Agenda Item: 9

Pension Fund Committee

Dorset County Council

Date of Meeting	9 September 2013
Officer	Report of the Fund Administrator
Subject of Report	Fund Administrator's report
Executive Summary	The purpose of this report is to update the Committee on the allocation of the assets and overall performance of the Fund as at the end of the first quarter of the 2013/14 Financial Year to 30th June 2013. The report also provides a commentary on the performance of the fund managers who are not considered elsewhere on the agenda and to address other topical issues for the Fund that do not require a separate report. The Independent Adviser's report is contained at Appendix 2, and will be presented separately at the meeting. The report shows that overall the Fund returned -1.0% over the quarter, and out performed its benchmark which returned -1.5%. Return seeking assets added 0.08%, whilst the liability matching assets returned -9.97%. For the same period the WM Local Authority average returned -0.7%.
Impact Assessment:	Equalities Impact Assessment: N/A
	Use of Evidence: N/A
	Budget: N/A
	Risk Assessment: The Pension Fund assesses the risks of its investments, which are considered as part of the strategic allocation. In

	addition risk analysis is provided alongside the quarterly performance monitoring when assessing and reviewing fund manager performance
	Other Implications: N/A
Recommendation	1) Members consider and comment upon the activity and overall performance of the Fund. 2) That no asset allocation changes are made at this time
Reason for Recommendation	To ensure that the appropriate management arrangements are in place and are being monitored, and to keep the asset allocation in line with the strategic benchmark.
Appendices	Appendix 1: New Money Forecast Appendix 2: Report of the Independent Adviser Appendix 3: HSBC Manager Performance and Risk analysis for the quarter to 30 June 2013
Background Papers	HSBC Performance Statistics
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1. Background

1.1 The Dorset County Pension Fund currently receives more money in contributions and investment income than it pays out as pensions and retirement grants. It is anticipated that there will be a surplus of income over expenditure from these cash flows of £33m in the 2013/14 financial year. The anticipated cash flows for 2013/14 along with the historic trends are illustrated in Appendix 1.

1.2 These ‘new money’ levels are reviewed throughout the year, and Members are alerted if there is any significant variance from what is expected.

2. Fund Cash flow

2.1 Table 1 summarises the main cash flows for the Fund for the three months to 30 June 2013.

Table 1 – Statement of Cash flows for the three months to 30 June 2013

		£M	**£M**
Cash at 1st April 2013			**52.4**
Add:	New Money	9.7	
	Property Sales	1.7	
	Private Equity Redemptions	2.4	
	Currency Hedge Gain	4.9	
			18.7
Less:			
	Net UK Equity Purchases	1.6	
	Private Equity Purchases	0.5	
			2.1
Cash at 30th June 2013			**69.0**

2.2 The prediction for net new money into the Fund for 2013/14 was £33.2m at the start of the year. The actual amount of cash received to the end of the first quarter was £9.7m, which is slightly ahead of what would be expected at this stage of the year.

2.3 Following a detailed budget monitoring exercise, it is expected that the Fund surplus for the year will be in line with the budget, although contributions from employers and employees is expected to be £1.8m higher than estimated. This income is partially offset by an expected reduction in property income, due to a re-gear of the lease at Clerkenwell Road, resulting in a 6 month rent free period being offered as part of the contract. The lease extension is on more favourable terms for the Fund and this has been reflected in an increase in the value of the property. The overall gain in income is now expected to be offset by a higher than anticipated increase in the amount of pensions paid.

2.4 Appendix 1 shows the budget monitoring for 2013/14 compared with the budget and the 2012/13 outturn, as well as graphs showing the historical trends of income and expenditure, and the net position of contributions less pensions paid.

3. Fund Portfolio Distribution

3.1 The last strategic review in June 2011 changed the asset allocations and at the February 2013 meeting Members agreed further distributions to JP Morgan and Barings to bring the allocations into better alignment with the target allocation. Table 2 illustrates the current position and the comparative figures as at 1st April 2013

Table 2 – Dorset Fund Market Values – Comparative Figures

		Dorset Fund Market Values						
		Actual at 1 April 2013		**Actual at 30 June 2013**		**Target Allocation**		**Flexibility**
Asset Class	**Manager**	**£M**	**%**	**£M**	**%**	**£M**	**%**	**+ / - %**
Bonds	(Several)	402.8	20.9	374.0	19.7	380.4	20.0	3
UK Equities	(Several)	536.1	27.8	528.9	27.8	532.5	28.0	5
Overseas Equities	(Several)	505.4	26.2	502.3	26.4	513.5	27.0	5
Property	(CBREi)	162.1	8.4	162.6	8.5	190.2	10.0	3
Absolute Return Funds	(Several)	89.9	4.7	90.3	4.7	114.1	6.0	-
Private Equity	(Several)	52.2	2.7	51.7	2.7	76.1	4.0	-
Diversified Growth	(Barings)	91.2	4.7	90.1	4.7	95.1	5.0	-
Cash	(Internal)	54.1	2.8	69.0	3.6	-	-	-
Cash	(Pictet)	31.5	1.6	33.0	1.7	-	-	-
		1,925.3	**100.0**	**1,902.0**	**100.0**	**1,902.0**	**100.0**	

3.2 The figures show that against the target allocation, the Fund is now slightly underweight in Bonds, which have seen a significant reduction in value since the start of the financial year, mainly driven by the news from the US that the Federal Reserve may start to taper its asset purchasing programme.

3.3 UK and Overseas equities remain slightly underweight. However, the underweight position on overseas equities is largely due to the tactical asset allocation decisions of Pictet to hold part of their holding as cash rather than equities. Once this cash is added to the overseas equities allocation, it is overweight by 110 basis points (bps). The Fund continues to be underweight in the alternative fields of Absolute Returns, Private Equity and Diversified Growth. This is mainly due to the on going review of alternatives and the fact that Private Equity has started to distribute some of the returns that have been made.

3.4 The Property portfolio continues to be underweight due to the sales of Howard House, Bristol and the industrial units in Hertford at the end of the financial year. Although no properties have been purchased in the first quarter, two properties in Cambridge and Leeds have been purchased in July and August for a total of £8.2m, which will increase the weighting by 43bp. To counter this there has been a sale of equity in the CBRE Property Fund which was returned to the Fund in May 2013 of £1.68m. The fund manager, CBREi, continue to seek suitable assets to purchase and are currently considering several sites to complement the portfolio and to align with the strategic allocation.

3.5 The Fund held £69m of cash (3.6%) which is being held for cash flow purposes and to allow the necessary investments in property and private equity as they arise, as well as to provide liquidity for any foreign exchange losses that might occur at the end of each quarter. The property transactions highlighted in paragraph 3.4 will reduce the cash held accordingly.

4. Overall Fund Performance

4.1 The performance of the Fund during the first quarter shows an overall return of -1.03%, an out performance of the benchmark of -1.51% by 0.48%. Over a 12 month period the Fund has returned 16.53% against the benchmark of 15.25%, an outperformance of 128 bps.

4.2 The Fund has outperformed its benchmark over 3 years returning an annualised 12.09% against the benchmark of 11.95%.

4.3 However, over 5 years the Fund has returned an annualised 6.53% against the benchmark of 7.34%, an underperformance of 81 bps. Members will recall that the Fund suffered significant falls in value during 2008 which is reflected in this performance figure.

4.4 When considering the overall performance it is important to note the split between the “Return seeking assets” and the “Liability matching assets”. Since the implementation of the strategic review in 2012, the Fund has held a proportion of the assets in an Inflation Hedging Strategy, managed by Insight. These assets are not held to add growth, but to match the movements in the Fund’s liabilities. It is therefore important to consider that in normal circumstances, the benchmark movement of these assets is a proxy for the Fund’s liabilities.

4.5 This Liability Matching strategy, conducted by Insight has returned 27.64% since its inception on 1st July 2012. During quarter one of 2013/14 Return seeking assets have returned 0.08% against the benchmark of -0.48%. The Liability Matching assets have returned -9.97% against the benchmark of -10.50%. This strategy is intended to hedge against the impact of increasing pensions liabilities which are linked to, amongst other things, the consumer prices index (CPI). CPI can not currently be hedged as there is not a sufficiently developed futures market, so the Dorset strategy targets the retail prices index (RPI) swaps market to act as a proxy for CPI which tends to be lower than RPI. Table 3 shows the overall performance of the Fund, but makes the distinction between the return seeking assets and the liability matching assets.

Table 3 Summary Fund Performance by Asset Class 3 months to 30 June 2013

		3 Months to 30 June 2013		
Asset Category	Manager	Dorset	Benchmark %	Over/(Under)
		%	%	%
Overall Fund Performance	**All**	**-1.03**	**-1.51**	**0.48**
Total Return seeking assets	**(Various)**	**0.08**	**-0.48**	**0.56**
UK Equities	(Various)	-0.74	-1.52	0.78
Overseas Equities	(Various)	-0.05	0.35	-0.40
Bonds	(RLAM)	-3.17	-3.81	0.64
Property	(CBREi)	2.96	1.85	1.11
Hedge Funds	(Various)	1.69	1.66	0.03
Private Equity	(Various)	3.02	-1.66	4.68
Diversified Growth	(Barings)	-1.21	1.12	-2.33
Cash	(Various)	0.70	0.00	0.70
Total Liability matching assets		**-9.97**	**-10.50**	**0.53**
Inflation hedging bonds	(Insight)	-9.97	-10.50	0.53

4.6 In considering the performance of the Fund as a whole, there are two main areas that explain where the performance is being generated. These are the asset allocation (market contribution) of the Fund and within those allocations the stock selection (selection contribution) choices that have been made. The stock selection element is a measure of the fund managers' ability to outperform their benchmark. The asset allocation is the effect of decisions to change the weighting of the different asset classes within the Fund.

4.7 The HSBC performance report, contained at Appendix 3, gives an attribution analysis of the performance for the quarter on pages 4 and 5. This analysis shows that the market contribution had a positive effect against the benchmark of 27 bps whilst stock selection was broadly neutral, contributing 5 bps to outperformance. Return seeking assets contributed 35 bps mainly driven by equities (UK and Overseas) of 14 bps, cash 11 bps and currency hedging 21 bps. The stock selection contribution, whilst broadly neutral overall, was hit by the poor performance of Overseas equities reducing performance by 33 bps, mainly caused by Emerging markets making up 21 bps and the US 10 bps. Property contributed 10bps, Private Equity 12 bps and UK equities 20 bps.

5. Barings Diversified Growth Fund

5.1 The Diversified Growth allocation was mandated to Barings on 30 March 2012. Diversified Growth Funds are designed to give fund managers total discretion over how and where they invest which means that the portfolio holds a wide range of investments against a diverse range of asset classes. The Barings fund seeks to achieve out performance against a cash benchmark by focussing on asset allocation decisions. This fund targets equity like returns with about 70% of the equity risk.

5.2 The performance of Barings for the three months to 30 June 2013 and since inception is illustrated in Table 5.

Table 5 – Diversified Growth – Barings Performance 3 months to 30 June 2013

Manager	Value at 1 April 2013	Market Value at 30 June 2013	3 Month Performance		Since Inception Performance	
	(£000's)	(£000's)	Performance %	BM %	Performance %	BM %
Barings	91,225	90,125	-1.21	1.12	5.20	4.70

5.3 The Barings fund has had a poor first quarter of 2013/14, following the strong final quarter of 2012/13. It has underperformed its benchmark by 2.33% over the quarter, although its performance since inception shows an out performance of 50 bps. The fund had been doing well during the first 7 weeks of the quarter but was affected by the suggestion by the US Federal Reserve that they may start to end the asset purchasing scheme which has resulted in the extremely cheap money in the US markets. This resulted in a sell off of bonds and equities as the markets reacted. The price of gold also reduced significantly as investors abandoned it as a safe haven on the back of the better economic outlook for the US. Markets have improved somewhat following the quarter end and the fund has responded accordingly.

6. Manager Progress (excluding UK equities)

Active US Equity

6.1 The performance of Intech for the 3 months to 30 June 2013 is illustrated in Table 6.

Table 6 – Performance of Intech – US Equity

	USD $				GBP £			
	Market Value 1 April 2013 ($000's)	Market Value 30 June 2013 ($000's)	Perform-ance %	Bench mark %	Market Value 1 April 2013 (£000's)	Market Value 30 June 2013 (£000's)	Perform ance %	Bench-mark %
Intech	151,112	154,416	2.19	2.91	99,514	101,810	2.31	3.03

6.2 The Intech fund actively manages US equity stocks using disciplined mathematical processes to outperform the benchmark at the same level of risk. During the first quarter the fund made positive returns of 2.31%, although this lagged behind the benchmark of 3.03%. This is in line with expected tolerances and Intech will continue to follow the model that has served it well in the past. Over the past three years, to 30th June 2013, the fund has returned an annualised 18.63% which matches its benchmark (S&P 500). .Over five years the fund has returned 7.46% per annum against the benchmark of 7.10%.

Emerging Markets Equity

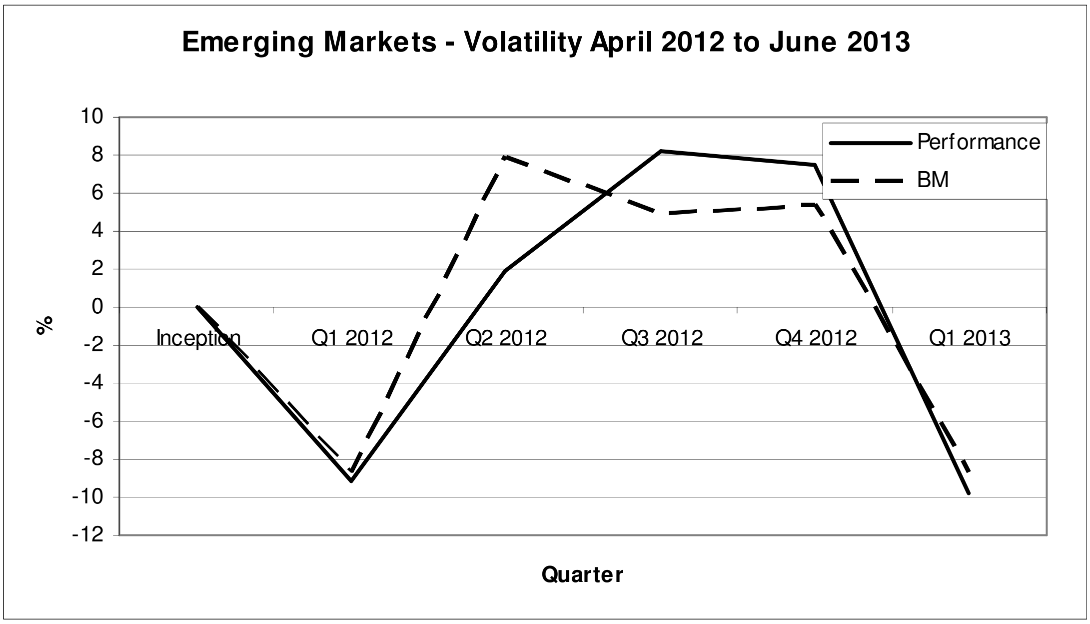
6.3 The JP Morgan mandate commenced on 5th April 2012. The performance of the fund for the three months to 30 June 2013 is shown in Table 7.

Table 7 – JP Morgan Emerging Markets Performance for the 3 months to 30 June 2013

	Value at 1 April 2013 (£000's)	Market Value at 30 June 2013 (£000's)	Performance %	Benchmark %
JP Morgan	72,324	65,229	-9.81	-7.97

6.4 Emerging markets had a really poor first quarter with markets reacting to the US Federal Reserve's tapering comments. This had a big impact on emerging market debt and currencies in particular. There was also public unrest in Turkey and Brazil which had a short term impact on market sentiments. JP Morgan operate a strategy with multiple drivers of country sector and stock (top down approach) alongside the fundamental and qualitative analysis (bottom up), and they believe that Emerging markets have now entered a valuation 'territory' that is typically reserved for crisis periods and it is therefore a time to invest.

6.5 Emerging market equities are seen as the asset class which will offer the most growth over the medium term, albeit with high levels of volatility. The chart below shows the differences in quarterly performance since inception and highlights the volatility of the performance to date alongside the benchmark.



Private Equity

6.6 The Pension Fund has committed to investing with Harbour Vest and Standard Life in their Private Equity Fund of Funds. Private Equity is an area that takes several years for commitments to be fully invested, and the table below shows the position as at 30 June 2013.

6.7 Table 8 shows the commitment Dorset has made to each fund in Euros and US Dollars, the draw downs that have taken place to date and the percentage of the total drawdown against Dorset's commitment. It also shows the funds that have been returned to the Dorset Fund, the valuation as at 30 June 2013 and the total gains or losses, which includes the distribution plus the latest valuation.

Table 8 Private Equity Commitments, Draw downs and Valuations as at 30 June 2013

Manager	Commitment	Drawn down	% of Commit-mint	Distribution	Valuation	Gain / (Loss)
	€m	€m		€m	€m	€m
HarbourVest HIPEP V Partnership Fund 2006 (Euro)	12.000	10.380	87%	2.72	10.201	2.541
HarbourVest HIPEP V Direct Fund 2006 (Euro)	3.000	2.880	96%	0.593	2.482	0.195
Standard Life European Strategic Partners 2006 (EUR)	22.000	18.455	84%	4.032	15.883	1.460
Standard Life European Strategic Partners 2008 (EUR)	17.000	6.756	40%	0.507	6.475	0.226
	$m	$m		$m	$m	$m
HarbourVest HVP VIII Venture Fund 2006 (USD)	15.200	12.844	85%	2.961	13.085	3.202
HarbourVest HVP VIII Buyout Fund 2006 (USD)	22.800	17.214	76%	4.686	15.974	3.446
HarbourVest HVP IX Buyout Fund 2009 (USD)	15.000	2.213	15%	0	2.290	0.077
HarbourVest HVP IX Venture Fund 2009 (USD)	10.000	1.700	17%	0	1.744	0.044

6.8 Private Equity is a long term investment and as such the performance should be reviewed over the longer term. The benchmark used for this fund is the FTSE All Share index. Table 9 shows the performance over 3 and 5 years against the benchmark, with both funds performing well over a three year period. Over a 5 year period Harbourvest have out performed the benchmark, although Standard Life are 90 bps behind. Members will recall from the June meeting that there has been a significant jump in the 5 year benchmark from 2.4% to 6.7% during the previous quarter due to the relative performance of the stock exchange that is used as the benchmark. Over the medium to long term the annualised performance is therefore positive. During the last quarter, distributions from Habourvest, in particular, have been greater than the drawdown's, which has contributed in the continued underweight position in the private equity portfolio.

Table 9 Private Equity Performance 3 and 5 years

	3 Years to 30 June 2013		5 Years to 30 June 2013	
Manager	**Dorset %**	**Benchmark %**	**Dorset %**	**Benchmark %**
HarbourVest	14.34	12.80	8.52	6.69
Standard Life	14.73	12.80	5.59	6.69

Hedge Fund (Absolute Returns) Managers

6.9 The Pension Fund has active investments with two Fund of Hedge Fund managers; International Asset Management (IAM), and Gottex. There are also investments in delayed redemption funds with the previous manager, Pioneer. Whilst a notice of redemption was given to Pioneer as at 1 April 2009, there remains about £2.3m held in illiquid investments pending sales. Table 10 shows the current portfolio and performance for the three months to 30 June 2013 alongside the performance over 5 years.

Table 10 Hedge Fund Performance for the three months to 30 June 2013 and 5 Years

Manager	Value at 1 April 2013	Market Value 30 June 2013	3 Month Performance %	3 Month Benchmark %	5 Year Performance %	5 Year Benchmark %
Gottex (£000's)	30,280	30,235	-0.15	1.38	-6.78	6.12
Pioneer (£000's)	2,340	2,315	-1.07	1.63	-0.67	7.17
IAM (£000's)	57,277	58,012	2.78	1.80	5.92	7.40
IAM ($000's)	86,976	87,986	1.16	1.80	n/a	n/a

6.10 The performance of Gottex has lagged behind the benchmark during the quarter. The main reason for the poor performance has been the positions taken on mortgage backed securities in the USA which have been sold off due to a view of a worsening market position.

6.11 The Pioneer fund continues to be unwound and continues to disappoint the quarterly figures have been poor and are worse than the 5 year performance.

6.12 The IAM fund out performed their benchmark over the quarter returning 2.78% after exchange rate hedging against the benchmark of 1.8%. IAM are the only hedge fund who have made a positive return over the previous five years and have also shown positive performance over the last 12 months of 8.34% against the benchmark of 7.4%. IAM believe that this improvement in performance is due to markets beginning to normalise again after the financial crisis.

6.13 Alternative assets, and especially hedge funds will be central to the strategic review that will follow the results of the triennial Fund valuation in September.

7. Treasury Management

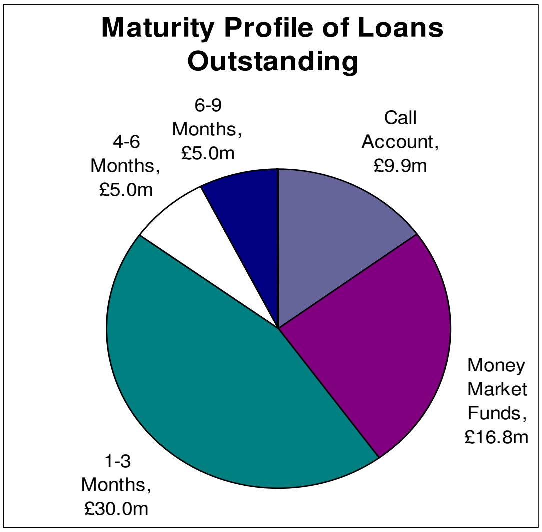
7.1 The Pension Fund generates cash flows throughout the year which need to be managed. The Fund therefore holds a proportion of cash that is invested in call accounts, money market funds and fixed term deposits. A breakdown of the balances held internally as at 30 June 2013 is shown in Table 11. Additional cash balances are also held tactically by Pictet within their overseas equity portfolio.

7.2 Since the credit crunch, there has been a significant reduction in the number of countries and financial institutions that are deemed safe for investments. The Council's treasury management advisers have recently advised that cash balances can be invested for more than 3 months in the big four UK banking groups. The majority of cash continues to be lent for less than 3 months in UK institutions to ensure that the money is both secure and liquid, and so it is available for distribution.

7.3 In terms of performance, the weighted average yield continues to reduce as, higher return investments mature and have to be replaced with lower rate ones. Internally managed cash returned 0.22% over the quarter to 30 June 2013 compared to the benchmark of 0.10%. These low market rates are been caused by the restrictions on counterparties resulting in a flight to quality, large corporations holding large cash balances and general market improvements in liquidity following the funding for lending scheme. The overall weighted average return of the cash invested at 30 June 2013 was 0.69%.

Table 11 – Analysis of Cash Balances Held

Lender/ Borrower	Amount £'000	Rate %
Loans		
Nationwide Building Society	10,000	0.44
Lloyds TSB Bank	5,000	1.90
Lloyds TSB Bank	5,000	1.10
Lloyds TSB Bank	5,000	0.70
National Westminster Bank	10,000	0.80
Nationwide Building Society	5,000	0.44
Total Loans	**40,000**	
Call Accounts		
National Westminster Bank	9,915	0.60
Money Market Funds		
PF Agnes MMF	15,000	0.43
PF Federated Prime Rate	500	0.42
PF Goldman Sachs	1,300	0.37
Total Money Market Funds	**16,800**	
Total	**66,715**	0.69



9. Reform of the LGPS

9.1 Members will be aware of the forthcoming changes to the Local Government Pension Scheme (LGPS). It has been reported to the last two Committee meetings, that the Department for Communities and Local Government (DCLG) had started the consultation process for the regulations that underpin the operation of the new scheme.

9.2 The Fund responded to the initial consultation document in February 2013, and subsequently the CLG have revised the regulations, and issued a consultation on this which closed in early May. The Fund responded to this revised consultation, and commented that whilst the regulations seemed reasonable as a framework, there was more detail required to administer the scheme effectively, and that the key to implementing the new scheme on 1 April was that this regulation, and accompanying guidance was issued in a timely manner.

9.3 The Fund has also responded to the CLG's consultation on transitional regulations, which will oversee the change from the existing scheme to the new 2014 scheme. The CLG also issued a consultation on miscellaneous changes to the regulations and elected member pensions. The Fund responded to all consultations at the end of May, and copies of all responses are available if members wish to see them.

9.4 At the last Committee meeting future governance arrangements for the LGPS were also discussed, in response to another consultation that had been issued. A response to this was made by the deadline which was the end of August.

9.5 At the National Association of Pension Funds Local Authority conference on 21 May the Local Government Minister, Brandon Lewis announced a call for evidence on efficient management of Local Government Pension Schemes. He said that wanted to give the poorer performing funds time and opportunity to “up their game” however he is keen to ensure that funds are efficient and well managed, and so does not rule out structural change in the future.

9.6 He also commented on the debate that has been ongoing for a number of years over the appropriate number of LGPS funds, and whether indeed bigger was better. The minister added that he wanted to answer this question, but also to consider whether small was actually any worse.

9.7 This subject was also discussed in some detail at the last meeting of the Committee. As this is a fast moving area, with different views and pieces of evidence being issued on a regular basis, officers will bring members up to date with the latest position verbally at the meeting. The consultation deadline is 27 September and the Fund will be responding. If members have any additional views that they wish to add to the response, they are invited to do so.

10. Asset Allocation

11.1 At the previous meeting of the Committee the review of the Fund’s alternative assets, and the plans for a review of the overall strategy later in the year were agreed. In paragraph 3 above, the Fund’s current portfolio allocation is shown, and shows that £69.0M or 3.6% of the Fund was held in cash at the end of June, against a benchmark holding of zero. Although as reported in paragraph 3.4 the property portfolio invested around £8.2M in July and August, reducing the cash level accordingly.

11.2 There is the option to allocate this cash is to other asset classes. However, when it is considered that as the property portfolio remains around £30M (1.6%) underweight, and Private Equity is around £27M (1.4%) short of its target, it would be sensible to hold this balance in cash pending investments in these areas. It will also be helpful to hold the cash balances to enable the implementation of the outcome of the strategy review.

11.3 It is recommended that no changes to the Fund’s asset allocation are made at this time.

Paul Kent
Fund Administrator
August 2013