Agenda Item:

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Pension Fund Committee

Dorset County Council

Date of Meeting	9 September 2013
Officer	Director for Corporate Resources
Subject of Report	**Review of Investment Management Arrangements**
Executive Summary	The Pension Fund's investment managers are generally subject to formal review by the Committee on a triennial cycle. However, performance of each is measured on a quarterly basis and any concerns are reported to the Committee. The appointments of the Standard Life UK equity manager has been subject to annual review due to performance concerns. In addition to Standard Life, the Fund's property manager CBREi are due for triennial review, and Janus Intech the US Equity managers. The final area that would be due for review is Private Equity. This area will, however, be given specific focus in the Fund's overall strategic review, which will give specific focus to the alternative portfolio. The review will also look in some detail at Fund of Hedge Funds.
Impact Assessment:	Equalities Impact Assessment: N/a
	Use of Evidence: N/a
	Budget: Investment management fees are charged directly to the Pension Fund and are budgeted for.

	Risk Assessment: N/a
	Other Implications: None
Recommendation	That the Committee : i) Agree that Standard Life be reappointed to manage UK equities, and that they continue to be reviewed annually. ii) Agree that Janus Intech be reappointed to manage US equities, and that this appointed be reviewed in 12 months. iii) Agree that CBRE be reappointed for review in three years time.
Reason for Recommendation	To ensure that the Fund has the appropriate management arrangements in place.
Appendices	HSBC Risk and Return analysis
Background Papers	HSBC performance statistics
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1. Background

1.1 The Pension Fund's managers are generally subject to formal review by the Committee on a triennial cycle. However, performance is measured quarterly and any concerns are considered by officers and, if necessary, brought to the attention of this Committee. Managers are required by the Local Government Pension Scheme (LGPS) regulations to be on one months notice. The current manager review position is:

Manager	Date of previous review	Date of next review	Review to be based on performance to
Pictet (Developed Equity)	September 2011	September 2014	31 March 2014
Internal Manager	September 2011	September 2014	31 March 2014
CBREi (Property)	September 2010	September 2013	31 March 2013
Royal London (Bonds)	September 2011	September 2014	31 March 2014
IAM (Hedge Funds) (1)	September 2008	November 2013	30 September 2013
Gottex (Hedge Funds) (1)	September 2010	November 2013	30 September 2013
AXA Framlington (UK Equity)	September 2012	September 2015	31 March 2015
Schroders (UK Equity)	September 2012	September 2015	31 March 2015
Standard Life (UK Equity)	September 2012	September 2013	30 June 2013
Janus Intech (US Equity)	September 2010	September 2013	31 March 2013
2 Private Equity managers (2)	Appointed April 2006	November 2013	31 March 2013
JP Morgan (EM equity)	Appointed March 2012	September 2015	31 March 2015
Insight (Liability matching Bonds)	Appointed March 2012	September 2015	31 March 2015
Barings (DGF)	Appointed March 2012	September 2015	31 March 2015

Note 1: The appointments of these managers will be formally reviewed as part of the Fund's overall review of strategy later in 2013

Note 2: These investments take some time to come to fruition and in broad terms there is no market in which to realise the investment before the Fund has run its full term.

1.2 The table highlights those management arrangements that are due for review at this and the next meeting. The alternative management arrangements, in particular

Private Equity and Hedge Funds, will be subject to a separate review as part of the Funds overall strategic review later in the year, and as such are not reviewed here.

2. UK Equities – Standard Life

2.1 In 2006 the Fund appointed 3 external active UK equity managers to complement the internal passive portfolio. At the same time as these appointments, Schroders were appointed to manage a UK small company mandate, replacing the previous manager. At the first triennial review in 2009, the number of managers was consolidated, and the Fund now has AXA Framlington and Standard Life managing the large and mid cap area, and Schroders for small cap stocks.

2.2 In 2012 the appointments of each UK equity manager was reviewed, and all were re-appointed. However, due to some concern over performance, it was agreed that the appointment of Standard Life would reviewed annually.

2.3 The following paragraphs review the performance of the manager. The strategic position of the UK equity portfolio against the current actual position is shown is the table below.

UK Equity portfolio - 30 June 2013

	Strategic target		Actual		Difference
	%	£M	%	£M	£M
Internal Manager	67	353.8	66	346.2	- 7.6
AXA Framlington	14	73.9	17	88.2	14.3
Standard Life	14	73.9	13	67.2	- 6.7
Schroders	5	26.4	5	26.4	-
Total	100	528.0	100	528.0	

2.4 The strategic target for the Fund is to have two thirds of the UK equity portfolio managed on a passive basis, and one third on an active basis, and the table shows that the portfolio currently reflects this.

2.5 The table also reflects the additional value added by AXA Framlington when compared to Standard Life over the period since appointment, when it is considered that both managers had the same initial funding.

2.6 The table below summarises the performance of Standard Life over various periods to 30 June 2013.

Performance to 30 June 2013

	3 months	1 year	3 years	5 years
Standard Life	1.4%	30.3%	14.1%	7.0%
Benchmark (FTSE All Share)	-1.7%	17.9%	12.8%	6.7%

Note: 3 and 5 year performance numbers have been annualised

2.7 The table highlights that over the last three years the Standard Life fund has achieved some significant outperformance against the FTSE All Share benchmark. Because of this, the performance over five years is also now ahead of the Index, which is another positive. However, Standard Life are engaged as an active manager with a long term target of outperforming the FTSE All Share by 2.5% per annum, and whilst they have achieved this over one year, over three and five there is still some way to go.

Risk Analysis

2.8 In reviewing the risk analysis of the Fund's managers, it is important to study the trends rather than pick isolated numbers, and therefore the most interesting parts of the analysis are the charts. The charts for each manager are identical in make up, and by way of explanation; the red line shows the 3 year rolling outperformance, which is the amount that the manager has outperformed the benchmark over rolling three year periods. The green line shows the level of risk (or volatility of performance) that the manager is taking relative to the benchmark ; a positive number shows more volatility than the benchmark, and a negative number less volatility. The blue line shows the "information ratio" which is a statistical measurement of return achieved for the level of risk taken. It is generally accepted that in the long run an information ratio of more than 0.5 is good performance, and would give top quartile performance. Whilst in this instance the Fund is only reviewing Standard Life, the analysis of AXA Framlington and Schroders are included in the Appendix by way of comparison.

2.9 The Standard Life investment has suffered somewhat by comparison to AXA Framlington, but it can be seen from the performance data above, that over the 3 year period under review it has achieved an annualised outperformance of 1.3%. The quarterly performance of the Standard Life portfolio can be quite volatile, but over 3 years this performance is reasonable, although below the performance target, as mentioned previously.

2.10 The volatility of the portfolio can be seen when looking at the risk analysis. It can be seen that the risk levels (which measure volatility) are significantly higher than the benchmark, and historically the levels of risk have not helped achieve higher performance. However, the trend of the red line (showing outperformance) has moved into positive territory, and demonstrates the 3 year outperformance. It is also useful to note that the trend of the information ratio is positive, and this is currently at 0.17.

2.11 Whilst the performance of Standard Life has been volatile, it is pleasing to note that it has been more positive recently, and that the trend appears to be a positive one. It is also pleasing to note that throughout the difficult times for the Standard Life fund, they have not changed their strategy, and have stuck fundamentally to their processes. It is also interesting to note that the make up of the Standard Life portfolio tends to result in outperformance in positive markets, whereas AXA Framlington is less directional. From the Dorset Fund's point of view, it does mean that the two managers complement each other well.

2.12 The improvement in performance is a positive sign for the Fund, and with this in mind it is recommended that Standard Life are retained to manage the portfolio. However, given the longer term outperformance is still below the target of 2.5% per annum, the Committee should continue to formally review on an annual basis.

3. US Equities – Janus Intech

3.1 In 2006 the Fund appointed two active US equity managers to complement the passive arrangements with Pictet. In 2010 the number of managers was rationalised, and Janus Intech were retained as the Fund's sole US Equity manager.

3.2 Members will be aware that Intech use a purely mathematical investment process to seek to build a more efficient portfolio than the benchmark, with returns in excess of the index while maintaining benchmark like risk. The process does not attempt to predict the direction of the market, nor does have any view on any particular stock in the portfolio. Instead, it employs an optimisation process to build a portfolio by looking to capture stocks' volatility.

3.3 The table below shows the performance of the Janus Intech portfolio over a number of different periods.

Performance to 30 June 2013

	3 months	1 year	3 years	5 years
Janus Intech	2.2%	19.6%	18.6%	7.5%
Benchmark (S&P 500)	2.9%	20.6%	18.4%	7.0%

<u>Risk Analysis</u>

3.4 When reviewing the performance of the Fund's appointed investment managers, it is important to assess the returns with reference to the levels of risk being taken in the portfolio, as described earlier in the report. This particularly pertinent for equity managers, and so, the risk report for Janus Intech is also attached in the Appendix.

3.5 The report shows that the Janus Intech portfolio has consistently achieved volatility at or around that of the benchmark. The chart would also appear to show a reasonably volatility of relative returns, however when the scale of the Janus Intech chart is compared with that of Standard Life or AXA Framlington it is clear that the volatility of the Janus Intech portfolio is very low.

3.6 It is also interesting to note that the beta of the Janus Intech portfolio is almost exactly 1, which backs up the theory that they are not attempting to predict the direction of the market. If a portfolio has a beta of more than 1, it is more likely to outperform in a rising market, whereas less than one the opposite is true. A beta of almost exactly 1 confirms that no directional view is being taken.

3.7 Given the low volatility and longer term performance it is appropriate for the Fund to retain Janus Intech as manager. However, given the underperformance over the last year it would be sensible to review in 12 months time to ensure that it is no more than a blip.

4. CBRE Global Investors

4.1 In November 2011 the Fund's property manager ING Real Estate was sold to CBRE Global Investors, and since then the portfolio has been managed by CBRE. A number of the individuals transferred from ING to CBRE, including the Dorset portfolio's fund managers, and this has allowed a good level of consistency in the management arrangements.

4.2 Prior to the CBRE takeover, the Dorset Fund had employed ING Real Estate Investment Management (ING REIM) since 2002, and in various forms since the mid 1980's. The Fund originally appointed Rothschild as property manager in 1983, the Rothschild property team moved to Baring, Houston and Saunders in 1997, and subsequently, following ING Bank's purchase of Barings, to ING REIM in 2002.

4.3 This arrangement is the longest standing of all of the Dorset fund management arrangements, and has proved very beneficial over the years. The Fund has benefited from close working relationships with the manager, which has given them a good understanding of our requirements.

4.4 The portfolio managed by ING REIM falls in to two distinct categories; the Direct property and Indirect pooled vehicles. The Direct portfolio is approximately 79% of the total investment by value, and as 30 June 2013 consists of 18 properties, and ranges from the smallest, an industrial unit in Croydon, worth £1.65M, to the largest a retail park in Norwich, valued at £15.65M. The majority of these direct holdings will be held as longer term investments. For example the retail park in Norwich has been in the portfolio since 2010, and industrial unit in Croydon since 1988.

4.5 Investments are also made into indirect pooled property vehicles, which are designed to complement the direct portfolio, and allow the Dorset Fund to access types of investment that might not be possible in a direct manner. The Fund is currently invested in 5 indirect funds. It is also worth noting that indirect vehicles give an additional potential for returns with the addition of an element of debt; this can of course have the opposite effect in falling markets. Given the Fund's previous experience in this area, the Fund's exposure to debt is now less than 1% of the portfolio.

4.6 When measuring the performance of the portfolio it is useful to look at both types of investment. The table below shows the performance of the portfolio for the periods to end of June 2013. The second table shows the performance in each of the last 5 years. Given the long term nature of property investing it is appropriate to show longer term performance

Performance to 30 June 2013

	3 months	1 year	3 years	5 years
Direct portfolio	3.2%	7.3%	7.7%	4.5%
Combined	2.6%	6.2%	7.0%	0.2%
Benchmark (IPD Quarterly Universe)	1.9%	4.8%	6.4%	2.3%

Year ending 30 June	Direct property	Indirect pooled funds	Total	Benchmark - IPD Universe
2009	-23.2%	-61.8%	-36.7%	-25.1%
2010	28.1%	42.8%	30.2%	25.5%
2011	10.0%	15.1%	10.5%	9.9%
2012	5.7%	3.7%	4.5%	4.6%
2013	7.3%	5.4%	6.2%	4.8%

4.7 It is clear from the performance data, the mixture of direct and indirect property investments has, on the whole, worked well for the Dorset Fund. In 2010 and 2011 indirect outperformed, and therefore added value to the direct holdings, whereas in 2012 and 2013 the opposite was true. In the main the complimentary characteristics of each type of investment has proved beneficial, with the overall portfolio performing in line or better than, the benchmark over each of these 4 years. The notable exception to this, was 2009, which was affected significantly by one investment. Members will be aware of the impact that the pooled investment at 88 Wood Street had on the overall portfolio, and the effect that gearing can have in a market downturn.

4.8 The performance of the direct portfolio is very pleasing, considering the level of buying activity that has taken place over the last 5 years. The size of the direct portfolio has increased from 14 properties valued at £84.3M in June 2008, to 18 properties valued at £127.5M in June 2013. Over this period 6 properties have been sold and 10 purchased. Given this level of turnover, and given that the average cost of buying a property is around 7%, the portfolio has continued to perform well.

4.9 2008-2009 was clearly a tough period for investors, and the Dorset Fund suffered, however since then, the property portfolio has been re-structured, and now is well placed going forward. The performance over the period has been very solid, and for those reasons, it is recommended that CBRE Global Investors are re-appointed for a further three years.

Paul Kent
Director for Corporate Resources
August 2013