Pension Fund Committee

Fund Administrator's Report

Date of Meeting: 20 June 2019

Lead Officer: 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 31 March 2019. 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 funding level is estimated to have improved from 83.2% at the last triennial valuation, as at 31 March 2016, to 91.3% as at 31 December 2018. This estimated improvement is largely the result of the substantial appreciation in the value of the Fund's assets in 2016-17. This is only a draft position, and the actuary is now working on the full assessment of the funding position for the triennial valuation as at 31 March 2019. The value of the Fund's assets at 31 March 2019 was £3,023M compared to £2,854M at the start of the financial year. The quarter saw large rises in all listed equities' markets, which drove a rise in the value of the Fund's assets of 6.3% from 31 December 2018. This rise erased the falls of the previous quarter when the value of the Fund's assets fell by 5.8%. The Fund's investments returned 6.0% over the financial year to 31 March 2019. This was below the combined benchmark of 7.4%, but above the discount rate (or target rate of return) of 5.4% assumed by the actuary at the last valuation. As at 31 March 2019, 41% of the Fund's liabilities were hedged against inflation sensitivity.
Equalities Impact Assessment: Not applicable.
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.

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. iii) Note the publication of the draft (unaudited) Pension Fund accounts for 2018-19.
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) Appendix 6: Draft Pension Fund Accounts 2018-19
Background Papers:
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1. Funding Update

1.1 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.

1.2 As at 31 March 2016, the Fund had a funding level of 83.2% i.e. the assets were 83% of the value that they would have needed to be to pay for the benefits accrued to that date, based on the assumptions used.

1.2 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.

1.3 As the actuary is now working on the full assessment of the funding position as at 31 March 2019, their latest indicative assessment is based on the position as at 31 December 2018. 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.

1.5 The results of this assessment indicated that the current projection of the funding level as at 31 December 2018 was 91.3%. However, the final position at 31 March 2019 will depend on the assumptions adopted as part of the 2019 valuation process.

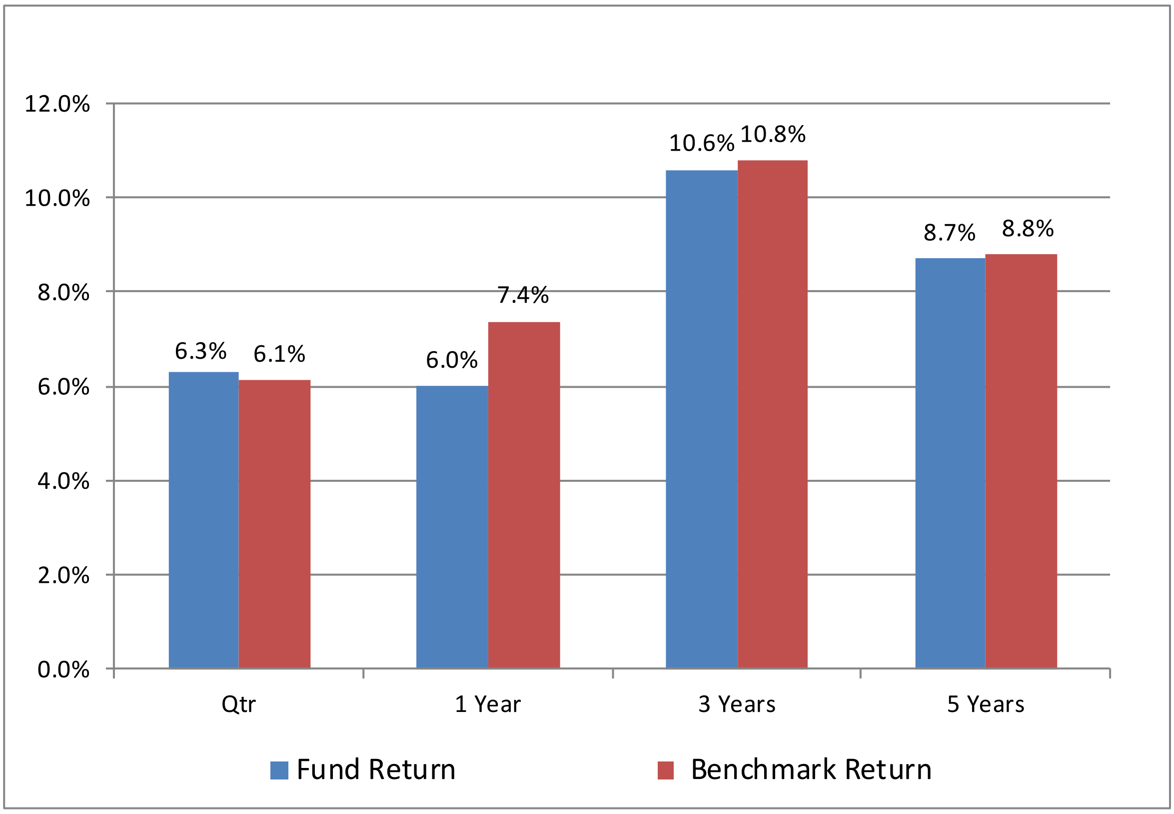
2. Asset Valuation Summary

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

	31-Mar-18		31-Mar-19		Target Allocation	
Asset Class	**£M**	**%**	**£M**	**%**	**£M**	**%**
UK Equities	684.4	24.0%	643.0	21.3%	604.7	20.0%
Overseas Equities	654.2	22.9%	703.0	23.3%	665.2	22.0%
Emerging Markets Equities	103.2	3.6%	98.2	3.2%	90.7	3.0%
Total Listed Equities	***1,441.8***	***50.5%***	***1,444.2***	***47.8%***	***1,360.6***	***45.0%***
Corporate Bonds	204.5	7.2%	214.4	7.1%	181.4	6.0%
Multi Asset Credit	136.2	4.8%	139.7	4.6%	151.2	5.0%
Diversified Growth	173.3	6.1%	176.1	5.8%	241.9	8.0%
Infrastructure	106.6	3.7%	138.7	4.6%	151.2	5.0%
Private Equity	76.5	2.7%	80.3	2.7%	151.2	5.0%
Property	295.4	10.4%	323.3	10.7%	362.8	12.0%
Cash	40.0	1.4%	105.1	3.5%	-	0.0%
F/X Hedging	-	0.0%	0.7	0.0%	-	0.0%
Total Return Seeking Assets	**2,474.3**	**86.7%**	**2,622.5**	**86.7%**	**2,600.3**	**86.0%**
Liability Matching Assets	379.7	13.3%	401.1	13.3%	423.3	14.0%
Total Asset Valuation	**2,854.0**	**100.0%**	**3,023.6**	**100.0%**	**3,023.6**	**100.0%**

3. Investment Performance Summary

3.1 The overall performance of the Fund's investments to 31 March 2019 is summarised below.



3.2 The Fund returned 6.0% for the twelve months to 31 March 2019, underperforming the combined benchmark by 1.4%. Over the longer term, the Fund underperformed its benchmark over 3 years, returning an annualised 10.6% against the benchmark return of 10.8%, and underperformed over 5 years, returning an annualised 8.7% against the benchmark of 8.8%.

3.3 The Fund's relative underperformance 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 in part 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.

4. Implementation of changes to Strategic Asset Allocation

4.1 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.

4.2 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 7.1% against the revised target of 6%.

4.3 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%.

4.4 The allocation to Listed Equities reduced from 50.5% at the beginning of the financial year to 47.8% as at 31 March 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 July 2018. In November 2018, assets under management of external UK Equities manager AXA Framlington were transferred to the Brunel UK Equities Active portfolio.

4.5 As part of these transitions there were disinvestments of £37M from the self-managed UK Equities portfolio, £34M from the Allianz portfolio, and £10M from the AXA Framlington pooled fund, followed by a further £15M disinvestment from the LGIM passive equities fund.

4.6 Since the end of March there have been further disinvestments from listed equities portfolios of £50M- £25M from Brunel's UK active portfolio, £5M from Brunel's LGIM smart beta global equities portfolio, £10M from Investec and £10Mfrom Wellington. These disinvestments will reduce the Fund's allocation to listed equities to approximately 46% (based on current asset values).

4.7 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 £1.2M being invested in January 2019, with a further 2.0% commitment to the Brunel Secured Income portfolio of which £2.9M was also invested in January 2019. Drawdowns against commitments will be funded from cash balances and/or further disinvestment from equities and corporate bonds.

4.8 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.

5. Performance by Asset Class and Investment Manager

UK Equities

5.1 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 - £374.0m assets under management (AUM)

	Performance	Benchmark	Relative
Quarter	9.4%	9.4%	0.0%
Since inception	-3.3%	-3.2%	-0.1%

Schroders - £52.0m AUM

	Performance	Benchmark	Relative
Quarter	1.8%	5.1%	-3.3%
12 months	-5.6%	-3.1%	-2.5%
3 years p.a.	10.9%	5.9%	5.0%
5 years p.a.	9.8%	4.9%	4.9%
Since inception p.a.	9.9%	6.2%	3.7%

Global Developed Markets Equities

5.2 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 - £219.8m AUM

	Performance	Benchmark	Relative
Quarter	11.6%	9.9%	1.7%
12 months	12.2%	12.0%	0.2%
3 Years p.a.	13.7%	14.4%	-0.7%
Since inception p.a.	13.4%	13.7%	-0.3%

Wellington - £238.0m AUM

	Performance	Benchmark	Relative
Quarter	10.8%	9.9%	0.9%
12 months	11.6%	12.0%	-0.4%
3 years p.a.	15.1%	14.4%	0.7%
Since inception p.a.	14.6%	13.7%	0.9%

Brunel/LGIM Smart Beta - £149.2m AUM

	Performance	Benchmark	Relative
Quarter	9.2%	9.2%	0.0%
Since inception	2.4%	2.7%	-0.3%

Brunel/LGIM Smart Beta (Hedged) - £131.8m AUM

	Performance	Benchmark	Relative
Quarter	11.6%	11.1%	0.5%
Since inception	1.9%	1.1%	0.8%

5.3 Relative performance in the quarter and the financial year to date was above the benchmark for both Investec and Wellington. Over twelve months Investec outperformed their benchmark by 0.2%, whilst Wellington underperformed by 0.4%. 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 - £98.2m 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	7.5%	7.4%	0.1%
12 months	-4.9%	-0.3%	-4.6%
3 years p.a.	14.6%	14.4%	0.2%
5 years p.a.	9.1%	8.9%	0.2%
Since inception p.a.	5.6%	5.7%	-0.1%

5.6 The quarter to 31 March 2019 saw emerging markets outperform its benchmark after a tough year. There were strong performers by both China and Russia with Turkey being one of a few countries to decline over the period.

Corporate Bonds - £214.3m 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	5.3%	5.4%	-0.1%
12 months	4.8%	4.5%	0.3%
3 years p.a.	7.0%	5.9%	1.1%
5 years p.a.	7.5%	6.8%	0.7%
Since inception p.a.	8.7%	8.5%	0.2%

5.8 The manager was below benchmark for the quarter but above benchmark over one year and all longer periods.

Multi Asset Credit (MAC) - £139.7m 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	2.9%	1.2%	1.7%
12 months	2.6%	4.8%	-2.2%
Since inception (Dec-17)	2.6%	4.7%	-2.1%

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 - £3203m 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	2.0%	0.9%	1.1%
12 months	5.4%	6.0%	-0.6%
3 years p.a.	6.9%	6.8%	0.1%
5 years p.a.	10.3%	9.7%	0.6%
Since inception p.a.	7.9%	7.8%	0.1%

5.12 The portfolio has underperformed the Investment Property Databank (IPD) benchmark over one year but outperformed over three and five years.

Diversified Growth Funds (DGF) - £176.1m 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	6.1%	1.2%	4.9%
12 months	1.6%	4.9%	-3.3%
3 years p.a.	5.2%	4.6%	0.6%
5 years p.a.	4.1%	4.6%	-0.5%
Since inception p.a.	4.3%	4.6%	-0.3%

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 31 March 2019 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	107.3	74.9	70%	68.8	46.9	40.9
Aberdeen Standard	76.6	53.4	70%	54.9	32.1	33.5
Brunel	60.0	1.5	3%	0.0	1.3	-0.2
Total	**243.9**	**129.8**	**53%**	**123.6**	**80.3**	**74.2**

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 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.

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

HarbourVest - £46.9m AUM

	Performance	Benchmark	Relative
Quarter	-2.8%	9.4%	-12.2%
12 months	23.3%	6.4%	16.9%
3 years p.a.	15.4%	9.5%	5.9%
5 years p.a.	18.3%	6.1%	12.2%
Since inception p.a.	10.8%	5.7%	5.1%

Aberdeen Standard - £32.1m - AUM

	Performance	Benchmark	Relative
Quarter	-4.3%	9.4%	-13.7%
12 months	19.7%	6.4%	13.3%
3 years p.a.	10.7%	9.5%	1.2%
5 years p.a.	11.0%	6.1%	4.9%
Since inception p.a.	3.1%	6.2%	-3.1%

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 at the benchmark for these investments. Performance is summarised in the tables below:

Hermes - £51.9m AUM

	Performance	Benchmark	Relative
Quarter	-0.9%	2.4%	-3.3%
12 months	-1.2%	10.0%	-11.2%
3 years p.a.	6.8%	10.0%	-3.2%
Since inception p.a.	7.8%	10.0%	-2.2%

5.21 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 - £86.8m AUM

	Performance	Benchmark	Relative
Quarter	0.7%	2.4%	-1.7%
12 months	18.0%	10.0%	8.0%
3 years p.a.	16.7%	10.0%	6.7%
Since inception p.a.	16.7%	10.0%	6.7%

5.22 During the quarter, IFM completed two acquisitions: a 25% stake in VTTI B.V. from Buckeye Partners for US$487.5 million and executed an agreement to acquire a 30% stake in Deepwater Container Terminal Gdansk, the largest container terminal in Poland.

5.23 The broader portfolio continued to deliver positive returns in local currency terms, with outperformance, in particular from Impala Terminals, Vienna Airport, VTTI and Manchester Airports Group. This performance was partially offset by negative yields from Arqiva Limited, and Colonial Pipeline Company.

5.24 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) - £401.1m AUM

5.25 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

5.26 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 March 2019, 13.3% of the Fund's assets were invested in the mandate but 41.1% 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.

5.27 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.

5.28 The performance of the manager is detailed in Appendix 5 and summarised below.

	Performance	Benchmark	Relative
Quarter	5.8%	5.2%	0.6%
12 months	8.6%	8.4%	0.2%
3 years p.a.	22.1%	16.1%	6.0%
5 years p.a.	9.9%	8.9%	1.0%
Since inception p.a.	12.7%	11.3%	1.4%

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 31 March 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%
Total Fixed Term Deposits	10,000	0.95%
Call Accounts		
National Westminster Bank	11,298	0.20%
Svenska Handelsbanken	10,000	0.68%
Total Call Accounts	21,298	0.43%
Money Market Funds		
Aberdeen Standard	15,000	0.78%
BNP Paribas	15,000	0.80%
Federated Prime Rate	15,000	0.78%
Deutsche	4,800	0.75%
Goldman Sachs	8,650	0.71%
Total Money Market Funds	58,450	0.77%
Holding Accounts		
State Street Custody Accounts	14,800	0.70%
Property Client Account	567	0.00%
Total Holding Accounts	15,367	0.67%
Total Cash / Average Return	**105,115**	**0.70%**

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 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 March 2019

	£M	£M
Cash at 1 April 2018		**40.0**
Less:		
Property Transactions (net)	25.9	
Infrastructure Drawdowns (net)	18.9	
Currency Hedge (net)	23.5	
		68.3
Plus:		
Private Equity (net)	11.8	
UK Equity transactions (net)	7.0	
UK Passive Internally Managed Disinvestment (net)	36.6	
Allianz Disinvestment (net)	34.2	
AXA Framlington Disinvestment (net)	10.0	
LGIM UK Passive (net)	15.0	
Net Contributions	18.8	
		133.4
Cash at 31 March 2019		**105.1**

7. Pension Fund Accounts 2018-19 (Appendix 6)

7.1 Dorset County Council draft unaudited accounts for 2018-19, including the Pension Fund accounts, were approved for publication by the Chief Financial Officer 3 May 2018. The statutory deadline for publication of the draft accounts is 31 May each year.