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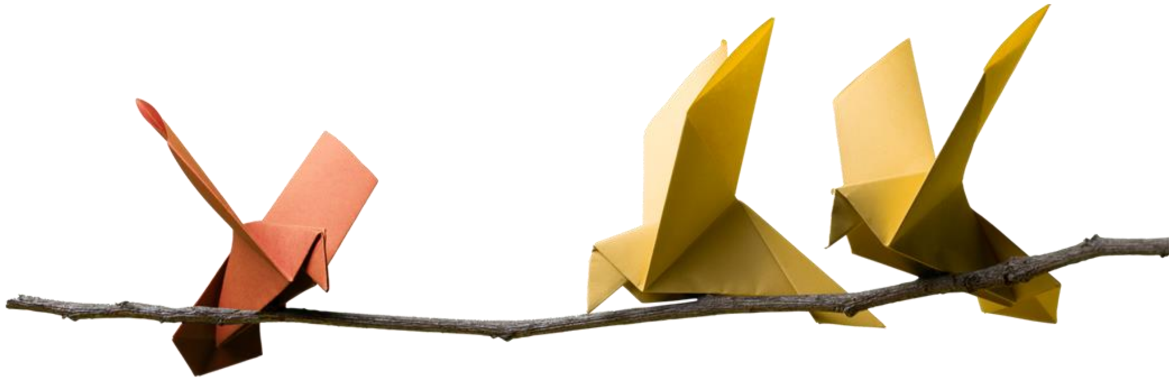
Avon Pension Fund

Panel Investment Report Quarter to 31 December 2023



February 2024

Steve Turner

A business of Marsh McLennan

Contents

Executive Summary

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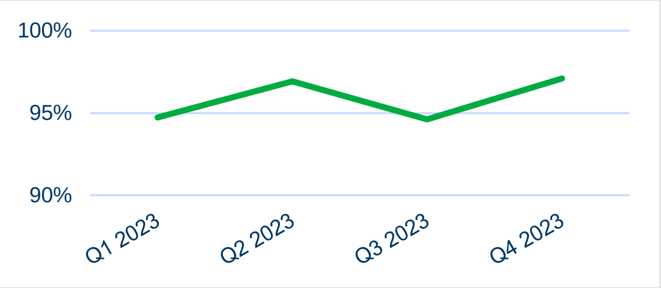
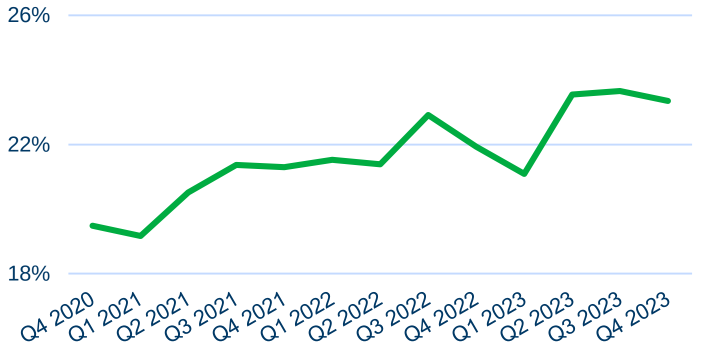
Executive Summary

Market background	• Over the quarter, global equities were boosted by expectations of looser central bank policy and the related decline in bond yields. Soft landing hopes rose, while the US tech giants performed well. • UK nominal and real yields fell across the curve and inflation expectations declined.
Mercer market views	• Our medium term outlook (as at January 2024) is mixed. • The potential for the global economy landing softly, falling inflation, resilient business balance sheets and the ongoing potential for AI should support equity prices in the near term. • However, we are conscious that equity valuations are rich and the recent strong rally creates the risk of underperformance if we are wrong that inflation will fall further.
Funding level and risk	• The funding level is estimated to have increased over the quarter to c. 97% as the value of the assets rose by more than the estimated present value of the liabilities. *(The rise in the estimated value of the liabilities was driven by a move to a lower actuarial discount rate basis of CPI + 2.5% as at 31 December 2023 versus 30 September 2023, as well as the impact of observed inflation).* • The funding level is estimated to be c. 1% higher over the year to 31 December 2023 (as illustrated to the right). • The Value-at-Risk increased over the quarter to £1,371m, but fell as a percentage of liabilities to 23%. • Levels have gradually increased since 2020 due to market movements and changes in forward-looking assumptions.





Executive Summary

Performance

- The strong returns on Fund assets over the quarter were driven by the Equity and LDI portfolios. The Multi-Asset portfolios also contributed, whilst the contribution from Alternatives was mixed.
- The Equity Protection detracted (as expected given market movements), whilst the Currency Hedge added to returns due to Sterling strengthening.

- Underperformance relative to the strategic benchmark over the one year period was due to most of the Fund's mandates underperforming, with the main exceptions being Multi-Asset Credit (which outperformed) and Global High Alpha Equities (which matched its benchmark).
- The main driver of underperformance over three years was the active equity mandates.

	3 Months (%)	1 Year (%)	3 Years (% p.a.)
Total Fund **(1)**	8.7	8.5	3.3
Strategic Benchmark **(2)** (ex currency hedge)	5.9	10.6	7.7
Relative **(1 - 2)**	**2.8**	**-2.2**	**-4.3**

- The Currency Hedge added to returns over the quarter and one year period due to the relative strengthening of Sterling, but detracted over three years.

- Absolute returns compared to the strategic returns modelled at the strategy review in 2023 have been mostly positive for the Equity and the Liquid Growth assets, but mostly negative for the Illiquid Growth assets.

Asset allocation and strategy

- A net amount of c. £66m was drawn down to the Brunel private market portfolios during the quarter.
- £100m was disinvested from the IFM Core Infrastructure portfolio, which served to bring the mandate in line with its strategic target allocation (4%).
- In October, the Fund disinvested £200m from the Brunel Paris Aligned Equity fund, with the exposure replicated synthetically within the BlackRock portfolio, in order to raise cash ahead of reinstating the hedging trigger framework.
- Following this, a number of interest rate triggers were breached causing BlackRock to increase the interest rate hedge ratio to the 30% maximum (39% as a % of assets). The Plan will have benefitted from this change given the fall in interest rates since then.

Market Background

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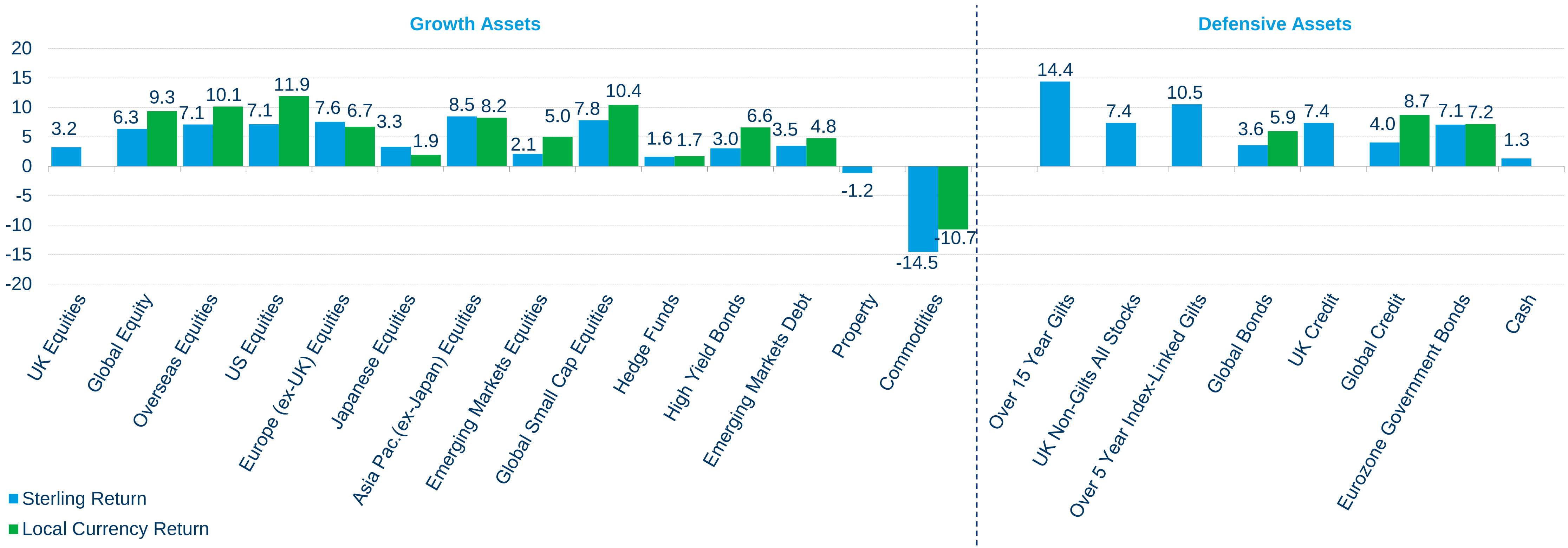
Market Background

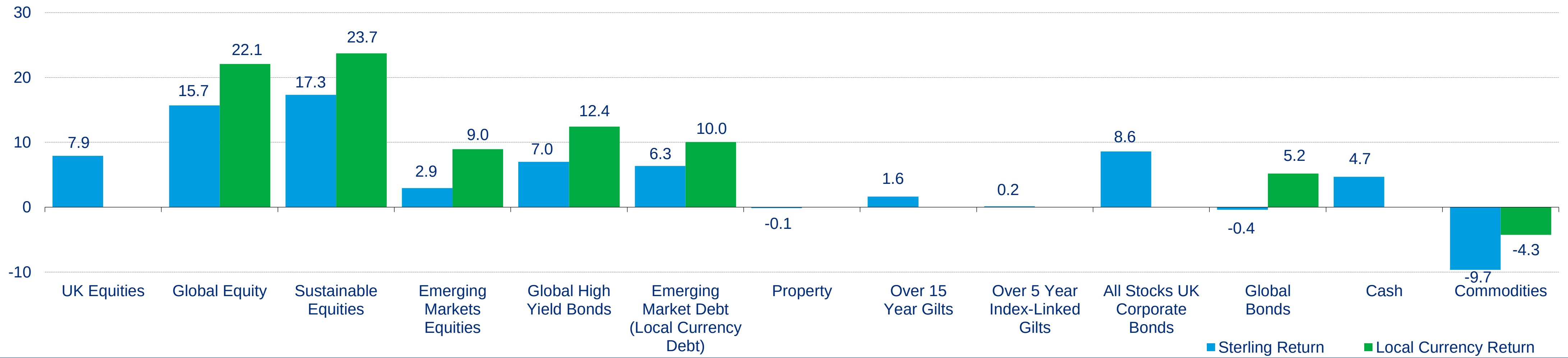
Return over 3 months to 31 December 2023 (%)



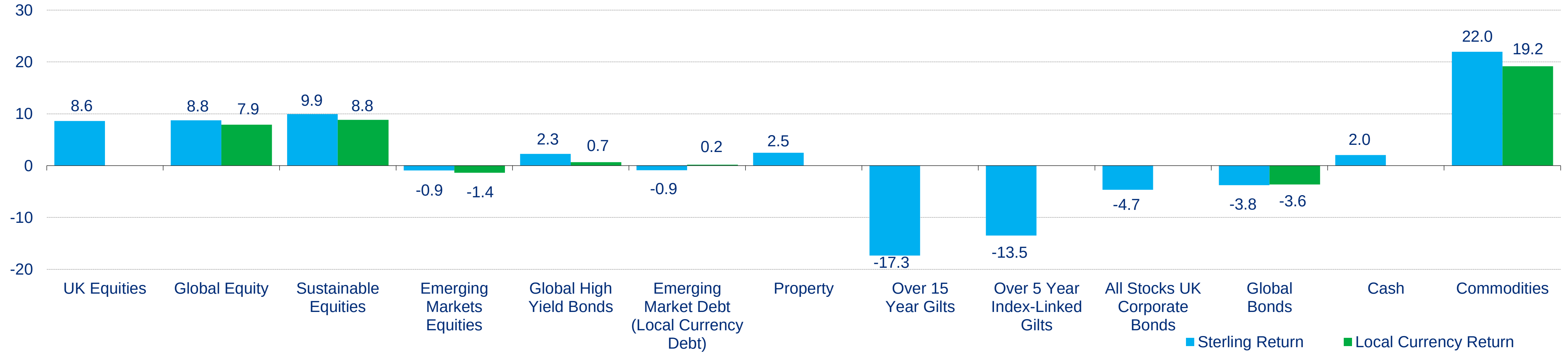
The fourth quarter of 2023 started off with low expectations owing to high long-term interest rates and renewed geopolitical tensions in the Middle East. Markets reached their lows near the end of October due to risk-off sentiment. However, in November, slowing inflation in the US and other regions raised hopes that interest rates may have peaked, thereby boosting investor confidence. Over the quarter, the US Federal Reserve kept rates unchanged, shifting towards a dovish tone. Inflation expectations also continued to decline over the quarter.

Market Background – 1 & 3 Years

Return over 12 months to 31 December 2023 (%)



Return over 3 years to 31 December 2023 (% p.a.)



Mercer

Source: Refinitiv

Funding Level and Risk

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Funding Level and Deficit

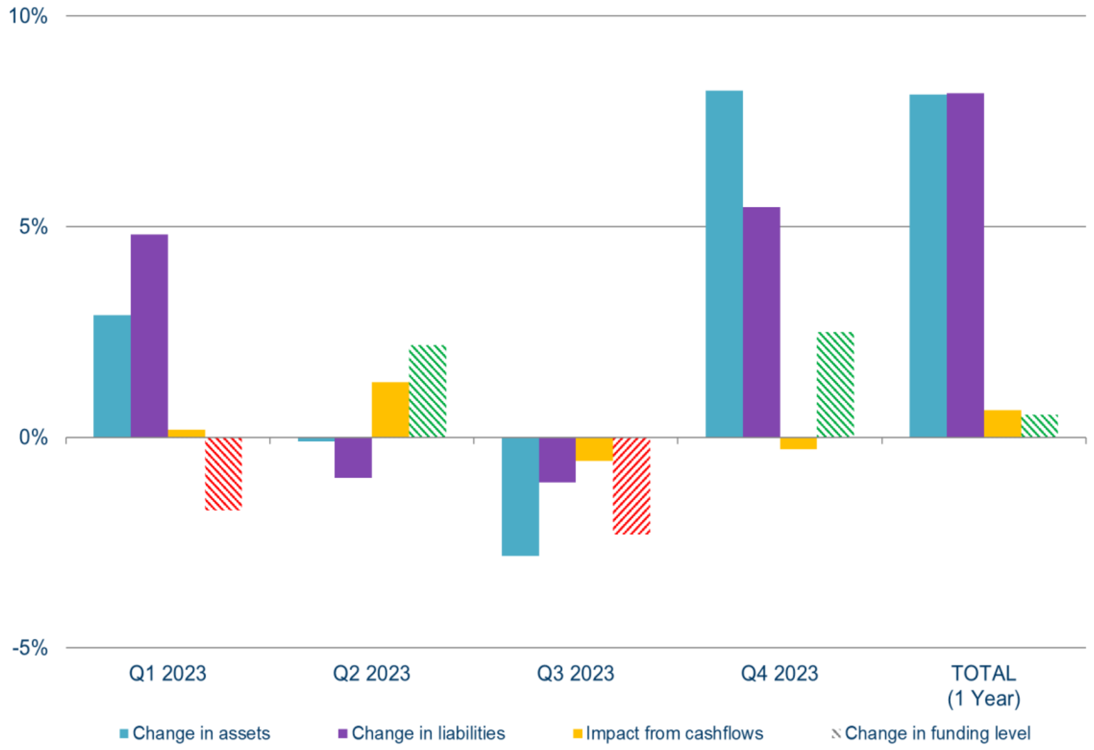
The Fund’s assets returned 8.7% over the quarter, whilst the liabilities are estimated to have increased by c. 5%.

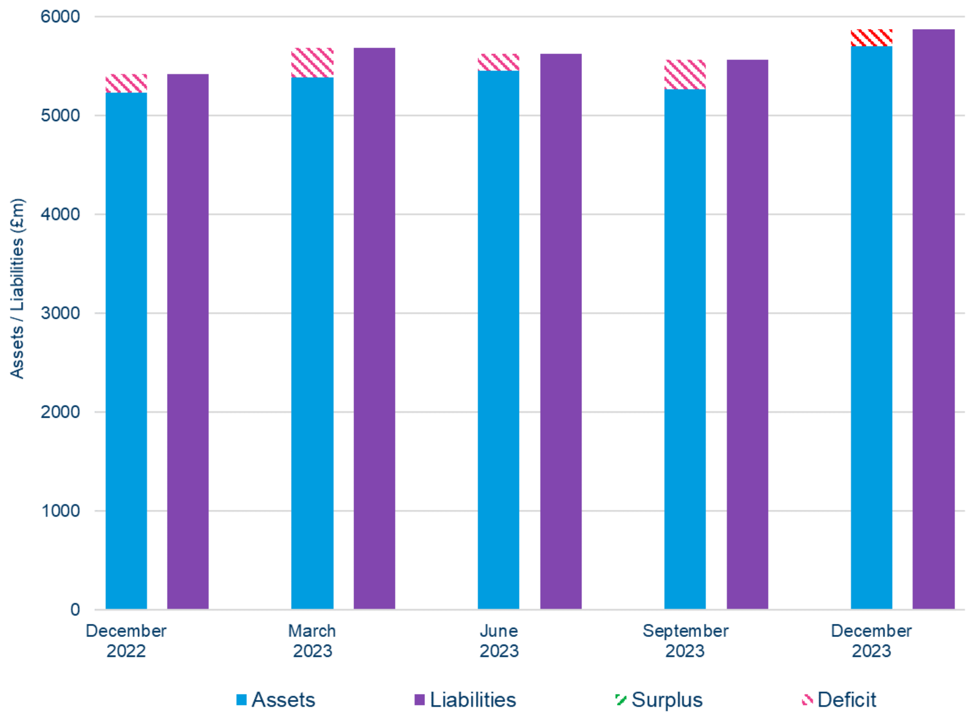
The combined effect of this saw the estimated funding level increase to c. 97%.

The funding level is estimated to be c. 1% higher over the year to 31 December 2023.

The rise in the estimated value of the liabilities was driven by a move to a lower actuarial discount rate basis of CPI + 2.5% as at 31 December 2023 versus 30 September 2023, as well as the impact of observed inflation.

The deficit was estimated to have decreased over Q3 from c.£300m to c.£170m.



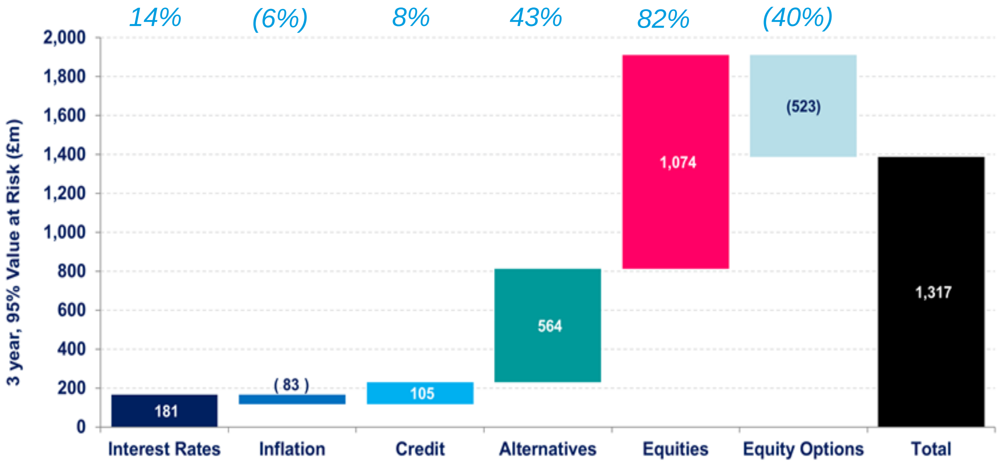


Liability values are estimated by Mercer. They are based on the actuarial valuation assumptions as at 31 March 2022 and the ‘CPI plus’ discount basis.
Impact figures are estimated by Mercer.

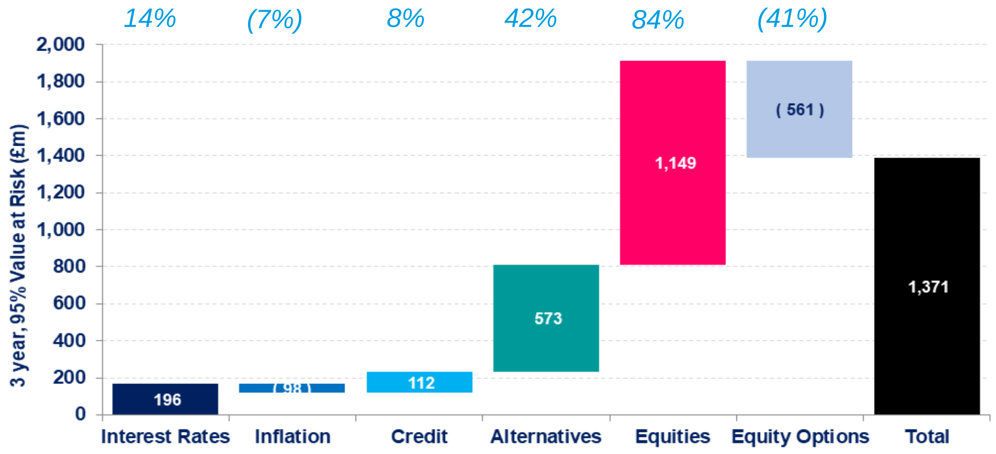
Risk Decomposition – 3 Year Value at Risk

- The two charts below illustrate the main risks that the Fund is exposed to, 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.

30 September 2023



31 December 2023



- As at 31 December 2023, if a 1-in-20 ‘downside event’ occurred over the next three years, the funding position could deteriorate by at least an additional **£1.4bn**.
- 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 increased by £54m over the quarter**, due to the rise in the absolute value of the assets.
- As a percentage of liabilities, VaR decreased slightly to 23% due to the increased value of the liabilities.

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.
Both are using cashflows from the 2022 valuation.

Performance Summary

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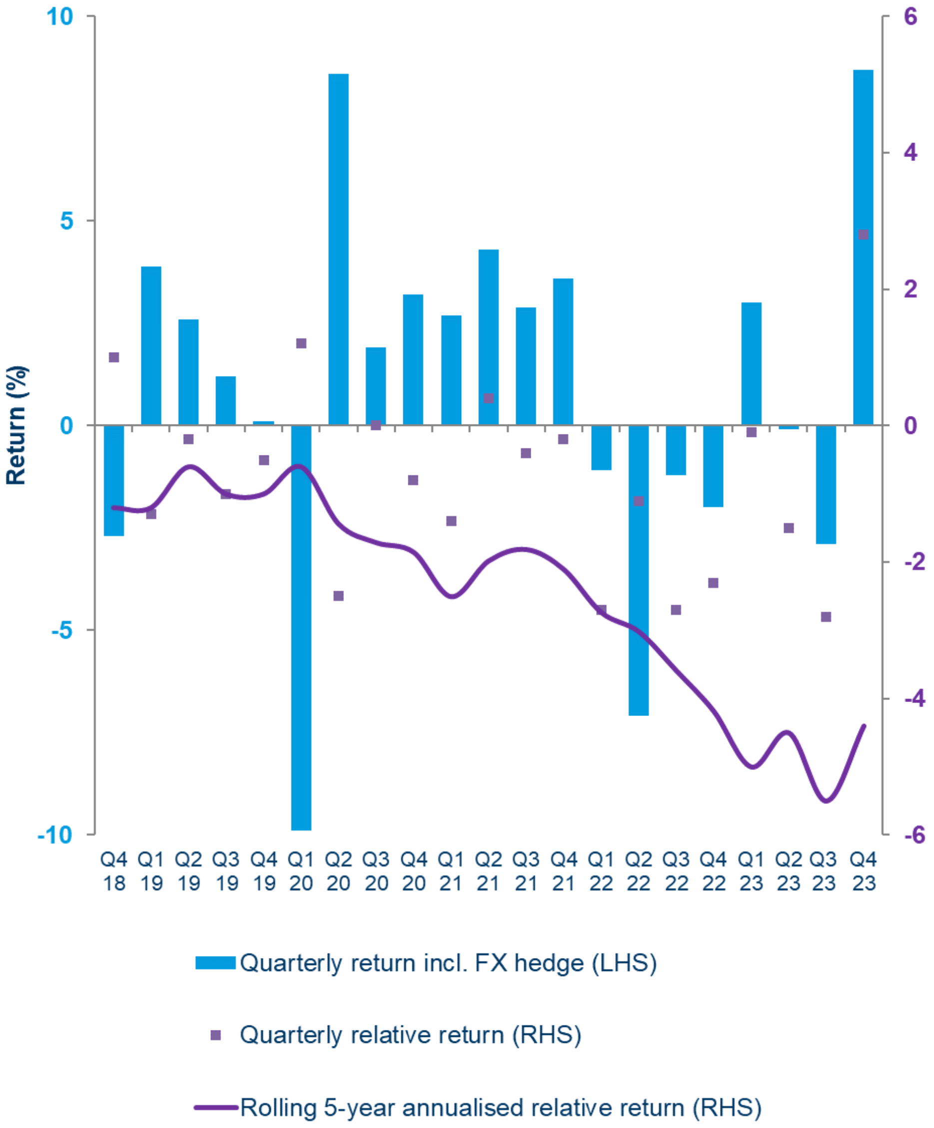
Total Fund Performance



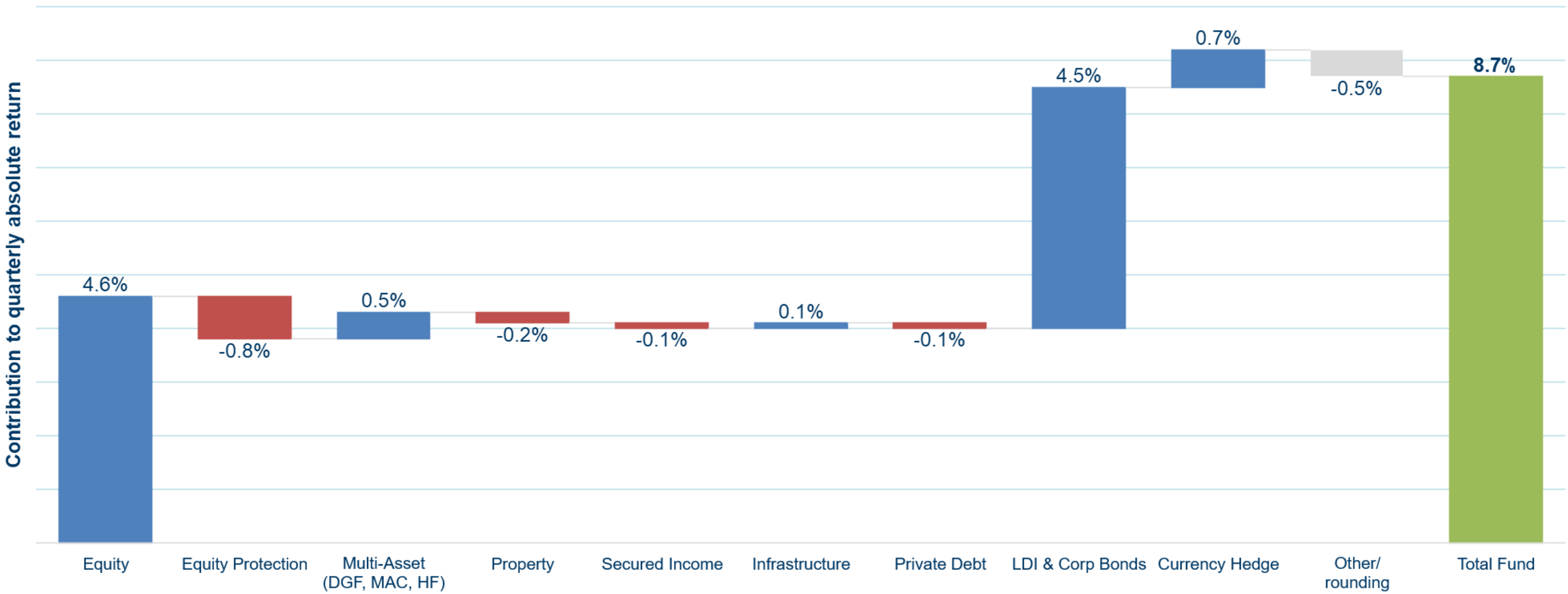
	3 Months (%)	1 Year (%)	3 Years (% p.a.)
Total Fund **(1)**	8.7	8.5	3.3
Total Fund (ex currency hedge)	8.0	7.1	3.6
Strategic Benchmark **(2)** (ex currency hedge)	5.9	10.6	7.7
Relative (1 - 2)	**2.8**	**-2.2**	**-4.3**

Source: Custodian, Mercer estimates. Returns are net of fees. 'Relative' figures may not sum due to rounding.

Commentary

- As illustrated on the next slide, the positive return of Fund assets over the quarter was driven by Equity assets and the LDI portfolio.
- Relative performance was positive over the quarter, due mainly to the Sustainable Equity, Diversified Returns, Multi-Asset Credit and (in aggregate) Renewable Infrastructure portfolios.
- Underperformance relative to the strategic benchmark over the one year period was due to most of the Fund's mandates underperforming, with the main exceptions being Multi-Asset Credit (which outperformed) and Global High Alpha Equities (which matched its benchmark).
- The main driver of underperformance over three years was the active equity mandates.
- The Currency Hedge added to returns over the quarter and one year period due to the relative strengthening of Sterling, but detracted over three years.

Total Fund Performance Attribution – Quarter



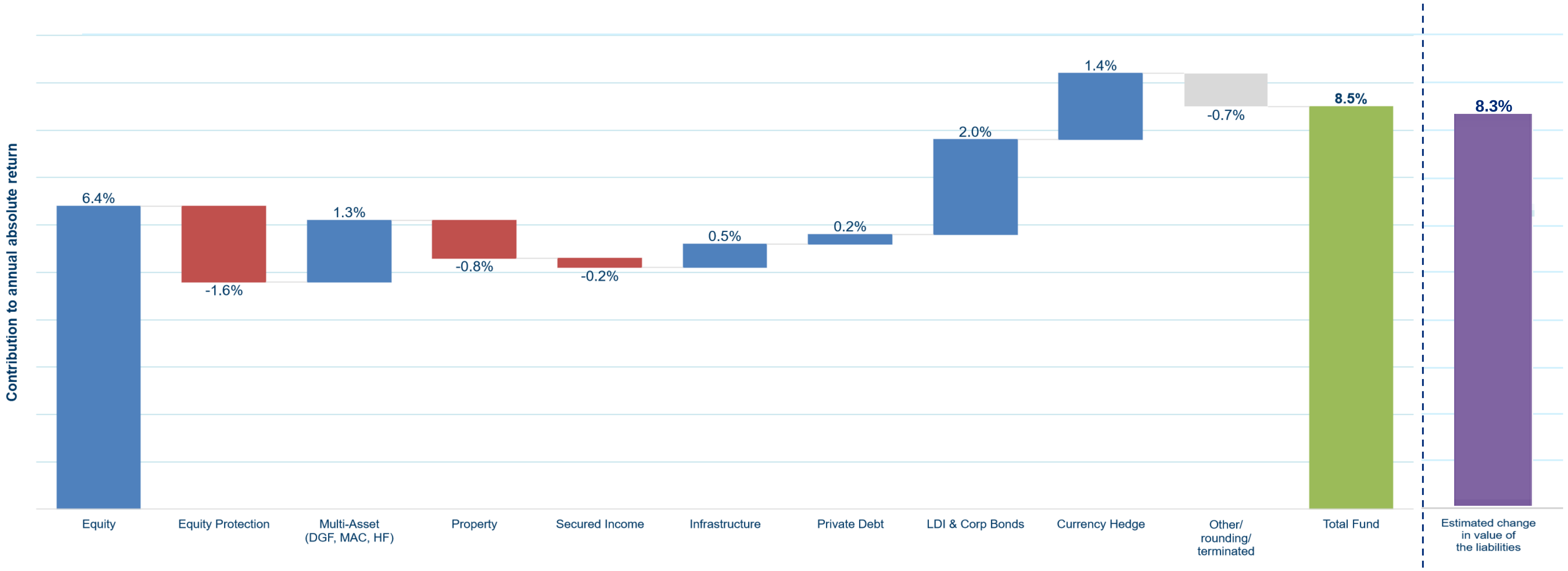
Source: Custodian and Mercer estimates
'Other' contributions to the total can include the relatively small holdings in the ETF, cash, the impact of cashflows and terminated mandates, as well as rounding.

The strong returns on Fund assets over the quarter were driven by the Equity and LDI portfolios. Multi-Asset portfolios also contributed, whilst the Alternatives were mixed.

The Equity Protection detracted due to rising underlying equity markets.

The Currency Hedge contribution was positive due to the strengthening of Sterling.

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.
A significant portion of the rise in the estimated value of the liabilities was driven by a move to a lower actuarial discount rate basis of CPI + 2.5% as at 31 December 2023 versus 30 September 2023, as well as the impact of observed inflation.

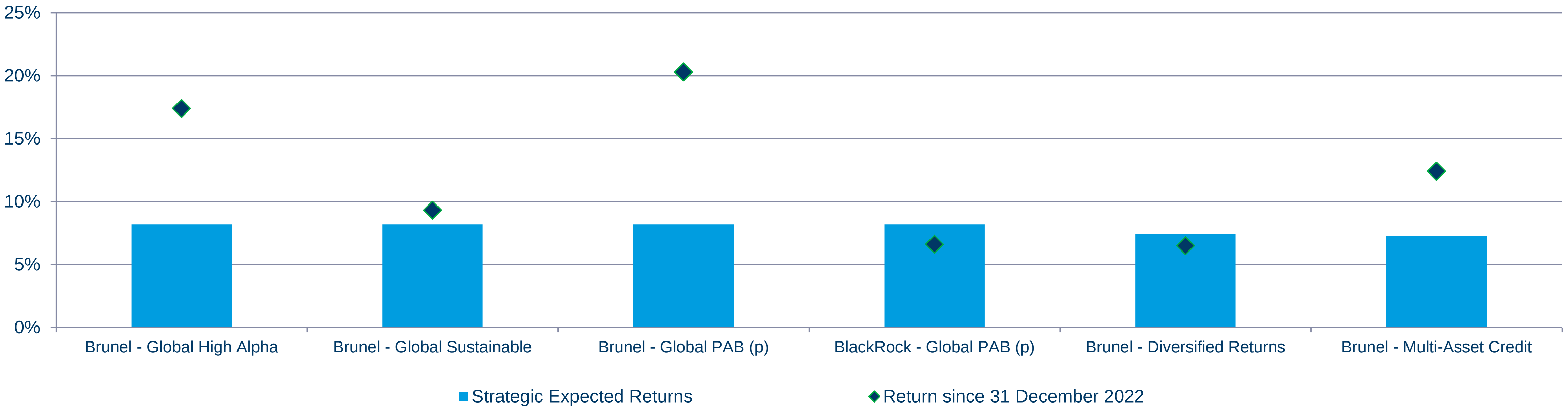
Equity was also the main driver of positive returns over the 1 year period.

Multi-Asset, Infrastructure, Private Debt and LDI were positive, whilst the Equity Protection, Property and Secured Income were negative.

The Currency Hedge contribution was positive due to the strengthening of Sterling.

Performance vs. Expected Strategic Returns

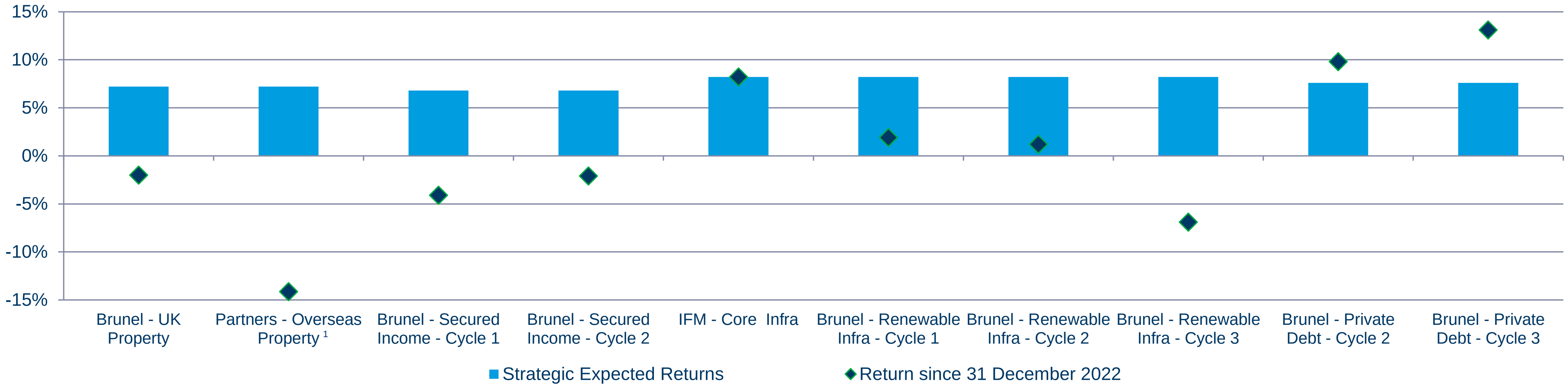
Growth Asset	Brunel Global High Alpha	Brunel Global Sustainable	Brunel / BlackRock Passive Global PAB	Brunel Diversified Returns	Brunel Multi-Asset Credit
Benchmark Allocation	10.5%	10.5%	20.5%	6.0%	6.0%
Commentary	Returns above expectations since December 2022 due to equity market strength over 2023. No active management impact over this period.	Returns above expectations since December 2022 due to equity market strength, though mandate has underperformed the benchmark.	Brunel PAB (FTSE index) returns above expectations since December 2022 due to equity market strength. BlackRock synthetic PAB (MSCI index) returns below expectations, though exposure has only been in place since May 2023.	Returns slightly below expectations since December 2022 due to weak performance in H1.	Returns above expectations since December 2022 thanks to strength in high-yield debt markets.



Notes:
We have illustrated the performance of the key mandates within the Fund's investment strategy.
Actual returns are from 31 December 2022 to 31 December 2023, except if otherwise stated below. Returns for periods over a year have been annualised.
The strategic expected returns are from the 2023 strategy review, which reflect the 10 year mean Mercer Q4 2022 asset model assumptions.

Performance vs. Expected Strategic Returns

Growth Asset	Brunel UK Property	Partners Overseas Property	Brunel Secured Income	IFM Core Infra	Brunel Renewable Infra	Brunel Private Debt
Benchmark allocation	3.75%	3.75%	9.0%	4.0%	5.0%	4.5%
Commentary	Returns below expectations since December 2022 due to the challenges seen in Property markets over 2023.			Returns in line with expectations since December 2022.	Returns for all cycles below expectations since December 2022. Mandates are still in the drawdown phase; the first drawdowns were in January 2019, October 2020 and October 2022 respectively.	Returns above expectations since December 2022 for both cycles. Mandates are still in the drawdown phase; the first drawdowns were in September 2021 and December 2022 respectively.



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The strategic expected returns are from the 2023 strategy review, which reflect the 10 year mean Mercer Q4 2022 asset model assumptions.
[1] Returns are shown up to 30 September 2023, as this is the latest data available.

Mandate Performance to 31 December 2023

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
Brunel Global High Alpha Equity	6.2	6.8	-0.6	17.4	17.4	0.0	7.3	10.3	-2.7	+2-3	Target not met
Brunel Global Sustainable Equity	8.0	6.4	+1.5	9.3	15.9	-5.7	3.6	8.7	-4.7	+2	Target not met
Brunel Passive Global Equity Paris-Aligned	6.8	6.7	+0.1	20.3	20.3	0.0	N/A	N/A	N/A	-	N/A (p)
MSCI World Paris-Aligned (Synthetic)	7.1	7.1	0.0	N/A	N/A	N/A	N/A	N/A	N/A	-	N/A (p)
Brunel Diversified Returns Fund	3.2	2.0	+1.2	6.5	7.8	-1.2	3.0	5.1	-2.0	-	Target not met
Brunel Multi-Asset Credit	5.4	2.3	+3.0	12.4	8.8	+3.3	N/A	N/A	N/A	-	N/A
Brunel UK Property	-1.3	-1.1	-0.2	-2.0	-1.6	-0.4	N/A	N/A	N/A	-	N/A
Partners Overseas Property*	-6.4	2.5	-8.7	-18.7	10.0	-26.1	-3.0	10.0	-11.8	-	Target not met
Brunel Secured Income - Cycle 1	-0.4	0.2	-0.6	-4.1	3.9	-7.7	-0.9	6.6	-7.0	+2	Target not met
Brunel Secured Income - Cycle 2	1.0	0.2	+0.8	-2.1	3.9	-5.8	N/A	N/A	N/A	+2	N/A
IFM Core Infrastructure	2.4	2.5	-0.1	8.2	9.9	-1.5	11.3	7.2	+3.8	-	Target met
Brunel Renewable Infrastructure - Cycle 1	0.5	0.2	+0.3	1.9	3.9	-1.9	6.4	6.6	-0.2	+4	Target not met
Brunel Renewable Infrastructure - Cycle 2	1.6	0.2	+1.4	1.2	3.9	-2.6	8.2	6.6	+1.5	+4	Target not met
Brunel Renewable Infrastructure - Cycle 3	-1.0	0.2	-1.2	-6.9	3.9	-10.4	N/A	N/A	N/A	+4	N/A
Brunel Private Debt - Cycle 2	-2.0	2.3	-4.2	9.8	8.8	+0.9	N/A	N/A	N/A	-	N/A
Brunel Private Debt - Cycle 3	3.6	2.3	+1.3	13.1	8.8	+4.0	N/A	N/A	N/A	-	N/A
BlackRock Corporate Bonds	10.7	10.7	0.0	10.2	10.2	0.0	-10.0	-10.0	0.0	-	N/A (p)
BlackRock LDI	18.4	18.4	0.0	4.4	4.4	0.0	4.1	4.1	0.0	-	N/A (p)
Equity Protection Strategy	-0.2	N/A	N/A	-5.5	N/A	N/A	-3.0	N/A	N/A	-	N/A

Source: Investment Managers, Custodian, Mercer estimates. Returns are net of fees. Returns are in GBP 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 target. Red = mandate underperformed target. Black = mandate performed in line with target (mainly reflecting passive mandates).

Performance for 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.
Performance for MSCI World Paris-Aligned (Synthetic) has been converted to GBP by Mercer, as the associated index is denominated in USD.
*Partners performance is to 30 September 2023, as this is the latest data available.
**Where the outperformance target has not already been incorporated into the benchmark returns shown. See Appendix for further details.
Performance is not yet illustrated for Secured Income Cycle 3 investment, which will become more meaningful with the passage of time.

Asset Allocation

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Valuation by Asset Class

Asset Class	Start of Quarter (£'000)	End of Quarter (£'000)	Start of Quarter (%)	End of Quarter (%)	Benchmark (%)	Ranges (%)			Relative (%)
Global High Alpha Equity	652,442	709,926	12.4	12.5	10.5	5.5	-	15.5	+2.0
Global Sustainable Equity	565,170	610,460	10.7	10.7	10.5	5.5	-	15.5	+0.2
Paris-Aligned Equity*	1,342,923	1,450,823	25.5	25.4	20.5	12.5	-	28.5	+4.9
Diversified Returns Fund	346,912	357,917	6.6	6.3	6.0	3	-	9	+0.3
Fund of Hedge Funds**	24,174	23,247	0.5	0.4	-	No set range			-
Multi-Asset Credit	316,209	333,224	6.0	5.8	6.0	3	-	9	-0.2
Property	328,138	316,007	6.2	5.5	7.0	No set range			-1.5
Secured Income	546,652	569,156	10.4	10.0	9.0	No set range			+1.0
Core Infrastructure	325,290	230,754	6.2	4.0	4.0	No set range			+0.0
Renewable Infrastructure	175,333	199,456	3.3	3.5	5.0	No set range			-1.5
Private Debt	180,756	197,730	3.4	3.5	4.5	No set range			-1.0
Local / Social Impact	-	0	-	0	3.0	No set range			-3.0
Corporate Bonds	165,443	183,069	3.1	3.2	2.0	No set range			+1.2
LDI & Equity Protection	900,673	1,366,378	17.1	24.0	12.0	No set range			+12.0
*Synthetic Equity Offset**	-728,850	-1,005,747	*-13.8*	-17.6	-	-			-
Other***	127,087	159,474	2.4	2.8	-	0	-	5	-
Total	**5,268,365**	**5,701,894**	**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.
*Paris-Aligned includes synthetic exposure via the BlackRock QIF; Synthetic Equity Offset reflects an offsetting value to account for the difference between the exposure to equity markets and the actual mark to market value of the holding.
**Mandate due to be terminated.
***Valuation includes internal cash, the ETF and currency instruments.

Valuation by Manager

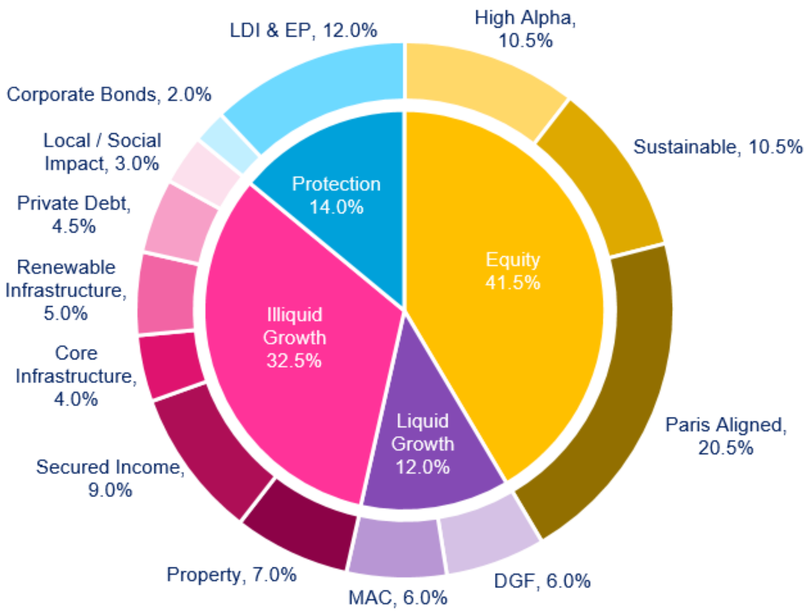
Manager	Asset Class	Start of Quarter (£'000)	Cashflows (£'000)	End of Quarter (£'000)	Start of Quarter (%)	End of Quarter (%)
Brunel	Global High Alpha Equity	617,895		656,096	11.7	11.5
Brunel	Global Sustainable Equity	565,170		610,460	10.7	10.7
Brunel	Passive Global Equity Paris Aligned	614,073	-200,015	445,076	11.7	7.8
BlackRock	MSCI Paris-Aligned (Synthetic)*	728,850	+200,000**	1,005,747	13.8	17.6
Brunel	Diversified Returns Fund	346,912		357,917	6.6	6.3
JP Morgan	Fund of Hedge Funds	24,174		23,247	0.5	0.4
Brunel	Multi-Asset Credit	316,209		333,224	6.0	5.8
Brunel	UK Property	182,581	-42	180,117	3.5	3.2
Schroders	UK Property	12,738		13,263	0.2	0.2
Partners	Overseas Property	132,819		122,626	2.5	2.2
Brunel	Secured Income – Cycle 1	308,645	-4,522	303,032	5.9	5.3
Brunel	Secured Income – Cycle 2	105,805	-2,770	104,171	2.0	1.8
Brunel	Secured Income – Cycle 3	132,202	+32,285	161,953	2.5	2.8
IFM	Core Infrastructure	325,290	-100,000	230,754	6.2	4.0
Brunel	Renewable Infrastructure – Cycle 1	107,496	+1,190	109,393	2.0	1.9
Brunel	Renewable Infrastructure – Cycle 2	60,038	+15,998	77,554	1.1	1.4
Brunel	Renewable Infrastructure – Cycle 3	7,799	+4,710	12,509	0.1	0.2
Brunel	Private Debt – Cycle 2	154,272	+10,585	161,464	2.9	2.8
Brunel	Private Debt – Cycle 3	26,485	+8,442	36,266	0.5	0.6
BlackRock	Corporate Bonds	165,443		183,069	3.1	3.2
BlackRock	LDI & Equity Protection	900,673	+200,000	1,366,378	17.1	24.0
BlackRock	*Synthetic Equity Offset**	-728,850	-200,000**	-1,005,747	-13.8	-17.6
Record	Currency Hedging (incl. collateral)	36,142		74,307	0.7	1.3
BlackRock	ETF	59,927	-40,000	23,222	1.1	0.4
Internal Cash	Cash	64,792	+49,857	115,315	1.2	2.0
Total		**5,268,365**	**-24,611**	**5,701,894**	100.0	100.0

Source: Custodian, Investment Managers, Mercer. Totals may not sum due to rounding.

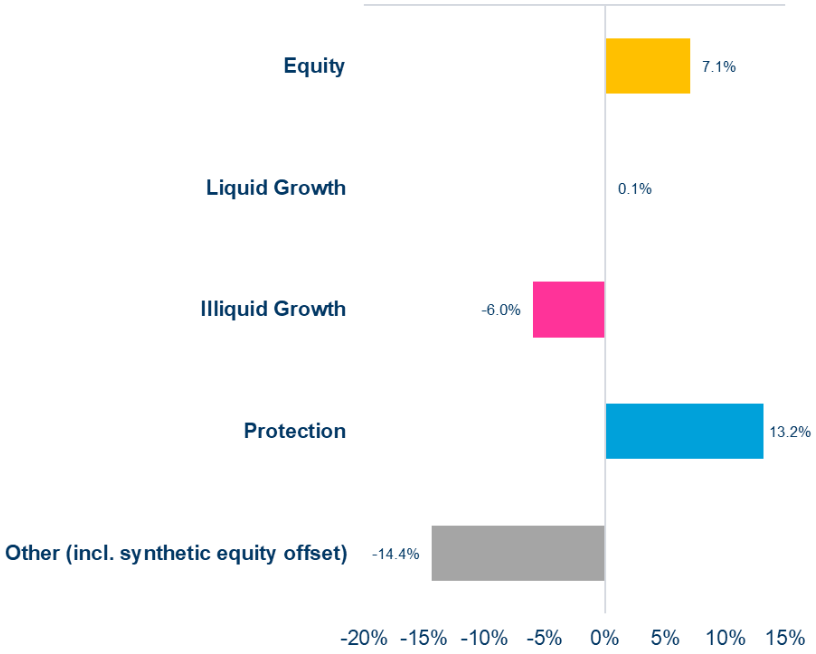
The cashflow column shows only the cash movements within the asset portfolio. It does not include non-investment cash movements such as employer contributions or pension payments made, however these amounts are included in the 'Internal Cash' start and end balance to reflect the asset value position of the total Fund. * MSCI Paris-Aligned synthetic exposure is via the BlackRock QIF; Synthetic Equity Offset reflects an offsetting value to account for the difference between the exposure to equity markets and the actual mark to market value of the holding. ** Cashflow represents change in synthetic exposure.

Positioning relative to target

Strategic Asset Allocation ("SAA")



Relative positioning



Commentary

- The Plan last updated its Strategic Asset Allocation as part of the 2023 Investment Strategy Review.
- The right hand side chart displays the actual relative weights of the key portfolio building blocks compared to the SAA:
  - The overweight to Equity reflects relative outperformance to other parts of the portfolio over the past year.
  - The underweight to Illiquid Growth reflects recent relative underperformance, and the fact that capital is yet to be drawn down to the Local / Social Impact portfolio.
  - The overweight to Protection reflects the collateral boost provided by the synthesising of some of the Equity allocation; meaning that in practice an overweight to this building block is likely to persist and is unlikely to trigger any consideration for action, which would continue to be driven more specifically by collateral adequacy requirements.

Current Topics

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Current Topics

"LGPS: Next Steps on Investment" Consultation: Government Response

"LGPS: Next Steps on Investment" Consultation – Government Response: Key Clarifications and Changes

Asset Pooling

There is no intention to take steps to mandate a move to fewer pools in the immediate term. Desire in the future to move towards a smaller number of pools with directly invested assets >£50bn.

Funds should either pool all assets by 31 March 2025 or provide justification for those assets which remain outside e.g. where it is difficult to do so or where there are value for money grounds.

Passive funds explicitly reference as a type of investment where it might not make financial sense to hold directly within a pool.

The government will set out a preferred model of pooling - characteristics and outcomes focused.

Investment in other pools should be made only through a fund's own pool.

Levelling Up

Requirement for Funds to set a plan to invest up to 5%, but Funds have complete autonomy on whether to invest more or less than the 5% ambition.

Will provide additional clarity as to what constitutes levelling-up in guidance.

Encourage funds to consider investing in projects which support levelling up through their pool.

Recognise that some levelling up investments in local projects may be below the necessary scale to attract pool investment, and so some funds may wish to continue to invest outside the pool.

Private Equity

Setting an ambition to invest 10% in private equity would not mandate investment and the ambition is not restricted to private equity in the UK.

Whilst the 10% ambition relates to private equity allocations, the government recognises the broader opportunities in private markets including, for example, private debt which may also provide good returns for funds whilst contributing capital for companies seeking to grow.

Funds should start preparing now for the new guidance, given ISS's will need to be updated before 31 March 2025

Relevance to the Fund

✔

The outcome of this consultation will have an impact on the Fund.. Further work could be done around mapping the Fund's existing investments to the Levelling Up Missions

"LGPS: Next Steps on Investment" Consultation – Government Response: Mercer View

Despite the government's response acknowledging material opposition from respondents to a large number of the initial proposals, they have largely pressed ahead with the initial proposals unchanged. There have been some welcome changes e.g. in terms of not requiring net returns to be quoted against a consistent benchmark and making levelling-up reporting on a best efforts basis. There have also been some welcome clarifications, such as no intention to move to fewer pools in the immediate term and confirmation the government isn't seeking a "pooling at all costs" approach.

Whilst we acknowledge that there are differing opinions across the LGPS, we expect many Funds will be disappointed that the 31 March 2025 pooling deadline remains. However, we take comfort that this will be on a "comply or explain" basis and that retention of certain assets outside of the pools can be maintained if justified on value for money grounds, or where a pool doesn't provide a suitable solution. We also expect many Funds will be disappointed that the government have retained the ambitions of 5% in levelling-up and 10% in private equity. Importantly, the response is clear that these targets are purely ambitions and that it is entirely up to individual Funds how much (if anything) they invest in either levelling-up and / or private equity, acting in line with their fiduciary duty. It should not be taken as a given that these ambitions will be appropriate for all individual Fund circumstances.

In the context of the government's desired direction of travel, we believe that the government's adoption of the 'comply or explain' approach is balanced and pragmatic. By providing Funds with the opportunity to explain their actions, rather than mandating any one approach, it ensures that the decision making process can remain robust and in the best interests of members and employers.

It is clear that the government has a long-term vision for the LGPS, based on realising economies of scale through consolidation and Funds seeking returns by having a wider role in supporting investment in the UK economy. Whether this is in the best interests of Fund members and employers will be debated for a considerable time. We welcome a continued open dialogue with the government and will continue to monitor developments.

Multi-employer investment strategies

Multi-employer Investment Strategies: Practical Considerations

Can manage investment risk in a targeted way.

Can de-risk while contributions remain affordable for employers.

Can manage an employer through its life-cycle, including to exit.

Specific strategy for exited/exiting employers, where the Fund wants to take lower risk to manage orphaned liabilities.

Increased Operational and administrative complexity.

Likely to obtain higher costs.

Additional governance and monitoring requirements.

Current Topics

2024 – Looking ahead

Mercer's views of structural trends and emerging risks – 5 years and beyond – and their impact

Regime Change

Dispersion and Dislocation
Geopolitical risk remains elevated. Nimble alpha generators should capitalize on dispersion and dislocation.

Efficiency Gains
A more attractive outlook for fixed income implies a greater role in portfolios, but a return to negative equity/bond correlations cannot be assumed.

Super-cycles

Inflation tides
As rate rises bite, and cyclical inflation pressures subside, many structural inflation pressures remain: resources demand; supply chain realignment; the risk of fiscal largesse; "greenflation".

Shifting sands
Extraordinary debt levels are significant again, as power shifts from borrowers to lenders.

Mega-trends

Energy modernisation
Disruption in energy supply has highlighted the need for energy security, and the connection to the energy transition.

The natural (re)order
Awareness of nature loss and its consequences signal regulatory shift but could create opportunities in regenerative and innovative solutions.

Increasing Time Horizon

Relevance to the Fund

✓ The Fund has a well-diversified portfolio, but receives frequent updates on market trends and developments.

The 2024 agenda considerations below will be relevant to the Fund as it will be for the whole LGPS community.

Preparing for the 2025 Actuarial Valuation Cycle

- Understand your current funding position
- Work closely with your Fund Actuary and Investment Consultant to understand strategic implications on contribution requirements in order to strike a balance
- Manage the employer dialogue and policy development well in advance of the 2025 valuations
- Cashflow and liquidity will be key given contribution requirements could be lower and benefits higher (as a result of high inflation)

2024 looks to be another busy year for the LGPS

- LGPS regulation due to be updated to incorporate 'Next Steps' proposals
- 'TCFD' Reporting requirements confirmed?
- c.7% uplift in member benefit payments
- Preparing for 2025 Actuarial Valuation cycle
- Sustainability leaders adopting TNFD framework

Cashflow considerations

Actions to take

Cashflow modelling
Engage with your Actuary to understand future benefit outgo. Economic scenario analysis can assist in understanding impacts of higher than expected inflation on these.
Engage with private markets managers for expectations on drawdowns and distributions. Noting these are likely to be lumpy.

Investigate sources of income
Engage with investment managers and your pool to establish likely levels of distributions and frequency of these.
For ongoing cashflow needs to meet member benefits liquid assets with strong levels of income might be best sources.

Private Markets
Consider use of liquid proxies or establish a liquidity waterfall to ensure all drawdowns can be met.
Prudent action, even if estimated, to be Cashflow neutral given lumpy nature of private market calls and distributions

Investment Strategy
Ensure Cashflow considerations are integrated into investment strategy discussions.
Stronger funding levels could present opportunities to increase assets which provide strong levels of income.

Relevance to the Fund

✓ The Fund conducts cashflow / liquidity analysis on a broadly triennial basis. It could be appropriate to make this more frequent; on closer to an annual basis.

Appendix

Q4 2023 Equity Market Review

Global equities were positive, supported by expectations that interest rate cuts may be approaching and expectations of a global soft landing. Within equities, developed markets outperformed emerging markets. Technology stocks continued their strong run and the so-called "magnificent seven" increased 7.7% in sterling terms.

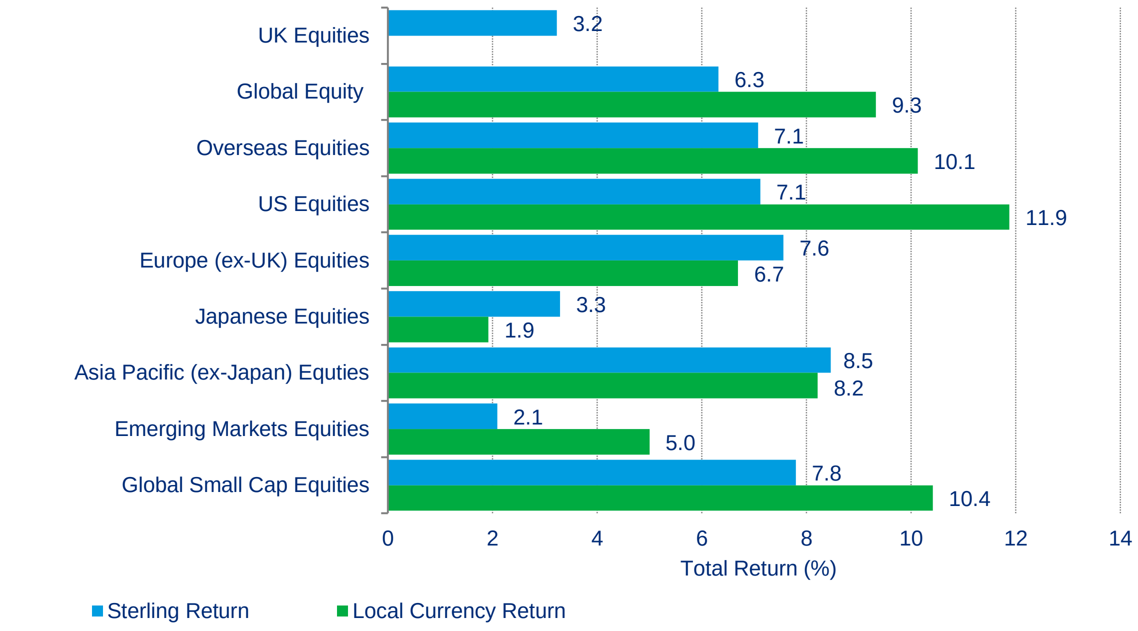
Global equities returned 6.3% in sterling terms and 9.3% in in local currency terms as sterling appreciated against the dollar.

US equities returned 11.9% in local currency terms, whilst European (ex-UK) equities returns 6.7%, and Japanese equities returned 1.9%.

Emerging markets ('EM') equities returned 5.0% in local terms.

Global small cap stocks returned 10.4% in local terms. Small-cap equities were positive as cyclical assets outperformed during the quarter on expectations that a sharp recession may have been averted.

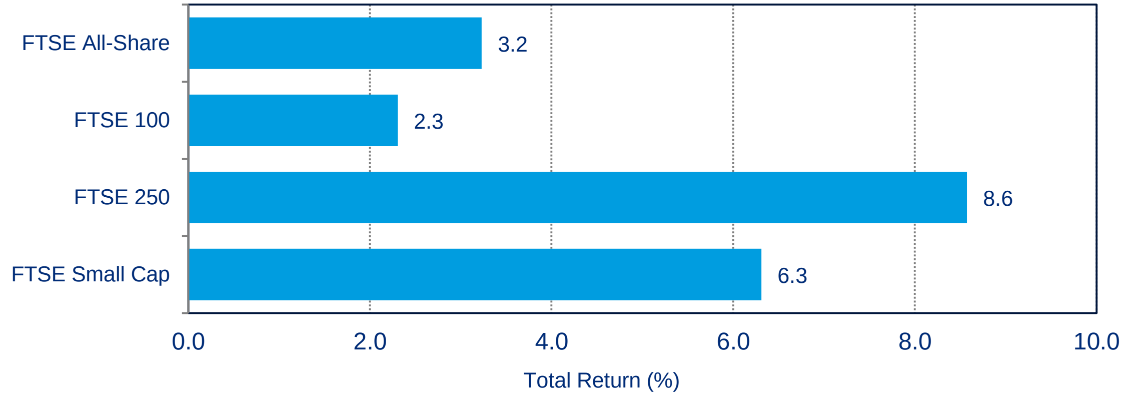
Equity Performance



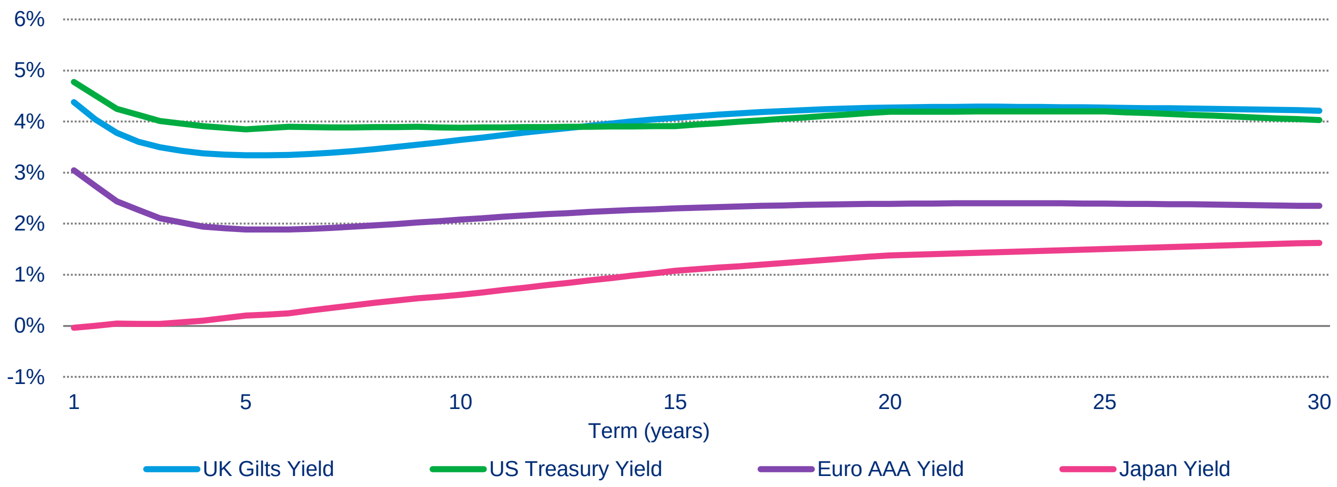
The **FTSE All Share** index returned 3.2% over the quarter with the large cap **FTSE 100** index returning 2.3%. More domestically focused equities (**FTSE 250**) produced positive returns. The **small cap** index produced a positive 6.3% return.

Strong performance in Financials and Consumer Goods sectors supported the UK performance relative to global equities.

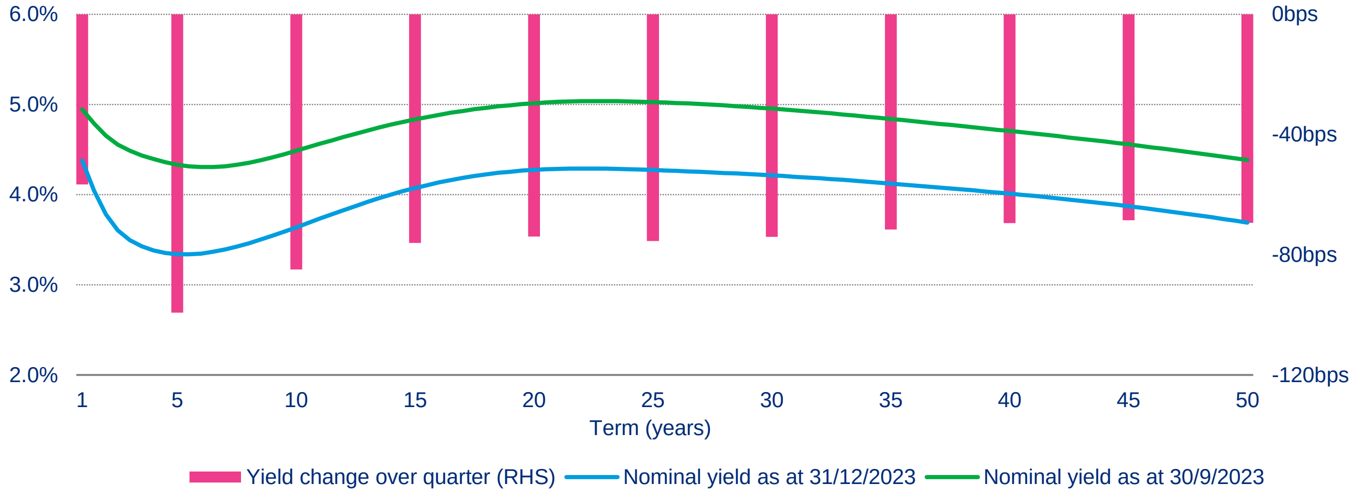
FTSE Performance by Market Cap



Q4 2023 Bond Market Review



Source: Mercer and Bloomberg



Source: Mercer

Government Bond Yields

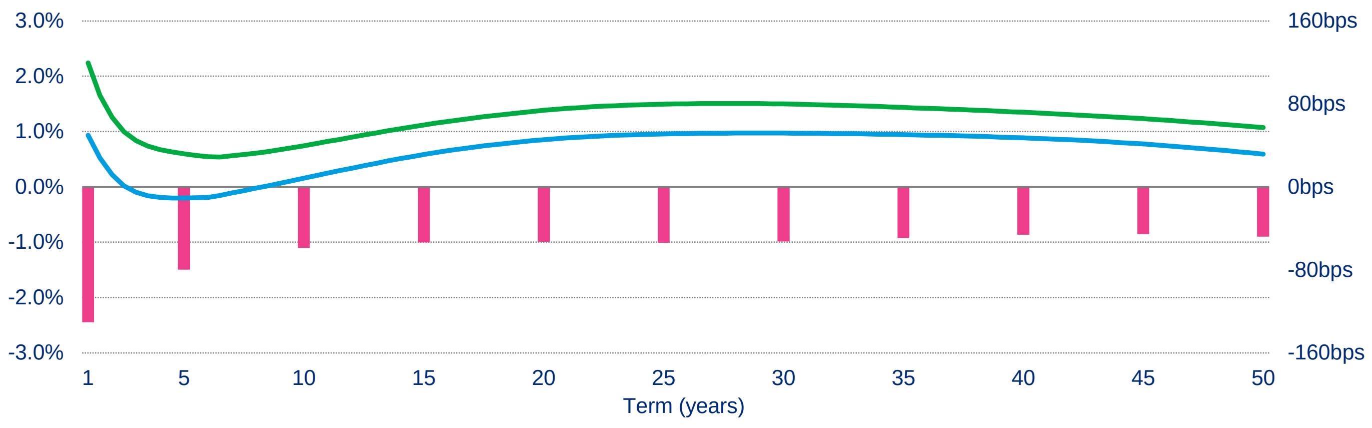
10-year global government bond yields fell sharply over the quarter. The rally in bonds was driven by lower-than-expected inflation numbers and dovish comments from central banks, particularly the Federal Reserve.

In the UK and US, 2-year yields fell by 0.9% and 0.8% respectively. 10-year yields also fell in the UK and US by 0.9% and 0.7% respectively.

The downward movement in yields was observed across the entire yield curve, with yield curves moving in a parallel downward direction. However, yield curves remain inverted in most developed markets.

The German 10-year yield fell by 0.81%; as the European Central Bank (ECB) was considerably less dovish than the Fed but bond markets still moved to price in a significant amount of rate cuts in 2024.

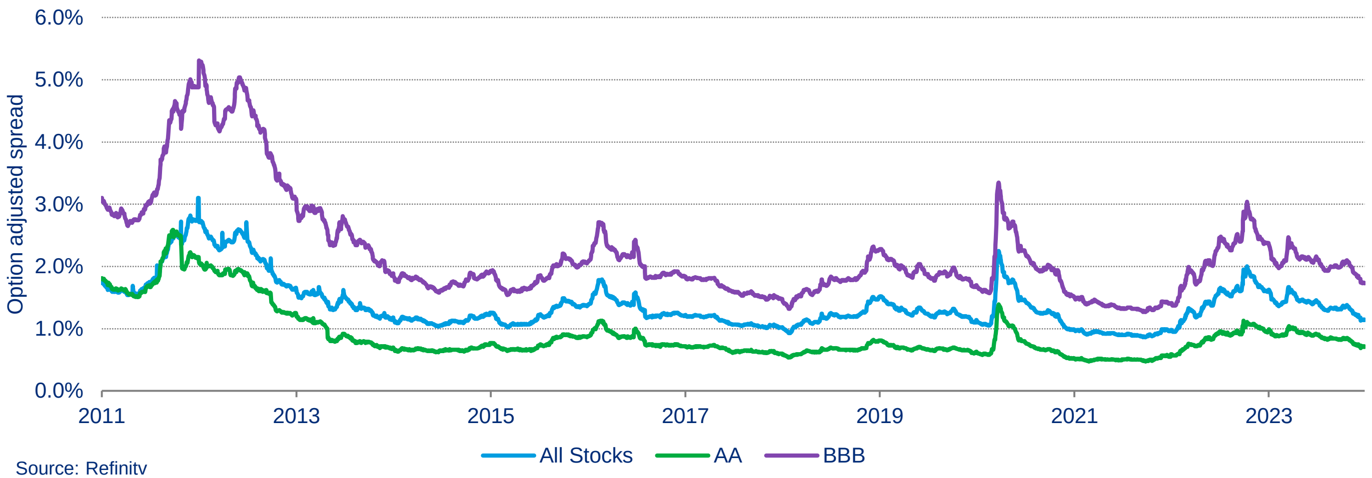
Q4 2023 Bond Market Review



Source: Mercer

UK Index-Linked Gilt Yields

UK real yields fell across the entire curve, led by lower-than-expected inflation prints which drove more rate cuts to be priced in at the front end of the curve. UK inflation remains considerably above target. Market based measures of inflation expectations, in the form of breakeven inflation, fell significantly over the quarter. The UK 10-year breakeven rate finished the quarter at ~3.48% (c.35bps over the quarter).



Source: Refinitv

Corporate bonds

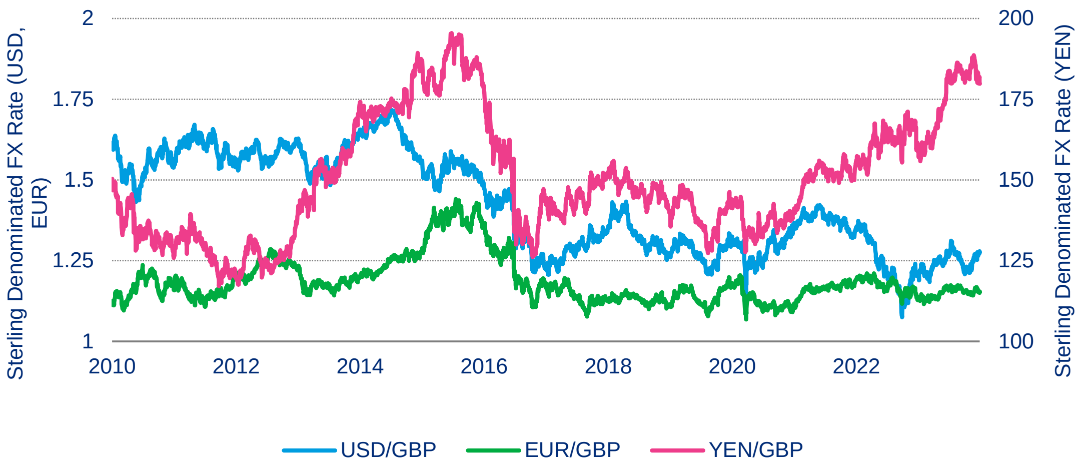
Spreads on UK investment grade credit tightened over the quarter, with spreads on lower rated credit tightening more than for higher rated credit.

Q4 2023 Currency Market Review

Sterling's performance over the quarter was strong against the dollar mainly driven by a weak dollar following a flurry of macro headlines over the quarter. This sent the U.S. dollar to its lowest level in five months versus sterling. While against the EUR, sterling remains stable, but it continued its falling streak against the Yen.

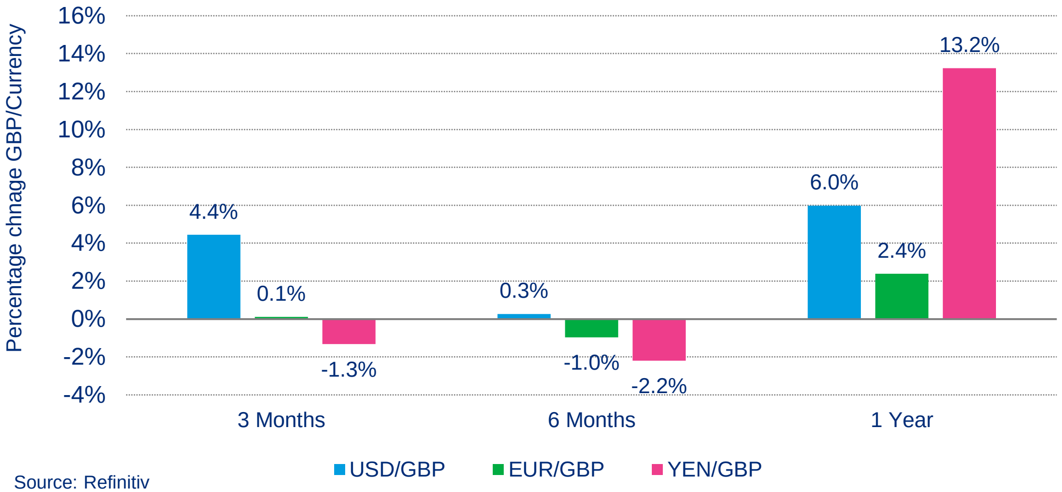
On a 12-months basis, sterling has appreciated considerably versus U.S. dollar and yen but marginally versus euro.

Sterling Denominated FX Rate



Source: Refinitiv

Change in sterling against foreign currencies



Source: Refinitiv

Q4 2023 Property

UK property as measured by the MSCI Index decreased by 1.2% over the fourth quarter of 2023.

Dynamic Asset Allocation (DAA)

Dashboard, Positioning & Outlook for UK constrained Portfolio

UK Economic Outlook

UK equities lagged behind global equities (GBP terms) in the final quarter of 2023. Global equities were boosted by expectations of looser central bank policy and the related decline in bond yields. Soft landing hopes rose, while the US tech giants performed well. Given the UK's low-tech exposure the index underperformed relative to global equities. UK 10-year nominal bond yields fell sharply over the quarter, declining 0.9% to 3.5%. However, looking simply at the total quarter decline masks much of the volatility witnessed during the quarter, as over 0.6% of the total decline happened in December alone. UK yields fell, broadly in line with a rally in global bond markets which was driven by softer inflation and the Fed discussing rate cuts. Two-year yields moved in a similar fashion which led to the curve moving parallel downwards. In terms of currencies, Sterling weakened versus most major currencies over the quarter with the exception of the US dollar, which sold off. Similar to a quarter ago, the UK economy is doing just about enough to maintain economic activity marginally in positive territory, despite tight fiscal and monetary policy**.**

Dynamic Asset Allocation (DAA) Positioning

Equities	In terms of UK equities, valuations are attractive, however, we think they are attractive for a good reason and given the mixed outlook for the UK economy we prefer to take risk elsewhere in the equity universe. We remain overweight emerging market (EM) equities versus Developed Market (DM) equities. EM economic growth is expected to be better than DM in 2024, driven by a recovery in China and decent growth across most other parts of EM. We are neutral on small cap equities, given the current position in the business cycle the global economy currently sits, where small cap equities may be vulnerable if there was any material change in the current economic narrative.
Growth Fixed Income	We hold a favourable view on Emerging Market Debt (EMD) Local Currency (LC). EMD LC is attractive because first we expect local yields to decline as central banks cut interest rates and second we expect EM currencies to strengthen versus the US dollar as EM currencies are cheap in general and we expect the US dollar to decline. We expect this trend will continue and broaden in 2024 as EM inflation declines further. We retain a moderately negative view on global high yield, especially when compared with other growth fixed income assets.
Defensive Fixed Income	We held a favourable overweight view on gilts in Q4 because we thought the sell-off was overdone and that inflation would fall and ultimately return to target. Following the rally at the end of last year we have reduced that view and the overweight gilt view is now much smaller. We prefer nominal bonds relative to real bond yields, expecting so-called break-even inflation rates to narrow.

Constrained	
Equities	**2%**
DM ex-UK	-1%
UK	0%
EM	3%
Small Cap	0%
Growth Fixed	**0%**
EM Debt (LC)	2%
Global HY	-2%
Defensive Fixed	**-2%**
Nominal Gov ex-UK	-2%
UK Gilts	*2%*
Real Gov ex-UK	0%
UK Index-Linked Gilts	*-2%*
IG Credit ex-UK	0%
UK IG Credit	*0%*

Source: Mercer. For illustrative purposes only. As at January 2024.
A constrained portfolio is one that is limited to core asset classes and cannot go underweight cash. Tracking error is the relative risk of the DAA positions. All assets are unhedged.

Global Property Market Outlook

- The next couple of quarters are likely to remain challenged with negative data points (whether these show lagged data or not). However, as 2024 dawns upon us, it becomes crucial to recognize that the best opportunities are to be had in the early days of market stabilization – when prices are attractive, but sellers still outnumber buyers.
- Entering 2024, the global economy appears to be on course for a "soft landing", supporting the strong occupational fundamentals in most real estate sectors and markets. It is important to recognise that positive rental growth and inflation-driven NOI growth softens the impact from outward yield shift and higher debt costs.
- Together with relatively low Net Asset Values, the period ahead could finally present the opportunity for investors, seeking to gain or increase exposure to income-producing real estate, to enter the strongest core/core-plus funds. With subscription queues having reduced across even the strongest of these funds, new capital may be drawn in a matter of months.
- For those clients with a higher risk appetite, the opportunity to achieve outsized returns from market dislocations also remains. Managers of value-add and opportunistic funds are seeing attractive repricing opportunities materialise and investors can best take advantage by committing capital to funds able to deploy in the near-term.
- As traditional banks retrench, re-financings mature and the funding gap grows, we also see the opportunity for alternative lenders to deploy capital and generate equity-like returns while occupying a sheltered position in the capital stack.
- Finally, over the longer term, real estate can provide asynchronized returns from liquid investments or other private market asset classes due to the asset class's inflation-linked qualities and ability to tap into different economic sectors. This remains a fundamental reason to include the asset class in a diversified portfolio.

	EUROPE		
Equity	Core/ Core+	Value Add	Oppor-tunistic
Themes	CPI Linkage	ESG refurbs	Niche sectors
	UK repriced assets	Secondary locations	Aggregation
	CBD-style offices	High leverage	Spec Development

Attractive value: With substantially higher interest rates and less bank financing available, real estate debt strategies show highly attractive risk-adjusted returns. Equity investors can also tap into this theme by backing certain opportunistic managers. Strong capital value growth prospects remain for several undersupplied niche sectors across markets.

Worst value: We think that real estate markets will see more repricing in the first half of 2024. We have maintained the US Core/Core+ segment as "less attractive" for now as this market works through this process of repricing. While capital value corrections are also still likely in the other regions, the worst looks to be behind us in the UK and parts of Europe, while markets in Asia Pacific are more boosted by growth and should see more shallow declines.

Disclaimer: For illustration purposes only. The above 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 do not imply advice to liquidate existing investments.

Further guidance is available in Mercer's *Global Market Summary: Quarterly Real Estate Report, January 2024*

Very attractive	Attractive	Neutral	Less Attractive	Unattractive	Not applicable

Summary of Mandates

Manager	Mandate	Benchmark/Target	Outperformance Target (p.a.)	Inception Date
BlackRock	Passive Paris-Aligned Equity (Synthetic Exposure)	MSCI Paris-Aligned Benchmark	-	May 2023
Brunel	Global High Alpha Equity	MSCI World	+2-3%	November 2019
Brunel	Global Sustainable Equity	MSCI AC World	+2%	September 2020
Brunel	Passive Global Equity Paris Aligned	FTSE Developed World PAB Index	-	October 2021
Brunel	Diversified Returns Fund	SONIA +3-5% p.a.	-	July 2020
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 (Cycles 1-3)	CPI	+2%	January 2019
IFM	Core Infrastructure	SONIA +5% p.a.	-	April 2016
Brunel	Renewable Infrastructure (Cycles 1-3)*	CPI	+4%	January 2019
Brunel	Private Debt (Cycles 2-3)	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	-	-	-

* The primary performance objective of this mandate is a Net IRR of 8% p.a. (GBP). Its inflation-plus benchmark is used by the custodian due to a greater ability to incorporate and the objective has value over the relative short-term, however, over time, comparison against the IRR objective will become more relevant.

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 Emerging
Global Small Cap Equity	MSCI World Small Cap
Hedge Funds	HFRX Global Hedge Fund
High Yield Bonds	ICE BofAML Global High Yield
Emerging Market Debt	JP Morgan GBI EM Diversified Composite
Property	MSCI UK Monthly Total Return: All Property
Commodities	S&P GSCI
Over 15 Year Gilts	FTA UK Gilts 15+ year
Sterling Non Gilts	ICE BofAML Sterling Non Gilts
Over 5 Year Index-Linked Gilts	FTA UK Index Linked Gilts 5+ year
Global Bonds	ICE BofAML Global Broad Market
Global Credit	Bloomberg Capital Global Credit
Eurozone Government Bonds	ICE BofAML EMU Direct Government
Cash	SONIA

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