Agenda Item:

7

Pension Fund Committee

Dorset County Council

Date of Meeting	8 September 2014
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 some performance concerns. In addition to Standard Life, the Fund's Internal UK Equity Manager and Bond manager Royal London (rlam) are due for triennial review. The Fund's global equity manager, Pictet is also due for review, but members will be aware of the on-going discussions with Pictet, and therefore this is excluded from this report, and will be reviewed by the Committee later in the year. The appointment of Janus Intech as the Fund's US equity manager will be considered as part of this review of the overall global equity management arrangements.
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 for review in 2017. ii) Agree that the internal manager be reappointed for review in 2017. iii) Agree that rlam be reappointed for review in 2017.
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
Report Originator and Contact	Name: Nick Buckland Tel: 01305 224763 Email: n.j.buckland@dorsetcc.gov.uk

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	November 2014	31 June 2014
Internal Manager	September 2011	September 2014	31 March 2014
CBREi (Property)	September 2013	September 2016	31 March 2016
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 2013	September 2014	31 March 2014
Janus Intech (US Equity)	September 2010	November 2014	31 June 2014
2 Private Equity managers (2)	Appointed April 2006	November 2016	31 March 2016
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: As part of the Fund's strategic review it was decided to redeem all hedge fund investments. These are included here for sake of completion

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. Investment in Private Equity was reviewed and confirmed as part of the Strategic review.

1.2 The table highlights those management arrangements that are due for review at this and the next meeting. The structure of the global equity portfolio, including the mandates of Pictet and Janus Intech will be reviewed in more detail later in 2014, and therefore are not included within this report.

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 - 31 March 2014

	Strategic target		Actual		Difference
	%	£M	%	£M	£M
Internal Manager	67	389.0	63	365.6	- 23.4
AXA Framlington	14	81.3	18	102.8	21.5
Standard Life	14	81.3	14	78.9	- 2.4
Schroders	5	29.0	6	33.3	4.3
Total	100	580.6	100	580.6	

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 has a greater proportion to active than passive. This due to good performance from the active part of the portfolio. Recommendations elsewhere on this agenda look to address this issue.

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 31 March 2014

	3 months	1 year	3 years	5 years
Standard Life	-1.2%	17.5%	10.4%	20.0%
Benchmark (FTSE All Share)	-0.6%	8.8%	8.8%	16.4%

Notes: 3 and 5 year performance numbers have been annualised
Outperformance target is Benchmark + 2.5% per annum.

2.7 When Standard Life's performance was reviewed 12 months ago, the concern was around the longer term performance. 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 when this was reviewed in 2013 this target had not been met. It is pleasing to report that due to an excellent year in 2013-14 this is now not the case, and the five year performance is now showing outperformance of 3.6% per annum.

Risk Analysis

2.8 In reviewing the risk analysis of the Fund's managers, in the Appendix, 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 and 5 year periods it has achieved an annualised outperformance of 1.6% and 3.6% respectively. The quarterly performance of the Standard Life portfolio can be quite volatile, but has improved.

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 has continued to improve in the last twelve months, and is currently at 0.30.

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 Due to this improvement in the short term and long term performance and the risk analysis, it is recommended that Standard Life are re-appointed. It is also recommended that this appointment be reviewed every three years to bring it in line with other managers.

3. UK Equities – Internal Manager

3.1 The County Council's Treasury and Investments team have been managing the passive UK equity portfolio since 1986, with a target of tracking the performance of the FTSE350 Index +/- 0.5%. There is evidence that, over the long term (15 years plus), only 20% of active fund managers achieve performance in excess of the index, and therefore, if you can match the index, you will be outperforming 80% of active managers. Passive management also has an advantage over active management in terms of manager fees. Typically an active UK equity manager would charge around 0.4 – 0.5% of asset value, whereas for passive managers the range is more like 0.05-0.1%. For Dorset's in-house managed fund the cost is around 0.025%.

3.2 The portfolio aims to track the FTSE350 by holding each stock in the index, in the same weight (by market capitalisation) as the index itself. For example, if BP is 5% of the index, then the internal portfolio will hold 5% in BP shares. There is no attempt to analyse stock performance, or to "stock-pick", the process is mathematical. The portfolio is reviewed monthly, and traded when necessary to keep the portfolio in line with the Index. Since 2006 the core passive UK equity portfolio has been supplemented by a selection of active managers who seek outperformance using active management techniques.

Performance to 31 March 2014

	3 months	1 year	3 years	5 years
Internal Manager	-0.9%	8.7%	8.7%	16.2%
Benchmark (FTSE 350)	-0.7%	8.5%	8.7%	16.2%

3.3 The performance of the portfolio is shown below, and over all periods, including the 3 years under review, has performed as expected. The portfolio had a market value of £365.6M as at 31 March 2014.

<u>Risk Analysis</u>

3.4 The Risk Analysis for the Internally managed portfolio is included for the sake of completion, but as the portfolio is managed on a passive basis designed to track the performance of the index, it does not add a great deal of insight. It shows that the performance of the portfolio is in line with the benchmark, and that the portfolio has an information ration of close to zero, which is to be expected for this type of mandate.

3.5 The structure of the UK equity part of the Fund, with the core in-house portfolio tracking the index, AXA Framlington and Standard Life actively managing large to mid-cap stocks, and Schroders managing small cap in the same way has been in place for eight years. The low-risk, passive approach of the in-house portfolio complements the active approach of the external managers, and it is therefore recommended that the internal management of the portfolio continue for a further three years.

4. Bonds – Royal London Asset Management

4.1 Royal London Asset Management (rlam) were appointed, as one of two bond managers, by the Dorset Fund in 2007. Since the appointment of Insight in 2012 to manage the Fund's liability matching portfolio rlam's mandate has focussed purely on Corporate Bonds, and has a target to outperform the benchmark by 0.5% per annum.

4.2 The rlam portfolio has been a consistent performer for the Dorset Fund, and has added value over all time periods shown. The table below shows that the outperformance target has been met over 1 and 5 years. The 5 year performance is exceptional and shows outperformance of 6.6% per annum.

Performance to 31 March 2014

	3 months	1 year	3 years	5 years
rlam	3.0%	4.1%	14.1%	16.1%
Benchmark (iBoxx Sterling Non-Gilt over 5 years)	3.0%	1.4%	13.8%	9.5%

4.3 Members will be aware that in the first two years after rlam's appointment in 2007, global bonds markets suffered severely, and the rlam portfolio was not exempt from this. The performance for the 12 months ended 31 March 2009, for example was 23.8% below benchmark. There were a number of reasons behind this underperformance, not least the portfolio behind corporate bonds, and the benchmark being government gilts.

4.4 The reason for including this performance information was to demonstrate the recovery that the rlam portfolio has made since the lows of 2009. As at 31 March 2009 the rlam portfolio had a "since inception" performance of -3.0% against a benchmark of 8.6%. This compares to "since inception" performance to the end of March 2014 of 9.6% per annum against the benchmark return of 9.8%. the recovery in the portfolio is clear to see.

Risk Analysis

4.5 The risk analysis for the rlam portfolio complements the performance data, in that whilst the portfolio is showing outperformance it is doing so by taking less risk than the benchmark. This is shown by the green line on the analysis being consistently below zero.

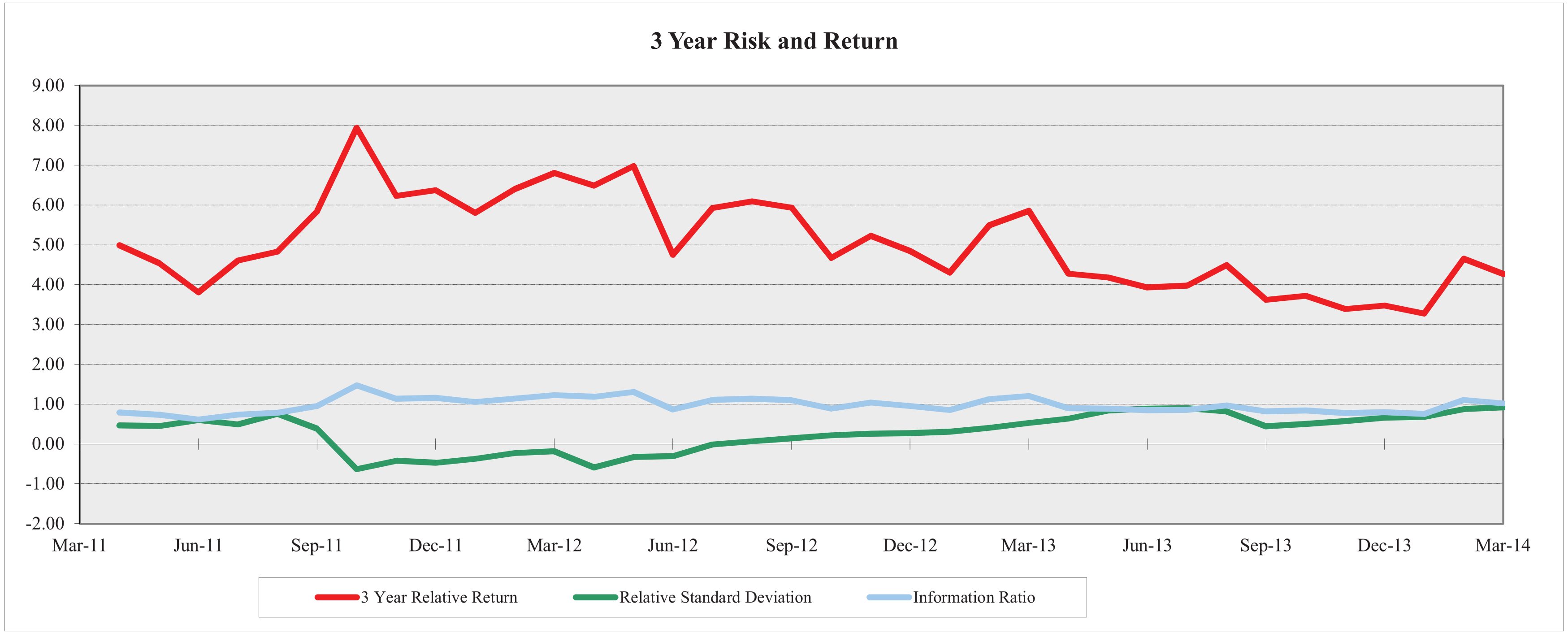
4.6 The analysis also shows that the information ratio (the blue line) is consistently above zero, albeit this has fallen slightly in recent quarters.

4.7 The rlam portfolio is constructed to give the Dorset Fund an element of protection when markets fall, and this can be seen in the analysis of the Beta. Beta is another measure of risk, which shows the likelihood of the portfolio to participate in positive markets and/or be protected in falling markets. A Beta of 1 indicates that the portfolio will move in line with markets, and would be expected from passive management, such as the internal portfolio. A Beta of greater than 1 shows that a portfolio is likely to perform better in rising markets, and less than 1 shows the opposite. It is pleasing therefore that the rlam portfolio has maintained this low Beta, yet continued to peform in positive markets.

4.8 Given all of the analysis, it is recommended that rlam are appointed for a further three years, to be formally reviewed in 2017.

Paul Kent
Pension Fund Administrator
August 2014

Last 3 Years Risk

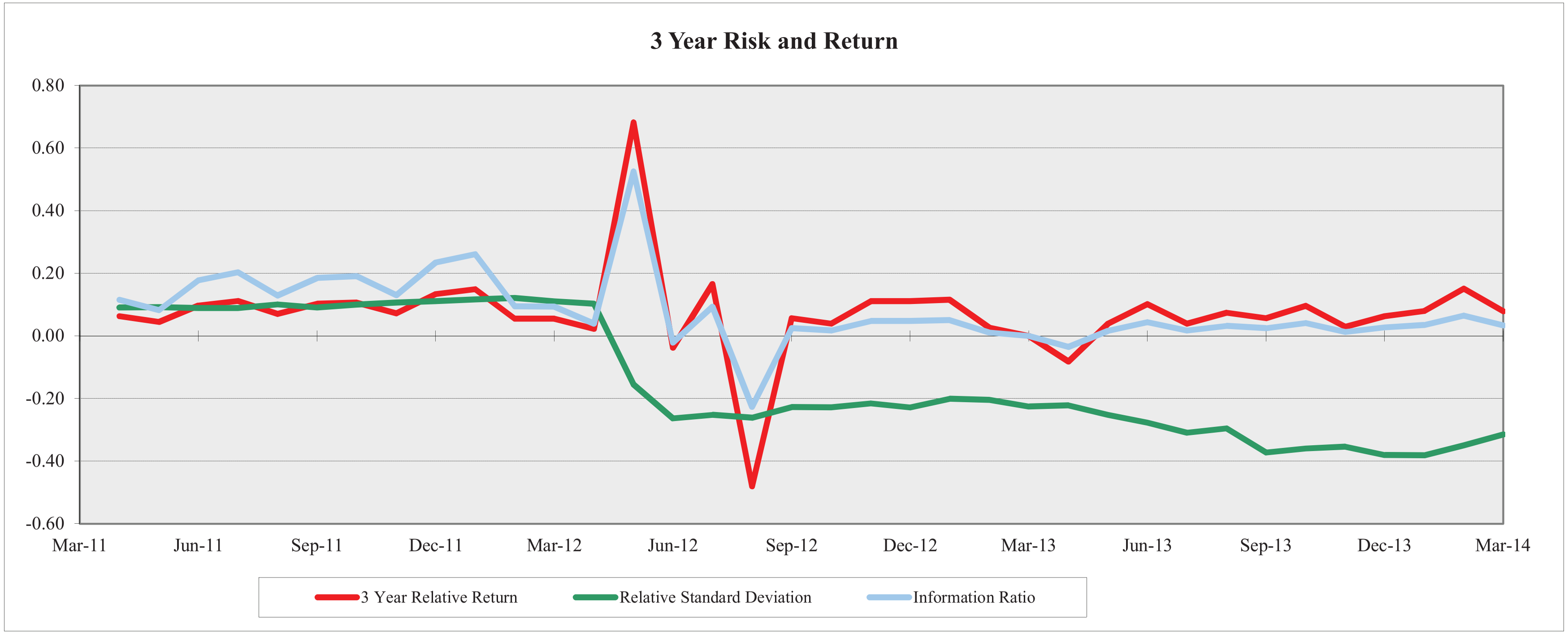


Rolling 3 Year Risk	30/06/2011	30/09/2011	31/12/2011	31/03/2012	30/06/2012	30/09/2012	31/12/2012	31/03/2013	30/06/2013	30/09/2013	31/12/2013	31/03/2014
Fund	10.63	12.22	20.09	26.93	19.22	14.46	12.69	15.15	17.23	14.05	13.22	13.45
Benchmark	6.56	6.03	12.89	18.84	13.81	8.04	7.48	8.78	12.80	10.07	9.41	8.80
Relative Return	3.81	5.84	6.37	6.80	4.75	5.94	4.85	5.86	3.93	3.62	3.48	4.27
Relative Standard Dev.	0.61	0.39	-0.47	-0.19	-0.31	0.14	0.27	0.53	0.88	0.44	0.66	0.92
Information Ratio	0.61	0.96	1.15	1.23	0.87	1.10	0.96	1.21	0.85	0.82	0.80	1.02
Beta	0.99	0.97	0.91	0.92	0.91	0.93	0.95	0.98	1.01	0.97	0.99	1.03

- Each plot on the chart shows the (monthly) rolling 3 year relative return / 3 year relative standard deviation
- As such, two consecutive plots actually contain 35 months of identical data
- The result is an indication of trends in the relative return and risk

- Where the (green) relative standard deviation is greater than zero, this indicates the risk in the fund to be higher than the risk in the benchmark
- Where the (green) relative standard deviation is less than zero, this indicates the risk in the fund to be lower than the risk in the benchmark

Last 3 Years Risk

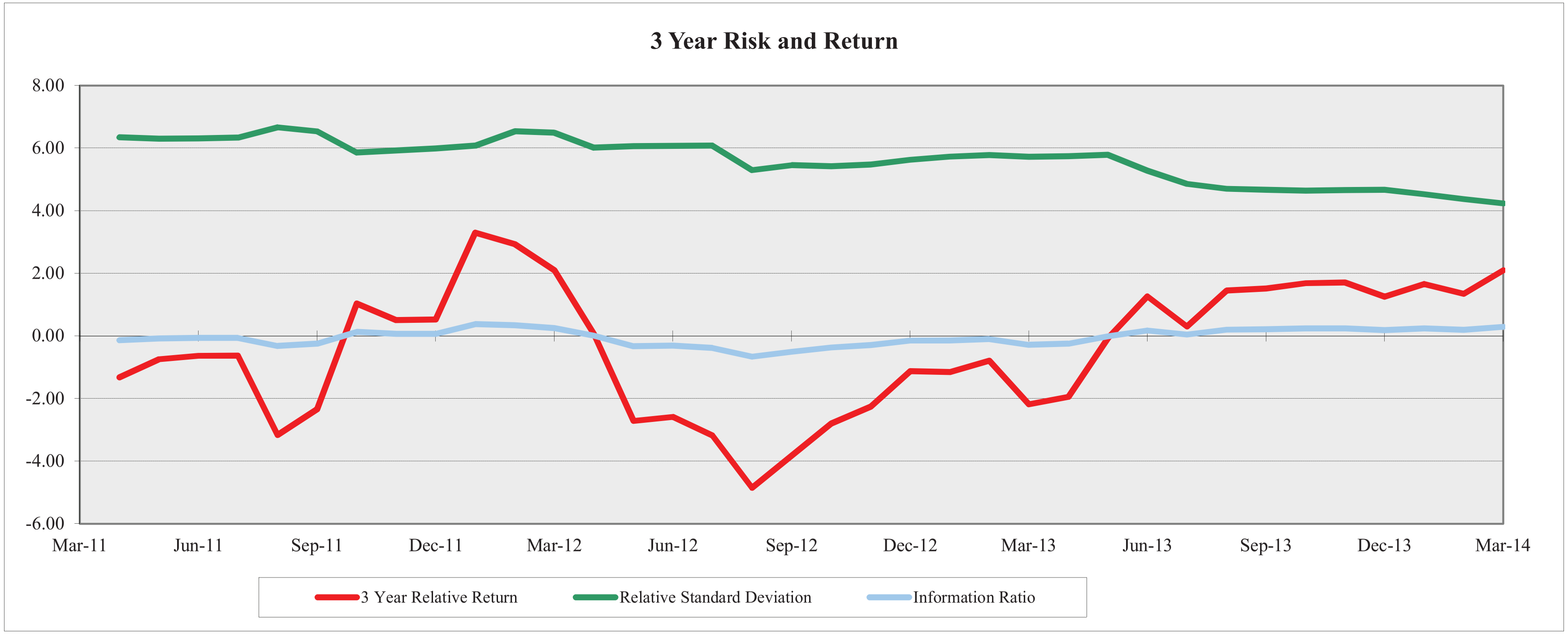


Rolling 3 Year Risk	30/06/2011	30/09/2011	31/12/2011	31/03/2012	30/06/2012	30/09/2012	31/12/2012	31/03/2013	30/06/2013	30/09/2013	31/12/2013	31/03/2014
Fund	6.67	6.11	12.96	18.79	13.78	8.14	7.53	8.69	12.85	10.01	9.37	8.76
Benchmark	6.56	6.00	12.81	18.72	13.83	8.08	7.42	8.69	12.74	9.95	9.30	8.67
Relative Return	0.10	0.10	0.13	0.05	-0.04	0.06	0.11	0.00	0.10	0.06	0.06	0.08
Relative Standard Dev.	0.09	0.09	0.11	0.11	-0.26	-0.23	-0.23	-0.23	-0.28	-0.37	-0.38	-0.31
Information Ratio	0.18	0.18	0.23	0.09	-0.02	0.02	0.05	0.00	0.04	0.02	0.03	0.03
Beta	1.01	1.01	1.01	1.01	0.97	0.97	0.97	0.96	0.96	0.95	0.94	0.95

- Each plot on the chart shows the (monthly) rolling 3 year relative return / 3 year relative standard deviation
- As such, two consecutive plots actually contain 35 months of identical data
- The result is an indication of trends in the relative return and risk

- Where the (green) relative standard deviation is greater than zero, this indicates the risk in the fund to be higher than the risk in the benchmark
- Where the (green) relative standard deviation is less than zero, this indicates the risk in the fund to be lower than the risk in the benchmark

Last 3 Years Risk

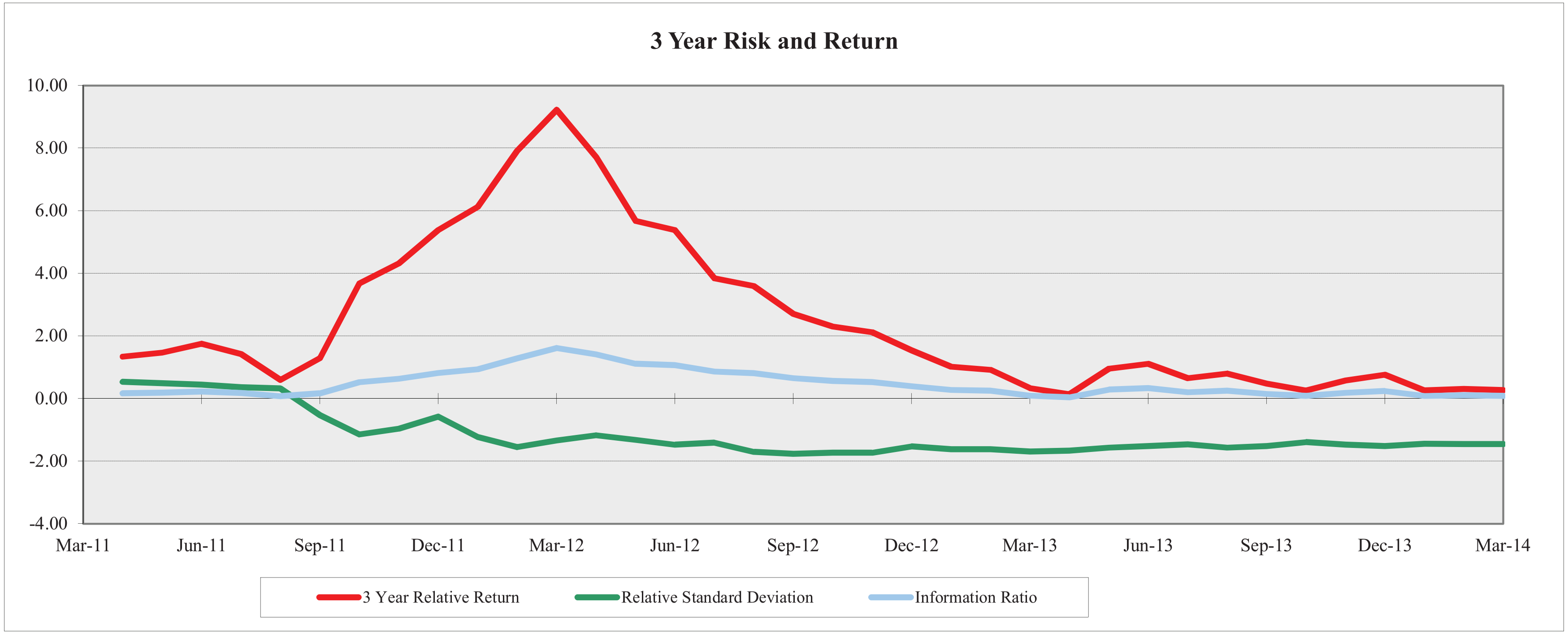


Rolling 3 Year Risk	30/06/2011	30/09/2011	31/12/2011	31/03/2012	30/06/2012	30/09/2012	31/12/2012	31/03/2013	30/06/2013	30/09/2013	31/12/2013	31/03/2014
Fund	5.89	3.55	13.48	21.34	10.87	3.91	6.26	6.40	14.22	11.73	10.79	11.09
Benchmark	6.57	6.03	12.89	18.84	13.81	8.04	7.48	8.78	12.80	10.07	9.41	8.80
Relative Return	-0.63	-2.34	0.52	2.10	-2.58	-3.83	-1.13	-2.18	1.27	1.51	1.26	2.10
Relative Standard Dev.	6.30	6.54	5.99	6.49	6.06	5.46	5.63	5.72	5.28	4.66	4.66	4.24
Information Ratio	-0.07	-0.25	0.06	0.24	-0.31	-0.51	-0.15	-0.28	0.17	0.21	0.18	0.30
Beta	1.36	1.39	1.38	1.44	1.42	1.41	1.43	1.44	1.42	1.36	1.37	1.30

- Each plot on the chart shows the (monthly) rolling 3 year relative return / 3 year relative standard deviation
- As such, two consecutive plots actually contain 35 months of identical data
- The result is an indication of trends in the relative return and risk

- Where the (green) relative standard deviation is greater than zero, this indicates the risk in the fund to be higher than the risk in the benchmark
- Where the (green) relative standard deviation is less than zero, this indicates the risk in the fund to be lower than the risk in the benchmark

Last 3 Years Risk



Rolling 3 Year Risk	30/06/2011	30/09/2011	31/12/2011	31/03/2012	30/06/2012	30/09/2012	31/12/2012	31/03/2013	30/06/2013	30/09/2013	31/12/2013	31/03/2014
Fund	9.17	12.19	15.22	19.47	18.43	15.71	16.95	16.18	13.21	11.38	12.93	14.05
Benchmark	7.30	10.76	9.34	9.38	12.38	12.66	15.17	15.79	11.97	10.85	12.08	13.75
Relative Return	1.75	1.29	5.38	9.23	5.38	2.71	1.54	0.33	1.11	0.48	0.76	0.26
Relative Standard Dev.	0.44	-0.53	-0.57	-1.34	-1.48	-1.77	-1.53	-1.69	-1.52	-1.52	-1.52	-1.46
Information Ratio	0.22	0.17	0.82	1.62	1.06	0.65	0.39	0.09	0.33	0.15	0.24	0.08
Beta	0.83	0.77	0.79	0.72	0.75	0.75	0.76	0.76	0.80	0.78	0.78	0.78

- Each plot on the chart shows the (monthly) rolling 3 year relative return / 3 year relative standard deviation
- As such, two consecutive plots actually contain 35 months of identical data
- The result is an indication of trends in the relative return and risk

- Where the (green) relative standard deviation is greater than zero, this indicates the risk in the fund to be higher than the risk in the benchmark
- Where the (green) relative standard deviation is less than zero, this indicates the risk in the fund to be lower than the risk in the benchmark