Capita

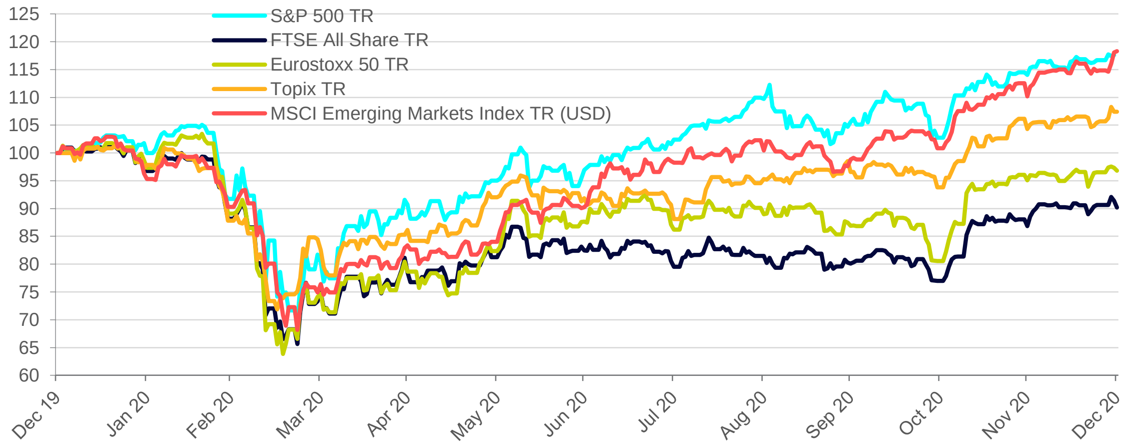
Quarterly Investment Bulletin

December 2020

Contents

Global Equities continued bounce back with significant rises over the quarter

Figure 1: Equity Market Returns (rebased at 100) [1]



Source: Bloomberg, Capita

Equity Markets	Percentage Change			
Index	**30/09/2020 (Price)**	**1 Month**	**1 Quarter**	**1 Year**
S&P 500 (TR)	7759	3.8%	12.1%	18.4%
FTSE ALL-Share (TR)	7069	3.9%	12.6%	-9.8%
EuroStoxx 50 (TR)	7695	1.8%	11.4%	-3.2%
Topix (TR)	2820	3.0%	11.2%	7.4%
MSCI Emerging Markets Index TR (USD)	624	7.4%	19.7%	18.3%

Source: Bloomberg, Capita | [1] Total returns in local currency

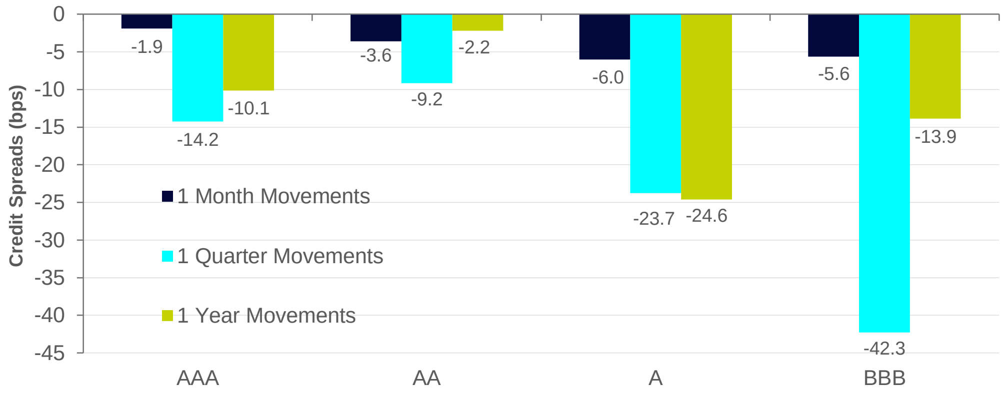
- Global equities generally made significant gains in the fourth quarter of 2020. All major indices made positive returns over the quarter, in excess of +11% return.
- US equities posted a strong quarter of positive performance, rising by +12.1%. This means that the S&P 500 index finished 2020 up by +18.4%. This is a much-welcomed gain and a significant recovery following the coronavirus pandemic, which saw the index fall by nearly 20% over Q1 2020.
- With the announcement, in December, of the long-awaited trade deal agreement between the UK and the EU, the FTSE All-Share index returned +12.6% over the quarter. The UK Equity market finished 2020 at -9.8% for the year due to the significant impact of the coronavirus pandemic, on what is predominantly a service-based economy.
- In the eurozone, the EuroStoxx 50 index returned +11.4% over the quarter, showing that the eurozone's economic recovery finished strongly in the fourth quarter. Much like the UK, European equities are still at negative levels since the start of the year, down by around –3.2%.
- In Japan, the Topix index made very strong gains over the quarter, returning around +11.2%. The Japanese equity market finished 2020 strongly at around +7.4% since the beginning of the year, this is significantly better than some of their peers around the world.
- In emerging markets, the MSCI Emerging Markets Index returned +19.7% over the quarter, the most of all major indices shown, and finishing the year at +18.3% only beaten by the US in 2020.

Corporate bond spreads contract again in Q4

Corporate credit

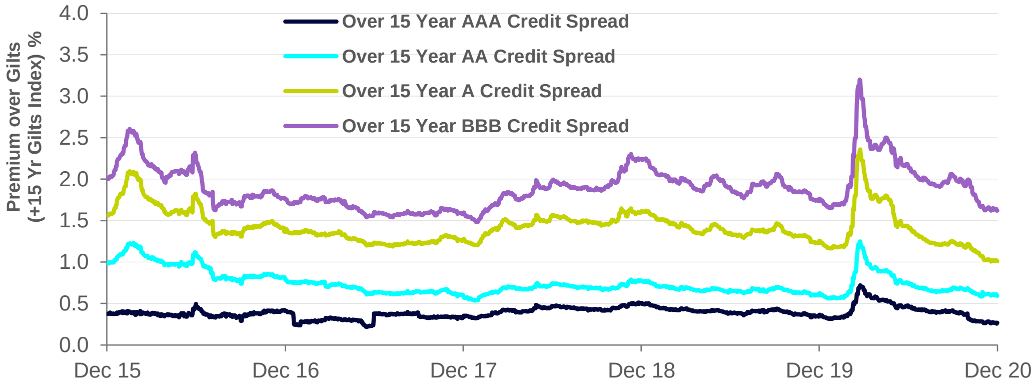
- UK corporate bond spreads narrowed significantly over the quarter for investment grade credit universe. This was particularly seen at the lower ratings.
- Decreased credit spreads on lower rated bonds over the past quarter may reflect investors' moving from safer instruments into corporate bonds as global markets and business / consumer confidence gradually picks up.

Figure 2: GBP corporate bond spreads over gilts by rating (change over month/quarter/year)



Source: Bloomberg, Bank of America Merrill Lynch, Capita

Figure 3: GBP corporate bond spreads over gilts by rating (historic)



Source: Bloomberg, Bank of America Merrill Lynch, Capita

Nominal gilt yields increase across most of the curve

Figure 4: Nominal term structure of gilts

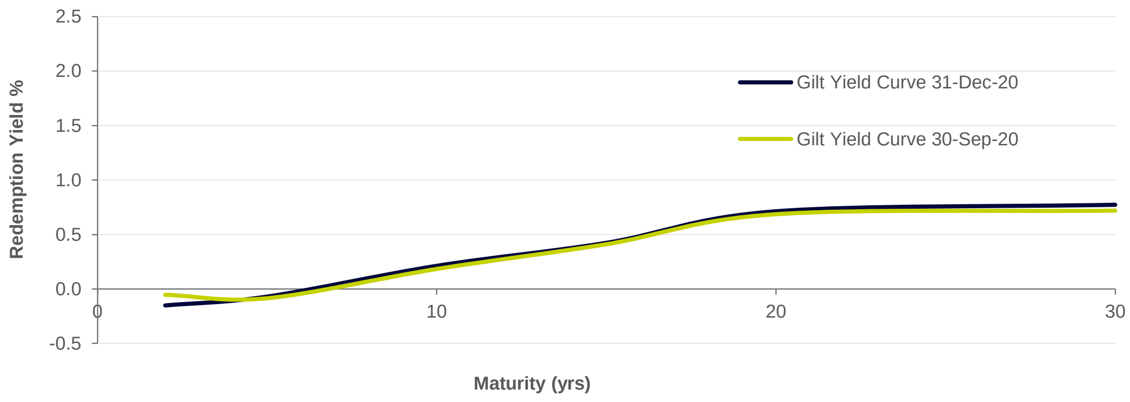
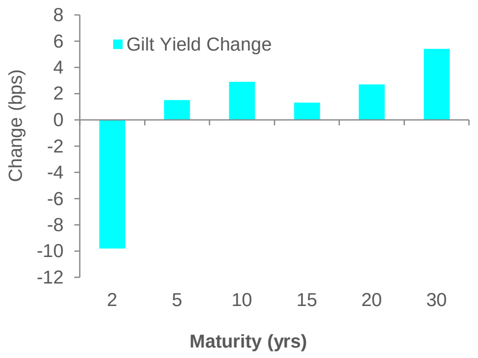


Figure 5: 10-year and 30-year nominal yields

Source: Bloomberg, Capita



Source: Bloomberg, Capita

Nominal Gilt Yields	Maturity Points (yrs)					
	2	5	10	15	20	30
Current % as at 31/12/2020	**-0.15**	**-0.07**	**0.21**	**0.42**	**0.71**	**0.77**
1 Month Change (bps)	-11	-6	-7	-8	-8	-6
1 Quarter Change (bps)	-10	2	3	1	3	5
1 Year Change (bps)	-74	-72	-65	-71	-57	-60

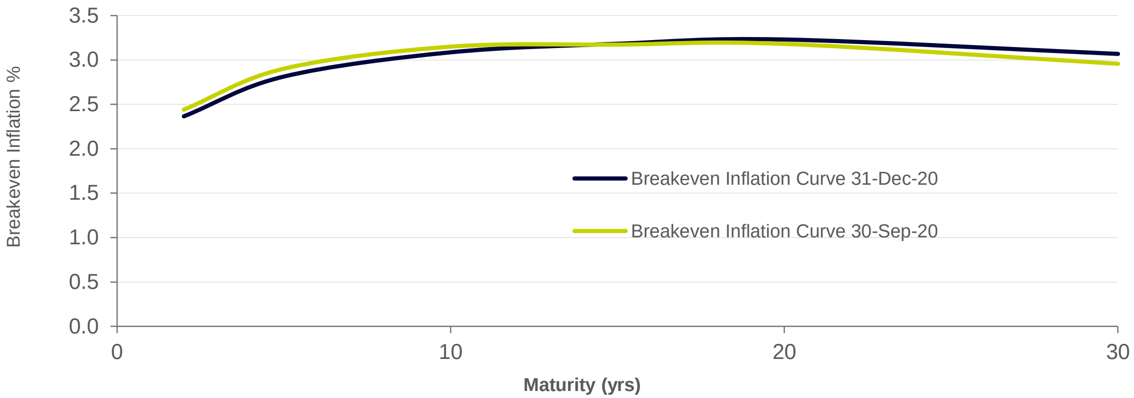
Source: Bloomberg, Capita

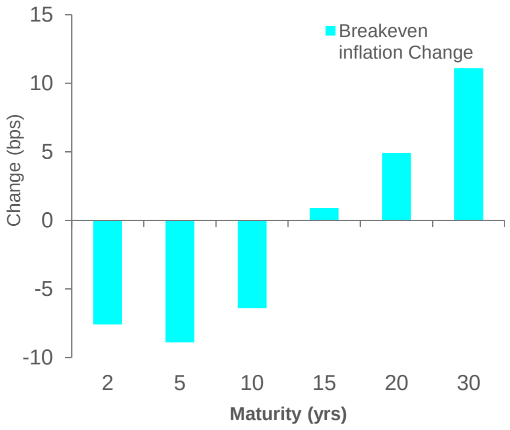
Nominal yields

- Nominal gilt yields increased across all maturities except 2 years, over the fourth quarter of the year.
- Yields remain below 1% despite recovering after the drastic decline. The recovery is welcomed news for pension schemes with funding levels being positively impacted by a fall in liabilities.
- The current Bank of England base rate remains at 0.1% after being cut to the all-time low in March this year.

CPI inflation falls to lowest level at quarter end since 2015

Figure 6: Gilt breakeven Inflation [2]





Gilt break-even inflation	Maturity Points (yrs)					
	2	**5**	**10**	**15**	**20**	**30**
Current % as at 31/12/2020	**2.36**	**2.81**	**3.09**	**3.18**	**3.23**	**3.07**
1 Month Change (bps)	-4	-13	-10	0	-1	-1
1 Quarter Change (bps)	-8	-9	-6	1	5	11
1 Year Change (bps)	-14	-14	-14	-4	3	-5

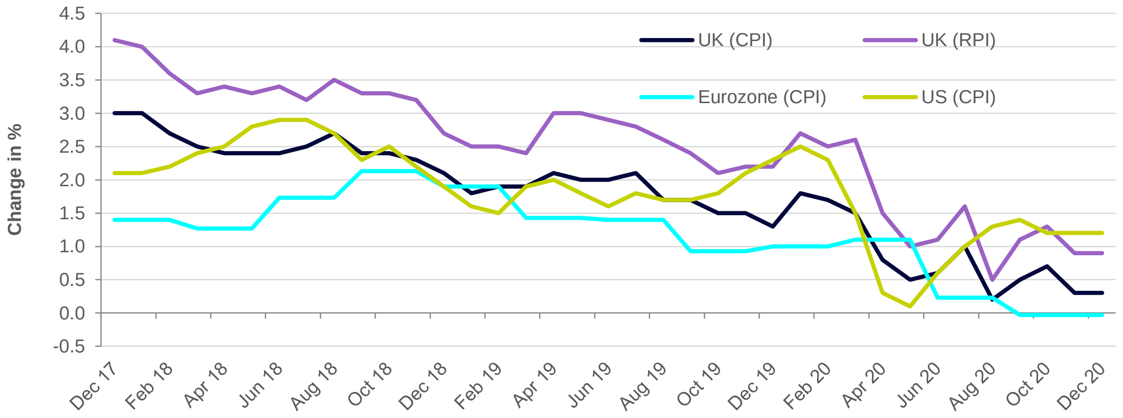
Source: Bloomberg, Capita

[2] Gilt breakeven inflation has been calculated as the difference between nominal Gilt yields and real Gilt yields.

Source: Bloomberg, Capita

Figure 7: CPI in the UK, US and Eurozone

Source: Bloomberg, Capita



Inflation

- UK CPI inflation fell over the quarter from 0.5% as at end of September (as restated) to 0.3% at end of the quarter [3]. UK RPI was also down to 0.9% compared to 1.1% for the end of the previous quarter.
- Inflation expectations adjusted upwards across all maturity points 15 years and above and adjusted downwards across all maturity points 10 years and below. with the largest effect for the middle term but are still lower than one year ago.

[3] At the publication date of this bulletin, the ONS had not yet announced the end December CPI and RPI rates so we have used end November figures as the latest available.

Real yields fall at the longer end of the curve

Figure 8: Gilt real yield[4] term structure

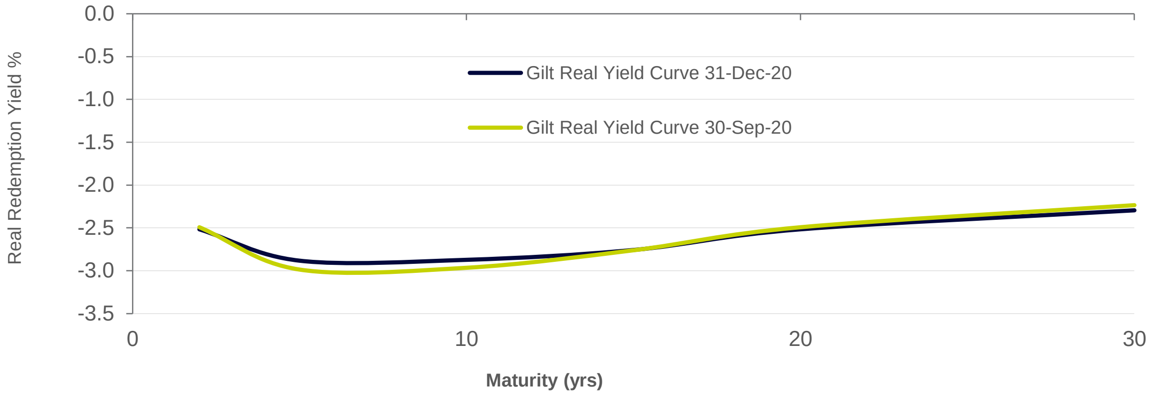
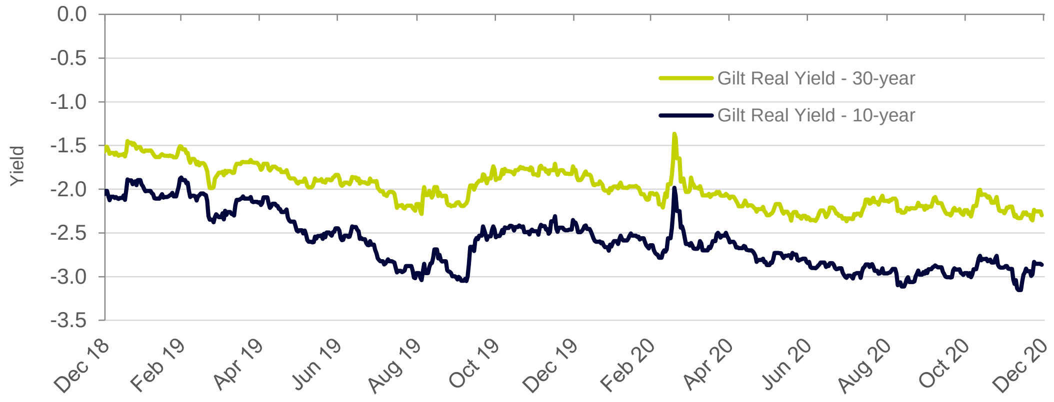
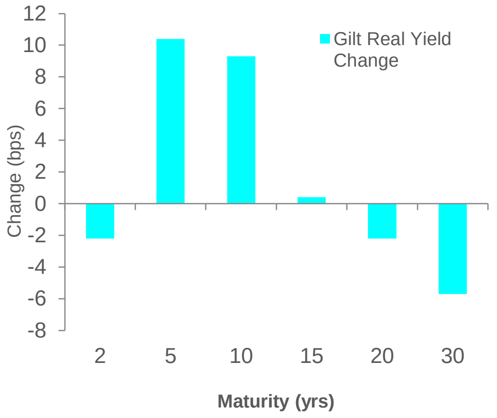


Figure 9: 10-year and 30-year real yields

Source: Bloomberg, Capita





Source: Bloomberg, Capita

Real Gilt Yields	Maturity Points (yrs)					
	2	5	10	15	20	30
Current % as at 31/12/2020	**-2.52**	**-2.88**	**-2.87**	**-2.76**	**-2.52**	**-2.29**
1 Month Change (bps)	-7	7	3	-9	-7	-4
1 Quarter Change (bps)	-2	10	9	0	-2	-6
1 Year Change (bps)	-60	-58	-52	-66	-60	-56

Source: Bloomberg, Capita

[4] Gilt real yield has been calculated as the yield on index-linked Gilts

Real yields

- Real gilt yields remain negative for all maturities.
- Real yields fell at 2, 20 and 30 year maturities but rose significantly for 5 and 10 years. Real yields rose slightly for 15 years maturity.

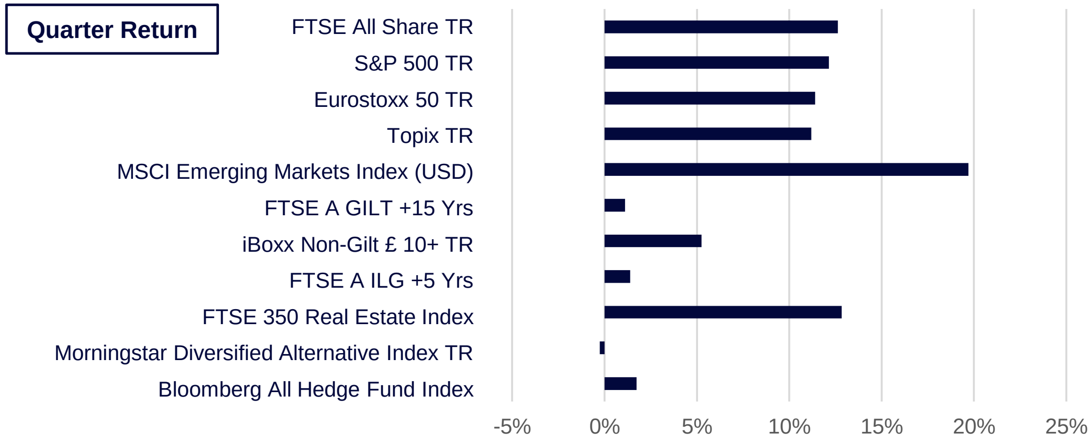
Asset class performance summary in local currency

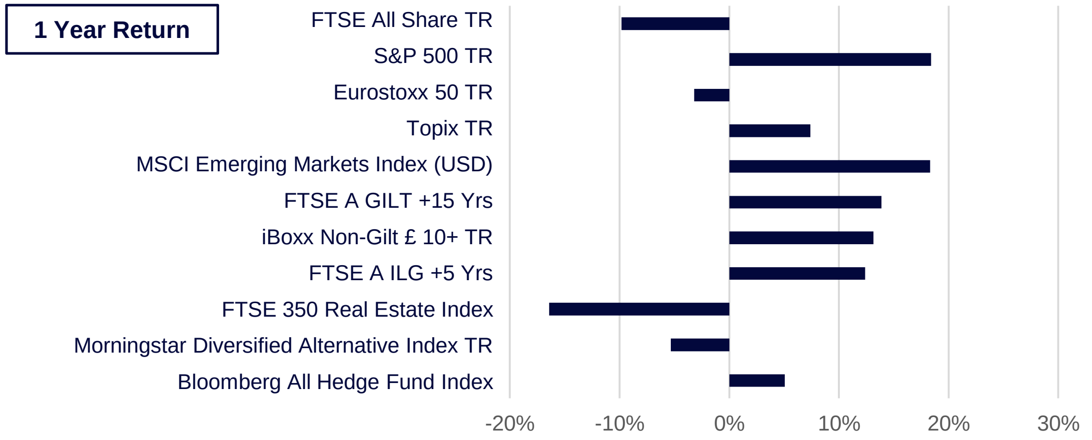
Asset class performance summary

- The charts below and the table to the right show the one-quarter and one-year performance in local currency of investments in major asset classes to the end of December 2020.
- Over the quarter, emerging markets equities was again the best performing asset class.

Asset Class	Quarter Return	1 Year Return
FTSE All Share TR	12.6%	-9.8%
S&P 500 TR	12.1%	18.4%
Eurostoxx 50 TR	11.4%	-3.2%
Topix TR	11.2%	7.4%
MSCI Emerging Markets Index TR (USD)	19.7%	18.3%
FTSE A GILT +15 Yrs	1.1%	13.9%
iBoxx Non-Gilt £ 10+ TR	5.3%	13.2%
FTSE A ILG +5 Yrs	1.4%	12.4%
FTSE 350 Real Estate Index	12.8%	-16.4%
Morningstar Diversified Alternative Index TR	-0.3%	-5.3%
Bloomberg All Hedge Fund Index	1.7%	5.0%

Total returns in local currency | Source: Bloomberg, Capita





Asset class performance summary in GBP

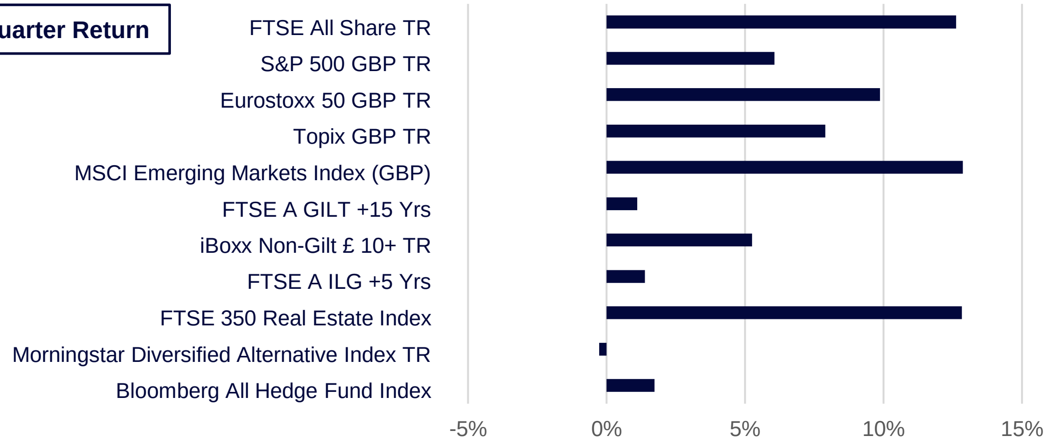
Asset class performance summary

- The charts below and the table to the right show the one-quarter and one-year performance of sterling-denominated investments in major asset classes to the end of December 2020.

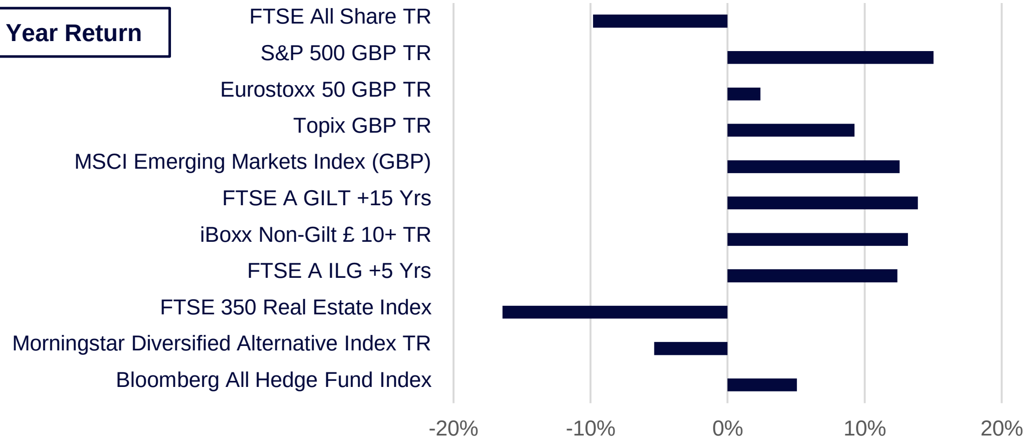
Asset Class	Quarter Return	1 Year Return
FTSE All Share TR	12.6%	-9.8%
S&P 500 GBP TR	6.1%	15.0%
Eurostoxx 50 GBP TR	9.9%	2.4%
Topix GBP TR	7.9%	9.3%
MSCI Emerging Markets Index (GBP)	12.9%	12.6%
FTSE A GILT +15 Yrs	1.1%	13.9%
iBoxx Non-Gilt £ 10+ TR	5.3%	13.2%
FTSE A ILG +5 Yrs	1.4%	12.4%
FTSE 350 Real Estate Index	12.8%	-16.4%
Morningstar Diversified Alternative Index TR	-0.3%	-5.3%
Bloomberg All Hedge Fund Index	1.7%	5.0%

Total returns in GBP | Source: Bloomberg, Capita

Quarter Return



1 Year Return



An Introduction to ESG & Sustainable Investment by Joel Riddaway

What is Sustainable Investment?

Consideration of Environmental, Social and Governance (“ESG”) factors is vital to measuring the sustainability and societal impact of an investment. This approach to investment in the pensions industry is **vital to ensuring a sustainable future** for us all and our future generations. **Everybody in the industry is responsible** for ensuring ESG issues are taken seriously, from scheme members to trustees and employers and no pension scheme is too small to not have to consider ESG issues.

Why is consideration of ESG issues so important?

According to the World Economic Forum’s 2020 Global Risks Report, severe threats to our climate and society account for **all of the top long-term risks we currently face**. These issues could have a huge impact on society, companies, and the world now and in the future with potentially **irreversible effects**. Whilst E only makes up one third of “ESG” and all 3 should be considered, it is **clear to see the challenges we face** in the shape of the current climate change/global warming crisis.

What can be done?

There are many ways in which ESG considerations can be applied to investment decisions across **a full spectrum of engagement** from excluding companies with the lowest ESG scores from an investment selection, to actively allocating assets to companies with higher ESG scores for this reason. The **combined influence** of the asset management industry ($Trillions) can be hugely persuasive on corporate behaviour, **encouraging positive behaviours**.

Investing in companies who risk breaking ESG rules poses a **material risk to long-term investment returns,** and an allocation to ESG positive themes can even take advantage of good investment opportunities which **could boost long-term investment returns**.

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What are the current regulations?

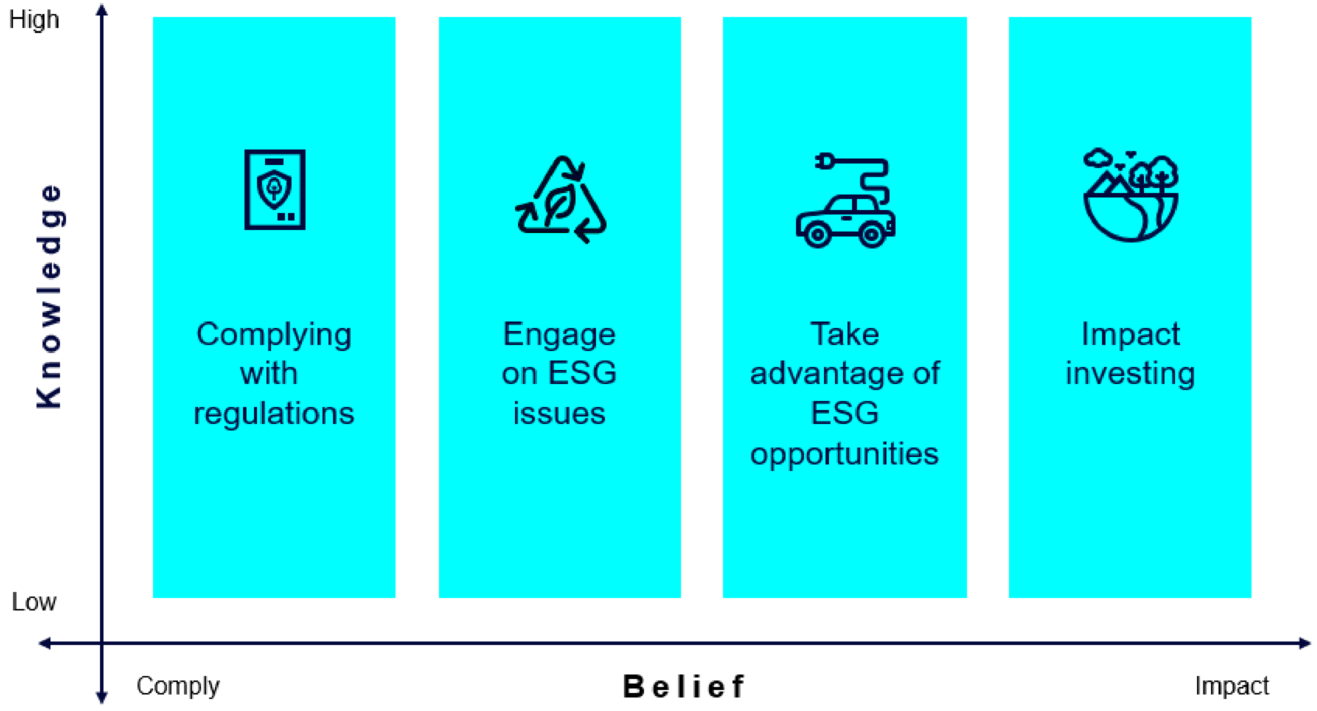
The Department for Work and Pensions ("DWP") new regulations clarify that ESG and climate change considerations are included in "Financially material considerations". The **consideration of ESG issues are not optional** and not just the right thing to do, a failure to consider ESG issues puts trustees at **significant risk of breaching their legal and regulatory duties.** There has been increasing regulatory pressure on this for a long time.

What should you be doing?

As a pension trustee board, it is important to **agree on where you sit on the sustainability spectrum**. But this is a process where, as a trustee, you first need to know your own beliefs, then the beliefs of others on your board and then align that to your corporate sponsor belief. To do that, we suggest you think about the knowledge you have and what your beliefs are on the sustainability spectrum. An example of this spectrum can be seen to the right.

Your position on the spectrum is not just about selecting particular investment funds or solutions, but also **considering the impact of others on sustainability**, for example how your advisers, lawyers and administrators act.

Once each trustee has placed themselves on the sustainability spectrum, the trustee board should **review this and challenge each other**, discussing and concluding the position on the spectrum as a board. Getting to **an agreed approach** is important before considering how these concepts will be implemented within a pension scheme.



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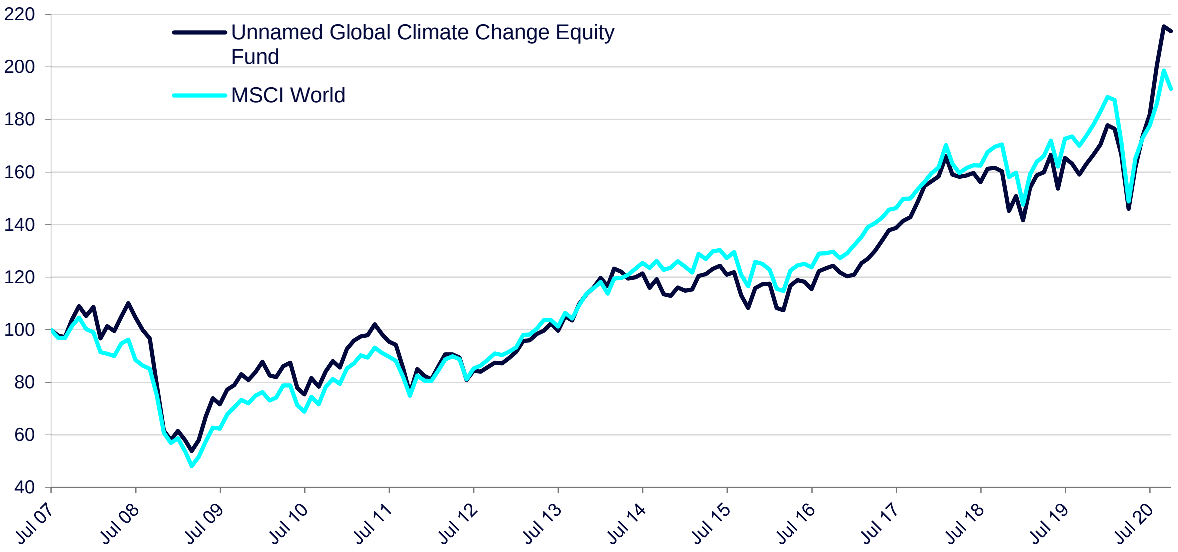
A recent client case study

We recently undertook an investment strategy review with one of our clients which included reviewing their current equity portfolio construction. We see this as a natural time for us to help our clients consider ESG issues in further detail and look to **implement an "ESG-friendly" solution where appropriate into their portfolios.**



The clients views

Given the nature of the client, it is clear to us that their sponsoring employer and members would absolutely expect the trustee board to be considering ESG issues in their investment decision making. However, this client isn't an exception, most (if not all) **sponsoring companies will have policies in relation to sustainability** and it is Capita's view that trustees should **align their scheme's investments with the beliefs of the employer**. This as a minimum should be to **consider climate change as a material risk**.

Capita's house views

It is our belief that, whilst no asset class is immune, equity investments should typically get the most focus (and at least include solutions to minimise climate change risk within a portfolio) due to the unique ability to both vote and tilt within this asset class. We also strongly believe that **no client is too small**, and all of our clients need to know about our ESG views and we challenge clients that do not support our views.

Given this, we saw the **review of the clients equity portfolio as the perfect time to explore ESG solutions** within a portfolio in a cost-effective way. We (and the client) appreciate that the work is not done there, but it is a big step in the right direction for the Scheme by exploring an "ESG-titled" passive global equity fund as an alternative to a traditional "market-cap" passive global equity fund.

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Challenge your Fund Managers

We will ensure all of our recommended managers are **considering ESG issues when taking investment decisions**. Of course, different investment managers have different approaches so it is **important for you to understand what your investment managers' ESG policies are** and how these align with your beliefs.

We have a series of 10 questions that are a reasonable starting point for understanding the views and actions of the fund managers which include such areas as:

- the firm wide philosophy on Responsible Investment / ESG;
- integrating ESG factors into your investment process; and
- reporting on the role of ESG factors in your investment decision making process.

Please get in touch if you would like the full list of questions.

Contacts and Regulatory Statement

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