REDINGTON

West Midlands Pension Fund

YOUR MARKET AND INVESTMENT UPDATE

Q3 2023

Private and Confidential

WHAT HAPPENED DURING THE QUARTER

Pete Drewienkiewicz (Chief Investment Officer)

Market Summary

After a strong first half of the year, risk assets saw a more challenging Q3 as markets finally digested the "higher for longer" message from global central banks. Yield curves across developed markets moved meaningfully higher over the quarter even as the pace of rate hikes slowed, helping high yield bonds to outperform higher-quality corporate debt. The Fed and Bank of England now appear to be close to the end of their respective hiking cycles, although a prolonged period of above-target inflation or even stagflation remains a risk.

Key Points for You

- Expected returns decreased over the quarter from Gilts + 3.8% at 30th June 2023 to Gilts + 3.3% at 30th September 2023. This was primarily driven by a reduction in the allocation to Equities (in line with the direction of travel towards the Fund's new SAA) as well as a reduction in our expected return assumption for Equities.
- Asset-side risk, as measured by VaR 95%, decreased from 16.5% at 30th June 2023 to 15.4% at 30th September 2023. This was also primarily driven by the reduced allocation to Equities.

Market Data

Equity Index	Level	Change since 30-Jun-23	Change since 30-Sep-22
FTSE 100 (Total Return)	8078	2.2%	14.7%
S&P 500 (Total Return)	9247	-3.3%	21.6%
EuroStoxx 50 (Total Return)	1933	-4.8%	30.0%
Nikkei 225 (Total Return)	55787	-3.3%	25.4%
MSCI World (Total Return)	6991	-2.6%	20.4%
MSCI Emerging Markets (Total Return)	653	-1.4%	10.9%
FX			
USD vs GBP	1.22	-4.0%	9.3%
EUR vs GBP	1.15	-0.9%	1.3%
Credit Spreads			
Sterling Non-Gilt Index	116	-6 bps	-19 bps
Sterling Non-Gilt 15Y+ Index	158	-6 bps	-30 bps
Global Investment Grade	126	-6 bps	-35 bps
US Investment Grade	142	-8 bps	-41 bps
Global High Yield	385	-8 bps	-128 bps
European High Yield	339	0 bps	-117 bps

Market Data

UK Gilts	Level	Change since 30-Jun-23	Change since 30-Sep-22
10Y	4.53	10 bps	34 bps
30Y	5.04	66 bps	132 bps
UK Nominal Swaps			
10Y	4.60	7 bps	-5 bps
30Y	4.42	50 bps	71 bps
Gilt Breakeven Inflation			
10Y	3.78	-1 bps	-21 bps
30Y	3.48	8 bps	-26 bps
UK RPI Swap			
10Y	3.93	-4 bps	-50 bps
30Y	3.41	0 bps	-40 bps
UK Gilt Real Rates			
10Y	0.76	11 bps	56 bps
30Y	1.56	57 bps	158 bps
US TIPS			
20Y	2.58	75 bps	51 bps
30Y	2.23	72 bps	66 bps

VIEWS FROM THE ASSET CLASS SPECIALISTS

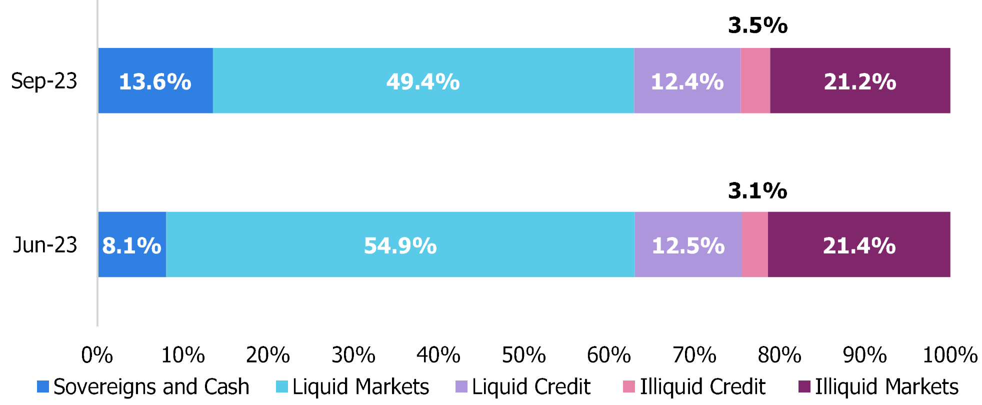
 **Kate Mijakowska** **Government Bonds**	In Q3 2023, UK 30-year nominal gilt yields rose 48bps. Breakeven inflation at the same tenor fell 5bps, bringing UK 30-year real yields 53bps higher. Despite both the US Federal Reserve ('Fed') and Bank of England ('BoE') pausing rate hikes in September, the market repriced for "higher for longer" rates expectations. This is driven by factors including: the Fed's messaging, continued resilience of labour markets, upcoming high net government debt supply, and in the US a higher than expected CPI print for August. In Q3, yield curve slopes also exhibited significant volatility. At the end of September 2023 in the UK, the 2-year yield sat 47bps higher than the 10-year yield. This is materially steeper than at the end of June, when the difference was 88bps. In late September, the BoE's Andrew Hauser made a speech which indicated the Bank's intention to launch a lending facility directly for non-bank financial institutions, which would include pension schemes, to aid financial stability in periods of market stress.
 **Oliver Wayne** **Liquid Markets (Equities)**	Developed markets ('DM') delivered modest positive returns in GBP over Q3, primarily due to the devaluation of GBP vs USD. The information technology sector – which includes the tech companies: Apple, Microsoft, Alphabet, Amazon, Tesla, Nvidia, and Meta, collectively known as the "Magnificent Seven" – experienced a challenging quarter, with most of these companies seeing declines in their stock prices. Despite the broader market challenges, energy stocks delivered strong positive returns. This was driven by significantly higher energy prices after Russia and Saudi Arabia cut oil production. Emerging markets ('EM') moderately outperformed DM, albeit with some dispersion from a single country perspective. From a style factor basis it was generally a good market for value managers and a more challenging market for growth investors. There was no material size effect in DM, but smaller sized companies continued to materially outperform in EM.
 **Alex Robinson** **Liquid Markets (Multi-Asset)**	It was a fairly disappointing Q3 for risk assets as investors digested the scenario of a higher for longer interest rate environment following generally stronger than expected US economic data. Equity and fixed income markets sold off as interest rates continued to climb. This move hurt a number of long-only multi-asset managers, particularly those that have been increasing duration in anticipation of a central bank pivot on interest rates. Commodities had a very strong quarter, driven by significantly the higher energy prices after Saudi Arabia and Russia cut oil production. For diversified risk premia strategies, the positive performance in commodities should have helped to offset some of the poorer performance in equity and fixed income. Trend-following strategies were broadly positive, and strong performance from the value factor will have benefited those with style focused market neutral equity exposure as well. In the 'event driven' space, merger arbitrage saw strong performance in Q3 as the Amgen/Horizon Therapeutics and Activision Blizzard/Microsoft lawsuits were resolved and both deals closed, providing improved sentiment to the broader M&A space.

VIEWS FROM THE ASSET CLASS SPECIALISTS

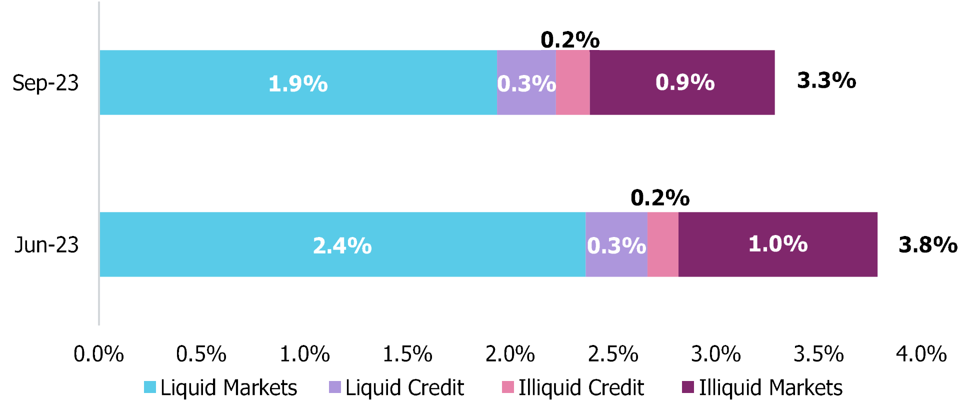
 **Chris Bikos** **Liquid & Semi-Liquid Credit**	Credit spreads across the quality spectrum tightened over Q3, but for long-duration assets this was not enough to compensate for the losses caused by the increase in interest rates. Sterling credit outperformed its US counterparts, and the top-performing space was short-dated sterling credit (1 to 10 years corporate credit) at c.3.5%. In July, the Fed and the European Central Bank ('ECB') raised rates by 0.25%, with the ECB continuing to hike in September. The Bank of England raised the base rate to 5.25% in August but kept rates unchanged in its September meeting. Moving to emerging markets ('EM'), EM Local was the worst-performing asset class, delivering -3.3% over the period. Performance in EM corporates was negative, but dispersion in the asset class was high, with high yield posting positive returns outperforming investment grade. The performance of EM sovereigns was negative at -2.2%, as spreads moved wider. Leveraged loans had another positive quarter, delivering positive returns in both the US and Europe despite the slight uptick in defaults. The asset class continues to benefit from its floating-rate nature and high income generation.
 **Sarah Miller** **Illiquid Credit**	Private credit dry powder exceeds $0.5tn and fundraising is down 12% year on year (Preqin). This is markedly stronger than the ~30%YoY fundraising decline across private markets in aggregate, reflecting the relative opportunity and appetite for credit. The velocity of deployment and realisation has decreased. Disciplined lenders look to high-quality borrowers able to adapt to inflationary and rate pressures to minimise margin contraction. Demand for larger deals has led to spreads narrowing by 25-50 bps. Slower realisation of capital from primary funds is driving the growth in secondary market funds, with the key objective of generating liquidity. A question raised regularly is whether the asset class has been tested – private loans were originated by the likes of CIT and GE (finance companies) prior to the 2008 Financial Crisis and tested throughout. With the increased presence of institutional investors, and increased scale and breadth of offerings, the more pertinent question is whether managers have been tested. Our expectation is for dispersion in performance.
 **Tricia Ward** **Illiquid Markets**	Across private markets, fundraising has remained well below expectations (c.26% less than Q1-Q3 2022 according to Preqin) and is currently trending to be lower than it has been for 10 years. Global M&A is also down to $2 trillion, 27% down on Q1-Q3 2022. The UK energy market has been through a period of elevated power prices over the last 18 months, which has contributed positively to infrastructure asset performance. However, this has started to come back in line with historical averages, with a number of regulatory schemes implemented to bring stability back to the market. In September, the UK Offshore Wind auction received no bids as a result of market participants believing that the maximum price set by the government for Contract for Difference contracts was too low, making projects financially unfeasible in an environment of high rates and inflation (with costs expected to have increased by 40%). UK residential property funds took stock of the scrapping of proposed updates to Minimum Energy Efficiency Standards by the UK Government, with most saying they will stick to the target of EPC C for new tenancies by 2025 and 2028 for existing tenancies.

YOUR ASSET ALLOCATION AND EXPOSURE

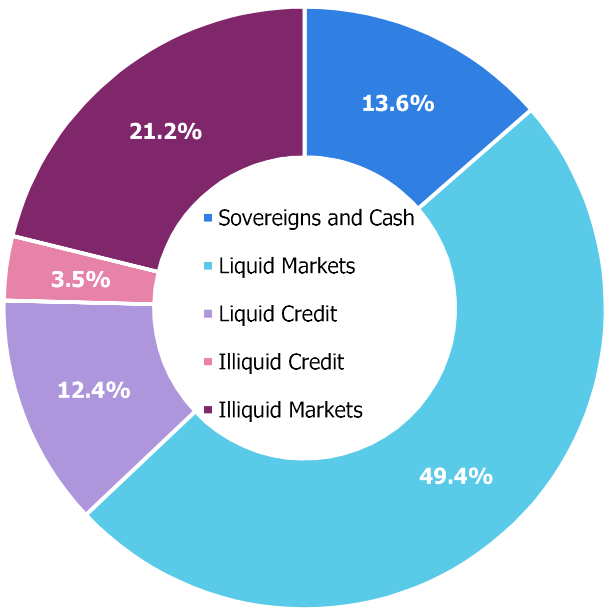
Asset Allocation Change



Expected Return Contribution Change (over gilts)



Note, asset class expected returns are in the appendix.

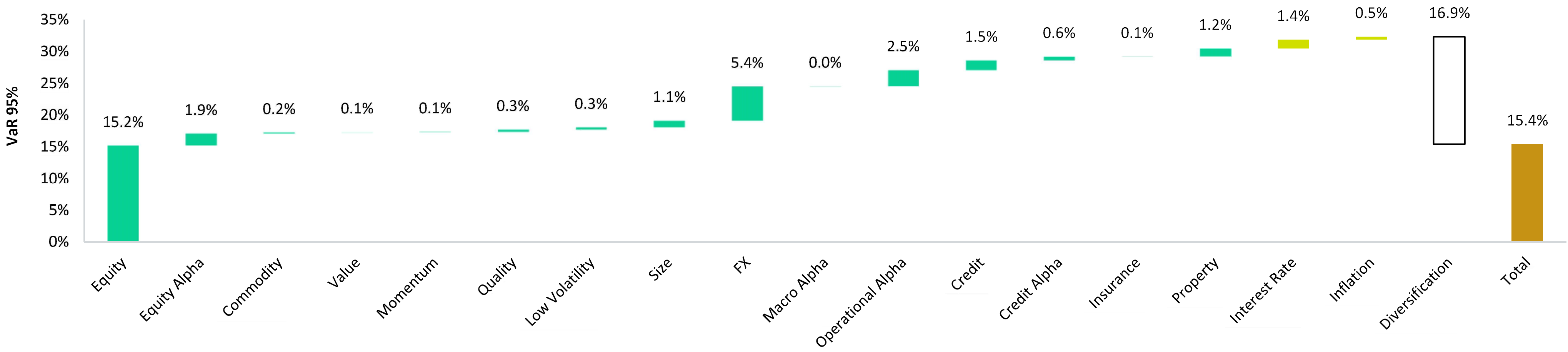


Detailed Asset Allocation

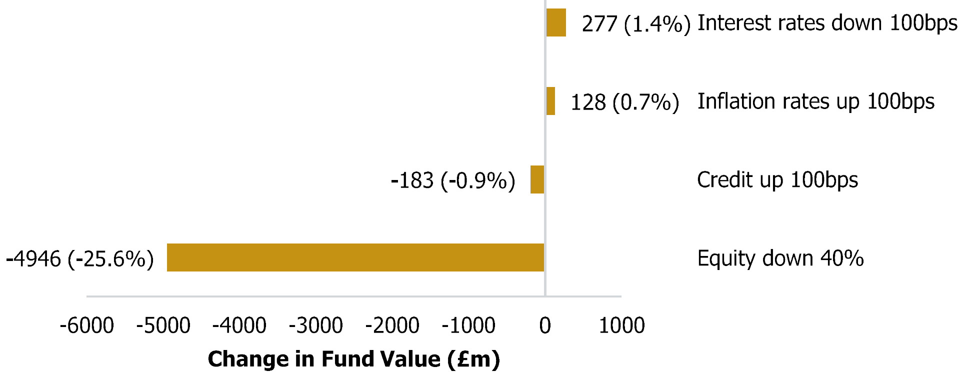
Cash	9.0%	Sustainable Equities - WHEB	0.6%
LGIM Overseas Bonds	0.5%	Emerging Markets Equities	6.4%
Index-Linked Gilts	3.4%	Aegon Short Dated Investment Grade Bond Fund	1.5%
Nominal Gilts	0.7%	UK Corporate Bonds	2.7%
ACS LGPS UK Equity Passive Fund	5.4%	LGPS Central Global Active IG Corporate Bond Fund	0.9%
ACS LGPS Global Ex UK Passive Equity	13.7%	Multi-Class Credit	3.5%
ACS LGPS All World Equity Climate Multi Factor	11.4%	Emerging Market Debt Funds	3.8%
LGPS Central Global Equity Multi Manager Fund	6.5%	Illiquid Credit	3.5%
LGIM UK Small Cap	0.3%	Infrastructure	5.4%
Equities held with Merrill Lynch	0.4%	Property	7.1%
Smaller Equity Positions	0.1%	Opportunistic Funds	0.9%
Sustainable Equities – Impax	2.5%	Private Equity	7.8%
Sustainable Equities - RBC	2.1%		

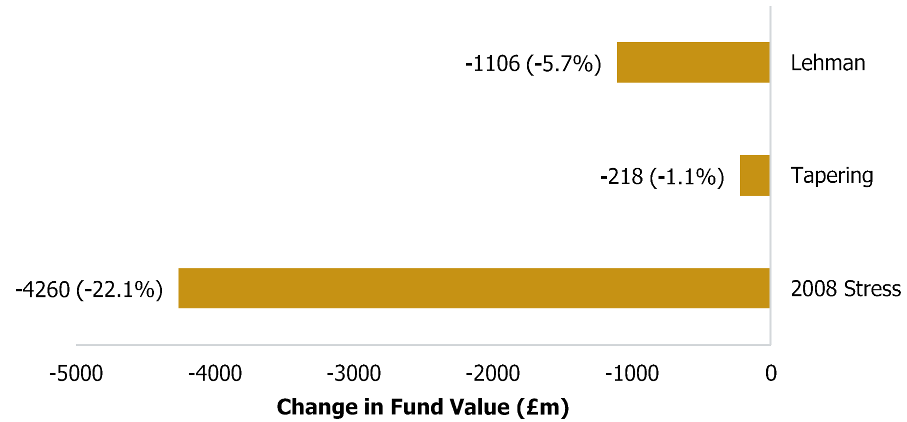
HELPING YOU UNDERSTAND YOUR RISK

Current Value-at-Risk 95% (Asset Only)



Scenario Analysis





APPENDICES

REDINGTON'S EXPECTED RETURNS – SEPTEMBER 2023

Asset Class	Expected Return (Gilts +)	Volatility	Expected Fees (p.a.)
Equity			
Developed Market Equities	3.7% ↓	16.8% ↓	0.0%-0.1%
Sustainable Equities	3.9% ↓	15.9% ↓	0.2%-0.4%
Emerging Markets Equities	4.3% ↓	20.1% ↓	0.1%-0.2%
Liquid Credit			
Corporate Debt GBP – Passive	1.2% ↓	5.3% ↓	0.1%-0.2%
Corporate Debt GBP – Active	1.5% ↓	5.4% ↓	0.2%-0.3%
Emerging Market Debt – Corporates	2.1% ↓	6.4% ↓	0.4%-0.6%
Emerging Market Debt – Local Currency Sovereign	3.1% –	12.9% ↓	0.5%-0.8%
Emerging Market Debt – Hard Currency Sovereign	2.2% ↑	7.7% ↓	0.5%-0.8%
Multi-Class Credit Global	3.7% ↓	7.1% ↓	0.4%-0.7%
Illiquid Credit			
Diversified Matching Illiquids	2.7% ↓	7.4% ↓	0.3%-0.5%
Opportunistic Illiquid Credit	4.8% ↓	10.6% ↓	1.0%-1.5% (+ performance fee)
Securitised Opportunities	3.6% ↓	5.5% ↓	0.5%-0.7%
Special Situations	6.3% ↓	13.6% ↓	1.0%-1.5% (+ performance fee)
Illiquid Markets			
Private Equity	5.2% ↓	30.4% ↓	1.0%-1.5% (+ performance fee)
Commercial Property	3.5% –	11.8% –	0.4%-0.6%
Renewable Infrastructure (Whole Projects)	3.1% ↓	14.8% –	0.5%-0.7% (+ performance fee)

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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