

	<p>Budget: 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.
<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: Listed Equities Report Appendix 2: Corporate Bonds Report Appendix 3: Property Report</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. 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 92.9% as at 30 September 2018. This improvement is largely the result of the substantial appreciation in the value of the Fund’s investments in 2016-17.
- 1.2 The Actuary has estimated that the average required employer contribution would be 20.6% of payroll compared 21.4% at the 31 March 2016 funding valuation.
- 1.3 Performance for the quarter was slightly ahead of the Fund’s combined benchmark, and is broadly in line with benchmark over all longer periods.
- 1.4 The quarter saw large gains in overseas developed equities markets, with UK and emerging markets equities markets generally quiet flat.
- 1.5 The quarter saw very high absolute and relative returns from both the Fund’s private equity managers, in part as a result of 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.
- 1.6 Similarly, absolute and relative returns from IFM, one of the Fund’s two Infrastructure managers, for the financial year to 30 September 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.

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 September 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 September 2018; and
 - estimated Fund returns based on Fund asset statements provided to 30 September 2018.
- 2.4 The results of this assessment indicate that the current projection of the funding level as at 30 September 2018 is 92.9% (90.1% at 30 June 2018) and the average required employer contribution would be 20.2% of payroll assuming the deficit is to be paid by 2038 (22.2% at 30 June 2018). 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 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.

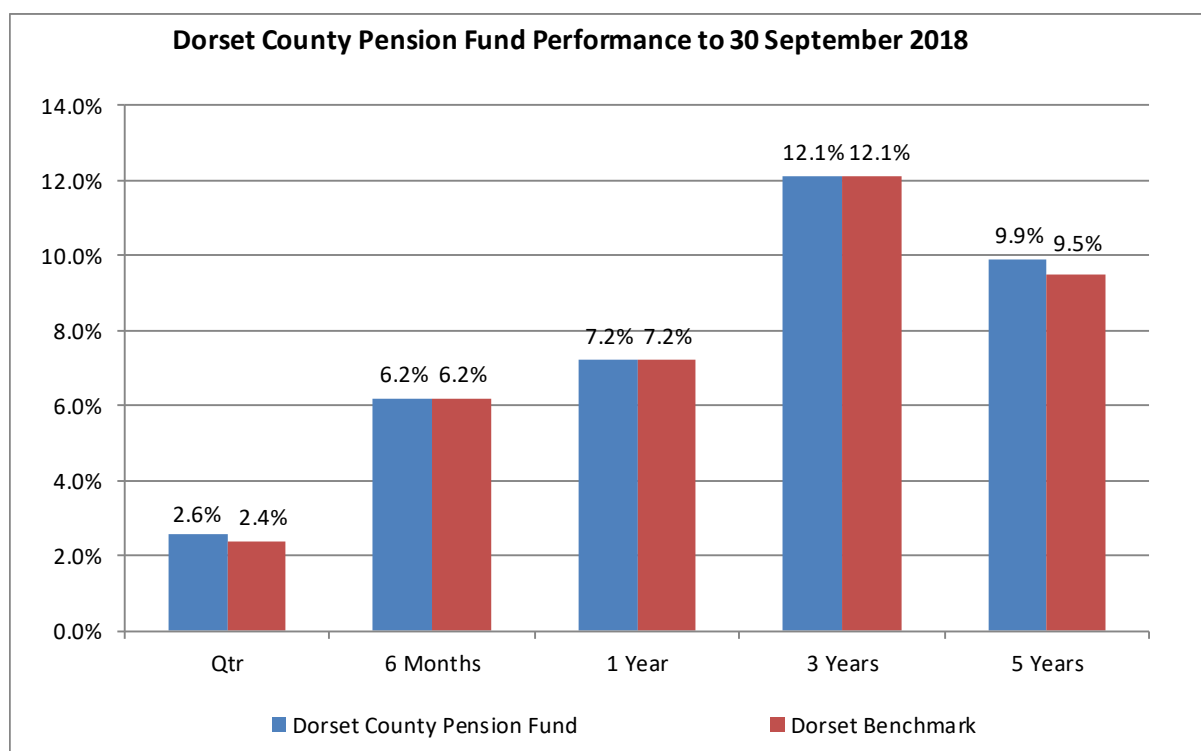
2. Asset Valuation

- 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 September 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).

Asset Class	Manager	31-Mar-18		30-Sep-18		Target Allocation		Tolerance
		£M	%	£M	%	£M	%	
UK Equities	Several	647.2	22.7%	659.6	21.8%	604.0	20.0%	+/- 4.0%
Overseas Equities	Several	691.4	24.2%	755.7	25.0%	664.4	22.0%	+/- 4.0%
Emerging Markets Equities	JP Morgan	103.2	3.6%	97.4	3.2%	90.6	3.0%	+/- 0.5%
Total Listed Equities		1,441.8	50.5%	1,512.7	50.1%	1,359.1	45.0%	
Corporate Bonds	RLAM	204.5	7.2%	203.2	6.7%	181.2	6.0%	+/- 1.5%
Multi Asset Credit	CQS	136.2	4.8%	138.7	4.6%	151.0	5.0%	+/- 1.0%
Diversified Growth	Barings	173.3	6.1%	178.7	5.9%	241.6	8.0%	+/- 1.0%
Infrastructure	Several	106.6	3.7%	136.5	4.5%	151.0	5.0%	+/- 1.0%
Private Equity	Several	76.5	2.7%	83.2	2.8%	151.0	5.0%	+/- 1.0%
Property	CBRE	295.4	10.4%	310.5	10.3%	362.4	12.0%	+/- 1.0%
Cash	Internal	40.0	1.4%	72.8	2.4%	-	0.0%	-
F/X Hedging	State Street	-	0.0%	0.5	0.0%	-	0.0%	-
Total Return Seeking Assets		2,474.3	86.7%	2,636.3	87.3%	2,597.4	86.0%	
Liability Matching Assets	Insight	379.7	13.3%	383.9	12.7%	422.8	14.0%	+/- 3.0%
Total Asset Valuation		2,854.0	100.0%	3,020.2	100.0%	3,020.2	100.0%	

3. Investment Performance

- 3.1 The overall performance of the Fund’s investments to 30 September 2018 is summarised below.



- 3.2 The Fund returned 6.2% for the financial year to 30 September 2018, matching its benchmark. Over the longer term, the Fund matched its benchmark over 3 years, returning an annualised 12.1%, and overperformed over 5 years, returning an annualised 9.9% against the benchmark of 9.5%.

- 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 September 2018, return seeking assets returned 6.9% against the benchmark return of 7.1%, and liability matching assets returned 1.1% against the benchmark return of -0.5%. 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 Equities

- 4.1 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). The performance of the Fund’s external managers is detailed in Appendix 1, and summarised in the tables below.

AXA Framlington

	Performance	Benchmark	Relative
Quarter	-1.3%	-0.8%	-0.5%
Financial Year to Date	6.4%	8.3%	-1.9%
12 months	3.4%	5.9%	-2.5%
3 years p.a.	7.7%	11.5%	-3.8%
5 years p.a.	6.5%	7.5%	-1.0%
Since inception p.a.	7.4%	6.2%	1.2%

Schroders

	Performance	Benchmark	Relative
Quarter	1.1%	-2.1%	3.2%
Financial Year to Date	6.6%	4.8%	1.8%
12 months	9.7%	0.6%	9.1%
3 years p.a.	16.1%	9.4%	6.7%
5 years p.a.	14.6%	8.6%	6.0%
Since inception p.a.	11.4%	7.1%	4.3%

Brunel/LGIM Passive

	Performance	Benchmark	Relative
Quarter	-1.6%	-1.5%	-0.1%
Since inception p.a.	-1.6%	-1.5%	-0.1%

Global Equities

- 4.2 On 18 July 2018, the holdings under the management of Allianz transferred to the Brunel Smart Beta portfolio managed by LGIM. The performance of the Fund’s

external global equities managers is detailed in Appendix 1 and summarised in the tables below.

Investec

	Performance	Benchmark	Relative
Quarter	5.8%	6.3%	-0.5%
Financial Year to Date	14.7%	14.9%	-0.2%
12 months	13.3%	14.4%	-1.1%
Since inception p.a.	16.9%	17.4%	-0.5%

Wellington

	Performance	Benchmark	Relative
Quarter	7.6%	6.3%	1.3%
Financial Year to Date	15.7%	14.9%	0.8%
12 months	17.2%	14.4%	2.8%
Since inception p.a.	18.9%	17.4%	1.5%

Brunel/LGIM Smart Beta

	Performance	Benchmark	Relative
Quarter	3.0%	3.1%	-0.1%
Since inception p.a.	3.0%	3.1%	-0.1%

Brunel/LGIM Smart Beta (Hedged)

	Performance	Benchmark	Relative
Quarter	2.8%	2.6%	0.2%
Since inception p.a.	2.8%	2.6%	0.2%

- 4.3 Relative performance in the quarter and the financial year to date was below the benchmark for Investec, whilst Wellington outperformed their benchmark over the same period. Over twelve months Wellington outperformed their benchmark but Investec underperformed theirs. Over the longer term both 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 Wellington are above their benchmark whilst Investec are underperforming their benchmark.

Emerging Markets Equities

- 4.4 The performance of JP Morgan, the Fund’s emerging markets equities manager is detailed in Appendix 1 and summarised below.

	Performance	Benchmark	Relative
Quarter	-0.8%	0.1%	-0.9%
Financial Year to Date	-5.7%	-2.1%	-3.6%
12 months	-2.4%	2.0%	-4.4%
3 years p.a.	18.4%	18.1%	0.3%
5 years p.a.	8.2%	8.2%	0.0%
Since inception p.a.	5.9%	5.9%	0.0%

- 4.5 Emerging markets equities in the quarter were weighed down by a slowdown in the pace of Chinese credit growth, and fears over the vulnerability of some economies to

tighter US monetary policy and concerns about the potential impact of global trade tensions. China has successfully slowed the pace of non-bank credit growth but, faced with the external headwind of US tariffs, the authorities are now easing policy to support domestic growth. This should provide some support for those countries that depend on Chinese demand.

- 4.6 In the quarter, Taiwanese stocks were the biggest detractors from performance for JP Morgan, primarily driven by technology stocks due to concerns over weak sales for the latest generation iPhone and a cyclical slowdown in semiconductors. Over the last 12 months, the strategy has underperformed driven by stock selection, notably in Asia. Long term performance over 3 and 5 years is broadly in line with benchmark.

Corporate Bonds

- 4.7 The performance of the Fund’s external Corporate Bonds manager, RLAM, is detailed in Appendix 2, and summarised below.

	Performance	Benchmark	Relative
Quarter	-0.4%	-0.6%	0.2%
Financial Year to Date	-0.6%	-1.0%	0.4%
12 months	1.0%	0.0%	1.0%
3 years p.a.	6.2%	5.4%	0.8%
5 years p.a.	7.2%	6.2%	1.0%
Since inception p.a.	8.5%	8.4%	0.1%

- 4.8 Absolute returns were negative for the quarter and financial year to 30 September, but ahead of benchmark for all periods. The manager outperformed the broader sterling credit market, with performance driven by their positioning in financials and being underweight in supra-nationals.

Multi Asset Credit (MAC)

- 4.9 The performance of the Fund’s external MAC manager, CQS, is covered in further detail elsewhere on the agenda and is summarised below.

	Performance	Benchmark	Relative
Quarter	1.5%	1.2%	0.3%
Financial Year to Date	1.8%	2.3%	-0.5%
Since inception (Dec-17)	2.7%	3.9%	-1.2%

Property

- 4.10 The performance of the Fund’s external Property manager, CBRE, is detailed in Appendix 3, and summarised below.

	Performance	Benchmark	Relative
Quarter	0.7%	1.7%	-1.0%
Financial Year to Date	2.5%	3.5%	-1.0%
12 months	7.6%	8.6%	-1.0%
3 years p.a.	7.6%	7.5%	0.1%
5 years p.a.	11.4%	10.9%	0.5%
Since inception p.a.	7.9%	7.9%	0.0%

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

Private Equity

- 4.12 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.
- 4.13 The tables below summarise performance to date for both managers.

HarbourVest

	Performance	Benchmark	Relative
Quarter	8.2%	-0.8%	9.0%
Financial Year to Date	23.6%	8.3%	15.3%
12 months	23.5%	5.9%	17.6%
3 years p.a.	19.1%	11.5%	7.6%
5 years p.a.	19.4%	7.5%	11.9%
Since inception p.a.	11.3%	6.1%	5.2%

Aberdeen Standard

	Performance	Benchmark	Relative
Quarter	7.5%	-0.8%	8.3%
Financial Year to Date	18.1%	8.3%	9.8%
12 months	23.7%	5.9%	17.8%
3 years p.a.	15.0%	11.5%	3.5%
5 years p.a.	11.6%	7.5%	4.1%
Since inception p.a.	3.1%	6.6%	-3.5%

- 4.14 Private Equity is an asset class that takes several years for commitments to be fully invested. The table below summarises the commitment the Fund has made in total to each manager, 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 September 2018 and the total gains or losses, which includes the distribution plus the latest valuation.

Private Equity Commitments, Drawdowns and Valuations

<u>Manager</u>	<u>Commitment Drawdown</u>			<u>Distribution Valuation</u>		<u>Gain</u>
	<u>£m</u>	<u>£m</u>	<u>%</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>
HarbourVest	107.7	70.9	66%	63.5	48.2	40.9
Aberdeen Standard	77.7	53.2	68%	49.1	35.0	31.0
Brunel	60.0	0.0	0%	0.0	0.0	0.0
Total	245.4	124.0	51%	112.7	83.3	71.9

- 4.15 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, Aberdeen Standard and the Brunel private markets team to identify further opportunities for investment.

Diversified Growth Funds (DGF)

- 4.16 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. The fund’s objective is to deliver ‘equity like’ returns (over the long term) but with about 70% of the equity risk.
- 4.17 The performance for Barings is summarised below.

	Performance	Benchmark	Relative
Quarter	1.7%	1.2%	0.5%
Financial Year to Date	3.1%	2.4%	0.7%
12 months	2.7%	4.7%	-2.0%
3 years p.a.	6.7%	4.5%	2.2%
5 years p.a.	4.7%	4.6%	0.1%
Since inception p.a.	4.8%	4.6%	0.2%

- 4.18 The manager’s decision to shift equity allocations to US and the long-held allocation to Japan were the main contributors to performance. Substantially reducing the exposure to emerging market debt also aided performance.

Infrastructure

- 4.19 The Fund has two external infrastructure managers, Hermes and IFM. 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 Hermes senior management holding in total the remaining 10.5%. Infrastructure and private equity mandates will continue to be managed under their existing ownership and governance structure.
- 4.20 As with Private Equity, Infrastructure is a long term investment that takes several years for commitments to be fully invested. Performance to date for each manager is summarised in the tables below:

Hermes

	Performance	Benchmark	Relative
Quarter	-1.7%	2.5%	-4.2%
Financial Year to Date	-1.0%	5.0%	-6.0%
12 months	8.6%	10.0%	-1.4%
3 years p.a.	8.8%	10.0%	-1.2%
5 years p.a.	N/A	N/A	-
Since inception p.a.	8.4%	10.0%	-1.6%

- 4.21 Valuations of regulated utilities have decreased reflecting the impact of recent policy announcements by UK regulators in relation to price controls in the water and energy sectors.

IFM

	Performance	Benchmark	Relative
Quarter	7.8%	2.5%	5.3%
Financial Year to Date	13.1%	5.0%	8.1%
12 months	22.4%	10.0%	12.4%
3 years p.a.	N/A	N/A	-
5 years p.a.	N/A	N/A	-
Since inception p.a.	18.3%	10.0%	8.3%

- 4.22 During the quarter, IFM completed the acquisition of a 49% stake in FCC Aqualia (a leading Spanish water company) and the disinvestment of its remaining 20% stake in 50Hertz. Positive returns were driven by outperformance from 50Hertz, Vienna Airport, and Manchester Airports Group, partially offset by a negative yield from Mersin International Port. Distributions also contributed to performance.
- 4.23 Following the end of the quarter, IFM GIF announced the acquisition of a 50% stake in Impala Terminals, a diversified portfolio of base metal terminal infrastructure assets located in Peru, Spain and Mexico. The transaction is subject to regulatory approvals in Europe.
- 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	4,143
Valuation 30-Sep-18	383,860

- 4.26 Officers and the Independent Adviser, supported by Mercer, have concluded 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 be implemented 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 September 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	2,330	0.15%
Svenska Handelsbanken	5,000	0.68%
Total Call Accounts	<u>7,330</u>	<u>0.51%</u>
<u>Money Market Funds</u>		
Standard Life	8,000	0.66%
BNP Paribas	15,000	0.68%
Federated Prime Rate	15,000	0.69%
Deutsche	15,000	0.70%
Goldman Sachs	700	0.63%
Total Money Market Funds	<u>53,700</u>	<u>0.68%</u>
<u>Holding Accounts</u>		
HSBC Custody Accounts	-	0.00%
Property Client Account	2,043	0.00%
State Street Custody Accounts	9,716	0.00%
Total Holding Accounts	<u>11,759</u>	<u>0.00%</u>
Total Cash / Average Return	<u>72,789</u>	<u>0.56%</u>

- 5.2 The Fund is currently ‘cashflow positive’ as it 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 £20M 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 six months ended 30 September 2018

	<u>£M</u>	<u>£M</u>
Cash at 1 April 2018		40.0
Less:		
Property Transactions (net)	15.4	
Diversified Growth Fund (net)	0.0	
Multi Asset Fund (net)	0.0	
Infrastructure Drawdowns (net)	22.8	
Currency Hedge (net)	22.0	
		<u>60.2</u>
Plus:		
Private Equity (net)	8.8	
UK Equity transactions (net)	36.6	
Liability Matching Bond (net)	0.0	
Overseas Equities	35.3	
Hedge Funds (net)	0.0	
Bonds (net)	0.0	
Increase in Cash	12.3	
		<u>93.0</u>
Cash at 30 September 2018		<u>72.8</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 6.7% 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 21.8% against the revised target of 20%.
- 6.4 The internally managed passive UK equity portfolio, and the Allianz managed Global Equity portfolios transitioned to Brunel portfolios managed by Legal and General Investment Management (LGIM) in July 2018. In order to bring equity allocations closer to target, as part of these transitions there was a disinvestment of the self-managed UK equity portfolio of £30M, and disinvestments totalling £35M from the Allianz managed Global Equity portfolio.
- 6.5 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.
- 6.6 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.

Richard Bates
Pension Fund Administrator
November 2018