Dorset County Pension Fund - DAAF Report

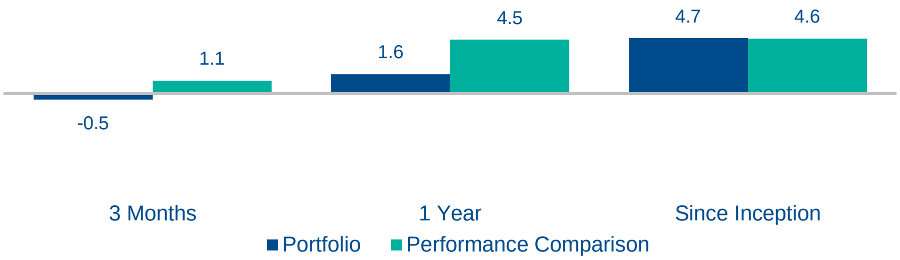
Quarterly Investment Review

Q1 2014

Contents

Summary

Performance Versus Performance Comparison In GBP Terms (%) - Periods To 31 March 2014



Portfolio Value (GBP)	
31 December 2013	93,199,361
31 March 2014	92,714,625

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.

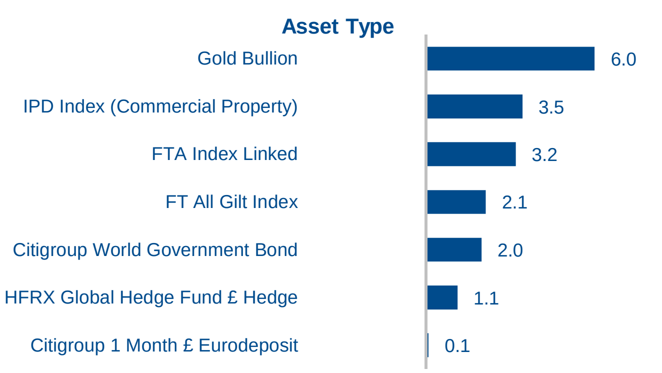
The Fund performed poorly during the quarter with a fall of 0.5% compared with an investment objective of LIBOR plus 400 basis points, which equated to 1.1% for the period. This brings the return for the twelve month period to only 1.6%, compared to an investment objective of 4.5%. Over three years the Fund has fallen slightly behind its objective, but remains slightly ahead over the period since inception.

Our significant weighting in Japanese equities detracted value, as did our heavy weighting to UK equities. Both lagged other equity markets. Stock selection was also a slight negative this quarter after a strong performance last year.

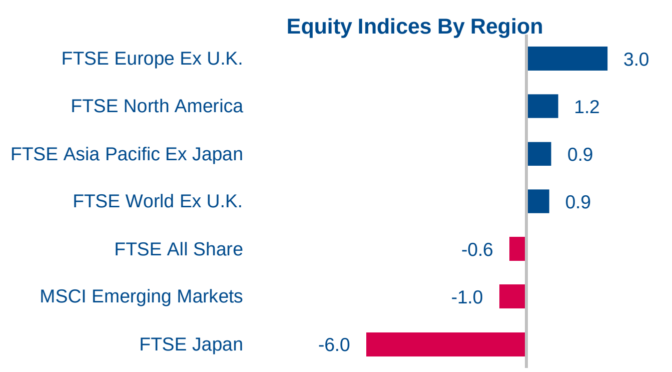
We reduced cash, and added to equities in the US, Japan and Taiwan. We also bought a basket of global mining stocks. In fixed income, we switched US index-linked bonds into conventional, sold the position in Australia and added to UK corporate bonds as well as emerging debt.

We expect our primary asset at this point of the cycle to remain equities. We expect the tepid economic recovery to be positive for corporate profits, but not sufficiently strong to trigger a sudden move towards tighter monetary policy. As usual, however, the data flow will not be even and so we remain vigilant. In this environment, we expect bond yield spreads to move lower.

Market Review - In GBP Terms (%) - Q1 2014



Source: FTSE, Citigroup, IPD, HFRI, Barings



Source: FTSE, MSCI, Barings

The strongest returns during the quarter came from Gold Bullion, which provided a modest rebound of 6% after a disastrous year in 2013. UK Commercial Property continued its steady recovery with a return of 3.5% on the IPD index. UK index linked bonds did well with a rise of 3.2%, while Gilts returned 2.1%, slightly ahead of the Citigroup World Government bond index return of 2%. Hedge funds returned 1.1%.

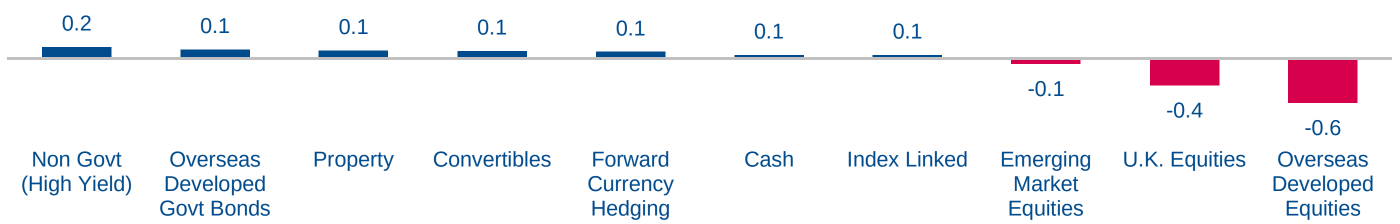
Europe was again the strongest regional equity market, with a total return of 3%. North America managed a return of 1.2%. Meanwhile, the UK market underperformed with a decline of 0.6%. Emerging Markets also fell in value under the impact of China's continued slowdown and the political tensions caused by Russia's annexation of the Crimea.

The worst market though was Japan, which fell by 6% over the period as investors began to fret about the rise in Sales Tax in April causing the economic recovery to falter. Since the quarter end, most markets have continued a modest rally.

Performance - Q1 2014

Absolute Returns & Contributions (%)

Total Contribution



Region / Asset Type	Account Return (%)	Total Contribution (%)
Non Govt (High Yield)	1.4	0.2
Overseas Developed Govt Bonds	2.8	0.1
Property	2.7	0.1
Convertibles	2.0	0.1
Forward Currency Hedging	n/a	0.1
Cash	0.5	0.1
Index Linked	n/a	0.1
Emerging Market Equities	-2.5	-0.1
U.K. Equities	-1.3	-0.4
Overseas Developed Equities	-2.7	-0.6
Total		**-0.3**

Performance Summary

Fixed income added value over the quarter. The Fund had modest positive contributions from High Yield bonds, which added 16 basis points, Convertible Bonds which added 10 basis points and US government bonds which added 13 basis points. Emerging Market bonds had a slight negative contribution due to the large sell off in Russian bonds. The Fund also received a positive contribution of 11 basis points from Property.

Equities detracted value however. The UK market lagged other Developed Markets during the quarter, and our exposure here cost the Fund 35 basis points, while Emerging Market equities also made a negative contribution to performance.

The biggest detractor, however, was overseas equities, and particularly Japan. The Japanese market was weak this quarter, as investors expressed concern about the rise in the sales tax in April. Exposure to Japan cost the Fund 57 basis points. US equities made a small positive contribution.

Stock selection was slightly behind the local index return for in-house funds and third party funds, after a very strong contribution in 2013. As can be seen below, positive contributions to performance came from the Baring Europe ex UK Fund, Legal & General US Index Trust and, in fixed income, the Muzinich Americayield Fund. Negative contributions came from the Baring Asia Pacific Equity Component Fund, our primary vehicle for investing in Japanese equities, and also our UK equity vehicle, which lagged the UK market during the period.

Moving from the quarter to look at performance over the past year, our sluggish performance has been due to a number of factors. The most important has been the strength of Sterling, which has tended to diminish the returns earned from overseas holdings. Although we often hedged significant parts of our overseas holdings, helping to mitigate this factor, residual exposure had a negative impact on our returns. Another negative factor was our preference for the US and UK equity markets at the expense of European equities, which proved buoyant over the period.

Major Stock Contributions To Return (%)

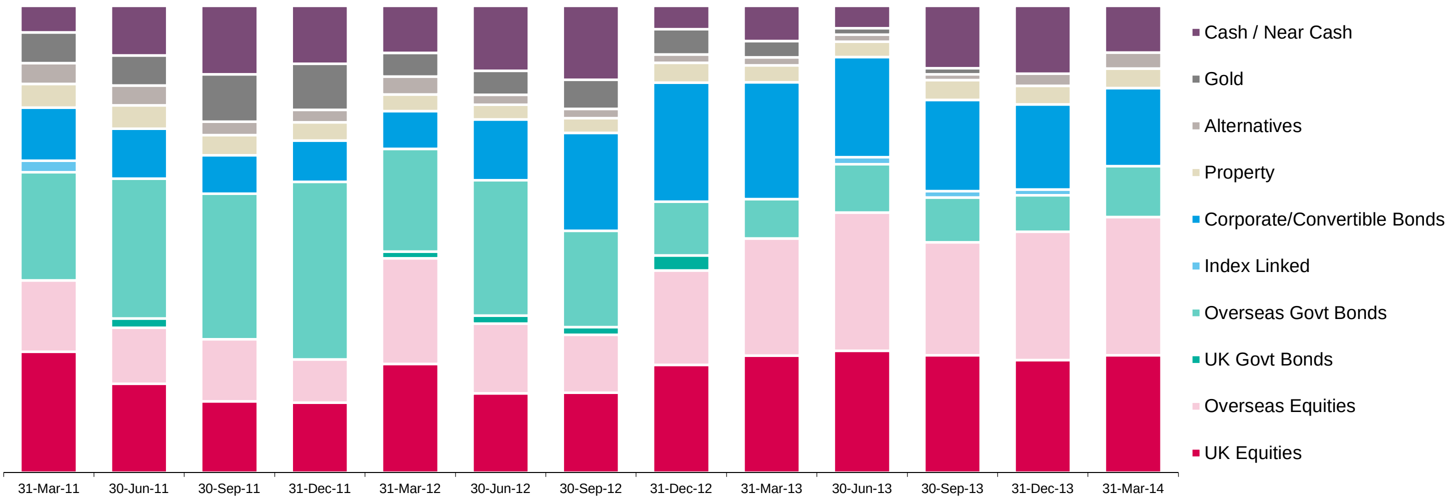
Name	Contribution (%)	End Weight (%)	Region / Asset Type
Baring Europe Ex UK Fund	0.1	3.3	Europe Ex UK
US Treasury 2.875% 15May2043	0.1	0.0	USD Govt Bonds
Muzinich Americayield Fund	0.1	3.5	HY US Non Govt Bonds
Legal & General US Index Trust	0.1	4.0	USA Equities
Bishopsgate Long Term Property Fund	0.1	2.9	U.K. Property
Baring Global Growth Trust	-0.1	1.5	Global Equity Funds
Cazenove UK Opportunities	-0.1	2.5	U.K. Equities
Russia (MF) 7% 25Jan2023	-0.1	0.0	Emerging Govt Bonds
Baring UK Equity Component Fund	-0.2	16.4	U.K. Equities
Baring Asia Pacific Equity Component Fund	-0.8	9.1	Japan Equities

Source: Barings, Gross of Fees

Aggregated Holding

Investment Strategy

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

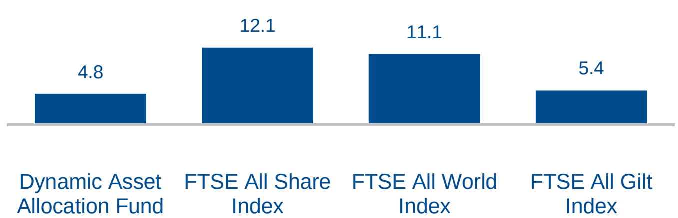


The 'Cash' weight, where applicable, may include cash on deposit, cash funds, short dated T-Bills (or equivalent), FFX, income receivable and initial margin, variation margin and cash backing deposits. Futures are allocated on an economic exposure basis.

Top 10 Holdings - 31 March 2014

Name	Weight (%)	Region / Asset Type
Baring UK Eq. Comp. Fund	16.4	UK Equities
Baring Asia Pacific Eq. Comp. Fund	9.1	Japan Equities
Neuberger High Yield Bond	4.7	HY US Non Govt Bonds
Legal & General US Index Trust	4.0	USA Equities
US Treasury 2.75% 15Feb2024	3.8	USD Govt Bonds
Muzinich Americayield Fund	3.5	HY US Non Govt Bonds
Baring Europe Ex UK Fund	3.3	Europe Ex UK Equities
AXA UK Select Opportunities	3.3	UK Equities
Baring Far East (ex Japan) Eq. Comp. Fund	2.9	Emerging Asia Equities
Bishopsgate Long Term Property Fund	2.9	UK Property

Risk Characteristics



Annualised Volatility % (Rolling 3 Year Standard Deviation)

We made some modest changes in asset allocation during the quarter.

We reduced our holding in cash by about six percentage points. Most of this went into equities, which were increased from about 49% at the start of the quarter to just over 54% by quarter end. We increased our holdings in the US, Japan and Taiwan and added a small basket of global mining stocks.

The latter arose from our belief that the slowdown in demand for mined materials from the emerging economies has been pretty fully discounted in the share prices of the leading miners, which have underperformed substantially over the past two years. As these companies are substantially reducing their capital expenditure programmes, their free cash flow and therefore their ability to distribute dividends will rise very sharply, in our estimation.

Our investment in Taiwan follows an earlier investment into Korea during the previous quarter and reflects our view that the recovery in Western consumer demand will gradually start to benefit those Emerging Markets with strong export sectors.

In fixed income we switched our holding in US Index linked bonds into conventional US bonds. We sold the small remaining position in Australia.

We also added to our holdings in UK corporate bonds and emerging market bonds. Within the latter category we sold our exposure to Russian government bonds early on in the Crimean crisis and favoured instead Turkey, Mexico and Poland.

The net effect of these changes was to reduce the maturity profile of the fixed income part of the portfolio, as can be seen in the detailed asset allocation breakdown on page 7.

Source: Barings

Investment Outlook

The past quarter has proved quite challenging for investors. The problem has not been the economic trends, which in the developed world have been favourable, even if occasionally obscured by bad weather, but more the political environment in many countries and the uncertainty over the outlook for monetary policy.

Surveying the world, the economic recovery is gaining momentum in many regions. In the US, the sharp cutbacks in government spending seen last year are likely to be far milder in 2014. The housing sector, which had been a major contributor to the recovery, has plateaued under the impact of higher mortgage rates. However, both consumer demand and business activity are continuing to increase. Partly, strengthening consumer demand reflects continued job creation along with some wage growth. We are also seeing a gentle rise in business fixed investment. Together these factors suggest to us that US GDP growth will continue to expand at a rate of 2.5-3.0%, only slightly ahead of the long-term trend. As such, we expect spare capacity will only be very gradually used up, meaning that inflationary pressures are likely to remain very low, absent any external shocks.

So how will the US Federal Reserve policy adapt in this post-crisis environment? Janet Yellen, the new Chair of the Federal Reserve, has already caused some confusion by her use of English after the last FOMC meeting. The markets then became fixated on the exact meaning attached to her comments and whether the first increase in the policy rate would be in early 2015, or later. The market's neurosis over each tiny twist in the Fed's communications is one of the negative side effects of the emergency easy monetary policy. Even as investors take advantage of the virtually free money provided by the Fed, they are at the same time increasingly paranoid about the likelihood that the stimulant will be removed. In our opinion, this in itself will act as a brake on growth becoming too strong or stoking inflationary pressures.

In addition, in the US as well as Europe, macro prudential measures to limit the level of leverage in bank balance sheets and ration the availability of credit to consumers will act as an effective monetary noose, preventing the credit cycle from getting into its normal upswing. It will probably also justify the Fed staying looser for longer by keeping the cost of credit low, even as markets become less convinced of the credibility of Fed policy making. Given the continued fragility of Western economies and the slow progress in reducing their debt levels, this analysis is helping to shape a more cautious view of how US and global interest rates will "normalise" over the next decade. We believe the average level of interest rates will be structurally lower over this period and the eventual peak will also be far more modest than we had become used to in the post WWII period. Interestingly, the IMF has just published a paper with similar conclusions (*Monetary Policy in the New Normal*, IMF Staff Discussion Note April 2014, www.imf.org). But a low real risk free interest rate may also imply that all financial market returns are structurally lower.

Turning to Europe, green shoots of recovery are appearing across most of the peripheral markets. The squeeze on the banking sector seems to have passed its worst, as banks scramble to cut their balance sheets ahead of the next stress tests. Credit conditions are still tight for the corporate sector, but consumer confidence is improving, even as unemployment remains high. The Northern economies of Scandinavia and Germany are doing comparatively well, with both business and consumer demand remaining firm. In the periphery, Ireland, Spain and Portugal are all seeing their export sectors recover and their current accounts turn positive. Greece has even managed to persuade the triumvirate of lenders to release the next tranche of the rescue package.

Our biggest concerns remain France and Italy, countries where growth is still painfully slow and the appetite for reform is questionable. Mr Renzi came to power in Italy following a coup within the centre-left government. It is not clear how he will get the economy moving, but he does represent the increasing public opposition to fiscal retrenchment. Meanwhile, a very unpopular French President has been forced to appoint a new prime minister and to try to re-shape his Socialist government onto a more business-friendly tack.

In the case of both countries we have severe reservations as to whether they can achieve growth rates that will allow them to escape the debt trap that they are in currently. For the time being, however, the markets are looking at the external environment and judging that there is enough momentum to lift both countries away from danger.

In the UK, economic data has also strengthened significantly, with expectations for GDP growth at around 3% this year, putting it among the highest rates in the OECD. There is widespread scepticism over the durability of the housing recovery. The physical shortage of housing stock and inadequate output together with generous government underwriting of housing loans to first time buyers, is serving to drive prices up rapidly. This has the knock-on effect of improving consumer confidence as it causes a significant fall in mortgages with negative equity, as well as a general feel good factor. It is unlikely to last beyond the next election, as this stimulus will be cut by whichever government is elected. We are seeing a general rise in manufacturing activity, though not enough to turn around the trade account. We find the continued resilience of Sterling more puzzling, given the electoral odds stacked against the current coalition for next May's general election. Foreign investors may be in for an unpleasant surprise with a much less business-friendly government.

In Japan, the Central Bank is continuing its Quantitative Easing (QE) programme of buying up government bonds at a prodigious rate. Economic activity levels have fallen back over the past few months and while demand will have picked up in March ahead of the April rise in Sales Tax, the outlook over the coming months is still uncertain. The biggest threat is the erosion of consumer purchasing power as the inflation rate is now above the level of wage growth. This real squeeze on living standards has been offset by a run down in savings, but this cannot persist indefinitely. The government is trying to persuade the corporate sector to raise wages given the improvement in their competitive position and profitability stemming from the fall in the Yen. Large companies have begun to lift base salaries and bonuses, but small and medium sized businesses are more cautious. For the time being we remain positive on the prospects for Japan but, much depends on the economic data over the coming months and we are following developments closely.

In Emerging Markets, investors have been faced on the one hand by the spectre of a revanchist Russian government destabilising Ukraine and then annexing the province of Crimea, while in the other hemisphere, China is still clearly decelerating as the new administration clamps down on corruption and excesses in the shadow banking sector. But political uncertainty is not confined to these countries. Turkey faced a critical election, India is just about to go to the polls with the Congress party likely to fall from power, while both South Africa and Brazil face general elections later in the year. Central banks have in many cases had to defend currency crises through raising interest rates, again contributing to slower growth. Looking ahead we cannot yet see a catalyst that will turn these economies around and growth differentials will continue to favour Developed Markets.

The main implication from this analysis is that our primary asset for this point in the economic cycle will remain equities. We expect the generally tepid economic recovery to be positive for corporate profits, but not sufficiently strong to trigger a sudden move towards tighter policy by the world's central banks. Indeed, deflationary forces remain sufficiently strong in several areas of the world – notably Europe and Japan – that new QE measures could well still be deployed. But the data flow as usual will not be even. Weak patches will be followed by stronger patches. And so equities will probably enjoy strong spurts followed by setbacks, as investors fret about early moves on the interest rate front. For the time being, we also favour Developed Equity Markets, and a more cautious approach to emerging equities, which although cheaper, are still suffering from high political risk and declining economic momentum.

In the fixed income space, we do not find government debt particularly interesting. The cyclical trend for interest rates is gently upwards, but given the earlier comments about the structure of interest rates, a huge sell off in government bonds is unlikely. However, in this world of modest growth and low real rates, spread-based products, like High Yield bonds and Emerging Market Debt will continue to attract flows. Gentle economic expansion will keep corporate failure rates low, while in the Emerging world absolute debt levels are still quite modest by Western standards. This should mean that spreads gradually move ever lower and may possibly breach their previous low points. There will eventually be a day of reckoning, but possibly not for a considerable time into the future.

An additional conundrum for UK investors is the continuing strength of Sterling. Being based here, we perhaps see the warts in our economic fabric rather too easily. Meanwhile, we are manufacturing high-end housing units that continue to attract overseas flight capital. Given the political tensions in the world, there seems to be a permanent one way flow.

We can construct scenarios in which a less business friendly government eventually derails this juggernaut; an aggressive mansion tax would probably do the trick. However, foreign investors may have judged that with government finances as precarious as they are and an industrial sector that is not ready to take up the slack, any incoming government would have limited room for manoeuvre and would be unlikely to risk alienating foreign investors.

This may well be a complacent view, but it means that in the short term Sterling seems to be gaining an unwarranted reputation as a safe haven currency. As a result, the question of hedging overseas holdings, whether equities or bonds, will remain very pertinent.

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.

DAA FUND QUARTERLY CONFERENCE CALL

On a quarterly basis we hold an Investor conference call. This is an opportunity for investors to hear the Fund Manager review the last quarter's performance, as well as hearing his thoughts for the coming months. There is also an opportunity for investors to pose questions to the Fund Manager. If you would like to be invited to these calls then please email **londoncsm@barings.com**

Baring Asset Management Limited Board (1st April 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 31 December 2013 (%)						Portfolio Positions As At 31 March 2014 (%)					
Total Equities	**51.61**						**54.78**					
Developed Equities	**48.79**						**51.12**					
UK Equities	24.09						25.18					
Overseas Developed Equities	**24.70**						**25.94**					
North America	4.00						7.48					
Japan	10.27						11.54					
Europe Ex UK	4.17						1.71					
Asia Pacific Ex Japan												
Global Equity Funds	4.87						3.45					
Specialist Equity Funds	1.39						1.76					
Emerging Equities	**2.82**						**3.66**					
EMEA Equities	0.05						0.04					
Emerging Asia Equities	2.04						2.92					
Latin America Equities												
Global Emerging Pooled	0.74						0.71					
		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	**27.23**			**4.07**		**3.73**	**27.59**	**1.19**		**8.47**		
Developed Govt Bonds	**4.54**			**2.02**		**2.52**	**5.76**			**5.76**		
UK Govt Bonds												
Overseas Developed Govt Bonds	**4.54**			**2.02**		**2.52**	**5.76**			**5.76**		
USA Govt Bonds	3.71			2.02		1.70	5.76			5.76		
Euro Govt Bonds												
Australia Govt Bonds	0.83					0.83						
Emerging Govt Bonds	**3.28**			2.05			**5.12**	1.19		2.71		
Index Linked	**1.21**					**1.21**						
US Index Linked	1.21					1.21						
Corporate & Convertibles	**18.20**						**16.72**					
Investment Grade Non Govt	**1.35**						**2.05**					
GBP Inv Grade Non Govt Bonds	1.32						2.02					
US Inv Grade Non Govt Bonds												
Emerging Inv Grade Non Govt Bonds	0.03						0.02					
Global Convertibles	**5.28**						**5.29**					
High Yield Sub Inv Grade	**11.58**						**9.38**					
US High Yield Non Govt Bonds	11.56						9.36					
Euro High Yield Non Govt Bonds	0.01						0.01					
Alternative Investments	**6.61**						**7.59**					
Property	**4.00**						**4.17**					
Hedge Funds	**2.41**						**3.00**					
Structured Products												
Gold												
Commodity Funds	**0.04**						**0.04**					
Private Equity	**0.16**						**0.38**					
Cash & Equivalents	**14.55**						**10.04**					
Net Hedging Position	**1.03**						**0.10**					
Cash	**13.52**						**9.94**					
Other												
Total	**100.00**						**100.00**					

*** Maturity Breakdown is shown against segregated assets.**

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

Source: Barings, close of business valuation.

BARINGS