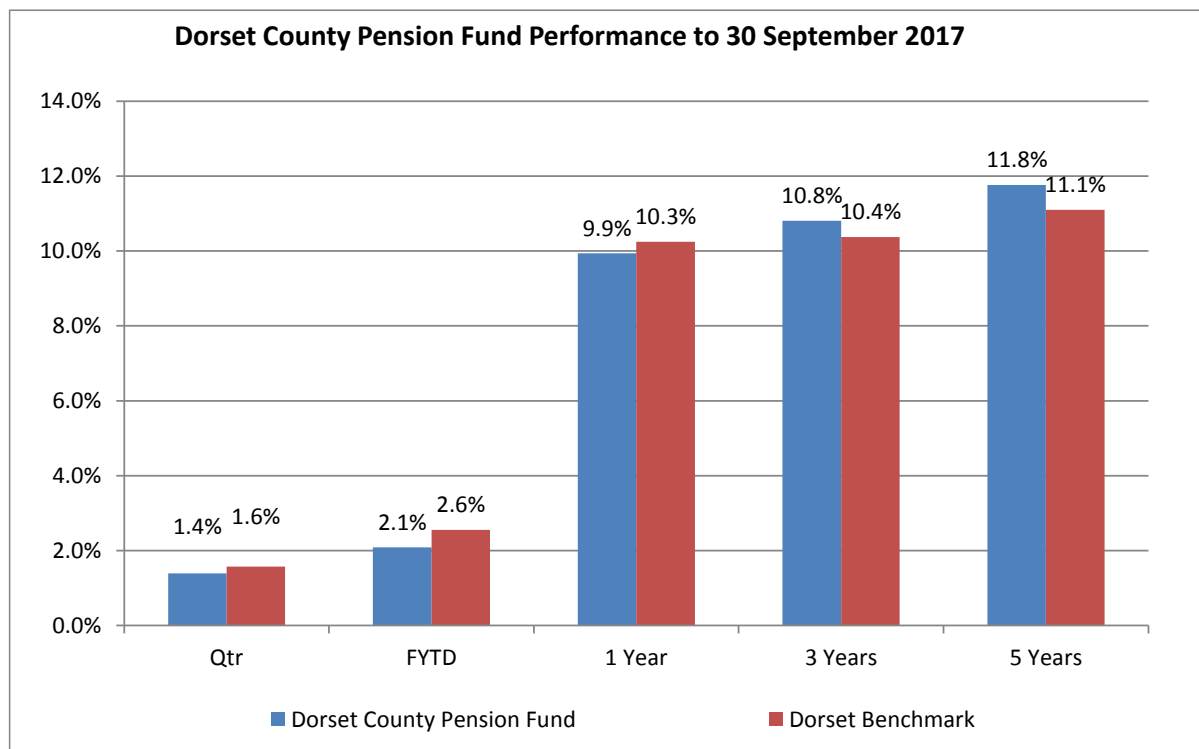


	<p>Risk Assessment: The Fund assesses the risks of its investments in detail, and considers them as part of the strategic allocation. In addition, risk analysis is provided alongside the quarterly performance monitoring when assessing and reviewing fund manager performance.</p>
	<p>Other Implications: None</p>
<p>Recommendation</p>	<p>That the Committee :</p> <ul style="list-style-type: none"> i) Review and comment upon the activity and overall performance of the Fund. ii) Note the progress in implementing the new strategic asset allocation.
<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: HSBC Manager Performance to 30 September 2017 Appendix 2: UK Equities Appendix 3: Global Equities Appendix 4: Corporate Bonds Appendix 5: Liability Driven Investment Appendix 6: New Money Forecast</p>
<p>Background Papers</p>	<p>HSBC Performance Statistics</p>
<p>Report Originator and Contact</p>	<p>Name: David Wilkes Tel: 01305 224119 Email: d.wilkes@dorsetcc.gov.uk</p>

1. Background / Summary

1.1 As at 30 September 2017, the value of the Fund’s assets was £2,820M, compared to £2,737M at 31 March 2017.

1.2 The overall performance of the Fund to 30 September 2017 is summarised below.



1.3 Key issues to note are:

Absolute and relative returns from Private Equity for the financial year to 30 September were adversely affected by the appreciation of sterling. All investments are held in US dollars and Euros but performance is measured against the FTSE All Share index, therefore currency movements can contribute to volatility in relative performance.

Similarly, absolute and relative returns from IFM, one of the Fund’s two Infrastructure managers, for the financial year to 30 September were adversely affected by the appreciation of sterling. The investments are held in US dollars but performance is measured against a 10% absolute return in sterling.

The value of the Fund’s liability hedging mandate with Insight has fallen by approximately £10M in the financial year to date (after allowing for a disinvestment of £20M). This indicates that the value of the Fund’s liabilities will also have fallen over that period.

The contractual documentation is close to finalisation with CQS, the Fund’s newly appointed Multi Asset Credit manager, and it is planned to be invested 1 December 2017. As well as meeting the target requirement of the new strategic asset allocation, this investment will also largely address the current issue of overly high cash balances held by the Fund.

In response to MiFID II, the majority of the Fund’s external investment managers have confirmed acceptance of the administering authority’s application to opt up to professional investor status.

2. Asset Valuation

2.1 The table below shows the Fund’s asset valuation by asset class at the beginning of the financial year and as at 30 September 2017, together with the target allocation as agreed at the last meeting of the Committee, 13 September 2017.

Asset Class	Manager	31-Mar-17		30-Sep-17		Target Allocation	
		£M	%	£M	%	£M	%
UK Equities	Several	694.7	25.4%	716.1	25.4%	564.0	20.0%
Overseas Equities	Several	671.8	24.5%	687.8	24.4%	620.4	22.0%
Emerging Markets Equities	JPM	91.2	3.3%	99.8	3.5%	84.6	3.0%
Corporate Bonds	RLAM	313.5	11.5%	318.6	11.3%	169.2	6.0%
Multi Asset Credit	CQS	-	0.0%	-	0.0%	141.0	5.0%
Diversified Growth	Barings	119.1	4.4%	123.9	4.4%	225.6	8.0%
Infrastructure	Several	98.0	3.6%	103.3	3.7%	141.0	5.0%
Private Equity	Several	77.0	2.8%	73.7	2.6%	141.0	5.0%
Property	CBRE	241.1	8.8%	266.3	9.4%	338.4	12.0%
Absolute Return Funds	Several	0.4	0.0%	-	0.0%	-	0.0%
Cash	Internal	30.3	1.1%	60.6	2.1%	-	0.0%
Total Return Seeking Assets		2,337.1	85.4%	2,450.1	86.9%	1,156.2	86.0%
Liability Matching Assets	Insight	399.8	14.6%	369.9	13.1%	394.8	14.0%
Total Asset Valuation		2,736.9	100.0%	2,820.0	100.0%	1,551.0	100.0%

3. Overall Fund Performance

3.1 The Fund returned 2.1% for the financial year to 30 September 2017, an under-performance of the benchmark return of 2.6% by 0.5%. Over the longer term, the Fund under-performed its benchmark over 1 year, returning 10.0% against the benchmark return of 10.2%, and out-performed over 3 years, returning an annualised 10.8% against the benchmark of 10.4%, and over 5 years, returning an annualised 11.8% against the benchmark of 11.1%.

3.2 When considering overall performance it is important to distinguish between ‘return seeking’ and ‘liability matching’ assets. The Fund holds a proportion of its assets in an inflation hedging strategy, managed by Insight Investments which are not held to add growth, but to match the movements in the Fund’s liabilities.

3.3 For the financial year to 30 September 2017, return seeking assets returned 2.85% against the benchmark return of 3.23%, and liability matching assets returned -2.83% against the benchmark return of -2.74%. The liability matching strategy is intended to hedge against the impact of increasing pensions liabilities which are linked to the Consumer Prices Index (CPI). CPI cannot currently be hedged as there is not a sufficiently developed futures market, so the Fund’s strategy targets the Retail Prices Index (RPI) swaps market to act as a proxy for CPI which tends to be lower than RPI.

3.4 The table below shows the overall performance of the Fund by asset class, making the distinction between return seeking and liability matching assets.

Asset Category	Manager	6 Months to 30 September 2017		
		Dorset %	Benchmark %	Over/(Under) %
Overall Fund Performance	All	2.09	2.55	-0.46
Total Return Seeking Assets	Various	2.85	3.23	-0.38
UK Equities	(Various)	4.74	3.66	1.08
Overseas Equities	(Various)	3.61	3.19	0.42
Bonds	(RLAM)	1.57	0.67	0.90
Property	(CBRE)	5.44	4.87	0.57
Private Equity	(Various)	-0.37	3.58	-3.95
Diversified Growth	(Barings)	4.05	2.14	1.91
Infrastructure	(Various)	1.60	4.88	-3.28
Total Liability Matching Assets		-2.83	-2.74	-0.09
Liability Driven Investment	(Insight)	-2.83	-2.74	-0.09

- 3.5 There are two main drivers of performance - the asset allocation (market contribution) of the Fund and within those allocations the stock selection (selection contribution) choices that have been made. Market contribution reflects the effect of decisions to change the weighting of the different asset classes within the Fund, and selection contribution is a measure of an investment manager’s ability to outperform their benchmark. Appendix 1, the HSBC performance report, includes an attribution analysis of the performance for the financial year to date.

4. Performance by Asset Class

UK Listed Equities

- 4.1 The performance of the Fund’s internally managed UK equities passive portfolio and its two external managers is detailed in Appendix 2, and summarised below.

FINANCIAL YEAR TO 30 SEPTEMBER 2017

	Market Values		Performance	Benchmark	Benchmark Description
	31/03/2017	30/09/2017	%	%	
	£M	£M			
Internal	461.7	466.3	3.9	3.5	FTSE 350
AXA Framlington	185.4	196.1	5.7	3.6	All-Share
Schroders	47.6	53.7	13.1	6.4	Small Cap*
Total	694.7	716.1	5.1	3.2	

*FTSE Small Cap ex Investment Trusts

THREE AND FIVE YEAR ANNUALISED PERFORMANCE

	Three Years		Five Years	
	Performance %	Benchmark %	Performance %	Benchmark %
Internal	8.6	8.4	10.0	9.9
AXA Framlington	7.4	8.5	10.1	10.0
Schroders	18.7	12.4	19.2	16.8

- 4.2 Both the Fund’s external managers have strongly outperformed their benchmarks this financial year to date, particularly Schroders, and over the longer term AXA

appear to be recovering lost ground from last year. The performance of the internally managed passive portfolio is within the tolerance of +/-0.5% against the benchmark.

Global Equities

- 4.4 The performance of the Fund’s three external global equities managers is detailed in Appendix 3, and summarised in the table below.

	Allianz	Investec	Wellington
Quarter to Date			
Performance	3.3%	1.6%	1.1%
Benchmark	1.5%	1.5%	1.5%
Relative Return	1.8%	0.1%	-0.4%
Six Months to Date			
Performance	3.1%	2.1%	1.3%
Benchmark	1.7%	1.7%	1.7%
Relative Return	1.4%	0.4%	-0.4%
Twelve Months to Date			
Performance	16.1%	14.5%	14.4%
Benchmark	14.4%	14.4%	14.4%
Relative Return	1.7%	0.1%	0.0%
Since Inception			
Performance	20.1%	18.9%	19.8%
Benchmark	19.0%	19.0%	19.0%
Relative Return	1.1%	-0.1%	0.8%

- 4.5 It has been a good quarter for Allianz, relatively flat for Investec with Wellington below benchmark by 0.4%. Over the longer term all three managers have recorded very high absolute returns largely driven by the depreciation of sterling following the result of the EU referendum, with Allianz and Wellington now above their benchmark since inception December 2015 and Investec still marginally down.

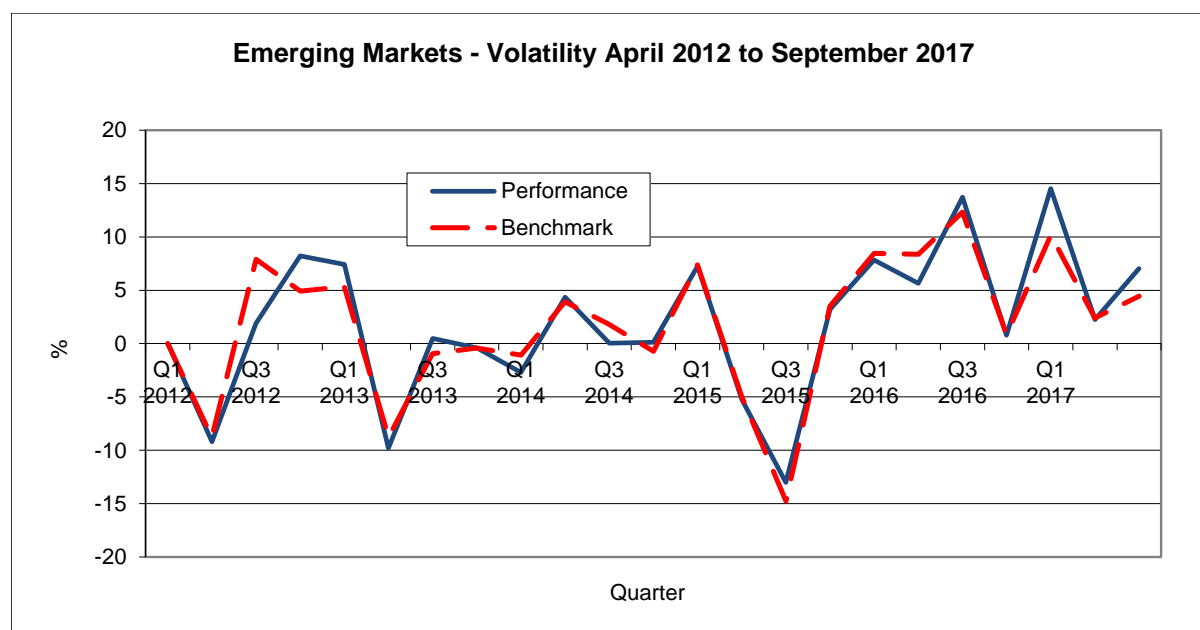
Emerging Markets Equities

- 4.6 The performance of JP Morgan for the six months to 30 September 2017 is summarised below.

	Market Value	Market Value	6 months to 30 September 2017	
	01-Apr-17	30-Sept-17	Performance	Benchmark
	(£000's)	(£000's)	%	%
JPM	91,232	99,846	9.44	6.86

- 4.7 The return of 9.4% for the six months to 30 September 2017 was above the benchmark of 6.9% by 2.6%. The fund manager comments that Brazilian exposure has contributed to performance. The domestic Brazilian stocks, education provider Kroton and banks Itau and Banco do Brazil were top contributors due to the strong recovery in earnings and improved economic growth outlook. Within the IT sector component manufacturers delivered the strongest returns over the quarter, albeit they were weaker in September as demand for the iPhone 8 were lower than expected as consumers wait for the iPhone X.

4.8 Emerging market equities are believed to be one of the most likely asset classes to offer the most growth over the medium term, but 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.



Corporate Bonds

4.9 The performance of the Fund’s external Corporate Bonds manager, RLAM, is detailed in Appendix 4, and summarised below.

	Performance	Benchmark	Relative
Quarter	0.47%	0.07%	0.40%
Financial Year to Date	1.57%	0.67%	0.90%
12 months	1.75%	-0.79%	2.54%
3 years p.a.	7.88%	7.25%	0.63%
5 years p.a.	8.09%	6.75%	1.34%
Since inception p.a.	9.12%	9.19%	-0.07%

4.10 The key drivers of performance in the quarter were the bias towards financials, and subordinated bonds in particular, and the underweight allocation in supranationals, along with stock selection within secured and structured sectors.

Property

4.11 There is a separate report on the agenda for this meeting providing detail on the performance of the Fund’s property manager, CBRE, but for future meetings their report will appended to the Fund Administrator’s report. CBRE’s performance is summarised in the table below:

	Performance	Benchmark	Relative
Quarter	2.20%	2.50%	-0.30%
Financial Year to Date	5.44%	4.87%	0.57%
12 months	9.20%	9.60%	-0.40%
3 years p.a.	9.90%	9.40%	0.50%
5 years p.a.	11.70%	10.70%	1.00%
Since inception p.a.	7.92%	7.81%	0.11%

Private Equity

4.12 The Fund has committed to investing with HarbourVest and Standard Life in their Private Equity ‘fund of funds’. Private Equity is a long term investment and as such the performance should be considered over the longer term. Additionally, as the benchmark used for this fund is the FTSE All Share index and the investments are held in US dollars and Euros, currency movements can contribute to volatility in relative performance.

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

Private Equity Overall Performance

Manager	3 Years to 30 Sept 2017		5 Years to 30 Sept 2017	
	Dorset %	Benchmark %	Dorset %	Benchmark %
HarbourVest	19.53	8.51	19.51	10.02
Standard Life	8.94	8.51	10.67	10.02

4.13 Private Equity is an asset class that takes several years for commitments to be fully invested. The table below shows the commitment the Fund has made to each fund in Euros and US Dollars, the drawdowns that have taken place to date and the percentage of the total drawdown against the Fund’s commitment. It also shows the distributions that have been returned to the Fund, the valuation as at 30 September 2017 and the total gains or losses, which includes the distribution plus the latest valuation.

Private Equity Commitments, Drawdowns and Valuations

<u>Manager / Fund</u>	<u>Commitment</u>	<u>Drawdown</u>	<u>% of</u> <u>Commitment</u>	<u>Distribution</u>	<u>Valuation</u>	<u>Gain /</u> <u>(Loss)</u>
	<u>€m</u>	<u>€m</u>		<u>€m</u>	<u>€m</u>	<u>€m</u>
HV Partnership V	12.000	11.400	95%	13.941	3.912	6.454
HV Direct V	3.000	2.880	96%	3.747	0.348	1.215
HarbourVest Total €m	15.000	14.280	95%	17.689	4.260	7.669
SL 2006	22.000	20.082	91%	21.649	6.093	7.660
SL 2008	17.000	15.296	90%	9.804	11.363	5.871
Standard Life Total €m	39.000	35.378	91%	31.453	17.456	13.531
Overall Total €m	54.000	49.658	92%	49.142	21.716	21.200
	<u>\$m</u>	<u>\$m</u>		<u>\$m</u>	<u>\$m</u>	<u>\$m</u>
HV Venture VIII	15.200	14.896	98%	14.719	10.461	10.284
HV Buyout VIII	22.800	21.546	95%	24.035	10.947	13.437
HV Buyout IX	15.000	9.488	63%	4.169	9.221	3.902
HV Partnership VII (AIF)	20.000	8.500	43%	0.781	9.189	1.470
HV Venture IX	10.000	8.500	85%	3.025	8.927	3.452
Harbourvest Partners X AIF	10.000	1.050	11%	0.081	1.249	0.279
Harbourvest Partners X AIF	5.000	0.763	15%	0.038	0.850	0.125
HarbourVest Total \$m	98.000	64.742	66%	46.847	50.844	32.949
SL SOF I	16.000	10.775	67%	6.548	10.853	6.627
SL SOF II	20.000	8.406	42%	4.285	10.806	6.685
SL SOF III	20.000	0.677	3%	0.000	0.661	-0.016
Standard Life Total \$m	56.000	19.857	35%	10.833	22.320	13.296
Overall Total \$m	154.000	84.599	55%	57.680	73.164	46.245

- 4.14 For the six months to 30 September 2017 total drawdowns have been £3.8M and total distributions £11.2M. 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.

Diversified Growth Funds (DGF)

- 4.15 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.
- 4.16 The performance for Barings for the six months to 30 September 2017 is summarised below.

	Market Value	Market Value	6 months to 30 September 2017	
	01-Apr-17	30-Sept-17	Performance %	Benchmark %
	£000s	£000s		
Barings	119,069	123,893	4.05	2.14

- 4.17 There is a separate report from Barings on this agenda.

Infrastructure

- 4.18 The Fund has two external infrastructure managers, Hermes and IFM. As with Private Equity, Infrastructure is a long term investment that takes several years for commitments to be fully invested. Performance is summarised in the table below:

	Hermes	IFM
Quarter to Date		
Performance	2.1%	0.0%
Benchmark	2.4%	2.4%
Relative Return	-0.4%	-2.4%
Six Months to Date		
Performance	3.0%	0.9%
Benchmark	4.9%	4.9%
Relative Return	-1.9%	-4.0%
Twelve Months to Date		
Performance	8.1%	10.6%
Benchmark	10.0%	10.0%
Relative Return	-1.9%	0.6%
Since Inception		
Performance	8.1%	9.4%
Benchmark	8.8%	8.3%
Relative Return	-0.8%	1.1%

- 4.19 For the Fund’s investments with Hermes, Associated British Ports has performed in line with expectations, but the management team remain cautious on the outlook for the rest of the year in light of continued political uncertainty generally, particularly in relation to the ongoing negotiations on the terms of the UK’s exit from the EU.
- 4.20 Eurostar increased passenger numbers and corresponding revenues in comparison with the same period in 2016. However, there was a noticeable decline in ticket sales following the recent terrorist events in London and Manchester and management continue to closely monitor customer reaction to such shocks.
- 4.21 Following the acquisition of an equity interest in Cadent Gasin March 2017, an important milestone in the execution of the work program set out at acquisition was achieved with the appointment of Sir Adrian Montague, as independent chairman, to the board. Cadent Gas has traded in line with expectations since acquisition.
- 4.22 For IFM, the key contributors to fund performance in the quarter were Freeport Train 2, M6 toll and Manchester Airports Group. During the quarter, all outstanding shares of VTTI Energy Partners LP were acquired, as were 28.34% of the outstanding shares of OHL Mexico SAB de CV.
- 4.23 Absolute and relative returns from IFM for the financial year to 30 September were adversely affected by the appreciation of sterling. The investments are held in US dollars but performance is measured against a 10% absolute return in sterling, therefore currency movements can contribute to volatility in relative performance.

Liability Driven Investment (LDI)

- 4.23 The performance of the Fund’s external LDI manager, Insight, is detailed in Appendix 5. As set out in the table below the value of the assets has fallen by approximately

£10M over the financial year to date, however this means that the value of the Fund’s liabilities will also have fallen.

	£000s
Valuation 01-Apr-17	399,793
Investment	0
Disinvestment	-20,000
Increase / (Decrease) in Valuation	-9,917
Valuation 30-Sep-17	369,876

- 4.24 Performance in the quarter to 30 September 2017 was driven by a slight fall in cost of inflation protection through swaps combined with slightly higher gilt and interest rate swap yields. The 20 year RPI swap rate ended the quarter at 3.52% and the 20 year yield on index-linked gilts was at -1.52%.

5. Cash and Treasury Management

- 5.1 The Fund currently receives more money in contributions and investment income than it pays out as pensions and retirement grants. It is estimated that there will be a surplus of income over expenditure from these cash flows of approximately £20M in the 2017/18 financial year. The outturn cash-flows for 2016/17 and the anticipated cash flows for 2017/18 along with the historic trends are shown in Appendix 6.
- 5.2 The table below summarises the main cash flows for the Fund for the financial year to date.

Statement of cash-flow for the six months ended 30 September 2017

	<u>£M</u>	<u>£M</u>
Cash at 1 April 2017		30.3
Less:		
Infrastructure Drawdowns (net)	3.7	
UK Equity transactions (net)	0.2	
Property Transactions (net)	17.7	
		<u>21.6</u>
Plus:		
Private Equity (net)	7.4	
Liability Matching Bond (net)	20.0	
Currency Hedge (net)	15.9	
Hedge Funds (net)	0.4	
Increase in Cash	8.2	
		<u>51.9</u>
Cash at 30 September 2017		<u>60.6</u>

- 5.3 The cash flow above summarises the most significant transactions that have taken place for the financial year to 30 September 2017. Since the end of September, the most significant transaction has been the receipt of a Hermes Distribution for £2.6M leaving cash balances of approximately £62.2M at the 30 October 2017.
- 5.4 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 2017 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.

	Amount £000s	Rate %
<u>Call Accounts</u>		
National Westminster Bank	1,385	0.01%
Total Call Accounts	<u>1,385</u>	<u>0.01%</u>
<u>Money Market Funds</u>		
Standard Life	15,000	0.22%
BNP Paribas	15,000	0.23%
Federated Prime Rate	14,400	0.21%
Deutsche	11,300	0.20%
Total Money Market Funds	<u>55,700</u>	<u>0.22%</u>
<u>Holding Accounts</u>		
HSBC Custodian Account	1,477	0.00%
Property Client Account	2,013	0.00%
Total Holding Accounts	<u>3,490</u>	<u>0.00%</u>
Total Cash / Average Return	<u>60,575</u>	<u>0.20%</u>

- 5.5 It is intended to partly fund the investment with CQS, the Fund’s new Multi Asset Credit manager by significantly reducing cash balances. Officers are also looking at options to supplement the use of overnight money market funds with holdings that offer better returns without significantly higher risk or reduced liquidity.

6. Markets in Financial Instruments Directive (MiFID) II

- 6.1 Under the current UK regime, local authorities are automatically categorised as ‘per se professional’ clients in respect of non-MiFID scope business and are categorised as ‘per se professional’ clients for MiFID scope business if they satisfy the MiFID large undertakings test or if they fulfil certain ‘opt-up criteria’. Dorset County Council, as administering authority for the Fund, is currently categorised as a ‘per se professional’ client by all our investment managers and other relevant financial institutions.
- 6.2 Following the introduction of the Markets in Financial Instrument Directive 2014/65 (“MiFID II”) from 3 January 2018, financial institutions will no longer be able to categorise a local authority as a ‘per se professional client’. Instead, all local authorities must be classified as ‘retail clients’ unless they are opted up by each institution to ‘elective professional client’ status.
- 6.3 At the last meeting of the Committee it was resolved that officers apply for the administering authority to opt up from retail client to elected professional status with all relevant institutions. At the time of writing the majority of the Fund’s external investment managers have confirmed acceptance of this application with only three still to confirm.

7. Implementation of changes to Strategic Asset Allocation

- 7.1 At its last meeting 13 September 2017, the Committee considered a report on the review of the strategic asset allocation of the Fund following the results of the latest triennial actuarial valuation, and agreed a number of changes.
- 7.2 It was agreed that the new 5% allocation to Multi Asset Credit be reached as soon as possible, and noted that CQS had been appointed as the preferred provider following a manager selection process. At the time of writing the contractual agreements with CQS are close to finalisation, and it is planned that that the investment will be made on 1 December 2017, funded from existing cash balances and partial disinvestment from the corporate bonds mandate with RLAM.
- 7.3 The increased allocations to infrastructure, private equity and property will be achieved if and when suitable opportunities arise with existing managers. Any such increases will be funded firstly from any excess proceeds from the disinvestment from corporate bonds, and secondly from the disposal of UK equities from the internally managed portfolio.
- 7.4 For all other asset classes, where the current allocation is different to the new target, the target will be achieved through allocation to the appropriate Brunel portfolio as and when these become available from April 2018 onwards.

Richard Bates
Pension Fund Administrator
November 2017