Aon Hewitt
Retirement and Investment

Powys County Council Pension Fund

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MTAA Update: Mandate period to 29 February 2016

Introduction

The Medium Term Asset Allocation (MTAA) mandate has been running since 2011. Aon Hewitt's Global Asset Allocation Team provides advice in respect to the medium term asset allocation (1 to 3 year outlook) on all of the Fund's assets, with the exception of the investment in Private Equity.

It was agreed that performance would be measured with the objective to outperform the strategic benchmark over a three year (rolling) timeframe. The initial three year mandate period was completed on 28 February 2014, and the Investment Committee took up the option of a further three year mandate with effect from 1 March 2014.

Within this report we will look at performance since original inception in 2011, in addition to the specific performance of the current mandate.

Performance

The performance of the MTAA mandate is measured over a rolling three year timeframe. This is because the positions taken against the benchmark are medium term in nature, and so may take longer than one quarter, or even one year, to add value. Performance under three years is susceptible to shorter term market movements. Therefore, emphasis should not be placed on short term performance.

The original mandate ran from 1 March 2011 to 28 February 2014 and performance was calculated to be **27.7%** cumulative (8.5% annualised) net of transaction fees, compared to the benchmark of **27.2%** cumulative (8.4% annualised). We have calculated the mandate added c. **£1.9m**, net of transaction fees, compared to the MTAA benchmark over this period.

The current mandate, which has been running since 1 March 2014 has returned **16.4%** cumulative (7.9% annualised), net of transaction fees, compared to the benchmark of **16.7%** cumulative (8.0% annualised). The current mandate has detracted c. **£1m** compared to the MTAA benchmark over the 24 month period to 29 February 2016. The current mandate is still running and as mentioned above, performance should be assessed over the medium term rather than a shorter time frame.

Overall, since inception to 29 February 2016, the performance of the MTAA assets (based on index returns) was **48.7%** cumulative (8.3% annualised), net of transaction fees, compared to the benchmark return of **48.4%** cumulative (8.2% annualised). This equates to an approximate value added above the MTAA benchmark, since 1 March 2011 to 29 February 2016 of **£0.9m**, net of transaction fees.

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The table below shows the returns for significant periods.

Period	Fund Performance (%) (Net)	Benchmark Performance (%)
1 March – 31 Dec 2011	1.7	1.9
2012	8.8	8.6
2013	14.9	14.0
2014	11.9	12.5
2015	4.9	4.2
January 2016	-0.6	-0.2
February 2016	0.3	0.5

Attribution

The MTAA positions are recommended based on a medium term outlook of 1 to 3 years, and so emphasis should not be placed on short term performance.

The main contributors to performance over the initial three year mandate to 28 February 2014 were as follows:

- Over the initial three years the underweight and overweight positions taken in regional equities added value;
- The overweight position to Cash added value;
- The underweight position to Index Linked Gilts added value;
- The main detractor to performance over the three years was the overweight position to Hedge Funds.

The main contributors to performance over the mandate period from 1 March 2014 to 29 February 2016 were as follows:

- Performance to the end of 2015 was positive, market volatility experienced during early 2016 led to active positions losing value;
- Overall gross performance was in line with the benchmark, with transaction costs leading to marginal underperformance on a net of fees basis;
- The overweight allocation to Property since the trades carried out in 2015 added value;
- Active positions in regional equity in the UK, Japan, and Europe ex UK added value;
- The partial hedge of Euro exposure added value as the Euro fell in value over the period;
- The underweight allocation to US regional equity detracted value;
- The underweight allocation to Gilts detracted value;
- The overweight allocations to Hedge Funds and Absolute Return Bonds detracted value.

Positioning

The MTAA positions aim to enhance the Fund's performance relative to the strategic benchmark by taking advantage of assets becoming over or under valued. This is accomplished by over or underweighting amounts in asset classes compared to the benchmark.

The next table shows the positioning in the various asset classes as at 29 February 2016 and also the positions relative to benchmark at different times.

Asset Class	Benchmark	Relative allocation compared to benchmark		
	[(1)]29 February 2016 (%)	[(1)]29 February 2016 (%)	[(2)]1 March 2014 (%)	[(2)]Average Over New Mandate (%)
Equity	48.7	0.7	-0.5	-0.2
Corporate Bonds	6.6	1.4	-0.3	0.4
Fixed Interest Gilts	3.7	-2.7	-1.6	-1.5
Index-Linked Gilts	16.3	-3.2	-1.3	-2.7
Property	10.6	4.2	-0.8	1.9
Hedge Fund of Funds	7.7	0.1	2.5	1.2
ARB	6.5	-1.4	0.8	0.3
Cash	0.0	0.8	1.3	0.6

[(1)]Allows for intra-quarter benchmark drift.
[(2)]Relative to the benchmark that applied at the time.

Transitions

The MTAA team regularly monitor the position of the Fund compared to the strategic benchmark, including monitoring the allocation to the active managers.

In order to take further over/underweight positions or rebalance appropriately, the MTAA team will recommend actions for the Investment Committee to carry out.

Details of all transactions so far during this project, including associated costs, can be found in the appendix.

Over the year to 29 February 2016, twenty MTAA transitions were carried out. These incurred total costs of c. £826k, of which c. £653k was related to increasing the property holdings (separately to the strategic increase in property). The property trades had average transition fees of around 5% of the assets transferred, which is within the acceptable range for property investments.

When we place a trade we always look to minimise costs. Savings can be made with property investments by trading in the secondary market rather than buying directly from the manager.

We worked closely with Schroders to identify and exploit these opportunities to minimise transaction costs for the Fund as far as possible. Since the initial investment with Schroders, savings of around £120k have been made by investing through the secondary market. Savings relating to the increase in the strategic allocation to property are not included in this figure.

Performance Measurement

Aon Hewitt calculates the performance of the fund and benchmark regularly. However, due to the nature of some of the funds and indices used, the performance figures are not available straight away and so unaudited or the most recently available data is used until the audited figures are available.

The benchmark for the project is set out below. This benchmark is allowed to drift during the quarter subject to market movements, and is rebalanced at the end of each quarter.

Asset Type	MTAA Asset	MTAA Index	Current Benchmark (%)
Return Seeking	Equities	FTSE Developed World	49.5
	Property	IPD Index	10.5
	HFOF	HFRI FOF Composite	8.0
	ARB's	3 Month GBP LIBOR	6.5
Matching	Corporate Bonds	iBoxx Sterling Non-Gilts	6.5
	ILG	FTSE UK Index-Linked over 5yrs	15.5
	Gilts	FTSE UK Gilts All Stock	3.5

Performance Appraisal

We carried out a calculation that compared the current fund value with the expected fund value had there been no MTAA transitions.

The performance of the assets has been calculated by taking the starting position of the Fund, and rolling the value forward by the performance of the managers. Using this approximation, the first mandate (1 March 2011 to 28 February 2014) added c. *£4.9m over the value of the assets had they been invested as they were before the MTAA arrangement was put in place in 28 February 2011.

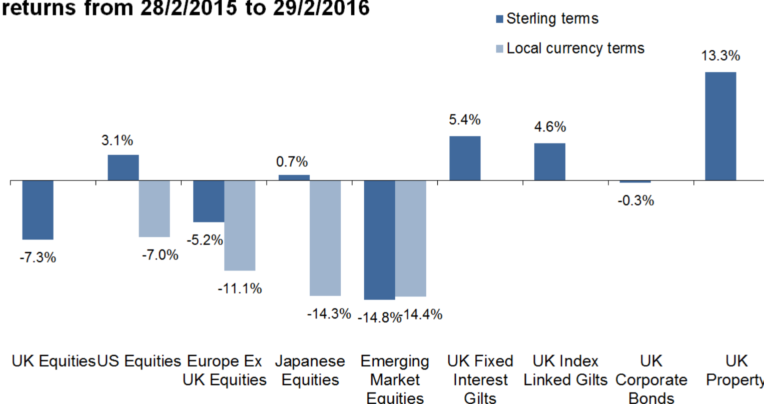
The second mandate (1 March 2014 to 29 February 2016) detracted c. £1.0m from the value of the assets had they been invested in line with the strategic benchmark.

*Please note that the above figure is an estimate. For example, the calculation involves rolling transitioned assets forward by the performance of the fund or asset class from which they were transferred.

Appendix: Market Background

12 Months to February 2016

Index returns from 28/2/2015 to 29/2/2016



Source: Datastream/IPD

General Background

- Economic momentum slowed globally over the year, with the US suffering from a fall in confidence and business activity, weaker Chinese economic growth, and global trade failing to grow. Eurozone economic growth steadily improved as the weaker euro boosted exports, but Japan's economy experienced two (non-consecutive) quarters of recession over the year. UK growth remained steady, although fears over a 'Brexit' from the EU ignited some concerns over the UK's future economic prospects.
- After intense speculation on the timing of the US interest rate lift off, the Federal Reserve (Fed) pulled the trigger in December, raising the target federal funds band from 0-0.25% to 0.25-0.5%. However, expectations over the timing of future rate rises were tempered heavily on increasing economic uncertainty. In the Eurozone, ongoing concerns over weak growth and deflation caused the European Central Bank (ECB) to expand quantitative easing (QE) in Q1 2016 and bring interest rates even lower. The Bank of Japan (BoJ) continued with its aggressive QE programme in an effort to ramp up inflation. Monetary easing also continued in China as authorities attempted to control the slowing economy and volatile financial markets. Concern over the effectiveness of developed market central bank easing actions grew, causing unexpected market moves after the easing announcements.
- In May 2015, the UK electorate voted in a conservative government after great outcome uncertainty. In Greece, after months of negotiations over austerity conditions, the left wing Syriza Greek government came to a bailout agreement with its creditors. A snap election, in which Alexis Tsipras was re-elected, followed soon after. In the second half of 2015, the European migrant crisis became one of the dominant themes in news headlines. After UK Prime Minister David Cameron secured a deal with Brussels over reformed terms of the UK's EU membership, a referendum over a British exit from the

EU was set for June 2016.

- After the brent crude oil price rebounded back to nearly $70 per barrel in spring 2015, prices fell again, eventually hitting lows of $28 per barrel in January 2016. All other major commodity prices also fell over the year as Chinese growth weakened. This helped to keep global inflation low and the US, UK and various other economies experienced inflation levels close to zero.
- Over the year, the MSCI All Country World Index returned -1.5% in sterling terms as sterling weakened broadly in the second half of the period over Brexit fears. Equities experienced especially violent falls in August, triggered by an unexpected managed devaluation of the Chinese renminbi, and in January, over global growth worries.
- UK gilt yields fell over the twelve months to February 2016, with yields at some maturities falling to record lows. The Fed's first interest rate rise in almost a decade finally took place in December, but concern over growth in the US and the rest of the world prevented yields from rising higher.
- UK corporate bond spreads over government bonds widened over the period as the increase in risk aversion and falling oil prices had an impact.
- UK property returns were strong, with the IPD Monthly Index rising 13.3% over the period.

UK Equities

- Despite the UK experiencing sturdy economic growth, the UK equity market returned -7.3% over the period. The market's sizeable resource component exposed the market to falling commodity prices.

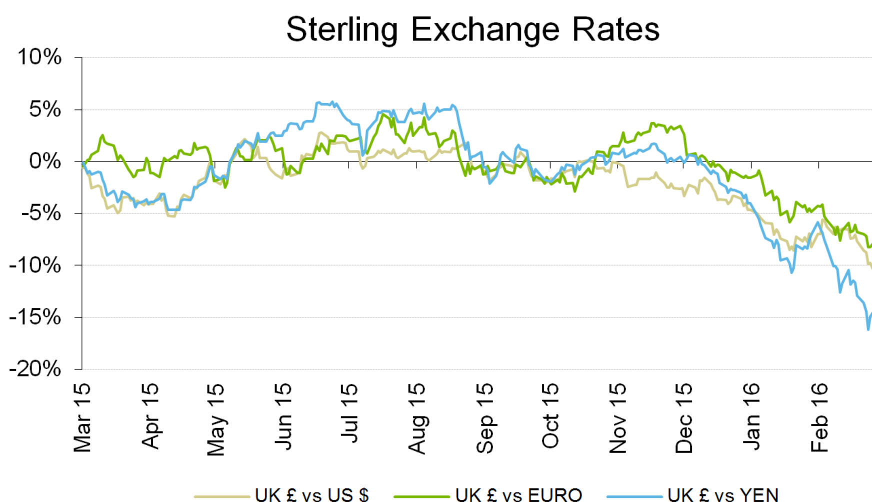
Overseas Equities

- The US and Japan were the only regions to provide a positive return in Sterling over the period. For US equities relative performance was strong against a backdrop of reduced risk appetite. US equities provided a -7.0% return in local currency terms, but the strong US dollar brought the sterling return up to 3.1%.
- Japanese equities performed very strongly at the beginning of the period, boosted by domestic equity buying and additional quantitative easing, even as economic data was weak. However, we saw the Japanese stock market underperform other markets as Chinese weakness and yen strength both weighed on exporters. Concern over policy effectiveness and the economy reversed positive investor sentiment. Japanese equities provided the joint lowest local currency return (-14.3%) but sterling returns (+0.7%) were better as the yen strengthened versus sterling over the year.
- Continental European equities returned -11.1% in local currency terms whilst sterling weakness at the start of 2016 brought the sterling return up to -5.2%. Accommodative monetary policy from the ECB was offset by weak Eurozone and global growth, which hurt the market given the openness of the Eurozone economy.

- Emerging market performance was weak, mainly caused by ongoing

uncertainty over China's growth and weak commodity prices. There was also concern over the impact of Fed monetary policy on the region. Emerging market equities returned -14.4% in local currency terms and -14.8% in sterling terms over the full period.

Currencies and Interest Rates

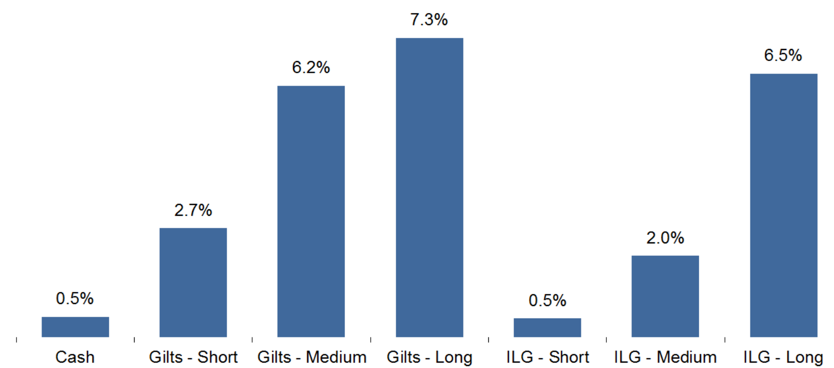


Source: Datastream

- UK policy rates remained at 0.5%, unchanged since March 2009. Decent UK economic data and aggressive monetary easing in the Eurozone caused sterling to appreciate early in the period. However, sterling depreciated broadly later on the back of jitters over the impending EU referendum and broad strength in both the euro and yen.
- The Federal Funds rate target band was raised from 0-0.25% to 0.25-0.5% in December 2015. However, the push back in interest rate rise expectations after December saw the dollar weaken against the strong euro and yen. The US dollar appreciated by 9.8% against sterling over the year.
- The ECB, in response to the lack of inflationary pressures in the economy, kept in pursuit of easier monetary policy. However, the euro appreciated by 6.9% against sterling over the year as Brexit fears pressured sterling and the ECB focused more on domestic stimulus.
- The BoJ left rates at 0-0.1%, unchanged since December 2008, and continued with its aggressive quantitative easing programme. However, the currency strongly appreciated as global equity market volatility increased the appeal of the “safe haven” currency and investors grew sceptical of QE impact on the yen. The yen appreciated by 14.9% against sterling.

Gilt Returns

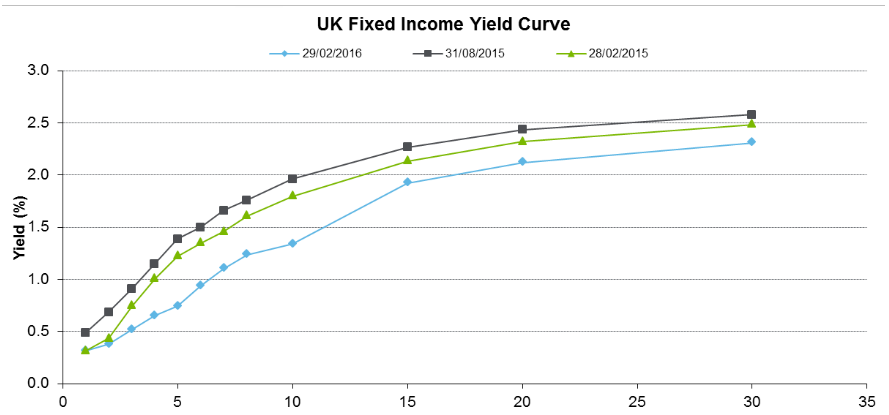
Index returns from 28/2/2015 to 29/2/2016

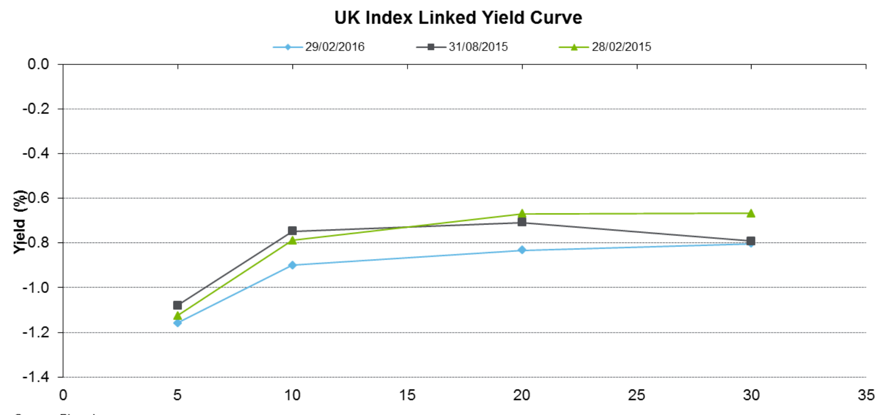


Source: Datastream

- UK fixed gilts returned 5.4% and index-linked gilts returned 4.6% over the whole period.
- Long dated fixed interest gilt returns were the highest, outperforming short and medium term maturities. The same occurred for index-linked gilts.
- Index-linked gilts underperformed fixed gilts at all maturities as index-linked yields fell by less at long maturities and actually rose marginally at medium maturities.

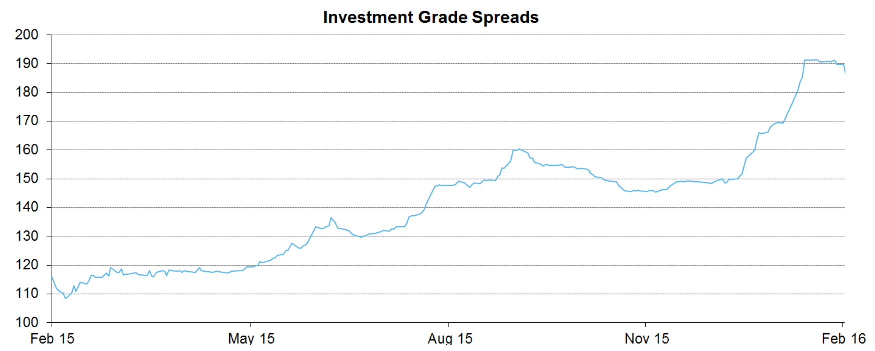
Fixed Interest and Index-Linked Yield Curves





- Gilt yields fell over the year. Fixed gilt yields rose during the start of the period before falling back again, most notably at the start of 2016, during which the UK 20-year fixed gilt yield fell by approximately 40 basis points. The index-linked curve fell across the whole curve.

UK Investment Grade Credit



- UK iBoxx non-gilt credit spreads (the difference between the yields on non-government bonds and equivalent maturity government bonds) widened by 74 bps to 190 bps over the year. UK non-gilts returned -0.3%, underperforming gilts.
- The widening in spreads came as investors re-priced risk assets more cautiously over the year.
- Credit spreads widened the most for BBB-rated issues whilst AAA-rated spreads widened the least.

Appendix: Past Trades and Rationale

Trades

Details of previous trades that have occurred during the period from 28 February 2014 to 29 February 2016 following our recommendations, and the rationale provided, are included below:

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22 December 2015

We recommended a reallocation of assets within the BlackRock portfolio.

- £2.8m disinvestment from Japanese equities (50:50 split between hedged and unhedged)
- £2.8m investment into Gilts (50:50 split between fixed and index-linked)

Japanese equities and Bonds

Japanese equities have performed very well during 2015 with the Nikkei 225 up at 18,800 (at 15 December). We therefore recommended taking profit on some of the Fund's overweight position. We expect Japanese equities will outperform other equity markets on a currency hedged and unhedged basis. However, Japanese slowing earnings momentum and limited further profit margin gains give us a reason to cut back on the overweight position. The fall in oil prices and weak manufacturing numbers give a negative backdrop for the global equity market as we approach the end of the year.

A combination of the oil price and inflation expectations falling creates a more bond friendly environment, so we recommended reducing the underweight bond position with the proceeds of the Japanese equity sale.

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11 November 2015

We recommended a reallocation of assets within the BlackRock portfolio.

- £3.5m disinvestment from Sterling Liquidity Fund
- £3.5m investment into 5 to 15 Years Corporate Bonds

Cash and corporate bonds

UK corporate spreads relative to government bonds have risen on risk aversion for the last few months and now provide a more attractive level to buy corporate bonds. The momentum that was causing credit spreads to rise has receded somewhat and credit spreads look to have now stabilised. At the same time, gilt yields have risen recently on speculation that the US Federal Reserve will hike policy rates soon. The fund has an underweight position to fixed income, and we would like to take this opportunity to reduce the underweight position slightly by purchasing corporate bonds.

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23 October 2015

We recommended a reallocation of assets within the BlackRock portfolio.

- £2.3m disinvestment from European Equities
- £4.5m disinvestment from Up to 5 Year Gilts
- £2.3m investment into UK Equities
- £4.5m investment into US Equities

Equities and short dated gilts

After the equity market weakness over the previous few months, we proposed to take advantage of more attractive valuations compared to a quarter ago by increasing net exposure to equities by £4.5m and moving positions back closer to the benchmark where appropriate. This will result in a 0.5% underweight to equities overall.

We remain cautious on equity markets as they remain fairly expensive and earnings expectations look weak given the global growth outlook.

We suggested trimming the overweight to European equities as the market is particularly exposed to a global growth slowdown and is also vulnerable to certain stock specific developments (e.g. VW and Glencore) on top of uncertainties surrounding the Eurozone economy.

We suggest funding the 1% net increase in equities by selling 1% of short-dated gilts. We remain underweight bonds as we expect bond yields will rise over the next year. We think the yield uptrend will be gradual as neither growth nor inflation surprises are likely to be major bond negative factors.

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15 October 2015

We recommended disinvesting from Insight Absolute Bonds and placing money into the BlackRock Sterling Liquidity Fund in preparation for future MTAA positions.

Absolute return bonds

In this highly volatile environment, we think that there is merit in being able to take advantage swiftly of market moves and, therefore, we suggest holding some cash until a bond or equity opportunity arises. We therefore propose to sell 1.5% of the fund (£6.9m) of the absolute return bond strategy (ARBS). The duration protection role of this holding has been de-emphasised as we have lowered our bond yield expectations since the start of the year on the back of a reduction in the expected level of the UK bank rate over the medium term.

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26 August 2015

We recommended funding an additional opportunistic £5m investment with Hermes through the sale of Index-Linked Gilts (£3m) and Fixed Gilts (£2m).

Gilts and Property

When an additional opportunity to invest with Hermes materialised we recommended increasing investment and moving to an overweight position in Property.

We currently still have a favourable view on property compared with equities and fixed income. The UK economy remains robust and relatively sheltered from current high levels of market risk aversion. We also have a very favourable view on the Hermes Fund and it is 'Buy' rated.

One of the current property fund managers CBRE is currently selling down, due to the nature of it being a closed ended fund. It is therefore returning cash to Powys (c.£3m had been disinvested over the previous 12 months) and consequently the overweight property allocation would reduce all else being equal. Therefore, a further allocation to property currently is likely to keep the overweight closer to our desired levels over the next 12-24 months.

Following the recent fall in yields since mid-June, UK government bonds have begun to move further away from our view of fair value, and consequently have begun to look more expensive.

Index linked gilts look expensive relative to fixed income gilts, with breakeven inflation remaining expensive. However, in order to keep things balanced and to not over expose the Fund to one risk, we have recommended taking £3m from index linked gilts, with the remaining £2m to be taken from fixed gilts.

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27 July 2015

We recommended the £12.4m raised from disinvestments in Hedge Funds and ARB were invested with Schroders (£5.2m) and Hermes (£7.1m). £60k was retained in the Fund's reserve account.

Property

In connection with the increased allocation to property to align the allocation to the strategic benchmark, we recommended an allocating assets to the buy rated managers, Schroders and Hermes.

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30 June 2015

We recommend disinvesting £8m from GAM.

Hedge funds

In order to fund the increased exposure to property we recommended that the hedge fund position was brought back to a neutral position. This meant selling around £8m of hedge fund assets. We recommended that this was funded from GAM given their recent downgrade from a 'Buy' rating to a 'Qualified' rating and also given the large allocation to GAM.

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15 June 2015

We recommended disinvesting £4.4m from the absolute return bonds to fund the property investment.

Absolute return bonds

This brings the allocation back to neutral. Given the Insight fund only targets LIBOR +2%, we prefer to allocate this overweight position to property as we feel the asset class offers more attractive returns

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31 May 2015

We recommended increasing the allocation to property using liquid assets.

We recommended disinvesting £2.45m from Index Linked Gilts, £2.45m from short dated Gilts, £5.2m from US Equity and investing £2.5m into UK Equity and £13.9m into the property market.

Equities and short dated gilts

Sell c.£8m from equities and short dated gilts. This will move the actual allocation more in line with the proposed MTAA benchmark, allowing for recommended overweight and underweight positions.

These funds can be disinvested relatively quickly and so in order to gain exposure to the UK property market we recommend that the funds are invested with Schroders.

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25 May 2015

We recommended removing the European currency hedge.

Remove European currency hedge

Our negative view on the euro against sterling has moderated given the scale of euro weakness over the past few months since the ECB's quantitative easing programme was launched. Growth and inflation expectations have picked up and this should help to prevent the euro weakening substantially from current levels, although we should note that we still think the Eurozone economy will remain fairly fragile.

In addition, the unexpected result of a Conservative majority at the recent general election has removed the short-term uncertainty around a weak UK government or hung parliament that the market was pricing in, which has helped sterling to rally sharply. However, the new government has promised a referendum on the UK's EU membership by 2017 which could be a negative for sterling over the medium term if business confidence is affected.

Given the value added by the euro hedge has been substantial and also given our belief that most of the impact of QE on the euro has already been priced in, we propose using recent sterling strength as an opportunity to remove the remainder of the hedge. We will continue to monitor the exchange rates and could potentially look to reintroduce the hedge should the euro strengthen significantly.

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31 March 2015

We recommended lowering the weighting to equities, given the fact that equities have risen recently. We recommended disinvesting £7.8m from emerging market equities and £7.1m from UK equities and investing £3.6m in US equities and £4.3m in Japanese equities. We recommended investing the remaining £7m by investing £0.8m in short-dated gilts, £2.2m in corporate bonds and £4m in index linked gilts.

Equities

Disinvest from the equity portfolio to bring the equity weight back towards 52%. As part of the rebalancing we recommended:

Reducing the underweight to the US back towards 10% of the equity portfolio.

Increasing the overweight to Japan to c. 8% of the equity portfolio from 5.9%. Our view on Japan remains positive given strong company balance sheets and we expect the Bank of Japan to ease monetary policy again this year. Given the currency hedge in place we would allocate equal amounts to the hedged and unhedged share class.

Increasing the underweight position in UK equities to c.5% of the equity portfolio from a current 2.2% underweight. Earnings growth for 2015 is forecast to be negative as exposure to commodity and oil stocks is high. The general election in May could lead to some weakness in the UK market.

Reducing the overweight to Emerging markets by about 3% to be c. 3% overweight. We believe that recent weakness in emerging currencies may continue, especially as the US Federal Reserve begins to raise interest rates and this could be a negative for emerging markets.

Bonds

We recommend investing the proceeds into the bond portfolio keeping the current weights broadly unchanged, but excluding absolute return bonds given the fund with Insight is closed.

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25 March 2015

We recommended reducing the European and Japanese currency hedge from 100% to 50%.

Europe

We think that the euro will weaken against the USD and that ultimately higher UK rates and Eurozone QE will push sterling higher against the euro.

Given that the euro hedge has added value in the Powys account, as a lot of the impact of QE on the euro has already been felt, and that there is a build-up of some short-term GBP negatives now (such as the upcoming election and uncertainty on rates), we propose that we halve the current euro hedge.

Japan

We have a similar view on the yen in so much that ultimately we think that the direction will be determined by monetary easing by the Bank of Japan.

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3 March 2015

We recommended increasing exposure within European equities, reducing the sensitivity of fixed income assets to interest rate rises. We recommended disinvesting £2.5m from Japanese equities, £5m from Asia Pacific equities and £2.5m from UK equities and investing the proceeds in European equities. We also recommended disinvesting £6.7m from long-dated gilts, and investing £4.9m in corporate bonds and the balance in European equities. This would mean a total investment into European equities of £11.9m.

Equities

Europe ex UK equities underperformed over the past few years, particularly in comparison to the US. However, given the European Central Bank recently announced a large quantitative easing programme, this is likely to be supportive to the region's equity markets. We therefore recommend moving from an underweight position to a slightly overweight position. However, we still remain cautious on global equities as a whole so we recommend remaining neutral to equities at the portfolio level.

Bonds

Recently bond yields have continued to fall and hit new all-time lows across the curve, albeit finishing the week higher. We believe that ultimately yields will rise from their current low levels, and therefore continue to have a negative view on bonds. As we believe yields will rise, we recommend tilting the bond portfolio towards shorter duration bonds so that the impact on returns when yields rise will be less pronounced. In addition, credit spreads are currently wider than they were last summer. Given this, and that the duration of corporate bonds is lower than the long-dated gilts, we recommend switching 1% of the portfolio from long-dated gilts to corporate bonds.

In order to ensure the split between bonds and equities remains in line with our views we recommend investing the surplus from the bond trades into the European ex UK equity fund.

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5 December 2014	We recommended investing £4m held in cash in the Schroders property fund. **Property** Commercial property has performed strongly across all sectors over the last 18 months and high demand has caused yields to move lower. However, capital values are still below their peak and valuations look attractive relative to other asset classes. We therefore have a positive view on the asset class and we recommend adding to the property holding within the portfolio, especially as we currently have an underweight allocation.
31 October 2014	Following a recommendation of an investment of £4.5m into Insight's Bond+200 fund in September 2014, we entered into the queue with Insight with the hope of investing as soon as possible. Insight informed us that the queue had run down and the Fund was able to invest the monies at the next available dealing date (31 October). Given the current low levels of bond yields, our asset allocation team recommended disinvesting from the ILG portfolio to fund the investment. **Index Linked Gilts** To fund the purchase, the Asset Allocation team recommended that the monies were taken from index-linked gilts. The sharp fall in bond yields over October led the team to believe that it is more likely that yields will rise from this point, which will have a negative impact on bond performance with longer duration bonds suffering the most. Given that the index-linked gilt holding has a longer duration than the holdings in fixed gilts and corporate bonds, we recommended disinvesting the monies from index-linked gilts in order to reduce the interest rate sensitivity of the bond portfolio.

8 October 2014

We recommended disinvesting £9m from US equities and investing the proceeds in an Up to 5 Year Gilt Index Fund.

Equities
Given recent equity market volatility the Asset Allocation team was keen to reduce the Fund's exposure to equities. The decision to reduce the equity exposure from US equities was due to US equities falling by less than 2% from all-time highs achieved earlier in the month whereas markets such as Asian Pacific equities fell nearly 7% in September due to riots in Hong Kong, concerns over the pace of US interest rate rises and the release of weaker Chinese data. On valuation grounds, the US is less attractive with a forward price/earnings ratio of 16.0 versus 12.4 for the Asian Pacific market.

Bonds
We expected UK bond yields to rise from their current low levels and were therefore reluctant to buy longer dated gilts, corporates or index-linked gilts. The portfolio already had a significant overweight to hedge funds and we were in the queue to make further investments in property and absolute return bonds. In the shorter term, we therefore recommended allocating the proceeds to shorter-dated fixed interest bonds as they have a higher yield than cash without increasing the duration of the bond portfolio materially.

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9 June 2014

We recommended disinvesting £1.29m from Index Linked Gilts, £1.72m from Fixed Gilts and £1.29m in Cash, investing the proceeds (£4.3m) in Asian Pacific equities.

Bonds
We recommended to sell bonds as we believe yields are on an upwards trend. The rally we have seen so far this year has been a reaction to the strong falls we saw last year and we think the factors that have driven the rally are likely to fade as the market focuses once more on rate normalisation. Equity markets have also been driven up recently by central banks maintaining a more accommodative monetary stance than was previously anticipated. The outlook for equities remains uncertain, which limits the amount of equities we are keen to hold.

Asian Pacific Equities
However, we propose buying Asia Pacific equities. They have been one of the worst performing regions over the last 12 months but we expect them to gain some benefit from an improving economic outlook in China.

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14 April 2014

We recommended disinvesting £4.4m from Index Linked Gilts and investing £3.3m in Emerging Markets Equity and £1.1m into UK Equity.

Emerging Markets Equity

Following a weak first quarter, the outlook for Emerging Market equities was slowly improving. Emerging Markets looked cheap for some time but investor sentiment was starting to show positive signs. It is worth noting that because the equity portfolio is benchmarked against the FTSE World Index (which has 0% EM exposure), this trade means that the portfolio will have a reasonable overweight position to EM equity.

UK Equity

We proposed to increase marginally the allocation to the UK equity market given its underperformance in recent months.

Index Linked Gilts

Index-linked gilts performed well year to date and looked particularly expensive at the beginning of April. Therefore it again seemed opportunistic to reduce the Fund's allocation here.

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2 April 2014

Transfer to hedged share class

We recommended moving the Europe ex-UK Equity holdings to a currency hedged version of the fund given our view that the euro is overvalued versus sterling.

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27 March 2014

We recommended buying £3.3m of UK Equities and selling £3.3m of Index Linked Gilts.

Rebalance
The rationale for this trade was to maintain the bond and equity relative positions ahead of the benchmark rebalance at the end of this month. It did not represent a change in position.

We proposed buying UK equities as they underperformed year to date whilst we similarly proposed selling index-linked gilts as they have outperformed the other bond asset classes year to date.

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11 March 2014	We recommended transferring £4.2m of European Equities to cash. **European Equities** After a difficult January for Global Equities, due to global imbalances and political uncertainty, equities bounced back up to higher levels. We were concerned that they could suffer another correction, with much political uncertainty still circulating around Europe. To reduce the equity allocation, we recommended to sell Europe ex-UK equities, given their recent strong performance when compared with other regions and the fact that they have become less attractive from a valuation standpoint. Our asset allocation team also held the view that the region's economic recovery will not be as smooth as the market appears to be expecting. **Cash** Again, with much global uncertainty, it was seen as sensible to realise the gains into cash and wait for an opportunity to invest further.
28 February 2014	We recommended that £4.2m was transferred from cash to Absolute Return Bonds. **Absolute Return Bonds** The Fund had a cash holding that was earmarked for an upcoming property investment, though the timing of this investment was not specifically known at this stage. Given the unattractive returns on cash, Aon Hewitt thought that allocating these funds to the Absolute Return Bond fund which is targeting a return in excess of cash seemed appropriate given market conditions. Although bond yields were expected to rise in the medium term, the near-zero duration of the Absolute Return Bond fund mean it will be largely unaffected by rate rises

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