Appendix A

YOUR MARKET AND INVESTMENT UPDATE

Q1 2021

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

Q1 2021 saw the combination of continued fiscal stimulus and the hope of an end to the pandemic further reverse some of the market moves seen in the first three quarters of 2020. The combination of fiscal and monetary policy (at least in the US) looks to make up for the fall in growth due to the pandemic and potentially some of that from the 2008 financial crisis. Whether the US will succeed in stimulating growth and/or inflation where Japan has failed remains to be seen with pandemic-related "bounce-back" effects likely to the main driver of economic statistics over the next few quarters. The lack of such aggressive policy intervention in the UK and the rest of Europe may lead to a divergence in both economic and market performance with the US.

Key Points for You

- Expected return increased from Gilts + 3.3% at 31 December 2020 to Gilts + 3.5% at 31 March 2021. This was largely driven by an increase in equities and a reduction in cash as a percentage of total assets, and an increase in the expected return on equity assets.
- Asset-side risk, as measured by VaR 95%, increased from 15.4% at 31 December 2020 to 16.4% at 31 March 2021. This was driven by a higher allocation to equities, with equity risk being the main driver of overall risk, and a reduced allocation to cash. Asset-side risk at 31 March 2021 has moved higher than the stated risk budget of 16%, however remains within an acceptable range of this target.

Market Data

Equity Index	Level	Change since 31-Dec-20	Change since 31-Mar-20
FTSE 100 (Total Return)	6482	5.0%	21.9%
S&P 500 (Total Return)	8238	6.2%	56.4%
EuroStoxx 50 (Total Return)	1669	10.8%	44.4%
Nikkei 225 (Total Return)	48538	7.0%	56.7%
MSCI World (Total Return)	6350	6.1%	50.7%
MSCI Emerging Markets (Total Return)	774	4.0%	53.0%
FX			
USD vs GBP	1.38	0.8%	11.0%
EUR vs GBP	1.18	5.0%	4.4%
GBP vs JPY	0.7	-7.5%	-12.5%
Credit Spreads			
Sterling Non-Gilt Index	90	-10 bps	-112 bps
Sterling Non-Gilt 15Y+ Index	144	-14 bps	-103 bps
Global Investment Grade	92	-11 bps	-173 bps
US Investment Grade	102	-11 bps	-196 bps
Global High Yield	352	-30 bps	-408 bps
European High Yield	290	-36 bps	-338 bps

Market Data

UK Gilts	Level	Change since 31-Dec-20	Change since 31-Mar-20
10Y	0.94	71 bps	58 bps
30Y	1.41	62 bps	57 bps
UK Nominal Swaps			
10Y	1.07	67 bps	47 bps
30Y	1.25	67 bps	64 bps
Gilt Breakeven Inflation			
10Y	3.62	42 bps	63 bps
30Y	3.38	28 bps	70 bps
UK RPI Swap			
10Y	3.72	31 bps	40 bps
30Y	3.40	29 bps	61 bps
UK Gilt Real Rates			
10Y	-2.68	29 bps	-4 bps
30Y	-1.97	33 bps	-13 bps
US TIPS			
20Y	-0.01	39 bps	-16 bps
30Y	0.20	46 bps	3 bps

VIEWS FROM THE ASSET CLASS SPECIALISTS

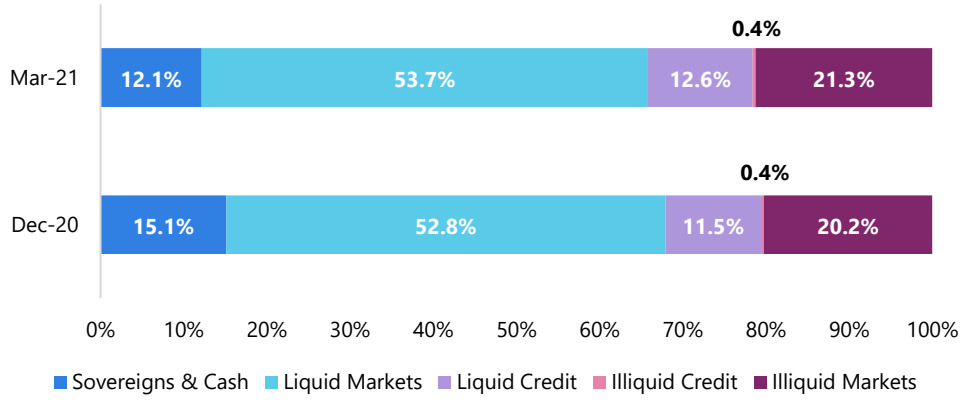
		**Kate Mijakowska** **LDI and Overlay**	The UK nominal gilt yield curve moved sharply higher over the quarter, following positive news about vaccine rollout and investors' optimism about economic prospects. The largest move occurred at the 10-year point, with the nominal yield up 70bps, which is remarkably high. Inflation expectations also rose significantly, with the 20-year inflation breakeven rate up 30bps over the quarter. Overall, real yields are up considerably (38bps at the 20-year point); we therefore expect most clients to have experienced a reduction in their LDI collateral buffers. Repo spreads remain low relative to history, with all tenors now below SONIA + 10bps. In March, the Chancellor's Budget announcement revealed there will be at least £15bn of green gilt issuance this fiscal year. Also in March, the FCA announced that GBP LIBOR will either cease to be provided or no longer be representative from January 1st, 2022.
		**Oliver Wayne** **Liquid Markets (Equities)**	Developed markets delivered a positive return during the first quarter of 2021, supported by the roll-out of COVID-19 vaccines and news of further US fiscal stimulus. Emerging markets registered a moderately lower positive return, with emerging-market vaccine programmes lagging developed markets. China was the worst-performing market following exceptionally strong returns in 2020. Economically sensitive sectors continued to extend their recovery. From a factor perspective, the rotation observed in Q4 2020 broadly persisted in Q1 2021. Value and high volatility outperformed in all regions. Momentum was the worst-performing factor group. From a size perspective, smaller companies continued to outperform larger companies as investor risk appetite remained elevated in both developed and emerging markets.
		**Tom Wake-Walker** **Liquid Markets (Multi-Asset)**	The majority of multi-asset and liquid alternative strategies generated positive performance in Q1 as risk-on assets – equities and commodities – rose on continued optimism around an economic recovery. Significant government stimulus drove inflation expectations, positively affecting both asset classes while proving detrimental to government bond pricing. As a consequence, risk parity performance was generally muted but discretionary strategies holding more equity beta generally profited. Trend following benefited over the quarter as long equity and commodities positioning and short bond positioning drove returns. Equity style premia strategies were generally positive, with some dispersion driven by the degree to which managers weight the value factor. Value continued its strong performance as investors reacted to economy reopening news and higher interest rates by rotating into more cyclical names.

VIEWS FROM THE ASSET CLASS SPECIALISTS

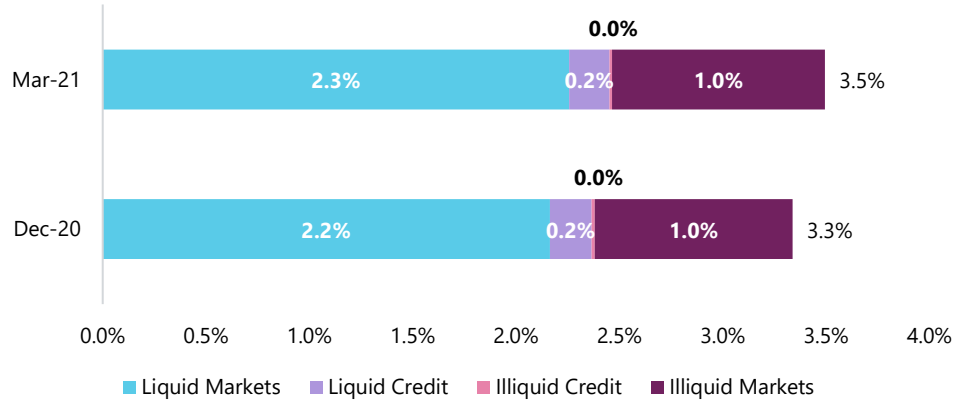
		**Chris Bikos** **Liquid & Semi-Liquid Credit**	Government yields rose across major markets, with the 10-year US treasury yield reaching 1.74%. The UK 10-year yield increased by 70 basis points (bps) to 0.91% and in Europe yields rose by 20bps (as measured by 10-year Bund). Yield curves steepened, and credit markets were range-bound as investors considered potential inflation risks on fixed income markets. In the US, high yield returned 0.9% in the first three months, but leveraged loans (which are predominately floating rate) returned 2.0% over the same period. It was a similar picture in Europe, with high yield returning 1.5% and loans 1.7%. Across corporate credit markets, spreads tightened but that was not enough to offset the negative impact from rising rates, leading to negative total returns across maturity buckets (especially at the long end). Structured credit markets traded with a positive tone in Q1 2021, benefiting from their floating-rate nature, tightening spreads and lower defaults. In emerging markets, Turkey was in the news as President Erdogan fired another central bank governor and, whilst Turkish assets underperformed, the contagion to other emerging markets was limited.
		**Sarah Miller** **Illiquid Credit**	Private market activity held strong over the first quarter of the year, with c.$1.3trillion worth of M&A deals announced, the second highest ever to be reported in any quarter. Deal activity across private credit echoed this sentiment with a bias towards sectors less affected by COVID-19. This clear bifurcation in activity between sectors – with fewer deals closed in sectors worst hit by COVID-19 such as travel, leisure and hospitality – continued to be a theme over Q1. Globally, direct lending dry powder continues to increase; as at the end of February 2021 it was reported at c.$108bn compared to $82bn and $107bn at year-end 2019 and 2020 respectively. Special purpose acquisition company (SPAC) IPOs – an alternative route for private corporates to go public – reached new highs in Q1, accounting for 17% of quarterly M&A activity.
		**Jaspal Phull** **Illiquid Markets**	Rental collection has picked up significantly over the last two quarters and investor confidence appears to be increasing in line with general business confidence. However, transactional volumes across all of the commercial property sectors remained subdued, driven by the fall in activity across the London office market. This activity is expected to recover as social distancing measures ease. The UK industrial property market remains pressured by the inexorable rise of e-commerce and structural change in retail distribution. Demand for industrial space from tenants is strong, whilst investors are also actively looking to get more exposure. This increase in demand is pushing both rents and pricing higher. Lending markets remain active, but pricing and liquidity has diverged, with sectors out of favour (such as retail and hotels) treated very differently to the rest.

YOUR ASSET ALLOCATION AND EXPOSURE

Asset Allocation Change

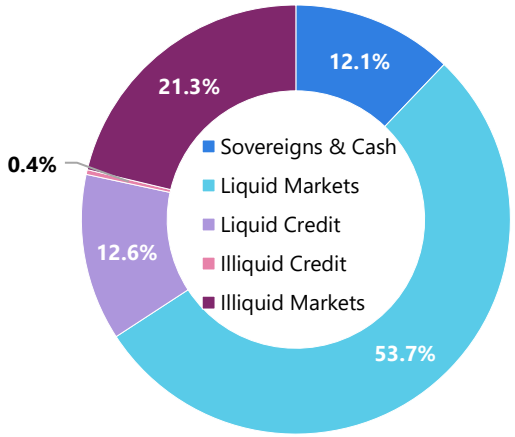


Expected Return Contribution Change (over gilts)



Note, asset class expected returns are in the appendix.

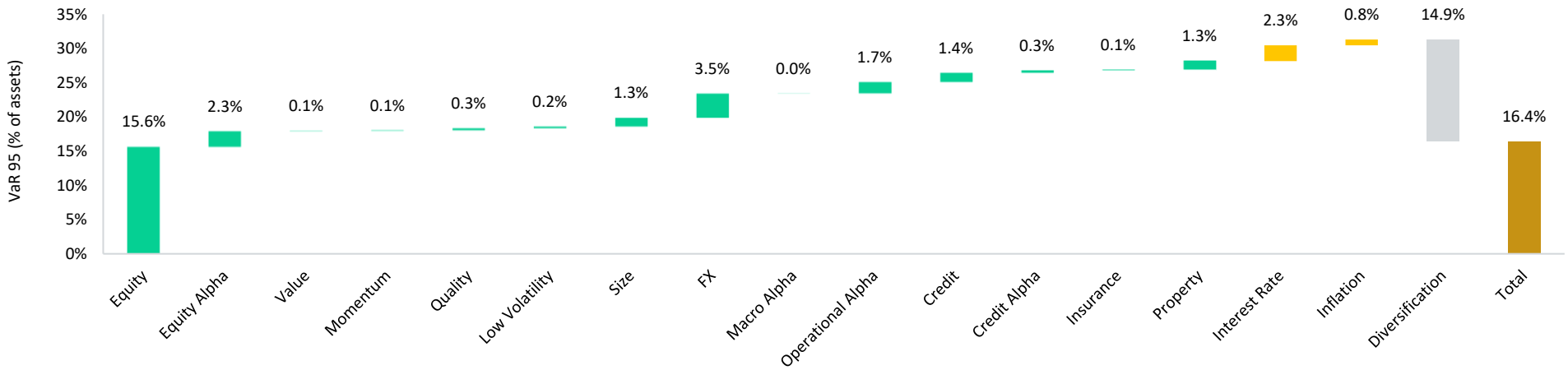
Detailed Asset Allocation



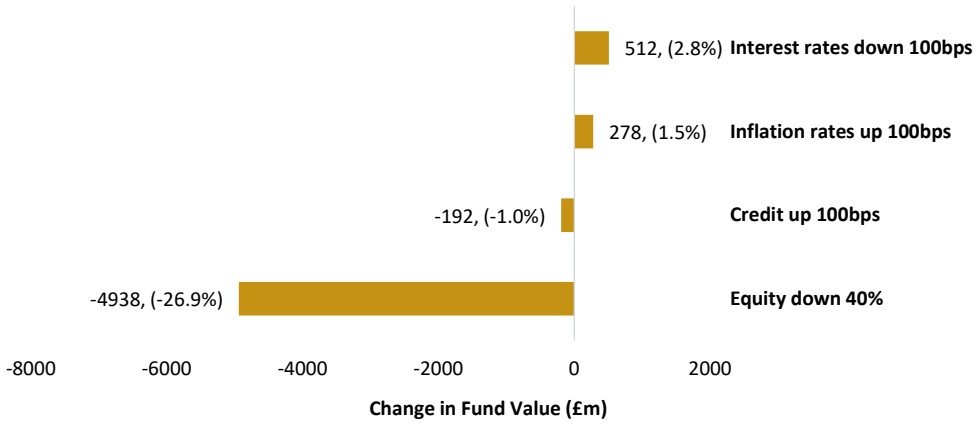
3.0% Cash
5.2% Index-Linked Gilts
1.8% Nominal Gilts
0.6% LGIM Overseas Bond Fund
1.6% US TIPS
5.9% ACS LGPS UK Equity Passive Fund
13.8% ACS LGPS Global Ex UK Passive Equity Fund
3.0% ACS LGPS Global Equity Dividend Growth Factor Fund
10.1% ACS LGPS All World Equity Climate Multi Factor Fund
5.8% LGPS Central Global Equity Multi Manager Fund
0.3% LGIM UK All Share
1.1% Global Active Futures
0.6% Equities held with Merrill Lynch
0.1% Smaller Equity Positions
2.3% Sustainable Equities - Impax
2.2% Sustainable Equities - RBC
0.6% Sustainable Equities - WHEB
2.8% Emerging Markets Equities - AGF
3.0% Emerging Markets Equities - BMO
2.1% Emerging Markets Equities - Mondrian
1.6% Aegon Short Dated Investment Grade Bond Fund
3.6% UK Corporate Bonds
1.1% LGPS Central Global Active IG Corporate Bond Fund
2.1% Multi-Class Credit
4.1% Emerging Market Debt Funds
0.4% Schroders FOCUS II
4.6% Infrastructure
7.5% Property
1.7% Opportunistic Funds
7.5% Private Equity

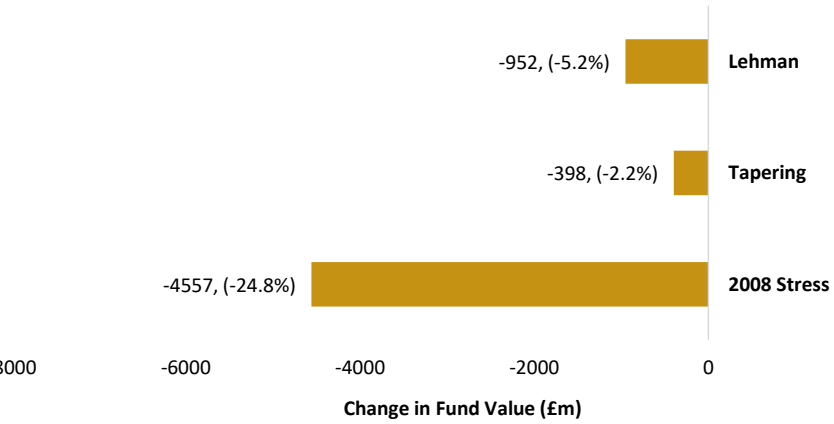
HELPING YOU UNDERSTAND YOUR RISK

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



Scenario Analysis





APPENDICES

REDINGTON'S EXPECTED RETURNS – MARCH 2021

Asset Class	Expected Return (Gilts +)	Volatility	Expected Fees (p.a.)
Equity			
Developed Market Equities	4.0% ↑	17.8% –	0.0%-0.1%
Sustainable Equities	4.3% ↑	16.3% ↑	0.2%-0.4%
Emerging Markets Equities	4.6% ↑	20.9% ↓	0.1%-0.2%
China A Share Equities	5.9% ↑	30.7% ↑	0.3%-0.8%
Liquid Credit			
Corporate Debt GBP – Passive	0.8% –	5.4% ↓	0.1%-0.2%
Corporate Debt GBP – Active	1.1% –	5.5% ↓	0.2%-0.3%
Emerging Market Debt – Corporates	1.9% ↓	5.8% ↓	0.4%-0.6%
Emerging Market Debt – Local Currency Sovereign	2.6% –	13.3% ↓	0.5%-0.8%
Emerging Market Debt – Hard Currency Sovereign	1.7% –	7.9% ↓	0.5%-0.8%
Multi-Class Credit Global	2.2% ↓	6.7% ↑	0.4%-0.7%
Illiquid Credit			
Diversified Matching Illiquids (Uninvested)	2.4% ↑	6.6% –	0.3%-0.5%
Opportunistic Illiquid Credit	3.8% ↓	9.8% ↑	1.0%-1.5% (+ performance fee)
Securitised Opportunities	2.8% ↓	5.6% ↓	0.5%-0.7%
Special Situations	4.4% ↓	15.7% ↑	1.0%-1.5% (+ performance fee)
Illiquid Markets			
Private Equity	5.9% ↑	31.7% ↑	1.0%-1.5% (+ performance fee)
Insurance-Linked Securities	4.4% –	10.0% –	1.0%-1.5%
Renewable Infrastructure (Whole Projects)	3.7% ↓	13.7% ↑	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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