Agenda Item:

10

Pension Fund Committee

Dorset County Council

Date of Meeting	13 June 2013
Officer	Report of the Fund Administrator
Subject of Report	Fund Administrator's report
Executive Summary	The purpose of this report is to update the Committee on the allocation of the assets and overall performance of the Fund for the 2012/13 Financial Year to 31st March 2013. The report also provides a commentary on the performance of the fund managers who are not considered elsewhere on the agenda and to address other topical issues for the Fund that do not require a separate report. The Independent Adviser's report is contained at Appendix 2, and will be presented separately at the meeting. The report shows the Fund returned 16.80% over the year, and out performed its benchmark by 0.04%. For the same period the WM Local Authority average returned 13.80%.
Impact Assessment: *How have the following contributed to the development of this report?**	Equalities Impact Assessment: N/a
	Use of Evidence: N/a
	Budget/ Risk Assessment: N/a
Recommendations	1) Members consider and comment upon the activity and overall performance of the Fund. 2) That the committee consider the results of the review of Alternative Assets, and agree to defer any conclusions pending a review of the overall strategy. 3) That the Committee agree to make no changes to the Fund's Asset Allocation at this time.

Reason for Recommendation	To ensure that the appropriate management arrangements are in place and are being monitored, and to keep the asset allocation in line with the strategic benchmark.
Appendices	Appendix 1: New Money Forecast Appendix 2: Report of the Independent Adviser Appendix 3: HSBC Manager Performance for the year to 31 March 2013
Background Papers	HSBC Performance Statistics
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1. Background

1.1 The Dorset County Pension Fund currently receives more money in contributions and investment income than it pays out as pensions and retirement grants. This 'New Money' was £46.2m for the 2012/13 financial year, which is more than originally anticipated for the year largely due to a large one off payment of approximately £9.7m from a large scheme employer as a contribution toward their share of the deficit. The change in the additional funding is illustrated in Appendix 1.

1.2 The new money levels are reviewed throughout the year, and Members are alerted if there is any significant variance from what is expected.

2. Fund Cashflow

2.1 Table 1 summarises the main cashflows for the Fund for the year to 31 March 2013.

Table 1 – Statement of Cashflows for the Financial Year ended 31 March 2013

		£M	**£M**
Cash at 1st April 2012			**84.8**
Add:	Increase in Cash	46.2	
	Redemption from rlam	160.0	
	Redemption from Pictet	57.0	
	Redemption from Pioneer	1.5	
	Property Sales	8.7	
	Private Equity Redemptions	4.9	
			278.2
Less:	Investment with Insight	160.0	
	Investment with JP Morgan	68.0	
	Investment with Intech	19.0	
	Investment with Barings	6.0	
	Net UK Equity Purchases	8.3	
	Private Equity Purchases	7.3	
	Property Purchases	34.0	
	Currency Hedge Loss	8.0	
			310.7
Cash at 31st March 2013			**52.4**

2.2 The prediction for net new money into the Fund for 2012/13 was £32m at the start of the year. The actual amount of cash received was £46.2m, which is more than the revised projection, presented to the February meeting of the committee of £39m. Appendix 1 shows the budget outturn (new money) for 2012/13 compared with previous years and includes the budget prediction for 2013/14 which shows net new money of £33.3m.

2.3 During 2012/13, employer contributions were £12.5m more than originally estimated, mainly due to a £9.7m lump sum contribution from a large employer and additional contributions towards the actuarial strain costs of early retirements. Employee contributions of £24.1m were marginally higher than anticipated but lower than the 2011/12 contributions of £25m. Transfer values, which are difficult to predict, showed a net income of £3.6m, which is lower than past years.

2.4 Investment income was £29.5m for the year which is higher than the estimated amount and is largely due to the additional investments in the property portfolio which resulted in rents increasing by £2.7m to £10.8m.

2.5 In relation to expenditure, payments to pensions increased by £5.3m to £90.5m, which was more than anticipated. Management expenses were less than expected by £0.2m to £4.2m which reflects some of the recent changes in the Fund's management arrangements.

3. Fund Portfolio Distribution

3.1 The last strategic review in June 2011 changed the asset allocations and at the February meeting Members agreed further distributions to JP Morgan and Barings to bring the allocations into better alignment with the target allocation. Table 2 illustrates the comparative figures as at 31st March 2013.

Table 2 – Dorset Fund Market Values – Comparative Figures

		Dorset Fund Market Values						
		Actual at 1 April 2012		Actual at 31 March 2013		Target Allocation		Flexibility
Asset Class	**Manager**	**£M**	**%**	**£M**	**%**	**£M**	**%**	**+ / - %**
Bonds	(Several)	307.7	18.8	402.3	20.9	384.2	20	2.5
UK Equities	(Several)	461.8	28.2	536.1	27.9	537.8	28	5
Overseas Equities	(Several)	408.7	24.9	505.4	26.3	518.6	27	5
Property	(CBREi)	140.4	8.6	162.1	8.4	192.1	10	2.5
Absolute Return Funds	(Several)	84.5	5.1	89.9	4.7	115.2	6	0
Private Equity	(Several)	44.7	2.7	49.6	2.6	76.8	4	0
Diversified Growth	(Barings)	79.0	4.8	91.2	4.7	96.0	5	0
Cash	(Internal)	84.8	5.2	52.3	2.7	0.0	0	0
Cash	(Pictet)	28.7	1.7	32.0	1.6	0.0	0	0
		1640.3	**100.0**	**1920.8**	**100.0**	**1920.8**	**100**	

3.2 The figures show that against the target allocation, the Fund is slightly overweight in Bonds, which is mainly due to the increase in value of the Liability Matching Bond portfolio which saw a £47m (28%) rise in the quarter and has taken the allocation to a marginally overweight position, albeit within the tolerances allowed.

3.3 Overseas Equities are showing as slightly underweight, although this is because of the active tactical position of Pictet, the fund manager, to hold part of their allocation as cash. Once cash is added, there is an overweight position of 90 basis points, which can largely be explained by the large rally in global equities in relation to other asset types.

3.4 The Property portfolio is underweight due to the sales of Howard House, Bristol and the industrial units in Hertford. The increase in the relative value of the Equities and Bond portfolios has also had an impact on the relative weighting of the Property portfolio. The Property Fund manager continue to seek suitable assets to purchase and are currently considering several sites to complement the portfolio and to align with the strategic allocation.

3.5 Absolute Return Funds and Private Equity continue to remain underweight whilst the review of the Fund's alternative investments is carried out.

3.6 The Barings Diversified Growth Fund received an allocation of £6m in February and now represents 4.7% of the portfolio, just below the 5% target allocation.

4. Overall Fund Performance

4.1 The performance of the Fund over the past financial year shows an out performance with a return of 16.80% compared to the benchmark of 16.76%. During the final quarter the Fund out performed its benchmark with a return of 10.28% compared to 10.00%. The overall performance of the Fund has been affected during the period by the new strategy to undertake liability hedging, which is designed to follow liabilities rather than seek asset performance.

4.2 When considering the overall performance it is important to note the split between the “Return seeking assets” and the “Liability matching assets”. Since the implementation of the strategic review in 2012, the Fund has held a proportion of the assets in an Inflation Hedging Strategy, managed by Insight. These assets are not managed to add growth, but to match the movements in the Fund’s liabilities. It is therefore important to consider that in normal circumstances, the benchmark movement of these assets is a proxy for the Fund’s liabilities.

4.3 This Liability Matching strategy is conducted by Insight, and this portfolio has returned 35.12% since its inception on 1st July 2012. Table 3 shows the overall performance of the Fund, but makes the distinction between the return seeking assets and the liability matching assets. The strategy is intended to hedge against the impact of increasing pensions liabilities which are linked to, amongst other things, the consumer prices index (CPI). CPI can not currently be hedged as there is not a sufficiently developed futures market, so the Dorset strategy targets the retail prices index (RPI) swaps market to act as a proxy for CPI which tends to be lower than RPI.

4.4 The Fund has benefited from the performance of the Liability Matching strategy which saw a £47.6m increase in value during the last quarter. The main driver for this was the decision by the Office for National Statistics (ONS) to continue with the methodology it uses to calculate the RPI. The markets had expected the basis to change and that the new calculation would produce a lower RPI figure, and lower the difference between RPI and CPI, and this was therefore priced into the RPI futures markets. The continuation of the current methodology resulted in the RPI swap prices increasing significantly and it therefore benefited the Fund considerably, without an increase in underlying liabilities which have not been affected by the ONS decision.

4.5 In considering the performance of the Fund as a whole, there are two main areas that explain where the performance is being generated. These are the asset allocation of the Fund and within those allocations the stock selection choices that have been made. The stock selection element is a measure of the fund managers’ ability to outperform their benchmark. The asset allocation is the effect of decisions to change the weighting of the different asset classes within the Fund.

4.6 The HSBC performance report, contained at Appendix 3, gives an attribution analysis of the performance for the quarter on pages 5 and 6. This analysis shows that, once currency hedging has been removed, asset allocation had a positive effect against the benchmark, whilst stock selection was broadly neutral. The main drivers of the market contribution have been Bonds which have benefited from the increase in the price of RPI swaps and the continued solid management of the Royal London Bond holdings.

4.7 Over the longer term the Fund has seen some strong performance, particularly when compared with other Local Authority Funds. Over 3 years the Fund achieved a return of 10.3% which is marginally below the benchmark, but is well ahead of the Average Local Authority Fund which returned 8.1%. The performance is also significantly in excess of the Actuaries assumed long term rate of return of 6.9% per annum, which will be good news for the 2013 Actuarial Valuation of the Fund.

4.8 After the Financial Crisis of 2007-2009, the value of the Fund fell to just under £1 Billion; at the end of March 2009 the total Fund value was £999 Million. Over the 4 year period since this low markets have seen a significant recovery, and the Dorset Fund has benefited from this. The Fund performance over this period is 16.9% per annum, against a benchmark return of 15.4% and the average local authority fund which returned 14.3%.

Table 3 Summary Fund Performance by Asset Class 12 months to 31 March 2013

		12 months to 31st March 2013		
Asset Category	Manager	Dorset	Benchmark %	Over/(Under)
		%	%	%
Overall Fund Performance	**All**	**16.80**	**16.76**	**0.04**
Total Return seeking assets	**(Various)**	**14.95**	**15.25**	**-0.30**
UK Equities	(Various)	16.73	17.02	-0.29
Overseas Equities	(Various)	16.52	16.98	-0.46
Bonds	(RLAM)	20.45	18.47	1.98
Property	(CBREi)	3.73	2.55	1.18
Hedge Funds	(Various)	4.83	6.83	-2.00
Private Equity	(Various)	13.06	16.78	-3.72
Diversified Growth	(Barings)	7.84	4.79	3.05
Cash	(Various)	13.00	0.00	n/a
Total Liability matching assets		**35.12**	**29.49**	**5.63**
Inflation hedging bonds	(Insight)	35.12	29.49	5.63

5. Royal London Asset Management

5.1 The Committee has previously received reports from the larger individual fund managers. However, due to the addition of new fund managers as part of the process of diversification it is becoming unwieldy for each large fund manager to present to the Committee as regularly. It is planned therefore for each of the larger five managers to present to the Committee once a year on a rotating basis, with no more than three at any one meeting.

5.2 The Royal London fund continued its strong performance and returned 2.5% during the final quarter against the benchmark of 1.8%, giving an out performance for the year of 1.98% against the benchmark of 18.47%. The out performance was all due to the stock and sector selection decisions by the manager, who remains positioned for a further tightening of credit spreads. The high relative weighting in secured and asset backed securities also had a positive contribution as it was one of the best performing sectors. Low exposure to supranational and highly rated consumer bonds also helped with the relatively performance for the period.

5.3 Table 4 illustrates the change in value of the RLAM bond portfolio for the financial year to 31st March 2013.

Table 4 – Royal London Asset Management – Performance for the year to 31st March 2013

Manager	Market Value 1 April 2012	Transfer of Holding to Insight*	Market Value 31 March 2013	Return %	Benchmark %
	(£000's)	(£000's)	(£000's)		
RLAM	307,737	(160,000)	190,012	20.45	18.47

* on 28th June 2012 £160m of Bonds were transferred from RLAM to Insight as part of the Asset Matching (Liability Hedging) programme

6. Barings Diversified Growth Fund

6.1 The Diversified Growth allocation was mandated to Barings on 30 March 2012. Diversified Growth Funds are designed to give fund managers total discretion over how and where they invest which means that the portfolio holds a wide range of investments against a diverse range of asset classes. The Barings fund seeks to achieve out performance against a cash benchmark by focussing on asset allocation decisions. This fund targets equity like returns with about 70% of the equity risk.

6.2 The performance of Barings for the financial year is illustrated in Table 5.

Table 5 – Diversified Growth – Barings Performance year to 31 March 2013

Manager	Market Value 1 April 2012	Market Value 31 March 2013	Performance %	Benchmark %
	(£000's)	(£000's)		
Barings	79,000	91,225*	7.84	4.79

*An additional £6m allocation was made to the fund on 28th February 2013

6.3 The Barings fund has had a strong final quarter and has out performed its benchmark by 4.47% which has heavily contributed to an out performance for the year of 3.05% above the benchmark. The main drivers of this improvement are UK and overseas equities which have continued the rally seen towards the end of 2012 and corporate bonds. Emerging market equities, alternatives and gold also saw positive returns. The main drag on performance was cash holdings and currency.

7. Manager Progress (excluding UK equities)

Active US Equity

7.1 The performance of Intech for the 12 months ending 31 March 2013 is illustrated in Table 6.

Table 6 – Performance of Intech – US Equity

	USD $				GBP £			
	Market Value 1 April 2012 ($000's)	Market Value 31 March 2013 ($000's)	Performance %	Benchmark %	Market Value 1 April 2012 (£000's)	Market Value 31 March 2013 (£000's)	Performance %	Benchmark %
Intech	101,502	151,112	14.80	13.97	63,530	99,514	20.45	19.93
* The valuation as at 31 March 2013 includes the additional investment of £19m ($30.2m) on 5th April 2012								

7.2 On 5th April 2012 £19m was added to the Intech portfolio as part of the overall strategic review and resulting pension fund rebalance. The Intech fund actively manages US equity stocks using disciplined mathematical processes to outperform the benchmark at the same level of risk. During the year the fund returned 20.45% compared with the benchmark of 19.93%. The higher performance when converted to Sterling is because of the relative strength of the US dollar compared to Sterling. Intech continue to perform well with the fund contributing growth of 78.87% over the past 5 years.

Emerging Markets Equity

7.3 The JP Morgan mandate was funded on 5th April 2012. The performance of the fund for the year to 31st March 2013 is shown in Table 7.

Table 7 – JP Morgan Emerging Markets Performance for the year to 31 March 2013

	Initial Investment 4 April 2012 (£000's)	Market Value 31 March 2013 (£000's)	Performance %	Benchmark %
JP Morgan	58,000	72,324*	7.57	7.31

* £10m additional investment made on 28th February 2013

7.4 The Pension Fund invested in the JP Morgan Emerging Markets Diversified Equity Fund as part of the overall fund restructure on 5th April 2012, a further £10m investment was made on 28th February 2013, to bring the holding into balance with the target allocation. The initial investment was funded from the proceeds of the sale of the Pictet Emerging Markets Fund. The aim of the JP Morgan fund is to provide longer term capital growth in emerging markets by identifying value based countries, stocks and sectors which will drive this longer term growth. Emerging market equities are seen as the asset class which will offer the most growth over the medium term, albeit with high levels of volatility.

7.5 The performance for the year was adversely affected by a very poor first quarter for emerging markets generally which has since been offset by improvements over the rest of the year, with out performance during the second half of the year against the benchmark of 5.31% over the past 6 months. The Emerging Markets area is a long term growth and performance should be assessed over a 3 to 5 year time horizon.

Private Equity

7.6 The Pension Fund has committed to investing with HarbourVest and Standard Life in their Private Equity Fund of Funds. Private Equity is an area that takes several years for commitments to be fully invested, and the table below shows the position as at 31 March 2013.

7.7 Table 8 shows the commitment Dorset has made to each fund in Euros and US Dollars, the drawdowns that have taken place to date and the percentage of the total drawdown against Dorset's commitment. The latest valuation and gain or loss against drawdown is also illustrated.

Table 8 Private Equity Commitments, Drawdowns and Valuations as at 31 March 2013

Manager	Commit ment	Drawn down	% of Commit-ment	Valuation	Gain / (Loss)
	€m	€m		€m	€m
HarbourVest HIPEP V Partnership Fund 2006 (Euro)	12.000	10.380	87%	12.604	2.224
HarbourVest HIPEP V Direct Fund 2006 (Euro)	3.000	2.880	96%	3.083	0.203
Standard Life European Strategic Partners 2006 (EUR)	22.000	18.738	85%	16.981	-1.757
Standard Life European Strategic Partners 2008 (EUR)	17.000	6.263	37%	6.004	-0.259
	$m	$m		$m	$m
HarbourVest HVP VIII Venture Fund 2006 (USD)	15.200	12.464	82%	15.309	2.845
HarbourVest HVP VIII Buyout Fund 2006 (USD)	22.800	16.872	74%	20.472	3.600
HarbourVest HVP IX Buyout Fund 2009 (USD)	15.000	2.213	15%	2.295	0.082
HarbourVest HVP IX Venture Fund 2009 (USD)	10.000	1.700	17%	1.756	0.056

7.8 Private Equity is a long term investment and as such the performance should be reviewed over the longer term. The benchmark used for this fund is the FTSE All Share index. Table 9 shows the performance over 3 and 5 years against the benchmark, and demonstrates a solid annualised performance. The 5 year rolling benchmark has increased significantly since the last quarter report, from 2.51% to 6.74%. This is due to a fall in value of shares at the start of the 5 year benchmark period (Q1 2008) and the rally in equities in the last quarter (Q1 2013).

Table 9 Private Equity Performance 3 and 5 years

	3 Years to 31 March 2013 2012		5 Years to 31 March 2013		*Note: 5 years to 31 Dec 2012*
Manager	**Dorset %**	**Benchmark %**	**Dorset %**	**Benchmark %**	*Benchmark %*
HarbourVest	11.67	8.78	5.99	6.74	*2.51*
Standard Life	13.96	8.78	5.41	6.74	*2.51*

Hedge Fund (Absolute Returns) Managers

7.9 The Pension Fund has active investments with two Fund of Hedge Fund managers; International Asset Management (IAM), and Gottex. There are also investments in delayed redemption funds with the previous manager, Pioneer. Whilst a notice of redemption was given to Pioneer as at 1 April 2009, there remains about £2.3m held in illiquid investments pending sales. Table 10 shows the current portfolio and performance for the year ended 31 March 2013.

Table 10 Hedge Fund Performance year to 31 March 2013

Hedge Fund Managers

Manager	**Market Value 31 March 2012**	**Market Value 31 March 2013**	**Performance %**	**Benchmark %**
Gottex (£000's)	28,870	30,280	4.89	5.69
Pioneer (£000's)	3,487	2,340*	12.79	6.75
IAM (£000's)	52,109	57,278	4.51	7.40
IAM ($000's)	83,254	86,976	9.01	7.40

* a distribution of £487k from Pioneer was received in November 2012 and a further £690k was received in March 2013

7.10 The performance of Gottex improved in the final quarter of the financial year, although this was insufficient to outperform the benchmark for the year as a whole. Performance has largely been driven by positions taken on asset backed securities.

7.11 The Pioneer fund has given two redemptions during the year, which has lowered the market value of the fund. Despite a strong performance for the year, the annualised return over the last 5 years has been 0.12% against the benchmark of 7.4%.

7.12 The IAM fund out performed their benchmark over the year returning 9.01% against the benchmark of 7.40% in dollar terms. However, overall since inception the IAM fund has returned an annualised 6.48% against the benchmark of 7.4%. Over the last 3 years the fund has returned on average 1.43% per annum against the 7.4% benchmark.

7.13 A review of the Fund's alternative assets, in particular fund of hedge funds has been started and is discussed in depth elsewhere on this agenda.

8. Treasury Management

8.1 The Pension Fund generates cashflows throughout the year which need to be managed. The Fund therefore holds a proportion of cash that is invested in call accounts, money market funds and fixed term deposits. A breakdown of the balances held internally as at 31 March 2013 is shown in Table 11.

Additional cash balances are also held tactically by Pictet within their overseas equity portfolio.

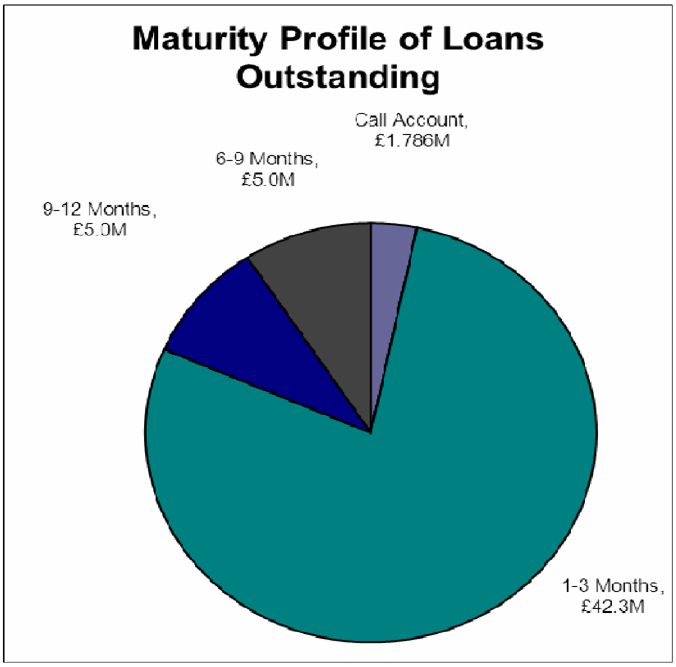
8.2 Since the credit crunch, there has been a significant reduction in the number of countries and financial institutions that are deemed safe for investments. The Council's treasury management advisers have recently advised that cash balances can be invested for more than 3 months in the big four UK banking groups. The majority of cash continues to be lent for less than 3 months in UK institutions to ensure that the money is both secure and liquid, and so it is available for distribution.

8.3 In terms of performance, the weighted average yield continues to reduce as, higher return investments mature and have to be replaced with lower rate ones. Compared to the benchmark, internally managed cash returned 0.93% over the year to 31st March 2013 compared to the benchmark of 0.41%. These low market rates are been caused by the restrictions on counterparties resulting in a flight to quality, large corporations holding large cash balances and general market improvements in liquidity following the funding for lending scheme.

Table 11 – Analysis of Cash Balances Held

As at 31 March 2013

Fixed Term Deposits	**£000**	**%**
Lloyds TSB Bank	5,000	1.90
Lloyds TSB Bank	5,000	1.00
Lloyds TSB Bank	5,000	0.70
Landesbank Berlin AG	5,000	0.47
Lloyds TSB Bank	5,000	1.10
National Westminster Bank	10,000	1.25
Nationwide Building Society	10,000	0.44
	45,000	
Call Accounts		
Natwest	7,335	0.80
Property Rent Account	557	0.50
HSBC Holding Account	1,229	0.50
	9,121	
Total Cash	54,121	
Weighted Average Yield	0.45%	



This figure excludes the cash held by Pictet as part of the overseas equities Holdings.

The cash held in the property and HSBC Accounts are operational cash balances.

9. Reform of the LGPS

9.1 Members will be well aware of the forthcoming changes to the Local Government Pension Scheme (LGPS). It was reported to the last Committee meeting, that the Department for Communities and Local Government (DCLG) had started the consultation process for the regulations that underpin the operation of the new scheme.

9.2 The Fund responded to the initial consultation document in February 2013, and subsequently the CLG have revised the regulations, and issued a consultation on this which closed in early May. The Fund responded to this revised consultation, and commented that whilst the regulations seemed reasonable as a framework, there were more detail required to administer the scheme effectively, and that the key to implementing the new scheme on 1 April was that this regulation, and accompanying guidance was issued in a timely manner.

9.3 The Fund has also responded to the CLG's consultation on transitional regulations, which will oversee the change from the existing scheme to the new 2014 scheme. The CLG also issued a consultation on miscellaneous changes to the regulations. The Fund responded to both consultations at the end of May, and copies of all responses are available if members wish to see them.

9.4 The CLG have issued a fourth consultation on proposed changes on access to the LGPS for elected members. The Fund has until early July to respond to this consultation and any comments for inclusion in a response will be welcomed.

9.5 At the National Association of Pension Funds Local Authority conference on 21 May the Local Government Minister, Brandon Lewis announced a call for evidence on efficient management of Local Government Pension Schemes. He said that wanted to give the poorer performing funds time and opportunity to "up their game" however he is keen to ensure that funds are efficient and well managed, and so does not rule out structural change in the future.

9.6 He also commented on the debate that has been ongoing for a number of years over the appropriate number of LGPS funds, an whether indeed bigger was better. The minister added that he wanted to answer this question, but also consider whether small was actually any worse.

9.7 Members will be kept up to date with progress in this area, and the Dorset Fund will respond to the consultation and call for evidence that are issued in this regard.

10. Review of Alternative Assets

10.1 At the February meeting of the Committee it was reported that a review of the Fund's allocation to alternative assets was due to commence. The intention of the review was to assess the Fund's existing alternative assets, and look at their effectiveness in giving diversification, and helping the Fund manage volatility.

10.2 JLT were appointed to conduct the review on the Fund's behalf, and officers and the independent adviser had an initial meeting in March to scope the review and assess the work required. The process was agreed and further meeting was scheduled for 8 May, to review the progress that JLT had made, and agree the next steps.

10.3 At the meeting on 8 May it was agreed that John Finch of JLT would present to this Committee meeting a summary of the work that had been undertaken, and that is elsewhere on the agenda.

10.4 In summary the findings of the review were inconclusive, in terms of strong views of the need to change. There were not any compelling arguments for asset classes that might offer a better risk-return opportunity than the Fund currently has. The Fund is also due to receive the results of the triennial actuarial valuation in the next 6 months, after which it would be sensible to review the appropriateness of the overall investment strategy. Subject to the Committee's views on JLT's presentation it is recommended that the review of alternatives is subsumed into a review of the overall strategy which will commence later in the year.

11. Asset Allocation

11.1 The previous paragraphs discuss the progress on the review of the Fund's alternative assets, and the plans for a review of the overall strategy later in the year. In paragraph 3 above, the Fund's current portfolio allocation is shown, and shows that £52.3M or 2.7% of the Fund was held in cash at the end of March, against a benchmark holding of zero. It could be suggested, therefore that this cash is allocated to other asset classes. However, when it is considered that the property portfolio remains around £30M (1.6%) underweight, and Private Equity is around £27M (1.4%) short of its target, it would be sensible to hold this balance in cash pending investments in these areas.

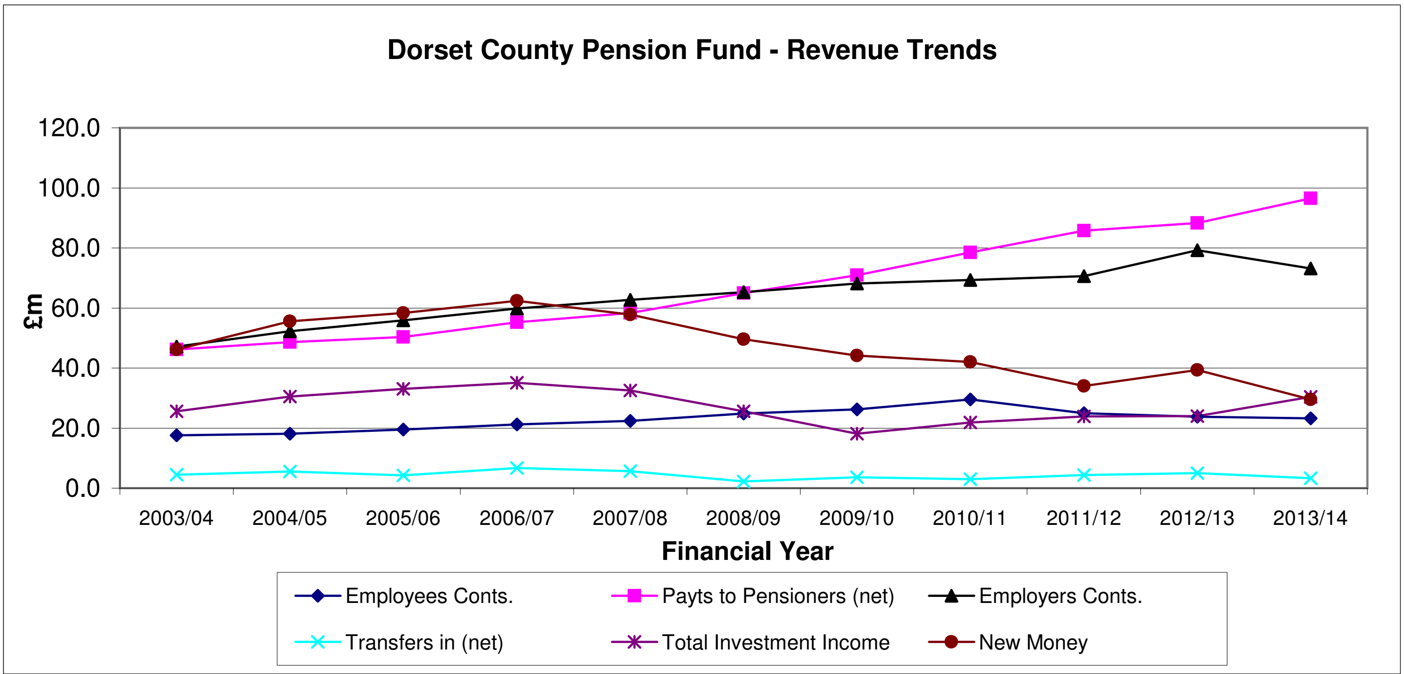
11.2 It is recommended that no changes to the Fund's asset allocation are made at this time.

Appendix 1

BUDGET MONITORING

	Actual 2011/2012	Original Estimate 2012/2013	Actual 2012/2013	Variance 2012/2013	Estimate 2013/14
	£'000	£'000	£'000	£'000	£'000
INCOME:					
Employers' Contributions	70,624	69,100	81,579	12,479	73,200
Employees' Contributions	24,956	23,600	24,097	497	24,100
Transfer Values (net)	4,041	5,000	3,627	-1,373	3,300
Investment Income	26,833	24,000	29,521	5,521	30,400
TOTAL INCOME:	**126,454**	**121,700**	**138,824**	**17,124**	**131,000**
EXPENDITURE:					
Net Management Expenses	4,010	4,400	4,202	-198	4,200
Payments to Pensioners (net)	85,724	85,200	90,521	5,321	93,500
TOTAL EXPENDITURE:	**89,734**	**89,600**	**94,723**	**5,123**	**97,700**
NET NEW MONEY FOR THE YEAR	**36,720**	**32,100**	**44,101**	**12,001**	**33,300**

REVENUE TRENDS & FORECASTS



Appendix 2

REPORT OF THE INVESTMENT ADVISER
PREPARED FOR

Dorset County Pension Fund

Pension Fund Committee

on June 13th 2013

Investment Outlook

Alan Saunders
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Dorset County Pension Fund
JUNE 2013
Report of the Investment Adviser

Investment Outlook

Summary

Since our February report, markets have continued the upwards surge that started in Q3 last year. We characterised the rally then as a reassessment of global risks after the traumas of the banking crisis and the subsequent Eurozone debacle. Without much support from the macroeconomic environment , we questioned its durability though when sentiment turns we know from past experience that momentum can drive markets for some time without much support from the fundamentals. .Evidence of economic recovery seems now to be coming through, at least in the US though it is still tentative.

The bull market in risk assets includes equities [though emerging markets have lagged behind]and bonds, particularly high yield bonds as investors chase income but property and commodities have been left behind. The fuel on the flames has been lit by central banks in the US and Japan who have moved decisively this year to flood the markets with money through the final phase of quantitative easing[QE}. The end of the bull run could come if it becomes apparent the policy is not working: increasingly though the fear is growing that when the central banks stop buying bonds, rising bond yields will choke off the rally.

Economy

The evidence of genuine recovery rather than a mere bottoming out of the global economy is still pretty patchy. Recently, in the US we have seen better signs of consumer revival with a 10% rise in house prices and much better consumer confidence surveys. The Fed's new objective of driving unemployment down to 6.5% still has some way to go but already Bernanke has thrown hints that the latest burst of QE, the buying of mortgage bonds, may be coming to an end. With fiscal policy moving towards austerity with the introduction of the $1.2tr "sequester " on government spending, passed since our last report, the economy needs monetary policy to stay loose for some time. Even so, a move back to 3% growth seems plausible now with inflation remaining subdued despite QE.

The UK has at least avoided a triple dip recession as the Q4 GNP numbers were revised upwards, as they often are. There is as yet no sign of any sustainable recovery beyond the anaemic 0.5- 1% growth built into market expectations. At least, inflation is falling back again with CPI last reported at 2.4%. The Chancellor is struggling to rein in government spending beyond 2015 in order to hit his budget deficit targets which keep eluding him. Sterling weakness will help at the margins but the consumer remains reluctant to spend. And a new Governor is about to take over at the bank of England with a mandate to be flexible.

The most interesting experiment in economic policy is of course going on in Japan where the new PM is trying to shake the economy out of twenty years of economic torpor through unconventional monetary policy ,targeting a 2% inflation rate. While a Q1 GNP rise of 3.5% may not be entirely attributable to the change, there is no doubt the weakness of the yen and the dramatic rise of the stock market has followed on from this change of direction. As elsewhere, the hope is that the so-called " wealth effect " will translate into higher spending.

The yen's weakness has given rise to talk of a currency war in Asia with many competitors complaining about loss of competitiveness. Emerging market economies are struggling at present with resource economics like South Africa languishing while China has been unable to restore growth momentum yet.

Europe has been out of the headlines for a while and markets have made a reasonable recovery. The election result in Italy could have caused trouble with the success of populist movements and the rejection of some if not all of the agreed austerity measures. Austerity is taking something of a backseat with Germany perhaps realising after the Cyprus debacle that limits had been reached on what electorates would stomach The EU has allowed countries like France and Spain another two years to get their budget deficits down to 3% of GNP.. The banking system still needs to do more to write off bad debts on property, in particular, while raising more capital but markets are being more generous in pricing bank bonds and, for that matter, government bonds . The economic outlook is still poor with falling output and rising unemployment [12%] but the sense of financial crisis has passed.

Markets

Equity markets have surged to new post- crash highs since our last report when something of a consolidation was taking place. Japan has led the way with a rise of over 60% in six months while emerging markets continue to lag. Last year, the rally was led by quality growth stocks and high dividend stocks but more recently leadership, at least in the US, has come from pro-cyclical sectors like industrials and resource stocks as investors gain confidence that the economy is turning. Clearly, market valuation is beginning to look stretched. The lagging emerging markets are something of a puzzle. Concerns over the growth outlook are one explanation but another is the rise in the cost base as wages catch up- a deliberate policy in China- which means margins are coming under pressure.

Last time, we stated that markets should move to higher levels by year end as recovery became more evident with support coming from rising dividends and takeovers as companies' cash balances are so high. We also anticipated something of a correction which has clearly not happened yet, despite some recent wobbles. Paradoxically, most commentators now believe a sell-off will most likely occur when the Fed stops its current bond buying, forcing yields higher and removing the liquidity prop to markets Thus good news on the economy could become bad news for the markets !

Government bond yields have remained near the lows with continuing support for Spanish and Italian bonds. UK gilts continue to hover around the 2% level for 10 year gilts and with negative real yields on shorter dated index linked .Investment grade corporate bond spreads continue to narrow in modestly while high yield bonds are trading close to all-time highs, as investors chase yield. Previously toxic parts of the market like mortgage debt or commercial real estate debt are also finding favour .While a return of risk appetite is welcome, there could be trouble ahead, especially when the central banks rein in QE.

Property

Commercial property has had its own bubble in the UK with the weight of money, often from overseas, going into central London offices but otherwise this is an asset class that has been left behind in the global rally Elsewhere, capital values have continued to decline, though this could be coming to an end. The divergence between prime and secondary markets remains as striking as ever and retail and industrial have clearly suffered badly. However, there do appear to be signs of revival in the major regional cities so that on a three year view property could show competitive returns of some 6%pa, in line with the running yield.

Alternatives

Alternatives range in scope from those that can be considered as an alternative to equities like hedge funds or diversified growth funds where the emphasis is on absolute returns and where performance is best measured against cash[cash plus] to those that could be considered as an alternative to bonds with long duration inflation matching assets like infrastructure or some property. The portfolio only has exposure to the former at present.

Hedge funds at last have produced some decent returns in 2013 after a poor run since the crash .Returns were some 4% to the end of April with fund of funds matching single strategy funds. Managers claim that more normal market conditions facilitate stock selection as with long-short equity funds and benefit macro funds and trend following CTAs . The question is how long will this better performance last.

Asset Allocation

The fund sets a strategic benchmark following the triennial valuation designed to repair the deficit over time together with contributions. It does not engage in tactical asset allocation, ie making judgements between equities and bonds but it does rebalance when the relationship between major asset classes strays outside the ranges. The tactical asset allocation that does exist is undertaken by our diversified growth manager under their remit. A further source of asset allocation changes takes place more commonly with private sector schemes which derisk their strategy over time as their funding ratios improve by selling equities for bonds and by hedging out the inflation and interest rate risk of their liabilities.

There is no pressure to do this with local authority schemes and our particular actuarial approach makes this even less necessary. That should not mean the asset allocation should be frozen in aspic. It can change because return expectations change or because risk management suggest further diversification is sensible. This was the thinking behind the decision to increase the alternatives exposure at the expense of equities.

At present, we are reviewing the alternatives strategy and this requires some revisiting of the investment strategy. This in turn depends on the valuation and the actuarial discount rate chosen to discount pension liabilities. Our challenge is to craft a strategy that will produce returns equal to or exceeding that discount rate at acceptable levels of risk.

Alan Saunders
Senior Adviser
AllenbridgeEpic Investment Advisers

Dorset County Pension Fund Total

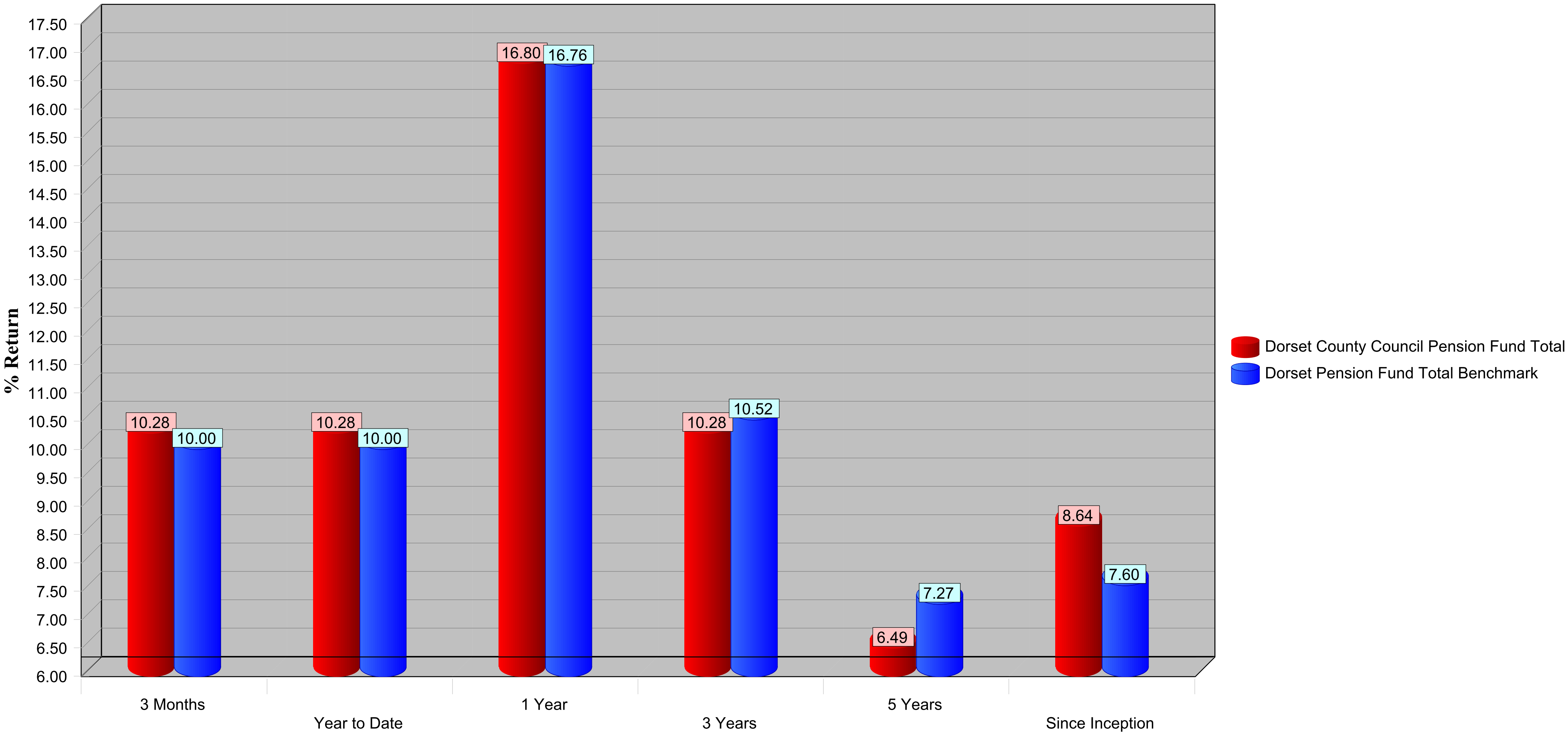
01 Jan 2013 - 31 Mar 2013

Manager Summary

Portfolio	Initial Market Value	Initial Market Value %	Net Investment	Capital Gain / Loss	Final Market Value	Final Market Value %	Income	Portfolio Return %	Benchmark Return %
Dorset County Council Pension Fund Total	**1,739,414,206**	**100.00**	**7,952,327**	**173,432,071**	**1,920,798,604**	**100.00**	**5,065,923**	**10.28**	**10.00**
Dorset - AXA Framlington UK Equity	78,473,476	4.51		9,827,659	88,301,135	4.60		12.52	10.32
Dorset - Barings Asset Management	80,689,190	4.64	6,000,000	4,535,758	91,224,949	4.75		5.58	1.11
Dorset - Currency Hedging	0	0.00	5,115,368	-5,115,368	0	0.00		-176.20	
Dorset - Gottex Hedge Fund	29,121,737	1.67		1,158,591	30,280,327	1.58		3.98	1.37
Dorset - HarbourVest Private Equity	28,436,065	1.63	-801,085	2,516,240	30,151,219	1.57		8.86	10.32
Dorset - IAM Hedge Fund	51,786,202	2.98	3,373,615	2,117,134	57,276,951	2.98		4.26	1.80
Dorset - ING Property	161,701,198	9.30	318,481	41,291	162,060,970	8.44	2,098,738	1.32	1.07
Dorset - Insight Fund	165,211,610	9.50		47,594,943	212,806,553	11.08		28.81	24.77
Dorset - Internally Managed Cash	67,345,720	3.87	-15,010,720	0	52,335,000	2.72	95,818	0.16	0.10
Dorset - Internally Managed UK Equity	324,094,120	18.63	870,848	30,022,628	354,987,596	18.48	2,377,213	10.00	10.29
Dorset - JP Morgan	58,176,461	3.34	10,000,000	4,148,008	72,324,469	3.77		7.43	5.32
Dorset - Janus Intech US Equity Fund	83,965,323	4.83		15,548,716	99,514,039	5.18		18.52	18.40
Dorset - Pictet Global ex UK Equity	319,350,798	18.36	-892,889	47,067,012	365,524,921	19.03	357,218	14.89	15.22
Dorset - Pioneer Hedge Fund	3,086,467	0.18	-1,023,055	276,756	2,340,167	0.12		9.98	1.62
Dorset - Royal London Bonds	184,748,631	10.62	144,927	4,553,676	189,447,234	9.86	136,936	2.54	1.79
Dorset - Schroders UK Equity	23,845,817	1.37	-30,839	2,567,368	26,382,345	1.37		10.77	11.00
Dorset - Standard Life Private Equity	18,520,094	1.06		917,702	19,437,796	1.01		4.96	10.32
Dorset - Standard Life UK Equity	60,861,297	3.50	-112,325	5,653,959	66,402,931	3.46		9.29	10.32

All periods > 1 year have been annualised.

Long Term Performance, Total Fund



All periods > 1 year have been annualised.

Gain/Loss Analysis

Category	Initial Market Value	Net Investment	Final Market Value	Capital Gain/Loss	Income	% Return
TOTAL ASSETS	**1,739,414,206**	**7,952,327**	**1,920,798,604**	**173,432,071**	**5,065,923**	**10.28**
Total Return Seeking Asets	**1,574,202,596**	**7,952,327**	**1,707,992,051**	**125,837,128**	**5,065,923**	**8.34**
Total Assets ex Hedging	1,574,202,596	2,836,958	1,707,992,051	130,952,497	5,065,923	8.68
Total Equities	921,068,655	8,170,014	1,041,440,582	112,201,913	2,717,797	12.48
UK	487,274,710	727,685	536,074,008	48,071,613	2,377,213	10.35
Dorset UK Internally Managed	324,094,120	870,848	354,987,596	30,022,628	2,377,213	10.00
AXA Framlington UK Equity	78,473,476		88,301,135	9,827,659		12.52
Standard Life UK Equity Select Fund	60,861,297	-112,325	66,402,931	5,653,959		9.29
Schroders UK Small Cap Equity	23,845,817	-30,839	26,382,345	2,567,368		10.77
Overseas Equities	433,793,944	7,442,330	505,366,574	64,130,300	340,584	14.86
North America	240,041,461	-1,958,189	279,896,456	41,813,184	198,275	17.51
Pictet North America	156,076,138	-1,958,189	180,382,417	26,264,468	198,275	16.96
Janus Intech US Equity	83,965,323		99,514,039	15,548,716		18.52
Europe ex UK	84,706,836	-2,379,561	91,837,864	9,510,589	126,983	11.56
Pictet Europe ex UK	84,706,836	-2,379,561	91,837,864	9,510,589	126,983	11.56
Japan	39,729,620	1,410,439	48,893,530	7,753,471	5,161	19.31
Pictet Japan Equity	39,729,620	1,410,439	48,893,530	7,753,471	5,161	19.31
Pacific ex Japan	11,139,566	369,641	12,414,255	905,048	10,165	8.34
Pictet Pacific ex Japan	11,139,566	369,641	12,414,255	905,048	10,165	8.34
Emerging Markets	58,176,461	10,000,000	72,324,469	4,148,008		7.43
JP Morgan Global Emerging Markets	58,176,461	10,000,000	72,324,469	4,148,008		7.43
Total Bonds	184,748,631	144,927	189,447,234	4,553,676	136,936	2.54
Royal London Bonds	184,748,631	144,927	189,447,234	4,553,676	136,936	2.54
Total Property	161,701,198	318,481	162,060,970	41,291	2,098,738	1.32
ING Property	161,701,198	318,481	162,060,970	41,291	2,098,738	1.32
Total Cash	95,044,358	-13,345,939	84,331,856	2,633,437	112,452	3.12
Total Hedge Funds	83,994,405	2,350,560	89,897,445	3,552,480		4.26
Gottex Hedge Fund	29,121,737		30,280,327	1,158,591		3.98
Pioneer Hedge Fund	3,086,467	-1,023,055	2,340,167	276,756		9.98
IAM (Hedged)	51,786,202	3,373,615	57,276,951	2,117,134		4.26

Gain/Loss Analysis

Category	Initial Market Value	Net Investment	Final Market Value	Capital Gain/Loss	Income	% Return
IAM Hedge Fund	51,786,202		57,276,951	5,490,749		10.60
Currency Hedging (IAM)		3,373,615		-3,373,615		-193.75
Private Equity	46,956,159	-801,085	49,589,015	3,433,942		7.31
HarbourVest	28,436,065	-801,085	30,151,219	2,516,240		8.86
Standard Life Private Equity	18,520,094		19,437,796	917,702		4.96
Diversified Growth Fund	80,689,190	6,000,000	91,224,949	4,535,758		5.58
Baring Dynamic Asset Allocation Fund	80,689,190	6,000,000	91,224,949	4,535,758		5.58
Total Currency Hedging	0	5,115,368	0	-5,115,368		-176.20
Total Matching Assets	**165,211,610**		**212,806,553**	**47,594,943**		**28.81**
Insight Liability Fund	165,211,610		212,806,553	47,594,943		28.81

All periods > 1 year have been annualised.

Asset Allocation

Category	Initial Market %		Final Market %		Local Currency % Return		Base Currency % Return	
	Portfolio	Benchmark	Portfolio	Benchmark	Portfolio	Benchmark	Portfolio	Benchmark
TOTAL ASSETS	**100.00**	**100.00**	**100.00**	**100.00**	**8.92**	**8.46**	**10.28**	**9.99**
Total Return Seeking Asets	**90.50**	**90.00**	**88.92**	**90.00**	**6.84**	**6.64**	**8.34**	**8.32**
Total Assets ex Hedging	90.50	90.00	88.92	90.00	7.17	6.64	8.68	8.32
Total Equities	52.95	55.00	54.22	55.00	10.11	9.35	12.48	12.15
UK	28.01	29.00	27.91	29.00	10.35	10.32	10.35	10.32
Dorset UK Internally Managed	18.63	20.00	18.48	20.00	10.00	10.29	10.00	10.29
AXA Framlington UK Equity	4.51	4.00	4.60	4.00	12.52	10.32	12.52	10.32
Standard Life UK Equity Select Fund	3.50	4.00	3.46	4.00	9.29	10.32	9.29	10.32
Schroders UK Small Cap Equity	1.37	1.00	1.37	1.00	10.77	11.00	10.77	11.00
Overseas Equities	24.94	26.00	26.31	26.00	9.80	8.26	14.86	14.20
North America	13.80	13.65	14.57	13.65	9.89	10.20	17.51	17.82
Pictet North America	8.97	9.65	9.39	9.65	9.45	10.03	16.96	17.59
Janus Intech US Equity	4.83	4.00	5.18	4.00	10.71	10.61	18.52	18.40
Europe ex UK	4.87	5.35	4.78	5.35	7.12	5.74	11.56	10.28
Pictet Europe ex UK	4.87	5.35	4.78	5.35	7.12	5.74	11.56	10.28
Japan	2.28	2.10	2.55	2.10	21.17	21.46	19.31	19.58
Pictet Japan Equity	2.28	2.10	2.55	2.10	21.17	21.46	19.31	19.58
Pacific ex Japan	0.64	1.10	0.65	1.10	2.66	3.21	8.34	9.55
Pictet Pacific ex Japan	0.64	1.10	0.65	1.10	2.66	3.21	8.34	9.55
Emerging Markets	3.34	3.80	3.77	3.80	7.43	-0.44	7.43	5.37
JP Morgan Global Emerging Markets	3.34	3.80	3.77	3.80	7.43	-0.44	7.43	5.37
Total Bonds	10.62	10.00	9.86	10.00	2.54	1.79	2.54	1.79
Royal London Bonds	10.62	10.00	9.86	10.00	2.54	1.79	2.54	1.79
Total Property	9.30	10.00	8.44	10.00	1.32	1.07	1.32	1.07
ING Property	9.30	10.00	8.44	10.00	1.32	1.07	1.32	1.07
Total Cash	5.46		4.39		3.12		3.12	
Total Hedge Funds	4.83	6.00	4.68	6.00	3.99	1.66	4.26	1.66
Gottex Hedge Fund	1.67	2.00	1.58	2.00	3.98	1.37	3.98	1.37
Pioneer Hedge Fund	0.18		0.12		2.23	1.62	9.98	1.62
IAM (Hedged)	2.98	4.00	2.98	4.00	4.26	1.80	4.26	1.80

Asset Allocation

Category	Initial Market %		Final Market %		Local Currency % Return		Base Currency % Return	
	Portfolio	Benchmark	Portfolio	Benchmark	Portfolio	Benchmark	Portfolio	Benchmark
IAM Hedge Fund	2.98	4.00	2.98	4.00	10.60	1.80	10.60	1.80
Currency Hedging (IAM)							-193.75	
Private Equity	2.70	4.00	2.58	4.00	3.58	10.32	7.31	10.32
HarbourVest	1.63	2.00	1.57	2.00	2.67	10.32	8.86	10.32
Standard Life Private Equity	1.06	2.00	1.01	2.00	4.96	10.32	4.96	10.32
Diversified Growth Fund	4.64	5.00	4.75	5.00	5.58	1.11	5.58	1.11
Baring Dynamic Asset Allocation Fund	4.64	5.00	4.75	5.00	5.58	1.11	5.58	1.11
Total Currency Hedging	0.00		0.00		-176.20		-176.20	
Total Matching Assets	**9.50**	**10.00**	**11.08**	**10.00**	**28.81**	**24.77**	**28.81**	**24.77**
Insight Liability Fund	9.50	10.00	11.08	10.00	28.81	24.77	28.81	24.77

All periods > 1 year have been annualised.

Relative Attribution

Category	Currency Contribution	Market Contribution	Selection Contribution	Total Contribution
TOTAL ASSETS	**-0.15**	**-0.60**	**1.02**	**0.26**
Total Return Seeking Asets	**-0.15**	**-0.51**	**0.67**	**0.01**
Total Assets ex Hedging	-0.15	-0.23	0.67	0.29
Total Equities	-0.22	0.09	0.27	0.14
UK	0.01	-0.01	0.01	0.01
Dorset UK Internally Managed	0.02	-0.02	-0.05	-0.05
AXA Framlington UK Equity	-0.01	0.01	0.09	0.09
Standard Life UK Equity Select Fund	0.01	-0.01	-0.03	-0.03
Schroders UK Small Cap Equity	-0.00	0.01	-0.00	0.00
Overseas Equities	-0.23	0.10	0.26	0.14
North America	0.02	0.02	-0.04	-0.01
Pictet North America	-0.03	-0.00	-0.05	-0.08
Janus Intech US Equity	0.04	0.02	0.01	0.07
Europe ex UK	-0.02	0.01	0.06	0.05
Pictet Europe ex UK	-0.02	0.01	0.06	0.05
Japan	-0.01	0.03	-0.01	0.02
Pictet Japan Equity	-0.01	0.03	-0.01	0.02
Pacific ex Japan	-0.02	0.02	-0.00	-0.00
Pictet Pacific ex Japan	-0.02	0.02	-0.00	-0.00
Emerging Markets	-0.19	0.02	0.25	0.08
JP Morgan Global Emerging Markets	-0.19	0.02	0.25	0.08
Total Bonds	-0.00	-0.04	0.07	0.03
Royal London Bonds	-0.00	-0.04	0.07	0.03
Total Property	0.01	0.06	0.02	0.09
ING Property	0.01	0.06	0.02	0.09
Total Cash	-0.06	-0.24		-0.31
Total Hedge Funds	0.01	-0.10	0.29	0.20
Gottex Hedge Fund	0.00	0.02	0.04	0.07
Pioneer Hedge Fund	-0.00	-0.01		-0.01
IAM (Hedged)	0.01	-0.11	0.25	0.14

Relative Attribution

Category	Currency Contribution	Market Contribution	Selection Contribution	Total Contribution
IAM Hedge Fund	0.01	0.06	0.25	0.32
Currency Hedging (IAM)	-0.00	-0.18		-0.18
Private Equity	0.11	-0.02	-0.17	-0.08
HarbourVest	0.09	-0.01	-0.12	-0.03
Standard Life Private Equity	0.01	-0.02	-0.05	-0.06
Diversified Growth Fund	0.00	0.02	0.20	0.22
Baring Dynamic Asset Allocation Fund	0.00	0.02	0.20	0.22
Total Currency Hedging	-0.00	-0.28		-0.28
Total Matching Assets	**-0.00**	**-0.08**	**0.34**	**0.26**
Insight Liability Fund	-0.00	-0.08	0.34	0.26

All periods > 1 year have been annualised.