Mercer

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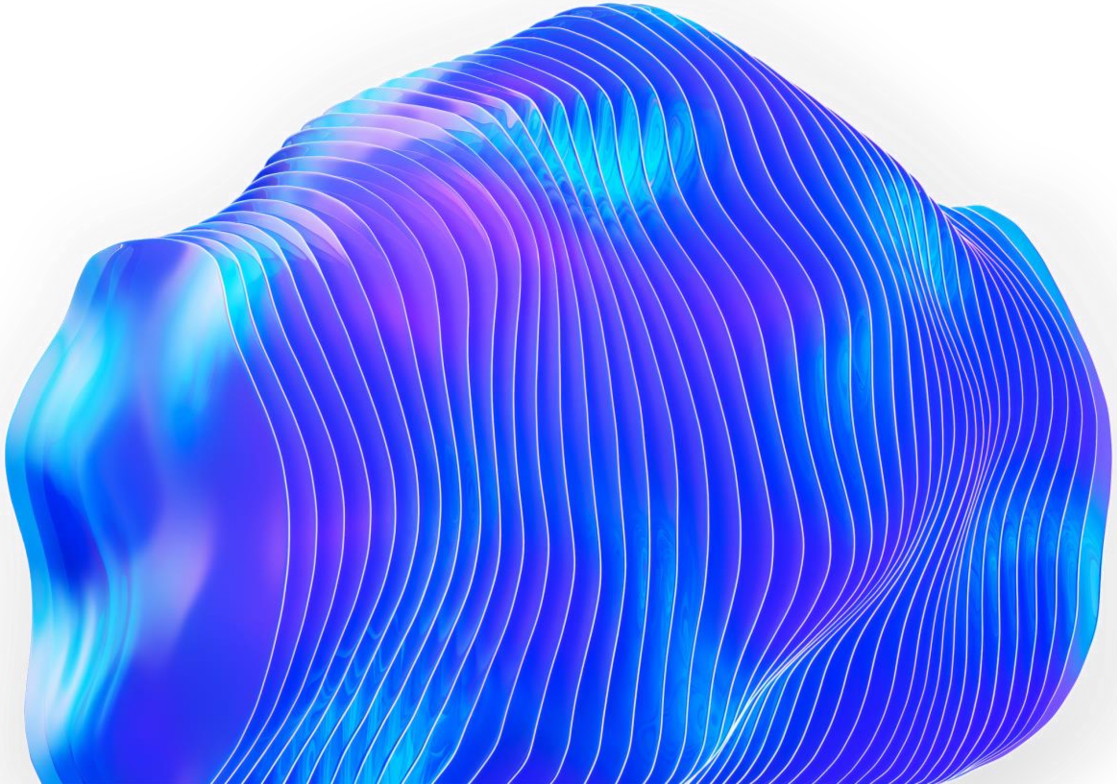
# Avon Pension Fund

## Panel Investment Report Quarter to 31 March 2024



May 2024

Steve Turner

A business of Marsh McLennan

# Contents



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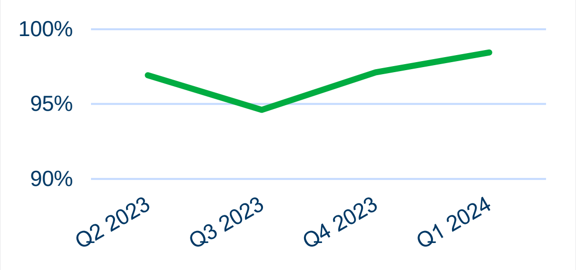
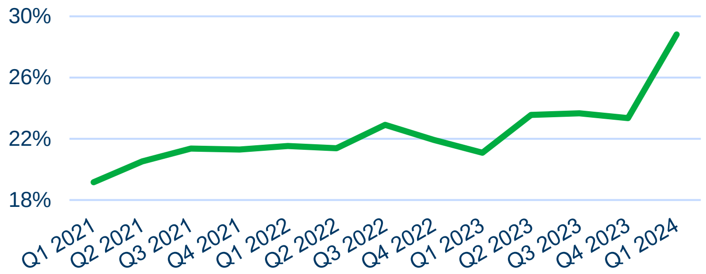
# Executive Summary

1

# Executive Summary

| | |
|---|---|
| Market background | • The first quarter of 2024 was characterised by a repricing of interest rate expectations, especially for developed markets central banks. The timing of potential rate cuts by the US Federal Reserve, ECB and BOE were pushed back to the second half of 2024.<br>• Despite rising bond yields, equity markets continued to rally driven by AI enthusiasm, strong corporate earnings and resilient earnings.<br>• Headline inflation in the UK fell to 3.4% in February from 4% in December. Base effects played a significant part in inflation declining, however, food and energy costs are also declining sharply. The Bank of England maintained interest rates at 5.25%. |
| Mercer market views | • Our medium term outlook favours growth fixed income and nominal UK government bonds, with a slight overweight to equities (Emerging Market and Japanese equities).<br>• A global economy landing softly, falling inflation and wage growth, resilient consumer and business balance sheets and the ongoing potential for artificial intelligence (AI) should support equity prices in the near term. However, we are conscious that equity valuations are rich and have rallied a lot in recent months. |
| Funding level and risk | • The funding level is estimated to have increased over the quarter to c. 98% as the value of the assets rose by more than the estimated present value of the liabilities.<br>• The funding level is estimated to be c. 4% higher over the year to 31 March 2024 (as illustrated to the right).<br>• This is despite a move to a lower actuarial discount rate basis (of CPI +2.5%) during the period, which is reflected in the figures from 31 December 2023, and all else equal served to increase the value placed on the liabilities.<br>• The Value-at-Risk increased over the quarter to £1,701m, and to 29% as a percentage of liabilities.<br>• Levels have gradually increased since 2020 due to market movements and changes in forward-looking assumptions. For Q1 2024 in particular, VaR has also increased due to the reduction in the coverage of the equity protection strategy (as expected). |



# Executive Summary

**Performance**

- The positive return of Fund assets over the quarter was driven by the Equity portfolios. The Multi-Asset strategies also fared well.
- The Equity Protection Strategy detracted as expected given underlying market returns, although the impact was partly mitigated by the reduction in the coverage during the quarter. Performance of the Illiquid Growth portfolio was mixed.

- Underperformance relative to the strategic benchmark over the one year period was in particular due to the active equity funds underperforming and detraction to returns from the Equity Protection strategy as underlying equity returns were positive. Elsewhere underlying relative performance was mixed.
- The main drivers of underperformance over three years was the active equity mandates, the Equity Protection, Overseas Property and Secured Income.

| | 3 Months (%) | 1 Year (%) | 3 Years (% p.a.) |
|---|---|---|---|
| Total Fund **(1)** | 2.3 | 7.8 | 3.2 |
| Strategic Benchmark **(2)** (ex currency hedge) | 2.4 | 9.8 | 7.1 |
| Relative **(1 - 2)** | **-0.0** | **-2.0** | **-3.9** |

- The Currency Hedge had no overall impact on returns over the quarter. It added to returns over the one year period due to the relative strengthening of Sterling, but conversely detracted over three years.

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

**Asset allocation and strategy**

- A net amount of c. £81m was drawn down to private market portfolios during the quarter, which includes the funding of c. £35m of the £50m commitment to Schroders Greencoat Wessex Gardens; the first mandate to be implemented for the Local / Social Impact portfolio.
- A c. £50m disinvestment from the Brunel Paris Aligned Equity fund during the period helped to fund these draw downs.

**Liability hedging mandate**

- BlackRock was in compliance with the investment guidelines over the quarter.
- The interest rate and inflation trigger framework was revised and reinstated in October 2023.
- Following the reinstatement of the framework, several interest rate triggers were hit leading BlackRock to trade up to the target (39% as a % of assets) aggregate interest rate hedge ratio. The inflation hedge ratio was c. 22% as a % of assets at the same date. The trigger framework was subsequently paused whilst a wider review of the Fund's liquidity framework is undertaken.

**Collateral position**

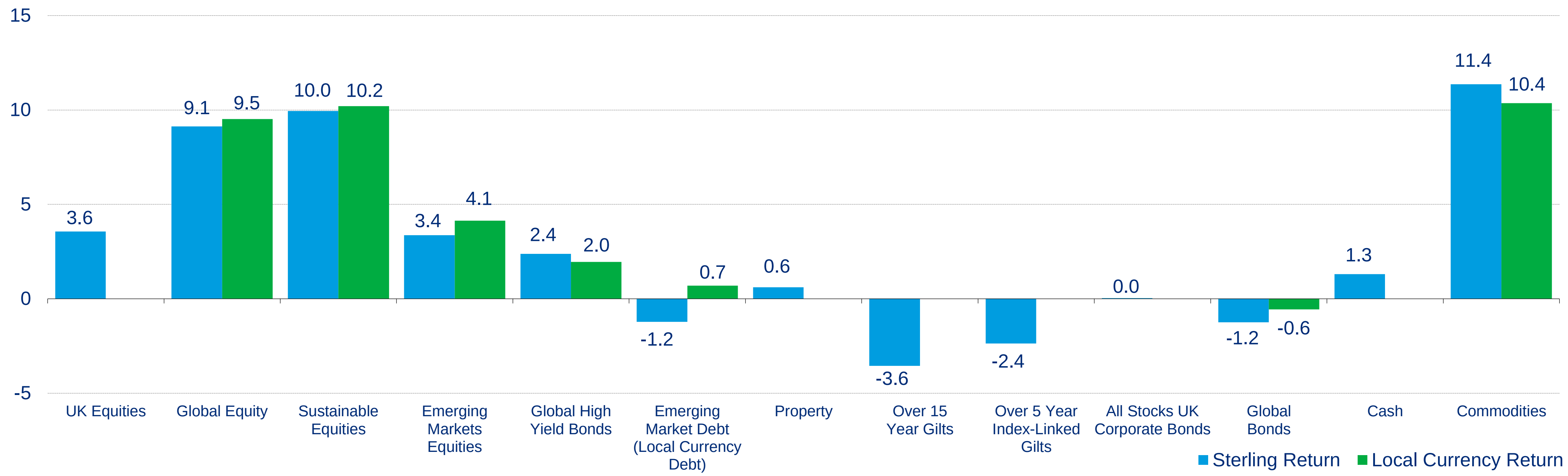
- Following the reduction in the equity protection coverage ratio in March, the Fund has adopted an updated collateral monitoring framework reflecting the significant change in exposures within the risk management portfolio.
- Inclusive of assets within the collateral waterfall and the updated collateral monitoring framework, there was a total interest rate buffer of 7.1% as at 31 March 2024.

# Market Background

2

# Market Background

## Return over 3 months to 31 March 2024 (%)

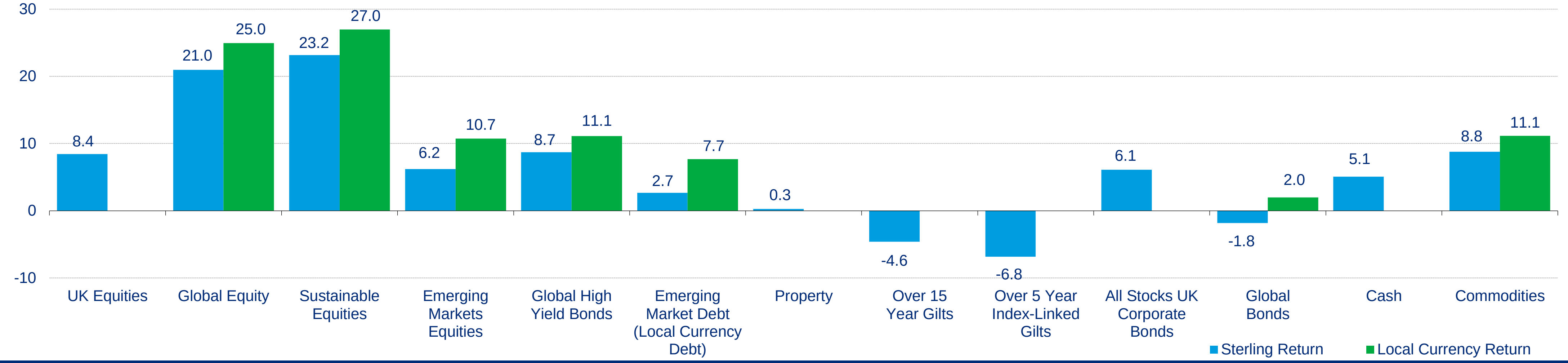



The first quarter of 2024 was characterised by a repricing of interest rate expectations, especially for developed market (DM) central banks. The timing of potential rate cuts by the US Federal Reserve, ECB and BOE were pushed back to the second half of 2024 as growth and inflation data surprised to the upside.

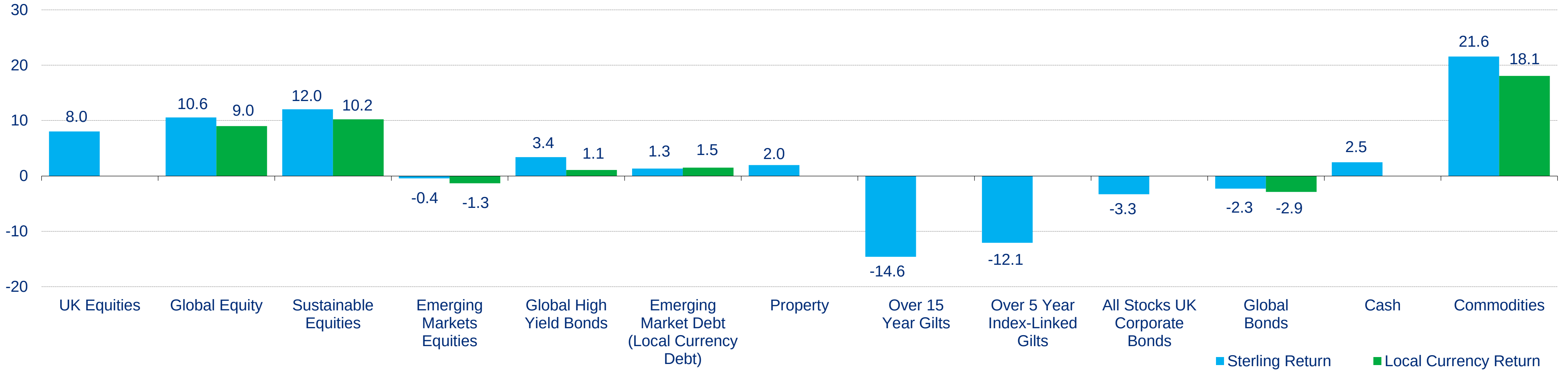
Despite rising bond yields, equity markets continued to rally driven by AI enthusiasm, strong corporate earnings and resilient earnings activity. Japanese equities outperformed its peers on the back of solid earnings growth and a weaker yen. Emerging Market equities were held back by weakness in China, although Chinese equities did rally in the second half of the quarter.

# Market Background – 1 & 3 Years

## Return over 12 months to 31 March 2024 (%)




## Return over 3 years to 31 March 2024 (% p.a.)

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Source: Refinitiv

# Funding Level and Risk

# 3

# Funding Level and Deficit

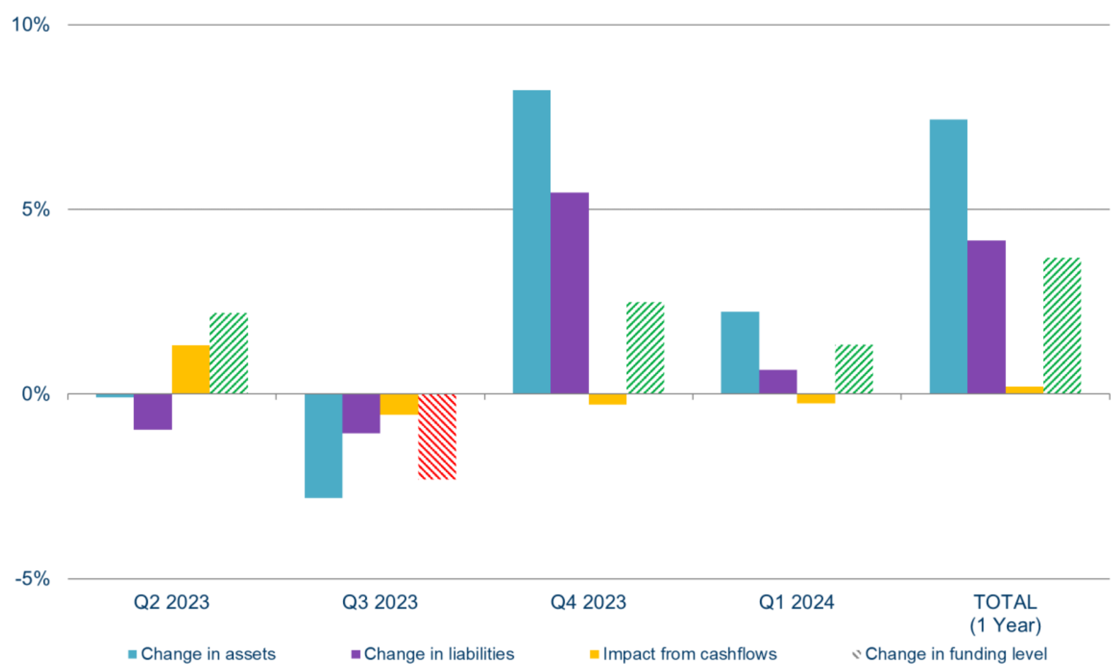
The Fund's assets returned 2.3% over the quarter, whilst the liabilities are estimated to have increased by c. 0.6%.

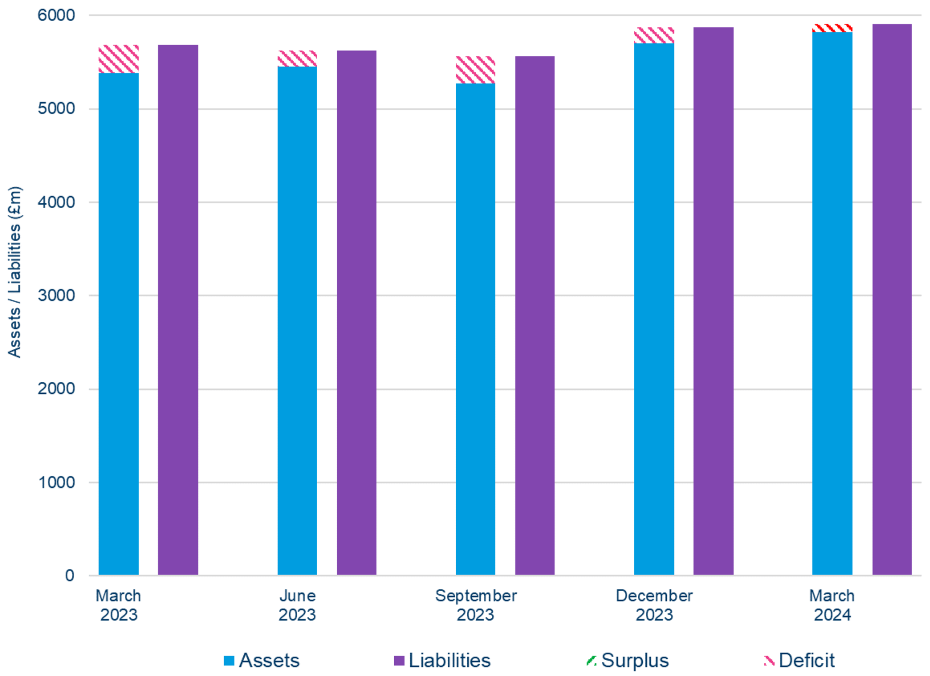
The combined effect of this saw the estimated funding level increase to c. 98%.

The funding level is estimated to be c. 4% higher over the year to 31 March 2024.

***The rise in the estimated value of the liabilities shown for Q4 2023 includes the impact of a move to a lower actuarial discount rate basis of CPI + 2.5% (from CPI + 2.8%), which is reflected from 31 December 2023 onwards.***

The deficit was estimated to have narrowed over Q1 from c.£170m to c.£92m.




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 95$^{th}$ 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 31 March 2024, if a 1-in-20 ‘downside event’ occurred over the next three years, the funding position could deteriorate by at least an additional **£1.7bn**.
- 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 £332m over the quarter**, due to the rise in the absolute value of the assets, an increase in underlying volatility assumptions and the reduced coverage of the equity protection strategy.
- As a percentage of liabilities, VaR increased to from 23% to 29%.

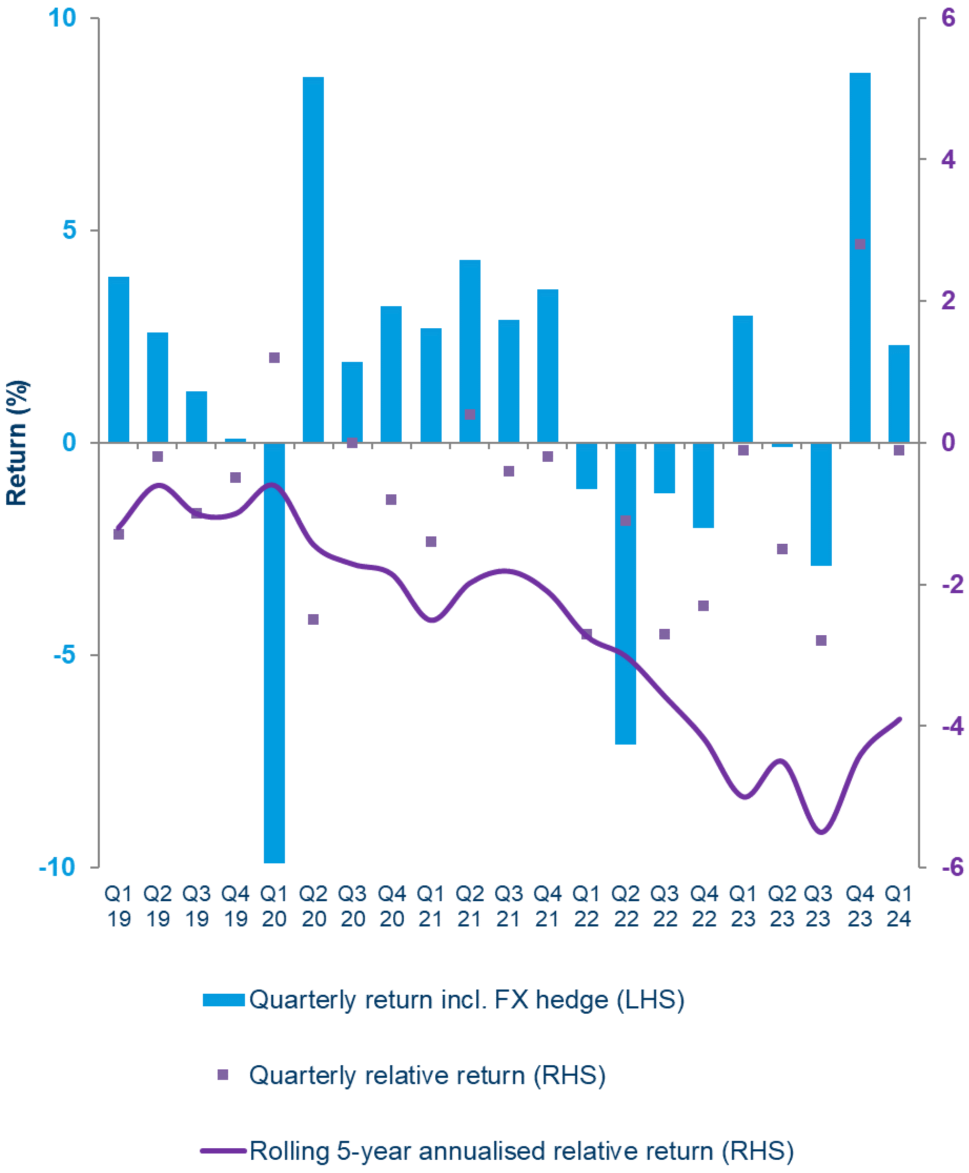


VaR figures shown are based on approximate liability data rather than actual Fund cashflows, and are based on the strategic asset allocation at the time.
They are therefore illustrative only and should not be used as a basis for taking any strategic decisions.
Both are using cashflows from the 2022 valuation.

# Performance Summary

# 4

# Total Fund Performance



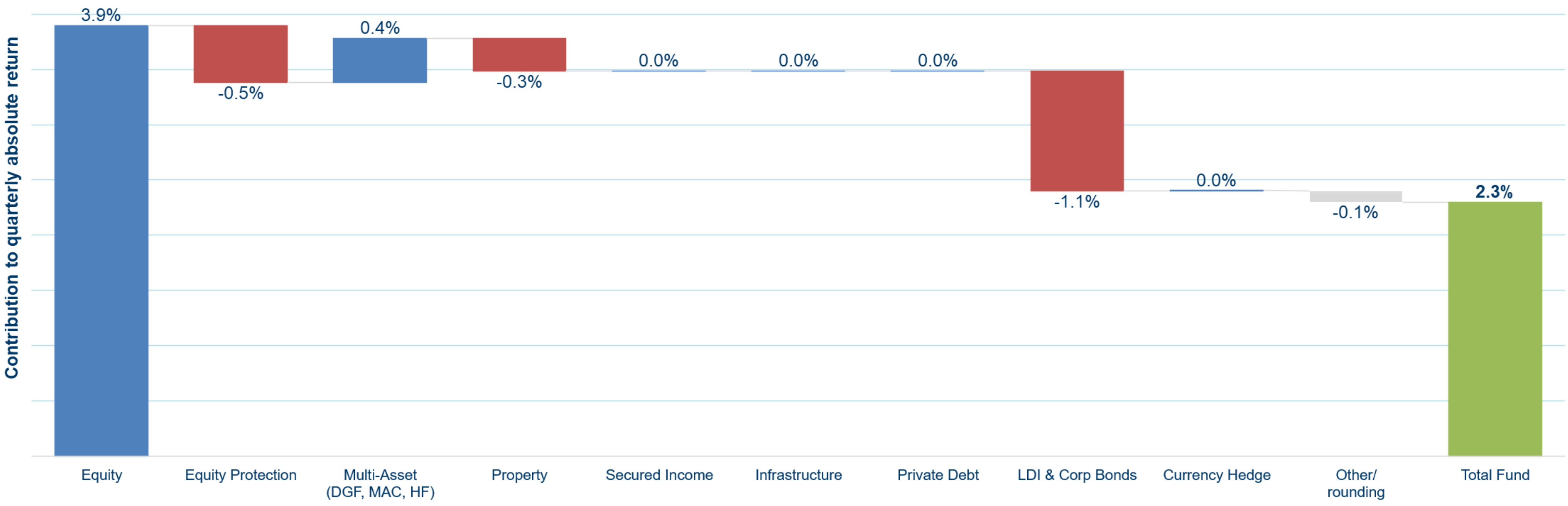

| | 3 Months (%) | 1 Year (%) | 3 Years (% p.a.) |
|---|---|---|---|
| Total Fund **(1)** | 2.3 | 7.8 | 3.2 |
| Total Fund (ex currency hedge) | 2.3 | 7.1 | 3.6 |
| Strategic Benchmark **(2)** (ex currency hedge) | 2.4 | 9.8 | 7.1 |
| **Relative (1 - 2)** | **-0.0** | **-2.0** | **-3.9** |

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 mainly driven by Equity assets. The Multi-Asset strategies also fared well.
- Relative performance was broadly neutral over the quarter, as the active equity mandates generally performed in line with their benchmarks, whilst the outcomes for the Liquid and Illiquid Growth assets were mixed.
- Underperformance relative to the strategic benchmark over the one year period was in particular due to the active equity underperforming and detraction to returns from the Equity Protection strategy as underlying equity returns were positive. Elsewhere underlying relative performance was mixed.
- The main drivers of underperformance over three years were the active equity mandates, Equity Protection, Overseas Property and Secured Income.
- The Currency Hedge had no overall impact on returns over the quarter. It added to returns over the one year period due to the relative strengthening of Sterling, but conversely detracted over three years.

# Total Fund Performance Attribution – Quarter

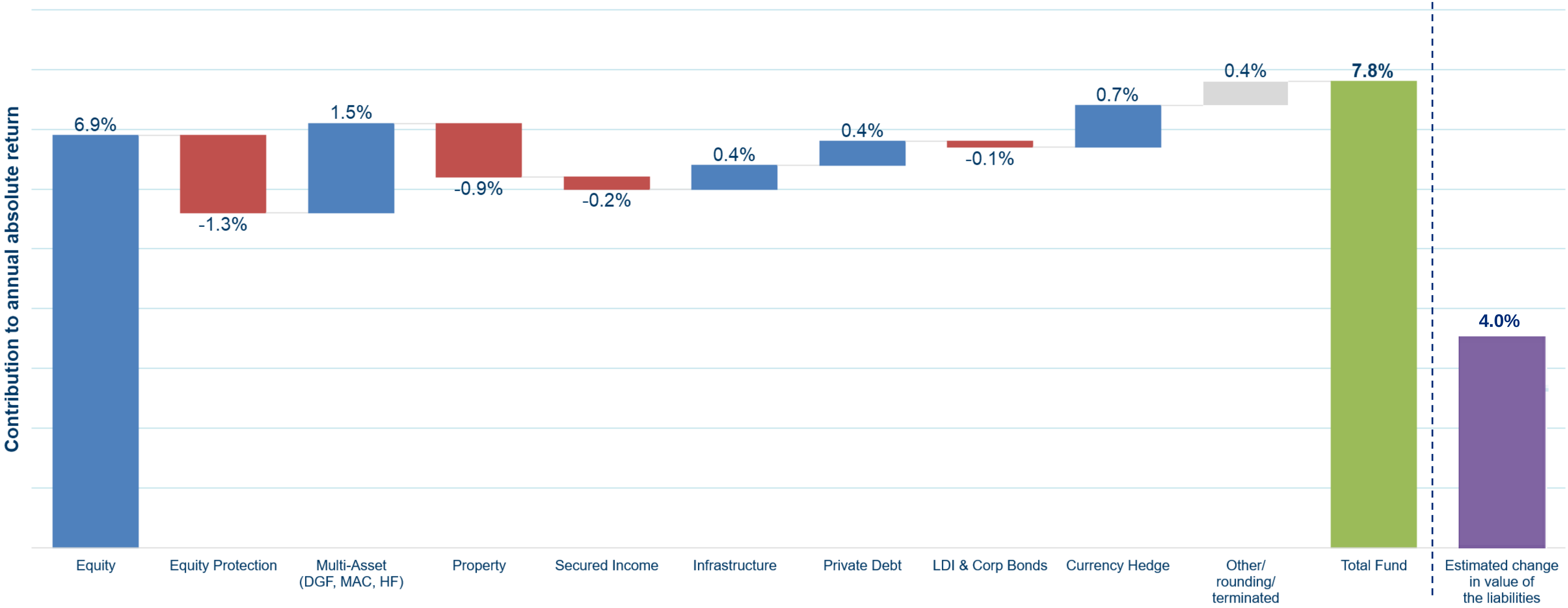



Source: Custodian and Mercer estimates
‘Other’ contributions to the total can include the relatively small holdings in the ETF, cash, the impact of cashflows and terminated mandates, as well as rounding.

The strong returns on Fund assets over the quarter were driven by the Equity portfolio. Multi-Asset portfolios also contributed, whilst the Alternatives did not have much impact.

The Equity Protection Strategy slightly detracted as expected given underlying positive returns from equity markets, although the impact was partly mitigated by the reduction of the coverage from 100% to 50% of the equity portfolio during the quarter.

# 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 one year period, with Equity Protection slightly offsetting this as expected.

Multi-Asset, Infrastructure and Private Debt were also positive, whilst Property and Secured Income were negative.

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

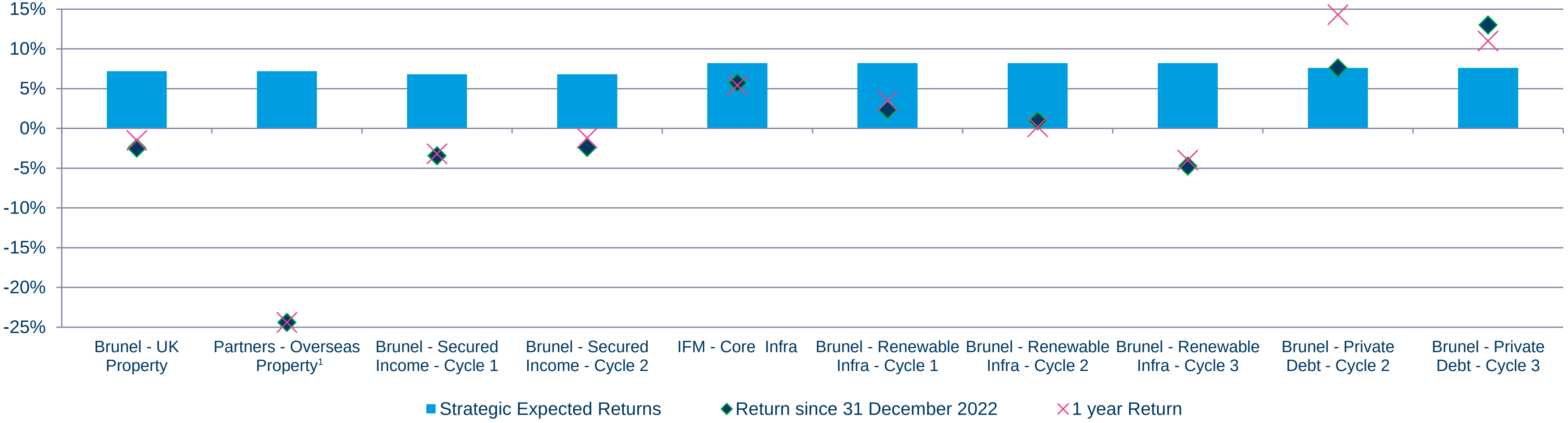
# Performance vs. Expected Strategic Returns

| *Growth Asset* | Brunel<br>Global High Alpha | Brunel<br>Global Sustainable | Brunel / BlackRock<br>Passive Global PAB | Brunel<br>Diversified Returns | Brunel<br>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. 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.<br><br>BlackRock synthetic PAB (MSCI index) returns above expectations since May 2023; when exposure was put in place. | Returns above expectations since December 2022, thanks to the absolute returns seen in the past three quarters.<br>Strong Q1 2024 returns were driven by equity exposure, which had been added to over the prior six months. | 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 March 2024, 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** | 3.5% | 3.5% | 9.0% | 4.0% | 5.0% | 4.5% |
| **Commentary** | Returns below expectations since December 2022 due to the challenges continuing to be seen in Property markets. | | | Returns slightly below expectations since December 2022. Returns prior to this date, since the mandate's inception, are noticeably stronger. | 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 for cycles 1 and 2 are stronger over their since inception periods. | Returns in line with expectations for cycle 2, and above expectations for cycle 2, since December 2022. Mandates are still in the drawdown phase; the first drawdowns were in September 2021 and December 2022 respectively. |




**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 March 2024, 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.
[1] Returns are shown up to 31 December 2023, as this is the latest data available.

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# Mandate Performance to 31 March 2024

| 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 | 9.9 | 10.0 | -0.1 | 20.5 | 23.1 | -2.1 | 9.6 | 12.4 | -2.5 | +2-3 | Target not met |
| Brunel Global Sustainable Equity | 9.2 | 9.3 | -0.1 | 13.2 | 21.2 | -6.6 | 6.6 | 10.7 | -3.7 | +2 | Target not met |
| Brunel Passive Global Equity Paris-Aligned | 7.6 | 7.6 | 0.0 | 21.3 | 21.3 | 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 | 4.3 | 2.0 | +2.3 | 10.9 | 8.1 | +2.6 | 4.9 | 5.5 | -0.6 | - | Target not met |
| Brunel Multi-Asset Credit | 2.2 | 2.3 | -0.1 | 11.8 | 9.2 | +2.4 | N/A | N/A | N/A | - | N/A |
| Brunel UK Property | -1.1 | 0.4 | -1.5 | -1.5 | -1.0 | -0.5 | 2.1 | 0.8 | +1.3 | - | Target met |
| Partners Overseas Property* | -12.0 | 2.5 | -14.1 | -24.4 | 10.0 | -31.3 | -6.4 | 10.0 | -14.9 | - | Target not met |
| Brunel Secured Income - Cycle 1 | -0.2 | 0.6 | -0.8 | -3.2 | 3.2 | -6.2 | -1.6 | 6.7 | -7.8 | +2 | Target not met |
| Brunel Secured Income - Cycle 2 | -0.9 | 0.6 | -1.5 | -1.2 | 3.2 | -4.3 | 2.0 | 6.7 | -4.4 | +2 | Target not met |
| Brunel Secured Income - Cycle 3 | -1.1 | 0.6 | -1.7 | N/A | N/A | N/A | N/A | N/A | N/A | +3 | N/A |
| IFM Core Infrastructure | -0.9 | 2.5 | -3.3 | 5.4 | 10.2 | -4.4 | 10.3 | 7.6 | +2.5 | - | Target met |
| Brunel Renewable Infrastructure - Cycle 1 | 1.0 | 0.6 | +0.4 | 3.5 | 3.2 | +0.3 | 7.9 | 6.7 | +1.1 | +4 | Target not met |
| Brunel Renewable Infrastructure - Cycle 2 | 0.0 | 0.6 | -0.6 | 0.2 | 3.2 | -2.9 | 8.6 | 6.7 | +1.8 | +4 | Target not met |
| Brunel Renewable Infrastructure - Cycle 3 | 1.1 | 0.6 | +0.5 | -4.0 | 3.2 | -7.0 | N/A | N/A | N/A | +4 | N/A |
| Brunel Private Debt - Cycle 2 | -0.2 | 2.3 | -2.4 | 14.3 | 9.2 | +4.7 | N/A | N/A | N/A | - | N/A |
| Brunel Private Debt - Cycle 3 | 3.0 | 2.3 | +0.7 | 11.0 | 9.2 | +1.6 | N/A | N/A | N/A | - | N/A |
| BlackRock Corporate Bonds | -0.6 | -0.6 | 0.0 | 6.5 | 6.5 | 0.0 | -8.1 | -8.1 | 0.0 | - | N/A (p) |
| BlackRock LDI | -4.5 | -4.5 | 0.0 | -2.6 | -2.6 | 0.0 | -1.7 | -1.7 | 0.0 | - | N/A (p) |
| Equity Protection Strategy | -0.9 | N/A | N/A | -3.6 | N/A | N/A | -2.8 | N/A | N/A | - | N/A |

Source: Investment Managers, Custodian, Mercer estimates. Returns are net of fees, unless otherwise stated. Returns are in GBP terms
From this report onwards, relative returns are calculated 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 the LDI portfolio is estimated by Mercer based on the change in exposure. These returns are gross of fees.
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

# 5

# Valuation by Asset Class

| Asset Class | Start of Quarter (£'000) | End of Quarter (£'000) | Start of Quarter (%) | End of Quarter (%) | Benchmark (%) | Ranges (%) | Relative (%) |
|---|---|---|---|---|---|---|---|
| Global Equity | 709,926 | 755,210 | 12.5 | 13.0 | 10.5 | 5.5 - 15.5 | +2.5 |
| Global Sustainable Equity | 610,460 | 666,871 | 10.7 | 11.5 | 10.5 | 5.5 - 15.5 | +1.0 |
| Paris-Aligned Equity* | 1,450,823 | 1,517,779 | 25.4 | 26.1 | 20.5 | 12.5 - 28.5 | +5.6 |
| Diversified Returns Fund | 357,917 | 373,170 | 6.3 | 6.4 | 6.0 | 3 - 9 | +0.4 |
| Fund of Hedge Funds** | 23,247 | 23,907 | 0.4 | 0.4 | - | No set range | +0.4 |
| Multi-Asset Credit | 333,224 | 340,487 | 5.8 | 5.9 | 6.0 | 3 - 9 | -0.1 |
| Property | 316,007 | 299,369 | 5.5 | 5.1 | 7.0 | No set range | -1.9 |
| Secured Income | 569,156 | 600,319 | 10.0 | 10.3 | 9.0 | No set range | +1.3 |
| Core Infrastructure | 230,754 | 228,645 | 4.0 | 3.9 | 4.0 | No set range | -0.1 |
| Renewable Infrastructure | 199,456 | 206,889 | 3.5 | 3.6 | 5.0 | No set range | -1.4 |
| Private Debt | 197,730 | 203,367 | 3.5 | 3.5 | 4.5 | No set range | -1.0 |
| Local / Social Impact | - | 35,085 | - | 0.6 | 3.0 | No set range | -2.4 |
| Corporate Bonds | 183,069 | 181,886 | 3.2 | 3.1 | 2.0 | No set range | +1.1 |
| LDI & Equity Protection | 1,366,378 | 1,340,450 | 24.0 | 23.0 | 12.0 | No set range | +11.0 |
| *Synthetic Equity Offset** | -1,005,747 | -1,090,079 | -17.6 | -18.7 | - | - | - |
| Other*** | 213,304 | 169,037 | 3.7 | 2.3 | - | 0 - 5 | +2.3% |
| **Total** | **5,701,894** | **5,818,000** | **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

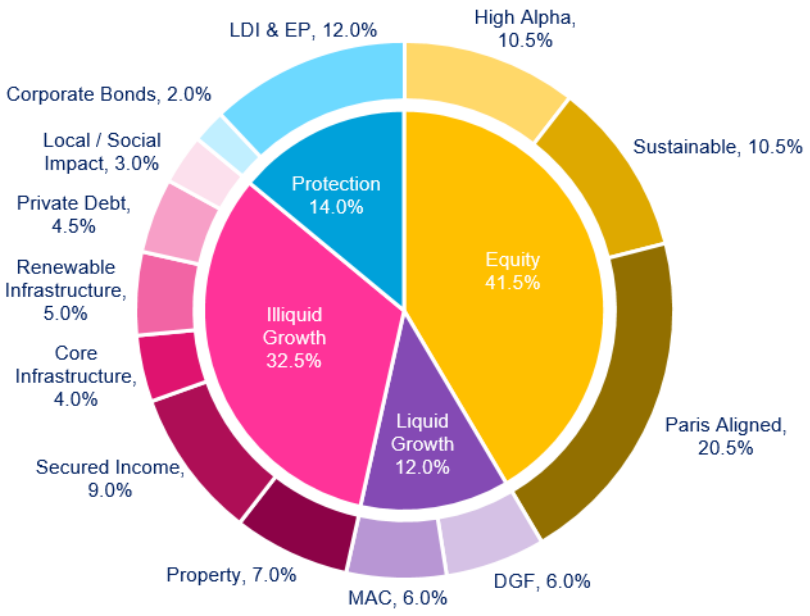
| Manager | Asset Class | Start of Quarter (£'000) | Cashflows (£'000) | End of Quarter (£'000) | Start of Quarter (%) | End of Quarter (%) |
|---|---|---|---|---|---|---|
| Brunel | Global High Alpha Equity | 656,096 | - | 720,796 | 11.5 | 12.4 |
| Brunel | Global Sustainable Equity | 610,460 | - | 666,871 | 10.7 | 11.5 |
| Brunel | Passive Global Equity Paris Aligned | 445,076 | -50,011 | 427,700 | 7.8 | 7.4 |
| BlackRock | MSCI Paris-Aligned (Synthetic)* | 1,005,747 | - | 1,090,079 | 17.6 | 18.7 |
| Brunel | Diversified Returns Fund | 357,917 | - | 373,170 | 6.3 | 6.4 |
| JP Morgan | Fund of Hedge Funds | 23,247 | - | 23,907 | 0.4 | 0.4 |
| Brunel | Multi-Asset Credit | 333,224 | - | 340,487 | 5.8 | 5.9 |
| Brunel | UK Property | 180,117 | - | 178,154 | 3.2 | 3.1 |
| Schroders | UK Property | 13,263 | -365 | 13,185 | 0.2 | 0.2 |
| Partners | Overseas Property | 122,626 | - | 108,030 | 2.2 | 1.9 |
| Brunel | Secured Income – Cycle 1 | 303,032 | -6,278 | 296,092 | 5.3 | 5.1 |
| Brunel | Secured Income – Cycle 2 | 104,171 | -1,548 | 101,660 | 1.8 | 1.7 |
| Brunel | Secured Income – Cycle 3 | 161,953 | +42,606 | 202,568 | 2.8 | 3.5 |
| IFM | Core Infrastructure | 230,754 | - | 228,645 | 4.0 | 3.9 |
| Brunel | Renewable Infrastructure – Cycle 1 | 109,393 | +2,366 | 112,995 | 1.9 | 1.9 |
| Brunel | Renewable Infrastructure – Cycle 2 | 77,554 | +1,821 | 79,509 | 1.4 | 1.4 |
| Brunel | Renewable Infrastructure – Cycle 3 | 12,509 | +1,633 | 14,385 | 0.2 | 0.2 |
| Brunel | Private Debt – Cycle 2 | 161,464 | - | 161,102 | 2.8 | 2.8 |
| Brunel | Private Debt – Cycle 3 | 36,266 | +4,833 | 42,265 | 0.6 | 0.7 |
| BlackRock | Corporate Bonds | 183,069 | - | 181,886 | 3.2 | 3.1 |
| BlackRock | LDI & Equity Protection | 1,366,378 | - | 1,340,450 | 24.0 | 23.0 |
| BlackRock | *Synthetic Equity Offset** | -1,005,747 | - | -1,090,079 | -17.6 | -18.7 |
| Record | Currency Hedging (incl. collateral) | 74,307 | -30,000 | 46,603 | 1.3 | 0.8 |
| BlackRock | ETF | 23,222 | -20,000 | 3,354 | 0.4 | 0.1 |
| Schroders Greencoat | Wessex Gardens | - | +35,085 | 35,085 | - | 0.6 |
| - | Internal Cash | 115,315 | +2,478 | 118,635 | 2.0 | 2.0 |
| - | Residual Assets | 459 | - | 446 | 0.0 | 0.0 |
| Total | | **5,701,894** | **-17,379** | **5,818,000** | 100.0 | 100.0 |



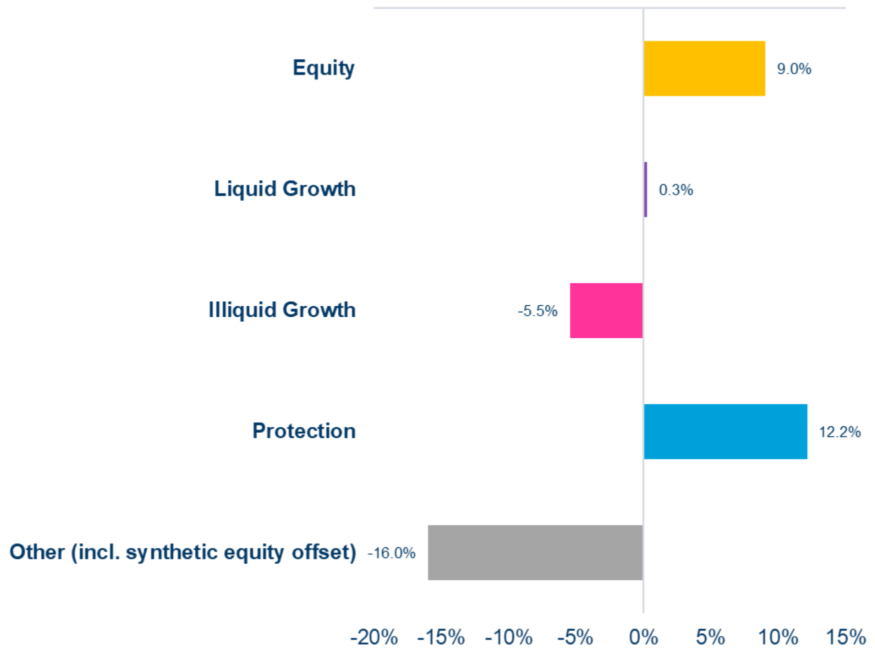
Source: Custodian, Investment Managers, Mercer. Totals may not sum due to rounding. The cashflow column shows only the cash movements within the asset portfolio. It does not include non-investment cash movements such as employer contributions or pension payments made, however these amounts are included 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.

# 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.
- A net amount of c. £81m was drawn down to private market portfolios during the quarter, which includes the funding of c. £35m of the £50m commitment to Schroders Greencoat Wessex Gardens; the first mandate to be implemented for the Local / Social Impact portfolio.

# Current Topics

# 6

# Current Topics

## When did you last review your equity portfolio?

### Equity Portfolio reviews

- Rightly so, the majority of Officer and Committee's time is spent on the Strategic asset allocation, the split between high level asset classes (equities, fixed income, alternatives). This drives the largest proportion of returns.
- But we have also seen over recent years, particularly with the strong rally in Value equities and the outperformance of the magnificent 7 over 2023, that the **portfolio construction within the equity portfolio can also have a large impact on performance.**
- As LGPS Funds consider moving more assets to the pools (where they haven't already), this offers **a great time to assess the make up of the Fund's equity portfolio.**
- For those who have already moved their equities to the pools, it will also be appropriate as we start to see long term (3 to 5 year) performance come through and also new equity funds be launched.

**The investment approach of your equity manager(s) will have a big impact on their performance. Blending complementary approaches together can build more robust portfolios**


### Relevance to the Fund

The Committee last reviewed the Equity portfolio as part of the 2023 Investment Strategy Review, which covered a number of the themes illustrated.

The last deep dive into portfolio style exposures took place in 2021.

Continued underperformance of the active mandates could be one prompt for an updated deep dive review in the near future.

### Mercer's Equity and Fixed Income Playbooks

Intra-asset class portfolio construction is a key part of investment strategy, ensure it is not ignored to build more robust portfolios. Prior to switching assets to pools is a great time to undertake a review.

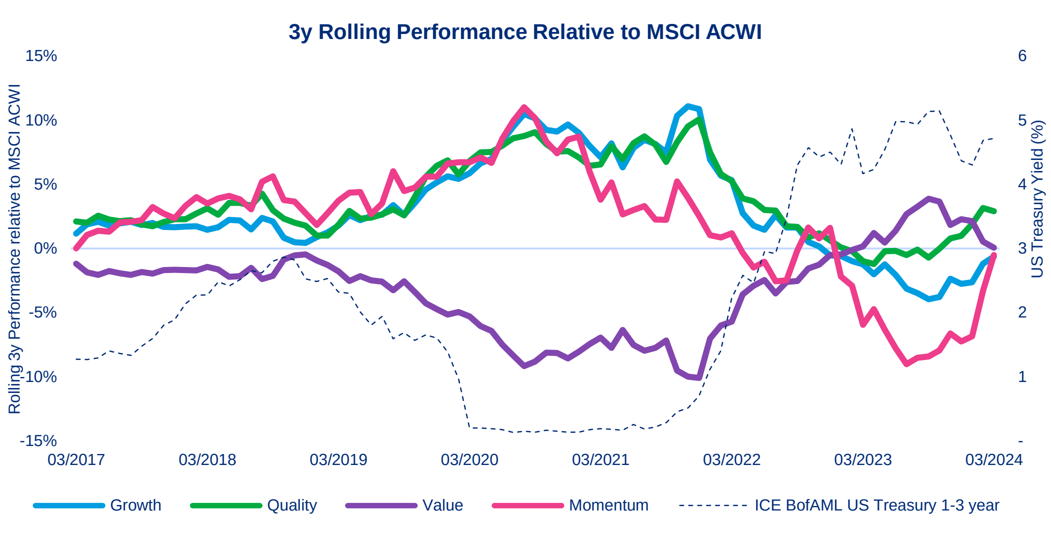
**01** Even the most skilful managers experience periods of underperformance. Patience and the ability to take a long-term view should be rewarded

**02** Bias towards higher quality alpha sources that have shown to be the most repeatable and evidence based

**03** Empower skilled managers with flexibility to exploit market inefficiencies

**04** Be mindful of regime shifts, external factors and sustainable factors that have a material impact on client outcomes

### Change Coming in 2024?




Growth and Quality stocks struggled in the rising yield environment of 2022 and 2023,a more stable monetary backdrop in 2024 may be more favourable for these styles.

# Current Topics

## Climate Topics

### Incorporating Private Markets in Net Zero Monitoring: Overview

**1**

Challenges with data include lack of standardisation, availability, quality & accessibility.

**2**

Growing number of managers can provide carbon data, with large gap between leaders and laggards.

**3**

While challenges remain overall private market managers are improving.

**4**

Increased data sets allow clients to start increasing monitoring and exploring target setting, but also to engage with managers about expectations.

**5**

IIGCC guidance available for private equity, infrastructure and real estate. Private debt and venture capital on the way.

**6**

Mercer template available for data requests across all private market investments – helps standardise and collate large amounts of data.

**IIGCC guidance on Net Zero monitoring is now available for private equity, infrastructure and real estate.**

### Importance of scaling climate solutions

Scaling up investment in climate solutions is an imperative for a successful net zero transition.

The total investment required to limit global average temperature rise to 1.5°C above pre-industrial levels between now and 2050 is estimated to range from USD 109 trillion to USD 275 trillion across renewable energy, low carbon transport, energy efficient buildings, electrification of industrial processes and more*

Institutional investors have a key role to play in funding this gap, with a growing number committed to monitoring climate solutions, incorporating them into transition planning and setting targets.

*Green equity exposure in a 1.5°C scenario: Applying climate investment trajectories with green revenues (FTSE Russell, 2022)

### Monitoring climate solutions exposures: IIGCC New Guidance

Two primary climate solutions metrics identified in the IIGCC ‘Investing in climate solutions: listed equity and corporate fixed income’ guidance. The two metrics complement one another: green revenue is backward looking, while green capex is forward looking.

**Green Revenues**

Revenues from the sale of climate solutions products and services.

**Green Capex**

- Capital expenditure in new climate solutions technologies and products.

- Green capex is typically reported in financial terms (e.g., USDm, €m, £m) based in last financial year.

### Relevance to the Fund

✔

The Fund monitored Green Revenues and Green Capex for the first time in the 2024 ACT report.

In this report a summary of the Fund’s private market mandates’ decarbonisation positions was also set out. We’d expect this to continue to be enhanced as data availability improves.

## Other Recent Governance Announcements

### The Pensions Regulator (“TPR”) Guidance on Private Markets – Critical success factors

| Manager Selection | Strategic Allocation | Manager Access/Pooling | Risk Management | Market Awareness |
|---|---|---|---|---|
| Ability to identify and select established, highly rated fund managers who bring specialized expertise and talent to the strategy they are implementing. | A strategic allocation to private markets implemented via a long-term portfolio construction plan and sustained commitments to private market partnerships over time for vintage diversification. | Access to highly rated fund managers and the ability to identify emerging fund managers in order to potentially enhance returns and further a program’s maturation. Pools are at various stages of offering Private Markets. | Spread risk through diversification: by business stage, fund strategy, industry, geography, manager and time. | Greater alpha potential through active management with high quality managers expected to demonstrate significant value-add. |

### Others (further details available on request)

- TPR General Code of Practice
- DLUHC: Preparing the Pension Fund Annual Report
- Financial Markets Law Committee: Trustee Fiduciary Duty in the Context of Sustainability
- March budget: Investing in Children’s Homes
- Levelling Up Advisory Council: Accelerating Regional Growth

### Relevance to the Fund

✔

Officers and the Committee are kept up to date on regulatory developments.

The Fund’s private market holdings have been discussed several times in the past couple of years, for which these success factors have been key considerations.

# Appendix

# Q1 2024 Equity Market Review

Speculation surrounding artificial intelligence (AI), broadly positive corporate earnings and stronger economic activity all drove equities higher over the quarter. Japanese equities also continued to rally on the back of stronger corporate earnings linked to higher nominal growth.

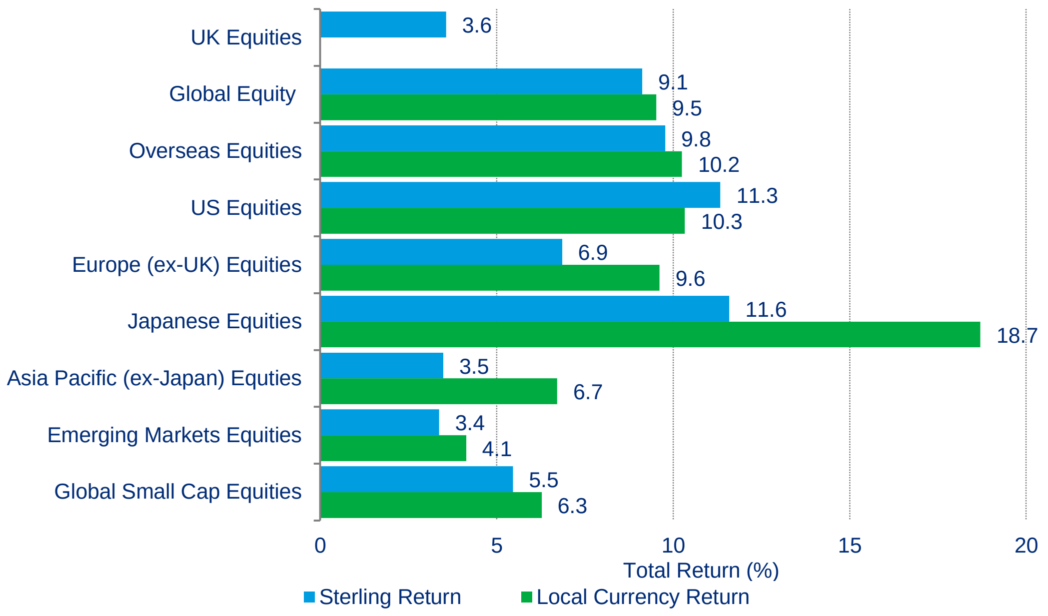
**Global equities** returned 9.1% in sterling terms and 9.5% in local currency terms as sterling depreciated against the dollar.

**US equities** returned 10.3% in local currency terms, whilst European (ex-UK) equities returns 9.6%, and Japanese equities returned 18.7%.

**Emerging markets (‘EM’) equities** returned 4.1% in local terms.

**Global small cap stocks** returned 6.3% 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.

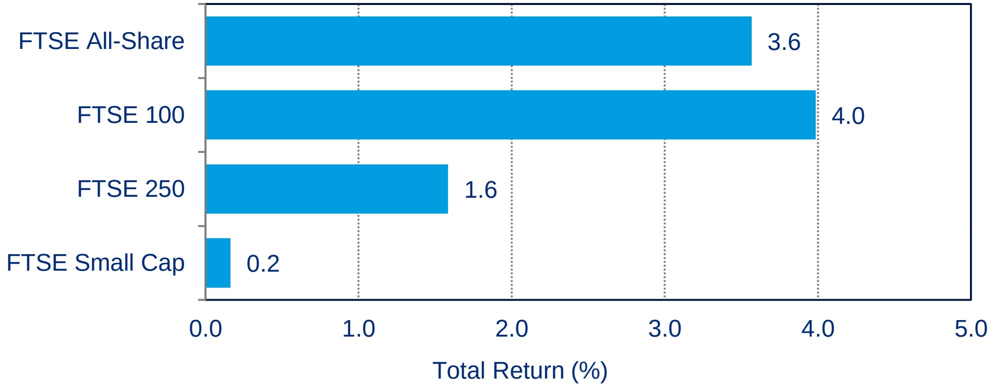
## Equity Performance




The **FTSE All Share** index returned 3.6% over the quarter with the large cap **FTSE 100** index returning 4.0%. More domestically focused equities (**FTSE 250**) produced positive returns. The **small cap** index produced a positive 0.2% return.

Strong performance in consumer goods and oil & gas supported the UK performance relative to global equities.

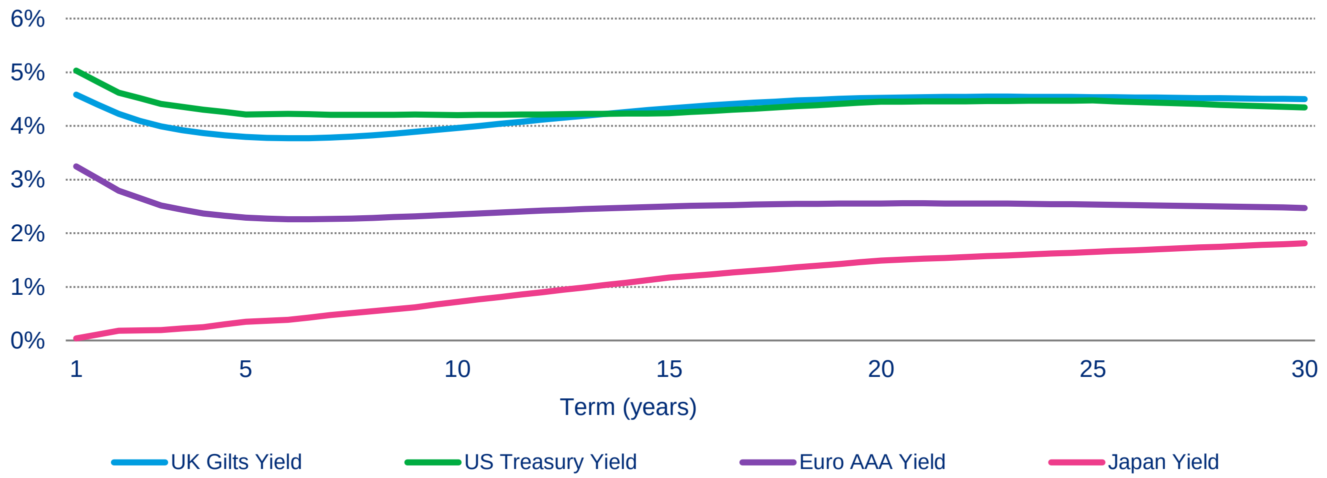
## FTSE Performance by Market Cap



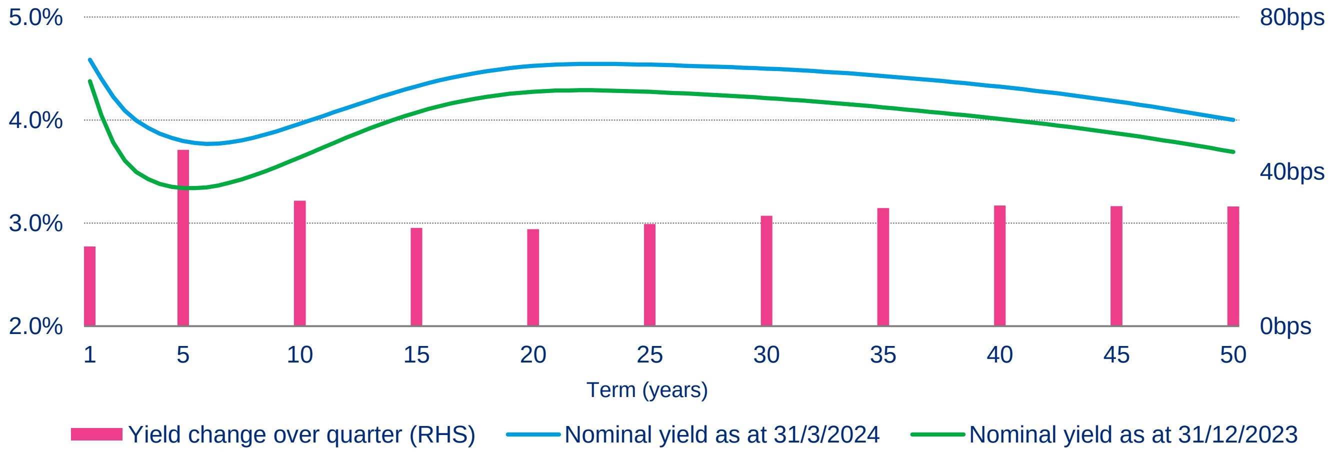

Mercer

Source: Refinitiv

# Q1 2024 Bond Market Review




Source: Mercer and Bloomberg




Source: Mercer

## Government Bond Yields

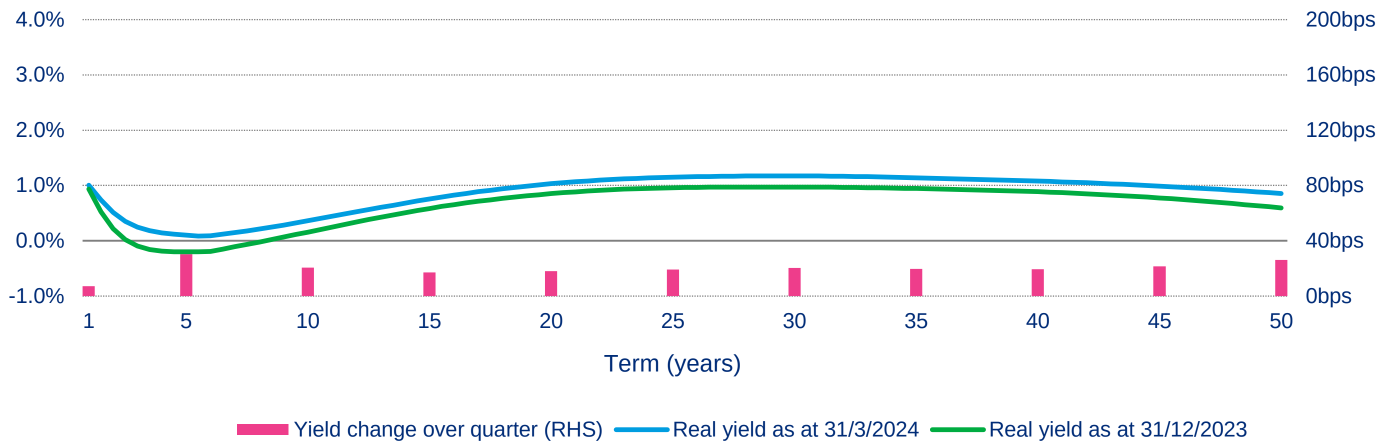
10-year global government bond yields rose over the quarter. The sell-off in bonds was driven by repricing of rate cut expectations, following upside surprises to growth and inflation data.

In the US, labor market resilience and sticky inflation postponed rate cut expectations from March to June 2024, while stubborn service inflation and wage growth in the UK pushed back rate cut timing in the UK to August 2024.

The 10-year benchmark bond yield in the US, UK and Germany rose 32 bps, 40 bps and 28 bps, respectively. Meanwhile, the yield curve across these regions continued to be inverted.

The Bank of Japan however moved in contrast, hiking interest rates for the first time in 17 years, albeit retaining its bond buying plans, this led to 10-year JGB yields ending the quarter below 0.8%.

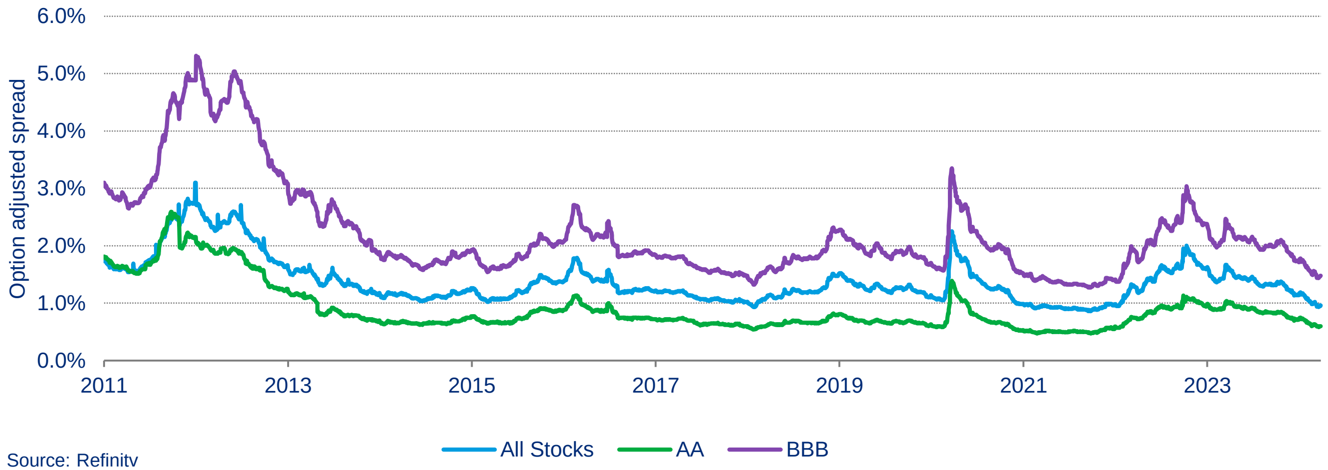
# Q1 2024 Bond Market Review




Source: Mercer

## UK Index-Linked Gilt Yields

UK real yields rose across the entire curve over the last quarter, with the 5-year segment witnessing an upside of 26 bps. Concerns of price pressures staying elevated on account of services inflation and resilient wage growth played through. Nevertheless, the BOE expects inflation to decline closer to 2% in the second quarter of 2024. However, UK 10-year breakeven rates finished the quarter at ~3.64% (16bps higher over the quarter).




Source: Refinitv

## Corporate bonds

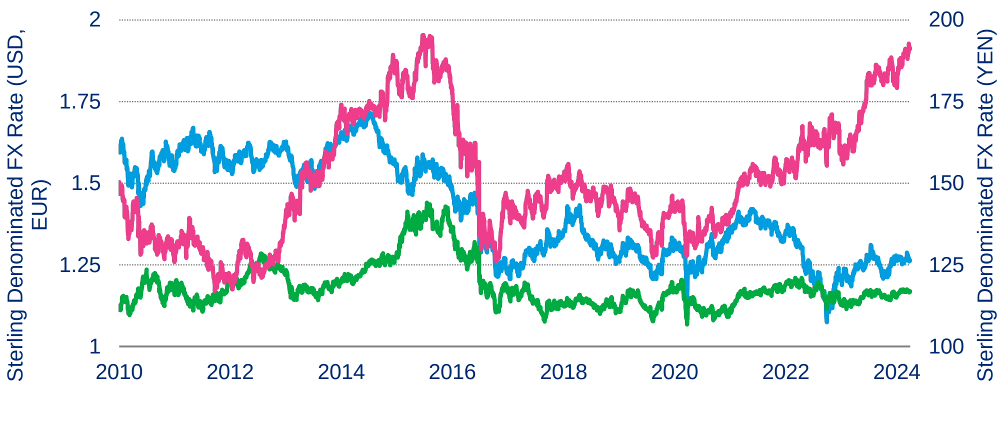
Spreads on UK investment grade credit tightened over the quarter, with spreads on lower rated credit tightening more (25bps) than for higher rated credit (11bps).

# Q1 2024 Currency Market Review

Sterling remained weak against the dollar over the quarter as the dollar appreciated after better-than-expected economic data reduced expectations of a March FOMC rate cut. The US dollar index rose ~3% in the quarter, even though it recorded a 1.7% depreciation on a 12-month basis.

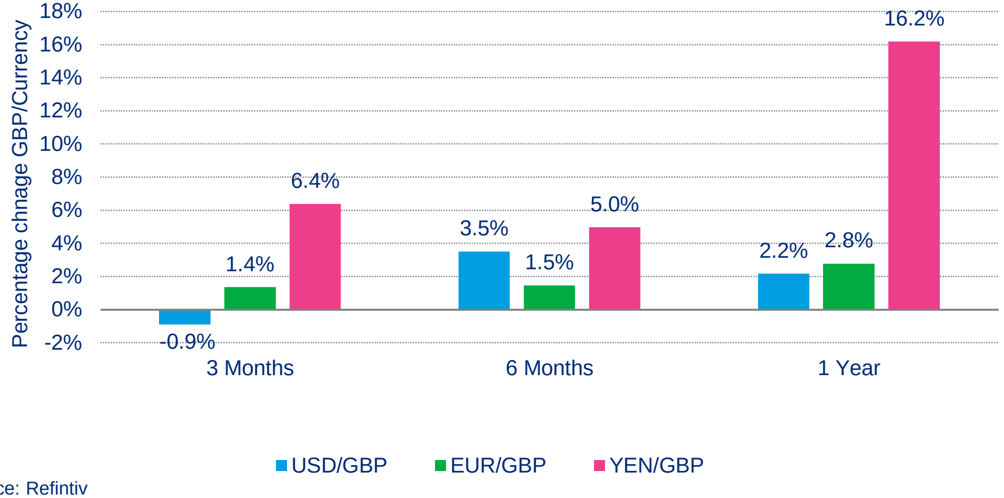
Similarly, against the EUR and JPY, sterling remained under pressure over the first quarter. On a 12-months basis however, sterling outperformed against the yen and marginally versus the dollar and euro.

**Sterling Denominated FX Rate**




Source: Refinitiv

**Change in sterling against foreign currencies**




Source: Refintiv

# Q1 2024 Property

UK property as measured by the MSCI Index increased by 0.6% over the first quarter of 2024.

# Dynamic Asset Allocation (DAA)

## Dashboard, Positioning & Outlook for UK constrained Portfolio

### UK Economic Outlook

UK equities underperformed global equities (in GBP terms) in the first quarter of the year. The rally in global equities was driven by decent earnings growth and central banks in the developed world broadly confirming that rate cuts remain on the horizon. Growth stocks and AI-linked names outperformed. 10-year UK gilt yields rose 0.4% over the quarter, broadly in line with global bond markets. Higher global bond yields were primarily driven by two consecutive upside surprises in the US inflation. Sterling weakened versus the US dollar however strengthened against most other major currencies. The UK economy slipped into a technical recession at the end of 2023 as the economy shrank 0.1%[1] in Q3 followed by a 0.3%[1] in Q4. The fall in Q4 GBP was driven by a slowdown in consumption due to higher interest rates. Household consumption also fell with the savings ratio ticking modestly higher[2].

### 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 mixed outlook for 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 support corporate profit growth, both within and outside of China. 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. However, they are considered attractive on both an absolute and relative valuation basis. |
| **Growth Fixed Income** | As per last quarter, we kept a favourable view on Emerging Market Debt (EMD) Local Currency (LC). EMD LC is attractive due to the expectation of declining local yields as central banks cut interest rates. Additionally, EM currencies are expected to strengthen versus the US dollar as they are considered cheap in general and we expect the US dollar to decline. Central banks in countries like Brazil, Poland, Hungary, Chile, and Peru have already been cutting rates in 2023, and this trend is expected to continue and broaden in 2024 as EM inflation declines further. We also retain the same moderately negative view on global high yield, especially when compared with other growth fixed income assets. |
| **Defensive Fixed Income** | From a positioning standpoint, we retain our overweight position in UK gilts. Gilts did not enjoy the developed government bond rally to the same extent at the back end of last year leading to more attractive valuations. We retain our underweight real gilts vs nominal gilts, expecting the so-called break-even inflation rates to narrow further as inflation rates come down. |

1 Office of National Statistics, quarter on quarter growth

2 Office of National Statistics

**Constrained**

| **Equities** | **1%** |
|---|---|
| DM ex-UK | -2% |
| *UK* | *0%* |
| EM | 3% |
| Small Cap | 0% |

| **Growth Fixed** | **0%** |
|---|---|
| EM Debt (LC) | 2% |
| Global HY | -2% |

| **Defensive Fixed** | **-1%** |
|---|---|
| Nominal Gov ex-UK | -1% |
| *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 April 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 first half of 2024 is likely to remain challenged with negative data points (whether these are lagged or not). However, as this happens, it becomes crucial to recognize that attractive opportunities are more likely to be had in the early days of market stabilization – when prices are attractive, but sellers still outnumber buyers. We therefore encourage investors not to be spooked by near-term noise but to focus on the medium-term opportunity and long-term benefits of a real estate allocation.
- The global economy continues to be broadly 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.
- Core funds are reaching a low point in NAV, and annual returns for core funds have turned the corner. With subscription queues having dissipated across even the strongest of these funds, new capital may be drawn in a matter of months. Buying units at a low basis is a good starting point for a track record. Without making stretched assumptions, managers are predicting double digit fund returns in the 2025 for low-risk real estate.
- For those clients with a higher risk appetite, the opportunity to potentially 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 an opportunity for alternative lenders to deploy capital and potentially generate equity-like returns while occupying a sheltered position in the capital stack. However, with many US funds having raised significant capital, competition can be fierce, and margins have started to come down as managers compete for deals in sectors perceived to be most attractive (such as residential). This makes sourcing channels a critical factor to assess.
- Finally, over the longer term, real estate may 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 real estate 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 |
| | Offices | High leverage | Spec Development |

Very attractive | Attractive | Neutral | Less Attractive | Unattractive | Not applicable

**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 core portfolios has been the bulk of repricing and we have upgraded our view of the US market to reflect this. In the next couple of quarters, we expect the core segments to turn attractive again. With economic growth rates relatively soft and capex budgets hard to defend when prices and liquidity are subdued, value-add remains hard to pull off.

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, April 2024*

# 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 |
| Schroders Greencoat | Wessex Gardens* | SONIA + 3% p.a. | - | February 2024 |
| 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 for both of these mandates is a Net IRR of 8% p.a. (GBP). The inflation/cash-plus benchmarks are 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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