

# Additional Voluntary Contributions (AVC) Funds

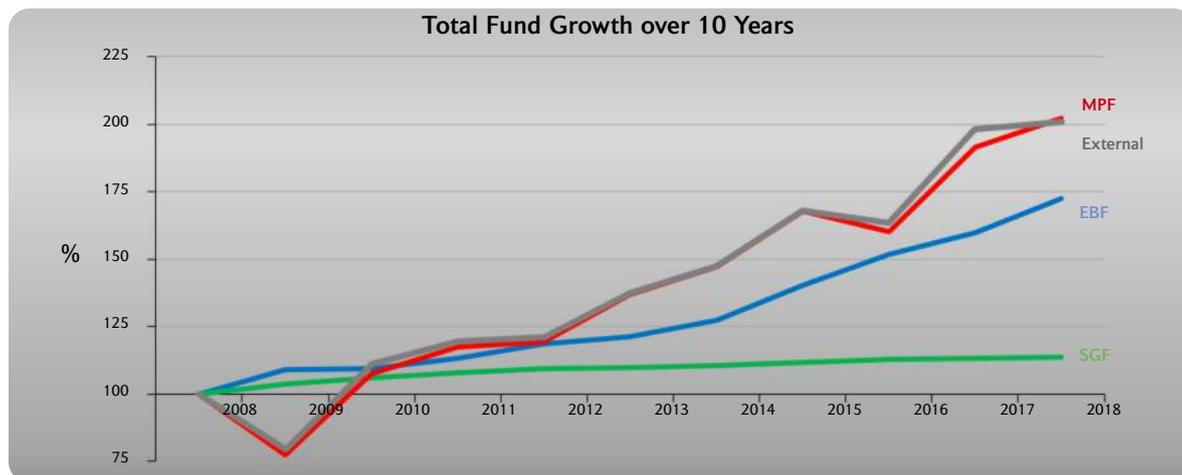
## Investment Commentary 2017/18



This report details how the three AVC Funds – the Short-Dated Gilts Fund (SGF), the Equity Biased Fund (EBF) and the Mixed Portfolio Fund (MPF) performed during the year ending 31 March 2018, as well as detailed information on how the MPF Fund is invested.

### At a glance: Performance of the Funds\*

The chart below shows how £100 would have changed in value over 10 years if invested in the Short-Dated Gilts Fund (SGF), the Equity Biased Fund (EBF) or the Mixed Portfolio Fund (MPF). A group of external funds with similar objectives to the MPF is included for comparison purposes.



\*Past performance is no guide to the future; the value of investments can fall as well as rise.

# Investment Commentary 2017/18

## Our AVC Funds in detail

Our 'AVC Plan – information leaflet' is available on the AVC Funds page of our website, [www.mybapension.com](http://www.mybapension.com) and describes the three AVC Funds available, the different type of return each fund provides as well as information about how you can manage your AVC investments between the three funds.

### Short-Dated Gilts Fund (SGF)

*"The return for monies invested in the SGF for the whole of 2017/18 was 0.48%."*

The investment objective of the SGF is to produce returns related to the interest rate on government gilt-edged securities. Rates of interest vary from year to year but the value of the investment cannot go down. SGF investors will receive the average rate from the three highest-yielding, gilt-edged securities, which have less than five years to maturity. Interest is applied annually to money held in the SGF at the beginning of the Scheme year. The return for money invested in the SGF for 2017/18 was 0.48%. Money that is invested in the SGF during the Scheme year receives interest on a proportional basis. For example, money invested in July and held to the end of the Scheme year will receive eight-twelfths of the current annual interest rate. Where funds are switched into, or out of, the SGF during the year, interest is calculated separately in respect of the money held before and after the date of the switch.

### Equity Biased Fund (EBF)

*"The total return for monies invested in the EBF for the whole of 2017/18 was 7.88%."*

The investment objective of the EBF is to produce a return, which consists of two parts - a Guarantee Component and a Bonus Component.

**Guarantee Component** - this rate is declared each calendar month and is currently based on the monthly return on the Sterling Overnight Index Average rate (SONIA). The Trustees can change the index from time to time, having taken suitable advice. For the year 2017/18 the annualised interest rate for each month's Guarantee Component varied between 0.19% and 0.49%, with an average of 0.31% for the year. The Guarantee Component cannot be less than zero.

**Bonus Component** - this rate is currently declared in advance, usually by the end of April each year. It is effective from 1 April and remains the same for the whole of the Scheme year ahead. The Bonus Component is calculated by the Schemes' Actuaries. The Trustees can change the benchmark portfolio from time to time, having taken suitable advice. When determining the Bonus Component the Actuaries compare the actual rate of return achieved by the benchmark portfolio in recent years to the Guarantee Component and then calculate a weighted average return in excess of the Guarantee Component. It is possible for the Bonus Component to be zero but it cannot be less than zero. The Bonus Component contains an allowance for the cost of ensuring that the overall EBF return is no lower than the Guarantee Component. This allowance is reviewed from time to time and is currently 4.0% p.a. For the year 2017/18, the Bonus Component was 7.3%.

The total return for monies invested in the EBF for the whole of 2017/18 was 7.88%. The Actuary has declared that the Bonus Component effective from 1 April 2018 for the coming year is 6.6%.

Money that is invested in an EBF Account for the whole of a calendar month will currently be credited with interest for the month at a rate comprising the Guarantee Component declared for that month plus one-twelfth of the Bonus Component declared for the Scheme Year in which that month falls.

Neither the SGF nor the EBF are classified as pure money purchase funds. There is a risk that money in an SGF or EBF Account might be used partly or wholly to make good other promised Scheme benefits if APS or NAPS were ever to wind up with insufficient funds to pay all of the promised benefits in full.

### Mixed Portfolio Fund (MPF)

*"The MPF returned 5.64% for the year ending 31 March 2018."*

The MPF is a pure money purchase arrangement, similar to a unit trust. Money invested in an MPF Account is used to buy units, the value of which depends on the investment value of the underlying assets of the MPF. The value of the units can go up or down. The investment objective for the MPF is reviewed every three years. It sets the framework for the types of investments the MPF can hold and what percentage of the MPF should be invested in each type of asset class.

The Fund benchmark currently has 80% of the assets in equities, split between the UK, North America, Europe, Japan, Asia Pacific and Emerging Market regions. The remainder of the Fund's benchmark assets are in bonds (18%) and cash (2%).

Positive investment returns are derived from capital growth, dividend and interest income. Investments in equities tend to be riskier and more volatile than many other types of investment which means the value of the Fund can fall as well as rise. In addition the overseas investments are in foreign currencies and their value may fall or rise when measured in Pounds sterling. There are arrangements in place, known as currency hedging, which aim to partly protect the portfolio. The hedge seeks to reduce the long term volatility of the Fund by lowering the Fund's exposure to foreign currencies.

The Trustees have set a target for the Fund Manager to exceed the weighted return on the benchmark assets by 0.5% p.a. measured over a five year period. The approach to achieving excess return above the benchmark involves exercising discretion in allocating between the asset classes described above which means the actual holding in each asset class may vary within agreed parameters. The Fund Manager also selects individual equities and bonds with the objective of outperforming the benchmark constituents.

### MPF Fund Benchmark

The Trustees set a benchmark for each type of asset class held within the Fund and use this to monitor the Fund's performance. For example, the performance of the MPF's portfolio of North American Equities is benchmarked against

the returns of the S & P 500 index. The performance of UK equities is measured against the FTSE All Share index. Each asset has its own benchmark comparator and these are combined to form a composite benchmark. The performance of the MPF will vary from the benchmark to the extent that actual asset holdings of the MPF have deviated from the asset allocation policy.

## Performance of the MPF

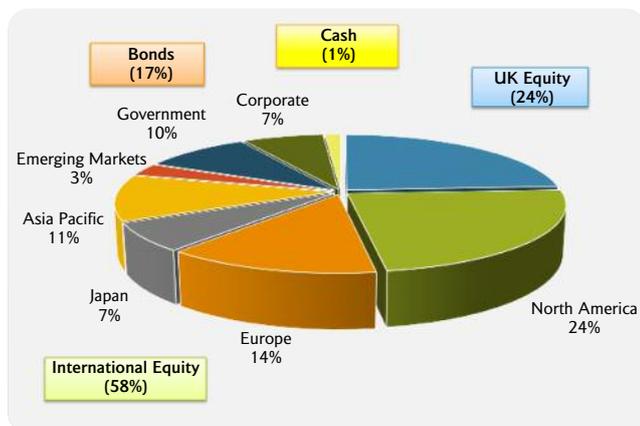
Overseas equity markets posted strong returns while domestic equity and bond markets were more subdued.

*“The benchmark returned 4.8% over the year and so the Fund outperformed its benchmark by 0.8%.”*

The Fund’s target is to beat its benchmark by an average of 0.5% per annum over a five year period. This goal has not been achieved over the latest five years, largely due to stock selection in earlier years.

The return on the MPF was above the 1.4% average achieved by other large AVC providers in the market place over the latest year. Over longer time periods the MPF has similar performance to these other funds. The returns are described in more detail in the ‘AVC Funds Performance Returns’ table on page 4.

The chart below shows how the MPF was invested at 31 March 2018.

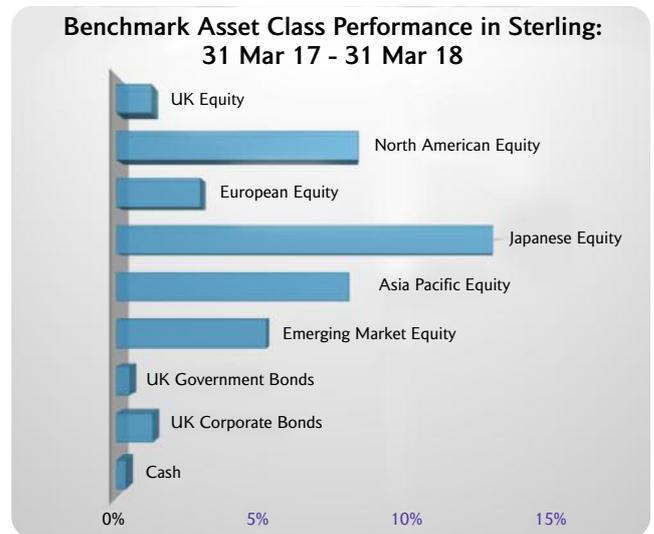


Equity market returns in local currency were strong around the globe over the year, with the exception of the UK and Europe which lagged behind. Subdued returns in the UK and European equity markets were due to political uncertainty and lower relative economic growth. US tax reform and the performance of the technology sector were positive for US equities.

The rebound in sterling dampened international equity returns measured in Pounds, except in the US and Japan where this was partially offset by the Fund’s currency hedging policy.

UK bonds produced modest positive returns. There was a pull towards higher yields due to rising inflation and progress in the Brexit negotiations which reduced demand for safe haven investments. This was offset by structural demand for bonds and rising geo-political risks pushing yields downwards.

The chart below shows the return for each asset class within the MPF over the year.



Global growth in 2017 exceeded most expectations and this has caused the major central banks to discuss exit strategies from the extraordinary monetary policies pursued since the global financial crisis. Central banks are, however, cautious on removing stimulus as there are only tentative signs of wage growth despite low unemployment rates. Further moves in interest rates hinge on the path of inflation.

The UK is one of a few countries where inflation has been above the target as higher import prices followed from sterling weakness, after the referendum vote to leave the European Union (EU). In response, the Monetary Policy Committee (MPC) at the Bank of England began to remove stimulus and increased interest rates in November 2017 for the first time in ten years. Although import price inflation has since shown signs of fading, the MPC has left the door open to further “gradual and limited” interest rate increases depending on the strength of economic data as we move through 2018. The UK labour market has been resilient, but wage growth is required to satisfy some members of the MPC that a further change in monetary policy is warranted. In addition the economic outlook could still be clouded by Brexit related uncertainty.

2017 saw the eurozone stage a cyclical recovery which became broader and increasingly solid over the course of the year. Synchronised global growth supported the eurozone region but there was a pause in activity in early 2018. This was attributed to the strength of the currency and temporary factors such as the weather and strikes. The European Central Bank (ECB) has continued with quantitative easing measures for now, but the President of the ECB, Mario Draghi, remains confident that inflation will converge with its 2% target over the medium term. This is despite elections in France, Germany and Italy which have increased political risk and supported safe haven flows to some bond and currency markets.

In the US fiscal policy moved to centre stage as markets eagerly awaited news on Trump’s pre-election pledges. The passage of the tax bill reform by the US Senate in December 2017 boosted US corporate cash flows. This was viewed as positive for US growth and underpinned economic momentum even

though upward pressure on wages remains limited. The US Federal Reserve (Fed) have continued raising interest rates as the economy is at a later stage in its cycle than other countries. The Fed stand ready for any overheating from the positive growth backdrop.

The Fund remained overweight equities throughout most of 2017, although we took a more cautious stance last summer on geo-political, trade and valuation concerns. The Fund also moved to be less underweight in bonds which have continued to outperform cash.

### Mixed Portfolio Fund's 10 Largest Holdings

The chart below shows the largest ten holdings in the MPF as at 31 March 2018 with the percentage of the Fund invested.



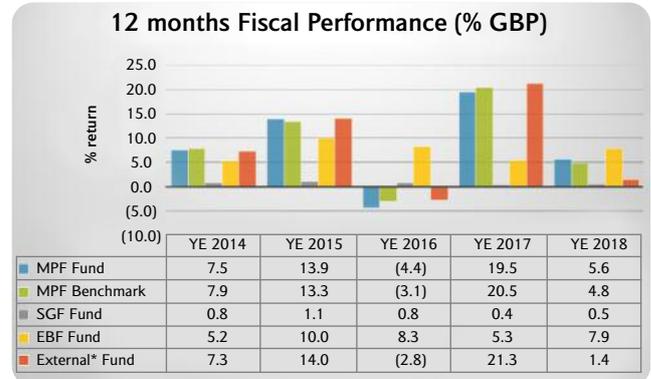
### Corporate Governance

The Portfolio Managers follow the UK Stewardship Code which aims to improve and enhance the quality of engagement between companies and institutional investors. The Portfolio Managers monitor and engage with companies on aspects of corporate governance and exercising voting rights in all regions through our custodian bank. Research and monitoring aspects of corporate social responsibility are also taken into account to assess impacts on shareholder value. In respect of climate change, the Fund Manager participates in the Carbon Disclosure Project investor initiatives to encourage investee companies to disclose their impact on the environment and natural resources. The outcomes of these programmes are reported back yearly to the Trustees of APS and NAPS. The voting records of the Fund Manager are held on our website: [www.mybapension.com](http://www.mybapension.com) in the 'Corporate Governance' section of the 'Scheme documents' page.

### Unit Price and Charges

The MPF unit price changes monthly according to the performance of the Fund. The number of units bought each month will depend on the money invested and the unit price. Expense charges are incurred when buying and selling units in the MPF. These are currently being paid by British Airways. There are no expense charges paid by members in the SGF or the EBF; any expenses are classified as Scheme expenses.

AVCs are a long-term investment and the historical returns are detailed below. Monthly and annualised returns for all AVC Funds can be found on the 'Latest AVC Fund Rates' page of our website.



\*External independent AVC performance numbers have been provided by Willis Towers Watson.

### AVC Funds Performance Returns\*

Annualised returns over period

		10 Years	5 Years	3 Years	1 Year (to 2018)
MPF	Fund	7.3	8.1	6.5	5.6
MPF	Benchmark	7.4	8.4	7.0	4.8
EBF	Fund	5.6	7.3	7.2	7.9
SGF	Fund	1.3	0.7	0.6	0.5
External	Fund	7.2	7.9	6.2	1.4

\*Past performance is no guide to the future; the value of investments can fall as well as rise.

Michelle McGregor Smith  
Chief Executive  
British Airways Pension Investment Management Limited  
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Whitlocke House, 2-4 Lampton Road,  
Hounslow, Middlesex, TW3 1HU  
Telephone: 020 8538 2100  
Fax: 020 8572 6235  
Email: [enquiries@bapensions.com](mailto:enquiries@bapensions.com)  
Website: [www.mybapension.com](http://www.mybapension.com)