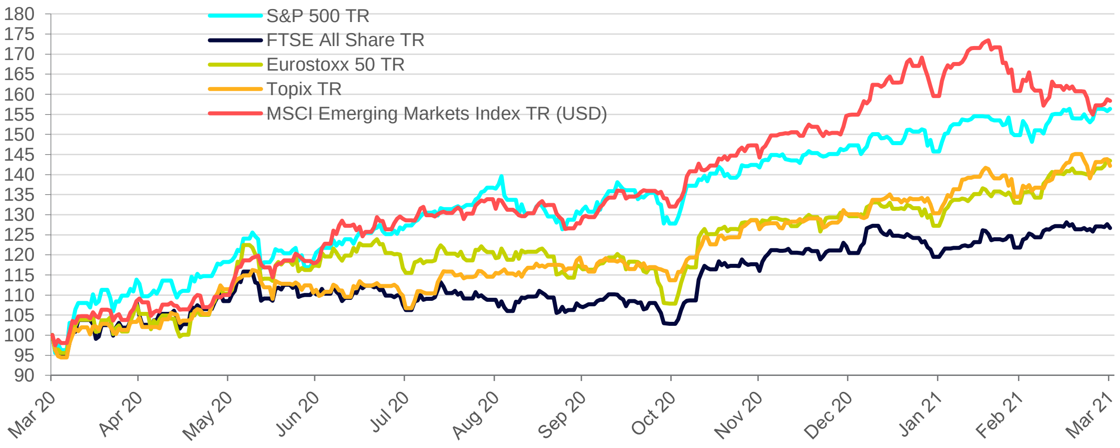
Quarterly Investment Bulletin

March 2021

Contents

Global Equities continued to 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	**31/03/2021 (Price)**	**1 Month**	**1 Quarter**	**1 Year**
S&P 500 (TR)	8238	4.4%	6.2%	56.4%
FTSE ALL-Share (TR)	7436	4.0%	5.2%	26.7%
EuroStoxx 50 (TR)	8515	7.9%	10.7%	43.5%
Topix (TR)	3081	5.7%	9.3%	42.1%
MSCI Emerging Markets Index TR (USD)	638	-1.5%	2.3%	58.4%

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

- Global equities generally made significant gains in the first quarter of 2021. All major indices made positive returns over the quarter, with European equities in excess of +10% return.
- US equities posted a strong quarter of positive performance, rising by +6.2%. This means that the S&P 500 index is now up by +56.4% since the end of March 2020. This is a significant recovery following the coronavirus pandemic, which saw the index fall by nearly 20% over Q1 2020.
- With the apparent early success of the UK's coronavirus vaccine rollout programme, the FTSE All-Share index returned +5.2% over the quarter. The UK Equity market is now up by 26.7% since end March 2020.
- In the eurozone, the EuroStoxx 50 index returned +10.7% over the quarter. European equities are now up by 43.5% since end March 2020.
- In Japan, the Topix index made strong gains over the quarter, returning around +9.3%. The Japanese equity market is now up by 42.1% since end March 2020, similar to European equities.
- In emerging markets, the MSCI Emerging Markets Index returned +2.3% over the quarter, after a negative return of -1.5% in March 2021.

Nominal gilt yields increase significantly across the curve

Figure 4: Nominal term structure of gilts

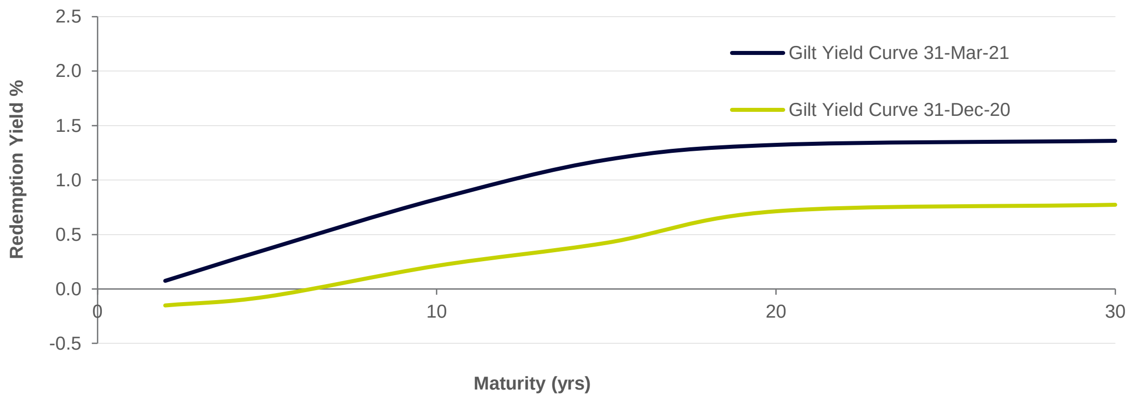
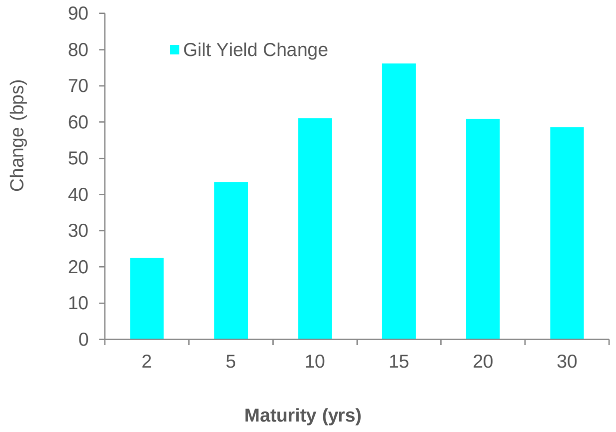


Figure 5: 10-year and 30-year nominal yields

Source: Bloomberg, Capita



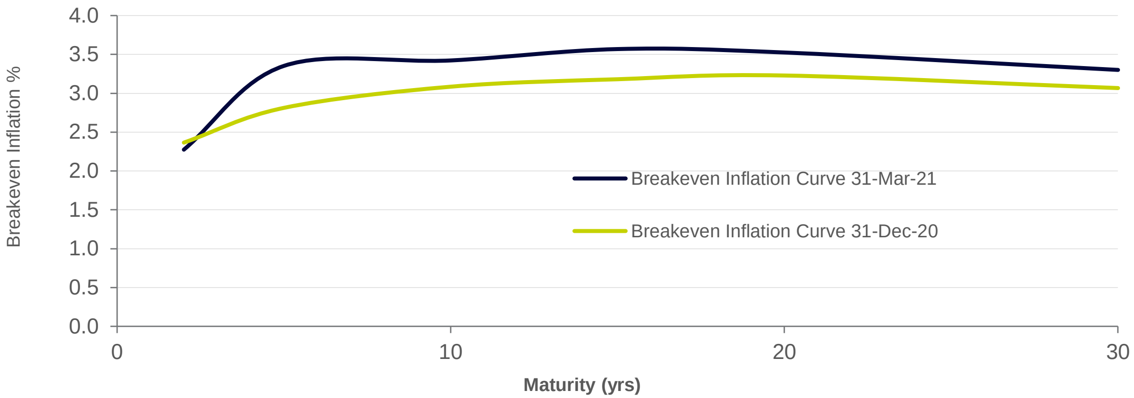
Source: Bloomberg, Capita

Rise in both gilts yields and growth assets presents opportunities

- Nominal gilt yields increased significantly across all maturities, over the first quarter of the year.
- Funding levels have improved significantly as liabilities have fallen, and growth assets like equities have continued to rise. This has presented an attractive de-risking opportunity for some schemes as they have found themselves ahead of where they expected to be on their Journey Plan.
- This is especially true for schemes with relatively low levels of liability hedging (LDI).
- Trigger-based dynamic de-risking strategies, where funding levels are tracked daily and pre-agreed de-risking is undertaken when triggers are hit, have been invaluable this quarter.

Future inflation expectations rise
Realised (past) inflation remains historically low

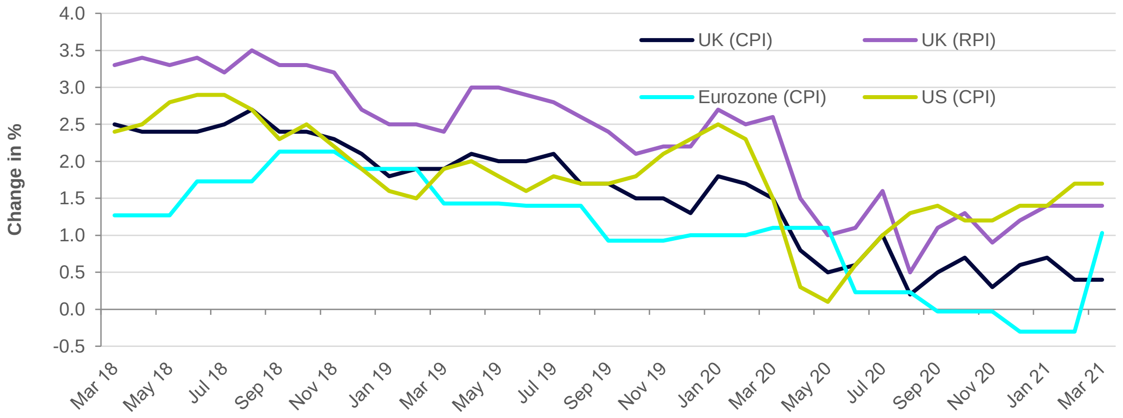
Figure 6: Gilt-Implied Future Inflation Expectations [2]



Source: Bloomberg, Capita

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

Figure 7: Realised (past) CPI in the UK, US and Eurozone



Source: Bloomberg, Capita

Inflation

- Future inflation expectations adjusted upwards significantly, with the largest effect for the middle terms. This has acted to increase pension scheme liabilities.
- However, the increase in future inflation expectations has typically been more than offset by the rise in nominal gilt yields, leading to a fall in liabilities overall.
- Realised (past) UK CPI inflation fell over the quarter from 0.6% as at end of December (as restated) to 0.4% at end of the quarter [3]. Realised UK RPI, however, was up to 1.4% compared to 1.2% for the end of the previous quarter (as restated).

[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 February figures as the latest available.

Real yields increase across most of the curve

Figure 8: Gilt real yield[4] term structure

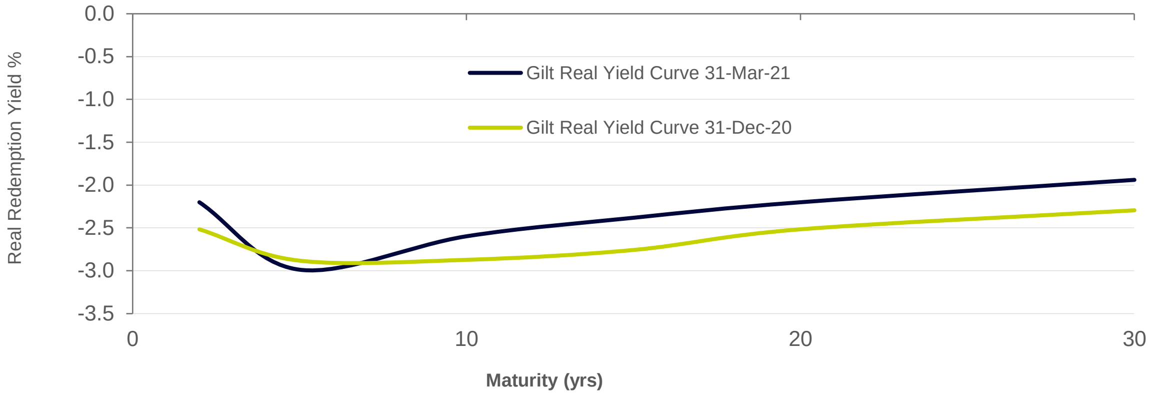
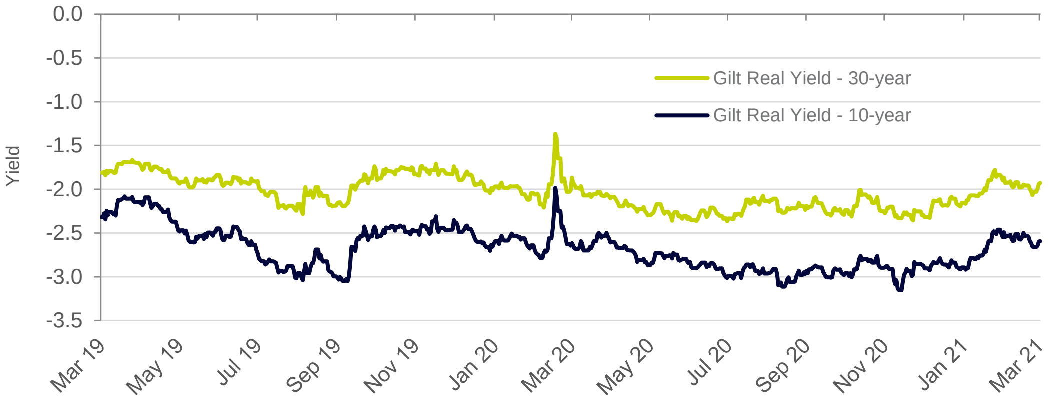
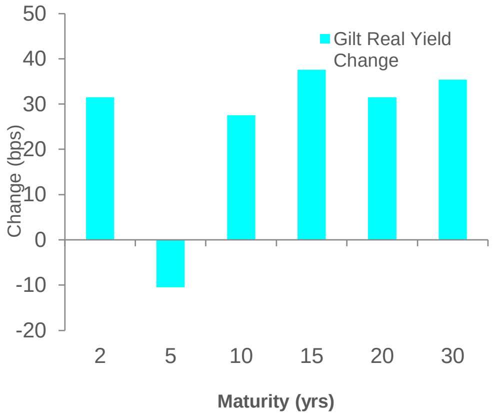


Figure 9: 10-year and 30-year real yields

Source: Bloomberg, Capita





Source: Bloomberg, Capita

Real Gilt Yields	Maturity Points (yrs)					
	2	5	10	15	20	30
Current % as at 31/03/2021	**-2.20**	**-2.99**	**-2.60**	**-2.38**	**-2.20**	**-1.94**
1 Month Change (bps)	-10	-23	-14	-5	-10	-10
1 Quarter Change (bps)	32	-11	28	38	32	35
1 Year Change (bps)	1	-42	5	5	1	7

Source: Bloomberg, Capita

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

Real yields

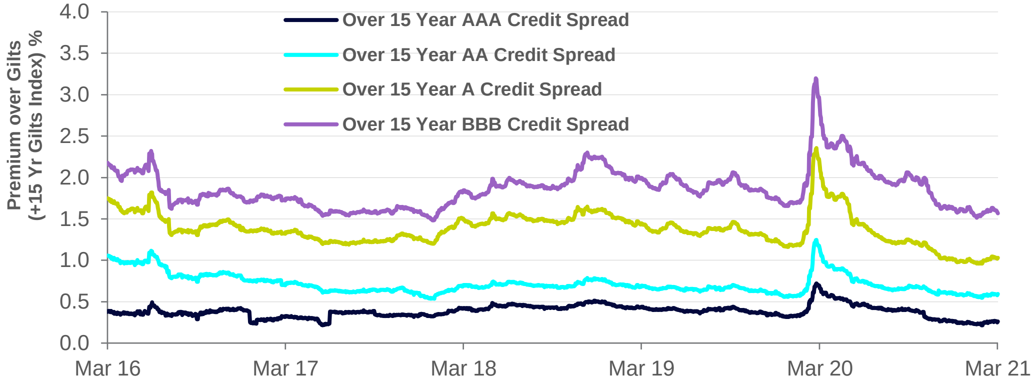
- Real gilt yields remain negative for all maturities.
- Real yields rose significantly across all maturities, except five years, and are now at similar levels to one year ago across most of the curve.

Corporate bond spreads largely unchanged over the quarter

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

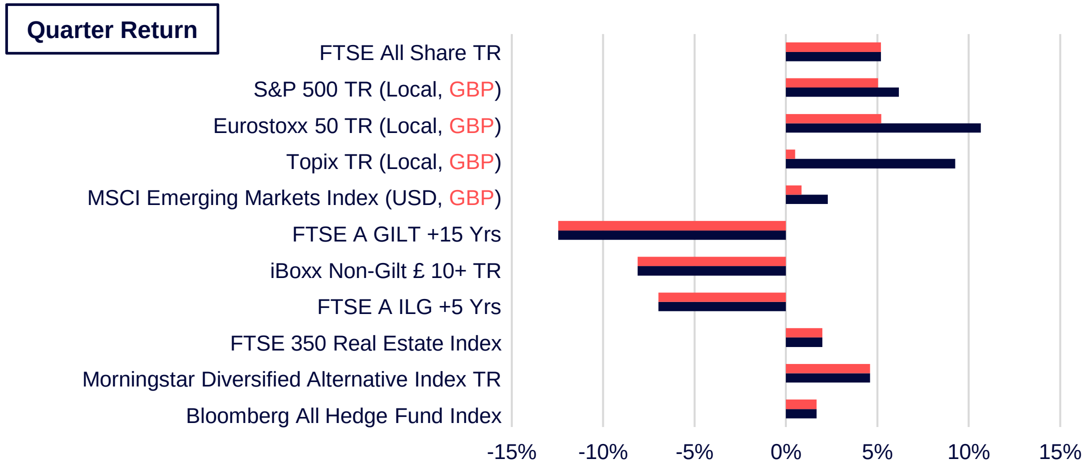
Asset class performance summary in local currency and GBP

Asset class performance summary

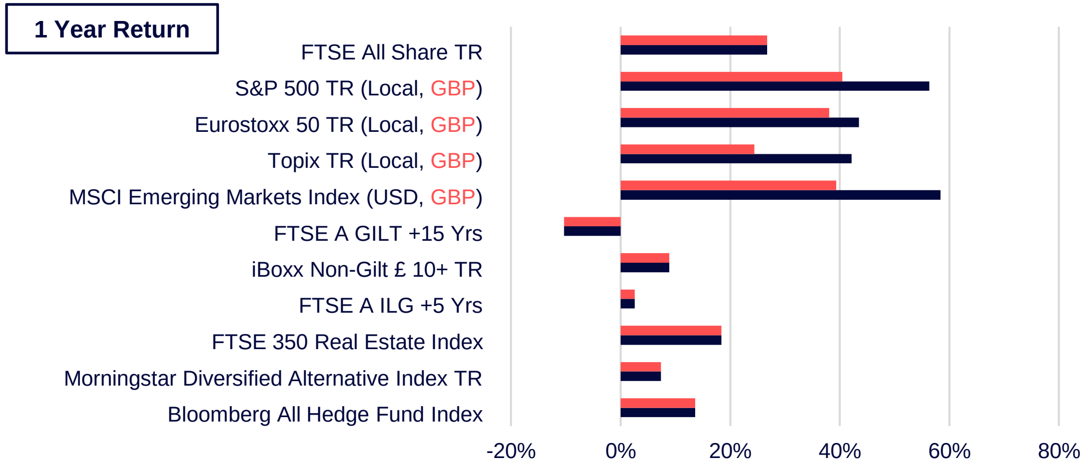
- The charts below and the table to the right show the one-quarter and one-year performance in local currency and GBP of investments in major asset classes to the end of March 2021.
- Over the quarter, European equities was the best performing asset class.

Asset Class	Quarter Return	1 Year Return
FTSE All Share TR	5.2%	26.7%
S&P 500 TR (Local, GBP)	6.2%, 5.0%	56.4%, 40.5%
Eurostoxx 50 TR (Local, GBP)	10.7%, 5.2%	43.5%, 38.0%
Topix TR (Local, GBP)	9.3%, 0.5%	42.1%, 24.4%
MSCI Emerging Markets Index TR (USD, GBP)	2.3%, 0.8%	58.4%, 39.4%
FTSE A GILT +15 Yrs	-12.5%	-10.4%
iBoxx Non-Gilt £ 10+ TR	-8.1%	8.9%
FTSE A ILG +5 Yrs	-7.0%	2.6%
FTSE 350 Real Estate Index	2.0%	18.4%
Morningstar Diversified Alternative Index TR	4.6%	7.4%
Bloomberg All Hedge Fund Index	1.7%	13.6%

Total returns in local currency, GBP | Source: Bloomberg, Capita



Source: Bloomberg, Capita



Source: Bloomberg, Capita

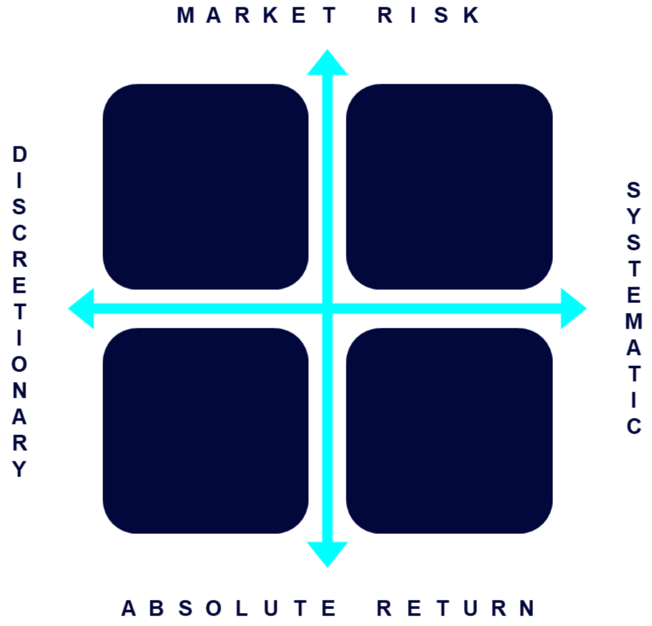
A review of Diversified Growth Funds by Ben Crabbe

What is a Diversified Growth Fund (DGF)?

DGFs aim to achieve a stable return stream, significantly in excess of the risk-free rate but with only a fraction of equity volatility.

To achieve this aim, they invest in a diverse portfolio of assets and / or use a variety of investment techniques. Their approaches vary significantly, with wide ranges across equity beta exposure, use of alternatives, systematic or discretionary management and the use of dynamic asset allocation.

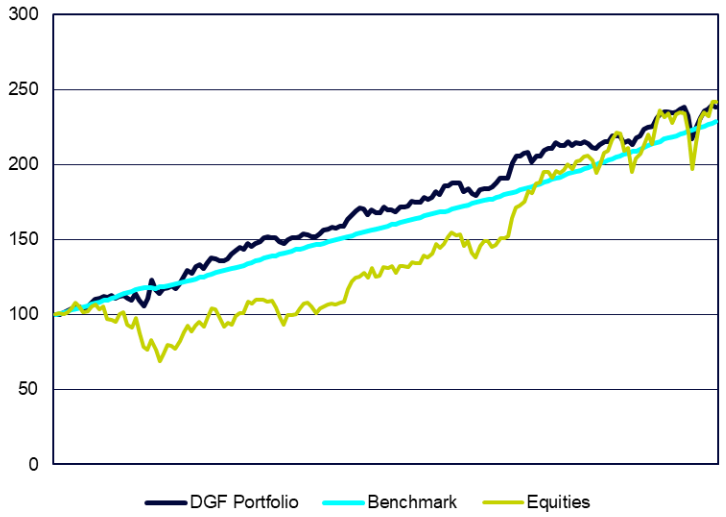
All approaches are valid, and often a combination of funds / approaches may work better than any single approach in isolation.



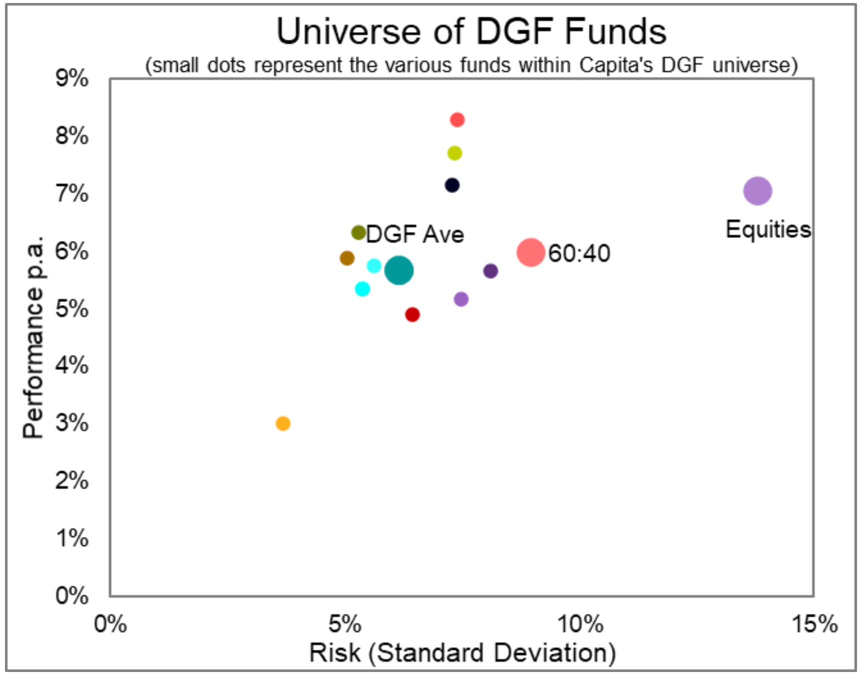
Why DGFs?

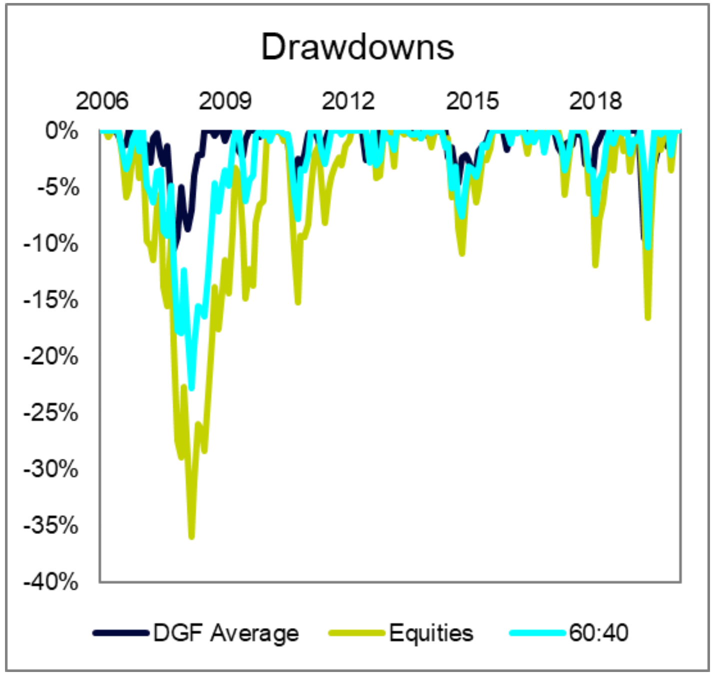
A typical pension scheme will split its investment portfolio between matching assets and growth assets. While the matching assets will look to “match” any changes in the value of the liabilities, the growth assets are intended to be the engine that drives outperformance of the liabilities.

DGFs sit within a pension scheme’s growth assets portfolio, and their key attraction is the ability to deliver incremental outperformance of the liabilities, without incurring huge volatility that would affect funding levels. The incremental outperformance is achieved by investing in a broad variety of asset classes and using a range of investment strategies.



A review of Diversified Growth Funds by Ben Crabbe





How have DGFs performed?

A criticism of DGFs has been around their ability to consistently outperform a 60% equity : 40% bond fund.

However, our analysis shows that, while the returns of a typical DGF may be similar to a 60:40 fund, DGFs, particularly the good ones, are able to achieve this level of return with reduced risk, measured both in terms of standard deviation of returns and drawdowns.

This is important when considering funding level volatility and the optimal use of the risk budget. This leads us to conclude that DGFs play a key role in a pension fund portfolio.

“Our analysis shows that, while the returns of a typical DGF may be similar to a 60:40 fund, DGFs, particularly the good ones, are able to achieve this level of return with reduced risk, measured both in terms of standard deviation of returns and drawdowns.”

A review of Diversified Growth Funds by Ben Crabbe

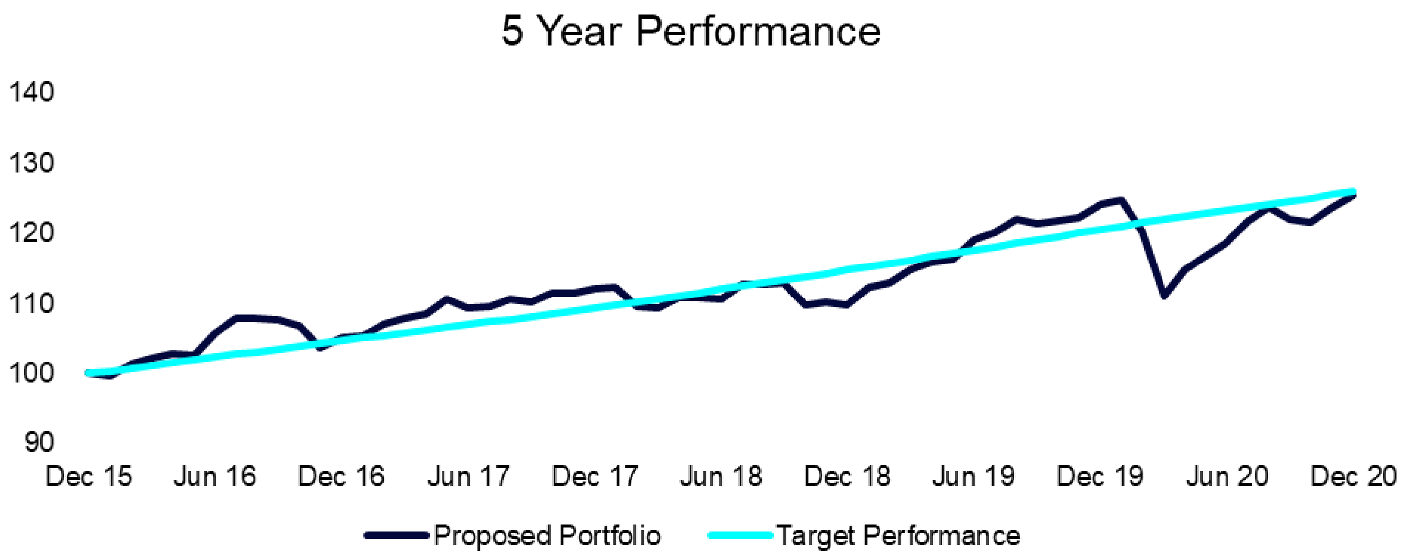
Illustrative example

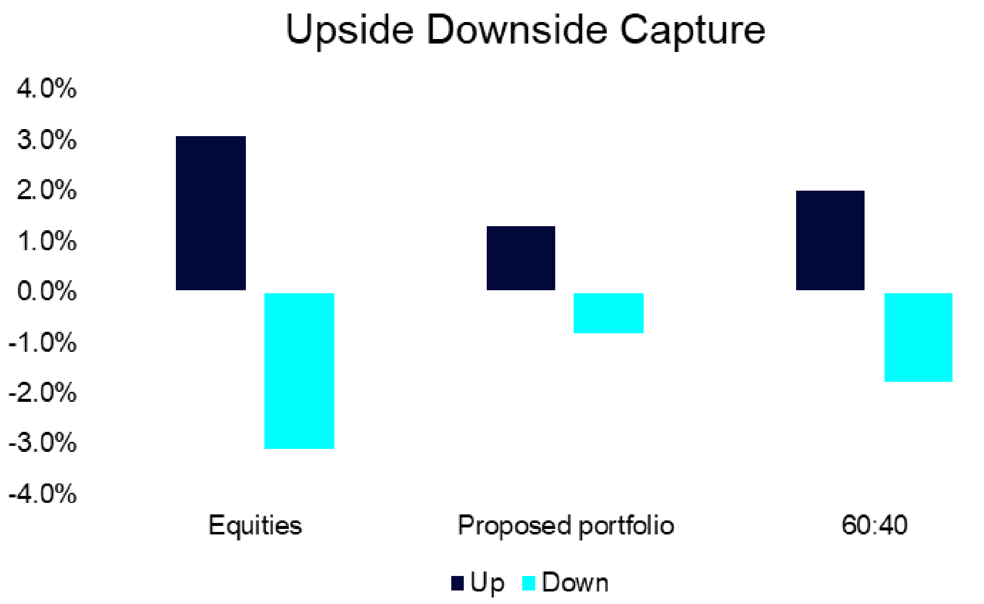
Larger pension schemes will often split their DGF exposure across two or even three managers.

A combination of diversified funds will often produce better risk-adjusted performance, particularly if the component fund styles are different but complementary.

The illustrative “proposed” portfolio has managed to produce strong returns while protecting capital through limiting volatility and drawdown risk by:

- Diversifying across a wide range of asset classes and investment opportunities
- Focusing on asset allocation, portfolio construction, trade sizing and risk exposures
- Tactically allocating assets according to value, the economic cycle and momentum
- Skewing return outcomes by using options or option-like trades.





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