Dorset County Pension Fund Committee 21 June 2018

Global Equities performance for the period ending 31 March 2018

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 Management.

2. Valuation

2.1 The table below summarises the valuations for the three managers as at 1 April 2017 and 31 March 2018. No additional investment has been made with the three managers this financial year.

	Allianz £000s	Investec £000s	Wellington £000s	Total £000s
Valuation 01-Apr-17	270,886	193,966	206,868	671,720
Investment	-	-	-	-
Distribution	-	-	-	-
Increase in Valuation	10,992	1,961	6,635	19,588
Valuation 31-Mar-18	281,878	195,927	213,503	691,308

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 March 2018.

	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%

3.2 Both Allianz and Wellington outperformed their benchmarks for the three months to 31 March 2018 by 1.1% and 1.5% respectively. Investec underperformed its benchmark by 1.6%. Since inception, Allianz and Wellington outperformed their benchmark by 1.4%, whilst Investec has underperformed by 0.5%.

4. Market Review

4.1 It was a volatile quarter for global equities, which started the year strongly before suffering sell-offs in February and March. Initially stocks rallied, boosted by ongoing optimism over the health of the global economy and by expectations that tax reforms would help to lift US company profits. Despite record levels of global M&A activity, most equity markets ended the quarter with losses.

4.2 US equities commenced the New Year on a strong footing, buoyed by better-than-expected corporate earnings and optimism that tax reform would provide a further uplift to profits. However, rising bond yields and signs of a pick-up in wage growth led to a sharp correction in February. While stocks subsequently recovered some of these losses, escalating fears of a global trade war following the Trump administration's decision to impose tariffs on key imports caused a further sell-off in late March. Overall, US equities ended the quarter with slight losses.

4.3 Euro-zone equities ended the quarter with negative returns (in EUR terms). Company earnings remained supportive, but the strength of the euro tempered investors' sentiment and politics remained a concern as Italy's elections resulted in no outright winner, with populist parties gathering the largest votes. After modest gains in January, euro-zone equities joined the global sell-off in February and March amid growing fears of a global trade war following the Trump administration's decision to implement tariffs on key imports.

4.4 Equity markets in the Pacific ex Japan region retreated over the quarter, although returns at a country level varied considerably. Sentiment was undermined by escalating fears of a global trade war and the possible effects on global growth.

4.5 Japanese equities were sold off over the quarter, lagging most other regions as the strength of the Japanese yen weighed on returns. Japan's fourth-quarter GDP growth was revised. This is the eighth consecutive quarter of growth and the longest unbroken period of expansion in almost three decades.

4.6 Emerging market equities outperformed developed market ones, ending a volatile quarter with slight gains. On balance, emerging markets in Asia rose slightly, but returns at a country level were mixed. While China rallied modestly, Indian equities fell over the quarter.

Manager Commentaries

5. Allianz

5.1 In this quarter, the portfolio outperformed the benchmark by 1.1% as trend-following styles offset the weakness in Value. Overall sector allocation was positive during the quarter with gains from an overweight in IT and underweight in Consumer Staples and Energy. Stock selection was also positive particularly in Consumer Staples, Consumer Discretionary and Industrials. Regional allocations made a small contribution through an overweight in the Eurozone and underweights to the UK, Europe and Pacific Basin ex Japan. Stock selection within Pacific Basin ex Japan and the UK was positive,

5.2 The first quarter of 2018 has been a mixed period for the investment styles approach. Value, the most prominent investment style lagged the benchmark and delivered a negative return. The trend-following investment styles Momentum, Revisions Growth and Quality were positive in aggregate over the quarter. Growth also ended the period in positive territory. The pattern of relative returns from Allianz's five key styles is broadly consistent with average of historic peak cycle readings. In such an event, Growth, Quality, Momentum and Risk typically do well while Value remains the weakest contributor.

5.3 Sector allocation was positive during the quarter with gains evident from the overweight in IT (+4bps) and the underweight in Consumer Staples (+6bps) and Energy (+4bps). Collectively these offset the overweight in Telecom Services and Consumer Discretionary which were the biggest detractors from relative performance. Stock selection was positive with contributions from exposure to Consumer Staples, Consumer Discretionary and Industrials. Stock selection within Health Care and Telecom Services detracted from relative performance.

5.4 Overall the regional allocation made a small contribution to relative performance. The overweight in the Eurozone and the underweight in UK, Europe ex UK and Pacific Basin ex Japan were successful (each +2bps). The underweight in Japan, and overweight in Emerging Europe, Middle East and Africa detracted (each -2bps). Stock selection was strong in Pacific Basin ex Japan and the UK, but less successful in Europe. Contributions at a stock level within single regions reflect the different performance contributions of different investment styles within those regions.

6. Investec

6.1 The portfolio underperformed its index over the quarter. Stock selection in the technology and healthcare sectors was the leading cause of this underperformance. On a regional level, the UK and North American holdings detracted, while the Asia-Pacific stocks, particularly in Singapore, contributed positively to relative returns.

6.2 The technology and UK underperformance was mostly due to one stock: business IT firm Micro Focus. Although concerns about the company’s lack of operating momentum in light of its highly levered business structure had prompted to start selling the stake, the stock was still held in the portfolio in mid-March when the company announced a profits warning that saw its shares lose half their value. The warning – due to issues integrating newly-acquired HP Enterprise – also prompted the resignation of its CEO as its stock de-rated down due to doubts about the company’s goal of hitting its long term profitability target. Elsewhere in the technology sector, performance was held back by social media giant Facebook, which became embroiled in a data misuse scandal in the latter part of the quarter.

6.3 The portfolio was negatively impacted by corporate actions from Cigna and AXA. The former is a US healthcare provider that saw its shares retreat after it announced that it was purchasing pharmacy benefits manager Express Scripts for US$54 billion. Meanwhile, French insurer AXA fell on the news that it was paying a 33% premium for XL group, which some analysts thought was excessive. Cigna is still held, however, the XL deal prompted AXA to be sold.

6.4 More positively, energy holdings were able to contribute to relative returns. Relative performance was boosted by not holding US oil majors Exxon and Chevron, which both sold off over the quarter. Among other stocks, online booking platform Priceline, which coincidently changed its name to Booking Holdings, rallied well in the lead up to, and upon delivery of, its quarterly results on the last day of February. Results showed good growth in total room bookings, which enabled the company to significantly boost its buyback programme. Success was had with several technology holdings across the portfolio, none more so than US cloud service provider NetApp. Although the company sold off following the release of its most recent earnings update, its shares went on to rally over the subsequent weeks as investors chose to look beyond some initial margin worries, focusing instead on its impressive sales growth and free cash flow generation. Relative performance was also enhanced by being underweight in the underperforming telecommunication sector over the quarter.

7. Wellington

7.1 The Global Research Equity portfolio outperformed the index during the quarter with eight of eleven sectors contributing positively to relative results. Stock selection in financials and health care boosted returns, while consumer discretionary and consumer staples companies offset a portion of these gains.

7.2 Within financials, the position in XL Group, a property and casualty insurance company, contributed most to outperformance. In February, the stock price appreciated after rumours began circulating that the company was in talks to be acquired, and in March it was announced that XL Group would be acquired by AXA, a French multinational insurance firm, at a very attractive premium after a challenging 2017. In addition to XL Group, not holding Wells Fargo boosted relative results as that business continues to struggle after its account fraud scandal. In the US, the preference is for banks that have technological advantages and strong franchises, such as Bank of America, the largest portfolio holding.

7.3 Within health care, Japanese Pharmaceutical Eisai, was a notable performer this quarter. In early February, it was announced that Eisai and Merck would enter into a global Strategic Oncology Collaboration for LENVIMA (an anti-cancer drug currently used in treating thyroid cancer). This collaboration has allowed Eisai to monetise an asset that is less valued by the market and get more cash/funding in the near-term. The position is held given Eisai's strong pipeline and innovative work in developing a treatment for Alzheimer's. Ono Pharmaceuticals also outperformed during the quarter on positive news regarding pricing dynamics of their key revenue driver, Opdivo. Ono partnered with Bristol-Myers in the development of Opdivo, and as such they have rights to the cancer treatment in Japan, Korea, and Taiwan, as well as royalty streams outside these regions. Volume growth through treatment options for multiple forms of cancer leads us to believe Opdivo revenue should grow. An overweight position will continue to be held.

7.4 The consumer discretionary sector proved to be the largest detractor for the quarter. Underperformance was led by the position in Comcast, a US-based global telecom conglomerate. Its share price dropped materially following the announcement of its bid for Sky, the UK-based pay TV provider. Comcast is well-positioned in the industry with an attractive moat in residential broadband and trades at a meaningful discount.

7.5 Within consumer staples, British American Tobacco weighed on relative results during the quarter. The company reported weaker than expected volumes and greater industry completion than anticipated. British American Tobacco continues to push into the next generation products with its heat-not-burn product increasing share in key markets. In our view, the company's current valuation does not reflect the potential from this product portfolio. In addition, problem markets are starting to improve, volume declines moderating, and operational efficiencies from the restructuring program coming through. The position will continue to be held.

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