Pension Fund Committee

Dorset County Council

Date of Meeting	17 September 2018
Officer	Pension Fund Administrator
Subject of Report	**Fund Administrator's Report**
Executive Summary	The purpose of this report is to update the Committee on the funding position, and the valuation and overall performance of the Fund's investments as at 30 June 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. The current projection of the funding level as at 30 June 2018 is 90.1% and the average required employer contribution would be 22.2% of payroll assuming the deficit is to be paid by 2038. The value of the Fund's assets at 30 June 2018 was £2,953M compared to £2,854M at the start of the financial year. The Fund returned 3.5% over the quarter to 30 June 2018, underperforming its benchmark which returned 3.8%. Return seeking assets returned 4.4%, whilst the liability matching assets returned -2.6%.
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 activity and overall performance of the Fund. ii) Note the progress in implementing the new strategic asset allocation. iii) Note the publication of the final audited Pension Fund accounts for 2017/18. iv) Agree the Risk Register.
Reason for Recommendation	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.
Appendices	Appendix 1: UK Equities Appendix 2: Global Equities Appendix 3: Corporate Bonds Appendix 4: Property Appendix 5: Pension Fund Risk Register
Background Papers	
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1. Key issues to highlight

1.1 The estimated funding level has improved from 83.2% at the last triennial valuation, as at 31 March 2016, to 90.1% as at 30 June 2018. This improvement is largely the result of the substantial appreciation in the value of the Fund's investments in 2016-17.

1.2 However, the Actuary has estimated that the average required employer contribution would be 22.2% of payroll compared 21.4% at the 31 March 2016 funding valuation, due to lower assumed future investment returns and higher assumed long-term inflation.

1.3 The quarter saw very large gains in UK and overseas developed equities markets, reversing the losses in the previous quarter. These gains in developed markets were partially offset by large losses in emerging markets, driven by the appreciation of the US dollar against local currencies.

1.4 Absolute and relative returns from Private Equity for the quarter were favourably affected by the appreciation of the dollar. 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.

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

1.6 The value of the Fund's liability matching assets, manged by Insight, fell by 2.6% in the quarter.

2. Funding Update

2.1 The Fund's actuary, Barnett Waddingham, undertake a full assessment of the funding position every three years. This was last completed as at 31 March 2016 and will be next undertaken as at 31 March 2019.

2.2 In addition to the full triennial assessment, officers have now asked Barnett Waddingham to carry out indicative updates on the funding position on a quarterly basis. It is intended that this will provide a better understanding of movements in the Fund's overall funding position between triennial valuations.

2.3 The assessment as at 30 June 2018 is based on:

- the results of the last triennial actuarial valuation as at 31 March 2016
- estimated whole Fund income and expenditure items for the period to 30 June 2018; and
- estimated Fund returns based on Fund asset statements provided to 30 June 2018.

2.4 The results of this assessment indicate that the current projection of the funding level as at 30 June 2018 is 90.1% and the average required employer contribution would be 22.2% of payroll assuming the deficit is to be paid by 2038. This compares with the funding level of 83.2% and average required employer contribution of 21.4% of payroll at the 31 March 2016 funding valuation.

2.5 Whilst the funding level has improved and the deficit has reduced since the previous valuation, the cost of ongoing benefits has increased due to lower assumed future investment returns and higher assumed long term inflation, resulting in an increase in the calculated total required contribution rate. Actual contribution rates will remain unchanged until the results of the next triennial valuation are agreed for 2020-21 onwards, based on a full review of liabilities and assets at 31 March 2019.

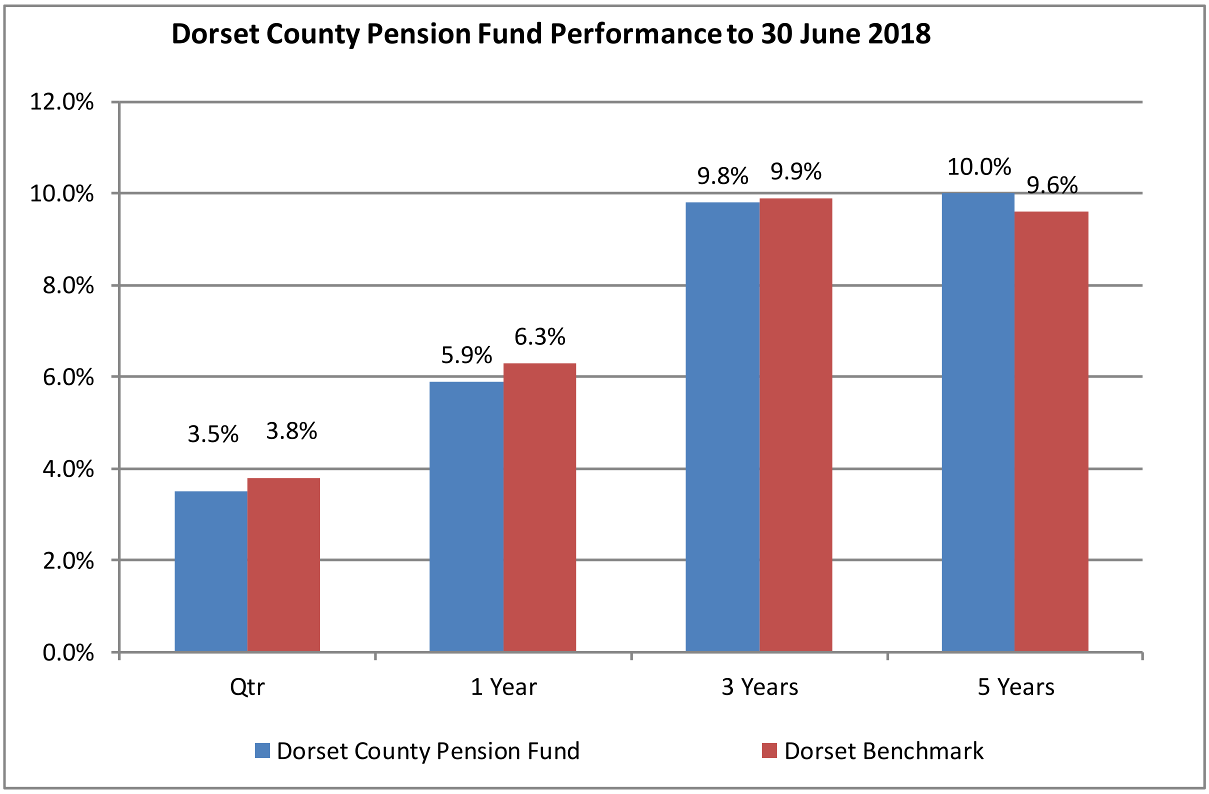
2. Asset Valuation

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 June 2018, together with the target allocation as agreed at the meeting of the Committee, 13 September 2017, and the tolerances for each asset class as stated in the Investment Strategy Statement (ISS).

		31-Mar-18		30-Jun-18		Target Allocation		Tolerance
Asset Class	**Manager**	**£M**	**%**	**£M**	**%**	**£M**	**%**	
UK Equities	Several	647.2	22.7%	701.3	23.8%	590.5	20.0%	+/- 4.0%
Overseas Equities	Several	691.4	24.2%	735.2	24.9%	649.6	22.0%	+/- 4.0%
Emerging Markets Equities	JPM	103.2	3.6%	98.2	3.3%	88.6	3.0%	+/- 0.5%
Corporate Bonds	RLAM	204.5	7.2%	204.1	6.9%	177.2	6.0%	+/- 1.5%
Multi Asset Credit	CQS	136.2	4.8%	136.6	4.6%	147.6	5.0%	+/- 1.0%
Diversified Growth	Barings	173.3	6.1%	175.6	5.9%	236.2	8.0%	+/- 1.0%
Infrastructure	Several	106.6	3.7%	132.5	4.5%	147.6	5.0%	+/- 1.0%
Private Equity	Several	76.5	2.7%	82.1	2.8%	147.6	5.0%	+/- 1.0%
Property	CBRE	295.4	10.4%	299.4	10.1%	354.3	12.0%	+/- 1.0%
Cash	Internal	40.0	1.4%	22.1	0.7%	-	0.0%	-
F/X Hedging	State Street		-	4.1	-0.1%			
Total Return Seeking Assets		**2,474.3**	**86.7%**	**2,583.0**	**87.5%**	**2,539.3**	**86.0%**	
Liability Matching Assets	Insight	379.7	13.3%	369.7	12.5%	413.4	14.0%	+/- 3.0%
Total Asset Valuation		**2,854.0**	**100.0%**	**2,952.7**	**100.0%**	**2,952.7**	**100.0%**	

3. Investment Performance

3.1 The overall performance of the Fund's investments to 30 June 2018 is summarised below.



3.2 The Fund returned 3.5% for the financial year to 30 June 2018, an under-performance of the benchmark return of 3.8% by 0.3%. Over the longer term, the Fund under-performed over 3 years, returning an annualised 9.8% against the benchmark of 9.9%, but overperformed over 5 years, returning an annualised 10.0% against the benchmark of 9.6%.

3.3 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.

3.4 For the financial year to 30 June 2018, return seeking assets returned 4.4% against the benchmark return of 5.2%, and liability matching assets returned -2.6% against the benchmark return of -4.6%. 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.

4. Performance by Asset Class

UK Listed Equites

4.1 The performance of the Fund's internally managed UK equities passive portfolio and its two external mangers is detailed in Appendix 1, and summarised below.

Financial Year To 30 June 2018

	Market Values £M		Performance	Benchmark	Benchmark Description
	31/03/2018	30/06/2018			
Internal	401.4	437.6	9.30%	9.30%	FTSE 350
AXA Framlington	190.7	205.5	7.70%	9.20%	All-Share
Schroders	55.1	58.1	5.40%	7.00%	Small Cap*
Total	647.2	701.2	8.51%	9.08%	

*FTSE Small Cap ex Investment Trusts

Three And Five Year Annualised Performance

	Three Years		Five Years	
	Performance	Benchmark	Performance	Benchmark
Internal	9.7%	9.5%	8.9%	8.7%
AXA Framlington	6.2%	9.6%	8.3%	8.8%
Schroders	16.4%	9.6%	16.9%	12.3%

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 to date, but AXA have underperformed theirs.

4.3 On 11 July 2018, the internally managed UK equity portfolio transferred to the Brunel UK Passive Equities portfolio managed by Legal & General Investment Management (LGIM).

Global Equites

4.4 The performance of the Fund's three external global equities managers is detailed in Appendix 2, and summarised in the table below.

	Allianz	Investec	Wellington
Quarter to Date			
Performance	7.5%	8.4%	7.6%
Benchmark	8.1%	8.1%	8.1%
Relative Return	-0.6%	0.3%	-0.5%
Twelve Months to Date			
Performance	12.0%	8.9%	10.2%
Benchmark	9.3%	9.3%	9.3%
Relative Return	2.7%	-0.4%	0.9%
Since Inception			
Performance	17.6%	16.1%	17.5%
Benchmark	16.4%	16.4%	16.4%
Relative Return	1.2%	-0.3%	1.1%

4.5 Relative performance in the quarter was good for Investec but Allianz and Wellington underperformed their benchmark. Over twelve months Allianz and Wellington outperformed their benchmark but Investec underperformed theirs. 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.

4.6 On 18 July 2018, the holdings under the management of Allianz transferred to the Brunel Smart Beta portfolio managed by LGIM.

Emerging Markets Equities

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

	Market Value 01-Apr-18	Market Value 30-Jun-18	3 months to 30 June 2018	
	(£000's)	(£000's)	Performance %	Benchmark %
JPM	103,281	98,198	-4.90	-2.20

4.8 Emerging markets generally have been hit by the strength of the dollar against local currencies, and the growing tensions in trading relations with the US, most notably China and Turkey.

Corporate Bonds

4.9 The performance of the Fund's external Corporate Bonds manager, RLAM, is detailed in Appendix 3, and summarised below.

	Performance	Benchmark	Relative
Quarter	-0.2%	-0.4%	0.2%
12 months	1.9%	0.6%	1.3%
3 years p.a.	6.7%	6.1%	0.6%
5 years p.a.	7.9%	6.8%	1.1%
Since inception p.a.	8.7%	8.6%	0.1%

4.10 Fund returns were marginally negative for the quarter and less than 2% for the last 12 months, but ahead of benchmark for both periods. 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.

Multi Asset Credit (MAC)

4.11 The performance of the Fund's external MAC manager, CQS, is summarised below.

	Performance	Benchmark	Relative
Quarter	0.3%	1.1%	-0.8%
Since inception (Dec-17)	1.2%	2.6%	-1.4%

Property

4.12 The performance of the Fund's external Property manager, CBRE, is detailed in Appendix 4, and summarised below.

	Performance	Benchmark	Relative
Quarter	1.8%	1.7%	0.1%
12 months	9.3%	9.4%	-0.1%
3 years p.a.	8.6%	8.0%	0.6%
5 years p.a.	11.8%	11.2%	0.6%
Since inception p.a.	8.0%	7.9%	0.1%

4.13 The portfolio has underperformed the IPD benchmark over 1 year but outperformed over 3 and 5 years.

Private Equity

4.14 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.

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

	3 Years to 30 Jun 2018		**5 Years to 30 Jun 2018**	
Manager	**Dorset**	**Benchmark**	**Dorset**	**Benchmark**
HarbourVest	19.7%	9.6%	17.2%	8.8%
Aberdeen Standard	14.6%	9.6%	11.2%	8.8%

4.16 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 June 2018 and the total gains or losses, which includes the distribution plus the latest valuation.

Private Equity Commitments, Drawdowns and Valuations

Manager / Fund	Commitment	Drawndown		Distribution	Valuation	Gain / (Loss)
	€m	€m	%	€m	€m	€m
HV Partnership V	12.000	11.520	96%	15.423	2.595	6.497
HV Direct V	3.000	2.880	96%	3.850	0.175	1.144
HarbourVest Total €m	15.000	14.400	96%	19.272	2.769	7.641
SL 2006	22.000	20.160	92%	23.729	4.285	7.854
SL 2008	17.000	15.757	93%	12.182	10.636	7.061
Standard Life Total €m	39.000	35.917	92%	35.910	14.922	14.915
Overall Total €m	**54.000**	**50.317**	**93%**	**55.182**	**17.691**	**22.557**
	$m	$m	%	$m	$m	$m
HV Venture VIII	15.200	14.896	98%	17.328	9.340	11.772
HV Buyout VIII	22.800	21.774	96%	27.670	8.780	14.676
HV Buyout IX	15.000	11.288	75%	6.555	10.096	5.364
HV Partnership VII (AIF)	20.000	11.400	57%	1.889	12.519	3.008
HV Venture IX	10.000	9.500	95%	3.851	10.409	4.760
Harbourvest Partners X AIF (Buyout)	10.000	1.700	17%	0.181	2.029	0.510
Harbourvest Partners X AIF (Venture)	5.000	1.588	32%	0.083	1.831	0.327
HarbourVest HIPEP VIII	25.000	2.125	9%	0.000	2.413	0.288
HarbourVest Total $m	123.000	74.270	60%	57.557	57.417	40.705
SL SOF I	16.000	12.887	81%	8.728	10.058	5.900
SL SOF II	20.000	11.155	56%	7.190	15.132	11.166
SL SOF III	20.000	3.920	20%	0.598	5.125	1.803
Standard Life Total $m	56.000	27.962	50%	16.517	30.314	18.869
Overall Total $m	**179.000**	**102.232**	**57%**	**74.074**	**87.732**	**59.574**

4.17 For the three months to 30 June 2018 total drawdowns have been £1.2M and total distributions £4.8M. 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 the Brunel private markets team to identify further opportunities for investment.

Diversified Growth Funds (DGF)

4.18 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.

4.19 The performance for Barings for the three months to 30 June 2018 is summarised below.

	Market Value 01-Apr-18	Market Value 30-Jun-18	3 months to 30 June 2018	
	£000s	£000s	Performance %	Benchmark %
Barings	173,342	175,674	1.30	1.20

4.20 Equities were the main contributor to the performance, particularly the European allocation. The main area of weakness was emerging debt. The Turkish exposure was a negative to the fund and was cut over the quarter.

Infrastructure

4.21 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	2.3%	5.0%
Benchmark	2.4%	2.4%
Relative Return	-0.1%	2.6%
Twelve Months to Date		
Performance	7.6%	13.6%
Benchmark	10.0%	10.0%
Relative Return	-2.4%	3.6%
Three Years to Date		
Performance	9.8%	n/a
Benchmark	10.0%	n/a
Relative Return	-0.2%	n/a
Since Inception		
Performance	9.6%	16.6%
Benchmark	10.0%	10.0%
Relative Return	-0.4%	6.6%

4.22 In July 2018, Federated Investors Inc. completed their acquisition of a 60% stake in Hermes Investment Management from BT Pension Scheme (BTPS). BTPS retain a 29.5% stake in Hermes, with members of Hermes senior management holding in total the remaining 10.5% stake. Private Equity and Infrastructure mandates will continue to be managed under their existing ownership and governance structure.

4.23 During the quarter, IFM completed a number of transactions, including a disinvestment of its 20% stake in 50Hertz, the acquisition of 100% of OHL Concesiones and the subsequent disinvestment of it 49% direct stake in Conmex, realised its investment in the Freeport Investment Notes 2 and announced the acquisition of a 37.5% interest in GCT Global Container Terminals Inc. located in the United States and in Canada. Positive returns in the quarter came from Freeport Investment Notes 2, Mersin International Port and OHL Concesiones, partially offset by a negative yield from Vienna Airport.

4.24 The Fund's investments with IFM are held in US dollars but performance is measured against a 10% absolute return in sterling, therefore absolute and relative returns will be affected by currency movements.

Liability Driven Investment (LDI)

4.25 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-18	379,717
Investment	0
Disinvestment	0
Increase / (Decrease) in Valuation	-10,008
Valuation 30-Jun-18	369,709

4.26 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. The results of this review are expected to conclude shortly.

5. Cash and Treasury Management

5.1 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 June 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 %
Call Accounts		
National Westminster Bank	788	0.15%
Total Call Accounts	788	0.15%
Money Market Funds		
Standard Life	4,000	0.53%
BNP Paribas	12,600	0.53%
Federated Prime Rate	3,000	0.53%
Total Money Market Funds	19,600	0.53%
Holding Accounts		
HSBC Custody Accounts	-	0.00%
Property Client Account	561	0.00%
State Street Custody Accounts	1,210	0.00%
Total Holding Accounts	1,771	0.00%
Total Cash / Average Return	**22,159**	**0.47%**

5.2 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 £10M to £15M in the 2018/19 financial year. The table below summarises the main Fund's main cash flows for the financial year to date.

Statement of cash-flow for the three months ended 30 June 2018

	£M	£M
Cash at 1 April 2018		**40.0**
Less:		
Property Transactions (net)	2.3	
UK Equity transactions (net)	0.1	
Diversified Growth Fund (net)	0.0	
Multi Asset Fund (net)	0.0	
Infrastructure Drawdowns (net)	21.7	
Currency Hedge (net)	9.9	
		34.0
Plus:		
Private Equity (net)	3.5	
Liability Matching Bond (net)	0.0	
Overseas Equities	10.0	
Hedge Funds (net)	0.0	
Bonds (net)	0.0	
Increase in Cash	2.6	
		16.1
Cash at 30 June 2018		**22.1**

5.3 Since the end of June, there have been the following significant cash transactions, leaving cash balances of approximately £66M at 31 August 2018.

- Disinvestment from Allianz of £10M; and
- Disinvestment from Brunel UK Passive Equities portfolio of £30M.

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 6.9% 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 5.9% against the revised target of 8%, and the current allocation to UK Equities as 23.8% 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. A commitment of 2.0% has been made to the Brunel Private Equity portfolio, with a further 2.0% commitment to the Brunel Secured Income portfolio. Drawdowns against commitments will be funded from cash balances and/or further disinvestment from equities and corporate bonds.

6.5 For all other asset classes, where the current allocation is different to the new target, it is expected that the target will be achieved through allocation to the appropriate Brunel portfolio as and when these become available.

7. Pension Fund Accounts 2017/18

7.1 Dorset County Council final audited accounts for 2017/18, including the Pension Fund accounts, were published 24 July 2018. A copy of the Pension Fund Accounts is included in the Fund's annual report.

8. Risk Register

8.1 The Fund's risk register summarises the main, high level risks facing the Fund, and is attached at Appendix 5. The Fund's administration team also maintain a more detailed register of administration and governance risks, which is included in the Pensions Administration report later on the agenda for this meeting.

Richard Bates
Pension Fund Administrator
September 2018