



# **DORSET COUNTY PENSION FUND**

## **UK Equity Report for 6 months ending 30 September 2016**

- Internal Managers Report
- Valuation Report
- Transaction Report

## **Dorset County Pension Fund Committee – 24 November 2016**

### **UK Equity Report**

#### **Report of the Internal Manager**

#### **1. Purpose of the Report**

1.1 To review the management of the UK equity portfolio.

#### **2. Recommendations**

2.1 That the report and performance be noted.

#### **3. Background**

3.1 The UK Equity portfolio has two active managers, AXA Framlington and Schrodgers as well as the internally managed passive fund. This combination of managers and styles is designed to give the opportunity of outperformance against the FTSE All Share index and has a two thirds passive and one third active mix. Details of the combined portfolio (£660.2M at 30 September 2016) are shown in the table at paragraph 5.2.

3.2 The internally managed passive fund aims to track as closely as possible the FTSE 350 index which measures the progress of the majority of the UK equity market. At 30 September 2016, the FTSE All Share index was made up of 630 individual stocks ranging from Royal Dutch Shell Plc, the largest UK company (market value £157.6 Billion) down to the smallest in the index, Hansa Trust Plc (market value £35.0 Million). Direct investment is made in the largest 350 companies, which comprises 96.8% by value of the index. Investment in the smallest companies which make up 3.2% of the index is achieved by a holding in the Schrodgers Institutional UK Smaller Companies Fund which is managed on an active basis.

#### **4. Market Background**

4.1 There was good performance from the UK markets in the six months to September 2016. The FTSE100 was the best performing index rising 11.7% (724 points), whilst the FTSE250 was the worst performing major UK index rising 5.6% (945 points). In comparison, there was mixed performance from major world indices. The Hang Seng was the best performer rising 12.1% (2,521 points), whilst the Nikkei225 was the worst performer falling 1.8% (309 points).

4.2 Over the twelve month period, all major UK equity markets rose. The FTSE100 was the best performing index rising 13.8% (838 points), whilst the FTSE250 was the worst performing UK index rising 7.1% (1,188 points) over the same period. In comparison, there was mixed performance from major world indices. The Dow Jones rose 12.4% (2,024 points), whilst the Nikkei225 fell 5.4% (938 points) over the same period.

4.3 The FTSE100 ended September 2016 with a fourth monthly gain, and a seventh rise in the last eight months and is now 8.9% higher than its pre EU referendum level, aided by falls in the value of Sterling. In August 2016, the FTSE100 reached its highest closing position of 6,941.2 since March 2015. The biggest gains since the referendum have been made by gold miners, exporters with big dollar earnings and companies with stable incomes such as pharmaceutical groups, utilities and food and drink companies. The top risers in the FTSE100 since the referendum have been

Fresnillo (46.4%), Anglo American (39.3%) and Glencore (38.7%), all from the mining sector. The FTSE100 biggest fallers have been Capita (38.5%), easyjet (34.3%) and the Royal Bank of Scotland (28.6%).

- 4.4 The FTSE250 has risen 3.1% (538 points) since the EU Referendum. These companies are far more exposed to the domestic UK economy than those in the FTSE100. The largest rising stocks in the FTSE250 since the EU Referendum are Kaz Minerals plc (58%), Sophos Group Plc (48.9%) and Acacia Mining Plc (45.4%). Kaz Minerals plc and Acacia Mining are from the Mining Sector, whilst Sophos Group is from the Software and Computer Services Sector. In general, housebuilders, banks and airlines have been the biggest fallers since the referendum. The FTSE250 biggest fallers were Countrywide Plc (38.5%), Grafton Group Plc (30.1%) and McCarthy & Stone (29.8%). These were from the Real Estate, Support Services and Household Goods respectively. In the US, the Dow Jones has recouped all its losses after the EU Referendum and has risen by 1.6% (297 points) to the 30 September 2016.

Six Months to 30 September 2016

| Country   | Index                          | 31/03/2016 | 30/09/2016 | % Change |
|-----------|--------------------------------|------------|------------|----------|
| UK        | FTSE100                        | 6,174.9    | 6,899.3    | 11.7     |
| UK        | FTSE250                        | 16,926.1   | 17,871.4   | 5.6      |
| UK        | FTSE350                        | 3,445.4    | 3,812.4    | 10.7     |
| UK        | Small Cap                      | 4,542.8    | 4,974.9    | 9.5      |
| UK        | Small Cap ex Investment Trusts | 6,009.7    | 6,503.9    | 8.2      |
| UK        | All Share                      | 3,395.2    | 3,755.3    | 10.6     |
| Japan     | Nikkei225                      | 16,758.7   | 16,449.8   | -1.8     |
| US        | Dow Jones                      | 17,685.1   | 18,308.2   | 3.5      |
| Hong Kong | Hang Seng                      | 20,776.7   | 23,297.2   | 12.1     |
| France    | Cac 40                         | 4,385.1    | 4,448.3    | 1.4      |
| Germany   | Dax                            | 9,965.5    | 10,511.0   | 5.5      |
| China     | Shanghai Composite             | 3,003.9    | 3,004.7    | 0.0      |

Twelve Months to 30 September 2016

| Country   | Index                          | 30/09/2015 | 30/09/2016 | % Change |
|-----------|--------------------------------|------------|------------|----------|
| UK        | FTSE100                        | 6,061.6    | 6,899.3    | 13.8     |
| UK        | FTSE250                        | 16,683.0   | 17,871.4   | 7.1      |
| UK        | FTSE350                        | 3,384.7    | 3,812.4    | 12.6     |
| UK        | Small Cap                      | 4,482.8    | 4,974.9    | 11.0     |
| UK        | Small Cap ex Investment Trusts | 5,885.5    | 6,503.9    | 10.5     |
| UK        | All Share                      | 3,335.9    | 3,755.3    | 12.6     |
| Japan     | Nikkei225                      | 17,388.2   | 16,449.8   | -5.4     |
| US        | Dow Jones                      | 16,284.7   | 18,308.2   | 12.4     |
| Hong Kong | Hang Seng                      | 20,846.3   | 23,297.2   | 11.8     |
| France    | Cac 40                         | 4,455.3    | 4,448.3    | -0.2     |
| Germany   | Dax                            | 9,660.4    | 10,511.0   | 8.8      |
| China     | Shanghai Composite             | 3,052.8    | 3,004.7    | -1.6     |

5. **Performance**

- 5.1 The internally managed passive portfolio is modelled to track the index with a tolerance of +/-0.5% pa allowing for the costs of rebalancing. The figures shown below summarise the performance of this portfolio:

| <b>Period</b>           | <b>Dorset</b> | <b>Index</b> | <b>Relative</b> |
|-------------------------|---------------|--------------|-----------------|
|                         | <b>%</b>      | <b>%</b>     | <b>%</b>        |
| 3 months to 30/09/2016  | 8.15          | 7.63         | 0.52            |
| 6 months to 30/09/2016  | 13.59         | 12.90        | 0.69            |
| 12 months to 30/09/2016 | 17.14         | 16.88        | 0.26            |
| 3 years to 30/09/2016   | 6.67          | 6.51         | 0.16            |
| 5 years to 30/09/2016   | 11.10         | 10.93        | 0.17            |

The performance of the internally managed portfolio was outside the agreed tolerance for the quarter just ended and the financial year to date, but still within its tolerance for the 12 months, three years and five to date.

## 5.2 SIX MONTHS TO 30 SEPTEMBER 2016

|                 | <b>Market Values</b> |                   | <b>Performance</b> | <b>Benchmark</b> | <b>Benchmark</b>   |
|-----------------|----------------------|-------------------|--------------------|------------------|--------------------|
|                 | <b>31/03/2016</b>    | <b>30/06/2016</b> | <b>%</b>           | <b>%</b>         | <b>Description</b> |
|                 | <b>£M</b>            | <b>£M</b>         |                    |                  |                    |
| Internal        | 365.7                | 443.1             | 13.6               | 12.9             | FTSE 350           |
| AXA Framlington | 108.0                | 176.1             | 4.3                | 12.9             | All-Share          |
| Standard Life   | 71.9                 | 0.0               | -                  | -                | All-Share          |
| Schroders       | 38.6                 | 41.0              | 6.5                | 8.2              | Small Cap*         |
| <b>Total</b>    | <b>584.2</b>         | <b>660.2</b>      | <b>10.7</b>        | <b>12.1</b>      |                    |

\*FTSE Small Cap ex Investment Trusts

The figures for the whole UK equity portfolio show:

- The combined portfolio has underperformed its benchmark over the six month period by 1.4%.
- Both of the active UK managers underperformed their benchmarks with AXA Framlington underperforming by 8.6% and Schroders underperforming by 1.7%.

## THREE AND FIVE YEAR ANNUALISED PERFORMANCE

|                 | <b>Three Years</b> |                  | <b>Five Years</b>  |                  |
|-----------------|--------------------|------------------|--------------------|------------------|
|                 | <b>Performance</b> | <b>Benchmark</b> | <b>Performance</b> | <b>Benchmark</b> |
|                 | <b>%</b>           | <b>%</b>         | <b>%</b>           | <b>%</b>         |
| Internal        | 6.7                | 6.5              | 11.1               | 10.9             |
| AXA Framlington | 6.0                | 6.6              | 11.9               | 11.0             |
| Schroders       | 11.0               | 8.3              | 17.0               | 17.5             |

The figures for the whole UK equity portfolio show:

- Over both the three and five year period the Internally Managed Fund has outperformed its benchmarks by 0.2%, within its agreed tolerance.
- AXA Framlington underperformed their benchmark over the three year period by 0.6% but outperformed its benchmark by 0.9% over five years.
- Schroders outperformed its benchmark over three years by 2.7% but underperformed its benchmark by 0.5% over five years.

## 5.3

The table below shows how the three UK Equity manager's valuations have changed over the financial year to 30 September 2016.

## MARKET VALUE OVER SIX MONTHS TO 30 SEPTEMBER 2016

|                 | <u>Market Value</u> |                 | <u>% of Total UK Equity as at</u> |                 |
|-----------------|---------------------|-----------------|-----------------------------------|-----------------|
|                 | <u>31/03/16</u>     | <u>30/06/16</u> | <u>31/03/16</u>                   | <u>30/06/16</u> |
| <u>Manager</u>  | <u>£M</u>           | <u>£M</u>       | <u>%</u>                          | <u>%</u>        |
| Internal        | 365.7               | 443.1           | 62.6                              | 67.1            |
| AXA Framlington | 108.0               | 176.1           | 18.5                              | 26.7            |
| Standard Life   | 71.9                | 0.0             | 12.3                              | 0.0             |
| Schroders       | 38.6                | 41.0            | 6.6                               | 6.2             |
| <b>Total</b>    | <b>584.2</b>        | <b>660.2</b>    | <b>100.0</b>                      | <b>100.0</b>    |

5.4 Each external manager's commentary is summarised below:

### **AXA Framlington**

2nd Quarter 2016/17

#### Performance

During the second quarter, the fund returned 10.4/% against the FTSE All Share return of 7.8%. For the twelve months to date the Fund returned 8.4% against its benchmark of 16.8%. RPC, the largest holding in the portfolio, was the biggest contributor to relative performance, whilst Rightmove and Dixons Carphone rallied after the EU Referendum falls in the previous quarter. The best relative performing sector was Industrials, which includes Support Services. The biggest negative contributor to relative performance was Biotech BTG. They are struggling to get reimbursement in the USA for their varicose vein treatment. The worst relative performance sector was Financials, whilst Mining shares rallied, which was a negative as the Fund does not hold any.

#### Activity

There were no new holdings established in the quarter, but stocks added to were Breedon, Eco Animal Health and Ascential. The holding in Poundland was sold after the increased takeover bid from Steinhoff. The discount retailer B&M European Value Retail S.A. was sold down and profits taken in St. James Place, Paddy Power Betfair, Booker and BT.

#### Outlook and Strategy

The weakness of sterling continued to favour overseas earners. Fragile global economic growth is causing many companies to downgrade expectations, compounded by the EU referendum. Monetary tightening in the USA is now envisaged, although the outcome of the US Presidential election and some European elections may influence this. UK domestic stocks are still under pressure regarding the outlook for consumption during EU Referendum negotiations. However, after these sharp falls, many rallied in this quarter. US monetary tightening is now expected with the implications for bond yields. Continued anaemic global growth will lead to further lowering of earnings expectations next year.

### **Schroders**

2nd Quarter 2016/17

#### Performance and Market Summary

During the second quarter, the Fund returned 15.7% against the Small Cap benchmark of 12.8%. Over the twelve month period the Fund returned 8.5% against its benchmark of 10.5%. Over three years the Fund outperformed the benchmark by 2.6% but underperformed by 0.5% over the five year period. Strong positive contributions came from companies such as Blue prism, MJ Gleeson and Craneware who all delivered solid results. Taptica International continued on its recovery in what has proven to be a challenging 18 months for the ad tech space. Continuing scepticism about the ability of companies to deal with the impact of the EU Referendum saw domestic stocks such as Dart (travel agent and airline) and

Safestore (self storage centres) underperform. Majestic Wine had a profit warning following difficulties in its Naked Wines arm in the United States. Impatience with the operational progress of cosmetic operator Sinclair Pharma began to show itself in the share price. Carclo's pension deficit deteriorated significantly thanks to moving bond rates and was obliged to pass on its dividend for the foreseeable future.

#### Activity

New holdings were purchased in Tax Systems, Autins Group and Hollywood Bowl, whilst Blue Prism, Finsbury Food, Morses Club and Avon Rubber were added to. Complete sales of Wireless Group, Photo-Me, 4d Pharma and Redcentric happened in the quarter. Partial sales of Cape, Charles Stanley, Devro, Trifast and Ted Baker amongst others occurred in the quarter.

#### Outlook and Strategy

Emerging evidence of continued positive economic growth since the referendum has provided some support to the performance of domestic facing companies, particularly relative to the experience immediately after the result when the shares fell sharply. As noted already, investor optimism about the outlook for the domestic economy has softened, as investors anticipate a negative impact on consumer spending from what is expected to be a period of rising inflation. Reflecting this, the earlier strengthening in the performance of domestic facing companies has generally levelled off in recent weeks, particularly relative to the performance of the FTSE100. Companies are using the environment of low interest rates to make acquisitions to supplement organic growth. This is being well received by the market and it is a trend that is expected to continue. Seeking organic growth will continue, along with pricing power where possible and avoiding companies with too much debt because, in a deflationary environment, the latter can destroy the value of equity very quickly.

## 6 **Review of Activity**

6.1 The Internal managed portfolio had seven corporate actions in the six month period to 30 September 2016, of which the following were in the second quarter of the year:

- In July, Darty Plc was taken over by Groupe Fnac SA for £0.1M.
- In September, Arm Holdings Plc was taken over by Softbank Group Corp. for £5.0M.
- In September, Home Retail Group Plc was taken over by Sainsbury (J) Plc for £0.1M.

6.2

- In July, the UK Equity Internally Managed Passive Fund was rebalanced. The total value of purchases and sales were £11.1M with a net purchase of £1.9M. There were 27 purchases (£6.5M) and 106 sales (£4.6M).
- In August, due to cashflow reasons, the decision was made to redeem £10M from the UK Equity Internally Managed Passive Fund. The total value of purchases and sales were £10.3M with a net sale of £10.0M. There were 2 purchases (£0.2M) and 181 sales (£10.2M).

## 7 **Stock Lending**

7.1 Stock lending is managed in the UK on an agency basis by HSBC, and overseas on the same basis by Pictet.

7.2 Total overseas stock lending income for the year to 30 September 2016 is £20,185. Net income for UK stock lending was £83,290 over the same period, giving a total of £103,475.

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**November 2016**