Pension Fund Committee

Fund Administrator's Report

Date of Meeting: 12 March 2020

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 pension fund's investments as at 31 December 2019. The report provides a summary of the performance of all external investment managers and addresses other topical issues for the pension fund that do not require a separate report. Barnett Waddingham, the pension fund's actuary, have now completed their full assessment of the funding position for the triennial valuation as at 31 March 2019 and the Funding Strategy Statement has been updated accordingly. 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 pension fund's assets at 31 December 2019 was £3,163M 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 pension fund's assets. The total return from the pension fund's investments over the financial year to 31 December 2019 was 5.8%, compared to the combined benchmark return of 5.0%. Over the last 12 months the pension fund's investments have returned 12.5%, above the Fund's combined benchmark return of 11.4% and above the actuarial discount rate of 5.0%. As at 31 December 2019, 40% of the pension 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 polices that would trigger an impact assessment.
Budget: Not applicable.
Risk Assessment: The risks associated with the pension fund's investments are assessed in detail and considered 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 pension 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 pension fund.
2) Note the progress in implementing the strategic asset allocation.
3) Approve the updated Funding Strategy Statement (FSS).

Reason for Recommendation:

To ensure that the pension 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: Funding Strategy Statement
Appendix 2: Brunel Portfolios Performance Report for quarter ending 31-Dec-2019
Appendix 3: Corporate Bonds Report (RLAM)
Appendix 4: Multi Asset Credit (CQS)
Appendix 5: Property Report (CBRE)
Appendix 6: 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 pension 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 pension 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 Results for all scheme employers were received and shared with employers in November 2019. The final certificate of the contribution rates applicable for all scheme employers for 2020-21, 2021-22 and 2022-23 must be issued by the actuary before 31 March 2020.

1.4 Following the conclusion of the triennial revaluation the Funding Strategy Statement (FSS) has been updated accordingly for approval by the Committee (see Appendix1). The purpose of the FSS is to:

- Establish a clear and transparent fund-specific strategy that will identify how employers' pension liabilities are best met going forward;
- Support the desirability of maintaining as nearly constant a primary contribution rate as possible, as defined in the regulations;
- Ensure that the regulatory requirements to set contributions to meet the future liability to provide scheme member benefits in a way that ensures the solvency and long-term cost efficiency of the pension fund are met; and
- Take a prudent longer-term view of funding those liabilities.

1.5 These objectives are desirable individually but may be mutually conflicting. The FSS seeks to set out how the administering authority has balanced the conflicting aims of affordability of contributions, transparency of processes, stability of employers' contributions and prudence in the funding basis.

1.6 Barnett Waddingham have been asked to carry out an indicative update on the funding position as at 31 March 2020, and thereafter on a quarterly basis until the next full triennial review. This should provide a better understanding of movements in the pension fund's overall funding position between triennial valuations.

2. Asset Valuation Summary

2.1 The table below shows the pension fund's asset valuation by asset class at the beginning of the financial year and as at 31 December 2019, together with the target allocation as agreed at the meeting of the Committee on 13 September 2017.

Asset Class	31-Mar-19 £M	31-Mar-19 %	31-Dec-19 £M	31-Dec-19 %	Target Allocation £M	Target Allocation %
UK Equities	643.0	21.3%	670.5	21.2%	632.5	20.0%
Overseas Equities	703.0	23.3%	793.1	25.1%	695.8	22.0%
Emerging Markets Equities	98.2	3.2%	105.3	3.3%	94.9	3.0%
Total Listed Equities	***1,444.2***	***47.8%***	***1,568.9***	***49.6%***	***1,423.2***	***45.0%***
Corporate Bonds	214.4	7.1%	229.3	7.3%	189.8	6.0%
Multi Asset Credit	139.7	4.6%	144.6	4.6%	158.1	5.0%
Diversified Growth	176.1	5.8%	186.2	5.9%	253.0	8.0%
Infrastructure	138.7	4.6%	178.9	5.7%	158.1	5.0%
Private Equity	80.3	2.7%	92.0	2.9%	158.1	5.0%
Property	323.3	10.7%	327.3	10.3%	379.5	12.0%
Cash	105.1	3.5%	70.5	2.2%	-	0.0%
F/X Hedging	0.7	0.0%	1.3	0.0%	-	0.0%
Total Return Seeking Assets	**2,622.5**	**86.7%**	**2,799.0**	**88.5%**	**2,719.9**	**86.0%**
Liability Matching Assets	401.1	13.3%	363.7	11.5%	442.8	14.0%
Total Asset Valuation	**3,023.6**	**100.0%**	**3,162.7**	**100.0%**	**3,162.7**	**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 pension fund's strategic asset allocation. 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 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%.

3.4 The total allocation to Listed Equities has reduced from 53% when the strategic allocation was agreed to approximately 50% as at 31 December 2019, compared to the target of 45%.

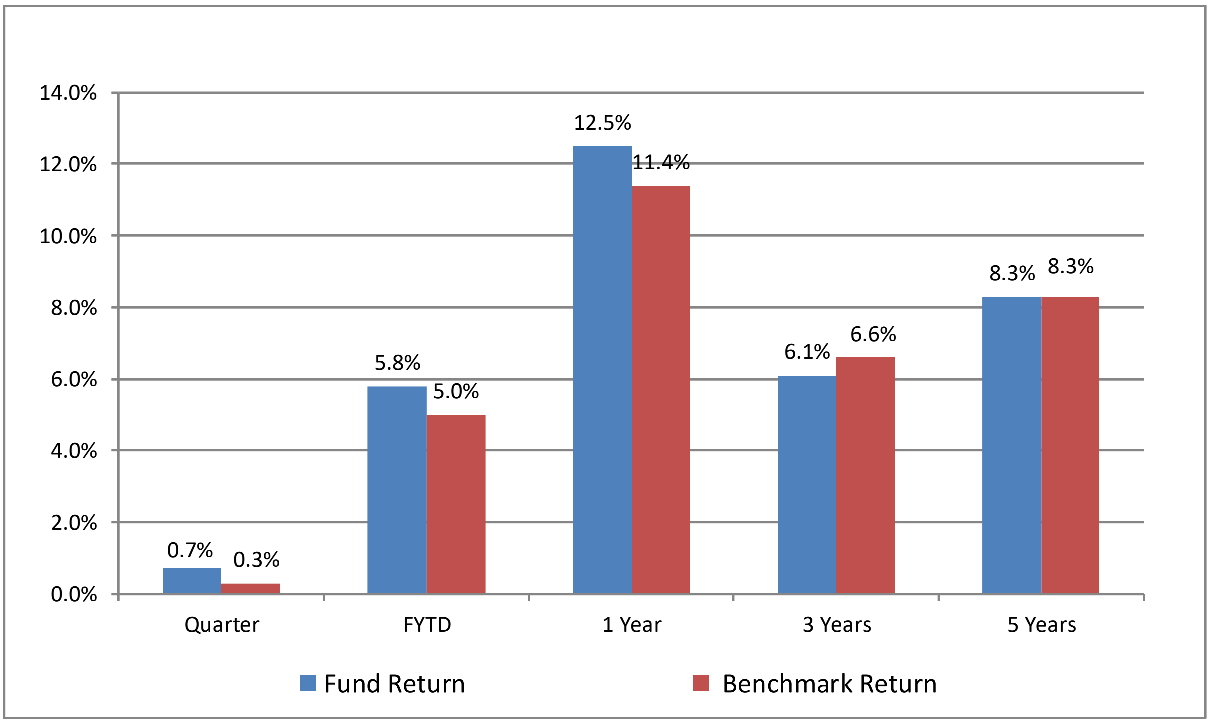
3.5 The increased allocations to infrastructure, private equity and property will be achieved if, and when, suitable opportunities arise with existing managers or through allocation to the appropriate Brunel portfolio as and when these become available. A commitment of 2.0% has been made to the Brunel Private Equity portfolio with £3.8M invested as at 31 December 2019, with a further 2.0% commitment to the Brunel Secured Income portfolio of which £10.6M had been invested by the end of December 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. T

3.7 Now that the results of the triennial valuation are known, there will be a review of the pension fund's strategic asset allocation. Investment consultants, Mercer, have been appointed to assist with this review. The recommendations of this review will be discussed at the next meeting of the Committee in June 2020.

4. Investment Performance Summary

4.1 The overall performance of the pension fund's investments to 31 December 2019 is summarised below (returns for three and five years are annualised figures).



4.2 The pension fund returned 0.7% for the three months to 31 December 2019, outperforming the combined benchmark of 0.3% by 0.4%. Over the longer term, the pension fund outperformed its benchmark over 1 year, returning an annualised 12.5% against the benchmark return of 11.4% but underperformed its benchmark over 3 years returning an annualised 6.1% against the benchmark return of 6.6%. The pension fund matched its combined benchmark over 5 years, returning an annualised 8.3%.

4.3 The Brunel Pension Partnership's performance report for the quarter ending 31 December 2019 is attached as Appendix 2. This report includes market summaries from Brunel's investment officers and an overall performance summary for the Dorset pension fund, together with more detailed information in relation to Dorset's assets under Brunel's management.

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 pension fund's external mangers is summarised in the tables below.

Brunel/LGIM Passive - £407.2m assets under management (AUM)

	Performance	Benchmark	Relative
Quarter	4.2%	4.2%	0.0%
Financial Year to Date	8.9%	8.9%	0.0%
12 months	19.2%	19.2%	0.0%
Since inception p.a.	3.5%	3.6%	-0.1%

Brunel UK Active - £178.0m AUM

	Performance	Benchmark	Relative
Quarter	5.4%	4.2%	1.2%
Financial Year to Date	9.1%	8.9%	0.2%
12 months	19.6%	19.2%	0.4%
Since inception p.a.	14.1%	13.6%	0.5%

Schroders - £61.8m AUM

	Performance	Benchmark	Relative
Quarter	14.3%	12.2%	2.1%
Financial Year to Date	18.7%	11.9%	6.8%
12 months	20.9%	17.7%	3.2%
3 years p.a.	12.5%	5.5%	7.0%
5 years p.a.	14.0%	8.3%	5.7%
Since inception p.a.	10.7%	6.7%	4.0%

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 pension fund's external global equities managers is summarised in the tables below.

In November 2019, the pension fund invested £125M in the Brunel High Alpha Developed Markets Equities. This was funded by partial disinvestment from assets under the management of the pension fund's two global equities' managers, Investec (£60M) and Wellington (£65M).

Investec - £179.7m AUM

	Performance	Benchmark	Relative
Quarter	0.5%	1.0%	-0.5%
Financial Year to Date	9.4%	11.6%	-2.2%
12 months	22.1%	22.7%	-0.6%
3 Years p.a.	9.3%	10.0%	-0.7%
Since inception p.a.	13.3%	14.1%	-0.8%

Wellington - £203.8m AUM

	Performance	Benchmark	Relative
Quarter	1.4%	1.0%	0.4%
Financial Year to Date	13.5%	11.6%	1.9%
12 months	25.8%	22.7%	3.1%
3 years p.a.	11.3%	10.0%	1.3%
Since inception p.a.	15.2%	14.1%	1.1%

Brunel/LGIM Smart Beta - £148.8m AUM

	Performance	Benchmark	Relative
Quarter	-1.4%	-1.2%	-0.2%
Financial Year to Date	10.0%	10.1%	-0.1%
12 months	20.0%	20.3%	-0.3%
Since inception p.a.	8.2%	8.5%	-0.3%

Brunel/LGIM Smart Beta (Hedged) - £156.6m AUM

	Performance	Benchmark	Relative
Quarter	4.9%	4.9%	0.0%
Financial Year to Date	10.8%	10.8%	0.0%
12 months	23.5%	23.7%	-0.2%
Since inception p.a.	8.3%	8.9%	-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 0.6%, whilst Wellington outperformed by 3.1%. Since inception in December 2015 Wellington are above their benchmark whilst Investec are underperforming their benchmark.

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

Emerging Markets Equities - £105.3 AUM

5.5 In October/November 2019, the pension fund's investment in the JP Morgan Emerging Markets Diversified Equity Fund transferred to the Brunel Emerging Markets Equity portfolio for a value £101.4M. The performance of the Brunel Emerging Markets Equity portfolio is summarised below.

	Performance	Benchmark	Relative
Since inception	1.2%	0.9%	0.3%

Corporate Bonds - £229.3m AUM

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

	Performance	Benchmark	Relative
Quarter	-0.4%	-1.1%	0.7%
Financial Year to Date	7.0%	6.4%	0.6%
12 months	12.7%	12.2%	0.5%
3 years p.a.	6.2%	5.0%	1.2%
5 years p.a.	6.4%	5.6%	0.8%
Since inception p.a.	8.7%	8.5%	0.2%

5.7 The manager outperformed over all periods measured.

Multi Asset Credit (MAC) - £144.6m AUM

5.8 The performance of the Fund's external MAC manager, CQS, is detailed in Appendix 4 and summarised below.

	Performance	Benchmark	Relative
Quarter	1.3%	1.2%	0.1%
Financial Year to Date	3.5%	3.6%	-0.1%
12 months	6.4%	4.8%	1.6%
Since inception p.a.	3.3%	4.8%	-1.5%

5.9 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 - £327.3m AUM

5.10 The performance of the Fund's external property manager, CBRE, is detailed in Appendix 5, and summarised below.

	Performance	Benchmark	Relative
Quarter	0.3%	0.0%	0.3%
Financial Year to Date	1.7%	1.3%	0.4%
12 months	2.6%	1.3%	1.3%
3 years p.a.	6.4%	5.9%	0.5%
5 years p.a.	7.4%	6.8%	0.6%
Since inception p.a.	7.6%	7.5%	0.1%

5.11 Assets under the management of CBRE at 31 December were valued at £316.5m, with a further £10.8m in secured long income property funds under the management of Brunel.

Diversified Growth Funds (DGF) - £186.2m AUM

5.12 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.

5.13 The performance for Barings is summarised below.

	Performance	Benchmark	Relative
Quarter	1.5%	1.2%	0.3%
Financial Year to Date	5.7%	3.7%	2.0%
12 months	12.1%	4.9%	7.2%
3 years p.a.	4.8%	4.7%	0.1%
5 years p.a.	4.3%	4.6%	-0.3%
Since inception p.a.	4.6%	4.6%	0.0%

5.14 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

5.15 Private Equity is an asset class that takes several years for commitments to be fully invested. The table below summarises the commitment the pension fund has made in total to each manager, the drawdowns that have taken place to date and the percentage of the total drawdown against commitments. It also shows the distributions that have been returned to the pension fund, the valuation as at 31 December 2019 and the total gains or losses on investments.

Private Equity Commitments, Drawdowns and Valuations

Manager	Commitment	Drawndown		Distribution	Valuation	Gain
	£m	£m	%	£m	£m	£m
HarbourVest	105.6	76.2	72%	74.5	52.4	50.7
Aberdeen Standard	75.3	57.6	76%	61.5	34.2	38.1
Brunel	60.0	3.8	6%	0.0	5.4	1.6
Total	**240.9**	**137.7**	**57%**	**136.0**	**92.0**	**90.4**

5.16 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.

5.17 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.

5.18 The tables below summarise performance to date for the pension fund's two legacy managers, HarbourVest and Aberdeen Standard.

HarbourVest - £52.4m AUM

	Performance	Benchmark	Relative
Quarter	-1.1%	4.2%	-5.3%
Financial Year to Date	21.4%	8.9%	12.5%
12 months	18.0%	19.2%	-1.2%
3 years p.a.	14.7%	6.9%	7.8%
5 years p.a.	18.9%	7.5%	11.4%
Since inception p.a.	11.7%	6.1%	5.6%

Aberdeen Standard - £34.2m AUM

	Performance	Benchmark	Relative
Quarter	-3.3%	4.2%	-7.5%
Financial Year to Date	8.2%	8.9%	-0.7%
12 months	3.5%	19.2%	-15.7%
3 years p.a.	9.1%	6.9%	2.2%
5 years p.a.	11.8%	7.5%	4.3%
Since inception p.a.	3.5%	6.5%	-3.0%

Infrastructure

5.19 As with Private Equity, Infrastructure is a long-term investment that takes several years for commitments to be fully invested. The pension fund has two external infrastructure managers, Hermes and IFM. The target for each manager is a 10% absolute annual return and this is used at the benchmark for these investments. Performance is summarised in the tables below:

Hermes - £72.7m AUM

	Performance	Benchmark	Relative
Quarter	-0.6%	2.4%	-3.0%
Financial Year to Date	6.6%	7.4%	-0.8%
12 months	5.7%	10.0%	-4.3%
3 years p.a.	6.8%	10.0%	-3.2%
Since inception p.a.	8.0%	10.0%	-2.0%

IFM - £106.3m AUM

	Performance	Benchmark	Relative
Quarter	-0.6%	2.4%	-3.0%
Financial Year to Date	9.9%	7.4%	2.5%
12 months	10.7%	10.0%	0.7%
3 years p.a.	13.8%	10.0%	3.8%
Since inception p.a.	16.0%	10.0%	6.0%

5.20 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) - £363.7m AUM

5.21 A proportion of the pension fund's assets are held in an inflation hedging strategy, managed by Insight Investments which are not held to add growth, but to match the movements in the pension fund's liabilities.

5.22 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 2019, 11.5% of the pension fund's assets were invested in the mandate but 40% of the pension fund's liabilities were hedged against inflation sensitivity i.e. if 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 £40M.

5.23 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.

5.24 The performance of the manager is detailed in Appendix 6 and summarised below.

	Performance	Benchmark	Relative
Quarter	-11.4%	-12.0%	0.6%
12 months	-5.8%	-6.4%	0.6%
3 years p.a.	-1.0%	-2.9%	1.9%
5 years p.a.	5.9%	4.5%	1.4%
Since inception p.a.	9.5%	8.3%	1.2%

6. Cash and Treasury Management

6.1 The pension fund generates cash flows throughout the year which need to be managed, and therefore holds some cash in call accounts, money market funds and fixed term deposits. A breakdown of the balances held internally as at 31 December 2019 is shown below, including balances held in the custodian bank accounts and in a 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	0.90%
Nationwide Building Society	10,000	0.75%
Plymouth City Council	10,000	0.72%
Total Fixed Term Deposits	30,000	0.79%
Call Accounts		
National Westminster Bank	242	0.20%
Total Call Accounts	242	0.20%
Money Market Funds		
Aberdeen Standard	9,500	0.74%
Federated Prime Rate	8,900	0.73%
Total Money Market Funds	18,400	0.74%
Holding Accounts		
State Street Custody Accounts	20,733	0.70%
Property Client Account	1,142	0.00%
Total Holding Accounts	21,875	0.66%
Total Cash / Average Return	**70,517**	**0.73%**

6.2 The pension 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.

6.3 The table below summarises the main pension fund’s main cash flows for the financial year to date.

Summary Cashflow for the Financial Year to 31 December 2019

	£M	£M
Cash at 1 April 2019		**105.1**
Less:		
Property Transactions (net)	-1.1	
Infrastructure Drawdowns (net)	-38.7	
Private Equity Drawdowns (net)	-9.8	
Net Transfers to other pension funds *	-25.0	
Brunel Global High Alpha	-125.3	
Brunel Emerging Markets	-101.4	
		-301.3
Plus:		
LGIM Smart Beta (disinvestment)	5.0	
Currency Hedge (net)	1.8	
Brunel UK Equities Active (disinvestment)	25.0	
J P Morgan (disinvestment)	101.4	
Investec (disinvestment)	60.0	
Wellington (disinvestment)	65.0	
Net Income	8.5	
		266.7
Cash at 31 December 2019		**70.5**

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 pension fund to the Wiltshire Pension Fund.