DORSET LIABILITY MATCHING PORTFOLIO

For the period
01 April 2013 to 30 June 2013

Contents

Investment Summary

Summary of Performance	7
LDI Analysis	8
LDI Analysis Continued	9
LDI Attribution	10
Pooled Activity & Attribution - Libor Plus Fund	18
Pooled Activity - Insight Liquidity Sterling Fund	19

Investment Analysis

Sterling LDI	23
Money Market Bulletin - UK	24
Fixed Income Market Review	25

Investment Outlook

Money Market Bulletin - UK	33
Fixed Income Outlook	34

Appendices

Summary Portfolio Valuation	41
Notes & Important Information	42

Investment Summary

DORSET LIABILITY MATCHING PORTFOLIO

For the period 01 April 2013 to 30 June 2013

Summary of Performance

Performance summary to 30 June 2013

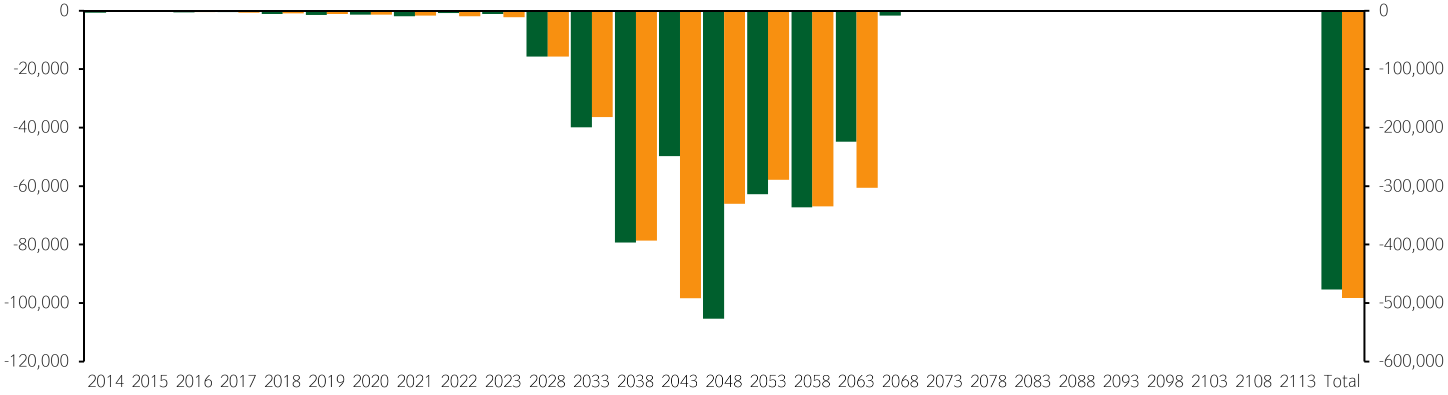
	3 months (%)	Since Inception (%)
Portfolio	-10.46	27.64
Benchmark	-10.50	26.79
Relative Return	0.04	0.84

	3 months (£)	Since Inception (£)
Portfolio	-22,133,230	41,517,830
Benchmark	-22,259,238	40,238,937
Relative Return	126,008	1,278,894

Source: Insight Investment
Inception date for performance purposes: 31 October 2012
Any footnotes relate to the current quarter-end; historic footnotes available on request

LDI Analysis

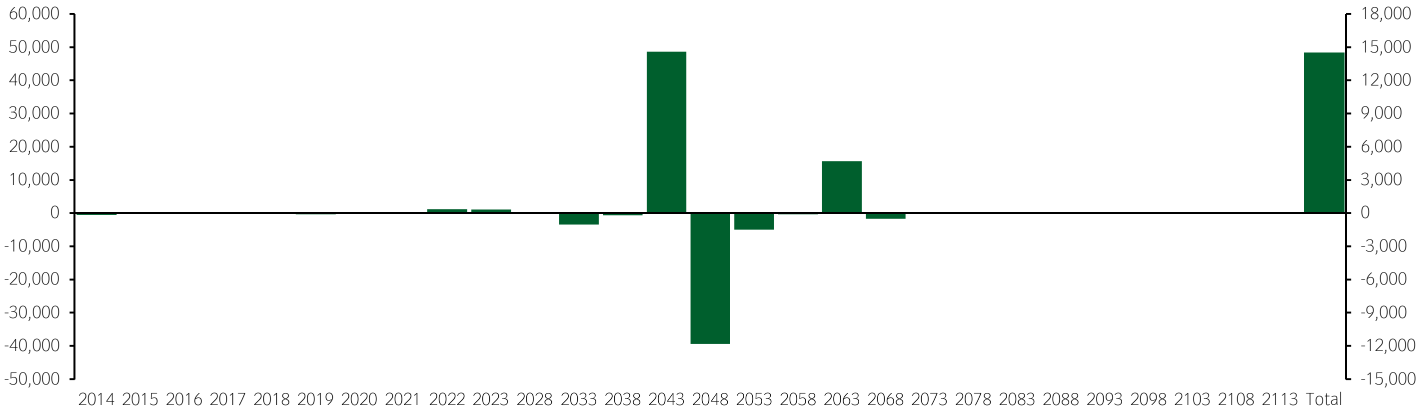
Interest Rate Risk (PV01)
Assets vs Liabilities (£)



Source: Insight Investment

Interest Rate Sensitivity (PV01): The change in the present value of the scheme assets or liabilities resulting from a 0.01% (one basis point) parallel upward shift in the discount curve.

Current Portfolio vs Liabilities (£)



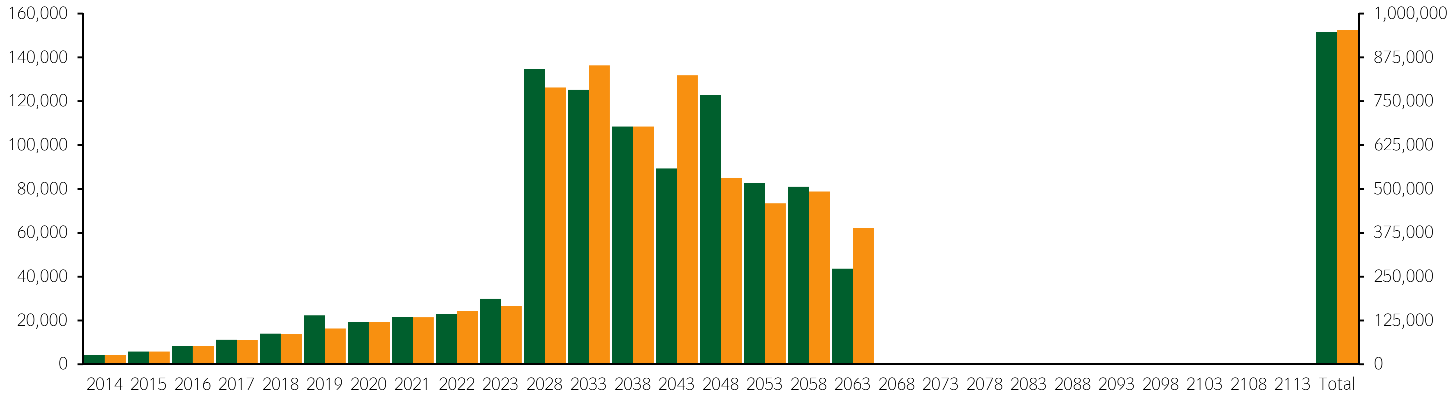
Source: Insight Investment

Note: Liability benchmark sensitivities will equal asset sensitivities where no liability benchmark is available

LDI Analysis Continued

Inflation Risk (IE01)

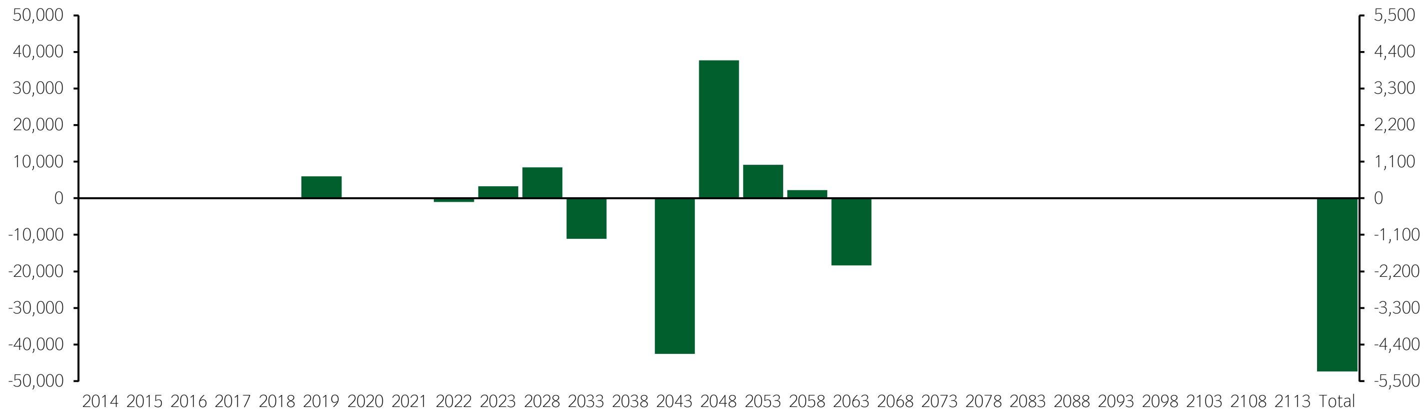
Assets vs Liabilities (£)



Source: Insight Investment

Inflation Sensitivity (IE01): The change in present value of the inflation-linked schemes assets or liabilities resulting from a 0.01% (one basis point) parallel upward shift in the inflation expectation curve.

Current Portfolio vs Liabilities (£)

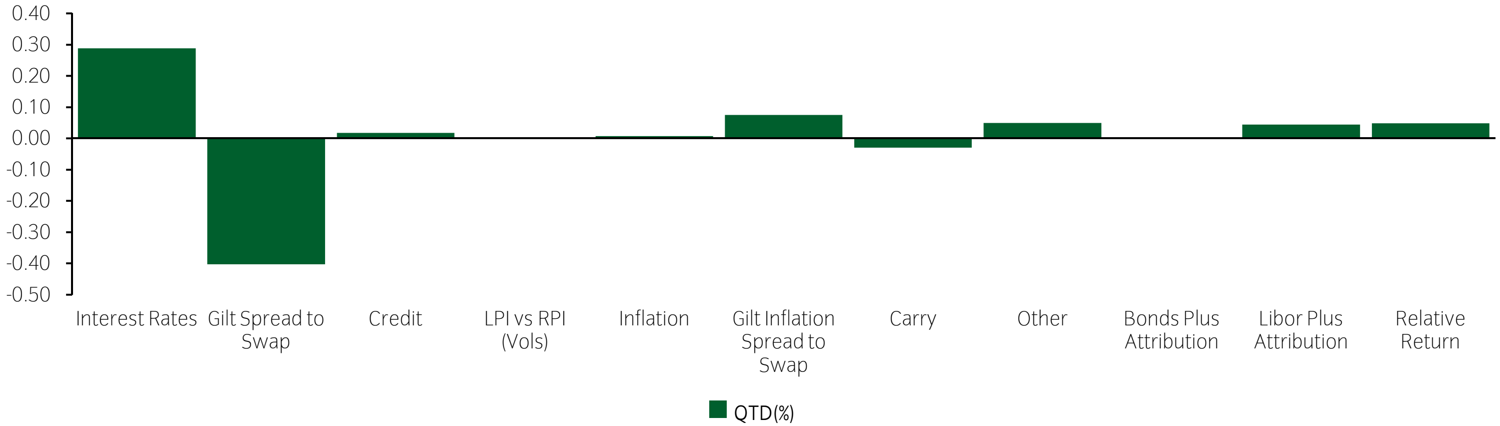


Source: Insight Investment

Note: Liability benchmark sensitivities will equal asset sensitivities where no liability benchmark is available

LDI Attribution

Quarter-to-date relative percentage attribution



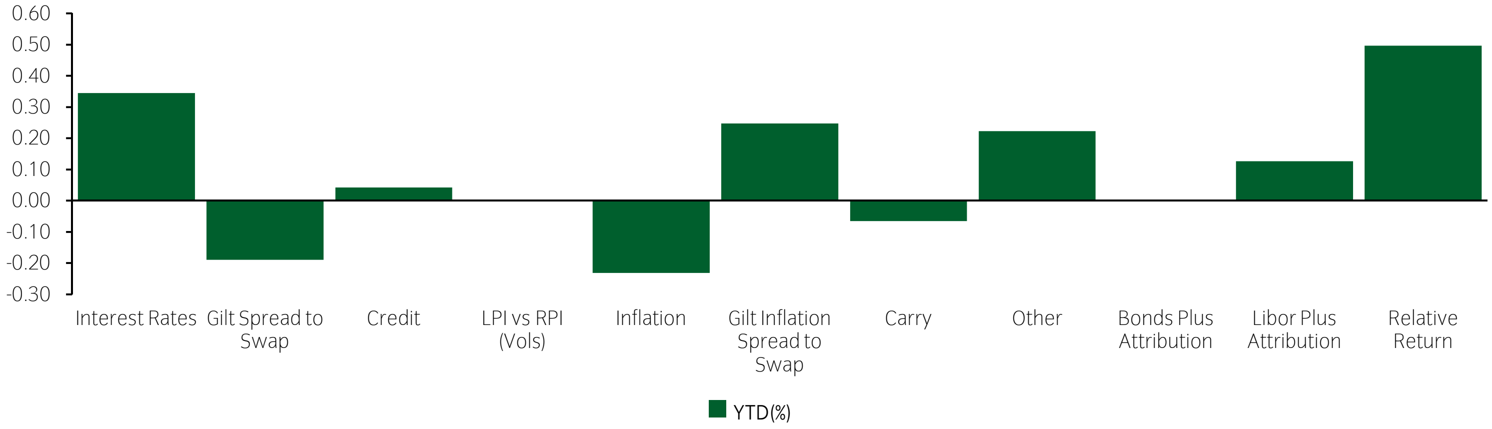
Description	QTD (%)
Interest Rates	0.29
Gilt Spread to Swap	-0.40
Credit	0.02
LPI vs RPI (Vols)	0.00
Inflation	0.01
Gilt Inflation Spread to Swap	0.08
Carry	-0.03
Other	0.05
Bonds Plus Attribution	0.00
Libor Plus Attribution	0.04
Relative Return	0.05

Note: The percentage attributes and returns are calculated geometrically, and therefore the relative return may differ to the arithmetic percentage return shown on the returns summary page.

All figures are calculated geometrically

LDI Attribution

Year-to-date relative percentage attribution



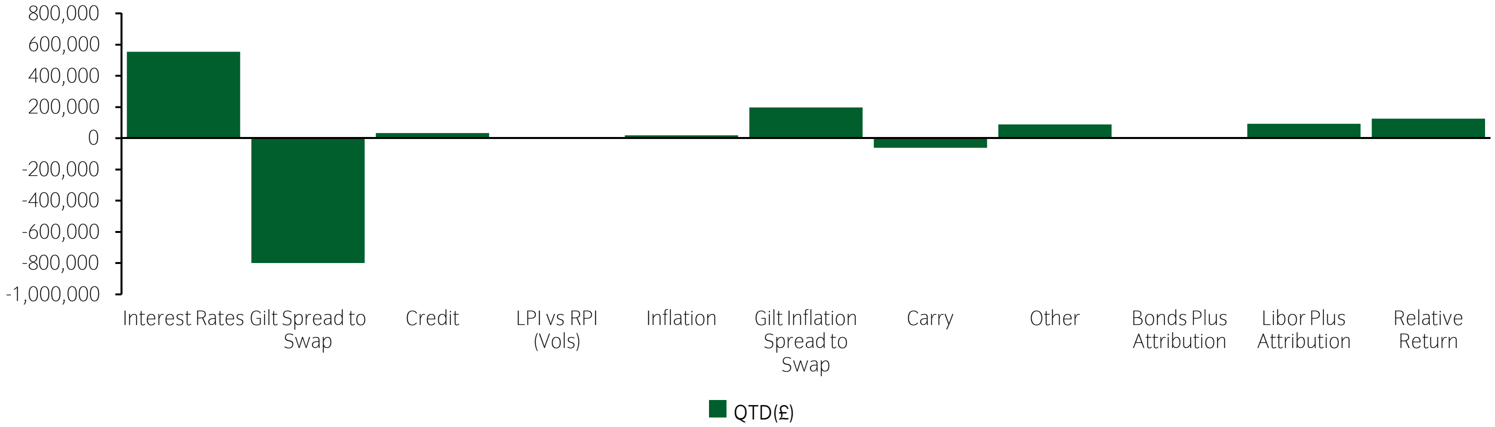
Description	YTD (%)
Interest Rates	0.35
Gilt Spread to Swap	-0.19
Credit	0.04
LPI vs RPI (Vols)	0.00
Inflation	-0.23
Gilt Inflation Spread to Swap	0.25
Carry	-0.07
Other	0.22
Bonds Plus Attribution	0.00
Libor Plus Attribution	0.13
Relative Return	0.50

Note: The percentage attributes and returns are calculated geometrically, and therefore the relative return may differ to the arithmetic percentage return shown on the returns summary page.

All figures are calculated geometrically

LDI Attribution

Quarter-to-date relative monetary attribution

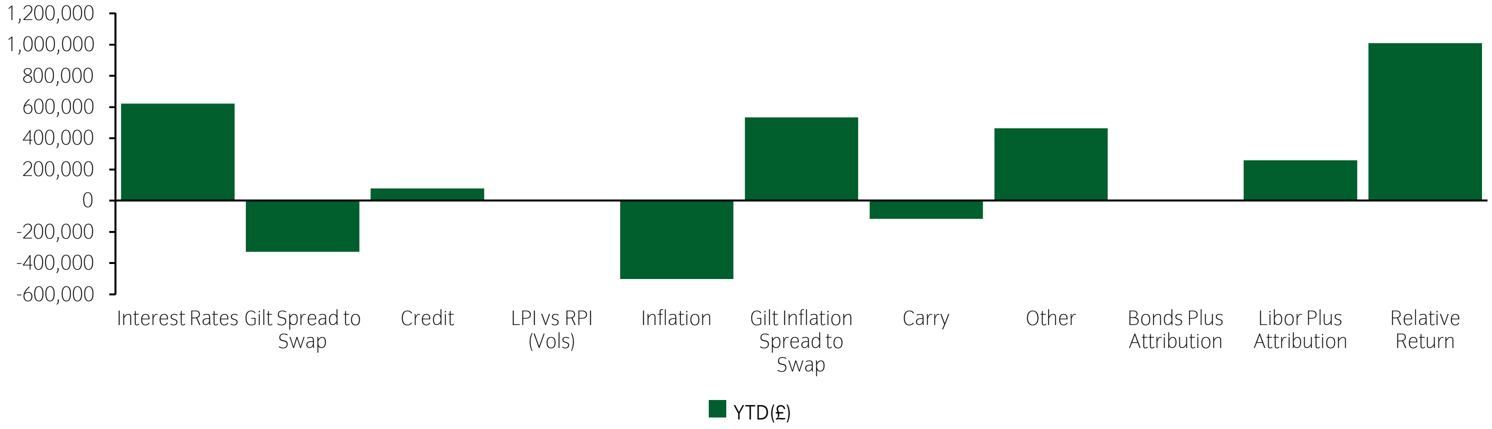


Description	QTD (£)
Interest Rates	555,064.36
Gilt Spread to Swap	-799,160.45
Credit	33,026.09
LPI vs RPI (Vols)	0.00
Inflation	18,906.99
Gilt Inflation Spread to Swap	197,497.26
Carry	-61,436.31
Other	88,433.66
Bonds Plus Attribution	0.00
Libor Plus Attribution	93,676.63
Relative Return	126,008.24

All figures are calculated geometrically

LDI Attribution

Year-to-date relative monetary attribution

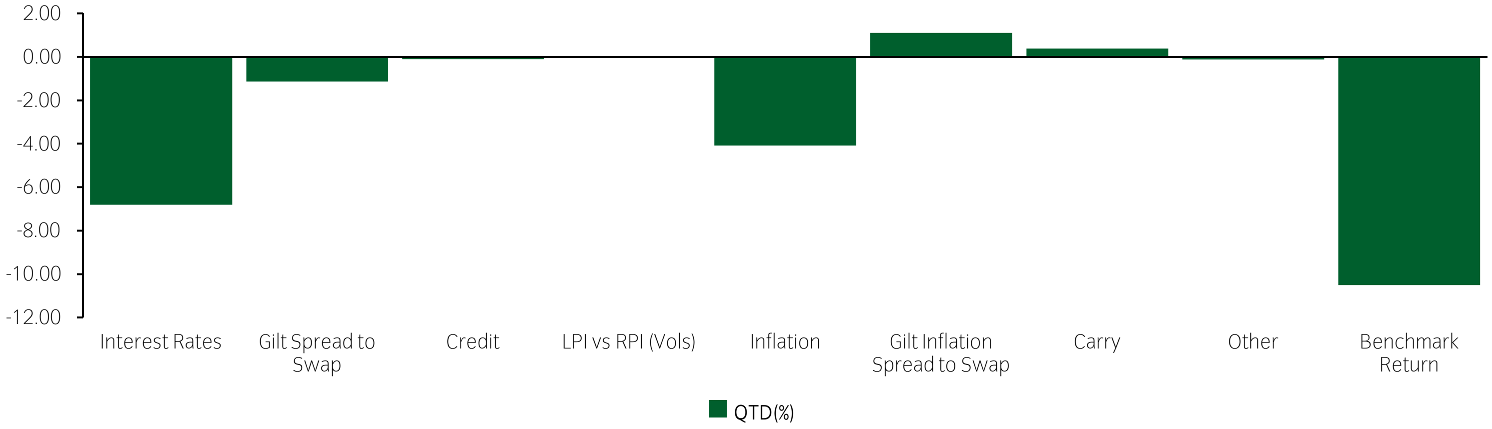


Description	YTD (£)
Interest Rates	622,604.65
Gilt Spread to Swap	-327,698.36
Credit	78,487.33
LPI vs RPI (Vols)	0.00
Inflation	-502,596.58
Gilt Inflation Spread to Swap	533,164.77
Carry	-116,342.32
Other	463,211.53
Bonds Plus Attribution	0.00
Libor Plus Attribution	258,774.40
Relative Return	1,009,605.41

All figures are calculated geometrically

LDI Attribution

Quarter-to-date benchmark percentage attribution



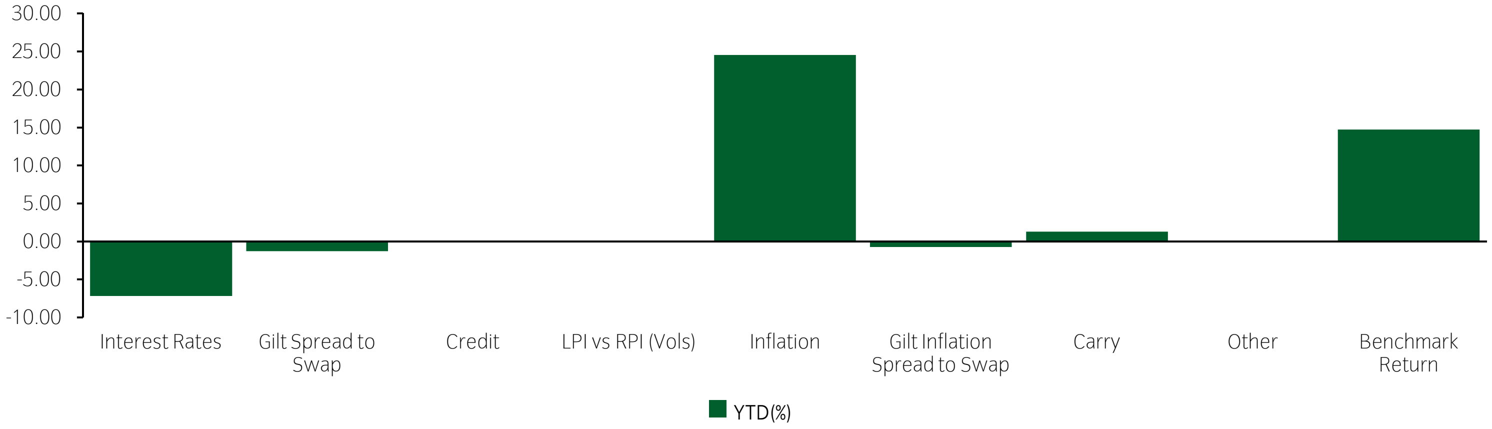
Description	QTD (%)
Interest Rates	-6.81
Gilt Spread to Swap	-1.14
Credit	-0.10
LPI vs RPI (Vols)	0.00
Inflation	-4.08
Gilt Inflation Spread to Swap	1.11
Carry	0.38
Other	-0.12
Benchmark Return	-10.50

Note: The percentage attributes and returns are calculated geometrically.

All figures are calculated geometrically

LDI Attribution

Year-to-date benchmark percentage attribution



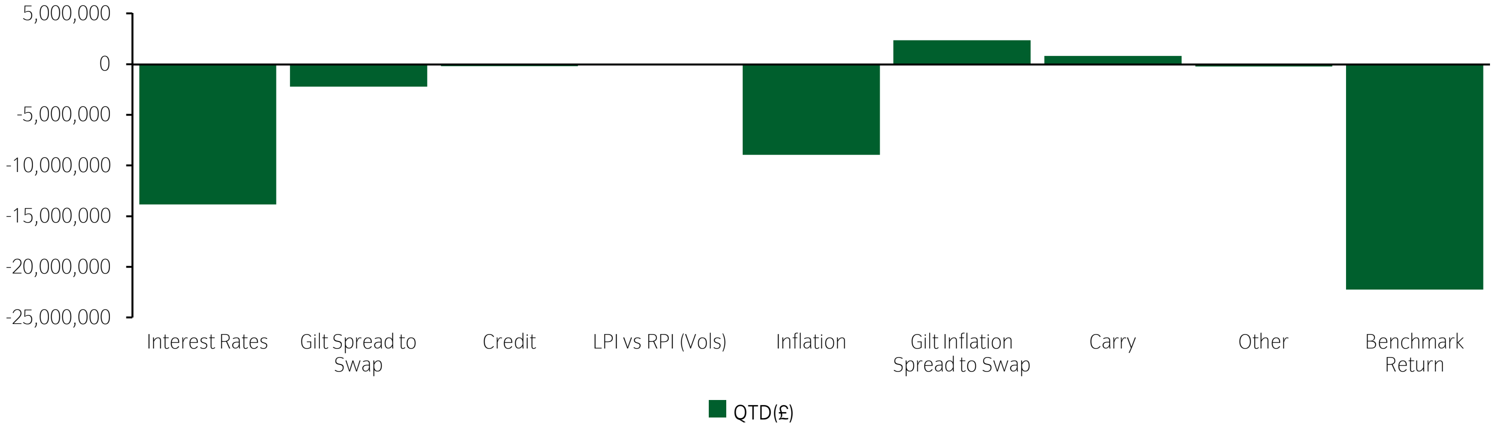
Description	YTD (%)
Interest Rates	-7.17
Gilt Spread to Swap	-1.28
Credit	-0.10
LPI vs RPI (Vols)	0.00
Inflation	24.54
Gilt Inflation Spread to Swap	-0.74
Carry	1.31
Other	0.07
Benchmark Return	14.74

All figures are calculated geometrically

Note: The percentage attributes and returns are calculated geometrically.

LDI Attribution

Quarter-to-date benchmark monetary attribution

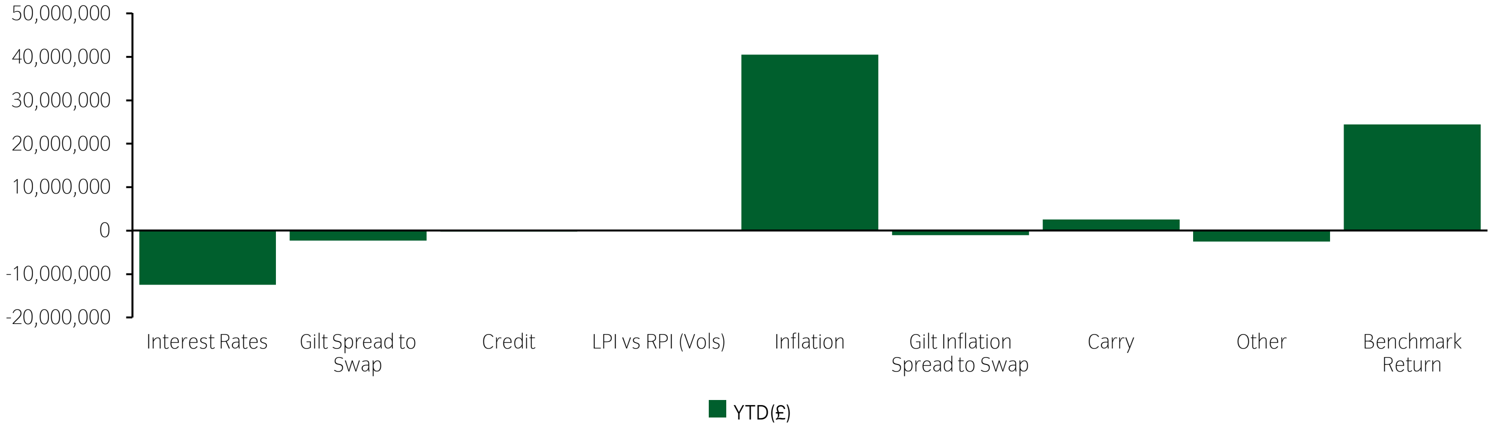


Description	QTD (£)
Interest Rates	-13,851,996.94
Gilt Spread to Swap	-2,223,181.78
Credit	-196,865.68
LPI vs RPI (Vols)	0.00
Inflation	-8,947,657.50
Gilt Inflation Spread to Swap	2,371,156.67
Carry	824,727.59
Other	-235,420.51
Benchmark Return	-22,259,238.15

All figures are calculated geometrically

LDI Attribution

Year-to-date benchmark monetary attribution



Description	YTD (£)
Interest Rates	-12,481,106.22
Gilt Spread to Swap	-2,320,890.15
Credit	-215,281.29
LPI vs RPI (Vols)	0.00
Inflation	40,520,816.92
Gilt Inflation Spread to Swap	-1,069,004.32
Carry	2,566,792.87
Other	-2,543,170.98
Benchmark Return	24,458,156.82

All figures are calculated geometrically

Pooled Activity & Attribution - Libor Plus Fund

Performance summary to 30 June 2013

	3 months	1 year	3 years	5 years	Since inception
Portfolio (%)	0.95	8.03	5.14	5.89	6.04
Benchmark (%)	0.13	0.57	0.78	1.30	1.76
Outperformance (%)	0.82	7.46	4.36	4.59	4.28

Returns are gross of fees

Returns over 1 year are annualised

Benchmark: 3 Month Sterling LIBOR

The investment team and approach remains consistent

Performance data is based on LIBOR Plus Fund (UCITS III structure) from 31 March 2011 onwards

Prior to this date the LIBOR Plus Fund (QIF structure), whose assets transferred into the UCITS III structure on 31 March 2011

Asset backed securities breakdown

	Portfolio %
Prime RMBS	58.90
Buy to Let	1.10
Leveraged Loan CLO	4.80
SME CLO	2.70
CMBS	14.40
Cash	4.50
UK Non-conforming RMBS	13.60

Source: Insight Investment

Activity

- Our investment theme during the quarter remained consistent with our long-run view that a combination of liquid residential mortgage-backed securities (RMBS) and a diversified portfolio of commercial mortgage-backed securities and UK non-conforming paper is the best approach in the senior asset-backed securities (ABS) market.
- Trading activity was high during April and May. We continued to believe the UK's Funding for Lending Scheme will support prime RMBS valuations leading investors to seek out other higher-yielding assets, so we added exposure to UK non-conforming paper and commercial mortgage-backed securities (CMBS). We also participated in new issues in the prime RMBS and collateralised loan obligation markets, and further reduced our Dutch RMBS position.
- During the first half of June the Fund was focused on capital preservation with a view to building cash balances and reducing risk in higher-volatility markets. We sold selected collateralised loan obligations, UK non-conforming paper, CMBS and bonds issued by entities in the eurozone's peripheral markets. Towards the end of the quarter we began to reinvest in selected areas to take advantage of the cheaper prices.

Attribution

- The Fund outperformed its benchmark over the quarter. In the first half of the period, tightening spreads in the higher-beta markets drove performance, specifically in Australian RMBS, commercial mortgage-backed securities and UK non-conforming debt.
- June was a more difficult month for the Fund, with exposure to underperforming UK prime AAA assets detracting from returns.

Pooled Activity - Insight Liquidity Sterling Fund

Summary of portfolio allocation (%)

	Portfolio 31 Mar 2013	Portfolio 30 Jun 2013	Movement
Certificates of deposit	26.0	35.6	9.6
Corporate Bond	0.0	0.0	0.0
Commercial paper	28.3	21.1	-7.2
Corporate floating rate	3.9	1.6	-2.3
Repurchase agreement	16.4	3.9	-12.5
Government Bond	0.0	3.6	3.6
Supranational	0.0	0.0	0.0
Time deposits and cash	25.4	34.2	8.8
Total	**100.0**	**100.0**	0.0

Source: Insight Investment

10 largest holdings

Company	Market value* (£'000)	Portfolio (%)
RBS Call Account	1399.9	9.0
Abbey National Call Account	724.9	4.7
TD Citibank 0.45% 01.07.2013	699.9	4.5
TD Societe Generale 0.43% 01.07.2013	650.1	4.2
Repo Barclays 0.38% 28.06.2013	600.2	3.9
UK Bonds 2.50% 16.08.2013	555.0	3.6
TD ING 0.43% 01.07.2013	550.3	3.5
TD DnB 0.40% 01.07.2013	350.8	2.3
Z/C CP Standard Chartered 15.10.2013	254.1	1.6
TD Northern Trust 0.20% 01.07.2013	252.5	1.6

* Market value within the Insight Liquidity Sterling Cash Fund as at 30 June 2013

Source: Insight Investment

Activity

- Activity was moderate through the quarter. A continuing combination of weak, albeit improving, economic growth data and above-target inflation maintained expectations that interest rates may remain unchanged for several years.
- Trading focused largely on highly liquid, short-dated instruments. The Fund made selective additions to the Certificates of Deposit/Commercial Paper portfolio, primarily from bank issuers.
- The weighted average maturity of the Fund was 30 days at the beginning of the quarter, and after a slight decrease early in the period, stood unchanged at 30 days by the end of the period.

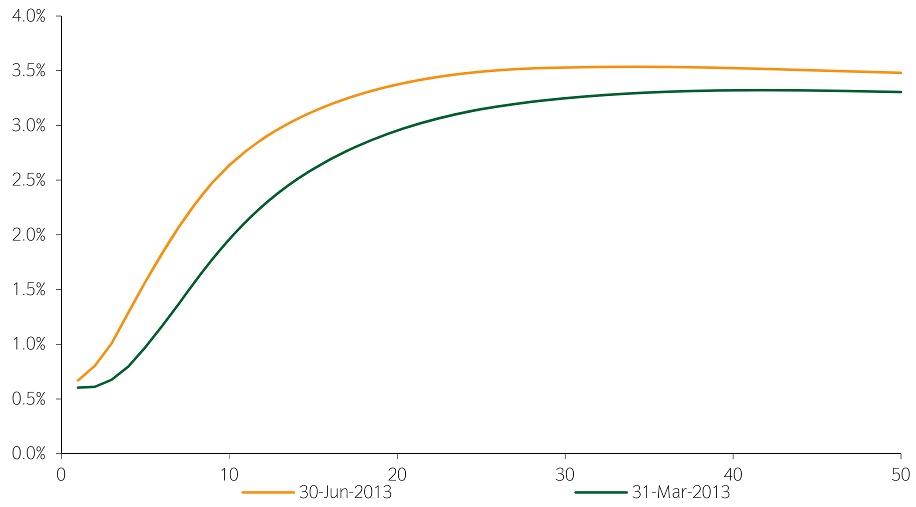
Investment Analysis

DORSET LIABILITY MATCHING PORTFOLIO

For the period 01 April 2013 to 30 June 2013

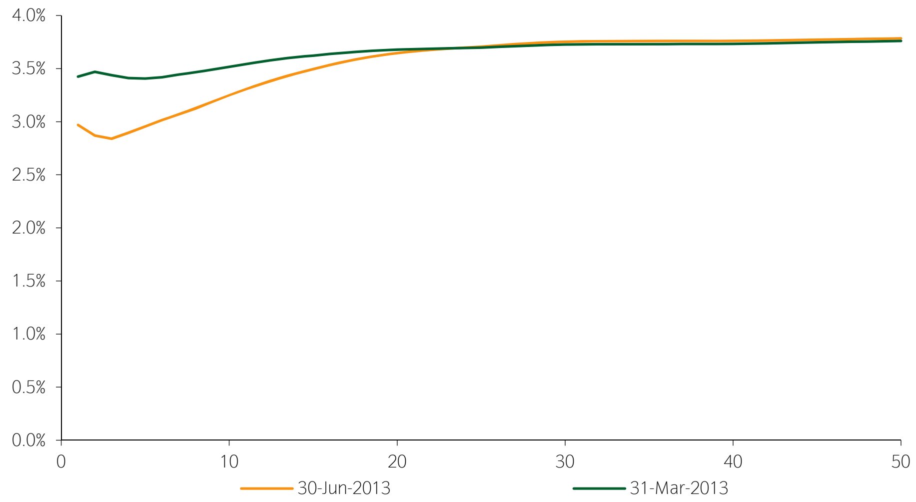
Sterling LDI

Interest rate swap rates (%)



Source: Xenomorph broker quotes composite

RPI swap rates (%)



Source: Xenomorph broker quotes composite

Market review

- The quarter began with the Bank of Japan announcing a programme of bond purchases which aimed to move inflation to a 2% target in two years by doubling both the monetary base and the BoJ's monthly purchases of Japanese government bonds (JGBs) to 7.5 trillion Yen (c.£50bn).

- Gilt yields generally fell across most maturities over the course of April driven by the general risk on environment driven by central bank easing and ongoing grab for yield by investors. This was quickly reversed in May and June as a result of global markets focussing on the potential 'tapering' of the US Federal Reserve's quantitative easing (QE) programme. The result was that bond yields and interest rate swap rates rose over the quarter. Interest rate swap rates rose by 0.36% on average across the curve.

- The Bank of England's MPC voted to maintain the current policy stance which had a minimal effect on the gilt market. The unchanged stance comes as Mark Carney replaced Sir Mervyn King as the governor of the Bank of England. Inflation expectations remained relatively stable over the quarter despite falling inflation rates in other countries, indicating liability hedging activity.

- Long-dated conventional z-spreads and long-dated index-linked z-spreads ended the quarter slightly wider.

- Increases in interest rate swap rates led to real rates rising by c.45bp at 20 years and by c.15bp at 50 years to finish the quarter at -0.24% and -0.29% respectively. The 20 year index-linked gilt yield also rose by c.40bp to finish the quarter at -0.03%.

Money Market Bulletin – UK

Market review

- Economic figures released over the quarter were generally positive. GDP data reported that the economy expanded in the first quarter of 2013 by 0.3%, driven by a strong rebound in the services sector. Growth in services boosted the economy in the second quarter, and manufacturing and construction activity also returned to growth as the period progressed.
- The latest data suggests the CPI measure of inflation declined slightly from 2.8% to 2.7%.
- 1-month sterling Libor fell slightly from 0.50% to 0.49% while the 3-month Libor rate remained unchanged at 0.51%. Gilt yields increased: 2-year gilt yields rose from 0.21% to 0.40%.

Fixed Income Market Review

Overview

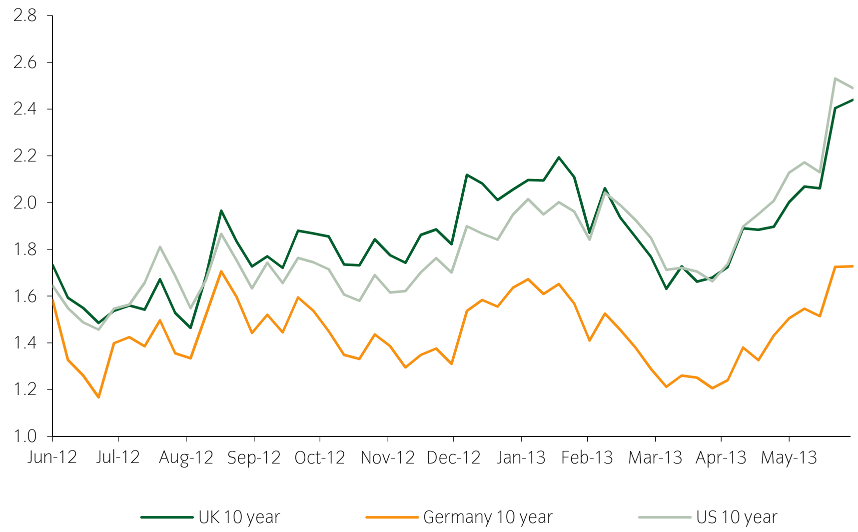
The quarter started positively for global bond markets. April saw new and concerted liquidity-providing measures from central banks, weaker-than-expected global economic data and falling commodity markets. Investors were also encouraged by the scale and scope of the stimulus package from the Bank of Japan. However, yields rose substantially in May and June (Chart 1). Comments from the US Federal Reserve that it might begin to slow its quantitative easing programme led to a substantial sell-off in global government bond markets, contributing to significant weakness across other asset classes. Emerging market debt was initially unaffected by the concerns, but as the fears started to spread, it too succumbed and the asset class suffered record investor outflows.

UK

UK gilt yields moved significantly higher over the quarter. While April was relatively uneventful, the announcement in May by Federal Reserve chairman Ben Bernanke that the US central bank may reduce its quantitative easing programme later this year led to a sharp correction in government bond markets globally. The UK was no exception. The yield curve in both the conventional and index-linked markets flattened markedly as shorter maturities started to price in eventual interest rate rises; money markets are now pricing the possibility of rate hikes in late 2014. In the conventional market, five-year bond yields increased 72bps to 1.43%, 10-year yields gained 67bps to 2.44% while 40-year bond yields rose 34bps to 3.59%. However, the correction was most acute in the index-linked market, where 5-year real yields rose 116bps to -1.43%. By contrast, 50-year real yields only rose 19bps to 0.03% over the quarter. Returns in the index-linked market (-6.7%) were the worst since the Merrill Lynch inflation-linked gilt index launched in 1994.

Economic data for the UK was broadly positive through the quarter due to a strong recovery in services, which accounts for the majority of UK economic activity, along with improving figures in manufacturing and construction; such data supported forecasts of positive growth in Q2. This came after official figures also showed positive growth in the first quarter of the year. However, the latest CPI data showed that prices had risen by 2.7% over the prior year, higher than the target rate of 2%. From a monetary policy perspective there was no change over the quarter, with the Bank of England preferring to focus on its Funding for Lending scheme while holding the base rate at 0.5% and maintaining its asset purchase scheme at £375 billion.

Chart 1: UK, German and US 10-year government bond yields (%)



Source: Bloomberg

Fixed Income Market Review Continued

US

US Treasury yields moved significantly higher over the second quarter. Treasuries had enjoyed their best month since July 2012 in April, but yields rose substantially over May and June. With US economic data improving (GDP has accelerated to 2.5% on an annualised basis), markets were caught off guard by comments from Federal Reserve chairman Ben Bernanke that the US central bank may taper its quantitative easing programme later this year. This led to a substantial sell-off in global government bond markets, and contributed to significant weakness across other asset classes. US money markets moved to price in the possibility of rate hikes in second half of 2014. Federal Reserve officials then verbally intervened to discourage expectations of an early rise in interest rates, which boosted investor sentiment. The US yield curve steepened between 2-year and 7-year treasuries but flattened from 10-year to 30-year treasuries. Five-year yields ended the quarter up 63bps to 1.40% while 30-year yields gained 40bps to end the quarter at 3.5%.

Europe ex UK

Despite the European Central Bank's (ECB) decision to cut base rates from 0.75% to a historic low of 0.5% in May, German bund yields rose over the quarter, pushed higher by the broader re-pricing of sovereign debt. Fears over reduced liquidity in China also affected investor sentiment. Five-year to 10-year bunds sold off the most. The curve steepened between 2-year and 6-year bunds but flattened from 6-year to 30-year bunds. 10-year bund yields ended the quarter up 44bps to 1.73%. Economic readings remained weak for the eurozone as a whole, with composite output data measuring activity in the services and manufacturing sectors indicating a continuing decline, though the rate of decline slowed over the quarter. Inflation also slowed for the region as a whole, with prices rising by 1.6% over the past year.

Peripheral markets, namely Spain and Italy, generally experienced a tightening of spreads during the quarter until June. The periphery suffered from the broader market sell off. Portugal was the one peripheral eurozone country that did experience significant spread widening over the quarter. Given its appeal to emerging market debt investors in recent times, it was caught up in the sell-off in emerging market debt.

Emerging market debt

The quarter started positively for emerging markets. Local rate markets were the star performers as the lacklustre global economic environment and falling commodity prices increased the likelihood of further monetary easing from emerging market central banks. External sovereign bonds, having underperformed in the first quarter of the year, recovered strongly in the early part of the second quarter as investors took advantage of attractive relative valuations. External corporate bonds also posted a positive performance although record high issuance and lingering uncertainty in several troubled sectors resulted in underperformance versus global peers.

However, volatility in the various emerging market debt asset classes rose substantially in May and June (Chart 2). Concerns that the Federal Reserve might begin to slow its quantitative easing programme led to a substantial sell-off in global government bond markets, contributing to significant weakness across other asset classes. Emerging market debt was initially unaffected by the concerns, but as the fears started to spread, emerging market debt succumbed and the asset class suffered record outflows.

The impact on the different emerging market debt sub-asset classes was varied. Despite weaker growth data and 11 emerging market central banks cutting interest rates during May, yields on local currency bonds in some countries rose substantially, with the most liquid and heavily-owned countries suffering the most. Thus, over May and June, the JP Morgan GBI-EM Global Diversified index fell 10.4% in local currency terms on an

Fixed Income Market Review Continued

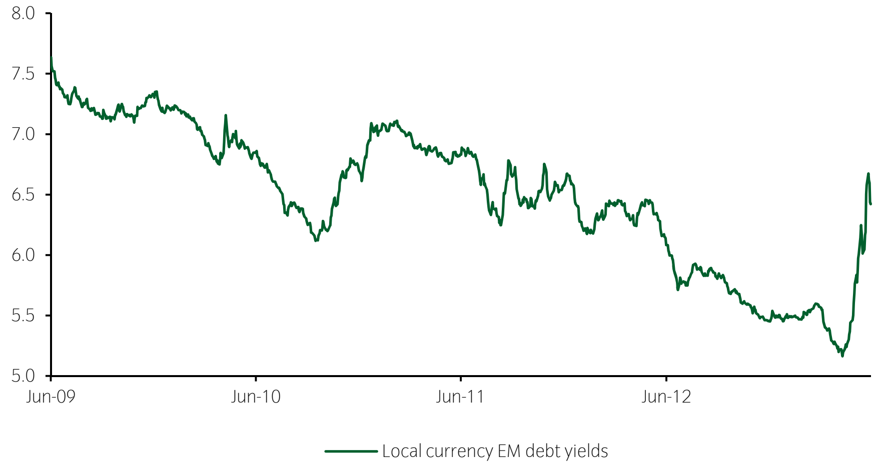
unhedged basis and -4.8% on a currency hedged basis. External sovereign debt, being the most rate-sensitive asset class, was also negatively impacted, with the JP Morgan EMBI Global Diversified index falling 8.3% in US dollar terms over May and June. Corporate bonds denominated in external currencies were relatively less affected (the JP Morgan CEMBI Broad Diversified index slipped 5.6% in US dollar terms), perhaps due to the cushion provided by higher spreads and lower sensitivity to interest rates.

That said, markets did experience a turnaround towards the end of the quarter amid bids by Federal Reserve officials and the Chinese Central Bank to calm markets, with the Fed explaining that the withdrawal of quantitative easing would be a gradual and controlled process while China tried to reassure investors that there would be enough money in the economy to ensure the smooth functioning of its financial markets.

Investment grade credit

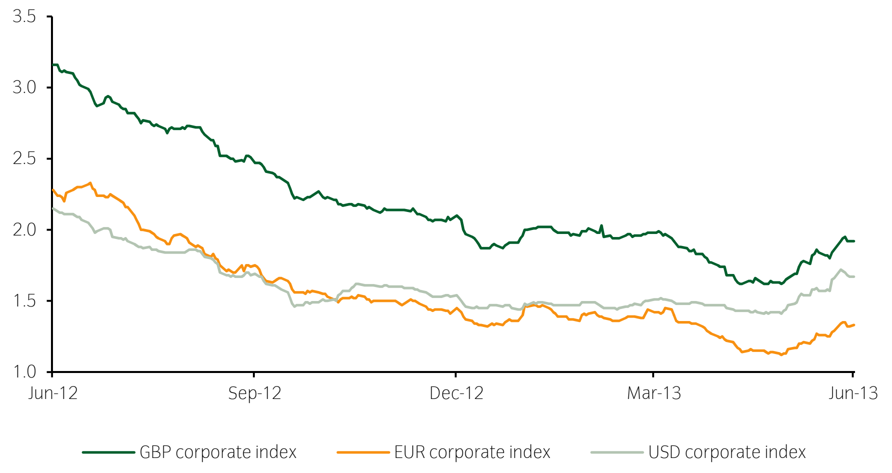
Investment grade credit spreads tightened over the first half of the quarter before widening again in the latter half. In the first half, the financials sector (banks and insurance) performed well, as did names in the eurozone periphery. Issuance of new bonds continued during April and the early part of May and was met with strong demand as investors continued to search for yield. However, with the US Federal Reserve indicating that its quantitative easing programme could be slowed towards the end of the year, spreads widened sharply (Chart 3). Long-dated, lower-rated bonds underperformed, and bonds issued by companies based in Europe's periphery generally performed more weakly than those issued by companies in Europe's core. CDS markets widened in sympathy as liquidity was poor and the bid for CDS protection was much higher than the offers of protection.

Chart 2: Yields on local currency emerging market debt (%)



Source: JP Morgan, Bloomberg

Chart 3: UK, European and US corporate yield spreads (%)



Source: Merrill Lynch, Bloomberg

Fixed Income Market Review Continued

High yield

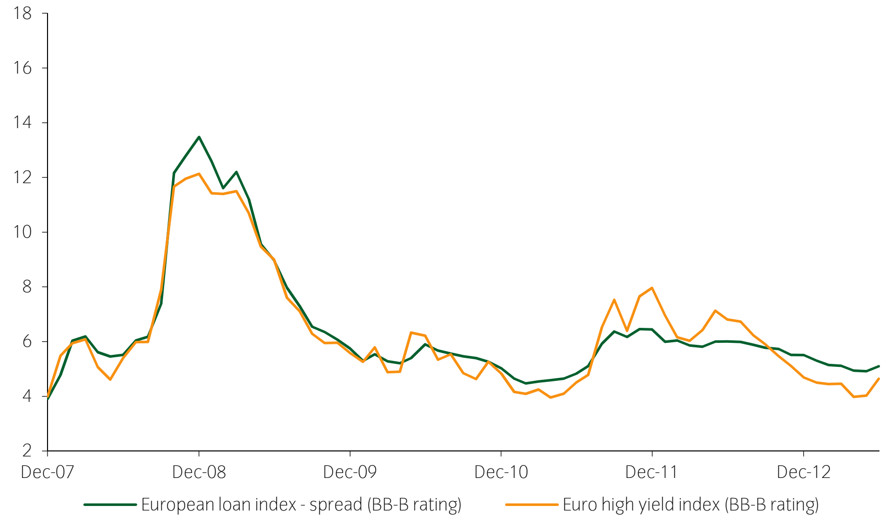
The high yield market was very strong during April and the first half of May, as concerns about the eurozone sovereign debt crisis ebbed and there was an improvement in US economic data. However, during the latter half of May and over June, markets were much weaker, hit by concerns about the possible tapering of the US quantitative easing programme. In Europe, spreads initially narrowed 94bps to 454bps before giving back those gains from mid-May. In the US, spreads had narrowed 62bps to 424bps by the early part of May before widening 97bps by the end of June.

Until June, there continued to be significant amounts of new bond issuance in both the US and European markets. In the first five months of the year, euro-denominated issuance was running at record levels, hitting €47bn, of which 42% was priced during April and May alone. Inflows into the asset class and the refinancing of existing issues helped to absorb the supply. However, new issue supply came to a sudden halt in June and investor outflows were significant. Around a third of the bonds issued since the beginning of the year are bonds that we would categorise as 'credit negative', such as funding acquisitions and shareholder dividend payments. Indeed, with the increase in supply has come a notable decline in quality, with many issuers coming to the market with increased levels of leverage (up from 0.6x at the beginning of the year to 4.2x at the end of June - levels last seen in 2009) while issuing bonds with weaker covenants.

Loans

The second quarter was a strong period for the loan market, with the asset class proving resilient in the face of the June sell-off that negatively impacted the wider financial markets. There was a good flow of new issues, consisting of both refinancings and of buyouts. Even during June, issuance picked up in an effort to print deals ahead of the summer break. Overall volumes may have lagged previous months, but the long-awaited supply surge (19 loans launched during the month) afforded investors the ability to pick and choose for the first time this year. While the market appeared to brush off the volatility, investors were cautious about funding the more esoteric and highly levered deals. The correction also presented an opportunity for managers of new collateralised loan obligation vehicles (CLOs) to ramp up portfolios and pick up assets in the secondary market. As at the end of June, loan issuance was at its highest in 2.5 years, with issuance in the first half of the year standing at €39.6 billion, a 158% increase on the same period last year.

Chart 4: Yield spreads between European loans & high yield (%)



Source: Credit Suisse

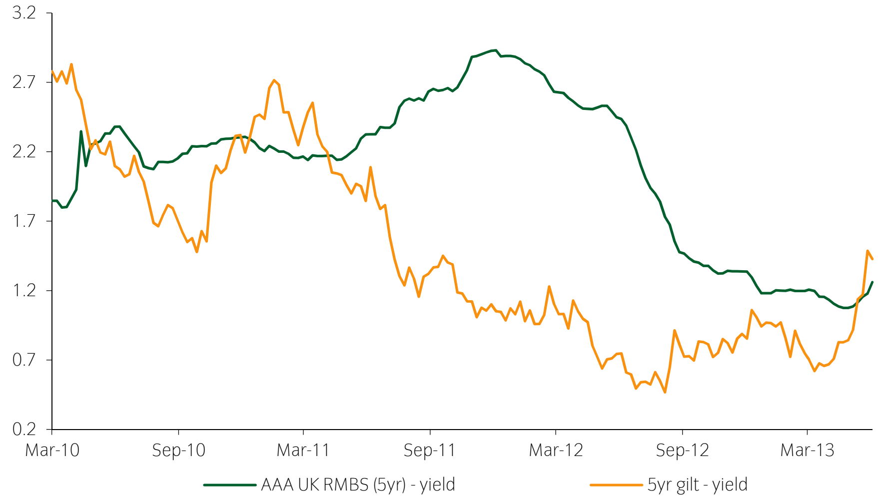
Fixed Income Market Review Continued

In addition, there were continued inflows into the asset class, with new CLOs continuing to print and existing CLOs still looking to invest their cash before their reinvestment periods closed. While there was the publication in May of a new consultation by the European Banking Association that threatened to upset the CLO market (proposing issuers of CLOs to retain at least 5% of any outstanding deals as an incentive for the issuer to keep issuing standards high), after some initial short-term weakness the impact was largely muted. Over June, even the higher volatility names only declined by around two points at the most, compared to larger multiple point moves in other credit markets. Even at the height of the volatility in financial markets, many dealers were willing to provide firm liquidity (albeit at a discount) and so used the weakness to cover their short positions and top-up well-liked names. The default rate, as measured by the S&P European Leveraged Loan Index (ELLI), fell over the quarter from 5.9% to 5.3%, with the main sectors affected being directories, cable and European retail.

Asset-backed securities

The asset-backed securities (ABS) market performed well during April and May, before being negatively impacted by the global market downturn in June. Over April and May the best-performing assets were in the non-prime residential mortgage-backed securities (RMBS) markets where the compression between higher and lower-volatility credit saw renewed strength. The announcement of the extension of the UK's Funding for Lending scheme led the prime RMBS markets to rally further. The primary market was busy and diverse, with issuance from the prime RMBS, auto, non-conforming RMBS and collateralised loan obligation markets in the UK, Netherlands, Australia and France.

Chart 5: AAA rated RMBS yields vs. short-dated gilts (%)



Source: Bloomberg, JP Morgan

In June, the ABS market finally reacted to the movements in the broader credit markets, experiencing the largest decline since mid-2011 (Chart 5). The Barclays AAA index posted a drop of 41bps while the AA index fell by 110bps. Demand from retail banks for paper was, unsurprisingly, very weak as most chose to watch the market and wait for better times. This left the dealer community with supply to absorb, something that they became increasingly unwilling to do. As a result, the June new issue market was relatively subdued with a €2 billion German transaction and a £200m UK non-conforming deal being the only notable issues. Towards the very end of the month a combination of a calmer credit backdrop and hedge fund 'bottom fishing' saw support to some of the highest-volatility markets.

Fixed Income Market Review Continued

Currency

The main theme in currency markets during the second quarter of the year was a sharp increase in market volatility. This manifested itself in broad-based strength in the US dollar, with investors looking to the world's reserve currency for safety (Chart 6). In addition, stronger US employment data and comments from Federal Chairman Ben Bernanke which implied that the Federal Reserve would reduce bond purchases drove a sharp sell-off in treasuries, and the rise in yields helped the US currency to rally. Yen weakness continued to be a theme in the early part of the quarter, especially after the aggressive policy steps taken by the Bank of Japan, but towards the end of the May and into June the yen strengthened after a sharp sell-off in the Japanese equity market. The Reserve Bank of Australia cut interest rates and signalled that it remained uncomfortable with the strength of the domestic currency, which was a catalyst for a sustained move lower in the Australian dollar against the US dollar. Weak commodity prices also proved negative for the Canadian dollar and South African rand over the quarter. Elsewhere, sentiment improved with regard to the euro, while emerging market currencies suffered amid the generally risk asset sell-off.

Chart 6: US dollar strength

Source: Bloomberg

Investment Outlook

DORSET LIABILITY MATCHING PORTFOLIO

For the period 01 April 2013 to 30 June 2013

Money Market Bulletin – UK

Outlook

- Deleveraging and fiscal austerity will continue to hamper the UK economy, but encouraging data is suggesting strength in the housing and labour markets.
- Sterling weakness may drive an uplift in activity and inflation has started to fall below expectations, but another bout of monetary easing seems unlikely. However, we may see surprises on monetary policy as Mark Carney begins his term at the Bank of England.
- We believe gilt yields may rise slightly over the next year, but the divergence in growth rates between the US, UK and Europe makes it difficult to forecast movements in the gilt yield curve.

Fixed Income Outlook

UK

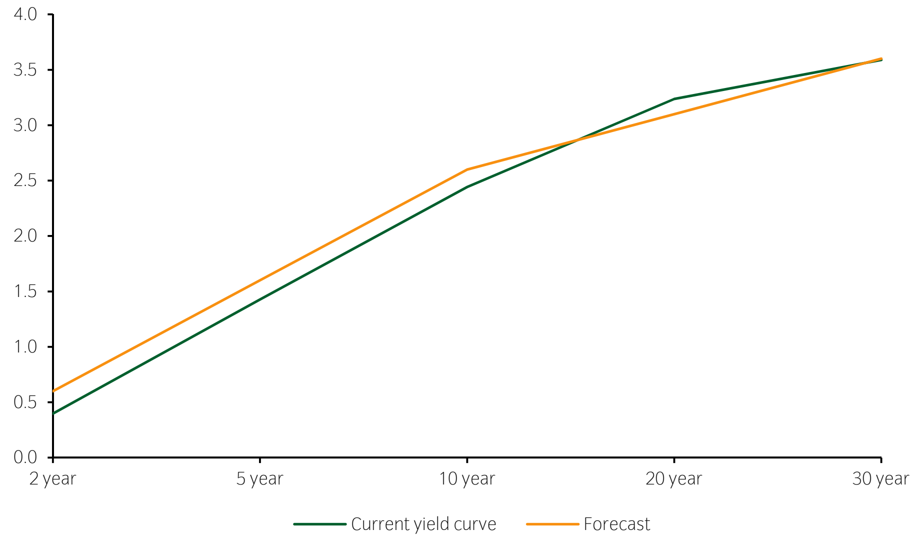
The UK is starting to enjoy some positive tailwinds. Key economic indicators have picked up and we now expect growth to be close to trend next year, with global trade expected to be supportive. Recent inflation data have surprised to the downside, which could allow for more policy flexibility but with the recent improvement in data another bout of monetary easing appears unlikely. New Bank of England governor Mark Carney may seek to introduce some form of "forward guidance" regarding central bank policy, and while it is possible for the Bank of England to restart gilt purchases if the data turns down, we expect the main focus to be on this and the Funding for Lending scheme as ways to stimulate growth. Indeed, there have been signs that this scheme is leading to an uptick in mortgage applications. Given our growth, inflation and base rate forecasts, over the next 12 months we are forecasting a small further rise in gilt yields (Chart 1). The future shape of the yield curve is difficult to forecast from here given the divergence between growth rates in the US, UK and eurozone, but we will continue to look to take advantage of relative value opportunities between the UK and other geographic markets as and when they become available.

Europe ex UK

Economic data for Europe has been weaker than expected, led by core countries, while the periphery has stabilised at a low level. We are expecting a small improvement into next year to slightly below-trend growth. Factors that suggest a less negative outcome include lessening austerity, an improvement in exports, together with an improvement in confidence to reflect stabilisation in the periphery. We are also encouraged by the bilateral agreement between Germany and Spain, which enables the Spanish Development Fund to lend to small business at the same rate as the equivalent German institution. We hope to see more of these bilateral programmes and expect further slow progress towards banking union. From a policy perspective, the combination of weak overall growth and low inflation is deemed likely to prompt the ECB to keep interest rates at today's historically low levels for the foreseeable future.

We will continue to explore relative value opportunities between Germany and other EU and non-EU countries while actively managing our exposure to the peripheral countries. We were slightly overweight Spain and Italy versus the core eurozone countries over the second quarter and this is likely to continue during the third quarter. Any recovery in the US is likely to feed through to the Eurozone, but not to the extent that rates would rise at any time over the next couple of years. This could lead to a further rise in bund yields but peripheral yields are likely to remain within their existing range or move slightly lower.

Chart 1: UK gilt curve 12m forecast



Source: Bloomberg

Fixed Income Outlook Continued

US

Ben Bernanke's comments should not have come as a surprise to the markets. Markets were naïve if they thought the Fed would entertain allowing unconditional easing to continue indefinitely regardless of the data. With the economy withstanding the 'fiscal cliff' (a mix of tax rises and spending cuts) better than the Federal Reserve had expected, it is right to expect a hike in rates at some point in the future. However, the Federal Reserve will seek to manage a gradual rise in yields rather than further dislocation. If the economic data continues to be supportive the Federal Reserve is likely to start tapering quantitative easing towards the end of the year, bringing the programme to a gradual end during the course of 2014. Our base case is that the US economy is experiencing a slow, but steady recovery. We will continue to be positioned for curve flattening.

Emerging market debt

In our view we are going through a `regime change', and we expect the transition to a permanent shift in the global liquidity environment to be accompanied by elevated volatility. For the next few months, markets are bound to exhibit high sensitivity to US economic data and communications from the Federal Reserve, as well as emerging market flows data. Hence, in the near term we are minded to shift our trading strategy to a more tactical basis, concentrating on liquid, short-duration assets.

However, value unequivocally has been created. Thus, any stability in US treasury yields, or a clearer picture on the tapering schedule and Chinese growth and credit dynamics, may prompt us to take fuller advantage of the significantly cheaper valuations and cleaner technical positions, particularly if outflows subside. Also, while core market developments remain the main drivers of emerging market assets for the time being, once the dust settles and volatility subsides country fundamentals will gain more importance than ever. Investment in emerging market debt is likely to go back to basics, with individual country fundamentals back in the driving seat, rather than an indiscriminate search for yield in an abundant global liquidity environment.

Investment grade credit

The greatest risk to credit investors remains interest rate risk both in terms of (i) the risk a fear of rising yields prompting investor withdrawals from bond and credit funds; and (ii) to a lesser extent, a rising cost of finance for companies. We also fear rising leverage (and downgrades in credit ratings) on the back of increased merger and acquisition activity and leveraged buyouts. On the plus side, the environment for defaults continues to be very benign, with companies generally enjoying healthy balance sheets. When market volatility reduces we expect to see continued new issuance from corporates as companies seek to tap the market before yields rise any further.

In terms of credit strategy, our funds are likely to continue to be conservatively positioned in terms of risk. We are broadly neutral in unsecured investment grade, with only a small net long coming from secured assets. With regard to sectors, we are overweight defensive sectors such as securitised bonds (namely commercial mortgage-backed securities), transport (such as Gatwick and Heathrow airport bonds) and covered bonds (bank bonds backed by collateral). We are generally underweight in utilities, telecoms, basic industrials, senior banks and peripheral Eurozone bonds.

Fixed Income Outlook Continued

High yield

Interest rate risk remains the largest threat to fixed income generally, while indigestion of new high yield issuance coupled with investors' low cash balances will also drive the direction of the market. In addition, there is a risk that companies may stop buying back callable bonds (thus increasing duration) if they fear refinancing will be more expensive or unavailable. As such, we have been gradually getting more defensive. Over the second quarter we increased cash levels and sold higher-volatility names. However, we expect the volatility to eventually subside, given the summer lull, lack of new issuance, limited comments by the Fed regarding quantitative easing and dealers' reduced balance sheets. This should provide new opportunities to redeploy cash: assets are now available in the 5-6% range versus 2-4% at the beginning of the second quarter. As such, we believe short-dated high yield remains a compelling investment as in our view it provides the optimum risk-adjusted method of investing in this asset class given the overall yield compression. We anticipate short-dated high yield to return 4%-5% over 2013, whilst overall high yield will struggle to return more than 6%. We will continue to keep cash levels high and focus on short-dated lower-volatility exposure; favoured sectors include financials, media, energy, telecoms and securitised bonds (namely CMBS and RMBS).

Loans

Given the recent increase in better-quality supply, we have become much more constructive on the loan market at this point in the year compared to the beginning of 2013. Loans as an asset class remain in demand, especially given their floating-rate nature in an environment where investors are concerned about rising interest rates. Even during June's sell-off they remained relatively resilient, with loans generally only falling a couple of points or so versus double-digit drops in other markets. The slew of new issues has been very welcome with some good investable deals, although the need to remain selective remains, particularly for US deals, which tend to be aggressively structured. We will continue to use market weakness to invest in new deals at more competitive levels given our focus on long-term fundamentals rather than a short-term trading strategy. Despite concerns about the European Banking Authority retention proposal, this can be seen as a positive for the market as only established and larger CLO managers will be able to issue new vehicles and potentially avoid the poorer-quality issuance that came to the market in 2006/07.

Asset-backed securities

Given that the asset-backed securities (ABS) market remains a structurally undersupplied market and in our view offers the cheapest way to reset to Libor quarterly, it's our belief that any improvement in the appetite for credit will see a commensurate increased demand for ABS. That said, as the events of June highlighted, too many of the current investors have a short-term investment appetite (e.g. hedge funds), so any sustained weakness in the broader credit markets is likely to negatively impact the ABS market. Therefore, actively trading the volatility continues to be our preferred route to managing risk currently.

Our investment theme in the first half of June was one of capital preservation, with a view to building cash balances and taking off risk in the higher beta markets. We sold positions in collateralised loan obligations, UK non-conforming paper, commercial mortgage-backed securities (CMBS) and peripheral eurozone markets, which is a testament to the depth of liquidity the ABS market is able to boast even in difficult conditions. Towards the end of the quarter we began to selectively re-invest in our favoured areas at cheaper prices.

Fixed Income Outlook Continued

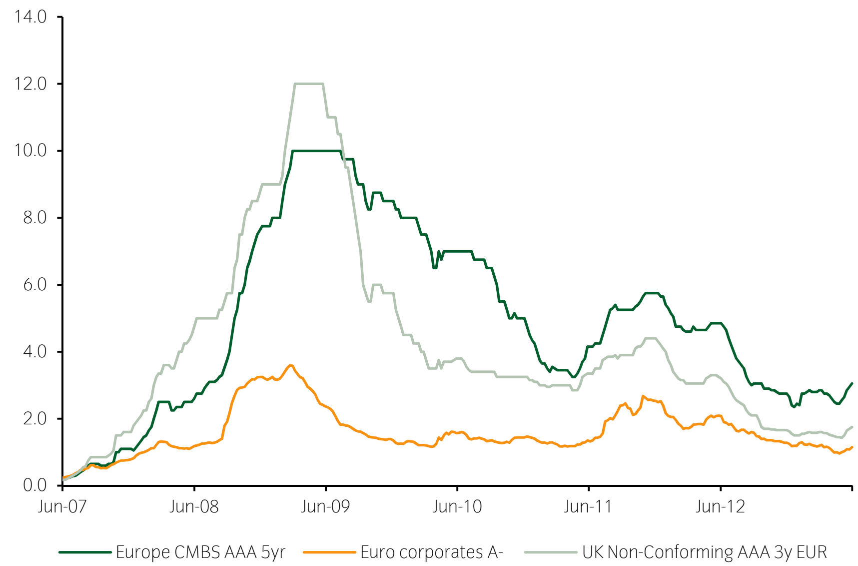
We continue to believe that the long-term strategic value of the asset class remains strong. Given the floating-rate nature of the asset class, we believe there will be investor interest in securities which offer credit risk without duration (interest rate) risk, particularly when interest rates start to rise. We expect any tightening in spreads to encourage new issuance, which is likely to be well received and perform well in the secondary market.

From a geographic point of view, the UK is our favoured market for a number of reasons: its improving economic fundamentals and rising house prices; the limited supply (due to the Funding for Lending scheme); the implementation of the Help to Buy scheme which should allow a wave of refinancing which in turn will trigger accelerated pre-payments on mortgages (and the underlying residential mortgage-backed securities (RMBS) deals). As such we see value in UK non-conforming paper, buy-to-let deals and CMBS (Chart 2). Elsewhere, we also like German RMBS and our exposure to Spain and Italy is very short-dated and as such we are happy to continue to maintain this allocation. In terms of sales, we have been reducing our exposure to Dutch RMBS given the softening of the housing market and we expect to trim our Australian exposure as we believe the market is vulnerable to widening from the current tight levels.

Currency

Our currency strategy had been positioned for a rise in volatility levels prior to the sharp moved we have seen in the first half of 2012. Following this period of increased period of market volatility we have now reduced position sizes somewhat to lock in performance gains. However, our overall views on the outlook for currency markets remain unchanged. We remain underweight the Japanese yen in the belief that the fundamental backdrop continues to be negative for the currency. We also continue to believe that commodity currencies such as the Australian dollar and South African rand look expensive relative to their fundamental drivers such as commodity prices and interest rates. In contrast, we remain optimistic on the euro, and the short-term outlook for the US dollar: the latter has a tendency to outperform during periods when currency market volatility rises as investors look to the world's reserve currency for safety.

Chart 2: UK non-conforming and CMBS versus A rated Euro corporates (%)



Source: JP Morgan

Appendices

DORSET LIABILITY MATCHING PORTFOLIO

For the period 01 April 2013 to 30 June 2013

Summary Portfolio Valuation

As at 30 June 2013

	Book Cost GBP	% of Total Book Cost	Market Value GBP	% of Total Market Value
Fixed Income				
Sterling				
Investment Funds	147,957,061.56	100.00	191,579,242.02	100.00
Total Sterling	147,957,061.56	100.00	191,579,242.02	100.00
Total Fixed Income	147,957,061.56	100.00	191,579,242.02	100.00
Total	**147,957,061.56**	**100.00**	**191,579,242.02**	**100.00**

Notes

We would also point out:

- All features in this pack are current at the time of publication but maybe subject to change in the future.
- Unless otherwise stated, the source of information is Insight Investment. Any forecasts or opinions are Insight Investment's own at the date of this document and may change. They should not be regarded as a guarantee of future performance.
- This document is intended for investment professional only and should not be relied upon by private investors. No modifications or amendments to this presentation may be made without prior consent from Insight Investment. The document is to be used by the intended recipient(s) only and the document may not be forwarded to a third party without prior consent from Insight Investment.
- Depending on the investor's currency of reference, currency fluctuations may adversely affect the value of investments and the income therefrom.
- Past performance is not a guide to future performance.
- Unit prices may go down as well as up, particularly in the short term. The value of an investment may fluctuate and cannot be guaranteed. Unless otherwise indicated, the performance of the pooled funds illustrated is calculated on an offer to bid basis with income reinvested and net of management charges.
- Trading in derivative instruments may involve a higher degree of risk and there can be no assurance that the objectives of the portfolio will be attained.
- Telephone calls may be recorded.
- To view the Insight Pension Fund Level 1 Disclosure, please visit http://www.insightinvestment.com/global/documents/apssandtran/pension_fund_disclosure_code_-_level_1.pdf

Important Information

Issued by Insight Investment

- Issued by Insight Investment Management (Global) Limited, authorised and regulated by the Financial Conduct Authority. Registered office 160 Queen Victoria Street, London EC4V 4LA.