



Pension Fund Committee

Fund Administrator's Report

Date of Meeting: 27 November 2019

Director: Aidan Dunn, Executive Director Corporate Development

Executive Summary:

The purpose of this report is to update the Committee on the Pension Fund's funding position, and the valuation and overall performance of the Fund's investments as at 30 September 2019. The report provides a summary of the performance of all external investment managers and addresses other topical issues for the Fund that do not require a separate report.

Barnett Waddingham, the Fund's actuary, have now completed their full assessment of the funding position for the triennial valuation as at 31 March 2019. The funding level is estimated to have improved from 83% as at 31 March 2016 to 92% as at 31 March 2019.

The estimated value of the Fund's assets at 30 September 2019 was £3,139M compared to £3,023M at the start of the financial year. The quarter saw rises in all listed equities markets, which drove a rise in the value of the Fund's assets.

The total return from the Fund's investments over the financial year to 30 September 2019 was 5.1%, compared to the combined benchmark return of 4.8%. Over the last 12 months the Fund's investments have returned 5.2%, below the Fund's combined benchmark return of 5.9%.

The Fund's relative underperformance over the last year is partly a result of high cash balances that have built up as part of the cautious approach to market outlooks. It is also driven by the managers with 'cash plus' or 'absolute return' benchmarks not directly linked to market returns. The Fund's currency hedging strategy also acts as a 'drag' on performance, at times when sterling depreciates against other major currencies, particularly the US dollar.

As at 30 September 2019, 45% of the Fund's liabilities were hedged against inflation sensitivity through the Fund's Liability Driven Investment (LDI) mandate with Insight Investment.

Equalities Impact Assessment:

This report does not deal with any new strategies or policies that would trigger an impact assessment.

Budget:

Not applicable.

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.

Climate Implications:

The Fund's Investment Strategy Statement requires all external investment managers to consider and manage all financially material risks arising from environmental issues, including those associated with climate change.

Other Implications:

None.

Recommendation:

That the Committee:

- 1) Review and comment upon the activity and overall performance of the Fund.
- 2) 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 target.

Appendices:

- Appendix 1: Listed Equities Report
- Appendix 2: Corporate Bonds Report (RLAM)
- Appendix 3: Multi Asset Credit (CQS)
- Appendix 4: Property Report (CBRE)
- Appendix 5: Liability Driven Investment (Insight)

Background Papers:

Funding Strategy Statement June 2017
Investment Strategy Statement March 2018

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1. Funding Update

- 1.1 The Fund's actuary, Barnett Waddingham, undertakes a full assessment of the funding position every three years. This was last completed as at 31 March 2016 when the Fund had a funding level of 83% i.e. assets were estimated to be 83% of the value that they would have needed to be to pay for the expected benefits accrued to that date, based on the assumptions used.
- 1.2 The actuary has now completed its latest triennial review of the funding position as at 31 March 2019, and the estimated funding level has improved to 92%.
- 1.3 In addition to the full triennial assessment, officers have 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.
- 1.4 Results for all scheme employers were received and shared with employers in November 2019. The final certificate of the contribution rates applicable for all employers for 2020-21, 2021-22 and 2022-23 must be issued by the actuary before 31 March 2020 at the latest.
- 1.5 Committee members will receive a full update on the results of the latest valuation from Barnett Waddingham at the training day on 26 November 2019.

2. Asset Valuation Summary

- 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 2019, together with the target allocation as agreed at the meeting of the Committee on 13 September 2017.

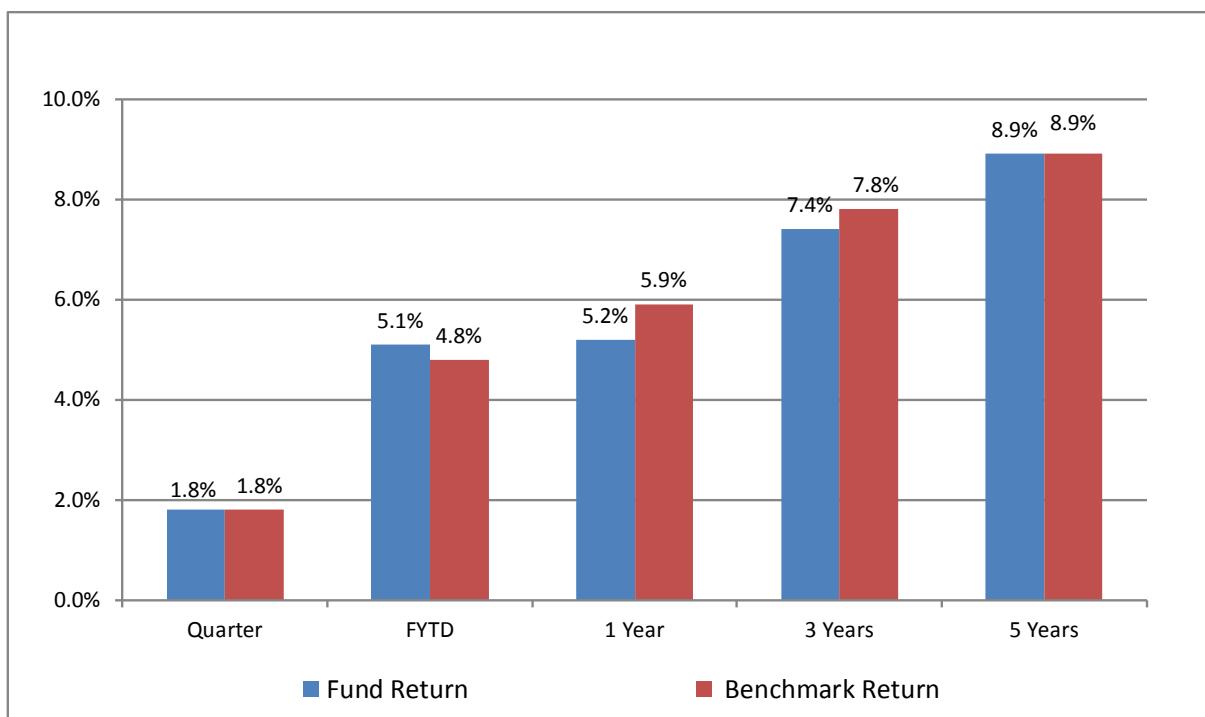
Asset Class	31-Mar-19		30-Sep-19		Target Allocation	
	£M	%	£M	%	£M	%
UK Equities	643.0	21.3%	642.8	20.5%	627.8	20.0%
Overseas Equities	703.0	23.3%	771.8	24.6%	690.6	22.0%
Emerging Markets Equities	98.2	3.2%	101.8	3.2%	94.2	3.0%
Total Listed Equities	1,444.2	47.8%	1,516.4	48.3%	1,412.6	45.0%
Corporate Bonds	214.4	7.1%	230.3	7.3%	188.3	6.0%
Multi Asset Credit	139.7	4.6%	142.7	4.5%	157.0	5.0%
Diversified Growth	176.1	5.8%	183.4	5.8%	251.1	8.0%
Infrastructure	138.7	4.6%	177.1	5.6%	157.0	5.0%
Private Equity	80.3	2.7%	93.9	3.0%	157.0	5.0%
Property	323.3	10.7%	321.9	10.3%	376.7	12.0%
Cash	105.1	3.5%	69.1	2.2%	-	0.0%
F/X Hedging	0.7	0.0%	0.2	0.0%	-	0.0%
Total Return Seeking Assets	2,622.5	86.7%	2,735.0	87.1%	2,699.6	86.0%
Liability Matching Assets	401.1	13.3%	404.1	12.9%	439.5	14.0%
Total Asset Valuation	3,023.6	100.0%	3,139.1	100.0%	3,139.1	100.0%

3. Implementation of changes to Strategic Asset Allocation

- 3.1 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.
- 3.2 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 7.3% against the revised target of 6%.
- 3.3 The increased allocation to Diversified Growth Funds (DGF) was met in part by investing a further £50M in the Baring Dynamic Asset Allocation Fund in February 2018 funded by partial disinvestment from the then internally managed UK equities portfolio. This leaves the current allocation to DGF as 5.8% against the revised target of 8%. This shortfall will be met when the Brunel DGF portfolio is open for investment, expected January/February 2020.
- 3.4 The total allocation to Listed Equities has reduced from 53% when the strategic allocation was agreed to 48% as at 30 September 2019, compared to the target of 45%. In July 2018, the internally managed passive UK equity portfolio, and the global equity investments managed by Allianz transitioned to Brunel portfolios managed by Legal and General Investment Management (LGIM). In November 2018, assets under management of external UK Equities manager AXA Framlington were transferred to the Brunel UK Equities Active portfolio.
- 3.5 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 £3.2M invested as at 30 September 2019, with a further 2.0% commitment to the Brunel Secured Income portfolio of which £2.9M had been invested by the end of September 2019. Drawdowns against commitments will be funded from cash balances and/or further disinvestment from equities and corporate bonds.
- 3.6 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. There will be a review of the strategic asset allocation now that the results of the triennial valuation are known.

4. Investment Performance Summary

- 4.1 The overall performance of the Fund's investments to 30 September 2019 is summarised below (returns for three and five years are annualised figures).



- 4.2 The Fund returned 1.8% for the three months to 30 September 2019, matching the combined benchmark. Over the longer term, the Fund underperformed its benchmark over 1 year, returning an annualised 5.2% against the benchmark return of 5.9% and underperformed its benchmark over 3 years returning an annualised 7.4% against the benchmark return of 7.8%. The Fund matched its combined benchmark over 5 years, returning an annualised 8.9%.
- 4.3 The Fund's relative underperformance over one year is partly a result of the high cash balances which we have allowed to develop as part of cautious approach to current market outlook. It is also driven by the performance of managers who have 'cash plus' or 'absolute return' benchmarks which are not directly linked to market returns, particularly over the shorter term. The Fund's currency hedging strategy also acts as a 'drag' on performance, at times when sterling depreciates against other major currencies, particularly the US dollar.

5. Performance by Asset Class and Investment Manager

UK Equities

- 5.1 In July 2018, the internally managed UK equity portfolio transferred to the Brunel UK Passive Equities portfolio managed by Legal & General Investment Management (LGIM). In November 2018, assets under the management of AXA Framlington transferred to the Brunel UK Equities Active portfolio. The performance of the Fund's external managers is detailed in Appendix 1 and summarised in the tables below.

Brunel/LGIM Passive - £391.0m assets under management (AUM)

	Performance	Benchmark	Relative
Quarter	1.3%	1.3%	0.0%
Financial Year to Date	4.5%	4.6%	-0.1%
12 months	2.8%	2.7%	0.1%
Since inception	0.9%	1.0%	-0.1%

Brunel UK Active - £168.8m AUM

	Performance	Benchmark	Relative
Quarter	0.3%	1.3%	-1.0%
Financial Year to Date	3.4%	4.6%	-1.2%
Since inception	9.6%	10.8%	-1.2%

Schroders - £54.0m AUM

	Performance	Benchmark	Relative
Quarter	-0.8%	-1.2%	0.4%
Financial Year to Date	3.9%	-0.3%	4.2%
12 months	-8.0%	-7.8%	-0.2%
3 years p.a.	9.9%	3.0%	6.9%
5 years p.a.	11.1%	5.7%	5.4%
Since inception p.a.	9.9%	6.0%	3.9%

Global Developed Markets Equities

- 5.2 In 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 - £239.3m AUM

	Performance	Benchmark	Relative
Quarter	3.0%	3.8%	-0.8%
Financial Year to Date	8.9%	10.6%	-1.7%
12 months	6.4%	7.8%	-1.4%
3 Years p.a.	11.4%	12.2%	-0.8%
Since inception p.a.	14.1%	14.8%	-0.7%

Wellington - £266.6m AUM

	Performance	Benchmark	Relative
Quarter	3.9%	3.8%	0.1%
Financial Year to Date	11.9%	10.6%	1.3%
12 months	7.9%	7.8%	0.1%
3 years p.a.	13.1%	12.2%	0.9%
Since inception p.a.	15.9%	14.8%	1.1%

Brunel/LGIM Smart Beta - £158.7m AUM

	Performance	Benchmark	Relative
Quarter	4.9%	4.9%	0.0%
Financial Year to Date	11.5%	11.4%	0.1%
12 months	10.9%	11.0%	-0.1%
Since inception	11.2%	11.4%	-0.2%

Brunel/LGIM Smart Beta (Hedged) - £141.4m AUM

	Performance	Benchmark	Relative
Quarter	2.6%	2.6%	0.0%
Financial Year to Date	5.7%	5.7%	0.0%
12 months	4.7%	5.1%	-0.4%
Since inception	6.1%	6.7%	-0.6%

- 5.3 Relative performance in the quarter was above benchmark for Wellington but Investec were below their benchmark. Over twelve months Investec underperformed their benchmark by 1.4%, whilst Wellington outperformed by 0.1%. Since inception in December 2015 Wellington are above their benchmark whilst Investec are underperforming their benchmark.
- 5.4 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 - £101.8m AUM

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

	Performance	Benchmark	Relative
Quarter	-0.5%	-1.1%	0.6%
Financial Year to Date	3.7%	1.9%	1.8%
12 months	4.5%	3.7%	0.8%
3 years p.a.	8.5%	7.9%	0.6%
5 years p.a.	8.9%	8.1%	0.8%
Since inception p.a.	5.7%	5.6%	0.1%

- 5.6 The quarter to 30 September 2019 saw emerging markets outperform its benchmark as both stock selection and country allocation contributed to relative returns. Stock selection in Taiwan was one of the leading contributors to relative returns during the period.

Corporate Bonds - £230.4m AUM

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

	Performance	Benchmark	Relative
Quarter	4.6%	5.0%	-0.4%
Financial Year to Date	7.5%	7.6%	-0.1%
12 months	13.4%	13.6%	-0.2%
3 years p.a.	5.4%	4.0%	1.4%
5 years p.a.	7.6%	7.0%	0.6%
Since inception p.a.	8.9%	8.8%	0.1%

- 5.8 The manager was under the benchmark for the quarter and 12 months but above the benchmark over all longer periods.

Multi Asset Credit (MAC) - £142.7m AUM

- 5.9 The performance of the Fund's external MAC manager, CQS, is detailed in Appendix 3 and summarised below.

	Performance	Benchmark	Relative
Quarter	0.6%	1.2%	-0.6%
Financial Year to Date	2.2%	2.4%	-0.2%
12 months	2.9%	4.8%	-1.9%
Since inception (Dec-17)	3.1%	4.7%	-1.6%

- 5.10 The target for the CQS fund is cash (1 month LIBOR) plus 4% over the longer term, and this is used as the benchmark for the investment.

Property - £321.9m AUM

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

	Performance	Benchmark	Relative
Quarter	0.8%	0.3%	0.5%
Financial Year to Date	1.5%	0.9%	0.6%
12 months	4.0%	2.1%	1.9%
3 years p.a.	6.8%	6.6%	0.2%
5 years p.a.	8.2%	7.7%	0.5%
Since inception p.a.	7.7%	7.6%	0.1%

- 5.12 Assets under the management of CBRE at 30 September were valued at £318.9m, with a further £3.0m in secured long income property funds under the management of Brunel.

Diversified Growth Funds (DGF) - £183.4m AUM

- 5.13 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.

- 5.14 The performance for Barings is summarised below.

	Performance	Benchmark	Relative
Quarter	1.6%	1.2%	0.4%
Financial Year to Date	4.2%	2.4%	1.8%
12 months	2.7%	4.9%	-2.2%
3 years p.a.	4.1%	4.7%	-0.6%
5 years p.a.	4.5%	4.6%	-0.1%
Since inception p.a.	4.5%	4.6%	-0.1%

- 5.15 The target for the Barings fund is cash (3 month LIBOR) plus 4% over the longer term and this is used as the benchmark for the investment.

Private Equity

- 5.16 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 30 September 2019 and the total gains or losses on investments.

Private Equity Commitments, Drawdowns and Valuations

<u>Manager</u>	<u>Commitment</u>	<u>Drawdown</u>	<u>Distribution</u>	<u>Valuation</u>	<u>Gain</u>
	<u>£m</u>	<u>£m</u>	<u>%</u>	<u>£m</u>	<u>£m</u>
HarbourVest	113.1	80.6	71%	75.8	55.7
Aberdeen Standard	79.9	58.2	73%	60.5	34.2
Brunel	60.0	3.2	5%	0.0	4.0
Total	253.0	142.0	56%	136.3	93.9
					88.2

- 5.17 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.
- 5.18 The Fund has committed to investing with HarbourVest and Aberdeen Standard 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.

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

HarbourVest - £55.7m AUM

	Performance	Benchmark	Relative
Quarter	8.9%	1.3%	7.6%
Financial Year to Date	22.8%	4.6%	18.2%
12 months	22.5%	2.7%	19.8%
3 years p.a.	19.0%	6.8%	12.2%
5 years p.a.	20.9%	6.8%	14.1%
Since inception p.a.	12.1%	5.9%	6.2%

Aberdeen Standard - £34.3m AUM

	Performance	Benchmark	Relative
Quarter	3.1%	1.3%	1.8%
Financial Year to Date	11.9%	4.6%	7.3%
12 months	13.4%	2.7%	10.7%
3 years p.a.	12.5%	6.8%	5.7%
5 years p.a.	12.6%	6.8%	5.8%
Since inception p.a.	3.9%	6.3%	-2.4%

Infrastructure

- 5.20 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. The target for each manager is a 10% absolute annual return and this is used as the benchmark for these investments. Performance is summarised in the tables below:

Hermes - £78.2m AUM

	Performance	Benchmark	Relative
Quarter	4.2%	2.5%	1.7%
Financial Year to Date	7.2%	4.9%	2.3%
12 months	7.0%	10.0%	-3.0%
3 years p.a.	7.9%	10.0%	-2.1%
Since inception p.a.	8.6%	10.0%	-1.4%

IFM - £98.9m AUM

	Performance	Benchmark	Relative
Quarter	4.2%	2.5%	1.7%
Financial Year to Date	10.6%	4.9%	5.7%
12 months	15.4%	10.0%	5.4%
3 years p.a.	16.0%	10.0%	6.0%
Since inception p.a.	17.4%	10.0%	7.4%

- 5.21 The investments with IFM are denominated in US dollars but performance is measured in sterling, therefore currency movements can contribute to volatility in performance.

Liability Driven Investment (LDI) - £404.1m AUM

- 5.22 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.
- 5.23 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 30 September 2019, 12.9% of the Fund's assets were invested in the mandate but 45% 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 £45M.
- 5.24 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.
- 5.25 The performance of the manager is detailed in Appendix 5 and summarised below.

	Performance	Benchmark	Relative
Quarter	-0.2%	0.3%	-0.5%
12 months	7.9%	9.1%	-1.2%
3 years p.a.	6.5%	4.6%	1.9%
5 years p.a.	9.2%	8.4%	0.8%
Since inception p.a.	11.8%	10.6%	1.2%

6. Cash and Treasury Management

- 6.1 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 2019 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%
Standard Chartered	10,000	1.00%
Nationwide Building Society	10,000	0.90%
Plymouth City Council	10,000	0.72%
Total Fixed Term Deposits	<u>40,000</u>	0.89%
Call Accounts		
National Westminster Bank	2,719	0.20%
Total Call Accounts	<u>2,719</u>	0.20%
Money Market Funds		
Federated Prime Rate	6,800	0.73%
Total Money Market Funds	<u>6,800</u>	0.73%
Holding Accounts		
State Street Custody Accounts	18,609	0.70%
Property Client Account	982	0.00%
Total Holding Accounts	<u>19,591</u>	0.66%
Total Cash / Average Return	<u>69,110</u>	0.78%

- 6.2 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 2019/20 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 30 September 2019

	£M	£M
Cash at 1 April 2019		105.1
Less:		
Property Transactions (net)	-0.9	
Infrastructure Drawdowns (net)	-25.7	
Private Equity Drawdowns (net)	-8.4	
Currency Hedge (net)	-10.8	
Net Transfers to other pension funds *	-25.0	
		-70.8
Plus:		
LGIM Smart Beta (disinvestment)	5.0	
Brunel UK Equities Active (disinvestment)	25.0	
Net Income	4.8	
		34.8
Cash at 30 September 2019		69.1

- 6.3 *From 1 November 2018, Wiltshire Pension Fund became the administering authority for Dorset and Wiltshire Fire and Rescue Service, therefore becoming responsible for

the liabilities of LGPS scheme members previously employed by Dorset Fire and Rescue Service. As a result of these changes, a transfer payment of £25M was made by the Fund to the Wiltshire Pension Fund.