RUSSELL INVESTMENTS

Emerging Markets Equity Sub-fund

Summary

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The proposed sub-fund:

- Provides a diversified exposure to six highly rated specialist EM managers. Manager diversification reduces risk, without lowering expected excess returns.
- Offers complementary exposure to Authorities' existing EM holdings in global equities
- Results in £1.4m p.a. of savings in manager fees
- Creates operational benefits and results in transactional cost savings through Enhanced Portfolio Implementation (EPI)
- By using EPI, provides the option for Authorities to systematically decarbonise the portfolio. Our initial analysis suggests it is possible to reduce the Carbon footprint by 25% and Carbon reserves by at least 25% relative to the MSCI EM index, with low tracking error to the underlying managers. This represents a positive first step towards carbon reduction and could be enhanced further over time, as the Authorities' requirements evolve.

Proposed sub-fund structure

The table below shows the proposed manager line up at the sub-fund's inception. All proposed managers have Russell Investments' highest manager research rank of 4 (Hire). Appendix 1 outlines how ESG is embedded in our manager research process.

Manager	Strategy type	%
Manager A	Growth, Mid-Cap tilt	15%
Manager B	China specialist	5%
Manager C	Relative Value, Mid-Cap tilt	25%
Manager D	Earning Momentum	15%
Manager E	Growth at a Reasonable Price	15%
Manager F	Pragmatic Value	25%

Source: Russell Investments. For illustrative purposes only.

Multi-Manager Structure

Recap

We recommend using multiple complementary managers for three key reasons:

1. Diversify manager selection risk

While we believe that our highest ranked managers each have a better than average chance of outperforming, this is not a certainty. The likelihood that outperformance will be delivered in practice is increased if more than one manager is hired as it helps to diversify manager selection risk.

2. Access multiple excess return drivers

It is important to combine managers adopting complementary investment approaches, as reflected through different styles and philosophies of investing. Each manager will have a distinct expected performance pattern at various points in the market cycle. Accessing all avenues of opportunity can help to ensure that the portfolio has exposure to a diversified set of sources of added value at any point in time increasing the expected consistency of outperformance.

3. Consistency of excess return drivers

Even if all hire-ranked managers were expected to produce the same outperformance over time, their return streams will not be perfectly correlated, resulting in reduced active risk at total portfolio level. In turn, this will reduce the distribution of outcomes around the aggregate outperformance of the manager line-up, again making the excess returns of the overall portfolio less volatile than a single manager.

Risk and Return

By carefully selecting the right combination of high conviction managers with a low correlation of excess returns, we were able to construct the sub-fund in order to achieve the target excess return, while reducing the aggregate tracking error.

Expected excess return (gross)	2.0%

Source: Russell Investments. For illustrative purposes only.

Indicative fees

The overall fees are lower than those currently paid by the Authorities. Based on the expected launch AUM of £430m, the new fee will result in WPP savings of £1.4m p.a. This figure accounts for the decarbonisation fee.

	Average WPP fee	Proposed, with decarbonisation
Overall fee	**0.74% p.a.**	**0.41% p.a.**

EPI

The proposal assumes using Enhanced Portfolio Implementation approach in implementing the mandate. We will be providing a separate EPI paper which will set out the benefits of adopting this approach in more detail however specifically for emerging markets the below considerations also make the benefits of EPI particularly compelling:

- Access to managers at AUM levels that otherwise may not be attractive for segregated mandates and accessing managers otherwise closed to new segregated business
- Efficiency gains when implementing future changes to the structure and crossing opportunities in the day to day management of the fund
- Flexibility to strategic changes – under an EPI arrangement, the structure will be more resilient to changes in total AUM
- Implement ESG views – owning your holdings would allow optionality should the Authorities wish to implement ESG related views in the future.

Decarbonisation

Several Authorities have sought to reduce the carbon footprint of their passive equity portfolios by switching to a low carbon index. Over the last six months, we have introduced a method that would allow WPP to also reduce the carbon exposure in their active equity portfolios.

Our initial analysis of the proposed EM sub-fund has shown that WPP could reduce Carbon footprint by 25% and Carbon reserves by at least 25% relative to the MSCI Emerging Markets Index, while keeping the tracking error versus the manager composite relatively low.

The strategy is customisable. This means that we can adjust the targets to balance the trade-off between decarbonisation and tracking error.

De-carbonisation represents a positive first step towards reducing the carbon footprint and reserves in the active EM portfolio, whilst balancing the requirement to meet the Authorities' fiduciary duty to generate returns. Should the Authorities wish to implement further decarbonisation in the future, the structure is future-proofed via EPI. For example, if fossil fuels are completely excluded and a new ex-fossil fuels benchmark is introduced, this will be straightforward to implement. In this scenario, we would continue to use EPI for its operational and cost efficiencies, but we would no longer need to apply the decarbonisation overlay.

Appendix 1

Integrating ESG Factors

Russell Investments' responsible investing practices are drawn from our beliefs and policy. We believe a deep understanding of how ESG factors impact security prices is value-adding to a skilful investment process.

One way we incorporate environmental, social and governance (ESG) factors into our investment process is when evaluating asset managers' investment strategies.

What is our ESG ranking system?

As part of our manager research evaluation process, we have a dedicated ESG rank that reflects the quality and competitive edge of asset managers' investment strategies. These ESG ranks are a qualitative assessment of how well active managers understand the impact of ESG factors on short and long-term security price evolution, portfolio level risk, and/or the return profile of the portfolio.

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Manager demonstrates:

- **Strong** awareness of potential risk/returns of ESG issues on securities and portfolios
- **Strong understanding** of how portfolio positioning reflects management of ESG risks /contribute to value added
- **Superior breadth** of perspective and analysis on ESG issues vs peers

Manager demonstrates:

- **Adequate** awareness of potential risk/returns of ESG issues on securities and portfolios
- **Limited understanding** of how portfolio positioning reflects management of ESG risks/contribute to value added
- **Undifferentiated** perspective and analysis on ESG issues vs peers

Manager demonstrates:

- Meaningful **discrepancies** between target ESG guidelines and portfolio holdings
- Manager's perspective and analysis on ESG issues **lacks rigour**

Our ESG ranking process is integrated into our standard manager research and ranking process; it is not intended to qualify or disqualify any product on its own. Rather, it is intended to provide us with additional insight on each manager's product(s).[1] Our overall product rank still reflects our expectations of a strategy's potential for sustainable excess returns.

Depth of our ESG manager rank coverage

Our manager research team conducts multiple touch points with asset managers.

- In-depth manager due diligence meetings
- Annual ESG Manager Survey[2]
- Qualitative sources and third-party data and dedicated ESG meetings on an ad hoc basis

This combination of inputs gives our research analysts more comprehensive picture of whether the manager appropriately assesses the risk and return impacts of ESG issues on individual portfolio holdings and the overall portfolio construction process.

Breadth of our ESG manager rank coverage

ESG criteria have been an integral part of Russell Investments' manager research evaluation. The breadth of our ESG coverage is reflected by our product coverage across over 1,200 products among 4- and 3-ranked strategies.

[1] Our ESG ranks, like our overall ranks, apply to individual strategies and products rather than to firms.

[2] 2018 ESG Survey: How are managers integrating ESG?

Important Legal Information