

Suffolk County Council Pension Fund

Investment strategy and structure

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Agenda

- Equity structure
 - UK / Overseas split
 - Accessing diversified mix of approaches
 - Alternative passive approaches
 - Getting the best from active management
- Routes to accessing alternatives
 - Investment options
 - Procurement options
- Next steps and timescales



Current equity structure

	Region	Current Benchmark %	Distribution of equities (%)	Distribution of Global equities (%)	FTSE All World benchmark allocation (%)	Principal variation (columns 3 and 4) (%)
UK	UK (dedicated)	22.6	34.8			
Global Equities	UK (residual)	3.4	5.2	8.0	8.0	-
	Europe ex UK	9	13.9	21.2	18.0	+3.2
	North America	19	29.2	44.8	46.1	-1.3
	Japan	2.5	3.9	5.9	7.4	-1.5
	Asia Pacific	3.5	5.3	8.3	8.1	+0.2
	Emerging Mkts	5	7.7	11.8	12.4	-0.6

- UK exposure much greater than market cap weight
- Effectively 7.5 times exposure to UK listed stocks compared with market cap



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Impact of current UK equity exposure

- Size of stock positions
 - Top 5 stocks make up 27% of index, top 10 stocks make up 42% of index
 - Typical holding in Shell much larger than in Exxon
 - ◆ Both oil majors, competing globally, Exxon larger
 - ◆ Current size of holdings not based on stock fundamentals (but on UK versus overseas allocation)
 - Academic evidence that more equal weighted positions outperform cap weighted positions over time
- Supports view that lower UK allocation is optimal



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Impact of current UK equity exposure

➤ Sector biases relative to global markets

Sector	UK sector weight (%)	Global sector weight (%)	Difference (%)
Oil & Gas	16.2	10.2	+6
Basic Materials	12.2	8.2	+4
Industrials	7.3	11.9	-4.6
Technology	1.8	9.6	-7.8

- UK dominated by specific sectors
- Lack of representation in other market sectors
 - e.g. Technology, Manufacturing
- High UK equity exposure “inefficient”



Current structure – mandate types

Manager	Mandate type	Benchmark allocation (%)
Legal & General	Passive – overseas, regional fixed	14.0
AllianceBernstein	Active UK focussed	14.0
BlackRock	Active UK focussed	6.6
JP Morgan	Active global market cap	13.2
Newton	Active global market cap	13.2
Millennium	Equitised cash	4.0
Total		65.0

- Existing structure reliant on market cap benchmarks



Assessing market cap benchmarks

For	Against
<p>Index construction is simple. Broad exposure to wide universe. Wide use means liquidity and low transaction costs. Index funds need very little or no rebalancing due to index construction. Management fees are low. Appeals to finance theory: CAPM and EMT.</p>	<p>Methodology leads to holding more in (potentially) overvalued stocks. Empirically, past performers tend to do badly; past losers tend to do well. Market cap flies in the face of this. Concentration issues (e.g. Shell) Prone to bubbles; sensitive to price which reflects investor sentiment rather than fundamentals (dot com bubble). Higher volatility portfolios.</p>

- Consider diversifying benchmark index construction



Alternatives approaches to passive

- Back history shows alternative passive approaches have outperformed market cap – no future guarantee
- Examples of alternative passive approaches
 - Size – equal weighted portfolios typically outperform! difficult in practice (but reveals market cap inefficiency)
 - Fundamental – weight stocks on factors such as price to book, cash flow, dividends. Give more weight to stocks with low price to earnings ratios (a value bias)
 - Momentum – allocates to stocks progressively according to how long and how fast the share price has been rising; reduces weighting in stocks which are falling in price



Performance of alternative passive

Historic performance of style based approaches

Representative returns 1989-2010	Size tilt %	Val tilt %	Mom tilt %	Size + Val %	Size+Mom %	Val+Mom %	All three %	MSCI World
Annualised return	8.16	8.82	7.45	8.51	7.86	8.20	8.20	6.67
Annualised volatility	17.56	17.80	17.13	17.61	17.02	17.06	17.14	17.43
Excess return	1.49	2.15	0.77	1.83	1.19	1.53	1.53	

Source: State Street Global Advisers

- State Street's analysis shows that
 - Each tilt added value relative to market cap index
 - none of the tilts had a material effect on portfolio volatility
- Similar results have also been found other studies



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Alternative passive approaches

- Our views
 - Over longer time periods, there may be imperfections in market capitalisation indices which are exploitable
 - Market capitalisation indices tend to have a momentum bias; diversified indexation worthwhile
- Conclusions
 - Scope to diversify index-tracking portfolios away from pure reliance on market capitalisation-based indices
 - Return potential suggests worthwhile replacing some active management with alternative passive
 - ◆ Particularly "index-sensitive" active



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Active – diversifying equity exposure

- Alternative passive not the only way of diversifying equity exposure
- Select active managers doing something “different” from market cap benchmark
 - High active share
 - Thematic
 - Dividend focus
- Seek active approaches that improve diversification
 - increase chance of outperforming market cap indices



Recommendations to Committee

- Reduce the allocation to UK equities in favour of overseas equities
- Propose medium term target of 25%:75% split
- Overseas regional equity split can be amended by adapting Legal & General benchmark
- Consider whether to use some active for alternative passive
 - Assuming Committee comfortable with alternative passive or active approaches



Investing in alternatives

- Committee previously agreed to the following:
 - 2% allocation to timberland
 - 5% allocation to infrastructure
 - 10% allocation to absolute return
- Issues to be resolved
 - Investment route –
 - ◆ segregated/pooled
 - ◆ single fund or fund of funds
 - Procurement requirements (to be agreed with Officers)

Our views

- Absolute return
 - Pooled fund most efficient
 - Open to range of offerings – OJEU process
- Infrastructure
 - Direct, fund of funds or listed options available
 - Prefer pooled, either single fund or fund of funds basis
 - Procurement dependent on Council view
- Timberland
 - Target exposure through range of pooled funds
 - Procurement dependent on Council view

Next steps

- Committee to provide views on alternative passive or new active
 - Alternative passive – can be implemented speedily (L&G have products available)
 - Active equity with differentiated style OJEU process, or pooled fund “decisions”
 - ◆ Further discussion required
- Alternatives allocation - agree investment and procurement route
 - Typically invest / commit over 12-36 month timeframe



Thank You

Any questions?



General risk warning

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