Pension Fund Committee

Dorset County Council

Date of Meeting	24 November 2016
Officer	Pension 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 two quarters of the 2016/17 Financial Year to 30 September 2016. 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 14.65% over the six months to 30 September 2016, underperforming its benchmark which returned 14.70%. Return seeking assets returned 12.14%, whilst the liability matching assets returned 32.69%.
Impact Assessment:	Equalities Impact Assessment: N/A
	Use of Evidence: N/A
	Budget: N/A

	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.
	Other Implications: None
Recommendation	That the Committee : i) Review and comment upon the activity and overall performance of the Fund. ii) Make no additional changes to asset allocation at this time. iii) Agree the requirement for an extraordinary meeting of the Committee in January 2017 to approve the Final Business Case for Project Brunel.
Reason for Recommendation	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.
Appendices	Appendix 1: New Money Forecast Appendix 2: Report of the Independent Adviser Appendix 3: HSBC Manager Performance for the six months to 30 September 2016
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. There has been a surplus of income over expenditure from these cash flows of approximately £5M in 2016-17 to date, compared to the forecast of approximately £15M for the full year. The outturn cash-flows for 2015/16 and the anticipated cash flows for 2016/17 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 six months under review.

Statement of cash-flow for the six months ended 30 September 2016

	£M	£M
Cash at 1 April 2016		**91.8**
Less:		
Infrastructure Drawdowns (net)	29.8	
UK Equity transactions (net)	23.1	
Liability Matching Bond (net)	45.0	
Currency Hedge (net loss)	24.4	
Private Equity (net)	1.7	
		124.0
Plus:		
Upfront Payments of Employer Contributions*	13.0	
Property Transactions (net)	4.8	
Hedge Fund redemptions (net)	0.9	
Fixed Interest (net)	10.0	
Overseas Equities (net)	55.0	
Increase in Cash	5.2	
		88.9
Cash at 30 September 2016		**56.7**

*£26M received as upfront contributions, of which 6/12ths represents cash in advance as at 30 September 2016.

2.2 The cash flow above summarises the most significant transactions that have taken place for the six months to the end of September 2016. Since the end of September, the most significant transaction has been the receipt of £9M for the takeover in October of one of the Fund's passively managed UK equities, SABMiller, by US listed Anheuser-Busch InBev, leaving cash balances of approximately £65M at the end of October 2016.

3. Fund Portfolio Distribution

3.1 The table below shows the position as at 30 September 2016. The target allocation shown is the 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, amended by the decision made at the meeting 1 March 2016 to equalise the target allocations for UK Equities and Global Equities at 26.25% each.

		31-Mar-16		30-Sep-16		Target Allocation	
Asset Class	**Manager**	**£M**	**%**	**£M**	**%**	**£M**	**%**
Bonds	(Several)	524.1	23.0%	682.2	26.6%	629.4	24.50%
UK Equities	(Several)	584.2	25.7%	660.2	25.7%	674.4	26.25%
Overseas Equities	(Several)	625.6	27.5%	675.1	26.3%	674.4	26.25%
Property	(CBREi)	246.3	10.8%	238.7	9.3%	256.9	10.00%
Absolute Return Funds	(Several)	1.8	0.1%	0.9	0.0%	-	0.00%
Infrastructure	(Several)	29.0	1.3%	64.1	2.5%	102.8	4.00%
Private Equity	(Several)	65.4	2.9%	75.3	2.9%	102.8	4.00%
Diversified Growth	(Barings)	107.6	4.7%	115.8	4.5%	128.5	5.00%
Cash	(Internal)	91.8	4.0%	56.7	2.2%	-	0.00%
Total		**2,275.8**	**100.0%**	**2,569.0**	**100.0%**	**2,569.0**	**100.0%**

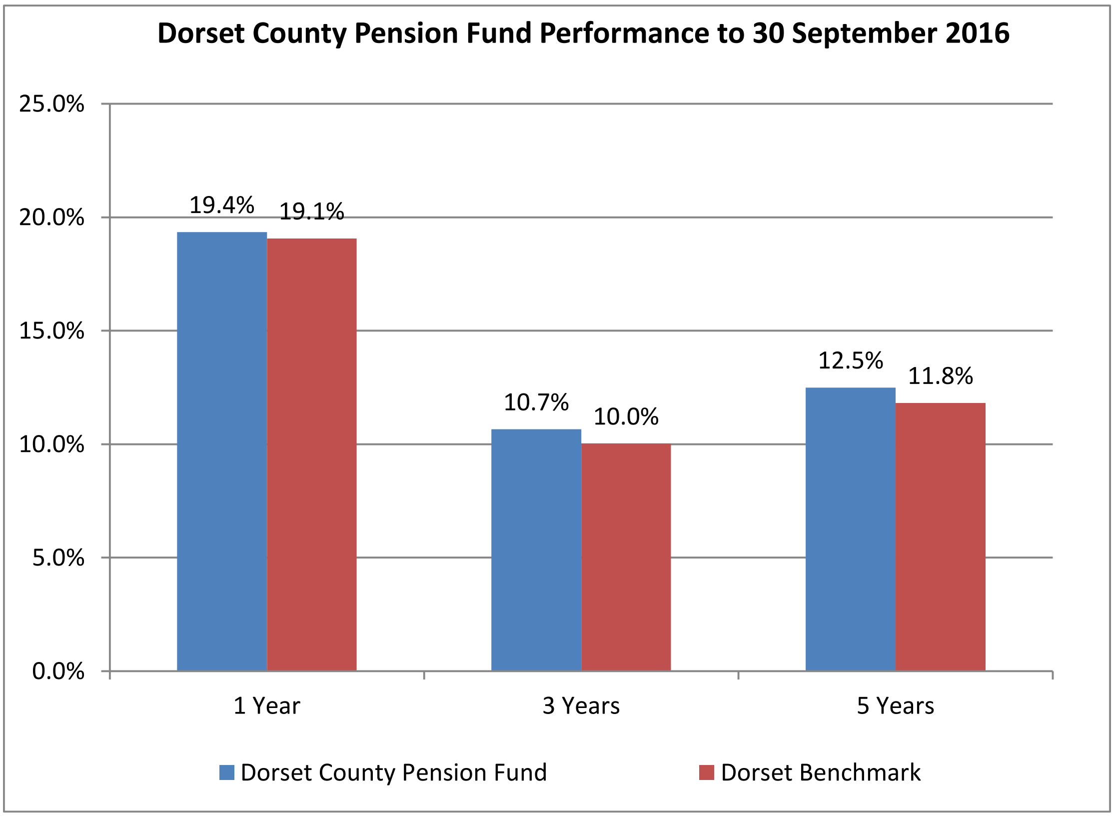
3.2 The table above shows that in most asset classes the Fund's allocation is now close to or slightly above target, with the exception of Private Equity and Infrastructure which will take a number of years to fully drawdown.

4. Overall Fund Performance

4.1 The performance of the Fund for the six months to 30 September 2016 shows an overall return of 14.65%, a marginal underperformance of the benchmark of 14.70% by 0.05%. This high level of short term returns by the Fund and its benchmark have been driven largely by the impact of sterling's depreciation, following the result of the EU referendum, on the asset classes the Fund is invested in, rather than relative outperformance of the markets by the Fund's managers.

4.2 Over the longer term, the Fund has exceeded its benchmark over 3 years, returning an annualised 10.66% against the benchmark of 10.03%, and over 5 years, returning an annualised 12.50% against the benchmark of 11.82%.

4.3 The chart below shows the overall performance for 1, 3 and 5 years against the Fund's bespoke benchmark. Following State Street's decision to discontinue providing performance measurement services to third party UK clients after Q1 2016, we are not currently able to provide a comparison with the LGPS average performance. However, the Cross Pool group have asked LGPS National Frameworks to run a tender for a replacement provider.



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 For the six months to 30 September 2016, Return Seeking assets have returned 12.14% against the benchmark of 11.90%. The Liability Matching assets have returned 32.69% against the benchmark of 33.29%. 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.

Asset Category	Manager	Dorset %	Benchmark %	Over/(Under) %
		6 Months to 30 September 2016		
Overall Fund Performance	**All**	**14.65**	**14.70**	**-0.05**
Total Return Seeking Assets	**Various**	**12.14**	**11.90**	**0.24**
UK Equities	(Various)	10.22	12.65	-2.43
Overseas Equities	(Various)	16.88	18.17	-1.29
Bonds	(RLAM)	12.65	13.34	-0.69
Property	(CBREi)	1.13	0.20	0.93
Private Equity	(Various)	9.73	12.85	-3.12
Diversified Growth	(Barings)	7.60	2.24	5.36
Infrastructure	(Various)	9.74	4.88	4.86
Total Liability Matching Assets		**32.69**	**33.29**	**-0.60**
Bonds	(Insight)	32.69	33.29	-0.60

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 8 to 10. This analysis shows that the market contribution had a positive effect of 26bps against the benchmark and stock selection was negative by 14bps.

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 six months to 30 September 2016 is summarised below.

	Market Value at 1 April 2015	Market Value at 30 September 2016	6 months to 30 September 2016	
	£000s	£000s	Performance %	Benchmark %
Barings	107,588	115,760	7.60	2.24

5.3 The return of 7.60% for the six months to 30 September 2016 was above the benchmark of 2.24% by 5.36%. The fund manager comments that their position in Japanese equities was a positive contributor to performance, whilst their holding in the FTSE100 was a mild positive due to its large proportion of multinational companies that benefitted from their overseas earnings. The return was ahead of both the performance compactor and global equities.

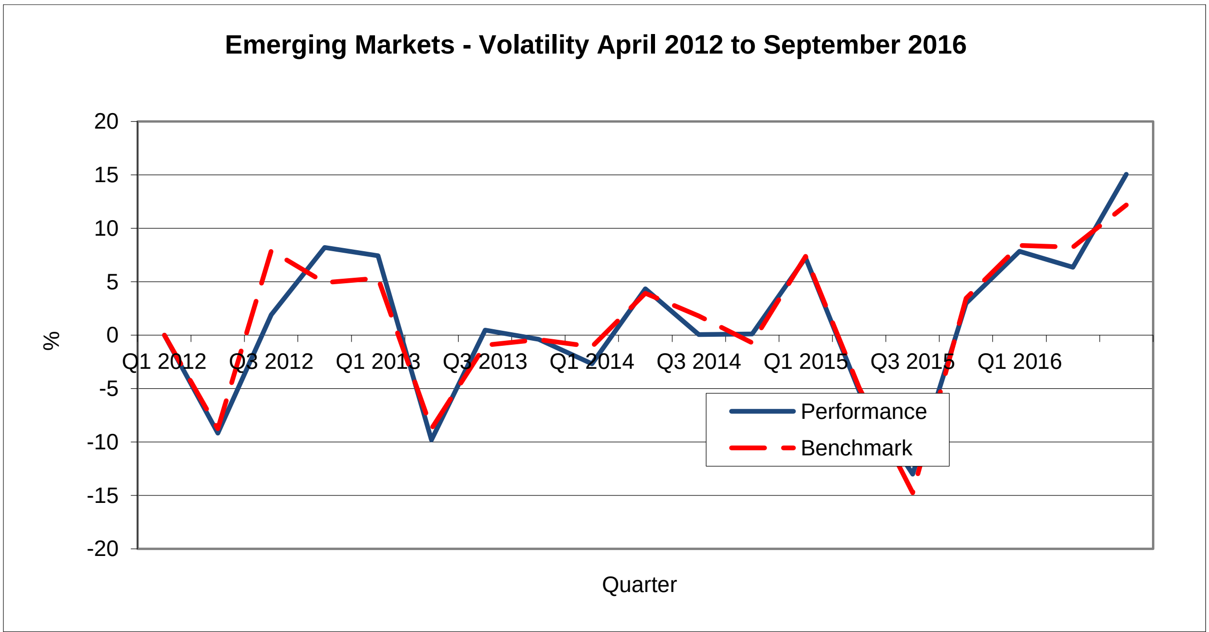
Emerging Market Equity

5.4 The performance of JP Morgan is summarised below.

	Market Value at 1 April 2016	Market Value at 30 September 2016	6 months to 30 September 2016	
	(£000's)	(£000's)	Performance %	Benchmark %
JPM	65,186	79,765	22.37	21.74

5.5 The return of 22.37% for the six months to 30 September 2016 was above the benchmark of 21.74% by 0.63%. The fund manager comments that the outperformance was driven by longstanding country and sector positions, and stock selection in India and Taiwan, most notably in the information technology and energy sectors. Stock selection in China has helped performance but this was offset by the overweight holdings in Turkey which was a major detractor from performance.

5.6 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

5.7 The Fund has committed to investing with HarbourVest 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 September 2016.

5.8 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 September 2016 and the total gains or losses, which includes the distribution plus the latest valuation.

Private Equity Commitments, Drawdowns and Valuations

Manager / Fund	Commitment	Drawn down	% of Commit-ment	Distribution	Valuation	Gain / (Loss)
	€m	€m		€m	€m	€m
HV Partnership V	12.000	11.400	95%	11.911	5.420	5.930
HV Direct V	3.000	2.880	96%	3.249	0.726	1.095
SL 2006	22.000	19.904	90%	18.796	7.849	6.741
SL 2008	17.000	14.454	85%	6.616	11.470	3.632
	$m	$m		$m	$m	$m
HV Venture VIII	15.200	14.820	98%	12.811	11.327	9.318
HV Buyout VIII	22.800	21.204	93%	20.272	12.383	11.451
HV Buyout IX	15.000	9.038	60%	2.186	8.905	2.054
HV Partnership VII (AIF)	20.000	5.750	29%	0.295	5.718	0.264
HV Venture IX	10.000	7.950	80%	1.865	8.804	2.718
SL SOF I	16.000	11.114	69%	3.549	11.492	3.927
SL SOF II	20.000	5.025	25%	1.984	6.257	3.216
Harbourvest Partners X AIF	10.000	0.500	5%	0.000	0.513	0.013
Harbourvest Partners X AIF	5.000	0.325	7%	0.000	0.301	-0.024
SL Capital SOF II FeederLP	20.000	8.394	42%	1.680	9.826	3.112

5.9 For the six months to 30 September 2016 total drawdowns have been £9.4M and total distributions £7.7M. In order to meet the target allocation, there is a requirement to keep committing to Private Equity funds, and officers are in regular discussions with HarbourVest and SL Capital to identify further opportunities.

5.10 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. Both managers are showing strong performance over both periods, which is pleasing. The difference between the two sets of performance is largely due to HarbourVest investing mainly in US dollars and Standard Life mainly in Euros.

Private Equity Overall Performance

	3 Years to 30 Sept 2016		5 Years to 30 Sept 2016	
Manager	Dorset	Benchmark	Dorset	Benchmark
	%	%	%	%
HarbourVest	20.86	6.58	17.20	11.04
Standard Life	11.29	6.58	11.49	11.04

6. Treasury Management

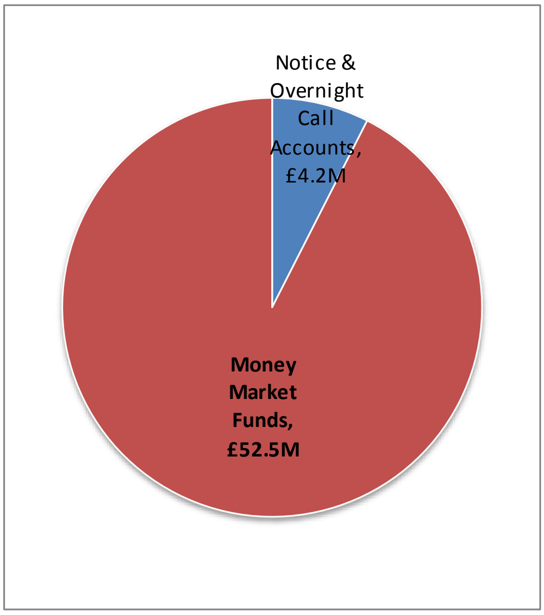
6.1 The Fund generates cash flows throughout the year which need to be managed. The Fund therefore holds a proportion of cash that is invested in call accounts, money market funds and fixed term deposits. A breakdown of the balances held internally as at 30 September 2016 is shown in the table below. Relatively small cash balances are also held in the custodian bank account at HSBC and in a property rent collection account where a float is required 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. For further details, please see the annual Treasury Management report on this agenda.

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 over the six months, which is ahead of the benchmark, as measured by the 7 day LIBID, at 0.25% for the same period. 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.

Lender/Borrower	**Amount £000s**	**Rate %**
Fixed Term Deposits		
Total Loans	-	-
Call Accounts		
National Westminster Bank	2,530	0.25%
Total Call Accounts	2,530	0.25%
Money Market Funds		
Standard Life	15,000	0.50%
BNP Paribas	15,000	0.52%
Federated Prime Rate	15,000	0.53%
Deutsche	7,500	0.36%
Total Money Market Funds	52,500	0.49%
Holding Accounts		
HSBC Custodian Account	876	0.00%
Property Client Account	840	0.00%
Total Holding Accounts	1,716	0.00%
Total Cash / Average Return	**56,746**	**0.47%**

Duration of Investments



7. Asset Allocation

7.1 At the meeting of the Committee in July, the Chief Treasury and Pensions Manager highlighted the possible demands on the Fund's cash over the remainder of the financial year, including further potential currency hedging payments, calls for additional collateral for the inflation hedging mandate and drawdowns of commitments to infrastructure investments. Options for meeting cash demands were agreed and implemented prior to the last meeting of the Committee in September. The Fund Administrator and the internal team will continue to monitor the cash-flow on an on-going basis, and will make further recommendations for change as and when the need arises.

8. LGPS Investment Reform and Pooling – Project Brunel

8.1 The Full Business Case for Project Brunel is close to completion and will need to be considered by the Pension Fund Committee before approval by Cabinet and Council. It is proposed that an Extraordinary Meeting of the Committee will be needed in January 2017.

8.2 The Chairman is attending a meeting of the Shadow Operations Board (SOB) 23 November 2016, and will be able to provide a verbal update to the Committee.

Richard Bates
Pension Fund Administrator
November 2016