Appendix A

REDINGTON

YOUR MARKET AND INVESTMENT UPDATE

Q1 2019

West Midlands Pension Scheme

Private and Confidential

QAS Institute and Faculty of Actuaries ®
Quality Assurance Scheme

WHAT HAPPENED DURING THE QUARTER

Philip Rose
(CIO, Strategy & Risk)

Market Data

Central banks have, in aggregate, moved from tightening monetary policy to being on hold, feeding through to a strong rally in risk assets in the first quarter.

At the same time, markets have moved to discounting unchanged or easing monetary policy rather than additional tightening. This does leave markets open to the possibility of disappointment if the economy rebounds from the current slow growth priced in and central banks resume tightening, but also limited room to cut rates if there is a downturn.

The increased importance of China, both as a major driver of growth and in offering a relatively uncorrelated business cycle, is not yet reflected directly in many investor portfolios.

Key Points for You

- Targets need to be clarified through an investment strategy review to allow the Pension Risk Management Framework to be agreed (pg 5).
- Risk is broadly in line with the current indicative target.
- Expected return increased over the quarter due to an update to our equity expected return assumption. It remains below the 3.5% target.
- Equities are the dominant contributor to expected return and risk (pg 6 & 7) – there may be scope to reduce the reliance on equities.

Equity Index	Level	Change since 31-Dec-18	Change since 30-Mar-18
FTSE 100 (Total Return)	6515	9.5%	7.7%
S&P 500 (Total Return)	5664	13.6%	9.5%
EuroStoxx 50 (Total Return)	1344	12.3%	3.5%
Nikkei 225 (Total Return)	33960	6.9%	0.9%
MSCI World (Total Return)	4662	12.6%	6.7%
MSCI Emerging Markets (Total Return)	581	9.8%	-1.9%
FX			
USD vs GBP	1.30	2.1%	-7.0%
EUR vs GBP	1.16	4.4%	2.1%
Credit Spreads			
Sterling Non-Gilt Index	127	-18 bps	14 bps
Sterling Non-Gilt 15Y+ Index	177	-21 bps	9 bps
Global Investment Grade	115	-25 bps	22 bps
US Investment Grade	127	-26 bps	20 bps
Global High Yield	369	-108 bps	48 bps
European High Yield	323	-103 bps	66 bps

UK Gilts	Level	Change since 31-Dec-18	Change since 30-Mar-18
10Y	1.03	-27 bps	-39 bps
30Y	1.57	-29 bps	-13 bps
UK Nominal Swaps			
10Y	1.22	-23 bps	-30 bps
30Y	1.38	-18 bps	-13 bps
Gilt Breakeven Inflation			
10Y	3.36	9 bps	24 bps
30Y	3.43	5 bps	7 bps
UK RPI Swap			
10Y	3.52	-4 bps	18 bps
30Y	3.47	0 bps	4 bps
UK Gilt Real Rates			
10Y	-2.32	-36 bps	-62 bps
30Y	-1.86	-33 bps	-20 bps
US TIPS			
20Y	0.87	-42 bps	-2 bps
30Y	1.01	-29 bps	2 bps

VIEWS FROM THE ASSET CLASS SPECIALISTS

Kate Mijakowska

LDI and Gov Bonds

Q1 2019 was another quarter with substantial interest rate falls. Both nominal and index-linked gilt yields fell by 0.2-0.3% across the curve. The 20-year index-linked gilt yield reached an all-time low in March at -2.0%. Gilt z-spreads (gilt spreads over swaps) fell by 0.1% at the middle and long end of the curve, as gilts outperformed swaps. While breakeven inflation was broadly flat on the quarter, there has been volatility within Q1 on the back of the report published by the House of Lords Economic Affairs Committee in January. The report pointed to flaws in the RPI and recommended that the government and the UK Statistics Authority decide on a single measure of inflation within the next 5 years, as well as the issuance of gilts linked to CPI in the interim. The Government is obliged to respond to the report.

Nick Samuels

Liquid Markets

Equity markets rallied strongly after a weak finish to 2018, as investors priced in the likelihood of no US rate hikes in 2019, and tempering China-US tensions. The rally was led by the US and Europe, with a more muted response from Japan and UK. China A shares, however, were the standout market as investors finally began to recognise the opportunity there. Quality/Growth orientated Global Equity strategies continued to outperform Value, as they did in 2018.

The underperformance of Value as a factor meant for muted – albeit still positive – returns in Diversified Risk Premia strategies, as other factors such as Momentum and Defensive failed to offset sufficiently.

The strong equity markets helped Diversified Growth Funds rally after a tough Q4 2018, with the more asset allocation orientated funds outpacing those that look to make relative value calls.

Chris Bikos

Liquid & Semi-Liquid Credit

The first quarter of 2019 saw a reversal of the sell-off in Q4 2018. Rates fell and credit spreads tightened, resulting in positive returns across all major credit asset classes. In the US, long-dated and high yield credit were the strongest performing asset classes, driven respectively by falling rates and credit spreads. Overall, lower-rated bonds (single B and below) lagged in terms of performance. Sterling assets across all maturities had a positive quarter, with returns coming equally from spread and rate movements. In Europe, the ECB announced a new lending programme for banks but more details around the maturity, cost and size are expected later in Q2. European high yield and corporate debt delivered positive returns. Emerging market bonds had a positive quarter, with US dollar-denominated debt outperforming local currency bonds as certain EM currencies weakened.

Tom Duggan

Illiquid Credit

Q4 2018 market volatility did not persist long enough to create a wider move in illiquidity premia. However, the impact of market volatility has brought the downside protection characteristics of private credit to the forefront of investors' attention. Data provider Preqin commented that fundraising activity has shifted away from direct lending and over to distressed debt and special situations during Q1 2019. Limited Partners have seen healthy distributions over the last two years, and so client re-allocation has been strong. 2018 was the fourth consecutive year of >$100bn inflows to private credit. This has led to marginal spread compression and seemingly weaker underwriting standards in certain parts of the market. Our rated managers continue to be cautious in the light of relatively compressed yields, elevated corporate leverage levels and pressure on loan covenants and documentation.

Keir Macdonald

Illiquid Markets

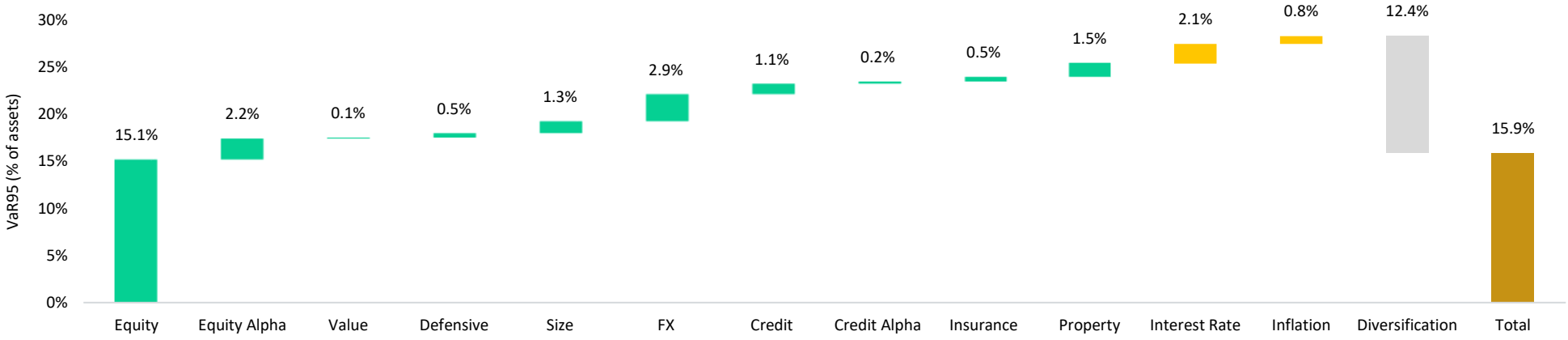
The Q1 2019 UK property market saw a continuation of the 2018 trend of divergence between the stronger-performing industrial sector and the weaker retail sector.

In infrastructure, the number of global completed deals continues to fall, and the UK market remains highly competitive across sectors. With Private Finance Initiative (PFI) and Private Finance 2 (PF2) discontinued, investors seeking government-backed sterling revenues are now pursuing a limited number of opportunities to finance rail infrastructure with government-backed availability-based contracts.

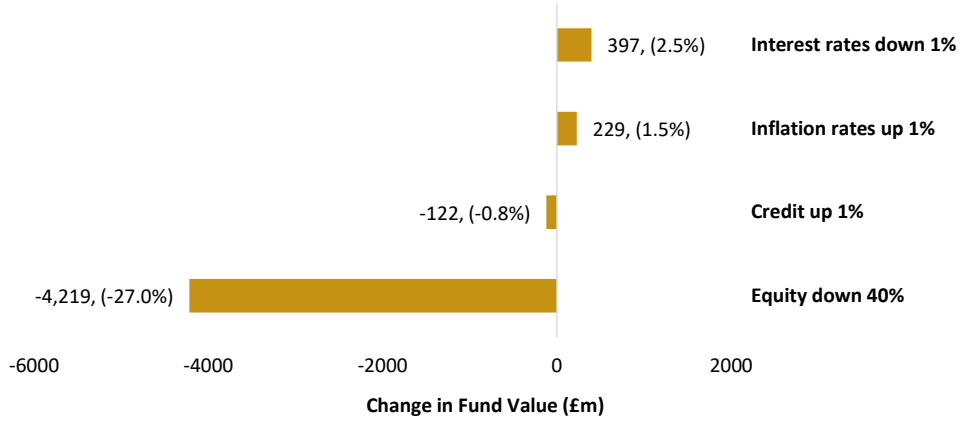
In the insurance-linked securities market, 1/1 renewals occurred at rates broadly flat or slightly down relative to the previous year, with the exception of accounts that suffered significant losses, such as Californian insurers affected by wildfires. The broad focus over Q1 has been on loss creep from 2018, namely from the California wildfires and Typhoon Jebi.

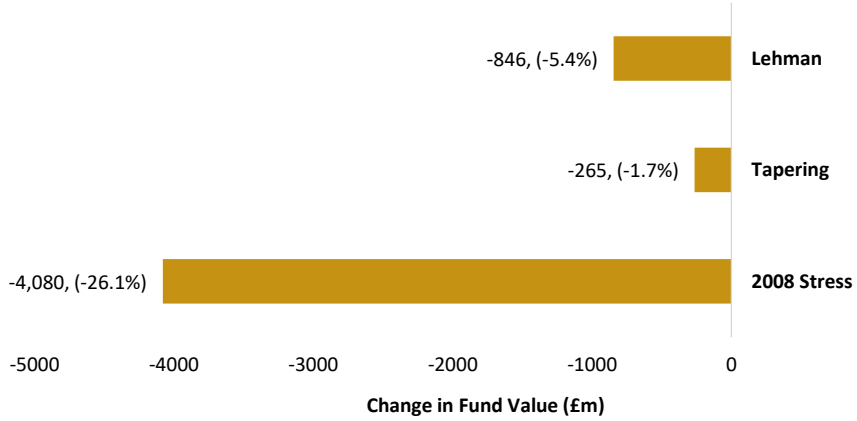
HELPING YOU UNDERSTAND YOUR RISK

Current Value-at-Risk 95%



Scenario Analysis





ASSET CLASS UNIVERSE

MORE CONTRACTUAL

ILLIQUID ← → LIQUID

LESS CONTRACTUAL

ILLIQUID CREDIT

- Private Placements
- Distressed Debt
- Infrastructure Debt
- Real Estate Debt
- Opportunistic Illiquid Credit
- Securitised Opportunities
- Residential Mortgages
- Middle Market Lending
- Specialty Finance

LIQUID AND SEMI-LIQUID CREDIT

- [Government Bonds/Cash]
- Investment Grade Corporate Debt
- Emerging Market Debt
- Structured Credit
- Multi-Class Credit
- High Yield
- Leveraged Loans
- Absolute Return Credit
- Credit Relative Value

ILLIQUID MARKET STRATEGIES

- Catastrophe Insurance
- ILS
- Private Equity
- Commercial Property
- Long Lease Property
- Residential Property
- Social Housing
- Infrastructure Equity
- Renewables

LIQUID MARKET STRATEGIES

- Global Equity
- Emerging Market Equity
- Chinese Equity
- Japanese Equity
- European Small Cap Equity
- High Alpha Equity
- Sustainable Equity
- Multi-Asset / Diversified Growth
- Alternative Risk Premia
- Relative Value Strategies
- Hedge Funds

REDINGTON'S EXPECTED RETURNS

Asset Class	Expected Return (Gilts +) (March 2018)	Volatility	Expected Fees (p.a.)
Equity			
Developed Markets Equity (Passive/Active)	4.3%	17.1%	0.1%-0.7%
Emerging Markets Equity (Passive/Active)	4.9%	21.0%	0.2%-0.7%
Japan Equity (Active)	4.3%	17.1%	0.6%-0.7%
Asia Pacific Equity (Active)	4.3%	17.1%	0.6%-0.7%
European Equity (Active)	4.3%	17.1%	0.5%-0.6%
China Equity (Active)	5.5%	27.1%	0.7%-0.8%
Sustainable Equity (Active)	4.5%	15.4%	0.4%-0.5%
Fixed Income			
UK Corporate Debt	1.2%	5.4%	0.1%-0.2%
US Corporate Debt	1.2%	4.7%	0.1%-0.2%
Structured Credit	1.5%	4.2%	0.3%-0.4%
Emerging Market High Yield	2.3%	5.6%	0.5%-0.7%
Liquid Alternatives			
Diversified Risk Premia	5.1%	9.8%	0.5%-0.8%
Illiquid Assets			
Social Housing	4.5%	11.6%	0.7%-0.9%
Private Equity	4.3%	24.5%	1.5%-2.0%
Property (Direct)	3.4%	11.7%	0.3%-0.4%
Property (Indirect)	3.3%	11.7%	0.5%-0.7%
Insurance-Linked Securities	3.0%-4.5%	10.9%	1.5%-2.0%

Fee data is estimated based on fees of preferred managers in each strategy. In practise each fee would be negotiated for West Midlands and may be considerably lower.

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