

Agenda Item:

# Pension Fund Committee

11

**Dorset County Council**


Date of Meeting	14 September 2015
Officer	Chief Financial Officer
<b>Subject of Report</b>	<b>Fund Administrator’s Report</b>
Executive Summary	<p>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 2015/16 Financial Year to 30 June 2015. 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.</p> <p>The Independent Adviser’s report is contained at Appendix 2, and will be presented separately at the meeting.</p> <p>The report shows that overall the Fund returned -0.34% over the quarter to 30 June, outperforming its benchmark which returned -1.21%. Return seeking assets returned -1.11%, whilst the liability matching assets returned 5.35%. For the same period the WM Local Authority average returned -2.5%.</p>
Impact Assessment:	Equalities Impact Assessment: N/A
	Use of Evidence: N/A
	Budget: N/A

	<p>Risk Assessment: The Fund assesses the risks of its investments in detail, and considers them as part of the strategic allocation. In addition, risk analysis is provided alongside the quarterly performance monitoring when assessing and reviewing fund manager performance.</p>
	<p>Other Implications:  None</p>
<p>Recommendation</p>	<p>That the Committee :</p> <ul style="list-style-type: none"> <li>i) Review and comment upon the activity and overall performance of the Fund.</li> <li>ii) Note the appointments of Allianz, Investec and Wellington manage the Global Equity portfolio.</li> <li>iii) Continue with the 50% currency hedge on foreign currency exposure</li> <li>iv) Agree to allocate an additional £10M to the IFM infrastructure fund.</li> <li>v) Make no additional changes to asset allocation at this time.</li> </ul>
<p>Reason for Recommendation</p>	<p>To ensure that the Fund has the appropriate management arrangements in place and are being monitored, and to keep the asset allocation in line with the strategic benchmark.</p>
<p>Appendices</p>	<p>Appendix 1: New Money Forecast Appendix 2: Report of the Independent Adviser Appendix 3: HSBC Manager Performance for the three months to 30 June 2015</p>
<p>Background Papers</p>	<p>HSBC Performance Statistics</p>
<p>Report Originator and Contact</p>	<p>Name: Nick Buckland Tel: 01305 224763 Email: n.j.buckland@dorsetcc.gov.uk</p>

## 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 approximately £20M in the 2015-16 financial year. The anticipated cash flows for 2015/16 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. Cash flow

- 2.1 The table below summarises the main cash flows for the Fund for the three months under review.

	<u>£M</u>	<u>£M</u>
<b>Cash at 1st April 2015</b>		<b>33.1</b>
<b>Less:</b>		
UK Equity purchases (net)	1.0	<u>1.0</u>
<b>Plus:</b>		
Hedge Fund redemptions	4.9	
Private Equity distributions (net)	1.4	
Infrastructure distributions (net)	3.1	
Currency Hedge Gain	16.3	
Increase in Cash	3.8	
		<u><b>29.5</b></u>
<b>Cash at 30 June 2015</b>		<u><b>61.6</b></u>

- 2.2 The cash flow above shows the most significant transactions that have taken place for the financial year to the end of June 2015. Please note that the net Infrastructure distributions include a £4.3M ‘equalisation’ receipt from Hermes to clear all cash prior to final close of the Fund. However a subsequent drawdown payment of £6.4M has been made to Hermes 1 July 2015.

## 3. Fund Portfolio Distribution

- 3.1 The table below shows the position as at 30 June 2015, and the target allocation shown is the temporary strategy as agreed at the September 2014 meeting of the Committee, due to the then concerns over the Barings mandate, and subsequent postponement of the search for an additional Diversified Growth Fund manager.

<b>Asset Class</b>	<b>Manager</b>	<b>31-Mar-15</b>		<b>30-Jun-15</b>		<b>Target Allocation</b>	
		<b>£M</b>	<b>%</b>	<b>£M</b>	<b>%</b>	<b>£M</b>	<b>%</b>
Bonds	(Several)	562.6	24.2%	564.4	24.4%	566.0	24.5%
UK Equities	(Several)	623.5	26.8%	618.1	26.8%	635.3	27.5%
Overseas Equities	(Several)	628.8	27.0%	593.2	25.7%	577.5	25.0%
Property	(CBREi)	228.8	9.8%	233.8	10.1%	231.0	10.0%
Absolute Return Funds	(Several)	8.3	0.4%	3.3	0.1%	-	0.0%
Infrastructure	(Several)	26.8	1.2%	24.8	1.1%	92.4	4.0%
Private Equity	(Several)	59.2	2.5%	58.9	2.5%	92.4	4.0%
Diversified Growth	(Barings)	111.6	4.8%	111.5	4.8%	115.5	5.0%
Cash	(Internal)	75.5	3.2%	102.2	4.4%	-	0.0%
<b>Total</b>		<b>2,325.0</b>	<b>100.0%</b>	<b>2,310.2</b>	<b>100.0%</b>	<b>2,310.2</b>	<b>100.0%</b>

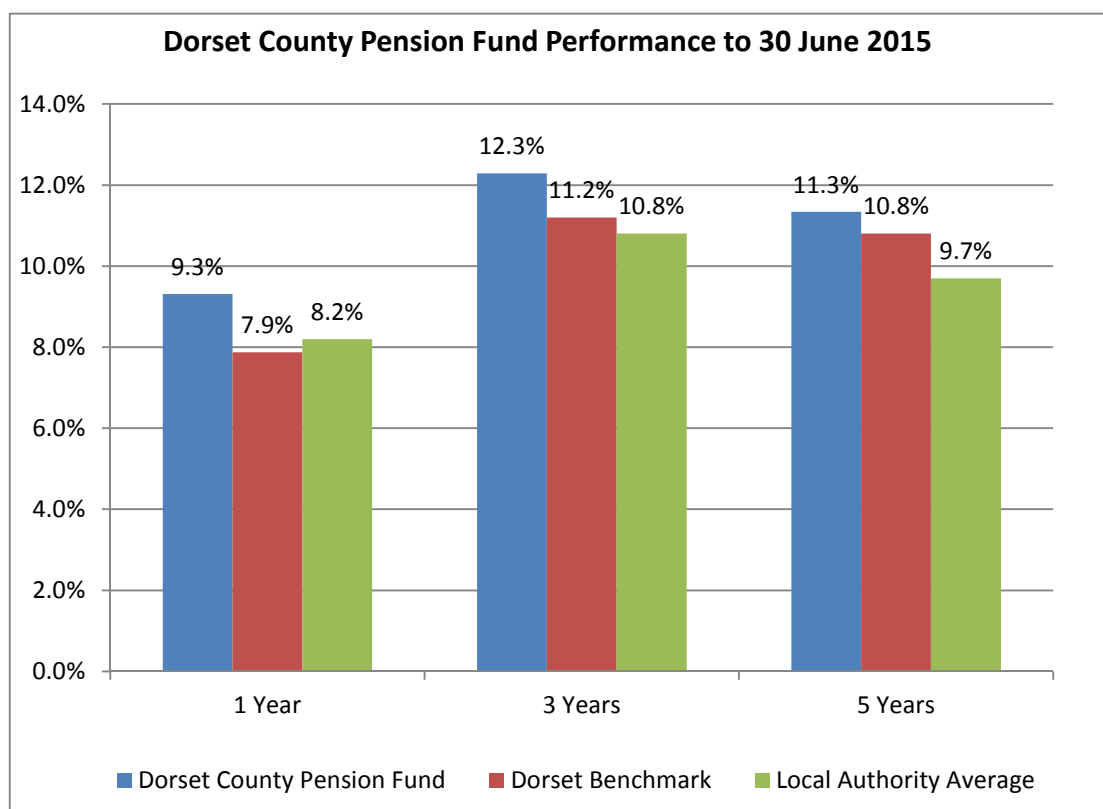
3.2 The table above shows that in most asset classes the Fund’s allocation is now close to or slightly above target, with the exception of Private Equity and Infrastructure which will take a number of months to fully drawdown. Overseas Equities are currently above target but this will be addressed as part of the changes to management arrangements agreed at the March 2015 meeting.

#### 4. Overall Fund Performance

4.1 The performance of the Fund during the first quarter shows an overall return of -0.34%, an outperformance of the benchmark of -1.21% by 0.87%. Over the 12 month period to 30 June 2015 the fund has returned 9.31% against the benchmark of 7.87%, an outperformance of 1.44%

4.2 The Fund has exceeded its benchmark over 3 years, returning an annualised 12.29% against the benchmark of 11.20%, and over 5 years, returning an annualised 11.34% against the benchmark of 10.80%.

4.3 The chart below shows the overall performance for 1, 3 and 5 years against the Fund’s bespoke benchmark, and the Local Authority average performance.



- 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 annualised 11.77% since its inception on 1st July 2012. For the quarter to 30 June 2015, Return Seeking assets have returned -1.11% against the benchmark of -2.12%. The Liability Matching assets have returned 5.35% against the benchmark of 5.35%. 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 cannot 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. The table below shows the overall performance of the Fund, but makes the distinction between the return seeking assets and the liability matching assets.

<u>Asset Category</u>	<u>Manager</u>	<u>3 Months to 30 June 2015</u>		
		<u>Dorset</u> %	<u>Benchmark</u> %	<u>Over/(Under)</u> %
<b>Overall Fund Performance</b>	<b>All</b>	<b>-0.34</b>	<b>-1.21</b>	<b>0.87</b>
<b>Total Return Seeking Assets</b>	<b>Various</b>	<b>-1.11</b>	<b>-2.12</b>	<b>1.01</b>
UK Equities	(Various)	-0.12	-1.30	1.18
Overseas Equities	(Various)	-5.45	-5.19	-0.26
Bonds	(RLAM)	-4.54	-5.20	0.66
Property	(CBREi)	3.46	3.48	-0.02
Private Equity	(Various)	2.03	-1.58	3.61
Diversified Growth	(Barings)	-0.12	1.13	-1.25
Infrastructure	(Various)	4.78	2.41	2.37
<b>Total Liability Matching Assets</b>		<b>5.35</b>	<b>5.35</b>	<b>0.00</b>
Bonds	(Insight)	5.35	5.35	0.00

- 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 year to date on pages 7 and 8. This analysis shows that the market contribution had a positive effect of 65bps against the benchmark and stock selection was positive by 25bps. Return seeking assets had an overall positive contribution of 90bps mainly driven by UK equities (31bps), bonds (9bps) and private equity (9bps).

## 5. **Manager Progress**

### Diversified Growth

- 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 for Barings for the quarter and twelve months to 30 June 2015 is summarised below.

Market Value at 1 April 2015	Market Value at 30 June 2015	3 months to 30 June 2015		12 months to 30 June 2015	
£000s	£000s	Performance %	Benchmark %	Performance %	Benchmark %
111,640	111,509	-0.12	1.13	6.98	4.58

- 5.3 Over the quarter the Fund delivered a 0.12% negative return, against the benchmark of 1.13%. The fund manager comments that performance was hurt by exposure to equities in Europe and in emerging markets, particularly South Korea and Taiwan, which the manager believes should gain from recovery in the western developed economies.

#### Active US Equity

- 5.4 The performance of Janus Intech is summarised below.

	Market Value		Performance	Benchmark
	01-Apr-15	30-Jun-15	%	%
USD \$000s	215,614	213,396	-1.03	0.28
GBP £000s	145,244	135,688	-6.58	-5.35

- 5.5 The Janus Intech fund actively manages US equity stocks using disciplined mathematical processes to outperform the benchmark at the same level of risk. Over the last 3 months the fund made a negative return of 6.58%, against the benchmark of -5.35%. Over the last 12 months the fund made a positive return of 19.30%, against the benchmark of 16.79%. Over the past three years, the fund has returned an annualised 18.14% against the benchmark return of 17.21%. Over five years the fund has returned 16.92% per annum against the benchmark of 16.18%.

#### Emerging Market Equity

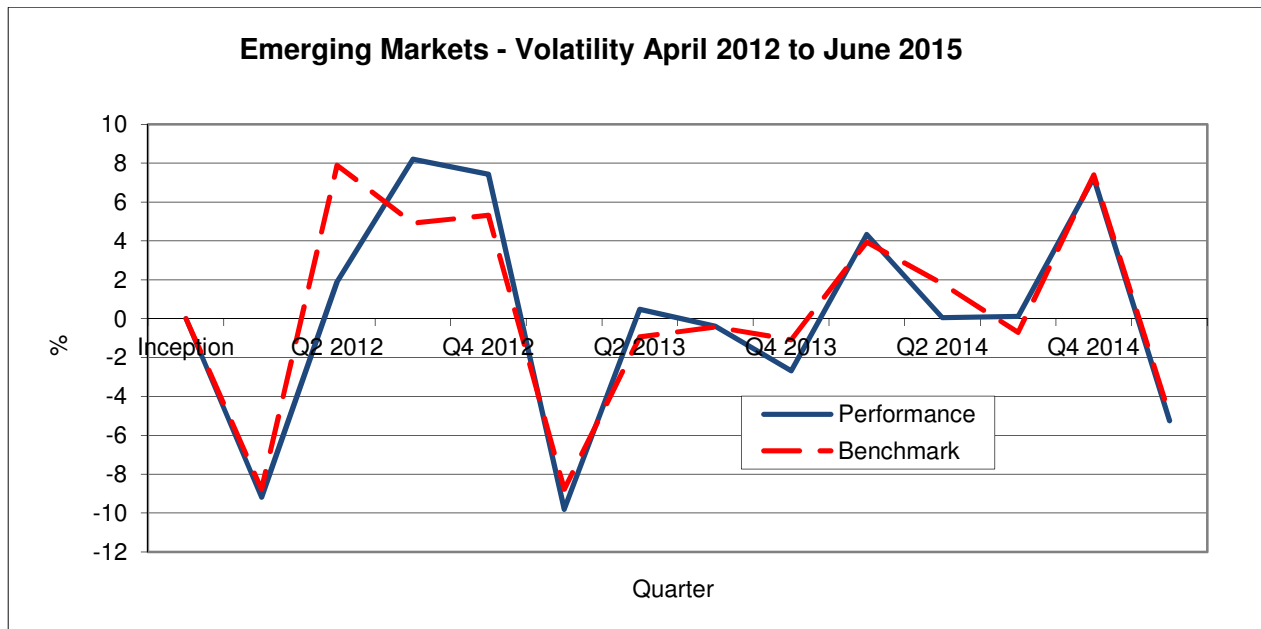
- 5.6 The performance of JP Morgan is summarised below.

Value at 1 April 2015	Market Value at 30 June 2015	3 months to 30 June 2015		12 months to 30 June 2015	
(£000's)	(£000's)	Performance %	Benchmark %	Performance %	Benchmark %
71,205	67,468	-5.25	-4.95	1.79	3.15

- 5.7 The return of -5.25% for the 12 months to 30 June 2015 was below the benchmark by 0.30%. The fund manager comments that emerging markets witnessed another volatile period in the quarter due to concerns about tightening monetary policy in the

US despite weak growth, the overvaluation of Chinese equities and the impasse in Greece’s talks with its creditors.

- 5.8 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

- 5.9 The 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 2015.
- 5.10 The table 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 2015 and the total gains or losses, which includes the distribution plus the latest valuation.

<u>Manager</u>	<u>Commitment</u>	<u>Drawn down</u>	<u>% of</u>	<u>Distribution</u>	<u>Valuation</u>	<u>Gain / (Loss)</u>
			<u>Commitment</u>			
	<u>€m</u>	<u>€m</u>		<u>€m</u>	<u>€m</u>	<u>€m</u>
HV Partnership V	12.000	11.280	94%	8.467	8.303	5.490
HV Direct V	3.000	2.880	96%	2.350	1.536	1.006
SL 2006	22.000	19.535	89%	11.293	14.276	6.034
SL 2008	17.000	12.045	71%	2.539	12.431	2.925
	<u>\$m</u>	<u>\$m</u>		<u>\$m</u>	<u>\$m</u>	<u>\$m</u>
HV Venture VIII	15.200	14.592	96%	9.503	14.170	9.081
HV Buyout VIII	22.800	20.520	90%	15.250	14.711	9.441
HV Buyout IX	15.000	6.262	42%	1.118	6.165	1.021
HV Venture IX	10.000	6.150	62%	1.083	6.865	1.798
HV Partnership VII (AIF)	20.000	2.300	12%	0.000	2.254	-0.046
SL SOF I	16.000	5.690	36%	0.000	5.941	0.251
SL SOF II	20.000	1.277	6%	0.000	1.787	0.510

- 5.11 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. The table below shows the performance over 3 and 5 years against the benchmark.

#### Private Equity Overall Performance

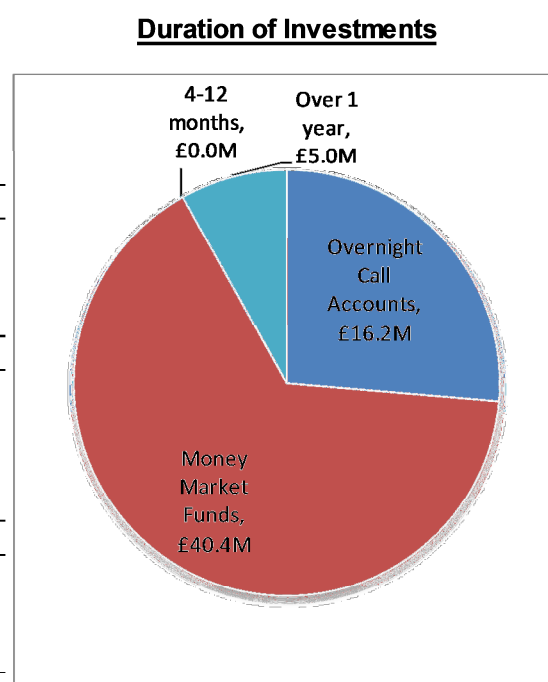
<u>Manager</u>	<u>3 Years to 30 June 2015</u>		<u>5 Years to 30 June</u>	
	<u>Dorset</u>	<u>Benchmark</u>	<u>Dorset</u>	<u>Benchmark</u>
	<u>%</u>	<u>%</u>	<u>%</u>	<u>%</u>
HarbourVest	16.17	11.04	14.49	10.75
Standard Life	8.26	11.04	11.29	10.75

## 6. Treasury Management

- 6.1 The 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 2015 is shown in the table below. Additional cash balances are also held tactically by Pictet within their overseas equity portfolio, and there are relatively small amounts of cash held with the custodian bank account at HSBC and in a property rent collection account where a float is required to be held for working capital purposes.
- 6.2 Since the financial crisis of 2008-09, 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, Capita, have advised that cash balances can be invested for more than 3 months in the big four UK banking groups – Barclays, HSBC, Lloyds and RBS. 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.
- 6.3 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 0.14% over the three months, which is ahead of the benchmark, as measured by the 7 day LIBID, at 0.09% for the quarter. These low market rates have broadly been caused by the funding for lending scheme and Bank of England restrictions on how banks have to treat liquid deposits.



<u>Lender/Borrower</u>	<u>Amount</u> £000s	<u>Rate</u> %
<b><u>Fixed Term Deposits</u></b>		
Lloyds Banking Group	5,000	1.00%
<b>Total Loans</b>	<b>5,000</b>	<b>1.00%</b>
<b><u>Call Accounts</u></b>		
National Westminster Bank	89	0.25%
Svenska Handelsbanken	14,500	0.45%
<b>Total Call Accounts</b>	<b>14,589</b>	<b>0.45%</b>
<b><u>Money Market Funds</u></b>		
Standard Life	15,000	0.47%
Federated Prime	15,000	0.46%
Goldman Sachs	10,350	0.44%
<b>Total Money Market Funds</b>	<b>40,350</b>	<b>0.46%</b>
<b><u>Holding Accounts</u></b>		
HSBC Custodian Account	917	0.00%
Property Client Account	719	0.00%
<b>Total Holding Accounts</b>	<b>1,636</b>	<b>0.00%</b>
<b>Total Cash / Average Return</b>	<b>61,575</b>	<b>0.49%</b>



## 7. Global Equity Managers

- 7.1 Members will recall that the Fund undertook a procurement process for at least two Global Equity managers supported by bfinance. At the last meeting of the Committee members were updated on progress of the search, and that the shortlisted managers were due to be interviewed by officers and the independent adviser on 30 June and 1 July. The Committee agreed to delegate authority to the Fund Administrator, after consulting with the Chairman and Vice-Chairman to make the appointments.
- 7.2 Over the two days at the end of June, and early July, the selection panel interviewed the shortlisted 10 managers. Each of the short-listed managers presented their strategy, and were asked a numbers of questions to assess the most appropriate for the Dorset Fund. At the end of the process the managers and their strategies were compared, and colleagues from bfinance analysed the compatibility of the preferred managers, to assess whether the approaches were likely to be complimentary.
- 7.3 As a result of the interviews and additional analysis it was decided to recommend the appointment of Allianz Global Investors to the Smart Beta mandate, and Investec and Wellington Asset Management to the Active mandate. The assets will be split 40:30:30 respectively, which is £200 Million invested with Allianz, and £150 Million each with Investec and Wellington. This recommendation was made to the Chairman and Vice Chairman, and was agreed.
- 7.4 The Legal documents for each investment are currently with the Fund’s legal advisers, and it is hoped that this legal process will be concluded by the end of September. The Fund is also looking to appoint a transition manager to manage the process of moving the assets, and it has been identified that the Lancashire fund has set up a framework contract which we can access.
- 7.5 It was hoped that the transition would take place at the end of September, but it is now likely that it may be nearer the end of October. The Committee will be updated

as to progress, and it is intended that the new managers will all be invited to present to the Committee over the next year, to introduce themselves and their strategies.

## **8. Pension Fund award**

- 8.1 Members will recall that the Fund had received a nomination from industry publication Engaged Investor’s annual Trustee awards. The Fund had been nominated in the category of best Local Government Fund. The Chief Treasury and Pensions Manager, Nick Buckland was also nominated in the category of best Pensions manager.
- 8.2 The awards ceremony took place on 2 July at a London hotel, and was attended by the Chairman and the Chief Treasury and Pensions Manager. It is pleasing to report that the Fund won in its category, and were the only Local Government winner at the event. Nick Buckland was unsuccessful in his category, but was pleased to have been the only LGPS nominee.

## **7. Asset Allocation**

- 7.1 As mentioned in previous paragraphs, the Fund is due to transition to the new global equity arrangements in the next month or so, and at this stage, the imbalance in the allocation, as highlighted in paragraph 3 will be rectified.
- 7.2 Paragraph 3 also highlighted an under-allocation to Private Equity and Infrastructure, due mainly to the time taken for each asset class to draw down committed funds, and also the relative movements in value against other asset classes. Members in June 2014 to allocate £50M over two years, to attempt to address this, and progress on this was reported to the last Committee.
- 7.3 The decision to allocate to infrastructure has been a relatively recent one, and in a similar way to Private Equity it takes some time for the committed funds to be drawn. However, due to movements in values of other assets, even when the funds are fully invested the Fund will be short of its 4% target. An opportunity has been identified to commit additional funds to the IFM investment, and it is therefore recommended to commit a further £10M on the same terms. The Hermes fund is now closed and so there is no opportunity to make any additional investments.
- 7.4 In a separate report on today’s agenda the issue of the Government agenda to encourage Local Government funds to pool investments is addressed, and an approach to this is recommended. Due to the imminent nature of these proposals it is suggested that any changes to managers or allocations, unless needing urgent attention, are deferred until there is more clarity. Members will be updated at each meeting, and in between where necessary, should anything arises that changes this.

## **8. Currency Hedging**

- 8.1 The Fund currently has in place a hedge to manage the effect of currency movements on the Fund’s global equity investments. This has been the position since 2005, when it was agreed that half of the foreign currency exposure be eliminated by hedging.
- 8.2 The position of hedging 50% of the currency exposure has remained unchanged since, and has been reviewed on a number of occasions. Due to the imminent change of global equity management arrangements it would seem appropriate to consider whether the hedge remains in place.

- 8.3 Over the long term, exchange rates are expected to fluctuate around some mean rather than be directional. As such, currency risk is sometimes considered "unrewarded". Which is in contrast to, for example, investing in equities, that are expected to increase in value over the long term hence compensating you as the investor for the volatility in their value over the shorter term. It is very difficult to assess at any one time what the correct "mean" exchange rate is, if not the current level. It is also true that overseas currency exposure can be a positive contributor to returns if the overseas currency appreciates relative to Sterling.
- 8.4 Overseas currency exposure can be a diversifier of returns. During the financial crisis in 2008 / 09, the MSCI All Country World Index fell by nearly 50% in US Dollar terms but by only around two-thirds of this in Sterling terms i.e. Sterling investors exposed to overseas currency benefited from overseas currencies appreciating relative to sterling.
- 8.5 Whilst hedging can be an enhancement to returns, it can also be a drag, depending on the relative interest rates. However, generally, overseas currency exposure leads to increased volatility.
- 8.6 In Dorset’s experience hedging currencies has helped reduce the volatility of returns, however, it has meant that cash balances have been higher than the Fund may wish due to the need to keep enough cash to settle the forward currency contracts at the end of each quarter. These settlements can be of a reasonably significant nature, as can be seen in the cash flow analysis in paragraph 2.1, which shows that during the last quarter the hedges realised £16.3M.
- 8.7 Whilst there are practical issues to consider around the implementation of the hedge it is still considered by most consultants and advisers to be a sensible approach. It is also believed that 50% is about the right level; any less than 50% starts to reduce the effect of the hedging, and when you start to get towards 75% the risk reduction benefit starts to minimise. It would, therefore be appropriate to continue to hedge 50% of the foreign currency exposure, and to ensure that it is considered as part of the overall strategic review after the results of the next actuarial valuation have been received.

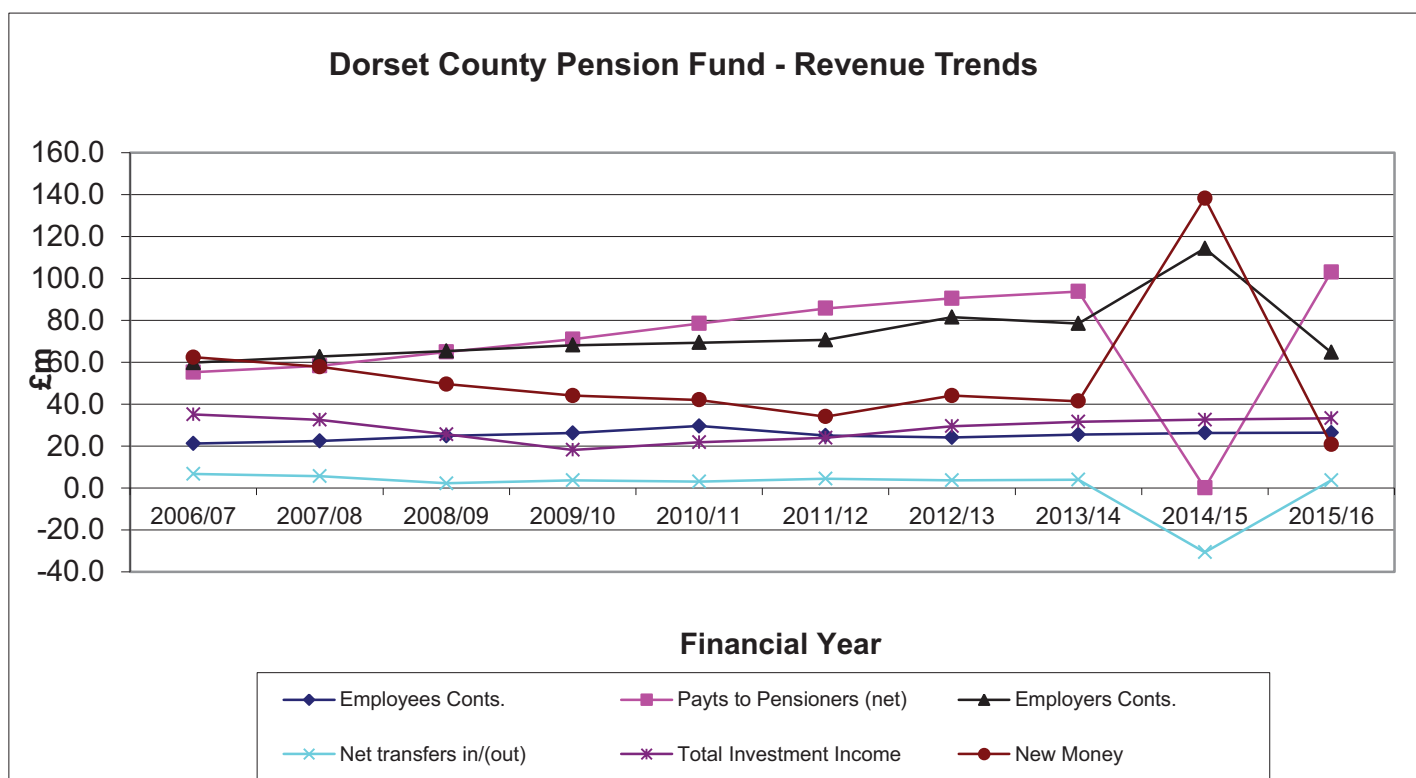
**Richard Bates**  
**Pension Fund Administrator**  
September 2015

## Appendix 1

### BUDGET MONITORING

	Actual 2013/14 £'000	Actual 2014/15 £'000	Estimate 2015/16 £'000
<b>INCOME:</b>			
Employers' Contributions	78,500	113,400	64,800
Employees' Contributions	25,400	26,300	26,400
Transfer Values (net)	4,000	3,200	3,700
Investment Income	31,600	34,900	33,300
<b>TOTAL INCOME:</b>	<b>139,500</b>	<b>177,800</b>	<b>128,200</b>
<b>EXPENDITURE:</b>			
Net Management Expenses	4,300	4,800	4,300
Payments to Pensioners (net)	93,800	100,000	103,100
Transfer of Probation Service to Gtr Manchester		34,400	0
<b>TOTAL EXPENDITURE:</b>	<b>98,100</b>	<b>139,200</b>	<b>107,400</b>
<b>NET SURPLUS FOR THE YEAR</b>	<b>41,400</b>	<b>38,600</b>	<b>20,800</b>

### REVENUE TRENDS & FORECASTS





**REPORT OF THE INVESTMENT ADVISER  
PREPARED FOR**

**Dorset County Pension Fund**

**Pension Fund Committee**

**On September 14 2015**

**Investment Outlook**

**Alan Saunders**

**AllenbridgeEpic Investment Advisers Limited (AllenbridgeEpic)**

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The value of investments and the income from them may fluctuate and may fall as well as rise. Past performance is not necessarily a guide to future investment returns. Investments may involve foreign currency transactions (i.e. denominated in a currency other than the investor's base currency) and may therefore be subject to fluctuations in currency values and the value of such investments may fall as well as rise. The investor may not get back the original amount invested. Simulations based on past performance may not necessarily be a reliable guide to future investment returns.

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## Report of the Investment Adviser

### Investment Outlook

At the time of writing, equities are heavily in retreat after showing modest gains in the first half of the year, banked in the first quarter. The sell-off in China equities and growing concerns over the Chinese economy seem to be the main drivers behind the selling. The correction in major markets has gone further than we experienced earlier with the Greek crisis but it does not yet have the feel of a bear market, perhaps because trading has been light in the summer months. Even so, it is the worst setback since 2011 when Europe became an issue.

Global economic signals still remain mixed and given stock market uncertainties it would be no surprise if the Fed were to push back its first rate rise from the expected September date. Certainly, inflation remains subdued and the oil price has fallen back below \$50/bbl. compared to the recovery to \$65/bbl. in our last report. There is no pressing need to tighten policy.

Subdued economic growth- and weak emerging market growth- is not really what stock markets want to hear as they were pricing in more of a recovery in corporate earnings. The recent sell-off has at least brought valuation back to more attractive levels and long term buyers may start to provide support soon.

#### Economy

In the UK, the economic data is slightly puzzling. GNP rose 0.7% in Q2, much better than Q1, but manufacturing output fell. We have also had two months of rising unemployment. It seems that manufacturing and exports are struggling against a background of sterling strength and weak global demand but the consumer is holding up and the housing market reviving. The post-election budget should not affect the near term but the Chancellor has sensibly pushed back his projected budget surplus by a year, relaxing the so-called austerity. We still assume a base rate rise in the spring.

The fall in oil prices back to 2009 levels is something of a surprise but seems to reflect the potential re-emergence of Iran as an exporter again after the recent agreement. It provides a welcome tax cut to a struggling global economy. There has been little change in the developed world since the last report and it will be interesting to see if policy makers respond to the threat of weaker asset prices again because of the confidence effects. Thus, the Fed may delay the first rate increase while the ECB and the Japanese central bank may extend QE still further.

This would mirror the efforts of the Chinese authorities who are resorting to conventional and unconventional measures to stop the market slide though without much luck. They have a difficult balancing act. Long term they need to rebalance the economy away from investment, an astonishing 45% of GNP and towards the consumer and to reduce the overall debt burden. A market shock would facilitate this but at the expense of unnerving the consumer. Not least of the decisions the authorities have taken is to devalue the currency which risks setting off competitive devaluations throughout Asia which would be bad for growth, as in the 1930's.

In Europe, the immigration crisis has taken Greece off the front pages. It may come back with the proposed election and subsequently possible debate over debt write offs a likely outcome.

## Markets

The second quarter proved fairly uneventful despite the Greek issue. Equities weakened but not dramatically. Thus the FTSE All Share index fell 1.6% and global equities some 5% in sterling terms, with Europe and some emerging markets doing less well but this partly reflected sterling strength. Gilt yields actually rose so that bonds produced negative returns, some 3% negative for both gilts and index linked.

The elephant in the room however proved to be China. In the last report, we suggested a correction was overdue and the market has now fallen back some 40% from Q2 highs despite the authorities' interventions. We also suggested, less successfully, that the impact on wider markets should be relatively subdued. Most markets fell some 10% in August alone. The UK was typical and it is now some 11% below year end levels with no sign of stabilising yet. It is probably the worst performing major market this year. The US is down some 5% but Europe and Japan, especially, are in positive territory still. Emerging markets are mixed with commodity countries suffering badly.

China is probably the catalyst but as we argued in the last report markets had taken a lot on trust in terms of global recovery and have been propped up by expansionary central bank action so a fuller correction was perhaps overdue. While markets did not appear frothy- with the exception of the US perhaps- there has been a long bull run since the last correction in 2011. Let alone 2009. The US had risen some 75% since 2011, likewise Japan though the UK has risen only 20%, dragged down perhaps by its heavy exposure to commodity companies.

Probably markets will begin to stabilise, especially if the FED delays its rate increase. For a full blooded bear market, we would expect to see beginnings of a financial crisis of which there is little evidence or a serious weakening in global economic prospects, of which there is some but insufficient evidence with inflation still subdued, consumer demand should hold up. In that event, there is a good case for long term investors beginning to take advantage of the recent setback in equities. Emerging markets remain the enigma. Valuation looks most compelling but geopolitical and financial risk seems high still for many markets making the timing issue trickier.

Gilt markets have moved in an opposite direction and are now showing positive returns for the year, sustained by the continuing good news on inflation and the growing view that low base rates will be lower for longer. Clearly, if the BOE raises rates more quickly, then gilt yields could rise sharply and returns could be quite negative.

## Property

The UK commercial property market remains buoyant and has not reflected the recent anxiety in equity markets a forecast return of 12% for the year as a whole remains well ahead of other asset classes.

As in the last report, the occupancy market remains firm with rents rising apart from the retail sector and the strength has extended across most regions. There is no sign yet of the predicted sell-off in City or West End offices and the election result has encouraged overseas buyers who had been holding off to come back in.

Yields will probably bottom out later this year or early next year depending on the wider market sentiment but property still seems set to produce positive returns next year.

## **Alternatives**

We have delegated the task of tactical asset allocation to our Diversified Growth manager who times moves across markets according to short term tactical views and is judged as to how he produces returns over and above a cash benchmark. Our manager has quite a high equity exposure so we may have done less well in the recent setback.

As indicated before, alternatives like private equity and infrastructure dance to a different tune and are both illiquid assets where we have to commit for a long time. Private equity is a geared equity play where we should expect higher returns over time than quoted equities while infrastructure is also a long term investment where we are attempting to achieve a positive return in real terms

## **Asset Allocation**

Our asset allocation reflects a long term strategy designed to repair the pension fund deficit which requires us to achieve a certain long term return. We are more diversified than many local authority schemes and run less equity exposure than most which will help in relative terms during a market correction such as presently.

**Alan Saunders Senior Adviser**

**Allenbridge Epic Investment Advisers**





**Dorset County Pension Fund Total**

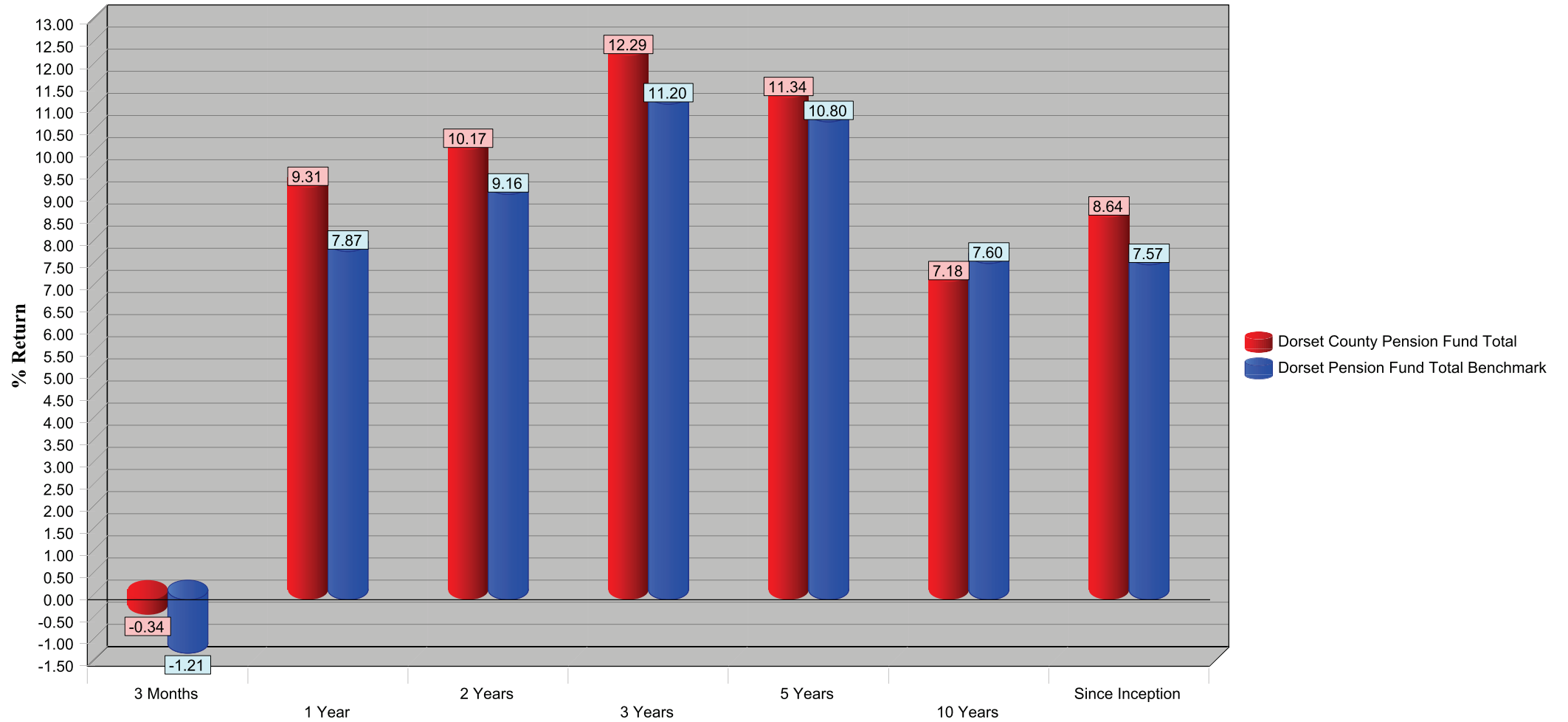
**01 Apr 2015 - 30 Jun 2015**

## Manager Summary

Portfolio	Initial Market Value	Initial Market Value %	Net Investment	Capital Gain / Loss	Final Market Value	Final Market Value %	Income	Portfolio Return %	Benchmark Return %
<b>Dorset County Pension Fund Total</b>	<b>2,325,040,739</b>	<b>100.00</b>	<b>2,566,889</b>	<b>-17,413,954</b>	<b>2,310,193,674</b>	<b>100.00</b>	<b>9,662,890</b>	<b>-0.34</b>	<b>-1.21</b>
Dorset - AXA Framlington UK Equity	108,712,914	4.68		981,936	109,694,849	4.75		0.90	-1.58
Dorset - Barings Asset Management	111,639,571	4.80		-130,741	111,508,830	4.83		-0.12	1.13
Dorset - CBRE Property	228,774,054	9.84		5,017,216	233,791,270	10.12	2,933,281	3.48	3.46
Dorset - Currency Hedging	0	0.00	-16,321,475	16,321,475	0	0.00		562.81	
Dorset - Gottex Hedge Fund	1,960,675	0.08	-243,606	107,599	1,824,668	0.08		6.25	1.38
Dorset - HarbourVest Private Equity	34,570,876	1.49	-434,697	917,281	35,053,459	1.52		2.66	-1.58
Dorset - Hermes Fund	26,757,401	1.15	-3,146,928	1,186,231	24,796,704	1.07		4.78	2.41
Dorset - IAM Hedge Fund	4,817,235	0.21	-4,627,766	-179,016	10,452	0.00		-46.72	1.80
Dorset - Insight Fund	276,464,387	11.89		14,794,387	291,258,775	12.61		5.35	5.35
Dorset - Internally Managed Cash	33,129,501	1.42	28,445,694	-1	61,575,194	2.67	51,846	0.14	0.09
Dorset - Internally Managed UK Equity	401,418,226	17.26	760,909	-11,527,211	390,651,924	16.91	5,421,658	-1.56	-1.72
Dorset - JP Morgan	71,204,662	3.06		-3,736,280	67,468,382	2.92		-5.25	-4.95
Dorset - Janus Intech US Equity Fund	145,243,572	6.25		-9,555,790	135,687,782	5.87		-6.58	-5.35
Dorset - Pictet Global ex UK Equity	454,704,106	19.56	-865,132	-23,096,572	430,742,402	18.65	1,046,885	-4.87	-5.25
Dorset - Pioneer Hedge Fund	1,549,332	0.07		-113,991	1,435,341	0.06		-7.36	1.63
Dorset - Royal London Bonds	286,132,625	12.31	210,813	-13,209,403	273,134,035	11.82	209,220	-4.54	-5.20
Dorset - Schroders UK Equity	34,872,355	1.50	-47,519	2,536,767	37,361,603	1.62		7.28	5.42
Dorset - Standard Life Private Equity	24,585,144	1.06	-1,021,662	271,841	23,835,324	1.03		1.12	-1.58
Dorset - Standard Life UK Equity	78,504,102	3.38	-141,741	2,000,318	80,362,679	3.48		2.54	-1.58

All periods > 1 year have been annualised.

Long Term Performance, Total Fund



All periods > 1 year have been annualised.

## Gain/Loss Analysis

Category	Initial Market Value	Net Investment	Final Market Value	Capital Gain/Loss	Income	% Return
<b>TOTAL ASSETS</b>	<b>2,325,040,739</b>	<b>2,566,889</b>	<b>2,310,193,674</b>	<b>-17,413,954</b>	<b>9,662,890</b>	<b>-0.34</b>
<b>Total Return Seeking Assets</b>	<b>2,048,580,463</b>	<b>2,566,889</b>	<b>2,018,939,011</b>	<b>-32,208,341</b>	<b>9,662,890</b>	<b>-1.11</b>
Total Assets ex Hedging	2,048,580,463	18,888,364	2,018,939,011	-48,529,817	9,662,890	-1.91
Total Equities	1,252,269,270	256,001	1,211,309,941	-41,215,330	6,417,224	-2.79
UK	623,507,597	571,649	618,071,055	-6,008,191	5,421,658	-0.12
Dorset UK Internally Managed	401,418,226	760,909	390,651,924	-11,527,211	5,421,658	-1.56
AXA Framlington UK Equity	108,712,914		109,694,849	981,936		0.90
Standard Life UK Equity Select Fund	78,504,102	-141,741	80,362,679	2,000,318		2.54
Schroders UK Small Cap Equity	34,872,355	-47,519	37,361,603	2,536,767		7.28
Overseas Equities	628,761,673	-315,649	593,238,885	-35,207,139	995,567	-5.45
North America	371,909,234	1,023,782	349,342,196	-23,590,821	265,296	-6.26
Pictet North America	226,665,662	1,023,782	213,654,414	-14,035,031	265,296	-6.06
Janus Intech US Equity	145,243,572		135,687,782	-9,555,790		-6.58
Europe ex UK	107,618,148	940,005	103,034,707	-5,523,446	685,248	-4.50
Pictet Europe ex UK	107,618,148	940,005	103,034,707	-5,523,446	685,248	-4.50
Japan	57,331,352	-4,585,344	51,738,082	-1,007,927	23,755	-2.05
Pictet Japan Equity	57,331,352	-4,585,344	51,738,082	-1,007,927	23,755	-2.05
Pacific ex Japan	20,698,276	2,305,908	21,655,519	-1,348,665	21,268	-5.49
Pictet Pacific ex Japan	20,698,276	2,305,908	21,655,519	-1,348,665	21,268	-5.49
Emerging Markets	71,204,662		67,468,382	-3,736,280		-5.25
JP Morgan Global Emerging Markets	71,204,662		67,468,382	-3,736,280		-5.25
Total Bonds	286,132,625	210,813	273,134,035	-13,209,403	209,220	-4.54
Royal London Bonds	286,132,625	210,813	273,134,035	-13,209,403	209,220	-4.54
Total Property	228,774,054		233,791,270	5,017,216	2,933,281	3.48
ING Property	228,774,054		233,791,270	5,017,216	2,933,281	3.48
Total Cash	75,524,281	27,896,210	102,238,987	-1,181,504	103,164	-1.47
Total Hedge Funds	8,327,242	-4,871,373	3,270,461	-185,408		-2.27
Gottex Hedge Fund	1,960,675	-243,606	1,824,668	107,599		6.25
Pioneer Hedge Fund	1,549,332		1,435,341	-113,991		-7.36
IAM (Hedged)	4,817,235	-4,627,766	10,452	-179,016		-46.72

## Gain/Loss Analysis

Category	Initial Market Value	Net Investment	Final Market Value	Capital Gain/Loss	Income	% Return
IAM Hedge Fund	4,817,235	-4,627,766	10,452	-179,016		-46.72
Private Equity	59,156,020	-1,456,359	58,888,783	1,189,121		2.03
HarbourVest	34,570,876	-434,697	35,053,459	917,281		2.66
Standard Life Private Equity	24,585,144	-1,021,662	23,835,324	271,841		1.12
Diversified Growth Fund	111,639,571		111,508,830	-130,741		-0.12
Baring Dynamic Asset Allocation Fund	111,639,571		111,508,830	-130,741		-0.12
Infrastructure	26,757,401	-3,146,928	24,796,704	1,186,231		4.78
Hermes	26,757,401	-3,146,928	24,796,704	1,186,231		4.78
Total Currency Hedging	0	-16,321,475	0	16,321,475		562.81
<b>Total Matching Assets</b>	<b>276,460,276</b>		<b>291,254,663</b>	<b>14,794,387</b>		<b>5.35</b>
Insight Liability Fund	276,460,276		291,254,663	14,794,387		5.35

All periods > 1 year have been annualised.

## Asset Allocation

Category	Initial Market %		Final Market %		Local Currency % Return		Base Currency % Return	
	Portfolio	Benchmark	Portfolio	Benchmark	Portfolio	Benchmark	Portfolio	Benchmark
<b>TOTAL ASSETS</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>0.96</b>	<b>0.05</b>	<b>-0.34</b>	<b>-1.21</b>
<b>Total Return Seeking Assets</b>	<b>88.11</b>	<b>88.00</b>	<b>87.39</b>	<b>88.00</b>	<b>0.36</b>	<b>-0.68</b>	<b>-1.11</b>	<b>-2.12</b>
Total Assets ex Hedging	88.11	88.00	87.39	88.00	-0.44	-0.68	-1.91	-2.12
Total Equities	53.86	52.50	52.43	52.50	-0.55	-0.75	-2.79	-3.15
UK	26.82	27.50	26.75	27.50	-0.12	-1.30	-0.12	-1.30
Dorset UK Internally Managed	17.26	18.50	16.91	18.50	-1.56	-1.72	-1.56	-1.72
AXA Framlington UK Equity	4.68	3.75	4.75	3.75	0.90	-1.58	0.90	-1.58
Standard Life UK Equity Select Fund	3.38	3.75	3.48	3.75	2.54	-1.58	2.54	-1.58
Schroders UK Small Cap Equity	1.50	1.50	1.62	1.50	7.28	5.42	7.28	5.42
Overseas Equities	27.04	25.00	25.68	25.00	-0.98	-0.18	-5.45	-5.19
North America	16.00	14.00	15.12	14.00	-0.75	0.21	-6.26	-5.36
Pictet North America	9.75	9.00	9.25	9.00	-0.57	0.17	-6.06	-5.36
Janus Intech US Equity	6.25	5.00	5.87	5.00	-1.03	0.28	-6.58	-5.35
Europe ex UK	4.63	5.00	4.46	5.00	-2.66	-3.96	-4.50	-5.92
Pictet Europe ex UK	4.63	5.00	4.46	5.00	-2.66	-3.96	-4.50	-5.92
Japan	2.47	2.00	2.24	2.00	5.94	5.22	-2.05	-2.66
Pictet Japan Equity	2.47	2.00	2.24	2.00	5.94	5.22	-2.05	-2.66
Pacific ex Japan	0.89	1.00	0.94	1.00	0.17	-0.87	-5.49	-6.32
Pictet Pacific ex Japan	0.89	1.00	0.94	1.00	0.17	-0.87	-5.49	-6.32
Emerging Markets	3.06	3.00	2.92	3.00	-5.25	0.82	-5.25	-4.84
JP Morgan Global Emerging Markets	3.06	3.00	2.92	3.00	-5.25	0.82	-5.25	-4.84
Total Bonds	12.31	12.50	11.82	12.50	-4.54	-5.20	-4.54	-5.20
Royal London Bonds	12.31	12.50	11.82	12.50	-4.54	-5.20	-4.54	-5.20
Total Property	9.84	10.00	10.12	10.00	3.48	3.46	3.48	3.46
ING Property	9.84	10.00	10.12	10.00	3.48	3.46	3.48	3.46
Total Cash	3.25		4.43		-1.47		-1.47	
Total Hedge Funds	0.36	0.00	0.14	0.00	-0.60	1.59	-2.27	1.59
Gottex Hedge Fund	0.08	0.00	0.08	0.00	6.25	1.38	6.25	1.38
Pioneer Hedge Fund	0.07		0.06		-1.85	1.63	-7.36	1.63
IAM (Hedged)	0.21	0.00	0.00	0.00	-46.72	1.80	-46.72	1.80

## Asset Allocation

Category	Initial Market %		Final Market %		Local Currency % Return		Base Currency % Return	
	Portfolio	Benchmark	Portfolio	Benchmark	Portfolio	Benchmark	Portfolio	Benchmark
IAM Hedge Fund	0.21	0.00	0.00	0.00	-46.72	1.80	-46.72	1.80
Private Equity	2.54	4.00	2.55	4.00	5.02	-1.58	2.03	-1.58
HarbourVest	1.49	2.00	1.52	2.00	7.80	-1.58	2.66	-1.58
Standard Life Private Equity	1.06	2.00	1.03	2.00	1.12	-1.58	1.12	-1.58
Diversified Growth Fund	4.80	5.00	4.83	5.00	-0.12	1.13	-0.12	1.13
Baring Dynamic Asset Allocation Fund	4.80	5.00	4.83	5.00	-0.12	1.13	-0.12	1.13
Infrastructure	1.15	4.00	1.07	4.00	4.78	2.41	4.78	2.41
Hermes	1.15	2.00	1.07	2.00	4.78	2.41	4.78	2.41
IFM		2.00		2.00		2.41		2.41
Total Currency Hedging	0.00		0.00		562.81		562.81	
<b>Total Matching Assets</b>	<b>11.89</b>	<b>12.00</b>	<b>12.61</b>	<b>12.00</b>	<b>5.35</b>	<b>5.35</b>	<b>5.35</b>	<b>5.35</b>
Insight Liability Fund	11.89	12.00	12.61	12.00	5.35	5.35	5.35	5.35

All periods > 1 year have been annualised.

## Relative Attribution

Category	Currency Contribution	Market Contribution	Selection Contribution	Total Contribution
<b>TOTAL ASSETS</b>	<b>-0.02</b>	<b>0.65</b>	<b>0.25</b>	<b>0.88</b>
<b>Total Return Seeking Assets</b>	<b>-0.02</b>	<b>0.67</b>	<b>0.25</b>	<b>0.90</b>
Total Assets ex Hedging	-0.03	-0.04	0.25	0.18
Total Equities	0.07	0.03	0.07	0.17
UK	-0.00	-0.00	0.32	0.31
Dorset UK Internally Managed	-0.01	0.01	0.03	0.03
AXA Framlington UK Equity	0.01	-0.02	0.12	0.11
Standard Life UK Equity Select Fund	-0.00	0.00	0.14	0.14
Schroders UK Small Cap Equity	0.00	0.00	0.03	0.03
Overseas Equities	0.08	0.03	-0.25	-0.14
North America	-0.08	-0.00	-0.15	-0.23
Pictet North America	-0.03	-0.00	-0.07	-0.10
Janus Intech US Equity	-0.05	-0.00	-0.08	-0.13
Europe ex UK	0.01	0.02	0.06	0.09
Pictet Europe ex UK	0.01	0.02	0.06	0.09
Japan	-0.03	0.02	0.02	0.01
Pictet Japan Equity	-0.03	0.02	0.02	0.01
Pacific ex Japan	-0.00	-0.00	0.01	0.01
Pictet Pacific ex Japan	-0.00	-0.00	0.01	0.01
Emerging Markets	0.17	-0.00	-0.19	-0.02
JP Morgan Global Emerging Markets	0.17	-0.00	-0.19	-0.02
Total Bonds	-0.00	0.01	0.08	0.09
Royal London Bonds	-0.00	0.01	0.08	0.09
Total Property	-0.00	-0.01	0.01	-0.01
ING Property	-0.00	-0.01	0.01	-0.01
Total Cash	0.04	-0.04		-0.00
Total Hedge Funds	-0.00	-0.00	-0.01	-0.01
Gottex Hedge Fund	0.00	0.00	0.00	0.01
Pioneer Hedge Fund	-0.00	-0.00		-0.00



## Relative Attribution

Category	Currency Contribution	Market Contribution	Selection Contribution	Total Contribution
IAM (Hedged)	0.00	-0.00	-0.01	-0.01
IAM Hedge Fund	0.00	-0.00	-0.01	-0.01
Private Equity	-0.09	0.02	0.16	0.09
HarbourVest	-0.08	0.01	0.14	0.06
Standard Life Private Equity	-0.01	0.02	0.03	0.03
Diversified Growth Fund	-0.00	-0.00	-0.06	-0.07
Baring Dynamic Asset Allocation Fund	-0.00	-0.00	-0.06	-0.07
Infrastructure	-0.04	-0.05		-0.09
Hermes	-0.01	-0.00		-0.01
IFM	-0.03	-0.05		-0.07
Total Currency Hedging	0.01	0.71		0.72
<b>Total Matching Assets</b>	<b>0.00</b>	<b>-0.02</b>	<b>0.00</b>	<b>-0.02</b>
Insight Liability Fund	0.00	-0.02	0.00	-0.02

All periods > 1 year have been annualised.

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