

Agenda Item:

Pension Fund Committee

7

Dorset County Council


Date of Meeting	8 September 2014
Officer	Pension Fund Administrator
Subject of Report	Review of Investment Management Arrangements
Executive Summary	<p>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.</p> <p>This report reviews the performance of each of the Fund's external UK equity managers, the JP Morgan global emerging market portfolio, and the Barings DGF fund.</p> <p>The JP Morgan and Barings arrangements have been in place for three years, and as such this is the first formal review.</p> <p>The analysis within the report makes the appropriate recommendations, however, given the government agenda for pooling of LGPS investments, it is not considered appropriate at this time to be considering any changes. When the agenda and future arrangements have become clearer, then any necessary changes will be made.</p>
Impact Assessment:	<p>Equalities Impact Assessment:</p> <p>N/a</p> <p>Use of Evidence:</p> <p>N/a</p>

	<p>Budget: Investment management fees are charged directly to the Pension Fund and are budgeted for.</p>
	<p>Risk Assessment: N/a</p>
	<p>Other Implications: None</p>
Recommendation	<p>That the Committee :</p> <ul style="list-style-type: none"> i) Reappoint AXA Framlington, Schroders and Standard Life to manage UK equities for a further period of 2 years ii) Reappoint Barings to manage the DGF investments for a period of three years iii) Reappoint JP Morgan to manage global emerging market equities for a period of three years.
Reason for Recommendation	<p>To ensure that the Fund has the appropriate management arrangements in place.</p>
Appendices	<p>HSBC Risk and Return analysis</p>
Background Papers	<p>HSBC performance statistics</p>
Report Originator and Contact	<p>Name: Nick Buckland Tel: 01305 224763 Email: n.j.buckland@dorsetcc.gov.uk</p>

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 month's notice. The current manager review position is:

Manager	Date of previous review	Date of next review	Review to be based on performance to
Internal Manager	September 2014	September 2017	31 March 2017
CBREi (Property)	September 2013	September 2016	31 March 2016
Royal London (Bonds)	September 2014	September 2017	31 March 2017
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 2014	September 2017	31 March 2017
HarbourVest ⁽¹⁾	Appointed April 2006	November 2017	31 March 2017
SL Capital ⁽¹⁾	Appointed April 2006	November 2017	31 March 2017
JP Morgan (EM equity)	Appointed March 2012	September 2015	31 March 2015
Insight (Liability matching Bonds)	Appointed March 2012	September 2017	31 March 2017
Barings (DGF)	Appointed March 2012	September 2015	31 March 2015
IFM ⁽¹⁾	Appointed September 2014	September 2020	31 March 2019
Hermes ⁽¹⁾	Appointed September 2014	September 2020	31 March 2019
Allianz	Appointed September 2015	September 2019	31 March 2019
Investec	Appointed September 2015	September 2019	31 March 2019
Wellington	Appointed September 2015	September 2019	31 March 2019
Pictet (Developed Equity)	Mandate to be terminated in 2015		
Janus Intech (US Equity)	Mandate to be terminated in 2015		

Note 1: 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 and Infrastructure 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 meeting.

2. UK Equities

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. Each of the managers has been reviewed on a regular basis since then.

2.2 The Standard Life investment has proven to be a great deal more volatile than others and so has been reviewed on a more regular basis, and was most recently reviewed in 2014. Given the performance continues to be volatile, it is appropriate to review all 3 external UK Equity managers simultaneously, within this report.

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

UK Equity portfolio - 30 June 2015						
	Strategic target		Actual		Difference	
	%	£M	%	£M	£M	
Internal Manager	67	414.1	63	390.7	-	23.4
AXA Framlington	14	86.5	18	109.7		23.2
Standard Life	14	86.5	13	80.3	-	6.2
Schroders	5	30.9	6	37.3		6.4
Total	100	618.0	100	618.0		

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 has a greater proportion to active than passive. This due to good performance from the active part of the portfolio. The proportions are closer than they were when this was reviewed in 2014, and reflects that additional investment that was made in the internal portfolio in October 2014 as a result of deferring additional investments in DGF.

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 each of the managers over various periods to 30 June 2015.

Performance to 30 June 2015				
	3 months	1 year	3 years	5 years
Standard Life	2.5%	5.0%	16.5%	12.6%
AXA Framlington	0.9%	8.8%	14.5%	14.9%
Benchmark (FTSE All Share)	-1.6%	2.6%	11.0%	10.8%

	3 months	1 year	3 years	5 years
Schroders	7.3%	13.2%	20.9%	20.1%
Benchmark (FTSE Small Cap)	5.4%	8.4%	23.5%	17.1%

Notes: 3 and 5 year performance numbers have been annualised
 Outperformance targets are: AXA Framlington - Benchmark + 3% p.a.
 Standard Life - Benchmark +2.5% p.a.
 Schroders – Benchmark + 2.5% p.a.

- 2.7 The results in the table above are all positive over most periods the only period showing any underperformance is Schroders over 3 years, all other periods for all managers show outperformance against benchmark, which is very pleasing.
- 2.8 It is pleasing that the return to positive performance from Standard Life that was considered at the review 12 months ago has continued, and they are now showing some consistency of performance, with reduced volatility.
- 2.9 AXA Framlington continues to shows consistent performance and has more than achieved its outperformance target over all periods. The fund, managed by Nigel Thomas, continues to be one of the Dorset Fund’s top performers.
- 2.10 Whilst Schroders have seen some periods of underperformance, over the long run they have also outperformed their target, in an area of the market (Small Cap) which can see some real swings in performance.
- Risk analysis
- 2.11 The risk analysis for each manager is attached in the Appendix, and again shows some positive information for most. The AXA Framlington report shows the most consistent levels of risk and return with a positive information ratio (the blue line) over all 3 year periods shown. The information ratio is actually above 0.5 for most periods under review, which is an extremely positive measure.
- 2.12 The Standard Life analysis has kept a positive information ratio for the last 9 quarters, which shows a good deal of improvement. The chart also shows that the relative risk being taken within the portfolio (the green line) has reduced over time from a standard deviation of over 5 three years ago, to just over 1 now. These are both positive measures, and bode well for the investment.
- 2.13 Schroders analysis is less positive, and shows a negative information ratio in recent periods. The relative risk has remained consistently below that of the index, and this is a positive thing in reducing volatility. Perhaps, the most interesting thing to note within the Schroders analysis is the beta which has consistently been between 0.75 and 0.65. This should mean that the portfolio will perform better in falling markets, and this has been a deliberate positioning of the portfolio by the fund manager.

2.14 Given all of the above analysis, it is recommended that each of the managers is reappointed for a period of 2 years, with a view to reviewing the overall structure of the UK equity portfolio in the strategic review that will be due after the next Actuarial Valuation. It is also likely that the national agenda for pooling of LGPS investments will affect the future arrangements.

3. Diversified Growth – Barings

3.1 As a result of the Strategic review that the Fund conducted in 2011, a 5% allocation was made into Diversified Growth Funds (DGF), and after a competitive process the Barings Dynamic Asset Allocation Fund (DAAF) was selected, and the investment was made on 1 April 2012.

3.2 The Barings Fund aims to achieve equity like returns, but with only two thirds of the volatility that you associate with equities. The Fund is benchmarked against cash, and has a long term annualised target return of LIBOR plus 4%, with the underlying assumption being that over the long run equities will achieve a premium over cash of at least 4%.

3.3 Members will recall that in August 2014, Barings announced that three senior personnel involved in the management of the DAAF had left the company; this included the two lead fund managers; Percival Stanion and Andrew Cole. Percival was replaced by Marino Valensise, who was previously the Chief Investment Officer of Barings.

3.4 The Committee considered the future of the Barings investment at the September 2014 and November 2014 meetings and, after having met with the new management team in November 2014, it was decided to stay invested, and review the position at the September 2015 meeting.

3.5 As a result of the uncertainty over the future of the Barings investment, it was also decided to postpone the search for an additional DGF manager, and allocate the earmarked fund to the internally managed UK equity portfolio, and the corporate bond portfolio managed by rlam. This was to be temporary arrangement pending this review of Barings.

3.6 The table below shows the performance of the Barings DAAF over 3, 12 and 36 months to the end of June 2015.

Performance to 30 June 2015			
	3 months	1 year	3 years
Barings DAAF	-0.1%	7.0%	5.6%
Benchmark (LIBOR + 4%)	1.1%	4.6%	4.6%

3.7 It is pleasing that the performance of the DAAF has held up, since the departure of the key individuals last year, with the one year return outperforming the benchmark by 2.4%, and the three year annualised return being 1% ahead.

Risk Analysis

3.8 Whilst it is interesting to look at the risk analysis for the Barings fund, it is not particularly informative, because the investment is benchmarked against cash. It is also less relevant for investments that have less than 5 years data, as it is not possible to identify trends. The DAAF will therefore always be taking greater risk than

the benchmark, and will also, it is hoped achieve significant outperformance. The HSBC analysis confirms both of these.

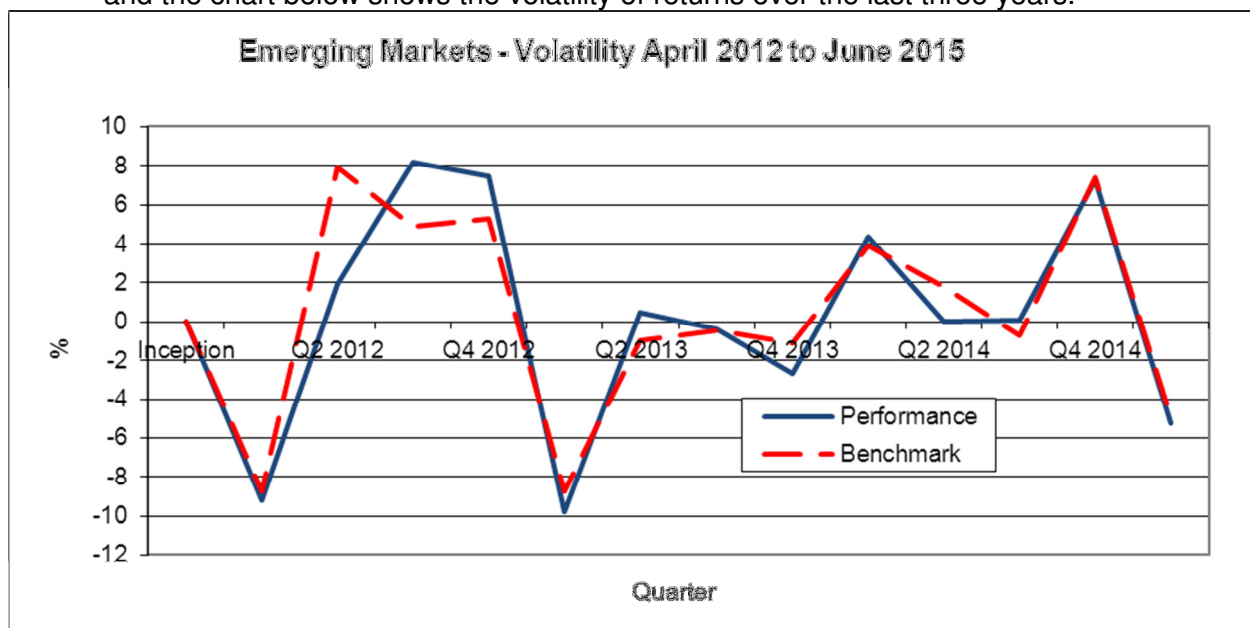
- 3.9 It would therefore be appropriate to re-appoint Barings, and recommence the search for an additional DGF manager. However, given recent developments around pooling of LGPS investments, which is covered elsewhere on this agenda, it is sensible to keep the temporary arrangement in place, until there is greater certainty of future arrangements, and continue to defer the search for an additional DGF manager.

4. Emerging Market Equity – JP Morgan

- 4.1 JP Morgan were appointed as the Fund’s Global Emerging Market equity manager with effect from 1 April 2012, and so this is their first triennial review.
- 4.2 It is accepted that Emerging Market equities are particularly volatile investments, and it also accepted to compensate for this returns, over the long run, should exceed those in developed equity markets. For these reasons the Fund’s allocation to the area, is roughly in proportion with Emerging Market equities share of the Global Equity market (circa 12-15%). Therefore as the Fund target weight to non-UK equities is 25% around 3% of the total Fund is in Emerging Markets.
- 4.3 The table below shows the performance of the JP Morgan investment over 3 months, 12 months and 3 years. The 3 year performance is annualised.

Performance to 30 June 2015			
	3 months	1 year	3 years
JP Morgan	-5.3%	1.8%	3.4%
Benchmark (MSCI Emerging Markets)	-5.0%	3.2%	3.6%

- 4.4 The table shows that the JP Morgan portfolio has underperformed its benchmark over each period, although over the 3 year period under review only by 0.2% per annum. As mentioned previously Emerging Market equities are particularly volatile, and the chart below shows the volatility of returns over the last three years.



- 4.5 It would be tempting to look at the underperformance against the benchmark, and reach a conclusion on the suitability of the investment; however, given the difficult market conditions, it is also appropriate to benchmark JP Morgan against a range of other managers. This will determine whether it has been possible for most managers to have beaten the benchmark or not.
- 4.6 We have been able to obtain benchmarking information from a range of 14 other Global Emerging Market equity managers, and the results do show the JP Morgan performance in a different light. The table below shows the average and median performance of the peer group of 15(including JP Morgan) and the ranking from 15.

	JP Morgan	Average	Median	Rank (from 15)
6 months	1.62	- 0.57	- 0.55	4
12 months	1.80	- 0.42	- 1.11	5
3 years	3.40	2.93	2.94	7

- 4.7 By comparing the JP Morgan performance with the peer group, it supports the view that it has been a difficult market for managers to outperform the index. To demonstrate this, the Index outperformed the average manager over all periods. It was also ranked 2nd 3rd and 5th from the 15 comparators over 6, 12 and 36 months.

Risk Analysis

- 4.8 Whilst it is interesting to look at the risk analysis for the JP Morgan fund, it does not show a great deal of relevant data as the investments have been held for less than 5 years data and it is therefore not possible to identify trends. The risk analysis does show that the JP Morgan fund does have slightly higher risk than the index, and has a beta of 1.01, meaning that it is marginally more likely to outperform in rising markets.
- 4.9 Given the performance of the manager, in particular the comparisons with the peer group, it is appropriate to re-appoint JP Morgan for a period of three years. The performance will be kept under regular review, and if any trends are identified then it will be brought to the Committee's attention.

Richard Bates
Pension Fund Administrator
 August 2015

3 Year Risk Summary

Portfolio	3 Year Returns			3 Year Standard Deviation			Other Risk Measures			
	Fund Return	Bmk Return	Relative Return	Fund St.Dev.	Bmk St.Dev.	Relative St.Dev.	Tracking Error	R-Squared	Beta	Information Ratio
Dorset County Pension Fund Total	12.28	11.12	1.04	5.79	6.22	-0.40	1.36	0.95	0.91	0.77
Dorset - Internally Managed Cash	0.73	0.38	0.35	0.08	0.01	0.08	0.08	0.04	2.54	4.37
Dorset - Internally Managed UK Equity	10.91	10.83	0.08	9.90	9.80	0.09	1.71	0.97	0.99	0.04
Dorset - AXA Framlington UK Equity	14.47	11.04	3.10	10.10	9.70	0.36	4.51	0.80	0.93	0.69
Dorset - Schroders UK Equity	20.92	23.50	-2.08	7.32	9.70	-2.17	4.53	0.79	0.67	-0.46
Dorset - Standard Life UK Equity	16.49	11.04	4.92	10.89	9.70	1.09	4.87	0.80	1.00	1.01
Dorset - Pictet Global ex UK Equity	14.14	15.34	-1.04	8.60	9.07	-0.43	0.93	0.99	0.94	-1.13
Dorset - Janus Intech US Equity	18.14	17.22	0.79	10.93	10.12	0.73	2.03	0.97	1.06	0.39
Dorset - JP Morgan	3.39	4.15	-0.74	12.33	11.57	0.68	3.98	0.90	1.01	-0.19
Dorset - HarbourVest Private Equity	16.17	11.04	4.62	11.04	9.70	1.22	15.93	0.03	-0.21	0.29
Dorset - Standard Life Private Equity	8.26	11.04	-2.50	9.57	9.70	-0.11	13.77	0.00	-0.02	-0.18
Dorset - Royal London Bonds	9.79	7.61	2.02	7.19	7.76	-0.53	0.94	0.99	0.92	2.16
Dorset - Gofrex Hedge Fund	5.65	5.66	-0.01	5.10	0.05	5.05	5.08	0.01	-7.86	0.00
Dorset - IAM Hedge Fund	-14.16	7.41	-20.09	27.44	0.00	27.44	27.28	0.00	n/a	-0.74
Dorset - Pioneer Hedge Fund	10.03	6.71	3.11	9.21	0.05	9.15	9.15	0.04	34.73	0.34
Dorset - CBRE Property	12.97	12.33	0.56	6.04	1.85	4.12	5.39	0.20	1.47	0.10
Dorset - Barings Asset Management	6.36	4.61	1.67	4.59	0.05	4.54	4.58	0.00	-1.77	0.37
Dorset - Currency Hedging	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

* All figures are annualised

** Results are shown only for those portfolios with three full years of history

Definitions

RISK - The degree of risk in a portfolio is usually associated with the degree of uncertainty in the return achieved and is generally defined by the volatility (or variability) in its returns over several consecutive time periods.

Standard Deviation - is the measure most commonly used to represent variability.

Tracking Error - is the standard deviation (variability) of the three year relative returns. It is a measure of how closely the fund tracks the benchmark month on month.

R-Squared - is a statistical measure of how closely the fund returns are related to the benchmark returns. It is derived from the correlation coefficient between the fund and benchmark returns. R-Squared represents the proportion of the total variance of the portfolio return that is attributable to market movements, and may lie at any point between 0 and 1. The closer the result is to 1, the more perfectly correlated are its returns with the benchmark.

Beta - is a statistical measure of relative risk giving an indication of the extent to which the returns of a fund are sensitive to the movements of the markets in which it is invested. A beta value of 1 indicates that the assets will move in line with the market. A figure greater than 1 indicates that the assets will tend to outperform a rising market and underperform a falling one (i.e. more volatile than the market). The reverse applies to a beta of less than 1.

Information Ratio - is a measure of the relative return of the fund compared to the benchmark relative to the benchmark risk taken. It is calculated as the relative return divided by the tracking error. The result is a 'risk-adjusted' measure of relative return.

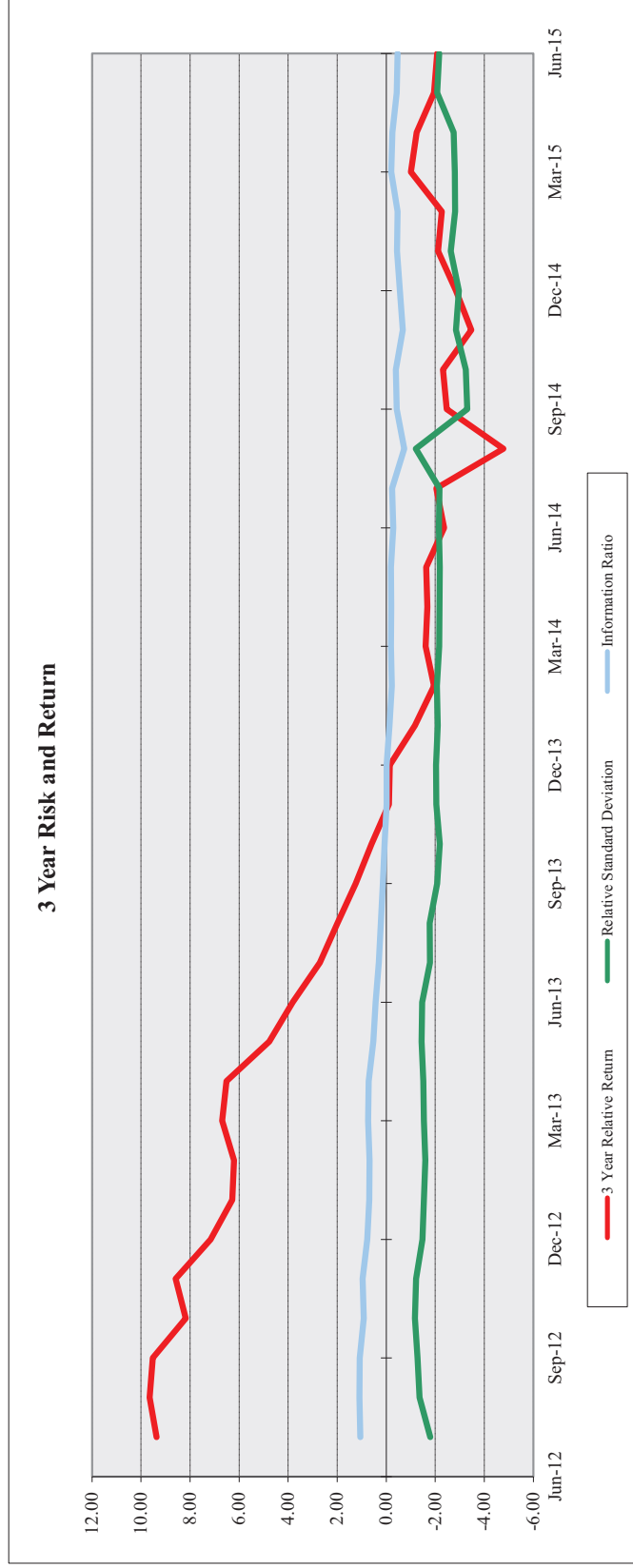
Last 3 Years Risk



Rolling 3 Year Risk	30/09/2012	31/12/2012	31/03/2013	30/06/2013	30/09/2013	31/12/2013	31/03/2014	30/06/2014	30/09/2014	31/12/2014	31/03/2015	30/06/2015
Fund	14.46	12.69	15.15	17.23	14.05	13.22	13.45	11.43	16.30	13.42	12.32	14.47
Benchmark	8.04	7.48	8.78	12.80	10.07	9.41	8.80	8.92	13.94	11.13	10.64	11.04
Relative Return	5.94	4.85	5.86	3.93	3.62	3.48	4.27	2.31	2.07	2.05	1.52	3.10
Relative Standard Dev.	0.14	0.27	0.53	0.88	0.44	0.66	0.92	0.95	1.12	0.62	0.25	0.36
Information Ratio	1.10	0.96	1.21	0.85	0.82	0.80	1.02	0.50	0.46	0.44	0.33	0.69
Beta	0.93	0.95	0.98	1.01	0.97	0.99	1.03	1.02	1.03	0.96	0.92	0.93

- 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
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Last 3 Years Risk



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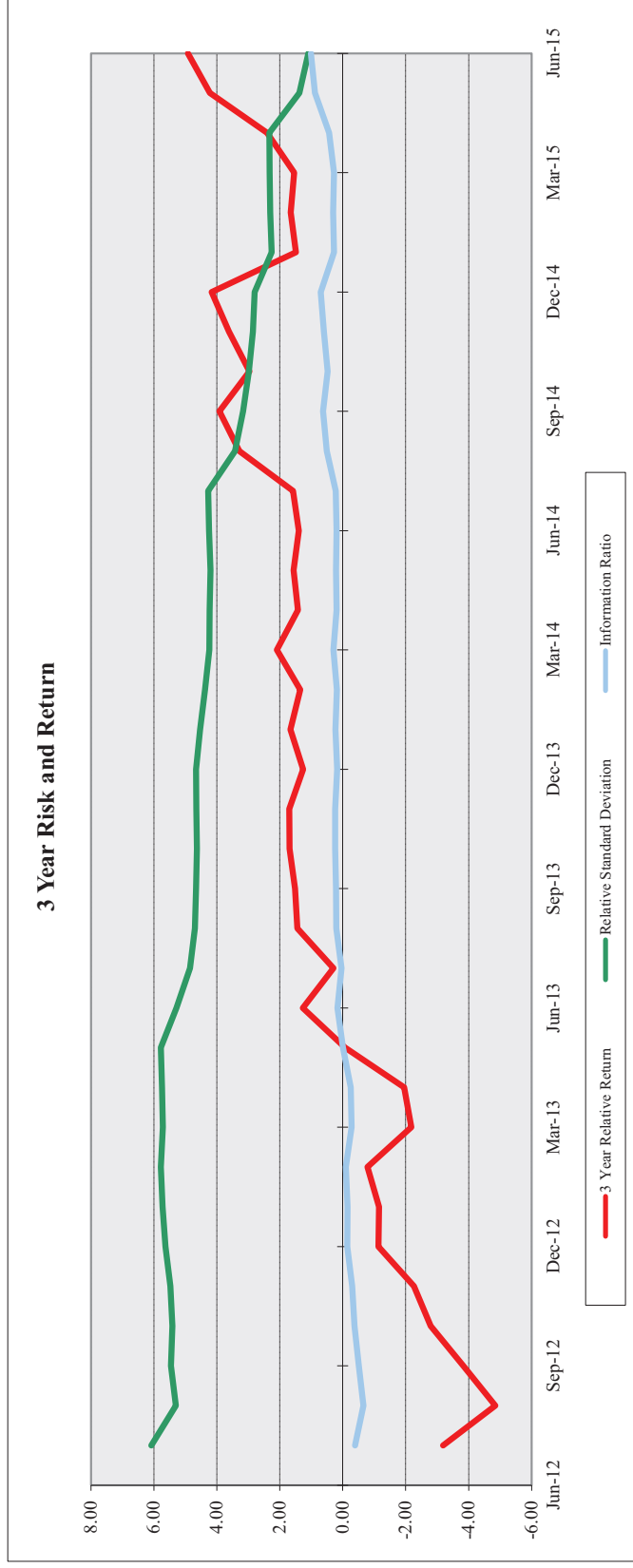
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Last 3 Years Risk



Rolling 3 Year Risk	30/09/2012	31/12/2012	31/03/2013	30/06/2013	30/09/2013	31/12/2013	10/79	31/03/2014	30/06/2014	30/09/2014	31/12/2014	31/03/2015	30/06/2015
Fund	3.91	6.26	6.40	14.22	11.73	10.79	11.09	11.09	10.44	18.40	15.76	12.35	16.49
Benchmark	8.04	7.48	8.78	12.80	10.07	9.41	8.80	8.80	8.92	13.94	11.13	10.64	11.04
Relative Return	-3.83	-1.13	-2.18	1.27	1.51	1.26	2.10	2.10	1.40	3.92	4.16	1.54	4.92
Relative Standard Dev.	5.46	5.63	5.72	5.28	4.66	4.66	4.24	4.24	4.25	3.17	2.80	2.32	1.09
Information Ratio	-0.51	-0.15	-0.28	0.17	0.21	0.18	0.30	0.30	0.19	0.63	0.70	0.28	1.01
Beta	1.41	1.43	1.44	1.42	1.36	1.37	1.30	1.30	1.30	1.21	1.18	1.14	1.00

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