Dorset County Pension Fund Committee 17 September 2018

Global Equities performance for the period ending 30 June 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 2018 and 30 June 2018. No additional investment has been made with the three managers this financial year.

	Allianz	Investec	Wellington	Total
	£000s	£000s	£000s	£000s
Valuation 01-Apr-18	281,878	195,927	213,503	691,308
Investment	-	-	-	-
Distribution	-	-	-	-
Increase in Valuation	11,126	16,504	16,233	43,863
Valuation 30-Jun-18	293,004	212,431	229,736	735,171

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 30 June 2018.

	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%

3.2 Investec outperformed its benchmark for the three months to 30 June 2018 by 0.3%. Both Allianz and Wellington underperformed their benchmarks by 0.6% and 0.5% respectively. Over the twelve month period to 30 June 2018 both Allianz and Wellington outperformed their benchmark while Investec underperformed by 0.4%. Since inception, Allianz and Wellington outperformed their benchmark by 1.2% and 1.1% respectively, whilst Investec has underperformed by 0.3%.

4. Market Review

4.1 In general, global equities advanced over the second quarter. Most markets touched a peak in mid/late May, but retreated through June amid concerns over an escalating trade war between the US and its major trading partners. However, while developed market equities gained, emerging market equities retreated in the face of a strengthening US dollar.

4.2 US equities went higher for much of the three month period, touching a peak in Mid-June before growing concerns resulted in a weaker end to the quarter. Company earnings remained supportive, but US shares lagged their global counterparts throughout April and May due to rising US bond yields and unease over whether earnings growth may have peaked.

4.3 Eurozone equities rose modestly over the quarter (in EUR terms), but lagged many other developed markets amid heightened political risks in Italy and fears over the impact of increased US tariffs on trade. After weeks of negotiation the Italian anti-establishment Five Star Movement and far-right league agreed to form a coalition government with policies that set it on a confrontational path with the EU.

4.4 Equity markets in the Pacific ex Japan region delivered solid gains over the quarter. However, regional performance was distorted by strong returns from one of the region's largest markets, Australia. Elsewhere, stock markets were generally weak as trade tensions between the US and China weighed on investor sentiment.

4.5 Japanese equities advanced slightly over the quarter. Shares touched a peak in late May, but later joined in the global stock market retreat caused by an escalating trade war.

4.6 Emerging market equities fell over the quarter, underperforming developed market stocks as they suffered significant outflows amid fears of a global trade war. Higher US interest rates and a strengthening US dollar also weighed on investor sentiment. At a regional level, Eastern European markets held up the best, while Latin America markets were the weakest.

Manager Commentaries

5. Allianz

5.1 In this quarter, the portfolio underperformed the benchmark by 6 bps as value was weaker on a relative basis than the other investment styles. Volatility in the performance of value was driven by a series of strong headwinds including strong outperformance of the most expensive (Technology) stocks; weaker leading indicators and a flattering of the yield curve hurting cyclical value stocks; and trade war fears impacting value segments like Automobiles and Semis.

5.2 The two trend following investment styles, Revisions and Momentum, as well as more defensive investment style Quality, have been doing well throughout the year, contributing positively to the relative performance. Overall, the mandate suffered from the weak performance of the investment style Value which was not compensated by the relative gains from Non-Value investment styles.

5.3 The contrarian investment style was lagging behind the benchmark, detracting from the relative performance of the mandate. The volatile relative performance of value in the quarter was driven by:

- The strong performance lead of the most expensive (Technology) stocks.

- Weak momentum of global business sentiment indicators signalling a cyclical slowdown and hindering the performance of typically more cyclical value stocks.
- Further flattening of the yield curve hurting the performance of financial stocks as a flattening yield curve means less to earn from lending.
- The trade war rhetoric hurting exporters in all regions of the world, and in particular value segments like automobiles and semis stocks.

5.4 Investment styles Momentum/Growth/Revisions contributed positively to relative performance in the quarter. However, the mandate did not fully capture the solid performance of the investment styles as this outperformance was largely attributed to the most expensive Momentum/Growth/Revisions names.

5.5 Sector allocation effect was slightly negative with the underweight in Energy detracting from relative performance while the underweight in Financials contributed positively. Overall, stock selection effect was negative whilst it was most successful within Healthcare, Financials and Energy. Stock selection within IT and Industrials detracted on a relative basis.

5.6 Regional allocation detracted slightly from relative performance. The underweight in Japan and Europe ex UK and the overweight in Emerging Markets in Europe, Middle East and Africa were successful, while the overweight in the Eurozone hurt relative performance the most. Stock selection was strong in Europe ex UK, and less successful in Pacific ex Japan or Emerging Markets in Europe, the Middle East and Africa. The contributions from stock selection within single regions are the effect of different performance contributions of different investment styles within those regions.

6. Investec

6.1 Global equities managed to recover from a first quarter slump to advance by 0.5% over the three months to the end of June, in dollar terms. The index returns betray significant differences between regions as this year's twin causes of volatility, US monetary tightening and the simmering US-China trade tensions continued apace. The quarter saw an additional rate hike from the US Federal Reserve, which propelled the US dollar higher. Meanwhile, the US-China tensions threatened to boil over after Donald Trump gave indications that he may look to drastically ramp up tariffs levied on Chinese imports.

6.2 Amid this background, emerging markets were negatives to performance while North America outperformed significantly. Within emerging markets, several countries were impacted by political uncertainty, polls in Turkey, Brazil and Mexico triggered negative market reactions. Politics also drove returns in developed markets as Italy joined the growing list of countries voting in populist governments.

6.3 Sector wise, energy shares continued to outperform as oil prices climbed to new multi-year highs due to the possibility of a global supply shortage due to Venezuela's crumbling output and the prospect of renewed sanctions against Iran.

6.4 Helpful stock picking ensured the portfolio outperformed its performance comparison index. Proving particularly helpful to relative performance over the quarter were the energy, consumer discretionary and information technology sectors. In consumer discretionary, several key holdings rallied off the back of very positive earnings. Chief among those was US jeweller Tiffany, which reported better than expected same store sales. This, along with enthusiasm about the company's recent product launches and incoming CEO, saw investors bid up Tiffany shares in anticipation that recent results may indicate the start of an earnings up cycle. Other names which contributed to performance in the sector included Planet Fitness, which benefited from management comments about recent performance and AMC Networks due to recent peer merger activity.

6.5 Within the technology sector, storage infrastructure provider NetApp was the single largest contributor at stock level overall as it managed to extend its recent rally on the strength of US enterprise IT spending. Highlights for NetApp over the quarter included its analyst day in April, when the firm raised its revenue growth and free cashflow guidance, and a material earnings beat in late May. Sector peer VMware also added over the quarter after reporting similarly good results. The portfolio also benefited from both advantageous positioning and helpful stock picking in the energy sector thanks to the ongoing strength in oil prices. Top performing holdings in the sector included US firms Hess and Valero.

6.6 In contrast, financials and materials detracted most from relative returns at sector level. Within financials, the portfolio experienced some headwinds in selected names, mainly US insurer Unum and Danish bank Danske. The former two was attributable to a deterioration of performance at its legacy long-term care book of business which overshadowed solid results in its underwriting business. Meanwhile, Danske was held back by disappointing trading revenue and allegations of money laundering at its Estonian subsidiary. Elsewhere, Hong Kong listed Chinese pork producer WH Group also detracted as it was caught up in the ongoing US-China trade tension. Although WH Group has little direct US-China sales exposure, investors and analysts became concerned that recent tariffs levied on US pork by Chinese authorities may strand large quantities of US pork domestically, therefore negatively impacting pricing and profitability at its recently acquired Smithfield Foods division.

7. Wellington

7.1 The Global Research Equity portfolio underperformed the index during the quarter. Positive stock selection in consumer discretionary and industrials could not outweigh negative selection in consumer staples, healthcare and financials. Negative selection within consumer staples was driven primarily by overweight positions in Coty and British American Tobacco. Shares of Coty, an emerging beauty franchise, fell after the company reported mixed quarterly results. Stronger-than-expected top-line results in the luxury division were offset by weakness in the consumer beauty business. The turnaround story following its purchase of Proctor & Gamble beauty assets is taking longer than expected and has proven to be costlier than anticipated. The position has been trimmed. In the case of British American Tobacco (BAT), the company’s share price fell in sympathy after Phillip Morris reported weak earnings. BAT’s business mix has an attractive split of 50% US/50% International markets, features a diversified portfolio across next generation products, and its core underlying business continues to perform as expected.

7.2 Within healthcare, two related firms focused on emerging cancer treatments, Bristol-Myers-Squibb and Ono Pharmaceutical, detracted most. The two companies share exposure to the immune-oncology (IO) agent Opdivo as Ono holds rights in Japan, South Korea and Taiwan while Bristol holds rights in all other markets. Although Opdivo reported positive clinical results for their lung cancer treatment in April, the stock prices fell primarily due to positive results for rival Merck’s cancer therapy Keytruda, which the market has viewed more favourably. The belief is that Bristol-Myers and Ono have the infrastructure to build IO treatments that can be used in a variety of cancers and mutations. Both positions will continue to be held.

7.3 Within financials, stock prices declined across the broad sector and our overweight position in Bank of America proved to be the largest detractor. Weakness from the overweight positioning in Bank of America was partially offset by underweight positioning in JPMorgan Chase and PNC Financial Services, which both declined during the quarter. Following a successful stress test, Bank of America announced it will increase its annual dividend by 25% and begin a share repurchasing program. Italy-based Anima Holdings and UniCredit also detracted during the quarter as the country's financial sector was pressured by political and economic uncertainty. Given the current valuations and potential positives to fundamentals, both positions will both still be held.

7.4 Within consumer discretionary, strong security selection in the retail subsector, particularly online home furnishings company, Wayfair, led results. Shares of Wayfair surged after the company reported better-than-expected revenue for the first quarter and management raised second quarter sales guidance, driven by strong customer advertising. Wayfair is well positioned to grow its home goods category with a large customer base, diverse product offerings, and a growing distribution network. TJX Companies, the largest global off-price apparel and home goods retailer which operates the TJ Maxx, Marshalls, and Home Goods brands also contributed to positive relative returns. The company reported strong quarterly results, beating consensus. TJX can achieve same-stores sales growth as it captures new customers with strong inventory management, targeted marketing, and excellent execution by a top management team. In addition, the company is unique in large caps as it has potential to outperform in both offensive and defensive macro environments.

7.5 Selection within the industrials sector was led by positions in Safran and TransUnion. Safran is a French producer of aircraft and rocket engines, propulsion systems, and aerospace equipment. The stock price rose after the company reported better-than-expected sales in the previous quarter driven by strong organic revenue growth. With global air travel continuing to increase year over year, management demonstrating prudent capital allocation, and synergies coming through from a recent acquisition of Zodiac, Safran has a long runway for growth and the position will remain held. Transunion also reported impressive first quarter results highlighted by organic revenue growth across market segments. In addition, the company announced the acquisition of Callcredit, the second largest UK consumer credit bureau, during the quarter. The above-market growth should be sustainable as the company benefits from launching new products and expanding into new verticles.

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