Pension Fund Committee

Dorset County Council

Date of Meeting	27 February 2019
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 31 December 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 31 December 2018 is 91.3% and the average required employer contribution would be 20.2% of payroll assuming the deficit is to be paid by 2038. The value of the Fund's assets at 31 December 2018 was £2,844M compared to £2,854M at the start of the financial year. The Fund returned -0.3% over the financial year to 31 December 2018, which is below its strategic benchmark of 1.5%. Return seeking assets returned -0.5%, whilst the liability matching assets returned 0.8%.
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.
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: Listed Equities Report Appendix 2: Corporate Bonds Report Appendix 3: Property Report
Background Papers	
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1. Key points to highlight

1.1 The estimated funding level has improved from 83.2% at the last triennial valuation, as at 31 March 2016, to 91.3% as at 31 December 2018. This improvement is largely the result of the substantial appreciation in the value of the Fund's assets in 2016-17.

1.2 The Actuary has estimated that the average required employer contribution would be 20.2% of payroll compared 21.4% at the 31 March 2016 funding valuation.

1.3 The quarter saw large falls in all listed equities' markets, which drove a fall in the value of the Fund's assets of 6% from £3.02 billion at 30 September 2018 to £2.84 billion at 31 December 2018.

1.4 The performance return for the quarter was 5.9% compared to the combined benchmark return of 4.5%, which has had a negative impact on absolute and relative performance over the financial year to date and all longer periods.

1.5 As at 31 December 2018, 38.8% of the Fund's liabilities were hedged against inflation sensitivity.

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 31 December 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 31 December 2018; and
- estimated Fund returns based on Fund asset statements provided to 31 December 2018.

2.4 The results of this assessment indicate that the current projection of the funding level as at 31 December 2018 is 91.3% (92.9% at 30 September 2018) and the average required employer contribution would be 20.2% of payroll assuming the deficit is to be paid by 2038 (20.6% at 30 September 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.

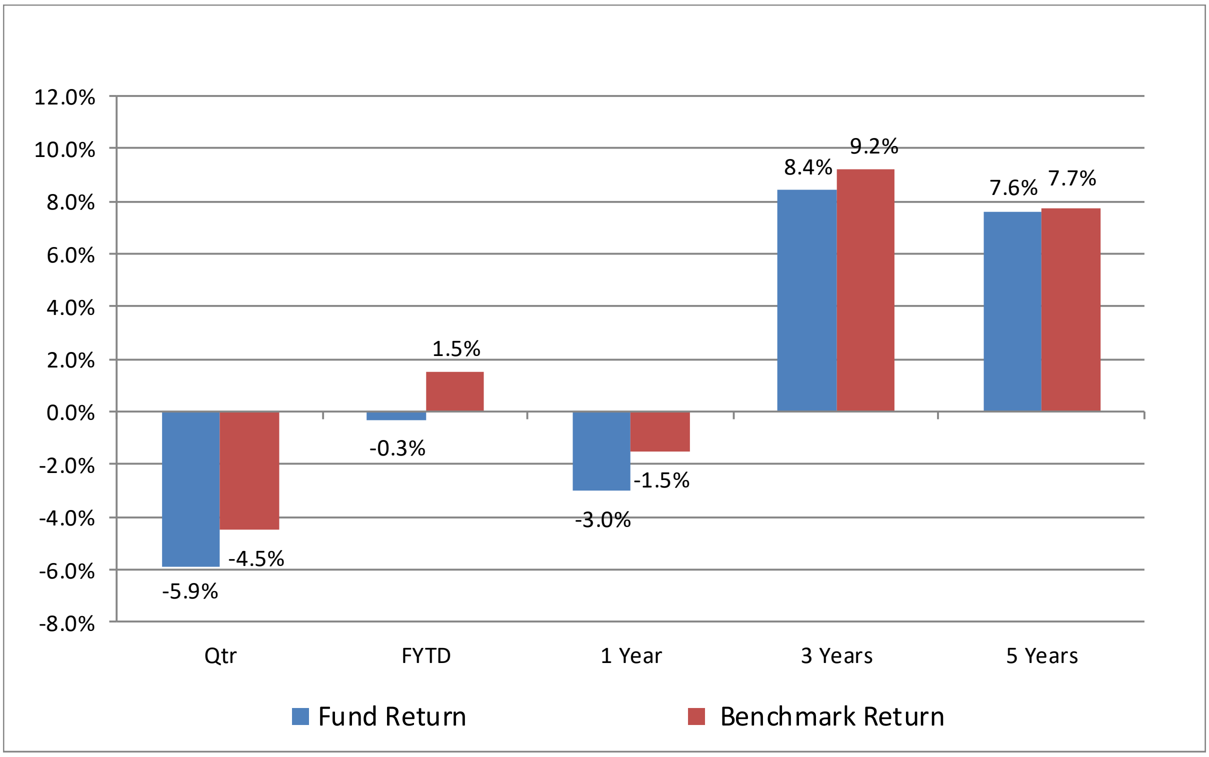
2. Asset Valuation

2.1 The table below shows the Fund's asset valuation by asset class at the beginning of the financial year and as at 31 December 2018, together with the target allocation as agreed at the meeting of the Committee, 13 September 2017.

		31-Mar-18		31-Dec-18		Target Allocation	
Asset Class	**Manager**	**£M**	**%**	**£M**	**%**	**£M**	**%**
UK Equities	Several	684.4	24.0%	596.1	21.0%	568.8	20.0%
Overseas Equities	Several	654.2	22.9%	635.4	22.3%	625.7	22.0%
Emerging Markets Equities	JP Morgan	103.2	3.6%	91.3	3.2%	85.3	3.0%
Total Listed Equities		***1,441.8***	***50.5%***	***1,322.8***	***46.5%***	***1,279.8***	***45.0%***
Corporate Bonds	RLAM	204.5	7.2%	203.5	7.2%	170.6	6.0%
Multi Asset Credit	CQS	136.2	4.8%	135.8	4.8%	142.2	5.0%
Diversified Growth	Barings	173.3	6.1%	166.0	5.8%	227.5	8.0%
Infrastructure	Several	106.6	3.7%	138.6	4.9%	142.2	5.0%
Private Equity	Several	76.5	2.7%	84.6	3.0%	142.2	5.0%
Property	CBRE	295.4	10.4%	317.5	11.2%	341.3	12.0%
Cash	Internal	40.0	1.4%	93.7	3.3%	-	0.0%
F/X Hedging	State Street	-	0.0% -	1.0	0.0%	-	0.0%
Total Return Seeking Assets		**2,474.3**	**86.7%**	**2,461.5**	**86.6%**	**2,445.9**	**86.0%**
Liability Matching Assets	Insight	379.7	13.3%	382.6	13.5%	398.2	14.0%
Total Asset Valuation		**2,854.0**	**100.0%**	**2,844.1**	**100.0%**	**2,844.1**	**100.0%**

3. Investment Performance

3.1 The overall performance of the Fund's investments to 31 December 2018 is summarised below.



3.2 The Fund returned -0.3% for the financial year to 31 December 2018, underperforming its benchmark by 1.8%. Over the longer term, the Fund underperformed its benchmark over 3 years, returning an annualised 8.4% against the benchmark return of 9.2%, and underperformed over 5 years, returning an annualised 7.6% against the benchmark of 7.7%.

3.3 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. For the financial year to 31 December 2018, return seeking assets returned -0.5% against the benchmark return of 1.2%, and liability matching assets returned 0.8% against the benchmark return of 3.1%.

4. Performance by Asset Class and Investment Manager

UK Listed Equites

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). On 21 November 2018, assets under the management of AXA Framlington transferred to the Brunel UK Equities Active portfolio. The performance of the Fund's external mangers is detailed in Appendix 1 and summarised in the tables below.

Brunel/LGIM Passive - £341.8m assets under management (AUM)

	Performance	Benchmark	Relative
Quarter	-10.2%	-10.2%	0.0%
Since inception	-11.6%	-11.6%	0.0%

Schroders - £51.9m AUM

	Performance	Benchmark	Relative
Quarter	-12.9%	-12.1%	-0.8%
Financial Year to Date	-7.2%	-7.8%	0.6%
12 months	-10.6%	-13.8%	3.2%
3 years p.a.	10.1%	3.9%	6.2%
5 years p.a.	9.8%	4.3%	5.5%
Since inception p.a.	10.0%	5.9%	4.1%

Global Developed Markets Equites

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 - £196.9m AUM

	Performance	Benchmark	Relative
Quarter	-12.4%	-11.3%	-1.1%
Financial Year to Date	0.5%	1.9%	-1.4%
12 months	-5.9%	-3.0%	-2.9%
3 Years p.a.	9.6%	11.6%	-2.0%
Since inception p.a.	10.6%	11.4%	-0.8%

Wellington - £214.9m AUM

	Performance	Benchmark	Relative
Quarter	-13.0%	-11.3%	-1.7%
Financial Year to Date	0.7%	1.9%	-1.2%
12 months	-2.6%	-3.0%	0.4%
3 years p.a.	11.1%	11.6%	-0.5%
Since inception p.a.	12.0%	11.4%	0.6%

Brunel/LGIM Smart Beta - £136.7m AUM

	Performance	Benchmark	Relative
Quarter	-8.9%	-8.8%	-0.1%
Since inception	-6.2%	-6.0%	-0.2%

Brunel/LGIM Smart Beta (Hedged) - £118.2m AUM

	Performance	Benchmark	Relative
Quarter	-11.2%	-11.3%	0.1%
Since inception	-8.7%	-9.0%	0.3%

4.3 Relative performance in the quarter and the financial year to date was below the benchmark for both Investec and Wellington. Over twelve months both Wellington and Investec underperformed their benchmarks. Since inception in December 2015 Wellington are above their benchmark whilst Investec are underperforming their benchmark.

4.4 Please note that the Fund's Global Equities managers have some exposure to UK equities (approximately 6-7% of assets under management).

Emerging Markets Equities - £91.3m AUM

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

	Performance	Benchmark	Relative
Quarter	-6.2%	-5.3%	-0.9%
Financial Year to Date	-11.6%	-7.2%	-4.4%
12 months	-13.6%	-9.3%	-4.3%
3 years p.a.	14.8%	14.7%	0.1%
5 years p.a.	6.9%	7.1%	-0.2%
Since inception p.a.	4.6%	4.8%	-0.2%

4.6 The final quarter of 2018 saw emerging markets further challenged after a tough year. There were significant falls in China, by far the largest of the emerging markets, driven by ongoing uncertainty around US tariffs and regulatory tightening concerns.

Corporate Bonds - £203.5m AUM

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	0.2%	0.1%	0.1%
Financial Year to Date	-0.5%	-0.8%	0.3%
12 months	-1.8%	-2.2%	0.4%
3 years p.a.	6.3%	5.4%	0.9%
5 years p.a.	6.9%	6.3%	0.6%
Since inception p.a.	8.3%	8.2%	0.1%

4.8 Absolute returns were positive for the quarter and for the financial year to 31 December 2018 and ahead of the benchmark for all longer 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) - £135.8m AUM

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

	Performance	Benchmark	Relative
Quarter	-2.1%	1.2%	-3.3%
Financial Year to Date	-0.3%	3.5%	-3.8%
12 months	0.4%	4.7%	-4.3%
Since inception (Dec-17)	0.6%	4.7%	-4.1%

4.10 The benchmark for the CQS fund is cash (1 month LIBOR) plus 4% over the longer term.

Property - £317.5m AUM

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

	Performance	Benchmark	Relative
Quarter	0.9%	1.5%	-0.6%
Financial Year to Date	3.4%	5.1%	-1.7%
12 months	5.5%	7.1%	-1.6%
3 years p.a.	6.8%	6.9%	-0.1%
5 years p.a.	10.6%	10.6%	0.0%
Since inception p.a.	7.8%	7.8%	0.0%

4.12 The portfolio has underperformed the Investment Property Databank (IPD) benchmark over 1 year and 3 years and matched the index over 5 years.

Diversified Growth Funds (DGF) - £166.0m AUM

4.13 Diversified Growth Funds 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 objective of the Barings fund is to deliver 'equity like' returns (over the long term) but with about 70% of the equity risk. The manager seeks to achieve out performance against a cash benchmark by focusing on asset allocation decisions.

4.14 The performance for Barings is summarised below.

	Performance	Benchmark	Relative
Quarter	-7.1%	1.2%	-8.3%
Financial Year to Date	-4.2%	3.6%	-7.8%
12 months	-6.4%	4.8%	-11.2%
3 years p.a.	2.8%	4.6%	-1.8%
5 years p.a.	2.8%	4.6%	-1.8%
Since inception p.a.	3.5%	4.6%	-1.1%

4.15 The benchmark for the Barings fund is cash (3 month LIBOR) plus 4% over the longer term.

Private Equity

4.16 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 31 December 2018 and the total gains or losses, which includes the distribution plus the latest valuation.

Private Equity Commitments, Drawdowns and Valuations

Manager	**Commitment**	**Drawndown**		**Distribution**	**Valuation**	**Gain**
	£m	**£m**	**%**	**£m**	**£m**	**£m**
HarbourVest	110.0	75.3	68%	68.1	49.4	42.2
Aberdeen Standard	79.0	54.6	69%	53.4	35.2	34.1
Brunel	60.0	0.0	0%	0.0	0.0	0.0
Total	**249.0**	**129.8**	**52%**	**121.5**	**84.6**	**76.2**

4.17 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.

4.18 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 these investments 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.

4.19 The tables below summarise performance to date for both managers.

HarbourVest - £49.3m AUM

	Performance	Benchmark	Relative
Quarter	2.6%	-10.2%	12.8%
Financial Year to Date	26.8%	-2.8%	29.6%
12 months	22.2%	-9.5%	31.7%
3 years p.a.	17.8%	6.1%	11.7%
5 years p.a.	18.9%	4.1%	14.8%
Since inception p.a.	11.2%	5.1%	6.1%

Aberdeen Standard - £35.2m - AUM

	Performance	Benchmark	Relative
Quarter	6.0%	-10.2%	16.2%
Financial Year to Date	25.2%	-2.8%	28.0%
12 months	29.4%	-9.5%	38.9%
3 years p.a.	15.2%	6.1%	9.1%
5 years p.a.	13.1%	4.1%	9.0%
Since inception p.a.	3.5%	5.6%	-2.1%

Infrastructure

4.20 As with Private Equity, Infrastructure is a long term investment that takes several years for commitments to be fully invested. The Fund has two external infrastructure managers, Hermes and IFM. Performance to date for each manager is measured against a 10% absolute annual return benchmark, and summarised in the tables below:

Hermes - £52.3m AUM

	Performance	Benchmark	Relative
Quarter	0.7%	2.5%	-1.8%
Financial Year to Date	-0.4%	7.5%	-7.9%
12 months	5.6%	10.2%	-4.6%
3 years p.a.	8.9%	10.1%	-1.2%
Since inception p.a.	8.6%	10.0%	-1.4%

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 - £86.2m AUM

	Performance	Benchmark	Relative
Quarter	3.6%	2.5%	1.1%
Financial Year to Date	17.2%	7.5%	9.7%
12 months	22.9%	10.2%	12.7%
Since inception p.a.	18.0%	10.0%	8.0%

4.22 During the quarter, IFM completed two acquisitions: a 37.5% stake in Global Container Terminals (GCT), an operator of four container terminals in Canada and the US, and a 50% stake in Impala Terminals (a diversified portfolio of base metal terminal infrastructure assets located in Peru, Spain and Mexico). Following the end of the quarter, IFM completed the acquisition of an additional 25% stake in VTTI.

4.23 The broader portfolio continued to deliver positive returns in local currency terms, with outperformance, in particular from Freeport Train 2, Indiana Toll Road and Mersin International Port. This performance was partially offset by negative yields from VTTI, Arqiva Limited, M6Toll and Vienna Airport.

Liability Driven Investment (LDI) - £382.6m AUM

4.24 The Fund's external LDI manager is Insight Investments. 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, and these changes have now been implemented.

4.25 LDI strategies allow pension schemes to continue investing in return-seeking assets while hedging out their liability risks through the use of leverage. As at 31 December 2018, 13.5% of the Fund's assets were invested in the mandate but 38.8% of the Fund's liabilities were hedged against inflation sensitivity i.e. if the value of the Fund's liabilities increased by £100m (purely as a result of changes to inflation expectations), the value of the assets under management would be expected to increase by approximately £39m.

4.26 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.

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 31 December 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 %
Fixed Term Deposits		
Lloyds Banking Group	5,000	0.90%
Lloyds Banking Group	5,000	1.00%
Total Fixed Term Deposits	10,000	0.95%
Call Accounts		
National Westminster Bank	415	0.15%
Svenska Handelsbanken	5,000	0.68%
Total Call Accounts	5,415	0.64%
Money Market Funds		
Aberdeen Standard	15,000	0.74%
BNP Paribas	15,000	0.77%
Federated Prime Rate	15,000	0.74%
Deutsche	11,000	0.73%
Goldman Sachs	15,000	0.69%
Total Money Market Funds	71,000	0.73%
Holding Accounts		
HSBC Custody Accounts	-	0.00%
Property Client Account	582	0.00%
State Street Custody Accounts	6,713	0.75%
Total Holding Accounts	7,295	0.69%
Total Cash / Average Return	**93,710**	**0.75%**

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.

Summary Cashflow for the Financial Year to 31 December 2018

	£M	£M
Cash at 1 April 2018		**40.0**
Less:		
Property Transactions (net)	22.1	
Infrastructure Drawdowns (net)	19.6	
Currency Hedge (net)	25.9	
		67.6
Plus:		
Private Equity (net)	10.2	
UK Equity transactions (net)	7.0	
UK Passive Internally Managed Disinvestment (net)	30.0	
Allianz Disinvestment (net)	34.2	
AXA Framlington Disinvestment (net)	10.0	
LGIM UK Passive (net)	15.0	
Net Contributions	14.9	
		121.3
Cash at 31 December 2018		**93.7**

6. Implementation of changes to Strategic Asset Allocation

6.1 At its meeting on 13 September 2017, the Committee agreed a number of changes to the strategic asset allocation of the Fund. 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 5.8% against the revised target of 8%, and the current allocation to UK Equities as 21.0% 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. On 21 November 2018, assets under management of external UK Equities manager AXA Framlington were transferred to the Brunel UK Equities Active portfolio. As part of these transitions there were disinvestments of £30M from the self-managed UK Equities portfolio, £35M from the Allianz portfolio, and £10M from the AXA Framlington pooled fund, followed by a further £15M disinvestment from the LGIM passive equities fund.

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
February 2019