

Pension Fund Committee

Dorset County Council



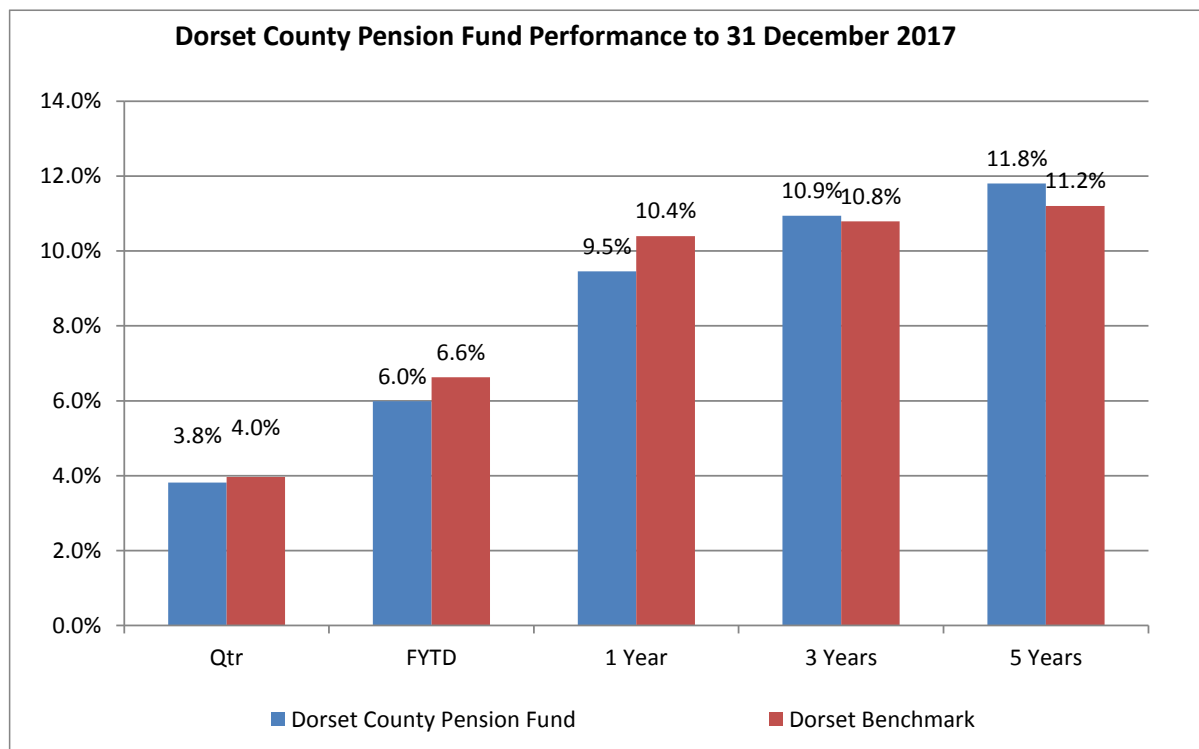
Date of Meeting	28 February 2018
Officer	Pension Fund Administrator
Subject of Report	Fund Administrator’s Report
Executive Summary	<p>The purpose of this report is to update the Committee on the valuation of the assets and overall performance of the Fund as at 31 December 2017. The report also provides a summary of the performance of all internal and external investment managers who are not considered elsewhere on the agenda and addresses other topical issues for the Fund that do not require a separate report.</p> <p>The value of the Fund’s assets at the end of the quarter was £2,926.5M compared to £2,737M at the start of the financial year.</p> <p>The Fund returned 6.0% over the financial year to 31 December 2017, underperforming its benchmark which returned 6.6%. Return seeking assets returned 6.8%, whilst the liability matching assets returned 1.0%.</p>
Impact Assessment:	<p>Equalities Impact Assessment:</p> <p>N/A</p>
	<p>Use of Evidence:</p> <p>N/A</p>
	<p>Budget:</p> <p>N/A</p>

	<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. iii) Approve the revised Investment Strategy Statement (ISS) March 2018.
<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 31 December 2017 Appendix 2: UK Equities Appendix 3: Global Equities Appendix 4: Corporate Bonds - RLAM Appendix 5: Property - CBRE Appendix 6: Liability Driven Investment - Insight Appendix 7: New Money Forecast Appendix 8: Investment Strategy Statement March 2018</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 31 December 2017, the value of the Fund’s assets was £2,926.5M, compared to £2,737M at 31 March 2017.

1.2 The overall performance of the Fund to 31 December 2017 is summarised below.



1.3 Key issues to note are:

Absolute and relative returns from Private Equity for the financial year to 31 December 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 31 December 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 new 5% allocation to Multi Asset Credit manager CQS was achieved in full with an investment of £135M on 1 December 2017, funded from a partial disinvestment from the corporate bonds mandate with RLAM (£120M) and existing cash balances (£15M).

The increased allocation to Diversified Growth Funds (DGF) has been met in part by investing a further £50M in the Baring Dynamic Asset Allocation Fund in February funded by partial disinvestment from the internally managed UK equities portfolio.

The Investment Strategy Statement (ISS) has been updated to reflect the changes to the Fund’s asset allocation agreed by the Committee at its meeting 13 September 2017 (see Appendix 8).

In response to the requirements of MiFID II, the Fund had been successfully ‘opted up’ to professional investor status with all of the Fund’s external investment managers and key advisers by the 3 January 2018 deadline.

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 31 December 2017, together with the target allocation as agreed at the meeting of the Committee, 13 September 2017.

<u>Asset Class</u>	<u>Manager</u>	<u>31-Mar-17</u>		<u>31-Dec-17</u>		<u>Target Allocation</u>	
		<u>£M</u>	<u>%</u>	<u>£M</u>	<u>%</u>	<u>£M</u>	<u>%</u>
UK Equities	Several	694.7	25.4%	744.9	25.5%	585.3	20.0%
Overseas Equities	Several	671.8	24.5%	721.2	24.6%	643.8	22.0%
Emerging Markets Equities	JPM	91.2	3.3%	105.7	3.6%	87.8	3.0%
Corporate Bonds	RLAM	313.5	11.5%	206.7	7.1%	175.6	6.0%
Multi Asset Credit	CQS	-	0.0%	135.3	4.6%	146.3	5.0%
Diversified Growth	Barings	119.1	4.4%	126.3	4.3%	234.1	8.0%
Infrastructure	Several	98.0	3.6%	103.7	3.5%	146.3	5.0%
Private Equity	Several	77.0	2.8%	76.1	2.6%	146.3	5.0%
Property	CBRE	241.1	8.8%	277.1	9.5%	351.2	12.0%
Absolute Return Funds	Several	0.4	0.0%	-	0.0%	-	0.0%
Cash	Internal	30.3	1.1%	45.3	1.5%	-	0.0%
Total Return Seeking Assets		2,337.1	85.4%	2,542.3	86.9%	2,516.8	86.0%
Liability Matching Assets	Insight	399.8	14.6%	384.2	13.1%	409.7	14.0%
Total Asset Valuation		2,736.9	100.0%	2,926.5	100.0%	2,926.5	100.0%

3. Overall Fund Performance

- 3.1 The Fund returned 6.0% for the financial year to 31 December 2017, an under-performance of the benchmark return of 6.6% by 0.6%. Over the longer term, the Fund under-performed its benchmark over 1 year, returning 9.5% against the benchmark return of 10.4%, and out-performed over 3 years, returning an annualised 10.9% against the benchmark of 10.8%, and over 5 years, returning an annualised 11.8% against the benchmark of 11.2%.
- 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 31 December 2017, return seeking assets returned 6.76% against the benchmark return of 7.34%, and liability matching assets returned 0.95% against the benchmark return of 1.04%. 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	9 Months to 31 December 2017		
		Dorset %	Benchmark %	Over/(Under) %
Overall Fund Performance	All	5.99	6.63	-0.64
Total Return Seeking Assets	Various	6.76	7.34	-0.58
UK Equities	(Various)	8.80	8.70	0.10
Overseas Equities	(Various)	8.78	8.19	0.59
Bonds	(RLAM)	4.89	3.10	1.79
Property	(CBRE)	8.50	7.89	0.61
Private Equity	(Various)	2.36	8.72	-6.36
Diversified Growth	(Barings)	6.07	3.28	2.79
Infrastructure	(Various)	4.91	7.41	-2.50
Total Liability Matching Assets		0.95	1.04	-0.09
Liability Driven Investment	(Insight)	-2.83	-2.74	-0.09

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 31 December 2017

	Market Values £M		Performance	Benchmark	Benchmark Description
	31/03/2017	31/12/2017			
Internal	461.7	485.7	8.99%	8.63%	FTSE 350
AXA Framlington	185.4	201.9	8.80%	8.72%	All-Share
Schroders	47.6	57.3	20.76%	9.28%	Small Cap*
Total	694.7	744.9	9.84%	7.99%	

Three And Five Year Annualised Performance

	Three Years		Five Years	
	Performance	Benchmark	Performance	Benchmark
Internal	10.0%	9.9%	10.3%	10.1%
AXA Framlington	7.9%	10.1%	10.5%	10.3%
Schroders	21.3%	13.7%	19.8%	15.5%

- 4.2 Of the Fund’s external managers, Schroders have strongly outperformed their benchmark for the financial year to date, whereas AXA have only marginally outperformed theirs. The performance of the internally managed passive portfolio is within the tolerance of +/-0.5% against the benchmark.

Global Equities

- 4.3 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	4.6%	5.5%	4.6%
Benchmark	4.6%	4.6%	4.6%
Relative Return	0.0%	0.9%	0.0%
Financial Year to Date			
Performance	7.8%	7.7%	6.0%
Benchmark	6.4%	6.4%	6.4%
Relative Return	1.4%	1.3%	-0.4%
Twelve Months to Date			
Performance	12.5%	13.5%	12.6%
Benchmark	11.8%	11.8%	11.8%
Relative Return	0.7%	1.7%	0.8%
Since Inception			
Performance	20.0%	19.5%	19.8%
Benchmark	19.0%	19.0%	19.0%
Relative Return	1.0%	0.5%	0.7%

- 4.4 Relative performance in the quarter has been good for Investec, but relatively flat for Allianz and Wellington. 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, and all three are now above their benchmark since inception December 2015.

Emerging Markets Equities

- 4.5 There is a separate report on the agenda for this meeting providing detail on the performance of JP Morgan, the Fund’s emerging markets equities manager. JP Morgan’s valuation and performance for the financial year to date is summarised below.

	Market Value	Market Value	9 months to 31 December 2017	
	01-Apr-17	31-Dec-17	Performance %	Benchmark %
	(£000’s)	(£000’s)		
JPM	91,232	105,703	15.86	14.22

Corporate Bonds

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

	Performance	Benchmark	Relative
Quarter	3.27%	2.42%	0.85%
Financial Year to Date	4.89%	3.10%	1.79%
12 months	8.08%	5.48%	2.60%
3 years p.a.	7.14%	6.21%	0.93%
5 years p.a.	8.10%	6.79%	1.31%
Since inception p.a.	9.36%	9.26%	0.10%

- 4.7 The most prominent sources of outperformance were the Fund’s overweight allocation to financials, particularly to subordinated debt, and the stock selection within secured and structured debt.

Property

- 4.8 The performance of the Fund’s external Property manager, CBRE, is detailed in Appendix 5, and summarised below:

	Performance	Benchmark	Relative
Quarter	2.91%	2.88%	0.03%
Financial Year to Date	8.50%	7.89%	0.61%
12 months	10.68%	10.23%	0.45%
3 years p.a.	9.36%	8.94%	0.42%
5 years p.a.	12.11%	11.07%	1.04%
Since inception p.a.	7.98%	7.87%	0.11%

Private Equity

- 4.9 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.

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

Manager	3 Years to 31 Dec 2017		5 Years to 31 Dec 2017	
	Dorset	Benchmark	Dorset	Benchmark
HarbourVest	18.1%	10.1%	18.2%	10.3%
Standard Life	9.2%	10.1%	9.9%	10.3%

- 4.11 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 31 December 2017 and the total gains or losses, which includes the distribution plus the latest valuation.

Private Equity Commitments, Drawdowns and Valuations

Manager / Fund	Commitment	Drawdown	% of Commitment	Distribution	Valuation	Gain / (Loss)
	€m	€m		€m	€m	€m
HV Partnership V	12.000	11.520	96%	14.700	3.265	6.446
HV Direct V	3.000	2.880	96%	3.747	0.324	1.192
HarbourVest Total €m	15.000	14.400	96%	18.448	3.589	7.637
SL 2006	22.000	20.141	92%	22.515	5.254	7.627
SL 2008	17.000	15.338	90%	10.343	11.308	6.313
Standard Life Total €m	39.000	35.479	91%	32.858	16.561	13.940
Overall Total €m	54.000	49.879	92%	51.306	20.151	21.578
	\$m	\$m		\$m	\$m	\$m
HV Venture VIII	15.200	14.896	98%	15.815	9.905	10.824
HV Buyout VIII	22.800	21.774	96%	25.666	10.372	14.263
HV Buyout IX	15.000	10.058	67%	5.131	9.673	4.747
HV Partnership VII (AIF)	20.000	9.500	48%	1.364	10.205	2.070
HV Venture IX	10.000	8.500	85%	3.373	9.382	4.255
Harbourvest Partners X AIF	10.000	1.050	11%	0.181	1.714	0.845
Harbourvest Partners X AIF	5.000	1.113	22%	0.083	1.220	0.191
HarbourVest HIPEP VIII	25.000	0.000	0%	0.000	0.111	0.110
HarbourVest Total \$m	123.000	66.890	54%	51.613	52.581	37.304
SL SOF I	16.000	10.759	67%	7.359	10.565	7.165
SL SOF II	20.000	10.748	54%	5.369	13.139	7.759
SL SOF III	20.000	2.446	12%	0.053	2.424	0.031
Standard Life Total \$m	56.000	23.953	43%	12.780	26.129	14.956
Overall Total \$m	179.000	90.843	51%	64.393	78.710	52.260

- 4.12 For the nine months to 31 December 2017 total drawdowns have been £8.3M and total distributions £18.1M. 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)

- 4.13 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.
- 4.14 The performance for Barings for the nine months to 31 December 2017 is summarised below.

	Market Value 01-Apr-17	Market Value 31-Dec-17	9 months to 31 December 2017	
	£000s	£000s	Performance %	Benchmark %
Barings	119,069	126,296	6.07	3.28

- 4.15 In February 2018, a further investment of £50M was made to the Baring Dynamic Asset Allocation Fund funded by partial disinvestment from the internally managed UK equities portfolio.

Infrastructure

- 4.16 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	3.5%	3.2%
Benchmark	2.4%	2.4%
Relative Return	1.1%	0.8%
Nine Months to Date		
Performance	6.6%	4.0%
Benchmark	7.4%	7.4%
Relative Return	-0.8%	-3.4%
Twelve Months to Date		
Performance	9.1%	8.4%
Benchmark	10.0%	10.0%
Relative Return	-0.9%	-1.6%
Since Inception		
Performance	8.6%	15.2%
Benchmark	8.9%	10.0%
Relative Return	-0.3%	5.2%

- 4.17 There is a separate report on the agenda of this meeting detailing the performance of the Fund’s investments with Hermes.
- 4.18 For IFM, OHL Mexico, M6toll, Freeport Investment Notes and Indiana Toll Road were the key contributors to fund performance for the quarter on a local currency basis. There were no detractors to performance during the quarter. Distributions contributed 0.8% to the Master Fund’s performance as Anglian Water Group, Manchester Airports Group, Colonial Pipeline Company, Indiana Toll Road, OHL Mexico, VTTI B.V., and Mersin International Port together distributed US\$148.2 million to the Master Fund.
- 4.19 During the quarter, IFM GIF completed the acquisition of a controlling stake in Mersin International Port and increased its direct ownership in Conmex (held in OHL Mexico). In December, IFM GIF also realised its investment in the Freeport Investment Notes and participated in a portion of the new Freeport Investment Notes 2 issuance.

Liability Driven Investment (LDI)

- 4.20 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	4,457
Valuation 31-Dec-17	384,250

- 4.22 Officers and the Independent Adviser, supported by Mercer, are in discussions with Insight to refresh the liability benchmark, revisit the fee basis and improve the monitoring framework.

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 nine months ended 31 December 2017

	<u>£M</u>	<u>£M</u>
Cash at 1 April 2017		30.3
Less:		
Infrastructure Drawdowns (net)	4.5	
UK Equity transactions (net)	0.7	
Property Transactions (net)	23.2	
Multi Asset Fund (net)	135.0	
		163.4
Plus:		
Private Equity (net)	9.7	
Liability Matching Bond (net)	20.0	
Currency Hedge (net)	15.7	
Hedge Funds (net)	0.4	
Bonds (net)	120.0	
Increase in Cash	12.6	
		178.4
Cash at 31 December 2017		45.3

- 5.3 Significant transactions since the end of December, include the completion of the purchase of the London public house and restaurant portfolio (£15.2M) and an exit sum received from one employer who has left the scheme (£3.2M), leaving cash balances of approximately £35M at 15 January 2018.
- 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 31 December 2017 is shown in the table below, including balances held in the custodian bank account and in a property rent collection account where a float is required for working capital purposes.

Call Accounts

National Westminster Bank	2,495	0.01%
Total Call Accounts	2,495	0.01%

Money Market Funds

Standard Life	7,900	0.35%
BNP Paribas	15,000	0.40%
Federated Prime Rate	14,400	0.39%
Deutsche	3,700	0.37%
Total Money Market Funds	41,000	0.38%

Holding Accounts

HSBC Custodian Account	1,178	0.00%
Property Client Account	621	0.00%
Total Holding Accounts	1,799	0.00%

Total Cash / Average Return	45,294	0.35%
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6. Markets in Financial Instruments Directive (MiFID) II

- 6.1 Under the previous UK regime, local authorities were automatically categorised as ‘per se professional’ clients in respect of non-MiFID scope business and were 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, was previously 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 By the 3 January 2018 deadline, the administering authority for the Fund had been successfully ‘opted up’ to professional investor status with all of the Fund’s external investment managers and key advisers.

7. Implementation of changes to Strategic Asset Allocation

- 7.1 At its 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. The following paragraphs summarise progress in implementing these changes.
- 7.2 The new 5% allocation to Multi Asset Credit manager CQS was achieved in full with an investment of £135M on 1 December 2017. It was funded from a partial disinvestment from the corporate bonds mandate with RLAM (£120M) and existing cash balances (£15M). This leaves the current allocation to Corporate Bonds as 7.1% against the revised target of 6%.

- 7.3 The increased allocation to Diversified Growth Funds (DGF) has been met in part by investing a further £50M in the Baring Dynamic Asset Allocation Fund in February funded by partial disinvestment from the internally managed UK equities portfolio. This leaves the current allocation to DGF as 6.0% against the revised target of 8%, and the current allocation to UK Equities as 23.7% against the revised target of 20%.
- 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 from proceeds of further disinvestment from corporate bonds and equities.
- 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.

8. Investment Strategy Statement (ISS)

- 8.1 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 require administering authorities to formulate and to publish an Investment Strategy Statement (ISS), in accordance with guidance issued by the Department for Communities and Local Government (CLG) in September 2016.
- 8.2 The ISS replaces the requirement for administering authorities to formulate and publish a Statement of Investment Principles (SIP). The aim of the 2016 investment regulations is to transfer investment decisions and their consideration more fully to administering authorities, with less central prescription than before. The ISS must also detail the Fund’s approach to pooling, including its commitment to “a suitable pool” that meets the criteria published by CLG in November 2015.
- 8.2 The ISS had to be first published by 1 April 2017, then kept under review and revised from time to time, but at least every three years. Subsequently, the Committee approved the Fund’s current ISS at its meeting 1 March 2017. As a result of the changes to the Fund’s asset allocation agreed by the Committee it has been necessary to amend the ISS and to publish the revised version as set out in Appendix 8.

Richard Bates
Pension Fund Administrator
February 2018