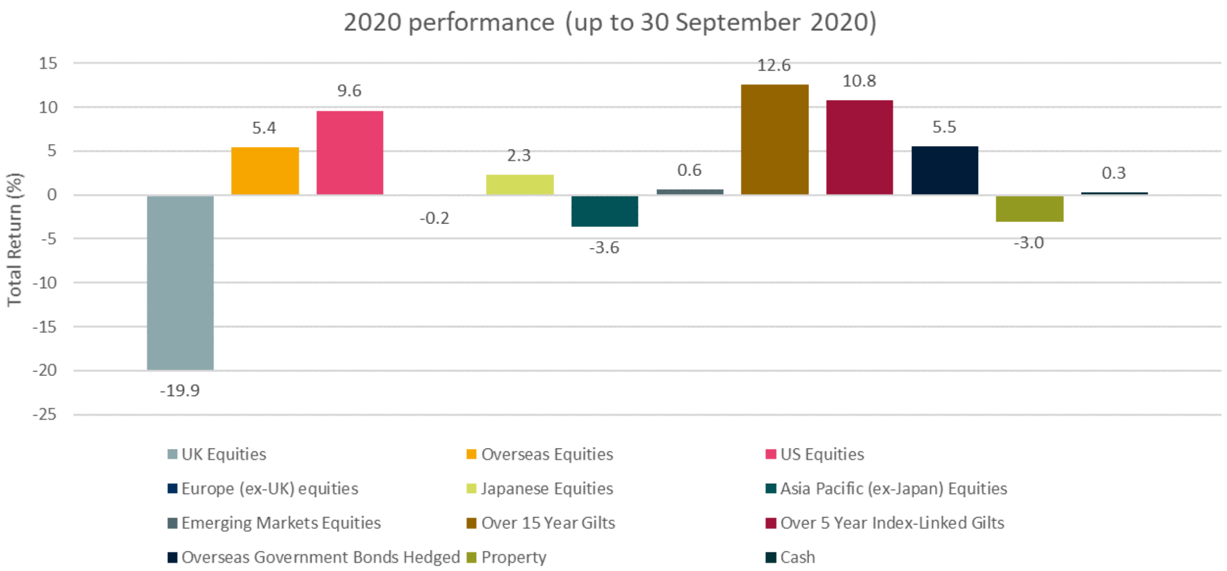
Scheme Investment Update

As the chart below shows, 2020 has proven to be a volatile year for many asset classes, with some assets substantially increased in value and others falling considerably. Developed market equities were hit by the exponential growth of the pandemic in March, with many countries putting large parts of their economic infrastructure into "deep freeze" in an attempt to slow the spread of the virus. However, equity markets generally rebounded strongly in the second quarter on the back of unprecedented government and central bank policy support. Many equity markets now sit higher than they started the year.

UK equities have been a notable exception – they were among the hardest hit in March 2020 with the FTSE 100 posting its worst quarterly performance since 1987. While UK equities did recover somewhat over the second quarter of the year, performance lagged all other major equity markets, in part due to the sectors most heavily represented in the UK equity market being particularly impacted by the pandemic. Renewed fears of a disorderly post-Brexit trading arrangement over the latter part of 2020 continued to weigh heavily on UK equity valuations.

Bonds generally delivered good returns over the year, in particular in the UK. In response to the developing economic crisis, the Bank of England cut rates twice in March (which generally increases bond prices), pledged unlimited short-term financing for large companies and expanded its bond buying programme. These measures, coupled with an increased appetite for defensive assets, saw bonds prices rise sharply over the first half of 2020.



In Sterling terms. Source: Bloomberg

Scheme investments

Scheme performance was broadly neutral over 9 months to 30 September 2020, smoothing volatility during the yea, with negative performance in the first quarter of 2020 being made up for by positive performance over the following two quarters. The Scheme's position has been helped by its relatively low-risk investment allocations, and the decision to not hold any direct UK equity investments (which as above have substantially underperformed global markets).

The Scheme's index-linked gilts have delivered the strongest returns. In a difficult year for equities, the Kiltearn active equity fund delivered the weakest returns, failing to participate in much of the recovery seen since the initial crisis. However, the Scheme's equity investments are now relatively small. Alternatives and credit investments posted mixed returns, generally falling over the first quarter then recovering over the rest of the year.

The mix of Scheme assets has stayed largely the same over the year, apart from a reduction to one of the alternative holdings to fund ongoing benefits and one of the fixed income growth investments. The Trustees have managed the Scheme's cash position carefully over 2020, balancing the need to maintain sufficient cash to pay current benefits, while avoiding selling undervalued assets before they have had a chance to recover their value.

The spread of the Scheme's assets at the beginning of the year and 30 September 2020 is shown in the charts below. Note the Scheme disinvests some assets from time-to-time to meet pension payments, which offsets some investment growth.