



DORSET COUNTY PENSION FUND

UK Equity Report for quarter ending 30 June 2013

- Internal Managers Report
- Summary Valuation
- Transaction Report

Dorset County Pension Fund Committee – 9 September 2013

UK Equity Report

Report of the Internal Manager

1. Purpose of the Report

1.1 To review the management of the UK equity portfolio.

2. Recommendations

2.1 That the report and performance be noted.

3. Background

3.1 The UK Equity portfolio has 3 active managers, AXA Framlington, Standard Life and Schroders as well as the internally managed passive fund. This combination of managers and styles is designed to give the opportunity of outperformance against the FTSE All Share index and has a two thirds passive and one third active mix. Details of the combined portfolio (£528.0M at 30 June 2013) are shown in the table at paragraph 5.2.

3.2 The internally managed passive fund aims to track as closely as possible the FTSE 350 index which measures the progress of the majority of the UK equity market. At 30 June 2013, the FTSE All Share index was made up of 608 individual stocks ranging from HSBC Holdings, the largest UK company (market value £127.0 Billion) down to the smallest in the index, Hansa Trust (market value £30.4M). Direct investment is made in the largest 350 companies, which comprises 97.6% by value of the index. Investment in the smallest companies which make up 2.4% of the index is achieved by a holding in the Schroders Institutional UK Smaller Companies Fund which is managed on an active basis.

4. Market Background

4.1 With the exception of the Small Cap index, all major UK markets fell in the three month period to 30 June 2013, whilst major world markets rose over the same period. The FTSE100 ended the three month period to 30 June 2013 at 6,215.5, a fall of 196 points (-3.1%), making the FTSE100 the worst performing UK index. The Small Cap was the best performing UK index over the period which rose 11 points (0.3%). The best performing world index was the Nikkei225 rising 1,279 points (10.3%) with the Hang Seng the worst performing world index which fell 1,496 points (-6.7%).

4.2 In May 2013, the FTSE100 reached its highest level in thirteen years. An intraday high of 6,875.6 had been recorded in May before closing slightly lower at 6,840.3, within ninety points of its December 1999 peak. The Dow Jones passed 15,000 for the first time ever on 2 May 2013 and closed at an all time high of 15,409.4 on 28 May 2013. The Dow Jones' point gain for 2013 is greater than any other year on record. In Japan the Nikkei225 reached its highest level of 13,225.6 since August 2008. Stimulus efforts by central banks around the world pushed stock markets higher this year, having made equities more attractive than lower yielding bonds.

Country	Index	31/03/2013	30/06/2013	% Change
UK	FTSE100	6,411.7	6,215.5	-3.1
UK	FTSE250	13,923.0	13,798.2	-0.9
UK	FTSE350	3,448.6	3,353.5	-2.8
UK	Small Cap	3,805.6	3,816.5	0.3
UK	All Share	3,380.6	3,289.7	-2.7
Japan	Nikkei225	12,397.9	13,677.3	10.3
US	Dow Jones	14,578.5	14,909.6	2.3
Hong Kong	Hang Seng	22,299.6	20,803.3	-6.7
France	Cac 40	3,731.4	3,738.9	0.2
Germany	Dax	7,795.3	7,959.2	2.1

- 4.3 In April, credit rating agency Standard & Poors (S&P) affirmed the top rated AAA rating for the UK but warned there was a possibility of a downgrade if the economy weakened. The rating was left on a negative outlook due to a one-in-three chance that its rating could be cut over the next two years if the UK's economy weakened beyond current expectations. S&P said its rating was based on the UK remaining a member of the European Union.
- 4.4 In April, credit rating agency Fitch became the second major rating agency to cut the UK's AAA rating to AA+ on concerns about the weakness of the economic position and the impact on the UK's debt outlook. The outlook was upgraded to Stable, removing the threat of further rate downgrades in the near future. Fitch are the second credit rating agency to cut the UK's AAA rating after Moody's downgraded the UK's rating in February 2013.
- 4.5 In May, the European Central Bank cut its interest rate for the first time in ten months to a record low of 0.50% from 0.75% due to ongoing concerns about the Eurozone's economy. The interest rate cut was made to stimulate growth, as the economic downturn that affected Spain and Italy appeared to be spreading to countries such as Germany, Austria and Finland. The recession across the Eurozone continued into a sixth quarter as the economy shrank 0.2% between January and March and is the longest recession since the Euro was launched in 1999. The Eurozone's economy is now 1% smaller for the same period as compared with a year ago.
- 4.6 In June, the UK economy avoided a return to recession after the economy grew 0.3% in the first quarter of 2013 after a contraction of 0.3% in the previous quarter. The growth was mainly attributable to the Services sector, which accounts for around three quarters of the economy, rising 0.6% in the quarter and a small contribution from production, largely due to mining and quarrying. The Construction sector continued to struggle falling 2.5% and has been a significant negative on economic growth in recent years.

5. Performance

Internally managed passive portfolio

- 5.1 The internally managed passive portfolio is modelled to track the index with a tolerance of +/- 0.5% pa allowing for the costs of rebalancing. The figures shown below are for this part of the Fund only.

Quarter To	Dorset %	Index %
30/06/13	-1.6	-1.7
Total	<u>-1.6</u>	<u>-1.7</u>

Notes:

- The Dorset Fund is marginally outperformed the benchmark over the three month period to 30 June 2013 but well within the allowed tolerances.

5.2

THREE MONTHS TO 30 JUNE 2013

Manager	Market Values		Performance	Benchmark	Benchmark Description
	31/03/2013 £M	30/06/2013 £M	%	%	
Internal	355.0	346.2	-1.6	-1.7	FTSE 350
AXA Framlington	88.3	88.2	-0.1	-1.7	All-Share
Standard Life	66.4	67.2	1.4	-1.7	All-Share
Schroders	26.4	26.4	3.6	3.8	Small Cap
Total	<u>536.1</u>	<u>528.0</u>	<u>-0.7</u>	<u>-1.5</u>	

The figures for the whole UK equity portfolio show:

- The combined portfolio has outperformed its benchmark over the three month period by 0.8%.
- Standard Life and AXA Framlington outperformed their benchmark by 3.1% and 1.6% respectively in the three month period to 30 June 2013 whilst Schroders underperformed their benchmark by 0.2%.

- 5.3 Each external manager's commentary is summarised below:

Schroders

1st Quarter 2013/14

During the quarter, the Fund returned 3.6% against the Small Cap benchmark of 3.8%. The fund's performance was driven by stock specific factors rather than industry sectors. Dart Group continued to perform well. It has successfully transformed itself from a low-cost airline into a highly profitable packaged holiday business. It targets cost-conscious customers with all-inclusive deals, which has been a growth area in the austere consumer environment. Ted Baker also performed very strongly. A trading update in June revealed top-line growth was exceeding expectations by a considerable margin and recorded retail sales growth of 30.7% for the twenty weeks to mid-June. Ted Baker is expanding in the US and China as it continues to grow the brand internationally. UK house builder Gleeson rallied strongly, benefitting from measures introduced by the government earlier this year to ease access to mortgages. Microgen also rallied after announcing a strategic review

which sparked speculation that it was an attractive takeover target. Negative to performance were a number of index constituents that performed strongly, but are not held by the fund and detracted from relative returns. Such Stocks included Xaar (which moved up into the FTSE250) and Greencore Group. Pawnbroker Albemarle & Bond fell following a profit warning owing to the lower gold price. Devro, which produces collagen casings for food products, saw its shares fall as it experienced production issues during the quarter, but these are being resolved. A position in MP Evans was bought, which operates palm oil plantations in Indonesia. The business is growing rapidly, yet the shares remain attractively valued. Also added was mobile marketing firm InternetQ where a recent acquisition boosted its geographical footprint in this rapidly growing market. The holding in Hargreaves Services was sold as the company's strategy became unclear. The focus for the fund remains on companies that generate attractive returns on capital, have good long term prospects and opportunities to improve profitability.

Standard Life

1st Quarter 2013/14

During the quarter, the fund returned 1.4% against the FTSE All Share Index return of -1.7%. During the quarter, the Fund purchased shares in bookmaker William Hill whose agreements to buy out its online joint venture and a business in Australia should be positive for the company's valuation. The holding in Essar Energy were added to, where a successful refinancing and more supportive Indian power generation regulation reinforced our conviction in the shares upside potential. BskyB was added to following recent weakness created by the perceived competitive threat from rival BT's sports TV strategy. The market is overlooking the continued strong growth on offer and its loyal customer base.

The fund sold its holding in Persimmon during the period as while the economic backdrop continued to be very positive, the valuation appears full following a significant re-rating relative to the sector. Whitbread was also sold after a material re-rating to a level above its long-term average valuation and its competitors and its share price already appears to be discounting management growth targets as far out as 2018. The holding in Spectris, the instruments and controls business were reduced given heightened uncertainty over the timing of orders and the holding in private equity firm 3i was reduced on concerns that growth in the value of its underlying investments remain sluggish.

Lloyds Banking Group was the most notable contributor to performance during the quarter. The shares rose on positive trading helped by encouraging UK housing market data. Engineering company GKN hosted a bullish capital markets day which reassured investors about the positive outlook for margins in its key Aerospace and Driveline businesses. Underweight positions in Diageo, SAB Miller and British American Tobacco also contributed positively as rising developed market bond yields made these stocks less attractive on a relative basis. Mining shares made a negative net contribution over the quarter, with holdings in Rio Tinto and Glencore Xstrata outweighing positive contributions from underweight positions in Anglo American and BHP Billiton as metal and mineral prices in general declined in response to lower demand in China. In transport, FirstGroup shares fell in response to a much larger than expected rights issue prompted by an imminent credit rating downgrade.

AXA Framlington

1st Quarter 2013/14

During the quarter, the fund returned -0.1% against the FTSE All Share Index return of -1.7%. Positives to performance was Xaar, the maker of ink jet printing technology, who significantly upgraded forecasts and was the best performer in the quarter; ITV, the largest holding in the Fund, performed well as advertising revenue was expected to improve in the second half of 2013; consumer services, including retailers and media, was the best performing sector and being underweight in banks and financials aided performance. Negatives to performance included Imagination

Technology, a supplier of graphics semiconductor designs for companies including Apple and Samsung, reported lower licence income and was the worst contributor, whilst Technology shares which were the worst performers. Stocks added to included Wolseley, Ashtead, Travis Perkins, BT, Johnson Matthey, Dixons Retail, WPP and Miton. Breedon Aggregates was purchased as they expanded in the North of England and Scotland. The final shares of BP and Pearson were sold. Weir Group was reduced and NCC (computer services) and Mitie (contracted out services) were sold on lower growth expectations.

6 Review of Activity

- 6.1 There have been three significant corporate actions in the three month period to 30 June 2013.
- In April 2013 William Hill had a Rights Issue for £0.1M
 - In May 2013 there was a Scheme of Arrangement for the merger of Xstrata Plc with Glencore International Plc for £1.4M
 - In June 2013 First Group had a Rights Issue for £0.1M.
- 6.2 The portfolio was rebalanced in June 2013. The total value of purchases and sales were £2.5M with a net purchase of £1.2M. There were 35 purchases (£1.9M) and 18 sales (£0.7M).

7 Stock Lending

- 7.1 Stock lending is managed in the UK on an agency basis by HSBC, and overseas on the same basis by Pictet.
- 7.2 Total overseas stock lending income for the year to 30 June 2013 is £35,863. Net income for UK stock lending was £36,330 over the same period, giving a total of £72,193. This compares to the period to 30 June 2012 where the UK stock lending figure was £35,445 and the overseas stock lending was £40,172, giving a total of £75,617.

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August 2013

If you have any queries on this report please contact Nick Buckland, Chief Treasury and Pensions Manager on 01305 224763 or email n.j.buckland@dorsetcc.gov.uk

Dorset County Pension Fund
Summary Valuation at Close of Business
30 June 2013

<u>Summary by Group</u>	Book Cost	Market Value	
	£ 000's	£ 000's	%
Mining	14,003	23,195	6.70
Oil & Gas Producers	31,340	52,131	15.06
Chemicals	817	2,351	0.68
Construction & Materials	2,354	2,458	0.71
Forestry & Paper	128	565	0.16
Aerospace & Defence	2,964	8,326	2.40
Electronic & Electrical Equipment	656	1,424	0.41
Industrial Engineering	1,046	3,314	0.96
Automobiles & Parts	263	922	0.27
Household Goods & Home Construction	2,428	8,498	2.45
Beverages	4,054	14,718	4.25
Food Producers	1,703	8,187	2.36
Healthcare Equipment & Services	379	1,382	0.40
Personal Goods	281	1,350	0.39
Pharmaceuticals & Biotechnology	9,551	25,452	7.35
Tobacco	5,197	16,515	4.77
General Retailers	2,914	6,359	1.84
Industrial Metals	745	455	0.13
Travel & Leisure	5,721	11,117	3.21
Media	5,064	10,142	2.93

Support Services	5,509	14,203	4.10
Industrial Transport	236	329	0.10
Food & Drugs Retailers	3,945	7,763	2.24
Fixed Line Telecommunication	4,080	5,229	1.51
Electricity	1,546	3,182	0.92
Gas Water & Multiutilities	5,151	10,629	3.07
Banks	36,469	41,887	12.10
Non Life Insurance	2,299	3,338	0.96
Life Insurance	8,870	13,325	3.85
Equity Investment Instruments	3,702	7,245	2.09
Real Estate Investments & Services	837	1,084	0.31
Real Estate Investment Trusts	3,441	5,045	1.46
Technology Hardware & Equipment	768	2,642	0.76
Software & Computer Services	1,953	2,585	0.75
Financial Services	3,770	6,744	1.95
General Industrial	1,131	2,212	0.64
Mobile Telecommunications	17,621	17,941	5.18
Oil Equipment Services & Distribution	742	1,962	0.57
Total Equities	193,678	346,206	100.00
Total Valuation	<u>193,678</u>	<u>346,206</u>	100.00

Summary of Transactions for the Period**1 April - 30 June 2013**

Cash Transaction Summary

Schedule	Purchases	Sales	Net Cash Invested
	£	£	£
UK Equities	3,519,395.29	2,116,890.69	1,402,504.60
	<u>3,519,395.29</u>	<u>2,116,890.69</u>	<u>1,402,504.60</u>

UK Equities**Purchases**

No. of Shares	Description	Date	Price £	Cost £
29,552	William Hill	5-Apr	2.45	72,402.40
198	HICL Infrastructure	9-Apr	1.20	236.61
930,243	Glencore Xstrata	1-May	1.49	1,390,445.66
23,000	HICL Infrastructure	14-Jun	1.29	29,739.00
4,000	Royal Bank of Scotland Group	14-Jun	3.14	12,573.97
1,000	Berendsen	14-Jun	7.61	7,605.00
8,000	Fisher James and Sons	14-Jun	9.59	76,680.48
1,000	Rolls-Royce Holdings	14-Jun	11.90	11,900.00
2,000	Phoenix Group Holdings	14-Jun	6.50	13,002.85
4,000	Morgan Advanced Materials	14-Jun	2.70	10,795.88
5,000	Brewin Dolphin Holdings	14-Jun	2.34	11,698.50
42,000	HSBC Holdings	14-Jun	6.89	289,389.12
1,000	Murray International Trust	14-Jun	11.35	11,352.27
2,000	BAE Systems	14-Jun	3.91	7,814.19
1,000	Rathbone Bros	14-Jun	15.47	15,469.35
47,000	Direct Line Insurance Group Ord	14-Jun	2.14	100,567.60
128,000	Barclays Ord	14-Jun	3.00	384,301.49
5,000	Sports Direct International	14-Jun	5.20	26,005.92
36	Personal Assets Trust	14-Jun	346.60	12,477.60
5,000	Ophir Energy	14-Jun	3.64	18,208.82
170,000	Thomas Cook Group	14-Jun	1.18	199,795.26
1,000	Wood John Group	14-Jun	7.96	7,961.74
5,000	Filtrona	14-Jun	6.88	34,413.84
6,000	Ocado Group	14-Jun	3.22	19,302.23
1,000	CRH	14-Jun	13.34	13,339.30
18,000	British Land Reit	14-Jun	6.00	107,960.74
23,000	Glencore Xstrata	14-Jun	3.15	72,384.21
22,000	St.James's Place	14-Jun	5.55	122,128.31
31,000	Dixons Retail	14-Jun	0.42	12,965.09
26,000	888 Holdings	14-Jun	1.50	38,932.24
12,000	NMC Health	14-Jun	3.28	39,338.11
32,000	Schroder Asia Pacific Fund	14-Jun	2.43	77,742.65
6,000	Home Retail Group	14-Jun	1.35	8,120.01
1,000	Close Bros Group	14-Jun	9.45	9,454.90
10,000	Rentokil Initial	14-Jun	0.89	8,923.83
2,000	Bodycote	14-Jun	5.11	10,215.50
3,000	St Modwen Properties Reit	14-Jun	2.86	8,567.23
12,000	Keller Group	14-Jun	9.47	113,621.74
131,249	First Group	25-Jun	0.85	111,561.65

3,519,395.29

UK Equities**Sales**

No. of Shares	Description	Date	Price £	Proceeds £	Profit / (Loss) £
304,998	Xstrata	1-May	4.56	1,390,445.66	0.00
2,000	Alliance Trust	14-Jun	4.26	8,524.19	5,372.39
500	Astrazeneca	14-Jun	32.38	16,190.00	8,076.25
500	BH Global	14-Jun	11.50	5,750.00	1,072.20
2,000	BH Macro	14-Jun	21.67	43,330.00	11,493.49
49,500	British Assets Trust	14-Jun	1.28	63,360.00	26,038.97
2,000	BSKYB Group	14-Jun	7.97	15,940.00	6,912.01
5,000	BTG	14-Jun	3.72	18,600.00	8,588.91
500	Derwent London Reit	14-Jun	23.04	11,518.94	6,226.01
28,000	Dexion Absolute	14-Jun	1.49	41,692.00	2,385.93
500	Diageo	14-Jun	19.04	9,519.21	6,645.43
1,000	Hargreaves Lansdown	14-Jun	9.15	9,154.09	6,066.90
3,000	JD Sports Fashion	14-Jun	8.80	26,400.00	2,467.50
17,000	Londonmetric Property Reit	14-Jun	1.08	18,324.09	-3,036.27
6,000	Morrison WM Supermarkets	14-Jun	2.66	15,980.27	8,964.79
104,000	Raven Russia Reit	14-Jun	0.75	77,480.00	13,208.00
13,000	Royal Dutch Shell B	14-Jun	21.77	283,043.79	109,215.15
4,000	Sage Group	14-Jun	3.40	13,588.45	9,787.75
62,000	Stobart Group	14-Jun	0.78	48,050.00	-31,289.75
				2,116,890.69	198,195.66
				2,116,890.69	198,195.66

Other Transactions

The following Capitalisation / Consolidation issues took place
during the 3 month period 1 April - 30 June 2013

<u>Company</u>	<u>Old Holding</u>	<u>New Holding</u>
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Capitalisation Issues

None this quarter

Consolidation Issues

Hiscox	73,955	65,819
Spirax Sarco	14,500	13,961
Sage	227,500	216,265
Invensys	151,505	121,204
Computacenter	16,000	14,400