,712	1.7	1.1
Partners	Overseas Property	178,563	-2,207	179,206	3.4	3.3
Brunel*	Secured Income	280,324	61,731	350,558	5.3	6.4
IFM	Core Infrastructure	365,544		389,545	6.9	7.1
Brunel*	Renewable Infrastructure	50,205	5,510	55,286	0.9	1.0
BlackRock	Corporate Bonds	130,825		134,187	2.5	2.4
BlackRock	LDI & Equity Protection	562,219		526,595	10.6	9.6
Record**	Currency Hedging	97,316	-25,000	72,250	1.8	1.3
BlackRock	ETF	108,631	25,000	67,385	2.0	1.2
Internal Cash***	Cash	58,223	12,695	73,977	1.1	1.3
Total		5,301,031	42,137	5,570,651	100.0	100.0

Source: Investment Managers, Mercer. Totals may not sum due to rounding and other residual holdings.
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. Q2 Cash valuation also includes the assets in transit towards the new Brunel MAC mandate.
* Valuations include both funding cycle allocations.
** Valuation includes the collateral holdings for the currency overlay.

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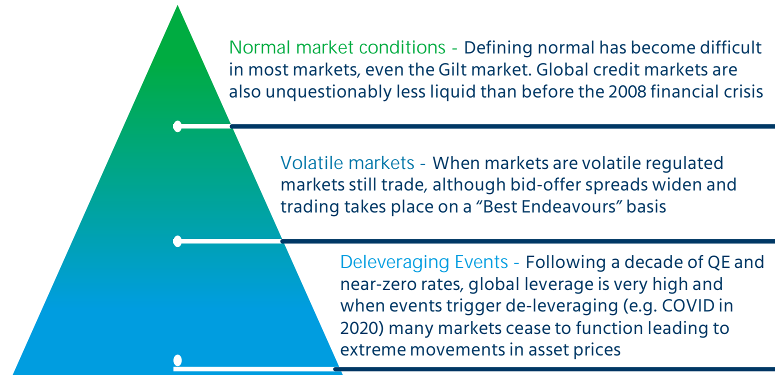
Current topics

Current topics

Liquidity Risk

Selling assets with poor secondary market liquidity to meet cash flow or collateral calls should be the last resort. Not all assets traded on regulated markets are liquid.



Regulated markets are not always liquid and the "liquidity gap" has narrowed

Declining liquidity in regulated markets has been secular trend since the 2008 crisis. Over the same period, unregulated markets have deepened leading to a significant rise in secondary market trading.

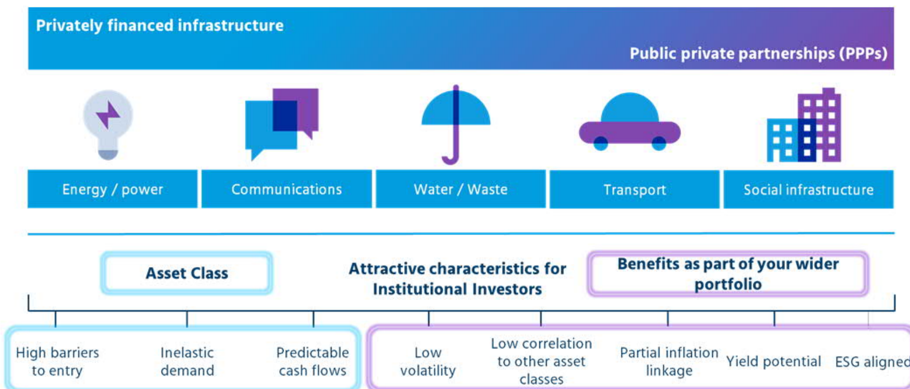
Relevance to the Fund

Liquidity is still an important consideration for Officers, particularly in times of severe market stress. It could also be subject to cash calls from the risk management and currency overlay portfolios.

Infrastructure – investing in the future

Long-term trends with positive investment implications:

Policy: Shift from monetary to fiscal stimulus
Urbanization: Regulatory and corporate imperatives
Population demographics: Increasing demand for infrastructure
Sustainability: Regulatory and corporate imperatives
Technology: Digitalization, data usage & communication



Risk/return considerations:

Political and regulatory factors
Infrastructure assets are subject to political scrutiny as well as potential regulation, given their importance to society.

Legal and compliance factors
Infrastructure assets are subject to numerous laws, statutes and regulations and asset owners must be proactive as these requirements change over time.

Environmental, social and governance factors
Many infrastructure investments have environmental footprints that must be managed as well as a focus on health & safety and the impact on local communities.

Operating and technical factors
Infrastructure investments are often complicated assets with unique characteristics and risk to manager (e.g. operating risk and technical risk).

Infrastructure can also help meet ESG rules, provided substance overrules form

Relevance to the Fund

These considerations are a reminder on the attractiveness of the asset class, in which the Fund also has a sizeable allocation and capital is continuing to be drawn down.

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Current topics

Why consider responsible investment?

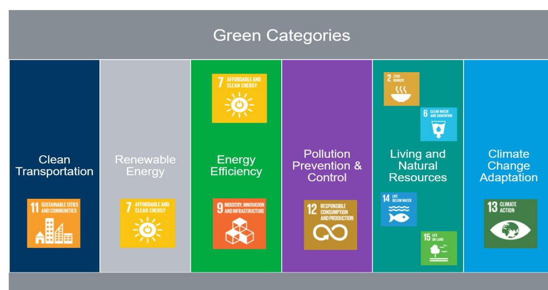
Mercer's Sustainable Investment Pathway

Relevance to the Fund

The Fund has committed to net zero by 2050, and has began to develop a plan to implement and monitor this.

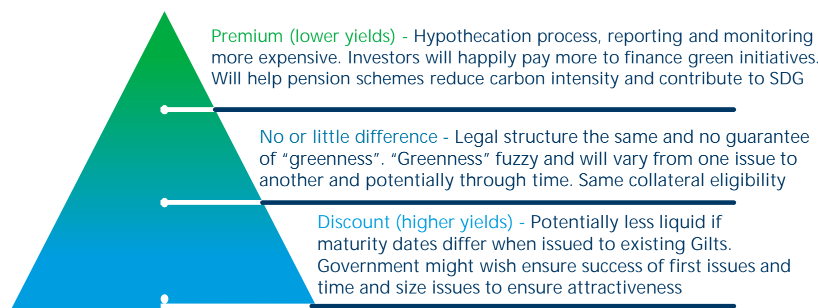
Gilts are going green

£15 billion to be issued this fiscal year beginning September



Source: HM Treasury, Green Financing Framework

The pricing conundrum



Evidence for green sovereign issues in France, Ireland, Belgium and Norway is mixed with green bond prices very close to current yield curves

Relevance to the Fund

The Fund could consider a "green bond" strategy in future and how this could fit within the portfolio. It could in the first instance engage with BlackRock on their views on pricing, future growth and their potential role in LDI portfolios.

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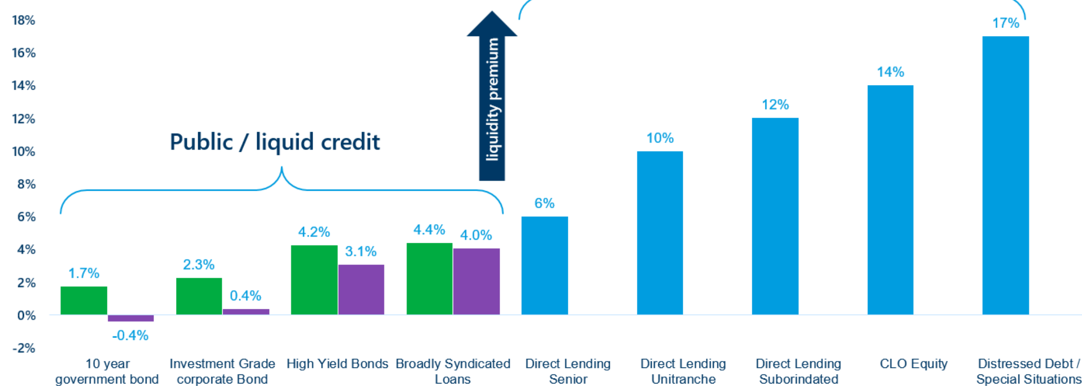
Current topics

Private Debt revisited

What is Private Debt?



Source: DataStream and S&P LCD. 10 year government bond: Bloomberg Barclays US Treasury Bellwether: 10 year and Germany Government Stored Yield Curve 10 year, Investment Grade Corporate Bond: Bloomberg Barclays US Corporate Investment Grade and Bloomberg Barclays Euro Aggregate Corporates, High Yield Bonds: Bloomberg Barclays US High Yield 2% Issuer Cap and Bloomberg Barclays Pan European High Yield, Broadly Syndicated Loans: S&P Leveraged Loan Index and S&P European Leveraged Loan Index. Private Credit spreads are estimates based on Mercer analysis.

How did we get here?

Investor appetite

Attractive Risk Return
Replacing lower performing asset classes in an era of falling yields

Supply constraints

Regulations & Consolidation
Banks continue to reduce lending activities

Demand for private finance

Private Debt Growth
Driving demand for credit no longer supplied by Banks

What is the evidence?

- ✓ Lower default and higher recovery rates
- ✓ Higher return than other growth fixed income asset classes, with no realised increase in risk
- ✓ Resiliency and downside protection versus more volatile growth asset classes

Relevance to the Fund

The Fund has already earmarked a 5% strategic allocation to Private Debt into which capital will begin to be drawn down. This serves as a timely reminder of the benefits of investing in the asset class.

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Appendix

Q2 2021 equity market review

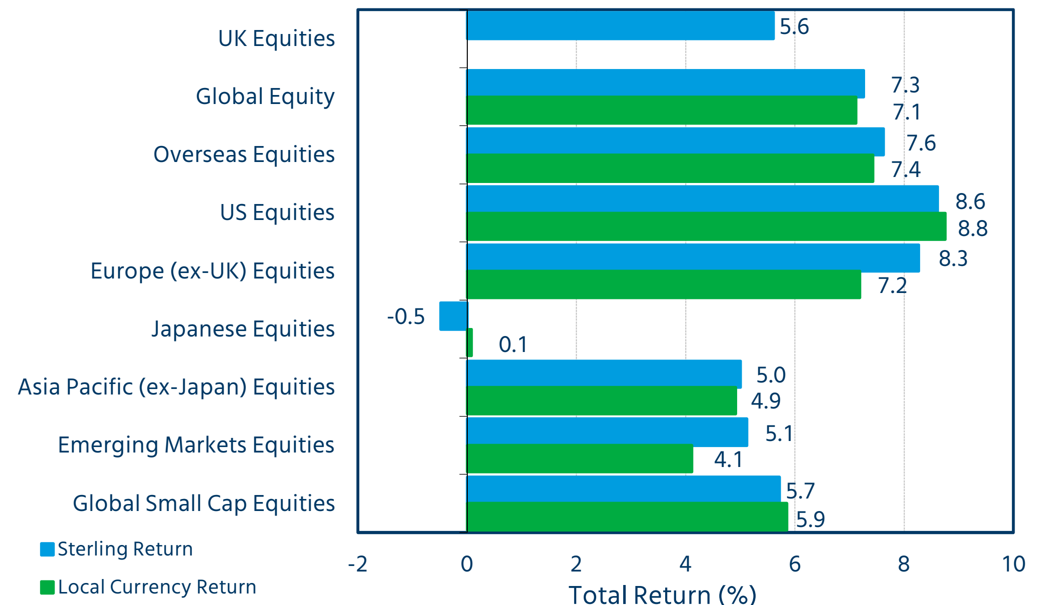
Global equity markets rallied over the quarter, returning 7.3% in sterling terms and 7.1% in local currency terms. Volatility in equity markets was lower compared to the first quarter of the year. However, fears of inflation and an acceleration in policy tightening did lead to a number of spikes in volatility. Reopenings across the western world and the ongoing strong recovery in corporate earnings supported equity momentum.

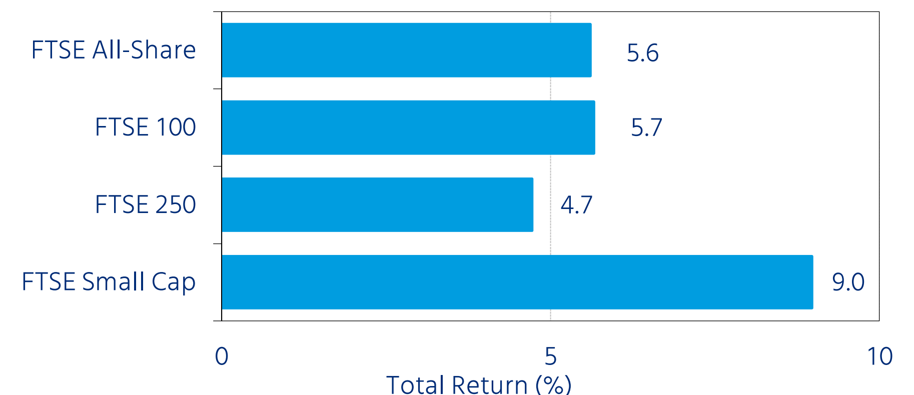
US equities returned 8.8% in local currency terms whilst European (ex UK) equities returned 7.2%. With a heavier weight in growth than in value and heavy exposure to tech stocks, the US benefited more from growth outperforming value over the quarter.

Emerging markets ('EM') equities returned 4.1% in local terms. Brazilian and Russian equities saw strong returns over the quarter, driven by rising commodity prices. Returns were positive for all other regions as well, including for India in spite of a pandemic-related slowdown. China was the weakest EM performer as a result of the ongoing regulatory crackdown on its tech sector and credit tightening.

Global small cap stocks returned 5.9% in local terms. Small caps lagged global equities as momentum began to slow somewhat after a very strong first quarter.

The **FTSE All Share index** returned 5.6% over the quarter. The large exposure to financials, oil & gas, and basic materials supported UK equities as markets priced in the cyclical recovery and rising commodity prices.





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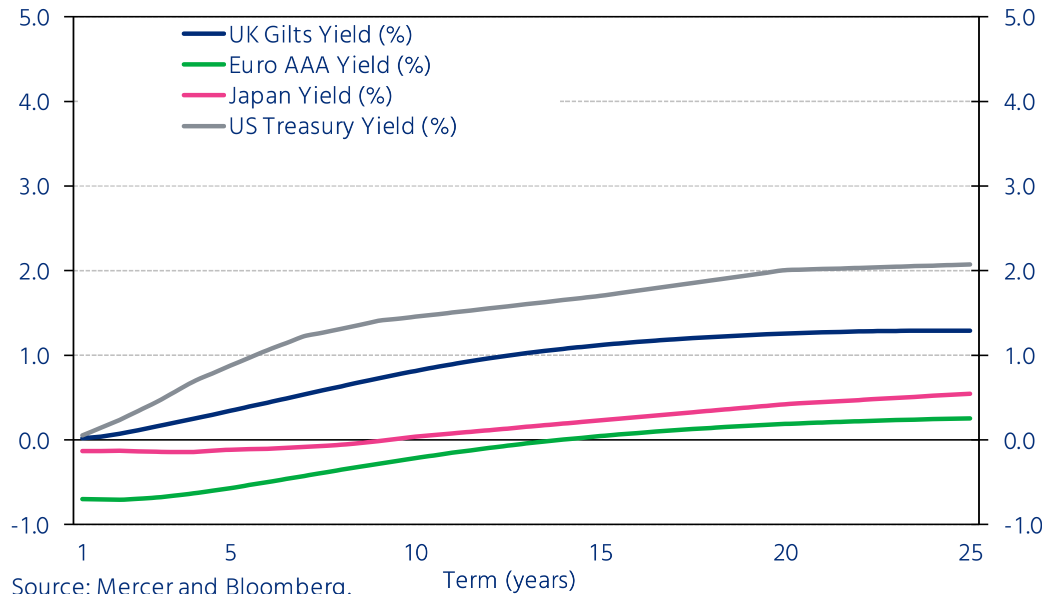
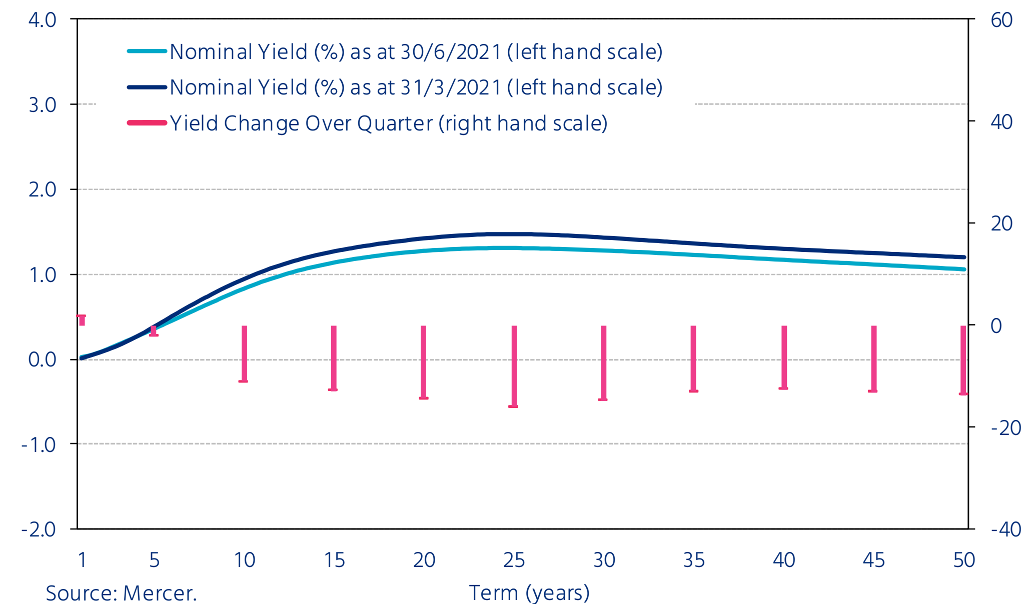
Source: Thomson Reuters Datastream.

Q2 2021 bond market review (1)



Source: Mercer and Bloomberg.



Source: Mercer.

Government Bond Yields

Government bond yields generally fell globally over the quarter after the rebound seen in Q1. The US 10-year government bond yield fell by 30 basis points as inflation worries eased somewhat towards quarter end and the Federal Reserve qualified its June statement that was initially perceived to be less dovish than expected. UK and Japanese 10-year benchmark yields fell by 13 and 4 basis points respectively. However, the German 10-year yield rose by 9 basis points.

UK Nominal Gilt Yields

The UK yield curve shifted downwards over the quarter as inflation expectations eased despite fiscal and monetary policy continuing to remain loose.

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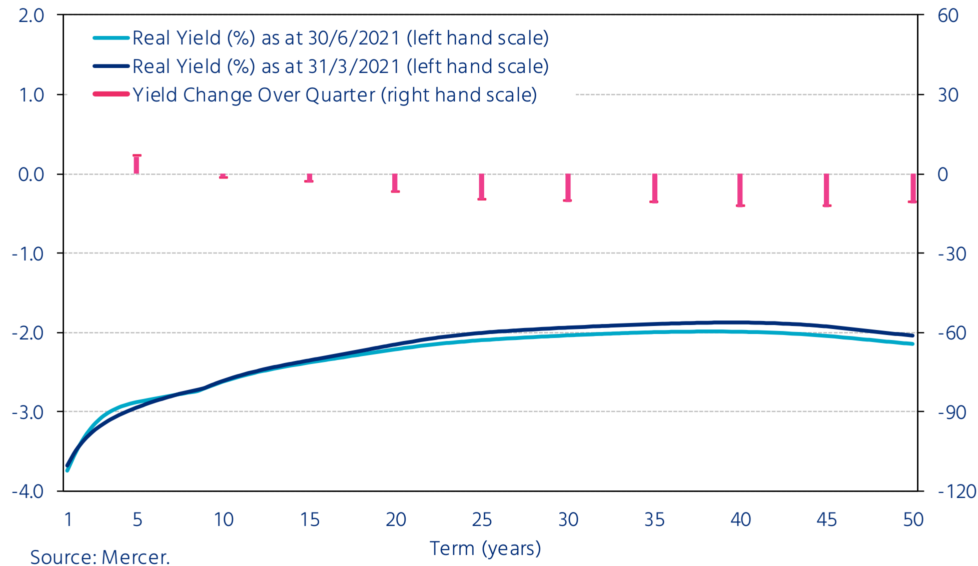
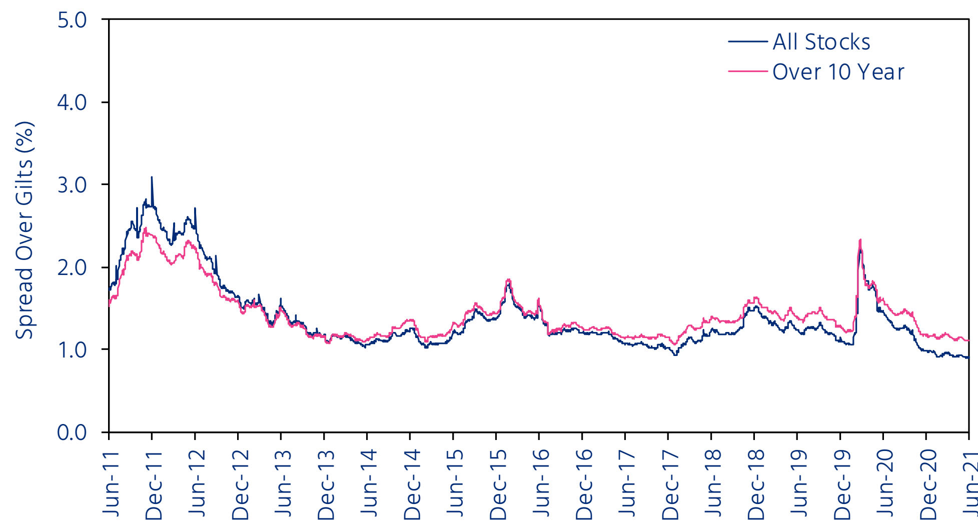
Q2 2021 bond market review (2)



Source: Mercer.

UK Index-Linked Gilt Yields

UK real yields fell across the curve, in line with nominal yields. The fall in nominal yields offset the decrease in inflation expectations.



Source: Thomson Reuters Datastream.

Corporate bonds

UK investment grade credit spreads tightened marginally over the quarter, as demand for spread assets remained strong. Investment grade spreads for the All Stocks Index have retraced all of the spread widening experienced in 2020 and remain below their late-2019 level.

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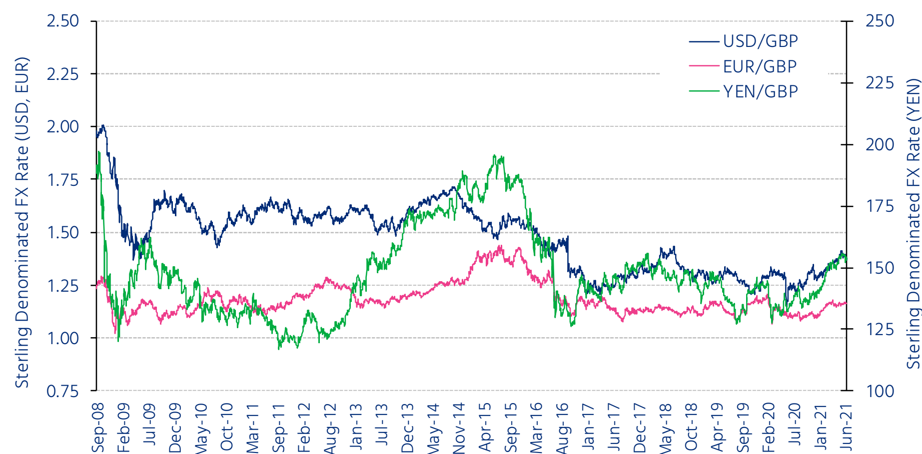
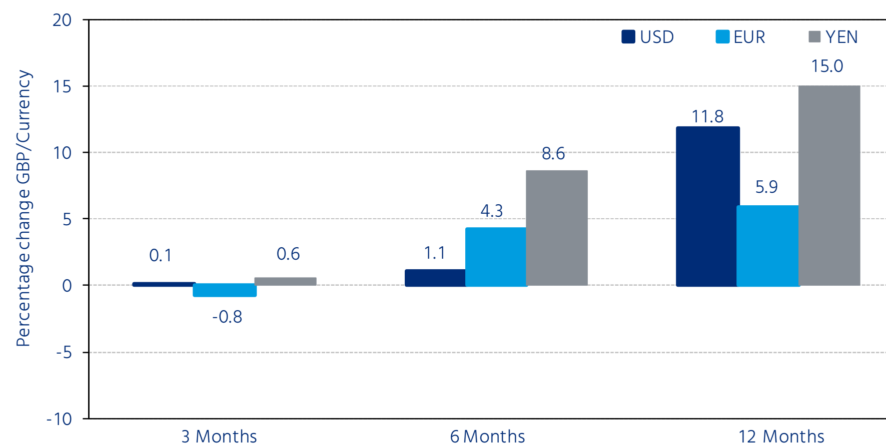
Q2 2021 currency market review

Sterling was relatively stable against all major developed currencies compared to previous quarters. On a one year basis, sterling has enjoyed a post Brexit rally after the final transition out of the EU. There was also optimism over Britain's gradual reopening thanks to its successful vaccination programme. The US dollar weakened against other major developed market currencies on a one year basis driven by the combination of rising inflation relative to other countries and concerns over excessively lose monetary and fiscal policy.





Q2 2021 property

UK property as measured by the MSCI Index increased by 3.9% over the quarter to 30 June 2021.

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Source: Thomson Reuters Datastream.

Summary of mandates

Manager	Mandate	Benchmark/Target	Outperformance Target (p.a.)
BlackRock	Global Equity (passive)	MSCI World	-
Brunel	Global High Alpha Equity	MSCI World	+2-3%
Brunel	Global Sustainable Equity	MSCI AC World	+2%
Brunel	Global Low Carbon Equity (passive)	MSCI World Low Carbon	-
Brunel	Emerging Market Equities	MSCI Emerging Markets	+2 -3%
Ruffer	Diversified Growth Fund	3 Month LIBOR +5% p.a.	-
Brunel	Diversified Returns Fund	SONIA	+4-5%
JP Morgan	Fund of Hedge Funds	3 Month LIBOR +3% p.a.	-
Brunel	Multi-Asset Credit	SONIA	+4-5%
Schroder	UK Property	IPD UK Pooled	+1%
Brunel	UK Property	MSCI/AREF UK Quarterly Property Fund Index	-
Partners	Overseas Property	Net IRR of 10% p.a. (local currency)	-
Brunel	Secured Income	CPI	+2%
IFM	Core Infrastructure	3 Month LIBOR +5% p.a.	-
Brunel	Renewable Infrastructure	CPI	+4%
Brunel	Private Debt	3 Month LIBOR + 4% p.a.	-
BlackRock	Buy-and-Maintain Corporate Bonds	Return on bonds held	-
BlackRock	Matching (Liability Driven Investing)	Return on liabilities being hedged	-
Record	Passive Currency Hedging	N/A	-
BlackRock	Exchange-Traded Fund (ETF)	Bespoke benchmark to reflect total Fund allocation	-
Cash	Internally Managed	7 Day LIBID	-

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Market statistics indices

Asset Class	Index
UK Equities	FTSE All-Share
Global Equity	FTSE All-World
Global Developed Equity	FTSE AW Developed
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
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.

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