Avon Pension Fund

Panel Investment Report
Quarter to 30 September 2021

November 2021

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Executive summary

Market background

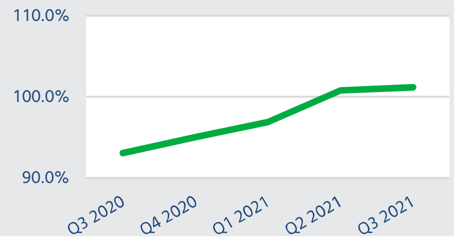
- The third quarter of 2021 started with optimism over reopenings but ended with global slowdown fears, amid concerns over the Delta variant and supply chain pressures.
- Developed equity markets remained in positive territory overall despite the sell-off in September though emerging markets contracted, driven by the regulatory crackdown in China and the restructuring of the large property developer Evergrande.
- Inflation expectations increased significantly, and gilt yields rose in response to hawkish signals from central banks.

Mercer market views

- Our medium term views on the global economy continues to be that growth will remain strong, albeit with some potential short-term challenges.
- Corporate profit growth is expected to remain strong, though the heightened prospect of central bank tightening could undermine equities.

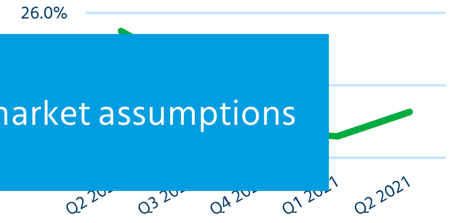
Funding level and risk

- The funding level is estimated to have improved slightly over Q3 to just over 101%, as asset growth outweighed the rise in the value of the liabilities.
- It is estimated to have increased by 8% over the year to 30 September 2021 (as illustrated to the right).



- The Value at Risk rose over the quarter to £1,134m, or 20.5% of liabilities
- Risk
  the
- Whil
  from Q4 2020.

VaR commentary to follow shortly due to availability of capital market assumptions



Executive summary

Performance

- Most assets delivered positive returns over the quarter, particularly the LDI portfolio given the rise in inflation expectations.
- Equity assets were up overall, and private market assets in UK Property, Secured Income and Infrastructure did well.
- 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 and the currency hedge in place.
- Relative performance was mixed at the mandate level, though the Hedge Fund and Core Infrastructure mandates have continued to stand out in outperforming their benchmarks. The Diversified Returns mandate has also done well over the year.

	3 Months (%)	1 Year (%)	3 Years (% p.a.)
Total Fund **(1)**	2.9	13.8	6.0
Strategic Benchmark **(2)** (ex currency hedge)	3.3	16.2	7.8
Relative **(1 - 2)**	**-0.4**	**-2.4**	**-1.8**

- Absolute returns for all growth mandates, except for the two older Property funds and the Renewable Infrastructure mandate still being drawn down, have been above the strategic returns modelled at the last investment strategy review in March 2019.

Asset allocation and strategy

- The Fund received its first capital call from the Private Debt commitment with Brunel, to be drawn down over time towards its 5% target strategic allocation.
- 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.
- Post quarter-end, the Committee agreed to terminate the Fund's holdings in Emerging Markets Equity. Holdings will be distributed between the High Alpha and Sustainable Equity mandates (which still contain emerging markets exposure).
- From a strategic perspective, the allocation to Diversified Returns will also be reduced, and the global equity mandates correspondingly increased in order to maintain the overall expected return of the portfolio in light of the reduction in emerging markets equities. However, no rebalancing will take place at this stage due to prevailing relative positioning.

Market background

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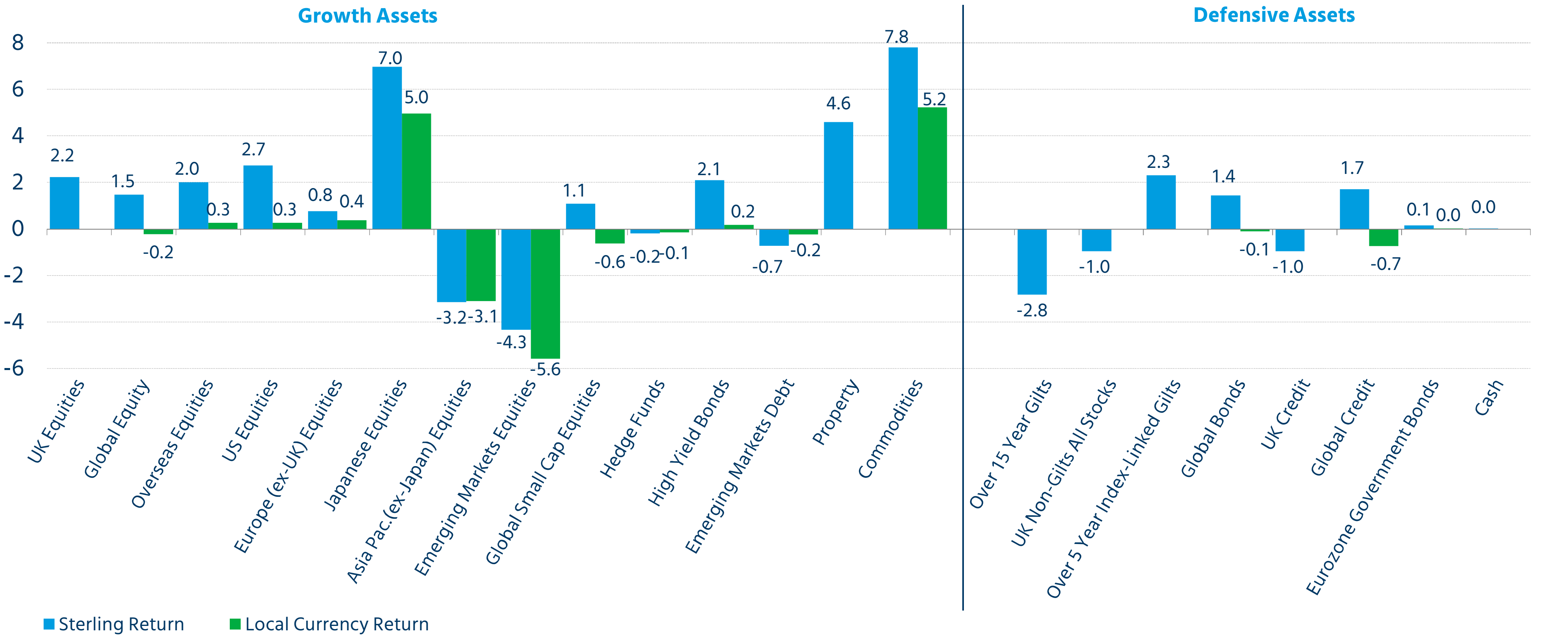
Market background

Return over 3 months to 30 September 2021 (%)



The third quarter of 2021 started with optimism over reopenings but ended with global slowdown fears. Over the first half of the quarter, the US, UK and much of Europe went ahead with fully reopening their economies which drove risk on sentiment. However, concerns over the Delta variant prompted some economies with 'zero Covid' policies, mostly around Asia Pacific to re-impose restrictions. This added to already existing supply chain pressures.

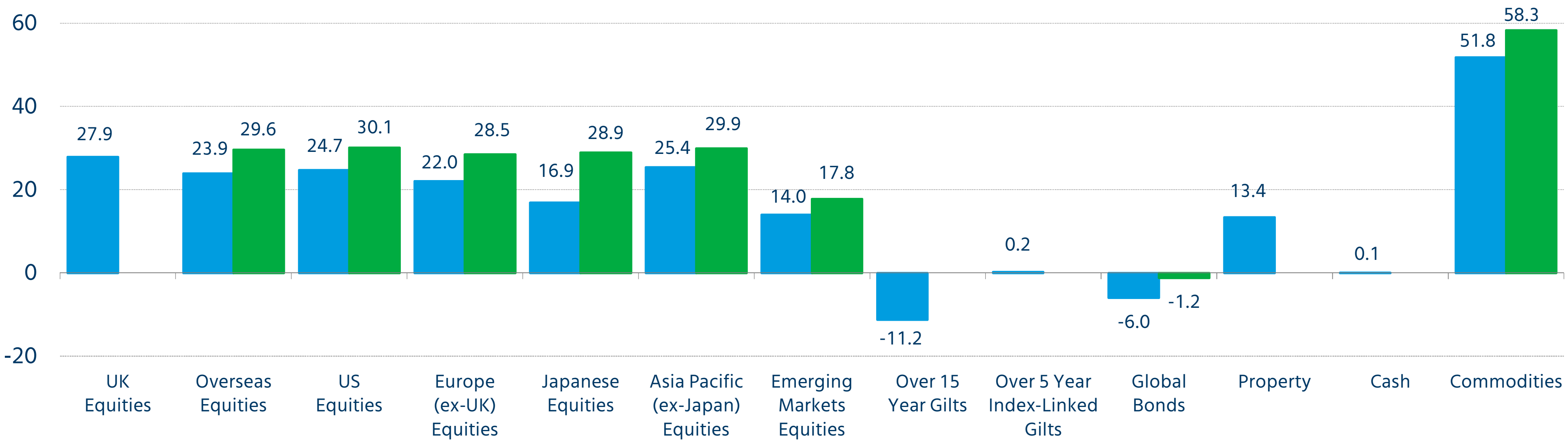
The supply impact was increasingly felt later in the quarter, in combination with concerns over pent-up demand peaking and Covid fears leading to a deterioration in sentiment. The struggles of China's largest property developer, Evergrande as well as the Chinese government intensifying its regulatory crackdown, against sectors such as technology and private education, added to concerns.

Mercer

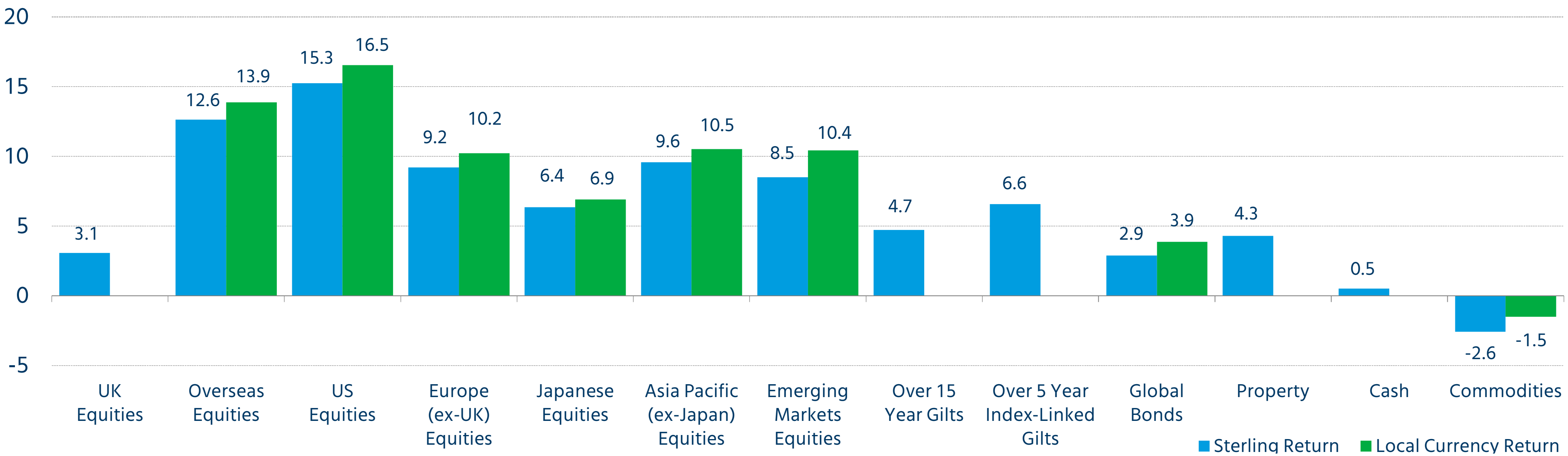
Source: Thomson Reuters Datastream.

Market background – longer term

Return over 12 months to 30 September 2021 (%)



Return over 3 years to 30 September 2021 (% p.a.)



Source: Thomson Reuters Datastream.

Mercer market views

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Market Outlook

Global equity returns were flat over the quarter in US dollar terms on the back of heightened fears over recent increases in the price of energy and related supply chain disruptions. However, central banks and in particular the US Federal Reserve continued to assert that the rise in inflation was transitory and would dissipate over time. A weaker sterling led to positive global equity returns in the low single digits for unhedged UK investors. Bonds rallied at the start of the quarter as signs that the reopening surge in activity was fading started to emerge, although bond yields rose towards quarter end as the Federal Reserve began to indicate that tapering was imminent and other central banks such as the Bank of England also started to turn more hawkish.

Economic activity remained strong although the rise of the delta variant and shortages of people and goods in some sectors slowed activity through the quarter. While governments mostly avoided imposing new lockdowns, activities in certain face-to-face sectors, most notably travel, softened. In addition, ongoing supply disruptions in a range of sectors (most notably the auto sector) led to both less activity and higher prices. There were also signs that businesses were struggling to recruit the staff they needed and that this had put upward pressure on wage growth.

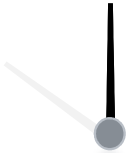
We expect economic growth to remain strong, although supply disruptions and near term weakness in China, could lead to near term growth being weaker than we had thought. However, any growth shortfall this year may be offset by better growth next year, especially in China and supply constrained sectors. It seems likely that the impact of COVID on economies and markets will fade, especially in those economies that have vaccinated the most.

Inflation, which has risen sharply should moderate, although remain above target for a while. While we share the US Federal Reserve view that much of the inflation increase is temporary, we think that rising wages and higher inflation expectations create the risk of a longer lasting move higher in inflation. We expect central banks to gradually withdraw some of the stimulus that was added last year.

We have reduced our high level weighting to equities from overweight to the positive side of neutral and have increased our cash position commensurately. On the one hand, corporate profit growth, which has been exceptionally strong over the last 18 months, should remain decent, while the tailwind from the poor returns available from other asset classes (such as bonds and cash) will continue. On the other hand the recent rise in inflation and the potential for it to be much longer lasting than anticipated, creates risk that the Federal Reserve and other central banks will have to tighten policy aggressively. This could undermine equities, perhaps materially. We remain underweight defensive fixed income and on the positive side of neutral on growth fixed income. We have also made marginal changes to the equity sub asset class positions.

Overweight | Neutral weight | Underweight

Mercer's current position/view



Position/view last time (if changed)

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.*

Mercer

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

Listed equities

ASSET CLASS	JULY 2021	OCTOBER 2021	COMMENTARY
Global Equity	Neutral	Neutral	**The MSCI World Index returned 2.6% in GBP terms over 2021Q3 and returned 15.0% year-to-date[1]. We have slightly increased our broad market equity sector position from the negative side of neutral to neutral within the global equities portfolio to offset our downgrade of defensive equities.** At this time our concerns about valuations and frothy sentiment in equity markets offset our expectation for a supportive economic background. Whilst we acknowledge the current soft patch in the economic recovery, we have confidence that growth will return to its previous path once fear over Covid-19 abates and the supply chains situation improves. However, we believe that markets are pricing this recovery in already and remain vulnerable to adversity in the short term , especially policy error as central banks commence efforts to tighten monetary policy. Moreover, we believe that other sectors such as small cap equities stand to benefit more strongly from the economic recovery regaining its momentum in the medium term as the economy recovers from the recent challenges.
Global Small Cap Equity	Neutral	Neutral	**The MSCI Small Cap index returned 1.1% in GBP terms over 2021Q3 and 15.1% on a year-to-date basis[1]. We have maintained our small cap allocation at the overweight side of neutral.** The macro environment remains favourable in the medium term as the current headwinds abate, especially for small caps that are expected to benefit significantly from the full and unconstrained domestic reopening that have happened in most of the developed world. 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. In relative terms, valuations have also become more attractive relative to large cap over the quarter.
Emerging Markets	Neutral	Neutral	**The MSCI Emerging Markets index returned close to -6% in GBP terms over 2021Q3 and close to 0% on a year-to-date basis[1]. We have maintained our position at the overweight side of neutral for emerging markets equities within the global equities portfolio.** Valuations remain 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 maintain our more prudent position for now. This positive tilt leaves us exposed to potential upside surprises, after so much negativity has been priced in during the quarter.

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[1]Source: Bloomberg, DataStream as of end of 3Q2021

Growth fixed income

ASSET CLASS	JULY 2021	OCTOBER 2021	COMMENTARY
EM Debt (Local Currency)	Neutral	Neutral	**EMD local currency markets fell through Q3 2021, posting a return of -0.7% in GBP hedged terms[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 while EM rates continue to look attractive on a credit rating adjusted basis. Whilst the economic backdrop for emerging markets have improved, a number of headwinds exist and could pose a risk to the rebound continuing on the same trajectory. The persistence and level of inflation along with the direction of the US dollar are notable headwinds, however, with a lower duration profile, the sector is more insulated from higher rates compared to hard currency. We maintain a preference for local currency due to the attractive carry offered, lower duration profile and FX upside potential.
EM Debt (Hard Currency)	Neutral	Neutral	**EMD hard currency markets rose through Q3 2021, posting a return of 1.7% in GBP hedged terms[1]. We have maintained our overall neutral allocation within the growth fixed income portfolio.** Inflation continues to weigh on sentiment with price increases picking up pace, and the transitory nature of inflation coming into question across select portions of the market. The spread dislocation between investment and non-investment grade continues with higher quality spreads broadly returning to pre-COVID tights, while high yield spreads remain wider by around 80bps. Whilst macro developments have been broadly positive; the Fed's more hawkish tone and the persistence of inflation are some of the key risks coming to the fore. Despite the recent slowdown in some countries, manufacturing sectors continue to recover with strong commodity prices providing support to a number of exporting nations.
Global Loans	Neutral	Neutral	**Over 2021Q3, global loans returned 3.6% in GBP hedged 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 of 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 remain low, and we believe investors are seeing sufficient reward for the level of risk. Our outlook for elevated interest rate volatility has us favoring the floating-rate nature of the loan asset class versus high yield.
High Yield	Neutral	Neutral	**Over 2021Q3, global high yield returned 2.7% on a USD 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 appears quite limited at this point. While strong fundamentals and easy lending support low default activity, spreads may be vulnerable to any hiccups in growth expectations. 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.

[1]Source: Bloomberg, DataStream as of end of 3Q2021

Defensive fixed income

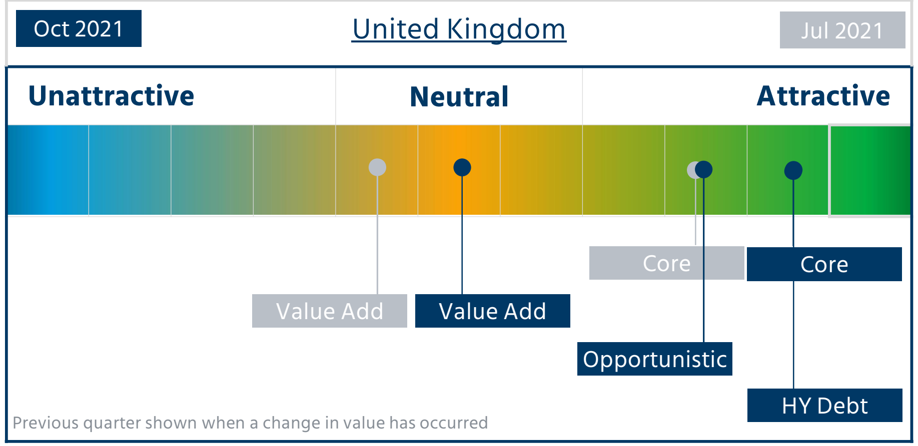
ASSET CLASS	JULY 2021	OCTOBER 2021	COMMENTARY
UK Sovereign Bonds	Neutral	Neutral	**Over 2021Q3, UK sovereign fixed income was flat in GBP terms[1]. We have maintained our position in UK sovereign fixed income on the underweight side of neutral within the defensive fixed income portfolio.** Like in other regions, the third quarter was largely characterised by concerns over inflation, with the UK experiencing the largest jump in inflation since records began. Ultimately this sent UK government bond yields upwards, with 10yr gilts breaching 1% for the first time since the pandemic began in March 2020. The gilt sell off was largely off the back of a more hawkish tone from the Bank of England, with the Governor signalling rate rises could even occur before the end of the year, well ahead of previous expectations. While gilts are now cheaper than last quarter, risks largely in the form inflation surprises, are ever present. Yields are likely to come under further upward pressure as output gaps close.
UK Inflation-Linked Bonds	Underweight	Underweight	**Over 2021Q3, UK inflation linked bonds returned 2.3% in GBP terms[1]. We have maintained our underweight position in UK inflation linked bonds within the defensive fixed income portfolio.** UK breakevens widened further over Q3, and remain unattractive on outright valuation grounds, and also relative to nominal sovereign bonds, with UK inflation unlikely to average 3.8% over the next 10 years. Easing inflationary pressures will likely see current levels of inflation moderate. Nevertheless, timeframes remain uncertain, and other factors like wage pressures and persistent supply bottlenecks may see somewhat stickier inflation than expected. We maintain our underweight position within defensive fixed income as we view risk to be better allocated elsewhere.
UK Buy and Maintain Credit	Neutral	Neutral	**Over 2021Q3, UK buy and maintain credit returned -1.0% in GBP terms[1]. We have maintained UK investment grade credit within the defensive fixed income portfolio at neutral.** UK investment grade spreads were little changed over the quarter and remain tight, both on an absolute and historical basis. However, like in other developed markets, this tightness is in part a reflection of the quality of the market. In this sort of environment credit selection is key, with many managers focusing on the crossover space and sectors in which the 'reopening trade' still has room to play. Although risk free assets have cheapened over the quarter, they remain expensive by historical standards, which should continue to support credit markets. However, upside potential seems limited and we therefore deem a neutral position still appropriate.

Mercer

[1]Source: Bloomberg, DataStream as of end of 3Q2021

Real Estate Outlook and Opportunities

Relative Attractiveness by Fund Style



- **Core:** We have improved our positive view on core investment strategies compared with last quarter. We expect a strong end to 2021 as the strong recovery of investment and occupier markets feeds through into the performance of core real estate strategies. We expect the core UK institutional investor base to remain focused on income security, such as that offered by long lease strategies.
- **Value Add**: Income risk strategies remain at neutral but are more attractive than last quarter. The recovery of occupier markets has surprised on the upside and we have more confidence in the medium term outlook overall 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 remains while 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

- We expect the UK economy to grow strongly over the next few quarters. Unemployment is likely to continue to fall and reach low levels over the next few years. The biggest risk to this benign outlook comes from the possibility of much tighter monetary policy, which might happen if inflation fails to fall back to target as central bankers hope. The BoE indicated in September that the bank rate could start rising later in 2021.
- In our view the outlook for UK 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. **Mid-market Private Rented Residential:** We think strategies targeting higher yielding Private Rented Residential assets that are affordable to average households should be attractive. The sector has robust supply and demand dynamics and should be attractive to cash flow focused investors in search of diversification and inflation protection. However, operational expertise are the key to minimizing cost inefficiencies.
2. **Logistics:** The fundamentals of supply and demand remain strong for logistics sites in and around major urban areas as commerce continues to move towards a home delivery model while supply is generally constrained by competing land uses. Attractive pricing is difficult to achieve for standing assets and so build to core strategies appear more attractive.
3. **Accessible non-fashion retail:** Following several years of declining values as a result of weakening occupier demand we think there now appears to be relative value in the sector, although risks remain elevated. We think accessible retail Parks with rebased rents, sustainable income profiles and low fashion exposure have attractive risk return dynamics at current pricing levels.

Funding level and risk

4

Change in deficit

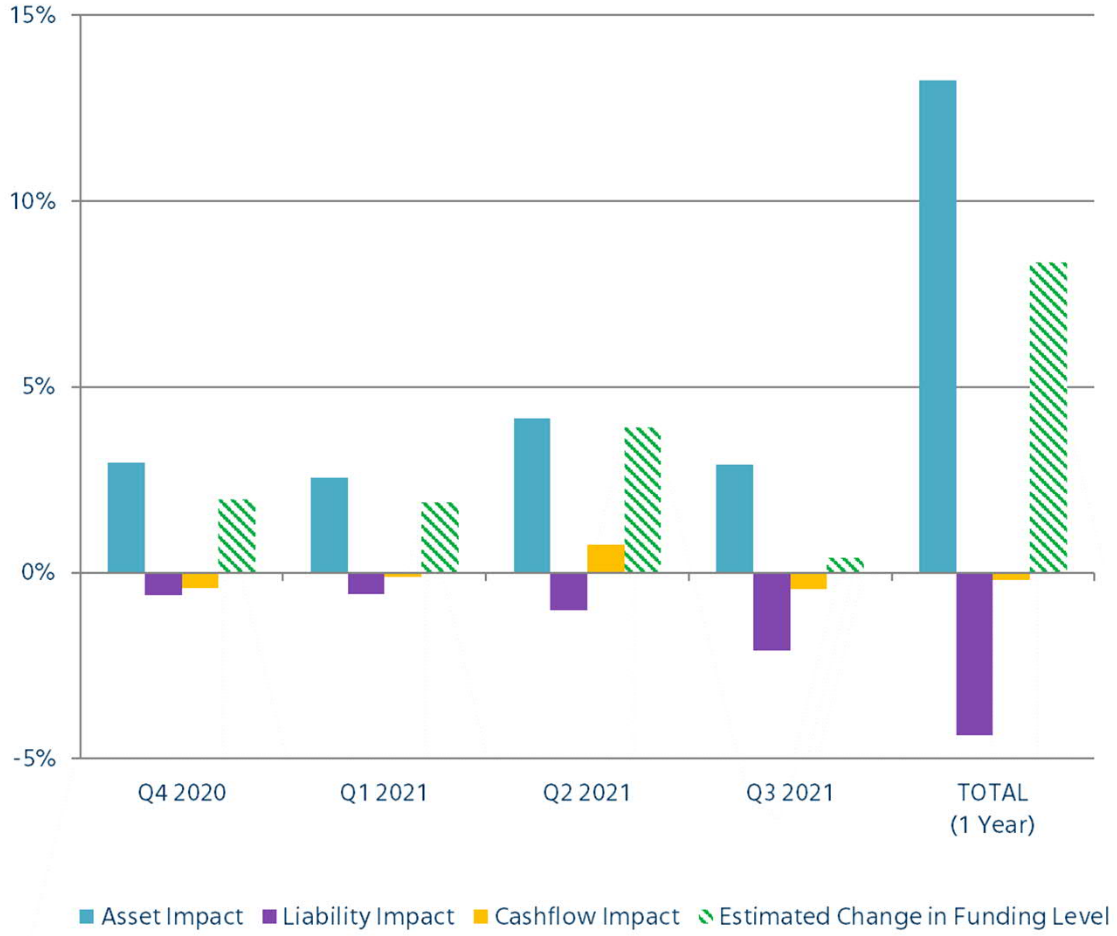
Based on financial markets, investment returns and net cashflows into the Fund, the surplus was estimated to have increased slightly over Q3 to £66m.

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.

Liability values are estimated by Mercer.

Funding level attribution



The Fund's assets returned 2.9% over the quarter, whilst the liabilities are expected to have increased by c. 2.1% due to the rise in inflation.

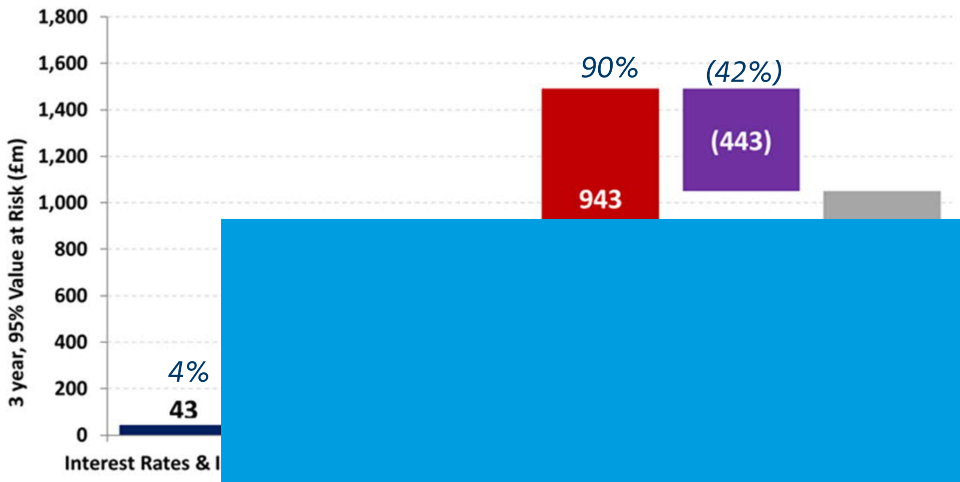
The combined effect of this, also allowing for expected cashflow over the period, saw the funding level improve slightly to just over 101%.

The funding level is estimated to have increased by c. 8% over the year to 30 September 2021.

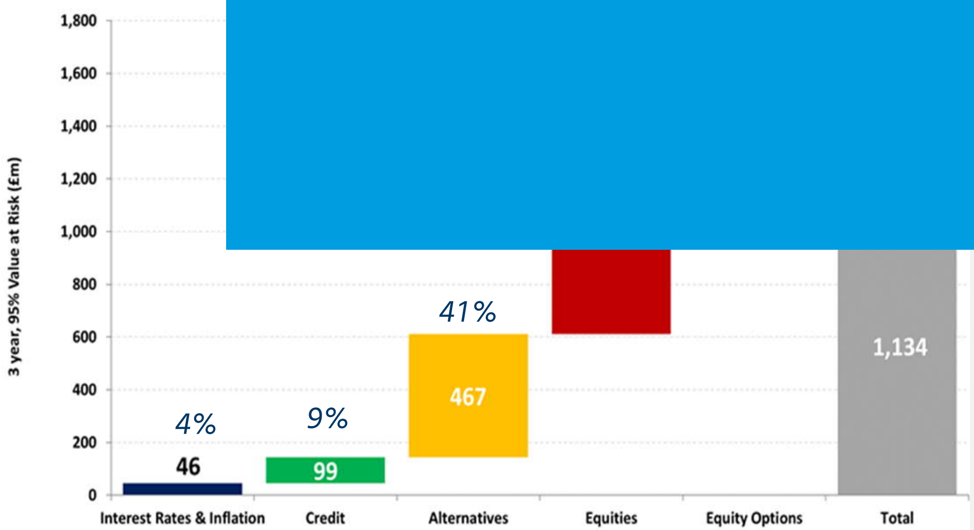
Impact figures are estimated by Mercer.

Risk decomposition – 3 year Value at Risk

31 March 2021



30 June 2021



VaR commentary to follow shortly due to availability of capital market assumptions

- 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'.
- f each chart shows k (VaR) over a one- r a downside scenario vhat would be the estimate' of what the
- shows that if a 1-in- xt three years, the east an additional
- ents the contribution ng risk exposures edit 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.

Mercer

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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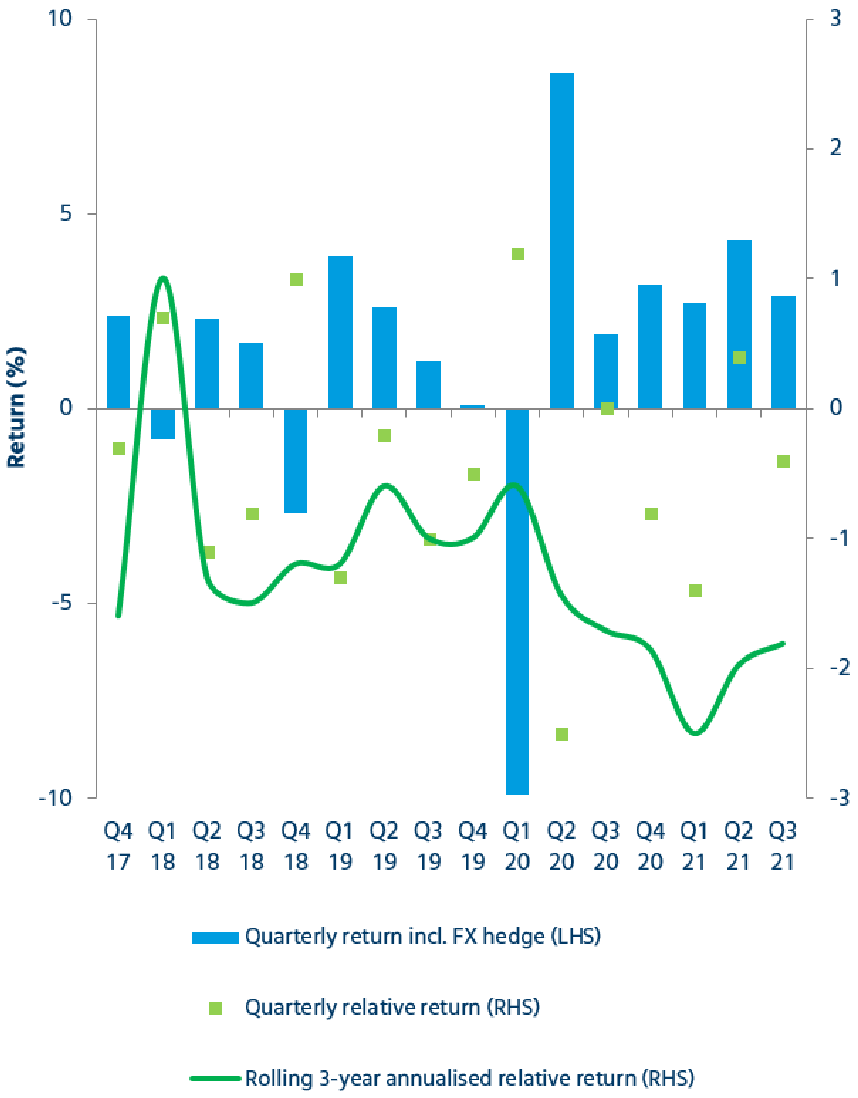
Total Fund performance



	3 Months (%)	1 Year (%)	3 Years (% p.a.)
Total Fund **(1)**	2.9	13.8	6.0
Total Fund (ex currency hedge)	3.4	12.8	5.9
Strategic Benchmark **(2)** (ex currency hedge)	3.3	16.2	7.8
Relative (1 - 2)	**-0.4**	**-2.4**	**-1.8**

Commentary

- Most assets delivered positive returns over the quarter, and the largest contribution came from the LDI portfolio given the rise in inflation expectations. The Fund outperformed its benchmark before factoring in the currency hedge, which detracted due to a weakening of Sterling.

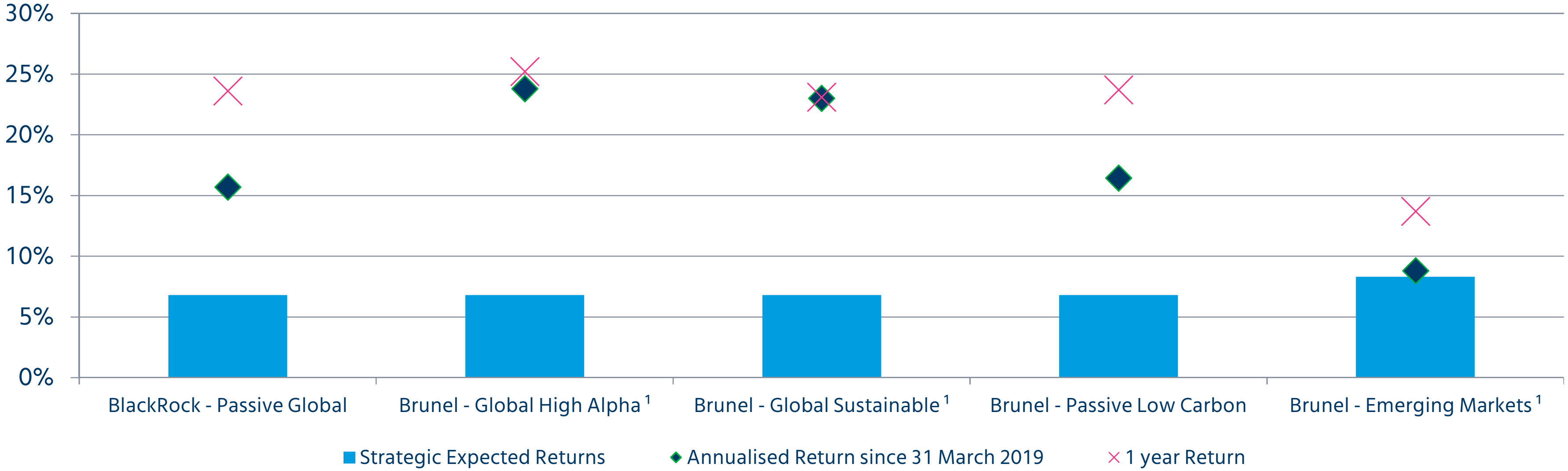
- Equity assets were up overall due to the rise in developed markets. The Sustainable mandate did particularly well as a result of stock selection at the manager level, though the Emerging Markets mandate detracted. This was mitigated by the Equity Protection strategy, which as a whole slightly added value over the quarter. The UK Property mandate with Brunel was another notable performer, and other private market assets within Secured Income and Infrastructure also had a modest contribution to outperformance.

- Over the one year and three year periods, the outperformers continue to be the Hedge Fund and Core Infrastructure mandates compared to their cash plus benchmarks, whilst the Property portfolios have underperformed. The Diversified Returns mandate has also done well over the year. Renewable Infrastructure remains in negative territory over the year due to it being in the draw down phase, but is ahead of target since inception.

- The Equity Protection strategy is the main reason for underperformance relative to the strategic benchmark over the one and three year periods, though this is in line with expectations given the increase in the underlying equity markets. The Currency Hedge made a positive contribution over both periods as sterling strengthened.

Performance vs. expected strategic returns

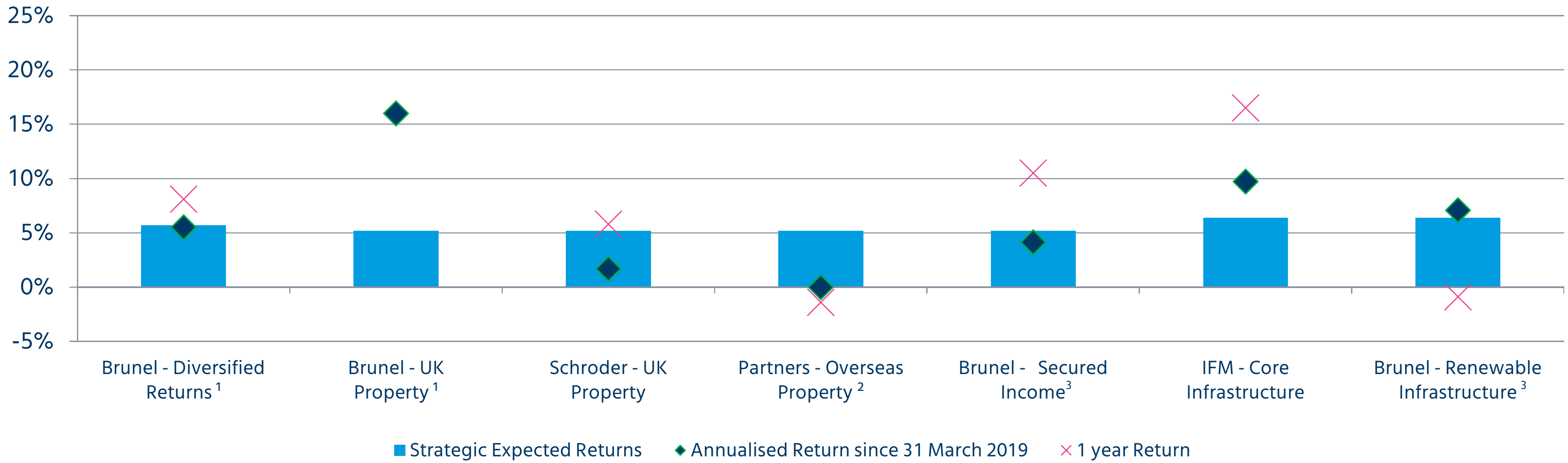
	BlackRock Passive Global Equity	Brunel Global High Alpha	Brunel Global Sustainable	Brunel Passive Low Carbon	Brunel Emerging Markets
Benchmark allocation	12.0%	10.0%	10.0%	10.0%	5.5%
Commentary	Returns have been above expectations for all equity mandates, given the strength of equity markets since 2019.				
	Returns are above strategic expectations and the mandate has tracked the underlying market	Strong manager outperformance adding to returns	Strong returns from equity markets and the mandate has now outperformed thanks to a strong third quarter	Returns are above strategic expectations and the mandate has tracked the underlying market	Returns are above strategic expectations though the mandate has underperformed benchmark since inception



Notes:
We have illustrated the performance of the key mandates within the Fund's investment strategy.
Actual returns are from 31 March 2019 to 30 September 2021, except if otherwise stated below. Returns for periods over a year have been annualised.
The strategic expected returns are from the 2019 strategy review, which reflect the 20 year mean Mercer Q1 2019 asset model assumptions.
[1] Mandate was incepted after 31 March 2019. A list of inception dates can be found in the Appendix.

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 and some of the asset class positioning of the four underlying 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 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. Recent signs of J-curve uptick	Returns above expectations as real assets have delivered. Recent outperformance influenced by non-recurring gains on certain assets and valuation increases.	Returns above expectations (despite contracting over one year period), but mandate is still in the drawdown phase



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[1] Mandate was incepted after 31 March 2019. A list of inception dates can be found in the Appendix.
[2] Returns are shown up to 30 June 2021, as this is the latest data available.
[3] Returns currently reflect those for the first commitment cycles only.

Mandate performance to 30 September 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 Passive Global Equity	2.5	2.4	+0.1	23.6	23.5	+0.1	12.0	11.9	+0.1	-	N/A
Brunel Global High Alpha Equity	1.7	2.6	-0.9	25.2	24.1	+0.9	N/A	N/A	N/A	+2-3	N/A
Brunel Global Sustainable Equity	3.6	1.5	+2.1	23.1	22.7	+0.3	N/A	N/A	N/A	+2	N/A
Brunel Passive Global Low Carbon Equity	2.4	2.5	-0.1	23.7	23.9	-0.2	12.7	12.8	-0.1	-	N/A
Brunel Emerging Market Equity	-6.5	-5.7	-0.8	13.7	13.7	0.0	N/A	N/A	N/A	+2-3	N/A
Brunel Diversified Returns Fund	0.6	0.0	+0.6	8.1	0.1	+8.0	N/A	N/A	N/A	+4-5	N/A
JP Morgan FoHF	-0.6	0.8	-1.4	11.8	3.2	+8.3	8.8	4.5	+4.2	-	Target met
Brunel Multi-Asset Credit	0.6	1.0	-0.4	N/A	N/A	N/A	N/A	N/A	N/A	-	N/A
Schroder UK Property	0.6	4.5	-3.8	5.8	13.1	-6.5	1.8	4.0	-2.1	+1	N/A
Brunel UK Property	5.4	4.5	+0.9	N/A	N/A	N/A	N/A	N/A	N/A	-	N/A
Partners Overseas Property*	1.3	2.5	-1.2	-1.4	10.0	-10.3	1.2	10.0	-8.0	-	Target not met
Brunel Secured Income	3.6	1.0	+2.6	10.5	3.0	+7.3	N/A	N/A	N/A	+2	N/A
IFM Core Infrastructure	3.8	1.3	+2.5	16.5	5.2	+10.7	8.9	5.6	+3.1	-	Target met
Brunel Renewable Infrastructure	2.7	1.0	+1.7	-0.9	3.0	-3.8	N/A	N/A	N/A	+4	N/A
BlackRock Corporate Bonds	-1.5	-1.5	0.0	-0.8	-0.8	0.0	6.8	6.8	0.0	-	N/A
BlackRock LDI	18.1	18.1	0.0	49.0	49.0	0.0	8.3	8.3	0.0	-	N/A
Equity Protection Strategy	0.2			-0.1			-1.3			-	N/A

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 net of fees.
Returns are in GBP terms, except for JP Morgan and Partners , whose performance is shown in local terms.
Relative returns have been calculated geometrically (i.e. the portfolio return is divided by the benchmark return) rather than arithmetically.
A summary of the benchmarks for each of the mandates is given in the Appendix.
Green = mandate exceeded benchmark. Red = mandate underperformed benchmark. Black = mandate performed in line with benchmark (mainly reflecting passive mandates).

Performance for JP Morgan and Partners in IRR terms. Performance for IFM is in TWR terms.
Performance of the Secured Income and Renewable Infrastructure mandates currently reflect those for the first commitment cycles only.
Performance of the Equity Protection Strategy is estimated by Mercer based on the change in market value of the options over time, accounting for realised profit/loss upon rolling of the strategy.
*Partners performance is to 30 June 2021 as this is the latest date that this is available. The mandate's inception was in 2009.

Asset allocation

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Valuations by asset class

Asset Class	Start of Quarter (£'000)	End of Quarter (£'000)	Start of Quarter (%)	End of Quarter (%)	Benchmark (%)	Ranges (%)			Relative (%)
Passive Global Equity	755,574	760,524	13.6	13.3	12.0	7	-	17	1.3
Global Sustainable Equity	586,798	607,893	10.5	10.6	10.0	5	-	15	0.6
Passive Global Low Carbon Equity	745,054	763,187	13.4	13.4	10.0	5	-	15	3.4
Emerging Market Equity	299,916	280,490	5.4	4.9	5.5	3	-	9	-0.6
Diversified Growth Funds	530,215	533,213	9.5	9.3	10.0	5	-	15	-0..7
Fund of Hedge Funds*	283,763	288,796	5.1	5.1	-	No set range			0.1
Multi-Asset Credit	317,989	322,864	5.7	5.7	6.0	3	-	9	-0.3
Property	353,307	346,729	6.3	6.1	7.5	5	-	10	-1.4
Secured Income**	350,558	385,384	6.3	6.7	10.0	5	-	15	-3.3
Core Infrastructure	389,545	403,824	7.0	7.1	5.0	2.5	-	7.5	2.1
Renewable Infrastructure**	55,286	70,741	1.0	1.2	5.0	2.5	-	7.5	-3.8
Private Debt	-	19,530	-	0.3	5.0	0	-	7.5	-4.7
Corporate Bonds	134,187	132,115	2.4	2.3	2.0	No set range			0.3
LDI & Equity Protection	526,595	630,516	9.5	11.0	12.0	No set range			-1.0
Cash***	241,631	164,295	4.3	2.9	-	0	-	5	2.9
Total	5,570,651	5,710,102	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.

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	268,832		275,451	4.8	4.8
Schroder	Global Equity	1,524		1,545	0.0	0.0
Brunel	Global High Alpha Equity	440,841		448,289	7.9	7.9
Brunel	Global Sustainable Equity	586,798		607,893	10.5	10.6
Brunel	Global Low Carbon Equity	745,054		763,187	13.4	13.4
Brunel	Emerging Market Equity	299,916		280,490	5.4	4.9
Brunel	Diversified Returns Fund	530,215		533,213	9.5	9.3
JP Morgan	Fund of Hedge Funds	283,763		288,796	5.1	5.1
Brunel	Multi-Asset Credit	317,989	2,876	322,864	5.7	5.7
Brunel	UK Property	115,388	17,950	140,467	2.1	2.5
Schroder	UK Property	58,712	-29,918	29,669	1.1	0.5
Partners	Overseas Property	179,206	-5,816	176,593	3.2	3.1
Brunel	Secured Income*	350,558	22,487	385,384	6.3	6.7
IFM	Core Infrastructure	389,545		403,824	7.0	7.1
Brunel	Renewable Infrastructure*	55,286	13,318	70,741	1.0	1.2
Brunel	Private Debt	-	19,175	19,530	-	0.3
BlackRock	Corporate Bonds	134,187		132,115	2.4	2.3
BlackRock	LDI & Equity Protection	526,595		630,516	9.5	11.0
Record	Currency Hedging**	72,250	-30,000	16,330	1.3	0.3
BlackRock	ETF	139,475	-40,000	102,066	2.5	1.8
Internal Cash	Cash***	73,977	6,634	80,830	1.3	1.4
Total		5,570,651	-23,385	5,710,102	100.0	100.0

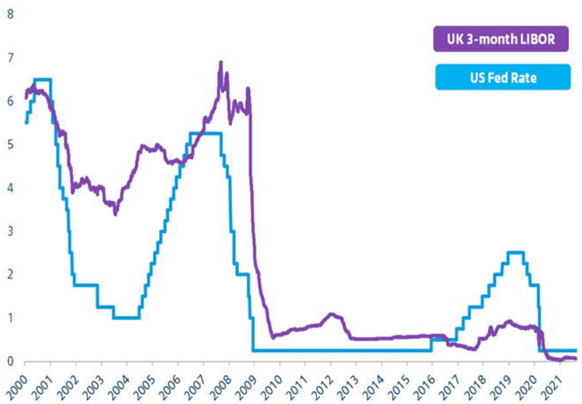
Source: Investment Managers, Mercer. Totals may not sum due to rounding and other residual holdings.
The cashflow column shows only the cash movements within the asset portfolio. It does not include non-investment cash movements such as employer contributions or pension payments made, however these amounts are included in the 'Internal Cash' start and end balance to reflect the asset value position of the total Fund.
* Valuations include both funding cycle allocations.
** Valuation includes the collateral holdings for the currency overlay.
*** Valuation includes assets in transit.

Current topics

7

Current topics

Walking the razor's edge – tapering, rates and inflation

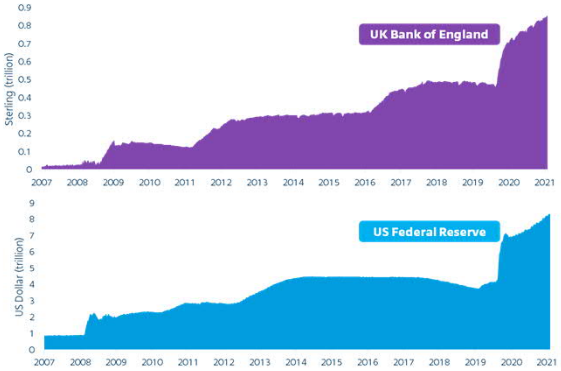


Official rates

A more modest version of the 2017 to 2019 tightening cycle is what central banks seem to be suggesting

Hard to envisage yields reaching early 2000's level, especially in UK

Major constraint is scale of household indebtedness



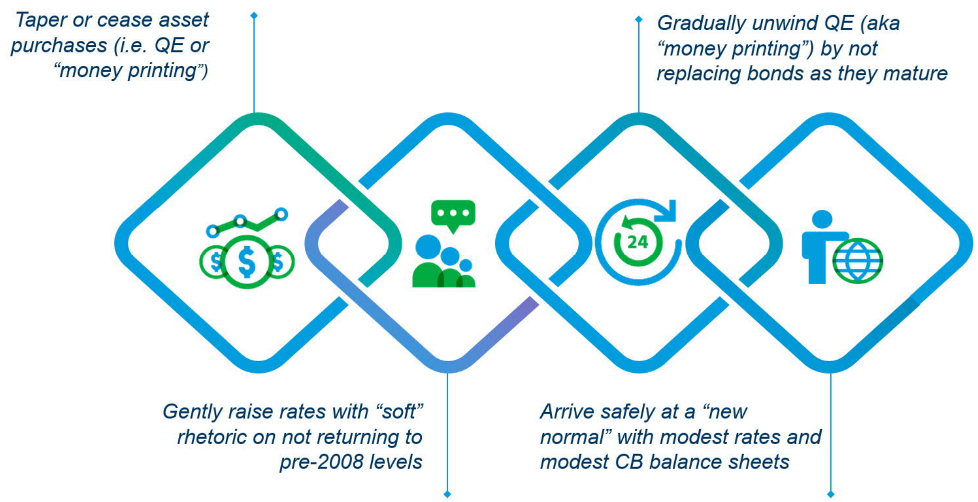
QE aka "money printing"

QE was once considered a Japanese phenomena

In both US and UK scale is now 4-5 times levels seen in wake of global financial crisis

Critics argue it has inflated asset prices, contributed to economic inequality, and "drug" to which markets are "addicted"

"Exit plan" appears to be "walk carefully along a razors edge"



What could go wrong?
Inflation: Structural rather than temporary. CB action or tolerance?
Long and variable lags: Changes amplified over time
Loss of credibility: Markets decide that policy regime is damaging and not sustainable
Miscommunication: Mixed messages lead to loss of confidence and volatility
Political pressure: Constituency again policy due to perceived impact on inequality and damage from low rate "addiction"

What should you do?

- Discuss views
- Develop contingency plan
- Regularly re-evaluate
- Assess "tail" risk

Relevance to the Fund

Officers receive monthly risk reports, including the Equity Protection strategy and LDI strategy. The Panel receives quarterly summaries of Mercer's forward looking market views.

Current topics

ESG in Fixed Income portfolios

ESG factors are just as important in fixed income, especially when considering how they relate to **managing downside risk.**

A growing body of literature supports the view that ESG integration in fixed income can have a **material impact from a credit risk perspective.**

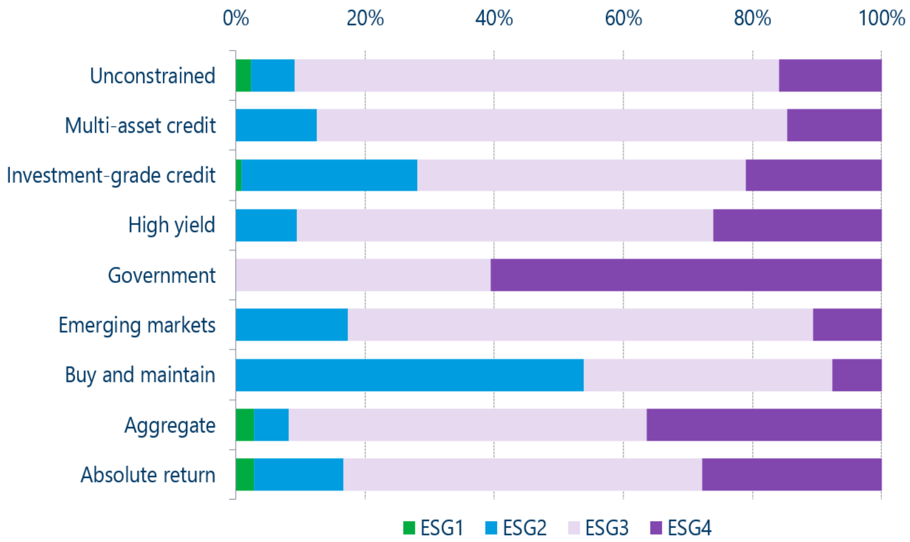
Integrating ESG in Buy and Maintain mandates

B&M portfolios rely on **bottom-up** fundamental assessment of an issuer's ability to service debt in order to generate returns.

Leading Investment managers will focus on integrating ESG considerations into their credit rating process and take an informed and proactive approach to understanding the credit implications of the various "E", "S" and "G" issues

Top-Down sector views on the most pertinent ESG issues are also important.

As a systemic risk, climate change will affect all sectors and companies in different ways, but energy and utility sectors are likely to be impacted the most negatively if we see a swift and coordinated move to a low-carbon pathway, while sub-sectors such as renewable energy are likely to benefit.



Source: MercerInsight® Data as at December 31, 2020.

Understanding climate change risks

Work with asset managers to better understand and set carbon-footprint targets for portfolios (ideally at the mandate-design stage).

Challenge managers on how they are managing climate-change risks for key companies and sectors.

Stewardship

Request engagement reporting from asset managers (specific to investor's portfolio).

Ask asset managers for evidence and case studies of positive outcomes (not just activity) across E, S and G issues.

Engage asset managers to monitor and explain ESG risks

What are the most material ESG risks within the portfolio and how are investors being compensated for them?

Are they predominantly idiosyncratic tail risks or systemic risks?

How are they split by company level or sector-level risks?

Climate-aware or sustainable offerings:

Ask your managers if they offer climate-aware or sustainable versions of your fixed income strategies?

B&M have highest proportion of highly-rated strategies because leading managers in this space:

- focus on ***integrating ESG*** into ratings process as systematically and seamlessly as possible
- use ***climate change metrics and transition scores*** to assess holdings in climate critical sectors
- take ***holistic approaches to stewardship*** on key themes such as diversity and climate change.

Relevance to the Fund

The Fund only has a 2% strategic allocation to investment grade credit with BlackRock, though the manager should still be held to account on its ESG and stewardship policies, and frequent disclosures on this could be helpful.

Appendix

Q3 2021 equity market review

Equity markets performance was mixed over the third quarter.

Global Equities returned -0.2% in local currency terms. Markets sold off during the second half of September amid fears of a global economic slowdown, driven by peaking demand and supply constraints, potential contagion from the restructuring of Evergrande and large central banks signalling that monetary policy might become less expansive.

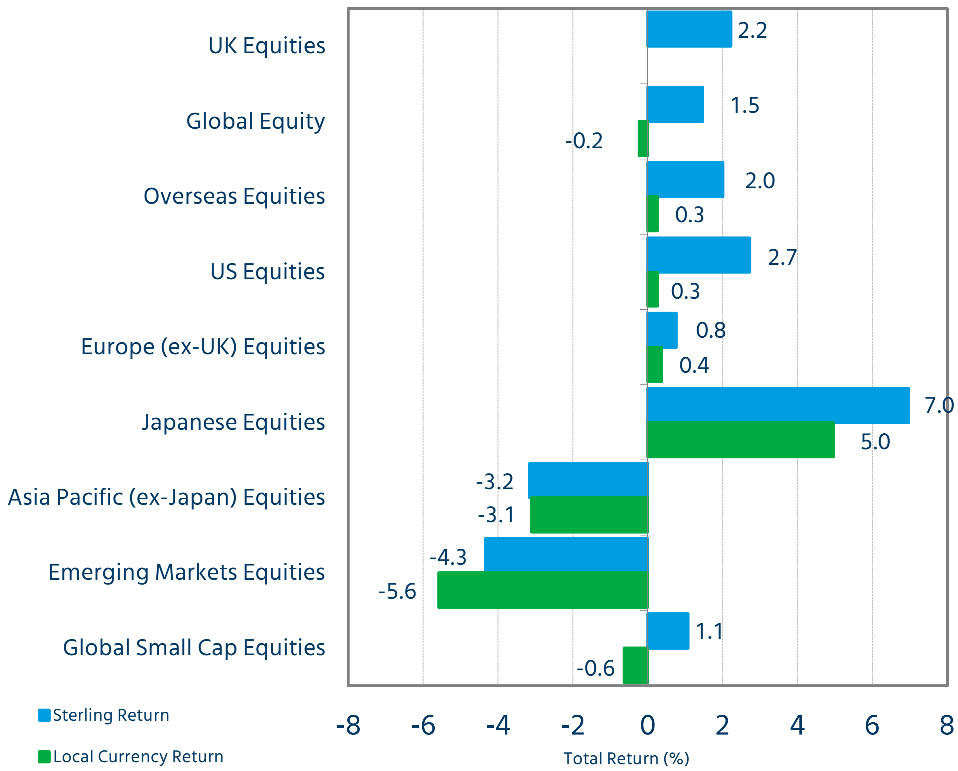
US equities returned 0.3% in local terms whilst **European (ex-UK) equities** returned 0.4%. Exposure to global trade and rising energy prices were headwinds for European equities. **Japanese equities** stood out as the best performer as political uncertainty reduced somewhat following the change in prime minister, returning 5.0%.

Emerging markets equities returned -5.6% in local terms, driven by the sell-off in China. Offshore Chinese stocks entered correction territory in light of the far-reaching regulatory crack down. Asia Pacific (ex-Japan) returned -3.1% as Covid restrictions held back growth in the region.

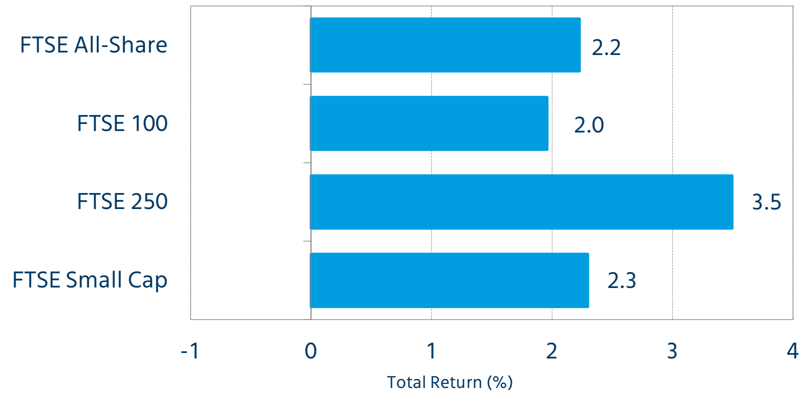
Global small cap stocks returned -0.6% in local terms. Small caps lagged global equities in local currency terms, as reopening momentum began to slow somewhat after a very strong first half of the year.

The FTSE All Share index returned 2.2%. The large exposure to financials, oil & gas, and basic materials supported UK large caps once again while small caps benefited from the economic rebound as the UK economy fully reopened earlier in the quarter. Momentum weakened later in the quarter due to soaring natural gas prices shocking the energy sector and lorry driver shortages exacerbating supply constraints, especially for crucial products such as petrol.

Equity Performance - Three Months to 30 September 2021



FTSE Performance by Market Cap (FTSE) - Three Months to 30 September 2021



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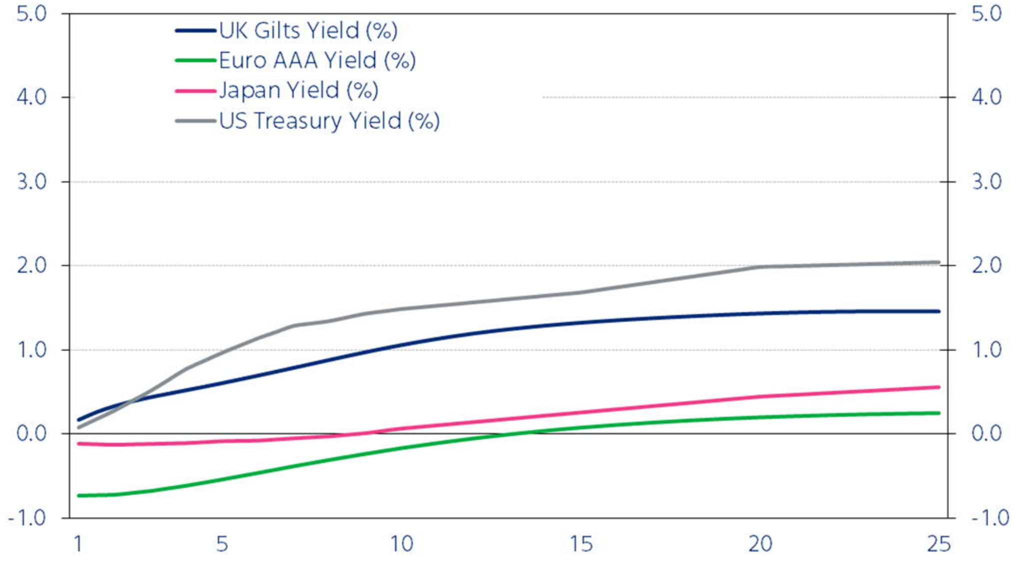
Source: Thomson Reuters Datastream.

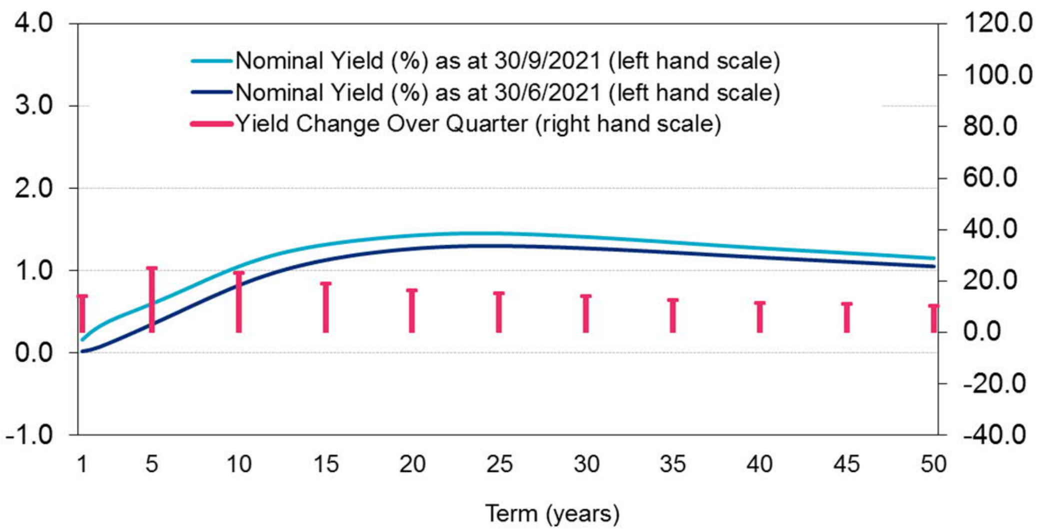
Q3 2021 bond market review



Source: Mercer and Bloomberg.

Government Bond Yields

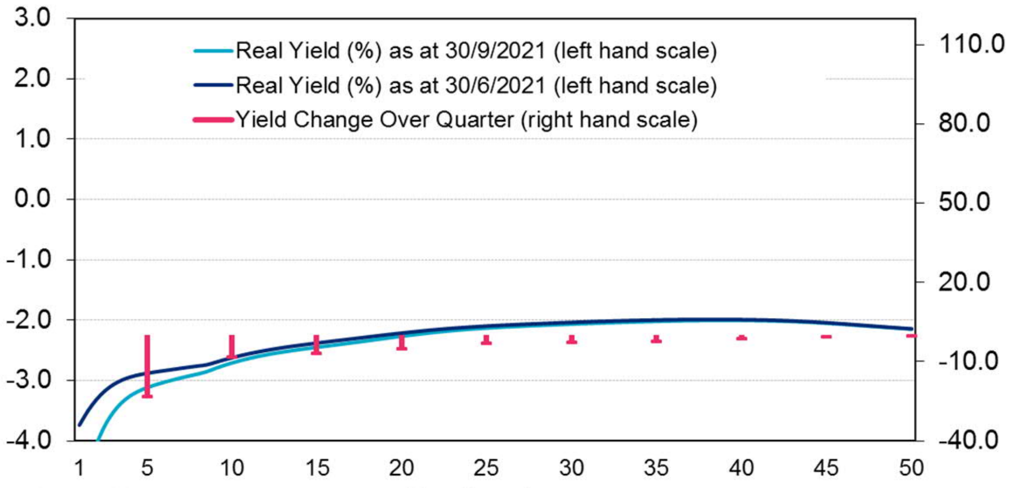
Global government bond yields generally rose over the quarter. Gilt yields rose sharply in September after falling earlier in the quarter. The UK 10-year benchmark yield rose by 27 basis points and the yield curve shifted upwards, with the 5 and 10-year yields rising the most. The US 10-year government bond yield rose by 8 basis amid expectations of tapering of asset purchases later in 2021.



UK Nominal Gilt Yields

The UK yield curve shifted upwards over the quarter. The Bank of England surprised markets by bringing forward expectations of the timing of rate increases, hinting at a move in 2022 with the first increase potentially coming as early as late 2021. During the quarter, the first green gilt was issued by the UK government and was met with strong demand from the market.

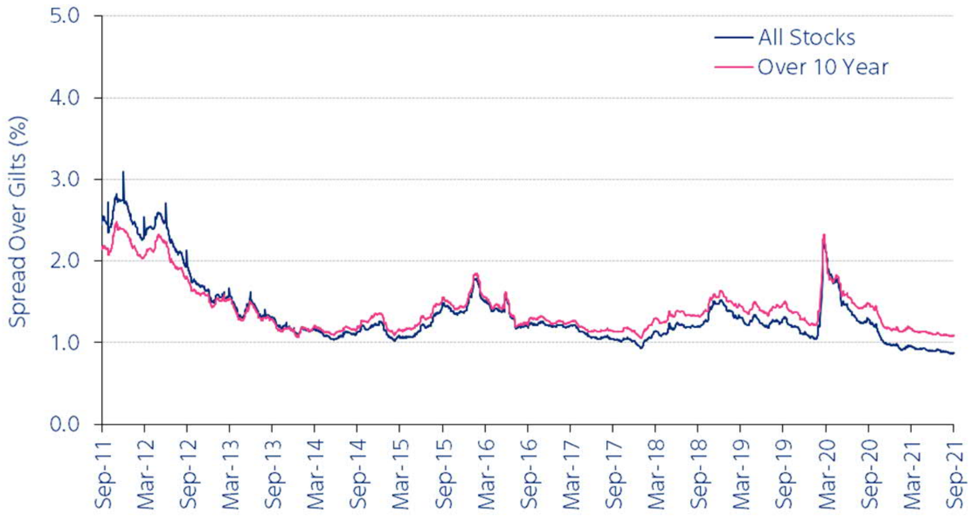
Q3 2021 bond market review



Source: Mercer.

UK Index-Linked Gilt Yields

UK real yields fell across the curve, more so at the short end. Market based measures of inflation expectations, in the form of breakeven inflation, shifted upwards. The UK 10-year breakeven rate rose 50bps to 3.8% - the highest level since the 2008 Financial Crisis.



Source: Thomson Reuters Datastream.

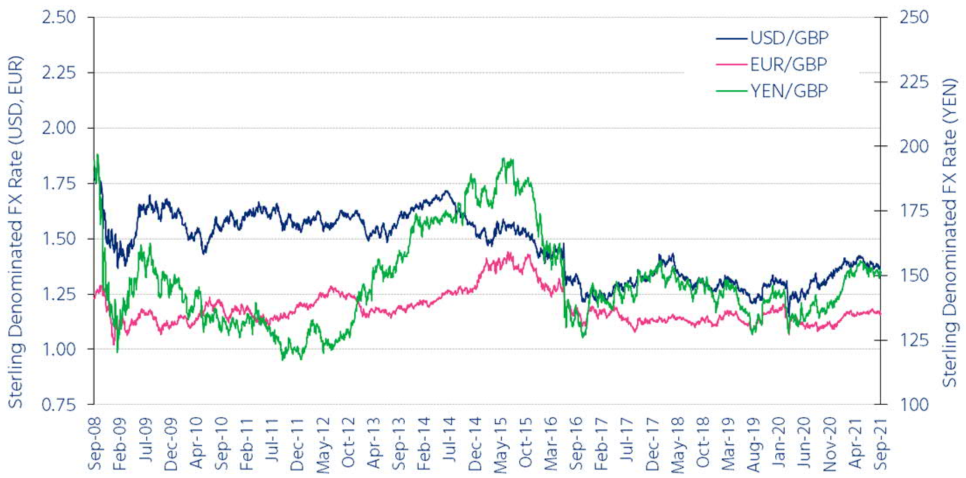
Corporate bonds

Yields on investment grade credit generally rose as the increase in government bonds was only partially offset by tighter credit spreads.

Q3 2021 currency market review

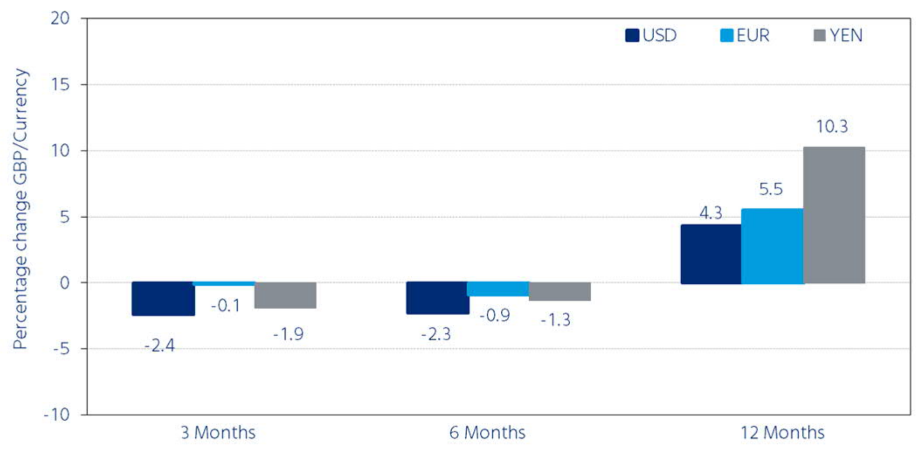
Sterling depreciated against all major developed currencies as the energy and supply shortages made investors re-consider their bullish positioning amid reopenings and a smooth Brexit. Nevertheless, on a one year basis, sterling appreciation against major currencies remains substantial. The US dollar strengthened against major developed market currencies over the quarter, due to monetary tightening in the US and safe haven demand towards the end of September.

Sterling Denominated FX Rate



Source: Thomson Reuters Datastream.

Change in sterling against foreign currencies



Source: Thomson Reuters Datastream.

Q3 2021 property

UK property as measured by the MSCI Index increased by 4.6% over the quarter to 30 September 2021.

Source: Thomson Reuters Datastream.

Summary of mandates

Manager	Mandate	Benchmark/Target	Outperformance Target (p.a.)	Inception Date
BlackRock	Passive Global Equity	MSCI World	-	December 2017
Brunel	Global High Alpha Equity	MSCI World	+2-3%	November 2019
Brunel	Global Sustainable Equity	MSCI AC World	+2%	September 2020
Brunel	Passive Global Low Carbon Equity	MSCI World Low Carbon	-	July 2018
Brunel	Emerging Market Equity	MSCI Emerging Markets	+2 -3%	October 2019
Brunel	Diversified Returns Fund	SONIA	+4-5%	July 2020
JP Morgan	Fund of Hedge Funds	3 Month LIBOR +3% p.a.	-	July 2015
Brunel	Multi-Asset Credit	SONIA	+4-5%	June 2021
Schroder	UK Property	IPD UK Pooled	+1%	January 2009
Brunel	UK Property	MSCI/AREF UK Quarterly Property Fund Index	-	January 2021
Partners	Overseas Property	Net IRR of 10% p.a. (local currency)	-	September 2009
Brunel	Secured Income	CPI	+2%	January 2019
IFM	Core Infrastructure	3 Month LIBOR +5% p.a.	-	April 2016
Brunel	Renewable Infrastructure	CPI	+4%	December 2018
Brunel	Private Debt	3 Month LIBOR + 4% p.a.	-	September 2021
BlackRock	Buy-and-Maintain Corporate Bonds	Return on bonds held	-	February 2016
BlackRock	Matching (Liability Driven Investing)	Return on liabilities being hedged	-	February 2016
Record	Passive Currency Hedging	N/A	-	March 2016
BlackRock	Exchange-Traded Fund (ETF)	Bespoke benchmark to reflect total Fund allocation	-	March 2019
Cash	Internally Managed	7 Day LIBID	-	-

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Market background indices

Asset Class	Index
UK Equity	FTSE All-Share
Global Equity	FTSE All-World
Overseas Equity	FTSE World ex UK
US Equity	FTSE USA
Europe (ex-UK) Equity	FTSE World Europe ex UK
Japanese Equity	FTSE Japan
Asia Pacific (ex-Japan) Equity	FTSE World Asia Pacific ex Japan
Emerging Markets Equity	FTSE AW Emerging
Global Small Cap Equity	MSCI 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
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

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