Dorset County Pension Fund Committee 20 June 2019

Listed Market Equities – Performance Summary

1. Equity Markets Performance

1.1 The quarter to 31 March 2019 was a more positive one for equity markets as they made gains, offsetting falls from the previous three months and rebounding from a weak end to 2018 as concerns over the China-United States dispute eased (although perhaps temporarily) and major central banks grew more accommodative.

1.2 US equities recovered from a weak October to December 2018 quarter to post significant gains in the quarter ending 31 March 2019. January 2019 was especially strong, as the Federal Reserve confirmed it would adjust planned interest rate rises to compensate for deteriorating economic momentum and the US government shutdown ended.

1.3 In the Eurozone equities enjoyed strong gains in the quarter ending March 2019, recovering falls in the previous quarter. Stock markets were supported by central banks stepping away from tighter monetary policy. The European Central Bank said that interest rates would remain at current levels at least until the end of the year.

1.4 In the UK, there were strong performance of the UK's technology sector and consumer goods companies, including the FTSE100's tobacco and beverage sectors. A number of lowly-valued, domestically-focused areas bounced back strongly following the delay to Brexit beyond March 2019.

1.5 The FTSE100 rose 3.2% between 1 April 2018 to 31 March 2019 despite Brexit uncertainty and the trade war between the US and China worried investors but they were in line with global equities.

1.6 In the US, the S&P 500 rose 7.3% over the twelve-month period to 31 March 2019.

1.7 The tables below show the performance of UK and World indices over three and twelve months to 31 March 2019.

Three months to 31 March 2019

Country	Index	31/12/2018	31/03/2019	% Change
UK	FTSE100	6,728.1	7,279.2	8.2
UK	FTSE250	17,502.1	19,117.5	9.2
UK	FTSE350	3,722.2	4,033.1	8.4
UK	Small Cap	5,177.2	5,466.4	5.6
UK	Small Cap ex Investment Trusts	6,779.0	7,127.7	5.1
UK	All Share	3,675.1	3,978.3	8.3
Japan	Nikkei225	20,014.8	21,205.8	6.0
US	S & P 500	2,506.9	2,834.4	13.1
Hong Kong	Hang Seng	25,845.7	29,051.4	12.4
France	Cac 40	4,730.7	5,350.5	13.1
Germany	Dax	10,559.0	11,526.0	9.2
China	Shanghai Composite	2,493.9	3,090.8	23.9

Twelve months to 31 March 2019

Country	Index	31/03/2018	31/03/2019	% Change
UK	FTSE100	7,056.6	7,279.2	3.2
UK	FTSE250	19,460.5	19,117.5	-1.8
UK	FTSE350	3,941.2	4,033.1	2.3
UK	Small Cap	5,593.1	5,466.4	-2.3
UK	Small Cap ex Investment Trusts	7,354.9	7,127.7	-3.1
UK	All Share	3,894.2	3,978.3	2.2
Japan	Nikkei225	21,454.3	21,205.8	-1.2
US	S & P 500	2,640.9	2,834.4	7.3
Hong Kong	Hang Seng	30,093.4	29,051.4	-3.5
France	Cac 40	5,167.3	5,350.5	3.5
Germany	Dax	12,096.7	11,526.0	-4.7
China	Shanghai Composite	3,168.9	3,090.8	-2.5

1.8 There was positive performance from the UK markets in the three months to 31 March 2019. The FTSE250 was the best performer rising 9.2% (1,615 points). The Small Cap excluding Investment Trusts was the worst performing UK index despite rising 5.1% (349 points). The FTSE100 rose 8.2% (551 points) over the same period. In comparison, performance from world indices were equally positive. The Shanghai Composite was the best performer rising 23.9% (597 points). The Nikkei225 was the worst performer despite rising 6.0% (1,191 points). The S&P 500 rose 13.1% (328 points) over the same period.

1.9 Over the twelve-month period to 31 March 2019, there was mixed performance from the major UK indices. The FTSE100 was the best performer rising 3.2% (223 points). The Small Cap excluding Investment Trusts was the worst performing UK index falling 3.1% (227 points). In comparison, performance from world indices were equally mixed. The S&P 500 was the best performing index rising 7.3% (194 points). The Dax was the worst performer falling 4.7% (571 points) over the same period.

2. Market Review

2.1 Global equities rose to their best quarterly return since September 2009. Markets were buoyed by productive trade negotiations between the US and China, and by dovish rhetoric from the major central banks.

2.2 The US delayed its plan to increase tariffs on US$200 billion of imports from China amid constructive dialogue between US and Chinese trade representatives on key issues and growing optimism that the two countries can ultimately reach a trade agreement.

2.3 Brexit risks increased after Parliament rejected prime Minister Theresa May's deal for the third time, raising the prospect that Britain could depart the European Union without a withdrawal agreement.

2.4 On the monetary front, the European Central Bank surprised markets by keeping interest rates low, sharply cutting growth forecasts and announcing an extended liquidity policy. The US Federal Reserve left short-term interest rates unchanged and indicated that rates will likely remain unchanged throughout 2019.

UK Equity performance for the period ending 31 March 2019

3. Background

3.1 On 11 July 2018, the internally managed passive UK equity portfolio transferred to the Brunel UK Passive Equities portfolio managed by Legal & General Investment Management (LGIM). On 21 November 2018, one of the two UK Equity managers, AXA Framlington was transferred in full (sale proceeds £177M) to the UK Equities Active Brunel portfolio. The Fund still has one UK equity active manager, Schroders.

3.2 This combination of managers and styles is designed to give the opportunity of outperformance against the FTSE All Share index and has a two thirds passive and one third active mix. Details of the combined portfolio (£613.6M) at 31 March 2019) are shown in the table at paragraph 4.1.

3.3 Investment in the smallest companies which make up 3.5% of the index is achieved by a holding in the Schroders Institutional UK Smaller Companies Fund which is managed on an active basis.

4. Valuation

4.1 The table below summarises the valuations for the five managers as at 1 April 2018 and 31 March 2019.

	In-House	AXA	Schroders	LGIM	Brunel	Total
	£000s	£000s	£000s	£000s	£000s	£000s
Valuation 01-Apr-18	401,402	190,746	55,096	0	0	647,244
Investment	0	0	0	434,849	177,044	611,893
Disinvestment	-434,849	-187,044	0	-46,999	0	-668,892
Change in Valuation	33,447	-3,702	-3,063	-13,836	10,552	23,398
Valuation 31-Mar-19	0	0	52,033	374,014	187,596	613,643

5. Performance

5.1 The table below summarises the performance for each manager in absolute terms and compared to their respective benchmarks for the quarter, the financial year and since inception to 31 March 2019.

	Schroders	LGIM
Quarter to Date		
Performance	1.8%	9.4%
Benchmark	5.1%	9.4%
Relative Return	-3.3%	0.0%
Twelve Months to Date		
Performance	-5.6%	-
Benchmark	-3.1%	-
Relative Return	-2.5%	-
Three Years p.a.		
Performance	10.9%	-
Benchmark	5.9%	-
Relative Return	5.0%	-
Five Years p.a.		
Performance	9.8%	-
Benchmark	4.9%	-
Relative Return	4.9%	-
Since Inception		
Performance	9.9%	-3.3%
Benchmark	6.2%	-3.2%
Relative Return	3.7%	-0.1%

Global Equities performance for the period ending 31 March 2019

6. Background

6.1 With effect from mid December 2015, the Fund replaced its then two global equities managers, Pictet Asset Management and Janus Intech, with three new managers, Allianz Global Investors, Investec Asset Management and Wellington Management. On 18 July 2018 Dorset's global equities under the management of Allianz were successfully transitioned to the Brunel Smart Beta portfolio, managed by Legal & General Investment Management (LGIM). In addition, JP Morgan has been the Fund's emerging markets equities manager since April 2012.

7. Valuation

7.1 The table below summarises the movement in valuations for all managers for the financial year to 31 March 2019.

	Allianz £000s	Investec £000s	Wellington £000s	LGIM £000s	JPM £000s	Total £000s
Valuation 01-Apr-18	281,878	195,927	213,503	0	103,281	794,589
Investment	0	0	0	275,115	0	275,115
Distribution	-310,115	0	0		0	-310,115
Increase in Valuation	28,237	23,838	24,669	5,936	-5,104	77,576
Valuation 31-Mar-19	0	219,765	238,172	281,051	98,177	837,165

8. Performance

8.1 The table below summarises the performance for each manager in absolute terms and compared to their respective benchmarks for the quarter, the financial year and since inception to 31 March 2019.

	Investec	Wellington	LGIM Smart Beta	LGIM Smart Beta (Hedged)	JPM
Quarter to Date					
Performance	11.6%	10.8%	9.2%	11.6%	7.5%
Benchmark	9.9%	9.9%	9.2%	11.1%	7.4%
Relative Return	1.7%	0.9%	0.0%	0.5%	0.1%
Twelve Months to Date					
Performance	12.2%	11.6%	-	-	-4.9%
Benchmark	12.0%	12.0%	-	-	-0.3%
Relative Return	0.2%	-0.4%	-	-	-4.6%
Three Years to Date					
Performance	13.7%	15.1%	-	-	14.6%
Benchmark	14.4%	14.4%	-	-	14.4%
Relative Return	-0.7%	0.7%	-	-	0.2%
Five Years to Date					
Performance	-	-	-	-	9.1%
Benchmark	-	-	-	-	8.9%
Relative Return	-	-	-	-	0.2%
Since Inception					
Performance	13.4%	14.6%	2.4%	1.9%	5.6%
Benchmark	13.7%	13.7%	2.7%	1.1%	5.7%
Relative Return	-0.3%	0.9%	-0.3%	0.8%	-0.1%

8.2 Investec outperformed its benchmark over three months by 1.7% and by 0.2% over the twelve months to the 31 March 2019. Wellington outperformed their benchmark by 0.9% over three months but underperformed by 0.4% over twelve months. Since inception, Wellington has outperformed their benchmark by 0.9%, whilst Investec has underperformed by 0.3%.

8.3 JP Morgan have outperformed their benchmark for the quarter by 0.1% but underperformed by 4.6% over twelve months. JPMorgan outperformed the benchmark by 0.2% over the 3 and 5 years. Since inception JP Morgan have underperformed their benchmark by 0.1%.

9. Manager Commentaries (Active Mandates)

9.1 Schroders (UK Smaller Companies)

The fund underperformed its FTSE Small Cap (ex-investment companies) benchmark over the period of three and twelve months but outperformed over three and five years. Shares in casual dining specialist Restaurant Group de-rated following news of the untimely departure of the company’s dynamic CEO. Full-year results were broadly in line with expectations and Wagamama, the recently acquired UK and international operator of Asian themed restaurants, continues to trade well.

Specialist plastics maker Carclo issued a significant profit warning in January due to challenges in its LED technologies division. There was some positive news from the group’s smaller aerospace division, which has continued to perform slightly ahead of expectations and well ahead of the prior year. This position now accounts for less than 0.3% of the total portfolio. Biotechnology company Oxford BioDynamics retreated to similar levels as this time last year due to concerns around profitability. Hampering profitability is management's drive to increase investment into revenue-generating research and other projects spanning various fields such as immune-oncology, fibrosis and thyroid cancer.

On the positive side, specialist builder of affordable housing MJ Gleeson performed well on the back of robust interim results. Mobile advertising platform provider Taptica International bounced back following a very poor performance in the previous quarter as the market welcome its acquisition of AIM-quoted peer RythmOne. Meanwhile, supplier of technology and resources to the education sector RM performed well on the back of solid full-year results.

The holding in Tax Systems was sold following a recommended bid approach for the supplier of corporation tax software and services. The successful investment in Strix was sold, who are the global leader in kettle safety controls. A new holding in fashion retailer Superdry following their demotions from the FTSE 250 index was purchased. A new position in high technology products and services supplier Oxford Instruments was acquired.

9.2 **Investec (Global Equities)**

The quarter to 31 March 2019 was very positive for the performance of the fund and it outperformed the index. The outperformance was largely due to strong stock picking. After a very volatile closing few weeks of 2018, analysts believe that valuations across the portfolio were oversold, giving conviction to keep the portfolio's position.

The quarter was especially good for returns in the consumer staples sector. A large part of this contribution was due to 'premiumisation' of Chinese consumer spending. Several unique opportunities have arisen, with Chinese pork producer WH Group benefiting from the de-escalation of trade tensions with the US.

Returns by Chinese financials AIA rallied on news that regulators had accepted the company's request to expand into a further three regions. Returns in the sector were also enhanced by a rebound from US banking giant Citigroup.

The fund benefited from solid results from cloud infrastructure provider VMware and payment processor Worldpay, which both demonstrated their ability to capture the structural growth opportunities presented by the growing reliance of internet and digital services. Worldpay attracted a takeover bid from competitor FIS, cementing its position as one of the quarter's best performing holdings.

On the negative side, some setbacks across the materials sector were experienced as US chemical firm DowDuPont and fertiliser company Mosaic both retreated amid concerns about slowing demand in their respective markets. DowDuPont was sold and the holding in Mosaic was reduced to reflect a lower conviction after recent setbacks.

Healthcare was also a negative performer as proposed changes to the US's drug pricing framework led several insurance and benefit managers to perform less well. There was relative underperformance from Cigna and United Health but both firm's holding will still be held and will assess the likely impact the regulation could have on each stock's 4Factor credentials.

9.3 **Wellington (Global Equities)**

The portfolio outperformed the index over the quarter performing 10.8% against its benchmark of 9.9%.

Strong selection in information technology and real estate was partially offset by selection in healthcare and communication services. On a regional basis, strong stock selection in North America and Developed Europe & Middle East ex UK was partially offset by selection in Japan and United Kingdom.

Within information technology and real estate, the top relative contributors were overweights to SS&C Technologies and American Tower, respectively. Within healthcare and communication services, the top relative detractors were overweights to Eisai and BT Group respectively.

SS&C Technologies shares rose as the company reported strong quarterly results driven by earlier-than-expected cost synergy realisation from recent acquisitions. American Tower reported strong fourth quarter 2018 results due to increased use of mobile data which drove demand for tower space. Shares in Eisai declined during the quarter after the company terminated two Phase 3 clinical trials of aducanumab in Alzheimer's disease. Competitive broadband prices and regulatory headwinds continue to pressure BT Group's share price.

9.4 **JP Morgan (Emerging Market Equities)**

Global Market Review: The quarter to 31 March 2018 brought a new wave of optimism, with Emerging Markets equities rallying strongly. The sell-off in the quarter was driven largely by concerns about the potential for an escalation in the trade war between the US and China, fears that higher interest rates could damage the US economy and broader worries about a slowdown in global growth. In response to these concerns, the Federal Reserve gave investors hope that a recession could be avoided in the short term and boost sentiment around global equities.

By market, China was one of the strongest performers, given the progress on trade talks and concrete plans by the Chinese authorities to stabilise growth. Russia outperformed, again through improving sentiment, this time relating to sanctions. Turkey was one of a handful of countries to decline over the period, with concerns resurfacing relating to president Erdogan's handling of the economy.

3 Month review: The portfolio marginally outperformed its benchmark over the three month period, with stock selection detracting to relative returns while country allocation contributed. Performance was led by stock selection in Russia, where Lukoil was among the top contributors in the period, after the company announced strong quarterly results. The stock was further boosted by guidance from management that they will introduce changes to the dividend policy which could increase dividend per share.

Stock selection in the financial sector also aided relative performance, specifically driven by stock picks in China, including exposure to China Merchants Bank.

Korea was the single largest detractor in the period, as this cyclical market has lagged Emerging Markets overall year to date, despite very attractive valuations, as investors worried about global growth. Moreover, the market was dragged down by corporate earnings downgrades, especially in the semiconductor sector. Being overweight proved a negative on performance, as Emerging Markets overall produced roughly double the return of Korea in the quarter.

12 Month Review: The portfolio underperformed its benchmark over the twelve month period, with stock selection weighing on relative performance, while country allocation had a neutral effect. Stock selection in Taiwan proved to be a drag on relative returns, led by stocks that have exposure to the Apple supply chain. The portfolios exposure to Global Wafers, a global leader in semiconductor technology, weighed on relative performance during the period, as the stock fell over 35% (in USD terms) on the back of slower than expected demand as a result of softer global growth.

Stock selection in China was a key detractor to relative performance. US-China trade tensions and disappointing smartphone demand significantly dampened investors' confidence, particularly hurting the Apple supply chain names. Additionally, the exposure to Baidu, weighed on relative returns, as internet names broadly traded down with US FAANG stocks towards the end of 2018, without any fundamental news flow.

On the positive side, the portfolio's exposure to Brazil, boosted relative returns as the election of Jair Bolsonaro drove the Brazilian market higher in the last quarter of 2018 and the beginning of 2019, on elevated hopes for market-oriented reforms.

Market Outlook: US growth was expected to come off the boil and move back to trend, but not fall into recession and there is optimism that, while it was painful for emerging market equities, it clears the way for improved performance in 2019. Valuations remain attractive and domestic earnings continue to grow. Nonetheless, as the global cycle matures portfolio activity has been focused on looking for relative value, reducing banks in Brazil after the post-election rally, adding Mexico where the collective view of analysts is more positive today than any point in the last five years, and adding to onshore Chinese A-share after their dramatic falls in 2018.

The portfolios are continuing to tilt in favour of attractively-valued markets and stocks. Efforts are focussed on avoiding the potential for value traps, rotating the portfolio towards stocks with positive earnings trends. Defensive sectors are being added to at a margin and keeping cash available to exploit opportunities that may emerge in this period of heightened volatility.

It is never easy to experience periods of meaningful underperformance. However, when the strategy experienced sharp drawdowns in prior periods (2008 and 2018), performance recovered over subsequent quarters by staying true to the philosophy and process, while managing risks tightly.

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