Dorset County Pension Fund

Investment Manager's Report

6 months to 30th September 2013

Mike Collins

21 November 2013
Pictet, London

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Portfolio summary

Portfolio summary

- **Mandate:** Global ex UK Equities
- **Benchmark:** MSCI Composite (53% North America, 12% Japan, 29% Europe ex UK, 6% Pacific ex Japan).
- **Objective:** The portfolio aims to outperform the benchmark
- **Since inception:** 31 July 1990
- **Asset as at 30th September 2013:** GBP 370,958,767
- **Assets as at 31st March 2013:** GBP 365,510,098
- **Performance 6 months to 30th September 2013 (unhedged):**

  Portfolio = 2.48%

  Benchmark = 3.34%

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Source: Pictet / MSCI

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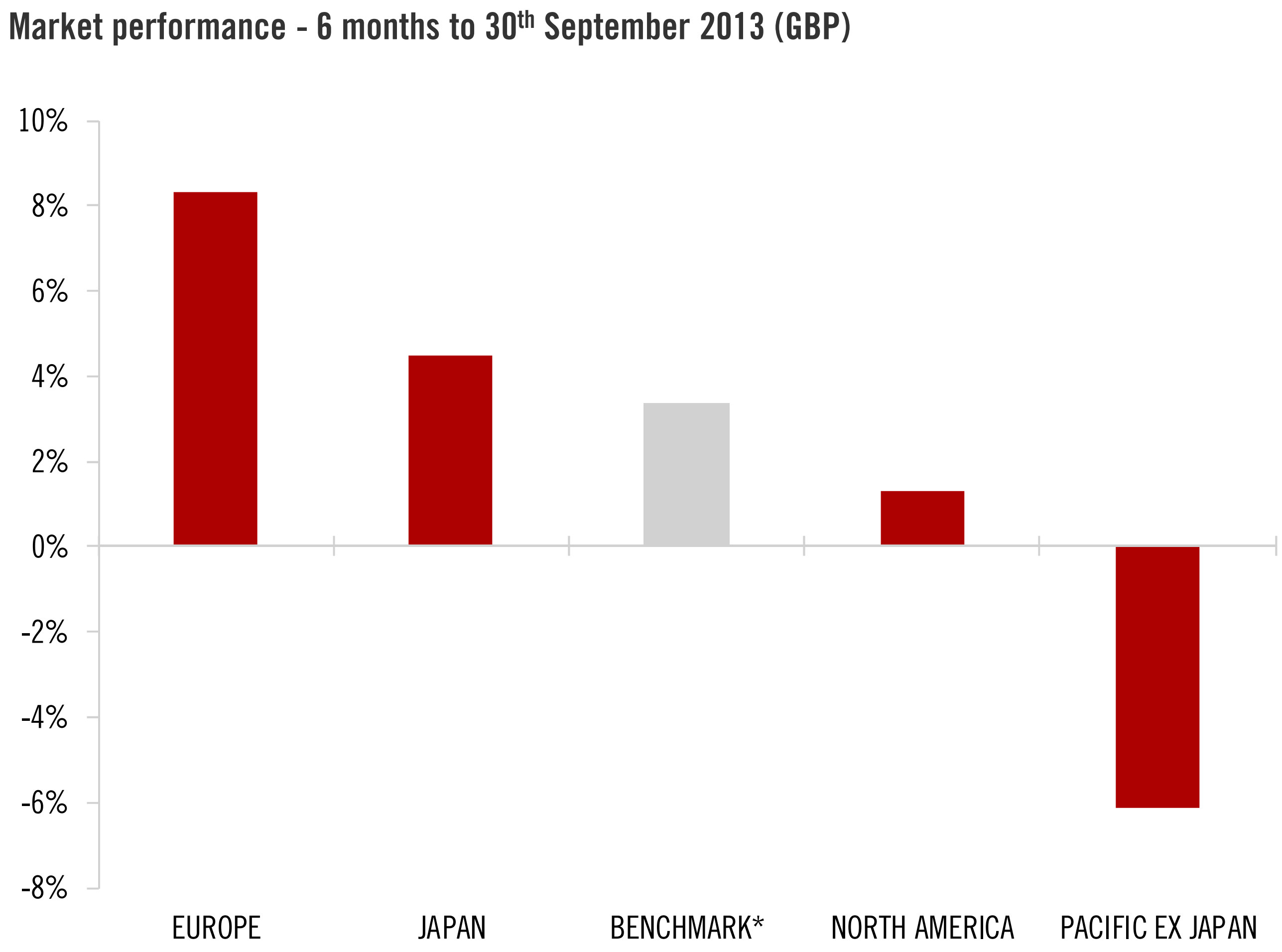
Performance review

Performance of indices

- Stocks enjoyed gains across developed and emerging markets, with the S&P 500 Index hitting record highs as investors expressed relief at the US Federal Reserve's decision to delay the scaling back of its asset purchase programme.
- How different current investor attitudes are from those prevailing in 2008 when central bankers were seen as the major contributors to the global economic crisis and when the announcement of a rescue measure was treated with incredulity.



* Benchmark: MSCI Composite (53% North America, 12% Japan, 29% Europe ex UK, 6% Pacific ex Japan).
Source: Pictet / FactSet 6 months to 30.09.2013

Review of performance

Performance (% Return, GBP)

	3 MTH	6 MTH	1 Year	3 Years*	5 Years*	Since 31.03.08*	Since Inception*
DORSET	1.05%	2.48%	20.28%	10.87%	10.36%	8.35%	7.67%
BENCHMARK	1.77%	3.34%	22.40%	11.36%	10.66%	8.20%	7.81%
DIFFERENCE	**-0.72%**	**-0.86%**	**-2.12%**	**-0.49%**	**-0.30%**	**0.15%**	**-0.14%**

Portfolio: Dorset County Council
Benchmark: MSCI Composite (53% North America, 12% Japan, 29% Europe ex UK, 6% Pacific ex Japan)
Since Inception: 31. 07.1990
*Annualised. Tailored benchmark has evolved since inception in line with portfolio objectives.
Source: Pictet / MSCI

- Overall, our policy for the six months to September 2013 delivered a performance of 0.86% below the composite equity benchmark.
- The fund's relative return was adversely impacted by high cash levels in a period of rising share prices. Moreover, the cash return was negative, a consequence of holding US $ and Japanese Yen in a period of Sterling strength.

6 months to 30th September 2013 (GBP)

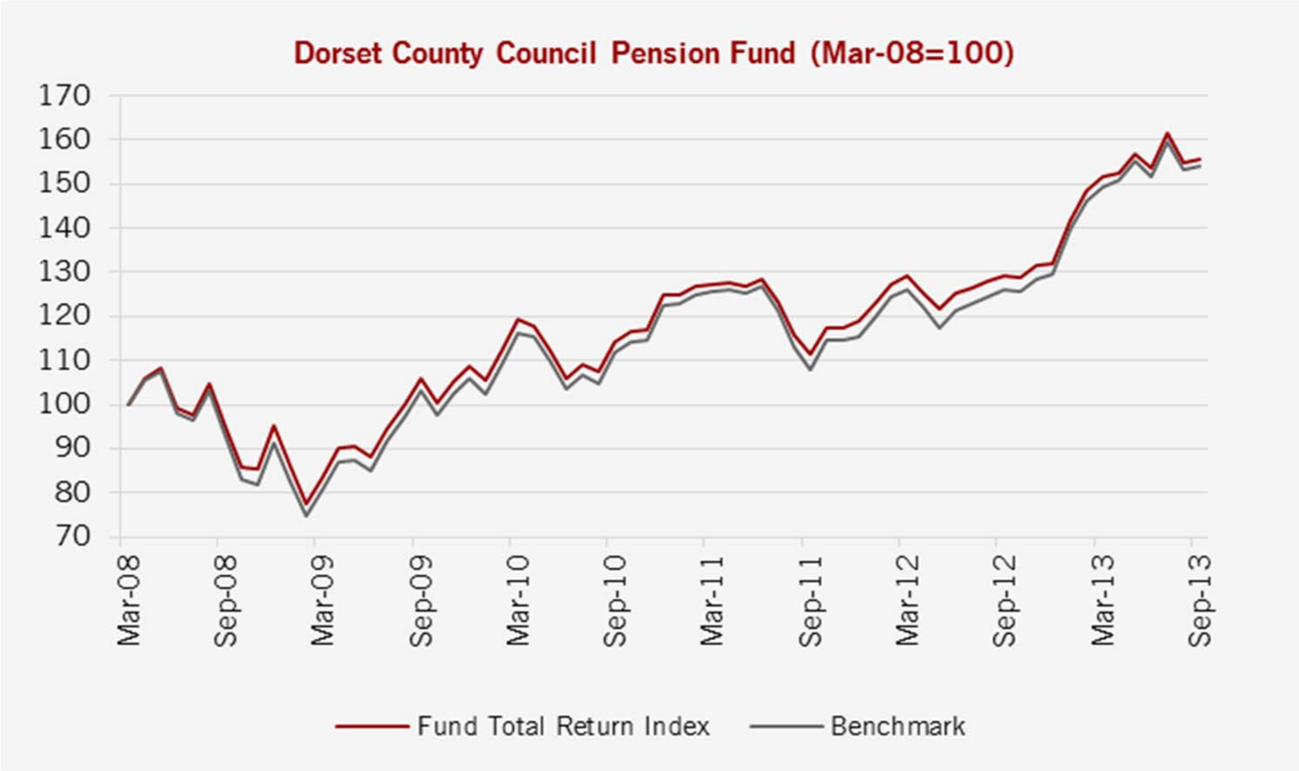
	Portfolio		Benchmark		Attribution Analysis		
	Average Weight	Return	Average Weight	Return	Allocation	Selection	Total
Total	**100.0**	**2.5**	**100.0**	**3.3**	**(0.7)**	**(0.1)**	**(0.9)**
NORTH AMERICA	50.0	1.2	52.8	1.3	0.0	(0.0)	(0.0)
EUROPE	26.6	7.8	29.1	8.3	(0.1)	(0.1)	(0.2)
JAPAN	11.4	4.5	12.1	4.5	0.0	(0.0)	0.0
PACIFIC EX JAPAN	3.2	(5.3)	5.9	(6.1)	0.2	0.0	0.3
[Cash]	**8.8**	**(8.0)**	**--**	**--**	**(0.9)**	**--**	**(0.9)**

Portfolio: Dorset County Council
Benchmark: MSCI Composite (53% North America, 12% Japan, 29% Europe ex UK, 6% Pacific ex Japan)
Source: Pictet / FactSet at 30.09.2013. Portfolio and benchmark weights are average over the period.
Totals may not exactly equal sum of constituents due to rounding.

Dorset County Pension Fund – Evolution of performance

Over the entire period between end-March 2008 and end-September 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-September 2013 the total fund delivered an average annual return of 8.35%, above the average annual index return of 8.20%. Note that the fund remains above the index even against the backdrop of a 54% gain in index levels.

Dorset County Pension Fund Performance



Source: Pictet

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Outlook

Global Outlook

Given that high levels of borrowing risk producing an economic and financial crisis should asset prices fall, the obvious response of Central Banks to such an environment should be to work towards lower debt levels and lower asset prices. Conversely, Central Banks are working in the opposite direction by keeping asset prices high and preventing a major whole economic deleveraging.

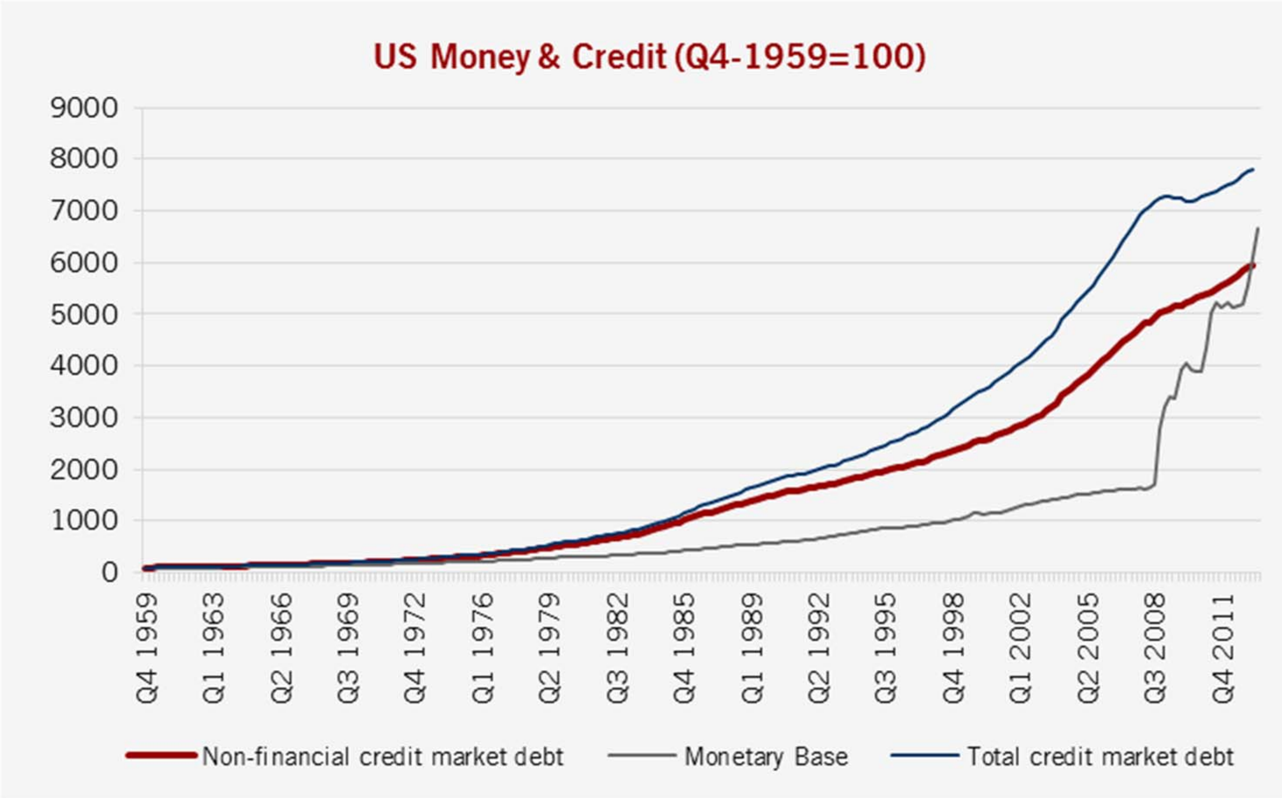
The developed world desperately needs the generation of higher private savings, the corollary of rising investment expenditure and improving long-term growth potential. Instead, accommodative monetary conditions and distorted financial markets keep savings low, investment down and help to maintain an almost total reliance on consumption as a source of growth.

It is true that global GDP has recovered over the past few years. However, with the vast majority of productive assets now devoted to consumption, there is now very limited scope for economies to grow in the years ahead. In essence, then, it is apparent that much of the economic growth seen since 2009 has been at the cost of future activity.

It should be clear to all that a suitable response to the high borrowing and inflated asset prices of 2003-2007 is not to encourage even lower savings and higher asset prices. Unfortunately, this is the situation the world now finds itself in and the ultimate cost of deflating the bubble is far higher today than it was in 2008 or 2009. At some point, when the lack of growth momentum becomes obvious to all, there is likely to be a market bust, either of the 2008 deflationary variety or through accelerating inflation. Our belief continues to be that the degree of monetary easing to date has not yet been of a sufficient magnitude to prompt a surge in consumer prices, making a brief period of deflation the more likely outcome.

US Credit Market Debt

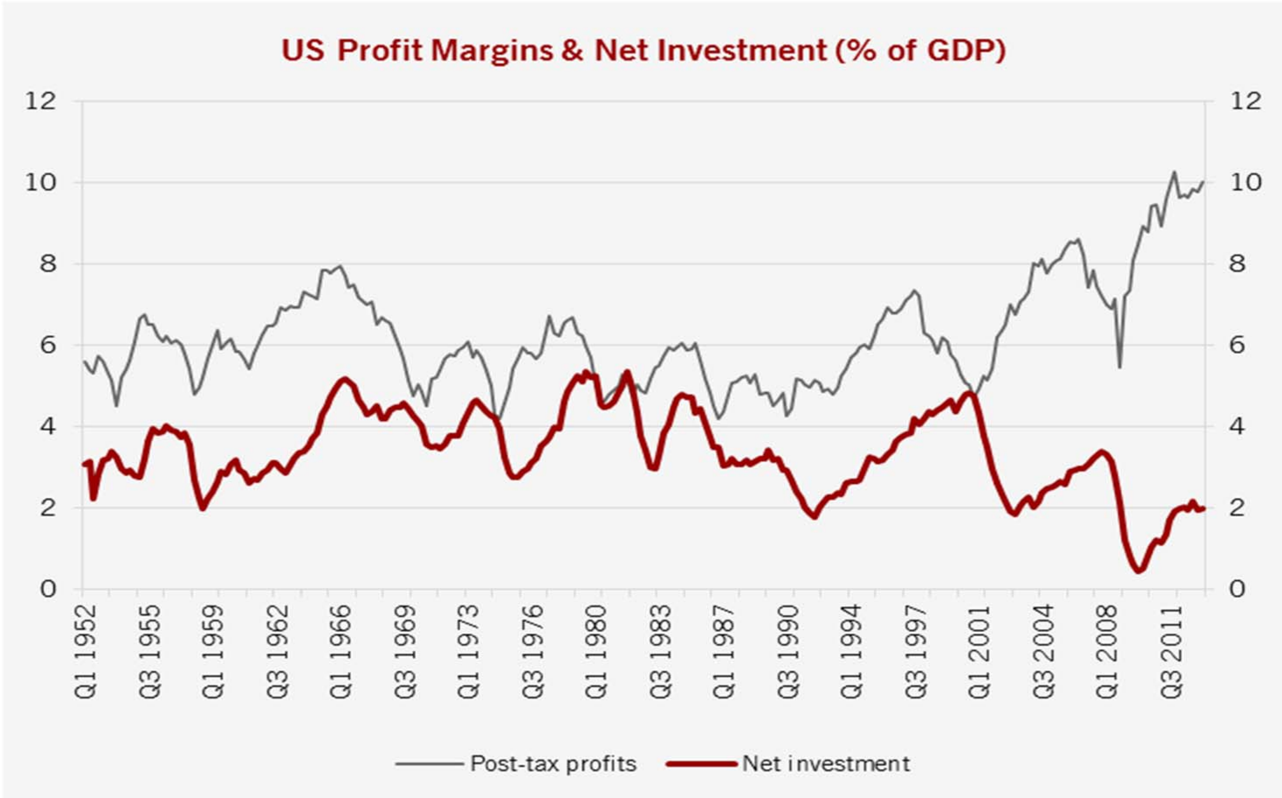
Share prices and company profits have risen, but the cost has been reigniting the credit excesses which produced the credit crunch of 2007 and 2008.



Source: Thomson Datastream / Pictet

US Profit Margins & Net Investment

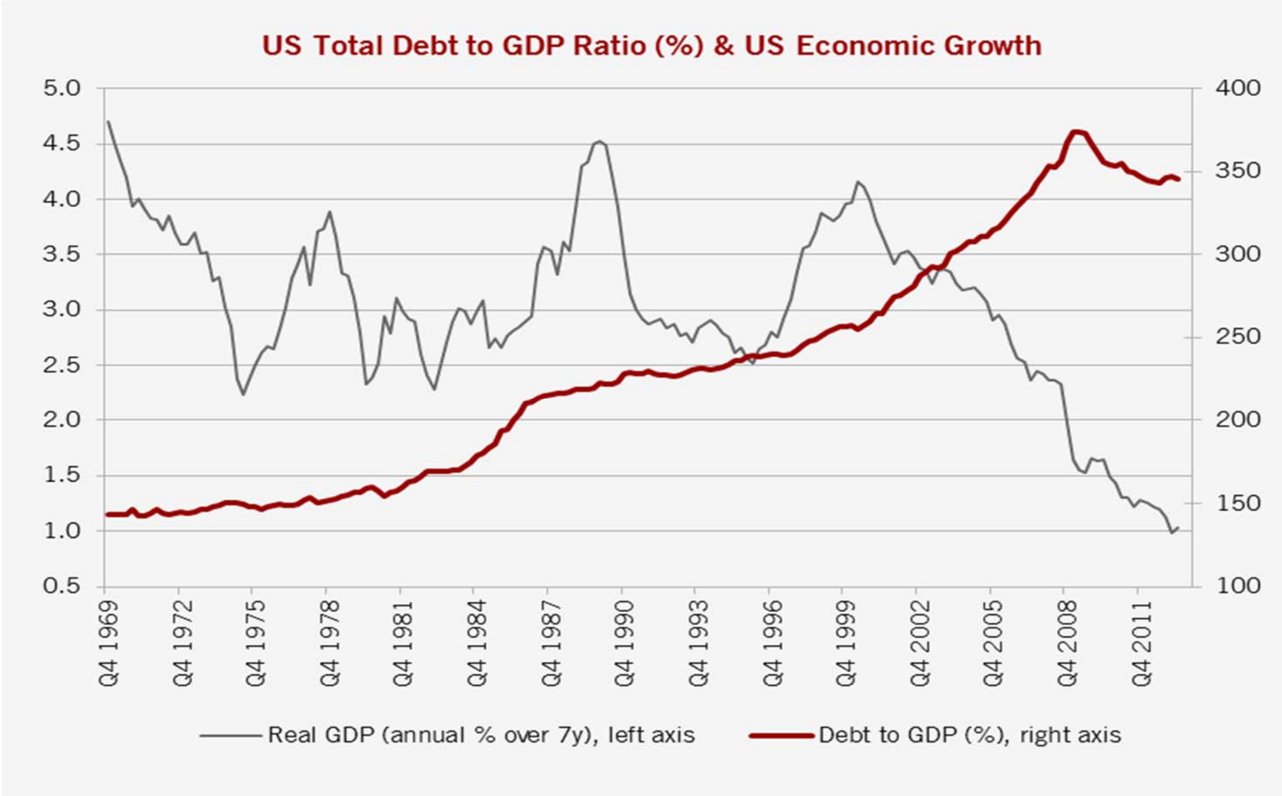
With a Central Bank supporting demand, firms have taken a back seat, such as cutting investments. Excellent for near-term profits, but very poor for long-term economic activity and long-term profits. In the early 1970s, US companies invested 15 times as much cash as they distributed to shareholders; in recent years the ratio has dropped to below two. With executives paid in bonuses linked to their share price there is an obvious incentive to boost short-term share performance over the expense of long-term growth.



Source: Thomson Datastream / Pictet

US Debt & Real GDP

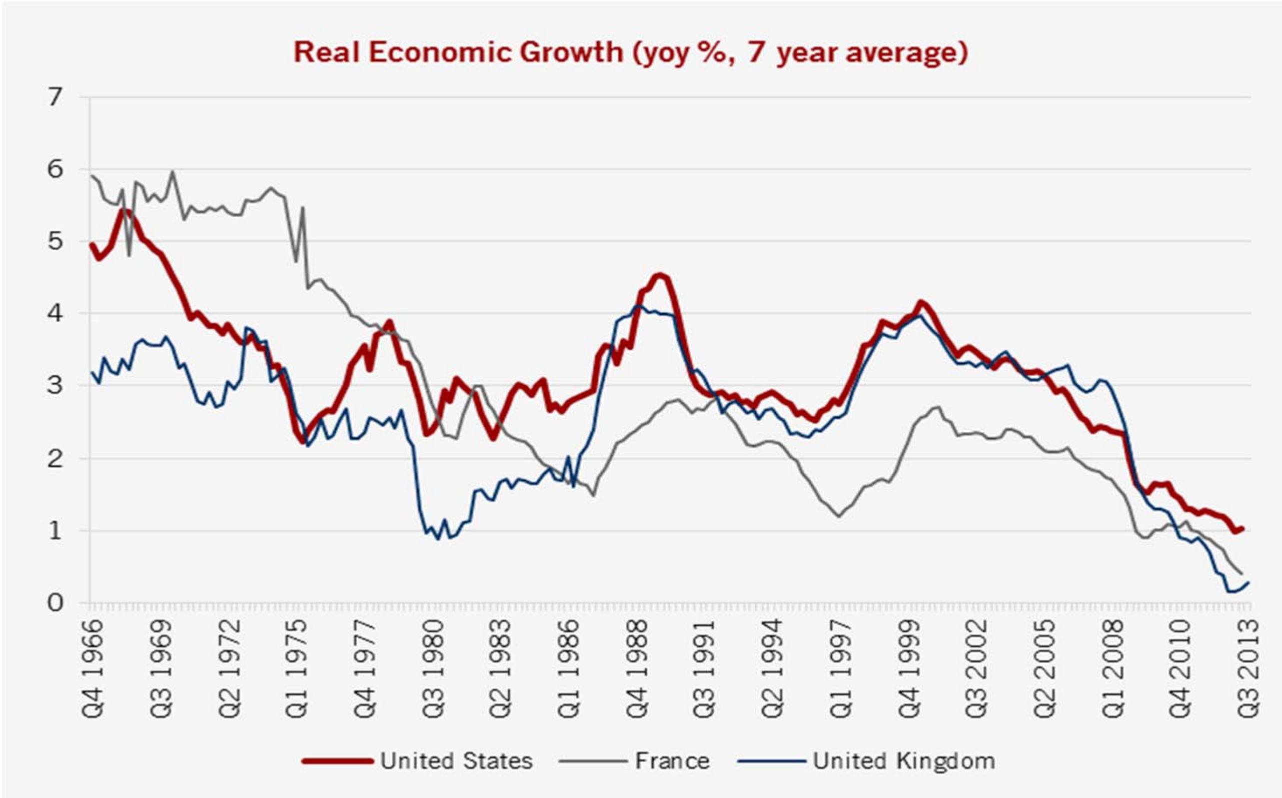
Rising debt levels can be beneficial for activity if used to support investment in both capital and labour. Since 2000, however, debt has fuelled a series of asset bubbles with no flow through to the real economy. Eventually, of course, it will be impossible for QE fixated investors to ignore the plight of the real economy and equities will tumble.



Source: Thomson Datastream / Pictet

Real Economic Growth: US, UK & France

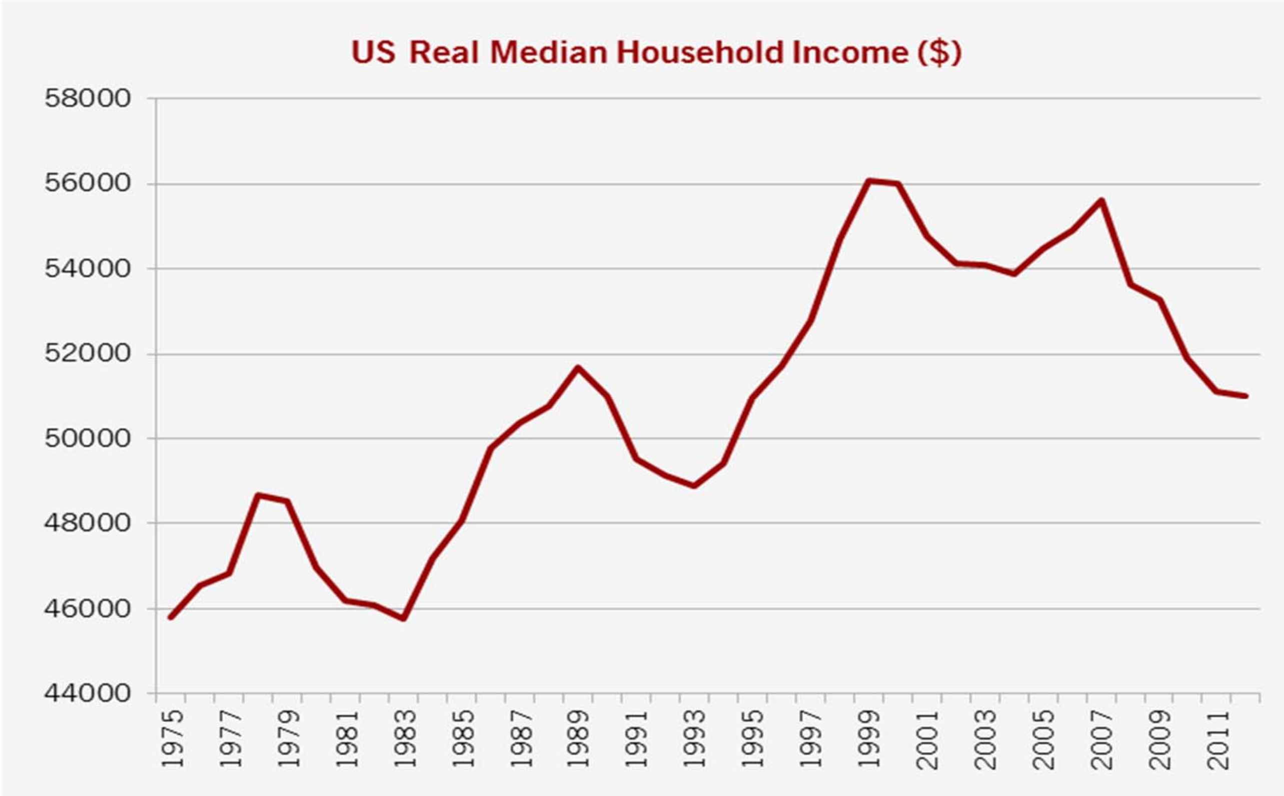
And note that the decline in growth rates is a common feature across the developed world. Moreover, with correlation across economies growth rates so high, any economic downturn ahead is likely to be synchronised, raising the risk, in such an eventuality, of a major and sustained global recession.



Source: Thomson Datastream / Pictet

US Household Income

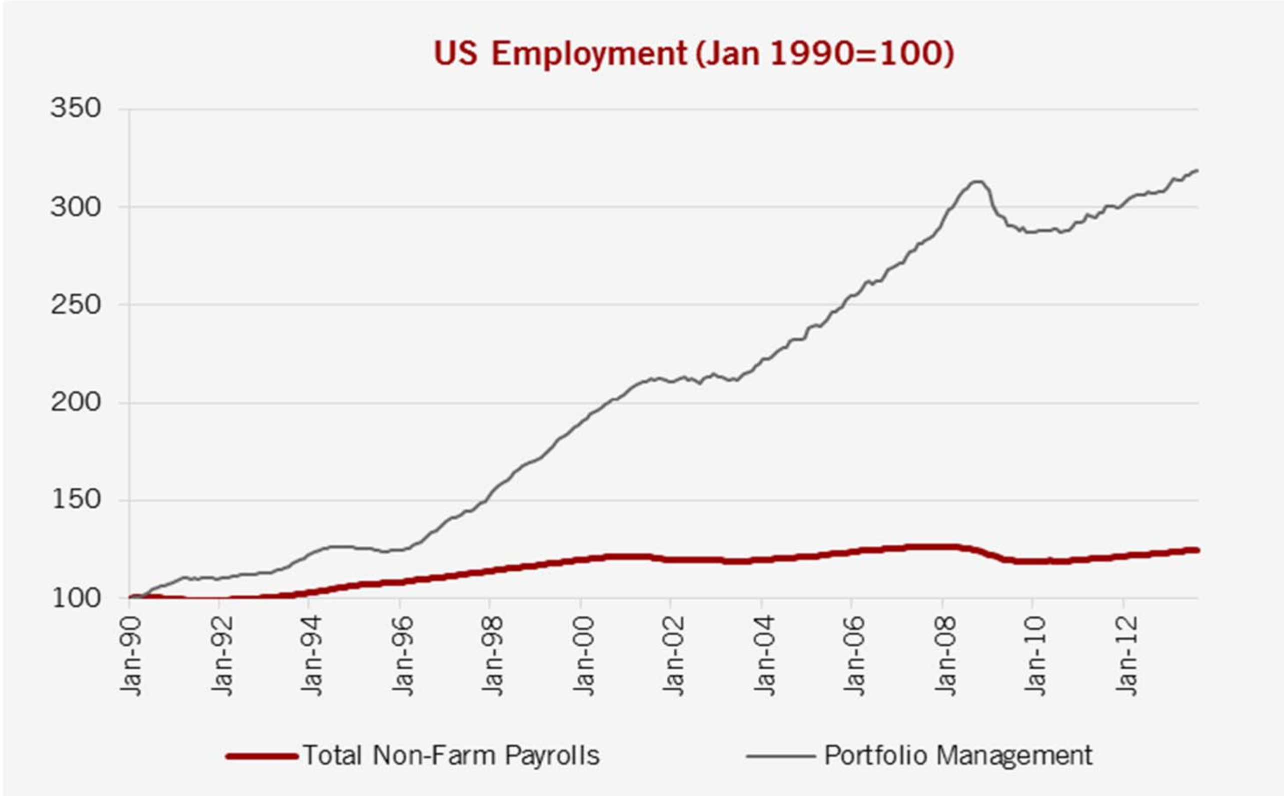
QE may have provided a short-term fillip for companies, but by preventing economic change the real economy is struggling. Most individuals continue to experience an erosion of real incomes. The latest reading for the US inflation-adjusted median household income is lower than that seen in 1989 and 9% lower than the peak seen in 1999.



Source: Thomson Datastream / Pictet

US Investment Professionals

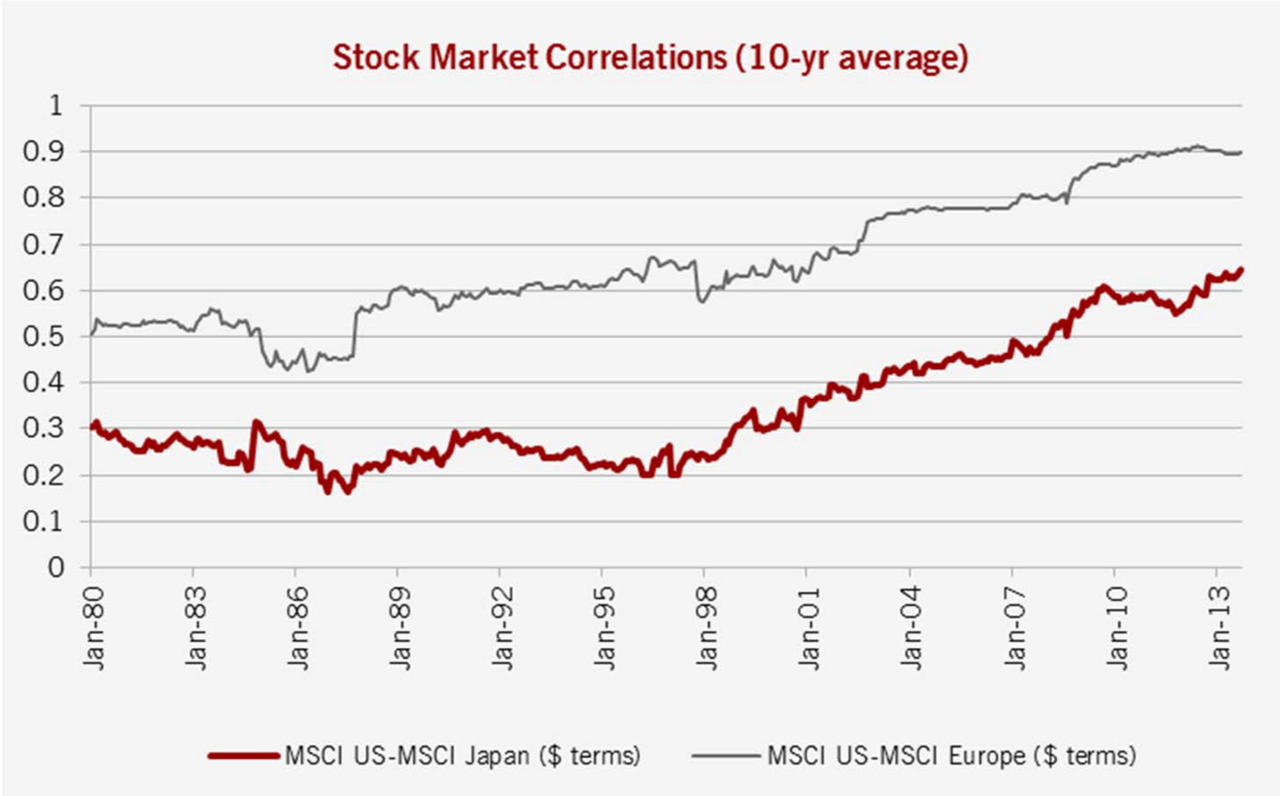
One area has, of course, done very well out of the consumption and financial asset bubble – the investment industry itself. No surprise then to see the sector advising that QE be continued.



Source: Thomson Datastream / Pictet

Stock Market Correlations

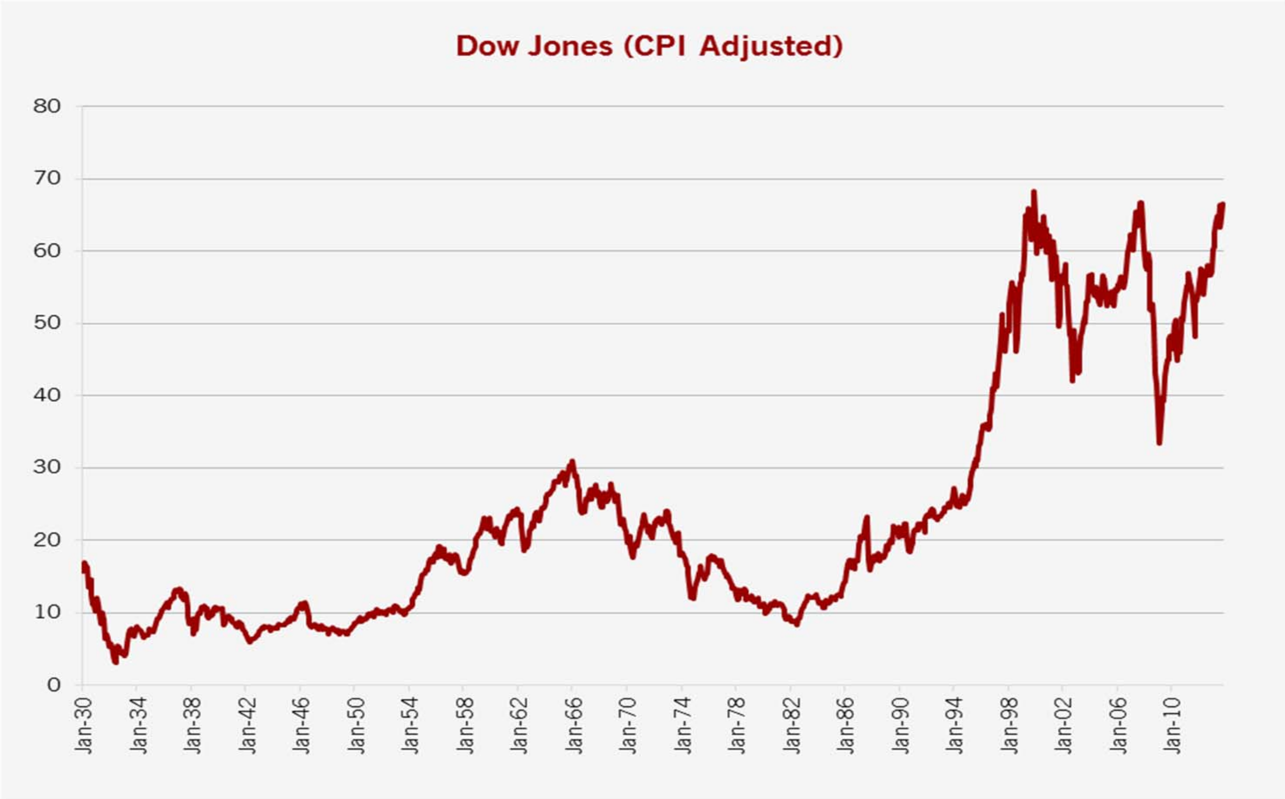
With the improved perception of Central Bankers, financial markets now move on every word of Bernanke and Co. Risk assets everywhere are led by monetary policy pronouncements in the US. No surprise then to see a striking rise in the correlation between movements in US equities and the rest of the world.



Source: Thomson Datastream / Pictet

Dow Jones Index

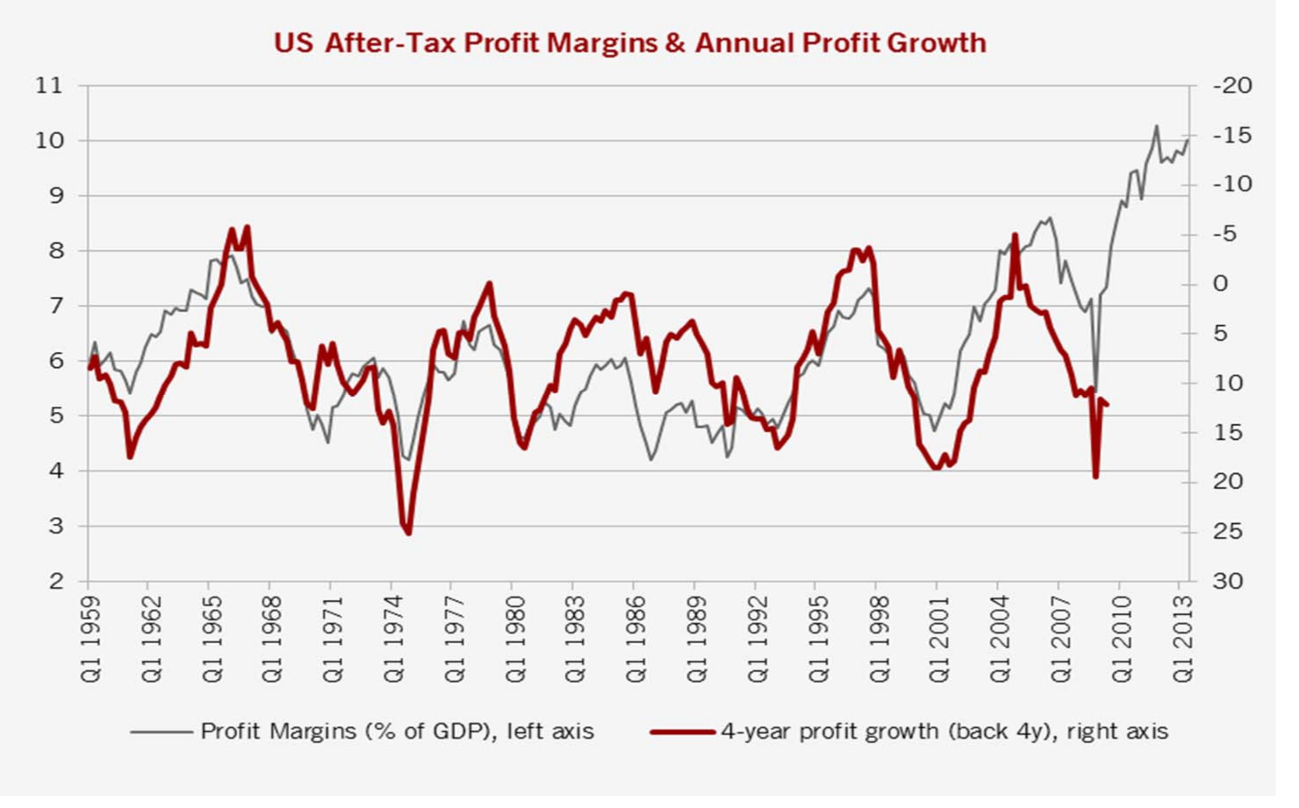
The real value of the US stock market witnessed a slow and erratic rise through most of the 20th Century. The surge in the late 1990s was associated with the adoption of easy monetary conditions and a spike in debt levels. Central Banks have spent the last decade attempting to prevent the debt edifice from collapsing. They will inevitably lose this battle.



Source: Thomson Datastream / Pictet

US Profit Margins & Profit Growth

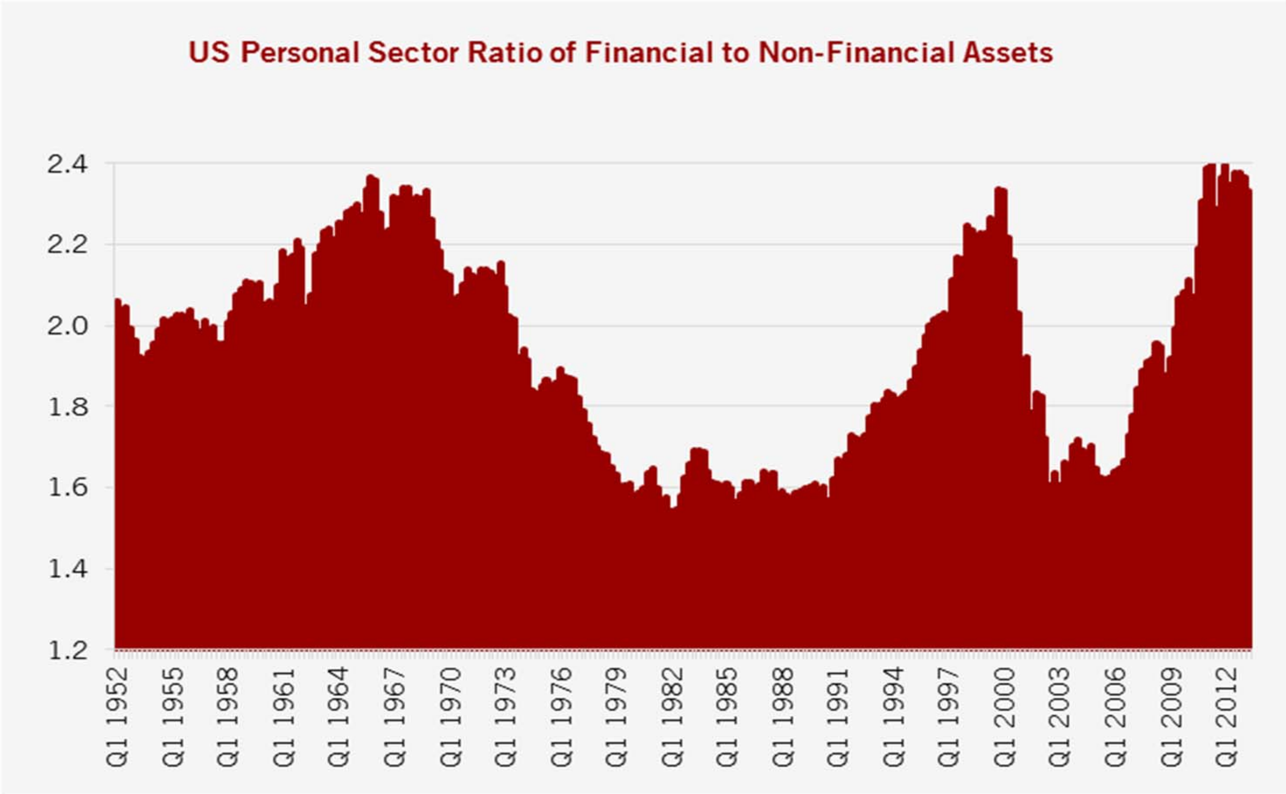
There is an established long-term inverse relationship between profit margins and profit growth over subsequent years. If the connection continues to hold, and we have no reason to think otherwise, then total profits could fall by 60% in the next four years.



Source: Thomson Datastream / Pictet

US Financial and Non-Financial Assets

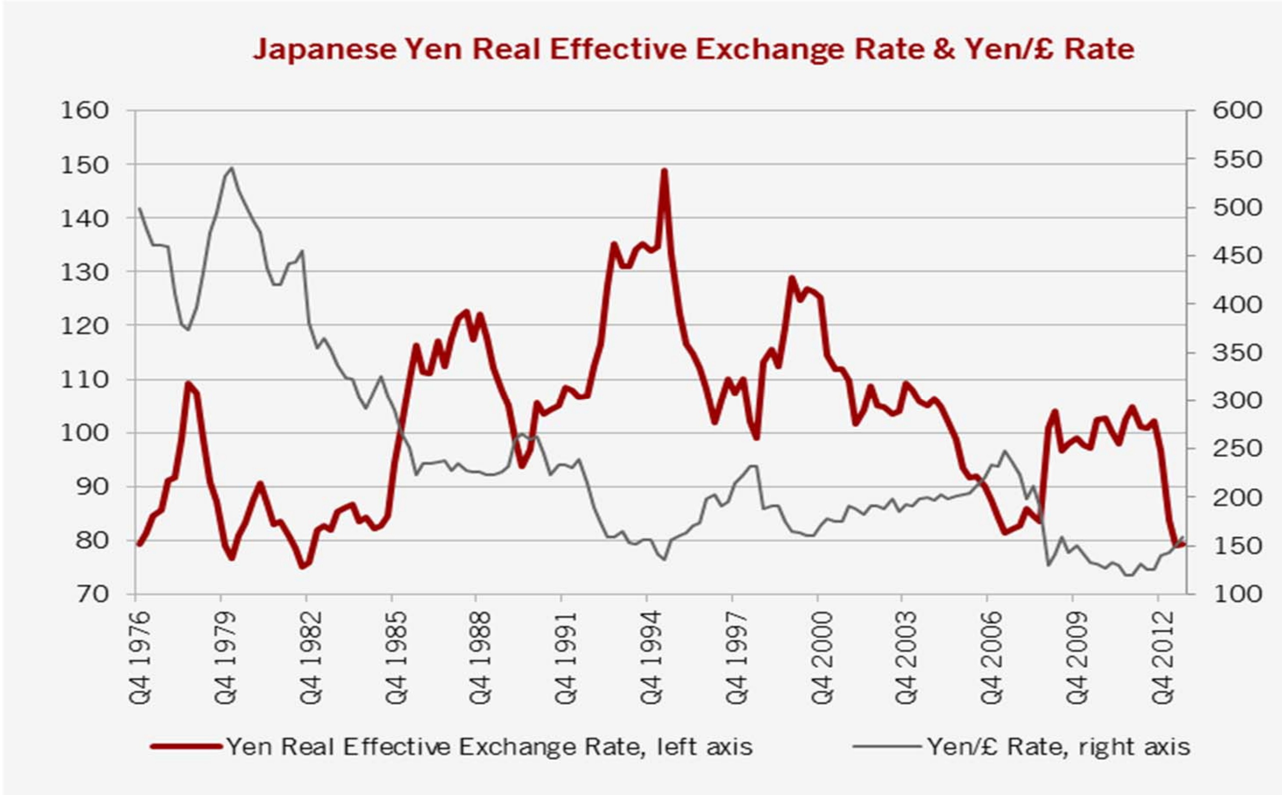
All of our work indicates that QE may have boosted the price of financial assets but has done very little for the real economy. The value of financial assets has been boosted by “moral hazard” i.e. the belief that buying equities will be rewarded because Central Banks are targeting asset prices. Sooner or later, however, the reality that long-term growth prospects have rarely been lower will dawn on investors and markets will fall sharply.



Source: Thomson Datastream / Pictet

Japanese Yen Real Effective Exchange Rate

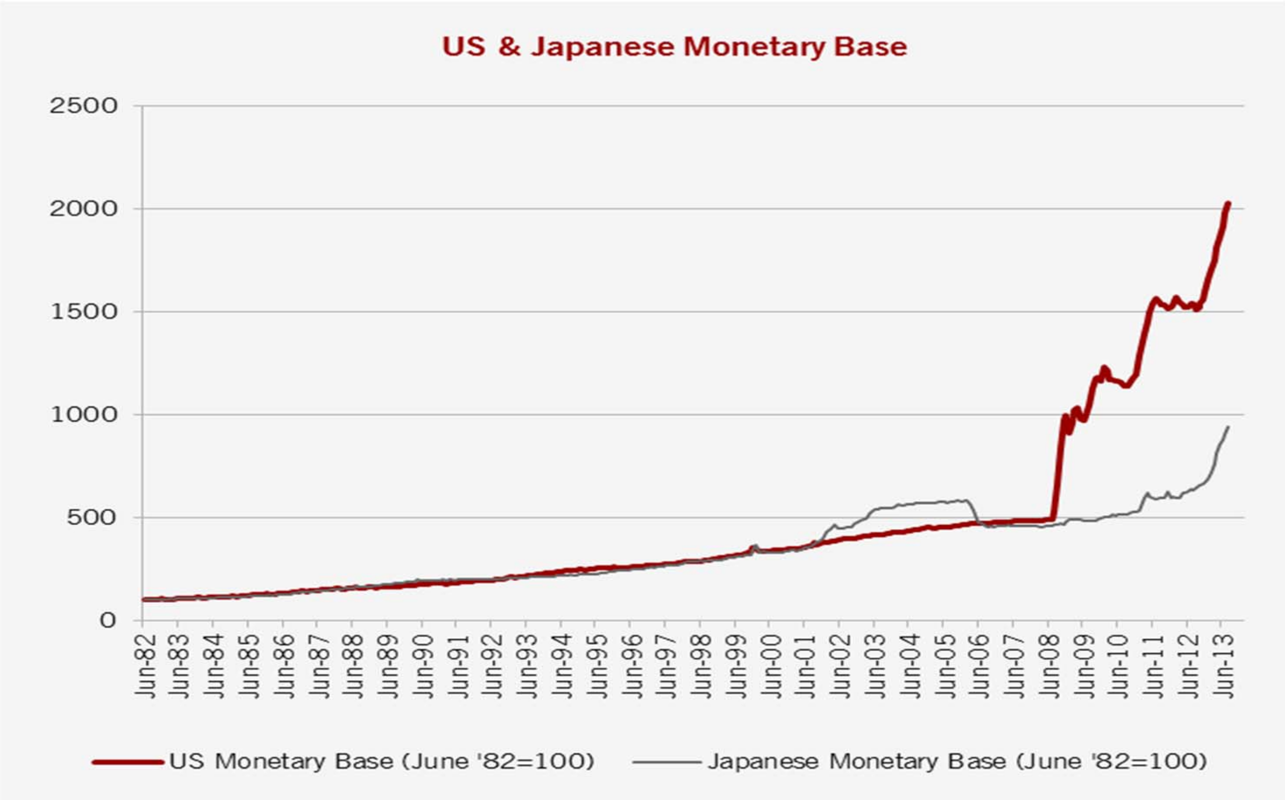
After recent weakness in the yen, holding yen going forward makes good sense. Indeed, the real effective yen exchange rate is now back close to forty year lows.



Source: Thomson Datastream / Pictet

US & Japanese Monetary Base

Many investors fear that money printing will ultimately translate into a sharp rise in inflation expectations and, even perhaps, a loss of confidence in money's ability to act as a reliable store of value. It is certainly true that money printing in the US and Japan has surged in recent years. In the case of the US, the monetary base has grown in size to a value almost 20% of GDP. Hard to know when the Rubicon is finally crossed, but I suspect this point is probably in excess of 25%.



Source: Thomson Datastream / Pictet

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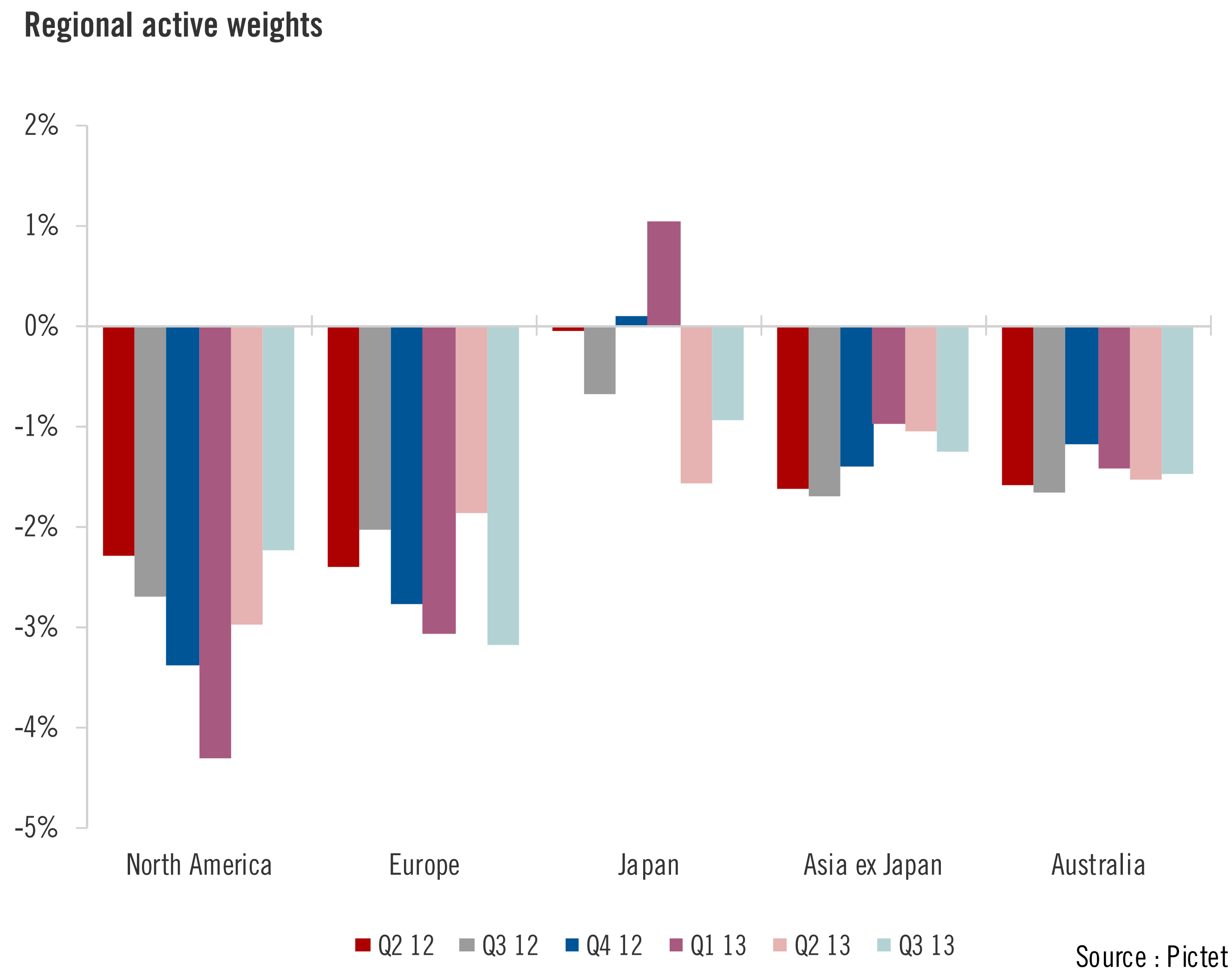
Portfolio positioning and strategy

Portfolio profile

	Portfolio Weight	Benchmark Weight	Active Position
Total	**100.0%**	**100.0%**	
North America	49.6%	51.9%	-2.2%
Europe	26.5%	29.7%	-3.2%
Japan	11.4%	12.3%	-0.9%
Asia ex Japan	3.1%	4.4%	-1.3%
Australia	0.2%	1.6%	-1.5%
[Cash]	**9.1%**	**0.0%**	

Portfolio: Dorset County Council
Index: MSCI Composite (53% North America, 12% Japan, 29% Europe ex UK, 6% Pacific ex Japan)
Source: Pictet / FactSet as at 30.09.2013

Evolution of relative regional weights



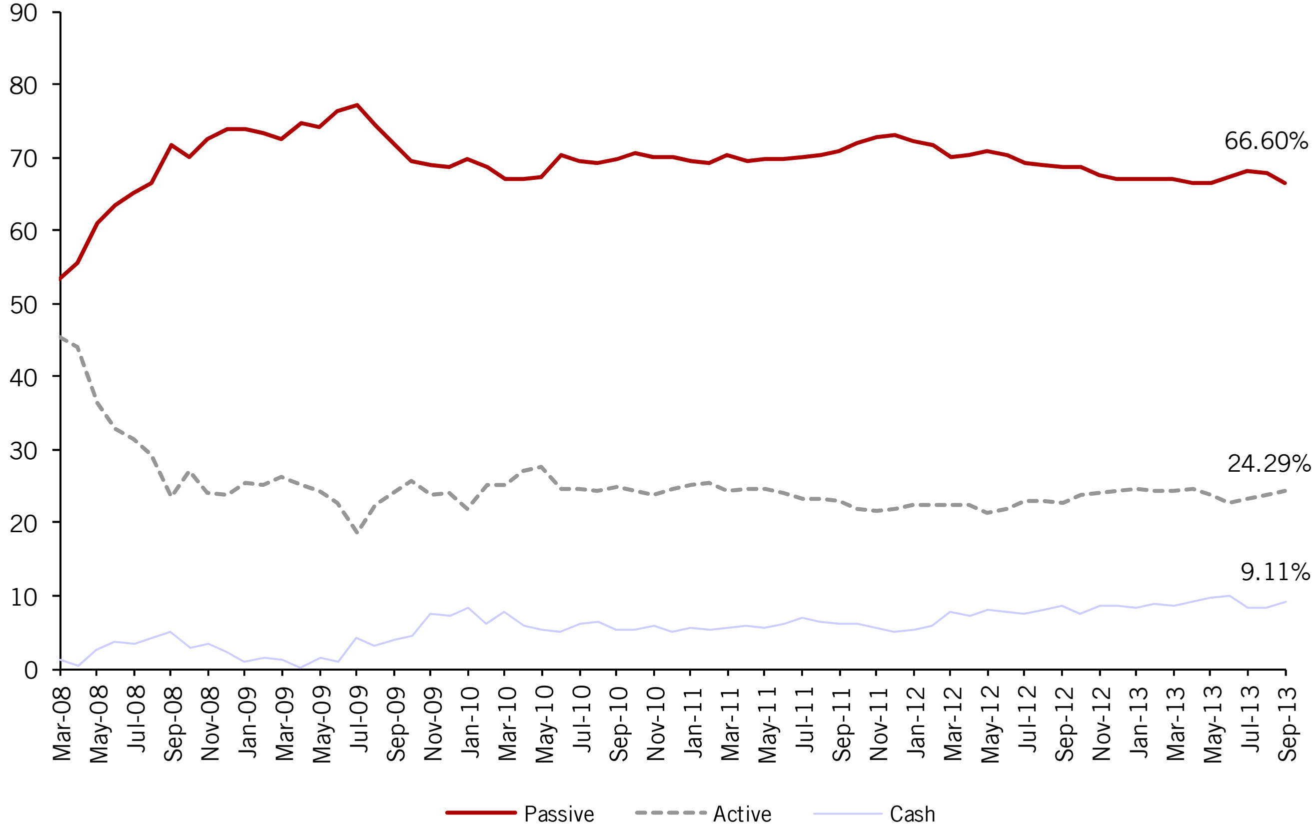
Source : Pictet

Portfolio: Dorset County Council
Index: MSCI Composite (53% North America, 12% Japan, 29% Europe ex UK, 6% Pacific ex Japan)
Source: Pictet / FactSet as at 30.09.2013

Dorset County Pension Fund - Evolution of Active and Passive Exposure

The two major changes made after March 2008 were to raise cash levels and to cut active equity exposure. Market exposure was raised again in late 2008/early 2009 as equities fell and cash levels bottomed at 0.2% of the total fund at end-April 2009. Since then, however, as equities have risen, the fund beta has gradually been reduced, reflecting our assessment of a steady fall in prospective equity returns.

% weights

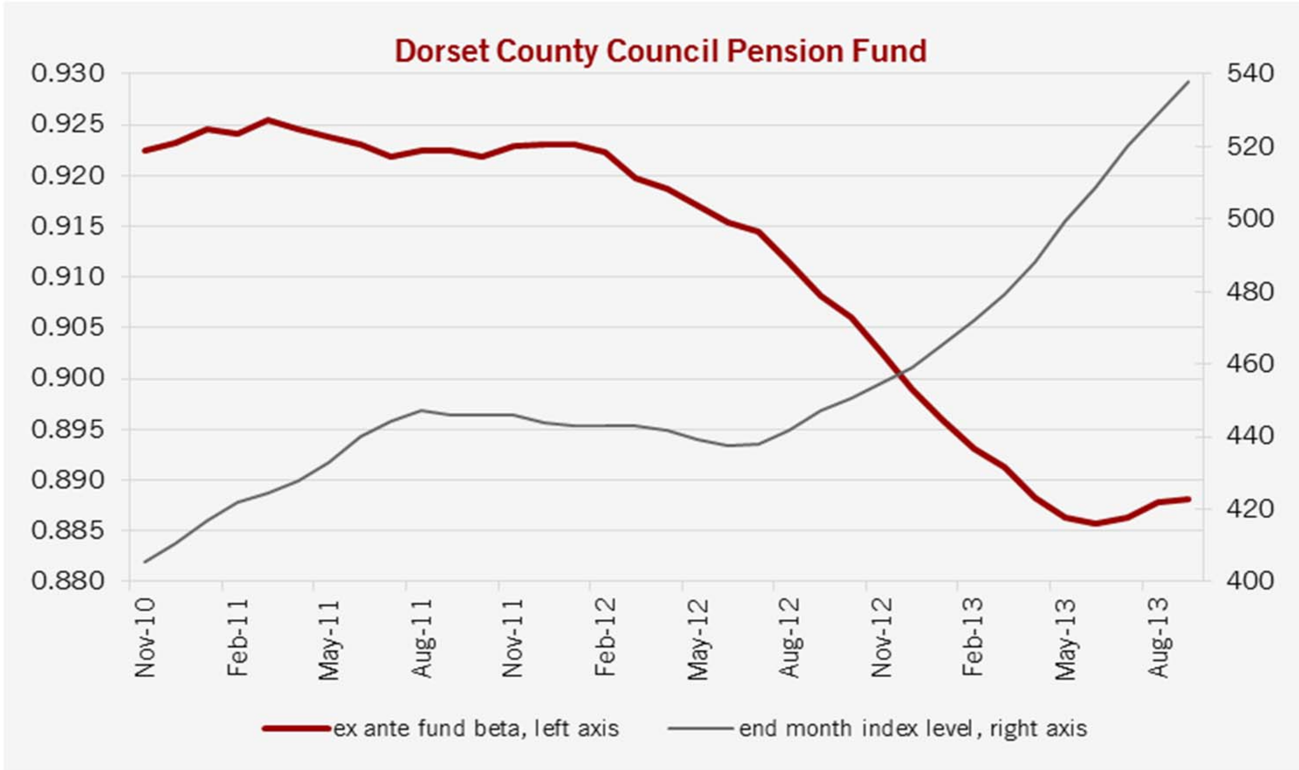


Portfolio: Dorset County Council
Source: Pictet. March 2008 to September 2013

Dorset County Pension Fund - Evolution of Ex Ante Beta

Contrarian picture if we look at end month ex ante fund beta calculations against end month index level readings. Estimated beta currently stands just below 0.890 and the likelihood is that portfolio beta will be reduced in coming months.

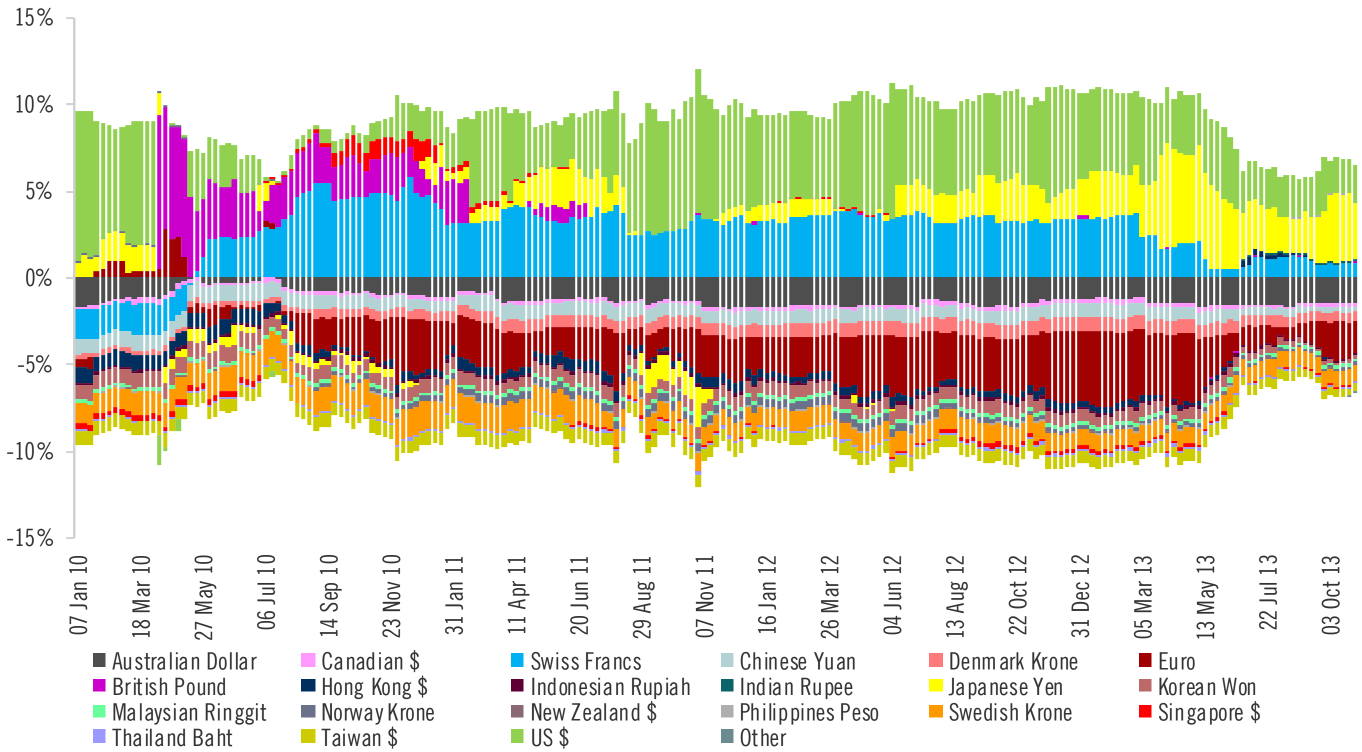
Dorset Fund Beta (ex ante, rolling 12 months)



Dorset County Pension Fund - Evolution of total currency exposure

Over the course of 2012 the largest overweight exposures of the fund was US$ (courtesy of a significant cash holding in dollars) and Swiss Francs (through an overweight in Swiss equities). During 2013, however, a sharp fall in the Japanese yen has provided an opportunity to raise exposure to this asset class.

Foreign Exchange Exposure – Active Weights



Source: Pictet

Appendix – Active portfolio profiles

1. Global portfolio profile – Geography, sector & size

Geographical profile - Europe

	Portfolio Weight	Benchmark Weight	Active Position
Total	100.0%	100.0%	
France	25.0%	22.3%	2.7%
Germany	22.4%	20.0%	2.4%
Italy	6.5%	4.7%	1.8%
Sweden	8.7%	7.4%	1.3%
Switzerland	21.8%	20.9%	0.9%
Norway	2.2%	1.8%	0.3%
Greece	0.0%	0.1%	-0.1%
Spain	7.0%	7.3%	-0.3%
Portugal	0.0%	0.4%	-0.4%
Austria	0.0%	0.7%	-0.7%
Ireland	0.0%	0.8%	-0.8%
Denmark	1.4%	2.6%	-1.2%
Belgium	1.4%	2.7%	-1.3%
Finland	0.0%	2.0%	-2.0%
Netherlands	3.7%	6.4%	-2.7%

Sector profile - Europe

	Portfolio Weight	Benchmark Weight	Active Position
Total	100.0%	100.0%	
Industrials	18.1%	13.9%	4.2%
IT	7.9%	4.4%	3.5%
Energy	9.5%	6.1%	3.4%
Cons. Disc.	12.6%	11.0%	1.6%
Financials	22.9%	21.5%	1.4%
Health Care	13.8%	14.5%	-0.7%
Utilities	1.2%	3.9%	-2.7%
Cons. Staples	9.8%	12.5%	-2.7%
Telecoms	2.0%	4.9%	-2.9%
Materials	2.3%	7.4%	-5.1%

Sector profile - Japan

	Portfolio Weight	Benchmark Weight	Active Position
Total	100.0%	100.0%	
Materials	11.1%	6.4%	4.7%
IT	13.2%	9.7%	3.5%
Telecoms	7.5%	5.2%	2.3%
Financials	23.1%	21.4%	1.7%
Energy	2.8%	1.1%	1.6%
Cons. Staples	5.6%	6.4%	-0.8%
Cons. Disc.	19.5%	21.5%	-2.0%
Industrials	17.4%	19.7%	-2.3%
Utilities	0.0%	2.9%	-2.9%
Health Care	0.0%	5.8%	-5.8%

Portfolio: Dorset County Council
Index: MSCI Composite (53% North America, 12% Japan, 29% Europe ex UK, 6% Pacific ex Japan)
Source: Pictet / /PAMFolio as at 30.09.2013

2. Portfolio profile – Active positions & risk

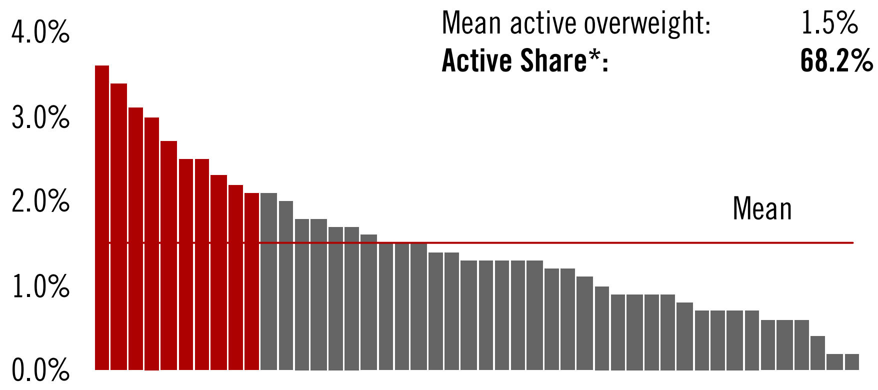
Top 10 active weights - Europe — **Number of positions: 46**

Holding name	Weight	Active weight
Roche Holding B.Jce	7.1%	3.6%
Nestle	7.5%	3.4%
Total	5.3%	3.1%
Adidas Nom.	3.4%	3.0%
Bnp Paribas	4.0%	2.7%
Schneider Electric	3.3%	2.5%
Alfa Laval	2.6%	2.5%
Publicis Groupe	2.6%	2.3%
Allianz Reg.	3.5%	2.2%
Telefon Ericsson 'B'	2.8%	2.1%

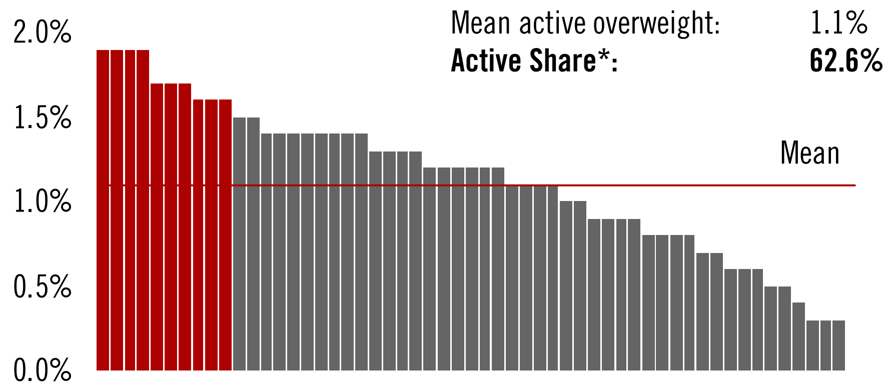
Top 10 active weights – Japan — **Number of positions: 56**

Holding name	Weight	Active weight
Nexon	2.0%	1.9%
Yamato Kogyo	1.9%	1.9%
DIC	1.9%	1.9%
Omron	2.1%	1.9%
Sumitomo Mitsui Financial Group	3.9%	1.7%
Tsuruha Holdings	1.7%	1.7%
Mitsubishi Ufj Lease & Finance	1.8%	1.7%
Daicel	1.7%	1.6%
Ryohin Keikaku	1.6%	1.6%
Hitachi High-Technologies	1.6%	1.6%

Stocks held - active weight profile (top 10 highlighted)



Stocks held - active weight profile (top 10 highlighted) - Japan



Portfolio: Dorset County Council. Benchmark is MSCI Composite. Rebalanced to 100% (53% North America, 12% Japan, 29% Europe ex UK, 6% Pacific ex Japan)
*Sum of positive active weights in the portfolio or, how much of the portfolio is different from the index.
Source: Pictet / PAMFolio, as at 30.09.2013

Biographies

Biography

Mike Collins

Senior Investment Manager

Balanced and Quantitative Investment Team

Mike Collins joined Pictet Asset Management in 1999. He is a Senior Investment Manager and provides top down asset allocation and strategy recommendations for Pictet Asset Management.

Before joining Pictet, he worked in the economics and strategy team of Norwich Union Investment Management. As well as providing analysis of the UK and mainland Europe, he was also responsible for top level asset allocation and long term investment strategies for some of their funds.

Mike graduated from the University of Durham with a first class degree in Economics.

Akua Brako - Raja

Client Relationship Manager

CRM team

Akua Brako joined Pictet Asset Management in 2005 as a Client Relationship Manager.

Before joining Pictet, she worked at Fidelity Investments with responsibility for Client Services.

Akua graduated from King's College London in 2003 with a BA in German with Applied Computing. She has also completed the Securities Institute – Investment Administration Qualification before becoming an Investment Management Certificate holder.

Glen Cargill

Head

CRM International team

Glen Cargill joined Pictet Asset Management in 2005 as a Senior Client Relationship Manager with responsibility for North American clients. In 2010 he was appointed Head of the International Client Relationship Management team based in London.

Before joining Pictet, Glen spent nine years with HSBC Investments (UK) Limited where he was an Associate Director responsible for relationships with a wide range of pension fund and mutual fund clients. He previously spent five years with the Save & Prosper Group in London.

Glen is a Chartered Fellow of the Chartered Institute for Securities & Investment and also holds the Investment Management Certificate (IMC).

For more information, please contact

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