Pension Fund Committee

Dorset County Council

Date of Meeting	24 November 2016
Officer	Pension Fund Administrator
Subject of Report	**Global Equities Managers Report**
Executive Summary	The purpose of this report is to update the Committee on the performance of the Fund's Global Equities Managers as at the end of the second quarter of the 2016/17 Financial Year to 30 September 2016.
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 performance of the Fund's Global Equities managers.
Reason for Recommendation	To ensure that the Fund has the appropriate management arrangements in place and are being monitored.
Appendices	None
Background Papers	Quarterly manager reports.
Report Originator and Contact	Name: David Wilkes Tel: 01305 224119 Email: d.wilkes@dorsetcc.gov.uk

1. Background

1.1 With effect from mid December 2015, the Fund replaced its then two global equities managers, Pictet Asset Management and Janus Intech, with three new managers, Allianz Global Investors, Investec Asset Management and Wellington Investment Management.

2. Valuation

2.1 The table below summarises the valuations for the three managers as at 1 April 2016 and 30 September 2016.

	Allianz	Investec	Wellington	Total
	£000s	£000s	£000s	£000s
Valuation 01-Apr-16	227,083	166,965	166,341	560,389
Investment	-	-	-	-
Distribution	(20,000)	(15,000)	(20,000)	(55,000)
Increase in Valuation	33,202	21,007	35,777	89,986
Valuation 30-Sep-16	240,285	172,972	182,118	595,375

2.2 No additional investment has been made with the three managers this financial year. At the last meeting of the Pension Fund Committee it was agreed to redeem £20M from Allianz, £20M from Investec, and £15M from Wellington. These redemptions have now been received in full.

3. Performance

3.1 The table below summarises the performance for each manager in absolute terms and compared to their respective benchmarks for the quarter, the financial year and since inception to 30 September 2016.

		Allianz	Investec	Wellington
Quarter				
	Performance	8.2%	8.8%	8.8%
	Benchmark	7.9%	7.9%	8.0%
	Relative	0.3%	0.9%	0.8%
Financial Year to Date				
	Performance	14.7%	16.2%	18.6%
	Benchmark	17.2%	17.2%	17.6%
	Relative	-2.5%	-1.0%	1.0%
Since Inception (Dec-2015)				
	Performance	18.6%	18.2%	21.9%
	Benchmark	19.8%	21.5%	23.8%
	Relative	-1.2%	-3.3%	-1.9%

3.2 All three managers have returned high absolute returns over the three periods measured. All three managers have exceeded their benchmarks over the quarter, but Wellington is the only manager to have exceeded its benchmark over the financial year to date. All three managers are below their benchmarks since inception (December 2015).

4. Market Review (from the Allianz report)

4.1 Global equities rallied over the quarter, recovering from a sharp sell-off at the end of June following the UK’s unexpected referendum result. Signs of improvement in China’s economy also supported share prices. The information technology sector led the advance, and the financials, materials, consumer discretionary and industrials sectors also posted meaningful gains. However, after robust returns in the first half of the year, more defensive sectors, such as consumer staples, telecommunication services and utilities, retreated as investors rotated into more cyclical stocks.

4.2 US equities rallied modestly over the quarter, with the S&P 500 Index touching new record highs, helped by better-than-forecast company earnings and generally supportive economic news. However, some weak economic data reports weighed on the market in September, as did an increasing focus on November’s presidential election.

4.3 European equities advanced over the quarter, as they continued to recover from their sharp sell-off in the wake of Brexit. Returns at a country level were mixed, with Germany posting robust gains while Denmark retreated. Japanese equities overcame disappointing economic news to deliver robust returns over the quarter, boosted by stimulus measures from both the government and the Bank of Japan. However, the strength of the yen continued to present headwinds, with surveys of manufacturing activity continuing to fall, while the purchasing managers’ index of service sector activity fell below 50 in August, also indicating a contraction.

4.4 Emerging market equities delivered robust returns over the quarter, with the MSCI Emerging Markets Index touching its highest level in over a year in September. All three regions gained, with Asia leading the advance, followed by Latin America and then Eastern Europe.

Manager Commentaries

5. Allianz

5.1 The mandate outperformed its benchmark by 30bps over the third quarter with broadly equal contributions from all investment styles. Portfolio construction and successful stock selection in Consumer Discretionary, Financials and IT contributed to outperformance.

5.2 The quarter turned out to be decisively ‘risk-on’ (that is, conditions where assets considered to be high risk tend to perform well), which helped higher ‘beta’ investment styles like value and small caps (that is, investments inherently more volatile than the market). The investment style ‘value’, Allianz’s most prominent investment style, outperformed the index strongly by 3.9%, making a significant contribution to the portfolio’s relative performance. This risk-on environment was detrimental for lower beta investment styles like high ‘quality’ and stable ‘growth’, and also for trend following investment styles like price ‘momentum’ or ‘earnings revisions’ that currently exhibit a lower beta profile. Performance of value and trend-following strategies in the quarter was essentially the opposite of the performance seen in the previous quarter ending 30 June 2016.

5.3 Trend following investment styles like price momentum strategies, earnings revisions strategies and stable growth strategies have struggled in the quarter, which whilst they detracted from performance did not offset the gains from investment style value, making this a positive quarter for the mandate.

5.4 2016 has been a challenging year for global style investors. This can be seen in the relative performance of global investment styles vs the MSCI Index, as well as in the returns of the MSCI factors themselves.

6. Investec

6.1 The portfolio generated positive absolute returns over the quarter, as well as beating its comparison index on the back of positive stock selection. Key positive sectors included the industrial, consumer staples and real estate sectors, while the healthcare, energy and telecommunication services sectors generally lagged behind. For the first time since the second quarter of 2015, the performance of Investec's 4Factors in the market proved to be a tailwind to portfolio performance, rather than a headwind. This was largely due to the abovementioned rebound in the Value factor over the quarter, to which the portfolio has a positive skew.

6.2 eBay was a top performer in the third quarter, as the company released a positive set of results that proved it could continue to grow its revenue and profitability. The semiconductor segment advanced on the back of positive demand from smartphones following the iPhone 7 launch, supporting the holding in NXP Semiconductor, a company further boosted by merger and acquisition rumours. Hewlett Packard benefited from on-going corporate restructuring, while German multi-national enterprise software giant SAP also advanced on the back of a solid earnings report. In contrast, not holding Amazon and an underweight position in Apple held back relative returns – Amazon reported positive earnings, while Apple's launch of the iPhone 7 was taken positively.

6.3 Industrial stocks rallied on the back of positive sentiment and a sharp recovery following the Brexit turmoil earlier in the quarter. Within the sector, Komatsu and Siemens added to returns. Siemens' share price rallied after it announced better-than-expected quarterly results following strong performance at its energy businesses. The company also raised its profit guidance.

6.4 The overweight position in HeidelbergCement rallied strongly throughout the quarter as it continued to divest underperforming divisions and was buoyed by positive market sentiment towards its takeover of Italian competitor Italcementi. Thor Industries, the world's largest manufacturer of recreational vehicles, advanced on the back of strong demand from younger buyers.

6.5 The overweight position in oil exploration and production company Hess Corporation was one of the largest single stock detractors on oil price volatility and squeezed margins, which resulted in lowered analyst ratings. However, not holding Exxon Mobil helped as the stock fell along with the wider sector. BT Group also weighed on returns, suffering from poor sentiment following Brexit and criticism over its Openreach division, which runs the UK's broadband infrastructure.

6.6 Pfizer and Teva Pharmaceutical both suffered on the back of pricing concerns in the US. Pfizer also stepped away from a potential breakup, which was taken negatively by the market. However, not holding Bristol-Myers Squibb in the sector helped support relative returns. US regional gas and electric utility Public Service Enterprise Group saw its stock suffer as the market rotated out of defensive utility stocks – the stock remains attractively priced as a result.

6. Wellington

7.1 During the quarter, the Global Research Equity portfolio outperformed the MSCI World Index. Stock selection within energy and industrials were the primary contributors to relative outperformance, while the portfolio's holdings in health care and utilities weighed on results.

7.2 In industrials, transportation companies helped drive portfolio returns for the quarter. XPO Logistics, a multiservice transportation and logistics company, reported record second quarter profit as its e-commerce business surged. As a result, the company saw a meaningful increase in its share price.

7.3 In industrials, transportation companies helped drive portfolio returns for the quarter. XPO Logistics, a multiservice transportation and logistics company, reported record second quarter profit as its e-commerce business surged. As a result, the company saw a meaningful increase in its share price.

7.4 The technology and hardware industry was another bright spot for the portfolio this quarter. Seagate Technology, a provider of electronic data storage, posted strong double digit returns as capacity growth showed signs of strengthening and a restructuring plan aimed at improving gross margins took hold. Arista Networks, a leader in software-driven cloud networking solutions for large data centres, was also a strong portfolio contributor. The company continues to gain market share and reported earnings ahead of Wall Street estimates.

7.5 In terms of detractors, security selection in health care, primarily within the pharmaceutical and biotech industry, continued to weigh on relative returns. Bristol-Myers Squibb, a US-based biopharmaceutical company, declined after releasing disappointing results from its clinical trial for Opdivo as a monotherapy for the treatment of first-line lung cancer. Despite short-term weakness, Wellington continue to believe the company's combination strategies and its pipeline of products will result in strong future growth.

7.6 Bristol-Myers Squibb's (BMY) disappointing clinical results negatively impacted another health care holding, Japan-based Ono Pharmaceutical, as Ono has regional rights to BMY's Opdivo drug. The company's share price was already under pressure after Japan's Health Ministry announced plans to update guidelines on the use of some expensive drugs in Japan, beginning with Ono's Opdivo.

Richard Bates
Pension Fund Administrator
November 2016