

Agenda Item:

Pension Fund Committee

7

Dorset County Council


Date of Meeting	27 November 2014
Officer	Chief Financial Officer
Subject of Report	Fund Administrator’s Report
Executive Summary	<p>The purpose of this report is to update the Committee on the allocation of the assets and overall performance of the Fund as at the end of the second quarter of the 2014/15 Financial Year to 30 September 2014. The report also provides a commentary on the performance of the fund managers who are not considered elsewhere on the agenda and to address other topical issues for the Fund that do not require a separate report.</p> <p>The Independent Adviser’s report is contained at Appendix 2, and will be presented separately at the meeting.</p> <p>The report shows that overall the Fund returned 3.97% over the six months to 30 September, underperforming its benchmark which returned 4.11%. Return seeking assets added 4.07%, whilst the liability matching assets returned 2.79%. For the same period the WM Local Authority average returned 3.8%.</p>
Impact Assessment:	Equalities Impact Assessment: N/a
	Use of Evidence: N/a
	Budget: N/A

	<p>Risk Assessment: The Fund assesses the risks of its investments in detail, and considers them as part of the strategic allocation. In addition, risk analysis is provided alongside the quarterly performance monitoring when assessing and reviewing fund manager performance.</p>
	<p>Other Implications: None</p>
<p>Recommendation</p>	<p>That the Committee :</p> <ul style="list-style-type: none"> i) Review and comment upon the activity and overall performance of the Fund. ii) Make no asset allocation changes at this time. iii) Remove support ratings as a means of assessing the financial strength of counterparties, for Treasury Management purposes.
<p>Reason for Recommendation</p>	<p>To ensure that the Fund has the appropriate management arrangements in place and are being monitored, and to keep the asset allocation in line with the strategic benchmark</p>
<p>Appendices</p>	<p>Appendix 1: New Money Forecast Appendix 2: Report of the Independent Adviser Appendix 3: HSBC Manager Performance and Risk analysis for the six months to 30 September 2014</p>
<p>Background Papers</p>	<p>HSBC Performance Statistics</p>
<p>Report Originator and Contact</p>	<p>Name: Nick Buckland Tel: 01305 224763 Email: n.j.buckland@dorsetcc.gov.uk</p>

1. Background

- 1.1 The Dorset County Pension Fund currently receives more money in contributions and investment income than it pays out as pensions and retirement grants. It is anticipated that there will be a surplus of income over expenditure from these cash flows of £36.8M in the 2014-15 financial year. The anticipated cash flows for 2014-15 along with the historic trends are illustrated in Appendix 1.
- 1.2 These “new money” levels are reviewed throughout the year, and Members are alerted if there is any significant variance from what is expected.

2. Cash flow

- 2.1 The table below summarises the main cash flows for the Fund for the six months under review.

	<u>£M</u>	<u>£M</u>
Cash at 1st April 2014		116.3
Less:		
Property Transactions (net)	8.6	
Private Equity drawdowns (net)	0.1	
UK Equity purchases (net)	0.4	
Barings - additional investment	10.0	
Insight - additional investment	50.0	
RLAM - additional investment	50.3	
Transfer of Probation Service to Gtr Manchester PF	34.4	
		<u>153.8</u>
Plus:		
Hedge Fund redemptions	46.3	
Currency Hedge Gain	1.0	
Lump sum contributions	49.0	
Net New Money	13.4	
		<u>109.7</u>
Cash at 30th September 2014		<u><u>72.2</u></u>

- 2.2 The cash flow above shows the most significant transactions that have taken place this financial year up to the end of September 2014.
- 2.3 The most significant transactions that have taken place since 30 September were the additional allocation to UK equities of £26M agreed by the Committee in September, which was made in October and the acquisition of Pilgrim House, Aberdeen, for £10M, which was made in early November.
- 2.4 As a result of this and other transactions, including monthly payments to pensioners, the Fund’s cash balances as at the start of November were £39 Million. Whilst there are a number of transactions projected between now and the end of the financial year, this still leaves the Fund with a significantly reduced holding in cash and the position will continue to be monitored. Please see also the transactions referred to in paragraphs 6.3 and 6.4 below.

3. Fund Portfolio Distribution

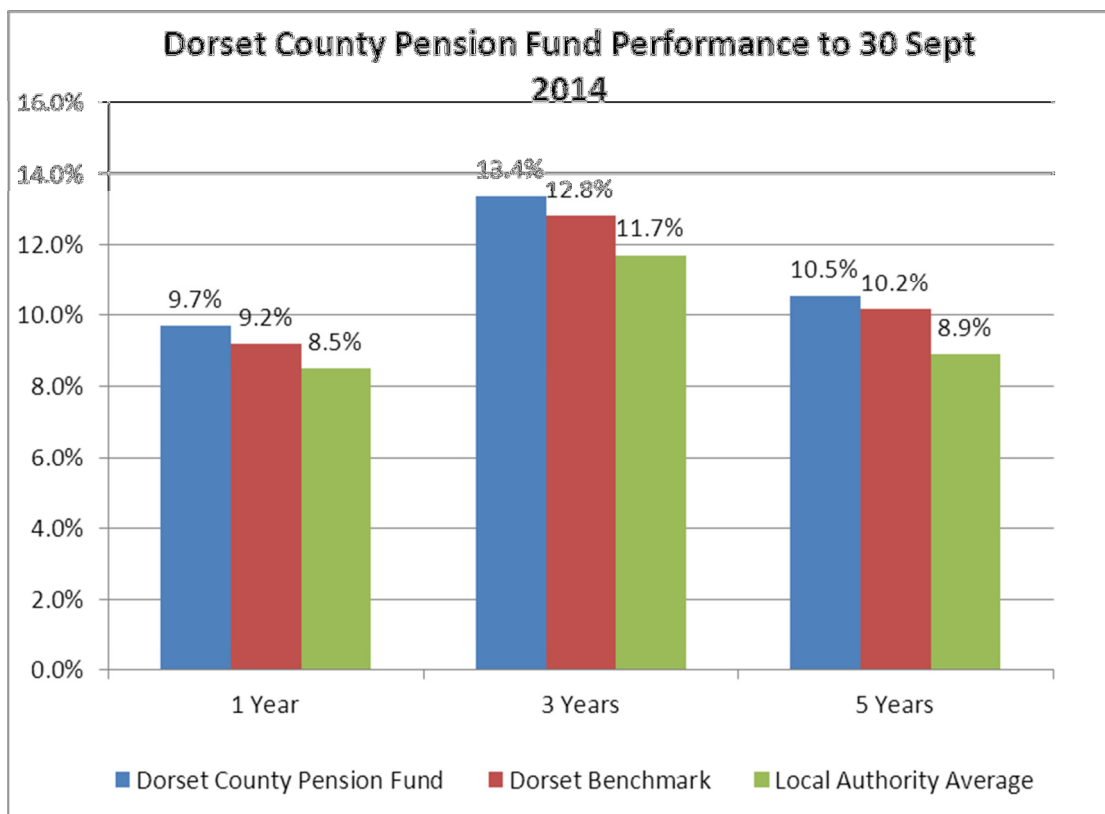
- 3.1 Members will be aware of the changes made to the Fund’s strategy at recent meetings, and therefore, the benchmark against which the asset allocation is currently measured is somewhat a “work in progress”. The table below shows the position as at 30 September 2014, and the target allocation shown is as agreed at the September meeting of the committee.

Asset Class	Manager	01 April 2014		30 Sept 2014		Target Allocation	
		£M	%	£M	%	£M	%
Bonds	(Several)	396.8	19.1%	517.1	23.8%	531.6	24.5%
UK Equities	(Several)	580.7	27.9%	571.9	26.4%	596.7	27.5%
Overseas Equities	(Several)	562.7	27.1%	590.2	27.2%	542.5	25.0%
Property	(CBREi)	187.1	9.0%	211.3	9.7%	217.0	10.0%
Absolute Return Funds	(Several)	90.2	4.3%	44.9	2.1%	-	0.0%
Infrastructure	(Several)	-	0.0%	-	0.0%	86.8	4.0%
Private Equity	(Several)	53.2	2.6%	57.6	2.7%	86.8	4.0%
Diversified Growth	(Barings)	92.7	4.5%	104.7	4.8%	108.5	5.0%
Cash	(Internal)	116.3	5.6%	72.2	3.3%	-	0.0%
Total		2,079.8	100.0%	2,169.9	100.0%	2,169.9	100.0%

- 3.2 It is clear from the table above that there are a number of areas where the Fund’s allocation is different from the target. It is however appropriate to consider this as a “work in progress”, moving toward the target allocation over the next 6-9 months. Members will be aware that the allocations to Private Equity and Infrastructure will take a number of months to fully drawdown.
- 3.3 The table shows the Fund to be underweight in UK equities against the revised target. However this was remedied with the addition of £26M to the internally managed portfolio in October.
- 3.4 The Bond portfolio is also showing an underweight position which will be improved with the £10M allocation to Insight, as agreed at the last meeting. This will be made in early December.

4. Overall Fund Performance

- 4.1 The performance of the Fund during the first two quarters shows an overall return of 3.97%, an underperformance of the benchmark of 4.11% by 0.14%. Over the last 12 month period the Fund has returned 9.69% against the benchmark of 9.19%, an out performance of 0.50%.
- 4.2 The Fund has exceeded its benchmark over 3 years returning an annualised 13.36% against the benchmark of 12.81%.
- 4.3 The chart below shows the overall performance for 1, 3 and 5 years against the Fund’s bespoke benchmark, and the Local Authority average performance.



- 4.4 When considering the overall performance it is important to note the split between the “Return Seeking assets” and the “Liability Matching assets”. Since the implementation of the strategic review in 2012, the Fund has held a proportion of the assets in an Inflation Hedging Strategy, managed by Insight. These assets are not held to add growth, but to match the movements in the Fund’s liabilities. It is therefore important to consider that in normal circumstances, the benchmark movement of these assets is a proxy for the Fund’s liabilities.
- 4.5 This Liability matching strategy, conducted by Insight has returned 12.40% since its inception on 1st July 2012. For the six months to 30 September Return Seeking assets have returned 4.07% against the benchmark of 4.26%. The Liability Matching assets have returned 2.79% against the benchmark of 2.79%. This strategy is intended to hedge against the impact of increasing pensions liabilities which are linked to, amongst other things; the consumer prices index (CPI). CPI cannot currently be hedged as there is not a sufficiently developed futures market, so the Dorset strategy targets the retail prices index (RPI) swaps market to act as a proxy for CPI which tends to be lower than RPI. The table below shows the overall performance of the Fund, but makes the distinction between the return seeking assets and the liability matching assets.

<u>Asset Category</u>	<u>Manager</u>	<u>6 Months to 30 Sept 2014</u>		
		<u>Dorset</u>	<u>Benchmark</u>	<u>Over/(Under)</u>
		<u>%</u>	<u>%</u>	<u>%</u>
Overall Fund Performance	All	3.97	4.11	-0.14
Total Return Seeking Assets	Various	4.07	4.26	-0.19
UK Equities	(Various)	0.01	1.10	-1.09
Overseas Equities	(Various)	5.49	6.05	-0.56
Bonds	(RLAM)	6.80	6.49	0.31
Property	(CBREi)	11.65	9.29	2.36
Hedge Funds	(Various)	0.41	3.35	-2.94
Private Equity	(Various)	7.55	1.24	6.31
Diversified Growth	(Barings)	2.09	2.26	-0.17
Cash	(Internal)	2.55	0.18	2.37
Total Liability Matching Assets		2.79	2.79	0.00
Bonds	(Insight)	2.79	2.79	0.00

- 4.6 In considering the performance of the Fund as a whole, there are two main areas that explain where the performance is being generated. These are the asset allocation (market contribution) of the Fund and within those allocations the stock selection (selection contribution) choices that have been made. The stock selection element is a measure of the fund managers’ ability to outperform their benchmark. The asset allocation is the effect of decisions to change the weighting of the different asset classes within the Fund.
- 4.7 The HSBC performance report, contained at Appendix 3, gives an attribution analysis of the performance for the quarter on pages 7 and 8. This analysis shows that the market contribution had a neutral effect against the benchmark and stock selection was negative overall, reducing performance by 14bps. Return seeking assets had an overall negative contribution of 17bps mainly driven by equities (UK and Overseas) of -40bps. The stock selection contribution was hit by equities, which had a negative contribution of 51bps, offset by positive contributions from property (22bps) and private equity (15bps). In all other areas contributions were broadly neutral.
- 4.8 The performance in UK equities stands out in the period, whilst there is no particular reason for this both Standard Life and AXA Framlington have underperformed which has affected the overall return.

5. Manager Progress (excluding UK equities)

Barings Diversified Growth Fund

- 5.1 The Diversified Growth allocation was mandated to Barings on 30 March 2012. Diversified Growth Funds are designed to give fund managers total discretion over how and where they invest which means that the portfolio holds a wide range of investments against a diverse range of asset classes. The Barings fund seeks to achieve out performance against a cash benchmark by focussing on asset allocation decisions. This fund targets equity like returns with about 70% of the equity risk.
- 5.2 The performance for Barings for the six months to 30 September 2014 is summarised below.

	Market Value at 1 April 2014	Market Value at 30 Sept 2014	6 months to 30 Sept 2014		12 months to 30 Sept 2014	
	£000s	£000s	Performance %	Benchmark %	Performance %	Benchmark %
Barings	92,715	104,697	2.09	2.26	3.59	4.57

- 5.3 Over the quarter the Fund delivered a modest positive return, but was slightly below the benchmark. The portfolio benefited from exposure to overseas developed equities, particularly in the US and Japan, where performance was good, and exposure to bonds and commercial property, offset by the significant exposure to UK equities which delivered a negative return.

Active US Equity

- 5.4 The performance of Intech is summarised below.

	Market Value		Performance	Benchmark
	01-Apr-14	30-Sep-14	%	%
USD \$000s	185,004	196,977	6.47	6.42
GBP £000s	110,967	121,501	9.49	9.44

- 5.5 The Intech fund actively manages US equity stocks using disciplined mathematical processes to outperform the benchmark at the same level of risk. Over the first two quarters the fund made a positive return of 6.47%, against the benchmark of 6.42%. This is in line with expected tolerances and Intech will continue to follow the model that has served it well in the past. Over the past three years to 30 September 2014, the fund has returned an annualised 21.49% against the benchmark (S&P 500) return of 21.36%. Over five years the fund has returned 15.96% per annum against the benchmark of 15.39%.

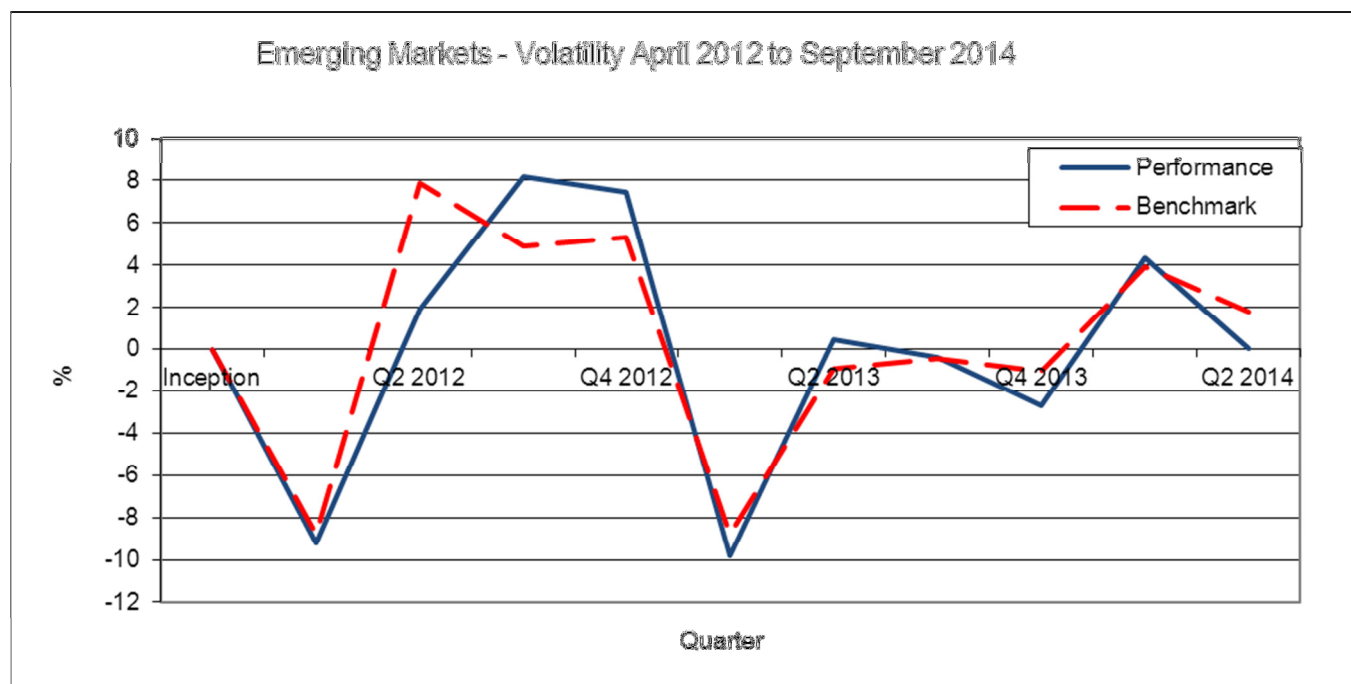
Emerging Market Equity

- 5.6 The JP Morgan mandate commenced on 5th April 2012. The performance of the investment is shown below.

	Value at 1 April 2014	Market Value at 30 Sept 2014	6 months to 30 Sept 2014		12 months to 30 Sept 2014	
	(£000's)	(£000's)	Performance %	Benchmark %	Performance %	Benchmark %
JP Morgan	63,528	66,316	4.39	5.79	1.18	4.19

- 5.7 The return of 4.39% for the first two quarters was below the benchmark by 1.40% and the annual return is now 3.01% below the benchmark at 1.18%. The fund manager comments that disappointing emerging market growth has prompted the weak performance of cheaper assets held, such as China, Brazil, consumer discretionary and IT hardware names, reflecting uncertainty about the business and earnings cycle.

5.8 Emerging market equities are seen as the asset class which will offer the most growth over the medium term, albeit with high levels of volatility. The chart below shows the differences in quarterly performance since inception and highlights the volatility of the performance to date alongside the benchmark.



Private Equity

5.9 The Pension Fund has committed to investing with Harbour Vest and Standard Life in their Private Equity Fund of Funds. Private Equity is an area that takes several years for commitments to be fully invested, and the table below shows the position as at 30 September 2014.

5.10 The table shows the commitment Dorset has made to each fund in Euros and US Dollars, the draw-downs that have taken place to date and the percentage of the total drawdown against Dorset’s commitment. It also shows the funds that have been returned to the Dorset Fund, the valuation as at 30 September 2014 and the total gains or losses, which includes the distribution plus the latest valuation.

Private Equity Commitments, Drawdowns and Valuations

<u>Manager</u>	<u>Commitment</u>	<u>Drawn down</u>	<u>% of Commitment</u>	<u>Distribution</u>	<u>Valuation</u>	<u>Gain / (Loss)</u>
	<u>€m</u>	<u>€m</u>		<u>€m</u>	<u>€m</u>	<u>€m</u>
HV Partnership V	12.000	11.040	92%	6.080	8.730	3.770
HV Direct V	3.000	2.880	96%	1.470	1.927	0.517
SL 2006	22.000	19.181	87%	7.254	15.775	3.848
SL 2008	17.000	10.359	61%	1.047	11.314	2.002
	<u>\$m</u>	<u>\$m</u>		<u>\$m</u>	<u>\$m</u>	<u>\$m</u>
HV Venture VIII	15.200	14.060	93%	7.134	14.183	7.257
HV Buyout VIII	22.800	19.380	85%	9.094	18.074	7.788
HV Buyout IX	15.000	3.975	27%	0.509	4.011	0.545
HV Venture IX	10.000	4.300	43%	0.353	4.742	0.795
SL SOF	16.000	4.641	29%	0.000	4.758	0.117

- 5.11 Private Equity is a long term investment and as such the performance should be reviewed over the longer term. The benchmark used for this fund is the FTSE All Share index. The table below shows the performance over 3 and 5 years against the benchmark.

Private Equity Overall Performance

<u>Manager</u>	<u>3 Years to 30 Sept 2014</u>		<u>5 Years to 30 Sept</u>	
	<u>Dorset</u>	<u>Benchmark</u>	<u>Dorset</u>	<u>Benchmark</u>
	<u>%</u>	<u>%</u>	<u>%</u>	<u>%</u>
HarbourVest	12.98	13.94	14.63	9.74
Standard Life	10.57	13.94	13.91	9.74

6. Update on Strategic Review

- 6.1 At the meeting of this Committee in March 2014 a new strategic asset allocation mix was agreed. At the subsequent meetings in June and September members were updated on the progress that had been made in implementing the new strategy.
- 6.2 At the September meeting it was agreed to defer the search for an additional DGF manager to complement Barings, and to temporarily increase the allocations to corporate bonds, and UK equities by 2.5% each. As reported in paragraph 2 above, the allocations to the Internal Manager (£26M) and rlam (£50M) have both been made.
- 6.3 The appointments of IFM and Hermes as Infrastructure managers were also ratified at the September meeting. The Legal process has now been completed for each of these appointments and the Dorset Fund has been admitted into both funds as at the end of October, earlier than originally planned. Members will recall that an advantage of the Hermes fund was the ability to get a proportion of the commitment invested at an early stage. As a result an investment of £26.895M (around 67% of the commitment) was made on 13 November.
- 6.4 The divestment from the fund of hedge fund investments has taken a little longer as, by their very nature, they are a little less liquid. At the time of writing around 20% of

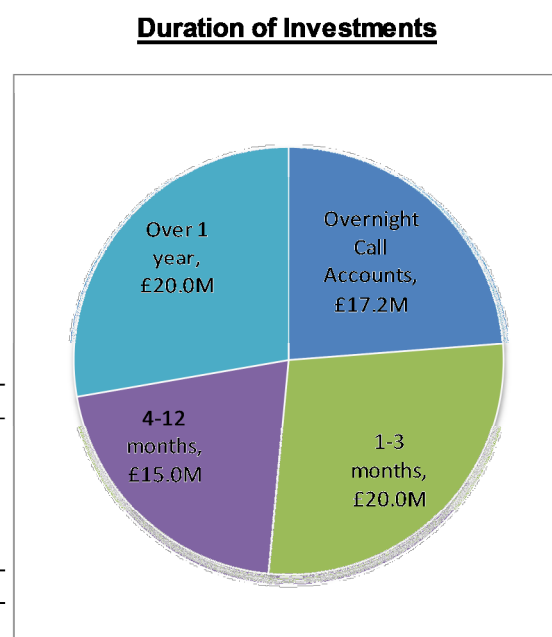
the IAM fund remains invested and will run down over the next few months. The Gottex fund is due to repay around 95% of the investment by the middle of November with the remaining illiquid investments being repaid over the next few months.

- 6.5 Overseas equity investments are subject to a report elsewhere on this agenda and will be realigned to target weight as a result of its recommendations.
- 6.6 Members agreed at the meeting in June that £50 Million be committed to Private Equity investments over the following two years. At the September meeting it was reported that US\$20 Million (around £12 Million) had been committed to the SL Capital Secondary Opportunities second fund. There have been no additional commitments since this. Officers will be meeting with HarbourVest on 17 November, and if appropriate opportunities are identified that fit the Dorset Fund’s requirements, additional commitments may be recommended. Members will be updated verbally as to progress at the meeting and formally at the next meeting of the committee.

7. Treasury Management

- 7.1 The Fund generates cash flows throughout the year which need to be managed. The Fund therefore holds a proportion of cash that is invested in call accounts, money market funds and fixed term deposits. A breakdown of the balances held internally as at 30 September 2014 is shown in the table below. Additional cash balances are also held tactically by Pictet within their overseas equity portfolio, and there is a small amount of cash held with the custodian bank account at HSBC and in a Property rent collection account where a float is required to be held for working capital purposes.
- 7.2 Since the credit crunch, there has been a significant reduction in the number of countries and financial institutions that are deemed safe for investments. The Council’s treasury management advisers, Capita, have recently advised that cash balances can be invested for more than 3 months in the big four UK banking groups – Barclays, HSBC, Lloyds and RBS. The majority of cash continues to be lent for less than 3 months in UK institutions to ensure that the money is both secure and liquid, and so it is available for distribution.
- 7.3 In terms of performance, the weighted average yield continues to reduce as higher return investments mature and have to be replaced with lower rate ones. Internally managed cash returned 1.04% over the six months, which is ahead of the benchmark, as measured by the 7 day LIBID, at 0.18%. Over the twelve months to 30 September the Fund has achieved 1.47% against the benchmark of 0.37%. These low market rates have broadly been caused by the funding for lending scheme and Bank of England restrictions on how banks have to treat liquid deposits.

<u>Lender/Borrower</u>	<u>Amount £000s</u>	<u>Rate %</u>
<u>Fixed Term Deposits</u>		
Lloyds Banking Group	5,000	1.00%
Lloyds Banking Group	10,000	0.89%
Lloyds Banking Group	5,000	0.98%
Lloyds Banking Group	5,000	0.57%
Lloyds Banking Group	5,000	0.57%
Barclays Bank Plc	15,000	0.61%
Oversea-Chinese Banking Corp	5,000	0.50%
United Overseas Bank Limited	5,000	0.50%
Total Loans	55,000	0.70%
<u>Call Accounts</u>		
National Westminster Bank	430	0.25%
Barclays Bank FIBCA	600	0.40%
Svenska Handelsbanken	15,000	0.50%
Total Call Accounts	16,030	0.49%
<u>Money Market Funds</u>		
Total Money Market Funds	-	-
<u>Holding Accounts</u>		
HSBC Custodian Account	657	0.01%
Property Client Account	480	0.01%
Total Holding Accounts	1,137	0.01%
Total Cash / Average Return	72,167	0.64%



- 7.4 The Pension Fund assesses the risk of each potential counterparty by using, as part of range of measures, credit ratings. The three credit rating agencies, Fitch, Standard and Poors and Moody’s, assess the financial strength of each institution in a number of ways and rate them accordingly.
- 7.5 One of the assessments that the credit rating agencies make is referred to as the “support rating”, which vary from 1 (the highest) to 5 (the lowest) and estimate the likelihood that support from a sovereign or parent would be received should it become necessary. The current strategy states that the Pension Fund would not use counterparties with a support rating of less than 3.
- 7.6 The credit rating agencies have been undertaking a review of these support ratings, with the rationale being the evolving regulatory background and unwillingness of Governments to step in if there is a problem with an institution. The primary drive is to remove implied levels of support previously built into the ratings. In time, this will see most, if not all, support ratings drop to 5 (indicating little or no likelihood of sovereign support).
- 7.7 Furthermore, the removal of implied sovereign support will see Long Term ratings gravitate towards Viability ratings (Fitch) and Financial Strength ratings (Moody’s). As such there will be little reason to use Support ratings or the “standalone” ratings from Fitch (Viability) and Moody’s (Financial Strength). It is therefore recommended to discontinue their use.

- 7.8 The Pension Fund will still pay regard to the following minimum short and long term ratings:

Short term: F1

Long term: A-

- 7.9 The Pension Fund’s treasury management advisers, Capita, will continue to monitor these ratings and report on any changes. Credit Default Swap (CDS) prices and other market intelligence will also continue to be used.

8. Asset Allocation

- 8.1 No further changes to the asset allocation agreed at the September meeting of the committee are recommended at this time.

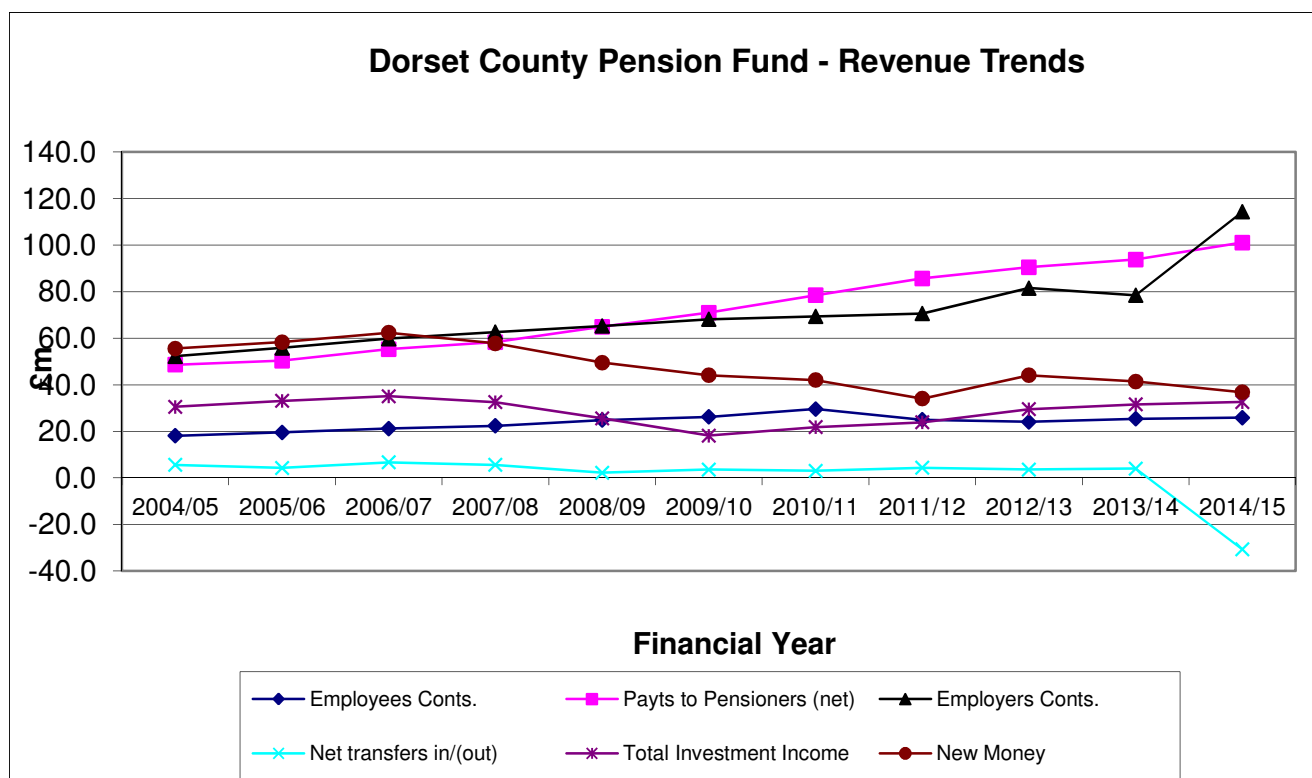
Richard Bates
Pension Fund Administrator
November 2014

Appendix 1

BUDGET MONITORING

	Actual 2012/2013	Actual 2013/14	Estimate 2014/15
	£'000	£'000	£'000
INCOME:			
Employers' Contributions	81,579	78,474	114,400
Employees' Contributions	24,097	25,412	25,900
Transfer Values (net)	3,627	3,961	3,700
Investment Income	29,521	31,649	32,600
TOTAL INCOME:	138,824	139,496	176,600
EXPENDITURE:			
Net Management Expenses	4,202	4,278	4,300
Payments to Pensioners (net)	90,521	93,803	101,100
Transfer of Probation Service to Gtr Manchester			34,400
TOTAL EXPENDITURE:	94,723	98,081	139,800
NET NEW MONEY FOR THE YEAR	44,101	41,415	36,800

REVENUE TRENDS & FORECASTS





**REPORT OF THE INVESTMENT ADVISER
PREPARED FOR**

Dorset County Pension Fund

Pension Fund Committee

On November 27th 2014

Investment Outlook

Alan Saunders

AllenbridgeEpic Investment Advisers Limited (AllenbridgeEpic)

AllenbridgeEpic Investment Advisers Limited is a subsidiary of Allenbridge Investment Solutions LLP

alan.saunders@allenbridgeepic.com

www.allenbridgeepic.com

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Dorset County Council Pension Fund
November 2014
Report of the Investment Adviser

Investment Outlook

Equity markets have had something of a correction since our last report with markets falling in September and October. While there were some specific factors like the Scottish referendum , no particular event kicked off the selling. A correction was overdue as markets had got ahead of the improvement in the global economy which remains elusive. The Eurozone remains on the edge of deflation , Japan is struggling and emerging markets are very mixed in their fortunes with only the US and UK recoveries looking well established.

One of the more unexpected developments this year has been the strength of government bond markets as investors seek security. Yields on both UK gilts and index-linked have moved lower and this of course has sharply reversed the improvement in UK pension fund deficits. Another unanticipated event has been the collapse in oil prices, following the downtrend in other commodity prices with Brent moving from \$110/bbl to \$85/bbl, a move tolerated by Saudi Arabia, the swing producer. Such a move brings winners and losers, western consumers gaining and Russia and US shale producers being among the losers.

Markets need to consolidate at these lower levels before we can assume the bull trend is intact. So far, investor nerves seem to be holding

Economy

The referendum result was an obstacle overcome though sterling has not made up the lost ground against the dollar. Electoral uncertainty will become a factor in markets in the months ahead and it is unlikely to be a favourable one. The government remains vulnerable to the charge that real incomes have not grown at all though that of course is true of all developed economies including the US. Its stewardship of the public finances also is looking a touch vulnerable as the budget deficit is not coming down as projected, due mainly to lower tax receipts. Meanwhile, it looks less likely that the first rise in interest rates will be brought forward given the continuing good news on inflation though no one knows how much spare capacity there is before that reverses and wage increases pick up.

In the US, attention is switching away from economics to politics with the November mid- term elections due soon. This is likely to increase the Republican majority in the House , making effective government more difficult. This month marks the end of tapering, ie the withdrawal of the QE provision of liquidity to the economy. It seems to have worked given the dramatic reduction in unemployment but the economy is still struggling to gain traction . A doveish Federal Reserve looks relaxed about raising rates though a strengthening dollar is presumably factoring that in.

In Europe, the economic situation remains the same , albeit it now appears to be affecting Germany too where growth is slowing. The good news recently is that the ECB's stress tests on banks suggest that most have sufficient capital to withstand a whole range of negative scenarios, excluding outright deflation. An Asset Quality Review indicated that some banks need to increase their provisions and others to raise fresh capital but we appear to be over the Eurozone banking crisis. It is the case of course that credit creation remains very weak but that

may not be the fault of the banks but reflect weak sentiment and weak effective demand from consumers and business.

Elsewhere, Japan is also struggling to avoid deflation and achieve self-sustaining growth. Most likely, the government will abandon its intention to increase the sales tax again after the negative effect on growth of the previous rise. In the emerging markets, Brazil and Russia are both struggling. In Brazil, the re-election of the left-wing Ms Rousseff does not sound good news for the economy while Russia is suffering from sanctions and the oil price. The picture is mixed though with India going through a better patch and China managing its credit slowdown

Markets

UK gilts produced a total return of 7% in the year to end September, with similar returns from UK corporates. Index linked did better still, suggesting some rise surprisingly in inflationary expectations. Ten year gilt yields are back down to 2.2% from 2.7%, some way from the lows reached in 2012 of 1.6% but yields were expected to go up not down! The narrowing of credit spreads seems to have come to an end and, for riskier high yield bonds, spreads are widening out as a more risk averse mood affects investors.

The UK stock-market has lagged global equity markets in the first nine months of the year and sold off another 4% in October, somewhat better than Europe and Japan but not as good as the US . We are now in negative territory for the year with the FTSE 100 Index trading in the 6300-6400 range. Sterling's strength against the Euro and yen has reduced overseas returns still further though the opposite is true for the US as sterling is now weaker against the dollar.

This is only a correction in equities and at present it does not arouse concern, being less than 10%. We have been expecting this for some time. Assuming the Eurozone does not deteriorate further, there does not seem an obvious catalyst for a further downward lurch. The likelihood of rising policy rates next year in the US and UK has been well flagged but will still cause some waves when it starts, especially in emerging markets which remain vulnerable to a rising dollar. As we stated last time, markets really need to get more evidence of a recovery in corporate earnings to justify the long bull run and there is not much evidence of that yet. Upside therefore could be limited near term.

Property

The commercial property market continues to storm ahead and a high double digit return is expected for this year. Pension fund investors are increasingly seeking long lease inflation linked properties which are being driven down to low yields but still capable of delivering a real return. Areas that look more vulnerable due to changing consumer shopping habits are high street shops, out of town large supermarkets and bulk good stores. Otherwise , the market looks strong across the board and the recovery is currently expected to last into next year.

Alternatives

Diversified Growth funds seem to be struggling this year but should hopefully achieve their inflation plus 3-5% targets. Hedge fund returns are in the same low ball-park figure with a rise of 3% across all strategies. Those that have a fairly high equity exposure have not received much support from markets. Likewise, credit based funds have struggled with the end of the credit spread compressions. While a more risk-averse market environment might limit potential, managers should also be able to deliver through short positions and from alpha generation.

As indicated last time, alternatives like private equity and infrastructure dance to a different tune.

Asset Allocation

Bonds have now outperformed equities this year but have been left behind in turn by property. Our LDI portfolio will have performed well in an environment of falling real yields but of course it is a risk reducing exposure rather than a return seeking asset. Inflation hedges have been increased recently and more capital has been allocated so that a greater hedging target can be achieved in the long run. It seems that other LA schemes are now looking at LDI as a way forward.

Alan Saunders Senior Adviser

Allenbridge Epic Investment Advisers



Dorset County Pension Fund Total

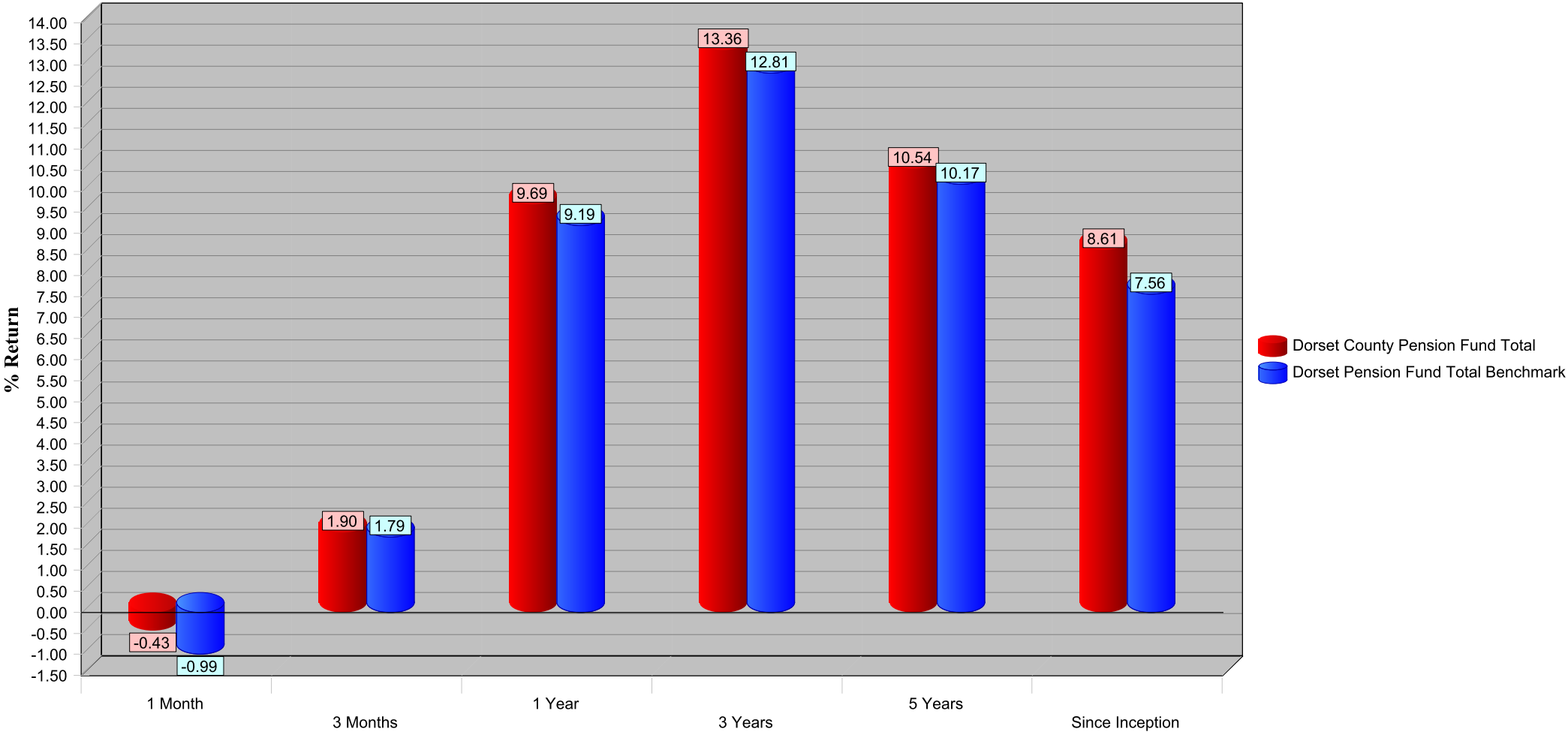
01 Apr 2014 - 30 Sep 2014

Manager Summary

Portfolio	Initial Market Value	Initial Market Value %	Net Investment	Capital Gain / Loss	Final Market Value	Final Market Value %	Income	Portfolio Return %	Benchmark Return %
Dorset County Pension Fund Total	2,080,695,680	100.00	23,506,909	65,656,707	2,169,859,295	100.00	18,370,331	3.97	4.11
Dorset - AXA Framlington UK Equity	102,820,736	4.94		-1,763,524	101,057,212	4.66		-1.72	1.24
Dorset - Barings Asset Management	92,714,625	4.46	10,000,000	1,982,609	104,697,234	4.83		2.09	2.26
Dorset - CBRE Property	187,103,558	8.99	8,827,946	15,338,540	211,270,043	9.74	6,874,858	11.65	9.29
Dorset - Currency Hedging	0	0.00	-1,063,124	1,063,124	0	0.00		-294.03	
Dorset - Gottex Hedge Fund	32,340,874	1.55		458,264	32,799,138	1.51		1.42	2.79
Dorset - HarbourVest Private Equity	32,461,796	1.56	-2,029,910	3,168,725	33,600,611	1.55		10.18	1.24
Dorset - IAM Hedge Fund	56,101,381	2.70	-45,831,794	230,716	10,500,303	0.48		-5.23	3.63
Dorset - Insight Fund	199,426,885	9.58	50,003,950	6,384,492	255,815,327	11.79	3,950	2.79	2.79
Dorset - Internally Managed Cash	117,877,610	5.67	-46,847,199	1,137,256	72,167,666	3.33	386,779	1.04	0.18
Dorset - Internally Managed UK Equity	365,643,358	17.57	-18,396	-2,970,201	362,654,761	16.71	8,563,351	1.51	1.30
Dorset - JP Morgan	63,527,522	3.05		2,788,751	66,316,273	3.06		4.39	5.79
Dorset - Janus Intech US Equity Fund	110,966,854	5.33		10,534,461	121,501,315	5.60		9.49	9.44
Dorset - Pictet Global ex UK Equity	387,613,062	18.63	-1,846,883	16,632,950	402,399,128	18.54	2,222,502	4.90	5.31
Dorset - Pioneer Hedge Fund	1,800,440	0.09	-336,422	150,714	1,614,732	0.07		10.55	3.31
Dorset - Royal London Bonds	197,328,985	9.48	50,622,121	13,312,352	261,263,458	12.04	318,890	6.80	6.49
Dorset - Schroders UK Equity	33,322,350	1.60	-83,382	-672,377	32,566,592	1.50		-2.02	-3.78
Dorset - Standard Life Private Equity	20,770,265	1.00	2,383,820	890,167	24,044,251	1.11		3.76	1.24
Dorset - Standard Life UK Equity	78,875,379	3.79	-273,818	-3,010,311	75,591,250	3.48		-3.83	1.24

All periods > 1 year have been annualised.

Long Term Performance, Total Fund



All periods > 1 year have been annualised.

Gain/Loss Analysis

Category	Initial Market Value	Net Investment	Final Market Value	Capital Gain/Loss	Income	% Return
TOTAL ASSETS	2,080,695,680	23,506,909	2,169,859,295	65,656,707	18,370,331	3.97
Total Return Seeking Assets	1,881,268,795	-26,493,091	1,914,047,919	59,272,215	18,370,331	4.07
Total Assets ex Hedging	1,881,268,795	-25,429,967	1,914,047,919	58,209,091	18,370,331	4.01
Total Equities	1,106,626,076	-2,667,595	1,122,624,295	18,665,814	10,329,321	2.62
UK	580,661,824	-375,596	571,869,815	-8,416,413	8,563,351	0.01
Dorset UK Internally Managed	365,643,358	-18,396	362,654,761	-2,970,201	8,563,351	1.51
AXA Framlington UK Equity	102,820,736		101,057,212	-1,763,524		-1.72
Standard Life UK Equity Select Fund	78,875,379	-273,818	75,591,250	-3,010,311		-3.83
Schroders UK Small Cap Equity	33,322,350	-83,382	32,566,592	-672,377		-2.02
Overseas Equities	525,964,252	-2,291,999	550,754,480	27,082,227	1,765,970	5.49
North America	308,183,699	-9,338,407	324,616,077	25,770,786	503,156	8.63
Pictet North America	197,216,845	-9,338,407	203,114,762	15,236,325	503,156	8.12
Janus Intech US Equity	110,966,854		121,501,315	10,534,461		9.49
Europe ex UK	94,783,778	6,979,745	96,363,483	-5,400,041	1,175,342	-4.31
Pictet Europe ex UK	94,783,778	6,979,745	96,363,483	-5,400,041	1,175,342	-4.31
Japan	41,593,381	5,067,803	50,631,791	3,970,607	11,473	8.62
Pictet Japan Equity	41,593,381	5,067,803	50,631,791	3,970,607	11,473	8.62
Pacific ex Japan	17,875,872	-5,001,140	12,826,857	-47,875	75,999	3.35
Pictet Pacific ex Japan	17,875,872	-5,001,140	12,826,857	-47,875	75,999	3.35
Emerging Markets	63,527,522		66,316,273	2,788,751		4.39
JP Morgan Global Emerging Markets	63,527,522		66,316,273	2,788,751		4.39
Total Bonds	197,328,985	50,622,121	261,263,458	13,312,352	318,890	6.80
Royal London Bonds	197,328,985	50,622,121	261,263,458	13,312,352	318,890	6.80
Total Property	187,103,558	8,827,946	211,270,043	15,338,540	6,874,858	11.65
ING Property	187,103,558	8,827,946	211,270,043	15,338,540	6,874,858	11.65
Total Cash	154,020,795	-46,398,133	111,633,852	4,011,190	847,261	2.55
Total Hedge Funds	90,242,696	-46,168,216	44,914,174	839,693		0.41
Gottex Hedge Fund	32,340,874		32,799,138	458,264		1.42
Pioneer Hedge Fund	1,800,440	-336,422	1,614,732	150,714		10.55
IAM (Hedged)	56,101,381	-45,831,794	10,500,303	230,716		-5.23

Gain/Loss Analysis

Category	Initial Market Value	Net Investment	Final Market Value	Capital Gain/Loss	Income	% Return
IAM Hedge Fund	56,101,381	-45,806,952	10,500,303	205,874		3.01
Currency Hedging (IAM)		-24,842		24,842		-96.55
Private Equity	53,232,061	353,910	57,644,862	4,058,892		7.55
HarbourVest	32,461,796	-2,029,910	33,600,611	3,168,725		10.18
Standard Life Private Equity	20,770,265	2,383,820	24,044,251	890,167		3.76
Diversified Growth Fund	92,714,625	10,000,000	104,697,234	1,982,609		2.09
Baring Dynamic Asset Allocation Fund	92,714,625	10,000,000	104,697,234	1,982,609		2.09
Total Currency Hedging	0	-1,063,124	0	1,063,124		-294.03
Total Matching Assets	199,426,885	50,000,000	255,811,377	6,384,492		2.79
Insight Liability Fund	199,426,885	50,000,000	255,811,377	6,384,492		2.79

All periods > 1 year have been annualised.

Asset Allocation

Category	Initial Market %		Final Market %		Local Currency % Return		Base Currency % Return	
	Portfolio	Benchmark	Portfolio	Benchmark	Portfolio	Benchmark	Portfolio	Benchmark
TOTAL ASSETS	100.00	100.00	100.00	100.00	3.89	4.10	3.97	4.11
Total Return Seeking Assets	90.42	90.00	88.21	90.00	3.98	4.25	4.07	4.26
Total Assets ex Hedging	90.42	90.00	88.21	90.00	3.92	4.25	4.01	4.26
Total Equities	53.19	55.00	51.74	55.00	2.45	3.42	2.62	3.44
UK	27.91	29.00	26.36	29.00	0.01	1.10	0.01	1.10
Dorset UK Internally Managed	17.57	20.00	16.71	20.00	1.51	1.30	1.51	1.30
AXA Framlington UK Equity	4.94	4.00	4.66	4.00	-1.72	1.24	-1.72	1.24
Standard Life UK Equity Select Fund	3.79	4.00	3.48	4.00	-3.83	1.24	-3.83	1.24
Schroders UK Small Cap Equity	1.60	1.00	1.50	1.00	-2.02	-3.78	-2.02	-3.78
Overseas Equities	25.28	26.00	25.38	26.00	5.15	6.03	5.49	6.05
North America	14.81	13.65	14.96	13.65	5.68	6.29	8.63	9.24
Pictet North America	9.48	9.65	9.36	9.65	5.22	6.24	8.12	9.15
Janus Intech US Equity	5.33	4.00	5.60	4.00	6.47	6.42	9.49	9.44
Europe ex UK	4.56	5.35	4.44	5.35	1.20	3.52	-4.31	-2.34
Pictet Europe ex UK	4.56	5.35	4.44	5.35	1.20	3.52	-4.31	-2.34
Japan	2.00	2.10	2.33	2.10	12.52	11.15	8.62	7.31
Pictet Japan Equity	2.00	2.10	2.33	2.10	12.52	11.15	8.62	7.31
Pacific ex Japan	0.86	1.10	0.59	1.10	0.70	3.63	3.35	4.81
Pictet Pacific ex Japan	0.86	1.10	0.59	1.10	0.70	3.63	3.35	4.81
Emerging Markets	3.05	3.80	3.06	3.80	4.39	5.98	4.39	6.05
JP Morgan Global Emerging Markets	3.05	3.80	3.06	3.80	4.39	5.98	4.39	6.05
Total Bonds	9.48	10.00	12.04	10.00	6.80	6.49	6.80	6.49
Royal London Bonds	9.48	10.00	12.04	10.00	6.80	6.49	6.80	6.49
Total Property	8.99	10.00	9.74	10.00	11.65	9.29	11.65	9.29
ING Property	8.99	10.00	9.74	10.00	11.65	9.29	11.65	9.29
Total Cash	7.40		5.14		2.55		2.55	
Total Hedge Funds	4.34	6.00	2.07	6.00	0.29	3.35	0.41	3.35
Gottex Hedge Fund	1.55	2.00	1.51	2.00	1.42	2.79	1.42	2.79
Pioneer Hedge Fund	0.09		0.07		7.49	3.31	10.55	3.31
IAM (Hedged)	2.70	4.00	0.48	4.00	-5.23	3.63	-5.23	3.63

Asset Allocation

Category	Initial Market %		Final Market %		Local Currency % Return		Base Currency % Return	
	Portfolio	Benchmark	Portfolio	Benchmark	Portfolio	Benchmark	Portfolio	Benchmark
IAM Hedge Fund	2.70	4.00	0.48	4.00	3.01	3.63	3.01	3.63
Currency Hedging (IAM)							-96.55	
Private Equity	2.56	4.00	2.66	4.00	7.31	1.24	7.55	1.24
HarbourVest	1.56	2.00	1.55	2.00	9.66	1.24	10.18	1.24
Standard Life Private Equity	1.00	2.00	1.11	2.00	3.76	1.24	3.76	1.24
Diversified Growth Fund	4.46	5.00	4.83	5.00	2.09	2.26	2.09	2.26
Baring Dynamic Asset Allocation Fund	4.46	5.00	4.83	5.00	2.09	2.26	2.09	2.26
Total Currency Hedging	0.00		0.00		-294.03		-294.03	
Total Matching Assets	9.58	10.00	11.79	10.00	2.79	2.79	2.79	2.79
Insight Liability Fund	9.58	10.00	11.79	10.00	2.79	2.79	2.79	2.79

All periods > 1 year have been annualised.

Relative Attribution

Category	Currency Contribution	Market Contribution	Selection Contribution	Total Contribution
TOTAL ASSETS	0.07	-0.00	-0.20	-0.14
Total Return Seeking Assets	0.07	-0.03	-0.20	-0.17
Total Assets ex Hedging	0.07	-0.09	-0.20	-0.22
Total Equities	0.07	0.04	-0.51	-0.40
UK	0.01	0.03	-0.27	-0.23
Dorset UK Internally Managed	0.01	0.08	0.03	0.12
AXA Framlington UK Equity	0.00	-0.02	-0.15	-0.16
Standard Life UK Equity Select Fund	0.00	0.01	-0.19	-0.18
Schroders UK Small Cap Equity	0.00	-0.04	0.03	-0.02
Overseas Equities	0.06	0.01	-0.24	-0.16
North America	0.01	0.02	-0.09	-0.05
Pictet North America	-0.02	-0.01	-0.09	-0.12
Janus Intech US Equity	0.04	0.03	0.00	0.07
Europe ex UK	0.06	0.00	-0.10	-0.04
Pictet Europe ex UK	0.06	0.00	-0.10	-0.04
Japan	-0.01	0.01	0.03	0.03
Pictet Japan Equity	-0.01	0.01	0.03	0.03
Pacific ex Japan	-0.00	-0.01	-0.03	-0.04
Pictet Pacific ex Japan	-0.00	-0.01	-0.03	-0.04
Emerging Markets	-0.01	-0.02	-0.05	-0.07
JP Morgan Global Emerging Markets	-0.01	-0.02	-0.05	-0.07
Total Bonds	-0.00	-0.00	0.03	0.02
Royal London Bonds	-0.00	-0.00	0.03	0.02
Total Property	0.00	-0.05	0.22	0.17
ING Property	0.00	-0.05	0.22	0.17
Total Cash	-0.01	-0.14		-0.15
Total Hedge Funds	0.01	0.01	-0.07	-0.06
Gottex Hedge Fund	0.00	0.01	-0.02	-0.01
Pioneer Hedge Fund	0.00	0.00		0.00

Relative Attribution

Category	Currency Contribution	Market Contribution	Selection Contribution	Total Contribution
IAM (Hedged)	0.01	0.00	-0.05	-0.05
IAM Hedge Fund	0.01	-0.00	-0.05	-0.05
Currency Hedging (IAM)	0.00	0.00		0.00
Private Equity	0.01	0.04	0.15	0.19
HarbourVest	0.01	0.02	0.12	0.14
Standard Life Private Equity	-0.00	0.03	0.03	0.06
Diversified Growth Fund	-0.00	0.01	-0.01	-0.00
Baring Dynamic Asset Allocation Fund	-0.00	0.01	-0.01	-0.00
Total Currency Hedging	0.00	0.05		0.06
Total Matching Assets	-0.00	0.03	-0.00	0.03
Insight Liability Fund	-0.00	0.03	-0.00	0.03

All periods > 1 year have been annualised.

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