Dorset County Pension Fund – Board Report

Global ex UK Equities

For the quarter ended 31 March 2013

Contents

Note:

Pictet Asset Management Limited (PAM) prepares valuations based on security prices quoted as at the close of business on the valuation date or the last trading day before the valuation date if the relevant exchange is closed on the valuation date. Quoted securities are valued at the last traded price quoted by the appropriate local exchange or at a market price quoted by the appropriate local exchange according to the local pricing convention/source. Investments in Pictet open-ended funds are valued at the most recently calculated net asset value.

If the portfolio holds any securities not quoted on a local market, these securities are valued at prices obtained from accredited sources by Pictet. The sources may be supplied upon request.

Pictet Asset Management Limited is authorised and regulated by the Financial Services Authority.

Portfolio Overview

Portfolio Details	
Fund Manager	Mike Collins
Portfolio Value	365,510,098 GBP
No. of stocks in portfolio	860
Mandate	Global ex UK Equities
Quarterly Performance	
Fund	
Dorset County Council Pension Fund	14.88%
Index	
Benchmark*	15.22%
Cashflow	-1,250,107 GBP

* Benchmark:

- FTSE World ex UK to December 2003;
- MSCI Comp (40% North America, 20% Japan, 15% Europe ex UK, 5% Pacific ex Japan, 20% Emerging Markets) to March 2006;
- MSCI Comp (27% North America, 24% Japan, 18% Europe ex UK, 6% Pacific ex Japan, 25% Emerging Markets) to August 2006;
- MSCI Comp (85% World ex UK, 15% Emerging Markets) to April 2007;
- MSCI Comp (45% North America, 10% Japan, 25% Europe ex UK, 5% Pacific ex Japan, 15% Emerging Markets) to March 2012.
- MSCI Comp (53% North America, 12% Japan, 29% Europe ex UK, 6% Pacific ex Japan) Total Return to date.

Market review

Riskier asset classes gained in the first quarter of 2013 and government bonds saw declines as investors became increasingly confident that the ultra-easy monetary policies of major central banks were beginning to fuel a recovery in world growth. Markets were buoyed by US employment figures, Japan's plans to deliver a fiscal and monetary boost to shore up its economy and the fact that both Spain and Portugal successfully completed government bond auctions. A potential setback came in the shape of an unexpected decline in fourth quarter US GDP, but with underlying figures showing a solid increase in business investment, investors took the news in their stride.

Currency markets continued to be the focus of attention, with dovish central bank rhetoric helping to bring renewed instability. Sterling fell particularly sharply after Britain was stripped of its triple-A rating by Moody's – a move which compounded pressure on a currency already weakened by the prospect of further monetary easing measures to support an ailing economy. The £/$ exchange rate fell to a low of 1.50 in March, well down from the 1.63 reached in December 2012.

Over the quarter the MSCI World index rose by 15.5% (TR in GBP terms), a return boosted in part by sharp falls in sterling in the period under review. Looking at the regions, the performance laggard was Europe ex UK (+10.3% on the quarter), held back by uncertainty over both fiscal policy and the potential for political gridlock following election stalemate in Italy. The United States, in contrast, performed well with the region recording a gain of 18.5% in the first three months of the year, driven by a belief that the policies of Chairman Bernanke were finally delivery significant growth advances. Equities in Tokyo also performed well with the MSCI Japan Index posting a 19.6% gain over the quarter.

Our reading of the business cycle shows that upward momentum improved in recent months, led by developed economies. Global leading indicators rose, convincing many commentators that the recovery is becoming entrenched. The turnaround in global growth has been led by the United States, with a strong pick-up in business investment and industry orders painting a more optimistic picture for the economy. At the same time, resilient consumer spending, a steady housing rebound and strong hiring indicate that growth should have moved ahead in the first quarter. The major threat comes from the estimated US$85bn of sequestration cuts, but an ultra-loose monetary stance goes some way to offsetting the potential drag on growth from this source.

The economic picture is more muted in the euro zone, which remains in a mild recession. This said, the fortunes of countries at the core and periphery continue to diverge, with a robust German economy contrasting strongly with continued deterioration in both Spain and Italy. Our expectation remains for a rate cut by the ECB in the second quarter of 2013 – a move which would weaken the euro and provide a boost to the export sector, the region's current main driver of growth.

The lack of clear winners in the Italian elections has the potential to shatter the calm that had returned to European financial markets. In the absence of strong government to force through a reform agenda, the fear is that Italy might be shut out of capital markets, and that jitters might spread to other heavily indebted economies.

As well as the United States, China has provided a boost to global demand, supported by solid consumer spending and a strong revival in construction activity. Of course, if the latter source of growth was to continue then the chance of further government action to cool the property market increases.

Performance analysis and portfolio activity

Overall, our policy for the first quarter of 2013 delivered a performance below the composite equity benchmark. In these three months the fund delivered a total return of 14.88% compared to an index return of 15.22%. Looking at the quarter in more detail, the fund's quarterly relative return was adversely impacted by above average levels of cash during a period of rising share prices. Over the entire turbulent period for markets between end-March 2008 and end-March 2013 the fund remains above the benchmark, gaining more in the equity downswings of 2008 and 2011 than it lost in periods of equity strength. Between end-March 2008 and end-March 2013 the total fund delivered an average annual return of 8.69%, above the average annual index return of 8.35%.

The Japanese portfolio performed above the MSCI Japan index during the quarter. The policy stance of the new Abe administration continues to be the main factor driving the performance of Japanese equities. The immediate implications of this stance are looser fiscal policy in the near term (aimed at post-earthquake reconstruction as well as upgrading Japan's ageing infrastructure) and increased pressure on the Bank of Japan to adopt a more aggressive approach towards monetary easing (as witnessed by the switch from a 1% inflation "goal" to a 2% inflation "target"). The main short-term economic impact of the new policy has been to weaken the yen from below ¥80 against the dollar in the last quarter of 2012 to the current level of around ¥94. Against this background it is no surprise to find the best performing sectors as those benefiting from the weaker yen (tyre companies, shippers etc) and those standing to benefit most from a more reflationary environment going forward (financials in general and real estate in particular). The strongest performing holdings over the quarter were mostly in the real estate and financial sectors, benefitting from the more benign policy setting described above. Of particular note were credit card operator Aeon Credit (which is seeing a substantial improvement in earnings from the move to a holding company structure), office leasing major Mitsubishi Estate, and the off-benchmark holdings in the REIT sector (residential and logistics). Amongst small cap holdings contract manufacturer Siix was a particularly strong performer. Siix is seeing increased demand from Japanese companies looking to consolidate their supply chain throughout the Asian region. The weaker performing holdings were mostly in defensive sectors and included prescription drug dispenser Ain Pharmaciez. Our strategy continues to be to maintain or increase exposure to the theme of monetary easing whilst at the same time maintaining discipline on fundamentals and valuations. In terms of exporters, for example, Daicel is a new holding which is highly competitive in its core product areas and at the same time is a significant beneficiary of yen weakness. Similarly, the REIT positions we have added are fundamentally attractive both in terms of the quality of their assets and the valuations at which they trade. At the same time, we continue to see a lot of value in small and mid caps and have maintained our overweight position in this area.

In Europe, our actively managed holdings outperformed the benchmark over the quarter. The blend of stocks with diversified drivers contributed to this outperformance. Adidas was the top contributor for the quarter having delivered strong results with tight inventory control helping to alleviate concerns around cash generation. Ericsson also reported a good quarter, with gross margins trending in the right direction and strong cash conversion. Our view that 2013 will see a gradual shift from low margin modernisation activity to higher margin capacity expansion in the mobile telecom infrastructure market has been confirmed, not least by numerous telecom companies guiding for a marked increase in capital expenditure in 2013 and beyond. Roche, our only big weight in multinational pharmaceutical, jumped 25% as investors looked for a high quality drug portfolio combined with consistent strategic execution and potential upside surprises from its attractive product pipeline. On the negative side, Thrombogenics corrected around 10% from its highs driven by profit taking of early investors cashing in a doubling of the shares. The portfolio shifted more and more towards large capitalisation stocks during the first quarter as an increasing number of our smaller capitalisation compounders approached or met our valuation targets. Under the scenario of sub-par growth and a volatile macroeconomic environment it becomes ever more important to identify companies with a recurring and visible cash-flow stream that can compound their earnings for longer than the market gives them credit. The opportunity for these companies to substantially increase their payout to investors in the coming quarters is beginning to be recognised by the market, but is far from being priced in. For the first time in many years our portfolio runs an underweight exposure in the mid cap space.

Market outlook and portfolio strategy

The strong increase in share prices seen in recent months has been driven by the belief that all major global central banks are now committed to printing money with the explicit goal of supporting asset prices. The famous "Greenspan Put" where monetary policy was used to support share prices whenever the US witnessed a significant correction in share prices has been replaced by a global put with all central banks copying the US practice. Of course, as previous experience shows, when buying panics push share prices away from economic reality, severe bear markets follow (2000 to 2002 and 2007 to 2009 provide obvious examples). This time is unlikely to be any different.

The global economy is in many ways no different in structure to that seen in the dark days of 2008. The developed world, for example, is saddled with too much debt, too few savings and an economic structure weighed down by excessive consumption, both by the government and consumer sectors. It is so important to remember that when the bulk of economy's economic resources are devoted to current over future consumption then it becomes increasingly difficult to grow. With few resources devoted to investment spending we can be sure that economic growth rates will not only stay low, they will fall, and this is the position that the US, the world's dominant economy, finds itself today. Against this backdrop, prospects for company profits are bleak. Economic growth has gathered some strength in recent months, convincing many that the US has finally entered a self-sustaining upswing. But we have been here before. Each new money printing programme has been followed by higher asset prices and a brief period of stronger economic data, before structural economic headwinds once more reassert themselves and growth declines. We expect the current experience to be the same with US growth likely to lose momentum again over the rest of 2013.

Money printing can be useful if utilised to support growth during a time of economic restructuring. Instead, restructuring, and associated economic weakness, has been put on the back burner, policymakers happy to use money printing to generate short-term economic gains and to take credit for new highs on stock market indices while turning a blind eye to declining productivity, rising structural unemployment and, perhaps most concerning of all, growing social inequality between the owners of capital and the salaried majority.

Market commentators have been quick to identify the current high level of profit margins in the US as a sign that the good times for equities can continue for awhile longer. Such optimists are ignoring the obvious fact that a corporate surplus has to be funded by government and household borrowing, the two factors cancelling each other out. In other words, unless one expects the US budget deficit to continue to rise *ad infinitum* then the US corporate surplus has to fall in coming years. Indeed, historical observation suggest that the current high level of US profit margins are likely to be followed by a collapse in US profits of 50% or more. Remembering that the major buyer of US equities in recent years has been US companies, a profit collapse of such a magnitude will, other things being equal, produce a market collapse of a similar size.

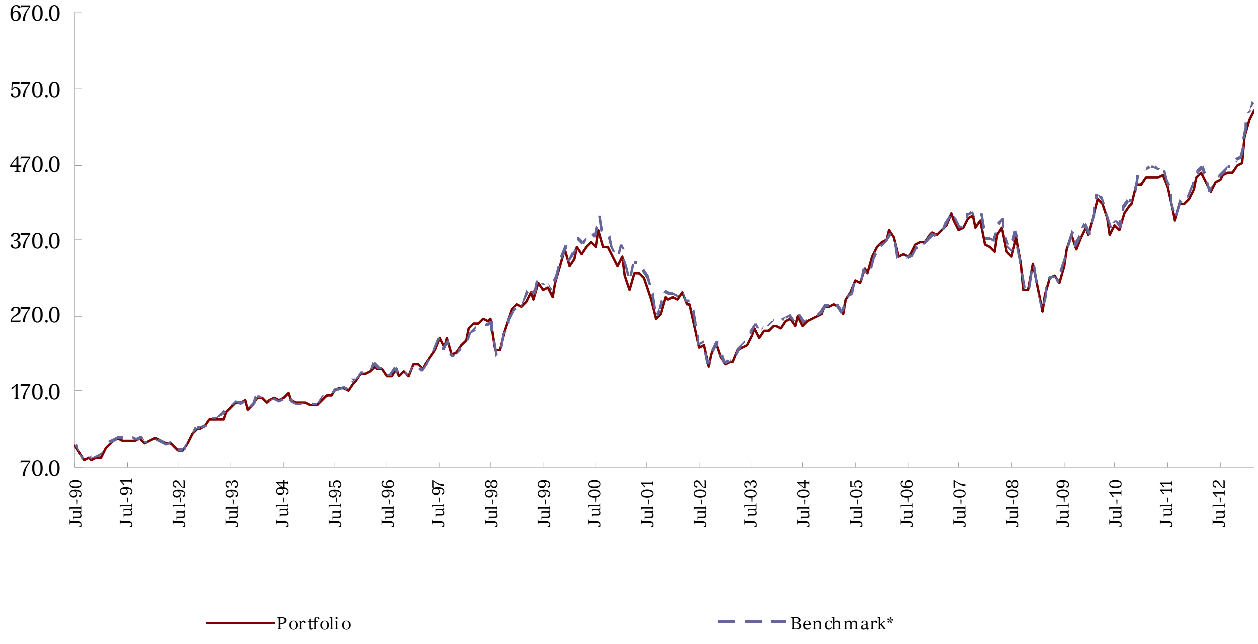
In summary then, my view is that we are close to an extreme in the price of equities and that the risks for the next six months or so are skewed heavily toward the downside. The general view regarding the power of central banks to raise asset prices has progressed from incredulity in late 2008 to a near blind acceptance today. Talk of deflation has ended and the major threat is now seen as a normalisation of monetary conditions. There is also a widespread belief that there is a wall of money waiting to support an equity melt-up. Prevailing views represent a near total reversal of those seen five years ago at market lows and so should at the very least generate some doubt about future equity prospects. It is true that measures of "liquidity" such as US M2 and foreign debt holdings held at the Fed have risen sharply since the announcement of QE3 last year, but these indicators of liquidity have moved with and not led equity markets. As is always the case in times of euphoria as risk appetite peaks, leverage rises to support the rise in share prices. In a sense the rise in share prices in the past 6 months has driven "liquidity" and not the other way around. This "liquidity" can vanish as quickly as it appeared. We have now reached the most dangerous point for markets since 2008. It is quite possible that momentum drives share prices somewhat higher in coming weeks, but the prognosis thereafter is poor. Given current market pricing and my assumption that deflation is still more likely that significant inflation (at least in the short-term), the most attractive trades to me are to continue selling equities and to raise exposure to both US$ cash and Yen cash after recent weakness. The Bank of Japan may wish to hit a rate of 110 Yen/US$ but if the market & economic environment changes and cyclical currencies come under pressure then it's chances of success collapse.

Cash levels were 8½-9% at the end of the first quarter of 2013, moving ever closer to the maximum permitted cash exposure of 10%. Moreover, the composition of the significant cash holding is gradually changing, with the weight in Japanese yen, a strong beneficiary of a renewed deflationary scare, rising from an insignificant level in late 2012 to 25% of the cash holding by the end of the first quarter of 2013. The result has been a steady reduction in the total portfolio beta (a measure of the responsiveness of the portfolio to changes in index levels) as markets have risen. At the end of 2011 the total portfolio beta was 0.93 while by June 2012 the beta had fallen to 0.90. By the end of the first quarter of 2013 the portfolio beta was down to 0.88.

From 1 January 2013 to 31 March 2013

Overall Performance (%)

	3 Months	6 Months	9 Months	12 Months	2 Years	3 Years	4 Years	5 Years	Since Inception
Portfolio Performance %	14.88	17.37	21.28	17.54	9.16	8.36	16.09	8.69	7.73
Benchmark**	15.22	18.44	22.90	18.27	8.93	8.66	16.66	8.35	7.83



* Benchmark:
- FTSE World ex UK to December 2003;
- MSCI Comp (40% North America, 20% Japan, 15% Europe ex UK, 5% Pacific ex Japan, 20% Emerging Markets) to March 2006;
- MSCI Comp (27% North America, 24% Japan, 18% Europe ex UK, 6% Pacific ex Japan, 25% Emerging Markets) to August 2006;
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- MSCI Comp (53% North America, 12% Japan, 29% Europe ex UK, 6% Pacific ex Japan) Total Return to date.

From 1 January 2013 to 31 March 2013

Attribution Analysis

	Portfolio		Benchmark		Attribution Analysis		
	Average Weight	Return	Average Weight	Return	Allocation	Selection	Total
TOTAL	100.00	14.85	100.00	15.22	(0.64)	0.26	(0.37)
2 NORTH AMERICA	49.41	17.52	53.24	17.59	(0.08)	(0.03)	(0.11)
Canada	4.00	8.04	4.33	8.19	0.02	(0.01)	0.02
United States	45.41	18.39	48.91	18.46	(0.10)	(0.03)	(0.13)
3 EUROPE	26.05	11.56	28.85	10.28	0.12	0.31	0.44
Austria	--	--	0.19	2.14	0.02	–	0.02
Belgium	0.46	5.60	0.79	16.56	(0.00)	(0.05)	(0.05)
Denmark	--	--	0.81	11.71	0.02	–	0.02
Euroland Funds	5.35	6.85	--	--	(0.40)	–	(0.40)
Finland	--	--	0.54	10.29	0.02	–	0.02
France	3.78	4.61	6.38	7.70	0.18	(0.10)	0.08
Germany	2.79	11.41	5.80	7.33	0.21	0.11	0.31
Greece	--	--	0.04	22.06	(0.00)	–	(0.00)
Ireland	--	--	0.18	20.86	(0.01)	–	(0.01)
Italy	1.03	4.82	1.47	(3.41)	0.07	0.08	0.15
Netherlands	0.75	(3.69)	1.66	9.65	0.05	(0.09)	(0.05)
Norway	0.35	17.04	0.62	7.54	0.02	0.03	0.05
Portugal	--	--	0.12	6.70	0.01	–	0.01
Spain	1.07	4.76	2.01	1.33	0.13	0.02	0.15
Sweden	1.36	21.10	2.21	17.46	(0.02)	0.05	0.03
Switzerland	9.11	19.16	6.04	19.55	0.14	(0.04)	0.10
4 JAPAN	12.62	19.79	11.96	19.58	0.03	0.02	0.05
Japan	5.92	20.07	11.96	19.58	(0.20)	0.02	(0.18)
Japan Funds	6.70	19.57	--	--	0.23	–	0.23
5 PACIFIC EX JAPAN	3.30	8.30	5.95	9.61	0.15	(0.04)	0.11
Asia Ex Japan Funds	1.82	8.28	--	--	(0.11)	–	(0.11)
Australia	0.04	13.17	1.66	16.79	(0.01)	(0.01)	(0.03)
China	0.15	(6.56)	1.14	2.18	0.12	(0.01)	0.11
Hong Kong	0.47	11.23	0.58	10.73	0.01	0.00	0.01
Indonesia	--	--	0.17	21.44	(0.01)	–	(0.01)
Korea	0.29	1.86	0.92	3.61	0.07	0.00	0.07
Malaysia	--	--	0.21	6.09	0.02	–	0.02
New Zealand	--	--	0.02	18.71	(0.00)	–	(0.00)
Philippines	--	--	0.06	27.35	(0.01)	–	(0.01)
Singapore	0.18	12.30	0.36	11.19	0.01	0.00	0.01
Taiwan	--	--	0.66	6.83	0.05	–	0.05
Thailand	--	--	0.16	17.88	(0.00)	–	(0.00)
CASH	8.61	5.18	--	--	(0.85)	–	(0.85)
Cash	8.61	5.18	--	--	(0.86)	–	(0.86)

Performance calculated gross of fees in British Pounds
Souce: PAM / FactSet

Valuation Reports

Summary Portfolio Valuation

at 31 March 2013

	BOOKCOST GB	MARKET VALUE GB	%
Total	**277,116,951**	**365,510,098**	**100.00**
EQUITIES	**245,949,156**	**333,528,066**	**91.25**
Australia	694,956	767,010	0.21
Belgium	1,304,474	1,524,744	0.42
Canada	10,149,258	14,029,841	3.84
China	912,486	891,712	0.24
France	11,731,350	12,620,864	3.45
Germany	9,735,859	11,728,762	3.21
Global	38,439,281	45,453,212	12.44
Hong Kong	1,673,181	1,856,026	0.51
Italy	3,514,629	3,471,527	0.95
Japan	40,528,639	48,893,530	13.38
Netherlands	2,436,894	2,338,682	0.64
Norway	980,810	1,253,600	0.34
Singapore	595,924	672,313	0.18
South Korea	1,095,385	1,094,447	0.30
Spain	3,229,698	3,460,677	0.95
Sweden	3,851,891	5,053,700	1.38
Switzerland	7,427,280	12,064,843	3.30
USA	107,647,162	166,352,576	45.51
DIVIDEND ACCRUALS		**463,571**	**0.13**
CASH	**31,167,796**	**31,518,461**	**8.62**

Transaction Summary

From 1 January 2013 to 31 March 2013

	PURCHASES GB	SALES GB	NET EFFECTS GB
Total	**19,747,878**	**22,285,085**	**2,537,206**
AUSTRALASIA	**609,027**	**1,450,099**	**841,072**
Australia	609,027	1,450,099	841,072
EUROPE	**3,282,293**	**2,362,553**	**-919,741**
Belgium	808,373	519,161	-289,212
France	55,032	233,911	178,879
Germany	2,418,888	225,046	-2,193,842
Netherlands	0	136,018	136,018
Spain	0	623,066	623,066
Switzerland	0	625,351	625,351
FAR EAST	**1,831,390**	**958,770**	**-872,620**
China	522,770	0	-522,770
Hong Kong	516,201	261,083	-255,118
Singapore	51,182	0	-51,182
South Korea	741,238	697,687	-43,551
GLOBAL	**7,346,782**	**10,301,140**	**2,954,358**
Global	7,346,782	10,301,140	2,954,358
JAPAN	**5,885,544**	**4,461,720**	**-1,423,824**
Japan	5,885,544	4,461,720	-1,423,824
NORTH AMERICA	**792,842**	**2,750,804**	**1,957,962**
Canada	80,864	191,314	110,450
USA	711,978	2,559,490	1,847,512

Monthly Performance Summary

From 1 January 2013 to 31 March 2013

Dorset County Council Pension Fund

Date	GBP Value	Cashflow	CFDate	1 Mth	3 Mth	6 Mth	9 Mth	1 Yr	2 Yrs	3 Yrs	YTD	Incep.
Jan-13	342,132,476	-794,404	2	7.40%	10.00%	12.14%	13.37%	15.38%	6.61%	10.31%	7.40%	7.46%
Feb-13	357,979,133	-240,806	1	4.70%	13.01%	16.08%	22.20%	16.73%	8.24%	9.75%	12.45%	7.65%
Mar-13	365,510,098	-214,897	1	2.16%	14.88%	17.37%	21.28%	17.54%	9.16%	8.36%	14.88%	7.73%

Benchmark*

Date	GBP Value	1 Mth	3 Mth	6 Mth	9 Mth	1 Yr	2 Yrs	3 Yrs	YTD	Incep.
Jan-13	517.40	7.91%	11.23%	13.79%	14.56%	16.71%	6.65%	10.95%	7.91%	7.58%
Feb-13	541.21	4.60%	13.85%	17.52%	24.48%	17.41%	8.18%	10.24%	12.87%	7.76%
Mar-13	552.46	2.08%	15.22%	18.44%	22.90%	18.27%	8.93%	8.66%	15.22%	7.83%

* Benchmark:

- FTSE World ex UK (TR) to December 2003;
- MSCI Comp (50% North America, 25% Japan, 18.75% Europe ex UK, 6.25% Pacific ex Japan) to March 2006;
- MSCI Comp (36% North America, 32% Japan, 24% Europe ex UK, 8% Pacific ex Japan) to August 2006;
- MSCI World ex UK to April 2007;
- MSCI Comp (53% North America, 12% Japan, 29% Europe ex UK, 6% Pacific ex Japan) Total Return to date.

Dorset County Council Pension Fund (Hedged)

Date	GBP Value	Cashflow	CFDate	1 Mth	3 Mth	6 Mth	9 Mth	1 Yr	2 Yrs	3 Yrs	YTD	Incep.
Jan-13	339,561,900	-794,404	2	6.24%	9.61%	12.67%	12.80%	15.80%	5.80%	9.63%	6.24%	6.77%
Feb-13	350,077,651	-240,806	1	3.17%	11.07%	14.53%	21.98%	14.60%	6.62%	9.48%	9.60%	7.14%
Mar-13	365,246,027	6,248,120	28	2.55%	12.40%	15.69%	20.69%	16.39%	7.73%	8.02%	12.40%	7.40%

Benchmark**

Date	GBP Value	1 Mth	3 Mth	6 Mth	9 Mth	1 Yr	2 Yrs	3 Yrs	YTD	Incep.
Jan-13	187.15	7.91%	11.23%	13.79%	14.56%	16.03%	6.18%	10.76%	7.91%	8.61%
Feb-13	195.76	4.60%	13.85%	17.52%	24.48%	16.60%	8.03%	10.10%	12.87%	9.16%
Mar-13	199.83	2.08%	15.22%	18.44%	22.90%	18.27%	8.23%	8.43%	15.22%	9.34%

** Benchmark:

- FTSE World ex UK to December 2003;
- MSCI Comp (40% North America, 20% Japan, 15% Europe ex UK, 5% Pacific ex Japan, 20% Emerging Markets) to March 2006;
- MSCI Comp (27% North America, 24% Japan, 18% Europe ex UK, 6% Pacific ex Japan, 25% Emerging Markets) to August 2006;
- MSCI Comp (85% World ex UK, 15% Emerging Markets) to April 2007;
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