

## 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 2016/17 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 **31 December 2016**.

#### Fund Value and Asset Allocation

	Fund Value as at 31.12.16	Target allocation	Fund asset allocation at 31.12.16	Variation from Target
	£m	%	%	%
<b>Fixed Interest</b>				
Bonds	422.3	14.0	11.2	
Cash	73.2	2.0	1.9	
	<b>495.5</b>	<b>16.0</b>	<b>13.1</b>	<b>-2.9</b>
<b>Equities</b>				
Passive Equities	1,639.9	40.0	43.4	
Active Equities	565.4	15.0	15.0	
	<b>2,205.3</b>	<b>55.0</b>	<b>58.4</b>	<b>+3.4</b>
<b>Diversified Growth Funds</b>	<b>563.1</b>	<b>15.0</b>	<b>14.9</b>	<b>-0.1</b>
<b>Alternatives</b>				
Property	361.2	10.0	9.6	
Infrastructure	152.4	4.0	4.0	
	<b>513.6</b>	<b>14.0</b>	<b>13.6</b>	<b>-0.4</b>
<b>Total Fund</b>	<b>3,777.5</b>	<b>100.0</b>	<b>100.0</b>	

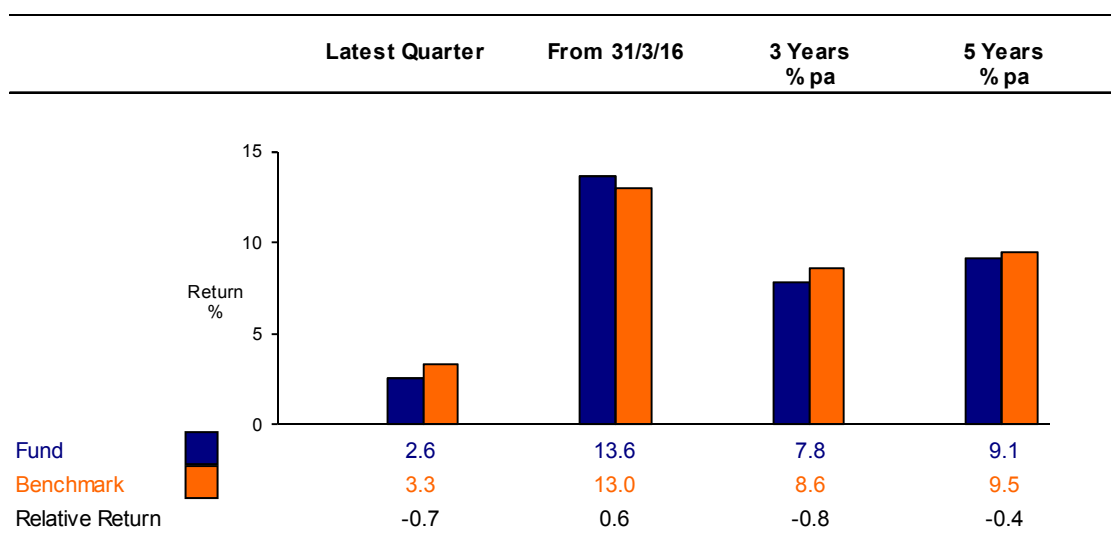
- The Fund value as at 31<sup>st</sup> December 2016 stood at £3,777.5 million, an increase of £90m over the quarter, and an increase of £440m since 1<sup>st</sup> April.

- As reported at the December meeting of the Committee, a decision was taken following the end of the September quarter to rebalance the asset allocation back towards the target. £50 million was redeemed from the passive equities allocation, with £40 million reinvested in Diversified Growth Funds and £10 million retained as cash. This reduced the equities overweight position to 2.5%. However, following another quarter in which equities have outperformed other asset classes, the allocation to equities is again more than 3% above target. Following discussion with the Committee's Independent Investment Advisor, no action has been taken to undertake further rebalancing pending the outcome of the Strategic Asset Allocation review undertaken by Mercer.
- The fixed interest allocation remains just under 3% below target at the quarter end, as a result of the global bonds mandates managed by Lazard and Wellington being below their target allocation. The Committee has previously agreed to maintain the allocation to fixed interest below its target level at the meeting in May 2014.

## 2) FUND PERFORMANCE

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

### Longer Term Fund Performance Summary



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

The last quarter has seen a return below benchmark. However, the nine months to 31 December 2016 have seen an absolute return of +13.6%. This is ahead of the Fund benchmark of +13.0%. The longer term three and five year returns remain below benchmark.

A breakdown of the performance of the Total Fund for the **nine months to 31 December 2016** and the comparative Index returns are shown in the table below:

## **Performance for the nine months to 31 December 2016**

<b>Sector</b>	<b>Fund Return</b>	<b>Benchmark</b>	<b>Benchmark Description</b>
	<b>%</b>	<b>%</b>	
Global Fixed Interest	6.5	8.3	BarCap Global Bonds / MSC
Cash (inc Foreign Currency)	1.1	0.2	GBP 7 Day LIBID
Passive Equities	18.6	18.8	Devon Bespoke Passive Index
Active Equities	20.7	25.8	FTSE World
Diversified Growth Funds	7.5	3.1	Devon Multi Asset Benchmark
Infrastructure	13.9	0.2	GBP 7 Day LIBID
Property	2.3	1.7	IPD UK PPF All Balanced Funds

<b>Total Fund</b>	<b>13.6</b>	<b>13.0</b>	<b>Devon Bespoke Index</b>
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Key issues over the quarter include:

- Following the outcome of the referendum and the decision to leave the European Union, a major casualty of the result was a significant fall in the value of Sterling. This has had a positive effect of increasing the value of the Fund's overseas assets in Sterling terms and pushing up the value of UK shares where companies benefit from overseas earnings. Bond values also rose as a flight to quality and fears about growth and inflation compressed yields yet further, although this has partly reversed over the last quarter.
- As agreed at the December meeting of the Committee, additional currency hedging has been put in place. The passively hedged North America, Europe and Japan funds managed by State Street have been changed from a 50% static hedge to a 100% static hedge. The dynamically hedged funds remain unchanged. In addition forward currency contracts have been put in place to hedge the currency risk in respect of the Montanaro European Smaller Companies Fund, the RWC European Focus Fund and the First State European Diversified Infrastructure Fund, all of which have significant exposure to the Euro. The additional currency hedging will safeguard the gains made from the fall in the value of Sterling should it strengthen over the coming months, but will reduce the opportunity of further gains should Sterling weaken further. Given the significant fall in Sterling over 2016, the most significant risk to the fund would be a strengthening of Sterling against the Euro and US Dollar.
- The active equity managers have had a poor quarter, and as a result are now collectively below the FTSE World benchmark. This is largely a result of an underweight exposure to the US market which rallied strongly following the election of Donald Trump.
- The diversified growth funds (DGFs) have outperformed their cash plus benchmarks at a time of positive returns in equity and bond markets.
- The infrastructure investments have performed well over the 9 months, also aided by the currency movements, and have also provided significant income distributions to the Fund.
- Property has seen reductions in capital values as a result of uncertainty following the referendum result, but the income yield has resulted in an overall positive return over the 9 months.

### **3) BUDGET FORECAST MONITORING AND CASH MANAGEMENT**

- (a) Appendix 1 shows the actual to date and revised forecast for 2016/17 against the original budget forecast. This shows a deficit of £14.9m between contributions received and benefits paid out in the first half of the year. In addition £7.0m in management expenses has been incurred over the six months. This is offset by the receipt of £11.6m investment income from

property and infrastructure, with a further £7.9m being reinvested by the Fund's investment managers.

- (b) However, the gap between contributions received and benefits paid is forecast to reduce over the last quarter of the year. The increase in the revised forecast for employer contributions results from some of the Fund's employers deciding to pay in additional contributions in 2016/17 to reduce their deficit and thereby reduce the deficit contributions that will be needed in future years. The revised forecast also shows an increased forecast for transfers in from other pension funds, where the original forecast has already been more than achieved.
- (c) The Investment Oversight and Accounting heading includes an additional £50,000 Brunel costs. Actuarial costs to date appear to be significantly over budget, but will be reduced by the year end as a result of recharges for specific work done for individual employers.
- (d) At 31 December 2016 the unallocated cash on deposit amounted to £46.9m. The cash held is being maintained at a lower level than in the past, and it is therefore necessary to ensure its liquidity for cashflow purposes. Hence the majority of cash is held in money market funds or call accounts with immediate or short term access. However, the cash figure includes £20m placed into longer 6 month deposits. This includes the £10m retained in cash from the rebalancing undertaken at the end of the September quarter. A further £8.2m was received as a return of capital from one of the Specialist Funds. The additional cash is being held to meet future cashflow requirements, including the infrastructure commitment yet to be drawn.

### Cash on Deposit

Type of Deposit	Maturity period	Actual as at 31/03/16 £m	Average Interest Rate %	Current as at 31/01/17 £m	Average Interest Rate %
Call and Notice Accounts	Immediate	39.2	0.41	3.9	0.29
	2 Day Notice	0.0		23.0	0.47
Term Deposits	<30 Days	0.0		0.0	
	>30 Days	0.0		20.0	0.60
<b>TOTAL (at 31st January 2017)</b>		<b>39.2</b>	<b>0.41</b>	<b>46.9</b>	<b>0.51</b>

- (e) The weighted average rate being earned on cash deposits, as at 31 January 2017, was **0.51%**. 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. The rates available have fallen further following the Bank of England's decision to reduce the base rate to 0.25%. However this has been offset to a certain extent by the use of a money market fund with a 2 day notice period for the withdrawal of cash that offers a better rate, and the use of six month term deposits.
- (f) The deposits in place during the year fully complied with the Fund's Treasury Management and Investment Strategy for 2016/17.

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Local Government Act 1972

List of Background Papers Nil

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## Devon County Council Pension Fund Budget / Forecast 2016/17

	Actual 2015/16 £'000	Original Forecast 2016/17 £'000	Actual to Dec 16 £'000	Revised Forecast 2016/17 £'000	Variance from Original Forecast £'000
<b>Contributions</b>					
Employers	(117,079)	(117,000)	(82,603)	(122,000)	(5,000)
Members	(36,201)	(36,000)	(27,416)	(36,000)	0
Transfers in from other pension funds:	(4,766)	(3,000)	(6,388)	(7,500)	(4,500)
	<b>(158,046)</b>	<b>(156,000)</b>	<b>(116,407)</b>	<b>(165,500)</b>	<b>(9,500)</b>
<b>Benefits</b>					
Pensions	132,435	135,000	102,042	135,000	0
Commutation and lump sum retirement benefits	30,035	32,000	21,645	32,000	0
Lump sum death benefits	3,777	4,000	3,194	4,000	0
Payments to and on account of leavers	443	200	384	400	200
Payments for members joining state scheme	6,986	6,000	4,083	6,000	0
	<b>173,676</b>	<b>177,200</b>	<b>131,349</b>	<b>177,400</b>	<b>200</b>
<b>Net Withdrawals from dealings with fund members</b>	<b>15,630</b>	<b>21,200</b>	<b>14,941</b>	<b>11,900</b>	<b>(9,300)</b>
<b>Investment Income</b>					
Received as Cash	(19,021)	(19,100)	(17,833)	(19,100)	0
Reinvested by Fund Manager	(16,722)	(14,300)	(10,948)	(14,300)	0
	<b>(35,743)</b>	<b>(33,400)</b>	<b>(28,781)</b>	<b>(33,400)</b>	<b>0</b>
<b>Administrative costs</b>					
Peninsula Pensions	1,523	1,713	715	1,713	0
	<b>1,523</b>	<b>1,713</b>	<b>715</b>	<b>1,713</b>	<b>0</b>
<b>Investment management expenses</b>					
External investment management fees - invoiced	5,242	5,950	3,436	5,950	0
External investment management fees - not invoiced	2,994	3,000	2,216	3,000	0
Custody fees	140	115	25	115	0
Transaction costs	3,508	3,510	2,159	3,510	0
Stock lending income & commission recapture	(94)	(85)	(70)	(85)	0
Other investment management expenses	50	25	18	25	0
	<b>11,840</b>	<b>12,515</b>	<b>7,786</b>	<b>12,515</b>	<b>0</b>
<b>Oversight and governance costs</b>					
Investment & Pension Fund Committee Support	85	92	67	92	0
Pension Board	21	27	20	26	(1)
Investment Oversight and Accounting	288	333	330	383	50
Legal Support	43	43	14	43	0
Actuarial Services	41	60	120	60	0
Investment Performance Measurement	24	42	8	42	0
Subscriptions	38	41	17	41	0
Internal Audit fees	13	14	0	14	0
External Audit fees	29	29	14	29	0
	<b>582</b>	<b>681</b>	<b>591</b>	<b>730</b>	<b>49</b>
<b>Total Management Expenses</b>	<b>13,945</b>	<b>14,909</b>	<b>9,092</b>	<b>14,958</b>	<b>49</b>