CT/17/94
Investment & Pension Fund Committee
17 November 2017

INVESTMENT MANAGEMENT REPORT

Report of the County Treasurer

All recommendations contained in this report are subject to confirmation by the Committee before taking effect.

Recommendations:

(i) That the Investment Management Report be noted;

(ii) That the Committee note compliance with the 2017/18 Treasury Management Strategy.

1) FUND VALUE AND ASSET ALLOCATION

The table below shows the Fund value and the asset allocation for the Fund compared to the target asset allocation as at **30 September 2017**.

Fund Value and Asset Allocation

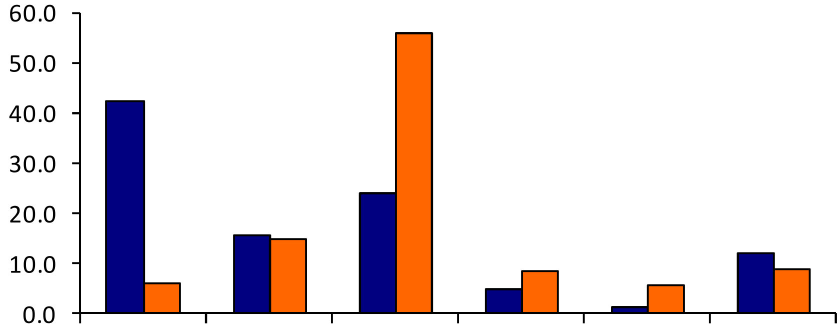
	Fund Value as at 30.09.17	Target allocation 2017/18	Fund asset allocation at 30.09.17	Variation from Target
	£m	%	%	%
Fixed Interest				
Global Bonds	213.8	6.0	5.3	
Multi-Sector Credit	220.5	6.0	5.4	
Cash	98.9	1.0	2.4	
	533.2	**13.0**	**13.1**	**+0.1**
Equities				
Passive Equities	1,789.4	43.0	43.8	
Active Global Equities	418.4	10.0	10.3	
Active Emerging Markets	184.2	5.0	4.5	
	2,392.0	**58.0**	**58.6**	**+0.6**
Alternatives/Other				
Diversified Growth Funds	601.5	15.0 *	14.7	
Property	374.8	10.0	9.2	
Infrastructure	155.1	4.0	3.8	
Private Debt	23.9	0.0 *	0.6	
	1,155.3	**29.0**	**28.3**	**-0.7**
Total Fund	**4,080.5**	**100.0**	**100.0**	

* Medium term allocation of 3% to Private Debt agreed, but this will be built up over time, funded from a decreased allocation to diversified growth funds

- The Fund value as at 30th September 2017 stood at £4,080.5 million, an increase of £90m over the quarter, and £150 million since 31st March.

- The table shows the target asset allocation for 2017/18 as set out in the Investment Strategy Statement. With the exception of cash, the actual allocations are all within 1% of the target and no action is required to rebalance between asset classes. While the allocation to cash is higher than target, this will be reduced by the drawdown of the commitment made to private debt funds.
- The following table gives the geographical split of the Fund's equity allocations against the FTSE World geographical weightings:

<u>Geographical Split of Equity Allocation compared to the FTSE All World Index</u>



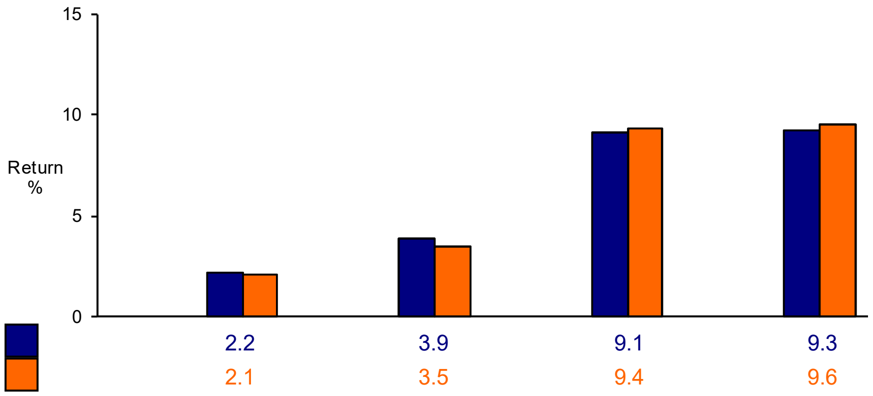
	UK	Europe Ex UK	North America	Japan	Asia/Pacific (ex Japan)	Emerging Markets
Fund	42.2	15.5	24.0	4.8	1.5	12.0
FTSE All World	6.1	14.9	55.8	8.5	5.9	8.8

- The table shows that the Fund has an over-exposure to the UK and a significant under-exposure to North America compared to the world market. There is also a smaller under-exposure to Japan, while the exposure to Europe and the combined exposure to Asia/Pacific (ex Japan) and Emerging Markets is about right.
- It was agreed at the February committee that in principle, the Fund should look to reduce its overweight to UK equities by reallocating to overseas equities, predominantly to US equities with a small proportion to Japanese equities. However, as a result of the perception that the US market looked expensive, it was proposed that the reallocation should only take place after a period of under-performance of the US market in comparison with the UK market. Trigger points were agreed on that basis for the County Treasurer in consultation with the Chairman to move up to an initial £100m from UK passive equities to overseas passive equities, should the appropriate trigger points be hit.
- However, the US market has continued to outperform the UK, and has delivered a capital return of 15.0% (FTSE North America Index in USD) over the calendar year to date (to 30th October), compared with a return of 6.3% for the UK market (FTSE All Share Index). Therefore the trigger points have not been met and no action has been taken. There is a strong possibility that the agreed trigger points will not be hit for a significant period, which means that the Fund remains exposed to the risks associated with the UK market's sectoral biases (i.e. the FTSE All Share index has a heavy exposure to commodities and mining and to the financial services sector, rather than being balanced across all sectors of the economy). It is therefore proposed to put in place an alternative strategy, which is set out in a separate report on this agenda.

2) FUND PERFORMANCE

The performance of the Total Fund over the last quarter, the financial year, and on a rolling three and five year basis are shown in the following chart.

<u>Longer Term Fund Performance Summary</u>



	Latest Quarter	2017/18	3 Years % pa	5 Years % pa
Fund	2.2	3.9	9.1	9.3
Benchmark	2.1	3.5	9.4	9.6
Relative Return	0.1	0.4	-0.3	-0.3

The performance statistics quoted are net of fees for the current financial year and the last three years, but the five year figures shown combine gross performance up to 31 March 2014 and net of fees performance from 1 April 2014 onwards.

The financial year to date has seen a return 0.4% above benchmark. The total absolute return was +3.9%, ahead of the Fund benchmark of +3.5%. The longer term three and five year returns remain below benchmark.

A breakdown of the performance of the Total Fund for the quarter **<u>to 30 September 2017</u>** and the comparative Index returns are shown in the following table:

<u>Performance for the quarter to 30 September 2017</u>

Sector	Fund Return %	Benchmark %	Benchmark Description
Global Bonds	-0.2	-0.7	BarCap Global Bonds
Multi-Sector Credit	3.9	3.6	MSC Bespoke *
Cash	0.1	0.1	GBP 7 Day LIBID
Passive Equities	4.2	4.3	Devon Bespoke Passive Index
Active Global Equities	5.3	2.4	FTSE World
Active Emerging Markets	2.8	6.9	MSCI Emerging Markets
Diversified Growth Funds	3.4	2.0	Devon Multi Asset Benchmark
Property	5.4	4.8	IPD UK PPF All Balanced Funds
Infrastructure	1.7	2.5	GBP 7 Day LIBID+5%
Private Debt	-3.0	1.3	GBP 7 Day LIBID+5%
Total Fund	**3.9**	**3.5**	**Devon Bespoke Index**

*Composed of 1/3 Bank of America Merrill Lynch Global High Yield Constrained Index; 1/3 JPMorgan Emerging Markets Bond Index Plus; 1/3 CSFB Bank Loan Index.

Key issues over the six months include:

- The active equity and fixed interest managers have performed well over the half year, with above benchmark returns, with the exception of the emerging markets equities mandate which significantly underperformed.
- Currency issues have again had an impact, with a weakening dollar reducing the value of the Fund's unhedged US exposure. This has had an adverse impact on the infrastructure return, and on the dynamic currency hedged passive US exposure. However the increase in the static hedged portion of the passive portfolio from 50% to 100% has protected the Fund to some extent. Conversely the strengthening Euro has meant that the additional Euro hedges put in place have had a negative impact on both equity and infrastructure returns.
- The diversified growth funds (DGFs) have outperformed their cash plus benchmarks at a time of modest positive returns in equity and bond markets.
- Property has also seen a positive return ahead of the benchmark.
- The private debt return reflects currency movement on the US fund investment. No income distributions had been received by the end of September, given the investment has only just been made.

3) BUDGET FORECAST MONITORING AND CASH MANAGEMENT

(a) Appendix 1 shows the actual to date and revised forecast for 2017/18 against the original budget forecast. There was a deficit of **£9.1m** between contributions received and pension benefits paid out during the quarter.

(b) The income received as cash reflects the income from the property mandate, distributions from infrastructure investments and interest on internally managed cash. This income was sufficient to cover the gap between pension benefits payments paid and the contributions received over the quarter. The remaining income is from the Fund's segregated equity and bond mandates and is reinvested by the fund managers.

(c) Pension administration costs for the first quarter reflect the payment of the annual charge for IT support during the quarter. The updated forecast for the year is still in line with the original forecast. The actual expenditure to date for investment management and oversight and governance are generally low as payments are made in arrears. The high expenditure on actuarial services reflects costs over the quarter that will be recharged to employers, which will then reduce the net expenditure.

(d) At 31 October 2017 the unallocated cash on deposit amounted to **£47.0m**. This is summarised in the following table. The cash held is being maintained at a lower level than in the past, with a target level of only 1% of the Fund, and it is therefore necessary to ensure its liquidity for cashflow purposes. However, the return of capital from one of the specialist funds has resulted in £10m being placed in a 6 month notice account. The additional cash is being held to meet future cashflow requirements, including providing for the drawdown of investment commitments.

Cash on Deposit

Type of Deposit	Maturity period	Actual as at 31/03/17	Average Interest Rate	Current as at 31/10/17	Average Interest Rate
		£m	%	£m	%
Call and Notice Accounts	Immediate	10.1	0.29	37.0	0.31
	6 Month Notice	10.0	0.80	10.0	0.80
Term Deposits	<30 Days	10.0	0.45	0.0	
	>30 Days	20.0	0.60	0.0	
TOTAL (at 31st October 2017)		**50.1**	**0.55**	**47.0**	**0.42**

(e) The weighted average rate being earned on cash deposits, as at 31 October 2017, was **0.42%.** This reflects the current low interest rate environment and the need to ensure liquidity as a result of the low level of cash being maintained.

(f) The deposits in place during the year to date have fully complied with the Fund’s Treasury Management and Investment Strategy for 2017/18.

Mary Davis

<u>Local Government Act 1972</u>
List of Background Papers   Nil
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Appendix 1

Devon County Council Pension Fund Budget / Forecast 2017/18

	Actual 2016/17 £'000	Original Forecast 2017/18 £'000	Actual to Sept 17 £'000	Revised Forecast 2017/18 £'000	Variance from Original Forecast £'000
Contributions					
Employers	(123,163)	(127,000)	(60,861)	(127,000)	0
Members	(36,709)	(37,000)	(18,207)	(37,000)	0
Transfers in from other pension funds:	(8,205)	(6,000)	(3,347)	(6,000)	0
	(168,077)	(170,000)	(82,415)	(170,000)	0
Benefits					
Pensions	136,549	142,000	70,507	142,000	0
Commutation and lump sum retirement benefits	27,716	30,000	16,612	30,000	0
Lump sum death benefits	3,751	4,000	1,713	4,000	0
Payments to and on account of leavers	719	500	215	500	0
Payments for members joining state scheme	5,684	6,000	2,485	6,000	0
	174,419	182,500	91,533	182,500	0
Net Withdrawals from dealings with fund members	**6,342**	**12,500**	**9,118**	**12,500**	**0**
Investment Income					
Received as Cash	(23,276)	(24,000)	(11,564)	(24,000)	0
Reinvested by Fund Manager	(16,576)	(17,000)	(9,318)	(17,000)	0
	(39,852)	**(41,000)**	**(20,882)**	**(41,000)**	**0**
Administrative costs					
Peninsula Pensions	2,059	2,000	1,242	2,000	0
	2,059	**2,000**	**1,242**	**2,000**	**0**
Investment management expenses					
External investment management fees - invoiced	6,182	6,900	2,592	6,900	0
External investment management fees - not invoiced	4,343	4,400	1,444	4,400	0
Custody fees	107	115	25	115	0
Transaction costs	1,370	1,500	721	1,500	0
Reversal of accrual	(2,471)	0	0	0	0
Stock lending income & commission recapture	(109)	(100)	(35)	(100)	0
Other investment management expenses	50	50	0	50	0
	9,472	**12,865**	**4,748**	**12,865**	**0**
Oversight and governance costs					
Investment & Pension Fund Committee Support	92	95	27	95	0
Pension Board	26	27	12	27	0
Investment Oversight and Accounting	281	285	113	285	0
Brunel Pension Partnership	146	440	22	440	0
Legal Support	34	30	0	30	0
Actuarial Services	69	40	150	40	0
Investment Performance Measurement	38	0	0	0	0
Subscriptions	19	20	16	20	0
Internal Audit fees	22	14	0	14	0
External Audit fees	29	29	7	29	0
	755	**980**	**347**	**980**	**0**
Total Management Expenses	**12,286**	**15,845**	**6,337**	**15,845**	**0**