EMD allocation

Introduction

This note, addressed to the Pensions Committee of the Suffolk County Council Pension Fund, discusses the Fund's Emerging Markets Debt ('EMD') allocation and the recent proposal to consolidate that allocation with the BlackRock bond mandate.

Background

Our November 2015 report *'Strategy and structure update for 2015'* proposed a consolidation of the Fund's dedicated EMD allocation into the main bond portfolio (specifically via the BlackRock bond mandate).

There were a number of reasons for this:

1 The broader investment universe offered by the newer bond mandates that allow an investment in EMD meaning a dedicated allocation is less necessary;

2 Potential for tactical management of the higher volatility EMD allocation to add value over the long term. This was not available in the previous structure that assumed a static 2% allocation, irrespective of market view; and

3 Continuation of the consolidation of mandates to achieve a simpler structure (where this makes sense from a cost/benefit basis).

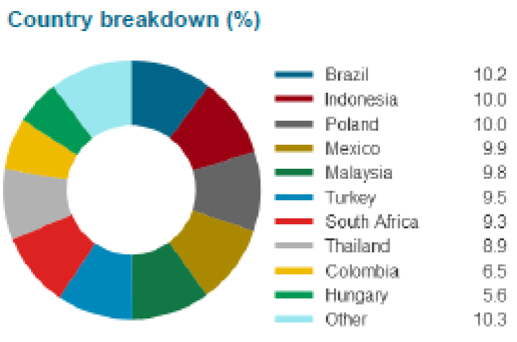
In addition, given the weak performance of EMD, it was proposed that the EMD allocation could be phased down on strong performance of the mandate (a 0.5% sale for every 5% growth in the EMD market from 30 September 2015 was suggested).

Current position

Following that discussion, further information on the country allocation of the EMD mandate was requested. Further, it was agreed to closely monitor the performance of the allocation and consider action following strong performance.

EMD country allocation

The following chart (from L&G) sets out the country allocation of the passive local currency fund in which the Suffolk Fund invests as at 31 March 2016:



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EMD performance

Since 30 September 2015, the L&G EMD fund Suffolk invest in has returned in excess of 15%. This is in part due to the recovery of EM currencies as oil and basic materials have recovered.

Given our proposal for a 0.5% sale for every 5% recovery, this would suggest a 1.5% sale of the EMD allocation (leaving a further 0.5% to be sold).

Proposal

Given the strength of recovery, continued uncertainty and desire to minimise governance, we would favour a full sale of the EMD allocation and move to active management of the EMD allocation.

The BlackRock bond fund had a 13% allocation to EMD as at 30 April 2016. Transferring the full allocation to BlackRock would mean an allocation of 8.5% to their mandate and a c1% allocation to EMD at the total Fund level (given their proportion of total Fund assets and current allocation to EMD).

This appears a sensible approach to us to maintain the allocation whilst taking advantage of the potential for active management to add value.

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For and on behalf of Hymans Robertson LLP

Risk warning

Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investment in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of an investment. As a result, an investor may not get back the amount originally invested.

Past performance is not necessarily a guide to future performance.