

Pension Fund Committee

Dorset County Council



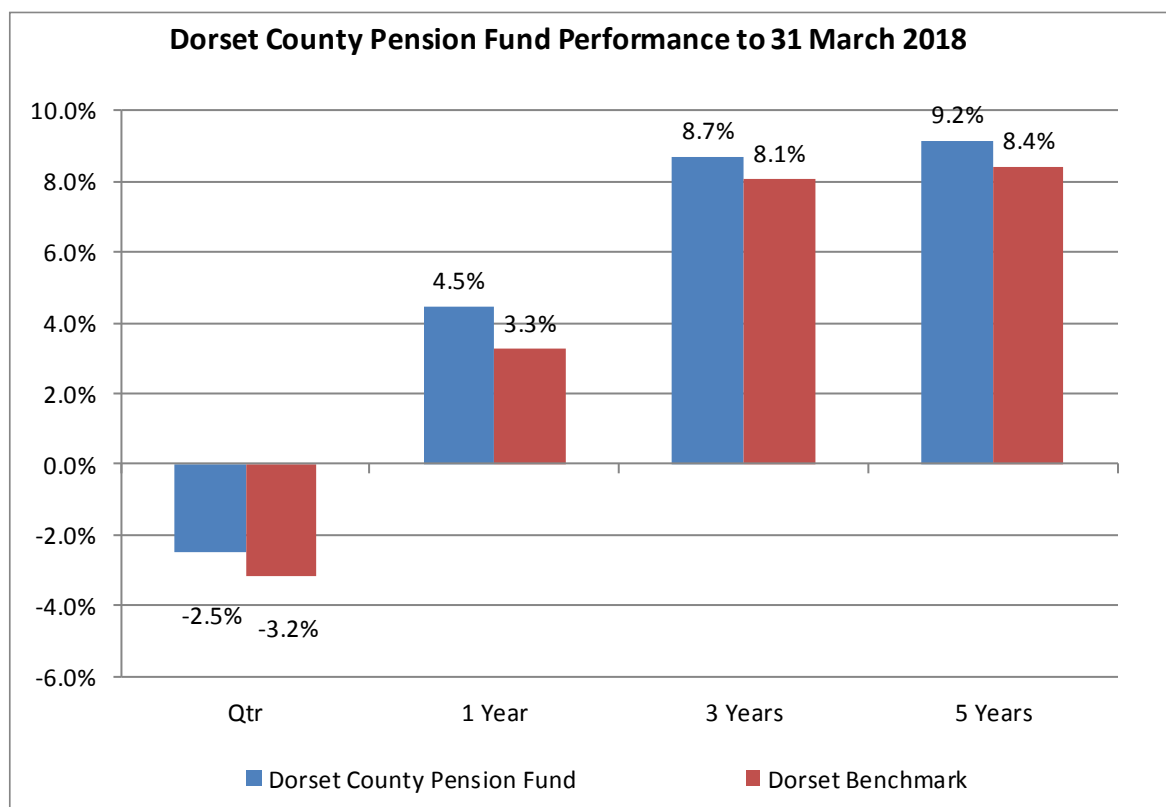
Date of Meeting	21 June 2018
Officer	Pension Fund Administrator
Subject of Report	Fund Administrator’s Report
Executive Summary	<p>The purpose of this report is to update the Committee on the valuation of the assets and overall performance of the Fund’s investments as at 31 March 2018. The report provides a summary of the performance of all internal and external investment managers, 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 financial year was £2,854M compared to £2,737M at the start of the financial year.</p> <p>The Fund returned 4.5% over the financial year to 31 March 2018, outperforming its benchmark which returned 3.3%. Return seeking assets returned 5.2%, whilst the liability matching assets returned -0.2%.</p>
Impact Assessment:	Equalities Impact Assessment: N/A
	Use of Evidence: N/A
	Budget: N/A

	<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) Note the publication of the draft (unaudited) Pension Fund accounts for 2017/18.
<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 March 2018 Appendix 2: UK Equities Appendix 3: Global Equities Appendix 4: Corporate Bonds Appendix 5: Property Appendix 6: Draft Pension Fund Accounts 2017/18</p>
<p>Background Papers</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 March 2018, the value of the Fund’s assets was £2,854M, compared to £2,737M at 31 March 2017.

1.2 The overall performance of the Fund to 31 March 2018 is summarised below.



1.3 Key issues to note are:

The quarter to 31 March 2018 saw a fall in UK and overseas equities markets, with the total equities returning -4.65% against the combined benchmark return of -5.5%.

Absolute and relative returns from Private Equity for the financial year 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 March 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.

CBRE, the Fund’s property manager, completed the purchase in February 2018 of four public houses and a restaurant in prime London locations for £14.6M.

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 March 2018, together with the target allocation as agreed at the meeting of the Committee, 13 September 2017.

Asset Class	Manager	31-Mar-17		31-Mar-18		Target Allocation	
		£M	%	£M	%	£M	%
UK Equities	Several	694.7	25.4%	647.2	22.7%	570.8	20.0%
Overseas Equities	Several	671.8	24.5%	691.3	24.2%	627.9	22.0%
Emerging Markets Equities	JPM	91.2	3.3%	103.3	3.6%	85.6	3.0%
Corporate Bonds	RLAM	313.5	11.5%	204.5	7.2%	171.2	6.0%
Multi Asset Credit	CQS	-	0.0%	136.2	4.8%	142.7	5.0%
Diversified Growth	Barings	119.1	4.4%	173.3	6.1%	228.3	8.0%
Infrastructure	Several	98.0	3.6%	106.6	3.7%	142.7	5.0%
Private Equity	Several	77.0	2.8%	76.5	2.7%	142.7	5.0%
Property	CBRE	241.1	8.8%	295.4	10.4%	342.5	12.0%
Absolute Return Funds	Several	0.4	0.0%	-	0.0%	-	0.0%
Cash	Internal	30.3	1.1%	40.0	1.4%	-	0.0%
Total Return Seeking Assets		2,337.1	85.4%	2,474.3	86.7%	2,454.4	86.0%
Liability Matching Assets	Insight	399.8	14.6%	379.7	13.3%	399.6	14.0%
Total Asset Valuation		2,736.9	100.0%	2,854.0	100.0%	2,854.0	100.0%

3. Overall Fund Performance

- 3.1 The Fund returned 4.5% for the financial year to 31 March 2018, an over-performance of the benchmark return of 3.3% by 1.2%. Over the longer term, the Fund out-performed over 3 years, returning an annualised 8.7% against the benchmark of 8.1%, and over 5 years, returning an annualised 9.2% against the benchmark of 8.4%.
- 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 March 2018, return seeking assets returned 5.18% against the benchmark return of 3.64%, and liability matching assets returned -0.24% against the benchmark return of -0.16%. 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	12 Months to 31 March 2018		
		Dorset %	Benchmark %	Over/(Under) %
Overall Fund Performance	All	4.46	3.25	1.21
Total Return Seeking Assets	Various	5.18	3.64	1.54
UK Equities	(Various)	2.81	1.19	1.62
Overseas Equities	(Various)	4.88	3.84	1.04
Bonds	(RLAM)	3.73	1.65	2.08
Property	(CBRE)	10.58	9.94	0.64
Private Equity	(Various)	2.01	1.25	0.76
Diversified Growth	(Barings)	4.15	4.43	-0.28
Infrastructure	(Various)	10.56	10.00	0.56
Total Liability Matching Assets		-0.24	-0.16	-0.08
Liability Driven Investment	(Insight)	-0.24	-0.16	-0.08

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. During the financial year there were net disinvestments of £46M from the internally managed portfolio primarily to fund an increased allocation to Diversified Growth Funds (DGF).

Financial Year To 31 March 2018

	Market Values £M		Performance	Benchmark	Benchmark Description
	31/03/2017	31/03/2018			
Internal	461.7	401.4	1.26%	1.07%	FTSE 350
AXA Framlington	185.4	190.7	2.88%	1.25%	All-Share
Schroders	47.6	55.1	16.19%	2.21%	Small Cap*
Total	694.7	647.2	3.01%	1.22%	

*FTSE Small Cap ex Investment Trusts

Three And Five Year Annualised Performance

	Three Years		Five Years	
	Performance	Benchmark	Performance	Benchmark
Internal	5.8%	5.7%	6.6%	6.5%
AXA Framlington	3.9%	5.9%	6.7%	6.6%
Schroders	17.0%	9.0%	16.4%	11.6%

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

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	-3.7%	-6.4%	-3.3%
Benchmark	-4.8%	-4.8%	-4.8%
Relative Return	1.1%	-1.6%	1.5%
Twelve Months to Date			
Performance	3.8%	0.8%	2.5%
Benchmark	1.3%	1.3%	1.3%
Relative Return	2.5%	-0.5%	1.2%
Since Inception			
Performance	15.8%	13.9%	15.8%
Benchmark	14.4%	14.4%	14.4%
Relative Return	1.4%	-0.5%	1.4%

- 4.4 Relative performance in the quarter and for the financial year has been good for Wellington and Allianz, but Investec have underperformed. Over the longer term all three managers have recorded high absolute returns largely driven by the depreciation of sterling following the result of the EU referendum. Since inception in December 2015 Allianz and Wellington are above their benchmarks whilst Investec are underperforming their benchmark.

Emerging Markets Equities

- 4.5 The valuation and performance for the financial year of JP Morgan, the Fund’s emerging markets equities manager is summarised below.

Emerging Markets Equity

	Market Value 01-Apr-17	Market Value 31-Mar-18	12 months to 31 March 2018	
	(£000’s)	(£000’s)	Performance %	Benchmark %
JPM	91,232	103,281	13.21	11.36

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	-1.1%	-1.4%	0.3%
12 months	3.7%	1.7%	2.1%
3 years p.a.	5.3%	4.3%	1.0%
5 years p.a.	7.3%	6.1%	1.2%
Since inception p.a.	9.0%	8.9%	0.1%

- 4.7 Fund returns were negative for the quarter, but ahead of benchmark. Stock selection within secured and structured debt was the main positive for the Fund over the quarter, more than offsetting the negative impact of the underweight allocation to supra-nationals and overweight in financials.

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	1.9%	1.9%	0.0%
12 months	10.6%	9.9%	0.6%
3 years p.a.	9.2%	8.6%	0.6%
5 years p.a.	12.2%	11.2%	1.0%
Since inception p.a.	8.0%	7.9%	0.1%

- 4.9 The portfolio has outperformed the IPD benchmark over 1, 3 and 5 years. The acquisition of four London pubs and a restaurant was completed in February for £14.6M.

Private Equity

- 4.10 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.

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

Manager	3 Years to 31 Mar 2018		5 Years to 31 Mar 2018	
	Dorset	Benchmark	Dorset	Benchmark
HarbourVest	15.6%	5.9%	14.8%	6.6%
Standard Life	11.6%	5.9%	9.7%	6.6%

- 4.12 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 March 2018 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>Distribution</u>	<u>Valuation</u>		<u>Gain / (Loss)</u>
	<u>€m</u>	<u>€m</u>	<u>%</u>		<u>€m</u>	<u>€m</u>	<u>€m</u>	
HV Partnership V	12.000	11.520	96%		15.079	2.867	6.426	
HV Direct V	3.000	2.880	96%		3.850	0.219	1.188	
HarbourVest Total €m	15.000	14.400	96%		18.929	3.085	7.614	
SL 2006	22.000	20.160	92%		23.473	4.560	7.873	
SL 2008	17.000	15.778	93%		11.728	10.817	6.768	
Standard Life Total €m	39.000	35.938	92%		35.202	15.377	14.641	
Overall Total €m	54.000	50.338	93%		54.130	18.462	22.255	
	<u>\$m</u>	<u>\$m</u>	<u>%</u>		<u>\$m</u>	<u>\$m</u>	<u>\$m</u>	
HV Venture VIII	15.200	14.896	98%		16.602	9.090	10.796	
HV Buyout VIII	22.800	21.774	96%		26.393	9.603	14.222	
HV Buyout IX	15.000	10.688	71%		5.345	10.022	4.679	
HV Partnership VII (AIF)	20.000	10.300	52%		1.695	10.639	2.034	
HV Venture IX	10.000	9.200	92%		3.591	9.489	3.880	
Harbourvest Partners X AIF (Buyout)	10.000	1.700	17%		0.181	1.904	0.385	
Harbourvest Partners X AIF (Venture)	5.000	1.263	25%		0.083	1.365	0.186	
HarbourVest HIPEP VIII	25.000	2.125	9%		0.000	2.224	0.099	
HarbourVest Total \$m	123.000	71.945	58%		53.890	54.335	36.280	
SL SOF I	16.000	12.862	80%		8.294	10.102	5.534	
SL SOF II	20.000	11.750	59%		6.489	14.992	9.731	
SL SOF III	20.000	4.573	23%		0.378	5.160	0.965	
Standard Life Total \$m	56.000	29.185	52%		15.161	30.253	16.229	
Overall Total \$m	179.000	101.130	56%		69.051	84.588	52.509	

- 4.13 For the twelve months to 31 March 2018 total drawdowns have been £14.9M and total distributions £23.8M. In order to meet the target allocation, there is a requirement to keep committing to Private Equity funds. Officers are in regular discussions with HarbourVest, SL Capital and from April 2018 the Brunel Pension Partnership private markets team to identify further opportunities for investment.

Diversified Growth Funds (DGF)

- 4.14 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.
- 4.15 The performance for Barings for the twelve months to 31 March 2018 is summarised below.

	Market Value 01-Apr-17	Market Value 31-Mar-18	12 months to 31 March 2018	
	£000s	£000s	Performance %	Benchmark %
Barings	119,069	173,342	4.15	4.43

- 4.16 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

- 4.17 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	6.3%	4.9%
Benchmark	2.4%	2.4%
Relative Return	3.9%	2.5%
Twelve Months to Date		
Performance	13.3%	9.2%
Benchmark	10.0%	10.0%
Relative Return	3.3%	-0.9%
Three Years to Date		
Performance	11.8%	N/A
Benchmark	10.0%	N/A
Relative Return	1.8%	N/A
Since Inception		
Performance	9.9%	16.0%
Benchmark	9.0%	10.0%
Relative Return	0.9%	6.0%

- 4.18 Hermes outperformance for the quarter was largely due to an increase in the valuation of investments in underlying funds, the addition of a bolt-on investment undertaken by Energy Assets Group ('EAG') and a new investment in National Grid Gas Distribution ('Cadent Gas').
- 4.19 Outperformance during the quarter for IFM came from M6 toll, Mersin International Port and OHL Mexico, partially offset by negative yields from Anglian Water Group, VTTI and Vienna Airport. Following the end of the quarter, IFM completed the acquisition of 100% of OHL Concesiones at an equity purchase price of €2,158 million with the subsequent divestment of the Fund's 49% direct stake in Conmex expected to be completed in June 2018.

Liability Driven Investment (LDI)

- 4.20 The movement in the value of the assets under the management of Insight Investments, the Fund's external LDI manager, for the financial year is summarised in the table below.

	£000s
Valuation 01-Apr-17	399,793
Investment	0
Disinvestment	-20,000
Increase / (Decrease) in Valuation	-76
Valuation 31-Mar-18	379,717

- 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 was estimated that there would be a surplus of income over expenditure from these cash flows of approximately £20M in the 2017/18 financial year. The table below summarises the main cash flows for the Fund for the financial year.

	<u>£M</u>	<u>£M</u>
Cash at 1 April 2017		30.3
Less:		
Property Transactions (net)	39.7	
Diversified Growth Fund (net)	50.1	
Multi Asset Fund (net)	135.0	
		<u>224.8</u>
Plus:		
Infrastructure Drawdowns (net)	0.7	
Private Equity (net)	8.9	
UK Equity transactions (net)	46.1	
Liability Matching Bond (net)	20.0	
Currency Hedge (net)	19.6	
Hedge Funds (net)	0.4	
Bonds (net)	120.0	
Increase in Cash	18.8	
		<u>234.5</u>
Cash at 31 March 2018		<u>40.0</u>

- 5.3 There have been no significant cash transactions since the end of March, leaving cash balances of approximately £38M at 31 May 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 March 2018 is shown in the table below, including balances held in the custodian bank accounts 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	-692	0.01%
Total Call Accounts	<u>-692</u>	<u>0.01%</u>
<u>Money Market Funds</u>		
Standard Life	13,500	0.35%
BNP Paribas	15,000	0.40%
Federated Prime Rate	8,600	0.39%
Total Money Market Funds	<u>37,100</u>	<u>0.38%</u>
<u>Holding Accounts</u>		
HSBC Custody Accounts	1	0.00%
Property Client Account	713	0.00%
State Street Custody Accounts	2,873	0.00%
Total Holding Accounts	<u>3,587</u>	<u>0.00%</u>
Total Cash / Average Return	<u>39,995</u>	<u>0.35%</u>

6. Implementation of changes to Strategic Asset Allocation

- 6.1 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.
- 6.2 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 7.2% against the revised target of 6%.
- 6.3 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 6.1% against the revised target of 8%, and the current allocation to UK Equities as 22.7% against the revised target of 20%.
- 6.4 The increased allocations to infrastructure, private equity and property will be achieved if and when suitable opportunities arise with existing managers or through allocation to the appropriate Brunel portfolio as and when these become available from April 2018 onwards. Any such increases will be funded from proceeds of further disinvestment from corporate bonds and equities.
- 6.5 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.

7. Pension Fund Accounts 2017/18 (Appendix 6)

- 7.1 Dorset County Council draft unaudited accounts for 2017/18, including the Pension Fund accounts, were approved for publication by the Chief Financial Officer 30 April 2018, two weeks earlier than for 2016/17, and four weeks earlier than for 2015/16. With effect 2017/18, the statutory deadline for publication of the draft accounts is 31 May each year, previously this was 30 June.

Richard Bates
Pension Fund Administrator
June 2018