Dorset County Pension Fund - DAAF Report

Quarterly Investment Review

Q4 2013

Contents

Summary

Performance Versus Performance Comparison In GBP Terms (%) - Periods To 31 December 2013

Portfolio Value (GBP)	
30 September 2013	91,372,734
31 December 2013	93,199,361

Inception: 30 March 2012

Source: Barings, Net of fees

Periods over 1 year are annualised

Performance Comparison: Sterling LIBOR +4%

The above returns and values are based on your investment in the Fund. The remainder of the report is based on the overall investment Fund.

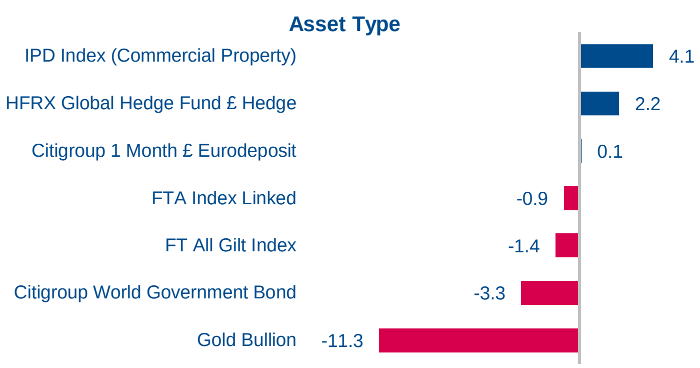
The Fund was again ahead of its stated objective over the quarter, with a return of 2.0%, versus a return of 1.1% for 3m LIBOR+400 basis points. The Fund is also ahead over the one year period with a return of 7.9% versus its investment objective of 4.5%. It is also just ahead over the three year rolling period and since the inception of the Fund.

We are slightly disappointed with returns over both the quarter and the year, given that we have favoured equities in a bull market. Sterling has been strong, so our exposure to overseas currencies, particularly the US dollar, has been negative. We have mitigated this by hedging significant amounts of foreign assets back into Sterling, but even the residual exposure has been a negative influence.

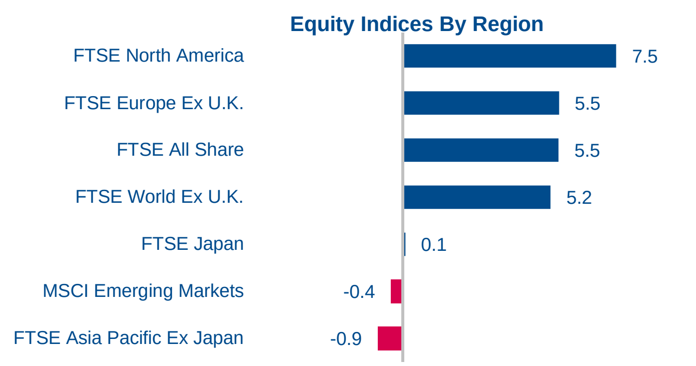
In addition, bond markets have generally been weak, and despite having mostly short-duration positions that were less badly affected by bond market weakness, it still cost us performance. Similar factors affected our holdings in Gold bullion and, to a lesser extent, hedge funds, which were denominated in US dollars, and even cash holdings.

Looking out from here, while equities look fully valued versus bonds, they stand to benefit from an improved earnings outlook, and we expect equity markets to move into higher ground this cycle, at least in part due to the very supportive nature of global monetary policy. There remain significant risks in the current environment, however, and the possibility of higher levels of volatility in financial markets should not be discounted.

Market Review - In GBP Terms (%) - Q4 2013



Source: FTSE, Citigroup, IPD, HFRI, Barings



Source: FTSE, MSCI, Barings

Fixed income markets generally delivered negative returns over the course of the quarter as the Federal Reserve and other central banks started to "taper back" the level of bond buying provided at the height of the financial crisis.

Gilts returned -1.4% this quarter, with investors tending to favour equities instead, while index-linked bonds also declined. US Treasury yields moved higher, supported by generally strong economic data, and the Citi World Government Bond Index returned -3.3%.

Commercial property had a strong quarter, helped by growth in the real economy, while hedge funds and other alternative investments have also started to perform well in this environment.

Gold bullion fell sharply as the prospect of inflation remains distant, at least in the short term, and investors saw little diversification value in continuing to hold Gold bullion.

Developed equity markets have continued to benefit from the combination of better than expected economic data and supportive central bank policy.

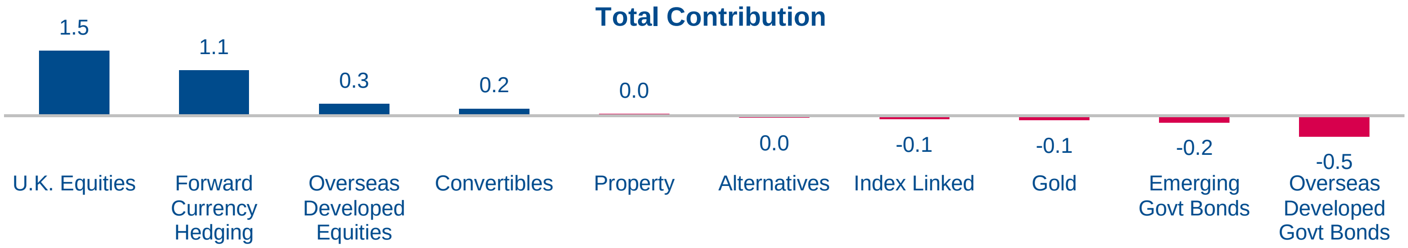
The US market led the way, with a 7.5% return from the FTSE North America Index. UK and European equities both returned a strong 5.5% in Sterling terms, while World ex UK equities lagged slightly with a 5.2% rise.

In spite of strong returns in local currency terms, the continued decline of the Japanese Yen against Sterling left the Japan equity market struggling to post a positive return this quarter.

Emerging markets once again delivered lacklustre returns in an environment where developed economies have been leading global growth. The MSCI Emerging Markets Index delivered a return of -0.4% in Sterling terms.

Performance - Q4 2013

Absolute Returns & Contributions (%)



Region / Asset Type	Account Return (%)	Total Contribution (%)
U.K. Equities	6.4	1.5
Forward Currency Hedging	n/a	1.1
Overseas Developed Equities	1.2	0.3
Convertibles	3.0	0.2
Property	1.1	0.0
Alternatives	-1.8	0.0
Index Linked	-6.7	-0.1
Gold	n/a	-0.1
Emerging Govt Bonds	-3.4	-0.2
Overseas Developed Govt Bonds	-7.1	-0.5
Total		**2.1**

Performance Summary

The Fund continued to have a preference for equities over bonds in Q4, with the biggest contributor to returns coming from UK equities. Here, both the large and small cap allocation performed well, both performing in excess of their respective indices.

Overseas developed equities also contributed positively in terms of the US, Europe and Global allocations. However the performance of Japanese equities was more muted due to a negative contribution from stock selection over the quarter.

Exposure to US and Australian government bonds detracted value despite the reduced allocation. Overseas developed bonds returned -0.5 per cent. Sterling strength persisted and the Fund made use of forward hedging to reduce non-Sterling risk, which positively contributed 1.1 per cent to performance.

Exposure to US High Yield in Sterling terms produced a flat return over the period, while Convertible bonds fared better, contributing 0.2 per cent to overall returns. The poor performance in Emerging government bonds continued, especially in Sterling terms. Having established a 1.5 per cent position in the Fund post the summer rout, the allocation contributed -0.2 to returns in Q4.

Property contributed a flat return over the quarter as performance from the underlying investments was offset by the initial cost of purchase.

Gold performed poorly over the quarter. The position was cut severely over the year, and the allocation has now been removed from the portfolio as we see little chance for sustained appreciation in the asset while providing little diversification.

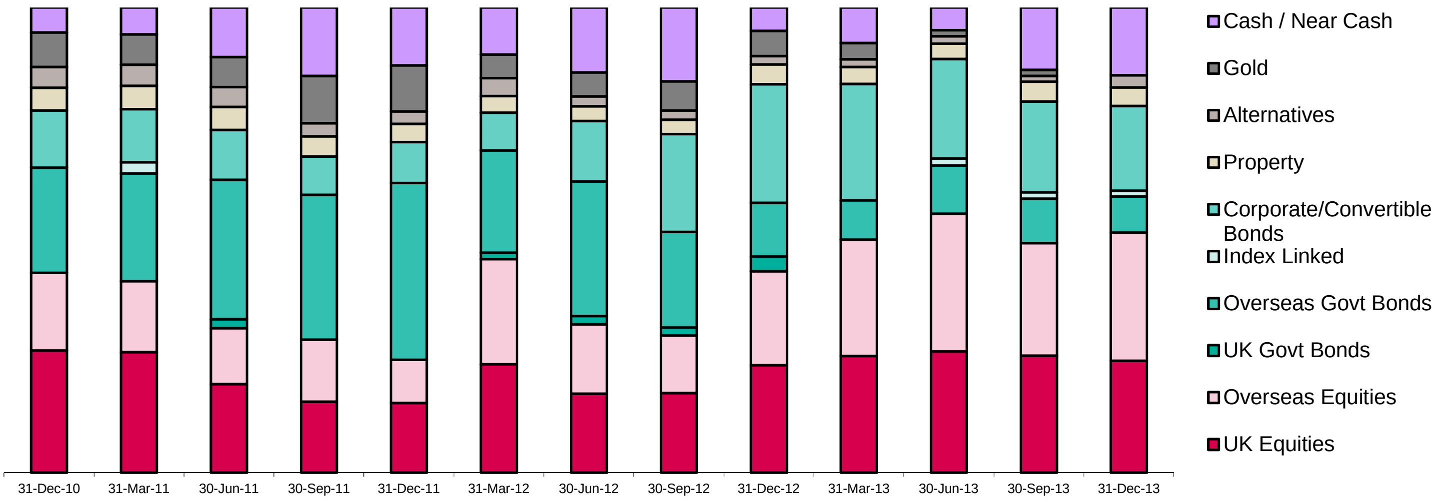
Major Stock Contributions To Return (%)

Name	Contribution (%)	End Weight (%)	Region / Asset Type
Baring UK Equity Component Fund	1.0	16.9	U.K. Equities
Legal & General US Index Trust	0.3	4.0	USA Equities
AXA UK Select Opportunities	0.2	3.3	U.K. Equities
Baring Europe Ex UK Fund	0.2	3.3	Europe Ex UK
Baring Global Growth Trust	0.2	3.1	Global Equity Funds
Cazenove UK Opportunities	0.1	2.6	U.K. Equities
Old Mutual UK Alpha	0.1	1.7	U.K. Equities
US Treasury 2.875% 15May2043	-0.1	1.7	USD Govt Bonds
Baring Asia Pacific Equity Component Fund	-0.2	10.0	Japan Equities
Australia 3.25% 21Apr2029	-0.3	0.8	Asia Pacific Govt Bonds

Source: Barings, Gross of Fees

Investment Strategy

Baring Dynamic Asset Allocation Fund - Changes in Asset Allocation Rolling 3 Years



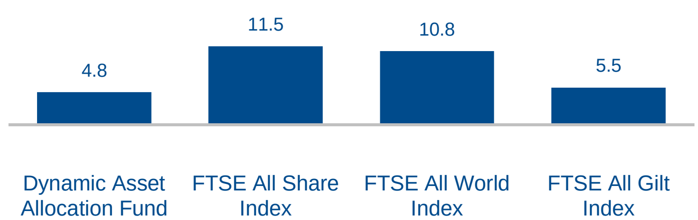
The 'Cash' weight, where applicable, may include cash on deposit, cash funds, short dated T-Bills (or equivalent), FFX, income receivable and initial margin, variation margin and cash backing deposits.

Futures are allocated on an economic exposure basis.

Top 10 Holdings - 31 December 2013

Name	Weight (%)	Region / Asset Type
Baring UK Equity Component Fund	16.9	UK Equities
Baring Asia Pacific Equity Component Fund	10.0	Japan Equities
Legal & General US Index Trust	4.0	USA Equities
Muzinich Americayield Fund	3.5	HY US Non Govt Bonds
AXA UK Select Opportunities	3.3	UK Equities
Baring Europe Ex UK Fund	3.3	Europe Ex UK
Baring Global Growth Trust	3.1	Global Equity Funds
Neuberger High Yield Bond	3.0	HY US Non Govt Bonds
AXA Short Duration High Yield Fund	2.9	HY US Non Govt Bonds
NT Bishopsgate Long Term Property	2.8	UK Property

Risk Characteristics



Annualised Volatility % (Rolling 3 Years)

The chart at the top of the page suggests that we have made few asset allocation changes over the quarter. That is indeed the case, though there have been a few subtle changes at the margin.

We have, as in previous quarters, continued to reduce the Fund's exposure to interest rate risk by further cuts in our exposure to Australian Government bonds and UK investment grade credit. Elsewhere within the fixed income portion of the portfolio, following the sharp sell off in Emerging market sovereign debt during the summer, we have established a small position in Russian and Mexican local currency debt, which when combined with Polish dollar bonds represent 1.5% of the Fund.

With monetary stimulus slowly being removed in the United States, and with it the worst fears of an imminent inflationary scare, Gold has continued to fall and we have sold our remaining holding.

In seeking to find effective diversification we have increased the Fund's exposure to Hedge Funds. Well managed, we believe they will offer superior returns over bonds, though they are unlikley to keep up with equities, which we still favour though with a little less enthusiasm today following the higher-than-expected returns last year.

Within the equity portion of the Fund, we have made very minor adjustments. UK Small cap exposure has been reduced in favour of similar sized companies in Europe.

Elsewhere, we have initiated a small position in South Korea, our favoured Emerging equity market, and expect to add a smaller position in Taiwan in the coming weeks. For much of the last year we have had little to no exposure to Emerging market equities.

It is apparent that analysts are overly optimistic about the prospects for earnings growth even as the world recovery seems to be gaining ground. Portfolio insurance in the form of Put options is currently cheap, so we have sought to protect the Fund from any sharp set-back in equity markets with some Puts on some of our UK, US and European equity exposure.

Sterling has continued to strengthen against most of the major currencies. In order to ensure that the Fund is not disadvantaged, we have further increased the currency hedging of overseas assets back into Sterling. Currently the Fund's net currency exposure stands at around 80% Sterling.

Source: Barings

Economic data in the West have consistently, if modestly, surprised on the upside over recent months, and our confidence in the recovery is growing, even if the scale of the recovery remains muted.

In the US we have continued to see good employment data, with the three month average for job creation around 200,000 per month. Confidence in the resilience of the employment market is also improving, as evidenced by the rise in the "quit" ratio. People are more willing to walk out of existing jobs without the security of a new position. Retail sales have also been gently gaining ground and housing activity and car sales continue to make headway even with slightly higher mortgage rates. Capital investment has remained soft, but all the survey data on corporate spending plans are pointing towards a modest recovery in coming months.

Perhaps most encouraging was the evidence that the US economy had sailed through the recent government shut down without any appreciable damage. Maybe this is one benefit that comes from increasing cynicism among the general public about national politics. The political fallout from the budget fight seems to have been sufficiently negative (especially for the Republicans) that it has provoked a rare display of concord between the parties, with the result that the House of Representatives actually passed a new spending bill that will allow the government to go on functioning for the next two years. That counts as a very long time horizon in the context of US politics.

With that uncertainty out of the way, the Fed has now moved to taper its bond buying programme by US$10 billion per month. It has not committed itself to a fixed time horizon to completely end its intervention, but the consensus is now for purchases to gradually wind down and to cease by the end of 2014. Given the latest print of US GDP at 4.1% for Q3, the justification for further quantitative easing is ebbing away rapidly. Even so, we believe that the Fed will remain very sensitive to the data flow and will adapt the speed of its "tapering" accordingly. It may also allow them to "un-taper" and reverse the process if the data suddenly falls away. They also took the opportunity to further extend their monetary guidance on interest rates with the declaration that rates would not rise until unemployment was significantly below the 6.5% level.

One area we will still be keeping a very close eye on is inflation. Recent data has remained very soft. Activity may be rising, but not at a sufficiently fast rate to take up spare capacity fast enough to get prices rising. So even in the strongest of the major economies, deflationary forces are still powerful. This is not just a US phenomenon. It could tap into a global theme with increasing intensity over the next year – one of low, or stagnating global demand and very weak pricing. For the moment we do not believe that it will turn into outright deflation, which would be a very threatening development. But the situation bears close scrutiny over the coming months.

Turning to Europe, we have revised up the outlook slightly even on the Continent, as Germany seems to be showing renewed signs of life. Certainly the leading indicators there are turning up again. Meanwhile, the compromise agreement that allowed the SPD to form a grand coalition government with Mrs Merkel's CDU/CSU includes provisions for higher minimum wages and slightly more generous pensions. This will provide a modest fillip to domestic demand there, even as it undermines tight control of unit costs. Housing activity is also picking up and house prices are actually rising for the first time in over a decade. Peripheral countries are also doing better, with Ireland now out of special measures, Greece getting into a primary surplus on its budget and Spain seeing a remarkable turnaround in its balance of payments. But the picture is clouded by the developments in France, where the economy looks as if it is slumping back into recession and in Italy, where there has been very little sign of any recovery and the government seems to lack any appetite for reform.

Another worrying sign is the continued shrinkage in credit in the banking system. With the European Central Bank stress test due next year, banks are likely to have to raise very large amounts of capital to help offset even greater write-offs on non-performing loans. In the meantime, they are still shedding assets, restricting credit to the business and personal sector and keeping credit spreads high.

This suggests to us that while the fiscal squeeze may well be minimal next year, as indeed it has been in 2013 given the number of countries which have made no progress in hitting deficit reduction targets, European growth will remain anaemic in 2014, at say an average of about 1% across the continent. Unfortunately, in contrast to the US, the reaction function of the European Central Bank also remains low. The internal split, with a German led faction resistant to unorthodox measures, means that we will need bad news to spur a significant policy response.

The UK has followed the US pattern of continuous upgrades in recent months led by the housing and car sectors. Overall retail sales have been patchy, reflecting the continued squeeze on real incomes. After all, UK consumers have not had the benefit of shale oil and gas deflating energy costs. There is also a high degree of scepticism that the housing recovery is built on sand and that when we actually start building enough houses to meet demand, the bubble could deflate dramatically. The Bank of England has at least ended some of the most stimulatory measures. However, the planning laws permanently squeeze the ability of house builders to meet demand, so we see little risk of a big setback this side of the next election.

Within Europe, the UK is likely to be one of the strongest economies next year, with growth likely to be towards the 3% level. This should improve the fortunes of the incumbent government, but it may be too late to overcome the opposition lead in the polls. It is possible that by the end of the year that the markets begin to fret about the possibility of a populist left-biased Labour Party returning to power. In the meantime, Sterling has continued to strengthen, a development that is likely to hamper a rebalancing of the economy towards the manufacturing sector. It could also leave the currency vulnerable to a sudden turn in sentiment as the election approaches.

In Japan, the latest data has been a little softer, but not so much as to seriously challenge the recovery. All attention is focused on the impact of the April sales tax rise. If this hits domestic demand hard, then Mr Abe's economic recovery plan could be jeopardised. We are watching closely for whether the Japanese corporate sector raises labour rates and pays higher winter bonuses. This would help to mitigate the tax rise and give support to a sustained consumer recovery. The latest data points on employment, wage growth and inflation have all been positive, but the news trend needs to remain positive beyond April for a sceptical investment community to be convinced that Mr Abe has made a decisive break in the deflationary trend.

The other major economy on watch is China. There still seems to be a policy conflict between the Central Bank, which wants to curtail the level of credit growth and the Administration, which wants to maintain GDP growth at 7.5%. Over the past weeks the interbank market has shown clear signs of stress, similar to the period in June during the "Taper Tantrum", with short-term repo rates climbing sharply above 8%. This suggests that many banks were struggling to finance themselves. The People's Bank of China provided emergency liquidity to stop any institution failing, but was slow to allow a general relaxation of conditions. How long it is allowed to maintain this stance is open to question, but the longer it plays hardball the more likely that growth rates will fall again.

Investment Outlook

Equities have had a very strong run, with most markets up by 20% or more. Hence, our recent decision to moderate our equity exposure in the expectation that there would be a pause, or even a modest pull back as markets digested the signalled end to quantitative easing and some disappointing earnings in Europe particularly. There has been some talk of equity market valuations reaching unsustainable levels. Our work does not support that view.

Rather, equities look fully valued versus bonds, but stand to benefit from the improvement in the earnings outlook that should accompany the economic recovery. We believe that the recent churning in markets will eventually subside and that equity markets will move into higher ground this cycle, at least in part due to the very supportive nature of global monetary policy. Our next move in this asset class is, therefore, likely to be an upgrade. Bonds, meanwhile, are likely to have a dreary time.

Overall, our assessments of the major economies improved again over the last few months and have continued to open up the gulf with the Emerging world, where growth rates have continued to disappoint and monetary policy is either tightening, or remains tight after the recent currency weakness. This pattern is likely to be repeated, certainly in the first half of 2014, as the imminent elections in many emerging markets prevent governments from embarking on radical reform. As a result we expect continued political turbulence over coming months, similar to the worrying recent developments in Thailand and Turkey.

Looking forward, we still favour equities over bonds. The past year has been a poor one for G7 bond markets and US government bonds have experienced one of only three loss-making years since 1976, according to Barclays Capital. For 2014, we expect a further upward drift in bond yields as global economic recovery continues and bond investors are gradually enticed into investments in the real economy. Emerging market bonds are also vulnerable to this continuing trend, at least in part because some of the huge flows into the asset class will be disturbed by the signs of political instability and continued currency weakness.

However, while policy measures are supportive for asset prices in 2014, there are still significant risks embedded in the current environment. We do not believe that the European Sovereign debt crisis is yet over as there has been not agreement on the mutualisation of liabilities. We do not expect the crisis to erupt this coming year, though the ECB Bank stress test is a potential catalyst, but it remains a source of instability in the long term.

We are also concerned about the impact of China’s conflicting policy goals of weaning the country off its credit addiction without slowing its growth rate. One of these objectives will be sacrificed, and the consequence will probably be greater instability in the long term. The risks of Japan falling back into a deflationary slump are plain for all to see, as is the significant political risk that is now attached to several Emerging market countries. Indeed, we would not be surprised to see several changes of regime over the next year.

Then, of course, we have to remain open to the risk that in fact the world recovery gathers pace faster than even the bulls now expect and that at some point the markets start to demand a change in monetary policy, ahead of the central banks' willingness to do so. This possibility, while bringing good news in the form of higher activity, employment etc, would also very likely cause a severe dent to the credibility of central bank policy. The out-turn would, therefore, also involve higher levels of volatility - and we believe that the possibility of increased volatility in financial markets is something that investors should be prepared for.

Account Management Information

Investment Objective

The Fund aims to achieve an absolute return of 4% in excess of cash based on the 3 month LIBOR. There can be no guarantee that the investment objective of the Fund will be achieved.
Volatility Target: To seek to maintain the predicted standard deviation of the Annualised Return within 70% of predicted global equity volatility as calculated by the manager.

Other Information

Please note that the portfolio contributions and returns shown on page 2 are based on internally calculated data and are shown gross of fees and charges. This differs from the official NAV per unit based performance shown on page 1 which is shown net of fees and charges.

Baring Asset Management Limited Board (2nd January 2014)

Marino Valensise Chief Investment Officer	**David Brennan** Chairman & Chief Executive	**Roger Crandall** Non-Executive (MassMutual)
Michael Rollings Non-Executive (MassMutual)	**Tim Corbett** Non-Executive (MassMutual)	**Elizabeth Ward** Non-Executive (MassMutual)

Account Management Team

Investment Manager Percival Stanion	**Relationship Director** Brian Corris +44 (0)20 7214 1306 Brian.Corris@barings.com	**Client Service Manager** Westley Price +44 (0)20 7214 1479 Westley.Price@barings.com

Important Information

Detailed Asset Allocation

Asset Type	Portfolio Positions As At 30 September 2013 (%)						Portfolio Positions As At 31 December 2013 (%)					
Total Equities	**49.37**						**51.61**					
Developed Equities	**49.07**						**48.79**					
UK Equities	25.14						24.09					
Overseas Developed Equities	**23.93**						**24.70**					
North America	3.52						4.00					
Japan	9.92						10.27					
Europe Ex UK	2.92						4.17					
Asia Pacific Ex Japan	0.17											
Global Equity Funds	5.64						4.87					
Specialist Equity Funds	1.77						1.39					
Emerging Equities	**0.30**						**2.82**					
EMEA Equities	0.05						0.05					
Emerging Asia Equities	0.10						2.04					
Latin America Equities												
Global Emerging Pooled	0.14						0.74					
		Maturity Years						Maturity Years				
		1-3Yr	3-5Yr	5-10Yr	10-15Yr	15Yr+		1-3Yr	3-5Yr	5-10Yr	10-15Yr	15Yr+
Total Fixed Interest	**30.47**			**1.90**		**7.60**	**27.23**			**2.02**		**3.73**
Developed Govt Bonds	**8.15**			**1.90**		**6.25**	**4.54**			**2.02**		**2.52**
UK Govt Bonds												
Overseas Developed Govt Bonds	**8.15**			**1.90**		**6.25**	**4.54**			**2.02**		**2.52**
USA Govt Bonds	3.94			1.90		2.04	3.71			2.02		1.70
Euro Govt Bonds												
Australia Govt Bonds	4.21					4.21	0.83					0.83
Emerging Govt Bonds	**1.42**						**3.28**					
Index Linked	**1.34**					**1.34**	**1.21**					**1.21**
US Index Linked	1.34					1.34	1.21					1.21
Corporate & Convertibles	**19.55**						**18.20**					
Investment Grade Non Govt	**2.82**						**1.35**					
GBP Inv Grade Non Govt Bonds	2.79						1.32					
US Inv Grade Non Govt Bonds												
Emerging Inv Grade Non Govt Bonds	0.03						0.03					
Global Convertibles	**5.59**						**5.28**					
High Yield Sub Inv Grade	**11.14**						**11.58**					
US High Yield Non Govt Bonds	11.12						11.56					
Euro High Yield Non Govt Bonds	0.01						0.01					
Alternative Investments	**6.77**						**6.61**					
Property	**4.27**						**4.00**					
Hedge Funds	**1.13**						**2.41**					
Structured Products												
Gold	**1.31**											
Commodity Funds	**0.05**						**0.04**					
Private Equity	**0.02**						**0.16**					
Cash & Equivalents	**13.39**						**14.55**					
Net Hedging Position	**0.65**						**1.03**					
Cash	**12.74**						**13.52**					
Other												
Total	**100.00**						**100.00**					

A look through of 3rd party pooled vehicles has not been applied to this analysis

Source: Barings

BARINGS

AWARDED TO
BARING ASSET
MANAGEMENT LIMITED
2010