

Avon Pension Fund

Panel Investment Report Quarter to 30 June 2022

August 2022

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Executive summary



Executive summary

Market background

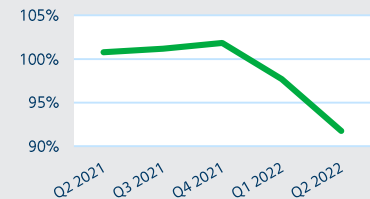
- The broad macro trends seen since the beginning of the year continued throughout the second quarter of 2022. Surging commodity prices led to new multi-decade inflation records.
- Central banks doubled down on monetary tightening, resulting in elevated market volatility and a sell-off in virtually all asset classes except commodities and property. Growth expectations were dialled down drastically over the quarter.

Mercer market views

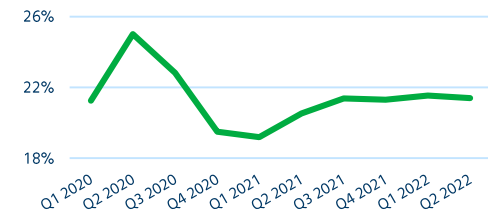
- Our medium term outlook is mixed after the turbulent start to 2022, given the crosscurrents at play.
- High inflation and rising interest rates are typically not a good environment for most risk assets. However markets have already fallen sharply year-to-date and our concerns around valuations have eased as a result.

Funding level and risk

- The funding level is estimated to have decreased over Q2 to 92%, as the assets fell in value by more than the liabilities.
- It is estimated to have decreased by 9% over the year to 31 March 2022 (as illustrated to the right).



- The Value-at-Risk fell slightly over the quarter to £1,272m, largely due to the fall in absolute value of the assets.
- It was broadly unchanged as a percentage of liabilities at 21.4%.
- Risk as a proportion of liabilities has increased over the year due to rises in expected volatility. However it remains below the levels of 2020, in part due to the move from a static to dynamic equity protection strategy.



Executive summary

Performance

- The Fund assets fell in value primarily due to negative returns from the equity and LDI portfolios as markets declined. The Diversified Returns and Multi-Asset Credit mandates also lost value (as we would expect given the market backdrop).
- The alternatives in real assets and the Equity Protection cushioned losses.

- Underperformance relative to the strategic benchmark over the one year period to 30 June 2022 is mainly due to the underperformance of the active equity and multi-asset mandates.
- This has also contributed to underperformance over the three year period, alongside the Equity Protection and Overseas Property.

	3 Months (%)	1 Year (%)	3 Years (% p.a.)
Total Fund (1)	-7.1	-2.0	3.0
Strategic Benchmark (2) (ex currency hedge)	-6.0	2.5	6.0
Relative (1 - 2)	-1.1	-4.5	-3.0

- Conversely the real assets have done well over the one and three years against their benchmark.
- The Currency Hedge overlay detracted from returns over all time periods shown due to a weakening of Sterling.

- Absolute returns for the global equity mandates compared to the strategic returns modelled at the strategy review in 2019 have been mixed. The most recently-incepted Paris-Aligned mandate has underperformed due to its point of inception, though the underperformance of the Sustainable Equity mandate is due to active management.
- The Diversified Returns and Multi-Asset Credit mandates have also fallen short of expectations due to this year's losses, however the alternative assets have generally outperformed.

Asset allocation and strategy

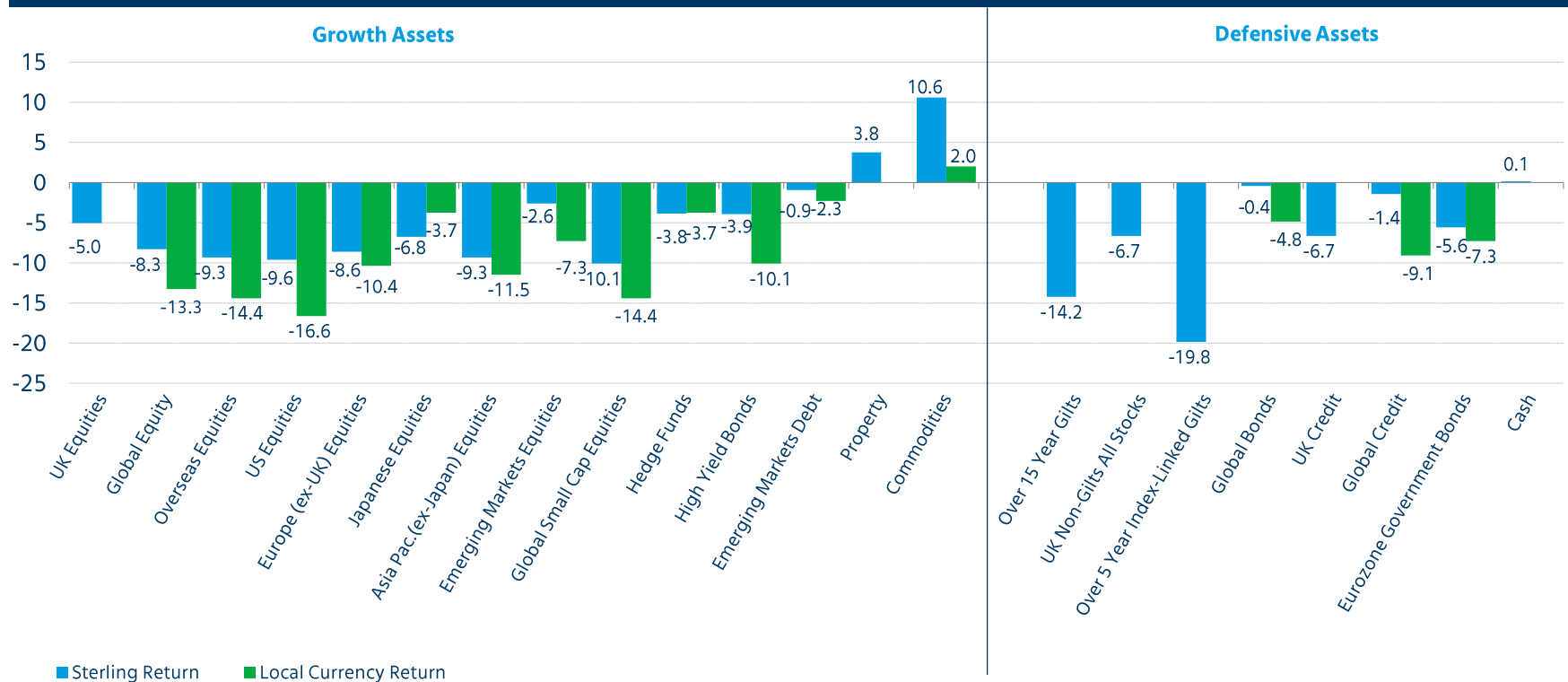
- During the quarter, the BlackRock QIF collateral pool was topped up by £60m, funded from the Hedge Funds mandate which is in the process of being wound down.
- A net amount of c£47m was drawn down to the Brunel private market portfolios during the period.
- At quarter-end, all asset classes were within their ranges, except for the Core Infrastructure allocation due to its stronger relative recent performance. This is offset by the equivalent underweight to Renewable Infrastructure.

Market background



Market background

Return over 3 months to 30 June 2022 (%)

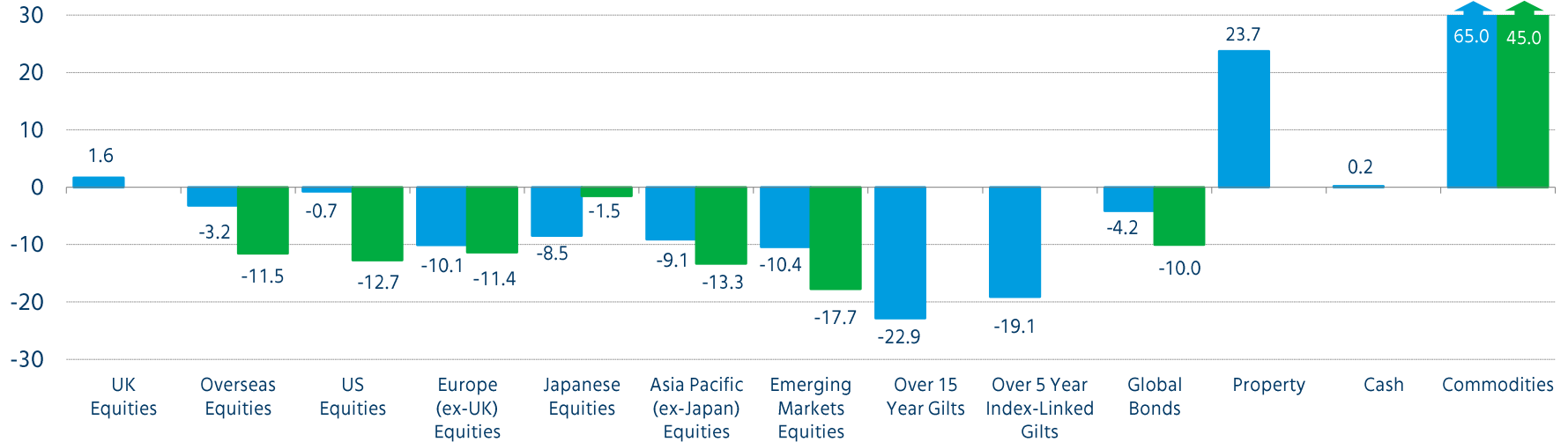


The broad macro trends seen since the beginning of the year continued throughout the second quarter of 2022. Surging commodity prices, to a large degree the result of the ongoing conflict in Ukraine and supply chain disruptions from Chinese lockdowns, led to new multi-decade inflation records.

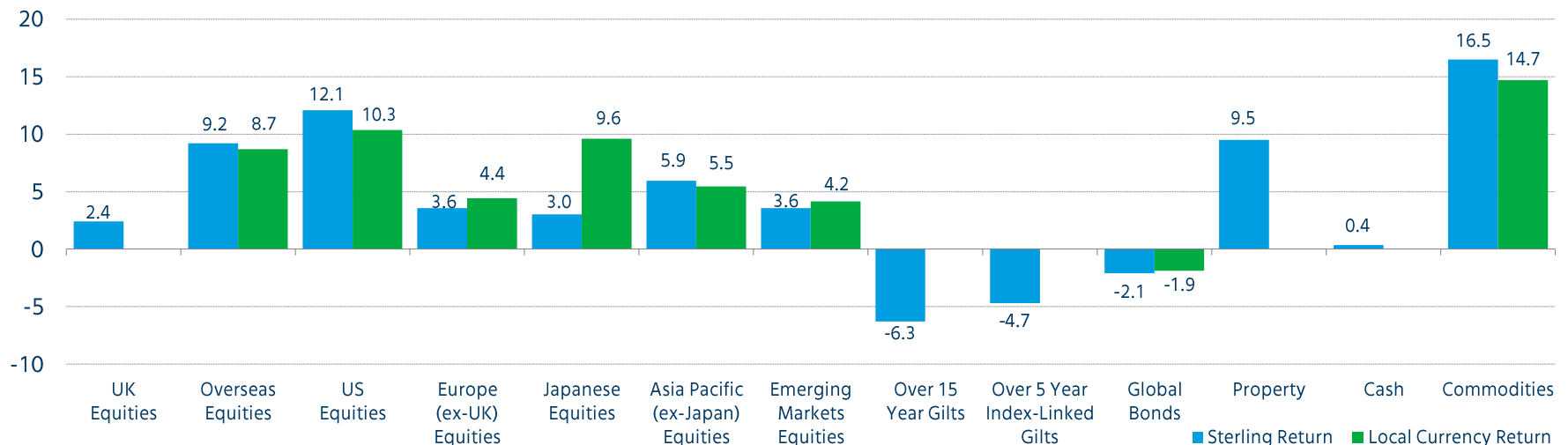
Central banks in many major regions doubled down on monetary tightening as a consequence, resulting in elevated market volatility and a sell-off in virtually all asset classes except commodities and property. Growth expectations were dialled down drastically over the quarter with a growing number of investors seeing a recession as an increasingly plausible scenario.

Market background – 1 & 3 years

Return over 12 months to 30 June 2022 (%)



Return over 3 years to 30 June 2022 (% p.a.)



■ Sterling Return ■ Local Currency Return

Mercer market views



Market Outlook (July 2022)

Mercer's current position/view

Position/view last time (if changed)

Global equities and almost all other asset classes fell sharply in Q2 as inflation continued to rise and central banks accelerated their interest rate hiking plans. Having fallen by c. 5% (USD return) in Q1, global equities as represented by the MSCI World Index fell by over 10% (USD return) in Q2 with a whiff of panic visible in June following a much worse than expected US inflation reading at the start of the month. Both equities and bonds have experienced close to their worst first six months of the year ever, albeit after over a decade of very strong performance. Central banks continued to raise interest rates, with 0.5% hikes becoming the new normal, while the US Fed raised rates by 0.75% in June, its largest single meeting increase since the 1990s. Government bond yields rose sharply in many parts of the world, with yields hitting their highest level since the immediate aftermath of the great financial crisis in some countries. Bond markets in China and Japan were the key standouts with both continuing to experience low inflation and stable interest rates. Commodity prices were strong for much of the quarter although weakened into quarter-end on fears that the rate hikes would push the US into recession. The US dollar rose against most currencies, with the Japanese yen especially weak.



Global economic growth was soft on the back of sharply higher inflation which ate into household budgets. While higher wages helped cushion the blow, higher wages failed to match inflation leading to negative real income growth in most parts of the world. The main bright spot remained labour markets with unemployment at or close to the lowest level in decades in many parts of the world. However despite the strength in labour markets, consumer confidence fell to very low levels, suggesting weak consumption in the months ahead. Business investment remained decent, despite the inflationary pressure as businesses continued to invest, in part to resolve supply chain challenges and boost inventories. The Chinese economy remains out of sync with the rest of the world and is being driven largely by its approach to COVID, where it continues to target zero cases.



Inflation rose sharply in most countries, with the notable exceptions of China and Japan, where it remained subdued. Inflation in the US and elsewhere was driven by both non core items (food and energy) and core items. The breadth of the increases took many by surprise and suggested higher inflation may last longer and take higher interest rates than had previously been expected. Household inflation expectations also rose, leading to fears that higher inflation would become self re-enforcing.



Looking forward, the US economy will inevitably slow sharply as the Fed hikes rates. The Fed (and to a lesser extent other central banks) is explicitly targeting a period of slower growth to soften labour demand and end the upward pressure on wages. Whether this leads to a recession and a so-called hard landing is uncertain. We think a hard landing is likely to be avoided, because of the strength of household and corporate balance sheets and the possibly that some of the inflationary pressures will ease. However, any further sharp rise in commodity prices on the back of the conflict in Ukraine would make achieving a soft landing more difficult. The Chinese economy is likely to accelerate in the near term as the economy re-opens.



We expect inflation to remain above target, although to reduce from current levels over the next few quarters. Recent weakness in commodities, if sustained, would lead to a sharper fall and there are some tentative signs of the supply chain pressures easing. Despite this it will take several quarters for the tightness in labour markets to ease and central bankers are likely to continue to raise interest rates and reduce the size of their balance sheets (QT) for some time.

Uncertainty is high at the moment and as a result we do not have strong views on most asset classes. High inflation and rising interest rates are typically not a good environment for most risk assets. However markets have already fallen sharply year-to-date and our concerns around valuations have eased as a result. Some assets have started to look cheap. In addition, sentiment appears to be very low and risk markets could rally if a soft landing is ultimately achieved. We considered increasing our rating on both equities and growth fixed income to overweight, but decided against it given elevated risk levels and uncertainty over the near term path of inflation. For fixed income, we increased overall positioning to growth fixed income to the overweight side of neutral and increased defensive fixed income to neutral. Within equities, we did increase our exposure to small cap equities which appear cheap relative to large cap and would be supported by a soft landing. Our overweight to cash was consequently removed.

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

Listed equities

ASSET CLASS	APRIL 2022	JULY 2022	COMMENTARY
Global Sustainable Equity	Neutral	Neutral	The MSCI World Index returned -9.0% in GBP terms over 2022Q2 and -11.1% on a year-to-date basis.¹ We have maintained our broad market equity sector position at neutral within the global equities portfolio. Valuations have improved considerably over the quarter. Most metrics are now at or slightly below their long term average (except for CAPE). However, the macroeconomic outlook continues to deteriorate which may justify lower valuations to a degree. Inflation remains at multi-decade highs and central banks therefore maintain an accelerated pace of tightening. The earnings outlook is still somewhat optimistic given the slowdown in consumer sentiment and deteriorating economic outlook. It seems that the equity sell-off was mainly driven by rising discount rates rather than equity markets positioning for higher recession risk. This leaves room for further downside even if more attractive valuations have also increased the upside. Investor sentiment as measured by the Bank of America fund manager June 2022 survey kept deteriorating with investor optimism on global growth falling to an all-time low and the fear of stagflation rising to multi-decade highs. 25% of investors see a global recession as the biggest tail risk. Attractive valuations that compensate only partly for our unfavorable macro backdrop and sentiment informs our decision to remain neutral on broad market equities.
Global Small Cap Equity	Neutral	Neutral/Positive	The MSCI Small Cap index returned -10.1% in GBP terms over 2022Q2 and -13.4% on a year-to-date basis.¹ We have upgraded our small cap allocation from neutral to the overweight side of neutral. The asset class looks much more attractive as valuations improved considerably and more than for large caps. Most valuation metrics are now 0.5–1 standard deviations below their long term averages. Small cap's cyclical nature make it more vulnerable in a downturn but we would equally expect more upside in a soft landing which is our base case. As with other equity sectors, sentiment has worsened and remains unfavorable for small caps. A majority of investors believe large cap equities will outperform small-caps over the next year, the highest proportion in a decade. Nevertheless, attractive valuations that compensate small cap investors more than large cap investors for macro downside and leave more upside if our soft landing base case materializes inform our decision to increase our exposure to small cap.
Emerging Markets	Neutral	Neutral	The MSCI Emerging Markets index returned -3.9% in GBP terms over 2022Q2 and -8.0% on a year to date basis.¹ We have maintained our current neutral position for emerging market equity. Valuations have further improved and remain attractive relative to their own history but are not attractive compared to developed markets anymore. Emerging market equities (driven by China) being the strongest performing equity sector on a relative basis over the quarter has reduced the valuation discount. A weakening economy, even if it is just a soft landing is a headwind for export-orientated economies and the recent slowdown in commodity prices has already started to reduce the momentum for commodity exporting countries. Even if the easing of Chinese lockdowns and continued policy support is expected to improve the growth outlook for China, such lockdowns could return at short notice, Macau being the latest example. According to the Bank of America Global FMS, investors still see EM equities as a candidate for the best performing asset class of 2022. In summary, our neutral position is informed by valuations still being attractive but less so on relative basis and macro-economic uncertainty, especially around Chinese lockdowns which offsets positive sentiment.

¹Source: Bloomberg, DataStream as of end of 2Q2022

²Source: Factsset

Growth fixed income

ASSET CLASS	APRIL 2022	JULY 2022	COMMENTARY
Global Loans	Neutral	Neutral	Over 2022Q2, global loans returned 3.6% in GBP hedged terms¹. We have maintained our position at neutral within growth fixed income. Loans outperformed the other growth fixed income asset classes for the second straight quarter given their lack of duration risk. The dramatic sell-off in rates has resulted in much better absolute valuations given significantly higher all-in yields across credit sectors, including bank loans which now offer a current yield of 8.5%. Further, their floating rate nature and senior secured position makes them quite appealing in an environment of more hawkish central banks. JP Morgan has revised up their 2022 leveraged loan default rate to 1.25%, but still below the long-term average of 3.1%. Importantly from a pure default perspective, only 6.2% of the securities in the high yield bond and loan markets are due to mature in the next two years, which takes a significant level of refinancing risk off the table over the DAA horizon. However, we see bank loan spreads as vulnerable to further widening given the deterioration in quality coinciding with further economic stress. Whilst the appetite for floating rate remains, technicals may not be as supportive as one would expect over the near-term.
High Yield	Neutral	Neutral	Over 2022Q2, global high yield returned -2.3% on a GBP hedged basis¹. We have upgraded our position to the positive side of neutral within growth fixed income. The recent drawdown in the high yield market has increased the opportunity set in the asset class as the index now yields roughly 270bps more than it did at the start of the quarter. While absolute yield levels are attractive, spread valuations still appear rich given the increasingly uncertain macro environment. JP Morgan has revised up their 2022 high-yield bond default rate to 1.25%, but still below the long-term average of 3.6%. While strong fundamentals support low default activity going forward, it is worth pointing out that spreads may be vulnerable to an environment with less abundant liquidity and potentially slower economic growth. Given rising recessionary risks, the relative value between floating rate loans and high yield bonds is more evenly distributed. Given the better overall credit quality within the high yield asset class, we hold a slight preference for high yield over global loans.
EM Debt (Local Currency)	Neutral	Neutral	EMD local currency market returns fell through Q2 2022, posting a return of -0.9% in GBP hedged terms¹. We have marginally reduced our position to neutral within the growth fixed income portfolio. We maintain a slight preference relative to Hard Currency due to more attractive spread valuations, historically cheap EM currencies, and generally lower duration profile. FX has held up surprisingly well given the nature of the risk-off event, but rates are coming under pressure. The sharp rise in commodity prices has continued to drive a number of idiosyncratic stories and will support both headwinds and tailwinds for a number of regions. EM central banks continue to raise rates in the face of ongoing inflationary pressures, supporting highly attractive real yields across the asset class. Flows into the asset class continue to be heavily stemmed by the general risk-off environment as well as the continued rising rate path of EM central banks.
EM Debt (Hard Currency)	Neutral	Neutral	EMD hard currency markets underperformed through Q2 2022, posting a return of -4.0% in GBP hedged terms¹. We have reduced our position to a lower conviction neutral allocation within the growth fixed income portfolio. Spreads continued to widen and remain elevated versus pre-pandemic levels. The continued strength of the US dollar, rising rates and continuing geo-political risks are headwinds, as is the large duration component of the asset class. Performance during 2022 has been driven by Russia's invasion of Ukraine and the sustained global inflationary pressure and subsequent rate hikes. The impact this particular event has had on global commodity prices will weigh further on global growth which had already slowed, stoking fears of recession and even a period of stagflation. The recent dollar rally, in tandem with a hawkish Fed and subsequent rising US rates, will increase the effective interest payments on dollar denominated debt. Sentiment remains vulnerable to the slowdown in global growth, inflation, US rate hikes and the ongoing conflict in Ukraine.

Defensive fixed income

ASSET CLASS	APRIL2022	JULY 2022	COMMENTARY
UK Sovereign Fixed Income	Neutral	Neutral	Over 2022Q2, UK sovereign bonds returned -1.3% in GBP terms. We have maintained our neutral position in UK sovereign fixed income within the defensive fixed income portfolio, but have become marginally more negative given the ongoing inflation risks to the UK economy. Gilt yields moved markedly higher over the quarter in response to elevated levels of inflation, despite softening towards the end. We note that the BoE, which was one of the more hawkish major central banks at the turn of the year, has adopted a more dovish tone, following concerns around growth, acknowledging that households will likely come under significant pressure in the coming months with surging energy prices and other factors placing a significant burden on households. The UK economy is suffering ongoing supply side issues which will likely ensure inflation remains elevated, but headwinds to growth mean that they may struggle to raise rates as much as priced, with the UK economy already slowing.
UK Inflation-Linked Bonds	Underweight	Underweight	Over 2022Q2, UK inflation linked bonds returned -17.5% in GBP terms. We maintain our underweight position in the defensive fixed income portfolio. Long term breakevens across developed markets fell over Q2 as the market narrative shifted slightly from inflation to lower growth, weighing on the asset class. Valuations have improved as real yields have increased, but we still consider UK linkers expensive (for structural local market reasons) despite the potential for inflation to continue to surprise on the upside. Globally, we would still expect inflationary pressures to ease as temporary supply-side factors slowly normalize, seeing current inflation prints falling from their very elevated levels but likely remaining above central bank targets within our 1-3 year time horizon. However, timeframes remain highly uncertain and the risk of stagflation has increased since Russia's invasion of Ukraine as well as renewed lockdowns in China, both of which have exacerbated pressures on supply chains. From a technical perspective, the market continues to be actively supported by participants seeking to hedge higher inflation expectations.
UK Investment Grade Credit	Neutral	Neutral	Over 2022Q2, UK investment grade credit returned -6.7% in GBP terms. We have maintained UK investment grade credit within the defensive fixed income portfolio at neutral, but have become more positive off improved valuations. Risk-off sentiment dominated and spreads widened over the quarter in all geographies and sectors in response to slowing growth risks. At this point, there may be opportunities to tactically add exposure, particularly given our "soft landing" base case. But with the possibility of spreads moving wider from here, we remain cautiously positioned from an overall beta perspective given concerns over slowing economic growth and central banks intent on curbing inflation, and the impact on earnings growth. At current levels, however, credit offers a potentially decent income cushion for any further widening, and the asset class looks very attractively priced particularly over the longer end of the 1-3 year DAA horizon. Despite the heightened risk environment, corporate fundamentals remain solid, while downgrade and default expectations remain muted. M&A activity, and its subsequent effect on corporate balance sheets, is one to watch, although we view UK/Europe as less aggressive than the US in this regard. With higher core yields, the market may see less demand for spread product. However, after outsized issuance in 2020 and 2021, coupled with increased funding rates, this has seen less supply over 2022.

Global Property Market Outlook

During the first quarter of 2022, the market showed great strength, activity and returns. Inflation concerns caused investors to focus on securely leased prime assets with inflation-linked income. However, since persistent inflation led to aggressive rate hikes by the US Federal Reserve (+150bps in five months) and several other Central Banks, attention is shifting towards the valuation side of returns. As the market is catching up with this reality, the next few quarters are likely to show a slowdown in the market until greater clarity on the economic and financial backdrop can justify renewed stabilization.

Real estate markets are not decoupled from the macro economic environment but the resilient and long-term nature of property should assist the asset class in remaining relatively stable in the period ahead as both equity and fixed income portfolios will suffer more from a recessionary environment caused by high inflation and rising interest rates. This notwithstanding, we anticipate the positive value growth observed in the past year to erode or even turn negative in some market segments. This unevenness will be caused by the relative weight of capital together with each properties ability to concert high inflation into NOI growth. cash was consequently removed.

EUROPE		
Themes	Core/ Core+	Value Add
	CPI Linkage	ESG refurbs
	Nichesectors Eg. Life Science, Living niches	Aggregat ion
RE debt	Bond-like long lease	High leverage
	Senior/ Whole	Mezz/ HY
		Rescue / NPLs

Attractive value: Real estate's attractive attributes of long-term contractual cash-flows linked to inflation, illiquidity premiums and potential for GDP de-linking should remain at the forefront of investors' minds. The change in paradigm brought by the rapid rise in interest rates, at this point, is directly benefiting real estate debt strategies as well as opportunistic managers who can exploit capital market distress without relying (much) on external finance themselves.

Worst value: We have moderated our expectations compared to last quarter due to a weakening macro-economic and financial environment. We have moderated our outlook for Core to neutral as short-term risks appear on the downside, although the income growth component is an important mitigant and reason why investors may still want to enter this part of the market.

Disclaimer: For illustration purposes only. The table presents a simplified perspective at the time of writing this report and is subject to change without notice. All categories offer attractive opportunities and optimal allocations are subject to manager selection. The outlook represented is for new investors with a non-constrained risk budget over a 3 to 5 year investment horizon. 'Unattractive' positions therefore does not imply advice to liquidate existing investments.

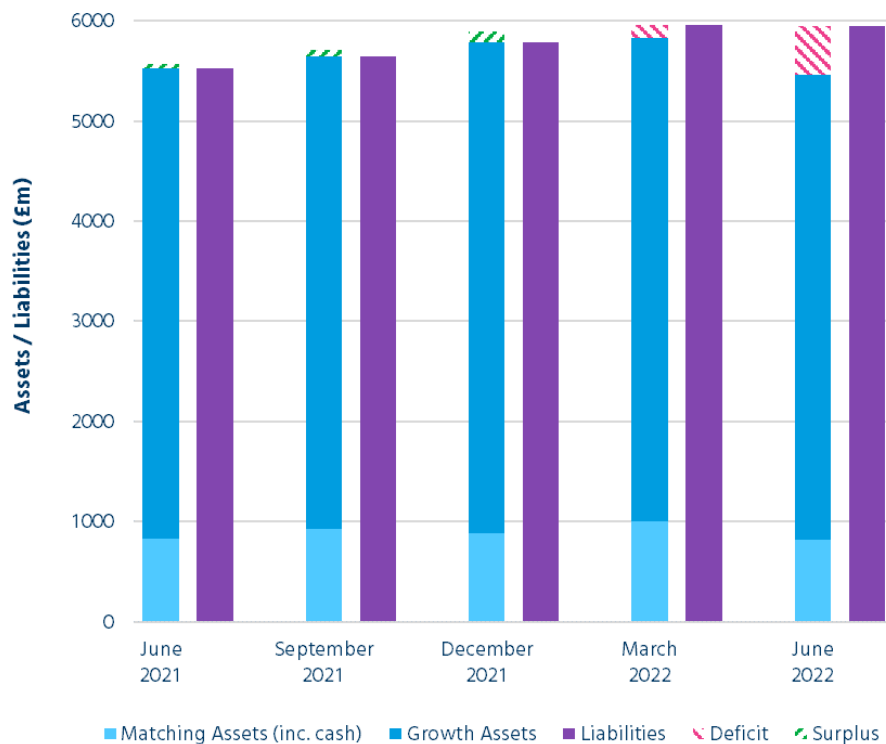
Further guidance is available in Mercer's *Global Market Summary: Quarterly Real Estate Report, July 2022*

Very attractive	Attractive	Neutral	Less Attractive	Unattractive	Not applicable
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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 widened over Q2 to £490m.

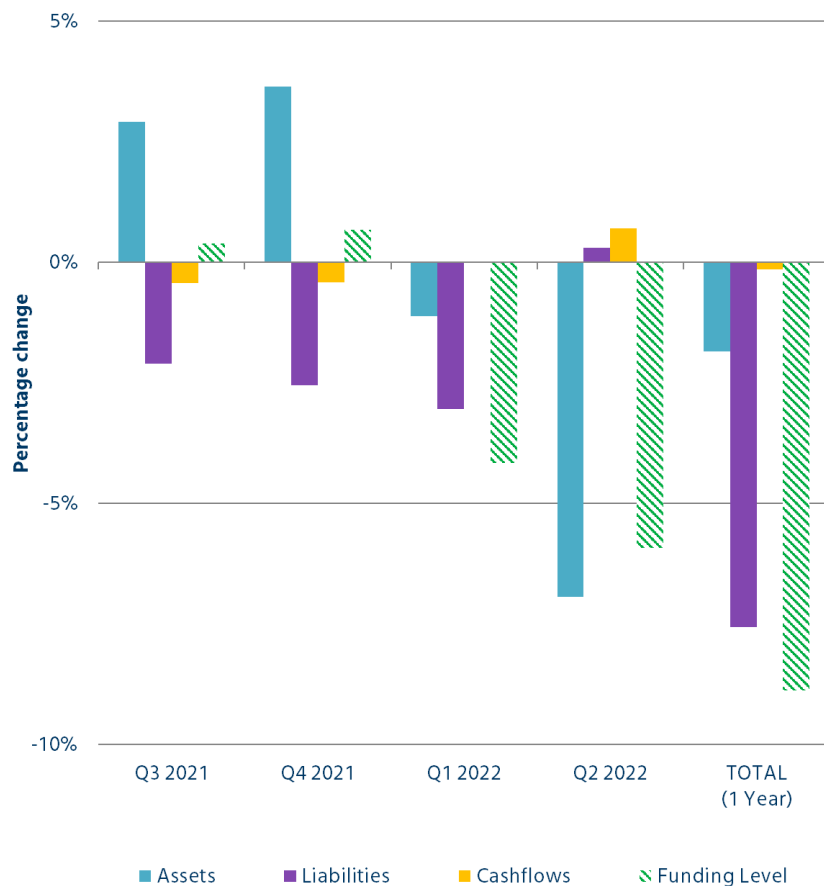
This occurred due to the fall in value of the assets, whilst the present value of the liabilities fell only marginally.

Liability values are estimated by Mercer.

They are based on the actuarial valuation assumptions as at 31 March 2019 and the 'CPI plus' discount basis.

31 March 2022 estimates have been revised upon receipt of updated asset / liability data.

Funding level attribution



Q1 2022 estimates have been revised upon receipt of updated asset / liability data.

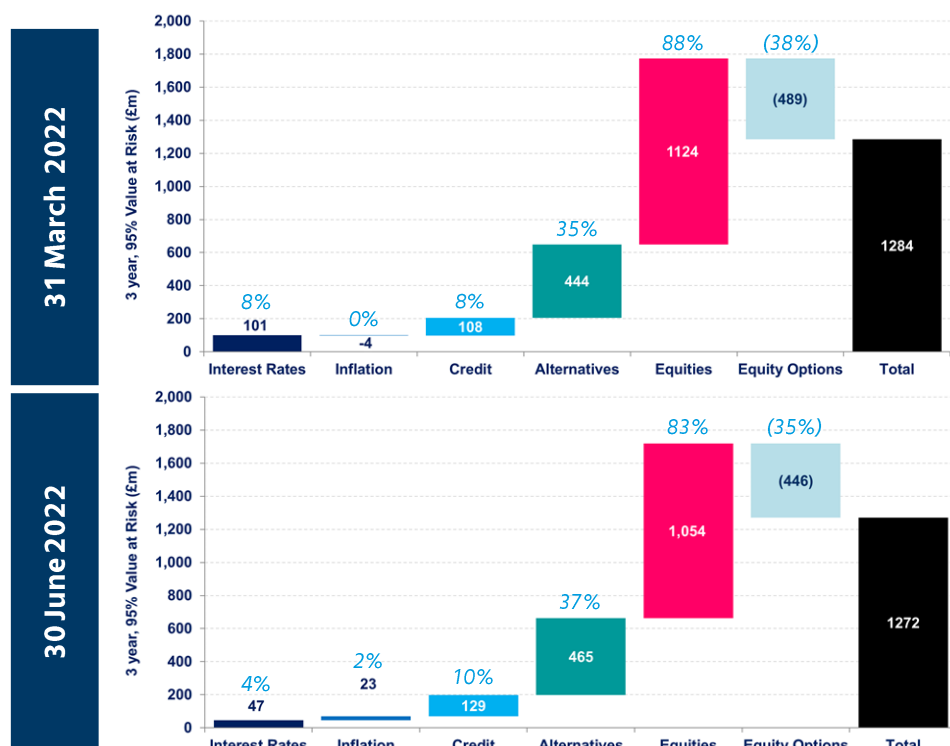
The Fund's assets contracted by 7.1% over the quarter, whilst the liabilities are expected to have fallen by c. 0.3% due to the rise in inflation.

The combined effect of this, also allowing for expected cashflow over the period, saw the funding level decrease to c.92%.

The funding level is estimated to have decreased by c. 9% over the year to 30 June 2022.

Risk decomposition – 3 year Value at Risk

- The two charts below 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 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 final columns show 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.



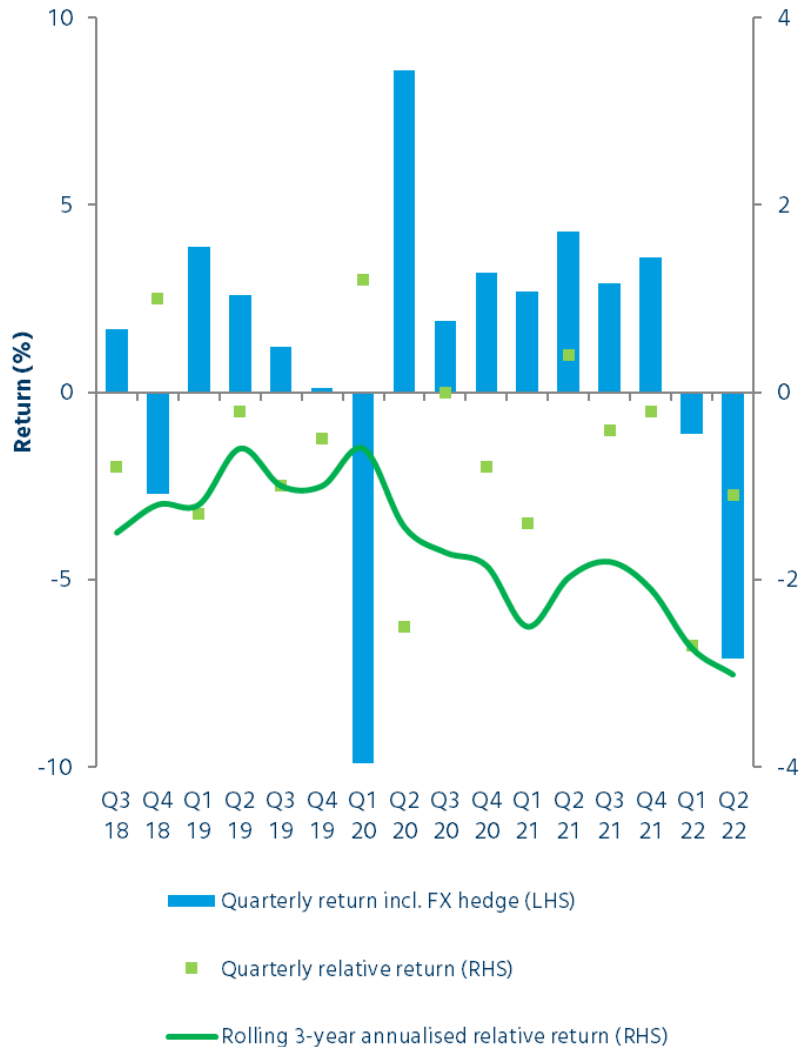
- As at 30 June 2022, if a 1-in-20 'downside event' occurred over the next three years, the funding position could deteriorate by at least an additional **£1.3bn**.
- Each bar to the left of the total represents the contribution to this total risk from the primary underlying risk exposures (interest rates and inflation, changes in credit spreads, volatility of alternative assets and equity markets, and the benefit from equity options).
- Overall **the VaR decreased slightly over the quarter**, largely due to the fall in absolute value of the assets. This outweighed increases in the expected underlying volatility of the growth assets.

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

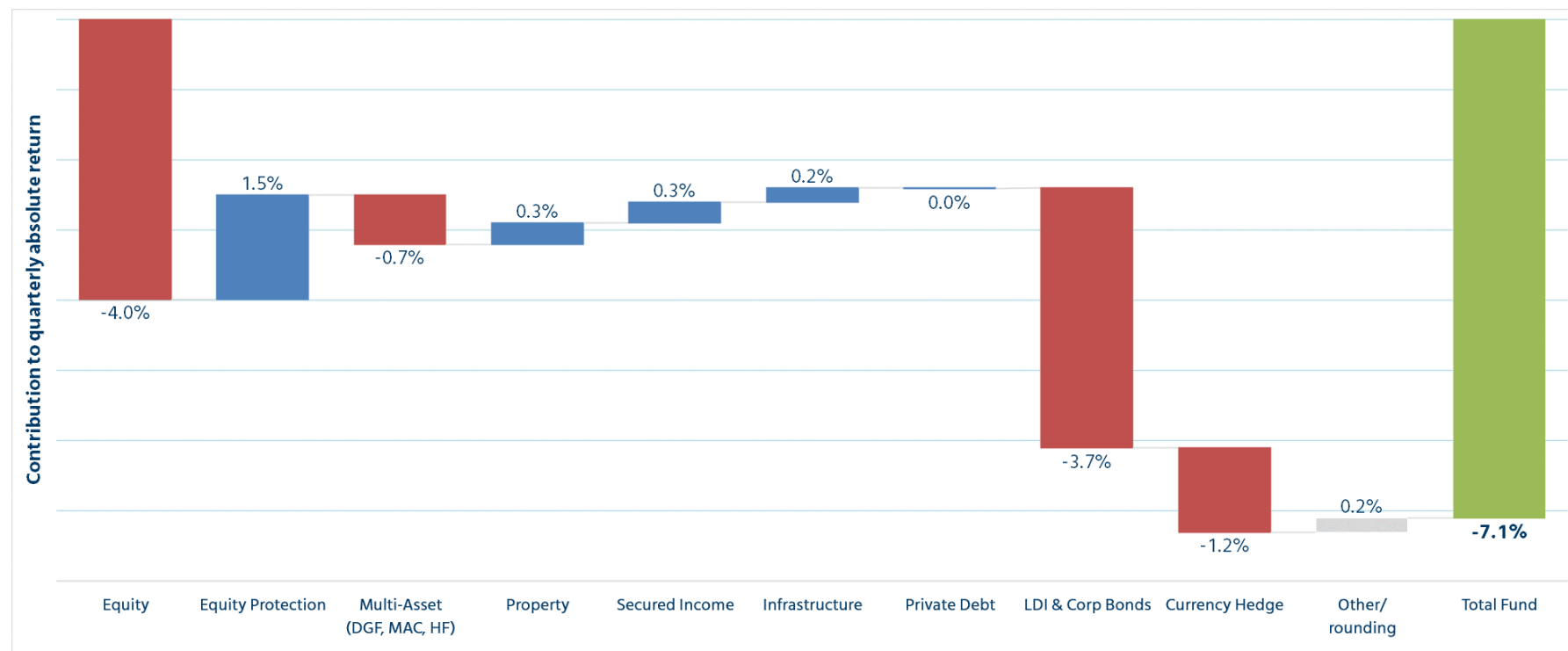


	3 Months (%)	1 Year (%)	3 Years (% p.a.)
Total Fund (1)	-7.1	-2.0	3.0
Total Fund (ex currency hedge)	-5.9	-0.1	3.1
Strategic Benchmark (2) (ex currency hedge)	-6.0	2.5	6.0
Relative (1 - 2)	-1.1	-4.5	-3.0

Commentary

- As illustrated on the next slide, the fall in the value of Fund assets over the quarter was driven by equity market sell-offs, and the contraction of the LDI portfolio due to the fall back in long-dated inflation.
- The Diversified Returns and Multi-Asset Credit mandates also lost value, and the Currency Hedging detracted due to a weakening of Sterling. However the alternatives mandates (invested in real assets) held up, and the Equity Protection strategy also cushioned losses to a degree.
- Underperformance relative to the benchmark was driven by the Brunel High Alpha and Sustainable Equity mandates, and the multi-asset mandates also underperformed against their 'cash plus' benchmarks. Relative performance within the alternatives were mixed, though IFM and Brunel Private Debt were positive highlights.
- Drivers of the underperformance over three years include the Equity Protection strategy (as expected in an overall environment of positive returns on underlying equity markets), Overseas Property and the more recent underperformance of the active equity and multi-asset mandates.
- Over three years, relative performance of the Hedge Fund and Core Infrastructure mandates continues to be strong. Outperformance has also been seen from the Renewable Infrastructure and Secured Income mandates against their inflation benchmarks, albeit short of their outperformance targets.

Total Fund performance attribution – quarter



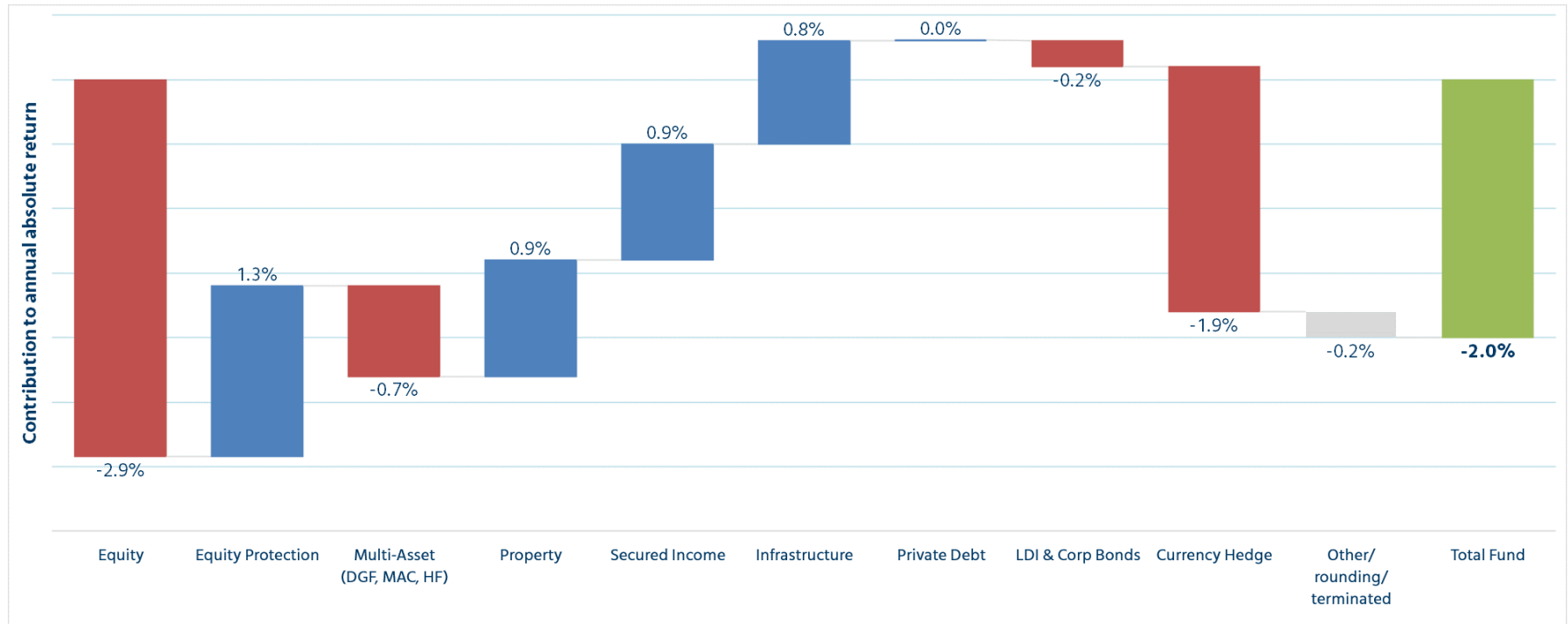
Source: Custodian and Mercer estimates

'Other' contributions to the total can include the relatively small holdings in the ETF, cash, the impact of cashflows and terminated mandates, as well as rounding.

The fall in the value of Fund assets over the quarter was driven by equity market sell-offs, and the contraction of the LDI portfolio due to the fall back in long-dated inflation.

The Diversified Returns and Multi-Asset Credit mandates also lost value, and the Currency Hedging detracted due to a weakening of Sterling. However all of the alternatives mandates (invested in real assets) held up, and the Equity Protection strategy also cushioned losses to a degree.

Total Fund performance attribution –1 year



Source: Custodian and Mercer estimates

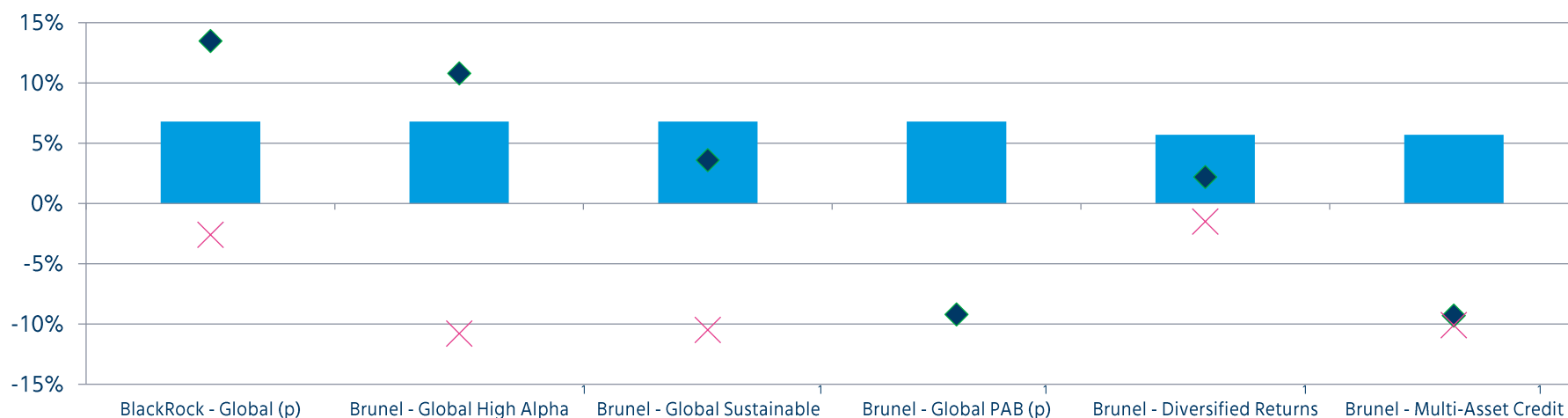
'Other' contributions to the total can include the relatively small holdings in the ETF, cash, the impact of cashflows and terminated mandates, as well as rounding.

The performance drivers over Q2 have also been the key determinants of returns over the 1 year period:

- The Equity and LDI portfolio drove the negative performance.
- The alternative investments and Equity Protection cushioned losses.

Performance vs. expected strategic returns

	BlackRock Passive Global Equity	Brunel Global High Alpha	Brunel Global Sustainable	Brunel Passive Global PAB	Brunel Diversified Returns	Brunel Multi-Asset Credit
Benchmark allocation	4.0%	12.5%	15.0%	10.0%	6.0%	6.0%
Commentary	Returns above strategic expectations since inception, but below over the year. Mandate has tracked the underlying market.	Returns above expectations since inception, but below over the year. Strong initial mandate outperformance added to returns, though recent relative performance has been weaker.	Returns below expectations due to mandate underperformance since inception.	Returns below expectations due to equity market weakness since inception. Mandate is still in its first year so longer-term performance will be more meaningful.	Returns below expectations due to muted performance in H2 2021 followed by contractions in 2022.	Returns below expectations due to negative returns across fixed income markets in 2022.



Notes:

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

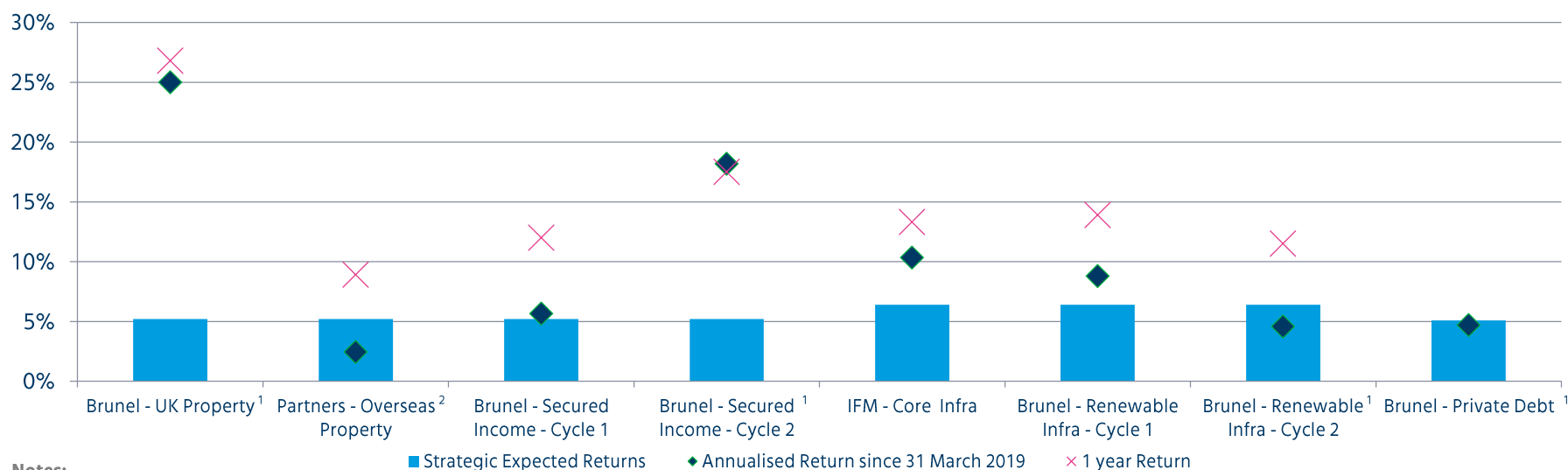
Actual returns are from 31 March 2019 to 30 June 2022, except if otherwise stated below. Returns for periods over a year have been annualised.

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 inception after 31 March 2019. A list of inception dates can be found in the Appendix.

Performance vs. expected strategic returns

	Brunel UK Property	Partners Overseas Property	Brunel Secured Income	IFM Core Infra	Brunel Renewable Infra	Brunel Private Debt
Benchmark allocation	3.75%	3.75%	10.0%	5.0%	5.0%	5.0%
Commentary	Returns above strategic expectations; property has fared very well since inception in January 2021.	Returns below expectations. Recent improvements seen and generally the mandate's longer-term performance is stronger.	Returns above expectations for both cycles; especially cycle 2 (first drawdown in 2021), thanks to strong property markets. Mandates are still in the drawdown phase.	Returns above expectations as assets have continued to deliver.	Returns above expectations for cycle 1 (2019), but below for cycle 2 (2020). Mandates are still in the drawdown phase so longer-term performance will be more meaningful.	Mandate inceptioned in September 2021; too early to draw conclusions.



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 June 2022, 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 inceptioned after 31 March 2019. A list of inception dates can be found in the Appendix.

² Returns are shown up to 31 March 2022, as this is the latest data available.

Mandate performance to 30 June 2022

Manager / Asset Class	3 Months			1 Year			3 Year			3 Year Performance Target (% p.a.)	3 Year Performance vs Target
	Fund (%)	B'mark (%)	Relative (%)	Fund (%)	B'mark (%)	Relative (%)	Fund (% p.a.)	B'mark (% p.a.)	Relative (% p.a.)		
BlackRock Passive Global Equity	-9.3	-9.1	-0.2	-2.6	-2.6	0.0	8.7	8.7	0.0	-	N/A (p)
Brunel Global High Alpha Equity	-10.3	-9.0	-1.4	-10.8	-2.1	-8.9	N/A	N/A	N/A	+2-3	N/A
Brunel Global Sustainable Equity	-10.3	-8.4	-2.1	-10.5	-3.7	-7.1	N/A	N/A	N/A	+2	N/A
Brunel Passive Global Equity Paris-Aligned	-9.1	-9.1	0.0	N/A	N/A	N/A	N/A	N/A	N/A	-	N/A (p)
Brunel Diversified Returns Fund	-3.0	0.9	-3.9	-1.5	3.4	-4.7	N/A	N/A	N/A	+3-5	N/A
JP Morgan FoHF	0.2	1.0	-0.8	-2.5	3.4	-5.8	7.2	3.2	+3.9	-	Target met
Brunel Multi-Asset Credit	-8.6	1.2	-9.7	-10.1	4.4	-13.9	N/A	N/A	N/A	-	N/A
Brunel UK Property	4.8	3.9	+0.9	26.8	23.3	+2.8	N/A	N/A	N/A	-	N/A
Partners Overseas Property*	0.9	2.5	-1.6	8.9	10.0	-1.0	2.2	10.0	-7.1	-	Target not met
Brunel Secured Income - Cycle 1	2.8	4.0	-1.2	12.0	9.4	+2.4	5.7	4.1	+1.5	+2	Target not met
Brunel Secured Income - Cycle 2	4.4	4.0	+0.4	17.5	9.4	+7.4	N/A	N/A	N/A	+2	N/A
IFM Core Infrastructure	3.1	1.4	+1.6	13.3	5.4	+7.5	8.7	5.5	+3.1	-	Target met
Brunel Renewable Infrastructure - Cycle 1	4.1	4.0	+0.1	13.9	9.4	+4.1	6.9	4.1	+2.7	+4	Target not met
Brunel Renewable Infrastructure - Cycle 2	2.3	4.0	-1.6	11.5	9.4	+1.9	N/A	N/A	N/A	+4	N/A
Brunel Private Debt	3.4	1.2	+2.2	N/A	N/A	N/A	N/A	N/A	N/A	-	N/A
BlackRock Corporate Bonds	-10.8	-10.8	0.0	-18.9	-18.9	0.0	-3.0	-3.0	0.0	-	N/A (p)
BlackRock LDI	-27.4	-27.4	0.0	0.7	0.7	0.0	1.0	1.0	0.0	-	N/A (p)
Equity Protection Strategy	3.6			2.8			-3.3			-	N/A

Since inception performance for Partners, which was the largest underperformer over the three year period, has been at 5.7% p.a. *

Source: Investment Managers, Custodian, Mercer estimates. Returns are net of fees.

Returns are in GBP terms, except for JP Morgan 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 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 31 March 2022 as this is the latest date that this is available. The mandate's inception was in 2009.

Asset allocation

6

Valuations by asset class

Asset Class	Start of Quarter (£'000)	End of Quarter (£'000)	Start of Quarter (%)	End of Quarter (%)	Benchmark (%)	Ranges (%)	Relative (%)
Global Equity	1,007,071	960,653	17.3	17.6	16.5	11.5 - 21.5	+1.1
Global Sustainable Equity	802,687	719,751	13.8	13.2	15.0	10.0 - 20.0	-1.8
Paris-Aligned Equity	574,338	522,026	9.9	9.6	10.0	5 - 15	-0.4
Diversified Returns Fund	538,061	522,169	9.2	9.6	6.0	4 - 10	+3.6
Fund of Hedge Funds*	171,125	119,113	2.9	2.2	-	No set range	+2.2
Multi-Asset Credit	315,433	288,351	5.4	5.3	6.0	3 - 9	-0.7
Property	391,001	399,363	6.7	7.3	7.5	5 - 10	-0.2
Secured Income	468,845	503,068	8.0	9.2	10.0	0 - 15	-0.8
Core Infrastructure	427,128	441,256	7.3	8.1	5.0	2.5 - 7.5	+3.1
Renewable Infrastructure	89,252	101,434	1.5	1.9	5.0	0 - 7.5	-3.1
Private Debt	42,713	64,267	0.7	1.2	5.0	0 - 7.5	-3.8
Corporate Bonds	121,987	108,803	2.1	2.0	2.0	No set range	0.0
LDI & Equity Protection	708,640	593,303	12.2	10.9	12.0	No set range	-1.1
Other**	167,500	112,446	2.9	2.1	-	0 - 5	+2.1
Total	5,825,924	5,456,148	100.0	100.0	100.0		

Source: Custodian, Investment Managers, Mercer. 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.

**Valuation includes the internal cash, the ETF and currency instruments.

The underweights to Renewable Infrastructure and Private Debt mandates reflects the fact that the mandates are still being drawn down. Their control ranges have been temporarily widened to account for this.

The overweight to Core Infrastructure reflects its stronger relative recent performance. It offsets the underweight to Renewable Infrastructure.

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	288,513	60,000	321,713	5.0	5.9
Brunel	Global High Alpha Equity	695,906		624,338	11.9	11.4
Brunel	Global Sustainable Equity	802,687		719,751	13.8	13.2
Brunel	Passive Global Equity Paris Aligned	574,338	-54	522,026	9.9	9.6
Brunel	Diversified Returns Fund	538,061		522,169	9.2	9.6
JP Morgan	Fund of Hedge Funds	171,125	-60,760	119,113	2.9	2.2
Brunel	Multi-Asset Credit	315,433		288,351	5.4	5.3
Brunel	UK Property	210,953	-61	221,124	3.6	4.1
Partners	Overseas Property	168,035	-9,832	166,227	2.9	3.0
Brunel	Secured Income – Cycle 1	381,102	-1,966	389,926	6.5	7.1
Brunel	Secured Income – Cycle 2	87,742	20,750	113,142	1.5	2.1
IFM	Core Infrastructure	427,128	44	441,256	7.3	8.1
Brunel	Renewable Infrastructure – Cycle 1	70,620	3,196	76,871	1.2	1.4
Brunel	Renewable Infrastructure – Cycle 2	18,632	5,346	24,562	0.3	0.5
Brunel	Private Debt	42,713	19,400	64,267	0.7	1.2
BlackRock	Corporate Bonds	121,987		108,803	2.1	2.0
BlackRock	LDI & Equity Protection	708,640		593,303	12.2	10.9
Record	Currency Hedging*	-10,360	10,000	-73,019	-0.2	-1.3
BlackRock	ETF	105,127		95,672	1.8	1.8
Internal Cash	Cash	93,576	2,198	102,417	1.6	1.9
Total		5,825,924	48,258	5,456,148	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.

* Valuation includes the collateral holdings for the currency overlay.

Current topics



Current topics

The ESG spotlight turns to natural capital

Protecting natural capital is the next big challenge and an essential component of mitigating climate change

What is biodiversity and natural capital?

- **Biodiversity** is the variety of living things on Earth and includes the variability within and between species, and within and between ecosystems;
- **Natural capital** includes the services the ecosystem provides to society and economies.



- Over half of the world's economic activity is highly or moderately dependent on nature.

The Taskforce on Nature-related Financial Disclosures (TNFD) is aiming to replicate the success of the TCFD:



The TNFD published its beta framework on 15 March 2022 and its second iteration, including draft metrics in June 2022. TNFD is in a consulting phase ahead of producing the final recommendations in September 2023.

- It seeks to understand the interactions between business and natural capital;
- It aims to agree a framework to monitor nature impacts to encourage businesses and investors to minimise negative impacts on nature and maximise positive impacts
- The TNFD will create a toolkit for business leaders and the financial community to allocate capital away from nature-negative and towards nature-positive outcomes

Mercersits on the TNFD forum and is actively involved in providing feedback and input to the TNFD

What can investors do now?



Relevance to the Fund



The Fund has been proactive on ESG considerations, though this is an emerging theme which could come further to the fore in this space.

Current topics

Bear Market 2022 – Inflation, Recession & Investments

The worst start to a year in decades. Very few safe havens.

How did we get here?

Policy response

To fight inflation, central banks have become hawkish, with multiple rate hikes. This aims to tame inflation, at the cost of economic growth.

High inflation

In response to a surge in demand and decline in supply, inflation has risen to multi-decade highs. Price pressures remain more persistent than market expectations.

Supply chain disruption

A spike in demand following lockdown for consumer goods in 2022, after a quiet 2020/2021, has put strain on supply chains. Labor shortages are also a contributor.



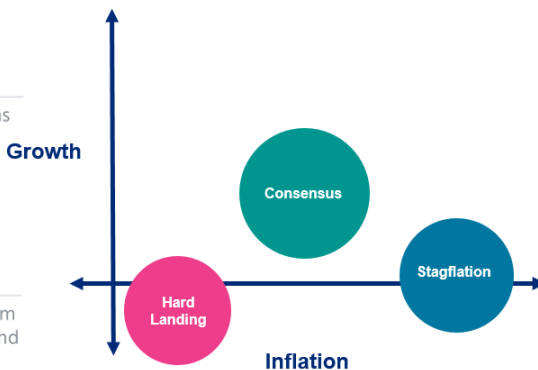
War in Ukraine

The conflict in Ukraine, which came as a surprise to the world, led to severe trade disruption and for the two commodity rich nations.

High commodity prices

Disruption of commodity exports from Russia & Ukraine, sanction activity, and a consistent underinvestment in key sectors such as energy saw most commodity prices soar.

Where are we heading?



For illustrative purposes.

An economic slowdown with sticky inflation is likely the biggest risk for markets

Relevance to the Fund



The Fund has a well-diversified portfolio, including some allocations to the real assets and defensive strategies cited, which have protected value during times of market stress.

Asset classes for consideration

Real Assets



Private Debt

Private debt provides an illiquidity premium above typical bond yields, and is therefore suitable to Schemes with long investment horizons. As a floating rate instrument, it also constitutes an inflation hedge.



Infrastructure Equity

Infrastructure by its nature usually invests in assets with benefit from inflation.



Inflation Linked Bonds

Following the sell of in index-linked gilts some schemes may with low levels of hedging may wish to increase hedges



Real Estate

Rental income holds a high level of inflation linkage, and therefore provides a strong hedge against inflation pressures, alongside consistent positive cashflow.



Commodities

High commodity prices were a key factor in recent inflation. Allocations to commodities via multi asset funds or direct investment can provide a hedge against further price level increases.



Defensive Strategies



Convertible Bonds

Convertible bonds provide upside potential via its equity conversion component, along with downside protection via coupon payments. As such, it is in a position to benefit from a market recovery, with less risk.



Absolute Return Bonds

With the recent increase in credit spreads, ARB strategies have a wide range of investment opportunities. In addition, low risk and minimal duration exposure and ability to go short can provide an element of downside protection.



Low Volatility Equity

Within equity portfolio (which is a real asset), a low volatility approach can help reduce limit the impact of negative equity returns during a recession.



Hedge Funds

Market conditions have been favourable to some Hedge fund strategies (trend, macro) and hedge fund returns have been some of the best returns achieved in over a decade. Further volatility is likely to continue to favour these strategies.



Equity Protection

Further downside across equity markets, in a persistent stagflation environment for example, can be hedged against via the use of equity protection strategies, such as put option.

Appendix

Q2 2022 equity market review

Equity markets posted deep negative returns over the second quarter.

Global Equities returned -13.3% in local currency terms. Markets were significantly weaker across the globe as financial conditions tightened, input prices rose and recessionary risk increased.

US equities returned -16.6%, whilst European (ex-UK) equities returned -10.4%. Japanese equities returned -3.7%.

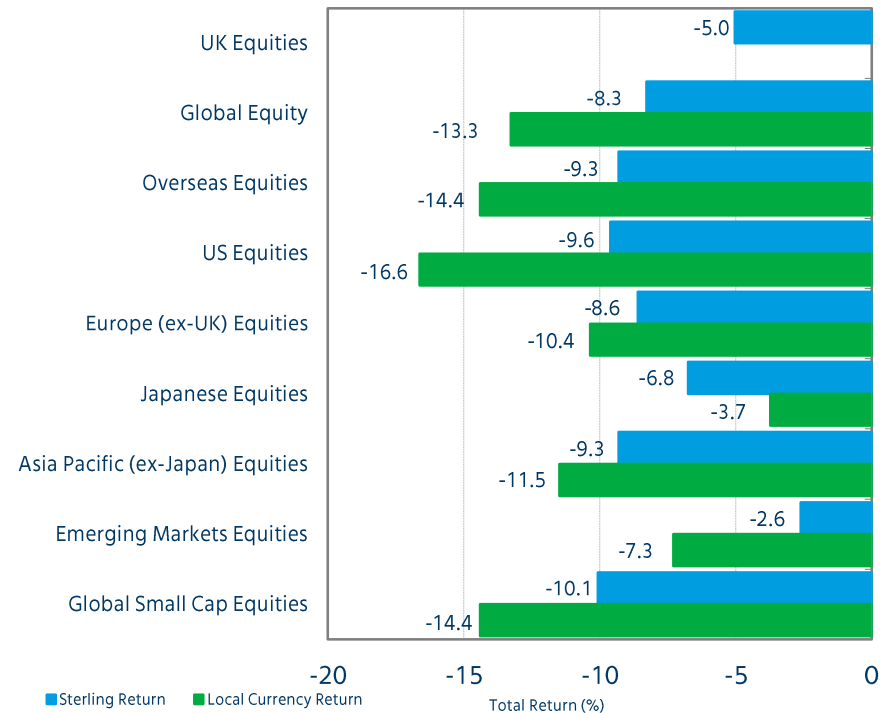
Emerging markets equities returned -7.3%. China rallied late in the quarter as lockdowns ended, monetary policy remained supportive and regulators softened their rhetoric. Outside of China, other Asian markets were weak due to supply disruptions and fears of a global slowdown that could have a negative impact on exports.

Global small cap stocks returned -14.4%. Small caps lagged global equities due to their cyclical nature and thus downside susceptibility, should a recession materialise.

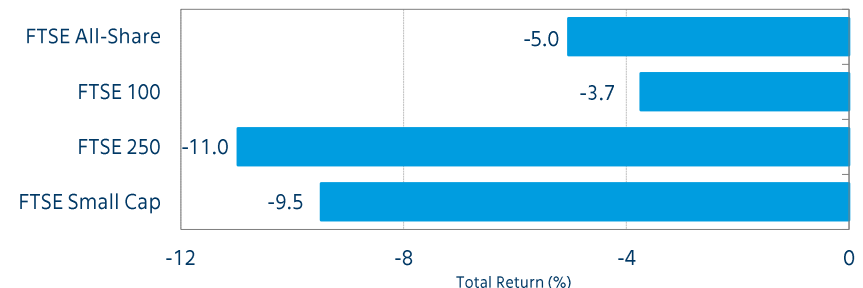
The FTSE All Share index returned -5.0% over the quarter with the large cap FTSE 100 index returning -3.7%. The FTSE 100 and FTSE All-Share's large exposure to consumer services and financials was a headwind over the quarter, offset to a degree by its large oil & gas exposure even if momentum for the latter slowed towards quarter end.

UK small cap and mid-cap stocks that are more reflective of the domestic UK economy produced negative returns in line with global small cap stocks.

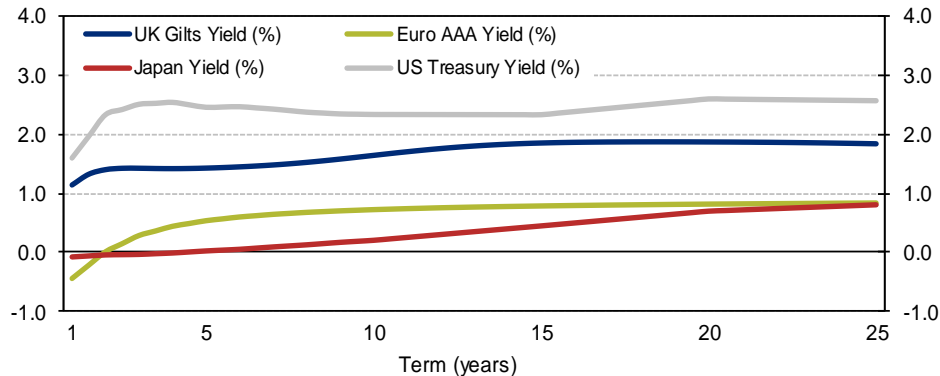
Equity Performance - Three Months to 30 June 2022



FTSE Performance by Market Cap - Three Months to 30 June 2022



Q2 2022 bond market review



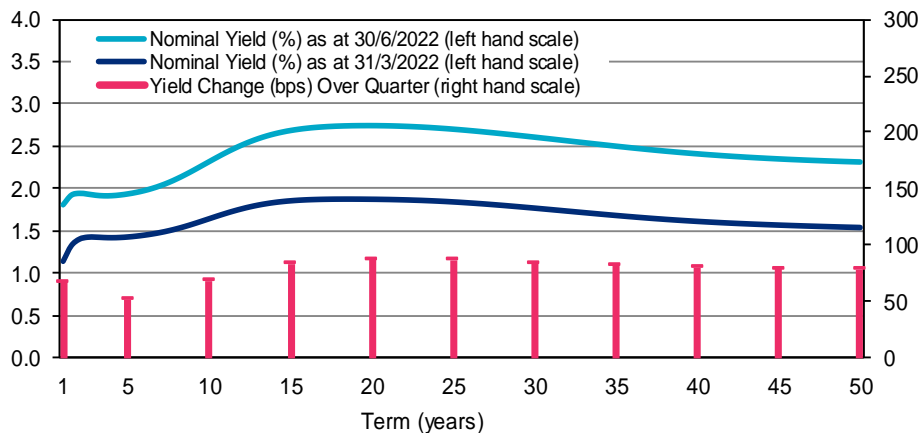
Source: Mercer and Bloomberg.

Government Bond Yields

Global government bond yield curves rose over the quarter, as yields at the ultra-short end of the curve reacted to tightening central bank policy and longer dated yields rose as well.

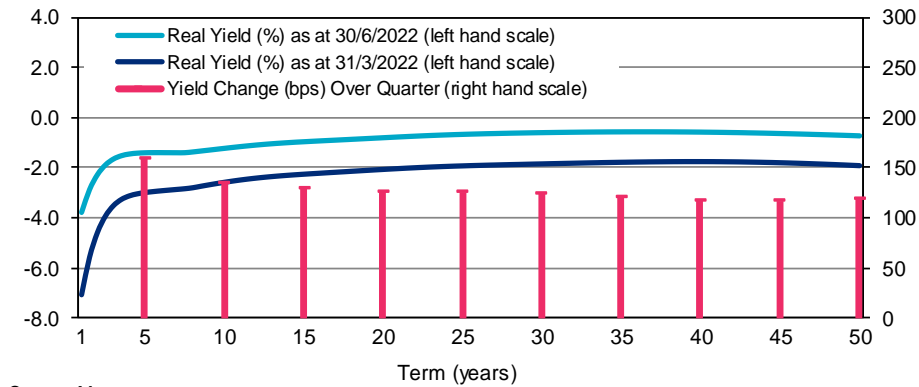
2-year yields in the UK and US rose 48 and 62bps respectively. 10-year gilt yields rose by 61bps while US 10-year treasury yields rose by 67bps.

Both the Federal Reserve and the Bank of England raised interest rates over the quarter several times and are expected to continue to tighten policy throughout the rest of 2022.



Source: Mercer.

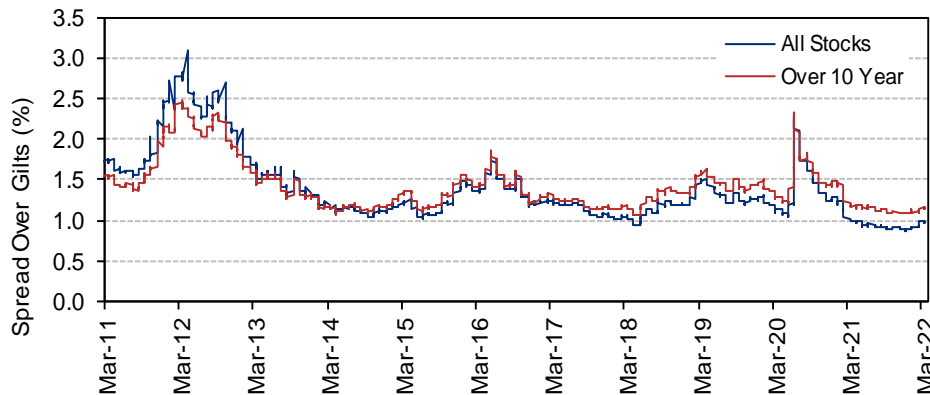
Q2 2022 bond market review



Source: Mercer.

UK Index-Linked Gilt Yields

UK real yields rose across the curve. Market based measures of inflation expectations, in the form of breakeven inflation, fell over the quarter. The UK 10-year breakeven rate fell to 3.7%, nearly 65 bps lower than at the end of last quarter. The fall in breakevens offset the increase in nominal yields which led to the increase in real yields.



Source: Refinitiv.

Corporate bonds

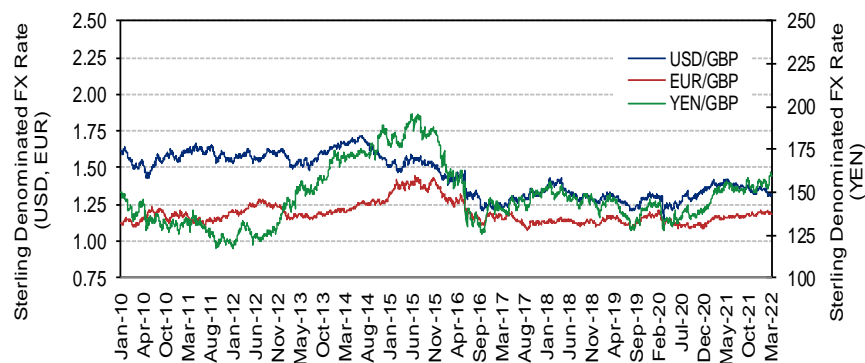
Spreads on UK investment grade credit widened for the quarter as corporate bond yields increased in light of slowing growth concerns.

Q2 2022 currency market review

Sterling depreciated versus the US dollar and Euro but appreciated versus the Yen over the quarter.

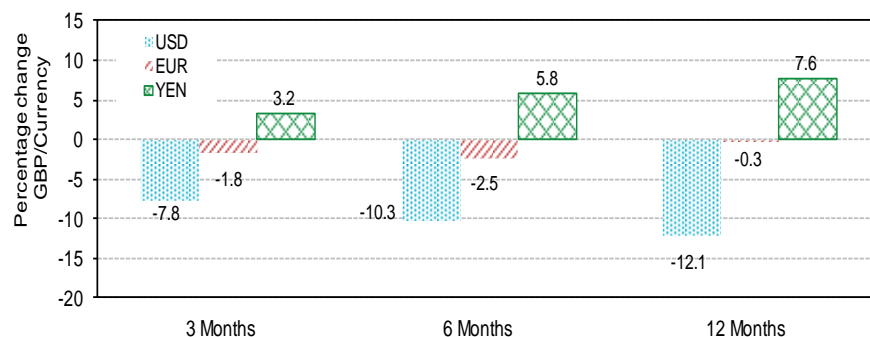
Monetary policy divergence between the regions was one of the drivers. For the year as a whole, Sterling has appreciated versus the Yen as stronger economic growth and the prospect of tighter monetary policy made Sterling more attractive relative to the former. Sterling weakened against US dollar as both growth prospects and the yield outlook favored the latter.

Sterling Denominated FX Rate



Source: Refinitiv.

Change in sterling against foreign currencies



Source: Refinitiv.

Q2 2022 property

UK property as measured by the MSCI Index increased by 3.8% over the quarter to 30 June 2022.

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	Passive Global Equity Paris Aligned	FTSE Developed World PAB Index	-	October 2021
Brunel	Diversified Returns Fund	SONIA +3-5% p.a.	-	July 2020
JP Morgan	Fund of Hedge Funds	SONIA +3% p.a.	-	July 2015
Brunel	Multi-Asset Credit	SONIA +4-5% p.a.	-	June 2021
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	SONIA +5% p.a.	-	April 2016
Brunel	Renewable Infrastructure	CPI	+4%	January 2019
Brunel	Private Debt	SONIA + 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	-	-	-

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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