Appendix A

YOUR MARKET AND INVESTMENT UPDATE

Q3 2020

West Midlands Pension Fund

REDINGTON

West Midlands Pension Fund

bsi. ISO/IEC 27001 Information Security Management

QAS Institute and Faculty of Actuaries Quality Assurance Scheme

Private and Confidential

WHAT HAPPENED DURING THE QUARTER

Philip Rose
(CIO, Strategy & Risk)

Market Summary

Markets continued to recover in the third quarter but at a more modest rate than the strong rebound seen in the second quarter. Many equity and credit markets have made up most or all of their Q1 losses but in this regard are moving ahead of the economies of many countries, which - with the notable exception of China - have not yet recovered the losses caused by the ongoing pandemic.

The continued interplay between fiscal and monetary stimulus and the pandemic means there is continued divergence between the performance of difference regions and sectors, meaning that diversification remains important. While central banks continue to try and pursue inflationary policies to date, general they continue to undershoot their inflation targets.

Key Points for You

- Expected return remained constant at Gilts + 3.4%. The fall in expected return for public equities through the implementation of varying expected returns in our model was offset by an increased expected return for private equity. Additionally, the fall in expected return for credit assets resulting from tighter credit spreads was offset by our credit model refinements.
- Risk, as measured by VaR 95%, was broadly unchanged over the quarter: 15.6% at 30 September vs. 15.4% at 30 June.

Market Data

Equity Index	Level	Change since 30-Jun-20	Change since 30-Sep-19
FTSE 100 (Total Return)	5570	-4.0%	-18.1%
S&P 500 (Total Return)	6919	8.9%	15.1%
EuroStoxx 50 (Total Return)	1352	-0.7%	-8.0%
Nikkei 225 (Total Return)	38259	4.7%	8.7%
MSCI World (Total Return)	5325	6.7%	8.5%
MSCI Emerging Markets (Total Return)	642	8.6%	12.5%
FX			
USD vs GBP	1.29	4.2%	5.1%
EUR vs GBP	1.10	-0.1%	-2.2%
GBP vs JPY	0.7	-1.7%	-2.5%
Credit Spreads			
Sterling Non-Gilt Index	135	-14 bps	6 bps
Sterling Non-Gilt 15Y+ Index	188	-14 bps	-6 bps
Global Investment Grade	140	-25 bps	14 bps
US Investment Grade	156	-26 bps	13 bps
Global High Yield	518	-66 bps	131 bps
European High Yield	434	-33 bps	116 bps

Market Data

UK Gilts	Level	Change since 30-Jun-20	Change since 30-Sep-19
10Y	0.26	8 bps	-21 bps
30Y	0.82	14 bps	-18 bps
UK Nominal Swaps			
10Y	0.40	3 bps	-25 bps
30Y	0.58	15 bps	-13 bps
Gilt Breakeven Inflation			
10Y	3.27	17 bps	-19 bps
30Y	2.97	-1 bps	-20 bps
UK RPI Swap			
10Y	3.49	10 bps	-25 bps
30Y	3.01	-1 bps	-22 bps
UK Gilt Real Rates			
10Y	-3.01	-10 bps	-2 bps
30Y	-2.15	15 bps	2 bps
US TIPS			
20Y	-0.32	-25 bps	-91 bps
30Y	-0.23	-15 bps	-84 bps

VIEWS FROM THE ASSET CLASS SPECIALISTS

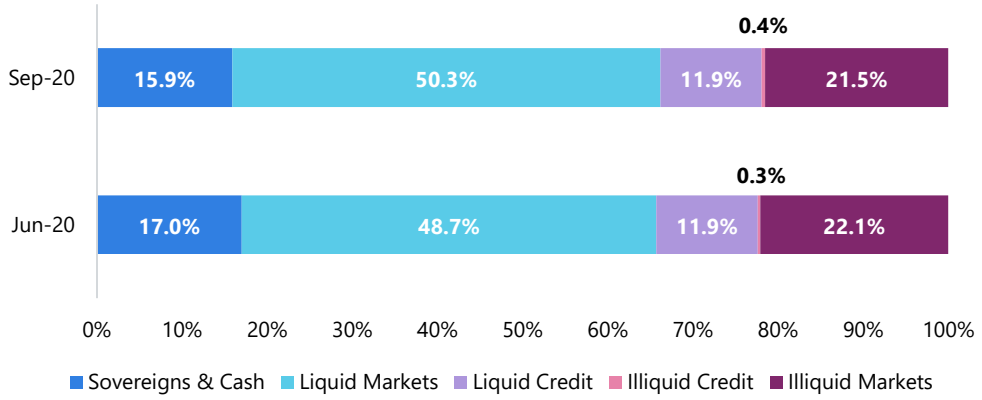
		**Kate Mijakowska** **LDI and Government Bonds**	In August, the pace of the Quantitative Easing programme was reduced, and so the net gilt supply remains positive. The gilt market is now pricing in negative interest rates up to 6 years and the Bank of England has begun engaging with commercial banks on their readiness to deal with zero or negative rates. Overall, 20-year real yields were up 0.1%, driven by nominal yields as 20-year inflation was broadly flat. Breakeven inflation and real gilt yields rose 0.2% at the 5-year point. Repo remained 'cheap' at below Sonia +0.2% for 3m repo. The consultation on RPI reform closed in August 2020; however, the timing of the results remains uncertain following the Chancellor's decision to postpone the Autumn budget. Progress was, however, made on cessation of LIBOR; the International Swaps and Derivatives Association is expected to release the fallback supplement this month, with an effective date of 25 January 2021.
		**Oliver Wayne** **Liquid Markets: Equities**	Equity markets delivered positive returns in the third quarter of 2020 as governments continued to provide stimulus to counteract the impacts of COVID-19. Asia and the US outperformed Europe, with the UK market delivering negative returns and extending its year-to-date underperformance. From a factor perspective, the dispersion in performance widened during the third quarter as momentum and growth factors continued to outperform. Conversely, value factors continued to materially underperform the broader market, extending the underperformance experienced during the first half of the year. The wide dispersion in factor performance has resulted in a wide dispersion of manager returns, with value investors facing a material headwind compared to growth-oriented investors. From a size perspective, smaller companies moderately outperformed larger companies as investor risk appetite remained elevated in both developed and emerging markets.
		**Tom Wake-Walker** **Liquid Markets: Multi-Asset**	Long-biased multi-asset portfolios benefited from predominantly positive performance across asset classes during the quarter. On the whole, we saw portfolio managers becoming more sanguine about the level of risk in markets. Commodities rose over the quarter, with metals and some energies leading the way. This, along with rising equity markets, supported risk parity allocations but did cause losses for some trend following strategies which experienced a particularly tough September. On the systematic side, equity market neutral and equity style premia strategies suffered from a continuation of the underperformance of the value factor. By some measures, this factor has had its worst period of performance in 100 years and is influencing managers' returns to varying degrees dependent on the weighting in their approach.

VIEWS FROM THE ASSET CLASS SPECIALISTS

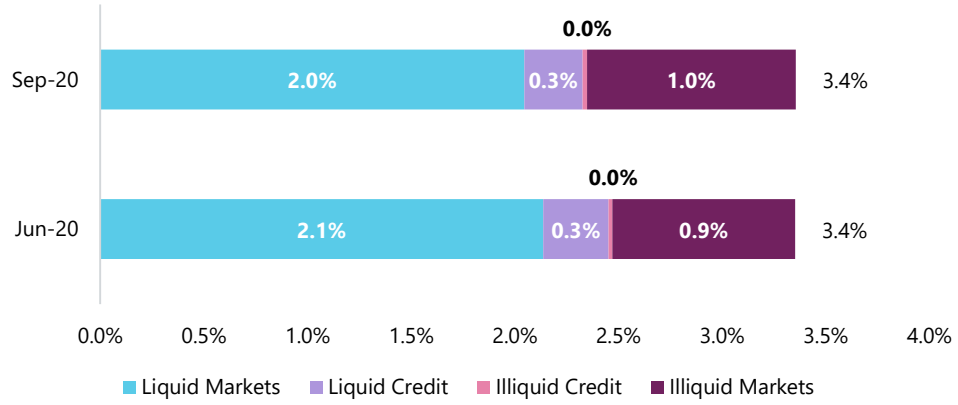
		**Chris Bikos** **Liquid & Semi-Liquid Credit**	In bond markets the tone was predominantly "risk on" over the quarter, but became more muted in September amid rising COVID infection rates, uncertainty over the US election and political deadlock over a US fiscal stimulus package. Global central banks continued their monetary policy support, maintaining short-term interest rates near historical lows. In the US and the UK, government yield curves steepened slightly, with short-term yields moving lower and long-term yields rising. European government bonds performed well, and yields moved lower across all maturities. Moving to corporate credit, corporate spreads tightened across the board and risky assets delivered strong returns. Consequently, corporate bonds outperformed government bonds. High yield was a strong performer, with US, European and emerging market indices posting positive returns. Across geographies, both investment grade and structured credit delivered positive returns. Emerging market currencies were mixed, while local currency bonds made a modest positive return.
		**Tom Duggan** **Illiquid Credit**	In a quarter that would typically be defined by a lull in activity over the summer months, private markets saw somewhat of a resurgence in Q3. The market can be broadly defined into two categories and lending activities. First, businesses with tailwinds as a result of COVID-19 where deal flow is extremely healthy and pricing is at or below pre-COVID levels, albeit with higher arrangement fees. M&A activity was particularly strong in this cohort as Refinitiv reported that more than $1trn worth of transactions globally were completed in September alone. These were mostly in coronavirus-resilient sectors such as healthcare, technology, telecoms etc. The second category are businesses that have been negatively affected by COVID-19 that have sought out rescue finance or restructured their balance sheets to more flexible, and more expensive, capital solutions. In terms of manager performance, on the whole we have seen outperformance relative to the March/April re-underwrite. Nonetheless, this remains within the context of higher default rates and increased monitoring of negatively affected portfolio companies.
		**Jaspal Phull** **Illiquid Markets**	Q3 saw a resemblance of a return to more normal levels of activity; however, there is still some way to go to recover to pre-pandemic levels. The Royal Institution of Chartered Surveyors paved the way for property funds to begin to reopen, having recommended a lifting of the material uncertainty valuation clause placed on most UK real estate assets. This had forced funds to gate in March in the wake of the lockdown measures. The continued low rates of rent collection – even from high-covenant strength tenants – continues to be a concern, with an estimated £4.5bn of rent withheld since the beginning of March. Property funds with high retail & leisure exposure are facing the greatest difficulties. Contracted infrastructure assets continue to fare well and retain a positive long-term outlook.

YOUR ASSET ALLOCATION AND EXPOSURE

Asset Allocation Change

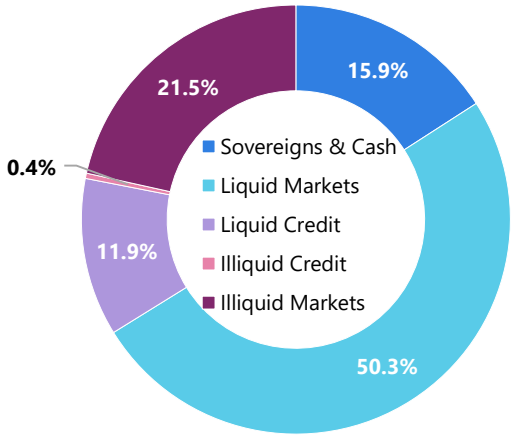


Expected Return Contribution Change (over gilts)



Note, asset class expected returns are in the appendix.

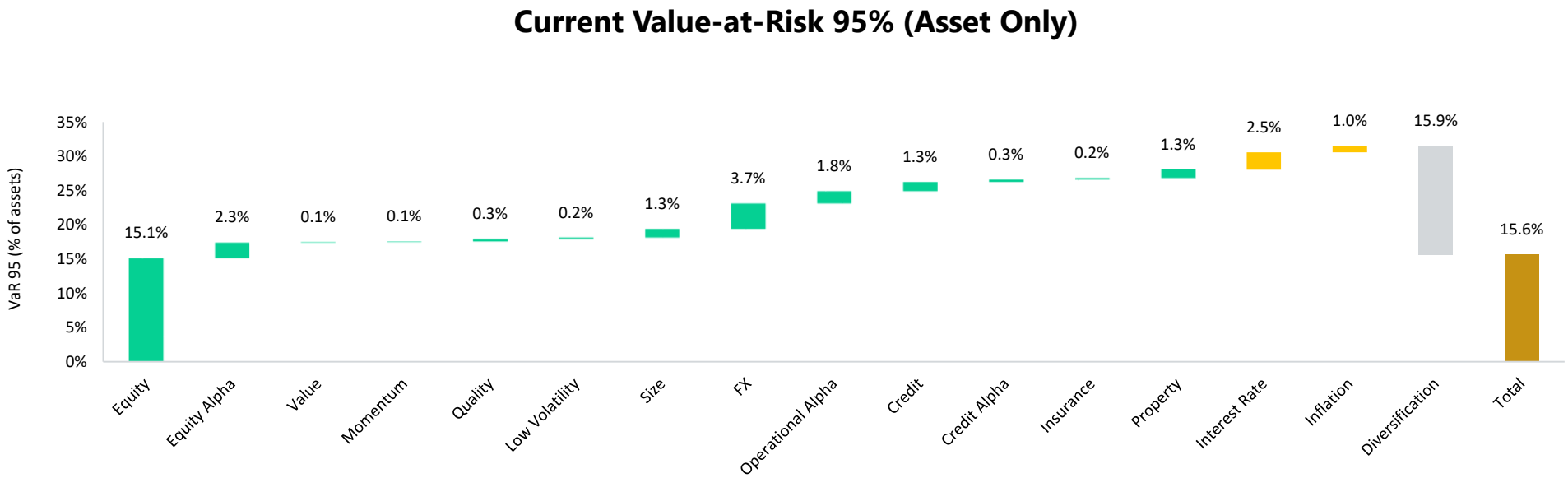
Detailed Asset Allocation



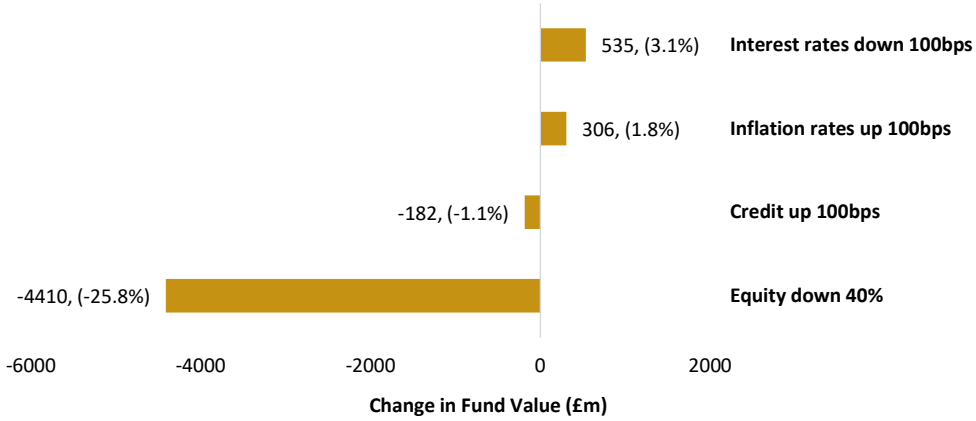
6.0% Cash GBP
5.9% Index-Linked Gilts
2.0% Nominal Gilts
1.9% US TIPS
5.3% ACS LGPS UK Equity Passive Fund
13.1% ACS LGPS Global Ex UK Passive Equity Fund
3.0% ACS LGPS Global Equity Dividend Growth Factor Fund
10.0% ACS LGPS All World Equity Climate Multi Factor Fund
5.3% Global Equities - External
1.2% Global Equities - Internal
2.2% Impax Sustainable Equity Fund
2.1% RBC Sustainable Equity Fund
0.6% WHEB Sustainable Equity Fund
0.1% Overseas Legacy Passive Equities
0.0% UK Equities
7.4% Emerging Markets Equities

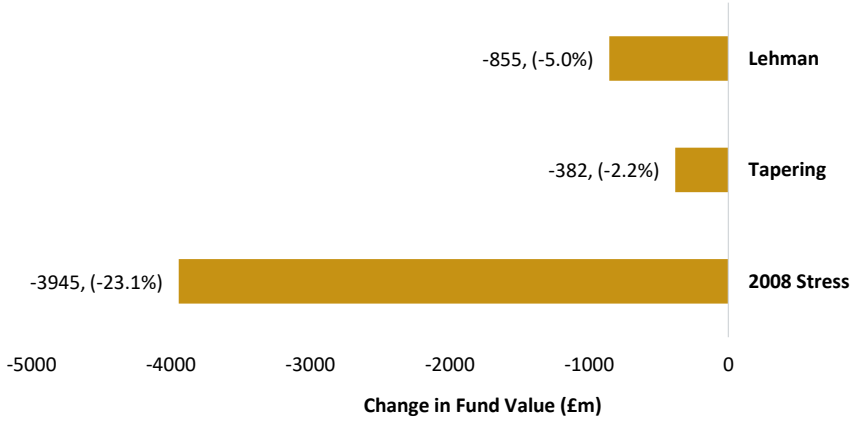
3.9% UK Corporate Bonds
1.2% LGPS Central Global Active IG Corporate Bond Fund
2.8% Other Fixed Interest (Secured Loans)
4.0% Emerging Market Debt Funds
0.4% Securitised Opportunities
2.2% Direct Infrastructure
5.5% Direct Property
2.4% Indirect Infrastructure
1.9% Indirect Property
1.1% Insurance-Linked Securities
1.3% Opportunistic Funds
7.2% Private Equity/Secondaries

HELPING YOU UNDERSTAND YOUR RISK



Scenario Analysis





APPENDICES

REDINGTON'S EXPECTED RETURNS – SEPTEMBER 2020

Asset Class	Expected Return (Gilts +)	Volatility	Expected Fees (p.a.)
Equity			
Developed Market Equities	3.9% ↓	17.8% –	0.0%-0.1%
Sustainable Equities	4.1% ↓	16.2% ↓	0.2%-0.4%
Emerging Markets Equities	4.4% ↓	20.7% ↓	0.1%-0.2%
China A Share Equities	5.7% ↓	31.2% ↑	0.3%-0.8%
Liquid Credit			
Corporate Debt GBP – Passive	1.0% ↓	5.8% ↓	0.1%-0.2%
Corporate Debt GBP – Active	1.4% –	5.9% –	0.2%-0.3%
Emerging Market Debt – Corporates	2.7% ↓	6.2% ↓	0.4%-0.6%
Emerging Market Debt – Local Currency Sovereign	3.3% ↓	14.1% ↓	0.5%-0.8%
Emerging Market Debt – Hard Currency Sovereign	2.4% ↓	8.8% ↓	0.5%-0.8%
Multi-Class Credit Global	3.7% ↓	7.2% ↓	0.4%-0.7%
Illiquid Credit			
Diversified Matching Illiquids (Uninvested)	2.3% ↓	6.8% ↓	0.3%-0.5%
Opportunistic Illiquid Credit	5.5% ↓	10.8% ↓	1.0%-1.5% (+ performance fee)
Securitised Opportunities	3.5% ↓	5.9% ↓	0.5%-0.7%
Special Situations	6.3% ↓	16.5% ↓	1.0%-1.5% (+ performance fee)
Illiquid Markets			
Private Equity	5.4% ↑	32.0% ↑	1.0%-1.5% (+ performance fee)
Insurance-Linked Securities	4.4% ↓	10.0% ↓	1.0%-1.5%
Renewable Infrastructure (Whole Projects)	3.8% ↓	14.2% ↓	0.5%-0.7%

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

GLOSSARY

Term	Description
Annual Management Charge (AMC)	The fee charged by the asset manager for managing the fund, typically expressed as an annual percentage on the invested assets. This excludes additional expenses, e.g. administrative costs, which when combined with the AMC make up a fund's total expense ratio (TER).
Credit Risk	The risk of financial loss as a result of the inability or unwillingness of an entity to make payments as they become due. Many types of relationships involve credit risk, such as those in which a company owes money to its suppliers (trade debt) or where a counterparty is required to make payments under a derivative contract (counterparty credit risk).
Credit Spread	The difference in the yield between two different bonds, due to different credit quality. The credit spread reflects the additional yield an investor can earn from taking incremental credit risk. Is it often quoted in relation to the yield on government bonds.
Inflation	The average rate at which prices (of products and services) increase over time. It gradually reduces the value of money over time – the higher the rate of inflation, the greater the erosion of value.
Risk Attribution	The process of attributing certain components of total risk to various sources such as inflation risk, credit risk, equity risk, etc.
Stress Testing	A tool used to assess a portfolio's exposure to large – but plausible – shocks. In the broadest sense, stress testing is a 'what if' exercise and can be modelled across various scenarios. For example, a stress test can be used to simulate the performance of a portfolio during 9/11, Black Monday and the Global Financial Crisis of 2007-08.
Value-at-Risk (VaR)	The minimum value that the Fund would expect to lose (at risk) for a given confidence level, over a given time horizon. We have used a 1-in-20 (i.e. 95%) confidence level. For example, if a portfolio's 95% 1-year VaR is £200 million, it would have a 5% chance (1-in-20) of suffering a loss over the year of £200 million or more.
Volatility	A measure of variability that is used as a common metric for risk. It represents the value of one standard deviation change in the value of an assets' return. Under certain assumptions, we are able to use this measure to calculate the probability of a given change in the value of the asset or portfolio.
Yield	The income return on an investment. It is based on the received cash flows of a security and is usually expressed as an annual percentage.
Yield Curve	A graphical representation showing the yields of a set of financial instruments by maturity. For example, the par interest rate swap curve or the UK Gilt curve.

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