10(e)

Pension Fund Committee

Dorset County Council

Date of Meeting	1 March 2017
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 third quarter of the 2016/17 Financial Year to 31 December 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 31 December 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	52,938	32,194	48,063	133,195
Valuation 31-Dec-16	260,021	184,159	194,404	638,584

2.2 No additional investment has been made with the three managers this financial year. At the meeting of the Pension Fund Committee September 2016 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 31 December 2016.

	Allianz	Investec	Wellington
Quarter to Date			
Performance	7.4%	6.5%	6.6%
Benchmark	7.1%	7.1%	7.1%
Relative Return	0.3%	-0.6%	-0.5%
Financial Year to Date			
Performance	21.5%	23.4%	25.5%
Benchmark	25.5%	25.5%	25.5%
Relative Return	-4.0%	-2.1%	0.0%
12 Months to Date			
Performance	23.2%	23.8%	24.8%
Benchmark	28.2%	28.2%	28.2%
Relative Return	-5.0%	-4.4%	-3.4%

3.2 All three managers have returned very high absolute returns over the three periods measured but all three managers have significantly underperformed their benchmarks for the 12 months to 30 December 2016.

4. Market Review

4.1 Global equities climbed for the third consecutive quarter, as shares were buoyed by expectations that President-elect Trump would implement tax cuts, reduce regulatory restrictions and adopt a pro-growth policy stance. Many major developed market indices touched multi-month highs, while emerging market equities tended to retreat. The Financials sector led the advance, boosted by higher bond yields, while rising oil prices bolstered energy companies. Economic news in the US was positive. The final estimate of third-quarter GDP growth was revised up to an annualized rate of 3.5%, driven by higher-than-expected consumer spending. The unemployment rate fell to a nine-year low of 4.6% in November, while housing starts and consumer confidence reached nine-year highs.

4.2 European equities overcame rising political concerns to end the quarter near 11-month highs. The rally was partly driven by weakness in the euro, which helped to lift the outlook for the region's exporters.

4.4 Emerging market equities fell over the final quarter of 2016 amid fears of higher US interest rates and concerns over more protectionist policies in the US. However, returns at a regional level varied considerably: while emerging markets in Asia were among those with the weakest returns, Eastern European equities posted strong gains. Along with China, Indian shares were among those with the weakest returns over the quarter.

Manager Commentaries

5. Allianz

5.1 The pronounced strength of the investment style 'value' was offset by the weakness of the more defensive styles in the quarter.. Sector allocation added slightly to relative performance over the quarter with a positive contribution from the underweight in Real Estate and Consumer Staples and a small negative contribution from the underweight to Financials. Stock selection was most successful in Consumer Staples and Consumer Discretionary but was weaker in Health Care and Energy. Regional allocations resulted in a 1bp loss, however, stock selection within regions was successful with positive contributions from North America, Japan and the Eurozone. Stock selection within the UK and Pacific Basin ex Japan was negative this quarter.

5.2 2016 was a challenging year for Allianz's investment styles, and hence for the strategy, as four of their five key investment styles were lagging. However, the investment style 'value', their most prominent investment style, ended the year in positive territory.

6. Investec

6.1 The performance of Investec's Four Factors approach provided a tailwind for portfolio performance in the quarter, rather than a headwind. The Value Factor outperformed to such an extent that it became the best performing Factor across the year as a whole. The Earnings, Strategy and Technical Factors were negative in the fourth quarter, but overall Factor performance was positive due to the contribution from Value alone. While the portfolio is positively skewed towards Value stocks, Investec's process favours companies that score well on a number of different measures. This means the portfolio is more balanced, but missed out on some exposure to those 'deep value' companies that rallied so strongly in the second half of 2016. Additionally, stock selection had a negative overall impact on returns.

6.2 With the rotation into Financials (especially US banks) driving market returns over the quarter, much of the performance of the portfolio came down to which of these companies we did or did not own. The positions in Citigroup and Morgan Stanley were among the best per formers over the quarter, bolstered by the US election result, a rise in bond yields and the prospect of a potential rolling back of existing and slated regulation by president-elect Donald Trump. In contrast, the lack of exposure to Bank of America, JP Morgan Chase and Wells Fargo meant some of the gains witnessed across the US banking sector after the election result were missed.

6.3 Stocks within the Materials sector made a significant contribution to the performance of the portfolio over the period, thanks to good stock selection in the mining, chemicals and paper manufacturing industries. Within this sector, the holdings in Lundin Mining Corporation, Rio Tinto and UPM Kymmene Oyj all added to returns. Canadian mining group Lundin saw gains from an increase in metals production (ahead of levels previously announced) and the sale of an African copper mine for US$1.14 billion. Anglo-Australian miner Rio Tinto, meanwhile, performed well as it continued to streamline operations by divesting or closing low returning assets. Finnish paper manufacturer UPM rallied on earnings upgrades and a confirmation that it had exceeded operating profit forecasts.

6.4 Stock selection in healthcare equipment & services stocks boosted performance during the quarter, with the holding in United Health performing notably well as a result of its programme to manage costs and actively return capital to shareholders via buybacks and dividend growth. The potential repeal of Obamacare would also be supportive for health insurers.

6.5 The holding in Japanese telecoms group KDDI hurt returns, as the company saw sales revenue growth nudge downwards and it was chastised by the Japanese Communications Ministry, along with two of its rivals, for disguising higher service fees by discounting handsets. More broadly, telecoms and utilities firms have been negatively affected by developments in the bond market and by concerns of higher inflation.

6.6 Investec’s overweight in the software and services sector also hurt returns, with computer games group Activision Blizzard among the worst performers, after uninspired reviews for its latest products and evidence of declining volumes.

7. Wellington

7.1 During the quarter, the Global Research Equity portfolio underperformed the MSCI World Index. Stock selection within energy information technology, and consumer staples were the primary detractors from relative performance, while the portfolio’s holdings in financials and materials helped boost relative returns.

7.2 In contrast to last quarter where the oil and gas industry was a significant source of outperformance, this quarter saw a reversal with oil and gas representing the portfolio’s weakest industry on a relative basis. Underweight positions in several major oil and gas companies, such as Royal Dutch Shell and Chevron, weighed on portfolio results. In addition, the portfolio’s overweight to other US players including Newfield Exploration, Pioneer Natural Resources, and Rice Energy detracted from relative returns.

7.3 Information technology, particularly software and services companies, also proved to be challenging for the portfolio this quarter. Workday, a US-based record-keeping company with an integrated application system and cloud computing capability, delivered healthy quarterly results, but a handful of delayed deals due to post-election and Brexit uncertainties weighed on investor confidence. Wellington view this as a short-term hiccup for a company with strong subscription growth potential and solid cash flow margins, and took the opportunity to add to our position on weakness.

7.4 Consumer staples was another area of relative underperformance mainly due to our food and beverage holdings. Netherlands-based Unilever came under pressure owing to currency headwinds and a challenging economic environment in a number of its primary markets. More generally, we saw a rotation out of franchise stocks, considered safe and defensive, in favour of highly cyclical investment opportunities. Wellingotn view Unilever as an attractively valued food, home, and personal care company with strong growth prospects and compounding capabilities, and have added to our position on weakness.

7.5 Coty, a US-based beauty distributor, was also a detractor within consumer staples this quarter. The company reported soft results with weak organic sales growth and a tepid outlook. Coty has an attractive portfolio of assets, which was recently enhanced by the acquisition of Proctor & Gamble's beauty assets. Wellington expect the relatively new CEO and private equity investors, JAB, to drive organic growth by focusing on a handful of brands, categories, and geographies that offer the most promising opportunity going forward which should reward patient investors.

7.6 The materials sector was a notable contributor this quarter with chemical company Methanex serving as the primary driver of relative sector outperformance. Canada-based Methanex, the world's largest supplier of methanol (used as antifreeze, solvent, denaturant for ethanol, and biodiesel production), rallied on the back of rising methanol prices and limited new supply coming on. The company has a diverse network of production sites, which enables the company to deliver methanol cost effectively. In addition, Methanex is increasing its capacity after a period of heavy capex and is transitioning into a phase of strong free cash flow generation.

Richard Bates
Pension Fund Administrator
February 2017